

# Commentary

BUFFIN PARTNERS INC.

ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

## Economic Recovery in Asia

At the end of 2008 the economic outlook for Asia was widely believed to be negative based on various pessimistic economic forecasts. The International Monetary Fund reported that in the fourth quarter of 2008, GDP in Asia (excluding China and India) had plummeted by about 15 percent on a seasonally adjusted annualized basis. This was a steeper downturn than in other regions of the world and was larger than expected based on historic correlations of growth between the Asian and western economies. However, econometric forecasting models based on historic correlations are not sufficiently robust to provide accurate forecasts in times of exceptional economic turmoil. The financial and economic crisis of 2008 impacted the Asian economic region in successive stages; the first stage was a result of the effect from stress in the countries at the center of the crisis; international bank flows to Asia turned negative as a result of deleveraging among major banking institutions; external bond issuance virtually stopped; equity markets and local currencies, other than the Japanese yen, recorded substantial declines as capital rapidly flowed from the region. Shortages in dollar funding affected domestic money markets in Asia and the reversal of private flows was followed by a collapse in exports from the region that contracted by as much as 30 percent in most Asian countries and by about 40 percent in Japan.

But the experience of the Asian nations in 2009 has demonstrated the remarkable resiliency of the Asian economies with a rebound in economic activity that has surprised many observers as well as professional economists. Asia is actually leading the global economic recovery; industrial production in export-dependent Asia has regained most of the decline since September

2008 and has fully returned to pre-crisis levels in some Asian countries, notably Korea, with a sharp rebound in export volume. Another factor contributing to the Asian economic recovery has been a region-wide increase in domestic demand. Global financial conditions have eased from the peak crisis level, corporate credit spreads have narrowed, and net equity inflows are increasing, thus helping to sustain the Asian economic recovery. The current rebound is to a considerable extent driven by a restocking of global inventories and may not be sustainable without a full recovery in demand in western economies. Asia's economies are also being supported by large fiscal stimulus measures; Asia's fiscal response to the global economic and financial crisis has been larger than in the average of G20 nations. It is also noteworthy that exchange rate devaluations have contributed to export-led recovery in some Asian countries.

Asia's political leaders acknowledge the need to manage local economies in such a way as to increase trade within Asia and to reduce future reliance on trade with the United States and other western economies. The ten member nations of the Association of Southeast Asian Nations (ASEAN) plus China, Japan and South Korea recently met in Thailand and discussed how to increase trade within the East Asian region, with an emphasis on lowering of tariffs and developing a wider Asian free-trade zone. Both China and Japan exert considerable influence in the region and provide guidance on how a future pan-Asian economic bloc might emerge in the form of an East Asian Community. China is actively seeking to expand the role of the renminbi to replace the US dollar in regional trade transactions and is providing substantial funding for infrastructure development in the ASEAN region. It is anticipated that the

ASEAN free trade area will be launched in early 2010.

China's economy continues to maintain its momentum with an 8.9 percent growth in the third quarter of 2009. Growth in industrial output and retail sales served to offset weakness in export activity. According to China's National Bureau of Statistics, China's economy is at a vital moment of recovery and stabilization as the pressure on external demand is still serious and it remains an arduous task to expand domestic demand and adjust the structure of the economy. The World Bank's latest *China Quarterly Update* predicts that China's economic growth is likely to remain robust but cautions that the costs of keeping economic policy in an expansionary mode will prove more costly over time. China is increasingly focused on implementing social and economic policies to maintain employment levels and ensure social stability. Government policies are emphasizing social issues such as health, education, and social security. Improved rural pension programs were introduced this year; progress is being made with health care reform to make health care more affordable and accessible; and the establishment of banking facilities in rural areas is being encouraged. China's inflation remains subdued and is likely to continue to provide the basis for a stable economic environment. China continues to lead the world's economic growth and the emerging recovery from the 2008 financial crisis.

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