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The Global Financial Crisis: Decoupling of East Asia—Myth or Reality?

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Abstract

The “decoupling” of East Asia from its economic interactions—both in trade and finance—with the rest of the world refers to the phenomenon of a weakening of the impact of demand and supply shocks emanating from the advanced countries on the region’s economic performance since the early 1990s. Available empirical evidence, including the faster recovery of East Asia from the 2008 global economic crisis, does not appear to lend credence to the decoupling thesis. However, with increases in income throughout the region and the three free trade agreements (FTAs) of the People’s Republic of China (PRC), Japan, and Korea with the Association of Southeast Asian Nations (ASEAN) (which have entered into force), East Asia will witness a continuing expansion in intra-regional trade, much of which will consist of horizontal intra-industry trade. At the same time, if East Asia succeeds in instituting an efficient capital control regime and in strengthening the Chiang Mai Initiative Multilateralization (CMIM), it will be able to cope better with the volatility of capital flows to the region. Together these developments will then help speed up economic integration among ASEAN+3 member states to build a region that is more self-contained than it has been.

JEL Classification: E 32, F15, R11

Contents

1. INTRODUCTION

There has been much discussion about the "decoupling" of East Asia[1] from its economic interactions—both in trade and finance—with the rest of the world, in particular from the advanced economies of North America and Europe. Decoupling is a term that defies precise definition, yet there is considerable controversy about its causes and significance[2]. In the context of East Asia, decoupling often refers to the phenomenon of a weakening of the impact of demand and supply shocks emanating from the advanced countries on the economic performance of East Asian economies or their growth, which has become more independent from cyclical developments of the global economy. To some it is a reality; to many it is a myth.

During much of the postwar period, most of East Asia's developing economies and Japan had relied heavily on the growth of domestic demand of the United States (US) and Europe for their growth. As most of these countries had adopted an export-led growth strategy, this dependence had persisted until the late 1990s. During this period, the causal direction of economic inter-linkages between East Asia and the advanced countries had largely been asymmetric. Demand and supply shocks originating in the advanced countries had been transmitted to East Asian economies through the trade and financial channels to have a significant effect on their growth. In contrast, however, the impact of similar disturbances occurring in East Asia on the advanced economies had been negligible.

Since the early 2000s, this uni-directional causality, it is argued, has undergone a change to one that is more bi-directional. Output shocks from East Asia's emerging economies have had a more pronounced effect on cyclical fluctuations in the advanced economies than before and the effects of external shocks on East Asia have become stronger in the 2000s (Kim, Lee, and Park 2009). Many other studies have pointed to an absence of empirical evidence of the development of East Asia as a self-contained region.[3]

Most of these studies cover the period before the 2008 global financial crisis. In view of the faster recovery of East Asia from the 2008 global economic crisis, it would be interesting to examine whether the crisis has changed the structure of trade linkages and financial spillovers between East Asia and the rest of the world to lend credence to the decoupling thesis. For this purpose, section 2 of this paper identifies some of the factors that are likely to cause such decoupling. Section 3 is devoted to an analysis of East Asia's experience with the 2008 global crisis, to examine whether the crisis has strengthened the case for the decoupling. Section 4 discusses the prospects for the decoupling in lieu of conclusions.

2. CAUSES OF DECOUPLING

Causal inspection of Figure 1 and Figure 2 in the Appendix leaves little doubt that the economic growth of the US and the European Union (EU) has had a significant effect on the growth of East Asia. More rigorous studies confirm this observation. In the three US recessions of 1982, 1991, and 2001, a one percentage point fall in US growth was accompanied by a decline of about 0.5 percentage points on average in median growth of East Asia, comprising the People's Republic of China (PRC); Indonesia; the Republic of Korea (hereafter Korea); Malaysia; the Philippines; Taipei,China; and Thailand (WEO. April 2007. International Monetary Fund (IMF), chapter 4).

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[1] East Asia refers to ASEAN+3. Emerging Asia or emerging economies in Asia includes twelve countries of ASEAN+3 excluding Japan. East Asian economies or countries refer to some or all of ASEAN+3 depending on the context in which they are used.

[2] See World Bank (2006), Anderson (2007), IMF (2007), Park and Shin (2008), Athukorala and Kohpaiboon (2009 and 2010)

[3] Representative of these studies are Athukorala and Kohpaiboon (2009 and 2010).

Another more recent study estimates that a 1% decline in US and euro area growth could lower gross domestic product (GDP) growth across Asia by 0.3 percentage points, with estimates ranging from a low of about 0.1 percentage points for Indonesia to a high of about 0.6 percentage points for Malaysia (Regional Economic Outlook for Asia and Pacific 2010 IMF).[4]

Park and Song (2011) present a somewhat different picture in their estimates of the effects of external shocks on the output of nine East Asian economies—Association of Southeast Asian Nations (ASEAN)5; the PRC; Japan; Korea; and Taipei,China.[5] Global shocks account for relatively large output variations only in the PRC and the Philippines, whereas regional shocks tend to cause relatively large changes in the domestic output of Korea; Singapore; Taipei,China; and Thailand. The two shocks are equally important in Japan; Malaysia; and Taipei,China.

If decoupling is defined in terms of the growing idiosyncrasy of East Asia's business cycle, it depends on a number of factors that include East Asia's growth strategy, intra-regional trade, and financial linkages with the global financial system. They are of particular interest from the perspective of this study.

2.1 Rebalancing growth: Relying more on domestic demand

Throughout East Asia, there has been a reexamination of the viability of the region's preoccupation with export-led growth. The export-led development strategy would not have worked had it not been for the voracious appetite of US consumers for Asian exports. Now that demand for Asian manufactures by consumers in the US and Europe is likely to remain weak for years to come, even when the global economy recovers and financial stability is restored, export-led growth may no longer be a practical option. This awareness has led to an emerging consensus that emerging Asia should take steps to restructure the economies and change existing institutions to try to break away from export dependence and rely more on domestic demand as a source of growth.

According to the Asian Development Outlook (2009), "rebalancing represents a return to the generally more balanced structure of demand and growth that prevailed in the region prior to the 1997 Asia crisis" (p.66), implying that in the context of the Asian economy rebalancing means restoring current account balance. Economic restructuring for rebalanced growth would in general lead to a decline in the share of exports in GDP and that of the current account surplus.

2.2 Importance of intra-regional trade

The argument for decoupling on the trade side is founded on the belief that business cycle co-movements are a function of trade linkages.[6] There is some analytical support for this conclusion. Frankel and Rose (1998) demonstrated that business cycle correlations increase as trade integration deepens. The decoupling would then be observed if the share of intra-regional trade in East Asia's total trade rises. Shin and Wang (2004) showed that this point applies to Asia in particular. Imbs (2004) and Calderon, Chong, and Stein (2007)

[4] In this study Asia includes Singapore and Japan, in addition to the sample countries of the 2007 study.

[5] For each country, regional output is measured by a trade-weighted average of the output of other eight countries. Global output is a trade-weighted average of the output of the US, Canada, Australia, and five European advanced countries (France, Germany, Italy, the Netherlands, and the United Kingdom).

[6] Representative of this view are statements by Anderson (2007) about the PRC, to the effect that "There's no reason to argue over whether the mainland is 'decoupling' from the global cycle—as far as macro growth is concerned the economy is and always has been effectively 'decoupled,' and The PRC has little to fear from a global demand slowdown (page 1)."

documented that business-cycle transmission is especially powerful when trade is intra-industry—which is increasingly the fact in Asia.

An increase in intra-regional trade would not necessarily be associated with decoupling in East Asia. This is because decoupling depends not only on the share, but also on the degree of horizontal integration of intra-industry trade. East Asia's intra-regional trade structure is often compared to a conveyor belt carrying parts, components, and other industrial materials produced by Japan and other East Asian emerging economies to the PRC for assembly and export to the rest of the world. This structure is known as international "production fragmentation" within a vertically integrated production process. The product fragmentation has been an important driving force behind the rise in intra-regional trade in East Asia, but not the decoupling.

In this vertical integration, the PRC serves as the processing and assembly platform for the final goods destined for the global market. According to Athukorala and Kohpaiboon (2010), the share of parts and components in total exports of Japan and other East Asia's emerging economies to the PRC had been rising in the run-up to the 2008 crisis. This means that its trade with the rest of the world had been critical to East Asia's growth and that a negative shock in the US or Europe would reduce imports of final goods from East Asia, thereby affecting the region's business cycles.

Following the argument of international production fragmentation, the Asian Development Bank (ADB 2008) concluded that the story of decoupling (or uncoupling in their terminology) was no more than a myth. The report shows that emerging Asia is closely tied to global goods markets and that impulses run from the US, the EU, and Japan backward through the region. In this view, the PRC has become a more independent source of demand in recent years, but it still remains largely a conduit for importing parts and components from other countries in the region and assembling them into final goods to be exported.

2.3 Financial integration

Beginning in the early 1980s, many of East Asia's emerging economies have embarked on reforms to deregulate and open their financial markets and intermediation industries. Financial liberalization has deepened and diversified linkages of these economies with financial markets of the US and other industrialized countries, although it has made a relatively limited contribution to regional financial integration in East Asia.[7] As East Asia's financial linkages with the rest of the world have increased, so have capital flows to the region. The tighter linkages have also enlarged the scope of spillovers from external shocks to the region, with the attendant increase in the correlation of asset prices of East Asia with those of the US and European countries.[8]

As far as East Asia is concerned, however, the direction of spillovers from an external financial shock has mostly been uni-directional. That is, the variation in the asset prices of the US and Europe has exerted a significant effect on the asset prices of East Asia, but the reverse has not been the case. This asymmetry stems from the fact that compared with industrialized economies, holdings of external assets as a share of GDP in East Asia are relatively small. Furthermore, a large share of these assets is held in foreign exchange reserves of which demand is insensitive to changes in financial market conditions.

A high degree of volatility of capital flows to East Asia has its causes in some of the salient features of East Asia's financial systems. One such feature is that financial markets of East Asia's emerging economies are relatively small, shallow, and lack liquidity. They have ~~only~~ a

[7] The average measures of financial integration with the US are much higher compared with those with other countries in the region.See Park and Shin (2008),

[8] According to the IMF (2007), financial linkages serve as an important channel through which demand and supply shocks are transmitted from one country to another in the global economy.

limited capacity ~~to~~ for absorb capital inflows. When large global investors enter these economies in search of high returns, they often overwhelm domestic financial markets, raising stock prices and causing currency appreciation beyond a level consistent with the economy's fundamentals. When they leave unexpectedly, as they often do, they suffer from a shortage of reserve currency liquidity, precipitating the collapse of asset prices and in some cases even endangering the safety of the financial system itself.

Another feature is emerging East Asia's heavy dependence on global financial intermediation conducted in reserve currencies—the dollar and the euro—and dominated by global financial institutions headquartered in the US and Europe. Few of East Asia's commercial banks and investment banks are global players, although they may be large in terms of assets. As a result, when a sudden reversal of capital inflows takes place, East Asia's commercial banks cannot easily fill in to supplement shortages of liquidity in reserve currencies. For instance, when foreign lenders and investors sell off their East Asian assets and refuse renewal of their short-term loans, US dollar or euro liquidity dries up. If financial market participants overreact to an event like the failure of Lehman Brothers, the liquidity shortfall could provoke a currency crisis and a run on central bank reserves, as it did in Korea in 2008.

To be sure, East Asia's central banks are able to make additional liquidity available by dipping into their foreign exchange reserves.[9] During the six-month period beginning in September 2008, when the crisis was in full force, the central banks stepped in to ease the liquidity shortage. But the subsequent loss of foreign exchange reserve precipitated further currency depreciation, thereby setting off a chain of reactions in which the depreciation ended up in a further reserve loss and threatened the solvency of those banks unable to roll over their external loans.

A third feature is related to the asymmetric risk structure of capital flows in which the region as a whole imports safe financial assets—to be held monthly as reserves—while exporting risky ones (Crockett 2002). This asymmetry leaves East Asia highly susceptible to crisis contagion. When a crisis or a disturbance occurs in an emerging economy, investors with exposure in other markets become conscious about the possibility of spread of the crisis to other emerging economies. When they hold risky assets like those issued by East Asia's emerging markets, foreign investors leave these markets simultaneously, even though their fundamentals are strong, shifting their portfolio investments to high quality riskless assets, as they did when the 2008 crisis broke out.

3. THE 2010 GLOBAL ECONOMIC CRISIS AND DECOUPLING

If the decoupling had taken root before the crisis, one would expect that East Asia could have remained relatively immune to or had been spared partially at least the effects of adverse disturbances originating in countries outside the region, such as the US sub-prime crisis.

Following the bankruptcy of Lehman Brothers in September 2008, many economies in East Asia slid into a deeper recession than had been anticipated and some of them were pushed to the brink of a breakdown of their financial systems. The overall macroeconomic deterioration was serious enough to refute the decoupling thesis and for hopes that East

[9] It is true that East Asia collectively holds more than $4 trillion in foreign exchange reserves, but the bulk of these reserves are held by the PRC and Japan. Other East Asian economies may not have held enough reserves to prevent currency speculation. ASEAN+3 has established a reserve pooling scheme for liquidity support for its members, but it has played little role during the crisis, thereby failing the market test. Except for Hong Kong, China; Singapore; and Japan, financial markets of other East Asian economies are far less integrated into the global financial markets than those in Europe.

Asia would serve as a regional engine of growth strong enough to moderate the downturn of the global economy to be dashed.

Against all odds, however, beginning in the second quarter of 2009, East Asia has staged an impressive rebound, which has been followed by a sustained recovery. This recovery has raised the expectation that emerging Asia would return to its pre-crisis path of growth and stability, in line with the IMF forecast (IMF 2010). The PRC's economy grew by 9.2% in 2009 and by 10.3% in 2010—more than the Chinese authorities had forecasted—to the point where it is threatened with asset and consumer price inflation. The Asian NIEs (Hong Kong, China; Korea; Singapore; and Taipei,China), which were battered most by the crisis, have been making a strong comeback, posting an average growth of 8.2% (IMF 2010) in 2010. Do these developments add up to provide any empirical evidence supporting the decoupling phenomenon?

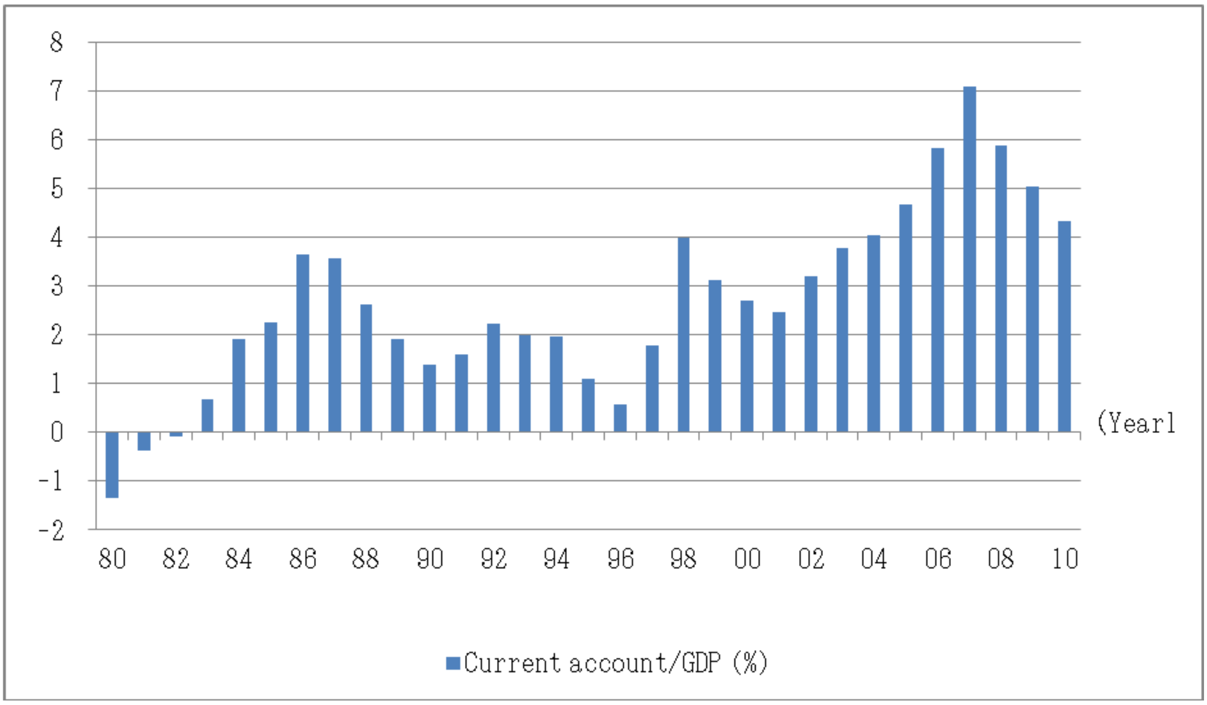
3.1 Domestic Demand-led Recovery

A recent IMF economic outlook for Asia and Pacific (2010) shows that economic growth in East Asia except for Japan has been driven first by fiscal and monetary stimulus and then sustained by the subsequent expansion of private demand since the recovery began in 2009. Perhaps it is premature to conclude whether rebalancing growth has been taking root or the domestic demand-led output growth is likely to be a short-run development, or whether emerging Asia will return to export-led growth once the global economy recovers fully from the crisis. However, there is considerable evidence to suggest that domestic demand will continue to be a more important source of growth in East Asia in the coming years. One such piece of evidence is that in all East Asian economies, except Korea, the ratio of exports to GDP has been declining since 2005 (World Bank Database 2011); another is that the current account surplus as a proportion of GDP of ASEAN+3 has also been declining since 2007 (Figure 1).

In addition to these developments, the PRC will undergo structural changes that will bring about rapid growth in the demand for consumer goods, including imported ones, as it sustains rapid growth. In fact, the draft of its 12th five-year plan (2011–2015) highlights a policy shift toward boosting domestic consumption as one of the engines of growth, which will lead to a "moderate" increase in imports of consumer goods.[10] In the PRC, private consumption as a proportion of GDP has stabilized since 2009 after years of decline. The reform of retirement pensions and extended health care coverage are likely to reduce precautionary incentives to save (IMF 2010). At the same time, a number of East Asian countries including the PRC, Indonesia, Malaysia, the Philippines, and Thailand have given high priority to investment in infrastructure development. These changes in policy are in line with a new mandate that East Asia's emerging economies need to steer themselves to a more balanced growth strategy.

[10] A recent study suggests that if increases in income are complemented by exchange rate appreciations, East Asia will see a steady increase in imports of consumer goods. See Thorbecke (2010).

Figure 1: Ratio of Current Account Balance to GDP of East Asian Region[11] (%)



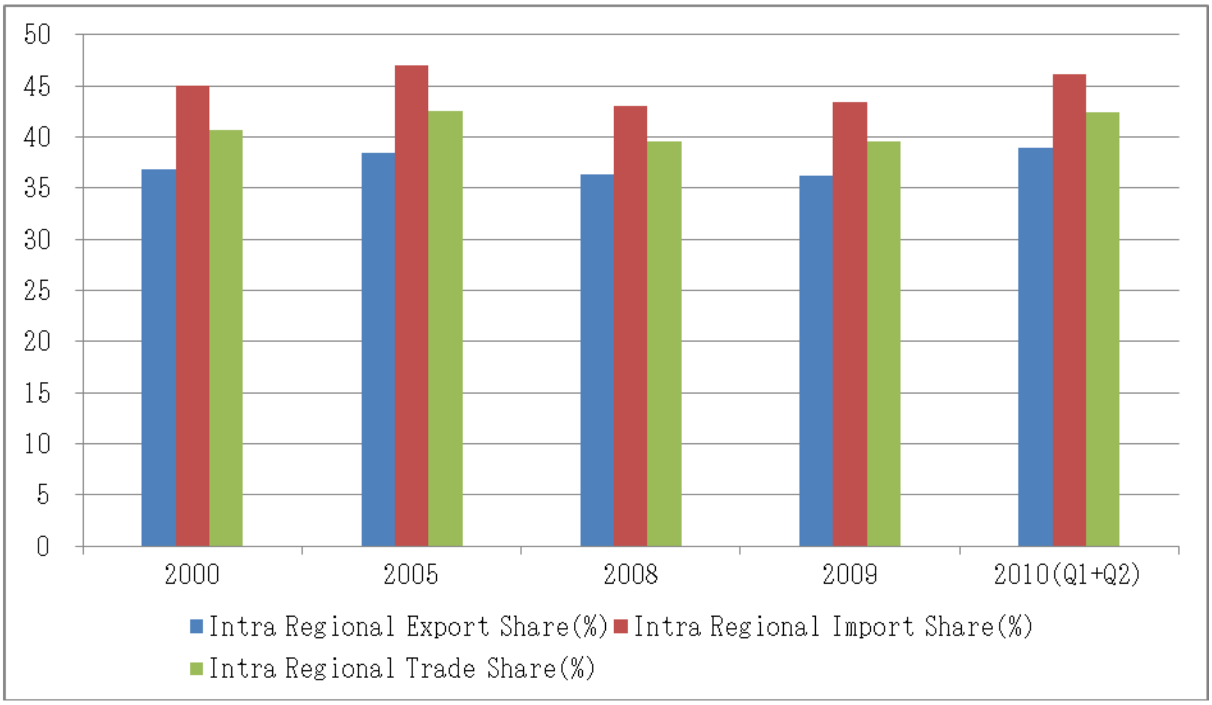
Source: IMF, World Economic Outlook Database, 2011.

3.2 Intra-regional trade integration

The share of intra-regional trade in East Asia rose to an all time high of 42.5% in 2005. For the next three years, it declined before turning up again in the first quarter of 2009 (see Figure 2). By the second quarter of 2010, it had returned to the level of 2005. Much of this increase has come from the PRC's growing absorption of exports of other East Asian countries. In expanding its capacity to import from East Asian countries, the PRC has strengthened its foothold as a hub for East Asia's regional trade.

[11] The region includes ASEAN5; Hong Kong, China; Taipei,China; the PRC; Korea; and Japan.

Figure 2: Share of Intra-regional Trade in ASEAN+3



Source: IMF, *Direction of Trade*, various issues

Available data on intra-industry trade are somewhat sketchy. Estimates of five-year averages of the Grubel and Lloyd (1975) index for intra industry trade for eight East Asian economies from 1990 to 2004, where the intensity is estimated in manufacturing against the PRC, show that the indices of the eight economies vis-à-vis the PRC almost doubled on average over the ten-year period from 1990–94 and 2000–04.[12] In contrast, with regard to the US the same indices barely changed between the two periods.

In a recent study, Athukorala and Kohpaiboon (2010) show that the share of parts and components imports in the PRC's total manufacturing imports rose from 18% in 1994–95 to more than 46% in 2006–07. This increase is presented as evidence for the rise in vertical integration in East Asia's intra-industry trade and the region's dependence on external trade for growth. Data on the trade in parts and components for East Asian economies for the recent periods are not available, but some of the recent macroeconomic and trade developments in the region since 2007 suggest that the share has declined and will continue to do so.

Like many other East Asian economies, intermediate inputs account for a lion's share of Korea's total exports to the PRC. However, since 2005, when it reached an all time high of 82%, the share has been declining: in 2008 the share fell below 70% (Jeong 2009). It would not be surprising if a similar development has taken place elsewhere in East Asia, largely because throughout East Asia countries have been moving towards embracing, to varying degrees, a new growth strategy depending more on domestic demand than before. This rebalancing suggests that integration in intra-regional trade is likely to proceed not just through trade in parts and components, but also through trade in final goods. In this regard, the PRC holds the key to future progress in decoupling of East Asia.

The 2008 crisis hit the PRC's export oriented industries hard, slashing total exports by more than 12% in 2009. It also cut the PRC's imports from other East Asian economies as well as from the rest of the world by about 10%. However, beginning in the first quarter of 2009, the

[12] The eight economies are: ASEAN5 plus Japan; Korea; and Taipei,China.

PRC's imports have been increasing. By the first half of 2010, its imports from the East Asian economies had returned to the level of 2008 (see Figure 3).

Figure 3: Shares of Major Asian Countries* in the PRC's total Exports and Imports

Source: IMF, *Direction of Trade*, various issues

Notes: *They are: ASEAN5, Japan; Korea; and Taipei,China

Using vector auto-regression (VAR) models, Park and Shin (2010) show that the PRC's imports have had a significant positive effect on the GDP of other East Asian economies in the post-Asian crisis period. The positive effect was more pronounced during the period from the last quarter of 2008 to the first quarter of 2010, supporting the claim that the import demand from the PRC has contributed to the region's speedy and robust recovery from the global crisis.

Park and Shin (2010) go on to argue that the PRC is "beginning to become an engine of growth for other Asian countries" (p.18)[13]. The 12th five-year plan projects a somewhat moderate pace of annual growth of 8%. It remains uncertain whether the PRC would be able to achieve the target if exports continue to decline as a share of its GDP and the fiscal stimulus is phased out, although IMF (2011) is bullish about the PRC's growth prospect, forecasting more than 9% growth for both 2011 and 2012.

Taking a longer term perspective, the increase in intra-regional trade in East Asia is likely to be powered by the proliferation of free trade agreements (FTAs) in the region. ASEAN member states have 5–10 year plans to remove most of the structural and institutional obstacles to creating an economic community that visualizes free trade of goods and services, and free movement of labor and capital by 2020. The PRC-ASEAN FTA, which is the third largest in terms of GDP came into effect in January 2010. The PRC signed an Economic Cooperation Framework Agreement (ECFA) with Taipei,China on 29 June 2010, which is a preferential trade agreement (PTA) between the governments of the two sides. Both Japan and Korea concluded FTAs with ASEAN.

Even before these FTAs entered into force, total trade of ASEAN, Japan, and Korea with the PRC was growing at a double digit rate. Since 2010, there has been a phenomenal increase in trade between the PRC and other countries in East Asia. During the first six months of 2010, ASEAN's total exports to the PRC rose by more than 86% and its imports by 63% year

[13] When the VAR model is modified to account for The PRC's imports from East Asia derived from the US demand for The PRC's final goods, much of The PRC's positive impact disappears over a longer horizon. See Park and Shin (2010).

on year. For Japan and Korea the rate of growth was 48% and 60%, respectively. This trade expansion is likely to bring about synchronization of output movements in East Asia. Such a process would be a natural evolutionary outcome of trade expansion and geographical proximity among the members of the group.

3.3 Financial spillovers

The huge shock waves of the 2008 global financial crisis shook East Asia's financial markets to the core. During the period from the collapse of Lehman Brothers in September of 2008 to the first quarter of 2009, throughout the region stock prices nosedived and the exchange rates except for those pegged to the dollar depreciated against the US dollar and exhibited a higher degree of volatility than before. The sovereign spreads widened and the credit default swap premia, a measure of the quality of financial liabilities denominated in the US dollar, sharply increased. Despite its initial virulence, the crisis was short-lived. By the end of the first quarter of 2009, stability had returned to East Asia's financial markets.

In retrospect, however, East Asia's financial systems were better able to withstand the onslaught of the 2008 crisis largely because, unlike those in other parts of the world, the region's financial institutions did not hold large amounts of US "toxic" assets. A series of financial reform the crisis-hit countries undertook in the wake of the 1997–98 Asian financial crisis appear to have improved efficiency and stability of their financial systems to better weather the crisis.[14]

Since the recovery began, however, East Asia has once again been inundated with a flood of capital inflows. Ample global liquidity, the relatively robust growth and low public debt in East Asia together with expectations for low interest rates in mature markets, and a shift in global asset allocation have all come together to fuel capital flows to the region. Compared with 2009, total inflows into the region more than quadrupled in 2010. This massive increase is feared to exacerbate the risk of inflation, asset price bubbles, financial sector instability, excessive appreciation, and risks associated with a sudden stop of capital flows.

There is also the risk of the financial turmoil in Europe spreading to other regions including East Asia. Given the financial linkages with countries in East Asia, financial spillovers from Europe through higher risk aversion and lower equity prices could lead to an abrupt reversal of capital flows and a slowdown in growth and demand that would negatively affect the growth prospects of East Asia.

As long as emerging Asia is unable to mitigate a high degree of volatility of capital flows and asset prices, financial spillovers will bar any further decoupling of East Asia. Therefore, if emerging Asia is serious about erecting a buffer against external disturbances, it needs to consider instituting some of the remedies for controlling vagaries of capital flows. One such remedy is to impose controls on capital inflows. While the controversy on the effectiveness of such controls persists, there has been a reexamination of some of the control measures emerging Asia could adopt to reduce the volatility of capital inflows at the IMF (Ostry et al. 2011)

Regardless of its effectiveness, the capital controls alone will not be enough to restrict capital inflows. In particular, emerging economies will need to take precautionary measures to safeguard against large and unexpected capital outflows caused by the market's overreaction, which could trigger a reserve currency liquidity crisis.

To prevent a liquidity crisis, East Asia's emerging economies would benefit from consolidating the regional liquidity support system—the Chiang Mai Initiative Multilateralization (CMIM)—and from joining forces to help create a global liquidity safety net that could provide short-term liquidity when they suffer from a reserve currency liquidity crisis

[14] Park and Shin (2011) claim that the 2008 crisis did very little in undermining safety and soundness of East Asia's financial systems.

caused by a sudden reversal of capital inflows. The G-20 has been working on creating a liquidity safety net, and if such a net is complemented by capital control measures, East Asia's financial markets and institutions will be better equipped to insulate themselves from any unpredictable shocks ~~to~~ emanating e from global financial markets.

4. PROSPECTS FOR DECOUPLING

Emerging East Asia's rapid and robust recovery from the 2008 crisis has reopened the debate on the decoupling. In this paper, it is shown that the available evidence from recent changes in intra-regional trade and financial linkages with global financial markets together with the episode of the 2008 crisis does not confirm either decoupling or re-coupling.

Much of emerging Asia's current recovery has been powered by the expansion of domestic demand bolstered by fiscal stimulus. It is too early to tell whether this domestic demand led-growth would be sustainable and, if it can be, whether it will boost intra-regional trade enough to develop a firmer base for decoupling. It also remains uncertain whether the PRC will be able to absorb a large share of imports from other emerging economies to help it withstand a future slowdown in the US and the EU. However, these uncertainties need to be weighed up against the background of a number of recent developments in East Asia that point to the formation of a region more self-contained than before.

Emerging Asia appears to be on the way to pre-crisis dynamism and growth. This, which will be further supported by the three FTAs of the PRC, Japan, and Korea with ASEAN (which have entered into force), will spur intra-regional trade. In addition, the PRC and Korea have expressed interest in starting negotiations for a bilateral FTA between themselves. Japan and Korea are expected to resume their FTA negotiations, which have for some years been stalled by disagreements over agricultural trade. A long debated proposal for creating an FTA among the PRC, Japan, and Korea is no longer idle speculation.

With increases in income throughout the region, East Asia will witness a continuing expansion in intra-regional trade, much of which will consist of intra-industry trade that is more horizontal than before. At the same time, if East Asia succeeds in instituting an efficient capital control regime and in strengthening the CMIM, which will be part of a global liquidity safety net, it will be able to better cope with the volatility of capital flows to the region. Together these developments will then help speed up economic integration among ASEAN+3 member states to build a region that is more self-contained than before, as it will be less affected by the cyclical movements of the industrialized countries in North America and Europe.

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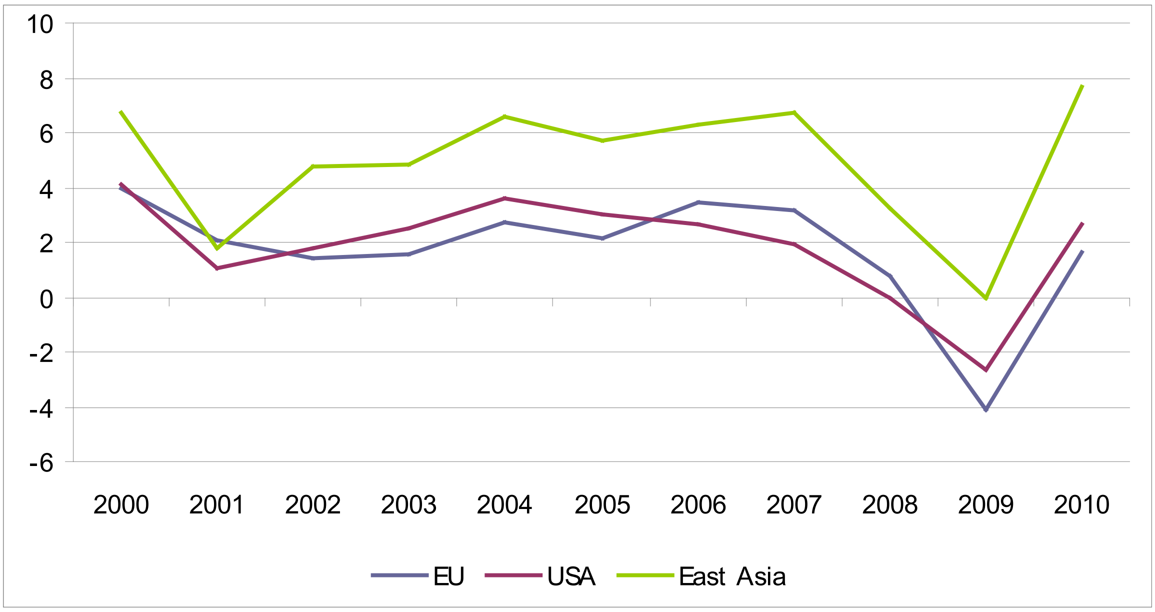
APPENDIX

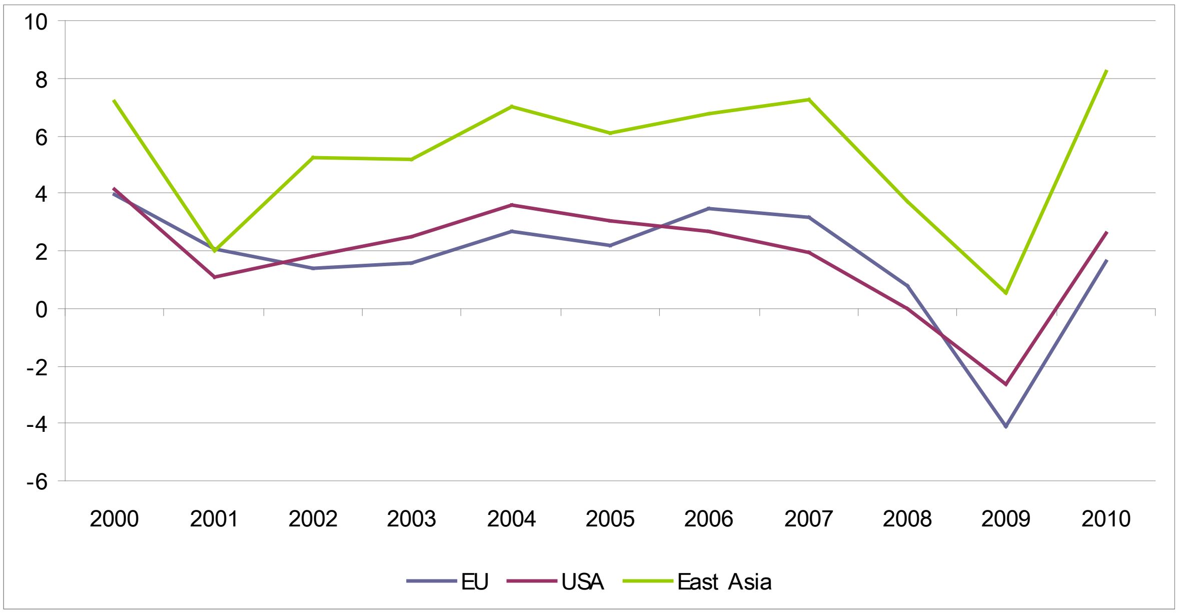
Figure A1: GDP growth rate for major regions* (2000–2010)—Including Japan (%)



Note: *Major regions include the EU, the US, and East Asia (ASEAN 5; the PRC; Hong Kong, China; Taipei,China; Korea; and Japan).

Source: IMF, World Economic Outlook Database, October 2010

Figure A2: GDP growth rate for major regions (2000–2010)—Excluding Japan (%)



Note: *Major regions include the EU, the US, and East Asia (ASEAN 5; the PRC; Hong Kong, China; Taipei,China; Korea; and Japan).

Source: IMF, World Economic Outlook Database, October 2010