Politics, Economy Threaten Asia's Growth

July 23 2008

The continuing global economic slowdown presents challenges to Asian countries that are reminiscent of the run-up to the 1997-1998 crisis. The region is beset with political uncertainty and slowing growth in major export markets:

--A democratically elected government took power in Thailand in February after over a year of military rule. However, the government has faced widespread street protests echoing the run-up to the 2006 coup.

--The party that has ruled Malaysia since independence suffered an unprecedented defeat in the March 2008 parliamentary election, raising the possibility of a difficult political transition in the year ahead.

--Governments throughout the region fix fuel prices using a combination of subsidies and price controls. Persistently high oil prices require adjustment of price caps. This has potential to generate widespread unrest, especially when combined with rising food prices.

--High oil prices and the declining housing market continue to act as a break on U.S. demand.

--Euro appreciation against the dollar and tighter credit conditions due to financial institutions' exposure to the U.S. real estate market cloud the outlook for European economies.

However, there are a number of differences between now and the 1990s. The Asia five in 1997 suffered from external imbalances that rendered them vulnerable when foreign creditors' sentiment shifted in response to negative political or economic news. These countries' external positions are now almost uniformly strong due to their current account surpluses and ample foreign reserves.

Regional dynamics. China's economic expansion has drastically changed the region's economic dynamics. In the late 1990s, export competition between China and the Asia five resembled a zero-sum game. Recently, expansion of Chinese exports has boosted demand for exports from other economies in the region. The rise in intra-Asian trade has reduced the region's vulnerability to downturns in the U.S., Europe and Japan.

Persistent risks. While the countries most affected by the 1997 crisis have significantly improved regulation and supervision of banks and other financial institutions, financial sector weakness persists in the region. The fragility of China's financial system--which the government has been slow to clean up--poses a risk to growth in China and the region as a whole.

Still, the likelihood of a full-blown crisis remains small. China's $1.8 trillion in foreign reserves mean the government would have resources to deal with anything short of a massive banking crisis. Dislocations would reduce regional economic growth, but sound fundamentals mean that other Asian economies would not fall into crisis.

Source: Oxford Analytica