SESSION 3
FINANCIAL STABILITY: REGULATIONS OF THE FINANCIAL SECTOR
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Session 3 began with opening remarks by **Mr. Tao Zhang** | Chief Representative for Asia and the Pacific office, BIS, and **Mr. Albert Park** | Chief Economist, ADB. Mr. Zhang discussed the implications of monetary policies for financial stability, emphasizing the importance of central banks' quick responses to avoid collateral damage and maintain financial stability over the last years. He pointed out that the global financial system has been largely strain-free since March 2023, and market pricing suggests a smooth landing.

Mr. Park, in his remark emphasized the ADB's commitment to advancing financial stability across the region and highlighted the importance of regional cooperation and financial safety net arrangements to withstand exogenous shocks in emerging markets.

Keynote speech

The keynote speech was delivered by **Mr. Andrew Sheng** | Distinguished Fellow of the Asia Global Institute, University of Hong Kong & Former Chairman of the Securities and Futures Commission of Hong Kong on the topic "Financial stability: Regulation of financial sector – a balance sheet approach". His speech focused on three key areas: i) global financial stability trends, ii) the balance sheet approach to stability, and iii) the key changes in the global financial system as technological, geopolitical and climate change risks rise.

Main points:

- Current financial regulation and supervision has avoided major crises due to the prompt actions of central banks, whose balance sheets have expanded four to five times since 2008.
- The return of industrial policy signals a rise in protectionism and a decline in free market competition. If wealthy countries turn to isolationism and protectionism, it raises the question of who will finance the immense needs of poorer countries to achieve Net Zero and tackle widening social inequality in terms of income and wealth. Hence, technology and central banks need to rethink their roles.
- When examining risk volatility, ASEAN+3 central banks exhibit lower risks than the U.S. banking system. This resilience stems from lessons learned after the Asian Financial Crisis, where East Asian economies bolstered their foreign exchange reserves and allowed their exchange rates to depreciate against the U.S. dollar.
- As real interest rates rise, the real sector must adjust with asset bubbles correcting. At the same time, risks from technological disruption, geopolitical and social unrest and climate change are increasing.

- East Asian region remains growth zone, and central banks can be important thought leaders in helping to improve regional and local innovation, knowledge-based shares prosperity and moving steadily towards Sustainable Development Goals (SDGs) achievement.

Panel discussion

The discussion was moderated by **Mr. Tao Zhang** | Chief Representative for Asia and the Pacific office at BIS, joined by **Mr. Eddie Yue** | Chief Executive, Hong Kong Monetary Authority, **Mr. Nandalal Weerasinghe** | Governor, Central Bank of Sri Lanka, **Ms. Nor Shamsiah Mohd Yunus** | Advisor, Central Bank of Malaysia, and **Mr. Andrew Sheng** | keynote speaker.

Lessons learnt in safeguarding financial stability

- Hong Kong's experience demonstrates the importance of maintaining strong FX reserves and robust capital and liquidity buffers within the banking system. Despite banking crises in the U.S. and Europe, Hong Kong has not witnessed significant capital outflows, underscoring the value of sufficient reserves and disciplined management.
- Across Asia, developing local currency bond markets and effective risk-hedging strategies are essential. In Malaysia, the local bond market's growth has been crucial in diversifying the financial system, enabling banks to manage risks better.
- Most Asian central banks have a comprehensive set of policy tools, including macroprudential tools, which are vital in protecting the banking system from the boom-bust cycles of financial markets. Capital management tools are integrated into policy frameworks to ensure stability.
- The BIS's macro-financial stability frameworks and the IMF's integrated policy frameworks aim to unify this set of tools, offering guidance on when and how to deploy them, and how to calibrate responses in different scenarios.
- The events of March 2023 in Sri Lanka underscore the critical importance of central bank's ability to act proactively and decisively. To prevent any spillover effects and potential crisis, it is essential to be prepared, ensure everything and maintain the capacity to respond decisively.

Structural challenges and key risks to financial stability

- Transition financing is a formidable and novel challenge. In much of Asia, the emphasis is not merely on investing in green initiatives but on transforming existing 'brown' assets into green over time. This is extremely important not only for achieving Net Zero targets, but also from a socio-economic perspective.
- We currently lack a clear taxonomy to define what constitutes a transition, and it varies significantly across sectors, such as coal, steel, and other industries. Each requires its own specific pathway.
- Data analytics are currently lacking. For central banks to include small banks in the green framework, they must provide training in data analytics and stress testing.

- Cyber risk presents a significant challenge for central banks today. Cybercriminals often stay several steps ahead, but cooperation in sharing cyber intelligence is still in its early stages.
- The world is dealing with the issue of interest rates staying ‘high for long’ or ‘higher for longer’. Businesses are finding it challenging to refinance debt and governments are facing increased costs on their pandemic-era borrowings.

Building resilience of the financial system

- Under the current system, finance is increasingly concentrated. The top 10 financial institutions, whether in asset management, insurance, or banking, are becoming more dominant and concentrated. Hence, it is crucial for emerging markets to collaborate and leverage the latest technology to truly democratize finance.
- It is imperative to give more attention to macroprudential measures and FX interventions, as they are often underutilized. Systematic use of these measures can help stabilize even the most disruptive capital flows that threaten financial stability.
- Regional cooperation is important for providing regional safety nets and ensuring stability across Asia. Additionally, effective collaboration in financial regulation, monetary policy and cyber risk, both domestically and internationally, is crucial for moving forward.