FOFM

ASIA

A PROFILE OF ECONOMY & FINANCE

GLOBAL MEDIA PARTNER

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ASIA: A PROFILE OF ECONOMY

ASIAN ECONOMY

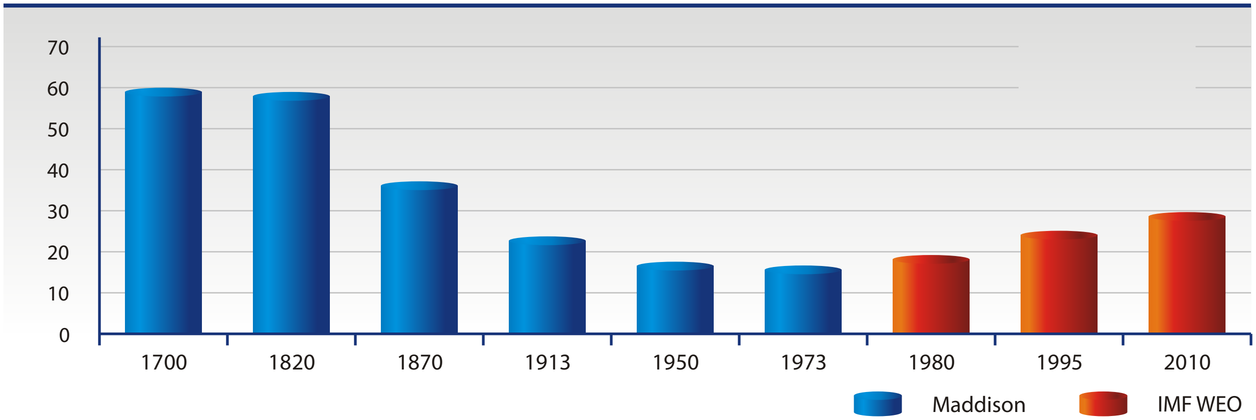
Asia was a prosperous economic region contributing a lion's share of global Gross Domestic Product (GDP) through the middle ages till the 19th century. In fact, in 1700, India, endowed with natural resources and a population of 165 million, was the world's largest economy, followed by China with 138 million people. A century later, in 1820, as Industrial Revolution was gathering pace, India and China accounted for half of global GDP. Then came the Industrial Revolution in Europe and by the start of the First World War, Europe and America became the dominant economies and accounted for more than half of global GDP.

Asia is set to regain its past glory in the 21st century. Globally, the rise of China and India has moved the international production-possibility frontier further outward as a result of more effective specialization. China has become the newest manufacturing hub of the world and India the most economical provider of IT services and the populations of over two billion progressively drive the global aggregate demand, thus making the two nations the critical engines of global economic growth.

According to an ADB report released in 2011, Asia's rise will be led by seven economies: China, India, Indonesia, Japan, South Korea, Thailand and Malaysia. Between 2010 and 2050, it is projected that these seven economies would account for as much as 87 percent of total GDP growth in Asia and almost 55 percent of global GDP growth.

The following table shows Asia's share of global GDP, which was on a declining trend from 1700 to 1980, has started to climb from the 1980s.

Asia's Share of Global GDP (in %)



Source: Maddison, Angus: Contours of the World Economy: IMF World Economic Outlook, October 2010.
Data for 1750-1790 is in PPP and data for 1991-2010 is in market prices.

SHIFTING ECONOMIC POWER

The balance of international economic power is shifting from the North Atlantic region to the Asia-Pacific region in the recent decades and out of the top 15 economies, 11 are from Asia.

Gross Domestic Product

Country	Rank 1990	Rank 2009	Country	Rank 1990	Rank 2009
United States	1	1	Russia	5	9
Japan	2	2	Indonesia	9	10
China	4	3	Hong Kong	10	11
India	8	4	Thailand	11	12
Canada	3	5	Singapore	14	13
South Korea	6	6	Malaysia	13	14
Australia	7	7	Philippines	12	15
Taiwan	-	8			

Source: World Bank

During 1990-2009, the GDP of many Asian countries increased manifold. China registered 660 percent increase followed by India (328 percent) and the other Asian countries also witnessed impressive growth.

Gross Domestic Product (in $ bn)

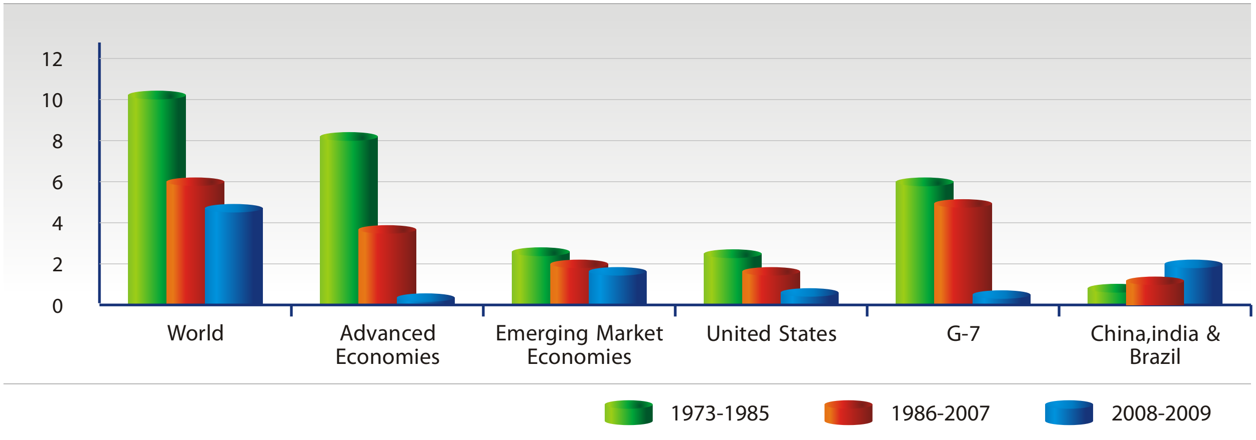
Country	1990	2000	2009	Country	1990	2000	2009
United States	7055.0	9764.8	11364.2	Russia	385.9	259.7	397.9
Japan	4111.3	4667.4	4869.9	Indonesia	109.2	165.0	258.5
China	444.6	1198.5	2937.5	Hong Kong	108.4	169.1	234.2
India	269.4	460.2	885.4	Thailand	79.4	122.7	173.9
Canada	535.6	724.9	846.8	Singapore	44.7	92.7	143.5
South Korea	283.6	511.7	752.8	Malaysia	45.5	90.3	137.1
Australia	280.5	399.6	548.1	Philippines	55.8	75.9	111.7
Taiwan	-	303.2	427.0	World	23996.7	31876.3	39758.5

Source: World Bank

ASIA'S RISING CONTRIBUTION TO GLOBAL GROWTH

The relative contribution of advanced economies to global growth over time declined from 70 percent between 1973 and 1985 to 57 percent between 1986 and 2007, and then to 6 percent during 2008-09, while the contribution of emerging economies rose from 26 percent to 39 percent, and then to 86 percent during the same periods. China, India and Brazil together accounted for an increasingly larger share of the developing countries' contribution, rising from 11 percent to 22 percent, and then to 71 percent during the three periods. The global financial crisis during 2008-09, which hit economic growth in mature economies harder than emerging economies, was the causative factor for such a shift in share of contributions from mature economies to emerging economies.

Contribution to Global Growth, by Group and Region, 1973-2009 (in percent)



Source: Brookings Institution
Notes: Share contributions are derived by dividing world GDP growth by group/region's growth. Growth is calculated using PPP exchange rates

CHANGES IN COMPOSITION OF OUTPUT

During the last 50 years, there has been a noticeable shift in the composition of economic output in emerging economies with a declining share in agriculture and a rising share in industry and services, whereas during the same period advanced economies experienced a contraction in the share of industrial and agricultural output.

Changes in Composition of Output by Group and Sector, 1960-2008 (in percent)

Group	1960-1972	1973-1982	1986-2008
World			
Agriculture	5.67	4.41	3.93
Industry	32.98	31.86	29.45
Services	61.39	63.73	66.63
Advanced Economies			
Agriculture	3.50	2.43	1.90
Industry	33.60	32.11	28.11
Services	62.90	65.46	66.63
Emerging Market Economies			
Agriculture	21.59	15.72	11.78
Industry	27.93	29.74	34.19
Services	50.48	54.54	54.03
Other Developing Economies			
Agriculture	28.96	20.97	19.93
Industry	29.91	33.90	32.12
Services	44.61	45.13	48.47

Source: Brookings Institution

At the same time, industrial activity is growing at a more rapid pace in emerging economies compared to advanced economies. Industrial output in emerging economies grew 6.47 percent from 1960 to 1972, 5.54 percent between 1972 and 1985, and 6.67 percent between 1986 and 2008. This compares to advanced countries' rates of industrial growth of 5.41 percent from 1960 to 1972, 1.65 percent from 1973 to 1985, and 1.78 percent for the 1986-2008 period.

China has become competitive not only because of its lower labour costs but also because it is a huge importer of sophisticated components from other East Asian countries for assembly and re-export to Western markets. Its integration into global production networks is reflected in the fact that it runs bilateral trade deficits with nearly all East Asian countries and bilateral trade surpluses with most developed countries—particularly the United States and European countries.

China and India are actively trying to upgrade their ability to compete in higher value-added segments of manufacturing—design, innovation and marketing of products—by increasing support for research and development and technological acquisition. For example, since 2000, China has invested 1.4 percent of its GDP in R&D and India has invested 0.8 percent. China and India are increasing their R&D expenditures at over 8 percent per year.

GROWTH OF OUTPUT

A comparison of average annual growth of developing countries of Asia vis-à-vis developed countries reveals that most Asian countries have done better than developed countries.

Growth of Output: 2000-09

Developing Countries	Average Annual % Growth		
	Agriculture	Industry	Services
India	2.9	8.6	9.5
China	4.4	11.8	11.6
Hong Kong	-3.3	-2.6	5.3
Indonesia	3.4	4.1	6.2
South Korea	2.0	5.4	3.7
Malaysia	3.5	3.5	6.4
Pakistan	3.5	6.8	5.9
Philippines	3.6	4.0	6.1
Singapore	2.3	5.4	6.2
Thailand	2.3	5.6	4.2
Developed Countries			
US	2.1	0.9	2.3
UK	0.6	-0.6	2.9
Australia	0.0	2.6	3.7
Japan	-0.3	1.7	1.5
Germany	-0.3	0.3	1.5

Source: World Development Indicators 2011

GLOBAL TRADE

The share of global trade accounted for by developing countries, particularly in Asia, has increased significantly, rising from 23 percent in 1990 to 45 percent in 2010, and it is estimated to reach 70 percent by 2050. Much of this rise has been due to an expansion of exports from developing countries to other developing countries (often referred to as South-South trade). Trade between developing countries rose from \$0.3 trillion in 1990 to \$3.0 trillion in 2008, or from 9 percent to 20 percent of global trade.

Within the developing world, Asia plays the largest role, accounting for over 75 percent of South-South trade. China is the world's largest merchandise exporting country and the dominant trading partner of most countries. Other developing countries, such as India, Brazil, Indonesia and Mexico, are likely to join the ranks of the top exporting countries soon. Developing countries have become more important markets for developed countries, with their share of advanced economies' exports rising from 23.3 percent in 1985 to 33.9 percent in 2009.

Trade Flow and Trade Partners

Country	Trade Flow (in $ bn, constant 2000 PPP)		Trade Partners (in %)	
	2000	2009	Top Export Partner 2009	Top Import Partner 2009
United States	2572.1	3039.1	Canada (19)	China (19)
China	530.2	2045.5	US (20)	Japan (12)
Japan	957.6	1105.2	China (19)	China (22)
Hong Kong	476.3	868.2	China (51)	China (46)
South Korea	401.6	766.1	China (22)	China (18)
Canada	617.4	607.7	US (78)	US (52)
India	130.5	395.1	UAE (12)	China (11)
Russia	176.4	367.4	Netherlands (12)	Germany (14)
Australia	178.0	315.2	China (22)	China (15)
Malaysia	206.7	275.8	Singapore (14)	China (14)
Thailand	153.3	210.2	US (11)	Japan (19)
Indonesia	117.9	194.8	Japan (20)	Singapore (17)
Philippines	82.7	105.6	US (18)	Japan (13)
Vietnam	35.1	101.9	US (19)	US (22)
New Zealand	36.6	44.2	Australia (23)	Australia (18)

Source: World Bank, World Development Indicators 1990-2011, and CIA, The World Factbook 2011

Exports from emerging economies grew exponentially with exceptional performance from countries like China, India and Vietnam during 1995-2009. Similarly, imports also grew substantially in China, India, Vietnam and Indonesia indicating the growing share of these countries in world trade.

Country	Exports (in $ million)		Country	Exports (in $ million)	
	1995	2009		1995	2009
Australia	69,710	234,298	South Korea	147,761	432,097
Bangladesh	4,431	17,011	Malaysia	83,369	186,424
China	147,240	1,333,346	Philippines	26,795	47,611
India	38,013	258,822	South Africa	34,402	78,563
Indonesia	52,923	133,255	Thailand	70,292	180,653
Japan	493,991	673,615	Vietnam	9,498	62,752

Source: World Bank

Country	Imports (in $ million)		Country	Imports (in $ million)	
	1995	2009		1995	2009
Australia	74,841	242,311	South Korea	155,104	393,172
Bangladesh	7,589	23,165	Malaysia	86,851	144,873
China	135,282	1,113,234	Philippines	33,317	54,950
India	48,225	328,036	South Africa	33,375	80,816
Indonesia	54,461	112,233	Thailand	82,246	155,777
Japan	419,556	650,364	Vietnam	12,334	72,446

Source: World Bank

FOREIGN EXCHANGE RESERVES

At the end of 2010, developing and emerging economies held approximately $6.2 trillion (67 percent) of the total foreign exchange holdings of $9.3 trillion. Fifteen years earlier, their foreign exchange reserves were only $0.46 trillion, or 33 percent of the world stock.

In 2010, China, with $2.8 trillion of foreign exchange reserves, accounted for 66 percent of all developing economies' exchange reserve holdings. Compared to its 16 percent share of holdings in 1995, this represents a dramatic increase. Based on current projections, asset holdings may shift further towards emerging economies, such as China, Hong Kong, Singapore and India in the future.

Foreign Exchange Reserves by Country – Q1 2011

Country	FX Reserves (in $ billion)	Country	FX Reserves (in $ billion)
China	3200	India	310
Japan	1100	South Korea	307
Russia	525	Switzerland	280
Saudi Arabia	466	Hong Kong	277
Taiwan	400	Singapore	243
Brazil	337	Germany	221
		Others	2034

CAPITAL FLOWS

Private capital flows to Asian countries have risen substantially over the past 25 years, growing from 1.3 percent of their GDP in the mid-1980s to 5 percent in recent years. International financial flows over the past two decades have grown much faster than trade flows. This development stems from the rapid liberalization of capital movement in emerging economies after the mid-1980s, including privatization of state-owned banks and removal of restrictions on the acquisition of assets by foreigners. During the 1980s, debt accounted for nearly three-quarters of all assets and liabilities of emerging economies. This share was offset by a corresponding increase in the shares of foreign direct investment (FDI) and portfolio equity. Of these two forms of capital flows, FDI (both inward flows and outward flows) has contributed substantially to accelerating the growth and integration of developing countries into the global economy.

FDI INFLOWS

In recent years, developing countries have accounted for three of the top six destinations for FDI flows, with China moving up to become the second largest FDI recipient in 2009, behind the United States. Brazil and Russia are the other two emerging economies that have received substantial FDI inflows.

FDI OUTFLOWS

According to the United Nations data, cash-rich emerging economies have been increasing their share of global FDI outflows. At the end of 2009, developing countries held about 16 percent of the global outward FDI stock.

China is the largest developing country, with $62 billion in FDI outflows in 2009.

Country	FDI Inflows ($ bn)		FDI Outflows ($ bn)		Country	FDI Inflows ($ bn)		FDI Outflows ($ bn)	
	1995-2005 annual average	2009	1995-2005 annual average	2009		1995-2005 annual average	2009	1995-2005 annual average	2009
United States	140.5	129.9	132.3	248.1	Kazakhstan	1.9	12.7	0.0	10.1
China	48.8	95.0	3.8	48.0	Thailand	4.8	6.0	0.4	3.8
Hong Kong	22.2	48.5	25.4	52.1	South Korea	5.3	5.8	4.0	10.6
Russia	5.5	38.7	4.9	46.1	Indonesia	1.4	4.9	0.9	3.0
India	4.1	34.6	1.0	14.9	Pakistan	0.7	2.4	0.0	0.0
Australia	9.6	22.6	4.0	18.4	Malaysia	4.1	1.4	2.0	8.0
Canada	20.7	18.7	27.3	38.8	New Zealand	1.9	0.4	0.0	0.0
Singapore	13.2	16.8	8.1	6.0	World	741.1	1114.2	717.9	1101.0

MIDDLE CLASS

Asia's middle class is one of the fastest-growing population groups in the world. According to the World Bank, the middle class of South Asia and East Asia accounted for 1.4 percent of the global population and 2.1 percent of global income. By 2030, the World Bank forecasts that this same group will account for 8.9 percent of the population and 7.7 percent of global income—much higher than the middle class growth in other developing regions. Asia is projected to have more middle class population by 2030, even surpassing the mature economies.

THE GLOBAL MIDDLE CLASS, 2009: PEOPLE AND SPENDING

Country	**Number of People** (in million) and **global share** (in %)		**Consumption** (billions PPP$) and **global share** (in %)	
North America	338	18	5602	26
Europe	664	36	8138	38
Central and South America	181	10	1534	7
Asia-Pacific	525	28	4952	23
Sub-Saharan Africa	32	2	256	1
Middle East and North Africa	105	6	796	4
World	1845	100	21278	100

Asia's growth in the global economy will bring new challenges, responsibilities and obligations. As Asia becomes the centre of the global economy, it will be in its own interest that the rest of world also does well economically and politically. Peace and security throughout the world will be essential for its long-term prosperity. The Asian Century will be century of shared global prosperity.

ASIAN FINANCIAL MARKETS 2000-10

CHANGING FINANCIAL LANDSCAPE

A vibrant, dynamic and well-functioning financial market leads to a host of improved economic outcomes through various channels such as mobilization of savings, allocation of resources to productive uses, easy facilitation of transactions and risk management among others. In particular, the ***financial depth***—the extent to which an economy is making use of bank intermediation and financial market activity—is associated with higher rates of economic growth and broader access to financial services as well.

Despite the impressive economic growth in Asia during 2000-10, Asia's financial sectors and markets continue to face major challenges, which vary greatly in scope depending on country-specific development stages. Asia's financial sectors and markets have not progressed in tandem with the real sector economy and financial sectors remain much smaller in size compared to those of advanced economies.

The past decade (2000-10) has witnessed tremendous changes and growth in the financial sector in many countries across the Asian region. The relative share of stock market, debt market and banking sector in providing external funding for the private sector has been undergoing a drastic change over the last ten years with a discernible shift towards disintermediation in many Asian countries. This new trend largely reflects the fact that many economies in Asia are gradually transforming from a bank-based financial system to a market-based financial system. The Asian region has improved its market share modestly in different segments of the global financial market between 2004 and 2009 compared to the US and Europe, though US and Europe still dominate the financial market.

GLOBAL FINANCIAL MARKETS (% share):

	Europe		US		Asia		Rest of the World	
Segment	**2004**	**2009**	**2004**	**2009**	**2004**	**2009**	**2004**	**2009**
Commercial Banking	56	53	14	14	24	26	6	7
Insurance Premium	37	40	34	28	22	24	7	8
Pension Funds	19	21	68	63	5	5	8	11
Mutual Funds	35	33	50	48	6	8	9	11
Equity Turnover	32	16	50	58	15	22	4	2
OTC Derivatives	70	65	24	24	4	5	2	6
Exchange-Traded Derivatives	38	43	54	49	7	7	1	1
Forex Turnover	53	56	19	18	19	19	9	7

Source: www.thecityuk.com

Asia's financial system is historically skewed with a dominant banking system. The debt, currency and equity markets have been evolving only in recent years in most Asian countries. The share of stock markets and debt markets in the financial system have grown much faster than the banking sector in most of the Asian economies in the last ten years. The following table shows the relative share of the different segments of the financial system as a percentage of GDP.

SIZE AND COMPOSITION OF FINANCIAL SYSTEM (% of GDP)

Economy	Banks		Nonbanks		Market Capitalization		Bonds	
Year	2000	2010	2000	2010	2000	2010	2000	2010
China	168.8	229.8	8.8	21.5	27.1	45	16.9	50.5
Hong Kong	505.5	703.1	196.4	509.4	363.9	1,198	35.8	73
India	60	98	15	35.2	32	97.9	23.7	54.4
Indonesia	70.8	34.4	7.5	14.1	18.7	50.6	36.8	14.9
South Korea	147.9	169.9	44.1	71.6	31.2	98.1	74.4	110.3
Malaysia	154.2	202.3	16.5	22.5	124.7	166.5	73.3	98.6
Pakistan	73.7	84.6	2.4	13.2	10	21	36.1	32.4
Singapore	243.4	287	36	48.7	239.6	270.9	47.5	75.5
Sri Lanka	..	64	10.7	22.7	6.8	22.2	..	..
Thailand	132.3	150.5	142.1	40.1	26	82.5	27.4	66.8
Euro zone	230	315.9	272	234.7	..	..	86.9	107
Japan	311.3	323.6	279.3	232.2	64.1	37	103.6	198.4
United States	79.6	106.3	-	304.8	115.9	91.4	138	172

Source: ADB

GROWTH OF BANKING ASSETS

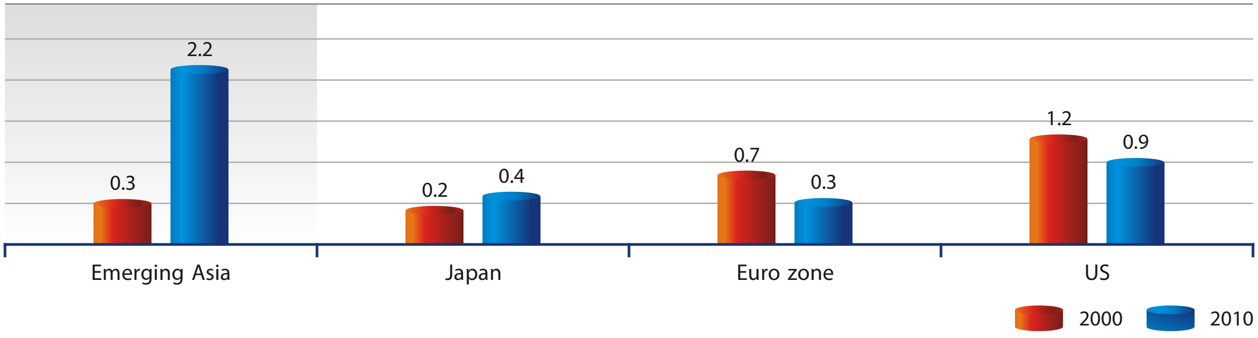
The assets of Asian banks have witnessed significant growth in the past decade as shown below:

Country	Bank Assets in 1990 (as % of GDP)	Bank Assets in 2000 (as % of GDP)	Bank Assets in 2010 (as % of GDP)
India	51.5	60	98
China	90	168	229
South Korea	65.7	147	169
Singapore	75.6	243	287
Japan	259.7	311	323
Euro zone	-	230	315
US	110.9	79	106

Source: ADB

Asian banking systems strengthened their operational efficiency and their earnings have improved. The return on assets (ROA) of banks in emerging Asian economies has increased sevenfold over a period of ten years and is higher than that of the euro zone and the US banks during the same period.

Return on Assets



Note: Euro zone refers to 50 large banks in the region.

Emerging Asia includes India, China, Bangladesh, Hong Kong, Indonesia, South Korea, Malaysia, Nepal, Pakistan, the Philippines, Singapore, Sri Lanka and Thailand.

Source: ADB

NONPERFORMING LOANS ON THE DECLINE

The NPA levels have come down drastically for most Asian countries over the last ten years.

Country	Bank Nonperforming Loans (% of total gross loans)		Country	Bank Nonperforming Loans (% of total gross loans)	
Year	2000	2010	Year	2000	2010
China	22.4	1.1	Malaysia	15.4	3.4
Hong Kong	7.3	0.8	Philippines	24	4.3
South Korea	8.9	1.9	Singapore	3.4	1.8
Bangladesh	34.9	11.2	Thailand	17.7	3.9
India	12.8	2.4	Japan	5.3	1.8

Source: ADB

However, there are still areas of improvement in terms of their efficiency, inclusivity and stability.

STOCK EXCHANGES

Development of stock markets is closely related to the economy's overall development in many Asian countries. As the economy develops, stock markets tend to dominate the financial system and become more active and efficient relative to other segments of the financial system. Market size is positively correlated with the ability to mobilize capital and diversify risk. The stock market capitalization in Asia has registered remarkable growth during 2000-10, although in varying degrees. The number of listed domestic companies is also on the rise, which is another measure of market size. Well-functioning stock markets facilitate easily accessible information, lower transaction costs, improve resource allocation and boost economic growth.

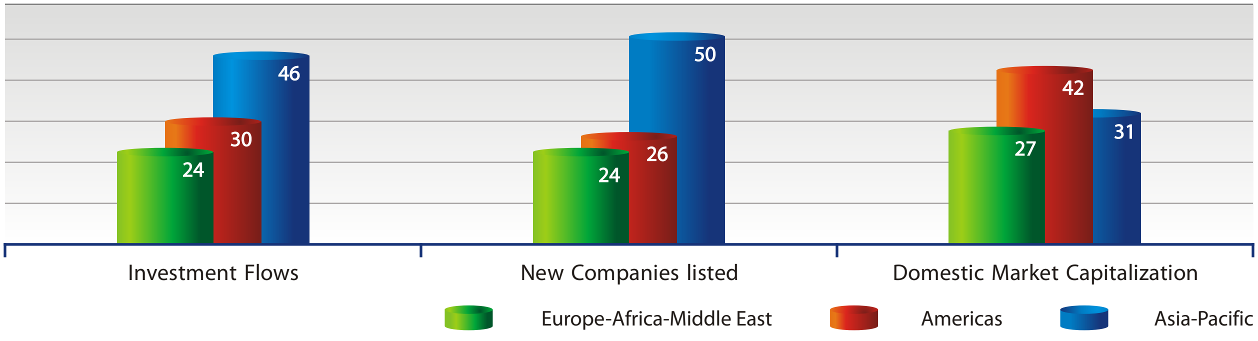
Developing Countries	Market Capitalization				Listed Companies	
	$ million		% of GDP		No. of Domestic Companies	
	2000	2010	2000	2010	2000	2010
India	148064	1615860	32.2	85.6	5937	4987
China	580991	4762837	48.5	100.4	1086	2063
Hong Kong	623398	2711334	368.6	1088.3	779	1396
Indonesia	26834	360388	16.3	33.0	290	420
South Korea	171587	1089217	32.2	100.5	1308	1781
Malaysia	116935	410534	124.7	132.6	795	957
Pakistan	6581	38169	8.9	20.5	762	644
Philippines	25957	157321	34.2	49.7	228	251
Singapore	152827	370091	164.8	170.5	418	461
Thailand	29489	277732	24.0	52.4	381	541

Developed Countries	Market Capitalization				Listed Companies	
	$ million		% of GDP		No. of Domestic Companies	
	2000	2010	2000	2010	2000	2010
USA	15104037	17138978	152.6	106.8	7524	4279
UK	2576992	3107038	174.4	128.6	1904	2056
Australia	372794	1454547	89.4	136.1	1330	1913
Japan	3157222	4099591	67.6	66.6	2561	3553
Germany	1270243	1429707	66.8	39.0	1022	571

Source: WFE

According to the data from the World Federation of Exchanges (WFE), equity finance in the Asia-Pacific region accounted for 46 percent of the world total in 2011. Asia's stock market capitalization represents 31 percent of the global total and Asia accounted for highest number of new companies listed through Initial Public Offerings (IPOs) in 2011.

Share of Asia in World Capital Market (%) 2011



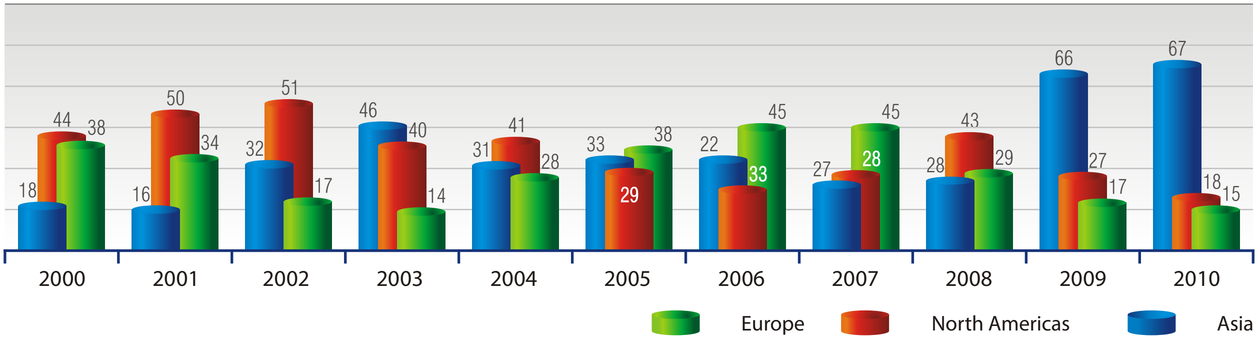
Source: WFE

The following table highlights the growing dominance of Asian bourses in Initial Public Offering (IPO) listings during 2000-10 from a modest share of 18 percent to a lion's share of 67 percent.

Year	IPO listed ($ million)	Year	IPO listed ($ million)
2001	96,083	2006	262,509
2002	59,878	2007	252,651
2003	54,867	2008	72,747
2004	141,378	2009	106,980
2005	171,386	2010	270,080

Source: ADB

IPO Listings (%) - Regional Share



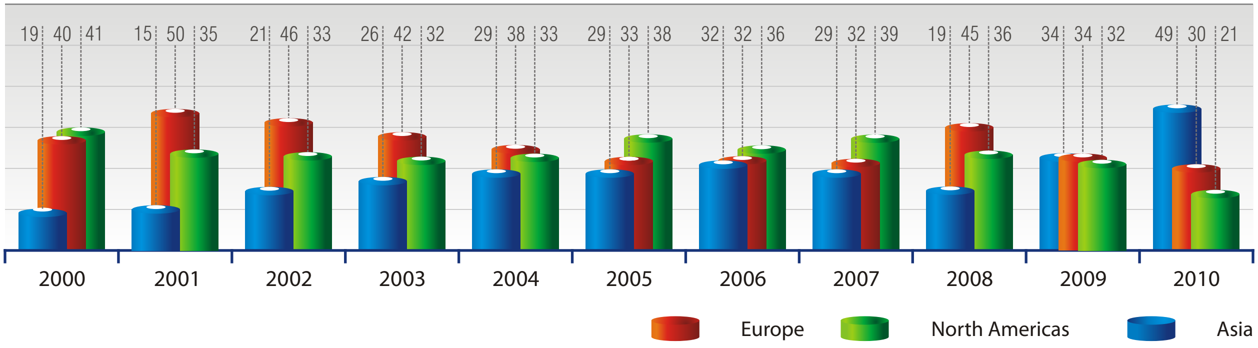
Source: WFE

Similarly, the percentage of equity issuance in Asian exchanges showed an upward trend from 19 percent in 2000 to 47 percent in 2010. This shift may in part be attributed to subdued activity in Europe and the United States post-crisis. It is likely, however, with the growth in demand in Asia that the preference in IPOs and equity listings will continue to rise.

Year	Equity Issuances ($ million)	Year	Equity Issuances ($ million)
2001	453,198	2006	747,782
2002	339,257	2007	861,031
2003	444,894	2008	583,386
2004	557,233	2009	868,195
2005	581,921	2010	824,828

Source: WFE

Equity Issuance by Region (in%)



Source: WFE

MUTUAL FUNDS

The mutual fund industry in Asia has recorded a growth of 83 percent during 2004-10, which is higher than global growth rate during the same period.

Region	2004	2010	Growth (%)
America	8780593	13586869	55
Europe	5640425	7902835	40
Asia-Pacific	1677887	3067323	83
Africa	54006	141615	162
World	16152911	24698642	52

Source: Investment Company Institute, USA

Many Asian equity markets today have greater diversity in terms of products, investors and traders and have progressively eased restrictions on market access and foreign exchange regulations. These markets also have introduced liberalized tax regimes and modern methods of settlement and custody to broaden and deepen the markets.

CURRENCY MARKET

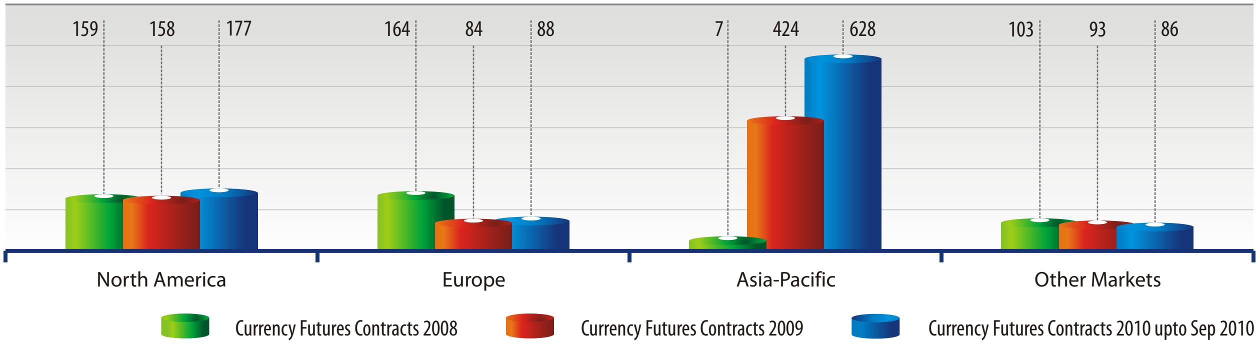
Foreign exchange has today evolved into an asset class, like stocks and bonds, due to its deep liquidity, volatility and low cost per trade. The proliferation of different types of electronic trading platforms in recent years has made the forex market more accessible to investors. The development of internet trading platforms has made the customer segment of the forex business more competitive, leading to the emergence of non-bank service providers.

Japan (6 percent of the global turnover), Singapore (5 percent), and Hong Kong (5 percent) are the leading centres of foreign exchange in Asia. India's foreign exchange market is a fast-growing market because of the strong economic growth and the increasing depth and openness of domestic financial markets in the economy. The growth is evidenced both in the spot and derivatives segments. The daily average turnover in the spot market has seen a rise. The spot market remains the most important segment in the Indian foreign exchange market, accounting for roughly 50 percent of total turnover. In the derivatives market, foreign exchange swaps account for the largest share of the total derivatives turnover, followed by forwards.

CURRENCY FUTURES MARKET

Worldwide, the size of the currency futures market, though rapidly growing, is small in relation to the size of OTC spot as well as forward market. There has been a robust growth in currency futures transaction volumes, types and users over the years in Asia.

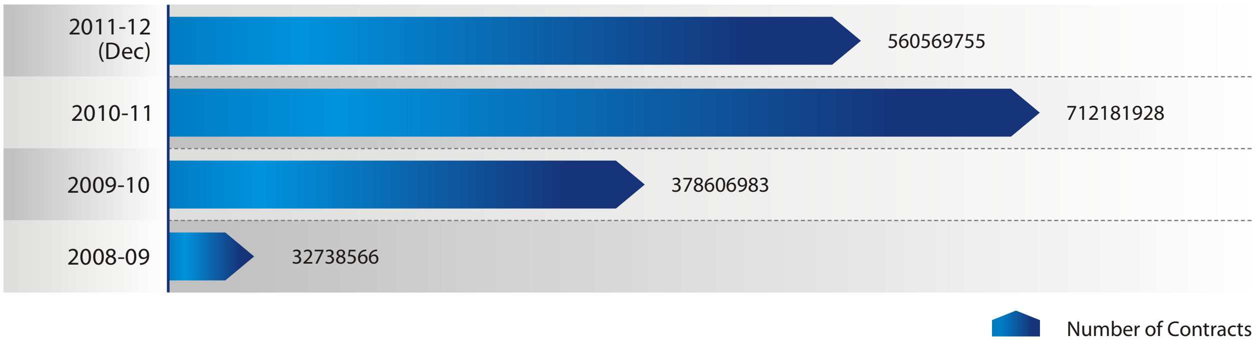
Currency Futures Contracts (in million)



One of the significant developments in the currency futures markets is the emergence of India as a leading player in the currency futures market, since currency futures trading started in August 2008 in India. The following table shows that India tops the list among the major markets, as far as number of contracts traded. However, India's share in global futures market in terms of notional value is hardly 2 percent, as the size of the contract in India is small ($1,000) as compared US futures markets where the standard size is $1 million.

Indian currency futures market is growing at a fast pace as shown below:

Currency Futures



Source: SEBI

ASIAN COMMODITY MARKETS

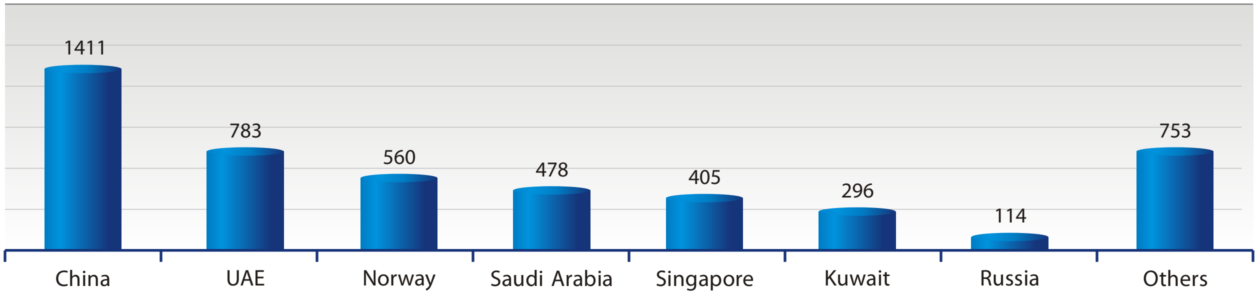
Commodities witnessed robust growth during 2000-10 in terms of volume and value of trading on exchanges. This was largely a result of the growing attraction of commodities as an asset class. Commodity trading volumes on exchanges in China and India have shown significant growth in recent years.

Worldwide, there are around 50 major commodity exchanges that trade in more than 90 commodities. Metals are predominantly traded in London, New York, Chicago and Shanghai and energy contracts in New York, London, Tokyo and the Middle East, which together account for more than 83 percent of the value of all exchange-traded contracts. In terms of the number of futures contracts traded, China and the UK have three exchanges amongst the largest ten, the US two and Japan and India one each. The Dalian Commodity Exchange is the largest commodities exchange in the world followed by the Shanghai Futures Exchange and CME Group. Trading on exchanges is fairly concentrated with the top five exchanges accounting for 86 percent of contracts traded globally. Emerging economies have driven demand for various commodities, particularly markets in China, India and the Middle East; slow supply responses have amplified price pressures; and low interest rates and the weakening of the dollar have been a supporting factor. Commodity exports continue to play an important role in emerging market economies of Asia although their exports have become much more diversified in terms of both composition and destinations.

SOVEREIGN WEALTH FUNDS

Sovereign Wealth Funds (SWFs) have been in existence since 1953 and their profiles have gained importance only in recent years. The substantial size and high liquidity of SWFs' assets have turned the government sector into an important international investor group. Historically, majority of SWFs from the Middle East have been commodity-based. A new class of non-commodity-based funds evolved in 1980s. Those funds were created from trade or fiscal surpluses. The trend began in 1981, with Singapore setting up the Government of Singapore Investment Corporation Pte Ltd (GIC), which was funded by the accumulated national savings and sustained balance of payments surpluses. China Investment Corporation (CIC), established on September 29, 2007, is funded through the issuance of special treasury bonds. Currently, non-commodity-based funds account for around 40 percent of total AUMs of SWFs. Asia and the Middle East account for close to 80 percent of SWF assets as of December 2011. The following graph is a snapshot of major countries holding SWF assets.

Sovereign Wealth Funds (AUMs as of Dec 2011(in $ bn))



As SWFs have long-term investment horizons and are not highly leveraged, they represent a steady source of investment capital that may help to stabilize markets. The financial services sector was the largest recipient of SWF direct investment between 2005 and 2011, accounting for over a third of transactions. SWFs bring significant benefits to global capital markets in terms of increasing market liquidity and financial resource allocation.

BOND MARKETS

LCY-denominated Asian bonds are emerging as an asset class and are attracting both domestic and foreign investors searching for yield and diversified portfolios. In 2010, growth momentum in government bond markets continued as economic recovery gained traction. The LCY corporate bond market is also expected to show steady growth as an additional funding source for domestic companies and an attractive investment alternative for investors.

As a percentage of the region's gross domestic product (GDP), the bond market of emerging Asia has ranged between 55 percent and 58 percent in recent years. The fastest-growing LCY bond market in Asia since 1996 has been China. The share of the six largest markets of the Association of Southeast Asian Nations (ASEAN) countries— Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam have approximately doubled over the last 15 years. South Korea's LCY bond market expanded from 1.1 percent of the global total in 1996 to 1.8 percent in 2010.

Bonds Outstanding in Major Markets (US$ billion)

	March 2011		1996	
Economy	**LCY Bonds Outstanding**	**% of World Total**	**LCY Bonds Outstanding**	**% of World Total**
United States	25475	38.1	10926	42.9
Japan	11504	17.2	4456	17.5
France	3421	5.1	1261	4.9
Germany	2815	4.2	1888	7.4
United Kingdom	1727	2.6	678	2.7
China	3066	4.6	62	0.2
South Korea	1211	1.8	283	1.1
Indonesia	118	0.2	7	0.0
Malaysia	259	0.4	71	0.3
Philippines	73	0.1	28	0.1
Singapore	187	0.3	25	0.1
Thailand	225	0.3	19	0.1
Vietnam	16	0.0	-	-
Brazil	1528	2.3	299	1.2
India	711	1.1	81	0.3

Source: Bank of International Settlements and Asian Bonds Online

Top Five Corporate Bond Markets in Asia

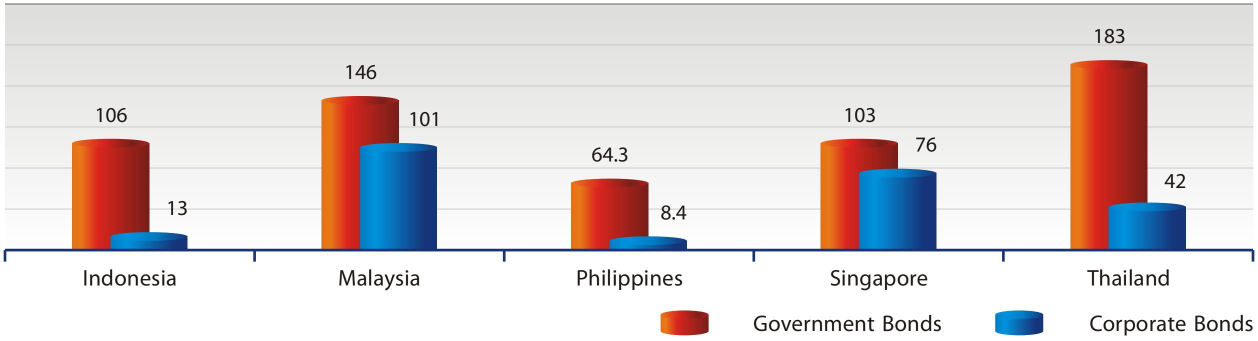
Country	Q1 2011 (amount in $ bn)	% of Total Bond Market
China	696	23
South Korea	687	57
India	179	21
Malaysia	103	40
Thailand	44	20

Source: www.asianbondsonline.org

Since the Asian crisis, ASEAN-5 countries (Association of Southeast Asian Nations—Indonesia, Malaysia, the Philippines, Singapore, and Thailand) have expended considerable efforts to develop their domestic bond markets, but, relative to their GDP, these markets are not larger than they were a decade before, according to a recent IMF working paper published on June 14, 2011.

In many ways, the ASEAN-5 bond markets compare well with other emerging markets. The size of the local currency debt markets in Thailand and Singapore are reasonably large for emerging markets, while Malaysia's market is larger than most emerging markets. These markets also boast a sophisticated infrastructure. Malaysia's market has been boosted by efforts to promote the issuance of Islamic bonds, while Singapore has managed to overcome its relatively narrow domestic issuer base by encouraging overseas firms to issue in the local currency market.

Bond Market as of Dec 2010 in ($ bn)



Source: www.adbbondsonline.com

The bond market in Asia is under different stages of development. In all ASEAN-5 countries, trading of government and corporate bonds continues to be executed mostly in the OTC market, usually telephone-based, with the exception of the Philippines and Singapore (for government debentures). In the case of Philippines, almost all transactions with government debt and corporate bonds take place on electronic platforms developed by PDEX, the local exchange. In the case of Singapore, government bonds are mostly traded through an electronic platform developed by Bloomberg. In Thailand, an electronic system developed by the stock exchange is used to trade both government and corporate bonds, but OTC trading continues to be the most commonly used venue. Electronic platforms for the trading of government and corporate bonds exist in Indonesia and Malaysia also, but these platforms are not used as frequently as OTC. OTC markets in the ASEAN-5 region fare well in transparency vis-à-vis international best practices.

With foreign investors increasing the share of emerging market assets in their portfolios to match their weight in the global economy, the additional demand is likely to reduce interest rates, improve liquidity and thereby encourage firms to issue bonds, expanding the market size. In other words, foreign participation is likely to trigger bond market development.

INSURANCE MARKET

Emerging economies account for over 85 percent of the world's population but generate only around 10 percent of insurance premiums. Insurance in emerging economies has experienced strong growth over the last decade with an average yearly growth of 11 percent between 2001 and 2010 while the mature economies grew only by 1.3 percent during the same period. The global share of life and non-life premiums in emerging economies have jumped from 5 percent and 7 percent in 2001 to 14 percent and 16 percent in 2010, respectively.

The following tables provide a cross-country comparison of insurance penetration and density in Asian economies.

Insurance Penetration, 2002-10 (in %)

Country	2002	2010
Bangladesh	0.46	0.9
Hong Kong	6.65	11.4
India	3.26	5.1
Japan	10.86	10.1
Malaysia	4.91	4.8
Pakistan	0.62	0.7
China	2.98	3.8
Singapore	4.91	6.1
South Korea	11.61	11.2
Sri Lanka	1.3	1.4
Taiwan	10.16	18.4
Thailand	3.24	4.3
World	8.14	6.9

Insurance Density, 2002-10 (in USD)

Country	2002	2010
Bangladesh	1.6	5.8
Hong Kong	1583	3635.5
India	14.7	64.4
Japan	3498.6	4390.2
Malaysia	198	421.1
Pakistan	2.7	6.1
China	28.7	158.4
Singapore	1030.7	2823.4
South Korea	1159.8	2339.4
Sri Lanka	10.6	34.2
Taiwan	1279.2	3296.2
Thailand	65.2	199.4
World	422.9	627.3

Note: Insurance density is premium (in USD) divided by population whereas insurance penetration is premium divided by GDP (both in USD). Density is in USD and penetration is in percent.

GROWTH OF OTC MARKETS

The OTC market in derivatives has seen remarkable growth especially in India and Korea, according to the report released by International Organization of Securities Commissions (IOSCO) in July 2010.

REPORTED OTC DERIVATIVES ACTIVITY FOR EMERGING COUNTRIES

(Average Daily Turnover in USD billion)

Country	2004	2007	2010
Bahrain	1	2	4.5
Brazil	2	1	1.5
Chile	1	2	0.2
China	...	1	1.5
Colombia	0	1	0.0
Czech Republic	2	4	0.3
Estonia	0	1	1.0
Hungary	2	5	4.2
India	**4**	**27**	**30.6**
Indonesia	1	1	3.4
Israel	2	5	10.0
South Korea	**11**	**23**	**43.8**
Malaysia	1	2	1.0
Philippines	0	1	2.1

Source: Basel Triennial Survey, September 2010

OTC derivatives are generally bilateral and privately negotiated agreements that give the flexibility to the users to hedge their various risks.

Instruments

Interest rate contracts are the most preferred type of instrument in the OTC derivatives market and foreign exchange contracts and credit default swaps are the other instruments largely traded in the OTC market. However, those amounts are relatively small.

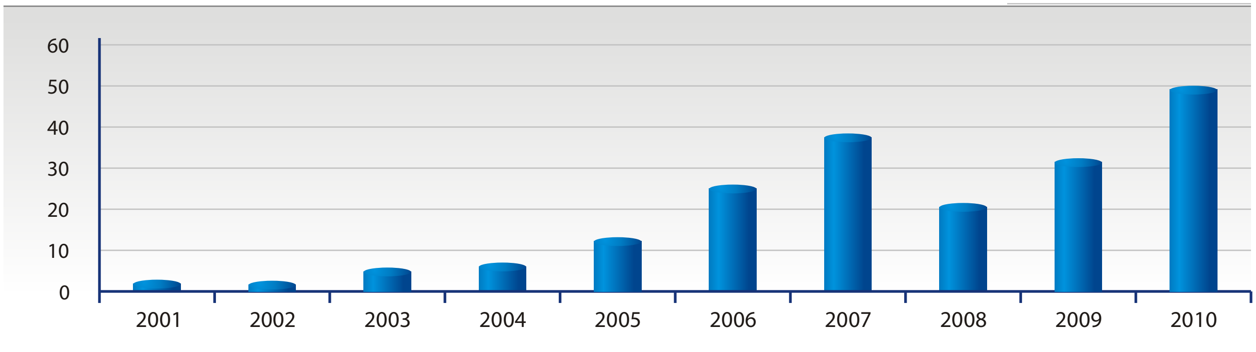
ISLAMIC CAPITAL MARKET

The emergence of a distinct Islamic capital market is a natural progression in the growth of the Islamic financial services industry where capital market transactions are governed by Shariah principles and are free from prohibited activities and elements such as riba (usury), maisir (gambling) and gharar (ambiguity). Today, the Islamic financial market runs parallel to the conventional financial market in many countries in Asia and provides investors with an alternative investment philosophy that is rapidly gaining acceptance. The growing awareness of and demand for investing in accordance with Islamic principles has created a flourishing Islamic capital market. The fact that the Islamic financial market does not prohibit participation from non-Muslims adds to the depth and breadth of this market.

GEOGRAPHICAL SPREAD

The market for Islamic finance is very prominent in countries like Malaysia, Iran, Turkey, Sudan, Egypt, Jordan, Syria, Indonesia, Bangladesh, Pakistan and countries that form the Gulf Co-operation Council (GCC) as well as Hong Kong, Singapore, the US, France, Germany and the UK, which have indigenous Muslim population. The Muslim population of the world today is estimated at about 1.5 billion, representing 23 percent of the total world population of over 6.5 billion. Latent Islamic funds in global financial institutions are estimated at US$1.3 trillion while the Islamic financial market is estimated to be US$230 billion in size, with an annual growth rate of 12 percent to 15 percent. There are over 250 Islamic financial institutions currently operating in about 75 countries worldwide, with more than 100 Islamic equity funds managing assets in excess of US$5 billion.

Sukuk Global Issues ($ bn, annual issues)



ISLAMIC INDICES

Islamic indices have been launched in various markets and have performed relatively well as compared to their conventional counterparts. Key indices include Dow Jones Islamic Index, FT Islamic Index, Jakarta Islamic Index, and Kuala Lumpur Shariah Index, etc.

ISLAMIC MUTUAL FUNDS

Islamic mutual funds or Islamic unit trust funds are managed in compliance with Shariah principles. Islamic mutual funds typically engage Shariah boards to advise and ensure that investment operations and portfolios are managed in compliance with Shariah principles. In some jurisdictions, the retention of Shariah boards for Islamic funds is required under the law. The total number of funds stands at around 760, having risen more than threefold from around 250 in 2004. Equity funds account for the largest segment: 35 percent of funds, followed by alternative investments and feeder funds: 16 percent, fixed income: 14 percent, money market: 14 percent, and commodities: 12 percent. The domicile of funds is heavily concentrated with over 70 percent of funds, based on number and value, managed in four jurisdictions: Saudi Arabia, UAE, Malaysia and Kuwait. Other significant jurisdictions include the US, from where funds to the value of $2.7 billion are managed, and the UK, from where 34 funds are managed.

Islamic Funds Distribution by Country (Funds based on home country of asset manager)

Insurance	Value $bn	Number of Funds
Saudi Arabia	22.8	181
UAE	6.1	82
Malaysia	5.1	177
Kuwait	4.0	100
US	2.7	8
Bahrain	1.2	24
UK	0.3	34
Other countries	10.1	188
Total	**52.3**	**794**

Source: Ernst & Young

THE WAY FORWARD

Asia is in the midst of transition from growth based on inputs and factor accumulation to growth based on productivity, i.e., from quantity of investment to efficiency of investment. Such a role requires deeper, broader and more liquid financial markets. Asia's equity markets are more susceptible to abrupt swings in global investor sentiment, potentially increasing capital flow volatility and its local currency bond markets remain largely fragmented and fragmentation hinders market liquidity. The region's equity markets have grown robustly and have emerged as an important source of corporate funding in a few large developing economies such as China and India on the back of strong foreign capital inflows. However, the development of local currency bond markets need to keep pace with the equity market.

There is lot of scope for improvement in the Asia's financial integration. Asia's financial markets remain largely fragmented and the region's financial markets are integrated more with the global markets rather than with each other in the region.

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