

**THE U.S. ECONOMY
MAY HAVE CONTRACTED PNEUMONIA,
BUT MANY ASIAN ECONOMIES
MAY ONLY SUFFER THE SNIFFLES**

With one economist after another, and with one, internationally respected banker after another forecasting a recession for the United States of America, the questions are being asked:

‘OK, then, which economy(ies) is most likely to be able to withstand any prolonged US economic meltdown? How will Asia withstand such an onslaught should a US recession materialise?’

The consensus appears to be that the economy of the People’s Republic of China (PRC) is in the best position to withstand the suggested US economic problems (the worst scenario basis) and, because of the strength of the PRC’s economy, it could help to ameliorate the economic problems that are looming on the horizon for some (or many) of its neighbouring trading partners.

However, in **TARGET**’s view, it is highly unlikely that the strength of the PRC economy will be the financial band-aid for the neighbours of the most-populous country of the world.

(For the record, **TARGET** () is not convinced that the US economy will, or has, fallen into recession, but time will tell. Please refer to **TARGET** Intelligence Report, Volume X, Number 66, published on April 9, 2008, headlined: **‘RECESSION IN THE U.S. MAY BE UNLIKELY, AT THIS JUNCTURE, BUT WHAT ABOUT STAGFLATION?’**)

The economy of the PRC is being powered, not just by its exports to the US and Europe, but, also, by ever-increasing domestic consumption.

This could well be a buffer for the economy of the country, to be sure, but it will do little for the rest of Asia, most of those countries, likely to suffer from a global slowdown as the US economy hobbles along at a slower and slower pace.

Domestic demand in the PRC is accelerating and appears to be insulated from the US economic slowdown, with excess industrial capacities, waning appreciably.

In order to meet demand at home, the PRC continues to import increased shipments of coal, oil, and minerals of just about all kinds.

For the next 2 years or so, this situation is quite likely to continue and could even escalate.

The PRC is a large importer of goods from its neighbours, but a large proportion of these imports is destined to be re-exported in the shape of value-added products.

An example of this situation is Taiwan where about 35 percent of its total exports go to the PRC.

In fact, Taiwan’s exports to the Middle Kingdom account for about 20 percent of its GDP (GDP = **Gross Domestic Product**: The annual, total value of goods produced and services provided in a country, excluding transactions with other countries).

However, one must bear in mind that not all of the imports, reaching the PRC’s shipping/airport terminals, remain in the country.

In this regard, statistics indicate that about half of all of the PRC's imports are swallowed up in processing and assembly centres.

From there, the finished products are re-exported to trading partners of the PRC, specially the US, eurozone and Japan, which, in aggregate, account for about 70 percent of the country's exports.

Of that figure of 35 percent of Taiwan's total exports, only about 10.50 percent is used in the production of goods, consumed domestically.

Clearly, therefore, Taiwan's economy will only benefit to the extent of its exports to the PRC, those exports, that is, that are used in the production of goods for domestic consumption.

Statistics indicate that that figures is between 10.50 percent and 12 percent, annually adjusted.

If this is the case for the economy of Taiwan where the value of its exports, amounting to about 20 percent of that territory's GDP, is landed in the PRC, for other trading partners of the PRC, the growth of the economy of the country will be of little help to those economies.

In conclusion, therefore, it would appear that only the PRC's economy will be somewhat insulated from a prolonged slowdown in the economy of the US.

That is not the complete story, however.

While the US economy continues to slow, it is noted that commodity prices are continuing to rise.

Much of this, of course, is due to the translation value of the US dollar vis-à-vis other '*hard*' currencies of the world.

Continued strong demand for most commodities from Asia – the PRC, in particular – has caused commodity prices to rise, in many cases, to record-high levels.

As the price of crude oil continues to rise, it has a knock-on effect on what are known as '*soft*' commodities, such as sugar and corn, both of which are used in the production of biofuels.

There is, also, the matter of an accumulation of foreign exchange/external wealth by many of the emerging economies of Asia.

This liquidity suggests that these economies are less dependent of capital inflows than in the past.

As such, these economies see no reason to allow (or be pressured into) currency floats and, instead, prefer to introduce more flexible, foreign-exchange regimes.

In days of yore, fixed exchange rates, linked to dependence on capital inflows, more often than not used to finance current account deficits, led to one crisis after another as investors lost confidence in various countries' governments.

This caused those governments to react in direct response to the threat of a concerted exodus of capital with monetary tightening which had the effect of slowing down domestic consumption.

This resulted, naturally, in an economic slowdown in those countries.

Emerging markets improved fiscal positions and lower government debt are permitting these governments to pursue policies that are not contrary to existing policies.

What this all means is that, while the US economy may have contracted chronic '*pneumonia*', for many of Asia's tigers, they may only experience a slight sniffle.

And, as for the PRC's economy, it is likely to be only slightly affected by the malaise of the US.

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