

Asian "recovery" on shaky foundations

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Most economic policy bodies and think tanks have concluded that the Asian economies have recovered from the crisis of 1997-98 and can look forward to stronger growth in the coming period. The Pacific Economic Cooperation Council, for example, has predicted that growth in the region will expand from the 3.9 percent recorded in 1999 to 4.9 percent this year.

However optimism over the region's economic future has been called into question by a number of recent comments by economic analysts who maintain that the recovery rests on shaky foundations, dependent to a great extent on continuing US economic growth and exports to the US market.

In a recent report, cited in a *Wall Street Journal* article, entitled "If America Sneezes ..", Bill Belchere, the Asian economic analyst for Merill Lynch warned that "Asia's healing process appears to be losing momentum." The Asian recovery was dangerously dependent on growth in the US economy and the volatile technology sector in particular.

According to the *WSJ*: "A drop [in US demand] could expose deep structural problems, including the heavy debt lingering in the region more than two years after the financial crisis."

Or in Belchere's words: "If the tide rolls out, we may find that much of the wreckage is still there."

UBS Warburg economist Arup Raha, quoted in the same report, said that the words "recovery" and "robust" could be replaced by "double dip". "The recovery in South East Asia has been singular in nature in that it relies on exports. Right now, this is the danger," Raha said.

Pointing to the dependence on the US market, the *WSJ* commented: "The big fear is weaker exports. South East Asia's recovery has been powered largely by US consumers, who are buying everything from Indonesian-made sneakers and Thai silk to Philippine-

assembled Intel chips. The US is the largest buyer of South East Asian goods, more than 20 percent of exports from Thailand and Malaysia and nearly 30 percent from the Philippines. The ripple effect is even greater. Much of the trade within South East Asia is in parts and materials used to make goods that are later sold to the US.

"Adding these 'goods in process' to the consumer spending that flows from US trade, analysts estimate the impact on regional economies could be multiplied by several times."

The stability of Asian stock markets is also of concern. An article published in the *Australian* last month, entitled "Asia Still on the Brink", pointed to significant falls in Asian bourses over the past two months.

"For those who heeded the chorus of 'go international' advice from the investment advisers—and went into funds with Asian exposures—their hair will already be standing up on end.

"Just look at the Nikkei: from 20,883 in mid April to 16,008 six weeks later. Or the Hang Seng: 18,301 in late March, 13,722 in late May, before its latest bounce. South Korea's main index down from 915 to 655 ... was another. The picture in Singapore, Thailand, Indonesia and the Philippines is no better."

The article cited comments by Ord Minnet chief economist Frank Shostak who maintains that recent claims of an "Asian recovery" are superficial. According to Shostak, the "bounce" in the Asian region is nothing more than a response to rapid increases in money supply which, when reversed, will leave all the underlying problems in the region just as they were two years earlier.

Governments have injected large amounts of money into their economies over the past two years but this process cannot go on indefinitely. According to Shostak: "They're scared of pumping too much money

because they'll create price inflation. The Asian recovery is a phony one, there is no substance behind it."

The underlying instability of the East Asian economies and their dependence on the continued rise of Wall Street was also the subject of a report published in the *Far Eastern Economic Review* in late April. Written in the aftermath of the plunge of the NASDAQ index on April 14, the article warned that "financial contagion in once again infecting Asia's markets."

"On April 17 an estimated \$US200 billion was wiped off the value of Asian stocks as index after index around the region followed the NASDAQ benchmark into free fall. While the April 17 sell off may have been a simple knee jerk reaction, the fear that prompted Asian investors to unload their stock holdings in response to the slide in US equities has a rational base. The relationship works like this: Plunging stock prices erode the wealth recently accumulated by US households. Facing a decline in the value of their assets, consumers tend to spend less, reducing the demand for the manufactured goods that have long been a mainstay of Asian exports to the United States. US corporate demand for Asian goods is also likely to suffer. Rising capital costs implied by falling stock prices could force companies to curtail investments in information technology."

The *FEER* article cited comments by Fred Wu, head of economic research at the Development Bank of Singapore, who pointed out that of \$328 billion worth of electronic goods exported by Asian countries last year, \$117.5 billion or 36 percent went to the US. Wu estimated that reduced US demand for Asian exports could knock as much as two percentage points off the economic growth rates of countries around Asia.

With continuing economic stagnation in Japan—the world's second largest economy—and US economic growth dependent on continuing inflows of foreign investment to fuel the unstable Wall Street bubble, the Asian "economic recovery" could be rather short-lived.



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