

APPROVED FOR
RELEASE DATE:
30-Nov-2009

East Asia: Trade Shocks Loom

Selected East Asian Countries: Total Exports to US and Other Countries, 1986-96

in a "deepening crisis" scenario, imports next year by South Korea and the ASEAN-Four--Indonesia, Malaysia, Thailand, and the Philippines--would decline by \$110 billion, or 22 percent, from a forecast made just before the onset of the crisis. The scenario assumes Asian policymakers vacillate, leading to a chain of further bankruptcies, capital flight, debt restructuring problems or moratoriums, and a sharp constriction of investment.

- It assumes growth falls sharply in Southeast Asia, South Korea, and Japan, leading to further depreciation of these countries' currencies as well as slower growth in emerging markets worldwide.
- China and Hong Kong depreciate in this scenario, leading to a further round of depreciation in the rest of Asia and in Latin America.

Aggravating US Trade Deficit

A "deepening crisis" could cost the US as much as \$12.5 billion in exports to the ASEAN-Four and South Korea next year. The economic slowdown in these countries will entail large cutbacks in purchases of US capital and transportation equipment and consumer goods, which account for two-thirds of their imports from the US.

- US exports will be hurt more than Japanese or European exports because of the relatively stronger appreciation of the US dollar.

At the same time, currency depreciations will make exports from these countries more competitive globally, including in the US--which now absorbs 18 percent of ASEAN-Four and South Korean exports. The combination of cutbacks in imports and more competitive exports means the US will sustain larger trade deficits.

- these countries' total current account balances will improve by as much as \$32 billion next year.

The spillover of the crisis into other economies of the region--especially Japan, which together with ASEAN purchases one-third of ASEAN-Four and South Korean exports--would lead the East Asian

[Redacted]

countries to rely primarily on the US and European markets. A slowdown in intraregional trade could lead to a repeat of the situation of the mid-1980s, when the US absorbed one-half of these countries' capital equipment and consumer goods exports. [Redacted]

Mitigating Factors [Redacted]

The ability of East Asian exporters to step up foreign sales will depend on how quickly they ramp up production, forge new distributor relationships, and obtain short-term financing to cover trade transactions. Plummeting regional demand could reduce cash-flows for these firms and hinder banks' willingness to finance current operations.

[Redacted]

In an alternate scenario--"slump, then rebound"--East Asian governments pursue effective crisis management, limiting outright recession to South Korea, Thailand, and Japan. The US trade deficit next year rises in this scenario but by less than in the "deepening crisis" scenario. [Redacted]

~~Confidential~~ [Redacted]

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