Asia: Addicted to debt

Policy makers are seeking a new model as a period of rapid economic expansion draws to a close.

Can Asia overcome its addiction to debt? That is the question across the region as economies slow and borrowing costs rise. After more than a decade of often blistering growth, many fear that Asia’s golden era may be drawing to a close.

When George Magnus, the economist, penned his report “Is Asia’s miracle over?” in 2012, the feedback was sceptical. Many presumed the financial crisis was little more than a bump for the world’s most dynamic region, and the rebound would prove lasting.

But now, with exports still weak, quantitative easing in the west being unwound, and domestic economies laden with debt, the idea that the Asian boom has already peaked is rapidly going mainstream.

Asia’s economic miracle, with China at its heart, has been a driving force for the region and the rest of the world. It has halved the proportion of people living on less than $2 a day over the past decade. Average incomes have doubled in South Korea, Malaysia and Thailand, and risen more than fivefold in China and Indonesia, according to the Asian Development Bank. Since China joined the World Trade Organisation in 2002, emerging Asia’s share of global gross domestic product has risen from 11 per cent to 21 per cent, says the International Monetary Fund. The contribution to growth has been far greater.

Even during the financial crisis, Asia powered ahead on the back of China’s mammoth stimulus package and record low borrowing costs as central banks across the world slashed rates. Those measures boosted demand for Asian exports but, more importantly, helped companies and consumers fuel domestic growth with cheap credit.

While much has been written about China’s debt addiction, the experience is far from unique within Asia. Credit levels have risen sharply since 2008 in Hong Kong, Singapore, Thailand and Malaysia, while already high levels of household debt in South Korea and Taiwan have tracked even higher.

During times of accelerating growth, that might not be a cause for concern. But now much of Asia is faltering. Credit intensity – the amount of borrowing needed to generate a unit of output – has surged, while productivity growth has tumbled. The debt train appears to be fast running out of track just as the world prepares for higher interest rates.
“There’s no problem in having the debt to GDP growth go up. It doesn’t have to collapse necessarily as long as you can turn around productivity growth,” says Fred Neumann, Asian economist at HSBC. “The big problem Asia faces is to implement structural reforms that are politically unpalatable before a crisis actually occurs.”

Asia’s traditional engine of exports is failing to fire. Thanks partly to rising costs at home and changes in the way developed economies consume, exports to the US and the eurozone have dropped from 14 per cent of developing Asia’s GDP in 2005 to just over half that level now, says HSBC.

Without the export boost, Daiwa estimates Asian economies, excluding Japan, will grow 5.8 per cent next year, from 9.2 per cent in 2010. The time when Asia grew at near double digits appears to have passed.

While those rates still seem enviable compared with the west, Duncan Wooldridge, chief Asian economist at UBS, says the region now faces its own version of a recession, in which economies continue to expand but far below their historical average.

“If we’ve exhausted our ability to put a high floor under [economic] growth with rapid credit growth, and we’re not going to experience a boomtime in exports, then how can growth in Asia return to its long-term path? It’s highly unlikely,” says Mr Wooldridge. “The most likely scenario is we will be stuck in a lower-growth trajectory for some time to come.”

The trend can be reversed only with deep, far-reaching reform – something that has rarely happened without a financial crisis as a spark, he adds.

The onset of tapering by the Federal Reserve could be the high water mark for the Asian miracle. Borrowing costs across the world are already ticking higher even before interest rates rise – something that will test Asia’s ability to pay back its debts.

The search for a new economic model will challenge policy makers and business leaders. “The basic point here is we’re not going to repeat the growth rates we had over the previous decade,” says Bruce Kasman, chief global economist at JPMorgan.

“We have an adjustment to wean economies off of a model that was very credit-dependent . . . The success or failure of that adjustment will tell you a lot about whether we find the balance with growth that isn’t as strong, but is still potentially pretty solid and positive for the global economy. History doesn’t speak too well to how these adjustments play out.”

RELATED TOPICS   China
income OECD countries grew per-capita GDP by 0.9% annually over that period. None of this disproves the thesis that China is heading hard for the shoals and dragging other economies in its wake. But if we are to reach into the history books then we ought to recall some of the inaccurate predictions as well.

When most of Asia’s fixed exchange rates blew up in 1997 and submerged regional growth, Krugman was (dare I say) magnanimous in disclaiming any foresight of a crisis. His point was a critique of long-run productivity growth. Yet that, too, was challenged by the speed with which most of the crisis-hit Asian economies rebounded in the ‘00s. Hard lessons had been learned. Unfortunately this article stops short of moving past the obvious -- if Asia’s private sector leveraging is unsustainable then of course a deleveraging must ensue -- and focusing on the question of whether Asian economies need a new model or just a dose of old-fashioned capitalist reality that may already be on the way.

Exports to US and Eurozone decrease. And that is expected.. How are exports to other countries in Asia or BRIC ? These have much more potential to grow than the exports to US and Europe and it is what we need to watch to assess the future growth of the region...

Who is truly addicted to debt? The east or the west?

Asia’s so called addiction to debt largely reflects its need for capital to quickly build a mordern infrastructure and industry base which took the developed world centuries to build. Such addiction, or more properly called investment, has and will continue to contribute to the internal growth of Asia while it is relying less and less on export for growth. The same cannot be said about the west whose addiction to debt for consumption is quickening the downward spiral.

Good luck on the QE withdrawal. With stock market in the west at bubble level, we will soon find out who is truly addicted.

Mr Magnus is remarkably quiet when markets are rallying...

The demand side of economies (consumer, business and govt spending) are cyclical but the supply side (tax rates, education, capital, labour, infrastructure) are structural. Other Asian countries are unable to get their houses in order due to ineffective and inefficient governments but Singapore stands out for being the best-run country. The ruling People’s Action Party has an impeccable track record. Singaporeans and forign investors alike continue to have unwavering faith in the Singapore government.

And Asia is unique in this regard??????????

I wish Japan’s QQE had not lent a hand in exercebating the debt levels of its Asian neighbours.
Asian Crisis II... the return...?!

Printed from: http://www.ft.com/cms/s/0/d22a8580-bb39-11e3-948c-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© THE FINANCIAL TIMES LTD 2014 FT and ‘Financial Times’ are trademarks of The Financial Times Ltd.