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Asia in 2020: growth models and imbalances

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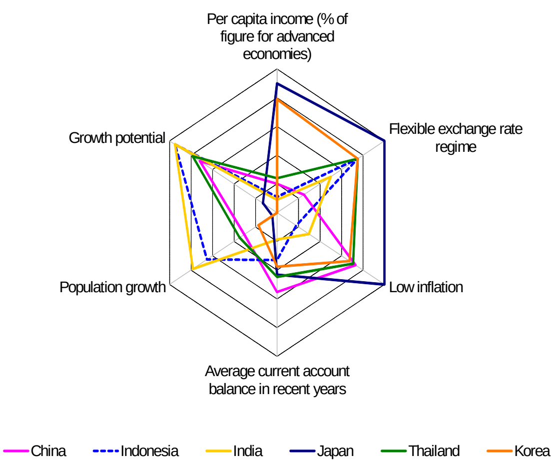
- Asia has been by far the most dynamic region of the world over the past decade, powered most notably by China's rapid growth, to the point where it now accounts for more than two-thirds of world growth.
- In most Asian countries, income levels are progressively converging with those of the advanced economies, and these countries are developing their physical and financial infrastructure. Considerable essential basic needs remain unfulfilled, and this should help to fuel continuing growth between now and 2020.
- Growing regional integration is another feature of this process. This integration primarily concerns trade, through regional agreements and bilateral free trade treaties boosting the share of intra-zone trade, partly with the emergence of global production chains and the specialisation of some countries in logistics. But the integration is also financial, with the growth of domestic, local currency-based financial markets.
- The Asian countries' growth model is largely based on their external surpluses, which result in part from policies supporting their export sectors. These accumulating surpluses, in a context of imperfectly flexible exchange rates, account for the bulk of the expansion of global currency reserves.
- In most Asian countries, very high levels of national savings go hand in hand with a relatively low investment rate. The latter will need to rise, in order to pay for the spending on infrastructure and education required to sustain these countries' growth potential.
- The situation in China and Vietnam is somewhat different: investment has risen but has become less productive in recent years. Ultimately, China will have to rebalance its model in favour of consumption, as the population ages. More immediately, one cannot rule out a crisis scenario triggered by domestic debt and the rapid growth of the property sector.

The situation in the principal countries in the region



Source: IMF, World Bank.

Interpretation: the more favourable a country's situation for a given indicator, the closer the figure is to the edge of the lozenge. Starting from the top and moving rightwards, this implies a per capita income close to that of the advanced economies, a more flexible exchange rate regime, lower inflation, a higher current account surplus, a more youthful population (measured as the percentage of under-14 year olds in the total population) and a higher growth potential (measured by the gap between per capita electricity consumption and that of the largest consumer).

MINISTÈRE DE L'ÉCONOMIE ET DES FINANCES

MINISTÈRE DU COMMERCE EXTÉRIEUR

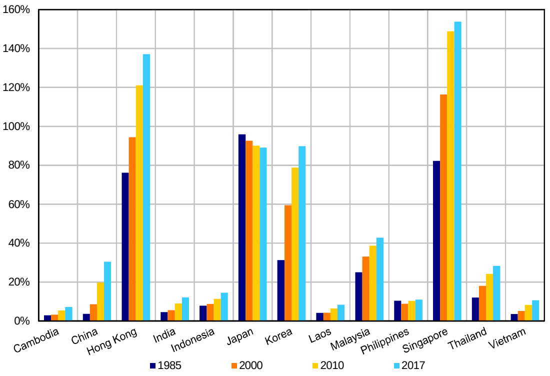
1. Most of the countries in Asia will continue to grow and regional integration is expected to continue

1.1 Most Asian countries are still middle-income countries

Convergence theory states that the living standards (measured by per capita GDP) in the least well-off countries (the periphery) will ultimately converge with those of the advanced (core) economies[1]. Asia presents a very mixed picture, in this regard (see Chart 1). While Japan, Hong Kong and Singapore can be thought of as belonging to the region's core, a process of convergence appears to be at work for the other countries, albeit still very patchy for some of them. Convergence is forecast to continue over the next five years, in the IMF's baseline scenario.

Socio-economic indicators (in Table 1) confirm that most of the countries in the region continue to lag, with the exceptions of Japan, South Korea and Hong Kong, which appear to be best-placed. Cambodia and Laos are the least-developed countries. Urbanisation rates are relatively low in some large countries, especially in India, Thailand and Vietnam. So a rise in the rate of urbanisation is plausible, demanding parallel development of infrastructure.

Chart 1: Per capita GDP in the Asian countries is converging towards that of the advanced economies



Source: IMF: World Economic Outlook database.

Interpretation: The indicator, which shows per capita GDP for each country relative to the average for the advanced economies (all measured in terms of purchasing power parity), means that China's per capita GDP represented 4% of that of the OECD countries in 1985 and could rise to 30% in 2017.

Projections by the *Centre d'Etudes Prospectives et d'Informations Internationales* (CEPII) (chart 2) confirm that Asia's share of global GDP is expected to grow significantly, from 23% in 2008 to 33% in 2025, and nearly 50% in 2050. China is expected to account for the bulk of this rise.

Table 1: Socio-economic indicators of development

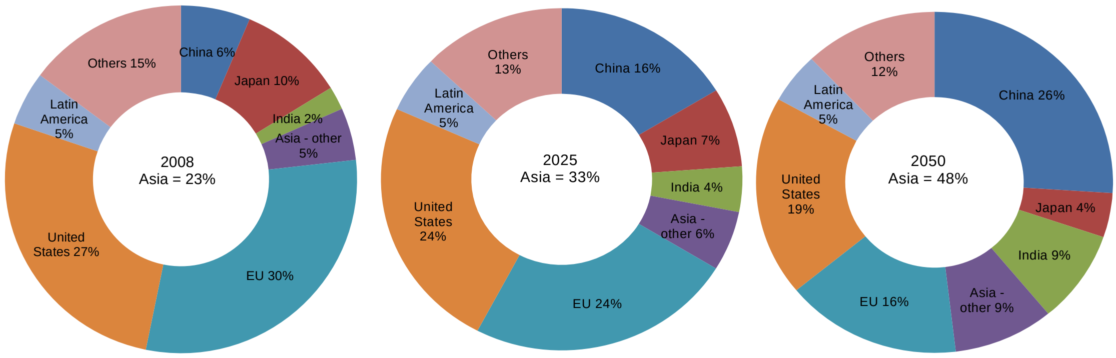
	Indicator of human development	Access to secondary education	Population aged between 0 and 14 yrs	Urban population	Electricity consumption	Improved water source in urban areas
	Rank	% of population with access	% of total population	% of total population	kWh per inhabitant	% of population with access
	2011	2010	2010	2010	2009	2010
Cambodia	139	46	32	23	131	87
China	101	81	19	45	2631	98
Hong Kong	13	83	12	100	5925	100
India	134	60 *(2008)*	30	30	571	97
Indonesia	124	77	27	54	590	92
Japan	12	100 *(2009)*	13	67	7819	100
Korea	15	97 *(2009)*	16	82	8980	100
Laos	138	45 *(2008)*	35	33	–	77
Malaysia	61	68 *(2009)*	30	72	3614	100
Philippines	112	82	35	66	593	93
Singapore	26	–	17	100	7948	100
Thailand	103	79 *(2011)*	20	34	2044	97
Vietnam	128	77	23	29	918	99
Advanced countries	–	100	17	78	9064	100

Source: United Nations, World Bank (World Development Indicators).

The human development index (HDI) is a composite indicator of health, education and living conditions in a country. A high rank signifies a poor HDI. Access to secondary education is an indicator of human capital, from which it is possible to estimate the level of qualification of the labour force. The share of population aged under 14 gives an idea of population ageing. The last three indicators serve to measure the lag in terms of infrastructure development (urbanisation, energy, and public services).

(1) History shows that this argument is not true in all cases, as in Latin America in the 1980s, when income in these countries diverged from that of the advanced economies, which is why people speak of a "lost decade".

Chart 2: Asian countries' share of global GDP



Source: CEPII, "The World Economy in 2050: a tentative picture" WP 2010-27.

Looking to 2017, Asian growth will account for half of global growth, according to IMF forecasts. At that point, Latin America is expected to account for just 8%, emerging Europe for 7%, the United States 14% and the euro zone 6%.

1.2 Asian countries are playing a growing role in financial globalisation

Asian countries have built up their domestic financial markets since the end of the Asian crisis of 1997/1998, largely caused by Asian companies' foreign exchange debt. While lower inflation and the improving current account balance may have contributed to this, markets denominated in local currency also grew up in response to political demand. Several initiatives were launched within the Asean+3[2] grouping, the **Asian Bond Markets Initiative** (ABMI) among them. Emerging countries' governments shared a common concern to borrow in their own currency, which sparked the development of these markets (Table 2), still embryonic fifteen years ago. The size of Asia's bond markets expanded from 2% of the world total at the end of 1996 to 8% at the end of 2011.

Table 2: Growth of Asia's financial markets

	1996			2011		
	Bonds in local currency (USD Bn)	Share of country's GDP (%)	Non-residents' share (%)	Bonds in local currency (USD Bn)	Share of country's GDP (%)	Non-residents' share (%)
China	62	7	–	3 247	44	–
India	81	22	–	649	39	–
Indonesia	7	3	0	111	13	29.5
Japan	4 456	95	6,1	12 626	215	6.7
Korea	283	49	0	1 179	106	11.2
Malaysia	71	70	2,4	263	94	26.5
Philippines	28	30	–	75	35	–
Singapore	25	26	–	188	72	–
Thailand	18	10	0	229	66	12.2
Vietnam	0	0	0	17	14	–
Brazil	299	36		1 368	55	11.3

Source: BIS, Asia Bonds Online.

Today, these markets have developed across the entire yield curve, chiefly catering to public borrowers. The **corporate** market is still embryonic, except in Japan and South Korea, where it surpasses in size the market in government securities. Another factor boosting this growth in bond markets was the increasing liberalisation of capital movements, leading to a considerable expansion in the share of non-residents, especially in Indonesia and Malaysia[3].

This liberalisation of capital movements is taking place gradually, and is less advanced in China, India and Vietnam than elsewhere. In all countries, China included, the sequence of events in this process is frequently similar, starting with the granting of permission to non-residents to import capital, and then allowing residents to transfer capital out of the country.

The opening of the capital account consists in the progressive easing of administrative restrictions (generally in the form of investment quotas, as in India). These are progressively removed, both for portfolio investments as well as for foreign direct investment (FDI), even though many restrictions remain in place.

In Chine, heavy controls remain on resident capital outflows, although recent initiatives have increased the flow of outward FDI. What makes China unusual is its policy of internationalising the yuan concomitantly with its progressive liberalisation of the financial account.

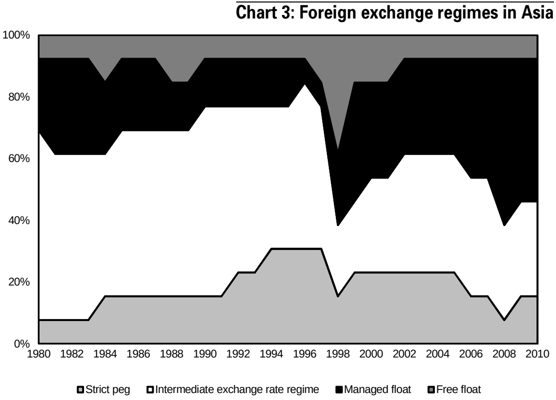
(2) Asean (Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar, Cambodia) plus China, South Korea and Japan.

(3) The progressive uprating of these countries' sovereign debt and the progressive incorporation of their domestic bond debt into the global indices were further contributing factors. Malaysia joined Singapore and Japan in Citigroup's World Government Bond Index in 2007.

The first tries to promote use of the yuan took place **offshore**, insofar as capital controls restrict the possibilities for non-residents to carry out transactions in China. Hong Kong is the platform for internationalisation par excellence, a bond market, bank deposit accounts and the possibility of transacting business in yuan having been put in place.

The authorities plan to organise these operations in China in a subsequent phase. The Chinese government recently announced its intention to set up a settlement platform in yuan, in Shanghai. Non-residents' access to the Chinese market is being extended steadily, with the progressive raising of their investment quota in the financial markets, under the so-called **Qualified Foreign Institutional Investor** programme.

Chart 3: Foreign exchange regimes in Asia



Source: Ilzetzki, Reinhart and Rogoff (2011), "Exchange Rate Arrangements into the 21st Century: Will the Anchor Currency Hold?", mimeo.

The progressive development of financial markets and an increasingly sound macroeconomic framework have also set the scene for increasingly flexible exchange rates in Asia (Chart 3). An insufficiently flexible exchange rate may be designed to keep an currency undervalued so as to support the export sector's competitiveness, a criticism often levelled at Asia's emerging economies (see Part 2). But this is not without domestic risks with respect to control over nominal trends.

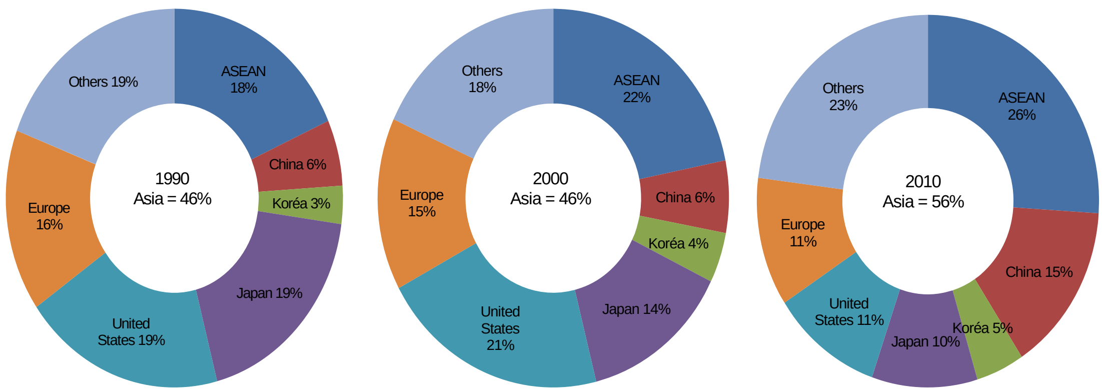
Over the last fifteen years, several countries have moved to a managed float regime (South Korea, Indonesia, Thailand, and more recently Malaysia and the Philippines). More recently, China has made its exchange rate regime more flexible (from July 2005 onwards), but then switched back to a fixed-rate regime in 2009-2010 in the wake of the crisis in the developed countries.

It has modified its regime only marginally since then. Even today, Japan alone has a fully floating currency, although that does not rule out oral or physical intervention in the currency markets.

1.3 The Asian countries are engaged in a process of increasing regional integration

Several initiatives by the Asian countries have increased their trade and financial integration. The fact that some of these initiatives were taken recently suggests that more can be expected. Already, the share of intra-zone trade within Asean (Chart 4) increased from18 to 26% between 1990 and 2010, and China's share of the region's exports went from 6 to 15% between 2000 and 2010[4]. This growth in regional trade is partly attributable to the way in which production chains are now organised, which may, moreover, originate in and/or be directed towards countries outside the region. In China, imports for re-export represented 30% of imports in 2011, while re-exports represented 46% of total exports.

Chart 4: Geographic destination of ASEAN exports



Source: Chelem (CEPII).

This growing interlinking of production chains is reinforcing interdependence, especially when a crisis or natural disaster hits a link in the chain, as in the case of the earthquake in Japan or the floods in Thailand in 2011. The growing importance of China in world trade also introduces a risk of spillovers, with the possibility that a crisis there could spill over to the other emerging economies, particularly via the commodities price channel, as pointed out by the IMF[5]. This regional integration looks set to continue, but Asia remains vulnerable to weaker demand in the advanced economies.

Financial integration too has made progress in Asia, but even if it is still limited, both inside the region and vis-à-vis the rest of the world. So these countries, Asean and South Korea particularly, are more vulnerable to financial shocks[6], even if the room for manoeuvre accumulated over recent years means these countries are better-equipped to cope with them.

(4) See also the role of the admissions of China and Vietnam to the WTO (in 2001 and 2007 respectively), which foreshadowed the conclusion of free-trade agreements, including one between China and Asean, which took effect in 2010.
(5) IMF (2011), People's Republic of China: Spillover Report for the 2011 Article IV Consultation and Selected Issues.
(6) According to an IMF working paper (to be published), "How do Asian financial linkages to systemic economies vary over time?".

Swaps[7] agreements between countries in the region, either regional or bilateral, are another stabilising factor. These agreements ensure secure access to foreign exchange liquidity, either for purposes of financial stability, or for trade settlement purposes (in yuan, for example). In line with this, there have been three noteworthy developments concerning bilateral agreements:

- The first concerns financial stability. In 2008, after access to dollar liquidity came under strain, South Korea and Singapore (together with Brazil and Mexico) signed a **swap** agreement for USD 30 billion each with the United States. At the end of 2011, Korea signed an agreement with Japan for a USD 30 billion dollar-won line (this line complementing a yen-won line).
- The second concerns trade settlement and the internationalisation of the yuan. China has signed bilateral agreements worth a total of USD 260 billion to support the settlement of its foreign trade in yuan[8 9], which reached 9% of the total at the end of 2011.
- The third concerns the first direct yen/yuan transactions since the beginning of June 2012.

In addition, a few years ago Asean+3 established a financial safety net, the **Chiang Mai Initiative**, initially consisting of bilateral **swap** lines, whose total amount was increased from USD 60 to 120 billion in 2010, and doubled once again in May 2012. A regional macroeconomic surveillance unit (AMRO) was set up in 2011, as part of this arrangement.

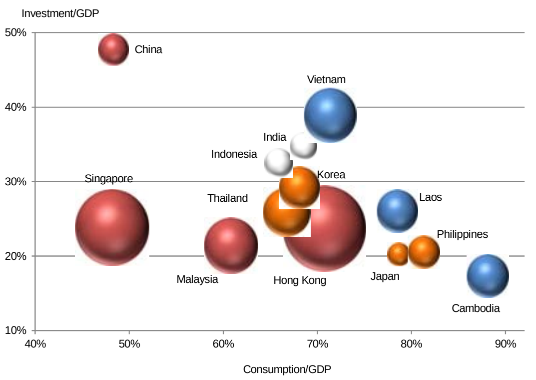
This process of regional integration appears increasingly to concern the banking sector also. According to BIS figures, the cross-border exposure of Asia-Pacific banks in emerging Asia rose from 17% at the end of 2007 to 22% at the end of 2011. This process could continue, with the prospect of deleveraging by the developed countries' banks in order to meet the new liquidity ratios, notably, without prejudice to more specific country issues.

2. Ultimately, the principal Asian countries will surely have to rebalance their growth model

2.1 Characterising the growth model of countries in the region

The growth model in most of the region's countries is unbalanced (Chart 5), as evidenced by a significant external surplus or deficit. The countries with the largest surpluses are China, Hong Kong, Malaysia and Singapore, reflecting a surplus of savings over domestic investment. Conversely, savings do not cover all investment in Vietnam, Cambodia and Laos, leading to significant current account deficits.

Chart 5: Distribution of domestic demand, degree of openness of economies and current account imbalances



Source: IMF, CEIC.

Interpretation: In China, consumption accounts for 48% of GDP, as does investment, while the degree of openness (corresponding to the size of the bubbles) is 25%. The colour of the bubbles corresponds to the average current account balance for 2002-2011, red when the balance is above 5% of GDP, orange when it is between 0 and 5%, white when it is close to equilibrium, and blue when it is in deficit.

Concerning the distribution of domestic demand, the Philippines, Laos and Cambodia rely on domestic consumption. China relies above all on a very high rate of investment, as does Vietnam to a lesser extent.

The economies of the main Asean countries are based on their export sector, making them vulnerable to external shocks.

Most of the Asian countries have seen sharp falls in inflation in recent years, though it is higher in India, Indonesia, Vietnam, Cambodia and Laos than in the rest of the region. This persistence of relatively higher inflation is evidence of under-investment or unproductive investment, and of other factors as well[10].

The countries whose exports are least diversified (Table 3) are particularly vulnerable to external shocks. This is the case for commodity-exporting countries, i.e. Cambodia, the Philippines and Laos, or for those whose main business is logistics, i.e. Singapore and Hong Kong.

Where imports are concerned, most countries-China especially-are net importers of commodities, notably energy. However, apart from the small countries, these economies are sufficiently diversified not to have suffered too great a deterioration in their terms of trade[11] despite rising commodity prices in recent years. The risk posed by a further rise in commodity prices to the region's external balance is therefore less acute than in other emerging zones.

(7) A swap line is an agreement between central banks whereby the latter pledge to supply each other with liquidity for a specific period of time. For example, if the United States and South Korea sign a USD 30 billion agreement and Korea draws USD 16 billion on this line, this means that Korea will receive this amount in dollars and the United States the equivalent in won. Unless it is rolled over, the transaction is supposed to be unwound before the agreement's term.

(8) Agreements with Hong Kong, S. Korea, Brazil, Malaysia, Singapore, Indonesia, Argentina, Thailand, Kazakhstan, the Emirates, New Zealand, Belarus, Pakistan, Turkey, Mongolia, Iceland and Uzbekistan.

(9) This is part of a wider programme to internationalise the CNY which also comprises the creation of offshore markets (bonds, bank deposits), starting with Hong Kong.

(10) Subsidised consumer prices (energy in particular) produces two inflationary effects arising from the resulting low prices: over-consumption of these goods, leading to shortages of them, and under-investment in the production of these goods, further exacerbating these shortages. This factor is most powerful in India and Indonesia.

(11) Ratio of export prices to import prices.

Table 3: : Export concentration index

Least developed countries	0.43	India	0.15
Cambodia	0.34	Korea	0.15
Philippines	0.33	Vietnam	0.14
Laos	0.32	Japan	0.13
Singapore	0.27	China	0.11
Hong Kong	0.20	Thailand	0.09
Malaysia	0.16	Advanced economies	0.06
Indonesia	0.16		

Source: UNCTAD.

Methodology and interpretation: The concentration index has been standardised so as to obtain values of between 0 (strong export diversification) and 1 (no diversification). This indicator cannot be interpreted in a linear fashion. Exports are highly diversified when the index is less than 0.1 and start to be relatively less diversified when the index reaches 0.25 and above.

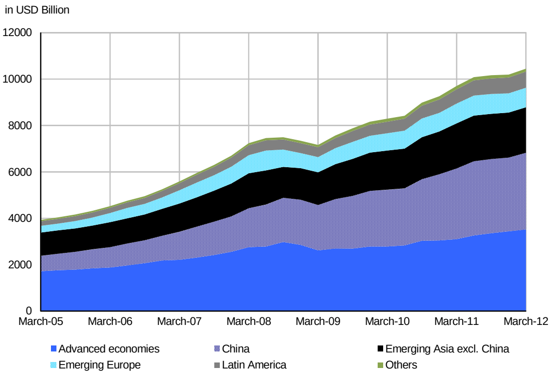
2.2 The savings/investment balance and the consequences of these growth models

While most of the countries in the region generate current account surpluses, this phenomenon originated only around fifteen years ago, coming after the Asian crisis. Before that, Japan and Singapore alone produced surpluses. Before the crisis, investment rates in the great majority of emerging economies in the region (Hong Kong, Indonesia, South Korea, Malaysia, Thailand and Singapore) were far above present day levels, and even exceeded their savings rates, which explains their current account deficits. The crisis led to a steep fall in investment rates, even though savings rates remained at comparable levels, opening the door to large current account surpluses. These surpluses have combined with ever larger inflows of private capital, attracted by high growth potential, the demise of problems of debt sustainability, and stable exchange rates. According to the IMF's most recent estimate, in its **External Balance Assessment** (EBA), the Asian economies' exchange rates still diverge sharply from their equilibrium values. Thailand, South Korea and China in particular all have undervalued exchange rates. Conversely, the Indonesian and above all Indian rupees are reckoned to be overvalued. Consequently (Chart 6), Asian countries have accumulated foreign exchange reserves, now hold almost half of world reserves, and are generating a transfer of savings to the advanced economies.

Attention is drawn to three specific situations:

- China, where the investment rate remained high (and even rose) after the Asian crisis (48% in 2011), even if a rise in the savings rate (51% in 2011) allows the country to remain in current account surplus.
- Vietnam, whose situation looks like the Asian countries pre-1997 crisis, with strong growth in investment and current account deficits.
- India, where deficits are rising moderately, but are concentrated on the public sector.

Chart 6: Asia's share of world foreign exchange reserves is growing



Source: Reuters, IMF.

Interpretation: In China, foreign exchange reserves expanded from USD 660 to 3,300 billion between March 2005 and March 2012. Over this period, China's share of global foreign exchange reserves grew from 16.8 to 31.6%.

Consequently, as strong as it is in many countries, growth may be seen as unbalanced. The majority of the surplus savings prevalent in most countries is held in relatively low-yielding foreign government debt. Countries still lagging behind in their development (Chart 1) would do well to invest more in their economy, because of their very substantial needs in terms of infrastructure and manpower training.

2.3 Rebalancing the growth model: could this happen soon?[12]

The Asian crisis of 1997 showed that unproductive investment could trigger the crisis. The ICOR indicator[13] measures the number of units of investment needed to obtain an additional unit of GDP, and can therefore be used to assess the quality of investment. This indicator captured advance signs of deterioration prior to the Asian crisis and thus appears to have some predictive power. The ICOR has deteriorated in the two countries that have experienced strong investment growth in recent years. It averaged 5 in China (its highest figure since the beginning of the 1990s) over the period 2009 to 2011, and 6 in Vietnam (a historical high). This finding points to a probable weakening of growth in these two countries. In Vietnam, it even signals a risk of crisis and hence a sudden, sharp rebalancing, since this speculative investment is coupled with an external deficit and a low level of foreign exchange reserves[14], in a situation resembling that of the Asian countries in 1997.

(12) This sub-section discusses the case of countries whose current model could raise problems of sustainability (Vietnam, China), that of the other countries having been discussed in 3.2; concerning China, B. Delozier and C. Rebillard (2010), "A more balanced growth for China: challenges and prospects", *Trésor Economics* no. 75, presents a more comprehensive survey.

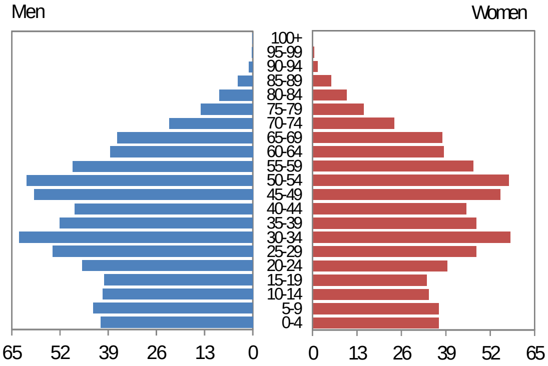
(13) ICOR: Incremental Capital Output Ratio. A level of 3 may be considered a good ICOR level. The ICOR can be calculated as the ratio of investment to GDP growth.

(14) A calculation based on the methodology applied in an IMF Policy Paper ("Assessing Reserve Adequacy", 2011) shows that, at their end-2011 level, foreign exchange reserves are reckoned to represent only 40% of the potential needs they could serve to cover (i.e. a portion of short-term debt, capital outflows, a switch of monetary assets from dongs into dollars, or a sudden fall in exports). The comfort zone is between 100 and 150%.

In China, demographic factors could lead to a fall in the savings rate, due to population ageing (Chart 7). According to the lifecycle theory, a youthful population has an incentive to set aside precautionary savings[15], in order to maintain a high level of consumption after retirement. Savings could fall in favour of consumption, as the population ages, which would progressively help to rebalance the growth model.

A rebalancing of China's growth model is needed, moreover, given the global economy's necessarily limited capacity to absorb Chinese exports, which currently represent 10% of total world exports.

Chart 7: Age structure of Chinese population in 2020



Source: US Census Bureau.

Interpretation: In China, the 40-44 age group will comprise 48 million men and 45 million women, in 2020. The shape of China's age structure is the same as for a developed country.

3. A number of risks could undermine the Asian countries' growth dynamic, chief among them being debt or overdue rebalancing of growth models

The likeliest scenario between now and 2020 is that the region's economies continue to converge with those of advanced economies' income levels (Chart 1). Alongside the conventional natural hazards (such as the impact of Japan's earthquake on production chains) and geopolitical risks, there are risks relative to this baseline scenario, at some time in the future.

3.1 Debt-related risks

In the short-to-medium term, questions could arise over the sustainability of debt in several countries in the region. The main questions concern:

- Japan's public debt: the level of public debt (thought to be near 250% of GDP gross, and 150% net, according to the IMF) looks high as such. Until now, residents' (the banking sector especially) appetite for public debt has been a source of strength. Moreover, the global dearth of risk-free assets has driven non-residents to increase their holdings of Japanese government securities (they currently hold 8.3% of Japan's public debt). The adoption by the authorities, on 15 January 2013, of a fiscal stimulus representing more than 2 percentage points of GDP for 2013 ought to help bolster activity, but could undermine the public finances. While the doubling of the consumption tax from 5 to 10% by 2015 should help to consolidate the public finances, new fiscal measures will be needed to achieve the government's target of halving the primary deficit in 2015 and a balanced budget in 2020.
- India's public debt: the current account deficit has its origins mainly in the public deficit, which reached 9.2% of GDP in the 2010/11 financial year (including 2.7 percentage points for the provinces), bringing public debt to 70% of GDP. This deficit is structural, and the slowdown in growth now perceptible in India could hamper efforts to rebalance. Under these circumstances, Standard & Poor's and Fitch have threatened to withdraw the country's **investment grade** status. It is currently rated BBB[16].
- Private debt in South Korea: household debt stood at 87.5% of GDP at the end of 2011, compared with 90.7% in the United States. Most of this consists of mortgage loans, a majority of them variable-rate, and half of which expire by the end of 2013. The government has taken macro-prudential measures to contain the risks, including limits on debt-to-income ratios[17], and tax incentives to lower the share of variable-rate loans. However, households remain highly vulnerable to a fall in property prices and to a rise in interest rates.
- Local governments and property in China: the ratio of lending to GDP in China represents 150% of GDP, which is high for a country at this level of development.

A close watch needs to be kept on local government debt, because it is opaque and has increased steeply since 2008. This debt is estimated to represent between 22% and 34% of GDP, depending on the source. The financing channels are opaque, borrowing capacity being positively correlated with land prices. The government has ordered the banks to roll over these loans in order to avoid any payment incident. However, it looks as if part of these loans have been transferred from the commercial banks' loan books to those of the "**policy banks**" (public sector investment banks), where they are increasingly concentrated[18].

The property sector has grown rapidly and now represents 25% of GDP. In addition to the debt specific to this sector, property assets are being used as collateral for other types of debt (including that of local governments). While the **financial system stability report** published by the IMF in 2011 considered that non-performing loans resulting from a sharp drop in property prices would account for only 8% of total loans, vigilance is nevertheless called for.

(15) In China, this incentive to save is reinforced by the country's under-developed social security systems.
(16) Investment grade corresponds to BBB- or above, qualifying a country's bonds for inclusion in the portfolios of risk-averse investors.
(17) As announced on 23 July, the government has left itself room to raise this limit if the property sector appears in need of support.
(18) According to the investment bank Sanford Bernstein, this lending represents nearly 40% of these banks' loan books, versus an average of nearly 18% for the banking sector as a whole.

3.2 Risks associated with chronic under-investment

Most of the countries in the region are still middle-income countries, and still lag considerably in terms of infrastructure development and manpower skills. For these countries' per capita income to converge with that of the advanced economies they will need to invest heavily in both human and physical capital. The risk is that, in the absence of this investment, this convergence will come to a halt and these countries will remain middle-income countries, caught in the so-called **middle income trap**.

3.3 Failure to rebalance the growth model

In the short term, certain countries are at risk of a balance of payments crisis. Vietnam's trajectory is a matter of concern, in this regard, as is that of Cambodia and Laos, the last two being vulnerable because of their dependence on commodities exports.

Looking to the medium term, there is a concern that China will fail to rebalance its growth model sufficiently. The example of Japan shows that a thorough rebalancing is possible only by adopting structural reforms conducive to the development of the domestic market, capable of boosting domestic consumption sufficiently, failing which growth will progressively run out of steam[19].

Stéphane Colliac*

* *We wish to thank the Economic Departments at the French Embassies in Hong Kong, New Delhi, Beijing, Seoul, Singapore and Tokyo.*

(19) For a more complete panorama, see "Box 3: Key Lessons from Recent Japanese History", in the IMF staff report for the 2010 Article IV consultation on China.

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