Macroeconomics
for Emerging East Asia

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Preface

The idea for this book originated with my teaching a macroeconomics course to mostly Asian students at the Lee Kuan Yew School of Public Policy at the National University of Singapore. For my first year teaching the course, a standard US principles text had already been adopted for our use. Teaching macroeconomics from the standpoint of a country that prints the world's reserve currency and gives no thought to external balance or debt sustainability to students from Singapore, China, and Laos seemed altogether inappropriate. To even begin thinking about macroeconomics for these countries requires an understanding of the balance of payments and exchange rates, yet these topics were relegated to the final chapter of the text like an afterthought.

In my second year at the LKY School I had the opportunity to work with a colleague, Charles Adams, in designing a macroeconomics executive program for Vietnamese government officials. Charles had spent most of his career in Asia with the International Monetary Fund working to address macroeconomic policy problems in the region. He knew exactly how to structure a course in macroeconomics for Asia, and I caught on quickly enough that we were able to take turns delivering the program in Hanoi. It struck me that someone ought to write the textbook for such a course.

Around the same time, China was coming under fire for "manipulating" its exchange rate. I wrote a series of op-eds for the *Wall Street Journal* defending China's currency policy as rooted in sound macroeconomics. The anomalousness of this position prompted the paper's opinion page editor to ask me whether there was anyone else who agreed with my view. And again, it seemed to me that someone ought to write a textbook that would establish a way of thinking about macroeconomics for the Asian context.

I decided to step up. The book is designed from the outset for Emerging East Asia. It encompasses 13 economies: Cambodia; China; Hong Kong; Indonesia; Korea; Laos; Malaysia; Myanmar; the Philippines; Singapore; Taiwan; Thailand; and Vietnam. As different as they are in many ways, these economies can all be subsumed within a common framework for purposes of macroeconomic analysis, but it's a different framework from the one conceived for the US.

The economies of Emerging East Asia share the following salient features: (i) both internal balance, involving output growth at potential with inflation low and stable, and external balance, involving sustainable foreign trade and capital flows, matter for macroeconomic stability; (ii) the exchange rate figures importantly in macroeconomic policy; (iii) the role of the interest rate in monetary policy is circumscribed by the pressures of global capital flows (Singapore and Hong Kong being extreme cases) or by insensitivity of credit to interest rate movements (China being a case in point); and (iv) sustainability of public debt is a concern. By contrast, because the US is in the unique position of printing the world's reserve currency, external balance and debt sustainability are not at issue there. Further, because the US financial system is well developed and globally dominant, the interest rate serves as an effective, finely tuned instrument of monetary policy while the exchange rate does not figure in.

A technical summary aimed at the initiated follows in this paragraph, with the novice invited to hang on for inspiration. The book treats the balance of payments and exchange rates as foundational. Once the system of national accounts for measuring the domestic economy has been laid out, the balance of payments accounts are introduced. This sets the stage for presenting the basic identity equating an excess of national saving over domestic investment with a capital outflow that must be matched by a trade surplus. The basics of money creation are then explained with reference to the central bank balance sheet so as to illuminate the parallel between domestic bonds and foreign currencies for purposes of central bank trading operations. A full elaboration of foreign exchange markets follows with the implications of central bank intervention highlighted. Foundations thus in place, attention turns to theories of how an economy responds to shocks and why performance is prone to fluctuate over time. The policy chapters follow. Monetary policy is discussed with reference to both the interest rate and the exchange rate as instruments. Fiscal policy is examined with emphasis on debt sustainability. The coordinated exercise of monetary and fiscal policy for pursuit of combined internal and external balance is then analyzed with use of the Swan diagram. Two further chapters deal with macroprudential policy and the origins and management of crises.

To cap it off, the Epilog circles back to a motivating issue for the book: "currency manipulation", as charged most vociferously against China, but also against Vietnam, Taiwan, and in broader brush potentially any economy that relies on central bank intervention in the foreign exchange market to pursue macroeconomic stability. That means all 13 economies covered in this text. Central bank buying of foreign currency in exchange for newly issued domestic currency stimulates the economy by expanding the money supply and by making exports cheaper and imports more expensive to favor domestic production. Central bank selling of foreign currency and withdrawal of domestic currency does the opposite. Importantly, a central bank can only sell foreign currency to the extent that it has previously bought it. And it may need to sell a lot to stabilize an exchange rate in the face of heavy capital outflows, a leading cause of which is the pull of higher interest rates in the US when authorities there tighten monetary policy. When the US acts, the rest of the world must react. Foreign exchange market intervention is a prime tool for such reacting and for pursuing macroeconomic stabilization more generally. This book lays the foundations for understanding and justifying the exchange rate management behavior we observe.

No prior knowledge of economics is assumed on the part of students, although novices should be prepared to get up and running quickly. Those who have taken macroeconomics courses using standard US textbooks will find the training helpful in grasping the material even as they discover much that is new here. Those who are well versed in the discipline will appreciate the substantially different approach taken in this book to fit macroeconomics to the Asian milieu.

Finally, as this book goes to press, the Covid pandemic continues to cause economic disruption and pose policy challenges. For updates on the situation applying the framework developed in the book, interested readers are referred to the *Asia Economics Blog* of the American Committee on Asian Economic Studies. The website for this textbook keeps a running tally of posts keyed by chapter. Further to those with a broad interest in Asian economies, the Blog provides an open forum for presentation of research and analysis.