



Economic and Social Survey of Asia and the Pacific 2008

*Sustaining Growth and
Sharing Prosperity*



United Nations
ESCAP

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

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FOREWORD

This year marks the sixtieth anniversary of the publication of the *Economic and Social Survey of Asia and the Pacific*. The first issue, published in 1948, came against the backdrop of the devastation of the Second World War and set out to provide policy guidance for the recovery and reconstruction of the war-torn countries in the region. Since then, the *Survey* has presented an independent analysis of the region's socioeconomic developments, provided early warning signals and presented policy options and recommendations. Today, it is considered the most comprehensive annual review of economic and social development in Asia and the Pacific.

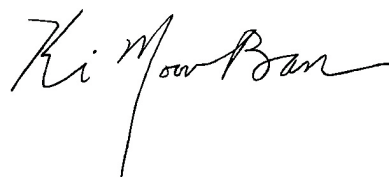
In this context, the *Survey* examines the region's key short- and medium-term prospects and challenges in macroeconomic and selected social areas, especially from the point of view of minimizing human suffering; be it from economic hardships or social instability. The *Survey* also explores critical long-term development issues relevant to all developing countries in the region.

As the 2008 *Survey* spells out that, having enjoyed the fastest growth in a decade in 2007, the developing economies in the region are expected to grow at a slightly lower but still robust rate of 7.7 per cent in 2008. The main short-term challenge to economic prospects comes from the still unraveling sub-prime crisis of the United States and its possible impact on the world economy. The *Survey* emphasizes that the region's solid macroeconomic fundamentals, painstakingly put in place and strengthened through the years, have prepared the countries of Asia and the Pacific to absorb and adapt to such external shocks.

Despite good economic performance and efforts by Governments to foster social development, there are a number of fault lines in the region. Over 600 million of the world's poor still live in Asia, nearly two thirds of the global total, and mainly in rural areas. Other statistics are equally staggering. Ninety-seven million children remain underweight. Four million children die before reaching age five. While the region is well prepared to ride the current turbulence in the global economy, even smaller economic shocks can severely affect the most vulnerable people. The long-term impact of these shocks in terms of poverty, unemployment and inequality is of deep concern, highlighting the need for sound policies to share prosperity and the fruits of high growth.

In this spirit, the 2008 *Survey* takes a closer look at agriculture as a critical factor for poverty reduction and rural development. Agriculture still provides jobs for 60 per cent of the working population in Asia and the Pacific, and shelters the majority of the poor. But neglect has undermined the sector's capacity to reduce poverty and inequality. Long-term development issues related to agriculture need to be addressed head-on. The *Survey* proposes a two-track strategy to ensure that agriculture is both economically and socially viable, so as to raise productivity and make real inroads against poverty.

I hope the findings of this 60th anniversary *Survey* will provide a basis for wider discussion among policymakers in Asia and the Pacific, and support the region in its endeavours to remain a leading engine of growth while achieving shared prosperity.



Ban Ki-moon
Secretary-General

February 2008

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EXECUTIVE SUMMARY

Healthy macroeconomic fundamentals to shield the region from global financial turbulence

After the fastest growth in a decade in 2007, the developing economies of the Asia-Pacific region are expected to grow at a slightly slower but still robust 7.7% in 2008. The region's developed economies are expected to grow at 1.6% in 2008, slipping from 2% in 2007. China and India, the region's economic locomotives, are expected to continue growing briskly in 2008, boosting the rest of the region. Commodity- and energy-exporting countries, particularly the Russian Federation, are expected to add to the momentum. The major drags on performance are the slowdown in the United States driven by the bursting housing bubble, the unfolding credit crunch in the United States and Europe, the appreciation of currencies in the region against the dollar and the high oil and food prices.

Although exports may suffer from the slower growth in industrial countries, strong domestic demand – driven by private consumption and investment in fast-growing countries and by fiscal accommodation – should cushion the blow. Export-dependent economies in East and South-East Asia will see exports contribute less to growth, but China's on-going expansion will continue to offer opportunities.

North and Central Asia will continue to benefit from consumption and construction, thanks to income from high energy prices. With economies traditionally driven by domestic demand, South and South-West Asia will benefit from strong private consumption and investment – and from expansionary fiscal policy in some countries. In the Pacific, Fiji and Tonga are expected to recover from economic contractions, while Papua New Guinea will enjoy rising consumption as the benefits of high commodity prices spill over to the rest of the economy.

The region's resilience lies mainly in its healthy macroeconomic fundamentals, enabling countries to adopt supportive fiscal and monetary policies. Government budget deficits have gradually declined and, in some countries, have turned to surpluses. There have been no signs of excessive current account deficits, as in the prelude to 1997. Countries have reduced their dependence on bank financing, addressed currency mismatches and improved the health of banking sectors. Large foreign reserves have added to the region's resilience.

Food inflation – the next big challenge: Inflation in the developing economies of the region is projected at 4.6% in 2008, down from 5.1% the previous year, with currency appreciation cushioning the impact of high oil and food prices. This projection, however, is subject to some uncertainty. The key question is how much last year's surge in prices will continue in 2008 and beyond. Oil prices are expected to decline from the record levels at the beginning of 2008 as the industrial economies slow, led by the United States. Food prices are likely to remain high, posing a greater inflationary risk because food accounts for a far higher proportion of consumer spending.

The rising food prices in 2007 were due in part to drought in Australia, flooding in China and dry weather in Europe. Added pressure came from the demand for biofuels. With the march towards biofuels apparently unstoppable, governments need to consider carefully the impact on the poor. ESCAP analysis shows that the poor have so far benefited little from the biofuel revolution despite its opportunities for lower income groups.

Currency appreciation to continue: Since 2006, major currencies in the region have risen against the dollar, a trend expected to continue in 2008, driven by the unwinding of large United States imbalances with the rest of the world and the turmoil in global financial markets. Currency appreciation sheltered the region's economies from high oil and food prices, but it dealt a blow to the competitiveness of exports. Countries whose currencies appreciated the most faced intensive competition from lower cost producers, surrendering market share, especially in price-sensitive, low-technology manufacturing, along with some agricultural commodities.

Downside risks to the 2008 outlook – navigating the subprime crisis

The subprime crisis in the United States is still unravelling, and a significant slowdown in the United States and further turmoil in financial markets cannot be ruled out. Often-fickle investor sentiment makes it difficult to predict when and how that turmoil might affect regional markets. Even so, countries can ensure that they are strong and flexible enough to absorb the shocks and adapt to any disruption in financial flows. Because economic shocks exact a heavy toll on poor and vulnerable people, efforts to mitigate the impacts are urgent.

So far, Asia-Pacific economies have remained fairly immune to the tighter credit conditions in the United States and the European Union. The region's corporate sector is generally cash-rich and not highly leveraged. The region is also reported to have little exposure to subprime or other vulnerable debt.

The main impact on the region will come through a downturn in exports. The United States has been cutting interest rates aggressively in response to slowing growth, fuelling further depreciation of the dollar. Countries in the region will face twin blows: reduced demand and less competitive exports to the United States. The possibility of substantial capital outflows from the region is another risk, whether triggered by external developments, concerns about the region's growth or reversals in the foreign exchange "carry trade".

In the worst case scenario of a recession in the United States and a deeper depreciation of the dollar, the impact in much of the region would be harsh. Most vulnerable will be the exporters of high-technology products, such as electronics, to the United States: Singapore, the Republic of Korea and Taiwan Province of China. The economy of China will remain reasonably resilient, as strong domestic demand should partly cushion the external shock. The impact is likely to be felt less in economies led largely by domestic demand, such as India.

To strengthen economies and to reduce the impact on the poor, countries must:

- **Solidify macroeconomic fundamentals – to maintain investor confidence and sustain economic growth.** Key policies are for moderate and stable inflation, low budget deficits and sustainable debt burdens – and more flexible exchange rates to absorb shocks.
- **Develop robust microeconomic foundations – to ensure efficient economic systems.** Clear property rights, overseen by a strong judiciary, allow companies and institutions to operate with confidence. Training programmes to improve labour mobility and measures to safeguard vulnerable segments of the working population are also important.
- **Ensure healthy financial sectors – to build confidence and benefit from capital inflows.** Financial markets need to be deepened by developing domestic and regional bond markets. Authorities must also keep pace with the greater diversity and complexity of new financial products.
- **Strengthen social safety nets – to support people facing hardship during economic downturns.** As

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