THE GLOBAL DEBT CRISIS AND ASIA'S LEADERSHIP: GEOPOLITICAL AND ECONOMIC IMPLICATIONS

*D**r Dan Steinbock**, Research Director, International Business, India, China and America Institute (ICA, USA) and Fellow, Shanghai Institute for International Studies, China spoke on the above topic at an ISIS International Affairs Forum held on 30th September 2010, Kuala Lumpur. The forum was chaired by **Dato' Dr Mahani Zainal Abidin**, Chief Executive of ISIS Malaysia. **Dr Jorah Ramlan,** Senior Analyst at ISIS Malaysia reports.*

Dan Steinbock

severe in the US, companies there are more likely to start spending on investments compared to Europe.

The credit crunch still prevails in major economies due to problems in the banking sector, which means lending to the non-financial sector is still at a low level. Adding up all the factors, Cooper forecast a significant slowdown of the major economies up to the early part of 2011.

While he hoped there would be enough spending by the corporate sector to offset the cuts in government and household spending so as to generate some growth, he cautioned that the pace of spending will be slow, and so will be the recovery. The situation was disappointing as normally, in the second year of recovery, economic growth increases at a faster rate but he thinks this is not likely. Instead, Cooper said, there is likely to be a permanent loss of GDP -- the cost of the financial crisis so to speak.

The outlook for the interest rate will remain very weak and we can expect monetary

Demonstrators in Greece riot over new taxes and government spending cuts required to secure a bailout package to keep the nation from defaulting

policy to become even looser in major economies, particularly the US. Major economies are turning to easy monetary policies in order to support recovery and to compensate for the existing constraints such as the accumulated huge budget deficit**.**

Outlook for Emerging Markets

The scenario is much brighter for the emerging markets said Cooper. Growth has slowed down somewhat compared to early 2010, which is to be expected given the rapid growth rate registered in earlier quarters, the rebound in world trade and the turn of inventory cycles.

… labour flexibility is constrained due to commitments towards mortgage payments as well as the inability to pay due to loss of income

Though growth rates across emerging markets have slowed somewhat, the figures are still healthy, said Cooper. Within the emerging markets, particularly in Asia, there is buoyant domestic demand, growing to a critical mass, that will help sustain growth in these countries.

The strength of domestic demand in China has helped to support economic growth in Asia. Strong import growth in China translates into strong production input growth in some Asian countries which has helped to sustain and increase consumer spending growth across Asia.

The good news for the emerging market said Cooper, is that in the face of the slowing of developed economies, many emerging economies still have ammunition that their governments can deploy to support recovery, if needed. In particular the fiscal positions of most emerging market economies are much healthier, and the level of government debts or the level of budget deficits much lower. There is also the ability to boost money supply effectively as demonstrated by China during the crisis.

However it would be wrong to say that the emerging markets are without problems. Claims about economic decoupling, said Cooper, are 'exaggerated and it would be wrong to exaggerate the degree of decoupling that emerging economies could achieve.'

The pressure on currencies illustrate this point. The current loose monetary policy, particularly in the United States, generates excess liquidity, and in efforts to seek better returns, attention will focus, naturally, on investing in healthy economies, which in turn puts an upward pressure on the currencies of these economies, especially in Asia.

Cooper also pointed out that while export dependency on OECD countries has declined somewhat, the exports are still at about 15 per cent of Asian economies' GDP which means any slowdown in OECD would to some degree affect economic growth in Asia and other emerging economies.

Cooper confessed that his is not an easy outlook. It is an uncertain outlook. He gave examples of several alternative scenarios.

He believes that the probability of the Central Forecast (Oxford) is at 45 per cent — lower than forecasted earlier in the year. This reflects the belief that the uncertainties surrounding the global outlook have actually intensified.

The probability of the 'down side risks scenario' (30 per cent) is twice as big as the probability of the 'upside risks scenario' (15 per cent). The probability of a double-dip recession in the US and Europe in 2011 is at 10 per cent, which is quite high, said Cooper, given that these economies had just experienced a recovery period.

Dan Steinbock addressing the participants at the forum

ISIS Senior Director, Steven Wong, posing a question

In conclusion, Cooper reiterated his earlier point -- what happens to the global economy will hinge on how the corporate sectors behave with their excess cash. He pointed out that the prevailing uncertainties would probably make the corporate sector behave more cautiously, which is why Cooper favours the down side risks scenario.

Dr Steinbock said that there are four key areas to the global debt crisis. He argued that in general, the crisis has two sides. One is cyclical -- the worst crisis was in the 1930s -- and the other is secular or structural transformation. Secular crisis has a contagion effect over time, resulting in the crisis moving from one global economy to another**.** His presentation thus discussed the recovery process of advanced economies, and emerging economies, focusing on Brazil, Russia, India, and China (BRIC). He also discussed Asian leadership and addressed the question of what could go wrong with the economies.

It is agreed that the global debt crisis has evolved from a financial crisis to an economic crisis specifically involving employment or unemployment issues. According to the International Monetary Fund (IMF), many countries are facing a fragile recovery. It is thought that the downside risk of the crisis is underestimated, as reflected in incomplete regulatory reforms, renewed weakness in the US property market, implosion of a bipolar world, failure of weak economies, and the rise of a multipolar world.

The deteriorating fiscal balance of the advanced economies is of concern to economists and policy makers. In the US, the issue is centred on the increasing government debt ratio. One solution is the healthcare reform introduced by the Obama administration. Although this is a novel idea, it will not contain the cost, as other issues remain, such as the need for financial reform; the failure of five major US banks that dominate 40 per cent of deposits and 50 per cent of major assets illustrate this. Labour flexibility is constrained because of the inability to make mortgage payments due to loss of income. This is a major concern since labour mobility is the greatest asset in the US and thus constitutes a serious problem as the unemployment gap is widening; it may reach the level of six to seven per cent in the coming years.

It is reported that 125,000 jobs are needed a month to sustain employment and to ensure the employment ratio is back to the level of the year 2007. Other economic considerations include the need for the balancing of personal consumption and savings to the level before the crisis.

On the leadership front, Steinbock is of the opinion that President Obama is losing political capital rapidly, which leads to difficulty in implementing policies. Economic pundits such as Nouriel Roubini, Robert Schiller, and Moody Corporation share negative views on the US economy and forecast it to worsen in the years to come.

Commenting on the European countries, specifically Western Europe, Steinbock quoted European Commission President, Jose Manuel Barosso's three scenarios of economic recovery for Europe in 2020. They are:

(1) Strong recovery, where the economy is able to make a full return to the earlier growth path and raise its potential to go further;

(2) Sluggish recovery, where the economy will have suffered a permanent loss of wealth and subsequently, start growing again from this eroded basis; and

(3) The lost decade, where the economy will have suffered a permanent loss of wealth and potential for future growth.

Steinbock's view is that the recovery is at a stage between the 'lost decade' and 'sluggish recovery,' and it is substantiated by his observation of several countries such as Germany, the UK, France, as well as Portugal, Ireland, Italy, Greece, and Spain (PIIGS). He highlighted problems faced by some of these countries, such as their expectation that Germany should bail them out, when in reality, Germany's economic growth is influenced by the decline in international trade due to trading partners such as the US and China.

The US China policy needs re-assessment, and must be based on US needs instead of China's needs, since China's growth strategy is investment-driven

In the UK, the massive amount of government spending under David Cameron's administration is of major concern. Should measures to overcome this expenditure be taken incrementally, hastily, or through political motivation? While France is faced with the issue of increasing its retirement age, Italy is engaged in fiscal measures to overcome the crisis. For Spain, the issue is a record high rate of unemployment, at 20 per cent, while other PIIG countries are experiencing a deficit exceeding five per cent, loss of competitiveness, and the possibility that they would take years to regain stability in their economies.

The Euro crisis is another issue to reckon with. While there appears to be no easy option, some countries have considered abandoning the euro temporarily. Others such as Finland agreed on a growth and stability pact, while some countries face protests against austerity measures due to their policy decisions.

There are mixed signals regarding recovery from the global debt crisis. Some seem to think that the worst is over while others disagree based on the unattractive bond spreads. The stress test imposed by the US and Europe on the economy is thought to be not so stressful. Thus, it is unable to measure investors' reactions and the impact on long-term competitiveness.

East Asia is still playing catch-up with advanced economies, while Japan continues to suffer from slow growth due to factors such as a savings crisis, a declining population, the impact of the financial crisis, and declining exports due to China's expanding export market.

As for the advanced economies, Steinbock concluded that if they do not do anything, and behave as if it is business as usual, global debt will increase phenomenally, leading to the failure of market economies, the rise of the extreme right wing in Europe, structural unemployment, and failure in the structure of economies.

Steinbock discussed the recovery process of the BRIC economies, starting with China, whose growth target was not taken seriously but has materialized favourably. India's protest movements do not appear to have had an impact on growth. However, the challenge for India is to sustain its economic activities despite the increasing oil price.

Russia on the other hand was hit hard by the declining oil prices from its high of US$ 145 a barrel two years ago. President Putin is facing problems improving the investment climate, and