The Global Financial Tidal Waves and its Influence on East Asian Economy

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Introduction

The financial crisis which was triggered by the US subprime loan problem has extended to the global financial market. It started from the bankruptcy of mortgage banks in 2007 and then there was such a sequence of the economic incidents such the relief of the Government Support Enterprises (Freddie Mac and Fannie Mae) by the US government, the disappearance of five large investment banks, the enormous amount of losses and the management crisis of gigantic commercial banks. The influence spreads to the real economy by the credit shrink which was caused by the financial crisis, the declining stock prices, and the depression of consumption. The real economy has suffered terribly with a rising unemployment rate and a negative economic growth rate. The influence is not confined in the United States and it extends to European nations, and has caused rising nations serious damages.

In this paper, I would like to clarify why such a situation has been developed by explaining the structure of the housing loan market in the United States. Then let us discuss the sequence of the events such as the outstanding of the subprime loan, the bankruptcy of mortgage banks, the relief of Freddie Mac and Fannie Mae, the relief of AIG by the government, the economic crisis of Iceland and rising nations, and the crisis of GM and Chrysler. In the latter half of this paper, the influence of this crisis on the East Asian economy will be analyzed and in the conclusion, I would like to consider the meaning of this crisis and the outlook for the future.

Housing loan market in the United States

The origin of the global economic crisis is the subprime loan problem in the United States. The subprime loan is the one to finance the mortgage at a higher rate than usual to those borrowers who have the past records of the arrears of their loans. The rising default rate of this type of loan has triggered this financial crisis. Therefore, to understand the causes of the finance crisis, we should first explain briefly the structure of the housing loan market in the United States.

The housing loan balance of the United States was about 10 trillion dollars in the end of 2007. Housing loans are classified into three kinds according to the borrower's risk. These are Prime, Alt-A (Alternative A), and Subprime. The score system (300 points-850 points) named FICO that Fair Issac Company developed is used to measure the borrower's risk. Loans are lent on the condition at prime when the score is over 680 points and at subprime in the case of below 660 points or 620 points. Alt-A is a case where the necessary documents including the income verification cannot be provided, although the score meets the requirement at prime. The total balance of the prime loan is 7.5 trillion dollars as shown in table 1, Alt-A is 1.4 trillion dollars and the subprime loan is 1.1 trillion dollars.

Table 1 Balance of Housing Loan in the United States

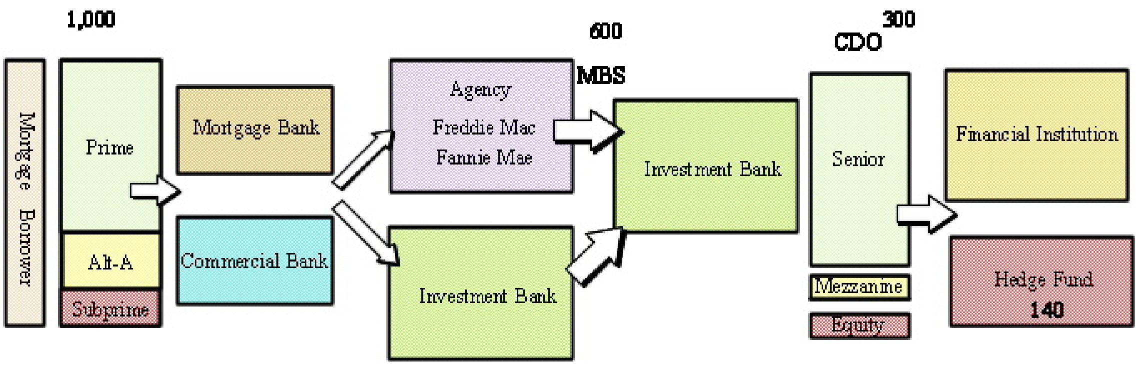
Types of Loans	Balance
Prime	7.5trillion
Alt-A	1.4trillion
Subprime	1.1trillion

Source: MBA (Mortgage Bankers Association)

Housing loans are lent by mortgage banks, commercial banks, and savings and loan associations (S&L) (Fig. 1). Among these, mortgage banks raise capital from the government-supported enterprises (Fannie Mae and Freddie Mac, they are called GSEs or Agencies), commercial banks, and investment banks, etc., taking commissions. The largest percentage of mortgages is lent by these mortgage banks in the United States.

A characteristic of the housing loan in the United States is that about 60 percent of the mortgage is securitized and issued in the form of residential Mortgage Backed Securities (MBSs). The mortgage is sold off from mortgage banks, commercial banks, and S&Ls to Agencies (Fannie Mae, Freddie Mac, and Ginnie Mae) and investment banks, etc. However, in principle, Agencies only buy the prime loans. Alt-As and the subprime loans are sold off to private investment banks etc.

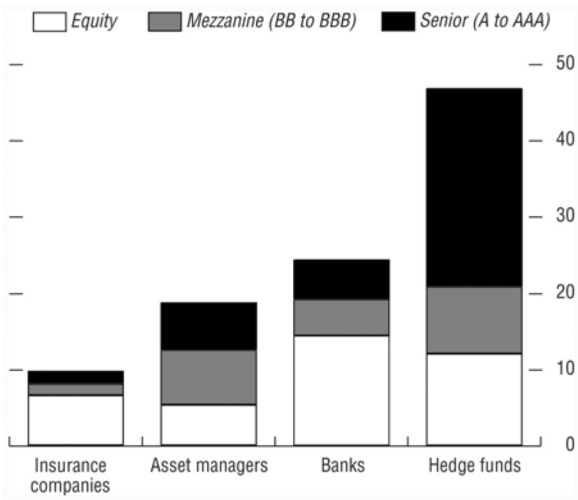
Fig. 1　Structure of housing loan market in the United States



Mortgages are securitized as MBSs by Agencies and investment banks, and are sold off to investment banks and other financial institutions. The majority of MBSs is the one that Agencies issue and guarantee. We call them Agency MBSs. Other MBSs are securitized by private financial institutions. (The ratio of these private MBSs (Non-Agency MBSs) shows a rapid increase with the expansion of the real estate bubble after 2003.)

Investment banks that buy MBSs issued by Agencies and other financial institutions re-securitize them, and compose CDO (Collateralized Debt Obligation). CDO is the security which is synthesized in complex ways from three kinds of mortgages (Prime, Alt-A and Subprime) and other loans including the auto loans and the consumers' loans. According to the size of the risk and the return, three types of CDOs are made. These three are (1) Senior (low-risk low-return), (2) Mezzanine (medium-risk and medium-return), and (3) Equity (high-risk and high-return). The Senior is evaluated as a high ranking of AAA among these, and the Mezzanine ranks as BB. These CDOs are bought by hedge funds and financial institutions for a speculative purpose (Fig. 1). Hedge funds own about the half of these and the rest is owned by banks, asset managers and insurance companies. They hold 25% to10% respectively (Fig. 2).

Fig, 2 Buyers of CDO (percentage)

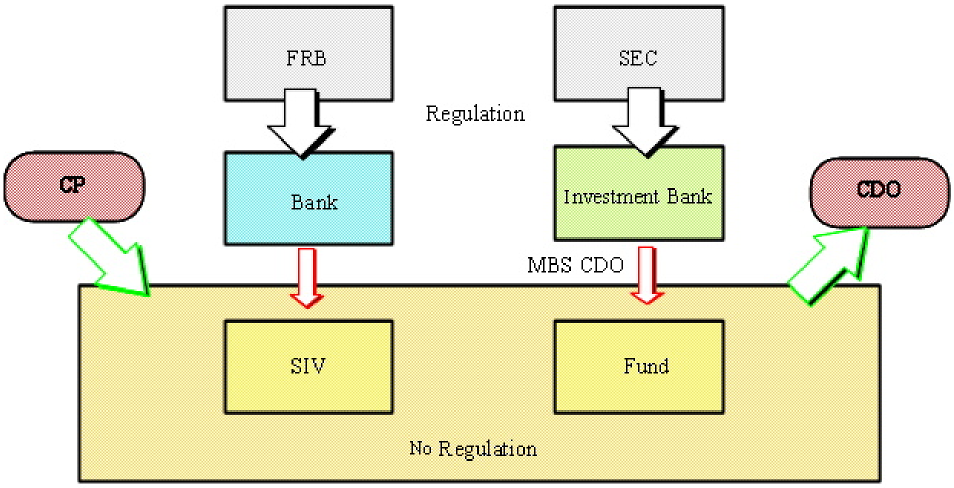


Source: IMF, *Global Financial Stability Report* , Oct 2007, p.15

Among these financial institutions, consumer banks are regulated by FRB, and investment banks are under the surveillance of SEC (The Securities and Exchange Surveillance Commission). But the regulations do not control the investment vehicles (SIVs, Structured Investment Vehicles) that were established by commercial and investment banks, and their subsidiary hedge funds. These SIVs and hedge funds are called "Shadow Banking System". (Fig. 3) The Shadow Banking System buys MBSs and CDOs that yield a high interest rate in the long term, issues commercial papers (ABCP) on the security of them, borrows a short term inter-bank (between the financial institutions) money at a low interest rate, and buys CDOs again. Therefore, hedge funds and SIVs can have tens of times as many transactions as they can with their own capital. This is a mechanism that enables big transactions using relatively a small own capital, and it is called "Principle of Leverage". The existence of this "Shadow Banking System" should be pointed out as one of the important factors that aggravated the global financial crisis.

For instance, let us assume that a hedge fund's own capital is 10 billion dollars, and the difference between a short-term interest rate and a long-term is 4%. If the hedge fund uses its own capital only, the profit is only 400 million dollars. However, if the fund, by using "leverage," deals ten times as large as it deals with its own capital, the profit can be 4 billion dollars, or the profit rate is 40%. However, a problem will occur if the hedge fund suffers a loss. If the fund loses the half value of the investment of 100 billion dollars, the loss amounts to 50 billion dollars. That means that it will lose five times as much as it owns and the fund should be bankrupt.

Fig. 3 “Shadow Banking System”



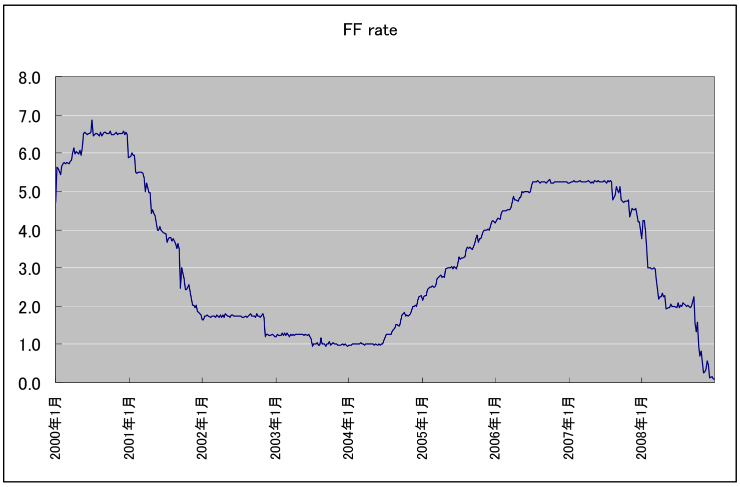
Source: Kaneko-David, *The Global Financial Crisis*, p.11

Real Estate Bubble and the Collapse

Among the three types of housing loans, the amount of the subprime loans expanded rapidly in 2004. What was the reason for this expansion? One reason was a fall of the interest rate in the United States. In the beginning of 2000’s the anxiety about the recession was intensified in the United States because of the collapse of the IT bubble and 9.11 simultaneously executed multiple acts of terrorism in 2001, which led FRB to reduce the interest rate. As a result, FF rate (Federal Funds Rate) fell to 1% as shown in Fig. 4. The oversupplied capital in the financial market was flowed into the housing loan market by such a monetary expansion. In that period, enterprises raised capital by direct finance issuing stocks and bonds .

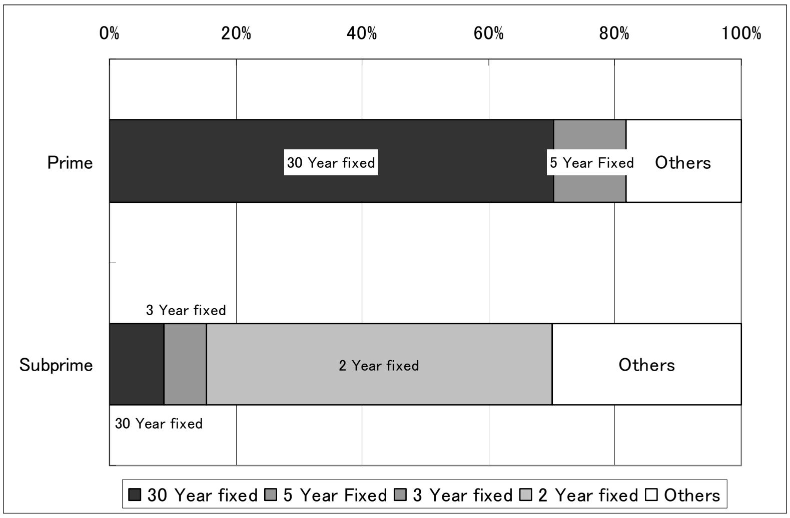
Another factor was the appearance of the new-type loan for low-income lenders who can pay easily in the early stage of payment. For instance, the majority of the subprime loans is the type in which the interest rate is fixed for the first two years and fluctuated thereafter, while the most part of the prime loans is the type of the 30-year fixed interest rate. In addition, the ultimate type called IO (Interest Only) appeared. It has to pay the interest rate only at first. Consequently, as shown in Fig. 5, most of the subprime loans are the floating-rate type; while over 708% of the prime loan is the type of a fixed interest rate for 30 years, 54.8 % is the type of the two-year fixed interest rate and 6.6 % is that of three years, If the interest rate rises after two or three years, lenders will not be able to pay their loans anymore.

Fig. 4 FF rate



Source: FRB

Fig. 5 Types of Prime and Subprime Loan

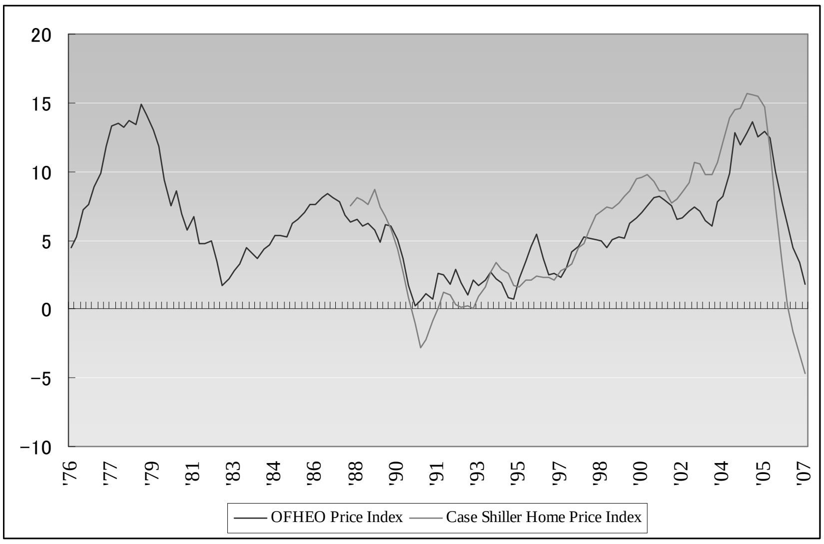


Source: Kurahashi-Kobayashi, *A Correct Way of Thinking for the Subprime Loan Problem*, p.60

Because the real estate price in the United States had continuously risen after 1990 (Fig. 6), such a new-type loan commodity encouraged the lower-income bracket to borrow the housing loans as soon as possible. They thought; if they can pay their subprime loans for several years, they can be evaluated as the prime loans when they convert them, and even if they cannot pay their loans, they could gain profits by selling off the real estate.

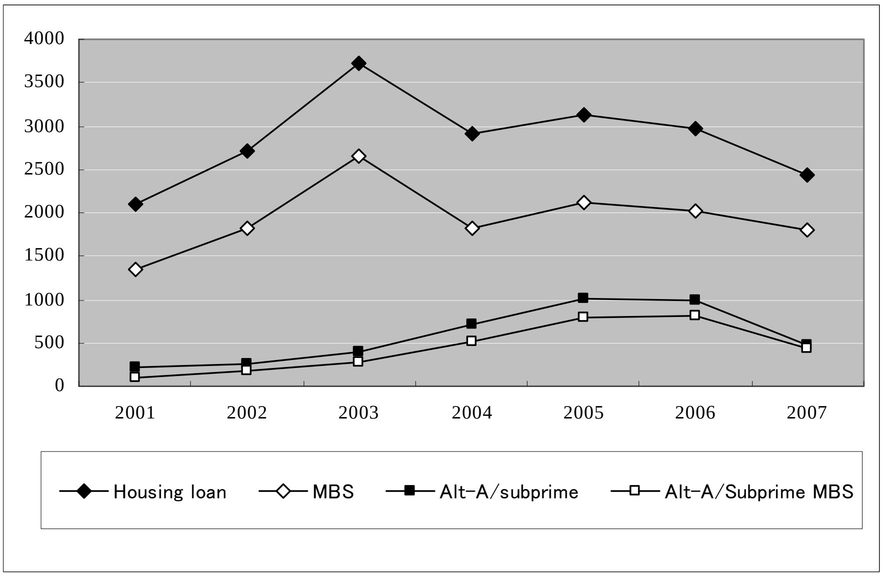
The rapid expansion of the inflow of capital and the amount of subprime loans caused a sharp price increase that can be called a “bubble” after 2004. Fig. 6 shows a change in the percentage of the housing price index. The light line shows Case-Shiller house price index and the dark line shows OFHEO (Office of Federal Housing Enterprise Oversight) price index. Both indexes indicate that the price index of each year grew 10 % more than that of its previous year from 2002 to the first half of 2006, but the rate decreased rapidly from the end of 2006, and fell below zero in 2007.

Fig. 6 House Price Index (compared with the previous year) %



Source: Office of Federal Housing Enterprise Oversight and S&P/Case-Shiller Home Price Indices

Fig. 7 Housing Loan, MBS, Subprime Loan and



Source: Inside *Mortgage Stability Annual 2008*

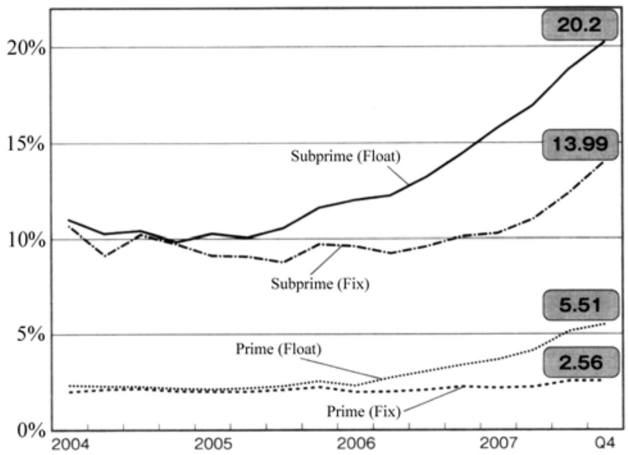
Fig. 7 shows the amount of housing loans, the amount of the issues of MBS, the amount of Alt-A/Subprime loans and the amount of the securitization of Alt-A/Subprime (the amount of the issue of MBS). We can see from the graph that, while in 2003 the total housing loan reached its highest, the amount of Alt-A/Subprime loans and its rate that occupies the total loan increased in 2004 and 2005.

Moreover, the securitization rate for the Alt-A/Subprime is very high.

Loans were thus able to be lent to those borrowers who were otherwise difficult to receive the financing. A critical situation might not have been caused as long as the prices of houses kept increasing. However, the bubble of the housing market collapsed in 2006.

The subprime loans fix their interest rate for the first two years and fluctuate it after that. The FF interest rate, which was 1% in January 2004, gradually rose to 5.25% in January 2007. As a result, the interest rate of the total housing loan also increased and so did the percentage of the delinquency of loans. At the same time, the bubble collapsed, and the house price index fell rapidly, and finally showed a negative growth in 2007 (Fig. 6). The percentage of the delinquency at the subprime rose rapidly, and the percentage of the delinquency of the total housing loan also rose greatly as shown in Fig. 6. It is natural that this tendency should be the most remarkable in the floating rate at the subprime.

Fig. 8 Percentage of Delinquency of Housing Loans



Source: Kurahashi and Kobayashi 'Idea with correct subprime problem' p.77

The rise of the percentage of delinquency of such a housing loan was fatal for the financial institutions that were dealings using leverage. In addition, the price of these securities will greatly fall because the credit rating agencies reduced the evaluation of MBS and CDO, and the investment banks and the hedge funds suffered massive losses.

For instance, the drop of the evaluations of assets from the 2nd quarter to third quarter of 2008 that Lehman Brothers held announced on September 10 are shown in the next table (*Weekly Diamond*, October 11, 2008). Every face value is 100 in this table. Lehman Brothers failed by such a loss. The value of holdings became 1/3.

	Q2 Q3
Alt-A	63 → 39
Subprime	55 → 34
CDO	35 → 29

IMF estimates the amount of their losses in *Global Financial Report* issued in April and October, 2008. Table 2 is the estimated losses.

Table 2 Estimates of Financial Sector Potential Writedowns (April and October, 2008 billion dollars)

	Writedowns on US loans			Writedowns on US Loans				
	outstandings	April estimated losses	October estimated losses	Banks	Insurance	Pensions/ savings	GSE and government	Other Hedge funds
Subprime	300	45	50	35-40	0-5	0-5		10-15
Alt-A	600	30	35	20-25	0-5	0-5		5-10
Prime	3,800	40	85	25-30	0-5	0-5	45-55	0-5
Commercial real estate	2,400	30	90	60-65	5-10	0-5		10-20
Consumer Loans	1,400	20	45	30-35	0-5	0-5		10-15
Corporate Loans	3,700	50	110	80-85	0-5	0-5		25-30
Levarraged Loans	170	10	10	5-10	0-5	0-5		0-5
Total for loans	12,370	225	425	255-290	5-40	0-35	45-55	60-100

	Losses on Related Securities			Losses on Securities				
	outstandings	April estimated losses	October estimated losses	Banks	Insurance	Pensions/ savings	GSE and Government	Other Hedge funds
ABS	1,100	210	210	100-110	40-45	35-55	10-15	10-25
ABS CDOs	400	230	290	145-160	55-75	30-45	15-20	15-30
Prime MBS	3,800	0	80	20-25	10-15	10-20	20-25	0-5
CMBS	940	210	160	80-90	20-25	15-35	10-20	15-20
Consumer ABS	650	0	0					
High-grade Corporate debt	3,000	0	130	65-75	20-30	20-35		5-20
High-yield Corporate Debt	600	30	80	45-50	10-15	15-20		5-15
CLOs	350	30	30	15-20	0-5	0-5		5-10
Total for Securities	10840	720	980	470-530	155-210	125-215	55-80	55-125
Total	23,210	945	1,405	725-820	160-250	125-250	100-135	115-225

Source: MF, *Global Financial Report*, October, 2008

According to Table 2, the estimated total loss of housing loans was 225 billion dollars in April and increased to 425 billion dollars in October. The total loss of the relating bonds was 720 in April and increased to 980 billion dollars in October. The total sum of the losses amounted to 1 trillion and 405 billion dollars, while it was 945 billion dollars in April. It is needless to say that there is a fear that this amount may be expanded because of an increase in the percentage of the delinquency. (On January 28, 2009, IMF announced that total losses increased to 2.2 trillion dollars.)

From the Subprime Loan Problem to the Financial Crisis and an the Economic Crisi

The subprime loans drove investment banks to bankruptcy who bought them from mortgage banks and securitized them and also drove hedge funds to bankruptcy who gained profits by purchasing MBSs and CDOs. In addition, stock prices fell, credit shrinkage was triggered, and it caused the real economy serious damages. Let us trace the development of the recent crisis.

2006

The price of the housing market in the United States became weak in 2006.

December: The mortgage banks that specify their business in subprime loan became difficult. The mortgage bank named Ownit Mortgage Solutions was bankrupt.

2007

April. 2: New Century Financial Co. which is placed No. 2 in the subprime loan market was bankrupt.

June 15: Bear Sterans, one of the major investment banks, provided 3.2 billion dollars for the relief of its subsidiary hedge fund.

July: Moodies and S&P (a credit rating agency) lowered the rating of the subprime related security.

July 19-20: Bernanke, Chairman of FRB, testified in the Congress that the losses of the financial crisis might amount to 50-100 billion dollars.

August 6: American Home Mortgage went bankrupt.

August 9: BNP Paribas, a French bank, refused the cancellation requests from the investors for its subsidiary three investment funds. Financial jitters were actualized (“Paribas Shock”)

September 7: Countrywide Financial, one of the biggest housing loan company in the United States, announced that it would reduce 10,000-12,000 employees by the end of 2007 (It was acquired by Bank of America for four billion dollars)

September 15: The Northern Rock Bank in Britain encountered a run on the bank. (It was nationalized in February, 2008.)

2008

March: Bear Stearns was practically bankrupt. It was acquired by JP Morgan Chase for 2.1 billion dollars.

March 27: FRB executes TSLF (Term Securities Lending Facility) which relieves financial institutions by exchanging MSBs etc. for Treasury Securities (the government bonds). It amounts to 400 billion dollars.

September 7: Fanny Mae and Freddie Mac (GSE or Agency) were under the control of the government. The government decides to execute the Preferred Stock Purchase Agreement of 200 billion dollars.

September 15: Lehman Brothers, an investment bank, which was the fourth largest in the United States went bankrupt. (the total assets 639 billion dollars and the total debts 613 billion dollars)

Dow-Jones showed a drop of 504 dollars.

Merrill Lynch was sold to Bank of America.

85 billion dollars are financed by the government to AIG, the biggest insurance company in the United States.

September 21: Goldman Sachs, the biggest investment bank and Morgan Stanley, the second largest, were transferred to bank holding companies. (the disappearance of the five large investment banks of the United States)

October 3: "The Emergency Economic Stabilization Act of 2008" (the bailout of the U.S. financial system) was enacted. It authorized the government to spend up to 700 billion dollars for purchasing non-performing assets of financial institutions.

October 6: Iceland declared the state of its financial emergency.

November 14-15: G-20 Leaders Summit on Financial Markets and the World Economy

December: Automaker GM and Chrysler received the bridge finance of 17.4 billion dollars from the government.

2009

February 17: The $787 billion package of spending and tax cuts (American Recovery and Reinvestment Act) was signed by President Obama.

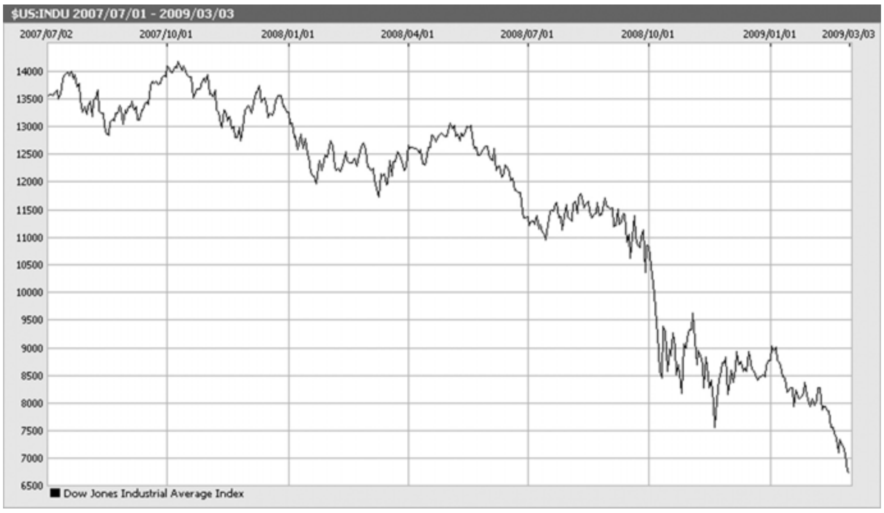
February 26: President Obama released a proposed budget which would bring the 2009 budget deficit to $1.75 trillion dollars.

February 27: US government took a 36% equity stake of Citigroup.

US Department of Commerce announced that GDP growth rate decreased at an annual rate of 6.2 percent in the fourth quarter of 2008.

March 2: The US government decided an additional 30 billion dollars bailout to AIG.

Fig.9 Dow Jones Industrial Average



In such a sequence of the events, the bankrupt of Lehman Brothers on September 15, 2008 has an important meaning. Differing from Bear Stearns and two GSEs (Fanny Mae and Freddie Mac), Lehman Brothers was not bailed out by the government and this gave a big shock to the stock market. Dow Jones index in the United States fell rapidly as shown in Fig. 9 and has not recovered up to the present. Commercial banks should naturally be reluctant to loan, because their property value was reduced and they suffered a great loss due to the subprime loan problem ("Credit crunch"). The financial market shrank, and it exerted various influences on the real economy. Moreover, the stock prices of not only the United States but also other countries dropped, and, as its result, all the countries in the world had to share the same problem; unemployment, credit shrinkage and recession.

Attention should be paid to the government's bailing out AIG. AIG was relieved, while Lehman Brothers was not. AIG was relieved because it is the biggest insurance company and they sold a large amount of CDS (Credit Default Swap) that would guarantee corporate bonds or securities in case that they cannot be repaid owing to bankruptcy etc. The balance of CDS reached 62 trillion dollars in the whole world in 2007. There might have been a danger that the confidence market in the world would collapse, if AIG that guarantees CODs failed.

Influence on the world

The financial crisis originated in the United States has spread to the whole world. It is Britain, among the advanced countries that suffered the greatest loss. The government announced a bank-rescue plan on October 8, 2008 that they should inject up to 50 billion pounds into financial institutions. They also announced the plan on October 13 which injects 37 billion pounds into three major banks including Royal Bank of Scotland (RBS). Iceland that had achieved s swift economic growth by promoting financial sectors was bitterly hit by the financial crisis. Geir Haarde, Prime Minister of Iceland, declared the state of emergency on October 6, 2008, saying "In the worst case, there must be a danger that the nation will go bankrupt together with banks." Iceland nationalized all private banks, and sold off overseas assets.

The financial crisis had serious influences on the rising nations. IMF and World Bank decided to support Pakistan, Belarus, Iceland, Ukraine, Hungary, Serb, and Kirgiz, immediately after IMF decided to support Iceland.

Table 3 Indexes of rising nations

	Current Account / GDP	Short-Term Foreign Deb/ Foreign Reserve	Debt from Foreign Bank (Net) / GDP	Credit Balance to Domestic Private Sector Growth rate
Iceland	-8.0		267.9	
Hungary	-5.5	0.9	54.1	18.0
Poland	-5.0	0.8	17.1	29.5
Estonia	-11.2	0.2	78.7	21.5
Ukraine	-7.6	1.0	9.5	63.9
Pakistan	-6.9	12.1	-4.8	21.6
Vietnam	-13.6	14.5	10.2	63.9
China	9.8	6.9	-1.1	17.5

Source: *Weekly Economis*t, December 9, 2008, p.20

The countries that IMF thinks are facing a crisis are Iceland, Central and East European countries, and Baltics, etc. The special features common to those countries are; they borrow from foreign countries though the current balance is a deficit, and the balance of the domestic credits to the domestic private sectors is big compared with GDP. Table 3 picks up the countries that have those features. The figures for which IMF expresses their concern are printed in gray.

Influence on Asian economy

Finally, I would like to analyze the influence on Asian economy. First of all, the losses directly caused by the subprime loan problem are not so serious in Asia. The total loss of the World’s 100 biggest banks as of May, 2008 is reported to amount to 379 billion dollars. Table 4 shows the losses of the United States and several Asian countries. The total loss of the whole Asia except Japan is only 10.8 billion dollar and this amount is less than 3% of the 379 billion dollars. The amount should be getting bigger at present because there should be losses which were not disclosed at that point of time and there should be cases where losses have increased since May, 2008. (There may be a case where banks bought securities that were issued by Lehman Brothers.) However, in any case, the total loss of Asian countries is not as big as that of EU nations.

Table 4 Asia's Subprime Losses

US	Japan	Korea	China	Malaysia	Total Asia
157.7	8.7	0.4	2.8	0.1	19.5

Source: Asian Development Bank, T*he US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?*, Dec. 2008, p.25.

In Asia, a decrease in the asset value of banks caused by the fall of stock prices must be a more serious problem. The banks that are fearful of the decrease in the capital adequacy ratio try to reduce their financing, therefore causing credit shrinkage. Table 5 shows that the stock market falls by 38.45% in Japan, 64.92% in China and 65.46% in Vietnam, compared with the previous year.

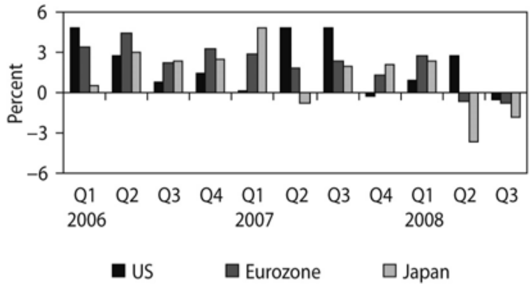
Table 5 Stock Price Index in Asia

		Feb. 20	1 week	1 month	6 month	1 year	3 years
US	NY DJ	7356.67	-6.17	-7.34	-35.49	-40.73	-33.73
Japan	NIKKEI	7416.38	-4.67	-8.05	-42.29	-44.28	-51.96
China	Shanghai	2261.48	-2.56	13.41	-10.38	-50.48	78.41
Korea	KOSPI	1065.95	-10.61	-5.40	-30.81	-36.85	-20.94
Singapore	Straits Times	1594.94	-6.49	-7.45	-42.04	-47.31	-32.40
Thailand	SET	434.67	-2.49	0.34	-37.01	-47.45	-41.11
Malaysia	Kuala Lumpur	889.71	-2.21	1.06	-17.10	-37.09	-3.83
Philippines	Philippines	1881.44	-1.99	-0.87	-29.84	-40.85	-9.72
Vietnam	VN index	252.57	-7.99	-16.61	-50.33	-66.09	-28.64
Indonesia	Jakarta	1296.94	-3.12	-3.51	-37.34	-51.77	3.97

Source: *Weekly Economist*, March. 10, 2009, p.89.

The most serious problem for the Asian economy may be that, owing to the decrease of the exports to the advanced countries caused by the recession, the Asian economic growth rate will be decreasing and the deficit in the current account will be increasing. The real GDP growth rate of the United States, Eurozone and Japan (G3) fell below zero in the latter half of 2008 (Fig. 10).

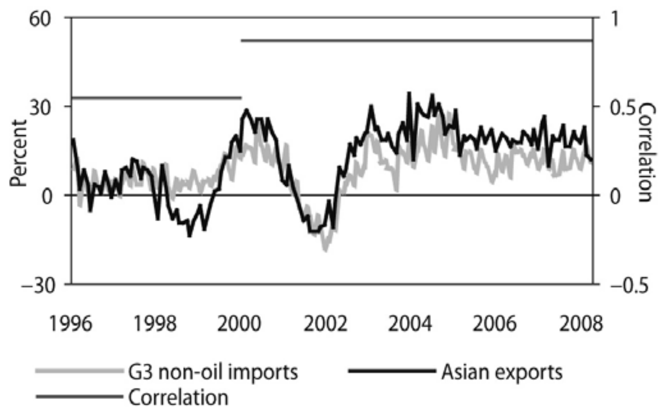
Fig. 10 Real GDP Growth Rate of US, Eurozone and Japan



Source: Asian Development Bank, T*he US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?*, Dec. 2008, p.43.

There is a strong correlation between the amount of the Asian exports and the G3 non-oil imports (Fig. 11). As the economic growth rates of G3 drop, the amount of the non-oil imports of G3 will decrease and so will the amount of the exports of Asian countries.

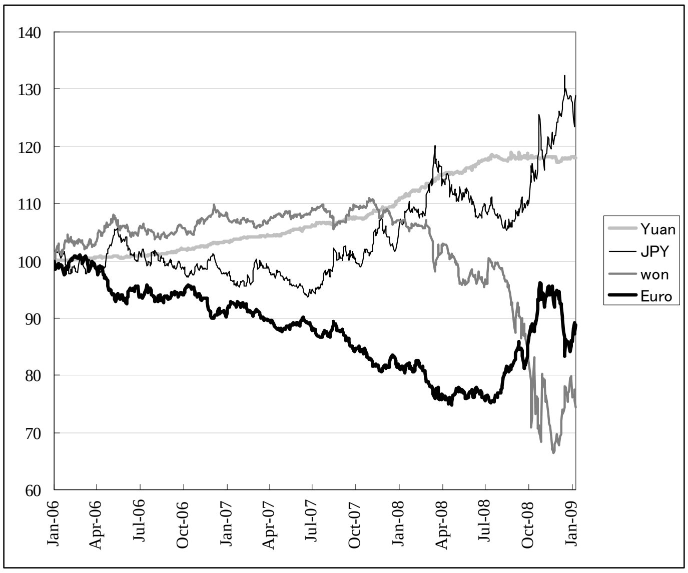
Fig. 11 Correlation of export growth rate and non-oil imports of G3



Source: Asian Development Bank, T*he US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?*, Dec. 2008, p.45.

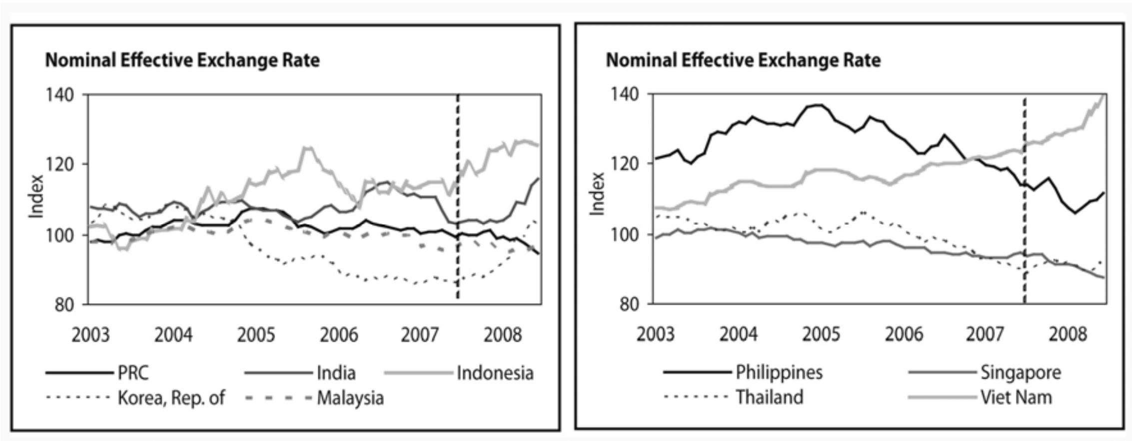
However, the exports to G3 from Asia have not decreased too much. One of the reasons may be that the exchange rates of Asian countries except Japan have fallen against US dollar. Fig. 12 shows the exchange rates of Japanese Yen, Chinese Yuan, South Korean Won and Euro against US dollar between Jan. 2006 and Jan. 2009. Won and Euro fell, while Yen and Yuan rose. The nominal effective exchange rates of some Asian countries are shown in Fig. 13. The exchange rates of India, Indonesia, and South Korea began to fall from the middle of 2007. For Thai and the Philippines, the exchange rates had been appreciating until the beginning of 2008, but since then the rates have been falling till now. The exchange rate of Vietnam has been falling since 2006 and, as IMF pointed out, Vietnam is one of the countries which are under the critical situation.

Fig. 12　Exchange Rates of Japan, China, South Korea and EU against US dollar



Source: FRB

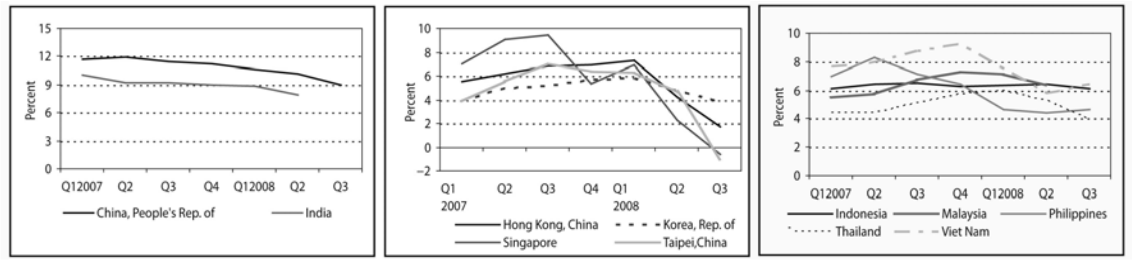
Fig. 13　Effective Exchange Rates of Asian Countries



Source: Asian Development Bank, T*he US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?*, Dec. 2008, p.47.

Surveying the economic growth rates of Asian countries and regions, those of China and India have not been falling sharply. On the other hand, those of Hong Kong, Taiwan, and Singapore have decreased rapidly. Japan’s economic growth rate of 2009 is estimated minus 2% according to the forecast of Bank of Japan. The economic growth rates of Indonesia, Thailand, Malaysia, the Philippines, and Vietnam have not decreased too much until the third quarter of 2008. But in the fourth quarter, GDP of these countries decreased rapidly. So the influence of the financial crisis is thought to have been not so serious in Asia in the first phase but gradually has had a strong influence on East Asian economy through the decrease of exports to developed countries. .

Fig. 14 Real GDP Growth rates of Asian economies



Source: Asian Development Bank, T*he US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?*, Dec. 2008, p.57.

Table6 Real GDP Growth rates of the fourth quarter of 2008

US	-3.8 %	China	6.8 %	Hong Kong	-2.5 %	Thailand	-24.4 %
Japan	-12.7 %	India	7.6 %	Korea	-20.8 %	Malaysia	0.1 %
UK	-5.9 %			Taiwan	-8.4 %	Indonesia	-3.6 %
Euro Zone	-5.8 %			Singapore	-16.4 %	The Philippines	4.5 %

For China, India, Taiwan, Hong Kong and Malaysia, rate are compared with the same month of the previous year

What was wrong?

What were the causes of the global financial and economic crisis? As we saw above, it might be clear that deregulations in financial markets, speculative transactions and the derivative dealings developed by the financial engineering are the direct reasons.

However, I think that the more essential problem should be found in the economic thought that places an excessive trust on the regulating ability of the market mechanism (monetarism) and the economic policies based on the thought. After 2000, this economic thought that had strengthened its influence since the Reaganomics in the 1980's became predominant with the appearance of Bush administration in the United States. Having thrown everything into the market mechanism, the regulations and the surveillance on financial markets have been weakening and the income inequality has expanded.

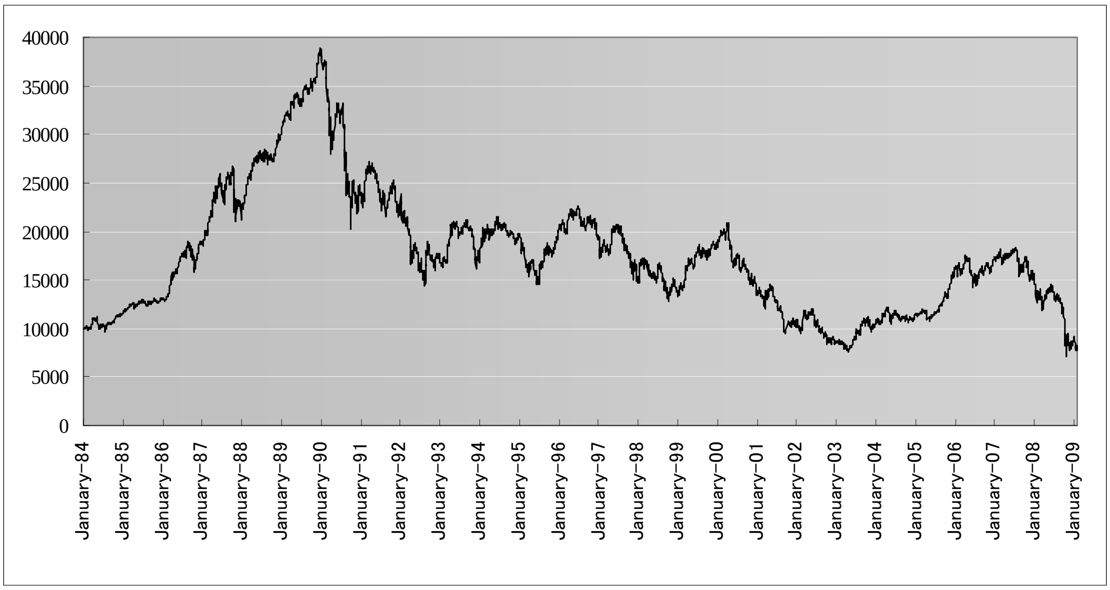
It is reasonable to conclude that the present financial crisis which has occurred from the subprime loans for the lower income bracket clearly shows the defects of such economic system and such an economic thought. Such an opinion as "Having lent loans to those who should not lend them is the cause of the subprime loan problem” is not wrong, but it is a more essential problem to have made up the system that produces those people, and lends money to them. After all, it might have been clarified that leaving inequalities uncontrolled makes the economic system essentially unstable.

Iceland aimed at being a financial nation, and Central and East European countries have introduced foreign investments and have been developing rapidly with the aim of westernization. But those countries are now in the middle of the financial crisis. This fact shows the importance of keeping the balance of the economic development. Since financial institutions in the United States are annihilated, the globalization by the financial capital of the United States and IMF that backs it up will also be facing its end.

What is the future of the World economy?

It is uncertain how long this crisis will continue. As long as the prices of houses keep falling and the default rate of mortgages keep rising, the prices of MBSs and CDOs will keep falling and the losses of financial institutions will be expanding. And if people feel anxiety about the economic conditions, their power of consumption might be sluggish. Japanese economy faced the serious recession caused by the collapse of the "Bubble Economy" in the beginning of 1990s. The recession had lasted for ten years since then. We are not still sure whether we have completely recovered from that or not (Fig. 15).

Fig.15　Stock Price Index of Japan (Nikkei average)



To overcome such a crisis, we have to admit that all we can do is to stick to the classical Keynesian policies of tax reduction, an interest rate cut, an increase in the money supply by the purchase of CP, and the public investments. The Obama Administration aims for "New New Deal" policies. However, the expansion of public investments will inevitably cause a budget deficit. If the capital doesn't flow into the United States from other countries, the exchange rate of US dollar will fall sharply. Therefore, the administration, in spite of their good start with great expectations from the American people, will be sure to be compelled to operate painful policies.

On the other hand, the Asian economy, compared with those of the United States and Europe, has not suffered a direct and a big damage by the financial crisis. Recession by a decrease in their exports is the biggest problem for Asian countries. But it may be possible for China and India to control the recession by stimulating domestic demands. In that case, the economic status of Asia will be getting more and more important in the global economy. To avoid recession, it is necessary for Asian countries to correct their domestic income inequalities and make the process of the economic development a more balanced one.

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