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A high unemployment rate and slow wage growth indicate that excess capacity exists in the labor market, which is expected to tighten in the months ahead, as indicated by the increasing number of job vacancies and advertisements.
After moderate growth in the first half of 2015, Australia’s economy gathered pace. GDP grew at 2.5 percent year over year owing to strong growth in exports and solid consumer spending offsetting the heavy drag from slumping business investment. Mining activity was up 5.2 percent quarter over quarter, helping net exports to contribute 1.5 percentage points to GDP growth. However, investments remained weak, while construction tied to mining plunged 7.1 percent quarter over quarter. Australia’s economy has grown more modestly recently due to the slowdown in the Chinese economy, which has curbed demand for Australia’s commodity exports. Yet, the latest GDP release suggests some improvement.

Lately, the composition of economic activity has been changing. There is evidence that the economy is gradually moving away from being export-driven to domestic demand-driven and from the resource to the non-resource sector. These gradual shifts, in response to declining mining investment and the recent fall in commodity prices, are expected to help the economy sustain growth at a desirable pace.
Drivers of growth

Low interest rates have supported strong growth in private consumption expenditure and dwelling investment in Australia. Although still below the historical average, private consumption expenditure grew at a robust pace of 2.7 percent in Q3. Growth in dwelling investment, too, remained healthy at 10.3 percent. Both these components of GDP are expected to drive domestic demand and, thereby, growth. Retail sales, motor vehicle sales, and surveys of consumers’ perception of their own finances indicated that consumption is expected to remain strong in the coming quarters. The number of multi-high-density dwelling approvals have been increasing at an impressive rate, indicating dwelling investment in the pipeline is likely to significantly contribute to growth. However, there are a few risks in the housing sector, as a few forward-looking indicators provide mixed signals. While residential building approvals are already high, house prices also are picking up quickly. In addition, banks’ lending standards have been tightening lately, to check housing credit growth. In other words, dwelling investment growth might increase, but at a moderate pace.

Economic activity in the services sector has been gathering momentum, while growth in the goods-related sectors (excluding the mining industry) has remained stagnant. Growth in household services and business services has improved considerably in the past few years, as suggested by the recent pickup in employment and the number of job vacancies in these sectors. According to the Australian Bureau of Statistics (ABS) capital expenditure survey of firms, measures of business conditions in the non-mining sectors are clearly above their long-run averages, primarily in the services sector. Exchange rate depreciation, too, has supported growth in services exports. Nonresidential investment, however, will likely remain subdued in the next year. Setting aside the expected fall in mining investment, growth in non-mining business investment does not look promising either, as indicated by the ABS capital expenditure survey and the low level of nonresidential building approvals. In addition, declining corporate profits and low capacity utilization may have an adverse impact on investment decisions. The services sector tends to be less capital intensive. As a result, growth in this sector has translated to more employment and limited capital investment. That said, there are a few signs that non-mining business investment may pick up, owing to low corporate borrowing rates, rising business credit, and improving conditions in goods-related industries. However, the strength and timing of the recovery remain uncertain.

Labor market and inflation

Employment in goods-related industries remains weak; it has been falling in the mining sector and has stagnated in the construction sector. However, the shift in the composition of economic activity toward labor-intensive services has supported overall employment
growth, which has outpaced population growth over the past year, according to government estimates.\(^5\) In addition, stagnant wage growth in relation to the unemployment rate has encouraged firms to employ people rather than invest in capital.

However, despite rising employment, the unemployment rate has remained stable, in the range of 6.00–6.25 percent, in this period. This is because, with rising labor demand, the supply of labor has also increased. The participation rate has trended up due to rising employment prospects and the government’s recent initiative that requires recipients of unemployment benefits to search for work more intensively than in the past. A high unemployment rate and slow wage growth indicate that excess capacity exists in the labor market, which is expected to tighten in the months ahead, as indicated by the increasing number of job vacancies and advertisements.

Headline inflation has remained subdued due to slower wage growth, lower fuel and utility prices, and overall weakness in economic activity. It is expected to remain so, although continued expansion in the housing market and a weak currency pose risks.

**Growth outlook and policy actions**

Australia’s growth in the near future depends significantly on the economic outlook of China, global trade, and both their implications on commodity demand and prices. Vulnerability in the financial sector and a decline in China’s demand for Australia’s exports present significant downside risks for the latter’s growth outlook. A shift in economic activity may help the economy to partially counter the impact of external risks, but growth in the consumer spending, dwelling investment, and services sectors will likely depend on the pace at which the labor market improves. Apart from the expected tightening of the labor market in the months ahead, a mismatch in required skills and job locations, as well as a prolonged period of weak labor market conditions, will likely hinder a substantial pickup over the medium term.

Overall, economic growth is projected to be within the range of 2.4–2.8 percent in 2015–16.\(^6\) The authorities have initiated a number of policies to support domestic demand, including a further easing of monetary policy in recent months. The monetary policy stance in the future will depend on the Reserve Bank of Australia’s assessment of the economic outlook. While policy rate reductions may not translate fully to more economic activity—rather, there is a possibility that further easing may exacerbate the risk of a house price bubble—significant external risks are likely to deter the bank from increasing interest rates anytime soon.

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**Endnotes**

1. Growth is measured year over year in this article, unless otherwise specified.
4. Ibid.
6. Ibid.
While President Jokowi’s attempts to attract foreign investments and develop manufacturing are appreciated, people will be looking more at economic growth and job creation. Without strong improvements in the labor market, consumers will likely hold on to their wallets.
Indonesia

Trudging through uncertain times

By Akrur Barua

The world economy is going through some nervous moments. Uncertainty over the impact of an impending rate hike by the US Federal Reserve (Fed), along with weak economic data from key emerging markets like China are keeping policymakers and investors on their toes. In this climate, Indonesia’s economy appears to be moving along at a moderate pace. Key components of the economy, such as private consumption, appear to be on relatively stable ground. Exports, however, have been a headache this year, primarily due to subdued global commodity markets. This, yet again, calls for urgent reforms to diversify the economy by easing regulations, encouraging small and medium enterprises (SMEs), boosting infrastructure, and creating a vibrant education system.

GDP expands at a modest pace in Q3

Indonesia’s economy grew 4.7 percent year over year in Q3, more or less the same as the previous quarter. Growth picked up across expenditure segments, except for exports (see figure 1). Private consumption was again a key growth driver in Q3, expanding by 5.0 percent. Although the figure is lower than in 2010–12, consumers appear to be benefitting from an expansion of social welfare schemes and expectations of a decline in inflation next year.
Fixed investments also picked up pace in Q3 (4.6 percent) from Q2 (3.7 percent). However, this is not enough to raise GDP growth to President Jokowi’s 7 percent target when he took office in 2014. Nevertheless, an uptick in Q3 is encouraging, especially as the government tries to spend more on infrastructure in the near term. Government consumption expanded 6.6 percent, up from 2.1 percent in Q2, providing much-needed relief to the economy in the face of declining exports.

Commodities are weighing on Indonesian exports

Exports fell for the fourth straight quarter in Q3, contracting 0.7 percent. This was worse than the 0.1 percent fall in Q2. The declining fortunes of exports owe much to fluctuations in global commodity markets. Indonesia is a key commodity exporter; almost a third of Indonesia’s goods exports this year are commodities. Asia is a major export destination, with China being a key market within the region. For example, Asia and the Middle East account for two-thirds of Indonesia’s goods exports.

Sadly, slowing growth in China and other key emerging markets have weighed on both prices and demand. Consequently, commodity producers like Indonesia have seen export
revenues decline (see figures 2 and 3). This is also reflected in the falling share of commodities in the total exports this year (from more than 50 percent in January to less than 30 percent in October). This in turn has dented GDP growth. For example, real growth in mining and quarrying has been in negative territory for the first three quarters this year (see figure 4).

Consumers, however, will continue to lend strength to the economy

Amid a weak external sector, Indonesia’s economy will continue to rely on domestic consumers. Consumers are likely to benefit from declining inflation in the coming months, especially with the impact of fuel subsidy cuts likely to fizzle out in early 2016. This will boost real incomes. In addition, Bank Indonesia’s (BI’s) focus on inflation is starting to give results. Inflation slowed down in October to 6.3 percent year over year from 6.8 percent in September (see figure 5).

Consumers, however, appear wary of slowing economic growth. While President Jokowi’s attempts to attract foreign investments and develop manufacturing are appreciated, people will be looking more at economic growth and job creation. Without strong improvements in the labor market, consumers will likely hold on

**Figure 3. Exports to key markets have been hit this year due to low commodity prices and demand**

![Graph of exports to key markets](image1)

**Figure 4. Real growth in mining and quarrying and key sub-components**

![Graph of real growth in mining and quarrying](image2)
to their wallets. In Q3, unemployment (non-seasonally adjusted) actually went up to 6.2 percent from 5.8 percent in Q2. Consumers’ weariness is already being felt, with retail sales slowing down, even as consumer confidence fell into negative territory in September (see figure 6).

BI will be wary of external events

While inflation appears to be inching down, the central bank also has its eyes fixed on a weakening rupiah (down 9.3 percent against the US dollar this year). BI will be worried about any further impact on the currency due to a Fed rate hike. What has also weighed on emerging market currencies is China’s currency strategy. The rupiah lost 3.9 percent against the US dollar in August, mainly due to the yuan’s devaluation (see figure 7).

Short-term instability in global financial markets will continue. In fact, markets are already keeping an eye on economic data from China and monetary policy developments in the Eurozone. This will keep BI on its toes, and it is not likely to ease monetary policy in the next two to three quarters. In its November meeting, BI kept its key policy rate on hold for the ninth straight month, although it cut the reserve requirement by 50 basis points to stimulate domestic demand. For now, the central bank can draw some comfort from an
improvement in the current account deficit (non-seasonally adjusted) to -1.9 percent of GDP in Q3 2015 from a high of -4.3 percent in Q2 2014.

It’s over to you, fiscal

In such a scenario, any stimulus to domestic demand will have to come from the fiscal side. After a low-key first half of 2015, the government introduced a slew of stimulus measures, including incentives for investments in special economic zones, labor market changes, and ease of doing business for SMEs. Also, the government appears to be pushing ahead with its infrastructure agenda after initial delays; its budget for 2016 includes an 8 percent hike in infrastructure spending. This is likely to aid fixed investment and GDP growth in the coming quarters. Hearteningly, Jokowi appears to be changing gears despite political pressures. Changes to his cabinet in August and efforts to include more technocrats are steps in the right direction. But, he has to do more to match action with intent. It could just be the boost that the economy needs to overcome external volatilities and to take advantage of greater economic integration in the region.
Despite the challenges that Singapore faces, constructive policies and healthy macroeconomic fundamentals continue to make it an attractive destination for investment and business. Externally as well, Singapore stands to gain from closer regional integration and trade agreements.
Singapore
Steering through challenging times
By Lester Gunnion

SINGAPORE finds itself in a rough economic environment. Internally, the city-state continues efforts to transition to economic activity of higher value addition and value creation while also focusing on improving social welfare. As expected, the climb up the value chain as well as the policy decision to stem the inflow of cheap foreign labor poses challenges, such as sharp wage increases in an already tight labor market. Integral sectors of the economy, such as manufacturing, that have relied heavily on low-wage, low-skill foreign labor are now under duress. Additionally, the absence of gains in productivity is a cause for concern.

Furthermore, the correction in Singapore’s housing sector continues to be a drag on growth. Externally too, Singapore’s trade-driven economy faces a challenging environment. Low oil prices, a strong US dollar, and weak global demand are reflected in Singapore’s soft merchandise export growth figures. Weak growth in domestic merchandise exports, in turn, adds to the burden of the manufacturing sector, which has been the primary drag on growth in real GDP over the last two quarters. On the contrary though, the services sector has been a source of growth, and this will likely continue through the near term. As a whole, growth in real GDP in 2015 is likely to be modest. However, despite the challenges that Singapore faces, constructive policies and healthy macroeconomic fundamentals continue to make it an attractive destination for investment and
Yet again, manufacturing was a sore spot for the economy—the sector shrank 4.6 percent on a quarter-over-quarter seasonally adjusted annualized basis, continuing from a decline of 17.3 percent in the previous quarter. Weakness in the manufacturing sector shaved off 1.2 percentage points from year-over-year GDP growth in Q3. In fact the Purchasing Managers’ Index (PMI) reading, an indicator of the health of the manufacturing economy, has remained below the critical mark of 50 from July to October, indicating four consecutive months of contraction.
Services producing industries grew 3.5 percent quarter over quarter in Q3, reversing a contraction of 0.2 percent in the previous quarter. Growth in services is likely to be driven by government-related services focused on skill development and education, household expenditure, and a healthy tourism sector. An increase in the number of tourist arrivals in Q3 compared to a year ago was reflected in the 11.9 percent growth in accommodation and food services in Q3. As a whole, the services sector is likely to compensate for the decline in the goods producing sectors of the economy. In fact, services producing sectors are likely to play an increasingly important role as Singapore climbs up the value chain. This is particularly pertinent as the focus for development shifts to clusters such as applied health services, logistics, and financial services.

**Internal challenges are likely to subdue growth**

Singapore’s internal restructuring process was always expected to bring along its share of challenges, as all economic restructuring processes do. Not least among these challenges is the shift away from low-skilled, low-wage foreign labor, especially in sectors like manufacturing that have relied heavily on foreign workers since the foreign worker policy was
liberalized between 2003 and 2008. In fact more than four-fifths of Singapore’s average annual growth of 5.8 percent over the last decade has been due to growth in the workforce. The current moderation of workforce growth, coupled with an already tight labor market, has resulted in sharp increases in the cost of labor—overall unit labor cost was up 4.5 percent from a year ago in Q3, continuing from increases of 5.4 percent and 5.1 percent in the previous two quarters. In the manufacturing sector, unit labor cost was up 8.1 percent in Q3 following a rise of 8.3 percent in the previous quarter.

For Singapore to keep growing, the alternative to workforce growth is gains in productivity, and the need for this is particularly significant given the uptick in the cost of labor and, more importantly, Singapore’s demographic challenge—an ageing population and slowing population growth. However, productivity growth numbers are a cause for concern—output per employed person has declined on a year-over-year basis for four of the last seven quarters. In fact productivity growth has been slowing since Q2 of 2010. The absence of productivity growth is Singapore’s immediate and most pressing concern as it attempts to move up the value chain to higher value addition and value creation.

Another internal challenge that Singapore’s economy faces is the unavailing of the housing sector. House prices have declined on a year-over-year basis for seven consecutive quarters with the largest decline of 4.24 percent in Q3 of 2015. The rental index for all residential property has also been in decline for seven consecutive quarters, and the vacancy rate for private residential property hovers close to 8.0 percent. It is highly likely that the oversupply in the housing sector will persist through the near term and therefore be a drag on overall growth.

Trade headwinds are another concern

Singapore’s internal concerns, taken along with its external challenges make for an overcast picture. Total merchandise exports in US dollar terms and on a year-over-year basis have contracted for each of the last 13 months. The low price of oil, the relative strength of the US dollar, the slowdown in China, and weakness in overall global demand are the primary factors that have weighed upon global trade in general and Singapore’s exports in particular. Non-oil domestic exports (NODX) from Singapore, a more specific indicator of the country’s domestic goods export sector, have been patchy at best. On a year-over-year basis, NODX declined by 3.0 percent in Q3, reversing growth of 2.1 percent in Q2. In October, NODX decreased 0.5 percent from a year ago, with exports to China declining 8.7 percent and exports to the United States declining 2.2 percent.

Singapore’s trade in services helps to brighten the picture. On a year-over-year basis the export of services grew 2.8 percent in Q3, following a 4.4 percent increase in Q2. However, any further weakening of global demand is likely to keep exports of services under check.

Given the headwinds that Singapore faces on the trade front, the Monetary Authority of Singapore (MAS), the country’s central bank, announced a slight reduction in the rate of appreciation of the Singapore dollar’s nominal effective exchange rate (S$NEER) policy band (in October). This measure is conservative at best, but leaves the MAS room for further easing of monetary policy, which is a possibility in the near term. Moreover, liftoff of interest rates in the United States is likely to cause further depreciation of the Singapore dollar against the US dollar, therefore providing some support to exports. However, higher interest rates in the United States will also cause depreciation in the currencies of emerging markets, some of which are Singapore’s competitors in trade.

A few bright spots amid the concerns

Though the economic situation for Singapore is indeed difficult, it is definitely not all doom and gloom. The positives include an increase in government spending—the budget
for 2015 outlines an increase in spending on education and infrastructure investment through to 2020. SkillsFuture, the government’s nation-wide skills development program is a positive step toward creating and sustaining gains in productivity. Furthermore, the identification and development of future growth clusters such as advanced manufacturing, applied health services, logistics, smart urban solutions, financial services, and aerospace, will make Singapore’s transition up the value chain a smoother process. Closer integration with the Association of Southeast Asian Nations (ASEAN) through the Asian Economic Community is also likely to boost growth (by 9.5 percent by 2030). Integration with ASEAN will also allow firms to shift lower-value manufacturing from Singapore to countries with lower labor costs, thereby allowing for efficiency and increased focus on higher value addition and value creation. Singapore also stands to gain from the Trans-Pacific Partnership as the dropping of tariff and non-tariff barriers is likely to boost trade.

In addition to these bright spots, Singapore’s macroeconomic fundamentals remain solid. As a result, the city-state still finds itself at the top of the Ease of Doing Business ranking. For now though, Singapore’s challenges will keep growth “close to 2.0 percent” in 2015 and modest over the near term.

Endnotes

2. Ibid.
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7. Singapore Department of Statistics/Haver Analytics, output per employed person, SA, 2010=100, accessed on November 24, 2015.
8. Urban Redevelopment Authority/Haver Analytics, Property Price Index, NSA, Q1 2009=100, accessed on November 24, 2015.
If oil remains largely subdued, which now seems likely, this will not only boost domestic demand in Korea, it will also boost demand for non-oil imports in Korea’s leading export markets such as the United States and Europe.
South Korea
Positive signs

By Dr. Ira Kalish

South Korea’s economy continues to suffer the consequences of China’s slow-down and Japan’s currency appreciation. Thus, the main hope for a revival of growth comes from domestic demand. The government has attempted to boost demand by temporarily reducing taxes on automobiles and durable consumer goods. The result was a surge in the growth of real GDP in the third quarter. The economy grew 1.2 percent from the second to the third quarter, the fastest rate of growth in five years. Was this a one-off event due to a temporary shift in policy, or does it suggest the start of a rebound?

The evidence is not conclusive, but there are some favorable signs. First, consumer confidence was up in October to the highest level in 2015. This, combined with strong employment growth, bodes well for increased consumer spending. Second, while dollar revenues from exports continue to decline, export volume is increasing. Moreover, although exports to China (Korea’s largest export market) are weak, the revival of the US and European economies has been helpful to exports. These two are the second and third largest export markets for Korea respectively. Plus, the Korean won has declined in value in the past year, setting the stage for greater export competitiveness. Third, the strong growth in the third quarter included a sizable surge in business investment. This bodes well for further increases in production. Also, given low inflation and the likelihood of an interest rate increase on the part of the US Federal Reserve, there is widespread expectation that Korea’s central
bank will leave interest rates unchanged, essentially continuing a relatively easy monetary policy. This should be helpful to the economy as well. Finally, given that the budget is roughly in balance, there remains considerable room for the government to engage in further fiscal stimulation (beyond the tax cuts), if the need should arise.

Another factor that is likely to be helpful to the South Korean economy is the very low price of oil. If oil remains largely subdued, which now seems likely, this will not only boost domestic demand in Korea, it will also boost demand for non-oil imports in Korea’s leading export markets such as the United States and Europe. Hence, the path that oil follows could make a big difference for Korea.

**Short-term challenges**

Although South Korea’s economy appears to be on the mend, problems remain. The most notable is the slowdown in China. If this worsens, it could have a significant negative impact on Korea, given the tight integration of the two countries’ supply chain in electronics manufacturing. Another problem is the large amount of external debt held by Korean businesses.
Longer-term challenges

In the past decade, South Korea’s economy grew at an annual rate of about 3.6 percent. Yet, economic growth is expected to be less than 3 percent for the remainder of this decade and less than 2 percent in the first half of the next decade. Why the deceleration? The main reason is demographics. Due to an unusually low fertility rate, the working-age population is expected to stabilize in the next few years and start to decline early in the next decade. Even if we assume that labor force participation expands, and even if we assume that labor productivity accelerates, economic growth is still likely to decelerate, given the big impact of demographics. Moreover, Korea’s population is set to rapidly age, increasing the ratio of retirees to workers and potentially creating headaches in terms of supporting the elderly population.

Thus, an important question concerns the extent to which productivity growth can be boosted. If it can, then the negative impact of demographics can be offset. Korea’s manufacturing sector has made huge strides, fueling Korea’s emergence as a world class economy. Yet, the services sector has not made much progress, with productivity being low compared to other OECD countries. And, as the economy becomes more affluent and more goods production moves offshore, the fate of the services sector will be critical. If Korea is to be in the same ranks as the United States, Japan, and Western Europe, it will need to boost the efficiency of its services sector.

There is plenty of low-hanging fruit in services. The service areas that have especially low productivity are business services, wholesale trade, and transportation. Among the possible explanations are low investment in these sectors, government regulations that protect inefficient players, and barriers to global trade in these sectors. The latter problem could be partly resolved if South Korea were to join the Trans-Pacific Partnership (TPP), the new free trade and investment agreement between 12 Pacific Rim nations. Indeed the South Korean government has sought membership, fearful that it will otherwise fall behind Japan, Malaysia, and Singapore in terms of competitiveness. Freer trade and capital movements for South Korea would likely go a long way toward boosting services productivity and competitiveness.
The more one looks at Asia, the clearer it becomes that the region’s ascendancy in the global economy will continue, providing strength and yet creating instability if risks are not addressed prudently.
Special topic: Packing a mightier punch
Asia’s economic growth among global markets continues

By Akrur Barua

In September, after much deliberation, the US Federal Reserve (Fed) decided to keep the federal funds rate on hold. The decision to postpone a rate hike was primarily due to concerns about growth in key emerging economies and volatility in global financial markets. A string of poor economic data from China and an equity sell-off there in Q3 had indeed raised risks to global growth. What was an eye-opener, however, was the strong impact of Chinese data on global markets, including the Fed’s decision to defer a rate hike. The latter made one thing very clear—China is now a powerful force in the global economic order.

China’s rise is yet another feather in the cap of Asia’s massive economy. Once a poorer cousin of the United States and Europe, Asia now boasts some of the world’s fastest-growing economies and is a major contributor to global growth (see figure 1). In addition to China and its neighbor, India, Asia also has a former powerhouse in Japan, an increasingly affluent South Korea, and the fast-growing Association of South East Asian Nations (ASEAN). In fact, the more one looks at Asia, the clearer it becomes that the region’s ascendancy in the global economy will continue, providing strength and yet creating instability if risks are not addressed prudently.
For the global economy, Asia’s size does matter

A key factor behind Asia’s rising influence is the size of its economy. In 1990, Asia’s share in world GDP in real US$ purchasing power parity (PPP) was 23.2 percent. By 2014, this went up to 38.8 percent, much larger than the shares of the United States and the European Union. In fact, Asia’s share is likely to go up in the coming years if current growth trends in key regional economies continue. For example, forecasts by Oxford Economics put Asia’s share at nearly 45 percent by 2025 (see figure 2).

Interestingly, there are major changes within Asia itself. In 2014, China’s share in Asia’s GDP (in real US$ PPP) was 43.1 percent, more than double its share in 1992. In contrast, Japan’s share fell sharply during this period. Oxford Economics’ forecasts show that this trend will continue (see figure 3).
Asia’s prominence in global supply and demand

For companies in the West, Asia has served as a factory. First, it was Japan. Then came countries like South Korea, Singapore, and Taiwan. Finally, China made its presence felt. In fact, Asian economies have benefited immensely by being part of global value chains (GVCs). Moreover, as certain countries moved up the value chain over time, others in the region occupied the space left vacant. Data from the Organization of Economic Cooperation and Development’s (OECD’s) Trade in Value Added (TiVA) database show that Asian countries have become ever more integrated with GVCs, thereby pushing up global trade, investments, and development (see figures 4 and 5).6

Within Asia itself, there are now strong production links. For example, Japanese carmakers have hubs in countries like Thailand, China, and India. These links have become stronger due to the rapid growth of regional economies, thereby providing large markets to global firms. For example, in 2010, China overtook the United States as the world’s largest auto market.7 Asia is now a key part of the growth strategies of multinational corporations (MNCs), ranging from banks to technology companies. For example, in the financial year
ended September 2015, 24.2 percent of Apple Inc’s revenues came from China, more than double the share in 2011.8 When the downturn of 2008–09 dented Western economies, banks like Standard Chartered were able to escape the worst of the crisis by betting on emerging markets in Asia and Africa.9

Given the expected rise in affluence and the numbers of the middle class, Asia’s role in global demand is set to increase further (see figures 6 and 7).10 Greater integration within the region (such as the ASEAN Economic Community) and trade agreements with global growth centers (like the Trans-Pacific Partnership) will only add to the lure of the Asian market.

Interestingly, Asia’s large contributions to global supply and demand have not benefitted foreign firms alone. Links to GVCs have helped Asian companies attain global center stage as well. In 2015, there were 190 Asian companies in the list of global Fortune 500 companies, up from 116 in 2001.11

Asian hunger for commodities is making a big impact

Asia’s influence is arguably the greatest on commodity markets. A few decades ago, demand from the United States was the key driver of oil prices. Not anymore. Surely, the
supply of US shale has a key role to play in global oil markets, but equally important is demand from emerging economies, led by China. According to data from the US Energy Information Administration (EIA), the Asia-Pacific region is now the world’s leading consumer of petroleum and other liquid fuels (see figure 8).¹²

Increasing demand from Asia has contributed to growth in non-oil commodity-producing nations as well, especially those rich in iron ore, copper, and coal. Nowadays, the fortunes of commodity producers such as Brazil, Chile,
and Indonesia are increasingly dependent on demand from emerging Asian countries, rather than the West alone (see figures 9 and 10).

Asia’s rush for commodities has also led to rising investments in resource-rich economies in Africa and Latin America. A number of commodity producers are also diversifying away from Western markets to growth centers in Asia. Russia’s major oil and gas deal with China in 2014 was as much a strategy to tap new demand sources as it was geopolitical grandstanding with the West.13 Iran has managed to retain India as a major client despite sanctions, and is aiming to build pipelines between the two countries. Even Gulf Arab countries are pushing hard to preserve and expand market share in Asia.14

Rising influence on global financial markets

While Japan and a few affluent nations in South East Asia have always been a part of global investors’ calculations, there is also a trend of increasing focus on fast-growing emerging economies in Asia. As a result, major global equity, bond, and currency markets are more interlinked with Asia now than ever before. This relationship is, however, not a one-way street, where events in the West impact Asia. Nowadays, movements in Asia...
have started impacting major markets in the West more profoundly. For example, currency weakness in Asia due to uncertainty over a Fed hike has dented the overseas dollar revenues of US corporations this year, thereby weighing on stock prices. Then again, when the bull run in Chinese stocks ran out of steam in June, the impact was felt across the world (see figure 11). And as the Fed makes its intentions clearer, investor focus has yet again shifted to emerging market growth, especially China.15

Ironically, within Asia, financial markets have become more interconnected due to growing trade and investment links within the region. When China devalued the yuan in August to free up the currency—a move praised by the International Monetary Fund—it created a flutter among other emerging market currencies, including Asian ones (see figure 12).

The need to match expectations with prudent leadership

Rising economic and financial links within the region and outside have ignited much debate on the need for more economic reforms in Asia. For example, China’s attempts to develop a domestic demand-driven economy will not bear fruit without financial market reforms. In Japan, structural bottlenecks will not go away without changes in the labor...
market, agriculture, and corporate governance. India's attempt to attract global investments will fail without reforms to the tax regime and easier business conditions. And in South Korea, concentration of economic power in a few firms cannot be remedied without sprucing up SMEs and entrepreneurship.

Are Asia's policymakers ready to match rhetoric on reforms with action? Are the region's giant emerging economies prepared for global economic leadership through more open and globally integrated financial systems including floating currencies? Will any sudden reforms by one country without information symmetry with global markets lead to short-term vulnerabilities (like the yuan devaluation in August)? Will Asian policymakers be able to broaden their focus to a more global one given the region's rising role in the world economy?

These are only some of the questions that will be asked of Asia's leaders as the region continues to progress. As they lead efforts to set up global development banks, fight climate change, and increase their presence in world bodies like the United Nations, Asian countries will have to collaborate more. Only then will Asia's rise be a more credible one, helping to create a more stable world order, both economic and political.

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