Research Focus

Pacific Economic Outlook 2005–2006: Regional imbalances threaten robust outlook

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The Pacific Economic Cooperation Council (PECC) recently released the Pacific Economic Outlook (PEO) 2005–2006 report, an annual forecast of 18 economies in the Asia Pacific region.

The PEO Forecasting Panel expects slower but still robust growth in the Asia Pacific region in 2005 after the significant economic expansion of 2004.

• The weighted average real GDP growth for PECC economies in 2004 was 5.4 per cent, up from 3.7 per cent in 2003. In 2005, growth for the region will moderate to 4.2 per cent.

• Inflation remains muted throughout the region, notwithstanding higher energy and non-oil commodity prices. Deflation in Hong Kong came to an end in 2004, and appears to have also ended in Japan.

• In East Asia, growth in 2005 will slow to 4.9 per cent from last year’s 6.5 per cent, which was the strongest since the 1997 financial crisis, while other PEO Asian economies will slow to 3.4 per cent from 4.9 per cent.

• In 2006, real GDP growth is expected to remain about the same as in 2005 — 4.3 per cent for the whole region, 5 per cent for East Asia and 3.3 per cent for other PEO Asian economies.

• Inflation will be muted throughout the region, notwithstanding higher energy and non-oil commodity prices. Oil prices are expected to average US$49.50 per barrel in 2005, up 19.3 per cent from the 2004 average, before falling to an average of US$41 a barrel in 2006.

The region’s strong performance in 2004 owes much to the traditional growth engines – United States and Japan. The United States economy expanded at a record-breaking clip in 2004. At 4.4 per cent real GDP growth, last year’s expansion was well above the historical average of 3 per cent in the last 25 years. Last year’s growth was led by very strong domestic demand, which saw a sharp increase in imports and further widening of the current account deficit. US growth is expected to taper off to around 3.5 per cent in 2005 and 3.3 per cent in 2006. After the sharp fiscal stimulus of the last two years, we expect fiscal policy to be neutral in 2005 and beyond. Monetary policy, on the other hand, remains expansionary despite a steady increase in interest rates since the middle of 2004. Tightening will continue through 2006 and 2007, but will not have a contractionary effect on the economy until the beginning of 2007.

The Japanese economy ended 2004 on an anticlimax, with fears that the nascent recovery had hit a speed bump and might even slip back into recession. For 2005 as a whole, real GDP growth is expected to be 1.3 per cent, which still counts as a decent performance for Japan given the past decade or so of recession-like conditions. The economy will continue to expand in 2006, with real GDP growth around 1.6 per cent. Thus the Japanese economy looks to be coming out of a decade-long slump, as well as an end to deflation.

Fears of a hard landing in China did not materialise in 2004. Rather, the economy has continued on its breakneck pace of expansion into the first half of 2005. The outlook for 2005 is for continued robust growth of 8.5 per cent, tapering to 8.2 per cent in 2006. Personal consumption will continue to gain importance in supporting Chinese growth, contributing 2.7 percentage points in 2005 and 3.2 percentage points in 2006. The primary driver of growth, however, will continue to be fixed asset investment, which is expected to slow to 16 per cent in 2005. The risk of a hard landing has diminished, but cannot be ruled out altogether. The current account surplus in China will rise from 2.4 per cent in 2004 to 3.1 per cent in 2005 and

Energy Policy

The Australia–Japan Research Centre is organising a series of video-conferences with the Asia-Pacific Energy Forum in Tokyo on energy policy and climate change. The Global Learning Development Network, hosted at the ANU by APSEG, is the venue for the events, which bring together experts from private and government Japanese think tanks, and government and non-government experts from Australia. Christopher Findlay coordinates the conferences which explore the scope for practical cooperation between Australia and Japan, and regional countries such as China, on steps to reduce greenhouse gas emissions consistent with the Kyoto Protocol on climate change.

Australia–Indonesia Young Leaders’ Dialogue

The third dialogue, organised by APSEG and the Habibie Center, will be held in Bandung on 16–19 July. This year’s theme is post-tsunami Indonesia-Australia relations. The aim of the dialogue is to promote bilateral awareness and understanding, by bringing together a spectrum of emerging opinion leaders from across both Indonesian and Australian society. The dialogue is an initiative of the Australia-Indonesia Institute and funded by the Australian Department of Foreign Affairs and Trade.

Events

5 July, Papua New Guinea Update (in association with the Lowy Institute), Sydney, at which APSEG Director Andrew MacIntyre is speaking.

School Seminars*

19 July, Hisa Matsushige (Osaka University), Human Resource Management in a small and medium-sized Japanese company

26 July, Ben Reilly (APSEG), Is there an ‘Asian’ model of democracy?

2 August, Chakriya Bowman (APSEG), Commodity currencies and cross-hedging

* Seminars are held at 12.30pm in Seminar Room 4, First Floor, Crawford Building
3.3 per cent in 2006, fuelling calls for early revaluation of the yuan and fanning protectionist sentiment in industrialized countries. Beijing’s response to these threats will be a barometer of financial stability in the region, and remains a major risk factor in this forecast. In the course of 2004, China overtook Japan as the second most important trading partner for many Asia Pacific economies and also overtook the United States as Japan’s most important trading partner.

Elsewhere in the region, Southeast Asia in 2004 produced its strongest growth performance since the 1997–98 financial crisis. The outlook for 2005 is for slower growth throughout the region, in part due to excessive expansion in such areas as construction and consumer spending, and also due to the less buoyant external demand. Despite the catastrophic human toll of the Indian Ocean Tsunami in the last days of 2004, the impact on overall economic output in affected Southeast Asian economies was relatively small. India is not part of the PEO group of economies and still a long way from joining the ranks of growth engines for the region, but it remains a major risk factor in this forecast. In the course of 2004, China overtook Japan as the second most important trading partner for many Asia Pacific economies and also overtook the United States as Japan’s most important trading partner.

There is a growing risk of conflict between Washington and Asian trading partners, especially China and other economies perceived to be ‘manipulating’ their currencies. The expiry of the World Trade Organisation’s Agreement on Textiles and Clothing at the beginning of 2005 has led to a sharp increase in Chinese apparel exports to industrialised countries, including the United States, which is adding to protectionist sentiment.

In the context of a trade and financial imbalance across the Pacific, the evolution of Asia-only regionalism could have adverse consequences for trans-Pacific economic and political relations. It is by no means inevitable that deeper integration on either side of the Pacific should lead to increased tension between the two sides, but there are a number of flash points around currency management, trade disputes and financial architecture — not to mention differences on political/security issues — that could lead to a more pronounced divide across the Pacific. The Asia Pacific Economic Cooperation (APEC) forum is the best (and only) body to forge stronger Pacific-wide ties, but there is a real danger of APEC members being increasingly distracted by regional and sub-regional priorities, eroding the commitment to the idea of an Asia Pacific community that has long been espoused by members of the Pacific Economic Cooperation Council. (PECC)

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**Short courses/training**

1–10 August, Leadership, management and governance in the public sector

1 August–21 October, University administration course for China Scholarship Council

29 August–16 September, Responsible parliamentary government

For more information contact Ms Ruth Tampipi, Professional Short Course Officer. ruth.tampipi@anu.edu.au or visit: http://apsec.anu.edu.au/exec/exec_short.php

**Publications**

Happy Isles in Crisis, Clive Moore

ISBN: 0 7315 3709 2, A$35 (inc GST), US$30

( the book traces the deep historical roots of the crisis in discontent, dissatisfaction and disaffection among the sometimes-disparate communities of the Solomon Islands over land and resources, the complex entwinement of traditional culture and modern society, poor governance and poor economic performance).

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