APEC SME Economic Crisis Monitor

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No. 2 September 2010
The Importance of SME Crisis Management to APEC

In the lately announced theme of the APEC SME Ministerial Meeting this year, the first of the three main sub-themes is “The Impact of the Economic Crisis on SMEs, and Countermeasures Implemented in Response.” This is the successive second year that issues related to the economic crisis are chosen as the discussion subjects for the APEC SME Ministerial Meeting, showing the importance of crisis management for the APEC SMEs. The establishment of the APEC SME Crisis Management Center (SCMC) and the issuing of the APEC SME Economic Crisis Monitor, then, are aimed to fulfill the needs of the APEC SMEs with regard to crisis management. As to the APEC SME Ministerial Meeting, which will be held in Gifu, Japan, in October, the Center will also provide relevant information, so as to make the discussions more constructive.

One of the main reasons why APEC keeps paying attention to economic crises is that the global economy has been shrouded by the shadow of a “double-dip recession,” or a “second crisis” since the financial crisis in 2008. This also shows the need for the Center to keep monitoring the crisis. With the issuing of this newsletter, the SMEs can obtain first-hand information about a crisis, knowing the crisis developments well in time, and making an early preparation and response by following the newsletter’s suggestions.

The September issue of this newsletter is focused on three major events with potential risks that happened in the last month: the rise of international food price, the slow recovery of the US economy, and the appreciation of the Japanese yen, among which the most emergent is the first one. We probe into the question of whether the food price rise is going to erupt as a crisis in the part of Crisis Alert of this issue. SMEs should take a load of their minds after reading that article. Secondly, the nine experts who monitor crises all over the world report the results of their monitoring. In their reports this month, it is found that there are several areas or economies facing the pressure of inflation or of deflation, which developments afterwards are worth observing.

Moreover, our experts also analyze for the readers the prospects of the global economy as well as explore the importance of newly established SMEs during the crisis. According to the analysis of our experts, though the global economy is full of uncertainties now, it is not quite possible for a second recession to take place.

To introduce a best practice to the readers, we invite a biotech company that has an experience of dealing with a crisis successfully to tell us about their principles in crisis management as well as about how to seize the business opportunities in the post-crisis era. Besides, we also present the latest great book by Joseph E. Stiglitz, the Nobel economic prize winner: "Freefall: America, Free Markets, and the Sinking of the World Economy". The book questions the free-market theory, considering the global financial crisis of 2008 as the consequence of free market principle.

With the presentations above, the readers can see that there are rich contents in this issue of the newsletter, which is featured by offering the readers some preliminary answers to the uncertain situation of the world economy. It is certainly our hope that our efforts will be helpful to the crisis management of the SMEs.

Robert Sun-Quae Lai, Ph.D.
Executive Director
APEC SME Crisis Management Center
There are various risk factors that are currently threatening the global economy, but the one that is most likely to spark off a real crisis is the recent rise in food prices. A number of world’s main food producing areas have experienced a series of natural disasters. This, coupled with price manipulation by speculators, has caused the price of wheat to rise by 50% since July, while the price of corn has risen by 25% and the price of soybeans has increased by 12%. One is immediately reminded of the global food crisis of 2007 – 2008, in which a combination of rising food prices and high oil prices led to inflation on a worldwide scale.

Will the recent dramatic rise in food prices trigger another food crisis? It should be noted that the causes of this year’s rise in food prices are different from those that brought about the last crisis. Last time, rising oil prices led to an increase in the cost of food production and transportation; the situation was exacerbated by the use of food crops as sources of biomass fuel in many economies, which contributed to food shortages. This time, however, the reasons for the rise in food prices are relatively straightforward; it is simply that abnormal climate has led to poor harvests in some world’s main food producing economies. Consequently, the extent of the price increases this time is much smaller than in 2007 – 2008. For example, whereas at one point in 2008 the price of wheat reached a historic high of US$13.3 a bushel, this time it has yet to rise beyond US$8.4 per bushel.

Given the relative simplicity of the reasons for this year’s rise in food prices, we need only examine the state of supply and demand in the global food market to gauge whether this rise in prices is likely to develop into a fully-fledged food crisis. Drought and massive fires have caused Russia to prohibit the export of wheat; this has been the single biggest factor affecting the global wheat market. However, Russia’s wheat production accounts for only 8% of the global total, and the fall in output this year represents only 1.6% of total global output. It will be relatively easy for other wheat-producing economies (such as the U.S. and Australia) to make up the difference. The U.S. Department of Agriculture has already announced that the U.S. recorded a good wheat harvest this year, sufficient to make up for the shortage of supply caused by the poor harvest in Russia. In point of fact, despite the impact of reduced output in Russia, both global grain production and global grain stocks of this year have reached their historical high levels. This suggests that the current rise in food prices is largely a short-term reaction to the events in Russia. As long as no more major natural disasters occur, food prices can be expected to return to reasonable levels once supply and demand has swung back into equilibrium.

There is no particular reason to believe that
any more serious natural disasters will break out in the near future, and therefore, we do not expect that the current situation will deteriorate into a food crisis. However, that is not to say that no factors could, in theory, spark off another food crisis. The most worrying of these are consumer sentiment and the effects of speculation in the futures market. The sudden rise in food prices has already caused panic among consumers. Food is a basic necessity; a dramatic rise in the price of food, or a food shortage, can cause a level of panic among consumers that is far more serious than it would be in the case of other goods. If this fear is translated into concrete action – in the form of hoarding and panic buying – then food prices that would not otherwise have risen may rise simply because consumers expect them to.

If consumers concern about the possibility of a food crisis, they would reduce spending on other types of goods in order to have more budget spending on food. Consumers may also start to save more and spend less, so as to have more money put by for an uncertain future. Given the current unease about the economic outlook for the European Union, the U.S. and China, a fall in consumer spending would magnify the danger that a double-dip recession may develop. To prevent this from happening, governments and international organizations must fulfill their responsibility to ensure that consumers have access to accurate, transparent information, thereby preventing herd behavior caused by information asymmetry, and making sure that consumers have the knowledge needed to prevent unnecessary panic.

**Given that there is currently no real meaningful shortage of supply in the food market,** it is suggested that small and medium enterprises (SMEs) in the food and beverage related industries should refrain from hoarding and building up high levels of inventory, because doing so will only exacerbate the prices rises. However, we would also recommend that, once prices have fallen back to a lower level, SMEs should try to build up a reasonable level of inventory regularly because, given the trend towards abnormal climatic conditions, events such as the poor harvest in Russia can be expected to occur quite frequently in the future. We would also suggest that SMEs in the food-related industries should try to increase the value-added of their products, thereby reducing the share of total production costs held by grain materials. Increasing the knowledge and innovation inputs of their products will help to make them less vulnerable to fluctuations in the price of grain in the future.
Some Risk of a Double-dip Recession in the U.S.

Robert Dekle

United States

There is some (slight) risk of a “double-dip” recession in the U.S. Private consumption growth is now too weak to underpin a strong recovery. The U.S. banking system has been sustained by massive government bailouts and very low policy interest rates, but progress in resolving the nonperforming loan problem has been slow, owing to the weak real economy.

U.S. Gross Domestic Product (GDP) growth slowed to an annualized 2.4 percent in the April to June quarter, from 3.7 percent in the January to March quarter. Revised GDP data to be released later is likely to show even lower growth in the second quarter, probably below 1.5 percent. While business investment rose by 17 percent, consumer spending rose by only 1.6 percent. Since consumption accounts for about 70 percent of U.S. GDP, this low growth in consumption has slowed overall GDP growth.

U.S. consumption growth is low, mainly because of the weak job market. The unemployment rate remained at 9.5 percent in July, which is a decline from the peak unemployment rate of 10.1 percent reached in October 2009. However, if we add to the total number of those unemployed, discouraged workers and those employed only part time when they would rather work full-time, and divide this total by the labor force plus discouraged workers, we get the ratio, 16.5 percent. This ratio represents the weak labor market better than the usual unemployment rate, and this ratio has hardly declined from its peak in late 2009. Obviously, with the job market so weak, uncertainty about job loss is high, and wages have grown more slowly, suppressing the growth in consumption.

This low-consumption growth has contributed to the growing pessimism of small-business owners. The index of small business optimism (collected by the National Federation of Independent Businesses) fell to 88.1% in July, from 89% in June, the second decline after slight improvement earlier in the year.

The continuing weak real economy has meant that nonperforming loans in the U.S. banking system have remained high. The ratio of 90 day past due loans to total loans was 5.64 percent in June 2010. Normally, this ratio is about 1 percent; even in past recessions, it never topped 4.1 percent. Clearly, U.S. banks are overall still weak, and this weakness has contributed to the tight financing for U.S. small businesses.

The interest spread between the 30-year mortgage rate and the Federal Funds rate roughly represents the revenues the banks earn from their loan activity. In July 2010, this spread was 4.5 percent, which is far higher than the 1-2 percent
spread that banks normally earn. This high spread has allowed U.S. banks to earn high profits, and provided that the economy does not enter into another recession, should help banks write-off their problem loans and return them to health in the near future.

**Canada**

Canadian GDP growth slowed to an annualized 3 percent in the April to June quarter, from 6.1 percent between January and March. Compared to the U.S., Canada’s consumption has been robust, while business investment has lagged.

The Canadian unemployment rate was 8.0 percent in July, falling from a mid-2009 peak of 8.5 percent. Over the longer term, the unemployment rate has averaged about 6.2 percent, so the Canadian job market is still weak, but not as weak as that in the U.S.

Reflecting the improving economy and jobs picture, the Canadian Central Bank raised its policy rate to 0.75 percent in late July, the second time the Bank has raised rates since the end of current crisis.

Canadian banks are already quite healthy, since they emerged from the financial crisis relatively unscathed. During the financial crisis, Canadian banks did not suffer from the inability to raise funds, since the funding base of Canadian banks depended much more on stable deposits than on the wholesale market. U.S. banks—highly reliant on the wholesale market—found that their ability to borrow was severely curtailed during the financial crisis. (The author is Professor at University of Southern California.)

## Northeast Asia

### Challenges from Currency and Consumer Price Fluctuations

**Chao-Jung Chuang**

Among the economies of this region, South Korea and Chinese Taipei enjoyed relatively stable consumer price fluctuations. Deflation in Japan is more serious since Japanese yen is experiencing significant appreciation. Meanwhile, in addition to skyrocketing wage, China has undergone nature disasters, which causes the price of food to rise and the worry about inflation to emerge.

The sharp appreciation of yen is in part because investors questioned about the value of euro and the recovery of U.S. economy, and yen is relatively a safer choice for hedging. Moreover, long term deflation in Japan makes the return of investment in yen considerably competitive. Local banks in Japan allocated their excess funds into Japanese government bond one after another for it is hard for them to find additional outlets for their money. Life insurance companies also purchased long-maturity bond on a mega scale. China has purchased Japanese government bond to a grand total of 1.27 trillion yen in the first 5 months of 2010, surpassing that in previous years. This is also one of the factors that pushed yen upward. Until this August, the exchange rate of yen against US Dollar has climbed to 85, a rate close to previous high.

The policy tools that Japanese government and the central bank can employ to fight with the appreciation are limited. If yen goes up continuously or keep at its current high exchange rate, the export revenue of Japanese corporations will drop, and employment and consumption will be affected thereafter. These developments would worsen the economy of Japan, which has been deeply troubled by deflation. However, though Governor of Bank of Japan Masaaki...
Shirakawa admitted that the appreciation harmed export in the short term, and the fall of the stock market has negative effect on capital expenditure and consumer spending, he forecasted that the outlook of Japanese recovery will be bright. After all, the Japanese economy is not strong enough to sustain the hard Japanese yen. Once one of U.S. or E.U. economy revives, Japanese yen will depreciate substantially.

Compared with the deflation problem in Japanese economy, the inflation rate of China rose from 2.9% in June to 3.3% in July, a rate goes beyond China government’s inflation target of 3% for this year. Many indicators show that the Chinese economy has slowed down. Industry output, fixed asset and retail sales all slid in July, and the increase of bank loans and money supply eased off. However, consumer prices went up further.

The consumer price goes up partly because climate, from south to north, is highly changeable and floods are much more common. Affected by the climate disasters, the prices of vegetable, grain, and eggs soared up and the price of food rose by 6.8%. It is probably a short term phenomenon which was caused by recent floods, but the risk of inflation still face China in the following months.

The rise of the price of food in the international market due to output reduction in grain, together with the increases of the cost of labor and raw materials, led consumer price in China upward to a certain level. Since May of this year, the number of labor dispute increases significantly because of labors’ request on wage raise. The tension between labor and employers caused lockout in large-scale factories located in China. Since the beginning of this year, the wage costs in Pearl River Delta and Yangtze River Delta, two of China’s manufacturing centers, have increased by 20-25%, and the average growth of minimum wage standard have reached 12%. The stress of increasing wage costs not only goes to manufacturing industry. Managers of service industry estimated that the wage costs of service industry will jump substantially in the second half of this year. (The author is the Director of China Economy and Industry Study Center, Taiwan Institute of Economic Research.)

No signs in the economic development across most of the economies in South East Asia except the Philippines shows a worrying concern, though some economies, affected by the withdrawal from the stimulus policies and the external shock from the Euro Union, slew down its pace of growth. By contrast, this area still remained its track to growth as the most active roles. The problem of the Philippines might also be resulted from its more and more severe fiscal deficits as most other PIIGS (Portugal, Ireland, Italy, Greece, and Spain) economies in Euro Union suffered from the sovereign debt crisis.

The Philippines

As usual, the Philippines’ fiscal deficit amounted to 2.5 billion US dollars in the first five months, which was about six times of 400 million US dollars the same time last year. External debt...
to Gross Domestic Product (GDP) of the second quarter this year to the fourth quarter last year rose to 33.2% and the overall outstanding of external debt amounted to 55.4 billion of US dollar by the end of March. More and more concerns focused on bottom line of the weak fiscal system to support the severe fiscal deficit.

Another serious problem of this economy is the threat from the lack of food. Rice import amounted from 0.72 million tons in 1997 to 2 million tons in 2009. It was expected to go up to 3 million tons within three years. In the first quarter, the rice production was only 3.49 million tons, decreasing 11.4%; the corn production was 2.41 million tons, decreasing 16.7%.

Obviously, the food shortage resulted from both the centralization of land and high birth rate, which amounted to 2.36%. At least, more than ten million people were unemployed.

**Viet Nam**

Viet Nam was confronted with the pressure of inflation as its growth in the first six months reached 6.16%, which led to the rise of Consumer Price Index (CPI) to 4.84% against 8.19%, the inflation at the same time last year. Average CPI for the first seven months of 2010 increased by 8.67% against the same period last year. The inflation made the poverty more severe so that more than 120 thousand people suffered from food shortage, though Viet Nam gained more from the rice export than ever.

**Singapore**

Export growth in Singapore eased sharply in July from the year before, reflecting the weaker demand as the Euro Union struggled to recover from the recession. Despite of the slowing export growth, Singapore is expected to remain its GDP growth at 15% in the whole year, which the peak might be in June.

Non-oil domestic exports grew 18.2% in July, sharply slower than the 28.5% year-on-year expansion last month. Shipments to the European Union grew at 26%, steeply lower than the 75% in June, while shipments to the U.S. grew at 30%.

**Malaysia**

GDP maintained its high growth in Malaysia at 8.9% in the second quarter. Thus, the CPI reflecting the inflation grew at 1.9% in July year on year, and at 0.3% compared to the data in June, influenced by the growth of food and transportation prices. While the unemployment rate raised from 3.2% in April to 3.3% in May. Another 25 basis points had been raised in early July for the third time this year.

**Indonesia**

As the biggest economy in South East Asia, Indonesia benefited in the past four years from the rapidly growing domestic consumption as it enjoyed the growth from the large population. The annual growth of 2010 was predicted to 5.9%, though more than 15% of population still suffering from the poverty and contributing little to the growth of consumption.

**Thailand**

It was encouraging among the consumers, the investors and the overseas tourists that economic growth was little derailed by the political protest in Thailand. That’s why the central bank raised its benchmark interest rate, the one-day bond repurchase rate by a quarter of a percentage point to 1.5 percent for the first time within almost two years after the political unrest ended last quarter. It was broadly believed that the recovery would accelerate to 7.6% this year.

Thai consumer confidence rose to 79.3 in July, though they still have concerns about the uncertainty of political development and recovery of the European Union. Another 189 new factories were approved to establish in July and total 1960 new factories were approved with a growth rate of 68% within the first seven months, providing 42 thousand job opportunities. That investment in property market is buoyant might persuade the property owners to sell. Automotive sales in Thailand continued to grow in July with the domestic sale of 65,672 units or 52.2% increasing from the same period last year. Export in the first half increased by 36.6% and accelerated to 46.3% in June. Many products, such as electronic, car and automotive parts, and electric appliance and rubbers, showed the significant growth as well. (The author is Director, Financial Markets Division, at Chinese Academy of Social Science.)
Inflation Expectations and Weak Domestic Demand Challenges for SMEs

Kenneth Waller

Australia: the Election and Constraints on Bank Lending of Concern to SMEs

Australia’s economic environment continues to perform well, notwithstanding current global uncertainties. The June quarter consumer price index showed inflation over the year at 3.1%, close to target inflation. As a consequence and also recognising global uncertainties, the Reserve Bank left the official cash rate unchanged at 4.5%. However, inflation remains a concern and official rate rises are anticipated in the months ahead. An important manufacturing index for July of 54.4 reflected some expansion in the sector. However, there was some decline in the performance of a service index, indicating some retraction in that sector. Export income is at unprecedented levels, due to higher prices for coal, iron ore, gas, copper and other commodity exports, resulting in the highest ever surplus trade balance of $3.5 billion in June. This was almost double the May surplus. Employment growth is also positive but related mainly to increases in part-time employment. Australian job advertisements recorded at an 18-month high in July and the unemployment rate was steady at just over 5%.

There are several reasons for concern over the outlook for SMEs. Firstly, the National Australian Bank June Business Survey showed a slowdown in retail sales and a fall in business confidence. The fact that retail sales have been struggling all year despite strong consumer confidence, which in August was at its highest level since January, might reflect a paradigm shift in consumer behavior toward savings at the expense of consumption. In adjusting to the effects of the global financial crisis, the banking sector continues its cautious lending policies.

Of particular interest for SMEs will be the outcome of the federal election on August 21st. At the time of preparing this note, the polls suggest a return of the government in the lower house by a slender majority. They also suggest that the Green Party will gain more seats in the Senate and could hold the balance of power in the upper house. If that occurred, it would play an influential role in the shape of any carbon reduction emissions policy. The Green Party has focused its campaign around stronger infrastructure and a robust emission trading scheme which would be considerably more ambitious than that proposed by the two major parties. Schemes aimed at reducing carbon emissions will inevitably cause financial strains on business and SMEs, and the public budget more broadly.

New Zealand: Improving, but weak domestic demand concerns SMEs

The economy is showing signs of recovery, led by export growth. This has contributed to an improvement in earnings which rose by 1.4 per cent in the second quarter from a year earlier, the first acceleration in almost two years. A fourfold increase in retail sales in the three months ended June 30th is forecast. The outlook for exports remains strong. Notwithstanding these improvements, the policy challenge is to raise domestic investment and consumption. The most recent jobless rate, seasonally adjusted, was 6.8 per cent, up from 6 per cent three months earlier. Consumer confidence has fallen for the second consecutive month, and service industry activity
fell from 55.1% in June to 50.5% in July, where 50% is the threshold between contraction and expansion.

In July the Ministry for Economic Development released its annual report on the state of SMEs in New Zealand as of 2009. It noted that 97.2% of businesses in New Zealand are defined as SMEs, with this statistic remaining steady since 2001. SMEs account for 30.6% of employment, contribute to 41.9% of total value added output (up from 40.7% in 2007) and exits from the sector were in a ratio of 1.02 to new entrants.

India: Inflation and the role of the Central Bank

India’s inflationary concerns were slightly averted in July with the Wholesale Price Index falling below double digits for the first time in 6 months but still showing a rise of 9.97% from a year earlier. Community tensions continued following the removal of subsidies on fuel. There is an expectation that inflation will be around 6 per cent by December 2010, via a ‘calibrated’ or gradual rise in the official rate, although this may be optimistic given that real interest rate is currently negative. If inflation does not subside, the reintroduction of fuel subsidies may become a political necessity, causing pressure on fiscal policy which is aimed at a reduction in the budget deficit to 5.5 per cent of Gross Domestic Product (GDP) in November 2010.

This inflationary issue has brought criticism of the RBI’s policy approach, reflecting concerns that the central bank’s monetary policies may be unpredictable and opaque. While the inflationary issue is also notable for distracting the government away from other intended economic reforms, the government has introduced stress testing to its banks. It also established a joint committee chaired by the Finance Minister to regulate the financial sector, with the Governor of the Risk-Based Inspection (RBI) as vice-chairman. These structures could mean an erosion of the independence of the Central Bank and as a consequence raise questions on the results of stress tests and the treatment of non-performing assets. The RBI has announced that it favours granting more licenses to banks in a bid to expand financial services to the economy's low-income populace and to rural areas, paving the way for possible financial infrastructure expansion.

India’s north-eastern states are to gain access to the sea through Bangladesh, thereby opening prospects for enhanced growth and economic activity for those states. U.S. senators have unanimously passed a proposal to nearly double the fees on work visas for Indian IT companies sending workers to the U.S. If enacted, this could impact, marginally, on SMEs supplying IT companies. (This author is Director, Australian APEC Study Centre at RMIT University.)

Latin America

Impact of Grain Price Rally on Inflation

Cheng-Mount Cheng

The drought in Russia had led to a prohibition of wheat exports that in turn saw international wheat prices surge by more than 70% since July 1st and pulled some of the other soft commodities together with it. This poses the following questions: a) is this surge going to be big enough to cause a surge in headline inflation?, and b) will central banks in Latam react to this surge in inflation?

In Latam, similar to other emerging economies, food constitutes a considerable weight in the Consumer Price Index (CPI) basket. Among
major Latam economies, Peru had the largest weight in food and beverages that accounted for 38% of CPI in 2010, down from 47% in 2009. Colombia followed in second with a weight of 28% for food and beverages in 2010. In Brazil and Mexico, food and beverages were around 23% of CPI in 2010. Chile had the lowest weight of 19%. It is note that despite that the weight in Peru has decreased recently, overall food basket remain comparable to their high values in the past to suggest some validity to a study of previous price spikes.

Of course, one question is to what extent global price pressures translate into local price pressures. The extent of the correlation could depend on various differing regulatory setup and the micro-structure of the relevant grain markets. Nonetheless, it appears that in general global food prices (in terms of local currency) and local food prices were strongly correlated in the five economies we have studied except Mexico, where the correlation seems less stable. In particular, global food prices are leading local food prices. This result suggests that rising wheat prices will likely cause inflation pressure in Latam economies to increase to some degree.

**Figure 1. Weight of food and beverages in CPI basket**

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<thead>
<tr>
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<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>Brazil</td>
<td>22.7%</td>
<td>23%</td>
</tr>
<tr>
<td>Mexico</td>
<td>23%</td>
<td>23%</td>
</tr>
<tr>
<td>Chile</td>
<td>18%</td>
<td>19%</td>
</tr>
<tr>
<td>Colombia</td>
<td>28%</td>
<td>28%</td>
</tr>
<tr>
<td>Peru</td>
<td>47%</td>
<td>38%</td>
</tr>
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Source: Citi Investment Research Analysis

**Figure 2. CPI Inflation in Latam (% Year-on-Year)**

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</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>3.6</td>
<td>5.7</td>
<td>4.9</td>
<td>5.1</td>
<td>4.6</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Chile</td>
<td>4.4</td>
<td>8.7</td>
<td>1.7</td>
<td>2.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Colombia</td>
<td>5.5</td>
<td>7.0</td>
<td>4.2</td>
<td>3.5</td>
<td>3.7</td>
<td>3.4</td>
<td>3.4</td>
<td>3.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.0</td>
<td>5.1</td>
<td>5.3</td>
<td>4.6</td>
<td>3.7</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
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</tr>
<tr>
<td>Peru</td>
<td>1.8</td>
<td>5.8</td>
<td>2.9</td>
<td>1.5</td>
<td>1.8</td>
<td>2.0</td>
<td>2.0</td>
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Note: The numbers in the green shaded area are estimated forecast, while the rest are actual figures.
Introduction

On July 23rd a stress test for EU banks was published by the European Central Bank. Although widely criticized, the results of the test seemed to be calm and reassure the markets. Moreover, banking reform and consolidation measures announced by individual economies generated a sense of confidence.

Other concerns about EU economies then seemed to emerge:

- Concerns of prospective sovereign debt defaults in some economies of Europe (Greece, Ireland, Spain, etc) revived
- Inflationary pressures were seen to be reviving, led initially by rising commodity prices, but exacerbated by rising food and grain prices
- Prospects for a Europe-wide revival in economic growth receded as the U.S. and Asian markets were perceived to be weakening
- Unemployment continues to worry policy makers throughout the EU

Towards the end of the reporting period, German and EU growth figures suggested a strong recovery. But optimism was combined with caution in view of the larger problems described above.

General situation:

- There is a distinctly more relaxed mood throughout the EU, with some exceptions (Greece and Hungary), even though economic uncertainty continues. Modest growth (EU average of 1%), relatively stable unemployment figures (still about 10%), and low inflation (1%) seemed to account for this.
- A greater sense of clarity about the key policy issues that need to be addressed has emerged. These are:
  - Inflation control strategies to deal with expected rises in commodity, raw material and food prices
  - Strategies to encourage and promote growth
  - Strategies to reduce fiscal deficits.
- While Greece and Spain are often described as the most problematic economies, it is the situation in the U.K. perhaps that concerns markets the most. Current U.K. plans to reduce fiscal deficits substantially may lead to 600,000 job losses in the government sector in the next few years. At the same time, inflation is now running at 3.1% and may rise sharply, raising the possibility of a slump.
- The U.K. however can offset these disadvantages by allowing Sterling to sink, stimulating economic revival through exports. But this strategy relies on:
  - Strong growth in the U.S., EU and Asia
  - Euro, Dollar, Yen and Renminbi gains in value
  - Those U.K. products are competitive.
- The situation in the Euro-zone is interesting.
The weaknesses of the some governments mean that the Euro is weakening, and EU exports (particularly German engineering products) are becoming more competitive in global markets.

- Banks and businesses through the EU continue to accumulate reserves, and avoid investing in an economic situation where demand is weak.
- Similarly, consumers are paying off debts and mortgages and cutting consumption.

**Implications for APEC SMEs:** It is difficult to establish direct effects of current situation, however indirect effects likely to be as follows (some of which remain unchanged from last months’ report):

**Micro/Firm Level**

- Strong and rising Asian currency values will make APEC SME products significantly more expensive in EU markets.
- EU demand will remain weak except for food and energy necessities.
- Payments may be delayed for services and products from APEC SMEs because of persistent banking system problems in the EU.
- Price pressures to reduce costs and improve quality likely to intensify.

**Macro/National Levels**

- Fears about inflationary pressures within the EU gaining strength (now because of rising international food prices) may lead to higher interest rates and a further fall in demand for goods and services, perhaps by early 2011.
- Sovereign debt fears in several EU economies leading to severe cuts in government spending. This in turn is expected to reduce demand significantly.
- European SMEs increasingly protectionist, though this is not the case with EU Multinational Corporations (MNCs). This could have medium to long term effects on the global trading system.

**Important developments during the month under review (July 15th – August 15th, 2010)**

August is usually a slow month in Europe because of the holiday season. Nevertheless, the following important developments/initiatives took place:

- EU-IMF team rejected Hungary’s fiscal austerity plans. Greece, on the other hand, was praised for its efforts. Critics say these austerity measures will induce a recession throughout the EU.
- The Commission approved a €1.4bn grant for research into nuclear fusion as part of its strategy to encourage nuclear energy.
- EU anti-dumping policies likely to be reviewed following the loss of a major case against China. This should have a profound effect of EU customs management strategies. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.)
Greece is showing signs of stabilization, but has been not out of the woods yet

Kuo-Yuan Liang

External events and investor sentiment is still more relevant than domestic economic progress as market reactions to the FOMC meetings shook regional markets, creating a hard time for unprepared SMEs.

**Domination of global events persists: global financial stability first priority economic recovery second**

Following the framework established in the previous issue, we first examine the currency market. Over the past month (July 10th to August 10th), the Euro, Zloty, Koruna, and Forint have all been on the rise against the US dollar, as the dollar has been particularly weak against most other currencies. During this period, the four currencies each rose by 4.2%, 6.9%, 7.0% and 4.4%, respectively. The rise of the Forint was moderate, as talks with the IMF broke down on July 18th. This caused some disturbance in both the stock and currency markets. However, the effect was relatively short lived, as markets soon went up again.

However, when this report was being prepared on August 11th, which was a day later after the US Federal Open Market Committee (FOMC) meeting, global stock markets and the European currencies all suffered a sharp decline, as markets were disappointed to hear the Fed acknowledging that the U.S. economic growth was weak. The Fed stated it would still keep low rates for an extended period, as well as maintain the size of its balance sheet. This will be done by redirecting money from due programs into the treasury markets, and refraining from introducing direct measures targeting specific areas. The resulting market effect was worldwide, prompting a fall of 2.4% in the Euro, 2.3% in the Zloty, 2.9% in the Koruna and 3.2% in the Forint, respectively against the US dollar. After a month long rally and the economy evidently on the path of recovery in July, nearly 50% of the recent currency appreciations were offset in one trading day, a perfect reminder that global events and investor confidence toward financial markets exert a much bigger influence over currencies than domestic economic developments. This dominance is expected to continue, as Europe as a whole is recovering at a snail’s pace amid widespread concerns over government debt, and fairly weak current accounts and foreign reserves in East Europe when compared to emerging Asia and Asian NIEs.

**Progress observed in most regional economies, employment still a weaker segment**

From the Essential Science Indicators (ESI) indicator, the general economic sentiment of the EU nations went up compared to the previous month. Although the improvement was less significant in the Baltic nations, the three bigger economies did enjoy an obvious improvement. Poland, who fell for two straight months prior to July’s survey, saw its decline stop and improve somewhat, while Czech and Hungary continued to witness improvements. In terms of the Retail Trade sub index, after declining for several months in Poland, it picked up significantly in July, while other sectors gained modestly. In the Czech Republic, the ESI rose, while only the Retail Trade sub index fell, due to weakening business expectations and
employment expectation components. In Hungary, the improvements in the ESI and uninterrupted rising trend over the past months imply that there is no reason to assume a pullback.

As for the Baltics, the ESI increased in all three nations. Declines were only seen in the Service Confidence of Lithuania, Consumer Confidence in Latvia and Service Confidence in Estonia. The situation in Greece has slightly improved for the second month, which was led by the Industrial Confidence and Service Confidence (mixed signals: improving demand but weak employment). The Retail Confidence continues to fall, while Construction and Consumer Confidences were both situated at the bottom.

Greece is showing some signs of stabilization, after months of nationwide unrest due to the various measures introduced to curb national debt and deficit difficulties. Greece is not out of the woods yet, but the entire nation and its people are gradually settling in with the reality. However, it will take a long time before we can firmly say Greece is improving. In general, the ESI has shown good progress over the region. The only concern still lies in the areas linked to employment, whether in terms of the current situation or future expectations.

**Conclusion**

As fluctuations in the exchange rates are essential to the financial markets and a good signal for detecting problems and flow of funds, most SMEs will find it too costly to perform currency hedging compared to larger firms that may have internal hedging departments. Given the high unpredictability of currency markets over the past month and vulnerability to reverse shocks, it is rather difficult for SMEs to be at ease in sharing the joy of economic recovery and improving economic sentiment. (The author is the President, Polaris Research Institute & Honorary Professor, College of Technology Management, National Tsing Hua University.)

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Russia has suffered from an unusually high temperature this month. The fire it caused has influenced more than ten million acres of food crops, about 20% of the farmlands in Russia, and has had a serious impact on the food security of the economy. The Russian government has announced a temporary prohibition against exporting wheat, mixed wheat, barley, rye, corn, wheat flour and wheat-rye mixed flour. Russia is the third largest wheat exporter in the world, and therefore this export prohibition has also severely influenced the trend of the international food futures market. The wheat futures price of the Chicago Board of Trade (CBOT) rose about 42%, the largest monthly increase in the past half century. Its current price is also the highest of the past 23 months, leading the corn future price to the highest of the past 13 months.

Many research institutions indicate that the commodities futures market has not been active since the financial crisis. With so many food producers being hit by the severe weather, however, the international hot money has got the chance to speculate the crop prices. Since the Russian Prime Minister, Vladimir Putin, reaffirmed in a government meeting that the export prohibition will not be lifted any time soon, and
may be prolonged to 2011, it is expected that the international food price will remain high in the future, having a greatly significant influence on the small and medium enterprises (SMEs) of the food, restaurant and retail industries.

Russia’s export ban, nevertheless, has benefited the agriculture of a certain economies in some indirect manner. According to F.O. Licht, a German analytical institution, the U.S. and Australia will profit most from the decrease of the food production in the Black Sea area. So far the U.S. wheat export has increased by 36%, and its Department of Agriculture has also claimed that its corn production would rise by 1.9% this year. In economies as such, the agriculture, the food processing industry, and the SMEs in other relevant industries will likely have some further improvements concerning their operation performance.

When it comes to the Middle East, the regional risks there are mostly influenced by the tension between Iran and the U.S.. The U.S. is currently enforcing trade sanctions against Iran, and other major economies will have to impose corresponding sanctions against Iran after the U.N. passes the sanctions resolution. At the present time, China and Russian would only enforce sanctions that are included in the U.S. resolution, and would not impose additional sanctions. On the part of other U.S. allies, Japan has only a symbolic gesture of an announcement by Toyota Motor Corporation of suspending car exports to Iran, which nonetheless has merely a tiny influence on the SMEs related to the car production system in Japan. Although South Korea has not conducted any specific sanctions against Iran yet, the Iranian government has unusually singled out South Korea, blaming it for joining in the U.S. sanctions against Iran while selling commodities to Iran at the same time, which makes Iran consider it necessary to boycott Korean goods.

Concerning how South Korean SMEs are influenced by Iran, since one of the only three overseas branches of Iran Melli Bank is located in Seoul, that branch functions as the business hub for Iran, and there will be a quite negative impact on Iran once South Korea cooperates with the U.S. and investigates the illegal conducts of the Seoul Branch of Iran Melli Bank. Iran is the third largest trade partner of South Korea in the Middle East, having about 11.4% of South Korea’s total trade amount in the entire region, and therefore it is our speculation that Iran, with its market importance, is very likely to adopt a first-strike strategy to force South Korea to stop cooperating with the U.S.. The future situation of Iran, therefore, will continue to have influences on the trade of various South Korean industries to Iran, including the commodities of rubber, motors, automobile components, refrigerators, etc. (The author is Vice President, Taiwan Institute of Economic Research.)

Global Commodity Market

Tensions in Iran will Slowly Affect Global Crude Oil Prices

Hwa-Nyeon Kim

In the last one month period (mid-July to mid-August), there have been gradually increasing signs of a crisis in the global commodity market. There was a slight gain in commodity prices due to U.S. dollar depreciation and weakening risks in relation to Europe’s fiscal debt problems. The commodity that received the most attention was grain, especially for wheat. This summer, a severe drought in Russia’s Black Sea region and floods in several grain producing economies sharply cut crop estimates. Adding to the shortage, Russian authorities banned all exports of grain causing the wheat price to spike. Moreover, the possibility of commodity prices going up within the next month is increasing amid U.S.-led sanctions against Iran for its nuclear ambitions. These sanctions against
Iran could unseat the stability of oil prices.

The two top commodity indices, the Reuters Commodity Research Bureau (CRB) Index and London Metal Exchange (LME) non-ferrous index, have shown moderate increases from mid-July to mid-August. The Reuters CRB index (year 1967=100) moved up from 475 points to 506 and the LME index (April 1999=1,000) increased from 2,917 to 3,455. The average for the Reuters CRB index from mid-July to mid-August increased 3.7% while the average for the LME index rose 8.4%. Such changes are evidence that there were sharper upward trends or steep slopes within the commodity indices compared to the previous month. In terms of price variations, daily price changes were higher than those in the mid-June to mid-July period, indicating an increase in investment risk in raw materials.

As for energy prices, the West Texas Intermediate (WTI) near month futures price moved within the range of 75.39 and 82.55 USD/barrel and Dubai crude prices moved between 72.43 and 78.59 USD/barrel during the same period. Both the minimum and maximum values were higher than those in the mid-June to mid-July period. Among non-ferrous metals, or more commonly known as base metals, lead and tin prices raised the most. Lead and tin prices rose 16.9% and 17.8% respectively on August 13th, compared to the previous month. The hottest base metals in the first half of this year, nickel and copper, also showed rising price patterns. The maximum price of copper and nickel for the last one month period were 7,425 and 22,565 USD/ton, respectively. The recent prices for these two base metals are still 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 increasing variations.

The most important variable we must keep a closer eye in the coming month (mid-August to mid-September) is how the sanctions against Iran will influence the global crude oil market. Concerns about the business impact of these global sanctions have been spreading. A survey conducted by the Korea Federation of Small and Medium Businesses in August showed that more than half of Korea’s SME trade with the Middle East have already suffered a loss. According to the survey, 56% of responding SMEs doing business with Iran said they had suffered a loss since the U.S. issued the ‘Comprehensive Iran Sanctions’ in early July. The survey also reported that exports to Iran have been reduced by 31.5%. The same situation may soon become a reality in other economies. In addition to these direct damages, SMEs will suffer from a rise in crude oil prices, which is an indirect result of the tension in Iran.

SMEs dependent on imported agricultural commodities will suffer from the skyrocket in prices. Therefore, SMEs in the food industry should increase their grain inventory. This is because, if inventory dwindles, SMEs will have to pay a higher price to import additional grain as a result of recently unpredictable weather conditions. (The author is Research Fellow at Samsung Economic Research Institute.)

<Table> Changes in Raw Material Prices - July 16th to August 13th, 2010.

<table>
<thead>
<tr>
<th>Index</th>
<th>Crude Oil (USD/barrel)</th>
<th>Non-ferrous Metals (USD/ton)</th>
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<tbody>
<tr>
<td></td>
<td>Reuters CRB</td>
<td>LME</td>
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<tr>
<td>Min</td>
<td>475</td>
<td>2992</td>
</tr>
<tr>
<td>Max</td>
<td>506</td>
<td>3455</td>
</tr>
<tr>
<td>Average</td>
<td>491</td>
<td>3279</td>
</tr>
</tbody>
</table>
| Mid-June to Mid-July Average | 473 | 3026| 76.03| 73.50| 6557    | 1762 | 19378  | 1786 | 17701| 1950       

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 future’s price traded in NYMEX and non-ferrous metal prices are based on the spot prices traded in LME.
Global economy is likely to be slow ahead, but no double dip

Cheng-Mount Cheng

Strengthening global economy battered by financial shocks

The global economy will likely continue a sustained but uneven recovery in the second half of 2010 and throughout 2011. But a double-dip recession that could take advanced economies back into a period of sustained negative growth is not likely to happen. According to an update from International Monetary Fund (IMF) in July, the world economy expanded at an annualized rate of over 5% during the first quarter of 2010. That was better than IMF’s April projection, mostly due to robust growth in Asia. Accordingly, IMF has raised 2010 global Gross Domestic Product (GDP) growth estimate to 4.6% from previous 4.2%, but maintained 2011 GDP growth for the global economy at 4.3% unchanged.

Beginning in the second quarter, however, turbulence in financial markets that reflected a drop in confidence about fiscal sustainability, policy responses, and future growth prospects have cast a cloud over the outlook. In particular, the European sovereign debt crisis in April has fuelled concerns over fiscal positions and competitiveness in some vulnerable euro area economies. Despite that consolidated efforts by the European Monetary Union and the IMF have quickly stabilized financial markets and resumed market confidence, the crisis has spilled over to cause a funding pressure in banking sector in Europe and spread through interbank markets globally. As risk appetite waned and markets scaled back expectations for future growth, assets in other regions, including emerging markets, also experienced substantial sell-offs. This spilled into sharp movements in currency, equity, and commodity markets. Thereafter the European Central Bank had successfully conducted a stress test on major European banks and the troubled economies of Greece and Spain had made progress in their fiscal reform efforts such that resumption of their government bond issuance had been receiving strong buying interests and the Euro quickly rebounded from a four-year low of 1.19 to as high as 1.32 in May.

Divergent Growth Performance in the Second Quarter

It turned out that the global economy had a divergent performance in the second quarter. The U.S. economy, for example, had its second quarter GDP growth slowed to 2.4% (initial reading) annualized rate from 3.7% in the first quarter on sluggish consumer spending. Japan, the world’s second largest economy until second quarter, had a dismal growth of only 0.4% annualized rate, down sharply from 4.4% recorded in the first quarter. By contrast, weak Euro had helped the euro area economies to post a solid growth of around 4.0% annualized rate in the second quarter as a whole, despite continuous recession seen in those fiscally stressed economies like Greece.

Emerging market economies appeared to experience a slowdown in the second quarter,
but in general still maintained a solid growth momentum. China second quarter GDP growth slowed to 10.3% on yearly basis from 11.9% in the first quarter. Russia saw its second quarter GDP growth accelerated to 5.2% year-on-year from 2.9% in the first quarter. Meanwhile market consensus had an estimate of 7.4% for Brazil’s second quarter GDP reading, which would only slow slightly from 9.0% in the first quarter. India’s second quarter GDP figure is expected to increase 8.7% over last year, slightly higher than first quarter’s 8.6%.

**Sustained Global Growth but with Uneven Recovery**

Going forward, IMF thinks the global economy will likely continue to recover, but with divergent trend among different regions. There is little evidence of negative spillover impact from the European sovereign debt crisis to real activity at the global level. Output in advanced economies will likely continue to increase at a slower pace in 2010 and 2011, mainly due to slow recovery of domestic demand. IMF estimated a 2.5% GDP growth for advanced economies in 2010 and 2011.

Output growth in emerging market will likely also edge down to 6.5% in 2011 from 6.8% in 2010. Key emerging economies in Asia and in Latin American will continue to lead the recovery. Nimble policy responses and stronger economic framework are helping many emerging economies rev up internal demand and attract capital inflows. Ongoing rebound in global trade is also supporting the recovery in emerging economies. However, the pace and drivers of growth will likely differ substantially across the region. In China, given the strong rebound in exports and resilient domestic demand so far in 2010, the economy is likely to grow by 10.5% in 2010 before slow to about 9.5% in 2011. In India, growth is expected to accelerate to 9.5% in 2010, as robust corporate profits and favorable financing conditions fuel investment, and then to settle to 8.5% in 2011. Both Newly Industrialized Asian economies and ASEAN economies are expected to grow by 6.5% in 2010 as a result of surging exports and private domestic demand, before moderating to 4.75% and 5.5% respectively in 2011.

**Inflation to remain mostly subdued**

Prices of many commodities fell during the financial market turmoil in May and early June but recovered some ground more recently. The IMF has revised down its baseline petroleum price projection to US$75.3 a barrel and US$77.5 a barrel for 2010 and 2011 from previously US$80 and US$83 respectively. IMF’s projection for nonfuel commodity price index have remained broadly unchanged despite international wheat prices have gone up more than 50% since July. Coupled with weak domestic demand, still-low level of capacity utilization and well-anchored inflation expectation, inflation pressures are expected to remain subdued in advanced economies, where headline inflation is expected to remain around 1.25%-1.5% in 2010 and 2011.

In contrast, inflation is expected to edge higher in emerging market to 6.25% in 2010 before subsiding to 5% in 2011. In some economies, rising asset prices (especially housing prices) have become a headache for policymakers in the region that will require a careful policy response.

**Expect accommodative monetary policy to stay longer in the advanced economies**

Given subdued inflation pressures, monetary policy in advanced economies will likely remain highly accommodative for the foreseeable future. This will help mitigate the adverse effects on growth of earlier and larger fiscal consolidations as well as of financial market jitters. After the announcement that it will reinvest proceeds from previously purchase of MBS in U.S. treasuries at August FOMC meeting, the U.S. Fed had signaled a reenergized commitment to low interest rates such that it will likely keep rates on hold all the way to the end of 2011. The Bank of England and European Central Bank are probably on hold until third quarter of 2011, while Bank of Japan will likely maintain current policy rate of 0.1% throughout 2011 with the possibility of injecting more liquidity into the financial markets.

Monetary policy requirements are more diverse for emerging market economies. Some of the larger, fast-growing emerging economies in emerging Asia and Latin America, faced with rising inflation or asset price pressures, have
appropriately tightened monetary conditions, and markets are pricing in further moves.

**Downside risks to global growth are much greater**

The IMF has seen downside risks rise more sharply. The main risk is an escalation of financial stress and contagion, prompted by rising concern over sovereign risk. This could lead to additional increases in funding costs and weaker bank balance sheets and hence to tighter lending conditions, declining business and consumer confidence, and abrupt changes in relative exchange rates. Given trade and financial linkages, the ultimate effect could be substantially lower global demand.

In addition, growth prospects in advanced economies could suffer if an overly severe or poorly planned fiscal consolidation stifles still weak domestic demand. Other risks include risks from uncertainty about regulatory reforms and their potential impact on bank lending and economy-wide activity. Low growth in advanced economies could complicate macroeconomic management in some of larger, fast-growing economies in emerging Asia and Latin America, which face some risk of overheating. (The author is Vice President, Citi Taiwan.)

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**Importance of Business Startups during a Recession**

*Hikaru Fukanuma and Iichiro Uesugi*

Since 1991, Japan Finance Corporation Research Institute (JFCRI), which one of the authors, Hikaru Fukanuma is affiliated with, annually conducts the Survey on Business Startups (SBS) in Japan. The sample is selected from the business startups for which Japan Finance Corporation made loans the year before the survey. As the surveys include the same questions every year, we can examine the trend of the entrepreneurs for almost 20 years. Based on the SBS, JFCRI publishes “White Paper on Business Startups in Japan (in Japanese)” with its summary (in Japanese) reported on the website of JFC. Also, the data may be available upon request by economists to the Social Science Japan Data Archive (SSIDA), which is operated by the Institute of Social Science, the University of Tokyo.

Latest survey, SBS 2009, was conducted in August 2009, and gathered the data from business startups, most of which were established January 2008 or later. At that period, Japan is under the bad economic situation. The Economic and Social Research Institute, Cabinet Office of Japan determines provisionally that a peak in business cycle was reached in the Japanese economy in October 2007, and a trough occurred in March 2009.

According to the Quarterly Survey of Small Business in Japan by JFCRI, Diffusion Index (DI) of the profit of small businesses, which is defined as the percentage of profitable businesses minus the percentage of unprofitable businesses, also went down during 2008. It was minus 63.6 at lowest on the First Quarter of 2009, and on the Third Quarter, when the SBS 2009 was conducted; it was still minus 60.8, which was the lowest level since 2001. Hence, the data of SBS 2009, gathered on the juncture of economic setback, show the operation of the business startups under the recession. We are going to analyze SBS 2009 comparing with the survey on the other years when the economic situations were better than 2008 to 2009.

First, the typical difference of the attributes of the entrepreneurs of SBS 2009 was the reason of the retirement from their former jobs. 85.1% of
entrepreneurs had fulltime jobs before they start their businesses, while 8.0% were part-timers and 6.9% were others. The portion with full time jobs was 85.2% in 2008, and had not changed so much for a long time. Among them, the portion of entrepreneurs who retired “With Their Will” was 76.6% in 2009, and was 80.1% in 2008. On the contrary, entrepreneurs who were “Forced to Quit” their job because of bankruptcy, closing, or downsizing of their employers was 16.8% in 2009, which is the highest after 2005, while 13.0% in 2008.

When we examine the data divided by the age of the entrepreneur, 29.7% of 50 to 59 years old people and 21.3% of over 60 years old people were “Forced to Quit” in 2009. In 2008, the portions were 20.3% and 10.7%, and we can see that they increased by almost 10%. Less than 40 years old, the numbers did not changed so much. Those facts shows that under the recessed economy, rather elder people are forced to retire their job and some of them choose to start their own business.

Another typical change was the performance of the business startups. DI of the profit was 12.2 in 2009, which was much worse than 33.8 in 2008. DI of sales growth, which is defined as the percentage of sales increase minus the percentage of sales decrease, was 28.7 in 2009, while 42.9 in 2008. Both data were the worst in recent 5 years. However, we also need to point out that these DIs were not so bad compared with those of old enterprises. On the Third Quarter of 2009, DI of the profit of small businesses by JFCRI was minus 41.3, and DI of the sales growth was minus 58.6. We can see that the performances of the newborn businesses were much better than the aged businesses even in the recessed period.

Furthermore, new businesses create new jobs. On average, 5.2 people including entrepreneurs themselves work for the sample startups in 2009. The number of the people was less than 5.7 in 2008 and also the worst since 2005; however, we should also know that, usually, the unemployment rate goes up under the recession. In fact, the Labor Force Survey by the Statistics Bureau shows that, in Japan, the unemployment rate was 5.4% and the number of employees 54.7 million in August 2009, when the SBS 2009 was made, while they were 4.1 % and 55.4 million in August 2008. Although the effect to create new jobs went down slightly compared with the booming years, we can say that job creation by the startups is much more important when the economy is in the bad situation.

Overall, we need to understand the business startups perform better than old enterprises, which means they will increase the productivity of the overall economy. Also, they create new job opportunities not only for entrepreneurs themselves but also for other people who are looking for a job. Of course, there are some disadvantages to create businesses under the recession. The entrepreneurs who were forced to retire suddenly tend to increase in percentage. They are not so much prepared to start business, usually. Also, in such economic situation, the performance of startups becomes worse. Hence, banks or officials who would support them must take care of the entrepreneurs much more than the booming period.

Lastly, because JFCRI has accumulated the data for a long time period, the authors could find out these evidences from these data. Note, however, that some results may be applicable to other economies while others may not, since the tendency of entrepreneurs and startups in other economies may be different from that in Japan. In order to promote startups and to enhance growth among SMEs both during economic crises and booming periods, the officials in each economy need to know the characteristics of startup companies. Hence, surveys on entrepreneurship, which are similar to SBS or Quarterly Survey of Small Business implemented by JFCRI, are highly recommended for the economies that do not have such data of their own. (Hikaru Fukanuma is Principal Economist, Japan Finance Corporation Research Institute, and Ichiro Uesugi is Senior Fellow, Research Institute of Economy, Trade and Industry.)
Lessons in Adversity: Acquiring the Art of Resilience

George Yeh

Two years after the outbreak of financial crisis, signs are showing that the worst should have now been behind us, with indices for retail sales, industrial production and world trade volumes bouncing back from the lows of 2008. But not only is the world economy still far from returning back to its “normal” activity, this global recession has made a permanent impact, and enterprises are now faced with the “new normal” to which they need to adapt in order to survive into the future.

A “new normal” that is hitting across the board in all industries is the consolidation among industry players. Many industries are now been dominated by a few mega players who grew in size through mergers and/or acquisitions. These mega players have more resources and capacities to survive the financial crisis, and in turn lead their respective industries out of economic recessions, sometimes with the aid of the Government. Not only is the biotech/pharmaceutical industry without exception, its particular industry trait goes further to enhance this development.

The biotech/pharmaceutical industry is one with an extremely time- and resource-consuming research and development process, much more so than most of the other industries. On average, a new drug takes about 12 to 15 years to develop, costing billions of dollars, and it is not unusual for a company to have to screen through thousands of compounds before one finally makes to the market, which further factored into the continuous increase in the R&D expenditure. Moreover, while the big pharma’s enjoyed for many years the billions of dollars brought about by their patent-protected drugs, they are now facing a drastic decrease of close to 40% in revenue with the expiration of these patents. These factors combined drove pharmaceutical companies into searching for alternative ways of developing new products and technology platforms, one of which is through merger and acquisition. The most famous M&A deal in 2009 between two pharmaceutical companies was the one between the Pfizer and Wyeth, transaction valued at US$68 Billion. With this merger, Pfizer will be acquiring in several profitable products (e.g. vaccine Prevnar, which has high margins and strong patent protection), and promising pipeline, such as its Alzheimer’s development program, which can help to cover the major revenue loss of around US$12 Billion with the patent expiration of Pfizer’s top selling drug, Lipitor.

On the other hand, biotech companies who are generally much smaller in scale are finding it increasingly difficult to raise funds after the financial crisis, especially for small and medium sized companies, since VCs are more critical about their investment than before. A new window of opportunity thus opened up for small and medium biotech companies with niche technologies or products to collaborate with big pharma’s through
partnering. The statistics on types of capital raised by U.S. biotechs in 2009 shows the definite trend of biotechs leaning to partnering as opposed to public and private financings with an overwhelming ratio of 66% to 34%.

Another trend that has also been observed across the board is the increase in the importance of emerging markets, and this is valid from manufacturing through to market distribution. With the advancement in technology, the world is becoming borderless. Human-intensive activities are thus been sourced out to emerging economies with enormous population and subsequent lower labor costs, such as India and China. The increase in purchasing power of these economies brought about by this shift in activities coupled with its population has in turn made these economies a force to be reckoned with in terms of their market potentials. This poses another opportunity for SMEs who are equipped with the globalization capacity to act as the bridge to the niche areas in these emerging markets, possibly overlooked by big enterprises.

Furthermore, in this era of globalization, SMEs who are quick to adapt to the climate of the borderless competition would no doubt be far more advantageous in many aspects. A true globalized company has to "think global" from Day One when considering their talent pool, technology and financing, only then can the company be positioned correctly when tapping into the global market and withstand the fierce borderless competition. However, for resource-constrained SMEs, it is also extremely important to focus on its core competitiveness; therefore SMEs should leverage the specialty of other companies wherever applicable, for example legal and regulatory specialists who are familiar with the local laws and regulations, to generate the most productive results possible. Transnational collaborations will be a new normal in industries across the board.

By comparison, Chinese Taipei is more concentrated with SMEs than other economies, it is thus important for these SMEs to realize the value proposition of Chinese Taipei, so to utilize these resources to their advantage. These value propositions can be evaluated from a number of facets; on the talent side, there are many local and returning Chinese professionals who has received higher level education from renowned universities and institutes all over the world. These talents with globalized training and scope contribute towards the versatility of innovation, producing competitive products and technologies; Financial-wise, Chinese Taipei's investment environment is comparatively mature and active, foreign venture capitalists favors Chinese Taipei over China for its transparency as well as the support programs from the Government in the form of grants and subsidies to facilitate the development of technology. Another trait that works to Chinese Taipei's SME’s advantage is the fact that Chinese Taipei is a small market, so for SMEs to survive, they are forced to look to other economies as their potential market, collaboration and financing partners, further induce them to go global.

In short, there are a few points that a SME should take into heart as a lesson from this recent adversity, so that not only would they have a better chance of survival, but also be better tuned for other challenges ahead:

1. Think Global at 1st Day – globalization is inevitable!!
2. Develop global layers of talents – versatility in talent brings about new ideas and creations!!
3. Stay focused on the core technology – SMEs do not have the luxury of wasting any resources!!
4. Bring in International Funds – the global network associated with the fund is invaluable!!
5. Don’t be afraid to ask, utilize the specialty of other companies where applicable – it’s better to ask silly questions than to make silly mistakes!!

The post financial crisis period may present enterprises with a more challenging environment, but new crisis could also mean new opportunities. Even though SMEs are much smaller in size and have much less resources, what a SME lacks in size, it can be made up with flexibility and mobility, a SME should always be paranoid, stay alerted to the climate changes and be quick to adapt for successes. (The author is President, Taiwan Liposome Company, Ltd.)
The global food crisis as seen from Russia's ban on the export of wheat

As a result of the persistent severe drought and unprecedented massive fires, it is forecasted that Russian wheat production in 2010 will decline by more than one third of quantity, which means that the third-largest wheat exporter in the world, Russia, as a result of their grain security considerations has no choice but to ban the export of wheat and other wheat-made agricultural products from August 15th through December 31st. The ban is likely to stand over to the next year.

Simultaneously, the sixth largest wheat exporting economy in the world, the Ukraine, which is also threatened by severe drought, is implementing a wheat export quota system. Additionally, there are droughts affecting Kazakhstan, the Ukraine, Germany, Poland, Hungary and the north of France, with the second-largest global wheat exporter, Canada, experiencing flood disasters, and the fourth-largest global wheat exporter, Australia, facing locust swarm threats. As the major global producers of wheat face climate and insect threats, expected to cause massive declines in production, the major importers of Russian wheat, such as Egypt and Middle East economies will have to compete for their supplies in the global marketplace, resulting in market prices for wheat reaching their highest level in 25 months.

Future wheat price adjustments will largely depend on the size of the crop shortfalls, whether other producers will be able to successfully fill the otherwise unmet demand, as well as any changes in the drought affecting Russia, etc. Since U.S. wheat stores are expected to reach their highest level in 23 years in 2011, they should be sufficient to fill the void caused by Russian production drops. At the same time as a result of the attractiveness of market prices, farmers may be motivated to reduce their acreage devoted to other crops, and switch to increase the size of their wheat plantings. Additionally, in light of rising wheat prices, some animal feeds have switched to other grains such as corn or soy meal, which should help ameliorate and stabilize wheat prices.

Moreover, the effects of the drought are not only limited to wheat, as in France the wheat harvest is expected to be reduced by about 6%, in Italy tomato production is expected to be reduced between 10% and 15%, in Germany corn production is expected to decline by 15%, in Holland tulip production is expected to decline by more than 10%, and in Poland fruit production is expected to decline by 20% with grain and vegetable production also likely to decline by 10%. Generally speaking then, adverse climate effects will result in declining agricultural harvests, which have already resulted in a steady slow trend towards increasing grain and feed prices, with recent corn and hog future prices experiencing dramatic rises, adding additional massive inflationary food price pressures globally.

Even if there should be favorable changes in the weather allowing for successful wheat harvest increases, the global grain crisis will nevertheless continue to remain in a perilous state, as long as the major producing economies remain subject to precipitous changes in the climate or other unfavorable production factors which could induce further massive changes in grain prices. For the foreseeable future, grain crisis threats will likely no longer be as unexpected, but will instead become all the more commonplace.

The Japanese Yen reaches 15 year highs against the US dollar

In August 2010 the Japanese yen surpassed
15 year highs against the U.S. dollar, representing an increase of 25% in the two years from August 2008, marking a dramatic increase of 45% from the low point of 123.89 yen during the 2007 financial crisis. It largely resulted from the pessimistic announcement from the Federal Reserve that the U.S. economic recovery could be stagnating, and the less than optimistic rigor of recent European economic indicators, causing massive repatriation of Japanese foreign investments from abroad.

Moreover, since 2010, to reduce China's foreign currency denominated asset risks, the Chinese have been scattering foreign currency assets for more than six months now. China sharply increased their holdings of Japanese yen assets and Japanese short-term bond positions, to a total of more than 1.73 trillion yen (about NT$ 640.7 billion), marking unheralded increases in excess of five times the cumulative totals for the past five years, naturally fomenting the unprecedented dramatic rising trends in the yen.

Additionally while the rising yen would not seem to greatly affect manufacturers who have already shifted their production abroad, it will greatly affect the remittance value of foreign currency denominated earnings abroad.

The most likely to be least affected by these changes will be exporters of critical Japanese technologies and equipment, as for these products changes in the value of the Japanese yen typically must be absorbed by the buyers.

While we can expect that the Japanese government will be subjected to tremendous pressures from domestic enterprises to intervene in the foreign exchange markets, nevertheless over the near term, it is highly unlikely that the Japanese government will be able to deploy any substantive measures. The rising yen will result in lower costs for Japanese imports, and the latest Consumer Price Index (CPI) has shown a decline of 1.5%, evincing a strong likelihood of further worsening in Japanese deflation. Although the economic trends for the most recent quarters have indicated a rebound, given the volatile foreign exchange variability, one should not be overly optimistic about future prospects.

Regardless of whether production will be subcontracted or otherwise relocated, either option will likely result in favorable advances for economies that are cooperate with Japan in OEM (Original Equipment Manufacturing) subcontracting.

The massive foreign currency movement in the valuation of the yen has caused dramatic increases in the prices of Japanese products, severely influencing their export competitiveness, and causing declining corporate profits, so it is highly likely that in the near term Japanese manufacturers will shift their production to contractors in other economies, while in the long-term, it may become more likely that they will shift production bases abroad. Orders originally scheduled for production in Japan may be relocated for production in economies with relatively lower overhead costs.

Deepening suspicions arise for a double-dip recession in the U.S. economy

With the announcement of several recent economic indicators inducing doom and gloom about the United States economy, many feel there is an appreciably rising risk of a double-dip recession (a double-dip recession occurs when a second period of negative economic growth occurs within 12 months of an economic recovery). Among those pessimistic U.S. economic indicators of late are the unremittingly high unemployment rates, which in July reached 9.6%, with nonagricultural employment declining by 131,000 jobs, and employment in private enterprises increasing by only 71,000 jobs.

The Consumer Price Index (CPI), having experienced three months of consecutive decline as of June, including a 0.1% decline from May, represents the longest consecutive decline since December 2008. July consumer confidence figures reached their lowest level within 11 months, massively declining from their June level of 76 points to 66.5 points; and as a result of declining production growth and rising labor costs, second quarter nonagricultural productivity declined for the first time since the fourth quarter of 2008 by 0.9%. 
Even though there was an apparently noticeable trend towards a substantial rebound in the U.S. economy in the first quarter, since June, declining prices continue to reflect the weakness in consumer spending, once again casting a deflationary shadow over the U.S. economy giving rise to pessimism about the possibility for a robust outlook. Economists at Deutsche Bank, JP Morgan Chase and Goldman Sachs have all announced adjustments in their U.S. Gross Domestic Product (GDP) forecasts, while some pessimistic forecasters have gone so far as to suggest that the U.S. might be entering into a period of sustained deflation similar to Japan's lost decade.

The United States Federal Reserve in light of the slow pace of economic recovery, considers that for the foreseeable near-term great improvements are not likely, and will continue quantitative easing of monetary policy, as well as increasing U.S. Treasury bond purchases. Even though all these are done, recovery of consumer confidence still remains a very arduous task, which poses a real probability of negatively impacting the likelihood for global economic recovery.
The 36th ISBC 2010: Stride across the Uncertain Age to New Opportunity and New Future

Ray Ho

International Small Business Congress (ISBC) is one of the leading international forums making substantial contribution to promote communication in an increasing globalized society. More than 800 delegates around the world are expected to participate in the congress this year.

The 36th ISBC will be held on October 4th -7th, 2010 in Taipei, Chinese Taipei. The main theme of the 36th ISBC is “Stride across the Uncertain Age to New Opportunity and New Future.”

Uncertainty in terms of business environment and natural environment has become common in our daily life. The 2008 financial crisis has impacted global economic development in an unprecedented scale. Earthquake, drought, famine, tsunami, avalanche and disease are surrounding us all the time. A local disaster may affect the whole globe in a matter of few days, such as the outbreak of SARS in 2003. In the global village, economies need to work hand in hand in combating those issues.

SMEs are most susceptible to external impact on the one hand; on the other many small firms are particularly flexible and acute in searching for new opportunity and new feature in turbulent times. Uncertainty in the terms of business environment and natural surroundings has become a great challenge, yet means new business approach.

Three main themes will be discussed in the congress:
- SMEs Opportunities in Responding to the Changes of External Environment
- Innovation, Incubation and Entrepreneurship
- Niches for SME in Regionalization and Globalization

About more details of ISBC 2010, please refer to official website (http://www.isbc2010.org/). Any further questions or information inquiry, please contact the Congress Secretariat at info@isbc2010.org.

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The agenda could be changed by the conference secretariat.
Joseph E. Stiglitz’ new book, Freefall: America, Free Markets, and the Sinking of the World Economy, was published in early 2010. In this book Stiglitz primarily elucidates and discusses how economic crises can erupt under misleading conception, attempting to disentangle the happenings before, after and during the 2008 economic crisis, so as to clarify the connection between crises and conceptions. Moreover, by virtue of discussions and elucidations over the misleading conceptions, he aims to share the experiences of past failures and the lessons people should learn from them, so as to avoid making the same mistakes again.

Among the misleading conceptions mentioned in the book, it is the main principle of modern economics, which advocates free markets and globalization theory, that Stiglitz criticizes the most. He considers free markets and globalization theory as the cause of this economic collapse, the worst ever since the Great Depression 75 years ago. The free-market theory is hardly applicable, and the markets cannot but face destruction without the governments that keep bailing them out. The main idea of the book, therefore, is how the free markets keep malfunctioning over and over again, leading to ill-advised policies and, furthermore, causing the global economic crisis of the century. Besides, the book certainly also discusses about what we can learn from those mistakes one after another.

From Chapters 1 to 9, Stiglitz provides a survey over the problems hidden under the 2008 financial crisis, and in the last chapter he discusses over the prospects of the society, i.e. a discussion that departs from the underlying reasons of the crisis. He not only examines how the crisis erupted and how the governments and enterprises dealt with it, but also takes a step further to comment on their responding strategies, on the theories related to the crisis, and on such important cases as series of fraud and mortgage problems. Meanwhile, it cannot be more reasonable for the author, an economist, to criticize relevant economic theories and offer the last chapter, entitled as “Toward a New Society,” as a final overall review.

So far as the crisis itself is concerned, it may be nothing new to many enterprises that have been keeping an eye on what is going on and changing in the economic world, and therefore this book seems to lack some novelty to them. As the author, however, provides different views and various perspectives over the crisis, SMEs can see this world financial turmoil through various viewpoints, such as the viewpoints of a chairman of the White House Council of Economic Advisers, as well as of a Senior Vice-President and Chief Economist of World Bank. Thus they may have some more and
deeper understandings of that turmoil.

In the first chapter of the book, “The Making of a Crisis,” Stiglitz begins by looking into the fundamentals of the making of the crisis, and then he discusses the issue of responsibility in various aspects, including the malfunctioning of the markets, the external factors, the economic recession, the complete picture of the crisis, etc. Furthermore, the author elucidates how the free markets brought about an unfavorable situation, what the underlying relevant factors that cause the crisis may be, and how markets are often unable to exert a positive effect. With this discussion, Stiglitz reaches a claim that proper regulations not only play an important role in economic development, but also reduce the frequency of crises and help to avoid such a huge price as the financial crisis in 2008.

In the last chapter, “Toward a New Society,” on the other hand, Stiglitz points out different levels of problems, such as problems of moral hazards, of measurements, of the sense of community and the sense of trust, etc. As to the issue of measurements, he takes Bhutan as an example. This economy, located in the Himalaya Mountains, once tried to establish “Gross National Happiness” (GNH). Even through the value of happiness, which includes spiritual values, can hardly be quantified completely as well as be measured by any indicators, these unquantifiable values must be taken seriously at a time when the economy and society are being redirected.

In the conclusion of the book, Stiglitz regards “change” as the inevitable consequence of the crisis. The global game rules have also been changed, and even though we can never come back to the pre-crisis world, there is still an opportunity to establish new financial systems, new economic institutions, and a new society. It is only by ignoring this opportunity that a true crisis will come. Although what the author discusses throughout the whole book is all aimed at the society and economic systems at an economy level, it is also true that the change that he mentions in his conclusion also refers to enterprises that are also a part of an economy as well as are therefore badly damaged by the financial tsunami in 2008. They should be cautious and rearrange their own structures, so as to strengthen their defensive ability and achieve the goal of sustainability.

Globalization has facilitated a rapid change in the economic structures of economies all over the world. Consequently, the 2008 financial crisis has left a significant mark in the economic history, and made it necessary to conduct a new review and rearrangement over economic thoughts. The financial crisis would be past, but the occurrences and challenges of other crises will not cease with the end of the 2008 crisis. Instead, they are very likely to be more severe and frequent as the globalization continues, compounded with the possibility that the resources which can be used to respond to crises may decrease. In other words, it is probable that enterprises will have to face a new crisis before getting recovered from the damage and impact of the last crisis. If the enterprises can survey the economic crises via different dimensions, therefore, they can have a more complete understanding of the crises; with a more complete understanding of the crises, they can further have more effective strategies to defend themselves and deal with the crises, reducing the impacts that a crisis would have over the enterprises.