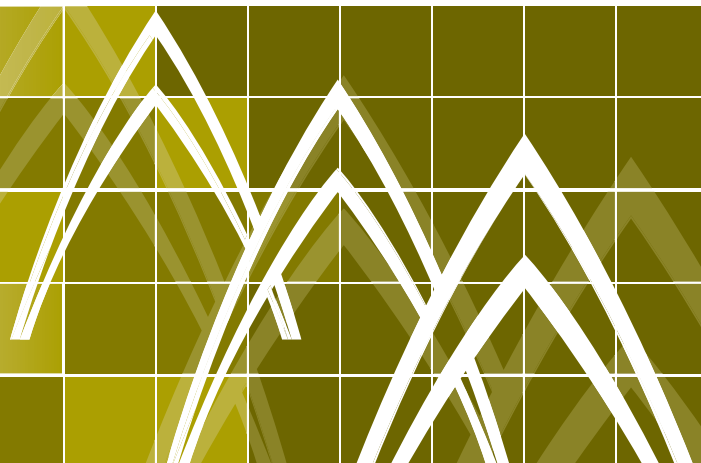


2

International Economic Developments and Cooperation





International Economic Developments and Cooperation

Overview

Global recession recedes...

The world economy showed signs of emerging from the worst recession since World War II, earlier than expected. The turnaround in early 2009 was encouraging given the unprecedented severity of the global financial crisis which emanated from the United States (US) and Europe and evolved into an economic crisis as asset prices fell and global demand plunged. The subsequent fall out impacted developing economies and resulted in a moderation in their growth. Nevertheless, recovery in the global economy is expected to strengthen in the second half of the year.

The recovery was attributed to a number of factors. Principal among them were the trillions of dollars injected by major central banks to unlock credit markets and the coordinated efforts to keep interest rates low to boost investments and consumption. At the same time, a number of countries launched fiscal stimulus packages to mitigate the effects of the crisis and to pump prime the economies. As a result, the global downturn is expected to stabilise, albeit with a smaller contraction, spurred by the better-than-expected performance of China, India and the rest of Asia.

The prospect for emerging and developing economies is expected to be positive in 2010. This is due to the full impact of monetary and fiscal measures working through the economies and efforts to diversify away from export dependency to domestic consumption taking effect. Developed economies, on the other hand, continue to grapple with financial institutions that face additional losses, businesses and households that experience difficulty accessing credit, as well as

high unemployment. Notwithstanding the various uncertainties, the global economy is expected to register modest growth in 2010.

The positive prospect is primarily a reflection of the effectiveness of the stimulus packages undertaken by a number of economies as well as international efforts to manage the crisis. Various multilateral meetings helped generate a synchronised and coherent international response to forestall an even harder landing of the global economy. Economies remain committed to the longer term objectives of reforming the global financial architecture and safeguarding the world

TABLE 2.1

Real Gross Domestic Product (GDP) for Selected Economies 2008 – 2010

		Change (%)	
	2008	2009 ¹	2010 ²
World	3.0	-1.1	3.1
Developed Economies	0.6	-3.4	1.3
United States	0.4	-2.7	1.5
Euro area	0.7	-4.2	0.3
Japan	-0.7	-5.4	1.7
Asia			
China	9.0	8.5	9.0
Republic of Korea	2.2	-1.0	3.6
India	7.3	5.4	6.4
ASEAN			
Indonesia	6.1	4.0	4.8
Philippines	3.8	1.0	3.2
Singapore	1.1	-3.3	4.1
Thailand	2.6	-3.5	3.7
Viet Nam	6.2	4.6	5.3
Malaysia	4.6	-3.0	2.0 - 3.0

¹ Estimate.

² Forecast.

Source: IMF and national authorities.



trading system. In the immediate term, they will continue to work together to restore financial stability and economic growth.

International Economic Developments

Growing signs of recovery...

The synchronised recession in the major economies affected the global economy in 2008, leading to a sharp contraction in global demand in the fourth quarter. This was precipitated by the collapse in financial markets in the advanced economies that caused an acute credit crunch, affecting firms and individuals. The sharp contraction that followed contributed to a steep fall in global trade and investment flows that continued into the first quarter of 2009, giving the appearance that the global economy was on the brink of sliding into a 1930s-like depression. However, massive fiscal and monetary interventions by governments as well as central banks to arrest the downward spiral, yielded results and the global economy showed signs of improvements in the second quarter of 2009.

In this context, emerging economies in general proved considerably more resilient in the face of the global recession. Economies such as India and Brazil, which are less export-dependent, were relatively unaffected by the sharp contraction in global trade at the end of 2008. Meanwhile, China cushioned its economy from the effects of the crisis with large monetary and fiscal stimulus resulting in an upturn in the first quarter of 2009 that further strengthened in subsequent quarters. China's resilience, in turn, continued to fuel the recovery in Japan and the euro area economies. Nevertheless, uncertainties continue to persist and global growth is expected to be lower at -1.1% in 2009 (2008: 3.0%).

Among the Group of Seven (G-7) economies, the US, euro area and Japan were hit the hardest by the global recession. The **US**, the epicentre of the financial crisis, continued to contract in 2009, albeit at a slower pace as the year progressed. After a decade of strong growth, the financial

turmoil and downturn in the housing market took its toll on the US economy, plunging it into the worst recession since the Great Depression. Starting from the third quarter of 2008, the economy contracted for four consecutive quarters. To mitigate the impact of the recession, the US government approved a rescue plan of USD700 billion in October 2008 and a stimulus package of USD787 billion in February 2009. These funds aim to bail out financial institutions as well as to create jobs, boost consumer spending and rebuild infrastructure. In addition, since December 2008, the Federal Reserve Board (the Fed) maintained its policy rates at a historic low of between 0.00% and 0.25% to further stimulate bank lending.

The measures to arrest the downturn began to take effect in the second quarter of 2009. Although the US economy declined 3.8% (April – June 2008: 1.6%), there were signs of improvement on a quarter-on-quarter (q-o-q) basis when the contraction eased to 0.7% (January – March 2009: -6.4%). Higher public spending and smaller cutbacks by consumers as well as increased net exports helped mitigate a record plunge in inventories. In addition, there were some positive developments in the housing market as sales increased supported by low interest rates, lower prices and tax credits for first-time buyers. The “cash-for-clunkers” scheme helped stimulate consumer spending and revive the automotive industry. Nevertheless, consumption spending continued to be subdued as unemployment remained high at 9.8% as at end-September (end-September 2008: 6.2%). Meanwhile, inflation continued to be low, recording 0.4% in August 2009 (August 2008: 0.0%), on account of lower energy prices. Based on these developments and as positive effects of the stimulus packages become more rooted in the second half, overall growth for 2009 is estimated to record a smaller contraction of 2.7% (2008: 0.4%).

Similar to the US, growth in the 16-nation **euro area** contracted sharply 4.8% in the second quarter of 2009 (April – June 2008: 1.4%). However, on a q-o-q basis, growth declined marginally at 0.2% (January – March 2009: -2.5%), mainly due to positive growth in Germany and France, the two largest economies in the euro area.



TABLE 2.2

**Inflation Rate for Selected Economies
2008 – 2009**

	Change (%)	
	2008	2009 ¹
World	6.0	2.5
Developed Economies	3.4	0.1
United States	3.8	-0.4
Euro area	3.3	0.3
Japan	1.4	-1.1
Emerging and Developing Economies	9.3	5.5
China	5.9	-0.1
Republic of Korea	4.7	2.6
India	8.3	8.7
ASEAN		
Indonesia	9.8	5.0
Philippines	9.3	2.8
Singapore	6.5	-0.2
Thailand	5.5	-1.2
Viet Nam	23.1	7.0
Malaysia	5.4	1.0

¹ Estimate for 2009.

Source: IMF and national authorities.

Growth in **Germany** was propelled by an increase in government and private consumption as well as construction activities. The government introduced a EUR85 billion (USD118 billion) stimulus package in January with EUR18 billion (USD25 billion) allocated for new construction activities and repair of public facilities. In addition, consumer spending increased at the fastest rate in more than two years, mainly boosted by the car scrappage scheme and lowest-ever inflation rates. While exports were lower than in the first quarter, imports fell even faster, resulting in an export surplus, further contributing to growth. Likewise, growth in **France** was driven by consumer spending and exports as well as the stimulus package totalling EUR26 billion (USD33 billion) announced in February 2009. The package was for public sector investments, to revitalise the automotive industry, support household incomes

for the worse off through tax cuts as well as subsidise employment contracts for the young. In addition, the government guaranteed new bank lending up to EUR320 billion (USD406 billion) and would also provide capital up to EUR40 billion (USD51 billion) if necessary, to increase liquidity and strengthen the banking system.

Inflation in the euro area declined from a peak of 4.0% in July 2008 to -0.2% in August 2009 due to lower crude oil prices and consumer demand. In a bid to weather the economic downturn, the European Central Bank (ECB) cut its policy rate to a record low of 1.00% in May and introduced a EUR60 billion (USD85 billion) asset-buying programme. Meanwhile, the unemployment rate rose to a 10-year high of 9.6% in August from 9.5% in July. For the year, growth in the euro area is expected to contract 4.2% (2008: 0.7%).

With the economic downturn easing, **Japan's** performance improved to -7.2% in the second quarter of 2009 (April – June 2008: 0.6%) from -8.7% recorded in the first quarter (January – March 2008: 1.3%). On a q-o-q basis, the economy grew marginally at 0.6%, driven by increased exports arising from demand in China and the emerging markets as well as the impact of the stimulus plan. The stimulus plan amounting to 56.8 trillion yen (USD570 billion), which included cash handouts and incentives to buy ecological products, boosted consumption and investments. As a result, consumer spending and government investment increased 0.8% and 8.1%, respectively in the second quarter of 2009.

Meanwhile, the Bank of Japan continued to keep its policy rate at 0.10% in August, unchanged since December 2008, to sustain economic recovery. Inflation fell 2.2% in August (August 2008: 2.1%), the fourth straight month of record falls due to lower costs of petrol and energy as well as transportation and communication. At the same time, the manufacturing sector is expected to recover from the global economic downturn as reflected in the Purchasing Manager's Index (PMI) which rose to 53.6 in August (August 2008: 38.0), the second consecutive month that the index remained above the 50-point threshold and the highest since November 2006. Notwithstanding the upturn in the manufacturing



sector, unemployment reached a six-year high of 5.4% in August (August 2008: 4.1%), primarily due to export-dependent companies which slashed jobs and production in the face of faltering global demand and falling profits. Although on a q-o-q basis Japan recorded the strongest growth among the G-7 economies during the second quarter, it is still anticipated to contract 5.4% in 2009 (2008: -0.7%).

East Asia's emerging economies (Association of Southeast Asian Nations - ASEAN, China, Hong Kong, Republic of Korea and Taiwan) exhibited signs of stabilisation in the second quarter of 2009. China's economy boosted the region as a whole and contributed to the improved performance which is expected to continue into the second half of the year. Overall economic growth in emerging East Asia is expected to record a lower rate of 3.0% in 2009 (2008: 6.1%), an indication that the region has yet to recover to the levels before the financial crisis.

China's Gross Domestic Product (GDP) rebounded from the lower growth rates registered in the last two quarters to record 7.9% in the second quarter of 2009 (April – June 2008: 10.1%). China continued to maintain strong growth on account of the fiscal stimulus package amounting to RMB4 trillion (USD586 billion) for the period 2009 to 2010, which resulted in a 33.5% increase in fixed asset investments. This translated into government expenditure on the construction of railways and roads, particularly in the earthquake-devastated regions of the country. In addition, tax cuts and consumer subsidies were also introduced to stimulate consumption and maintain economic growth. However, exports, the economy's mainstay, slid for eight straight months, contracting 21.8% in the first half of 2009 (January – June 2008: 21.9%) and dragging down GDP growth by 2.9 percentage points.

Meanwhile, inflation registered -1.2% in August, the seventh consecutive month of decline since February 2009 (-1.6%). This was due to lower prices of non-food items, which was exacerbated by overcapacity in the economy and lower domestic demand. In August 2009, People's

Bank of China kept its policy rate at 5.31%, having reduced it five times from September 2008 (7.47%). At the same time, lending quotas and the reserve requirement ratio which were lifted since November 2008 to free up more liquidity in the economy, resulted in a surge of bank lending (June 2009: 34.4% y-o-y). As part of efforts to sustain long-term growth, the government embarked on industrial restructuring and nurturing new economic growth areas such as retail trade, telecommunications, energy and environmental activities as well as healthcare. Against this backdrop, China's economy is envisaged to grow at 8.5% (2008: 9.0%) largely due to the government's fiscal stimulus and accommodative monetary policy, which is anticipated to bolster consumer demand.

Growth in the **Republic of Korea (ROK)** contracted 2.5% in the second quarter 2009 (April – June 2008: 4.3%), slower than a fall of 4.2% in the first quarter (January – March 2008: 5.5%). On a q-o-q basis, ROK's growth picked up 2.3% in the second quarter, the fastest pace in more than five years, fuelled by surging exports and rising consumer spending. Exports jumped 14.7% in the second quarter from the previous three months, while private spending rose 3.3%. In August, the Bank of Korea capped the policy rate at a record low of 2.00% for the fifth consecutive month, amid an environment of low inflation. Inflation eased for the sixth consecutive month to register 2.2% in August, y-o-y. However, inflation increased 0.4% from the previous month on account of a rise in food, fuel as well as transport prices. Meanwhile, unemployment recorded 3.7% as at end-August (end-August 2008: 3.1%), down from 3.9% the previous month, partly due to public sector jobs created in response to the 10-year high job loss of 219,000 in May 2009.

In order to further stimulate economic growth, the government implemented the "Green New Deal" totalling KRW50 trillion (USD38 billion) for the 2009 – 2012 period. The plan was a two-pronged approach towards green growth and job creation. The focus was on eco-friendly projects such as energy conservation, green transportation,



carbon reduction and energy-efficient industries. For the year, however, growth is expected to contract 1.0% (2008: 2.2%).

India registered relatively strong growth of 6.1% in the second quarter of 2009 (April – June 2008: 7.8%) on account of expansion in the services and manufacturing sectors. The services sector recorded robust growth at 8.1% (April – June 2008: 10.2%), mainly contributed by trade, hotels, transportation and communication sub-sectors. The agriculture sector, however, further moderated to 2.4% (April – June 2008: 3.0%) mainly due to lower harvests as a result of deficient rainfall.

In order to cushion the impact of the global economic downturn, India launched four stimulus packages in December 2008, January, February and July 2009, totalling Rs2,180 billion (USD447 billion). The packages aimed at improving access to infrastructure financing and boosting consumption through various policy rate cuts by the Reserve Bank of India. GDP is expected to grow at a slower pace of 5.4% in 2009 (2008: 7.3%).

Among the major ASEAN economies, Indonesia, the Philippines and Viet Nam registered positive growth. **Indonesia's** lower dependence on exports relative to its ASEAN neighbours cushioned it against the impact of contracting global demand and falling commodity prices. As a result, Indonesia posted strong growth of 4.0% in the second quarter of 2009 (April – June 2008: 6.4%), albeit the slowest pace since 2003, after expanding at 4.4% in the first quarter (January – March 2008: 6.3%). Growth was driven by private consumption and government spending, buoyed by the favourable outcome of the presidential election and fiscal stimulus measures amounting to Rp73.3 trillion (USD6.32 billion). Bank Indonesia lowered its policy rate to 6.50% in August, the ninth cut since December 2008 to stimulate investments and economic recovery. The inflation rate increased slightly to 2.8% in August 2009 due to an increase in energy price, after registering 2.7% in July, the lowest level since 2000. For the year, growth is expected to be at 4.0% (2008: 6.1%).

The **Philippine** economy grew 1.5% in the second quarter of 2009 (April – June 2008: 4.2%) after registering growth of 0.4% in the first quarter (January – March 2008: 3.9%). The better-than-expected performance was due to the effects of the stimulus plan working through the economy which led to an increase in government and consumer spending of 9.1% and 2.2%, respectively. Inflation decelerated further to 0.1% in August 2009, mainly due to lower food prices as domestic and global supply conditions improved. The central bank maintained its policy rate at 4.00% in August 2009 after a series of policy rate cuts since December 2008, to revive the economy. Growth is expected at 1.0% in 2009 (2008: 3.8%).

GDP growth in **Singapore** contracted 3.5% in the second quarter of 2009 (April – June 2008: 2.5%), an improvement compared with the -9.5% registered in the first quarter (January – March 2008: 6.7%). The better performance was mainly driven by a surge in output from the biomedical manufacturing cluster and inventory re-stocking as well as a significant improvement in financial services. Inflation fell further to 0.3% in August 2009 (August 2008: 6.4%) due primarily to lower costs of transport and communication as well as housing, which declined 0.4% and 1.6%, respectively. For the year, the economy is anticipated to contract at 3.3% (2008: 1.1%).

Thailand's GDP shrank 4.9% in the second quarter of 2009 (April – June 2008: 5.3%) compared with -7.1% registered in the first quarter due to the improvement in the global economy which helped boost exports. In January 2009, the government introduced a THB116.7 billion (USD3.3 billion) stimulus package, including cash for low-income earners as well as subsidies for transport and utilities, which cushioned the impact of the global slowdown. In addition, the government in August 2009 approved a three-year investment programme totalling THB1.06 trillion (USD31 billion) to further boost economic recovery. Inflation registered -1.0% in August (August 2008: 6.4%), the eight consecutive decline since January 2009, primarily due to a drop in prices of food as well as recreation and education. In August, the Bank of Thailand



maintained its policy rate set since April at 1.25% to ensure economic recovery. For 2009, growth is forecast to contract 3.5% (2008: 2.6%).

Viet Nam's GDP expanded 4.5% in the second quarter of 2009 (April – June 2008: 4.5%), higher than 3.1% recorded in the first quarter (January – March 2008: 7.4%). Growth was fuelled by improved performance in the industrial and services sectors, which grew 5.0% and 5.7%, respectively. Inflation eased to 2.0% in August, mainly due to lower food and foodstuff prices. In September, the State Bank of Viet Nam held its policy rate at 7.00%, unchanged since February 2009 and the lowest since 2004. For 2009, the economy is expected to register growth of 4.6% (2008: 6.2%).

Other developing countries are expected to record slower growth on account of the slump in external trade, capital outflows and lower commodity prices. Growth in the **Middle East** is estimated to moderate to 2.0% (2008: 5.4%) as it grapples with lower oil prices, weak export demand, domestic liquidity problems, falling remittances and tourism revenues as well as losses incurred on investments by their sovereign wealth funds.

Among the **oil-exporting countries** (Iran, United Arab Emirates, Saudi Arabia and Kuwait), the United Arab Emirates, which is a global financial centre, is expected to contract due to exposure to the volatile financial markets. Qatar, on the other hand, is expected to continue to record double-digit growth of 11.5% (2008: 16.4%) supported by strong exports of liquefied natural gas (LNG), maintaining its position as the world's largest exporter of LNG. Meanwhile, GDP growth in the **non-oil exporting countries** (Egypt, Jordan, Lebanon and Syria) is likely to average 4.5% (2008: 7.0%). The moderation is on account of a fall in exports, tourism, remittances and foreign direct investments (FDI) following the sluggish economic performance of key trading partners, in particular the US and the Gulf States.

Growth in the **Commonwealth of Independent States** (CIS) is expected to contract 6.7% in

2009 (2008: 5.5%) largely due to limited access to external funding caused by the global financial crisis, deteriorating demand from advanced economies and the fall in commodity prices, notably oil. In this context, the Russian economy, the largest in the region, is expected to shrink 7.5% (2008: 5.6%). The more closed economies namely, Azerbaijan, Tajikistan, Turkmenistan and Uzbekistan, with less exposure to the financial crisis, are expected to fare better. Meanwhile, Belarus, Ukraine, Armenia and Georgia sought International Monetary Fund (IMF) assistance to address balance of payments problems.

GDP growth in **Latin America** is expected to contract 2.5% in 2009 (2008: 4.2%) as commodity exports continue to fall and investments decline due to tightening credit markets as well as a sharp rise in the cost of capital. The region-wide economic slowdown is further exacerbated by the decline in consumption, tourism receipts and remittances as well as deteriorating public sector budgets. In particular, Mexico is expected to contract the most at 7.3% (2008: 1.3%) due to its close economic ties with the US.

Africa is projected to grow at a slower pace of 1.7% in 2009 (2008: 5.2%) mainly due to weaker commodity prices, sluggish demand for exports, lower workers' remittances and a reduction in FDI. The downturn is likely to be more pronounced in oil-exporting countries, in particular Angola and Equatorial Guinea, which are expected to record 0.2% (2008: 13.2%) and -5.4% (2008: 11.3%). South Africa's economy is projected to contract 2.2% (2008: 3.1%) due to large capital outflows.

Investment Flows

Sharp fall in global investment flows during downturn...

Global investments in 2008 were significantly affected by the financial and economic crisis. The United Nations Conference on Trade and Development (UNCTAD) report indicated that global investment flows contracted 14.2% to



USD1,697.4 billion in 2008 after a record high of USD1,978.8 billion in 2007. This marked the end of a growth cycle in international investments. Declining profitability, diminishing market opportunities as well as difficulty in accessing capital, impacted business sentiment and reduced propensity to invest.

Inflows of FDI to developed economies fell sharply by 29.2% to USD962.3 billion (2007: USD1,358.6 billion) as they were more severely affected by the financial crisis. In addition, the decline was attributed to a drastic fall in the number of cross-border mergers and acquisitions, an FDI mode prevalent in developed countries. Despite a steep decline of 42.4% to USD518.3 billion in 2008 (2007: USD899.6 billion), European Union (EU) was a major recipient of FDI inflows to developed economies with the largest share of

53.9%, mainly supported by its market size and a conducive business environment. Meanwhile, despite being the epicentre of the crisis, the US remained the single largest recipient of 16.6% of total global FDI. This was mainly due to increased internal lending activity to local affiliates from companies abroad. Other pull factors included major restructuring activities, large domestic market size and availability of quality human capital coupled with advanced technological infrastructure.

In 2008, FDI inflows to developing economies remained resilient, increasing 17.3% to USD620.7 billion (2007: USD529.3 billion). South, East and Southeast Asia continued to attract the bulk of FDI (47.9%), followed by Latin America and the Caribbean (23.3%). A major portion of the FDI into China and India was on account of sustained economic growth, large market size, availability of skills and talent as well as cheap labour. FDI in China was primarily in the manufacturing and real estate sectors, while for India, it was in computer and telecommunications services.

FDI into ASEAN declined 13.8% to USD59.9 billion in 2008 (2007: USD69.5 billion). Singapore accounted for the biggest share (USD22.7 billion), followed by Thailand (USD10.1 billion), Malaysia (USD8.1 billion), Viet Nam (USD8.1 billion) and Indonesia (USD7.9 billion). Viet Nam recorded the strongest growth of 20.9%, bolstered by its accession to the World Trade Organisation (WTO) in 2007, increased liberalisation and promotional efforts particularly for infrastructure development. FDI into Malaysia recorded a slight decline of 3.6% to USD8.1 billion in 2008 (2007: USD8.4 billion), reflecting the global downturn. The FDI was mainly in manufacturing industries, such as basic metals, electrical and electronic products, chemicals and chemical products as well as food.

In 2009, global FDI growth prospects are envisaged to remain sluggish, affected by the ongoing economic crisis and loss of investor confidence. Investors are likely to defer investment due to faltering profits, reduced access to financial resources, declining market opportunities as well as uncertainties in the global economic recovery.

TABLE 2.3

FDI Inflows by Selected Host Regions and Major Host Economies 2007 – 2008

	USD billion		Change (%)
	2007	2008	
World	1,978.8	1,697.4	-14.2
Top 5 recipients for 2008			
United States	271.2	316.1	16.6
France	158.0	117.5	-25.6
China	83.5	108.3	29.7
United Kingdom	183.4	96.9	-47.2
Russia	55.1	70.3	27.6
Developed Economies	1,358.6	962.3	-29.2
European Union	899.6	518.3	-42.4
Japan	22.5	24.4	8.4
Developing Economies	529.3	620.7	17.3
Asia and Oceania	332.7	388.7	16.8
India	25.1	41.6	65.7
ASEAN	69.5	59.9	-13.8
Singapore	31.6	22.7	-28.2
Thailand	11.2	10.1	-9.8
Malaysia	8.4	8.1	-3.6
Viet Nam	6.7	8.1	20.9
Indonesia	6.9	7.9	14.5
Transition Economies	90.9	114.4	25.9

Source: UNCTAD.

TABLE 2.4

Exports and Imports for Selected Countries January – August

	Imports			Exports			Total Trade		
	USD billion		Change (%)	USD billion		Change (%)	USD billion		Change (%)
	2008	2009		2008	2009		2008	2009	
United States ¹	1,741	1,234	-29.1	1,250	996	-20.3	2,992	2,230	-25.5
Euro area ²	2,439	1,637	-32.9	2,802	1,659	-40.8	5,241	3,296	-37.1
Japan	511	344	-32.7	536	350	-34.7	1,047	694	-33.7
China	786	608	-22.6	940	731	-22.2	1,726	1,339	-22.4
Singapore	224	153	-31.7	238	168	-29.4	462	320	-30.7

¹ Includes goods and services.

² January – June 2009.

Source : WTO and national authorities.

Trade Flows

Trade flows contract in line with global downturn...

Trade prospects for 2009 are heavily affected by the turmoil in the financial sector and resultant economic downturn, which led to a slump in global demand. Trade flows were further affected by a sharp deleveraging in credit to finance imports and exports. As a result, global trade flows are projected to decline substantially 11.9% in volume terms (2008: 3.0%).

A notable aspect of the current slowdown in world trade is its synchronised nature where monthly exports and imports of major developed and developing economies continued to fall in unison since September 2008. The contraction in developed countries is anticipated to be particularly severe with exports falling 13.6% (2008: 1.9%), while exports from emerging and developing economies are expected to shrink 7.2% (2008: 4.6%). Imports from developed economies are expected to also contract sharply 13.7% (2008: 0.5%), while emerging and developing economies will contract 9.5% (2008: 9.4%). Similarly, the demand for ASEAN output decreased due to the

downturn in the global economy. Nevertheless, significant intra-ASEAN trade flows helped balance the slower growth in exports to the developed countries.

Total trade for the **US** in the first eight months of 2009 decreased substantially to USD2,230 billion (January – August 2008: USD2,992 billion), a reduction of 25.5%. The poor performance was on account of declining external demand and tighter credit conditions for consumers and business entities. The major export destinations for the US were Canada, with a share of 13.1% of total exports, Mexico (8.1%), China (4.1%), Japan (3.3%) and the United Kingdom (3.0%). For 2009, US exports and imports are projected to decline sharply 12.1% and 15.4%, respectively.

Likewise, in the **euro area**, total trade contracted 37.1% to USD3,296 billion (January – June 2008: USD5,241 billion) during the first half of 2009. The euro area's main trading partners were the United Kingdom with a share of 11.9%, followed by the US (11.3%) and China (8.8%). The euro area's exports and imports of goods and services for 2009 are expected to decrease 23.7% and 23.9%, respectively.



China's total trade decreased 22.4% to USD1,339 billion for the months until August 2009 (January – August 2008: USD1,726 billion). China's main trading partners were the European Union (EU), accounting for 16.8% share of total trade, the US (13.7%) and Japan (10.6%). China's 2009 exports and imports in goods are expected to increase 22.9% and 15.2%, respectively.

Total trade for **Japan** in the months until August 2009 was USD694 billion (January – August 2008: USD1,047 billion), a reduction of 33.7%. In terms of its trade partners, China overtook the US, accounting for 20.5% of total trade, while the US registered 13.5%. Trade with ASEAN accounted for 14.1% (USD97.6 billion) share of total trade. Japan's exports and imports of goods and services for 2009 are expected to decrease 29.3% and 16.2%, respectively. One of the sectors hardest hit by the global recession was the automotive industry, where exports to the rest of the world fell 47.9%, while exports to the US dropped 58.7% in the second quarter of 2009.

Singapore recorded USD320 billion in total trade for the months until August 2009 (January – August 2008: USD462 billion), a reduction of 30.7%. Singapore's largest trading partners included the EU (13.6%), the US (13.0%), Malaysia (11.3%) and China (9.9%). For the year, total trade is expected to contract between 21.0% and 23.0%.

International Economic Cooperation

Coordinated action for global economic recovery...

International economic cooperation took on added significance as countries implemented coordinated policy measures to mitigate and contain the effects of the global financial crisis and economic downturn. At the multilateral and regional levels, solving the crisis took centre stage in an effort to stabilise the international financial system and restore growth.

In this context, international financial institutions (IFIs) such as the World Bank and IMF played an active role in assisting members manage the challenges posed by the global financial crisis. Of significance were the new arrangements initiated to assist crisis-affected countries by providing funds to address liquidity constraints and for development assistance. In this regard, the IMF undertook several measures to support members, such as the Flexible Credit Line facility to help countries with well-managed economies weather the crisis and return to sustainable growth. Equally important were measures to increase lending and provide technical assistance to low-income countries. Lending reached a record high of USD157 billion, with a sharp increase in concessional lending to poor countries. The lending framework was revamped to enable a doubling of members' access to the Fund's resources. It is expected to improve efficiency and conditionality of borrowing as well as customise lending according to the strengths and challenges faced by member countries.

The IMF's lending resources were further trebled to USD750 billion by the G-20 Leaders at the Summit in April 2009. As agreed during the Summit, the Fund injected liquidity amounting to USD250 billion worth of Special Drawing Rights (SDR) into the global economy to assist countries facing balance of payments problems. By the same token, the Asian Development Bank (ADB) tripled its capital base from USD55 billion to USD165 billion in response to the global economic crisis and to assist the longer-term development needs of the Asia-Pacific economies.

On the part of the World Bank Group, the International Bank for Reconstruction and Development (IBRD) established the Fast Disbursing Development Policy Loans facility. In addition, the World Bank also called on developed countries to increase aid by contributing an equivalent 0.7% of their stimulus package to a newly-established Vulnerability Fund. As at end-June 2009, USD6.8 billion was received from donor countries. In addition, the World Bank committed funds totalling USD58.8 billion, or 54%



more than in 2008, for 767 projects aimed at generating economic growth, alleviating poverty and assisting the private sector. One-third of the funds were channelled into infrastructure financing. The funds were disbursed through loans, grants, equity investment and guarantees to assist poor countries.

At the regional level, Malaysia, Singapore and Hong Kong coordinated their announcements to fully guarantee all deposits with banking and non-banking institutions. The guarantee up to end-2010 was largely pre-emptive and precautionary to preserve confidence in domestic financial institutions that remained well-capitalised with ample liquidity.

The ASEAN+3 (China, Japan and ROK) member countries, on their part, focused on improving the effectiveness of the Chiang Mai Initiative (CMI), launched in 2000 to assist member countries facing temporary balance of payments or liquidity problems to avoid a repeat of the 1997/98 Asian financial crisis. This involves the multilateralisation of swap arrangements (CMI multilateralisation – CMIM) to include all thirteen member countries under a single contractual agreement. An initial sum of USD80 billion was agreed to be established with commitments from ASEAN and Plus 3 member countries on a 20:80 basis. The sum was subsequently raised to USD120 billion in response to the speed and severity of the global financial crisis as well as to foster confidence and ensure regional financial market stability. Member countries are committed to ensuring that the CMIM arrangement is operationalised by end-2009.

Recognising the need to avoid a repeat of the current global financial crisis, the call to reform the international financial architecture gained impetus. Towards this end, the United Nations and the G-20 Leaders have committed resources to undertake coordinated responses to restore credibility and stability in the international financial system as well as confidence in IFIs. Efforts are focused on strengthening transparency and accountability, enhancing sound regulation, promoting integrity

in financial markets and reforming the Bretton Woods Institutions to adequately reflect the changing world economic order.

Prospects for 2010

Global recovery strengthens...

The growing signs of recovery in the global economy are expected to firm up in 2010, with emerging and developing countries, particularly Asia, leading the rebound. However, recovery is expected to be sluggish and not strong enough to mitigate the impact of high unemployment, especially in the developed countries. Additionally, with banks continuing to rebuild their balance sheets, credit flows will be constrained in advance economies. This could impact capital flows to emerging and developing economies.

The massive fiscal stimulus measures, which supported demand and lowered systemic risk in the financial markets, have also increased fiscal burdens significantly, especially in the developed countries. Public debt in developed countries, which was about 80% of GDP before the crisis, is projected to exceed 110% in the next five years. This raises issues of fiscal sustainability as well as the need to rein in spending and reduce debt levels over the medium term. Nevertheless, with consumption and investment continuing to be weak, caution remains against early unwinding of the stimulus packages before recovery is on firmer footing.

With growth among advanced economies expected to be tepid, global trade growth expected to remain weaker than usual at 2.5%. The US is projected to register a recovery of 1.5% in 2010, while the euro area is expected to grow at a slower pace of 0.3%. Stronger growth of almost 5% is nevertheless expected to be recorded by emerging economies, with Asian economies, particularly China and India, providing the impetus for global growth. As such, the global economy in 2010 is expected to resume growth at 3.1% (2009: -1.1%).



Global Financial Crisis: Causes and Policy Responses

Introduction

The global financial crisis, the most severe since the Great Depression, was triggered by the bankruptcy of one of the biggest global investment banks in the United States (US) in September 2008. This led to a sharp contraction of the global economy which began end-2008 and accelerated into the first quarter of 2009. From a financial crisis, it morphed into an economic crisis, as output fell and unemployment rose.

How the crisis began

The vulnerability of the financial system can be traced to the loose monetary policy in the major advanced economies after the dot-com crash of 2001. Low policy rates, mainly in the US during the period 2002 – 2004, boosted asset prices, particularly in housing and real estate, and provided impetus to consumption and investment through wealth effects. As a result, aggregate demand exceeded domestic output in the US, raising the current account deficit. Domestic demand in the US was met by the rest of the world, especially the emerging economies, providing goods and services at low costs. The emerging economies had accumulated current account surpluses due to lessons learnt from the Asian financial crisis, which were then invested in US Treasury Bills. The cheaper goods and services dampened inflation and contributed to continued accommodative monetary policy in the developed economies.

In the US, the stable macroeconomic environment encouraged the under-pricing of risks. The sustained rise in asset prices, coupled with low interest rates and innovative financial instruments resulted in a marked increase in mortgages to low credit-worthy households, through “no income, no jobs or no assets” loans.

As inflation began to edge up in 2004, the Federal Reserve Board (the Fed) tightened monetary policy, resulting in rising mortgage payments. This led to defaults on subprime loans and large losses for banks and financial institutions. In June 2007, the crisis deepened as the collapse of two highly-leveraged financial institutions caused systemic failure while credit markets froze. The credit crunch in the advanced economies as well as plunging consumer and business confidence affected the real sector. The recession in the major advanced economies adversely impacted export-reliant emerging and developing economies.

As the US and Europe grappled with measures to address the financial crisis, the collapse of the Lehman Brothers in September 2008 sent shock waves and shattered investor confidence. This galvanised governments to institute individual and coordinated responses to mitigate the impact and overcome the crisis.

Policy Responses

The crisis appears to be abating, attributed to the unprecedented fiscal stimulus totalling about USD5 trillion together with accommodative monetary measures. In the developed economies, the crisis prompted a substantial injection of capital into financial markets by their central banks. Apart from this, access to the central banks’ “lender of last resort” facilities was eased, foreign exchange swap facilities were established and reserve requirements were lowered. Most developed economies provided extensive assurances to depositors and creditors of banks and some non-bank financial institutions. These include a blanket guarantees on deposits and guarantees on bank debt issues in order to maintain funding and restore investor confidence. To forestall further write-downs and credit losses, the US and several European countries pursued bank intervention strategies that included arranged takeovers of the weaker entities by stronger partners, closures and nationalisation.

Emerging and developing economies initially appeared immune to the global financial crisis, particularly those countries which were less financially integrated into the global financial system, or which had stronger macroeconomic and financial fundamentals. As the crisis prolonged, they adopted measures to ease credit conditions by providing emergency liquidity support to the domestic banking system. A few emerging economies, particularly in East Asia, also implemented measures to increase deposit insurance coverage and introduce blanket guarantees to prevent capital outflows and bank runs. However, as the crisis deteriorated and affected the real economy, fiscal stimulus measures became policy priorities.



At the same time, international financial institutions initiated new arrangements to support economies facing balance of payments and liquidity crises. These institutions were injected with additional lending resources to assist crisis-affected economies in stabilising the financial sector, restoring growth as well as easing the burden of the poor and vulnerable groups.

Conclusion

It is increasingly evident that the global economy is beginning to recover due to the massive injections of fiscal stimulus and accommodative monetary policy. Nevertheless, the recovery is likely to be sluggish as investment and consumption are low while unemployment remains high. Further efforts need to be undertaken to strengthen and restore confidence in the financial system especially in the advanced economies. Meanwhile, private investment and consumption as well as assistance for the poor and the vulnerable groups need to be enhanced to restore growth.

The crisis proves that the current financial regulatory system is fundamentally flawed. The international financial architecture must be reformed to prevent the recurrence of such a crisis and to ensure sustained economic and financial stability.

Stimulus Packages in Selected Countries

Date Announced	Country	USD Billion	Focus of the packages
17 Feb 09	United States	787.00	Create jobs, boost consumer spending and rebuild infrastructure.
12 Dec 08	European Union	39.00	Cross-border projects including clean energy and upgrade telecommunications infrastructure.
13 Jan 09	Germany	118.00	Construction activities and repair of public facilities, child bonus, social benefits incentive for car scrappage scheme and tax cuts.
5 Nov 08	France	33.00	Public sector investments and reviving the automotive industry.
13 Dec 08 6 Apr 09	Japan	250.00 570.00	Government spending, stabilising the financial system, grants to local government, safety net for non-regular workers, small businesses, revitalising regional economies, promoting solar power and nursing and medical services, tax cuts for homeowners as well as companies.
10 Nov 08	China	586.00	Low-income housing, electricity, water, rural infrastructure projects aimed at environmental protection, health care and social welfare as well as technological innovation tax deduction for capital spending by companies.
3 Nov 08 9 Feb 09	Republic Korea	14.64 38.00	Infrastructure (including roads, universities, schools and hospitals), funds for SMEs, fisherman and families with low incomes, eco-friendly projects including the construction of dams, green transportation networks, expand existing forest areas and tax cuts.
28 Jan 09	Indonesia	6.32	Spending on infrastructure, tax incentives for companies and individuals, cuts in fuel and electricity prices.
21 Jan 09	Philippines	7.01	Infrastructure project, agriculture, education, and health, cash for poor households and tax cuts.
16 Dec 08	Viet Nam	6.00	Spending on infrastructure, housing, schools and hospitals as well as tax cuts.
22 Jan 09	Singapore	13.70	Infrastructure, subsidies for employee wages, training, cash handouts to low-income workers, increase in public sector hiring, assuming 80% of the risk on private bank loans, boosting aid to welfare recipients, government pensioners and students, personal income tax rebate and cut in maximum corporate tax rate.
29 Jan 09	Thailand	3.30	Cash for low earners, expanded free education, subsidies for transport and utilities as well as tax cuts.
30 Nov 08 10 Mar 09	Malaysia	1.93 16.20	High impact infrastructure projects, reducing unemployment and increasing job and training opportunities, easing the burden of the rakyat, in particular the vulnerable groups, assisting the private sector in facing the crisis and building capacity for the future.

