Asia's Tryst with the Global Financial Crisis

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Eighth India Korea Dialogue

Introduction

- In 2009 the global economy is set to witness the first decline in global output by 1.3% (IMF) to 1.7% (World Bank) in the post War II era.
- The last quarter of 2008 experienced a fall in global GDP of 6.25% (annualized) in the global output.
- In 2009, advanced economies are expected to contract by 3.8% compared to a growth of 0.8% in 2008.
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Impact on Asian Economies

- The speed and force with which the crisis impacted Asian countries was largely unanticipated.
- The downswing in growth rate has been much sharper than countries, which were at the epicentre of the crisis. Growth
- The decoupling theory, which argued that even if advanced economies went into a downturn, emerging economies will remain unscathed because of sound fundamentals, stands totally invalidated.
- Several factors such as capital flow reversals, declining export growth, sharp widening of spreads on sovereign and corporate debt and abrupt currency depreciations point toward a strong impact.

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Channels of Impact: Trade Channel

- Casual investigation suggests that Asian countries with greater trade integration have borne the brunt of the crisis. ▸ Trade Openness
- The rising intra-regional trade reflected intra-industry processing and assembly through vertically integrated production chains.
- Overall trade integration with the countries that were at the epcientre of crisis rose considerably over the last decade. ▸ Trade Integration
- The impact has been exacerbated by the product mix of the region's exports, most of which is concentrated in technology intensive manufacturing. ▸ Technology
- With the collapse of demand for these goods export growth rates plummeted in Asia. ▸ Exports

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- However, deepening financial ties with the West did expose the region to the forces of global deleveraging.
- International bank flows to Asian economies turned negative as rising loses pushed advanced economies' financial institutions to reduce their exposure to emerging markets. International Claims
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- Countries have reacted to the exchange market pressures with limited degree of foreign exchange intervention. ▸ Reserves

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Monetary and Financial Cooperation

Chiang Mai Initiative

- The Chiang Mai Initiative (CMI) was developed to provide an institutional support against speculative attacks on countries.
- Under the original mechanism Japan, China and South Korea signed bilateral agreements with the original five ASEAN member countries establishing a network of bilateral swap agreements (BSAs). ▸ CMI
- Through most of the period the CMI continued to be primarily bilateral in nature and the use of BSAs required approval from each lender.
- The size of the swap facility, till recently, has only marginally increased the financial resources available to the country to help them in their liquidity need.
- Only 20% of the BSA facility is immediately available to the borrowers while the rest 80% requires IMF approval.

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Strengthening the Chiang Mai Initiative

- At the Istanbul meeting in 2005 number of steps were decided on how to strengthen the CMI
  - Develop an effective regional surveillance.
  - Adopt a collective decision making mechanism as a first step toward multilateralization.
  - Expand the size of the bilateral agreements.
  - Increase the amount a country can draw without having an IMF program.
- There was an increase in the amount a country could draw without being subject to an IMF program from 10% to 20%.
- Recently there has been a transition to an expanded Chiang Mai Initiative, whereby a collectively managed regional fund with a corpus of $120 billion is set to be established.

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Widening the Chiang Mai Initiative

- The CMI continues to be an ASEAN+3 initiative and is yet to acquire a pan Asia profile.
- Has to contend with a resurgent International Monetary Fund.
- It would be able to do so by inviting other countries to join the Initiative.
- Given India's stockpile of reserves, it would be in a relatively comfortable position to contribute to the Initiative.
- India would benefit significantly by joining such an Initiative, which would stabilize its currency in the event of large outflows.

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- The Fund was supposed to invest in bonds issued by the public sectors of eight countries.
- ABF was unable to resolve an insolvency crisis arising from currency mismatch and maturity mismatch.
- Recognizing the threat of these mismatches and to promote local currency denominated bond, the central bankers introduced ABF-2 in December 2004 raising the corpus to $2 billion.
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Strengthening the Asian Bond Fund

- There is an immediate need to amplify the corpus of funds available with the ABF for it to play a deciding role in deepening capital market integration in the region.
- With countries exhibiting different degrees of current account deficits and surpluses, a strong bond market would help useful absorption of intra-regional debt flows.
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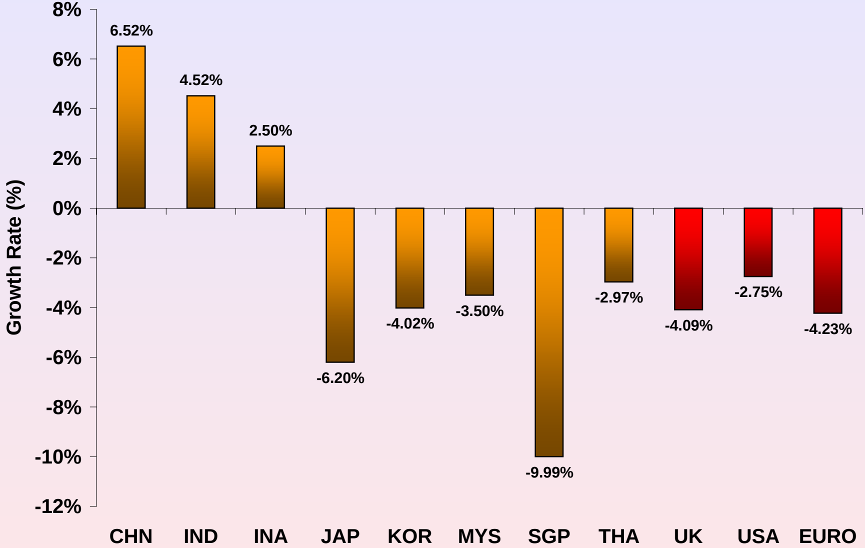
Thank You

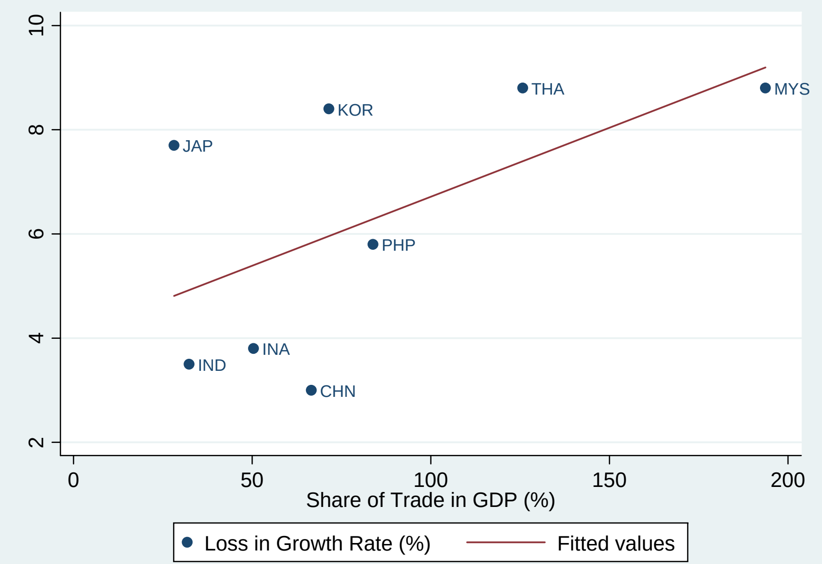
Estimated Growth Rates in 2009



Source: IMF's World Economic Outlook, April 2009

Asia

Trade Openness & Loss of Growth



▸ Trade Channels ▸ Singapore

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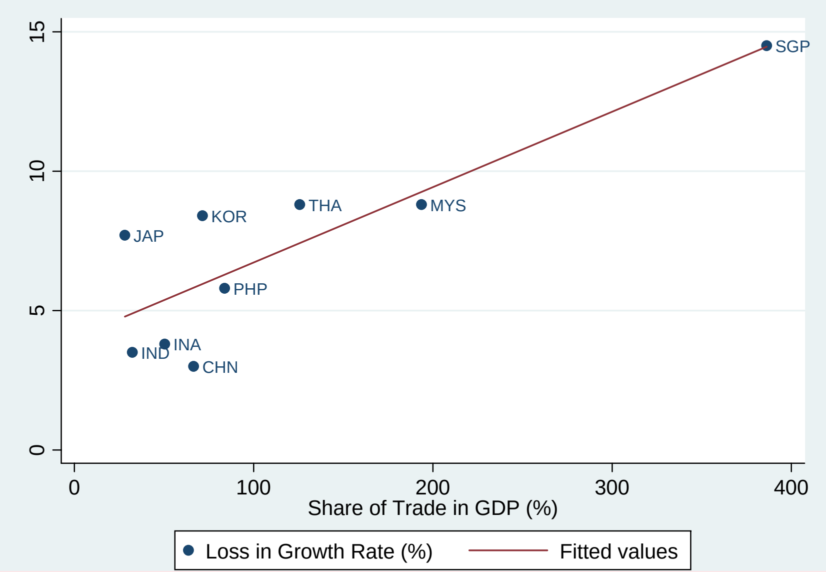

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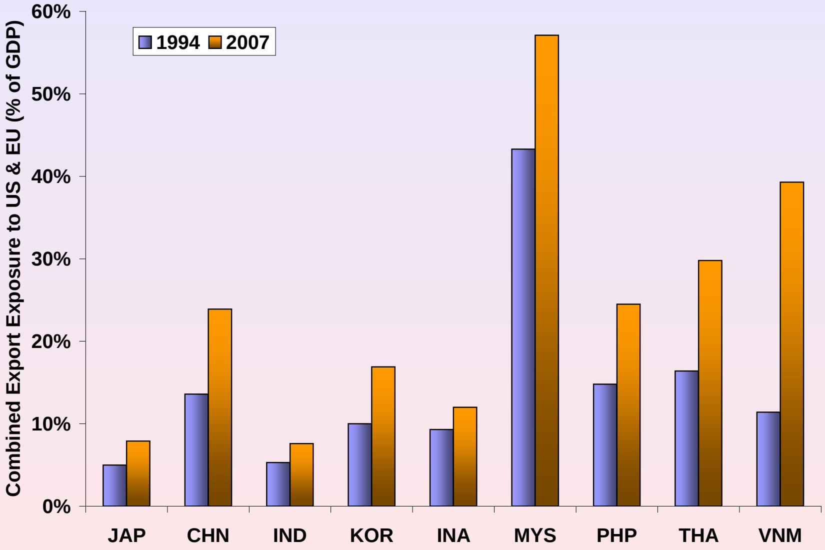
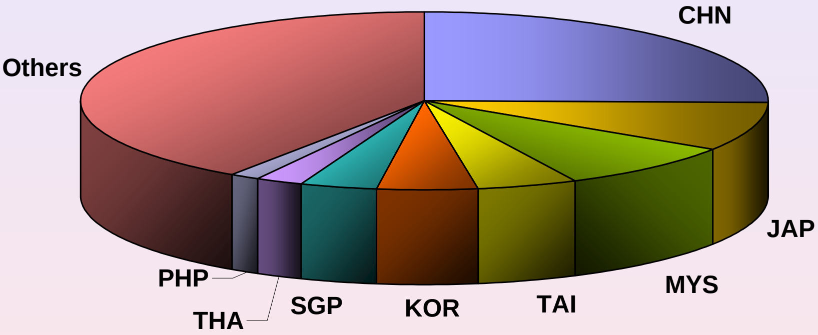
Trade Integration with EU & US



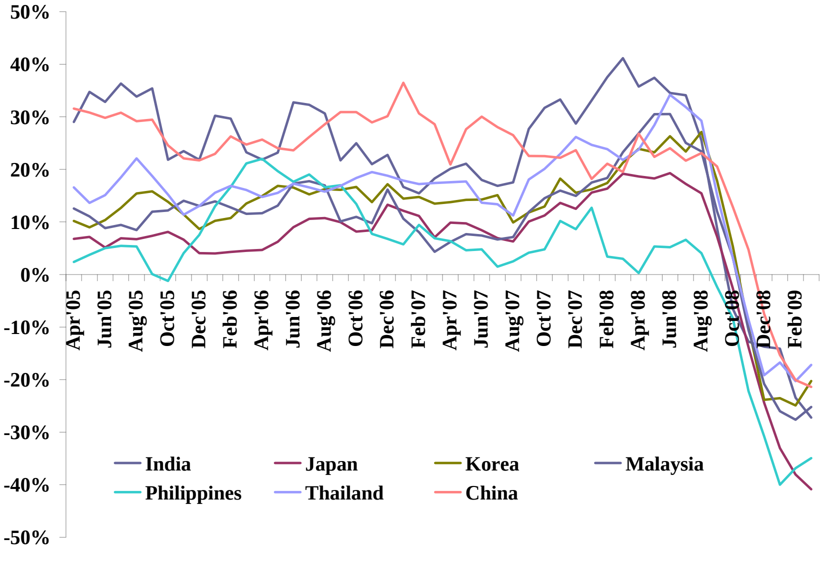
Trade Channels

US' imports of Advanced Technology Products



Trade Channels

Growth Rate of Exports (3 month average)



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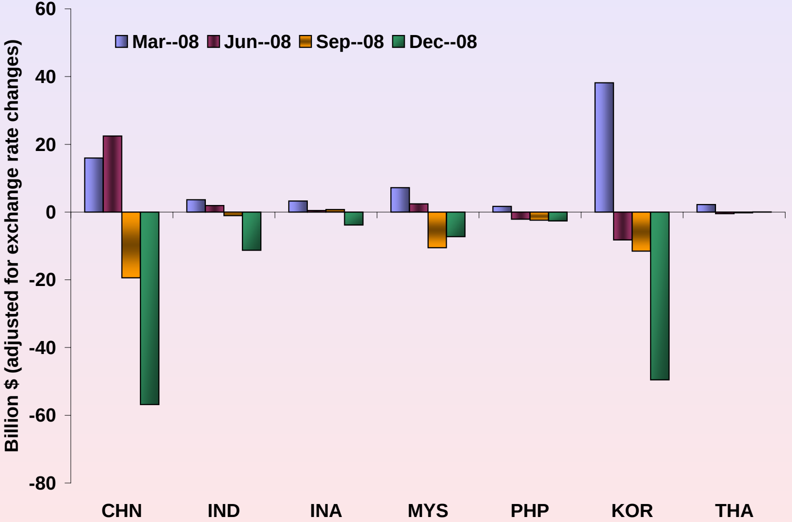
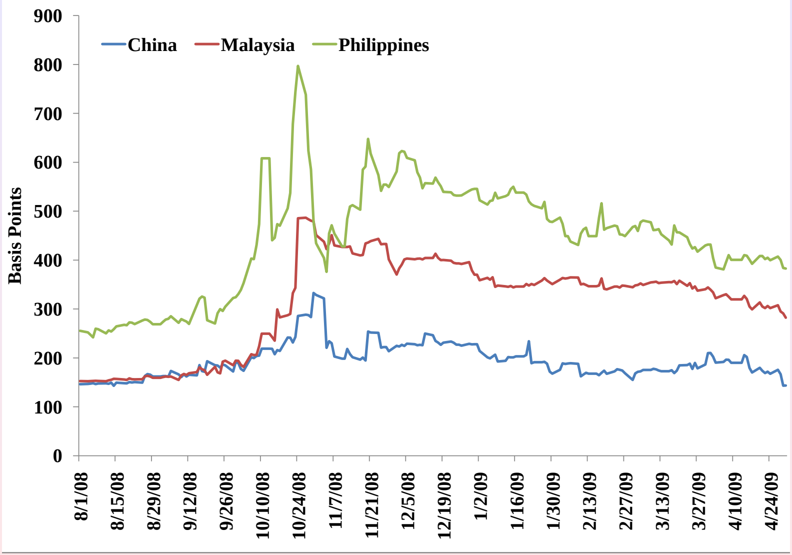
Changes in International Claims of Reporting Banks *vis-á-vis* Asian Countries



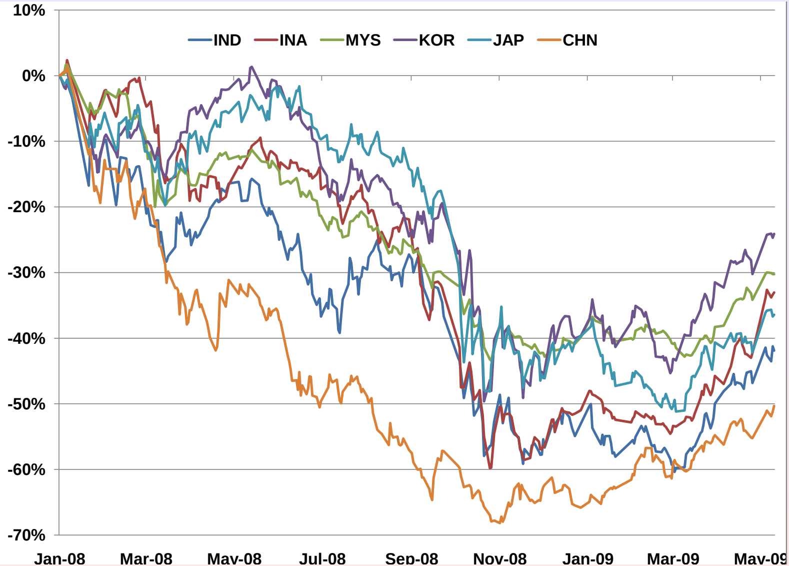
Financial Channels

JPMorgan Emerging Markets Bond Index Global



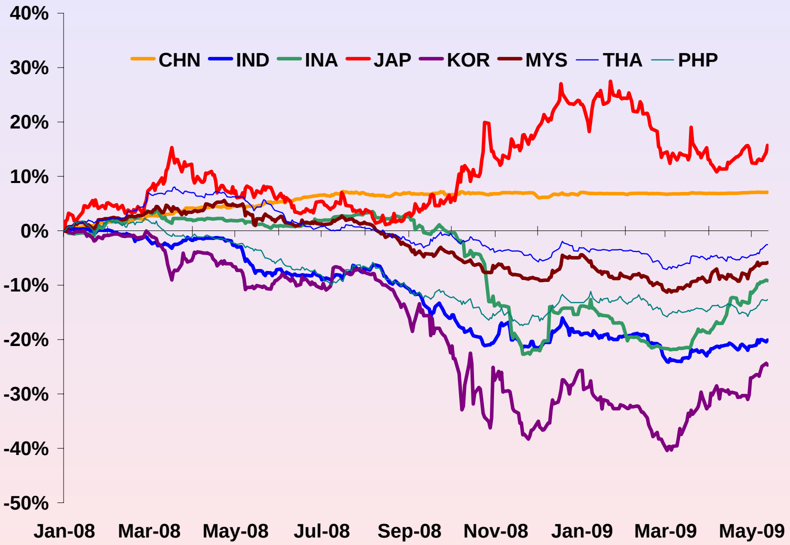
Financial Channels

Percentage Deviation of Asian Stock Markets



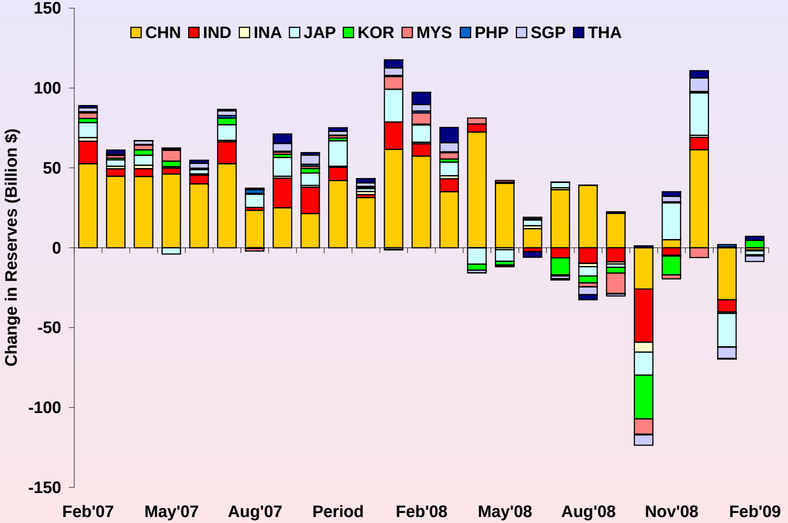
Financial Channels

Percentage Deviation of Asian Currencies



Financial Channels

Change in Reserve Holdings of Key Asian Countries



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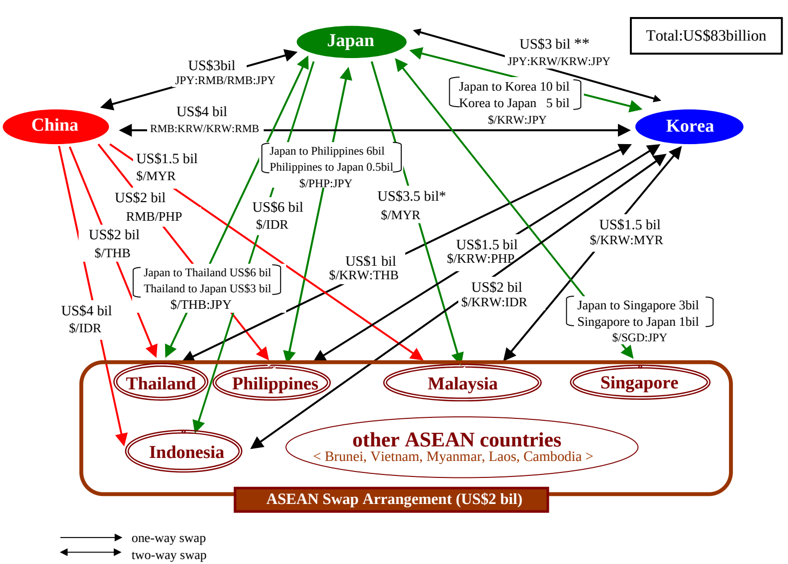
Chiang Mai Initiative Swap Arrangement



CMI