

# Global Economic Trends

---

Lawrence J. Lau, Ph. D.

President and Ralph and Claire Landau Professor of Economics

The Chinese University of Hong Kong

and

Kwoh-Ting Li Professor in Economic Development, Emeritus, Stanford University

Meeting of the International Advisory Board

The Asan Institute for Policy Studies

Hawaii, January 15, 2009

Phone: (852) 2609-8600; Fax: (852) 2603-5230

Email: [LAWRENCELAU@CUHK.EDU.HK](mailto:LAWRENCELAU@CUHK.EDU.HK); WebPages: [HTTP://WWW.CUHK.EDU.HK/VC](http://www.cuhk.edu.hk/vc)

# Outline

---

- ◆ Introduction
- ◆ The Partial De-Coupling of East Asia from the World Economy
- ◆ The Decline in East Asian Exports and Export Orders
- ◆ The East Asian Stock Markets
- ◆ Trends in Relative Exchange Rates
- ◆ Coordinated Simultaneous Economic Stimuli
- ◆ Concluding Remarks

# Introduction

---

- ◆ The financial earthquake has affected all of the developed economies, especially the United States. While North America and Europe have gone into economic recession, it is not an ordinary recession, because it is accompanied by a serious breakdown of the capital and credit markets and bankruptcy, insolvency and illiquidity of many major financial institutions.
- ◆ Fortunately, in East Asia, despite the steep decline in the stock markets, the financial institutions remain relatively sound and financial stability is not seriously threatened.
- ◆ However, East Asian exports to North America and Europe has slowed, and export orders have fallen precipitously since mid-September, to the order of 50%, on an year-over-year basis. This has caused derivative declines in the demands for shipping, transportation, logistics and storage.

# Introduction

---

- ◆ The declines in the East Asian stock markets are due primarily to three reasons: repatriation of capital back home by foreign investors; de-leveraging; and loss of confidence (irrational panic).
- ◆ The drying up of initial public offerings and other financial transactions.
- ◆ The reduction in wealth (even unrealized) also has a negative impact on domestic consumption and investment.
- ◆ The decline in visitor arrivals, especially from North America and Europe.

# Introduction

---

- ◆ All this means a decline in the rates of growth of real GDP and a rise in the rates of unemployment in many East Asian economies. The rate of growth has already turned negative for two consecutive quarters and is expected to remain negative for at least another two quarters. The unemployment rate is expected to edge up but will probably stop short of the high of 8% reached during the SARS period.

# The Partial De-Coupling of East Asia from the World Economy

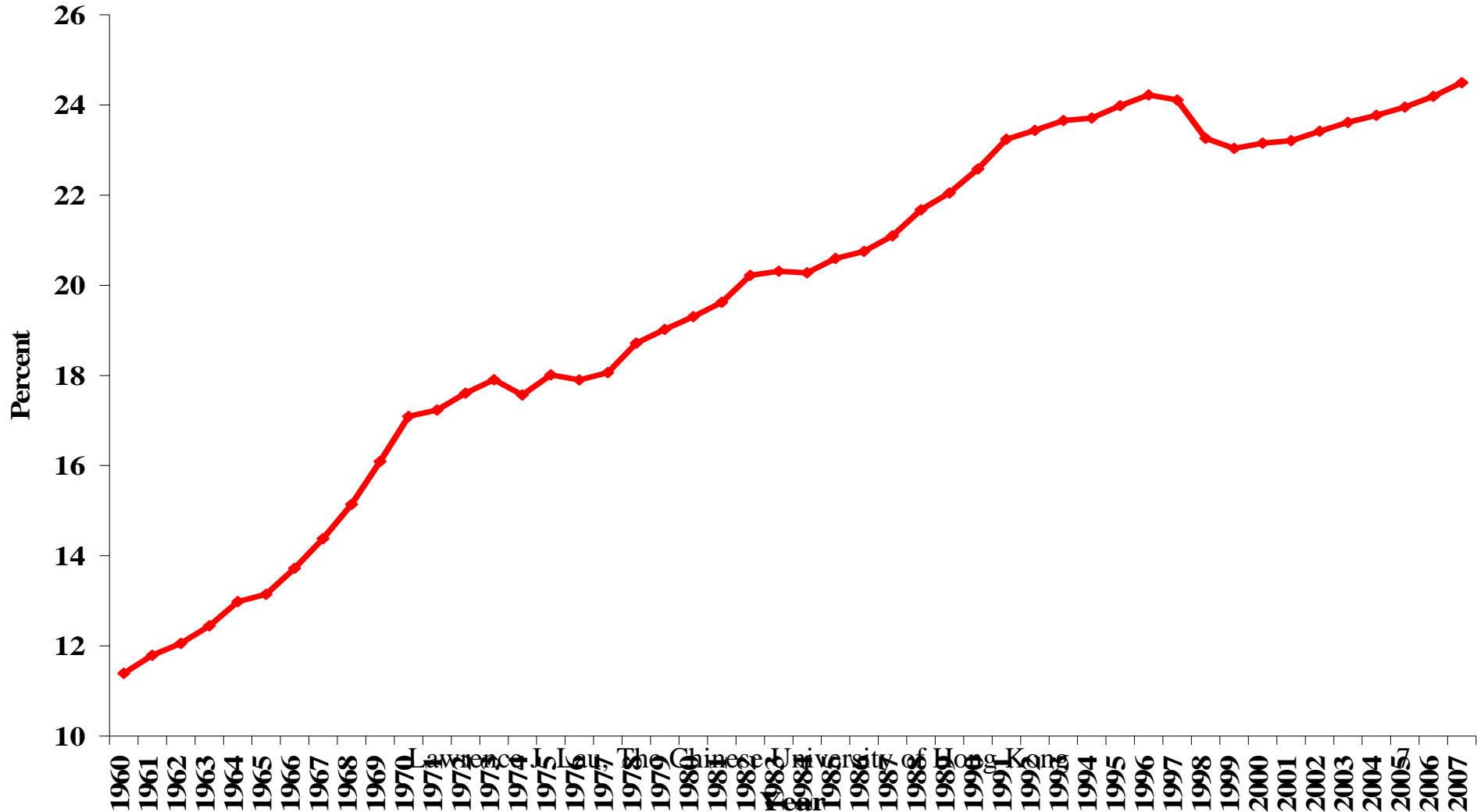
---

- ◆ The economic center of gravity of the world has been gradually shifting to East Asia from the United States and Western Europe and within East Asia from Japan to China.
- ◆ In 1960, East Asian GDP, comprising of the GDPs of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) + 3 (China (Mainland only), Japan, and South Korea) was less than 12 percent of World GDP. Today, East Asian GDP accounts for approximately a quarter of World GDP.

# East Asian Share of World GDP, 1960-present

---

East Asian Share of World GDP, 1960-present



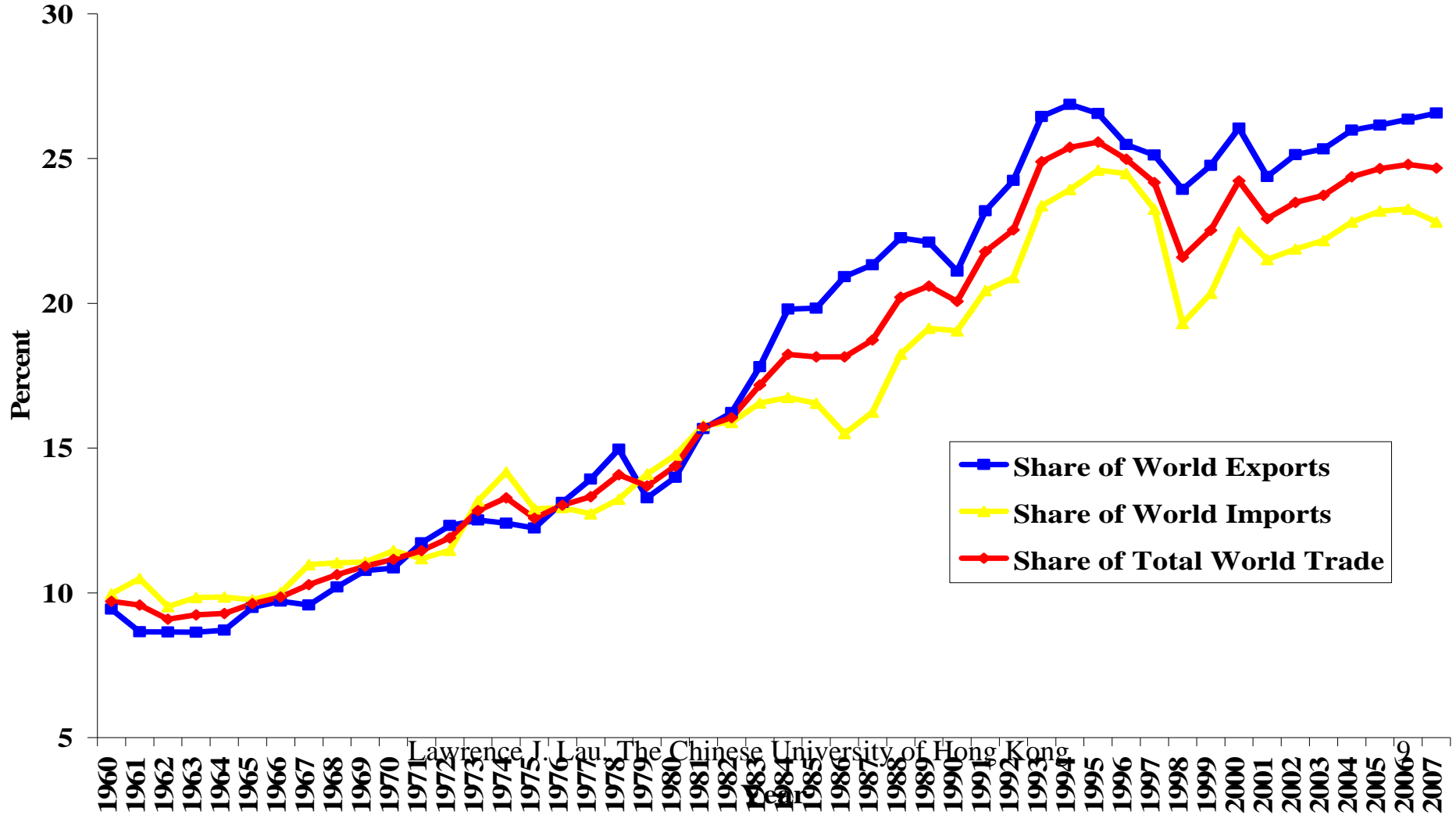
# The Partial De-Coupling of East Asia from the World Economy

---

- ◆ East Asian shares of world exports, imports, and international trade have also grown from approximately 10 percent in 1960 to a quarter in 2007, paralleling the growth of East Asian share of world GDP.
- ◆ Because of the rapid economic growth of China and the rest of East Asia outside of Japan, and the demand and supply that such economic growth has generated, the East Asian economies now trade more with one another than with economies outside of East Asia, including the United States. Approximately half of East Asian trade is among East Asian economies. This is a sea change compared to say thirty years ago when most of the East Asian trade was between East Asia and the United States and Western Europe.

# The Rising Ratio of East Asian Trade in Total World Trade, 1960-present

East Asian Share of Total World Trade, 1960-present



# The De-Coupling Hypothesis

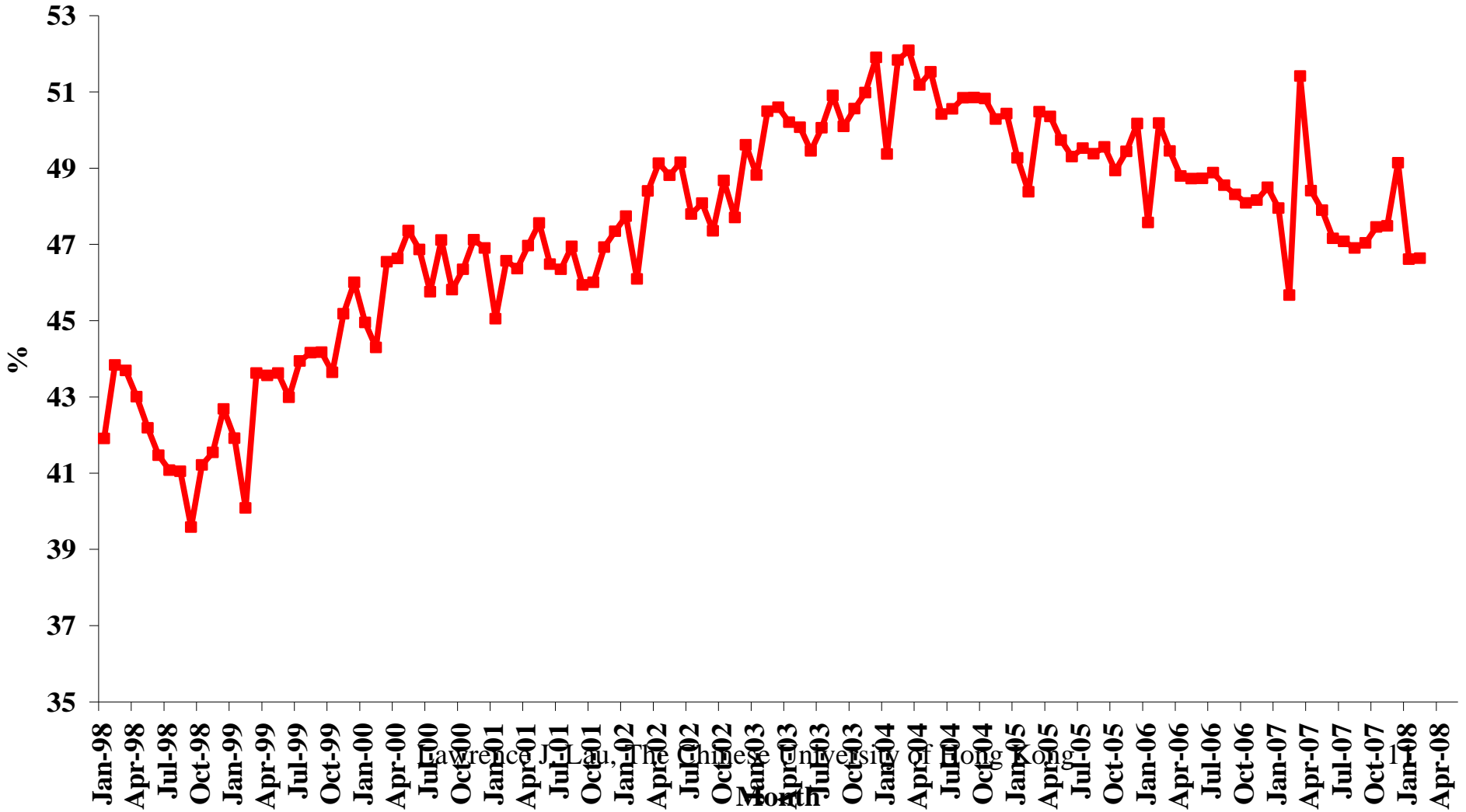
## The Changing Pattern of World Trade

---

- ◆ Interdependence of the East Asian economies has been rising sharply over the years and East Asian dependence on the United States and Western Europe has declined.
- ◆ The ASEAN Free Trade Area as well as its variations (+1 (China); + 3 (China, Japan and South Korea)) are rapidly becoming a reality.
- ◆ This is what gives credence to the idea of partial “de-coupling” of the world economies—that the Chinese and East Asian economies can continue to do reasonably well despite the current economic problems in the U.S. and elsewhere. However, China (and East Asia) are not large enough to turn around the whole world.

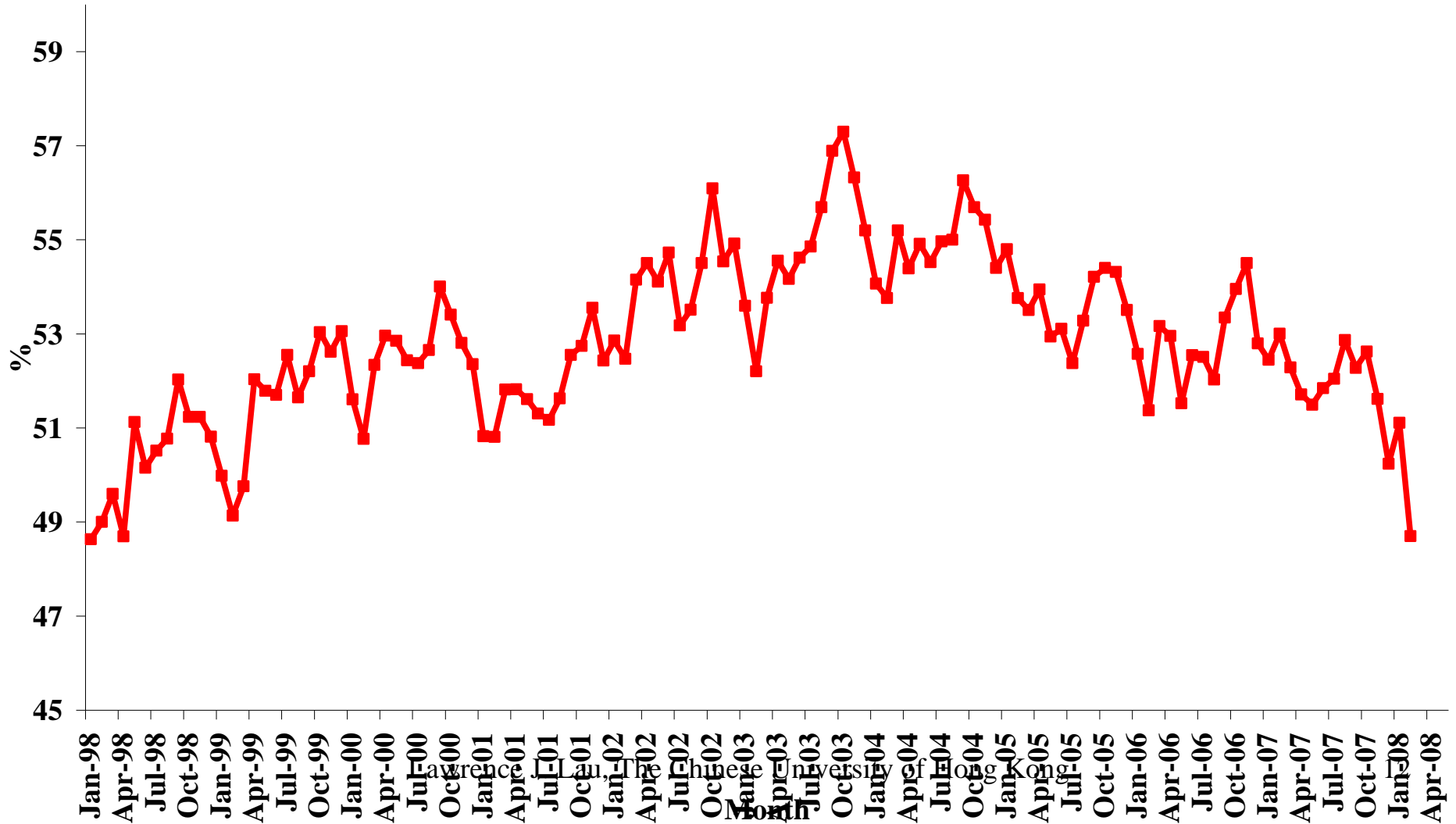
# The Share of East Asian Exports Destined for East Asia

The Share of East Asian Exports Destined for East Asia



# The Share of East Asian Imports Originated from East Asia

The Share of East Asian Imports Originated from East Asia



# The Partial De-Coupling of East Asia from the World Economy

---

- ◆ In general, the phenomenon of (partial) “decoupling” is expected to be operative. Chinese economic growth will be largely unaffected by external developments, including an economic recession in the United States. The other so-called BRIC countries—Brazil, Russia and India—are even less dependent on exports, especially exports to the U.S. Russia has benefitted from the high world price of oil (which has recently fallen back to more normal levels) but is not a major exporter of manufactured goods and hence will be relatively unaffected by the economic recession in the U.S. and elsewhere per se. India is also not a major exporter, except in computer software, and its economic growth is mostly internal-demand driven.

# The Partial De-Coupling of East Asia from the World Economy

---

- ◆ The BRIC countries can be expected to continue growing, albeit at somewhat lower rates, and the rest of developing East Asia should be able to manage.
- ◆ The high domestic savings rate found in almost all of the East Asian economies is a major advantage of East Asia, making it independent of capital inflows from developed economies and hence de-coupling much more possible and likely.
- ◆ During the East Asian currency crisis of 1997-1998, the mutual impacts of the simultaneous downturns and upturns on the part of East Asian economies on one another were amply demonstrated. So long as they continue growing together, by creating demands for one another's exports, their collective growth can be more or less sustained.
- ◆ Through it all, the rate of growth of Chinese real GDP remained relatively stable even as its rates of growth of exports and imports fluctuated widely.

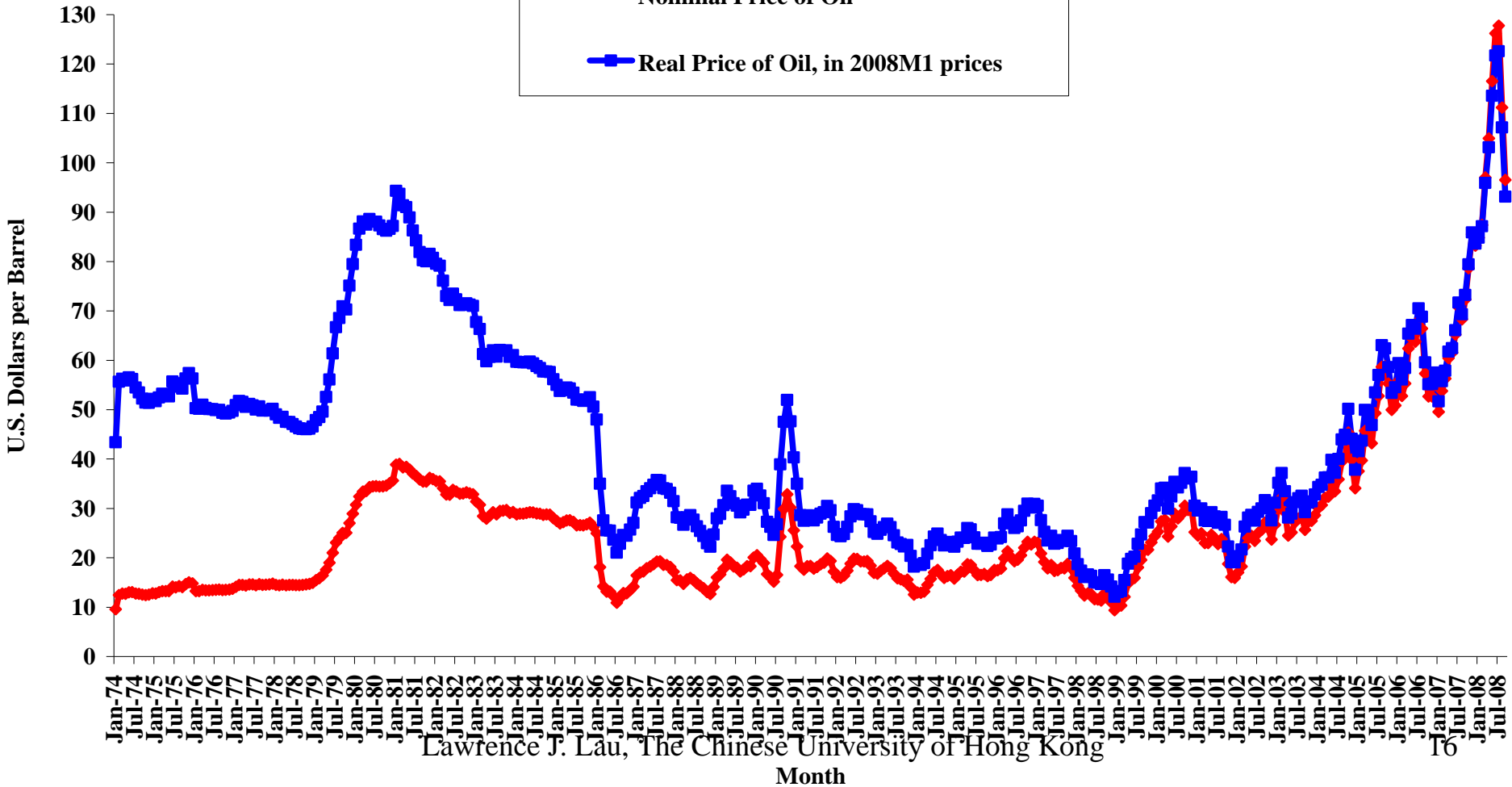
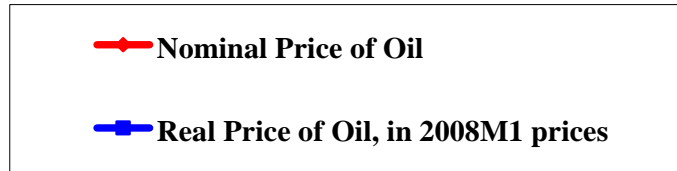
# The World Price of Oil

---

- ◆ The world price of oil has begun to return to more normal levels. The world price of oil, in real terms, is not significantly different from the price of oil prevailing in the early 1980s. It has the room to fall further to about US\$40 a barrel in 2008 prices which was the upper range of the price of oil between 1987 and 2004.

# The Nominal and Real World Prices of Oil (2008 prices)

Nominal and Real Price of Oil



Lawrence J. Lau, The Chinese University of Hong Kong

# The Decline in East Asian Exports and Export Orders

---

- ◆ Chinese exports have been expected to slow down not only because of the economic recession in the U.S. and elsewhere in the World but also because of many other factors such as the revaluation of the Renminbi by 20% since July 2005, the intensified enforcement of environmental regulations, the unification of the tax rates for domestic and foreign-invested enterprises which raises the taxes on foreign-invested enterprises, and the implementation of the new labor law, all of which preceded and were independent of the global financial crisis.
- ◆ However, the decline in export orders received by Chinese exporters of almost 50% year-over-year since September took almost everyone by surprise. While it is true that export orders have been expected to decline and have been declining, but not to this order of magnitude.

# The Decline in East Asian Exports and Export Orders

---

- ◆ Why was there such a large, precipitous decline? This was principally caused by the importers in the U.S. and elsewhere having their access to bank credit frozen. Importers cannot get their bankers to issue letters of credit to the Chinese exporters, or if they can, these letters of credit may not be accepted by the Chinese commercial banks. For those importers with impeccable reputation whose orders would be accepted by Chinese exporters even without a letter of credit, such as Hewlett-Packard, Nike and Wal-Mart, the problem has to do with the ability to finance their inventory with bank loans from their U.S. banks. As the availability of such credit dwindles, they also reduce their orders and wait until the inventory is exhausted. The net result is a huge reduction in orders for Chinese exports.

# The Decline in East Asian Exports and Export Orders

---

- ◆ It is, however, important to realize that this is not the result of a reduction in the expected demand for Chinese exports of this magnitude, but the result of the credit freeze in the U.S. It is also not the result of Chinese exports being too expensive, and thus a devaluation of the Renminbi and/or an increase in the proportion of Value-Added-Tax (VAT) rebate on exports are also not likely to be effective.
- ◆ According to the historical experience of the U.S. economy, real personal consumption is a much smoother series than real GDP or real personal income. Since 1949, the worst quarterly decline (at annualized rates) of personal consumption was 12% and since 1952 was less than 10%.

# The Decline in East Asian Exports and Export Orders

---

- ◆ Imports of consumption goods would therefore be expected to decline with personal consumption, but probably at no more than double the rate of decline of real personal consumption. For Chinese exports, which consists of mostly daily consumption goods targeted at the low-price market, the effect should be much smaller, as consumers switch from high-price to low-price items in an economic downturn. (Furniture and large appliances, such as television sets, that relate to housing, are exceptions.)
- ◆ So the expectation is that much of the lost export orders would bounce back in a quarter or two, and that much of this decline in export orders is only temporary and basically represents a delay or postponement of the demand by a quarter or two for Chinese exports, as opposed to a permanent reduction. Thus, the decline in Chinese exports, when averaged over a whole year, should not exceed 20%. In terms of GDP, the impact should be a reduction on the order of 1.5%, a significant but still manageable amount.

# The Decline in East Asian Exports and Export Orders

---

- ◆ The Chinese Government can however shorten the delay or postponement of demand by allowing the Chinese commercial banks to finance the exports of long-term seasoned exporters to their long-term customers so that they can ship their goods on a consignment basis and allow payment terms of 6 months after receiving the goods. This will allow Chinese export enterprises to continue their production with minimal interruption and layoffs of workers. To make this happen, the Chinese Government may need to guarantee these loans in whole or in part, possibly through the Export-Import Bank of China—otherwise the Chinese commercial banks may not be willing to extend such credit to the Chinese exporters.

# Long-Term Impact

---

- ◆ The Continuing Shift in the Economic and Financial Center of Gravity
  - ◆ U.S. and Europe gradually lose their pre-dominance.
  - ◆ There is a relative redistribution of wealth in favor of East Asia.
- ◆ Cash and Savings are King
  - ◆ Savers will own the world

# Long-Term Impact

---

## ◆ Beyond Renminbi Convertibility

- ◆ With the U.S.\$ likely to devalue over the intermediate to long term, despite its short-term strength, Hong Kong must prepare for the arrival of the full convertibility of the Renminbi.

# The East Asian Stock Markets

---

# Trends in Relative Exchange Rates

---

- ◆ New Global Financial Architecture and Regulatory Regime
- ◆ The global financial system will have to be restructured to limit the spillover effects.
- ◆ The global financial markets will be reorganized and reoriented, with new, hopefully safer products.
- ◆ The use of leverage, which used to be a substitute for savings, will be greatly reduced.
- ◆ Short-term international capital flows will be more closely monitored and regulated.

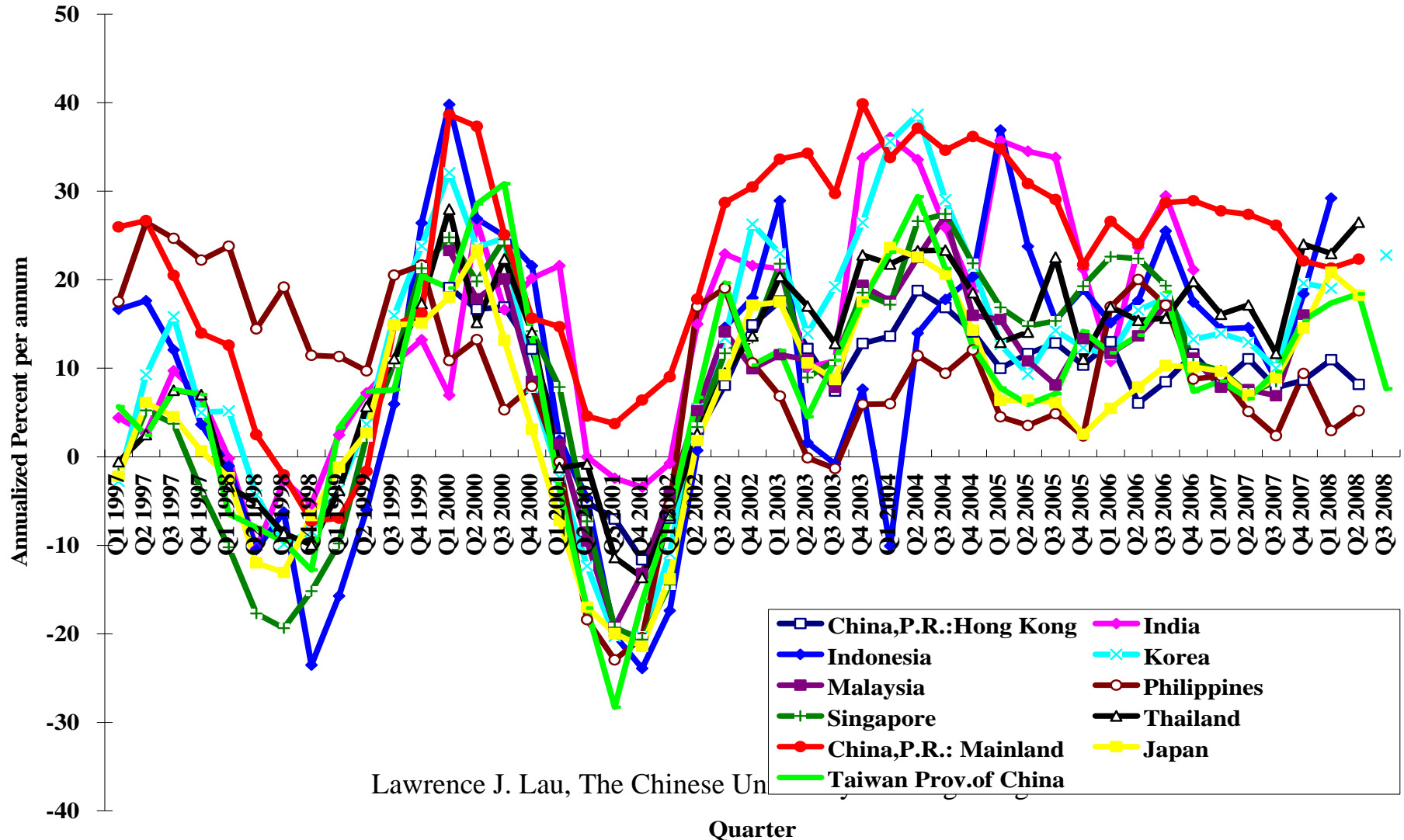
# Coordinated Simultaneous Economic Stimuli

---

## ◆ Coordinated Simultaneous Economic Stimuli

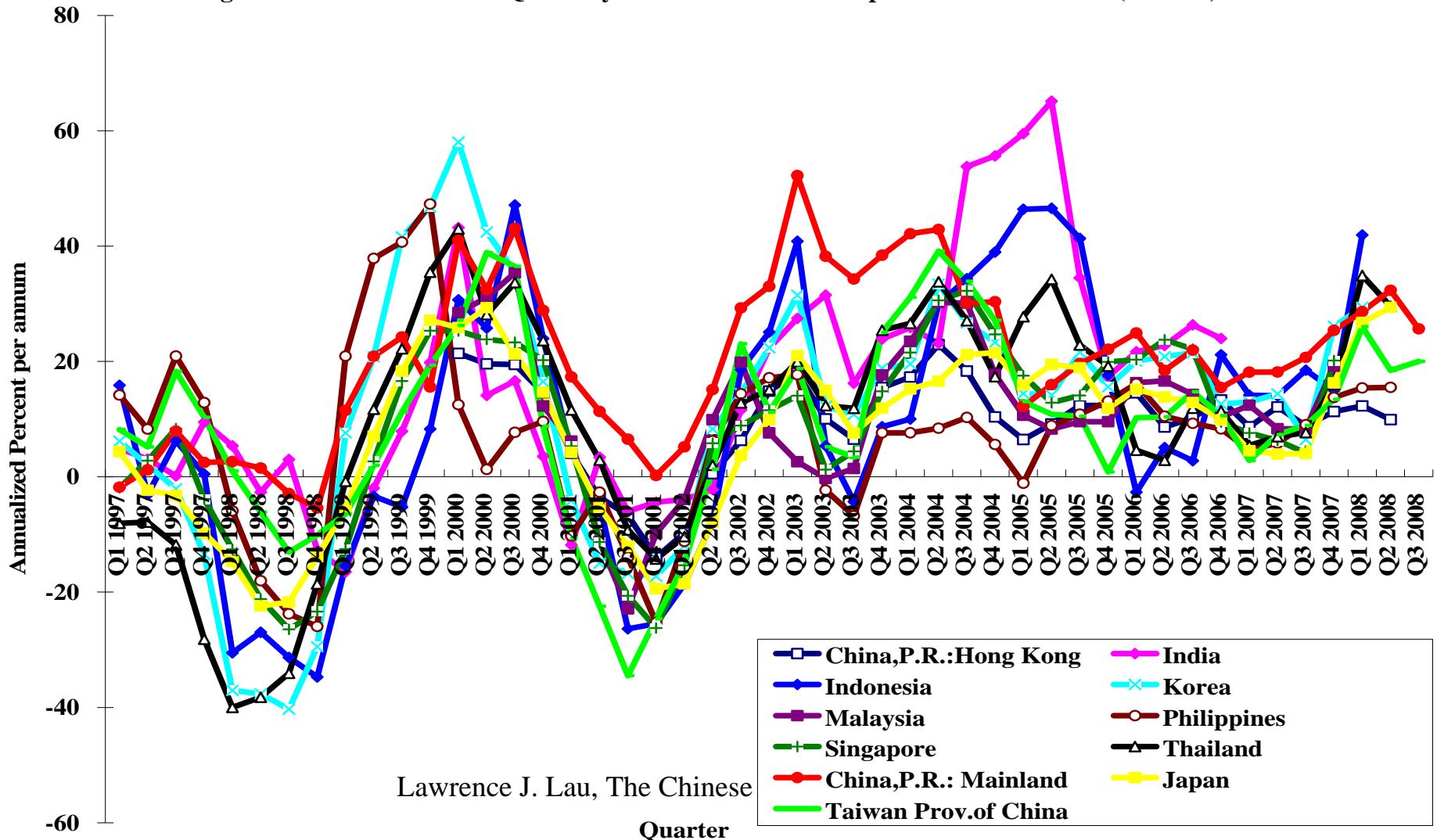
# Quarterly Rates of Growth of Exports of Goods: Selected East Asian Economies

Figure 3.2: Year-over-Year Quarterly Rates of Growth of Exports of Goods in US\$ (Percent)



# Quarterly Rates of Growth of Imports of Goods: Selected East Asian Economies

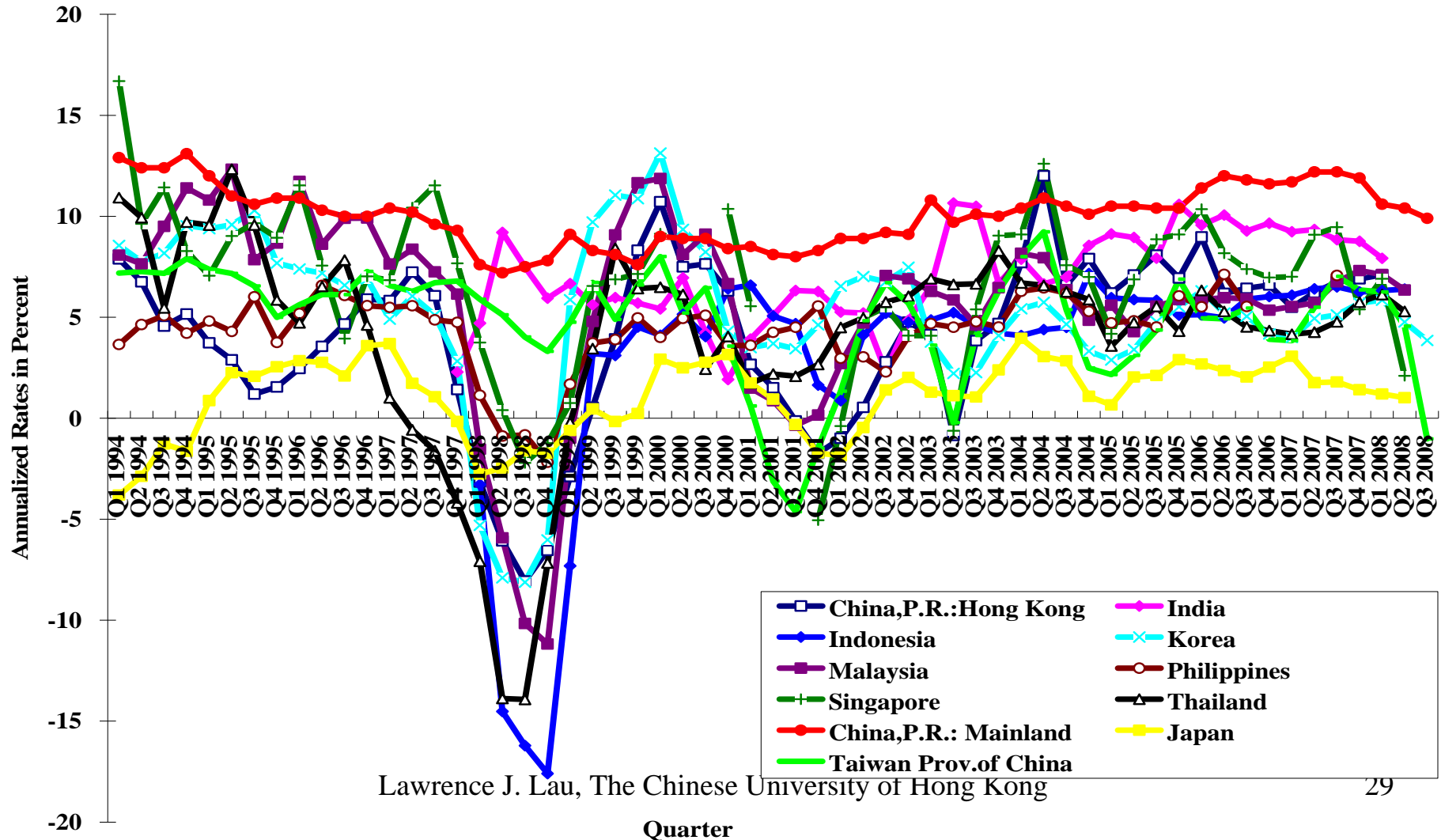
Figure 3.3: Year-over-Year Quarterly Rates of Growth of Imports of Goods in US\$ (Percent)



Lawrence J. Lau, The Chinese  
Quarter

# Quarterly Rates of Growth of Real GDP: Selected East Asian Economies

Figure 3.1: Quarterly Rates of Growth of Real GDP, Year-over-Year, Selected East Asian Economies



Lawrence J. Lau, The Chinese University of Hong Kong

# Concluding Remarks

---

- ◆ If the Chinese economy continues to grow in the 8% range in the next couple of years, the Hong Kong economy will be able to do reasonably well. I am confident that China will be able to grow at approximately 8% and that Hong Kong will be able to survive the financial earthquake relatively unscathed.
- ◆ The recovery will come sooner to East Asia