THE GOING GETS TOUGHER FOR EAST ASIAN ECONOMIES

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The "flying geese", coined by Hitotsubashi University in the sixties, are not flying any more. The miracle economies of East Asia seem to have fallen from grace after the humbling experience of the currency crisis of 1997-98. The East Asian tigers, having lost some stripes, are still licking their wounds in total disbelief. There is still too much pride, which presents problems of sorts in coming to terms with the new realities.

The economic woes of East Asia, which are basically structural in essence, as exposed by the recent financial crisis, have been compounded more recently by a major downturn, which is fundamentally cyclical in nature. This time around, they cannot export themselves out of the doldrums, as the export markets are slumbering. Nor can they spend their way out of the woods, as there are limits to fiscal pump priming. Even cuts in interest rates, which had worked in the past fairly well as a stimulus, seem haplessly ineffective.

Evidently, East Asia was able to fly high, propelled by strong external, not internal, demand. The United States, more than any other country, has been playing a pivotal role as a major export destination for East Asian products. As the largest economy in the world, and the biggest importer at that, the United States exerts enormous influence on the world economy in general and East Asia in particular.

It is quite obvious that the present economic problems of East Asia have much to do with the current slowdown in the US economy. Countries, which depend mainly on the US for their exports, especially those that rely heavily on electrical and electronic products, an industry that is experiencing a sharp downturn, are particularly vulnerable. The US economy, which grew by 5 per cent (which is hefty for a large mature economy) in 2000, is expected to post a modest growth of merely 1 per cent this year. The slowdown in the United States has turned out to be far more serious than initially thought, with the economy registering a marginal growth of 0.3 per cent in the second quarter and a negative growth of -1.1 per cent in the third. All indications are that it will contract further in the fourth quarter. The Sept 11 attacks in the United States have dashed the hope of a year-end recovery. Consumer confidence in the United States, where private consumption accounts for a large chunk of the economic pie, has been badly dented, sinking to a 7-year low in October. Unemployment in the United States is on the rise, reaching 5.4 per cent in October, and is expected to exceed 6 per cent in the second quarter of next year. The chances are that the US economy will not turn around until late next year. It then follows that East Asian exports to the United States will not pick up for next 10 -12 months.

This time around, there is no helping hand from Europe to offset the contraction in the US economy. The situation in Europe has an additive impact on East Asia, with many European economies experiencing sluggish growth. Germany, the second growth pole of the world economy, contracted in the third quarter. Growth for Euro-zone economies this year is forecast at 1.3 per cent, while unemployment hovers at 8.3 per cent. As a consequence, East Asian exports to Europe have been adversely affected.

Japan, the third growth pole, has been sick for a long time. Bank of Japan has recently revised its growth forecast for the economy in the current financial year down to –0.9 per cent. This would put the world's second largest economy in the fourth recession in a decade. Japan's unemployment rate hit a record 5.3 per cent in September. Private consumption, which forms about 60 per cent of Japan's gross domestic product (GDP), has been deteriorating rapidly in recent months. Evidently, Japan is deflating, while bad loans are soaring to dizzy heights. An ailing Japanese economy is bad for its neighbours, as all this translates into smaller exports to, and investment from, Japan.

The malaise seems contagious, affecting all countries across East Asia in varying degrees. The smaller and the more specialised economies are more vulnerable than the bigger and the more diversified. Thus, Singapore is suffering from its worst recession in four decades, with its GDP contracting by 11.1 per cent, on an annualised basis, in the third quarter this year, due primarily to plunging exports.

Even Taiwan, which has been remarkably resilient, is not immune. Its focus on electronic products, combined with its dependence on exports, is hurting the island economy. In the third quarter, Taiwan's economy shrank by 4.2 per cent year-on-year, the sharpest decline in more than two decades.

Malaysia, one of the better economies in the region in terms of macroeconomic fundamentals, is not spared either. The Malaysian economy, after posting a modest growth of 1.8 per cent in the first half this year and a negative (–1.3 per cent) growth in the third quarter, is headed for a technical recession in the second half, due again to plummeting exports, although GDP growth for the year as a whole is expected to be marginally positive at 0.3 per cent.

Thailand and the Philippines are also reeling under the impact of falling exports, albeit to a slightly lesser extent, as electronics and electrical products account for a smaller proportion of total exports than is the case with Taiwan, Singapore or Malaysia. Indonesia is affected even less, due partly to its export composition and partly to the low base. South Korea is holding up somewhat with a marginally positive 1.3 per cent growth in the third quarter

China appears to be an exception to all this, as it is still poised to garner a 7 per cent growth this year, which is not surprising in view of the smallness of its external sector relative to its huge domestic economy. However, China is seen not as a part of the solution to the woes of its neighbours, but rather as a part of the problem. China's huge domestic market and cheap labour are luring investors into the country at the expense of the rest of the region. Many expect this trend to gain further momentum upon China's entry into the World Trade Organization (WTO). Worse, China may even cause manufacturing in the neighbourhood to hollow out, as companies relocate to China in large numbers.

East Asia badly needs a locomotive, now that Japan is snoozing. China cannot be a locomotive in the near term. Despite impressive GDP growth, there is still considerable excess capacity in China, which is why the economy is deflating profusely with prices tumbling. Surely, this is bad news for its Asian competitors. Already, cheap Chinese products are dragging down prices across the region. It is not difficult to foresee squabbles in WTO in the near future over China's export dumping and undervalued currency, which would give Chinese exports an unfair advantage. Already, there are calls from Japan asking China to revalue the yuan with a view to taking the pressure off other economies in the region. Chinese deflation may get worse, not better, after the country's admission into WTO, as this would force major restructuring in the country.

There is little that East Asian countries can do about all this individually. Fiscal policy takes time to work itself out, not to mention resource constraints or concerns over public debt burden. Japan's persistent use of fiscal stimulus through budget deficits year after year has failed to lift the economy. Latest on this track is the 3 trillion yen extra budget allocation enacted mid-November and another 2.5 million yen supplementary budget a week later. Pump-priming, responsible for Japan's mountain of public debt, which now stands at a whopping 130 per cent of GDP, is not sustainable. Malaysia, too, has been pump-priming the economy, through deficit budgets and stimulus packages, more aggressively than Thailand, the Philippines or Indonesia. The lesson learnt is that increased public spending can at best provide some relief, but it cannot take up the slack.

Monetary policy, too, has been somewhat ineffective. Again, there are limits to interest rate cuts. Easy monetary policy has driven interest rates close to zero in Japan without any discernible impact on the economy. The Federal Reserves in the United States has reduced interest rates for the tenth time thus far this year, again without much impact. Malaysia has also been adopting a low interest rate regime in recent years. The most recent reduction was on 20 September when Bank Negara slashed the intervention rate by a half percentage point to 5.0 per cent, and further cuts are not unlikely. Be that as it may, recent experience the world over has cast serious doubts on the efficacy of the monetary policy instrument under the present conditions.

Although East Asian economies can do little individually to fight economic downturns, there is much that can be done collectively. Increased intra-regional trade is the key. At present, intra-regional trade accounts for roughly 49 per cent of East Asia's total trade, which pales in comparison with Europe's 68 per cent. Increased cooperation in trade will strengthen the case for increased financial cooperation among East Asian economies. Macroeconomic policy coordination among East Asian economies can also contribute to greater regional resilience. Present difficulties may well be a blessing in disguise, as these are likely to force East Asian economies to increasingly seek regional solutions through regional initiatives.