



CES Colloquium Series on Economic Issues

Rising China, anxious Asia? A Bayesian New Keynesian view

by

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Date: 1 March 2013 (Friday)

Time: 2.30 pm – 4.00 pm

Venue: H112, Kampar Campus

CPD Hours: 1.5 CPD Hours

ABSTRACT

Should Asia feel anxious about China's expansion? We look for the answer through the estimation of a two-country New Keynesian model of production fragmentation covering ten Asian economies, including China. The estimates show that vis-à-vis China, the developed Asia has a more fragmented production structure with higher domestic value-added embodied in intermediates traded with China whereas the developing Asian production chains are less fragmented with more foreign value-added. We also find that China's expansion made possible by favorable demand and price shocks benefits all Asian neighbors. Expansion driven by total factor productivity improvement, however, lifts the aggregate value-added in the developed Asia but not in the developing Asia, unless the shocks symmetrically originate in both China and the developing Asia. Fixing the regional currencies irrevocably to the U.S dollar ensures that China's productivity improvements are beneficial to all, regardless of the symmetry of shocks, although it is nearly irrelevant for responses to other type of shocks. Therefore, our answer to the introductory question is a simple no for the developed Asia and a conditional no for the developing Asia.

Staff and students are welcomed