

Policy Recommendations

East Asia's Role in Resolving the New Global Imbalances

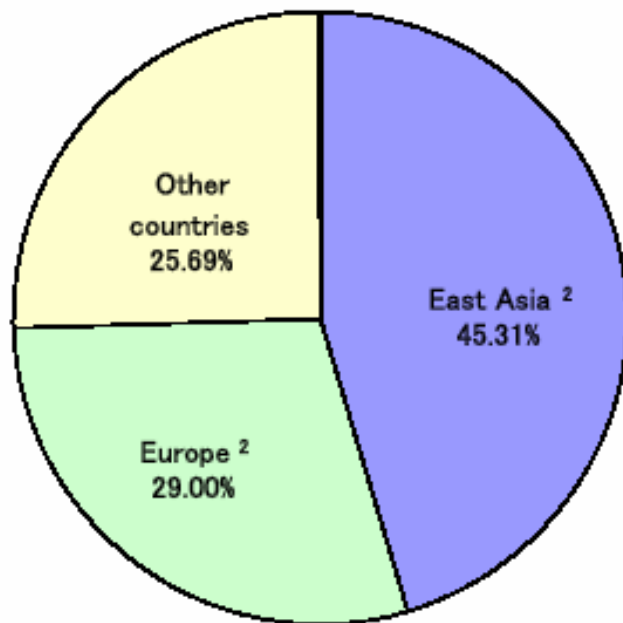
Drafted by
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In collaboration with members of the NEAT Working Group on
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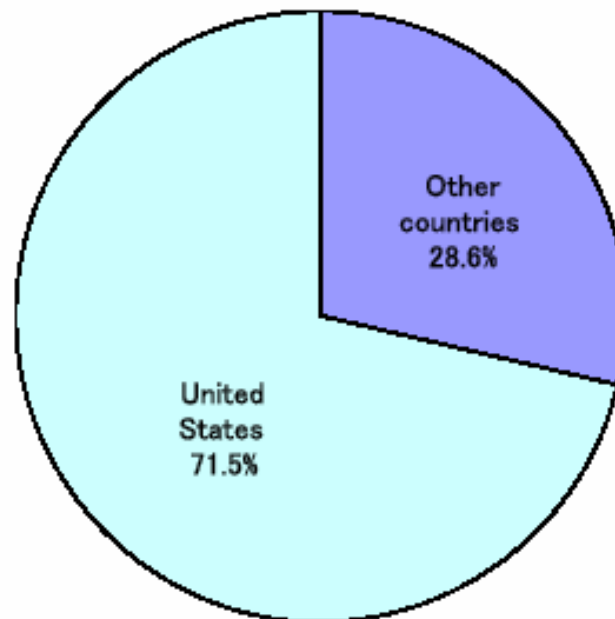
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Global Distribution of Current Account Surpluses (Net Capital Exports) and Current Account Deficits (Net Capital Imports) by Region and Country, 2003
(As a percent of the world sum of current account surpluses or deficits)

Countries That Export Capital¹



Countries That Import Capital³



Source: International Monetary Fund, World Economic Outlook database as of March 11, 2005

1 : As measured by countries' current account surpluses (assuming errors and omissions are part of the capital and financial accounts).

2: East Asia includes ASEAN plus China, South Korea, and Japan. Europe includes Euroland plus other countries in Europe that are running current account surpluses.

3: As measured by countries' current account deficits (assuming errors and omissions are part of the capital and financial accounts).

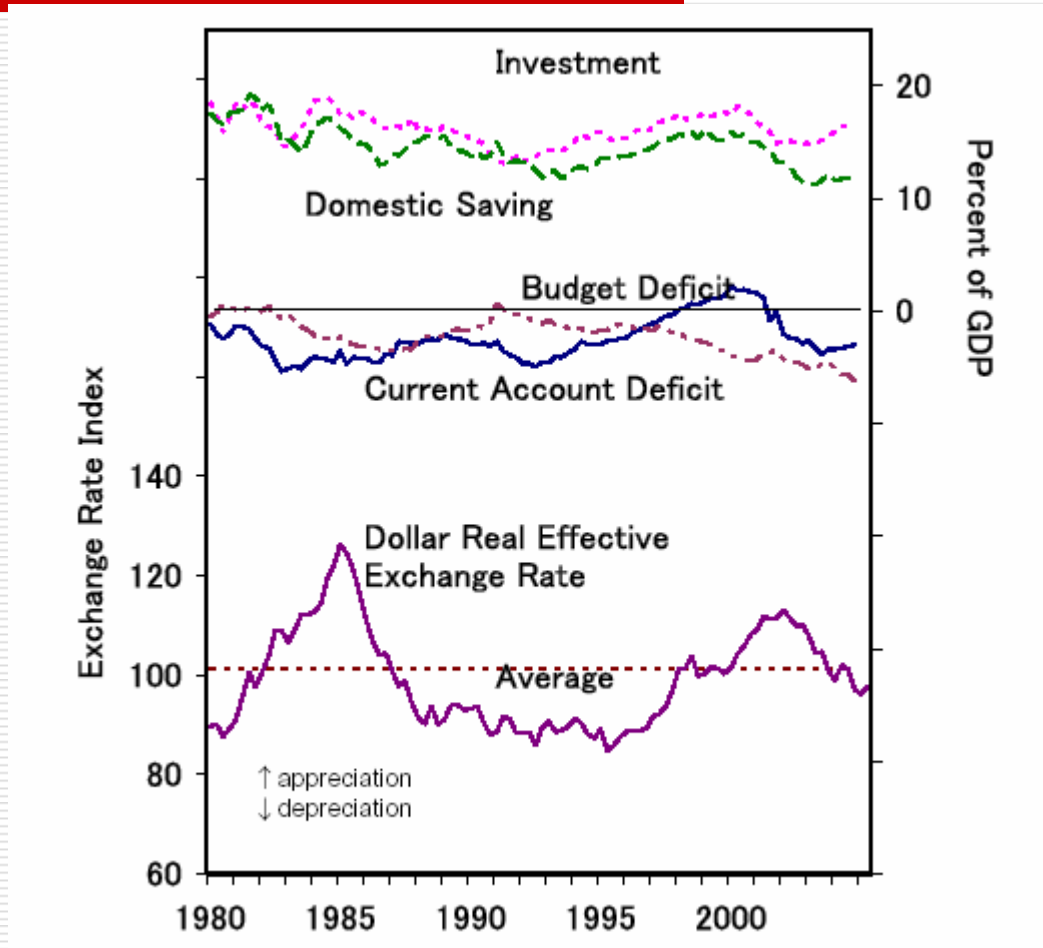
U.S. and East Asian Global and Bilateral Trade Balances, 2004

	(Billions of US\$)			
Country/Region	Exports from the US	Imports to the US	Bilateral trade balance with the U.S.	Global trade balance
Japan	52.2	129.8	75.6	110.5
China	34.7	196.6	161.9	32.0
Crisis-hit Economies				
Indonesia	2.7	10.8	8.1	21.2
Malaysia	10.9	28.2	17.3	25.6
Philippines	7.1	9.1	2.1	-0.7
South Korea	26.4	46.2	19.8	38.3
Thailand	6.4	17.6	11.2	9.7
Non-crisis Economies				
Hong Kong	15.8	9.1	-6.5	-12.1
Singapore	19.6	15.4	-4.2	26.6
Taiwan	21.7	34.6	12.9	6.1
Total of East Asia including Japan	197.6	497.6	298.0	261.4
U.S. Total with the Rest of the World	818.8	1,469.70	(-650.9)	-650.9

Source: US Census Bureau(2005)

Note: For comparison, exports from the U.S. to Europe equaled \$172.6 billion, imports to the U.S. from Europe equaled \$282.0 billion, and the trade balance equaled \$-109.3 billion.

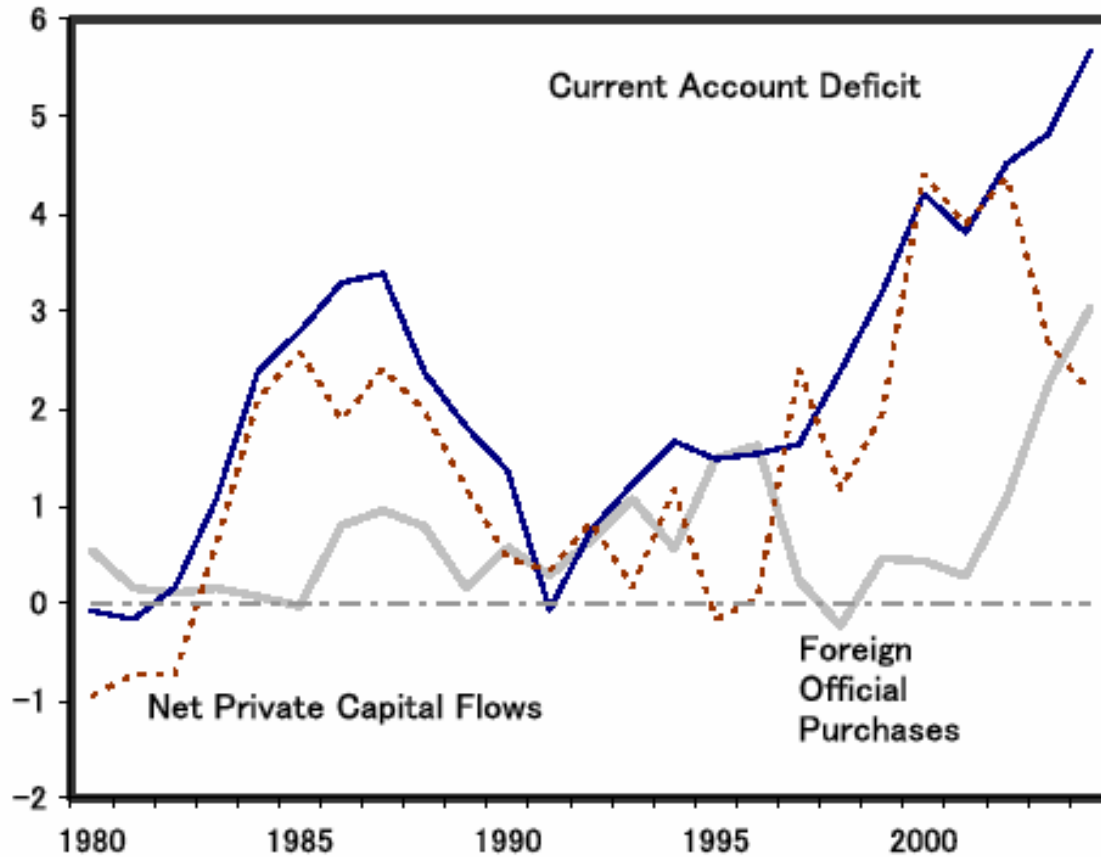
U.S. Investment, National Saving, Budget Deficit, and Current Account Deficit



Source: Federal Reserve Bank of St. Louis and Federal Reserve Board.

Note: The exchange rate is the Federal Reserve Board trade-weighted real exchange rate, deflated using PPIs. The dashed line represents the average exchange rate over the 1980-2004 period. The current account is measured so that a larger positive number represents increase in the deficit.

U.S. Current Account Deficit , Net Private Capital Flows into the U.S. and Official Purchases of Dollar Assets by Foreign Governments



Source: Bureau of Economic Analysis

The Increasing Share of U.S. Assets in the Portfolios of Investors from the Rest of the World (ROW)

	2004		10 years later		Eventually	
	U.S.	ROW	U.S.	ROW	U.S.	ROW
Own total financial assets, gross, U.S. \$	36 Trillion	40 Trillion	62 Trillion	69 Trillion		
% of U.S. GDP	300%	333%	300%	333%	300%	333%
External assets, gross, U.S. \$	9.5 Trillion	12 Trillion	16.2 Trillion	29.6 Trillion		
% of U.S. GDP	78%	100%	78%	142%	78%	198%
% of its own financial assets	26%	30%	26%	43%	26%	60%
Net external assets (NEA), U.S. \$	-2.5 Trillion	2.5 Trillion	-13.2 Trillion	13.2 Trillion		
					<u>If net interest rate on NEA = 0%</u>	
% of U.S. GDP	21%	21%	64%	64%	120%	120%
% of its own financial assets	7%	6%	21%	19%	40%	36%
					<u>If net interest rate on NEA = 1%</u>	
% of U.S. GDP					150%	150%
% of its own financial assets					50%	45%
					<u>If net interest rate on NEA = 2%</u>	
% of U.S. GDP					200%	200%
% of its own financial assets					67%	60%

Eventual net external debt/GDP = $c / (g - r)$, where
 c = current account deficit/GDP
 g = nominal growth rate of the economy
 r = nominal interest rate on net U.S. external debt

Assumptions: $c = 6\%$, $g = 5\%$, U.S. wealth = 300% of U.S. GDP, ROW wealth = 333% of U.S. GDP, U.S. and ROW wealth grow at the same rate, Percentage of U.S. wealth in foreign assets = 26%.

Note: Financial wealth measures net financial assets and excludes tangible assets such as real estate and durable goods.

Source: Bureau of Economic Analysis (2005), Blanchard *et al.* (2005), and Edwards (2005).

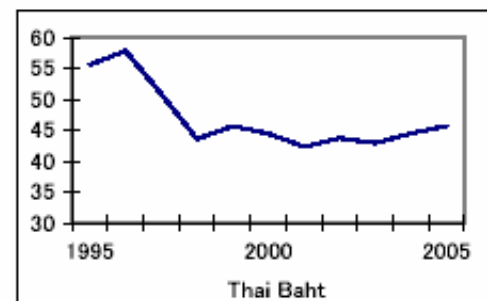
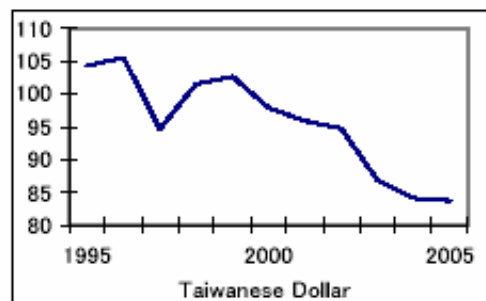
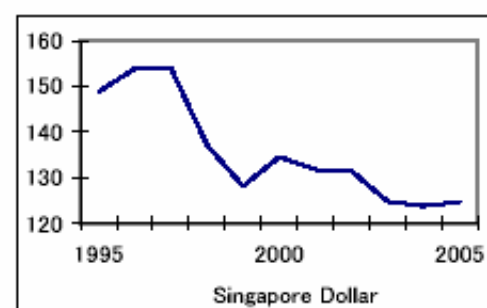
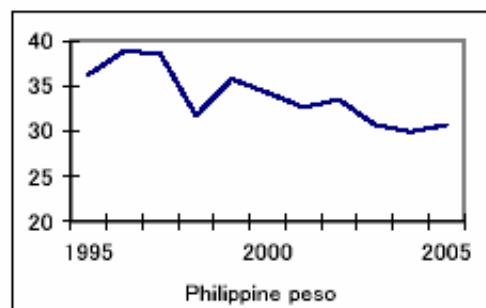
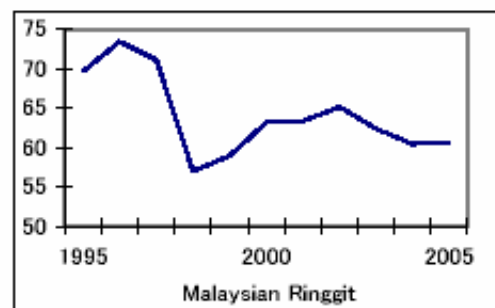
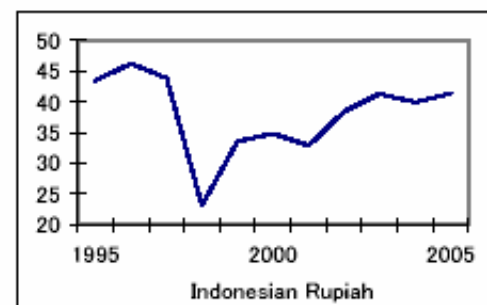
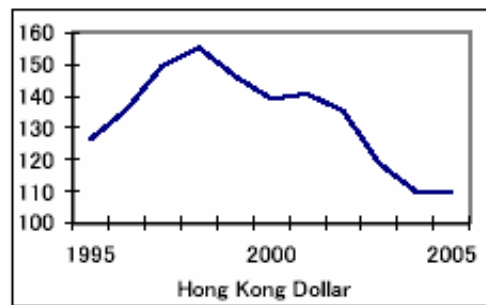
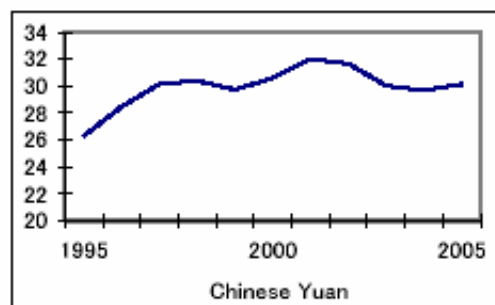
Domestic Savings, Capital Formation, and Resource Gap of East Asian Countries

(% of GDP)

	Gross Domestic Saving				Gross Capital Formation				Saving-Investment Gap			
	Pre-crisis		Post Crisis		Pre-crisis		Post Crisis		Pre-crisis		Post Crisis	
	1990	1995	2000	2003	1990	1995	2000	2003	1990	1995	2000	2003
Korea	37.2	36.5	33.9	32.8	37.7	37.7	31	29.4	-0.5	-1.1	2.9	3.4
Taiwan	27.6	25.9	24.4	23.5	23.1	25.3	22.9	17.2	4.5	0.6	1.5	6.3
Hong Kong	35.2	29.1	31.7	31.6	27.5	34.7	28.1	22.6	7.6	-5.5	3.6	8.7
Singapore	43.3	50.2	47.9	46.7	36.4	34.2	32	13.4	6.9	16.1	15.9	33.3
Indonesia	32.3	30.6	25.6	21.5	30.7	31.9	16.1	16	1.5	-1.3	9.5	5.5
Malaysia	34.4	39.7	47.2	42.9	32.4	43.6	27.2	21.8	2	-3.9	20	21.1
Phillipines	18.7	14.5	17.3	20.1	24.2	22.5	21.2	18.7	-5.5	-7.9	-3.9	1.4
Thailand	34.3	37.3	33.2	33.1	41.4	42.1	22.8	25.2	-7.1	-4.8	10.4	7.9
China	38.7	42.5	39	42.7	34.7	40.8	36.3	44.4	4	1.7	2.6	-1.7

Source: Key Indicators, ADB

Real Effective Exchange Rates in Asia (100 equals the purchasing power parity rate)



Money Supply, Annual Increase Rates: China, Korea, Malaysia, and Thailand, 2000-2005

	China		Korea				Malaysia				Thailand			
	M1	M2	M1	M2	M3	M0	M1	M2	M3	M0	M1	M2	M3	M0
2000	19.80	16.10	24.30	2.70	5.76	9.71	17.08	7.36	5.22	7.42	10.41	1.85	2.73	12.66
2001	14.03	13.66	18.65	7.04	9.46	12.00	6.37	4.04	4.69	4.34	8.39	5.51	5.71	8.03
2002	15.69	15.51	23.49	11.43	13.31	9.85	11.24	5.28	5.72	8.11	12.30	4.35	3.22	11.13
2003	19.19	19.98	6.55	7.49	8.22	4.81	10.73	8.58	8.31	9.84	14.88	2.39	3.57	11.62
2004	16.52	16.25	8.22	4.39	5.86	3.13	14.62	15.17	10.45	9.08	13.60	6.60	6.42	11.16
2005*	12.10	14.12	6.56	4.92	3.83	1.05	12.96	25.38	12.73	5.68	11.46	4.70	5.70	9.42

*Jan-March 2005

Source: Datastream

Inflation, Annual Rates of Consumer, Producer, and Stock Prices: China, Korea, Malaysia, and Thailand, 2000-2004

	China			Korea			Malaysia			Thailand		
	PPI	CPI	SHARE MARKET VALUE - SHANGHAI SE CURN	PPI	CPI	SHARE PRICES	PPI	CPI	SHARE PRICES	PPI	CPI	SHARE PRICES
2000	1.4%	1.4%	55.2%	-0.1%	3.2%	-48.8%	-3.8%	1.5%	-26.3%	3.6%	1.4%	-41.5%
2001	-5.7%	-2.2%	-17.4%	-2.6%	3.1%	23.3%	-1.9%	1.1%	1.1%	0.8%	0.7%	4.0%
2002	6.7%	1.4%	11.2%	2.7%	3.7%	-15.7%	12.1%	1.6%	-6.3%	4.9%	2.1%	12.7%
2003	1.1%	2.8%	7.9%	3.7%	3.3%	29.3%	2.6%	1.0%	21.8%	2.8%	1.3%	72.7%
2004	2.2%	-1.3%	-23.9%	4.0%	3.1%	6.6%	3.5%	2.4%	12.4%	8.2%	2.6%	-8.5%

Source: Datastream

Intra-regional Trade Share ^(a) (in percentage)

Regions	1980	1985	1990	1995	2000	2001	2002	2003
East Asia-15,including Japan ^(b)	34.7	40.2	45.6	55.5	54.0	55.4	57.3	54.0
Emerging East Asia-14 ^(b)	21.6	29.1	36.4	43.7	43.4	45.6	47.5	44.1
NIEs-4	7.7	10.7	14.3	18.1	16.4	17.5	17.1	16.1
ASEAN-10 ^(b)	18.0	20.3	18.9	24.1	25.7	24.1	24.4	24.0
NAFTA	33.8	38.7	37.9	43.2	48.7	49.0	48.3	46.0
European Union-15	52.4	52.5	58.6	56.8	62.2	62.1	62.4	64.4

Note: (a) The intra-regional trade share is defined as: $X_{ii}/\{(X_{i.} + X_{.i})/2\}$ where X_{ii} represents exports of region i to region i , $X_{i.}$ represents total exports of region i to the world, and $X_{.i}$ represents total exports of the world to region i .

(b) East Asia-15 includes Emerging East Asia-14 and Japan. Emerging East Asia-14 includes the Asian NIEs (Hong Kong, Korea, Singapore and Taiwan), nine ASEAN members (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Thailand and Vietnam) and China. ASEAN-10 includes Singapore.

Source: IMF, Direction of Trade Statistics, CD-ROM, Kawai(2005).

China's Processing Trade – 1993 and 2002

	Imports (%)					
	World-wide	S. Korea, Taiwan, HK	Japan	EU15	United States	Rest of world
1993						
Total imports	100	28	22	15	10	25
Normal imports	37	3	8	8	5	13
Imports for processing	35	18	8	2	2	6
Others	28	7	7	6	3	6
2002						
Total imports	100	26	18	13	9	33
Normal imports	44	7	6	8	5	17
Imports for processing	41	16	8	2	2	12
Others	15	3	3	3	2	4
	Exports (%)					
	World-wide	S. Korea, Taiwan, HK	Japan	EU15	United States	Rest of world
1993						
Total exports	100	29	17	13	18	22
Normal exports	47	12	10	7	6	13
Processed exports	48	16	7	7	13	6
Others	5	0	0	0	0	4
2002						
Total exports	100	25	15	15	21	24
Normal exports	42	8	6	7	7	15
Processed exports	55	16	9	8	14	8
Others	3	1	0	0	1	1
	Balance of Trade (billions of USD)					
	World-wide	S. Korea, Taiwan, HK	Japan	EU15	United States	Rest of world
1993						
Balance of trade	-12.2	-2.4	-7.5	-3.5	6.3	-5.1
Normal trade	5.2	8.0	0.7	-2.0	-0.0	-1.5
Processing trade	7.9	-3.8	-1.3	4.2	9.7	-1.0
Others	-25.2	-6.6	-6.9	-5.8	-3.4	-2.6
2002						
Balance of trade	30.4	3.2	-5.0	9.7	42.7	-20.2
Normal trade	7.1	3.4	1.1	-3.1	6.7	-1.0
Processing trade	57.7	5.9	3.1	19.6	39.9	-10.9
Others	-34.4	-6.1	-9.3	-6.8	-4.0	-8.2

Source:
 “CHINA’S INTEGRATION IN
 ASIAN PRODUCTION
 NETWORKS AND ITS
 IMPLICATIONS” By
 Guillaume GAULIER,
 Françoise LEMOINE, Deniz,
 NAL-KESENCI, June 2004
 (China’s Customs Statistics,
 author’s calculations)

The Trilemma and its Resolution

Exchange rate regimes Policy goals	Pre-WWI Gold standard or Currency Board	Bretton Woods 1945-1973	Floating Since 1973	Crawling bands
Fixing the exchange rate	○	○ (but soft peg)	✗ (sacrificed)	△ with bands (with regional lender of last resort)
Free capital movements	○	✗ (sacrificed)	○	△ with short- term capital controls
Independent Monetary policy for low inflation and high employment	✗ (sacrificed)	○	○	○

Source: M. YOSHITOMI (2004) "Capital Flows, Exchange Rate Regimes, and Emerging Market Economies in Asia", Fiscal Policy Research Institute, Ministry of Finance, Thailand