

# **Asian Business Cycle Synchronisation**

**Dong He**

Hong Kong Institute for Monetary Research

and

**Wei Liao**

Hong Kong Institute for Monetary Research

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## **Summary**

The accelerated pace of globalisation has led to a high degree of economic integration of Asian economies within the region, as well as with the rest of the world. At the centre of the globalisation process in East Asia is a rapid development of vertical trade integration. Since trade in complements tends to strengthen output co-movement, business cycles in East Asia may have become more synchronised.

We use a multi-level structural factor model to decompose the business cycles fluctuations into components driven by different underlying structural factors, namely a global supply factor, a global demand factor, a regional demand factor, and a regional demand factor for both nine East Asian economies and the G-7 group. We also examine the evolution of both world and region business cycle synchronisations over the last three decades and the different roles played by the four different structural factors.

We find that, while the role of the global factors has intensified over the past fifteen years for most of the economies, output fluctuations in Asia have remained less synchronised with the global factor than those in the industrial countries. The Asian regional factors have become increasingly important in tightening the interdependence within the region over time. Thus while emerging Asian economies cannot “decouple” completely from the advanced economies, they have nonetheless sustained a strong independent cycle among themselves. We also find that synchronised supply shocks contributed more to the observed synchronisation in output fluctuations among the Asian economies than demand shocks. This points to the role of productivity enhancement through vertical trade integration, rather than dependence on external demand, as the primary source of business cycle synchronisation in emerging Asia.