THE ROLE OF "EMERGING ASIA" IN THE GLOBAL ECONOMY

Over the last fifteen years, the economies of "Emerging Asia[1]" have developed rapidly, outpacing the rest of the world in terms of both output and export growth. In doing so, these economies have made a significant contribution to the increase in economic activity and international trade worldwide. Along the way, the region's economic structure and trade and investment patterns have undergone considerable transformation. Enhanced intra-regional specialisation has facilitated greater flows of trade and investment across the region. The rise of Emerging Asia in the world economy has been supported by strong competitiveness stemming from various sources. Of particular note is the emergence of China and, to a lesser extent, India. China has recorded the fastest output and export growth rates over the last 15 years and is playing an increasingly prominent role as a regional and world growth engine.

Emerging Asia has attracted the largest share of foreign direct investment (FDI) of any emerging market region and substantial portfolio and cross-border bank inflows. These inflows, together with increasingly large current account surpluses, have led to unparalleled growth in foreign exchange reserve accumulation in recent years.

1 INTRODUCTION

The economic performance of "Emerging Asia" over recent years, with its growing share of world real output and trade, has been outstanding. Rapid structural change has accompanied the development process in all of its economies. These changes have, in turn, been closely related to processes of market integration at both the regional and global level. Surprisingly, the Asian financial crisis of 1997-98 did not have a long-lasting negative effect on the region's real output and export growth, as the strength of the subsequent recovery demonstrated. Moreover, financing flows to Emerging Asia increased gradually, but steadily, following the crisis and were soon once again ahead of those to all other emerging market regions. In recent years, Emerging Asia has also become an important trading partner of the euro area, currently accounting for about 15% of the euro area's foreign demand and about 18% of its imports. It has also attracted an increasing amount of FDI flows originating in euro area countries. The rapid growth of China has played a key role in the region's dynamism. China's economy has now become one of the strongest engines of regional and world growth and the most important destination for FDI flows to emerging markets.

This article provides an overview of the increasing role of Emerging Asia in the global economy over the last fifteen years. Section 2 highlights the contribution of the region to global economic activity and international trade. Section 3 looks at Emerging Asia in terms of global capital flows, describing the region's current account positions and financial flows. Section 4 analyses the process of regional integration and regionalisation of economic activity across the economies of Emerging Asia, highlighting the important role that China has come to play in this process. Section 5 concludes.

2 EMERGING ASIA'S ROLE IN ECONOMIC ACTIVITY AND WORLD TRADE

The rise of the region as a global player has been accompanied by a significant transformation of its economies. Growing levels of per capita real incomes have resulted, to differing degrees, from a rapid absorption of workers into the industrial and service sectors, an increasingly educated labour force, rapid capital accumulation and technological upgrading to improve the efficiency of

1 This article defines "Emerging Asia" as comprising the economies of China, Hong Kong, India, Korea, Taiwan and the ASEAN-5 countries of Indonesia, Malaysia, Philippines, Singapore and Thailand.

Table 1 Per capita income[1)] in the economies of Emerging Asia

(USD; PPP-adjusted)

	current USD			constant USD 1995 = 100		
	1980	1990	2003	1980	1990	2002
China	220	320	1,100	708	1,482	4,054
Hong Kong	5,780	12,520	25,860	11,068	18,274	23,833
India	270	390	540	1,083	1,564	2,365
Korea	1,760	5,740	12,030	4,197	8,389	15,009
Taiwan[2)]	2,345	8,106	13,162	3,996	9,151	11,437
ASEAN-5						
Indonesia	500	620	810	1,346	2,087	2,857
Malaysia	1,830	2,380	3,880	3,730	5,079	8,080
Philippines	690	740	1,080	3,830	3,574	3,694
Singapore	4,830	11,840	21,230	8,926	13,435	21,296
Thailand	720	1,520	2,190	2,291	4,116	6,208

Sources: World Bank World Development Indicators and Asian Development Bank Key Indicators.
1) Unless otherwise indicated, per capita Gross National Income (GNI) estimated according to World Bank Atlas method of converting data in national currency to current US dollars.
2) ECB calculations.

resources. From a longer-term perspective, per capita income has risen considerably since 1990 (see Table 1). Looking at the per capita income in current US dollars, three distinct groups of economies can be readily identified: i) the richer city states of Hong Kong and Singapore, with per capita incomes exceeding USD 20,000 in 2002; ii) the maturing economies of Korea and Taiwan, with per capita incomes of some USD 10,000-15,000; and iii) the remaining economies, with per capita incomes of USD 4,000 or less. It is worth noting that, within this last group, India still has the lowest per capita income levels in both current and constant US dollar terms, despite its rapid economic growth in recent years.

The growth performance of Emerging Asia over the last fifteen years has been remarkable. During this period its economies have expanded at a faster pace than the world average, thereby increasing their share in global GDP from around 15% in 1990 to 25% in 2004 (see Table 2). Around three-quarters of this increase can be attributed to the Chinese economy, whose share in world output rose from 5.9% to 13.5% over the same period. India and the ASEAN-5 sub-region also increased their share in global real GDP, from 3.6% and 2.8% in 1990 to 4.9% and 3.7% in 2004 respectively. This growth performance took place in a rather sustained fashion, while the Asian crisis of 1997-98 had no long-lasting effect on the region.

Emerging Asia's economic performance has been export-driven. The region's share of total world exports rose from some 13% to over 21% between 1990 and 2004 (see Table 2). Around 60% of this increase stems from the growth of exports from China, now the world's third largest exporter (the euro area and the United States are the two largest).

Although India's exports still account for less than 1% of total world exports, an important feature in its case is the growth in exports of services as opposed to goods. Exports of services grew to account for 5.5% of nominal GDP and 33% of total exports of goods and services in 2004, compared with 1.5% and 20% respectively in 1990. Most of this growth can be accounted for by the outsourcing of international business operations by multinational information technology and telecommunications firms. These firms have sought to take advantage of India's relatively large, low-cost pool of highly skilled IT and

Table 2 Emerging Asia's share in world real GDP and exports

(as a percentage of world total; PPP-adjusted)

	Share in world real GDP				Share in world exports			
	1990	1995	2000	2004	1990	1995	2000	2004
Emerging Asia	**14.8**	**20.2**	**22.6**	**25.1**	**12.9**	**17.9**	**19.1**	**21.3**
China	5.9	9.3	11.5	13.5	1.9	2.9	3.9	6.9
Hong Kong	0.4	0.4	0.4	0.4	2.4	3.4	3.2	2.9
India	3.6	4.1	4.6	4.9	0.5	0.6	0.7	0.9
Korea	1.4	1.8	1.5	1.6	2.0	2.6	2.7	2.7
Taiwan	0.8	1.0	1.0	1.0	2.0[1)]	2.2[1)]	2.3[1)]	1.9[1)]
ASEAN-5	2.8	3.6	3.5	3.7	4.1	6.1	6.4	6.0
Indonesia	0.3	0.4	0.5	0.5	0.8	0.9	1.0	0.8
Malaysia	0.2	0.2	0.3	0.2	0.9	1.5	1.5	1.5
Philippines	0.2	0.2	0.2	0.2	0.2	0.3	0.6	0.5
Singapore	1.3	1.6	1.7	1.8	1.6	2.3	2.2	2.0
Thailand	0.8	1.1	0.9	0.9	0.7	1.1	1.1	1.1

Sources: IMF World Economic Outlook and Direction of Trade Statistics (unless otherwise stated).
1) Data supplied by Taiwan's Ministry of Finance.

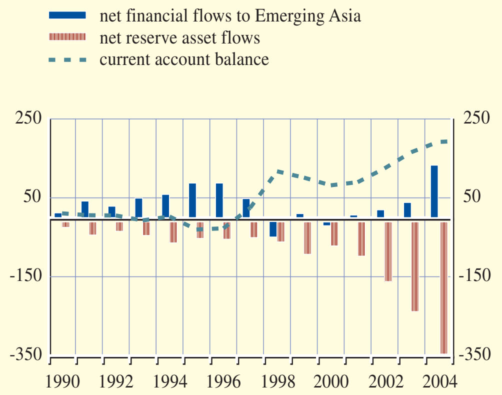
technical graduates, who are proficient in English. Despite their rapid growth in recent years, the IT and offshoring industries in India remain a relatively small part of the economy. In 2003 they accounted for around 4.5% of nominal GDP and employed approximately one million workers out of a total labour force of 482 million.

Emerging Asia's imports have also increased very rapidly since the 1990s. The region's demand for energy and non-energy commodities has, in particular, experienced a marked increase, and China has now become the second largest energy consumer in the world. In China, although coal continues to be the main energy source for producing electricity (the country accounts for 42% of global coal consumption), a rapid shift towards crude oil has been taking place. As a result, its crude oil consumption has tripled since 1985 (250 million tons in 2004) and its payments for net imports of crude oil – which currently account for 2.4% of GDP – have increased eightfold, turning the country into the third largest crude oil importer in the world. According to the International Energy Agency, since 2002 almost 40% of the increase in global oil demand is attributable to China, with its resultant considerable impact on global oil prices recently. China's demand has also been very strong for steel and all base metals traded in global markets. By 2003, the country had accounted for a significant share of global demand for iron ore (34%), steel (27%), copper (20%), aluminium (19%) and nickel (10%), while, over the past three years, it has been responsible for over 50% of the growth in global demand for all of these metals.

Emerging Asia's exceptional performance in terms of GDP growth and export growth is associated with efficiency gains derived from a process of increasing regionalisation of production (see Section 4). This process has contributed to a considerable rise in the importance of intra-regional trade among its economies, whose share of total trade has increased by some 10-20% over the last fifteen years. Turning to Emerging Asia's bilateral trade balances with the world's three largest economies, the region's total surplus vis-à-vis the euro area amounted to some 10% of its total bilateral trade in 2003, compared with a position close to balance in 1990. Over the same period, Emerging Asia's trade deficit vis-à-vis Japan declined slightly from 10.1% to 8.8%, while its surplus with the United States rose from 7.4% to 15.9% of total bilateral trade.

Chart 1 Selected items of Emerging Asia's balance of payments

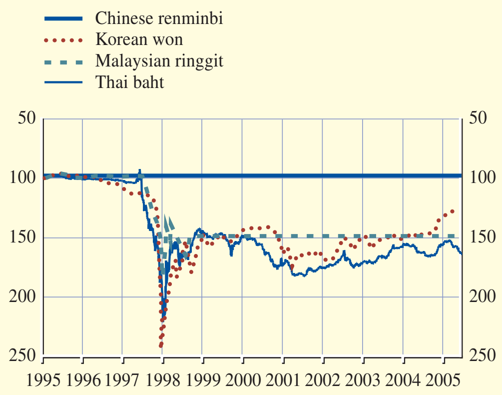
(USD billion)



Sources: IMF World Economic Outlook and ECB calculations.
Note: A negative value indicates an increase in net reserve assets.

Chart 2 US dollar exchange rates vis-à-vis selected currencies of Emerging Asia

(index: January 1995 = 100)



Source: Bloomberg.

3 GLOBAL CAPITAL FLOWS AND EMERGING ASIA

Since the early 1990s, Emerging Asia has attracted very large net financial flows, mainly in the form of foreign direct investment (FDI), as well as considerable portfolio inflows and cross-border bank lending flows. These financing inflows experienced a boom between 1992 and 1996 as a result of the combination of very strong regional growth in an environment of low interest rates in a number of industrialised countries and the opening up of the Chinese economy (see Chart 1). This initial cycle came to an abrupt end with the Asian financial crisis, when, in 1998, the region experienced a net outflow of USD 50 billion. Since 2001, net financial inflows to Emerging Asia have gradually re-emerged and, in 2004, accounted for almost one-half of the total net financing flows to emerging markets.

Before the financial crisis, Emerging Asia recorded close-to-balance current accounts and net financial inflows. This was in line with the pattern of growth explained by standard economic theory, which predicts that developing countries need to become net importers of capital to finance investment rates higher than their savings.

Since the crisis, however, most countries in Emerging Asia have reported increasingly large current account surpluses due to several factors. First, a boom in exports favoured by the large nominal and real depreciation of most Asian currencies in the aftermath of the crisis, and increased global demand for Asian exports, especially for those related to information technology. Since the crisis, most of the region's exchange rates vis-à-vis the US dollar have remained well below their pre-1997 levels, despite the rising current account surpluses (see Chart 2). This has allowed the region's economies to retain a substantial competitive advantage, especially given that most of the exports from Emerging Asia – and even exports to countries other than the United States – are invoiced in US dollars. Real effective exchange rates have also remained below pre-crisis levels in all of the countries except China and India (see Table 3). Second, a sharp decline in domestic investment rates in the aftermath of the crisis, combined with stable and high saving rates, led to large current account surpluses. An additional factor over the last few years has been that many countries

Table 3 Real effective exchange rates in Emerging Asia

(index: 1990 = 100)[1]

	1996	2000	2004
China	84.5	92.2	88.7
Hong Kong	133.8	144.0	114.7
India	77.1	78.0	77.9
Korea	98.7	84.7	84.2
Taiwan	95.4	91.2	75.6
ASEAN-5			
Indonesia[2]	101.6	70.0	79.8
Malaysia	106.1	87.6	80.5
Philippines	113.5	87.7	88.6
Singapore	117.6	105.6	96.2
Thailand	107.2	85.7	80.9

Sources: BIS and IMF International Financial Statistics (unless otherwise stated).
1) An increase (decrease) in the value of this variable implies a real exchange rate appreciation (depreciation).
2) Data supplied by JP Morgan.

in the region have also benefited from China's rising demand for capital goods and commodities and have seen their trade surpluses with this country increase substantially as a result.

Large current account surpluses in Emerging Asia are, of course, the mirror image of deficits in other economies and may call for adjustment in the future. Current account surpluses also reflect excess domestic savings over domestic investment needs. Indeed, saving rates in Emerging Asia are among the highest in the world and, according to IMF data, grew from 31% of nominal GDP in 2000 to almost 37% in 2004, while the share of savings in the United States decreased from 18% to 14% over the same period. Most of Emerging Asia's increased saving rate has been accounted for by China, where savings grew from 38% of nominal GDP in 2000 to 50% in 2004.

In addition to structural factors, the region's export performance has partly responded to developments in the real effective exchange rate (REER) of the region's currencies over the last fifteen years. In most of the economies in Emerging Asia, the REER has fallen (see Table 3). The extent of the real depreciation varies, nonetheless, across countries and ranges from 10% to 25%. The weakening of the currencies was already evident in non-ASEAN-5 countries in the mid-1990s, when China decided to abandon its dual exchange rate regime. However, the magnitude of these real depreciations increased during and after the period of the Asian financial crisis in 1997-98. Although the Chinese and Indian currencies did not experience significant nominal depreciations during the crisis, they too have undergone sizeable real depreciations over the past fifteen years. In fact, since 1990, the REER of China's and India's currencies has depreciated by 11.3% and 22.1% respectively.

The combination of current account surpluses and net financing inflows has led to most of the region's currencies being subjected to appreciation pressures, which have at times been countered by substantial official foreign exchange interventions. The result has been an unprecedented increase in foreign exchange reserve accumulation across Emerging Asia, from USD 695 billion in 2000 to USD 1.6 trillion in 2004, which is equivalent to more than 40% of the total global reserves held by central banks. As the official reserves have been largely reinvested abroad, Emerging Asia has, in fact, turned into a net exporter of capital for the rest of the world, despite the high net private inflows into the region (see Chart 1).

Among emerging markets, seven of the current top ten holders of foreign exchange reserves are Asian economies (see Table 4). The three main holders in Emerging Asia (China, Taiwan and Korea) currently hold enough reserves to cover more than ten months of imports and well in excess of 100% of their external short-term debt.

With respect to the composition of private net financing inflows to Emerging Asia, FDI inflows have been largely dominated by flows to China, which have, on average, accounted for 66% of the total net FDI inflows to Emerging Asia since 1990. Despite this high degree of concentration, FDI flows to many of

Table 4 Foreign exchange reserves in emerging market economies

(net of gold, SDR and reserve position at the IMF; end-of-period holdings; USD billion)

	1995	1997	1998	2000	2002	2003	2004
China	74	140	145	166	286	403	610
Taiwan	90	84	90	107	162	207	242
Korea	32	20	52	96	121	155	199
Russia	14	13	8	24	44	73	104
India	17	24	27	37	67	98	125
Hong Kong	55	93	90	108	112	118	124
Singapore	69	71	75	80	82	96	113
Malaysia	23	20	25	29	33	44	58
Mexico	16	27	30	36	46	56	61
Brazil	52	52	45	33	38	47	54
Remaining economies of Emerging Asia							
Thailand	35	26	28	32	38	41	48
Indonesia	13	16	22	28	31	35	35
Philippines	6	7	9	13	13	14	13
Total holdings of Emerging Asia	**414**	**501**	**563**	**695**	**946**	**1,211**	**1,567**
as a percentage of global reserves	30	31	35	36	40	40	42
Pro memoria:							
Global reserves	1,367	1,594	1,626	1,910	2,388	3,005	3,695
GDP of Emerging Asia	2,614	2,962	2,572	3,070	3,341	3,696	4,193
as a percentage of world GDP	9	10	9	10	10	10	10

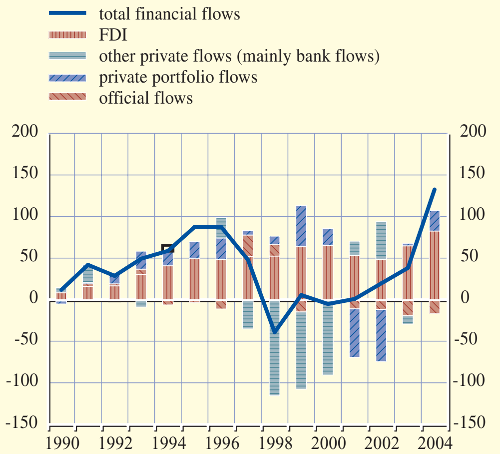
Sources: IMF International Financial Statistics and World Economic Outlook and ECB calculations.

the other fast growing economies, such as Singapore, Thailand, Malaysia and India, have also increased considerably. Interestingly, some of the more industrialised economies, such as Taiwan and Korea, have also been providers of FDI capital to less developed economies in the region. Furthermore, following the loss of competitiveness resulting from the various periods of rapid yen appreciation in the 1980s and 1990s, Japan has also become a major provider of FDI to the region. Contrary to portfolio inflows, FDI flows remained relatively stable during the 1997-98 Asian crisis and began to increase again soon after (see Chart 3).

Portfolio inflows and cross-border bank lending have been an important source of funding in Asian economies, with the exception of China. Portfolio inflows have been especially important in India and Korea, where, on an annual net basis, they have averaged USD 3.1 billion and USD 7.9 billion respectively since 1990. In both cases, a considerable amount of these flows has stemmed from privatisation drives and the acquisition of large quantities of shares in private domestic companies by overseas investors. In Korea, for example, purchases of shares in domestic private companies by non-

Chart 3 Composition of financial flows in Emerging Asia

(USD billion)



Source: IMF World Economic Outlook.

residents experienced a boom after the Asian crisis, as a result of the liberalisation of the foreign ownership laws.

Cross-border bank lending, statistically referred to mainly by the item "other private (capital) flows" (see Chart 3), was particularly important for Thailand, Indonesia, India and Korea, before the Asian crisis. However, this type of inflow was the one that was most negatively affected by the reversal of financial flows between 1997 and 1998. Flows under this category recorded an outflow of over USD 200 billion in the three years after 1997 and have only recently begun to return to their pre-crisis levels.

4 REGIONAL INTEGRATION IN EMERGING ASIA

The process of regional economic integration in Asia has been ongoing for a number of decades, but over the past decade it has accelerated with the emergence of China as a major global economic player. Throughout much of the 1980s, Japan was the driving force behind regional economic integration, as Japanese corporations undertook a large-scale relocation of manufacturing investment to the rest of Asia – especially the South-East and, later, China. A key motivation behind this process was for Japan to safeguard its cost competitiveness, following a strong yen appreciation and rising domestic real wages and land prices in the 1980s. Other maturing economies, such as Taiwan, Korea and Hong Kong, followed the example of Japan in relocating increasing parts of their production processes to South-East Asia and, in particular, China.

As a result, one of the key factors explaining the rapid pace of integration and growth in Emerging Asia has been the deepening of intra-regional trade, which currently accounts for over one-half of the region's total trade. A major feature distinguishing intra-regional trade in Asia is the fact that it has largely taken the form of intra-industry trade, particularly within the electronics, electrical machinery and telecommunications industries. Trade in machinery and transport equipment currently accounts for around one-half of all imports and exports in most of the economies of Emerging Asia (see Table 5). Moreover, most of this trade involves electronics or telecommunications-related goods, such as office machinery and automated data processing machines, telecom equipment and electrical machinery.

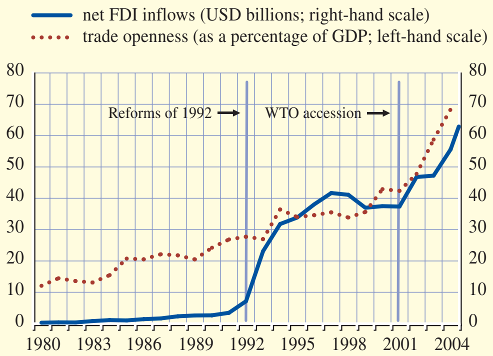
An additional, important feature of the regional integration process is that intra-regional FDI flows account for a substantial – and in some countries for the largest – share of total FDI inflows. In the case of the ASEAN countries, around 35% of FDI inflows come from Japan, Taiwan, Korea, Hong Kong and other ASEAN countries. In Taiwan, around 33% of

Table 5 Percentage share of total trade of Asian economies by SITC classification

	Exports: machinery and transport equipment	Imports: machinery and transport equipment	Exports: electronic and telecom goods	Imports: electronic and telecom goods
China	45	45	36	29
Hong Kong	50	51	45	44
Taiwan	52	42	41	28
Korea	63	34	37	22
Singapore	61	59	51	40
Malaysia	54	58	50	45
Indonesia	16	26	13	6

Source: CEIC.
Note: All data shown is for 2004. Data for India, Philippines and Thailand are not available.

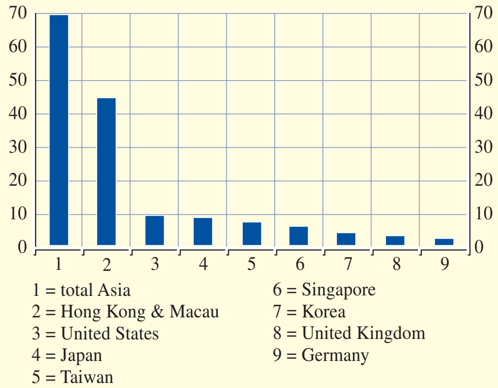
Chart 4 Evolution of China's trade openness and net FDI inflows



Source: IMF World Economic Outlook.
Note: Trade openness is calculated as the sum of imports and exports of goods and services, as a percentage of GDP.

Chart 5 Cumulative FDI inflows to China by source (1995-2001)

(as a percentage of total)



Source: National Bureau of Statistics Statistical Yearbook of China.
Note: Emerging Asia economies shown are those for which data is available.

FDI inflows come from other Asian economies, while in Korea they account for 12%. In many cases, these flows have been closely linked to the regional intra-industry electronics trade.

The combination of intra-regional FDI with the intra-regional trade in electronic and telecommunications goods has emerged mainly as a result of the coexistence of economies within the same region that are at very different stages of development. Firms belonging to the most mature economies in the region (namely Japan, Korea and Taiwan), which have themselves been major global players in ICT-related industries for many years, have relocated in increasing numbers the most labour-intensive stages of production of these industries to developing economies, such as China and the ASEAN countries.

China is playing a central role in the current acceleration of regional growth and economic integration in Asia. According to IMF figures, China is currently the third largest importer and exporter in the world and accounts for over one-half of all FDI to emerging market economies. Total trade rose from just 12% of GDP in 1980 to over 60% in 2004, while FDI inflows grew from USD 300 million to USD 56 billion over the same period.

One-half of China's exports is accounted for by foreign-funded enterprises. Similarly, one-half of its exports are imports that are reprocessed for export. Given this close interrelationship between trade and FDI, it is not surprising that both indicators received a major boost in 1992 with the liberalisation of foreign investment regulations, and again after 2001 when China entered the World Trade Organisation (see Chart 4).

FDI inflows to China are concentrated in manufacturing and almost 70% is attributable to other Asian economies (see Chart 5), chiefly, in order of importance, Hong Kong, Japan, Taiwan, Singapore and Korea.

The more mature neighbouring economies of Japan, Korea and Taiwan have also benefited significantly from China's demand for intermediate and capital goods. Their trade with China has increased rapidly to the point where China has now become the second largest trading partner of Korea and Japan, and Taiwan's first. These economies have managed to compensate for the rise in low-cost Chinese labour-intensive imports into their markets by increasing their own exports of higher value added goods even faster. As a result, they have posted large trade surpluses vis-à-vis China.

5 CONCLUSION

The performance of the economies of Emerging Asia has been outstanding over the last fifteen years and, as a result, their shares in world real output and exports have increased. Emerging Asia's impressive export growth has been supported by both extra-regional and intra-regional trade. The use of China as a low-cost export platform by other Asian countries partly explains the rise of intra-regional FDI and the rapid growth of Chinese exports to the rest of the world, but it has also created demand for higher value added imports of intermediate goods from the rest of Asia. The interaction of intra-regional FDI and intra-industry trade has given rise to what can be called an "Asian production chain", where different countries in the region have taken advantage of their diverse stages of development and comparative advantages to increase their growth potential.

These developments have gone hand in hand, over the past five years, with current account surpluses and net financing inflows that have led to appreciation pressures on most of the currencies of the region and that have at times been countered by substantial official foreign exchange interventions. The result has been an unprecedented increase in foreign exchange reserve accumulation across Asia, with the region currently accounting for more than 40% of total global foreign exchange reserves held by central banks. As the official reserves have largely been reinvested outside the region, Emerging Asia has turned into a net exporter of capital for the rest of the world, despite the high net private inflows to the region. Given the important economic weight of Emerging Asia, economic policy decisions taken in the region are having a growing impact on developments in the world economy.

Overall, there is no question that the outstanding growth performance of Emerging Asia over the last fifteen years has brought renewed dynamism to the world economy.