Box 1
Key measures to stabilize the financial system and stimulate the economy in major countries

The financial turmoil sparked by the US subprime mortgage crisis has persisted and spread to the world since September 2008. Its impact has resulted in the global financial markets' violent fluctuations along with downside risks to global economic growth. In response, a series of policy measures designed to stabilize the financial system has been taken by the US and many other governments, together with the joint actions employed by the EU, G7, IMF, and the euro area, to cope with the worldwide crisis. Moreover, growing concerns about the global downside risks stemming from the financial turmoil have prompted major countries to launch a succession of economic stimulus packages to alleviate the extent and impacts of the economic slump. Recent measures adopted by selected countries to stabilize the financial system and stimulate economic growth are summarized as follows.

1. Measures to stabilize the financial system

1.1 Liquidity injection

Major central banks including the US Federal Reserve Board and the Bank of England have implemented a series of measures aimed at easing liquidity pressures in short-term funding markets, which encompass: (1) introducing new accommodation facilities and extending the range of eligible collaterals for repo operations so that sufficient liquidity would be injected into the financial system; (2) cutting policy rates markedly several times or reducing reserve requirement ratios in order to ease money market constraints; (3) establishing temporary foreign currency swap mechanisms between major countries to mitigate the elevated pressures in the short-term US dollar funding market.

1.2 Government's assurance on interbank funding and a raise in deposit protection

To resolve credit crunches in interbank funding markets, the UK and fifteen members of the euro area successively announced guarantees on interbank lending with public funds. The US, Italy, and several other countries also provided guarantees on newly issued bank debt. Meanwhile, the UK, the US, twenty-seven member states of the EU, and some emerging countries sought to restore depositors' confidence through raising deposit insurance limits or providing blanket guarantees on deposits.

1.3 Supports for troubled financial institutions

To prevent systemic threats resulting from failures of large financial institutions, the US and many European governments have initiated massive programs to aid troubled financial institutions through lending, recapitalizing with public funds, nationalization, or arranging mergers or acquisitions by other financial institutions. For instance, a series of government supports has been provided to Fannie Mae, Freddie Mac, AIG, Citigroup, UBS, Fortis, Dexia SA, ING, and other financial institutions to help them overcome their financial distress.

1.4 Stock market rescue packages

The expanding global financial crisis and the accompanying economic slowdown caused global stock markets to tumble. To rescue stock markets, the US, Europe, and some Asian countries restricted short selling on financial stocks or banned naked shorting on all stocks. Some countries that were hard hit by the tumbling stock markets, such as Iceland, Russia, Brazil, and Indonesia, even temporarily suspended trading in the stock market. Moreover, South Korea and Japan eased restrictions on share buyback, while China cut the stamp tax on security transactions to 0.1% in an effort to boost local stock markets.

1.5 Other financial stabilization measures

In addition to those measures taken by individual countries, international organizations also took joint policy actions. For example, (1) the G7 finance ministers and central bank governors jointly released a five-point action plan designed to stabilize financial markets,[*] restore the flow of credit, and to support global economic growth; (2) leaders from fifteen member states of the euro area reached a consensus on the financial bailout framework, which allows individual countries to take the necessary steps to support troubled financial institutions in terms of their current state and requirement; and (3) the IMF announced the initiation of an emergency funding scheme to support member states in financial difficulty. Moreover, in order to mitigate the unfavorable impact of the application of fair value accounting rules on financial institutions, the International Accounting Standards Board (IASB) issued amendments to International Accounting Standards 39 (IAS 39) and International Financial Reporting Standards 7 (IFRS 7) that would permit reclassification of securities out of the trading category in rare circumstances without applying fair value assessments.

2. Economic stimulus plans

2.1 Measures to rescue housing market

The decline in housing prices is the origin of this financial crisis. To support the housing market, the US government promulgated the Housing and Economic Recovery Act in July 2008, which includes the following key measures: (1) refinancing eligible distressed homeowners' mortgages into affordable 30-year fixed-rate mortgages insured by the Federal Housing Administration (FHA); (2) providing assistance to borrowers and communities devastated by falling housing prices; and (3) raising the limits of new FHA-insured mortgages. The UK government later announced its Homeowners Support Package in September 2008. The package was designed to increase confidence, stability, and fairness in the housing market by (1) reducing the thresholds of housing tax breaks; (2) offering interest-free mortgages for first-time, low-income home buyers; and (3) for those who can not sustain their mortgages, the government offered a "sale and rent back" option (the so-called "government mortgage to rent" plan). Moreover, the governments of Japan, South Korea, Australia, and China also deployed a wide range of rescue plans to the domestic housing market, respectively, including (1) raising the mortgage tax-exemption limit, (2) reducing property taxes, (3) increasing the mortgage subsidy for first-time buyers, and (4) implementing a housing protection plan.

2.2 Tax cuts

In early 2008, the US government took the lead in introducing an economic stimulus plan focusing on tax rebates. The UK, France, Japan, South Korea, China, India, and Singapore later followed suit by adopting tax reform measures to boost private consumption and investment. For instance, (1) the governments of the US, Japan, South Korea, India, and Singapore offered tax cuts or tax rebates to individuals; (2) the US, France, South Korea, and India reduced corporate taxes; (3) the UK government cut value added tax (VAT) and slashed income tax rates for low-income and middle-income families while raising taxes on high-income earners; (4) the German government provided tax exemption for car buyers; (5) the South Korean government lowered inheritance tax rates; and (6) the Chinese government raised the rate of export tax rebates for specific products along with decreasing the tax rates relating to house purchases by individuals.

2.3 Expanding public expenditures

The governments of the UK, Germany, Australia, Japan, South Korea, and China successively unveiled large-scale plans for expanding public expenditures on infrastructure investments, aiming to boost domestic demand and prevent a protracted economic downturn. Among these countries, the scale of public funds used to expand public spending under South Korea's and China's economic stimulus plans in September and November 2008 reached on equivalent share of 17.9% and 16.2% of GDP, respectively.

2.4 Assistance to corporate sector and individuals

To mitigate the impacts on different sectors or industries, assorted fiscal support or loan assistance measures were undertaken by national governments in response to their respective economic and financial conditions. These assistance measures were mainly aimed at low- or middle-income families, employed labor, SMEs, and the construction sector.

* The details of the five-point plan include: (1) taking decisive action using all available tools to support struggling financial institutions and prevent their failure; (2) taking all necessary steps to unfreeze credit and money markets; (3) ensuring that banks can raise sufficient capital from public as well as private sources in order to continue lending to households and businesses; (4) strengthening deposit insurance and guarantee programs to maintain depositors' confidence; and (5) taking action, where appropriate, to restart the mortgage securitization markets. Accurate valuation and transparent disclosure of assets and consistent implementation of high quality accounting standards are necessary.