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# Executive Roundtable and Professional Placements

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## Session 1, Part 2

### Current Assessment:

Global and Regional Dimensions of Instability

全球和亚太地区不稳定因素

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### **Factors Contributing to Global and Asia-Pacific Region Instability**

More than a full year has now passed since the sub-prime lending crisis suddenly occurred in America in the middle of 2007. In the time since, the sub-prime lending crisis has led to significant difficulties for some major American financial institutions, such as Bear Stearns, and Countrywide; major banks such as Citibank have sustained substantial losses; real estate prices have tumbled; share market prices have fallen; and liquidity in the financial system is extremely tight. The US Treasury Department and the Federal Reserve had no alternative but to adopt a series of rescue measures: large injections of liquidity, and even directly providing capital to buy Fannie Mae and Freddie Mac, to avert a crisis in the financial system. Separately, the sub-prime lending crisis spread to Europe and Japan, and many banks found themselves in difficult circumstances: the European Central Bank, the Bank of England, and the Bank of Japan also had no alternative but to adopt appropriate measures, and made large injections of liquidity to maintain stability in the financial system. The sub-prime lending crisis led to a slowdown in economic growth in America, then Europe and Japan, and then affected other regions, including economic growth in the Asia-Pacific region.

Happily, since the Asian financial crisis which occurred in the late 90s, Asian countries and regions have adopted vigorous macro measures: great efforts have been put into adjusting and regulating their economic structure; raising the quality of economic growth; strengthening the financial sector; increasing exchange rate elasticity; and overall risk resistance capacity has been greatly enhanced. Asian countries and regions must, however, pay serious attention to the impact of the sub-prime lending crisis, take preventive measures, adopt vigorous measures, and strive to continue to maintain excellent growth momentum amidst an unstable external environment.

There are as yet no reliable figures about the speed with which the American sub-prime

lending crisis unfolded, how widely the exposure will extend, and how profound the dangers it poses. Investigating its causes, the first is that the low interest rate policy for many years past led to excess liquidity; the second is that in order to chase profits, banks were implementing excessively relaxed housing loan policy which led to a great increase in sub-prime lending; the third is that financial derivative products such as CDOs lacked essential transparency, changing hands time and again, with no ability to control the risk; the fourth is that some rating companies had not really carried out their professional duties, ratings were inappropriate, misleading investors. As a result, when American interest rates rose, this triggered the sub-prime lending crisis, and as problems with sub-prime lending became grave, the impact changed direction to affect the prime loans domain, which then affected banks' financial statements. When problems emerged with some high-profile major financial institutions, if the government had not acted to rescue them, and allowed them to go bankrupt, there would have been a domino effect, which could have brought about a complete collapse of the financial system. This is the basis for the US Treasury Department and the Federal Reserve sparing no effort to implement large scale rescue measures.

The first knock-on effect of the American sub-prime lending crisis was a major decline in the housing industry; to date, real estate prices had already seen a sharp drop of 15%, leading to a shrinkage in wealth, and a decline in consumption ability. And 70% of American economic growth comes from individual consumption, so when the American people's consumption ability declines, combined with a lack of confidence about the future, this naturally led to an economic slowdown. The most recent figures forecast that economic growth in the American economy in 2008 will be 0.9% lower than in 2007. With the economy in distress, combined with falling prices for all categories of financial products, it naturally led to a depreciation of the US dollar. The US dollar depreciation in addition gave impetus to a rise in commodity prices, especially the price of oil. Many Asian countries rely on petrol imports, and China has to rely on imports for almost half its petrol consumption. Large rises in import prices have created rises in prices in these countries and regions, increasing inflationary pressures.

The second major aspect of the impact of the sub-prime lending crisis is a direct one, with many Asian countries and regions relying on exports to America. The slowdown in the American economy will inevitably reduce imports from these countries and regions. Research clearly indicates that for each fall of one percentage point in American economic growth, economic growth in Asian countries and regions will correspondingly fall by 0.3–0.5%.

The third aspect of the impact is that depreciation of the US dollar will weaken competitiveness of this region's exports, because the majority of exports from this region are priced in US dollars, the relative rise in value of regional currencies will weaken their competitiveness.

The fourth aspect of the impact is that after the Asian financial crisis the majority of Asian countries and regions adopted reform and opening-up policies, and the majority of their capital markets are already open to the outside world. For example, control of 40%

of the market capitalization of the Korean share market lies in the hands of foreign investors. Falls in the American share markets brought on by the sub-prime lending crisis will inevitably have flow-on effects on share markets in this region, and have already led to large falls and severe turbulence on share markets in many Asian countries and regions.

The fifth aspect of the impact is that in order to stimulate growth in the economy, the Federal Reserve adopted a low interest rate policy, and has already dropped Reserve interest rates from the 5.25% of several years ago to their current 2%. And in order to deal with inflation, Asian countries and regions are forced to adopt correspondingly higher interest rates, which has created a disconnect with American interest rates. This will lead to a more rapid inflow of capital, restricting the room for the central banks of these countries to apply currency policies, and has increased revaluation pressures on local currencies.

Set out above are the main instability factors which Asian countries and regions are currently encountering. But as stated earlier, given this region's many years of sustained efforts from the time of the Asian financial crisis, the macro fundamentals of these countries and regions are good, and the risk resistance capacity of the financial sector has been greatly strengthened. All that is required is are timely policy adjustments, and properly handling the bringing of the links between inflation and economic growth under control, and the region will definitely be able to overcome these difficulties, and continue to maintain this region's excellent growth momentum.