

## Session D: The New Trends in Northeast Asia with the Global Financial Crisis

In Session D reports were made as below by the respective specialized researchers on the post-global financial crisis economic situation of each of the nations and regions in Northeast Asia.

On the ROK there was the following report from Yuichi Takayasu, Associate Professor at the University of Tsukuba.

- In comparing the post-global financial crisis ROK economy with the ROK economy after the 1997 Asian currency crisis, if you convert simply the -5.1% of the October-December quarter of 2008, when the drop was the most intense, to an annual rate, then the drop was equivalent to -18.9%, and the economy suffered a great shock second to the -27.7%, which in similar fashion was the -7.8% of the January-March quarter of 1998, when the drop was the most intense, converted simply to an annual rate. Incidentally, the ROK's potential growth rate is 4-5%.
- Analysis of the 1997 currency crisis
  - Regarding the 1997 crisis, exports decreased on a foundation of the economic slowdown from the fall in the price of semi-conductors in 1996, and of suffering the effect of the Asian Financial Crisis originating in Thailand and the attendant global economic contraction; the outcome of overseas financial institutions, which disliked such a situation, precipitously withdrawing foreign currency from the ROK, was that it triggered a foreign-currency liquidity crisis (the vulnerability of the international balance of payments sector), and created an extreme situation of the chain-reaction bankruptcies of ROK companies and bank failures.
  - A summary of the crisis where the shock had been magnified by endogenous factors—such as, for the constitution of ROK companies at that time, the characteristic features (vulnerability of the corporate sector) of 1) low profitability, 2) excessive dependence on borrowed money, and 3) the back-scratching between groups, and in addition, in terms of financial institutions, the vulnerability of the financial sector, where problems in liquidity arise, with 1) the potential high number of nonperforming loans and 2) the withdrawals of deposits from banks with uncertainty about their trustworthiness continuing.
  - Moreover, in the process of overcoming that currency crisis, while the ROK received financial support for supplementing liquidity from the IMF, the severely austere macro-economic policy (targeting the improvement of the capital balance, current-account balance, and investment and savings balance through a high-interest rate policy and severe fiscal austerity), which was a condition thereof, caused an unprecedented major recession,

and subsequently a traumatic memory remained for quite some time in the realm of the ROK economy.

- Immediately after the currency crisis, the resolution of the vulnerability of the financial sector (the improvement of the equity capital ratio by the injection of public money into rehabilitable banks, the purchase of nonperforming loans by asset management companies, and the setting of a ceiling for the ratio of nonperforming loans), the resolution of the vulnerability of the corporate sector (with the setting of a target value of 200% for the debt-to-net worth ratio, corporate revival with monitoring and workout by the banks, and the introduction of privately-organized schemes via the Corporate Restructuring Promotion Act), and the vulnerability in the current-account balance (not only the contraction of the investment and savings gap resulting from a decrease in the debt-to-net worth ratio and the slowing of plant investment via corporate restructuring reforms, but also a return to the black of the current-account balance) were planned and a success. Sufficient foreign currency exchange reserves and conclusion of agreements on bilateral currency swaps with the countries of Asia.
- Analysis of the 2008 global financial crisis
  - The recent global financial crisis was brought about by an external negative shock. In concrete terms the following two phenomena can be seen: 1) the decrease in exports from the contraction in external demand. (The ratio of exports to GDP was in the region of 40% from the second half of the 1990s to 2004, but in 2008 it was 70%. In addition the major trade partners were China, the United States and ASEAN.) 2) The slump in domestic demand and falling-off of investment accompanying the negative wealth effect from the fall in share prices (the increase in the ratio of holdings by foreigners via the deregulation of investment, the large size of the influence of that investment behavior, and the hike in share and bond investment funds), but:
  - Regarding the temporary outflow of foreign currency, with plentiful foreign currency reserves it is tackleable. The exchange rate devaluation (a weak won) also had a favorable effect on exports (with there being the import of raw materials and intermediate goods, the effect was limited).
  - The strengthening of the health of the economy via the restructuring reforms after the previous currency crisis (overcoming vulnerabilities), and preparation was also completed via the construction of a safety network through the coordination of all the countries.

On Russia there was the following report from Yugo Konno, Senior Economist at Mizuho Research Institute Ltd.

- Up to the second half of 2008 the stock market was strong and showing signs of a bubble. In the background: Putin's criticism of Mechel and the August invasion of Georgia. Inter-market trading, which was dependent on the raising of funds using share collateral, was in chaos from the Lehman shock. Added to the chaos of the stock market and the short-term money market, there was also the exchange market (depreciation of the ruble). The causes of this were:
    - After receiving a trade balance surplus and capital balance surplus via the surge in energy resource prices up to that point in time (with the outflow of capital continuing in the private sector in the meantime), and the de-facto liberalization of foreign-currency inflow and outflow via the drastic amendment to the foreign-currency-control legislation of July 2006 (the elimination of obligations on deposits and on the use of special bank accounts).
    - Under the managed-float system (doing everything possible to maintain the ruble) introduced after the currency crisis, with the pressure to sell the ruble strengthening from the second half of 2008, the central bank approved the small-scale enlargement of fluctuations. This led to a large-scale outflow of capital in the fourth quarter of 2008 (the central bank planned a stabilization, fixing the lower limit of the basket rate for the ruble at 41 rubles).
  - At the same time, the central bank, suffering a surge in the short-term interest rate immediately after the Lehman shock, greatly cut the reserve deposit rate in September and October, and in addition strengthened the supply of funds via selling operations and standing facilities (uncollateralized loans, subordinated loans, and funding to support the repayment of external debt). (On the flip-side there is the dilemma of having no choice other than to raise interest rates to maintain the ruble rate.) The same amount as the strategy that undertook such a strengthening of the supply of funds to the banking sector from the government and central bank (in the five-month period from the end of August 2008 to the end of January 2009: 4 trillion rubles, equivalent to US\$130 billion)—as an increase in the external assets of the banking sector in that period—didn't circulate round to the finance for Russia's foreign outflow and domestic firms. Rather, there was a credit squeeze domestically (from November 2008).
  - The program for government measures on the financial crisis announced in March 2009 is as below:
    - Tax reduction measures (crude oil export duties: alleviation gearing the calculation method to the oil price one month earlier; corporate profit tax: lowering of the tax rate, raising of the depreciation rate, and lowering of the tax rate for the simplified taxation system aimed at small and medium-sized enterprises).
    - Support for the domestic stock and bonds markets through the provision of subordinated loans via utilization of public welfare funds.
    - Support for the automotive industry and the military-industrial complex via federal budget measures.
- That progress, however, is also partly behind schedule.
- As points which foretell the subsequent direction of the Russian economy: 1) the trends in the price of crude oil; 2) the state of the manifestation of the effects of the program of measures on the financial crisis by the government and central bank; and 3) the extent of the clearing of debts overdue after idly exceeding the deadline (adjustment of the balance sheet).
- On Mongolia there was the following report from B. Tsolmon, Former Chief Operations Officer, Zoos Bank.
- After passing through a major economic slump immediately after the 1990 systemic transition to a market economy, Mongolia realized remarkable economic development. In recent years the economic growth rate in 2004-2006 was 8.4%, in 2007 10.2%, and 2008 per capita GDP was US\$1,960.
  - What has driven the economy is the mining sector (28.2% of GDP and 74% of exports in 2008). It may be said it is a monoculture by reason of Mongolia being blessed with mineral resources. For this reason Mongolia would take a direct hit from the current global financial crisis and the attendant slump in resource prices.
    - International balance of payments: the current-account balance went from +6.7% compared to GDP in 2007 to -13.7% compared to GDP in 2008 (the compensation of the current-account balance from FDI has also been on a downward trend since the fourth quarter of 2008).
    - Exchange rates: to maintain the rate of the togrog the central bank released US dollars. The foreign currency reserves, from their peak in mid-2008 of US\$1.0 billion, had fallen by half at the beginning of 2009. In spite of this, the togrog depreciated 38% during the period from December 2008 to March 2009.
    - Fiscal accounts: the share within revenue of the income from mining has in recent years been a little over 30%, and this is a sharp decrease. For 2008 it was -5% compared to GDP, and for 2009 this is forecast to worsen further (-6.5%).
    - Inflation: There was the impact of the exchange-rate depreciation and surge in the market prices of foodstuffs, and the surge continues.
    - Financial system: from the second half of 2008 a decrease in togrog deposits and a trend of increasing foreign-currency deposits continued, but subsequently slowed. Meanwhile, the ratio of nonperforming loans increased sharply (from 2.9% in September 2008, to 7.4% in February 2009, to 10.6% in April, and to 21.5% at the end of August). The banks have curbed loans to companies, and purchased central bank securities. There has been a reduction in liquidity.
    - Growth rate: Mongolia suffered the impact of the drop in the price of metal resources, the price of cashmere and other agricultural products, and the slump in the construction sector, etc., and the real

GDP growth rate in 2008 went from 8.9% to 0.5% in 2009.

- Influx of informal workers into urban areas from the increase in the incidence of poverty (35.2% in 2007-2008), the increase in the unemployment rate (officially 3.8%, actually 21-26%) and the bankruptcy of farmers and herders.
- The path to overcoming the crisis
  - IMF-supported standby (approved in April 2009)
  - There is a trend toward a reduction of the current account deficit via the recovery of exports, including resource prices (copper, etc.) picking up and gold exports resuming, and the curbing of imports. Income from tourism and remittances from overseas, however, have not yet recovered. The foreign currency reserves in July 2009 were US\$684 million (US\$1.270 billion in December).
  - The government, with the difficult situation of public finances continuing, is grappling for fiscal and financial stabilizing measures, including a cutback in expenditure on public investment and a comprehensive guaranteeing of deposits in accordance with the IMF prescription.
  - The agreement with the investors connected to the Oyuu Tolgoi copper and gold mine development will have a favorable effect on the development of the mining sector in the future.

On the economy of China's Northeast and China-DPRK economic cooperation there was the following report from Jin Zhe, Director, Institute for World Economic Studies, Liaoning Academy of Social Sciences.

- The impact of the international financial crisis for the three northeastern provinces of China (and one autonomous region) was indirect. Economic development in recent years has been centered on economic development via investment in the supply-side, including the strategy for the revitalization of the Northeast, heavy secondary industry and infrastructure. The degree of dependency on the outside world is relatively low. Regarding the DPRK, because of its adherence to a self-reliant economy, by means of regeneration by its own efforts and a planned economy, and its exports being centered on the three northeastern provinces, the fluctuations of that economic growth, along with the size of their impact, appear after a time-lag.
- The current international financial crisis can also be said to have exposed the contradictions and imperfect nature of capitalism, and through combining a socialist economic system with a market economy, with various ownership systems coexisting, is giving rise to smooth economic development, preventing the advent of just such a systemic cyclical economic crisis.
- As China's economic development is overly dependent on the international market and external trade—although domestically a financial crisis has not occurred—it has invited economic stagnation. A turnaround of this economic and industrial structure is vital. That said, there are high hopes that the Liaoning coastal economic zone development plan will drive

the economic development of the interiors of the three northeastern provinces, and this plan will have a great effect on the economic development of the DPRK.

- The DPRK: 2012 is the "year for opening the door to a Strong and Prosperous Nation". Oriented toward a self-reliant economy, there is dependence on imports in a marginal sector only. It is focused on electrical power, metals (the exports that are a source of foreign currency of iron and steel manufacturing, iron ore and coal to the three northeastern provinces) and the foodstuffs sector.
  - In China-DPRK relations priority is given to political, future, potential and strategic benefits. In recent years, based on materialistic principles, there have also been moves to focus effort on the development and upgrading of infrastructure (a plan for an infrastructure modernization investment of US\$22.0 billion).
  - Regarding relations with international society, above all else there are the economic sanctions stemming from "nuclear and security issues."
  - When these things are surmounted, there will be the green shoots of Northeast Asian regional cooperation through assistance for the development and upgrading of infrastructure, etc.

On China there was the following report from Ke Long, Senior Fellow, Economic Research Center, Fujitsu Research Institute (FRI).

- The 2009 real GDP growth rate was 8.5% (predicted value). The world is paying attention to China's economic growth.
- With the concerns about inflation in 2006-2007 the People's Bank of China implemented an orthodox financial and exchange rate policy of removing money from circulation and allowing the yuan to appreciate, via first raising the reserve deposit rate, and subsequently raising interest rates. In addition, as it introduced rules on total lending to commercial banks, liquidity was inadequate in the markets. Incidentally, after the reserve deposit rate was raised a total of 18 times from mid-2006 to mid-2008, the bank, with there also being the impact of the global financial crisis, changed this over to reductions.
- With the global financial crisis the government State Council, in addition to a financial easing policy in November 2008, announced a four-trillion-yuan measure for increasing public spending (high savings rate and leeway in public finance). As cause for concern was the emergence of "signs of an asset bubble (in real estate and shares, etc.)." The government and central bank, based on the above experiences, adopted a cautious response (did the 0.5% raise in the reserve deposit rate and the measure of additional tightening from 18 January 2010 depend on the trends in the CPI?).
- Constraining factors on the economic policies of the government and central bank are "employment" and "social security." For employment in particular, recently, where a global "jobless recovery" is widely touted, this has been notable in China. Therefore it is

necessary to continually promote domestic demand and consumption via the raising of the labor share, transforming the economic structure which to date has been one of investment and a dependency on exports, and striving for the fostering of service industries such as finance, information, and distribution, and the raising of the industrial structure to a high level. In addition, while the development of social security is an urgent task, amid there being the so-called "disparities" between employment sectors and between regions, an overnight solution is next to impossible. Patient

- approaches are necessary.
- ▶ Keeping as a basis the continuation of the current proactive fiscal policies and fiscal easing policies, it is necessary to actively proceed with economic structural reform and systemic reform therein. To that end further Japan-China cooperation is necessary.

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