

Asian economies need to learn to share the wealth

BY GERARD LYONS

Asia's economic prospects look good, but it would be wrong to conclude all is rosy. Far from it. Asia faces a number of risks and challenges. The risks could occur, the challenges already exist.

Some of these concerns were evident at the "Summer-Davos" that I attended in the middle of this month. This is the World Economic Forum's annual meeting in China. It attracted 1,500 participants to Tianjin, including Premier Wen Jiabao (溫家寶), politicians, policy makers, academics, business leaders and economists. Last year the theme was "reviving growth." This year it was "sustainable growth." This was spot on as it is Asia's biggest challenge.

Export dependency means Asia is heavily influenced by events in the West. With the US stagnating and southern Europe in recession this may trigger further global uncertainty and market volatility.

Worries need to be kept in perspective. It was always likely the world economy would slow in the second half of this year, as the impact of policy stimulus wore off.

This slowdown has triggered fears of a double-dip, with the world slipping back into recession. I do not think there will be a double-dip but the risk exists. If there were a double-dip it would most likely be triggered by a policy mistake, another shock such as higher oil prices, or a loss of confidence. However, for many in the US the rebound will be so weak anyway it may not feel like a recovery.

Asia is clearly not decoupled from what happens in the West, but it is well insulated. Currency reserves are high, fiscal and external balances sound in most countries. Also, central banks, many of whom are now raising rates, always have the ability to ease if needed. In contrast, the policy cupboard is bare in the West.

Often overlooked, the Asian economy is as big as the US. The US has a US\$14.3 trillion economy. China's economy is just over US\$5 trillion, having just overtaken Japan's, while the ASEAN region is US\$1.7 trillion and India US\$1.25 trillion. Add in South Korea and others, including Pakistan, and Asia's economy is well over US\$14 trillion. As Asia switches to domestic-led growth its economy will grow in size and become less dependent on the US.

A big risk would be if anything derails China. The authorities have already tightened monetary policy in order to prevent overheating. Recent data suggests China's economy is stabilizing. This is good news.

Yet, during my recent visit to China it was apparent there is widespread unease about the property market, and rightly so. Prices in the biggest cities are far too high and need to adjust.

I am often asked if China is a bubble economy. No is the answer but it is an economy prone to bubbles, particularly in

authorities need to act to lower property prices without triggering a collapse.

That leads on to wider challenges across Asia, of which there are a few.

For many countries inflation is a genuine risk, with rising food prices and stubborn energy prices. Hence central banks are raising rates. The problems are greatest in India and Vietnam. It is also a problem in Indonesia. China, too, recently saw inflation reach a 22-month high, but whilst food prices there were up 7.5 percent, non-food prices were up only 1.5 percent. Thus China needs to be gradual, not aggressive, in tightening.

Some countries are wary of raising rates too much for fear of attracting hot money. Indeed, a challenge across Asia is controlling capital inflows. Too much money is flowing in too quickly, fuelling asset bubbles and the fear of a boom-bust. Some, like Malaysia, Thailand and Indonesia, have allowed their currencies to appreciate.

If inflows continue, temporary capital controls may be justified but the key is to continue to develop and deepen financial markets, although that takes time.

Perhaps a bigger challenge for Asia is not talked about enough: the need to invest in infrastructure and how to pay for this. Over the next decade Asia will need about US\$8.3 trillion of infrastructure investment. Where will this money come from? Perhaps a start would be to channel domestic savings and foreign inflows. Such investment is needed to realize Asia's true potential and drive urbanization and job creation.

At the "Summer Davos" event I was surprised to hear how pessimistic some people were about corruption in a few Asian countries. This clearly needs to be addressed, perhaps as part of improved corporate governance and greater political transparency.

Asia's biggest risk, however, is minimizing the environmental costs of success. A big issue is water or, more particularly, the lack of it. There is a need for effective management of water resources. According to the Asian Development Bank, nine Asian countries are already "under stress" with less water than needed. The situation is deteriorating for most but some, like Australia and Singapore, have made progress. Water management is not yet a priority issue on the political agenda of enough number of countries.

Perhaps Asia's biggest challenge is its greatest opportunity: the need for more people to share in the region's success. Narrowing the poverty gap may be important for future stability. China talks of a harmonious society. This is needed across the region. Overall, Asia's prospects look good, but it is vital to be aware of near-term risks and ongoing challenges.

Gerard Lyons is group head of Global Research and chief