

Economic Recovery and Asia's Growth Strategy

**Masahiro Kawai
Dean and CEO
Asian Development Bank Institute**

**PECC STANDING COMMITTEE
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Toward Further Regional Economic Integration**

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Outline

- 1. The Challenges of Asia**
- 2. Asia's Economic Recovery**
- 3. Towards Balanced and Sustainable Growth**
- 4. Managing Capital Inflows**
- 5. Conclusions**

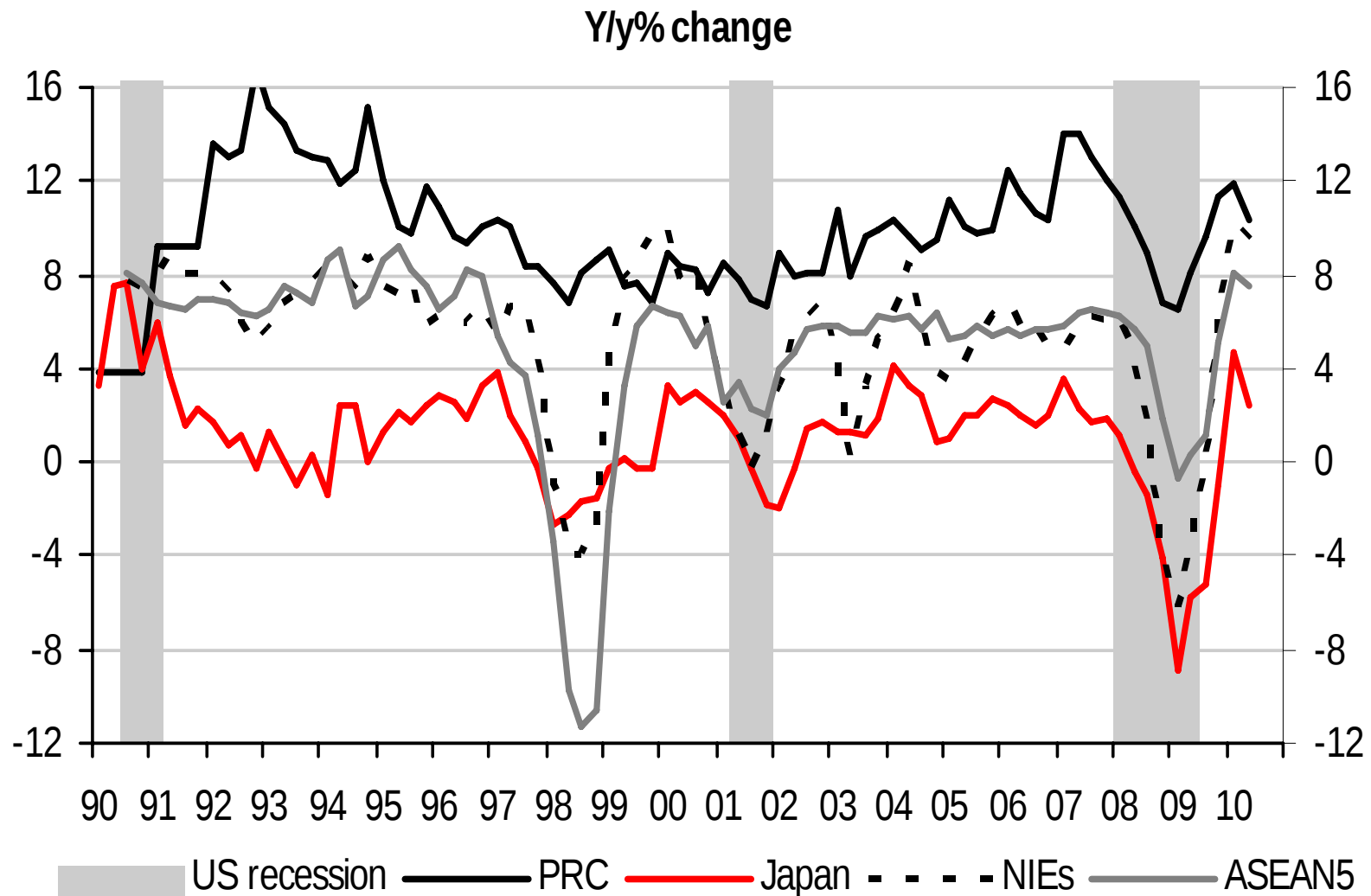
1. The Challenges for Asia

- Despite many improvements since the Asian financial crisis, Asia was still vulnerable to the global financial crisis
- US and European demand for Asian export products is likely to remain subdued
- Asia needs to rely more on regional and domestic demand for growth
- Asia needs to address other imbalances, such as environmental and social deficits
- How can Asia achieve more balanced, inclusive and sustainable growth?

2. Asia's Economic Recovery

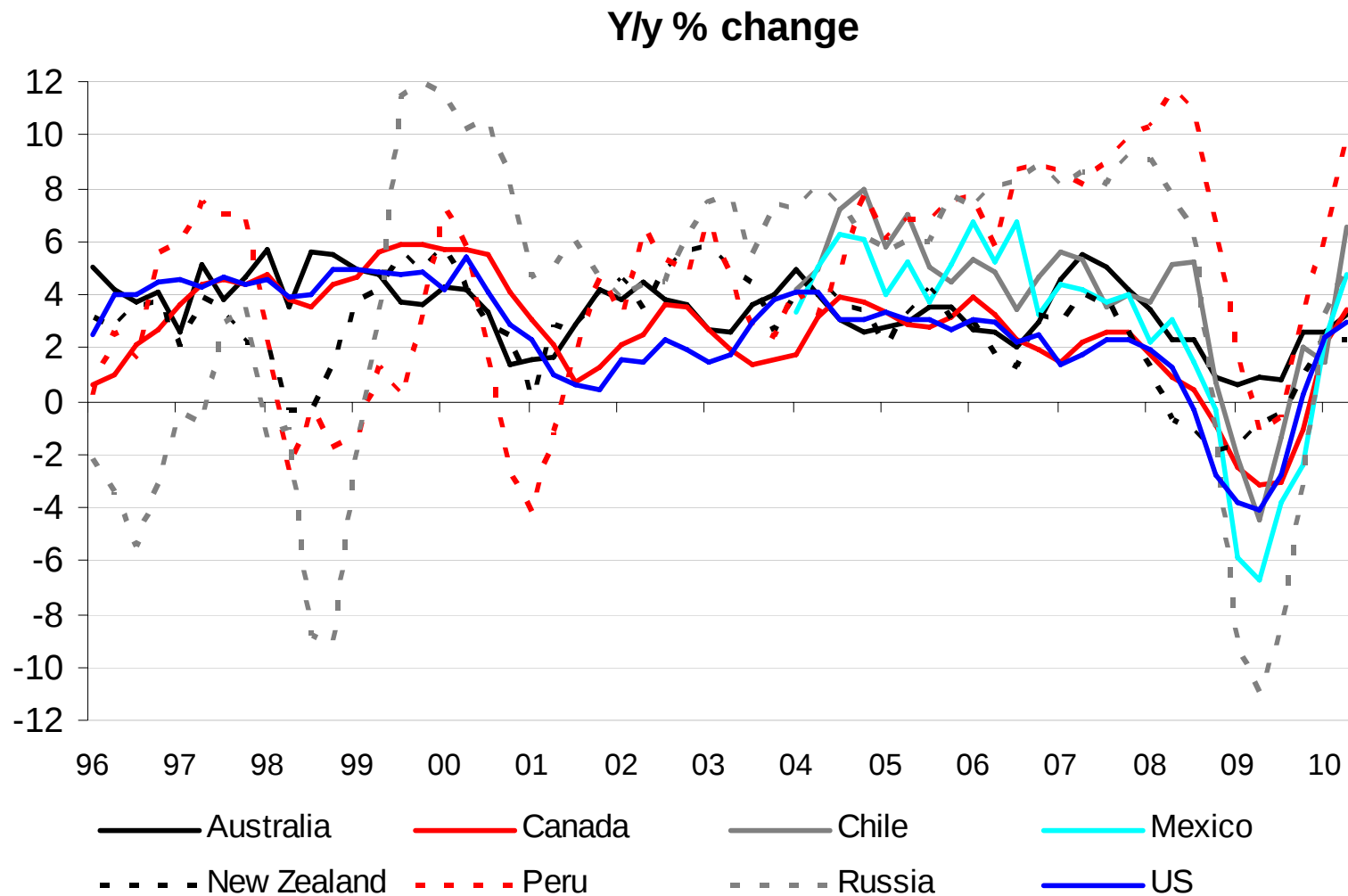
- US: Epicenter of the crisis, affecting Asian economies
- Globally concerted macroeconomic policy stimulus and commitment to trade openness have prevented a total collapse of the global economy
- Asian economies' strong fundamentals and macroeconomic policy action have supported economic recovery
- Current account imbalances have been reduced since the crisis

Asian GDP growth is recovering



Source: CEIC

So is non-Asian APEC GDP growth



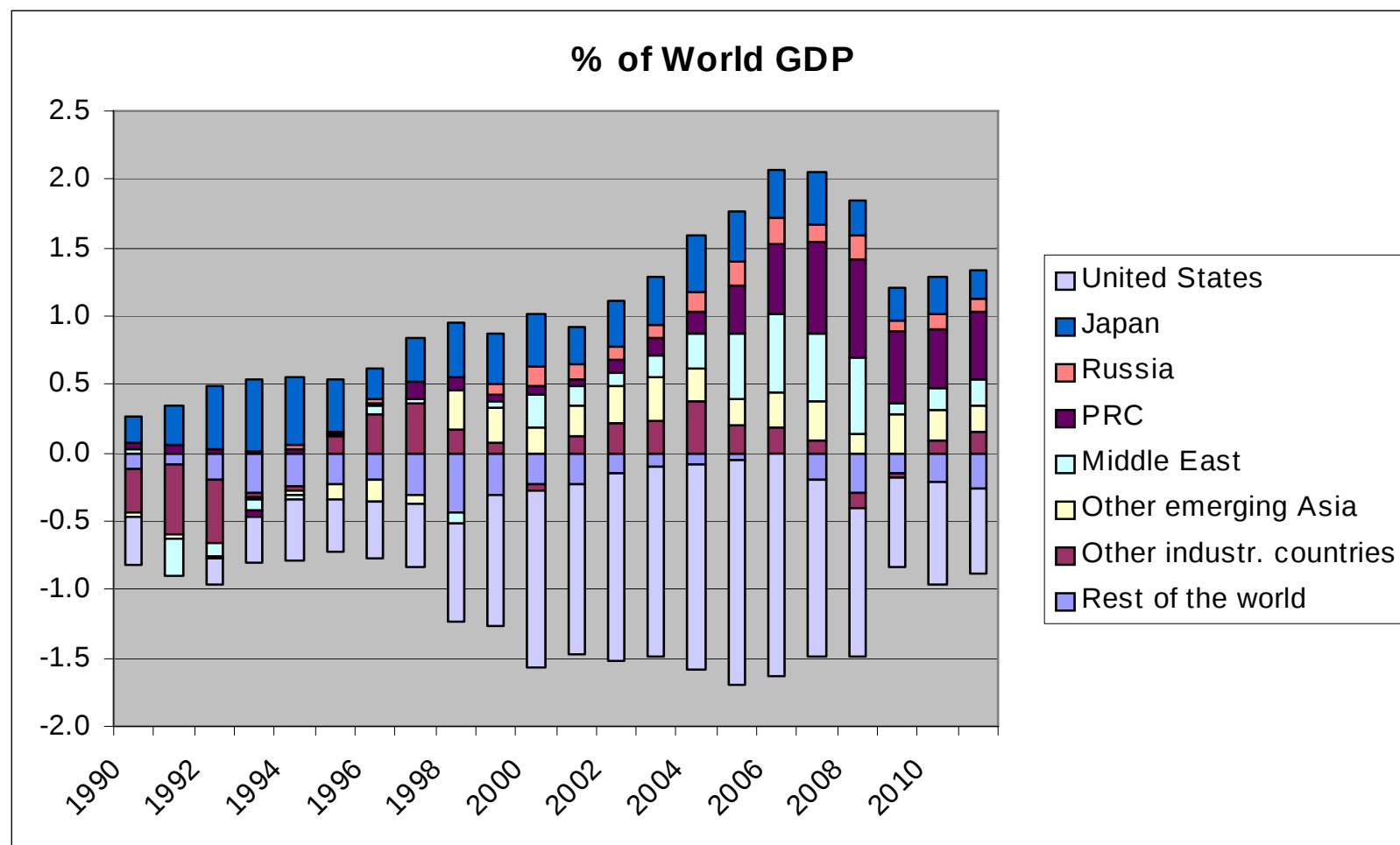
Source: CEIC

Economic growth projections 2010-11 show continued recovery

Real GDP, % change				
Country/Region	2008	2009	2010F	2011F
World	3.0	-0.6	4.8	4.2
Advanced economies	0.6	-3.2	2.7	2.2
United States	0.4	-2.6	2.6	2.3
Canada	0.5	-2.5	3.1	2.7
Japan	-1.2	-5.2	2.8	1.5
Asian NIEs	1.8	-0.9	7.8	4.5
Emerging/developing economies	6.1	2.5	7.1	6.4
Developing Asia	7.7	6.9	9.4	8.4
PRC	9.6	9.1	10.5	9.6
ASEAN-5	4.7	1.7	6.6	5.4
Russia	5.6	-7.9	4.0	4.3
Western hemisphere	4.2	-1.7	5.7	4.0
Mexico	1.5	-6.5	4.4	4.4

Source: IMF World Economic Outlook, Oct. 2010.

Global current account imbalances have narrowed since the crisis



Note: (1) Data for 2010 and beyond are IMF projections

(2) Unlike the original IMF data, other emerging Asia includes Asian NIEs

Source: IMF, World Economic Outlook database (Oct. 2010)

But risks to the recovery remain

Decoupling of growth prospects

- Lingering concerns about a “double-dip”
- Sovereign risks in Southern Europe
- Risk of too early fiscal tightening, especially in Europe

Monetary policy divergence

- QE(2) in the US and Europe, while monetary tightening in emerging Asia
- Capital inflows to Asia
- “Currency war” concerns

3. Towards Balanced and Sustainable Growth

- Asian economies' previous growth pattern was skewed toward export-dependence on the US and Europe
- This provided great benefits to Asia in terms of growth and poverty reduction
- But it had undesirable side effects:
 - Unsustainable current account surpluses
 - Greater income and social divide
 - Rapid deterioration of the environment

Elements of Asia's New Growth Strategy

- A. Current account sustainability** through balancing production with spending and a shift towards regional demand-led growth and corresponding supply-side adjustments
- B. Social inclusion** through greater focus on inclusive growth (anti-poverty, equity, access to opportunities, social resilience)
- C. Environmental sustainability** through greater focus on green growth
- D. Regional cooperation and integration**

A. Balancing production & spending

- **Demand side:** Encourage consumption or investment depending on the country
 - Household consumption (household income distribution, social sector protection, financial sector)
 - Investment (infrastructure investment, business climate)
- **Supply side**
 - Productivity growth of nontradables sectors (traditional and new services)
 - Green industry (energy efficiency, clean energy, environment)
 - SME development
 - Human capital, knowledge, innovation (to avoid the middle-income country trap)
 - Eliminating factor market distortions
- **Regional market integration**
 - Targeting the rising middle class

B. Inclusive growth

- **Expand opportunities:**
 - Sustainable growth through appropriate macroeconomic, trade, financial, and other policies;
 - Adequate infrastructure (transport, energy, water, etc.)
 - Soft infrastructure: good governance and rule of law
- **Broaden access to opportunities:**
 - Investment in health, education, and other basic social services to expand human capacities
 - Financial inclusion
 - SME support
 - Improve income distribution
- **Improve social safety nets** to strengthen social resilience
 - Enhance social protection, including health, education, housing, unemployment, pension, targeted transfer system

C. Environmental sustainability through green growth

- Cap and trade in advanced economies
- Carbon tax
 - Shift of tax burden from goods (labor/capital) to bads (energy/resource/pollution/emission)
 - Social protection: Cash transfer schemes for the poor to mitigate negative impact
 - Revenues could support R&D & deployment
- Clean Development Mechanism
- Technological innovation vital

D. Regional cooperation & integration

- **Intra-Asian** trade integration can promote more trade among Asian economies and, hence, more production and spending
- Integration of regional financial markets (eg, through bond markets) can help recycle Asia's savings to finance Asia's investment
- Systemic financial risks, due to capital inflows, can be better managed on a regional basis
- **Trans-Pacific integration** through TPP (and FTAAP) can connect Asia with the Americas
- APEC-level cooperation allows green-growth technology transfer and creation of a large carbon market

4. Managing Capital Inflows

- Risks of rapid capital inflows
 - Loss of macroeconomic stability (inflation, overheating)
 - Damage to financial stability (potential for bubbles in stock and real estate prices)
 - Risk of sudden capital flow reversal
- Asia has had some episodes of capital inflows:
 - Prior to the Asian financial crisis (1997-1998)
 - Prior to the global financial crisis in Korea

Policy responses to capital inflows

- Macroeconomic policy measures
 - Sterilized intervention (not sustainable)
 - Exchange rate appreciation (competitiveness implication)
 - Fiscal policy tightening (not easy in the short run)
- Structural policy measures
 - Financial sector reforms (a long-term measure)
 - **Stringent supervision & regulation over bank lending**
 - Import liberalization
 - **Easing restrictions of capital outflows**
 - **Capital controls**
- Global and regional cooperation
 - Reserve currency country's central bank may pay attention to global implications of its monetary policy
 - Regional policy dialogue

5. Conclusions

- Short-term economic recovery goals have been achieved, but risks to outlook remain
- The longer-term objective of achieving balanced and sustainable growth should also address social and environmental issues
- Rebalancing trans-Pacific growth calls for policies to promote higher savings in the US, together with higher spending in Asia
- This requires closer policy cooperation: structural reforms, intra-Asian regional market integration, regional infrastructure investment, stronger social sector protection, green growth, and regional financial cooperation
- In the short run, managing capital inflows is a big challenge

Thank you
For more information:

Dr. Masahiro Kawai
Dean & CEO
Asian Development Bank Institute

mkawai@adbi.org

+81 3 3593 5527

www.adbi.org