

Highlights—ADO 2009 Update

Despite a notable slowdown in its economic expansion relative to potential, developing Asia is leading the recovery from the global downturn. Its growth is underpinned by the relatively healthy state of its financial systems prior to the financial crisis; by the fiscal and monetary stimuli that have been quickly provided by governments and central banks across the region; and by the rapid turnaround in its larger, less export-dependent economies.

However, risks remain on the downside: hasty withdrawal of the fiscal and monetary measures supporting aggregate demand would stunt developing Asia's nascent recovery, and any slippage in the major industrial economies' recovery would delay the region's return to its long-term growth path.

To develop more resilient economies, developing Asia should broaden the scope and structure of openness. Reducing its vulnerability to external shocks requires policy makers to tackle the geographically unbalanced structure of its trade, capital flows, and movement of workers. By promoting closer economic linkages within the region and a more balanced internal economic structure with a bigger role for domestic demand, policy makers in developing Asia will be able to achieve rapid yet stable growth for the region.

Key Messages

- The global economy may just be coming out of its worst peace-time downturn since the Great Depression of the 1930s. Part 1 of this *Update* to the *Asian Development Outlook 2009 (ADO 2009)* that was released in March, envisages a global economic contraction this year on account of steep declines in world trade and industrial production. While fiscal stimulus packages and easy monetary policies have averted a collapse of the global financial system and limited the depth of the recession, conditions for a sustainable world economic recovery are still uncertain.
- The main channel by which the global financial crisis and economic slump spread to developing Asia was the collapse of demand in major global markets, hitting the region's exports. With a large proportion of regional trade in parts and components supporting supply chains, imports also buckled. The more open economies of East Asia and Southeast Asia—such as Hong Kong, China; Republic of Korea (henceforth Korea); Malaysia; Singapore; Taipei, China; and Thailand—were hardest hit, and their economies contracted significantly from the second half of 2008 until well into the first half of 2009.
- But many regional governments' quick and decisive response to the weak global environment prevented a freefall in developing Asia's economic growth. Tax cuts, greater public spending, targeted assistance, and easy monetary policies boosted consumption and investment. The regional economy is now poised to achieve a V-shaped rebound. The larger economies provided much of the impetus for the region's transition to recovery. In addition, stronger financial systems in the region than elsewhere at the onset of the financial crisis underpinned the region's resilience to the global downturn.
- Nevertheless, there is no room for complacency, and the region's nascent recovery faces downside risks. Externally, a lengthier global downturn than currently forecast would retard the region's full recovery, and without a revival of the global economy, the region's long-term growth potential would remain unattainable. Internally, in its current economic structure, developing Asia cannot be the sole driver of its own growth. Likewise, mistimed exit strategies for fiscal and monetary stimuli would imperil the region's rebound; and pulling away the carpet of fiscal and monetary support before the recovery has a firm foothold may lead to a double-dip decline instead of the expected V-shaped rebound.
- To strengthen its economic resilience and sustain its development, developing Asia must adopt policies to broaden the scope and structure of its openness to trade, capital flows, and movement of workers. Part 2 of this *Update* calls for promoting intraregional economic links while maintaining vital existing links with the rest of the world. Success in this twin-track approach will enable the region to exploit the potentially vast but largely neglected gains from closer relations with its neighbors. Combined with a stronger domestic economy, broader openness can help regional economies achieve rapid yet stable growth.

Outlook for 2009 and 2010

- Since the publication of *ADO 2009* in March, global economic conditions have worsened, requiring an update of forecasts for the G3 economies of the United States, eurozone, and Japan. A deeper contraction of 3.7% in 2009 is now seen in the G3, followed by a modest recovery of 1.1% in 2010 as inflation remains quiescent. The volume of world trade is set to decline more sharply this year but rebound more quickly next year, both relative to *ADO 2009*.
- Oil prices have been rising steadily since March 2009, but have stayed well below July 2008's peak. Global demand remains subdued and inventory levels high. In addition, production capacity of members of the Organization of the Petroleum Exporting Countries is projected to increase substantially. Together these factors should damp the scope for further price increases in the short term. Nonenergy prices have been less volatile, increasing only subtly since the beginning of this year. The nonenergy price trajectory in the next 2 years depends on a host of factors, including a recovery in demand, weather conditions, and supply setbacks.
- While some signs of worldwide economic stabilization are beginning to emerge, risks to the global outlook remain tilted to the downside. Governments around the world slashed interest rates and taxes and raised spending to boost sagging aggregate demand. Yet exiting these measures too early may lead to a protracted slowdown and derailment of the global recovery, and correct timing is key to avoiding a double-dip downturn. Increased resort to protectionist measures and the persistent stalemate in global trade negotiations is likewise threatening the fragile trade rebound. In addition, the continued weakness in housing markets could also cloud prospects for the world economy, while cost-push inflation may return with resurgence in global oil prices. Finally, the risk of a global emergency from H1N1 flu may have diminished, but the virus could still mutate into a more virulent strain, with far more serious public health consequences.
- Despite the notable slowdown in growth this year in most economies across developing Asia, the region has proved to be more resilient than earlier feared. Part 3 of this *Update* projects economic expansion of developing Asia to come in at 3.9%, revised up by 0.5 percentage points from the *ADO 2009* forecast of 3.4%, on the back of much stronger growth in East Asia and South Asia. The growth projection for 2010 is likewise upgraded to 6.4% from 6.0% in March.
- This resumption of growth has taken place amid a low to mild inflation environment across the region. Coming off last year's peak, inflation in developing Asia is forecast to come in at just 1.5% in 2009, down from the March projection of 2.4%. More robust growth is likely to push prices up faster in 2010, raising the forecast to 3.4%. Central bankers in the region will therefore want to put a tight watch on monetary policies so as not to encourage asset bubbles that would inflate prices to levels that are no longer justified by fundamentals.

- Slower growth in industrial countries has resulted in a weak recovery in developing Asia's exports. But imports were even more sluggish as demand for intermediate goods waned. Overall, the region's current account is expected to register a surplus of 5.0% of GDP in 2009. With developing Asian economies increasingly relying on domestic demand to boost growth, their current account surplus is projected to fall further to 4.3% of GDP in 2010.
- There are notable divergences in the outlook across subregions and economies. In particular, the *Update* upgrades projections for East Asia and South Asia, while downgrading those for other subregions. Likewise, it has raised forecasts for the larger regional economies, such as the People's Republic of China (PRC), Korea, India, and Indonesia, while lowering those for the smaller, generally more open economies.
- Economic expansion in East Asia is now projected to reach 4.4% in 2009, supported by stronger growth in the PRC and a shallower contraction in Korea, than foreseen in *ADO 2009*. The PRC's massive fiscal stimulus package announced last year and the aggressive monetary easing in 2009 bolstered economic growth in that country. The Government's 8.0% growth target set at the start of the year now looks within reach, with the *Update* projecting the economy to expand by 8.2%. Similarly, Korea's fiscal stimulus has been effective, and the economy is forecast to shrink by just 2.0% this year, compared with March's 3.0% forecast.
- Subregional inflation is set to decline to 0.2% in 2009, largely because the PRC and Taipei,China will see deflation. In 2010, consumer prices are expected to rise to 2.6% on account of a gradually strengthening subregional recovery. Current account projections are slightly downgraded for the next 2 years, relative to March.
- Prospects for growth this year in South Asia have improved to 5.6%, up from the *ADO 2009* forecast of 4.8%, with the *Update* shifting up the outlook for five of the eight subregional economies. India's economic expansion, in particular, has been upgraded by 1 percentage point to 6% due to the expected positive effects of a continued large fiscal stimulus announced in its July 2009 budget and the emerging signs of recovery in private business confidence. Subregional inflation has been contained following the drop in oil prices in the second half of last year, with some economies starting to record deflation in recent months. Consumer prices are thus forecast to increase at 4.7% in 2009, below the 5.6% expected in March.
- In 2010, subregional growth is likewise upgraded to 6.4% from 6.1% in *ADO 2009*. Stronger growth is projected to lift prices, raising the inflation forecast to 4.9% from 4.4% in March. In current-account terms, the drop in global oil prices from last year's peak provided much relief for South Asia's economies, curtailing the projected subregional deficit to 1.7% and 2.2% of GDP in 2009 and 2010, respectively.
- Aggregate growth in the 10 Southeast Asian economies is now expected to slow to 0.1% in 2009 compared with the March growth forecast of 0.7%. More positive prospects for Indonesia and Viet Nam failed to counterbalance the deterioration among the more open, as well as the smaller, economies in the subregion. Next year, overall growth is put at 4.3%, similar to the March forecast.

- Considerably weaker domestic demand and lower oil and food prices are expected to lead to a sharper than earlier expected decline in inflation across the subregion. In 2009, the forecast is revised downward to 2.5% from 3.3% in *ADO 2009*. The inflation projection for 2010 is maintained at 4.1%. As a precipitous decline in exports is likely to be more than offset by a steeper decline in imports, the subregion's current account surplus in 2009 is now expected to be 5.4% of GDP, against the 4.4% predicted in March. Next year, the surplus is forecast to come in at 4.6% of GDP owing to a mild recovery in demand for the subregion's exports from industrial countries and a pickup in imports.
- Across Central Asia, projections for economic growth are now much bleaker than in *ADO 2009* due to lower commodity prices; a deeper downturn in the Russian Federation (the subregion's main trade and financial partner); and weaker capital inflows, investments, and remittances. Subregional growth is forecast to slow to 0.5% in 2009 and 3.6% in 2010, compared with 3.9% and 4.8% projected in March. The largest Central Asian economy, Kazakhstan, is seen contracting by 1.0% in 2009, a reversal from the 2.0% growth earlier expected in *ADO 2009*, as it grapples with the fallout from a banking crisis and lower oil prices.
- Inflation pressures in the subregion have been curbed by sharp drops in domestic demand and lower commodity prices. As a result, the *Update* revises downward the inflation forecasts for 2009 and 2010 to 7.6% and 7.3%. The overall current account position of the subregion is also very likely to deteriorate, as hydrocarbon exporters labor under lower oil prices and hydrocarbon importers suffer from greatly reduced remittance inflows.
- Economic growth in the Pacific in 2009 is slightly downgraded to 2.8% from 3.0% expected in March, largely as a result of a less optimistic growth forecast for the Democratic Republic of Timor-Leste (the subregion's third-largest economy). Only three of the 14 subregional economies are likely to expand by more than 1.0% this year. Weaker prospects stem from falling incomes from tourism and remittances brought by the global slowdown. The *Update* pencils in minor adjustments for subregional inflation and the current account.
- Overall, developing Asia is set to emerge from the global slump ahead of the rest of the world. Progress in rehabilitation efforts after the Asian crisis in 1997–98 ensured that the region's financial systems were relatively healthy when the global financial crisis erupted, and allowed the region to manage, in the main, a soft landing. Fiscal stimulus measures and easy monetary policies also proved to be highly effective in bolstering regional growth.

Broadening openness for a resilient Asia

- Openness to foreign trade and capital flows has underpinned world economic growth in the last 60 years, and will continue to do so in the future. Developing Asia's economic success, including robust growth that raised per capita incomes and lowered poverty levels, likewise depended on its outward orientation. But the 1997–98 Asian financial crisis and the latest global slump have exposed the risks that the region faces from a narrow application of openness. Broadening the scope and structure of openness is needed to support developing Asia's economic resilience and sustained development.
- During the Asian crisis, the massive reversal of foreign capital inflows underlined the risk of excessive financial openness. A key lesson learned from that crisis was the need for strong domestic institutional capacity—that is, sound and efficient financial systems—to effectively manage financial globalization. In the aftermath of the crisis, developing Asia reformed its financial systems, boosting its resilience to financial shocks, and to a large degree shielding itself from the effects of the recent tumult.
- However, the region's recovery from the 1997–98 crisis came at the expense of overreliance on extraregional demand, a dependency that, in the last year or so, has battered the region's exports, reduced capital inflows, and slashed remittance growth. A key lesson is that regional policy makers need to address the geographically unbalanced structure of the flows of its trade, capital, and workers.
- Mechanisms need to be put in place to safeguard domestic economies against excessive and unbalanced openness. Policies to build up domestic capacity and enhance regional cooperation are required to bolster the resilience of regional economies and reduce their vulnerability to external shocks.
- Strengthening intraregional trade (especially for final goods) can help reduce developing Asia's overdependence on exports to industrial countries and can provide an additional engine of short-run recovery and long-run growth. Achieving this entails boosting domestic economies through a wide range of rebalancing policies as outlined in *ADO 2009*; removing barriers to intraregional trade, particularly behind-the-border obstacles to freer trade in goods and services; and promoting regional cooperation to institutionalize concrete and specific efforts toward facilitating intraregional trade.
- Effectively managing financial globalization can ensure that capital flows are less destabilizing to regional economies. This requires encouraging a shift in the composition of foreign capital to less volatile longer-term inflows by improving the investment climate; strengthening domestic financial markets with requisite oversight mechanisms, and keeping appropriate levels of foreign exchange reserves (especially those economies with managed exchange rate systems); and supporting the establishment of regional capital markets, to be able to successfully tap and mobilize the regional savings pool.

- Migration is increasingly important in the global landscape, and Asian countries are well known labor exporters. Also, remittances are a more stable source of foreign currency than many other nontrade sources. Developing Asia's governments should therefore maximize the benefits of labor flows by ensuring that the migration channel is kept open, enhancing the safety and security of formal systems for funds transfers, and providing an environment that encourages households to invest more of the funds that they receive. Regional cooperation to avoid protectionist policies would also enhance the interests of both home and host countries.

Subregion/Economy	Table 1 Growth rate of GDP (% per year)					Table 2 Inflation (% per year)				
	2008	2009		2010		2008	2009		2010	
		ADO 2009	Update	ADO 2009	Update		ADO 2009	Update	ADO 2009	Update
Central Asia	5.7	3.9	0.5	4.8	3.6	16.4	10.6	7.6	7.8	7.3
Azerbaijan	10.8	8.0	3.0	6.7	4.5	20.8	12.0	4.0	7.0	7.0
Kazakhstan	3.3	2.0	-1.0	3.3	2.5	17.3	10.0	8.0	6.4	6.4
East Asia	6.5	3.6	4.4	6.5	7.1	5.4	1.1	0.2	1.3	2.6
China, People's Rep. of	9.0	7.0	8.2	8.0	8.9	5.9	0.8	-0.5	1.0	3.0
Hong Kong, China	2.4	-2.0	-4.0	3.0	3.0	4.3	1.5	1.3	2.0	2.0
Korea, Rep. of	2.2	-3.0	-2.0	4.0	4.0	4.7	2.0	2.5	2.0	2.5
Taipei, China	0.1	-4.0	-4.9	2.4	2.4	3.5	0.6	-0.7	1.2	0.2
South Asia	6.3	4.8	5.6	6.1	6.4	9.6	5.6	4.7	4.4	4.9
Bangladesh	6.2	5.6	5.9	5.2	5.2	9.9	7.0	6.7	6.5	6.5
India	6.7	5.0	6.0	6.5	7.0	8.7	3.5	2.5	4.0	4.0
Pakistan	4.1	2.8	2.0	4.0	3.0	12.0	20.0	20.8	6.0	10.0
Sri Lanka	6.0	4.5	4.0	6.0	6.0	22.6	8.0	5.0	6.0	6.0
Southeast Asia	4.1	0.7	0.1	4.2	4.3	8.6	3.3	2.5	4.1	4.1
Indonesia	6.1	3.6	4.3	5.0	5.4	9.8	6.3	5.0	6.9	6.0
Malaysia	4.6	-0.2	-3.1	4.4	4.2	5.4	1.5	1.1	2.4	2.6
Philippines	3.8	2.5	1.6	3.5	3.3	9.3	4.5	3.2	5.0	4.5
Singapore	1.1	-5.0	-5.0	3.5	3.5	6.5	0.5	0.0	2.0	2.0
Thailand	2.2	-2.0	-3.2	3.0	3.0	5.5	0.5	-0.5	1.5	2.0
Viet Nam	6.2	4.5	4.7	6.5	6.5	23.0	4.0	6.8	5.0	8.5
The Pacific	5.2	3.0	2.8	2.7	3.1	9.5	6.2	6.1	4.9	5.2
Fiji Islands	1.2	-0.5	-1.0	0.2	0.5	7.7	4.5	7.0	4.5	7.0
Papua New Guinea	7.2	4.0	4.5	3.5	3.9	10.8	7.0	7.0	6.0	5.5
Developing Asia	6.1	3.4	3.9	6.0	6.4	6.9	2.4	1.5	2.4	3.4

Notes: **Developing Asia** refers to 44 developing member countries of the Asian Development Bank and Brunei Darussalam, an unclassified regional member; **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei, China; **Southeast Asia** comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam; **South Asia** comprises Islamic Republic of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka; **Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan; and **The Pacific** comprises Cook Islands, Fiji Islands, Kiribati, Republic of the Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Republic of Palau, Samoa, Solomon Islands, Democratic Republic of Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Data for Bangladesh, India, and Pakistan are recorded on a fiscal year basis. For India, the fiscal year spans the current year's April through the next year's March. For Bangladesh and Pakistan, the fiscal year spans the previous year's July through the current year's June.