

Can Asia Decouple?

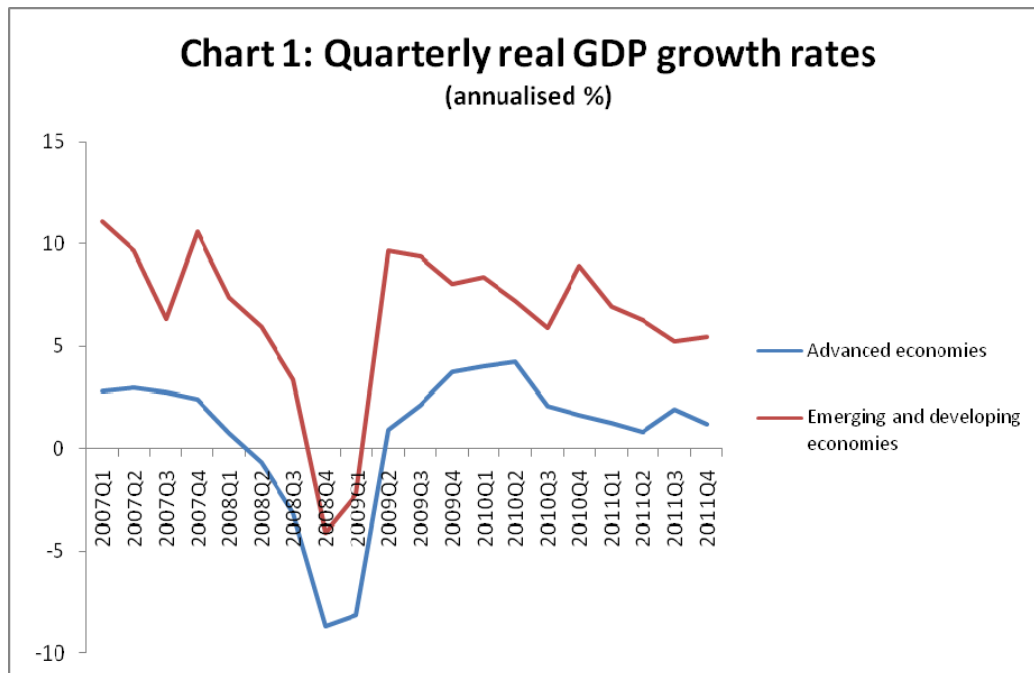
C.P. Chandrasekhar and Jayati Ghosh

When the Global Financial Crisis struck in 2008, there were many analysts who argued that some developing countries – especially in developing Asia and in particular China – could not only avoid the adverse effects of the crisis but also emerge as an alternative growth pole for the world economy. The extent to which economic “fundamentals” quickly unravelled across the developing world came as a surprise to them, as falling exports and dramatically reversing capital flows caused economic distress in many countries and affected even the strongest of them.

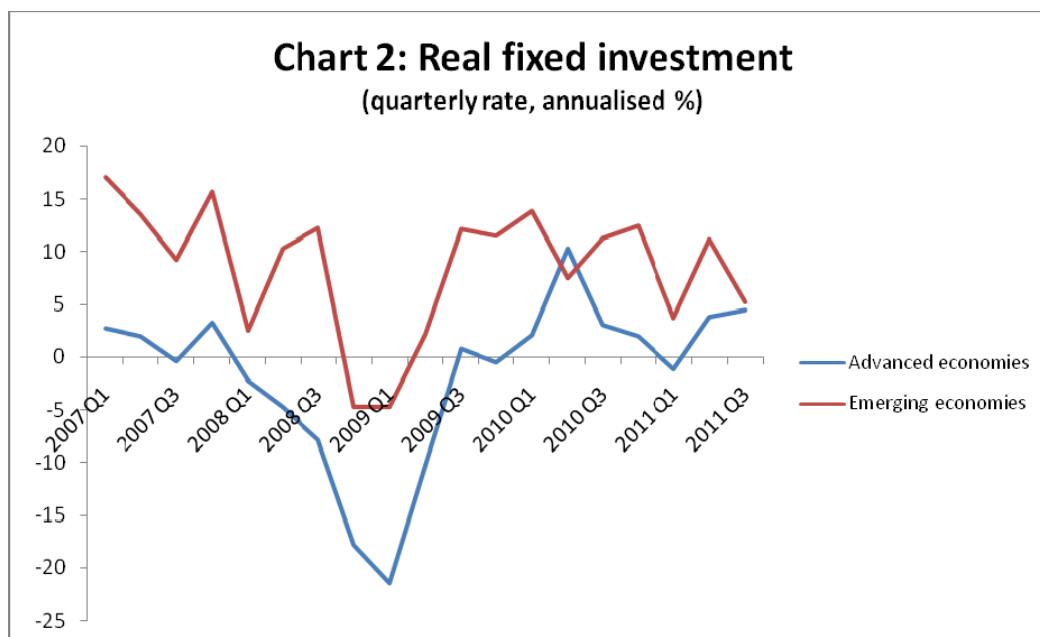
Even in countries like China that were earlier seen as relatively immune, only very proactive countercyclical measures, including fiscal stimulus packages and very substantial monetary and credit easing, allowed the growth momentum to be restored.

Nevertheless, it is certainly true that in many parts of the developing world, and especially Asia, the recovery was faster and sharper than was experienced in the North. In China and India, average incomes did not fall but continued to grow, albeit at a slower rate. By 2010 it was being argued that in these large countries and elsewhere, the growth engine was increasingly decoupled from the sputtering and hesitant recovery that was evident in the northern countries.

Now that prospects for the world economy are once again looking gloomy, the relatively quick recovery in several developing countries is being seen as a potential alternative source of expansion. As the US gets enmeshed in politically determined fiscal constraints and the eurozone crisis plays out to create chronic economic weakness and potential disaster in Europe, it is clear that expecting any positive stimulus from these two large regions is misplaced. Instead, eyes are turning towards the BRICs, or to the region of developing Asia, to provide another growth pole in what will otherwise be a sagging and even dismal global economic story.



Source: IMF World Economic Outlook Update, January 2012



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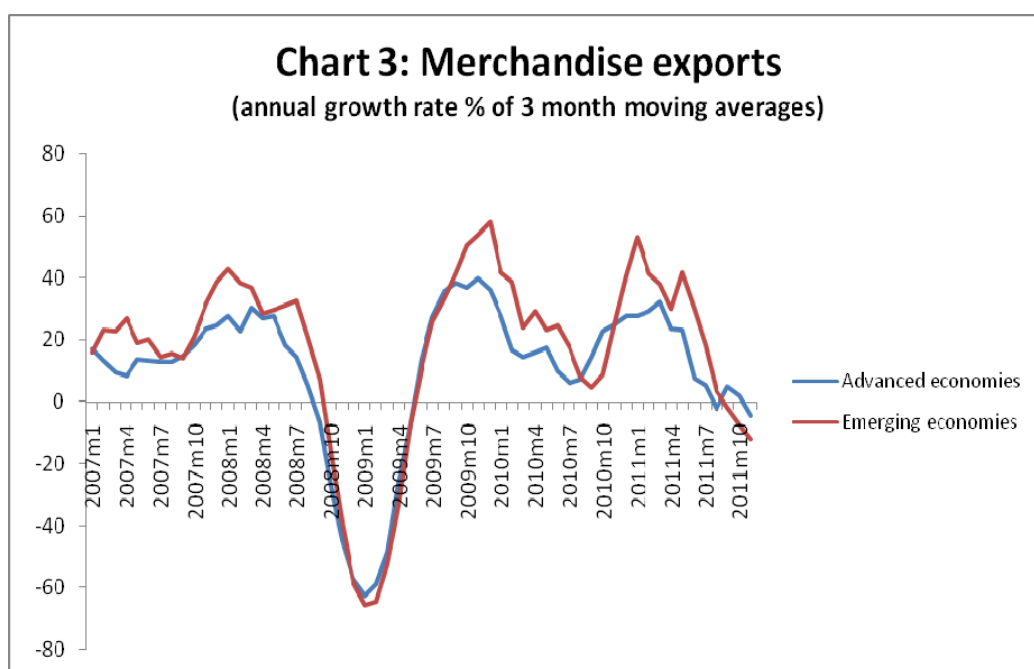
To what extent are such hopes justified? Consider the recent trends in growth and investment, as shown in Charts 1 and 2. As is evident from Chart 1, while overall GDP growth rates in emerging and developing economies remained higher than in the advanced countries, they also turned negative in the last quarter of 2008 and the first

quarter of 2009. What is more striking is the synchronicity of even quarterly changes, between the advanced and developing economies.

It is true that the divergence between the two groups of economies has grown slightly in the last few quarters, but the difference is still less than it was in 2007, during the global boom. More significantly, the direction of movement appears to be similar for both categories of countries, suggesting that the forces impelling change are still largely determined by what is going on in Northern economies.

In the period just before and after the Great Recession, a similar story seemed to be the case for fixed investment rates. However, since the middle of 2009 the picture of fixed investment seems to have been more mixed. Even so, the dampening effect on investor expectations, emanating from the gloom in developed markets, is evident.

Presumably one reason for the gloom is the impact that the slowdown in the US and Europe has on exports of developing countries. Here the story – described in Chart 3 – is unambiguous and depressing. Export growth rates from both advanced and developing countries tend to move in tandem, and if anything, merchandise exports of developing countries (in value terms in this chart) have been even more volatile and fallen even more sharply, including in the very recent past.

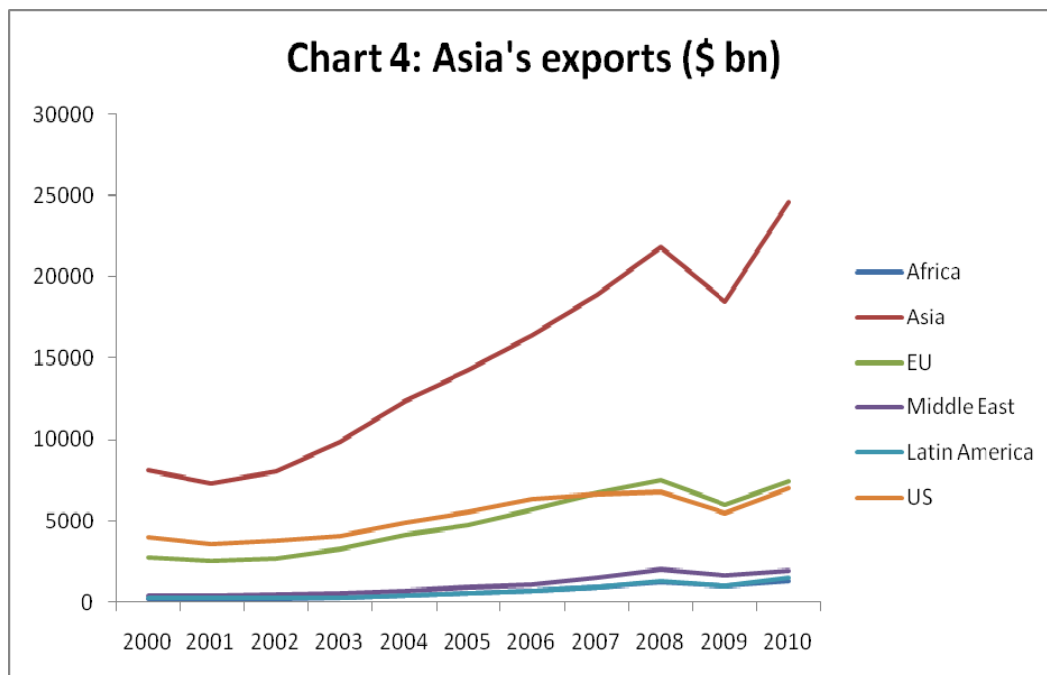


Source: IMF World Economic Outlook Update, January 2012

Incidentally, the picture would look even bleaker if services exports were to be included, since service exports have experienced substantial deceleration in the recent past. This includes not just those services that are affected by the slowdown in trade (such as transport and related services) but also a range of other more employment-intensive activities such as tourism and IT-enabled services. Clearly, there is little sign of decoupling in trade.

But suppose we consider specifically Asia, which is still widely considered the most dynamic region. There has been much talk of how greater integration within developing Asia has already generated new patterns of trade, investment and economic activity, and that therefore increased Asian integration will provide more stimulus to growth in the region even if other areas stagnate.

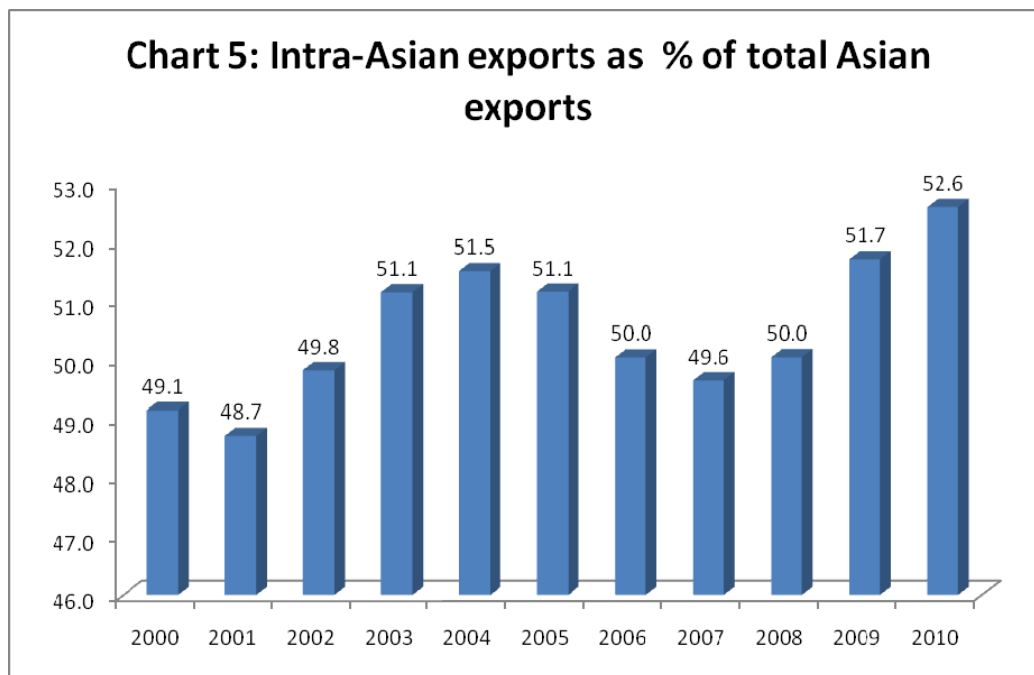
There is no doubt that intra-Asian trade has increased significantly in the recent past. As Chart 4 indicates, since the turn of the century, Asian exports within the region have not only been larger but have significantly outpaced exports to other major trading partners or regions. Even though there was a break in the upward trajectory in the crisis year of 2009, the subsequent revival of intra-regional trade suggests that there is still a lot of inherent dynamism.



Source: WTO online statistical database, accessed 18 January 2012

But still, it should be borne in mind that, even though intra-regional trade has increased, it is still only around half of all of Asia's exports. Chart 5 shows that while there have been changes in the share of intra-regional trade, with increases in the recent past, in this period it has been volatile around a fairly narrow band, fluctuating between 49 and 52 per cent of total exports.

This means that global currents are still very significant in determining trade patterns, particularly exports. And since so many countries in the region are highly trade-dependent and have generally chosen export-oriented growth as the model, the slowdown in exports will necessarily also affect levels of economic activity, employment and future investment.



Source: WTO online statistical database, accessed 18 January 2012

More than the quantitative indicators, it is also the pattern of integration and the quality of the activity that is important in this. Much of the rapid increase in intra-regional trade in developing Asia has been because of the emergence of a multi-location multi-country export production platform, largely organised around China as the final processor. This is why more than four-fifths of such trade consists of intermediate goods used in further production, rather than final demand.

Such trade is obviously closely linked to the behaviour of the ultimate export markets, which still remain dominantly in the North, despite recent changes in the direction of trade. Thus, for example, China (which is the fulcrum of much of this kind of export-oriented activity) still looks to the US and the European Union for just under 40 per cent of its total exports. Reduced demand from these areas will translate into reduced demand for raw materials and intermediates required for processing into goods for these markets. There is already some scattered evidence that this process has begun.

This suggests that expectations of Asia being able to blithely withstand the latest round of economic crisis are not just over-optimistic but probably wrong. It also means that Asian governments have to be prepared for this with proactive measures to cope, and that business as usual simply will not work in the evolving global scenario.

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