



DAVID HALE GLOBAL ECONOMICS

Can Asia Decouple from the US Economy?

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The investment outlook for Asia during 2008 will be determined by a mixture of economic and political events. The major threat to Asia this year is the slump in the US economy. It could dampen export growth in countries which have high ratios of trade to GDP, such as China, Malaysia, Taiwan, and Korea. The good news is that Asia has great potential to bolster domestic demand because of its large current account surpluses and huge foreign exchange reserves. Malaysia provides a good example of how such a decoupling process could occur. In 2007, it achieved 6.0% growth despite a slump in US exports because of resilient consumer spending and large new infrastructure projects.

It also is important to understand the true role of foreign trade in economies such as China. China's ratio of exports to GDP is 40% and 20% of exports go to the US. China therefore appears to derive 8% of GDP from exports to America. But only 20% of the value added of Chinese exports accrues to Chinese companies. The rest goes to suppliers of intermediate products in Taiwan, Korea, and Japan. China is the final assembly point in a global supply chain. As a result, the true value of exports to Chinese GDP is only 2%, not 8%. As China has tremendous growth momentum from urbanization, capital investment, and rising consumption, its growth rate should only slow to 10% this year from 11.5% during 2007.

The Indian economy will slow because the Reserve Bank has had to raise interest rates in order to contain inflation. The software companies could also suffer sales weakness because of the problems in American and European financial institutions. But as India now has strong growth momentum in investment and consumption, its growth rate will exceed 8.0% this year.

Vietnam has become a new high growth economy because of its success in attracting FDI. Foreign companies and robust domestic investment are turning Vietnam into a great exporting nation and will produce GDP growth of over 8.0% this year.

The best example of decoupling is Malaysia. The Malaysian economy has an export/GDP ratio of 180% and over 20% of exports go to the US. Malaysia was able to achieve a growth rate of over 6.2% during 2007 because of robust domestic consumption and large gains in infrastructure spending. Indonesia is benefitting from a boom in exports of palm oil and coal as well as increased infrastructure investment. The Philippines has been enjoying healthy growth in domestic consumption as well as large remittances from its foreign workers. Thailand is regaining its confidence after a military coup depressed consumption and investment during 2007. Thailand is also planning tax cuts and increased infrastructure investment this year.

Korea recently elected a new president who spent a long career in the business sector and is committed to bolstering economic growth. The two previous presidents were social Democrats with little interest in the economy. The new Korean leadership should set the stage for long needed economic reforms and a rebound in capital investment.

Taiwan will hold a presidential election in March. The polls are suggesting the KMT party will regain the presidency after eight years of rule by the Democrats. The KMT will seek to improve relations with China. Such a development could

bolster Taiwan's economy by opening the door to more direct trade with the mainland, access to China for Taiwan banks, tourism from China, and a perception that firms can use Taipei as a base to operate within China.

Asia will always be vulnerable to developments in the US economy because of its sheer size. But Asia in 2008 has an unprecedented opportunity for playing a growth leadership role in its own right. The region has over \$4 trillion of foreign exchange reserves. The banking system has recovered from the financial crisis of 1997-1998. Every country has huge infrastructure spending needs. The consumer sectors are not as overleveraged as their counterparts in English speaking countries. Asian governments have ample potential to stimulate domestic demand if exports falter because of a US recession. The current business cycle should therefore go down in the history books as the one in which Asia decoupled from the American economy and became a growth leader for the global economy

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