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A New Page Was Written

With increased globalization of the world economy, APEC needs a mechanism to deal with a variety of economic crises, which frequency is expected to be much higher than before. This signals an urgent need for Small and Medium Enterprises (SMEs) to strengthen their crisis management capabilities. To respond to this need, Chinese Taipei proposed the establishment of “APEC SME Crisis Management Center” in 2009. The proposal obtained strong support from APEC Ministerial Meetings and Economic Leaders’ Meeting, which leads to its successful launching on May 24, 2010 in Taipei.

In order to help SMEs to effectively prepare and cope with crisis, APEC SME Crisis Management Center (SCMC) formed an expert team to monitor and analyze the possible impacts of emerging or existing economic crises on SMEs. The team was convened in Taipei from 21-22 May 2010 to discuss the ways of monitoring and the format of the “APEC SME Economic Crisis Monitor”. The team observes key components of the global economy and indicators about SMEs development. The result of monitoring is published on the “APEC SME Economic Crisis Monitor” in a form of newsletter for APEC SMEs each month. Referring to the Monitor, SMEs can obtain timely information about the formation of crises; recognize a crisis when it emerges; and take necessary steps to prepare and cope with it. I am pleased to announce that the first issue of the Monitor is successfully published. I should thank the nine experts from APEC and European economies and our editorial team as well as APEC SME Working Group members for their supports.

In this issue, abundant interesting topics were addressed. Firstly, the Monitor presents crisis alert indicating that four hidden risks still exist underneath the economic revival. The crisis alert gives SMEs early warnings of crisis, which I believe is very helpful for SMEs to prepare crisis. Then, our nine experts report their monitoring results in each region of the world. They show that in some regions the recovery is quite healthy, and in others, steady economic growth is still not feasible. For those who concern the development of and the risks embedded in some specific regions, these reports can give them useful insights. In addition, this issue also provides in-depth knowledge about the European Union’s sovereign debt crisis and the recent development of China’s financial policy. Readers are able to understand two of the most important issues that affect the global economy nowadays. If readers want to know some practical experience dealing with crisis, such as how other SMEs successfully overcome the impact of crisis, this issue also present three living cases that can be learnt by other SMEs.

For those readers who want to quickly grasp the newest development of economic events of the world, this issue also digests three important news titles: crisis in euro zone, wage raise in China, and the appreciation of Renminbi. Of course, the establishment of APEC SME Crisis Management Center, which is considered a milestone of crisis management in APEC, is also introduced. Finally, this issue also guides readers to further explore other publications. This time, IMF’s Global Financial Stability Report was chosen.

I hope the content of the Monitor can provide the readers with useful knowledge about crisis preparedness and management. In our design, more useful and basic knowledge and guidelines about crisis management will be afforded in the next issues. I also sincerely expect feedback from readers of this issue.

Robert Sun-Quae Lai, Ph.D.
Executive Director
APEC SME Crisis Management Center
In the present post-crisis period, international economic development is starkly dichotomized: emerging economies are reviving strongly, while the recovery of developed economies is still quite weak. Bank systems in emerging economies have already been restored from the damages of the crisis. Though new challenges are still facing them, the restoration from past crisis is quite successful. Bank systems in developed economies, by the contrary, are still suffering from sluggish progress in the process of rebuilding, troubled by the problems of credit contractions and sovereign debts. This, however, does not mean that there is no risk encountering emerging economies. Though different from the risks facing the developed counterparts, no less challenges confronting emerging economies. Based on the regional reports of the Center’s expert team, I will discuss several latent risks menacing the stability of the international economy.

First of all, a steady economic growth is still not a feasible dream for developed economies in the short and middle term. It is primarily because these economies can choose only either one from the two main goals—economic growth or fiscal consolidation; they cannot achieve both at the same time, and most of them choose fiscal stability and compromise economic growth. To improve government finance, they adopt such contractive fiscal policies as reducing expenditures and increasing tax rates, resulting in a weaker market demand. Another important cause for the dropping demand is that consumers’ confidence has not yet been recovered generally in these areas, and meanwhile foreign investments have not yet been restored. The unclear prospect of developed economies’ economic revivals and the weakened market demand will threaten the continuous growth of the global economy.

Since the breakout of the financial crisis, most developed economies have been tormented by the problem of sovereign debt. After their actively dealing with this problem, there were still five European Union (EU) members (i.e. Greece, Spain, Ireland, Portugal and Italy) where the sovereign-debt crisis erupted. In the past few months, the global economy has already seen the power of the sovereign-debt crisis. In addition to the economies that have direct loan relations with those five debtors abovementioned, the global economy was also agitated. The effects now can be seen primarily in the turbulence in the global stock markets and the great fall of the Euro, while other affected dimensions are still unclear. Due to the active intervention and assistance by EU and International Monetary Fund, as well as the governments’ successful issuing of bonds, EU’s sovereign-debt crisis is mitigated temporarily. A continuous monitoring of the debt position and repayment of these economies and how the creditors are influenced, however, is still a key work in the future.

The two risks above are mainly threatening developed world, and the following discussion will be the risks that emerging economies are facing. Loose monetary policy adopted by governments all over the world and the lack of investment confidence in developed economies both lead to a huge flood-
in of foreign capital into emerging economies over a short time. Although this phenomenon is helpful for their economic growth, it also affects the financial stability and causes asset bubbles. As the history tells us, the overflow of money resulted from the flood-in of foreign capital is a significant cause of financial crisis for emerging economies. At the present moment, asset bubbles are gradually coming into being and foreign exchange rates are going up, and both are the early signs of a crisis. Therefore, we must pay close attentions to when and how the foreign capital would be withdrawn.

Closely related to this risk is the risk of inflation that emerging economies face. Even though inflationary fears are also growing in developed world, it is more substantial in their emerging counterparts. Fundamentally speaking, so far inflation crisis is still a worrying possibility, and there is still a way to go for the possibility to come true. If the speed of emerging economies’ growth and loose monetary policy continue, compounded with the huge inflows of foreign capital, the worrying possibility of inflation will become a reality. Fortunately, the currency and fiscal policy of emerging economies does not have to face a complicated dilemma as their developed counterparts do, and it is easier for them to prevent seed of inflation from growing by means of monetary policy. It should be especially noticed, however, that the global price of raw materials may probably be driven up by the fall of the US dollars in the future, and this is a risk which is hard to prevent and which will have a profound impact.
The current U.S. macroeconomic picture is mixed. U.S. real GDP grew at an annual rate of 2.7 percent in the quarter that just ended in March 2010, but this was down from the 5.6 percent growth rate achieved in the fourth quarter of 2009. Furthermore, the U.S. unemployment rate is stubbornly high at 9.5 percent, about where it has remained since December of 2009. Prospects for high growth for the remainder of the year are not bright, especially since consumers are cutting back, given the slow wage growth and a higher risk of unemployment.

What does this macroeconomic picture mean for small and medium-sized firms (SMEs) in the U.S.? The slow growth in the U.S. economy and especially in household consumption will mean that sales and profit growth for small and medium-sized firms will be unremarkable for the foreseeable future. There is no publicly available data set for the growth in sales for SMEs in the U.S. However, since many U.S. SMEs are in the retail sector, growth in retail sales may provide a proxy for the growth in overall SME sales.

The retail sales situation is still bleak. Retail sales declined by 10.1 percent between May 2008 and May 2009. While retail sales have rebounded by 6.6 percent between May 2009 and May 2010, today’s retail sales are still a full 4 percent below their mid-2008 levels. Thus, if retail sales are reflective of the situation facing the average U.S. SME, then it may take a while for the sales and profits of SMEs to recover.

This slow recovery in SME sales and profits means that their financial conditions are still rather poor. These poor SME financial conditions, and the fact that some banks, particularly smaller banks, are pressured by government regulators to be more selective in lending has meant that many SMEs are constrained in the amount of their borrowing. According to some surveys, only half of small businesses that tried to borrow in 2009 got all or most of what they needed. In contrast, in 2005, 90 percent of small businesses said they got all of the loans that they needed. This so-called “credit-crunch” of the SMEs is one of the most important challenges confronting U.S. policy-makers today.

The “credit crunch” of U.S. SMEs

Perhaps the most reliable information on SME credit is the Federal Reserve’s Senior Loan Officer Opinion Survey on Bank Lending (“Fed Survey”). This Survey indicates whether conditions are tightening for SMEs. As of the latest survey in the first quarter of 2010, credit conditions facing SMEs were still tight; much tighter than in the beginning of 2008, before the financial crisis started. In the first quarter of 2008, 51.8 percent of the loan officers said that they have tightened credit standards, but by the fourth quarter of 2008, that percentage rose to 69.2 percent.

This tight credit situation for SMEs continued during the first part of 2009; in the first quarter of 2009, 42.3 percent of the loan officers have tightened

The credit available for SMEs is still tight

Robert Dekle
credit. By the fourth quarter of 2009, however, only 3.7 percent of the loan officers have further tightened credit standards. In the first quarter of 2010, the percentage of loan officers who tightened credit was zero.

Thus, the picture seems to be that today, although loan officers are no longer tightening credit from the already very tight levels, they have not yet started to loosen the credit availability to SMEs. Moreover, for the big U.S. banks, lending to the SMEs has fallen much more dramatically than overall lending. In 2009, while overall lending dropped 4 percent from 2008, SME lending dropped by 9 percent. For the smaller U.S. banks, which are especially important to the smallest of enterprises, overall lending dropped by 0.2 percent, while SME lending dropped by 2.7 percent. No wonder U.S. SMEs are complaining about tight credit!

Alarmed by the decline in SME lending, U.S. policymakers have passed a slew of measures to try to spur SME lending. As part of last year’s government stimulus package, the U.S. Small Business Administration enhanced its loan-guarantee program, which gives banks more confidence to lend by reimbursing them in the case of default. The new program eliminated loan fees for borrowers while increasing the maximum guarantee amount from 75 percent to 90 percent. In addition, in late June 2010, Congress passed a $30 billion program to allow small banks to directly borrow from the government at low rates.

It appears, however, that these government programs have not been successful. Analysts believe that SME lending by U.S. banks will only recover when the entire U.S. economy and therefore SME sales and profits recover. This should improve the balance sheets of SMEs, and then make the banks less cautious in lending to the SMEs. (The author is Professor at University of Southern California.)

Northeast Asia

Economies have recorded a significant recovery from recession

Iichiro Uesugi and Hikaru Fukanuma

Recent development of the economies in the region including Japan, China, Korea, and Chinese Taipei is summarized in below. Note that we exclude North Korea from the report due to the unavailability of necessary statistics. Overall, the economies in the region have recorded a significant recovery from the previous recession although there are several negative indicators including unemployment.

Japan

The economy has been recovering after the severe recession caused by the financial crisis. Real GDP growth rates (year on year) for the past three quarters are positive and 0.4% (3Q 2009), 4.6% (4Q 2009), and 5.0% (1Q 2010).

Industrial production has been recovering rapidly after recording significant declines in 2008 and 2009. The year on year rates of growth of the production for the past three months have been 31.8% (March 2010), 25.9% (April 2010), and 20.2% (May 2010).

Unemployment rate has been declining to some extent but remains high, which is one of the negative indicators in the economy. After it marked the unemployment rate of 5.6% in July 2009, the rates for the past three months have been 5.0% (March 2010), 5.1% (April 2010), and 5.2% (May 2010).

Corporate profitability has been recovering significantly. Financial Statements Statistics of Corporations by Industry indicate that the corporations’ current profits grow by 163.8% in 1Q 2010 mainly due to the sales increase.
Business sentiment has been recovering. Bank of Japan’s Tankan Survey reports diffusion indices (DIs) about the current business conditions by firm-size and by industry, whose figures indicate the difference between the percentage of responding firms that regard current situation as good and the percentage of those that regard current situation as bad. DIs for large manufacturers and large non-manufacturers have been increasing for the four consecutive quarters and those for small and medium manufacturers and small and medium non-manufacturers have been increasing for the three consecutive quarters. Note, however, that DIs among small and medium enterprises (SMEs) for the next quarter are predicted to stop recovering in some industries including constructions.

Another business sentiment statistics reported by the Japan Finance Corporation focuses on the small businesses with no more than 20 employees. It reports that the DIs about sales marked the bottom in November 2009 but has increased ever since. The figures for the recent three month have been -26.9 (April 2010), -36.8 (May 2010), and -30 (June 2010).

China

The economy has been expanding after a slowdown of the growth in late 2008 and early 2009. Real GDP growth rates (year on year) for the past three quarters are positive and 9.1% (3Q 2009), 10.7% (4Q 2009), and 11.9% (1Q 2010).

Industrial production continues to grow. The year on year rates of growth of the production for the past three months have been 18.1% (March 2010), 17.8% (April 2010), and 16.5% (May 2010). Concerning foreign exchange rate, Renminbi has been stable and hence does not cause sizable impacts on other economies in the short-term.

Business climate index and entrepreneurs confidence index issued by the National Bureau of Statistics of China have been recovering from the bottom. These indices marked the bottom in 1Q 2009 for the business climate index (105.6) and 4Q 2008 for the entrepreneurs confidence index (94.6), respectively. Both of these indices have improved since then. Figures in the previous three quarters are 124.4 (Q3 2009), 130.6 (Q4 2009), and 132.9 (Q1 2010) for the business climate index and 120.1 (Q3 2009), 127.7 (Q4 2009), and 135.5 (Q1 2010) for the entrepreneurs confidence index, respectively.

Korea

The economy has been recovering after the severe recession caused by the financial crisis. Real GDP growth rates (year on year) for the past three quarters are positive and 13.4% (3Q 2009), 0.7% (4Q 2009), and 8.8% (1Q 2010).

Industrial production has been recovering rapidly after recording significant declines in the late 2008 and early 2009. The year on year rates of growth of the production for the past three months have been 22.5% (March 2010), 19.9% (April 2010), and 21.5% (May 2010).

Unemployment rate has been declining since it marked 4.8% in January 2010. The rates for the past three months have been 3.8% (March 2010), 3.7% (April 2010), and 3.2% (May 2010).

Business sentiment reported by the Federation of Korean Industries’ Business Survey Index has been recovering from the bottom. The index marked the bottom in December 2008 and rapidly increased in the first half of 2009. Figures in the previous three month are 108.9 (April 2010), 111.9 (May 2010), and 109.4 (June 2010).

Chinese Taipei

The economy has been recovering after the severe recession caused by the financial crisis. Real GDP growth rates (year on year) for the past three quarters are -1.0% (3Q 2009), 9.1% (4Q 2009), and 13.3% (1Q 2010).

Industrial production has been recovering rapidly after recording significant declines in 2008 and 2009. The year on year rates of growth of the production for the past three months have been 39.5% (March 2010), 32.0% (April 2010), and 30.7% (May 2010).

Unemployment rate has been declining since it marked 6.1% in August 2009. The rates for the past three months have been 5.7% (March 2010), 5.4% (April 2010), and 5.1% (May 2010).

Business sentiment reported by the Taiwan Institute of Economic Research survey has been recovering both in manufacturing and service industries. Figures in the previous three month for these industries are 116.54 (February 2010), 118.28 (March 2010), and 118.25 (April 2010) for manufacturing and 125.99 (February 2010), 126.55 (March 2010), and 132.00 (April 2010) for service, respectively. (Ichiro Uesugi is Associate Professor, Institute of Economic Research, Hitotsubashi University and Hikaru Fukanuma is Principal Economist, Research Institute Small & Micro Business Research Group)
Capital inflows and currency appreciation trouble the stability of economies

Honghui Cao

In the second quarter of 2010, South East Asia accelerates its recovery though the more serious sovereign debt crisis in PIIGS (Portugal, Ireland, Italy, Greece, Spain) makes the external demand growth slow down. However, with the capital inflows into this region, the local currencies have been appreciated, which might result in the shock to the stability of local markets and therefore threaten the recovering SME business in the coming quarters, making the withdraw from the stimulus policies more complicated.

In the first half of 2010, Singapore GDP growth rises by 19.3% and expands to 18.1% year-on-year, which surpasses China who has been the champion of growth and its overall growth this year is estimated to 13% to 15%.

In May, Malaysia’s external trade surplus reaches RM 8.1 billion which is the 151st consecutive month of trade surplus since November 1997. In the first five months of 2010, Malaysia’s trade grows at 30.2% year-on-year and makes its trade surplus increase 12.4% as against RM50.1 billion year-on-year. The central bank raised interest rates twice as growth accelerated, seeing that risks stemming from low borrowing costs are greater than any impact from Europe’s debt crisis, which makes more capital inflow to purchase Malaysian Ringgit and makes it appreciated more than 7.2% against the dollar, which touches the highest position in the past 19 months.

In the first half, Indonesia growth is predicted to boost by 5.8% to 6%, supported by increasing foreign trade and improving non-tax state income. Indonesia’s rupiah has gained 3.6% this year, after jumping 16% in 2009. Bank Indonesia on July 5 keeps its benchmark interest rate at a record-low 6.5% for it believes that the inflation prove temporary and the rupiah is likely to resume appreciation.

Even the Thai economy hits a 15-year high at 12 per cent growth in the first quarter though the political turmoil continues to dampen tourist confidence into at least the first half of 2010 and exports growth slows down which makes the capacity utilization fall. Its international reserves remain relatively large and external debt, especially short term debt remains low. This strong external account makes Baht against US dollar touch higher position. The private investment boosts and the inflation pressure remains for CPI hits 3.5% in May, which arises the rise of interest rate.

Philippine grows by 7.3% in the first quarter. Its export digs in April but rebounds a little in May year-on-year, which explains why its trade deficit reaches 846 millions US dollars in April and then why the short term external debts for government, bank and other sector go up in the first half. The annual headline CPI remains high though it eases a little from above 4.2% in the first five months to 3.9% in June and unemployment rate hits 8.0% in April. Philippine Peso against US dollar rises to 46.3027 since its depreciation in the global financial crisis. The central bank intervenes its exchange rate market several times to prevent the impacts from the capital inflows to the export growth for it is obviously not because of the strong economic performance, but because of the capital flow cross the border.

Viet Nam’s growth rises by 5.83% year-on-year in the first quarter and then 6.16% in the first half. But the so called imported inflation pressure becomes more serious as CPI rises to striking 8.75% year-on-year in the first half, which makes its control under 7% rather difficult. The imported commodity accounts for over 60% of the overall import, equaling $43 billion of total. Its import rises 38% in the first quarter year-on-year, while export falls 1.6%, to 14.1 billion dollars and the trade deficit hits over 25% of the export.

As China’s rapid growth is expected to slow down in the second half, most South East Asian economies might be confronted with the slowing growth of export as its counterpart in external trade. (The author is Director, Financial Markets Division, Chinese Academy of Social Science)
Global Trends impacting on the region

The IMF’s recent World Economic Outlook points to improving prospects for recovery from the global financial crisis but with higher risks. These arise because of the massive sovereign debt of some European economies and the possible impact of that debt on banks and financial markets. Risks are in the form of loss of confidence, withdrawal of liquidity to banks and financial markets and to lending to the real economy. While access to credit seems to be improving in both developing and advanced economies, these risks lead to the distinct prospect of a further serious contraction in global economic growth. In that event, SMEs would be impacted adversely through declines in domestic and international trade, and through limits on their access to credit and finance. These concerns would impact generally on all economies in varying degrees. The highly uncertain current financial situation arising from the European sovereign debt issue requires close monitoring by all economies, including importantly any worsening of credit conditions to SMEs. Credit flows within banking systems, lending to the private sector and any sharp decline in capital market issues will require close monitoring.

India

India and China are strongly performing economies at this time and driving the world economy. Both introduced measures to stimulate activity in response to the global financial crisis to maintain growth. Capital inflows and domestic credit availability are contributing to strong growth in India. Industrial production rose 17.6% year on year in April and is at near capacity levels. Credit growth rose 19.6%, corporate profits are strong and financing conditions are currently favourable. The output of India’s service industry – a major growth sector - reached a two year high in June. Car sales also increased in June. The microfinance industry has also been displaying healthy growth. However, the central bank is concerned about inflation, now running at around 10%. Controls on the price of fuel were lifted in June and this may have contributed to some initial upward pressure on prices. Inflation growth and a high level of government debt pose problems for economic management.

Good domestic conditions may be damaged by any worsening of the global financial environment outlined above.

Australia

The economy is recovering well from the global financial crisis. Growth is firm and unemployment is relatively contained at just over 5%. While the measures taken to stimulate activity during the crisis led to a sharp increase in public debt, plans are in place to eliminate this by 2013. Major parties contesting a Federal election to be held on 21st August, proclaim an early return to a budget surplus as a major priority. Outstanding credit continues to reduce from its 2008 peak, and outstanding small business credit remains stable. Banks are closely monitoring credit in light of uncertain global financial conditions. Access to finance is generally available to customers who meet higher approval standards. Government policies are aimed at efficiencies in tax administration to lower the burden on small enterprises. The $A has moved down against the $US by around 7% over the last two years or so but firming prices for major commodity exports have put a floor under the $A exchange rate. Labour market and doing business indicators are generally consistently positive. The economy-wide impact on prices of the outcome of a new minimum wages set by the Minimum Wages Panel of
Fair Work Australia, requiring a $26 per week increase in the minimum wage effective 1st July, a 1.2% rise in real terms, has yet to be assessed.

There are several issues of concern for SMEs and to government. The slow increase of the Non-Performing Loan ratio, a decline in total outstanding credit, and findings by the Sensis Business Index point to concerns on the availability of new bank credit banks to SMEs. The Sensis Business Index has recorded the largest drop in a single quarter of SME business confidence, “surpassing falls recorded during the peak of the global financial crisis.” These matters will be of concern to parties contesting the August election and they could if they are exacerbated by global financial uncertainty become serious challenges to an incoming government.

**New Zealand**

Despite having its worst recession in three decades as a consequence of the global financial crisis, the economy is slowly recovering. The authorities are forecasting growth of 3.5% for this year and next, based on export price and volume growth. Domestic demand is not expected to pick up in the short-term. Currently, businesses are strengthening their balance sheets but are doing so by reducing risks and investment.

Conditions for small firms deteriorated the June quarter and credit has remained subdued. Credit growth has failed to recover since the June quarter 2008 and the latest data, for the December quarter 2009, showed growth of only around a ½ percent. The non-performing loan ratio has been increasing while bank lending has been falling dramatically. Lending to the business sector fell in March by 7.5%. The government has recently introduced an emissions trading scheme and there is a prospect of an increase in the goods and services tax. These two measures could worsen what is an ordinary business outlook in the short-term. Constrained credit and finance conditions available to SMEs will need to be monitored in the period ahead. Any deterioration in the global financial environment will retard further economic recovery in the economy. (The author is the Director, Australian APEC Study Center)

Latin America (Latam) appears immune to the EU sovereign debt crisis. In this piece, we analyze three sources of possible contagion: financial, trade, and macro similarities.

The first possible contagion could be the perception that fiscal positions could also place Latin America in trouble. One example of this type of contagion based on macro similarities was Argentina during the Mexican 1994/95 crisis. Although Argentina had very small trade and financial linkage with Mexico then, the perception that Argentina had the same economic mix than Mexico – an overvalued currency with a fixed-exchange rate – spurred massive asset sales in Argentina. But this time the external/fiscal position and credit conditions in Latin America is substantially better than that of the Southern European economies. Consolidated public sector balance to GDP ratio in Latam was 2.9% in 2009 and expected to improve to -2.2% and -1.9% in 2010 and 2011 respectively, according to Citigroup research report. Current account balance to GDP ratio was also very low for Latam, only -0.3% in 2009 and expected to slightly enlarge to -1.1% in 2010 and -1.8% in 2011. In particular, the improved fiscal position in Latam is not a by-product of higher commodity prices or overheated economies, suggesting that lower commodity prices from potential fallout of Southern European debt will likely have a limited impact on Latam’s fiscal situation. Even though the structural primary balance has deteriorated in recent years, the situation in most Latam economies is still far better than the Southern European economies, with the exception of Argentina and Venezuela.
Figure 1. Latam: Structural Primary Balance as % of GDP

<table>
<thead>
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<th>2005</th>
<th>2007</th>
<th>2009</th>
<th>2010F</th>
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</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>4.2%</td>
<td>-0.2%</td>
<td>-0.8%</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Brazil</td>
<td>3.3%</td>
<td>1.5%</td>
<td>0.4%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Chile</td>
<td>1.0%</td>
<td>1.0%</td>
<td>-0.4%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Colombia</td>
<td>-1.3%</td>
<td>0.5%</td>
<td>0.2%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.9%</td>
<td>2.7%</td>
<td>1.9%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>14.9%</td>
<td>-8.0%</td>
<td>-10.4%</td>
<td>-8.0%</td>
</tr>
</tbody>
</table>

1 Latin America Macro and Strategy, 19 May 2010, Citi Investment Research Analysis

Note: Structural primary balance is the primary balance when GDP growth is at its long-term trend.

Source: Citi Investment Research Analysis

The second contagion channel is through trade. In general trade between the most affected economies in Europe and the Latam is small. Exports to Portugal, Ireland, Italy, Greece and Spain are below 10% of total exports for Latam economies. If, however, the crisis extends to Europe, the damage to Latam exports would be higher, particular to commodity exports. It should be noted that trade with China has been growing in recent years. Hence, only a double-shock of lower growth in Europe and China would severely affect the outlook for the region.

The third and main contagion channel would likely be through financial asset, bank lending and FDI, with a somewhat limited impact in market friendly economies. The impact of lower risk aversion would likely be higher in “high-beta” (more volatile) economies like Argentina and Venezuela, and probably in economies with a higher reliance in short-term flows like Brazil. However, high reserve adequacy levels, among other factors, will likely dampen the possible extent of a sudden stop in capital flows to the region. Spanish-owned banks have near 35% of total assets in Mexico, 27% in Chile, 24% in Peru, 133.5% in Argentina and 11% in Brazil. If the epicenter of the EU crisis moves to Spain, certainly those banks lending capacity will be affected. Also with high share of FDI from Spain, there is a risk that a distressing situation at home would lead the subsidiary to increase the amount of repatriated profits, and hence to lower FDI in Latam, leading to lower investment and growth in the region. Moreover, for market friendly credits, financing requirement will not likely be a source of trouble for Latam economies this year as most economies in the region had enough foreign reserves to cover capital outflow or external debt services. This also reflected on mild pickup of Latam economy’s 5-year CDS (credit default swap) rate, a gauge of default risk of government bonds, in the recent bout of European sovereign debt crisis. For Argentina and Venezuela, their 5-year CDS rose by about 32 basis points. But for Brazil, Chile, Colombia, Mexico and Peru, their 5-year CDS increased only 6 basis points on average.

In general, outlook for most economies in Latam remains rosy. In the recent updated forecast in July, the International Monetary Fund (IMF) upgraded Latam’s GDP growth projection in 2010 to 4.8% from previous 4.0%. But at the same time, the IMF also warned that downside risks to global growth are much greater. Therefore the Latam economies as a whole still need to be careful in their monetary policy, fiscal policy, and exchange rate adjustment, to help counter the effects of the external shocks. (The author is Vice President, Citi Taiwan).
Overall situation in Europe

For a variety of reasons, the European region has been particularly badly affected by the economic crisis, though the impact on individual economies has been uneven. Ireland, Spain, Greece, and Portugal have been worse hit than others. EU averages can be misleading.

Overall, however the situation is improving and stabilizing slowly, with many more structural reforms needed in banking, labour and pension markets. Growth is being sacrificed for fiscal consolidation, and medium term projections suggest very low growth and gradual rebuilding of banking, corporate, consumer and national balance sheets.

Falling Sterling and Euro values (against the US dollar and Swiss Franc), helps European exports and discourages imports – both considered positive in the present context, though potentially inflationary.

Background to the European policy context

Of the economies covered in this report, all but Norway are part of the EU. Sweden and the UK are both in the EU but are outside the Eurozone and thus make their own monetary policy.

Norway and the UK both have significant oil and gas resources, though these are diminishing. The EU as a whole is dependent on international suppliers for 80% of their energy needs, together with most of their raw material supplies.

The current policy focus in the EU is on sovereign debt and the banking system. Sovereign debt is being tackled by cutting budgets and increasing taxes.

Banks continue to horde money but have yet to resume lending or investment activity. This is of particular concern to companies that need trade finance, and for growth.

General situation

- Sense of economic uncertainty continues, though with greater clarity about the possible source of threats, now identified as coming from:
  - Sovereign debt
  - Banking system
  - Decrease in consumer and business demand

- Policy responses currently being pursued mainly at the economy level, though increasingly coordinated - or overlapping - attempts at EU and international (G-20, G-8) level coordination. Process is moving slowly and painfully

- Short to medium term growth prospects deteriorating as fiscal consolidation policies take hold and aggregate demand drops

- Concerns about inflationary pressures growing

- Investment decisions being delayed, especially by multinational corporations

- Uncertainty about energy and global warming framework policies for the long term, continue

- Unemployment in the Eurozone persistently high (at about 10%)

Important developments immediately before the period under review

- Agreement to establish an independent European Financial Stability Facility (EFSF) with €440 billion capacity
Simultaneous agreement to create a rescue fund of €110 billion for Greece

Developments during the month under review (June 15 – July 15, 2010)

- the European Council met in June and committed to a stress test for major European by July 23rd
- G-8, G-20 meetings in Toronto decided on fiscal consolidation (debt reduction) as a priority, at the cost of growth revival policies. This was a European initiative

Demand and growth projections:
- Budgetary cuts may reduce growth by 1% of GDP for economies pursuing strict fiscal discipline
- Aggregate demand for consumers and business dropping rapidly (estimates of 4–6% of GDP) as consumers retrench and business consolidates
- Short and medium term growth projections vary significantly across Europe, with an average projection of 0.9% growth in 2010 and 1.7% in 2011.

Fiscal policy developments:
- Severe cuts in government spending covering several years, announced in almost all EU states. The objective: to reduce budget deficits to less than 3% of GDP within 4–5 years, and to reduce accumulated debt to less than 40-50% of GDP
- Tax rises, especially in Value Added Tax (VAT), and tighter Income tax enforcement, especially in the UK, Greece, Spain, Italy and Portugal
- Growing expectations that Greece will ultimately default on its huge debt. This is increasingly considered the best option

Banking developments:
- Greek, Spanish, Italian and other banks managed to refinance part of their debt without much trouble by selling bonds in the market
- French and German banks, heavily exposed to Greek and Spanish debt (estimated at €800bn), have benefited indirectly from the IMF-ECB bailout of Greece
- Spain restructures their domestic banking system (the Cajas) through consolidation, depoliticisation and opening them to private investment. This follows the German Landesbank model for reforms.

Implications for APEC SMEs:

difficult to establish direct effects of current situation, however indirect effects likely to be as follows:

Micro/Firm Level
- Payments may be delayed for services and products from APEC SMEs because of persistent banking problems in the EU
- Price pressures to reduce costs and improve quality likely to intensify (partly because of falling currency values, partly because of falling domestic demand)
- European SMEs will press for more supply contracts from EU governments and European Multinational Corporations to protect employment

Macro/Economy Levels
- Fears about inflationary pressures within the EU gaining strength. May lead to higher interest rates and a further fall in demand for goods and services, perhaps by the end of 2010
- The private sector has accumulated about $3 trillion in reserves but is unwilling to invest because of falling demand and an uncertain policy situation, especially in energy markets. (The author is Associate Director & Senior Programme dvisor, International Policy Unit, London School of Economics and Political Science)

Sources of information

1. The Financial Times, London
2. The Economist, London
3. IMF World Economic Outlook and Global Financial Stability Report, April, 2010
4. BIS Annual Report, 2009-2010
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6. European Central Bank, Monthly Bulletin, for June and July 2010
At this moment, from a currency standpoint, there is no worrying market trend specifically related to the East Europe region. The current conditions are essentially being determined by developments in the broader Europe. Leading indicators also show rather steady and healthy developments in the major economies of East Europe, excluding a worsening of problems in Greece. Meanwhile, although there is relative weakness in Poland’s retail sector, this is mostly due to expectation factors, and it may only be a reflection of a falling stock market in recent months. It is a little early to conclude whether this sector will become a true concern, especially given the market rallying in July.

As part of the launch of the SME monitor program, this column article will discuss the developments in the East Europe region on a monthly basis. For this current issue, due to the limitation on the article length, I shall only discuss Poland, the Czech Republic and Hungary (the more relevant economies of the region), along with Greece (already considered a troubled area). I shall start the discussion using leading indicators and financial market information to gauge the broader developments. The chosen leading indicator is the Economic Sentiment Indicator (ESI), which surveys are conducted during the second half and the results released at the end of each month by the Eurostat. It is currently the most comprehensive survey that is publicly offered in a timely manner. Most important of all, its survey results cover nearly all the respective EU economies. Few other sources provide such comparable coverage. As for the financial market data, I will begin by discussing the exchange rate trends, as currency markets are the single most sensitive financial sector that is facing change.

In Figure 1 below, it shows the exchange rate trends of the Poland Zloty, Czech Koruna, Hungary Forint, and the Euro against the US dollar, normalized at 1/01/2010 rates, with an up tick representing an appreciation against the US dollar. We can see that the respective East Europe economies are closely tied to the Eurozone. Usually their currency trends are also closely related to each other. Amid the recent woes of the Eurozone sovereign debt concerns, the currency trends did not follow different patterns. From April 2010 to July 14 2010, the Euro fell 5.83%, while the Zloty, Koruna and the Forint respectively declined 11.69%, 5.93% and 9.90%. Although the Zloty and Forint fell relatively more, as their economies were smaller than the Euro, weathering the high volatility could still be achieved. Compared that with past experience, there is no cause for serious concern. From the outbreak of the US Freddie Mac and Fannie Mae troubles in mid July 2008 to the end of Oct. 2008 after the fatal blow of the Lehman bankruptcy, the three East Europe currencies each fell 26.3%, 22.35% and 27.95%, respectively, against the US dollar, compared to the 20.00% of the Euro. Once again it was the Zloty and Forint that fell an additional 6 percentage points than the Euro. This occurred at a time of a global scale deleveraging, and funds were being pulled out of the Eurozone and emerging Europe equally. Looking at the recent Europe sovereign debt concerns, it is not an event specific to East Europe, thus we find the relationship between the four currencies to be quite similar. However in Jan. and Feb. 2009, the market was concerned about emerging Europe’s high foreign debt, and from Jan. 2009 to March 4 2009 when the Dow Jones slumped to a low point, the East Europe currencies each fell 21.55%, 14.06% and 24.7%, respectively, while the Euro slipped by only 10.25%. This demonstrates how currency markets would react to a specific problem from emerging Europe. To sum up, despite the recent concerns on weakening growth prospects in the broader Europe region, up until now the markets do not see them as issues specifically related to East Europe.
By looking at the leading indicators, Figure 2 depicts the composite ESI of the four economies being discussed in this article, Poland, Czech, Hungary and Greece, as well as the broader Eurozone and European Union measures. Among them, the Hellenic Republic is clearly the outlier, which started to trend downwards in Nov. 2009. This was only days ahead of the sovereign credit downgrade cycle, which kickstarted on Dec. 5 2009 and initialized the trickle down effect the global market has witnessed in recent months.

Aside from the developments in Greece that has yet to show signs of stabilization, we have observed that the ESI for Poland has been dropping for two months. At the same time the ESI for the broader Europe has also been declining. Poland has not been particularly weak, which means Poland will unlikely be a key concern even in a worst case scenario. It only requires keeping a closer eye for any alarming signs.

The ESI survey has 5 major sub indexes, which are the Industrial Confidence (IC), Construction Confidence (CO), Consumer Confidence (CC), Service Confidence (SC) and Retail Trade Confidence (RT). Each owns a varying number of components. We again show the 5 sub indexes in Figure 3 thru 7 pertaining to the four economies and broader Europe. In the sub indexes, Greece is again clearly the underperformer in all aspects, with only minimal rebounds in certain areas. By focusing on Poland, we can quickly conclude that it was the Retail Trade confidence that dragged down Poland’s overall ESI the most, followed by a slight downturn in the Consumer Confidence. Other sectors were rather stable considering the events that have been occurring in Europe in recent months.
Essentially, Greece is in a potentially unstable position. As for Poland, due to the article length restriction, we shall focus on the components of Poland’s RT. All 5 RT components have encountered setbacks in the past two months. Among them, assessment of the “present business situation” was probably the most alarming, as it fell back to early 2009 levels, when at the time the market was still worrying that the region would see high foreign debt. The good news is that the other four components of the RT owned more speculative assessment. The negative sentiment could be overcome quickly by a stock market rally, just like the way the positive market outlook rapidly deteriorated due to the notable declines in May and June.

In conclusion, although there are signs of stagnation in Poland, it is too early to determine if this may dampen Poland’s recent positive recovery. Meanwhile, developments in the Czech Republic and Hungary have been quite healthy, leaving little doubt that this will change anytime soon. As for Greece, a more positive development would need to be seen before starting to discuss if it has reached the bottom. (The author is the President, Polaris Research Institute)
Russia and Middle East

Risks of financial instability remain

Ming-Hsin Kung

It is primarily through the supply and price of energy resources that the economies of the Middle East and Russia have their influence on global economy. Besides, the domestic markets of these two areas, as a part of the emerging market, have a lot to do with the long-term economic revival of the other major industrial economies.

According to IMF, the economies of the Middle East and Russia will revive slowly alongside with the world economy in 2010. At present the price, supply and demand of oil and natural gas are stable, which helps secure the steadiness of the energy industries in those areas. The export of the Middle East energy sector is expected to resume a growth of 30%, approximately US$ 682 billion, and the trade surplus is expected to resume the amount of US$140 billion in 2010. These prospects, as a result, are likely to improve the foreign exchange reserves of the Middle East and Russia, and to keep the sovereign debts and credits stable.

Influenced by the energy deals and cooperation between Russia and Iran, the US sanction on Iran may lose its effect someday in the future, which means that the energy trade in the Middle East and Russia can be further stabilized.

Besides, with the expansion of government expenditure, the loosen monetary policy, and the United Arab Emirates’ injection in Dubai’s financial institutions, the non-energy sectors of the Middle East area was able to avoid serious impacts and had a growth of 3.6% in 2009 (IMF). In 2010, likewise, those sectors are expected to continue to grow 4.1% with the ongoing expenditure expansions in economies such as Saudi Arabia, etc.

Since the establishment of GAFTA(Greater Arab Free Trade Area) in 1998, many international investments from the U.S., Europe and Asia have been attracted to the newly opened non-energy sectors, especially service markets, in the Middle East economies. When it comes to the cultivation of internationalized human resources, however, it has long been so limited by the religious faith in this area and by its rivalry with the West that it cannot provide sufficient labor needed by the increasingly rapid development of service industries. Consequently, the non-energy industries in the Middle East economies are highly dependent on foreign resources with regard to capital and labor. Once some exchange rate fluctuation occurs to the U.S. dollars (the means of international investments and payment) or once some risks occur to the economies of the source economies of the external investments, then the Middle East economies, especially the Arab Emirates, would immediately face an impact on economy and employment, for the Middle East environment that is currently convenient for investment and exchange also makes it easy for the investors, primarily large institutions, to withdraw quickly. At present, such major investors as the U.S., Europe, Japan, etc. are still facing the threats of fragile financial system, sovereign debts and credits and still having their economies that have yet to be steadily recovered, and therefore the business future of the Middle East area’s non-energy sector still has to be cautiously dealt with.

In addition to the systematic risks of the dependence on foreign investments to developed industries, there are still some other dangers in the credit condition of the Middle East and Russia. First of all, influenced by the factors of the support of the oil price, the flooding in of foreign investments, the rise of asset price and the increase of savings, the financial institutions have prominently expanded their credit to private sectors. With the impact that the financial tsunami has caused to the price of oil and natural gas, as well as the influence of the withdrawal of foreign investments, the balance sheets of the banks in the Middle East and Russia have generally showed worse
performances during the tsunami, with the effect of a great credit crunch. In other words, there are still risks to some extent in the financial systems in these areas; the governments have to continue their assistance for the banks to write off non-performing loans, and have to demand a higher transparency in the banks’ loan policy. In the medium and long term, there has been the problem of insufficient financial instruments in the areas of the Middle East and Russia. In the future, these areas will have to continue to develop a sound capital market environment, so as to provide the non-energy sectors with the capitals they need, reducing their reliance on foreign investments. (The author is Vice President, Taiwan Institute of Economic Research)

Global Commodity Market

The possibility of commodity price rise increases

Hwa-Nyeon Kim

In the last one month period (mid-June to mid-July), there have been no obvious signs of a crisis in the global commodity market and prices have remained reasonably stable. However, the possibility of commodity prices going up within the next month is increasing amid weakening US dollar appreciation. In a commodity market, it is assumed that a crisis breaks out when commodity prices go up too sharply or they exhibit extreme fluctuations.

The two top commodity indices, the Reuters CRB Index and LME non-ferrous index, have shown very steady movements from mid-June to mid-July. The Reuters CRB index (year 1967=100) moved up from 465 points to 482 and the LME index (April 1999=1,000) increased from 2,917 to 3,145. Such changes are evidences that there were no sharp upward trends or steep slopes within the commodity indices during the last month. In terms of price variations, the daily price changes were lower than those in the first half of this year, meaning that there was a decline in risk of investing in raw materials.

As for energy prices, the WTI near month futures price moved within the range of 71.98 and 78.86 USD/barrel and the Dubai crude price moved between 69.29 and 77 USD/barrel during the same period. Among non-ferrous metals, or more commonly known as base metals, lead and tin prices rose the most. Lead and tin prices rose 6.9% and 6.0% respectively on July 15, compared to the previous month. However, the hottest base metals in the first half of this year, nickel and copper, showed stable price patterns. The average price of copper and nickel for the last month were 6,560 and 19,410 USD/ton, respectively. The recent prices for these two base metals are much lower than the yearly highs of 7,950 and 27,600 USD/ton recorded in April. Other base metals including aluminum and zinc also revealed low variations within the last month.

Important variables we must keep a closer eye on for the next month (mid-July to mid-August) are the degree of US dollar depreciation and an increase in raw material demand due to China’s continuous growth. Traditionally, a weaker USD translates into stronger commodity prices. The recent rise in the EUR/USD to above the technical resisting line implies a more significant bout of USD weakness than the FX experts expected. Consequently, we will continue to see a weakening USD during the next one month period. In terms of demand, it is important to recognize that China was dominantly the largest contributor to the growth of global commodity demand in the first half of this year. In regards to China’s commodity growth, I expect China’s oil demand growth will remain in a strong upward trend in the latter half. However, there is rising suspicion that the growth rate of China’s raw material demand will fall slightly due to the economic slowdown after the
second quarter. China’s second quarter GDP growth was weaker than expected at 10.3%. And China’s industrial production growth in June fell to 13.7% year-on-year from 16.5% in May.

However, despite the recent stable commodity prices, the fact that they increased sharply compared to the previous year has made SMEs nervous. The Korea Federation of Small and Medium Businesses conducted a survey in July to find out what the biggest difficulties were for Korean SMEs. According to the survey, more than 67 percent of SMEs responded that they were not feeling the effects of the economic recovery, with the majority of these respondents saying that rising crude oil and base metal prices were blunting the positive momentum. 54.2 percent of respondents also believed that the rising cost of materials was the biggest setback.

To conclude, the already rising cost of raw materials will be a persisting threat in the latter half of this year. However, SMEs should not feel compelled to rush and purchase raw materials in advance to cope with the risk of increasingly high raw material prices. This is because, as we enter the last quarter of the year, the possibility of an economic slowdown is becoming a reality, which in turn, will increase the possibility that the prices of commodities that SMEs need will stabilize. (The author is Research Fellow at Samsung Economic Research Institute)

<Table> Changes in Raw Material Prices - June 15 to July 15, 2010.

<table>
<thead>
<tr>
<th>Index</th>
<th>Crude Oil (USD/barrel)</th>
<th>Non-ferrous Metals (USD/ton)</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Reuters CRB</td>
<td>LME</td>
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<tr>
<td>Min</td>
<td>465</td>
<td>2,917</td>
</tr>
<tr>
<td>Max</td>
<td>482</td>
<td>3,145</td>
</tr>
<tr>
<td>Average</td>
<td>473</td>
<td>3,028</td>
</tr>
</tbody>
</table>

Note: 1. The Reuters CRB index recorded 100 in 1967 and LME non-ferrous index recorded 1,000 in April 1999.
2. The WTI price is based on the near month futures price traded in NYMEX and non-ferrous metal prices are based on the spot prices traded in LME.
Introduction

The Eurozone within the European Union, covering 16 of 27 EU member states at present, was a project for monetary rather than fiscal union. The European Central Bank (ECB) was assigned the task of inflation control through interest rate and money supply management. It was not assigned responsibility for growth: this was left to individual member states to pursue through their own tax and spending policies. Debts and debt management was also left to individual EU member states, subject to a framework agreement called the Stability and Growth Pact (SGP) that required Eurozone members to limit annual deficits to 3% of GDP and accumulated deficits to about 40% of GDP.

Although this arrangement was recognised to be incomplete, and to carry some risks, it was felt that effective monetary management would impose ‘German discipline’ on other economies of the Eurozone. International bond markets also tended to view the Eurozone as an extension of Germany’s economy and didn’t adequately distinguish between the risks of individual member states.

Problems accumulate

While it was recognised that economies like Greece, Portugal and Spain had serious weaknesses in the management of their fiscal regimes, and struggled to follow the rules, it was felt that their share of the Eurozone economy was relatively small (about 12% in total), and the damage they could do to the overall system was limited. However, when Germany and France broke the rules for the Stability and Growth Pact and ran deficits greater than 3% of GDP, then budgetary discipline tended to break down across the whole Eurozone.

Italy was somewhat different, with a much larger share of the Eurozone economy (about 14%) and with serious long term structural problems relating partly to pension obligations towards state employees. The Italian government had however been moving steadily to improve its macro-economic situation, and hence enjoyed greater credibility in international markets, even though their long term debt obligations were huge.

At the same time, these economies found that they could borrow on international bond markets at relatively low rates of interest, and repay these loans from tax receipts arising out of much higher growth. Booming property markets and high growth in the years since the adoption of the Euro in all these economies contributed to this false sense of security.

The same was true in non-Eurozone economies (the UK, Denmark, Sweden and the economies of Central
and Eastern Europe) within the EU. Most economic growth in recent years was fuelled by a property market bubble, and governments enjoyed increased tax revenues and expanded spending programmes to beyond 3% of GDP.

With the onset of the financial and banking crisis, and the crash in property prices and the steep fall in growth, particularly in 2009, the insufficient capacity of these economies to service their government debts was exposed.

The European Central Bank however had no power to intervene (this was beyond their mandate) and national governments were left to find their own solutions to their problems of sovereign debt, which exposed them to the fury of the markets.

Every economy in the Eurozone was subject to close (and brutal) scrutiny by the markets, and analysts finally recognised that many European economies (both Eurozone and non-Eurozone) were similarly vulnerable. The UK, the Netherlands, France, Austria, Hungary and the Baltic states were at various levels of risk of default. The amounts involved were in excess of €3 trillion.

Options

The normal way in which a economies repays its debts in this situation is to restore growth through devaluation, making imports more expensive and exports more competitive. Higher inflation usually results, partly because of higher import prices and partly because of the removal of subsidies, which is then squeezed out of the system through higher interest rates.

To meet their immediate debt and other obligations, these economies would also have to borrow from the International Monetary Fund (the IMF) and accept conditionalities for structural reform in return, which would normally include currency devaluation and fiscal balancing measures.

But at least one of these policy options was not possible in the European context - though for the UK it still is - because of the ECBs mandate to keep inflation low and their commitment to currency stability. The ECBs focus on inflation targeting, in the context of the economic crisis that preceded the sovereign debt crisis, was met through lowering interest rates to counter deflationary pressures and to encourage liquidity in the banking system, which was of course in crisis. A loss of growth – and hence one of the major means to repay the debts – was the price the ECB was prepared to pay to preserve currency stability.

For the accession states of Eastern and Central Europe, including Hungary, Poland and the Baltic states, although not yet formally part of the Euro, they are already locked into the Euro system and cannot pursue independent monetary policies, and can thus be treated as Eurozone economies for most purposes.

Another option would have been to let these economies default on their debts (like Argentina in 2002), but this was thought to carry with it potentially catastrophic consequences for the European Union, the Eurozone and the global banking system. There were anxious days in May 2010 when the break-up of the European Union itself was predicted. EU leaders were extremely reluctant to allow Greece to default, and at the same time were alarmed at the contagion effect of a sovereign default in one member state, however small (Greece’s share of EU GDP is 2.6% only), spreading to the entire EU.

The leaders of France and Germany were also faced with another reality. Almost half the estimated stock of Greek and Spanish debt (thought to amount to about €800 billion) was thought to be held by French and German banks. Failure to repay could and would lead to another banking crisis, which both leaders recognised was a major threat to the global economy.

Austrian and Swiss banks were similarly vulnerable to debt defaults in Eastern and Central Europe, especially Hungary (for Swiss banks), while British banks were thought to be exposed to a wider spread of risks across the region as a whole.

Panic sets in

It became clear to the markets quite early on that a European solution was needed, but the European system had no institutional arrangement in place to deliver a solution. EU member states had first to agree on a broad approach and then create an institutional arrangement to back it up, without compromising the mandate of the European Central Bank (ECB).

Time was however against them. Markets were panicking and there was a clear flight of capital to the dollar, gold and other commodities as safe havens, while the value of the Euro and Sterling dropped alarmingly.
Bond rates for European economies increased dramatically and interbank lending virtually stopped – or became very expensive – because of uncertainty about how badly individual banks were exposed to the sovereign debt crisis.

This series of market-induced reactions only intensified the sense of crisis; some analysts suggested that the Greek crisis could have been solved with an early pledge by EU member states of €40-45bn, but the delay finally cost the EU closer to €1 trillion. EU leaders in turn blamed credit rating agency and speculative forces for their plight.

Throughout this crisis, it became increasingly apparent that there was a fundamental problem with the quality of government and banking data relating to the extent of the problem. No one had confidence in official Greek statistics on their fiscal position, and the banking system was similarly faulted for failing to maintain minimum levels of transparency. Similar concerns were echoed for Spain, Portugal, Italy, the UK, Hungary and others. It was a very European problem that had been neglected for years.

Agreements and important policy measures

Finally, through May and early June, things started coming together. A €110 bn rescue package for Greece was agreed on May 10th, with some immediate short term loans to prevent an imminent default, with each Eurozone member pledging a proportionate amount. But more important were commitments in the following areas:

- A €440 bn fund to deal with other potential sovereign defaults to be administered through a European Financial Stability Facility (EFSF) - a new and independent institution to be set up in Luxembourg. Loans to members would be provided at 5% initially.
- Agreement with the IMF to provide further funding for Greece and for the EFSF to bring the total stock of available resources for lending to €750 bn.
- A ‘stress test’ for European banks responsible for 60-65% of banking activity to be completed by July 23rd.
- Coordinated action to restore fiscal discipline in the EU through budget cuts and tax increases, where necessary.
- A commitment to a form of ‘economic governance’ which would coordinate and supervise economic and fiscal policy making throughout the Eurozone (including accession states).
- Ongoing commitments to improve bankingsupervision and regulation and to improve transparency.

Impact

Although EU member states were slow to respond and coordinate their policy responses, these policy measures have had a calming effect on the markets.

Recent bond sales by Greece, Italy, Spain and Portugal were oversubscribed quite substantially and money from the IMF and the EFSF has not been needed, other than for Greece’s immediate and initial requirements. Interest rates charged on these bonds are less than 5%, suggesting that the markets have reduced their risk assessments and are now comfortable with refinancing and rolling over the debt of even the most heavily indebted states, like Greece and the UK.

Stock markets around the world have bounced back significantly, and the value of the Euro has strengthened substantially in recent days.

Slovakia, which had yet to agree to the new funding facility, also finally conveyed their consent a few days ago, clearing the way for the new system to operate.

The worst of the crisis would thus seem to be over…

Unfinished business

But serious problems remain.

In the first place, Europe has opted overwhelmingly for fiscal tightening rather than growth as the means to deal with its debt problem. Questions remain of whether this will work. Many economists (led by Paul Krugman) question this approach and suggest that it will fail, meaning that the sovereign debt crisis will return at some stage. Some streams of economic opinion now think that Greece will default on its debt repayment obligations in the next year or two (because of low growth). How markets will react to the prospects of a Greek default remains to be seen.

Secondly, the role of the European Central Bank and the relationship between the European Union and member states probably needs to be substantially
redefined to explain exactly what is meant by ‘economic governance’. This will require major amendment to the Treaties, which will be politically complicated with the UK (and some others) opposed to any new powers for the European Union. At the very least it will take time and create further uncertainty, which markets dislike.

And finally, the banking system is being identified as the next major problem in the European Union. The stress tests scheduled to be announced on July 23rd are likely to raise more questions than answers, which may increase the sense of uncertainty in the markets. The methodology being followed is already being challenged and the results are not likely to satisfy the markets (as US stress tests did) but to lead to further speculation. If the findings of the stress test results on July 23rd shock the markets, then there will be another crisis in the coming months. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science)

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The Latest Development of Financial Policies in China
Honghui Cao

Lots of vital decisions in financial system have been made in China in June, 2010. Concerns from abroad differ a lot from those at home.

1. RMB exchange rate regime reform restarts from the arrangement in 2005

Obviously, RMB exchange rate regime is one of the most striking issues from abroad to observe China’s financial system in the first half for it has been the hot topic since the debate between China and other developed economies. Especially when RMB pegs US dollar again in 2008, US strongly expresses its expectation to make RMB appreciated. Finally, PBOC, the central bank decides on June 20 to further reform the RMB exchange rate regime by inducing the basket of currencies in which the economies play as the main counterparts of China in external trade.

As it follows upon the reform in 2005, it does not involve a one-off exchange rate revaluation this time. The RMB exchange rate floating bands also remains the same as previously announced in the inter-bank foreign exchange market, aiming to stabilize the RMB exchange rate basically around an adaptive and equilibrium level, and in the meantime, and achieve economic and financial stability.

With the recovery and the improvement of China’s balance sheet, this decision ends the peg to US dollar in the past two years during which RMB pegs dollar to maintain the stability against the financial crisis. The reform actually goes back to the institution launched in 2005 in a proactive, gradual and controllable process and as part of China’s independent policy initiatives.

The reform has encouraged the corporate sector to adopt new technology, promote innovation, and enhance competitiveness, helping the export sector improve competitiveness. The more floating exchange rate regime has driven the industrial reallocation and economic growth more comprehensive, balanced and sustainable. Thus, the export sector now has to learn to adapt to the exchange rate fluctuation and to manage the risks.
RMB exchange rate floating range is narrowed but remains basically stable in the worst of the crisis, which not only helps China to uphold external demand and mitigate the shocks of the financial crisis, but also contributes to the Asian and global economic recovery.

2. Loosening the credit or tightening the credit in the market?

CBRC (China Banking Regulatory Commission), the banking sector regulator urges the commercial banks and other financial institutions who operate deposits business to tighten their loans to the creditors in real estate market, even to cease the loans to the GFICs (Government financial investment companies) and cease the cooperative transaction between commercial banks and trust companies. The reason that CBRC takes the action early in the second quarter is because various overheating phenomenon impress the market players and the policy makers which resulted from excess liquidity.

The new balance of loans in the first half amount to 4.63 trillions RMB Yuan, which is also a tremendous supply for the market but a little higher than 4.5 trillions RMB Yuan, the target of CBRC. Thus, the growth of loans still hits 18.5%.

Affected greatly by the rapid growth of loans, the housing prices in top 20 cities almost doubled the first quarter while the housing prices in top 70 cities grow at 11.4% compared with the same time of 2009. Mortgaged loans amount to 453.8 billion RMB Yuan.

Another side-effect of over supply of credit loans is that some commercial banks surpass 75%, the red line of deposit-loan ratio set up by CBRC. For instance, some listed banks like Mingsheng Bank amounts to 81.89%, Industrial Bank amounts to 78.98%, Shenzhen Development Bank amounts to 78.61%. Even ICBC, the leader of the Big Four also feel nervous about the liquidity when CBRC tightens the requirement. Various competitive methods to attract deposits are adopted in the second quarter until CBRC asks for a pause.

It is really uneasy to oversee the transaction of market players for the information asymmetry. The regulators get shocked when find the transaction in the name of purchasing some financial products between commercial banks and trust companies amounts to 1.88 trillions RMB Yuan by the end of April. While it adds another 614.9 billion RMB Yuan in May. This kind of transaction is actually a way for trust company to finance from commercial banks, which pushes the development of loans growing more abruptly. Most of the financial products are based on real estate development and give the housing projects financing support indirectly.

GFICs, a typical financing entity established by provincial government, municipal government or the county government play a vital role in the infrastructure construction of urbanization. The balanced amount of its loans reaches as high as 7.38 trillion RMB Yuan by the end of the first half and the total entities amount to 8221. More than 5000 entities emerge by the end of June. Various worries from hone and abroad about the rapid growth of the GFIC have pushed CBRC to stop any business development based on GFIC in early June. But most concerns wrongly understand the risks resulting from the GFIC. Actually most risks may just root from the GFIC established by the county governments because most provincial governments and municipal governments enjoy much better fiscal conditions and better returns from the projects. It might make the GFICs loans become real NPL if just simply cutting the payment of the entities for most of them are being built the projects. It is important to clarify different situations of local governments and set up qualifications for the banking institutions which provide the GFICs with loans so as to stop the agriculture commercial banks and credit unions operated and controlled by the local governments.

3. Comments on the latest financial policies

Debates on the policies to tighten the mortgaged loans and the loans for real estate developers, GFICs mainly result from different understandings about the inflation or the deflation pressure. Those who urge to loosen loans still heavily rely on the stimulus plan which provides them with excess liquidity resulting in lots of side-effects. But it is really the time to withdraw from the fiscal investment and irrational supply of loans. (The author is the Director, Financial Markets Division, Chinese Academy of Social Science)
At the APEC SME Crisis Management Training workshop, I explored with participants if fundamental practices which have been successful are still relevant when the economy is in crisis. During my lecture, I presented 3 case studies from SMEs in Singapore to elaborate this. Here is the summary of the cases:

1) Goodrich Global Pte Ltd

Goodrich is the leading supplier of interior wall coverings. During the crisis, their Revenue decreased by 30% while their Profit decreased more than 30% due to the fact that their fixed cost was very high.

Goodrich was able to ride through the crisis due to the following:

- Financial Strategy – maintained healthy cash flow and established lines of credit to remain financially strong as crisis is good opportunity for those who are financially strong.

- Government assistance – Took advantage of government scheme to take loan of $5M from bank at 5% interest (guaranteed by government) as a standby due to uncertainty of how long crisis will last.

- Cost Reduction – Cut cost to prolong survival via:
  - Reduced inventory items and negotiate for lower cost
  - Postpone launch of new products (especially high end products) to cut marketing costs
  - Reduce advertising and promotion costs
  - Reduce accounts receivables

- HR maintained high staff morale as good people will leave first if staff morale are low and announced “No retrenchment” so that staff morale remain strong. Assurance that management and staff will “suffer” together but will not cut staff. Instead of retrenchment company opted for pay cut across the board on a reducing scale with highest pay cut for management. Explanation of pay cut was communicated clearly to all staff.

- Founder’s passion and strong sense of mission help to give confidence to staff:
  - CEO was personally involved in crisis management and boosted staff confidence with assurance by giving management guarantee
  - Relevant experience in crisis management was helpful as track record of riding through crisis adds weight to the situation.
• Projects at costs – In order to get enough projects to keep employees occupied, they tendered for some projects at cost.

• Diversified to other markets to increase profit – Focus effort on more lucrative market like China, Dubai and India which are not affected much by this crisis.

• New opportunities in crisis:
  - Acquired 2 companies (which can help Goodrich to increase competitiveness eg dyeing colour of fabrics) at good prices
  - Got showroom (Plaza Singapura) at attractive costs
  - Reposition company’s Branding with Consultant at reduced cost

2) Home-Fix D.I.Y. Pte Ltd

Home-Fix offers wide range of do-it-yourself home improvement products. During the crisis, their sales revenue per transaction decreased even though transactions were not affected. This showed their customers were affected by crisis.

Credit Crunch in banking sector affected Homefix’s expansion plan when their banker freeze loan for their building. They were forced to move into temporary location which has no sufficient space for operations and proper storage.

Home-Fix adopted the following strategies to ride through the crisis:

• Financial strategy:
  - Built new relations with 3 other bankers and increased credit lines to enable strong financial backing
  - New Bankers relation enabled new business relations

• Experienced CEO and founder of company was highly committed.
  - CEO gave staff confidence and assurance that he will be working with them to lead them through the crisis
  - CEO increased number of meetings with sales and operations staff to keep close tab on situation and give staff confident

• Cut cost to prolong survival. Home-Fix thus:
  - Reduced inventory items by only stocking on saleable items
  - Reduced promotion costs by embarking on targeted Direct Mails instead of mass mailing, and did demo workshop at selected stores instead of doing at all stores

• HR maintained close communications with staff to boost staff morale:
  - Homefix announced “No pay cut” to give staff peace of mind
  - CEO spent time to educate staff to be mindful that their customers are in pain and they should offer better customer services to their customers

• Took advantage of government schemes:
  - Recruited 3 undergraduates via government schemes to help in operation
  - Leveraged on government’s scheme to train staff in preparation for future

• Inventory strategy:
  - Kept close stock watch and cut slow moving and expensive items and focused on selling items that customers need

• Diversified to other markets to increase profit – Home-Fix opened new stores in Malaysia and Indonesia

• Marketing strategy:
  - In order to focus on customers’ need, Home-Fix invested on new system to focus on CRM (Customer Relationship Management) with government funding to improve knowledge of different customer segments and profiles to help in acquiring new customers at reduced cost. This proves to be useful as it helped Homefix narrow inventory items based on customers’ needs. CRM also helped them discover new emerging market and they were able to increase revenue as a result
  - The better customer service and demo workshops at outlets also helped to boost sales

• New opportunities in crisis:
  - Home-Fix took advantage of lower rental rates and leased 4 new outlets in Singapore and another 4 outlets in Malaysia
  - Implemented the CRM system with grant from government
  - Invested in new building with attractive interest rates from bankers

3) Network Courier

Network Courier is a 20 years old organisation with 170 employees.

During the crisis, 7% of existing customers closed down, 4% ended up in bad debt. Network Courier’s Sales volume dropped by 20% and the incoming calls at their call centre also decreased by 50%.

Network Courier adopted various effective strategies to ride through the crisis:
• Financial strategy:
  - Network has been consistent in putting aside portion of profit as reserve through good times.
  - Operated on a lean business model and has built up a sizeable reserve through the 20 years which helped them during the crisis

• Experienced CEO and founder of company
  - CEO is passionately involved in the company and meets staff in their monthly gathering to instil confidence that the company will pull through with their support
  - Relevant experience in crisis management is very helpful as track record of riding through crisis adds weight to the situation

• HR maintained close communications with staff to boost staff morale:
  - Network courier organises monthly staff gathering to build close bond
  - Most of them are loyal staffs who worked for long time due to the trust they have in the company
  - During networking night, CEO explained effect of crisis and requested staff to help company by:
    a) Increase Productivity – bring in more customers
    b) Cut cost – which involves freeze increment, freeze hiring and reduction of expenses

• Took advantage of government schemes:
  - Job Credit Scheme where government pays 12% of employees’ salary helps company save 12% of HR cost
  - Network Courier leverages on Government’s scheme for matured workers and employed matured workers to do delivery to save operation costs while creating news in the industry (free publicity). Instead of using motorbike, these matured despatch workers took MRT to do delivery and they are known as “Train Riders” (vs the usual despatch riders). This scheme helped company cut HR costs further
  - Managed to get more grant from government to develop “Virtual Client” System

• Operation (used technology to gain first mover advantage) - Development of “Virtual Client” system encapsulated founders’ 20 years’ experience in courier service.
  - This system automates operation processes and allows customers to do self-service for their collection and delivery thereby enabling company to save lots of operation costs while increasing productivity. Customers are also happy as they are able to monitor the processes online. This system gave the company their competitive edge and helped company cut operation cost while increasing revenue.

• Sales strategy:
  - Current despatch riders sell company’s service during delivery of items - This despatch cum sales tactic brought in 200 new customers in the year at no additional costs
  - Investment in technology (Virtual Client) enabled sales volume to increase. Customers are happier as they pay lesser too.

• New opportunities in crisis:
  - In order to handle issue of excess staff in call centre, network diversified into new line of handling visa applications for Indian embassy in Singapore. They became the first courier company handling visa application for embassy. This is usually handled by tour companies

The above 3 cases proved that fundamental practices are still relevant during crisis. Moreover, the market will get much smaller during crisis and it is very important for SMEs to innovate fast to gain first mover advantage to ensure they get to their customers first.

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Crisis in Euro zone

Since the breakout of Greek sovereign debt crisis, other four members of European Union, Portugal, Ireland, Italy, Spain, linked by the defective structure of Euro monetary system consequently incurred debt crisis which caused severe depreciation in Euro and the swaying status of the international financial market. The United Kingdom and Hungary are considered to be the next victims. In general, the debt crisis exploded in the world’s largest economic zone in 2010 results in rapid depreciation of its currency, deteriorating consumption power, and the slump of the global stock markets.

As joining the single monetary system in Euro zone, Greece and the other four economies have been losing their control and independence in monetary policies. In the unified currency system, the Government of Greece not only could no longer improve its trade deficits by making currency cheaper; but also need to suffer the appreciation of Euro as a result of European Central Bank’s consideration of the whole stability of European area.

During the recovery from the financial crisis, the members of European Union tied to strict fiscal regulations could not raise the debt they need to stimulate economies and expand demand. They were required by the regulations to turn to tight fiscal policies to improve government deficits, such as cutting government expenditures, increasing the tax rate and lowering wage level. The tight fiscal policies further worsened the condition of the employment market and decreased the domestic demands. Besides, the expenditure of social welfare was also forced to increase under the condition of decreasing tax revenues. Low interest rate policy of Euro had led to over consumption in private sector and over expanding fiscal expenditures. All mentioned events make the deficit of Greek government unable to be neglected.

It is a global concern whether the debt crisis of European economies would help trigger the second financial crisis. To solve the debt problem of relevant European economies, International Monetary Fund (IMF) and the European Union had reached a bailout agreement to help them walk out of the crisis. Meanwhile, the sovereign bond of Greece has been in circulation again, and the bonds issued by Portugal and Spain are receiving positive responses. The latest “World Economic Outlook” released by IMF upgrades the global economic growth rate, which shows that the influence of the debt crisis on the global economies is relieving.

However, temporary relief of the debt crisis in European economies is unable to resolve the long term problems imposed by unified monetary structure; there remain possibilities of the revisit of such crisis. Nevertheless, important lessons were learnt and experience was accumulated from the crisis to make sufficient preparation to prevent such crisis from happening again in the future.

Wage raise in China factories

No wage raise or labor protest in any single economy attracts more attention than in the world factory, China. Since the Foxconn (China) made a movement in increasing a huge amount of labor wage, it incurred a sequential wave of wage raise in China, which leads China to transforming to a world market from the past world factory. While the consumption power improved by wage raise, the potential and opportunities of China market have already become unable to be ignored by foreign investors around the world.

On the other hand, these corporations in China realized that there is no way back to decrease the labor costs in this area. For original equipment manufacturers, it is definitely hard to absorb the increasing labor costs due to their industry nature – thin profit margin, and
the resulted domestic inflation also burden them with increasing production costs. Thus, many manufacturers start to contemplate the possibilities of moving their plants, and it makes a great opportunity for relatively low labor costs economies, such as Vietnam, Indonesia and India, to attract corporations to invest in.

In a viewpoint of global aspect, globally low and stable inflation maintained by China would no longer exist after those waves of wage raise in China. Moreover, the Government of China declared the Renminbi reform recently, meaning the advantage of cheap labor costs and low product prices of the world factory are vanishing. For those firms heavily dependent on low costs of labor and low prices of materials in China, they certainly would face the diminishing of their competitive advantage. As for consumers, the price inflation would be also expected come visit soon.

**The appreciation of Renminbi**

In recent years, though the Government of China repeatedly claims the appreciation of Renminbi, Renminbi remained significantly stable. Not before June 20 when the Central Bank of China announced that it would be promoting foreign exchange regime reform gradually and claimed the reform would meet the needs for economic fundamentals and macroeconomic status in China, did Renminbi have more significant appreciation. In July 2010, the exchange rate of Dollars to RMB hit a record high to the 1:6.772 since 2005. At the same time, the occurrence of the debt crisis in European economies once made RMB appreciate by 15 percent. Because of the foreign exchange regime reform reassured by the Central Bank of China, the direction of RMB is even getting more attention. Though UBS predicted that RMB would appreciate by 3 to 5 percent this year, it is more likely that the Central Bank of China would make RMB appreciate based on demands and supplies of the monetary market and managed floating exchange regime referring to a basket of currencies.

As the largest exporting economy in the world, the appreciation of RMB would affect the global economy. It causes the increase of China’s exporting prices that diminishes purchasing power of other economies, and restrains foreign demands that lowers production utilization of China, further worsening the exporting competitiveness of foreign firms in China. Relatively speaking, the appreciation of RMB would benefit importers and increase the purchasing power of Chinese on foreign goods. In the short run, the appreciation of RMB results in higher prices in exporting products and temporary inflation in the global market; however, in the long run, the global economy may benefit from the enhanced consumption power of China on importing goods.
1. Introduction

Global business environment increasingly fills with uncertainty and risk that have already been beyond SMEs’ control. In consideration of the rapid changes of the global business environment of recent few years, when inflation attacked in the first place, then suddenly changed to a financial crisis, and finally turned to recession, grasping the fluctuation of the global economic environment becomes a difficult job for SMEs, not to mention responding to the fast changes effectively.

The inherent disadvantages of SMEs make it difficult for them to manage the global challenges such as the financial crisis recently occurred. SMEs are unable to identify crises and risks in the first place; it is usually too late when they perceive and recognize a crisis. This is mostly attributable to SMEs’ lack of capacity to analyze economic effects that an economic incident can generate on the overall global economy, as well as its impact on their business.

To enhance APEC SME crisis management abilities, Chinese Taipei proposed an “APEC SME Crisis Management Center” plan that is designed to assist SMEs in overcoming the impacts of global economic challenges, and offer suggestions for response measures.

This proposal was submitted to APEC SME Ministerial Meeting and Annual Ministerial Meeting and obtained strong support. In the 2009 Annual Ministerial Joint Statement and SME Ministerial Statement, the Ministers have encouraged the establishment of the APEC SME Crisis Management Center proposed by Chinese Taipei, which will be established in 2010. “To improve SMEs’ crisis management capabilities” has also been identified by the 2009 Leader Declaration as an important task for APEC during the coming years.

2. The Missions of the Center

1) Monitoring and analyzing the possible impacts of emerging or existing economic crises and challenges on SMEs

The center organizes a team constituted by experts from APEC economies to monitor the possible impacts of economic crises and challenges on SMEs in a timely manner. The main functions of the team are to interpret and analyze how and when an international challenge or crisis might affect SMEs’ operation, and design the strategy for SMEs to cope with it.

The team will observe key components of the global economy and indicators about SMEs development. Based on these data, the team will issue electronically the “APEC SME Economic Crisis Monitor” in a form of newsletter for APEC SMEs each month, and it will also be issued any time when deemed necessary. Suggestions about how to deal with emerging crises, if any, will also be provided. Referring to the Monitor, SMEs can obtain timely information about the formation of crises; recognize a crisis when it emerges; and take necessary steps to prepare and cope with it.
2) Training APEC SMEs in managing global economic challenges and crises

This center will offer training courses to enhance the ability of SMEs on monitoring, grasping and quickly responding to global economic challenges and crises. The process of training can be divided into two stages. The first stage is to train the trainers by APEC distinguished experts, and then the trainees go back to their home economies to train SMEs. The content of training may include new globalization trend, the interconnections of global economy, the routes and methods a crisis spreads to the globe, nature and supply-demand conditions of global oil and other raw material markets, and the operation of global financial markets.

3) Holding seminars or symposiums to discuss global economic challenges and the ways responding to it

The purpose of seminars or workshops is to explore the strategies to respond to newly emerging global economic challenges. The attendants are mainly experts in this field. Through seminars and workshops, experts may obtain new knowledge and insight from the interactions with each others. Their professional interactions allow them to cook new ideas and strategies to cope with global challenges and crises. The seminars or workshops can develop the means to immediately detect early warning signs of a crisis and the strategies to effectively respond to different types of crises.

4) Providing consulting service to APEC SMEs about crisis preparedness and management

When there is a clear sign of a crisis emerging, the Center will provide consulting service to individual SMEs about crisis preparedness and management based on their individual conditions. The service can be provided through the Internet, telephone, or on-site, if necessary. If it required on-site consultation, the Center will first ask local experts that have received training in the center to visit the SMEs.

5) Studying global economic crises and strategies of managing new global challenges and risks

In order to thoroughly and systematically explore the origin and spread of a crisis and design responding strategies that may apply to different economies and situations, it is necessary to launch high quality studies. The role of studies may be at crisis preparedness by which they can provide SMEs with principles and checklist to deal with crises. Studies will examine different kinds of crisis including financial, currency, banking, natural resource, and commodity crises, as
well as the responding strategies. Among all measures mentioned, studies may not be the timeliest measures, but it is most considered.

6) Buildup of the center website as a platform for APEC economies

The official center website (www.apecscmc.org) release crisis alarms, news, meeting papers, and research results. The website provides a place for SMEs to subscribe to the Monitor and the Monitor also be posted upon the website. In addition to information sharing, this platform can also play functions on e-learning and dialogue.

3. Events of this year

A series of events hosted by the Center has taken place during the period of May 21-28, 2010. First of all, the Center’s expert team of crisis monitor gathered together to discuss the way of crisis monitor and the format of “APEC SME Economic Crisis Monitor” from May 21-22. “APEC SME Economic Crisis Monitor” issues monthly and contains crisis alerts and other recommended measures and strategies for SMEs to prepare and cope with crisis. The meeting obtained fruitful results; the outcomes of the meeting have turned into the document, “Guidelines for the Operation of the Expert Team.”

Ambassador Muhamad Noor, also gave an address in which he expressed his congratulations on the successful establishment of the APEC SME Crisis Management Center and thanked Chinese Taipei for its hard work in this regard. Ambassador Noor said that: “Given the importance of SMEs to the region’s growth and prosperity, and given the challenges SMEs face in the current economic environment, it is a very timely initiative.”

From May 24-28, a training workshop was held. The content of the workshop included three opening speeches and ten plenary sessions with total 17 speakers form APEC economies. The purpose of the workshop is to train the trainees from 11 APEC developing economies to familiarize with the international economic crisis and the strategies to manage the crises. It provided knowledge such as new globalization trend, the interconnections of global economy, the routes and methods a crisis spreads to the globe, nature and supply-demand conditions of global oil and other raw material markets, and the operation of global financial markets. Business leaders were invited to share their experience in coping with the crisis. The trainees are expected to train the SMEs of their home economies when finishing the training.
The publication introduced is the first chapter of Global Financial Stability Report published on April 2010 by International Monetary Fund. The chapter argues that although the global financial system is increasingly better, the fragility of the current recovery means that appreciable risks continue to increase unabatedly.

The six primary focal topics of concern in the report include global financial stability, sovereign risk, banking problems and challenges, credit recovery risk, capital flows and bubble risks in the post-crisis environment, and policy implications.

Regarding global financial stability, restored health of the worldwide financial system is increasingly being realized, but because the state of the current economic resuscitation remains limp, and fiscal balance remains an unreachable objective, there are naturally many incipient risks lurking about. As deleterious governmental coffers have yet to notice robust improvements, sovereign risks remain corrosive to systemic stability, and conceivably could result in a worsening of credit risks.

The formative factors behind sovereign risks are many, including those risks resulting from government interventions affecting or prohibiting debt repayments due to economic or political considerations; the risks of government adoption of unfriendly attitude in measures respecting foreign capital flows; government implementation of trade restrictions or unpredictable and precipitous policy changes due to unfavorable economic circumstances faced by economies. Sovereign risks remain on the rise as a result of the various measures necessarily applied in response to the financial crisis. The resultant burdens on public debt are increasing, and the financial market lending remains conservatively tight. Liquidity is also reduced with the exit of government intervention measures. All these concomitantly result in sovereign risk premium increases and government reliance on policies which tend to evoke more appreciable sovereign risk.

The banking system sustained tremendous losses during this financial crisis, and currently remains focused on resolving residual problems from the crisis, as well as facing the new challenges posed as a result of the deleveraging process. This chapter considers that, while overall bank capital status has improved, there are nevertheless some sectors of financial systems which remain adversely affected by serious capital impairment, exposing them to credible insolvency risks. For example in the United States, regional lenders that heavily rely on mortgage markets are still subject to severe capital shortages. In Central and Eastern Europe, while banking systems can reduce the already precipitous level of bad debts in the short term, they yet remain subject to limp economic growth, which is exposing stability restoration of these regional banking systems to inchoate risks.

Thus this chapter argues that the financial system stability for the future will rely on thoughtful resolution
of sovereign risk, and assurance of that deleveraging can continue smoothly to completion.

In terms of credit provision and lending, even as banks continue to improve their balance sheets, they are limiting the volume of credit supply, and credit recovery is thus proceeding at a slower pace. While the private sector’s demands for credit are not experiencing appreciable growth, government credit requirements continue to increase. Since governments tend to rely on bond issues to increase their borrowings, this will result in tightening of the consumer credit supply, which will mean that overall there will continue to be a shortfall in available credit.

To combat the financial tsunami, there was a globally unprecedented loosening of monetary policy. As the prices of oil and gold surged along with rising global commodities prices, the worldwide monetary policy loosening meant an overabundance of capital, resulting in speculative investing. Combined with factors such as the weak dollar trend, the abovementioned development threatens the stability of the global financial system. This was especially the case with the newly emerging economies, which had to deploy broad ranging policy measures to deal with these massive capital inflows.

APEC SMEs (small and medium enterprises) responding to these global economic trends must assess a variety of factors. In those economies where banking systems have sustained appreciable losses, attention must be paid to sovereign risk and banking system stabilization. Since credit remains tight in their financial systems, SMEs in such economies must pay special heed to their liquidity problems, ensuring close observation for possible business impacts from probable government fiscal balancing measures (such as budget cuts and other tight fiscal policies deriving from debt repayment). Concerning SMEs in emerging economies, with large capital inflows, they must guard against the risk of the formation of another asset bubble. Across all economies, SMEs will need to pay attention to the risks inherent in other economies and the possible crisis impacts to their operations.

In regard to sovereign risk, such risks are obviously very difficult for SMEs to respond to. Especially given the complexity of the immediate post-crisis global economic system, with rapid policy turbidity, makes it all the more difficult to gain a grip on higher sovereign risk. Staving off these risks necessitates reliance on international cooperation. There must be a functioning intergovernmental policy coordination mechanism, such that the framework ensures effective minimization of deleterious impacts from one’s own policies to others.

While SMEs find it quite difficult to adopt proactive countermeasures to deal with these risks and threats, they cannot afford to avoid deploying some defensive measures. For SMEs largely reliant on export, they should try to alleviate overdependence on economies still suffering from financial system instability, and assure early hedges against currency fluctuations of emerging markets. For all of the APEC SMEs, given continuing high risk in the global economic environment, they should maintain minimal financial leverage and a healthy stable financial status. Because of the naturally limited resources that SMEs can use to deploy in the face of a financial crisis, a conservative and prudent stance is still the best policy to SMEs.
This section selected the statistics of four economies to demonstrate their economic and crisis positions. China and the United States were chosen due to their economic significance and the profound impact they may generate once a crisis lurks in their economies. The United Kingdom is the symbolic economy of European recovery, and Greece is the economy on the center of international concern.

**China**

**GDP Growth Rate**

*Source: National Bureau of Statistics of China*

**Deficit Spending**

*Source: National Bureau of Statistics of China*

**Registered Unemployment Rate in Urban Areas**

*Source: National Bureau of Statistics of China*

**Currency Exchange**

*Source: National Bureau of Statistics of China*
United States

**GDP Growth Rate**

Source: U.S. Bureau of Economic Analysis

**US Federal Debt as Percentages of GDP**

Source: Budget of the U.S. Government: Historical Tables Fiscal Year 2011

**Unemployment Rate**

Source: U.S. Bureau of Labor Statistics

**Exchange Rate**

Source: Board of Governors of the Federal Reserve System

United Kingdom

**GDP Growth Rate**

Source: Office for National Statistics

**Unemployment Rate**

Source: Office for National Statistics
Greece

Source: National Statistical Office Of Greece

Source: Ministry of Finance

Source: Europe Central Bank

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