

GURU SPEAK: WHAT SHOULD EMERGING ECONOMIES DO TO SURVIVE

Chaipat Poonpatpibul

For the past two weeks it has been clear that emerging market economies (EMEs) have not decoupled from the current global financial crisis. With their stock markets plummeting and exchange rates showing increasing volatility, an important question is whether EMEs can pull through this crisis.

The answer depends on the availability of a cushion and appropriate deployment of available policy tools. With exports slowing down in the second quarter of 2008 and prospects negative going forward, boosting domestic demand is crucial to alleviating the overall impact.

Most EMEs have announced fiscal stimulus measures including tax reductions, soft-loan provisions, utility-fee reductions and domestic stock purchases. Some have also eased monetary policy.

To support growth, trade diversification to markets relatively less affected by this financial crisis, like the Middle East, will also be important.

Aside from the financial-centre states, the EMEs with higher levels of short-term debts are more exposed to massive shifts in capital flows.

External and financial-sector resiliency becomes the key buffer against the present pressures, and the EMEs that have learned the importance of foreign reserves from their past crises will be in a better position to cope with capital outflows.

As asset bubbles frequently precede financial crises, the resiliency of several EMEs also hinges on a much slower pace of rising home prices compared to the US and many European cases.

Those EMEs that have implemented cautious prudential and supervisory policies to prevent asset bubbles will have realized this benefit firsthand.

Readiness to provide sufficient liquidity in times of market stress has epitomized the recent rescue operations of the G3 and will also be vital for EMEs.

During the present turmoil, the most crucial task of policy-makers is to restore and enhance confidence.

Emphasizing clear, timely and consistent communication from all authorities and enhancing public understanding of the negative impacts are essential to dampening the psychological effects of news and information from diverse sources.

At the regional level, coordination in crisis prevention and management among EMEs will further boost confidence and limit damage. It will also prevent potentially undesirable repercussions from an individual economy's measures on others during these difficult times.

Is there any light at the end of the tunnel? Yes, but few economies will escape this financial crisis unscathed. Although financial markets have calmed down somewhat in response to the concerted commitment by G7 governments to ensure the viability of financial institutions and financial markets, the episode is likely to be far from over.

How severe the wounds will be depends on how well prepared strategy is, including good cooperation from private and public sectors.

History has demonstrated time and time again that surviving crises depends critically on the ability to minimize the panic-stricken reactions of the public throughout a turbulent period.

Source: The Nation