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APEC Symposium on Enhancing SME Capacity of Managing the Risks Associated with Trade Liberalization

The APEC Symposium on Enhancing SME Capacity of Managing the Risks Associated with Trade Liberalization is scheduled to be held on August 16th to 17th this year (2011) by the APEC SME Crisis Management Center (SCMC). As an important, major event of the SCMC this year, this symposium is aimed at helping the APEC SMEs respond to the risks related to trade liberalization, enhancing their capacity of finding out the crisis in time and quick responses.

Elites from the industrial, official, and academic fields in the APEC region are all invited to the symposium, including Franklin L. Lavin, Chairman of the Public Affairs Practice for Edelman Asia Pacific; Kenneth Waller, Director of the Australian APEC Study Center; Cathy Jabara, Senior Economist at US International Trade Commission; Diana Smallridge, President and CEO of International Financial Consulting Ltd. in Canada; Kenneth Lo, Chairman & CEO of the Industrial Bank of Taiwan; and Venus C. Genson, CEO and President of Venus Group, Philippines.

During the two days of the symposium, an important topic to be deeply discussed will be the trade environment that the SMEs are facing, and the importance of relevant risk management to their development. The main issues include: how to enhance the SMEs’ capacity of managing trade liberalization, how to avoid and respond to the exchange rate risks, and how to enhance their abilities to manage legal, political, and credit risks. People from different fields are all welcome to attend this symposium.

The current issue of this newsletter is to examine how the US debt crisis would develop in the future, and how it would impact the APEC SMEs. At the part of Crisis Alert, it is our view that, although the risk of US default caused by the debt ceiling can be ignored, we can never afford ignoring its impact. This event is warning us the seriousness of the US debt problem. The risks that have been developing rapidly since the financial crisis, including a flood of hot money, an appreciation of the currency, a soaring of commodity prices, and an imported inflation, etc., may re-emerge under the impacts of the US debt crisis.

Also, in the current issue we invite experts to introduce the global sovereign credit ratings to the readers, and to discuss how the European debt crisis would impact the APEC region. According to their opinion, the APEC economies may be greatly influenced by the European debt crisis, but those are not entirely negative influences; that crisis can also serve as an opportunity to the APEC members.

Moreover, we invite David Lin, President of Fuburg Industrial Co., Ltd., to talk about how to survive the crisis of over-competition by dispersing the risks in the Red Sea of the over-competitive domestic markets. Facing the domestic paper diaper market full of severe competitions, Fuburg not only changed its direction to expand its foreign markets, but also develop a diversity of products at the same time. In this way, the company avoided depending its future on a single market and a single product; it can respond to the risks with more flexibility.

Moreover, we select the most concerned news events, interpreting their contents for our readers. These events include: the US debt crisis, the application of cloud computing technology in the SMEs, and the European debts that may probably cause a new financial crisis. In the meanwhile, we introduce to the readers a best-selling book about the crisis: The Black Swan: The Impact of the Highly Improbable. This book surveys the issue of what kind of attitude we should hold towards some extreme events that are usually neglected and hard to predict.

At this present moment when the crisis risks become higher due to the debt problems of the US and Europe, we urge the APEC SMEs to make preparations as early as possible.

Robert Sun-Quae Lai, Ph.D.
Executive Director
APEC SME Crisis Management Center
The US government is close to default because the current debt ceiling constrains the US’s leverage to repay the debt. Given the scale of the damage that a default would cause, the Republicans and Democrats in Congress have reached the consensus to raise the debt ceiling. This acceptable solution made the US able to meet its financial obligations at least in the short run. Though it has been already expected that a default is actually highly unlikely, the side effects of the current situation cannot be ignored.

This crisis has warned people just how serious the US debt problem is. The US government budget deficit now amounts to 9% of GDP, a level exceeded only by Greece and Egypt; the percentage in 2008 was just 3.2%. This ballooning of the budget deficit has led to a steady increase in the amount of US accumulated public debt. In 2008, the US gross public debt was USD 9.98 trillion; according to US government estimates, this figure will have risen to over USD 15.14 trillion by the end of 2011, an increase of 51.7%. As a percentage of GDP, the US gross public debt will have risen from 69.2% of GDP to 99% in the same period. This means that, not only is the total value of outstanding US public debt rising to a historic high, the size of the public debt as a percentage of GDP is also set to reach its highest level since 1949.

Of course, the really serious problem is not the absolute size of these figures, but rather the speed of debt accumulation and the outlook for the future. Even if US public debt does reach 99% of GDP, by international standards that is actually not a spectacularly high figure. The key issue is that this debt has been fast accumulated in such a short space of time, raising concerns about the ability of the US to repay its debts, and about the impact that debt repayment will have on US government spending. In addition, the outlook of the US debt position is not very bright. In reality, it can be assumed that US public debt will continue to grow speedily over the next few years, rising to an estimated USD 19.68 trillion (nearly 30% higher than 2011) by 2015.

Given that there are currently no signs of the US economy picking up to any significant extent, any attempt to reduce US public debt will inevitably involve a reduction in government expenditure. In their plans for dealing with the debt problem, both the Democrats and the Republicans expressed the need to reduce the budget deficit. However, tighter fiscal policy would have a negative impact on economic growth. At the same time, the debt problem will also place upward pressure on interest rates, which will tend to restrict demand. Therefore, the adoption of a contractionary fiscal policy by the US government is sure to be accompanied by a looser monetary policy by the Federal Reserve (Fed).

Over the next few years, therefore, US fiscal and monetary policy can be expected to take the form of “tight fiscal policy combined with loose monetary policy”, with the aim of reducing the debt burden while also seeking economic growth.
A loose monetary policy is certain to exacerbate the problem of excess liquidity. These developments will cause the US dollar to remain weak, other economies’ currencies to appreciate against the US dollar, and commodity prices to continue to rise.

What this means is that, after a few months’ respite, all the risk factors that emerged in the aftermath of the global financial crisis – including excess liquidity, currency appreciation of emerging economies, rising commodity prices, and import-led inflation – are to re-emerge. The difference of this round is that the keys to determine whether the global economy can rid itself of these risk factors are how successful the US reduces its debt burden, and how well the US government control its budget deficit. This also means that the US cannot afford another bailout action if a new financial crisis erupts as it adopted in response to the global financial crisis of 2008.

The combination of a continued, long-term depreciation of the US dollar, the maintenance of a loose monetary policy over an extended period, and import-led inflation, will cause continued instability in the global economy. Adding the threat posed by the European debt crisis to this instability, it is clear that the outlook for global markets is not bright. While the US debt crisis is not in and of itself as serious as the European debt crisis, its effects could be more far-reaching. Debt reduction is not something that can be achieved overnight, and it can be assumed that the global economy will continue to feel the impact of the US and European debt crises for some time to come.

Given these circumstances, SMEs in the APEC member economies will be faced with a higher level of operating risk, and need to start viewing risk hedging as a vital part of their business strategy. They should monitor fluctuations in exchange rates and in international raw materials prices carefully, and should ensure that they are prepared for possible future risks.
United States

For the second month in a row, job growth was anemic. The US added just 18,000 jobs in June. Private sector hiring slipped to its lowest pace in a year, and government continued shedding workers. The June unemployment rate ticked up to 9.2%, from 9.1% in May. Many remain hopeful that hiring will resume in the months ahead as supply-chain disruptions from the Japanese earthquake dissipate, and lower gasoline prices boost spending power. However, a distinct possibility remains that hiring will remain sluggish, and that consumers will hold off on spending, that in turn will make companies reluctant to hire.

Hiring was weak among all industries. Manufacturing jobs increased by only 6,000, retailing increased by only 5,000, while construction fell by 9,000, and the financial services sector declined by 15,000. At the very least, the weak jobs report makes it highly unlikely that the Fed will increase interest rates in the foreseeable future.

According to a recent US Chamber of Commerce report, US small businesses are not hiring at a clip anywhere close to bringing down the unemployment rate. Almost two-thirds of small business executives said that they are not hiring, and one-fifth are actually slashing payrolls. Many small business executives are gloomy about the economy’s prospects, with 41% expecting the economy to become worse over the next two years.

In June, the overall consumer price inflation rate rose 3.6% from the previous year. The “core” CPI, which excludes food and energy increased at 1.6%. The overall inflation rate increased much more than the “core”, because of the 3.7% increase in food prices, and the 20.1% increase in energy prices.

The US Federal Reserve informally tries to target the “core” CPI inflation rate to around 2%, while eyeing the unemployment rate. Given the current 1.6% “core” CPI inflation rate, the Fed has more reason to keep the policy Federal Funds rate at near zero, especially given the elevated unemployment rate.

Since hitting a recent peak in February 2002, the dollar is down 28% in real terms, according to an inflation-adjusted index by the Federal Reserve. That has helped boost exports and raise the earnings of US corporations. US exports in 2010 were USD 1.3 trillion, up from USD 700 trillion in 2002.

Much of that USD 600 billion increase was due to increased demand for food and manufactured goods from fast growing economies. However, some economists have estimated that up to USD 200 billion of that increase is due to the weaker dollar. However, many economists are wary
of a further dollar depreciation. A further dollar depreciation will expand exports and employment, but will raise inflation. Higher inflation, however, will increase required bond yields, increasing the cost of borrowing, and raising unemployment. Moreover, US firms with operations in economies such as China will lose out, as their exports to the US will be more expensive. Thus, the political consensus in the US today seems to be shifting against pressuring China for a further exchange rate appreciation.

Canada

The Canadian economy is expected to grow at 2.8% in 2011, leading the industrialized economies in terms of economic activity. Inflation rates in May rose 3.7%, the highest in more than eight years. The strong Canadian dollar, however, is expected to be a drag on growth. Given the slight downside risks to growth, the Bank of Canada is expected to keep policy interest rates constant at 1%, or at most raise them to 1.25% by the end of the year. (The author is Professor at University of Southern California.)

Northeast Asia

Excess Expansion of China’s Real Estate Market

Naoyuki Yoshino

China’s economic indicators from January 2011 to June 2011 were announced by the spokesman of National Statistical Bureau, Mr. Sheng Lai Yun. The followings are the figures.

| Real GDP Growth Rate 2011 January-March | +9.6% |
| Real GDP Growth Rate 2011 April-June | +9.5% |
| (1) Primary Industry | +3.2% |
| (2) Secondary Industry | +11.0% |
| (3) Tertiary Industry | +9.2% |
| Contribution of Real Growth | |
| (i) Consumption | +47.5% |
| (ii) Capital Formation | +53.2% |
| (iii) Net Export | -0.7% |
| Housing Sales | +22.3% |
| Growth rate of M2 | +15.9% |
| Growth rate of Bank Loans | +16.9% |
| Growth rate of Bank Deposits | +17.6% |
| Real estate investment (Growth rate) | +25.6% |
Figures of China’s economy alert the excess expansion of real estate investment and housing sales together with inflation. I would like to focus on the asset prices in this report.

The bubble formation in China can be described as follows:

(1) Excess supply of liquidity by the Central Bank

Due to current account surpluses, China’s foreign exchange reserves are keeping on increasing. Despite several changes in reserve requirements of banks, bank loans are expanding at 16.9% which makes M2 (money supply) grow at 15.9%.

(2) Housing prices

June 2011 figures of housing price of 70 cities in China, 14 cities show no change and 12 cities show slight decline of housing price. Among 44 cities where housing prices rose in June, 24 cities show slower growth rate of housing price compared to May 2011 figures.

(3) Sources of funds to real estate sector

In January-June 2011 period, Chinese developers of real estate market raised RMB 4,099 billion which is 21.6% increase compared to the previous year. An increase of total funding to real estate sector (21.6%) far exceeds the rate of economic growth (9.5%). When the economy reaches to the steady state, both figures will grow in the same manner. However, the real estate market in China is yet to be calmed down.

Mr. Sheng Lai Yun comments about the real estate market in China as follows.

(i) Chinese government is increasing the supply of housing for social welfare purposes. Thus the housing construction is rising, which will calm down the housing price.

(ii) Housing prices in many cities show slower increases compared to last year.

However, the increase of total investment in real estate is 32.9% which is almost the same as last year’s figure of 33.2%. The major reason of the huge investment is due to high profitability of the real estate market.

Chinese government restricted the carry-over of asset to stop speculative purchase of the real estate. The real estate developers cannot own the land more than six months before they start actual construction. Housing supply for ordinary people is planned by 10 million housing construction. Central government warned the local government to watch carefully the over-supply of credit to real estate sector and that excessive increase of rent for housing must be regulated. Carefully monitoring of rental housing market and various information about real estate market have to be collected by local government level to pursue stricter control and regulations in local governments.

<table>
<thead>
<tr>
<th>Sources of Funds to Real Estate Sector</th>
<th>RMB 4,099.1 billion (21.6%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Loans</td>
<td>RMB 702.3 billion (6.8%)</td>
</tr>
<tr>
<td>Foreign Money</td>
<td>RMB 43.8 billion (75.5%)</td>
</tr>
<tr>
<td>Own Assets</td>
<td>RMB 1,646.3 billion (32.7%)</td>
</tr>
<tr>
<td>Others</td>
<td></td>
</tr>
<tr>
<td>&lt;Real Estate Investment&gt;</td>
<td></td>
</tr>
<tr>
<td>January- December, 2010</td>
<td>33.2%</td>
</tr>
<tr>
<td>January-June, 2011</td>
<td>32.9%</td>
</tr>
</tbody>
</table>
Deep causes of real estate bubbles

There are several factors behind the real estate bubbles:

(i) Excess liquidity in the financial market, namely excess supply of bank credit and excess increase of money supply are deep causes of real estate bubble.

(ii) Even if real estate loans are regulated, banks can lend money to companies and individuals without going through real estate sector which will keep the real estate prices rising.

(iii) When the real estate market is rising, the revenue of the local government will rise due to higher real estate prices. However, the rising price of real estate market would be based on the bubble, and the losses accruing to various sector such as real estate and housing sector after the collapse of the bubble would be much more damage to the central and local governments. Furthermore, banking sector would face huge default loan losses.

Chinese government should restrict easy monetary policy by absorbing excess money supply from the market; otherwise many policies which will be implemented in China will not work.

There will develop many by-pass channels to fund real estate and housing construction as long as the excess liquidity of the financial market is stopped.

The John Taylor rule of the monetary policy was often introduced in many economies which focus on inflation and economic growth as objectives of the monetary policy. China’s case is different from US sub-prime loan crisis of 2008 and Japan’s asset bubble of late 1980s. Chinese economy is facing both high inflation and high asset price. It makes Chinese central bank much easier to conduct monetary policy to restrict its excessive supply of money. The US was facing lower inflation and high housing price which made the Federal Reserve Board (FRB) difficult to control its monetary policy.

Higher reserve requirement is one of the policy tools however, absorbing liquidity from banking sector by the use of (i) open market operations, (ii) raising interest rate in the short term money market used in western economies, and this must be established in China. At the same time, increases in foreign exchange reserves must be controlled to reduce its money supply. (The author is Professor of Economics, Keio University.)
Last month, Standard & Poor’s cut Greece’s long-term sovereign credit rating to CCC, creating fears over the eurozone debt crisis. Greece is now the lowest-rated sovereign in the world, below Ecuador, Jamaica, Pakistan and Grenada. Standard & Poor’s said: “In our view, Greece is increasingly likely to restructure its debt in a manner that, under the conditions of any package of additional funding provided by Greece’s official creditors, would result in one or more defaults under our criteria.”

What is Standard and Poor’s sovereign credit rating? What about Standard & Poor’s sovereign credit ratings for East Asian economies? In this report, we will answer the second question. In the CM Knowledge of this issue, we will discuss in more details about Standard and Poor’s sovereign credit rating.

The following table gives us a clear picture about sovereign credit ratings for East Asian economies. This is a list of East Asian economies by credit rating, showing long-term sovereign credit ratings as reported by one of the three major credit rating agencies: Standard & Poor’s.

<table>
<thead>
<tr>
<th>Economy</th>
<th>S&amp;P Rating</th>
<th>Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>BB+</td>
<td>Positive</td>
</tr>
<tr>
<td>Malaysia</td>
<td>A-</td>
<td>Stable</td>
</tr>
<tr>
<td>Philippines</td>
<td>BB</td>
<td>Stable</td>
</tr>
<tr>
<td>Singapore</td>
<td>AAA</td>
<td>Stable</td>
</tr>
<tr>
<td>Thailand</td>
<td>BBB+</td>
<td>Stable</td>
</tr>
<tr>
<td>Vietnam</td>
<td>BB-</td>
<td>Negative</td>
</tr>
</tbody>
</table>

Table 1: Standard and Poor’s Long-term Sovereign Rating for East Asia Economies, June, 2011

Indonesia, The Philippines, and Vietnam are all in the BB range. The BB range is the highest one of speculative-grade category. This reflects significant political risk, with political factors possibly disrupting economic policy. Income is low to moderate, and there are problems with economic diversification and structure. The central bank tries to keep sustainable monetary and exchange rate policies, but financial markets are not well developed. When economy growth slows, the financial sector is likely to come under stress. Capital markets have a short history. Debt and debt service are usually high and variable. Openness to trade and international financial systems are more restricted than at higher rating levels. Government revenue and expenditure flexibility is limited by already-high taxes/fees, collection difficulties and spending pressure.

Thailand is in the BBB+ range, which is the lowest one of investment-grade category. This reflects that political factors play an important role here than at higher levels, but economic policies are mainly market-oriented. Median per capita GDP is about USD 5,000, far below the “A”
median’s USD 11,000. Debt may be high, but there is more reliance upon short-term debt. Capital markets are less developed, and the financial sector may be small.

Malaysia is in the A-range. The economies in this range have enjoyed quite rapid economic development and economic diversification in recent years; a result of their success in economic liberalization. It has a fairly independent central bank with sustainable monetary and exchange rate policies, but less flexibility than at higher rated; moderate inflation. The financial sector is well-regulated. A public sector has moderated internal and external debt.

Singapore is in the AAA range, which is the highest rating in Standard and Poor’s. The economies in this range typically have strong and stable political systems, open to global trade and finance, with a prosperous and diverse economy. They also have high per capita income, an independent central bank, low inflation, a well-regulated financial sector and capital markets, and ample external liquidity and low external debt.

In the Outlook column, it is easy to find that Malaysia, the Philippines, Singapore, Thailand are stable. Indonesia has a positive outlook. But as we pointed out in the previous monthly report of this monitor, Vietnam’s outlook is still negative. (The author is professor at Renmin University of China, Beijing and The University of Birmingham, UK)

Official Interest Rates under Pressure Because of Inflation

Kenneth Waller

Australia

Coal exports have been slow to recover in Queensland after widespread flooding of mines in January and this impacted on the first quarter growth. Weak consumer demand is contributing to general concern over the emergence of a two-speed economy. Growth in minerals and commodities more broadly are powering investment and the resultant stronger dollar is impacting adversely on manufacturing and services sectors. Rising food, petrol and electricity prices plus higher interest rates are impacting on consumer confidence. In a pointer to falling consumer sentiment, a major department store chain, David Jones, sharply downgraded its earnings forecast in July. Official data shows sales in department stores fell 1.4% was up 0.4% in cafes and restaurants in the month.

The Reserve Bank governor has sought to reassure Australians that the economy is not faltering. The decline in manufacturing, tourism, and retail are all due to structural adjustment with rising demand in the emerging world, which come offsetting slow growth in the developed economies. He pointed to the unemployment rate being well below the average level for the past 15 years of 6% as an indicator of economic health. Monthly ANZ survey or job advertisements showed a pickup in demand in June. Ads for last month rose 3.7% compared with the 6.5% drop in May. The Prime Minister has expressed confidence in the resources-led economy based on solid Asian growth and despite uncertainty in the US and Europe. However, the RBA (Reserve Bank of Australia) has noted that its forecast for robust economic growth this year of 4.25% is unlikely to be achieved.

The household saving ratio as a percentage of disposable income has climbed by 11% to levels not seen since the 1980s. Australian home
prices fell 2% in the second quarter and rental growth slowed to 1.3%, according to a recent NAB (National Australia Bank) survey. Prices are expected to decline 1.4% over the next year, compared with growth of 0.5% predicted in the bank’s March quarter survey.

Interest rates are on hold for the time being and the RBA will await more data before moving rates. Economists are divided on whether there will be a small rate move, up or down, later in the year. Minutes from the 5th July RBA board meeting revealed greater concern with the global economy and less emphasis on the need for domestic interest rate rises. The CPI release on 27th July will be a pointer to the timing and movement of any interest rate change.

Amid serious political controversy, and following work by a parliamentary group, the government has determined a tax on carbon emissions at AUD 23 per tonne to be introduced in July 2012 on 500 polluters. The tax will be replaced three years later by an emissions trading scheme that will be priced on a world carbon price but aimed at delivering an 80% cut in emissions (based on 2,000 emissions) by 2050. The passage of legislation, which also reaffirms renewable energy targets and funding for research and development and taxation reforms, will no doubt be a rough and gruelling political battle for the government and will be strongly opposed by the opposition party. For these reasons a high degree of uncertainty continues as to whether the government, with a majority of one, will get the package through. Public opinion points to a serious decline in support for the governing Labour Party.

New Zealand

The economy grew by 0.8% in the March quarter, more than twice the central bank’s forecast, and a year on year increase of 1.5%. This follows GDP expansion of 0.5% in the December 2010 quarter. The Finance Minister noted that the promising figures might be a sign of better times ahead. Westpac Bank also notes that economy is certainly showing signs of being well into recovery. The positive data is attributed to growth in manufacturing, up 3.6%, with large increases in machinery, metal product, and food and beverages. Reconstruction in Christchurch, a rebound in retailing and wholesaling, record commodity export prices, interest rates at 40-year lows, improving business confidence, and lower household debt are important factors. Added to this the expected economic boost from the Rugby World Cup adds to the positive tone. As a consequence the growth is forecast for the Westpac predicts a 0.6% increase in the June quarter. Real estate and business services are up 1.0% due to increases in business services, wholesale trade, up 1.5%, construction activity, down 4.3%, the volume of spending by New Zealand households up 0.4%. The better than expected first quarter growth may indicate that the economy was in better shape than expected around the time of the earthquake.

The NZD reached a post float high of 85.07 against the USD on the 14th July following of better than expected growth figures. This has added to predictions that the central bank may raise its benchmark rate from a record-low 2.5% in the fourth quarter. The Reserve Bank Governor stated last month that the pace and timing of increases in borrowing costs will be guided by the speed of the economic recovery from the February earthquake. Inflation figures released this week showed levels are at a 21-year high with higher prices for fuel, food and power. The consumer price index rose 1% in the three months ended 30th June, and an annual increase of 5.3%. A rate rise before the end of 2011 seems likely.

India

The Reserve Bank is scheduled to undertake a quarterly review of the credit policy on 26th July. A change in official rates will be under consideration. Rates have been raised ten times since March 2010. June inflation results were at 9.44% driven by higher manufactured goods and fuel prices and up from 9.06% in May. This result it likely to trigger a further rate hikes, notwithstanding arguments against that by the Banker’s Association. Headline inflation is expected to moderate to around 6% by March 2012 from the current rate of over 9%.

The free trade agreement (FTA) between India and Malaysia will come into force this month giving Indian professionals, including contractual service suppliers and independent professionals, access to opportunities in Malaysia. Items of interest to Indian exporters like basmati rice, mangoes, eggs, trucks, motorcycles and cotton garments, will attract lower or no duty in Malaysia. The new agreement will encourage the temporary movement of business people and will
also help boost cross-border investment between the two economies. Bilateral trade between Indian and Malaysia 2010-2011 fiscal year was USD 10 billion.

Singapore’s imports from India increased by 48% to SGD 9.34 billion in the first half of this year from SGD 6.3 billion a year ago. The Indian government may curtail exports of cotton in the current season as stocks are reported to be much lower than earlier reported. Corporate lobbyists will no longer be able to represent industry concerns following government changes to the way industry interacts with regulators. Only trade and industry associations will be able represent industry concerns. A meeting of Pakistan and India’s joint working group on cross-Line of Control (LoC) confidence-building measures determined that steps would be taken to increase the flow of goods through the LoC.

Micro, Small and Medium Enterprise (MSME) business confidence has declined for the July-September quarter due to high inflation and fears of a further hike in interest rates by the RBI (Reserve Bank of India). The Business Confidence Index (BCI) of Small Medium Enterprises (SMEs) for the second quarter stood at 57.2, a decline of 4.9 points compared with the April-June period. (The author is Director, Australian APEC Centre at RMIT University.)

Contagion of European debt crisis on Latam is peripheral

Cheng-Mount Cheng

The world is now witnessing a three-pronged deterioration of the global economic outlook. First and foremost, European debt crisis has spilt over from Greece to Italy that once again shock-waved financial market. Simultaneously, US growth had obviously lost momentum as signs of flagging business confidence and slow improvement in labor markets point to downside risks for activity. Third, China’s economy is suffering from a policy induced slowdown, as policymakers continue to use all sorts of tool to cramp down inflation that is likely to plateau above 5% for a while. Thus for Latam (Latin America) the external environment is not as favorable as it was one month ago.

Still, we think the current deceleration in Latam growth pace is, for the most part, the result of tighter fiscal and monetary domestic policies and not much of impact from the deteriorating European debt crisis. We identify two main contagion channels from the sequel of peripheral Europe’s fiscal woes, if the situation were to worsen. The first and most important is the effect on commodity prices, of which the Latam as a whole is a net exporter. The second source of vulnerability is financial in nature, as lower asset prices and higher volatility could have an impact on growth. Unsurprisingly, the most vulnerable economies are Argentina and Venezuela, as they are the most reliant on commodity exports to keep their economies on track.

In our view, the moderation in most of Latin America’s growth pace is related to local authorities’ attempt to tighten policy rather than the effects of the current global environment. For example, in Brazil, higher real interest rates, real exchange rate appreciation, the deceleration in public spending and other measures to contain activity have started to slow down the pace of growth. This is evidenced by the deceleration in real wage increases and softer credit expansion,
which point to slower growth in the quarters ahead. Similarly in Chile, where the base effect of last year’s earthquake is starting to fade, fiscal policy has had a more active countercyclical role. In Peru, policy stimulus withdrawal in both fiscal and monetary policies has certainly played a role in bringing down growth rates, with political uncertainty related with Ollanta Humala’s victory in the presidential election likely causing Peruvian economy to decelerate at a faster-than-expected pace. Yet, considering that the problem in those economies was then overheating, rising inflation, and excessive real appreciation of currencies, the cooling-off of activity is not entirely unwelcome.

Remaining economies in Latam present other characteristics. For example, Colombia and Mexico were among the last in the region to recover from the downturn and should continue to see upward growth momentum in the second half of this year (for Colombia) or next year (for Mexico). Even Argentina and Venezuela present differences of their own. In Argentina, activity remains resilient, as the government will likely maintain highly expansionary fiscal and monetary policies ahead of October’s presidential election. In turn, the brunt of the economic downturn will likely be felt in 2012, as the effects of real exchange rate appreciation pervade through the economy. For Venezuela, recovery from the downturn has only just begun on strong public spending, and thus slower activity growth is not likely to happen in the near term.

The fact that commodities make up an important part of Latam exports makes this region particularly prone to commodity price fluctuations. Venezuela’s exports are made up almost entirely of oil and oil-related goods, while more than half of Chile’s exports are copper. Thus regarding to the commodity channel, Latam seems to be more vulnerable to a shock stemming from the US or China, than to a setback in peripheral Europe. The US is still Latam’s main export destination, while China and other emerging Asia economies have also become important receivers of Latam exports. Demand from the euro area as a whole is still important to Latam exports; however, the share of exports to peripheral European economies is quite small. Hence, we believe a worsening situation in Europe should not have a drastic consequence over Latam economies directly through trade. The impact would be more significant through falling commodity prices. But given that intra-regional exports represent an important share of total exports for the region, Latam economies could protect themselves to some degree from rising external uncertainty.

Another channel that could have a negative impact on Latam from European debt crisis is through financial markets and in particular global liquidity, which could hurt asset prices and reduce capital inflow to the region. We think the most likely scenario going forward is a slow removal of additional liquidity by world central banks. This would pose only mild risks for the Latam activity as a slower but steady pace of world liquidity growth would allow this region to sustain its growth pace. A second scenario is that the contraction of liquidity may not occur at all, especially if there is QE3 (Quantitative Easing 3) from the US Fed. This would imply higher inflation fears. A third scenario involves a quick removal of excess liquidity that could cause Foreign Direct Investment (FDI) inflow to Latam to fall sharply and to pose a considerable hurdle to current healthy growth rates in the region. (The author is Vice President, Citi Taiwan.)
The month under review was dominated by the contagion effect of the sovereign debt crisis affecting the peripheral economies of the Eurozone, Greece, Ireland and Portugal.

Through the course of this month, three things became increasingly clear:

· Firstly, that Greece and perhaps Ireland and Portugal would probably have to default on part of their debt (sometimes called restructuring) which would have unknown consequences for mainly EU, UK and American banks – in part because the degree of these banks’ exposure to the sovereign debt of these three economies is not altogether clear.

· Secondly, that the markets were looking with increasingly alarm at the sovereign debt situation in Italy and Spain – the third and fourth largest Eurozone economies, and the possibility of a sovereign default. This alarm stemmed in large part from problems with growth in these economies and to some extent from political uncertainty.

· And thirdly, that any solution to the debt crisis would have serious long-term consequences for growth and employment, and hence political and social stability.

The underlying fear is that the global banking system will face another crisis of almost unimaginable proportion if the debt crisis in the Eurozone spins out of control. The publication of banking stress test results on 15th July did little to alleviate this concern, as these tests were not considered robust enough.

At the same time, three international issues were adding to the sense of worry of policy makers in Western Europe:

· The deadlock over US debt reduction negotiations and the possible consequences of a US default in early August;

· Indications of a slowdown in the Chinese economy and its impact on global demand;

· Rising levels of “imported” inflation and whether this was going to continue into the future, particularly with respect to energy and food prices.

Developments in these three areas would have serious implications, both direct and indirect, to European business strategies, to central bank inflation strategies, and to growth and employment strategies of governments.

As a consequence of all these developments, together with the continuing debt problems of the UK, there seems to be a growing realisation that growth rates will remain low for a long time, and that Western European governments will have to play a smaller role in the economy and state policy management because of deep and long term requirements to cut budgets. The people of these economies will also enjoy less state support, and will have to save more for their own retirement, housing, health and education. At the same time, wages will remain stagnant and productivity will have to rise if these economies are to compete globally. This suggests a massive shift in the lifestyles of people in Europe over the next generation or so, and a lowering of business expectations.

Interestingly, while attention was focused on these larger policy concerns, a number of important policy initiatives at the EU and member economies were also being advanced or announced during the month.
The first of these was about the need to integrate EU telecoms markets, particularly in the mobile phone sector, to give EU citizens roaming facilities at much lower costs.

The second was about the fisheries sector where proposals are being considered to radically reorganise the common fisheries policy to make it more market oriented and sustainable.

The third was in emissions control, trading and management where a number of policy initiatives are slowly making their way through the co-decision making process that would have the effect of imposing stricter caps on polluting industries (including airline and maritime services), facilitating trading and the use of market mechanisms, and the use of green alternatives. Associated with this point was the policy announcement in the UK that the government would be playing a greater role in regulating and managing electricity generation to facilitate a shift to green and sustainable alternatives.

Overall however the dominant issue in the EU during this month was the debate over the future of the Eurozone in the context of the current crisis. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.)

International financial shockwaves may damage regional economy

Kuo-Yuan Liang

International and regional struggles create persisting market turbulence

According to the previous column that was written in mid-June, the international financial landscape has evolved notably. The Greeks remain under the spotlight, and the Americans are gaining attention due to their budget cap talks.

In terms of the Greek debt issue, following Prime Minister George Papandreou surviving a vote of confidence by his parliament and the successful legislation of further austerity, it has shifted back to the Eurozone level. During the past month, several suggestions were proposed and discussed, including the French banks and subsequently the Germans as well in offering to reinvest 70% of their maturing Greek debt in 30-year Greek bonds and EFSF (ESM)1 debt. Yet, rating agencies considered this a selective default.

1 That is, European financial stability facility (EFSF)/ European stability mechanism (ESM)

A more recent proposal was by the Institute of International Finance (IIF) to let the EFSF (ESM) buy back outstanding Greek debt in secondary markets, which is currently prohibited due to German opposition at its establishment. These approaches were in accordance to the Brady Bonds spirit we have elaborated in a special article last month, in which the voluntary proposal swaps the current debt to bonds of longer maturities with better guarantee. Meanwhile, the buyback plan provides the option for those who wish to reduce Greek exposure to exit at a discount price amid the inactive trading volume in Greek bonds.

In my opinion, it takes great courage for the EU officials to admit it needs to include Greek default in the solution mix. They have finally acknowledged that things won’t become better with mere austerity and rescue measures. Therefore, as the Greek issue was about solvency from the
very beginning, denying the need for a default would delay finding an ultimate solution. But, they are finally getting it right. Currently, the EU is discussing strategies that may include elements such as default and buyback. The obstacles now are the EFSF might demand additional funding to prepare for the contagion spreading from Greece to Spain and Italy, and be given permission to buy bonds in secondary markets. Both approaches will require unanimous support from all the Euro Area members. The political wrangling will certainly create turbulence in the markets in the coming months.

In the US debt cap, though the East Europe region has nothing to do with the distant giant, in case it develops into a crisis, or merely into an economic slowdown, capital may once again flow back to the developed world as they did in the financial crisis. It should be noted that fluctuations in the international financial markets have always been a real threat to the relatively small East Europe economies which use their own currency and typically do not have large foreign reserves.

Looking into the foreign exchanges market, we can clearly see the turbulence that has occurred in the past few days. In less than two weeks, starting from the EU’s possible acceptance of Greek default on 4th July to the US sovereign rating being placed on negative watch by Moody on 12th July, the Euro swung violently against the US dollar, depreciating by 4%. If intra-day highs and lows were included, the fluctuation is even greater. The region’s major currencies swung along with the Euro, falling by 4% in Koruna, 5% in Zloty, and 6% in Forint, respectively, against the US dollar, where the fiscally weaker economies slipped more sharply. This is just one of the many ways in how international events can substantially affect the region’s economies.

**ESI survey data shows most economies unchanged**

Looking into the June ESI(Economic Sentiment Indicator) survey data, the major economies in the East Europe region, excluding Greece, have seen little changes from May, mostly small declines or increases. In terms of regions which saw declines, in Poland, the drop was mainly in the industry and retail trade. In the industry, the declines concentrated in expected selling prices and production expectation, while in retail trade the drop was more general. In Estonia, the fall in the ESI concentrated in the service sector. The decline in the sector was a general trend, excluding the rising employment expectation.

In the regions whose ESI climbed in June, the Czech service and retail trade sectors were up slightly, while the other sectors were stable. In the service sector, the business climate advanced the most, followed by an expected climbing demand. But other items factors such as employment fell as well, limiting the overall rise. In retail trade, the components of the business situation and orders were up, but they were dragged down a bit by the decline in employment expectations and lower inventory.

In Hungary, though the general ESI was up, sharp differences were witnessed between its sectors. The industry and service sectors were up, while construction, consumer and retail trade sectors were down. In the industry sector, production expectations and order books climbed, fighting a decline in employment expectation and selling price. In the service segment, with advances in business climate, past demand and employment were held back by weaker expected demand and employment. In the three sectors that declined, the setback was quite general among their components.

In Lithuania, the improvement of the ESI enjoyed support from all sectors, but observing the components, declining employment expectations served as a notable noise in several sectors. Finally, in Latvia, the industrial sector declined, while others rose. The drop in the industry sector was due to the weakening expectations on production, employment, and selling price. In the other four sectors that climbed, the advances were quite general.

Hence, we may come to a conclusion that the major forces driving down the sectors were related to the employment and selling price, and for some cases, it was related to the production expectation in the industrial sector. By contrast, the increases mostly stemmed from improving business climate and production expectations, as well as improving household finances after commodity prices fell somewhat in the past months. (The author is President, Polaris Research Institute & Honorary Professor at College of Technology Management, National Tsing Hua University.)
Regional Business Risks Remaining High Due to Fiscal Instability and Protectionism in Russia, and Tensions in Iran

Ming-Hsin Kung

Due to the decline of international oil price and the slow pace of its privatization of state-owned enterprises, Russia may face higher fiscal deficit and more problems of sovereign debts in the second half of the year. This is remarkably different from the relatively stable economic situation in Russia’s private sectors. The economic risks that Russia faces in the second half of the year, therefore, will come in terms of sovereign debts and the relevant problems of exchange-rate stability.

Russia’s fiscal deficit problem is still quite severe now. According to its government, the problems will become more complicated if the budget deficit rises to more than 3% of GDP. In the meanwhile, however, the Russian Central Bank still offered Bank of Moscow—the fifth largest bank of the economy—a bailout of USD 14 billion, which is the highest amount ever seen in the economy. This move will probably have further impacts on fiscal and exchange-rate stability in the medium and short term.

In addition, Russia is now at the key moment of its foreign trade policy. It is currently planning to cooperate with Belorussia and Kazakhstan to expand their regional economic integration for starting to build up Euraisan Economic Community in 2013. Nevertheless, there are still many disputes in the negotiation among the US and European economies regarding Russia’s entrance of World Trade Organization (WTO).

Earlier in July, Prime Minister of Russia Vladimir Putin expressed a very tough protectionistic attitude about its automobile industry, and President Dmitri Medvedev also declared that Russia must enact a policy of replacing imported products with domestic products in the industrial sector. Both statements not only make it more uncertain for Russia to join WTO but also have impacts on the possibility that whether it can enter other importance systems such as the TPP (Trans-Pacific Partnership). Even though the bilateral trading relation between Russia and China is getting closer now, Russia’s protectionism may prevent the US and China from supporting the economy.

As a result, Russia will face higher economical and managerial risks from the latter half of this year to the next year. Furthermore, the risks in the private sector come primarily from the fact that the export sector may hardly be able to perform well because of the European debts and relatively low international energy prices. As to the risks in the government sector, risks may be seen mainly from the problems of deficit and debts, which are continuously expanding. Fortunately, the agricultural sector in Russia has gradually recovered, and the growth rate of the economy’s CPI has been controlled around 9.6% without increasing since April. Consequently, the risk of stagflation and sovereign debts has been reduced later this year.

When it comes to the Middle East and North Africa, business risks are considered high due to the political instability. However, there are some changes seen on the factors leading to the political instability in the Middle East later this year. Earlier this year, the political instability in the Middle East and North Africa were mainly caused by the trend of democratization inside each economy. Yet, as presidential elections will be held in
Yemen and Egypt, this instability will be reduced. Besides, the United Arabic Emirates (UAE) will offer Egypt a worth USD 3 billion aid package and USD 750 million granted to develop housing and infrastructure projects, which will also help to stabilize the North Africa region.

On the other hand, the tensions in the Middle East are caused mainly by the deep-rooted conflicts between the West and this region. The risks in the Middle East region have been increased by the tensions between Israel and such economies as Lebanon and Palestine and the declaration made by the US that Iran is to resume the work of its underground uranium enrichment plant. So far the US has enlarged the range of its trade sanction against Iran, and Iran itself is also faced with the risks of foreign-exchange shortage enlarging the exchange-rate fluctuations. Consequently, Iran’s economic crisis may probably destabilize the political and military situations in the Middle East.

The overall net Foreign Direct Investment (FDI) inflow in this region reached USD 52 billion in 2010, but there were still declines by 1% and 1.1% in the import and export trade between the Middle East and other regions in the world. As the tensions continue in both halves of this year, it is predicted that investments and trades may go on decrease in the Middle East this year, and that the growth rate of CPI may become more than 9% by the end of this year. It is worthwhile of the APEC SMEs to keep their attentions on these hazardous situations. (The author is Vice President, Taiwan Institute of Economic Research.)

Speculative money moves back to commodity markets

Hwa-Nyeon Kim

In the last one month (from mid-June to mid-July 2011), warning signs of a crisis in the global commodity market have continuously eased. Commodity price indices showed somewhat of a sideward trend. WTI (West Texas Intermediate) oil prices fell to a five-month low of about USD 90/barrel on investors’ concerns over the impact of Europe’s debt crisis on the global economy. And Dubai oil prices also dropped to nearly USD 100/barrel, this time on concerns that the fiscal risk deriving from Italy and Spain were spreading. Due to the uncertainties over a second Greek bailout and a concrete solution to Europe’s debt crisis, Italian and Spanish bond yields rose above 6%. Accordingly, the Bank of America Merrill Lynch warned that sovereign contagion would trigger critical stress signals. Thus, worries over Europe’s debt risk continue to spread in the raw material markets.

If there is a commodity which is worth mentioning this month, it is copper, with prices approaching the 95% range of February’s record high of USD 10,148/ton. Copper prices have drifted higher as tight global supplies and firm Chinese demand helped offset investors’ worries over the sovereign debt concerns in both the US and EU. China, the largest copper consumer in the world, grew at a faster-than-expected pace of 9.5% in the second quarter. Accordingly, investors are optimistic that copper demand will remain strong in the second half of the year and are thought to have come to the conclusion that China’s current monetary tightening efforts would not sharply slow the economy.

Starting from early July, there have been signs that ample global money liquidity will return to the commodity markets. And speculative money, in particular, will be the first to move. According to the data released by the US Commodity Futures Trading Commission (CFTC), there were an additional 12.5 thousand contracts in NYMEX crude oil non-commercial net long positions in the second week of July along with numerous increases in other commodity markets. Non-commercial net
long positions are regarded as a proxy variable for speculative investment demand. Speculative money has also shown re-entry signals in the agricultural commodity markets. Non-commercial net long positions in CBOT (Chicago Board of Trade) corn for the week ending on 12th July increased by 14.8 thousand contracts and those in soybeans rose by 13.4 thousand contracts. Sugar trade in the ICE (Intercontinental Exchange) also posted a notable gain in net long positions.

The top two commodity indices, the CRB (Commodity Research Bureau) spot Index and LME (London Metal Exchange) non-ferrous index, have shown slightly different performances from mid-June to mid-July. The CRB spot index (year 1967=100) moved from 547 to 557 and the LME index (April 1999=1,000) from 3,975 to 4,292. The average for the CRB index from mid-June to mid-July decreased 1.5%, while that for the LME index increased 1.7%. In addition to the decrease in the CRB index, such changes are greater than those of the previous month. This implies that downward trends within the commodity indices are becoming fixed. In terms of price variations, the daily price changes in the LME index were greater than those seen during the mid-May to mid-June period, indicating an increase in investment risk in commodities.

As for energy prices, the WTI near month futures price moved within the range of USD 90.61 and USD 98.67 /barrel and Dubai crude prices between USD 101.07 and USD 111.89 /barrel during the same period. However, the oil price averages from mid-June to mid-July were smaller than those during the previous month, with the average prices of WTI and Dubai decreasing 4.5% and 1.4%, respectively.

Among non-ferrous metals, or more commonly known as base metals, lead and zinc prices raised the most following the previous period, with the average price of lead and zinc rising 4.6% and 3.7% respectively. Copper prices also showed rising price patterns. The maximum price for copper during the last one month period was USD 9,713 /ton. However, other metals such as tin, aluminum and nickel revealed decreasing variations.

There are too many uncertainties in the global financial markets including commodities. However, one interesting fact is that as mentioned above, speculative money showed a shift back to the commodity markets despite the current uncertainties over the debt risks in the US and EU. Because speculative investment does not translate into a strong economy, the increase in the speculative positions of major commodities will not be a good sign in terms of stabilization of commodity prices. Therefore, Small and Medium Enterprises (SMEs) should pay close attention to the movement of non-commercial positions in the commodity futures markets and make provisions for any sudden jumps in raw material prices. (The author is Research Fellow at Samsung Economic Research Institute)

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<th>Index</th>
<th>Crude Oil (USD/barrel)</th>
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<td>LME</td>
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<td>Min</td>
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<td>Max</td>
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<td>4,292</td>
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<td>Last Month Average</td>
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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 Effect of Europe’s Debt Crisis on the APEC Region

Julius Sen

While it is almost impossible to make a direct connection between events in Europe and the APEC region, there is no doubt that developments in Europe’s sovereign debt crisis will have an impact on the global economy more generally, and in time this will affect the APEC region. At the same time, developments in the US (in terms of debt management and restoring economic growth) and in China (in the event that growth slows significantly, or that inflation rises sharply), will also have a global impact. How these larger processes will interact with one another, and affect various regions of the world is being actively debated and discussed by policy makers and business investors everywhere.

Reports of the past few months have touched on different aspects of the crisis. This essay attempts to summarise some of the key issues. Several scenarios can be considered at this stage with respect to the European dimension to this set of problems:

First, if Greece defaults on its debt obligations: if only Greece defaults, or restructures, then the contagion effect can be contained. Greece represents only 2-3% of the Eurozone economy, and a default on its debt stock of about EUR 300 billion would not be that catastrophic, and could probably be absorbed by the global financial and banking system. However, the impact on the domestic economy of Greece would be severe, with parallel policies aimed at cutting budget deficits, privatising state enterprises and assets, taking effect.

With or without default, Greece can expect years and years of low or no growth, with high unemployment and growing social distress. At the same time Greece cannot reasonably leave the Eurozone as this would intensify their problems. While this scenario looks alarming from a Greek perspective, the sale of state assets and enterprises represents an opportunity for international investors: Greece is expected to raise EUR 50 billion in the next two years - a figure that can rise to EUR 200-300 billion if everything is sold. For Asian and international investors, this represents a unique opportunity to acquire assets within the EU.

Second, if other economies in the Eurozone default on their debt obligations: in that event, other peripheral economies will default first - that is Portugal and Ireland - and much the same scenario would apply as described above of course on a larger scale, difficult but containable. However, if the contagion spreads to Italy and Spain - considered to be the next in line - then the problem assumes a system - threatening magnitude. The problem in this context is not simply one of scale, but also of impact. All these economies, including others like the UK, are simultaneously pursuing...
consolidation and austerity strategies that will reduce growth and increase unemployment, making debt servicing harder to achieve. In this situation, there is a real danger of the contagion spreading to the banking sector, even if restructuring can be achieved.

Third, if the global banking system is compromised, under the scenario described above, and in the event of even a partial default, the global banking system is likely to come under enormous pressure. In the main, German and French banks will bear the primary loss, but this will spread rapidly to banks that refinanced many of these loans, and this would drag American, British and many other international banks into the mix. The question being debated currently is how the banking system will react.

One line of thinking is that the banks will be able to absorb the losses without much difficulty, but will continue to strongly make the case that any widespread default would be catastrophic. The alternative line of thinking is that the effects of contagion will indeed be serious because some of the banks holding Eurozone debt are "systemically important". In response to this situation, regulators have been busy during the past few months recapitalising vulnerable banks, and requiring mainstream banks to hold more reserves to deal with a possible crisis.

Fourth, if growth fails to materialise in the Eurozone; a longer term of worry for the EU is that growth will fail to revive and competitiveness will decline, leading to the long term erosion in economic and political power. This seems to be inevitable in the current model of globalisation, especially where labour costs in Asian and other emerging economies can be kept down, and where the high cost of social welfare systems can be largely avoided.

In this scenario, the direction of events in several areas will be affected. For example, the loss of competitiveness will possibly lead to the acquisition of those assets in EU economies by emerging economies on a significant scale, with MNCs (multinational corporations) of Asian and emerging economies increasingly dominating the global business agenda as a consequence. Indeed, this process could advance more rapidly than anyone's anticipation because of the debt crisis on the European side, and the accumulation of vast reserves by some emerging economies. Another possibility: leadership in the global climate change and alternative energy agendas will be assumed by emerging economies, who will use this privilege to align their priorities with international regulatory requirements - something that the US and the EU used to benefit from and often take for granted.

Taking the uncertainty of the US situation into account in addition, and factoring in China's tapering growth levels and the instability of the Arab world and the effect this has on global energy supplies, the current situation in the global economy is fraught with uncertainty and could evolve in one of several directions. Anticipating developments is thus very difficult. At the same time, it is increasingly clear that the EU will decline as an economic power given their onerous debts and policies of consolidation and austerity. This in turn will almost certainly lead to massive asset transfers to international investors and a shift in policy and business leadership to other parts of the world. If the US is also unable to resolve its problems - which seems likely - then this process will possibly intensify, though how and in what form is hard to determine or anticipate.

For APEC economies, these developments could have huge consequences, with opportunities and threats distributed across economic and business sectors. Broadly speaking, economic sectors with significant reserves, or with access to financing, will be best placed to take advantage of these developments. Business sectors heavily integrated with Western MNCs, could face difficulties, but paradoxically, could also be in the best position to take advantage of these developments. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.)
Global Sovereign Ratings

Sovereign credit ratings are similar to credit ratings for individuals. A sovereign credit rating is a financial indicator to potential investors of debt securities such as government bonds. There are three major global credit rating agencies: Moody’s, Standard & Poor’s (S&P), and Fitch Ratings. They use letter designations (such as AAA, B, CC) to represent the quality of a bond. Bond ratings below BBB/Baa are considered to be below investment grade and are called junk bonds.

Sovereign credit ratings focus on the future ability and willingness of sovereign governments to pay their commercial and financial obligations in full and on time. Sovereign ratings are forward-looking estimates of default probability. They are not an economy’s rating. Thus, they do not give any evaluation on exchange rate or regulatory risk or anything that affects the business operation of the private sector.

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<tr>
<th>Moody’s Long-term</th>
<th>S&amp;P Long-term</th>
<th>Fitch Long-term</th>
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Source: http://en.wikipedia.org/wiki/Bond_credit_rating
Defaults on sovereign foreign currency bonds have occurred many times since the 19th century. Sovereign bond default rates became very high during World War II. In the 1970s and 1980s, the main medium for financing governments was international bank loans. Defaults on international bank loans peaked in the early 1990s and have since fallen, whilst the bond default rates have increased again.

The main analytical framework for sovereign credit ratings covers the following categories: political risk, income and economic structure, economic growth prospects, fiscal flexibility, general government debt burden, offshore and contingent liabilities, monetary flexibility, external liquidity, and external debt burden.

The following table is a list of selected economies by credit rating, showing long-term sovereign credit ratings as reported by Standard & Poor's.

From table 2, we can see that most of the developed economies are in the category “AAA” and their outlooks are “Stable”, with the exception of the United States. Most of PIIGS outlooks are “Negative”. Most developing economies are in the category “BBB” and their outlooks are “Stable”. This may explain why the whole world’s attention is on the Eurozone. (The author is Professor at Renmin University of China, Beijing and The University of Birmingham, UK)

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<th>Table 2: S&amp;P Long-term Sovereign Credit Ratings</th>
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<td><strong>Selected Developed</strong></td>
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<td><strong>PIIGS (Portugal, Ireland, Italy, and Greece)</strong></td>
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Fuburg Industrial Co. Ltd., now in its 35th year of establishment, is the earliest entrant of the business of adult diapers in Asia. Over the past 35 years, Fuburg has undergone the chronological challenges from a virtual monopoly as the sole provider, to market preeminence as the leading brand, and finally to fierce internecine cut-throat competition with competitors engaged in vicious self-defeating price-based market wars.

After went public, Fuburg saw huge losses from 2000 to 2006 due to price competition, which amount was over 75% of overall paid-in capital. As third-five competitors went out of business, Fuburg was finally able to survive under the red ocean.

This miraculous survival was not a result of Fuburg’s strong capitalization, but rather Fuburg paid much prudent attention to responding strategies under this crisis. The operating direction of Fuburg does not indulge in single market as predominant, but spread risks to reach out into different overseas markets and diversify products, with a focus on managing market channels, to successfully establish their own business model.

**Excessive competition burn down all savings**

In Chinese Taipei’s shallow plate-like market, there were six competitors active in similar production. In a market that was simply flooded with competition and overinvestment in production capacity, interested foreign investors were naturally hesitant, sensing that Chinese Taipei’s market had not already been under control, and the competitors was burning down all savings through excessive competition.

President David Lin recalls, “The real force that affected massive losses on the industry were not increases in raw materials overhead costs, but from excessive price competition”.

As for Fuburg’s secrets to survival, one key was their successful spreading of risks, devoting only 80% of their capital resources to facing the consequences of their intra-industry competition,
and reserving 20% for development of overseas market. President Lin made effort to increase the percentage of export and at the same time, work to invest in overseas manufacturing facilities.

The portion of international sales was increased from 30% to 70%, and besides their operations on Chinese Taipei, Fuburg expanded to China and Thailand to establish manufacturing factories.

Besides diversifying single market risks, Fuburg also sought to expand its product offerings, by developing premium lines among its infant diaper and hygiene products, which emphasized their value-added contributions.

So when the diaper market on Chinese Taipei was subjected to precipitously furious price gouging wars, Fuburg had early sensed the need to move its market reliance abroad and to other products, so that even amidst such unrestricted internecine warfare, Fuburg was able to endure only tangential affects.

The art of surviving

As the fierce price wars became most intense, Fuburg was able to think reversely, and not remain sycophantically fixed on brands, but working to establish effective logistics and marketing channels.

President Lin explained his perspective: “When price wars were raging, if one were solely dependent on middlemen then there might be no room for maneuvering, but if you brought upstream and downstream to your control, you can flexibly adjust sale pricing, so that as long as we could maintain profitability, our market penetration rates were no longer of critical concern after our 35 years in operation.

President Lin thus understood that manufacturers today must survive in an environment of minimal profitability, such that the absence of one’s own platform could easily make it impossible to remain afloat.

So after building up a successful marketing and distribution network, this virtual asset can be essential not only for marketing one’s own products, but others’ offerings or competitor products, such that Fuburg had emerged as a retailer as well.

During the crisis as the rapid changes affected the direction and momentum of Fuburg’s path to survival, the means to staying alive became apparent through this survivability instinct; that is, eliciting a fruitful business model and ensuring that they did not make the same mistakes twice.

Reaching out for the reeds and grasping every opportunity

Innovation and new product development are the means of risk diversification. For Fuburg, even at the advent of their introduction of adult diapers 20 years ago, the product potential was not widely appreciated, and the market prospects were not seen as particularly bright. Throughout the arduous competition that followed, Fuburg adhered to diversification principles, entering into maternal and infant products, including infant washing detergents, infant wipes, feminine hygiene pads, breast pads, bottles, and nipples, while also greatly expanding their potential customer base.

In spite of the inherent constraints to the marketplace on Chinese Taipei, Fuburg was able to successfully penetrate the Japanese markets. President Lin explained, “The greater the variety of our product offerings, the greater the possibility for our profitability and the more stable our operations will be, all of which entails a much greater competitive profile”.

In terms of research and development prospects, rather than emphasizing only a single product, Fuburg focused on strategies anticipating evolving market trends instead. Single product strategy requires a sufficient market size for the product, so for Fuburg, innovation diversification was an appropriate operating strategy. Maintaining maximal market adaptability, Fuburg pays attention to product life cycles for adjustments throughout the research and development process.

Innovation can produce value-adding that can help enhance one’s competitive posture in the market. When facing stiff price competition, Fuburg was able to develop alternate brands as new fronts in the battles. This not only can counteract the competitors’ market penetration, but also helped reduce any deleterious effects on existing brands or the firm overall.
**Appropriate utilization of public resources**

President Lin also sought to remind other SMEs that they should ensure appropriate utilization of public resources, to apply for tax abatements, subsidies, and participate in cooperative programs, as well as competitive events designed to enhance their visibility.

Since SMEs have limited resources, they need to ensure careful stewardship to deploy resources only where actually needed and productive. Moreover, in terms of one’s entrepreneurial attitude, it is important for SMEs to not think of themselves as small or insignificant, but to have an appreciation for their proper place in the global market, and to work assiduously in developing new markets with utmost sensitivity and perceptiveness.

**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 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 US Debt-Ceiling Crisis

It takes long time for the US congress to reach an agreement on the debt-ceiling issue to avoid default. Moody’s and S&P have put the US on negative credit watch list. The number of the US Public Debt Clock is running up in a fast speed after passing the USD 10 trillion in 2009. In July, 2011, the US debt limits had to be raised again to avoid default. The US debt ceiling shadowed US bond market with uncertainty, which is called “periodic uncertainty” by Moody’s, meaning that the US has been trapped in a circle that every time when the new loans reached the ceiling, a recent raised debt ceiling will be once again insufficient and reveal the potential of default.

Doubtful investors start to sell part of the US long-term bonds so that the prices are slipping recently, and accordingly, the interest rate will possibly rise. If the sovereign debt crisis keeps aggravating, there will be impacts on the stability of global market.

As former US Treasury Secretary Summers said, “The one thing that is very clear is that not raising the ceiling makes Armageddon inevitable.” The first to collapse in the chain reaction will be a dump of US bonds, then the deeply depreciated US dollars and rocketing prices of store of value, like gold, at a record high. Besides, the domino effect of US default might force capital to flee to raw materials, such as oil, and agricultural products to hedge.

To the SMEs that are export oriented, depreciated US dollars will savagely impact their operation. Rising prices of raw materials are unfavorable for cost controls as well. In the end, those economies targeting the US as a main export customer will face shrinking orders caused by decreases in US consumer demands.

Presently, most research institutes and economists believe that US debt-ceiling problem will be resolved eventually. In addition, US sovereign bonds are and still will be seen as a main target of foreign reserves by many important economies, especially Asian ones. As a result, the bonds are going to be supported by strong orders, and are not likely to be dumped immediately. However, rating agencies, including Moody’s, S&P and Fitch Ratings, are planning to degrade triple-A rating of the US to reflect possible risks of default, which will inevitably influence investors’ confidence in US bonds.

Cloud Computing for SMEs

In fact, there is nothing new in the technology of cloud computing. Nevertheless, the reason why cloud computing has been highly valued recently is that it can help to cut down costs and improve efficiency greatly for SMEs.

The basic application of cloud computing is to store information. In the past, in order to store and back up important information, most companies choose to build up their own storage servers for ensuring the information security. However, this will only make the information be stored in one place, no matter virtually or physically, which still pose risks on information safety, not to mention the high cost of data storage and maintenance. As a result, the storage services using cloud computing have gained its popularity.

Thanks to the widespread of internet network, cloud services are free from physical barriers. In addition to basic storage services, information management, such as emails and applications, can also be accessed through cloud services. Furthermore, cloud software enables an integration of information stored in the cloud so that different data providers can exchange their works and ideas in a short time, hence improving efficiency.
Now the cloud service applications have been developed to the extent that information service providers, such as Google, Microsoft, Apple, etc., are able to offer substantial services for free to make the life and work environment more convenient. With the Internet, users can work and share files even without downloading software, so that a great amount of bandwidth and storage spaces can be released, which therefore accelerates operational speed. Besides, the cloud-based firewall has been set up in advance, thus improving information security. At present, the concept of cloud computing is still in its early stage. In addition to software improvements, the compatibility with smart phone and tablet PC will also be one of the key elements for the future development of cloud computing.

**Will the European debt issue trigger a new financial crisis?**

Some thought that after the EUR 12 billion bailout fund to Greece, European debt crisis, though might not be totally resolved, can at least be controlled and limited to Greece without spreading out to other economies. However, credit rating agencies did not consider this way. Fitch Ratings further degraded Greece’s credit rating into CCC, while Moody’s Investors Service downgraded Portugal’s rating from Baa1 to junk territory Ba2 and retained a negative outlook. Soon after that, Moody’s degraded Ireland’s rating to junk, or Ba1, with negative perspective.

The crisis started from downgrades by credit rating agencies, but the key problem is that the contagion may spread to Italy and Spain which is the EU’s third and fourth largest economy respectively. It is noted that the total debt amount of Spain itself has been equal to the sum of bailout funds to Greece, Ireland and Portugal combined. Besides, Italy’s sovereign debt has also far surpassed the amount that the EFSF (European Financial Stability Facility) can afford.

Though the bank systems of indebted EU members have passed the stress test, which indicates less liquidity problems in the financial systems, several EU economies still fail to get positive reviews from rating agencies no matter how hard they tried to cut the debts and deficits. The question now for the European debt crisis is that banks could not be certain about the risk level of EU’s unhealthy bonds, and there are negative reviews placed continuously by rating companies, hindering the abilities of these indebted economies to defuse debt. It is hard to say if the market confidence in Spain and Italy will fall, and if it really happened, this may lead to an increase on the bond interest rate and difficulties to pay the mature bond, which may possibly aggravate the situation and force Spain and Italy to seek the EFSF for rescue packages. The underlying issue for the Eurozone is that whether the rescue for Greece can help to stop the crisis from expanding to other core members.

SMEs should pay close attention to the issue because the instability of the Eurozone will directly oscillate the Euro exchange rates and also have impacts on the other non-EU economies. The impacts will be seen in several aspects: on the one hand, Swiss franc reveals strong trends, appreciating vigorously against the Euro; and on the other hand, due to the European debt crisis, Zloty and Forint fell violently against Swiss franc to a record low, which will add to the two economies’ interests on loans.
The author of one of the best-selling books: Fooled by Randomness, Nassim Nicolas Taleb, has turn over the readers’ conventional ways of thinking by providing a revolutionary perspective. There are some ideas such as:

- What we don’t know has been playing a much bigger role in our lives than what we think we know;
- Actually we are living in the world of extremes, with profound inequalities, a solitary observation could reject those what we thought was truth;
- We are very eager for been disciplined or being around with rules, and this fact forces us to believe that the world is not as random as it otherwise appears.

The author has been discussed about these related issues from the prospects of psychology, natural science, philosophy, and business management. He intends to force the readers to re-examine their understanding of the relations between forecasting and randomness.

Perhaps the most interesting part is the fact that the author’s creative streams of thinking for this work does not rise from academics of philosophy but come from a WWII (World War II) reporter’s diary. Taleb has found that the diary only indicates what is happening (the reality of random occurrences) but not what has happened (the causes that lead to the results).

When mentioning WWII, the majority of historical works have all addressed too many underlying signs before WWII such as the increasingly intense on the European mainland, the imminence of war...etc. But from the written diary, what has been really reported was: no one suspected anything like war might happen in their near future. In fact, people have been lived their normal lives without predicting the outbreak of the war.

As the author noted, people have some extent of cognitive distortion to the history and the contemporary issues, and this kind of misconception to the facts is mainly coming from the illusion of understanding, the modification to the actual memories, and the overemphasis on apparent sources of information and the information coming from professionals.

So what does the “black swan” refer to? The Black Swan refers to those outliers, those incidents that happen just once could be more than sufficient to overturn the general inferences from typical events. Even for people who believe that all swans in the world are white, which has been re-confirmed hundreds of thousands of times, one single black swan can nevertheless overturn this inference that we had come to believe. This book
is not designed to encourage readers to rely on classification, generalization, and logical reasoning as ways to learn about the events happening in the world; on the contrary, the author hopes to force readers to think about the unexpected that may differentiate from the modus operandi.

In the first half of the work, the author put his efforts on discussing what makes our cognition fail to understand the reality from psychology, neurophysiology, and cognitive science perspectives. The latter half of the work explored the limitations of predictions and how to deal with these limitations from business and natural science perspectives.

**What is going wrong with our cognition?**

“**Black swan events**” have three characteristics: unpredictable, significant, and subsequently interpretable. Black swan events, though unpredictable, have significant impacts on our world. However, we tend to fabricate explanations for these events, making them less random as they really are, seemingly easier to predict. The author believes that these black swan events are hidden behind many things—from major incidents like religious prominence to the trivial of one’s personal life—seemingly predictable, but in fact not at all.

According to the author, people are blind to black swan events because of confirmation errors, narrative fallacy, emotional impediments to properly infer, and the silent evidences. Confirmation errors refer to our tendency to confirm and pay attention to what we have known rather than what we do not know yet. In the past, a new enemy or sudden weather changes may have been black swan events; while recurrence of these events instilled both fear and concern about them. Nowadays, our nature and instincts inherited from the past force us to emphasize merely on the little part of uncertainty, such as typhoons, earthquakes and other natural disasters, with continuously ignoring the other even more unknown or unfamiliar uncertainties. And this, however, becomes our challenge now.

Narrative fallacy, as Taleb explained, refers to our tendency to fabricate stories, over-interpret and over-emphasize on causality. Our misunderstanding on black swan events mostly come from the misuse of our inner system of interpretation and emotions, which drag our focus on the events that we think vivid and definite. Moreover, the emotional impediments, including our sense of expectations, sense of achievements, and peer pressures and so on, will also leave us blind spots to understand black swan events.

**How can we deal with the constraints of prediction?**

In this book, the author has also mentioned the arrogance to knowledge, which means that people tend to believe and feel superior to the acquired knowledge, showing an attitude of arrogance. Such arrogance makes us easily overestimate what we have know and underestimate the unknown. In other words, we often underestimate the outliers, that is, the unknown black swan events. From Taleb’s argument, the majority of unexpected accidents that result in problems cannot be predicted because we are not able to be aware of future incidents.

Nevertheless, bearing these limitations in mind to avoid errors, we will still be able to come up with some preventive measures. The author also suggests that when we make predictions, we must take the unpredictability into account with considering and differentiating from possible positive black swan accidents (such as accidental invention and discovery, etc.) as well as negative black swan accidents (such as the financial crisis, natural disasters and other adverse events).

In addition, Taleb also pointed out that it may not be appropriate to explain or predict those abnormal events by employing Gaussian distribution (normal distribution model). Instead, we should observe and make predictions from empirical approaches and results. He has further contended that this argument could also apply to the concept of investment. We may have to face losses if we merely take use the so called Gaussian bell-shaped distribution model as our logics to predict and react.

Examining from neurophysiology, cognitive sciences, and business management, to probability theory, the impressively knowledgeable author takes different angles to explain what we know about the unknown. If you have not yet read this book, or you have never challenged your own conventional thinking outside the box, then this
book will be very suitable for you to read. There will be no doubt that you may view things from a whole new level with critical and unique insights to crisis management and the black swan events.
The APEC Small and Medium Enterprises Crisis Management Center (SCMC) has held the APEC Symposium on Enhancing SME Capacity of Managing the Risks Associated with Trade Liberalization at Shangri-La's Far Eastern Plaza Hotel Taipei on 16th to 17th August 2011, with the purpose to assist the SMEs in responding to the risks concomitant of trade liberalization and to endow the SMEs with the capabilities of forward thinking and risk management. There were more than six hundred attracted to attend this symposium, and distinguished experts from industrial, governmental, and academic fields and from various economies were invited to provide lectures, sharing their practical experiences.

These particularly invited officials included Bill Shih-Chao Cho, Director General of the Bureau of Foreign Trade of Chinese Taipei; Franklin Lavin, former Under Secretary of Commerce for International Trade of the U.S.A.; and Kenneth Waller, Director of the Australian APEC Study Center, to name a few. Representatives of APEC members, including the United States, Canada, Australia, New Zealand, Malaysia, the Philippines, Indonesia, Japan, Singapore, Peru, Mexico, etc., all came to share with and benefit one another.

As analyzed by Robert Sun-Quae Lai, Executive Director of APEC SCMC, there are five strategies that the SMEs can adopt to strengthen their competency:

1. to digitize -- absorbing ICT (Information and Communication Technology) Knowledge and applying ICT into the core of business so as to make better decision and reaction;
2. to fundamentally nurture the quality -- deepening business technology through quality management and thus create the uniqueness of the enterprise;
3. to implement cluster innovation -- assisting SMEs in achieving synergy through clustering;
4. to cooperate -- encouraging SMEs to enlarge not only intra-company but also intra-industry exchanges, which will enable them to create new business opportunities together;
5. to finance -- accomplishing the accounting system, improving the financial structure, and accessing to funds for operation and development through financial assisting platform.

As the global economy keeps changing, it is important for the SMEs to keep the capabilities of forward thinking and risk management in order to adapt to the competitive international environment. After the symposium, SCMC will work with Chinese Taipei, the US and Singapore to formulate the “APEC Principles on Enhancing SME Capacity of Managing the Risks Associated with Trade Liberalization,” which can serve as a reference for the APEC members to help their SMEs overcome trade barriers.

The APEC SME Crisis Management Center, established in Chinese Taipei, is planning to develop greater diversity, assisting SMEs to enhance global competency with satisfying their particular demands in business and risk management, including business continuity planning (BCP), financing, global supplying chains, human resources, innovation, and entrepreneurship.

Looking Forward to the Future and Aiming at the Global Market, SMEs Brightening Chinese Taipei with Efforts and Performance