

Chapter IV Assumptions in East Asian Economic Forecasts

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Chapter IV

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1. *International Economic Environment*

Yen to Be around 110 to the Dollar

Here, let us consider the main aspects of the international economic environment relevant to economic forecasts of East Asia.

For South Korea, Taiwan, and the other Asian NIEs, trends in the value of the yen against the U.S. dollar are important as their products compete with goods of Japan in the international market. The ASEAN4 and China also find the trends in the yen-dollar rate important as they have an effect on FDI from Japan, the United States, and NIEs in those regions. Here, the yen-dollar rate is assumed to be around US\$1=110 yen up to the year 2005.

A look at the trends in the yen-dollar rate over the past 10 years (see Figure 3) reveals that the fall in value of the yen to the US\$1=120 yen level such as in the first half of 1997 (January to April period) increased Japan's trade and current account surplus. This increase in the trade and current account surplus in turn caused a correction of this yen depreciation. The fact that the baby boomer generation will remain healthy parts of the work force up to the year 2005 is another reason why the above exchange rate was assumed.

Status Quo in Crude Oil Prices

The prices of crude oil and other primary commodities are also assumed as continuing at the current low level up to 2005. Demand for crude oil in Asia, in particular, East Asia, will continue growing in the future along with industrialization. Supplies of crude oil, however, are projected as increasing. First, the UN is expected to ease further the economic sanctions on Iraq. Furthermore, the oil installations in Russia and other parts of the former Soviet Union will be improved in the near future.

World Economy to Grow by 3% and Trade by 6%

Solid economic growth can be envisioned for the industrialized countries as a whole in the next

10 years. In the 1980s, Japan was a leading presence among the industrialized nations due to improvements in quality control and introduction of robots and other modern equipment. In the 1990s, particularly after the business recession following the end of the Gulf War, it has been the United States which has played the lead role in the industrialized nations through the restructuring of white collar jobs and administrative sectors through introduction of personal computers and other office automation and the internationalization of information. While the leading player may change again, the industrialized countries as a whole should sustain solid economic growth up to 2005.

Inflation in the industrialized countries will remain low as well. First, information and services are being internationalized through the Internet and other media. Global competition is increasing in not only goods, but services as well. In Europe, the EU is moving toward monetary union. Therefore, up to the end of the 20th century, the member states of the EU can be expected to follow fiscal austerity policies and continue suppressing inflation. Even after monetary union is achieved, they should follow policies aimed at restraining the fiscal deficit and inflation. This is another reason why a low inflation is assumed for the industrialized nations as a whole.

In short, an average annual 2 percent rate of economic growth is assumed for the industrialized countries as a whole up to 2005. Economic growth in the world is expected as rising by 3 percent a year and global trade by 6 percent.

2. *Impact of Reversion of Hong Kong and China After Deng Xiaoping*

Before making any economic forecasts for East Asia for 2005, it is necessary to consider the impact of the reversion of Hong Kong on East Asia and the state of affairs in China after Deng Xiaoping.

Hong Kong has served as a channel for trade and FDI for China since the People's Republic

began its reforms and open door policy in 1978. It also plays a key role as the financial center of East Asia. Basically, Hong Kong will retain these functions even after reversion. Hong Kong should also enjoy the plus factor of an increase in tourists in 1997, the year of reversion. According to Toida and Hiratsuka (1995), the only place which may be adversely affected by Hong Kong's reversion is basically Taiwan.⁹⁾

China and Taiwan adopt opposing positions on three direct communications links, direct information and shipping lanes, and direct trade. Taiwan refuses to establish such direct official relations with China. China, on the other hand, desires such direct ties from the standpoint of "one China". Up until the reversion of Hong Kong to China, the two sides used Hong Kong as a "third country" through which they indirectly dealt with each other.

China and Taiwan are economically closely tied with each other due the sharp rise in trade and in FDI from Taiwan to China in the past 10 years or so. In the past year, use of an inexpensive undersea cable for communications between the two rather than routing calls through Hong Kong or Japan has started becoming feasible.

Taiwan hopes to maintain nominally indirect, but de facto direct ties by designating part of Kaohsiung as a special economic and trade zone (treatment as third party). China holds a comparative advantage in human resources, while Taiwan holds one in capital and technology. On top of this, they already have close economic ties. The two should therefore reach some sort of agreement on continuing with their good economic relations even after reversion of Hong Kong.

Should China and Taiwan not find some solution on direct ties, the Philippines could take the place of Hong Kong as a channel between the two and in so doing earn some economic advantages. At

the present time, the Philippines is laying the groundwork for this using the former U.S. naval base at Subic Bay as a trade center suitable as a channel for indirect ties between China and Taiwan.

In the following economic forecasts of East Asia, it is assumed that China and Taiwan will reach an economically rational agreement on ties and that economic relations between the two will continue without problem even after reversion.

The session of the National People's Congress held after the demise of Deng Xiaoping reaffirmed the political establishment's support for the reforms and open door policy launched by Deng. It is true that this was just after the death of Deng. Stability was being stressed in the reforms of the state-owned enterprises and foreign relations. China also aimed at a stable 8 percent macroeconomic growth for 1997 with a rate of inflation under the rise in retail prices of the previous year (6.1%).

China has found itself faced with problems of cumulative debts and inefficiency of its state-owned enterprises along with the progress made in its reforms (conversion to a market economy). Further, the high growth rate achieved through industrialization has resulted in a growing disparity in income between the cities and countryside — creating a major social problem. The economic projections of East Asia given below, however, were made based on the assumption that the reforms and open door policy will continue under the new collective leadership and that the above problem will be gradually solved without any major political upheavals.

Note:

9. Extract Japanese translation of Toida and Hiratsuka (1995) and additional explanations by Hiratsuka of the impact of the reversion of Hong Kong on East Asia are found in Hiratsuka and Uemura (1995).