Global Financial Crisis: Regional Impacts

This article summarises the presentation by Mr Jayant Menon[1] during the 2009 Cambodia Outlook Conference and relevant insights from his article in CDRI's Annual Development Review 2008–2009.

Impact on Output Growth

The world has been battling an unprecedented financial and economic crisis. Since it started in 2007 with the US subprime mortgage fiasco, the crisis has become worse and more widespread. For the first time in the post-World War II period, the US, euro zone and Japan (G3) experienced a synchronised contraction of their economies. Output growth of the US dropped from 2 percent in 2007 to 1.1 percent in 2008, forcing the unemployment rate up to 7.8 percent as of December 2008. Output growth of the euro zone fell from 2.6 percent to 0.7 percent over the same period. After many of its major financial institutions became direct casualties of the crisis and business investment and consumer spending retracted, the euro zone officially entered recession by late 2008. Meanwhile, Japan's economy shrank by around 3 percent, its export-led growth severely affected by the weakening in global demand (Table 1). By now, with the crisis felt virtually in all parts of the world, where the turmoil started seems to matter little. The paramount consideration is how to recover from the serious damage that the crisis has inflicted and avoid a repeat of history, based on understanding and resolution of the problems that led to it. Lack of regulation and prudential controls on subprime lending triggered the financial collapse and hence must be one of the key problems that need to be addressed immediately.

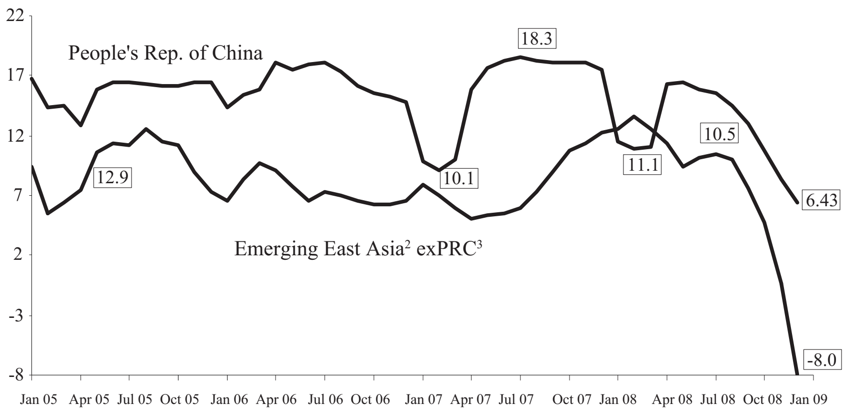
Emerging east Asia (referring collectively to ASEAN, the newly industrialised economies or NIEs and China) was not spared the impact of the crisis, disappointing initial speculation that most might be able to escape the financial and economic turmoil. However, the region was able to weather the crisis better than other parts of the world. Its output growth decreased from 9 percent in 2007 to 6.1 percent in 2008. GDP growth of ASEAN narrowed to 4.3 percent in 2008 from 6.5 percent in the preceding year. The contraction in growth of NIEs' GDP was more severe, dropping from 5.6 percent in 2007 to 1.8 percent last year. China's growth likewise eased significantly over the same period after reaching record-breaking levels in previous years, decreasing about 3 percentage points (Table 1).

Table 1: GDP Growth

	2006	2007	2008	Difference 07-08
Emerging East Asia	8.7	9	6.1	**-2.9**
ASEAN	6	6.5	4.3	**-2.2**
NIEs	5.5	5.6	1.8	**-3.8**
China	11.6	11.9	9	**-2.9**
Japan	2	2.4	-0.7	**-3.1**
US	2.8	2	1.1	**-0.9**
Euro Zone	2.8	2.6	0.7	**-1.9**

**Above are the raw data for Table 1 of Article 3, Summary of J. Menon's article. Note that the rest of the figures in all the articles were directly extracted from presentations.*

Figure 1: Industrial Production Growth[1] (y-o-y, %)



1 3-month moving average.
2 Refers to ASEAN-4; Korea, Rep. of; Singapore; and Thailand; does not include Hong Kong, China; Brunei Darussalam; Cambodia; Lao People's Democratic Republic; Myanmar; and Viet Nam, for which monthly data are not available.
3 PRC = People's Rep. of China; Source: OREI staff calculations based on CEI PRC = People's Rep. of ChinaCdata.

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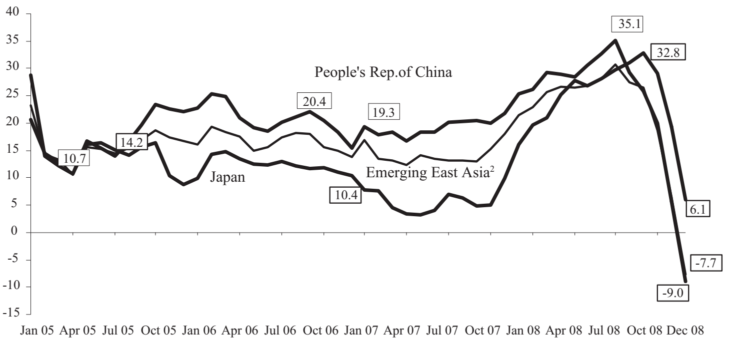
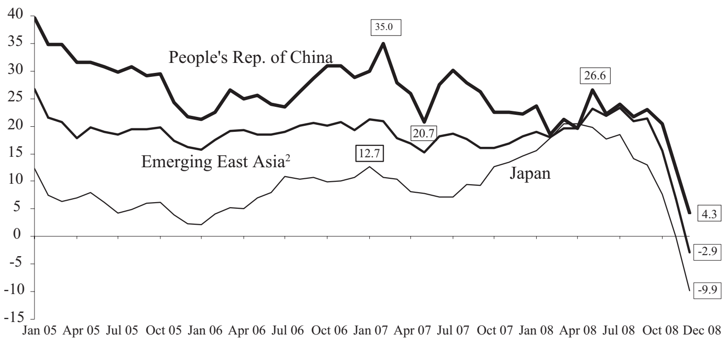
Figure 2: Merchandise Import*[1] *($ value, y-o-y, %)



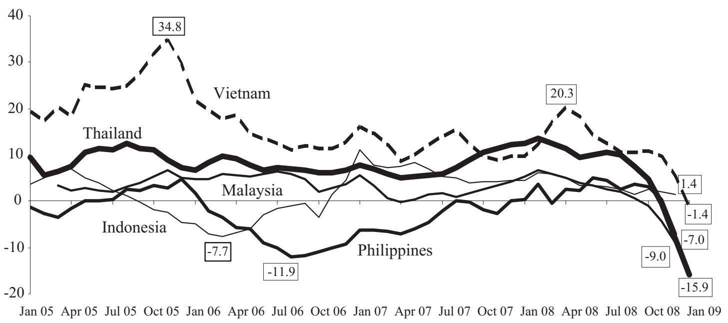
1 3-month moving average; 2 Refers to PRC, NIE-3, and ASEAN-4.
Source: OREI staff calculations based on CEIC data.

***Figure 3: Export Growth1** ($ value, y-o-y, %)*



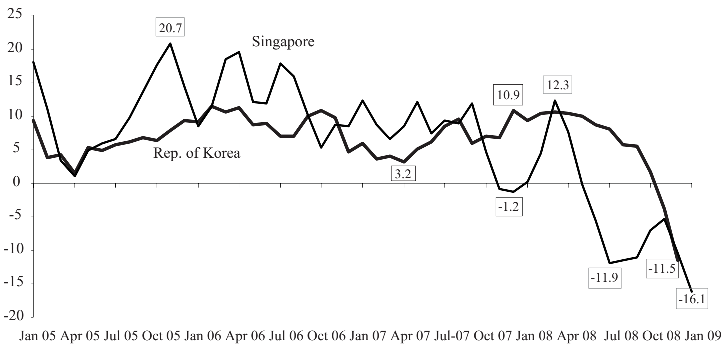
1 3-month moving average; 2 Includes PRC, NIE-3, and ASEAN-4.
Source: OREI staff calculations based on CEIC data.

Figure 4: Industrial Production Growth*[1] *─ASEAN-4, Vietnam (y-o-y, %)



1 3-month moving average.
Source: OREI staff calculations basedon CEIC data.

Figure 5: Industrial Production Growth*[1] *─Korea and Singapore (y-o-y, %)



1 3-month moving average.
Source: OREI staff calculations based on CEIC data.

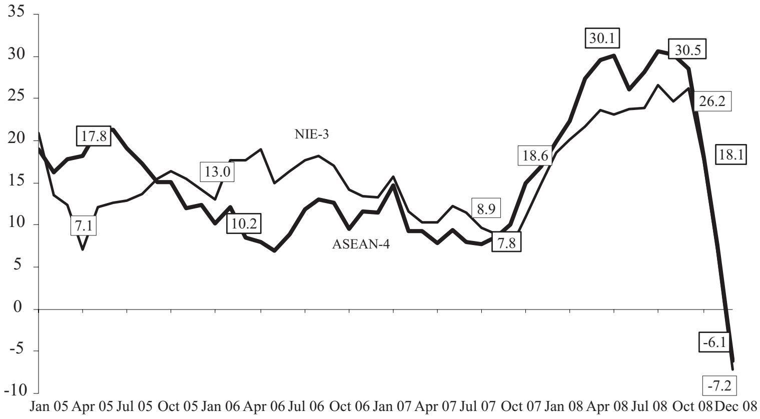
Impact on Production and Trade

The worldwide economic slowdown has been marked by a deceleration in production and trade. Global manufacturing outputs have slumped as import demand from the G3 economies receded rapidly. The slowdown in demand from the advanced world has seriously hurt the exports of emerging economies, as available statistics from emerging east Asian countries demonstrate. The growth of industrial production in emerging east Asia, excluding China, nosedived from 11.1 percent in January last year to -8 percent in January this year (three-month moving average, year on year) (Figure 1). Growth of export and merchandise import values for the region, including China, the NIE 3 (excluding Taiwan) and ASEAN 4, also turned negative by the end of 2008 (Figures 2 and 3).

Detailing the above, the industrial output and exports of individual ASEAN 5 countries (including Vietnam) all contracted due to lower world demand for their products. Until the third quarter of 2008, Vietnam's industrial production held up relatively well. However, it also eventually succumbed to the impact of the crisis, contracting by as much as 14 percent in January 2009 (3mma, y-o-y). The rest of the ASEAN 5 countries experienced the same worsening of industrial production, that of Thailand deteriorating the most (Figure 4). Thailand's internal political mayhem helped drag down the economy. Merchandise import and export values both contracted dramatically by end of last year. Those values for the ASEAN 4 region decreased by about 6 percent and 11 percent respectively by December 2008 (Figures 6 and 7). Among the ASEAN 4, Philippine exports suffered the most in 2008.

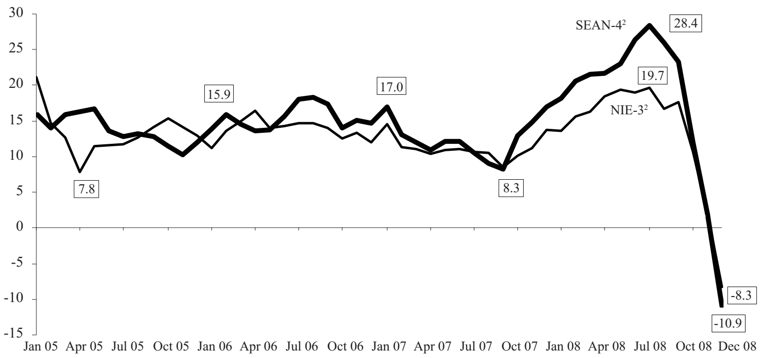
Because their industrialisation was driven by the opening of their economies, the effects of the crisis on the trade-dependent NIEs were devastating. South Korea's industrial production

Figure 6: Merchandise Import Growth[1]—NIE-3 and ASEAN-4 *($ value, y-o-y, %)*



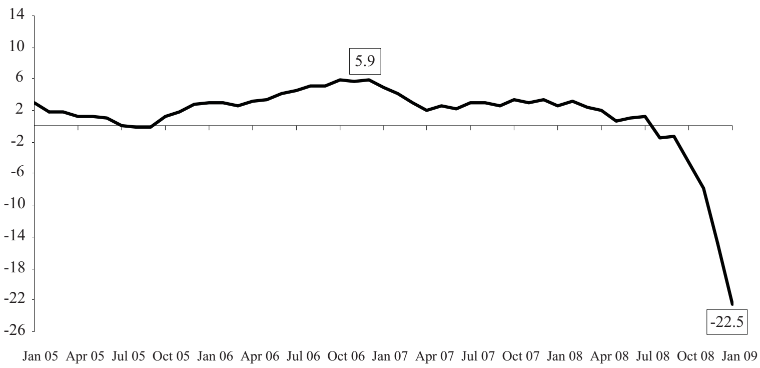
1 3-month moving average.
Source: OREI staff calculations based on CEIC data.

Figure 7: Export Growth[1]—NIE-3 and ASEAN-4



1 3-month moving average.
2 ASEAN-4 includes Indonesia, Malaysia, Philippines, and Thailand; NIE-3 includes Hong Kong, China; Republic
Source: OREI staff calculations based on CEIC data.

Figure 8: Industrial Production Growth: Japan[1] *(y-o-y, %)*



1 3-month moving average.
Source: OREI staff calculations based on CEIC data.

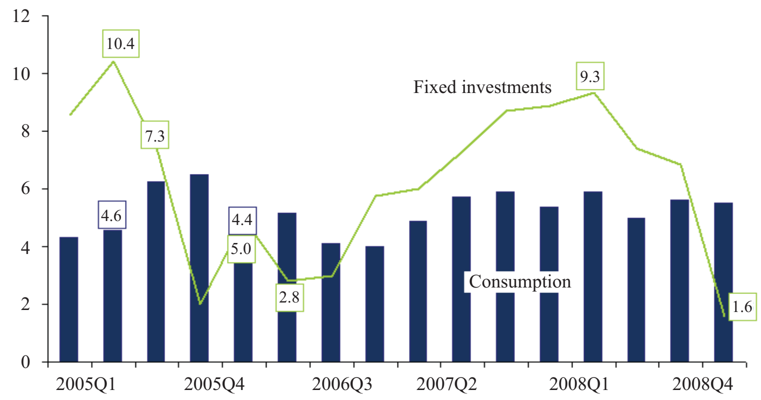
growth plunged sharply between October 2008 and January 2009. That of Singapore plummeted abruptly between October 2007 and July 2008 and bottomed out at -17 percent in January 2009 (Figure 5). Mirroring the trend in the ASEAN 4, the growth of merchandise import and export values in the NIE region turned negative by the end of 2008 (Figures 6 & 7). As of December 2008, Taiwan's export performance was much worse than that of its fellow NIEs.

China's industrial production, on the other hand, still grew in January 2009, although at a slower pace, its three-month moving average reaching 6.43 percent. Weaker export orders and softening investment can be chiefly blamed for the slower expansion, although other factors such as the closure of factories during the Olympic Games also contributed to the slowdown. China's exports grew positively in December of last year but likewise at a slower rate (Figure 3). Its merchandise imports contracted by 9 percent as of the same month (Figure 2). The blow to Japanese production and trade has been much harsher. Its industrial production shrank alarmingly by about 23 percent in January (3mma, y-o-y) (Figure 8) because of the sharply declining world demand for its manufactured products and the country's long-standing problem of sluggish domestic demand. Japan's export value contracted by approximately 10 percent by the end of last year (3mma, y-o-y).

Impact on Consumption and Investments

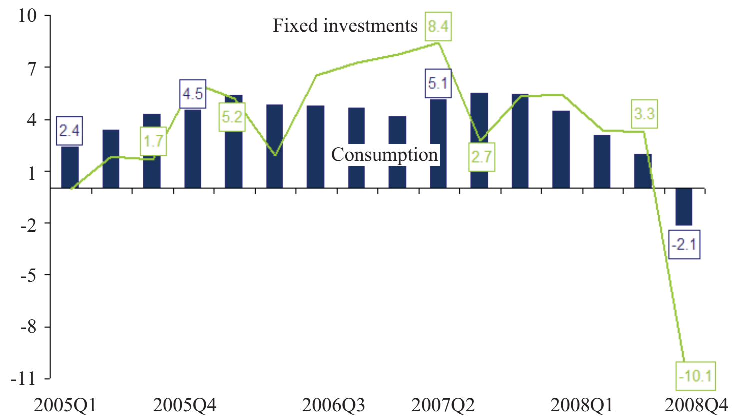
Helped by public spending, the still positive and steady growth in consumption in the ASEAN-4 countries provided the much needed anchor to their economies in the face of flagging investments. After reaching a high of 9.3 percent in the first quarter of 2008, growth of fixed investments in the region retreated to 1.6 percent in the final quarter of the year (Figure 9). The severe credit crunch, coupled with weaker growth prospects and heightened investor wariness, largely underpinned this deceleration. Fixed investments in the NIEs contracted even more. While a modest

Figure 9: Domestic Demand Growth—ASEAN-4 *(y-o-y, %)*



Source: OREI staff calculations based on CEIC data.

Figure 10: Domestic Demand Growth—NIE-3 *(y-o-y, %)*



Source: OREI staff calculations based on CEIC data.

growth of 3.3 percent was still recorded for the third quarter of 2008, there was a sudden drop of 10 percent in last year's fourth quarter. In contrast to the ASEAN 4, consumption in the NIEs also dropped by 2 percent in fourth quarter 2008 (Figure 10). NIE governments have approved various schemes such as fiscal packages to stimulate domestic demand but these are yet to have any substantial effect.

Stock prices in the ASEAN 4 and NIEs have also plunged, hurting private consumption and investment. In South Korea and Taiwan, stock market indices fell 35 to 40 percent as credit conditions tightened, export demand for technology products weakened, and overseas investments incurred substantial losses. Indonesian and Thai stock indices fell by nearly 50 percent. Most currencies in the said regions also depreciated significantly following the crisis. Among the NIEs, the South Korean currency experienced the greatest depreciation, because of a widening current account deficit and sharp withdrawal of foreign portfolio investment. Among the ASEAN 4, the Indonesian rupiah suffered the most due to massive foreign portfolio de-leveraging and investment flight.

Outlook and Policy Responses

Dark clouds continue to hover over the world and regional economies, and the possibility of greater deterioration cannot be discounted. The situation presents more downside risks. Reflecting this sentiment, growth projections have become more pessimistic. Based on IMF estimates, the US and euro zone are expected to contract by 1.6 percent and 2 percent respectively, while developing Asia is anticipated to grow at a slower pace in 2009. Encouragingly, governments everywhere, including those of emerging east Asia, have quickly and boldly met the challenges posed by the global crisis. Extraordinary and historic measures have been taken to cushion and counter the shock, including coordinated massive injections of liquidity into institutions and markets by the world's major central banks. In the US, the Federal Reserve brought interest rates down to their lowest level in the history of modern monetary policy. European countries took exceptional measures to rescue banking systems, Denmark and Ireland announcing blanket deposit and debt guarantees. In emerging east Asia, bold fiscal stimulus packages have been approved that make way for augmented spending on infrastructure and social safety nets. Tax cuts and increased subsidies have been initiated in an effort to spur sagging economies. Despite these bold steps, financial conditions remain stressed, domestic and external demand remain depressed, and recovery is predicted to take place only very gradually and at a very modest rate.