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Outlook 2008

UPDATE

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Foreword

Faced with a decelerating global economy, turbulent financial markets, and elevated commodity prices, the region of developing Asia is expected to experience a slowdown in growth in 2008 and 2009. This *Update to Asian Development Outlook 2008 (ADO 2008)*, published in April this year, marginally revises down the forecast for the region's growth for 2008 to 7.5% from the earlier 7.6%.

In most economies in the region, growth has slowed. In the People's Republic of China, expansion moderated to 10.4% in the first 6 months of 2008 from the robust 11.9% seen in the same period of 2007. This stems from the softening of external demand and the cumulative impact of monetary tightening in recent years. India, in the first quarter of FY2008 (April–June), saw its slowest growth since 2004 as inflation and higher borrowing costs damped consumer spending and investment.

Regional growth in 2009 is expected to further decelerate to 7.2%, lower than the previous projection of 7.8%. This assessment, however, is less certain, primarily because the outcome depends both on the duration and extent of the current global downturn and the runup in commodity prices, as well as on how Asian economies respond to domestic and external shocks.

Inflation forecasts are revised significantly upward as rising global prices of food and fuel have added to inflation pressures across developing Asia. Price increases started to accelerate in the second half of last year. The increases have not been limited to food and fuel prices, as rising raw materials costs pushed up manufactured goods prices as well. Wage pressures are also building up in many Asian economies. It is now anticipated that the region will register an average inflation of 7.8% in 2008 and 6.0% in 2009.

The *Update* presents four thematic essays discussing the recent global commodity price rises and their impacts on developing Asia. They suggest that high international commodity prices are here to stay. Prices are also expected to remain volatile, a combination affecting the region's growth prospects. One important finding is that in many countries, demand-pull rather than cost-push factors are causing high prices. The role of monetary policy is thus still relevant in containing price pressures, and monetary authorities should impose requisite tightening measures to prevent inflation from becoming entrenched.

However, monetary tightening is not without risks. Since the slowdown in the leading industrial economies will hit developing Asia's export and growth performance, tightened monetary policy could reinforce a contraction in the region even after demand has already begun to slacken. Still, these risks should not be overstated. The more urgent priority for monetary authorities is to contain inflation expectations.

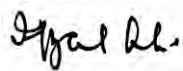
The region's growth prospects remain fundamentally sound, even after the G3 slowdown is factored in. Therefore, these risks do not diminish the broad policy message—that there has to be a reshifting of the basic monetary stance toward tightening throughout developing Asia.

The *Update* was prepared by the staff of the Asian Development Bank from the following departments: Central and West Asia, East Asia, South Asia, Southeast Asia, Pacific, and Economics and Research, as well as the resident missions of the Asian Development Bank. The economists who contributed the sections are bylined in each chapter. The subregional coordinators were Padmini Desikachar for Central and West Asia; V.B. Tulasidhar for East Asia; Tadateru Hayashi for South Asia; Sharad Bhandari for Southeast Asia; and Craig Sugden for the Pacific.

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Richard Niebuhr and Anthony Patrick as the economic editors made substantive contributions to the country chapters, subregional summaries, and other parts of the publication. Jonathan Aspin did the style and copy editing. Elizabeth E. Leuterio was responsible for typesetting and data linking, as well as graphics generation, assisted by Maria Susan Torres. The cover was designed by Joe Mark Ganaban. Zenaida Acacio and Lagrimas Cuevas provided administrative and secretarial support. The publication would not have been possible without the cooperation of the Printing Unit under the supervision of Raveendranath Rajan.

Ann Quon, Omana Nair, and Andrew Perrin of the Department of External Relations planned and coordinated the dissemination of the *Update*.



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Definitions

The economies discussed in *Asian Development Outlook 2008 Update* are classified by major analytic or geographic groupings. For purposes of the *Update*, the following apply:

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

Unless otherwise specified, the symbol "\$" and the word "dollar" refer to United States dollars. The *Update* is based largely on data available up to 1 September 2008.

Acronyms and abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
BPO	business process outsourcing
CPI	consumer price index
EU	European Union
FDI	foreign direct investment
FY	fiscal year
GDP	gross domestic product
IMF	International Monetary Fund
IOC	international oil company
MAE	mean absolute error
NOC	national oil company
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OTEXA	Office of Textiles and Apparel
PRC	People's Republic of China
q-o-q	quarter-on-quarter
RMSE	root-mean-square error
saar	seasonally adjusted annualized rate
SAARC	South Asian Association for Regional Cooperation
US	United States
VAT	value-added tax
WTO	World Trade Organization

Highlights—*ADO 2008 Update*

Moderating growth and rising inflation have characterized developing Asia in the first 8 months of 2008. High international commodity prices are likely to stay for the long haul and have exacerbated homegrown inflation pressures. But containing inflation in the face of a serious global downturn will lead to a slowdown in regional growth in 2008 and 2009. This short-term sacrifice is required for longer-term economic, social, and political gain. Prudent macroeconomic management with reforms tackling the fundamental causes of tight commodity balances is also essential, if developing Asia is to ride out the global storm, weigh anchor, and set course for faster medium-term growth and modest inflation.

Key messages

- Developing Asia's 9.0% expansion in 2007 was the highest in almost two decades. However, the many years of robust growth supported by accommodative monetary policies buttressed excessive aggregate demand that nurtured price pressures. Turbulence in global markets has fanned the flames of inflation. Developing Asia's consumer price inflation is therefore seen rising from 4.3% in 2007 to 7.8% in 2008 before ebbing to 6.0% in 2009. The confluence of these external and internal factors is expected to slow growth to 7.5% in 2008 and 7.2% in 2009.
- In many countries, demand-pull rather than cost-push factors are causing high prices. Monetary policy thus has a major role in containing these price pressures, and regional economies need to address rising inflation even at the expense of slower (short-term) growth. Central banks should impose the requisite tightening measures to prevent inflation from becoming entrenched in their economies.
- Risks—such as a prolonged slowdown in major industrial countries, continued elevated levels of international oil and food prices, persistence of high inflation, and policy reticence—are bearing down on the regional outlook, which is more heavily tilted to the downside than in April.

- The myth of uncoupling has been exploded. The worsening outlook for major industrial economies is buffeting developing Asia's export, equity, and offshore bond markets. The region clearly remains heavily reliant on industrial countries for its exports and has not uncoupled from their business cycles. The loss of investor confidence in industrial countries' equity markets has crossed over to Asia. The risk premium on dollar-denominated offshore bonds of Asian issuers has risen sharply since the outbreak of the subprime crisis in the United States. If the global slowdown extends beyond 2009 therefore, the repercussions for the region could be severe.
- The global oil market remains tight. While oil prices are likely to soften somewhat in the short run, they will stay high and volatile. Since food prices are heavily influenced by oil prices, the days of cheap food also seem to be over.
- Developing Asia will have to learn to adjust to this high global commodity price environment and to undertake the necessary structural reforms. But first, it must reestablish macroeconomic stability through sound monetary, fiscal, and exchange rate policies.
- Political pressures are building up in some countries, and these could result in the authorities' reluctance to pass needed reforms, and this risks deepening macroeconomic imbalances. Prolonged periods of political instability could inhibit investment and affect growth prospects in the medium term.

Outlook for 2008 and 2009

- Events in the first 8 months of 2008 suggest some major changes

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