

# Asia's Fitness Test

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Reuters Breakingviews



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## Remember Ben Bernanke's "savings glut"?

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In 2005, Mr Bernanke said US current account deficits were being caused by a global savings glut and Asia was playing a large role.



REUTERS/Jonathan Ernst

# Remember Tim Geithner's “benchmark for the future”?

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In 2010, Mr Geithner proposed to the G20 that non-commodity-producing nations be asked to limit their current-account surpluses to 4 percent of GDP.



REUTERS/Hyungwon Kang

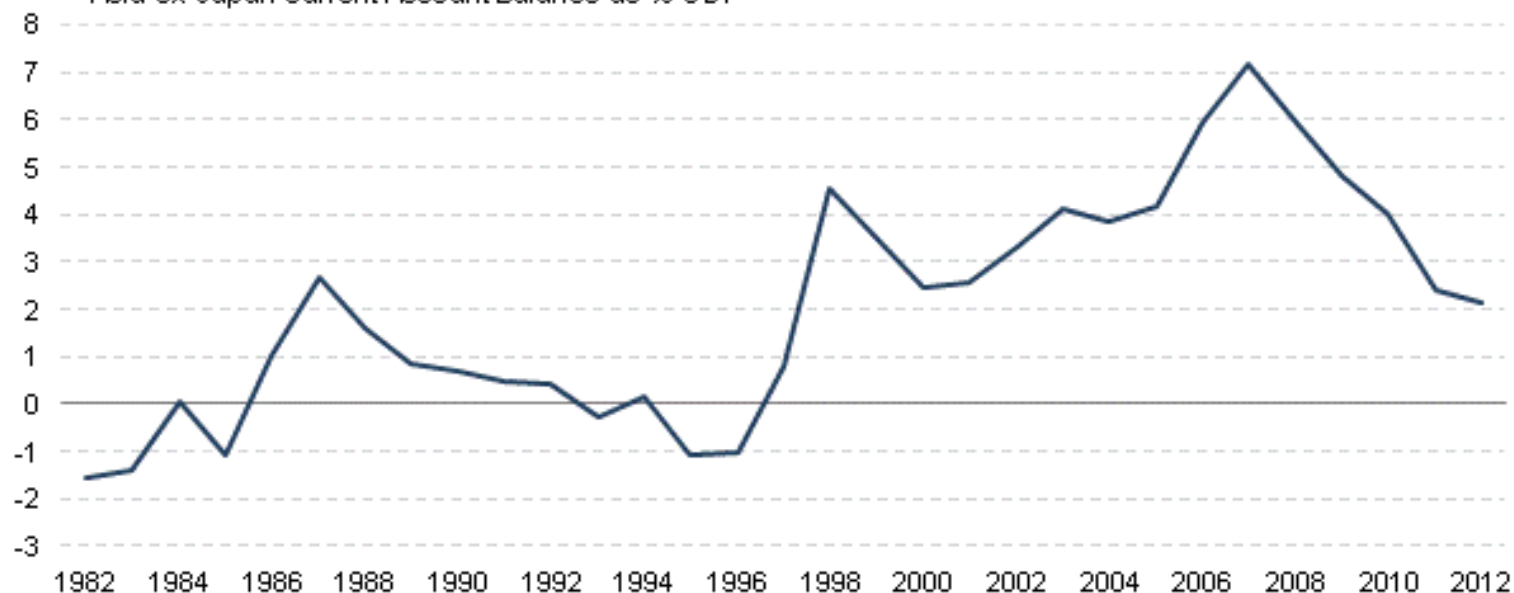


But all that ...

**IS IN THE PAST.**

# Asia's savings glut is vanishing

Asia-ex-Japan Current Account Balance as % GDP



Note: Asia-ex-Japan includes China, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, Indonesia, Thailand, the Philippines and India; World Bank and IMF data; 2012 current-account estimates by Consensus Economics and Oxford Economics

Source: Datastream Reuters graphic/Andy Mukherjee, C Trevethan 12/09/12



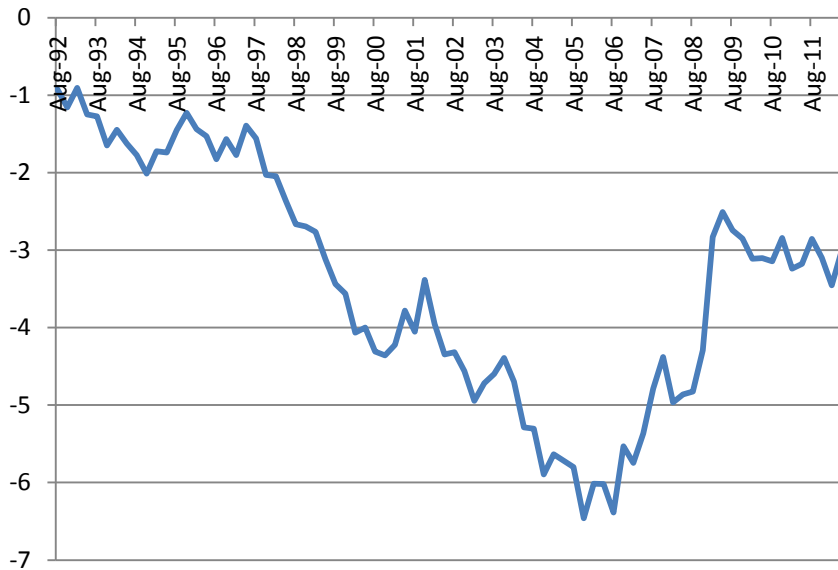
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# The good news is ... the global economy is rebalancing

**US current account balance as %  
of GDP**



Data Source: Datastream



REUTERS/Larry Downing

# The US consumer is deleveraging to repair his balance sheet

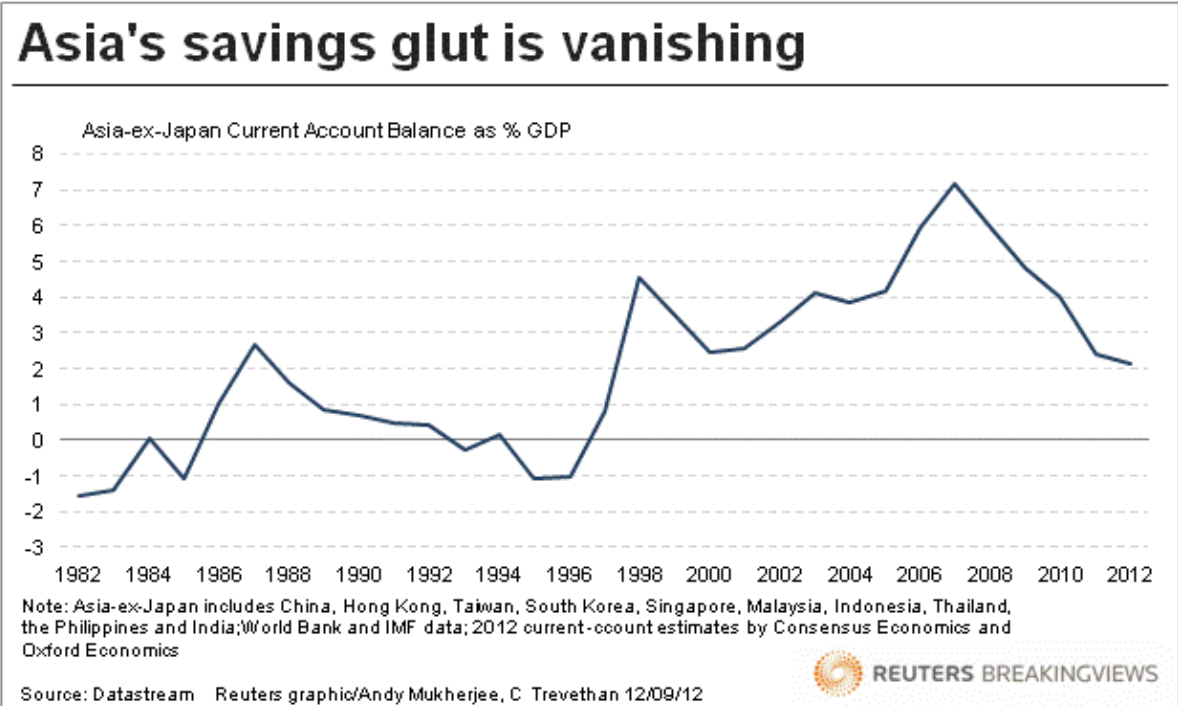
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REUTERS/Jonathan Ernst

# The counterpart of US deleveraging is a drop in Asia's trade surplus ...

China's current account surplus was just 2.8 percent of GDP last year, a far cry from the 10 percent it reached in 2007, and may narrow further.





# The bad news is ... falling surpluses could bring a whole new set of risks to our part of the world

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And that's why staying fit  
will be key ...



REUTERS/Bobby Yip

# A falling current account surplus means ...

- A decline in (S-I)
- Declining 'S' puts upward pressure on real interest rates
- A current account in deficit will nudge Asian currencies lower

Basic current account math:

$$Y = C + I + G + X - M \dots\dots\dots (1)$$

$$Y = C + S + T \dots\dots\dots (2)$$

$$(S - I) = (G - T) + (X - M) \dots\dots\dots (3)$$

$$(S_h - I_h) + (S_c - I_c) = (G - T) + (X - M) \dots\dots\dots (4)$$

When (X-M) falls, and there is either a fall or no change in (G-T), the corporate sector will have to issue more equity and debt, lowering (S<sub>c</sub> - I<sub>c</sub>). Only then will the household sector be able to maintain its pace of net acquisition of financial assets, (S<sub>h</sub> - I<sub>h</sub>). That may happen for a long time (US economy under Bill Clinton; pre-1997 Southeast Asia) or only in short bursts in a risk-on/risk-off world.

Increasing (G-T) to “neutralize” a falling (X-M) is not an option if public debt-to-GDP is high and there is a risk of “crowding out.”

## So where are the risks?

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Indian companies have been increasingly reliant on foreigners' money to finish projects already underway. The current account deficit shot up to a record 4.2 per cent of GDP in the last financial year. In the last two years, India's stock of foreign debt risen by 32 per cent. The central bank's foreign currency reserves have fallen.



REUTERS/POOL New

## So where are the risks?

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Indonesia is already grappling with a current account deficit this year. Bank Indonesia spent almost \$10 billion, or 9 percent of its reserves, in May and June defending the rupiah.



REUTERS/POOL New

## So where are the risks?

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Malaysia's non-commodity trade is already in deficit. A glut in palm oil supplies means further pressure on current account. Savings are declining just as investment momentum builds up.



REUTERS/Bazuki Muhammad

# So what should you and your clients be watching out for?

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## Crisis probability

Explanatory variable	Coefficient
Net External Liabilities	0.05 **
Import cover (reserves)	-0.007 *
Short-term to total debt	0.05 **
Per capita income	-0.03 *
Government effectiveness	-2 **



REUTERS/Eric Gaillard

Note: \*\* denotes significance at the 5 per cent and 1 per cent level, respectively. Estimates based on a study of Brazil, Chile, India, Korea, Malaysia, Mexico, Russia, South Africa and Turkey (Rajan Goyal, Reserve Bank of India, 2012)

# So what should you and your clients be watching out for?

An export recovery will obviously help ...

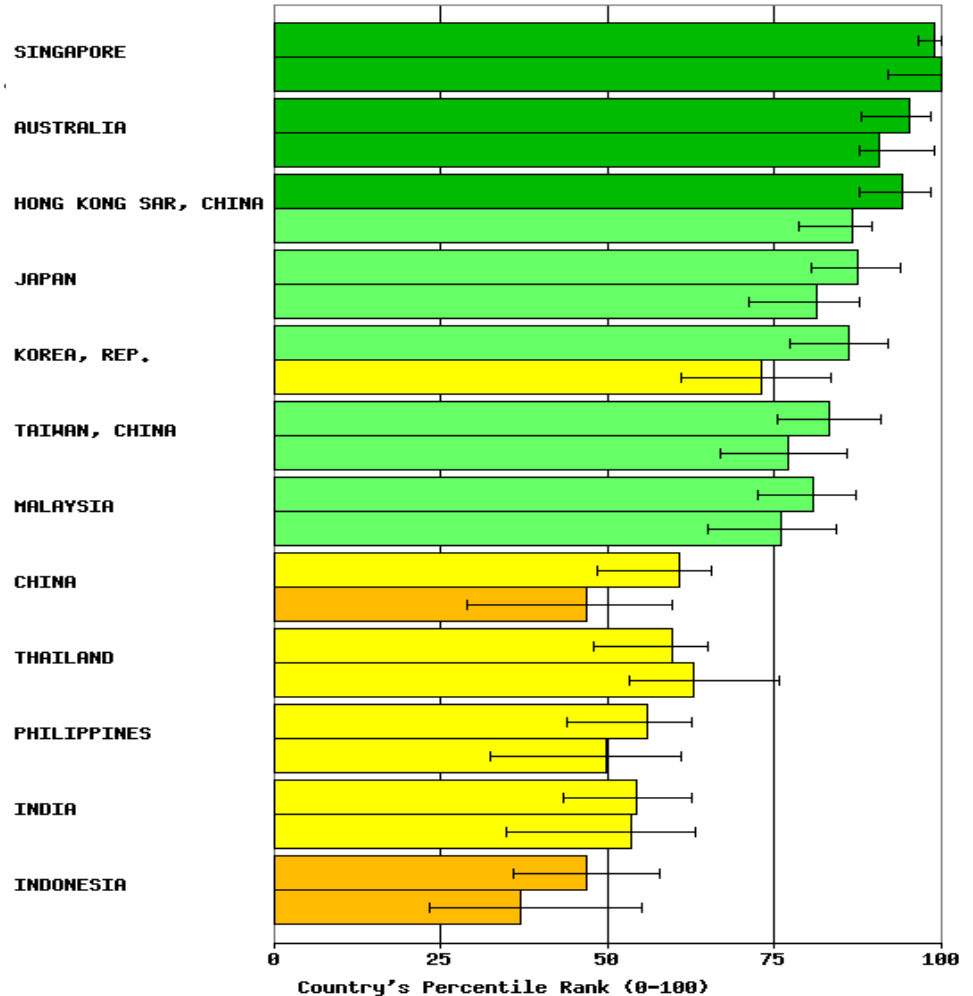


REUTERS/Stringer

But if global growth continues to disappoint ...

## Government Effectiveness (2011)

Comparison between 2011,1996 (top-bottom order)



Source: Kaufmann D., A. Kraay, and M. Mastruzzi (2010), The Worldwide Governance Indicators: Methodology and Analytical Issues

Note: The Worldwide Governance Indicators (WGI) are a research dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The WGI do not reflect the official views of the World Bank, its Executive Directors, or the countries they represent. The WGI are not used by the World Bank Group to allocate resources.

# Is it just cyclical?

No. Dwindling savings may also be playing a role. Some parts of Asia - particularly China, Hong Kong, Singapore, Taiwan and Korea - may struggle to retain past high savings rates because they are ageing rapidly.



REUTERS/Issei Kato



## In summary ...

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If global growth continues to be lackluster, Asia's shrinking current account surpluses could ultimately leave the region dependent on foreign savings for growth. In a risk-on/risk-off world, that could become a source of additional vulnerability. Policy makers' approach will be pro-growth but preserving stability will be equally important.

# Thank you for your kind attention

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