



Developing Asia amidst the global slowdown

Economics and Research Department
Asian Development Bank
2 April 2008



ADB

Key issues

- Growth and inflation in 2007
- Challenging external environment in 2008 and 2009
- Myth of uncoupling
- Growth will ease but remain solid
- Inflationary pressures will mount
- Structural responses for long-run growth

Growth in Developing Asia in 2007

Developing Asia recorded highest growth in 2 decades

- Region's 8.7% growth in 2007 tested speed limits
 - Led by PRC at 11.4%, highest in 13 years
 - India grew at 8.7%, marginally lower than previous year
 - Philippines at 7.3%, a 30-year high
- ⇒ High growth rates were spread across many countries

Growth in Developing Asia in 2007

Signs of overheating: rising consumer prices, inflation hits 5-year high

- PRC (4.8%), Mongolia (9%)
- Sri Lanka (20.2%), Pakistan (7.8%), Bangladesh (7.2%)
- Viet Nam (8.3%)
- Azerbaijan (16.7%)
- Timor-Leste (8.9%)

Growth in Developing Asia in 2007

Responses to rising fuel and food prices

- Subsidies: Indonesia, India
 - Tariff reduction: India, PRC
 - Export tax: PRC
 - Export restrictions: Viet Nam, India
 - Price controls: PRC, Indonesia, India
- ⇒ Resisting commodity price increases through administrative measures will have a high fiscal cost and will add to future inflation

Challenging external environment in 2008 and 2009

Coincident slowdown in G3

	2006 Actual	2007 Actual	2008 Projection	2009 Projection
GDP growth (%)				
Industrial countries	2.7	2.3	1.5	1.9
United States	2.9	2.2	1.5	2.0
Eurozone	2.7	2.6	1.6	2.0
Japan	2.4	2.1	1.5	1.5
World trade volume (% change)	10.1	7.5	7.0	7.7

➔ Coincident nature will limit options for Asian suppliers to switch to new markets

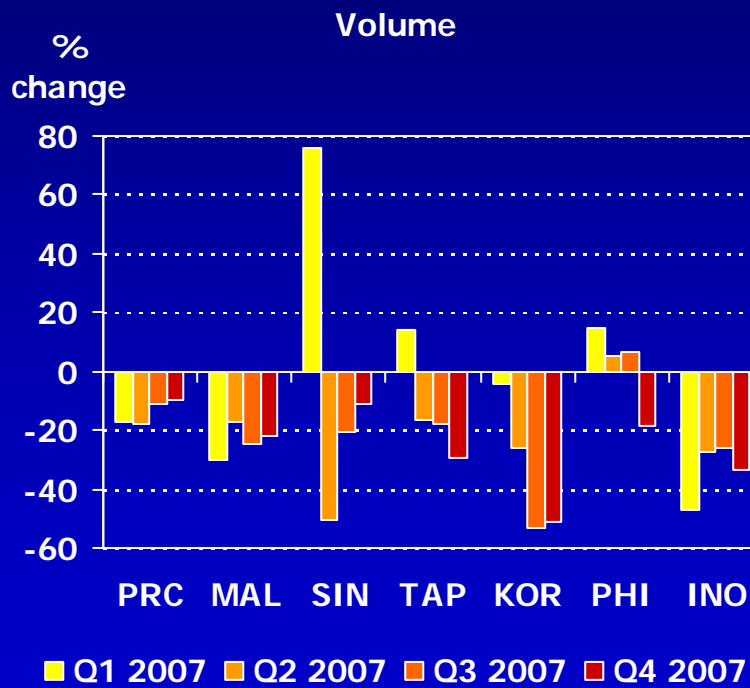
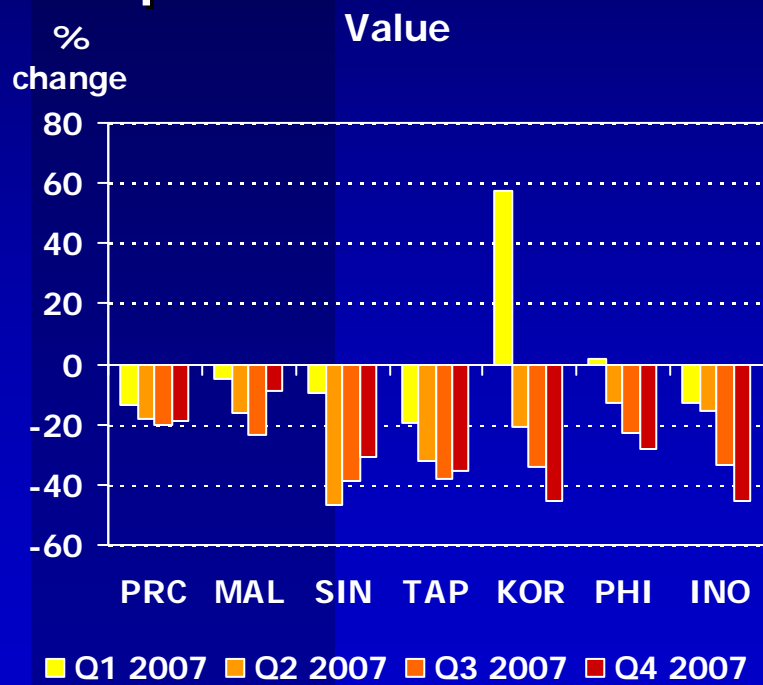
Challenging external environment in 2008 and 2009

Fuel and food prices will test new heights

- Oil prices: \$10/barrel rise annually since 2002; \$85/barrel projected in 2008
- Fertilizer (DAP) prices: \$260/ton in 2006 to \$768 in 2008 (Jan-Feb ave.)
- Rice prices: \$185/ton (Dec 02), \$378 (Dec 07), \$700 (Mar 08)
- Wheat prices: less than \$200/ton in 2006 to \$400 in 2008 (Jan-Feb ave.)
- Edible oil prices: \$650/ton in 2006 to \$1400 in 2008 (Jan-Feb ave.)

Myth of uncoupling

Dramatic decline of US computing equipment imports



Myth of uncoupling

Asian fallout from slower US growth

- Garment exports to the US from developing Asia weakened throughout 2007
- Footwear exports from Asia to the US fell sharply in successive quarters in 2007
- Toys, games, sports equipment exports to the US slowed in 2007

Myth of uncoupling

Intra-Asian trade cannot substitute for G3 slowdown

- Intra-Asian trade driven by vertically integrated Asian production chains
- Extra-Asian trade supported by G3 demand for final goods produced in these networks
- 61% of East and Southeast Asian exports directly meet final demand of G3

Myth of uncoupling

Financial integration and contagion

- Developing Asia's ties to global financial markets have tightened
- Stock of financial assets as a % of GDP in developing Asia has risen quickly
- Cross-border ownership of assets and liabilities has grown
- East Asian equity markets now track US equities more closely than before the 1997 Asian financial crisis

Myth of uncoupling

Global slowdown will lead to asset market adjustments in Asia

- Credit spreads have widened in offshore markets
- Equity markets in Asia have moved closely in step with US
- Financial ties to global hubs are tightening
- Direct exposure of Asian financial institutions to US subprime debt is small
- Asian banks are well capitalized, profitable, and not exposed to significant risks of leverage

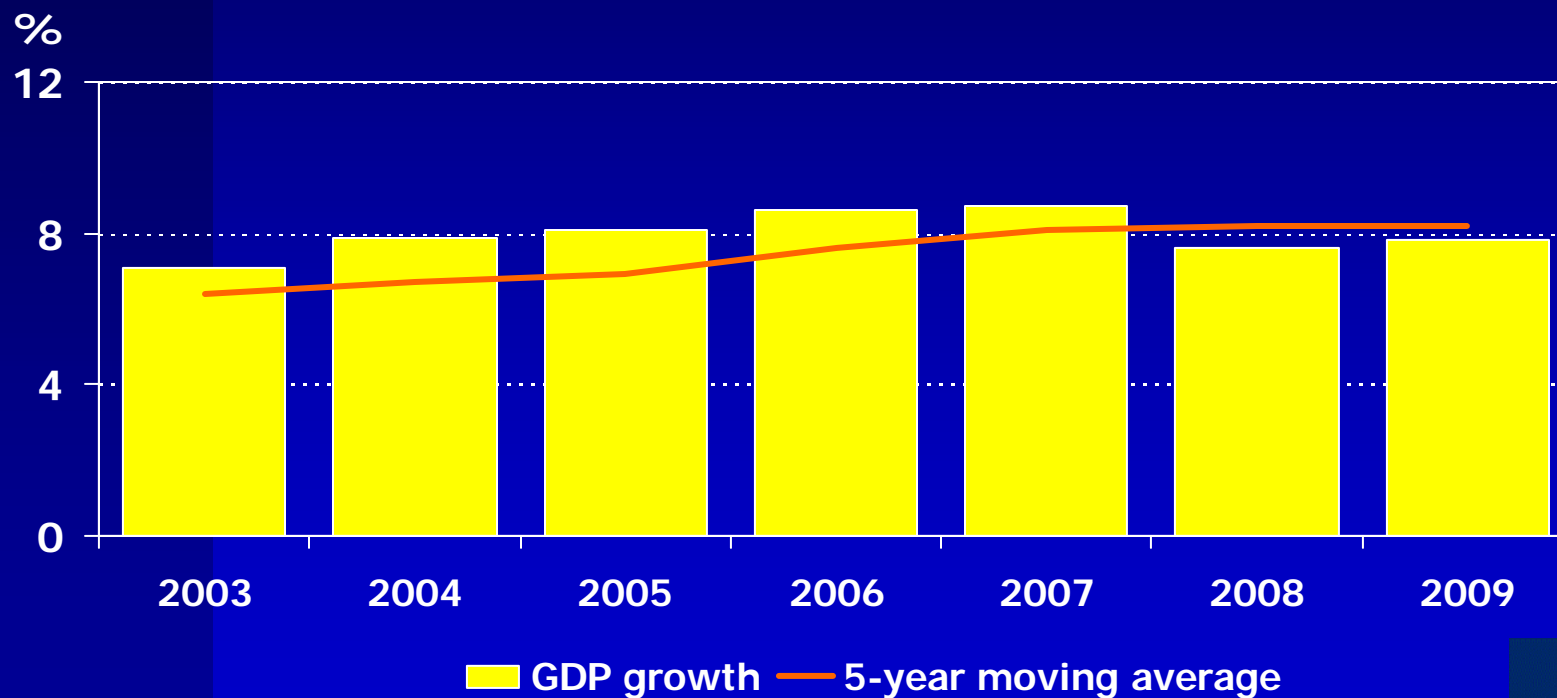
Growth will ease but remain solid

Domestic conditions remain favorable

- Region has generally favorable policy conditions
 - Productivity growth linked to economic modernization and structural transformation will continue
 - But developing Asia still tied closely to global activity through trade and financial channels
- ⇒ Growth to remain solid

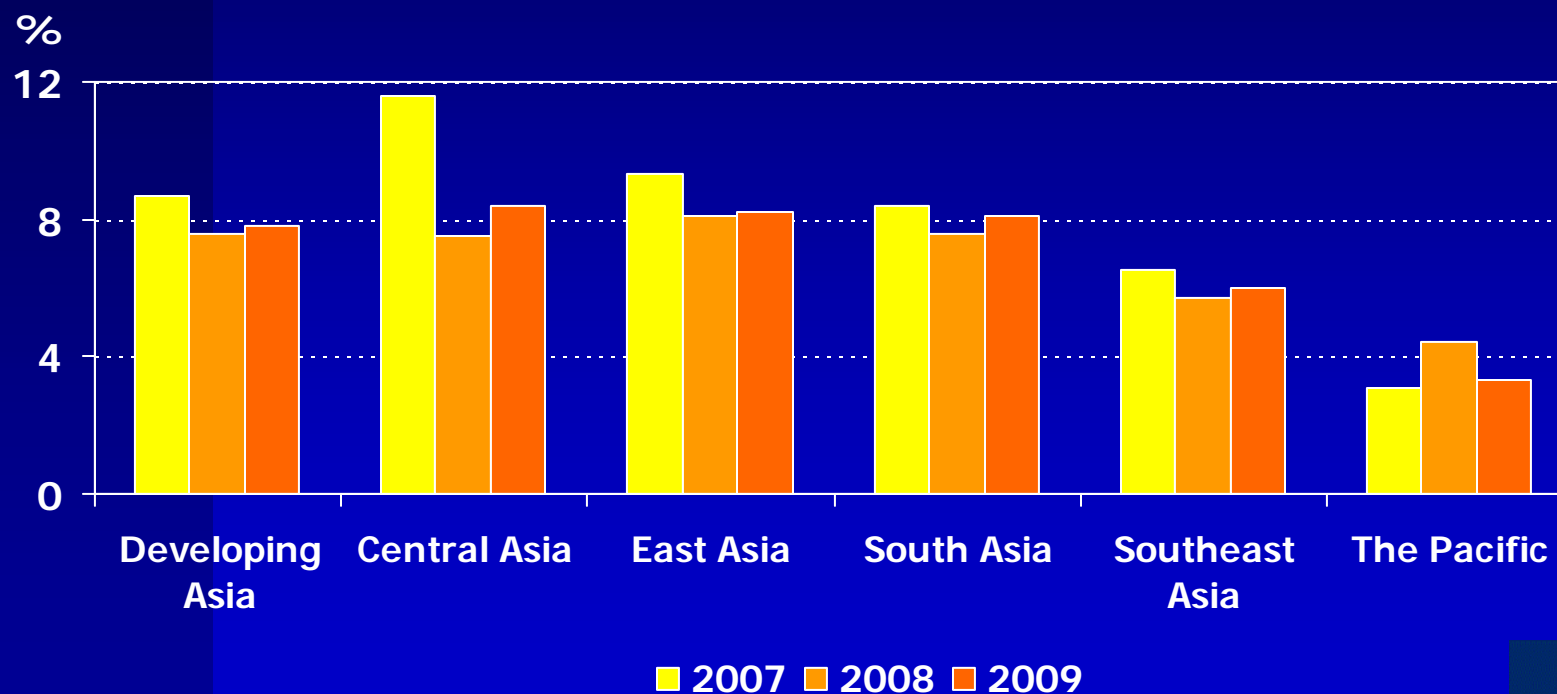
Growth will ease but remain solid

Aggregate GDP growth



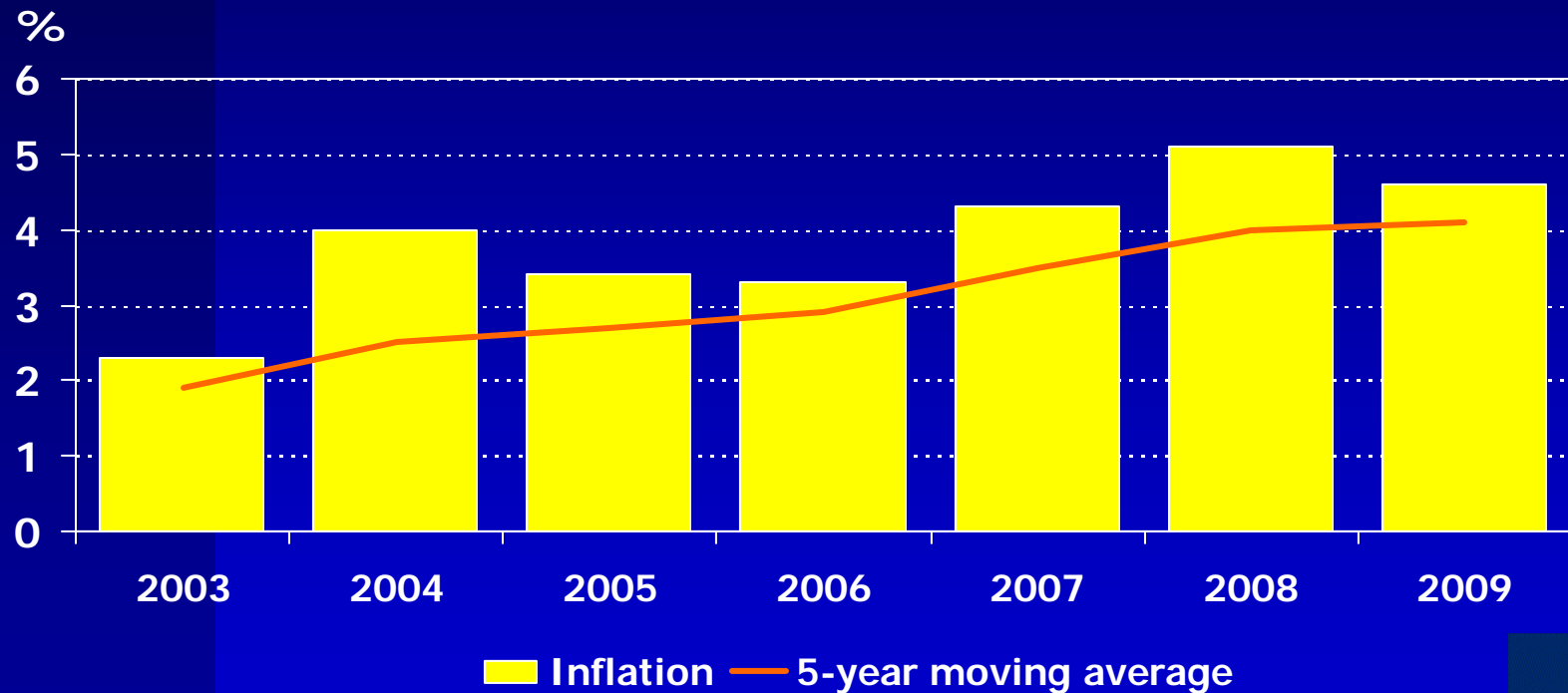
Growth will ease but remain solid

All but Pacific slows in 2008



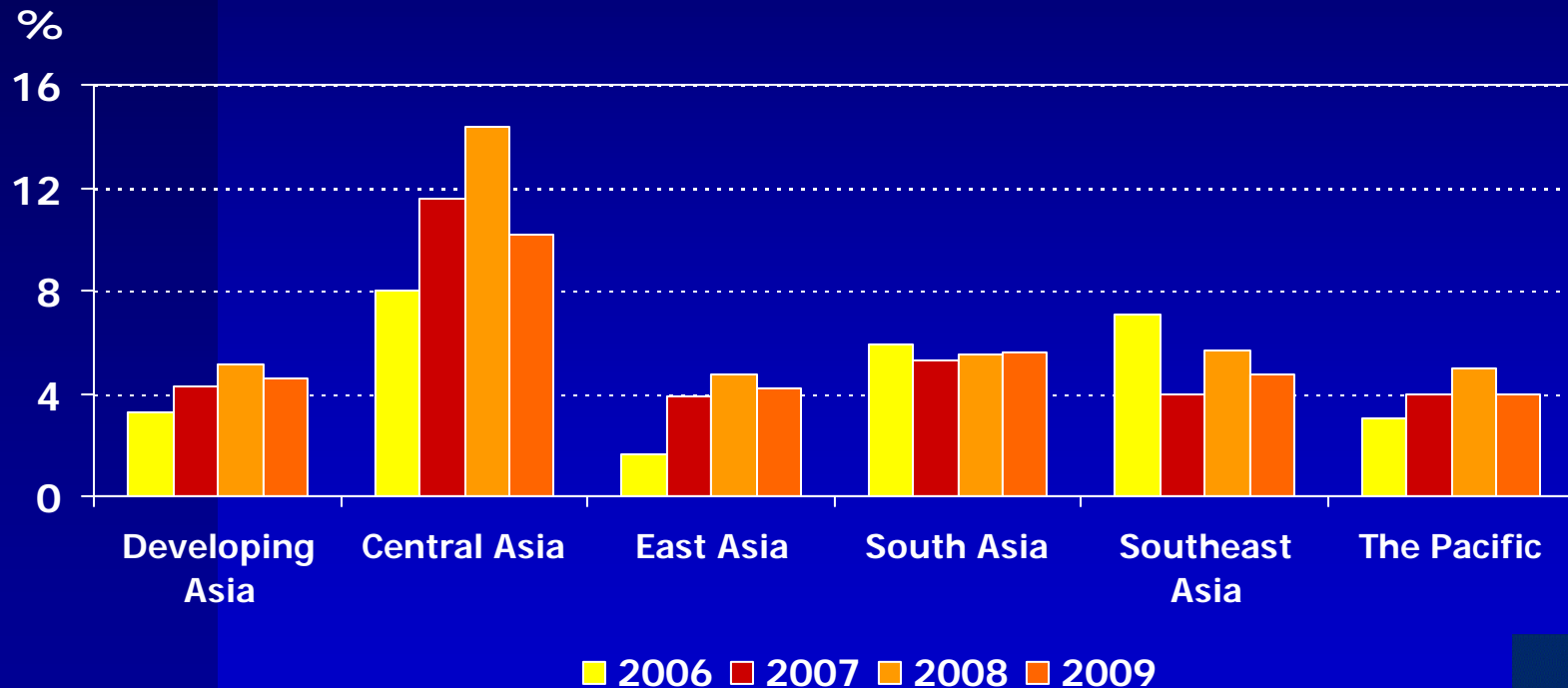
Inflationary pressures will mount

Aggregate inflation



Inflationary pressures will mount

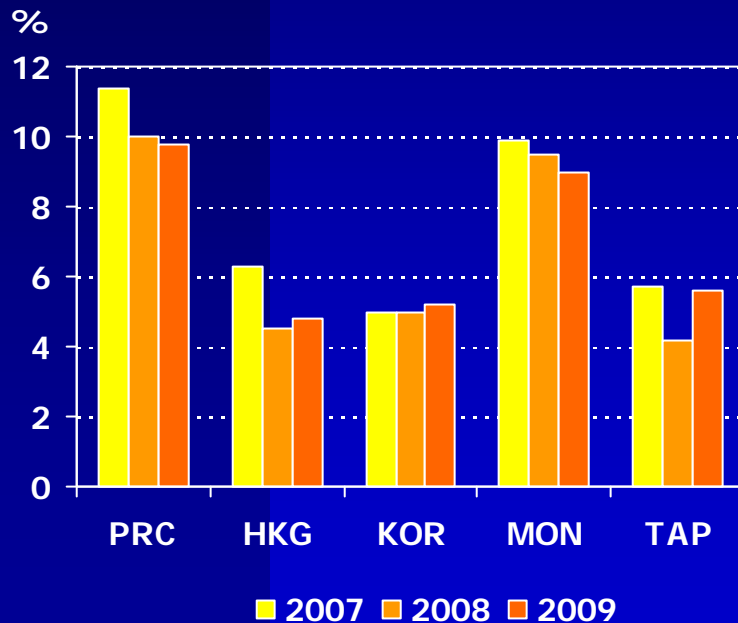
Inflation could hit decade-long high in 2008



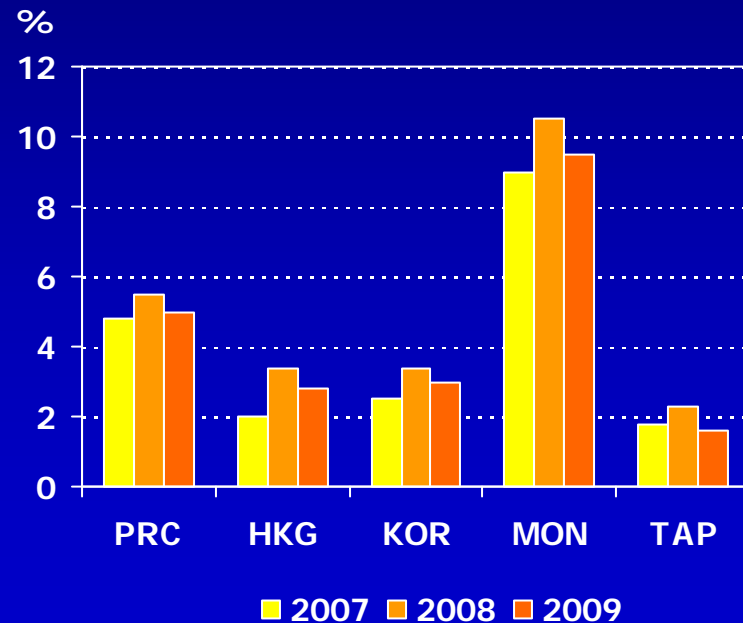
Growth will ease but remain solid, inflationary pressures will mount

East Asia's domestic demand will compensate for slowdown of exports

GDP



Inflation



Growth will ease but remain solid

Opportunities for rebalancing in the PRC

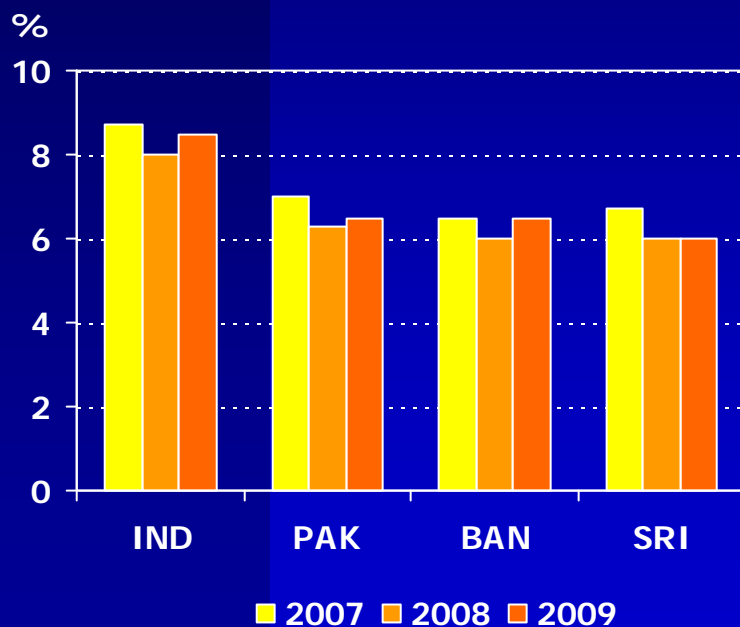
- Bring down inflation
- Avoid hard landing
- Address large current account surpluses and low consumption
- Strains on energy and the environment
- Rising income inequality

	2007	2008	2009
GDP growth	11.4	10.0	9.8
Inflation	4.8	5.5	5.0
CAB	10.9	9.9	8.6

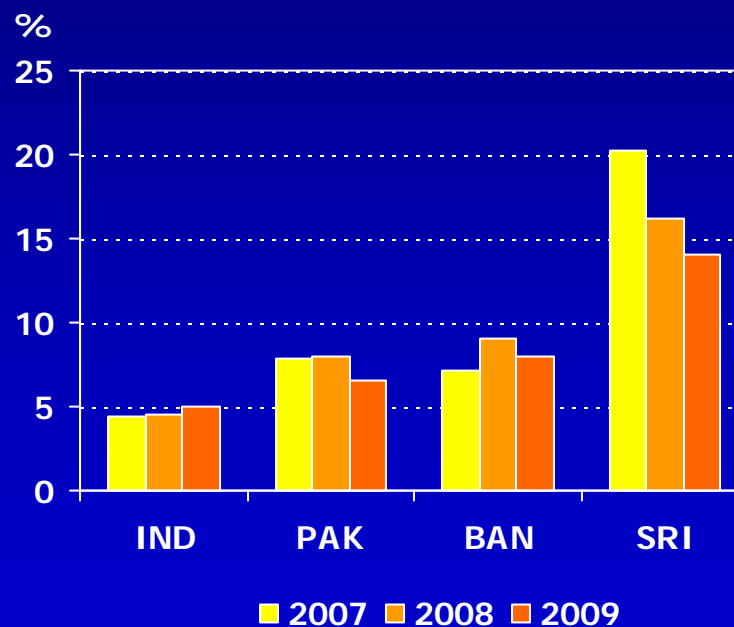
Growth will ease but remain solid, inflationary pressures will mount

South Asia less affected by G3 slowdown, vulnerable to high commodities prices

GDP



Inflation



Growth will ease but remain solid, inflationary pressures will mount

India's slowdown in 2008 temporary

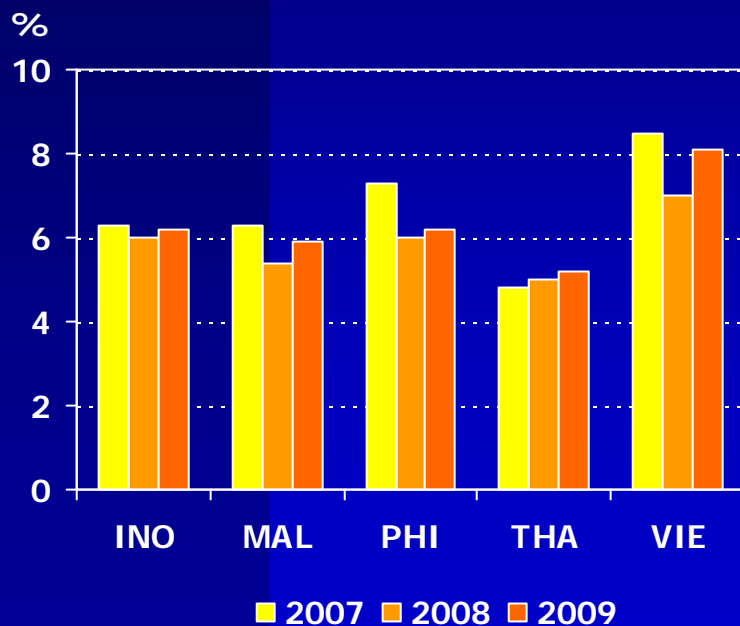
- Tighter monetary policies slowed growth
- Capital inflows raised reserves
- Rupee appreciation hurt some exports
- Slower growth in 2008 but chance of pick up in 2009
- High food inflation limits monetary policy options
- Fiscal consolidation that includes off-budget subsidies

	2007	2008	2009
GDP growth	8.7	8.0	8.5
Inflation	4.4	4.5	5.0
CAB	-1.9	-2.2	-2.6

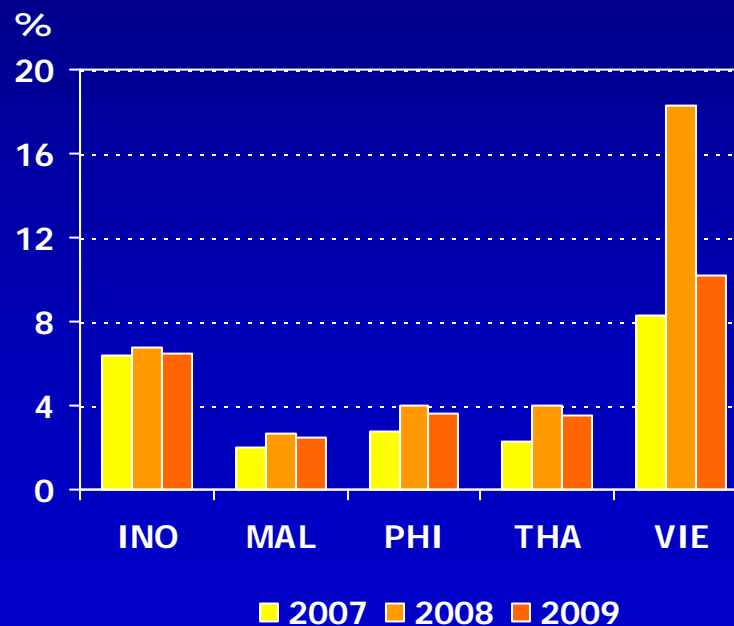
Growth will ease but remain solid, inflationary pressures will mount

Southeast Asia returns to trend, inflation picks up

GDP



Inflation



Growth will ease but remain solid, inflationary pressures will mount

Viet Nam's inflation must be reined in

- Bring down inflation through a policy mix of monetary and fiscal tightening, exchange rate flexibility
- Avoid banking system instability
- Need to ratchet up growth again
- Remove infrastructure bottlenecks
- Continue market-based reforms

	2007	2008	2009
GDP growth	8.5	7.0	8.1
Inflation	8.3	18.3	10.2
CAB	-8.0	-10.3	-9.4

Structural responses for long-run growth

Asia's longer-run growth trajectory dependent on structural and supply-side dynamics

- Rising agricultural productivity must accompany the increase in the share of output and employment in industry and services
- Modernization, technological improvements, and productivity increases in manufacturing and services are essential
- Demographic dividend is an enormous potential for many countries

Structural responses for long-run growth

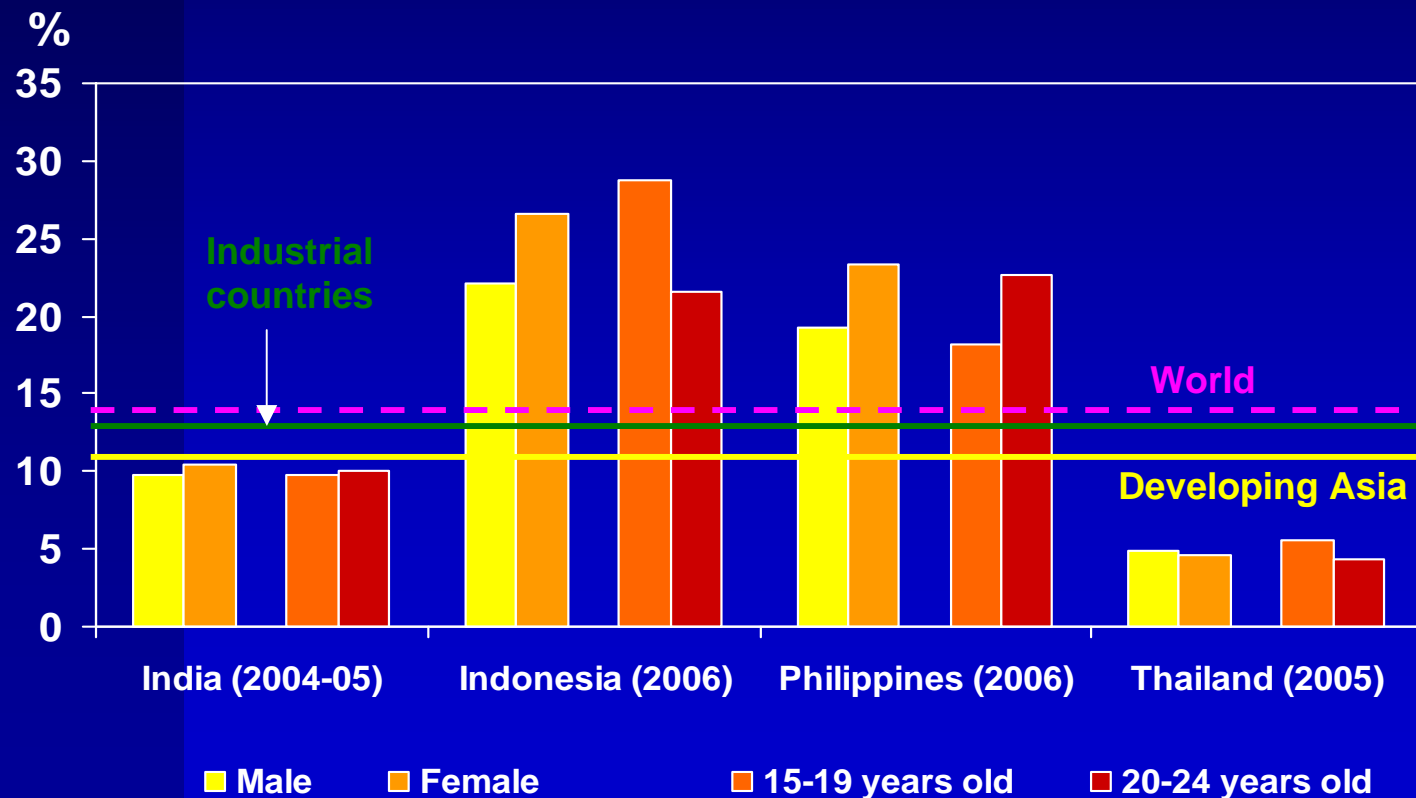
Young Asians: a squandered talent

- “Youth bulge” provides great potential for Asia
- Unemployment and joblessness on the rise
- Poor education and training pushing poor, young workers to informal jobs
- Education and training systems are failing Asia and redirection required to ensure relevance

Structural responses for long-run growth

Young Asians: a squandered talent

Youth unemployment rates



Structural responses for long-run growth

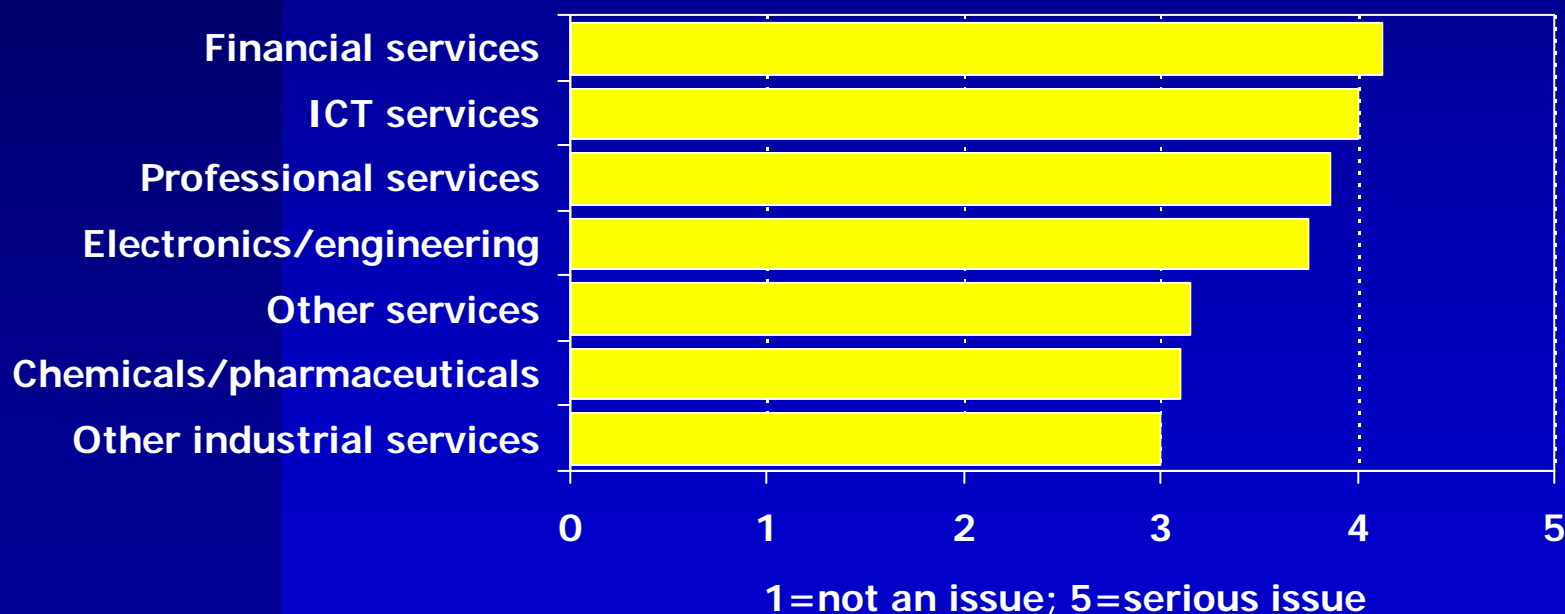
Asia's skills crisis

- Developing Asia suffering from dearth of professional skills
- Higher incomes have fueled demand for skills-intensive services
- Measures needed to stem brain drain and relax occupational restrictions
- Investment in appropriate education systems required

Structural responses for long-run growth

Asia's skills crisis

Shortage of qualified staff as an issue, Southeast Asia,
Dec. 2006 - Jan. 2007



Structural responses for long-run growth

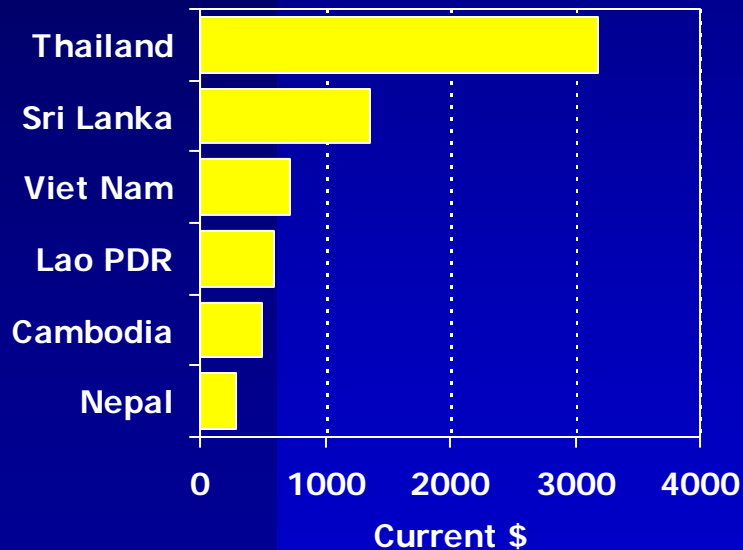
Asian workers on the move

- Intraregional migration is surging
- Yet current policies remain restrictive
- Greater labor migration presents opportunities for both sending and receiving economies
- Efforts to promote regional cooperation and liberalization of migration needed

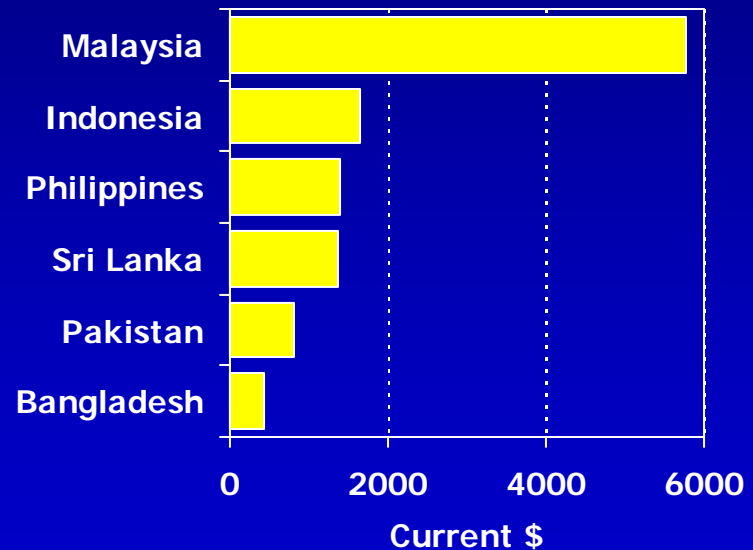
Structural responses for long-run growth

Asian workers on the move

Per capita income in Thailand and selected labor-sending neighbors



Per capita income in Malaysia and selected labor-sending neighbors



Risks

What is there to worry about:

- Inflation will accelerate and could hit a decade-long regional high → Tackle inflation at root
- Fiscal balances at risk → Exit strategies for subsidies and administered prices needed
- Trade and investment protectionism is a clear and present danger → Liberalize internal markets and trade

Key messages

- Coincident slowdown in G3 and rising fuel and food prices pose major challenges
 - Developing Asia's favorable policy climate, structural transformation, and productivity growth provide forward momentum
 - Developing Asia will post solid growth in 2008
- ➔ Asia not immune to global slowdown; neither is it a hostage