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Iwan Azis | Concern should be more over slowing growth

With global crude and commodity prices showing signs of easing off, the time is right for Asian economies to reintroduce stimulus packages to prop up the real sector, says Iwan Azis

Remya Nair

New Delhi: The focus of emerging market economies in Asia should shift from inflation control to slowing down of the economy, said **Iwan Azis**, head of Asian Development Bank's (ADB) office of regional economic integration (OREI). Azis, in an interview, said with global crude and commodity prices showing signs of easing off, the time is right for Asian economies to reintroduce stimulus packages to prop up the real sector. Edited excerpts:

What will be the impact of the US downgrade and the euro zone debt crisis on emerging market economies (EMEs)?

We don't know for certain but we can speculate a number of possibilities. At this moment, market is looking for safe haven. Though EMEs will be affected negatively by what's happening in the global economy, but, relatively, compared to the other parts of the world, emerging markets are doing better and will be considered safe havens by investors.



Most

Changing focus: Iwan Azis says the time is right for Asian economies to reintroduce stimulus packages to prop up the real sector. Photo Priyanka

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immediate impact will be the portfolio impact, especially for countries, which have a lot of assets in US dollars and US treasuries. With the US credit rating downgraded, countries like China, (South) Korea, Japan, Taipei China and some other Asean (Association of South East Asian Nations) countries that really rely on exports and have most of their reserves in US dollar will be impacted. That will be the direct effect.

The indirect effect will be more on the real sector. The depreciation of the US dollar will automatically mean appreciation of local currencies and that is a bad news for exports. But more importantly, it is almost certain that the global economy is slowing down, especially in the US and Europe. And those two are the traditional markets of exports, especially for final goods. So that will affect the export performance of Asia, especially exports-oriented Asian countries.

And the last one, and this is still evolving, and that's why (what) is still uncertain is the impact on the credit markets. Downgraded credit rating means cost of borrowing will go up. And, in the case of Europe, it is also exacerbated by the debt problems. We have started to hear news about some liquidity problem in the banking system in some countries in Europe, such as France, that are exposed to Greek debt. If banks in Asia are exposed to those banks, indirectly they will be affected also. But this is still evolving and information every day is still coming out. But there is a possibility that the credit markets will be affected similar to 2008, but I hope it will not be as severe.

What steps should be taken by EMEs such as India to minimize the impact on their economies?

The situation is still evolving and it's better to be worried and take precautionary moves. Until six months ago, policymakers in emerging market economies, especially Asia, have been struggling very hard to deal with inflationary pressures. I think, the pendulum shifts now to concern over the slowing down of the growth of the economy. I am not saying that inflation is no longer a threat. It is still a threat, but I think the concern should be more now on the slowing down of the economy, and that should translate into all kinds of policy—from monetary policy to fiscal policy and all kinds of other policies.

Remember, after the global financial crisis of 2008, the world economy was able to escape the further great depression to some extent thanks to G-20 (Group of 20 nations) because they were the ones who garnered all the efforts to stimulate economies.

By 2010, emerging markets had withdrawn stimulus packages as these markets have seen a V-shaped recovery. It gave impetus for policymakers to withdraw the stimulus package. In the short run, with this new development, I hope they are thinking twice about withdrawing the stimulus package.

The first short-term lesson is that when you are faced with this kind of great uncertainty in slowing down of the economy, the stimulus package works. The problem is that not all countries have the capacity for fiscal expansion. But overall, I would say Asian emerging markets have that capacity and, I think, will be moving or reintroducing stimulus package.

With inflation still a concern, is a stimulus package the right course of action to take?

We have to understand the sources of inflation. It is coming from two fronts in the

last couple of years. One is the standard aggregate demand, which is partly because of the strong V-shaped recovery. When economies recovered very strongly, naturally aggregate demand put pressure on the price level. The second source is commodity prices. Prices of food and oil went up in 2008 and then came down in 2009 because of the global crisis. Then prices started going up again in 2010. The good news is that beginning May this year, some of the commodity prices started coming down, like oil, and some food prices also started to come down. In a way, this gives the policymakers an opportunity to shift the pendulum more towards concern over the slowing down of the economy.

The stimulus package can really work in the real sector. Even if financial market recovers, the number of people that will be benefited by the recovery in the financial sector will be less than if the overall economy recovers. More people benefit when employment is created across agriculture, manufacturing and services sector. It is another reason why slowing down of economy should be the focus.

Do you think countries have the capacity for a stimulus package considering most of them are trying to rein in fiscal deficit?

The economy is always capable. The question is if policymakers are willing to do that. Indian fiscal deficit has been fairly high, but most of the emerging market economies still have room to do that. Then, of course, fiscal policy is only one tool. There is monetary policy also. It is unwise for policymakers to use any single policy tool. Policymakers in Asia are not just using fiscal or monetary policy, they are also using some administrative policy measures.

With EMEs emerging as safe havens, what steps should policymakers take to reduce volatility caused by short-term capital inflows?

The most important challenge for policymakers in the region is to look for ways to divert the massive capital inflows into more productive sectors. The irony is that though the region has excess liquidity, most of it is invested in financial assets rather than in real sector. That's why employment generation is limited. The region needs excess spending for infrastructure as infrastructure conditions are so bad. Not only physical infrastructure like roads and bridges but also...education and health. For instance, sovereign wealth funds can use the huge accumulated forex reserves to invest in particular sectors.

Do you think India should be cautious while going for financial sector reforms?

You have to put everything in place before opening up your financial sector, be it liberalizing the financial sector or full capital account convertibility. We have to be a little more careful with financial sector liberalization than trade liberalization because there is a huge degree of asymmetric information in the financial sector. In transaction of goods, asymmetric information is close to zero.

What is OREI doing to increase cooperation among Asian economies?

OREI is looking into three areas of cooperation—in the field finance, trade and infrastructure. So far, the final goods exports from Asia is mainly to two markets—US and Europe, which will be very difficult in the next 10 years. There is a need to increase trade within the region. Another issue is infrastructure. I am not talking about roads and bridges, but about issues such as trade facilitation, harmonization and standardization.

Cross-border holdings of financial assets in Asia has been low despite all talk of

regional cooperation. This is because the standard in one country is different from the other. Then there is problem of asymmetric information. When investors invest money they want to know all the details about payments and settlement procedures.

There is still a lot to be done if we really want to increase regional integration in trade, finance and infrastructure. Regional integration will happen. It's just about whether it will happen quickly.

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