

Asia's options in policy divergence

KOREAN ECONOMY



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What will be the new normality in the global economy in the near future? Since the global financial crisis in 2008 all the central banks have pursued the same policy target to overcome the financial crisis as quickly as possible and to resurrect the real economy for prosperity. Even if every economy was under different circumstances, its monetary policy was very much in the same vein and fully harmonized. It was a period of the global unity in policies, including the monetary one. But now it appears a huge change is looming after the Fed implied an earlier-than-expected exit strategy even though underlying reasons for such a dramatic retreat from what has been laid out since 2008 remain unclear. What is the key implication of the exit strategy from one of the most lenient and accommodative monetary expansions? It would be unnecessarily immense: for instance, rising interest rate, adjusted stock prices, tapering global financial flows or a fresh wave of protectionism, etc. It appears that those implications might usher in a period of policy

divergence in the global economy. The period of divergence is likely to be of great significance to emerging markets since the unity on economic and financial globalization in the past 30 years represented by GATT, WTO, and OECD have contributed to the economic development of emerging countries, in particular, the Asian Tigers, China, India and nowadays the Southern Asian countries. First, with the emergence of divergences, the Asian economies are likely to be hit by less liquidity due to disharmonized monetary policy as the advanced countries are emphasizing their own self-interest in order to protect their own industries and consumers. Second, the growth of consumer demand might be sluggish since the leading economies are likely to be more credit-constrained and more dollar-strapped if the monetary tightening continues. Third, the emerging countries may be swamped with the structural problems since they are relatively lagged in terms of debt restructuring and public efficiencies, along with the inflationary pressures due to the rapid expansion of industrialization and urbanization. Fourth, the growth-focused economic development might have undermined the income equality, the geographical disparity and the employment gap between the old and young generations. In a sense the emerging industrialized economies may need to re-consider and re-build their economic, financial and social policies by taking into account a new

paradigm of divergent conditions in the global economy. Furthermore, such reconsideration on a broader scale might be more crucial for the Asian economies whose growth have been heavily driven by the external demand, the continuous catch-up of technology, and the production of consumption goods. In spite of those difficulties, the Asian conundrum is, for the time being, related to the fact that they may not purely rely on the domestic market and, more importantly, still need to strengthen their global competitiveness comparable to the leading players of the advanced economies. Furthermore, Asian economies are more likely to be competitors in the global market as mentioned earlier due to the similar strategy for economic growth and they are converging into the similar stage of economic development. How can Asian economies resolve and prepare for the period of divergence of the global economy wisely and securely? It seems that the key task in preparing for the new wave is to secure the currency stability through safeguard such as the foreign reserve or the foreign assets given the strong tendency for dollarization. Even if the accumulation of foreign asset may be difficult or it may not be appropriate given the high expectation on the dollarization, the accumulation of foreign assets can be the uttermost solution in the worst case. Also Asian economies should

identify a new engine for growth. Given the necessity of external growth constrained by limited resources, high population, and short-term development, Asian economies should try to improve their technological excellence over the advanced economies. It cannot be achieved in a short period of time through cheap labor or long hours of work. It requires fundamental reforms of education, incentives structure, as well as overhaul of the job market, even if it might incur the additional cost of innovation in transition. In a sense Asian economies should willingly utilize their accumulated national wealth for next generation to be more innovative and to be more globally competitive. Additionally Asian economies should focus on the social safety net so as to smooth out the structural transition that might be led by lower exports, lower employment, and lower growth. The social safety net should be provided more effectively than before through improving the efficiency of the public sector. Reform of the public sector in a sense is the departure from the past when the public sector mobilized, directed, and led the economic growth, and is providing the full support for the private sector to be innovative, dedicated and risk-taking through fairness and transparency. Asians might be reminded of what saves the current economy and builds the new economy is taking one step at a time.

CEO COLUMN

1.5 mil. expats in Korea and creative economy



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The population of resident foreigners in Korea now exceeds 1.5 million. From 680,000 in 2003, the number has more than doubled in the past 10 years. This means that out of every 100 Korean residents, three are of foreign nationality. While this is of course lower than Dubai, where 90 percent of the residents are foreigners, or even Germany (8.7 percent) or Russia (7.7 percent), the number still tells of a major change in our society, especially when considering how the Korean people have always prided themselves on their homogeneity as a single-race society. However, there is a surprising amount of historical evidence indicating that Koreans actually have long lived in a multicultural environment. For example, records show that the naturalization of foreigners began in the early years of the Three Kingdoms Period, about 20 centuries ago. As a result, over 130 of the 280 or so family names in Korea come from naturalized ancestors.

spective is necessary if we are to realize the new opportunities provided by the diversity of a multicultural society. This diversity will allow us to improve our adaptability to new environments. All living organisms in the natural world have evolved in a direction that increases genetic diversity. Possessing a richer genetic diversity allows a race to adapt better to changes in the environment. In business and economics, the increase of foreign domestic workers increases our cultural diversity and thus allows us to adapt to global changes more effectively. Also, as we become more diverse, we gain new perspectives that make new advancements possible. If we as a society are to realize positive change, we first need to discover the areas in which change is necessary. It is difficult for Koreans, who are accustomed to the current state of matters around them, to identify such areas of improvement. On the other hand, expatriates living in Korea provide a fresh perspective on matters that we do not even notice anymore, thus making it possible to discover areas that require change and develop ideas on how to carry out such changes. As we assimilate these ideas, we become that much closer to realizing the globalization of our culture as well. The convergence of diverse views leads to innovation, and this is the key to our vision of fostering a creative economy. It is true that, up to now, the Korean economy has achieved growth based on the efficiency of homogeneity, rather than diversity. But the consensus is shifting toward the understanding that growth in this manner has now reached its limit and future economic growth must be fueled by creative innovation. Creative innovation is born when different perspectives are brought together and various specialties are combined. Studies show how groups with more diversity perform better on creative tasks than homogeneous groups. Rather than adhering to our identity as a "pure and single-race" nation, we should embrace diversity and incorporate it into Korean society. We can see how Athens, caught up in the narrow view of nationalism, failed to grow into an empire, while Rome chose to grant citizenship to ethnic citizens and went on to construct an empire that held sway over Europe for 10 centuries.

Chinese credit crunch

GLOBAL ECONOMY



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Economies are like bicycles: they get into trouble for going either too slow or too fast. It is hard for an economy to sustain high rates of growth if private credit does not follow suit. This is especially true if the construction sector is a major contributor to growth. The cases of the U.S., Ireland and Spain during the crisis illustrate this problem, and now China has become yet another example. Since 2009 credit

has expanded much faster than GDP, and real-estate prices have grown even faster. Still, the Chinese economy does not follow the usual pattern, in ways that actually add to the sense of alarm about the future of the world's second-largest economy. The most problematic feature of recent economic developments in China is that most of the credit expansion over the last four years comes from the shadow banking sector, i.e. financial intermediaries not supervised by the authorities. Analysts and investors are right to be concerned about this. A few weeks ago banks ceased to lend each other in the wholesale market, signaling the beginning of a credit crunch. On June 20 the inter-bank interest rate reached 25 percent, and bank shares took a hit. While the central bank played a role in making

credit more expensive by refusing to lend, it was a difficult moment in which banks were approaching the end of the second quarter. Another unique Chinese feature is that its financial system is not dependent on external financing. The domestic savings rate is much higher than in Europe or the United States. Moreover, China enjoys a large current account surplus. China has at its disposal considerable degrees of freedom. Still, the consequences of a credit crunch in China could be devastating, especially in the informal financial sector. Many small and medium enterprises depend on unconventional credit channels for survival. Clearly, monetary authorities are not likely to allow high rates of credit expansion. Investment will decline, and it has recently accounted for nearly half of GDP.

Chinese financial problems are likely to spill over into other parts of the global economy. Even if deleveraging takes place in an orderly and gradual way, Chinese GDP growth will suffer. This will in turn affect countries that export to China, especially Japan and South Korea. It may also prove devastating for exporters of commodities, especially Brazil. The timing of China's reckoning with its recent credit expansion could not be worse. The Federal Reserve has just signaled that quantitative easing may come to an end. Financial markets around the world are reeling. Uncertainty is on the increase, not only because of the continuing problems in Europe but because of the slowdown in emerging economies. Unfortunately, China's financial system is now adding to global financial woes.

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