The Global Economic Crisis and East Asian Perspectives

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1. The global imbalance between the US and the Asian economy.

- I would like to thank IDE-JETRO and ERIA for inviting me to this timely and meaningful Symposium on East Asia Beyond the Global Economic Crisis.

- This morning, I was deeply impressed with Prime Minister Hatoyama's welcoming address.

- As a panelist of this session, "The Global Economic Crisis and East Asian Perspectives," I was asked to

  discuss the global imbalance between the US and the Asian economy,
  present the possible scenario of the global balance and
  clarify the issues to be challenged by the East Asia.

- **First, what is the Global Imbalance?**

  Needless to say it is the US large and persistent current account deficit and the **large current account surpluses of Asia and oil producing countries.**

- When we discuss the causes of the financial crisis, we often focus on regulatory failure in the mortgage and finance industry.

  However, as well as regulatory failure there was a large global imbalance between the US and the Asian economy.
  Many feel this global imbalance caused, or at least exacerbated the current financial crisis.

2. The Causes of the Global Imbalance?

1. The US Dollar as the World's Reserve Currency.

- Because the US dollar is the world's reserve currency, there has been a large demand for US securities like Treasury bills.
- These capital flows have effectively financed the US current account deficit and explains why the US has been able to run a larger current account deficit than most other countries.

2. Low Long Term Interest Rates.

- The high demand for US securities such as US Treasuries and mortgage backed securities helped keep US interest rates low.
  It made borrowing for the US cheaper.

- There was great demand for savings in the US.
  This encouraged the US banks to offer increasingly sophisticated forms of investment.

- It explains why there was so much high demand for US mortgage backed securities even though the risk was very high.

2-1. The Causes of the Global Imbalance? (Continued)

3. Undervalued Chinese Yuan.

- China has tried to keep the Yuan undervalued to boost its exports.

  This undervaluation of the Yuan has made Chinese exports cheaper and boosted the Chinese Trade surplus.

- The US blamed China for the imbalance pointing to the undervaluation of the Yuan.
- This has been at times a political football, with US politicians deriding the 'protectionist' exchange rate policies of China.

- China defended themselves saying the global imbalance was caused by the US decision to pursue low interest rates and lax standards in lending criteria.
- They argue it is their right to pursue their own exchange rate policy.

4. Emerging market economies' sharp rise in current account surplus.

- Oil producing countries benefited from rising oil revenues due to higher oil prices.
- Asian countries including Korea reduced investment and increased savings after the Asian financial crisis of 1997.

3. IMF-backed framework to address the Global Imbalance.

- From Nov 2004 to Oct 2006, I was Executive Director of the IMF representing 14 Asia-Pacific member countries including Australia, New Zealand, Philippines and PNG as well as Korea.

- In June 2006, the IMF launched a new process of **multilateral consultations** to address the global imbalance. The IMF brought together key players in the global economy—China, the euro area, Japan, Saudi Arabia and the US—to work to reduce the imbalance in an orderly and growth-friendly manner.

- The goal was to avoid an abrupt unraveling of the imbalance caused by the large current account deficit in the US and big surpluses in some Asian and oil-producing countries.

- The strategy adopted by the IMF aimed to encourage

  "steps to boost national saving in the US, including fiscal consolidation;

  further progress on growth-enhancing reforms in Europe;

  further structural reforms, including fiscal consolidation, in Japan;

  reforms to boost domestic demand in emerging Asia, together with greater exchange rate flexibility in a number of surplus countries; and

  increased spending consistent with absorptive capacity and macroeconomic stability in oil-producing countries."

- In April 2007, the IMF released a statement of the participants' policy plans consistent with these aims and committed itself to monitor progress with implementation.

4. Changing Circumstances

- Since then the global economy has changed dramatically.
- Market turmoil—triggered by the US subprime mortgage crisis—has shaken confidence in money and credit markets worldwide.
- Policy attention in the US has shifted to aggressive easing monetary policy and fiscal stimulus to support the economy against concerns about a "credit crunch" and a possible U.S. recession.
- Financial market disruptions have also directly affected Europe.
- Sizable financial losses related to U.S. complex financial products have hit many European banks.
- Slower U.S. growth, financial dislocations and tighter lending conditions more broadly have raised concerns about a broader global economic slowdown.

5. The Possible Scenario of the Global Imbalance

- Global imbalances are not necessarily bad.
  They may reflect differences across countries in the rate of return on investment, or difference in the degree of risk or liquidity of different assets.

- But there are several reasons why global imbalances can be bad.
  Large global imbalances may reflect domestic problems or distortions.

- While global imbalances have declined during the crisis, they remain large and could widen again as the global economy normalizes.
  Thus, resolving this issue is essential for securing a sustained global recovery.

- The Leaders of the G-20, at their Pittsburgh summit, adopted a **Framework for Strong, Sustainable, and Balanced Growth,** which sets out a mutual assessment of policies and their implications for global growth.

- This shows commitment at the highest political level to ensure that global imbalances are addressed—and
  also reflects a shared understanding that all nations must do their part to secure strong, sustainable and balanced growth going forward.

6. The Issues challenged by the East Asia

- What can be done to rebalance global demand in a lasting way?

- Rebalancing does not mean that Asia should become inward looking and reduce trade. Openness must remain an essential element of Asia's growth model.
  The region's strong outward orientation, as reflected in the high ratio of trade and financial flows to GDP, has been a key factor in its remarkable economic performance.

- Singapore is a good example of the benefits of openness. Its economy is extremely open—gross capital flows are roughly the same as GDP, while exports and imports together account for about four time GDP. This openness, combined with pragmatic macroeconomic management, structural reforms, and a business-friendly environment, has been a cornerstone of Singapore's economic success, raising real income per capita five-fold in one generation.

- Rather, rebalancing means reinvigorating domestic demand and boosting intraregional trade through structural reforms aimed at boosting rates of return for investments in domestically-oriented sectors and removing impediments and bottlenecks to domestic spending.
  Such a recalibration of Asia's growth model is very much in the region's self-interest.
  In particular, it would reduce the region's dependence on demand from outside Asia.

6-1. The Issues challenged by the East Asia (Continued)

- Chinese authorities, with its large external surplus, are committed to boosting private consumption as the way to rebalance its economy. Improving social policies is needed to make more funds available for consumption.
- Developing financial markets to ensure a better allocation of capital, providing saving vehicles that raise household income, and expanding the availability of insurance products would also help. The corporate governance should be strengthened.
- Policy makers will need to continue keeping a close watch on credit and other asset markets to ensure that these structural boosts to consumption do not lead to overheating.

- For the world to succeed in its rebalancing efforts, exchange rates must be allowed to reflect medium-run fundamentals.

  Some Asian currencies are still undervalued relative to those of their major trading partners, while the euro is somewhat overvalued on this basis.

  So long as this remains the case, the price signals sent about the returns from tradable goods compared to those from non-tradable goods will continue to be skewed—thus delaying the rebalancing across countries, and more specifically the necessary recalibration of Asia's growth model.