

What should the G20 do?

The economic crisis is now a global problem, and requires a global solution. The G20 will convene in London early next month. This April meeting follows the G20 Leaders Summit on Financial Markets and the World Economy in Washington last November. This last meeting had produced general principles and a rough plan; part of what will happen in London is to assess what has been achieved and the next steps to take. In the midst of the most serious global economic crisis since the Great Depression, what should the G20 do?

The G20 grew out of the G33 and before that, the G22, formed in the wake of international financial crises 10 years ago. Before these, the world already had the G7, the group of finance ministers from the seven industrialised nations — Canada, France, Germany, Italy, Japan, the UK, and the US.

Not widely commented on but profoundly remarkable is how, in the course of the current global economic crisis, the G20 has quietly eclipsed the G7 as the closest thing we have to a guardian of the international financial system and the world economy.

The G20 adds to the original G7, the BRICS (Brazil, Russia, India, China, and South Africa); representation from Central America (Mexico), the Southern Hemisphere (Argentina, Australia), Northeast Asia and Southeast Asia (South Korea, Indonesia), MENA (Saudi Arabia, Turkey); and finally the EU as a single bloc. In this extension, the G20 includes 90% of world GDP, 80% of world trade, and two-thirds of the world's population.

What should the G20 do?

It has to be good that any international policy-making body engage more than before the emerging economies — not least those typically growing at rates three to four times that G7 countries usually do, and economies routinely contributing as much as the US does to world economic growth in dollar terms (even evaluated at market exchange rates, not purchasing power parity).

It is a simple recognition of the shift in the centre of gravity of global economic activity. More importantly, I will argue, resolving the current global economic crisis entails treating the emerging economies not as an afterthought but instead fully engaging them integrally in international policy-making.

Out of the November 2008 meetings and subsequent discussions, it is a fair guess that four principal planks will inform G20 deliberations in April:

1. Boost global demand, coordinated across nations, with both deficit and surplus countries playing well-defined roles. Use fiscal and monetary instruments. Prevent contagion spilling into emerging economies.
2. Improve financial markets and restore trust and confidence. Build a

better early warning system; provide transparency; improve supervision and cross-border regulation; raise management responsibility.

3. Strengthen world trade; steer clear of protectionism.
4. Keep an eye beyond the current financial turmoil. Continue towards meeting Millennium Development Goals; combat global climate change.

The first two are easy to sign up to, so long as policymakers pay mind to the dangers of over-shooting on them. Similarly, Item 3 greatly appeals but faces populist and nationalist pressures to not deliver. In the perception of some observers, item 4 is an unnecessary and distracting afterthought — but I will return to it later. For now, it is plain that the guardians of the world economy want and need to boost global aggregate demand without putting in place the ingredients for future international financial crises.

My goal here is not to go over again the blame game of who is responsible for what part of global imbalances and how those led to the current financial crisis.

The facts are well known. The US economy shifted from approximate trade balance in the early 1990s to a current account deficit of US\$900 billion by 2006: that last year, the US was consuming more than it was producing to the tune of one Indian GDP.

Over this time, the US bilateral trade deficit against China showed a parallel movement as the overall US trade deficit; so too, did the US bilateral trade deficit against the EU and the oil-exporting economies.

The world therefore partitioned into a bloc of large deficit countries on the one hand (the US, the UK) and a bloc of large surplus countries on the other (China, the oil-exporters, the EU [mostly Germany]). Whether prudent savings out East caused profligate consumption in the West, or the other way around, the end result is that massive international capital flows led to global imbalances that, in turn, through bad judgement and irresponsible behaviour, produced extreme financial leveraging. The unwinding of this superstructure, off of US subprime mortgage defaults, froze credit channels, crashed housing and property markets, and reduced incomes, output, and trade worldwide.

Boosting aggregate demand and restoring trust in financial markets, therefore, must at some level of abstraction be absolutely the right things to do.

The difficulty is that, all else equal, boosting demand in deficit countries worsens their deficit position and therefore exacerbates global imbalances.

Fixing credit channels in the West alone can only bring the global economy so far.

BY
DANNY QUAH



Getting surplus countries to boost their domestic demand seems to be a doubly effective recommendation: world demand will rise and global imbalances will unwind. The deficit countries will see exports rise and deficits fall; and the boost to external demand will lift incomes.

Emerging economies cannot be an afterthought

But why should the surplus countries suddenly agree to save less and import more?

The argument often heard is that while the current global economic crisis began in financial centres

people out of extreme (US\$1 a day) poverty. This number is about double the entire population of the US, and exceeds poverty reduction in all the rest of the world combined.

Before this, the US economy last underwent recession in 1991 and 2001. The first of those times US output fell, the same way it will do this year. But in 1991, China contributed to world economic growth three times at market exchange rates what the decline in US GDP turned out to be; East and Southeast Asia contributed 20 times; and the Middle East, North Africa, and South Asia (the MENASA economies) contributed double. In 2001, China contributed to world economic growth nearly one and a half times what the US did, again at market exchange rates; East and Southeast Asia, nearly double; MENASA, 60%.

So, longer term, in their development and export strategy China and East Asia have arguably done more for improving the human condition than pretty much everyone else. And, in recent US recessions, China and the rest of East and Southeast Asia and the MENASA economies have more than respectably held up their end of world economic growth.

Of course, this recession is different. Emerging economies now face sharply declining export demand, falling commodity prices, and rapidly shrinking FDI. In the category of bad news, Taiwan's exports in January 2009 were 40% lower than a year ago. For South Korea, the decline in industrial output in December 2008 over the past year is the steepest on record. Russia's industrial output fell 20% in January from the previous month. Japan's industrial production fell by 21% in the three months to November 2008, and its GDP fell last quarter by the steepest rate of decline since 1974.

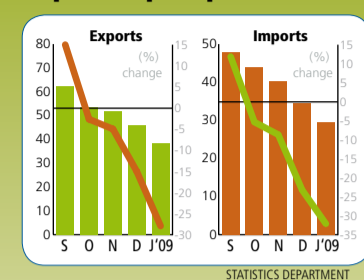
Even China's exports fell 13% in the fourth quarter of 2008 — but actually this means they are only 3% lower at the end of 2008 than a year before. This is hardly a catastrophic

collapse. Even without a global economic and financial crisis, China's economy was already having a rough 2008, with paralysing ice storms last February, the massive Sichuan earthquake in May, and then the tight grip of the Beijing Olympics in August.

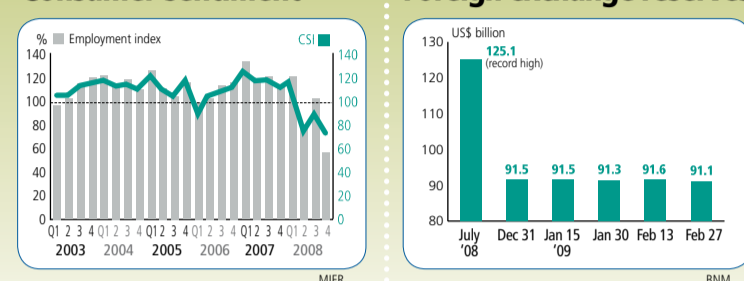
On the other hand, in the category of relatively positive news, the Shanghai stock market has continued to rise since China's RMB4 tril-

LOCAL indicators

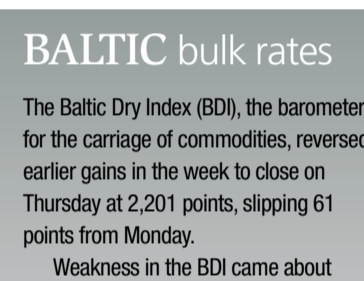
Export/Import performance



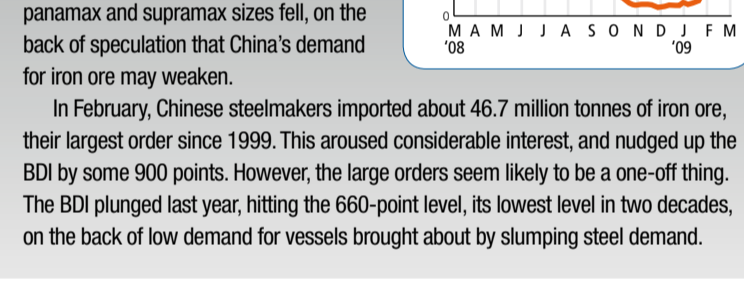
Business confidence



Consumer sentiment



Foreign exchange reserves



BALTIC bulk rates

The Baltic Dry Index (BDI), the barometer for the carriage of commodities, reversed earlier gains in the week to close on Thursday at 2,201 points, slipping 61 points from Monday.

Weakness in the BDI came about after charter rates for vessels of capesize, panamax and supramax sizes fell, on the back of speculation that China's demand for iron ore may weaken.

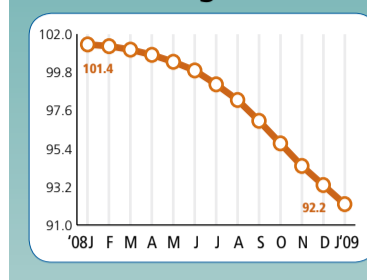
In February, Chinese steelmakers imported about 46.7 million tonnes of iron ore, their largest order since 1999. This aroused considerable interest, and nudged up the BDI by some 900 points. However, the large orders seem likely to be a one-off thing. The BDI plunged last year, hitting the 660-point level, its lowest level in two decades, on the back of low demand for vessels brought about by slumping steel demand.

lion fiscal stimulus announcement last November; it was up 13% by mid-February from the start of the Chinese New Year. In surveys, Chinese purchasing managers' confidence levels have risen every month since November.

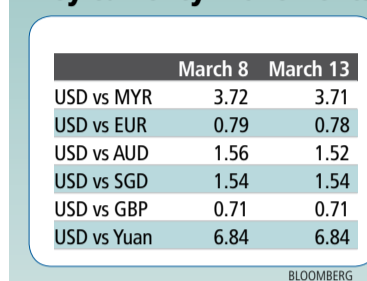
Total bank loans in China rose 19% at the end of 2008 from 12 months before, and continued their climb in January. New cellphone subscriptions in India reached a record of 11 million

GLOBAL indicators

OECD leading indicators



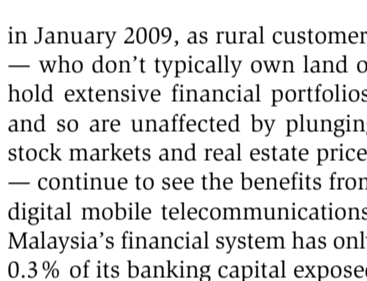
Unemployment



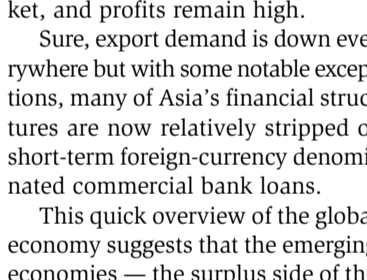
Key currency movements

	March 8	March 13
USD vs MYR	3.72	3.71
USD vs EUR	0.79	0.78
USD vs AUD	1.56	1.52
USD vs SGD	1.54	1.54
USD vs GBP	0.71	0.71
USD vs Yuan	6.84	6.84

China external trade



Crude oil/CPO/gold prices

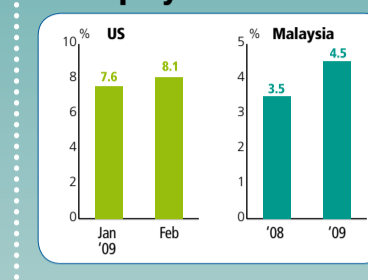


in January 2009, as rural customers — who don't typically own land or hold extensive financial portfolios, and so are unaffected by plunging stock markets and real estate prices — continue to see the benefits from digital mobile telecommunications. Malaysia's financial system has only 0.3% of its banking capital exposed to the US subprime mortgage market, and profits remain high.

Sure, export demand is down everywhere but with some notable exceptions, many of Asia's financial structures are now relatively stripped of short-term foreign-currency denominated commercial bank loans.

This quick overview of the global economy suggests that the emerging economies — the surplus side of the global imbalance equation — should not be treated simply as an after-

Purchasing managers index



Malaysia to announce industrial production for February. Market consensus anticipates a 1.3% drop.

Singapore to announce electronic exports and non-oil domestic exports for February which are expected to plunge 32% and 27.5% respectively

US to announce February Consumer Price Index (month on month) and 4Q2008 current account balance, which is expected to be US\$137.4 billion (RM507 billion)

Malaysia to announce manufacturing sales values for January

Bank Negara to announce external reserves. Malaysia to announce CPI for February

Inthepipeline

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China's aggregate savings.

Remember I had said I would come back to the Millennium Development Goals? Putting MDG centre stage is now no longer just an incidental last item on the To-Do list that the G20 will get to if it has time and resources left over. Instead, MDG should here be interpreted to provide emerging nations greater economic security. Emerging nations need to be made to feel engaged with international financial institutions, and that those institutions are on their side and will support them in the face of economic difficulties. With the greater participation of emerging and surplus countries in the G20, as opposed to the G7, this turnaround will slowly happen.

And it will be about time. ■

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