“Reforms to Financial Sector in South Asia to promote Economic Growth with Financial System Stability”

THE FUTURE OF FINANCIAL SECTOR REFORMS

Ananda Silva
Assistant Governor
Central Bank of Sri Lanka
Line up...

- Major Financial Sector reforms in South Asian economies – Strengths & Weaknesses
- Lessons for future reforms from the current crisis
- Regulatory measures to contain pro-cyclicality
Current Financial Architecture

**Strengths**

- Banking reforms introduced with opening up of the financial sector for domestic and foreign competition
- Expansion in the availability of credit information and other infrastructure
- Changes in the conduct of monetary policy
- Efficient and secure Payments & Settlements system
- Enhancement of the access to finance
- Strengthening of regulatory and supervisory framework
- Implementation of Basel II framework and improvement in the risk management mechanisms.
### Domestic Saving and Capital Formation as a % of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Domestic Savings</th>
<th>Capital Formation</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>22.8</td>
<td>24.4</td>
</tr>
<tr>
<td>Pakistan</td>
<td>13.5</td>
<td>15.8</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>12.9</td>
<td>13.1</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>12.0</td>
<td>14.6</td>
</tr>
<tr>
<td>Nepal</td>
<td>7.3</td>
<td>13.8</td>
</tr>
<tr>
<td>Bhutan</td>
<td>N/A</td>
<td>39.8</td>
</tr>
</tbody>
</table>

Source: Asian Development Bank
<table>
<thead>
<tr>
<th>Country</th>
<th>NPL to Total Loans</th>
<th>Bank Regulatory Capital to Risk-Weighted Assets</th>
<th>Bank Provisions to Nonperforming Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>8.8</td>
<td>5.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Pakistan</td>
<td>17.0</td>
<td>8.3</td>
<td>9.1</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>22.1</td>
<td>13.2</td>
<td>11.2</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>12.3</td>
<td>7.1</td>
<td>6.3</td>
</tr>
</tbody>
</table>

Source: International Financial Statistics - June 2009
<table>
<thead>
<tr>
<th>Economic Indicator</th>
<th>Afghanistan</th>
<th>Bangladesh</th>
<th>Bhutan</th>
<th>India</th>
<th>Maldives</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per capita ($)</td>
<td>350.1</td>
<td>486.8</td>
<td>1664.8</td>
<td>1028.7</td>
<td>3470.5</td>
<td>390.8</td>
<td>910</td>
<td>1616.1</td>
</tr>
<tr>
<td>GDP Growth (%)</td>
<td>11.5</td>
<td>6.4</td>
<td>17</td>
<td>9</td>
<td>7.6</td>
<td>2.6</td>
<td>6.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>13</td>
<td>7.2</td>
<td>5.2</td>
<td>4.7</td>
<td>7.4</td>
<td>6.4</td>
<td>7.8</td>
<td>15.8</td>
</tr>
<tr>
<td>Fiscal balance (%)</td>
<td>-1.8</td>
<td>-3.2</td>
<td>-3.4</td>
<td>-5.4</td>
<td>-7.8</td>
<td>-2</td>
<td>-4.3</td>
<td>-7.7</td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>0.9</td>
<td>1.4</td>
<td>10.5</td>
<td>-1.5</td>
<td>-40.1</td>
<td>-0.1</td>
<td>-4.8</td>
<td>-4.2</td>
</tr>
<tr>
<td>Gross International Reserves (month of imports)</td>
<td>3.6</td>
<td>3.3</td>
<td>12.9</td>
<td>15</td>
<td>3.1</td>
<td>8.9</td>
<td>4.5</td>
<td>2.9</td>
</tr>
<tr>
<td>M2/GDP</td>
<td>21.6</td>
<td>45.3</td>
<td>59.2</td>
<td>85.2</td>
<td>73.8</td>
<td>54.4</td>
<td>50.6</td>
<td>39.2</td>
</tr>
<tr>
<td>Bank Deposits/GDP</td>
<td>10.9</td>
<td>39.5</td>
<td>46</td>
<td>68</td>
<td>64.9</td>
<td>29.9</td>
<td>79.4</td>
<td>65.3</td>
</tr>
</tbody>
</table>

Source: ADB review on South Asia’s Financial Sector
Current Financial Architecture...

**Weaknesses**

- Major share of banking sector is state-owned, requiring better management
- Non-availability of appropriate regulatory environment for the development of non-bank institutions/market
- Non-availability of an institutional investor base
- Non-availability of derivative markets and securitization markets
Lessons from the Global Crisis

- Need for greater co-ordination and consistency between economic stability policies and regulatory framework
- Need for further strengthening the banking sector by allowing Mergers & Acquisitions
- Bringing the unregulated shadow banking system into the regulatory regime
- Development of non-bank financial institutions
Lessons from the Global Crisis...

- Need for developing capital markets
- Promoting long-term funding sources and derivative
- Improving access to finance
- Strengthening regulatory and supervisory framework
- Introduction of consolidated supervision to limit regulatory arbitrage
- Need for well-established resolution framework
Lessons from the Global Crisis

- Improving Corporate Governance
- Strengthening of disclosure requirements and introducing standards for compliance monitoring
- Developing a regional alliance to facilitate intra-trade, excess funds investments
- Disclosure of information with proper standards
- Improve the financial literacy and awareness among investors
Challenging the pro-cyclical risk taking behaviour of banks

- Having counter cyclical capital buffers and stronger quality of capital in the banks
- Introduction of leverage ratios
- Forward-looking provisioning
- Retaining a meaningful share of underlying assets
- Determining fair value measurement methodology
Challenging the pro-cyclical risk taking behaviour of banks

- Curtail over-reliance on external credit ratings and enhance internal rating capability
- Implementation of Pillar 2 – ICAAP & SRP under Basel II Framework
- Controlling of systemic risk in outsourcing internal control systems and the technical models
Concluding Remarks

- Sound and stable financial system is crucial.
- Prudent monetary policy supported by fiscal policy is essential to contain inflationary pressures.
- Striking balance between development of markets and sound regulations.
Thank you