Managing the Risks Associated with Trade Liberalization

As international trade is booming and becomes a main source of growth, SMEs are required to involve in international trade to be included in the trend of growth. To address the need of SMEs in the process of trade liberalization and make them able to share the fruit of international trade are the essence of “Inclusive Growth.”

While trade liberalization has brought many benefits to members’ SMEs, it also makes SMEs expose to greater risks, such as: political risk, credit risk, foreign exchange risk, etc. After trade liberalizes, foreign competitive products will enter the domestic market, so for those SMEs which are originally focused on domestic markets, they will have to face the risks from increasing competition and industrial transformation.

As SMEs lack sufficient experience in managing international risk, naturally they require assistance in these regards. In prior APEC dialogues on trade liberalization, the emphasis has usually been on how many benefits free trade can bring about for SMEs. But if SMEs cannot effectively manage the risks associated with trade liberalization, a singular emphasis on the benefits of free trade will not necessarily help SMEs expand trade volume. Hence, it is essential to engage in both trade liberalization and risk management to ensure maximal overall results in the hope of promoting free trade.

To improve the APEC performance and enhance trading, SCMC will hold the APEC Symposium on Enhancing SME Capacity of Managing the Risks Associated with Trade Liberalization in Taipei on 16th to 17th August, which is the most important event of the SME Crisis Management Center (SCMC).

The key point of the current issue is to continue monitoring the development of the European debt crisis and international inflation under the appreciation of the US dollar last month. As for Crisis Alert, it is our view that the hot money will keep flowing into the emerging economies and commodity markets, and that even though many analysts predict the inflation to be alleviated in the second half of the year, it may be too optimistic an expectation, because the situations are all full of uncertainties regarding the prospects of the US’s economic recovery, the emerging economies’ tightening policies, and the oil price.

Also, the current issue invites expert to discuss the future trend of raw material prices and offer a comparative analysis of the similarities and differences between the increase in raw material price in 2008 and that in 2011. We also invite F. T. Escalona, Executive Director of Phil-export, to talk about how the company supporting organization in the Philippines has led its members to pass the global economic crisis. The ways include holding conferences, developing products and markets, providing market information and other counsels, and so forth.

Moreover, we also select three most concerned news articles and analyze them for the readers: the QE2 expiring at the end of June, the credit ratings of several European economies being downgraded, and the death of Osama bin Laden causing the oil price to fall again. In the meantime, we also introduce to the readers a book published in 2009 by Suresh Goel, an Indian banker—Crisis Management: Master the Skills to Prevent Disasters. It surveys the nature of crisis management procedures and points out some obstacles companies would face in learning lessons from a crisis.

Although the international risk situations have appeared to be alleviated, not all developments are toward a favorable direction. We will continue observing the development of the European debt crisis and the international economic situation after the expiration of QE2.
The current international risk situation can be revealed by the appreciation of US dollars. The value of US dollars recently showed a relatively large upsurge in the international market, with the USD Index rising from the recent lowest point of 73.13 on 4th May to 76.16 on 23rd May, a rise by 4.1%. The main reasons for this increase include the death of Osama bin Laden, the impending end of QE2 (Quantitative Easing 2), and the impact of European debt crisis. However, after the short rise, the USD Index began to fall on 24th May. On 30th May, it decreased to 74.93, reflecting primarily the weakness in employment and real estate figures of the US. The above-mentioned four events (death of Osama bin Laden, QE2, European debt crisis, and disappointed US economic figures) are the major factors that influenced the risk situations last month.

Among these four events, the impending end of QE2 and the European debt turmoil have greater influence, and in terms of crisis, the two events happen to lead to opposite outcomes. After the QE2 ends, the US government will not continue buying bonds and releasing liquidity. Although this cannot reduce the amount of hot money and will only stop it from increasing, it can still help to reduce the possibility of a financial crisis caused by liquidity surplus.

On the other hand, Greece’s debt problem is getting worse and worse, and it may even have to restructure its debts. The credit ratings of Greece, Belgium, and Portugal have been downgraded, exerting a shocking effect even though this could have been expected. The debt problems of PIIGS (Portugal, Ireland, Italy, Greece and Spain) may hinder the recovery of the entire EU, thus increasing concerns about the possible visit of another crisis. It should be pointed out, however, that except for the decrease in market demands, the actual impacts of the European debt crisis are limited to the EU region, and in other regions around the world there would not be too much influence on the financial dimension.

During the past month, the US dollars had flowed back to the US because of the European debt crisis, leading to the appreciation of the US dollars and a decrease in the amount of the hot money around the globe. The international risk situation seems to be temporarily relieved. From a medium-term point of view, however, the US will maintain its easy monetary policy and low-interest-rate environment even after the QE2 ends, and the emerging economies will still continue enhancing the interest rates to resist inflation, leading to a constantly enlarging spreads between the interest rates of the two. Moreover, the US is still facing a serious debt problem. All these will assure that the hot money will flow back again to the emerging economies and commodity markets.

The end of QE2 and the European debt turmoil will both have some negative impacts on economic growth, especially to the advanced economies that are pursuing the post-crisis recovery in the US and Europe. Although these
events will also slow down the growth of the emerging economies, it does not conflict with their short term goal of cooling the overheated economic development.

The slowdown of economic growth is expected to generate effects on the commodity markets, such as the recent price correction of crude oil and agricultural products. The New York light crude oil once touched on USD 114.83 per barrel on 2nd May but then came to the recent lowest level of USD 94.63 on 6th May, and the same trend can also be seen in Brent oil. Since then, the crude oil price has been fluctuating in small range without any large increase by now.

In addition to the brief impact of the death of Osama bin Laden, the reasons for the oil price correction also include concerns about the slowdown of the US’s economic recovery and the tight monetary policy employed by emerging economies. Will the trend continue the same way? The US economy is now facing a difficult situation: its inflation rates soared from 2.1% in March to 3.2% in April, forcing the Fed to stop injecting funds into the economy before the recovery becomes stable. Though this decision will certainly bring some variables to the future recovery, theQE2’s influence on economic growth cannot be over-estimated, either. According to our earlier analysis, most of the funds released by QE2 became the hot money flowing abroad; not all of them stayed in the US and contributed to the growth.

As to the tight monetary policy employed by emerging economies, on the other hand, more and more major emerging economies have found the negative influences of such a policy on the domestic economy and society, such as the soaring of loan interest rates forcing SMEs to close. Consequently, some of these economies begin to seriously consider loosening the tight policy. Therefore, it can be realized that there is still a large uncertainty about the continuation of both the slowdown of the US recovery and the tight policy of the emerging economies.

Based on the above analyses, the hot money will keep flowing into the emerging economies and commodity markets, and it is still largely uncertain whether the US recovery will slow down, whether the emerging economies will loosen their tight policy, and whether the oil price will continue falling. Therefore, even though many analysts predict the inflation to be alleviated in the second half of the year, this may be too optimistic an expectation.
The US

Payrolls expanded by 244,000 in April, the biggest gain since May 2010. Private hiring, which excludes government jobs, expanded by 268,000, offset by cuts in all levels of government. Even with the strong hiring, the unemployment rate increased to 9%, because of technical reasons. Payrolls are calculated from a survey of employers, while the unemployment rate is calculated from a separate, smaller household survey. The household survey showed an increase in the number of people looking for jobs, including a sharp drop in farm and self-employed workers. Employment gains were broadly based: retailers, manufacturers, and even construction expanded.

The latest employment reports are in line with the Federal Reserve’s view of the evolution of the economy. The economy is growing fast enough to produce steady, but unspectacular job growth that is unlikely to bring the unemployment rate down quickly. The White House is predicting that the unemployment rate would fall between 2011 and 2012, falling below 8% by the Presidential election in 2012.

As expected, inflation rates increased in April, driven by a sharp increase in commodity prices. Overall prices increased 3.2% year-on-year, while the “core” inflation rate, which excludes food and energy—increased 1.3% year-on-year. The core rate was pushed up by price increases in automobiles and medical care.

In its most recent meeting, the Federal Reserve kept its benchmark interest rate between 0% and 0.25%, where it has been since March 2008. The Fed is expected to complete its USD 600 billion of Treasury bill purchases by June 2011, and it is unlikely to resume its purchases of Treasuries unless the economy significantly worsens. The Fed cut its forecasts of the US 2011 GDP growth to 3.2% from 3.65% in January, and raised its inflation forecast to 2.5%, with a “core” inflation rate forecast of 1.5%.

It is questionable whether the Fed will raise its benchmark interest rates before the end of the year, as the unemployment rate continues to be elevated. While some presidents of US regional Feds such as Kocherlakota and Fischer advocate interest rate increases as soon as possible, Chairman Bernanke is most likely to keep interest rates near zero as long as the unemployment rate remains above 6% or 7%. He will probably tolerate overall inflation rates approaching 4% or perhaps even 5%, before raising interest rates. We must remember that 2012 is an election year, and President Obama is likely to be re-elected if the unemployment rate is low and GDP growth is high, even if the inflation rate is somewhat high.

Thus, what is likely to continue is a weak and...
unstable dollar. While central banks in Canada, Europe, and Asia excluding quake-ravaged Japan are tightening money, the US continues to have a loose monetary policy. A weak dollar, so long as it does not destabilize the US financial markets, is positive for the US growth, as it stimulates the US net exports. We should continue to expect a depreciating dollar and rising dollar-based commodity prices.

**Canada**

At its April meeting, the Bank of Canada left interest rates unchanged at 1%. The Bank of Canada’s decision to leave interest rates steady must have been influenced by the desire to keep the Canadian dollar cheaper. The Canadian economy is quite strong; just recently, the Bank of Canada revised upwards its growth forecast for 2011 from 2.4% to 2.9%, with the Canadian economy likely to return to full employment by 2012.

Economists expect that Canadian interest rates will be raised sometime during the summer, most likely at the July meeting of the Bank of Canada. (The author is Professor at University of Southern California.)

**China’s Inflation — Causes and Possible Remedies**

*Naoyuki Yoshino*

It is often said that inflation is a monetary phenomena, and is caused by higher money supply. Recent high inflation in China cannot be explained from the quantity theory of money as stated. There are several factors behind the high rate of inflation in China today. This article will explain causes of inflation in China and its possible remedies.

**Five factors of inflation in China**

1. **Rise in commodity prices**

    When the western economies faced the recession, the central bank tended to introduce easy monetary policy by supplying lots of liquidity into the financial market. The domestic interest rate became lower and excess money supply started to look for higher rate of return. Excessive liquidity brought overseas capital investment to increase in emerging economies. Hot money started to flow into commodity market such as oil, copper, corns, etc.

    Commodity prices were driven up when easy monetary policy was introduced in the US and other western economies. However, China’s high demand and increased import of natural resources and food also pushed up commodity prices.

2. **Exchange rate adjustment**

    If the exchange rate was determined by the market in China, the inflow of capital would push up the exchange rate of RMB. The appreciation of currency reduces exports, and the demand for natural resources (i.e. commodities) would decline. However in China, the exchange rate adjustment is very sluggish due to currency control.

3. **Cost push inflation**

    Population moved from rural area to urban...
region in China, keeping the wage rate relatively low. Ample supply of labor forces from rural area made China’s wage rate relatively stable in the past. However, wage of workers started to increase in recent years because labor migration started to decline and the cost of living in cities started to rise. The wage push is another cause of inflation.

As economy grows, the living standard started to gradually rise which requires higher wage rate. Unless the technological progress overcomes the rising wage rate, the price of final products must rise. Costs of services sector such as transportation of goods and services push the price of end products much further.

4. Excess money supply

China’s current account surplus makes the money supply to grow much faster than desired. Asset of the Bank of China is slightly different from other central bank. Normally the central bank purchases government bonds from the market and supply its money into the market (i.e. open market operations). However, China’s case is different from other central banks. Peoples’ Bank of China does not hold enough government bonds which makes them difficult to absorb excess money from the market.

The foreign exchange reserves are rising in the asset side of the balance sheet, and thus the liability side must increase (i.e. increase in money supply) to balance the asset side and the liability side in equal. The central bank of China is trying to absorb excess money supply by raising reserve requirement from the banking sector. Further, the central bank is issuing its own bonds in order to absorb excess money from commercial banks. However, the money supply keeps on rising much more than the desired level due to continuous increase of foreign reserves caused by the current account surpluses.

5. Increase in housing and property prices

Higher money supply raised banks’ deposits in China. Banks were looking for the demand for their loans. The demand for loans in the property sector gradually started to rise due to economic growth. Rising housing property prices will create expectation of the boom in property market.

Since the housing and property markets respond slowly to the market condition, the excess supply will be created in the end, and the asset prices such as housing price and office rent will start to decline. Similar bubble can be observed in the US in 2005-2007 and in Japan 1987-1989. Strict control over money supply and bank loans are key remedies to stop potential bubbles in China.

Possible remedies in China

China has to either reduce accumulation of foreign exchange reserves or increase the issuing of the government bonds to the market. However, the government bond market is not well developed, making the central bank difficult to absorb money from the market through open market operations.

One proposal is to finance huge infrastructure investment by issuing infrastructure-bond. The infra-bond can be an instrument for the open market operation in the financial market in China. It is needed in China to develop the bond market.

Huge infrastructure needs exist in China. However, its financing is not easy. The infra-bond will be one of the ways to raise money from the capital market rather than relying on the government alone. Detail study can be seen by Naoyuki Yoshino (Chapter 6, OECD, Southeast Asian Economic Outlook, Fall, 2010).

The second proposal which is often proposed by many scholars and policy makers is the introduction of basket currency system into the exchange rate market. The exchange rate of RMB has to be gradually adjusted so as to match the market equilibrium by introducing basket currency system. The weight for the basket can be obtained by Yoshino, Kaji and Suzuki (Journal of Japanese and International Economy, 2004). RMB can be adjusted not only by the US dollar, but also euro, Japanese yen and other currencies. Optimal weight for each currency against RMB should take into account of trade and capital flows (Yoshino, Kaji and Suzuki (2004)).

Inflation will become huge impact on Chinese
Will Euro PIGS come to East Asia?

Zhenya Liu

PIGS is how the financial analysts refer to the troubled and heavily-indebted economies of Europe—Portugal, Ireland, Greece and Spain. Some others also use PIGS to include Italy—Europe’s longstanding biggest debtor.

Greece has attracted the investors’ attention since last year, even more recently. The concerns are over whether it will be able to pay off the huge government debt. Some even started to worry about the break-up of the eurozone.

How bad a situation is the PIGS in, and how does that compare with the East Asia economies?

Greece joined the euro in 2001. But since then the Greek government public spending soared. Now, Greece finds itself unable to cope with its huge debt loads and more than four times higher than European rules allow.

The Irish Republic economic growth was dependent on a property bubble. It was the first eurozone economy to fall into recession in 2008. It has injected EUR 7 billion into its two biggest banks, Allied Irish Banks and Bank of Ireland, and created a state-run agency to handle their bad debt.

With the real estate bubble burst in 2009, Spain economy contracted in the last three months of 2009. Spain remains the last major economy in Europe still in slow recovery. With the low economic growth expectation in Spain, many investors feel it will be the next economy to rattle financial markets.

Portugal was with its high borrowing and sudden reversal in economic fortunes, made it in the same category as Spain and Italy. Its finance minister told the press that Portugal faced "an extraordinary and exceptional situation, due to a major financial and economic crisis without precedent in our recent history".

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<td>Economy, in European Union:</td>
<td>13th largest</td>
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<td>Latest GDP figure:</td>
<td>2.8% (First quarter of 2011)</td>
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<td>Gross debt in 2010:</td>
<td>82.9% of GDP</td>
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<td>Gross debt in 2007:</td>
<td>25.4% of GDP</td>
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<td>Unemployment rate in 2/2011 :</td>
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<td>Gross debt in 2007:</td>
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<td>Unemployment rate in 2/2011 :</td>
<td>20%</td>
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<td>Population:</td>
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Will this euro PIGS come to East Asia economies? The short answer is NO. The reasons are the following: First, because of EU unification of its currency, all member economies lost their own flexibility of monetary policy and the main policy instrument for them is the fiscal policy. This is not the case in East Asia economies. Second, gross debt of GDP (%) in East Asia economies, except Singapore, is under 60%, so East Asia economies are not heavily-indebted. Third, PIGS problems happened when their economies went to recession. But the economic growth rates of most East Asia economies are over 5% with relative low unemployment rate recently. (The author is Professor at Renmin University of China, Beijing and The University of Birmingham, UK) 

### East Asian Economies

| Latest GDP figure in 2010: | 6.9%(Indonesia), 5.3%(Malaysia), 7.1%(Philippines), 12%(Singapore), 6.7%(Thailand), 7.2%(Vietnam) |
| Gross debt in 2010: | Basic balanced (Indonesia, Malaysia), 58%(Philippines, 2009), 118% (Singapore), 37%(Thailand), 45% (Vietnam) |
| Unemployment rate in 2011: | 8.2%(Indonesia), 5%(Malaysia), 7.3% (Philippines), 2%(Singapore), 1.2% (Thailand), 2.8%(Vietnam) |

### SMEs Struggling with Rising Price Inputs and Exchange Rates

**Kenneth Waller**

**South Pacific (India, Australia, New Zealand)**

**Australia**

In the Commonwealth budget presented to parliament on 10th May, the Treasurer announced that the government would return the budget to surplus in 2012/13, while delivering on major new spending priorities. The government claims that it will affect savings of USD 22 billion and restrain growth in spending. It seeks to achieve long-term budget sustainability. The opposition claims that the budget fails to deliver a sizeable structural surplus at a time when growth is strong and the terms of trade are higher than they have been for decades. Major planned expenditures relate to skills and training in the workforce, infrastructure, health and support for low income earners. The budget will extend a freeze on higher income limits for family payments and this resulted in opposition claims that the government is attacking middle Australia. The government is continuing to work on determining a price for carbon to be introduced next year and this also is being seriously questioned by the opposition.

Employment continues to grow strongly. Inflation has moderated and is currently at around decade lows. Nonetheless, given the expected pressures being caused by the commodities boom on costs, there is a real prospect of rises in official rates in coming months.

Key business surveys show business confidence in large companies is buoyant in Australia; business confidence rose over the
past year, with climbing revenue and profits and a survey shows that Australia is performing well on the global scale. The ASX 300 survey found that although big firms had been able to manage cost pressures more effectively, they were "considerably more pessimistic" about costs over the next three months, particularly for labour and materials. Confidence was strongest in the mining sector but with a rising AUD as a consequence of rising mineral and commodity prices, a shadow is being cast over the manufacturing industry, with big business in this sector showing the lowest confidence levels. As the Treasurer noted in his budget speech, a patchwork economy “grows unevenly across the economy.”

SMEs are not faring as well as companies in the resources sectors. The MYOB business monitor shows many Australian businesses struggling to work through a fragile economy are “doing it tough.” Business owners are pessimistic about the future outlook, and do not expect Australia’s economy to improve in the next 12 months. Higher fuel prices, interest rates and cash flows are expected to put SMEs under further pressure. In particular economic confidence in the SME sector has diminished in Queensland, Victoria and South Australia. It is claimed that SMEs are not very resilient or used to operating through tough economic conditions and that Australia’s softening business conditions has surprised small business owners. The National Australia Bank's (NAB) quarterly SME survey also found business conditions softened notably in the March quarter.

The squeeze on bank lending to SMEs is a key issue facing Australian economic prosperity. A banker has noted that the slashing of bank lending to small and medium business will have serious repercussions for Australia, as banks favour lending for residential dwellings. A number of overseas banks who were lenders to medium sized enterprises have left the market. A less prosperous SME sector would lead to repercussions beyond the business sector and would ultimately impact on the property market. There are some key structural and regulatory factors that are influencing the ability of SMEs to access finance. It is important for Australia’s long term economic prosperity that these issues are addressed.

Business bodies have urged Fair Work Australia to proceed with the proposed USD 9.50 minimum wage rise and while the trade union movement is pushing for a rise nearly three times higher. SMEs will be hurt most by a significant increase as they are less able to seek compensating price rises in the goods and services they produce.

India

Inflation eased to 8.66% in April, due to lower manufacturing prices, however, fuel price hikes will see inflation rise again. Inflation is attributed to continuing increases in commodity prices, rising incomes, strong demand, and growth. Finance Minister Pranab Mukherjee notes concern with the rate of inflation and the RBI has indicated that it may need to apply monetary brakes to manage the better the growth-inflation balance. The RBI raised rates in early May, its ninth rate hike since March 2010 by 50 basis points to 7.25%.

In spite of concern about the impact of fuel price hikes on inflation the Planning Commission notes that India needs to start weaning off fuel subsidies in order to align with global energy prices.

In good news for exporters, India is set to open up opportunities for its booming services sector through widening the India-ASEAN free trade agreement to include services and investment. In particular this will provide more business opportunities and projects especially in the construction work. India-Australia trade is also going to expand as both commit to doubling bilateral trade and to kick start negotiations for a free trade agreement.

The Commerce Industry will propose new benefits for exporters to replace the benefits provided by the 14 year old Duty Entitlement Pass Book scheme after the scheme ends in June.

The Trade Ministry is concerned about the trade deficit, warning that the manufacturing industry needs to ramp up if the economy is to keep up its booming growth and contain the trade gap but the manufacturing sector faces many challenges with inadequate infrastructure being a key issue. A new policy framework under consideration for
public private partnerships (PPPs) in infrastructure should assist in this area. The new policy will focus on outcomes while setting broad parameters in which partners can design and implement projects and with less regulatory burdens.

Following a crisis in microfinance in southern India last October, micro finance institutions are experiencing serious job losses. This was caused by widespread defaults by borrowers in rural areas.

**New Zealand**

Inflation, insurance bailouts, the Christchurch earthquake recovery and monetary policy are key issues.

The RBNZ (Reserve Bank of New Zealand) notes that monetary policy will remain supportive during the current period of the recovery phase from the Christchurch earthquake and in light of the general fragility of the economy. The insurance sector had been tested by the earthquake; the government will already provide a backup funding package for AMI Insurance to the value of NZD 500 million, and warns that more companies may also require financial support. RBNZ is fast tracking its supervisory work in the insurance sector and it is expected that some smaller insurers will not meet the revised regulatory standards. However, the central bank believes that the financial system broadly is more resilient and positioned to support economic growth, despite the fact that the economy still faces a volatile and uncertain environment.

Inflation is a key concern with expectations that the recovery could cause upward pressures on prices. Inflation increased by 4.6% in the year to 31st March.

The IMF notes that the economic damage of the Christchurch earthquake is relatively worse than the damage to Japan following the earthquake and tsunami. A first quarter ASB Bank Investor Confidence Survey showed levels at their lowest since the third quarter of 2009, stalling a six month stabilizing trend. However, ASB Bank expects that confidence will return as interest rates remain at record lows. A new audit licensing regime could help restore investor confidence in financial markets; it will establish a new licensing regime for major audits of banks, insurance firms and NZX-listed companies. Small to medium-size companies would not be affected.

Manufacturing and services growth stalled in March but recovered slightly in April according to the first surveys taken since the Christchurch earthquakes. Ongoing reconstruction in the South Island is expected to lift manufacturing growth, especially in the building sector.

The MYOB Business Monitor found that small businesses are doing it tough in New Zealand following the earthquake devastation and prolonged recession, but applauded small business owners for their capacity to work through fragile economic conditions. MYOB analysts point out that many small businesses are getting by with assistance from their accountants, banks, associates and mentors who help them run their businesses more effectively. However, small business confidence is low with only 23% of businesses expecting the economy to improve in the next 12 months, compared with 49% a year ago. MYOB called for greater government assistance in simplifying provisional tax rules and processes to help SMEs through this tough period. (The author is Director, Australian APEC Study Centre at RMIT University.)
The International Monetary Fund (IMF) published a paper on Emerging Markets’ (EM) experiences in dealing with capital flow in order to provide some possible framework for IMF policy advice on the spectrum of measures available to policymakers to manage inflows.

**Background and drivers of flows**

In the case of Brazil, IMF points out that deep capital markets and high interest rates are major reasons investors regard Brazil as one of preferred destinations for capital inflow into EM. Cyclical factors such as strong economic growth in the aftermath of the global crisis have reinforced structural factors exemplified by Brazil’s very high interest rates to result in large capital inflow and strong currency appreciation pressure. During the first 11 months of 2010, gross capital inflows amounted to close to USD 141 billion, compared with USD 92 billion in 2009 as a whole. Brazil has dominated capital inflows to Latin America, attracting a large share of global equity issuance in 2010 as well as steady fixed income inflows during 2010.

Brazil’s overall macroeconomic policy stance has reinforced pull factors to attract capital inflows. Fiscal policy has remained expansionary and the structural primary balance deteriorated in 2010 by 1% of GDP over 2009 despite the strong recovery. With inflation drifting higher, procyclical fiscal policy has raised the burden on monetary policy. The Central Bank of Brazil (BCB) has hiked rates by 300 basis points to 12.0% since April 2010, while intervening in large amounts. Intervention in the FX spot market reached USD 41 billion in 2010, pushing FX reserves to a historical high of USD 287 billion (17 months of imports or 600% of short-term debt) at end-2010. Recently the BCB also resumed intervention in the forward FX market. Despite this strong intervention, the currency has appreciated significantly in the post-crisis period. From December 2008 to early 2011, the exchange rate has appreciated around 50%, with most of the rebound taking place in the first stage of recovery. IMF staff estimates suggest the real is significantly overvalued in real terms.

**Impact of inflows**

Beyond their macroeconomic implications, especially on the exchange rate, large capital inflows do not seem to have had a large impact on domestic asset markets. Despite the large inflow into equity market in 2010, stock market valuation was mostly flat during the year, reflecting an increase in the supply of shares and a large rally in the earlier phase of recovery. Bank credit grew rapidly during 2010, but this was in part a reflection of policy decisions – 43% of credit expansion in 2010 came from public banks – and banks generally did not rely on external funding for their credit expansion. Rapid credit growth has in turn sustained a rapid rise in property prices that continue certain urban areas. But anecdotal evidence suggests the phenomenon circumscribed and not linked to capital inflows.

**Policy responses**

Capital inflows have touched various aspects of the policy framework. Beginning in December 2010, the BCB started tightening some prudential and regulatory measures, including: (1) an increase in capital requirements for most consumer credit operations with maturities of over 24 months; (2) an increase in unremunerated reserve requirement
on time deposits from 15% to 20%; and (3) an increase in the additional (remunerated) reserve requirement on sight and time deposits from 8% to 12%. The BCB explicitly pointed out that these measures will lessen the burden on monetary policy to contain inflationary pressures and thus help moderate pull factors.

A tax on inflows (IOF) has played a central part in the policy response to large capital inflows. The IOF, originally established in 1993, has been a key tool for managing capital inflows in recent years. Before the crisis, it was applied to fixed income inflows with a tax rate of 1.5% between March and October 2008. The tax rate was raised to 2% on 19th October, 2009 and has a broader coverage to include equity inflows as well. The rate on fixed income inflows was subsequently raised to 4% on 4th October, 2010 and to 6% on 18th October, 2010. Later the tax was also raised to 6% (from 0.38%) on the margin payments required on derivatives. On 29th March, 2011, the IOF tax of 6% was extended on most foreign loans with average life up to 360 days and further to foreign loans with average life up to two years on 6th April, 2011 On 7th April, 2011, the IOF tax for all consumer loans was raised to 3% from 1.5%. (The author is Vice President, Citi Taiwan.)

1 Recent Experiences in Managing Capital Inflows – Cross-Cutting Themes and Possible Policy Framework, IMF, 14th February, 2011.

The Resurgence of Debt Crisis

Julius Sen

An important announcement by the British government on the final day of the period under review could be of long term significance to the emerging economies of the APEC region. Though details are not clear, the government has decided to commit the UK to legally binding and drastic reductions in carbon emissions, by up to 50% of 1990 levels, by 2027, together with commitments to green alternatives to meet the requirements for economic growth.

The British government believes that this statutory measure will create a strong incentive for foreign investors to pump resources into the UK economy to develop alternative technology for a growing global market. Britain would thus establish a technological lead in this important area.

The month under review also saw important developments relating to developments in Libya and elsewhere in the Middle East. Two main developments may be identified in this context:

• A major surge in refugees and illegal migrants into the EU at a time of high unemployment is causing a social and political reaction with election results reflecting a strong anti-immigrant bias

• Governments are beginning to re-impose border controls and to consider renegotiating the Schengen agreement to deal with cross-border crime and illegal immigration

In effect, the reversal of this commitment to the free movement of people within some parts of the EU could cause difficulties in the operation
of the single market. However it is too early to
tell what final shape these policies will take and
whether they will cause the market to fragment
further.

Policy choices on how best to respond to the
debt problems of Portugal, Greece, Ireland and
Spain has divided expert opinion, and current ECB
and EU policy measures have been criticised as
being inadequate and short sighted. They have also
been defended as being necessary under the current
circumstances.

Markets and expert opinion – apparently
supported recently by IMF analysis – suggests
that Greece, Portugal and Ireland will have
to restructure their debt, in addition to taking
other measures to curb spending and raise taxes.
Restructuring the debt of these economies will hurt
banks in particular (though which ones is not clear)
and could cause an intensification of the crisis in
the Eurozone and elsewhere because the banking
sector is still vulnerable. So while it will help these
economies, it could hurt the banking system and
other economies.

At the same time the ECB and key EU
governments have adopted the opposite strategy
of trying to impose stringent conditions on these
highly indebted economies – which includes
budget and subsidy cuts and increases in tax
collection – in the hope that overall EU growth will
help these economies recover and thus avoid the
need to restructure by allowing them to repay their
debts. However the risk is that this strategy will not
work and the debt crisis will spread to Spain and
other economies, and possibly cause the Euro to
collapse.

The belief at the moment is that the ECB and
key EU governments will finally accept an orderly
restructuring of the debts of Greece, Portugal and
Ireland, but only in their own time and at their own
speed.

Taken together, this situation suggests that
the crisis in the UK and the Eurozone – whether
in the banking sector or in debt management –
will continue for some time. This in turn creates
uncertainty in markets and makes investors
nervous.

Two final bits of economic news complicate
this picture further. In the first place, inflationary
pressures seem to be building particularly for
imported raw materials, energy and commodities,
and interest rates will rise by the end of the year.
And secondly, growth seems to be stronger than
expected in some economies (France and Germany)
and this gives grounds for optimism about the
future.

While the full implications of all these
emerging features of European economies are
difficult to understand, it does seem that a multi-
speed Europe without various other internal
complexities will finally emerge. The implications
for the rest of the global economy and for the
APEC region of these developments will remain
uncertain and unclear for some time. (The author is
Associate Director& Senior Programme Advisor,
International Policy Unit, London School of
Economics and Political Sciences.)
Over the previous month, the market trends that were mentioned in the previous month continue to be observed. This includes volatile markets, high inflation and subsequent market sentiment declines. Meanwhile, the signals that show consumers starting to change their behavior are becoming stronger.

**Approaching the end of QE2, foreign exchange market face market reversal test**

In the markets, during the period between 15th April and 13th May, the Euro along with three major regional currencies initially appreciated against the US dollar which was a continuation of previous trends. Some notable depreciation was subsequently seen, beginning from the last week of April. All in all, the four currencies ended up slightly depreciated against the US dollar over the past month. This fluctuation is more related to the monetary policies of the US, in contrast to the economic and fiscal fundamentals of the respective economic areas.

Since November last year when the second round of asset purchases (known as QE2) was announced by the Fed, the global currency and commodity markets soared, amid the flood of US dollars. But with the QE2 gradually nearing its scheduled expiration of 30th June this year, and the Fed not planning a QE3 as said in its 27th April statement, the bullish market trends in global currencies and commodities are gradually beginning to reverse.

Further sell off was triggered by several dissatisfying economic data releases in the US, and the ECB unexpectedly did not lift interest rates, despite the inflation outlook clearly exceeding its 2% target. Volatile currency markets and capital withdraws will be more of a problem to the currencies of smaller economies. Thus, we will keep a close eye on this issue.

As for the assessment of the Fukushima earthquake, the supply chain shocks that were previously anticipated have indeed occurred. Fortunately, the impact has been limited, and concentrated in certain specific industries. Meanwhile, amid the Japanese component shortages, companies who previously faced intense competition from the Japanese companies could see businesses grow. Hence, the current developments in the economic fundamentals should be attributed more to domestic forces.

**ESI continues to show inflation hurting economy, service industry also down**

In terms of the economic fundamentals, in line with previous trends, the Economic Sentiment Indicator (ESI) data of most East European economies declined, though not as sharply as last month. Once again, the indicators that are more closely related to consumer sectors, such as consumer confidence and the retail trade confidence saw bigger declines in contrast to the business sector. However, during this month, the service sector confidence has also started to decline more apparently, thus becoming more in line with the general market decline trend.

Looking into the subcomponents, the rising prices, diminishing household wealth and an unfavorable future economic situation are the main causes that are further driving down the consumer
confident. Meanwhile, the declining employment expectations were the main reasons behind the retail trade and service sector declines. To sum up, this has created a general picture where the inflation pressure has hit consumers and made them feel less wealthy. The economic outlook has grown more pessimistic as economic growth slows down due to rising inflation. The slower economic growth has led to the service and retail industries expecting a drop in employment.

In some economies, the ESI did rise, such as Hungary and Lithuania. In Hungary, the ESI rose as the industrial sector confidence improved, while its consumer confidence and retail trade confidence stalled after previous declines in the past months. In Lithuania, the general ESI has been increasing on the back of rising industrial, consumer and construction confidence, while retail trade confidence just began to rebound following the large decline that occurred in January, due to the sharp service sector confidence drop. In general, after looking into the components data, the two exceptions are not as inconsistent as they may seem.

Besides, by looking at the other more general information sources, which is also less economy specific, such as the producer prices and the PMI report, they jointly show that despite rising input costs, inflation has still been increasing rapidly. Although manufacturers have successfully continued to raise the product selling prices and service fees, the increase rate has become slower recently, as the inflation in the producer prices in non-energy sectors have showed some moderation in recent months.

This tells us that firms are now more reluctant to fully reflect the cost increase to consumers, a big contrast to the latter of 2010 when manufacturing costs rose rapidly and were essentially passed down to consumers. In light of this development, it could be a signal of weakening demand. (The author is President, Polaris Research Institute & Honorary Professor, and Professor College of Technology Management, National Tsing Hua University.)

The market prices of international commodities and crude oil kept rising during the first four months of this year. However, the situation has begun to change in May. In the first week of May, a remarkable correction can be seen in the prices of international commodities and oil, though not in gold price. As a result, the Russian debt problems have once again became a concern, and OPEC’s medium-term plans for supplying crude oil have also been influenced.

So far as Russia is concerned, its government once hoped to see its fiscal deficit pressure eased with the help of the relatively high crude oil price. Russian Finance Minister once said that the economy revenues and expenditures can come to a balance due to the better international energy price, and that the federal budget deficit can also be kept around 2.3% of the GDP; therefore, Russia would not need to loan from foreign capital markets, at least temporarily. The trend of international oil price in May, however, would have an inevitable influence on how the Russian government determines its future economic and fiscal situations,
and further on how it decides its foreign-debts policy. Besides, Russia’s foreign exchange rates and inflation will change accordingly.

Once the international crude oil price drops dramatically, the export profits of Russia’s energy sector will be greatly impacted; the exchange rates of Russian rubles may depreciate; its foreign debts may increase again; and the pressure of imported inflation will be further pushed up. In terms of the current monetary policy, since the Russian government predicts the annual inflation rate in 2011 to be 7% to 8%, its central bank decided on 3rd May to raise the refinancing rate by 0.25 percentage points to 8.25%. Also, the overnight ruble deposit rate was increased to 3.25%. Therefore, Russia’s economy in the second half of the year may face higher risks due to such factors as the depreciation of exchange rates, the rise of interest rates, the imported inflation, the export of the energy sector, and the fiscal deficit of the government.

When it comes to the Middle East and North Africa, the news of Osama bin Laden’s death leads to a lower estimation of the Middle East’s risk premium by the market. Such other influences as the US stocks of crude oil and the poor industrial figures, and a remarkable correction in the crude oil price made the inflation pressure partially and temporarily be mitigated. Nonetheless, there is still dissatisfaction over the policy, high unemployment rate, and factors that push up food price, which will all keep the political situations unstable in the Middle East and North Africa.

Also, the OPEC economies still hold a conservative attitude towards the crude oil supplies in the second half of the year. So far 12 OPEC members have reduced oil production by 1.3 million barrels a day and Libya’s inability to supply oil will continue through to the end of the year. Consequently, in the following six months domestic investments and export of the energy sector will continue being unstable in the Middle East and North Africa. Moreover, the soaring commodity prices will also push up the 2011 inflation rates of this region to nearly 10%, which means a great risk and difficulty to the business operation of the SMEs. Our suggestion is, therefore, that the APEC SMEs still hold a relatively conservative attitude towards investments and business activities in those regions. (The author is Vice President, Taiwan Institute of Economic Research.)

Global Commodity Market

Raw material prices expected to fall moderately in the second half

Hwa-Nyeon Kim

In the last one month period (mid-April to mid-May 2011), warning signs of a crisis in the global commodity market have somewhat eased. Furthermore, from April, commodity price indices have shown slight downward trends. WTI crude oil prices slipped sharply below USD 100 /barrel, as investors weighed the impact of the US killing of Osama bin Laden in early May. And Dubai oil prices also dropped to nearly USD 100 /barrel on 6th May. Although the death of Osama bin Laden will ease the unrest in the Middle East in the short run, eventually, it will increase uncertainty more than clarity and will probably escalate tensions in the region. Consequently, oil prices rebounded, with Dubai prices at above USD 110 /barrel.

If there is a commodity which is worth mentioning this month, it is definitely silver as
silver prices dropped sharply from a thirty-one year high recorded in April. The price of silver slipped 28.4% to USD 34.8/oz from a record high USD 48.6/oz. The slump in price was due to Comex exchange in New York increasing the margin requirements and making it 84% more expensive for speculators to trade silver. The minimum amount of cash that must be deposited when borrowing from brokers to open new positions will rise to USD 21,600 per contract from USD 11,745 and such tight margin trading policies have triggered exits by silver investors.

Starting from early May, there have been signs that ample global money liquidity will withdraw from the commodity markets. And speculative money, in particular, will be the first to move. According to data released by the US Commodity Futures Trading Commission (CFTC), there was a reduction of 32.8 thousand contracts in NYMEX crude oil non-commercial net long positions in the second week of May along with numerous falls in other commodity markets. Non-commercial net long positions are regarded as a proxy variable for speculative investment demand. Speculative money has also shown exit signals in the agricultural commodity markets. Non-commercial net long positions in CBOT corn for the week ending on 10th May fell by 24.8 thousand contracts after having declined by 26.6 thousand contracts in the previous week. And non-commercial net long positions in soybeans declined by 13.6 thousand contracts, taking it to 114.9 thousand contracts, the lowest level seen since early August 2010.

The top two commodity indices, the CRB spot Index and LME non-ferrous index, have shown slight decreases from mid-April to mid-May. The CRB spot index (year 1967=100) moved up from 553 to 577 and the LME index (April 1999=1,000) from 3,995 to 4,393. The averages for the CRB index and the LME index, from mid-April to mid-May, decreased 0.9% and 3.1% respectively. In case of the LME index, the change is much larger than those in the previous month. This implies that downward trends within the commodity indices have become more apparent. In terms of price variations, the daily price changes of these two indices were bigger than those seen during the mid-March to mid-April period, indicating an increase in investment risk.

As for energy prices, the WTI near month futures price moved within the range of USD 97.18 and USD 113.93/barrel and Dubai crude prices between USD 100.48 and USD 119.23/barrel during the same period. Although the averages of oil prices from mid-April to mid-May were larger than those during the previous month, the growth rates of the average prices significantly decreased.

Among non-ferrous metals, or more commonly known as base metals, only the price of aluminum rose following the previous period, with the average price rising 3.4%. Among base metals, lead and zinc have become increasingly bearish, with the average prices declining 9.6% and 6.6% respectively, compared to previous averages. Prices for copper, nickel and tin also showed decreasing price patterns.

The recent sell-offs across the commodity markets are expected to last only a short period of time, however, the rally in commodity prices is expected to certainly stop soon. This also means that a turning point in commodity prices is approaching. Thus, in the second half of the year, raw material prices will show moderate decreasing patterns. A main reason for why raw material prices are predicted to drop is the expected temporary stop in US dollar weakness. If US quantitative easing (QE2) ends in June, the momentum of US dollar weakness will also ease. Because many economists regard a third round of quantitative easing, or QE3, as highly unlikely, the rate of increase in US dollar liquidity will slow down. If the degree of US dollar weakness lessens, raw material prices will also go down. In the case of crude oil, demand-supply conditions will not be as tight as in the first half of this year as the political tensions in the MENA region will be reduced. However, despite the decline in raw material prices, the fluctuations in price will not be very steep but quite moderate. Therefore, SMEs will still face increased costs in raw material prices in the second half of 2011 compared to the same period last year. (The author is Research fellow, Samsung Economic Research Institute.)
### Changes in Raw Material Prices - 18th April to 13th May 2011

<table>
<thead>
<tr>
<th>Index</th>
<th>CRB</th>
<th>LME</th>
<th>WTI</th>
<th>Dubai</th>
<th>Copper</th>
<th>Lead</th>
<th>Nickel</th>
<th>Zinc</th>
<th>Tin</th>
<th>Aluminum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Min</td>
<td>553</td>
<td>3,995</td>
<td>97.18</td>
<td>100.48</td>
<td>8,537</td>
<td>2,272</td>
<td>23,960</td>
<td>2,104</td>
<td>28,800</td>
<td>2,601</td>
</tr>
<tr>
<td>Max</td>
<td>577</td>
<td>4,393</td>
<td>113.93</td>
<td>119.23</td>
<td>9,611</td>
<td>2,720</td>
<td>26,775</td>
<td>2,374</td>
<td>33,000</td>
<td>2,772</td>
</tr>
<tr>
<td>Average</td>
<td>566</td>
<td>4,172</td>
<td>107.22</td>
<td>113.22</td>
<td>9,116</td>
<td>2,490</td>
<td>25,549</td>
<td>2,218</td>
<td>31,074</td>
<td>2,683</td>
</tr>
<tr>
<td>Last Month Average</td>
<td>571</td>
<td>4,304</td>
<td>106.17</td>
<td>111.66</td>
<td>9,528</td>
<td>2,753</td>
<td>26,390</td>
<td>2,374</td>
<td>31,537</td>
<td>2,593</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.
Recent patterns in raw material prices resemble 2008 situations

The prices of many raw materials hit an all-time high during the period from the fourth quarter of 2010 to early 2011. The price of copper surged to USD 10,148 /ton in February 2011, breaking the record set in 2008 of USD 8,985 /ton. The price of tin also jumped to USD 33,255 /ton in April 2011, exceeding the 2008 record of USD 25,500. The price of industrial raw materials (e.g. rare earth minerals, silicon, tungsten and antimony) and agricultural products (e.g. raw sugar, raw cotton and coffee beans) also posted record breaking prices.

On the other hand, with the slight downward trend in raw material prices after April 2011, concerns are spreading that there could be a repeat of the 2008 situation, where raw material prices shot up then declined just as sharply. Consequently, it will be worth examining the similarities and differences between 2008 and 2011. The three causes affecting raw material prices are as follows:

Tightening demand-supply conditions

As the global economy recovers, supply is unable to keep up with the rising demand for raw materials. While demand is expected to continuously rise, supply will not be able rise accordingly owing to sluggish investment in mines and production facilities in the wake of the global financial crisis. Oil demand in 2011 is expected to grow 1.6% year-on-year to 89.1 million barrel per day, the highest hitherto. Supplies of crude oil continue to be limited due to the political instability in the MENA region.

Demand for refined copper has been unmet since March 2010, and inventories are on the decline. In particular, the emerging market-driven, strong demand for raw materials is the major driving force behind the rise in raw material prices. China’s demand for crude oil and oil products has recovered to 2008 levels, spearheading a full-scale recovery in the global demand for raw materials.

In contrast to 2008, 2011 is anticipated to see a slowing demand for raw materials due to the sluggish growth of the global economy. However, up until the first half of 2008, when the global financial crisis had yet to surface, pullbacks in global economic growth and demand for raw materials were not forecasted. In October 2007, the IMF predicted that the global economy would slow down by only 0.4% point to 4.8% in 2008. In 2011, however, the growth rate of the global economy and demand for raw materials are projected to slow down further. For instance, growth in the global
demand for oil is forecasted to slide from 3.7% posted in the second half of 2010 to 2.1% in the first half of 2011.

**Ample dollar liquidity**

With the continuation of the worldwide trend of low interest rates, dollar liquidity, which has been in ample supply since the US’s second round of quantitative easing (QE2), is gushing into the raw materials market. According to Barclays Capital, Assets under Management (AUM) related to raw material funds and ETFs hit an all-time high of USD 354 billion in 2010. Net investment inflows in the raw materials market in 2010 amounted to USD 60 billion, the second highest following the USD 76 billion posted in 2009. Growing dollar liquidity is also fueling speculative demand in the raw materials market. In December 2010, non-commercial net long positions on WTI oil were more than 1.5 times the 2008 all-time-high figures, becoming the main force driving up oil prices. The grain market, which includes the highly volatile corn, has also seen speculative purchases on the rise.

In terms of liquidity, the difference between 2008 and 2011 is that this time around, there is no room for further interest rate cuts as major economies have already maintained their interest rates at low levels. Until the first half of 2008, dollar liquidity flowed into the raw materials market, influenced by a weak dollar and interest rate cuts aimed at addressing the US subprime mortgage crisis. Although in 2008, there was a low possibility of interest rate hikes by developed economies including the US, in 2011, developed economies can use interest rate hikes as a tool to control price instability. Deutsche Bank forecast that the Fed will raise the benchmark interest rate from the current 0~0.25% to 0.5% in the fourth quarter of 2011.

**Climate anomalies**

Climate anomalies including floods and extremely cold weather conditions will cut the production of agriculture products like grain, further pushing up prices. And due to such climate anomalies, global grain production is forecast to fall 2.2% year-on-year for the 2010/2011 grain year. The production of wheat and soybean is also likely to drop 5.4% and 1.8%, respectively, year-on-year during the same period.

As La Nina, characterized by unusually cold ocean temperatures, mainly affects the Southern Hemisphere, instability in agricultural production is expected to continue in the first half of 2011. From the end of December 2010 to early 2011, torrential rains wreaked havoc on Brazil and Australia. Thus, Brazil’s production of soybean and corn is expected to fall 2.2% and 9.1%, respectively, for 2010/2011. Climate anomalies have also disrupted the production and transportation of industrial raw materials. For instance, flooding rains in Queensland, Australia disrupted the production and shipment of coal and iron ores.

Regardless, the global grain inventory for 2011 is relatively higher than that for 2008. During the 2007/2008 grain year, the global grain inventory was 17.4%. However, with an increase in the inventory level after the global financial crisis, the grain inventory for the 2010/2011 grain year is holding at 19.2%. This is also true of crude oil. Oil inventories, which have also risen since the global financial crisis, will put downward pressure on oil prices. The US’s oil inventory was over 335 million barrels as of the last week of December 2010, more than 10% higher than the average for the past five years (2004 -2009).

**Up (first half) and down (second half) trends in raw material prices is expected but not as steep as 2008 levels**

Factors that are driving up raw material prices in 2011 have much in common with the factors in 2008, but there are differences in the intensity of influence and situations. Thus, raw material prices are unlikely to rise as steeply as seen in the first half of 2008. Compared to 2008, a global economic slowdown, a fall in demand for raw materials and economic retrenchment policies are more likely in 2011. Also, the inventory levels are higher than in 2008. Additionally, factors that depressed international oil prices in 2010 are expected to persist in 2011. China’s belt-tightening and a possible repeat of the EU fiscal crisis could put a damper on the price of raw materials.
In addition, ongoing discussions on ways to build a financial safety net which would restrict capital in- and outflows and curb speculative trade in the raw materials market will help dampen speculative demand in the raw material futures market. Therefore, the uptrend in raw material prices will be maintained in 2011, but the steep rises seen in the first half of 2008 are unlikely to be repeated. On the other hand, downward trends in raw material prices that could appear in the second half of 2011 will be not as steep as 2008 levels. (The author is Research Fellow, Samsung Economic Research Institute)

<table>
<thead>
<tr>
<th>Similarities</th>
<th>Differences</th>
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<tbody>
<tr>
<td>Tight supply and demand condition</td>
<td>Economic slowdowns and slowing demand for raw materials</td>
</tr>
<tr>
<td>Ample liquidity</td>
<td>Possible retrenchment policies e.g. interest rate hikes</td>
</tr>
<tr>
<td>Climate anomalies</td>
<td>Relatively ample inventory</td>
</tr>
</tbody>
</table>

*Table* 2008 vs. 2011
How a BSO Led its Members through the Global Economic Crisis?

F. T. Escalona

The global financial meltdown, which started in the US in late 2008, resulted in a three-year market downturn in trade of goods and services. In the case of the Philippines the negative impact on trade in goods was partly offset by the positive growth in services exports during the two-year recession that ensued. The 10% to 13% growth in services exports was maintained as deployment of overseas contract workers posted a net positive result, turning over record volumes of USD 14.4 billion in 2007, USD 16.4 billion in 2008 and USD 17.3 billion in 2009. Merchandise trade figures however showed a sharp drop in 2009 at USD 37.2 billion from USD 48.2 billion in 2008; although sharp recovery was immediately realized in 2010 at USD 51.39 billion.

The central Philippines region, which contributes about 6% to 10% to total export performance, registered a drop of roughly 4%, which is much lower than the overall decline of 22.8% for the entire economy. Philexport Cebu, the umbrella business support organization (BSO) for all exporting sectors in the Central Visayas region of the Philippines which covers four provinces, somehow anticipated an economic crisis at the early part of 2008 and reacted quickly, just before the global crisis started. The BSO ran a scenario planning session in the latter part of 2007 and followed this up with a “crisis management” session in early 2009. The result of both sessions was the implementation of market development program (MD program) which was crafted with the help of the Dutch, German and Canadian governments. Technical assistance was provided by these foreign governments out of their respective development aid funds. The MD program entailed product and market development. The theme of the program was “right products to the right markets.” The realization from the global crisis was that the Philippine exporters should not rely too heavily on the US and Japanese markets; that there are oceans of opportunities in Europe, South America and the Middle East. The growing EU market was in the forefront of the Philippine focus considering that there are indeed new emerging economies in the Eurozone.

The MD program started with a value chain mapping on key products from the furniture, gifts and home décor, fashion accessories and wearables, seaweed and health and wellness sectors. This was followed then by a coordination meeting between the players in the export industry, i.e. the exporters, supporters and enablers. The roles of these stakeholders were clearly defined and the importance of the respective roles of the parties was emphasized. The program dealt basically on the drafting of a sectoral profile for each sector, identifying new markets, product development and value networking. The strengthening of the individual business support organizations was also
ranked high in the priority action plan of the sector stakeholders.

A pool of 40 highly trained local export consultants, on top of the tutelage provided by foreign consultants from the Netherlands and Germany, were deployed to the sector BSOs to serve as mentors in the development of their respective Sector Export Marketing Plans (SEMPs). Philexport Cebu and the local offices of the Department of Trade and Industry worked hand in hand to secure the necessary funding to ensure the success of the MD program.

Market Intelligence (MI) was another key activity that helped meet the rigid requirements of the MD program especially on market research and analysis. Philexport Cebu, with the help of the Canadian, Dutch and German governments embarked on a project that aimed to establish a database of market information and statistics with the end in view of giving the exporters easy access to these valuable information. The MI facility, originally branded by the Canadian government as MKIS (market information service) was re-branded by the BSO as I-Search, a more marketable brand name.

Market breaking news, up-to-date statistics was made available to exporters via the BSO’s website (www.philexportcebu.org). Market Research and Analysis (MRA) was one of the key components of the MD program. A series of seminars, through a roadshow that was funded by the Dutch government, was delivered by the BSOs to the stakeholders in the MD program by the trained local consultants of the BSO’s Export Training and Coaching Center (ETCC). The trainings also involved key subjects such as market entry requirement, fair trade participation, conceptual marketing and branding.

The final draft of the SEMPs was completed around the fourth quarter of 2009. In these SEMPs one may find the priority actionable plans of the sector BSOs, a market entry strategy (for new target markets) and all other BSOs (including foreign ones), supporters and enablers who will play a critical role in their respective value chains. Also included in the SEMPs are timetables/timelines for the implementation of the priority items in their action plans.

Philexport Cebu, in early 2010, conducted a series of seminars on company auditing and profiling at firm level, for its local export consultants. This program was fully funded by the Dutch government. The said workshop was designed to build capacity for the BSO to be able to troubleshoot weaknesses and address threats of SME (small and medium enterprises) companies in order for them to effectively compete globally.

The following methods were used to instruct the local export consultants on how to audit and profile local SMEs, namely: 1) McKinsey’s 7S Approach (for management, firm and HRM); 2) the 5M Approach for operations and logistics; and 3) Marketing Mix (for marketing and services).

The export fitness and readiness of SME companies was determined through the resulting audits conducted by the local export consultants. The MD program with the corollary activities attached to it contributed to the establishment of value networks abroad, development of new markets in Russia, South America and the Middle East, somehow softening the blow brought about by the two-year recession which lasted till the end of 2009. (The author is Managing Editor, Philexport Cebu News Service)

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“APEC SME Economic Crisis Monitor” is calling for papers for this Column—CM Best Practice. We welcome SMEs and related associations to submit their successful experience in overcoming economic crises. All submitted papers must be at least 1,000 words, but no more than 1,200 words and should be mailed to scmceditor@tier.org.tw. All papers should be in English, and be sure to include author’s name and contact information. Remuneration will be provided once your paper is accepted for publication.
The end of June marks the end of QE2

After the emergence of the financial crisis in December, 2008, the Fed responded with a quantitative easing policy (QE1). By progressively lowering interest rates to nearly zero and purchasing residential mortgage-backed securities (RMBS) and government bonds, the Fed increased money supply to a total amount of 1.4 trillion US dollars.

In order to rejuvenate the economy, the Fed enacted the second round of quantitative easing (QE2) in November 2010, in efforts of simulating market liquidity with USD 600 billion purchase of treasury securities. Now due to a clearer recovery showed in 2011 and heating inflation, QE2 is about to expire at the end of June as scheduled. The Fed said that a low interest rate policy will be kept for a period of time. The Fed’s first step to “normalize” monetary policy is to reinvest with its profits from its security investment; then raising interest rates, and finally the Fed will sell QE2-linked assets in order to deflate its balance sheet.

Though QE2 is still in place, post QE2 effects have loomed up in financial market. Abundant money supply and low interest rates provided by QE2 allow investors to aim at investment with high-payoff and high-risks such as stocks and commodities. However, after the expiration of QE2, supporting forces for stocks and commodity prices will be weakened. Therefore, for the sake of a hedge strategy, demands for bonds will push bond prices up. Besides, treasury yields are going to decline. The ten-year treasury yield descend to its lowest level this year, at 3.09% in middle May.

In addition, there are many US corporations rushed their ways to issue bonds for an expectation of rising rates after QE2. According to Dealogic, month-to-date amounts of issuance of bonds in May, which is only half month passed, have exceeded the whole issuance amounts in April. Amounts of corporate bonds sold by investment agencies during January to May stood at USD 392 billion, which is a rise of around 30% than USD 296 billion in the same period last year. In order to take advantage of the lowest interest rates since May, companies not only rush to issue bonds but also to borrow money from banks. A survey done by Dealogic shows that five-year bank loans have reached USD 66.6 billion, approaching nearly 25 times than the same period last year.

Before the end of QE2 and a rise of interest rates, there will be increasing number of issuance of bonds and booming mortgage. Market will continuously take a wait-and-see policy towards future prospects. In addition, there will be more severe fluctuation in stocks and commodity markets.

European economies are facing continuous downgrades in their ratings

Several European economies are facing credit rating crisis. Besides Greece, Ireland, Portugal and Spain, a downgrade wind blew by credit rating agencies have swept Italy, Belgium and UK. Although IMF has agreed a EUR 26 billion rescue package for Portugal, it seems that there is hardly an end to the European sovereign debt crisis. To creditors, Greece’s both actions in cutting debt and restructurings means a default.

However, constant downgrades in credit rating might affect bond financing. Because Greece might not be able to meet its target of lowering deficit to 7.5% of GDP in 2011 and fail to offer a solution to debt problems, several credit rating agencies, including Moody’s Investors Service, who downgraded Greece’s rating from B1 to Ca
or C; Fitch cut the rating to B+; S&P also dropped Greece’s rating level. If Greece’s default happened, a danger would be post to banking sectors as well. In addition, the bail-out scheduled in June might face uncertainty so that Greek default risk would be increased. The EU might ask Greece to restructure its debt, which might cause debt crisis to spread over economies with poor credit ratings, such as Ireland and Portugal.

Italy, the third largest member economy in the EU, Belgium and the UK were recently downgraded by rating agencies. Italy’s ratings were lowered to negative by S&P and its possibility of further downgrades in the coming two years is 1/3 due to unclear outcome of a debt cut proposal during 2011 to 2014, and foggy economic prospects and economic reform. Now Italy’s long-term rating is A+ while short-term rating is A-1+. On the other hand, because of the difficulty in cutting debts, Belgium outlook is revised by Fitch from stable to negative but its rating remains at AA+.

It is worth noting that a Chinese credit rating agency, Dagong Global Credit Rating Co. (Dagong in short) cut local and foreign currency sovereign credit rating of the UK from AA- to A+ with a negative outlook. In a statement, the organization said that its decision is mainly motivated by a rising percentage of debt in GDP, which affects debt repayment capability of the UK. Meanwhile, due to Bank of England’s indeterminate monetary policy, debt crisis from neighboring economies and an estimation of about 40% of the UK banking system’s GBP 2 trillion worth of assets is exposed to risk, UK fiscal deficit is likely to be worsen.

Several EU member economies are facing more and more severe debt crisis. Besides, the crisis spread from relatively weak economy to the third and forth largest economies as Italy and Spain, and even the UK is on the list. Moreover, there are more concrete discussions about whether economies with weak credits like Greece should leave the euro zone.

The death of Osama bin Laden has had a stabilizing effect on global oil prices

Global oil prices embraced an unceasing uptrend since civil war broke in Libya on 16th February. Nevertheless, after the death of Osama bin Laden, WTI crude oil prices plunged to USD 99.8 per barrel in four days, which is the biggest one-day fall on record since 20th April 2009. GSCI Index of 24 raw materials collapsed 6.5% to 683.83, reaching the biggest drop since 7th January 2009.

Despite of a stabilizing effect on global commodity prices and a driving momentum supporting US dollar to rebound contributed by the death of Osama bin Laden at the time, recent oil prices are back to fundamentals. It is contributed by not only fundamentals of US economy, such as an increase of initial claims for US unemployment benefits, but also the coming end of QE2 and a worsening debt crisis in Europe, which results in a passive outlook on future prospects. These recent situations seemed to show a sign of dismissing short-term trends of oil and commodity prices affected by the death of Osama.
The 18th APEC Small and Medium Enterprises Ministerial Meeting and Related Meetings

Chia-Wen Huang

I. Introduction

The 18th APEC Small and Medium Enterprises Ministerial Meeting and related meetings were held from 13th May to 21st May 2011 in Big Sky, Montana, United States. Among these meetings, the 18th APEC SME Ministerial Meeting and the 32nd APEC SME Working Group (SMEWG) Meeting have discussed the issues of crisis management and obtained fruitful achievements. SCMC also reported its measures of responding to recent potential risks and crises to the SMEWG meeting.

II. The 32nd APEC SMEWG Meeting

The 32nd SMEWG meeting took place on 16th – 17th May 2011 with the aim to seek ways to build up a seamless regional economy by strengthening regional economic integration, expanding trade, promoting green growth and to encourage cooperation regulatory in the APEC region. The meeting this year was chaired by Dr. Robert Lai, Director General, Small and Medium Enterprise Administration, Ministry of Economic Affairs, Chinese Taipei.

In the meeting agenda, an item “Crisis Management including Natural Disasters and Economic Crisis” was taken root. In this section, four economies registered to present their views and experiences of crisis management. APEC economies emphasized on the best practices in the impact of the natural catastrophes on SMEs, and the countermeasures implemented in the light of government policies varying from economy to economy. To be universally known, most major natural disasters can and do have severe economic impacts in the APEC region. Disasters also appear to have adverse consequences for economic growth and development.

1. SCMC

SCMC reported its accomplishment in monitoring economic crises and risks. Until April 2011, SCMC published nine issues of APEC SME Economic Crisis Monitor. In the previous nine issues, many risks and potential crises were explored and given warnings. Take Issue 9 as an example, the Monitor has explored inflation, natural disaster in Japan, political tensions in Middle East. In Issue 8, it has explored food exploration, soaring oil prices and natural disaster in Australia. In Issue 5, hot money, inflation, currency surge, and price rise of commodity were explored. In addition to exploring these risks and potential crises, the Monitor has also taught SMEs how to effectively and instantly cope with them.

2. Australia

Australia presented a case study of “Assistance to SMEs in Flood Disasters”. The presentation outlined disaster assistance mechanisms and how they were activated during the 2010/11 summer to deal with an unprecedented number of natural disaster events. The Natural Disaster Relief and Recovery Arrangements as well as the various initiatives implemented to assist small businesses were also highlighted.
3. Japan

Japan presented a case study of “Japan’s Support for SMEs after the Earthquake”. The objectives of the presentation were to outline the damage to SMEs caused by tsunami, earthquake, radiation, and the widespread impacts on SMEs. Japan illustrated the relevant policies about financing, lending temporary facilities, and reconstruction of damaged factories and stores for the SMEs affected by the earthquake.

4. New Zealand

New Zealand presented an update of “Support to New Zealand SMEs after the Earthquake”. The objectives of the presentation were to share some of the issues faced by SMEs in Christchurch following the 22nd February 2011 earthquake and how the New Zealand Government restored business confidence in Christchurch. In addition, New Zealand made descriptions of some lessons learned in creating an emergency support package for SMEs.

As the discussion shown, responding policies reflected the different circumstances of each economy. Undoubtedly all representatives among APEC economies agreed that economic crises and natural disasters will continue to affect economic conditions in many ways and each economy must reinforce early-warning mechanisms or formulate effective and integrated policies to be well-prepared.

III. The 18th APEC SME Ministerial Meeting

On 20th - 21st May 2011, Ministers and senior officials from the APEC economies gathered in Big Sky, Montana, United States, for the 18th APEC Small and Medium Enterprise Ministerial Meeting (SMEMM).

The purpose of SMEMM is to have APEC ministers meet together under the main theme, “Leveraging Partnerships with APEC Small Businesses to Foster Innovation and Create an Entrepreneurial Society”, and discuss the difficulties and solutions for SMEs to promote export in the APEC region including four sub-themes:

1. Resolving Impediments to Increase SME Exports
2. Embracing Business Ethics to Enhance SMEs’ Competitions
3. Promoting SMEs’ Use of New Technologies to Reduce the Cost of Doing Business
4. Identifying Policies to Support Green SMEs

To achieve the precise linkage among APEC annual key priorities, Japan made a presentation focused on the supports for SMEs after the major earthquake in Japan. The objectives of the presentation were to illustrate the unprecedented challenge faced by Japan, its impact on Japanese economy in terms of supply and demand, as well as Japan’s responsiveness and cooperation with international organizations.

Ministers concluded that SMEs and entrepreneurs are particularly sensitive to natural disasters, as shown by examples in Australia, Japan, New Zealand and the United States this year. Concerning the implementation measures, it is significant for the need to share practices that help SMEs prepare for and recover from natural disasters. Chinese Taipei proposed a multi-year project of SME natural disaster preparedness to explore further collaboration between the SMEWG and the Emergency Preparedness Working Group (EPWG). Ministers expressed the highly supports to this project.
Retired Major of Indian Army and banker of State Bank of India, Suresh Goel, published “Crisis Management: Master the skills to Prevent Disasters” in 2009 and outlined the nature of the crisis management process and identified a number of barriers to the learning process for crisis events.

In the beginning, the author identified four important types of crises that involve an impending abrupt change, which are economic crisis, financial crisis, environmental crisis and international crisis. In terms of economic crisis, the author refers to the sharp transition to a recession, such as 1994 economic crisis in Mexico, Argentine economic crisis in 1999-2002, and South American economic crisis in 2002.

A financial crisis, different from economic crisis, may be a banking crisis or currency crisis that pertains to the uncertainty and herd behavior in the financial market. An environmental crisis relates to natural events that endanger human life and species. An international crisis, according to the author, is a situation where there is a perception of threat, heightened anxiety, expectation of possible violence and the belief that any action will have substantial consequences, including systemic banking crisis that all or almost all the banking capital in an economy is wiped out.

New technology that allows risks to be restructured in novel ways and deregulation that allows significant increase in the efficiency of capital deployed, have also brought a tendency to excessive risk taking.

Though crisis is a major, unpredictable event that threatens to harm an organization and its stakeholders, it is not unexpected. The author illustrates the strategies to tackle with sudden crisis are: (1) Be open and honest with media and customers alike; (2) React quickly; (3) Utilize only one spokesperson; (4) Arm yourself with the facts; (5) Stay on message without being unduly negative; (6) Do not lie to mislead the media, the public, or investigating agencies. These strategies are to establish and maintain contact with important groups, including employee, industry, and community groups.

Preparing contingency plans in advance is the first step to ensure an organization is well prepared for a crisis. The plan should contain information and guidance that help decision makers consider not only the short-term consequences, but also the long term impact on every decision. Following the crisis management strategy and contingency plan, the author also discusses major crises worldwide, including the subprime mortgage crisis, 1997 Asian Financial Crisis, and the global financial crisis in 2008-2009.
With regard to dealing with the uncertainty, the author suggests two phases to tackle the unknown situations. Risk assessment and mitigation are the pre-planning stage that allows us to be aware of the potential risks. The second phase is crisis assessment and management planning which identifies a group of senior executives to form a crisis management team. The crisis management team should receive recommendations and be accountable for providing approval and direction.

Besides, the preparation of contingency plan is necessary because things could occasionally go wrong. Most important of all, the author has defined key financial crisis resolution as a set of measures that restructure or reduce outstanding debt in order to be compatible with a sustainable growth path and reduce the potential crisis-prone debt structure.

However, it’s difficult to develop such a methodology to measure the debt sustainability.

Over the past year, two suggestions have been made to ease this situation. The first one is to suggest that all bonds issued by the government should include collective action clauses that explicitly specify processes to follow in the case of a default. The other one is proposed by Anne Krueger of the former Deputy Managing Director of International Monetary Fund (IMF), to establish international laws for a sovereign debt restructuring mechanism.

Finally, the author concludes with lessons learned from the global financial crisis, and made suggestion in regard to the emerging markets and the domestic macroeconomic policy in the face of international pressure. The major lesson we learned from this once-in-a-century financial crisis is to seriously consider what kinds of institutional relationships between central banks, regulators and other interested parties would serve to avoid and manage financial difficulties. This is, by no means, an easy task.