



ASIAN DEVELOPMENT

Outlook 2007

Update

Asian Development Bank

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The annual *Asian Development Outlook* provides a comprehensive economic analysis of 43 economies in developing Asia and the Pacific.

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Foreword

This *Asian Development Outlook (ADO) 2007 Update* revises upward the forecast for growth in developing Asia for 2007 to 8.3% from the 7.6% forecast earlier this year, in *ADO*. This reassessment stems from the exceptionally strong performance of Asia's giants—the People's Republic of China (PRC) and India.

Buoyed by exports, investment, and consumption, the PRC posted its fastest growth rate since 1994 at 11.5% in the first half of the year. India, on the back of its quickest expansion in 18 years, grew by 9.3% in the first quarter of FY2007 (April–June). The headline number for 2007 has also been lifted by faster than expected growth in Indonesia and the Philippines.

The *Update* anticipates a gentle slowing of growth through 2008, but cautions that the outlook is highly uncertain. Unfolding events make predictions at this juncture particularly hazardous. It is clear, however, that developing Asia would not be immune from processes that erode consumer and investor confidence in the wider, global economy. A steep downturn in the United States, with knock-on effects in Japan and the euro zone, would mark a significant deterioration in the external environment and would undoubtedly cut into regional growth going into 2008. Negative impacts would be transmitted through both trade and financial channels.

At the same time, however, developing Asia is in a much better position to cope with adverse external developments: it has stout financial defenses and some scope for policy adjustments. A key message of the *Update* is that, beyond the gyrations in the global economy, developing Asia's growth prospects will continue to depend on how well economies cope with their own domestic challenges.

The *Update* also presents an analysis of export performance in East and Southeast Asia. This examines the influence of real exchange rate changes on export performance during 1990–2006, a period in which intermediate goods trade burgeoned. The results suggest that supply-side factors—including the quality of infrastructure and the business investment climate—play a very important role in regional export performance. This is particularly true for manufactured products and for some of the fastest-growing industries in global trade, such as electrical and nonelectrical machinery, as well as transport equipment.

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 country chapters are: Mohammad Zahid Hossain and Rezaul Khan (Bangladesh); Jian Zhuang (People's Republic of China); Narhari Rao and Hiranya Mukhopadhyay (India); Purnima Rajapakse (Indonesia); Hiroki Kasahara (Malaysia); Jesus Felipe and Safdar Parvez (Pakistan); Tomomi Tamaki and Joven Balbosa (Philippines); Luxmon Attapich (Thailand); and Dao Viet Dung and Omkar Shrestha

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Frank Harrigan, Assistant Chief Economist, Macroeconomics and Finance Research Division, assisted by Cyn-Young Park and Edith Laviña, coordinated the overall production of the publication. Part 1, *Developing Asia and the world*, was prepared by Frank Harrigan, Cyn-Young Park, and Lea Sumulong. Juthatip Jongwanich provided the section on export dynamics in East Asia, with input from Ted James. Paolo Hernando contributed a box on oil subsidies, Gemma Estrada and Pilipinas Quising provided an analysis of ADO's forecasting performance, and Shiela Camingue authored a section on estimating regional and subregional growth.

Technical and research support was provided by Shiela Camingue, Gemma Estrada, Paolo Hernando, Pilipinas Quising, Nedelyn Ramos, Lea Sumulong, and Rashiel Velarde.

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. Artwork and cover design were rendered by Mike Cortes of /DoubleSlash/ Media Inc. Maria Susan Torres, Zenaida Acacio, and Pats Baysa 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 and Saby Mitra 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 2007 Update* are classified by major analytic or geographic groupings. For this publication, 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 43 developing member countries of the Asian Development Bank.
- **Central Asia** comprises Armenia, Azerbaijan, 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 US dollars.

The *Statistical Notes* give a detailed explanation of how data are derived.

The *Update* is generally based on data available up to **31 August 2007**.

Acronyms and abbreviations

ASEAN	Association of Southeast Asian Nations
CDO	collateralized debt obligation
CPI	consumer price index
EU	European Union
FDI	foreign direct investment
FPE	fraction of positive errors
FY	fiscal year
GDP	gross domestic product
GNI	gross national income
IMF	International Monetary Fund
MAE	mean absolute error
MNE	multinational enterprise
NIE	newly industrialized economy
PPP	purchasing power parity
PRC	People's Republic of China
RMSE	root-mean-square error
US	United States
VAT	value-added tax
WTO	World Trade Organization

ADO 2007 Update—Highlights

- With growth of 8.3%, 2007 is likely to be another bumper year for developing Asia. This estimate has been revised up from the 7.6% forecast in March made by *Asian Development Outlook 2007*.
- Strong growth in the People's Republic of China (PRC) (now put at 11.2%) and India (8.5%) will spearhead expansion, but there is a more general pattern of high and, in some countries, accelerating growth. In the first half of 2007, the Philippines grew by 7.3%, the highest rate in almost 20 years, and the country is expected to post growth of 6.6% for the full year. In Indonesia, growth continues to edge up and is now expected to finish the year above 6%.
- The outlook for 2008 remains favorable, and the baseline forecast points to only a marginal slowing of growth to 8.2%. Momentum in the PRC and India is seen staying robust. In the PRC, double-digit growth of 10.8% is expected, and the pace of expansion in India should remain at 8.5%. Indonesia's prospects continue to brighten, with growth of 6.4% penciled in.
- Symptoms of overheating suggest that output is growing at close to its potential in the PRC and India. Stoked by rising food prices, inflation pressures are building in the PRC. Credit is expanding, and equity and property markets have posted strong gains. In India, even though inflation has cooled, the central bank remains vigilant and shows no signs yet of easing interest rates.
- Recent convulsions in credit markets and the possibility of spillovers into the real economy heighten uncertainty about the future. Events are still unfolding and predictions at this time are unusually fuzzy, with the chances of downward revisions becoming more likely.

- If growth in the United States (US) lurches down, developing Asia would not be immune. But the tremors from a downturn in the US are likely to be modest and short-lived even if it falls into recession. Available evidence suggests that, depending on timing, severity, and duration, a US recession could clip growth in developing Asia by 1–2 percentage points. If a synchronous steep downturn in the US, euro zone, and Japan were to occur—an event that currently seems improbable—growth in developing Asia would be at greater risk. But stout reserves, improved financial systems, and scope for policy adjustments put the region in a better position to weather any storm.
- A special chapter in this *Update* looks at the dynamics of East Asia’s export performance over the past quarter century. Exports have been an important part of its growth story. The analysis reveals important changes over the years in the pattern and direction of exports and traces the emergence of sophisticated supply chains in the region. East Asia has shown itself to be particularly adept at positioning itself in the fastest-growing global export markets.
- As organizational and technological innovations have spurred the separation and refinement of tasks, their geographic dispersal, stimulated by the search for scale and cost advantages, has created trade. The chapter shows that this burgeoning “trade in tasks” is, in the short run, less sensitive to real exchange rate movements than are exports of primary commodities or finished manufactured goods. Supply-side factors, such as good infrastructure, a welcoming investment climate, and services and logistics support, play an important role in explaining export performance. The chapter finds, too, that demand external to Asia remains an important influence on regional exports. The parts and components that are traded within East Asia and that account for much of the growing regional integration are usually assembled in final products, which are shipped to external markets.

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