

The Global Economy Post the Financial Crisis

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Outline

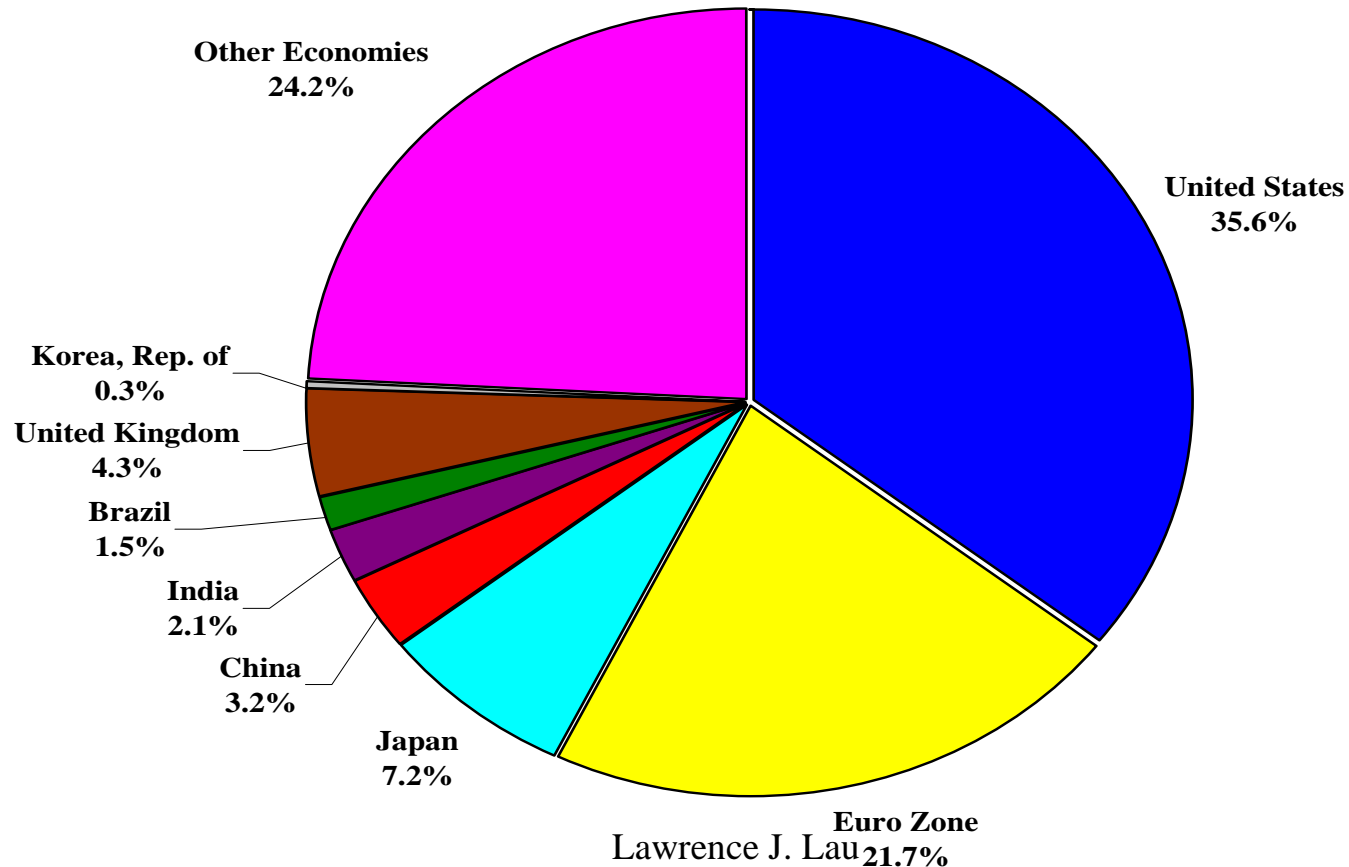
- ◆ Introduction
- ◆ The World Economic Situation
- ◆ The International Monetary Order
- ◆ Concluding Remarks

The World Economy Post the Global Financial Crisis

- ◆ The centre of gravity of the World economy is gradually shifting from the United States and Europe to Asia, including both East Asia and South Asia.
- ◆ The East Asian economies are partially de-coupled from the rest of the World economy, as evidenced by the performance of China, India and other East Asian economies during the 2007-2009 global financial crisis.
- ◆ However, the Chinese and East Asian economies are not large enough to turn the World around. The idea of a G-2 consisting of the United States and China is premature.

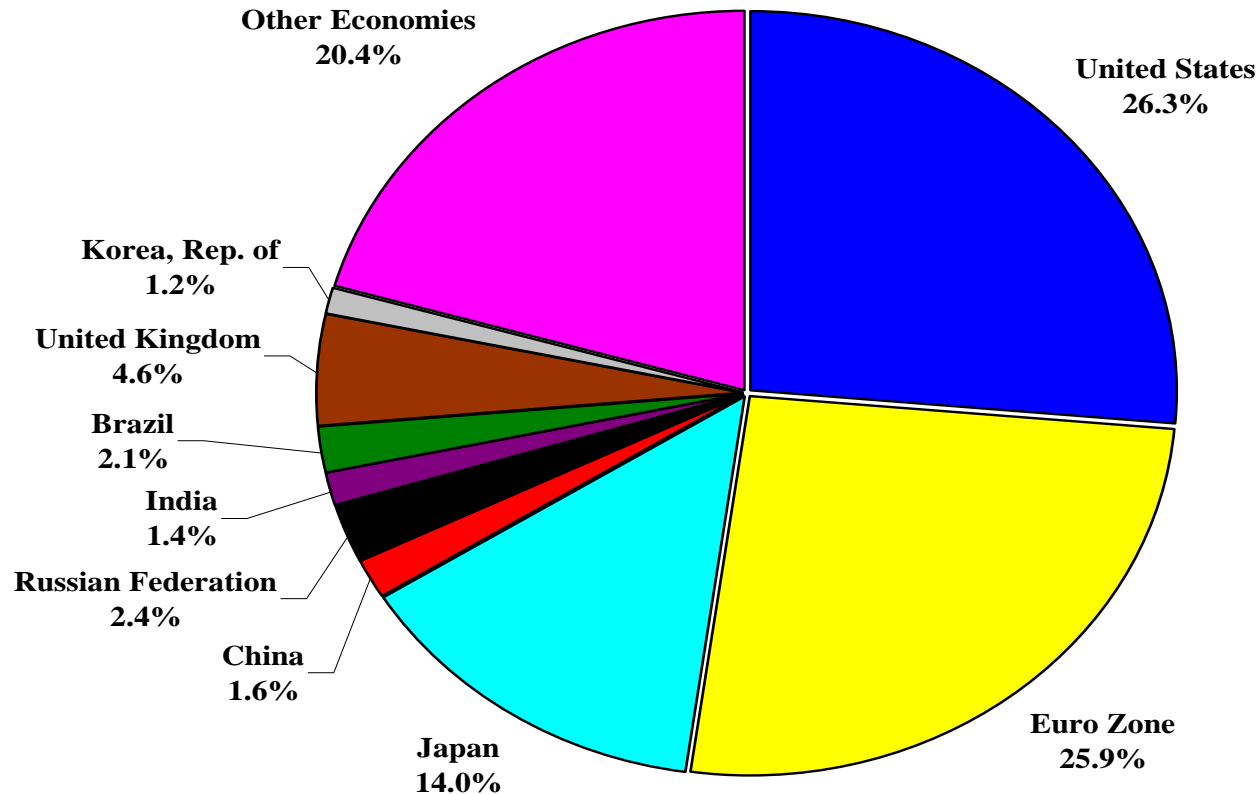
The Distribution of World GDP, 1970, US\$

The Distribution of World GDP in 1970, in USD



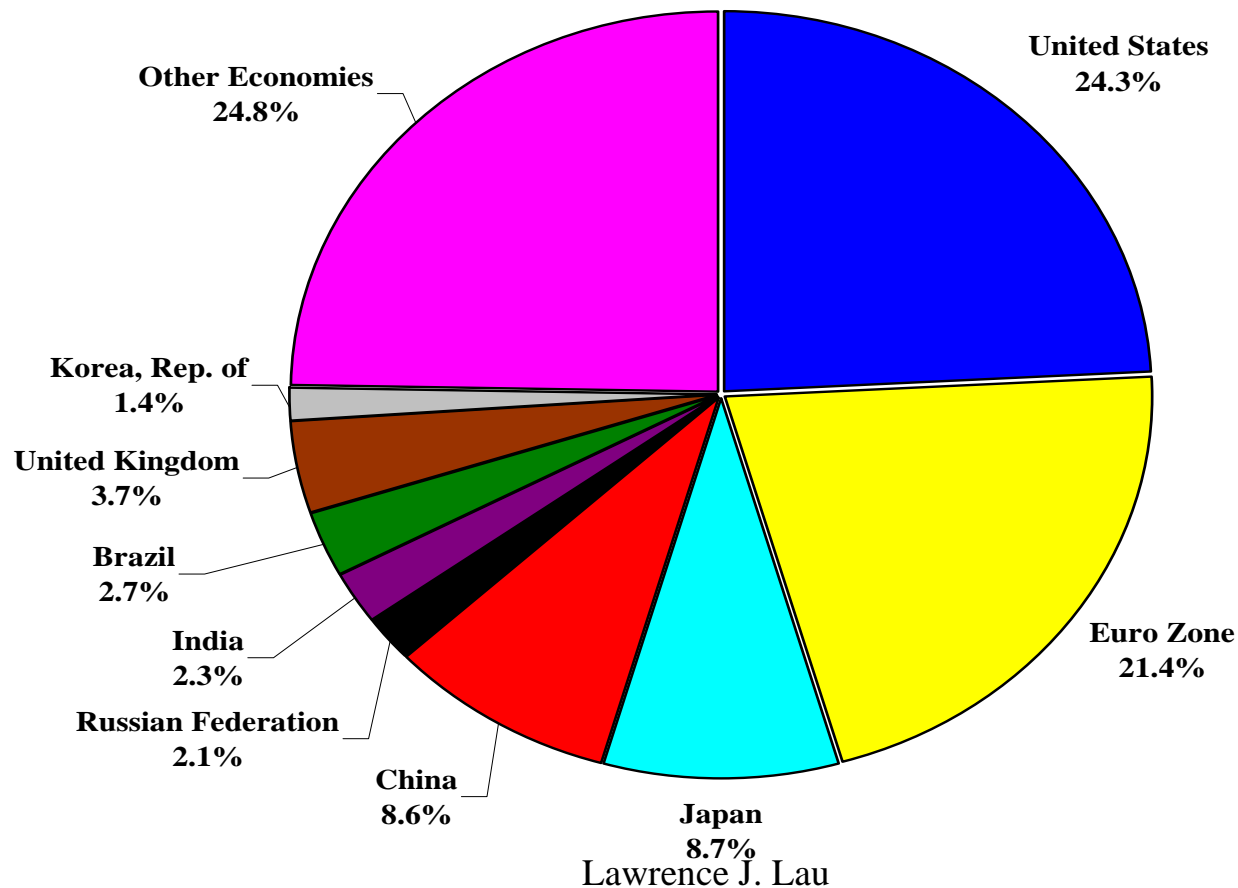
The Distribution of World GDP, 1990, US\$

The Distribution of World GDP in 1990, in USD



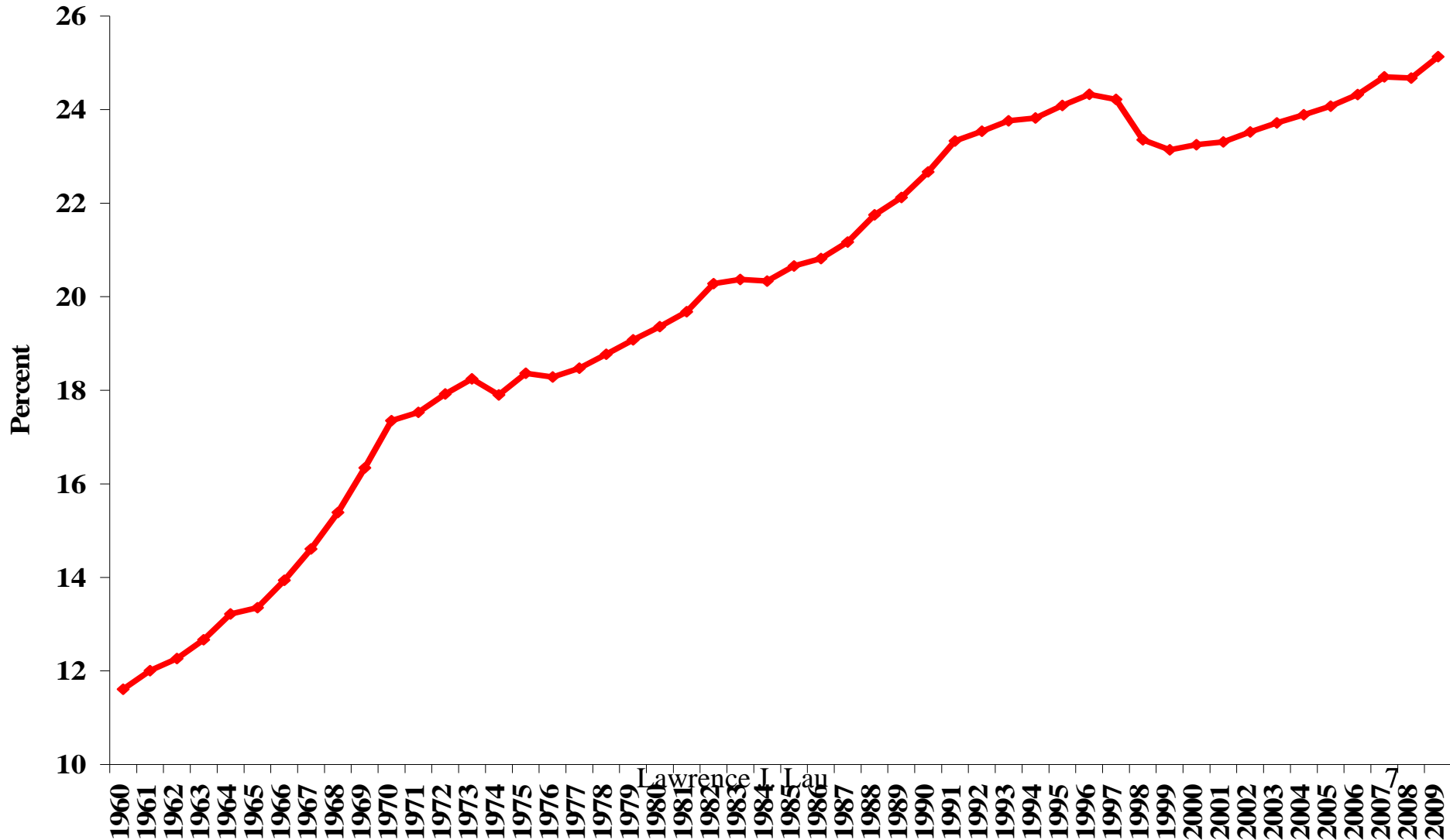
The Distribution of World GDP, 2009, US\$

The Distribution of World GDP in 2009, in USD



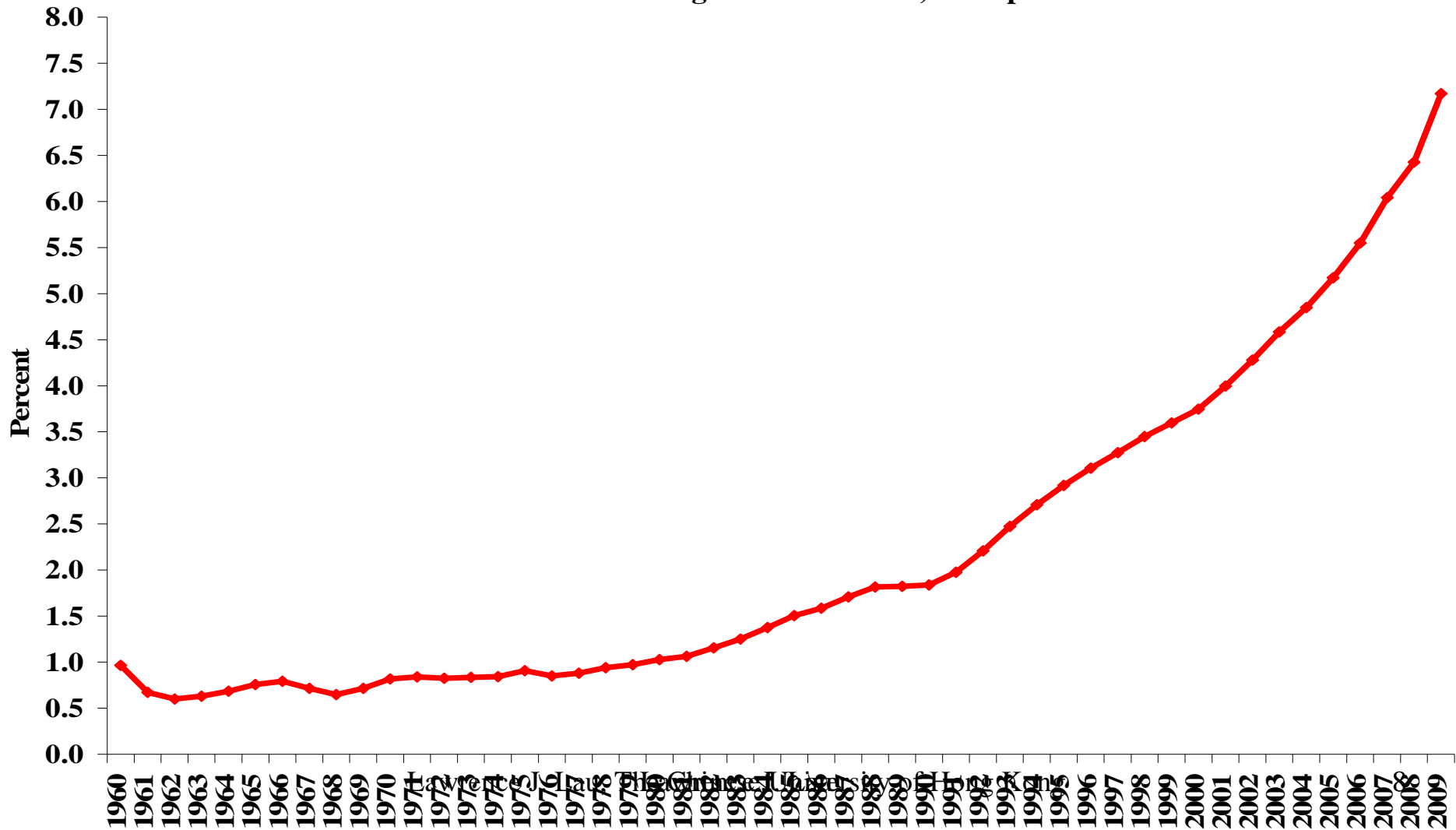
East Asian Share of World GDP, 1960-present

East Asian Share of World GDP, 1960-present



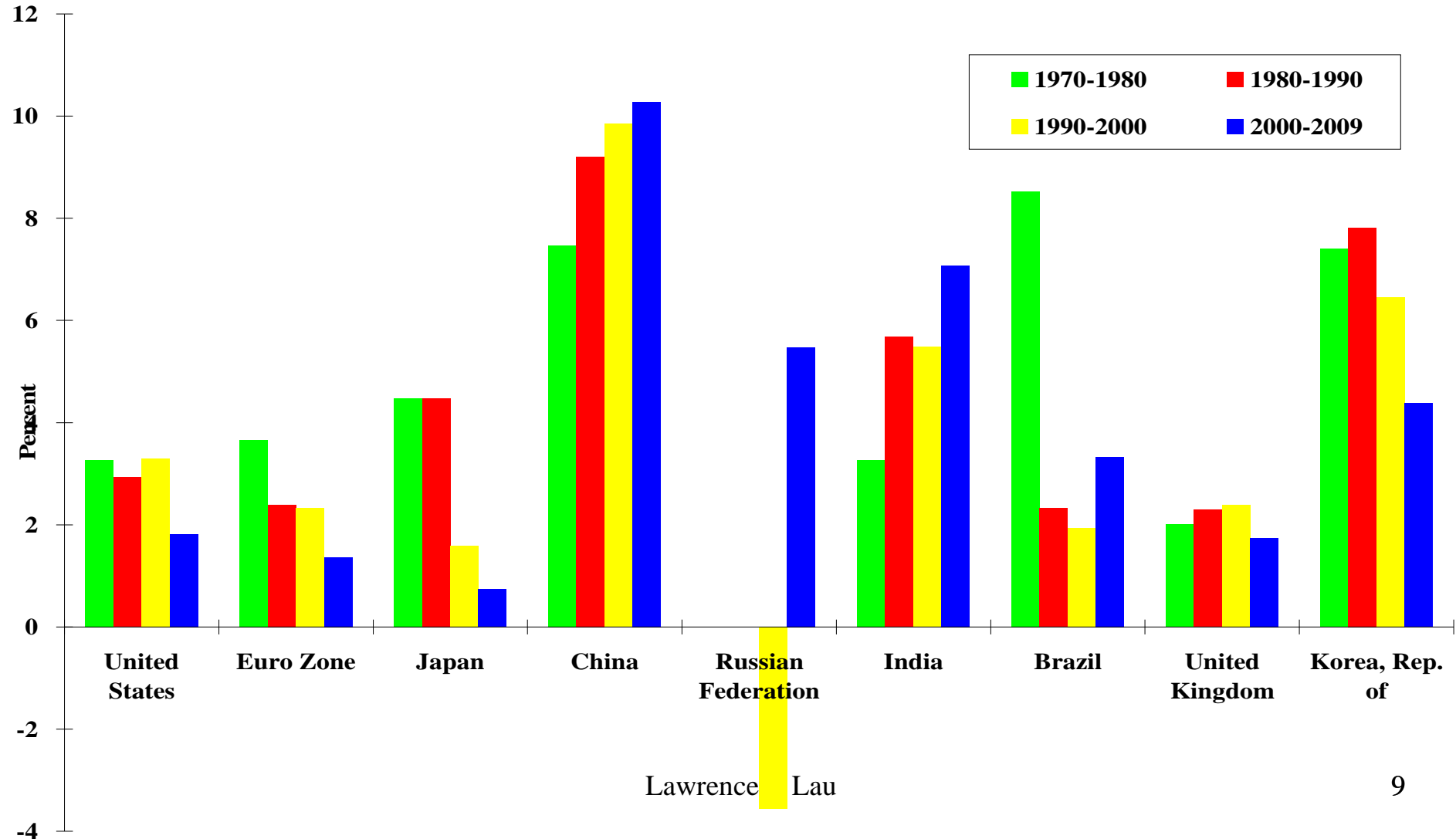
China's Share of World GDP, 1960-present

China's GDP as a Percentage of World GDP, 1960-present



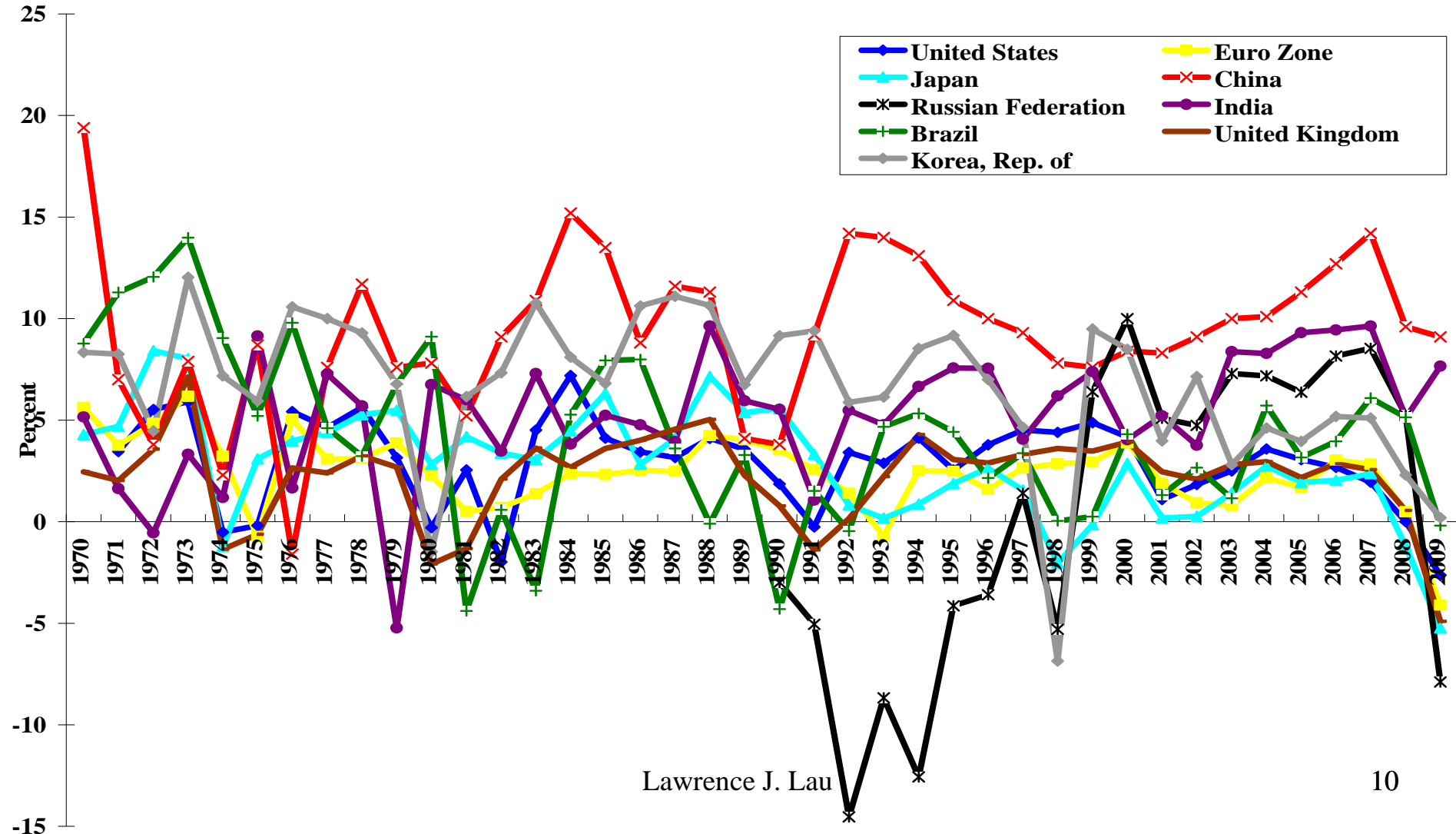
Average Annual Rates of Growth of Real GDP of Selected Economies

Average Annual Rates of GDP Growth of Selected Economies



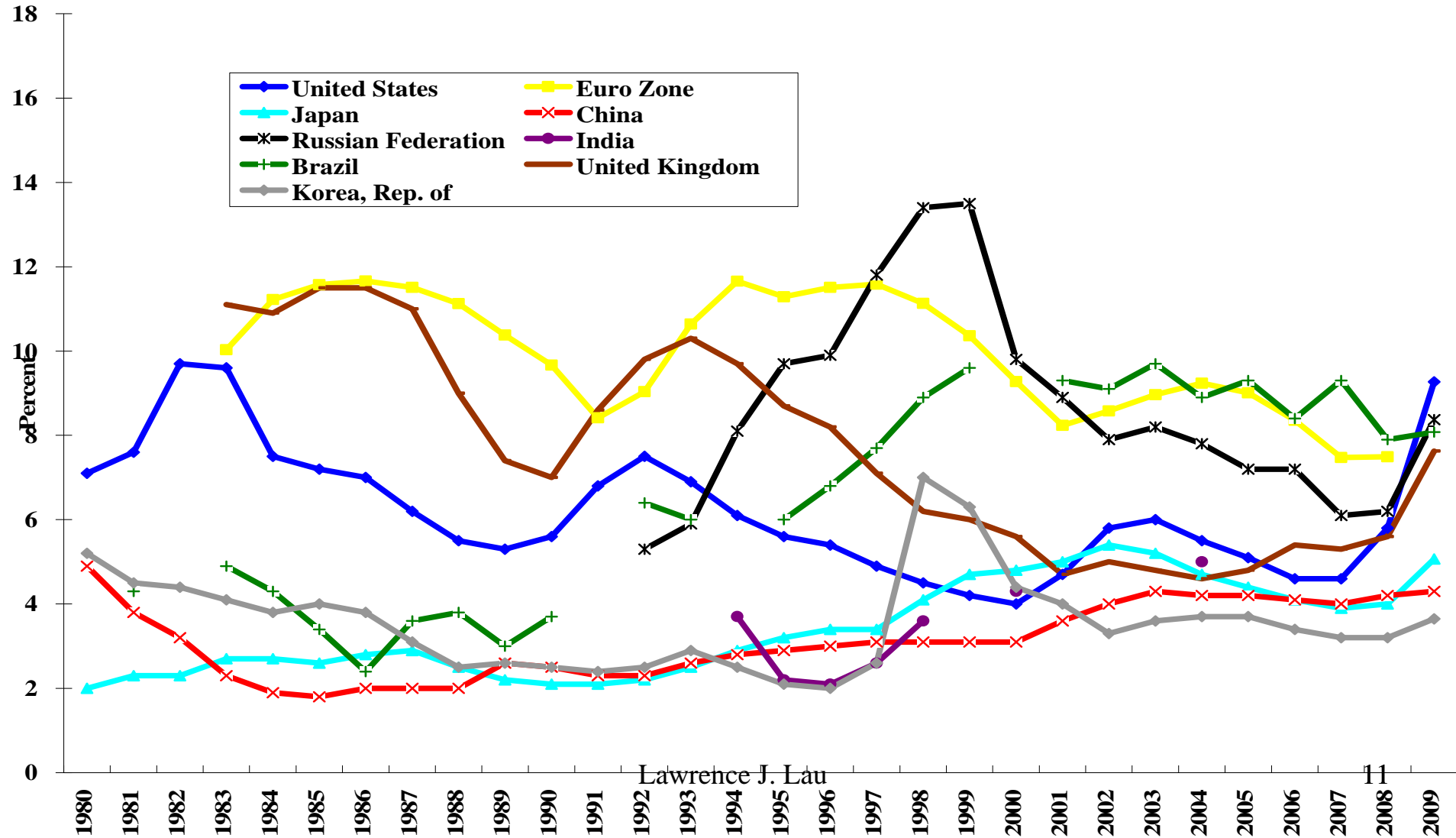
Annual Rates of Growth of Real GDP of Selected Economies

Annual Rates of GDP Growth of Selected Economies



The Rate of Unemployment in Selected Economies

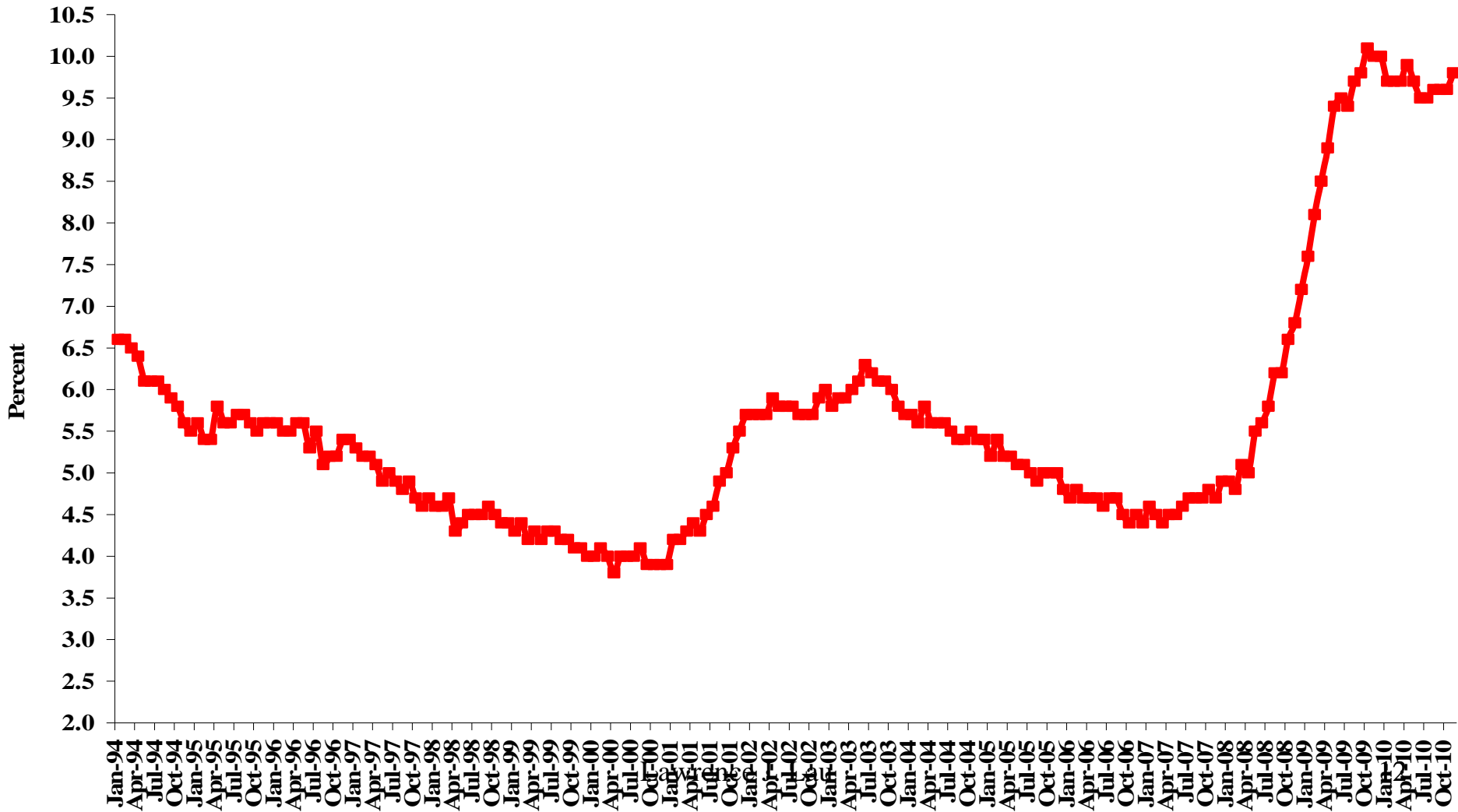
Unemployment Rates of Selected Economies



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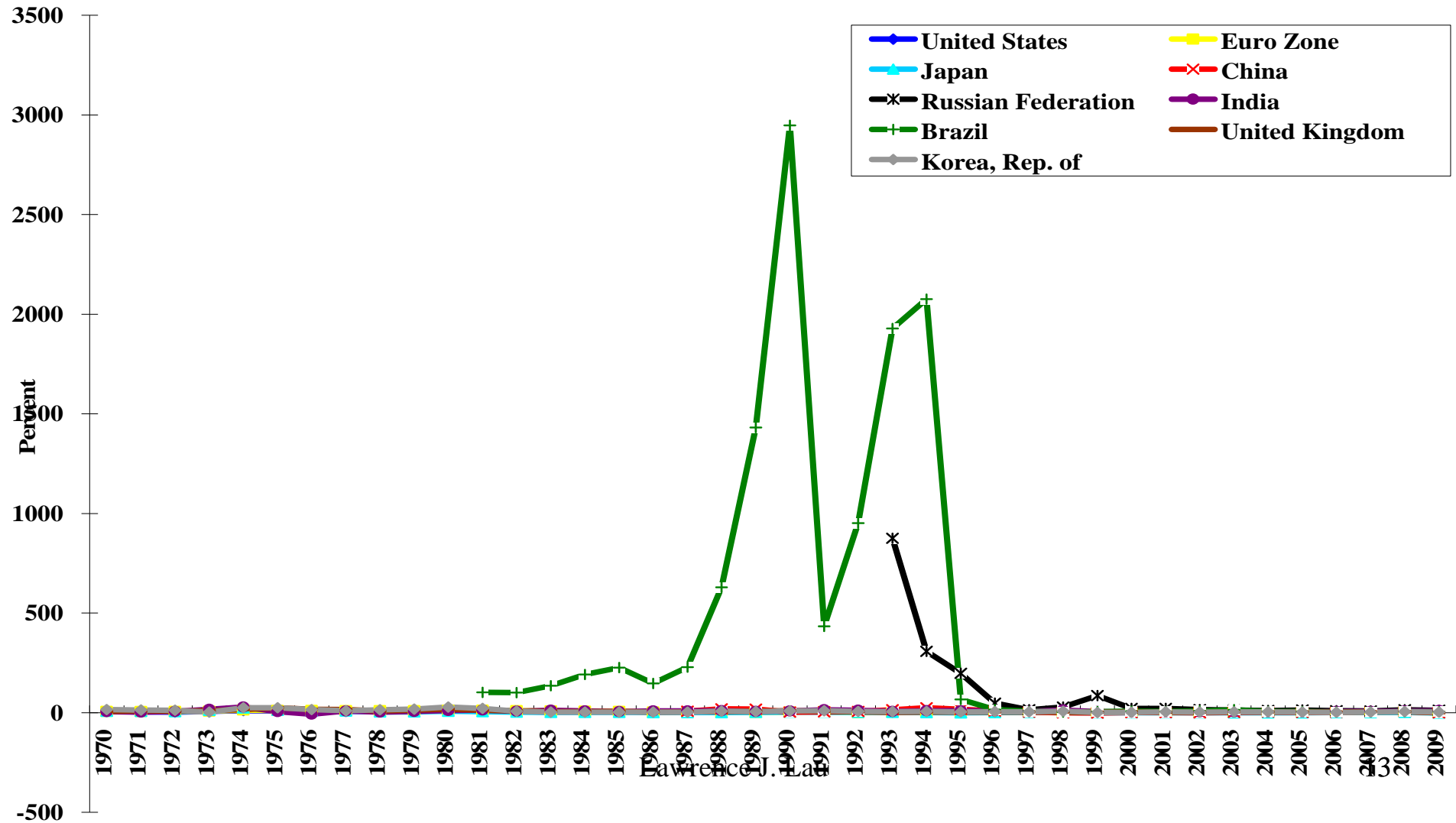
U.S. Unemployment Rate Seasonally Adjusted

Monthly Rates of U.S. Unemployment, seasonally adjusted



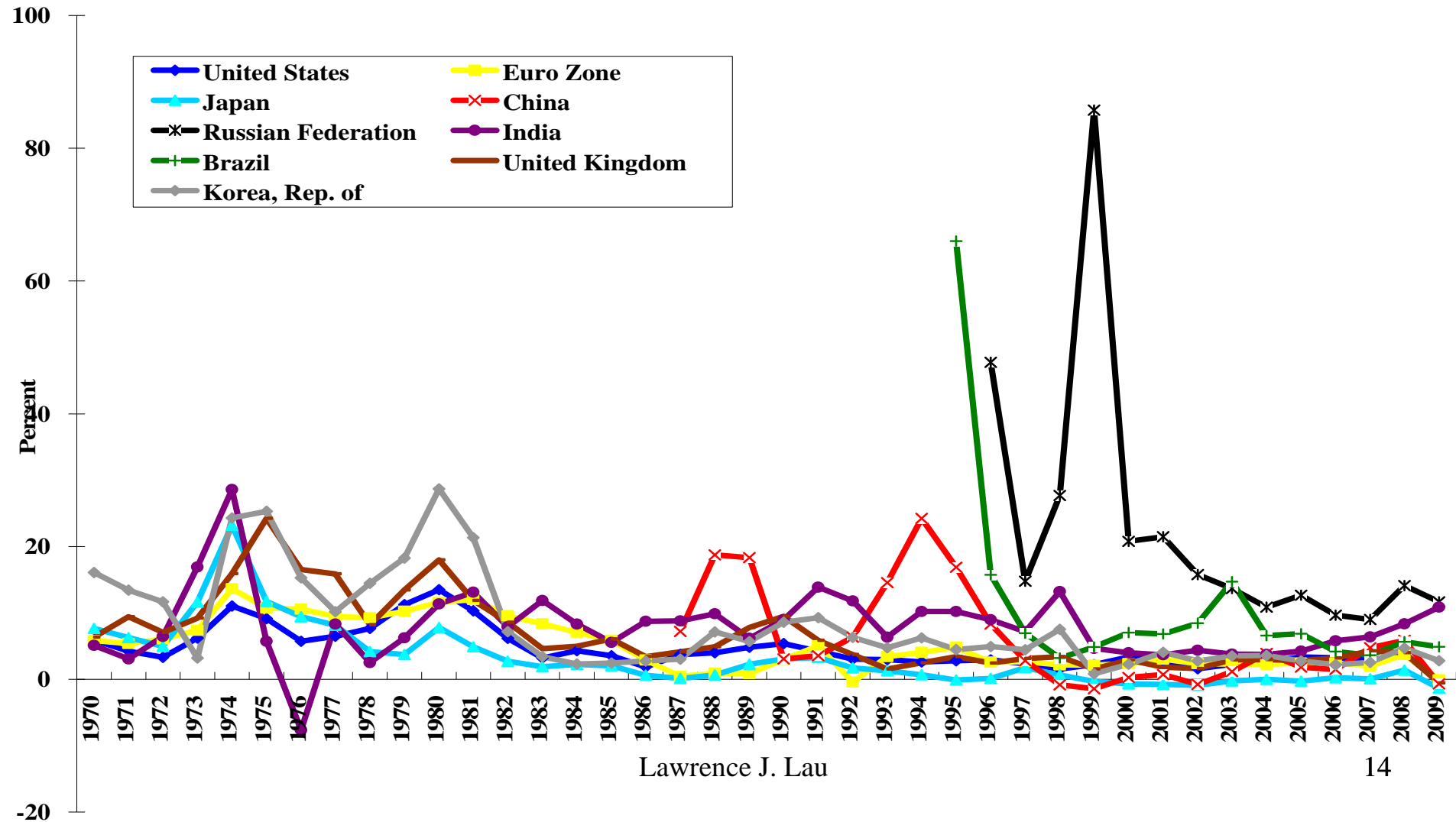
The Rate of Inflation in Selected Economies

Rates of Growth of CPI of Selected Economies



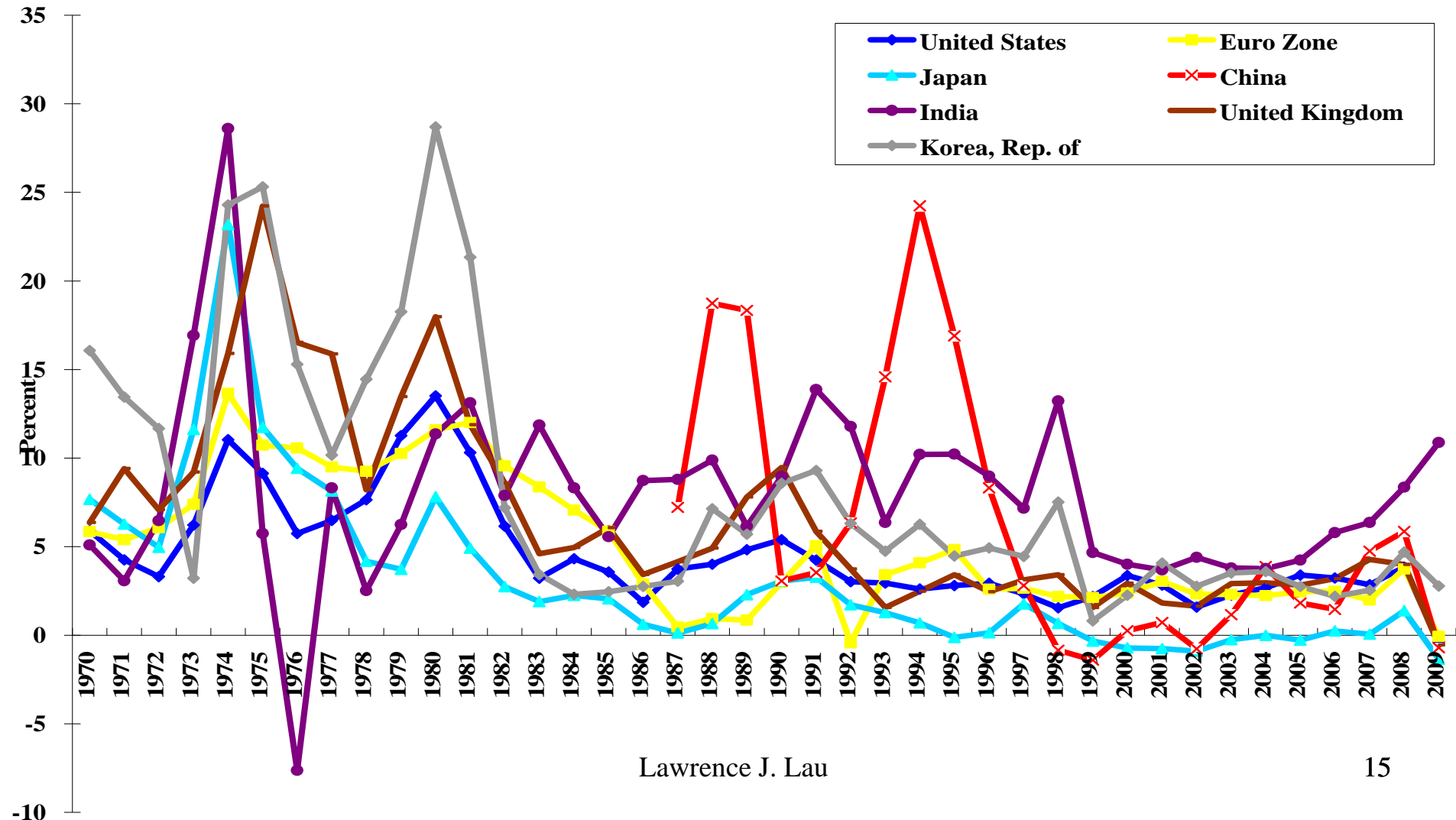
The Rate of Inflation in Selected Economies (without Brazil)

Rates of Growth of CPI of Selected Economies



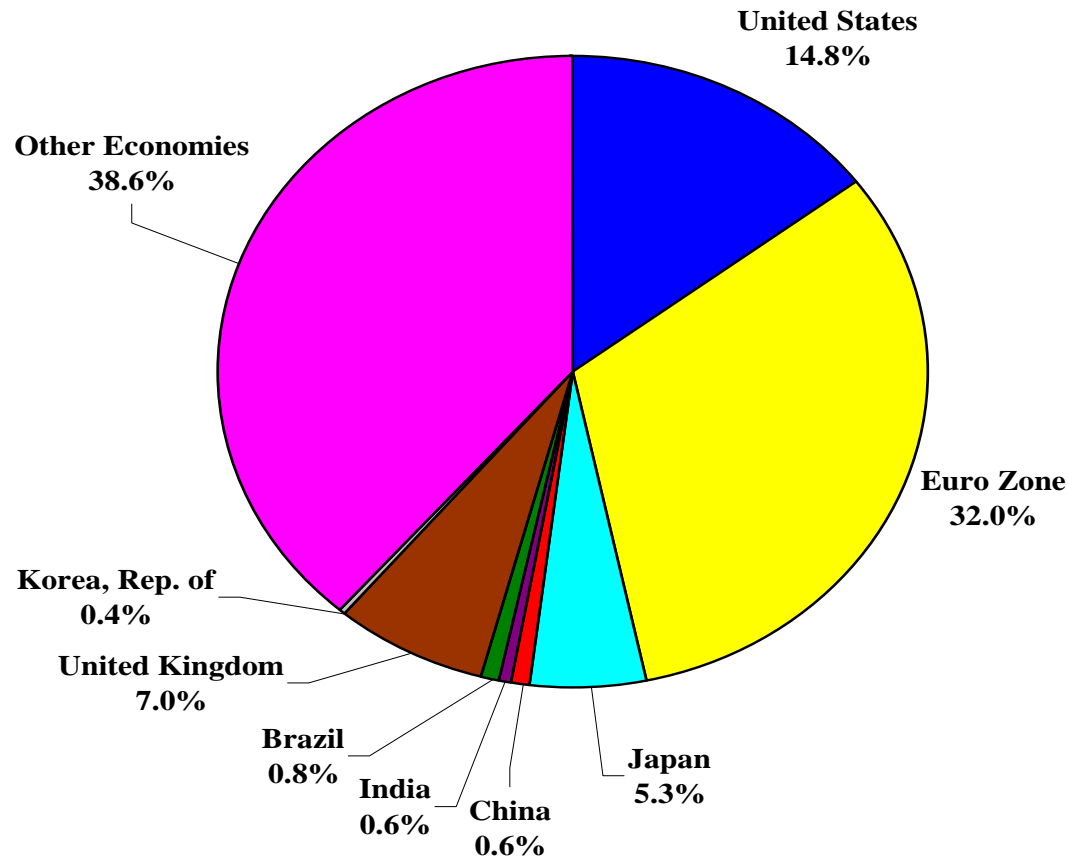
The Rate of Inflation in Selected Economies (without Brazil and Russia)

Rates of Growth of CPI of Selected Economies



The Distribution of Total International Trade in Goods and Services, 1970

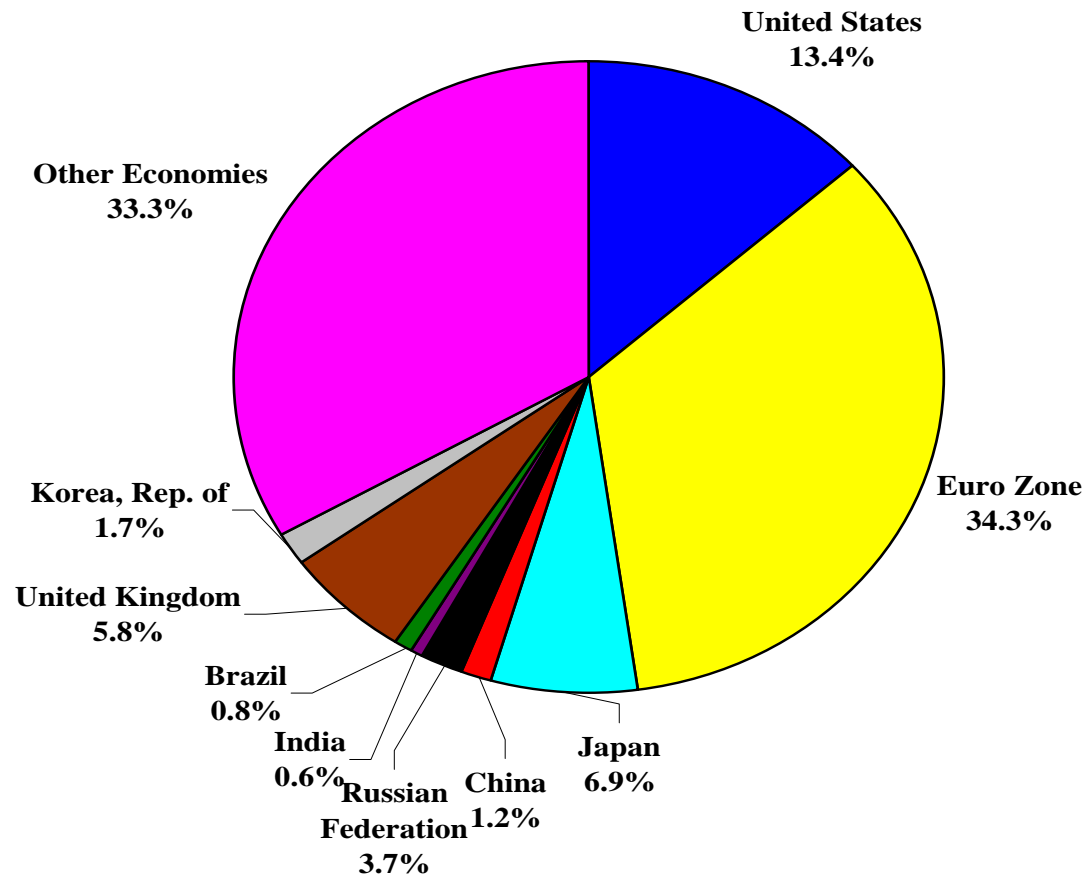
The Distribution of Total International Trade in Goods and Services in 1970



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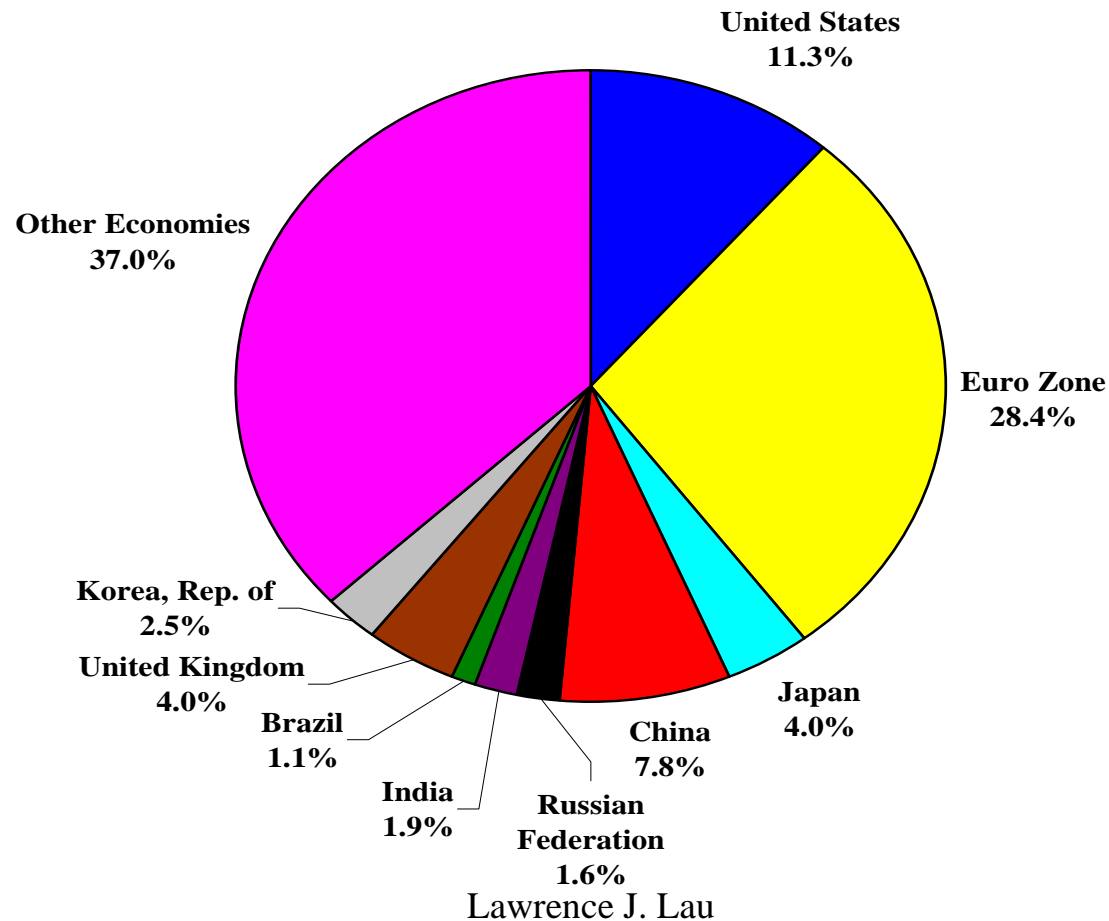
The Distribution of Total International Trade in Goods and Services, 1990

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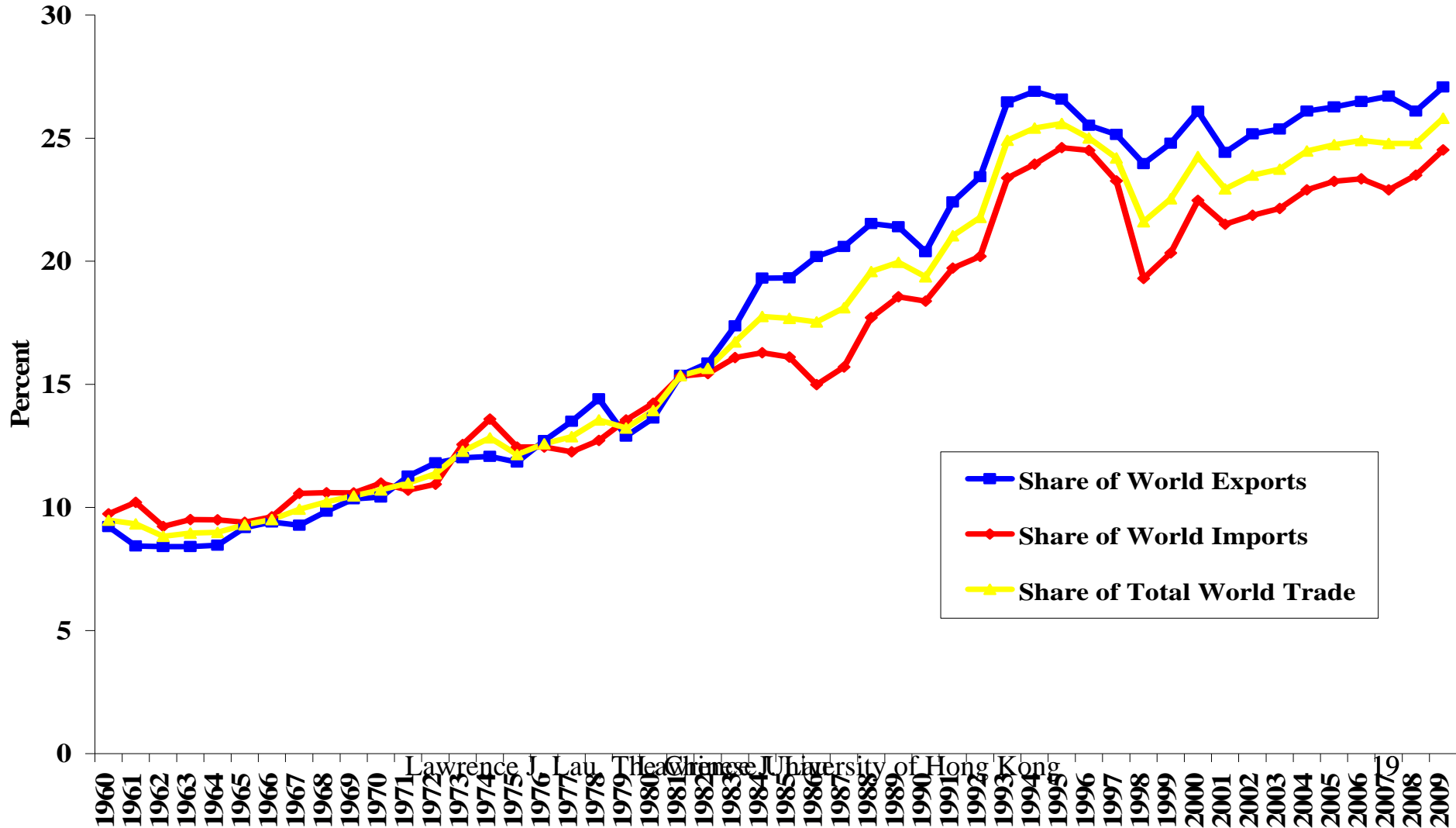
The Distribution of Total International Trade in Goods and Services, 2009

The Distribution of Total International Trade in Goods and Services in 2009



The Rising Share of East Asian Trade in Total World Trade, 1960-present

East Asian Share of Total World Trade, 1960-present



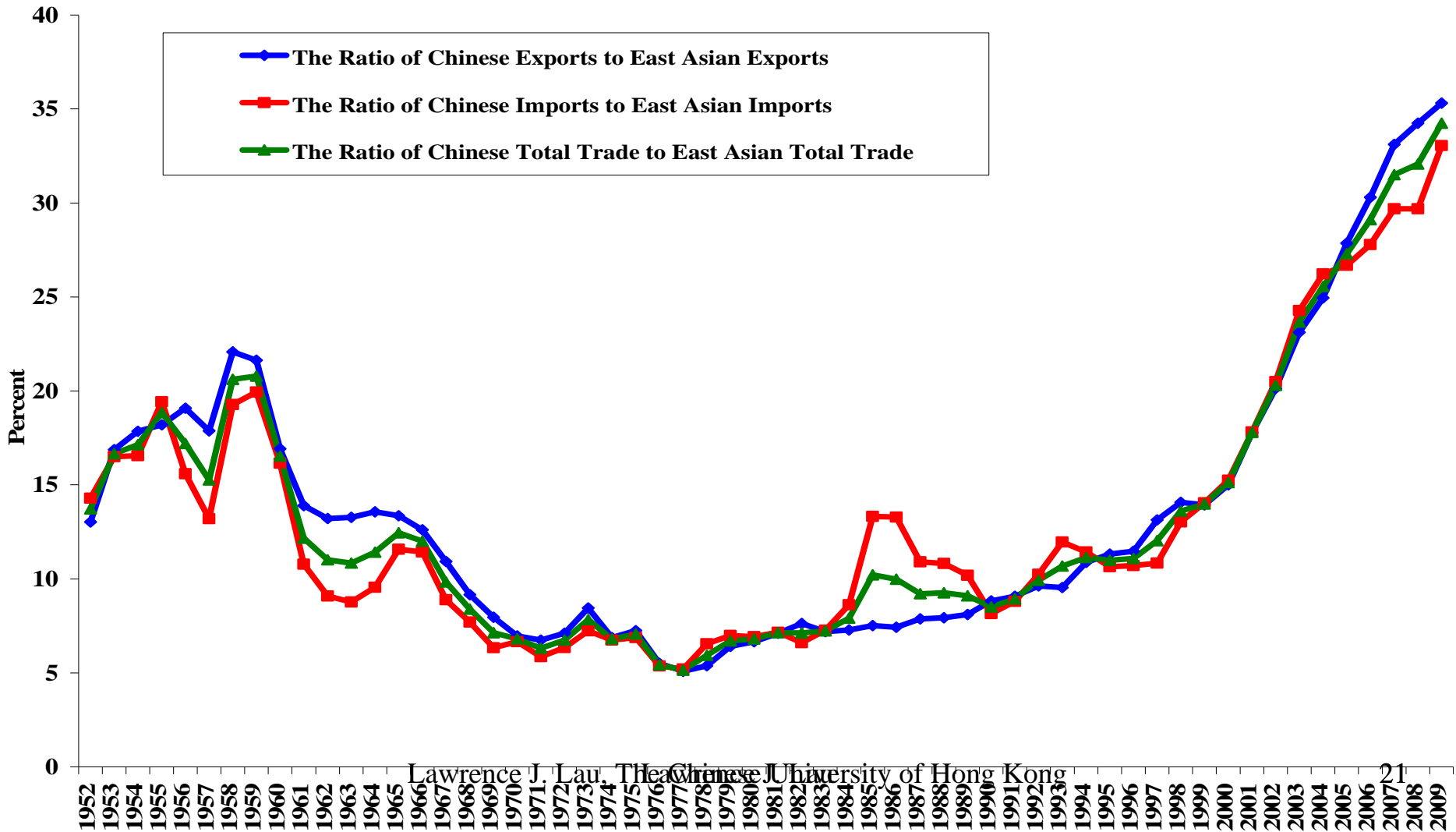
The Share of Chinese Trade in Total World Trade, 1950-present

The Ratio of Chinese Trade to World Trade



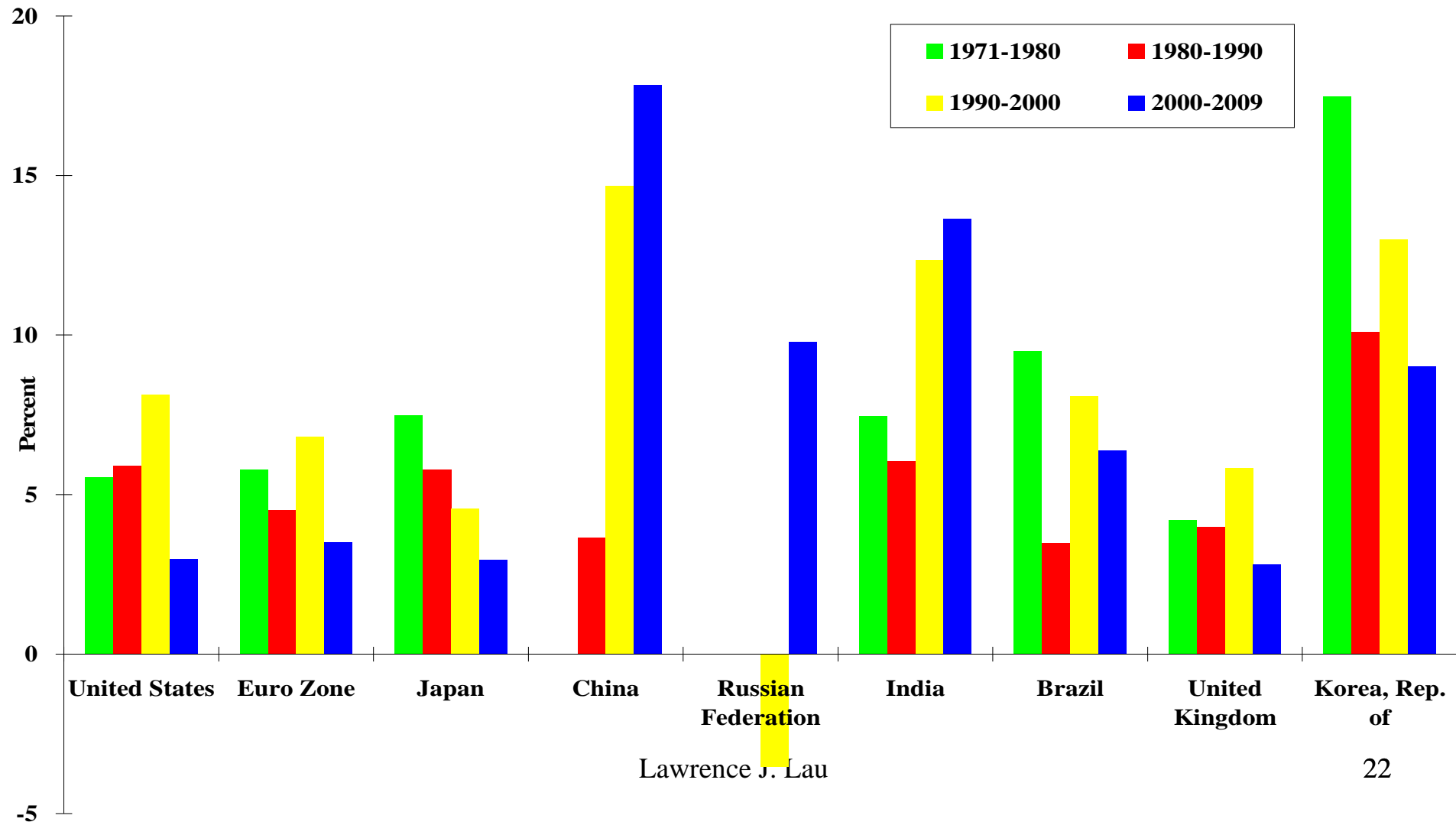
The Share of Chinese Trade in Total East Asian Trade, 1952-present

The Ratio of Chinese Trade to East Asian Trade



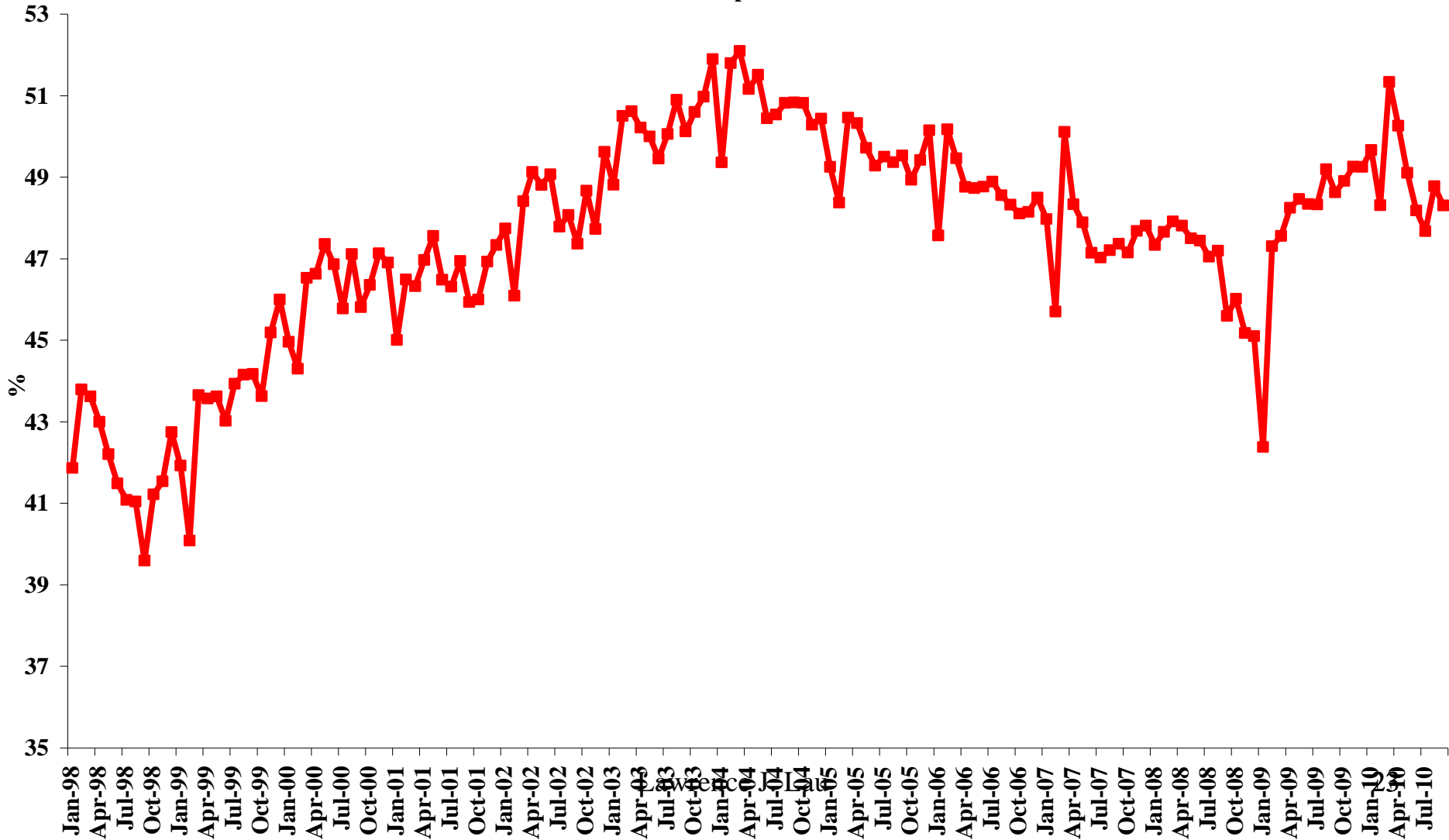
Average Annual Rate of Growth of Total International Trade in Goods and Services

Average Annual Rates of Growth of Total Trade in Goods and Services



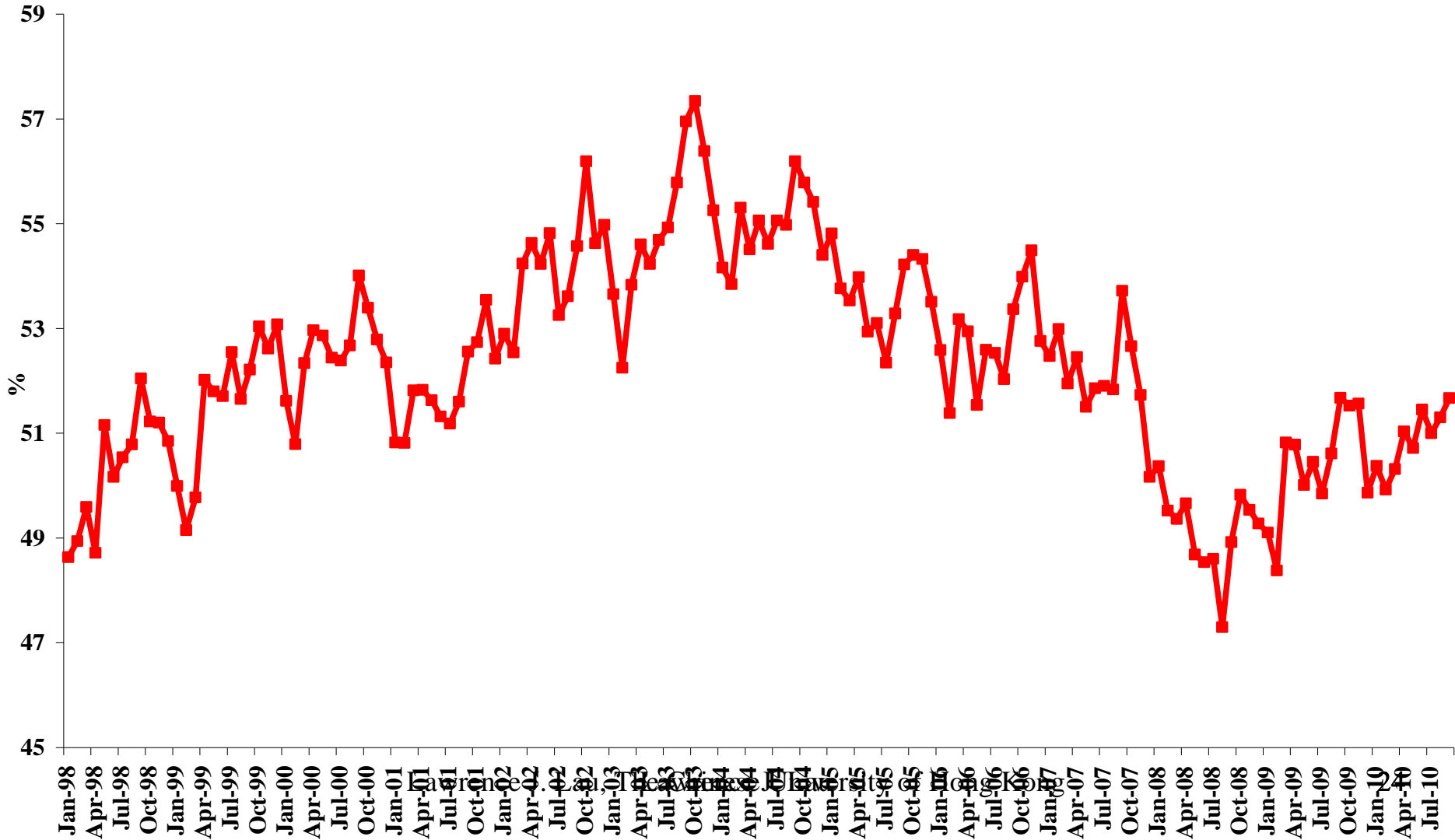
The Share of East Asian Exports Destined for East Asia

The Share of East Asian Exports Destined for East Asia



The Share of East Asian Imports Originated from East Asia

The Share of East Asian Imports Originated from East Asia



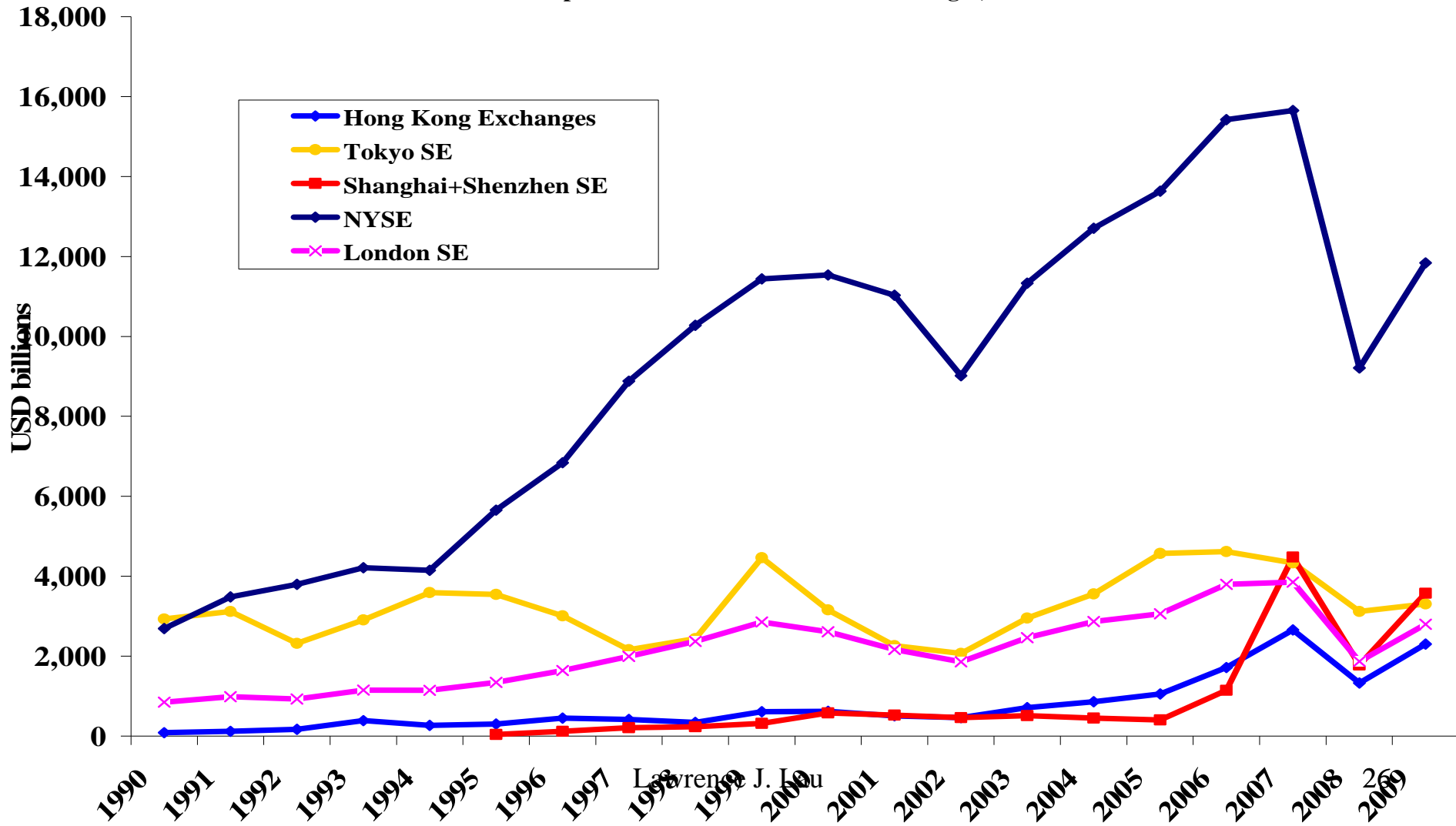
Market Capitalization of Stock Exchanges Year End 2009 (US\$)

- ◆ U.S.A. 15.1 trillion
- ◆ Europe 10.7 trillion
- ◆ East Asia 12.1 trillion

- ◆ Exchanges:
 - ◆ U.S.A.: NASDAQ and NYSE
 - ◆ Europe: Athens Exchange, BME Spanish Exchanges, Borsa Italiana, Budapest SE, Cyprus SE, Deutsche Borse, Irish SE, London SE, Luxembourg SE, NYSE Euronext (Europe), Oslo Bors, SIX Swiss Exchange
 - ◆ East Asia: Bursa Malaysia, Hong Kong Exchanges, Indonesia SE, Jasdaq, Korea Exchange, Philippine SE, Shanghai SE, Shenzhen SE, Singapore Exchange, Taiwan SE, Thailand SE, Tokyo SE Group
- ◆ Data source: World Federation of Exchanges

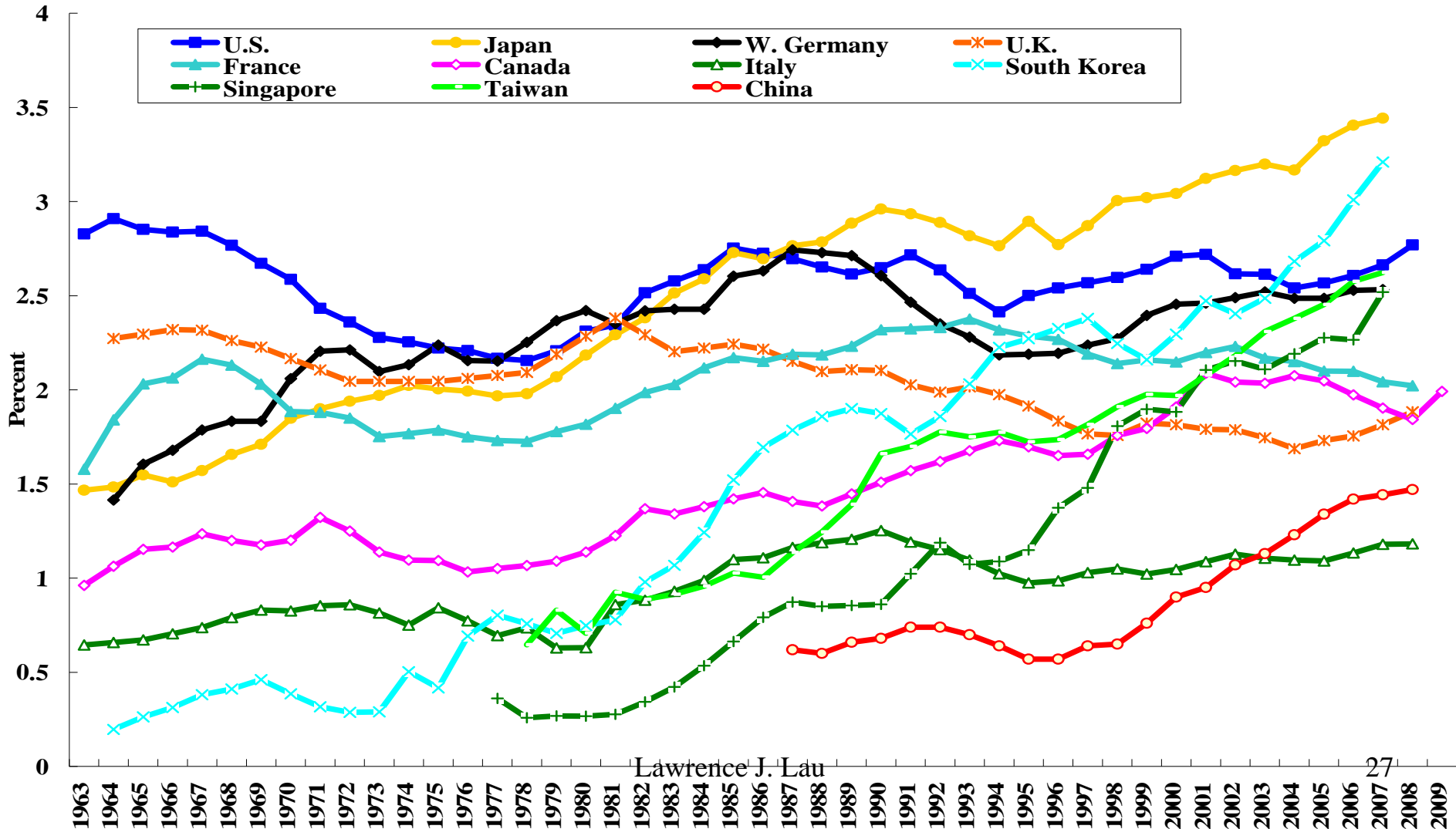
End of Year Market Capitalisation of Selected Stock Exchanges

End of Year Market Capitalisation of Selected Stock Exchanges, in USD billions



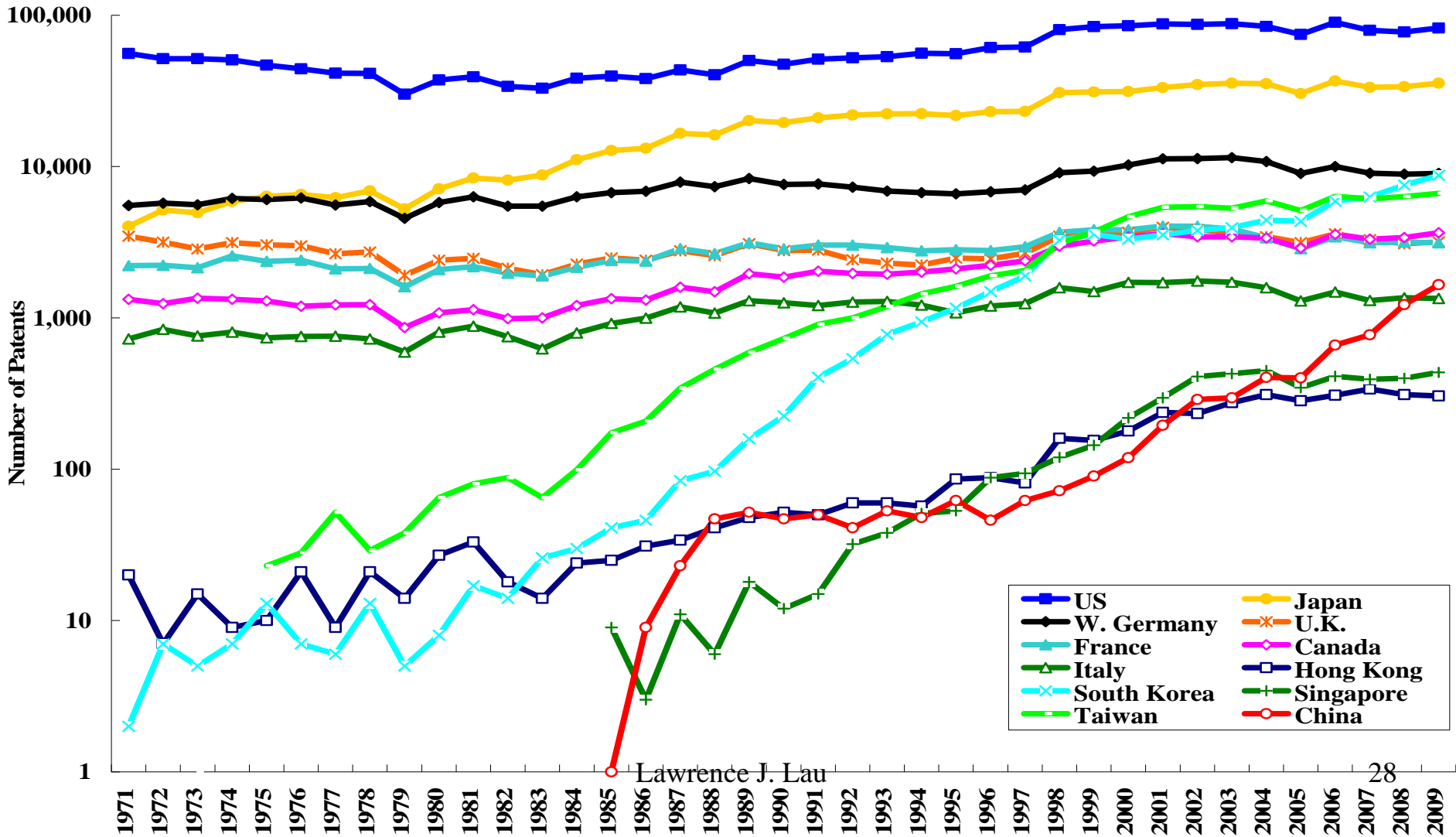
R&D Expenditures as a Ratio of GDP: G-7 Countries, 3 East Asian NIEs & China

Figure 8.1: R&D Expenditures as a Percentage of GDP: G-7 Countries, 3 East Asian NIEs and China



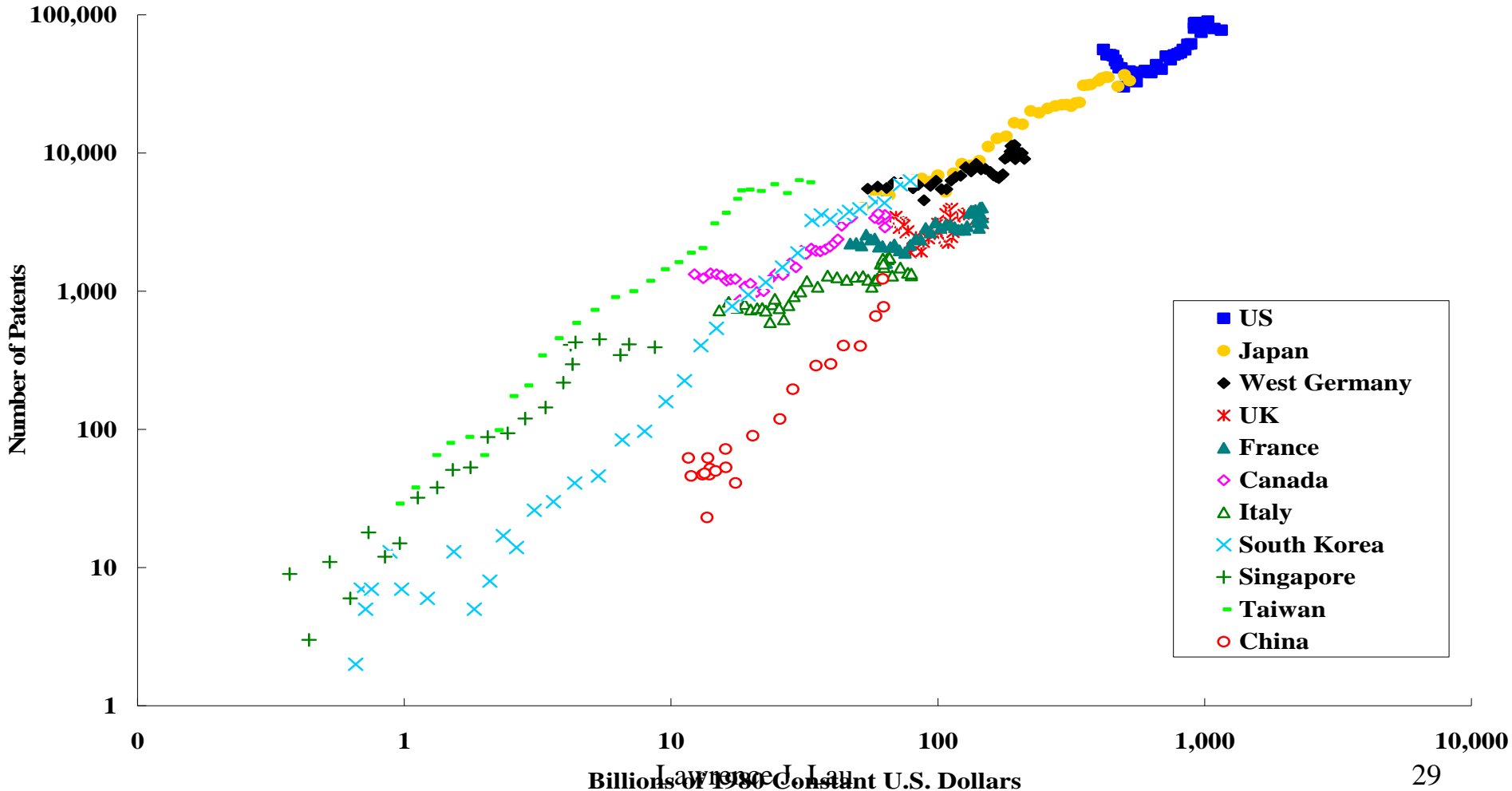
Patents Granted in the United States: G-7 Countries, 4 East Asian NIEs & China

Figure 8.3: Patents Granted Annually in the United States: G7 Countries, 4 East Asian NIEs and China



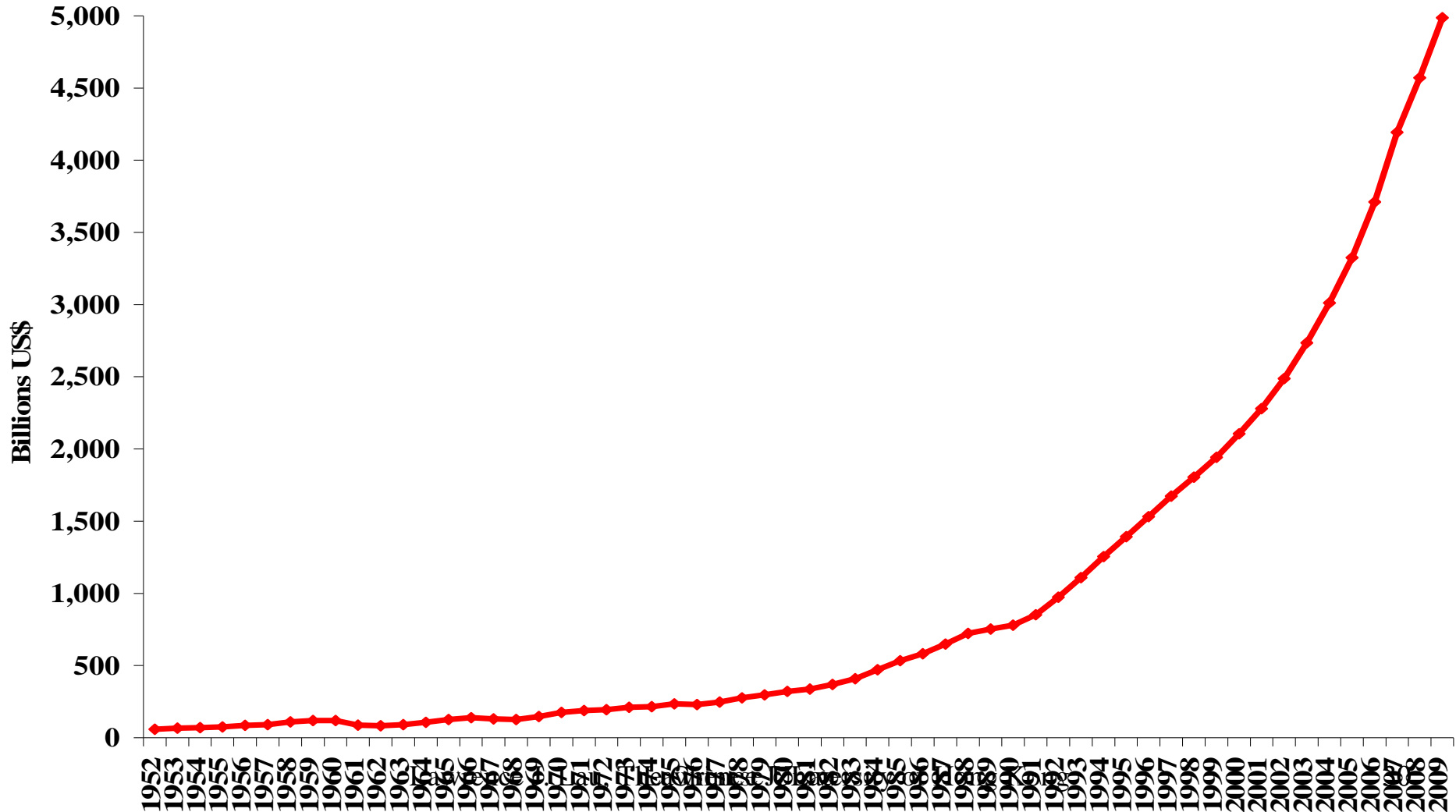
Patents Granted in the United States and R&D Capital Stocks, Selected Economies

Figure 8.4: The Number of U.S. Patents Granted Annually vs. R&D Capital Stocks



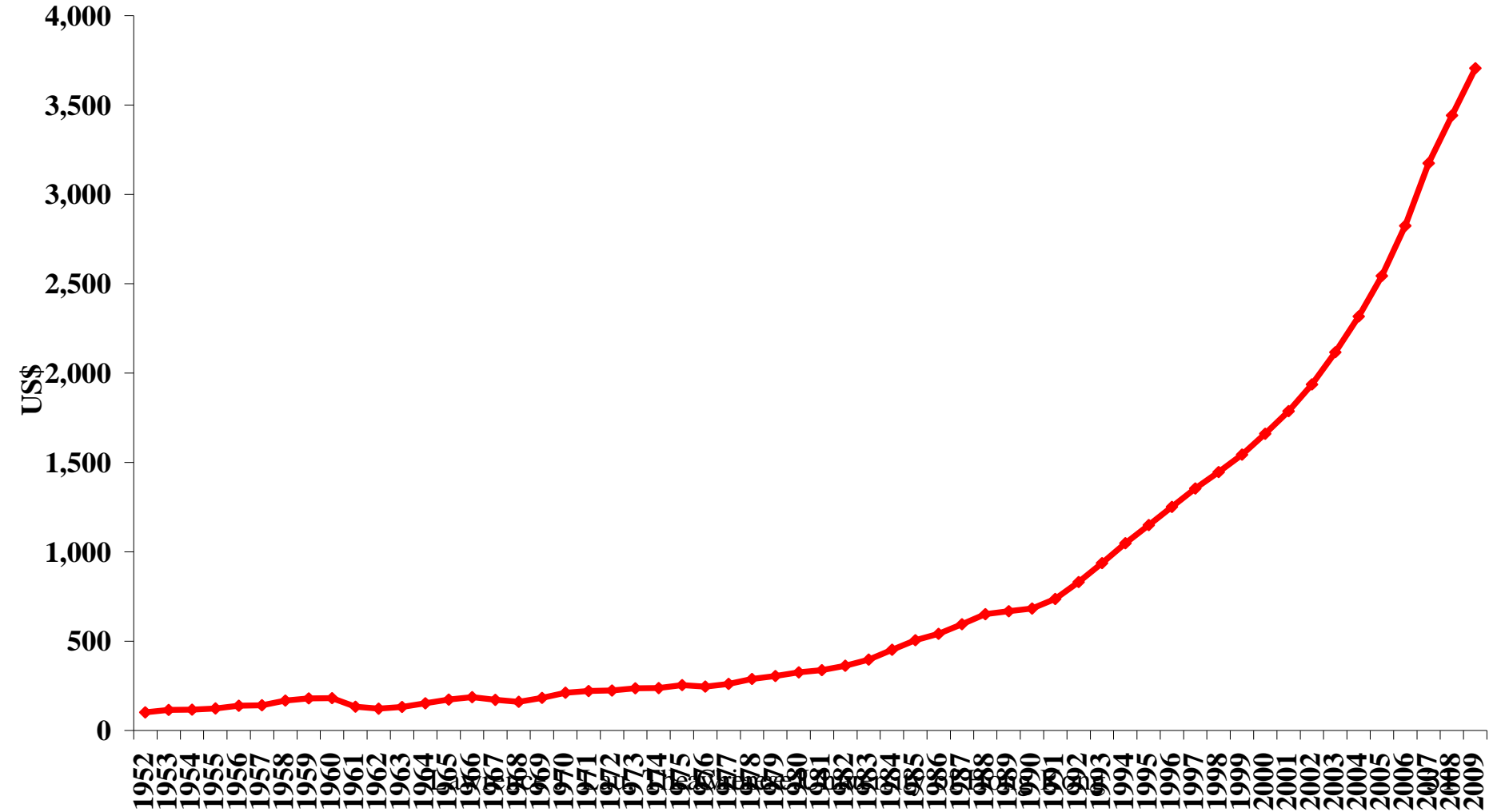
Chinese Real GDP in US\$ Since 1952 (2009 Prices)

Chinese Real GDP, in 2009 prices



Real Chinese GDP per Capita in US\$ Since 1952 (2009 Prices)

Chinese Real GDP per Capita, in 2009 prices



The International Monetary Order

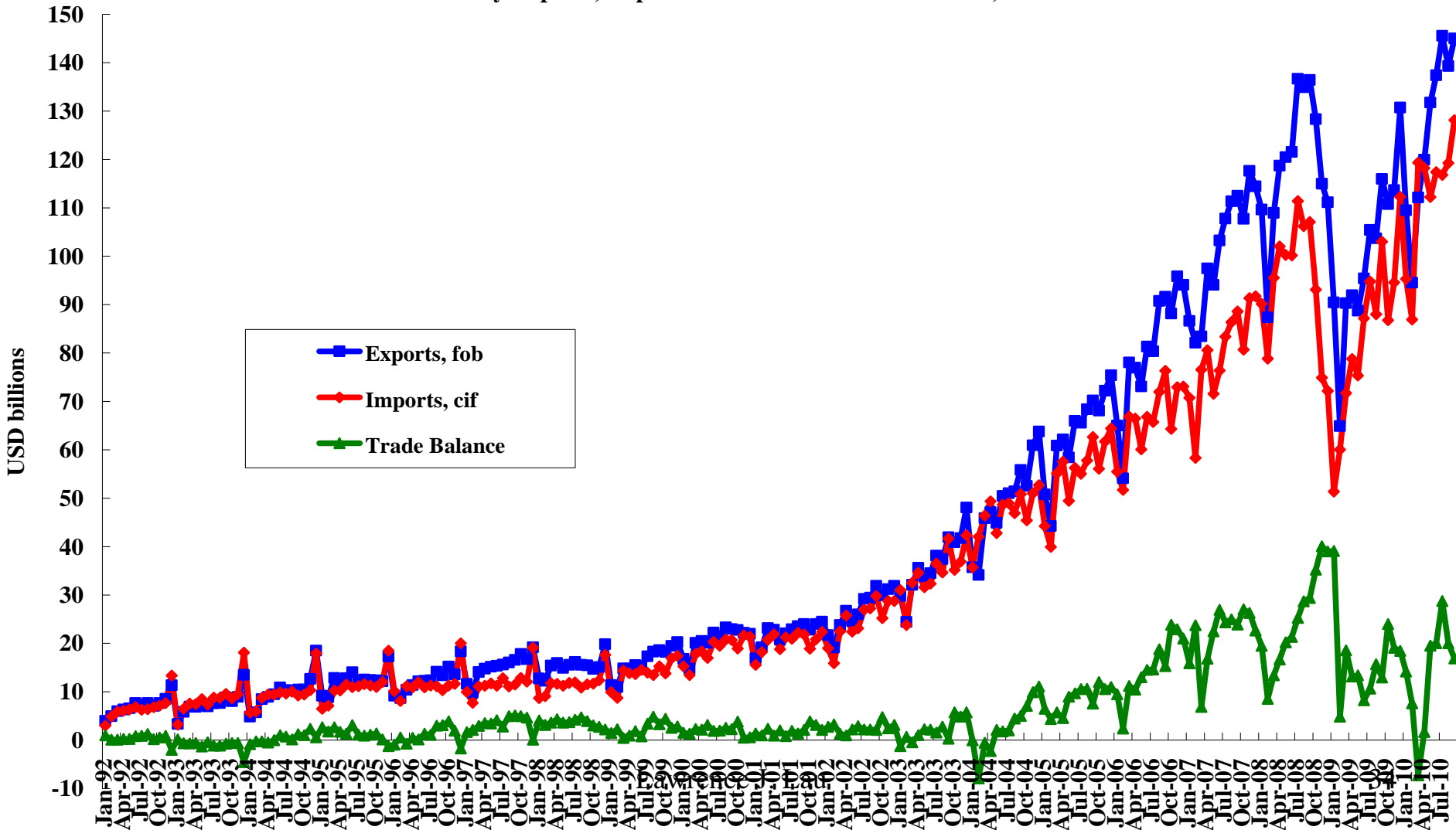
- ◆ The World economy has been depending on the United States to supply the international liquidity (international money supply) to support international transactions in trade and investment and for any other purposes. The international transactions balances used by most economies consist of U.S. dollars held as foreign exchange reserves in their respective central banks, which in turn have mostly been earned through trade surpluses with the United States and other economies.
- ◆ The rapid growth of international trade and investment during the past two decades has significantly increased the demand for international liquidity. However, the United States may no longer be willing or able or both to continue to supply the international liquidity post the global financial crisis. For example, it may start running a trade surplus instead of a deficit and therefore reducing the outflow of U.S. Dollars to the rest of the World.
- ◆ The U.S. Dollar, because of the various weaknesses of its economy, is also under pressure to devalue and has been devaluing vis-a-vis other currencies during the past year.

The International Monetary Order

- ◆ Three questions will arise:
- ◆ Will the supply of international liquidity continue to be adequate without the U.S. continuing to export U.S. Dollars?
- ◆ Are there alternatives to the use of the U.S. Dollar as an international currency?
- ◆ Will central banks around the World be willing to continue to hold a large proportion of their foreign exchange reserves in a depreciating currency?

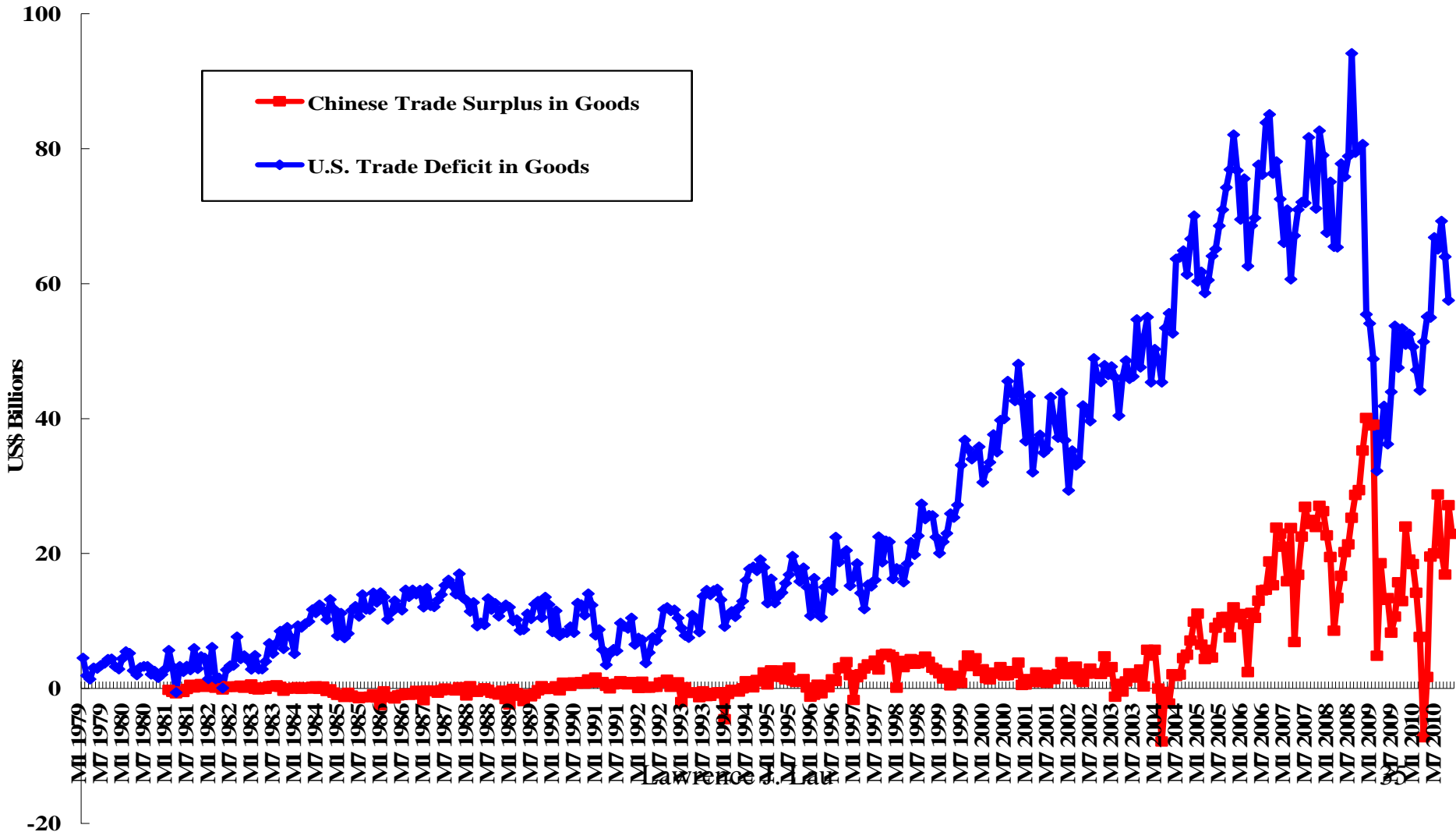
Chinese Monthly Exports, Imports and Trade Balance, US\$

Chinese Monthly Exports, Imports and Trade Balance of Goods, in U.S. Dollars



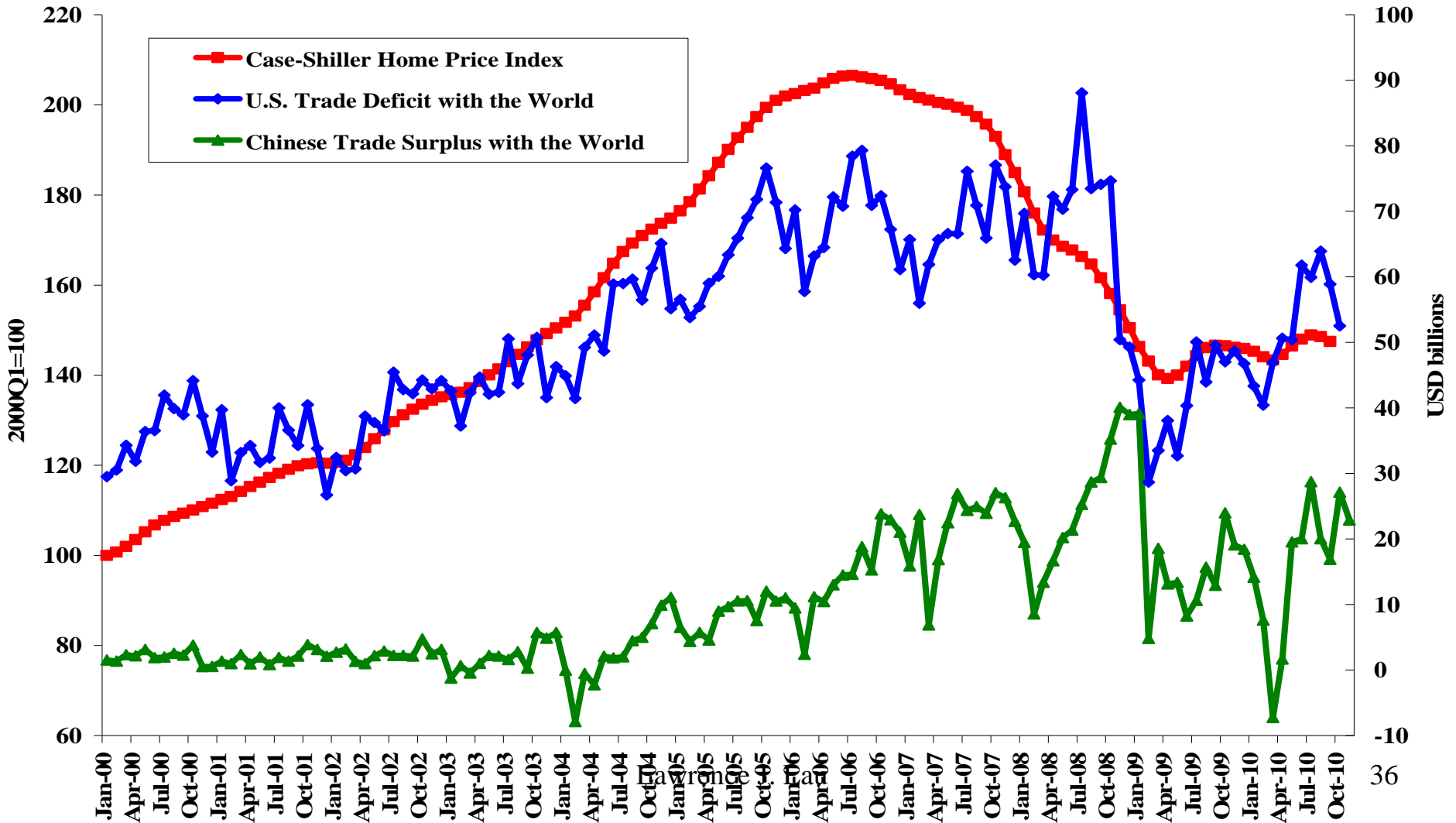
Monthly Chinese Surplus and U.S. Deficit with the World, Trade in Goods, Bill. US\$

Monthly Chinese Surplus and U.S. Deficit with the World, Trade in Goods, Billion US\$



Case-Shiller U.S. Home Price Index, Chinese Trade Surplus & U.S. Trade Deficit, Bill. US\$

Case-Shiller U.S. Home Price Index, Chinese Trade Surplus and U.S. Trade Deficit



Is the Renminbi (Yuan) Under-Valued?

- ◆ The currency of a country is considered under-valued if the country runs persistent surpluses in trade in goods and services combined vis-à-vis the entire World. It is considered over-valued if it runs persistent trade deficits vis-a-vis the World.
- ◆ A bilateral trade surplus, even a persistent one, says nothing about whether a country's currency is under-valued because it may still have a near zero or even negative trade balance vis-à-vis the entire World. Most oil-importing countries have persistent bilateral trade deficits with oil-exporting countries. And that does not necessarily mean the currencies of the oil-importing countries are over-valued relative to the respective oil-exporting countries.

Is the Renminbi (Yuan) Under-Valued?

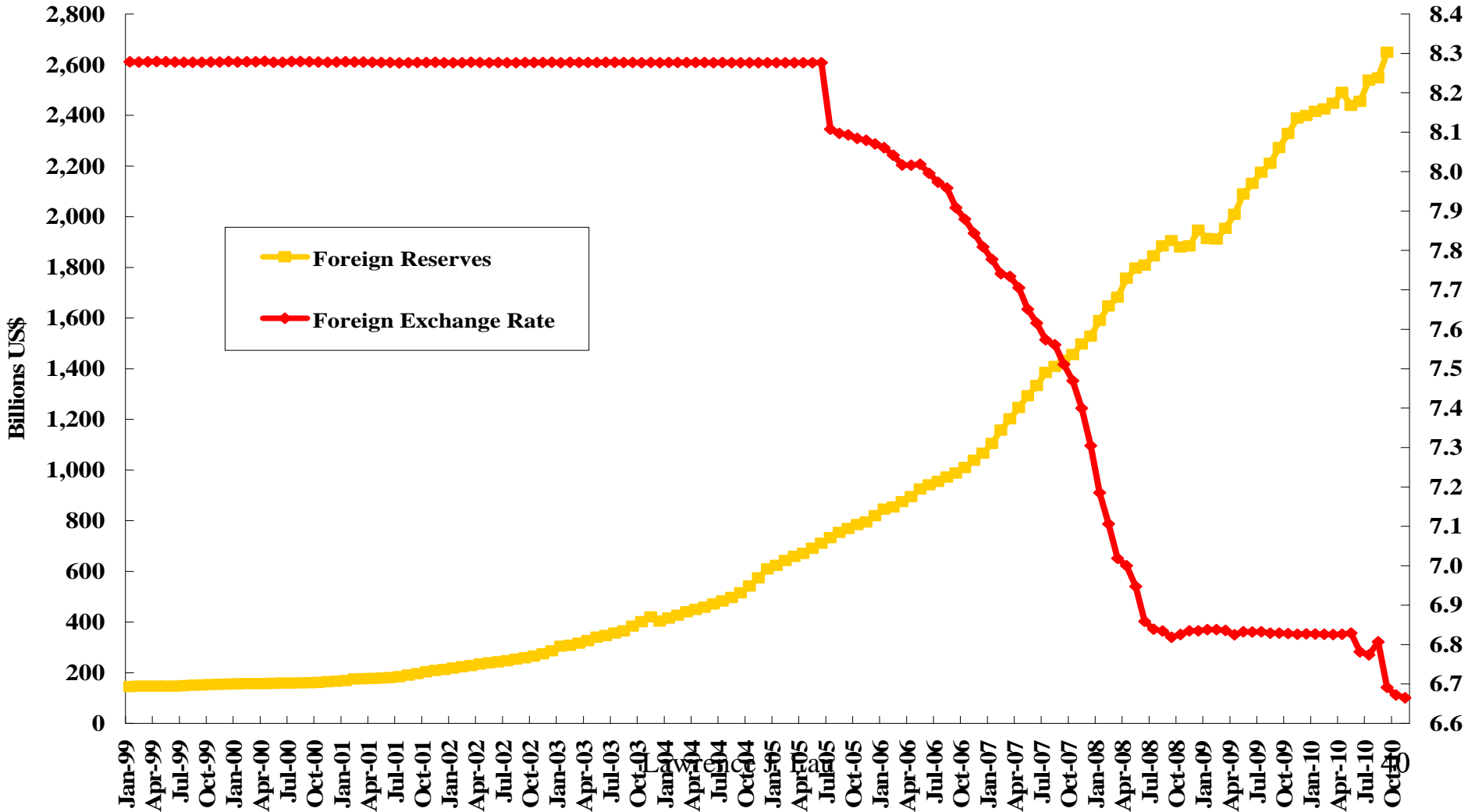
- ◆ The statistics on Chinese trade balances over the past three decades indicate that China has had essentially balanced trade in goods and services combined with the World until 2005 and that its trade surplus has once again become relatively insignificant beginning in 2010.
- ◆ In contrast, the large U.S. trade deficit with the World existed since at least 1998, long before 2005, before China had any trade surplus with the World. What this means is that while there is evidence that the U.S. Dollar might have been and continues to be over-valued, there is no evidence that the Renminbi was under-valued prior to 2005.

Is the Renminbi (Yuan) Under-Valued?

- ◆ In July 2005, the Renminbi was allowed to appreciate and rose 20% in nominal terms and 25% in real terms by the end of 2008.
- ◆ The Chinese trade surplus vis-à-vis the World, which began rising in 2005, reached a peak in 2008 when it began to decline rather precipitously. For 2009, it declined more than 30%. It continued to fall and turned negative in March 2010 and remained relatively low, especially when considered as a percentage of Chinese GDP.
- ◆ The long-term goal of the Chinese Government is to reduce the Chinese trade surplus vis-à-vis the World to zero. If the current trend continues, the goal of zero annual trade balance can probably be achieved by 2012, without necessarily any large adjustment in the nominal Yuan/U.S. Dollar exchange rate.

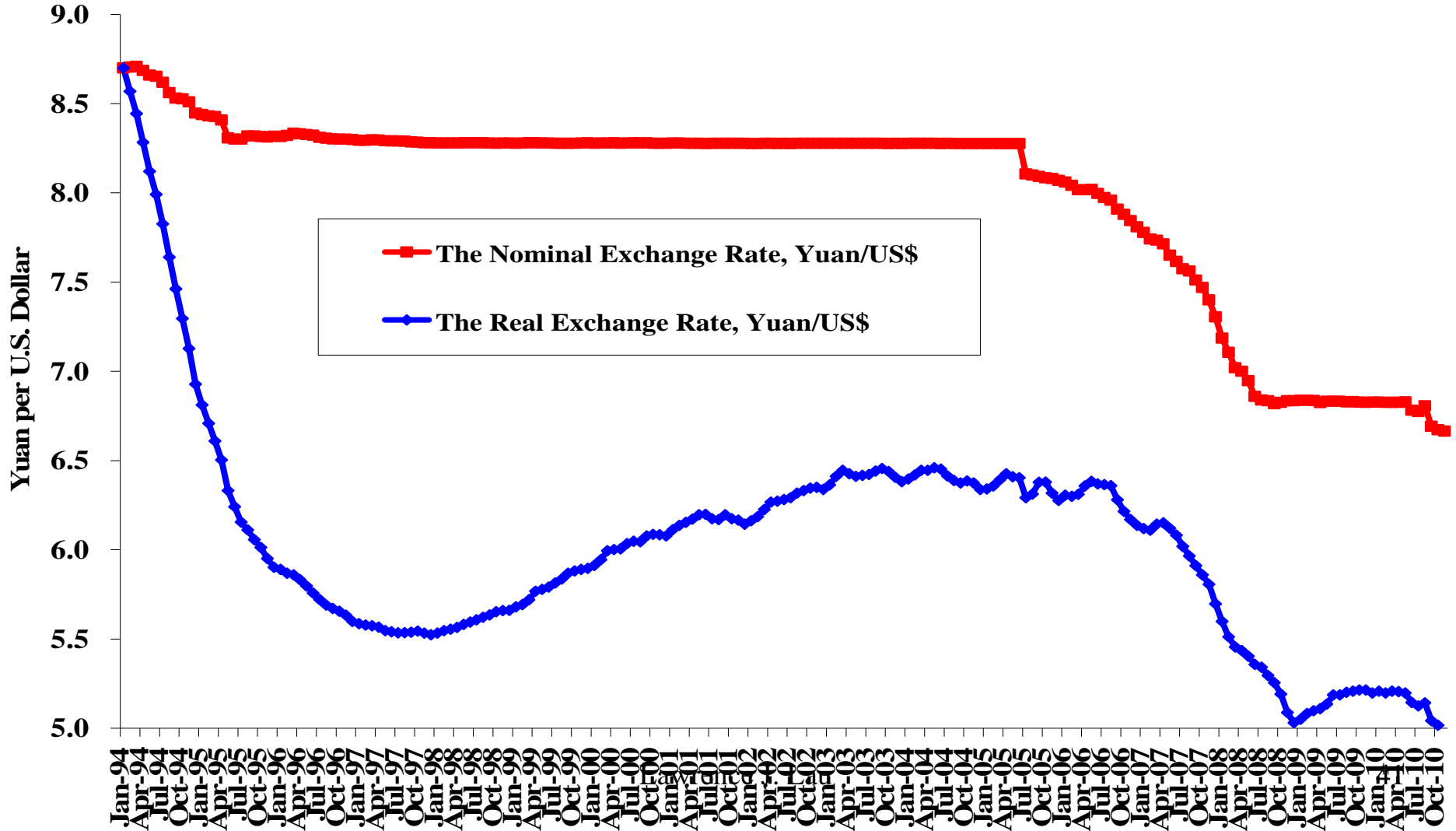
Chinese Foreign Exchange Reserves and the Yuan/US\$ Exchange Rate

Chinese Foreign Exchange Reserves and the Yuan/US\$ Exchange Rate at the End of the Month



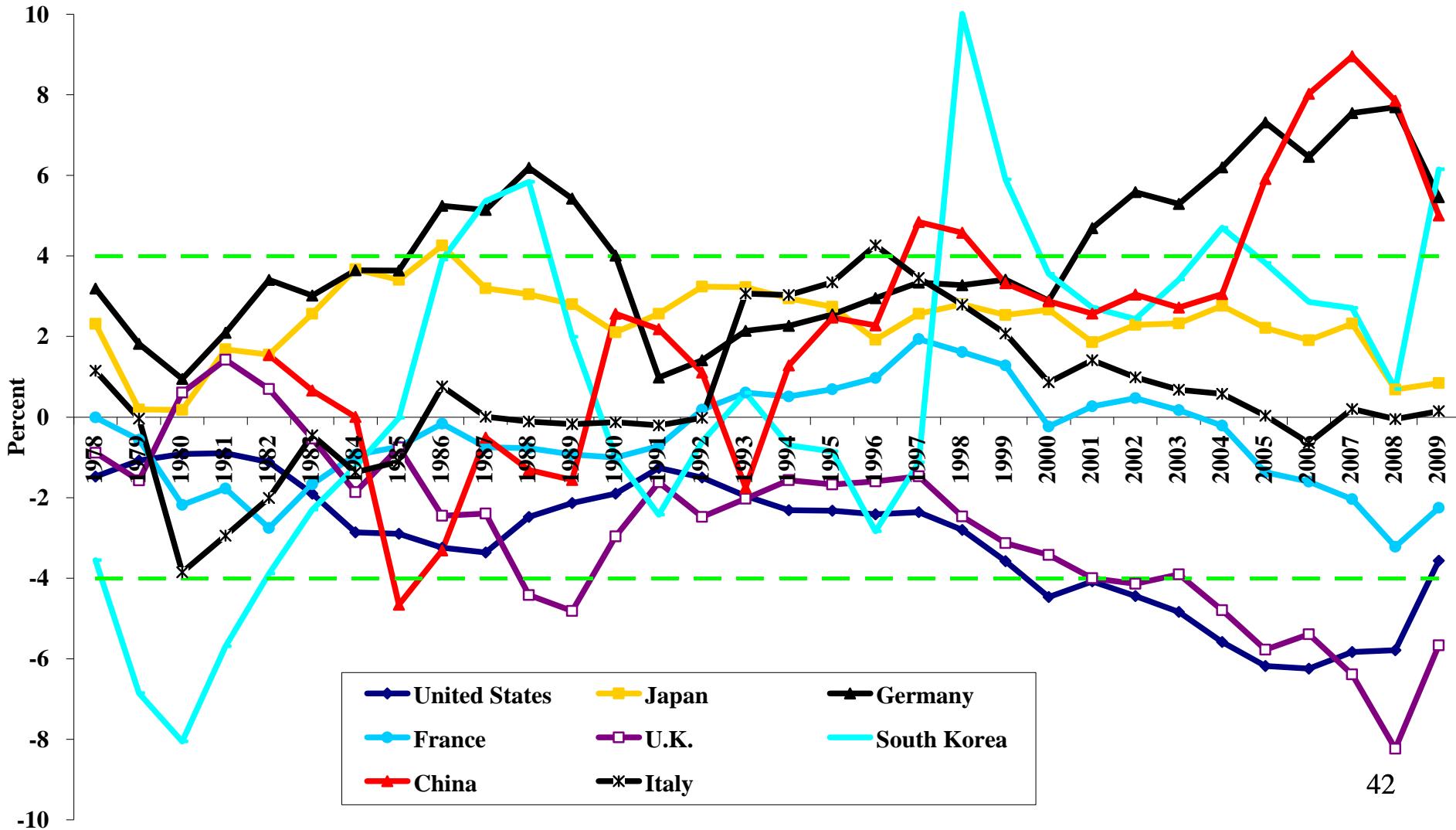
The Nominal and Real Yuan/US\$ Exchange Rates

The Nominal and Real Yuan/US\$ Exchange Rates (1994 prices)



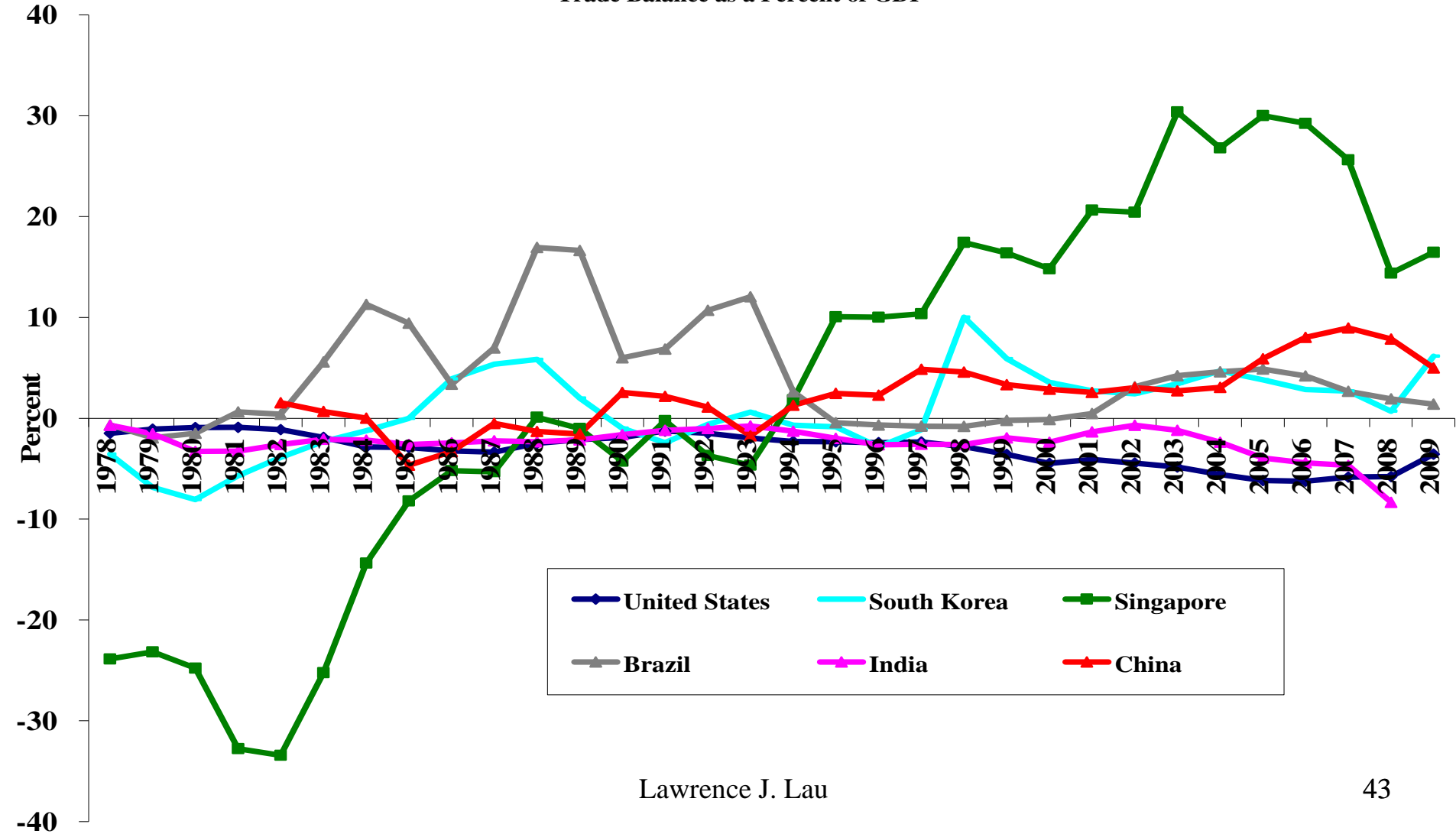
Trade Surplus (Deficit) as Percent of GDP, Selected Developed Economies & China

Trade Balance as a Percent of GDP



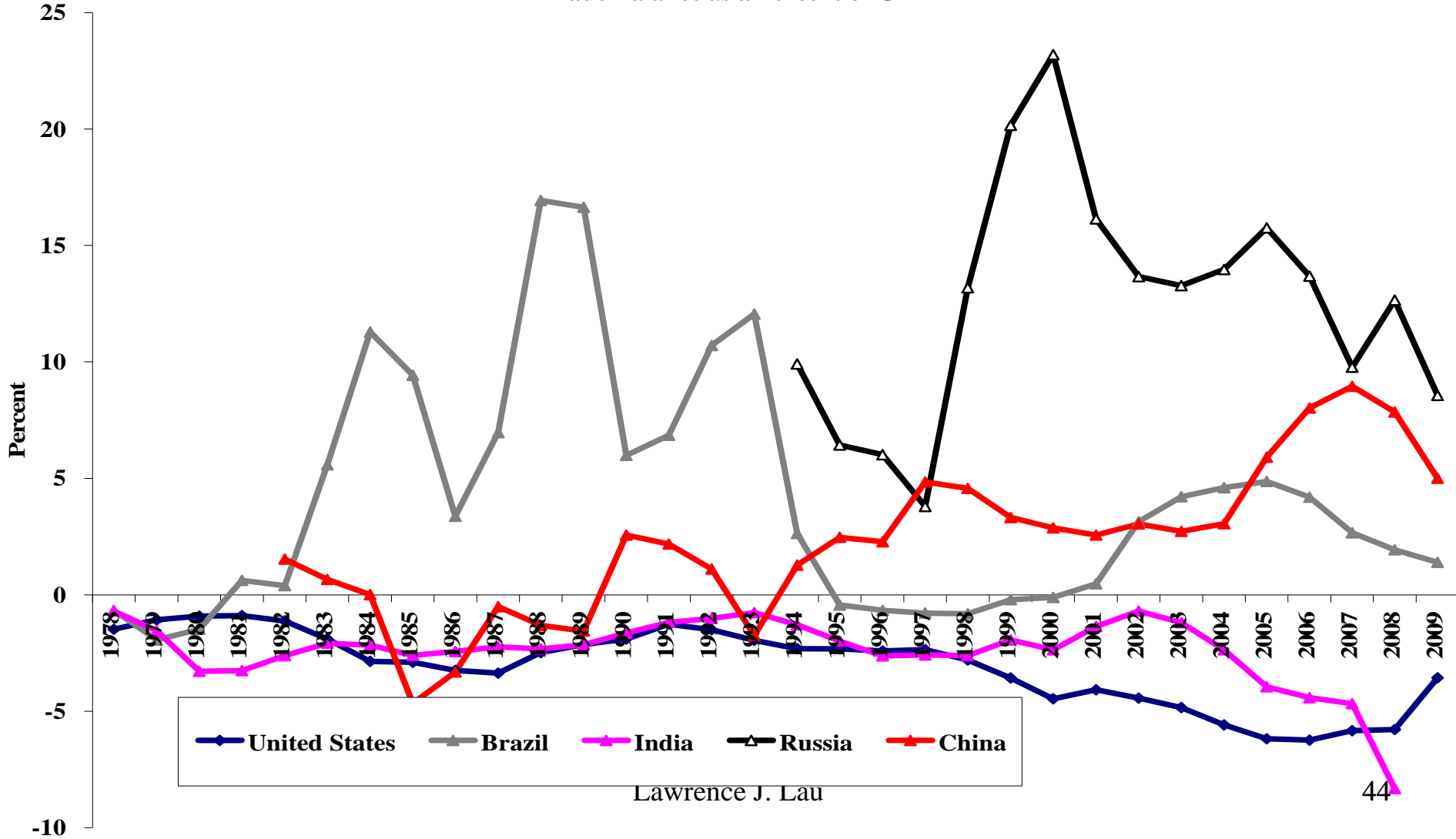
Trade Surplus (Deficit) as Percent of GDP, Selected Developing Economies & U.S.A.

Trade Balance as a Percent of GDP



Trade Surplus (Deficit) as Percent of GDP, BRIC Economies and the U.S.

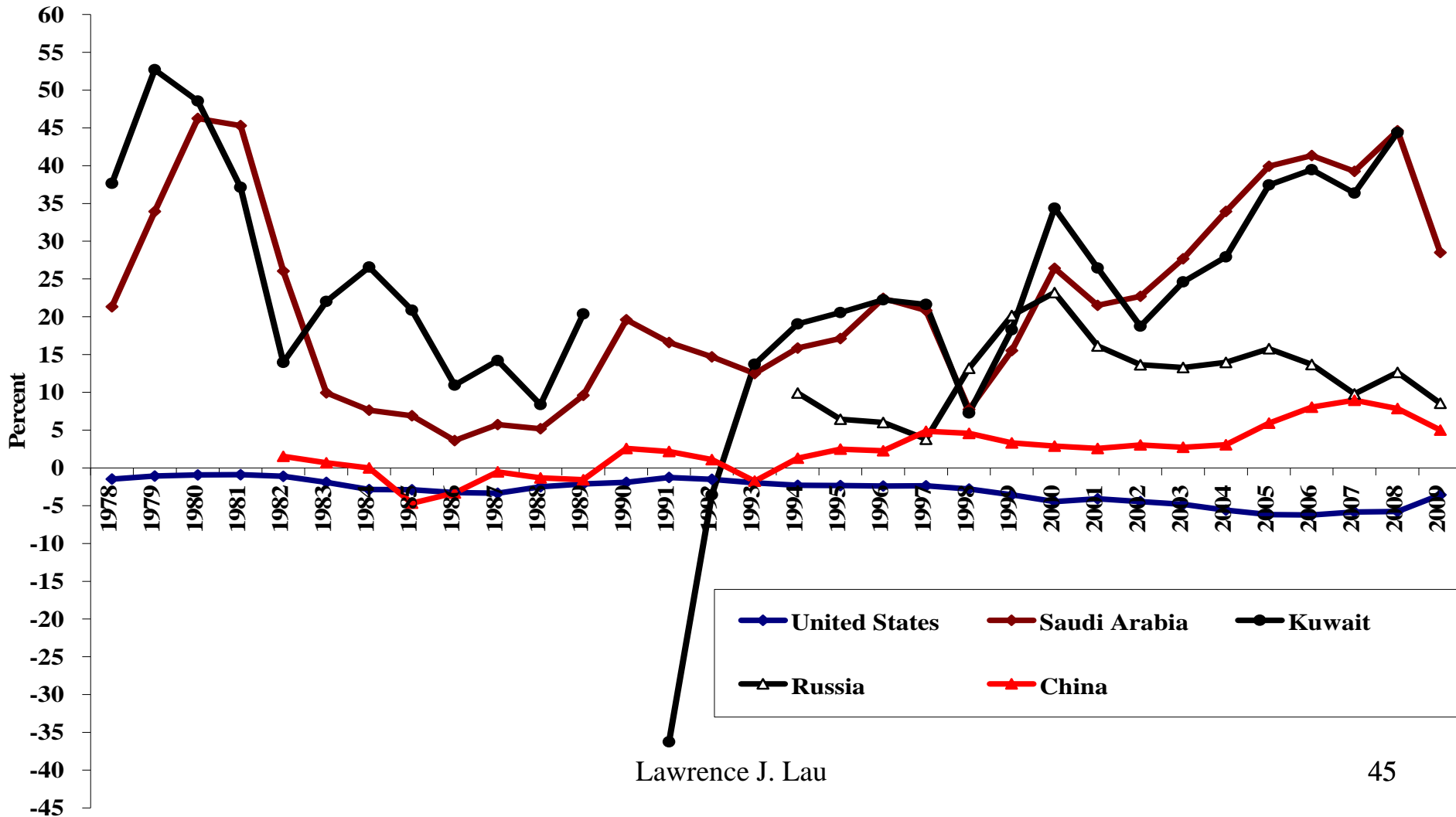
Trade Balance as a Percent of GDP



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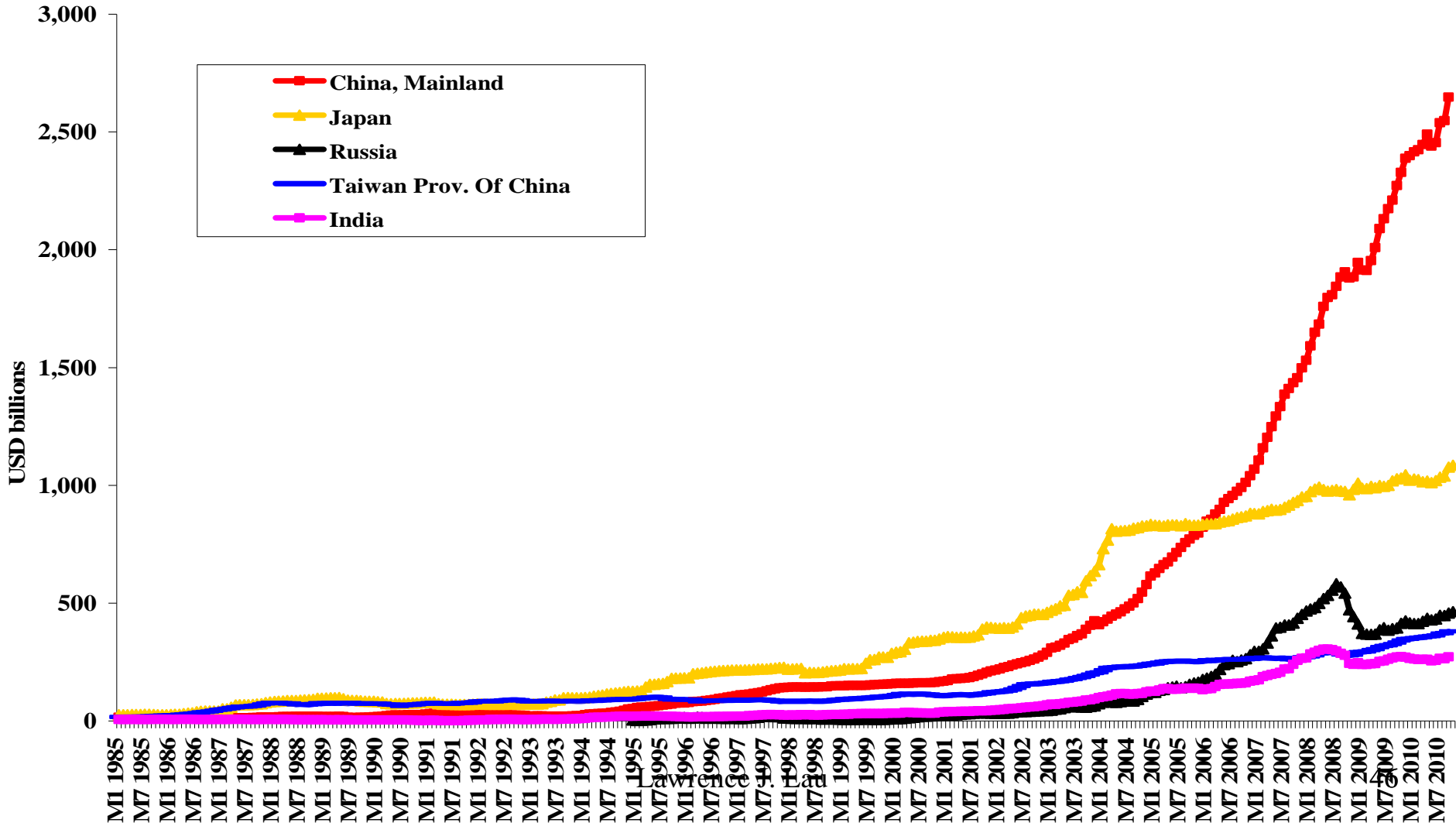
Trade Surplus (Deficit) as Percent of GDP, Oil-Exporting Economies, China and U.S.

Trade Balance as a Percent of GDP



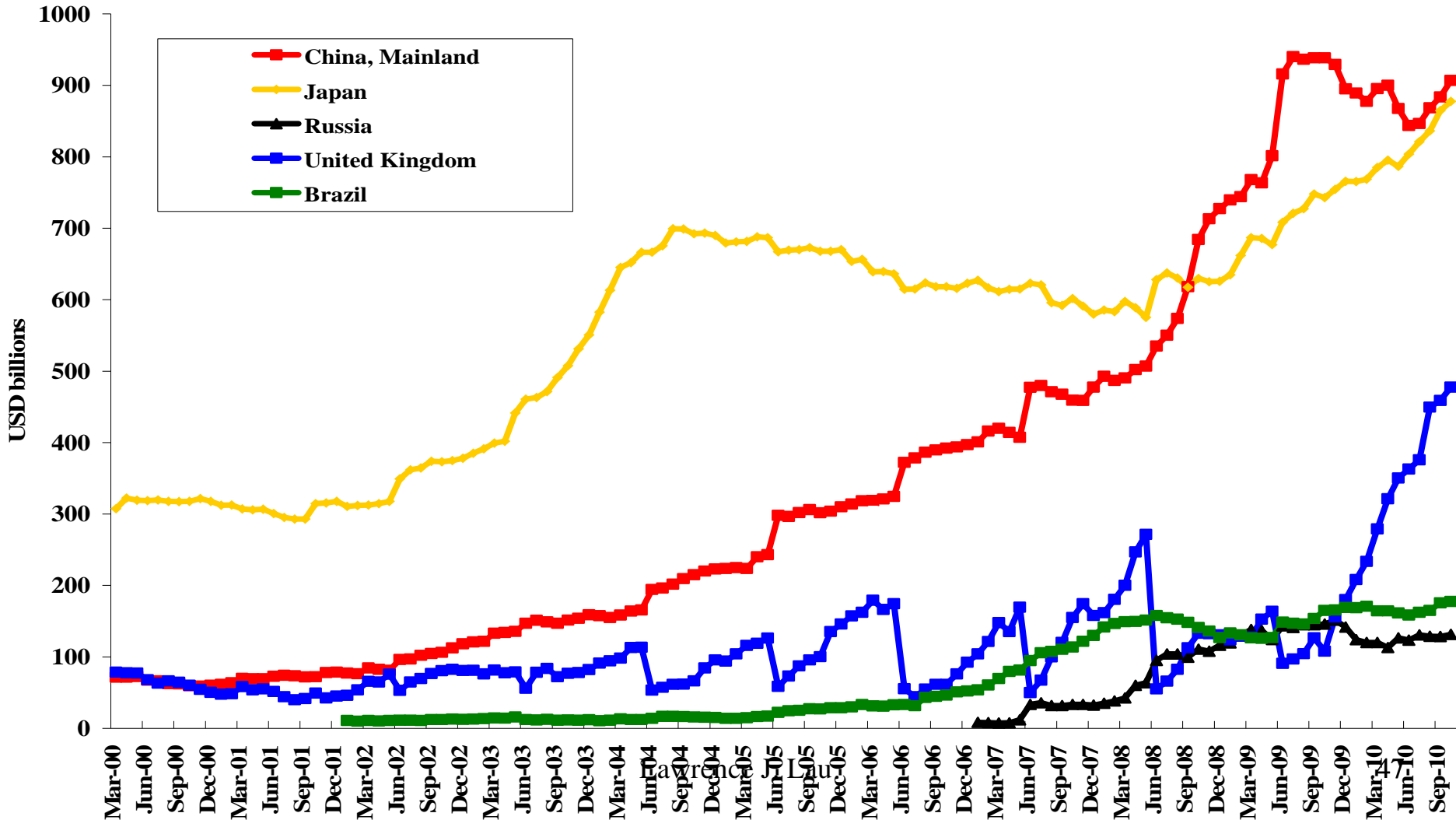
Total Foreign Exchange Reserves minus Gold, Selected Countries and Regions

Total Reserves minus Gold of Selected Countries and Regions



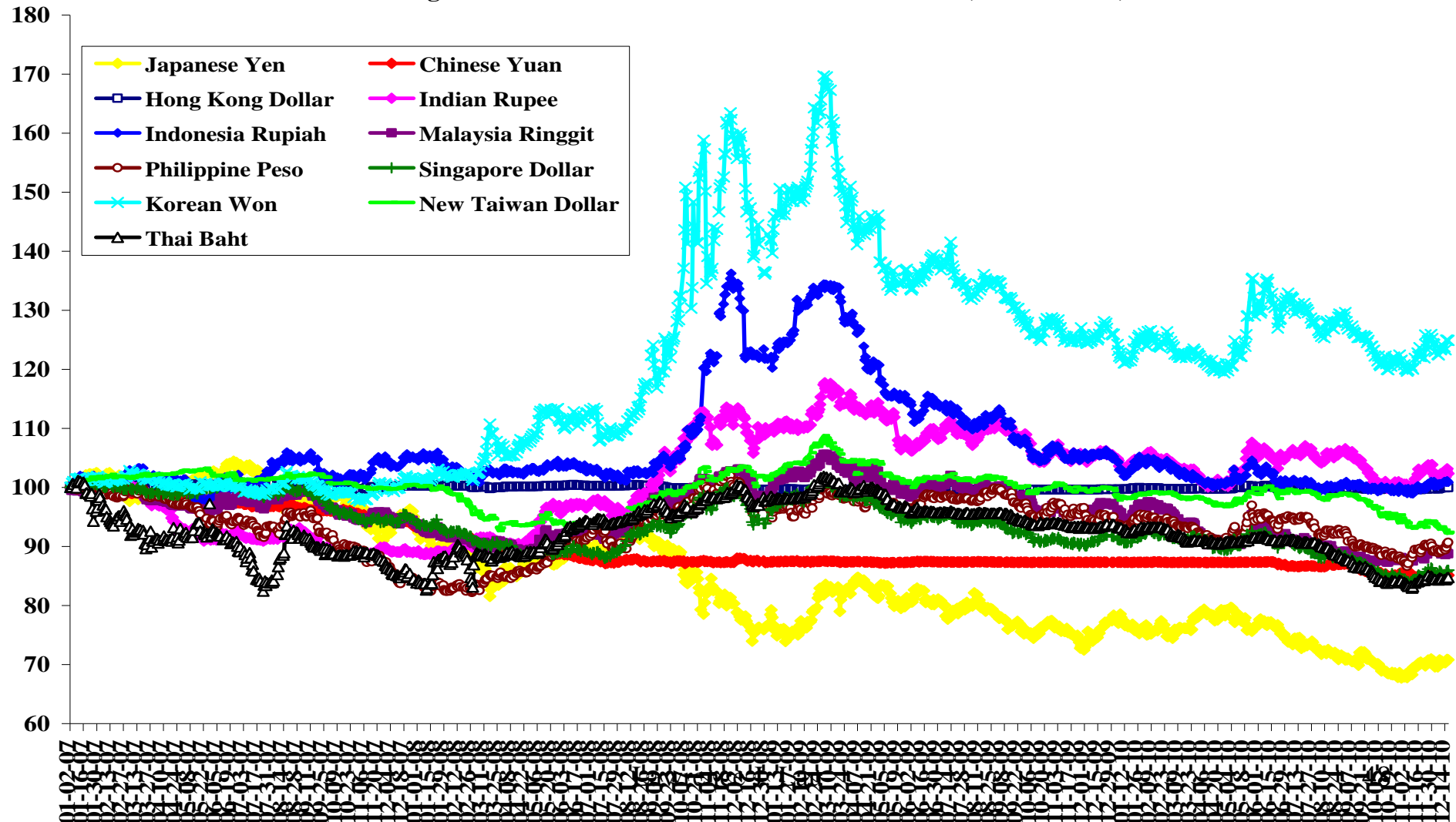
Major Foreign Central Banks' Holdings of U.S. Treasury Securities

Major Foreign Central Bank's Holders of U.S. Treasury Securities



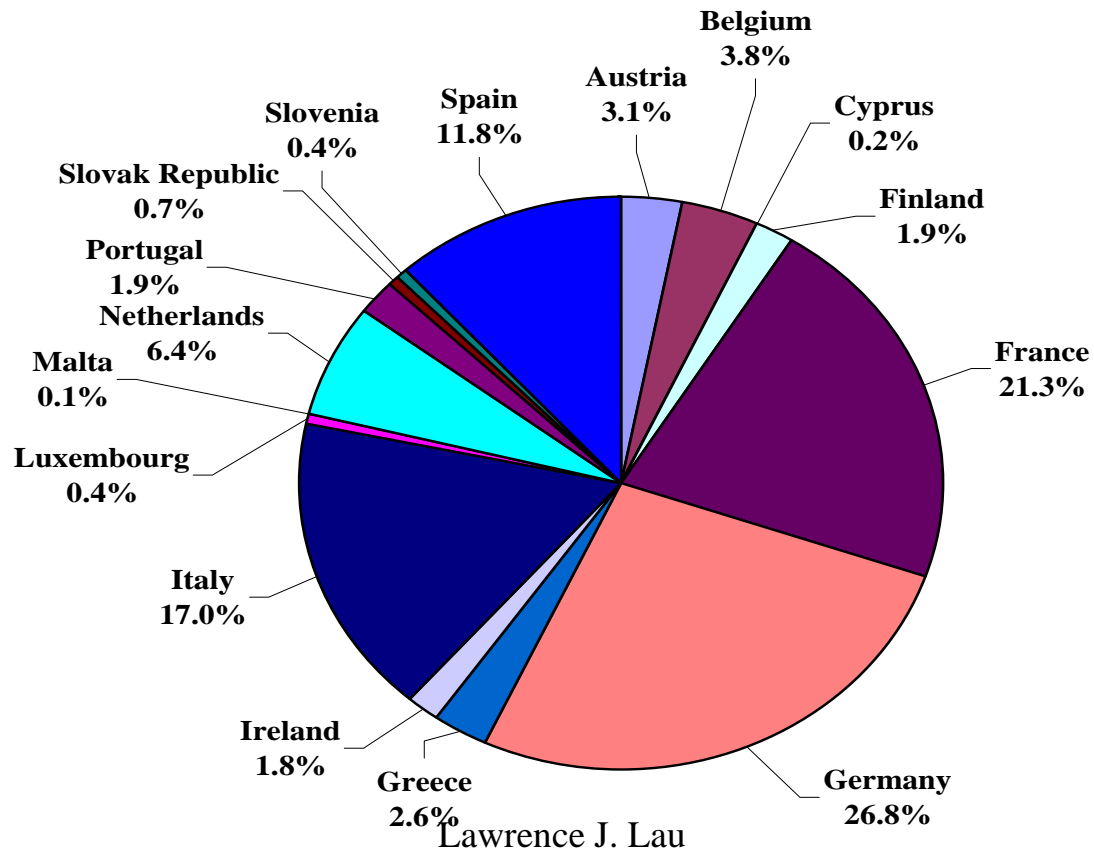
Exchange Rates of Selected East Asian Economies (1/2/2007=100)

Exchange Rate Index of Selected East Asian Economies (1/2/2007=100)



The Distribution of the GDP of Euro Zone in 2009

Distribution of the GDP of Euro Zone in 2009, in Euro billions



The Internationalisation of the Renminbi

- ◆ The Renminbi has been current accounts convertible since 1994. However, it has not become fully capital accounts convertible. There still exist both inbound and outbound capital controls in China. Some categories of capital movements require prior government approval. But individual Chinese citizens can remit up to US\$50,000 per person overseas each year, with few questions asked.

The Renminbi as a Settlement Currency

- ◆ If the Renminbi were to be used as a settlement currency by Chinese exporters and importers with their trading partners in East Asia, it would greatly reduce the Chinese demand for U.S. Dollars for international transactions purposes, and the People's Bank of China, China's Central Bank, would no longer need to hold as much foreign exchange reserves for transactions purposes as it does now.
- ◆ Approximately 35% of Chinese trade is conducted with East Asian economies. What this means is that the foreign exchange reserves maintained for the settlement of imports from East Asian economies can be reduced if the settlement currency is going to be the Renminbi itself.
- ◆ Chinese exports to East Asia except Japan amount to more than US\$300 billion a year. Similarly, Chinese imports from East Asia except Japan also amount to US\$300 billion a year. If imports can be settled in Renminbi, the requirement of foreign exchange reserves for transaction purposes can be reduced by US\$300 billion.

The Renminbi as a Settlement Currency

- ◆ Moreover, if other East Asian economies, such as Hong Kong, Indonesia, South Korea, Malaysia and Thailand also use the Renminbi as their settlement currency for trade amongst themselves, it would further reduce the demand for U.S. Dollars for international transactions purposes and hence the proportion of the foreign exchange reserves that the central banks of these economies hold in terms of U.S. Dollar-denominated assets. However, it may also increase demand of these central banks for Renminbi-denominated assets to be held as part of their foreign exchange reserves.

The Internationalisation of the Renminbi

- ◆ The willingness to accept and to hold a non-local currency depends, but not exclusively, on whether the currency is fully convertible. A person (firm) may be quite willing to accept and to hold a non-local currency, fully convertible or not, if he (it) knows that the next person (firm) he (it) comes across is also likely to accept the currency. There can be wide general acceptance of a non-local currency even in the absence of its full convertibility.
- ◆ Even though the Renminbi is not de jure fully convertible, it has gradually become de facto convertible in many economies in East Asia because of its wide general acceptance. For example, the Renminbi is widely accepted and used in Hong Kong, Macau, Laos, Myanmar, and other border areas even though it is not legal tender in these places.

Full Convertibility and the Renminbi as a Reserve Currency

- ◆ While it is true that the Renminbi is not fully convertible, it may nevertheless be maintained as part of foreign exchange reserves by an economy as long as there is a credible commitment by the People's Bank of China to convert any Renminbi presented by a foreign central bank into U.S. Dollars or Euros or any other so-called “hard” currencies. Foreign central banks can hold the Renminbi for potential transactions purposes with China or other economies willing to accept the Renminbi.

Concluding Remarks

- ◆ The centre of gravity of the World economy is gradually shifting to Asia (East Asia and South Asia) from North America and Europe. The shift is still on-going. However, it will probably take another 15 years before Chinese real GDP can catch up to the level of the United States real GDP. In the meantime, the U.S. economy will still be the largest in the World. And it will probably be another 40 years from now before Chinese per capita GDP reaches the same level as that of the U.S.
- ◆ The international monetary order is in need of restructuring. There are, however, other alternatives than the use of Renminbi as another reserve currency. For example, a multilateral settlement mechanism similar to what the Bank for International Settlements did for the Western European economies in the 1950s may work within East Asia. The use of “Special Drawing Rights (SDRs)” and a return to a quasi-gold standard, perhaps within a voluntary regional group of countries, are other possibilities.

Concluding Remarks

- ◆ Paradoxically, the global financial crisis of 2007-2009 has accelerated the pace of internationalisation of the Renminbi. China will be internationalising the Renminbi gradually and in a planned and orderly manner. It has already made a beginning by allowing the Renminbi to be used on a voluntary basis as an accounting and settlement currency in its international trade with selected countries and regions.
- ◆ In time, perhaps within the next five years, the Renminbi will become effectively fully convertible, in the sense that both inbound and outbound capital controls will be effectively lifted. However, it is possible that short-term capital flows, which are of little economic benefit to the recipient economies, may continue to be under some form of control.