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APEC Continuously Pays Attention to the Effect Caused by Natural Disasters on Small and Medium Enterprises

APEC Small and Medium Enterprise Ministerial Meeting (SMEMM) of 2011 will be held in Montana, Big Sky, US on 21st May. Besides the Ministerial Meeting, the APEC 32nd Small and Medium Enterprise Working Group (SMEWG) meeting will also be held at the same place on 16th May and 17th May.

In this time, the agenda of the SMEWG meeting specially adds an item of crisis management, which shows that APEC still pays much attention to the issue of responding to crisis. In this agenda item, Japan, Australia and New Zealand will report the impacts of natural disasters such as earthquakes, tsunamis and floods, on their economies and the follow-up strategies they adopt. Also, our center will make a presentation about measures that we take to help SMEs deal with a variety of risks and potential crises.

The more important thing is that APEC SMEWG will cooperate with APEC Emergency Preparedness Working Group (EPWG) to propose a multi-year plan for assisting SMEs in coping with natural disasters. Our center will be the executive unit of this plan. The content contains setting up the network of natural disaster preparedness, crisis monitoring, study and holding the training workshops for APEC SMEs. In the upcoming SMEWG meeting and the next EPWG meeting, this plan will be discussed.

Highlights of this month’s issue are to discuss the problems of currency appreciation and inflation that each economy has experienced after the 311 disaster in Japan. On the Crisis Alarm section, we consider that the rise of commodity prices, the threat of inflation and the currency appreciation will simultaneously threaten both emerging and advanced economies. Meanwhile, on the Crisis Management Knowledge section, we invite expert to teach SMEs how to lower the operational risks by interpreting the macro-economic indicators.

This issue also has a special interview with Jackson Lin, the general manager of Taiwan Mirror Glass Enterprise (TMG), talking about how TMG successfully applied the strategy of industrial clusters and overcome the crisis of the migration of a large number of industries from Chinese Taipei to Mainland China. TMG integrates those glass processing factories that are unwilling to move to Mainland China and makes full use of the effect of industrial clusters, forming the “Team Taiwan Glass” which reverses the industrial inferiority by the group power to overcome the crisis.

We also select some of the most concerned news and interpret them for readers including the downgrade of US credit rating outlook for the first time in 70 years, Portugal bailouts, G20 meeting on trade imbalance again. Meanwhile, we also introduce readers a book “When Free Markets Fail: Saving the Market When It Can’t Save Itself” which is published in 2010 and written by Scott McCleskey, the managing editor of Complinet New York. This book discusses the structure of financial regulations, roles of each regulation institution and the reasons of the financial crisis in 2008–2009.

The stability of the global economy is worsening after Japanese earthquake disaster, and the future economic prospects of each economy are threatened by the inflation and currency appreciation which occur at the same time. We will keep monitoring these latest situations so that we can timely manage the potential risks.

Robert Sun-Quae Lai, Ph.D.
Executive Director
APEC SME Crisis Management Center
Over the past month, the dangers threatening the global economy have become more serious and complex. Electric power shortages in the aftermath of the major earthquake in March have hindered Japan from a rapid recovery in industrial production. A significant risk of supply chain disruption remains. In the period immediately after the earthquake, there was an inflow of funds into Japan, but this has been followed by a large-scale outflow, leading to increased liquidity and an enhanced risk of inflation for the global economy as a whole.

Commodity prices remain stubbornly high. The price of oil has risen to the highest levels since October 2008; the NYMEX light, sweet crude oil price had reached USD 113 per barrel by 11th April, while the Brent crude price hit USD 126 per barrel on 8th April. The food price also began to rise again, with corn (maize) reaching a record high of USD 7.83 per bushel on 11th April.

Inflation has continued to worsen. The inflation rate in Mainland China rose from 4.9% in February to 5.4% in March, while in Vietnam inflation reached 14% in March. Brazil, South Korea, Thailand, the Eurozone and even the US all saw a significant rise in the inflation rate. Mainland China, Brazil, India, Thailand, Indonesia, South Korea and the Eurozone have raised interest rates this year in an effort to curb inflation. Brazil’s interest rates have been even raised to 12%. The worsening of inflationary pressure in March makes further interest rate hikes very likely.

Besides raising interest rates, another tool that many emerging economies have adopted in the fight against inflation is to loosen the control of their currencies value against the US Dollar and let them appreciate as a response to rising commodity prices. With the exception of the Japanese Yen, almost all important currencies have risen against the US Dollar, and the US Dollar Index has now fallen to its lowest level in three years. The Australian Dollar and Singaporean Dollar are trading at their highest level ever against the US Dollar.

In addition to the rise of interest rate and loosening their control over exchange rate, reasons for the weak US Dollar include the severity of the fiscal deficit in the US, downgrade of the US sovereign credit rating and market expectation that a rise in US interest rates would not occur in the near future. With hot money flooding into those economies whose currencies have risen against the US dollar, the financial stability of these economies is under threat.

Strong currencies will deteriorate the export competitiveness of many economies, though the exact degree of the impact will depend on exchange rates in each economy’s main competitors. Ireland and the economies of Southern Europe, which are still heavily indebted and are urgently in need of robust economic growth, will find that the appreciation of the Euro is harming their export performance, and is diminishing their ability to repay their debts. The recent decision by
the European Central Bank to raise interest rates has also affected the ability of these economies to renew economic growth and to reduce their indebtedness.

Have the interest rate hikes and currency appreciation policies adopted by economies around the world achieved the desired results? The devaluation of the US Dollar is itself one of the main reasons for rising commodity prices. When developing economies use appreciation of their currencies to bring down the price of imported goods in local currency terms, this will cause the price of commodities (which are usually valued in US Dollars) to rise, thereby offsetting much of the benefit that currency revaluation might have been expected to bring.

Raising interest rate is probably a necessary measure when an economy is experiencing rapid economic growth. It will also help the financial system back to normality, especially in an environment where interest rates had been very low. Appreciation of the currency in response to an inflow of foreign capital lured by rising interest rates is a perfectly normal phenomenon. However, what is definitely not normal is the way that most emerging economies did not see any significant devaluation of their currencies when interest rates were falling previously, but have experienced a pronounced appreciation when interest rates started to rise again. This makes the currencies of many emerging economies rise to a level that threatens to give rise to potentially fatal asset bubbles.

The underlying causes of this complex international situation are the imbalanced growth between economies and the “hot money” that is flooding the global economy. The dramatic economic growth achieved by the emerging economies is one of the key factors behind the recent wave of inflation and rising commodity prices. While the interest rate hikes that economies around the world have been implementing are more or less guaranteed to put the brakes on economic growth, it is less certain whether they will succeed in bringing inflation under control. This is because interest rate rises attract more foreign capital, which offsets the impact the interest rate hikes would otherwise have had in terms of bringing inflation down. This offsetting effect is likely to be especially pronounced this time given the huge quantities of hot money sloshing around the globe.

While the emerging economies’ interest rate hikes may go some way towards counteracting the imbalance in economic growth rates, they will do little to address the hot money problem. Although it now seems improbable that the US will implement a third round of quantitative easing (QE3), the US is also unlikely to raise interest rates in the near future. This means that, although the volume of hot money will not further enormously increase, it will not fall by much either. Another important factor to consider here is the outflow of capital from Japan in the aftermath of the March earthquake; this outflow will have caused the volume of hot money to increase to some extent.

It can be seen from the analysis presented above that the biggest single factor affecting the danger from inflation and the level of exchange rate risk in the coming months will be the volume of hot money in the global economy. At present, it appears that the huge quantities of hot money will cause a continued rise in commodity prices, and a worsening of inflationary pressure, along with a further appreciation of many currencies. All three of these phenomena will be simultaneously affecting the emerging economies and most of the advanced economies as well.
The US

The March unemployment rate fell to 8.8%, the lowest in two years. Approximately 216,000 jobs were added to the economy, offsetting the loss in jobs in the local government sector. Analysts believe that the economy is finally entering the job recovery stage, when the unemployment rate declines rapidly. The jobs report also showed that strong growth in business profits has not yet translated into higher hourly wage growth or increase in hours worked. The fact that incomes have barely kept up with inflation suggests that consumption growth going forward may be muted.

Even with the stronger jobs report, the US has 13.5 million unemployed people, and the percentage that are long-term unemployed, meaning that they have been unemployed for six months or longer, has increased to 45.5% in March, compared to 43.9% in February. If employment continued at the March pace, it would take eight years for the unemployment rate to return to its pre-recession levels of about 5%.

Still the appetite for further monetary policy loosening seems to be declining. With the labor market steadily gaining a firmer footing, the USD 600 billion program of Federal Reserve Treasury bond purchases set to expire in June is unlikely to be renewed. The current debate at the Fed of when to raise rates has only begun to take shape. While some Fed regional governors are now pushing to raise rates sooner than later, the main powers in the Fed, Chairman Bernanke, Vice-Chairman Yellen, and Federal Reserve Bank New York President, Dudley appear in no hurry to raise rates, given the still cloudy employment picture.

Still, the fact that actual inflation in March was 2.7% year-on-year, with “core inflation”—inflation excluding the volatile food and energy components—increasing in recent months from 0.8% in December to 1.1% in March, suggests that there may be an impending inflation surge. Energy prices have skyrocketed, increasing at 15.5% in March from the previous year.

According to the Taylor rule, the recent uptick in core inflation calls for an increase in short-term interest rates of 0.75%. There should be increased pressure for the Fed to increase interest rates. Otherwise, inflation rates may accelerate, and the dollar may plummet further.

Recent trade in futures contracts suggests that traders put a 50% chance that the Fed will raise short-term interest to 0.50% by December.

Borrowing by the US small businesses grew in February from the year before for the 12th straight month, as companies continued to finance the replacement of aging capital equipment. Total investment in the small business sector, a
key driver of employment growth, fell for the second consecutive month, suggesting mixed confidence in the strength of the recovery and an unwillingness to invest in employment expansion. Small businesses, however, seem to be having an easier time servicing their existing loans. Accounts behind 180 days or more or in default and unlikely to be paid fell to 0.75% of total receivables in February, their lowest level in 21 months. Accounts 90 days or more behind payment, or in severe delinquency, fell to 0.69% of total receivables in February, from 1.34% a year ago. Accounts in moderate delinquency, or those behind by 30 days or more, fell to 2.46%, from 4.20% a year ago. Small businesses, thus, appear to be getting their financial houses in order. Small businesses are seen as key to the US economic recovery, since they create most of the new jobs in the US.

Canada

The Canadian economy faces a relatively benign environment. The unemployment rate has been steadily declining and is now 7.8%. The core inflation rate remains below 1%, and economic growth in 2011Q1 is likely to easily top 3%. Given these benign circumstances, the Bank of Canada is likely to continue its tightening stance from its current 1% policy rate. It is likely that the Bank of Canada will raise interest rates by 25 basis points in July, and by December 2011, policy interest rates are forecasted to be at 2%. Since the Canadian economy is so interconnected with the US economy, a stronger US labor picture in the coming months is likely to further strengthen the Canadian economy. (The author is Professor at University of Southern California.)

Northeast Asia

Impact of Japan’s Earthquakes/Tsunami Disaster on Asian Economy and the Lessons to be Learned

Naoyuki Yoshino

On 11th March, 2011, one of the world largest earthquakes/tsunami in the history hit the northeastern part of Japan. The northeastern region of Japan produces only about 8% of Japan’s GDP and shares 18% of agriculture production. At the beginning, the impact of disaster itself looks not so big on overall Japanese economy. However, the nuclear electric power plants in the region, destroyed by the incident, are the main source of electricity supply to the Tokyo area, which is the basis for many parts and equipments producers.

The figure below shows the share of the various sectors in the northeastern part of Japan (white line) and Tokyo/surrounded region in the overall output. The region directly hit by the disaster is very small for its share of production in various sectors. However, the electric power shortage would affect Tokyo and its surrounded region where the electric power was supplied by damaged nuclear power plants.

As for all industries, damaged region only produces about 8%, however the Tokyo/surrounded region produces about 40% of all manufacturing industries. If the power shortage last longer, the entire damage must be very high. Among all sectors, finance and insurance’s share is more than 50%, and precision machinery’s share is above 45%.
In the supply chain of the Asian region, various parts of products are produced in various economies and the final products are assembled in other economy. The products were exported to the US, Europe and other area of the world. However the earthquake disaster forces various companies in Asia to change their suppliers of parts and equipment from Japan to other Asian economies. If the change of purchase of parts/equipment lasts longer, it will make Japanese recovery much slower. Some Japanese companies start to look for their new production basis from other Asian economies after the disaster to keep supply of parts and equipment stable. On the other hand, the disaster also reduces Japanese imports not only from Asia but also from other regions of the world.

What kind of lessons does Japan’s earthquakes/tsunami disaster bring to Asian economy?

(1) To prevent crisis is important, however Asian economies have to prepare for the post crisis responses.

(a) Quick supply of cash to the affected region economies by the Central Bank to secure payment system and transactions.

(b) People in the affected region should be allowed by the regional banks to withdraw their deposits from banks without passbook up to certain amount of money.

(c) Plenty of supply of money to cope with downturn of the economy should be immediately introduced by the Central Bank and the announcement of the Governor and the Prime Minister to secure the payment system and daily transactions are crucially important.

Figure 1: Share of north eastern part of Japan and Tokyo/surrounded region of production

Source, Development Bank of Japan, Monthly Overview, April 2011
(2) Asian economies that are located in a tropical climate will be much easier to absorb solar energy. Solar power is shown as much safer supply of energy than nuclear power. It is suggested to establish special funds that are collected from private investors to loan residents for setting up solar power energy supply. Investors who invested in the funds will receive dividends from the residents who set up their solar power equipment to their houses. The regional funds will be collected not only from their economies but also from outside of the economies. Government will put some capital for the funds and lend the money to those who need to set up solar power energy at their home. The fund can be called “Green” financing.

(3) Disclosure of various information about the incidents such as the leaks of nuclear radiation, how to rebuild the region etc.

(4) Quick policy reaction to construct houses in the region where the people suffer the loss of their homes should be taken as soon as possible. Those who had been directly suffered from earthquakes/tsunami should obtain priority support. Too much reliance on the government support will enlarge government budget deficits and will lead to crowding out effect in the future. Government has to find various measures to collect private sector funds into the recovery projects.

(5) All the procedures and policy reactions after the earthquakes/tsunami disaster should carefully reported, disclosed and should be reviewed for future lessons to Asian economies.

(6) Asian economies have relatively good fiscal condition due to higher growth than some European economies. However, it should prepare for the aging society where huge government spending would be required in the future. Various methods to introduce private sector funds rather than relying only government support must be developed. Huge infrastructure needs in the Asian region can also be constructed by introducing private sector funds.

(7) Investors to the infrastructure funds will be pension funds and insurance companies where the Asian region will be developed to cope with aging population in future. New market for the preparation of after retirement must be ready from now. (The author is Professor of Economics, Keio University.)

Southeast Asia

Vietnamese Economy: Not Just Hot

Zhenya Liu

From the mid-1980s to the early 1990s, East Asian economies were growing so well that in 1993 and 1994 the World Bank and the IMF were calling it the ‘Asian Economic Miracle’. Three years later, it had become the Asian Financial Crisis. This pattern repeated again in 2005 when Goldman-Sachs predicted that Vietnam would be the 17th largest economy by 2025. PricewaterhouseCoopers also forecasted that growth rates would reach 10%, pushing it up to around 70% of the size of the UK economy by 2050. On 24th April 2008, the Economist wrote a report on Vietnam entitled “Vietnam’s Remarkable Recovery”. However, two years later history repeated itself and this “Vietnam Economic Miracle” broken again.
The most recent development has been the Vietnamese government’s shocking devaluation of its currency by 9.2% on 11th February 2011. This is the fourth time in fourteen months that the currency has depreciated. It was also devalued on 26th November 2009 by 5.4%, 10th February 2010 by 3% and 17th August 2010 by 2.9%. This depreciation may help exports in the short run but it will also create inflationary pressure in an economy that is already suffering from inflation of 12.2% year on year. Of course, this inflationary pressure has been caused not just by currency depreciation, but also by food price increases and a fast increase in domestic demand due to rapid economic growth.

Vietnam’s external sector has a huge trade deficit; in 2010 it was USD 12.4 billion, around 12% of GDP. Exports are mainly processed sea food and rice. Import levels are extremely high in recent years, at almost USD 79.4 billion in 2008. The main imports are machinery, petroleum and fertilizer which act as a reinforcement to their growing agricultural export sector. There is a large capital outflow, around 5.6% of GDP. Due to their fixed exchange rate system, there has been the need to use foreign currency reserve which has now been depleted.

In the business sector, the credit market is growing too fast; in 2010 it was over 25% which is far too high for the economy. The majority of this credit goes to state owned enterprises (SOE), such as ship manufacturers and telecommunications, which tend to be highly inefficient. The giant SOE Vinashin, a ship-building firm, declared bankruptcy in 2010 with a debt burden of USD 4.5 billion which was left to the government to handle.

The Vietnamese business sector which is dominated by SOEs needs a massive overhaul to increase efficiency. The SOEs receive the majority of all foreign direct investment (FDI), which causes small private firms to suffer from lack of investment. Corruption and bureaucracy also plague the system with inefficiency, slowing down possible improvements.

In the government sector, the public debt to GDP ratio is over 50% of GDP while the fiscal deficit in 2010 was 7.4% of GDP.

It is time for the government to find creative solutions to solve the problems of excess cash liquidity and rising inflation. The policy package could include:

Disciplined government spending in order to control the deficit.

- A need for optimisation and prioritisation of public funded projects will reduce unnecessary spending. A revision of previous proposals will ensure that money and time are not wasted on any projects. There is a risk of overheating the economy with the current excess spending in all sectors.

- Controlled credit growth and money supply to improve the efficiency of bank loans.

- SOE reforms – possibility of conversion into public listed companies to avoid further inefficiencies that could occur in fully privatised companies.

- Export structure reforms.

- Optimisation of imports – minimising unnecessary imports to reduce trade deficit.

- Monitoring capital inflow and controlling capital outflow – to adjust the exchange rate, possibly resulting in a change of the system from fixed to floating.

- Anti-corruption and bureaucracy – minimising the lag between suggestions from planning to completion of a project or policy.

Of course I do not think the Vietnamese economy will collapse, but it is most certainly time for the government to think about how they can solve their problems. The government plays an important role in the economy and I hope they will be able to control the situation. Although the Asian Development Bank and the Vietnamese government have signed a USD 630 million financing facility to ease and accelerate the nation’s efforts for SOE reforms, there is further work to be done.

Privatisation or equalisation as it is known in Vietnam has been on the increase since 1989.
Regional Reports

South Pacific (India, Australia, New Zealand)

Natural Disaster Recovery in Sight While Inflation Causes Concern

Kenneth Waller

Australia

Australian Treasurer Wayne Swan is likely to announce a reduced growth forecast of just 2.25% in the May budget. This compares to the November 2010 forecast of 3.25%. Growth will decline as the Queensland flood crisis, Cyclone Yasi, and the Japanese tsunami and nuclear crisis have damaged Australia’s short-term prospects. However, growth will be sustained by mining and other private investments pouring into the economy. Australia is experiencing an historic investment boom and surging commodities prices creating economic conditions the government is likening to a gold rush. Terms of trade are at a 60-year high as Chinese and Indian demand for iron ore and coal surges. Nonetheless, tough budget is foreshadowed with significant spending cuts aimed at returning the budget to surplus by 2012-13.

The Australian Dollar is trading around USD 105 cents, and touched a 29-year peak of USD 105.81 cents in early April. The official view is that the strong Australian dollar is a net positive for the economy, although it has varying implications across different business sectors with the Treasurer conceding it has put sectors such as tourism and the export of educational services under strain.

Manufacturing companies generally have been adversely impacted. However, a Westpac Bank survey shows that consumer confidence is high and that people are optimistic on the economy for the year ahead. There has also been a surprise jump in business confidence with NAB business index at its highest level this year.

The government announced that Australia’s new carbon tax will be implemented from 1st July 2012 and that half of the tax will be returned to low and middle income households and trade exposed industries as compensation. The tax has been criticised with industry opinion split largely along the lines of manufacturers, exporters and the services sector. The carbon tax will transition after three to five years to a “cap and trade” emissions trading scheme that will be linked to international carbon markets.

The CPI is forecast to increase 3% this year and in 2012, the top of the central bank’s target range of 2-3%. Traders see a 26% chance that the RBA will raise interest rates in September based on bank bill futures trading. Australia’s jobless rate was down to 4.9% in March, matching a two-year low set in December and approaching what government officials view as full employment.

Vietnam’s Gini Coefficient was 0.37. It has now risen to over 0.4. It is most important that the government considers social implications of any and all economic policies. (The author is Professor at Renmin University of China, Beijing and The University of Birmingham, UK)
New Zealand

After pessimism from an NZIER survey released in late March regarding the costs to New Zealand’s recent natural disasters, estimates of the overall costs and economic outlook for New Zealand have improved. Official estimates of the costs for the Christchurch earthquake are now being set at USD 8.5 billion, down from early figures of up to USD 15 billion.

However, the IMF lowered its growth forecast, predicting economic activity would slow to 0.9% this year, compared with a 1.5% growth for 2010. This is a significant cut to the 3% earlier forecast. On a positive note the IMF notes that reconstruction efforts would fire the New Zealand economy next year, with GDP growth likely to rise to 4.1% in 2012. The Rugby World Cup later this year and increased trade should also help bolster growth.

The New Zealand government has rejected key recommendations of the IMF to make up for revenue shortfall through capital-gains and land taxes, citing instead a strategy based on spending cuts. The return to budget surplus has been delayed to 2015-16.

The IMF forecasts that the current account deficit will fall to 0.2% of GDP from 2.2% in 2010, and then widen to 4.4%.

A number of tax and recovery initiatives have been announced to assist businesses in quake affected areas. They include a USD 6.85 million package allocating money for business recovery coordinators, international visits for exporters, a trust fund for those in need following the quakes, and more money for workshops and business training. The Government has also announced proposed tax changes aimed at providing relief for quake-hit Christchurch businesses. Cabinet agreed on 11th April to three proposed changes in the rules for the tax treatment of depreciation, specifically around rollover relief, timing of deemed sales of destroyed insured assets, and losses on buildings.

In further positive news, the NZD hit a two-month high in April of USD 78.3 cents, reflecting rising terms of trade. The strong NZD and rising commodity prices have mixed impacts on the economy. The RBNZ is concerned about medium term inflation, even though the official cash rate was cut 50 basis points last month to 2.5% to help boost the economy, and this occurred despite a jump in the annual inflation rate to 4% in December on the back of a rise in GST and other price pressures. Inflation is forecast to rise to 4.1% in 2011 before easing to 2.7% in 2012. Unemployment is forecast to fall from 6.7% to 6.2%.

The upcoming budget will seek to assure credit rating agencies that a downgrade is unnecessary following Standard & Poor's revised outlook of New Zealand's credit rating to negative from stable last November. The budget will prepare for a withdrawal of stimulus measures put in place during its worst recession in almost two decades. The focus of the May budget will be on savings, investment and rebuilding Christchurch.

The New Zealand Overseas Investment Office is taking legal advice as it considers what to do about four North Island dairy farms bought illegally by a May Wang-linked company. Late last year, an application for retrospective consent for the purchase of four Crafar farms by UBNZ Funds and UBNZ Assets, was declined by the government after Ms Wang was declared bankrupt. UBNZ had bought the properties in February without applying for OIO approval. The OIO is seeking legal advice before deciding what action to take. Chinese company Shanghai Pengxin is expected to file its application to buy the Crafar family farms with the Overseas Investment Office (OIO) this week.

In a recent visit by EU Trade Commissioner Karel de Gucht, he stated that talks of an EU-NZ free trade agreement were premature.

India

Inflation in the year to end March accelerated to 8.98% exceeding the RBI forecast of 8% compared with 8.31% year end February. Higher fuel and manufactured product prices have been blamed for the rise and core inflation is at 29-month high. An RBI survey has shown that inflation is of great concern to households with the survey suggesting inflation could reach to over 12%,
mainly influenced by movements in food prices. On a positive note the Regus Business Confidence Index points to a buoyant business outlook and the IMF has advised that these levels of inflation are to be expected given the high growth India has been experiencing of above 8%. The Fund forecasts growth at 8.25% in 2011 and 7.75% in 2012.

Further interest rates rises are in prospect. Already the RBI has lifted rates eight times since early 2010. A rise of at least 25 basis points is expected when the annual monetary policy statement is to be unveiled on 3rd May.

The Indian Commission for Agricultural Costs and Prices has stated that India can easily export 3-4 million tons of wheat to obtain the benefit of higher global prices.

Bilateral trade between India and Japan is expected to decline in the first quarter due to the earthquake and tsunami in Japan. However, the trade target between the two economies of USD 12.5 billion is like to be achieved due to healthy growth registered in the first six months of 2010-11.

The BRIC economies meeting this month agreed to oppose increased trade protectionism and to coordinate their positions and to uphold the interests of developing economies. This follows calls from US trade officials for the group to recognize their capacity as exporters and to open markets and support the Doha round of WTO negotiations.

Officials have stated that due to the recent success of the talks in Brussels the India-European Union free trade agreement has a strong chance of being finalized by July 2011. (The author is Director of Australian APEC Study Centre at RMIT University.)

**Latin America**

**Assessing External Vulnerability**

*Cheng-Mount Cheng*

The global economy has faced more uncertainty in 2011 than 2010 due to so many disruptive things that ranged from the political uprisings of North Africa and the Middle East (MENA) to the natural disasters in Chile, New Zealand, Australia, and most recently Japan. Crude oil prices once again rise to near-record high, while food inflation continues to climb. Mainland China policymakers are aggressively trying to cool off their overheated economy by controlling credit growth. Those factors pose a threat to exporters in the world. Not to mention that sovereign debt problems in European peripheral economies are lingering and monetary policy in the US appears to be in a turning point.

Despite these negative developments, Latin American economies are in general able to remain on solid footing, thanks to their strong fundamentals, and have not experienced a significant reversal in capital inflow. It appears that the financial markets in Latam as a whole have decoupled from the rest of the world, at least for now. The rationale could be that while global investor’s appetite are turning more risk averse, the risk perception or evaluation imbedded in Latam
assets is actually improving in recent years. Thus investors regarded financial markets in Latam as a safer place to invest, compared to the past history.

Recently there is a study by Citigroup\(^1\) trying to explore the degree of vulnerability of Latam economies to external shocks. The study looks at the history data to estimate what percentage of the variability of economic activity, inflation, the real exchange rate, and the trade balance is explained by external shocks. Starting with economic activity, the external shocks being considered are changes in OECD growth, the price of oil, the terms of trade, LIBOR as a measure of international liquidity, and the VIX as an estimate of market sentiment towards risk.

The result suggests that OECD growth, oil prices, and LIBOR have more explanatory power than the VIX and the terms of trade. The study also suggests that the least vulnerable economy in Latam, despite being the most open one, is Chile, where external shocks explain 35\% of GDP growth variability. On the other hand, Mexico seems to be most vulnerable, with 82\% of GDP growth change explained by external shocks. The reason behind this result could be that Chile is a freer, more competitive, and micro-economically more efficient economy than Mexico.

With respect to inflation, the results show that this is mainly a domestic phenomenon. External shocks are able to explain between 6\% to 30\% of the inflation variability depending on the economy. International food prices appear to be a significant factor in Argentina while FX seems to be an important variable in Brazil and oil prices play a decisive role in Chile, Colombia and Peru. In Brazil and Venezuela, inflation is less likely affected by external shocks while Colombia is relatively vulnerable.

Finally the tests on trade balance and real exchange rate show that in Colombia, Mexico, and Venezuela external shocks account for more than 50\% of the variability of both trade balance and real exchange rate, making them more vulnerable than the other economies in the sample. Given the importance of oil shocks, the study goes further to see how large the elasticity of oil trade balance were with respect to the oil price to evaluate the direct impact of oil price change on real income. The result shows that 10\% increase in the dollar price of oil increases GDP by 1.25\% in Venezuela and decreases it by 0.08\% and 0.06\% in Chile and Peru respectively. If we also consider the indirect effects, the impact will become even larger. Obviously, rising oil prices will have a positive effect for net oil exporters, particular Venezuela, and a negative impact on net oil importers, namely, Chile and Peru.

To conclude, this empirical study suggests that external shocks to Latam economies account for a large percentage of short-term fluctuations in macroeconomic performance. Especially for real growth, real exchange rate, and current account, they are critically affected by global growth, term of trade, financial conditions, and oil prices. On the other hand, inflation is more exclusively determined by idiosyncratic factors in each Latam economy. If the Latam economies are still linked closely with the global economy, it would be interesting to see how long Latam financial market performance can continue to decouple from the rest of the world. (The author is Vice President, Citi Taiwan.)

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\(^1\) *Latin America Macro and Strategy Outlook, Citigroup, 25\(^{th}\) March 2011.*
During the month under review, events in Libya seemed to spin increasingly out of control, with EU economies finding it difficult to build agreement amongst themselves about how best to proceed, or to find effective common ground with NATO and Arab economies. The African Union also made a fruitless attempt to mediate and to start negotiations. Continuing uncertainty throughout the Middle East, particularly in Libya, Yemen, Syria and Bahrain, has also raised concerns about longer term migration flows and the effect on oil and energy prices in general – both of which could be destabilising for the EU political, social and economic system.

On the economic front, several ongoing developments have become increasingly worrying with unclear implications. Firstly, the debt crises in Portugal, Greece and Ireland have each required EU bailouts, and the fear is that these measures will not work unless accompanied by other policies to consolidate national finances.

Political signs from these economies – led by the election results in Ireland and the parliamentary vote in Portugal - indicate that political leaders lack the political authority to take tough policy decisions that could lead to an increase in unemployment or a reduction in government spending, or both, even if these measures are the only options available.

At the same time, there is now greater evidence that other EU member economies are looking to severely cut government spending and increase taxes in order to bring debt levels down – thus suggesting that a multi-speed recovery may emerge over time. This in time will complicate the work of the European Central Bank (ECB), together with efforts at policy coordination in other areas.

Taken together with significant reductions in personal and corporate debt levels, demand in EU economies over the past few months has fallen steadily, with reductions in imports from Asia and elsewhere beginning to show through. Energy and commodity imports count increasingly for a larger and larger share of imports, which itself poses a danger if these are inflationary.

The ECB also signalled its concerns with emerging inflation trends, and have raised their basic rate. In itself, this is a minor movement but could signal a longer term strategy of central banks around the world to raise rates in a coordinated strategy to deal with inflation. Indeed, inflation concerns fed by sharp increases in commodity and energy prices are beginning to focus the minds of policy makers throughout the world, with some talk of a return to normal central banking – that is where central banks concentrate on inflation control to the exclusion of almost everything else.

In analysing this emerging scenario, some analysts are drawing parallels with the 1970s during which recession, high inflation and high unemployment combined to sink much of the global economy into a decade of stagflation. According to some commentators, the global economy is just one crisis - possibly commodity or energy price increases - away from a major recession.

The month under review also saw efforts to redesign the stress tests for banks in the EU, which were thought to have largely failed in their earlier
attempts to gauge the vulnerability of individual banks. The new tests are likely to lead to more stringent compliance requirements, which will increase costs within banks. The effect will be to reduce or restrict banking activity further while these institutions consolidate and rebuild – or are rescued - where necessary.

The hope for Europe’s long term recovery is that demand from Asia and emerging markets will induce the growth process within the EU (based on exports). Their fear is however that high demand in these very economies will lead to a surge in imported inflation, which will harm European competitiveness. Demand from the US is expected to remain low for the foreseeable future, making that option unattractive. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.)

**East Europe**

**Volatile Markets, Inflation, Declining Sentiment, East Europe on Crossroad**

*Kuo-Yuan Liang*

At roughly one month after the Japan earthquake, the nuclear threat from the Fukushima power plant remains unsolved. Coupled by the persisting unrest in North Africa and the Middle East, the global economy and financial markets continue to react to the arising changes and challenges. In terms of the East Europe region, we have observed several trends, including volatile equity markets, exchange rate appreciation, and a dampening economic outlook. Moreover, the actual effect from the devastating earthquake remains hard to gauge. As new information and data are collected, it will need to be carefully examined. Based on current data, it appears there will be temporary negative effects on the economic sentiment, and the severity of its impact on the global consumption demand will come later, which can only be assessed by then.

**Inflationary pressure must be lifted soon, before weakened sentiment changes behavior**

The soaring oil prices have caused escalating inflationary pressure in most parts of the world. The upward trend in the oil, commodity and currency price started around September 2010, when the Fed announced its asset purchasing program, known as the QE2 by markets. At that time, as the economic growth momentum had just shifted to a higher gear in the US, the key obstacle was that the international financial market was more volatile as international capital were scrambling for investment and speculative destinations for hedging purposes.

The currency appreciation of the seriously indebted and economically weak Euro was clear evidence that the observed trend in recent months was not based on fundamentals. During the start of 2011, inflation though higher than previous levels, was still under control. But as the US economy took a faster pace, and the unrest in the Middle East intensified, where civil war erupted in Libya in February, oil prices started to surge much faster than what could be offset by the currency
appreciation. This caused inflationary pressure to escalate beyond endurance, notably exhibited by the ECB rate rise, despite the Eurozone’s moderate economic growth and high debt.

As the pace of inflation picked up, there were signs that it may hurt, or to a lesser extent, weigh on the global recovery. For instance, as the oil and gold price rose sharply over the past few months amid escalating inflation, copper, among other non-precious metals for industrial purposes, did not share the same strong upward trend, indicating a possible slump in real demand. Currently, it remains to be seen whether the rising inflation has actually hurt the economy, and if so, will it be strong enough to hamper the momentum of recovery. The economic signals we have now are mostly financial market price quotes and economic sentiment reports, which can only delineate a temporary market trend. Nevertheless, if inflation does not sharply come down soon, these leading information indicators could change the behavior of individuals and firms, and thereby trigger a reversal in the current global economic recovery.

**ESIs in East Europe fall sharply due likely to inflation or earthquake impact or both**

By looking at the ESI report of March, as before, we found that the economies have a sharp contrast between the different sectors. In terms of the EU 27 as a whole, the industrial and service confidence is still rising (albeit at a slower pace), while consumer and retail trade confidence both fell.

But when we observe the major East Europe economies, namely Poland, Czech, and Hungary, not only did retail trade and consumer confidence drop significantly, so did the industrial and service confidence (except for Czech service and Poland retail trade), evidently different from the overall picture. In terms of the varying components, the majority of them declined, excluding those representing inflation and prices. The decline stems either from the earthquake or inflation impacts or both. Temporary declines in the sentiment are not that uncommon, and it also takes time to actually shape and change the behavior of firms and consumers.

Before the weakening sentiment begins to alter the behavior of consumers and enterprises, we earnestly hope to see the earthquake worries cleared, and the oil price and speculative capital retreat, before growth momentum is lost. We will need to keep a close eye for any signs that might indicate that the economy is really starting to being affected. (The author is President of Polaris Research Institute & Honorary Professor, College of Technology Management, National Tsing Hua University.)
The economy of Russia is being influenced by the rising international raw material price, both positively and negatively. On the one hand, as a major exporter of energy in addition to the Organization of Petroleum Exporting Countries (OPEC), Russia has enjoyed the benefits brought by the sharp growth in oil price resulting from the tensions in the Middle East and North Africa, benefits that can be most obviously seen in its exports in the first season. Crude oil produced by Russia in this season costs USD 102.57 /barrel in average in the international energy market, not only by far higher than the actual price of USD 75.2 /barrel in the same period last year but also higher than what the Financial Ministry of Russia expected for the medium-term—USD 81 /barrel—when they were planning the budgets for 2011.

As Russia’s export price of oil has almost reached the highest point in three years, the federal financial situation of the economy this year may be better than that when the budgets were planned. Previously the deficit is estimated to be about 3.6% of the GDP, but now it seems very likely to turn into surplus based on the current trend of oil price, without any additional budgets allocated by the government. In addition to the likelihood of financial surplus, Russia has another positive prospect: its foreign reserves are increasing rapidly, with more than USD 500 billion by the end of April, close to the highest level prior to the financial tsunami.

Improvement in financial revenues and increase in foreign reserves, however, does not necessarily mean a better economic condition in the private sector; in reality, the increase in the international raw material prices has also been a great challenge to Russia’s industrial and living costs. Firstly, the domestic retail price of oil has risen with the international trend. Besides, under the influence of the drought last year, the increase in agricultural product price has led to an increase in food price: the Consumer Price Index (CPI) from February to March is more than 9% higher than the same period last year.

Now the Russian government is attempting to mitigate the food price by providing the market with its food stocks and raising the market interests rate by 0.25%. Some research institutes also point out, nonetheless, that since the food supply in the market may overpass the demand soon and the measures for mitigating food price may be ceased, they will not help reduce the inflation pressure of Russia in the medium and long terms. The fundamental question, after all, still lies in how Russia can fulfill a more diversified industrial structure, in which there will be less dependence on import and hence less risks of imported inflation.

As to the situations in the Middle East and North Africa, we keep giving high-risk warnings with regard to the economic prospects of these regions. With observations of indicators which reflect economic activities, the labor market—a lagging indicator—has changed prominently. Ever since the situations worsened in Libya, many foreign workers have actively left the economy.

According to the UN, about 213,000 foreigners had left Libya by the first week of April. If the turmoil goes on in the Middle East and North Africa, there will be more foreign workers forced to leave the regions for their home economies, which will have a great impact on the economic
performance of those economies that heavily rely on labors working overseas for remittances, such as the Philippines, Nepal, Bengal, Sri Lanka, etc. To take the Philippines as example, it is conservatively estimated that there are around more than three million Filipino people working in the Middle East and North Africa, which is about 30% of the total amount of the economy’s overseas workers, eleven million. In 2010, the remittances sent back by all overseas Filipino workers reached about USD 18.76 billion in total, about 10% of the GDP. It is necessary, therefore, to keep an eye on how the Southeast Asian APEC members would be impacted once the situations worsen in the Middle East and North Africa. (The author is Vice President, Taiwan Institute of Economic Research.)

Global Commodity Market

Higher raw material prices will deteriorate demand into the year-end

Hwa-Nyeon Kim

In the last one month period (mid-March to mid-April in 2011), there have been persistent warning signs of a crisis in the global commodity market. Although commodity price indices have shown slight downward trends from early April, crude oil prices broke this year’s high again on the back of ongoing uncertainty in the Middle East and North Africa (MENA). Brent crude oil prices increased to above USD120 /barrel and Dubai prices reached almost USD 120 /barrel. If there is a commodity which should be mentioned this month, it is definitely gold. Gold prices set fresh all-time highs as US credit rating company, S&P, revised the US credit rating outlook to a negative. Gold prices closed at a historical high of about USD 1,500 /oz, while silver prices recorded a thirty-one year high of USD 43 /oz in mid-April. The reasons for the skyrocketing gold prices are: 1) rising geopolitical tensions across the MENA region, 2) some uncertainties regarding Japan’s nuclear disaster, 3) the possibility of higher inflation, 4) a weaker US dollar, and 5) the reoccurring European sovereign debt risk. These five factors all worked to increase investors’ preference for safer assets, and as gold is regarded as the safest asset, gold prices inevitably shot up.

Again, crude oil prices gained much attention during the last month period on fears that the disruptions in Libya’s supply will continue. Besides the Libyan situation, the struggle in the Middle East took a turn for the worse, providing further supply outages. There have been little signs of improvement in Yemen, while the situation in Bahrain is no where near finding a solution. Based on the current situation of rapidly expanding oil demand and ongoing disruptions in Libya’s production, the Bank of America forecast the Brent crude oil price to average USD 122 /barrel in the second quarter of 2011, also believing that prices could break past the USD 140 /barrel mark in the next three months.

The top two commodity indices, the CRB spot Index and LME non-ferrous index, have shown slightly different performances from mid-March to mid-April. The CRB spot index (year 1967=100) moved up from 550 to 580 and the LME index (April 1999=1,000) from 4,118 to 4,469. The average for the CRB index from mid-March to mid-April increased 1.4%, while that for the LME index decreased 0.2%. Despite the increase in the CRB index, such changes are much
smaller than those of the previous month. This implies that upward trends and steep slopes within the commodity indices are weakening. In terms of price variations, the daily price changes in the LME index were less than those seen during the mid-February to mid-March period, indicating a decrease in investment risk in commodities.

As for energy prices, the WTI near month futures price moved within the range of 97.98 and USD 112.79 /barrel and Dubai crude prices between USD 104.19 and 118.32 /barrel during the same period. Both the minimum and maximum values of the crude oil prices were larger than those during the mid-February to mid-March period.

Among non-ferrous metals, or more commonly known as base metals, lead and aluminum prices rose the most following the previous period, with the average price of lead and aluminum rising 7.6% and 2.7%, respectively. Among base metals, lead has become increasingly bullish, as the world’s largest lead producing mine has just been closed and demand for lead is considerably strong. For these reasons, Barclays Capital revised the 2011 forecast for lead prices to be 9% at USD 2,826 /ton. Tin prices also showed rising price patterns. However, the prices of copper, nickel and zinc revealed decreasing variations.

The higher prices will gradually have a negative impact on oil demand by the end of the year. Certain aspects of weakening oil demand are emerging on the back of the sharp increase in raw material prices. Given the considerable jump in prices, it is hard to argue that demand in the emerging economies will continue to expand at such a fast pace. Among certain industries, the airline and shipping sector are most affected by the high oil prices. Because of the possibility of a slowdown in demand caused by high raw material prices, prices could drop even more sharply than expected into the year-end.

Therefore, SMEs in resource importing economies will face lower raw material costs but simultaneously see a weakening global economy at the end of the year. The former may be good news, however, the latter will not be good for SMEs. (The author is Research Fellow, Samsung Economic Research Institute.)

<Table> Changes in Raw Material Prices - 16th February to 15th April 2011

<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>CRB</td>
<td>LME</td>
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<tr>
<td>Min</td>
<td>550</td>
<td>4,118</td>
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<tr>
<td>Max</td>
<td>580</td>
<td>4,469</td>
</tr>
<tr>
<td>Average</td>
<td>571</td>
<td>4,304</td>
</tr>
<tr>
<td>Last Month Average</td>
<td>563</td>
<td>4,313</td>
</tr>
</tbody>
</table>

Note:
1. The 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.
How can a SME reduce operational risks by interpreting macroeconomic indicators? On the Use of Important Indicators

Ming-Hsin Kung

Extending the specific subject of the CM Knowledge for the SMEs in our October issue, 2010, this present issue demonstrates how the SMEs can judge the trend of business cycle by interpreting important macroeconomic indicators, so as to reduce their operational risks. As we point out in the introduction of our last issue, since the SMEs are smaller in their individual size and have a more focused range of products and services, among all the business cycle indicators it would be helpful enough for them to select only those indicators of supply and demand related to its own industry—such as the industrial production index of upstream and downstream industries, sales index, price index, which can be considered alongside with domestic interest rates, quantity of currency supply, foreign exchange rates, and the macro-economy and indicators related to supply and demand in the industry of the target market. A consideration and interpretation of these indicators will shed light to the business cycle trend of that industry in general.

From the aspect of economic analysis, what we should comprehend first is the changes in external conditions that are beyond SMEs control and the second would be the internal conditions. Presumably the market structures faced by the SMEs mostly belong to either perfect or imperfect competition markets, in which an individual SME could not affect the market supply and price. As to the use of important indicators, therefore, we need to first understand demand and supply of the industry, the trend of price, the macro-economics of the economies where the upstream suppliers and downstream buyers come from, and after that, the company’s plans for production and marketing based on price signals.

Here we would like to use a case of the supply chain centered on an international business to explain the logic in the use of the important indicators. The decision maker in this case is a television set producer, whose main business is to sell LCD TV set to the US markets and whose upstream suppliers come from Japan. What matters most for this company is to have the indicators relevant to both the price trend of LCD TV set in the US and the price trend of upstream source materials in Japan. Through such indicators the company can decide its own strategies for business operation.

As far as the price trend in the downstream markets is concerned, we can first observe the composite leading indicators of the target markets. The kind of indicators usually consists of not only those indicator groups that represent the trend of market demands, such as orders of consumption goods and capital goods, consumers’ confidence
index, and stock price index, etc., but also the indicators that reflect the trend on the cost side, such as the interest rates.

Indicators as such can serve as an important signal for a company to decide whether the economic situation changes in its downstream target markets. When the leading indicators keep rising, with the sales indicator of the target market keeping growing in that certain period and its stock indicator remaining steady, it means the prospects of demands of this market are stable and optimistic (a situation of more supply than demand). Under this circumstance, the market price signal is stable, and a SME can increase production appropriately within its market share.

At present the market leading indicators more commonly used in the international sphere are the Composite Leading Indicators (CLIs), announced by the Organization of Economic Co-operation and Development (OECD), and other leading indicators announced by major economies.

In addition, the target market’s sales indicator for the period and its indicators related to production and import also provide important information about the market price trend. In the above-mentioned case of LCD TV set, the indicators that reflect retailer sales conditions (excluding car sale) in the US play an important part in deciding the demands for the period. If the sales and stock figures of the primary channels of consumer electronics are also taken into consideration, SMEs can obtain better understanding of the possible changes in prices and economic situations in the future.

As to some product items that are also produced in the US, the ISM manufacturing production index is also an important indicator to decide the relative conditions of demand and supply in the market. Since the demands for the products of non-manufacturing industries often complement the ones of downstream manufacturing products, the ISM non-manufacturing production index can also serve as a supplementary indicator for assessing the market demands of the period.

With regard to the indicators related to upstream suppliers, which will influence the company’s cost side, the tendency concerning future supplies can be predicted through the surveyed indicators on business confidence. Also, orders of durable goods can also be used to judge whether the supply capacity of the economy’s companies will change in the medium and long term.

Under the circumstances that the changes in production index have a similar range with those in sales index, and that the stock index remains stable, the short-term tendency of the upstream supply prices are relatively stable. Once the production index becomes more and more decoupled from the sales index and changes can be seen in the stock index, on the other hand, it means the price in the upstream supplying market will change. Together with a consideration of the changes in the capital expense of that industry, we can take a step a further to judge the price trend in the medium and long term, which can serve as part of the decision on the cost side of the company in need of that upstream source materials. (The author is Vice President, Taiwan Institute of Economic Research.)
Facing the dramatic changes in the environment, perilous financial situation, and the disadvantage that Chinese Taipei has higher cost production than Mainland China, Taiwan Mirror Glass Enterprise (TMG) took the lead in integrating those glass processing factories that were unwilling to move to Mainland China, made full use of the effect of industrial clusters, reversed the industrial inferiority by the group power and overcome the crisis. Then, “Team Taiwan Glass” was gestated. Jackson Lin, General Manager of TMG, mocks the successful establishment and operation of the cluster as Chinese Taipei slang—“Gods designate me as the incense head, and it is my duty to treat everyone.” The general manager holds the great spirit that assisting others in achieving their goals is the same to accomplish his own, and he also possesses the macro-thinking and foresight. Lin leads “Team Taiwan Glass” to success.

Crisis becomes a turning point: Create the greatest opportunity for the glass industry

GM Lin considers that the biggest crisis of Chinese Taipei glass industry happened 15 years ago when many industries migrated to Mainland China. At that time, Chinese Taipei’s glass industry encountered bottleneck due to competition, and many industries migrated to Mainland China to set up factories. Confronting the crisis of the migration of upstream manufacturers, TMG coped with it by adopting the thinking of “cultivating localization in Chinese Taipei while promoting globalization.”

GM Lin regards the industry migration as natural phenomena and chooses to strengthen the depth and breadth of the business strategies. When a large number of industries moved to Mainland China, TMG adopted the strategy of promoting
strategic alliance and implemented the resource integration and the division of labor by the effect of industry cluster in order to get a foothold in Chinese Taipei. “We gathered together for warmth instead of moving to Mainland China.” The functions of the cluster alliance are to exhibit, produce and market jointly through collaboration and resource sharing.

The power of network: Reinforce the competitive advantages of the cluster

“The competitive advantages of a cluster, generated by various networks in the cluster, help an industry overcome the interior inertia and deadlocks to advance the upgrade of an industry.”

The cluster established by TMG divides into three networks. The first nucleus is the territory within an hour driving distance from Chang Hua Coastal Industrial Park, and the area from Chiayi to Hsinchu is the second nucleus. In addition, the third nucleus includes Northern Chinese Taipei (Taipei, New Taipei City and Keelung) and Southern Chinese Taipei (Kaohsiung City and Pintung County). There are more than 2,000 manufacturers in the cluster so far.

The factories and stores in the cluster of the glass industry led by TMG have good relationship and cooperate intimately with each other. According to the experience of TMG, the clustering benefit can save many tangible and intangible trading costs, enhance the international competitiveness, and help the company successfully avoid the financial crisis caused by the financial globalization.

Facing global competition: Build a Chinese Taipei’s brand

“That tulip is to the Netherlands as New Zealand is well known for kiwi fruit. People only know their places, not their brands.”

Having been engaged in glass industry for a long time, GM Lin has found that the glass industry in Chinese Taipei has the world's highest density. If manufacturers can work together with collective wisdom and concerted efforts, they must develop the strongest strength, find the advantages and create a Chinese Taipei’s brand jointly. GM Lin mentions the goal of “Team Taiwan Glass” is to set up a brand and to create the image that Chinese Taipei is the place selling the best glass in the world. Moreover, building a brand image is a choice to relieve the pressure of the financial crisis and mitigate the impact of global economic fluctuations.

Interaction in the Cluster and Leaders’ Magnanimity

Although clustered firms have their own clients, they cooperate with each other. It equates to take orders severally but serve jointly, including setting the joint display space, using machinery together, staff support and sharing the storehouses, etc. For example, the company who has the best capacity of packaging in the cluster can move the capacity to other clustered firms when it has fewer orders. Thus, it can not only apportion the expense, but also improve the production of the cluster.

In order to provide the common display space for clustered manufacturers, TMG has set up “Taiwan Glass Gallery” in its factory area, where it exhibits the products of the clustered manufacturers by turns and has large scale activities held by the clustered firms on traditional festivals every year. This is a successful model of the joint marketing.

This pattern seems simple, but the success of the execution depends on the leaders’ magnanimity and the ability of planning and management. Differing from general clusters, when facing a crisis, TMG never transfers the risk onto other small scale manufacturers and makes subcontractors close down. Instead, the aim of “Team Taiwan Glass” is to cooperate and support each other. There are six elements managed by TMG, the leader of the cluster, to support the object: the sufficiency in raw materials, the order sharing with clustered firms, the equipment and capacity sharing, the passive loans offered by TMG, the flexible stock and the professional service.

TMG always prepares sufficient raw materials that can be provided to the production line for three months when the suppliers are out of stock. Also, it adjusts its operating ratio for the team’s demand and different situations, and shifts orders to some
manufacturers to survive the crises. When other manufacturers need facilities, TMG lends them to the companies who have orders and offers fair treatment to amortize debts. It also lends its storage space unconditionally to manufacturers who need it.

Furthermore, TMG provides clustered manufacturers with the passive loans without condition in order to purchase the equipment that the cluster lacks. As for the administrative problems relating to the government that the clustered firms may confront, TMG has professionals to assist them in solving this kind of problem.

The above content shows that TMG leads the cluster with selfless devotion. It is the key for “Team Taiwan Glass” to stand firm in the environment which the industrial cluster policy prevails and to have manufacturers willingly make progress together.
The US credit rating outlook downgraded for the first time in 70 Years

On 18th April, Standard & Poor’s Ratings Services (S&P), for the first time in 70 years, downgraded the US long-term AAA and short-term A-1 sovereign ratings from “Stable” to “Negative,” indicating in the next 6-12 months, S&P is likely to cut US sovereign rating. Meanwhile, the possibility of downgrading US long-term credit rating is 33%. The reason of S&P’s downgrade is because in April, the amount of US public debt reached the debt ceiling of USD 14.29 trillion set by the Congress. Budget deficits will increase to USD 1.5 trillion. Between 2003 and 2008, the percentage of US budget deficits as of GDP was 2% to 5%. In 2009, however, the ratio had gone up to 11%, a number which has exceeded that of most economies with AAA sovereign credit rating.

Currently, Mainland China is the largest owner of the US Treasury bonds, holding USD 1.154 trillion in February. The second largest creditor is Japan, who has USD 890 billion government debts. In April, the proposal of establishing broad-based international reserve system had been discussed in BRICS meeting, reflecting the attitude towards the US. As a member of BRICS, Mainland China argued that if dollar-based foreign reserves decrease, the dollar will depreciate. However, the US Treasury bond is still stable compared with bonds issued by other economies, limiting the chance of large selloff.

The US government has proposed several plans to shrink the deficit/GDP ratio and expect to slash USD 4 trillion of deficits in 12 years. However, the spending cut may make the feeble recovery more vulnerable, which will hurt the global economy. The downgrade of the US credit rating, quantitative easing and loosening interest rates will continue to weaken the greenback. In order to hedge the risks, prices of precious metals such as gold and silver have skyrocketed recently. Furthermore, the weak dollars causes the increase of inflation in the globe.

Portugal asked for bailouts. The contagion of European debt crisis spreading

The Portugal government has officially asked European Union and IMF for bailouts. It hopes that European Financial Stability Facility (EFSF) help pay the matured debts of EUR 4.23 billion in April. Nonetheless, Portugal’s public debts of EUR 4.9 billion will be due in June. Moody’s has already downgraded Portugal’s rating to BAA1 while S&P put its rating in BBB-. As a result, the yields of Portugal’s government bonds are rallying on the downgrade of credit rating.

Although Ireland had obtained the bailout from European Union and IMF in the end of 2010, four Irish banks have yet to pass the stress test and need loans to maintain their solvency, leading to Moody’s downgrade to BAA3, close to junk bond, and negative watch. S&P lowered Ireland’s rating to BB+. Credit rating of Greece, the first periphery economy hit by public debt crisis in Europe, has been downgraded to BB- by S&P. It is highly likely that Greece will call for restructuring to solve its predicament, an action which will make investors suffer substantial losses. Consequently, bond yield of Greece continues to hit new highs.

After Portugal, Spain, the fourth largest economy in terms of GDP, has been seen as the next economy in Europe to apply for bailout. Spain had been downgraded to AA2 by Moody’s, citing its high debt burden. Specifically, the amount of bad debts of 30 small savings banks has recorded 15-year high because of the collapse of housing
The debt crisis is being worsened by the decision of ECB to raise interest rate by 25bps to 1.25% to contain the inflation in Europe. The hike will further deteriorate the ability of economies with heavy debt burden to pay off the debts, and results in the widening of yield spread and the increase of CDS of Greece, Ireland and Portugal, suggesting that those debts will be restructured at the cost of creditors and the auction of government bonds will be affected as well. Although the fund of EFSF is still enough, much higher costs will be paid by EFSF to survive the crisis if Spain also needs bailout.

**G20 meeting discussed trade imbalance again**

In April, meeting of G20 Finance Ministers and Central Bank Governors discussed five major issues: global trade imbalance, reform of international monetary system, stabilization of global commodity prices, enhancement of G20, and strengthening of IMF. Regarding the reform of international monetary system, the meeting’s resolution was to strengthen the coordination of exchange rate and to prevent high volatility. In addition, the scope of SDR is adjusted to enhance the monetary system. Another resolution was to carry out appropriate monitoring in the global commodity spot and futures market and increase the transparency.

In terms of trade imbalance, following the conclusion of the meeting in February, which included public debts, deficits, private debts and savings rate as the indicators of economic imbalance, this meeting proposed the second-stage guidelines of monitoring external imbalance. The bulletin of G20 meeting in Washington D.C. decided to use four models based on the above four indicators to define if there is any imbalance. IMF will apply these indicators to draw an analysis report, which will be submitted to the meeting of G20 Finance Ministers and Central Bank Governors as soon as in October. In the G20 Summit of November, IMF will recommend an improvement plan and preventive measures to formulate 2011 action plan.
When Free Markets Fail: Saving the Market When it can’t save itself

authored by Scott McCleskey, Published by John Wiley & Sons Inc., 2010

Ching-Chia Lee


The author explains the economic meltdown and makes suggestions to avoid a future crisis by using a jargon-free language. In the beginning, the author discusses how the systemic risk has gone from theory into reality. The systemic risk could bring down the entire financial system when dropping confidence on certain financial assets takes the market prices down with it due to the panic spreading in the market.

However, three principal approaches of policy options: keep the banks small; separate the banking from the investing and trading activities; and impose higher bank capital requirements, have not been helpful in terms of preventing the firms from becoming too big to fail. The reason those policy options will not work is simply because the complexity of the market and the fast speed by which information changes from day to day make them impossible to operate in reality.

In addition, the author points out several problems with deep implications for public policy and the future financial regulations. First, the unlimited financial innovation has led to a rise in complexity in the markets, and a rise in risks as well. Second, the mechanism of success rewarding operating in a self-interest way creates distorted incentives not just in the marketplace but in the workplace as well.

Third, the existing consumer protection in the financial markets is to provide choice and let customers make their own decision rather than protecting customers themselves. The customer protection by means of transparency before the financial crisis turns out not effective enough to avoid the systemic risks.

Forth, the concept of transparency itself is not transparent. The author discusses three degrees of transparency: reporting; disclosure; and true transparency and indicates that the regulations should require the information be made public and particularly in a clear manner that it should be easily and cheaply accessible to the public. Fifth, the reliance on credit rating agencies is misguided because rating agencies do not provide consistent estimates of creditworthiness but there is nothing to replace them with.

After laying out the problems in the financial
system, the author talks about the necessity of rebuilding the regulatory structure. Since the regulatory landscape has been influenced by the economic history of the economy, the US has many regulatory agencies, including the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Commodity Futures Trading Commission (CFTC), the Federal Trading Commission (FTC), and 50 state-level regulators for securities, banking, and insurance.

The debate over which agencies should do what has became so heated and the once-in-a-century financial crisis has created the opportunity to change the regulatory structure. Moreover, in terms of credit rating agencies, good regulation from the US Security and Exchange Commission (SEC) and good governance from within will be the key to rehabilitate the agencies and their reputation.

However, the author also points out that the politics of regulation is a difficult matter since regulation is a systematically political process. All important financial regulations have to go through the process of being drafted, negotiated, debated, compromised, amended, and voted through at least a House committee, a Senate committee, floor votes in both chambers, and then finally presidential approval. Therefore, we should recognize that the structure, the laws, and even the resources available to the regulators are the result of the political process based on politicians’ agreement.

In this regard, the author identifies a need for the government to provide a stable, experienced, well-trained regulatory service team across all financial regulatory agencies because, as author said, “No matter how regulation is improved and markets are reformed; everything depends on the quality of the monitoring, of the enforcement, and of the decision making of the regulators.”

In the end, the author points out that in order to prevent the reckless behavior, policy makers should focus on the incentives of the individuals (rather than that of the organizations) that actually make the decision that lead to a rise in risks. Those suggestions that author makes in this book reflect its book title, When Free Markets Fail: Saving the Market When it can’t save itself, that we are regulating markets as they are, not as we wish they were.