

Is the East Asian Recovery Real?

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The Basic Questions

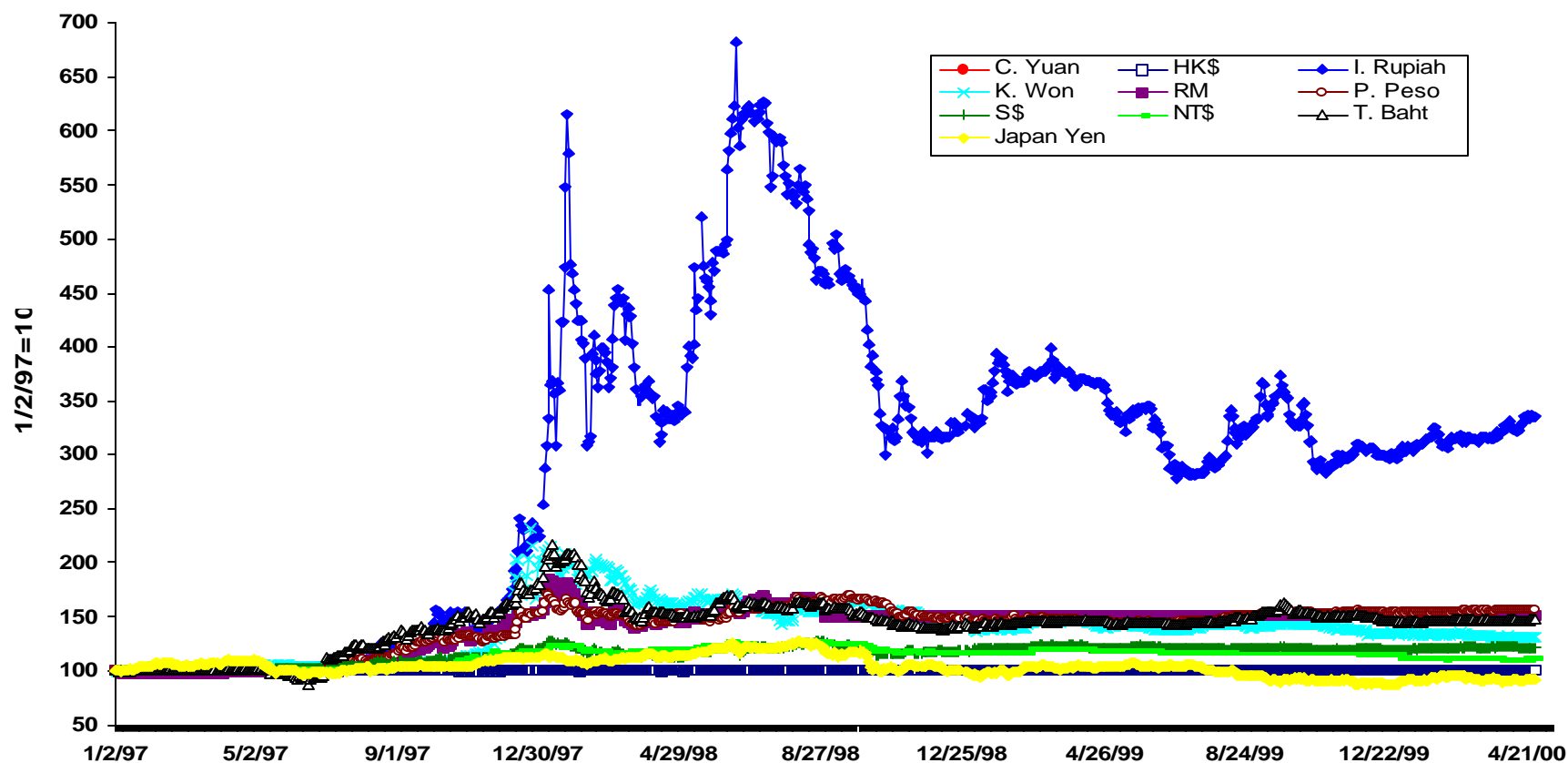
- ◆ Is there a real recovery?
- ◆ Is another crisis likely?
- ◆ What are the prospects of future economic growth?

Leading Indicators of Recovery

- ◆ Stabilization of the exchange rate
- ◆ Decline in the rate of interest
- ◆ Rise in the stock market
- ◆ Improvement in the balance of payments
- ◆ Rise in the official foreign exchange reserves
- ◆ Deceleration in the rate of decline of real GDP
- ◆ Leveling of the unemployment rate
- ◆ Narrowing of yield spread on U.S. dollar-denominated sovereign debt relative to U.S. Treasury securities
- ◆ Upgrading of credit ratings by rating agencies such as Moody's, Standard & Poor and Fitch IBCA

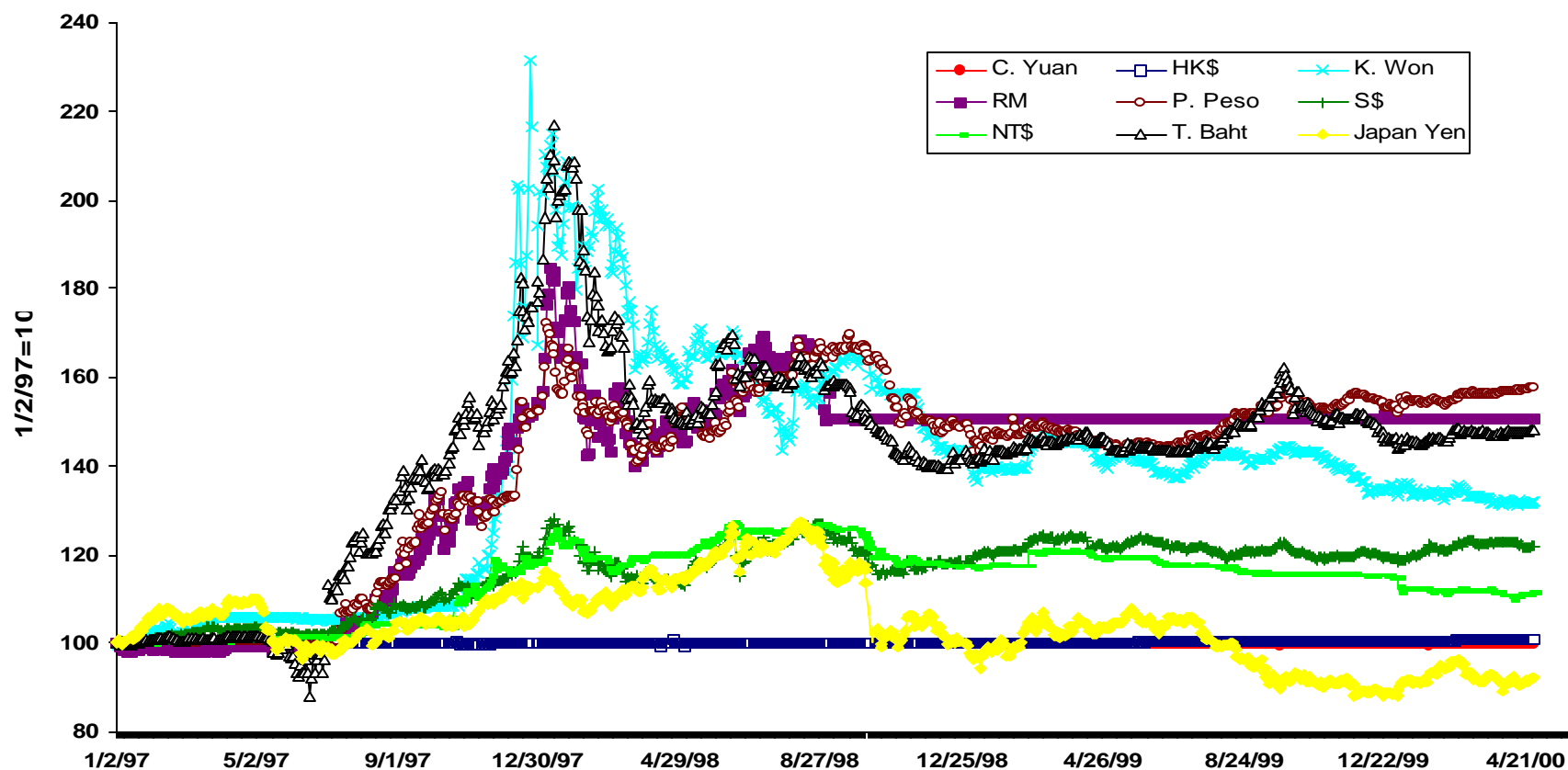
The Exchange Rates Have Stabilized

Indices of East Asian Exchange Rates
(Local Currency per U.S. Dollar, 1/2/97=100)



The Exchange Rates Have Stabilized

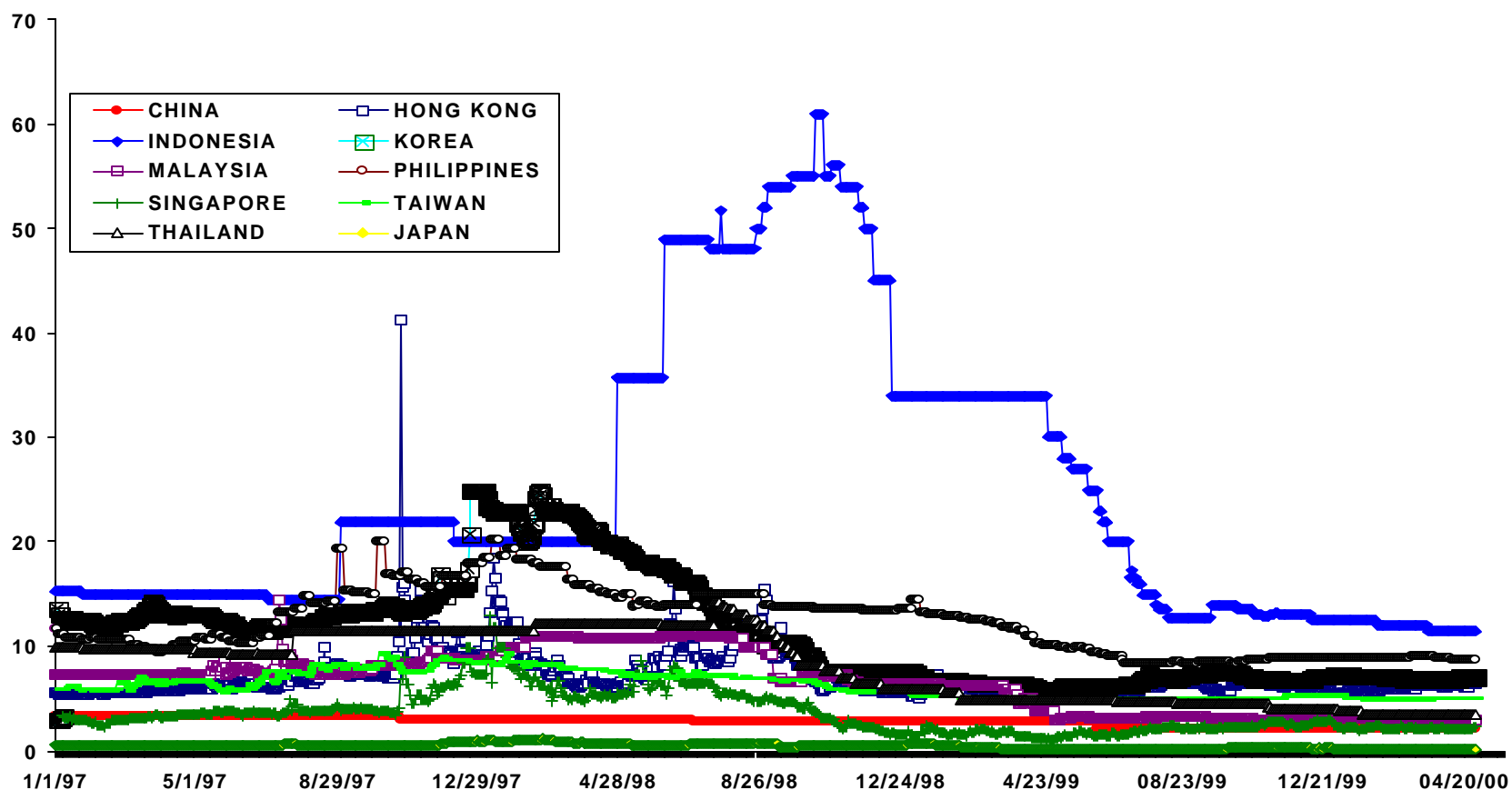
Indices of East Asian Exchange Rates
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The Interest Rates Have Declined

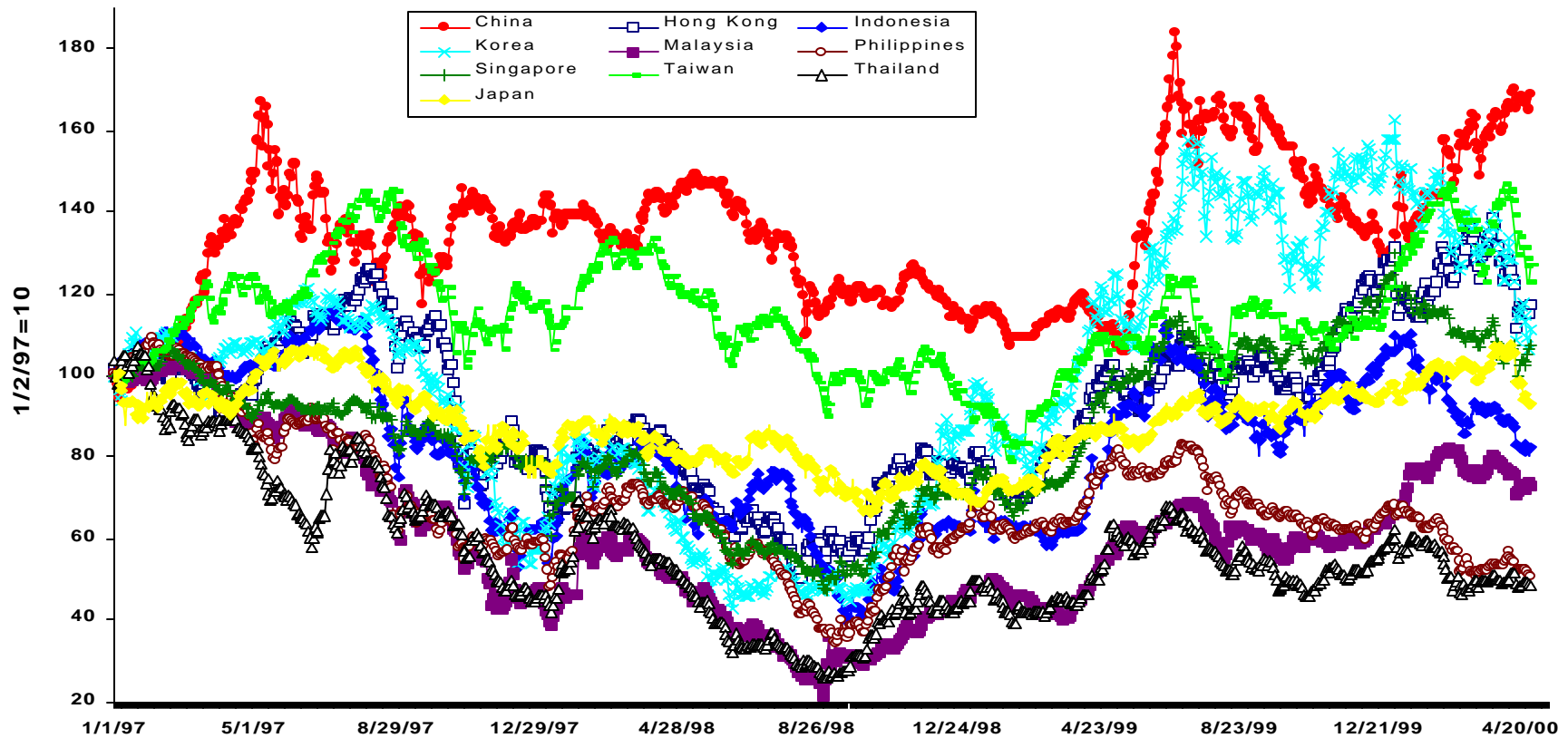
Short-Term Rates of Interest, Selected East Asian Countries
(percent p.a.)



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The Stock Markets Have Risen

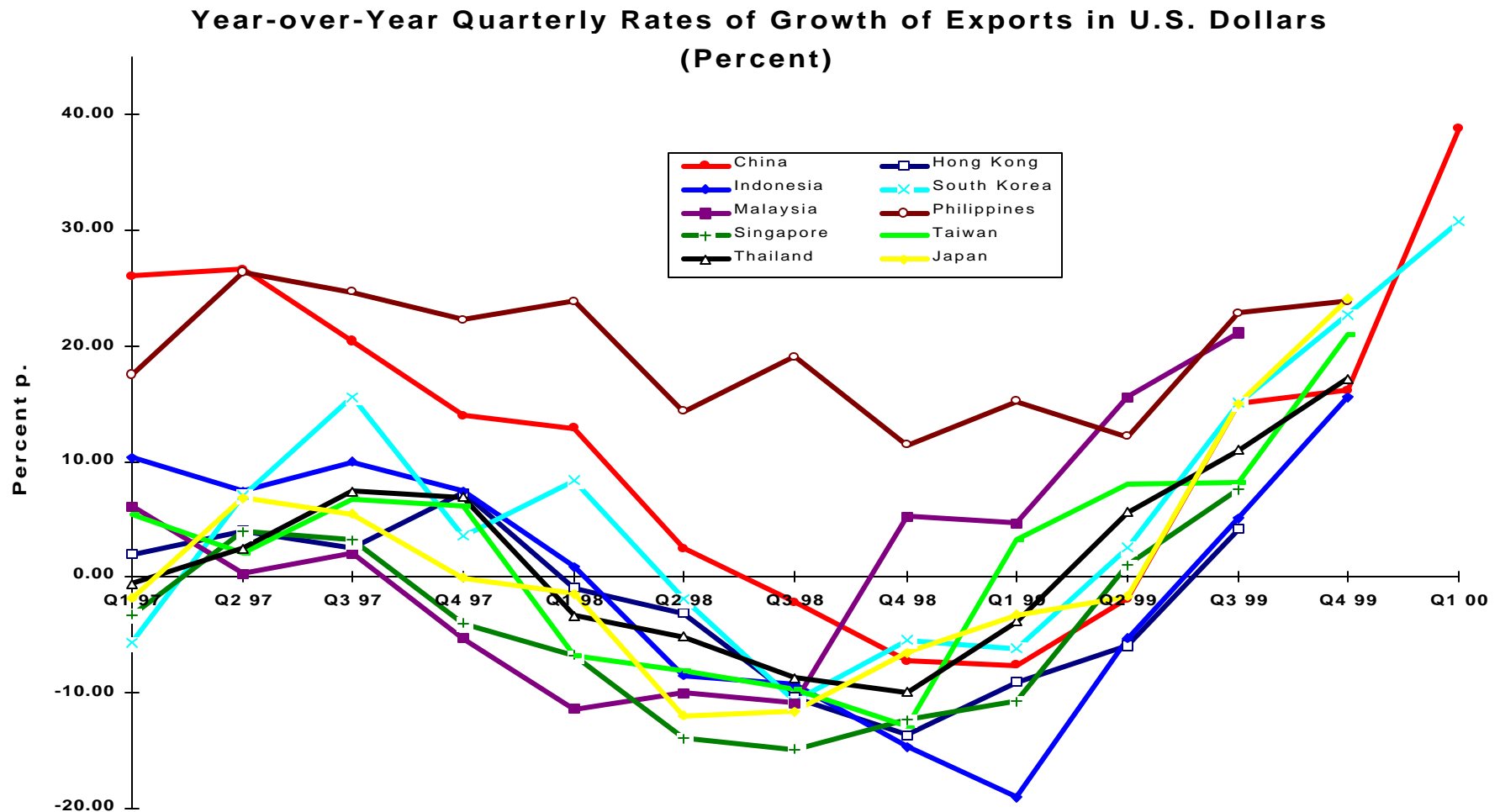
Indexes of East Asian Stock Exchange Indexes
(Local Currency, 1/2/97=100)



Is There A Real Recovery?

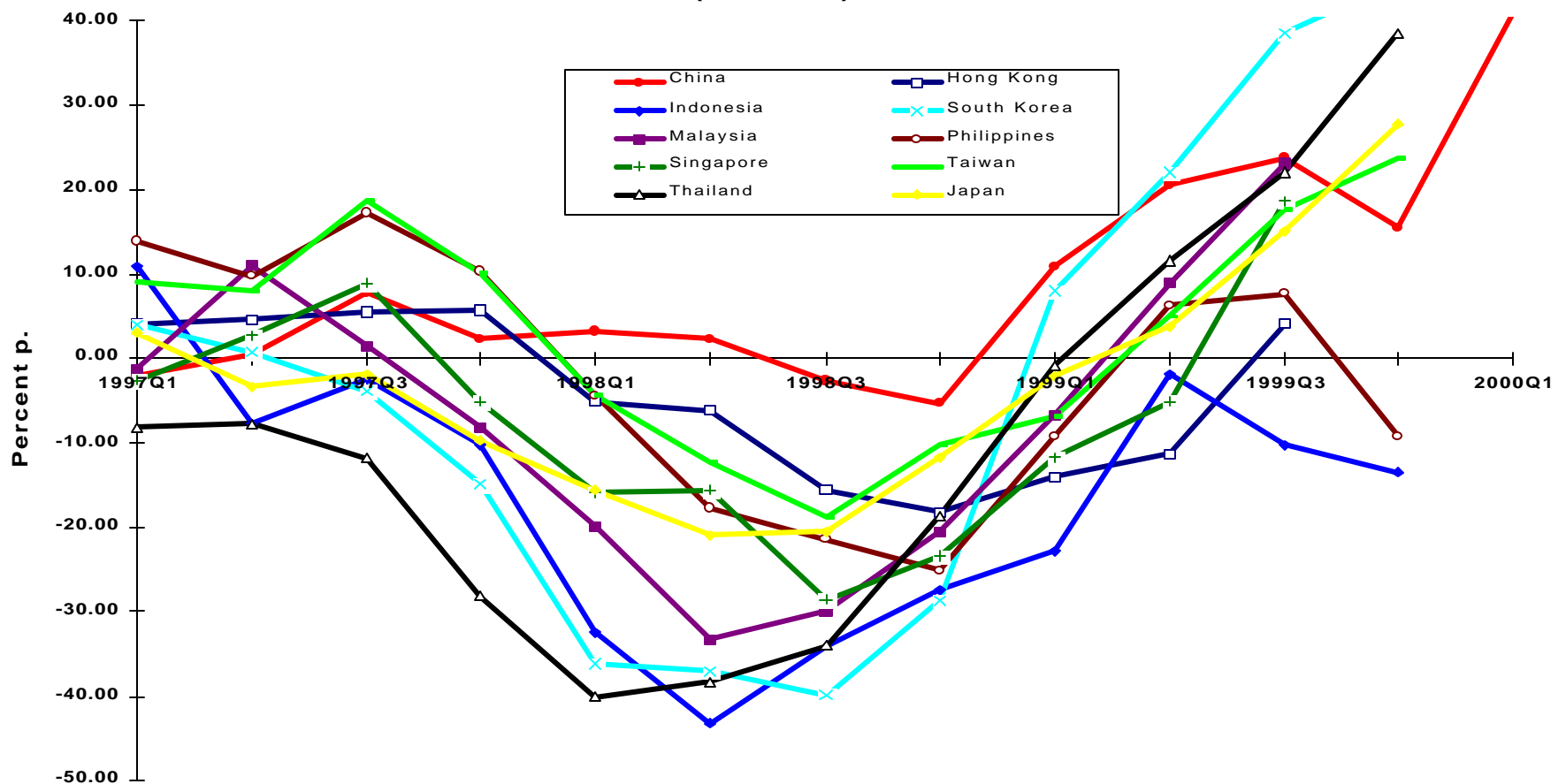
- ◆ For most of the East Asian economies, the bottom has been reached (0% rate of growth) in 2Q/1999
- ◆ The recovery is most tentative in Indonesia, with its political problems
- ◆ In quantity terms, exports have been growing very rapidly
- ◆ Foreign exchange reserves have been largely replenished
- ◆ Inflation caused by the devaluation has largely subsided
- ◆ The stock markets have recovered
- ◆ The recovery has been much stronger than expected because of synchronization across the East Asian economies

Rates of Growth of Exports in US\$ Terms Have Turned Positive



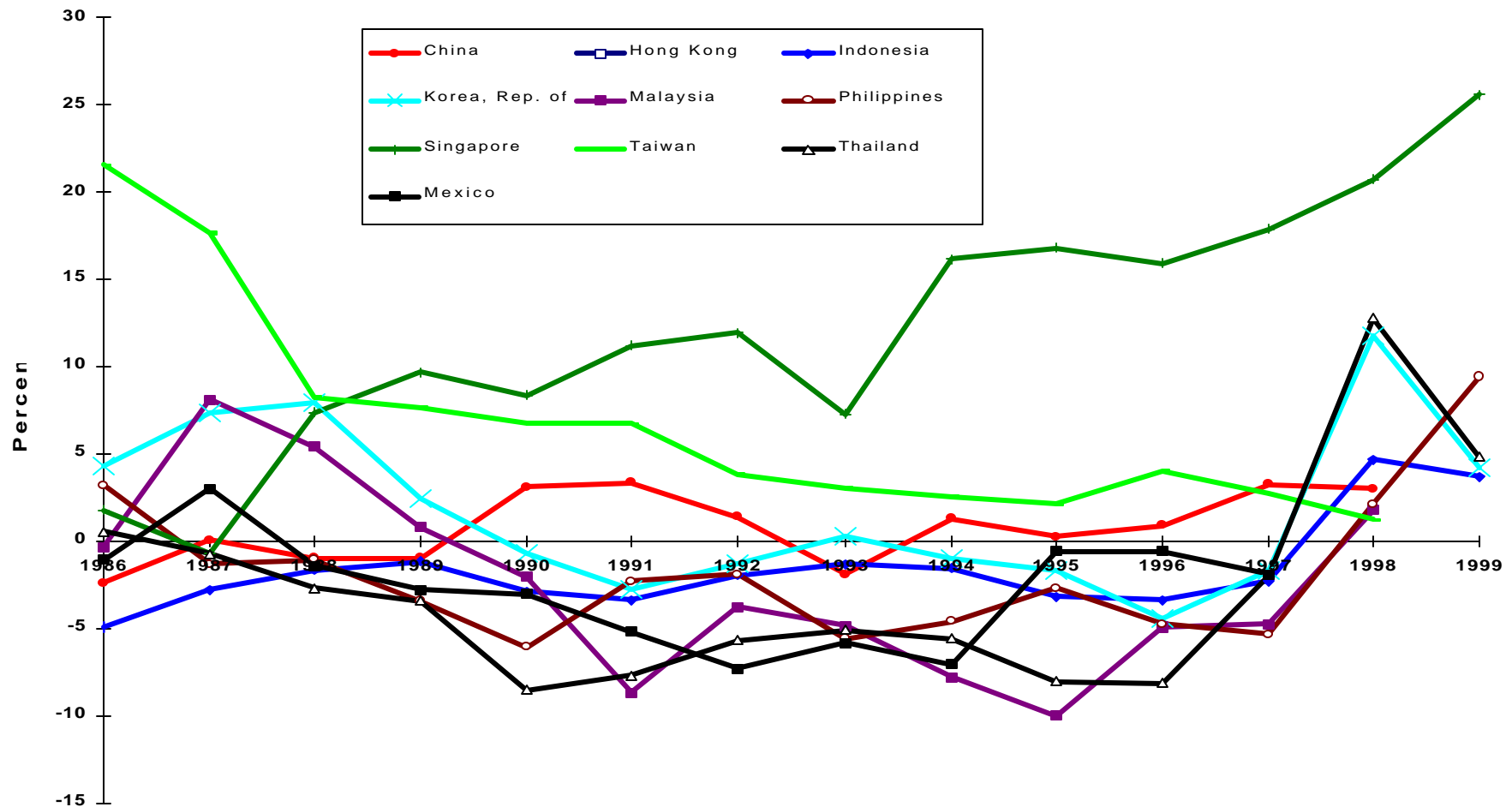
Rates of Growth of Imports in US\$ Terms Have Also Turned Significantly Positive

Year-over-Year Quarterly Rates of Growth of Imports in U.S. Dollars
(Percent)



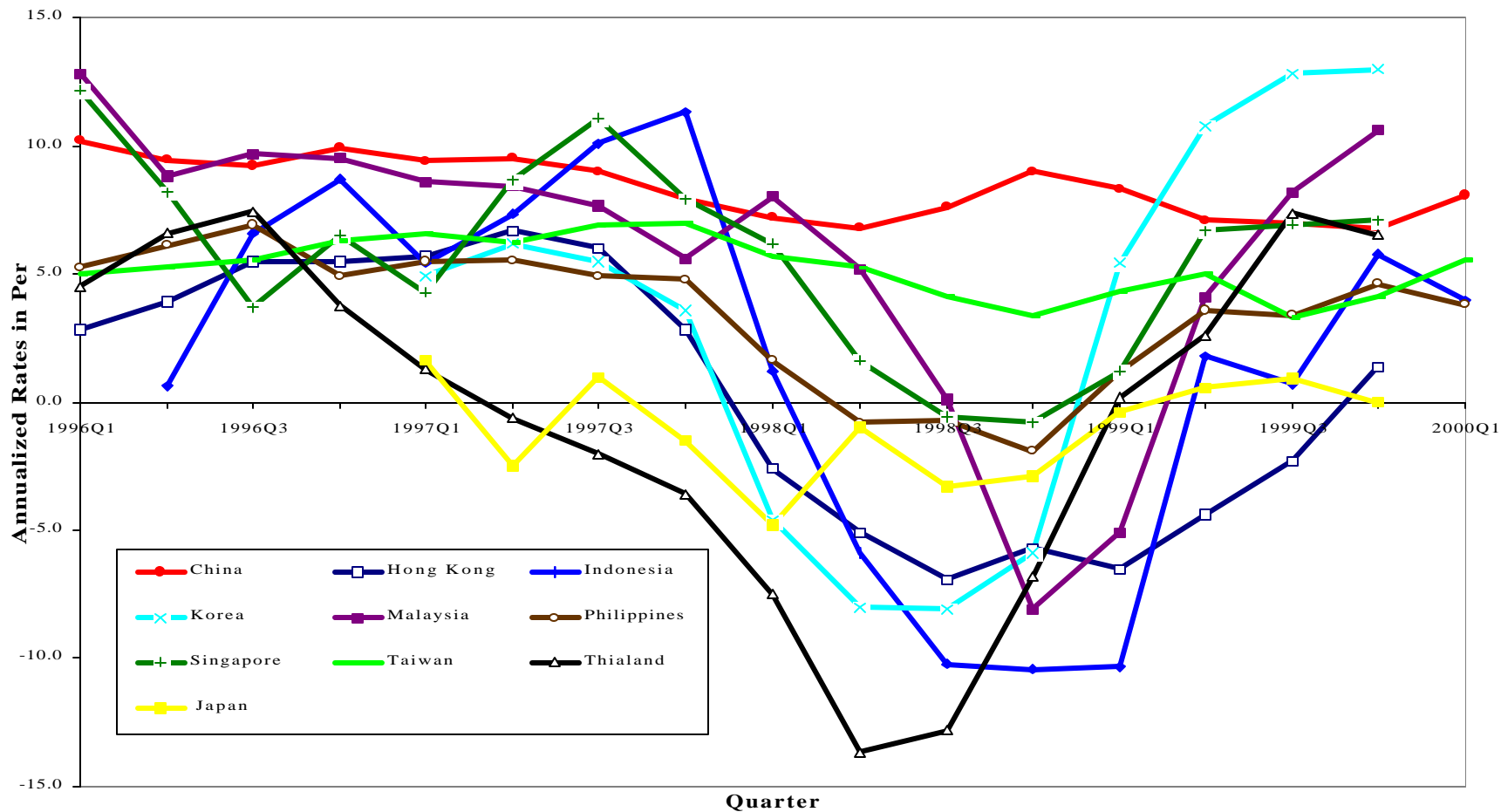
The Current Account Balances Have Turned Positive

The Current Account Surplus as a Percent of GDP



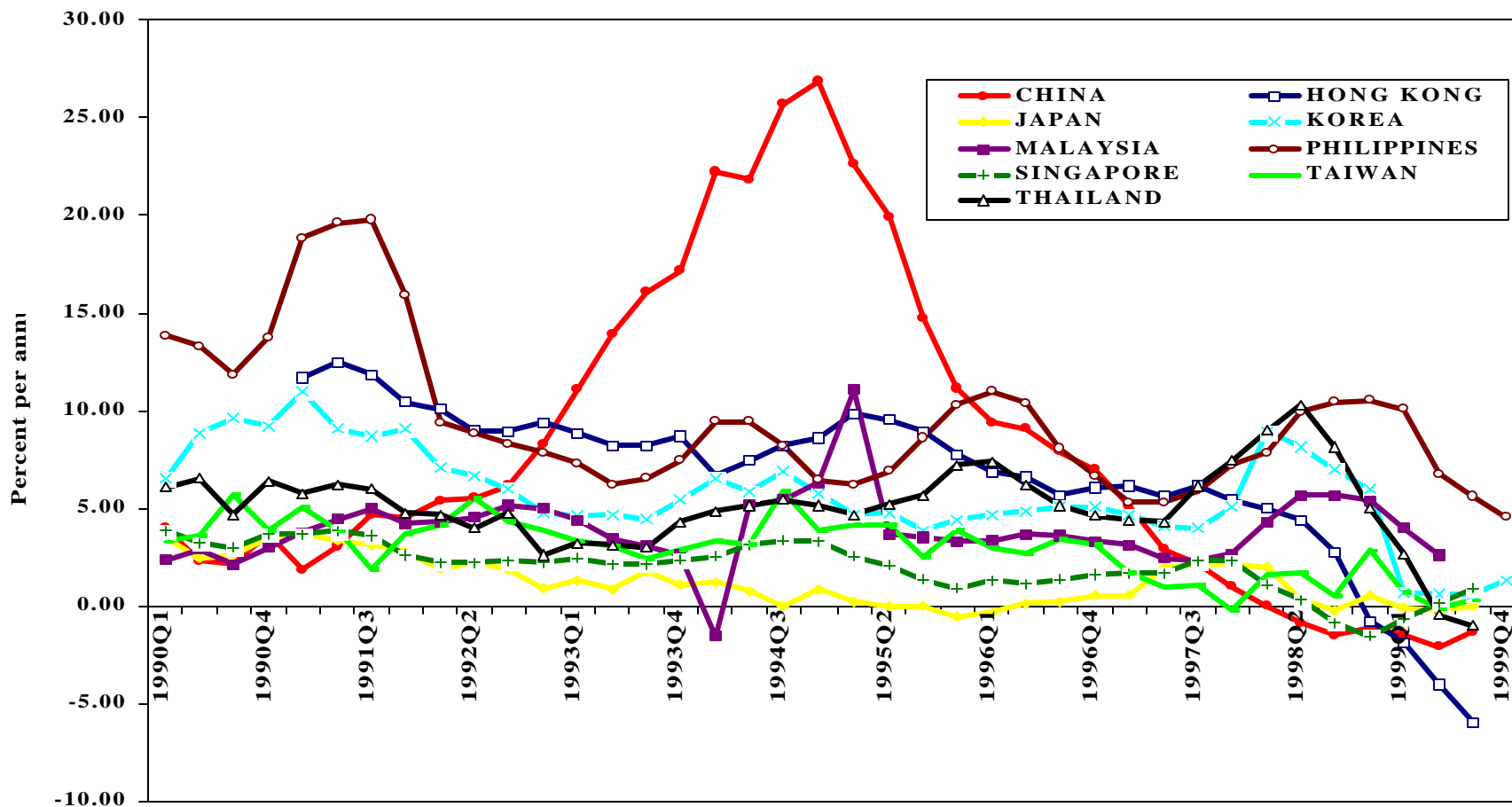
The Rates of Growth of Real GDP Have Turned Significantly Positive

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



The Rates of Inflation (Consumer Price Indexes) Have Subsided

Rate of Change of the Consumer Price Index (Year-over-Year)



How Robust is the Recovery?

The External Environment Has Stabilized (1)

- ◆ Since 3Q/1998, there have not been any speculative attacks on the East Asian currencies.
- ◆ The hedge funds had a “credit crunch” due to losses, net redemption and curtailment of available credit lines in the aftermath of the collapse of the Russian ruble and the “Long-Term Capital Management” crisis.
- ◆ The U.S. economy has been exceptionally strong but an asset-price bubble appears to be in the making and the economy may be heading towards a slowdown.
- ◆ The recovery of the Japanese economy is not imminent and likely to take some time; however, since it has been in recession since 1990, the East Asian recovery does not depend on an economic recovery in Japan. Moreover, the Yen has recovered from its low of almost 150 Yen/US\$ to stabilize around 100 Yen/US\$.

The External Environment Has Stabilized (2)

- ◆ The Chinese economy grew 7.8% in 1998 and 7.1% in 1999. Chinese exports have resumed its growth. The Renminbi should not need to be devalued.

How Robust is the Recovery?

Aggregate Demand Stimulation (1)

- ◆ The recovery is supported by the growth in public investment and in exports
- ◆ Private consumption demand has gradually revived because of lower rates of interest and stabilization of unemployment
- ◆ Domestic fiscal stimulus necessary because of weak domestic investment demand--International Monetary Fund conditions notwithstanding (IMF position on deficit financing by the affected East Asian economies has changed)
- ◆ Turning around expectations and providing incentives are the keys to stimulating private consumption and new private investment

Aggregate Demand Stimulation (2)

- ◆ Recapitalizing the domestic banks so that new loans to new projects are possible
 - ◆ Bailing out of old failed projects should be avoided
 - ◆ Recapitalization by the government should require capital contribution and risk-sharing by new or existing shareholders to avoid moral hazard
- ◆ Maintaining domestic political and social stability

How Robust is the Recovery?

Real Devaluation Presents New Opportunities

- ◆ The real devaluation in the East Asian currencies presents new opportunities for profitable investments once they are stabilized

How Robust is the Recovery?

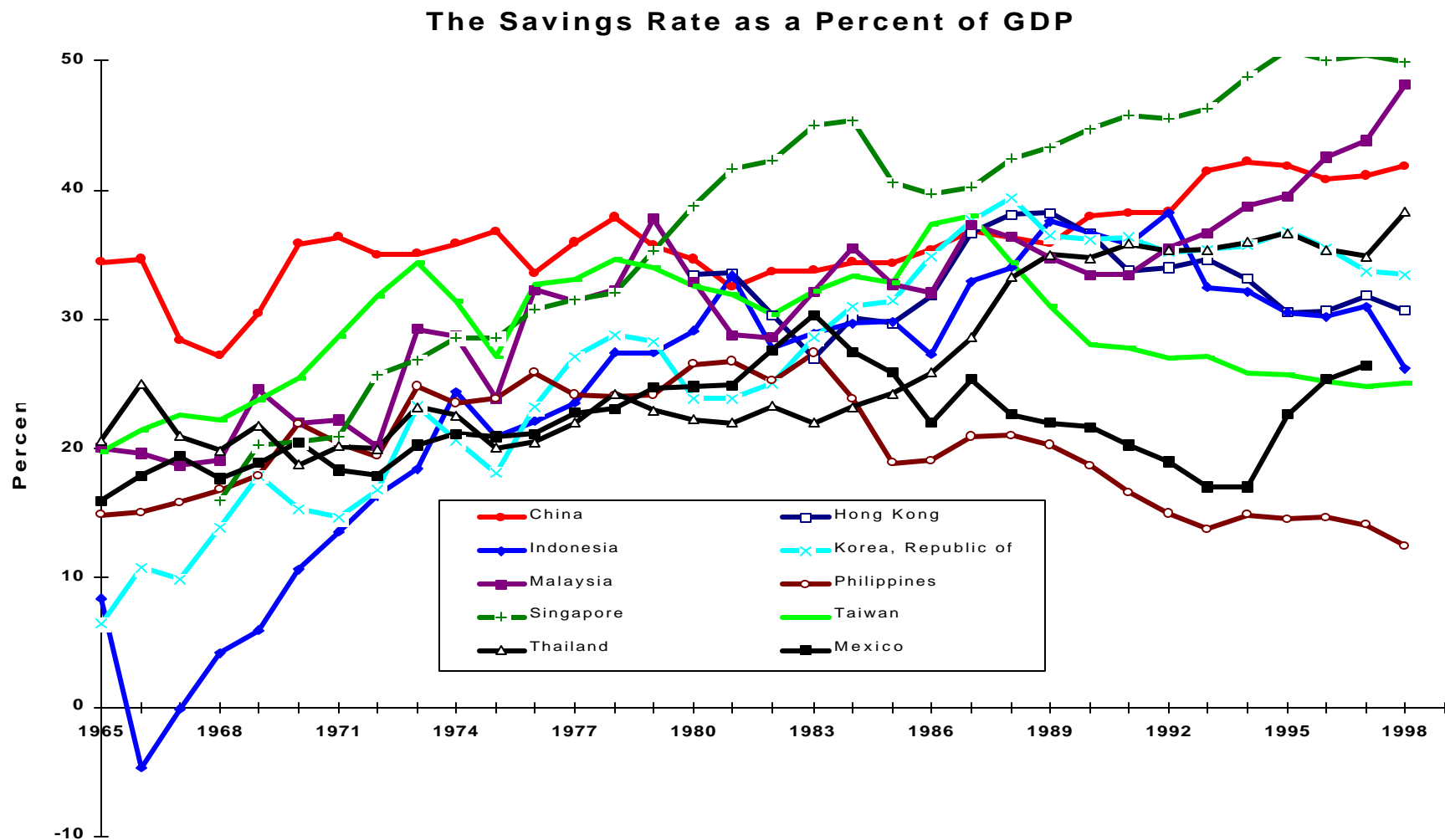
Synchronization of Upturns

- ◆ Over the last decade, the proportions of East Asian exports to other East Asian economies have been increasing rapidly
- ◆ By the late 1990s, approximately 50% of the exports of the East Asian economies are destined for other East Asian economies
- ◆ While the simultaneous downturns in the East Asian economies exacerbated the problems of one another, the simultaneous upturns have allowed the recovery to be extraordinarily rapid, with the rising import demands of each economy feeding into rising export demands of its trading partners

Is Another Crisis Likely?

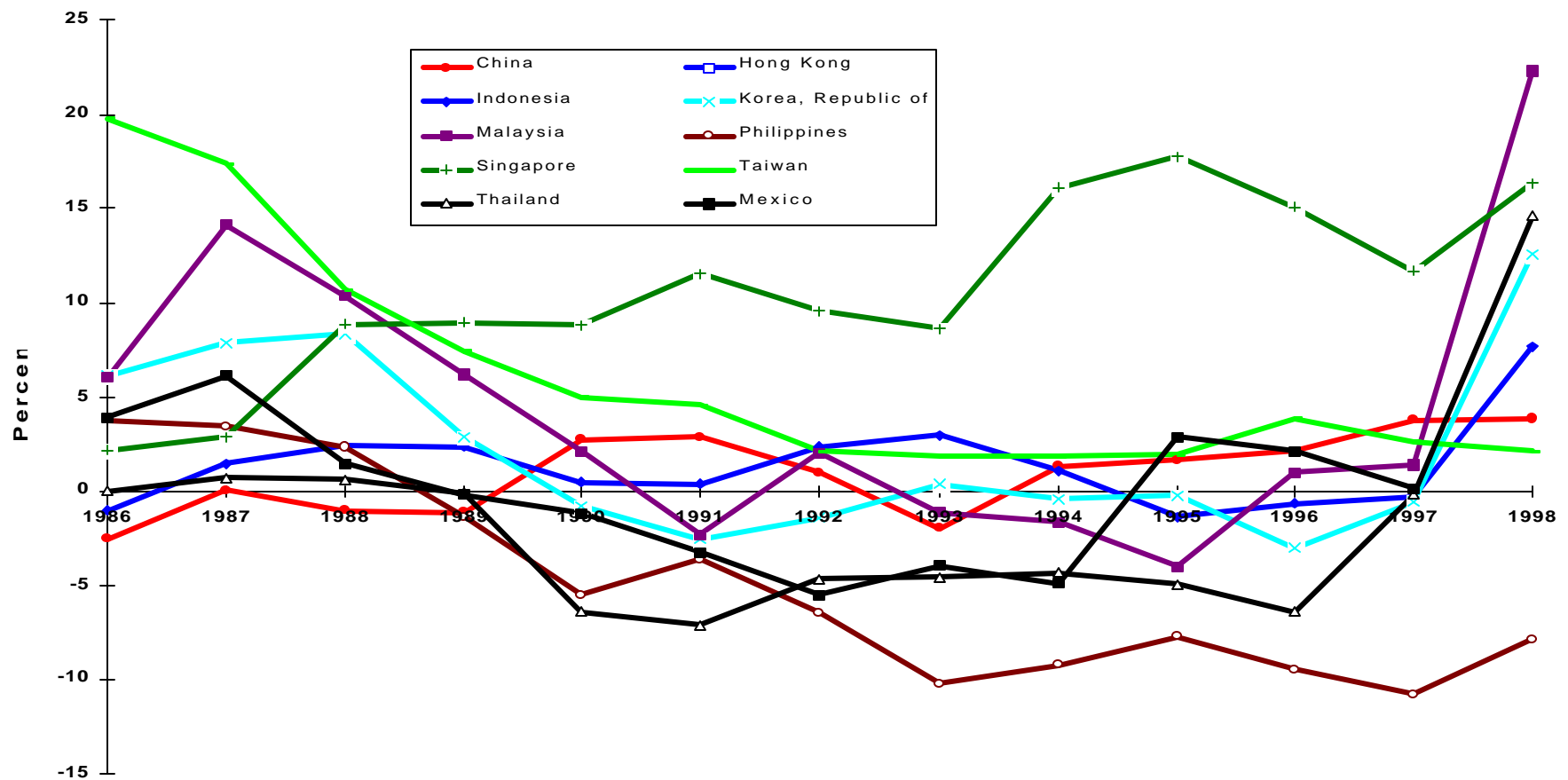
- ◆ Based on the early warning economic indicators, the East Asian economies are unlikely to have another crisis in the foreseeable future
 - ◆ The savings-investment gaps--also reflected as the current account gaps--have largely disappeared
 - ◆ The dependence on short-term foreign capital (portfolio investment--both equity and debt instruments--and loans) has been significantly reduced
 - ◆ Foreign investment now consists mostly of direct rather than portfolio investment
 - ◆ Both total and short-term external debts have declined
 - ◆ Foreign exchange reserves (working capital of a country) for supporting imports, debt service, and (potential) net short-term capital outflows have risen
 - ◆ Real exchange rates have depreciated significantly in most of the affected economies

The Savings Rates of East Asian Economies Have Remained High



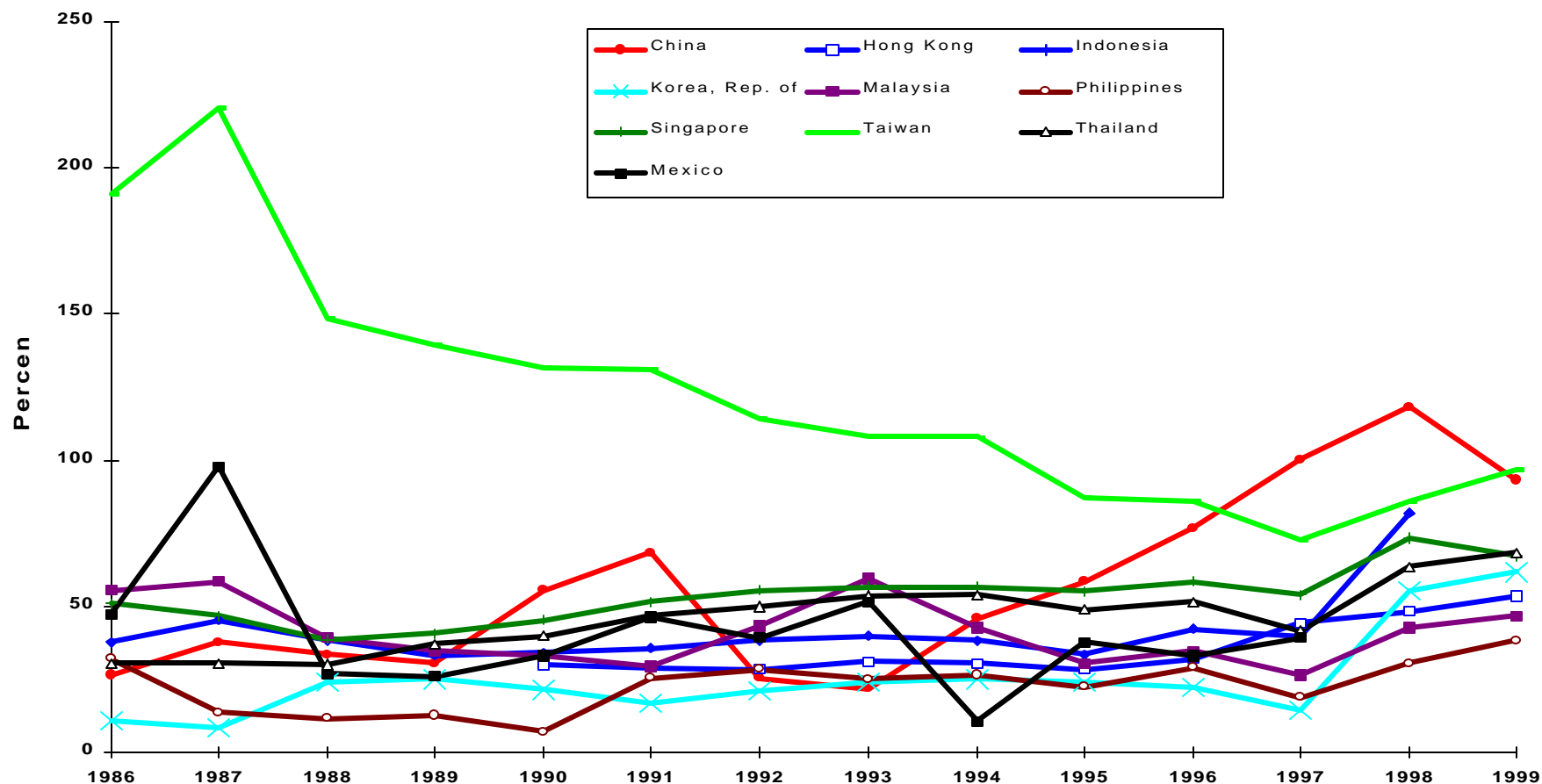
The Savings-Investment Gaps Have Disappeared

The Savings-Investment Gap as a Percent of GDP

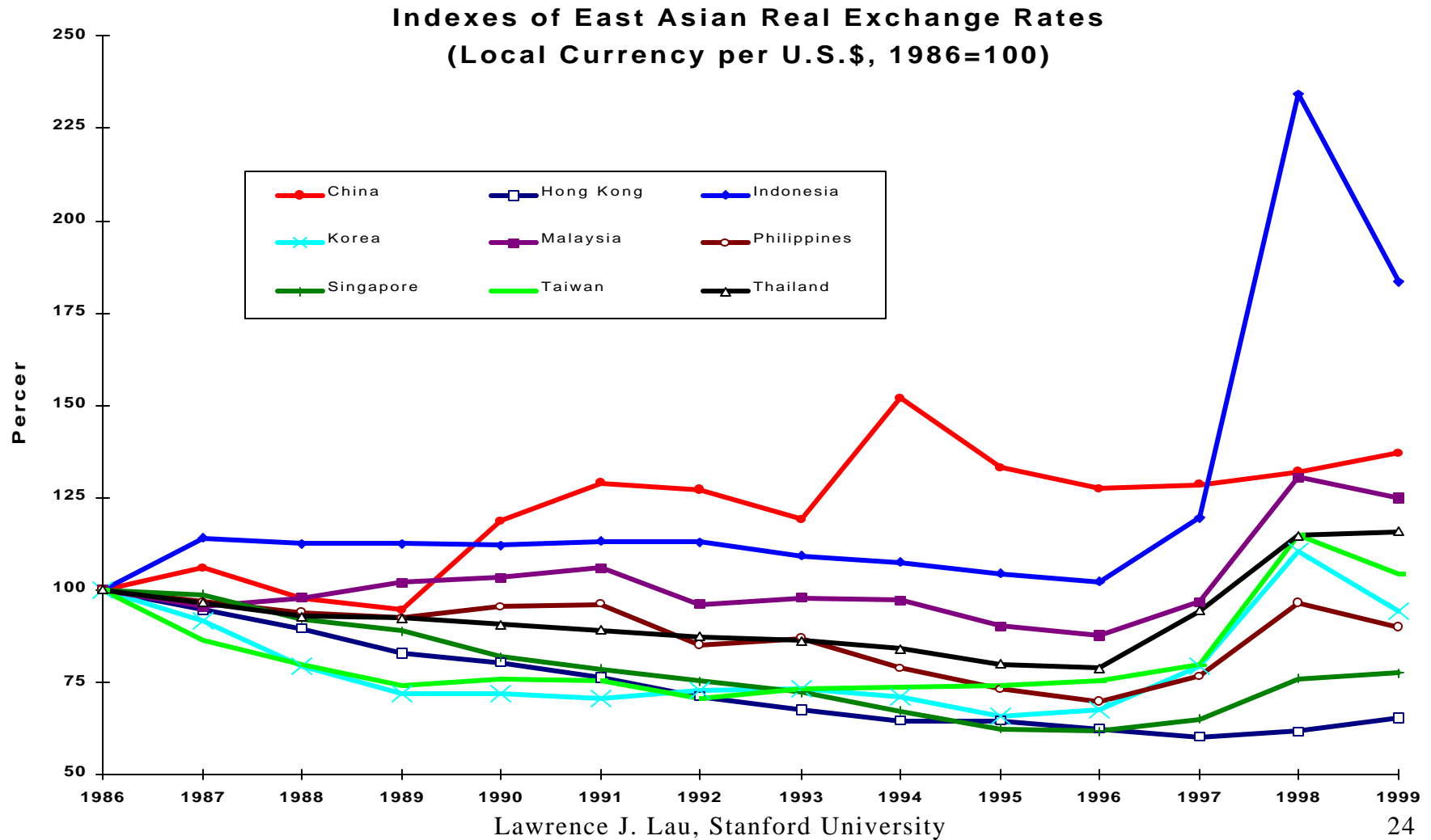


Foreign Exchange Reserves Have Risen as Percentages of Annual Imports

Foreign Exchange Reserves as a Percent of Imports



The Real Exchange Rates Have Depreciated Significantly from Its Peak



Prospects for Future Economic Growth Remain Good

- ◆ Past growth neither miracle nor a mere bubble
 - ◆ Economic growth experience replicated in different East Asian economies
 - ◆ Sustained economic growth over decades
 - ◆ Recent crisis due to many factors, of which “irrational exuberance” is only one
- ◆ Economic fundamentals remain sound--high savings rates, investment in human capital, market orientation
- ◆ Past economic growth attributable to growth in inputs, particularly the efficient and rapid accumulation of physical capital
- ◆ Considerable room for continuation of rapid tangible inputs-driven economic growth--tangible capital per unit labor still lags behind the developed economies
- ◆ Intangible capital per unit labor lags even further behind, offering additional opportunities for investment

Rates of Growth of Inputs & Outputs of the East Asian Developing & the G-7 Countries

Table 3.1: Average Annual Rates of Growth of Real GDP, Capital, Labor and Human Capital (percent)

(Extended sample period)

Country	Period	GDP	Capital Stock	Utilized Capital	Employment	Labor Hours	Human Capital	Average Human Capital
Hong Kong	66-95	7.4	8.8	8.6	2.6	2.4	4.8	2.1
S. Korea	60-95	8.5	12.3	12.3	3.1	3.3	6.2	4.0
Singapore	64-95	8.8	10.3	10.3	4.3	4.7	5.9	3.5
Taiwan	53-95	8.4	11.8	11.8	2.7	2.3	5.3	2.8
Indonesia	70-94	6.7	8.9	9.8	3.1	3.1	9.6	7.7
Malaysia	70-95	7.3	11.8	11.8	3.7	3.7	7.7	4.9
Philippines	66-95	4.0	5.8	5.9	3.2	3.2	10.8	8.5
Thailand	66-94	7.6	9.1	9.4	2.8	2.8	8.5	5.8
China	65-95	8.4	10.3	10.3	3.0	3.0	5.9	3.3
Japan	57-94	5.9	8.1	8.0	1.1	0.6	2.1	0.9
Canada	57-94	3.8	4.8	4.7	2.3	1.9	3.0	1.1
France	57-94	3.3	3.9	3.9	0.4	-0.2	2.0	1.1
W. Germany	57-94	3.2	3.3	3.1	0.1	-0.3	1.5	1.0
Italy	59-94	3.5	5.2	5.3	0.0	-0.3	1.8	1.3
UK	57-94	2.4	3.9	3.8	0.2	-0.1	1.2	0.8
US	49-94	3.1	3.0	3.3	1.7	1.3	2.1	0.8

The Major Uncertainties

- ◆ The movements of the Yen-Dollar and Yuan-Dollar exchange rates
- ◆ The rates of growth of the U.S. and Japanese economies
- ◆ The U.S. rate of interest (one instrument, two targets--the prices of goods and the prices of assets)
- ◆ The possibility of a bursting of the U.S. asset prices bubble (Could the reliance on an accommodative easing by the Federal Reserve Board after such an event create its own moral hazard?)
- ◆ The return of the hedge funds (are bubbles building in the East Asian stock markets again?)