



APEC SME
Crisis Management Center



APEC SME Economic Crisis Monitor

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Published by APEC SME Crisis Management Center

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Supervised by Small and Medium Enterprise

Administration, Ministry of Economic Affairs,

Chinese Taipei

No.6 January 2011

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Institutionalization of crisis management mechanisms helps prevent future crisis

The year of 2010 is ended. In retrospect, the international economy was full of risks and uncertainty. We have experienced different challenges, such as European sovereign debt crisis, the sharp rises in food price, the coexistence of inflation and deflation, as well as the volatility of exchange rates. To this day, some challenges are still in progress. Although we need to confront existing or forthcoming risks in the coming year as well, it is believed that the past experiences will contribute to our understanding and knowledge of the risk management.

In the past year, we saw the economies and international organizations endeavor to prevent crises and avoid risks. Most of their efforts have involved institutionalized crisis management mechanisms, and there were some significant examples like the agreement about the BASEL III, the establishment of the permanent European Stability Mechanism (ESM) by the EU, and the establishment of APEC SME Crisis Management Center (SCMC).

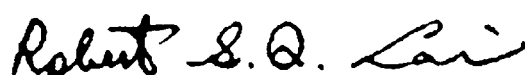
Nouriel Roubini, an economist and the author of *Crisis Economics*, has a famous saying: “Far from being exception, crises are the norm.” It is expected that future crisis will increase in frequency; thus, it is important to establish institutionalized crisis mechanisms, which will help prevent the incidence of future crisis.

In this issue, we will discuss various topics, including the recent fast flow of hot money, the inflation of some economies, and the fluctuations of exchange rates. In Crisis Alert section, we intend to monitor the current movement of hot money and point out that the most affected areas by hot money will be the East Asia. In Regional Reports section, our experts studied the latest international economic movements and discovered that the inflation rates and exchange rates in most economies have declined while the prices of certain raw materials kept rising.

Meanwhile, our expert was invited to discuss the past and current developments in Eastern Europe. According to this essay, though the hasty opening for the entrance of foreign capital formed the root of the region’s challenges today, it is believed that fiscal consolidation is the region’s first priority. In addition, we have extended a special invitation to Mr. Chi-Cheng Tsai, President of SingBee Furniture Company, to share the company’s valuable experiences to successfully ride out the financial crisis.

We also selected the most pertinent news of interest to share insights, including the increase of China’s inflation pressure, the extension of tax cuts in the US, and EU summit. Meanwhile we also introduce a masterpiece, *When Bubbles Burst*, by Mr. John P. Calverley.

The current risk situation remains unclear. At this very moment we are in a crucial stage to observe whether it would develop into crisis. However, if the possibility of crisis can be investigated by the amount of the currency, under the situation of increasing volume of hot money, it may presume the higher chance of crisis incidence.



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The Next Targets for Hot Money

Wen-Heng Chao

Ever since the global economy first came under threat from the excessive amounts of hot money flowing from economy to economy, the task of crisis monitor has basically become tracing hot money as it moves around the globe. Recently, relatively few major movements are found with respect to hot money. Some of the changes that have been seen are outlined below. Firstly, there are indications of an outflow of hot money from the US bond markets due to the concerns about the possibility that the prolonged tax cuts in the US may lead to a further deterioration in the fiscal health.

Secondly, though an examination of exchange rate fluctuations does not show any significant return of hot money into emerging markets, the currency market of Chinese Taipei appears to be an exception in this respect. The inflow of hot money into Chinese Taipei has brought about a continuing rise in the value of the New Taiwan Dollar against the US Dollar at a time when other currencies are depreciating. Thirdly, there are signs that hot money is flowing back into the commodity markets.

The decision by the US government to extend existing tax breaks is expected to boost economic growth. However, it will also lead to a further increase in the fiscal deficit of the US government. The combination of tax cuts and low interest rates is likely to encourage the money saved from tax reduction to turn into hot money. Given that the Federal Reserve has announced that the policy of

quantitative easing will keep unchanged, it can be anticipated that, in the short term at least, the volume of hot money will increase. Hot money which is withdrawn from the US bond markets is also quite likely to flow into the emerging economies instead.

After the last wave of appreciation, almost all currencies have now started to fall in value against the US Dollar. The New Taiwan Dollar is almost the only currency that is still appreciating. This strange phenomenon is, of course, a work of hot money. Historically, the fluctuations in the value of the New Taiwan Dollar have usually been relatively stable, and during previous international financial crises, the damage suffered by Chinese Taipei's currency market and its financial system as a whole has been limited. By comparison with other currencies, therefore, the New Taiwan Dollar does not offer the kind of large speculative profits that hot money seeks. In addition, Chinese Taipei's large foreign currency reserves ensure that any speculative attack on the New Taiwan Dollar would need to pay huge cost to have any chance of success.


Given these facts, why has the New Taiwan Dollar become a target for speculation by hot money? Many analysts believe that there is a connection with China. According to their analysis, the real target of the hot money is China, and the value of the New Taiwan Dollar against the US Dollar is being pushed up in order to put upward pressure on the Renminbi. If this really is the

case, then the scale of the speculators' ambitions is truly impressive, since an attempt to profit from fluctuations in the value of the Renminbi would require even more funds, and would involve an even higher level of risk.

The fact that hot money speculators would choose these two particularly challenging currencies as targets suggests that the amount of funds available to them is sufficiently large enough to shake the exchange rates of the Renminbi and New Taiwan Dollar. It also indicates that with huge cost involved, the profits that could be made from a successful attack would also be even more substantial, and would come not only from the China's and Chinese Taipei's currency markets, but also from the contagion effect on other currencies in East Asia and possibly worldwide, which can be exploited by speculators to their own advantage.

Whereas previously the vast majority of emerging economies were experiencing inflation, over the past month the upward pressure on prices has eased in most emerging economies. China and Brazil are now the only major economies where inflation is continuing to worsen significantly. Given that there has been no appreciation of the Renminbi, it is clear that the increase of China's inflation is due to domestic factors and other long-term factors. Inflation of this kind, which is hard to bring under control, reduces the space of policy maneuver to neutralize the impact of hot money.

Another target that hot money has never abandoned is the commodity markets. A main reason why hot money likes the commodity markets is that they are relatively free from administrative interference by individual economies. Over the past month, hot money has been flowing back into the commodity markets. The price of oil has risen from USD 80 a barrel to USD 90 a barrel, and there have also been significant increases in the price of maize, sugar, cotton, copper, nickel and steel. With more and more economies adopting capital controls to block the movement of hot money and climatic abnormalities becoming more common, it is safe to assume that the commodity markets will continue to constitute one of the main targets for hot money's speculation.

As can be seen from the above analysis, the flow of hot money is currently directed mainly at East Asia, particularly China and Chinese Taipei, as well as at the commodity markets. The phenomenon of unbalanced growth remains unchanged in the global economy with some East Asian economies starting to overheat on the one hand and no clear signs of recovery in the advanced economies on the other hand. Though the US economy is slowly recovering, the prospect of continued monetary easing in the US, at least in the short term, is still quite certain. All of these make East Asia the region most at risk from the negative impact of hot money. 

Regional Reports

North America

Weak labor market and low inflation rate increase the possibility of QE3

Robert Dekle



United States

US real GDP grew at a real annual rate of 2.5% in the third quarter of 2010, up from 1.7% in the second quarter. Consumption in the third quarter grew at 2.8%, up from 2.2% in the second quarter. However, the greatest contributor to growth was inventory investment; without this volatile component of GDP, growth would have been 1.2% in the second quarter. Looking forward, it is unlikely that US growth will significantly increase without acceleration in personal consumption.

Consumption, however, cannot increase without improvement in the labor market. The US labor market, however, continues to be weak. The unemployment rate turned worse in November, increasing to 9.8%. Employers added a total of 39,000 jobs in November, a sharp decline from the 172,000 created in October. In November, 15.1 million people were unemployed. Adding those unemployed people to others working part time, but would prefer full time jobs, and those that have given up looking for work, 17.1% of the labor force is “underemployed.”

The economy needs to add at least 120,000 jobs to prevent the unemployment rate from rising. To reduce the unemployment rate significantly, in line with previous recoveries, job creation has to be a lot stronger, up to 300,000 jobs a month. This level of monthly job creation is unlikely to

happen in the current recovery, so it may take up to a decade for the unemployment rate to return to its long-run level. In fact, if the jobs that the unemployed used to hold have simply disappeared, then the US unemployment rate may be permanently higher, at 8% or so. These permanently disappeared jobs may include sectors such as construction, finance, real estate, and manufacturing.

In November, the US overall consumer price index (CPI) inflation rate (seasonally adjusted annual rate) was 1.1%, below the Fed’s implicit target of 1.5 to 2%.

The weak labor market and the still muted overall US inflation rate may embolden the Federal Reserve to engage in further quantitative easing—in addition to the USD 600 billion already committed to purchasing US Treasury bonds. The Federal Reserve purchases of US Treasury bonds increase the reserves of the banking system. At the moment, this increase in bank reserves has not led to much “money creation,” since banks are reluctant to lend, and the demand for loans remains weak. However, once the economy shows stronger signs of recovery, bank loans and money supply may soar, leading to inflation. The weakness in the US dollar against Asian currencies and the increasing price of gold, oil, and other commodities reflect the expectations of foreign exchange and commodity traders that the dollar will be

cheaped by higher inflation.

The US government has recently introduced a USD 30 billion program to help lending to small- and medium-sized businesses enterprises (SMEs). This program includes provisions to spur small banks to lend, such as a low 1% borrowing rate from the program for the small banks. Small banks, which are the main lenders to SMEs in the US, argue that this program is not enough to spur them to lend. Small banks complain that government bank examiners are overly conservative, particularly in assessing the commercial real estate loans that small banks hold on their books. These bankers say that there is not enough demand for loans from borrowers who meet the stricter set of criteria set by bank examiners. Relaxing these

standards may then spur lending, but that may not be advisable, until the economy recovers further. A weak economy will mean that there are still weaker borrowers.

Canada

Canada's annual GDP growth slowed to 1.0% in the third quarter, after growing at 2.3% in the second quarter. Growth was slowed by dramatically slowed net exports, especially to the US. Consumer spending and business investment were robust, suggesting that when the US economy finally recovers, the Canada will grow robustly. (The author is Professor at University of Southern California.) [SCMC](#)

Northeast Asia

Inflationary Expectation and Change of Monetary Policies in China

Sayuri Shirai



China

China's economic performance has been resilient and dynamic, as reflected in an improvement of manufacturing PMI (Purchasing Managers' Index) from 54.7 in October to 55.2 in November. The index has remained above 50—indicating an expansion of economic activities—during the last 21 consecutive months. Retail sales have also been strong with the year-on-year sales growth exceeding 18% in both October and November.

Meanwhile, the rising inflation expectation has become a major concern for the government in the face of growing public outrage and a deteriorating consumer confidence index. CPI-based inflation and property prices in the 70 major cities reached 5.1% and 7.7%, respectively, on a

year-on-year basis. The major factor contributing to inflation was agricultural products, which recorded an 11.7% increase. This is attributable to (1) poor vegetable harvest, (2) global commodity price hikes, (3) rising production cost caused by an oil price increase, and (4) speculative activities promoted by the presence of excessive financial liquidity and active bank lending activities.

In response, the State Council announced price control guidelines in November 20th with the measures covering subsidies to low-income families, a release of government food reserves (such as grain, soybeans, and oil vegetable), and possible temporary price controls (if necessary). In early December, moreover, highway fees were exempted for truck drivers carrying fresh vegetables. In line with the State Council guidance, the number of commodity exchanges raised

transaction fees applied to commodity futures in order to curve speculative trading.

As for the real estate market, the prices remain overvalued in some large cities, such as Shanghai, Beijing, and Tianjin. The measures adopted by the government—such as an increase in down payment requirements and mortgage rates, an expansion of affordable housing supply, tightened controls over local governments' real estate activities—are insufficient to cope with growing real estate bubbles and speculative investment. Thus, real estate taxes are expected to be introduced early next year, starting in Shanghai and Chongqing cities as an experiment. The tax proceeds are likely to be allocated for increasing the supply of low-price housing for the public.

In December 10th, the People's Bank of China raised the reserve requirement imposed on banks by 0.5% to 18.5%—the seventh hike since the beginning of 2010. This measure was in reaction to the government's concern that the amount of RMB-denominated bank lending for November grew rapidly by RMB 564 billion, thereby bringing the total amount of lending for the first 11 months of 2010 to RMB 7.4 trillion—the amount closer to the yearly target of RMB 7.5 trillion.

The challenge faced by the government is to keep a right balance between containing inflation and achieving sustainable economic growth. An abrupt, excessive tightening of the monetary measures may destabilize the domestic economy and SMEs which have limited access to bank loans, and would in turn affect adversely the global economy. Indeed, the expected further monetary tightening has already led to volatile stock prices not only in Mainland China but also in other economies. In early December, the government signaled a shift of its monetary policy stance for 2011 from the current “moderately loose” to “prudent.” The inflation target for 2011 was also raised from the current 3% to the more realistic 4%, while maintaining the same economic growth target of 8%. The government is expected to raise base interest rates further and tighten the target on banks' credit volume next year.

Japan and Korea

In December 3rd, Korea finally reached a free

trade agreement (FTA) with the United States. The re-negotiations of the 2007 agreement were launched because US policy makers' disagreement over automobiles issues had remained. It was finally agreed that Korea would reduce its tariffs on US automobiles from 8% to 4% and eliminate them in the fifth year while loosening its safety and environmental standards applied to US automobiles. On the other hand, US would maintain the 2.5% tariff on Korean automobiles until the fifth year. If ratified, the FTA will remove tariffs on more than 95% of trade items between these two economies within the next five years.

According to the US International Trade Commission, the FTA is estimated to increase US exports to Korea by USD 10~11 billion annually. Meanwhile, the Korean government stresses that Korean GDP will expand by 6% over next ten years. Although Korea faces a deterioration of trade deficits in the agricultural sector, it is likely to be more than offset by an expansion of trade surpluses in automobiles and electronic products.

The Korea-US FTA has raised serious concerns among the Japanese manufacturers. Given that automobiles account for about 30% of Japan's export to the US, they may face an erosion of competitiveness over Korean manufacturers. The Japanese employers' associations have repeatedly pressured the Japanese government to participate in the Trans-Pacific Strategic Economic Partnership Agreement (TPP), or a multilateral free trade pact comprising 9 economies, whose prospective members include the US. Since the TPP covers a wider range of tariff cuts than general bilateral FTAs, however, the government faces strong opposition from farmers' organization (called “Nokyo” or JA) as well as the Ministry of Agriculture, Forestry and Fisheries (MAFF). The Korea-US trade deal may promote the exodus of Japanese large manufacturing firms into the TPP region, thereby damaging domestic SMEs and deteriorating employment conditions in Japan.

Japan's real GDP growth for the third quarter was revised upward from 0.9% (on a quarter-to-quarter basis) to 1.1%. Nonetheless, this favorable outcome has not relieved the government since the gain arose mainly from a temporary increase of household purchases of fuel-efficient automobiles before the expiration of government tax incentive

measures in early September and of tobacco products before a tax increase in October 1st.

Chinese Taipei

Mainland China and Chinese Taipei will start a second round of tariff negotiations on “early harvest products” in February 2011 under the ECFA (Economic Cooperation Framework Agreement). Chinese Taipei hopes that China will cut tariffs imposed on liquid-crystal displays (LCD) where it has strong export competitiveness. If realized, it may strengthen comparative advantages over

competing Korean and Japanese manufacturers.

Meanwhile, Chinese Taipei and Singapore decided to start negotiating on an economic partnership agreement (de-facto FTA) next year. This became possible after the signature of the ECFA between Mainland China and Chinese Taipei in June 2010. While competition intensifies among some manufacturers, this may enable Chinese Taipei to diversify and promote its supply chain production networks. (The author is Professor of Economics, Keio University.) 

Southeast Asia

Side-effects of Stimulus Policies and Capital Flows

Honghui Cao



In the first three quarters, USD 11.5 billion have rushed into Indonesia, the Philippines, Thailand, Viet Nam, India, Chinese Taipei and Korea. And then, the asset prices in emerging Southeast-Asia economies go up, increasing the inflation pressure and the worries about the downtrend of economic growth next year. All the currencies have been appreciated with the capital inflows more than 5%. The only exception in this region is Viet Nam.

Capital outflows reduce Viet Nam's foreign reserve abruptly, and the lack of information transparency also makes it more difficult to assess the uncertainty of its external balance sheet. External payment crisis might not be avoidable if the capital outflows could not be ceased and the foreign reserves could not be stabilized.

Capital flowing out of Viet Nam is due to several reasons: growing trade deficit, serious inflation pressure, shrink of foreign reserves and decrease in trust on Vietnamese Dong. First, trade

deficit in the 11 months of this year amounted to USD 10.66 billion, which expanded the current account deficit more than 7%. Secondly, the consumer price index (CPI) in November increased by 9.58% year-on-year, and even by 11.09% against the same period last year. The average CPI in the first ten months increased by 8.96% compared with the same period in 2009. The inflation pressure resulted from the credit expansion in the last years during which the government stimulated the economic growth and made the credit growth overpass 30%.

Thirdly, the foreign reserve in September, 2010 also decreased to USD 14.1 billion, much lower than USD 23.9 billion of the peak in 2008. Finally, the capital outflow continued as the foreign direct investment (FDI) up to November was estimated to be USD 13.3 billion, which decreased by 40% year-on-year. The realized FDI in the 11 months was estimated at nearly USD 10 billion, only up by 9.9% year-on-year. Vietnamese Dong against US dollar has depreciated by 20% since

2008. And the exchange rate in underground market was even 10% lower than the official rate. In other words, more depreciation expectation would make the market decrease its confidence of Don, purchase more foreign assets and precious metals as well as make the foreign reserves shrink more, which actually equals to the scale of 1.8 months import.

All these resulted from the policies the government stimulated its economy against the credit crisis. It enjoyed very stable growth in 2009, but the hesitation to withdraw from the expanding monetary policies pushed it into the latest trap though the central bank raised interest rate to 9% to stabilize its money market and the government took more measures to control the prices.

This gives other economies in this region a lesson that the stimulus policies would be changed and the growing capital inflows might reverse if the inflation pressure rises in the developed economies

someday. The uncertainty of the downtrend of economic growth might be the main concerns in Southeast Asia though the adoption of structural adjustment has improved the stability of growth. The Philippines might be the next point which the chain would break up because its growth might decrease below 5% next year.

Some new regional cooperation agreements against the cross border capital flows might soften the external shock of the capital inflow and outflow. More structural reform might strengthen the valuation and stability of the local currencies, which is the most efficient choice.

But what differs from the situation in 1997 is that the long-term investment opportunities may also emerge in the capital inflows if more improvement could be made in the local markets and legal systems. (The author is Director, Financial Markets Division, at Chinese Academy of Social Science.) [SCMC](#)

South Pacific (India, Australia, New Zealand)

Australian Financial System Reform to Enhance Competition in the Banking Sector

Kenneth Waller



Australia – Reforms to the financial system but concerns over sluggish consumer spending

In recent months, major banks have posted record profits and raised lending rates higher than rises in official rates. The higher lending rates reflect higher funding costs of banks. While there is consumer and political resentment, the Reserve Bank of Australia (RBA) has noted that lending rates are now a little above average. Nonetheless,

consumer and political resentment prompted the government to introduce a financial system reform package on 12th December, to enhance competition in the banking sector.

The reforms to end exit fees on mortgages when borrowers switch banks, effective July 2011, encourages building societies and credit unions to help form a new pillar in the banking sector, broadens the financial support for the issuance of residential mortgage backed securities as well as

allows banks, credit union and building societies to issue covered bonds.

The initiative to boost competition in the banking sector through the mutual societies could ultimately benefit small and medium enterprises but major banks already claim that the SME sector is already well served.

The introduction of covered bonds will enhance the quality of assets that banks and non-banks may hold on their balance sheets, provide an extra layer of protection for investors buying the bonds and therefore lead to a higher credit rating and lower funding costs to issuers, such as banks.

The RBA and Australian Prudential Regulation Authority (APRA), however, have expressed concern that covered bonds issued by banks would subordinate depositors to bond holders and this may conflict with the intent of depositor protection under existing banking laws. APRA intends to work with the government to prevent this from occurring.

Australia's GDP growth for the third quarter of 0.2%, was significantly lower than second quarter growth of 1.1% and resulted in an annualized growth of 2.7%, somewhat lower than forecast. Lower than expected private domestic demand suggests that the economy did not fully recover from the gap left by the removal of fiscal stimulus introduced in response to the global financial crisis.

Private business investment in the third quarter was relatively subdued, increasing by 2.1%. There was a rise in the savings rate to levels last seen in the mid-1980s, suggesting increasing caution by the community over the general outlook. That said, consumer confidence rose, albeit marginally, by one point to 114.5 in November, maintaining a five month of around 115. The confidence level of SMEs is increased by 7% to a net balance of 44%, according to Sensis.

The October trade surplus was widened by USD 811 million to USD 2.6 billion, an increase of 45% over September. The rise was mainly as a consequence of a significant drop in merchandise imports, reflecting slowing domestic demand.

Official rates remained on hold at 4.75% following the December RBA board meeting. The RBA noted that over the next few quarters, inflation was expected to be little changed.

A recent report shows that in the last two years, 75% of all jobs created have been taken by those over the age of 45, in response to the need to recover income and savings lost during the global financial crisis, as well as changes in attitudes to retirement. An Organization for Economic Cooperation and Development (OECD)/ International Finance Corporation (IFC)/ PricewaterhouseCoopers (PwC) joint study found that Australia's global business tax competitiveness has been declined over recent years. Australia currently ranks 48th out of 183.

India – Battling with itself; Strong growth but poor governance

Domestic demand is buoyant, contributing to a third quarter GDP growth rate of 8.9% year-on-year. India's manufacturing sector expanded at its fastest pace in six months in November due to new business and a sharp rise in export orders. Industrial output rose 10.8% in October, more than twice as fast as the rate seen in September. While the International Monetary Fund (IMF) has commended the economic policies associated with this growth, it has raised concerns over the prospect of the economy overheating.

Clouding the positive outlook for India is an apparent rise in the incidence of corruption. Most recent concerns include those involving ministers responsible for the building of facilities and the management of the Commonwealth Games, a serious housing scam in Mumbai, and bribes taken by bankers and culminating in illicit actions of the former telecom minister in awarding 2G licenses to several mobile operators, resulting in USD 40 billion lost in potential license fees. Several ministers have been forced to resign, impacting on community confidence and severely denting the reputation of the coalition government. The opposition, however, is seen as similarly corrupt, and thus has brought a shadow over governance in India.

Corruption and inefficiencies are costly to growth. It is believed that India has lost around

USD 16 billion a year to illicit outflows totaling in USD 462 billion from 1948 to 2008. Inefficiencies in the management of environmental regulation are highlighted as an impediment to business development and foreign investment.

SMEs in the IT sector have expressed concerns about the imminent end of the Software Parks of India (STPI) Scheme that provided a flat ten-year tax exemption on their profits.

New Zealand – Business reforms but a flat economy

Measures to reform the business environment include the introduction of employment laws which enables employees to cash-in their fourth week of holiday, allows a 90-day trial period for employees for companies of all sizes (where previously it was just for SMEs), makes it harder for unions to access the workplace, and allows employers to ask for proof of illness. In addition, the government's first research vouchers have been allocated as part of a NZD 321 million package to encourage business R&D.

These structural reform measures are regarded positively, as are the Government measures to improve budget transparency. Economic performance however, remains subdued. The Reserve Bank of New Zealand (RBNZ) maintained the official cash rate on hold at 3.0%

at its December meeting, concerned that the pace of economic growth has moderated. The Reserve Bank also noted that while interest rates are likely to increase modestly over the next two years, it is prudent to keep rates low until recovery becomes more robust. Corporate investment intentions are below average and household spending also remain weak. Retail sales fell in October by a seasonally adjusted 2.5%. Household credit remains flat and housing market activity is slowing further. Some further decline in house prices is anticipated in the near term. Manufacturing activity fell a seasonally adjusted 1.4%.

BusinessNZ's Economic Conditions Index at 15 for the December quarter was only three points higher than a year ago. Standard & Poor (S&P) has shifted its outlook for New Zealand from stable to negative. MYOB has noted only 37% of business owners expect the economy to improve in the next year, down from 49% in April.

SME's have further expressed strong dissatisfaction with government. Dissatisfaction increased from 25% in the June quarter to 42% in September for medium-sized businesses and for small businesses from 6% to 38%. MYOB and Business Mentors New Zealand are working together to create one of the economies' largest business networks for SMEs starting in 2011. (The author is Director, Australian APEC Study Centre at RMIT University [SCMC](#))

Latin America

Sovereign ratings improve; Prudential measures continue

Cheng-Mount Cheng



Uruguay's sovereign ratings upgraded while Chile's outlook turns positive

On December 8th Moody's Investor Service upgraded the local and foreign currency sovereign debt of Uruguay two notches from Ba3 to Ba1. Both ratings have a stable outlook. In the press

release, Moody's states that the upgrade decision was supported by a strengthened credit profile that includes: (i) a government debt structure characterized by moderate financing and rollover risk, (ii) lower vulnerabilities to economic and financial shocks, (iii) prospects for sustained economic growth and macro stability, and (iv)

a declining government debt ratio coupled with policy continuity on the fiscal front. According to Mauro Lenos, vice president and senior credit officer in Moody's Sovereign Risk Group, "Overall, progress observed in Uruguay's debt and fiscal indicators, combined with an outlook for continued improvement, validated a high Ba rating."

Later on December 16th Standard & Poor's (S&P) Rating Services revised its outlook on Chile to positive from stable, citing the resilience of Chilean economy to withstand adverse shocks. The rating agency has affirmed the A+/A-1 (foreign currency) and AA/A-1+ (local currency) ratings on Chilean debt. According to a statement by S&P's credit analyst Joydeep Mukherji, the upward revision is the result of many years of prudent economic management that has helped the economy become more resilient to adverse external shocks and natural disasters and has given it greater capacity to undertake countercyclical measures to cushion the impact of negative shocks.

S&P also said that the upward revision was warranted by Chile's responsive political system, transparent and accountable public institutions and an impressive fiscal track record. While further upgrades are contained by a lower level of development and economic diversification relative to average investment-grade economies, the combination of good export prospects, high level of foreign direct investment (FDI) inflows and continued investment abroad by Chilean pension funds will likely deepen Chile's integration with the world economy.

Those two cases demonstrate that efforts to reduce external debt and fiscal deficit as well as better macroeconomic management in some Latam economies have improved their overall economic resilience and lowered vulnerability to adverse external shocks.


Brazil and Costa Rica implement prudential measures

The Central Bank of Costa Rica (BCCR) set a new requirement on foreign loans (in either foreign or domestic currency) on December 2nd. According to a communiqué of BCCR, a 15% reserve requirement will be applied to (i) loans with maturities below one year, (ii) revolving loans, (iii)

loans that have pre-payment options embedded for the first year, regardless of their maturity, and (iv) any type of transaction that resemble short-term debt.

Starting January 2011, a 5% reserve requirement will be imposed, which will gradually rise up to 15% by May 2011. According to BCCR statement, the measure is designed to level the playing field between foreign loans and deposits, as a source of lendable funds for banks. The statement highlighted that there is currently an important amount of liquidity in global markets that has managed to find its way to emerging and developing economies. Therefore, it is necessary for the BCCR to take measures to maintain financial and monetary stability. One main purpose behind the decision is to put a brake on the colon's (CRC, Costa Rica currency) strengthening against the US dollar. In recent months, the BCCR has cut its benchmark rate with the aim of lowering interest rate differentials in order to prevent USD/CRC from trading at or below the floor of the foreign exchange band.

In Brazil, National Monetary Council (CMN) and the Central Bank also announced on December 3rd a set of measures aiming to improve regulation and keep the stability in the financial system. Among the measures, capital requirement was increased in several consumer credit operations. In addition, reserve requirement for cash and term deposits were increased to 12% from 8%, while those for ordinary term deposits rose to 20% from 15%. The Central Bank estimated that those measures could reduce liquidity by about BRL 61 billion. In terms of capital requirement measures, the authorities opted to raise the risk factor to 150% from 100% for the maturity of consumer's credit operations.

During his presentation, Brazil's Central Bank Chairman Meirelles said that such measures should be seen as complements of monetary policy although they cannot be considered a perfect substitute. Later on December 8th, Copon in a unanimous decision decided to keep the Selic rate at 10.75% unchanged. It's likely that the monetary authority will wait for the impact of previously announced macro prudential measures before resuming its rate hikes in 2011. (The author is Vice President, Citi Taiwan.) 

West Europe

Concern over the spread of the debt crisis to other economies remains

Julius Sen



Introduction

The Irish sovereign debt problem, together with the prospects of a wider EU contagion and the possibility of a Eurozone crisis, continued to dominate much of the political and financial news during the period under review.

Internationally, the Cancun conference on climate change and global warming was the most important story, with an agreement being reached on the last day (December 10th) that seemed to provide a platform for further progress in controlling carbon emissions and dealing with the costs of global warming.

Internal issues

The big internal issue in the European Union remains the debt crisis of peripheral states, and the possibility of the crisis being transmitted to other economies of the EU through the banking system.

The major long-term issue – that of reviving growth – has been largely postponed for dealing with this immediate crisis, but remains an important consideration for long-term stability and growth.

European policy makers and the European Central Bank (ECB) have been focusing on trying to contain the debt crisis before it spreads from the periphery to the core. Many policy ideas have been considered and a consensus seems to be emerging on an approach that will require some changes to the Lisbon Treaty regarding emergency funding, and greater policy coordination or coherence between governments in macro-economic policy

making to limit the possibility of future crisis conditions developing.

At the same time, the banking system is being shored up through a mix of policy measures and interventions, driven by global agreement in the G20 and EU level agreement. This is partly an effort to restore lending, and partly an effort to minimise the effects of contagion should they arise.

Interestingly, it is smaller banks that now appear to be more resilient with less exposure to risks and higher capital reserves. Whether this will lead to a revival in business lending remains to be seen.

The emerging status of Germany

Taken together, these measures reflect the centrality of the German economy to the survival and revival of the European economy, with France and a few other economies playing an important supporting role.

The German government is the government to watch, even though they still need to work with others by consensus. It is largely their ideas that will determine the future course of events, at least in economic, monetary and regulatory policy making. Internal debates within Germany, which has a very strong federal tradition, will be critical to any long-term understanding of German policy preferences.

In itself this represents something of a departure from earlier German involvement with EU affairs, which was low-key and normally confined to playing a supporting role in economies such as France. Perhaps we are seeing a reversal of

this particular power equation.

Thus, Germany's insistence on effective budget discipline as a condition to emergency lending will set the tone for EU policy makers for many years to come. It will lead to more balanced budgets and sustainable debt levels, which would almost certainly also mean lower long-term growth prospects.

To the German way of thinking, this is an important first step towards restoring market confidence in the bond market, and will in time bring down the cost of borrowing, in time providing incentives for greater investment in economic growth.

Currency values

The main criticism levelled against Germany's approach is that Ireland, Greece, Portugal and perhaps Spain will be forced to make very painful internal structural adjustments (wage reductions, spending cuts on welfare, privatisation, sale of state assets, etc.) because these economies can no longer devalue their currencies.

In reality, and partly because of market concerns about the sustainability of debt levels, the Euro has weakened considerably against the Dollar, Yen and Sterling. The effect is to make European exports—currently mainly German—

more competitive. Whether this will be enough of devaluation for the four economies mentioned above is unlikely, but it will lessen their structural reform burdens to an extent.

At the same time, the UK was hoping to devalue its way to competitiveness (through QE and other tactics) but now finds that the dollar and the Euro are also weakening, potentially neutralising this whole approach.

It is therefore difficult to say how all these plans and strategies will play out over time. We are obviously in the midst of a complex process that is difficult to read in terms of its long-term effects, and there will be many more twists and turns in the story before the global economy settles down.

Impact on APEC SMEs

Given this uncertain scenario, it is equally difficult to say how these policy measures will affect APEC SMEs. At best one can look at a marginal revival in EU growth and stabilisation of the banking sector, and suggest that this will have only an indirect effect on APEC SMEs, perhaps in areas where APEC and EU SMEs compete in the same international markets. (The author is Associate Director & Senior Programme Advisor, International Policy Unit, London School of Economics and Political Science.) [SCMC](#)

East Europe

East Europe economic outlook is steady despite Hungary downgrade

Kuo-Yuan Liang



Hungary receives unsurprising downgrade, close eye being kept on Romania

Rating agency Moody downgraded Hungary's sovereign credit ratings on December 6th by two ranks to Baa3, the lowest investment grade within their classification. This was equivalent to the score produced by Fitch, and one rank below Standard & Poor's rating system. Moody's downgrade sends a signal in which they disagree with the Hungarian government over the measures they have chosen in reducing their debt and deficit. This include halting public contribution to pension funds, a temporary tax increase in selected sectors such as energy, while cutting personal income tax. The disagreement stems from the belief that their package will only have a short-term effect, but hurt public finances in the longer-term.

As we noted in previous articles, Hungary is one of the economies that is situated in a more vulnerable fiscal position in the region along with Romania. In July, Hungary already raised concerns from foreign creditors when they broke talks with the International Monetary Fund (IMF) and EU over the contents of the austerity measures, thereby initiating the negative outlook from Moody. The resulting measures were not what creditors wished to see. The occurrence of the downgrade served to be a warning at the appropriate time: Hungary's finances, though slowly deteriorating, was fortunately still far enough away from being dreadful, with the growth rate around 3%, inflation at around 4% government debt to GDP ratio at 85% and government deficit to GDP at 5%. Thus, rating drop would not set off the kind of alarm bells as with Greece. In my view, amid the issuance of the warning, the situation in Hungary

may instead gradually become better if no warning has been issued. As the credit scorers have outlined the wrong-doings, we can now wait and see if Hungarian leaders can better overcome the problems.

With Hungary now downgraded, we might need to look more closely at Romania, the other fiscally weak economy in East Europe. The current ratings for Romania is Baa3 (Moody's) and BBB- (Fitch), the lowest investment grade and owning the same ranks as with Hungary. Although being given BB+ by S&P, which is the highest junk rate, it is two ranks under Hungary.

Economic survey showing overall encouraging improvements

The November ESI (Economic Sentiment Indicator) report showed widespread improvement among the region's economies. This time, the European Union was driven not only by the industrial sector, but by the German service sector. Most East Europe economies, which more or less were attached to the German growth engine, have improved their economic situations.


Concerns in the past few months were focused on the austerity measures that took effect in the Eurozone region and hurt domestic demand at the same time. Due to the declining service sector in peripheral Eurozone economies, such developments could also repeat itself in East Europe. It turned out in the November report that except for the Czech Republic, the service sector sentiment was improving among the region's economies. Though more austerity measures are still scheduled for implementation in the next few years, the improvement in the service sector is a favorable

sign, suggesting that the region's economies are more capable than expected in withstanding the negative impacts from the austerity measures.

European Commission expects the modest but steady growth in East Europe in its autumn economic forecast

The European Commission (EC) released its autumn economic forecast on November 29th, where the EC made its first forecast for 2012 along with revisions on its 2011 projections. In general, the EC expects a modest but steady growth and moderate inflation for most economies in the region. Among the larger economies, Poland's prospects for 2011 and 2012 stood out among the region, with economic growth forecast to be up to 3.9% and 4.2%, respectively. Another standout member was the Baltic state Estonia,

with 4.4% and 3.5% projected for 2011 and 2012, respectively.

Unsurprisingly, the obvious underperformer would be Greece, with -3.0% and 1.1% projected over the next two years. Inflation would only be a concern in economies such as Hungary and Romania, where the former was expected to see a 3.9% and 3.7% inflation rate, and the latter experiencing a 5.5% and 3.2% inflation rate, respectively, in the following two years, which is in line with the current assessment of the region's situation. For other economies, inflation will generally be between 2% and 3%, where economies growing at a faster rate would also witness a slightly higher inflation. (The author is President, Polaris Research Institute & Honorary Professor, and Professor College of Technology Management, National Tsing Hua University.) 

Russia and Middle East

Geo-economic cooperation leads to regional stability

Ming-Hsin Kung



2010 is the year in which Russia accomplished a great deal in expanding international economic relations. First of all, with the support of the US, EU and China in the process of its negotiation for entering the World Trade Organization (WTO), Russia is expected to become a member of WTO in 2011, which means an official opening of the gate for Russia to enter the global multilateral economic system.

Besides, after Russia achieved several energy cooperation deals with China, the economy with the greatest comprehensive power among its neighbors, it is now taking a more active step to include Central Asia and Eastern Europe as its geo-economic cooperation partners. Some recent developments include that Gazprom, a state-owned

natural gas company, will provide Ukraine with a loan of USD 1.5 billion. Moreover, Russia and Poland also signed a declaration of cooperation in economic modernization this month, which ensures that the emphases of bilateral cooperation will be put on such dimensions as "investment, the development of new fields of technology, improving the business climate for small and medium enterprises, increasing the efficient use of renewable energy," etc., and the cooperation between local governments will also be a focus. Also, Russia and Belarus signed the Agreement of Common Economic Space, which will reduce their bilateral oil export tariff. What all these developments demonstrate is that Russia is actively improving its economic and political relations with its neighbors.

In addition to expanding international economic relations, Russia has also been promoting the internationalization of the monetary system. In view of the foreign exchange reserve structure, the total amount of Russia's foreign exchange reserve has fallen to USD 489.3 billion by the end of November, in which 47% is the US Dollar, 41% is Euro, with 10% of the British Pound and 2% of the Japanese Yen.

However, with the US Dollar keeping depreciating, the central bank of Russia has been considering to reorganize the currency structure of its foreign exchange reserve. So far it has been investing in the Canadian Dollars, and has also considered including the Australian Dollars and other currencies. These economies, like Russia, are important producers of raw materials, and therefore the inclusion of their currencies into Russia's foreign exchange reserve structure will help stabilize the price of energy trade and of relevant commodities.

Moreover, the fact that China has officially opened up direct exchange between Renminbi and Ruble also contributes to the bilateral trade and the reduction of exchange rate risks and exchange costs between China and Russia. Overall, Russia has set up a good foundation for its medium- and long-term economic development with regard to the expansion of international economic relations.

Similar developments can be seen in the Middle East. Turkey and Poland have decided to simplify their visa procedures by next February,

as well as to strengthen their cooperation in such fields as defense industries, energy, infrastructure and tourism.

Likewise, Qatar has strengthened its cooperation with India in various industries. Besides, after winning the hosting right of FIFA World Cup, 2022, Qatar is expected to begin a variety of important public constructions since 2011. In addition to the plan of increasing the hotel accommodations to twice the number of the present level, Qatar also aims to build nine new competition gyms and overhaul three existing ones.

Moreover, railways and mass transportation networks will be constructed in accordance with touristic needs. According to the assessment of international investment institutes, Qatar is going to invest about USD 57 billion in the construction of relevant infrastructures. This would be a promising objective for the Gulf Cooperation Council (GCC) economies to strengthen their investment cooperation, as well as a good space for an alternative growth model other than the oil-driven one.

Since these infrastructures are designed for 2022, they are expected to introduce many top advanced technological ideas and corporations, and therefore to deepen the industrial and economic interactions among the Arab world, the West, and the Asia-Pacific Region, which will also benefit the economy and regional stability in the long term. (The author is Vice President, Taiwan Institute of Economic Research.) [SCMC](#)

Global Commodity Market

Which is stronger in determining next year's commodity prices: power of money or a slow down in the economy?

Hwa-Nyeon Kim



In the last one month period (mid-November to mid-December), there have been persistent warning signs of a crisis in the global commodity market. There was a slight downward adjustment in the commodity price indices on average but the prices for most of the main commodities, such as crude oil and copper, broke the yearly highs on the back of massive amounts of global liquidity. One point that deserves particular attention is that most commodity prices showed an upward trend in spite of a strong US dollar during the last one month period. Prices decreased just shortly after China's monetary tightening policies in late November but started to rebound from early December. However, in terms of demand, it is still uncertain whether commodity prices will continue rising amid the increasing possibility of a slowdown in the global economy, China's tightening worries and reoccurring sovereign debt risks in the European economies.

During the past few months, all financial investors seemed to have developed a keen interest in commodity investment. According to several news sources, as of early December, investors including hedge funds, pension funds and mutual funds hold record high positions in the commodity markets. According to data released by the US Commodity Futures Trading Commission (CFTC), contracts held by investors have risen this year through to October.

The commodity which received the most attention was copper. According to the CFTC, the number of contracts in the copper market was up 58% in just over two years since June 2008. Some analysts have argued that the purchase of more than USD 1 billion of copper by US investment bank

J.P. Morgan Chase & Co. could further increase copper prices. Moreover, due to the strong demand for copper, the warehouses of the LME, the hub of the copper trade, now hold only 350,000 tons of copper, down from 550,000 tons in February 2010. In turn, copper prices hit a record high of above USD 9,000/ton. Others argue that recently China's significant demand for copper has had an important impact on the copper market. Even if China hikes the bank reserve ratio by a further 0.5% point to fight against inflation in December and Europe's sovereign debt woes spread to Spain, the commodity market seems to be unaffected about these forces which could slow down the world economy, resulting in the continuous increases in prices.

The top two commodity indices, the Reuters CRB Index and LME non-ferrous index, have shown somewhat gradual increases from mid-November to mid-December. The Reuters CRB index (year 1967=100) moved up from 484 points to 506 and the LME index (April 1999=1,000) increased from 3,640 to 4,039. However, the averages and maximum values of the two indices were lower than those for the mid-October to mid-November period. These lower averages are mainly due to spreading concerns of China's monetary tightening and Europe's sovereign risk.

The average for the Reuters CRB index from mid-November to mid-December decreased to 13.3%, while the average for the LME index fell only 1.4%. Such changes are mixed signs that there are still upward trends but there is also a growing cautiousness within the commodity indices compared to the previous month. In terms of price variations, the daily price changes of the

LME index was higher than those during the mid-October to mid-November 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 80.44 and 89.38/barrel and Dubai crude prices moved between USD 81.33 and 88.89/barrel during the same period.

Among non-ferrous metals, or more commonly known as base metals, only the price of copper rose, while the average prices of zinc and lead fell the most by 10.6% and 7.2% respectively. The price of copper recorded to a new high of USD 9,260/ton since the global financial crisis began. Other base metals, including aluminum and tin, revealed decreasing variations.

From a longer-term perspective than just a one-month period, like a whole year, there will continue to be upward trends in commodity prices throughout next year, especially for the first half. However, we should keep a closer eye on which will have a stronger impact on the commodity

markets between the power of global money liquidity and the slowing down of the global economy in the coming year. It will be a battle of these two factors that determines the trends in the commodity markets. If the power of global money liquidity wins, commodity prices will increase sharply. On the other hand, if the effects of a slow down in the global economy are stronger, the commodity markets will stabilize without any sharp increases.

The year 2010 was a year of high growth for SMEs in general. However, such growth was largely attributable to the recovery from the stagnations of the 2009 financial crisis, and is expected to slow down in 2011. Moreover, next year there will be more risks caused by China's tightening monetary policy and the European sovereign debt problems. This means there is an increasing possibility that SMEs will face aggravated difficulties because of both high raw material costs and decreasing sales. (The author is Research Fellow at Samsung Economic Research Institute.) [SCMC](#)

CM Knowledge

The Past and Present of East Europe's Development Experience

Kuo-Yuan Liang



Most of the East Europe region joined the free market economy for only a little more than two decades. The transitions in respectively preparing them for the front stage from behind the curtain have each had some success. But they have also had to grapple with their share of difficulties from legacies of the past. In this article, we shall look into the past and present of the region's development experience, and discuss their future path and prospects.

Past glories, new ages

Many of the region's economies enjoyed a period of glory in the past. For a more distant period, Poland-Lithuania was once the largest European state roughly five centuries ago; Hungary and its Holy Crown had been a longtime power on the European continent; Bohemia (Czech) was also known for its prosperity and distinctive culture. In the 19th century, the occurrence of the Napoleon Wars, industrial revolution and the retreat of the Ottoman Turks, gave the region a new landscape. Prior to World War I, Hungary once had a strong industry and rich resources, but the supply chain was fragmented after the war when it lost territory to its neighbors and newly founded economies. Afterwards, in the aftermath of World War II, Poland was shifted to the west, allowing it to acquire the eastern front of Germany and its industrial base. The so-called "Iron Curtain" was subsequently lowered.

After the removal of the Iron Curtain, the region's economies respectively underwent structural reforms to adapt and implement market economy principles, and at the same time attract foreign investment to bring them the much needed capital they desperately needed for economic development. In the past two decades, aside from the inherent competitive advantages or natural resources, the key factor for economic success in the region, lied on how an economy swiftly reformed their institutions to adhere to the new economic environment.

The rush to openness and foreign capital laid the roots to today's challenges

Consequently, foreign capital with the allure of cheaper labor and the region's closeness with West European markets began entering the region, which brought years of economic success. While the region's economies were inevitably running large current account deficits amid the foreign investment inflows and capital goods imports for development needs, what also came was the rise in asset prices and increase in government expenditure. In the region's development process, these features also became their vulnerabilities during and after the global economic crisis. When foreign investors retreated, asset prices fell and government revenue declined, thereby causing the current account crisis that needed IMF assistance, ultimately resulting in a shaky banking sector, and

excessive sovereign debt and deficits, respectively.

The problems the region's economies have faced in the past two years and will continue to overcome were more or less the legacy of their development experiences. Those who ran a larger current account deficit, which meant they relied more on foreigners, suffered first. It then was the ones who had asset bubble bursts, as they needed to provide support to their crippled banking sector. More recently, focus has been on the sovereign debt concerns that have haunted all of Europe for the past year. With these lessons, I would expect regional governments to employ development strategies that are sustainable in the long run, while using more of their own domestic resources and rely less on foreigners in the future. (Please see my monthly article in Column 2.)

The better performers and Euro area members

While many of the past experience and future challenges are shared among the region, each economy has its own specific advantages and challenges. Poland, the best performing economy and most populous state in East Europe, benefits from a larger domestic market size, abundant young and professional labor and a more decentralized domestic economy with several economic significant regional clusters in addition to Warsaw, while other East Europe economies concentrate mainly on their capitals. Poland also has a diversified economic base that includes a more balanced portfolio of industries. This may be part of why Poland is the twelfth most favorable investment destination in the UN World Investment Prospects Survey 2010—2012.

Following Poland, the Czech Republic is the next favorable investment destination in the region. Equipped with a strong engineering base and a skilled labor force, with its critical location on the crossroad between developed and developing Europe, it has made it appealing to multinationals, especially those from German speaking economies. Turning our attention to Slovakia, Czech's former partner in Czechoslovak, as a Euro area member, it was relatively unaffected by the foreign exchange turbulence its regional neighbors encountered during the financial crisis. But, its disproportionately large automobile manufacturing

industry, has had it exposed to fluctuations in the auto industry, and may limit its economic growth potential. Slovenia is another highlight among the Euro area members in the region. By adopting the Euro, it has dodged currency market turbulences as well, but it also lost the exchange rate mechanism to adjust its relatively high wages and it has limited its ability to trade budget deficits for growth. Along with its small-size market, Slovenia appears less attractive to investors.

Fiscal consolidation the first priority

Hungary's once booming economy had started to slow down earlier even before the financial crisis. Looking ahead, Hungary's major challenges are fiscal consolidation (as I have noted in recent monthly articles), a shaky banking sector and over leveraged households. Though these are common issues in the region, Hungary's problems appear to be more challenging than average in the region. This would mean that Romania, another fiscally weak economy, would also need tough fiscal consolidation as well. However, aside from its problems, Romania has a large domestic market as it is the second populous economy in the region behind Poland. Together with its rich natural resources of oil and gas, it would provide Romania the resources needed for development.

States that need to climb up again on their own resources


Bulgaria was running extreme current account deficits prior to the crisis, and the financial crisis made that vulnerability exposed, as capital inflows were cut off to an economy owing the lowest per capita GDP in the region that desperately needed resources from the outside to develop. The other three Baltic republics have similar cases as Bulgaria. The underlying problem is commonly shared by the whole region, but is considered to be even more severe given the small size of their respective economy, including current account deficit, asset bubbles, and excessive credit growth, which severely struck their economies in the crisis. It is expected that they will need several years to deleverage.

East Europe will rise again, so this time in a more sustainable way

Indeed, there are challenges everywhere. But the region has some unique advantages. As mentioned before, its close proximity to the West Europe markets would attract both West Europe firms seeking cost reduction, and those who seek to enter the West Europe markets. Moreover, with the current expansion of the EU, EU structural and cohesion funds are flowing into the region and reshaping the region's infrastructure. Meanwhile, intellectual property laws in most economies are adhering to EU standards, reducing the risks for IP investments, as compared to other emerging market peers.

What would these developments mean to the SMEs? The SMEs in the region are usually funded by the owner's own capital, and are typically small retail and service businesses that are unrelated to exports. Current account deficits and currency valuation changes have limited direct impact to these business models, but they are more sensitive to changes in aggregate demand. Asset bubble

bursts and credit tightening, along with government fiscal consolidation will affect small businesses more.

In conclusion, governments and policy makers have learned a precious lesson-developing an economy is a delicate matter, an economy should rely more on their own internal resources and capacity, while a balanced industry portfolio is also more preferred. Relying too much on foreign capital makes an economy vulnerable to the changes in international financial markets, grow faster than the pace for long-term sustainability thus creating the risks of a bubble, and be impacted by speculation capital and excessive credit growth. The region is still dealing with the legacies of their past, thus it will take some time for them to regain their strength. But this time, they will choose a path that is sustainably more long term. (The author is President, Polaris Research Institute & Honorary Professor, and Professor College of Technology Management, National Tsing Hua University.) 

CM Best Practice

Discovering Incipient Risks to Harness Opportunities

Tsai Chi-Cheng



SingBee Enterprises Co., established in 1987, and initially concentrated on the production of OA office furniture. Now we becomes one of top three largest OA office furniture producers and achieving ISO certification for its factory in Chinese Taipei. Ten years ago, SingBee started to employ a diversification strategy with efforts to make LCD TV stands for the export markets of Japan, Europe and the US, and six year ago, it started to engage in R&D and production of children-oriented study furniture, currently enjoying the pre-eminent position across the Taiwan Straits and Hong Kong as the largest children-oriented furniture maker. It has earned a brand reputation as the first furniture firm made in Chinese Taipei exporting to the interior of China. After 24 years assiduous efforts, SingBee has grown from their origins as a producer entirely dependent on the domestic market to an enterprise with a healthy reform of 70% exports as well as 30% domestic sales volumes.

The global financial crisis of 2008 was a particularly painful experience for the vast majority of global enterprises, but for SingBee it was the substantial year which yielded their best performance to date with maximum growth in their number of clients and the growth in export sales by nearly 30%.

These impressive results are rightly attributed to the prescient fact that five years

preceding the crisis, hence, SingBee realized that the transformation and enhancement of competitiveness for traditional manufacturers are imperative. In order to achieve sustainable survival in markets, through a continuous course of investments in human and equipment resources over five years, we were able to completely transform the enterprise from the ground up, including significant R&D improvements, replacement and upgrade of antiquated production equipment, implementing the diversification in production lines, and the decentralization of the allocation in target markets. The whole success of these various initiatives was evinced by our remarkable performance against formidable market trials in 2008.

SingBee excelled in the innovation and design at its inception by integrating and modularizing high-quality materials to shorten new product development times. As SingBee began to confront the overcapacity of OA office furniture in domestic markets, we perceived an opportunity to redeploy our OA product strengths in modularization to develop LCD TV stands and children-oriented study furniture lines.

With the explosive growth in the 3C industries over the past five years, LCD TVs have already achieved market predominance over traditional sets. As consumer data clearly indicates,

customers all over the world have the acute demand for flat display TVs in sustained excess of 1 million sets annually. SingBee very precociously anticipated the arrival of a substantial new market for television stands, and began preparing to seize the opportunity. We began with securing the strategic cooperation of Japan's largest television stand maker Hayami, not only ensuring access to the Japanese partner's capital and their extensive television stand design know-how, but allowing dramatic enhancements to SingBee's product quality. Japan remains the largest export market for SingBee, accounting for more than half of overall export sales performance.

Relying primarily on the comparative advantages generated from Chinese Taipei's superior innovation and design capacities, we utilized the conjunctive strengths of Chinese Taipei in steel, glass, plastic fittings design, and imported wood sheets as materials, to develop a wide variety of different designs of value-added TV stands. SingBee took full advantage of Chinese Taipei's existing competitive strengths in basic industries and the prodigious local creative capacities, while participating every season in all the major global exhibitions (e.g., the largest CES electronics show) to maximize corporate exposure and popularity recognition, resulting in repeat success in achieving contracts for global retailer-branded OEM or ODM production.

Proper market allocation helped SingBee evade the risks inherent in the global financial crisis into a favorable opportunity. While assiduously opening a Japanese market presence, SingBee was able to secure orders as the fruit of their efforts over the years from participation in European and American exhibitions. So in our market allocation efforts, we were able to avoid the overconcentration of risks from single market dependence. During the doldrums of the global financial crisis, we were still able to preemptively enter new TV stand markets at the earliest moments to secure early entry advantages. Our cooperating clients are widely distributed throughout Russia, Germany, England, Italy, Iran, Saudi Arabia, Nigeria, Thailand, the US, and Central America, with an extensive array of more than 100 product line offerings, ensuring our market presence in every category from the low cost, low unit price

products to the high cost, high unit price products to meet all our customer's various needs.


Realizing that the profitability from manufacturing for others is limited, in 2010 SingBee began developing our own brand presence, focusing on the China as their primary initial market. As the domestic consumption capacity of the China has expanded dramatically in recent years, and given the strength of Chinese Taipei products in the market, SingBee is currently the premier furniture exporter that manufacturing in Chinese Taipei to the China market.

In terms of our children-oriented study furniture exports, the market demographics of China are impressive since an additional 20 million new children were born every year, compared to Chinese Taipei's new population growth in 2009 of only 190,000 newborns. The market potential in China after research analysis shows that it is worth investing. This is especially true in light of the cultural predominance of the Chinese traditional respect for the literati and intellectual accomplishment as the true hallmark of success. Every Chinese parents and grandparents strives for their progeny, so that these consumers are very willing to invest multiples of their monthly disposable incomes for purchases of ergonomic, well-designed, and appropriate children-oriented study furniture.

SingBee relies on the fundamentals of human factors engineering, to innovate environment-friendly and safe products, which appeal to children's developmental needs. Whether for desks or chairs, all can be adjusted according to the changing heights of growing children, including adaptive capacities in the desks for tilting to facilitate extensive studying. SingBee concentrates on improving consumer's quality of life, emphasizing the users' practical needs throughout the design process, to generate use-friendly designs, rather than forcing customers to simply accept whatever is offered and suffered from inadequate product designs.

Looking to the future, SingBee will continue to rely on its core domestic market in Chinese Taipei, to expand a global market presence. SingBee proudly explains that: there are no

industries which must decline into oblivion, only industries unable to create their own market opportunities when facing with challenges. For an enterprise, any risk always carries the seeds of an inherent opportunity lurking around, and the capacity of the firm to think outside the box will largely determine whether they enjoy competitive strength or weakness. As we continually reevaluate the firm's operational capacity status, maintaining

the prudentially necessary modicum of vigilance, while continuing to search for developing market trends as they emerge, we innovate responsively to anticipate and meet changing consumer needs, which is precisely the essential component in any firm's successful crisis management response. (The author is President, Sing Bee Furniture Company.) 

CMNews Digest *Szu-Min Chien*

Inflation pressure rises in China

The inflation has been severe since 2010 in China. The consumer price index (CPI) still rose by 4.4% in October, and in November even rose to the highest point in 28 months, 5.1% higher than the corresponding period last year. The main reason for the continuous increase of the CPI is the rise of food price and housing cost. The food price has increased by 11.7% compared with last year, primarily because the seasonal factor of winter has made the vegetable prices higher. The housing cost, including the rent, electricity and water bill, has increased 5.8%, the highest increase since September 2008. Besides, the price of imported raw materials has risen drastically, leading to the growth of the producer price index (PPI) by 6.1% in November compared with last year, and by 1.4% compared with the previous month; the PPI from January to November has increased by 5.5% compared with the corresponding period last year.

Many long-term factors cause inflation in China, such as the continuous growing of the foreign exchange reserve and of the supply of Renminbi. The economic rescue fund of RMB 9 trillion came from expanded loans, and it is also the cause of the increased supply of domestic currency. Moreover, the recent increase in the demand of electricity, oil, and transportation motivated by the economic growth has stimulated the rise of commodity price; the wage rise in China in the second half of the year has also enhanced the production cost. As a matter of course, the price rise of assets like real estate is another important reason for the current inflation.

To appease the fluctuations in commodity price, People's Bank of China not only announced an interest rate increase, but also raised the deposit reserve ratio several times to 18.5%, thus absorbing liquidity from the financial system. Also,

the Central Economic Work Conference of China has included the issue of commodity price into its priority work agenda in 2011, which demonstrates that such an issue is in need of long-term attention. The possible measures that China will take include appreciating the Renminbi, raising the interest rate, and cutting the income tax on interest earnings, which will help slow down the rise in prices.

The US prolongs the tax cut

The US President Barack Obama signed a bill on December 17th that prolongs the Bush-era tax cut package, with the aim to avoid the increase in the income tax, which is supposed to be enacted since January 1st, 2011. The two-year tax cut bill includes measures to release all US citizens from tax increase, to cut the payroll tax for a year, to prolong the government aid for the unemployed by 13 months, to offer tax cut to entrepreneurial investment, and to retain some tax benefits for the middle class. According to estimation, however, enforcing this tax cut bill will add USD 858 billion to the currently USD 1.3 trillion budget deficit, thus pushing it to the new highest point.

According to the US government, the tax cut bill and unemployment relief bill, once extended, can stimulate consumption, bring about economic recovery, create job opportunities, and help the unemployed. Nevertheless, there are also some different views, such as those who maintain that although the tax cut will function to offer a short-term stimulus, it will also exacerbate the debts of the US. In the opinion of Moody's international ratings agency, the proposed tax cut extension may probably lead to more risks of its sovereign ratings being downgraded; for the US government finance, tax cut may have more negative influences than the short-term positive effects. According to former Federal Reserve Chairman Alan Greenspan, reducing the budget deficit is more important than

the prolonged tax cut that will expire by the end of this year, and if the government raise debts to an extent higher than what it can afford, the consequence may probably be very dangerous.

The EU summit

The seventh EU summit this year was held among the leaders of EU members in Brussels on December 16th. The primary issues include how to prevent the European debt crisis from spreading, and how to maintain the stability of the Eurozone. The EU summit has convened six times this year, not only discussing how to prevent the sovereign debt crisis that has surged in the EU members this year from spreading, but also agreed to retrench the government budget of the members, so as to keep the members from accumulating more and more public deficit and debts. In addition to Greece and Ireland, the debt crisis has also spread to Portugal and Spain. At this time, the first two has received bail-out from the International Monetary Fund (IMF), but the latter two economies, and other economies exposed to potential future crisis, will need continuous aid.

The latest EU summit proposed to add a new provision to the Lisbon Treaty, the EU

regulations, so as to create a mechanism of permanent bail-out fund. The European Stability Fund, established cooperatively by EU and IMF, will be replaced by the new institutionalized European Stability Mechanism to help members deal with the problems of fluidity and debts. Under this mechanism, investors will have to bear the losses that would be possibly created by a crisis. Moreover, the amended treaty not only allows the Eurozone members to establish their own aid mechanism, but also sets up some qualification limits on financial assistance, which will ensure to some extent that the aids will not be indiscriminately excessive. Nevertheless, the details of this mechanism, such as its scale and range, will not be decided until the spring in 2011, and the mechanism will not replace the existing one until 2013.

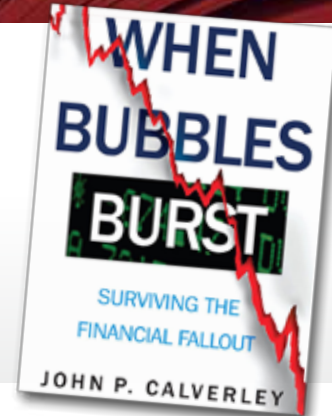
Concerning this mechanism, however, Carsten Brzeski, senior economist at ING, maintains that “EU does not solve the current crisis.” It means that the public debts of EU members may fail to retain their current value, and that the problem of the government unable to pay the debts may probably erupt before 2013. [SCMC](#)

CM Publication

When Bubbles Burst

-Authored by John P. Calverley, published by Nicholas Brealey Publishing in 2009

Hui-Wen Huang



In 2009 John P. Calverley published *When Bubbles Burst*. This work represented a continuation of his preceding work *Bubbles & How to Survive Them* published in 2004, and primarily focused on the relationships between bubbles and the economy in regard to the global financial crisis and appropriate response measures by government and investors. Besides explicating the 2008 global financial crisis, *When Bubbles Burst* also provides analysis with a financial behavior perspective about how the market had abated from the solid reality of the bricks and mortar economy, resulting in the creation of a bubble and crisis upon the bubble's bursting. This work contains many valuable and worthy recommendations in regard to the formative factors behind bubbles and appropriate responses by investors.

This book adopts a psychology approach to explicate the formation of bubbles and their bursting. It explains how investors come to believe that the likelihood of financial losses resulted from their investments are infinitesimal. For example, when investors have an indomitable sense that the stock market will surely continue to appreciate overall or real estate prices can only continue to increase, then investors will naturally tend to let down their guard in regard to appropriate prophylactic measures to preempt or hedge against the risk of financial losses.

This is all the more cases when investors are

achieving real profits. The profits will make them in a greater capacity to resist and a higher pain threshold for real losses, such that the invisible but assumedly rational evaluation of risks and rewards which ought to inform normal and proper market operations eviscerates and evaporates. The other case is when investors are overly confident that market forces will surely prevent any decline from occurring. They will ensure that any decline is merely momentary phenomenon backspace, and that there will be returned to long-term bull market trends without doubt. The markets in practice will derail from the concrete economy, creating economic bubbles.

Except for overconfidence and excessive optimism, the herd effect, cognitive dissonance, disaster myopia, and disaster magnification are all additional factors which may result in ineffectively and inadequately responsive market mechanisms resulting in creation of bubbles, followed by bursts, causing crises.

When bubbles occur in widely held assets, naturally there will tend to be disadvantageous results for the economy. While the stock market bubble may be risky, the largest historical bubble crises have resulted from real estate bubbles. According to the author's point of view, the stock market crash will not result in the direct dysfunctionality and destruction of the entire banking system, but, whenever the real estate

market crashes, there will be massive affects upon banks which widely hold collaterals in real estate.

The work very clearly shows that the incipient stages of a bubble, investors typically are inadequately cautious, while in reality, for investors at that time matters are already inherently very risky, and they should be deploying deeply scrupulous monitoring of market trends. If asset prices are very high and the bubble is still looming, it is advisable to reduce high-risk investment exposure, and enhance a broader range of low risk investments. However, it is not necessary that an investor engaging complete liquidation of their investments, unless the investor is completely unable to bear the consequences of any attendant risk. If market prices continued to remain unabated at very high levels, and the percentage of funds investment portfolio devoted to high-risk investments should also be appropriately downwardly adjusted to account for the increasing risk as the market goes higher.

As soon as a bubble occurs, if it will continue to grow, one requisite is that more investors will be entering the market, with the result that there will be more capital at risk through exposure. Ultimately when there are no new entrants willing to invest, or certain other events results in investors starting to liquefy their holdings, the bubble will begin to burst.

In order to reduce the harms from these bubble processes and to help forestall the problems associated with bubbles for the finance system, Dr.

Calverley has proposed that decision-makers should have a profound awareness and pay close attention to monetary policy and financial market policies, while investors need a better understanding of the market, and appreciate the existence of cycles and bubbles to avoid being sucked into the vortex of a bubble.

As several of our preceding issues have noted, a proper appreciation of risks is absolutely essential for effective responsiveness and management of risks, just as Sun Tzu's Art of War teaches "To know one's own strength and the enemy's is the sure way to victory." ***When Bubbles Burst*** helps readers better understand how it is that even in the most effective markets there still remains inherent risks which can result in the formation of a crisis.

Perhaps, a crisis is a consequence of various policy mistakes; or, the result of structural market problems; a result of finance problems, or perhaps any of these is simply our normal aspects of the cyclical nature of the markets, or merely in consequence of the unprecedented agglutination up all of these factors at the same time. But, regardless of which specific cause is the actual culprit, human factors certainly cannot be disregarded. As a result of a better appreciation and understanding of financial behaviors, it is possible that before a bubble-burst crisis arises, we can deploy effective pre-emptive countermeasures, while ensuring access to the most effective responsive measures when a bubble bursts, so as to achieve optimal investing objectives. [SCMC](#)