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# Emerging Economic Entity Crises in Post Financial Crisis Era –The impact and countermeasures against the escape of America from quantitative easing policy

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**Abstract.** Five years from the eruption of financial crisis in 2008, the global economy is also on its way to the restoration, among which the emerging economic entities, typically China, India, Brazil, South Africa, Indonesia, etc., have rapidly run away from the crisis and led the recovery of global economy, which may be considered as the engine of global economy growth in the post financial crisis. While, with the America declaring that it would gradually reduce the quantitative easing (QE) scale and escaped from the quantitative easing policy in the mid 2014, the fluctuation of global financial market was rapidly intensified, and the risk assets were largely sold off, with the emerging economic entities suffering serious impact. Furthermore, the anxiety about the "third round of financial crisis will burst out due to the emerging economic entities" is increasingly intensified. This article will first analyze the current economic situation of main global economic entities, discuss about the impact of America's escape from QE on the emerging economic entity and its mechanism, and finally propose the countermeasures for China.

**Keywords.** quantitative easing policy; emerging economic entity crisis; countermeasure

## 1 Introduction

In 2008, the financial crisis erupted and was rapidly spread over the world, with the global economy seriously impacted. As seen from Figure 1, the actual global GDP in 2009 dropped by 1.3%, among which the GDP of developed countries were dropped by 3.6%. With various countries successively releasing the financial currency policies to rescue the economy, the global economy was gradually recovered. In 2012, the actual global GDP in 2012 increased by 2.7%, among which the emerging economic entities and developing countries, typically China, India, Indonesia, etc., were increased by 5.2%, which can be considered as the engine of global economy growth, and the global economy was also on its way to the restoration.

With the combined impacts of synchronously released unlimited amount of easing currency policy by central bank of developed economic entities, the global economy has a new hope of restoration, and the financial market is also extremely encouraged. Seen from the Figure 2, the growth speed of main global economic entities fluctuated in the low rank of 2011-2012, and increased in 2013. The GDP growth speed of link relative ratios for China and Indonesia were both more than 1.4% in the first two seasons in 2013. And the growth speed of Turkey, Korea and Brazil were over 1% in the second season, which led the growth of global economy.

But it shall be noted that, after US Federal Reserve sent the QE signal, the fluctuation of global financial market increased sharply, and the risk assets were largely sold off. In May and June, the emerging economic entities suffered serious capital outflow, which made people worried about the eruption of the third global crisis. Therefore, the International Monetary Fund (IMF) pointed out in its released update of *Global Economy Envision* in July 9 that the current risk of global economy is increasing, especially in the emerging economic entities.[b] The correct assessment of impact of America's escape from QE on the emerging economic entities including our country is the key to efficiently respond to the challenge and realize the stable growth of economy.

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[b] Global Economy Envision of International Monetary Fund, Issue 7, http://www.imf.org/external/ns/cs.aspx?id=29

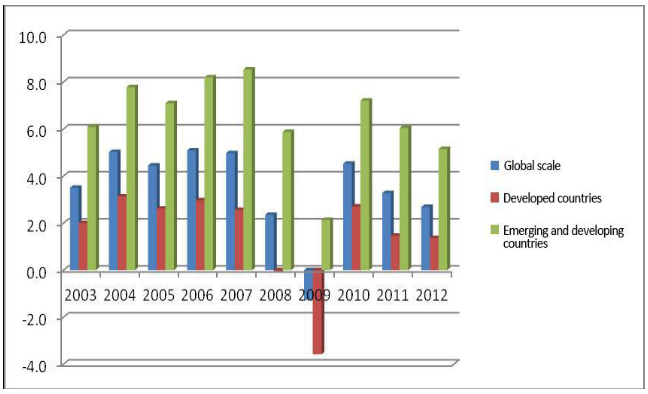


**Figure 1.** Actual global GDP growth speed in 2003-2012 (%). (Data source: IMF database)

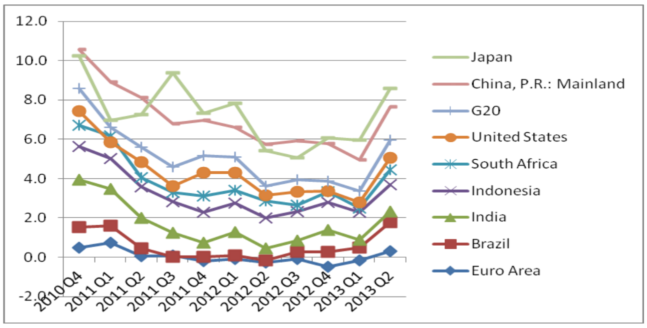


**Figure 2.** Seasonal GDP growth speed of some world economic entities in 2010-2013. (Data source: IMF database, database of China National Statistics Bureau)

## 2 Impact of America's escape from QE on the emerging economic entities

The economic impact of America's escape from QE was serious indeed. In June 19, 2013, due to the implication of Bernanke that the assets purchase scale might be reduced later this year, namely to reduce the QE3 scale. All the three stock indexes of stock market in New York were declined, with the rate over 1%. While the dollars were largely increased due to this good news, and meanwhile the RMB exchange rate declined for successive three days. In September 2013, US Federal Reserve declared that it did not quit from QE temporarily, and the stock exchange market of emerging market rebounded largely.

Actually early in the second season of 2013, with the intensified worry of investors on the escape of US Federal Reserve from the quantitative easing policy, the investor capital successively left the emerging market, which made the stock market in Latin America, Aisa-Pacific and other regions largely declined. The stock market in Brazil, Russia and China in the first half year "led in the world", with their decline rate respectively 22.14%、16.47% and 12.07%. From May 22 when Bernanke, the chairman of US Federal Reserve quited from QE3 signal to June 13, the MSCI emerging market index has accumulatively declined by over 10%. As shown in EPFR data, the one-week net outflow scale of emerging market country has created a new record in recent three years, being up to 5 billion dollars. [a]In summary, there are three impacts of America's escape from QE3 on the emerging economic entities:

1. Currency depreciation in emerging countries.

With America's escape from QE, the America's market interest rate will be increased so as to attract the international capital originally flowed to the emerging economic entities to reversely flow to America, so that the dollars will be appreciated, and the national currency of emerging economic entities depreciated. In such case, the currency depreciation reversely accelerate the capital outflow, which further worsened the economic situation and international balance of payment. As seen from Figure 3, since 2013, apart from RMB was slightly appreciated relative to dollars, and the currency of other countries were all depreciated, with the average depreciation 7.77%. The depreciation rates of India rupee, Brazil Real and Turkey new lira were up to over 10%, among which the depreciation rate of India rupee was the largest, namely 17%. We shall pay attention to this condition, because the current items of these countries are in deficit status all the year round. They will often depend on the capital inflow to compensate for the deficit of current items. In case that the deficit of current items are enlarged, and the capital inflow is reversed, the international balance of payment will be possibly worsened in a short time. In case of serious situation, the pressure of international balance of payment will appear. Before the eruption of financial crisis in Latin America and East Asia in 1990s, this case often happened. The historical lessons are worth to be learned. India, Brazil and other countries successively took the base measures against the capital outflow. India and Thailand central bank sold dollars to respond the decline of domestic exchange rate. In June 12, Brazil declared to relax restriction for part of the capital control measures released in 2010. In June 13, Indonesia increased the base interest rate. There's no doubt that increase of domestic interest rate will slow the domestic economic growth. The emerging economic entities countries shall correctly treat the relation for both.

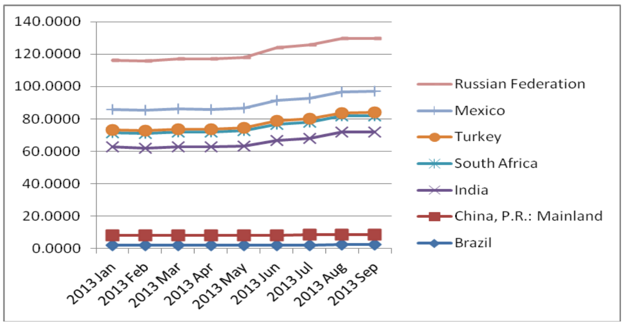


**Figure 3.** Exchange rate (direct exchange rate) of currency in emerging countries to dollars in January-September 2013. (Data source: IMF database)

[a]The logic between quantitative easing and global econo-my restoration--Seasonal Report of Global Economy Financial Envision of Bank of China (3rd season in 2013), Research Task Group for Global Economy in the International Financial Institute of Bank of China.

2. Outflow of international capital induces assets depreciation of emerging economic entities, with international attraction decreased and interest rate increased.

After financial crisis, a great number of international capitals came into the emerging economic entities market, which made its capital market largely increased. It shall be noted that in the assets flowed into these countries, a considerable part belongs to short-term assets with high liquidity. With the recent domestic assets strain in developed countries, the risk of emerging economic entities assets was increased, with the attraction of international assets decreased. The outflow of assets into emerging economic entities, plus the infection effect of capital market decline of developed economic entities, caused decline in prices for a part of emerging economic entities assets. In the future, the global assets may keep the trend to escape from the emerging market, and the increase of market interest rate and bonds yield rate and the recovery of dollar index may return the assets into America. The liquid short-term of emerging market may face a great pressure. Apart from the accidental increase of liquidity by Chinese central bank, the market liquidity strain among the banks in first half year in China and the sharp increase of inter-bank borrowing interest rate, part of the reasons for tightening the funds face is induced by the short-term capital outflow caused by escape of QE3 from the expectation.

3. International bulk assets price decline causes decreased export income for part of the emerging economic entities countries and further worsening of international balance of payment.

Recently, the global economy growth speed is slowed and not prosperous. The slowed demand on bulk goods and finished product stops or even declines the increase trend of goods price, decreases the income of export goods for part of the emerging economic entities and worsens the trade balance. In the second half year, the decreased price of iron minerals, soybean and other bulk goods, and the slowed or even decreased demand of developed countries on the goods will make the international balance face for part of emerging economic entities face a more rigorous situation.

The weak economy, intensified inflation, capital flights and other economic problems induced social unrest in some emerging countries, which further weakened the investment attraction of these countries. Millions of Brazilians walked on the street to protest the government, and strike happened everywhere in South Africa. The investment environment in the India was undesirable. The Foreign Direct Investment (FDI) of the last year decreased sharply by 29%.

There are two main reasons for crisis that may be induced by emerging market. In view of external causes, as the investor expected US Federal Reserve is about to quit from quantitative easing measure, the increase of dollar assets attraction will cause the global assets to re-adjust the investment layout and returned to developed countries from emerging market. The capital flight will impact the financial market and increase the financing costs of emerging market, so as to damage the economic growth. While, we shall pay more attention on the internal reasons for economic speed decrease of emerging market: the structural reform delay cannot be handled by existent development mode. For example, the problems faced by Brazil include the over low ratio of investment in GDP, excessive external financing dependence, poor educational quality, backward infrastructure, excessive trade protection measures, etc.. While the India economy is falling into the "stagflation" trap, and faces the serious deficit of current account, low economic efficiency, insufficient market opening and other problems. The Russian economy never succeeds to get rid of the over-dependence on the resources.

## 3 Chinese countermeasures

The America's escape from QE will have an adverse impact on Chinese economy. And thus the emerging market economy will be worsened and currency largely depreciated, which cause reduced import of emerging market countries from China, so as to hinder the Chinese export and impact the stable growth of Chinese economy. Since 2013, under the expectation of America's escape from QE, the financial markets in India, Indonesia and other emerging economic entities countries fluctuate, and are even subject to risk of financial crisis, of which the essence is that the outflow of currency policy in US Federal Reserve caused the decreased independence of currency policy for emerging economic entities, while the economic entities with rigid exchange rate system, blind opening capital items and unreasonable debt structure are attacked very hard.

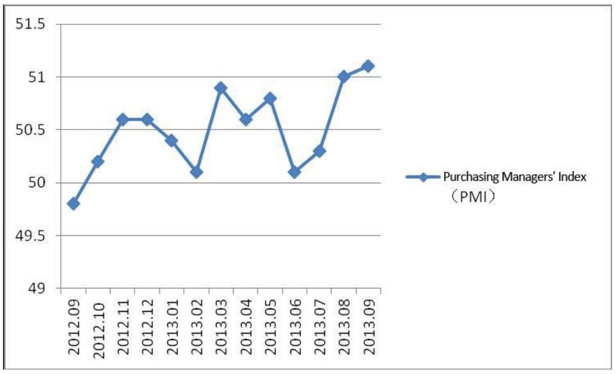


**Figure 4.** PMI index from Sept. 2012 to Sept. 2013 in China (%). (Data source: database of China National Statistics Bureau)

In contrast to the above countries, China kept its status in the sharp decline of currency exchange rate in this round of emerging market, and maintained the up-trend to dollars. Since 2013, in the powerful appreciation background of dollars, RMB was still appreciated by 1.4%. In the light of basic aspect of economy, the maintenance of surplus for current item and the recovered foreign trade situation were its powerful support. From the change in Purchase Manager Index (PMI) of manufacture industry, we can see the basic trend of Chinese economy. As seen from Figure 4, since 2012, PMI index is increased in the fluctuation, indicating that the basic aspect of economy is becoming better. In September 2013, PMI of Chinese manufacture industry was 51.1%, 0.1 increase compared to that in the last month. The continuous rise for 3 months indicates the Chinese current economy is increased with stability, and the uptrend of economic growth for three seasons is expectable. But the only increase of 0.1 percent, obviously reduced range, indicates the uptrend power of economy is not strong, and the future economic growth will generally present the stable trend.

The impact of America's escape from QE on Chinese market is not that obvious compared to that on India and other countries, but in the influence of "integration of global economy" and the large background of global assets back flowing to developed market in Europe and America, the domestic currency market and foreign exchange market will make response. Firstly in the light of entity economy, the emerging market economy will be worsened and currency largely depreciated, which cause reduced import of emerging market countries from China, so as to hinder the Chinese export. Secondly, the pressure of assets outflow from emerging market on China is not serious temporarily, but not optimistic in the long run. In the turning point of global liquidity, the "being strong" of RMB on emerging market currency may induce surplus contraction of current items, which will intensify the assets outflow pressure.

Furthermore, the intensified expectation of RMB depreciation will increase the risk of liquidation debt. Even China holds a large number of foreign exchange reserve, the surplus situation of current item will not change in a short-term, but it does not mean to avoid the RMB depreciation expectation. In the peak of sub-prime mortgage crisis and European debt crisis, if RMB unilateral depreciation expectation lasts a long time, the domestic enterprise will increase the foreign currency assets and RMB debt. The liquidity supply, assets price of domestic currency market and confidence on Chinese economy will be hit hard. In addition, the pressure from several raw material department and other import agent and the gradual escape of US Federal Reserve from quantitative easing policy will lay a declining pressure on bulk goods pressure, and the production and profits of relevant domestic bulk goods enterprise will be impacted.

In current situation that America is about to escape from QE3 and emerging economic entities may be in emergency, Chian may respond in the following aspects:

Firstly, stably facilitate the Chinese financial market, foreign exchange system, perfect the stable operation mechanism of capital market and improve the risk resistance of financial market and foreign exchange market. China has to construct a financial system structure in balanced development to realize the balanced development of bank and capital market. Facilitate the mixed business operation of financial industry, establish a uniform financial supervisory system. Meanwhile, China financial supervisory mode shall also be subject to corresponding adjustment. The unification of financial industry supervision has been the major trend. Furthermore, we shall facilitate the opening of capital account in order to realize the internationalization of RMB. We shall stably facilitate the process from transaction currency to priced currency, and from investment currency to reserved currency.

Secondly, we shall promote the economic development mode, industrial structure and export structure optimization by technical innovation to improve the quality of economic development. Intensify the technical innovation in the economic development, expand the possibility space of production by technical innovation, improve the product standard, promote the innovative ability of enterprise, accelerate the optimization and update of industrial structure, perfect the service system construction and finally form a harmony and unification of economic society and resources environment. Jointly use the global scientific resources, the global key elements in starting a business in China and obtain the core technology by foreign investment, etc.. Furthermore, we shall facilitate a wider production-study-research cooperation to provide a powerful support for enterprise technical innovation, make the backbone industries have their own core and key technologies and strengthen the self-innovation capacity and comprehensive competitiveness for enterprise. Strive to develop the emerging industry, optimize the economic structure and take the technical innovation investment as the most important strategic investment in the background of globalization of technical innovation.

Thirdly, we shall strengthen the cooperation with developed economic entities and the cooperative win-win among the emerging economic entities, as well as the system construction of horizontal cooperation. In the sustained decline of GDP growth speed in the current emerging economic entities, especially in BRICS, each field of society commonly pays attention to the sustained development for emerging economic entities. The slowed GDP for current emerging economic entities is inevitable, as the treatment of input inflation by emerging economic entities due to the extreme currency easing policy of developed economic entities must induce the slowed economy. While it does not affect the property of emerging economic entities conducive to economic development. China and other emerging economic entities countries shall get rid of the thinking set of traditional vertical cooperation. By innovating the development idea and strengthening the cooperation with development economic entities, it shall strengthen the cooperative win-win among the emerging economic entities, strengthen the system and mechanism construction of vertical cooperation, expand the vertical cooperation field, fully discover the potential of emerging economic entities, break the development bottleneck to realize the expansion of economic entity market, construction assets source, the sharing of scientific resources and finally realize the win-win.

In summary, though facing the short-term capital outflow, RMB depreciation pressure induced by America's escape from QE3, and the export decline and other factors induced by possible emerging economic entities crisis, China will not be seriously affected due to China's strict financial supervision, relatively independent foreign exchange market and excellent basic aspect of economy. China may also use this opportunity to perfect the capital, financial and foreign exchange market to facilitate the economy, transform the export structure and strengthen the cooperation with the wide emerging economic entities by technical innovation.

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