

**GLOBAL FINANCIAL CRISIS: MACROECONOMIC
POLICY ISSUES FOR ASIA**

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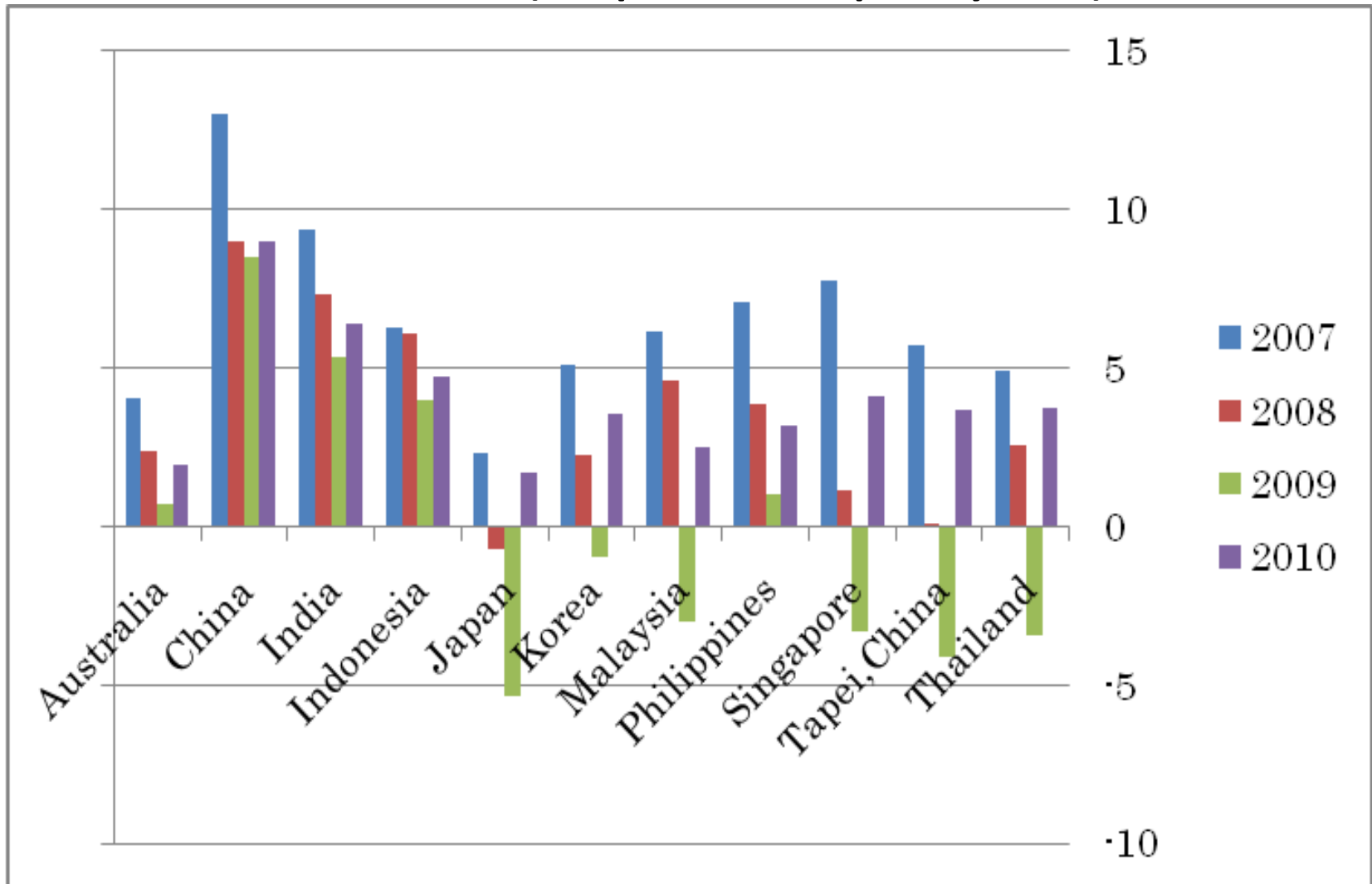
What the paper does

- Reviews major policy measures taken in Asia
- Draws lessons from the macroeconomic policy experiences of Asia
- Discusses medium-term issues for macroeconomic policy in Asia, including the need for rebalancing of demand
- Focus on China, India, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taipei, China, and Taiwan, with occasional references to other countries

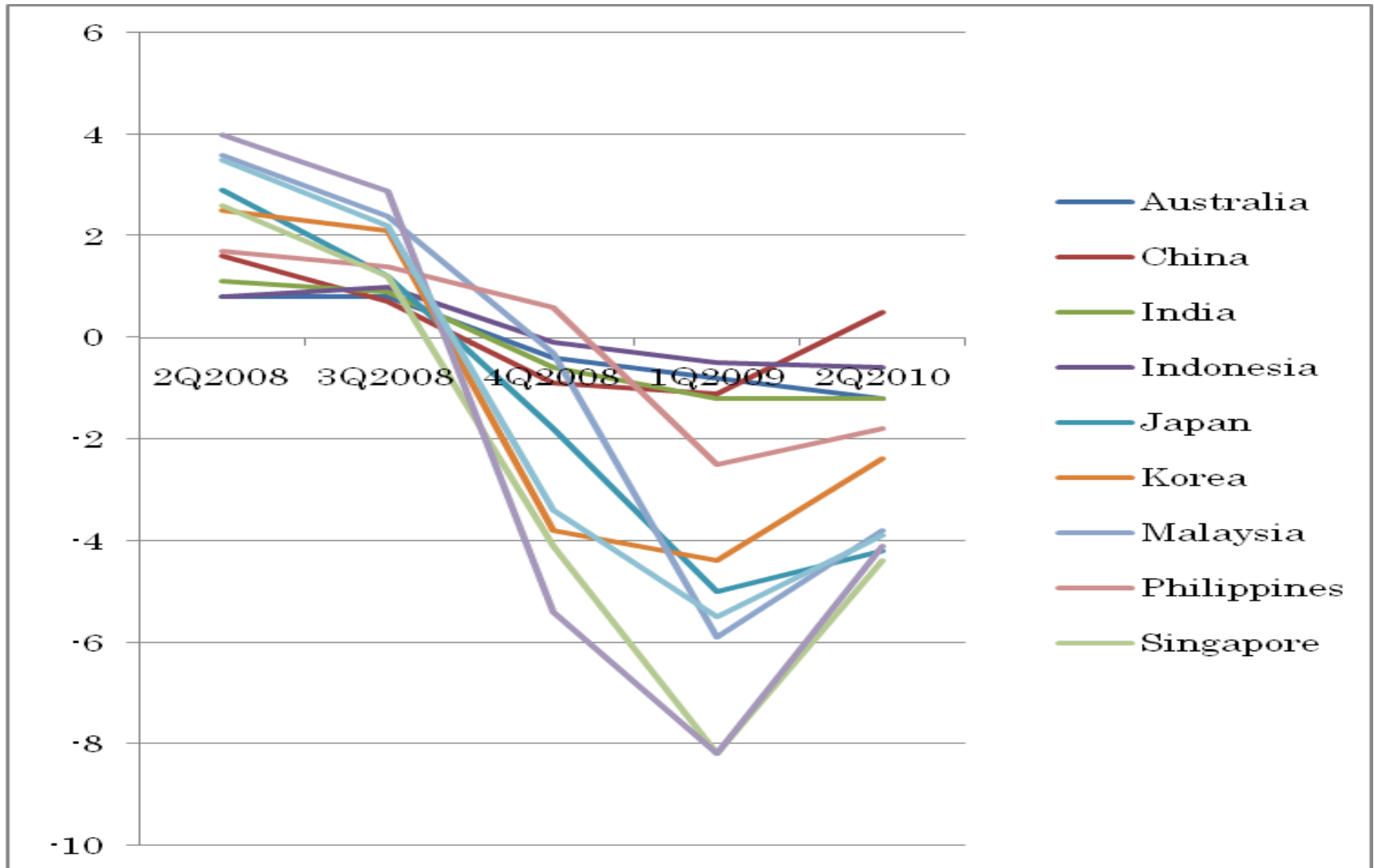
Macro Impact on Asia

- Severe on Japan, Taipei, China, Singapore, Thailand, and Malaysia
- Growth remained positive in China, India, and Indonesia (though adversely affected)
- Relatively early recovery of Korea

Real GDP Growth in Selected Asian Economies, 2007-10 (In percent per year)



GDP Gaps (by HP filter)



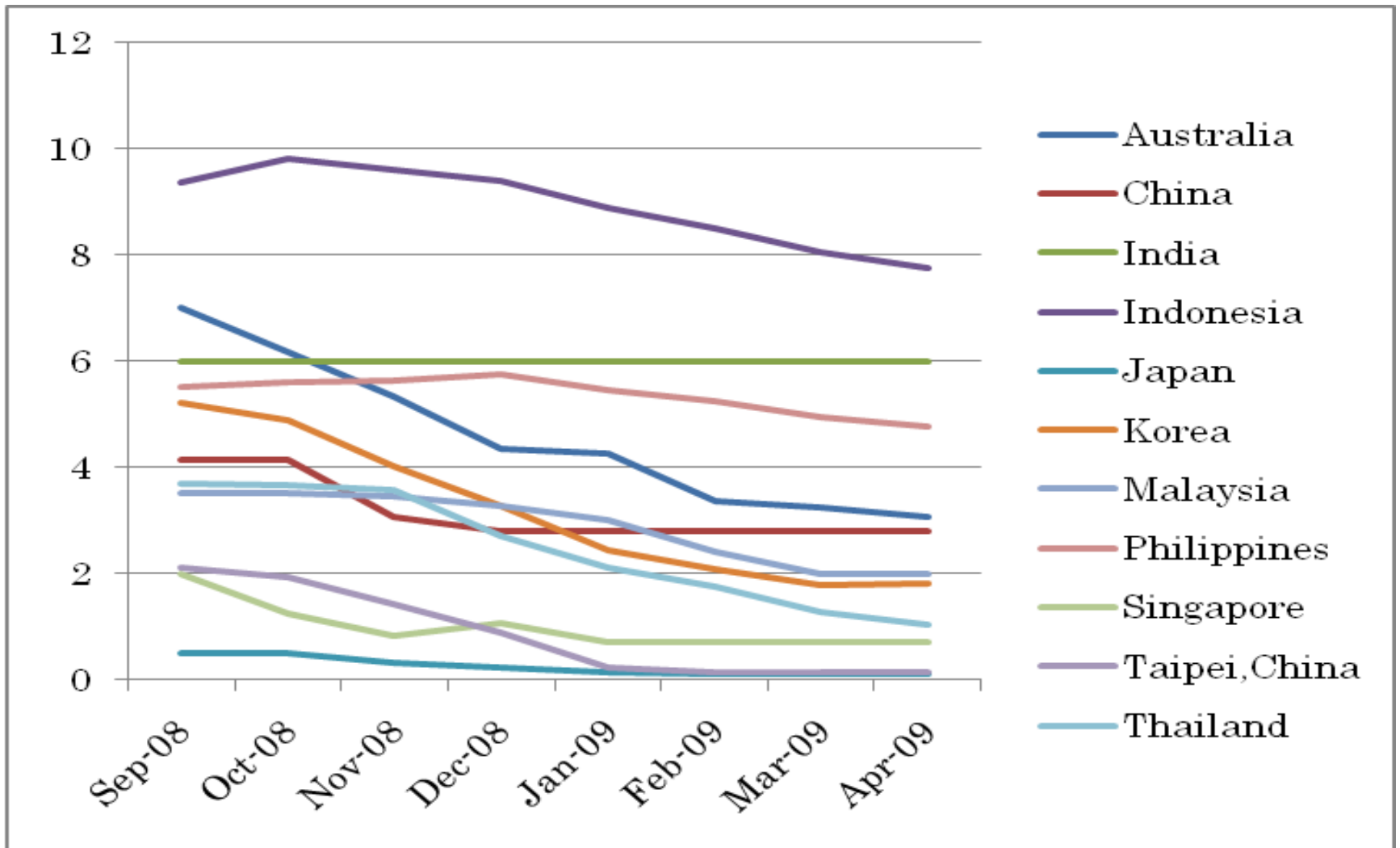
Monetary Policy—Measures

- Monetary tightening through the summer of 2008
- Following the Global Financial Crisis, Asia shift to monetary easing throughout Asia, but with different backgrounds and timings

Monetary Policy—Measures

- Cut in policy interest rates in almost all economies
- Other conventional measures (e.g. lower reserve requirements) in some
- Unconventional measures in a number of economies (especially Japan)—generally involving expanding eligible collateral and eligible parties for central bank facilities; some purchases of private sector debt

Market Interest Rates in Selected Asian Economies (In percent per year)



Monetary Policy—Effectiveness

- Monetary policy is effective when recession is not associated with a financial crisis
- Monetary policy was likely effective in countries that started with sufficiently high interest rates—because the financial sector was not impaired
- Some evidence of effectiveness of unconventional measures in other countries

Monetary Policy—Medium Term Issues

- Exit—the level of interest rates and unconventional measures
- Importance of keeping interest rates high during good times—need to resist tendency towards asymmetric use of monetary policy
- Exit from unconventional measures is made easy when they are introduced explicitly as time-bound measures (BOJ); need for good communication strategy

Monetary Policy—Medium Term Issues

- Inflation focus is important for price stability, but inflation targeting is not essential
- Need to give more attention to financial stability, but financial stability should not be assigned to the objective of monetary policy (no operational definition)
- Primary tool for financial stability should be financial regulation and supervision
- Broadly, financial stability is part of achieving price and macroeconomic stability

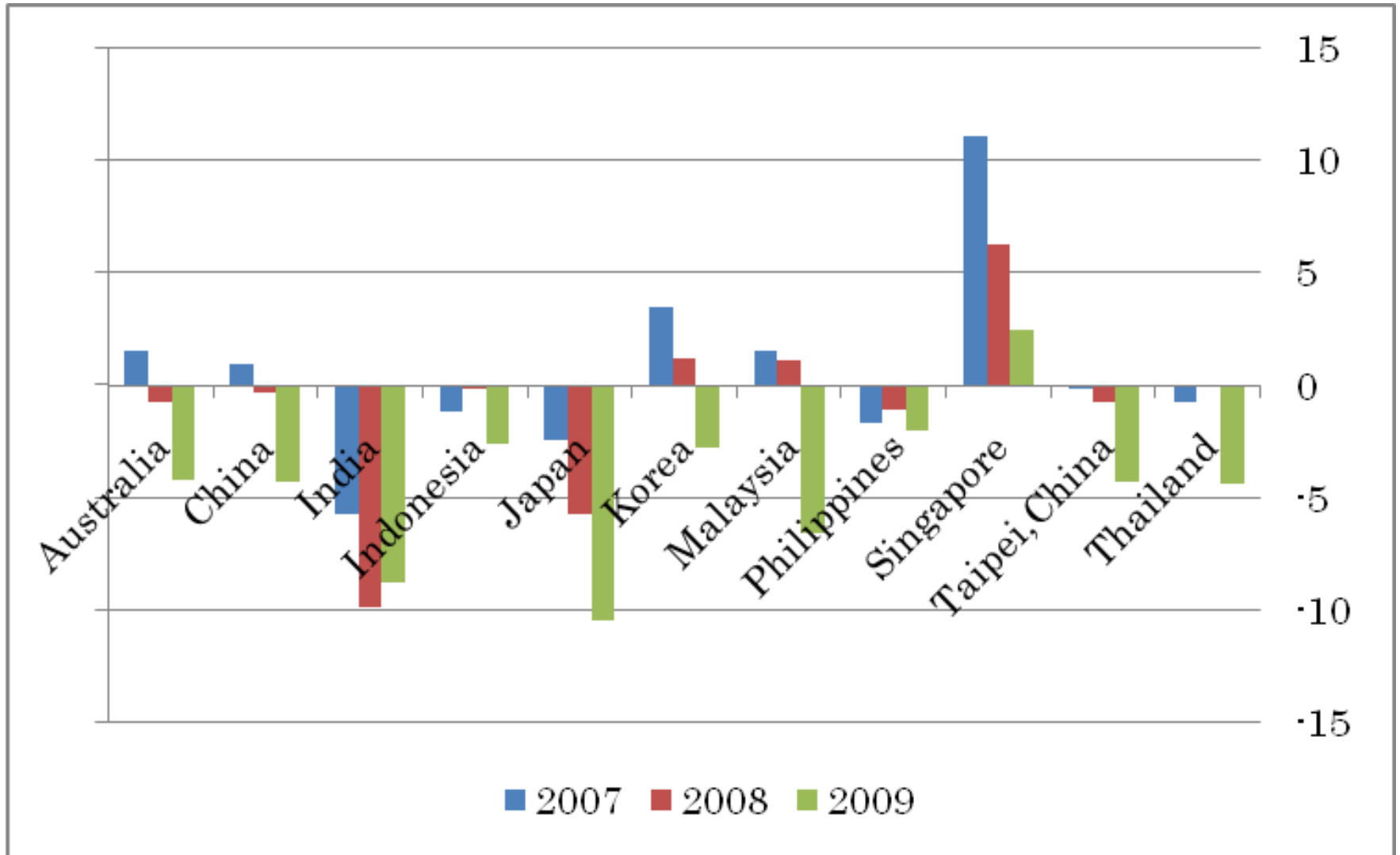
Fiscal Policy—Measures

- Substantial fiscal easing throughout Asia
- Net stimulus was particularly large in China and Korea
- Stimulus packages were generally larger in Asia than in other parts of the world
- Coupled with other factors (including automatic stabilizers), significant fiscal deterioration observed throughout Asia, especially in Malaysia, Japan, and Singapore (though Singapore retained a fiscal surplus)

Fiscal Policy in Major Asian Countries (In percent of GDP, change with respect to pre-crisis year 2007)

| | 2009 | | 2010 | |
|-----------|-----------------|--|-----------------|--|
| | Overall balance | Crisis-related discretionary fiscal measures | Overall balance | Crisis-related discretionary fiscal measures |
| Australia | -5.8 | -2.9 | -6.8 | -2.0 |
| China | -4.8 | -3.1 | -4.8 | -2.7 |
| India | -6.0 | -0.6 1/ | -5.6 | -0.6 |
| Indonesia | -1.4 | -1.4 | -0.9 | -0.6 |
| Japan | -7.4 | -2.4 | -7.5 | -1.8 |
| Korea | -6.2 | -3.6 | -6.2 | -4.7 |

Fiscal Balances in Selected Asian Countries (In percent of GDP)



Fiscal Policy—Measures

- Relatively healthy public finances in Asia allowed aggressive use of countercyclical fiscal policy
- Japan and India went ahead with an aggressive fiscal package, despite the high debt-to-GDP ratio
- Philippines had limited fiscal space, yet used all available fiscal space to expand fiscal policy

Fiscal Policy—Measures

- Transfers dominated Japan's packages, while government investment dominated fiscal packages in the rest of Asia
- Japan, Taipei, China and Thailand had cash payments to households
- Some use of tax cuts in various countries

Fiscal Policy—Implementation

- Limited absorptive capacity for government investment—large unused funds reported in China, Malaysia, Japan, Indonesia, etc.
- Tax cuts and transfers implemented rather quickly
- Infrastructure spending can lead to inefficiency and corruption and has a danger of becoming permanent

Fiscal Policy—Effectiveness

- In theory, effectiveness of fiscal policy is ambiguous
- Recent empirical work suggests that though the effectiveness is ambiguous, fiscal policy can be effective when recession is associated with a financial crisis; promoting demand from liquidity-constrained agents
- Targeted transfers and tax cuts to be preferred to investment, which is to be preferred to general transfers

Fiscal Policy—Effectiveness

- The experience of Asia suggests that the general cash transfer schemes of Japan and Thailand were failures (about 30 percent and 20 percent reported increased spending)—consistent with a similar study on the US experience
- Targeted tax cut in Thailand (waivers and reduction of real estate taxes) was effective in economic transactions
- Provision of government funds as working capital in Malaysia did not work

Fiscal Policy—Medium Term Issues

- Empirical evidence to show impact of debt on long-term long interest rates
- Fiscal institutions can mitigate the negative impact—suggesting the importance of the perception of medium-term fiscal sustainability

Fiscal Policy—Medium Term Issues

- No serious concerns about fiscal sustainability exist for Asia (high debt-to-GDP ratios for Japan and India)
- JGBs mostly held by domestic residents
- Several countries, Indonesia, India, Philippines—have fiscal rules in place, though the frameworks may need to be strengthened further
- Pressing need for introducing or strengthening automatic stabilizers, especially on the expenditure side (they correspond to targeted transfers that proved effective as a discretionary measure)

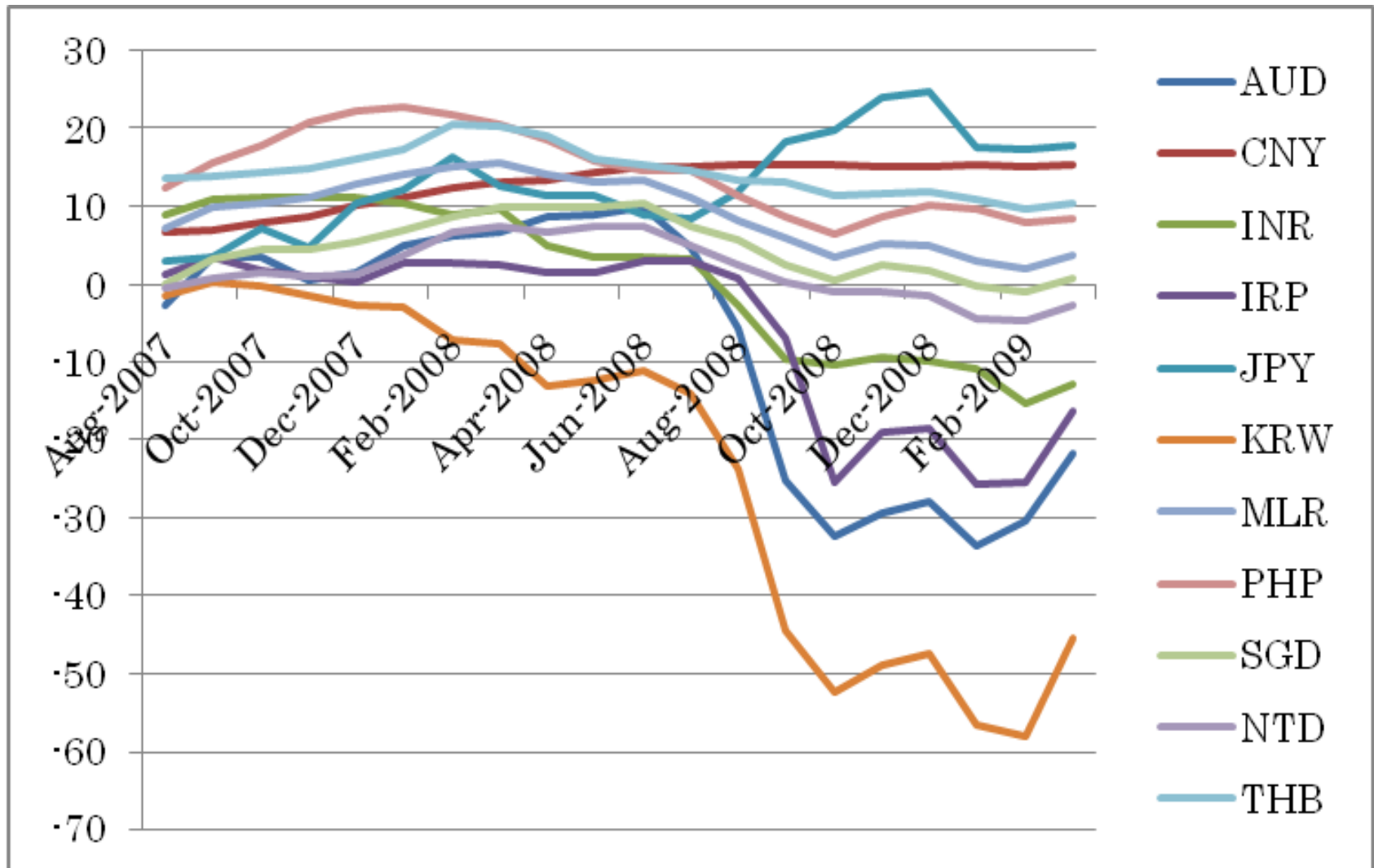
Gross Government Debt in Major Asian Countries (In percent of GDP)

| | 2007 (actual) | 2009 (estimate) | 2010 (projection) | 2014 (projection) |
|-----------|---------------|-----------------|-------------------|-------------------|
| Australia | 9.8 | 16.9 | 22.7 | 27.8 |
| China | 20.2 | 20.2 | 22.2 | 20.0 |
| India | 80.5 | 84.7 | 85.9 | 78.6 |
| Indonesia | 35.1 | 31.5 | 31.2 | 27.1 |
| Japan | 187.7 | 218.6 | 227.0 | 245.6 |
| Korea | 29.8 | 34.9 | 39.4 | 35.4 |

External Policies—Exchange Rate Policies

- Except for Japan, Asia has preference for stable US dollar exchange rates
- All currencies, except for the yen, experienced considerable softening against the US dollar
- As a result, the yen diverged significantly from the other Asian currencies as the crisis developed—exorbitant burden of adjustment for Japan

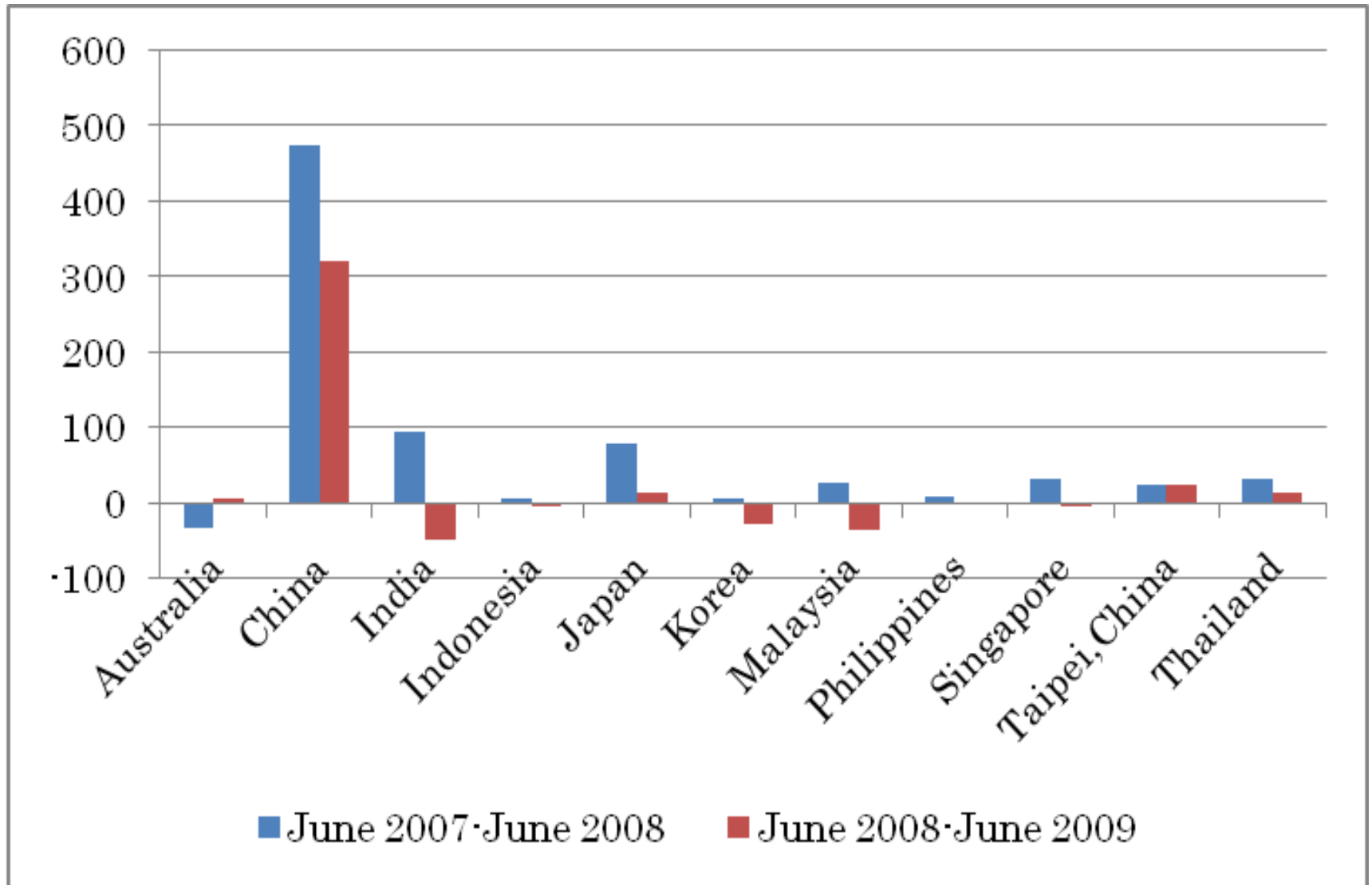
Selected Asian Currencies vis-à-vis the US Dollar (In cumulative percentage change from August 2007)



External Policies—Reserve Accumulation

- Reserve accumulation as an insurance against a sudden reversal of capital and a buffer against imported macroeconomic instability
- Reserve accumulation has a cost—a sacrifice of consumption
- Also it led to global imbalances
- With the experience at the height of the crisis, some Asian countries may resume accumulating more reserves—back to the pre-crisis regime

Changes in the Stock of Foreign Exchange Reserves in Selected Asian Countries (In billions of US dollars)



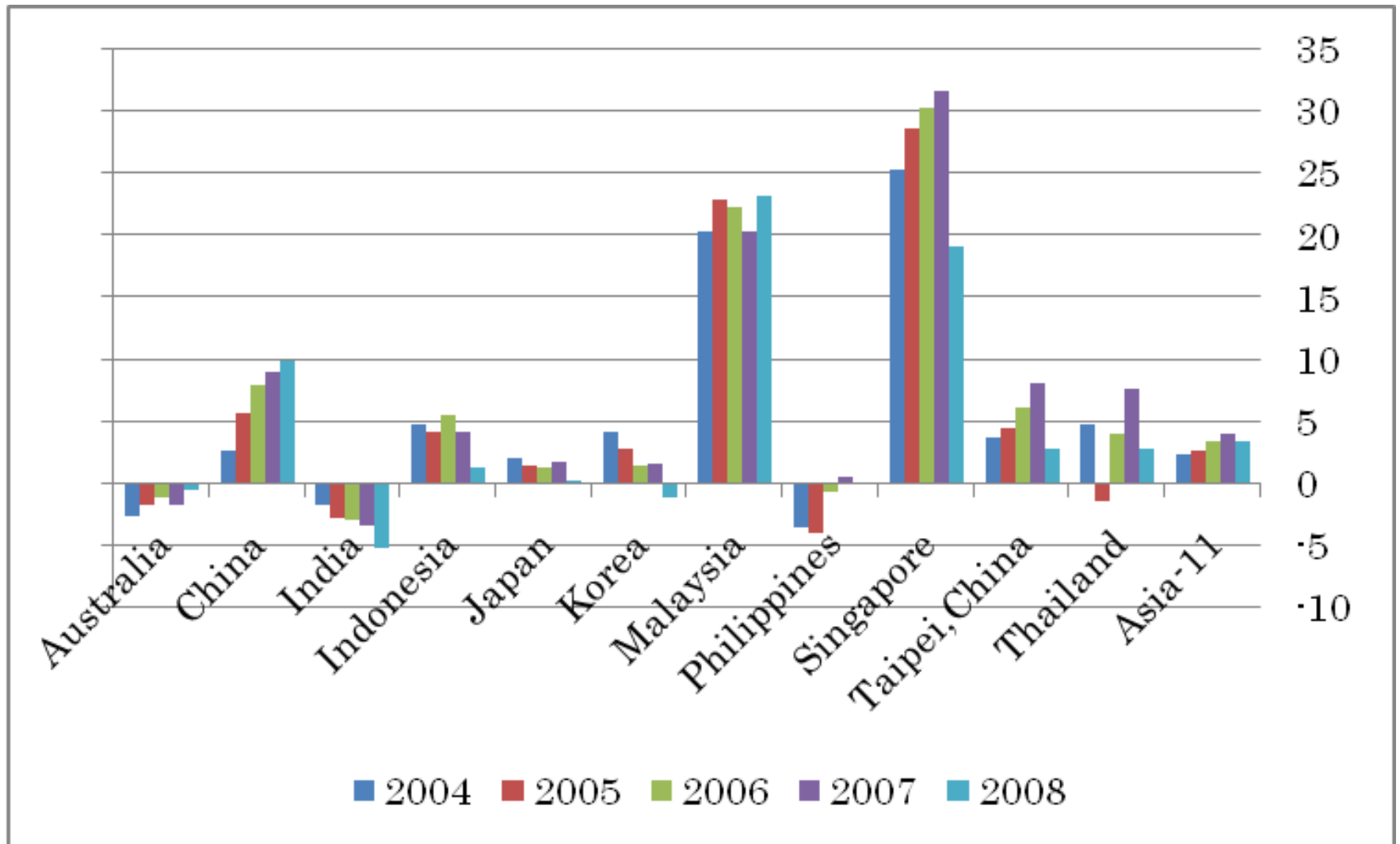
External Policies—Medium Term Issues

- Global rebalancing of demand requires that Asian economies should not continue to accumulate foreign exchange reserves in the form of US government debt
- A flipside of this is to refrain from stabilizing US dollar exchange rates
- Regional cooperation is key—CMIM could potentially reduce incentive for holding reserves; exchange rate cooperation can overcome collective action problem to increase flexibility against the US dollar

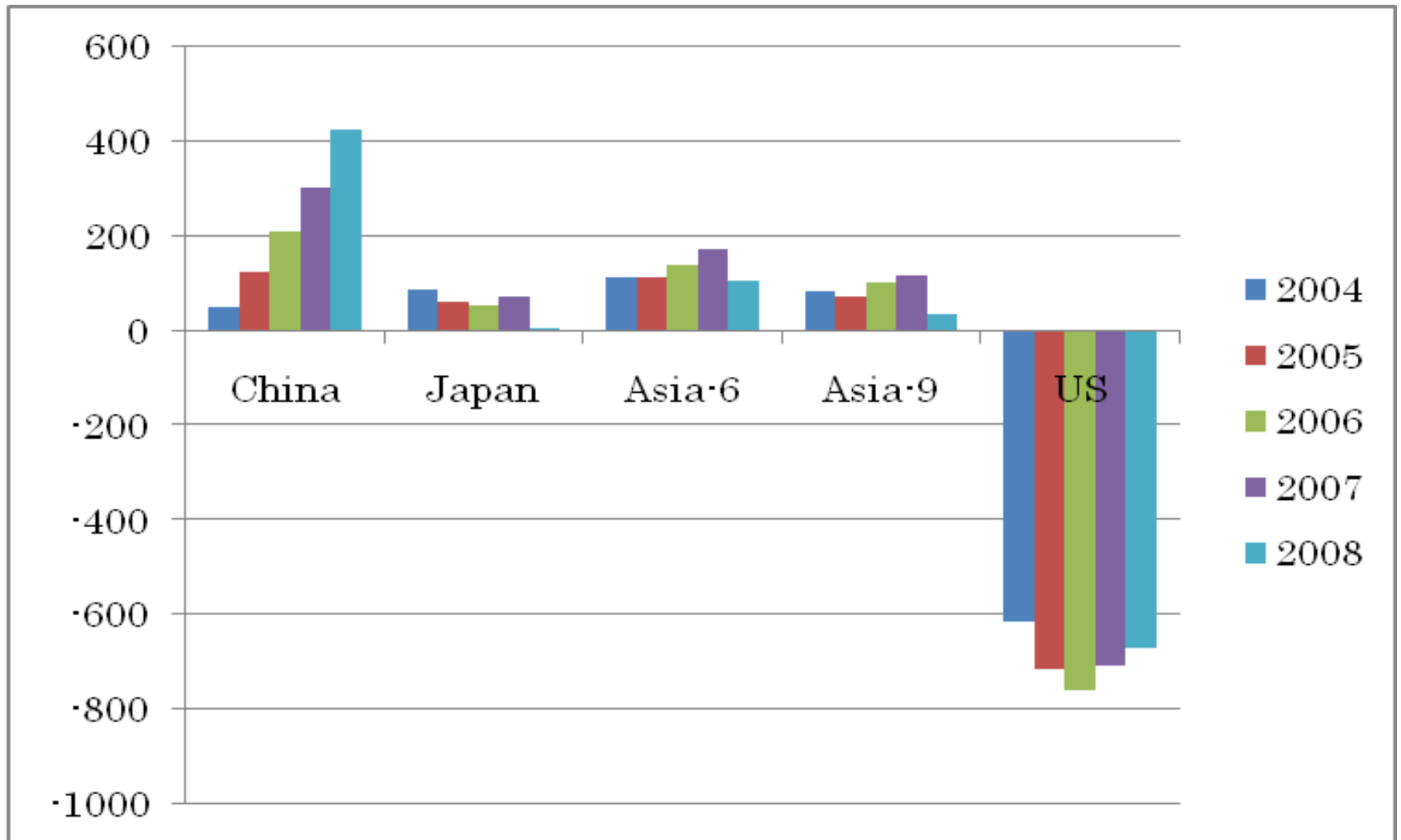
Global Rebalancing

- The role Asia can play in the global rebalancing of demand is large.
- In terms of imbalances as a percent of GDP, considerable policy adjustments are required of Singapore, Malaysia, and China.
- In terms of absolute scale, China must lead the way. Increasing government spending is an effective way to increase consumption in China by reducing precautionary savings.

Current Account Balances in Selected Asian Economies (In percent of GDP)



Global Rebalancing: Current Account Balances in Asia and the US (In billions of US dollars)



Conclusions

Two overwhelming lessons:

- (1) Countries must secure adequate monetary and fiscal policy space during good times with sufficiently high interest rates and sufficient fiscal discipline
- (2) With sufficient policy space, aggressive easing of monetary and fiscal policies can pull a country out of a serious global recession

Conclusions

Regional cooperation is key for facilitating orderly adjustment of global imbalances—to minimize incentive for reserve accumulation by offering an alternative insurance against a sudden reversal of capital and to ensuring a collective appreciation of the region's currencies against the US dollar through a mechanism to overcome the collective action problem

Thank you for your attention.