The Asian *Myth*

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The notion that the Asian economies have somehow insulated themselves from the United States is nonsense.

BY FRIEDRICH WU

With increasing evidence of an imminent bursting of the housing market bubble in the United States, aggravated by unfolding woes in the subprime mortgage sector and a consequent deceleration in consumer demand, a growing number of commentators have nevertheless advanced the sanguine argument that, this time around, the rest of the world would be able to avoid a "cold" even should the U.S. economy "sneeze." "Global economic growth has become less dependent on American spending," *The Economist* magazine has recently editorialized, while the *International Herald Tribune* has similarly opined that "economies around the world are weaning themselves from dependence on the American consumer."

In Asia, strong growth of 8–10 percent by the Chinese and Indian economies in the past few years has added much confidence and exuberance to this view. However, a more sober examination of the evidence at hand, especially in the Asian context, demonstrates that the argument is fundamentally fallacious, as the United States will remain an irreplaceable economic locomotive for Asia in the foreseeable future.

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Despite the recent hype about "Indian triumphalism," it will be decades before the country can emerge to serve as a growth engine for its Asian neighbors. Aside from a few pockets that have been penetrated by globalization, such as information technology and services outsourcing, an overwhelming majority of the Indian economy remains insular and over-regulated. In a recent World Bank report entitled *Doing Business in South Asia 2007,* India ranks a lowly 134th out of 175 countries on a business environment improvement index. Furthermore, as Edward Luce has somberly highlighted in his recent book *In Spite of the Gods: The Strange Rise of Modern India,* it would be sheer hubris for a country to proclaim itself to be the next great economic power when presently it still has more than 300 million of its people living in absolute poverty, only 10 percent of its workers employed in the formal economy, 35 percent of its population remaining illiterate, and the largest cohort of HIV-infected patients in the world, while corruption is so endemic and deep-rooted that the author laments that "it is the system."

In the case of China, its average 9–10 percent economic expansion in the past five years and its rising investment and trade ties with economies in the region have indeed helped lift the growth of its neighbors. Nevertheless, the Chinese economy itself is prone to recurring episodes of "over-heating," and hence lacks macroeconomic stability. As such, in the near term, it is hardly a reliable and sustainable growth engine for its economic partners. While the Beijing government has implemented since 2004 a plethora of administrative and market-based measures in an attempt to rein in runaway growth, the jury is still out on whether these policies could cool the turbo-charged economy. The International Monetary Fund and Asian Development Bank have separately warned that Asian economies and commodity-exporting countries with strong investment and trade ties to China would suffer various degrees of collateral economic damage should an overheating Chinese economy experience a precipitous fall into a hard landing.

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Aside from this risk, China itself is still very much dependent on the U.S. market. In 2005, nearly a quarter (21.5 percent) of its total exports were shipped to the United States. Even though other Asian countries have become less dependent on the U.S. market, the latter still absorbed between 10.4 percent (Singapore) and 20 percent (Malaysia) of these countries' total exports. Furthermore, exports to the United States account for as high as 20 percent or more of the GDPs of Hong Kong, Malaysia, and Singapore. The same ratios for China, Taiwan, and Thailand are lower, but still average a not-insignificant 7–10 percent. Last but not least, for many Asian countries, their growing exports of components and parts to China for assembling into finished products also depend on final demand in the U.S. market. Should the latter's demand decelerate or contract, Asian countries' exports to China would also falter.

Just as important, the United States is ranked the largest (for Malaysia, South Korea, and Taiwan) or second largest (Philippines, Thailand, and Singapore) foreign investor in many Asian countries. For these six countries, at least 25 percent of their 2005 total inward foreign direct investment came from U.S. multinationals. A trend or an abrupt decline in U.S. foreign direct investment in the region would certainly hurt most Asian economies, resulting in significant job losses.

Third, the direction of the U.S. dollar also affects many Asian economies. Collectively, it is estimated that major Asian central banks have amassed huge official foreign exchange reserves in excess of US$3.0 trillion. Most of these reserves have been invested in U.S.-dollar-denominated financial assets. A sharp drop in the

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Dollar Concern

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U.S. dollar exchange rate would shrink the value of these reserves significantly. Furthermore, as a major market for many Asian exporters, a decline in the value of the U.S. dollar would raise import prices in the United States and hence dampen consumer demand, which would in turn dent export revenues of Asian economies.

Finally, many Asian stock markets exhibit high correlations with the Dow Jones Industrial Average. The May–June 2006 meltdown in many Asian markets was triggered by the U.S. Federal Reserve's raising of interest rates, which subsequently caused investor sentiment in America to turn bearish. In the wake of the recent worldwide stock market sell-off, some commentators have erroneously put the blame on China's "Black Tuesday" (27 February) when the Shanghai market tumbled nearly 9 percent. The blame game is, however, rather disingenuous, since the insular, casino-like Shanghai and Shenzhen markets have so far exhibited hardly any correlation with either the mature or emerging markets outside China. As *Fortune* magazine has wisely pointed out, "there is no rational reason why a stock slump in China should strike fear in the hearts of investors beyond the Middle Kingdom. If the world's largest consumer market [the United States] falters, on the other hand, there will be shock waves, and they will ripple in the other direction across the Pacific, battering not only markets in China, but the many other Asian economies that continue to depend so heavily on U.S. exports for growth." Given the high percentage of household ownership of stocks in Asia, market and economic trends in the United States therefore have the power to increase or deplete household wealth in Asia.

As such, the economic fortunes of Asia and the United States will remain significantly intertwined until a time when the Chinese, Indian, and ASEAN economies can progress to a stage where their growth can be more driven by domestic consumption, investment, and innovation, as well as a higher level of intra-regional trade. That will not happen within this decade. Hence, harpings on a decoupling between the U.S. and Asian economies are as premature as they are unrealistic. ◆

Shock Waves

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—Fortune *magazine*