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Foreword

The frequent financial crises in the 1990s and the culminating 2008/2009 global recession have had worldwide impact. They have become less and less regional and more global. Increasingly important when defining their impact, however, are the policy responses taken. These have changed the nature and intensity of global liquidity, particularly when crisis and response originated in the world's largest economy.

Loose monetary policy in the United States during the early 2000s marked the beginning of major changes in global liquidity. These significantly affected emerging economies—especially in Asia. But nothing was more dramatic than the impact of the policy response to the global financial crisis. Consequently, concerns over financial instability mounted. This dramatic effect on global liquidity warrants a new regulatory framework, alternative early warning indicators, and—as a result—a set of macroprudential policies to complement standard monetary policy.

Before the 2008/2009 crisis, the predominant thinking centered around the lack of preconditions for successful financial liberalization. Corruption, weak enforcement, and limited understanding about how a liberalized financial sector operates were to blame. Recommendations thus focused on fixing those institutional factors—rather than questioning the virtue of the frictionless capital flows under capital account liberalization policy. Only after crisis struck the United States and Europe—where these institutional factors were supposedly strong—did people begin to challenge the predominant view and attention switched to financial regulation.

But the regulations proposed could also seriously impact other economies. If the "voice" of non-crisis economies—which includes most of emerging Asia—is not adequately heard, the new regulations could be disproportionally hard and unnecessarily harsh. Unless this financial regulatory asymmetry is corrected by listening to what emerging markets have to say, there is the risk that proposed regulations will lose their effectiveness. This is where the analysis in *Managing Elevated Risks* is useful.

Sponsored by the Asian Development Bank (ADB), the study was initiated in 2011 to look at three main issues: (i) how Asian economies translate the lessons of the global financial crisis into appropriate policies and reforms in terms of macro-prudential supervision relative to micro-prudential supervision; (ii) how robust are financial sector policies or reforms as a buffer to any systemic vulnerability to financial crises, and the extent of their contribution to financial soundness and stability; and (iii) what strategic direction should financial policies and regulatory reforms take. Three conferences were held—an inception seminar in July 2012 at ADB headquarters; a January 2013 meeting at the Hong Kong Monetary Authority with over 60 representatives of regulatory agencies, the private sector and academe; and a July 2013 conference in Seoul, Republic of Korea to discuss the results of research conducted on financial regulatory reform. Regulators from across Asia and the Pacific attended this final event.

Managing Elevated Risks is ultimately about how changes in global liquidity affect emerging Asia. It is intended to raise our understanding about the warranted regulatory framework and alternative early warning indicators—and from this to provide guidance in formulating a set of appropriate macroprudential policies. It highlights the mechanisms of how massive capital flows through noncore bank liabilities and capital markets can elevate the risk of financial instability and worsening socio-economic conditions, limiting the effectiveness of standard monetary policy.

This book would not have been completed without the excellent support from Raquel Borres, Marthe Hinojales, and Jong-Ho Lee of the ADB. The authors thank them for having helped bring the book to publication, and particularly for Ms. Hinojales, who co-authored Chap. 4, for her excellent research assistance.