An astonishing rebound

Asia's emerging economies are leading the way out of recession; now they must make their recovery last.

It never pays to underestimate the bounciness of Asia's emerging economies. After the region's financial crisis of 1997-98, and again after the dotcom bust in 2001, outsiders predicted a lengthy period on the floor—only for the tigers to spring back rapidly. Earlier this year it was argued that such export-dependent economies could not revive until customers in the rich world did. The West still looks weak, with many economies contracting in the second quarter, and even if America begins to grow in the second half of this year, consumer spending looks sickly. Yet Asian economies, increasingly decoupled from Western shopping habits, are growing fast.

The four emerging Asian economies which have reported GDP figures for the second quarter (China, Indonesia, South Korea and Singapore) grew by an average annualised rate of more than 10% (see article). Even richer and more sluggish Japan, which cannot match that figure, seems to be recovering faster than its Western peers. But emerging Asia should grow by more than 5% this year—at a time when the old G7 could contract by 3.5%. Western politicians should brace themselves for more talk of economic power drifting inexorably to the East. How has Asia made such an astonishing rebound?

Out of smoke and mirrors, say some Western sceptics. They claim China's bounceback is yet another fake. The country's numbers are certainly dodgy: the components of GDP do not add up, and the data are always published suspiciously early. China's economy probably slowed more sharply in late 2008 than the official numbers suggest. But other indicators, which are less likely to be massaged, confirm that China's economy is roaring back. Industrial production rose 11% in the year to July; electricity output, which fell sharply last year, is growing again; and car sales are 70% higher than a year ago.

And surely the whole of Asia cannot be engaged in a statistical fraud. South Korea's GDP grew by an annualised 10% in the second quarter. Taiwan's probably increased by even more: its industrial output jumped by an astonishing annualised rate of 89%. India was hit less hard by the global recession than many of its neighbours because it exports less, but its industrial production has also perked up, rising by a seasonally adjusted rate of 14% in the second quarter. Output in most of the smaller Asian economies is still lower than a year ago, because they suffered steep downturns late last year. But at economic turning points, one should track quarterly changes.

Thrift in the boom, stimulus in the slump

Asia’s rebound has several causes. First, manufacturing accounts for a big part of several local economies, and industries such as cars and electronics are highly cyclical: output drops sharply in a downturn and then spurts in the upturn. Second, the region’s decline in exports in late 2008 was exacerbated by the freezing up of global trade finance, which is now flowing again. Third, and most important, domestic spending has bounced back because the fiscal stimulus in the region was bigger and worked faster than in the West. India aside, the Asians entered this downturn with far healthier government finances than rich countries, allowing them to spend more money. Low private-sector debt made households and firms more likely to spend government handouts; Asian banks were also in better shape than their Western counterparts and able to lend more. Asia’s prudence during the past decade did not allow it to escape the global recession, but it made the region’s fiscal and monetary weapons more effective.

Western populists will no doubt once again try to blame their own sluggish performance on “unfair” Asia. Ignore them. Emerging Asia’s average growth rate of almost 8% over the past two decades—three times the rate in the rich world—has brought huge benefits to the rest of the world. Its rebound now is all the more useful when growth in the West is likely to be slow. Asia cannot replace the American consumer: emerging Asia’s total consumption amounts to only two-fifths of America’s. But it is the growth in spending that really matters. In dollar terms, the increase in emerging Asia’s consumer-spending this year will more than offset the drop in spending in America and the euro area. This shift in spending from the West to the East will help rebalance the world economy.

Beijing, Bangkok and Bangalore: beware boastfulness

It is easy to boost an economy with lots of government spending. But Asian policymakers now face two difficult problems. Their immediate dilemma is how to sustain recovery without inflating credit and asset-price bubbles. Local equity and property markets are starting to froth. But policymakers’ reluctance to let their currencies rise faster against the dollar means that their monetary policy is, in effect, being set by America’s Federal Reserve, and is therefore too lax for these perkier economies. The longer-term challenge is that once the impact of governments’ fiscal stimulus fades, growth will slow unless economic reforms are put in place to bolster private spending—something Japan, alas, never did (see article).

Part of the solution to both problems—preventing bubbles and strengthening domestic spending—is to allow exchange rates to rise. If Asian central banks stopped piling up reserves to hold down their currencies, this would help stem domestic liquidity. Stronger currencies would also shift growth from exports to domestic demand and increase households’ real spending power—and help ward off protectionists in the West.

Hubris is the big worry. With the gap in growth rates between emerging Asia and the developed world heading towards a record nine percentage points this year, Chinese leaders have taken to warning America about its lax monetary policy (while Washington has stopped lecturing China about the undervalued yuan). But it would be a big mistake if Asia’s recovery led its politicians to conclude that there was no need to change their exchange-rate policies or adopt structural reforms to boost consumption. The tigers’ faster-than-expected rebound from their 1997-98 financial crisis encouraged complacency and delayed necessary reforms, which left them more vulnerable to the global downturns in 2001 and now. Make sure this new rise is not followed by another fall.

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