

Asia can do with a booster shot for its Covid-19-hit financial system

Regional cooperation is needed to strengthen resilience across a wide range of areas, from banking risks to raising funds for climate-related projects

**Cyn-Young Park and
Ramkishan S. Rajan**

For *The Straits Times*

Covid-19 has battered, bent and reshaped many things in its wake. Asia's financial system has not been spared either.

The pandemic has exposed its structural weaknesses. The good thing is that the shortcomings spotlighted are an opportunity for all to step up efforts to collectively tackle them. This call to action applies to members of Asean+3 (Asean's 10 members plus China, Japan and South Korea).

Here are some areas of concern, which are drawn from a forthcoming Asian Development Bank (ADB) book entitled *Redefining Strategic Routes To Financial Resilience In Asean+3*.

BANKING RISKS

Although banks were generally in good shape when the pandemic hit, granting non-performing loans

could give rise to financial distress as policy support winds down. As the region continues to grapple with the pandemic and its ripple effects, the deteriorating credit quality of non-financial borrowers poses a clear and present danger to financial stability.

The region also remains vulnerable to the concentration of cross-border borrowing from regional and global banks. Regional regulatory cooperation should be strengthened to guard against region-wide slow-burn contagion. Greater sophistication in international financing activities of regional firms can also obscure the sources of increased external vulnerability.

FINTECH CHALLENGES AND OPPORTUNITIES

The pandemic has accelerated the shift towards fintech activities. Fintech can offer benefits in terms of greater efficiency, transparency, convenience and financial inclusion. According to a study commissioned by the ADB, digital financial solutions can address about 40 per cent of

unmet demand for payment services and 20 per cent of credit requirements of poor households and small businesses in Asia.

That said, there is a need to balance the benefits of financial innovation with possible costs involving financial stability, consumer protection, cyber-security, privacy and data protection, and measures to tackle money laundering and terrorism financing.

These areas require greater international cooperation in the development of legal, regulatory, and supervisory frameworks, monitoring capital flows, harmonising of standards, and better sharing of data. Regulators also need to recalibrate their policy frameworks to better deal with specific types of systemic and contagion risks arising from the interconnected activities of Big Tech firms across multiple sectors in various jurisdictions.

FUNDING SUSTAINABLE INFRASTRUCTURE

The region, still in the grip of a long-drawn pandemic, faces a substantial financing gap for infrastructure investment, especially if climate mitigation and adaptation needs are factored in.

An oft-cited study by the ADB in 2017 estimated the Asia-Pacific region's infrastructural needs at around US\$22.6 trillion (S\$30.7 trillion) over 15 years (2016-2030). The amount covers transport, power, telecommunications, water supply and sanitation. However, if the costs of climate mitigation and adaptation are included, the amount rises to US\$26.2 trillion.

Mobilisation of private finance for funding renewable energy and low-carbon infrastructure remains an acute challenge in the region. Despite the recent surge in interest in green bonds, concerns persist about green-washing and the lack of generally accepted standards about what constitutes environmental, social, and governance investment.

Regional cooperation could help develop standards and other measures to facilitate the development of green finance. More could also be done for greater regional consistency on

carbon taxes.

US DOLLAR DEPENDENCE

The continued dominance of the US dollar as an invoicing and reserve currency and in external financing presents significant challenges to regional economies as exchange-rate flexibility has limited capacity to insulate many of its economies from external shocks.

While some regional economies (particularly China, Japan, and Thailand) have taken important steps to internationalise their respective currencies, they have not made significant headway. There are, however, some signs that regional (own and partner) currencies are increasingly being used for trade among Asean+3 economies and with the European Union. Policy actions could help nudge this trend forward.

While reducing the region's US dollar dependence must remain an objective for the medium to long term, the immediate aim should be to develop a region-specific integrated policy framework that promotes macro-financial stabilisation in a US-dollar-dominated financial system.

FINANCIAL SUSTAINABILITY OF PENSIONS

The rapid population ageing in many Asean+3 economies has major implications for the

In view of the high degree of economic and financial interconnectedness in the region and the potential spillover impacts, clearly more could be done by Asean+3 to strengthen regional financial cooperation.

management of public and private pension systems. This is particularly acute in China, Japan, South Korea, Singapore, and Thailand, where old-age dependency ratios are rising sharply.

Despite the scale of pension coverage and sustainability as an issue, there appears to have been little discussion about it at the regional level. This is concerning from the perspectives of social welfare and macroeconomics as unsustainable pensions and rising contingent retirement liabilities might spark a fiscal crisis in one country with effects that spill over to neighbours.

On a positive note, pension funds with large assets under management are a potential source of demand that could facilitate development of local currency bonds.

In view of the high degree of economic and financial interconnectedness in the region and the potential spillover impacts, clearly more could be done by Asean+3 to strengthen regional financial cooperation.

There are many things it can work on, including developing regional capital markets for long-term finance, strengthening cross-border market infrastructure, improving regulatory cooperation, and tackling emerging issues such as financing climate change mitigation and the rapid rise of fintech and big tech firms in finance. Management of cross-border risks and enhancement of crisis surveillance form a substantial part of this effort.

A clear long-term vision is essential too for navigating the path of regional financial cooperation to achieve substantial results along agreed milestones of necessary reforms.

• Cyn-Young Park is Director of the Regional Cooperation and Integration Division in the Economic Research and Regional Cooperation Department of the Asian Development Bank. Ramkishan S. Rajan is Yong Pung How Professor at the Lee Kuan Yew School of Public Policy, National University of Singapore.