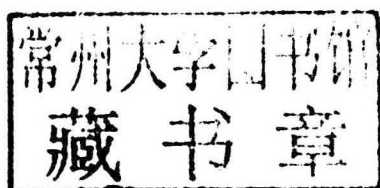


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Asian Competitiveness
Annual Report 2012



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Preface

In the past year, influenced by the debt crisis of developed economies and high unemployment, the world economy has experienced significant recession, bringing great challenge to the improvement of Asian economies and competitiveness of enterprises. The prices of international bulk commodities are rising sharply and the import inflation elevates the prices of developing economies, especially emerging economies. In this way, to fight inflation has become the primary macroeconomic objective for emerging economies. The tightening monetary policy to control inflation has further triggered economic recession in numerous developing economies. In a short term, it is hard for developed economies to have breakthroughs in science and technology-led endogenous development pattern. Instead, they adopt a strategy of export expansion and re-industrialization, thus becoming strong competitors of many developing economies in traditional markets. There are a lot of uncertainties of the prospects of world economy recovery, and the stagnation of world market expansion has greatly impaired the contribution of export to the development of various economies. The enterprises are faced with great pressure on production due to the lack of market demand, bringing great pressure to the improvement of competitiveness of economies and enterprises. Most Asian economies and enterprises are in the downstream of international industrial chain and are faced with more challenges and risks, which will bring about profound impact on Asian economies and the growth of enterprise competitiveness.

To fit into new situation and borrow ideas from the report of last year, The Boao Forum for Asia Asian Competitiveness Annual Report 2012 has been adjusted accordingly. Based on the negative impact of world economic recovery, the report of this year has laid significance on the investigation of the world economic environment on the competitiveness of economies and enterprises. Considering the close economic connection between Oceania and Asia, the report of this year has added investigation on the competitiveness of major economies and enterprises in Oceania—Australia and New Zealand.

In view of the creativity of the research on Asian competitiveness, the report is still to be improved. With the changes of international economic situation, the report needs continuous improvement and adjustment. We hope to try our best to provide perfect research results to meet the requirements of various circles of the society.

In the end, I would like to extend sincere gratitude to all the friends who have spent efforts and wisdom. We welcome valuable comments and suggestions from all circles of the society to help us improve the report on Asian competitiveness in the next year.



Zhou Wenzhong
Secretary General
Boao Forum for Asia

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Part One
Annual Report 2012—
Competitiveness of
Asian Economies

Chapter 1

Internal and External Environments Affecting the Competitiveness of Asian Economies

1.1 Global Economy Facing Unprecedented Challenges Again

In 2011, the world's economy entered a dangerous and sensitive period again with increased risk of a double-dip recession. Many countries have limited space to reform and advance their economic policies. The global economy is suffering from a lack of new breakthroughs in recovery and development and is in a painful transformation period. In short, the developed economies including Europe, the US and Japan face a series of challenges such as debt crisis, unemployment, stagnated economy and ineffective policies.

1.1.1 Global Economy Continuously Slowing Down

Research findings have shown that economic growth in a country would stall if its debt accounts for over 90% of its GDP. As stated by Lawrence Summers, former Treasury Secretary of the US, the US economy is now halfway to a "lost decade". Over last five years, the annual growth rate of the US economy was less than 1%, similar to that of Japan in the period of its bubble burst. So, the US will sustain a weak growth. In the first three quarters of 2011, the American economic growth rate was 0.4%, 1.3% and 2.5% respectively on a quarterly basis. Such growth was mainly driven by the expansionary fiscal policy and relaxing monetary policy. A weak endogenous effect is shown in the American

economic growth.

The Eurozone is also on the edge of recession. The economic growth rate in the first three quarters of 2011 was 0.8%, 0.2% and 0.2% respectively on a quarterly basis. In the fourth quarter of 2011, the prosperity indices of Germany, France, Italy and the UK hit the lowest record in the recent two years, which were below 100. The investment confidence index in the Eurozone also reached the lowest cyclical point. PMI (Purchasing Manager's Index) has retained less than 50 for a long time, with a further sliding trend. All these indicate that the European economy falls into a recession.

Japan's economy has not fully recovered from the devastating earthquake, which saw a 2.7% and 1.3% decline in the first and second quarter respectively, remaining decreasing for three consecutive quarters. The third quarter achieved a 6% increase, which was a recovery rebound after previously consecutive recession. It is difficult for the Japanese economy to achieve a stable growth because both domestic consumption and investment confidence in Japan are gloomy, coupled with limited adjustment space for domestic fiscal and monetary policies.

1.1.2 Heavy Debt Burden for the Developed Economies

Over the last three years, the private debt crises in the households, financial institutions and companies have evolved into a government credit crisis in the US. Various private debts have been somewhat reduced. However, the government debts rapidly increase

to 100% of its GDP. More severely, the political debate about the debt ceiling and arguments on how to reduce deficit between two parties in 2011 indicate that it is unlikely that the US can find a long-term solution to address the debt crisis. This is a fundamental reason why the S&P downgraded the US credit rating.

European sovereign debt crisis is currently still in a high-risk period. Since the outbreak of the global financial crisis, the credit risk in five countries such as Greece and Italy has been intensified and outstanding obligations in Germany and France are rocketing. Despite efforts of European countries at several European Summits of 2011, the European Union hasn't found any good solutions to address this crisis as the EU adopts a unified monetary policy and separated fiscal policy.

Although the Japanese debt is held by domestic investors, its public debt is over 220% of its GDP. 23.3% of public financial expenditure pays for government debt interests each year, while half of government income is from debt financing. Japan lacks political and economic support to solve the debt issue fundamentally.

1.1.3 High Unemployment in Developed Economies

Since the outbreak of the financial crisis, the unemployment in the US has retained over 9%. The current economic recovery doesn't improve the unemployment. To offset the human resource gap after a large scale of downsizing, many employers extend the working hours of current employees or increase their salary rather than employing new staff. Currently, high unemployment in the US would likely sustain for a long time. A large number of white collar workers are laid off at their 40's and 50's.

Europe also faces unprecedented unemployment. Since the outbreak of the financial crisis, the unemployment rate has maintained around 10%. The employment rate rose to 10.3% in October 2011, hitting the highest record in history. The unemployment rate in Spain reached 23%. The employment is further worsened in Greece, Portugal, France, Italy and the UK. Meanwhile, German and Dutch economies remain robust and their unemployment remains stable. Therefore, except for Germany and the Netherlands, high unemployment is prevailing in most key European countries.

1.1.4 Diminishing Macroeconomic Policies of Economies

Due to huge public debts accumulated in previous years, coupled with high social welfare and military expenditures, the American fiscal policies have limited space to play their functions. Regarding the monetary policy, the Federal Reserve promised to hold short-term interest rate near zero until at least the middle of 2013. However, after two rounds of the quantitative easing monetary policy, it is still not clear whether the "Reverse Operation" implemented by the Federal Reserve can boost household consumption and corporate investment. On the contrary, salary and benefit growth aggravate core inflation. The Federal Reserve may be forced to end the low interest rate policy.

The European fiscal policy is in a dilemma to adopt a proactive or tight macro-policy. On the one hand, economies with heavy debt urgently need to implement the proactive fiscal policy. On the other hand, these economies have to adopt tight fiscal policy in order to obtain aid from Germany and European Financial Stability Facility (EFSF). Major European countries including Germany, France and the UK, fully adopt the tight fiscal policy. Mario Draghi, the new President of the European Central Bank lowered the benchmark interest rate on November 3, 2011. If the result is not satisfactory, the European Central Bank may sustain the nonconventional monetary policy to continuously purchase the government debts of member countries for a long term.

Japan's fiscal and monetary policies also have many problems. Nearly one third of fiscal expenditure is from debt financing. In addition, the growth of fiscal income is bounded by the aging society and industrial hollowing-out. Furthermore, the zero interest rate policy implemented for a long time does not improve the deflation in Japan. How to solve "liquidity trap" is still the largest challenge for the central bank of Japan.

Apart from the advanced economies, Asia, Latin America, Russia experience both economic slowdown and inflation pressure. Various indices to measure the competitiveness of Asian economies slide somewhat due to the sustained recession of global economy.

1.2 Asian Macro-Economic Environment and Potential Systematic Risks

1.2.1 Asian Economies Slowing Down Significantly with High Inflation Pressure

In 2011, export-oriented Asian economies slowed down with continuously stagnated European and American economies (See Figure 1.1). However, the investment and consumption demands are robust within the region. Investment demands are driven by a large scale of infrastructure construction, while consumption demands benefit from increasingly improved employment and salary growth. All these make some Asian economies continuously face overheating pressure featuring continuous credit growth and high inflation. In particular, inflation is hiking in China, India, Malaysia, Thailand, China's

Hong Kong, Republic of Korea and Vietnam, which is mainly caused by external-oriented inflation due to increase of bulk commodity and energy prices.

Influx of foreign capital into Asian emerging economies is another barometer of Asian economy. Generally, the inflow of international capital is reduced sharply compared with 2010. Moreover, foreign investments in the first half of 2011 are significantly different from the second half of 2011 (See Figure 1.2). In the first half of 2011, the capital net inflow was still strong. However, a large amount of capital flew out of economies including China, India, China's Hong Kong and Singapore with the gloomy global economy in the second half of 2011. In particular, Asian capital market saw a large scale of sell-off and capital outflow in August and September, which indicates that European debt crisis and bank liquidity risk are continuously worsened and the weak American economy also significantly influences the Asian economy.

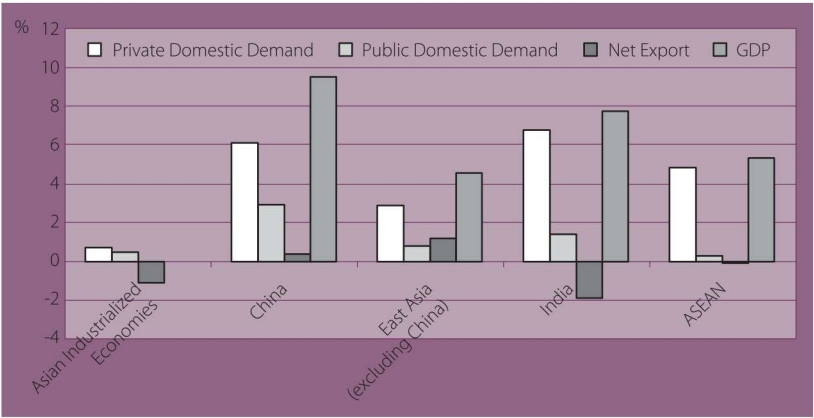


Figure 1.1 Economic Growth of Major Asian Economies in 2011

Source: www.imf.org

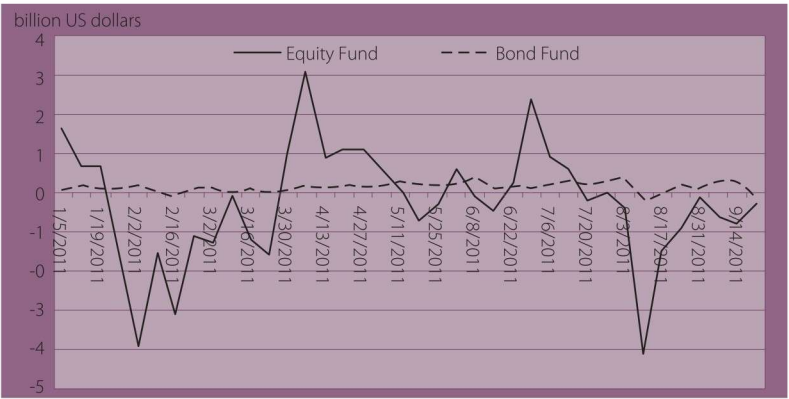


Figure 1.2 International Capital into Emerging Asian Financial Markets in 2011

Source: www.imf.org

1.2.2 Diversified Development in Asian Sub-Regions

The economic development is varied in different sub-regions across Asia (See Table 1.1). Specifically, most industrial economies in the Asia-Pacific region are significantly affected by natural disasters. Japan's industrial chain and domestic demands are suddenly hit by devastating earthquake. The Japanese economy fell into a continuous recession in the first and second quarter. Despite the huge demands for coal and iron ore in the international market, cyclone and flood disasters influenced mining export in Australia. Although New Zealand achieves a steady growth, it still hasn't totally recovered from the earthquake struck in January 2011.

In East Asia, robust domestic and regional demands support fast economic growth. The salary and employment growth boosts private consumption in China. Strong private investment and low-income housing construction offset reduced infrastructure investments. The economic and financial integration with the mainland supports robust economic growth in Taiwan and Hong Kong. Relaxing financing environment and salary growth stimulate domestic

consumption in the Republic of Korea.

In ASEAN countries, the growth of domestic demands, investment demands, in particular, eases economic slowdown brought about by reduced exports. The commodity export countries such as Indonesia and Malaysia benefited from rising bulk commodity price in the first half of 2011.

South Asian economies are boosted by continuous growth of household disposable income. The private consumption is still strong in India. However, private investments obviously slow down due to the gloomy global economy. Bangladesh adopts a relaxing monetary policy. The continuous credit expansion drives strong growth of household consumption. Such economic growth is a result of stable political environment and continuous macro-policies in Sri Lanka. The sluggish consumption in Nepal is because of reduced remittance from overseas Nepalese in the Middle East. The low-income Asian economies, Mongolia and Cambodia in particular, retained the economic growth due to raised bulk commodity price in the first half of 2011. However, these economies saw a slowdown in the second half of 2011 due to dropped commodity price.

Table 1.1 Economic Growth of Major Asia-Pacific Economies

	2010	2011e	2012e
Industrialized Economies in Asia-Pacific Region	3.7	0.0	2.5
Australia	2.7	1.8	3.3
Japan	4.0	-0.5	2.3
New Zealand	1.7	2.0	3.8
East Asia Economies	9.8	8.5	8.2
China	10.3	9.5	9.0
China's Hong Kong	7.0	6.0	4.3
Republic of Korea	6.2	4.0	4.4
China's Taiwan	10.9	5.2	5.0
South Asia Economies	9.8	7.7	7.4
Bangladesh	6.4	6.3	6.1
India	10.1	7.8	7.5
Sri Lanka	8.0	7.0	6.5
ASEAN Economies	7.6	5.3	5.5
Brunei	2.6	2.8	2.2
Cambodia	6.0	6.7	6.5
Indonesia	6.1	6.4	6.3