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Post Crisis World Economy
: While financial market turmoil in Europe has calmed, concerns remain for a further economic downturn[1]

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Asia continues to lead the economic recovery. Financial market turmoil from Europe has calmed. Concerns remain for a further economic downturn. US economy recently slows down.

Due to heightened concerns regarding the sovereign risk of developed economies brought by the fiscal crisis of Greece, investors' risk appetites have shrunk. In May, stock prices dropped sharply all over the world. Positive rescue efforts toward Greece made by the IMF, ECB and EU progressed, and the results of the "Stress Test" for principle European banks were announced. Stock markets have calmed down, and recovery is noticed in some areas.

The global economy continues to recover. In July, IMF announced its global economic outlook, estimating that the global real GDP growth will be 4.6 % in 2010 and 4.3 % in 2011 while that of 2009 was negative 0.6 %. As for the 2010, IMF revised its forecast for 2010 upward from that of April, reflecting the higher actual figure than

[1] This paper is the script of a speech delivered at the 3rd ABAC Meeting on August 25th, 2010 in Bangkok.

expected. IMF, however, states that the risk going forward is increasing in light of the global financial market turmoil in Europe. While emerging economies such as Asia and Latin America maintain solid recovery and expansion, the recovery of most of the developed economies still remains fragile. Some emerging economies, such as Eastern Europe and CIS (Commonwealth of Independent States) economies, show only moderate recovery. The extent of the recoveries varies for each region and economy.

Although the USA demonstrated economic recovery first among the developed economies, such recovery has slowed down since fiscal stimulus measures and inventory rebuilding ended. The real GDP growth of the second quarter 2010 (seasonally adjusted annualized basis) was 2.4 %, slowed down from 5.0 % of the forth quarter 2009. As for unemployment, nonfarm payroll increased only by 71,000 from June to July. During this recession, US lost as much as 8.47 million employments. The recovery of employment, however, has been as little as 0.63 million to date. Federal Open Market Committee (FOMC) announced in this month that they will reinvest their proceeds of mortgaged backed securities at maturity into the US Treasury, noting that the pace of the recovery of output and employment has slowed during the last few months. Although the Fed's fund rate target has been maintained, FOMC’s purchase of the US Treasury is considered to be de facto additional monetary easing. There are even some concerns that USA may suffer from deflation as Japan did.

In Europe, concerns regarding sovereign risk remain for some economies, and the deterioration of financial standing for some institutions is far severer than in the USA. Thus, there are concerns for a future downturn, while the weak Euro underpins the economy through export increase. Japan, on the other hand, shows mild recovery due to the economic boom in Asia, while suffering from weak domestic demand.

Asian economies continue solid recovery and expansion, and lead the global economic recovery. The real GDP growth of China in the second quarter was 10.3 % compared with that of last year, which decreased from 11.9 % in the first quarter, maintaining double digit growth for three consecutive quarters. Wage increase prevails in China, which is an inflationary factor, and some concerns have arisen regarding decreased competitiveness. However, the wage increase augments people’s purchasing capability, and makes the Chinese market much more attractive. Other Asian economies such as NIEs and ASEAN maintain solid recovery, by expanding exports to China and investments to infrastructure projects. Latin America maintains growth much faster than expected.

Downside risk still remains. Financial stress increases due to heightened sovereign risk. There are concerns about asset price bubbles in emerging economies.

In Europe, fiscal fragility was one of the main concerns that can trigger more financial turmoil. Financial markets in Europe, however, are rather calm at present, due to the implementation of the European Financial Stability Facility and the announcement of stress test results. The possibility of realizing the severe fiscal austerity plan announced by Greece was in question, but the quarterly review of IMF and EU suggests that the plan is duly under way.

The stress tests exercised in Europe have brought criticism that assumptions were too mild. Measures taken by European financial institutions to decrease their problem assets are insufficient compared with those of the USA. There may be some risks that problem assets increase where financial bubbles were severe in the real estate market. The risk appetites of financial institutions will remain low due to capital restriction. Thus, small and medium enterprises as well as households may have difficulty obtaining sufficient credit, which could be a downward factor of recovery.

In developed economies, recovery remains mild and unemployment is high. Thus, inflationary pressure will remain low. While emergency monetary easing may cease, easy monetary policy will continue for quite some time. Some emerging economies in Asia and Latin America such as China, Korea, Brazil, Chile have already tightened their monetary policies. The difference in the growth ratio and interest rate between emerging and developed economies grows larger, and capital inflow to emerging economies has been realized. After May, such capital inflow decreased due to withdrawal of global risk money, reflecting sovereign spreads widening. The liquidity increase brought by such capital inflow, however, may cause inflation and asset price financial bubbles in emerging economies when investors' risk appetites recover.

The task for the global economy including APEC economies: exit strategies for rebalancing growth.

Can emerging economies including Asia maintain solid economic recovery? Can developed economies attain autonomous recovery by switching demands from the public to private sector? Fiscal and monetary policies have limited measures, and exit strategies become much more difficult.

Since developed economies suffer from severe fiscal deficit, they expect a lot for monetary policies. A prudent approach is requisite for exit strategies from monetary easing.

Fiscal deterioration is not an issue only for Greece. For many developed economies where aging is a very serious issue, fiscal sustainability in the medium term is crucial. European economies, for example, have initiated efforts at fiscal reconstruction. For economies such as Greece and Ireland, which rely upon foreign capital, fiscal reconstruction is an urgent task, and the method of realizing this severe plan is important. Sufficient attention should be paid so that urgent fiscal reconstruction plans do not hamper nascent recovery. It is also important to develop a mid. and long term credible plan to restore fiscal sustainability with the careful selection of timing to implement exit strategies.

If consumers' concerns about mid-term fiscal prospects are eased by soothing fiscal burdens in the future and enhancing fiscal capability of governments, short-term negative effects by fiscal reconstruction to domestic demand will be alleviated.

In addition, emerging economies in Asia should maintain recovery by controlling capital inflows, inflation, and asset price financial bubbles. China has promptly taken various measures, such as curving speculation and increasing housing supply, to control real estate price increase, which are expected to prevent financial bubbles.

Chinese authorities announced a flexible foreign exchange rate regime for RMB in June. RMB has appreciated by 0.9 % towards US$ for last one month and half. This is appreciated as one of the measures taken to rebalance the growth. US Treasury announced in July that they appreciated the flexible RMB, but that RMB is still undervalued. The US Treasury will continue to monitor the level of RMB. Attention is necessary for a surge of protectionism in the US, where unemployment is still high and mid-term election is scheduled in November.

One of the factors which triggered the financial crisis this time is considered to be insufficient supervision by financial authorities of each economy towards large financial institutions whose business activities are expanded globally. Financial authorities could not catch up with technological innovations, and regulatory reforms are under way in USA and Europe. The UK announced a revised draft of financial supervision in June, and US financial regulatory reform bills were approved in July. Fortunately, US new regulations pay attention to negative effects towards real economy, by implementing a sufficient timeframe. ABAC welcome strong regulation to prevent financial crisis.

Public private dialogue should be continued on to make it clear the contents of detailed regulation and it's implementation timing to recover confidence of financier and function of the markets. Global coordination is requisite in international forums such as APEC, not to prevent smooth capital flow to emerging economies and economic development, when implementing new regulations.

The global economy is still fragile and bears downside risks. Cooperation and coordination across the globe is necessary to rebalance the economy. Thus, ABAC's proposals as the private sector's voice are extremely important, particularly to well prepare for the APEC Finance Ministers Meeting held in Kyoto this November. It is needless to say that competitive depreciation of currency is not desirable in light of its protectionist nature. In addition, an appropriate foreign exchange rate regime, macroeconomic policies, and regulatory reforms (in particular in the area of financial markets, safety nets, and global trade) should be advanced.

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