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China: Engine of Growth?

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Exports have become one of the major contributors to U.S. economic growth, offsetting losses from the homebuilding industry and providing support for a – so far – remarkably resilient manufacturing sector. Developing Asia has become not only a source of imports into the United States but also an important destination for U.S. exports. Almost 20% of U.S. exports go to the developing Asian countries, and China takes in over 30% of them.

China is the third largest importer, after Canada and Mexico, of U.S. manufactured goods: In 2007, China for the first time imported more U.S. goods than Japan did, for a total value of over $65 billion. U.S. exports to China have been growing at a rapid 24% per annum pace over the last five years, according to data compiled by the U.S. Department of Commerce.

Has developing Asia, with China at its core, become a relatively autonomous center of growth, one capable of providing some support and stability to global growth, in sharp contrast to the external demand-driven economy it was a decade ago? Although the still relatively small size of China's economy – $2.6 trillion compared to the United States' $13 trillion – does not allow for far reaching conclusions, recent data suggests that regional economic dynamics has shifted in the direction of greater internal Asian sustainability.

As the U.S. and European economies slow, China becomes the pivotal country to watch for signs of global economic weakness or resilience. So far growth in China remains robust, even if moderating somewhat from the last year's almost 12% pace. First quarter real GDP increased by an annualized 10.6% and China's leading economic indicators have rebound recently from last year's lows: their current level implies 10% and 10.5% real GDP growth in the next two quarters.

China's exports have remained robust so far, supporting the decoupling theses. Almost half of China's exports, however, are to developing countries and 70% of them go to developing Asia where economic activity historically has been driven by external demand, mostly from developed countries. The question then arises: How much of China's exports to the region are dependent in turn on the ultimate demand from the developed world?

To measure the resilience of China's Asian trade to changes in the region's exports to the rest of the world we estimated an econometric model*. Specifically, we examined China's trade with four major Asian economies: Korea, Taiwan, Malaysia, and Thailand. We found that China's exports to developing Asia are sensitive to ultimate external demand from the rest of the world. But there is not a one-to-one correspondence: Except for Thailand, the impact of a change in ultimate external demand for the region's exports is somewhat muted in magnitude when it comes to China's regional trade.

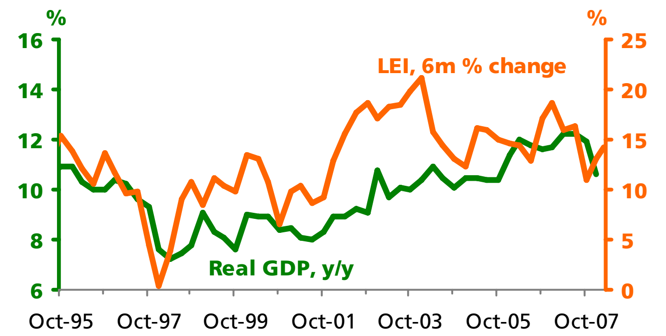
For Every 1% Change In A Country's Annual Export Growth To The World, China's Exports To That Country Change As Follows:

	AR(1)	OLS
Malaysia	0.31%	0.15%
Thailand	1.50%	1.19%
Korea	0.74%	0.46%
Taiwan	0.19%	0.39%

Source: ING IM estimates

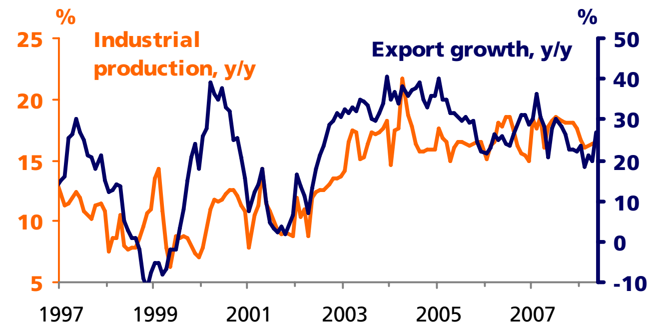
This analysis suggests that China has developed a regional trade buffer to mitigate an immediate adverse impact of global slowdown. But even if slowing demand from the developed countries finally affects China's export growth, that alone should not necessarily derail its economy. China's industrial production growth historically has been independent of the global business cycle and policy responses from the government have been able to smooth external shocks to the economic growth. Short of a global recession, China's economic activity and regional trade should remain relatively stable. ■

China's Leading Economic Indicators Imply 10-10.5% Real Economic Growth In The Current And Next Quarter.



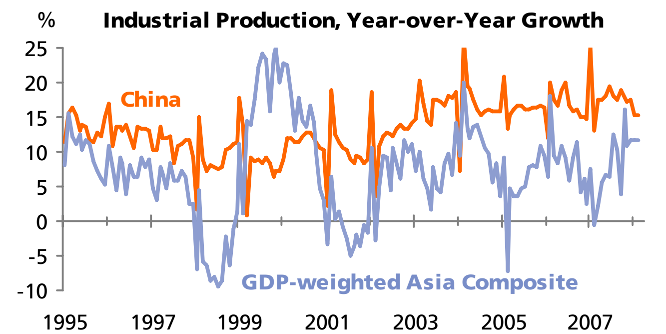
Source: Bloomberg

China's Industrial Production And Export Growth Remain Robust So Far.



Source: Institute of International Finance

China's Industrial Production Does Not Follow The Same Cycle As The Rest Of External Demand-Driven Region.



Source: Institute of International Finance

* *Because model results using time series data can vary with econometric techniques, the model was estimated using two procedures: maximum likelihood estimation with a first order autocorrelation parameter (AR1), and ordinary least squares (OLS). The dependent variable is China's exports to a country and independent variables are country's exports to the rest of the world and a one month lagged dependent variable. The data are the year-over-year percent change in exports from January 1995 to February 2008.*