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Asia's de-coupling is on track

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Despite a 25 per cent drop in the MSCI Emerging Asia Index since last October, there's growing evidence that the region has de-coupled sufficiently from the US economy not to follow it into what could be a deeper recession than 2001.

While exports and profits will arguably drop, many economists believe Asia will be considerably less affected than in previous American downturns due to much healthier macroeconomic fundamentals in the region.

Contrary to the consensus view at the time, Peter Redwood of Barclays Capital believes Asia's 2001 meltdown was less attributable to export slumps and more about a fall in investment. He said firms had too much debt and excess capacity, especially in the electronics sector which underscored the American recession.

By comparison, Redwood said firms are now in much better shape. Capacity utilisation is high across the region, and outside China investment as a share of GDP is low by historical standards.

With corporate balance sheets much stronger and real interest-rates lower firms look much less likely to slash investment than in 2001.

Adding to this optimism is stronger domestic demand (consumer spending and investment) and greater flexibility within the region's governments.

While America's troubles could affect Asia through various financial channels, Redwood concluded that large foreign-exchange reserves make Asian economies less vulnerable to foreign shocks. With budgets in surplus or close to balance, policymakers appear to have more room for a fiscal stimulus to support growth.

Nevertheless, some Asian economies, like Singapore, Hong Kong and Malaysia with exports to America equivalent to 20 per cent or more of their GDPs — have greater exposure to a US downturn than China and India with 8 per cent and 2 per cent respectively.

But HSBC economist, Robert Prior-Wandesford, said Malaysia's ability to grow GDP from 5.7 per cent at the end of 2006 to 6.7 per cent in the third quarter of last year, despite a plunge American exports belies those who doubt Asian economies cannot decouple.

Standard Chartered expects emerging Asia will grow by an average of 6.4 per cent in 2008, down from 7.8 per cent in 2007. By comparison, during the 2001 recession growth dropped by three percentage points to 4.2 per cent.

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