

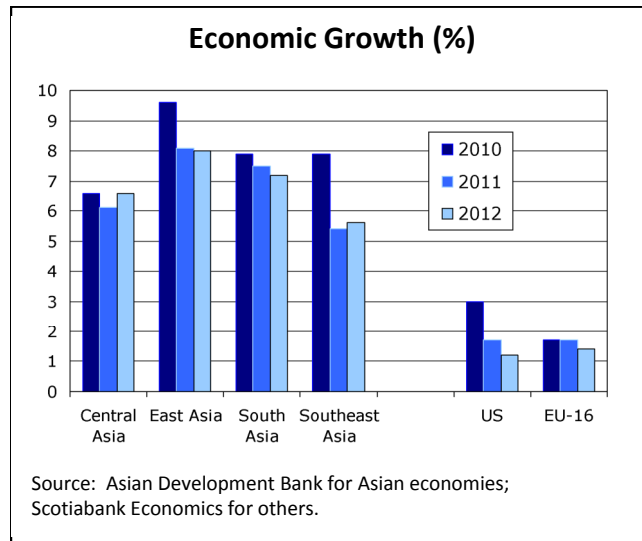


British Columbia in the Asian Century

It is no longer a question of if but rather a matter of when. Almost a decade ago – back in 2003, to be precise – the global economics group at Goldman Sachs drew attention to the rise of Asia and sent minor shockwaves through the US establishment with its proclamation that China would overtake America to become the world’s biggest national economy in 2041. At the time this was viewed as a credible projection, but the fact that the eclipse date was nearly forty years away meant it was still fairly abstract and was enveloped with the uncertainty that invariably attends multi-decade forecasts. Sustained double-digit growth in China prompted Goldman Sachs to revise its projection for the eclipse date to 2027 a few years later. And now, following the Great Recession and the prospect of a very subdued economic outlook for the United States, 2019 is the most widely cited year for China to surpass the US in overall economic size.¹

Asia’s Inexorable Rise

China’s ascent highlights a more general trend that is reshaping the world order: the emergence of Asia as the fastest-growing and most dynamic part of the global economy. Defined in the broadest terms, Asia consists of Japan, China and Korea, the myriad countries scattered across Southeast Asia, South Asia and Southwest Asia, along with Australia and New Zealand. Analysts sometimes examine a



narrower geographical region referred to as the Asia Pacific. It is comprised of all of East and Southeast Asia, as well as Australia, New Zealand and various minor island states.

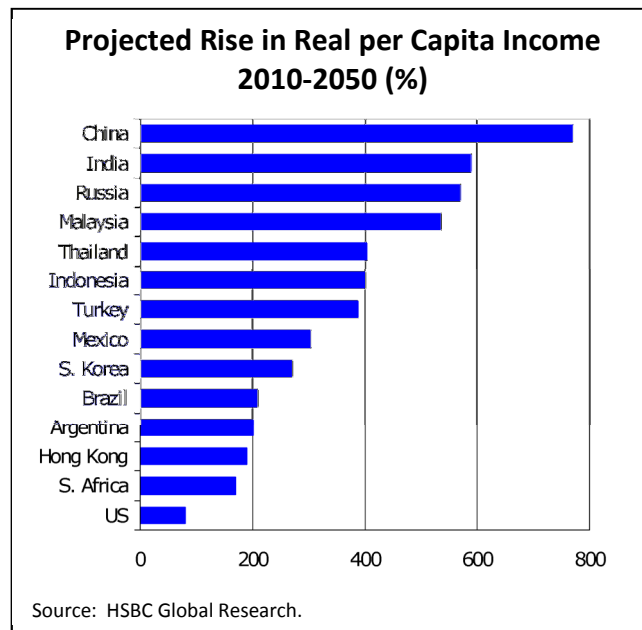
A recent report from HSBC Global Research, “The World in 2050,” sheds some interesting light on Asia’s position in the changing international pecking order. By mid-century, Asia will be home to three of the four largest national economies, based on gross domestic product calibrated in constant US dollars (China, India and Japan). Other Asian countries

¹ See The Economist, “Dating Game: When Will China Overtake America?” (December 16, 2010); and John Ross, “The Central Date For China’s GDP to Overtake the US at Market Exchange Rates in 2019.”



expected to be in the top 20 by mid-century are South Korea, Indonesia, Australia and Malaysia. Not far behind are Thailand, Iran and Hong Kong.²

HSBC's forecast for the future trajectory of per capita income is also illuminating. According to its projections, between 2010 and 2050 income per person, adjusted for inflation, will soar sevenfold in China, and climb by 300-600% in India, Malaysia, Thailand and Indonesia. By comparison, in the US it is predicted to be about 80% higher than today's level. This points to a dramatic expansion in the absolute as well as relative spending power of Asian households in the coming decades.



What is driving economic growth in Asia? The HSBC study shows that the story differs across the region. Some Asian countries benefit from sizable “demographic dividends,” as their working-age populations continue to increase at the same time as education levels improve; India is a prominent example, along with Malaysia and Indonesia. Other countries are moving quickly up the manufacturing and knowledge-production value chains; China falls in this category. Australia and Japan are gaining from their proximity to and fast-developing commercial ties with Asian markets elsewhere in the region.

Across emerging Asia³, forecasters expect brisk growth in domestic consumption as household incomes climb. In addition, most Asian countries are investing heavily to build infrastructure and upgrade education and human capital. More than a few also boast favourable macroeconomic fundamentals: healthy government balance sheets, open trade policies, and increasingly supportive policies toward private sector capital formation and property rights. That said, China and India are grappling with stubborn inflationary pressures, India continues to be hobbled by inadequate physical infrastructure, and corruption remains a major problem in several parts of the region.

² HSBC Global Research, The World in 2050 (January 2011).

³ Defined as all of Asia except Japan, Australia and New Zealand.



Accompanying Asia's rapid fire economic development is the emergence of an expanding spending-oriented middle class in China and other emerging markets. Hundreds of millions of Asians are poised to join the ranks of the global middle class in the coming decades.⁴ Between 2005 and 2010, per capita GDP in China jumped more than 150% to nearly US\$4,400.⁵ As this trend continues, it will translate into rising incomes and greater consumption of goods and services. Consumer lifestyles across much of Asia will evolve to become more energy-, metals- and protein-intensive. By one estimate, higher household incomes could feed a fivefold increase in personal consumption in China between now and 2025.⁶ A number of other emerging Asian economies, while not as far along the per capita output scale as China, are likely to experience similar advances in income and consumption. The implications for BC include significant gains in travel and tourism from Asia, growing Asian demand for energy, metals and other industrial raw materials, and an expansion in the market for wood-frame homes, which are seen as luxury homes in China.

Impact on British Columbia

The ascent of China and other Asian countries more generally is transforming the global economy and reshaping trade patterns. This historic shift is certainly being felt in British Columbia. Despite the apparent natural advantages that BC has in a north-south context – geographic proximity, a common language, similar institutions and business practices, a comprehensive free trade agreement (NAFTA) and a long history of close trading ties – BC now ships more merchandise goods to the Pacific Rim countries than to the United States.⁷

For many decades the US was the province's dominant trading partner, buying between 65% and 70% of its international merchandise exports. The Asia Pacific region accounted for less than one-quarter of BC's exports in 2000, while China was barely on the radar, buying just 2% of all goods shipped out of the province to international destinations. With data available for the first seven months of the year, 2011 is shaping up to be a watershed

⁴ H. Kharas, "The Emerging Middle Class in Developing Countries, OECD Development Centre Working Paper No. 285 (January 2010).

⁵ World Bank Development Indicators database, measured at current exchange rates.

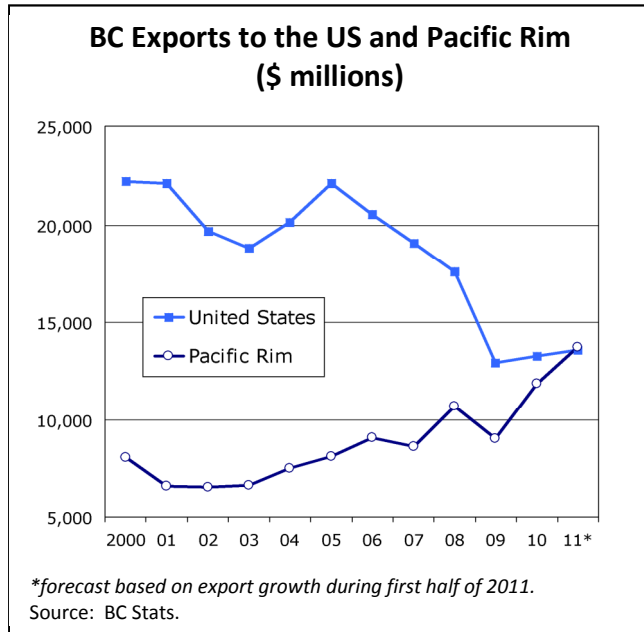
⁶ Goldman Sachs, "The Rise of the BRICs and N-11 Consumer," (December 2010), p. 9.

⁷ In the BC Stats export data the Pacific Rim includes: Japan, Hong Kong, Malaysia, Brunei Darussalam, Singapore, Laos, Mongolia, China, Indonesia, North Korea, South Korea, Philippines, Macau, Taiwan, Thailand, Vietnam, Australia, Fiji, New Zealand. Note that this definition excludes India, Pakistan, the rest of South Asia and Southwest Asia.



year for BC's trade profile: the province's trade orientation is now more aligned with the Pacific Rim (44% of exports) than with the US (42%).

Is this realignment permanent? Given divergent growth dynamics between advanced economies like the US and emerging economies such as China, India and Indonesia, we believe the answer is yes, at least for the foreseeable future. What's more, the gap is likely to widen, making BC even more aligned with Asia over the rest of this decade. The de-leveraging process affecting households and the public sector in many advanced economies promises to constrain economic growth across much of the OECD for a



half decade or more. With the dismal state of the US job market and the huge volume of home foreclosures still pending, US housing market and home building activity aren't expected to return to a sustained recovery phase for another three or four years. In contrast, China and other emerging Asian economies are on course for continued strong growth. Japan – traditionally BC's most important commercial partner in Asia – should also post respectable growth numbers for the next couple of years, as it recovers from the earthquake, tsunami and nuclear crisis that hit the country earlier this year.⁸

Some simple extrapolation confirms the Asia Pacific region is poised to play the dominant role in the province's export sector. BC's merchandise exports to the Pacific Rim have expanded by 11% on average over the past five years; over the same period, exports to the US have fallen by nearly 7% on average. If ones uses a conservative assumption that BC's export growth to the Pacific Rim moderates to an annual gain of 6%, and then assume that exports to the US are flat for the next two years but rise by 5% annually for the following three years, BC's exports to the Pacific Rim could reach \$18.7 billion by 2016, versus \$15.5 billion to the United States. In this scenario, the Pacific Rim would buy more than 46% of BC's exports in 2016, and the US 39%.

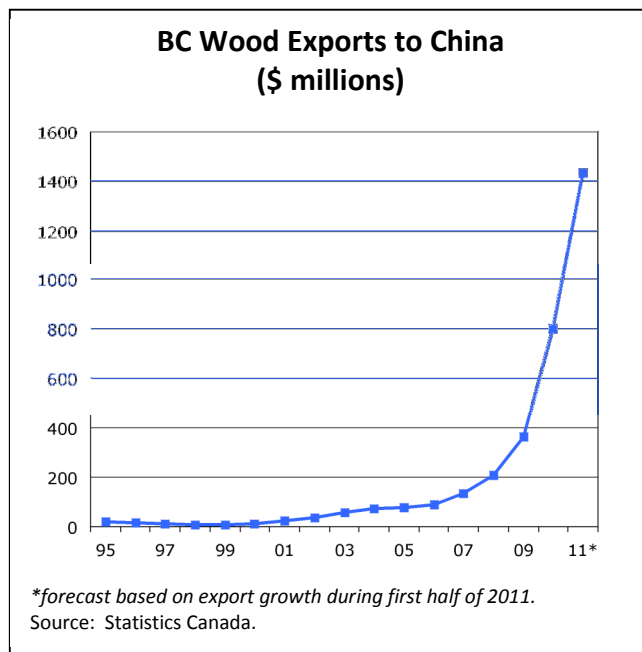
⁸ Scotiabank Economics, in its latest update, sees real GDP in Japan rising by 3.5% in 2012, following a flat year in 2011. In 2010 Japan's economy grew by 4.0%. Scotiabank Group, Global Economic Research, "Global Forecast Update" (September 1, 2011).



An even greater realignment towards Asia is possible. If one posits that the growth in China’s appetite for BC resources remains largely intact (increasing by 20% annually, less than half the pace of the past five years); that export growth to the rest of the Pacific Rim accelerates to 10% annually (twice the recent rate); and that exports to the US follow the pattern outlined above, then by 2016 approximately 53% of BC’s exports would go to Pacific Rim markets, and 35% to the United States. Extending the same growth projections to 2019 puts the Pacific Rim’s share at almost 60% and the US share at roughly 30%. Under this plausible but admittedly optimistic Asian growth scenario, the “market shares” for BC exports to the Pacific Rim and the US could fully reverse by 2019 compared to the situation in 2000.⁹

If BC’s natural gas sector develops as some analysts anticipate, this export realignment to the Asia Pacific could be even more dramatic. Plans to build at least one liquefied natural gas (LNG) facility in Kitimat to ship BC gas to Asian markets would cause the province’s gas exports to Pacific Rim to soar from nil to billions of dollars annually in a few years’ time. The potential market for BC natural gas sales in the US has been diminished by huge increases in the domestic supply of unconventional gas stemming from the use of new technologies. While a project of this scope will take a number of years to complete, the vast increases in North American supply, coupled with significantly higher gas prices in Asian markets, underscores the urgency of building the infrastructure and capacity to enable BC-produced natural gas to be delivered to lucrative offshore markets.

The transportation and logistics industry that is closely linked to BC’s (and Western Canada’s) resource-based economy also represents a sizable opportunity for the province in a world in which Asia is becoming a more influential economic force. In addition to moving BC exports to overseas destinations, the



⁹ Keeping growth in exports to the US at just 5% annually through to 2019 could also be considered pessimistic because at some point a meaningful recovery will take hold in US home building, resulting in a surge in lumber shipments and a boost to BC’s overall exports south of the border.



transportation/logistics sector is handling a growing volume two-way trade between the rest of North America and the Asia Pacific.

Over the past ten years, the value of international merchandise imports destined for BC or shipped through the province has risen at an annual average rate of 4%, even though the total value of imports in 2010 is still below the 2008 peak. On the import front, China is sure to loom larger in BC's (and Western Canada's) economic future. China's shipments of goods to or through BC have soared by 40% annually over the past decade. Overall import growth from Asia into or through BC, however, has been slower, as some other large Asian exporters (Japan, South Korea and Taiwan) have shipped lower volumes of goods into BC. Presumably China's export growth in part has come as the expense of production and exports for these other countries.

Both Port Metro Vancouver and the Port of Prince Rupert continue to experience strong volume growth. While the Fairview container terminal in Price Rupert began operating just a few years ago, expansion plans are already in place to boost annual capacity to 1.3 million TEUs.¹⁰ Rising demand in China and other parts of Asia is behind plans to build a potash export terminal and expand the coal terminal on Ridley Island.

Tourism is recognized an important economic driver for BC. The province's international tourism industry has struggled over much of this decade. Tighter airport and land border security, the strong Canadian dollar, escalating gas prices, SARS and H1-N1, and the 2008-09 global downturn have all conspired to reduce the number of international visitors coming to the province. In 2010, overnight visitors from the Asia Pacific region increased 11% over the previous year while visitors from China jumped nearly 20%; this partly reflects the impact of the 2010 Olympics. Over the first half of 2011 visitor numbers from the Asia Pacific slipped but the number from China increased by 7%. While recent indicators for Asian tourism in BC are generally positive, this is one area where caution about the longer-term outlook may be warranted, as the overall increase in visitors from the Asia Pacific has been muted and Asian consumers with the desire and means to travel have many other options available.

Conclusion

The global economy is being transformed. Growth in most of the advanced economies is expected to be very modest (at best) over the next few years, and in the US it may be stunted for a protracted period. In contrast, emerging economies, including those in Asia,

¹⁰ TEU = Twenty Foot Equivalent Units.



will account for the majority of global economic growth over the rest of the decade. This dynamic is expected to solidify the Pacific Rim as BC's leading trading region.

Ongoing economic development in China and other Asian markets also suggests that BC's resource industries as well as the transportation and logistics sector will be in an expansion mode over the foreseeable future. Segments of the construction industry will also benefit from requirements to build additional infrastructure and other major projects linked to BC's resource industries. Many other BC industries – tourism, international education, engineering, design, clean technology, and scientific/technical services – will also have opportunities to develop new business in what some commentators now refer to as the “Asian century.”
