Creating Opportunities for SMEs in International Competitions

It is noted that the global market is inevitably affected by the European debt crisis. Atentions are not only drawn on whether there will be contagion effects on Italy and other European Union (EU) members, but there are also worries if the debt issues could also influence the economy of France and Germany. Taking the potential damages from international hedge funds into account, the European Stability Mechanism (ESM) is challenged to obtain enough capital as planned. As the Europe debt crisis issue is still heating up and influencing over the future outlook of the global market, APEC SMEs should be prepared and adjust their operation strategies in order to minimize the possible impacts.

Besides, there are more and more free trade agreements established. On 22nd of November, the South Korean parliament has passed the Free Trade Agreement (FTA) with United States, which is less possible to be changed despite the strong domestic opposition. Furthermore, Japan has also agreed to join Trans-Pacific Strategic Economic Partnership Agreement (TPP). These agreements could have effects on APEC SMEs to compete internationally and globally. As understanding the importance of globalization to the SMEs under the changing and increasingly competitive environment, APEC SCMC has held “2011 Conference on Enhancing SME Internationalization” on 28th November, with inviting various experts who have participated in SME-related international conferences and activities to share their experiences for APEC SMEs and related departments to enhance their knowledge on future operations and innovation.

In this issue, the attention has been drawn to the current global economic situations. In Crisis Alert section, there are not only discussions about the Purchasing Manager Index (PMI), consumer confidence and business investment of major economies but also discussions on the bond market of Europe economies. As the current European market has shown little sign of recovery, it is necessary for APEC export-oriented SMEs to pay close attention to the export price changes. In Regional Reports section, the latest international economic situations and the potential economic impacts on the regional economies have been carefully analyzed.

In CM Knowledge section, our experts have paid special attention to the nature of the US unemployment rate. Discussions are drawn to the question whether the US unemployment rate is cyclical or structural phenomenon, which could help APEC SMEs relate the numbers with economic downturns. In CM Best Practice section, we invite the President of Cheerful Fashion Goods Co., Ltd., Chiel Hou, to talk about how the company employ different strategies and how the company transform through different stages to deal with and manage the encountered risks. In CM News Digest section, we have also selected the most concerned news and provide in-depth analysis for our readers, including China’s announcement of CPI which indicates a turning point of inflation, the temporary solution to the European debt crisis, and the collaboration of US and Japan to create the largest free-trade zone in the world, the TPP.

Since the global economic risks and uncertainties still remain considerable, it is necessary for all APEC SMEs to pay attention to the latest international economic movements and be aware of the potential risks and crises. This monitor will keep monitoring all the major global economic trends, with the attempt to provide SMEs supports for facing the continuously changing and increasingly competitive environment.
Observing the recently released Purchasing Manager Index (PMI) of the major economies, we can see that the Markit Manufacturing PMI of the Eurozone in November has fallen to a new low level since July 2009, which means the increasingly worsening debt crisis is dragging the Eurozone to the edge of recession, with the economic performance of Eurozone’s private sector shrinking for the third consecutive month in November. As shown by the data, the initial value of the Markit Manufacturing PMI of the Eurozone in November is 47.2, the third consecutive month for this value to be below the cut-off level of 50 ups and downs; this value once reached down to 46.5 in October, the lowest point in 28 months. The Markit/BME Manufacturing PMI of Germany in November fell to a new low level since July 2009. According to the data released on 23rd November by the research institute Market, although the service business activities were better than expectation, a decline in export demand caused German manufacturing industry to shrink for the second consecutive month, and this shrinking is still speeding up. Besides, the decline in output and in new orders made the Manufacturing PMI of Germany fell to 47.9 in November, which was not only lower than the expected level of 48.5 but also a new lowest level since July 2009. In October, this value stopped its expansion trend that had lasted for 27 consecutive months. In France, the initial value of the economy’s Markit/CDAF Manufacturing PMI is 47.6 in November, which is also a new low level since June 2009.

In terms of the bond market, the German government auctioned 10-year bonds of EUR 3.644 billion on 23rd November, with a coupon interest rate of 2% and the average bid rate of 1.98%. As the average level this year is 2.74%, the oversubscription rate is 1.1, lower than the average oversubscription rate within a year of 1.56, which hinted that the situations may be a poor demand in the bond market.

As many of the European economies have been bogged in the debt crisis, the relatively safer German bond has been sold better than others. The rather poor performance of German bond auction this time, however, signals some kind of danger by showing that investors have lost confidence in the entire Eurozone. Ever since Germany took on a higher responsibility in the Europe Financial Stability Facility (EFSF), there have been higher risks about the economy’s bonds. The auction of 10-year bond is always regarded as an indicator of the financial market. Germany is the most secure economy in the European debt crisis, having been ranked as AAA many times in the risk assessment by international credit rating companies. Judged from the current situation, other economies in the Eurozone have lost this treatment and been faced with an increasingly higher lending rates. For example, the interest rate of the 10-year bond of France has reached up to 3.6%, and that of Belgium even up to 5.16%, the highest point ever since 2002.

The poor performance of the German bond
Auction has triggered concerns about how the European debt crisis begins to threaten Germany, the largest economy in Europe; consequently the euro has fallen sharply against the dollar. Until now, the German bond has always been regarded as the last security fortress of the sovereign bond market in the Eurozone. The current signs of collapse of this fortress are, undoubtedly, a significant negative for the euro.

The continuous downturn of Europe's economy seems to reach close to, or even beyond, the level of falling in 2008, and this means that the economy has been worsened to a certain extent. How Greece forced its creditors accept a write-down of its debts in October has disillusioned investors who tend to walk on a tightrope. As the economic data continue to worsen, investors have started to worry about such convertibility of the bonds—worries that it will inevitably lead to a bond-selling rush. Bond-selling, however, will push up the debt ratio of related economies to a level too high to afford; to stabilize the bond market, the European Central Bank (ECB) will be forced to take actions. Nevertheless, ECB already has its own complex problems. First, there has always been a debate over the issue of whether ECB should play the firefighter role; and secondly, ECB is not able to issue a European unified bond and therefore has only limited capability of preventing risks. As the bond-selling situation goes worse and worse with the deteriorating economy, the worst outcome of ECB's rescuing act will be that, once it becomes exhausted, it will have to give up the rescue plan, letting the market return to its real price trend.

As the debt crisis continues in the US and in Europe, not only has the financial market been under the impact, but the business investment and the consumer confidence in the market have also been dragged. The weak economic performance and uncertain prospects will certainly influence the situations of export, production and employment in some industries in Chinese Taipei. Mr. Jung-Chiou Hwang, Vice-Minister of Chinese Taipei's Ministry of Economic Affairs said on 30th October that the export to Europe in the following six months is certainly under the impacts of the European debts, as shown by the growth rate of the amount of export orders and the structure of the market and products. In other words, manufacturers in the European market now are generally at an "inventory digestion stage," which may have some influence on the manufacturers in APEC region in the future, especially over their capacity utilization in one to two seasons.

Under the current circumstances that there has been no sign of improvement in the consumption of durable consumer goods in the US and European market, the domestic downstream products such as electronic components and optical components may also face a pressure to decrease their export average unit prices. If the unit prices fall too rapidly, the manufacturer may probably choose to lower the capacity utilization when there is such necessity, with the attempt to avoid loss. Therefore, considering all these factors, it is our advice that enterprises should pay close attention to how the export prices change, so as to prepare workarounds at the earliest possible moments.
US Economy Grows—but Slowly, Reducing Risks of “Double-Dip”

Robert Dekle

The US economy, gross domestic product (GDP), grew at 2.5% in the third quarter of 2011, a fast enough recovery to suggest that the US will not go into a “double-dip” recession anytime soon. However, the 2.5% growth rate is still too slow to quickly bring down the unemployment rate. GDP growth will have to be close to 4% for the unemployment rate to substantially decrease. Consumer spending, which accounts for 70% of US GDP rose by 2.5%, while non-residential investment rose by 16.3% and exports rose by 4%. A sharp further rise in consumer spending will be a perquisite for more and rapid GDP growth. The still high rate of unemployment remained a drag on residential investment.

While the third quarter growth figures were good, there is some risk that growth will dip in 2012, partly owing to the uncertainty regarding fiscal policy. Unless Congress expands the payroll (social security) tax cuts and extend unemployment benefits by year end 2011, economists warn that growth will be depressed by between 1.5 to 2% in 2012, implying a GDP growth rate of only 1% in 2012.

The US economy added 80,000 jobs in October, lowering the unemployment rate to 9.0%. The private sector added 104,000 jobs, offset by a loss of 24,000 jobs in government. But job growth needs to accelerate sharply to lower the unemployment rate, two years after the worst recession since the Great Depression of the 1930s. Two years after the recovery, the economy has regained just 2.3 million of the 8.8 million jobs shed during the slump. The unemployment rate has been 9% or higher during the last seven months. The nearly 14 million Americans that are unemployed are keeping a lid on consumption, contributing to slow growth.

Still there is some good news. Today, creation of only 120,000 jobs a month is sufficient to offset growth in the workforce and to reduce the unemployment rate. A decade ago, it took 150,000 jobs to keep the unemployment rate from rising. The main reason is demographic. The working age population of the US is growing more slowly today, and the share of those in the labor force has declined as well. The labor force participation rate is declining because of workers moving on from the 25 to 55 age groups with an 80% labor force participation rate, to the 56 and above age group, with a 40% participation rate. Thus, today with creation of only 120,000 jobs a month, it would be possible to lower the unemployment rate to 8.8% by the end of 2013, a slow rate of improvement for sure, but a decline nonetheless.

In October, the consumer price index (CPI) increased by 3.5% from a year earlier, compared to 3.8% in September. The CPI, excluding food
and energy increased, by 2.1% from a year earlier. Price increases in food and energy appear to be moderating, giving the US Federal Reserve greater scope in pursuing more expansionary monetary policy to stimulate the economy.

Canada

The Canadian economy continues to grow at a steady rate. Growth in the July to September quarter is estimated to be as high as 2.8% at an annual rate, propelled by surging net exports. The growth in net exports in September was especially high, owing to surging energy exports and declining machinery imports. However, with the persistently slow recovery in the US economy and the European economies on the verge of a recession, there is considerable fear that Canadian net exports will slow in the coming quarters, bringing growth in the export dependent economy to a standstill.

Reflecting these growth concerns, the Bank of Canada is expected to keep its policy rate at 1% for the foreseeable future. (The author is Professor at University of Southern California.)

Recent Excessive Exchange Rate Appreciation of Japanese Yen

Naoyuki Yoshino

Japanese economy had faced with two decades of slow growth, and Japan accumulated very high government debt in the past 20 years after the burst of bubble. However, Japanese yen did not depreciate; instead, it had been appreciated severely.

(1) History of Japanese Yen Fluctuations

Up until 1971, Japanese yen was fixed at the level of USD 1=360 yen. When General MacArthur came to rebuild Japan after the WWII, he asked, “What Japanese ‘yen’ mean?” The answer was that it means circle. Then he said it is 360 degrees so set Japanese yen to USD 1 = 360 yen. It sounds like a joke; however it was not sure at that time what the appropriate exchange rate was. In 1979, Japan had started to liberalize capital flows, and the flexibility of Japanese yen had been further progressed. In 1970s and 1980s, Japanese manufacturing industries such as automobile, television, and computers have gained international competitiveness due to technology advancement, and Japan’s exports to the US and other economies have expanded. In 1985, Japanese yen is appreciated when G7 met in New York and set up Plaza Accord.

(2) Appreciation of Japanese Yen and the Asset Bubble of late 1980s

Due to the high appreciation of Japanese yen, Japanese exports had been contracted to overseas, bringing recession in Japan. At then, the Central Bank of Japan started easy monetary policy by lowering its policy rate to record low level of 2.5%, and the money supply had also been increased. However, the expansionary monetary policy did not increase imports as expected; instead, it pushed up the stock price and the property prices. Banks started to make massive loans to real estate market, creating asset bubbles. As looking back, in December 1989, the peak of Japanese NIKKEI stock price was about 38,000 yen, while the current stock price is only about 8,500 yen.

(3) Exchange Rate Appreciation of Early 1990s

The appreciation of Japanese yen in 1990s has forced Japanese manufacturing industries to move to other Southeast Asian economies, which helped these economies to establish their industrial base. And in mid 1990s, Japan’s Foreign Direct Investment (FDI) had moved much more to China.
However, Japanese yen was not so much used for the trade in Asia. This could result from the facts that the exports from Asia were mainly directed to the US and that exports were not headed to Japan due to the stagnant economy of Japan at that time. Asian economies therefore received US dollars from their exports, and they used US dollars for their transactions among these economies. Consequently, trade relations between Japan and other Asian economies were quite strong, but Japanese yen did not become a means of exchange in Asian region.

(4) Recent High Appreciation of Japanese Yen

Japanese yen recently has been appreciated so much in several months, and is could be resulted from the fact that Euro, US dollar, Japanese yen, British pounds, and etc. are internationally traded currencies. Euro region is faced with sovereign debt problems, and US economy was weakened after Lehman crisis; the only reliable currency became to be Japanese yen. Further expansionary monetary policy in the US and Europe also created massive liquidity in the market. Investors are looking for international investments and heading to Japanese yen and international commodities.

If Chinese Yuan were liberalized, international investors would have headed to Chinese Yuan, which would have appreciated Chinese Yuan. But currently, Yuan market is still under control, and massive liquidity hits Japanese yen. Moreover, due to high appreciation of Japanese yen, not only large companies and SMEs (Small and medium sized Enterprises) are moving from Japan to China, Vietnam and other Asian economies.

(5) Seek for Long-term-based Solution for Japan

Japanese sovereign debts are held by Japanese domestic investors, including Japanese banks about 95% of entire debt, which is very different from European economies. Overseas investors see Japan as safe heaven. Japan has to keep on advancing its technological strength to cope with the changing industrial structure. At the same time, aging population turns to be serious problems. Baby boomers are retiring in a few years unless drastic reform would be implemented. It is noted that the pension system in Japan is regarded as Pay-as-you go system. The increase of retired people and the declining number of children could not support the traditional pension system in Japan. Retired people had to keep on working as a labor force before using robot in manufacturing industries. Japanese survey also indicates that many retired people would like to keep on working, but the wage rate has to be adjusted and based on their productivities. Japan’s aging population is ahead of other Asian economies. Japan has to experiment some best practices in order to cope with the problem of aging population. (The author is Professor of Economics, Keio University.)

<Figure 1> Japan’s Currency Fluctuation

(Source: Bank of Japan, Economic Outlook, Nov. 2011)
The European debt crisis has limited direct financial impacts on Southeast Asia. Since Southeast Asian economies have a limited amount of direct investment in European debt, the direct loss of the financial institutions within the region is restricted and controllable.

But, there is increased volatility in the financial markets within the region. Due to the close association of Southeast Asian economies’ financial markets with those of developed economies, there will be a negative conduction on this region’s financial markets caused by the continued turbulence in the developed financial market. On one hand, it will intensify the turmoil in financial markets within Southeast Asia; on the other hand, the continued chaos in international financial markets will have a psychological impact on the region’s economies in the long run.

Of course, the value of foreign exchange reserves in Southeast Asia economies has shrunk due to the depreciation of the euro caused by the European credit crisis.

The impacts of the European debt crisis on the real economy in Southeast Asia economies are more significant and serious due to the characteristics of Southeast Asian economies.

Southeast Asian economies strongly depend on foreign capital inflows, and the European Union (EU) has been the biggest source of foreign direct investments (FDI). Table 1 shows the basic data of EU investment in Southeast Asia economies in recent years.

The EU’s annual investment is maintained at the level of billions of euro, and accounted for 19.1% of total investment in Southeast Asian economies in 2009. The EU’s capital has played an important role in the economic development in Southeast Asia - withdrawal of this capital may lead to currency depreciation, capital markets shrinking, which will cause the shrinking of the wealth of local residents, enterprise finance difficulty, and will inevitably affect the economy severely.

<table>
<thead>
<tr>
<th>Source Economy</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Share in 2009</th>
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<tbody>
<tr>
<td>EU27</td>
<td>17,766</td>
<td>9,249</td>
<td>7,523</td>
<td>19.1%</td>
</tr>
<tr>
<td>USA</td>
<td>8,068</td>
<td>4,812</td>
<td>3,006</td>
<td>7.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>8,829</td>
<td>4,582</td>
<td>5,961</td>
<td>15.1%</td>
</tr>
<tr>
<td>China</td>
<td>1,684</td>
<td>2,100</td>
<td>1,505</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

Southeast Asian economies may also be affected by weakness in the EU markets through international trade. Table 2 shows Southeast Asia's trade with the selected economies. Southeast Asian economies’ trade with the EU accounted for a large proportion of its total amount. Southeast Asia economies’ trades have always been in surplus and have a high dependence on the European Union. The EU recession will reduce the EU’s import demand, which will lead to a slowdown of Southeast Asian exports, thereby affecting GDP growth in these economies.

<table>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EU27</td>
<td>187,572</td>
<td>171,786</td>
<td></td>
<td>29,349</td>
<td>14,196</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>179,068</td>
<td>149,572</td>
<td></td>
<td>33,684</td>
<td>14,831</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>173,062</td>
<td>160,864</td>
<td></td>
<td>-2,786</td>
<td>-4,727</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>171,118</td>
<td>178,185</td>
<td></td>
<td>-15,228</td>
<td>-15,003</td>
<td></td>
</tr>
</tbody>
</table>

(Data comes from the “ASEAN Community in figures” in http://www.aseansec.org/)
As discussed above, there is asymmetric interdependence between Southeast Asia economies and the EU. International trade (mainly in export markets) and FDI (mainly in funding) of the Southeast Asia economies are heavily dependent on the EU. The long run impacts of the European debt crisis on Southeast Asia could be considerable, and the future situation may be quite severe. (The author is professor at Renmin University of China, Beijing and The University of Birmingham, UK)

South Pacific (India, Australia, New Zealand)

External and Domestic Policy Threats Tempered by Expanding Regional Trade and Investment Opportunities

Kenneth Waller

Australia

The Reserve Bank of Australia (RBA) lowered its inflation rate outlook to around 2.5% for 2012, half a percentage point lower than it forecast three months ago. The economy is expected to grow by 2.75% in 2011 (down from 3.25% estimate in August). For the first half of 2012, RBA cut its growth forecast to 4% from 4.5% and its calendar year 2012 forecast to between 3 ~ 3.5% from 3.75%.

On 1st November, the RBA, citing easing inflationary pressures and volatility on global financial markets, cut the official rate for the first time in 31 months, lowering the cash rate to 4.5%, from a developed-world high of 4.75%.

The RBA cited that the main risk in its forecasts was the sovereign debt and banking problems in Europe which have caused periodic bouts of considerable uncertainty and volatility. It warned that “a materialisation of the downside risks in Europe could plunge the region into a "deep recession" and that there would be "flow-on effects to the rest of the world through financial, confidence and trade linkages". Notwithstanding, Australia’s strong trade relations with Asia make it less directly affected by the European crisis.

Mining-related sectors of the economy are growing strongly. For the other industries, the “high exchange rate, the fading injections from the earlier fiscal stimulus and changes in household spending and borrowing behaviour are contributing to subdued conditions.”

The green energy initiatives agreed upon in the recently concluded APEC Forum in Hawaii is expected to boost trade opportunities across the region. APEC leaders pledged to cut tariffs to 5% by 2015 on green goods, make their economies less energy intensive, align regulatory systems and simplify travel rules.

Prime Minister Julia Gillard said that the APEC Leaders’ commitments will open up markets to Australian-made goods such as wind turbine parts, energy efficient fuel cells, water-saving shower heads, and other energy efficiency related equipment that the economy is now exporting or considering exporting to APEC markets.

Of key importance in the APEC Hawaii forum was the announcement of a "broad agreement" between the nine members of the Trans-Pacific Partnership Agreement (known as TPP, which includes the US and Australia) to negotiate a comprehensive and ambitious trade and investment agreement to eliminate all tariffs and other trade barriers. TPP would comprise a total market of 500 million people with a GDP of USD 17 trillion,
larger than the 27-nation European Union. TPP still has the potential to grow further if economies like Canada and Mexico elect to join. Importantly, the Japanese Prime Minister advised APEC that Japan was interested in joining the TPP negotiations.

At a time when the world economy is beset by uncertainty and fears of a crisis spreading from Europe, the TPP trade deal is a welcome sign of the dynamism of the Asia-Pacific region and its capacity to be the engine of global economic growth.

Europe’s economic woes pose a threat to the Government’s commitment to deliver a budget surplus in 2012–2013. Thus sizeable spending cuts are expected to be announces before Christmas. Treasurer Wayne Swan stressed that a budget surplus is vital to retain the confidence of global markets and to contribute to a low interest rate environment.

On the labour front, more than 25,000 new workers will be needed to complete mining, natural gas and transportation projects in Queensland by late-2012, according to the industry-funded group Construction Skills Queensland.

Australia’s unemployment rate climbed in July and August before declining in October for the first time in seven months as employers hired additional workers. The number of people employed rose by 10,100 after registering a gain of 22,500 in September. The unemployment rate fell to 5.2% from a revised 5.3%.

Following strong opposition, the Parliament passed legislation for the introduction of a tax on carbon – initially at USD 23 per tonne of carbon emitted – to be applied to 500 major emitters, starting in July 2012. Ultimately, the intention is to replace the tax an emissions trading system based on a world trade price for carbon. The impact of the carbon tax will be offset by increases in pensions, increases in the tax free threshold of individuals and offsetting compensation to over four million households.

Another major piece of legislation, a minerals resources rent tax (MRRT) and an extension of an existing tax, the Petroleum Rent Resources tax, was passed through the lower house of Parliament this week. It will go before the Senate in 2012. This legislation has also been the subject of major opposition but the minority government managed to secure the support of independents and the green party. The “cost” of support includes raising the threshold before the tax (a tax on super profits) comes into play and the funding of research to assess the impact of the extraction of gas from rural grain producing areas. These changes on projected revenues will be marginal. The benefits to the community more broadly of these tax reforms include tax breaks for families and small businesses, a reduction in the corporate tax rate and an increase in the contributions to the superannuation savings of lower income workers. Infrastructure spending will also be increased. The intended policy is to broaden the benefits of the mining and commodities boom on the extraction of non-renewable resources.

New Zealand

The Reserve Bank continues a cautious monetary stance in November, keeping its policy rate at a record low of 2.5%. According to the International Monetary Funds (IMF) with heightened global risks the current pause is appropriate. Inflation persists above the target band of 1-3% but the IMF predicts annual headline inflation should fall within the target band. The IMF also forecasts growth of just over 2% in 2011 rising to 3.4% in 2012. Recovery and reconstruction costs will contribute to an estimated 2010/11 budget deficit of about 9% of GDP. Nonetheless, the government plans to return to a budget surplus by 2014 ~ 2015.

The Finance Minister has noted that the economy will be at the limits of its economic capacity over the next decade. It will remain competitive in the export sector with growth opportunities in China and India for NZ’s major exports in the agricultural, forestry and coal sectors.

New Zealand’s export industries have welcomed the announcement that economies involved in the Trans Pacific Partnership Agreement (TPP) have agreed to the broad outline of a deal. The partnership currently involves New Zealand, Australia, Brunei, Chile, Malaysia, Peru, Singapore, Vietnam and the United States and now Japan, Canada and Mexico are the latest economies showing interest in participating. The TPP negotiations would involve four of New Zealand’s ten most important trading partners. ExportNZ notes that Japan could open its highly protected
agriculture and services markets. Federated Farmers and Beef and Lamb said a TPP would transform New Zealand agricultural sectors.

One of New Zealand’s most important trading partners, Indonesia, will join the ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) agreement to take force from early next year. Under the agreement, by 2015, New Zealand exporters will receive tariff-free treatment in Indonesia on more than 90% of tariff items, compared with only 11% now.

India

Prime Minister Manmohan Singh speaking at the Summit of the world’s 20 leading economies announced on 4th of November that India hopes to achieve growth of between 7.6 and 8 % in 2012 ~ 2013 after an economic slowdown this year. India’s GDP expanded 7.7% in the second quarter of 2011 over the previous quarter, the slowest in six financial quarters. Analysts attribute the slowdown to recent monetary tightening. The Reserve Bank has raised interest rates a dozen times since March 2010 in an attempt to curb double-digit inflation. Historically, from 2000 until 2011, India's average quarterly GDP Growth was 7.45% reaching an historical high of 11.80% in December of 2003 and a record low of 1.60% in December of 2002).

Adjusted real quarterly growth rates since second quarter 2007 are shown in the graph below:

PM Singh said that India’s medium term strategy to return to higher growth would be to increase investments in infrastructure and to reduce the economy’s fiscal deficit through improved revenue collection. He also called on the IMF to help in the current crisis in Europe as it is hurting other economies as well. He also acknowledged that like many other emerging market economies, India is experiencing high levels of inflation.

India’s food inflation climbed to a 9-month high of 21.21% during the week ended 22nd October against 11.43% in the previous week, mainly due to rising prices of vegetables, milk, meat and fish. Food inflation quickened as vegetable costs jumped 28.9% from a year earlier, and milk prices climbed 11.7%, while eggs, meat and fish increased 13.4%.

According to the central bank Deputy Governor, India faces a “very real threat” from food inflation. The Reserve Bank has signalled a pause in its monetary tightening as Europe’s debt crisis threatens economic growth, saying recent past interest-rate increases will slow consumer demand.

Inflation rate for the non-food articles group was lower at 6.43% during the week ended 22nd October 2011 against 7.67% during the previous week. It was 25.09% during the comparable week of the previous year.

In a move to boost growth, the cabinet in October approved a new national manufacturing policy that aims to generate 100 million jobs and enhance the share of the manufacturing sector in GDP to 25% within the decade. At present, the sector contributes 15/16% of GDP.

The new policy involves the establishment of national investment and manufacturing zones
(NIMZs) to be developed as large integrated greenfield industrial townships and benchmarked against the best manufacturing hubs in the world. Each manufacturing zone will have an area of at least 5,000 hectares with state-of-the-art infrastructures. Investors in these zones will enjoy single-window clearance, lower regulatory and compliance burdens, liberal exit policy, incentives including exemptions from capital gains tax and for green manufacturing and technology acquisitions. Venu Srinivasan, chairman of TVS Motor Co. Ltd. however warned that a poor business environment makes investors think twice before putting their money in India. He noted that the government should address chokepoints such as land acquisition issues, water and electricity availability, regulatory issues related to labour, and proper training for rural-based manpower. The proposed manufacturing policy has set a plan to bridge the vast skills gap in India through public-private partnerships.

Pakistan granted India most favoured status – a move that paved the way for a full normalisation of trade relations and one that will spur economic activities for both economies. The Indian government and the business community welcomed this development. The Confederation of Indian Industry (CII) stressed that trade roadblocks like stringent visa rules, non-tariff barriers, communication difficulties and the opening of more trade routes still need to be addressed. For this part, the President of the Punjab, Haryana and Delhi Chamber of Commerce and Industry said that there is a need to bridge the information gap between the two economies such that investors in each will have greater awareness about the availability of goods and services and markets in the other.

US State Department spokeswoman Victoria Nuland said “this is a very, very big deal, very important”, could lead to really great economic opportunities for both India and Pakistan. Ms. Nuland said it “sets the kind of example that other [economies] in South and Central Asia should follow toward building an integrated regional economy”.

China’s foreign ministry spokesperson Hong Lei remarked that improved Pakistan-India relations is vital for peace, stability and development in the region. Hong Lei assured India and Pakistan that China would continue to support the improvement of their relations through dialogue and cooperation.

(The author is Director, Australian APEC Centre at RMIT University.)
Although hard to believe, developments during the period under review were even more dramatic than in the previous period, complicated as they were by political developments.

Broadly speaking, these developments may be summarised as follows:

- A Eurozone agreement to accept a 50% write-down of Greek debt (owed to the private sector); an agreement to boost the European Financial Stability Fund (EFSF) from EUR 440 billion to EUR 1 trillion, and an agreement to recapitalise vulnerable banks with more than EUR 100 billion, was insufficiently detailed to satisfy the markets;

- The Greek Prime Minister, Papandreou, decided to announce a referendum on the austerity package imposed on Greece by the Troika (the IMF, the European Commission and the EFSF), causing acute market turmoil;

- This spilled over into concerns over the serviceability of Italy’s debt (estimated at EUR 1.9 trillion – about 100% of GDP), intensifying market turmoil still further;

- Failure of the G8 and the G20 to find outside support (mainly from China, India and Brazil) for these various rescue packages, added further to this uncertainty;

- These developments led to the fall of the Greek and Italian Prime Ministers, and their replacement by reputed economists;

- Although a measure of calm has returned to the markets, there are now grave doubts about the survival of the Euro, and the viability of the banking system.

The full implications of these developments are currently being debated within the European Union (EU) and the Eurozone, in the press and media, and amongst policy makers and analysts in Europe and around the world. A wide variety of opinions are being expressed, some of which are particularly relevant for the APEC region. These can perhaps be grouped into the following categories:

- European debt repayment will depend on growth, and since this will not come from within the EU or the US for some years, growth will depend on strong Asian and global demand.

- Asian economies, together with mineral and oil exporting economies, thus need to do two things: to stimulate economic growth in their domestic markets which, to an extent, can be met by European exports, and to participate in any bailout or funding package for Greece and others, either through the IMF or the EFSF.

- The purchase of government bonds in the Eurozone at this stage would convey a strong signal of political support and would reassure and stabilise markets. From a European point of view, this would be both a source of hope and concern; while from a bondholder’s point of view this could represent a unique opportunity at a political, strategic and commercial level.

- Asset sales in Greece, Italy, Portugal, Spain, Ireland and perhaps elsewhere, will have to be used to help pay down debts in the absence of economic growth. Opportunities for Asian investors – both government and private sector – are likely to be considerable as this process develops.

- EU unemployment will remain high for some
time, and an EU strategy to help SMEs through financing, tax incentives and other means is likely to emerge. To deliver on this strategy, however, the EU will have to become somewhat protectionist, which will have implications for APEC economies.

Larger issues, such as the role of the dollar in the global economy, and strategies for rebalancing trade, though of enormous importance in themselves, are likely to be shelved until stability and growth return.

Concerns about the banking system should France and others come under serious pressure are beginning to surface. Confidence in finding a solution to the problem of contagion - that is the spread of the crisis to other Eurozone economies - is currently low in spite of statements of political commitment to finding a solution. At the same time, an alternative to the Euro is even harder to contemplate at this stage.

And with the fact that the elections in Spain are likely to lead to the defeat of the current government, the situation becomes even more complicated. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.)

East Europe

Extended Wait for Euro Debt Solution

*Kuo-Yuan Liang*

**European Debt Measures Finalizes, Technocrat Governments Established**

The month of October involved establishing a framework to solve the European debt crisis, which has been lingering for over two years. A consensus in the solution measures was finally agreed upon in the European Council meetings of 23rd and 26th October. However, the passing through national parliaments and the subsequent implementation were surely somewhat bumpy. As an economist, although I believe there is more that needs to be done, the plans accomplished to this point are still remarkable. These actions will, at the minimum, become part of the greater and ultimate solution to the debt crisis.

The current measures include leveraging the European Financial Stability Facility (EFSF) to above EUR 1 trillion to provide partial guarantees (possibly in the form of optional insurance policies) for newly issued sovereign debt, a “voluntary” bond exchange program for private Greek debt holders with a 50% cut on face value of debt, and requiring European banks to raise core tier one capital (common share equity) levels to 9% of risk weighted assets by the end of June 2012 (from current requirements of 4.5%). In exchange for the support, Greece and Italy will have to introduce additional domestic measures, which subsequently led to political unease in both economies.

In Greece, with the public in revolt, the rescue package agreed on 26th October encountered significant resistance at parliament, which included both opposition and ruling party members. Without the support needed to ratify, much less creating a unified voice to ensure the implementation of additional austerity and reform measures, then Greek Prime Minister George Papandreou called for a referendum for the 26th October package, with his own post on the line. As a referendum would surely fail, serious consequences, including a possible ejection from the Euro, implied by both Germany and France the move prompted the opposition to reverse its non-cooperative stance and support the European Union (EU) debt rescue package. With the opposition party in support of the package, the Greek Prime Minister dropped his referendum plans, and later resigned. Finally, after
some struggles, a new technocratic government was established in Greece. With Italy also establishing its technocrat cabinet, and Spain’s national elections putting most local governments under the same ruling party as the central government, the national politics of the Euro debt will ease for a while, until France’s elections next April.

**Structural Changes in the Euro Expected as Greek Riddles Referendum**

This incident had several implications. First, though Papandreou’s moves secured the political unity that was needed for passing the rescue package and laid the grounds for future implementation of austerity and reforms, his playing with fire, which could have ruined the hard fought rescue package, ultimately sacrificed his own political career. Second, during the incident, German and French leaders had to publicly put Greece’s future in the Euro on the line, once the unspoken issue in European politics. Currently, we have seen Germany’s main ruling party, the Christian Democratic Union (CDU) adopting party policies for establishing rules in exiting the Euro. I consider this as a positive development for the Euro, as it will enhance the governance structure of the currency, and reduce moral hazard. It also gives East Europe economies that are planning, but have not yet joined the Euro, the opportunity to rethink the pros and cons of joining, and what the single currency and further European integration would mean to their economy. Last, the referendum incident will motivate some populist movements around Europe, and we may see demand for more referendums regarding the Euro, bailouts, and other related issues. This might occupy some headlines for now, but referendums are a temporary fashion at best, and not a trend. Hence, in the long run, it will gradually fade.

**East Europe Economics and Finances Still at Risk**

With the new European landscape in mind, East Europe faces several challenges. In the European debt crisis solutions, bank capital requirements were significantly raised, and were given the time to seek private funding before official funding could step in. As it is widely known, East Europe relies heavily on funding and foreign investment from the Eurozone, and now with financial institutions facing tightening liquidity conditions and scrambling for fresh capital ahead of the 2012 June deadline, banks have been drawing cash from East Europe. International Monetary Funds (IMF) chief Christine Lagarde warned recently about such risks, in line with my view in previous columns. National capitals have to be prepared for emergency situations. Besides that, the recent contagion of the debt issue has not only affected Italy and Spain, but also fiscally weaker East Europe economies, as Hungary recently received a negative outlook from Fitch. Markets will continue to pay very close attention to the debt issue. Please notice that the real testament is when emergency US dollar liquidity measures provided by five leading central banks effectively fade next February, at a time when sovereign refinancing pressures escalate as bonds mature. (The author is President, Polaris Research Institute & Honorary Professor, College of Technology Management, National Tsing Hua University.)
Russia Faces a Relatively Stable Economy of Domestic Demand, while the Middle East Enjoys No Optimistic Industrial Outlook

Ming-Hsin Kung

According to the official statement released by the Russian government on the overall economic performance from January to September, Russia’s gross domestic product (GDP) had a good performance in the third season, expanding 4.8% from a year earlier; this is not only higher than the 3.4% of the second season, but it also becomes the largest increase since the second season of last year. In addition to the relatively low base period of last year due to a sharp fall in agricultural production caused by droughts, the reasons for this increase also include the easy monetary policy, which has been driving the economy’s corporate investments and private consumption expenditure towards the way of expansion. In other words, the total economy of Russia has been profited from the policy’s successful stimulation of the economy of domestic demand, having a more stable performance than the US and Europe.

The heating up of domestic demand also helps to recover the public’s confidence in manufacturing production, which was more worrying earlier. Unlike the past three months, when the purchasing managers’ index (PMI) of the manufacturing industries had been always below 50, in October the PMI rose to 50.4. Also, the domestic and foreign order reached to 51.6 and 50.8, respectively, from 49.9 and 48.6. It is evident from these figures that the domestic demand has been gradually heating up.

Another policy factor having influence over Russia’s economic performance in the third season may probably come from the adjustment of the energy tax. Effective from October, the economy’s new energy tax system primarily includes cutting the export tariffs of crude oil and high-quality oil, which has enhanced the fluidity of resources and the investment confidence of companies. Now Russia’s situation is still quite stable regarding the control of inflation. The change-rate of the annual consumer price index (CPI) can possibly be controlled lower than 7%, and therefore the cutting of export tariffs is not expected to trigger an increase in Russia’s domestic oil price.

As estimated by the Ministry of Economic Development of the Russian Federation, the economic growth rate can remain around 3.8% in the fourth season, meaning an annual growth rate as high as 4.1%, a relatively stable performance as compared to the US and Europe. However, the economy’s inflation rate is still generally higher than its economic growth rate; that is, people’s real income is likely still in decrease, and the real interest rates may still be negative. In an environment as such, people are not easily inclined to saving, and this would be unfavorable to Russia’s prospects of accumulating capitals and developing new industries. Prime Minister Vladimir Putin has set up a goal of 7% for the economic growth rate, leading to a positive growth of the real income. Besides, as to Putin’s re-entering the presidential election, although the international capital market in general has considered it to have positive influences, the situation remains to be observed.

When it comes to the Middle East and North Africa, the economic outlook of these regions is still not so optimistic under the influences of the debt crisis of the Eurozone and the internal unrest of the Middle East itself. As to the former, the economy of the Eurozone economies has been slow to recover, bringing impacts not only on the energy and tourism sector of the Middle East, but also on the economic growth of the export-oriented economies in the Bay Area. As to the aspects of geopolitics, there are still high risks of international conflicts in the region in view of the political
instability of Egypt, the constant conflicts between Israel and the Arabian economies, the difficulties Iraq has encountered in post-war reconstruction, and the remaining possibilities of the West’s military operations against Iran. Investments in this region, therefore, are certainly influenced by these high risks.

Regarding the performance of different industries in the Middle East and North Africa, first of all, the oil sector may be faced with a continuous falling of the price in the medium-long term, under such circumstances that there are the sufficient supplies in the second half of the year, that Libya has restarted its supply of oil, and that the global demand has slowed down. Coupled with the factor that the global risk appetite has become conservative, this may not only impact the economic performance of the oil exporters but also force those economies relying on external borrowings to face financing risks. Nevertheless, it can still be expected that investment projects from China and other emerging economies will keep increasing in terms of certain alternative energies and of the infrastructures including telecommunications. Together with the internal fiscal and monetary policies of the Middle East economies, there are still hopes that economic activities can be reactivated, thus lowering the youth unemployment rate, which is now high in the Middle East, and improving the deteriorating finance. (The author is the Vice-President of Taiwan Institution for Economic Research.)

Global Commodity Market

New Geopolitical Risk: Iran’s Nuclear Issue

Hwa-Nyeon Kim

There was a slight increase in warning signs of a crisis in the global commodity market in the last one month period (mid-October to mid-November 2011) as well as an upward turn in prices. Although the sovereign debt risks from Europe continued to weigh down on the commodity markets, healthy US economic data supported raw material prices. New car sales in the US rose 7% in October, with industrial output also rising and jobless claims falling steadily. Furthermore, a majority of commodity prices rose due to positive investor sentiment on expectations that the economic data from the US was signaling a recovery. However, high yields on Italian and Spanish sovereign bonds, both approaching above the critical 7% level, are infecting the global financial market, which in turn also undermines the confidence and stability in the commodity market. Europe’s fiscal contraction plans are still uncertain and they will heavily be affected by Europe’s political schedules including the elections. Financial markets including the commodity market will watch carefully to see how well European economies obey their fiscal deficit reduction plans and by how much sovereign debt is cut. Thus, worries over the contagion of the European fiscal crisis still continue to spread into the raw material markets.

If there is a commodity price worth mentioning this month, it is the West Texas Intermediate (WTI) crude oil price which was unusually undervalued. Since March 2011, the WTI price was below other crude oil prices. However, historically, there is a strong tendency for the WTI price to be greater than other crude prices such as Brent and Dubai oil as WTI contains low levels of lead and is a high quality crude. The reason why the WTI price was undervalued this year was that it was being oversupplied in Cushing where WTI is mostly traded and where there are insufficient pipelines to channel the crude to other locations. Often called a “US Midwest Glut,” as the export of WTI is prohibited, it results in an oversupply and high stock levels, directly translating into low prices. On the other hand, for other crude like Brent and Dubai, prices have been affected by the turmoil in the Middle East and North Africa (MENA) region starting in early 2011, which increased the supply risk. However from mid-November, the WTI price started rising faster than
Among non-ferrous metals, or more commonly known as base metals, there were two metals of which prices increased in the last one month period. Copper and tin prices rose following the previous period, with the average price of both metals going up 2.1% and 0.3%, respectively. On the other hand, prices for the remaining metals such as zinc, aluminum, lead and nickel showed decreasing price patterns.

Although the turmoil in Libya has subsided with the death of former Libyan president Gaddafi, new tensions have emerged in the Middle Eastern region due to Iran’s nuclear issue. The International Atomic Energy Agency (IAEA) released a report laying out its findings on Iran’s efforts to obtain nuclear technology and the possibility that Iran may build an atomic bomb in the near future using the current nuclear technologies and facilities. Iran immediately responded, claiming that the IAEA’s report on Iran’s nuclear program is biased, unprofessional, and politically motivated. Russia also criticized the report. However, the possibility of new sanctions on Iran and a military strike by Israel’s air-force has pushed up crude oil prices. The Iran nuclear issue will be hard to resolve. And consequently, this new tension in Iran, the second largest oil producer in the world, will strengthen the geopolitical risks in the MENA region rather than those in Libya and Syria. Therefore, although demand growth is limited due to Europe’s fiscal crisis, SMEs in especially the petro-chemical industry will see a further increase in crude oil prices and relevant petroleum prices. (The author is Research Fellow at Samsung Economic Research Institute.)

### Changes in Raw Material Prices - 17th October to 15th November, 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>CRB</td>
<td>LME</td>
<td>WTI</td>
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<tr>
<td>Min</td>
<td>495</td>
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<tr>
<td>Max</td>
<td>511</td>
<td>3,582</td>
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<tr>
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<tr>
<td>Last Month Average</td>
<td>512</td>
<td>3,391</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.
The US unemployment rate is currently stuck at 9% (as of October 2011), three years after the onset of the recession in fall 2008, and more than two years after the start of the recovery in the summer of 2009. The US unemployment picture has not been this poor since the early 1980s, when then Chairman Volker engineered a recession to combat the high inflation rate. What to do about the high unemployment rate is the biggest economic and public policy issue in the US today.

The key question is whether the current 9% unemployment rate is a cyclical or structural phenomenon. The long-run “natural” rate of unemployment in the US before the onset of the current recession—in mid-2008—was 5%. Economists believe that in the long-run (4-5 years), the unemployment rate will converge to the “natural” rate of 5%. If that is the case, then the current unemployment rate should over time decline to the “natural” rate of unemployment. However, it may be the case that the “natural” rate itself may have risen—if the natural rate has risen close to the current rate of unemployment of 9%, then there is no way to reduce the current rate of unemployment much lower unless it is accompanied by a huge burst of inflation.

The “natural” rate of unemployment rises when there is a fundamental change in the structure of the economy. For example, suppose that previously many construction jobs were available because of the housing boom of 2001-2007. A collapse in the housing sector would eliminate many of these construction jobs. Suppose in turn that the US demand for workers switched to Chinese speaking software engineers. Unless many of these construction workers learn Chinese and computer programming, they would not be able to switch to these newly available jobs.

That is, there is “supply-demand” mismatch in jobs arising from the change in the structure of the US economy. An increase in demand stimulated by more active government fiscal and monetary policy will not lower the unemployment rate in this case. Only by retraining the construction workers, so that they can speak Chinese and know how to program computer code will the “supply-demand” labor mismatch problem be alleviated, and the unemployment rate go down.

Our argument is that while the current unemployment rate is indeed high, there is not much evidence that the “mismatch” problem is any more severe in the current recession than in previous recessions. The “natural” rate of unemployment probably increased, but slightly, from 5% to around 6% at most. Thus, it is likely that the current high unemployment rate is mostly caused by cyclical factors. To lower the high unemployment rate, the US economy needs to recover, with higher consumption and investment. In addition, further US expansionary fiscal policies such as President Obama’s recent “Jobs Plan” will certainly help in raising the US growth rate, and lowering the unemployment rate.
The US Natural Rate of Unemployment

The “natural” rate of unemployment is the average level of unemployment around which the unemployment rate fluctuates. When unemployment is above its “natural” rate, then there is slack in the labor market, and scope for activist government policies to lower the unemployment rate.

Currently, the “natural” rate of unemployment is “estimated” to be around 5.2%. Thus, given that today, the actual rate of unemployment (9%) is above the natural rate, many economists believe that the actual unemployment rate will continue to decline until it reaches the natural rate. Still, given that the “natural” rate is just an “estimate”, it could be wrong.

For example, the estimate of the natural rate cannot usually take into account sudden structural changes in the economy, due to technological change or trade that changes the mix of skills that the US economy requires. While the estimate takes into account demographic shifts such as the entry of women or of young workers into the labor force, the estimate cannot take into account shifts that are relatively independent of demographics, but are strongly determined by changes in the economy’s industrial structure. For example, it cannot take into account the structural shift in demand from construction workers to computer science engineers, if that demand shift is independent of the workers’ age or gender.

If the usual estimate of the “natural” rate is wrong because of the increased mismatch of workers and jobs, and the “natural” rate is in reality 8%, then there may not be much scope for the actual unemployment rate of 9% to fall. The key question is: has the US “natural” rate of unemployment risen?

No Increased Worker-Employer “Mismatch” in the Current Recession

Daly, Hobijn, and Valletta (2011) evaluate whether the mismatch hypothesis can explain the current high unemployment rate. They examine labor supply and demand imbalances across industry sectors, states and occupations.1

Employment mismatches will occur with uneven job growth, with some sectors growing and other sectors shrinking. The actual amount of job reallocation can be calculated by the difference in job growth across different sectors. Daly, Hobijn, and Valletta show that:

“…the dispersion in employment gains and losses spiked in the most recent recession as a result of severe and unevenly distributed job declines. For example, construction employment declined nearly 25% from the start of the recession through the end of 2009, while health and education jobs grew by 4%. Similar to past recessions, job losses were concentrated in cyclically sensitive sectors such as construction and manufacturing. …As aggregate employment stabilized the dispersion in employment gains and losses across industries and states returned to pre-recession levels, suggesting very little imbalance in the pace of employment growth in recent months (p. 14)”.

Thus, the authors argue that mismatch during this recession is no worse than in past recessions. As the economy recovers, the mismatch should decrease as in past recessions. The US natural rate of unemployment has probably not increased very much from the estimated 5.2%.

Weak Economic Recovery Causes High Unemployment

If “structural” or the rise in the “natural” rate of unemployment cannot explain the high level of US unemployment, then the current unemployment rate must be high because the US economy is cyclically weak. The cyclical weakness of the overall economy is usually measured by the “output gap.” The output gap measures how much the current level of output departs from the potential level of output. When the output gap is positive, the economy is above the full employment level of output; that is, the economy is booming. When the output gap is negative, the economy is below its full employment level of output; that is, the economy is in a recession.

During the recession of 2008, the output gap went all the way down to -8%, lower than the -7.8% achieved in the last large recession of the early 1980s. While during the early 1980s, the output gap recovered rapidly and turned positive in a few quarters, the output gap after the recession of 2008 is still hovering around -8%. That is, even today, the output gap is historically huge and lingering. It is no wonder that given the weak economy, US firms are not hiring, and that the unemployment rate is large. (The author is Professor at University of Southern California.)
Creating Value through Crisis Management

Wei-Chung Huang

Cheerful Fashion Goods Co., established in 1983, is a company founded on the concept of creativity and design. Based on its motto, “Delicate, Interesting, and Creative”, the company has demonstrated how little things in life can be interesting through the use of its products. In proving its capability to its consumers, the company has earned numerous Good Design Awards, as well as owning over hundreds of patents, and the company currently exports to over 60 economies, some of which are currently defined as luxury brands at these economies. Cerruti 1881, LA VIN, and etc. are all part of its designer collection products, with a high quality assurance.

In 2005, as successfully combined with the image of Hakka Tung Blossom Festival, Cheerful has collaborated with other local firms and brought these well-designed Hakka-Tung-Blossom-themed products to the Frankfurt exhibition, opening a road for Cheerful to extend its reach to the cultural and creative industry. In 2007, Cheerful has decided to create a designer brand of its own, named as “poodehii”, which is designed to be the combination of western creativities, fashion and technology with eastern cultures. Through the incorporation of designers’ minds and hand crafting skills, a series of products representing the “heart” of quality life is created. Furthermore, Cheerful has also created a designer-based platform for poodehii as a force in pushing the development of cultural and creative industries. With such platform, Cheerful has earned a high valuation among its industries, winning the company the authorization in developing products for the World Games 2009 in Kaohsiung and products for celebrating the 100th birthday of Chinese Taipei.

Risks for Reaching Out

Though the company may seem to be in good hands, the hardship it took to survive through the years is surely admirable. The president, also the founder, of Cheerful Fashion Goods Co., Chiel Hou, shared his successful experiences in overcoming the hardship of entrepreneurship in difficult times. President Hou believes, in order for the company to expand, there is the need to extend the company’s reach by contributing capitals and time; however, the risk involved in the process may be crushing for SMEs in a startup or development phase as the capability of SME to finance or development are positively related to expansion.

When it comes to risk management, SMEs has their own way of managing risks. As for Cheerful, President Hou has stated:

“What is important for risk management is to eliminate the potential of risks, not just about managing risks when the risks come.”

In fact, due to a flood hitting its plant with huge loss of company’s inventories and equipment, Cheerful was once near the edge of collapse. Under this circumstance, it is foreseeable that the supply
chain would be cut off, resulting in a shortage of supply, due to the suppliers’ unwillingness to support with their fear that the company would not be able to adhere to the payment plan settled before. Encountering this situation, many SMEs could be considering shutting down the company due to the liquidity issues as the SME may not be able to deliver its promised products, disrupting its distribution cycle. But for President Hou, in resolving this issue, it is crucial to build up the company’s image of wealth, giving suppliers enough confidence to support the company. Such image not only rebuilt suppliers confidence as they believe Cheerful will not be so easily affected by the disaster, but it also helped Cheerful to be able to continue its supply chain in preventing the company from collapse. Though it takes some time to plan and manage the SME’s image, the benefits SMEs may receive far outweigh the efforts needed.

Strategy for Image Creation

Back in the 1980s, most of the companies in Chinese Taipei centered on original equipment manufacturing (OEM), of which the companies focus on lowering costs with reasonable quality. As years pass by, the new concept evolved toward original design manufacturing (ODM), which makes patents and copyright become an important issue. As President Hou pointed out, nowadays, the market is shifting toward the concept of “original brand manufacturing (OBM)”, where the SMEs are trying to establish a brand of their own. However, President Hou also indicated that there are many private brands and designers, but there are not many firms know how to manage a brand. The concept, OBM, should be defined as “original brand managing”, where companies should learn how to manage and create value out of a brand, not just manufacturing it.

In an extremely competitive market environment, OEM companies can only survive by competing with its competitors by lower prices to avoid losing their customers. On the other hand, products with strong brand, such as Louis Vuiton, Chanel, and etc., tend to resist the fluctuation in competitors’ prices because what the brands created is not just profit but the value and senses delivered. In other words, the luxury brands have developed an unbreakable image in customer’s mind, creating a sense, or feelings, that generate satisfaction and proudnesc of owning or carrying their products. This sense is what President Hou is attempting to build up in his products; yet, this process requires patience and long-term investment, which process could involve many factors and variables, resulting in considerable risks for the firm.

Considering the aforementioned, President Hou believes that a firm should first focus a few products (more specifically, a few brands) and make efforts to these products rather than a wide range of products (brands). Moreover, firms should also consider adopting internal marketing strategy; that is, employees should understand the value of brand as customers do. In this way, the value of brand can be delivered to the customers’ mind very successfully.

New Business Investment and Start-Up Management Strategy

President Hou has expressed his opinion on the start-up management strategy in an amusing way, “Starting a new business is like cooking a fish. At the beginning, you don’t use a huge frying pan with a high fire to cook a small fish and assign many people to look after this fish. They may come and flip the fish once a while, destroying the fish ultimately. What we should do is to take a small frying pan and cook the fish carefully with a small fire until its ready to be served.”

During the start-up phase of entrepreneurship, it is critical for firms not to lay out all its pieces in human resources. Hiring many employees will generate high marginal costs, this is not necessary when the profits are still low in the startup phase for the company. In addition, it may even create an imbalance in the work force. Taking Cheerful’s experience as an example, hiring many managers with good reputation (which they once did) in the start-up phase only created the imbalance in the work force and other employees’ incentive losses. As President Hou indicated, it is significant for SMEs to allocate their resources efficiently in right places.

The Complication of Risk Solving

President Hou also told us an interesting experience about the complication of risk solving, “A representative of a manager in our company once joined our high level meeting in resolving issues regarding to continuous delays in production, and he has suggested that we could just simply use a label stapler to solve this problem.”
Cheerful has once experienced a shortage in its supply. The reason was because the manufacturer could not deliver the products in time; and when tracing back to the reason why they could not deliver in time was because the labeling process is technological limited and not fast enough to meet the speed of delivering products. As a result, President Hou gathered a group of experts in resolving the issue. However, each of the plans that the experts suggested would cost the company a huge portion of its revenue in order to eliminate the issue. Therefore, the management team could not agree upon the final decision in resolving this issue. Once, during a meeting, an employee from distribution department, representing the department manager, suggested that the company should simply just buy label staplers, which is a low cost solution. This suggestion has immediately made, and President Hou came to realize that they have been making a big deal out of a small matter. Sometimes a simple adjustment could eliminate risks effectively without too much troubles and costs. After all, what SMEs need is to simplify the problems but not make them more complicated.

CALL FOR PAPERS

“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 semceditor@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.

Cheerful Fashion Goods Co., Ltd. is the leading stationery manufacturer in Chinese Taipei, aiming to cheer up the world as well as to create cheerful life for the consumers all over the world. You can find more information at http://www.cheerful.com.tw/
China Announced Its October CPI, Confirming a Turning Point of Inflation

On 9th November, China’s National Bureau of Statistics announced that the consumer price index (CPI) rose 5.5% year-on-year in October, which is in line with market expectations and represents inflation on the decline for the third consecutive month in China. According to Shen Jianguang, the Asia Managing Director of Mizuho Securities, the fact that the October CPI rose by 5.5% from a year earlier not only confirms the appearance of a turning point of the inflation, but also points to the possibility of a sharper decline in the following two months; the CPI may be lower than 4.5% in December. Besides, Lu Zhengwei, Chief Economist of Financial Markets, Industrial Bank, also said that the October CPI is consistent with expectations, but that the rise of PPI by 5.0% is lower than the expected 5.6%, meaning a decline phase of commodity price and a successful “soft landing” of China’s economy. In the future, the rise of the economy’s CPI is expected to be lower than 5.0% in both November and December, with an annual CPI of about 5.4% ~ 5.6%.

According to analysts, even though the macro-control policies have made the commodity price fall down from a high level, China is still faced with a high pressure of domestic inflation. Prime Minister Wen Jiabao already stressed that the first priority would be to stabilize the general level of commodity price, paying more attention to policy flexibility and carrying out pre- and micro-adjustments in proper times and proper ways. Meanwhile, the State Council also re-adjusted the policies in its recent executive meeting, pointing out clearly the necessity of controlling the flexibility of real-estate control policy. Although the CPI is going downward, Qu Hongbin, Chief Economist for Greater China, HSBC, said that the fall of CPI will only strengthen the confidence of the decision makers for partial easing; there is little likelihood for the monetary policy to be eased entirely until the CPI falls back to 4%. Lu Zhengwei points out that the Chinese authorities will continue “adjusting” their monetary policy rather than easing it entirely. In view of the possibility that the fiscal expenditure may speed up and of the fact that the US dollar exchange rate has not been reversed yet, this year will not witness such policies as an overall decrease in the statutory reserve ratio of all bank deposits, a lowering in the statutory reserve ratio of all small and medium banks, or cutting the interest rates.

Temporary Solution to European Debt-crisis

The problems of European debts have been harassing the global economy since 2010. The Greek bond issue was slightly eased because the EU works to enlarge the European Financial Stability Facility (EFSF) and because the Greek Prime Minister gave up the plan of referendum and the government reshuffled. The debt problems, however, already extended to Italy, whose bond yield reached on 9th November to a point of higher than 7%. As the analysis shows, a bond yield higher than 7% means that the economy can hardly have more financing costs and therefore needs an international rescue. Unlike Greece, Italy has an economic scale that is the third largest in Europe and a debt-scale that is 23% of the Euro zone. If it walks on the footsteps of Greece, that will be a catastrophe not only to the Euro zone but also to the international financial market. The amount of Italy’s outstanding bonds now is nearly EUR 1.6 trillion—a scale of debt even larger than the total amount of the debts of PIGS.

To resolve the economic problems, Berlusconi stepped down as prime minister and Mario Monti, former European commissioner took his place; the first task for the new Prime Minister is to recover the market’s confidence. Even though the new government may win more support from
the parliament for implementing more reforms, whether the market confidence will be boosted is still an issue to be observed due to the uncertain prospect. There are rumors in the market that the European Central Bank is buying Italian bonds continuously in order to lower its bond yield rate. However, Mario Draghi, the new president of the European Central Bank, indicated that the bond-buying plan is merely a “temporary measure,” with a “limited size.” Moreover, the Managing Director of the IMF, Christine Lagarde, will also visit Italy to conduct a detailed analysis on the economic problems. By 17th November, the 10-year government bond yield has fallen by 17% to 6.84%.

According to Liu Dongliang, currency analyst of the China Merchant Bank, the amount of Italy’s debts due within one year is about more than USD 4,500 billion, which will increase to EUR 1 trillion after the plans of EFSF to leverage the implementation of 4-fold; this means the actual fund size of Italy will have only be EUR 250 ~ 300 billion (about USD 400 billion). With insufficient market confidence, the EFSF can be depleted by the one single economy of Italy, even without entirely meeting its needs. It is a concern of analysts that since Greece has already set the precedent of winning debt write-downs through negotiation, orderly or disorderly default may also happen to other Eurozone economies such as Italy. The anxiety of the market will continue for months. At present, the market outlook of the euro and Australian dollars is expected to be bearish, and analysts from such US banks as Merrill Lynch and Morgan Stanley all estimate the euro to depreciate to the level of 1.31 to 1.32.

**The US and Japan Work Together to Create the Largest Free-trade Zone in the World, the Trans-Pacific Partnership Agreement (TPP)**

Following the steps of ASEAN 10+3, more and more free-trade organizations have been seeking co-operations, among which the most recent case is the decision of Japan—under Prime Minister Yoshihiko Noda—to participate in the Trans-Pacific Partnership Agreement (TPP), becoming its tenth member on 11th November. Consequently TPP has become the largest free-trade zone in the world, covering one third of the global GDP. Initially, TPP was a binding free-trade agreement (FTA) launched by four APEC members (Singapore, Chile, Burney, and New Zealand). With the rise of Asia-Pacific economy, the US joined it in 2009, strengthening immediately this little-known and loose organization and attracting many new members. Since the US participation is generally regarded as a challenge to ASEAN+N, which is dominated by China, whether China joins TPP or not has become an issue of concern. As to Chinese Taipei, its financial and economic departments of the government all consider joining TPP as an imperative; but the conditions for favorable open environment for trade remain an issue to be deliberated.

With the continuous downturn in the housing and job market, the shrinking of the domestic market, the serious lack of investment, the problem of national debts, and a shortage of domestic demand, foreign demands have become all the more important to the US, which therefore is active in signing various trade agreements with economies in Asia, including the US-Korea FTA that triggered a wide discussion. According to Hisashi Yamada, chief economist at the Japan Research Institute, Japan, with the limits of individual domestic industries such as agriculture, has been obviously lagged behind in the progress of the global economy and trade liberalization during the past ten years; therefore, although the act of joining in TPP itself may not yield a prominent economic effect, through this act Japan intends to be integrated in the trend of global free trade, thus helping to prevent the hollowing out of industry. Besides, there are also analyses that Japan’s primary purpose to join in TPP is to work with the US to resist China and Korea. This move, however, may cause a severe, negative impact on Japan’s agriculture, and therefore the Noda administration’s decision to join in TPP has also been greatly questioned.

Based on various analyses, the establishment of TPP will create the largest free-trade zone in the world, which may even be larger than EU. Through building up this organization, the US hopes to boost the economy effectively without relying on China too much at this time of European and US economic downturn. The decision to join TPP by Japan Prime Minister Yoshihiko Noda has not only boosted the US’s morale, but also made TPP a more important role with its follow-up effects. As more and more free-trade zones have been established one after another, the SMEs will certainly be faced with new competitions, but they can also discover new business opportunities therein. They can make preparations now for the upcoming new challenges.
What's Next?: Unconventional Wisdom on the Future of the World Economy
—Edited by David Hale & Lyric Hughes Hale; Published by Yale University Press, 2011

Chia-Yu Shen

As economic turmoil continues spinning the world, many people are asking: “What will happen next? What is the future of the world?” In this monitor, we are going to introduce an unconventional book that attempts to frame out the future of the world economy. *What's Next: Unconventional Wisdom on the Future of the World Economy* is edited by economic analysts David Hale (Chairman of David Hale Global Economics) and Lyric Hughes Hale (Commentator and Founder of China Online). They have considered the insufficiency of cold numbers and simple statistic projections, and thus the importance of social, financial, and political factors are indicated to be dramatically influencing the economy of major regions.

In this book, in order to understand what may happen to the future economy, a group of prestigious practitioner-theorists is assembled to demonstrate their comprehensive and carefully researched prognoses for the major economies of the world. There are totally eight sections framing out the possible future of the world economy. The first four sections bring together independent intellectuals’ perspectives on major economic trends of the world including Western Hemisphere, Europe, Asia, and Southern Hemisphere. The later half part of the book covers the main, critical and influential issues of the world economy with four sections: reserve currencies, the geopolitics of energy, crisis and reform, and lastly, neuroeconomics. This book reflects varied views on both essential macroeconomic and microeconomic questions, which are valuable for those SMEs who attempt to foresee the future of the world that closely connected to their business.

**Economic Trends in Major Regions of the World**

In the first half of the book, the carefully selected group of economic experts has drawn discussions on the critical economic trends in the major regions of the world. David Hale has argued that the US experienced sustained recovery from 2009 to 2010 due to significant monetary and fiscal stimulus. He has also pinpointed the resilience of the corporate sector, the large gains in productivity, but the high employment rate in the US. As Hale contended, the quantitative easing programs, the compromise on tax policy, and the fiscal stimulus that worth USD 797 million have forced economists to forecast the growth rate to 3.5–4%. However, the deficit reduction issues and the deeper bipartisan divides over fiscal policy have also been pinpointed with the assertion that “there will be no clear economic trade-off for deficit reduction” (p. XVII) unless the bond yields rise dramatically and show a danger sign to the economy, which may not happen until late 2012.

Canada, Mexico, and Latin America are also been discussed in the same part of the book. Joshua Mendelsohn has argued that Canada, as benefiting from stronger banking system, has shown clear
signs of recovery. This Toronto-based independent economic advisor has also indicated some facts of Canada, such as record low interest rates, rising home sales, stimulating fiscal policy, lowest public debt share, and better competitive position for handling climate change issues. Timothy Heyman, one of the leading independent institutional asset managers, has pointed out that Mexico’s future economy depends on how it deals with four critical issues: deep offshore oil exploitation, stronger tax system, security enhancement, and the political reform. Chairman of AMG, Pedro Pablo Kuczynski, has kept optimistic view towards Latin American near future with steady growth, sufficient labor force, increasing female participation and younger generation. However, he also identified that the pursuit for reforms of infrastructure, taxation and education will be the main challenge for Latin America.

As European debt crisis remains unresolved, chief economist of GaveKal Research, Anatole Kaletsky, has shown his concern on the European fiscal policy and pinpointed the need for a major currency depreciation to compensate for its fiscal policy. Louis-Vincent Gave, noting the slowing down Asian growth, has suggested some key factors for Asian market to keep the growing pace, such as the creation of global economy, financial innovation, and the moderation of steady economic growth. However, he has also noted some problems in East Asia, such as private debt, asset inflation and fiscal deficit. And in the later chapters, the economic experts from different regions will tell you how the global economic crisis influences other major regions of the world, including Japan, Sub-Saharan Africa, South Africa, Australia, and so on.

**Reserve Currencies**

Chief Economist of Invesco, John Green, has reviewed the global reserve currencies and further paid attention to the prerequisites for becoming a reserve currency. In addition, He has carefully examined some influential currencies such as the dollar, the euro, the yen, the RMB and even the SDR (Special Drawing Rights) to be the dominant reserve currency. The current development, the pre-conditions and the future prospects have been discussed in detail, which could be worth reading for APEC SMEs to understand further about the global reserve currency and its future possibilities. In fact, there are not only the global currencies that have been examined, but the gold rally and the factors that may determine the mid-term outlook of gold have also been investigated by the book’s editor, which we believe also worth understanding.

**The Geopolitics of Energy**

This book has also arranged one important section talking about the geopolitics of energy by four prominent experts examining specific issues from different perspectives: one from academia background, one as an entrepreneur, and two as economic advisors on climate change. Albert Bressand looks at the oil reserves, the oil-producing economies attitude, the CO₂ level, gas reserves and energy investment. Narimon Safavi investigates the open-ended political situation and the recent conflicts in Iran with noting the key revolutions over the past years and the assertion that the pro-reform forces will eventually prevail but with a long struggle. Lastly in this section, Brian Fisher and Anna Matysek discuss climate change issues with the implications for public policy on the global basis. From the well-known Kyoto Protocol to the future carbon market, they look at major economies’ attitude including the EU, the UK, the US, and China, but they hold pessimistic about the current negotiations in reducing carbon emissions, which may lead to the future three Celsius degree increase and great climate change.

**Crisis, Reform and Neuroeconomics**

In the later parts of this book, several issues have been taken into consideration in two chapters. One is to discuss about the global economic crisis by looking at bank regulation, possible measures of centre banks in the world, the global fiscal system, fiscal imbalances, financial reforms and the future of corporate compliance. Another is to look at the world economy from the process of investment decision-making (which is limited from “boundary rationality”) and the role of information in the modern age. We believe that the last two sections of this book provide APEC SMEs other perspectives to analyze the world economy and help to take better strategies.