THE GREAT FINANCIAL CRISIS AND HOW THE PHILIPPINES GOT AWAY FROM IT

Aris Zoleta[1]
[1]*Chartered Institute for Securities & Investment*
aris_zoleta@dlsu.edu.ph
ariszoleta.wordpress.com

PURPOSE/AIM & BACKGROUND

The recent GFC of 2008 in the US which start to move in other developed economies and lastly impact employment and growth of EMEs. In the era of globalization and financial interlinkages risk of contagion from one part of and to the rest of the world is a major concern among fiscal and monetary policymakers. In the episode the GFC, central banks in the developed world with the leadership of the FED are in increasing accommodating policy in supporting the financial market with liquidity provision while the EMEs are in competitive devaluation of currency to regain export market share. Like any other EMEs the Philippines experience its own demise of GFC. Many studies which focus on the impact of the crisis on trade, in welfare and financial market fails to account both the contagion mechanism and transmission of the GFC in the Philippines. This paper aims to contribute in literature on understanding the peculiar experience of the Philippines in avoiding the dire consequence of the GFC which is different from other EMEs. The paper documented that the Philippines is not severely impacted by GFC both via financial and trade linkage. This is different from the experience of other EMEs and developing economies which experience decline and output and increase unemployment (Dolphin and Chappell ,2010) and much slower capital inflow (Hannan, 2017).

THEORETICAL FRAMEWORK

Financial Linkage

Large bodies of literature discuss the mechanism of contagion transmission specifically from the developed world into EMEs. Stiglitz (2010) in his paper discusses optimal policy design when country experience crisis contagion. The paper concluded that despite mainstream thoughts on the benefits of trade liberalization on stability, financial integration will result in more instability during the crisis. A powerful analogy from medicine that during the onset of an infectious disease doctors shall contain and quarantine the carrier not spread them across which worsen the situation. Similar account by Fry-McKibben, Martin, and Tang (2013) in their paper suggests that asset market interconnectedness can increase contagion risks during a long period of a financial crisis their result also extend beyond the traditional risk associated in asset volatilities and correlation.

During the onset of a crisis like the GFC, asset classes across risk premium became highly correlated and increasing volatilities move across different segment of the financial market. Furthermore in the causes of GFC in 2008, MBS and CDOs as asset class is to small compare to other debt markets, a plunge of price of this securitized debt due to the rising default rate of subprime mortgages suppose not to tip off the entire financial system of the US and Europe but what it creates is uncertainties in the financial system that led into runs from wholesale liquidity provider mostly from asset managers in Europe, not only to MBS and CDOs but as well to highly rated debt instrument, as investors liquidating position moving into safe assets such as cash, gold, and US Treasury.

Trade Balance

The immediate result of GFC in world trade balance is that when the US enters into the recession, a country which reliant on the US as export market also gets into trouble. El Erian (2016) explains that in the pre-crisis era the US is considered to be the consumer of last resort this turn into the global trade imbalance when the rest of word export their product to the US. The result was imminent when the US recession causes less import of the US consumer to the rest of the world. India and China which is the largest emerging economies could pick up the slack that the US leave behind but the two countries experience their own domestic issue of excessive debt. During GFC emerging market term premium increases due to investors risk averseness to lend and on the demand side countries with an already high amount of debt will unlikely to increase borrowing as the cost of doing so increases and the prospect of improved export income also have slim chance to happen. In the context of permanent income hypothesis and the argument I laid it is difficult to find any country that will pick up the slack that the US consumer left behind. Germany, the Nordic country oil producing nation and Japan which possess high savings is potential candidate but this country is running large surpluses before and during the GFC (Bernanke, 2005)

FINDINGS/RESULTS

Based on the two contagions channeled on how the GFC can propagate into EMEs, we draw some results that are peculiar to the context of Philippines experience.

First, the Philippines have a quasi-capital control. Even we start liberalizing our capital account during the start of 1990 still there is still some prohibition in place by the constitution in particular on banking and other sector listed on Philippine Foreign Investment Negative List. In addition, the Bangko Sentral ng Pilipinas provide appropriate policy guidelines among bank through macroprudential policy limiting banks' exposure to excessive risk-taking both domestically and abroad. This result in a lower linkage of Philippines banks' balance sheet to the large US bank, making our domestic bank resilient in portfolio rebalancing of the globally active systemic financial institution.

Secondly, before and during the GFC, the Philippines already experiencing a decline in debt to equity ratio and existing large foreign reserve. This factor contributed to our improved current account balance which helps us cushion if there is any sudden stop of capital flows. Increase remittance abroad both from BPOs and OFWs continue to support our consumption-driven economy. Our decision either consciously or unconsciously to have an inward driven economy which is not reliant on export as our source of growth break the trade balance channeled of contagion during GFC.

Detrending the business cycles similar to study we made, (Argamosa and Zoleta, 2017) and result from Leither (2005) we see that Philippines saw mild volatility of ± 2 standard deviations from 1997 to 2016 which coincide the GFC and Asian Financial Crisis.

CONCLUSIONS

The macroprudential policy provides a major role in how the Philippines got away from the severe demise of GFC. A large body of literature supports the evidence on the benefits of capital flows in a global financial market and this paper supports any effort of policy-maker in liberalizing the capital account and increase participation in world trade, as other may otherwise infer on the result on the paper. The paper suggests increase study on contagion channeled and transmission mechanism in the context of the Asean Economic Integration so that we may able to design a system of breaks and stop once a crisis hits the region.

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