

Editorial

# Editorial for Special Issue “New Challenges in Asian Capital Markets”

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**Abstract:** We are pleased to announce the Special Issue on the New Challenges in Asian Capital Markets in the International Journal of Financial Studies. The focus of papers in this Special Issue is on the future challenges and/or future developments Asian Finance. In addition, one article provides a review of the literature on certain issues in relevance to the banking and capital markets in Asia. This Guest Editor's note synthesizes the contributing authors' propositions and findings regarding these challenges and developments and hopes that opens new venues for future research directions.

## 1. Introduction

Asian economies are characterized by the presence of large financial sectors, though the Asian economic landscape is a diverse place. More particularly, Asian financial sectors differ in certain ways from those in the rest of the globe. Banks dominate the financial sector in most Asian markets, as they do in Europe, but unlike in the U.S., where equity and bond markets have a larger role to play. In addition, the Asian banking sector is more focused on traditional bank businesses and rely less on lending to other banks and on selling products, such as swaps and other derivatives. This reliance on traditional banking is why shadow banking is a relatively new type of business in most Asian economies.

Another area in which Asia's financial sector differs from the rest of the world is its capital markets. Stock markets in Asia are highly volatile compared with those in other regions, though they often enjoy higher returns. Similarly, Asian countries' budget deficits, with some exceptions, tend to be relatively small. As a result, the development of bond markets has been somewhat slow. An important challenge for Asia's financial sector is to support rapid growth in the region. In addition, Asian finance has to tackle other significant challenges as well: the region's infrastructure deficit and demographic changes. Given the high saving rates in many of Asia's aging economies, and the significant investment needs across the region, finding ways to match the two could help growth and address the region's demographic challenges. These challenges call for larger financial systems which will make Asian financial systems more complex, leading to a process of greater regional integration which will generate greater provision of increasingly complex services by Asian banks, as well as capital markets. Therefore, the Asian finance requires new tools, such as credit default swaps and plain vanilla interest rate or exchange rate swaps. At the same time, there is the need for the loosening of capital account restrictions, especially in China and India.

Overall, Asian financial systems are expected to become significantly larger, more complex, and more interconnected than they are today. To ensure that these changes do not lead to a buildup in the kinds of risks that brought down some countries in the region during the Asian financial crisis and laid the global economy low during the global financial crisis, regulators and supervisors in Asia must stay on their toes. More interconnected financial systems can allow households and pension

funds to diversify, thus reducing their risk, but can also allow bankruptcies and bank failures to spread across borders. Regulatory cooperation has become the key issue as the world's financial sectors have become more integrated. Asia has an active role to play in international forums to ensure that this process can continue safely. As Asia continues to outpace the world in economic growth, the question will be how to make sure the world's fastest-growing financial system can also become its safest.

## 2. Papers

Therefore, this special issue of the International Journal of Financial Studies attempted to attract certain special papers that could tackle some of the challenges presented above. To this end, four papers have been finally selected that all provide an overall picture on the future of Asian finance. In particular, the first paper entitled: *Policy Impact on the Chinese Stock Market: From the 1994 Bailout Policies to the 2015 Shanghai-Hong Kong Stock Connect* by Yang-Chao Wang, Jui-Jung Tsai and Qiaoqiao Li, argues that the policy impact on the Chinese stock market has changed over time. By May 2015, global investors can directly invest in a more legalized and normalized Chinese stock market, whereas they are still concerned about the policy-oriented market and its attendant risks. Their empirical analysis employed the family of GARCH models to investigate the structural changes in risks with the implementation of a series of policies. Their findings documented that although many policies improved or stabilized the stock market, certain policies led to substantial volatility. Among them, macro-control policies and transaction cost adjustments were a double-edged sword, which should have been used with caution. Furthermore, with opening-up policies being launched recently, the Chinese stock market entered a new stage in which it affected international capital markets. However, the increased risks, which may result in a sharp turnaround, cause some worry.

The second paper entitled: *Does Bilateral Market and Financial Integration Explains International Co-Movement Patterns* by Mobeen Ur Rehman and Syed Muhammad Amir Shah explored the relationship between market integration, foreign portfolio equity holding and inflation rates on international stock market linkages between Pakistan and India. To measure stock equity inter-linkages, the analysis constructed an international co-movement index through rolling beta estimations. The market integration variable between these two countries was constructed using the International Capital Asset Pricing Model (ICAPM), while to check the impact of market integration, foreign portfolio equity holding and inflation rates on Pakistan-Indian stock market co-movements, it applied the Autoregressive Distributed Lag (ARDL) methodology. The level of convergence speed was also measured by the introduction of an Error Correction Term (ECT), followed by variance decompositions. Their results indicated the presence of a long-term relationship among the included variables along with a significance variance in bilateral co-movements due to inflation-rate differentials. More importantly, the significance of inflation rate differences between these two countries were in accordance with the portfolio balance theory, according to which investors possess information about the macroeconomic variables, thereby, they readjust their portfolios for effective diversification.

The third paper entitled: *Is Economic Development Promoting Monetary Integration in East Asia?* by Kentaro Kawasaki and Zhi-Qian Wang, investigated whether there existed international integrated markets across the East Asian economies, by employing the Generalized Purchasing Power Parity (G-PPP) model and attempted to provide a clear answer to the question on whether the East Asian region can be considered as an Optimum Currency Area (OCA). Their empirical results suggested that the G-PPP modelling across nine Asian countries, i.e. China, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore, Thailand and Vietnam, becomes more applicable over the period 2000-2013 than over the period 1984-1997. Accordingly, in the period of "globalization," which is characterized by the expansion of world trade, the increase of international capital flows, as well as the development of information and communications technologies, allowed the Asian economic development to have contributed not only to the economic integration of the region, but also to constructing the stable linkages of real exchange rates. Therefore, the authors recommend that it would help to adopt a

type of regional coordination for monetary policies to ensure the feasibility of a potential future monetary union.

Finally, the fourth paper entitled: *Capital Markets, Infrastructure Investment and Growth in the Asia Pacific Region* by Michael Regan, examined the relationship between activities related to infrastructure investments, capital market developments, the role of public institutions and economic development across the Asia Pacific countries. The author adopted a review approach drawing on empirical evidence over the recent decades. Their review analysis indicated that the infrastructure factor was an important asset class playing a central role in a nation's output, growth, productivity and microeconomic performance. Infrastructure investments also required investment and predictions of a widening gap in the future supply of infrastructure in the Asia Pacific region, which would require new forms of capital from both traditional and new sources, including a wider use of private participation, institutional investments, asset recycling and revenue bonds. Capital market developments were also necessary to raise long-term local currency finance and the evidence recommended that the progress with regional capital market integration was slow and a continuing reform agenda was also required. The dividend for regional countries was the prospect of higher levels of economic growth with infrastructure investments, capital market developments, and foreign direct investments which indicated a strong and positive association with growth rates. A crucial link in this association identified in the review was the part played by both national and regional institutions in improving the efficiency with which infrastructure could be managed and providing promising grounds for further research.



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