

# ASEAN Business Synchronization and Global Rebalancing

Bhanupong

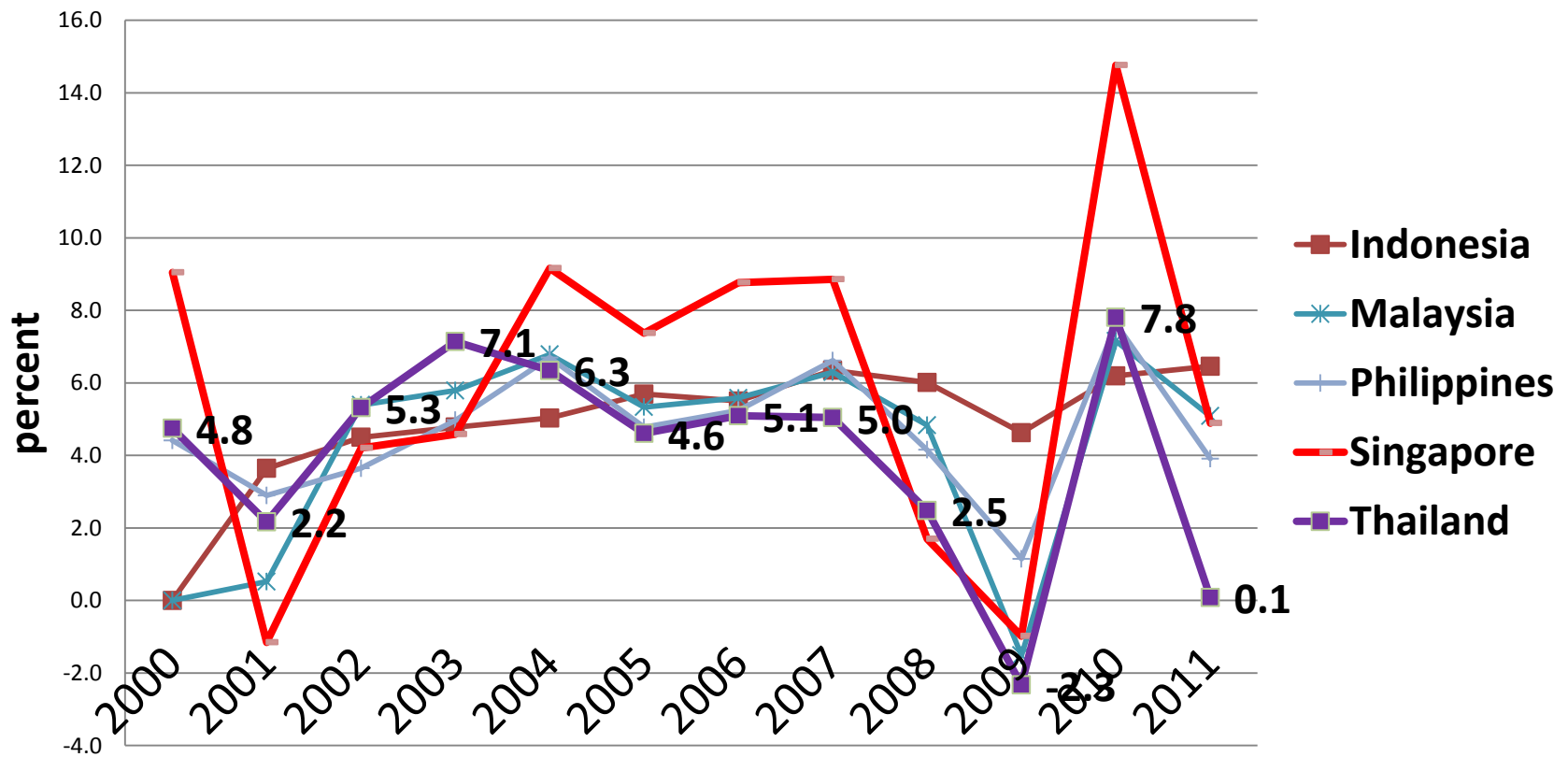
Lecture 21

# Main themes

- ASEAN business synchronization
- Determinants of investment-saving gap
- Balance of Payments Disequilibrium
- Global Rebalancing

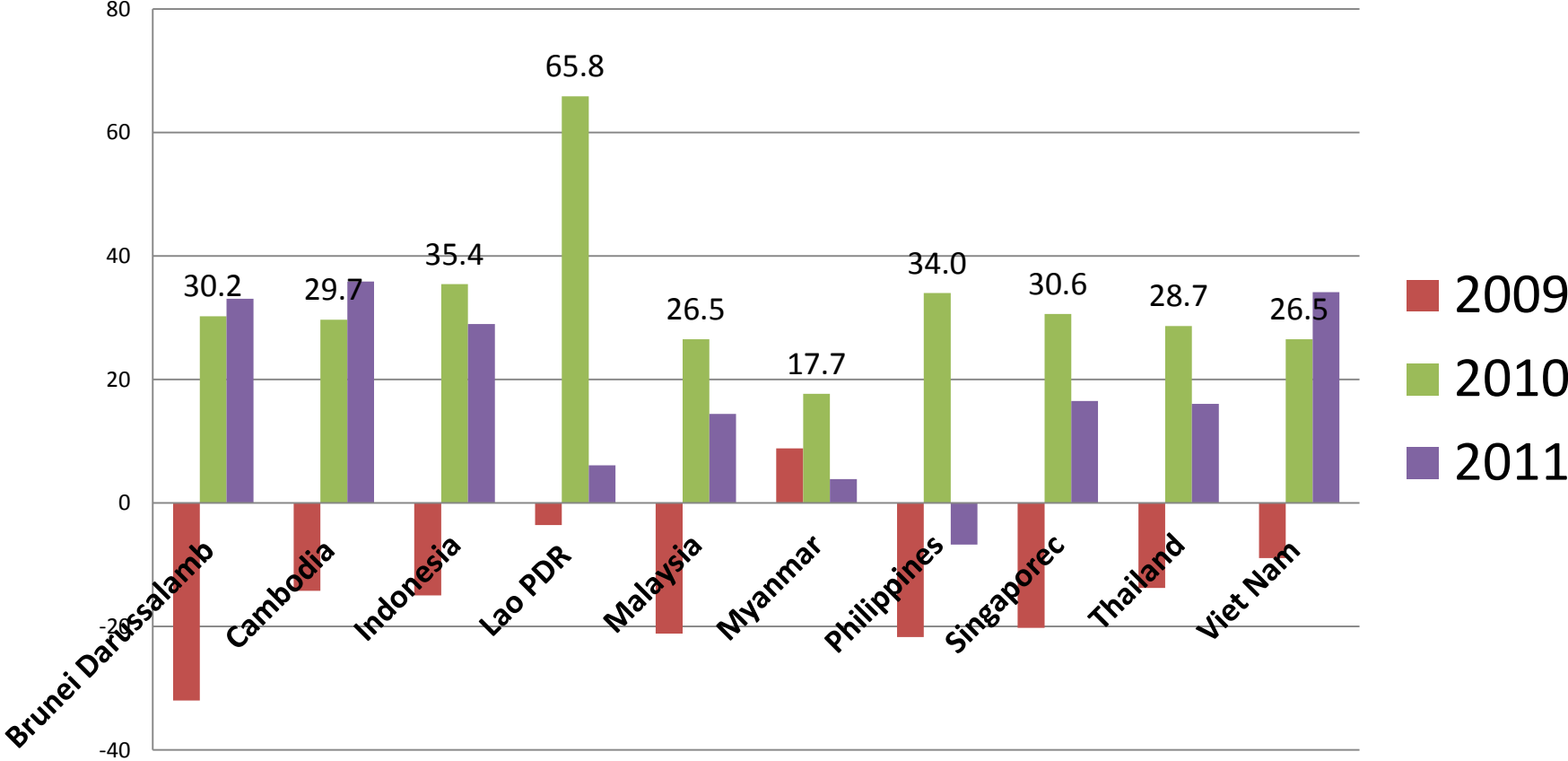
# ASEAN Business Synchronization

## GDP Growth: ASEAN 5



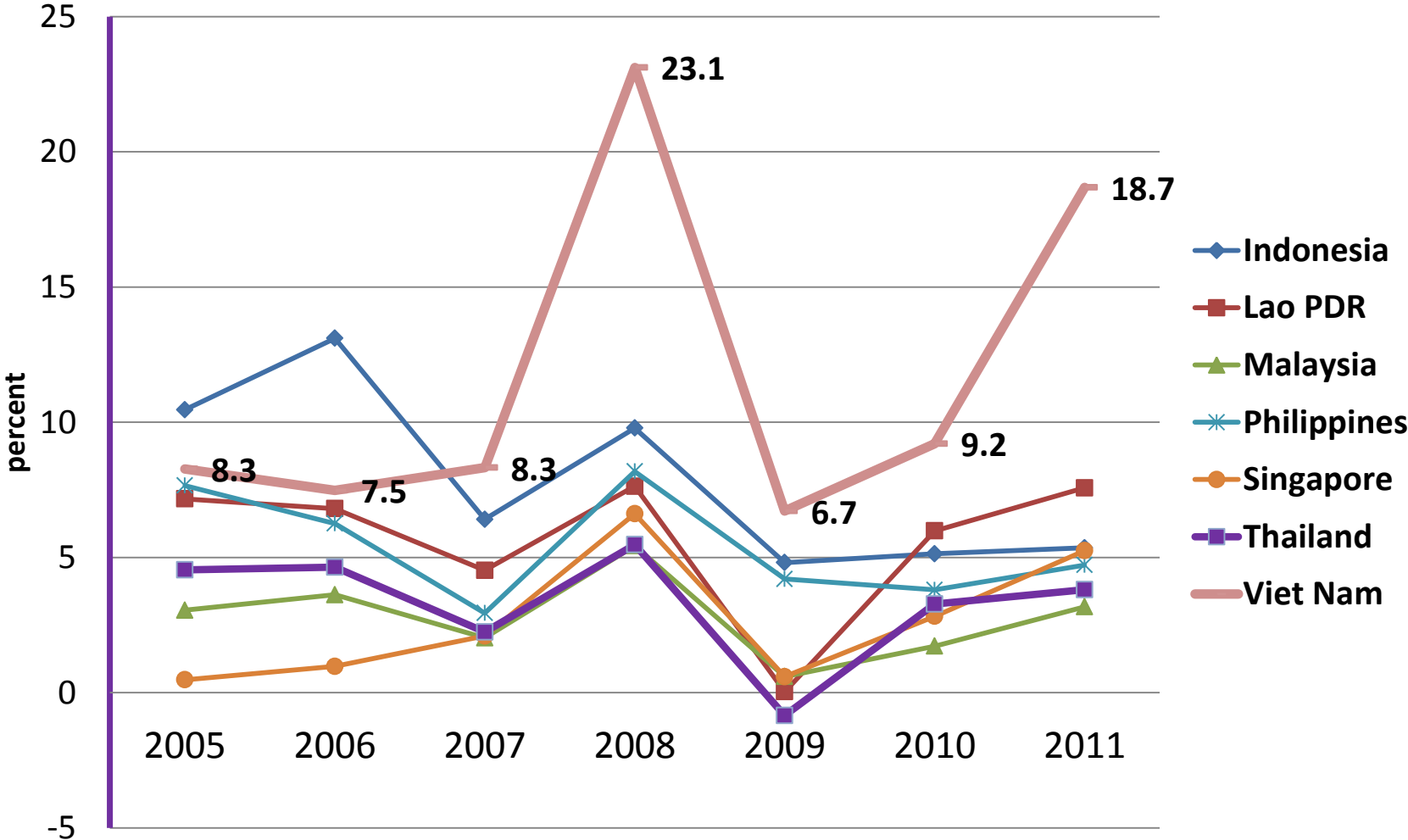
# What do ASEAN nations have in common?

## Impact of GFC on Exports (% growth)



# Inflation synchronization

## Inflation in Southeast Asian Economies



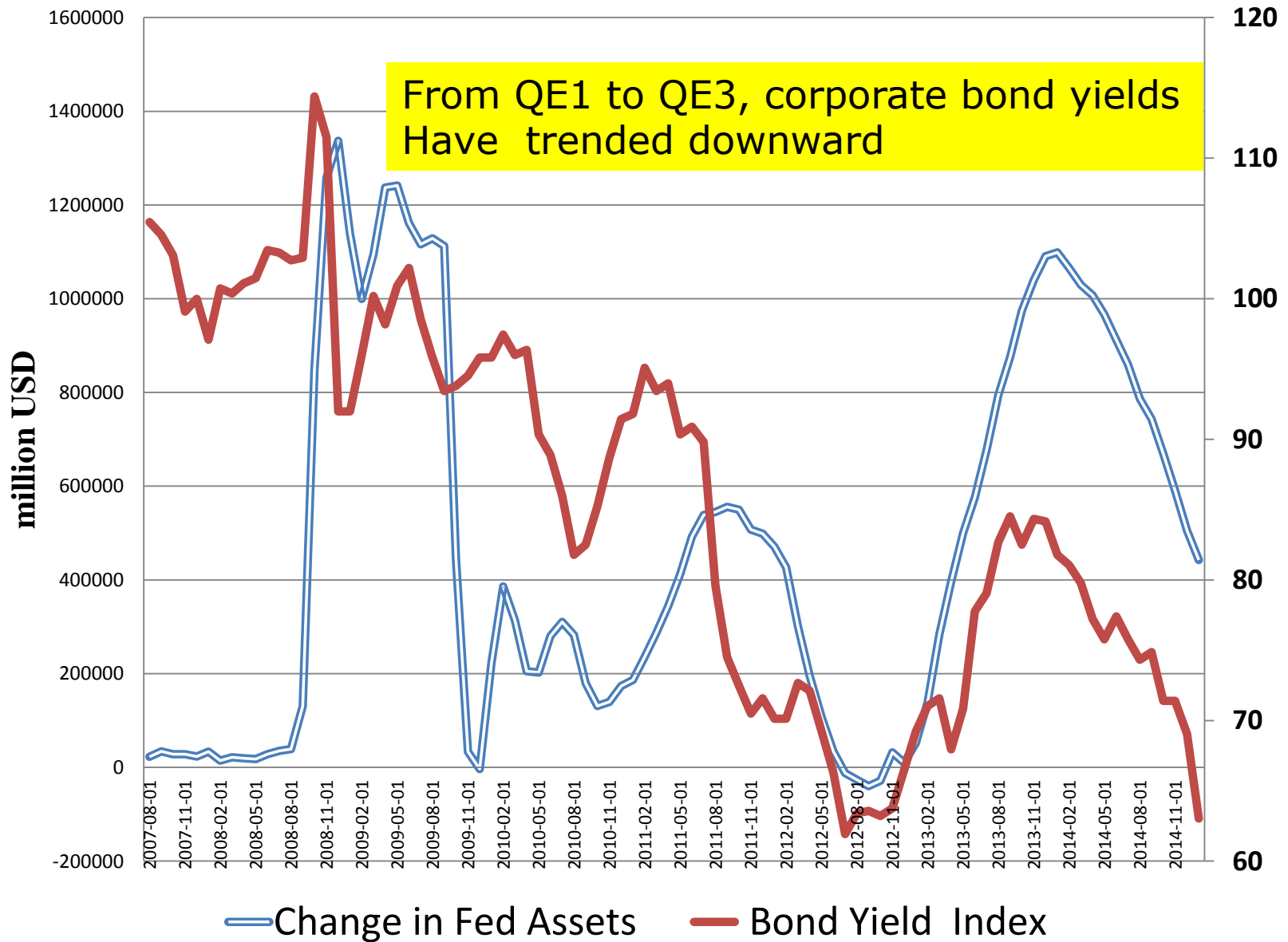
## BOT policy rate and Federal funds rate (FFR)



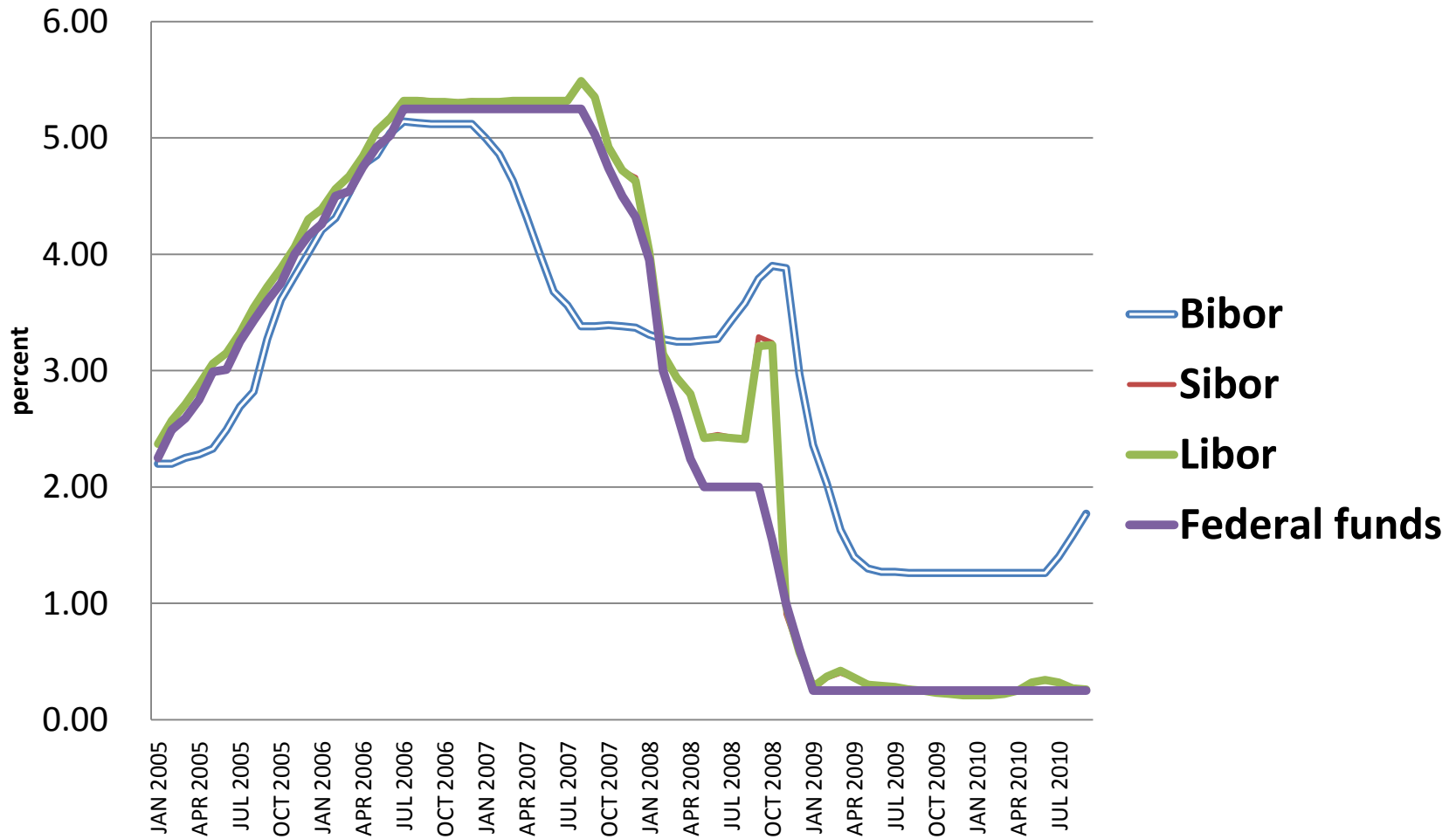
# Interest rates and bond yields

- Short vs. long term interest rates
- Investment depends of cost of borrowing or long term interest rate (bound yields)
- Bond yields are negatively related to prices of bonds
- When the Fed buys corporate bonds, the price of bonds increases, depressing the yields from holding bonds.

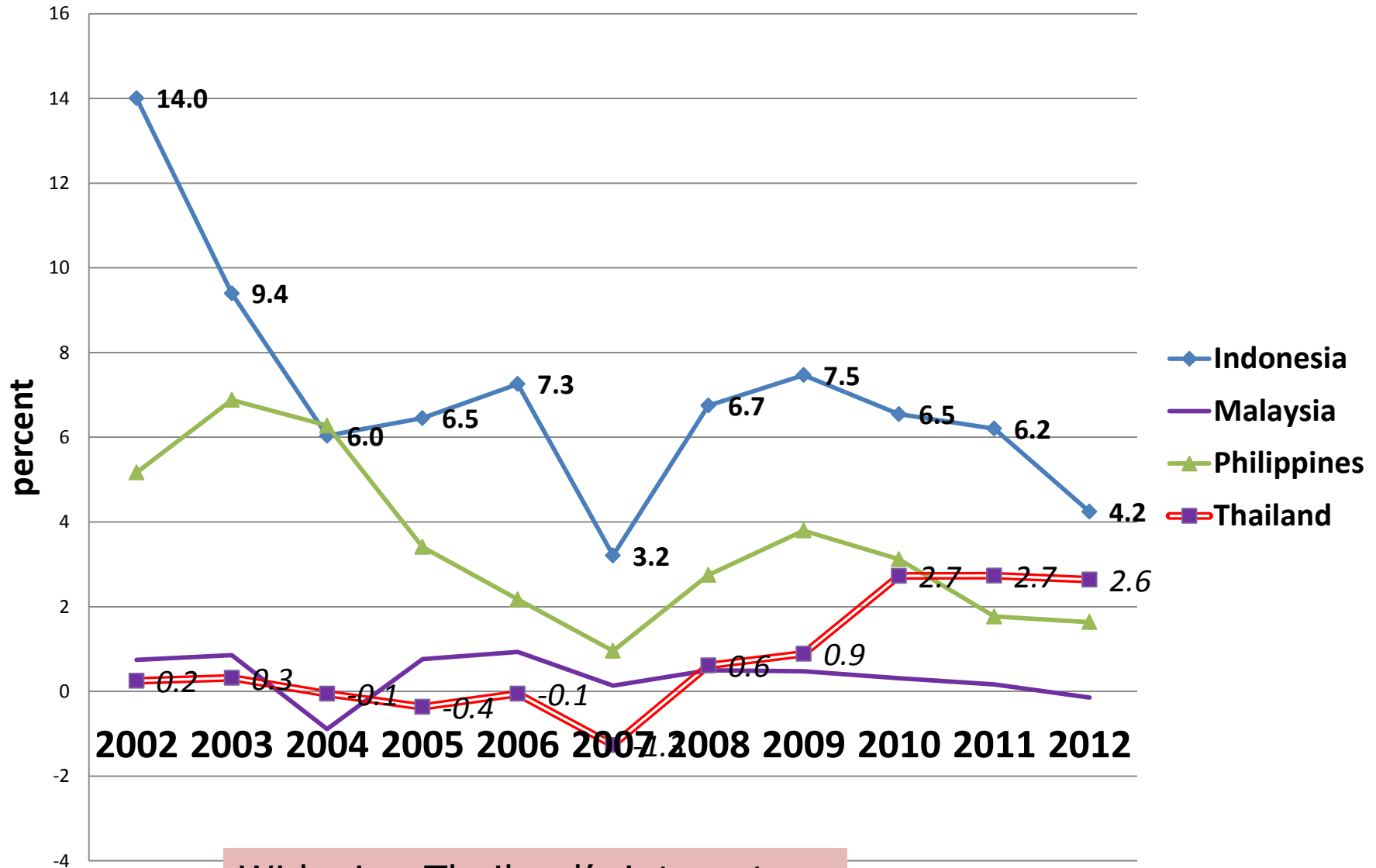
# QE and the US Corporate Bond Yields



# Interbank Offered Rates (IOR): Jan 2005-Sep 2010 (one week maturity)



# Money market rate differentials vis-à-vis Singapore



Widening Thailand's interest gap

# Financial globalization

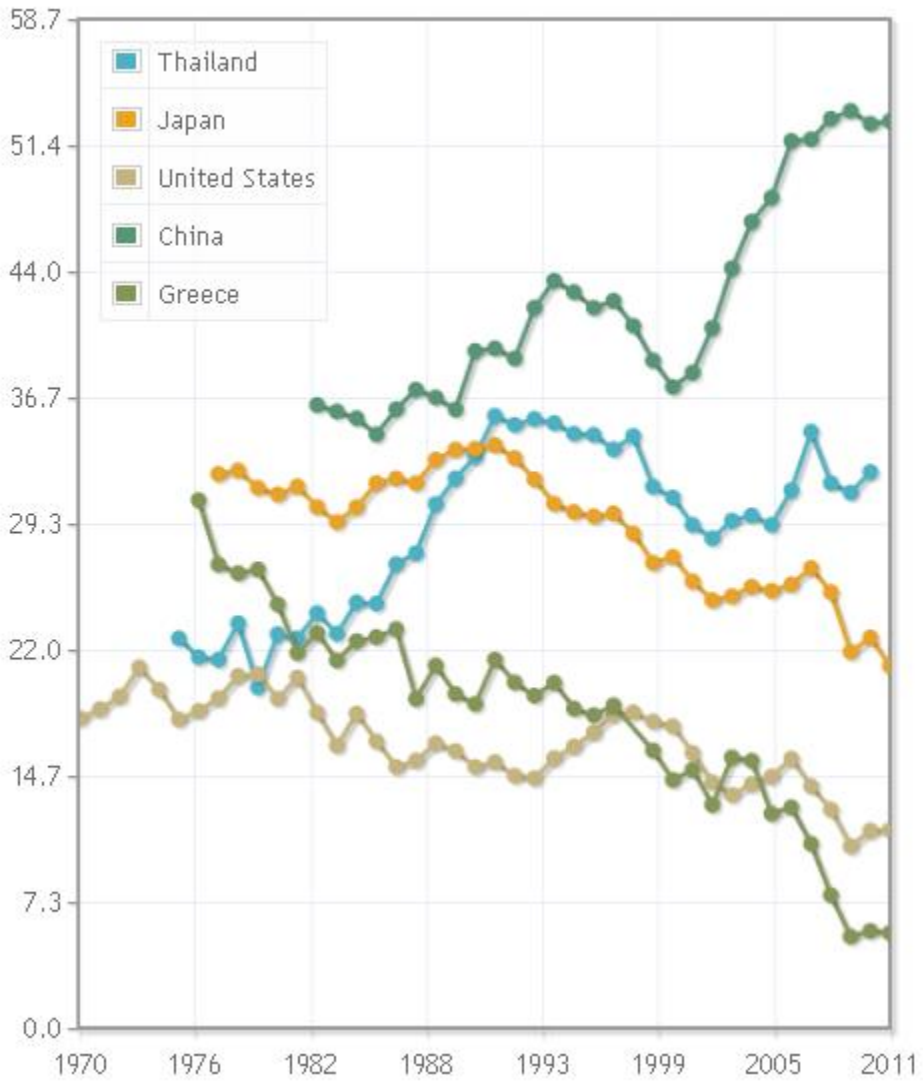
- Short term interest rates are closely related, reflecting free capital movements.
- Singapore's money market is more closely related to London, when compared to Bangkok's.
- Short-term money markets are less volatile in Bangkok, indicating higher degree of intervention by the BOT through adjusting the key policy rate.

# Saving and output growth rates

- There is a positive impact of growth on saving rate.
- $S/Y = f(g)$
- The faster the economy grows, the higher the saving rate.

# Gross savings (% of Gross National Income)

Gross savings are calculated as gross national income less total consumption, plus net transfers.

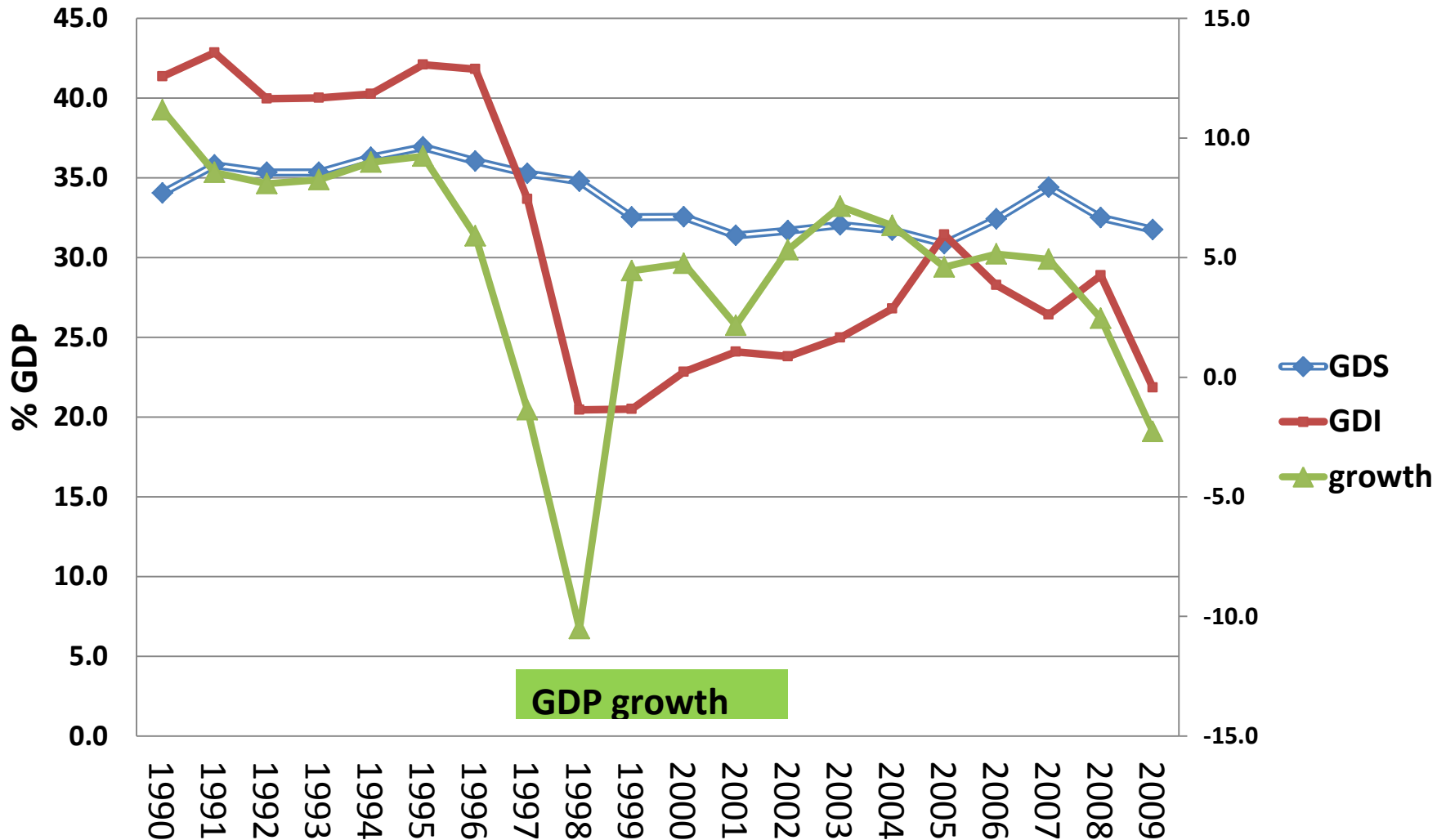


# Gross capital formation (% of GDP)

Gross capital formation (formerly gross domestic investment) consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories

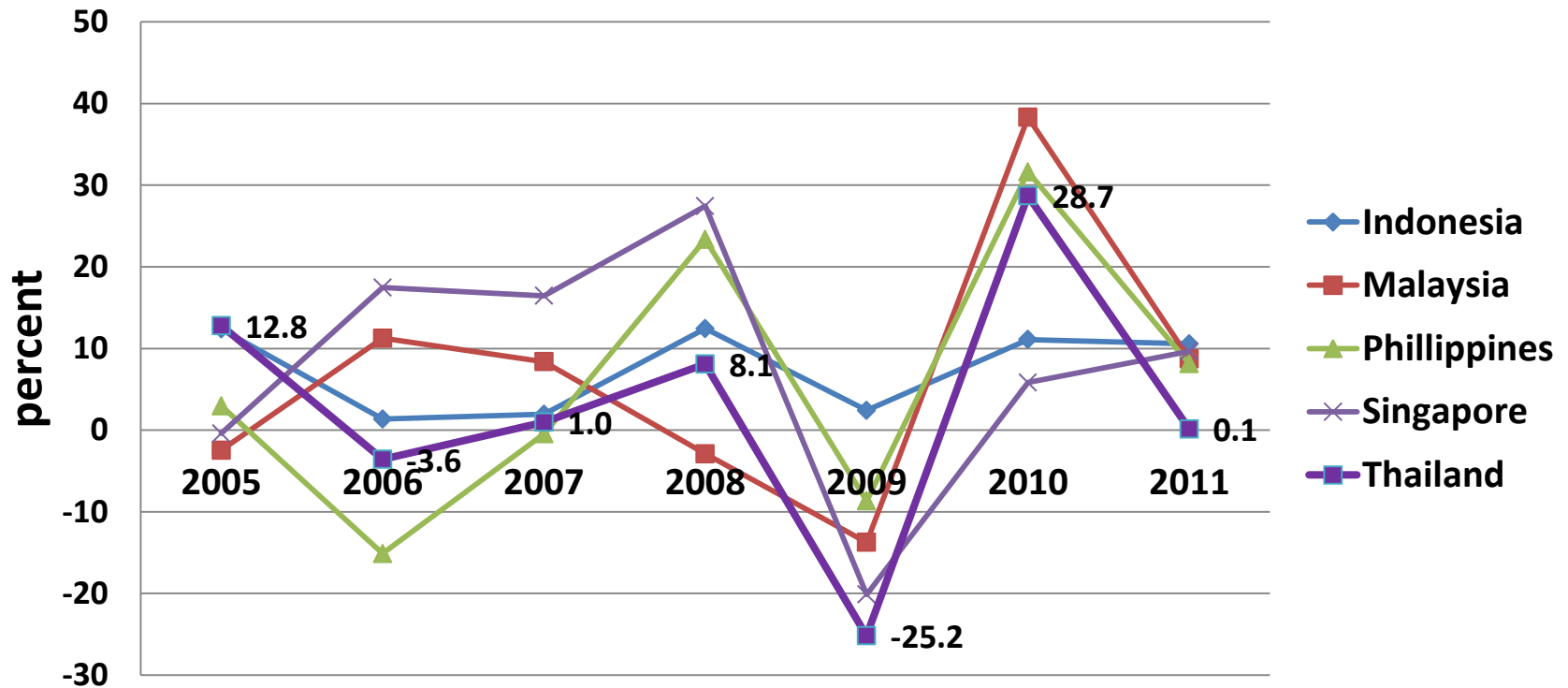


# Impact of output growth on Domestic Saving and Domestic Capital Formation



# ASEAN Investment synchronization

## Gross Domestic Investment (Rate of Change)



# Investment is induced by output growth

- Accelerator effect of output growth on investment: The faster the output grows, the higher the level of investment
- There are other factors determining investment rate: credit availability and the interest rate.

Balance of Payments (BP) equals net exports (NX) and net Capital Flows (CF)

$$BP = NX \left( Y, \frac{eP_f}{P} \right) + CF \left( i - i_f - \frac{\Delta e}{e} \right)$$

$\frac{\Delta e}{e}$  = expected depreciation

If people expect the baht to depreciate against the dollar, Capital outflow would take place

Widening interest gap would also lead to capital outflow

# Interest rate differentials

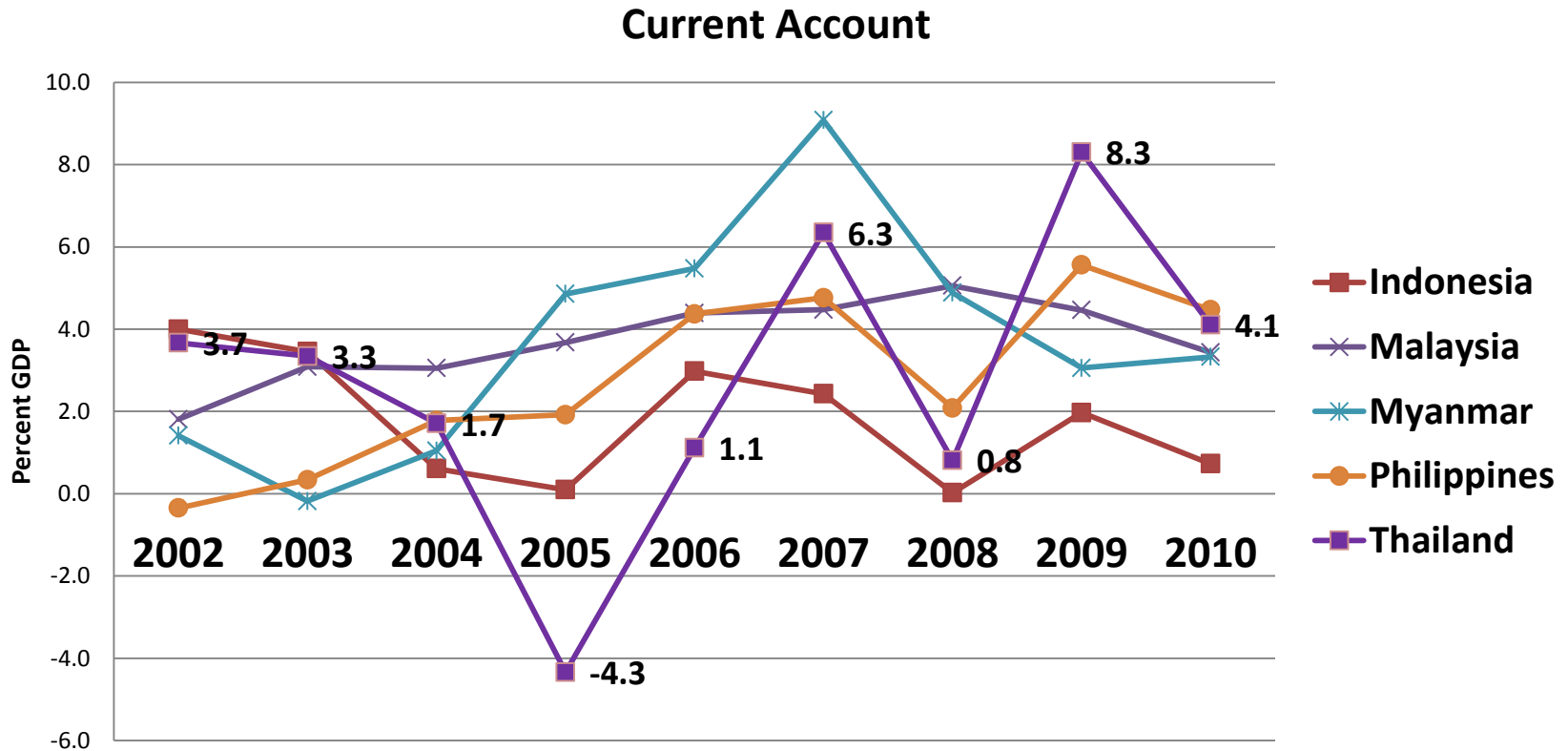
## BOT Policy rate and Federal Funds Rate



# ***Determinants of current account balances ( a subset of balance of payments)***

- Output growth
- Real interest rates
- Capital inflows
- Inflation
- Exchange rates
- Fiscal imbalance
- *These determinants are intricately related.*

# What do ASEAN countries have in common?



# Why does strong growth lead to current account deficit?

- Output growth leads to strong demand for imports of raw materials and capital goods.
- If growth is not export-driven, growth can lead to problem with current account.

## Why strong growth may lead to problems:

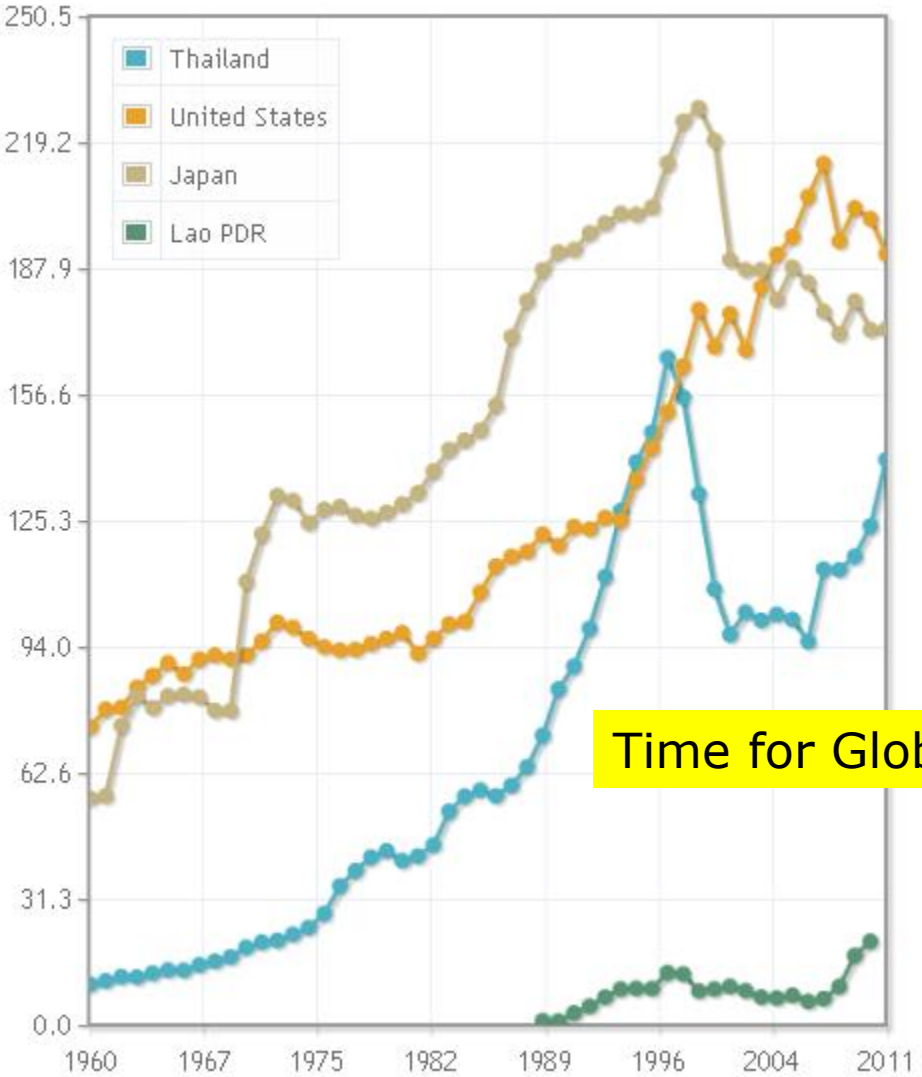
- When investment rises faster than savings,
- When bank credit grows faster than deposits.
- As investment-savings gap is widening,  
Current account deficit deteriorates.
- During economic downturn, we may observe surplus current account.

# Global Imbalances

- China experienced balance of payments surplus against the US and rising international reserves
- While the US encountered deficit balance of payments and rising debt
- ASEAN countries exports to China more than imports from China: They ran trade surplus against China.

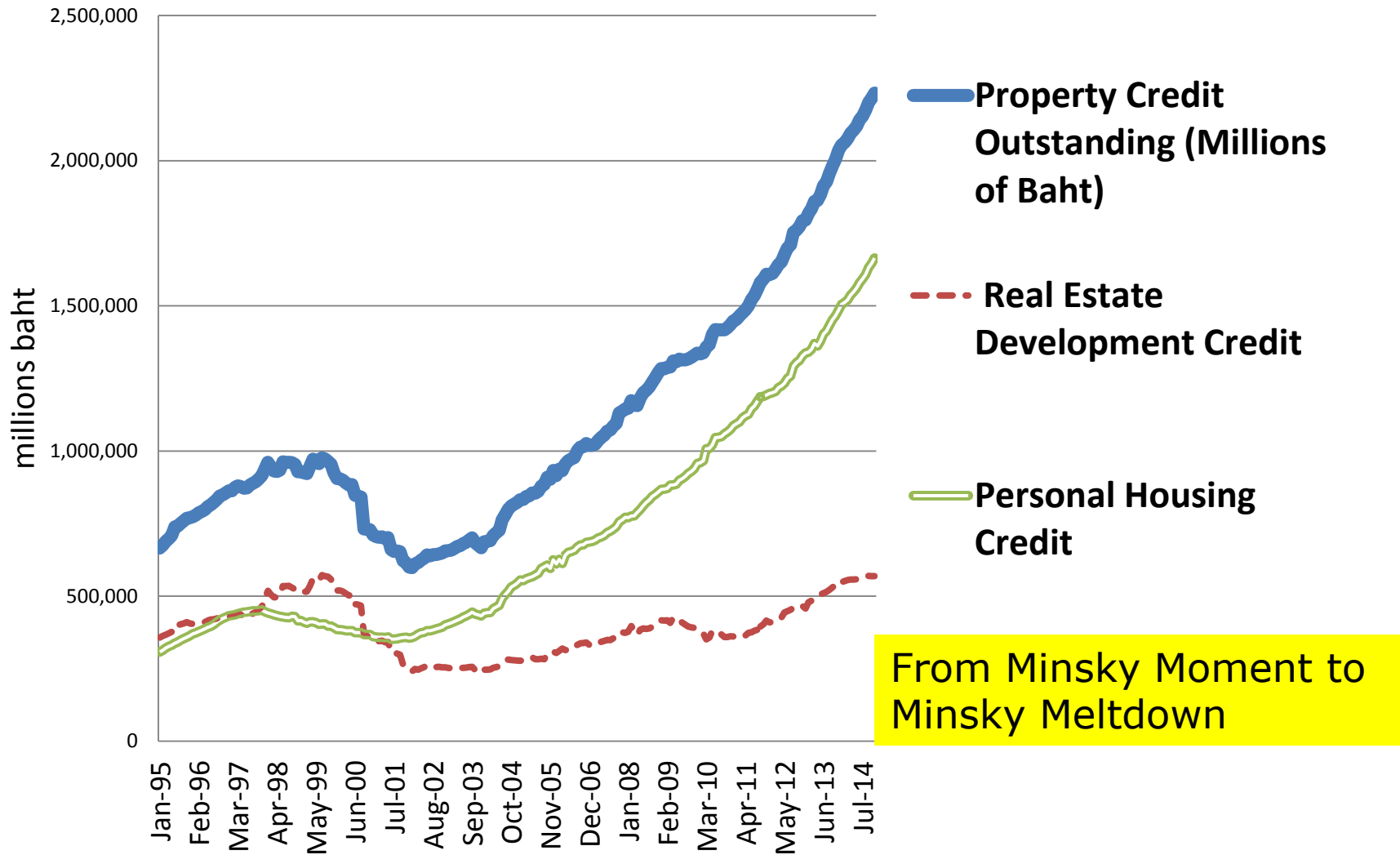
# Domestic credit to private sector (% of GDP)

Domestic credit to private sector refers to financial resources provided to the private sector, such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment.



Time for Global Rebalancing

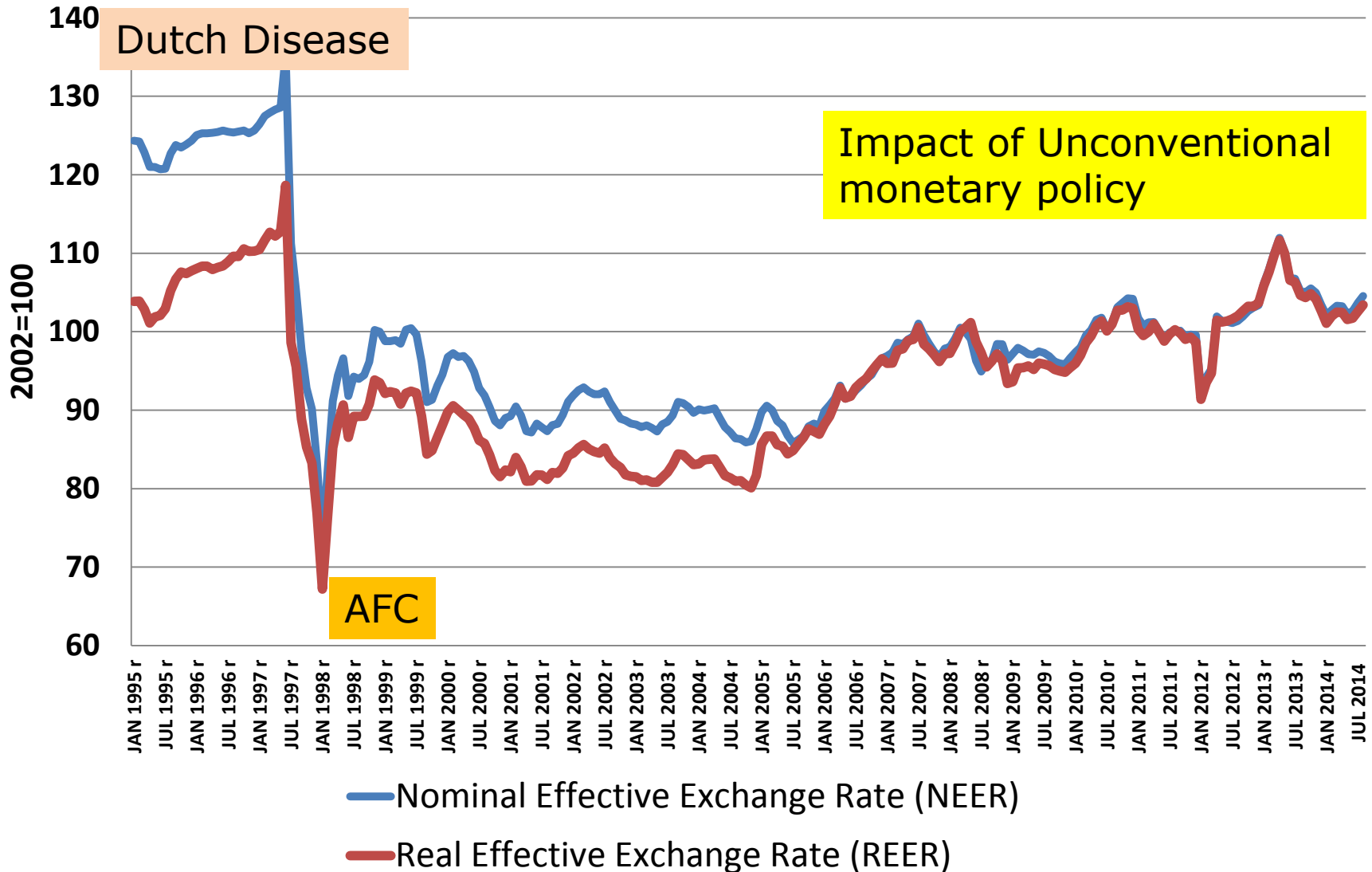
# Property Credit Booms



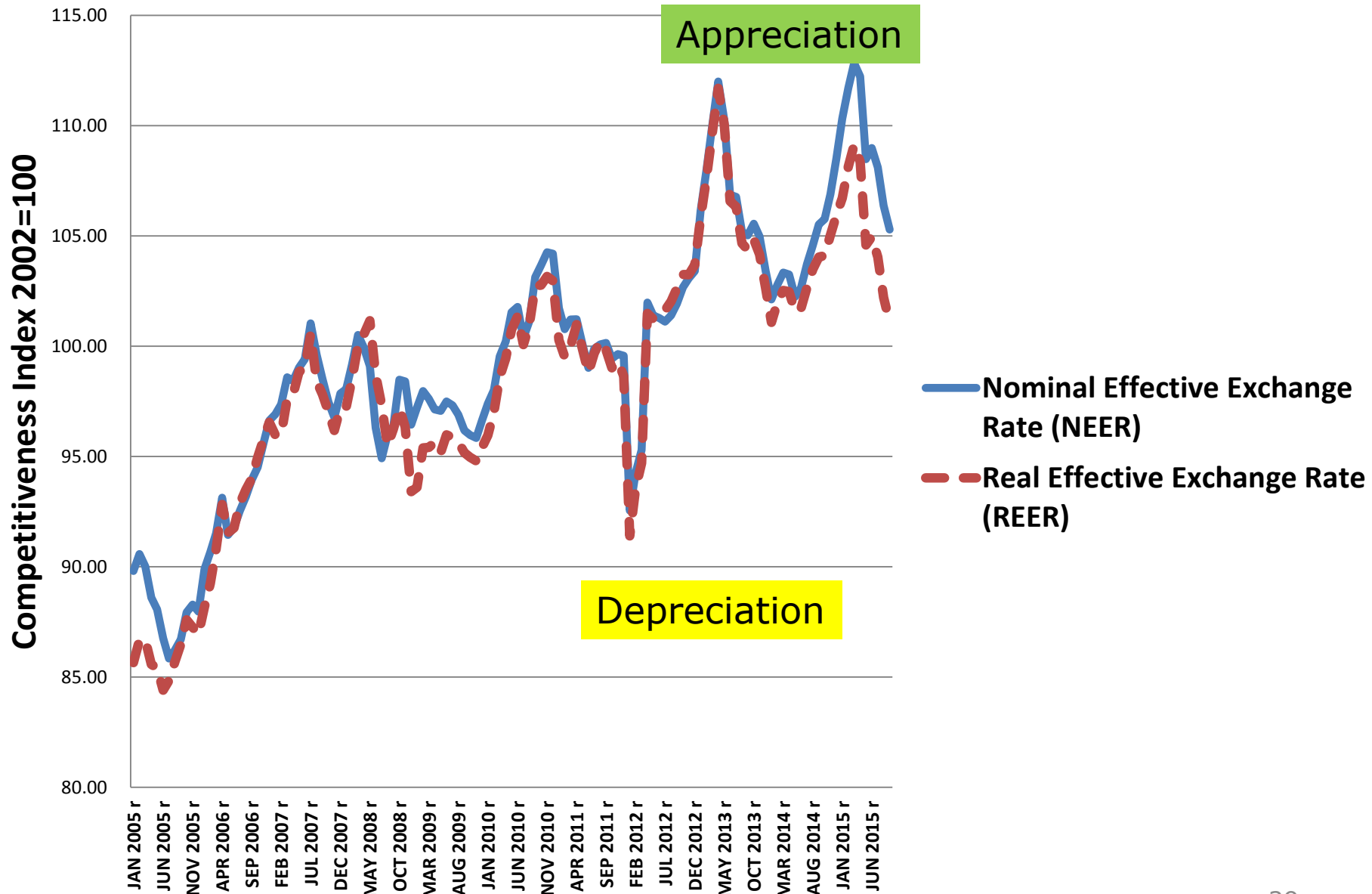
# A conventional strategy

- Growth is the first priority, in particular export growth.
- Capital inflows propel private investment.
- Exchange rate appreciation should be delayed as much as possible if high export growth is the target
- Exchange rate competitive (though unrealistic) exchange rates to drive exports.

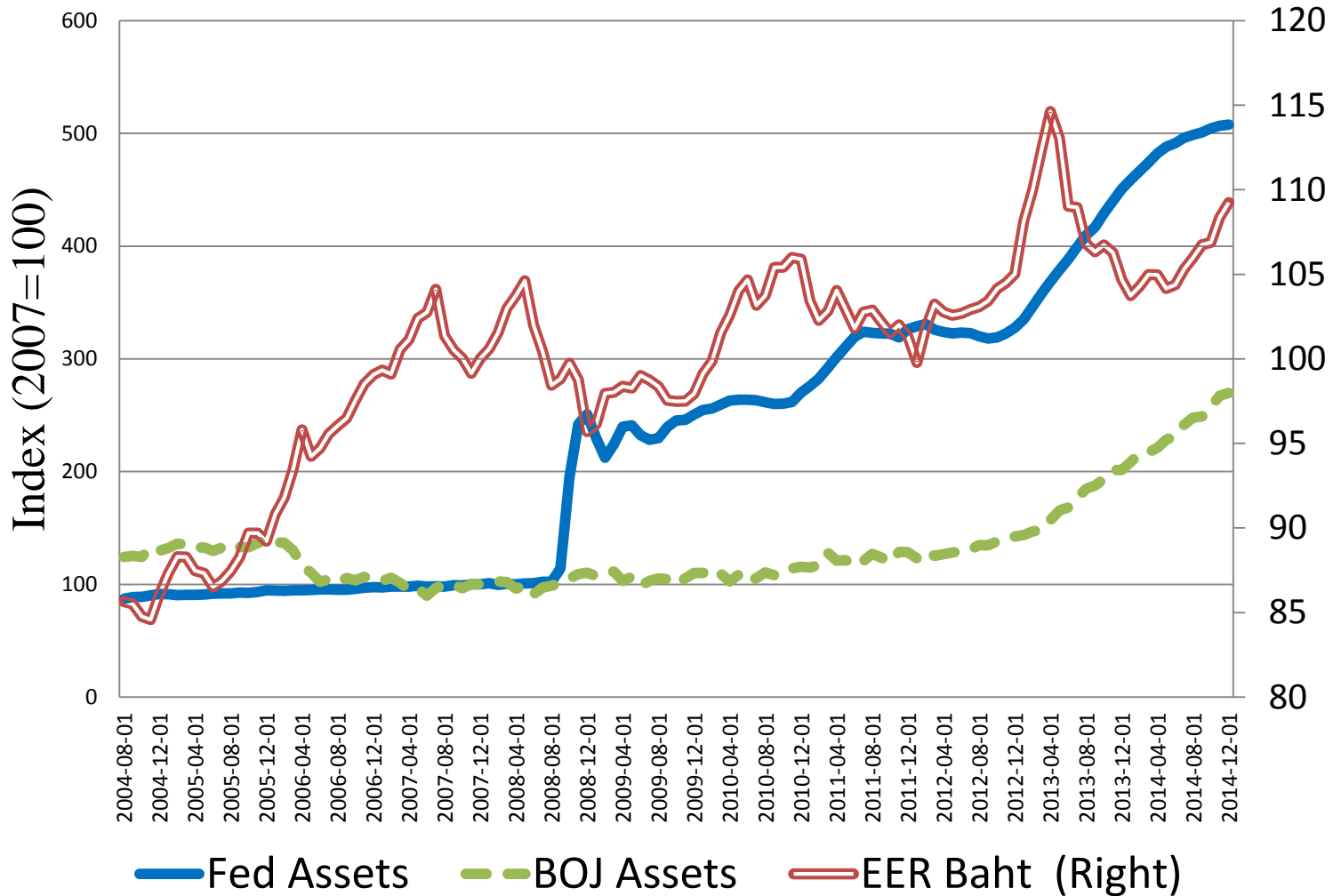
# Nominal and Real Effective Exchange rates: 1995-2014



# Effective Exchange Rate of the Baht



# QE and Thailand's international Competitiveness: Broad Real Effective Exchange rate (EER)



# The long run relationship

- Current account deficit takes place during the period of high growth, huge capital inflows, appreciating real effective exchange rate, and budget deficit.
- Strong output growth leads to deterioration in the current account.
- Capital inflows finance current account deficit.
- Appreciation of the REER leads to current account deficit.

- Current account surplus gives rise to output growth, while budget surplus has contractionary impact on growth.
- Capital flows are caused by rapid economic growth and currency appreciation.
- REER appreciates as capital account surplus is rising.
- In particular, after the Fed, BOE, and BOJ launched Quantitative Easing Monetary Policy.