

China and the Asia Region:
Myths and Consequences of Integration

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Hong Kong SAR



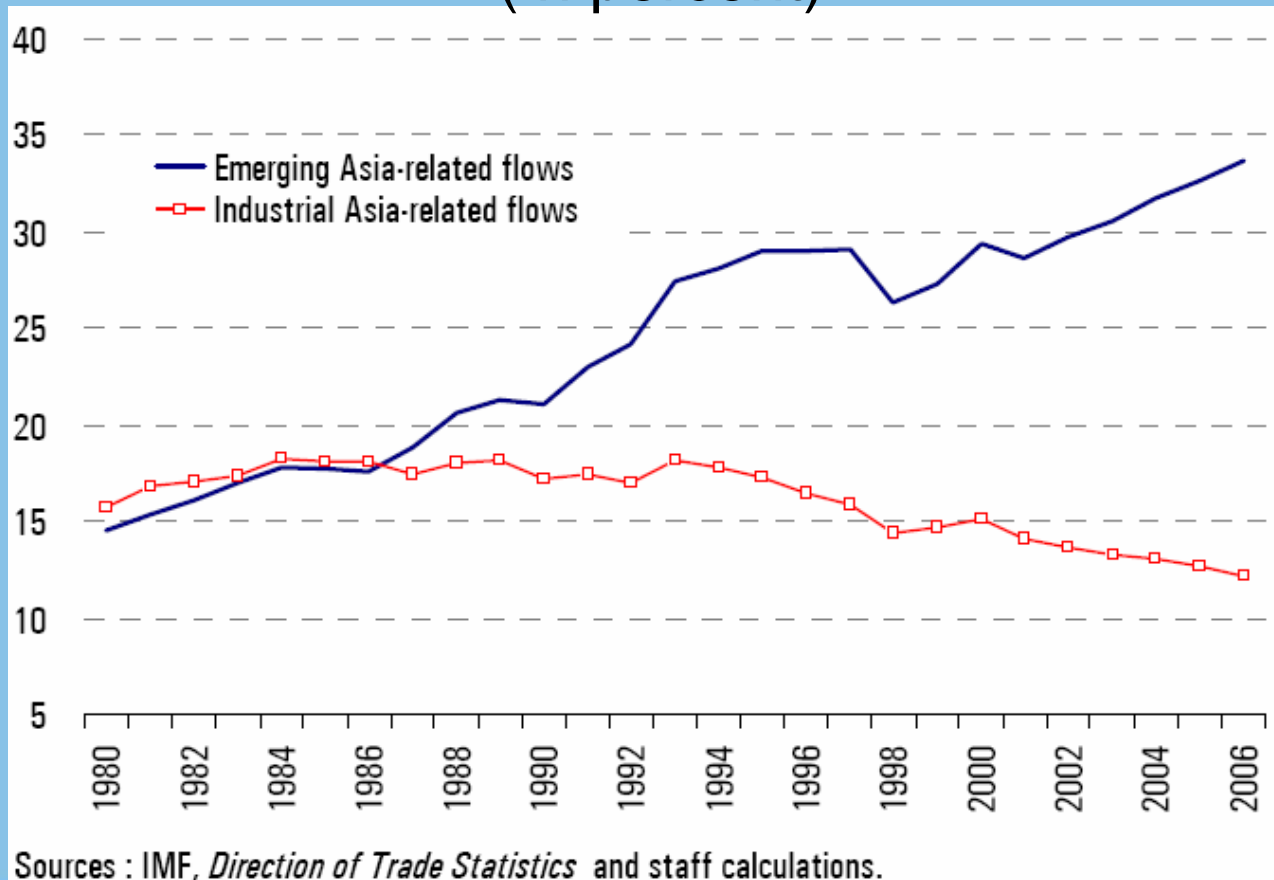
Organisers

Outline

- Myth 1: Trade integration has made Asia more resilient to outside shocks
- Myth 2: Economic and financial integration go hand-in-hand
- Consequences: Asia's real and financial linkages to the rest of the world remain key
- Outlook for Hong Kong: China's financial opening will be a key driver of future growth

Myth 1: Trade integration has made Asia more resilient to outside shocks

Asia's share in world trade flows
(In percent)



Myth 1: Trade integration has made Asia more resilient to outside shocks

Direction of Exports in 2006 (In percent of total exports)

			Direction					
			Asia			NAFTA	EU-15	Rest of World
			Total	Emerging Asia	Industrial Asia			
Exporting Region	Asia	Total	51.9 (9.2)	42.1 (11.7)	9.9 (-2.5)	20.7 (-6.9)	14.2 (-4.1)	13.2 (1.9)
		Emerging Asia	51.6 (4.1)	40.8 (9.8)	10.8 (-5.7)	20.1 (-4.6)	14.6 (-2.2)	13.6 (2.7)
		Industrial Asia	53.1 (16.2)	46.5 (16.9)	6.6 (-0.7)	22.5 (-8.7)	12.8 (-7.4)	11.6 (-0.1)
	NAFTA	19.5 (-5.8)	13.5 (1.0)	6.0 (-6.8)	52.5 (11.9)	14.6 (-7.4)	13.4 (1.3)	
	EU-15	8.2 (0.7)	6.1 (1.7)	2.2 (-1.0)	9.6 (1.2)	59.2 (-6.7)	23.0 (4.8)	

Sources : IMF, *Direction of Trade Statistics* and staff calculations.

¹ Numbers in parentheses are changes in shares from 1990 to 2006. Shaded cells indicate intraregional trade flows.

Myth 1: Trade integration has made Asia more resilient to outside shocks

Source of Imports in 2006 (In percent of total imports)

			Source					
			Asia			NAFTA	EU-15	Rest of World
			Total	Emerging Asia	Industrial Asia			
Importing Region	Asia	Total	59.9 (11.8)	46.0 (16.4)	13.9 (-4.6)	10.4 (-10.0)	10.6 (-5.3)	19.1 (3.5)
		Emerging Asia	62.7 (6.9)	47.0 (15.4)	15.7 (-8.5)	9.3 (-7.1)	10.1 (-4.9)	17.9 (5.1)
		Industrial Asia	50.3 (14.3)	42.7 (16.1)	7.6 (-1.8)	14.1 (-12.6)	12.3 (-5.0)	23.3 (3.2)
	NAFTA	30.9 (-1.7)	23.3 (7.0)	7.6 (-8.8)	36.2 (1.8)	16.0 (-2.7)	16.9 (2.6)	
	EU-15	12.5 (2.9)	9.9 (5.1)	2.5 (-2.1)	5.9 (-2.3)	57.8 (-7.0)	23.8 (6.3)	

Sources : IMF, *Direction of Trade Statistics* and staff calculations.

¹ Numbers in parentheses are changes in shares from 1990 to 2006. Shaded cells indicate intraregional trade flows.

Myth 1: Trade integration has made Asia more resilient to outside shocks

Direction of Exports in Asia in 2006 (In percent of total exports)

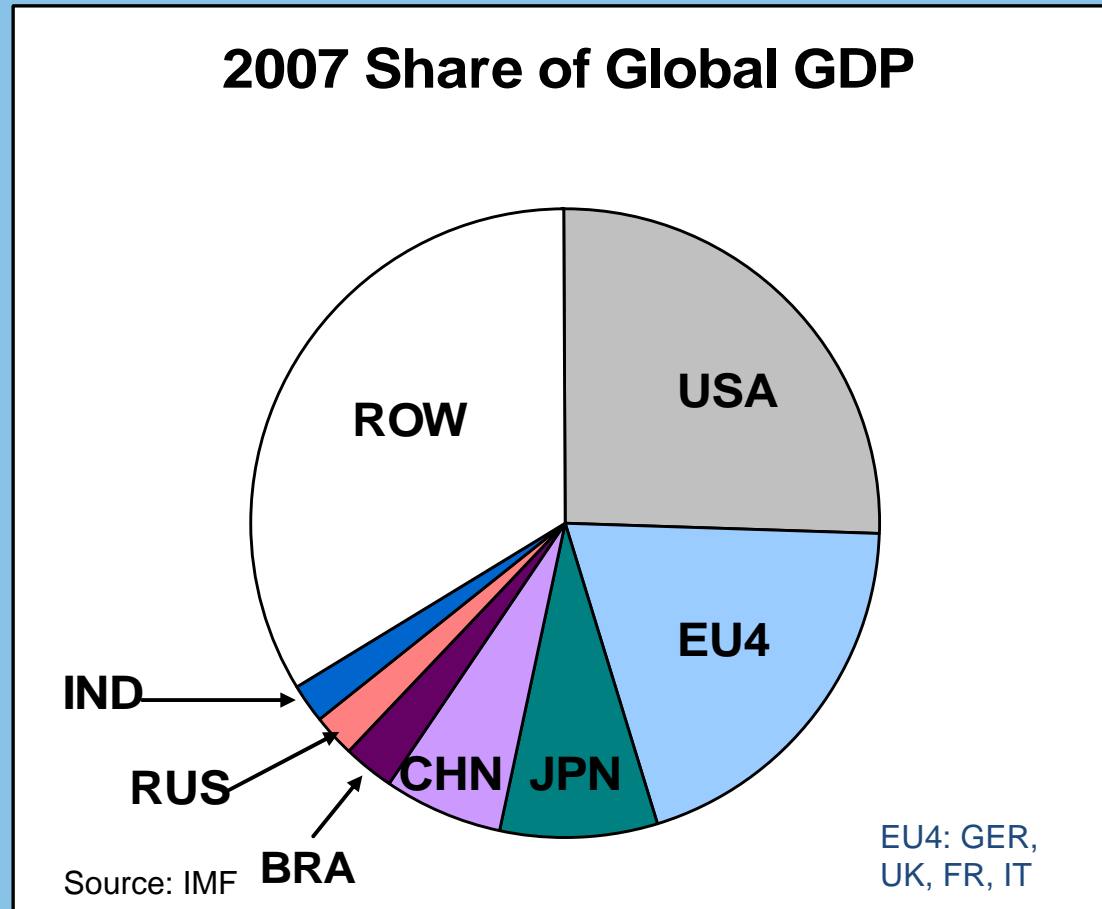
		Direction				
		NIEs	ASEAN-5	China	Industrial Asia	Rest of World
Exporting Region/Country	NIEs	14.0 (1.7)	12.2 (3.7)	25.4 (17.5)	8.3 (-5.1)	38.3 (-18.7)
	ASEAN-5	21.6 (0.3)	9.7 (5.4)	11.1 (8.9)	16.0 (-10.9)	39.6 (-5.1)
	China	22.8 (-18.4)	4.6 (1.7)		11.5 (-3.8)	59.7 (19.1)
	Industrial Asia	21.4 (2.6)	8.9 (1.1)	14.8 (12.5)	6.6 (-0.7)	46.9 (-16.2)

Sources: IMF, *Direction of Trade Statistics* and staff calculations.

¹ Numbers in parentheses are changes in shares from 1990 to 2006. Shaded cells indicate intraregional trade flows.

Myth 1: Trade integration has made Asia more resilient to outside shocks

Global demand is still centered in advanced countries



Myth 1: Trade integration has made Asia more resilient to outside shocks

Many “Asian” consumers are in the US...

Export Exposure to the United States				
<i>(In percent of GDP)</i>				
	Direct		Total	
	1994	2006	1994	2006
Japan	2.5	3.4	3.0	4.4
Australia	0.9	1.1	1.6	2.1
New Zealand	2.8	3.0	3.7	4.0
China	5.6	9.6	7.6	12.2
India	1.7	2.4	2.0	3.1
Hong Kong SAR	16.7	14.8	20.0	21.8
Korea	4.9	5.1	6.1	8.7
Singapore	23.9	17.3	31.9	30.8
Taiwan POC	10.4	9.9	12.9	15.5
Indonesia	3.3	3.5	4.5	5.6
Malaysia	18.0	22.7	25.0	31.7
Philippines	8.8	8.0	9.8	12.0
Thailand	7.0	10.5	8.9	15.1
Vietnam	1.4	15.2	2.8	18.5
Asia	7.7	9.0	10.0	13.3
Industrial Asia	2.1	2.5	2.8	3.5
Emerging Asia	9.2	10.8	12.0	15.9

Sources: UN COMTRADE Database; and IMF staff calculations.

Myth 1: Trade integration has made Asia more resilient to outside shocks

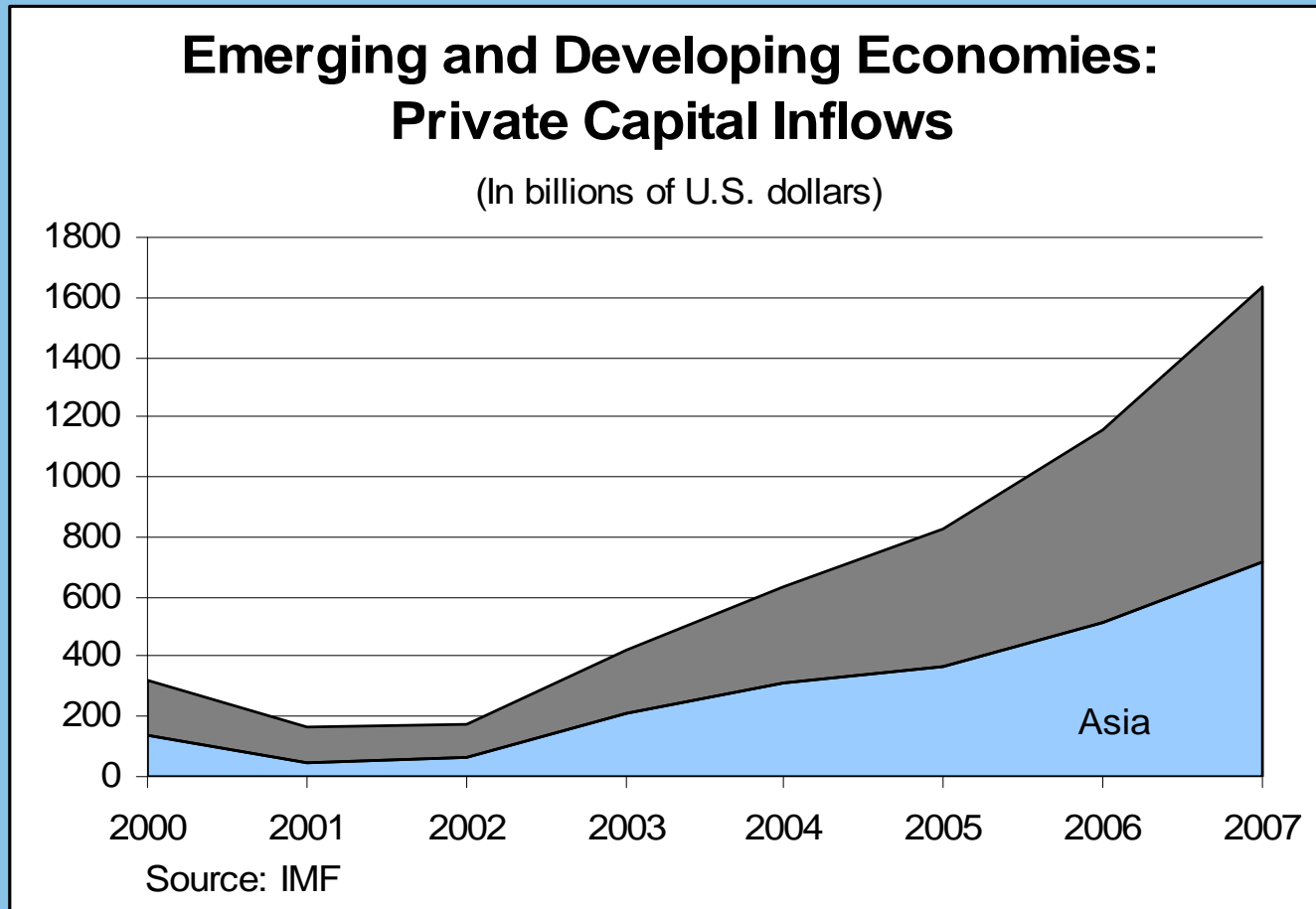
... and in the EU

Export Exposure to the EU-15				
<i>(In percent of GDP)</i>				
	Direct		Total	
	1994	2006	1994	2006
Japan	1.4	2.2	2.0	3.5
Australia	1.5	1.9	2.2	3.1
New Zealand	3.7	3.6	4.8	5.1
China	3.9	7.7	6.0	11.7
India	2.6	3.1	3.3	4.5
Hong Kong SAR	12.6	15.7	16.9	24.7
Korea	2.7	5.0	3.9	8.2
Singapore	17.0	20.1	25.5	35.7
Taiwan POC	5.2	7.1	7.9	13.6
Indonesia	3.4	3.7	4.8	6.4
Malaysia	11.4	13.8	18.3	25.4
Philippines	3.7	7.1	5.0	12.5
Thailand	5.2	8.7	7.5	14.7
Vietnam	6.6	15.0	8.6	20.8
Asia	5.8	8.2	8.3	13.6
Industrial Asia	2.2	2.6	3.0	3.9
Emerging Asia	6.8	9.7	9.8	16.2

Sources: UN COMTRADE Database; and IMF staff calculations.

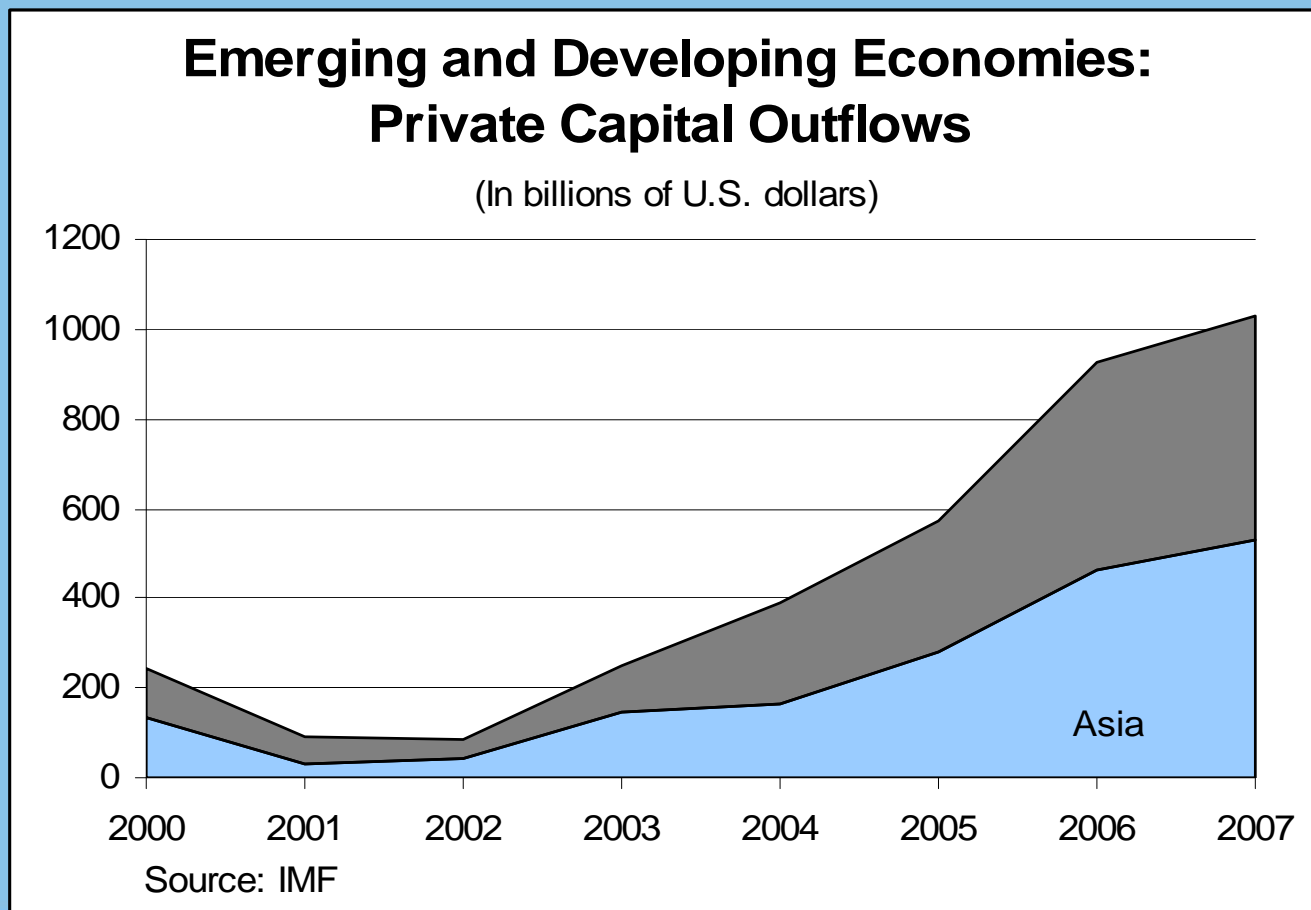
Myth 2: Economic and financial integration go hand-in-hand

Emerging Asia is key for global capital inflows



Myth 2: Economic and financial integration go hand-in-hand

... and also a major source of global capital.



Myth 2: Economic and financial integration go hand-in-hand

But bilaterally, intra-Asian investment is small

Share of FDI flows in 2006, total US\$2.7 trillion
(Percent)

		Investment from :				Total outflows
		Asia	US	EU5	Others	
Investment in :	Asia	3.4	0.6	0.9	2.4	7.2
	US	1.0	-	2.5	3.4	6.9
	EU5	0.4	2.7	3.7	5.4	12.3
	Others	1.0	6.8	8.8	7.1	23.7
	Total inflows	5.8	10.1	15.9	18.2	50.0
Overall flows		13.0	16.9	28.2	41.9	100.0

Myth 2: Economic and financial integration go hand-in-hand

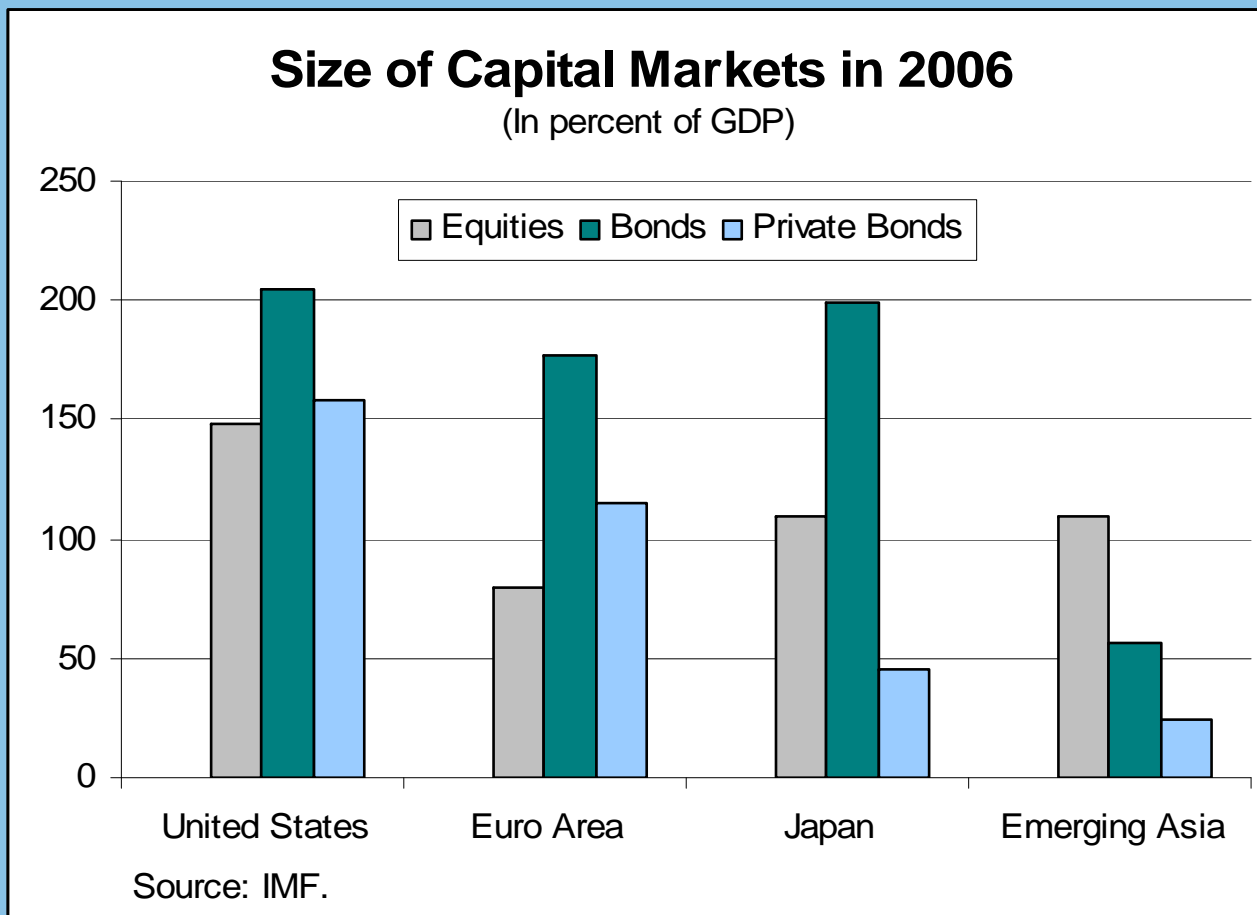
But bilaterally, intra-Asian investment is small

Share of portfolio investment in 2005, total US\$52 trillion
(Percent)

		Investment from :				Total
		Asia	US	EU5	Others	
Investment in :	Asia	0.4	1.7	0.9	1.2	4.2
	US	1.7	-	2.1	6.5	10.2
	EU5	1.2	2.8	4.5	7.3	15.8
	Others	2.1	4.4	6.7	6.5	19.7
	Total	5.4	8.9	14.2	21.5	50.0
Overall inv.		9.7	19.1	30.0	41.2	100.0

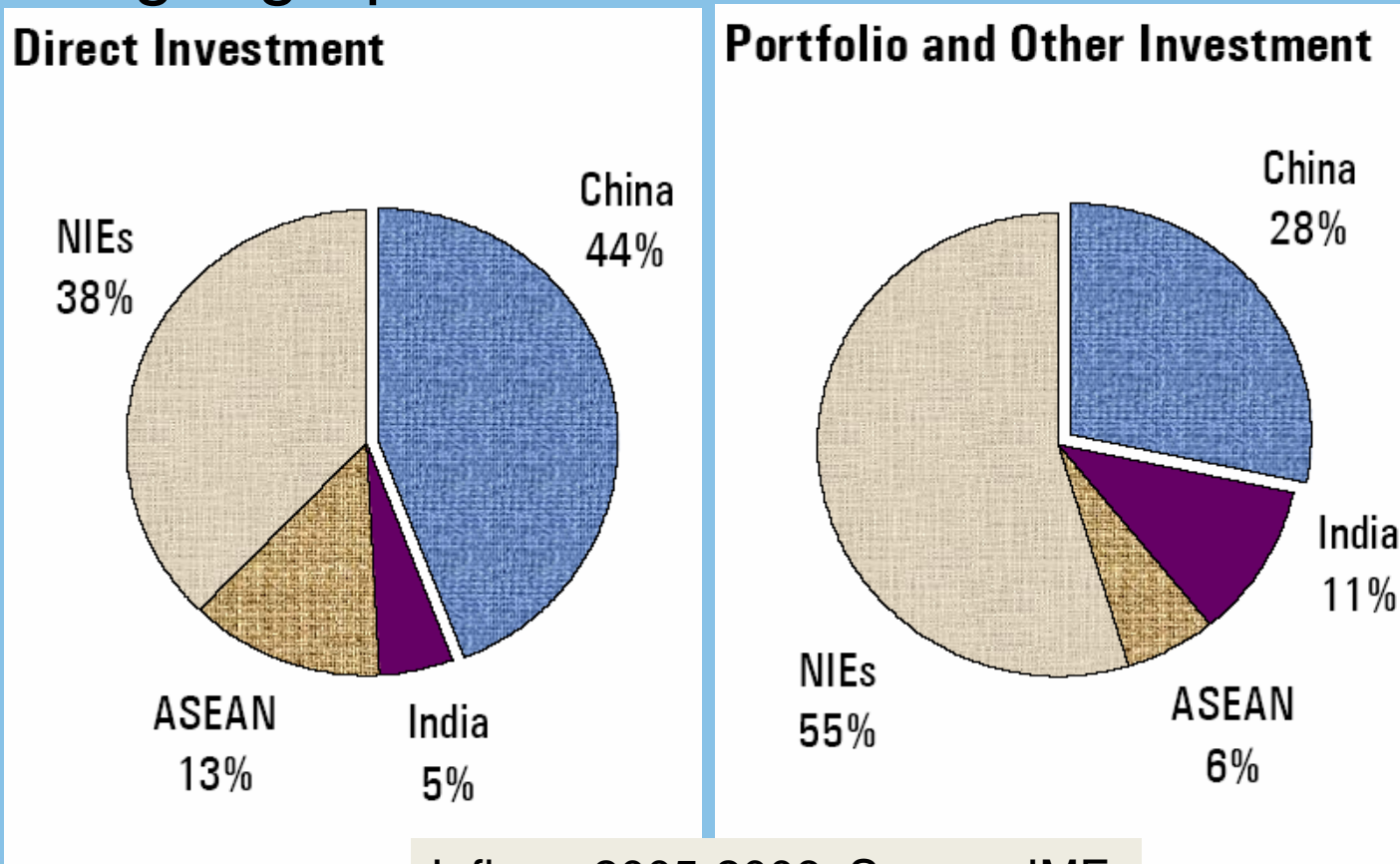
Myth 2: Economic and financial integration go hand-in-hand

In part this reflects lagging bond markets



Myth 2: Economic and financial integration go hand-in-hand

... and remaining capital controls, affecting the geographic breakdown of inflows...

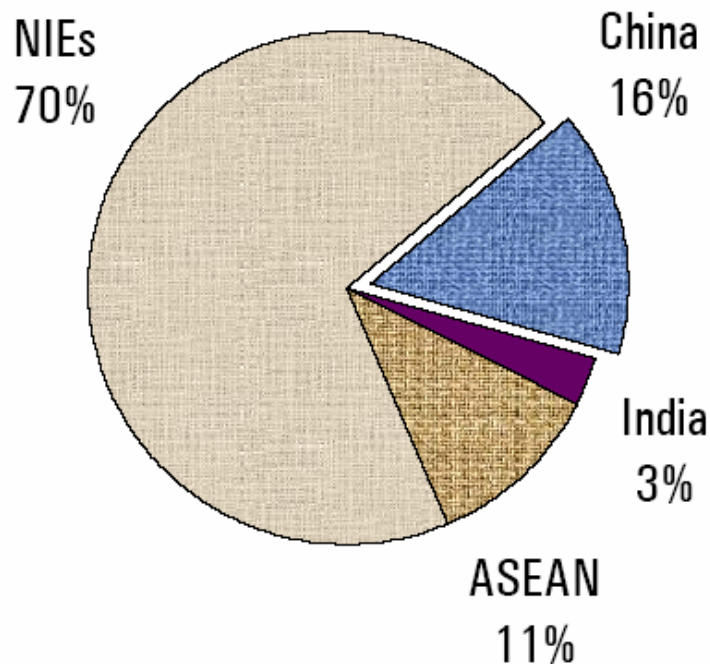


Inflows 2005-2006; Source: IMF.

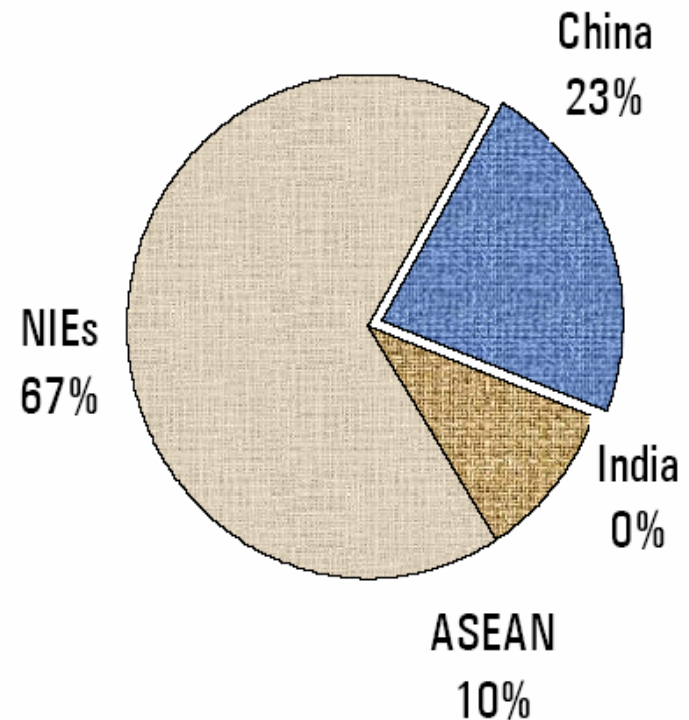
Myth 2: Economic and financial integration go hand-in-hand

... and outflows.

Foreign Direct Investment



Portfolio and Other Investment



Outflows 2005-2006; Source: IMF.

Myth 2: Economic and financial integration go hand-in-hand

In China, quotas remain small

- QFII at US\$30 billion < 0.7% of market
- QDII at RMB 90 billion < 0.5% of HK market
 - Performance hampered by limits on asset classes and choice of foreign markets
 - Interest in funds declined with the recent stock market slump

Consequences: Real and financial linkages to the rest of the world remain key

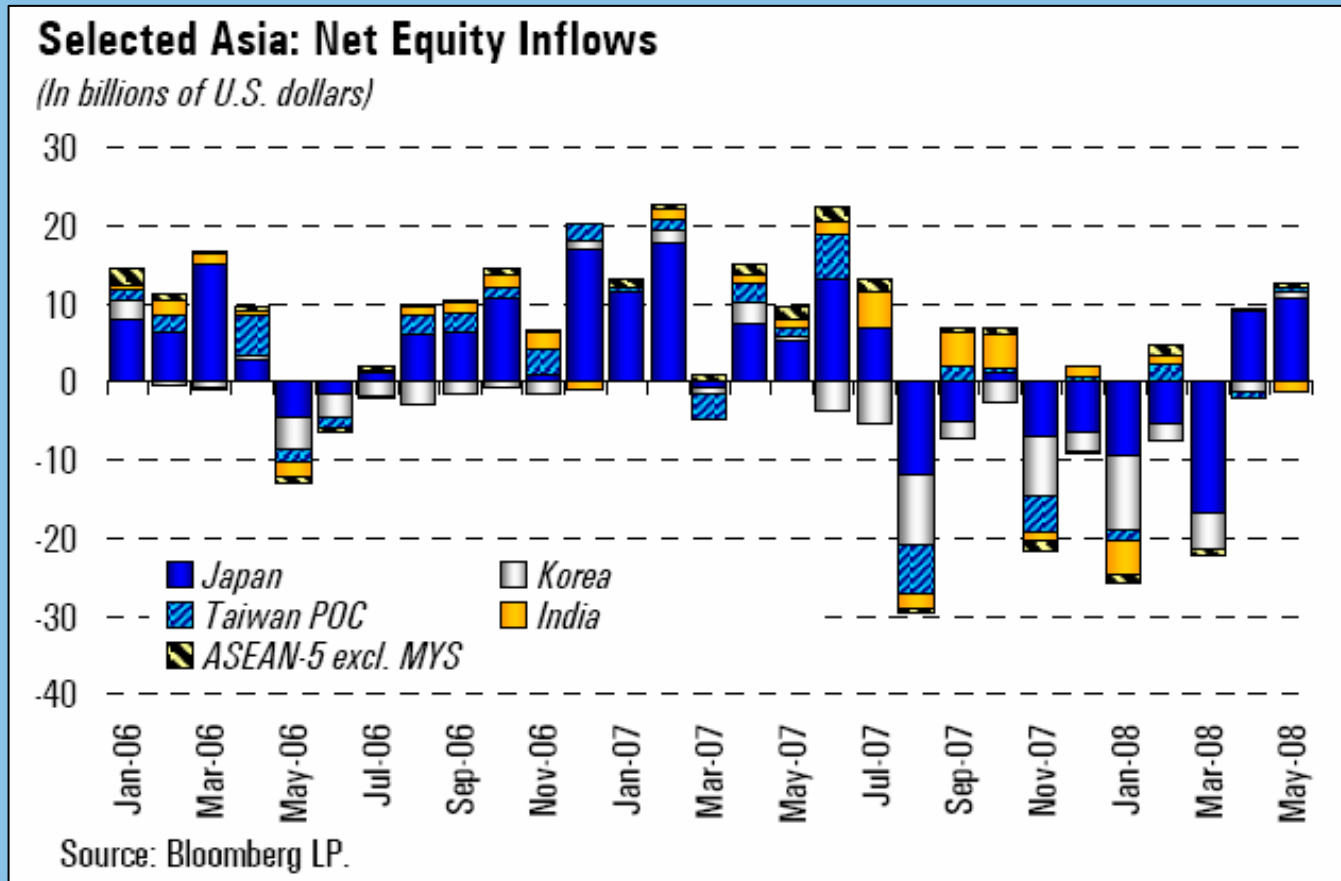
Growth has become more synchronized with US

Growth Correlation with the United States		
	1990-96	2000-07
Japan	-0.06	0.41
Australia	0.74	0.38
New Zealand	0.28	0.23
China	...	0.08
India	...	0.14
Hong Kong SAR	0.16	0.61
Korea	-0.32	0.30
Singapore	0.31	0.62
Taiwan FCC	0.24	0.61
Indonesia	0.06	0.05
Malaysia	-0.26	0.52
Philippines	0.28	0.47
Thailand	-0.20	0.47
Vietnam	...	0.20

Sources: OECData Company Ltd.; and IMF staff calculations.

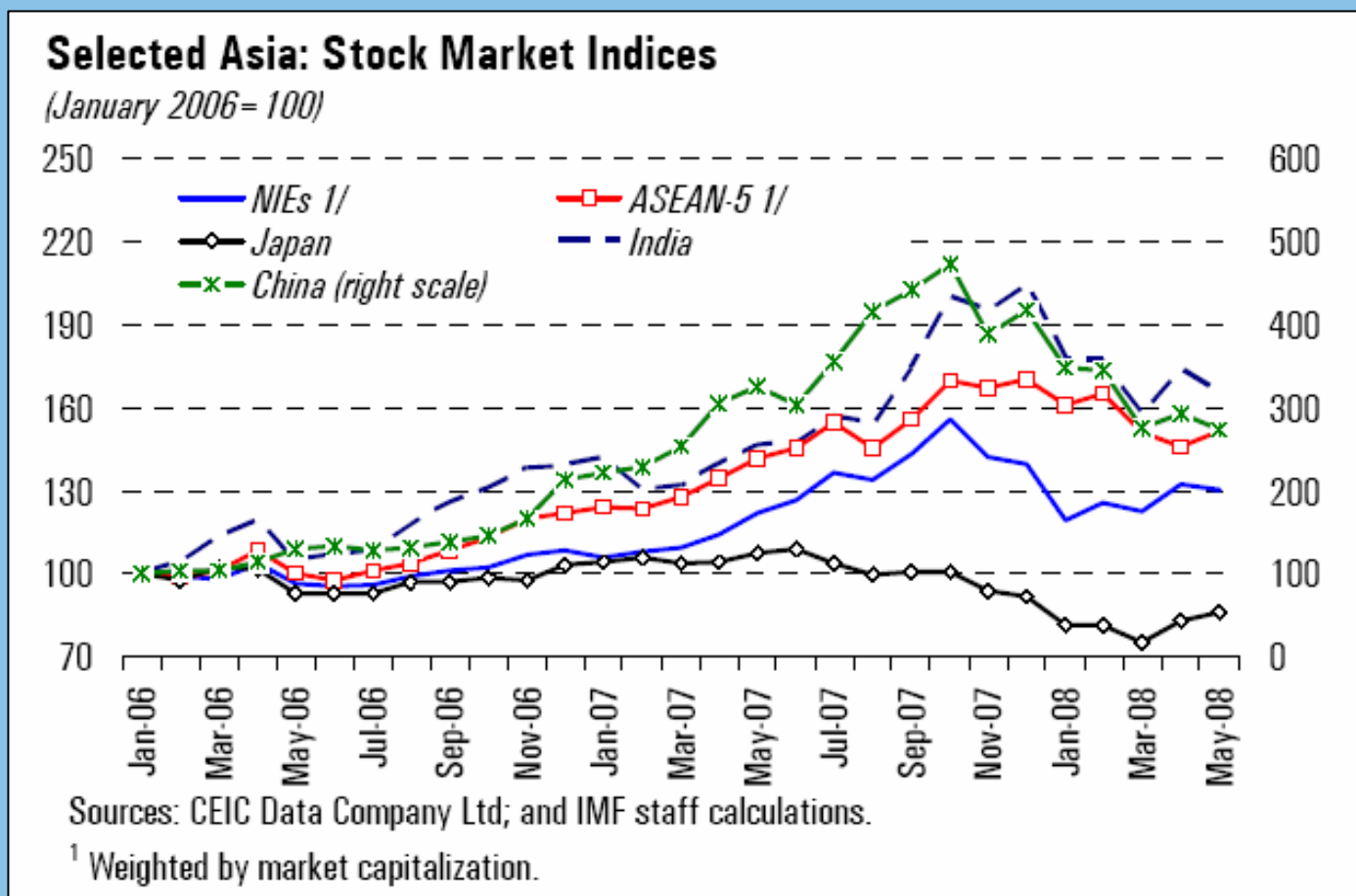
Consequences: Real and financial linkages to the rest of the world remain key

Asia has not been immune to global sell-off



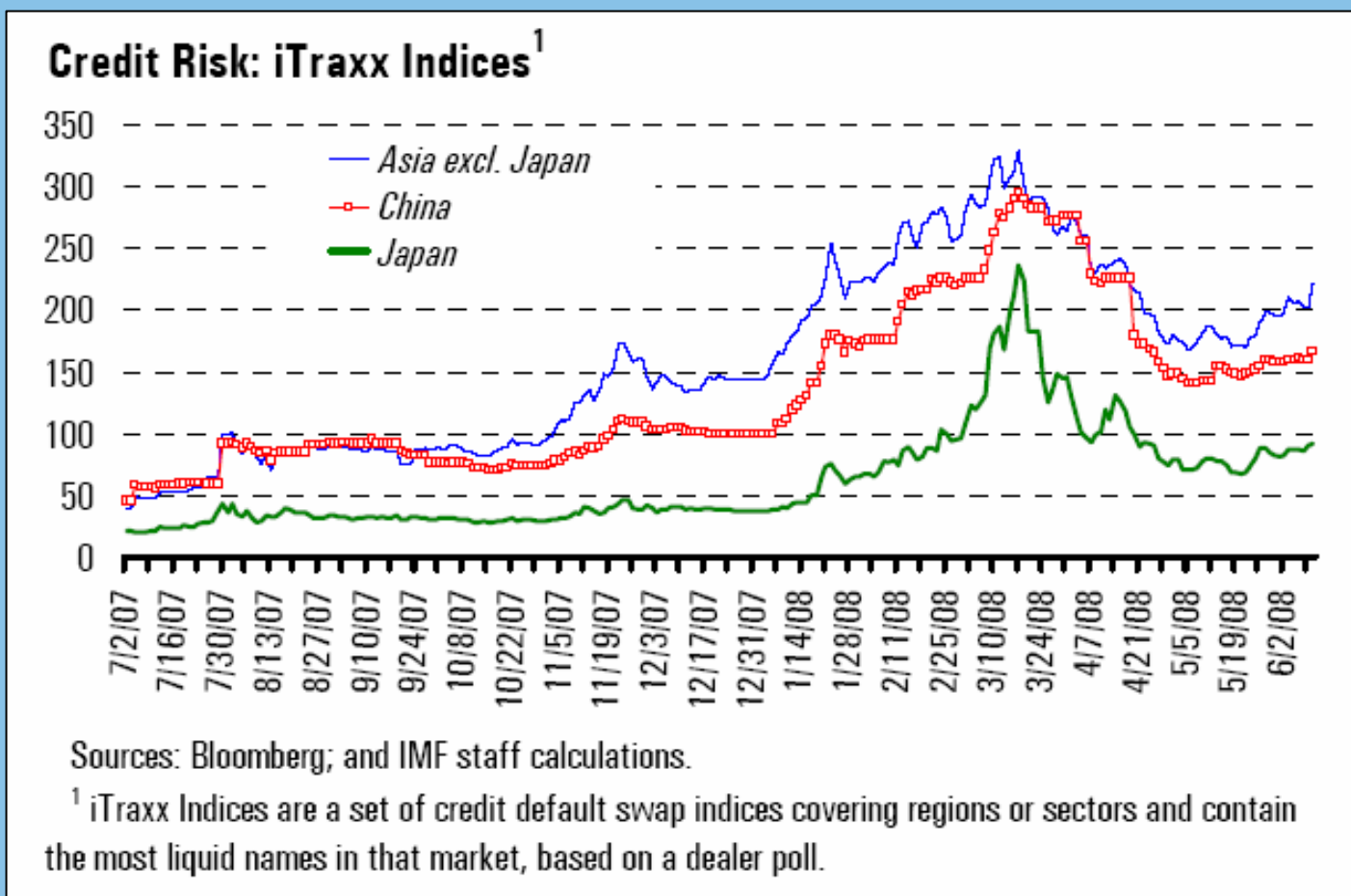
Consequences: Real and financial linkages to the rest of the world remain key

Stock markets have seen major declines



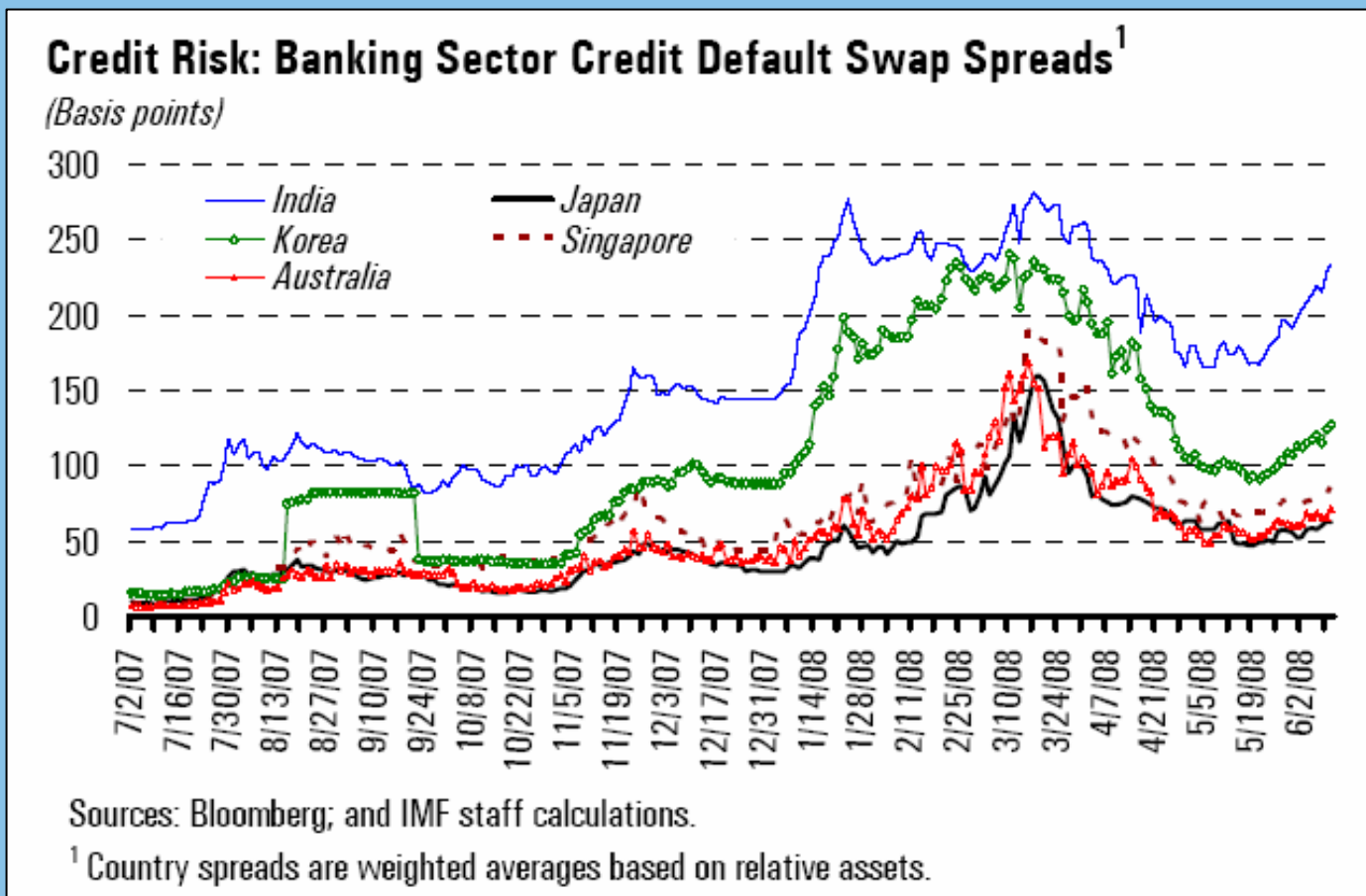
Consequences: Real and financial linkages to the rest of the world remain key

Credit risks have been repriced



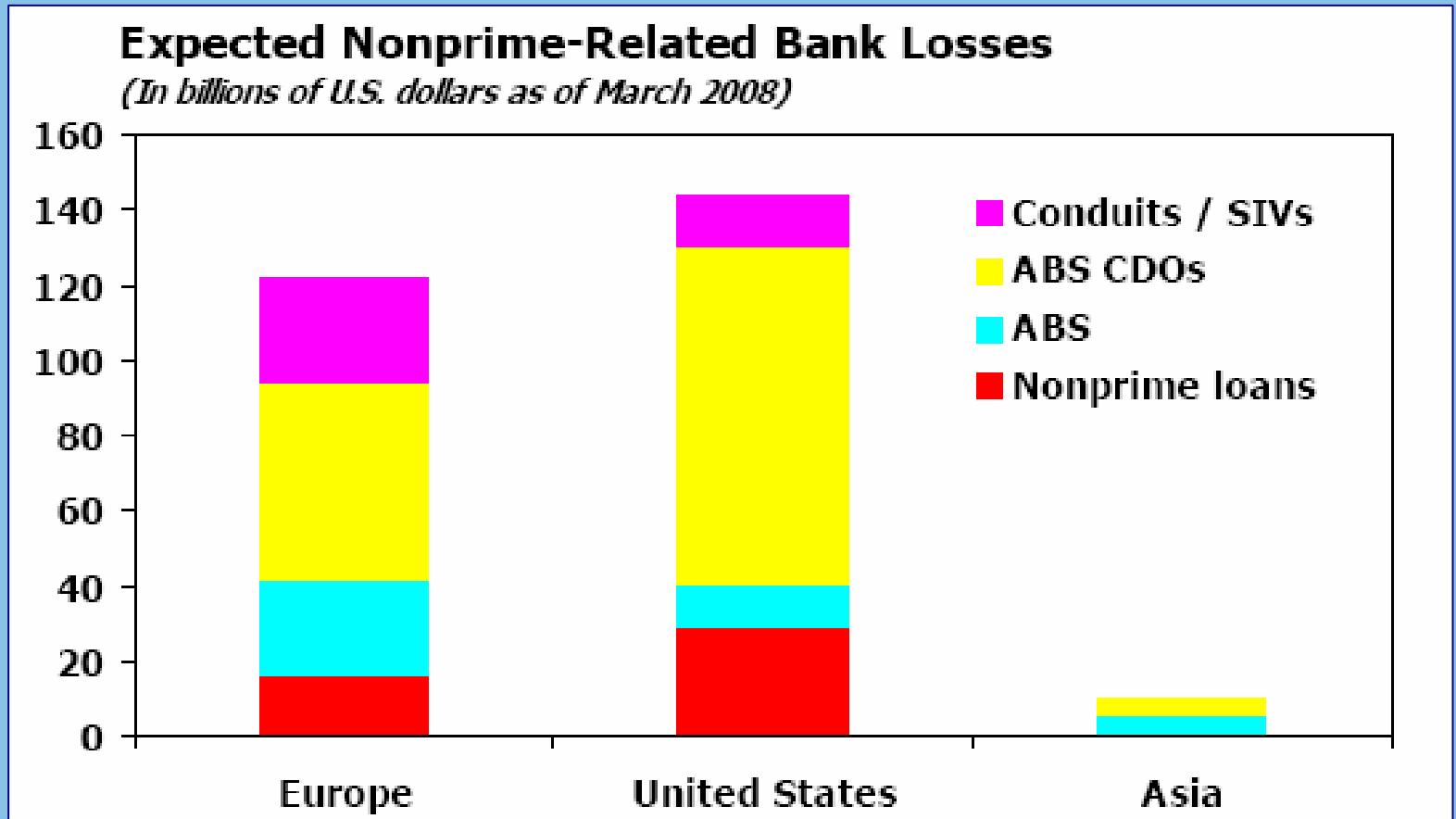
Consequences: Real and financial linkages to the rest of the world remain key

... including for banks



Consequences: Real and financial linkages to the rest of the world remain key

... although the direct subprime exposure is small



Outlook for Hong Kong: China's financial opening will be key

China offers significant potential for portfolio flows:

- HKMA study based on PF flows in OECD
- Assume China is as open as OECD
- PF outward investment would be US\$340 bn
- This is three times the actual level

Outlook for Hong Kong: China's financial opening will be key

Hong Kong is already China's key intermediary

A. Share of FDI flows in 2006, total US\$183 billion
(Percent)

	Investment from :											Total outflows
	HKG	CHN	India	IDN	JPN	KOR	MYS	PHI	SGP	TWN	THA	
HKG	-	7.3	-	-	1.8	0.1	-	-	0.7	0.3	-	10.2
CHN	15.2	-	-	0.1	4.1	3.0	0.3	0.2	1.8	2.9	0.2	27.8
India	-	-	-	-	0.4	0.1	-	-	0.2	-	-	0.6
IDN	0.0	-	-	-	1.1	0.2	0.0	-	-	-	-	1.3
JPN	0.1	0.0	0.0	0.0	-	0.0	0.0	0.0	0.0	0.1	0.1	0.3
KOR	0.0	0.2	-	-	0.3	-	0.0	-	0.1	-	-	0.7
MYS	0.0	0.1	0.0	0.0	0.1	0.1	-	-	0.3	0.1	-	0.7
PHI	0.0	0.0	0.0	-	0.5	0.0	0.0	-	0.1	0.0	0.0	0.7
SGP	0.2	0.0	0.0	0.1	1.4	0.2	-	-	-	0.5	0.0	2.5
TWN	0.0	-	-	0.0	0.5	-	0.1	0.0	0.3	-	0.0	0.9
THA	0.4	0.0	0.0	0.0	2.1	0.1	0.0	0.0	1.4	0.2	-	4.4
Total inflows	16.1	7.6	0.0	0.3	12.3	3.7	0.5	0.2	4.9	4.1	0.3	50.0
Overall flows	26.3	35.5	0.6	1.6	12.6	4.4	1.2	0.8	7.4	5.0	4.6	100.0

Note : Absolute values of flows are used in the calculation.

Outlook for Hong Kong: China's financial opening will be key

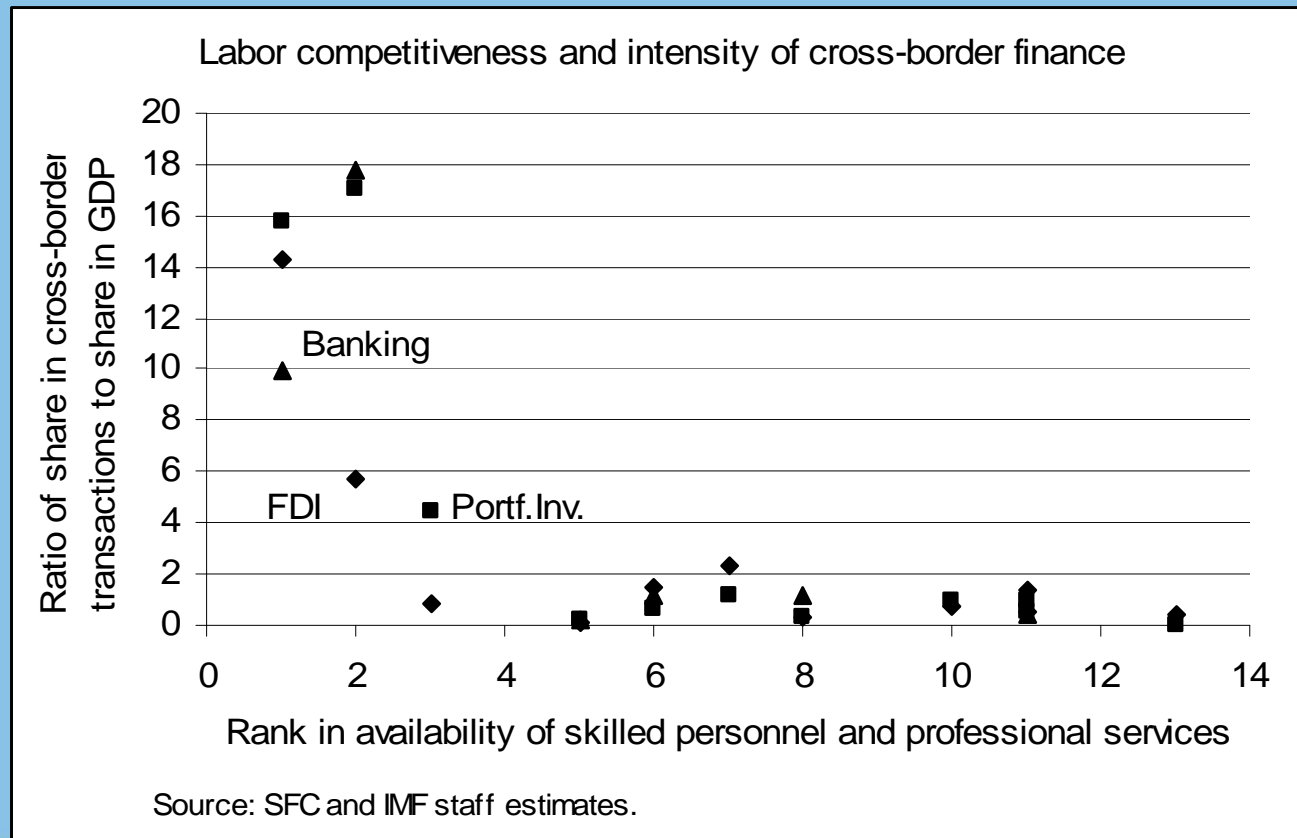
...both for FDI and portfolio investment

B. Share of portfolio investment in 2005, total US\$401 billion
(Percent)

	Investment from :											Total
	HKG	CHN	India	IDN	JPN	KOR	MYS	PHI	SGP	TWN	THA	
HKG	-	-	0.0	0.0	2.2	0.3	0.0	0.0	3.4	-	0.0	6.0
CHN	10.3	-	-	0.0	1.0	0.0	0.0	0.0	0.8	-	0.0	12.2
India	0.5	-	-	0.0	0.7	0.1	0.0	0.0	0.6	-	0.0	1.9
IDN	0.1	-	0.0	-	0.1	0.0	0.0	0.0	1.6	-	0.0	1.9
JPN	4.2	-	0.0	0.0	-	0.4	0.0	0.0	2.2	-	0.0	6.8
KOR	3.1	-	-	0.0	1.9	-	0.0	0.0	2.3	-	0.0	7.2
MYS	1.0	-	0.0	-	0.3	0.1	-	0.0	4.2	-	0.0	5.6
PHI	0.3	-	0.0	0.0	0.3	0.0	0.0	-	0.2	-	0.0	0.9
SGP	1.8	-	0.0	0.1	1.1	0.1	0.2	0.0	-	-	0.0	3.3
TWN	1.1	-	-	0.0	0.3	0.0	0.0	-	0.8	-	-	2.3
THA	0.6	-	0.0	0.0	0.2	0.0	0.0	0.0	1.1	-	-	1.9
Total	22.9	-	0.0	0.1	8.3	0.9	0.3	0.1	17.2	-	0.2	50.0
Overall inv.	28.9	12.2	1.9	2.0	15.1	8.1	5.9	1.0	20.5	2.3	2.1	100.0

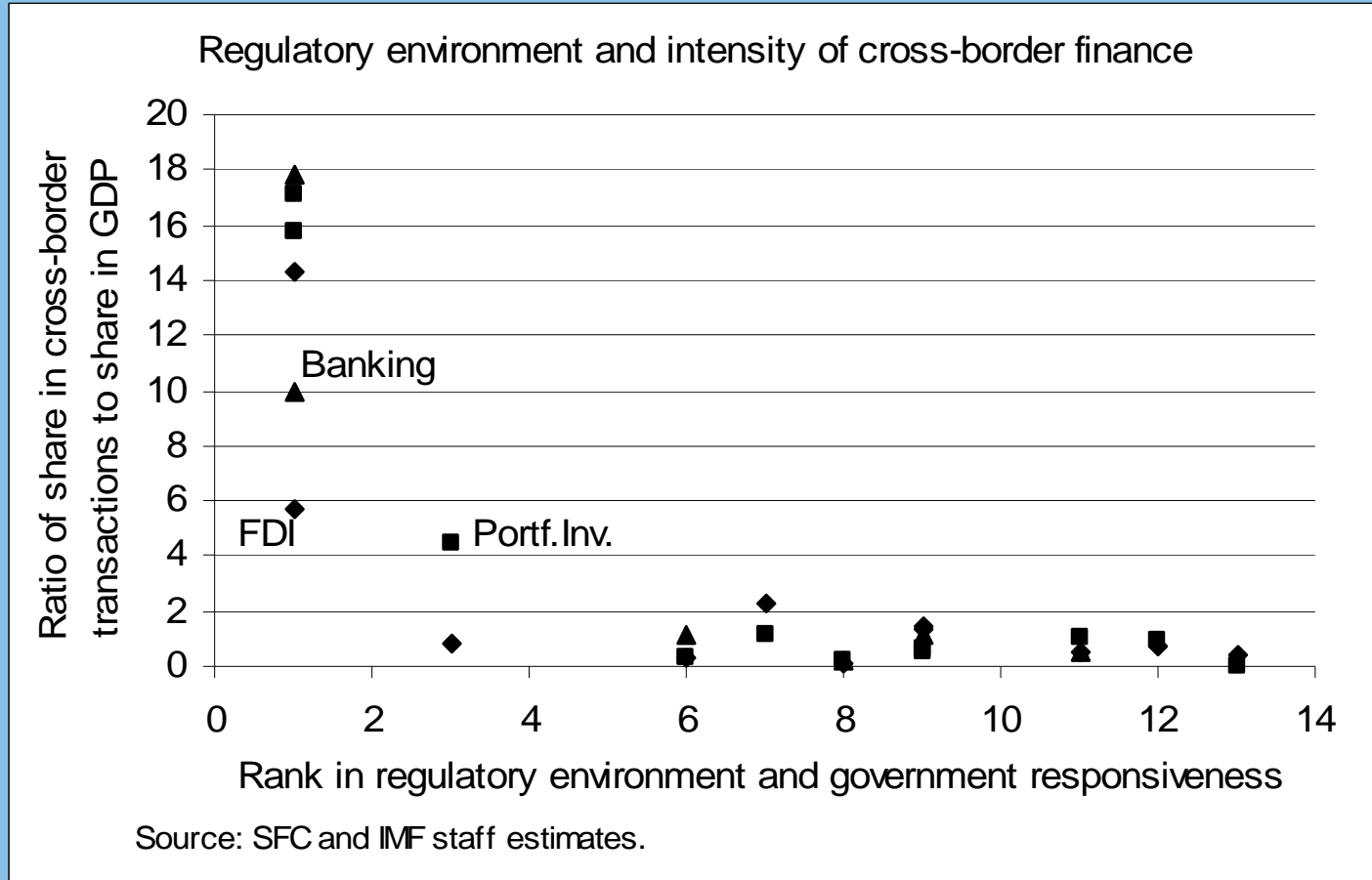
Outlook for Hong Kong: China's financial opening will be key

Hong Kong offers proximity and supply-side advantages, such as skilled labor...



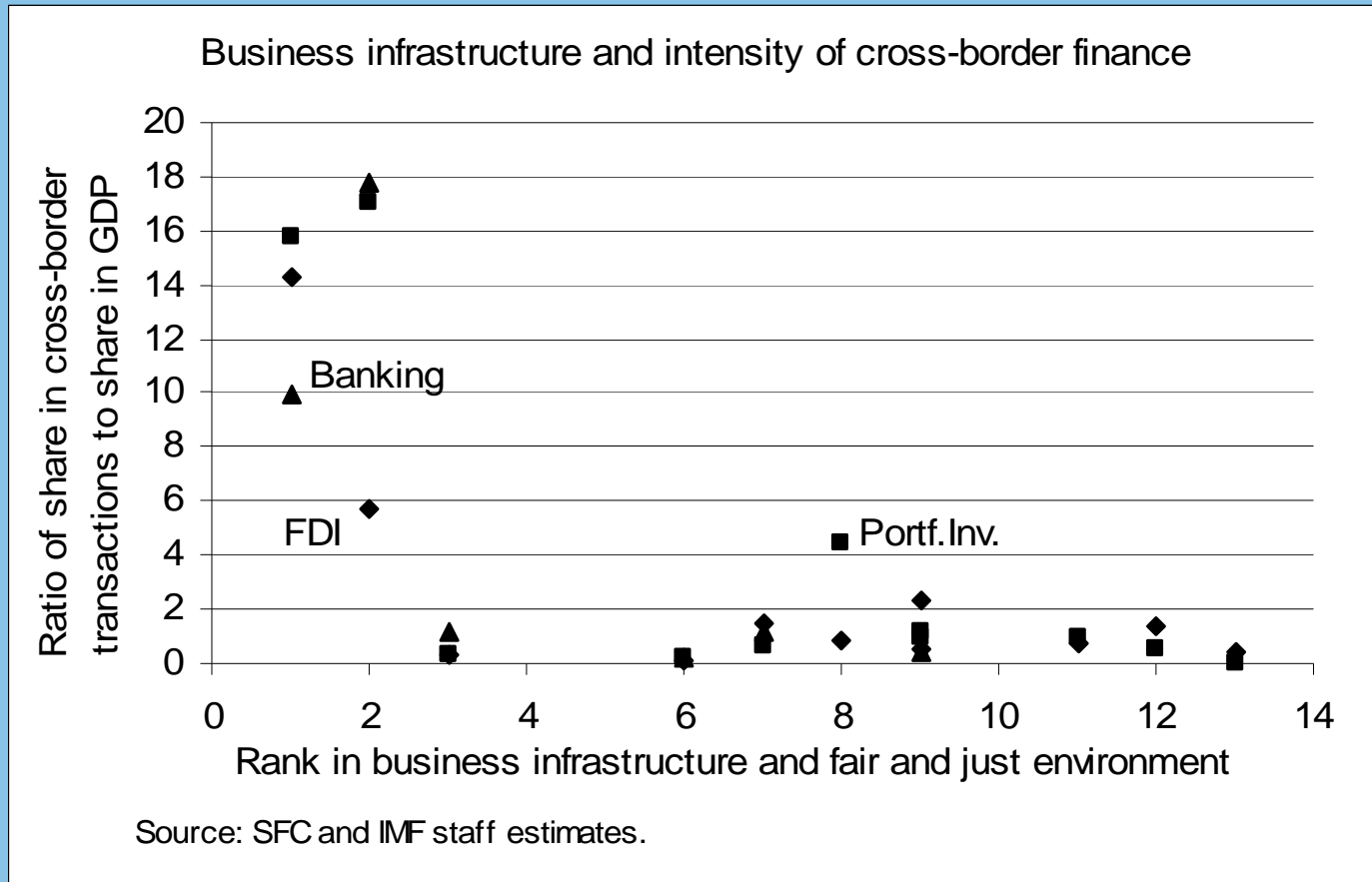
Outlook for Hong Kong: China's financial opening will be key

...regulatory environment...



Outlook for Hong Kong: China's financial opening will be key

...and business infrastructure.



Outlook for Hong Kong: China's financial opening will be key

- Recent administrative measures seem to underscore Hong Kong's privileged role
 - Mainland fund managers to establish subsidiaries here
 - Expansion of QDII
 - “Through train” pilot scheme
 - RMB bond issuance
 - IPOs of large Mainland banks

Outlook for Hong Kong: China's financial opening will be key

- *Longer term* :
 - How can HKSAR maintain its first-mover advantage?
 - Preeminence of financial centers can last long-time
 - But competitive strengths geared toward less China-centric model should be bolstered early

Outlook for Hong Kong: China's financial opening will be key

- Building an IFC without a hinterland would require:
 - Maintaining edge on labor, regulation and business infrastructure
 - Improving English language skills across all sectors of society
 - Further enhance quality of life
 - Developing new markets and instruments?

Thank You