

Developing Asia Journalism Awards

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Government Responses to the Global Financial Crisis

Mario B. Lamberte

Director of Research

Asian Development Bank Institute

[Note: This discussion material is largely based on various studies under the ADBI's Global Financial Crisis project. Some of the studies are already posted at the ADBI website]

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Outline

1. Review of the origins of the crisis
2. Impacts of the crisis
 - 2.1. Macroeconomic impacts
 - 2.2. Impacts on the banking system in Asia
3. Asia's responses to the crisis
4. Shape of the recovery
5. New growth strategy

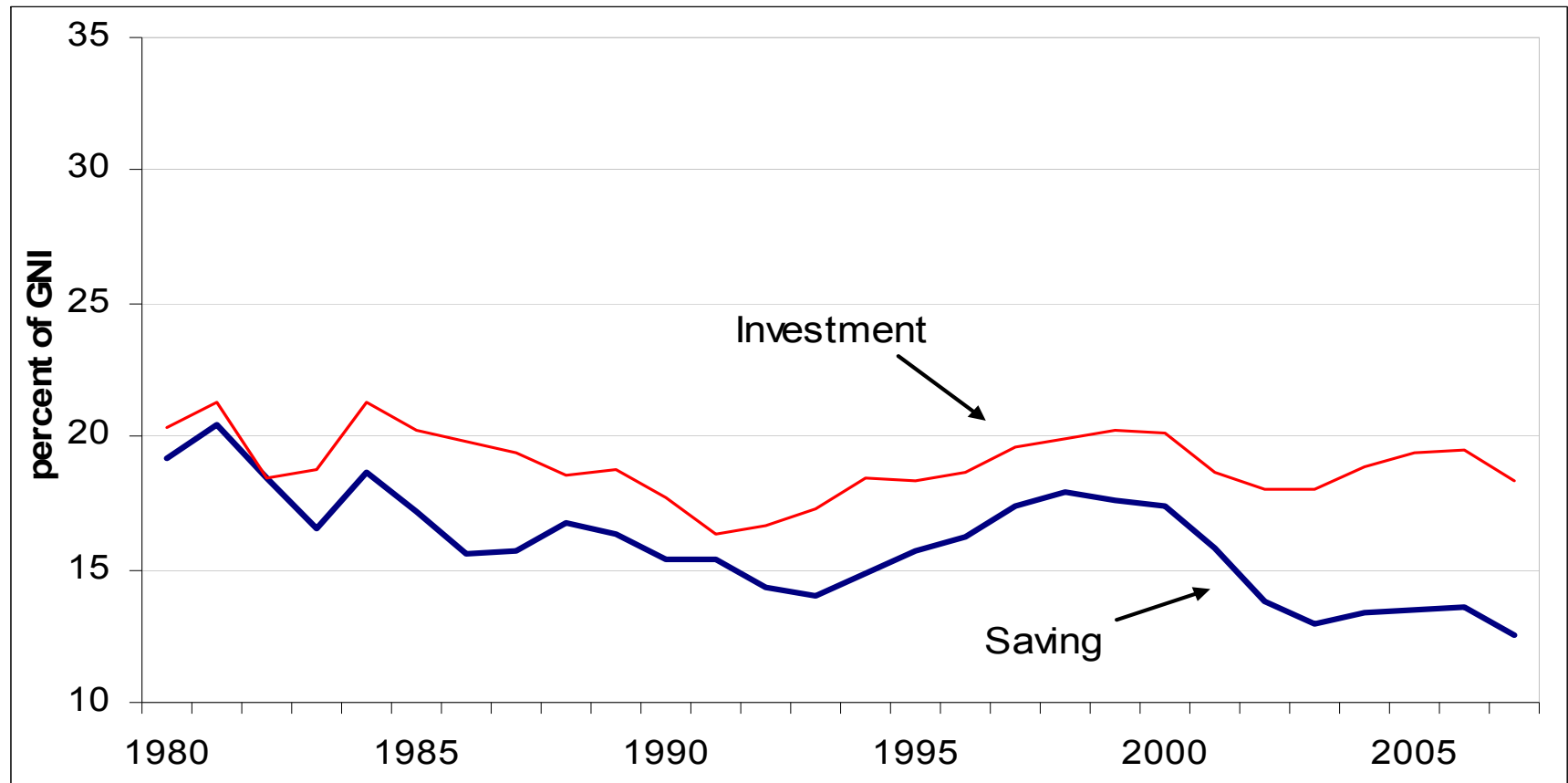
1. Review of the Origins of the Crisis

Causes:

- Global savings glut
- Lax monetary policy at the macro level
- Lax prudential regulation at the micro level

Global savings glut

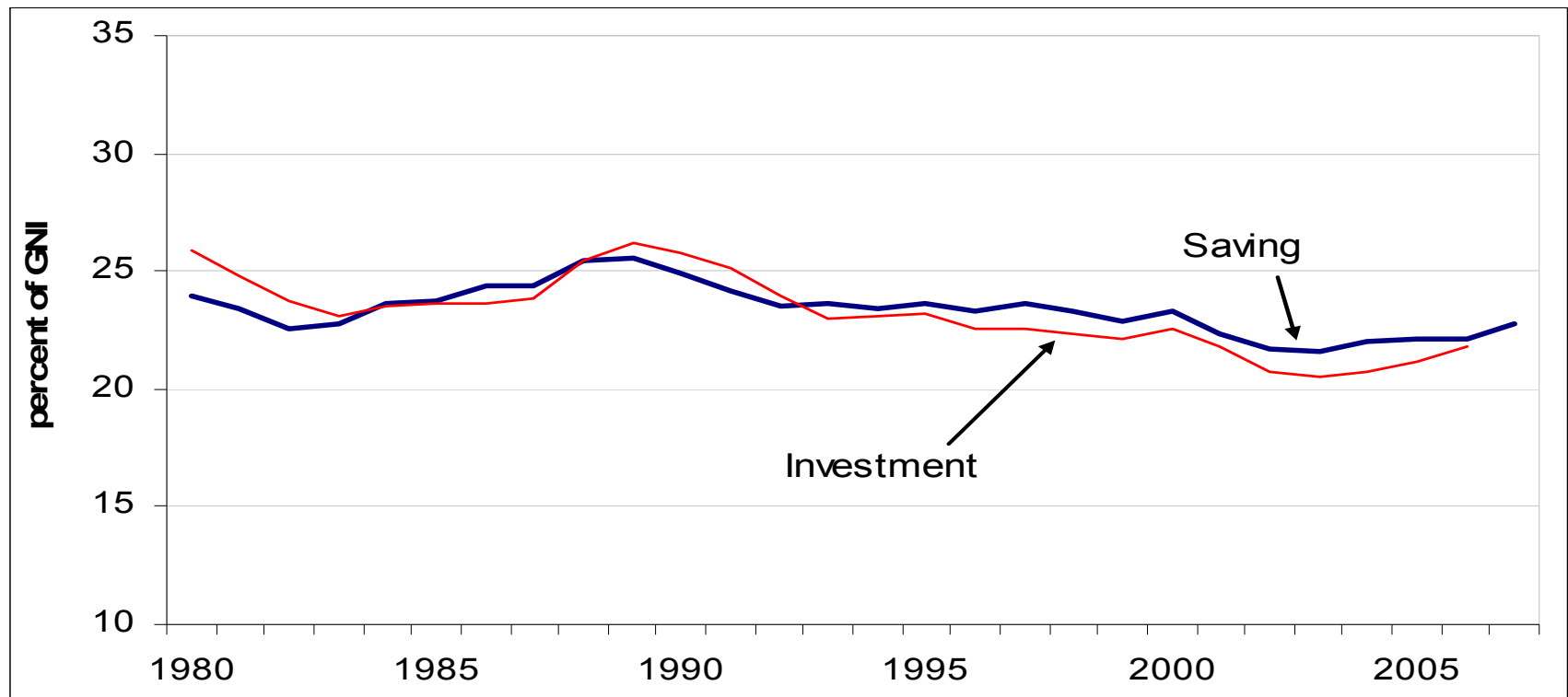
US saving too little....



Source: Bosworth (2009)

Global savings glut

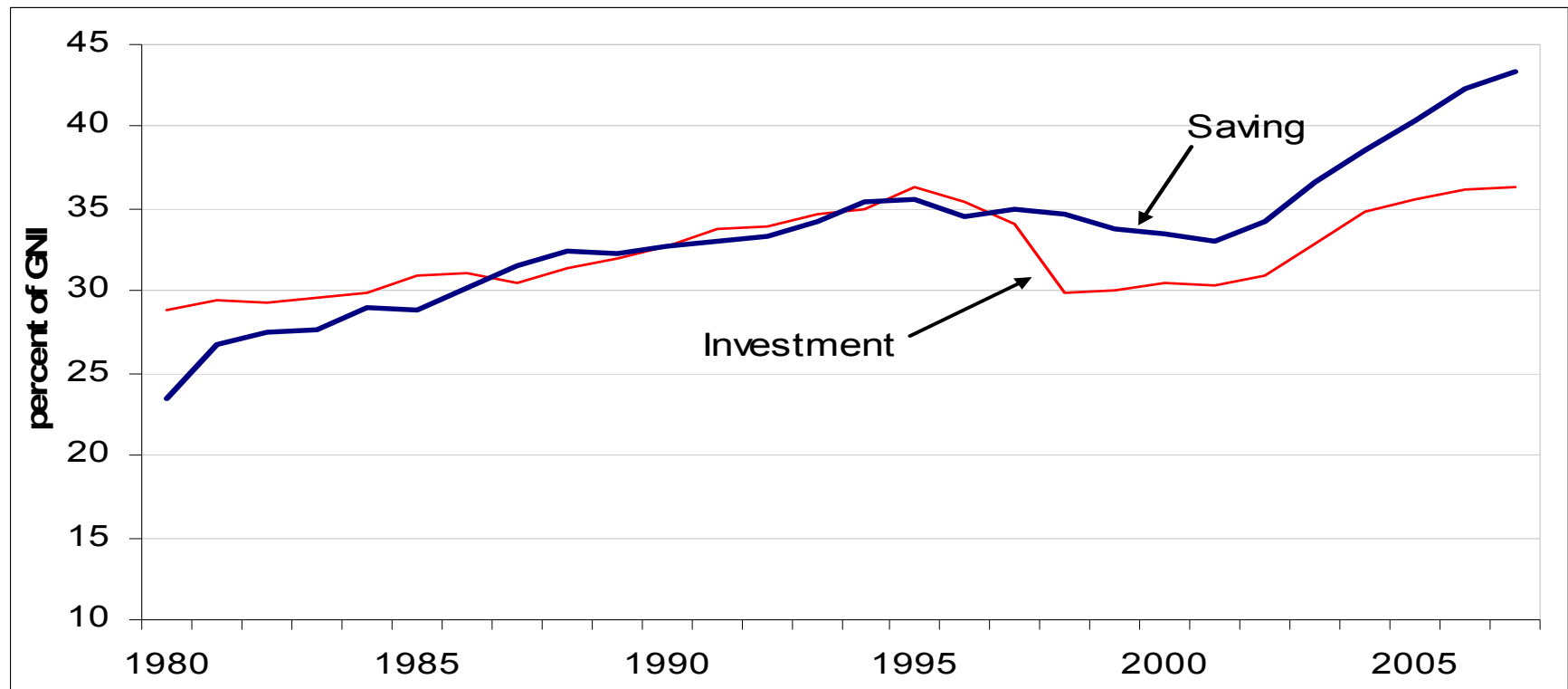
Saving and Investment generally declining in other industrial countries...



Source: Bosworth (2009)

Global savings glut

Emerging Asia investing less but saving too much...



Source: Bosworth (2009)

Comments:

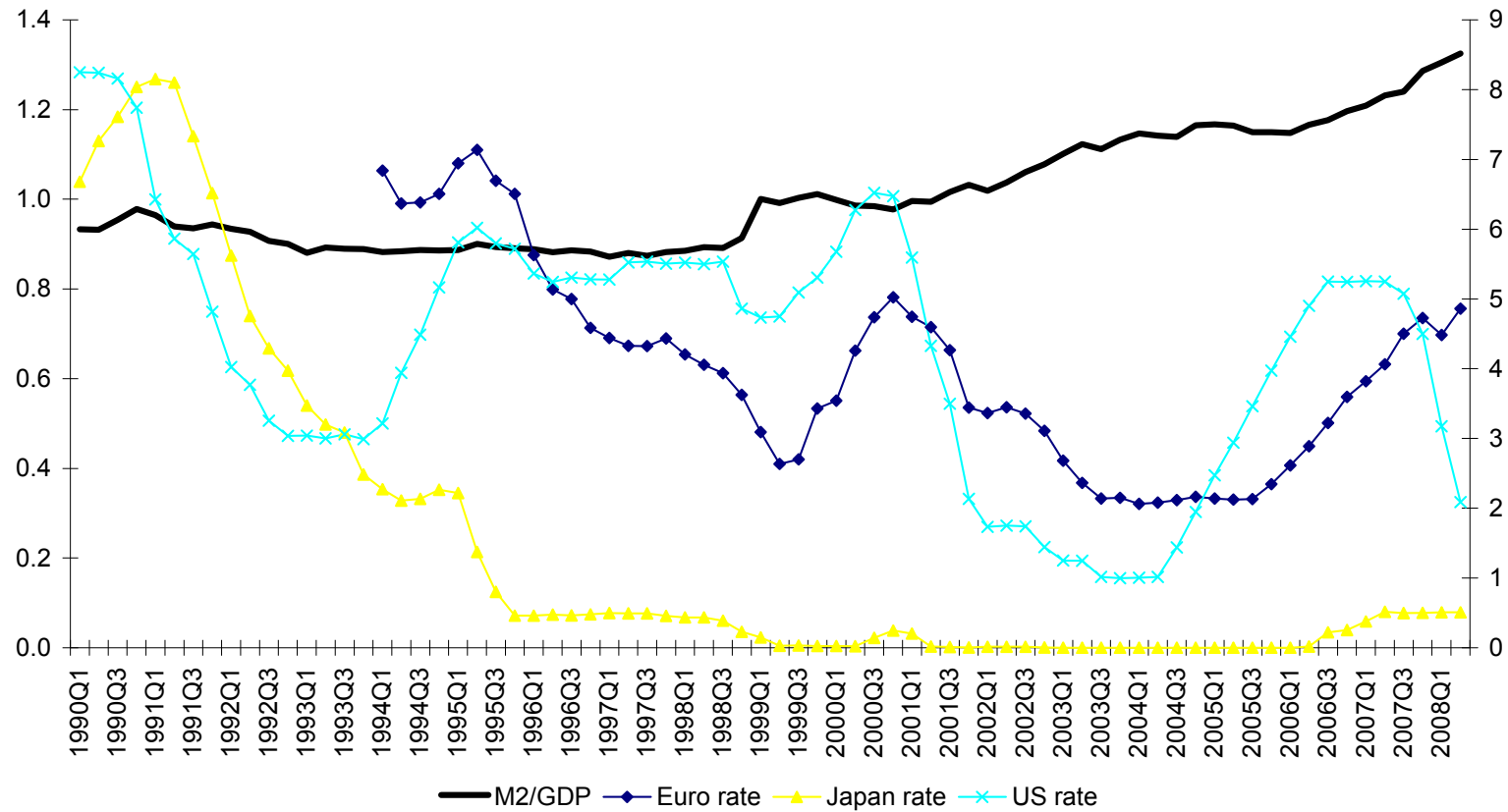
There was a global ‘savings glut’, the source of which was Asia. It is not clear ex ante whether the large current account imbalance between the US and the rest of the world can be attributed primarily to excess demand in the US or excess savings in the rest of the world. Bernanke (2005) had argued that the low level of US interest rates implied the latter rather than the former. Bosworth and Flaeen (forthcoming), however, show results suggesting that this view cannot be supported. They add that it is not evident that imbalances should translate into a strong impact on the level of global interest rates.

Comments:

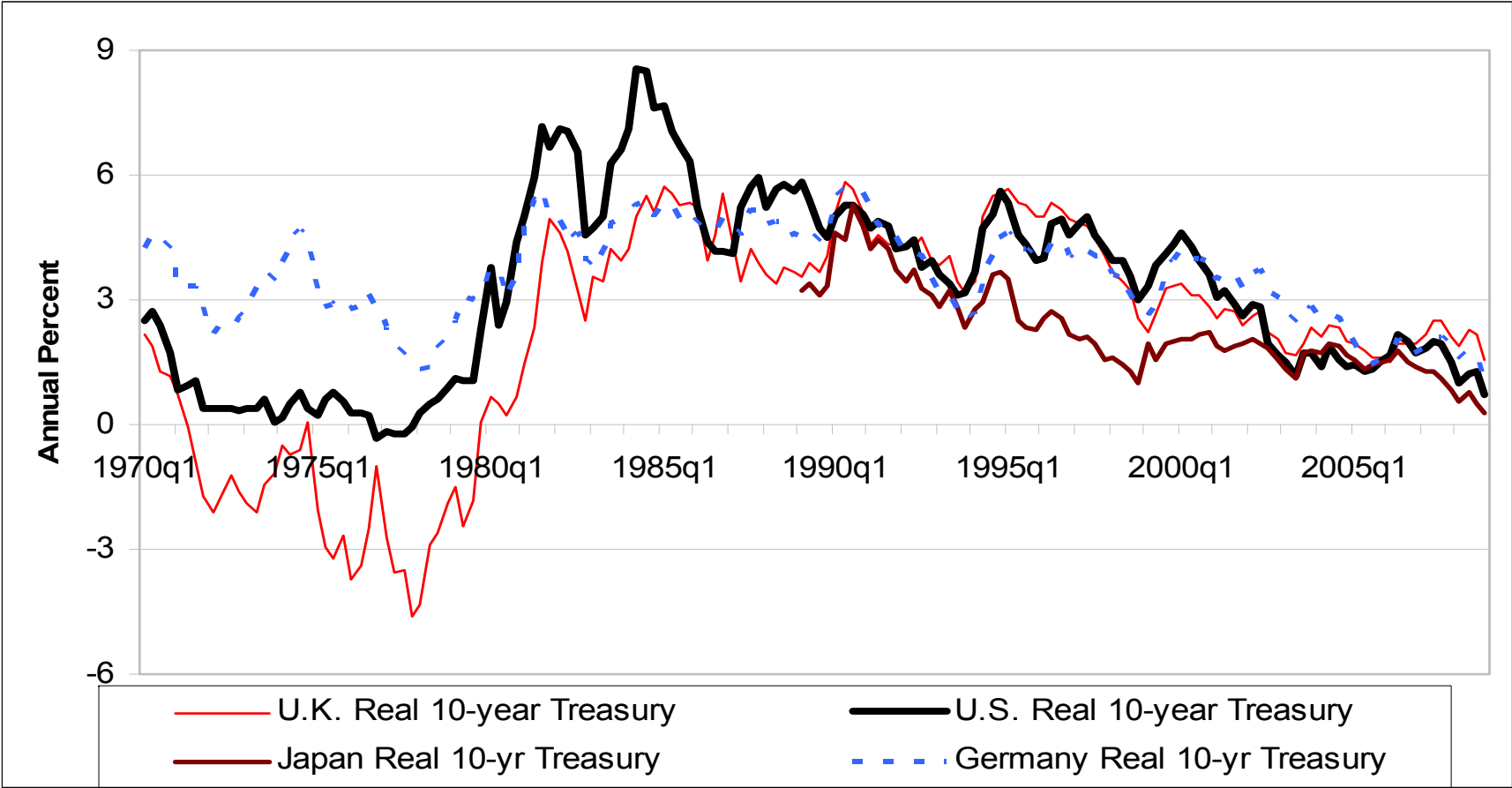
Lax monetary policy was a major contributor to the crisis. Global liquidity, measured by the ratio of the broad money supply (M2) to nominal GDP ratio in the US, Western Europe and Japan, has been increasing since the first quarter of 1999, reflecting the easy money stance. This led to the lowering of interest rates which encouraged investors to invest in risky assets to obtain higher yields. The result was an asset bubble in the US, especially in the mortgage market, and in a number of European countries.

Lax monetary policy....

Liquidity and Interest Rates (US, Japan, Euro Area)



Real Long-Term Interest Rates: United States, United Kingdom, Germany, and Japan 1970-2008



Source: Bosworth (2009)

Comments:

Lax monetary policy alone is not a sufficient condition for creating a financial crisis. Lax prudential regulation at the microeconomic level encourages unwarranted financial innovation in times of lax monetary policy and together they contribute to a crisis. History shows that boom and busts have been associated with financial innovation. In the current global financial crisis, the main innovation was securitization of loans, especially mortgage-backed securities associated with the ‘originate-to-distribute’ model of banks in the US, with a supporting role played by credit default swaps, a kind of insurance against bankruptcy. Interestingly, rather than selling the securitized assets, banks held on to them in unregulated off-balance-sheet vehicles to circumvent the Basel I and Basel II capital adequacy rules so that they maintain less capital though the risk remains the same.

World financial sector losses

Total Estimated Financial Sector Losses

(US\$ billions)	Balance	Oct. 2007 GFSR	Apr. 2008 GFSR	Oct. 2008 GFSR	Jan. 2009 Update	Apr. 2009 GFSR	Percent
United States							
Total loans	13,507	...	225	425	...	1,068	7.9
Total securities	13,047	...	720	980	...	1,644	12.6
Total loans and securities	26,554	200	945	1,405	2,200	2,715	10.2
Europe							
Total loans	20,759	...	...	...	...	888	4.3
Total securities	3,048	...	...	...	...	305	10.0
Total loans and securities	23,807	...	...	...	...	1,193	5.0
Japan							
Total loans	6,569	...	...	...	...	131	2.0
Total securities	789	...	...	...	...	17	2.2
Total loans and securities	7,358	...	...	...	...	149	2.0
Total							
Total loans	40,835	...	...	...	...	2,087	5.1
Total securities	16,884	...	...	...	...	1,966	11.6
Total loans and securities	57,719	...	...	...	...	4,054	7.0

Source: IMF

	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

2.1. Macroeconomic Impacts

Real GDP growth rates															
	Y/y%							Q/q%							
	08/Q1	Q2	Q3	Q4	09/Q1	Q2	Q3	08/Q1	Q2	Q3	Q4	09/Q1	Q2	Q3	CY08
PRC	10.6	10.1	9.0	6.8	6.1	7.9	--	--	--	--	0.6	1.5	3.5	--	9.0
Hong Kong	7.3	4.1	1.5	-2.6	-7.8	-3.8	--	1.0	-1.0	-0.8	-1.9	-4.3	-4.3	--	2.4
India	8.8	8.2	7.8	4.8	4.1	6.0	--	1.8	0.9	2.1	0.5	2.0	1.8	--	7.4
Indonesia	6.2	6.4	6.4	5.2	4.4	4.0	--	1.7	1.8	1.6	0.1	0.9	2.3	--	6.1
Japan	1.3	0.6	-0.3	-4.3	-8.7	-6.4	--	1.0	-1.1	-1.0	-3.5	-3.1	0.9	--	-0.7
Korea	5.5	4.3	3.1	-3.4	-4.2	-2.5	--	1.1	0.4	0.2	-5.1	0.1	2.3	--	2.2
Malaysia	7.4	6.6	4.8	0.1	-6.2	-3.9	--	1.7	0.6	0.1	-2.3	-5.1	--	--	4.6
Philippines	3.9	4.2	4.6	2.9	0.6	1.5	--	0.1	1.7	0.7	0.3	-2.1	2.4	--	3.8
Singapore	6.7	2.5	0.0	-4.2	-9.5	-3.5	0.8	2.9	-2.0	-0.5	-4.4	-3.2	4.8	3.5	1.1
Sri Lanka	6.2	7.0	6.3	4.3	1.5	2.1	--	--	--	--	--	--	--	--	6.0
Taipei,China	6.2	4.6	-1.0	-8.6	-10.1	-7.5	--	0.9	-0.6	-0.7	-7.6	-2.6	4.8	--	0.1
Thailand	6.0	5.3	3.9	-4.2	-7.1	-4.9	--	1.1	0.1	0.6	-5.9	-1.8	2.3	--	2.6
Viet Nam	7.5	5.8	6.5	5.5	3.1	4.4	--	--	--	--	--	--	--	--	6.2

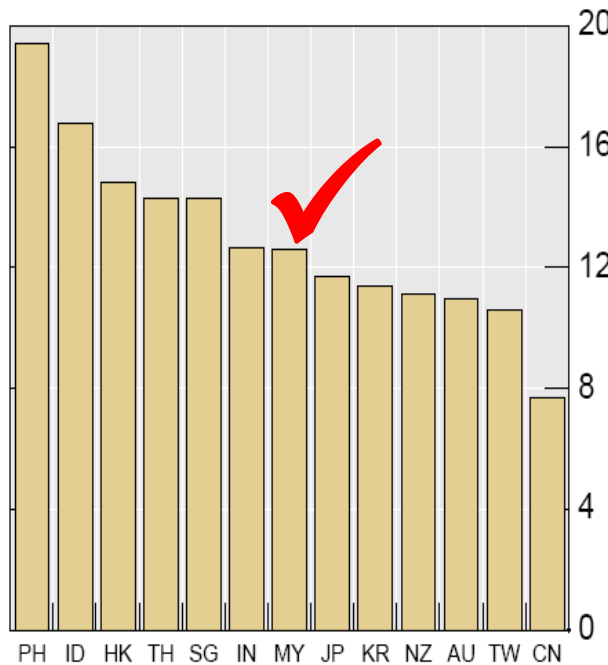
Source: CEIC

2.2. Impacts on Asian Banking Systems

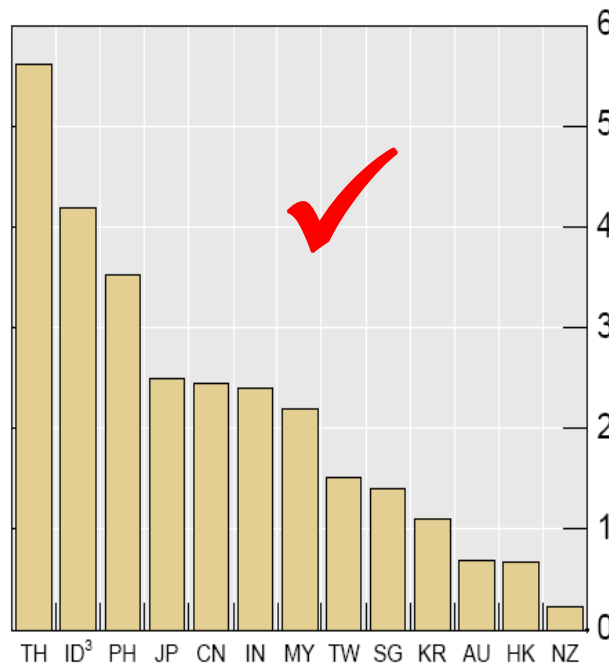
Asia has gone into the crisis with healthy financial systems?

Asian banks¹

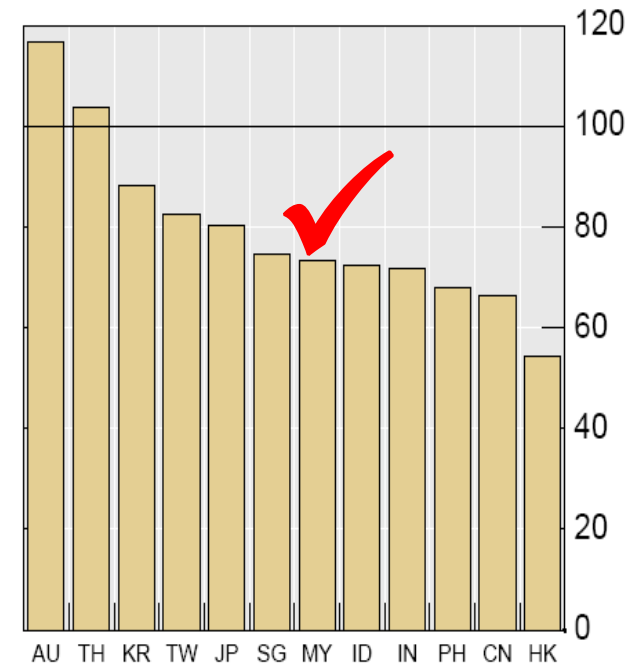
Capital adequacy ratios²



Non-performing loan ratios³



Loan to deposit ratios



Source: Filardo (2009).

Capital to Risk-Weighted Asset Ratios 2003–2008

Economy	2003	2004	2005	2006	2007	2008
Bangladesh	8.4	8.8	7.3	8.3	10.0	9.5
PRC	(5.9)	(4.7)	2.5	4.9	8.4	8.2
Hong Kong	15.3	15.4	14.9	15.2	13.4	14.3
India	12.7	12.9	12.8	12.3	12.3	13.0
Indonesia	22.3	19.4	19.3	21.3	19.3	16.8
Japan	11.1	11.6	12.2	13.1	12.9	12.3
Korea	11.1	12.1	13.0	12.8	12.3	10.9
Malaysia	13.8	14.4	13.7	13.5	13.2	12.6
Philippines	17.4	18.4	17.6	18.1	15.7	15.5
Singapore	17.9	16.2	15.8	15.4	13.5	14.3
Thailand	13.4	12.4	13.2	13.8	14.8	15.3

Source: IMF, 2009.

Bank Nonperforming Loan Ratios 2003–2008

Economy	2003	2004	2005	2006	2007	2008
Bangladesh	22.1	17.6	13.6	13.2	14.0	13.0
PRC	20.4	12.8	9.8	7.5	6.7	2.5
Hong Kong	3.9	2.3	1.4	1.3	0.9	1.0
India	8.8	7.2	5.2	3.3	2.5	2.3
Indonesia	6.8	4.5	7.6	6.1	4.1	3.5
Japan	5.2	2.9	1.8	1.5	1.5	1.5
Korea	2.6	1.9	1.2	0.8	0.7	1.1
Malaysia	13.9	11.7	9.6	8.5	6.5	5.1
Philippines	16.1	14.4	10.3	7.5	5.8	5.2
Singapore	6.7	5.0	3.8	2.8	1.5	1.4
Thailand	13.5	11.9	9.1	8.4	7.9	6.5

Source: IMF, 2009.

Stress-testing Asian banks...

The largest banking systems in East Asia have \$1,189bn in Tier 1 capital and a shortfall of \$758bn

- A leverage ratio of Tier 1 capital to assets of 5 per cent
- Non performing loans of 8 per cent of assets; and
- 100 per cent coverage ratio of reserves to non-performing loans.

East Asia	Tier 1	Shortfall
CHINA	345	-109
HONG KONG	53	-30
INDONESIA	12	-5
JAPAN	563	-519
KOREA	75	-44
MALAYSIA	24	-3
NEW ZEALAND	11	-14
PHILIPPINES	8	2
SINGAPORE	30	-5
TAIWAN	44	-37
THAILAND	23	4
Total	1,189	-758

Source: Pomerleano (2009)

However, the stress tests suggest that the majority of the banking systems can absorb the shock

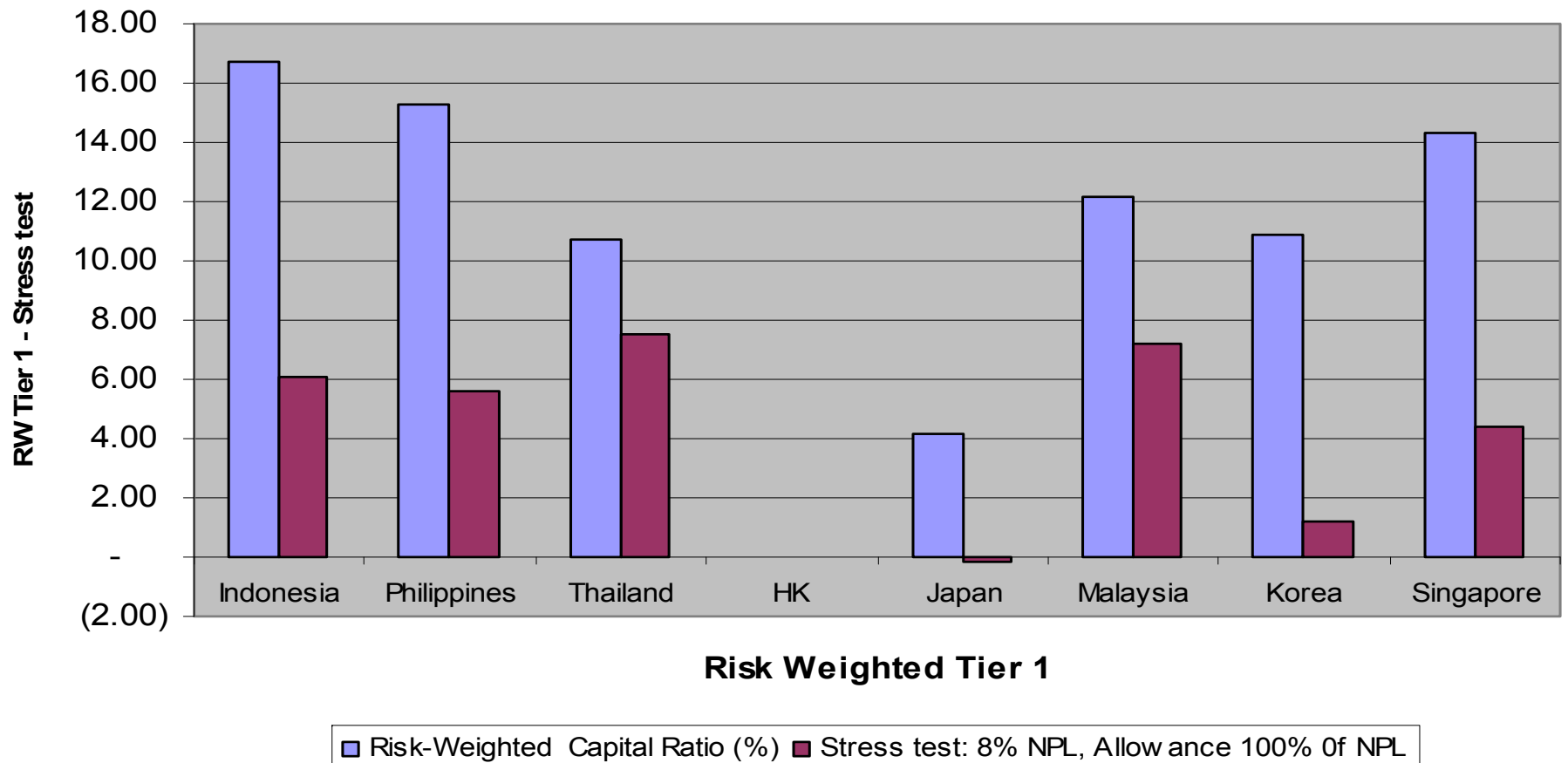
	Non Performing Earning Assets (%)	Provision (%)	Risk-weighted Capital Ratio (%)*	Stress Tested Risk-Weighted Capital Ratio (%)
Hong Kong	1.24	N.A.	14.80	
Indonesia	2.37	120.65	16.76	8.65
Japan	1.83	60.75	4.20	-0.13
Korea	0.80	174.33	5.73	1.23
Malaysia	2.23	334.63	12.16	7.20
Philippines	5.71	43.37	14.14	9.86
Singapore	1.40	119.90	7.70	5.14
Thailand	5.26	69.81	10.74	7.49

Note: Data are end of 2008 except Japan, Korea and Philippines which are Q3-2008. *Equity/Assets ratio is used for Japan, Korea, Philippines and Singapore.

Source: Hong Kong (various publications by HKMA); Indonesia (Indonesian Banking Statistics by CBI); Japan (JBA and FSA of Japan); Korea (Monthly Bulletin by FSC of Korea); Malaysia (MNB); Philippines (CBP); Singapore (SMA); Thailand (CBT).

Source: Pomerleano (2009).

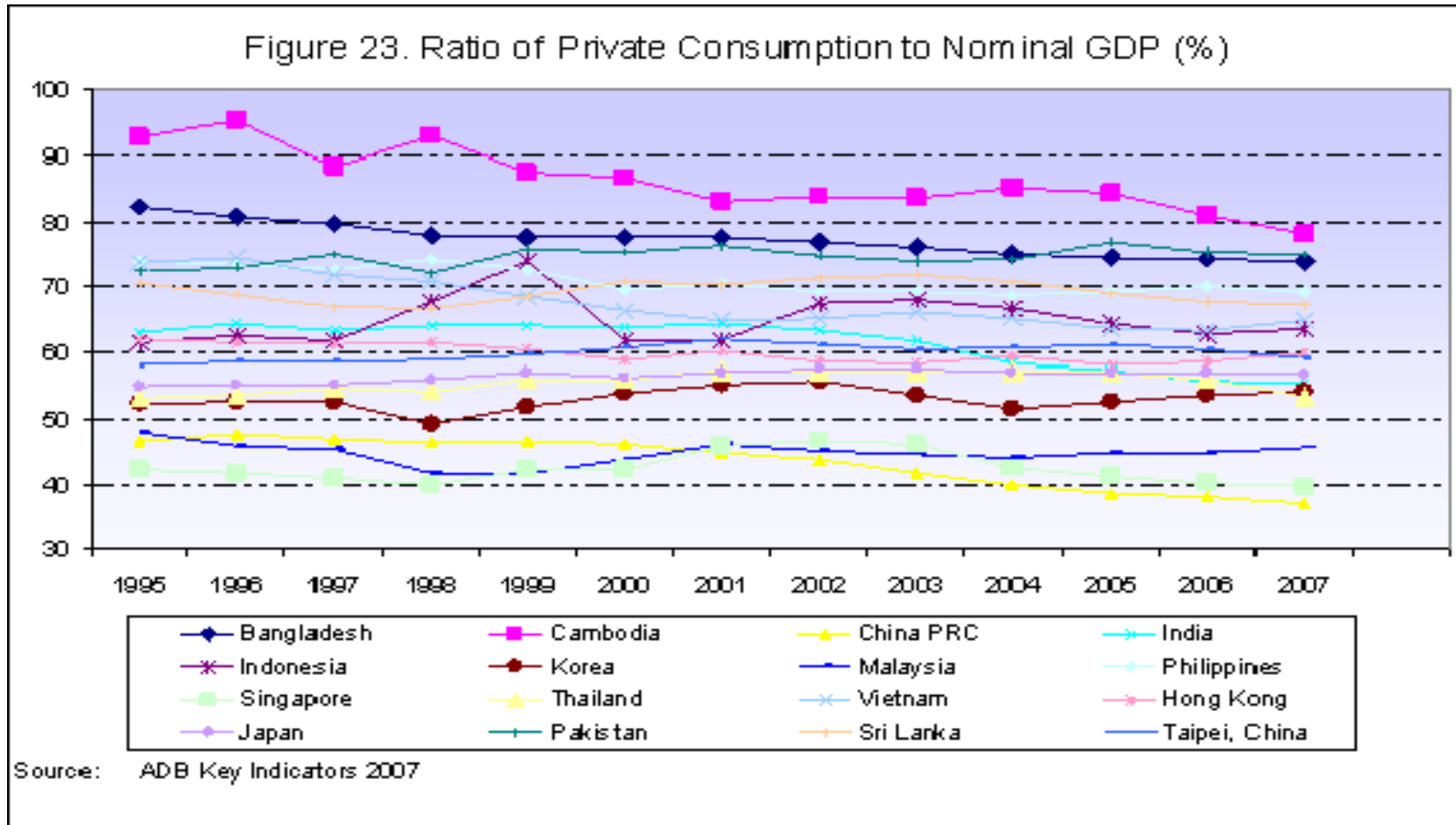
Stress Test: 8% NPL, 100% Coverage



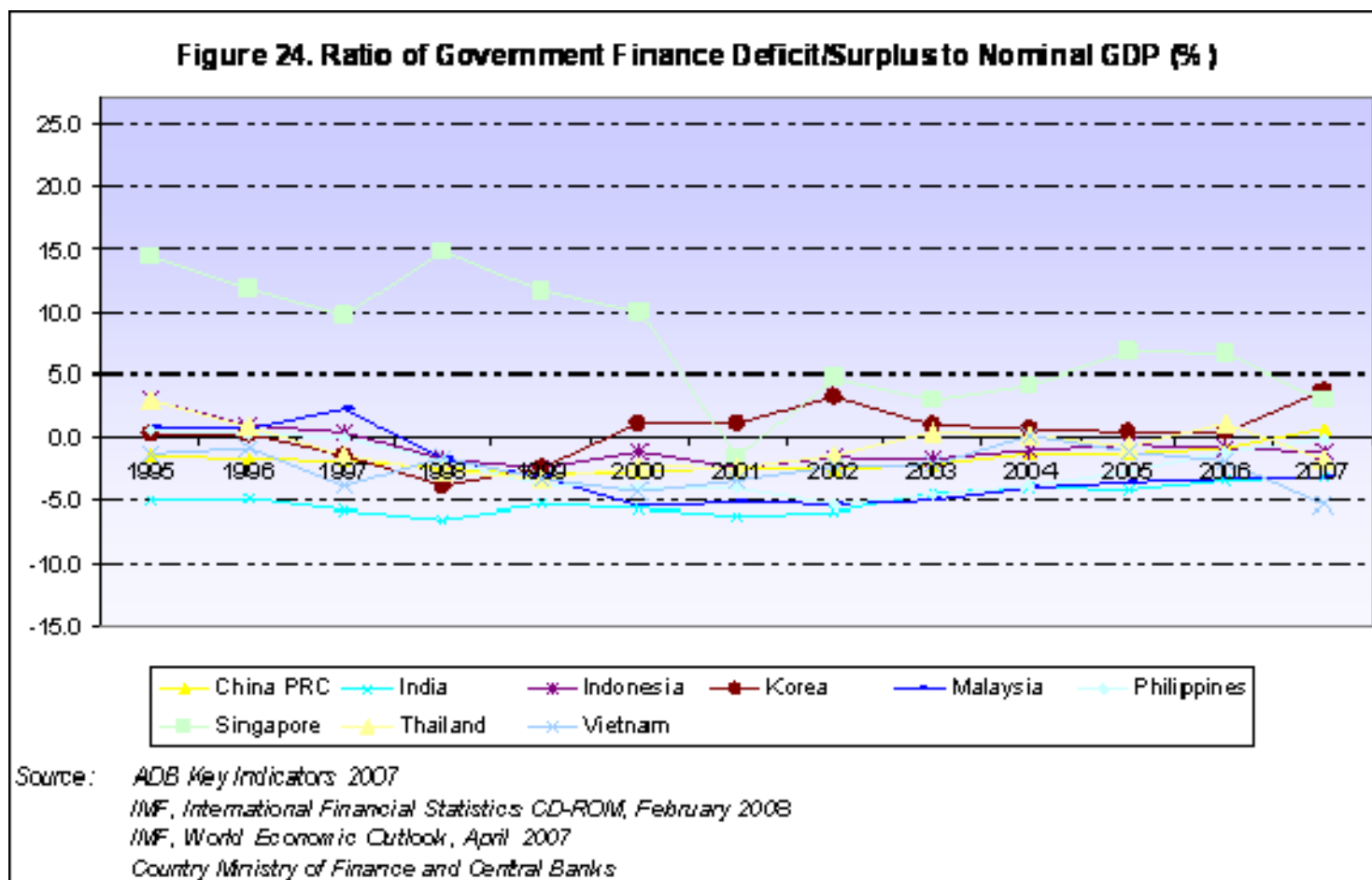
Source: Pomerleano (2009)

3. Asia's Responses

Room for expanding domestic consumption....



Fiscal space for infrastructure investment....



Monetary and financial system policy responses

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

Asian Policy Rates

%	Current	Chg. fm peak	Peak rate
China	5.31	-2.16	7.47
Hong Kong	1.00	-2.50	3.50
India	5.00	-4.00	9.00
Indonesia	7.50	-2.00	9.50
Japan	0.10	-0.40	0.50
Korea	2.00	-3.25	5.25
Malaysia	2.50	-1.00	3.50
Philippines	5.00	-1.00	6.00
Sri Lanka	16.50	-2.50	19.00
Taipei, China	1.50	-2.13	3.63
Thailand	1.25	-2.50	3.75
Vietnam	7.00	-7.00	14.00

Sources: Various newspaper reports.

Table 2: Fiscal Stimulus Plans of Selected DMCs

Fiscal Stimulus	Countries
More than 5% of GDP	People's Republic of China; Malaysia; Papua New Guinea; Singapore; Viet Nam
Between 2% and 5% of GDP	Hong Kong, China; India; Republic of Korea; Philippines; Taipei, China; Thailand
Between 0.5% and 2% of GDP	Cambodia; Indonesia; Pakistan
Less than 0.5% of GDP	Sri Lanka

Note: Based on announced fiscal stimulus packages of countries where data is available.

Source: ADB (2009)

4. Shape of the Recovery

- V-shaped?
- W-shaped?
- L-shaped?

Comments:

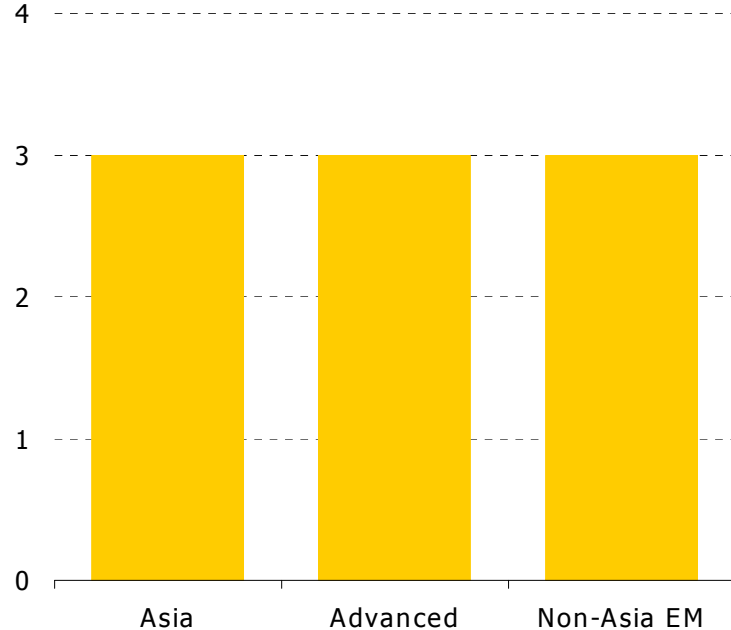
Considering size of GDP, China alone cannot pull up the world economy. Still, US and Europe economies can play a big role in the recovery. They must therefore do something to stabilize their economies and return to growth path.

2008 GDP			
	Own currency, bn	Exch. Rate (current)	USD bn
US			14264.6
Japan	507538.4	94.60	5365.1
China	30067.0	6.82	4408.7
Eurozone	9267.4	1.40	12974.4

Typical recession in Asia not very long nor very deep...

Duration of Past Recessions since 1980

(Median, in quarters)

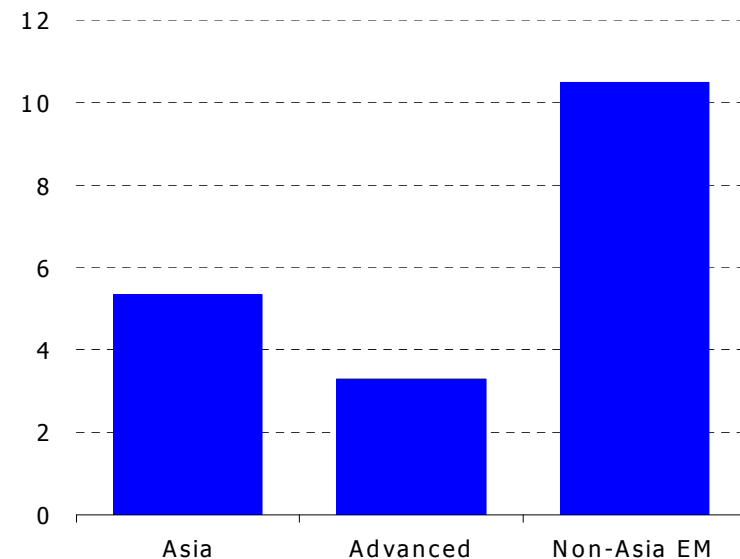


Source: IMF staff estimates.

Source: Miniane (2009)

Cumulative Loss in Output during Past Recessions since 1980

(Median, in percent; relative to output level in peak)

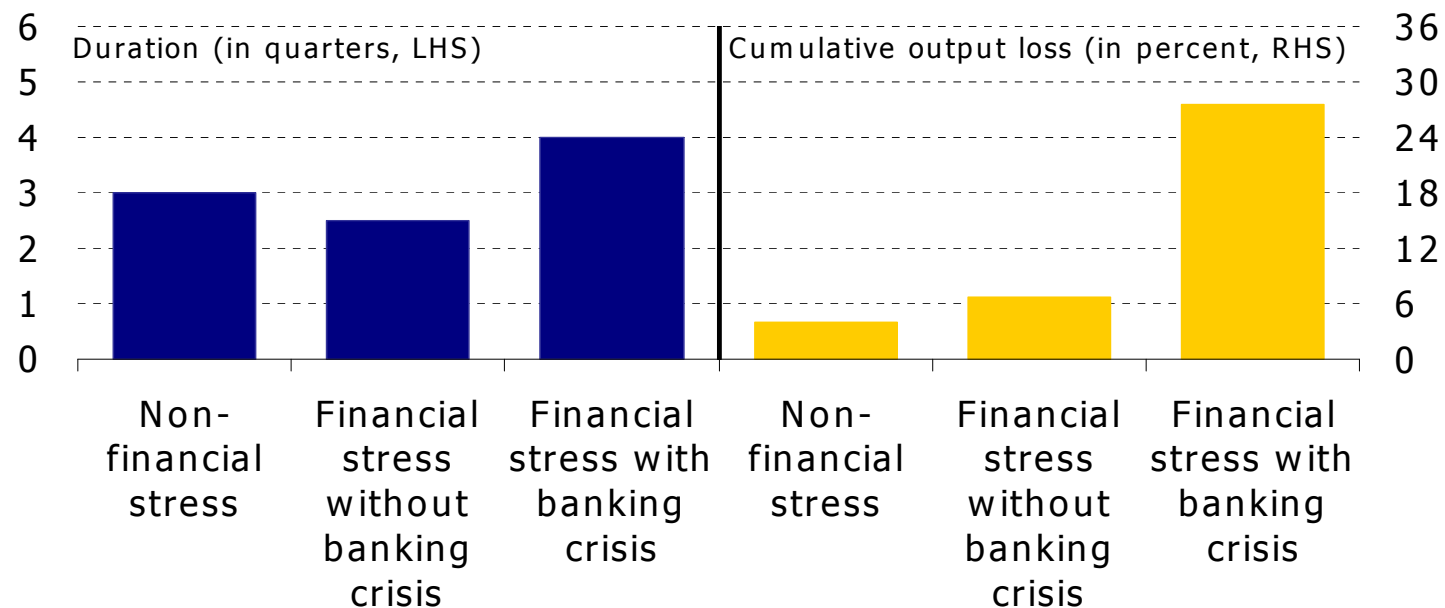


Source: IMF staff estimates.

...But financial stress recession, particularly banking crises, *very* deep...

Asia: Past Recessions since 1980

(Median)



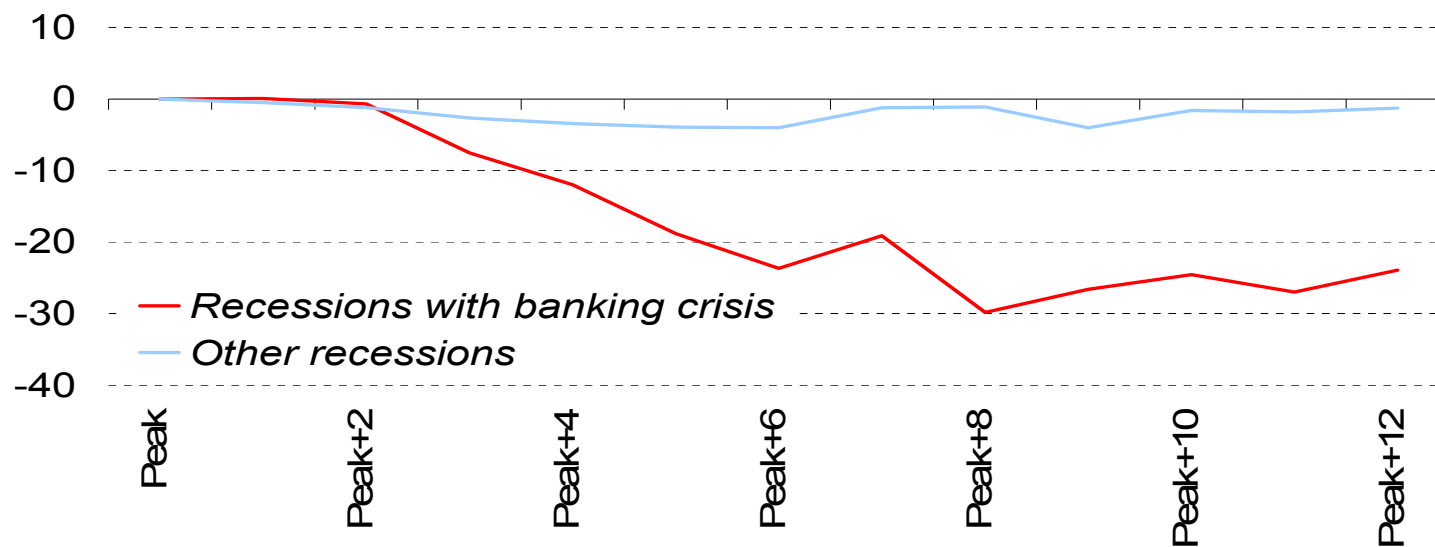
Source: IMF staff estimates.

Source: Miniane (2009)

...partly because credit is impaired.

Asia: Credit to Private Sector during Past Recessions since 1980

(Median y/y change in percent; rebased at the peak of the recessions = 0)



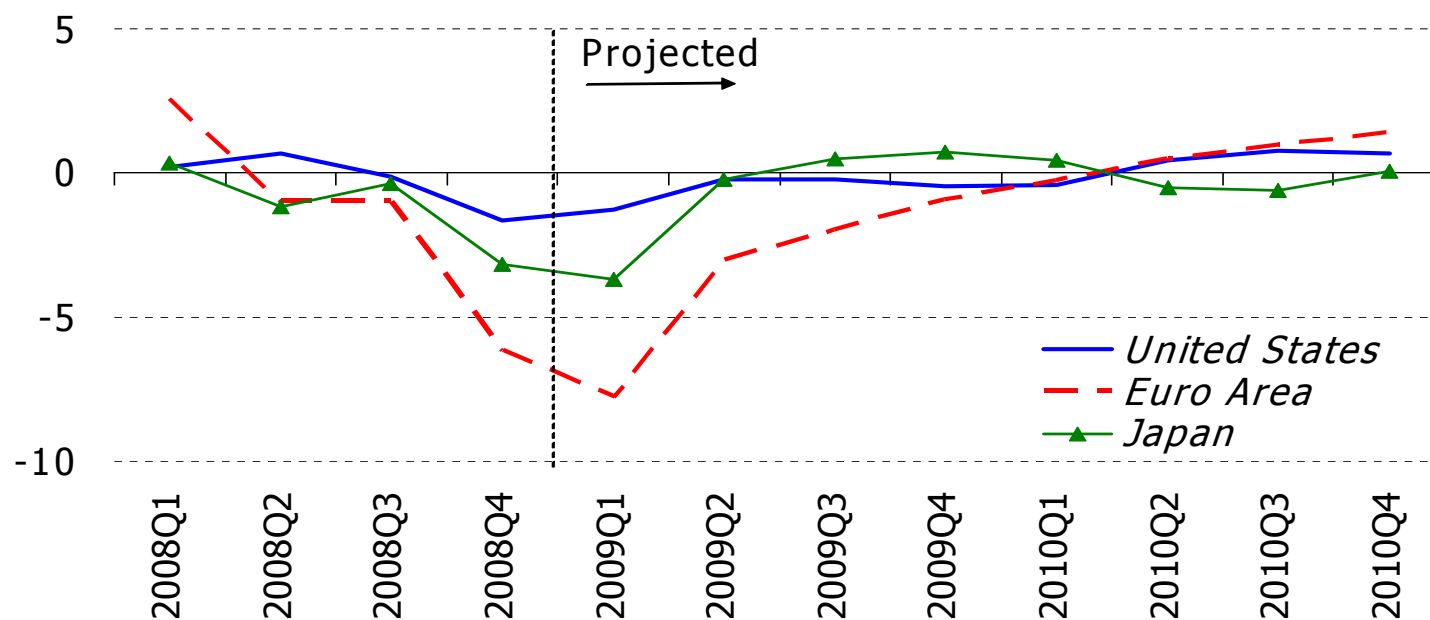
Source: IMF staff estimates.

Source: Miniane (2009)

Asia cannot count on strong G2 growth to help support an export-led recovery

Advanced Economies: Real GDP Growth

(Q/Q percent change, SAAR)

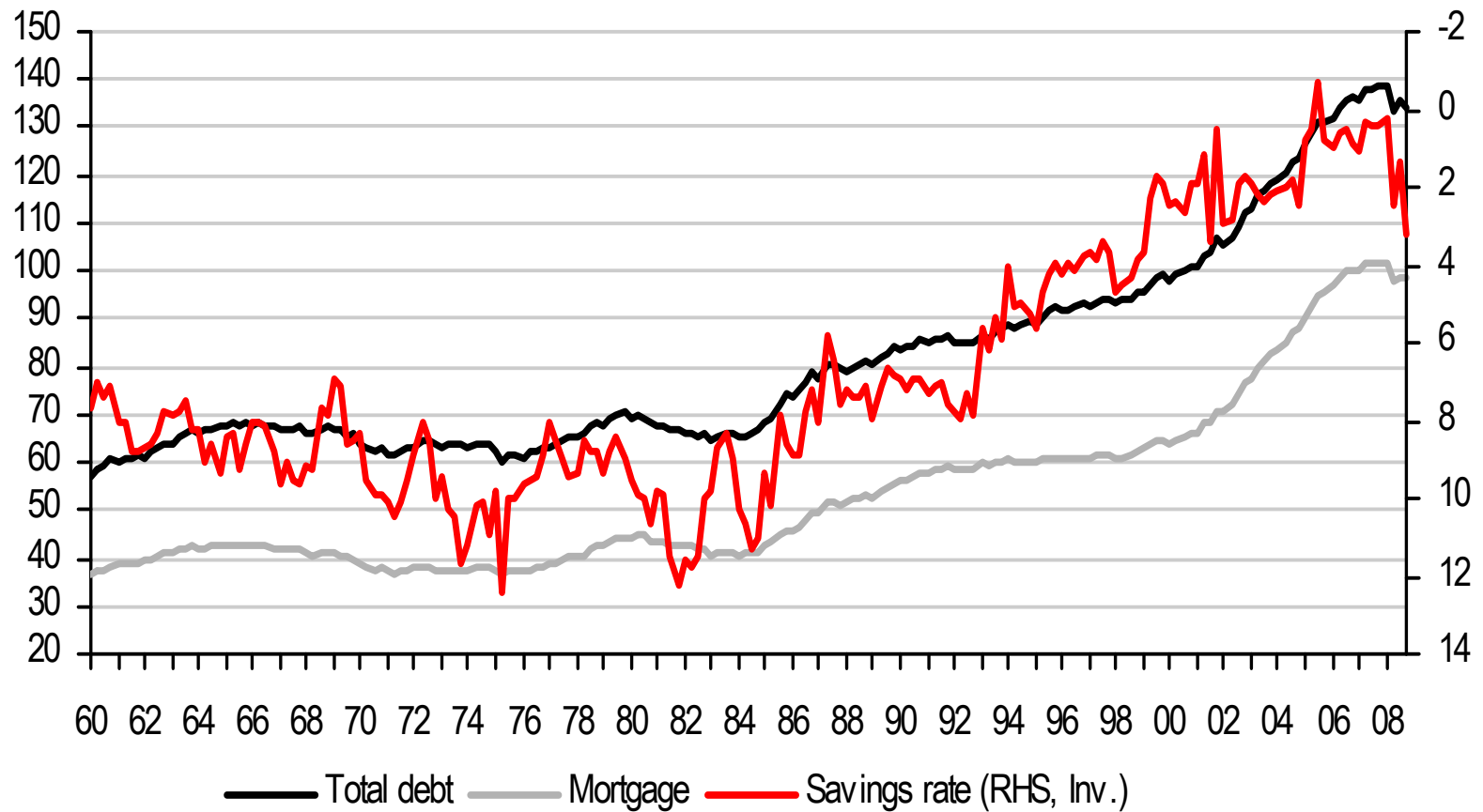


Source: IMF, WEO database.

Source: Miniane (2009)

US—Household debt vs. income

Ratio to Disposable Income, %



Source: FRB Flow of Funds, US BEA

5. New Growth Strategy?

Europe: “strengthened European growth strategy – more focused Europe-wide strategy for growth” (Gordon Brown, FT 27/05/09)

Asia: “rebalancing growth strategy”

Rebalancing Growth Strategy

Rebalancing growth means altering the composition of aggregate demand in favor of internal demand, rather than external demand, matched by changes in the production structure in favor of non-tradable goods and services.

Rebalancing Growth Strategy

On the demand side: many economies in the region have still room for increasing consumer spending, and one challenge is to remove obstacles to stronger spending. Fiscal resources could be directed to strengthening social sector protection (including health, unemployment insurance and pensions) to reduce precautionary motive for saving.

On the supply side: incentives that favor export-promotion and export-production have to be phased out. This does not mean a return to import substitution regime least policymakers may be tempted to entertain the idea of introducing all kinds of industrial policy measures.



Thank You!!!

Mario B. Lamberte
mlamberte@adbi.org
www.adbi.org