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.

- Growth rate of developing countries is set to decline from 6.1% in 2008 to 1.6% in 2009.
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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.

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.

- 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 epicentre of crisis rose considerably over the last decade.

- The impact has been exacerbated by the product mix of the region’s exports, most of which is concentrated in technology intensive manufacturing.

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The Asian financial sector has remained robust in the face of global financial turmoil, but there have been indirect effects. 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 losses pushed advanced economies’ financial institutions to reduce their exposure to emerging markets.

Access to international bond financing has become much more difficult with bond spreads increasing sharply.

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Monetary and Financial Cooperation
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). 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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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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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 11 members of the EMEAP Central Bank agreed in 2003 to establish the Asian Bond Fund, a regional investment fund investing in bonds denominated in U.S. dollars.

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.

Increasing participation to newer members as well as greater commitment of resources by the central banks would help alleviate this problem.
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Thank You
<table>
<thead>
<tr>
<th>Country</th>
<th>Growth Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CHN</td>
<td>6.52%</td>
</tr>
<tr>
<td>IND</td>
<td>4.52%</td>
</tr>
<tr>
<td>INA</td>
<td>2.50%</td>
</tr>
<tr>
<td>JAP</td>
<td>-6.20%</td>
</tr>
<tr>
<td>KOR</td>
<td>-4.02%</td>
</tr>
<tr>
<td>MYS</td>
<td>-3.50%</td>
</tr>
<tr>
<td>SGP</td>
<td>-2.97%</td>
</tr>
<tr>
<td>THA</td>
<td>-4.09%</td>
</tr>
<tr>
<td>UK</td>
<td>-2.75%</td>
</tr>
<tr>
<td>USA</td>
<td>-4.23%</td>
</tr>
<tr>
<td>EURO</td>
<td>-12%</td>
</tr>
<tr>
<td>UK</td>
<td>-10%</td>
</tr>
<tr>
<td>USA</td>
<td>-8%</td>
</tr>
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<td>EURO</td>
<td>-6%</td>
</tr>
<tr>
<td>USA</td>
<td>-4%</td>
</tr>
<tr>
<td>EURO</td>
<td>-2%</td>
</tr>
<tr>
<td>USA</td>
<td>0%</td>
</tr>
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<td>2%</td>
</tr>
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<td>USA</td>
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</tr>
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Source: IMF's World Economic Outlook, April 2009
Trade Openness & Loss of Growth

- CHN
- IND
- INA
- JAP
- KOR
- MYS
- PHP
- SGP
- THA

Share of Trade in GDP (%) vs. Loss in Growth Rate (%)

- **Fitted values**
- **Loss in Growth Rate (%)**
- **Trade Channels**

Sen Gupta (JNU)  
Financial Crisis  
8th Ind-Kor Dialogue  
16 / 25
Trade Integration with EU & US

Combined Export Exposure to US & EU (% of GDP)

- JAP
- CHN
- IND
- KOR
- INA
- MYS
- PHP
- THA
- VNM

US’ imports of Advanced Technology Products

- CHN
- JAP
- MY
- TAI
- PHP

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

Financial Channels

Sen Gupta (JNU)  Financial Crisis  8th Ind-Kor Dialogue  20 / 25
Percentage Deviation of Asian Stock Markets

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>0%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>40%</td>
<td>50%</td>
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Jan-08 Mar-08 May-08 Jul-08 Sep-08 Nov-08 Jan-09 Mar-09 May-09

Financial Channels

Sen Gupta (JNU)
The Agreement on the Swap Arrangement under the Chiang Mai Initiative (as of December 12, 2008)

Total: US$83 billion

- US$4 billion: Japan to Korea
- 10 billion: Korea to Japan
- 3 billion: US$/KRW
- JPY: RMB/RMB: JPY

- 6 billion: Japan to Philippines
- 0.5 billion: Philippines to Japan
- 1.5 billion: US$/MYR

- 2 billion: Japan to Singapore
- 3 billion: Singapore to Japan
- 1.5 billion: US$/KRW

Note: Total amount includes those under negotiation for renewal, but does not include New Miyazawa Initiative and ASEAN swap arrangement.

* Including New Miyazawa Initiative

The agreement between Japan and Malaysia: US$2.5 billion under the New Miyazawa Initiative and US$1 billion under the Chiang Mai Initiative

The Bank of Japan announced on December 12, 2008, that it had reached an agreement with the Bank of Korea on an increase in the maximum amount of the existing bilateral JPY/KRW swap arrangement from three billion US dollars equivalent to twenty billion US dollars equivalent. This increase will be effective until the end of April 2009.

one-way swap
two-way swap

ASEAN Swap Arrangement (US$2 bil)

other ASEAN countries
< Brunei, Vietnam, Myanmar, Laos, Cambodia >