

Highlights—ADO 2009

Developing Asia's economic growth in 2009 will slow to its most sluggish pace since the 1997–98 Asian financial crisis. The global downturn is having a pronounced impact on the region's exports, and subdued domestic demand will further crimp growth. Inflation pressures will abate on the back of slower economic expansion and falling commodity prices.

A regional recovery will have to wait until 2010 when the world economy bounces back. This outlook, however, continues to be overshadowed by serious downside risks. Further, Asia's large and persistent current account surpluses have contributed to the global imbalances underlying the current crisis, so it is in developing Asia's own self-interest to adopt policies to rebalance its growth.

Key messages

- Deteriorating global prospects have soured the medium-term outlook for developing Asia. Growth began to cool in 2008 from the record levels of 2007. In 2009, growth is projected to drop a further 3 percentage points to 3.4%. The region's growth is projected to rebound to 6.0% as the global economy experiences a mild recovery in 2010.
- The downturn will hit all developing Asia's subregions, substantially slowing the pace of poverty reduction. Governments in the region have acted decisively to fight the downturn through fiscal stimulus packages, but their impact remains uncertain.
- As global commodity prices continue to fall, inflation is expected to ease to 2.4% in 2009 and 2010. Due to a decline in exports and reduced remittances, the region's overall current account surplus is projected to fall to about 4.8% of GDP in the next 2 years. In Part 3 of *Asian Development Outlook 2009 (ADO 2009)*, economic prospects in a country-specific context are examined in more detail.
- The depth and length of the global downturn pose the biggest risk to developing Asia's outlook. Unless crisis-resolution and fiscal stimulus packages are effective, global recovery—and thus the region's recovery—will be delayed. Protectionism presents an especially significant risk to a global recovery, with serious implications for highly trade-dependent developing Asia. Although falling oil prices benefit the region—a major net oil importer—their volatility does not. Slowing growth and rising unemployment could give rise to social instability, which would further damp investment and growth. All in all, the downside risks to the region's outlook far outweigh the upside risks.
- The region's sharp slowdown underlines the risks of excessive dependence on external demand. Part 2 of *ADO 2009* explores the issue of rebalancing Asia's growth toward domestic sources. Effective rebalancing will require a mix of policies that will boost domestic demand and bolster the domestic economy. Specific policy options include transferring more corporate savings to households and strengthening social safety nets; creating a more attractive investment climate by improving institutions as well as social and physical infrastructure; pursuing a more active fiscal policy; and promoting small- and medium-sized enterprises and service industries. Such domestic policies must be matched by a concerted global effort to address global imbalances.

Performance in 2008

- Growth in 2008 fell across developing Asia with only the Pacific performing better than in 2007. Economic expansion decelerated to 6.3% from 9.5% in 2007, which had been the fastest rate in nearly two decades. Regional inflation spiked to 6.9% as global food and oil prices surged in the early part of 2008.
- Expansion in East Asia slowed to 6.6%, from a rapid 10.4% in 2007, as all five economies in this subregion decelerated. Weaker growth in manufactured exports was a major reason. The People's Republic of China (PRC) grew by a robust 9.0%, but the Republic of Korea's growth halved to 2.5% from 5% in 2007. Taipei, China's economy was flat in 2008 following the fourth-quarter fall in electronics exports. Aggregate inflation quickened, but at 5.4% remained the lowest of all the subregions.
- Southeast Asia's growth eased to 4.3%, from 6.4% in 2007. Indonesia maintained growth of above 6% for the first 3 quarters of 2008, before the global slowdown hit manufacturing and exports in the fourth. All the economies in this subregion slowed in 2008, with particularly weak growth in Singapore and Thailand. GDP growth in Viet Nam slowed to 6.2%, after 3 years of 8%-plus expansion. Subregional inflation more than doubled to 8.8%, but has been easing with the slowing demand and declining commodity prices.
- In South Asia, growth moderated to 6.8% from 8.6% in 2007. India's growth slowed during 2008, coming in at an estimated 7.1% for the year, well below the 9% pace of recent years. The global financial turmoil and deteriorating economic outlook caused a major reduction in capital inflows and marked falls in business and consumer confidence. In Pakistan, a large fiscal deficit triggered a balance-of-payments crisis that required stabilization support from the International Monetary Fund. Growth in Bangladesh, Bhutan, Maldives, and Sri Lanka moderated. Afghanistan's expansion was hit by drought, but Nepal rebounded from a slump.
- In Central Asia, growth in 2008 plummeted to 5.7% from 12%, with most countries experiencing a downdraft. Kazakhstan's limited access to global capital markets virtually halted domestic bank lending, cutting growth to only 3.2%.
- Growth in the Pacific strengthened to 5.1%, on the back of high energy prices benefiting resource-rich Papua New Guinea and Timor-Leste, and recoveries in Fiji Islands and Tonga. Inflation shot up last year, to a subregional average of 9.6%, propelled by strong growth of domestic demand in Papua New Guinea and rising global oil prices.

Global outlook

- Turbulence in financial markets and continued weakness evident in recent economic data dominate the global outlook for 2009–2010. GDP in the United States, eurozone, and Japan (G3) in 2009 is projected to contract by 2.6% and world trade volume is seen to decline by 3.5%. A mild recovery is anticipated in late 2010, with G3 growth expected at 1.1%.
- However, downside risks to this outlook are significant, and could further slash already dismal prospects. Ineffective crisis-resolution and fiscal stimulus packages could drag down the current bleak forecasts for the United States and other economies. Emerging protectionism is worrisome. Commodity prices are likely to remain volatile. Deflationary risks are in sight, which could lead to further deterioration of labor markets, yet monetary policy options to combat them will be increasingly limited. Social instability could pose additional threats to economic prospects.

Outlook for developing Asia

- The financial sectors of developing Asia's economies have so far largely weathered the crisis. Bank credit continues to flow normally to the real sector even though access to credit has tightened for riskier borrowers. Limited exposure to subprime assets and improved fundamentals since the 1997–98 Asian financial crisis explain the resilience to the global credit crunch. However, equity prices have tumbled and access to external financing has tightened.
- Apart from the financial channel, Asia has been hit by the global recession through the trade channel. The plunge in G3 income has led to a reduction in its import demand that has resulted in a contraction in developing Asia's exports. This export decline has weakened the region's current account position. Projections indicate that the surplus will decline to 4.9% of GDP in 2009 and to 4.7% in 2010.
- Across the region, factory closures and job losses are rising, weighing on consumer sentiment and forcing households to cut back spending. Slowing demand and the uncertain economic environment are discouraging investment. As business sentiment continues to worsen, capital spending will be restrained.
- Deteriorating global prospects have soured the outlook for developing Asia in the next 2 years. GDP growth is projected to reach only 3.4% in 2009, which is nearly 3 percentage points slower than the 2008 rate. As the global economy experiences a mild recovery in 2010, regional growth is projected to improve to 6.0%.

- The drop in demand accompanying the global slowdown and fall in commodity prices has eased inflation pressures in developing Asia. Prices are expected to increase by 2.4% in 2009, a considerable drop from the 2008 pace. Even with the global recovery anticipated to begin in late 2010, inflation should stay largely in check with the rate projected to continue at 2.4%.
- Growth in East Asia is forecast to decelerate to 3.6% in 2009, pulled down by declines in exports of manufactures and knock-on effects on incomes and investment. While the PRC is expected to expand by 7.0%, Hong Kong, China; Republic of Korea; and Taipei, China will contract. Inflation is expected to average less than 2%, except in Mongolia where it will ease but still be much higher than elsewhere in the subregion. Most of East Asia's economies will record current account surpluses. In 2010, East Asia's GDP growth is forecast to bounce back to 6.5% as global trade picks up and stimulus packages have a positive impact.
- Growth in the PRC is seen slowing to 7.0% this year, as exports decline and private investment subsides. Private consumption, though, is expected to remain relatively buoyant. Both public consumption and investment will be bolstered by the fiscal stimulus measures being rolled out by the Government. Inflation is expected to average less than 1%. The current account surplus, while narrowing slightly, will be substantial, and foreign exchange reserves will soar past \$2 trillion this year. GDP growth in 2010 is forecast to pick up to about 8%.
- Southeast Asia's growth is projected to dwindle to just 0.7% this year, with output contracting in the highly trade-exposed countries of Malaysia, Singapore, and Thailand. Inflation will decelerate to 3.3%, less than half the 2008 rate. In aggregate, the current account surplus will ease slightly, but most of the bigger economies are expected to record surpluses. Next year, all these economies are seen rebounding and recording moderately high growth rates.
- Growth in South Asia is expected to slow across the subregion in 2009. India will likely see only a 5% expansion, while Maldives, Pakistan, and Sri Lanka are expected to experience marked slowing. With little room for fiscal stimulus, these countries need to rely on monetary and structural policies to mitigate the headwinds from the global economic downturn.
- While not highly open, the economies of South Asia are still vulnerable to balance-of-payments pressures. Bangladesh, Pakistan, Nepal, and Sri Lanka all rely heavily on workers' remittances to offset large trade deficits, and their exports are concentrated in garments and textiles. Both sources of foreign exchange showed signs of weakening in 2008, possibly emerging as constraints.

- In Central Asia, growth is forecast to decelerate further to just 3.9% in 2009 and to less than 5% in 2010. This is mainly due to a further slowing in Kazakhstan to only 2% growth this year as the country continues to grapple with its banking problems. Growth is expected to fall to low levels in all the non-oil-producing countries, reflecting the full impact of the global economic slowdown in the Russian Federation, the subregion's main trade and financial partner.
- With slower economic expansion and weaker commodity prices, inflation is expected to moderate in Central Asia. The major macroeconomic challenge in 2009–2010 is keeping the balance-of-payments strains from reaching levels that would threaten growth in Armenia, Georgia, Kyrgyz Republic, and Tajikistan. These countries rely heavily on remittances from workers in Kazakhstan and the Russian Federation, and these inflows may well be curtailed by more than is now expected. Moreover, the adequacy of capital inflows is also at risk in light of the global credit crunch.
- Aggregate growth in the Pacific is set to slow to 3% in 2009, largely because Papua New Guinea's expansion will abate after 2 years of strong growth driven by the commodity boom. Fiji Islands is expected to slip back into contraction, hurt by the negative impact of the global slowdown on tourism and remittances as well as by severe flooding in early 2009. Inflation is expected to ease in all Pacific countries. Subregional growth is projected to remain close to 2009 levels next year.
- These deteriorating economic prospects will hinder the efforts to reduce poverty in developing Asia over the next 2 years. The consequences of the global slowdown for achieving the Millennium Development Goals are huge: had growth continued at the robust pace of 2007, more than 60 million additional people would have been lifted from poverty in 2009.
- Recognizing the adverse effects of the weaker regional outlook, developing Asia's governments have acted quickly. Many have begun fiscal stimulus packages and others have announced plans to follow suit. However, there is a dearth of information regarding the form, size, and implementation mechanisms of such packages. The overall impact on regional growth thus remains unclear.

Rebalancing growth

- Export-led growth has delivered enormous benefits to the region and will continue to do so. However, the pronounced impact of the current global downturn—in particular the synchronized recession of the G3—on developing Asia's growth underlines the risks of excessive dependence on external demand.
- The region's large and persistent current account surpluses are an integral part of the global imbalances underlying the current global financial crisis. Well before the outbreak of the current financial crisis, the region may have been paying a heavy price for its output–expenditure imbalance. This price includes not only welfare costs associated with consuming too little, but also opportunity costs arising from failure to use savings productively. Thus, rebalancing growth is fundamentally in developing Asia's self-interest.
- Bolstering domestic demand in response to weakened external demand requires a combination of policy measures. Given the diverse nature and underlying causes of developing Asian countries' current account positions, the optimal policy mix for rebalancing will necessarily differ by country. Nevertheless, effective rebalancing will require both policies that reinforce domestic demand and those that revitalize the domestic economy. For example:
 - * Strengthening domestic consumption requires policies that transfer more corporate savings to households, as well as policies that reduce the precautionary motive for savings among households.
 - * Governments should give priority to enhancing the investment climate rather than quantitative expansion of investment.
 - * A more active fiscal policy can mitigate weak external demand in the short run as well as lay the foundation for more robust domestic demand in the medium to longer term.
 - * Supply-side policies that promote small- and medium-sized enterprises and service industries will bolster production from firms that cater to domestic demand.
 - * Policies pertaining to financial development and adjustment of the exchange rate can promote a better balance between domestic supply and demand.
- A concerted global effort is required to effectively address global imbalances. Strengthened regional cooperation can provide developing Asia with additional resilience, even against such a large external shock as an abrupt unwinding of global imbalances.

| Table 1 Growth rate of GDP (% per year) | | | | | | Table 2 Inflation (% per year) | | | | |
|---|-------------|-------------|------------|------------|------------|--------------------------------|-------------|-------------|-------------|------------|
| Subregion/economy | 2006 | 2007 | 2008 | 2009 | 2010 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Central Asia | 13.3 | 12.0 | 5.7 | 3.9 | 4.8 | 9.0 | 11.2 | 16.2 | 10.6 | 7.8 |
| Azerbaijan | 34.5 | 25.4 | 10.8 | 8.0 | 6.7 | 8.3 | 16.7 | 20.8 | 12.0 | 7.0 |
| Kazakhstan | 10.7 | 8.9 | 3.2 | 2.0 | 3.3 | 8.6 | 10.8 | 17.3 | 10.0 | 6.4 |
| East Asia | 9.4 | 10.4 | 6.6 | 3.6 | 6.5 | 1.6 | 3.9 | 5.4 | 1.1 | 1.3 |
| China, People's Rep. of | 11.6 | 13.0 | 9.0 | 7.0 | 8.0 | 1.5 | 4.8 | 5.9 | 0.8 | 1.0 |
| Hong Kong, China | 7.0 | 6.4 | 2.5 | -2.0 | 3.0 | 2.0 | 2.0 | 4.3 | 1.5 | 2.0 |
| Korea, Rep. of | 5.1 | 5.0 | 2.5 | -3.0 | 4.0 | 2.2 | 2.5 | 4.7 | 2.0 | 2.0 |
| Taipei, China | 4.8 | 5.7 | 0.1 | -4.0 | 2.4 | 0.6 | 1.8 | 3.5 | 0.6 | 1.2 |
| South Asia | 9.0 | 8.6 | 6.8 | 4.8 | 6.1 | 5.9 | 5.5 | 9.6 | 5.6 | 4.4 |
| Bangladesh | 6.6 | 6.4 | 6.2 | 5.6 | 5.2 | 7.2 | 7.2 | 9.9 | 7.0 | 6.5 |
| India | 9.7 | 9.0 | 7.1 | 5.0 | 6.5 | 5.4 | 4.7 | 8.7 | 3.5 | 4.0 |
| Pakistan | 5.8 | 6.8 | 5.8 | 2.8 | 4.0 | 7.9 | 7.8 | 12.0 | 20.0 | 6.0 |
| Sri Lanka | 7.7 | 6.8 | 6.0 | 4.5 | 6.0 | 10.0 | 15.8 | 22.6 | 8.0 | 6.0 |
| Southeast Asia | 6.0 | 6.4 | 4.3 | 0.7 | 4.2 | 7.1 | 4.0 | 8.8 | 3.3 | 4.1 |
| Indonesia | 5.5 | 6.3 | 6.1 | 3.6 | 5.0 | 13.1 | 6.4 | 10.3 | 6.3 | 6.9 |
| Malaysia | 5.8 | 6.3 | 4.6 | -0.2 | 4.4 | 3.6 | 2.0 | 5.4 | 1.5 | 2.4 |
| Philippines | 5.4 | 7.2 | 4.6 | 2.5 | 3.5 | 6.2 | 2.8 | 9.3 | 4.5 | 5.0 |
| Singapore | 8.4 | 7.8 | 1.1 | -5.0 | 3.5 | 1.0 | 2.1 | 6.5 | 0.5 | 2.0 |
| Thailand | 5.2 | 4.9 | 2.6 | -2.0 | 3.0 | 4.6 | 2.3 | 5.5 | 0.5 | 1.5 |
| Viet Nam | 8.2 | 8.5 | 6.2 | 4.5 | 6.5 | 7.5 | 8.3 | 23.0 | 4.0 | 5.0 |
| The Pacific | 2.0 | 2.8 | 5.1 | 3.0 | 2.7 | 3.0 | 3.6 | 9.6 | 6.2 | 4.9 |
| Fiji Islands | 3.4 | -6.6 | 1.2 | -0.5 | 0.2 | 2.5 | 4.8 | 7.7 | 4.5 | 4.5 |
| Papua New Guinea | 2.6 | 6.5 | 7.2 | 4.0 | 3.5 | 2.4 | 0.9 | 10.8 | 7.0 | 6.0 |
| Developing Asia | 8.9 | 9.5 | 6.3 | 3.4 | 6.0 | 3.3 | 4.4 | 6.9 | 2.4 | 2.4 |

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.