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# Post Crisis World Economy
# : Rebalancing of Economic Growth[1]

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**The Global Economy is recovering much more quickly than expected. The extent of the recovery, however, varies for each economy**

The global economy continues to recover much faster than most of us expected. According to a recent forecast, IMF expects that the world real GDP growth is 4.2 % in 2010 and 4.3 % in 2011, after minus 0.9 % in 2009. Compared with the one announced half a year ago, IMF's forecast has been revised upward by as much as 1.1 % point for 2010. Nonetheless, while the emerging economies such as those of Asia and Latin America continue to have steady recovery and expansion, most of the developed economies are still fragile amidst the recovery. In addition, a delay in recovery has been noticed in Eastern Europe and CIS economies among the emerging economies. Thus, the extent of the recoveries varies for each region and economy.

Recoveries in developed economies also vary. The recovery of the US, which was the epicenter of the financial crisis, has been much faster than that of Europe and Japan. The real GDP growth of US in the first quarter 2010 was 3.2 % (seasonally adjusted

[1] This paper is the script of a speech delivered at the 2nd ABAC Meeting on May 19th, 2010 in Taipei.

annualized basis) while that of the fourth quarter 2009 was 5.6%. As for the unemployment about which many have serious concerns, nonfarm payroll increased by 290,000 from March to April 2010, which demonstrates the largest monthly increase since March 2006. This recovery has been brought on by rapid and continuous monetary and fiscal supports of the US Government as well as the relatively healthy balance sheet of the US corporate sector, excepting the financial institutions. Europe suffers from a much more severe deterioration of the financial sector than the US, and experiences delayed recovery in regions such as Eastern Europe and CIS economies with which most of the European economies have closer economic relation in terms of trade and investment. In addition, the weakness of the Euro as a single currency in the region is noticed through concerns on fiscal deterioration of some economies in the Euro area. The Euro tends to depreciate and brings turmoil to the financial markets. Japan, on the other hand, has enjoyed the recovery of the rest of the Asian economies, nonetheless maintains a mild recovery due to weak domestic demand.

The emerging economies, particularly in Asia, continue to experience robust recovery and expansion, functioning as a global growth center. These economies were less severely and directly impacted by the financial crisis. In addition, their fiscal situation was good just before the crisis, and thus they took strong economic stimulus measures. The real GDP growth of China in the first quarter of 2010 was 11.9 % (compared with the one in the same quarter of the previous year), which was better than 10.7 % in the fourth quarter 2009, maintaining double digit growth for two consecutive quarters. Other economies such as NIEs and ASEAN surrounding China demonstrate stable recovery due to the expansion of export and investment in infrastructure. In addition, Latin America has shown faster recovery than expected. The Eastern Europe and CIS economies, on the other hand, have demonstrated slow recovery.

**Downside risks remain. In particular, fragility of the fiscal situation in advanced economies and bubble phenomena in the emerging economies for asset prices**

Despite some regional variation, the economic recovery has progressed faster than expected. Accordingly, the various risks borne by the global economy seem to be gradually soothing. Nonetheless, new concerns have arisen in the financial markets, especially on the fiscal fragility in developed economies. The fiscal situation in Greece has deteriorated, and the yield of its government bond rose sharply. The yield spread with the benchmark German government bond increased. The Greek government asked EU and IMF for their support, and Euro of 110 billion will be injected in total. The general perception is that the crisis of fiscal default will be avoided by the rescue packages. Greece will need, however, fundamental solutions, incorporating stringent fiscal reconstruction to bring medium term stability.

US and some European economies as UK still suffer from damaged balance sheets of households after the bubble burst in the residential real estate market. In these economies, when the effect of fiscal measures weakens economic recovery will be slower. Concerns are that employment recovers very sluggishly, and that the unemployment rate remains high for the time being. Appropriate measures to secure employment are necessary to avoid prolonged chronic unemployment due to recession, which could turn to structural unemployment.

Although the financial crisis is over, disposal of financial institutions' problem assets in US and Europe have been insufficient. Overdue mortgage loans are still a severe issue. There are still some risks where problem assets may increase, in particular for commercial real estates and consumer credits. The US and European financial institutions' appetite for lending may continue to remain modest due to constraints of both quality and quantity of capital, although the worst situation is over. Thus, concerns prevail over the situation of limited financial supply for SMEs and households which heavily rely upon bank loans, which could eventually act as downside pressure for the economic recovery.

The inflationary pressure remains low in advanced economies due to mild economic recovery. Thus, looser monetary policies may continue to be taken, although an emergency rescue plan has ceased. Some emerging economies, on the other hand, already experience economic overheat, and have taken tightening monetary policy. Differences of growth and interest rates between emerging and developed economies increase capital inflow from developed to emerging economies. Rapid liquidity increase due to the capital inflow may bring inflation and bubble phenomena for asset prices in emerging economies. Some economies already show overheat in asset markets such as real estate, and need some corrective measures.

**Tasks for the global economy including APEC economies: Exit strategies for rebalancing the economic growth**

Can the emerging economies, including Asia, maintain sustainable economic recovery? Can developed economies bring autonomous recovery, stimulated by demand from private sector, not public demand? Economic measures taken by each economy including exit strategies get much more difficult when monetary and fiscal measures are limited.

Fiscal deterioration is not only an issue for Greece. Fiscal stability on a medium term basis is an urgent task for most of the developed economies who suffer from serious aging problems. Although strong fiscal stimulus measures can support economic recovery for the time being, fundamental structural reform efforts are necessary. Otherwise, concerns on fiscal fragility may increase the long-term interest rate, which may eventually hinder continuous recovery. Stabilizing the government bond market is necessary, by clarifying the time schedule for medium term fiscal reconstruction.

Emerging economies including Asia need to stabilize economic expansion, controlling capital inflow which can increase rapidly when responding to possible inflation and bubble phenomena. In Brazil, for example, capital inflow has been already regulated by raising financial transaction taxes. In China, such measures have been taken as suppressing speculative investments and increasing housing supply in order to control the overheating residential market, which are expected to prevent the bubble phenomena.

These measures taken by each economy, coupled with adequate measures on foreign exchange taken under global cooperation, could contribute to stable economic growth for economies with both surplus and deficit of current balance, and improve global imbalances.

One of the factors which brought the financial crisis this time is attributed to the insufficient supervision towards major international financial institutions since regulators fell behind the rapid innovation of financial engineering. Many regulatory reform efforts are examined in G20 to strengthen the regulatory framework for financial institutions, including new taxation, strengthening capital requirement, and regulation towards their investment activities for hedge funds. By the end of 2010, G20 is supposed to conclude so that new regulations are put in place by the end of 2012. While it is needless to say that some adequate regulations are necessary, extra attention should be paid not to hinder the sound development of the financial market, not to distort financial transactions, and not to prevent providing sufficient liquidity. New financial regulations might negatively affect the international financial intermediary functions.　Cooperation is duly needed, particularly with international forums such as APEC, to make sure that capital flow to the emerging economies are maintained and that sound economic development is assured.


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