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**NEWSCLIPPINGS AND ARTICLES
ON
CURRENT ECONOMIC SITUATION**

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How today's global recession tracks the Great Depression



Martin Wolf

Green shoots are bursting out. Or so we are told. But before concluding that the recession will soon be over, we must ask what history tells us. It is among the guides we have to our present predicament. Fortunately, we do have the data. Unfortunately, the story they tell is an unhappy one.

Two economic historians, Barry Eichengreen of the University of California at Berkeley and Kevin O'Rourke of Trinity College, Dublin, have provided pictures worth more than a thousand words (see charts).^{*} In their paper, Profs Eichengreen and O'Rourke date the beginning of the current global recession to April 2008 and that of the Great Depression to June 1929. So what are their conclusions on where we are a little over a year into the recession? The bad news is that this recession fully matches the early part of the Great Depression. The good news is that the worst can still be averted.

First, global industrial output tracks the decline in industrial output during the Great Depression horrifyingly closely. Within Europe, the decline in the industrial output of France and Italy has been worse than at this point in the 1930s, while that of the UK and Germany is much the same. The declines in the US and Canada are also close to those in the 1930s. But Japan's industrial collapse has been far worse than in the 1930s, despite a very recent recovery.

Second, the collapse in the volume of world trade has been far worse than during the first year of the Great Depression. Indeed, the decline

in world trade in the first year is equal to that in the first two years of the Great Depression. This is not because of protection, but because of collapsing demand for manufactures.

Third, despite the recent bounce, the decline in world stock markets is far bigger than in the corresponding period of the Great Depression.

The two authors sum up starkly: "Globally we are tracking or doing even worse than the Great Depression... This is a Depression-sized event."

Yet what gave the Great Depression its name was a brutal decline over three years. This time the world is applying the lessons taken from that event by John Maynard Keynes and Milton Friedman, the two most influential economists of the 20th century. The policy response suggests that the disaster will not be repeated.

Profs Eichengreen and O'Rourke describe this contrast. During the Great Depression, the weighted average discount rate of the seven leading economies never fell below 3 per cent. Today it is close to zero. Even the European Central Bank, most hawkish of the big central banks, has lowered its rate to 1 per cent. Again, during the Great Depression, money supply collapsed. But this time it has continued to rise. Indeed, the combination of strong monetary growth with deep recession raises doubts about the monetarist explanation for the Great Depression. Finally, fiscal policy has been far more aggressive this time. In the early 1930s the weighted average deficit for 24 significant countries remained smaller than 4 per cent of gross domestic product. Today, fiscal deficits will be far higher. In the US, the general government deficit is expected to be almost 14 per cent of GDP.

All this is consistent with the conclusions of an already classic paper by Carmen Reinhart of the

university of Maryland and Kenneth Rogoff of Harvard.^{**} Financial crises cause deep economic crises. The impact of a global financial crisis should be particularly severe. Moreover, "the real value of government debt tends to explode, rising an average of 86 per cent in the major post-World War II episodes". The chief reason is not the "bail-outs" of banks but the recessions. After the fact, runaway private lending turns into public spending and mountains of debt. Creditworthy governments will not accept the alternative of a big slump.

The question is whether today's unprecedented stimulus will offset the effect of financial collapse and unprecedented accumulations of private sector debt in the US and

decade. Over the past two quarters, for example, US households repaid just 3.1 per cent of their debt. Deleveraging is a lengthy process. Meanwhile, the federal government has become the only significant borrower. Similarly, the Chinese government can swiftly expand investment. But it is harder for policy to raise levels of consumption.

The great likelihood is that the world economy will need aggressive monetary and fiscal policies far longer than many believe. That is going to make policy makers – and investors – nervous.

Two opposing dangers arise. One is that the stimulus is withdrawn too soon, as happened in the 1930s and in Japan in the late 1990s. There will then be a relapse into recession, because the private sector is still unable, or unwilling, to spend. The other danger is that stimulus is withdrawn too late. That would lead to a loss of confidence in monetary stability worsened by concerns over the sustainability of public debt, particularly in the US, the provider of the world's key currency. At the limit, soaring dollar prices of commodities and rising long-term interest rates on government bonds might put the US – and world economies – into a malign stagflation. Contrary to some alarmists, I see no signs of such a panic today. But it might happen.

Last year the world economy tipped over into a slump. The policy response has been massive. But those sure we are at the beginning of a robust private sector-led recovery are almost certainly deluded. The race to full recovery is likely to be long, hard and uncertain.

^{*} 'A Tale of Two Depressions', June 2009, www.voxeu.org ^{**} 'The Aftermath of Financial Crises', Working Paper 14656 www.nber.org

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elsewhere. If the former wins, we will soon see a positive deviation from the path of the Great Depression. If the latter wins, we will not. What everybody hopes is clear. But what should we expect?

We are seeing a race between the repair of private balance sheets and global rebalancing of demand, on the one hand, and the sustainability of stimulus, on the other.

Robust private sector demand will return only once the balance sheets of over-indebted households, overborrowed businesses and undercapitalised financial sectors are repaired or when countries with high savings rates consume or invest more. None of this is likely to be quick. Indeed, it is far more likely to take years, given the extraordinary debt accumulations of the past

Balancing U.S.-China economic ties

Kenneth Rogoff
Cambridge Mass.

As the global economy stabilizes, there is a growing danger that the United States and China will slip back into their precrisis economic patterns, placing themselves and the rest of the world at risk. Despite Chinese official rhetoric about the need for a new global currency to replace the dollar, and U.S. lawmakers' flirtation with "Buy American" clauses (which scares everyone, not just the Chinese), no one will want to rock a boat that has almost capsized. So China continues to run a giant trade surplus, and the U.S. continues to spend and borrow.

Short-run stability certainly seems attractive right now. But if the U.S.-China trade and debt relationship merely picks up where it left off, what will prevent recurrence of the same unsustainable dynamic that we just witnessed? After all, huge U.S. foreign borrowing was clearly a key factor in creating the recent financial mess, while China's excessive reliance on export-driven growth has made it extraordinarily vulnerable to a sudden drop in global demand.

A giant fiscal stimulus in both countries has helped prevent further damage temporarily, but where is the needed change? Wouldn't it be better to accept more adjustment now in the form of slower postcrisis growth than to set ourselves up for an even bigger crash?

True, both the U.S. administration and China's leadership have made some sensible proposals for change. But is their heart in it? U.S. Treasury Secretary Timothy Geithner has floated a far-reaching overhaul of the financial system, and China's leaders are starting to take steps toward improving the country's social safety net.

Both of these measures should help a lot in bringing the U.S. and Chinese trade balances toward more sustainable levels. Greater financial regulation in the U.S. means consumers will not be able to borrow so easily to rack up huge mortgage and credit card debt. Chinese consumers, on the hand, might actually start spending more of their income if they can worry a bit less about saving for health care, their children's education and their old-age retirement.

Nevertheless, there is cause for concern. As the world seems to emerge from its horrific financial crisis, it is human nature for complacency to set in, and the domestic politics of the U.S.-China trade and financial relationship is deeply rooted. One shudders to think what lessons the U.S. financial sector will draw if, after the multitrillion dollar bailout, there are only superficial, toothless reforms. And will China's coastal export interests again prevail in exchange-rate policy decisions, at the expense of poor inland consumers?

Another reason to worry is that the global recovery is still fragile. U.S. and Chinese leaders have fought the crisis with not only massive fiscal stimulus, but also deep intervention into credit markets. Such extraordinary fiscal largess, all at taxpayers' expense, cannot continue indefinitely.

World Bank President Robert Zoellick has rightly warned that all this massive temporary fiscal stimulus is a "sugar high" that will ultimately pass without deeper reforms. As I have argued before, the endgame to the financial bailouts and fiscal expansion will almost certainly mean higher interest rates, higher taxes, and, quite possibly, inflation.

For better or for worse, it might not be possible to turn back the clock. The U.S. consumer, whose gluttony helped fuel

growth throughout the world for more than a decade, seems finally set to go on a diet. In addition to tighter credit, falling home prices and high unemployment will continue to put a crimp on U.S. consumer spending.

Frankly, higher U.S. personal saving rates would not be a bad thing. It would almost certainly help reduce the risk of an early repeat of the financial crisis. The obvious candidates to replace them are Chinese and other Asian consumers, whose combined economies are more than equal to that of the U.S. But are Asian governments prepared to abandon their mercantilist paradigm? Outside Japan, Asia policymakers certainly don't seem amenable to exchange-rate appreciation.

Since the beginning of this decade, at least a few economists (including me) have warned that the global trade and current-account imbalances needed to be reined in to reduce the chance of a severe financial crisis. The U.S. and China are not solely responsible for these imbalances, but their relationship is certainly at the center of it.

Prior to the crisis, there was plenty of talk, including high-level meetings brokered by the International Monetary Fund, but only minimal action. Now, the risks have spilled out to the entire world. Let's hope that this time there is more than talk. If U.S. and Chinese policymakers instead surrender to the temptation of slipping back to the precrisis imbalances, the roots of the next crisis will grow like bamboo. And that would not be good news for the U.S. and China, or anyone else.

*Kenneth Rogoff is a professor of economics and public policy at Harvard University, and was formerly chief economist at the IMF.
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COUNTRY FOCUS

Iskandar Malaysia: Southeast Asian hub continues to draw investors

A diversified economy including education, leisure, finance, manufacturing and logistics

TOURISM | Theme parks

Legoland, a catalyst to drive Iskandar tourism

Tourism is central to Iskandar's future success, and last December it signed up Legoland to create a \$210 million theme park — the brand's first in Asia.

Arlida Ariff, managing director of Iskandar Malaysia's investment arm, Iskandar Investment Bhd. (IIB), calls the park a catalytic initiative. "It marks a milestone," she says. "Not only is it the first of our leisure and tourism activities, it's also introducing a new brand to this part of the world." She adds: "We need to establish our presence and have the market recognize

that Iskandar is a destination for tourism." Legoland already has parks in Denmark, the United Kingdom, the United States and Germany, which incorporate models of landmarks from around the world made of millions of lego bricks as well as roller-coasters and other attractions. The brand is owned by Merlin Entertainments, the world's second-largest visitor attraction operator, which also runs Madame Tussauds in London — only Disney is bigger.

Merlin Entertainments, with a 20 percent stake in the project, will design and operate

the theme park, while a consortium led by IIB will own the balance.

When completed in 2013, Legoland will feature more than 40 rides and other attractions, and will target families with children aged between two and 12 — a growing sector of the population in Southeast Asia. Legoland is expected to attract tourists from all over Asia as well as the Middle East.

Johan Jakobsen, managing director of Legoland Parks, says: "Legoland is a long-term project. It will be here for the next 50 to 100 years, so we're taking a long-term view."

He adds: "The Legoland Malaysia Park will build upon the success of our other internationally recognized Legoland Parks in Europe and North America. We love the location of Iskandar Malaysia. We have no doubt that once it opens, it will become the ultimate destination in the region for families with young children."

Merlin Entertainment's chief executive, Nick Varney, says that the Iskandar development underlines the company's confidence in the market despite the current global economic slowdown. "We believe that

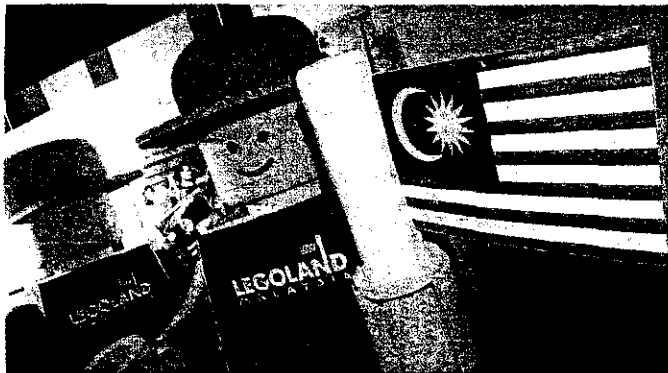
while quality branded attractions such as ours are not recession-proof, they are recession-resilient," he says. "Even when times are hard, people will still choose to get away from the gloom and have fun together with family and friends."

Azman Mokhtar, chief executive of Khazanah Nasional, the investment holding arm of the government of Malaysia, says: "Theme parks have a very clear and proven track record of attracting a large volume of new visitors as well as increasing the length of stay and increasing expenditure by visitors. This results in a strong multiplier for the local economy, creating opportunities for local businesses."

Legoland is the first of three major theme parks proposed for Iskandar. Other attractions relating to arts and culture, adventure and ecotourism, and golf-themed holidays, complemented with world-class entertainment, retail and restaurants, are also planned.

Sums up IIB's Ariff: "The idea is not to view tourism products in isolation, but to see Iskandar as an integrated tourism site to encourage longer stay and repeat visits." ■

'We love the location of Iskandar Malaysia. We have no doubt that once it opens, it will become the ultimate destination in the region for families with young children'



Introducing a new brand: Legoland is building its first park in Asia in Iskandar Malaysia.

COUNTRY FOCUS

Iskandar Malaysia: Southeast Asian hub continues to draw investors

A diversified economy including education, leisure, finance, manufacturing and logistics

FINANCE | Iskandar Financial District

Creating a center for Islamic finance

While the global financial system is in meltdown and some of the biggest names in world banking have collapsed, Islamic finance is making steady progress and has a bright future, says the ratings agency Standard & Poor's.

In its report "Islamic Finance Outlook 2009," it says that although the sector has suffered a knock-on effect from the global economic downturn, Islamic finance will resume the rapid growth it has enjoyed in the past 10 years. "Shariah-compliant assets now total about \$700 billion after growth exceeding 10 percent annually during the past decade," says Mohamed Damak, credit analyst at S&P. He adds: "When economies begin pulling out of the downturn, we expect Islamic finance to resume its rapid growth. The long-term pipeline for sukuk issuance is healthy, and the market is attracting interest from an increasing number of issuers in both Muslim and non-Muslim countries."

Malaysia has long been one of the world's leading centers for Islamic finance and has been active in the sector for more than three decades. Its strength lies in sukuk, or Islamic bonds. Malaysia issued the world's first sukuk in 1990 and in 2007 issued the largest ever, worth \$5 billion. Malaysia's takaful — or Islamic insurance — industry has also been gaining momentum and is increasingly recognized as a significant contributor to Malaysia's overall Islamic financial system.

Tan Sri Dr. Zeti Akhtar Aziz, governor of Bank Negara, Malaysia's central bank, says: "Unique to Malaysia is the development of the most comprehensive Islamic finance system in the world, which is also supported by a robust and rigorous legal, Shariah and regulatory framework. Malaysia is also at the forefront of innovation. The Islamic financial system in Malaysia is highly liberalized and open to participation by the rest of the world. It is becoming a meeting place for those who need to raise funds and those investors who have surplus funds."

Malaysia's standing as a world-class hub for Islamic finance will receive a further boost with the creation of the Iskandar Financial District, a center for financial institutions, banks and corporate headquarters, commercial office buildings, shopping centers, condominiums and serviced apart-

ments. It will also include five-star hotels as well as conferencing and meeting facilities. IFD, with an estimated development cost in excess of \$4.5 billion, was officially launched at Cityscape Dubai, the international real estate and development event, last October. It attracted the interest of local, regional and international investors as well as financial and development companies.

Investment in the project is spearheaded by Global Capital, an investment entity made up of prominent Middle Eastern and Malaysian investors, including Mubadala, Aldar, Malaysia Ventures (a subsidiary of Saraya Holdings), United World Infrastructure (UWI), Iskandar Investment Bhd. and Unity Capital.

As Islamic finance moves from being a niche market to an increasingly mainstream presence in the global banking system, conventional banks are increasingly setting up Islamic-compliant operations. Iskandar Financial District is expected to be particularly attractive to investors and to financial institutions because of its location between China and India, two economies still en-

joying rapid growth; its transportation links with Asia and the rest of the world; and its high-tech communications network.

IFD also looks set to benefit from the global financial situation. Banks — particularly non-Islamic ones, which have been hardest hit by the crisis — are having to cut costs, and Iskandar gives them an opportunity to move middle and back-office operations to a more cost-effective location.

But it is Iskandar's proximity to Singapore that should really enhance IFD and Malaysia's position as a hub for Islamic finance. As Richard Polkinghorne of Millennium Development International says: "It is a unique opportunity to have an Islamic financial center on the doorstep of Singapore, the fourth-biggest financial center in the world." ■

'It is a unique opportunity to have an Islamic financial center on the doorstep of Singapore, the fourth-biggest financial center in the world'

\$4.5 billion

is being invested in the Iskandar Financial District

COUNTRY FOCUS

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EDUCATION | Building for the future

EduCity poised to become Asia's knowledge hub

It's a long way from foggy Newcastle in northeast England to the sultry heat of Malaysia, but the Asian country is to become a second home for the University of Newcastle, which has chosen Iskandar Malaysia as the location for its first-ever overseas campus.

"Education is the new international currency," says Chris Brink, vice chancellor of Newcastle University, one of the United Kingdom's leading academic institutions. "Exporting higher education is a growing trend among Western institutions as more and more young people in developing countries seek the best possible education that will enable them to compete for the best jobs."

Education is crucial to Iskandar's plans to attract \$100 million in foreign investment by 2025. It aims to benefit from

the rising demand for international degrees with an educational hub called EduCity, which will host faculties from eight different international universities and attract students from the Association of Southeast Asian Nations region and around the globe. EduCity will specialize in a number of areas, including medicine, engineering, logistics, multimedia and business studies.

Newcastle University is the anchor tenant in EduCity and will open Newcastle University Medicine Malaysia (NUMed) in 2011. It will offer degrees in medicine and surgery recognized by the U.K. General Medical Council, but at about half the cost of the equivalent degree in the United Kingdom.

'Iskandar is an enormously impressive development'

NUMed will feature state-of-the-art facilities and will accommodate about 900 medical students, the first intake of which will enroll in September. Those who are selected will undertake the first two years of the bachelor of medicine and bachelor of surgery (MBBS) program at the Medical School in Newcastle, returning to Malaysia in 2011 to complete three to five years of clinical education.

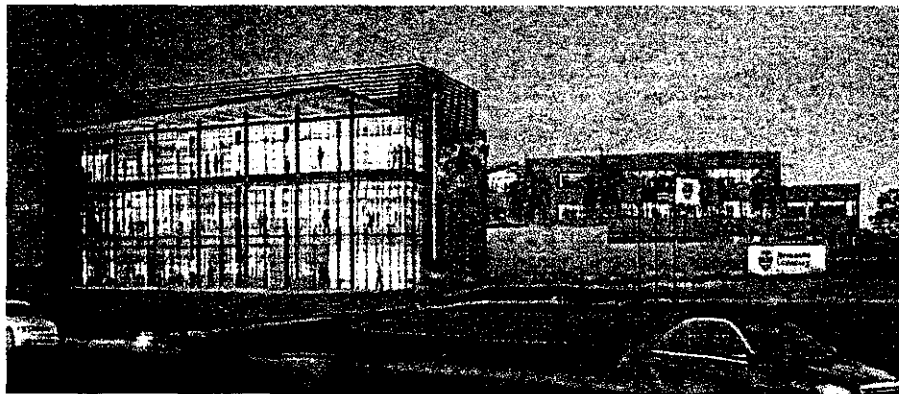
Says Brink: "Iskandar is an enormously impressive development, and it's a huge opportunity. Clearly, this is a growth area, and in a very farsighted manner the government of Malaysia is anchoring the development with an educational center — it's hugely attractive for us to be part of that, and it increases our international profile."

The United Kingdom's high commissioner to Malaysia, Boyd McCleary, says that other U.K. universities are also likely to set up campuses in Iskandar. He adds: "The people involved in running the Iskandar project recognized fairly early on that education was important — not just to get investment here, but as a core tenant — to demonstrate that Iskandar was for real."

The region has also entered into a collaborative agreement with two highly regarded institutions from the Netherlands — Maritime Institute Willem Barant and Maritime Institute de Ruyter — to explore the possibility of setting up a world-class Dutch Maritime Institute in EduCity.

Arlida Ariff, managing director of Iskandar Investment Bhd., says that the proposed institute would not only add to EduCity's reputation, but also provide much-needed expertise to Malaysia and other Asian countries' growing port and logistics industries.

Other international institutions look set to follow their example and export their brands to Iskandar to tap into growing demand in Asia for a Western education. ■



Newcastle University Medicine Malaysia (NUMed) will open in 2011.

ISKANDAR INVESTMENT BERHAD

COUNTRY FOCUS

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VIEWPOINT | Harun Johari, chief executive of Iskandar Regional Development Authority

Creating a sustainable vision for the future

Harun Johari became chief executive officer of the Iskandar Regional Development Authority in March. Before joining IRDA, he was chief executive of Iskandar's Port of Tanjung Pelepas, the fastest-growing port in the world. Johari has extensive international business experience and worked for Shell for 28 years, including a period as vice president of one of its global units, with stints in the United Kingdom and Australia.

What sort of investors are you seeking for Iskandar Malaysia?

With 80 percent of our investment target already in place, we are very selective, discerning and cautious about the type of investors we work with. We welcome genuine investors who prefer to take a longer-term perspective in line with our vision of developing a strong, sustainable metropolis of international standing. We are seeking bona fide business partners who take a 360-degree view and are in it for the medium and long term.

How is the global economic crisis affecting Iskandar?

These are certainly challenging times, but for the long-term investor, Iskandar offers interesting opportunities if they have the courage to seize them. It's easy to focus on the here and now and the problems that concern us all, and much of the attention of the business community is understandably focused on day-to-day issues. But companies and investors that have an eye on the future will be best placed for the inevitable upturn. We are focusing on a diverse range of industries and sectors that will make Iskandar stable and sustainable. Some of these sectors are "recession-proof," such as health and education. We have already brought in Newcastle University to set up its first overseas campus — NUSMed Malaysia — which is offering medical degrees, and others will follow. In terms of the health sector, Malaysia already attracts a growing number of patients from across Asia and the Middle East, and more state-of-the-art facilities will also allow us to strengthen our position in this competitive market.

What is the role of the Iskandar Regional Development Authority?

IRDA is the regulatory authority formed by an Act of Parliament and mandated to plan, promote and facilitate the development of Iskandar Malaysia into a strong and sustainable region where living, working, business and leisure converge seamlessly. One of our roles is to cut red tape to make life easier for investors.

How important is government support to Iskandar?

Iskandar Malaysia is a private-sector initiative that receives strong support from the federal and state government. Besides funding for the development of infrastructure such as roads, water and sewerage systems, the government has also provided



Says IRDA's Harun Johari: "We are focusing on a diverse range of industries and sectors."

some fiscal incentives to investors. In such a massive project as Iskandar, support from the civil service is also critical in facilitating approvals from various authorities.

What benefits and opportunities will Iskandar bring to local people?

Ultimately, Iskandar is about improving the quality of life for local people. It is projected that 800,000 new jobs will be created by 2025, and the unemployment rate is expected to fall from 3.4 percent to 1.8 percent. Part of our commitment to local people is the human-capital blueprint we are working on. Because Iskandar is a long-term project with a vision to create a sustainable metropolis, we have to have the right strategies in place to ensure a supply of talented workers. We are working on skills development so that our people have the right skills to fill the available jobs. We are focusing on a number of areas, including improving proficiency in English, ensuring that female graduates participate in the work force and benchmarking against best international practice to continuously improve our efforts.

How important is environmental, social and economic sustainability to your plans?

We are in the midst of finalizing blueprints and master plans to deal specifically with these issues. We have an environmental sustainability plan — looking at the conservation of sensitive mangroves, for example. We are looking to attract the health, education, creative and financial industries, and we know that they are very engaged with corporate social responsibilities. They have certain expectations about environ-

mental sustainability, and we will meet those expectations.

On the issue of social sustainability, we are very aware of our responsibilities to local workers and businesses. We are working to provide development opportunities for local businesses and to establish collaborative business ventures between investors and local contractors, service providers and vendors.

What is Singapore's involvement in Iskandar?

Singapore is only a short distance away and traditionally has been one of Iskandar's major investors, with the majority of investment coming from small and medium-sized enterprises. This trend has continued as the cost of doing business in Singapore gets higher. In the 15 months to March, 56 companies from Singapore based their operations here, with an average investment of 22.8 million Malaysian ringgit [\$6.52 million], making Singapore the third-biggest investor in Iskandar.

Malaysia and Singapore are also forging closer political ties. Our new prime minister, Datuk Seri Najib Abd Razak, and the prime minister of Singapore have made a firm commitment to collaborate on the development of Iskandar. It benefits both nations and symbolizes the strong relationship that we have. ■

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COUNTRY FOCUS

Iskandar Malaysia: Southeast Asian hub continues to draw investors

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MANUFACTURING | Investment opportunities

Iskandar beats India and China to land \$1.5 billion steel plant

One of the world's biggest stainless steel makers, the Spanish company Acerinox, is building a \$1.5 billion plant in Iskandar to compete in the growing Asian market. It is the biggest single foreign direct investment secured by Iskandar Malaysia to date and will help position the region as a premier destination for capital-intensive, high-technology industries. It will also make Malaysia one of the biggest steel producers in Asia.

The plant, a joint venture with Japan's Nisshin Steel, will have the capacity to produce one million tons of stainless steel a year to meet rising demand in the region. Acerinox's chief executive, Rafael Naranjo, says: "Consumption per capita in the Association of Southeast Asian Nations is relatively low, so the potential for growth is huge."

Acerinox already has plants in Spain, the United States and South Africa, but this is its first in Asia. "We've always looked at this area as an opportunity to invest," says Naranjo.

The company carried out an extensive search for a suitable site in Asia, and after conducting feasibility studies it rejected China and India in favor of Iskandar.

The new plant will be built on 140 hectares (345 acres) of land at Tanjung Langsat, near Johor's capital of Johor Bahru. It was selected because of its strategic location at the confluence of one of the world's busiest shipping lanes and its proximity to the other nine members of Asean as well as to Australia. Rafael Garvin Salazar, managing director of Bahru Stainless, the joint-venture company that will run the plant, explains that Iskandar "was picked to house

Acerinox's latest plant due to its geographic and strategic location, excellent infrastructure and political stability."

Iskandar Malaysia also has world-class port facilities. The Port of Tanjung Pelepas, at the southern tip of Johor, is the fastest-growing port in the world, according to research from the American Association of Port Authorities. It is naturally sheltered, has deep waters and is one of only a handful of ports in the world capable of handling the new generation of "mega" container ships.

Work began on the plant in March, and the \$320 million first phase will be completed next year. "After the first phase, the company will embark on an expansion program," says Salazar. "When fully completed in 2020, the plant will have the capacity to produce one million tons of stainless steel per annum."

About 20 percent of the plant's products will be sold in Malaysia and most of the remainder in India, Indonesia, Thailand, the Philippines and Vietnam.

Acerinox owns 67 percent of the plant and Nisshin Steel owns 30 percent, while the remaining 3 percent is held by Metal One Corp. of Japan. In a statement, Acerinox says: "This decision represents a very important strategic step in the Acerinox Group's development, improving our assets distribution, which is already unique in the sector. During the construction and assembly stage, many local workers and local companies will be employed, and when the plant is onstream it will create about 300 direct jobs in the first stage."

The plant when fully complete will provide 1,600 jobs and generate spinoff activities for the local economy. ■

LOGISTICS | Port of Tanjung Pelepas

Malaysia's top port strategically located for global trade

Just over a decade ago, the Port of Tanjung Pelepas (PTP) didn't exist; now it is one of the world's fastest-growing container ports.

PTP's success over the past 10 years is due to the increased container traffic between Europe and Asia and its location at the confluence of some of the world's busiest shipping lanes in the Strait of Malacca. Naturally sheltered and with deep waters, PTP is able to take even the biggest ships and, centered in the busy Southeast Asian markets, it is an excellent logistics and distribution center for both regional and global markets.

Malaysia has invested over \$1 billion in developing PTP Free Zone and associated infrastructure such as roads, railroads, airports and state-of-the-art cargo-handling facilities. It is now among the top 20 largest container ports in the world.

While many ports in Asia are struggling to formulate a strategy that will steer them out of the global economic crisis that has significantly slowed down ocean trade, PTP is still attracting business, thanks to its world-

class service, its efficiency and its cost-effectiveness.

PTP has recently signed a major agreement with the French shipping group CMA CGM to provide container terminal services and to handle some of its regional transshipment cargo. PTP's chairman, Datuk Mohd Sidik Shaik Osman, says: "We have sufficient terminal capacity and equipment to handle CMA vessels here at PTP, now and in the future. With our current terminal handling capacity of eight million TEUs and our plan to increase this to 12 million TEUs within the

next five years, we can accommodate not only the new volumes of CMA, but also that of other shipping lines."

The global economic downturn has a silver lining — it has created an opportunity for PTP to attract container lines looking at improving their efficiency, says PTP's chief executive, Captain Ismail Hashim. "The streamlined port services available at PTP directly benefits the customers," he adds, "as it translates into cost savings for them — for example, when their ships get turned around faster when calling at PTP."

**'Ships
get turned
around faster
when calling
at PTP'**



Maersk has switched its operations from the Port of Singapore to the Port of Tanjung Pelepas.

With two new berths in production and plans in place to expand still further, PTP is continuing to grow. Its role as a logistics hub is complemented by the significant expansion of nearby Senai International Airport.

Hashim says: "We are still confident that the PTP Free Zone holds a lot of benefits and advantages for local and foreign invest-

ment. However, during hard times like these, we have to put in more effort and dedication to go the extra mile in order to capture the opportunities, so we are also putting in a significant amount of effort to attract international freight forwarders who are involved in supply-chain management and total logistics as well as contract logistics." ■

COUNTRY FOCUS

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OVERVIEW | Special economic zone

A choice destination for business and lifestyle

As the global economic crisis deepens, one major development — Iskandar Malaysia — is weathering the storm and still attracting high levels of investment from around the world. Launched in 2006, this special economic zone on the southern tip of Malaysia in the state of Johor expects to attract \$100 billion in foreign direct investment by 2025 and to create 800,000 jobs. It is fast becoming the destination of choice for global business, trade and investment, as well as a place in which Malaysians and foreigners can live, work and play.

Iskandar Malaysia covers 856 square miles (2,217 square kilometers) and is three times the size of Singapore, just a few minutes' drive away across the causeway. It is strategically located along one of the world's busiest shipping lanes and home to the Port of Tanjung Pelepas. Served by a number of airports, it reaps the benefits of its strategic position both within the Association of South East Asian Nations and between the growing markets of India and China, offering access to a potential market of 2.5 billion people.

A number of international companies have already committed to Iskandar, including General Electric and the leisure operator Legoland, which plans to open a \$210 million theme park by 2013. The theme park development will be located in Nusajaya, close to the bridge with Singapore, and is expected to attract tourists from all over Asia. It will be developed and operated by Blackstone Group of New York under its Merlin Entertainments brand. John Jakobsen, managing director of Legoland Parks, says: "Our choice of Iskandar is based on a number of things. This region is doing really well and will become a magnet for tourism."

Arlida Ariff, managing director of Iskandar Malaysia's investment arm, Iskandar Investment Bhd. (IIB), calls Legoland's commitment "a strategic initiative that will give Iskandar buzz and bring in additional value to the surrounding businesses and investments coming into the region."

Some \$12.7 billion of committed investment has rolled in during the past two years — just over 90 percent of Iskandar's five-year target, achieved well ahead of time.

Harun Johari, chief executive of the Iskandar Regional Development Authority, says: "We have already been successful in mobilizing \$500 million out of the \$1 billion targeted for this year. Despite the world being in the grip of a financial downturn, investment has continued to flood in and targets have been achieved in less than half the allotted time. We are confident we will be able to sustain momentum."

The biggest single investment to date is \$1.5 billion from the Spanish stainless-steel company Acerinox, in a joint venture with Japan's Nisshin Steel. Together they are building a plant in Iskandar that will make Malaysia one of the biggest steel producers in Asia. Says Johari: "Acerinox's decision to site its operations here serves as a strong signal to the market that Iskandar Malaysia offers very strong and convincing

'Iskandar is focusing on bringing in investors from a wide range of industries and sectors'

value propositions that fulfill the requirements of big multinationals."

The region has also attracted \$1.2 billion in investment from a consortium comprising the Dubai-based real estate company Millennium Development International Company; Abu Dhabi's sovereign wealth fund, Mubadala; Akdar Properties from Abu Dhabi; and Kuwait Finance House. Their investment is expected to reach \$20 billion in the next few years as they build a flagship development called Medini. To include residential, commercial, entertainment and financial centers.

Khalid bin Khalifa Al Mubarak, chief executive of Mubadala Development, says: "You'll see first-class developments across the board, from the real estate component to the financial component to recreation and wellness. Each of these has a clear business case."

The Malaysian government has also made substantial commitments to Iskandar, investing \$2 billion in infrastructure, including a new six-lane coastal highway. The telecommunications company Telekom Malaysia is installing high-speed broadband services and data centers.

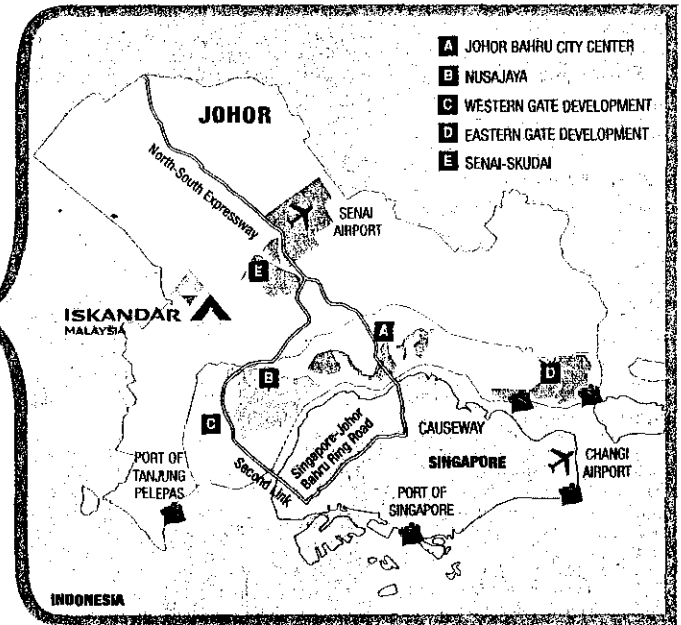
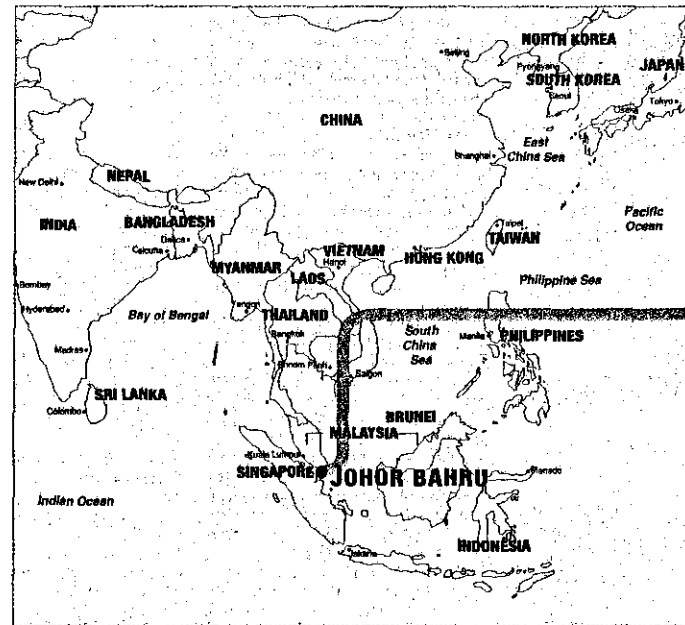
Malaysia is also a good environment in which to do business, according to Forbes magazine's annual "Best Countries for Business" report. This year, Malaysia moved 13 places up the rankings, from 38th place to 25th, and Forbes

says the country has transformed itself from a producer of raw materials into an emerging multisector economy.

Its strong investment in infrastructure, political stability, ease of doing business, closer relationships with its neighbor Singapore, and safe and secure environment for businesses and residents make the region a sound investment, says IIB's Ariff. "Iskandar is a low-risk investment," she says. "Start-up costs are probably the lowest in Asia. The cost of land is fairly low, and the cost of living is also low. Generally, for someone who is used to the high living expenses of Singapore, Hong Kong or Dubai, it is a very cost-effective location. And in these times, when investors are risk-averse, Iskandar is an attractive proposition."

The global economic downturn even offers some advantages. Construction costs have gone down by around 20 percent, and the highest-quality contractors, who may have been too busy to take on more work in the past, are now competing for business. More construction staff are available, so implementation moves more quickly.

Iskandar is focusing on bringing in investors from a wide range of industries and sectors to make the region a sustainable long-term prospect. "Iskandar for Malaysia is only two and half years old," says Johari. "This isn't a property play. The real story here is one of nation-building. It's about a wide range of businesses and different sectors, including education, health, logistics, manufacturing. It's about sustainability, job creation and quality of life." ■



Iskandar Malaysia facts and figures

- Iskandar is a special economic zone at the southernmost tip of Malaysia in the state of Johor. It covers 856 square miles (2,217 square kilometers) and is approximately three times the size of neighboring Singapore.
- It offers good land, sea and air transport facilities, and is strategically situated along one of the world's busiest shipping lanes.
- Iskandar expects to attract \$100 billion in foreign direct investment by 2025 and to create 800,000 jobs. To date, it has attracted \$12.7 billion in FDI over the past two years, just over 90 percent of its five-year target achieved well ahead of time.
- It is targeting selected industry sectors, including creative industries; education, financial advisory and consulting services; health-care services; logistics services; electronics; food and agro-processing; oleochemicals and petrochemicals; and tourism.
- Iskandar has already attracted a number of multinationals, including Acerinox, one of the world's biggest steel companies; General Electric; Maersk; and Legoland.
- Generous and flexible incentive and support packages are available to foreign investors, including corporate tax exemption for 10 years.

What is needed for a lasting recovery

Olivier Blanchard

In 2007, worried about the growing size of current account imbalances, the International Monetary Fund organised multilateral consultations to see what should be done about it. There was wide agreement that the solution was conceptually straightforward. To caricature: get US consumers to spend less. Get Chinese consumers to spend more. This would be good for the US, good for China, and good for the world. (There were messages to the other players – Japan, Europe, Saudi Arabia – but they were less important.)

Good for the US: it was clear even then that the consumption binge US consumers had embarked on was unwise, and that many of them would face problems in retirement. Good for China: it was clear that much Chinese saving reflected the absence of a social safety net. Providing health and retirement insurance was desirable on its own, and would naturally lead consumers to spend more.

Good for the world: combined with an appreciation of the renminbi relative to the dollar, the changes in consumption patterns could maintain full employment in both the US and China, and decrease current account imbalances. Lower consumption in the US would be offset by higher US net exports. Higher consumption in China would be offset by lower Chinese net exports. The US current account deficit would be reduced, and the Chinese current account surplus

would fall. As this orderly process of adjustment took place, and imbalances were steadily reduced, the risk of a sudden collapse of the dollar would decrease. And the world would be in much better shape.

It was an impressive piece of global macroeconomic planning. But, at least until the crisis, not much happened. Optimistic US consumers were just not in the mood to change their ways. Given the success of its export-led growth strategy and concerns about the need to maintain employment growth, the Chinese government continued to give priority to exports.

As if to prove the sceptics right, the crisis itself was not triggered by global imbalances. The dollar did not collapse, as feared. And, since the beginning of the crisis, dealing with global imbalances has gone down the priority list. Dealing with the state of the financial system has been, rightly, the focus of attention.

As the crisis evolves, however, and we start looking at eventual recovery, the issue of global imbalances is likely to return to the fore. Again, a central role will have to be played by the US and by China.

Half of the adjustment suggested in the multilateral consultations is coming into play: US consumers are, at last, cutting their spending. They have lost a lot of wealth, and it will take them many years of additional saving to undo that loss. And, more importantly, they have learnt a more general lesson. The world is more risky than they thought. Stock and housing prices can go down, and go down a lot. Planning for retirement

may require saving a lot more than was thought wise before the crisis hit.

The main unknown is about the other half of the adjustment. In response to the crisis, China has embarked on a major fiscal expansion, with a focus on investment rather than on consumption. This was the right policy given the need to increase spending quickly, but this increase in investment can only last for a while. The question is whether, as time passes, China will allow an increase in consumption. If it does, the 2007 master plan may come into being.

The world is more risky than US consumers thought. Stock and housing prices can go down, and go down a lot

Larger US net exports will replace US consumption and help sustain the US recovery. Larger Chinese consumption will compensate for lower Chinese exports and allow China to maintain high growth. The world recovery can proceed and we can emerge with a more balanced world economy.

Will this scenario naturally play out? Maybe, maybe not. China has announced ambitious healthcare reform, which goes in the right direction. But the export-led model that China has so successfully followed will not be abandoned overnight. And, looking beyond China, the crisis may have convinced many countries to

accumulate even more reserves, thus running even larger current account surpluses. These countries will not be eager to appreciate against the dollar and so allow for larger US net export.

What if there is no rebalancing? Without sustained domestic demand and higher net exports, the US recovery may weaken once the fiscal stimulus is phased out. In normal time monetary policy could help, by lowering interest rates and increasing demand; these are not normal times and rates can fall no further. Thus there will be heavy pressure on the US government to maintain a strong fiscal stimulus for as long as private demand is weak, and this may lead to larger and longer deficits than would be wise. While strong fiscal stimulus was and still is needed to fight the crisis, it cannot go on forever; at some stage, debt dynamics become unsustainable, markets react and fiscal deficits become counterproductive. Neither a weak US recovery nor unsustainable US debt dynamics are likely to be good for the world. The first probably means a stalled world recovery; the second probably means major problems in financial markets.

Sustained recovery requires decreased domestic US spending and increased domestic spending in China and much of the rest of the world together with adjustments in exchange rates. Global co-operation played a crucial role in the past year in avoiding a worse crisis. More global co-operation, with the US and China playing a leading role, is now needed.

The writer is chief economist of the IMF.

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The Upside to Japan's Recession

By Jesper Koll

The media is full of bad news from Japan, the worst-performing economy in the developed world during this recession. But there is upside to Japan's weakness. The downturn has given corporations an excuse to restructure and prepare for the eventual upturn—and both macro- and micro-economic forces are aligning to help boost this recovery.

On the macroeconomic front, Japan's terms of trade are improving. Corporate input costs are now falling almost four times faster than output prices, creating a strong base for companies' profit margins to expand. Construction companies are benefitting from lower cement prices; car compa-

nies are cheering over plunging steel prices; local retailers are snapping up prime location real estate at bargain basement prices; and a new generation of young entrepreneurs are happy to move into downtown offices as rents have come down. Japan is a net importer of basically all its energy and commodities, so the recent global deflation cycle has worked to boost competitiveness.

On the microeconomic side, corporate Japan has engaged in extraordinary restructuring efforts. In sharp contrast to the 1990s, corporate managers have been ruthless in cutting labor costs. Both full-time and part-time workers have been slashed at unprecedented rates. Summer bonuses—which typically compose around 15-20% of annual employment costs—have been slashed by 22%. The expensive baby boom generation is now moving off payroll and into retirement. The net effect of all this is a likely drop in total employment costs of as much as 10% this year. That's significant given that labor accounts for about 60-70% of most companies' costs.

Japanese companies are also pushing through fundamental restructuring of their supply chains and merchandizing channels. Toyota, Japan's largest car manufacturer, sourced steel from a Korean manufacturer for the first time in history. Sony plans to cut half of its suppliers. And major department stores are radically reducing suppliers and vendors. A meaner and leaner Japan Inc. is starting to emerge.

Critics allege the pending upcycle may be similar to the one Japan experienced in the 1990s. But the 1990s recession was domestic, while the present economic shock is external. It is harder for Japanese companies to recover from domestically generated problems because a domestic manager must shoulder the blame. In contrast, an external shock cannot be helped or controlled, and any downsizing response is thus impersonal. A global downturn is not a failure of management but a victimization by circumstance. This makes real restructuring possible in a culture that normally eschews losing face.

Companies are restructuring and preparing for a recovery.

Corporate Japan is also buoyed by smart policy making in Tokyo. The Taro Aso government has engaged in robust public spending—some 8% of last year's GDP. Much of this money has gone to small- and medium-size business loan guarantees. Tokyo's fiscal policy has also helped kick-start a new housing and construction boom. Unlike other developed countries, Japan avoided the real estate and housing bubble that crashed the U.S. economy. Unsold inventories are close to historic lows, and Japan is set to emerge first from the global housing slump. When this happens, discretionary consumer spending should increase, further boosting the recovery.

There is one significant downside to the current round of restructuring and windfalls from the better global terms of

trade. Japanese companies exposed to competitive foreign markets are the ones that will benefit most from a recovery, while Japanese companies focused on the domestic economy are trapped in a quagmire of ever growing rules and regulations. Unless policies are passed that unleash Japan's animal spirits back home, the country's export dependence will only increase.

This isn't an intractable problem. There are plenty of sectors that could expand rapidly in Japan, including those that tap into baby boomers' consumption as that generation retires. But as long as public policy is focused on restraining entrepreneurship, particularly the service sector, Japan will be doomed to remain nothing but a free-rider on the global business cycle.

In this respect, this year's parliamentary elections, which must be held before September 10, will be key to the strength and sustainability of Japan's future economic growth. Neither the ruling Liberal Democratic Party nor the opposition Democratic Party of Japan are perceived as pro-economic growth. Japanese businesspeople must work to change their minds before the next recession hits.

Mr. Koll is president of TRJ KK, a Tokyo-based investment research firm.

Business

TRADE WITH CHINA BOT considers swap pact

Published on June 20, 2009

The Bank of Thailand is conducting a study into the possibility of a swap agreement with China aimed at diversifying the currency risk of exporters and importers, its governor said yesterday.

If a currency-swap agreement is signed, Thailand will be able to use yuan or baht to settle some of its trade with China, rather than just the US dollar.

Argentina, Indonesia, Belarus, South Korea, Malaysia and Hong Kong have already signed currency-swap agreements with China. The size of the agreements, however, is small when compared with total trading volume, and there have been no transactions as yet.

Such agreements allow exporters and importers to settle trade deals in their respective local currencies instead of in the greenback.

Governor Tarisa Watanagase said the central bank was studying the size of the Kingdom's trading volume with China, as well as the size of credit lines.

The study will be finalised after discussions with the private sector about the need for such an arrangement, and the swap agreement would have to be approved by Parliament in accordance with the Constitution, she said.

"It will not make any progress if the private sector wants to [continue to] pay for trades in dollar terms," she added.

Tarisa said currency diversification would be beneficial to the Kingdom. Moreover, no disadvantages can be seen in having such payment flexibility.

The governor said that while trading in yuan was likely to escalate, it would not replace the US dollar and become an international currency in the short or medium term.

"It could be an international currency in the long term. The dollar will continue to be used more widely, deeply and with greater acceptance," she said.

Meanwhile, Tarisa said, the central bank plans to create risk-management tools to help exporters and importers cope with currency volatility.

For example, exporters could use purchase orders and insurance from the Export-Import Bank of Thailand when seeking loans from commercial banks.

Tarisa insisted that the central bank would continue to reduce the volatility of the baht and keep it in line with other regional currencies in order to maintain the Kingdom's competitive edge.

It yesterday discussed the currency issue as well as liquidity with the Federation of Thai Industries (FTI), the Thai Chamber of Commerce, the Association of Thai Travel Agents and the Thai Gold Card Importer and Exporter Association.

FTI chairman Santi Vilassakdanont said the private sector had asked the central bank to keep the baht in line with competitors' currencies. It has recently been 1 per cent stronger than other regional currencies.

Pongsak Assakul, vice chairman of the Thai Chamber of Commerce, said the Kingdom had lost 1.4-3.6 per cent of its competitiveness since the end of last year, when considering the nominal effective exchange rate and the real effective exchange rate.

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Malaysia looks to invest in China

BY DENIS MCMAHON

SHANGHAI—Malaysia's central bank could be poised to include yuan-denominated assets in its foreign-exchange reserves in what would be a symbolic step forward in Beijing's ambitions to promote the yuan as an alternative reserve currency.

The possibility arises as hand-wringing by governments around the world over the declining value of the U.S. dollar, which dominates reserve holdings, has sparked debate over other options for states to safely store their savings.

China's economy and currency—having fared better than most during the global financial crisis—are now stirring interest as such a safe haven. But strict Chinese capital controls have limited the scope for foreign governments to invest in China's financial products.

The China Securities Regulatory Commission said June 12 it had approved Bank Negara Malaysia as a qualified foreign institutional investor, or QFII. That status allows the Malaysian central bank to invest in China's exchange-traded equities and debt, including Ministry of Finance bonds. The CSRC, in line with its usual practice, didn't say how large an investment quota was allocated.

Bank Negara Malaysia's quota likely isn't big enough to mark a significant departure in the way it invests its reserves.

At the end of 2007, the last time the CSRC published quotas, the average size was between \$100 million and \$200 million. UBS AG had the big-

gest quota with \$800 million. That is a tiny percentage of the \$88.3 billion in international reserves Malaysia held at the end of May.

Bank Negara Malaysia declined to comment on how it intends to use its QFII quota, or how it allocates its reserves.

Technically, Malaysia's isn't the first central bank to receive a QFII quota; Norges Bank gained approval in October 2006. However, the Norwegian central bank's operations in China are run by Norge Bank Investment Management, its sovereign-wealth-fund unit, which invests much as any fund-management company does.

Strict Chinese controls have limited the scope for foreign investment.

In contrast, economists say, Bank Negara Malaysia conforms to the archetype of a central bank, limiting its reserve investments to highly liquid, low-risk assets such as U.S. Treasuries and European Union government bonds. It would be, potentially, the first central bank to buy Chinese government debt as a secure reserve.

The QFII investment approval came as the two countries' central banks were stepping up cooperation, and discussing how to conduct trade and investment in their own

currencies rather than the U.S. dollar. In February, China and Malaysia signed a currency-swap agreement, which when fully set up will increase the availability of yuan in Malaysia and ringgit in China.

Zeti Akhtar Aziz, Malaysia's central-bank governor, said the swap agreement would facilitate trade and investment between the two countries.

Her trip to China coincided with the QFII approval.

"The swap means that in any case Bank Negara Malaysia will be holding yuan in its reserves. That could mean cash, but it could also mean other very liquid assets," said Kit Wei Zheng, economist for Malaysia and Singapore at Citigroup.

There are limits to the appeal of investing reserve assets under a QFII quota.

"The yuan bond market is certainly not a liquid instrument, so you can't start maxing out your reserve holdings in yuan because it simply doesn't meet your primary concern as a central bank," said Stephen Green, an economist for Standard Chartered in Shanghai.

Also, Malaysia's central bank may have to wait before it is in a position to start investing in yuan-denominated assets. Given the yuan isn't freely convertible under the capital account, investors that receive a QFII quota must then get approval from China's currency regulator to buy yuan.

—K.P. Lee in Kuala Lumpur, Joy C. Shaw in Shanghai and Andrew Batson in Beijing contributed to this article.

A Recipe for Reviving Doha

By Catherine Ashton
And Simon Crean

With this week's meeting of the trade ministers of the Organization for Economic Cooperation and Development, and next month's G-8 summit, skeptics are already saying we are jumping back on the WTO "merry-go-round" for another futile run at a world trade deal. Some point to what they see as irreconcilable differences on the substance of the negotiations, saying that if a deal were in the offing it would have been achieved by now. The elements of the package already agreed offer everyone substantial gains. To re-ignite the Doha round, we need to give an idea of what a final deal might look like, and create a shared, solid perception by all WTO members that this is not an open-ended process.

To do so, we need to begin discussions on a wider range of key areas that will be part of the final deal we are looking for, called the "Single Undertaking." So far we have concentrated on two important elements: agriculture and industrial goods. The negotiations for these two elements are far ahead of other areas, and we should not re-open what has been achieved here. We need to build on that progress and tackle other issues such as trade rules or services, the fastest growing sector of world trade. Without progress in these areas it is difficult for each country to see the final package they would be signing up to.

Where special arrangements have been made to shield certain sectors from full tariff liberalization, we now need clarity from all—including developing countries—on what sectors they will protect. Not to go back on what has been agreed, but so that each WTO member can objectively weigh up what is on offer.

We also need to test what industrial sectors might be ripe for greater liberalization in so-called "sectoral" agreements, which would lead to deeper cuts in some areas as part of the broader talks. It is true that it was agreed a few years ago that these deals would only be for those who want to participate. We also cannot deny that negotiations in this area will be difficult, but sectorals will greatly improve the quality of the final Doha package. Exploratory talks of this kind should be in good faith with all of the largest economies—developed and developing—participating. If we are not able to explore now what a package acceptable for all needs to look like, including on sectorals, we will certainly fail.

Completing a Doha deal would immediately give a serious confidence boost to the world economy. A successful deal will also show that the WTO is not the creation of the big powers that have influenced the system over the past 50 years. Instead there will be a new rule book, the joint vision of the 153 members who run the WTO today. If we fail however, the multilateral system would take a serious hit beyond trade policy, bringing into question our ability to solve other global problems like climate change.

We have a new administration in place in Washington, and a strong returning government in New Delhi. Critically, these two key players have shown that they are ready to return to the negotiating table. Negotiators can take us part of the way, but real political will is needed. We should aim to make sufficient progress this year to reach final agreement on a full Doha package in 2010.

Ms. Ashton is European commissioner for trade and Mr. Crean is Australian minister for trade.

China will not save the world economy

But the Asian giant has a golden chance to restructure

Both too much and too little are expected of China's response to the economic crisis: too much, because the Asian giant can play only a modest role in rescuing the world economy; too little, because few believe the economy will be radically changed. The stimulus programme is helpful, for China and the world. But the real challenge is structural transformation.

As the World Bank's June quarterly update shows, China's response to the crisis has been a success. It forecasts economic growth at 7.2 per cent in 2009. This is a long way down from the 11.9 per cent in 2007. But it would be viewed as a triumph anywhere else. For such an open economy to cope with a fall in the rate of real export growth from 20 per cent in 2007 to 8 per cent last year and a forecast of minus 10 per cent this year is remarkable.

Nevertheless, the impact of China's stimulus on the rest of the world will be modest: the country generates only 7 per cent of global output, at market prices; moreover, the bank also forecasts a decline of 5 per cent in real imports this year. The net stimulus China will give to the rest of the world will only be around 0.1 per cent of global output in 2009.

Certainly, China needs to sustain demand. It can also afford to

do so: the fiscal deficit is forecast at a mere 5 per cent of GDP in 2009 and the risk of an upsurge in inflation is quite small.

Yet there is a danger. It is that what is needed in the short term makes required longer-term reform more difficult. As the World Bank notes, this stimulus is dependent on "government-influenced spending". That can only be a stop-gap. Both the opportunity created by the crisis and the time given by the stimulus must be used to shift the pattern of growth, instead.

The rapid past expansion of gross and net exports is not going to return. China must move, instead, towards an economy led by private rather than public demand, towards consumption rather than investment, towards labour-intensive services rather than capital-intensive industry and towards reliance on domestic rather than foreign markets.

These shifts demand a number of linked reforms: opening more sectors to private competition; raising interest rates paid by privileged borrowers and to hard-pressed savers; forcing state-owned enterprises to pay dividends and using the proceeds to support public services; and introducing a decent social safety net.

For China, this crisis is a golden opportunity. It must be seized.

Opinion

EDITORIAL**Time to join China as it challenges the dollar**

Published on June 22, 2009

As Thailand ponders a currency swap, seven trading giants have signed yuan agreements

Tarisa Watanagase, the governor of the Bank of Thailand, said last week the central bank was conducting a study into the possibility of creating an international currency swap agreement with China. This would be aimed at diversifying the currency risk of exporters and importers as well as the Bank of Thailand's international reserves. Tarisa did not specify as to when the study was going to be completed. But she pointed out that if the international currency swap agreement with China were to be signed, Thailand would be able to use the yuan or the baht, instead of relying on the US dollar alone, to settle some of its trade with China.

Since December, China has signed currency swap agreements with seven of its trading partners including Argentina, Belarus, Brazil, Hong Kong, Indonesia, Malaysia and South Korea. The swap agreements would enable these countries to pay for Chinese exports in yuan rather than dollars. At the same time, Chinese firms would pay the goods exported from these trading partners with their respective currencies. The sizes of the bilateral swap agreements between China and its key trading partners are huge. Argentina entered into a bilateral 70 billion yuan (US\$10.2 billion) currency-swap agreement that enabled Argentina to place orders for Chinese imports in yuan and not dollars. This followed a 100 billion yuan (\$14.6 billion) currency-swap agreement with Indonesia and a 20 billion yuan (\$2.9 billion) agreement with Belarus. Most recently, they closed an agreement with Brazil.

The trend is clear. China is taking its own step to challenge the predominance of the US dollar. As the US is dealing with its insolvent financial system and has been printing money to prop up its economy, confidence in the US dollar is waning. China, which now holds about \$2 trillion in US dollar assets, has diversified away from the US dollar assets. A weakening dollar would hurt Chinese wealth, built up over 30 years of economic liberalisation and growth. Hence, the bilateral currency-swap agreements are seen as an option right now to reduce the currency risks.

Although Thailand has established a sound relationship with China, it is inconvenient that it has moved slowly in financial cooperation, compared with other neighbouring countries, which have already entered into currency-swap agreements with China. Tarisa said the

central bank was studying the size of the Kingdom's trading volume with China, as well as the size of credit lines, in order to come up with an appropriate currency-swap agreement. The study would be finalised after discussions with the private sector about the need for such an arrangement, and the swap agreement would have to be approved by Parliament in accordance with the Constitution.

Thai exporters and importers still quote their goods in the US dollar. It will take a while before they see the advantages of diversifying their currency risks. Tarisa also agreed that currency diversification would be beneficial to the Kingdom, while there appear to be no disadvantages in having such payment flexibility with China.

In spite of the growing trading volume in the yuan, the Chinese currency is not likely to replace the US dollar in the near term. But China is preparing steps to emerge as a global economic power. To assume this role, its currency would also have to be widely used and broadly accepted. Still, the yuan is not yet fully convertible. This means that China's currency can't be exchanged on foreign exchange markets for other currencies because the Chinese government has deemed it nonconvertible. Unlike the dollar, yen, or euro, this limits the yuan's use in international trade transactions. So China has opted, in the near-term, to enter into these bilateral currency-swap agreements. China prefers to do things step by step. All this activity, however, has been seen as China's eventual move to make its currency fully convertible and to challenge the US dollar as the world's reserve currency.

A currency swap between countries is basically a foreign exchange agreement where one currency is traded for another for a negotiated period of time. In essence, the swap is like a loan where one country gives its currency to another in return for an equal amount of the other country's currency at a later date.

As China has diversified its foreign reserves risks, it is not clear how the Bank of Thailand has adjusted its reserves management.

A bilateral currency-swap agreement with China is one good step to take. The Thai central bank now holds more than \$120 billion in foreign exchange reserves, mostly in US dollar assets. China has moved frantically to convert its holdings of US dollar assets from long-term US treasuries to more short-term US treasuries. Moreover, one report indicated that it has used the US treasury holdings as collateral for loans to acquire hard assets such as oil, copper, soybean, gold or others which are strategic to China's long-term growth. Perhaps, the Thai central bank should start to look in this direction, as shown by the Chinese, to manage its foreign exchange reserves.

Asian growth picks up, but risks abound

BY ARRAN SCOTT

SINGAPORE—Asia is pulling out of a deep slump as a pickup in China's growth and hefty government spending measures and interest-rate cuts around the region kick in. But recovery faces stiff headwinds and big risks.

A sharp rebound in industrial production since March has driven cyclical upturns in many Asian-Pacific economies, reversing much of the cutbacks manufacturers made during the global economic crisis.

But the region's recovery is precarious. Key export markets remain weak and there is no guarantee China can continue to take up the slack. Moreover, if the world avoids a major relapse, rising prices could put policy makers in a bind, forcing them to choose between choking off growth or risk a surge in inflation.

"The recovery will be neither quick nor strong," said Nikhilesh Bhattacharyya at Moody's Economy.com. Like many other economists, Mr. Bhattacharyya says it will be late next year before the region is growing again at its full potential.

With companies still cutting investment and payrolls, domestic demand remains under pressure in most of the region. The U.S. and Europe—once dependable markets for Asia's cars, TVs, precision machinery and other products—continue to stagnate, hurting Asian exporters.

Public debt has soared on bor-

row-and-spend policies aimed at reviving growth, limiting the ability of many Asian governments to respond if their economies stumble again. Central banks will likely keep their feet on the accelerator until they are confident the recovery is sustainable, but the huge amount of money they have pumped into their banking systems could stoke inflationary pressures, particularly if oil and commodities prices extend a rise that began early this year.

Consumer prices are falling in many Asian nations, but inflation is set to "rear its ugly head again" from the fourth quarter, and financial markets and policy makers may not be prepared, says HSBC economist Robert Prior-Wandesforde. Central banks, fearful of derailing their economies, will likely err on the dovish side, prompting worries they could create bigger inflation problems as well as asset bubbles, he said.

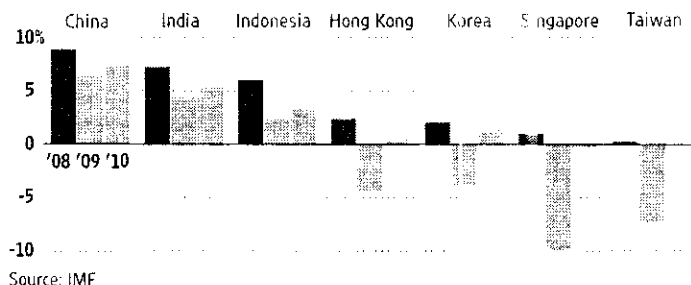
In South Korea and India, where banking systems are awash with liquidity, central bankers recently have begun to signal they could begin tightening policy early next year, if not sooner. But that could weigh on growth and cause their currencies to rise, harming exports.

A key risk to regional recovery is the performance of China, Asia's second-biggest economy.

"Nowhere in the world fills me with more skepticism than the Chinese economic recovery," said Albert Edwards, a London-based strategist at Société Générale. "What I

Asia economic outlook

Actual 2008 GDP, plus 2009 and 2010 IMF forecasts.



question is the quaint notion the markets now seem to have, that the Chinese economy can grow at a respectable rate when the rest of the world is in a deep recession."

Nomura, by contrast, reckons China can meet its official 8% economic-growth target for this year. The brokerage firm recently raised its 2010 GDP forecast to 10% from 8.5%, saying consumption and investment have surprised on the upside.

DBS says Asia is in a V-shaped recovery and predicts that over the next five years the region will return to the type of above-average growth it saw before the late-1990s financial crisis. The recent slump was caused by one-time factors, including the fading of an Olympics-driven boom in China and a "shell-shock" from the global credit crisis, DBS says, adding the upturn now under way will prove lasting because it isn't de-

pendent on the U.S. economy.

While Japan's economy, the largest in the region, continues to languish in deflation, India is looking good, partly because domestic demand makes up a large chunk of its economy. It is likely to gain momentum, with GDP growth rising to an annualized rate of 8% to 9% in the second half from around 5% to 6% in the first half, said Barclays Capital economist Sailesh Jha.

Indonesia, Southeast Asia's biggest economy, is another with a large domestic sector that has fared pretty well despite turmoil elsewhere. Singapore's nose dive, on the other hand, illustrates how a small, trade-dependent economy can suffer in the still-challenging global environment. It's the only major Asian-Pacific economy that the International Monetary Fund predicts will still contract next year.

Asian economies feel the pull of protectionism

News analysis

Pressure grows for governments to protect markets as regional trade slumps, writes Jamil Anderlini

Indonesia's industry minister proposed earlier this year that the country's civil servants – all 4m of them – should buy and wear only locally made shoes.

In the end this policy – a response to the global economic crisis – was opposed by others in the government. The trade minister said it would be a blatant violation of World Trade Organisation regulations and lead to protectionist retaliation from partners.

Similar tussles are playing out within governments across the region as they grapple with their protectionist instincts amid a pronounced slump in trade.

China and the Australian state of New South Wales have introduced "buy local" government procurement policies, while India and China have raised tax rebates for exporters.

India has restricted imports of Chinese toys. Indonesia has limited the points of entry for certain imports and Malaysia has banned the hiring of foreign workers in factories, stores and restaurants to protect its citizens from unemployment.

The South Korean government said yesterday it planned to roughly double import tariffs on raw materials including wheat, flour and liquefied natural gas from next month, despite having recently advocated to the Group of 20 a "name and shame list" for countries instituting new tariffs.

According to the World Bank, there has been a clear disconnect between the words and actions of countries throughout the region – and the world – since the G20 leaders signed a pledge last November to avoid protectionism.

But despite the growing list of measures being introduced, most analysts agree the region has remained relatively open to trade, even as exports for big Asian economies have plummeted 20-40 per cent in the first five months of the year against the 2008 period.

Most Asian governments, like those in the west, believe the key lesson from the Great Depression of the 1930s is that raising trade barriers will prompt retaliatory measures and

Asian governments have, for obvious reasons, been those in the least export-reliant leading economies – primarily India and Indonesia.

New Delhi is particularly concerned about surging imports from China, at a time when Indian companies such as Suzlon feel they have been unfairly cut out of government procurement projects related to China's \$585bn (€420bn, £360bn) infrastructure-heavy economic stimulus package.

Since the start of the year, India has instituted a number of anti-dumping investigations against Chinese goods and introduced various safety standard requirements that slow the flow of cheap Chinese imports.

There have been almost no new restrictions on trade from Taiwan or Japan, where in the 1980s the government almost gave in to Japanese ski manufacturers who wanted a ban imposed on imports of European ski equipment because of the "uniqueness" of Japanese snow.

But virtually every government in the region has raised concerns about protectionism in western countries, particularly the US, where the proposal of the "Buy American" policy has done more to boost protectionist Asian voices than anything else.

Additional reporting by Amy Kazmin in New Delhi, Christian Oliver and Jung-a Song in Seoul, Elizabeth Fry in Sydney, John Aglionby in Jakarta, Mure Dickie in Tokyo and Serena Tarling in London

40%

Steepest decline in exports among big Asian economies

exacerbate the recession.

Protectionist impulses are also being curbed by powerful export lobbies as well as by the fact that complicated global supply chains mean many imports are components needed to produce goods for export.

On balance, since the economic crisis began the most overtly protectionist

The Jakarta Post

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Letters: A single global currency: Why not?

Wed, 06/24/2009 11:36 AM | Reader's Forum

The next major realignment of the world's major currencies should be to a common currency managed by a monetary union central bank. When such a currency supports countries with 40-50 percent of the world's GDP, that currency will become the de facto single global currency, and the "tipping point" momentum will favor its continued growth, until it supports all the countries of the world.

Thus will come the single global currency managed by a global central bank within a global monetary union, and the benefits could be measured in the trillions, annually. Such a single global currency will provide what the people of the world want - stable money.

The primary problem for the Euro and every regional monetary union today is that they still exist in the multi-currency world, where the value of the currency will fluctuate against other currencies. If 16 countries can use the same currency, why not the 192 UN members? Those 192 countries now use 141 currencies and the number is dropping annually.

The Euro is definitely a harbinger of the future, and soon all 25 EU members will be part of the European Monetary Union, and by then, there will be more EU members to add. Several of the remaining non-Euro EU members are now seeking admission as soon as possible. The IMF has even urged several EU members to "Euroize" even before completing the standard accession process.

In addition to eliminating currency fluctuations, the use of a single global currency would eliminate the current foreign exchange trading expense of US\$400 billion annually (a small percentage of the \$3.8 trillion traded daily); eliminate currency risk; eliminate current account imbalances; eliminate the need for foreign exchange reserves (now totaling more than \$6 trillion); and bring other benefits worth trillions, such as reducing the impact of global financial turmoil such as we are now experiencing.

The Single Global Currency Association (www.singleglobalcurrency.org [1]) promotes the implementation of a single global currency by 2024, the 80th anniversary of the 1944 conference. That's only 15 years away. The world is moving toward a single global currency through the creation, expansion and merger of regional monetary unions.

Another route is through international monetary conferences proposals and agreements, such as were seen at Bretton Woods. The merger of the Eurozone with one or two other currencies is one possible route to a single global currency. The challenge now is to reach that goal deliberately, as soon as possible, with as little cost and as few crises as possible. If the Eurozone were to merge with the US dollar or the yen, or if the yen and the US dollar were to form a monetary union, the

road to a single global currency would be clear.

Morrison Bonpasse
Newcastle, Maine, United States

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Business

Bond outlook

Published on June 24, 2009

Many research houses and several media institutions have been strongly presenting information about an economic recovery.

Some refer to the results of global stimulus policies and some try to use many better-than-expected economic indicators to boost investor confidence in order to support their forecasts.

However, those economic figures can't lead to the conclusion that the global crisis has definitely bottomed out.

As long as the twin deficits in the US, which are the cause of the world economic crisis, haven't been solved, it's hard to guess that the world economy is in an expansion cycle.

In the past month, the bahtdenominated bond yield with tenors of a year or more moved up about 44-113 basis points to 1.5-5.4 per cent.

US treasuries with tenors of two years or more were marked up 26-60 basis points to 1.19-4.5 per cent in line with the higher oil and commodity prices in the global market.

Psychologically, rises in oil and commodity prices always arouse the worry of investors over inflation while the jump in government bond yields can be a crystal ball reflecting this expectation.

Consequently, higher inflation expectations push up the financial cost of investment.

The multiplier effect from government spending seems blunted because inflationary pressure not only erodes consumer purchasing power but also dampens investor motivation.

We can't deny that both consumption and investment are the most important variables to drive GDP while exports remain unreliable.

In this unclear situation, it is difficult for investors to manage their portfolios along with higher inflation and it is futile to wait for interest rates to head back up in the near future.

Fortunately, investors still have some hope from the extraordinary session of Parliament to approve a borrowing bill for Bt400 billion.

The Finance Ministry is going to issue stepup savings bonds worth Bt30 billion with a fiveyear maturity.

The first twoyear interest rate is expected to be higher than the market rate and will increase in the third, fourth and fifth years.

Investing in the stepup savings bonds is a good alternative in the current situation where riskaverse investors can get higher returns than bank deposits.

The savings bonds also tend to catch up to higher inflation as well.

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Opinion

THINK ASIAN

Can the IMF become the global banker?

Published on June 24, 2009

FLYING TO BOSTON for a conference on the global crisis, I went into the famous Harvard Coop bookstore in Cambridge. It was like my favourite candy store, I dashed here and there, picking up books I could not get in Asia and browsed new books that I could not see from Amazon.

Sitting in Harvard amongst the teachers of my teachers, I felt humbled by the collective brain power that gathered there.

After all, the former Harvard president is now chief economic adviser to the US president and running the show to rescue the US economy. There was one consensus - without the US economy recovering, it would be difficult to see a global recovery, but probably, the Chinese economy may be the first to recover.

Last week, I had promised to explain about the role of the IMF. Most people don't understand the idea of the SDR and what the IMF does. In Asia, the IMF is famously remembered for its role in trying to solve the Asian crisis, but many remembered the initials stood for I AM FIRED, because its recommended tough medicine initially created more deflation than easing the pain. Asian crisis countries could not print foreign exchange that they owed, whereas the West can print their own currencies and so ease the pain of crisis. But so far, the IMF has not played a role in either providing finance nor advice to the large countries, such as the US, UK and European Union, where the banking losses are the most severe.

The IMF medicine will be given to the smaller members who unfortunately repeated the mistakes of Asia to borrow foreign currency more than they could afford.

We have to understand a bit of history to understand the IMF. The IMF and the World Bank were created in 1945 under the famous Bretton Woods Conference. There was a famous debate between the economic adviser to the US Treasury, Harry White and Lord John Maynard Keynes, the most famous economist of his generation, who wanted a global central bank and a global development fund. In the end, the US Treasury view prevailed - the power of money creation was too important to give to a global agency; it was retained in the hands of the sovereign powers, of which the US was the dominant power after two

World Wars.

The present Global Financial Structure was the direct result of Pax-Americana, under which the US provided monetary stability and liquidity through the US dollar and a nuclear umbrella for global peace and security. In exchange, countries opened up trade and investments, following the principles of free trade. Bretton Woods opened up free trade and broke the power of the British Empire to operate under a tariff barrier.

The post-war global development is the direct consequence of the Bretton Woods strategy, just as the present crisis demonstrated its inadequacies and flaws.

Can the IMF be a global central bank? The common definition of a national central bank is that it is an issuer of the national currency, responsible for monetary stability, systemic financial stability and domestic payment system and also financial adviser to the government. Based on this definition, the IMF is not an issuer of global currency, it has some role in global monetary stability, it failed to stop recent systemic financial instability and is not responsible for global payment systems.

It does surveillance work on global standards, provides advice to member countries and did give some useful warnings on the recent crisis, but was ignored. So it is not the global central bank.

Indeed, the IMF is not even the central bank of central banks. That is the role of the Bank for International Settlements, based in Basel, which is the secretariat for central bank discussions, the Financial Stability Forum (now Board), the Basle Committee for Banking Supervision, the International Association of Insurance Supervisors and other central bank committees.

Basically, the IMF has a balance sheet of about US\$350 billion (available resources of US\$225 billion) and a staff of 2,600, based mainly in Washington DC.

It is remarkable how the IMF almost had no lending to its members by 2007 and just laid-off a lot of its experienced staff. By 2009, it was scrambling to give loans to several crisis economies and the G-20 had just promised to increase its resources to US\$1 trillion. Is it enough? If you think that the IMF has just announced that Western banks probably lost \$4.2 trillion, and that global cross-border banking is \$4.5 trillion, the new resources are helpful, but the task is huge.


Life cannot be easy for the deputy sheriff responsible for global financial stability, since he cannot influence the sheriff who hired him in the first place.

The deputy gets blamed for the tough medicine applied to the smaller members, but he cannot apply the same medicine for the sheriff. It is not an equal world.

Don't get me wrong. The IMF did not cause the financial crisis and can do a lot to ease the pain. It is an important provider of global public goods.

But until legitimacy and credibility is given to it by its dominant shareholders, it cannot be the global central bank, which is probably what the world really needs.

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Headlines

PM leaves for China to boost ties and economic cooperation

Published on June 24, 2009

Prime Minister Abhisit Vejjajiva left Bangkok on Wednesday morning for Beijing on a four-day official visit at the invitation of Chinese Premier Wen Jiabao in order to boost Sino-Thai cooperation.

It is his first visit to China since taking office in December.

Thai News Agency reported that his entourage is the biggest delegation Thailand has organized since he assumed office, and includes more than 100 representatives from both government and the private sectors.

The premier said that his trip is very important as China is a pivotal strategic partner and plays crucial roles in regional and world levels in the fields of economy and security.

During the visit from Wednesday to Saturday, he is scheduled to meet his Chinese counterpart Premier Wen Jiabao and pay a courtesy call on Chinese President Hu Jintao.

The government wished to upgrade Sino-Thai bilateral relations and partnership in terms of regional policy as well as China's role in relation to Asean.

He added that expanded economic cooperation is also on the agenda with Chinese leaders.

TNA reported three major topics to be discussed during the visit are Thai fruit exports to the Chinese market; investment in infrastructure projects - China's capital and expertise, particularly rail transport and tourism as Chinese tourists are quite important to the Thai economy.


Thai business executives had joined his delegation to China, therefore, he wanted to see the investment and business deals between Chinese and Thai businesspeople which would benefit the Thai economy.

Moreover, the Thai PM said he would raise the panda issue to discuss with Chinese leaders. He expected that the Chinese would understand and agree to extend the cub's stay in the kingdom.

The panda pair, Lin Hui and Chuang Chuang, produced a baby panda during their temporary stay in Thailand.

He said the baby panda, delivered on May 27 in Thailand by the panda Lin Hui was another ambassador to help bring the two countries even closer.

The Thai government hopes to set up a permanent panda research centre to give birth to more panda babies, though it needs the assistance and cooperation from China.

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Asia will struggle to escape its export trap



David Pilling

There has been much talk about Asia's rising middle class and the development of a new model based on domestic consumption. So far that is all it has been: talk. The plain fact is – the dazzling retail emporia of Asia's up-and-coming cities aside – the region has become more, not less, dependent on foreign demand.

A decade ago, when Asia was in the midst of its home-grown crisis, exports accounted for 37 per cent of regional output. Partly in reaction to that shock, which exposed an over-reliance on flows of foreign capital, economies ramped up their production of manufactured goods. A decade later, overseas shipments accounted for 47 per cent of output.

Asia's heightened reliance on external demand has been masked. In many countries, particularly China, consumption has conspicuously risen; people have been trading in their bicycles for scooters, and their scooters for cars.

But consumption has lagged behind overall economic expansion. While they were buying at home, their governments were even more furiously spending swelling trade surpluses on what Paul Krugman, the Nobel economist, calls "sterile claims" on the US Treasury. China's household consumption, for example, has fallen to a lowly 35 per cent of gross domestic product, against 50 per cent in the 1980s.

Inter-regional trade has also risen sharply, creating a false impression that Asia has somehow broken free of dependence on western consumers. But as much as 60 per cent of inter-regional trade is in components, part of a sophisticated regional supply chain whose final demand has nevertheless remained primarily American and European.

As a forthcoming article by Brian Klein and Kenneth Cukier in the journal *Foreign Affairs* points out, Asia's export-dependent economies – with the important exception of China – have fared even worse than the western economies where the lightning of the financial crisis struck. Taiwan's exports shrank in the last quarter of 2008 by 42 per cent, while production dropped at a faster rate than the US experienced during the Great Depression. Similarly sharp contractions have

happened all over Asia. For economies supposedly more resilient to falls in external demand, these have been savage declines indeed.

As Mr Klein and Mr Cukier write of the sputtering export-led model: "What brought the region so far in the 20th century may not take it much further in the 21st."

As long ago as 1985, when Washington and Tokyo were at loggerheads over what were, even

Chinese household savings are not particularly high. The big savers are the state and state-led corporations

then, considered Japan's unsustainable trade surpluses, Japan commissioned the Maekawa report to come up with ideas for breaking export dependence. Nearly 25 years later, the job remains undone.

As Clyde Prestowitz, a trade negotiator in Ronald Reagan's administration, says: "I was in the room in 1984 when Japanese prime minister [Yasuhiro] Nakasone promised that Japan would become an importing superpower. It hasn't

happened." His explanation is that economic structures are resistant to change. "Export-led economies are organised to export. All the incentives are to save, invest, produce and export. All the politics are organised around that system."

China, an economy in an earlier stage of development, has a better shot at transformation. But in China, too, national policies are more stuck in their ways than meets the eye.

It is now nearly universally accepted, for example, that one way to get Chinese to spend more is to improve the social safety net to encourage people to run down precautionary savings. Doubtless there is some truth in this. Yet, even if it could be achieved quickly, effects on spending would not be dramatic. The truth is Chinese household savings are not particularly high – lower, say, than in India. The big Chinese savers are the state and state-led corporations.

"It's not clear to me that Chinese consumers have lots of idle cash lying around," says Yasheng Huang, a professor at the Massachusetts Institute of Technology.

Mr Huang argues that the real cause of China's low consumption is stagnating incomes, particularly among the 700m rural inhabitants. He blames China's political-economic

structure which, he says, since the 1990s has stifled lending to rural enterprises and prioritised spending on the cities. Poor Chinese – and that means most of them – simply have not shared fully in economic growth. Interestingly, the same has happened in Japan, where flexible labour practices have exerted a downward pressure on wages. "It's an income problem and an income-distribution problem," says Mr Huang.

Such structural difficulties do not mean China and others cannot establish new growth models less dependent on debt-fuelled American consumers. If Mr Huang is right, much could be achieved in China simply by incentivising lending to the countryside or legalising underground rural banks.

Some of the adjustment will happen automatically. As exports fall, domestic consumption becomes a higher proportion of GDP whether you like it or not. Stimulus packages are already having an effect. The Japanese are buying fuel-efficient cars; the Chinese household electronics. But the trick will be to make domestic consumption – whether of goods or services – a permanent engine of growth.

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Inflation is the big threat to a sustained recovery

Alan Greenspan

The rise in global stock prices from early March to mid-June is arguably the primary cause of the surprising positive turn in the economic environment. The \$12,000bn of newly created corporate equity value has added significantly to the capital buffer that supports the debt issued by financial and non-financial companies. Corporate debt, as a consequence, has been upgraded and yields have fallen. Previously capital-strapped companies have been able to raise considerable debt and equity in recent months. Market fears of bank insolvency, particularly, have been assuaged.

Is this the beginning of a prolonged economic recovery or a false dawn? There are credible arguments on both sides of the issue. I conjectured over a year ago on these pages that the crisis will end when home prices in the US stabilise. That still appears right. Such prices largely determine the amount of equity in homes – the ultimate collateral for the \$11,000bn of US home mortgage debt, a significant share of which is held in the form of asset-backed securities outside the US. Prices are currently being suppressed by a large overhang of vacant houses for sale. Owing to the recent sharp drop in house completions, this overhang is being liquidated in earnest, suggesting prices could start to stabilise in the next several months – although they could drift lower into 2010.

In addition, huge unrecognised losses of US banks still need to be funded. Either a stabilisation of home prices or a further rise in newly created equity value available to US financial intermediaries would address this impediment to recovery.

Global stock markets have rallied so far and so fast this year that it is difficult to imagine they can proceed further at anywhere near their recent pace. But what if, after a correction, they proceeded inexorably higher? That would bolster global balance sheets with large amounts of new equity value and supply banks with the new capital that would allow them to step up lending. Higher share prices would also lead to increased household wealth and spending, and the rising market value of existing corporate assets (proxied by stock prices) relative to their replacement cost would spur new capital investment. Leverage would be materially reduced. A prolonged recovery in global equity prices would

thus assist in the lifting of the deflationary forces that still hover over the global economy.

I recognise that I accord a much larger economic role to equity prices than is the conventional wisdom. From my perspective, they are not merely an important leading indicator of global business activity, but a major contributor to that activity, operating primarily through balance sheets. My hypothesis will be tested in the year ahead. If shares fall back to their early spring lows or worse, I would expect the “green shoots” spotted in recent weeks to wither.

Stock prices, to be sure, are affected by the usual economic gyrations. But, as I noted in March, a significant driver of stock prices is the innate human propensity to swing between euphoria and fear, which, while heavily influenced by economic events, has a life of its own. In my experience, such episodes are often not mere forecasts of future business activity, but major causes of it.

For the benevolent scenario above to play out, the short-term dangers of deflation and longer-term dangers of inflation have to be confronted and removed. Excess capacity is temporarily suppressing global prices. But I see inflation as the greater future challenge. If political pressures prevent central banks from reining in their inflated balance sheets in a timely manner, statistical analysis suggests the emergence of inflation by 2012; earlier if markets anticipate a prolonged period of elevated money supply. Annual price inflation in the US is significantly correlated (with a 3½-year lag) with annual changes in money supply per unit of capacity.

Inflation is a special concern over the next decade given the pending

The need to finance large fiscal deficits could lead to pressure on central banks to print money to buy much of the new debt

avalanche of government debt about to be unloaded on world financial markets. The need to finance very large fiscal deficits during the coming years could lead to political pressure on central banks to print money to buy much of the newly issued debt.

The Federal Reserve, when it perceives that the unemployment rate is poised to decline, will presumably start to allow its short-term assets to run off, and either sell its newly

acquired bonds, notes, and asset-backed securities or, if that proves too disruptive to markets, issue (with congressional approval) Fed debt to sterilise, or counter, what is left of its huge expansion of the monetary base. Thus, interest rates would rise well before the restoration of full employment, a policy that, in the past, has not been viewed favourably by Congress. Moreover, unless US government spending commitments are stretched out or cut back, real interest rates will be likely to rise even more, owing to the need to finance the widening deficit.

Government spending commitments over the next decade are staggering. On top of that, the range of error is particularly large owing to the uncertainties in forecasting Medicare costs. Historically, the US, to limit the likelihood of destructive inflation, relied on a large buffer between the level of federal debt and rough measures of total borrowing capacity. Current debt issuance projections, if realised, will surely place America precariously close to that notional borrowing ceiling. Fears of an eventual significant pick-up in inflation may soon begin to be factored into longer-term US government bond yields, or interest rates. Should real long-term interest rates become chronically elevated, share prices, if history is any guide, will remain suppressed.

The US is faced with the choice of either paring back its budget deficits and monetary base as soon as the current risks of deflation dissipate, or setting the stage for a potential upsurge in inflation. Even absent the inflation threat, there is another potential danger inherent in current US fiscal policy: a major increase in the funding of the US economy through public sector debt. Such a course for fiscal policy is a recipe for the political allocation of capital and an undermining of the process of “creative destruction” – the private sector market competition that is essential to rising standards of living. This paradigm’s reputation has been badly tarnished by recent events. Improvements in financial regulation and supervision, especially in areas of capital adequacy, are necessary. However, for the best chance for worldwide economic growth, we must continue to rely on private market forces to allocate capital and other resources. The alternative of political allocation of resources has been tried; and it failed.

The writer is former chairman of the US Federal Reserve

Co-ordination falls away as the global crisis abates



Philip Stephens

After the financial crash, the economic collision? History may well be kind in its judgment on the international response to the crisis in financial markets. Muddled it may have been, but governments did muddle through. Now the emergency has passed, however, policymakers look set on going their own ways.

We have seen plenty of policy mistakes and mishaps during the past year. The choreography of co-ordination was frequently ragged – even in Europe, where the habit of working together is supposed to be deeply embedded. That said, there was a surprising degree of co-operation, and notably so between rich and emerging nations. China in particular can claim it has been a responsible as well as a big player.

The Group of 20 leading nations is clumsy and imperfect, but has shown itself a better reflection of the distribution of economic power in the world than the old western clubs. The G8 group of rich nations now struggles to be taken seriously, its task not made easier by the present chairmanship of Italy's Silvio Berlusconi.

The economic crisis, of course, is not over. The premature euphoria of recent weeks owes more to relief at meltdown averted than to real evidence that recovery is under way. Sensible policymakers are cautioning that the world economy could weaken again before it strengthens.

That said, the restoration of calm in the markets has been the signal

for cracks to appear about what to do next. Governments are making different choices on financial regulation. Hopes that they might have been shocked into tackling the root causes of global economic imbalances are fading.

This autumn the G20 will gather for another meeting, this time in Pittsburgh under Barack Obama's chairmanship. For all the US president's political weight, few are predicting a breakthrough in global economic governance.

The problem is one of competing diagnoses and prescriptions as well as diverging national interests. The US and much of Europe, to take one example, are adopting different approaches to bank regulation. Last week saw the Obama administration unveil a package of measures that seemed to bear more of the stamp of Wall Street than of Main Street. Continental Europeans want tighter constraints on the erstwhile titans of finance. Britain, as is its wont, may end up stranded mid-Atlantic.

The differences reach beyond both the appropriate rulebook for financial markets and the inevitable disagreements between Americans and Europeans about the liberal quotient in liberal capitalism.

This was brought home to me the other day when I listened to one of the US administration's top economic advisers. The official was speaking at a private gathering of international policymakers and scholars hosted by Washington's Brookings Institution, Germany's Alfred Herrhausen Society and the London-based Policy Network.

There were two possible threats to a sustained global recovery, the adviser offered. One was that the huge fiscal and monetary stimulus needed to rescue the financial system

The danger is that, without the glue of shared adversity, governments will fall to bickering again

would lead the world back into 1970s inflation. Another was that the authorities would withdraw the stimulus too quickly, leading to the economic stagnation experienced by Japan during the 1990s.

Both were threats to be taken seriously, but as far as the US administration was concerned the balance of risks lay firmly with the latter. Without a surge in economic growth or a spike in commodity prices, fears of runaway inflation were overdone. To argue otherwise, one would have to believe in what the official caustically called "immaculate conception inflation".

As for calls from all and sundry for a concerted effort to tackle global economic imbalances – code, as everyone knows, for the US current account deficit and the Chinese surplus – the US administration was relatively relaxed. The US deficit had already fallen sharply from its peak and the drop in the dollar's value would continue to shift the country's resources into exports.

It would certainly be welcome, the official avowed, if China and others did more to boost consumption; doubtless such issues would be the subject of intense discussion at international meetings. But in a world of mainly flexible exchange rates, there was no pressing need for formal agreements. "If some people wanted to wear blue shirts and others white", that was fine, he said.

You can agree or disagree with this analysis. Many people in Washington as well as beyond America's borders would dispute quite a lot of it. Republicans are not alone in believing that the soaring

US fiscal deficit is a harbinger of future inflation. Likewise, the authorities in Beijing are in plentiful company when they fret about a weak dollar. As for the Europeans, quite a few of them do believe in immaculate conception inflation.

What struck me about the official's presentation, though, was a sense of indifference – insouciance was another word that sprang to mind – about what other governments think. China may agonise about the impact of a further devaluation of the dollar on its \$2,000bn of US Treasury bills. Europeans may worry that the US will seek to inflate its way out of its indebtedness. Washington will get on making its own economic policy as it sees fit.

Put crudely – and here I am adding my own interpretation to the official's remarks – if the surplus countries do not boost demand in their economies, in so far as imbalances are a problem, a falling dollar will do the trick; and not much harm will be done.

Such economic unilateralism – and I do not intend here to absolve China or Germany from their responsibilities – sits uneasily with the multilateral engagement that is supposed to be at the heart of Mr Obama's foreign policy.

Perhaps another top official in the administration would have told a rather different story. Perhaps Beijing, Berlin and the rest need to be confronted with the alternative if they are to be persuaded to shoulder a share of the burden of adjustment. The danger is that, without the glue of shared adversity, governments will fall to bickering again.

It seems to me that two of the economic policy lessons of the financial crash need to be held on to. They may be obvious but they merit restating: the markets will not fix things of their own accord; and, though undoubtedly time-consuming and tedious, international co-ordination is the vital response to interdependence.

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Opinion

Arabian Gulf, Asean partnership can benefit all

Published on June 26, 2009

The world has changed. Old certainties are giving way to new realities and partnerships between regional blocs to play more active roles in tackling challenges before us are of the essence. The global financial crisis underlines the need to review our priorities and policies and take account of the shifting economic structure.

For the ten Asean members, a political, trade and cultural partnership with the GCC - the six nations of the Arabian Gulf - offers very strong opportunities. This is the thinking behind the history-making Ministerial meeting in Manama between our two blocs.

GCC-Asean cooperation needs to be focused, prioritising the promotion of peace and security, alleviation of poverty, human resource development, enhancement of trade and investment, protection of the environment and sustainable development, fighting terrorism and the encouragement of cultural and media exchange.

We have a packed agenda to explore. But issues of particularly pressing importance for our discussions include energy and food security and sustainable development, not to mention coordinating positions in international forums. In a world that too often succumbs to short-term fads and fancies, we are determined to build solidly for the long term.

Furthermore, our two economic blocs are growth centres for the new global economy. Together we have the potential to be among the leaders of renewed international economic growth, for the benefit of all countries.

Already, the GCC adds up collectively to a single market worth around US\$1 trillion (Bt34.12 trillion). And that is just a beginning.

By 2020, according to the calculations of the Economist Intelligence Unit, our common Gulf market will have doubled in size. That is 2 trillion reasons for the Asean to form a partnership with us.

We are committed to open markets, trading and investing across frontiers. We are not protectionist by temperament. We are careful not to over borrow and treat complex financial instruments with the caution that they have been shown to deserve.

We are just as committed as Asean to make sure that the GCC succeeds. Our aims are ambitious but, based on our track record, they are attainable in a very short space of time.

This is the encouraging background to our joint Ministerial Retreat - which, I am sure, will be effective for Asean and the GCC to draw up a realistic roadmap towards a practical working relationship. We are looking at dynamic action and measures to turn our common aspiration into tangible benefits for both sides.

A partnership between the GCC and Asean will be no surprise to anyone who knows our mutual history. We in the GCC are Asian and proud of it.

For thousands of years our two regions have traded with each other and embraced our respective cultures. Then, as now, our relations were not just between governments. Enterprising entrepreneurs developed profitable ties with each other and long-lasting personal friendships were forged. As we move towards stronger political, cultural and economic cooperation including an historic free-trade agreement, we will be encouraging our peoples to find new ways to work together for the benefit of both regions.

At both public and private level, we hope to see joint ventures spring up in banking and finance, trade and technology, and education and culture.

Each GCC country already has its own links with Asean. Speaking for Bahrain, I pay tribute from direct experience to the drive and enterprise of our Asean trade partners.

As the main banking centre in the Mena (Middle East and North Africa) region much of our co-operation has focused on banking and financial services. For example, Bahrain has exchanged ideas very profitably with Asean financial institutions on Islamic finance - which we have jointly nurtured to become one of the fastest growing and most ethical forms of finance in the world.

This is a classic illustration of how working together enables both sides to obtain greater benefits than if we acted alone. This is why I feel privileged to have initiated the Ministerial Meeting so we can tap into the political, economic and cultural potential before us.

Regional

NZ support Asean think-tank ERIA

Published on June 26, 2009

Jakarta--New Zealand has expressed the readiness to support the Economic Research Institute Institute for ASEAN and East Asia (ERIA), a new think-tank associated with the ASEAN Secretariat.

Minister of Foreign Affairs, Mr Murray McCully, told Secretary-General of ASEAN, Dr Surin Pitsuwan on Friday during a courtesy call that as a member of East Asia Summit, New Zealand will make policy recommendations at regional governmental meetings, such as the EAS, aimed at furthering East Asia's economic integration.

During the bilateral meeting at the Asean Secretariat, McCully reiterated that New Zealand has a strong commitment to ASEAN and will place more effort in enhancing its relations with the region.

McCully emphasised the importance of ASEAN especially in economic linkages in view of the recently concluded ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA), which represents the most comprehensive agreement ever concluded by ASEAN with its Dialogue Partners.

Dr Surin and McCully stressed the importance of the private sector in driving the implementation of the FTA.

Both sides also spoke about the future direction of EAS. Dr. Surin said that New Zealand's experience and expertise in human resource development, climate change and the environment can be areas of cooperation in the EAS process.

The two leaders further explored the possibility of upgrading ASEAN-New Zealand relations to a strategic dialogue partnership in view of the 35 years milestone in dialogue relations since ASEAN-New Zealand dialogue relations was first established in 1975. Both parties are now implementing the ASEAN-New Zealand Framework for Cooperation 2006-2010 which aims at promoting and enhancing dialogue relations.

Earlier, Australian Trade Minister Simon Crean has also expressed similar support to ERIA. Joint press statement on Asean plus Three Cooperation in Response to the Global Economic and Financial Crisis on 3 June 2009 said that ASEAN-led consultations among various

organizations and fora in the region including ERIA would contribute to safeguarding the region from future regional and global economic and financial crisis.

Experts from 16-member countries are currently pooling their experience and knowledge to do joint research projects contributing to better policy development for East Asia.

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Business

BT50-BN SAVINGS BONDS New batch ready if demand exceeds issue

Published on June 27, 2009

The Finance Ministry is prepared to issue another batch of government savings bonds soon, should the Bt50 billion's worth of bonds to be offered from July 13-21 fail to meet demand, Finance Minister Korn Chatikavanij said yesterday.

The maturity of the back-up batch might be longer than that of the July issue, he said.

The Finance Ministry will decide quickly whether the second batch needs to be issued as a back-up, he said yesterday at a contract-signing ceremony to appoint seven banks as selling agents for the Bt50-billion issue.

The July bonds, which have a five-year maturity, have excited great interest from the public due to the attractive coupon rates of 3 per cent for the first two years, 4 per cent for the third year and 5 per cent for the final two years.

"I'm confident they will sell out. The ministry initially planned to issue Bt30 billion's worth only, but banks suggest the market has a healthy demand, so Bt50 billion's worth will be offered, with subscription priority to senior citizens and low-income earners," said Korn.

The minister said the impact of the government-bond issue had caused commercial banks to hike their deposit rates in order to compete with the returns offered by the bonds. The spread between banks' deposit and lending rates has been narrowed as a result.

The July bonds will be distributed to the public via the seven banks' networks pro rata, based on their deposits.

Bangkok Bank takes the biggest portion at 24 per cent (Bt12 billion), followed by Krung Thai Bank at 20 per cent (Bt10 billion), Siam Commercial Bank at 17 per cent (Bt8.5 billion), Kasikornbank at 16 per cent (Bt8 billion), Bank of Ayudhya at 9 per cent (Bt4.5 billion), TMB Bank at 8 per cent (Bt4 billion) and Siam City Bank at 6 per cent (Bt3 billion).

The banks will not charge a distribution fee to either the government or investors.

The first batch of Bt15 billion's worth will be sold on July 13-14 to people aged 60 and over.

The second Bt15 billion's worth will be available on July 15-17 to the elderly and other groups of retail investors, while the final Bt20 billion's worth will go on sale on July 17, 20 and 21 to retail investors.

The minimum investment is Bt10,000 and the maximum Bt1 million for each subscriber.

Meanwhile, Bank of Thailand Deputy Governor Atchana Waiquamdee said the issue of the government bonds would slightly reduce excess liquidity in the system.

The bonds will absorb liquidity from the economy, but public spending will eventually bring the money back to the economic sector.

"The central bank has monitored liquidity at a level that keeps the policy interest rate at the current level," she said.

The bond issue will not cause market interest rates to rise, she added, because the 3-per-cent yield in the first two years is only slightly above the high end of the range of 1.5-2.75 per cent for two-year bank deposits.

Moreover, the July bonds will account for only 0.5 per cent of overall deposits of Bt1.6 trillion in the system.

Atchana said it was difficult to predict the rate of inflation over the next five years. The returns offered by the bonds are attractive for those who might be concerned about interest rates surging in the future.

"Savers may realise that deposit interest rates are very low and will possibly increase. The Finance Ministry has therefore introduced features that are attractive [step rates], so they will not be at much risk if market rates do climb," said Atchana.

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Those maddening economists

For most mortals, economics is a dark and deeply confusing topic. The vocabulary is dense, the relationships contorted. Economists are notorious for offering two — contradictory — opinions on most topics. So forgive us if we are confused at the most recent forecasts of the global economic outlook.

In its most recent assessment, the Organization for Economic Cooperation and Development (OECD), a group that includes the world's developed nations, sees the bottom of the recession. It expects its 27 member-country economies to shrink 4.1 percent this year, which in fact is an improvement over its March forecast of a 4.3 percent decline. This is the first time in two years the OECD has made an upward revision.

Yet only days earlier, the World Bank downgraded its forecast for the global economic outlook. The international lender concluded that the world economy will shrink 2.9 percent this year; in March it had anticipated a 1.7 percent drop, which it then called the worst on record.

The easy explanation for the differing estimates is the sample. The OECD numbers account for about 80 percent of the world economy (the 27 members along with Brazil, China, India and Russia). We could blame the other, less developed economies for creating the drag on global growth. But developing countries are thought to be weathering the downturn better than the developed world — their financial systems have not been as badly hit — which would imply that an improving OECD forecast would mean better overall economic prospects.

Growth will vary. The OECD anticipates China will record 7.7 percent growth this year, an improvement of more than 1 percentage point. By contrast, the U.S. economy is expected to shrink by 2.8 percent in 2009 (an improvement over the 4 percent forecast earlier), Japan will contract 6.8 percent, and the economies of the 16 nations comprising the euro zone will decline 4.8 percent (worse than the 4.1 percent estimated earlier). By 2010, however, the entire OECD group is expected to average 0.7 percent growth — anemic, but an improvement over the last forecast of a 0.1 percent contraction.

The OECD credits the massive stimulus packages that have been implemented by most member countries for turning the tide. "A really disastrous outcome has become more of a remote risk," said the head of the OECD economics department, Mr. Jorgen Elmeskov. But, he conceded, the recovery is likely to be "weak and fragile."

Two problems are front and center now. The first is cleaning up bank balance sheets — an issue that Japan knows well. Failure to eliminate uncertainty about bank liabilities will mean that credit remains tight, and that will act as a break on economic recovery.

The second problem is the prospect of massive government debt triggering inflation and halting recovery. While OECD experts encourage member governments to keep the fiscal pumps primed, they also urge them to begin developing "post-crisis policy strategies" to ensure that fiscal imbalances do not reverse hard-won gains when recovery is consolidated.

It is a fine line — and, again, one that Japan has walked with mixed success. In 1997, after years of stimulus packages finally sowed the seeds of recovery, the government increased taxes to get fiscal accounts back in order. That move killed the incipient blooms and plunged the economy back into stagnation.

The OECD warned member governments not to end the stimulus measures too soon. The Bank of Japan "should fight deflation through a strong commitment to implement effective quantitative measures until underlying inflation is firmly positive." According to BOJ policy board member Seiji Nakamura, the bank will continue with the special measures that it has used to stimulate the economy, such as buying commercial paper and corporate bonds. Those policies are set to expire in September.

For its part, the U.S. Federal Reserve is heeding the OECD's advice. Last Wednesday, the Federal Open Market Committee voted unanimously to maintain the rate for lending between banks in a record-low range of zero to 0.25 percent, and to keep the discount rate for commercial and investment banks at 0.5 percent. European governments have been more hesitant to open the spigots: That explains, in part, the sluggishness of the recovery in the euro zone.

Ultimately, however, the global economy will not recover to its previous heights. Credit was too readily available. Financial innovation — and what looks a lot like corruption — created bubbles. On the one hand, tighter financial regulation will curb the abuses and increase stability; on the other, it will result in significantly less capital being available. The OECD estimates that the level of trend output in its member countries is likely to be permanently reduced by nearly 3 percent. Lower output means higher unemployment. The lower the risk, the lower the rewards: That is an equation even noneconomists can understand.

Basic rules helped China sidestep bank crisis

Liu Mingkang

In an increasingly interconnected world, financial risks now spread like pandemics. One of the effective ways to prevent risk contagion is to set up firewalls between banking and capital markets.

Unfortunately, many people have forgotten this principle, or dispute it as "old-fashioned". However, in China we have maintained such a firewall mechanism in our financial system reform. Only qualified commercial banks are allowed to participate in non-banking activities, and have strict firewalls separating them. We insist that the main funding source of banks should always come from deposits. On top of that, the China Banking Regulatory Commission (CBRC) is developing a regulation that would require firewalls to be established between commercial banks and their controlling shareholders and between commercial banks and their non-banking subsidiaries, in order to prevent risk contagion.

Sometimes the most effective way to address a complex issue is by using basic, simple but useful measures. Practice shows us that traditional tools work, especially considering that financial engineering can malfunction. In recent months we have noticed that many regulators in the rest of the world have also started to embrace this "back to basics" approach.

Much has been written about what triggered the global financial crisis, but in my view it can be attributed to five factors. First of all, the firewall between capital and banking markets was eroded by unsound financial innovations. Second, macro-prudential regulation was neglected. Third, financial institutions had too much leverage and were too opaque. Fourth, incentives for staff at financial insti-

tutions were driven by short-term gains, rather than long-term benefits. Fifth, the bail-out put the cart before the horse by pumping in capital and liquidity before cleaning up balance sheets.

Today, China's financial system looks quite different from its western counterparts. Between 2003 and 2008, total banking assets have increased by Rmb3,470bn (\$508bn, €361bn), up 1.3 times, while profits in the banking sector have risen by Rmb521.8bn, a 17-fold increase. The better shape of the Chinese banking sector can partly be attributed to China's prudential banking regulation. We believe banks are deeply rooted in the real economy and while the financial sector can temporarily outpace the real economy, this cannot continue for ever.

In Chinese we say *jian mu bu jian lin*, meaning one who sees only the trees and misses the forest. As banking regulators we have always seen it as our responsibility to look at the whole system as an organic body since individual banks sometimes ignore or lack the means to look at risks at a systemic level. It has been our practice to conduct industrial assessments, monitor changes and alert banks with the findings to the potential systemic risks. We also take measures to prevent cross-market and cross-border risk contagion.

It is clear that when hordes of market players move in the same direction it will often result in irrational exuberance and a herd mentality. That is why supervisors must always play an important role. We believe it would be a bad mistake for supervisors to stay aloof. In China we trust those we regulate but always check what they tell us and retain the authority for a final inspection, especially on innovative financial products.

It is never an easy job to be a regulator in China, and even more difficult to be a good regulator. Despite our remarkable progress, the Chinese banking sector still confronts Herculean tasks. This year will undoubtedly be a tough one for China's economy. Banking institutions will find themselves in a more stressed environment. In this regard, more has to be done to improve corporate governance, internal controls, risk management, staff training and supervision expertise. For years, the CBRC has been upgrading its ability by drawing from international best practices while rooting its knowledge in the Chinese situation. The CBRC has recently been invited to join the Basel committee on banking supervision as well as the new Financial Stability Board. We will use these positions as an opportunity to share views, draw lessons and contribute to enhancing supervision both in China and internationally. Together, we will build a more efficient and transparent international financial system.

The writer is chairman of the China Banking Regulatory Commission

We believe that while the financial sector can temporarily outpace the real economy, this cannot continue for ever

Business

Thailand seeks asean service-sector liberalisation

Published on June 29, 2009

Thailand will propose the liberalisation of 10 service industries protected under the Foreign Business Act of 1999 to Asean countries at the regional bloc's ministerial summit in August, a Trade Negotiations Department official said.

The proposal would be in line with the bloc's commitment to liberalise services under the Asean Free Trade Agreement (Afta).

Foreign shareholdings in businesses in the industries would still be limited to 50 per cent, however.

The 10 industries are: communications, construction, distribution, education, environment, healthcare, tourism, entertainment, culture and sports, and transportation.

Nuntawan Sakuntanaga, director-general of the department, said the proposal would be submitted to the Asean Economic Ministers meeting in Bangkok in August. Service-sector liberalisation has already been ratified in principle by Parliament under Article 190 of the Constitution Act.

"Thailand will propose to liberalise 10 service businesses among Asean countries. However, foreign shareholdings would still be restricted under the FBA," she said.

Liberalising the 10 services would boost investment from other Asean countries, while giving Thai investors greater opportunity to invest in other Asean countries, Nuntawan said. It would also improve the investment environment in Thailand and further the government's policy of promoting investment in particular businesses, she said.

Provisions would remain in place to ensure that Thai enterprises remain competitive, including conditions on the number of foreigners working for the firms, as well as a minimum investment capital requirement for investment in the country, she said.

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Business

Guru Speak

Published on June 29, 2009

As signs of economic stabilisation have gradually emerged in various parts of the world, financial market players have increasingly paid attention to the potential central banks' strategies to exit from the near-zero rate policy and unconventional monetary policy.

An appropriate and timely exit strategy is particularly crucial in this crisis as risks from policy mistakes could be significant.

The main concern is whether central banks will be able to reverse the gear of their unconventional measures quickly and smoothly enough to ensure sustainable growth recovery without igniting economic instability.

There are three main types of so-called "unconventional measures" that central banks will have to exit from :

- Liquidity provisions
- Quantitative easing to bring down longterm interest rates through buying longterm government bonds
- Credit easing to revive the flow of credit through the purchase of commercial paper, corporate bonds and assetbacked securities.

In choosing the exit strategies, central banks will need to revisit three main considerations.

First, the speed and magnitude of the policy reversal are crucial for achieving a sustainable recovery over the medium term while maintaining credible inflation targets.

The risk of choking off the economic recovery or imposing heavy losses from holding securities on lenders could rise if the policy reversal happens too abruptly.

On the other hand, the economy could suffer from heightened inflationary and assetprice bubble concerns if the draining of liquidity does not occur soon enough.

Secondly, the appropriate sequencing to unwind various measures depends on the original combination of policy measures implemented and subsequent macroeconomic developments as well as conditions in different sectors of the financial system in each country.

For example, exiting from the liquidity provision scheme could start first once the money market is back to normal conditions.

Whether the rollback of quantitative easing to withdraw money injection should be done before a policy rate increase depends on the amount of liquidity prevailing in the system.

Indeed, excessive liquidity would hamper effectiveness of monetary policy tightening.

As for the reversal of credit easing policy, central banks could unwind the measures once the credit market resumes its normal intermediation function for the economy again.

Because economic recovery will not likely be robust; various market players expect that it will take quite some time before credit easing for certain credit instruments is unwound.

Lastly, communication of the planned policy reversal is crucial and should be formulated in a cohesive and transparent way such that it effectively anchors market expectations about future trends of inflation and economic activity.

For example, the Bank of Japan's initial announcement about necessary conditions for ending quantitative easing before the actual termination in March 2006 was welcomed as it provided transparency and was beneficial for guiding future interest rate expectation.

Central banks' exit strategy from crisis-management measures should be well-planned in advance.

Similar to the adoption of the unconventional measures, policymakers also need to remind themselves that successful implementation will need to be flexible and depends largely on a proper evaluation about the prevailing conditions in the financial markets and the economy.

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Business

Stimulus package 'to revive economy in Q4'

Published on June 29, 2009

The economy would still head downhill in the third quarter but would turn the corner in the fourth quarter after the government's stimulus-spending kicks in, a seminar heard yesterday.

"Overall, the economy in the second half of this year should report zero growth, with the growth in the fourth quarter netting out the contraction in the third quarter," said Ampon Kitti-ampon, secretary-general of the National Economic and Social Development Board.

He was a panellist at a roundtable on the prospects of the economy this year organised by the Thai Enlightenment Institute Foundation.

The Bt116-billion mid-year budget, Bt2,000 cheques handed out to some 9 million workers and farm-price support schemes will be the key to reviving the economy, he said.

The worst is over as judged by the indicators for exports, employment and government disbursements, he said.

Bandid Nijathavorn, deputy governor of the Bank of Thailand, said an improvement in economic conditions should start showing up, depending on consistent government spending, renewed confidence by the private sector and the lack of any unexpected incidents.

"There is a high possibility that we have experienced a bottoming out. But both the government and the private sector will have to continue to make the necessary adjustments to keep the economy going," he said.

Interest rates are not at an appropriate level, though businesses should have access to credit. Domestic demand might keep the economy humming but it can't offset the fall in earnings in the export sector, he said.

Somchai Jitsuchon, an economist at the Thailand Development Research Institute, said the economy would likely level out in the third or fourth quarter in line with the global economy.

But government spending would continue to be the main engine of growth, he said.

"Any recovery will be fragile, however, because the global economy is still beset by shaky consumption in the US and Japan, falling home prices in the US and volatile financial markets," he said.

Financial institutions in the developed economies have not been tackled in both recapitalisation and credit extension, he said. While the US is trying to reduce consumption by importing less and exporting more, China is relying more on the domestic market for growth.

This adjustment process would take time to work its way through, he said.

Mangkorn Thanasarnsin, vice chairman of the Federation of Thai Industries, said the economy here should start rallying in the third quarter while the private sector would need to break the mould to keep up with the changing economic environment.

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BoT: Economy past the worst

By: BangkokPost.com

Published: 30/06/2009 at 04:42 PM

There are signs that the Thai economy is emerging from the trough, a central bank official said on Tuesday. Bank of Thailand's Domestic Economy Department senior director Amara Sriphayak said the contraction of many economic figures in May 2009 such as the manufacturing production index and private consumption index had eased.

"The chance the Thai economy will sink further is low," Mrs Amara said. The business sentiment index in May also rose from 39.2 points in April to 45.4 points mainly because of higher pre-orders for electronic appliances, she said.

She expected the business sentiment index in the next three months to reach 50.2 points for the first time in 15 months, thanks to clear investment direction from the state sector.

"This could help the country's gross domestic product see a positive growth in the second quarter, but the annual economic growth would remain negative," she said.

However, investment from the private sector remained sluggish at 16.5 per cent in May because investors were waiting for more positive investment signals from the state sector.

At the same time, the inflation rate fell 3.3 per cent while the core inflation dipped 0.3 per cent, which was the first drop since January 2004.

2009 economy to shrink by 4%

By: BangkokPost.com

Published: 30/06/2009 at 10:45 AM

The country's gross domestic product for 2009 would contract by about four per cent this year due to the global recession, the dean of the business school at the National Institute of Development Administration (NIDA), Ekkachai Nittayasetrawat, said on Tuesday. Mr Ekkachai said even though the economy's slide bottomed out in the first quarter of the year, with the GDP at minus 7.1 per cent, the recession would continue in the second half of the year.

"We expect the GDP to shrink by about 6.8 per cent in the second quarter. The contraction should be about 4.5 per cent in the third quarter and then improve to plus 1.5 per cent in the fourth quarter," he said. "This will mean an overall minus 4 per cent for the whole year." He stressed that the government must make effective use of the 800 billion baht loans recently approved by the parliament.

The money should be spent to stimulate investment in mega-projects that could substantially shore up the economy, such as transport and logistic networks, electric trains, dual rail tracks and irrigation projects.

The government should also oversee the value of the baht to ensure that it is not too strong. The export sector was already suffering from the global financial meltdown and an over-valued currency would add to its problems.

The Jakarta Post

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Inflation likely slow, more room to spur growth

Aditya Suharmoko , The Jakarta Post , Jakarta | Tue, 06/30/2009 11:26 AM | Business

Inflation may slow even further in June, providing the central bank room to cut its benchmark interest rate to spur economic growth, Bank Indonesia officials said Monday.

"We predict year-on-year inflation in **June** may be less than 4 percent, about 3.8 percent," said BI deputy governor Hartadi A. Sarwono.

In May, inflation rose 6.04 percent from a year earlier, according to the Central Statistics Agency (BPS). BI cut its rate for seven straight months to 7 percent on June 3 in a bid to bolster growth in Southeast Asia's fastest-growing economy.

The BPS is scheduled to make an official announcement of June's inflation on Wednesday.

"There's still room **for the BI rate** to move, but by how much and when is another matter," acting BI Governor Miranda S. Goeltom said in Basel, Switzerland, where she attended a meeting of central bankers worldwide, Bloomberg reported.

"Certainly the inflation rate is going down."

Hartadi said inflation might slow as the base year, used as the reference year for determining a figure, of inflation in June last year was already high, due to the price hike for subsidized fuels in May 2008.

But he added BI would take into account factors other than inflation prior to determining its benchmark interest rate at the central bank's collegial meeting Friday.

"It's not only June's inflation, but other forward-looking evaluations," Hartadi said.

"We'll see whether the pressure of commodity prices, including oil, will have an impact on inflation before we make a decision."

He added Indonesia's economy in the second quarter this year might experience slower growth compared to the first quarter, when the country scored a positive 4.4 percent growth amid the global economic downturn that led most other countries' economies to plunge.

"**Growth** in the second quarter used to decline seasonally. But let's wait **for the actual figure**," he said.

Indonesia's economic growth will depend on global growth, mainly in the economies of the United States, China, South Korea and India.

"If our trading partners improve, we can expect our growth to be down to external factors, in addition to domestic consumption," he said.

Indonesia's main trading partners are China, the United States and Japan, according to the BPS.

Finance Minister Sri Mulyani Indrawati said exports and imports might have improved in the second quarter, contributing to growth.

"Investment is also not as bad as in the first quarter," she said.

"We'll see whether these two variables will be better."

But she hinted that because of the relatively high growth in the second quarter of 2008, this quarter's growth might be slower.

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Opinion

EDITORIAL

Sino-Thai relations have come a long way

Published on June 30, 2009

Thirty-four years since ties established, the two countries promise many more achievements

Today, Thailand and China commemorate 34 years of diplomatic relations. Throughout these years, both countries have cooperated closely in all areas, leaving no areas untouched. Despite frequent changes of governments and political uncertainties at home, China has remained a faithful friend demonstrating the kind of understanding that is often lacking in the West.

It took the extraordinary vision of former prime minister Kukrit Pramoj to decide unwaveringly that the time had come for Thailand to establish diplomatic relations with the world's most populous nation. Both sides set forth conditions for diplomatic ties. The Thai government called for the immediate termination of all assistance and links with clandestine communist insurgents in Thailand. Beijing was keen to see US troop withdrawal from Thai bases.

For a staunchly anti-communist nation and US ally, Kukrit's move was considered remarkable, if not impossible to carry out. Former prime minister Anand Panyarachun, who served as the chief of Thai envoys at the UN, started to lay the diplomatic groundwork right after the US government, under President Richard Nixon, severed ties with Taiwan and recognised China in 1972. But it took years of preparations and careful and discreet diplomatic manoeuvres in Thailand before legal contacts, both civilian and diplomatic, could be taken. The conservative security apparatus inside Thailand was very much opposed to the normalisation with China as they did not trust Beijing. Their utmost fear was that China would continue to support left-leaning insurgent groups inside Thailand.

In the first few years immediately after establishment of diplomatic ties, Sino-Thai relations came under severe strain due to the rise of right-wing elite groups and the pro-democracy crackdowns over a year later. The violence of October 1976 almost threw the newly formed friendship into the dustbin. But then common sense prevailed, dictated by the rapidly changing regional situation and mutual desire to cooperate for peace and stability in Southeast Asia.

The Cambodian conflict and all around assistance provided by China to Thailand, as the

frontline state of Asean, was the precursor to China's growing influence in the region. China remained the most committed supporter of Cambodian resistance groups since the end of 1978 to push out the occupation of foreign forces in Cambodia. From 1978-1992, Thailand and China worked hand in hand along with Asean, both in the military and diplomatic fields, to restore peace and stability inside Cambodia. The Cambodian peace agreement signed in Paris in 1991 was a testimony to their joint efforts and those of the international community.

After the Cambodian conflict, Sino-Thai relations have been transformed to encompass economic and trade relations. China has a huge domestic market to absorb the excess agricultural products from Thailand. Cheap consumer products from China also find new markets in Thailand before they venture into the rest of the region's markets.

In the 1990s, Thailand served as a conduit for China's diplomacy. Beijing lacked the confidence it has now in approaching the region because of its past associations with communist insurgent movements in several Asean countries. Thailand helped to augment trust and confidence in China's diplomacy and its peaceful intention in the region.

As a result, the region's fear of China gradually receded. Now, with China's growing economic and political clout, there is no need for such assistance. As the world's emerging superpower, China's cooperation has been sought after by all countries.

Sino-Thai relations have been characterised by close ties between prominent institutions and personalities. The members of the Thai royal family have made China their frequent destination. HRH Princess Sirindhorn has visited China more than three dozen times, not to mention other royal members. Defence cooperation between the two countries is very close and special. For instance, China's elite anti-terrorist forces held joint exercises and training with their Thai counterparts. Bilateral visits exceed more than 1000 annually.

More can be expected in coming years. When Prime Minister Abhisit Vejjajiva visited China last week, he asked Beijing to promote investment and tourism in Thailand. He also asked China to dispatch 2000 Chinese language teachers to Thailand due to the popularity of pu-tong-hua in Thailand.

It would be interesting to watch which direction Sino-Thai relations are moving towards. Both countries realise that they could do more for regional peace and stability, especially on issues related to Burma and the Korean peninsula. Together, they can continue to secure the regional environment that would be conducive for economic development.

The current global economic crisis also provides an opportunity for China and Thailand, as the current chair of Asean, to work together to strengthen cooperation between Asean and East Asia.