ADB Asian Development Bank

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Softening growth prospects for developing Asia

- Although advanced economies have largely met expectations so far in 2013, developing Asia has not achieved the momentum envisaged in the *Asian Development Outlook 2013*. This *Supplement* trims 0.3 percentage points from the region's growth forecasts, to 6.3% in 2013 and 6.4% in 2014.
- In the People's Republic of China, a weaker-than-expected first half of the year and tighter credit have dampened growth expectations, such that the economy is now forecast to expand by 7.7% in 2013 and 7.5% in 2014. This has had knock-on effects for other East Asian economies. East Asia's growth is revised down from 7.1% to 6.7% in both 2013 and 2014.
- In India, slowing fixed capital formation, weak industrial activity, and plodding progress on reform are weighing on the economy, now forecast to expand by 5.8% in 2013. South Asia is paced to grow by 5.6% in 2013 and 6.2% in 2014.
- Southeast Asia's strong start to the year is being tempered by slower growth in the People's Republic of China and continued weak demand from advanced economies for its exports. The five largest economies in the Association of Southeast Asian Nations are poised to grow by 5.2% in 2013 and 5.6% in 2014.
- With softer oil prices and relatively stable food prices, inflation in developing Asia is now forecast to dip to 3.5% in 2013.

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.

Outlook for major industrial economies

The *Asian Development Outlook* (*ADO*) *2013* envisaged tepid growth in the major industrial economies over the forecast horizon. Macroeconomic indicators for the first half of the year show gross domestic product (GDP) rising in line with these expectations (Table 1).

Table 1 Baseline GDP growth (%)

	2012	2013		2014	
		ADO 2013	*Revised*	*ADO 2013*	*Revised*
Major industrial economies[a]	1.1	1.0	1.1	1.9	1.9
United States	2.2	2.0	2.0	2.6	2.6
Euro area	−0.6	−0.3	−0.5	1.2	1.2
Japan	1.9	1.2	1.8	1.4	1.4

ADO = Asian Development Outlook, GDP = gross domestic product.

[a] Average growth rates are weighed by GNI, Atlas method (current US dollars).

Sources: Asian Development Bank. 2013. *Asian Development Outlook 2013*. Manila; ADB estimates.

The United States (US) is growing moderately, despite fiscal tightening there. While "Abenomics" stimulus is lifting Japan's growth somewhat above *ADO* forecasts, the lingering euro area contraction is generating slower-than-expected growth there in 2013. Contingent upon Japan's continued faster pace, the advanced economies may collectively exceed the *ADO 2013* forecast of 1.0% to grow by 1.1% in 2013. With the euro area recovering from its recession and the US strengthening further, 2014 GDP growth should meet the *ADO* forecast of 1.9%.

US GDP expanded at a seasonally adjusted annualized rate of 1.8% in the first quarter of this year, somewhat less than in the same period in 2012 but a marked improvement over the 0.4% recorded in the fourth quarter of 2012. Strong consumer

spending, investment in residential housing, and inventory accumulation offset the drag from declining government spending.

Signs are that strength in residential housing stretched into the second quarter. As of April 2013, the house price index had increased over the previous month continuously since January 2012. Housing starts in April–May 2013 were up more than 20% from a year earlier. Labor markets have also improved, with 589,000 jobs added in the second quarter of 2013, though the unemployment rate remained at 7.6% in June as workforce participation ticked up.

Industrial production has been improving, expanding by 1.6% in May 2013 over the previous year. However, the purchasing managers' index hovered around 50 throughout the second quarter, indicating neither expansion nor contraction in manufacturing.

Despite some positive signs, the effect of fiscal tightening—budget sequestration together with increases in payroll taxes and the tax rate on high income earners—may yet slow consumption growth in the months ahead. As such, forecasts for US GDP have been left unchanged from the *ADO 2013* projections, at 2.0% in 2013 and 2.6% in 2014.

Euro area GDP continues to contract, but with easing severity. In the first quarter of 2013, seasonally adjusted annualized GDP growth in Germany was a weak 0.3%, while output in France, Italy, and Spain declined further. Retail sales in May rose by 1.0% from April, after falling in the previous 3 months. Industrial production in April increased by a seasonally adjusted 0.4% in the euro area, mainly on account of Germany (1.2%) and France (2.3%), but production further declined in Italy (−0.3%). The June manufacturing purchasing managers' index in the euro area improved to 48.8, its highest level since February 2012, consistent with an easing pace of GDP contraction in the second quarter.

To help bolster the flagging economy, the European Central Bank lowered its interest rate on main refinancing operations from 0.75% to 0.50% on 8 May 2013 and is expected to maintain this lower rate in the months ahead. However, in crisis countries with impaired transmission mechanisms, low central bank refinancing rates are having little impact, as average bank lending rates in May on new business loans of up to €1 million were as high as 4.3% in Spain and 5.3% in Italy. Loan growth is likely to remain subdued as banks increasingly rely on short-term funding and thus are reluctant to extend long-term loans.

Euro area unemployment reached a seasonally adjusted 12.1% in May, up from 12.0% in April and March 2013. The unemployment rate increased in Spain to 26.9% and in Italy to 12.2%, but declined in Germany to 5.3% and steadied in France at 10.4%.

Looking ahead, economic activity is expected to pick up in the second half of 2013, with external demand and thus net trade countering the effects of weak internal demand. However, in light of the weaker-than-expected first quarter, the forecast for annual euro area GDP growth in 2013 has been revised down from −0.3% in the *ADO* to −0.5%. This improvement from −0.6% in 2012 is expected to extend into 2014 and strengthen, such that the euro area should achieve the *ADO* forecast of 1.2%.

In Japan, the package of monetary and fiscal reforms dubbed Abenomics seems to be bearing fruit. On the back of robust private consumption, GDP grew in the first quarter at double the seasonally adjusted annualized rate assumed in the *ADO*: 4.1% rather than 2.0%. In May, industrial production rose by a seasonally adjusted annualized rate of 2.0% over the previous month, doubling the 0.9% increase in April. The purchasing managers' index has improved steadily from 50.4 in March 2013 to 51.1 in April and 52.3 in June. The Tankan survey of business conditions is reporting optimism among manufacturers, who now expect corporate profits to expand this year.

Unemployment is at its lowest since October 2008: 4.1% in May 2013. Consumer confidence has wobbled somewhat in recent months but remains above its mid-2012 levels. Revived consumption has also pushed up import demand, widening the trade deficit to $8.4 billion in April 2013 from $5.4 billion a year earlier.

Despite strong first quarter growth, some indicators point to volatile economic conditions ahead. Core machinery orders, a leading indicator of capital spending in the next 3–6 months, improved markedly in March but dropped sharply in April. The value of the yen has swung wildly against the US dollar, depreciating to ¥102 per dollar on May 21 before appreciating again sharply to beyond ¥95 on June 13. When the Nikkei index plummeted by 7.3% on 23 May 2013, the stock market saw its largest single-day decline since the 2008 global financial crisis.

All in all, Japan's recovery is expected to pick up momentum as improvement in corporate profits bolsters household income and business investment, as exports pick up, and as the effects of Abenomics take root. In view of the strong first quarter, the 2013 growth forecasts are revised up from 1.2% in the *ADO 2013* to 1.8%. However, the impending value-added tax rate increase is cause to maintain the *ADO* growth forecast for 2014 at 1.4%.

Regional Economic Outlook

Growth outlook

Developing Asia had difficulty building momentum in the first half of 2013, despite the marginally better outlook for the advanced economies. The region was expected to bounce back from its relatively sluggish 6.1% growth pace in 2012, but it is now forecast to pick up only slightly to 6.3% in 2013 and 6.4% in 2014, a 0.3 percentage point reduction from *ADO 2013* forecasts (Table 2). Although the downward revision to growth forecasts for the People's Republic of China (PRC) is a key factor underlying the aggregate, unexpectedly subdued economic activity cuts across subregions.

Table 2 GDP growth, developing Asia (%)

	2012	2013		2014	
		ADO 2013	*Revised*	*ADO 2013*	*Revised*
Developing Asia	**6.1**	**6.6**	**6.3**	**6.7**	**6.4**
Central Asia	5.6	5.5	5.3	6.0	6.0
East Asia	6.5	7.1	6.7	7.1	6.7
China, People's Rep. of	7.8	8.2	7.7	8.0	7.5
South Asia	5.0	5.7	5.6	6.2	6.2
India	5.0	6.0	5.8	6.5	6.5
Southeast Asia	5.6	5.4	5.2	5.7	5.6
ASEAN-5	5.6	5.4	5.2	5.7	5.6
The Pacific	7.6	5.2	5.0	5.5	5.5

ADO = Asian Development Outlook, ASEAN = Association of Southeast Asian Nations.
Note: **Developing Asia** refers to 45 developing member countries of the Asian Development Bank . **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 Brunei Darussalam, Cambodia, the Lao People's Democratic Republic, Myanmar, and Singapore. **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. 2013. *Asian Development Outlook 2013*. Manila; ADB estimates.

In East Asia, the PRC's weaker-than-expected GDP growth of 7.7% year on year in the first quarter of 2013 and 7.5% in the second quarter points to slow but persistent growth deceleration. In May, industrial production expanded by a moderate 9.2%, and investment growth also weakened. Turbulence in the domestic interbank market in late June elevated funding costs (particularly for nonbank finance) and made financial institutions more averse to risk. This could further weaken investment in the remainder of the year, undermining growth at least in the short term. On the upside, consumption is expected to support growth as consumer confidence remains high and retail sales are picking up. This view is bolstered by continued wage growth in real terms and strong employment despite slackening economic growth. Imports and exports both saw growth decelerate substantially, partly because of a crackdown on over-invoicing trade flows to Taipei,China and Hong Kong, China to skirt capital controls. Export growth will likely remain soft as weak global activity and the strengthening renminbi weigh on external demand. Meanwhile, weaker domestic demand for capital goods and high-end consumer goods will be a drag on imports. Taken together, growth in the PRC is revised downward from 8.2% to 7.7% in 2013 and from 8.0% to 7.5% in 2014.

The slower PRC economy coupled with weak external demand from major industrial economies continue to stymie growth in most of East Asia, particularly in Hong Kong, China; Mongolia; and Taipei,China. Growth in Mongolia in the first quarter of 2013 braked to 7.2% year on year in line with the return of slower growth in the PRC and falling commodity prices. Hong Kong, China lost momentum in the first quarter of 2013 as the fragile international trading environment held GDP growth to a scant 0.2% seasonally adjusted, quarter on quarter terms. In Taipei,China, prospects are dimming following the release of weak first quarter data, and this is expected to continue until the second half of the year. In contrast, first quarter growth in the Republic of Korea exceeded market expectations, lifted by construction investment, plant equipment investment, and exports. Overall growth in East Asia has been revised down from 7.1% to 6.7% in both 2013 and 2014.

South Asia's largest economy, India, is expected to see growth moderate to 5.8% in 2013 against the earlier projection of 6.0%. While this is higher than the 5.0% posted in 2012, growth remains constrained by supply-side bottlenecks, as reflected in the continued slowdown in fixed capital formation, weakness in the industrial sector, and sluggish progress in pushing through badly needed structural reforms. However, growth in India is expected to accelerate in 2014 as slower inflation provides some scope for monetary easing that could boost investment and consumption. Growth will be further boosted by pre-election spending, and the pickup in US growth will support Indian tech companies and related service sectors.

The Sri Lankan economy is forecast to grow by 6.8% in 2013 on the back of a strong performance in

the first quarter of the year. Healthy growth in 2013 and acceleration to 7.2% in 2014 will be supported by further monetary easing and improved electricity generation that will power growth in domestic industry. By contrast, Afghanistan, Bangladesh, Nepal, and Pakistan are expected to report softer growth in 2013 than in 2012, as some of these countries face political transitions that could hamper economic policy making. The South Asia subregion is expected to expand by 5.6% in 2013 (marginally less than the *ADO 2013* projection of 5.7%) and pick up momentum to post 6.2% growth in 2014.

Southeast Asia's economic growth was generally solid in the first quarter of 2013. The Philippines achieved stronger-than-expected GDP growth of 7.8% year on year, as domestic demand was buoyed by accelerated public and private investment and stable remittance inflows. Indonesia's domestic demand continues to be strong, driven by private consumption and both private and public investment, with GDP growing by 6.0% year on year. Thailand's economic growth moderated to 5.3% year on year in the first quarter, coming off a rapid 2012 pace that largely reflected recovery from floods in 2011. Malaysia's economic growth slowed on weaker external demand and moderating domestic demand. The rest of the subregion is holding up relatively well, except that Singapore's open economy grew by only 0.2% year on year in the first quarter of 2013. Capital outflows from the subregion have fueled stock market volatility, but the real sector has so far been largely unaffected. With the softer outlook for the PRC, growth forecasts for Southeast Asia have been trimmed from 5.4% to 5.2% in 2013 and from 5.7% to 5.6% in 2014. Although less rapid than envisaged in the *ADO*, aggregate growth in the ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam, the five largest economies in the Association of Southeast Asian Nations) will continue to be solid at 5.2% in 2013 and 5.6% in 2014.

In Central Asia, as in other subregions, growth is moderating. The aggregate growth projection for the subregion is revised down from 5.5% to 5.3% in 2013 before edging up to 6.0% in 2014, as forecast in the *ADO*. The revision in 2013 reflects sluggish economic performance in Kazakhstan and Georgia, outweighing stronger-than-expected growth in the Kyrgyz Republic. In Kazakhstan, industrial production grew by a modest 1.8% in the first 6 months of 2013 (compared with 2.1% in the same period of 2012), as agriculture also grew slowly and construction dragged. Exports of oil are stagnant, and those of metals and grains are dropping. Growth may recover in 2014, when the Kashagan oil field is to be commissioned. In Georgia, upcoming presidential elections are creating policy and political uncertainty that is slowing investment as investors shift to a wait-and-see attitude. Faster growth is anticipated in 2014. Meanwhile, the Kyrgyz Republic posted strong growth of 8.4% year on year in the first 5 months of 2013, with industrial production growing by 21% as output from the Kumtor goldmine resumed.

The Pacific appears to be slowing more than anticipated in *ADO 2013*. Regional growth is now projected to moderate from 7.6% in 2012 to 5.0% in 2013, or 0.2 percentage points below earlier forecasts. Unexpectedly low government capital spending in Timor-Leste and lower gold production in Solomon Islands drive the revision. Although Papua New Guinea, the largest developing economy in the Pacific, is on track to achieve *ADO* growth forecasts, lower prices for export commodities present clear downside risks for government stimulus that was meant to support growth following the completion of a liquefied natural gas pipeline. In contrast, the Fijian economy is showing signs of picking up as planned infrastructure development moves ahead, and consumption and investment also appear to be on the rise, lending an upward bias to forecasts there. Growth projections for most of the smaller economies of the Pacific remain unchanged for 2013, except for Kiribati, where infrastructure investment is delayed, and Nauru, which is weighed by heightened political risks and weaker phosphate export prospects. A more positive global economic outlook is expected to spill over into the Pacific and accelerate growth in the region to 5.5% in 2014, in line with *ADO* projections. Buoying this upbeat projection are the start of liquefied natural gas exports from Papua New Guinea and post-cyclone reconstruction and infrastructure work in a few smaller Pacific island states.

Inflation outlook

Slow GDP growth in the region is helping to contain demand-side inflationary pressure in developing Asia. At the same time, commodity prices are set to decline at a faster pace than anticipated in the *ADO*. The growth slowdown in developing Asia and other emerging markets, along with continued softness in the major industrial economies, is suppressing demand for energy, while strong harvests are keeping food prices in check.

After topping $120 per barrel in mid-February 2013, the price of Brent crude reversed course and fell to a low of $98 in mid-April—its lowest since July 2012. Bearish market sentiment prevailed through the second quarter against the backdrop of weakening global demand. Although political tensions in the Middle East have pushed up oil prices in recent weeks, oil futures suggest that the market expects Brent crude

prices to fall back to around $102 in 2014. Expanded natural gas production globally is contributing to the softening of energy prices.

The World Bank index of food commodity prices fell for the fourth straight month in June, putting prices 1.9% below a year earlier. Grain harvests in most major producing countries are expected to exceed those of last year. The Food and Agriculture Organization sees food commodity markets, in particular cereals, to be more balanced in the 2013/14 agricultural season. It expects, for example, wheat production to be 6.5% higher than in 2012/13 as production recovers in drought-affected areas of Europe and Central Asia. Prices for rice, a key consumer commodity in developing Asia, have been relatively stable, even retreating somewhat from their 2012/13 levels as production is spurred by subsidies in large exporters such as India and Thailand.

With expected declines in commodity prices and decelerating growth, inflationary pressures within developing Asia will be generally less acute than anticipated in the *ADO 2013*. Inflation in the PRC averaged 2.4% in the first 6 months of 2013, well below the forecast 3.2% for the year as a whole. India has benefited from a favorable monsoon that pushed down domestic food prices, such that overall price increases should average 6.5% this year. For the region as a whole, inflation is forecast to average 3.5% in 2013 and 3.7% in 2014, half a percentage point off of *ADO* forecasts (Table 3). The ASEAN-5 appear to buck this trend of softer-than-expected price pressures, but this anomaly reflects a 44% increase in subsidized fuel prices in Indonesia in June 2013 that is pushing up consumer prices there. Inflation in Malaysia, the Philippines, Thailand, and Viet Nam is expected to be at or below *ADO* projections.

Table 3 Inflation, developing Asia (%)

	2012	2013		2014	
		ADO 2013	*Revised*	*ADO 2013*	*Revised*
Developing Asia	**3.7**	**4.0**	**3.5**	**4.2**	**3.7**
Central Asia	5.3	6.7	6.7	6.7	6.8
East Asia	2.6	3.1	2.4	3.3	2.7
China, People's Rep. of	2.6	3.2	2.5	3.5	2.7
South Asia	7.9	7.4	6.7	7.1	6.9
India	7.4	7.2	6.5	6.8	6.6
Southeast Asia	3.9	4.2	4.3	4.1	4.2
ASEAN-5	3.6	4.0	4.2	3.8	4.0
The Pacific	5.3	6.1	5.7	6.3	5.9

ADO = Asian Development Outlook, ASEAN = Association of Southeast Asian Nations.
Note: **Developing Asia** refers to 45 developing member countries of the Asian Development Bank . **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 Brunei Darussalam, Cambodia, the Lao People's Democratic Republic, Myanmar, and Singapore. **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. 2013. *Asian Development Outlook 2013*. Manila; ADB 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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