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Economics Group

Special Commentary

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How Important is China to Other Asian Economies?

Executive Summary

The financial volatility that has emanated from China in recent weeks has spilled over to other Asian economies. China has clearly become more economically integrated with its Asian neighbors over the past two decades or so, and deceleration in the world's second largest economy undoubtedly will exert a slowing effect on other Asian economies. Exactly how exposed are these economies to China?

Final spending in China accounts for 8 percent or more of value added in some small open economies in the region such as Hong Kong, Taiwan and Malaysia. However, for some larger economies, such as India and Japan, final spending in China accounts for much smaller percentages of value added in these economies. Indeed, final spending in the United States is equally important today to the entire Asian region as final spending in China. As long as real GDP growth in the United States, the world's largest economy, remains solid, non-Chinese Asian economies are not likely to crash and burn.

China is An Important Economic Engine for Some Asian Economies

The volatility in the Chinese stock market in recent weeks and continued signs of slowing growth in that country raises questions about which Asian economies would be most negatively affected by economic fallout from China. At the advent of the Asian economic crisis in 1997, China's economy, the seventh largest in the world at the time, was only about one-tenth the size of the American economy. By last year, however, the $10.4 trillion worth of GDP that China produced was second only to the $17.4 trillion U.S. economy in terms of individual economy size.[1]

China now takes in 13 percent of the region's exports.

Not only has China increased its importance in terms of global GDP, but it is a much more important trading partner for many economies, especially those in Asia, than it was two decades ago. As shown in Figure 1, "Asia" sent about 8 percent of its exports to China at the beginning of the Asian economic crisis nearly 20 years ago.[2] That proportion is now more than 13 percent. Moreover, the increasing importance of China as a trading partner is a broad-based phenomenon across the region. For example, Indonesia and Malaysia send a much higher proportion of their exports to China than they did 20 years ago (Figure 2). China's share of Japanese exports has shot up from about 5 percent in the mid-1990s to an incredible 18 percent today. Mainland China takes in more than half of Hong Kong's exports, which is equivalent to about 25 percent of GDP in Hong Kong.

[1] We convert GDP in different countries into U.S. dollar terms using market exchange rates. If the Eurozone is considered to be one economy, then its $13.4 trillion worth of GDP would make it the world's second largest economy.

[2] We include the IMF aggregate of "Emerging and Developing Asia" as well as Australia, Japan, South Korea, New Zealand, Hong Kong and Singapore in our definition of "Asia."

Figure 1

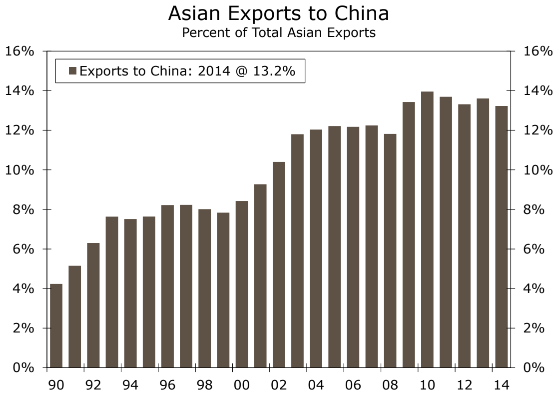
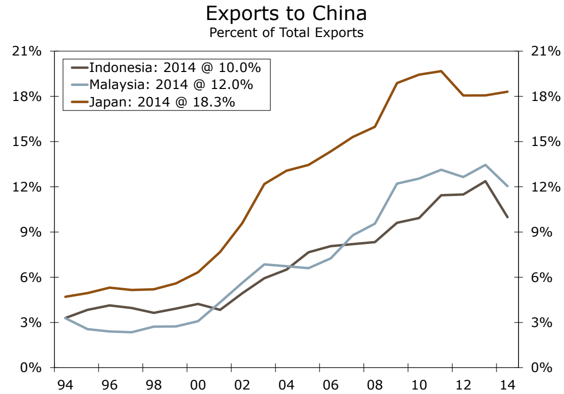


Figure 2



Source: International Monetary Fund and Wells Fargo Securities, LLC

Export-to-GDP ratios overstate China's economic "pull" on the region.

As we have discussed previously, however, simple export-to-GDP ratios are not the best way to measure the economic effect that one country has on another economy.[3] China is the "factory of the world" and many of the country's imports are reassembled into finished goods which are subsequently exported by China. Therefore, what is arguably more important for any country is not the amount of its exports that initially head to China (and which are captured by export data), but the amount of that economy's exports that ultimately end up in other countries in the form of finished products. As we have argued previously, the best way to measure the "true" economic effect that China has on other countries in the Asian region is via the contribution that its final domestic demand (i.e., final spending by Chinese consumers, businesses and the government) makes to value added in those other economies.

Figure 3

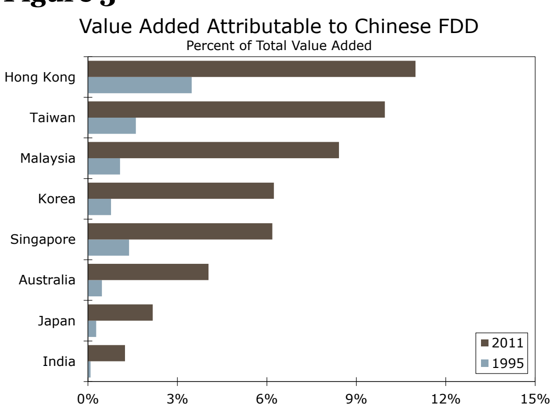
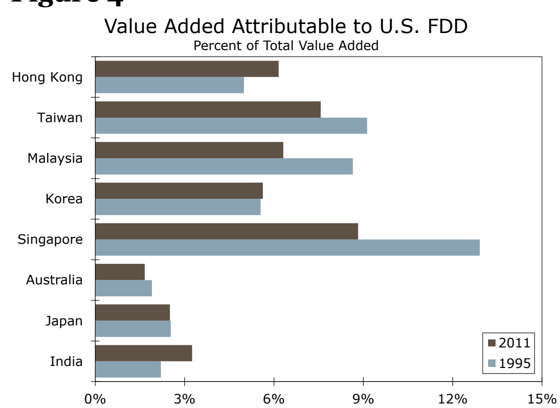


Figure 4



Source: Organisation for Economic Cooperation and Development and Wells Fargo Securities, LLC

As shown in Figure 3, final domestic demand (FDD) in mainland China accounts for 11 percent of value added in Hong Kong, clearly an impressive figure but not as high as the exports-to-GDP figure which was noted previously. In short, many of Hong Kong's exports to China are assembled into finished products on the mainland and then subsequently re-exported. FDD in China also accounts for fairly high percentages of value added in Taiwan and Malaysia. At the other end of the spectrum, Japan and India have much less direct exposure to FDD in China than do the

[3] **See "How Exposed Is the U.S. Economy to China?" (August 13, 2015) and "Could Developing Economies Take Down Developed Economies?" (August 21, 2015). Both reports are available upon request.**

economies of "Greater China." What sets Japan and India apart from Taiwan and Malaysia is that the former are relatively large economies in their own right.

How Important is the U.S. Economy for the Region?

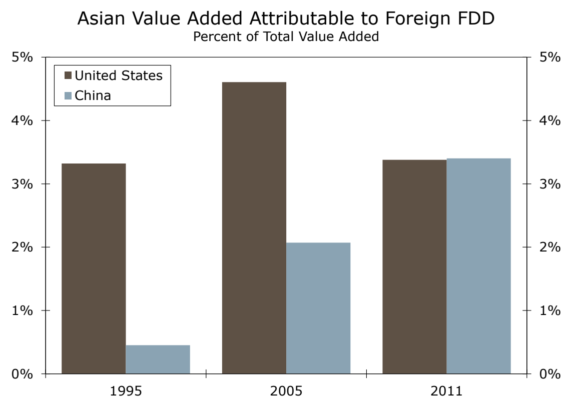
To compare the relative economic importance of China and the United States for individual Asian economies, we performed similar calculations for American FDD. The results are plotted in Figure 4. For most economies in Asia, China is more important than the United States in terms of value added in those economies. For example, 10 percent of Taiwanese value added is attributable to FDD in China whereas the comparable ratio for the United States is less than 8 percent. However, there are some individual economies in Asia (e.g., Singapore, Japan and India) for which FDD in the United States is more important than FDD in China. We refer interested readers to the appendix, where we offer a more complete look at the relative economic importance of China and the United States for individual Asian economies.

In terms of the overall region, we noted above that exports to China have risen from about 8 percent of regional exports 20 years ago to 13 percent today. In contrast, Asia's export share to the United States has trended lower over the past two decades (Figure 5). Despite this decline in export share, FDD in the United States is as important today for regional value added as it was in the mid-1990s. Specifically, more than 3 percent of value added in the total Asian region (excluding China) is attributable to final spending by the U.S. consumer, business and government sectors, which is unchanged from the ratio from 20 years ago (Figure 6). Although the relative importance of the Chinese economy to other Asian economies has clearly increased over the past two decades (Figure 3 and Figure 6), final spending in the United States is equally important today to these economies as final spending in China.

Final spending in the United States is equally important today to Asian economies as final spending in China.

Figure 5

Figure 6



Source: International Monetary Fund, Organisation for Economic Cooperation and Development, and Wells Fargo Securities, LLC

What likely has occurred over the past two decades is that Asian exports of raw materials and intermediate inputs that were once destined for the United States now are shipped to China instead. Those raw materials and intermediate inputs are assembled into finished goods in China and then re-exported to the United States. Just like 20 years ago, the United States is the final destination for many Asian exports. Unlike two decades ago, however, those exports first transit through China before ultimately ending up in America.

As we have noted previously, the United States is about twice as important to the global economy as China. Specifically, final spending in the United States accounts for roughly 3 percent of global value added. The comparable ratio for China is about 1.5 percent.[4] China may be the world's factory, but the United States remains the world's consumer. The Chinese economy may

[4] **See "How Exposed Is the U.S. Economy to China?" which was referenced in footnote #3.**

decelerate further in the next year. However, as long as the U.S. economy does not falter, the entire global economy is not likely to do so either.

Conclusion

China has become more economically integrated with its Asian neighbors over the past two decades or so, and final spending in the world's second largest economy accounts for more value added in non-Chinese economies in Asia than it did in 2005, let alone two decades ago. Final demand in China is especially important for value added in smaller economies in "Greater China" such as Hong Kong and Taiwan.

Despite the geographical proximity of China to its Asian neighbors, the United States is just as important economically to those economies as China. That is, final spending in the United States is equally important today to these Asian economies as final spending in China. Economic growth in the world's second largest economy will likely continue to slow in coming quarters. However, as long as real GDP growth in the United States, the world's largest economy with twice as much global "pull" as China, remains solid, non-Chinese Asian economies are not likely to crash and burn.[5]

[5] **We forecast that U.S. real GDP will grow 2.1 percent in 2015 and 2.5 percent in 2016. Our forecasts for global growth are 3.0 percent this year and 3.5 percent next year. See our "Monthly Economic Outlook," which is posted on our website.**

Appendix

	Value Added Attributable to Foreign FDD					
	1995		2005		2011	
	U.S.	China	U.S.	China	U.S.	China
Australia	1.9%	0.5%	2.4%	1.9%	1.7%	4.0%
Hong Kong	5.0%	3.5%	6.8%	6.5%	6.2%	11.0%
Japan	2.5%	0.3%	3.7%	1.3%	2.5%	2.2%
Korea	5.6%	0.8%	6.4%	3.8%	5.6%	6.2%
New Zealand	3.0%	0.5%	3.9%	1.4%	3.0%	2.6%
Singapore	12.9%	1.4%	12.2%	4.6%	8.8%	6.2%
Taiwan	9.1%	1.6%	9.6%	6.6%	7.6%	10.0%
Brunei	2.5%	0.6%	7.8%	3.1%	4.0%	5.8%
Cambodia	1.4%	0.4%	16.7%	0.8%	9.9%	1.8%
India	2.2%	0.1%	3.4%	0.8%	3.3%	1.2%
Indonesia	3.7%	0.5%	5.0%	1.8%	2.6%	3.0%
Malaysia	8.7%	1.1%	11.8%	5.4%	6.3%	8.4%
Philippines	7.2%	0.3%	6.8%	2.7%	4.1%	3.6%
Thailand	6.4%	0.6%	7.7%	2.5%	4.7%	4.9%
Vietnam	1.8%	0.9%	9.6%	3.5%	8.2%	5.3%

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