

Global Financial and Economic Crisis

Impacts, Responses and Policy

Recommendations for Asia's

Collective Action

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Introduction

- The global financial and economic crisis has been deepening sharply and begun to affect Asia (Japan, Asian NIEs, China and ASEAN) more severely than expected
- What is the prospect of the recovery of the global economy? Is the V-shape recovery (IMF scenario) likely?
- Given that US consumption may shrink (semi-) permanently, how should Asia adjust to the new environment to restore sustained growth?
- Both global and regional solutions are necessary.₃

The Global Financial and Economic Crisis

Rapid deterioration of the global economy and recovery prospects

- The latest IMF projection says that the advanced economies will recover in 2010 (from -2.0% in 2009 to 1.1% in 2010)
- But this projection may be too optimistic, as it is not clear how the recovery takes place and what factors will ensure recovery
- The US economy is expected to recover from -1.6% in 2009 to 1.6% in 2010 (IMF). But how?
- Can China and India lead the way to global recovery?
- If not, what are the implications for the global economy and Asia?

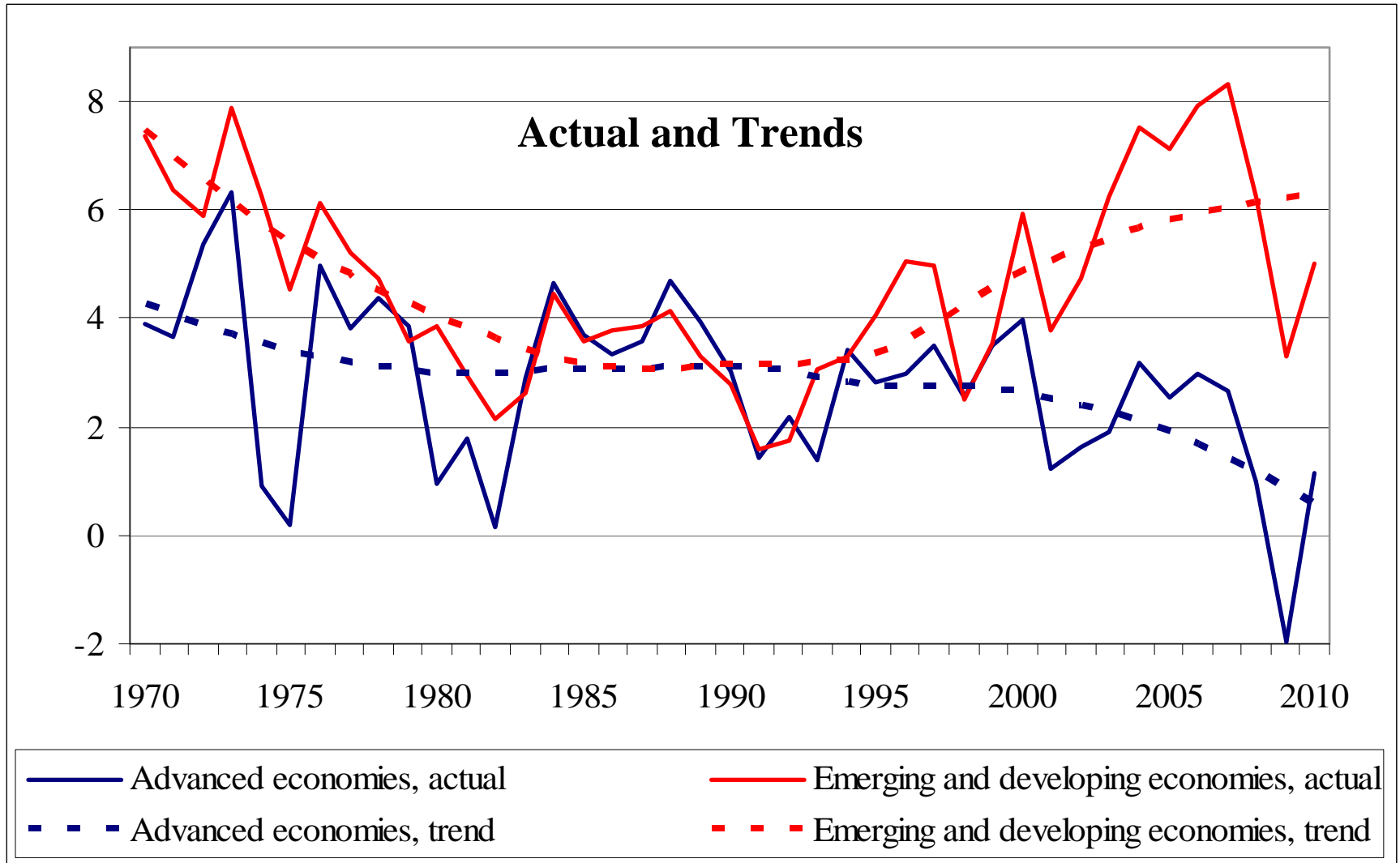
Economic growth projections for 2009-10

Country/Region	2007	2008	2009	2010
World	5.2	3.4	0.5	3.0
Advanced economies	2.7	1.0	-2.0	1.1
United States	2.0	1.1	-1.6	1.6
Euro area	2.6	1.0	-2.0	0.2
United Kingdom	3.0	0.7	-2.8	0.2
Japan	2.4	-0.3	-2.6	0.6
Asian NIEs	5.6	2.1	-3.9	3.1
Emerging/developing economies	8.3	6.3	3.3	5.0
Developing Asia	10.6	7.8	5.5	6.9
China	13.0	9.0	6.7	8.0
India	9.3	7.3	5.1	6.5
ASEAN-5	6.3	5.4	2.7	4.1

Note: Data for emerging & developing economies do not include those for Asian newly industrialized economies.

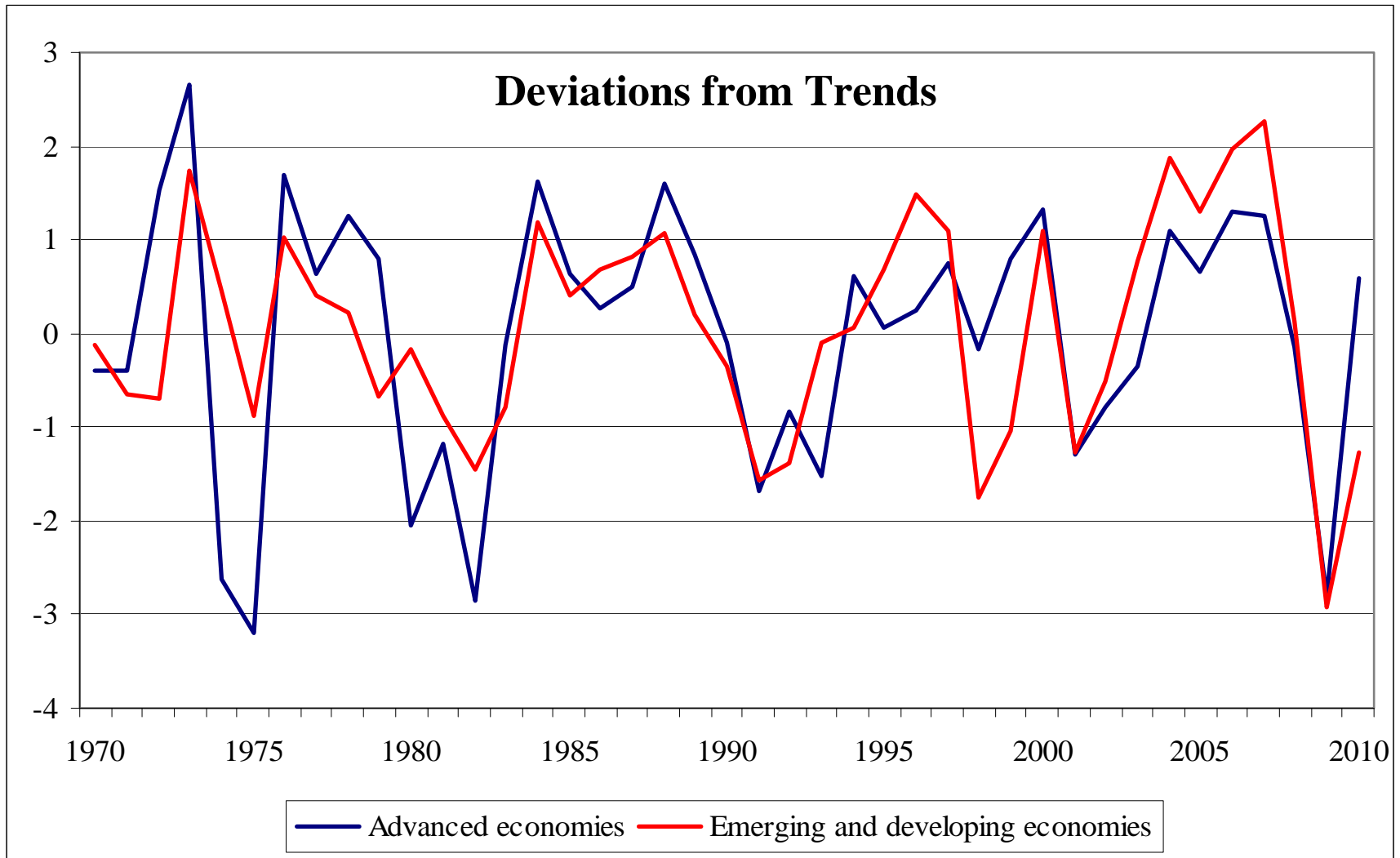
Source: IMF, *World Economic Outlook Update*, January 2009

“Trend decoupling” in real GDP growth 1970-2010



Source: Computed from IMF, WEO (October 2008) and WEO Update (January 2009)

“No decoupling” in GDP growth cycles 1970-2010



Source: Computed from IMF, WEO (October 2008) and WEO Update (January 2009)

US Economy

- Baseline scenario (V-shaped recovery): The US economy will begin to recover gradually in the second half of 2009 and achieve stronger growth in 2010
 - IMF: -1.6% in 2009, +1.6% in 2010
 - Bernanke: -0.5% to -1.3% in 09, +2.5% to +3.25% in 10
- Factors behind the baseline: monetary policy easing, fiscal stimulus and financial sector support
- Factors against the baseline
 - (1) Limited effectiveness of monetary policy in stimulating credit flows and nominal GDP growth
 - (2) Implementation lag of fiscal policy
 - (3) Housing price declines (another 15%?)
 - (4) Large “excessive” consumer debt to be reduced
 - (5) Financial sector toxic assets and rising NPLs
- U-shape recovery or L-shape stagnation is more likely

China, ASEAN and India

- Potential growth rate is high for China, ASEAN and India (trend decoupling)
- China and India have more robust domestic demand though their exports have been affected
- Monetary and fiscal policy support in place
- Economic size of China, ASEAN and India combined exceeds that of Japan, but is about 1/5 of US & Euro Area combined
- This implies that their robust growth may not be good enough to pull the global economy out of recession, but can provide some stimulus

Size of GDP (2007)	Local Currency Trillion	US Dollar Trillion
United States	13.8 USD	13.8
Euro Area	8.9 Euro	12.1
Japan	515.7 Yen	4.4
China	24.7 Yuan	3.2
ASEAN	-- --	1.3
India	47.1 Rupee	1.1

Implications for Asia

- For healthy recovery of Asia, global economic recovery starting from the US is key—particularly by restoring banking sector health
- Given that this is not easy, it is more prudent to assume that the US economy will not recover strongly over the next several years
- Asian economies need to respond to the crisis through further monetary policy easing and fiscal policy expansion where appropriate
- Asia needs to undergo structural adjustment to a (semi-)permanent decline in US consumption, by shifting away from an external (US and EU) demand-dependent economy towards a regional (Asian) demand-driven economy

Impact on Asia and Responses

Impact through the financial channel

- The initial impact was considered to be limited
 - Limited exposure to the US structured assets
 - Asian banks have been better managed
 - Supervisory frameworks have improved
- But liquidity shortage and credit crunch have spread
 - International liquidity shortage in Korea
 - Limited access to US dollar funding (Indonesia, etc)
 - Credit crunch nationally—hard on SMEs and other firms dependent on bank finance
- Domestic asset price (stock price) declines—
weakening the consumer & business confidence

Direct impact of the US subprime crisis is small but potential risks are high

Subprime losses in Asia (billion US dollars, %)

	USA	Europe	Japan	Korea	China	Other Asia	Total Asia
Subprime losses (in billions of USD)	487.8	280.1	16.2	0.4	5.8	5.6	28
Total bank assets (in billions of USD)	16637	45494	11255	1211	6872	2953	22291
Capital banks (in billions of USD)	1529	2518	613	78	297	50	1038
Subprime losses as share of capital (in percent)	31.91	11.12	2.64	0.57	1.95	11.11	2.70
Subprime losses as share of assets (in percent)	2.93	0.62	0.14	0.04	0.08	0.19	0.13

Notes:

Capital of banks and Total bank assets as of May 2008 for UK; as of Jul. 2008 for India; as of Sep. 2008 for Hong Kong, Malaysia, USA, Euro Area; as of Oct. 2008 for China, Indonesia, Singapore, Switzerland

Bank losses and writedowns are as of Feb. 2009

Japan - Mizuho Financial Group, Mitsubishi UFJ Financial Group, Sumitomo Financial Group and Nomura Holdings

Korea - Woori Bank

China - Bank of China, Commercial Bank of China, China Construction Bank

Malaysia - 0.3 % of capital base of banks

Singapore - DBS Bank

USA - 23 banks

Europe - 32 banks

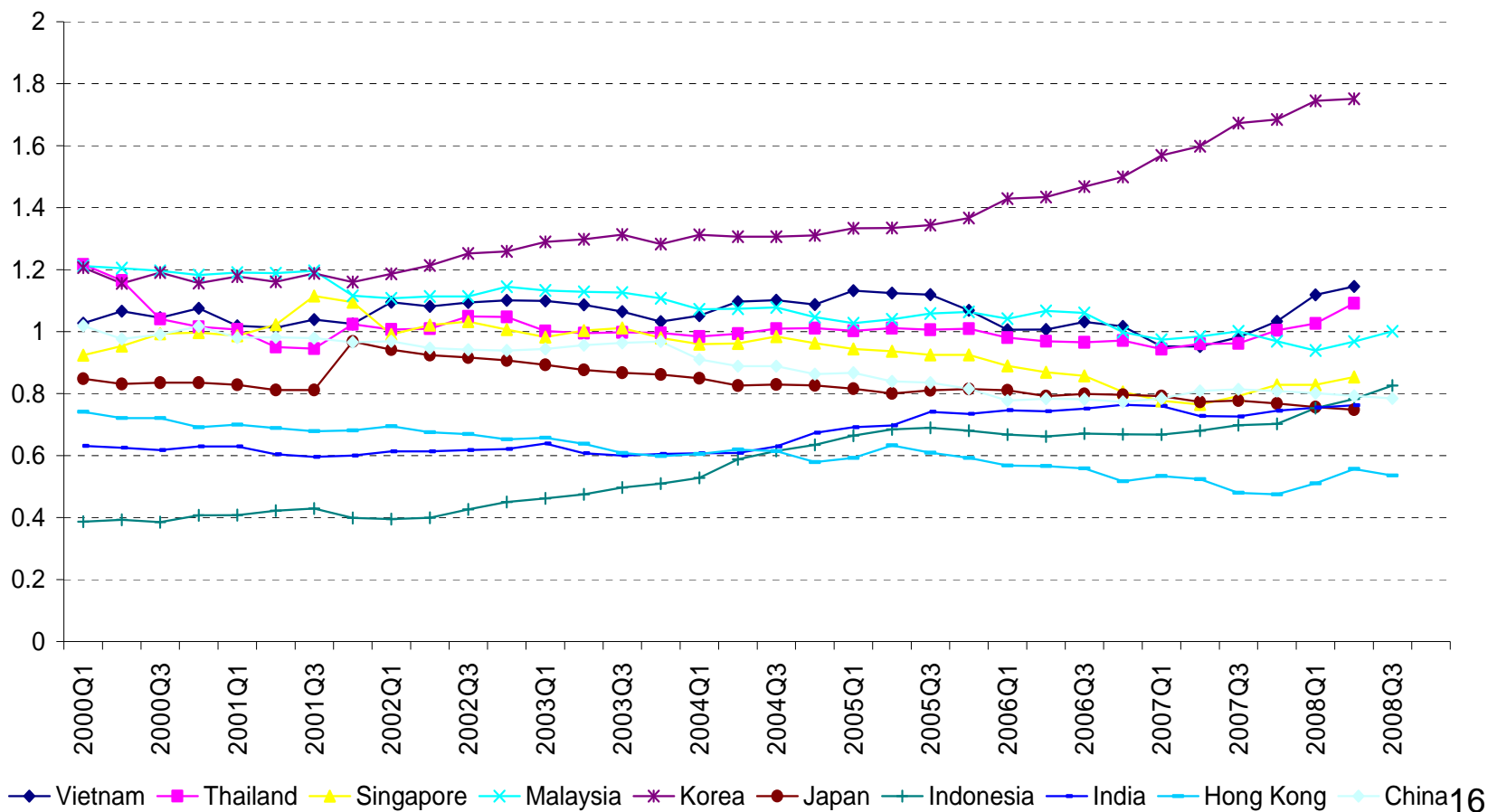
Emerging Asian banks have been in good shape so far, but a great deal of uncertainty remains...

Nonperforming loans (% of Commercial bank loans)

	2000-2004 Average	2004	2005	2006	2007 ¹	Sep-2008 ²
China, People's Rep. of	21.0	13.2	8.6	7.1	6.2	...
Hong Kong, China ³	4.8	2.3	1.4	1.1	0.9	0.8
Indonesia	10.6	5.7	8.3	7.0	4.6	3.9
Korea, Rep. of	3.5	1.7	1.1	0.8	0.6	0.7
Malaysia ³	8.9	6.8	5.6	4.8	3.2	2.4
Philippines ³	14.8	12.7	8.2	5.7	4.4	4.0
Singapore	5.3	5.0	3.8	2.8	1.8	...
Taipei,China	5.2	2.8	2.2	2.1	1.8	1.6
Thailand	13.5	10.9	8.3	4.1	3.9	3.3

Bank loans in emerging Asia rely more on deposits, except for Korean banks

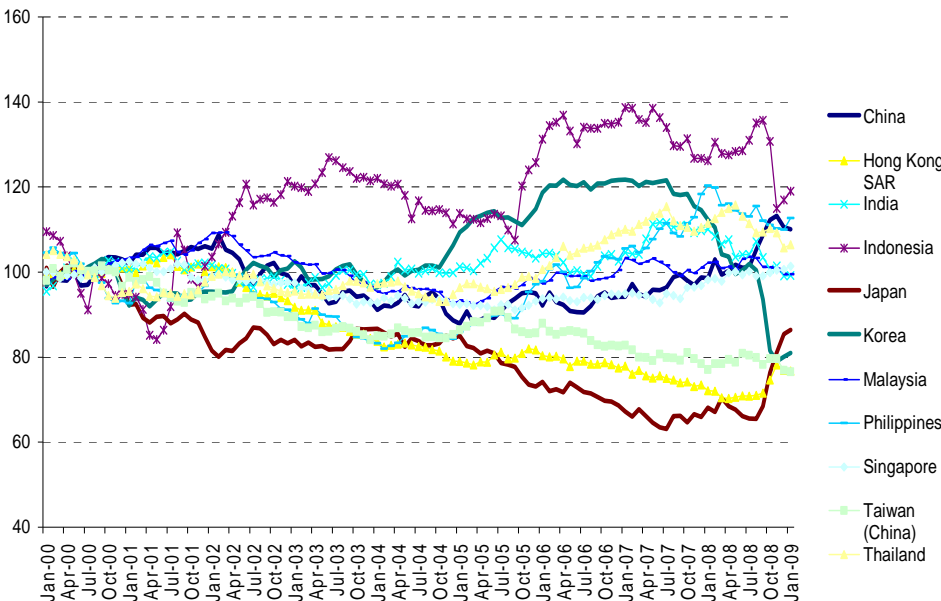
Loans to Deposit Ratio
(Claims of banking institutions to private sector / Demand and savings deposits)



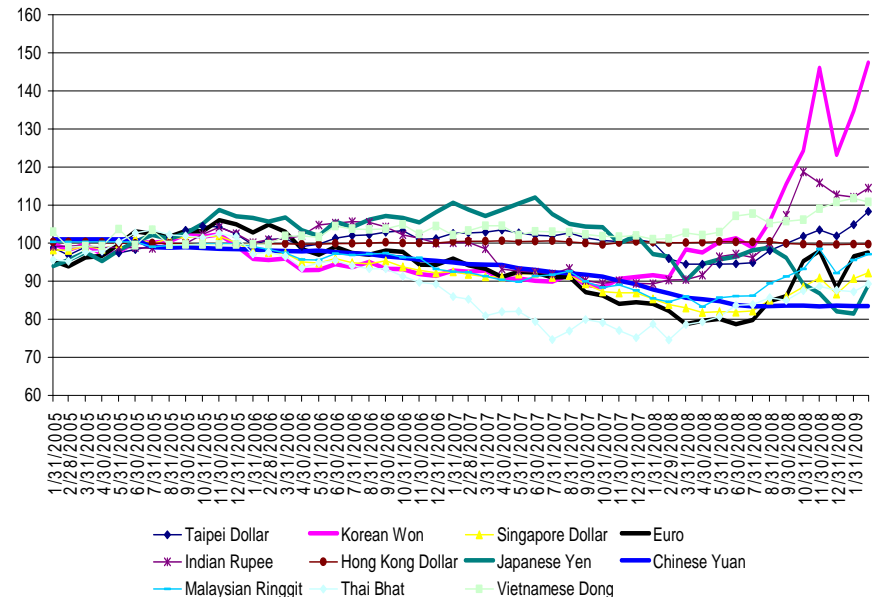
Source: Bloomberg; various news media; IMF, International Financial Statistics.

Asian currencies have depreciated except the yen, and pace of yuan appreciation has slowed/reversed

Real Effective Exchange Rates (2000=100): Jan.2000 - Jan.2009



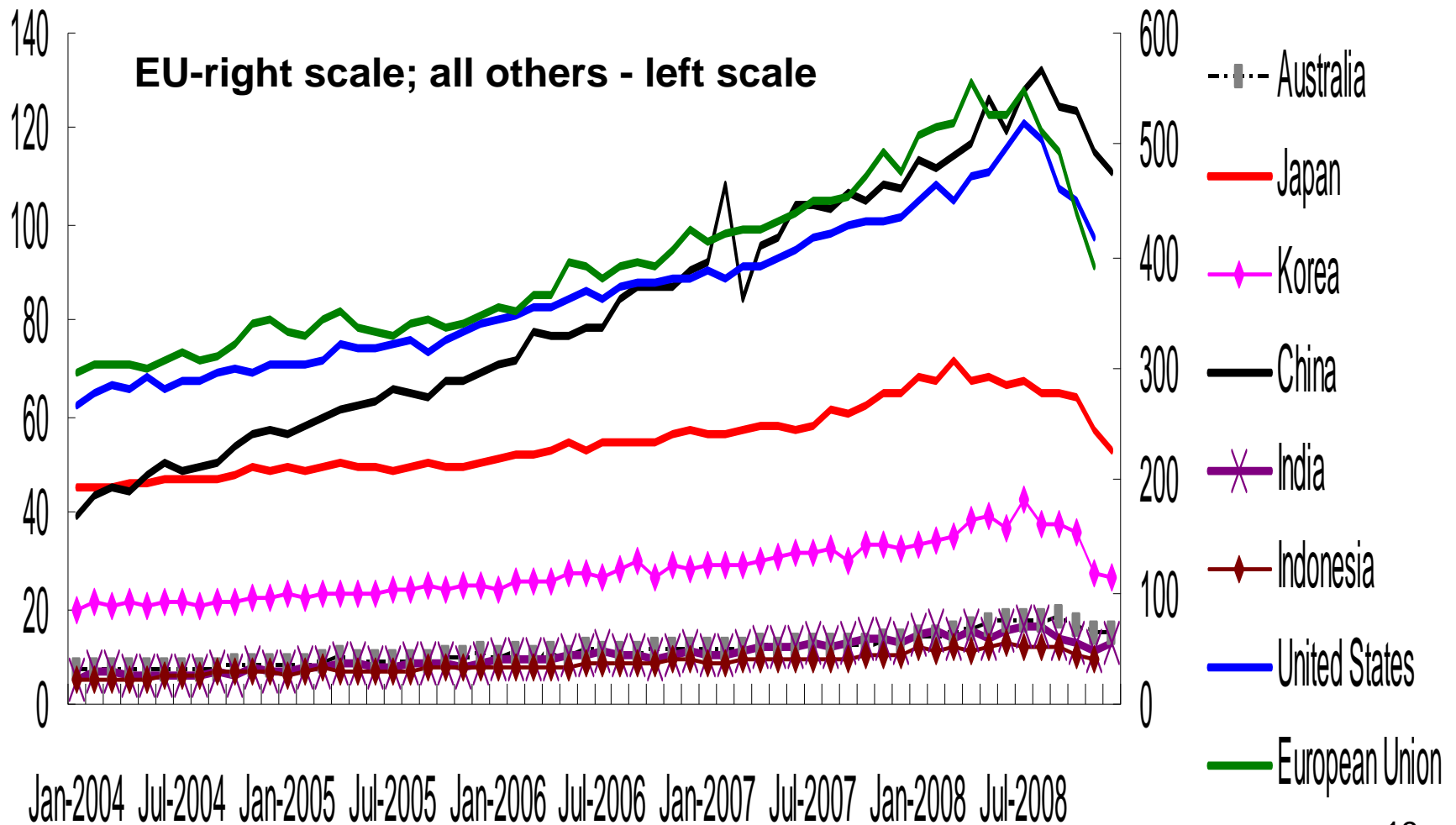
Exchange Rates to US Dollar (2005=100): Jan.2005 - Feb.2009



Impact through the real channel

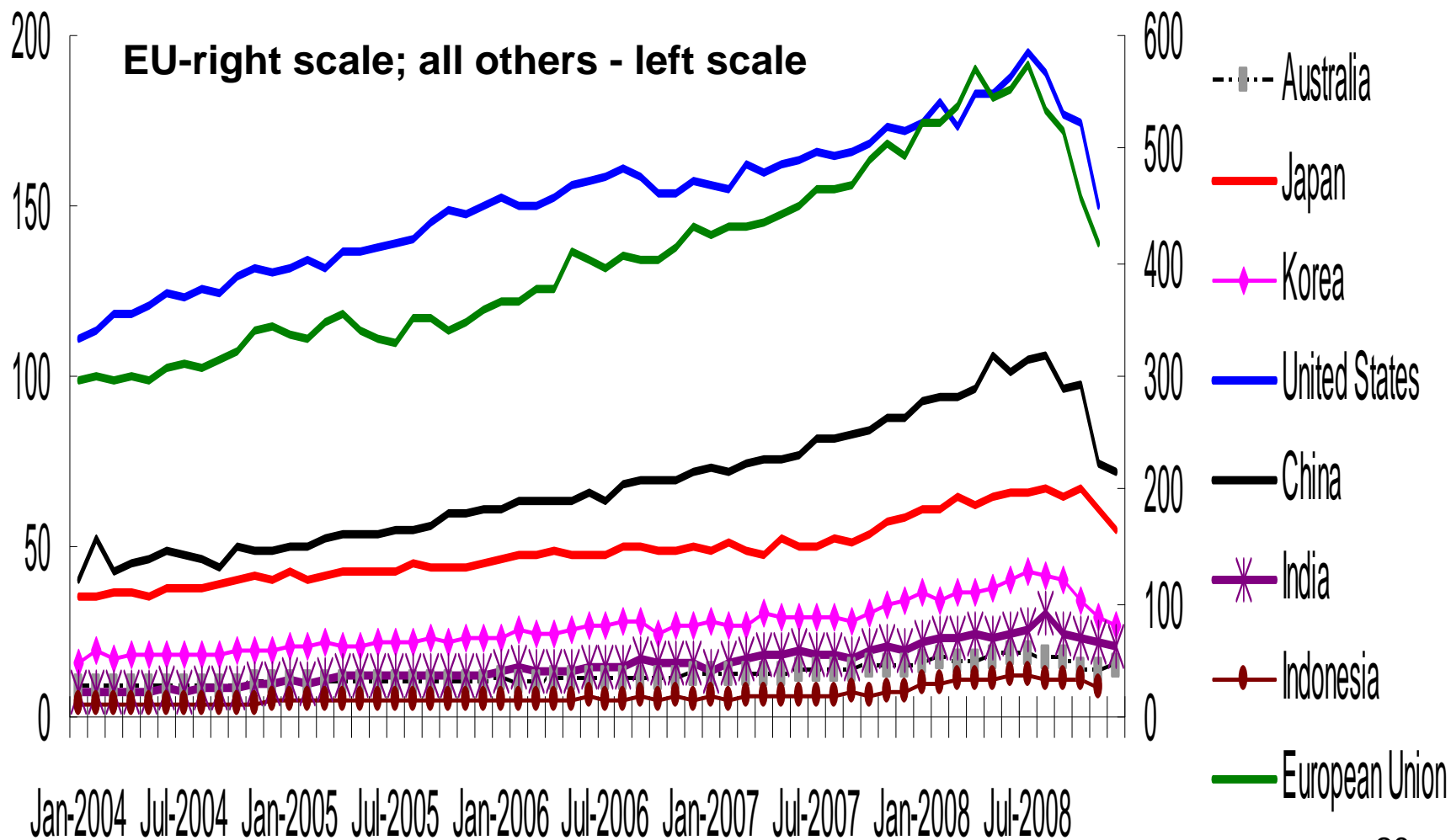
- Sharp declines in Asia's exports to the US & Europe: Taipei, China; Japan; Korea; Singapore
 - Disruption of export-driven growth in Asia
 - End of "Factory Asia"?
 - Risk of implosion of regional production network?
- Rapid declines in manufacturing outputs for export and in export-driven investment
- Risk of declines in remittance inflows from abroad
 - Philippines, India, Indonesia, Vietnam, etc.
- GDP growth is decelerating fast and unemployment is rising in the manufacturing sector

Exports of major economies, 2004-08 (Billions of US\$)



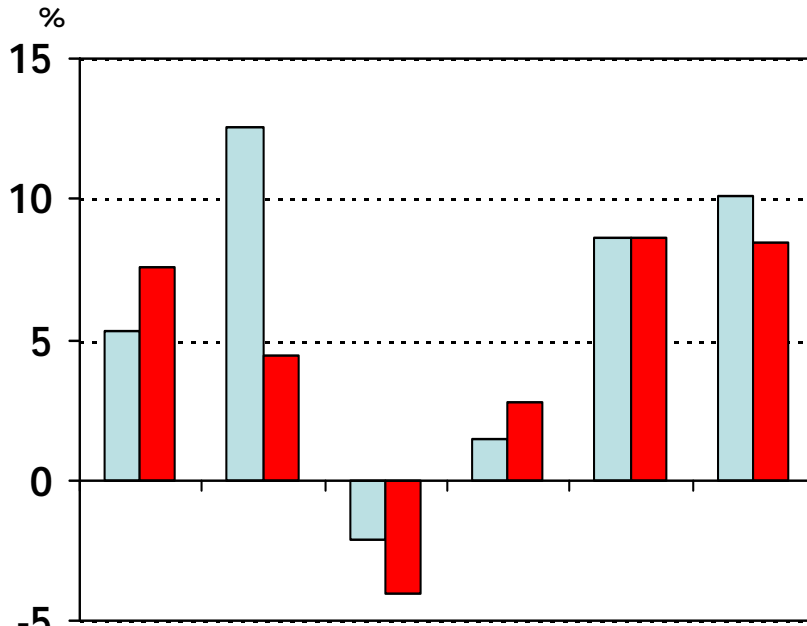
Imports of major economies, 2004-08

(Billions of US\$)



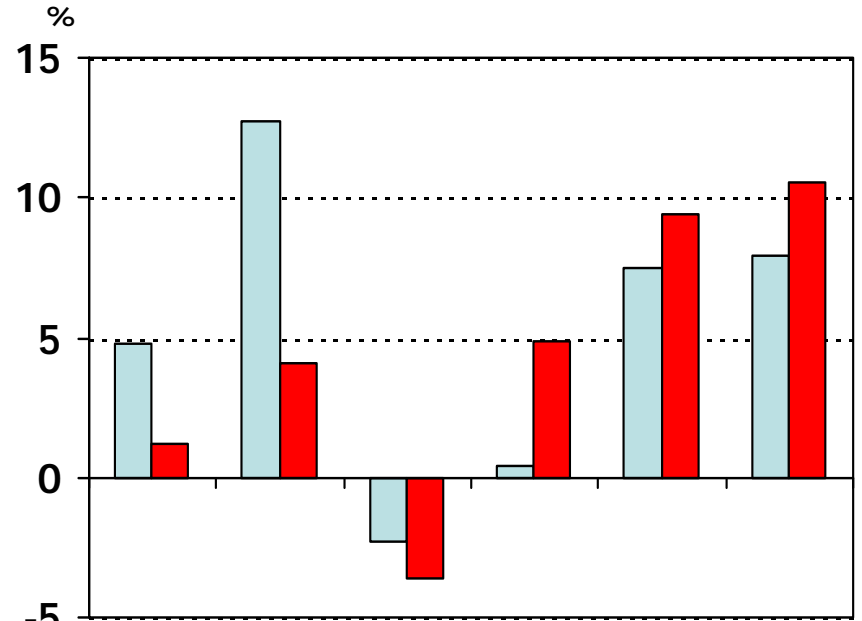
Impact of the financial and economic crisis on US imports, 2008

Total imports, % yoy



□ 2007 ■ 2008

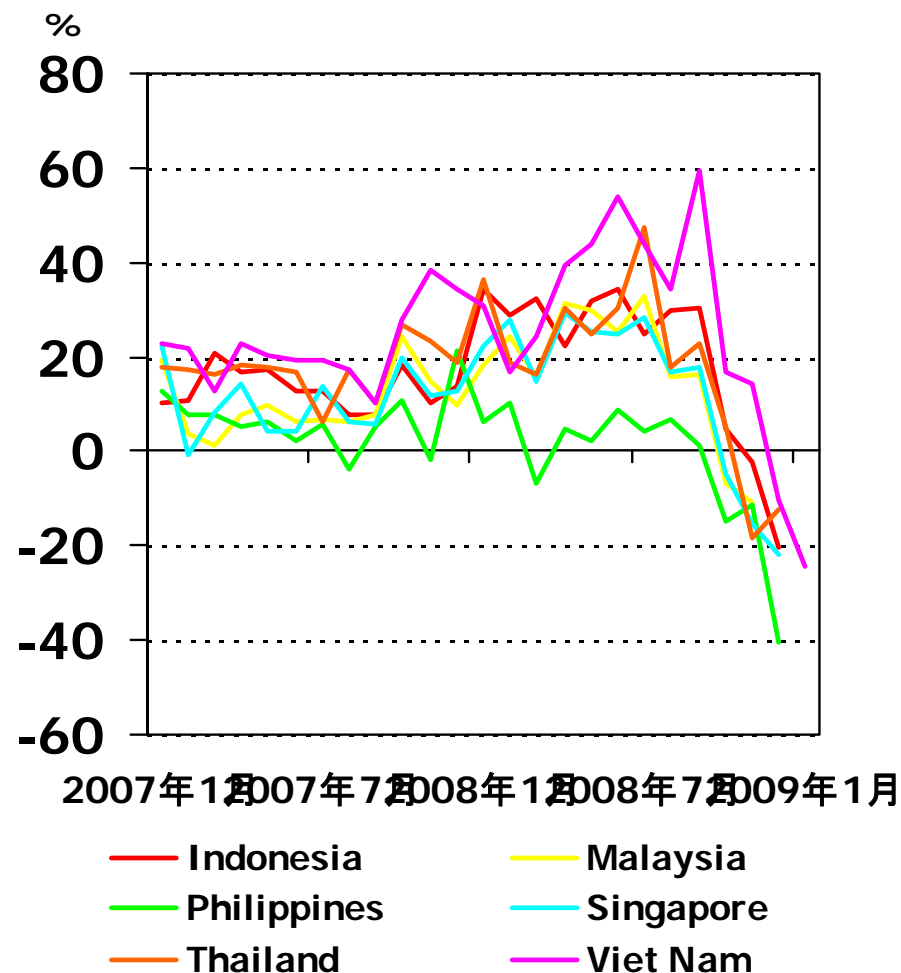
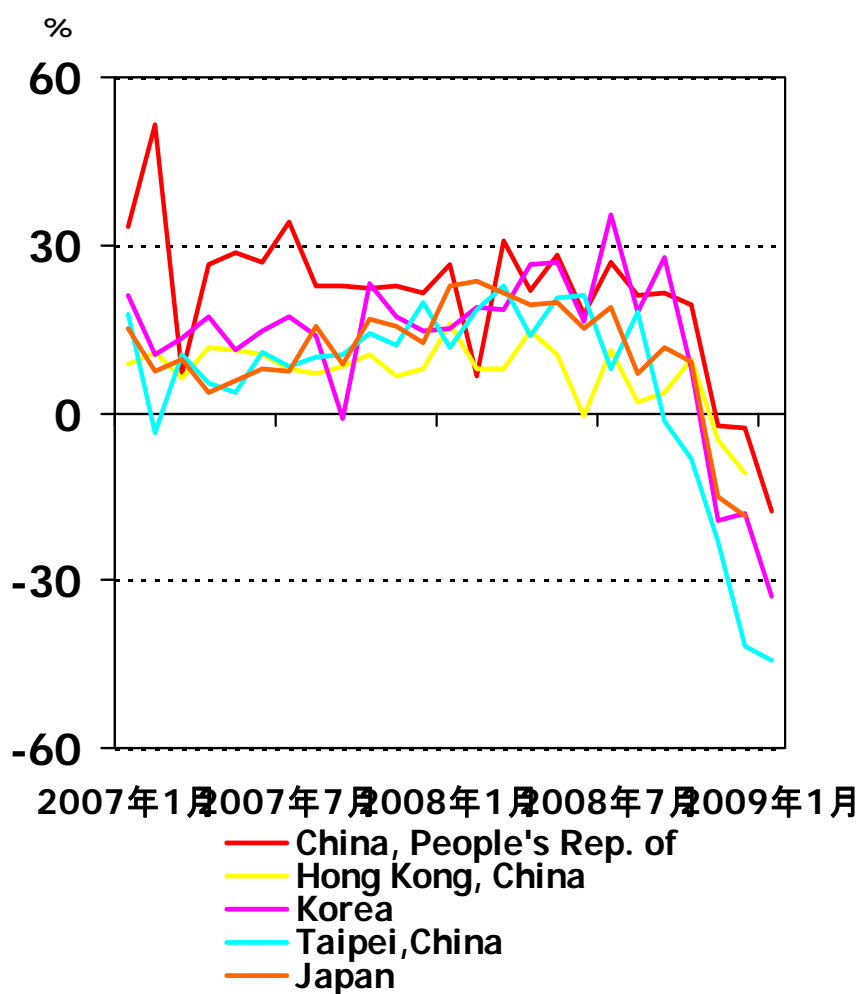
Total imports excl. mineral fuels, % yoy



□ 2007 ■ 2008

Slower export growth in Asia

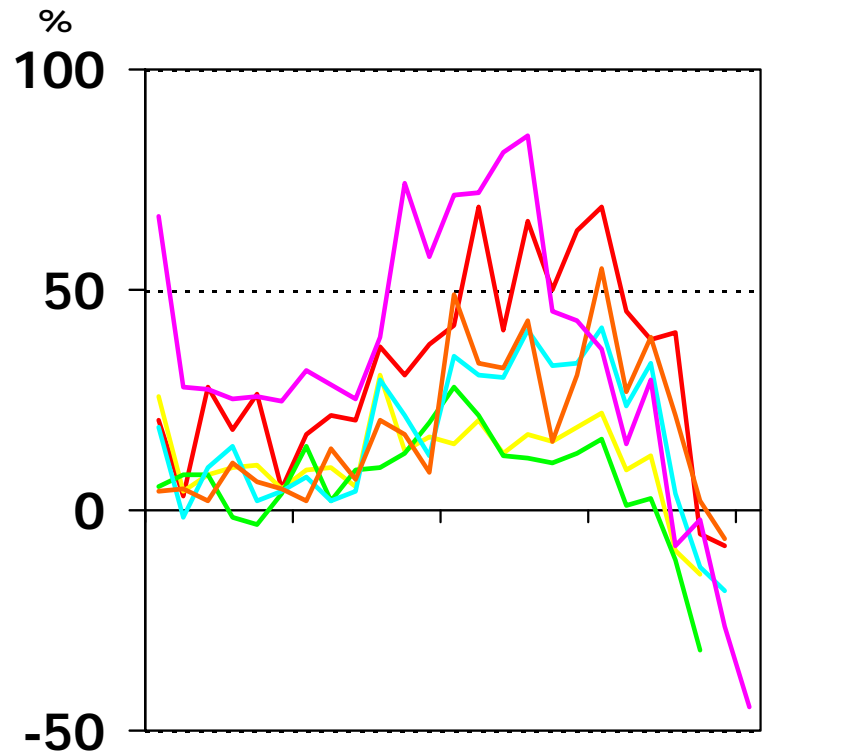
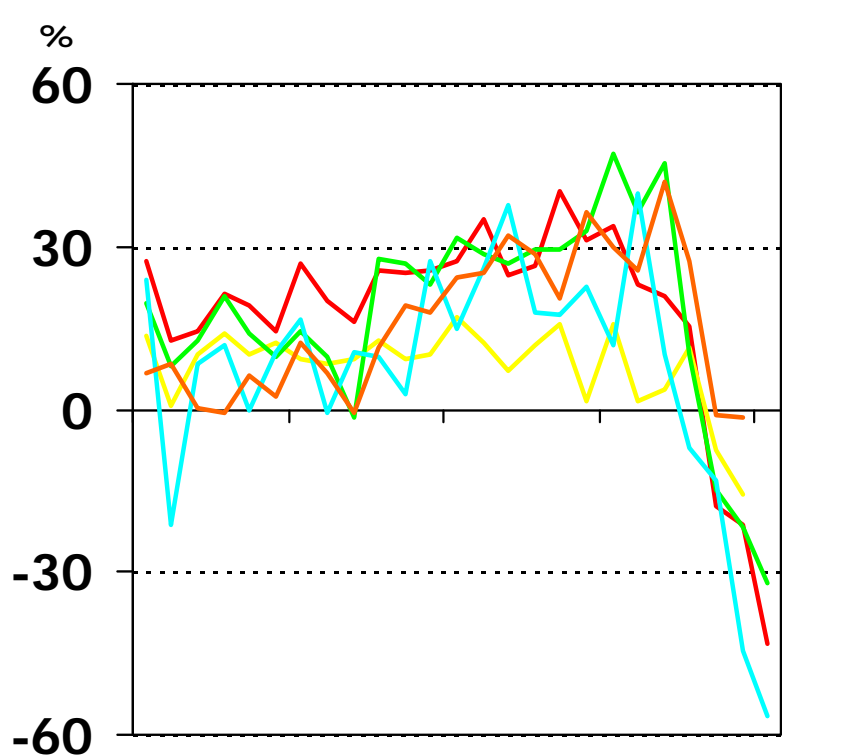
Monthly export growth (in US\$ terms), % yoy



Note: Data for PRC, KOR, TAP and VIE updated up to January 2009.

Slower import growth in Asia

Monthly import growth (in US\$ terms), % yoy



2007年1月 2007年7月 2008年1月 2008年7月 2009年1月

— China, People's Rep. of — Hong Kong, China
 — Korea — Taipei, China
 — Japan

2007年1月 2007年7月 2008年1月 2008年7月 2009年1月

— Indonesia — Malaysia
 — Philippines — Singapore
 — Thailand — Viet Nam

Note: Data for PRC, KOR, TAP and VIE updated up to January 2009.

Final demand for Asian exports still comes from the advanced economies

Final demand composition of Asia's export in 2006

Total Asia's exports = 100.0%					
Inside Asia = 51.8%			Outside Asia = 48.2%		
<i>of which to</i>			<i>of which to</i>		
final demand 16.5%	production 35.3%		final demand 23.2%	production 25.0%	
+	<i>of which to</i>		+	<i>of which to</i>	
	final demand inside Asia 15.1%	final demand outside Asia 20.2%		final demand inside Asia 0.9%	final demand outside Asia 24.1%
16.0%	← →		44.3%	←	
=			=		
Total final demand inside Asia 32.5%			Total final demand outside Asia 67.5%		

Asian growth is decelerating rapidly

	2008Q4 (yoy)	2008 (actual)	2009 (IMF)	2010 (IMF)
United States	-0.2	1.3	-1.6	1.6
Euro Zone	-1.2	0.7	-2.0	0.2
United Kingdom	-1.8	0.7	-2.8	0.2
Japan	-4.6	-0.7	-2.6	0.6
China	6.8	9.0	6.7	8.0
Hong Kong	-2.5	2.5	-2.0	2.5
Korea	-3.4	2.5	-4.0	4.2
Taipei,China	-8.4	0.1	-4.0	1.8
Singapore	-4.2	1.1	-4.9	1.9
Indonesia	5.2	6.1	3.5	4.0
Malaysia	[4.7]	5.7*	1.4	3.5
Philippines	4.5	4.6	2.2	4.0
Thailand	-4.3	2.6	-1.0 to 0.0#	4.0
Vietnam	5.5	6.2	4.8	5.8
India	5.3	7.3*	5.1	6.5

Note: (1) Numbers in [] are for the 2008Q3 data (yoy). (2) An asterisk (*) refers to an IMF projection. (3) # is government projection

Asia's Responses to the Global Financial and Economic Crisis

General observations

- The global financial and economic crisis is still unfolding, so are responses of Asian economies
- There are similarities and differences in responses among Asian economies in terms of scope, scale and speed
- Responses are uncoordinated, but the general strategy is to maintain confidence in the financial market, prevent the emergence of financial crises, and keep the growth momentum going

Some Specific Measures

- Liquidity injections (Japan, Korea)
- Monetary policy easing – almost all Asian economies
- Banking sector support
 - Hong Kong, Japan and Korea for precautionary bank capitalization program
 - Hong Kong, Singapore, Malaysia—deposit guarantee
- Fiscal policy expansion announced – most Asian economies
- International liquidity arrangement (BSA)
 - Korea and Singapore with US Fed (\$30 billion each)
 - Korea with Japan (central bank swap expanded to \$20 billion, until 30 April 2009) and with China (central bank swap expanded to \$30 billion)
 - Indonesia a stand-by with WB, ADB, JBIC & AusAID

Economies	Interest Rate	Reserve Requirement	Lending Facility	Bank Recapitalization Scheme/Funds	Deposit (loan) Guarantee/ Insurance	Fiscal Stimulus	Other Measures
1. Bangladesh	Increase	Decrease	No	No	Yes	No	Yes
2. China, PRC	Decrease	Decrease	No	No	No	Yes	Yes
3. Hong Kong, China	Decrease	No change	No	Yes	Yes (with new scheme)	Yes	Yes
4. India	Decrease	Decrease	Yes	No	Yes	Yes	No
5. Indonesia	Decrease	Decrease	Yes	No	Yes	Yes	Yes
6. Japan	Decrease	No change	Yes	Yes	Yes	Yes.	Yes
7. Korea	Decrease	No change	Yes	Yes	Yes (guarantee to short-term foreign loans)	Yes	Yes
8. Malaysia	Decrease	Decrease	Yes	No	Yes (with new scheme)	Yes	No
9. Pakistan	Increase	Decrease	Yes	No	No	Yes	Yes
10. Philippines	No change	Decrease	Yes	No	Yes	No	Yes
11. Singapore	Decrease	No change	Yes	No	Yes (with new scheme)	Yes	Yes
12. Sri Lanka	Decrease	Decrease	Yes	No	No	No	Yes
13. Taipei, China	Decrease	Decrease	No	No	Yes	Yes	Yes
14. Thailand	Decrease	No change	No	No	Yes	Yes	Yes
15. Vietnam	Decrease	Decrease	No	No	No	Yes	Yes

A US Demand Decline and Asia's Adjustment: A Simulation Study

A CGE simulation study

Objective of the simulation exercise

- Study the impact of a declining US demand on the adjustment of production and trade in Asia, based on Kawai and Zhai (2009)

Model assumptions

- Reduction of the US current account deficit, by 4.5% of GDP, through real depreciation of the US dollar against the rest of the world
- Constant bilateral real exchange rates among non-US economies
- Current accounts endogenously adjusted in response to real exchange rate changes
- Long run full employment

Improvement in the US current account reduces Asia's current account surpluses

	CA (change as % of GDP)	Terms of trade (% change)	Real private absorption (change as % of GDP)
China & HK	-2.6	1.2	2.6
JPN	-1.3	1.9	1.3
KOR	-2.6	1.4	2.5
TWN	-3.2	1.3	3.3
IDN	-2.0	1.2	2.3
MYS & SGP	-3.4	0.6	3.9
PHL	-2.7	1.0	3.0
THA	-2.8	0.9	3.0
VNM	-3.5	1.1	3.8
USA	4.5	-7.4	-5.1

Asia's output adjustment differs across countries and sectors

Percentage change in output

	East Asia	CHN	JPN	KOR	TWN	ASEAN6
Agriculture	0.3	0.7	-0.2	0.0	0.4	0.4
Textile	-2.1	-2.1	-1.3	-2.9	-2.1	-2.1
Apparel	-1.7	-1.9	-0.1	-1.2	-1.9	-3.2
Vehicles	-3.6	-0.7	-5.0	-3.6	-1.7	0.6
Electronics	-2.7	-3.0	-2.6	-3.1	-3.2	-1.9
Machinery	-3.0	-2.2	-3.9	-3.4	-3.4	-1.7
Other manufactg	-1.7	-2.8	-0.8	-1.6	-2.4	-1.6
Services	0.3	0.4	0.4	0.6	0.5	0.6

Findings of the CGE model simulation

- There will be a switch away from domestic demand-led growth to export-led growth in the US, and a switch away from export-led growth to domestic demand-led growth in non-US (particularly East Asian) economies
- A decline in US demand leads to structural adjustment in production and trade in East Asia
- East Asia's manufacturing sectors—such as vehicles, electronics and machinery—are major losers in the adjustment process, while its agricultural and services sectors are likely to gain from the expanded domestic demand

Policy Recommendations for Asia's Collective Action

Global solutions for the global crisis

- For the recovery of the global economy, US efforts at restoring banking sector health and sustained growth is vital
- Unwinding of US current account imbalances needs to be matched by reduction of surplus countries' current account surpluses
- International support for emerging market economies, particularly those affected in central and eastern Europe is vital
- From longer-run time perspectives, the reform of the international financial architecture is essential
 - (1) IMF reform
 - (2) Strengthening of crossborder supervision and regulation of systemically important financial institutions and hedge funds

Regional solutions for the crisis

- Adjust structurally to the likely (semi-)permanent decline in US consumption by rebalancing sources of growth
- Use fiscal policy to support medium- to long-term structural adjustment and growth potential
- Integrate regional markets through a region-wide FTA, building on ASEAN+1 FTAs among ASEAN+3 or ASEAN+6 countries
- Improve financial systems and supervision, particularly through regional financial cooperation
- Strengthen social sector protection
- Enhance regional reserve pooling (MCMI)
- Prepare for exchange rate coordination (ACU)

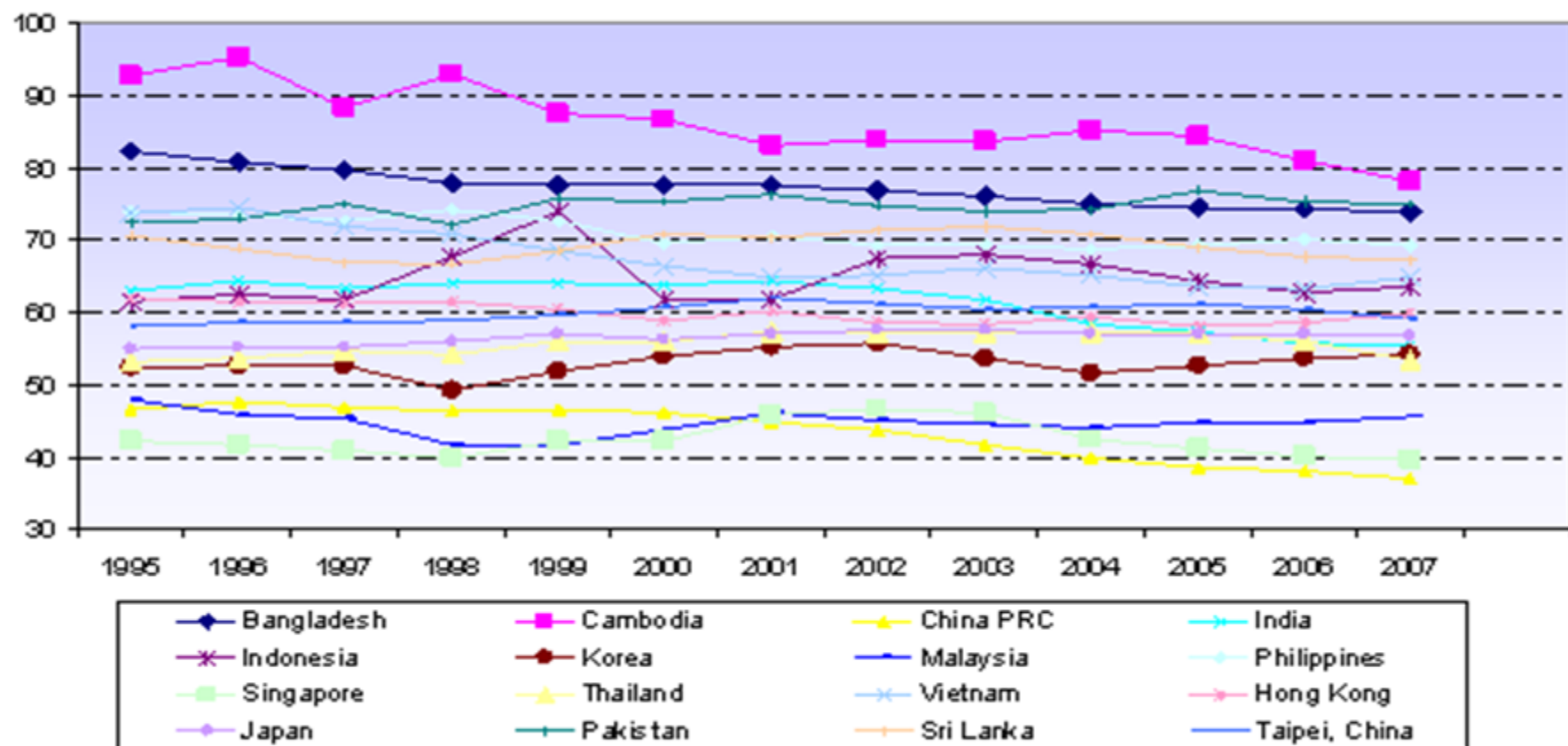
Fiscal policy to support Asia's adjustment

- In Japan, focus on increasing productivity, strengthening social security system, stimulating a shift to a low-carbon economy and other services
- In India and ASEAN, focus on investment in infrastructure, with better investment climate
- In China, focus on consumption—through reforms of social sectors (education, health and pension) and reduction in income inequality (rural sector development)—and environmental improvement and energy efficiency

Asia's consumption/GDP ratios are low

Room for expanding domestic consumption....

Figure 23. Ratio of Private Consumption to Nominal GDP (%)



Source: ADB Key Indicators 2007

Integrate the regional market through a region-wide FTA

- Resist protectionist policy during the crisis period and maintain open trade and FDI regimes
- Form an East Asia-wide FTA to integrate East Asian economies, create a greater market for regional firms and consumers, and encourage FDI
- Focus more on services liberalization
- Start from ASEAN+3 and expand to ASEAN+6
- ASEAN Economic Community building critical
- Japan, China and Korea need to work together to form a trilateral EPA or bilateral EPAs among them

Strengthen financial sectors & supervision

- Further financial market opening and integration requires strong and effective supervisory systems
- Need to consider best frameworks for financial system supervision over banking, securities, and insurance
- Further develop and integrate, local currency bond markets to mobilize regional savings for regional investment
- Create an Asian version of the Financial Stability Forum (FSF) for regional financial stability and harmonization

Enhance Asia's reserve pooling arrangement (MCMI)

- Complete CMI multilateralization (MCIM) as soon as possible with \$120 billion
- Flexibility in CMI use (no conditionality in exceptional cases) desirable, in line with IMF SLF
- IMF linkage should be dismantled
- For this purpose, enhance regional surveillance
 - Involve central bank governors in the ASEAN+3 finance ministers process
 - Establish an independent, professional secretariat
 - Take up the exchange rate issue (ACU)
 - Discuss fiscal policy and public debt issues

Prepare for collective currency appreciation

- Once the US financial system stabilizes, Asia likely re-attracts large capital inflows, given the region's robust economic prospect
- Then, Asia needs to manage capital inflows well to stem financial and macroeconomic instability (overheating, inflation, asset price bubbles)
- To ensure financial and macroeconomic stability and minimize loss of price competitiveness, Asia needs collective currency appreciation vs. the US dollar by keeping intraregional currency stability
- This requires closer exchange rate coordination

Asia should raise voice to argue...

- The US needs to restore economic growth and financial stability as soon as possible
- Advanced economy financial institutions must provide more international liquidity and funding support for emerging economies
- Advanced economies should keep markets open and avoid protectionism
- The US and Europe should strengthen financial sector supervision and regulation nationally and coordinate with emerging economies for global supervision
- The international financial institutions should be reformed in a way to reflect the growing importance of Asian economies

Conclusion

- The global financial crisis requires global solutions, but it is prudent to assume that the global and US recession will continue for some time
- Asia should explore regional solutions
- Asia's adjustment to a (semi-)permanent decline in US demand is crucial to recovery of the regional economy, thereby helping the global economy
- Asia needs to transform its economy, by rebalancing sources of growth away from external (or US-EU) demand toward domestic (& regional) demand
- This requires closer policy coordination in Asia: directing fiscal resources for structural adjustment, integrating regional markets, strengthening social sector protection and regional financial cooperation
- ASEAN is key to regional policy coordination

Thank you
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