

# Asia's economies

Claws or jaws

## Asia's economies can weather a Western slowdown—but not prevent it

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Who will be dinner?

IN THE English-speaking world, people escape from frying pans into fires. In Thailand, the proverb is couched differently: people are said to escape from tigers only to be eaten by crocodiles. The Thai economy, like many in Asia, sprang free from the great recession surprisingly quickly. This year the bigger threat has been the widening jaws of inflation. With that in mind, the Bank of Thailand raised interest rates on August 24th for the ninth time since mid-2010. But it was a split decision. The economic woes of America and Europe have darkened Asia's mood. Some can again hear the tiger's growl.

After last year's swift recovery from recession, policymakers in developing Asian countries congratulated themselves on the resilience of their economies. Their docile

banking systems, high saving rates and hoards of foreign exchange shielded them from the worst of the financial chaos. Their efforts to tighten fiscal and monetary policy before the crisis struck gave them room to loosen up in response, as exports collapsed and confidence evaporated. In April 2009 the Thai central bank cut rates to 1.25%—lower than in most Asian economies—alongside a fiscal push worth 3% of GDP. Emerging economies were hit harder than optimists expected, but responded better than pessimists feared.

That resilience may be tested again sooner than anyone would have liked. In announcing its latest rate decision, the Bank of Thailand noted the dangers posed to the economy by a slowdown in America and Europe. Thailand remains highly exposed to global trade: exports, including air conditioners, video cameras and fridges, as well as tourism, accounted for over 70% of its GDP in 2010. But the bank found consolation in Thailand's growing sales to its neighbours and to “new” markets farther afield. Last year China overtook America to become the country's leading customer.

That trend is not unique to Thailand. Most of its neighbours now sell a smaller share of their exports to America and Europe than they did before the crisis (see chart). The precise percentages may be misleading. These exports include parts and components that may end up in the West, after first being assembled into final products in another country. But there is no denying the trend.



The region's economies are not, then, as vulnerable to the tiger's claws as they were in 2008. The crocodile, on the other hand, is uncomfortably close. Thailand's headline consumer-price inflation (4.1% in the year to July) was too high for the

central bank's comfort, but lower than in many of its neighbours, such as China (6.5%), India, where wholesale prices rose by 9.2%, or Vietnam, where consumer prices rose by an alarming 23% in the year to August.

Asia's campaign against inflation has dragged on longer than its central bankers hoped. Higher food and commodity prices were expected to drop out of the inflation figures eventually, but instead seem to have leached into other consumer prices. One consequence of this prolonged fight is that nominal interest rates have been raised off the floor. Indonesia's policy rate is now 6.75%; India's is 8%. That gives central bankers some room to cut if the world economy sags. The big exceptions are Taiwan, where the discount rate is less than 1.9%, and Singapore, which carries out monetary policy by setting a path for the exchange rate, not the interest rate. With rates in America at rock bottom, and the Singapore dollar set to strengthen against its American counterpart, interest rates in Singapore are extraordinarily low.

Reducing rates would help Asia's economies withstand a modest slowdown in the West. Goldman Sachs, for example, has cut its 2011 rate forecast for Indonesia, Malaysia, Philippines and Taiwan, but has barely trimmed its growth forecasts for these countries. But rate cuts would also weaken the region's exchange rates, sharpening their competitiveness and doing little to help economies outside Asia.

A fiscal response would do more to buoy demand in the rest of the world, as it did from 2007 to 2009, when budget balances deteriorated markedly throughout the region. Thailand's new prime minister, Yingluck Shinawatra, is contemplating another budgetary splurge. But policymakers elsewhere will be reluctant to spill the red ink again. It took China's central government until June just to count the cost of its massive stimulus, which added greatly to the huge debts now burdening its local governments.

With luck, another stimulus package will not be necessary. America will overcome its current economic woes and Europe will muddle through. A modest slowdown in the West might even take the pressure off prices in Asia, without doing undue harm to the region's growth—a case perhaps of the tiger eating the crocodile. But it would be too much to hope that Asia's resilience might be sufficient to carry the rest of the world along, preventing a downturn in the first place.

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