

## Crouching tigers

*Asian economies are likely to be the first to pull out of the global recession.*



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ASIA'S tiger economies have suffered some of the sharpest declines in output during the global recession, and some fear that, because of their dependence on exports, they will not see a sustained recovery until demand rebounds in America and Europe. However, their doughty resilience should not be underestimated. They came roaring back unexpectedly fast after the Asian crisis of the late-1990s. They could surprise again.

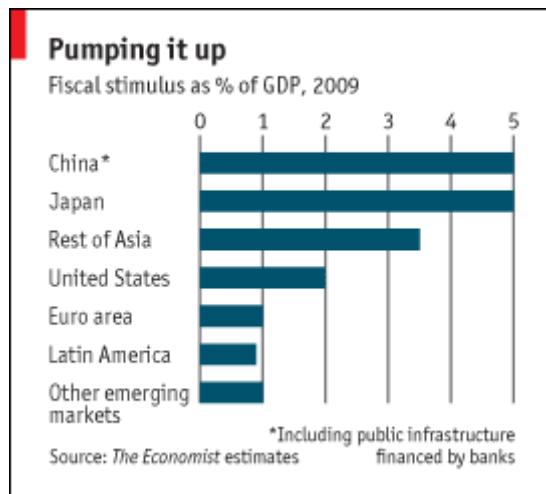
Across the region as a whole, the slump has been as bad as it was in 1998. China and India have continued to grow, but in the rest of emerging Asia GDP plunged by an annualised 15% in the fourth quarter of 2008. Only three economies have published first-quarter figures. China's GDP growth accelerated to an annualised rate of over 6%, up from around 1% in the previous quarter. South Korea's GDP expanded by 0.2%, after plunging 19% in the previous three months. But Singapore's GDP fell by 20%, even more than in the fourth quarter.

More timely export figures suggest that the worst may be over. Although the headline numbers show that South Korea's exports fell by 19% in the year to April, they rose by a seasonally adjusted annualised rate of 53% in the three months to April compared with the previous three months, Goldman Sachs estimates; Taiwan's grew by an annualised 29% over the same period. China's exports over the last few months have only managed to stabilise, but its industrial production jumped by an annualised 25% in the past three months.

Economists are revising up their forecasts for China's GDP growth this year: 8% may now be possible even if American consumers continue to be frugal. There is a widely pedalled myth that China's growth depends on American consumers. In fact, if measured on a value-added basis (to exclude the cost of imported components), China's exports to America account for less than 5% of its GDP.

There is more argument, however, over the smaller, more export-driven economies, such as Hong Kong, South Korea, Singapore and Taiwan. Robert Subbaraman, an economist at Nomura, offers several reasons why they are likely to remain sluggish for the time being. The recent rise in exports and production, he argues, largely reflects the fact that firms are no longer running down stocks. This will provide only a temporary boost unless global demand picks up. Firms' spare capacity also means that investment will continue to fall, while rising unemployment threatens to dent consumer spending. Nor is China's stronger growth likely to save the region. Over 60% of China's imports come from the rest of Asia, but about half of these are components which are assembled in China then sold to the rich world.

In its economic outlook on Asia published this month, the IMF forecast that the region excluding China and India would grow by only 1.6% in 2010, largely because it expects the American economy to be flat. However, Peter Redward, of Barclays Capital, argues that Asia can recover earlier and more strongly than elsewhere. In 2010 he reckons that the smaller Asian economies could grow by almost 4%, or close to 7% once faster growing China and India are added in.



One reason for his optimism is his explanation for why the Asian economies were hit harder than other parts of the world. Asians are often blamed for saving too much and spending too little, but Mr Redward argues that the main reason for their plight was that manufacturing accounts for a much larger share of GDP than elsewhere. Industries such as cars, electronic goods, and capital machinery are highly cyclical. A comparison across rich and emerging economies shows that GDP fell furthest last year in countries with the largest share of manufacturing. But this, in turn, could imply a sharp recovery.

A second reason for expecting a stronger bounce is that fiscal stimulus in Asia is bigger than in other regions. China, Japan, Singapore, South Korea, Taiwan and Malaysia have all announced fiscal packages of more than 4% of GDP for 2009, twice as large as America's stimulus this year. The pump-priming should also work better in Asia than in America or Europe, because modest corporate and household debts mean that tax cuts or cash handouts are more likely to be spent than saved. Banks, moreover, are in much better shape and so have more freedom to support an increase in domestic spending.

As the world's largest importer of oil and other commodities, the tiger economies have also benefited hugely from the fall in prices over the past year. This has acted like a tax cut, boosting real incomes and profits. Asia has enjoyed a gain from cheaper oil of almost 3% of GDP this year. Add in lower prices for food and raw materials and the total gain could match the governments' stimulus (though the danger remains of a renewed spike in oil prices).

Pessimists maintain that Asia has always been pulled out from previous recessions, such as the 1998 financial crisis, by strong exports to the West. However, a recent analysis by Frederic Neumann and Robert Prior-Wandesforde, both of HSBC, finds that, contrary to received wisdom, Asia's recovery from its 1998 slump was led not by exports, but by consumer spending. Exports to the West did not surge until 2000. The region's current-account surplus actually shrank between 1998 and 2001.

Thanks to a large fiscal stimulus and the healthier state of private-sector balance-sheets in most economies, domestic spending (consumption and investment) should revive earlier in emerging Asia than elsewhere, rising by perhaps 7% next year, up from 4-5% this year.

America's domestic demand is expected to remain weak in 2010 after falling sharply this year. Indeed, add in Japan and total Asian domestic spending (at market exchange rates) looks set to overtake America's next year.

But what of emerging Asia's longer-term prospects? Much of the increase in Asian domestic demand this year and next will come from government investment. Unlike rich countries, emerging Asia has room to keep investing in infrastructure for several years but governments need to encourage more consumption to fill the gap after the infrastructure projects are completed. Asian households' low rate of consumption and borrowing means that they have huge scope to spend more. Better social safety nets might encourage Asians to save less. Governments also need to lift households' share of national income by reducing their bias towards capital-intensive manufacturing and encouraging more labour-intensive growth.

Looking ahead, relatively robust expansion in domestic spending should help most Asian economies to keep growing faster than the rest of the world. But the tigers are unlikely to return to their heady growth rates of recent years—nor would that be desirable given the impact on inflation and the environment. Suppose that net exports contribute nothing to growth, while domestic demand grows at roughly the same pace as in the past five years, then emerging Asia could see growth of almost 7% over the next five years (around 8% in China, a more modest 5% in the smaller economies). That might sound like a let down for economies that enjoyed average growth of 9% in the three years to 2007. But it would still be around three times as fast as in the rich economies.

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