

## Uncoupling is still a myth

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The theme that developing Asia (excluding Japan) has gradually uncoupled its economy from that of the G3 (US, euro zone and Japan) has attracted a lot of attention in recent years.

Many now believe that as a result of uncoupling, a serious slowdown in the G3 economies would not restrain the resilient growth of many Asian economies to the extent that Asia would also dip into recession.

The data seems to offer some support for this view. For example, output growth in the G3 economies decelerated from about three per cent in 2006 to less than 2.5 per cent in 2007, and as a result their import volumes, which had been growing at 6-9 per cent until 2004, slowed to a rate of just above three per cent in 2007.

Yet the impact of this on developing Asian economies has so far been limited. In fact, developing Asia recorded the highest growth in almost two decades in 2007 - averaging 8.7 per cent; and GDP growth in 2008 is expected to be a robust 7.6 per cent, just shy of the past five years' average.

Nevertheless, the 2008 Asian Development Bank (ADB) outlook challenges the "uncoupling" view and warns that it would be a mistake to assume that economic troubles in the G3 have no impact on developing Asia. The G3 still remains the largest importer for many Asian economies, and falling consumer demand in the G3 can arrest growth in Asia to varying degrees.

### Long slowdown

Examining the uncoupling myth is crucial for the GCC economies since with the exception of Bahrain the bulk of exports of the other five states are sold in Asia (see table). Thus, if developing Asia were to be affected by the ongoing and longer-lasting slowdown in the G3, it would eventually affect the GCC economy by lowering the foreign demand for its exports (mainly oil and gas). This is an "indirect channel" through which the GCC economy could be affected (slowdown originating in the G3, which affects exports in developing Asia, which in turn weakens GCC exports). As can be seen from the table, exports of Qatar, Kuwait and Oman would be most seriously affected through this channel.

A "direct channel" via which GCC export growth could decelerate is the cooling of the global economy and the associated fall in oil prices to, say, the mid-2007 level, averaging below \$70 per barrel.

Since the interest of this article is exploring the notion of "uncoupling", we will focus mainly on the indirect channel of shock(s) affecting the GCC economy. Let us now briefly discuss how a slowdown in economic activity in the G3 could affect output growth in developing Asia, and the eventual spillover into the GCC economy.

Consumption demand in the US accounts for nearly 70 per cent of the \$14 trillion economy and this represents a huge slice of the world's effective demand. It is robust US consumer demand that has partly fuelled the Asian boom over the past five years.

US retail sales are essential to the growth of developing Asia's labour-intensive manufacturers and capital-intensive products. Thus, if we take US retail sales of clothing and footwear as indicators of consumer appetites, the ADB outlook reports that Asia's exports of both items have weakened in recent quarters, suggesting that consumer demand in the US is softening and as a result exports to the US from developing Asia are declining.

## **Sharp reversal**

Likewise, exports to Japan and the euro zone from developing Asia have also slowed in recent periods. For example, China, the dominant supplier of goods to Japan, suffered a sharp reversal from export growth to contraction in the second half of 2007. In parallel, imports from several East Asian countries and Southeast Asia to Japan plunged in 2007. In contrast, developing Asia's exports to the euro zone have not fallen sharply mainly due to the eurozone's strong demand. Importantly, imports by the US and Japan from the euro zone weakened in 2007.

Each global slowdown is different. When output growth in the US is decelerating due to a falling housing market, the meltdown in the subprime mortgage market and rising food and fuel prices (which in turn have slowed output growth in the euro zone and Japan), output growth in emerging Asia has remained robust and prospects for future growth are strong.

Notwithstanding, experiments by ADB have shown that a simultaneous one per cent reduction in GDP growth in the G3 and UK could reduce output growth in developing Asia by 0.6 per cent after a year, followed by a one per cent reduction the following year. When the depreciation of the US dollar is added to the reduction in the G3's GDP growth, it was found that developing Asia's growth is cut by 1.6 per cent within a year, which is a full percentage larger than the outcome when (real) exchange rates are steady.

This suggests that growth in developing Asia is still vulnerable to reductions in G3 growth, and what is particularly threatening is that a protracted slowdown in the G3 could give rise to trade and investment protectionism in the rich countries.

The deeper the global economy dips into recession, rising protectionism could present additional sources of risk for developing Asia.

If output growth in Asia eases due to the G3 slowdown, a lot of GCC exports are at stake whether measured in volume or value terms. The combination of rising inflation pressure and slower export growth could expose the GCC region to significant economic risk and uncertainty.

Nevertheless, if slower export growth is considered a way to hold GCC inflation in check, this could be viewed positively. Yet, a deeper and longer-lasting global slowdown could prove to be a real danger to the GCC.

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