

# The East and Southeast Asian Economies Emerging Strong from the Global Financial Economic Crisis

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The East and Southeast Asian economies<sup>1</sup> are rebounding solidly from the global economic downturn, underpinned by turnaround in exports, revival of domestic private demand and monetary and fiscal stimulus. Although most economies in East Asia contracted in 2009, overall GDP expanded by 6.1 per cent, compared to economic growth of 7.2 percent and 10.4 percent in 2008 and 2007 respectively. This growth in 2009 was almost entirely a result of 8.7 percent growth of the People's Republic of China (PRC). Economic growth of Southeast Asia slowed sharply to 1.3 percent in 2009, the weakest economic growth since the Asian financial crisis of 1997-98, compared to economic growth of 4.3 percent and 6.5 percent respectively in 2008 and 2007. Output would have declined had it not been for the relatively high growth of 4.5 percent in Indonesia, the biggest economy in the sub-region. According to Asian Development Bank, East Asia is forecast to grow faster to 8.6 percent in 2010 and slightly slower to 7.7 percent in 2011 with strong recoveries in the contracted economies. Southeast Asia's growth is forecast to accelerate faster to 7.4 percent and 5.3 percent in 2010 and 2011 respectively, with the five economies that shrank in 2009 will return to growth. East Asia's inflation is forecast to be lower to 3 percent in 2010 and maintain at this rate for 2011; with current account surpluses is expected be equal to about 5 percent of GDP for 2010 and for 2011. Inflation in Southeast is forecast to be lower to just 4 percent in 2010 and it is expected to remain at this rate for the following year; with current account surpluses are projected to be 5.7 percent in both years (*Asian Development Outlook 2010–Update*, ADB, 2010). The implementation of the monetary and fiscal stimulus packages have contributed to the rapid economic recovery of the region.

*The East and Southeast Asian economies recover strongly from the global economic downturn, underpinned by turnaround in exports, revival of domestic private demand and monetary and fiscal stimulus. The large monetary and fiscal stimulus packages have contributed significantly to economic rebound of the region.*

This article will describe the conditions and circumstances under which the East and Southeast Asian economies responded swiftly and massively to the negative impact of the global financial and economic crisis through appropriate changes in monetary and fiscal policies, the components of the monetary and fiscal stimulus packages, and the resilience of the East and Southeast Asian economies in coping with the crisis, and a brief discussion over exiting the extra ordinary monetary and fiscal stimulus packages. Next there will be a discussion over the exchange rates regimes and management of reserves. Further, a discussion will follow over medium and long term economic balanced growth strategies for the region that will depend more on domestic demand and less on exports to the advanced countries. The paper ends up with a summary and conclusion.

## I. Financial, Monetary and Fiscal Policies

The global financial and economic crisis struck East and Southeast Asian economies severely from late 2008 to early 2009. The region stands out as highly open to international trade. East Asia's share of exports in GDP in 2008 was 103.0 percent (the People Republic of China's share of export in GDP was 38.1 percent); for Southeast Asia the share of exports in GDP was 76.1 percent. The deep economic recessions in

advanced countries led to sharp reduction in import demand; and export growth plunged in the East and Southeast Asian economies with large losses in revenues, reduced income and investment. The sharp fall in import demand from the advanced countries and the slowdown of economic activity in the region required the authorities to respond fast and boldly to support the failing demand by pursuing countercyclical measures through easing both monetary and fiscal policy. The bold and fast responses were made possible by the sound and prudent monetary and fiscal policy pursued by the region in the past, including strong financial sectors, low inflation, low fiscal deficits and low gross public sector debt, accompanied by large foreign exchange reserves.

### *Financial and monetary policies*

Strengthened by financial reforms following the Asian financial crisis of 1997-98, the banking system in the region has been risk averse, maintaining large amounts of capital with high capital adequacy ratios and low non-performing loans. Regulatory policies, in particular supervision of banking and corporate sectors has improved substantially. The East and Southeast Asian banks have little exposure to US toxic assets and remain healthy; and there are no pressures on their balance sheets. No major bank failed in the region during the recent crisis. The banking and financial sectors have continued to function normally and resumed lending even during the depth of the crisis. Moreover the banking sector is largely free from the structural problems, such as the high household debt plaguing the United States of America. The sound East and Southeast Asian banking sector staves off credit crunch, helps to weather



the negative impact of the global financial and economic crisis by continuing lending

There has been a general consensus among the authorities in the region that high and volatile inflation tends to be detrimental to economic growth. Price stability is the principal policy objective of central banks in the region. Therefore the economies have sought the appropriate institutional framework for monetary policy. After the Asian financial crisis of 1997-98, Korea, Indonesia, Thailand and the Philippines abandoned their pegged currency regime and adopted inflation targeting framework to maintain price stability. The People's Republic of China (PRC), Hong Kong (China), and Vietnam have chosen exchange rate anchor to achieve price stability. Singapore is also promoting price stability by managing foreign exchange. Regardless of the framework of monetary policy adopted, average inflation rates in the region (with the exception of Vietnam) have been relatively low and stable. Monetary policy has aimed to keep inflation low and stable and the region succeeded to achieve relatively low and stable inflation in the 2000s. Average inflation rate was lower during 1999-2007 compared to 1990-1997 period, suggesting that policy frameworks have improved (Filardo, A. and H. Genberg 2010.). Low and stable inflation provided space for implementing easy monetary policy when the impact of the global financial crisis were really felt.

Before the outbreak of the global financial and economic crisis, however, the East and Southeast Asian economies were greatly concerned about inflationary pressure following the drastic rise of fuel and commodity prices in 2007/2008. Many regional authorities were forced to adopt tight monetary policies, facing the rising inflation and focused on price stability. For example, the People's Bank of China raised reserve requirements three times in 2008. Similar policies were adopted by central banks in Korea, the Philippines and Taipei, China. Singapore allowed its currency to appreciate, whilst Indonesia continued tight monetary policy by keeping high interest rate into late 2008.

When the impact of the global financial and economic crisis were really felt and the inflationary pressure was softening, the central banks in the region shifted to monetary relaxing. The falling prices of commodities and fuel allowed the authorities to cut interest rates aggressively. The traditional monetary policy was relaxed as indicated by cut in interest rate, expansion in credit and money. Many central banks in the region cut interest rates, lowered required reserve requirements, pumping huge liquidity through credit expansion. For example, the People's Bank of China cut five times the interest rates during September through December 2008; reserve requirements were lowered on several occasions and pumping large liquidity by removing credit growth limits.

Bank Indonesia, from December 2008 to August 2009 cut interest rates nine times; banks' reserve requirements were lowered and short-term central bank financing was expanded. The central bank of Korea from October 2008 to February 2009 cut base rate six times; swap lines with foreign central banks (Federal Reserve, People's Bank China and Bank of Japan) totaling \$90 billion were arranged, and an expansion of open market operation. In November 2008 Malaysia cut overnight policy rate with further cuts were announced in January and February 2009; a bilateral swap agreement was agreed with the People's Bank of China of 80 billion yuan and 40 billion ringgit. It seemed that monetary easing as an instrument of countercyclical policy was effective in helping to mitigate the impact of the global downturn. Because the financial sectors in the region were sound, it is believed that the usual transmission channels of monetary policy were intact, and that aggressive monetary policy easing (cuts in interest rates, large expansion of credits and money) helped to boost the pace of economic recovery.

#### *Fiscal policy*

However, in view of the severe contraction in economic activity in the region following the economic crisis, it was believed that further monetary easing will be of limited value to cope with the crisis. Many authorities in the region resorted to aggressive easing of fiscal policy. The immediate result of fiscal easing was a deterioration of the fiscal positions of all governments in the region mainly due to a rapid expansion of expenditures. For example, the sharpest deterioration was experienced by Malaysia, from a surplus of 1.1 percent of GDP to a deficit of 6.6 percent from 2008 to 2009; Singapore's fiscal position also deteriorated. But for the region, debt sustainability does not appear to be a serious concern over the medium term.

It is not always easy to determine exactly the size of fiscal stimulus, since some of the funds that allocated for expenditures would have been spent in any case. The size of the fiscal stimulus varies among countries. For example, the People's Republic of China in November 2008 announced a 4 trillion yuan fiscal stimulus

package for 2009 -10, which is equivalent to 13 percent of GDP. This formed the largest fiscal stimulus in the region. Other East and Southeast Asian countries rolled out large fiscal stimulus. Malaysia announced two stimulus packages, which amounted to 10 percent of GDP. Korea announced on several occasions fiscal stimulus, which amounted to 78.8 trillion (which was equivalent to 7.9 percent of GDP). The Philippines announced a stimulus package of 330 billion peso or 4.1 percent of GDP; Thailand announced a stimulus package that was equivalent to 2.4 percent of GDP, subsequently a medium term and much larger stimulus package (equivalent to 15 percent of GDP) was announced for infrastructure in three years; whilst Indonesia's stimulus package was 73 trillion rupiah, which amounted to 1.5 percent of GDP. The size of fiscal stimulus in the region was considerable.

To get an idea of the relative size of the Asian fiscal stimulus, a comparison to other economies could be made. The average stimulus size in 15 developing Asian economies was equal to 7.5 percent of GDP, almost three times the level of 2.8 percent for the G7 nations (*Asian Development Outlook 2010*, ADB, 2010, p. 77). It is estimated that the size of crisis related fiscal measures was exceptionally large in China. The region was in good position to unleash large stimulus packages rapidly because the economies have ample fiscal space, build up over years of fiscal prudence. Over the period of 1990 – 2008, fiscal balances for East and Southeast Asian economies were small. When the Asian financial crisis broke out in 1997-98, fiscal balances in region increased in the late 1990s, but then the authorities succeeded to cut back the deficits to low levels. Public debt ratios in the region show some variation but on the whole they are relatively low. For East and Southeast Asia, the public debt ratios have been relatively low, in the range of 40 percent – 60 percent of GDP for the period of 1990-2008 (Ch. Adams et al., 2010; *Asian development Outlook 2010*, ADB, 2010, pp.81-83). The low fiscal balances and public debt ratios in East and Southeast Asian economies signify the tradition of fiscal responsibility. Because East and Southeast Asian economies have run small budget deficits and accumulate manageable debt levels the region was able to afford large

countercyclical fiscal packages. It was the healthy state of government finances, particularly years of fiscal discipline that allowed a significant space for aggressive countercyclical fiscal policy.

On balance the region's fiscal stimulus packages are tilted toward higher spending, particularly on infrastructure spending. For the region, the share of fiscal expenditures for infrastructure purpose was considerable. For the PRC, Korea, the Philippines and Thailand infrastructure spending accounted more than 60 percent of the total fiscal spending package. Indonesia was an exception where a larger portion of the fiscal package involved tax-cuts and exemptions. This tendency towards infrastructure spending is consistent with the region's longstanding pro-growth orientation, since infrastructure will benefit economic growth in the long-run. However, large infrastructure spending entails serious implementation problems like failure to complete the project on time, the size of the infrastructure which exceeded the absorption capacity leading delays etc. On the whole the use of countercyclical fiscal policy seems to have succeeded to boost aggregate demand and output and is helping the region to pull out of the crisis. Empirical investigation support the belief that fiscal stimulus in the region have been more effective in East and Southeast Asia than elsewhere, because they are quicker and larger than in other part of the world which has contributed to the remarkable V- shaped economic recovery of the region.

#### ***Exiting easy monetary and fiscal stimulus?***

The active use of monetary and fiscal policy for countercyclical purposes marks a departure for the region that has traditionally used macro economic policy to promote macroeconomic stability rather than to boost aggregate demand and economic activity. In contrast to the industrialized countries, the region is not accustomed to such use of monetary and fiscal policy for countercyclical purposes. The adopted monetary and fiscal stimulus was an exceptional response to extraordinary shocks. In view of economic recovery is already strong in some of the countries in the region they will likely be first to consider exiting the easy monetary stance. Recently countries, like the PRC and Hong Kong, China,

Malaysia, Philippines and Vietnam have began initial unwinding monetary policy by raising interest rates. Exiting from easy monetary policy, under condition of regional robust economic recovery, interest rates differentials and currency appreciation will undoubtedly lead to increase in capital inflows. How best to manage capital flows is an important policy issue. Large capital inflows can increase macroeconomic risk of overheating the economy, inflation and pushing up asset prices excessively.

An exit from the extraordinary stance of monetary and fiscal policies when the economies recede to normal situation will be, however, challenging for the policymakers. As long as the global economy remains weak, there is always the risk of withdrawal fiscal stimulus prematurely. Because of the central role of monetary and fiscal stimulus in the region's economic recovery, and the popular perception that it really contributed to recovery, these may bring about a game changing shift in the region's philosophy from its traditional conservatism toward countercyclical activism during non-crisis periods. Example that game changing shift has some serious risks that higher government expenditures and, more generally, an expansion in the economic role of the government is often difficult to reverse or adjust even when they are no longer justified. International experience inform us that political economy factors make it difficult to reverse fiscal expansion undertaken during business downturns when the cycles move up again(Ch. Adams et al., 2010; *ADO 2010*, ADB, 2010).

Returning to the basic macroeconomic tradition of monetary and fiscal prudence will be challenging for East Asia and Southeast Asia. In the post-crisis state, the benign global economic environment of pre-crisis times may no longer prevail. To a large extent the regional rapid growth was the result of strong exports to major industrial economies, particularly to the US. As the global imbalance unwind, however, the US will have to make adjustments that are likely to cause Asia to experience a slowdown of exports. In the medium and long term, the region's economies need to rebalance growth, making more dependent on domestic demand and less on exports.

## II. Exchange rate and Reserve Management

This part of the paper will discuss the issues of exchange rate regimes and the management of foreign exchange reserve in the region prior to the outbreak of the global economic and financial crisis, and responses to the crisis and post-crisis situation.

### *Exchange rate regimes*

After the 1997-98 Asian financial crisis, Indonesia, Korea, the Philippines and Thailand chose to abandon pegged exchange regimes and adopted *de jure* floating exchange regimes, with varying degrees of exchange rate flexibility. Malaysia adopted initially conventional pegged arrangement and later on chose for managed floating. The PRC changed from conventional pegged arrangement to *de jure* managed floating with reference to a basket currency; which was similar to the announced regime in Singapore. Hong Kong, China, has had, over the last few decades, hard-pegged exchange rate regime. Despite the large diversity and *de jure* adoption of floating exchange rate regimes, the flexibility of exchange rates against the US dollar or a trade-weighted basket currencies in the region, remained low. It has been even noted that between 2000 and late 2008, exchange rate flexibility in many countries was declining. The limited and declining exchange rate flexibility does not match with the announced floating exchange regimes.

The low flexibility of exchange rate flexibility in the region has shown the high degree of government interventions in foreign exchange market. There are at least three main reasons that can be distinguished for heavy government interventions:

*Insurance.* The Asian financial crisis of 1997-98 encouraged the region to build up large foreign reserves that would protect the economies from another devastating crisis in the future. The build up of reserves has proved helpful in redressing the adverse effects of the recent crisis, particularly in containing a significant appreciation of real exchange rates. Build up reserves could also serve as an insurance against a sudden reversal of capital inflows. Reserves evidently allow economies to pursue exchange rate stability while at the same

time achieving some degree of financial openness.

*Stimulating exports and economic growth.* During normal periods, the authorities intervene in the foreign exchange markets to stimulate exports and growth. In the region observations show that interventions in the foreign exchange markets tend to be asymmetric toward preventing appreciation rather than depreciation. Authorities may intervene against appreciation because the exchange rate still plays important role in influencing trade.

*Exchange rate volatility.* Central banks often justify intervention in the foreign exchange markets to protect the economies from the impact of volatility. High frequency exchange rate volatility, caused by speculative capital flows, rather than by underlying macroeconomic fundamentals, would be undesirable.

With the strong economic recovery in the region, the authorities should reduce exchange rate misalignment and allow exchange rate to adjust into line with its so-called equilibrium level. Although defining the equilibrium exchange rate in practice is not straightforward and seems to be difficult, it is however possible to identify a wide band or range that may have meaningful policy implications. In terms of a trade-weight average basis, Cline and Williamson, for instance, show that currencies of four economies in the region exhibit noticeable undervaluation, namely the PRC (21.2 percent); Malaysia (17.7 percent); Taipei, China (13.6 percent) and Singapore (10.3 percent) (Cline, W.R. and J. Williamson, 2010). As it has been noted earlier, one of the key reasons to intervene heavily in the exchange rate market is the fear of losing export competitiveness due to appreciation of its own currency. To resolve the fear, policy coordination on exchange rates among the East and Southeast countries should be initiated. Given an equilibrium exchange rate guideline, these countries could agree on a gradual adjustment. International institutions, such as the G-20 and the IMF could play a role in finding such a range that provides policy advice to the regional governments. The coordination of exchange rates could also help to redress the global imbalance issue. It has been shown that the adjustment of the PRC

currency alone would have very limited effect on trade adjustment in the region; but an across-the-board appreciation of East and Southeast Asian currencies could have more powerful effect in reducing distortion, especially for the PRC (Thorbecke, W. and G. Smith, 2010).

### *Management of reserves*

One of the basic characteristic feature of the regional phenomenon is the rapid accumulation of foreign reserves managed by the central banks, which have been driven by both current account surpluses and net private capital flows (i.e., twin surpluses). It has been observed that the emergence of current account surpluses in the region is of a relatively recent phenomenon. It is found that as a whole the region run current account deficits before the 1997-1998 Asian crisis and it only began to run consistent current account surpluses after 1997. Although there is no clear single pattern of common current account behavior, four broad types of behavior can be identified belonging to the region (Ch. Adams and D. Park, 2009).

*Asian-crisis affected middle income economies* – Indonesia, Korea, Malaysia, Philippines, and Thailand. In this case, the current account positions shifted from deficits to large surpluses around the time of the Asian financial crisis with surpluses narrowing in recent years.

*Newly industrialized economies (NIEs)* – Hong-Kong, China, Singapore, Taipei, China. In these economies, current account have been in surpluses for extended periods with the surpluses increasing in recent years.

*Low-income current account surplus economies* (the Peoples' Republic of China). In this case, the current account tended to be in small surplus, with the surplus increasing substantially in recent years.

*Other low-income emerging economies* (Cambodia, Lao People's Democratic and Vietnam). In this case, the current account has been in deficit on average.

The large increase in the current account surplus for the region as a whole occurred in two distinct phases. In the immediate

aftermath of the 1997-1998 financial crisis, the increase in the region's surplus largely reflected swings in the current account balances of the crisis economies from positions of large deficit into large surplus. Subsequently, and especially after 2003, the increase in the region's overall surplus has been largely the result of a surge in the PRC's surplus, since the surpluses in most of the crisis economies have narrowed. The region's current account surpluses have been driven by the region's successful strategy of high and growing dependence on exports as the main engine of economic growth.

One major consequence of persistent current account surpluses has been an explosive growth of foreign exchange reserves held by the region's central banks. There is a growing consensus that the rapid growth of the region's reserves may have led to excess reserves that exceed of what is required for liquidity and insurance purposes. Excess reserves imply welfare losses. Regional cooperation can play an important role in reserve management. Several initiatives have been introduced. The decision of ASEAN +3 (the PRC, Japan and Korea) finance ministers to multilateralize Chiang Mai Initiative, creating reserve pooling of US\$120 billion and an independent surveillance unit to support decision making in the management of the pooled international reserve. Provided that the reserve pooling is sufficiently large and the scheme is truly of cooperative in nature, individual country may no longer has an incentive to keep a large amount reserve for insurance purpose. The recently modernized IMF (increase of capital, new arrangements for members to buy SDR notes, the newly established Flexible Credit Line etc.) and efforts to restore confidence in the IMF, can contribute to efficient reserve management.

### III. Rebalancing Regional Growth

Global imbalances refer to the large current account deficits and surpluses that have emerged in the world economy since the Asian financial crisis of 1997-98. The imbalances have been heavily concentrated in a small group of regions and countries, and until recently have displayed an unusually high degree of persistence. The imbalances have centered on the large current account deficits of the US, which peaked at close to



6 percent of GDP in 2006 and the corresponding surpluses in the rest of the world, in particular East and Southeast Asia, the oil producing Middle East and the Russian Federation. Although the Middle East and the Russian Federation contributed substantially to the surpluses, the large contribution of the East and Southeast Asian countries to the recent global imbalances has been important and growing and it has become an integral part of the global imbalances. As it has been earlier observed, current account surpluses are not an intrinsic structural characteristic of the region, but of recent development that emerged after the Asian financial crisis of 1997-98. It is evident, that large and persistent current account deficits cannot be financed indefinitely by persistent current account surpluses, and these will have to unwind at some point.

The region's surpluses ultimately come from the exceptional success of the region's outward looking export-oriented growth strategy. The distinction between the region's export orientation and its current account surpluses is important, because the latter which contributed to the global imbalances. Any discussion of rebalancing regional growth must keep in mind that export oriented growth is compatible with balanced growth. However it will be a mistake to believe that there is no need for far reaching adjustments, and that the region can return to the pre-crisis dependence on exports as the primary engine of growth. The temptation is stronger because this strategy has served the region remarkably well in the past. However,

there are several factors that stand against conventional thinking. Given the severity of the global financial and economic crisis, there is a great deal of uncertainty about global recovery prospects. The potentially severe and protracted nature of the G-3 (US, Eurozone, and Japan) and in particular the US downturn suggests that the region may be unable to return to its pre-crisis excessive dependence on exports, even if it wanted to. It is a more compelling case for why rebalancing growth toward domestic demand is in the region's self-interest.

It is necessary to distinguish between the short-term and the medium and long term policy implications of the present global financial and economic crisis. In the short term the undisputed priority of regional policy makers must be to manage the sharp slowdown of economic growth associated with the contraction of external demand. Short term management involves limiting the reduction of economic growth through expansionary monetary and fiscal policy. At the same time, the regional policy makers must fully recognize the medium and long term implications of unwinding global imbalances. It would be a serious mistake to just view the present slowdown as just another down turn. The sheer size of the global imbalances suggests that their unwinding may require a protracted period of adjustment in the US. For the region as a whole, the global crisis highlights the inherently unsustainable nature of growth based on excessive dependence on foreign demand in the medium and long term. This should serve as a wake call for regional

policy makers to take concrete actions to balance the economy. *The Asian Development Outlook 2009* argues that regional policy makers must make rebalancing growth a serious medium and long term objective, even as governments struggle with their short term responses to the economic crisis.

Empirical studies indicate that saving rates in the region were somewhat higher than implied by standard relationship between saving and its fundamental determinant in the period after the Asian financial crisis. One possible interpretation is that painful memories of the devastating Asian financial crisis encouraged households and firms to save more as a precaution. The rapid growth in the region, particularly the exceptionally rapid growth of the PRC, accounts for a continuous surge in region's saving rates. Since 2003, in particular, high and rising national saving has become the key contributor to the imbalance, especially in the case of the PRC, but also in the case of the newly industrializing economies of Hong-Kong, China; Singapore; and Taipei, China. On average, current national saving rates are high in the East and Southeast Asia, with the PRC leading the pack with its rate in excess of 50 percent of GDP in 2007. The unusually high saving rates in the PRC reflects unusually low consumption rates. This implies that policies aiming to increase consumption will contribute more effectively to unwinding global imbalances than those promoting investment.

The rising household saving rate in the PRC has played a key role in explaining the rising current account surplus in the region. The surge in household saving in the PRC has been driven largely by the rise in the saving rate of urban households. The increasing private burden of education and health expenditures seems among the strongest candidates for explaining the increase in saving rates. Provision of social health insurance has been seen to substantially weaken this motive for saving. Increasing public provision of education could also lower household saving by reducing the need to accumulate assets to finance future education expenditures. Hence policies that rationalize public spending to increase social transfers, reform pension systems, and provide universal health care systems and education are top priority.

The East and Southeast Asian countries vary widely in terms of current account positions; and this precludes one-size-fits-all policy prescription. In the Asian crisis – affected countries, the increase in consumption should not come at the expense of investment and that investment in these countries is close to its appropriate level. And that the policy makers should avoid policies that promote consumption at the expense of investment. Notwithstanding the heterogeneity of current account surplus in the region, some rebalancing of growth toward domestic demand will be required for the region as a whole. While rebalancing growth is necessary, rebalancing is bound to be difficult, protracted and complex structural process. It will have a pronounced impact on growth in the highly export-dependent East and Southeast Asia. Above all the mismatch between the structure of output and the structure of demand in many export-oriented East and Southeast Asian economies will constrain the rebalancing of demand and growth.

Looking ahead, the key question for the regional policy makers is how to strengthen domestic demand in response to weakened external demand. Given the diversity of the nature and underlying causes of the East and the Southeast Asian's current account positions, the optimal policy mix for rebalancing will necessarily differ from country to country. The most direct means for regional governments is to reduce the region's excessive dependence on external demand by implementing policies that boost domestic demand, and strengthening domestic consumption holds the key to more balanced growth in the region. The emergence of a large and rapidly growing urban middle class, whose demand for goods such as automobiles and household appliances is taking off and laying the foundations for a strong and sustainable domestic demand. Diluting the precautionary motive and more extensive social safety nets will boost consumer confidence and consumption. For countries like Indonesia, the Philippines, Thailand and Malaysia, creating a more attractive investment climate is of greater priority than expanding investment. Rebalancing growth not only requires policies of restructuring demand but also the need to change the structure of output.

The burden of adjustment in the unwinding of global imbalances cannot fall entirely on the economic policy of one country. Global imbalances are a global problem and resolving global imbalances require greater policy dialogue within the G-20 and the IMF or coordination, both regionally and globally.

## Summary and conclusion

The East and Southeast Asian economies recover strongly from the global economic downturn, underpinned by turnaround in exports, revival of domestic private demand and monetary and fiscal stimulus. The large monetary and fiscal stimulus packages have contributed significantly to economic rebound of the region. These were made possible by the sound and prudent monetary and fiscal policy pursued by the region in the past, including sound financial sectors, low inflation, low fiscal deficits and low public debts, accompanied by large foreign exchange reserves. It seemed that monetary easing was effective in helping to mitigate the impact of the global downturn. The size of the fiscal stimulus was considerable and has contributed to the V-shaped economic recovery of the region. Exiting from easy monetary and fiscal policies will be challenging for the policy makers. Despite large diversity and de jure adoption of the floating exchange rate regimes, the flexibility of exchange rates against the US\$ in the region, remained low, despite prevailing exchange rate misalignment. There is a growing need to adjust exchange rate in line with its equilibrium level. International dialogue and coordination, through G-20 and IMF could play a role in finding solutions. One of the characteristic features of the region is the rapid accumulation of foreign exchange reserves, managed by the central banks, generated by both current account surpluses and net private capital flows. The foreign exchange reserves are excessive, implying welfare losses. Regional and international cooperation can contribute to efficient reserve management. In the medium and long term perspective, the region needs to opt for a balanced growth strategies that will depend more on domestic demand and less on exports to the advanced countries. Global imbalances are a global problem and resolving global imbalances require greater policy dialogue and coordination.

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### **Note:**

<sup>1</sup> East Asia comprises People's Republic of China; Hong-Kong, China; Republic of Korea; Mongolia; and Taipei, China. Southeast Asia comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.