ADB Asian Development Bank

ASIAN DEVELOPMENT

# Outlook Supplement

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# Sluggish Global Economy Weighs on Asia's Growth

- Global economic growth remains sluggish and for 2012 and 2013 will be below the *Asian Development Outlook (ADO) 2012* forecast; the euro area debt crisis continues as the primary threat to the global outlook.
- For developing Asia, the outlook has dimmed, with GDP growth to reach 6.6% in 2012 and 7.1% in 2013 due to the weak global economic environment and slower growth in the People's Republic of China (PRC) and India.
- PRC's growth is expected to ease to 8.2% in 2012, as stimulus from its global financial crisis policy response unwinds, with an uptick to 8.5% in 2013 boosted by the recent loosening of macroeconomic policies.
- India's growth is forecast to moderate to 6.5% in 2012 before picking up to 7.3% in 2013 as high inflation and trade deficits make it difficult to ease monetary policy to stimulate demand.
- Inflation in developing Asia is projected to moderate to 4.4% given the weaker outlook on economic growth and the declining trends in international oil and food prices.

ADB's Regional Economic Outlook Task Force led in the preparation of the revised outlook for this ADO Supplement. The Task Force is chaired by the Economics and Research Department and includes representatives from the Central and West Asia Department, East Asia Department, Pacific Department, Office of Regional Economic Integration, South Asia Department, and Southeast Asia Department.

## Major industrial country outlook

Global economic growth remains sluggish, with rising concern that emerging economies are increasingly vulnerable to weak economic prospects in the United States (US) and euro area. Overall, growth in the major industrial economies (US, euro area, and Japan) is expected to be below what was forecast in April 2012. Given the data released since the *Asian Development Outlook (ADO) 2012*, the forecast for gross domestic product (GDP) growth in major industrial economies for 2012 and 2013 has been revised down by 0.1 percentage points for both years—to 1.0% and 1.6%, respectively (Table 1).

**Table 1. Baseline GDP growth (%)**

| | 2011 | 2012 | | 2013 | |
|---|---|---|---|---|---|
| | | *ADO 2012* | *Revised* | *ADO 2012* | *Revised* |
| Major industrial economies[a] | 1.2 | 1.1 | 1.0 | 1.7 | 1.6 |
| United States | 1.7 | 2.0 | 1.9 | 2.3 | 2.2 |
| Euro area | 1.5 | -0.5 | -0.7 | 1.0 | 0.8 |
| Japan | -0.7 | 1.9 | 2.2 | 1.5 | 1.5 |

[a] Average growth rates are weighed by GNI, Atlas method (current US dollars).
*Sources:* Asian Development Bank. 2012. *Asian Development Outlook 2012*; and ADB estimates.

The euro area continues to be under pressure. Although GDP remained flat in the first quarter of 2012, net exports were the only GDP component with a positive contribution to growth. Going forward, GDP in the euro area is expected to contract by 0.7% in 2012 before recovering to 0.8% growth in 2013, or for each year about 0.2 percentage points below that assumed in *ADO 2012*. Individual country performance within the euro area continues to vary immensely. German GDP grew strongly in the first quarter of 2012, reaching 2%

quarter-on-quarter at an annualized rate, while many other key economies contracted during the first quarter or are expected to do so over the remainder of the year. The economies of Italy, Spain, Portugal, and the Netherlands are all projected to shrink in 2012. Spain is widely seen to contract as well in 2013.

Absent a major crisis in Europe, the US will likely overcome its current sluggishness, growing 1.9% in 2012 before picking up to 2.2% in 2013. Compared with *ADO 2012*, these growth projections are slightly weaker. The downward first quarter GDP growth revisions for the US (from an advance estimate of 2.2% to 1.9%) and the surprisingly weak growth in payroll employment (80,000 new jobs in June instead of the expected 150,000 new jobs) fuelled the debate over sustainability of the US recovery and the need for further policy stimulus.

Overall, assuming no massive disruptions in international trade or finance, Japan's economy is expected to expand 2.2% in 2012, somewhat stronger than the *ADO 2012* forecast. GDP increased 4.7% the first quarter of 2012, following a 0.7% contraction the last quarter of 2011. With first quarter performance beating expectations, the outlook for the remainder of the year is more subdued, with real exports—a major driver the first 3 months of the year—slowing due to weaker foreign demand and a stronger yen (caused by "safe haven" capital flows). In particular, real exports to Europe and the People's Republic of China (PRC) appear to be lagging. Key drivers supporting growth include private consumption led by robust auto sales, a strong rebound in public investment in support of reconstruction from last year's earthquake, and a classic turn in the inventory cycle. Concern over the global economy, however, is reflected in the plunge in business investment.

## Regional Economic Outlook

### *Growth outlook*

Economic growth in developing Asia moderated during the first half of 2012 as slower growth in the US and euro area reduced demand for the region's exports. Worries over the economic strength of important developing economies have also emerged recently. Latest data from the PRC and India suggest growth will slow in the second half of 2012. Unwinding policy stimulus in some countries has also contributed to the region's weaker first half performance.

More generally, the outlook for developing Asia has weakened due to the difficult global environment and slower growth in the PRC and India. Table 2 summarizes the forecast for developing Asia's subregions, the PRC, India, and the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand, and Viet Nam). With the impact of a weaker external environment somewhat counterbalanced by policy easing, developing Asia's GDP growth is revised downwards to 6.6% in 2012 before recovering to 7.1% in 2013.

**Table 2. GDP growth, developing Asia (%)**

| | 2011 | 2012 | | 2013 | |
|---|---|---|---|---|---|
| | | *ADO 2012* | *Revised* | *ADO 2012* | *Revised* |
| **Developing Asia** | **7.2** | **6.9** | **6.6** | **7.3** | **7.1** |
| Central Asia | 6.2 | 6.1 | 5.8 | 6.2 | 6.2 |
| East Asia | 8.0 | 7.4 | 7.1 | 7.7 | 7.5 |
| China, People's Rep. of | 9.2 | 8.5 | 8.2 | 8.7 | 8.5 |
| South Asia | 6.2 | 6.6 | 6.2 | 7.1 | 6.9 |
| India | 6.5 | 7.0 | 6.5 | 7.5 | 7.3 |
| Southeast Asia | 4.6 | 5.2 | 5.2 | 5.7 | 5.6 |
| ASEAN-5 | 4.5 | 5.6 | 5.6 | 5.9 | 5.9 |
| The Pacific | 7.0 | 6.0 | 6.0 | 4.1 | 4.2 |

Note: **Developing Asia** refers to 44 developing member countries of the Asian Development Bank and Brunei Darussalam, an unclassified regional member; **Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan; **East Asia** comprises the People's Republic of China; Hong Kong, China; the Republic of Korea; Mongolia, and Taipei,China; **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka; **Southeast Asia** comprises the ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam) plus the economies of Brunei Darussalam, Cambodia, the Lao People's Democratic Republic, Myanmar, and Singapore; and **The Pacific** comprises Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Papua New Guinea, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

*Sources:* Asian Development Bank. 2012. *Asian Development Outlook 2012*; and staff estimates.

Economic growth in East Asia continued to moderate the first half of 2012 on deteriorating external demand and volatile financial markets. GDP growth in East Asia fell to 6.7% the first quarter of 2012, down from 7.6% the last quarter of 2011. Hong Kong, China and Taipei,China barely missed contracting in the first quarter, with both growing 0.4%. The first quarter growth in the Republic of Korea slowed to 2.8%, from 3.3% previously due to declining investment. Mongolia's economic growth, however, remained strong with GDP rising 16.7% in the first quarter. For the subregion, economic indicators for the second quarter point to continuing moderation, as growth in industrial production, retail sales, and exports moderate. The manufacturing purchasing managers' index (PMI) has also been trending down, indicating manufacturing

could expand at a slower pace. With the weaker global outlook and deepening eurozone debt crisis, growth in East Asia is expected to slow to 7.1% in 2012 before recovering to 7.5% in 2013.

PRC's growth is slowing as it unwinds policy stimulus implemented after the global financial crisis. However, authorities have taken measures in an attempt to prevent a further slowdown in economic growth by easing fiscal and monetary policies. The economy moderated further during the first half of 2012. GDP grew 8.1% in the first quarter, with net exports subtracting 0.8 percentage points. Growth may have slid further in the second quarter, as economic indicators were below expectations. Growth in industrial production and fixed asset investment continued their downward trend in April and May, and the weak manufacturing PMI points to further softness. To stabilize economic growth, PRC authorities began to ease macroeconomic policies. The People's Bank of China cut reserve requirements three times (by a total of 150 basis points) and lowered interest rates for the first time since 2008. Measures to boost consumption, increase expenditure in education and health, and speed up large infrastructure projects should allow the economy to pick up in the second half, unless the global economy falls into deep recession. GDP growth is expected to reach 8.2% in 2012, before accelerating to 8.5% in 2013.

South Asia economic growth will moderate as the weaker global environment reduces exports and investment inflows. Although somewhat offset by stable inward remittances, widening trade deficits have led to the depreciation of most currencies in the subregion and have helped drive inflation up since early 2012. While manufacturing growth is slowing in most countries, domestic conditions vary among major economies. Foreign investments have been declining in India and Pakistan. Based on the government's latest survey, however, real private consumption in Pakistan is expected to grow in FY2012 by a significantly higher rate than in FY2011, supported by inward remittances. The unpromising export outlook requires South Asia to curtail imports to ensure inflation and currency values stay healthy, while maintaining growth momentum. Given these developments, South Asia is expected to grow 6.2% in 2012 and 6.9% in 2013.

India's growth forecast has moderated as high inflation and trade deficits make it difficult to ease monetary policy to stimulate demand. The country continues to be plagued by strong inflationary pressures and increasing public debt. Government spending has been growing at 20% annually for the past 5 years, while consumer price inflation exceeded 10% since April 2011 as food prices continued to rise. GDP growth slowed sharply to 5.3% the first quarter of 2012, causing market observers to raise concerns over the strength of the economy. This weakness can be reflected in the low growth of motorcycle sales, a decline in business optimism, and slow credit growth. With persistently high inflation, monetary policy has little room to counter the slowdown in economic growth. Given these challenges, India's GDP is expected to grow 6.5% in FY2012 and 7.3% in FY2013.

Despite the weaker external environment, growth in Southeast Asia is expected to remain robust, supported by strong domestic demand and reconstruction in flood-affected areas. Vibrant domestic demand and private investment appeared to drive Southeast Asian growth in the first half. The region's economies expanded 4.3% in the first quarter after a weak 2.9% growth the last quarter of 2011—mainly due to the strong rebound in Thailand from the disruptions caused by last year's floods; and robust growth in the Philippines. The open economies of Singapore and Malaysia, however, posted slower growth in the first quarter as a result of the weaker external environment. Viet Nam's first quarter growth was also much lower than expected, pulled down by a contraction in construction and flat industrial production. Although the weak external environment will continue to hamper export growth for the subregion, private consumption will continue to support Southeast Asia's robust growth outlook. Retail sales have been picking up and consumer confidence remains upbeat—particularly in Indonesia and the Philippines. Most governments in the subregion also maintain sufficient policy space to ease monetary policy and provide fiscal stimulus if needed. The ASEAN-5 countries will continue to support growth of the subregion, accelerating to 5.2% in 2012 and 5.6% in 2013.

Lower oil prices and close links to the struggling euro area will likely hurt growth in Central Asia, where economic growth began decelerating in the first half of 2012. Kazakhstan's growth moderated from 8.3% the last quarter of 2011 to 5.5% the first quarter of 2012. Armenia and Georgia also slowed relative to the fourth quarter of last year. Some of the slowdown was due to weaker growth in Europe and the PRC—key markets for the subregion's exports. The slowdown in export growth also contributed to stagnant industrial production. The Kyrgyz Republic's economy has been hit by a drop in gold production, which accounts for half of industrial production. Falling oil prices will result in lower government revenues, which could partially be offset by drawing on oil windfall funds to fuel government expenditures. Strong public spending growth, development of a new oil field in Kazakhstan and the expansion of a new gas pipeline network in Turkmenistan should help support growth in the subregion. Growth in Central Asia is expected to moderate to 5.8% in 2012 before improving to 6.2% in 2013.

The resource-dependent countries in the Pacific are expected to slow due to the drop in commodity prices. But some of the smaller Pacific economies are benefiting from strong tourism earnings, mainly from Australia and New Zealand, and public development expenditures. Growth in the Pacific is driven primarily by developments in the large resource-exporting economies of Papua New Guinea (PNG), Solomon Islands, and Timor-Leste; which together account for two-thirds of regional output. Growth in the first two is projected to ease in 2012, as international prices for primary exports such as palm oil, gold, logs, copra and coffee decline, and some petroleum and forest reserves show signs of depletion. Growth is expected to slow further in 2013, as the construction of a liquefied natural gas project (in PNG) and public infrastructure investments (in Timor-Leste) begin to slow. Growth in the rest of the Pacific is expected to decrease to about 2% in 2012 and 2013. Strong tourism receipts, however, are boosting growth in some smaller Pacific economies such as the Cook Islands and Palau. Public expenditures on development partner-financed projects are also positively supporting growth in smaller Pacific countries. Economic growth in the Pacific subregion is projected to moderate from its 2011 decadal peak of 7.0% to 6.0% in 2012 and 4.2% in 2013.

### *Inflation outlook*

Weak global demand has also affected trends in international commodity prices. In general, they are projected to decline throughout 2012 and 2013. The trend in the international price for oil and food suggests prices for 2012 and 2013 to fall below 2011 levels.

From a peak of $128 per barrel in late February, the price of Brent crude has remained below the $100 per barrel mark since early June. This represents the steepest decline since 2008. The oil market cooled very rapidly with the price of Brent crude down nearly 18% during May. Behind the sharp turn in price trend was robust production in Organization of the Petroleum Exporting Countries in recent months (despite political tension with Iran) and the rise in Organisation for Economic Co-operation and Development inventories. The sharp appreciation of the US dollar and concerns over future oil demand are also contributing factors to the decline. Other indicators also point to the increasing softness in oil prices and the loosening of the oil market, such as the continued decline in price spreads for Brent crude oil futures, supporting the view that crude oil inventories are increasing and crude oil markets are less tight than earlier this year.

The international food price index is expected to remain below its 2011 level (it contracted 2.2% in May). The US Climate Prediction Center reports that the La Niña phenomenon—which caused drought in the southern US and severe dry spells in South America—has dissipated as expected and is unlikely to resurface this year. The Center further predicts that climate conditions will be neutral in the Pacific from July to September with equal chances of neutral or El Niño conditions for the remainder of the year. Fewer climatic disruptions to crops are thus expected, which bodes well for agriculture. The aggregate food price index is projected to fall 3% in 2012, softer than projected in the *ADO 2012*, before picking up slightly in 2013.

These developments in the international commodity prices will release some domestic inflationary pressures across the region. Along with the more muted prospects of economic growth, aggregate demand pressures for domestic price inflation in developing Asia is also projected to slow. The region's projected inflation for 2012 was thus revised down 0.2%. Inflation is expected to remain benign in 2013. This regional trend holds generally for most subregions except for South Asia, which is still struggling to tame domestic inflation (Table 3).

**Table 3. Inflation, developing Asia (%)**

| | 2011 | 2012 | | 2013 | |
|---|---|---|---|---|---|
| | | *ADO 2012* | *Revised* | *ADO 2012* | *Revised* |
| **Developing Asia** | **5.9** | **4.6** | **4.4** | **4.4** | **4.4** |
| Central Asia | 9.0 | 7.2 | 7.1 | 7.3 | 7.3 |
| East Asia | 5.0 | 3.7 | 3.5 | 3.7 | 3.7 |
| China, People's Rep. of | 5.4 | 4.0 | 3.7 | 4.0 | 4.0 |
| South Asia | 9.4 | 7.7 | 7.8 | 6.9 | 6.9 |
| India | 9.0 | 7.0 | 7.0 | 6.5 | 6.5 |
| Southeast Asia | 5.5 | 4.4 | 3.9 | 4.4 | 4.0 |
| ASEAN-5 | 5.6 | 4.6 | 4.0 | 4.7 | 4.3 |
| The Pacific | 8.6 | 6.6 | 6.6 | 5.4 | 5.4 |

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