

## The balance of economic power

# East or famine

**Asia's economic weight in the world has risen, but by less than commonly assumed.**

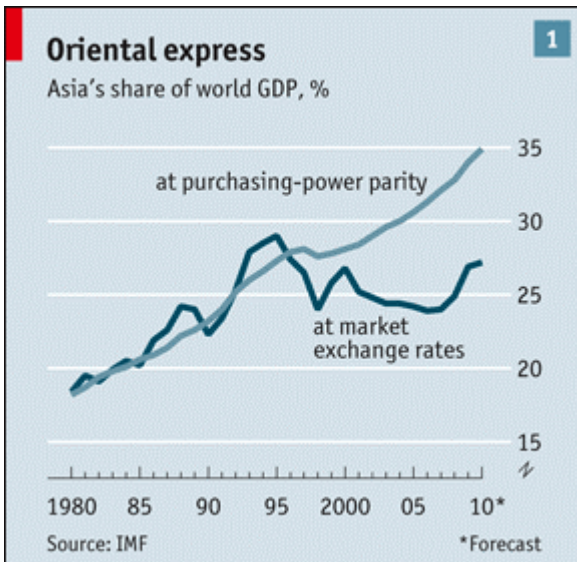
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THE idea that the world's economic centre of gravity is moving eastward is not new. But the global financial crisis, many argue, has given the shift in economic power from America and western Europe to Asia a big shove. Emerging Asia rebounded from recession much faster than the developed world; its banking systems and debt dynamics (see [article](#)) are much healthier. In 2009 China overtook Germany to become the world's biggest exporter. On one measure it now looks likely to become the world's biggest economy within ten years. But just how far has power really tilted towards Asia?

The region has certainly become more important to bankers and businessmen, accounting for a record share of many companies' profits last year. Several senior executives have relocated to Asia, the latest being HSBC's chief executive, Michael Geoghegan, who officially moved from London to Hong Kong on February 1st. Since 1995 Asia's real GDP (even including less sprightly Japan) has grown more than twice as fast as that of America or western Europe. Morgan Stanley forecasts that it will grow by an average of 7% this year and next, compared with 3% for America and 1.2% for western Europe.

Yet a closer look at the figures suggests that the shift in economic power from West to East can be exaggerated. Thanks partly to falling currencies, Asia's total share of world GDP (in nominal terms at market exchange rates) has actually slipped, from 29% in 1995 to 27% last year (see chart 1). In 2009 Asia's total GDP exceeded America's but was still slightly smaller than western Europe's (although it could overtake the latter this year). To put it another way, the output of the rich West is still almost twice as big as that of the East.

As for the popular belief that Asian producers are grabbing an ever-larger slice of exports, the region's 31% share of world exports last year was not much higher than in 1995 (28%) and remains smaller than western Europe's. Indeed, the shift towards Asia appears to have slowed, not quickened. Its share of world output and exports surged during the 1980s and early 1990s. Although China's share has grown since then, this has been largely offset by the decline in Japan, whose share of output and exports has halved.



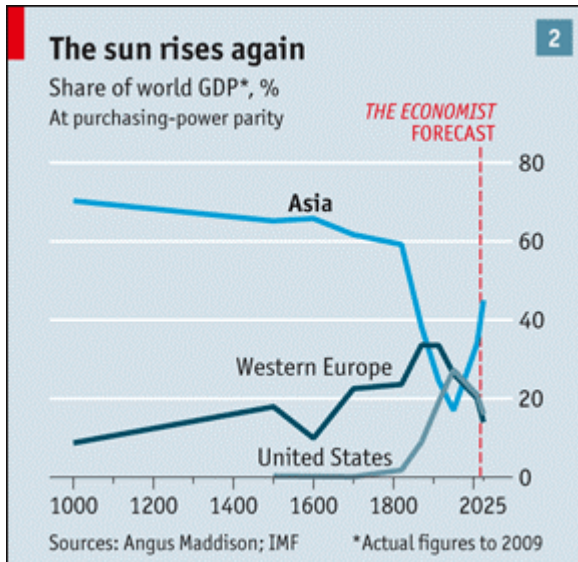
What about Asia's financial muscle? Asian stockmarkets account for 34% of global market capitalisation, ahead of both America (33%) and Europe (27%). Asian central banks also hold two-thirds of all foreign-exchange reserves. That sounds impressive, but their influence over global financial markets is more modest, because official reserves account for only around 5% of the world's total stash of financial assets. The bulk of private-sector wealth still lies in the West. The fact that Asian currencies make up only 3% of total foreign-exchange reserves indicates how far Asia still lags in financial matters.

The "rise of Asia" is no myth, however. GDP figures converted at market exchange rates understate Asia's real expansion. Many currencies tumbled during the Asian financial crisis in the late 1990s, slashing the dollar value of their economies. Japan's nominal GDP has been squeezed by deflation. More importantly, prices of many domestic products, from housing to haircuts, are always cheaper in low-income countries, implying that households' real spending power is bigger.

If GDP is instead measured at purchasing-power parity (PPP) to take account of these lower prices, Asia's share of the world economy has risen more steadily, from 18% in 1980 to 27% in 1995 and 34% in 2009. By this gauge, Asia's economy will probably exceed the combined sum of America's and Europe's within four years. In PPP terms, three of the world's four biggest economies (China, Japan and India) are already in Asia, and Asia has accounted for half of the world's GDP growth over the past decade.

Some economists claim that PPP measures exaggerate Asia's economic clout. What really matters to Western firms is consumer spending in plain dollar terms. Although over three-fifths of the world's population live in Asia, they only account for just over one-fifth of global private consumption, much less than America's 30% share. But official figures almost certainly understate consumer spending in emerging Asia, because of the poor statistical coverage of spending on services. Figures from the Economist Intelligence Unit, a sister company of *The Economist*, suggest that Asia accounts for around one-third of world retail sales. Asia is now the biggest market for many products, accounting for 35% of all car sales last year and 43% of mobile phones. Asia guzzles 35% of the world's energy, up from 26% in 1995. It has accounted for two-thirds of the increase in world energy demand since 2000.

Many Western firms are more interested in Asia's capital spending than its consumption, and here Asia is undoubtedly the giant. In 2009, 40% of global investment (at market exchange rates) took place in Asia, as much as in America and Europe combined. In finance, Asian firms launched eight of the ten biggest initial public offerings (IPOs) in 2009 and more than twice as much capital was raised through IPOs in China and Hong Kong last year as in America.



Winston Churchill once said: “The longer you can look back, the farther you can look forward.” The new economic order is in fact a resurgence of a very old one. Asia accounted for over half of world output for 18 of the past 20 centuries (see chart 2). And its importance will only increase in the coming years. Rich countries’ growth rates are likely to be squeezed over the next decade as huge household debts dampen spending, and soaring government debt and higher taxes blunt incentives to work and invest. In contrast, growth in emerging Asia (almost four-fifths of the region’s total output) is likely to remain strong. Robust growth should also give governments in emerging Asian economies the confidence to let their currencies rise, which would further boost the relative size of their economies in dollar terms.

By 2020 Asia could well produce half of some big Western multinationals’ sales and profits, up from a typical proportion of 20-25% today. Asian staff eagerly await the day when they can fix the times for international conference calls, so Europeans and Americans have to put up with after-midnight discussions with the Beijing office. That may be the best test of whether economic power has really shifted east.