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Post Crisis World Economy: Global Rebalancing[1]

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The Great Recession hit bottom, and recovery has been faster than expected.

As a result of the global financial crisis, world production and trade volume showed the largest drop after the latter half of 2008, the worst since World War II. Asia, especially China, however, has started recovery, among other economies, due to massive monetary and fiscal stimulus measures. In the third quarter, the US achieved positive growth for the first time since the past six consecutive quarters. The European nations follow the US. As I have repeatedly said, the worst situation is behind us.

As for the fourth quarter, the real GDP growth of China recovered double digit or 10.7 % in comparison with the previous year, the first time in the last 18 months. The growth is so strong that there are even some concerns for overshooting. Annual growth attained 8.7 %, well over the government's target of 8.0 %. The US also attained high growth. The real GDP growth in the 4th quarter was 5.7 %, and reflected the positive contributions from inventory investment, exports and personal consumption. The retail sales in holiday season showed moderate growth. The International Monetary Fund (IMF) revised its world output growth forecast upward by 0.3, 0.8 points respectively to

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1 This paper is the script of a speech delivered at the 1st ABAC Meeting on February 10th, 2010 in Melbourne.

-0.8% in 2009, 3.9% in 2010 in World Economic Outlook published in late January.

Lots of risks still remain...

The recovery has been much faster than most of us expected. It is, however, brought by the massive fiscal stimulus measures of each economy. Demands in the private sector have not yet become the driving force. In addition, the global economy bears various risk factors, and the basis for the recovery is still fragile.

The first risk factors are the delay of recovery in employment, and the rise of protectionism. US non-farm payrolls have been decreased by 7.2 million in the past two years. Although such a decrease is recently improving, it may take a while before turning to an increase. The unemployment rate exceeds 10 %, the highest since early '80s. Adjustments of heavy debt burden borne by households need time, and V-shaped economic recovery cannot be expected. Thus, the unemployment rate will stay high for a while. Under such circumstances, there are concerns for growing risks of protectionism as the mid-term election in November approaches. Not only the US but also other economies struggle to prevent deterioration of unemployment. We need to pay much attention to the further spread of protectionism across the globe.

Secondly, financial institutions, especially in the US and Europe, face significant risks. In addition to the fact that these institutions have not yet sufficiently disposed of their problematic assets, there are concerns that the problematic assets may further increase in the area of commercial real estate loans and consumer finance. In the case of the Japanese post bubble era, the fiscal stimulus measures ceased while the disposal of the problematic assets and the recovery of financial intermediary functions were insufficient. This is why Japan experienced the recession again. Based on Japan's experience, we cannot deny the possibility of double dip recession.

Thirdly, there is the risk that the bubble will start or even have started globally due to sufficient liquidity support, unprecedented monetary easing, and massive fiscal stimulus measures to respond to the collapse of the bubble economy. We need to pay special attention to make sure that the bubble does not start again in the emerging economies where significant recovery has been made. If we mishandle it, the risk may rise for a further “double-dip” deterioration for the emerging economies, while the developed economies grow mildly. In China, however, the monetary policy has already been tightened, and some measures have been taken to avoid an excessive rise of the real estate market. In Brazil, excessive capital inflow has been restricted by rising tax rates for financial transaction. These are good examples of the efforts to prevent the bubble economy, and reasonable results can be expected.

In addition, there are concerns about the rising risks that further tightening the financial regulation may confuse the market and prevent recovery. It is evident that the direct cause of the financial crisis was the treatment for sub-prime related financial products and lack of regulation. Currently, many measures are being examined including financial transactions taxes, taxes for financial industry such as special taxes for debts of financial institutions, regulations for banning investment activities by the banks for hedge funds, and tightening capital requirements. While it is needless to say that adequate regulations are necessary to prevent the crisis, deliberate attention should be paid not to distort financial transactions, limit the liquidity in the market, and prevent sound market development. The regulators should also examine the negative effect of taxes and regulations through financial capital markets to the macroeconomy.

Implementation of appropriate exit strategies: Timing and Methodologies

Exit strategies by each government become extremely important where the global economy holds various risks as stated above.

The lessons learned in the Japanese case show that a too early withdrawal of stimulus measures brings zigzag footsteps of recovery and prolonged recession. On the other hand, the US experience in early 2000s shows that missing the right moment to release the measures after the bubble collapse creates another bubble phenomenon.

The IMF suggests that the following seven principles be considered for drawing up exit strategies.

1. Timing should depend on the economic situation and financial systems.
2. Albeit some exceptions, top priority should be given to fiscal consolidation. Monetary policies can adjust more flexibly.
3. Exit strategies of fiscal measures should be aimed at maintaining sustainability for the medium term. They should be transparent, comprehensive and with sufficient disclosure of information.
4. Stronger primary balances should be the key driving force of fiscal adjustment, beginning with actions to ensure that crisis-related fiscal stimulus measures remain temporary.
5. Unwinding of unconventional monetary policies should not necessarily be ahead of

traditional monetary tightening.

6. When and how support policies should be suspended for financial institutions depend on economic situation, stability of financial markets, and market mechanisms.
7. Attention should be paid to other economies when exit strategies are considered. While policy cooperation does not necessarily mean simultaneous implementation of exit strategies, policy implementation without cooperation may bring negative influences.

In addition, the Financial Stability Board (FSB) places the following guidelines for exit strategies.

1. Pre-announced: Market participants should have time to adjust to the new circumstances that will accompany the termination of the policy. Public announcements of exit strategies can alleviate uncertainty in the market.
2. Flexible: Depending upon the market and economic environment, the strategies should be adjusted.
3. Transparent: Purpose, schedule, and implementation criteria should be fully understood by all the relevant parties.
4. Credible: The exit strategies should be prepared, based upon realistic assumptions.
5. Cooperation of each economy: Special attention should be paid for cross border effects such as arbitrage of regulations.

Each economy should implement appropriate exit strategies, based upon the above principles. While judging the right moment for exit strategies is difficult, urgent consideration for the issues and clarification of the medium term plan will enhance transparency.

Issues for the global economy surrounding APEC Economies:for global rebalancing

According to IMF, the economic volume of Asia and the US will be almost the same in 2014. On the other hand, Asia will experience diminution of production age population in the long run, except India. This is why there is a risk that Asia will lose its vitality due to rapid aging before sufficient economic developments are attained and the society matures. In order to sustain economic growth under the structural changes of the global economy, each economy should cooperate to implement short-term exit strategies. On top of this, support for emerging and developing economies is necessary in the long run.

During the crisis this time, we realized that the world is virtually in one piece and that a crisis in another economy can immediately be our own crisis. Another economy's issues can be our own issues, and thus the crisis cannot be settled only by our hands. Thus, domestically oriented policies cannot be implemented. This is when the new international framework of the G20 Summit has been established, and unprecedented global cooperation has been made. International Institutions will be strengthened, and some new regulatory organizations such as FSB have been created. Due to rapid economic, financial and fiscal measures under global cooperation, the recovery from the crisis has been attained much faster than was expected.

We now have to sustain the economic recovery, by blocking the risks on the global economy we face, through the framework of cooperation. At the same time, efforts are needed to solve the new issues we face, including climate change, energy and food security, on top of the conventional issues such as the eradication of poverty through economic growth and human security.

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