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IMPACT OF GLOBAL FINANCIAL CRISIS ON BUSINESS CYCLES IN DEVELOPING ASIA AND THE DECOUPLING HYPOTHESIS

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ABSTRACT

The global financial meltdown which was initiated by US based subprime lending market has led to the global financial crisis and the consequent economic crisis in the developed economies. Given the mammoth size of the crisis in the advanced economies some economists have started comparing it with the great depression of 1930s. There was a widespread optimism that the growth in the developing and emerging economies of East Asia would be decoupled from the difficulties that have pervaded the developed economies and the region would continue to move ahead as an autonomous growth pole. The present paper evaluates the impact of global financial crisis of 2008 on business cycles of major developing Asian economies by computing cyclical variation in their time series data. It reveals that the global financial crisis of 2008 has led the decline in the growth rate of the developing Asian countries and hence refutes the decoupling hypothesis. Moreover a very high rate of negative cyclical variation observed in the export figures of developing Asian economies in the year 2009 implies that the high level of global integration of these economies proves to be the major setback to the decoupling hypothesis.

KEYWORDS

decoupling hypothesis, economic crisis, global financial crisis, business cycles.

INTRODUCTION

After many years of impressive growth the world economy has experienced an equally important downturn that started in the third quarter of year 2008. The crisis was initiated by the financial meltdown in the US based sub prime lending market which later on led to the global financial crisis and the consequent economic crisis in the developed world. Initially many economists were optimistic that the growth in the developing and emerging economies of East Asia would be decoupled from the difficulties faced by the developed economies and the region would continue to move ahead as an autonomous growth pole. Such a view of number of economists was based on ample researches that have talked about some sort of decoupling of these emerging economies from the industrial world. Kose et. al (2008) observed that though there was substantial convergence of business cycles among the industrial economies and among Emerging Market Economies, but there has also been a concomitant divergence or decoupling of business cycles between these two groups of countries during the globalization period. They further suggested that even the existence of large spillover effects across financial markets need not necessarily imply real spillovers of similar magnitude. Rather the changing relative importance of global factors and group specific factors must be considered relevant in assessing the likely impact of such spillover effects. Pula and Peltonen (2009) though could not find any evidence of decoupling, but has calculated that emerging Asia is less “coupled” with the rest of the world than what is suggested by trade data. Fidrmuc and Korhonen (2009) have shown that in the last two decades the business cycles in the large emerging Asian economies and the developed economies have been quite different. Many developed countries have shown low or even negative dynamic correlations with China and India for the traditional business cycles which support the decoupling hypothesis. However their study has also argued that the increased co-movement of business cycles post 2008 crisis has at least represented a temporary setback to the decoupling hypothesis. Dooley and Hutchison (2009) also found evidence on decoupling–recoupling hypothesis as they have observed that emerging markets which were largely insulated and decoupled from the developments in U.S. financial markets from early 2007 to summer 2008 have later on responded very strongly to the deteriorating situation in the U.S. financial system and the real economy. Kim et al (2009) also found that real economic interdependence between emerging Asia and major industrial countries have also increased significantly in the post 1997-98 Asian financial crisis period, suggesting recoupling rather than decoupling in the recent years. (Boorman, 2009) opined that the explosion of global trade – the major force in the rapid growth of many emerging economies over the last few decades together with the ever increasing integration of financial markets has in fact increased the coupling of these economies with the industrial world. Walti (2010) has also found that there is no decoupling of business cycles in the emerging economies and the advanced economies in the recent years. Rather their study has found that the degree of business cycle interdependence has become stronger. Thus as observed in number of researches the decoupling hypothesis was short lived and soon proved superfluous. When the global crisis intensified it spread to the developing economies through current and capital accounts of balance of payments. The high level global integration of many developing economies and dependence on export led growth proved the major negatives. Consequentially, the region could not avoid a significant drop in growth. Growth even fell in the countries like China which have responded aggressively to the crisis. India too, could not remain immune to such global economic shock. The present paper evaluates the impact of Global financial crisis of 2008 on such developing economies and attempts to determine the decoupling status of such economies with major advanced economies.

OBJECTIVES OF THE RESEARCH

The present paper aims to achieve the following objectives:

1. To find the impact of global financial crisis on growth rate of developing Asia.
2. To find the impact of global financial crisis on the inflation in developing Asia.
3. To find the impact of global financial crisis on the exports and imports of goods and services of developing Asian economies.
4. To find the impact of global financial crisis on the currencies exchange rate of developing Asia.
5. To find the impact of global financial crisis on the FDI and the FPI inflows to the developing Asian countries.

DATA AND METHODOLOGY

The study analyses the impact of global financial crisis of 2008 on seven major developing economies of Asia, namely, China, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam. For the purpose of the study the data source used is the International Financial Statistics (IFS) of International Monetary Fund. The present paper finds the impact of global financial crisis of 2008 on developing Asia by doing the time series analysis. To achieve first four objectives the study has used the relative cyclical residual method and identified the cyclical variation in the time series data. For this purpose firstly, the data on different economic variables was collected using the IFS for the years 2003 to 2009. Secondly, the trend values for the respective years were obtained using the exponential trend equation. Thirdly, the yearly data as a percentage of yearly trend values was computed and then the deviation of these figures from 100 is measured to know the cyclical variation in the time series data. Finally, ‘t’ test is applied to establish the significance of cyclical variation. It is important to mention here that the seasonal variation never incorporates into annual data. Further the irregular component of time series is ignored as it is relatively small as well as unpredictable.

RESULTS AND ANALYSIS

The results and analysis section is divided into five parts which corresponds to the five objectives of the present research paper.

IMPACT ON ECONOMIC GROWTH

The impact of 2008 financial crisis on developing Asia's economic growth is assessed by evaluating the impact of such crisis on real GDP growth rate and the share prices. Table 1 (Figure 1) shows the impact of global financial and economic crisis on the developing Asia's Real GDP growth rate. In 2009, the developing Asian economies have observed a negative cyclical variation of 2.1 percentage points on average basis in their Real GDP growth rate which is found significant at 95 % level. Further, the growth was worst hit in Thailand and Malaysia i.e. 4.4 percent and 4.2 percent respectively. India's growth suffered only 1.2 percentage points. Moreover it is important to mention here that in year 2009 real GDP growth rate was hit negatively in all the seven selected developing Asian economies. Table 1 also reveals that the cyclical impact on real GDP growth rate had peaked out in year 2007 when the developing Asia's real GDP growth observed a positive cyclical variation of 1.7 percentage points. Figure 1 shows that the Thailand and Malaysia proved to be the most volatile economies in this economic cycle whereas Indonesia proved itself to be the most stable economy. India had shown moderate stability in its real GDP growth rate. In nutshell, a statistically significant negative cyclical variation in 2009 real GDP data implies that the global financial crisis of 2008 has led the downturn in the business cycles of developing Asian economies and hence rejects the decoupling hypothesis.

TABLE 1: DEVELOPING ASIA'S REAL GDP GROWTH RATE (% VARIATION FROM TREND VALUES)

	2003	2004	2005	2006	2007	2008	2009
CHINA	0.5	-0.8	-1.0	0.0	2.4	0.6	-1.6
INDIA	0.0	-1.0	-0.1	0.9	1.6	-0.1	-1.2
INDONESIA	0.3	-0.3	-0.2	-0.4	0.3	0.6	-0.4
MALAYSIA	-1.8	-0.1	0.2	1.1	2.6	2.3	-4.2
PHILIPPINES	-0.3	0.5	-0.1	-0.7	0.7	1.0	-0.9
THAILAND	-2.3	-0.2	0.4	2.0	3.0	1.6	-4.4
VIETNAM	-0.7	-0.5	0.2	0.8	1.6	0.4	-1.8
AVERAGE	-0.6	-0.3	-0.1	0.5	1.7	0.9	-2.1
STD. DEV.	1.1	0.5	0.5	0.9	1.0	0.8	1.6
t VALUE	1.54	1.87	0.52	1.51	4.56 **	2.93 *	3.46 *

* Significant at 95% level, ** Significant at 99% Level

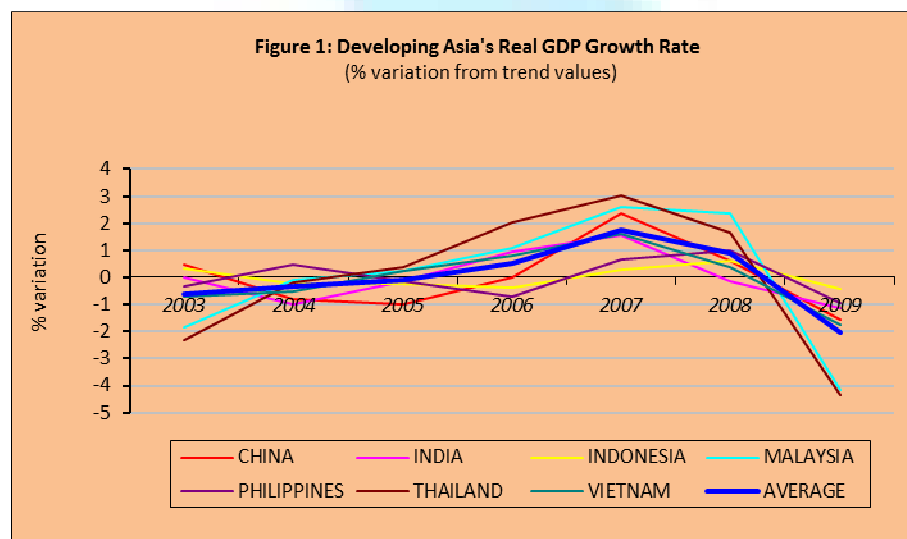
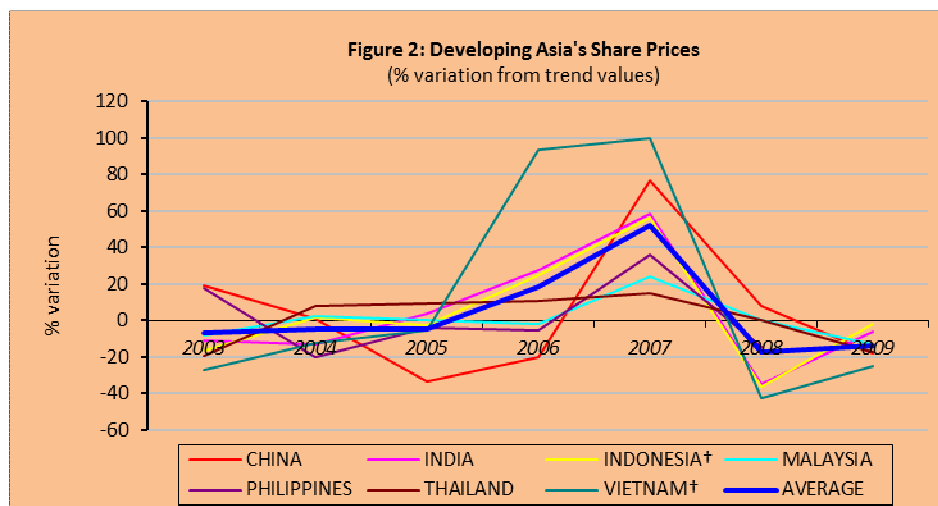


Table 2 analyses the impact of global financial crisis on the developing Asia's share prices. It shows that the yearly average share prices in developing Asia had negatively deviated from the secular trend figures by 17.1 and 13.1 percentage points for year 2008 and 2009 respectively. Figure 2 shows that the cyclical impact on share prices had peaked out in year 2007 when the share prices in developing Asia had deviated positively by 52.3 percentage points from their secular trend values. Again it is worth mentioning here that all the developing Asian economies witnessed positive cyclical variation in their share prices in 2007 and the same has turned negative for all of these economies in year 2009.

TABLE 2: DEVELOPING ASIA'S SHARE PRICES (% VARIATION FROM TREND VALUES)

YEAR	2003	2004	2005	2006	2007	2008	2009
CHINA	19.1	0.9	-33.4	-20.3	76.4	8.0	-17.8
INDIA	-10.9	-12.8	3.6	27.9	58.7	-34.7	-6.3
INDONESIA [†]	-16.3	1.6	-2.7	24.5	56.1	-36.5	-2.2
MALAYSIA	-8.1	2.4	0.5	-1.9	23.9	0.2	-13.1
PHILIPPINES	17.7	-20.1	-3.8	-5.2	36.0	-14.2	N.A.
THAILAND	-19.6	7.6	9.3	10.8	15.0	0.4	-17.2
VIETNAM [†]	-27.2	-12.5	-5.7	93.5	100.2	-42.8	-24.8
AVERAGE	-6.5	-4.7	-4.6	18.5	52.3	-17.1	-13.6
STD. DEV.	18.1	10.3	13.7	37.2	30.0	20.8	8.3
t VALUE	0.90	1.20	0.90	1.30	4.6 **	2.20	4.3 **

[†] For Indonesia and Vietnam share prices are year- end share prices. For others it is yearly average share prices.



IMPACT ON INFLATION

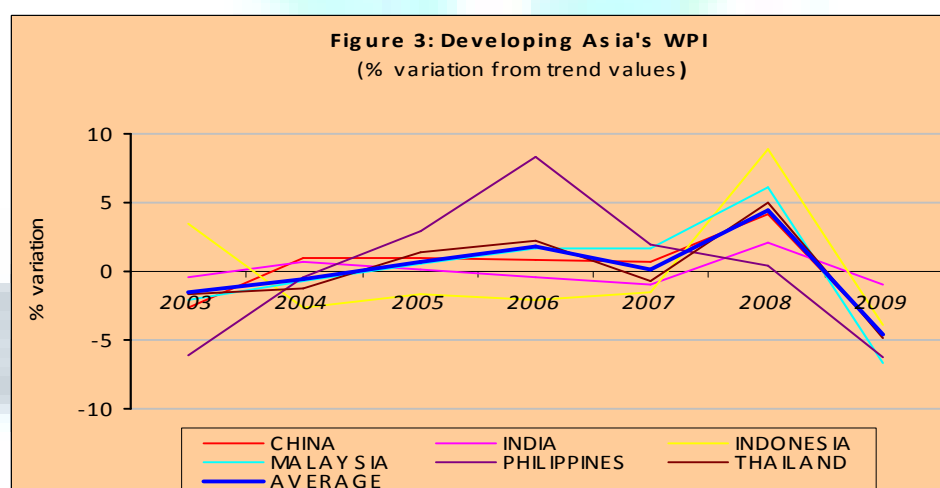
Table 3 shows the impact of global financial crisis of 2008 on inflation figures in developing Asia. It is revealed that in 2009 the cyclical variation has led an average decline of 4.6 percentage points in developing Asia's inflation figure (significant at 99% level). However India witnessed only a meager 1 percent point decline in inflation as a result of cyclical variation. Further the table shows that in year 2008, developing Asia has witnessed a very high positive cyclical variation in inflation, that is, 4.5 percentage points on average basis (significant at 95% level). Perhaps this was the one important reason that had hampered the developing Asia's performance in this period. Figure 3 shows that the cyclical variation component in inflation was higher for almost all the developing Asian economies. India is the only country where inflation was relatively less impacted by cyclical component.

TABLE 3: DEVELOPING ASIA WPI (% VARIATION FROM TREND VALUES)

YEAR	2003	2004	2005	2006	2007	2008	2009
CHINA	-2.7	1.0	0.9	0.8	0.6	4.2	-4.6
INDIA	-0.4	0.7	0.1	-0.5	-1.0	2.1	-1.0
INDONESIA	3.5	-2.6	-1.7	-2.0	-1.5	8.9	-3.9
MALAYSIA	-2.1	-0.7	0.5	1.6	1.7	6.2	-6.7
PHILIPPINES	-6.1	-0.4	2.9	8.3	1.9	0.5	-6.3
THAILAND	-1.6	-1.2	1.5	2.2	-0.7	5.0	-4.9
AVERAGE†	-1.6	-0.5	0.7	1.7	0.2	4.5	-4.6
STD. DEV.	3.1	1.3	1.5	3.6	1.4	3.0	2.0
t VALUE	1.2	1.0	1.2	1.2	0.3	3.7	5.5
						*	**

Significant at 95% level, ** Significant at 99% Level

† Excluding Vietnam as the WPI data for Vietnam was not available.



IMPACT ON EXPORT AND IMPORT OF GOODS AND SERVICES

Table 4 shows that in year 2009 the developing Asia's export of goods and services were knocked down by a negative cyclical variation of 17.5 percentage points on average basis (significant at 99 %). The table also shows that exports from India and China were the worst hit as these countries have observed a negative cyclical variation of 20.9 percent and 21.7 percent respectively in their export figures. Further it is revealed that the cyclical impact on developing Asia's exports of goods and services peaked out in year 2008 when it witnessed a positive cyclical impact of 11.3 percent points (significant at 99% level). Figure 4 reveal that broadly the export of goods and services from all the developing Asian economies were hit in line with the average figure. Moreover it also shows that the cyclical component had played a great role in the export of goods and services from developing Asia in the study period.

TABLE 4: DEVELOPING ASIA EXPORT OF GOODS & SERVICES (% VARIATION FROM TREND VALUES)

YEAR	2003	2004	2005	2006	2007	2008	2009
CHINA	-12.0	-1.4	4.3	9.6	14.8	12.1	-21.7
INDIA	-12.0	-1.6	6.8	9.0	10.6	13.5	-20.9
INDONESIA	-7.2	-2.2	4.2	6.0	6.2	11.3	-15.4
MALAYSIA	-9.5	0.4	2.8	6.2	9.3	11.6	-17.4
PHILIPPINES	-6.4	-1.9	-2.8	8.9	15.5	7.0	-16.7
THAILAND	-6.7	0.0	0.2	4.3	9.3	10.8	-15.3
VIETNAM	-7.1	0.6	1.5	4.1	5.7	12.9	-15.1
AVERAGE	-8.7	-0.9	2.4	6.9	10.2	11.3	-17.5
STD. DEV.	2.4	1.2	3.1	2.3	3.8	2.1	2.7
t VALUE	9.40	2.00	2.00	7.90	7.10	14.30	17.00 **
	**			**	**	**	

* Significant at 95% level, ** Significant at 99% Level

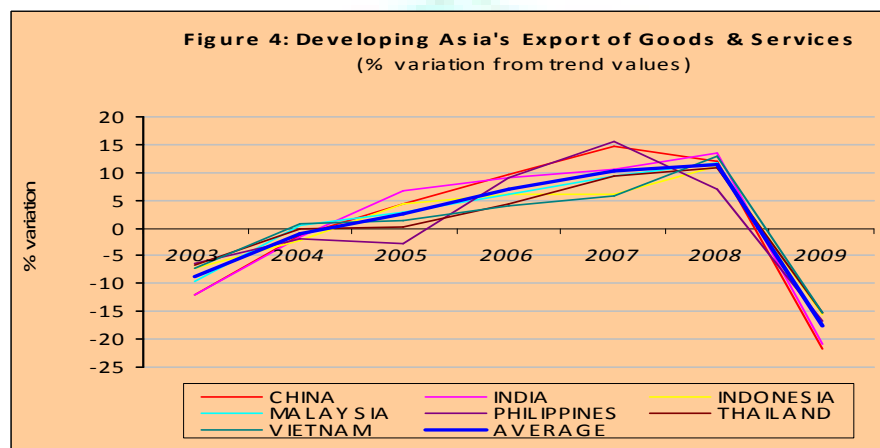
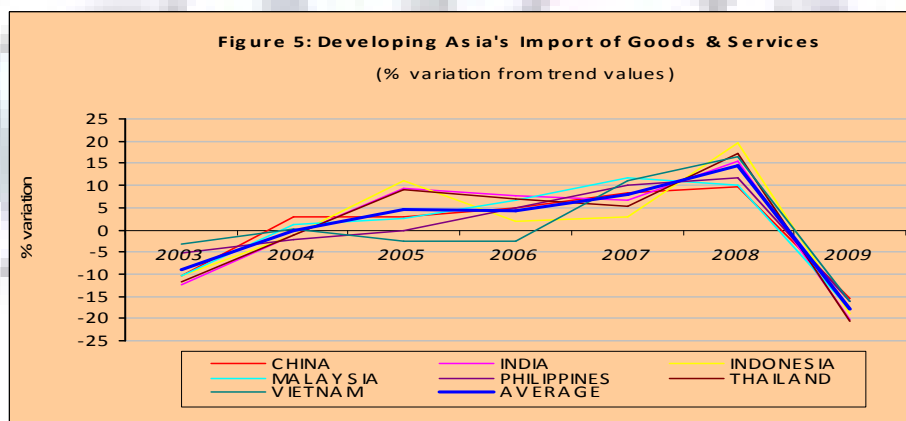


Table 5 shows that like exports the imports of developing Asian economies has observed a similar impact as a result of global crisis. In 2009, the cyclical variation had reduced the imports of goods and services of developing Asian economies by 17.9 percent points (significant at 99% level). It also reveal that the impact of cyclical variation on imports had also peaked in year 2008 when the average imports from developing Asia observed a positive cyclical variation of 14.3 percent points (significant at 99% level). Figure 5 shows that that the import of goods and services of all these developing economies were affected in line with the average figure.

TABLE 5: DEVELOPING ASIA IMPORT OF GOODS & SERVICES (% VARIATION FROM TREND VALUES)

YEAR	2003	2004	2005	2006	2007	2008	2009
CHINA	-10.4	3.0	2.9	4.9	8.3	9.8	-15.6
INDIA	-12.3	-1.3	9.2	7.8	6.7	15.4	-20.4
INDONESIA	-10.3	-1.1	11.2	1.7	2.8	19.4	-18.8
MALAYSIA	-10.5	1.0	2.6	6.6	11.6	10.1	-17.8
PHILIPPINES	-5.2	-2.4	-0.3	5.1	10.0	11.7	-16.1
THAILAND	-11.8	-1.2	8.9	7.1	5.4	17.3	-20.4
VIETNAM	-3.2	0.2	-2.7	-2.5	11.2	16.6	-16.3
AVERAGE	-9.1	-0.2	4.6	4.4	8.0	14.3	-17.9
STD. DEV.	3.5	1.8	5.3	3.6	3.3	3.8	2.0
t VALUE	6.90	0.30	2.30	3.20	6.50	10.00	23.50 **
	**			*	**	**	**

* Significant at 95% level, ** Significant at 99% Level



IMPACT ON CURRENCY EXCHANGE RATE

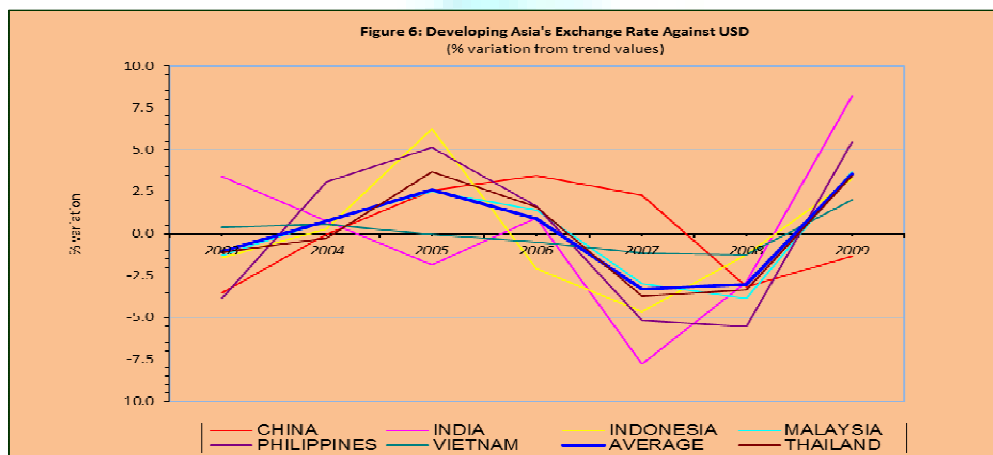
Table 6 reveals that in the year 2009, cyclical movement has caused an average depreciation of 3.5 percent points in developing Asia currencies versus USD (significant at 95 % level). Indian rupee had suffered the most followed by Philippines as a result of cyclical movement, whereas China was the only country

whose currency has rather appreciated against USD in this crisis period. Figure 6 show that Indian rupee has been the most volatile currency against USD in this period. Further it is also revealed that the cyclical variation in the developing Asian currencies had peaked out in year 2007.

TABLE 6: DEVELOPING ASIA YEARLY AVERAGE EXCHANGE RATE VERSUS USD (% VARIATION FROM TREND VALUES)

YEAR	2003	2004	2005	2006	2007	2008	2009
CHINA	-3.5	0.0	2.6	3.4	2.3	-3.2	-1.3
INDIA	3.4	0.7	-1.9	0.9	-7.8	-2.9	8.2
INDONESIA	-1.4	0.3	6.3	-2.1	-4.6	-1.2	3.3
MALAYSIA	-1.3	0.8	2.5	1.4	-3.0	-3.9	3.7
PHILIPPINES	-3.9	3.1	5.1	1.6	-5.2	-5.5	5.4
THAILAND	-1.1	-0.3	3.7	1.6	-3.7	-3.3	3.5
VIETNAM	0.4	0.6	0.0	-0.5	-1.1	-1.3	2.0
AVERAGE	-1.1	0.7	2.6	0.9	-3.3	-3.0	3.5
STD. DEV.	2.5	1.1	2.8	1.8	3.2	1.5	2.9
t VALUE	1.1	1.7	2.4	1.4	2.7	5.4	3.2
					*	**	*

* Significant at 95% level, ** Significant at 99% Level



IMPACT ON FOREIGN DIRECT INVESTMENT (FDI) AND FOREIGN PORTFOLIO INVESTMENT (FPI) INFLOWS

Since the FDI and FPI inflows fluctuate widely over the years it was neither appropriate, nor possible to identify the secular trend in the FDI inflows. Thus to find the impact of global crisis on FDI and FPI inflows, the figures for the year 2008 and 2009 were compared with the average figures of year 2003 to 2007.

IMPACT ON FDI INFLOWS

Table 7 shows the impact of global financial crisis on FDI inflows to developing Asian economies. It reveals that the average FDI inflows to developing Asian economies were nearly double (up 101 percent, significant at 95% level) in year 2008 as compared to the average of 2003 to 2007. However these FDI inflows came down drastically in year 2009. Compared to the average of 2003 to 2007 these inflows were only higher by 36 percent points and off course were lesser than year 2008. India had not suffered much as far as the impact of crisis on FDI inflows is concerned. Malaysia and Thailand suffered the most on account of FDI inflows.

TABLE 7: FDI INFLOWS TO DEVELOPING ASIA (IN MILLION USDs)

YEAR	2003	2004	2005	2006	2007	2008	2009	Average FDI Inflows in Million USD (2003 to 2007)	FDI Inflows in 2008 (% Deviation from Average of 2003-2007)	FDI Inflows in 2009 (% Deviation from Average of 2003-2007)
CHINA	47077	54937	79127	78095	138413	147791	78193	79530	86	-2
INDIA	4323	5771	7606	20336	25483	41315	34577	12704	225	172
INDONESIA	-597	1896	8336	4914	6928	9318	4877	4296	117	14
MALAYSIA	2473	4624	3966	6076	8590	7376	1387	5146	43	-73
PHILIPPINES	491	688	1854	2921	2916	1544	1948	1774	-13	10
THAILAND	5232	5860	8055	9453	11324	8531	4976	7985	7	-38
VIETNAM	1450	1610	1954	2400	6700	9579	7600	2823	239	169
AVERAGE									101	36
STD. DEV.									100	97
t VALUE									2.5	0.9
									*	

* Significant at 95% level

IMPACT ON FPI INFLOWS

Table 8 shows the impact of global financial crisis on FPI inflows to developing Asian countries. It clearly shows that huge money was withdrawn by the FIIs from these developing economies to face the mammoth crisis in their home country. When developing Asia was put together it was a clear cut case of negative FPI flows in year 2008. However in average percentage terms flows to developing Asia had fallen to one third of the average flows from year 2003 to 2007. Malaysia was worst hit both in absolute terms as well as in percentage terms. India was the second badly hit economy in year 2008 in terms of FPI inflows. China and Indonesia were the only two developing Asian economies which have observed a positive FPI flows. The table further shows that the FPI flows to these countries were mixed in year 2009. In absolute terms all of these countries observed positive FPI flows. China received the highest FPI inflows followed by India and Indonesia. When compared with the average inflows to these countries from year 2003 to 2007, Indonesia performed best on account of FPI inflows in year 2009 followed by India.

TABLE 8: FPI INFLOWS TO DEVELOPING ASIA (IN MILLION USDs)

YEAR	2003	2004	2005	2006	2007	2008	2009	Average (2003 to 2007)	Portfolio Inflows in 2008 (% Deviation from Average of 2003-2007)	Portfolio Inflows in 2009 (% Deviation from Average of 2003-2007)
CHINA	8444	13203	21224	42861	20996	9910	28804	21346	-54	35
INDIA	8216	9054	12151	9509	32863	-15029	21112	14359	-205	47
INDONESIA	2251	4056	5270	6107	9981	3059	10480	5533	-45	89
MALAYSIA	1174	8675	-2985	5557	9320	-21083	6048	4348	-585	39
PHILIPPINES	1381	288	3446	6144	3922	-4417	2331	3036	-245	-23
THAILAND	851	1856	7070	5714	2899	-2561	2343	3678	-170	-36
VIETNAM	n.a.	n.a.	865	1313	6243	-578	128	2807	-121	-95
AVERAGE									-203	8
STD. DEV.									184	63
t VALUE									2.9	0.3
									*	

* Significant at 95% level

CONCLUSIONS

The analysis of cyclical variation in time series data reveals that the global financial crisis of 2008 has definitely dented the growth in developing Asian countries and hence refutes the decoupling hypothesis. It happened primarily because of the contraction of global business which has caused a substantial decline in the exports of goods and services from the developing Asian countries. The huge outflow of foreign funds from the equity markets of these countries and a decline in the FDI inflows has also aggravated the problem by initiating rapid falls in these economies currency exchange rate against the US Dollar. The study also found that the present crisis has largely checked the high rates of inflation that has prevailed in most of these economies in the pre crisis period. Thus besides the global financial and economic reasons, the higher domestic inflation in these economies seem to be another important reason that had led the decline in the growth of these economies.

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