



Lecture Outline

# Global Economic Crisis and East Asian Economy

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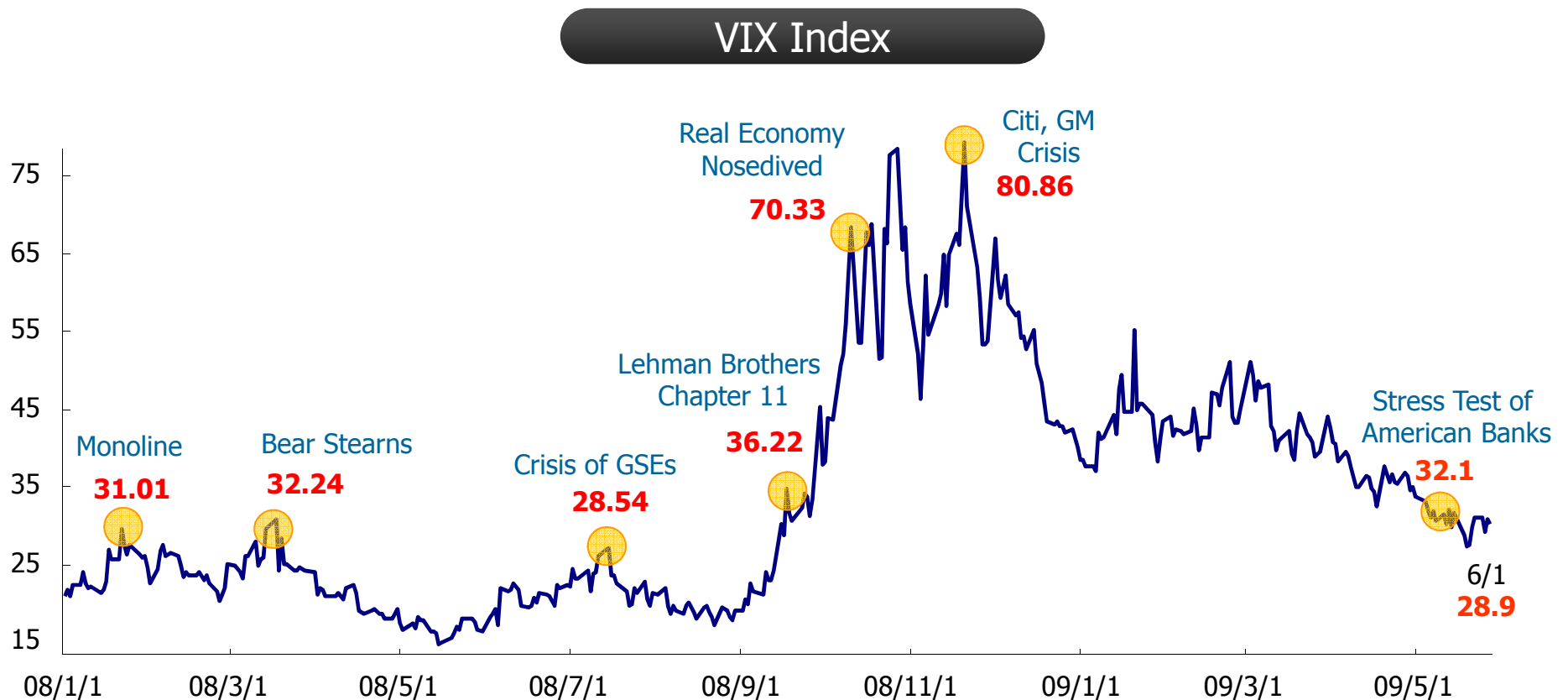


## Topics to be covered

- Global Economic Crisis: Causes and Prospect
- Impact on Korean economy and Government Policy
- Impact on China and Japan
- Regional Cooperation: Finance and Real Sectors
- Impact on Corporations: Japan vs. Korea
- Implications for Hokkaido Economy

# 2008 Global Financial and Economic Crisis

- 2007. 8 Subprime Mortgage Crisis Emerged
- 2008. 9 Lehman Brothers Bankruptcy
- 2008. 10 From Financial Crisis to Economic Crisis
- 2009. 5 Financial Market Stabilized



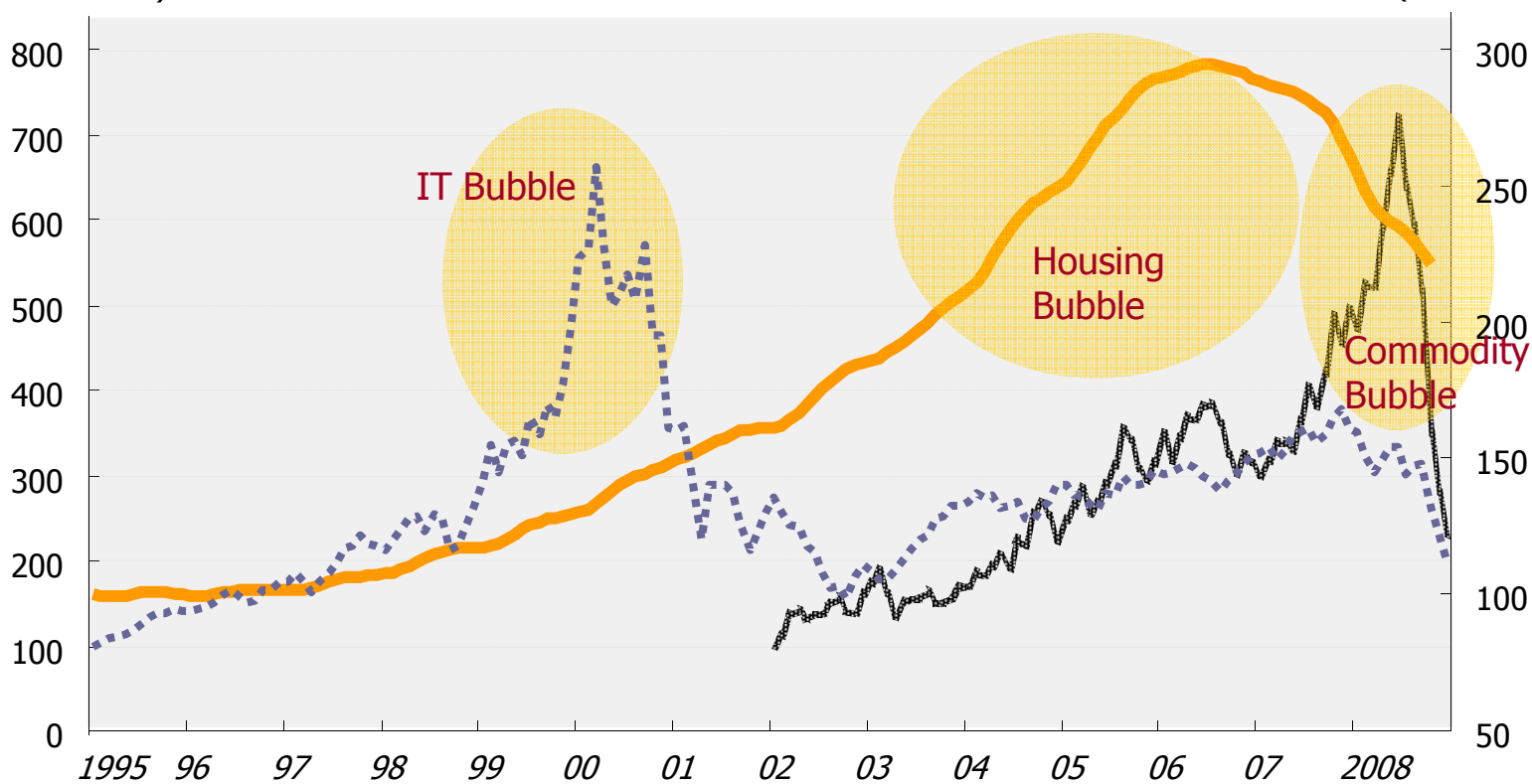
# Two Bubbles Burst after "Goldilocks Economy"

... NASDAQ  
(1995.1 = 100)

— WTI spot  
(2002.1 = 100)

## Bubble Cycles

— Housing index  
(1995.1 = 100)



\* source : Global Insight



# Causes of Global Financial Crisis of 2008

## ■ Immediate Reasons

- Low interest rates and excess liquidity of 2002-2004
- Manufactured products of China keeping inflation under control
- Liquidity flowing into asset markets: real estate and stock
- Housing market bubble and Subprime Mortgage Crisis

## ■ Structural Reasons

- Global Imbalance: the U.S. vs. East Asia and Oil Exporters
- Triffin Dilemma: Role of U.S. Dollar as Global Currency

## ■ Systemic Problems

- Anglo-American Capitalist System
- Lax Regulation of Financial Markets/Institutions (derivatives market)
- Management of Financial Institutions: risk-taking and compensation



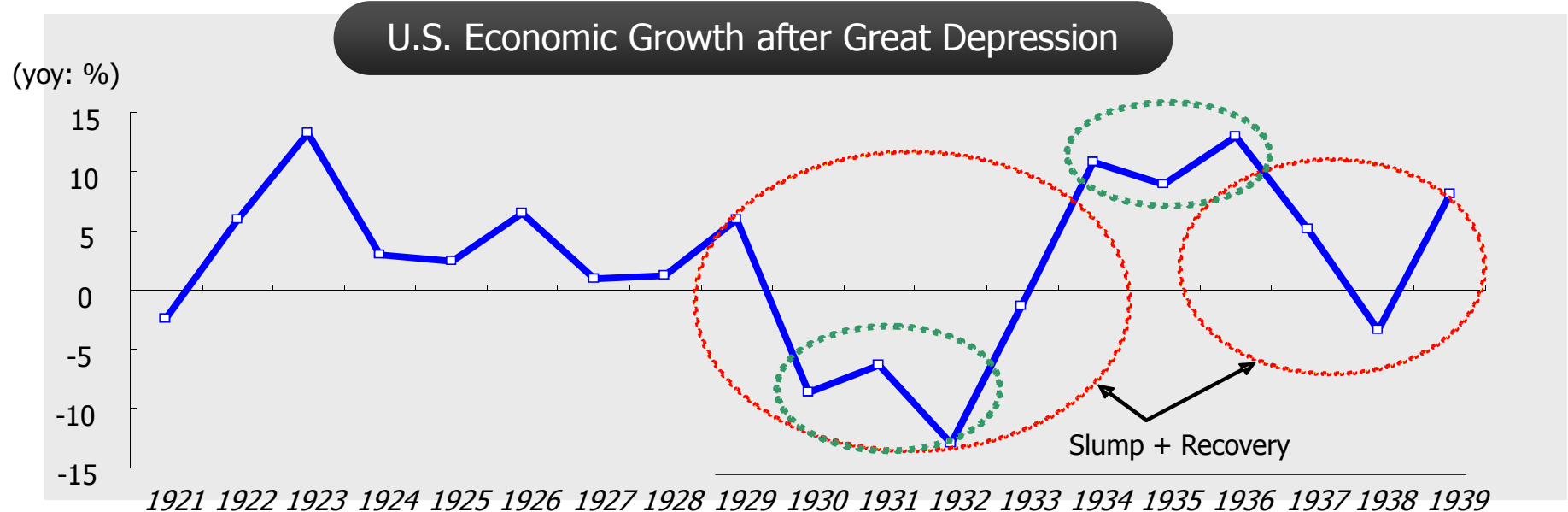
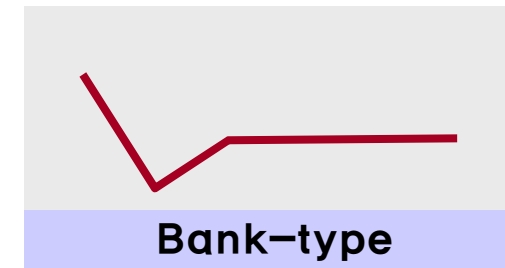
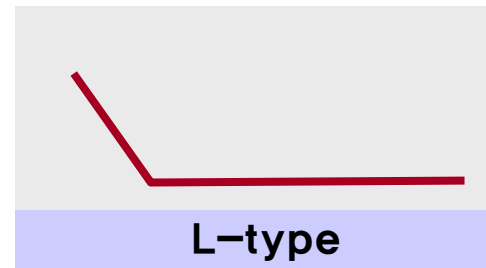
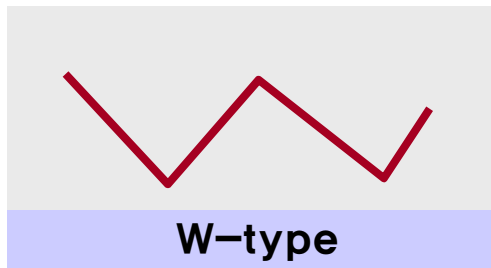
## Global Responses and Policy Coordination

- **Massive government spending and Zero Interest Rates**
  - Massive Capital Infusion on Financial Institutions
  - Fiscal Deficits of G7 Countries: 3-14% in 2009
  - Zero interest rates and unlimited supply of money
  
- **Policy Coordination**
  - Main Reason for Great Depression: Lack of Leadership
  - Spread of Protectionism has been under control
  - New Coordination Mechanism developed: G20 meetings
  
- **Prospect of Recovery**
  - Financial Meltdown unlikely
  - Emerging Markets seem to be robust, esp. China
  - Reaching the bottom of cycle?

# Prospect of Economic Recovery

## ■ Exit Strategy very difficult to manage

- Unemployment still increasing and housing prices declining
- Government budget deficits, excess liquidity and inflation pressures



Source : BEA, C.Romer(1989), Datastream

# Korean Economy: Vulnerable but Resilient

- **Vulnerable Because of 'open, small economy'**
  - High Dependence on External Trade
  - High Degree of Capital Market Openness
  - Small Domestic Market
  - Case Study: 'Success Cost' of Shipbuilding Industry and Short-term Capital Problem
- **Resilient thanks to 1997 Financial Crisis, or "IMF Crisis"**
  - IMF Imposing Austerity Policy as Conditions for Emergency Funding
  - More than one half of 30 Business Groups Closed down or Sold out
  - Business: Low Debt-to-Equity Ratio and Emphasis on Liquidity
  - Housing Loans were Regulated through Strict Rules (LTV and DTI)
  - Government Debt Level on Lower side among OECD Countries
- **Other Reasons for Relative Stability**
  - Social Costs Reduced Thru 'Job Sharing'
  - Chinese Economy Showing Robust Growth thanks to Fiscal Spending



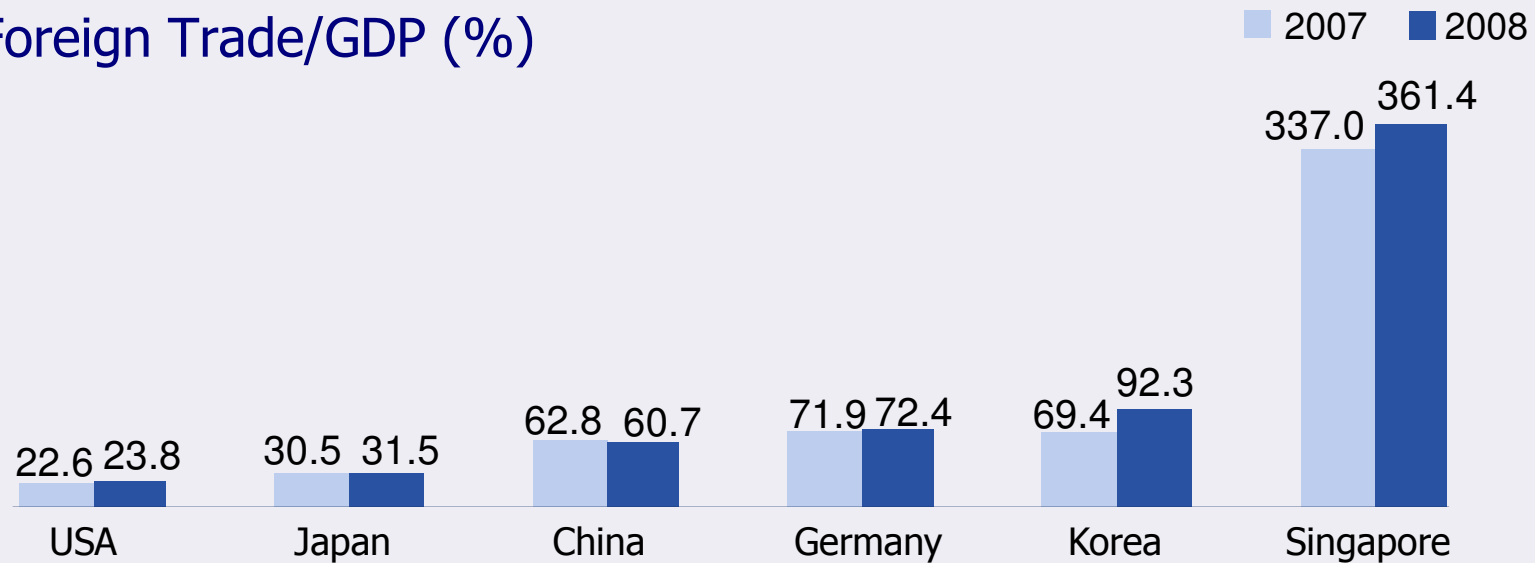
# Stock Market and Foreign Exchange Market Performance

- KOSPI : 1,435.26 (2007.1.2) → 1,360.54 (2009.6.23)
- Won/USD : 925.6 (2007.1. 2) → 1,372.80(2009.6.23)

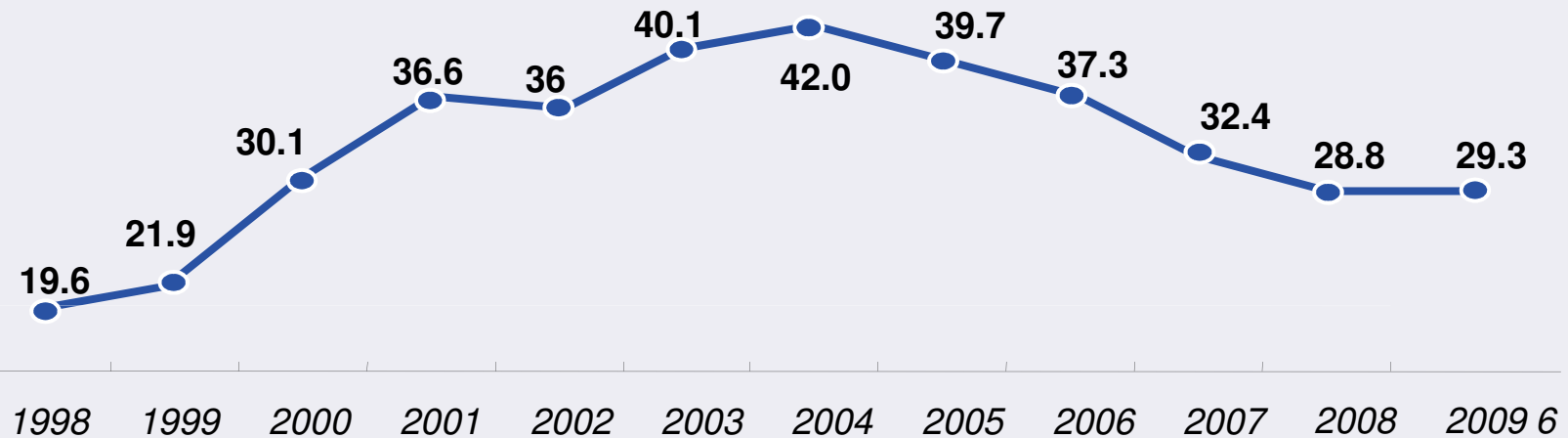


# Why is the Korean Won Vulnerable to Global Instability?

## Foreign Trade/GDP (%)



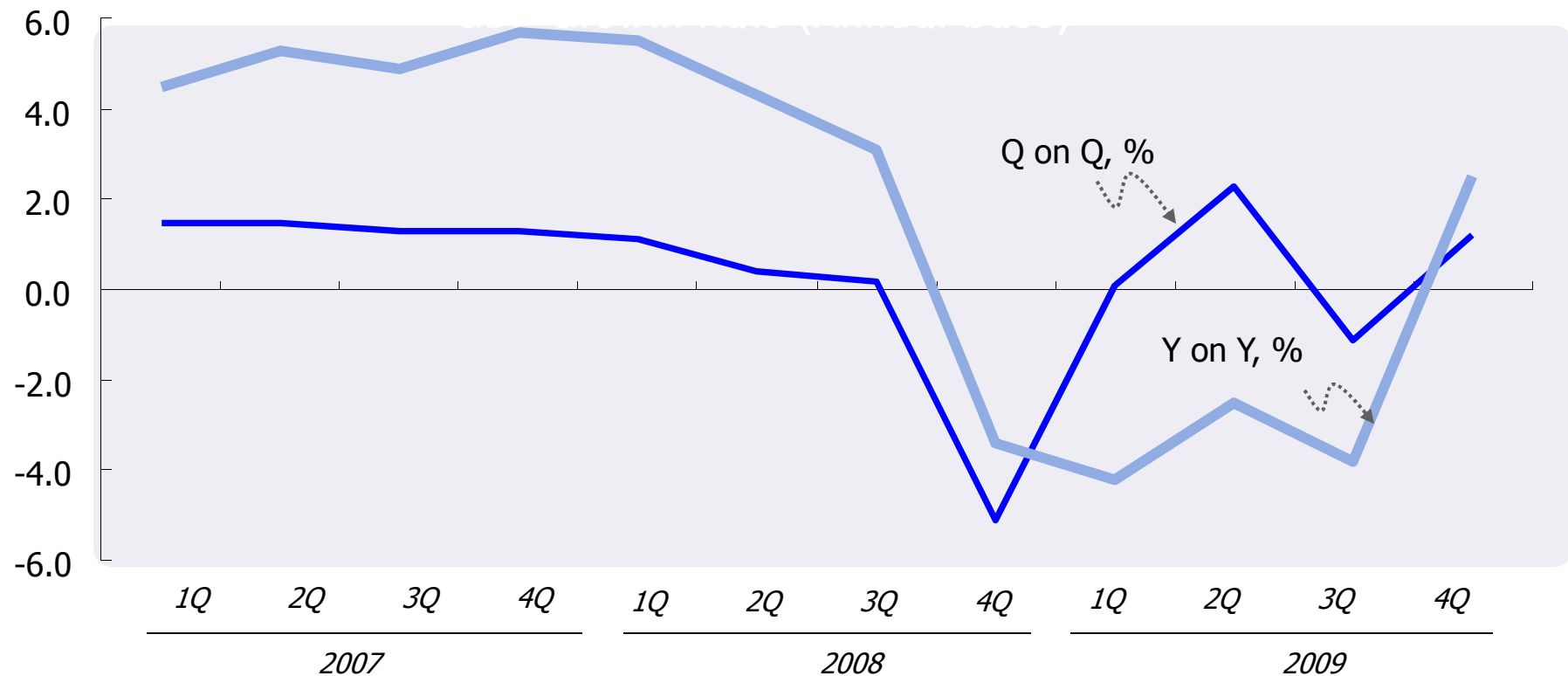
## Foreign Investors' Share in Equity Market (%)



## Korean Economy Bottomed out in 2Q 2009

- Quarter on quarter, the economy recorded positive growth of 2.3% in 2Q 2009 thanks to government spending.
- Year on Year base, the economy will move to positive growth in 4Q, 2009.

### GDP Growth Rates



# 1997 Crisis and the Current Global Crisis

## ■ Similarities

- Sharp drop of stock prices and currency (won) value
- Outflows of foreign portfolio investment
- Pessimistic views on Korean economy prevailing in the market

## ■ Differences

- Sound Public and Corporate Sector
  - Government Budget in Surplus
  - Debt/equity ratio of manufacturing industry
    - 1997 : 396.1% → 2007 : 97.8%
- Banking Sector more robust compared to 1997(BIS ratio)
  - 1998.6.: 9.14% - 6 of 12 commercial banks' ratios below 8%
  - 2008.6.: 11.16% - all banks' ratios above 10%
- Foreign Exchange Reserves over 240 billion U.S.dollars

## ■ Signs of Recovery

- Stock market index (kospi) back to pre-Lehman period
- Corporate profit performance surprising in 2009.2Q: Is this a sign of competitiveness or result of weak Korean won?
- Retail sales and credit card sales back to pre-crisis level
- Real estate prices in Kangnam(Seoul) area back to pre-crisis level

## ■ Uncertainties and Problems

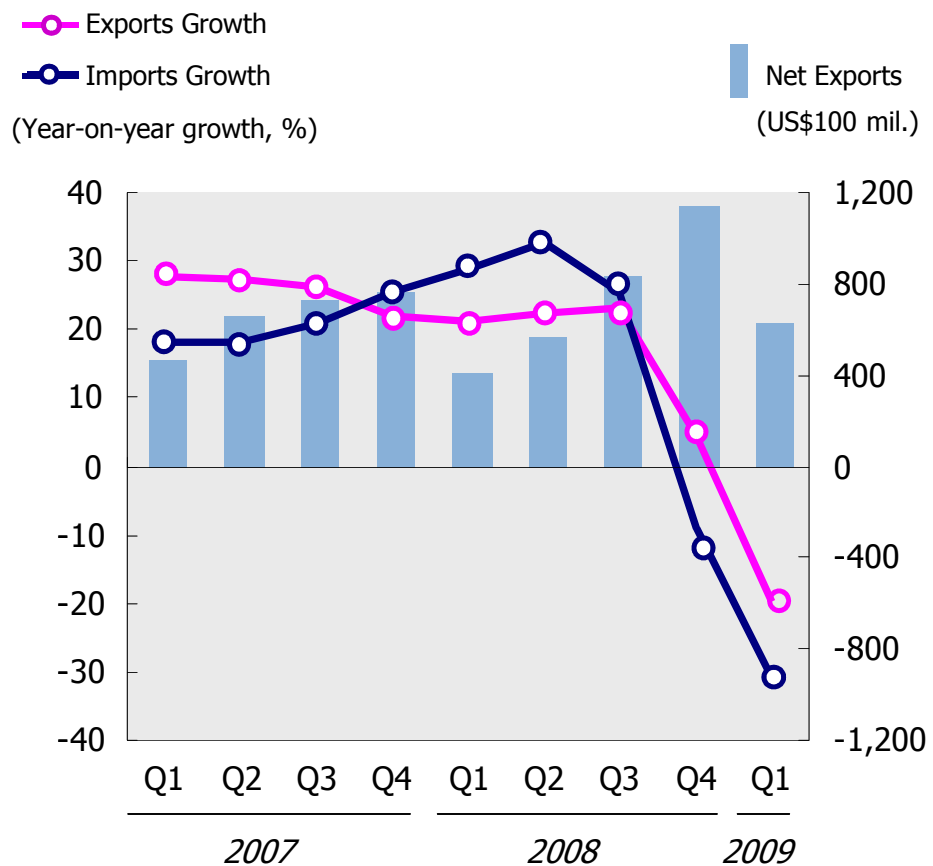
- Exports still sluggish, especially excluding ships
- Exports Very much dependent on Chinese Economy
- Corporate investments still lagging: -22.8% in 1H, -7.5% in 2H
- Corporate performance sustainable with higher value of Won?
- Decrease of jobs(20,000), mainly due to closing-down of subsistence retail stores and service est.

# Impact of Global Crisis on China's Economy

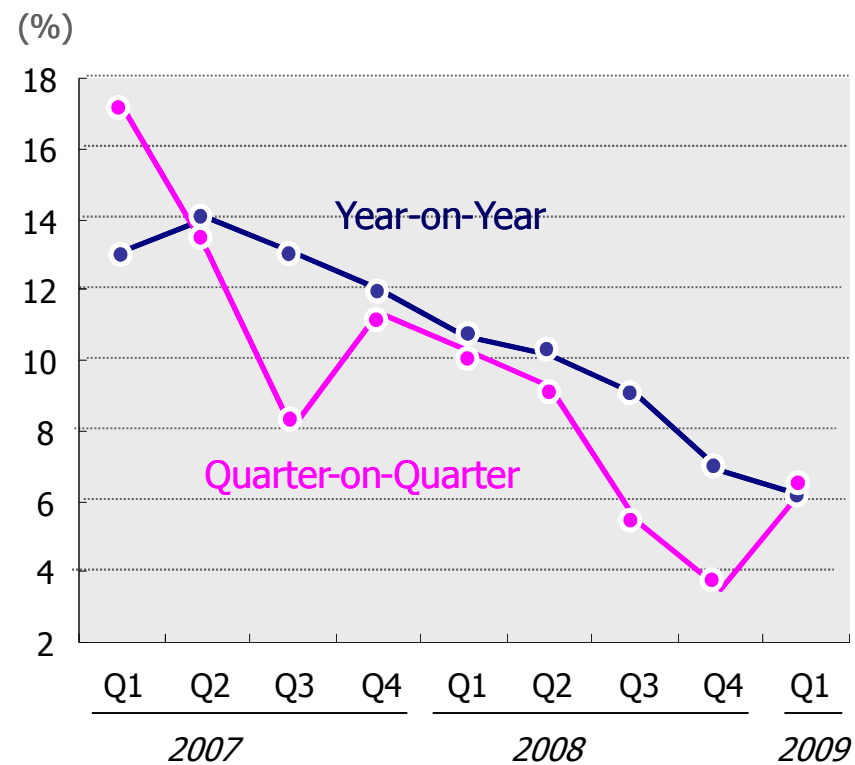
- **China Expected to Achieve 8% GDP Growth in 2009**
  - Despite Sharp Export Decline of over 20% in 1H
  - Thanks to expansionary government programs
  
- **China's stimulus package includes**
  - Government spending of 5.6 trillion yuan over 2 years (2009-2010)
    - 60% to stimulate domestic demand (such as farm income support)
    - 40% to enhance growth potential (such as solar energy and electric cars)
  - Monetary Policy
    - Interest rate reduction from 7.47% to 5.31%
    - Increase of money supply to stimulate investments
  
- **Key Question: Can domestic consumption and investments substitute for export declines?**
  - China's economy has been export- and investment-driven
  - Investments driven by size expansion of SOEs and monetary incentives that local government officials get from land sales and other incomes

# China's Export and GDP Growth

## Export Growth

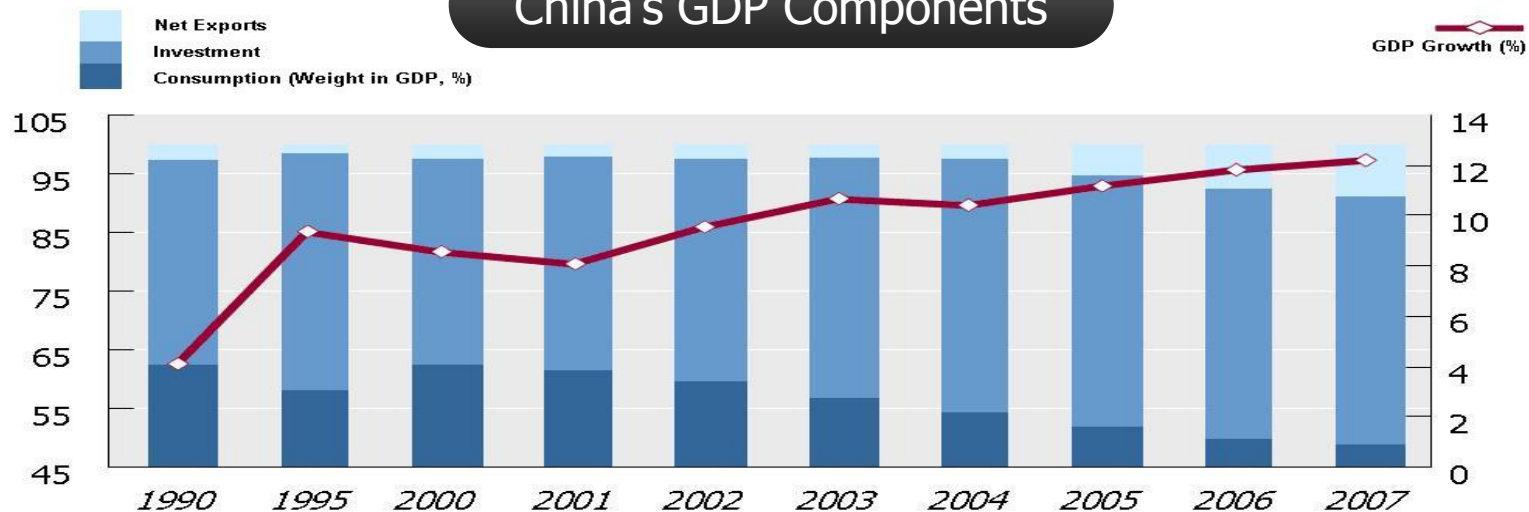


## GDP Growth

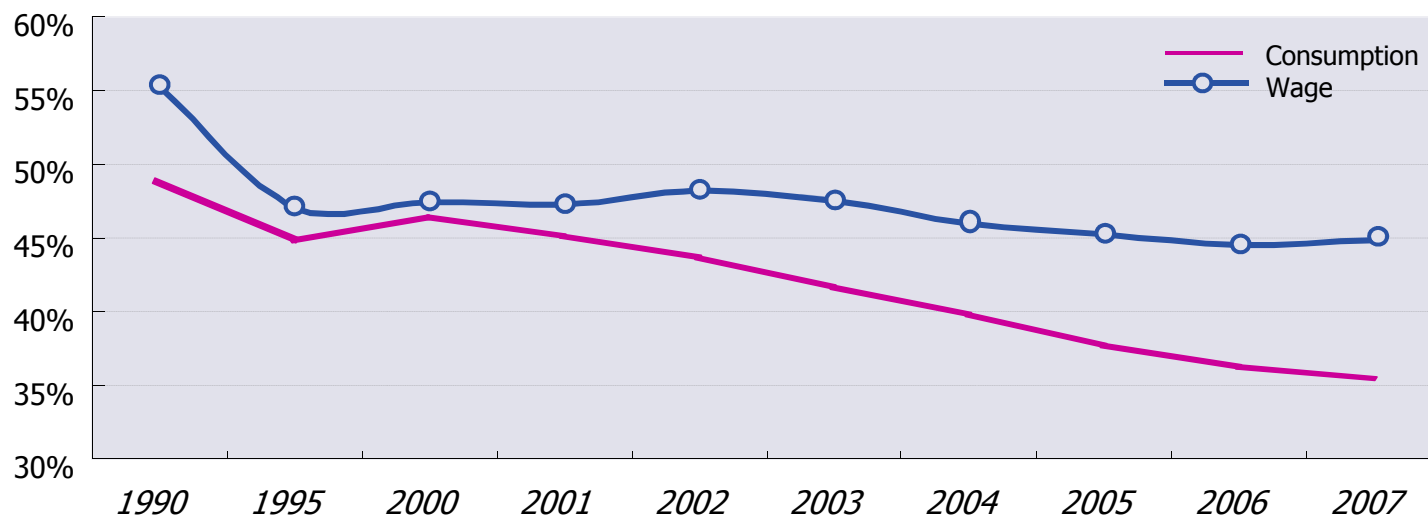


# Consumption and Investments in China's GDP

## China's GDP Components



## Weights of Consumption and Wages to GDP





## Difficult Policy Choices facing PRC

- **Foreign Exchange Reserves: 2 trillion dollar question**
  - China's foreign exchange reserves reaching 2 trillion U.S. dollars
  - 2/3 of reserves are dollar-denominated securities, including close to 800 billion U.S. T-bills and T-bonds
  - China is concerned about sudden fall of value of dollar, but does not have viable alternatives
  - Talking about SDR and diversifying out of dollar holdings, but actually purchasing U.S. government securities
  
- **Basic Dilemma of China's Economic Policy**
  - China's economic policy: "state-managed mercantilist policy"
    - Export promotion by managing exchange rates
    - Centralized foreign exchange control
  - Strong incentives to increase investments
    - Creating unemployment problems and social unrest
  - Difficulties of increasing private consumption
    - Shares of wages and consumption are gradually decreasing relative to GDP

# Impact of Global Crisis on Japan's Economy

## ■ Most Severe Impact on Japan

- 2008 4Q -13.5% and 2009 1Q -14.2% Growth (Q-on-Q base)
- Exports Declining 11.9% in 2008 4Q and 38.7% in 2009 1Q (on dollar base, Y-on-Y base)
- Export Decline affecting production, profits, employments, investments and consumption in a vicious chain reaction

## ■ Why So Severe Export Decline?

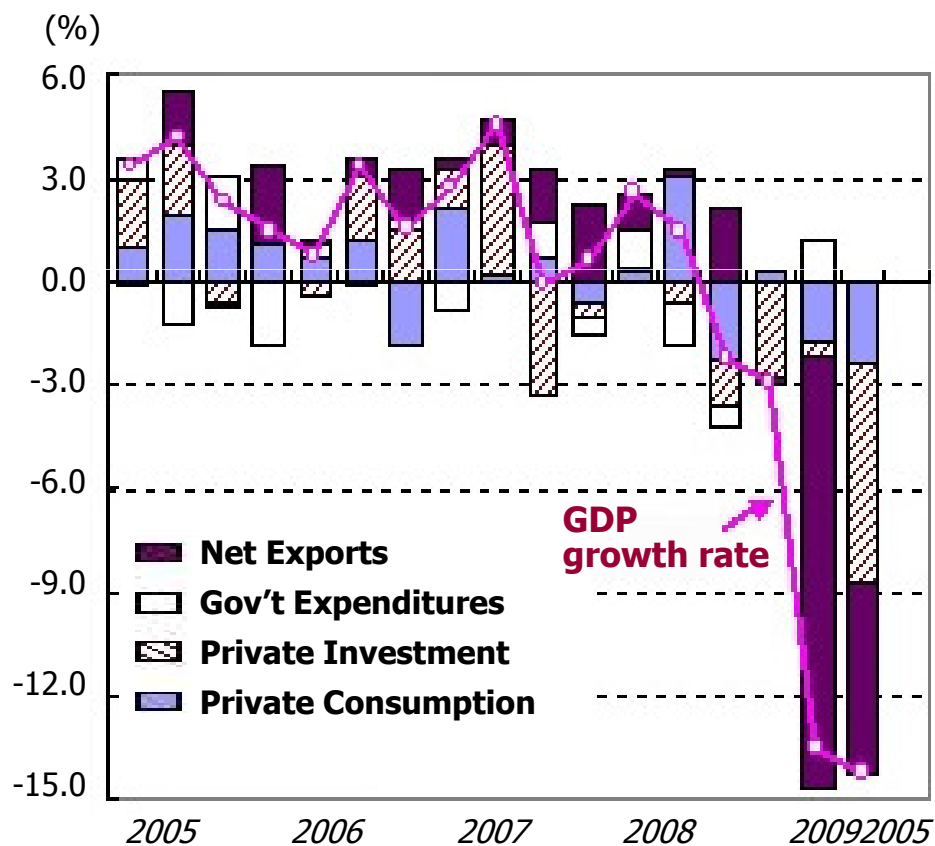
- Contribution of Net Exports to GDP Growth Rate very high
- Yen Appreciation adding further declines due to price competitiveness
- Dollar exports are translated into even smaller Yen exports, further weakening exports' contribution to GDP
- Yen appreciating due to wind-down of Yen Carry Trade

## ■ Export Declines Hitting Leading Industries Heavily

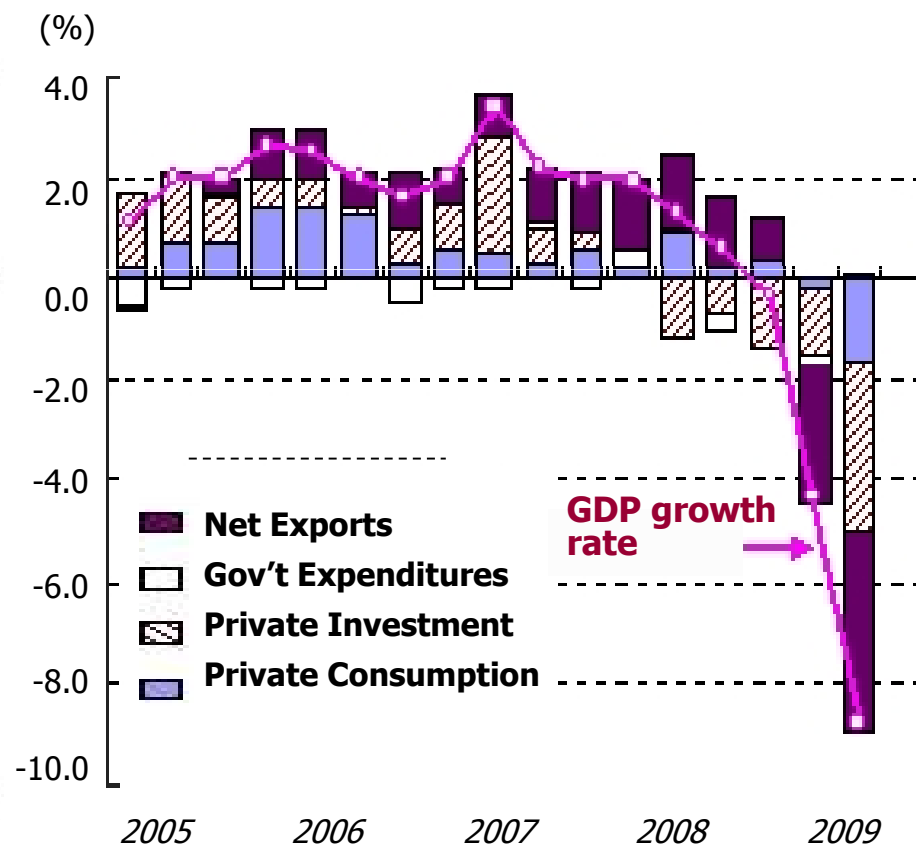
- Autos(-64.5%), auto parts(-47.7%), heavy machinery(-59.7%) and electronics(-40.7%) in 2009 1Q on dollar base(Q-on-Q)
- Sales and Profits of Large Corporations Severely Hurt by Export Declines<sup>1</sup>

# Japan's GDP Growth Rates

Quarter on Quarter



Year on Year



# Government Stimulus Package has Limited Impact

- **Government Stimulus Package totaling Yen 75.4 trillion**
  - Including 11.8 trillion Yen Budget Expenditures
  - Projected Budget Deficit of 9.9% of GDP for 2009
  - Others include Increase in Bank financing/guarantees and tax reductions
  - 97.2% of the package directed at vulnerable families and SMEs, with only 2.8 % on expanding growth potential
  
- **Freefall slowing down in recent months**
  - But unemployment is increasing, consumption sluggish and private investments continue to decline in 2H, 2009
  - GDP Expected to decrease by 6.9 % in 2009 on top of 0.7% in 2008
  - Potential growth rate of Japanese economy could decline to 1.5 % level, meaning almost five years required to recover 2007 level of economic activities

# Summary: Impact of Global Crisis on Three Countries

- **China: Robust but Systemic Imbalance**
  - Robust economic growth thanks to strong growth momentum
  - “State-managed Growth at any cost” strategy creating imbalances
  - External imbalance generating exchange rates/reserves dilemma
- **Japan: Shock Absorbing but Ineffective Policy Response**
  - Deep pockets (savings and reserves) absorbing external shocks
  - Trapped in Low Growth/Deflation spiral
  - Government has limited options to tackle economic stagnation
- **S. Korea: Vulnerable but Resilient**
  - Vulnerable due to high degree of openness in trade and capital
  - High crisis management capability due to Financial Crisis of 1997
  - Government policy: responsive and flexible

# Can Regional Cooperation Help Reducing Vulnerabilities?

- **Forex reserves to increase shock absorption capacity**
  - Three Countries have over 3 billion dollar reserves
  - Large amounts of reserves both costly and problematic
  - China, in particular, has a dilemma
  
- **Pooling Forex reserves in East Asia can reduce high costs of maintaining reserves – Chiangmai Initiative(CMI)**
  - Multilateralized Currency Swaps totaling USD 120 billion
  - 80 percent of the total shared by three NEA countries
  - A good start, but still a small amount compared to total reserves that the region has
  
- **Future Direction of Regional Monetary Cooperation**
  - Next 10 years: US Dollar and Euro will be dominant
  - IMF-Compatible Asian Monetary Cooperation?
  - Asia Monetary Fund or Regional Currency Bloc Unrealistic

## Tasks in Real Side: Expanding Regional and Domestic Growth

### ■ East Asia's Dependence on External Markets

- Consumption in the U.S. expected to decline from 72% to 67% of GDP over the next few years.
- Global economy and Asia should find alternative markets to substitute for American consumption.
- Asian exports' dependence on external markets is still 67%, including processed exports. (In terms of initial destination, 48%)

### ■ Policy options to expand regional demand

- Freer Trade and Investments
  - Regional FTA
  - Regional Development Bank for Infrastructure Investments
- Tapping Services Sector
- Low-carbon, Green Growth

# Final Demand Composition of Asia's Export in 2006

Total Asia's exports = 100.0%					
Inside Asia = 51.8%			Outside Asia = 48.2%		
<i>of which to</i>			<i>of which to</i>		
final demand 16.5%	production 35.3%		final demand 23.2%	production 25.0%	
+	<i>of which to</i>		+	<i>of which to</i>	
	final demand inside Asia 15.1%	final demand outside Asia 20.2%		final demand inside Asia 0.9%	final demand outside Asia 24.1%
16.0%			44.3%		
=			=		
<b>Total final demand inside Asia 32.5%</b>			<b>Total final demand outside Asia 67.5%</b>		

Source: ADB. Asian Development Outlook



# Does the Services Sector Have the Promised Potential?

- **Is the Regional Services Sector really underdeveloped?**
  - Services Sector in emerging markets undervalued due to non-tradable goods
  - Services Sector has more traditional establishments due to social reasons; e.g. one-man est. account for 1/4 of S. Korea's labor force
  - Asian services sector has more employment due to high standard of services demanded by Asian consumers.
  
- **Areas of Potential Growth in Asian Services Sector**
  - Finance
  - Education and Professional Services
  - Health Care
  - Tourism
  - Retail and Physical Distribution
  
- **What is needed?**
  - "Asia-centered Hub and Spoke Network"
  - "Asia-centered Knowledge and Intellectual Leadership"

# Areas of Collaboration in Low-Carbon, Green Growth

- **New Engines of Growth for the Coming Decade**
  - Renewable and New Energy
  - Low-carbon Production and Consumption
  - Bio and Healthcare
- **What East Asia has in Low-carbon, Green Growth**
  - Most energy-efficient economy
  - Technology leaders in electric and energy-efficient cars
  - High R&D expenditures of East Asian countries
- **Areas of Potential Collaboration**
  - Cap and Trade in greenhouse gas
  - Technology collaboration
  - Combating cross-border pollution, such as yellow dust

**Critical Question:** How to derive synergy in the coming technology competition in East Asia?

# Impact of Global Crisis on East Asian Corporations

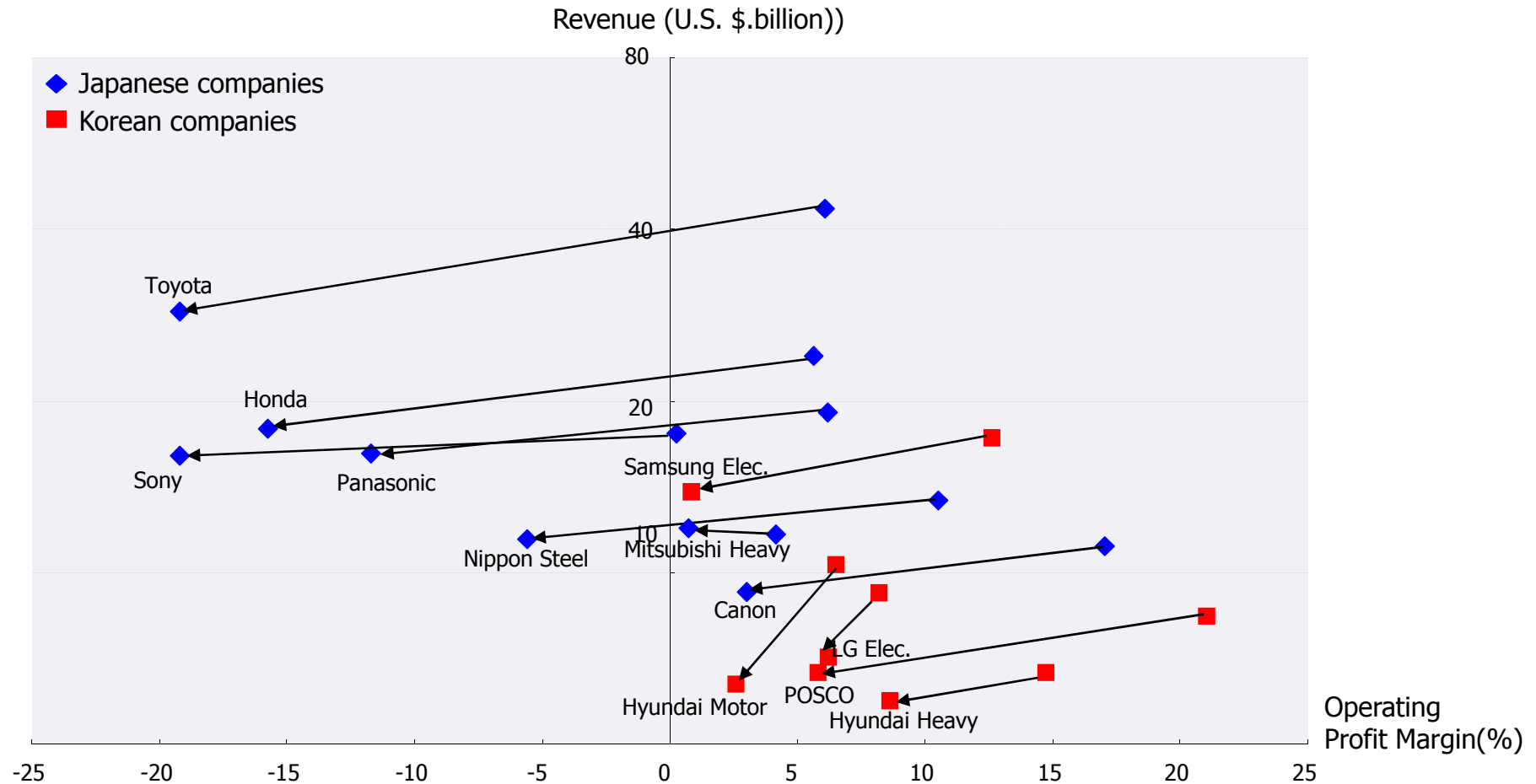
## ■ Global Financial Crisis and Global Corporations

- Non-financial corporations are relatively robust despite slow-down in sales and profits
- Biggest shock waves in the global auto sector due to GM and Chrysler – Global industry shakeout likely in coming years
- Even in other industries, new winners will emerge from current crisis: companies with liquidity and intangible assets

## ■ Impact of Current Crisis on East Asian corporations

- Japanese giants in electronics and heavy industry are hard hit.
- Korean global corporations are in good shape: depreciation of won helped them, but competitiveness of some KGCs are at high end.
- Big Chinese companies are least affected by the crisis due to the stable value of yuan and strong domestic demand – they are likely to emerge as actors in the next wave of M&A globally, especially in high-tech and resources industries

# Recent Performance of Korean vs. Japanese Companies ('08.1Q → '09.1Q)



note1: Sales revenues were converted into dollars by multiplying quarterly average of won/dollar and yen/dollar exchange rates.

2: Sales revenues of Korean companies were based on parent-only financial statements and those of Japanese companies were based on consolidated financial statements.

Source: KIS-Value (Korean companies), Thomson One Banker (Japanese Companies)

## Some Bold Projections for the Next Decade(2010-2020)

- The Global economy enters a period of low-growth, high-inflation.
- Center of Economic Growth will shift to Emerging Markets, esp. BRICs and Asia
- For the next decade, the United States will maintain the leadership position, but Pax Americana will gradually change into more fluid, multi-polar era.
- U.S. Dollar and Euro will share the role of reserve and transaction currencies, and the role of RMB will be limited.
- Biggest Challenge for the world and region will be how to live with 'rising China.'
- It is possible that new values emerge in capitalism and management philosophy; 'sustainable, post-growth economy.'
- Key words for next growth industries will be low-carbon, green and bio/health (green, smart and secure).

- **East Asia as Multiple Hubs and Spokes**
  - Still dominated by three nation-states, but
  - East Asia has six main economic hubs and multiple sub-hubs
  - Hubs and sub-hubs should have multiple linkages with others
- **East Asia as a Time Machine**
  - Has Five Centuries living together
  - Backward, Agricultural, Industrial, Information and Post-IT sectors at the same time
  - Advanced sectors have information and knowledge to share
- **Japan as an advanced society is in a peculiar position:**
  - Most aged society
  - Most energy-efficient, clean society
  - Sophisticated, post-growth consumption society
  - Galapagos Islands or Regional Life-style Hub?



# Implications for Hokkaido Economy: Three Key Words

## ■ Emerging Markets

- Linkages to Northeast China, Russia and North Korea
- Should develop logistics networks
- Utilize Tokyo and Honshu but develop linkages with other hubs

## ■ Low-Carbon, Green Growth

- Excellent Potential as “Clean and Green” lifestyle
- Climate Change can have positive effects on Hokkaido
- Should have “active population policy”

## ■ Service Industry

- Bio and Healthcare
- Natural or organic food
- Sports tourism
- Alternative Energy
- How to reduce costs?