

ASIAN DEVELOPMENT

Outlook 2007

Growth amid change

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Foreword

The *Asian Development Outlook 2007 (ADO 2007)* is the 19th edition of the annual comprehensive economic report on the developing member countries of the Asian Development Bank.

ADO 2007 provides an assessment of recent economic performance for 43 developing member countries, and projections for major macroeconomic indicators for 2007 and 2008. It also provides a diagnosis of macroeconomic challenges and future growth prospects for the region's economies.

The performance of developing Asia in 2006 was exceptional. Aggregate gross domestic product for the region grew at 8.3%, the fastest since 1995. Growth was aided by a highly favorable external environment, benign domestic circumstances, good economic management, and the fruits of reform efforts. Remarkable growth in the People's Republic of China and India underpinned this regional expansion, with a large number of other countries enjoying vigorous growth.

Even with exceptionally fast growth and rising oil prices, consumer price inflation did not, in general, accelerate in 2006. But this aggregate pattern disguises wide variation at the country and regional level. In some countries, evidence of overheating gathered as the year progressed. Authorities answered by raising interest rates, mopping up excess liquidity, and restraining credit growth and public spending.

The outlook for the international economy remains broadly favorable, although growth will slow in 2007. Despite production cuts by the Organization of the Petroleum Exporting Countries, crude oil prices are well off their highs of 2006 and are expected to continue stabilizing around \$57 a barrel in 2007. Some metals prices, such as copper, have also come down. Lower commodity prices will generally ease inflationary pressures and bring terms-of-trade gains, as developing Asia is a net importer.

Against this backdrop, still-robust growth of 7.6% and 7.7% for developing Asia is expected in 2007 and 2008. These projections imply that growth will move to a more sustainable footing and that overheating pressures that surfaced in 2006 will gradually ease. Growth in all subregions, except the Pacific, is seen softening in 2007. In the People's Republic of China in 2007 and 2008, softer external demand and policy curbs are expected to pull growth down gradually. In the short run, the Government is likely to restrict investment growth and cool the economy. In India, steps taken by the central bank to cool inflation are expected to slow the pace of investment and consumption spending. In other countries, such as Indonesia, growth is seen picking up in 2007 as lower interest rates and lower inflation give a boost to domestic spending. Falling prices of commodities in international markets, as well as vigilance from monetary authorities across the region, will help ease inflation in 2007. Developing Asia's current account is expected to be in surplus for 2007 and 2008.

As always, events could evolve in surprising and unexpected ways, and derail projections. Risks remain tilted down. Markets have moved to reprice risks, but calm could yet give way to less settled conditions. If asset prices get badly punctured and reversals occur, the chill would be widely felt. Although average oil prices are expected to be lower this year than last and to come down some more in 2008, they remain sensitive to supply conditions, surges in demand, and geopolitical events. In trade negotiations, time is running out for an agreement in the Doha Round, and in the developing vacuum, preferential trade agreements are gathering momentum, and calls for protection are becoming more audible. A human flu pandemic remains a threat. In many countries, elections are scheduled in the next year. Their conduct and outcomes will be important for confidence.

Over the next few decades, developing Asia's prospects will depend critically on its ability to adapt to a constantly changing environment. The theme for *ADO 2007*, growth amid change, looks at the evolutions that have been associated with successful growth experiences. Increasing technological sophistication and structural complexity are important dimensions of change. Industry and manufacturing have played a pivotal role, and in most countries, services have been an important provider of jobs. A key message is that "walking on two legs"—fostering both industry and services—is the only viable development model for many economies.

While prescriptions and priorities need to be country specific, the following elements are crucial: high investment rates that over time build, expand, and upgrade the range of economic activities; funds for infrastructure services that are vital for economies of scale and other benefits; relevant and purposeful education; markets that support labor mobility and flexibility, alongside affordable social protection; arrangements that lower risks and uncertainty for businesses, and that allow new firms to enter and old firms to exit; and removal of at- and behind-the-border impediments to integration.



HARUHIKO KURODA
President

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Definitions

The economies discussed in *Asian Development Outlook 2007* (ADO 2007) are classified by major analytic or geographic groupings. For purposes of ADO 2007, the following apply:

- **Association of Southeast Asian Nations (ASEAN)** comprises Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **Developing Asia** refers to 43 developing member countries of the Asian Development Bank discussed in ADO 2007.
- **Central Asia** comprises Armenia, Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **East Asia** comprises People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei, China.
- **South Asia** comprises Islamic Republic of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- **Southeast Asia** comprises Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.
- **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.
- Unless otherwise specified, the symbol "\$" and the word "dollar" refer to US dollars.

The *Statistical Notes* give a detailed explanation of how data are derived.

ADO 2007 is based on data available up to 15 March 2007.

Acronyms and abbreviations

ASEAN	Association of Southeast Asian Nations
CPI	consumer price index
EU	European Union
FDI	foreign direct investment
FY	fiscal year
GDP	gross domestic product
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
PRC	People's Republic of China
US	United States
VAT	value-added tax
WTO	World Trade Organization