

## Data is mixed, but Asia continues steady economic growth

- Mixed third quarter data broadly support the forecasts in October's *Asian Development Outlook 2012 Update (Update)* for developing Asia. With downside developments slightly outweighing positive events, this Supplement shaves the growth forecast for the region by 0.1 percentage point to 6.0% in 2012 and to 6.6% in 2013.
- The October rebound in industrial production in the People's Republic of China (PRC) likely signals an end to the third quarter soft patch—the economy should expand as anticipated in the *Update*: 7.7% in 2012 and 8.1% in 2013. However, with the continued slowdown in the other East Asian economies, growth in East Asia is slightly revised from 6.5% to 6.4% in 2012 and from 7.1% to 7.0% in 2013.
- India's economy continued to show weakness in the third quarter. Anemic industrial production as well as consumption and investment point to sluggish growth in the coming quarters. India's growth forecast is revised from 5.6% to 5.4% in fiscal year (FY) 2012 and from 6.7% to 6.5% in FY2013.
- A strong third quarter lifted prospects in Malaysia and the Philippines, boosting 2012 growth forecasts in the ASEAN 5 from 5.6% to 5.9%.
- Commodity price pressures have been relatively benign; developing Asia's inflation is expected to hover around 4%.

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

Recent data releases in the major industrial economies of the United States (US), euro area, and Japan are mixed. The third quarter gross domestic product (GDP) growth for the US and euro area came up stronger than anticipated in the *Update*, but Japan's figure is significantly weaker. All in all, as 2012 winds down, overall economic activity in these countries remains weak. For 2013, despite some downward adjustment for the euro area, the GDP growth forecast for these major industrial economies remains generally unchanged. Compared with the *Update*'s October forecast, 2012 is expected to be slightly stronger while 2013 will be slightly weaker (Table 1).

Table 1. Baseline GDP growth (%)

	2011	2012		2013	
		ADO 2012 Update	Revised	ADO 2012 Update	Revised
Major industrial economies <sup>a</sup>	1.2	1.1	1.2	1.5	1.3
United States	1.8	1.9	2.2	2.1	2.1
Euro area	1.4	-0.6	-0.4	0.5	0.2
Japan	-0.7	2.3	1.7	1.6	1.6

<sup>a</sup> Average growth rates are weighed by GNI, Atlas method (current US dollars).

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

The second estimate for third quarter 2012 from the US Bureau of Economic Analysis shows GDP expanded 2.7% at a seasonally adjusted annualized rate (saar). This was above market expectations and considerably better than the previous quarter's growth of 1.3%. Higher private and public consumption accounted for much of the third quarter growth.

The unemployment rate declined, and retail sales—a good indicator for private consumption—continually expanded. New data releases for October, however, suggest slower growth momentum for the last quarter of this year. The unemployment rate rose slightly in October at 7.9% (from September's 7.8%), and retail sales were down by 0.3%. The marginal changes were in part due to the adverse impact of the storm Sandy, which will further weigh on the strength of fourth quarter growth.

Looking ahead, considerable uncertainties remain over the strength of the US economy. Enduring weakness in Europe and the looming “fiscal cliff”—with little sign to date of clear resolution—are weighing down prospects for the US economy. The US Federal Reserve has renewed its pledge to continue monetary accommodation to support growth; by (i) keeping short-term policy interest rates exceptionally low until mid-2015, and (ii) moving ahead with its third round of quantitative easing through the purchase of \$40 billion per month of additional agency mortgage-backed securities. The US growth prospects for 2013 as forecast in the *Update* remain unchanged at 2.1%.

Although euro area forecasts remain pessimistic, recent data suggest that the recession in 2012 is milder than envisioned in September. The third quarter flash estimate indicates that GDP contracted by 0.2% *saar*, considerably better than the earlier forecast. Industrial production contracted 2.5% (seasonally adjusted) in September, following consecutive industrial output growths in July and August. Unemployment in September, however, continued to creep up reaching 11.7%, the highest recorded since the inception of the euro.

The decline in third quarter GDP was limited by Germany and France—the two largest euro area economies account for half the region's output. GDP advanced 0.9% *saar* in both countries. The next three largest economies (Italy, Spain, and the Netherlands), however, all contracted, with the Netherlands' GDP down 4.1%. More economic contractions in other parts of Europe imply it is more burdensome for Germany to continue generating growth for the bloc.

On debt resolution, the fiscal consolidation plan for Greece was signed this November following a long debate. The agreement, however, does not resolve uncertainties surrounding fiscal consolidation and still leaves out many details on the precise mechanisms for bringing down Greece's debt to GDP ratio on time. This contrasts with the earlier view that some solid resolutions to the debt problem could be worked out around the end of 2012.

Given these uncertainties, the euro area's economic rebound in 2013 may be weaker than what the *Update* anticipated. GDP growth in euro area in 2013 will

likely be marginal at about 0.2% as members' financial troubles remain unresolved.

After the policy-driven strength of the first half of the year, Japan's GDP contracted sharply by 3.5% *saar* in the third quarter of 2012, reflecting broad-based weakness in demand. Going forward, zero growth is projected in the fourth quarter, partly due to the impact on Japan's exports of recent tensions with the PRC. This implies annual growth of only 1.7% for 2012. This weakness is forecast to continue through 2013, with the economy expanding by an anemic 1.6%.

Considerable internal and external downside risks to Japan's outlook remain. Recovery from the March 2011 earthquake has been slow. Despite several government measures to mitigate the earthquake's impact, reconstruction has been weaker and slower than expected. Replacing Japan's nuclear power capacity remains the key challenge. The price of imported liquefied natural gas is high relative to Europe and especially the US. This damages the country's competitiveness and slows domestic activity. Moreover, the yen remains overvalued.

## Regional Economic Outlook

### Growth outlook

Available data through the third quarter of 2012 confirm that, as a whole, developing Asia's economic growth is cooling compared with last year's 7.2%. Although the mixed results largely support the *Update*'s projections, recent downside developments are expected to pare 0.1 percentage points from developing Asia's growth both this year and next (Table 2). Slower-than-expected growth for India, the newly-industrializing economies, and the two largest Central Asian economies slightly outweighs the more rapid expansion in some major Southeast Asian economies.

In the PRC, October data confirm September's economic recovery. Recent developments suggest the economy has bottomed out with industrial production growth rebounding to a 5-month high of 9.6% and fixed investment expanding 20.7%, backed by a 25.5% increase in infrastructure investment. Retail sales also remained resilient, growing 14.5% in October, driven by increased sales in automobiles and appliances. Despite continued weakness in the external environment, fourth quarter growth expected at around 7.7% will surpass second and third quarter levels and will likely reach 8% in the first quarter of 2013. Growth prospects in the PRC remain as forecast in the *Update*, reaching 7.7% in 2012 and 8.1% in 2013.

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

	2011	2012		2013	
		ADO 2012 Update	Revised	ADO 2012 Update	Revised
<b>Developing Asia</b>	<b>7.2</b>	<b>6.1</b>	<b>6.0</b>	<b>6.7</b>	<b>6.6</b>
Central Asia	6.6	5.7	5.3	6.0	5.7
East Asia	8.1	6.5	6.4	7.1	7.0
China, People's Rep. of	9.3	7.7	7.7	8.1	8.1
South Asia	6.2	5.5	5.3	6.4	6.2
India	6.5	5.6	5.4	6.7	6.5
Southeast Asia	4.6	5.2	5.3	5.5	5.5
ASEAN 5	4.5	5.6	5.9	5.7	5.8
The Pacific	7.0	6.0	6.0	4.2	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 Update*; and staff estimates.

Weak external demand from major industrial economies and the PRC, however, continues to weigh down the growth prospects for the rest of East Asia. This can be seen in the meager growth in Hong Kong, China; the Republic of Korea; Mongolia; and Taipei, China in the third quarter of 2012. Although slightly higher than the second quarter, Hong Kong, China's economy grew 1.3% year-on-year (y-o-y) in the third quarter, while the Republic of Korea recorded its slowest growth (1.6%, y-o-y) since the third quarter of 2009. Mongolia, which has enjoyed double-digit growth recently, had lower-than-expected growth of 5.6% in the third quarter of 2012. The external sector in these economies continued to deteriorate amid global headwinds. Together, economic growth in East Asia has been revised down slightly from 6.5% to 6.4% in 2012 and from 7.1% to 7.0% in 2013.

The uncertain global environment and tight monetary policies adopted to combat domestic inflation continue to pressure South Asian economies. Moreover, the late and uneven monsoon will hurt agricultural production in India and Nepal. In Bangladesh, the growth projection for FY2013 has been revised downward due to decelerating export growth, the result of weak global demand. Domestic demand remains anemic as the central bank continues tightening monetary policy.

In the Maldives, recent political turmoil, growing concern over the increasing fiscal deficit, rising public debt, and the effect of the weaker European economy on tourism point to continued economic fragility.

In India, recent economic data suggest that the economy remains sluggish. Industrial production (IIP) fell by 0.4% y-o-y in September after expanding a modest 2.3% in August. The September IIP contraction was below market expectations, driven by a decline in manufacturing. The July–September national accounts validate this weakness. GDP growth dipped to 5.3% in the second quarter of FY2012 from 6.7% in the same quarter during the previous fiscal year, mainly due to poor output in the farm and manufacturing sectors. Moreover, growth of private consumption expenditure was one of the lowest in recent years. With weak agricultural income keeping rural consumption low and fragile investment sentiment in the coming quarters, GDP growth is now projected at 5.4% for FY2012, below the 5.6% forecast in the *Update*. Growth in FY2013 has also been revised down from 6.7% to 6.5%—as the high deficit and inflation coupled with weak capital flows will make it difficult for the government to cut rates to boost the economy. Although other economies in South Asia are relatively resilient, the subregion is now expected to grow more slowly, at 5.3% in 2012 and 6.2% in 2013.

Surprisingly, Southeast Asia's economic growth has been slightly upgraded for 2012 due to stronger-than-expected results through the third quarter of the year in Malaysia and the Philippines. Malaysia's domestic demand continues to be strong, driven by private consumption and both private and public investment. The Philippine economy beat expectations as growth accelerated to 7.1% in the third quarter, compared with 3.2% in the same period last year. The strong third quarter performance was driven by services supported by sustained, accelerating growth in industrial output. Private consumption and investment, particularly in construction, held up well. Thailand is expecting a strong rebound in the fourth quarter due to the low base effect from the impact of last year's floods. The other economies in the subregion are holding up relatively well, except for Singapore's open economy. Latest economic data point to a sluggish economy, growing 0.3% in the third quarter compared with the same period last year. Overall growth in Southeast Asia is forecast at 5.3% in 2012 before edging up to 5.5% in 2013. The top five ASEAN economies will continue to grow at 5.9% and 5.8% in 2012 and 2013.

Growth in Central Asia continues to soften. Aggregate growth projections of the subregion are revised down from 5.7% to 5.3% in 2012 and from 6.0% to 5.7% in 2013, affected by difficulties in the subregion's two largest economies—Azerbaijan and Kazakhstan. In Azerbaijan, lower oil output and unexpected delay

in increasing civil servant salaries by the end of the year is clouding the growth outlook. In Kazakhstan, a weakened industrial sector due to a fall in global metal prices; a more than 20% decline in agricultural output; and delays in some major investment projects are contributing to the sluggish economy. GDP growth in the first 9 months of 2012 was 5.2% compared with 7% in the same period last year.

Economic growth in developing member countries in the Pacific is projected to average 6.0% in 2012 and 4.2% in 2013. This is unchanged from the *Update's* forecast as available high frequency indicators for these economies do not provide sufficient basis for adjustment. The weak global economy continues to only modestly impact Pacific economies. Tourism has continued to be robust in 2012 and remains a key growth engine for the Cook Islands, Fiji, Palau, Samoa, Tonga, and Vanuatu. Fluctuations in global commodity prices have dampened revenues for the Pacific's larger resource-exporting economies (e.g., Papua New Guinea, Solomon Islands, and Timor-Leste), but spending on major infrastructure projects—particularly in Papua New Guinea and Timor-Leste—appears to be supporting regional growth over the near-to-medium term. Lags in the impact of global economic events on Pacific economies are common, as their impact is usually transmitted through the Australian economy. Growth in Australia through 2012 has remained strong relative to other advanced economies—despite depressed global prices for its commodity exports, caused by lower demand from the PRC and other leading manufacturing economies.

### Inflation outlook

The international food price index in October continued its downward trend from previous months, falling nine points below the September level. The decline is largely due to reduced international prices of oils/fats, specifically soybean and palm oil. Abundant supply of fats and vegetable oil, coupled with weak external demand, contributed to market cooling. Grain prices remained elevated, above last year's level, as tight supply continued to support prices. However, supply is uneven across different types of grain with ample rice supply

offsetting shrinking supplies of maize and wheat. Thus, the October grain index edged up by less than 1 point. The year-to-date food index average shows food prices as a whole nearly back to its year-ago level. It is expected to continue its decline to fall slightly in 2012. Food prices in 2013 are forecast to grow 2% on the assumption of higher meat prices, lower grains production, and higher demand as the global economy slightly improves.

The international food price situation is expected to ease inflationary pressures in some economies in developing Asia, most notably the PRC and Central Asia. In South Asia, however, inflation remains a major concern. Overall, region's inflation forecast for 2012 is revised down to 4.0%, before inching up to 4.2% in 2013 (Table 3).

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

	2011	2012		2013	
		ADO 2012 Update	Revised	ADO 2012 Update	Revised
<b>Developing Asia</b>	<b>5.9</b>	<b>4.2</b>	<b>4.0</b>	<b>4.2</b>	<b>4.2</b>
Central Asia	8.9	6.4	5.4	6.7	6.5
East Asia	5.0	3.1	2.9	3.3	3.3
China, People's Rep. of	5.4	3.2	3.0	3.5	3.5
South Asia	9.4	8.6	8.3	7.4	7.4
India	8.9	8.2	7.9	7.0	7.0
Southeast Asia	5.5	3.9	4.0	4.0	4.0
ASEAN 5	5.6	3.9	3.9	4.2	4.2
The Pacific	8.6	6.3	6.3	5.4	5.4

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 Update*; and staff estimates.

### About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two-thirds of the world's poor: 1.7 billion people who live on less than \$2 a day, with 828 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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