

Asia and Pacific:

Challenges in a Turbulent Global Environment



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Key messages and roadmap

- Asia remains the main engine of global growth.
- But the region is facing a number of short-term risks.
- In the medium-term, Asia needs to prepare for the risk of a “new mediocre” in advanced economies and in its own economies.
- The global trade slowdown and anti-trade sentiment can hit Asia hard—Asia needs more balanced and inclusive growth.







Growth Outlook in Asia



Asia remains the global growth engine with mostly upward growth revisions

Growth Projections: Selected Asia

(percent change from a year earlier)

	 World	Asia	 China	 Japan	 India	Australia and New Zealand	ASEAN	Hong Kong, SAR
2015	3.1	5.4	6.9	0.5	7.6	2.6	4.7	2.4
2016	3.1	5.4	6.6	0.5	7.6	2.8	4.8	1.4
Revision from Apr. 2016	-0.1	0.1	0.1	0.0	0.2	0.4	0.0	-0.8
2017	3.4	5.3	6.2	0.6	7.6	2.7	5.1	1.9
Revision from Apr. 2016	-0.1	0.1	0.0	0.6	0.1	-0.2	0.0	-0.5

Source: IMF staff.

Note: Figures for India are on a fiscal year basis.



Asia remains the global growth engine with mostly upward growth revisions

WEO Real GDP	Current Projections			Revision from Apr. 2016	
	2015	2016	2017	2016	2017
Asia	5.4	5.4	5.3	0.1	0.1
Industrial Asia 1/	1.0	1.0	1.0	0.1	0.4
East Asia 2/	6.2	5.9	5.7	0.1	0.0
South Asia 3/	7.4	7.5	7.5	0.2	0.1
Bangladesh	6.8	6.9	6.9	0.4	0.0
Sri Lanka	4.8	5.0	5.0	0.0	0.0
Nepal	2.7	0.6	4.0	0.0	-0.4
ASEAN 4/	4.7	4.8	5.1	0.0	0.0
Cambodia	7.0	7.0	6.9	0.0	0.0
Lao P.D.R.	7.6	7.5	7.3	0.1	-0.1
Myanmar	7.0	8.1	7.7	-0.6	0.0
APD Small States 5/	3.0	3.0	3.4	-0.3	0.0
Mongolia	2.4	0.0	1.0	-0.4	-1.6

Source: IMF, World Economic Outlook database.

1/ Industrial Asia includes Australia, Japan, and New Zealand.

2/ East Asia includes China, Hong Kong SAR, Korea, and Taiwan Province of China.

3/ South Asia includes Bangladesh, India, Sri Lanka, and Nepal.

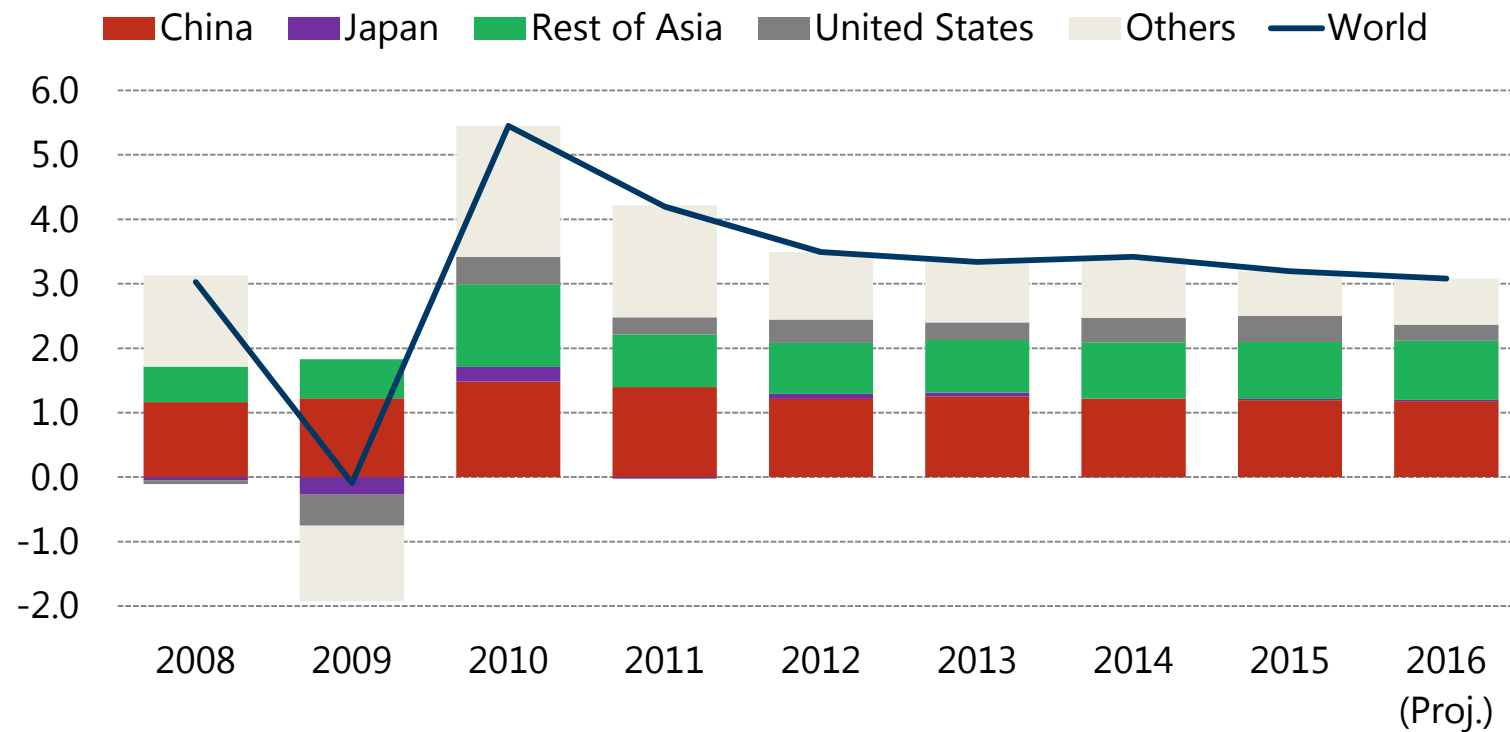
4/ ASEAN includes Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

5/ Simple average of APD Small States which include Bhutan, Fiji, Kiribati, Maldives, Marshall Islands, Micronesia, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

The region continues to deliver two-thirds of global growth

Contribution to Global Growth, 2008-16

(In percentage points)



Sources: IMF, World Economic Outlook; and IMF staff calculations.



Asia: Downside risks to the outlook

Near-term:

- Global trade slowdown
- Sudden tightening of global financial conditions (asynchronous monetary policies in AEs, de-risking)
- China rebalancing, if bumpy
- Natural disasters and geopolitical tensions

Medium-term:

- “New mediocre” in advanced economies



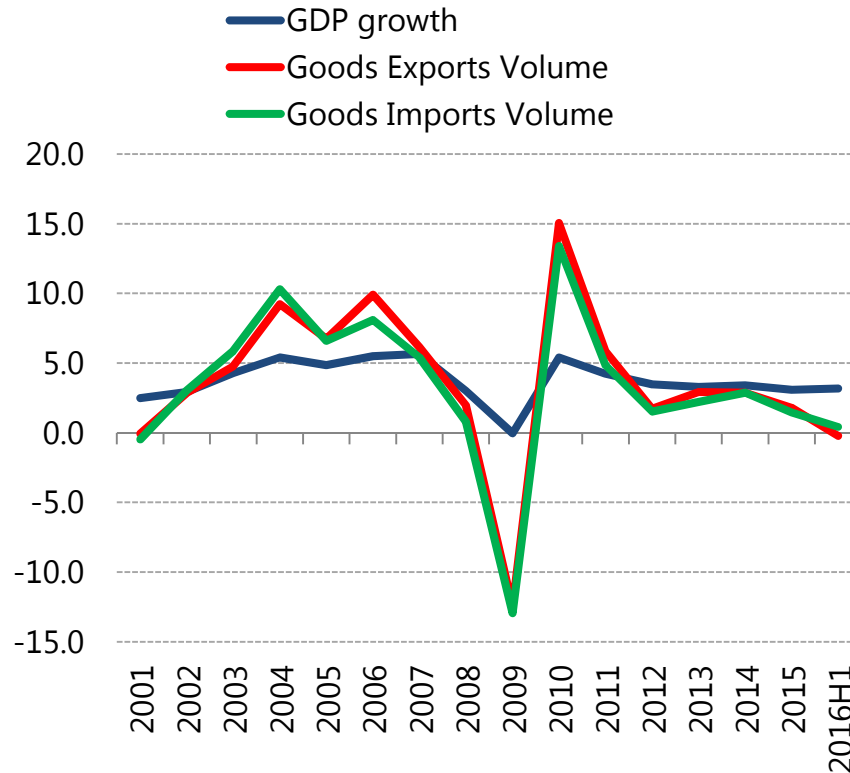
What are the Near-term Risks and Vulnerabilities in Asia?



Trade growth is weaker than GDP growth, especially in Asia

World: GDP Growth and Trade Performance

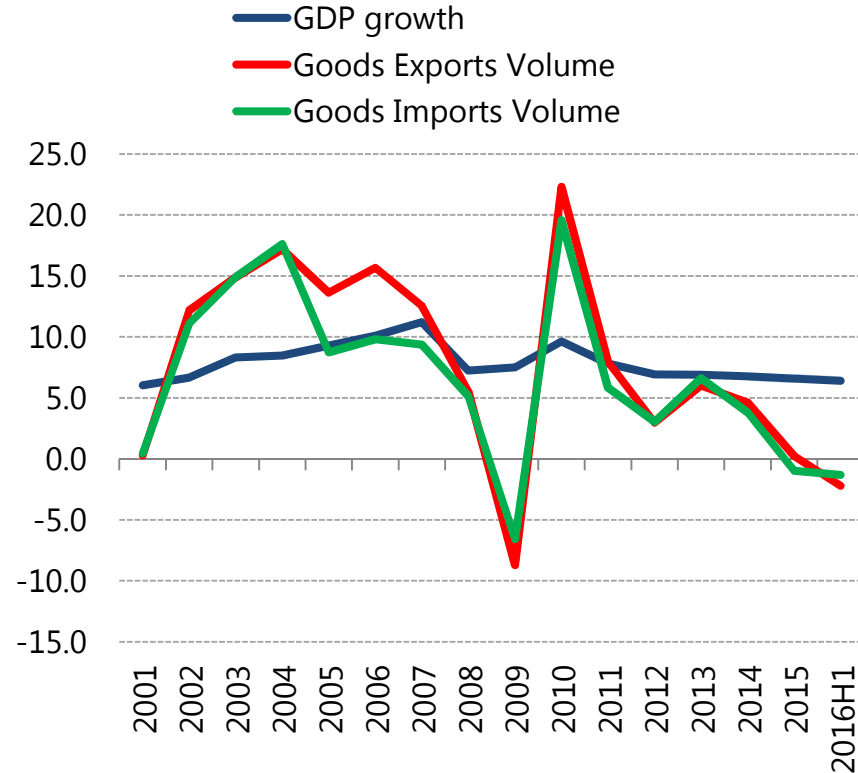
(Year-over-year percent change)



Sources: IMF, WEO database; CPB database; and IMF staff calculations.

EM Asia: GDP Growth and Trade Performance

(Year-over-year percent change)

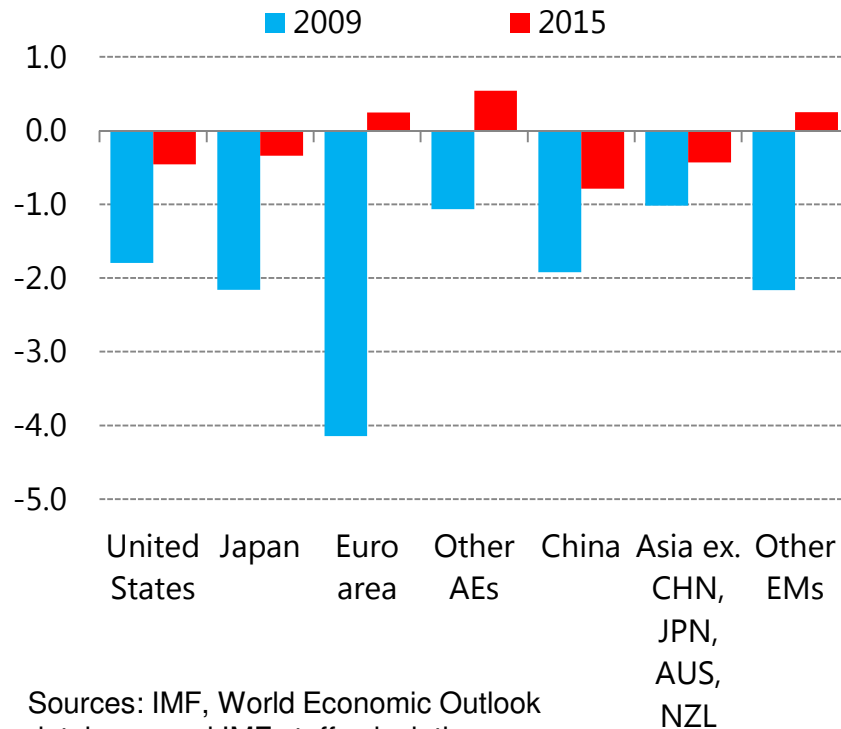


Sources: IMF, WEO database; CPB database; and IMF staff calculations.

Unlike in the past, China and EMs contributed more to the recent trade slowdown

Contribution to Change in Global Export Volume Growth

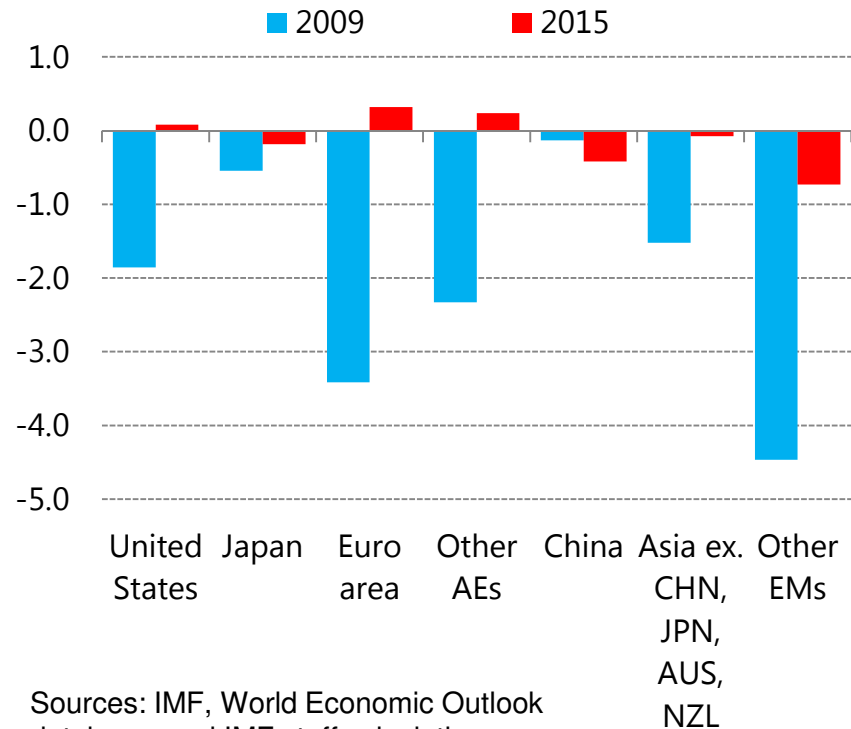
(Year-on-year percent change)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Contribution to Change in Global Import Volume Growth

(Year-on-year percent change)

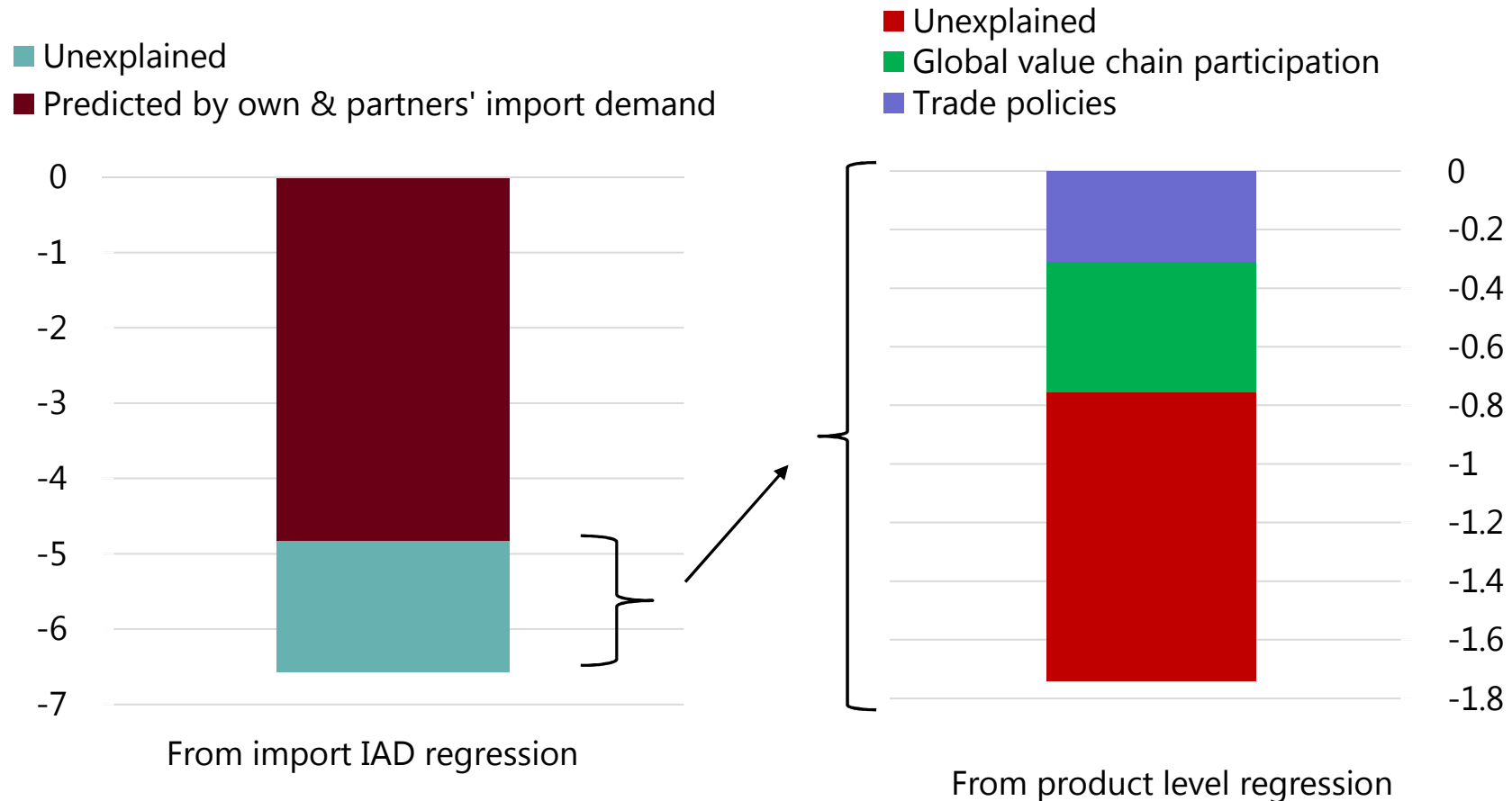


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Trade policies and supply chains maturation have contributed to the slowdown in trade

Contributions to slowdown in real goods import growth 1/

(In percent)



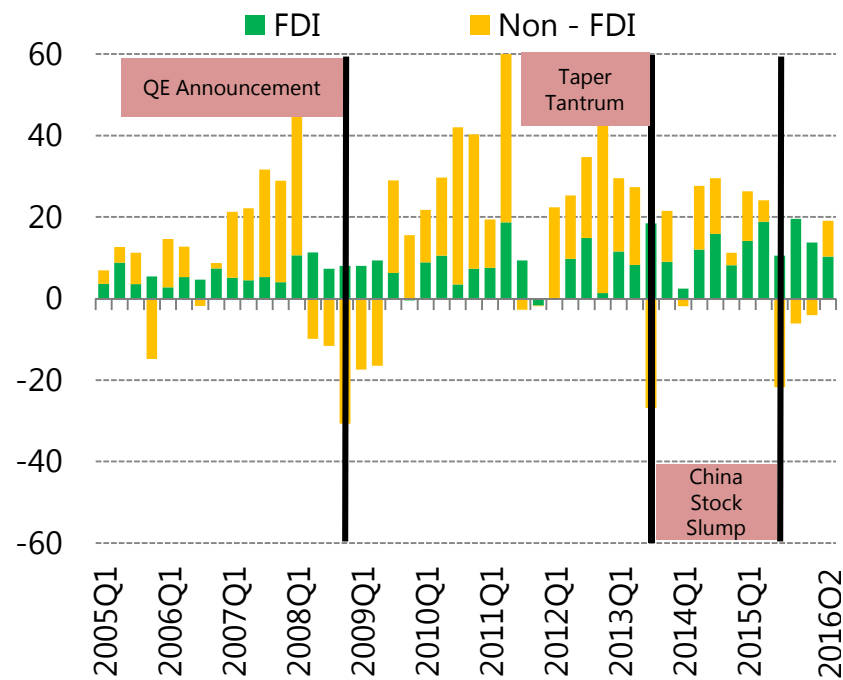
Sources: Chapter 2, October 2016, IMF *World Economic Outlook*.

Note: 1/ Baseline based on an import demand model linking real import growth to growth in import intensity-adjusted demand (IAD) and relative prices. See WEO Chapter 2, Annexes 2.3 and 2.5.

Capital flows have been volatile as global financial conditions are tightening

Emerging Asia excl. China: Capital Flows

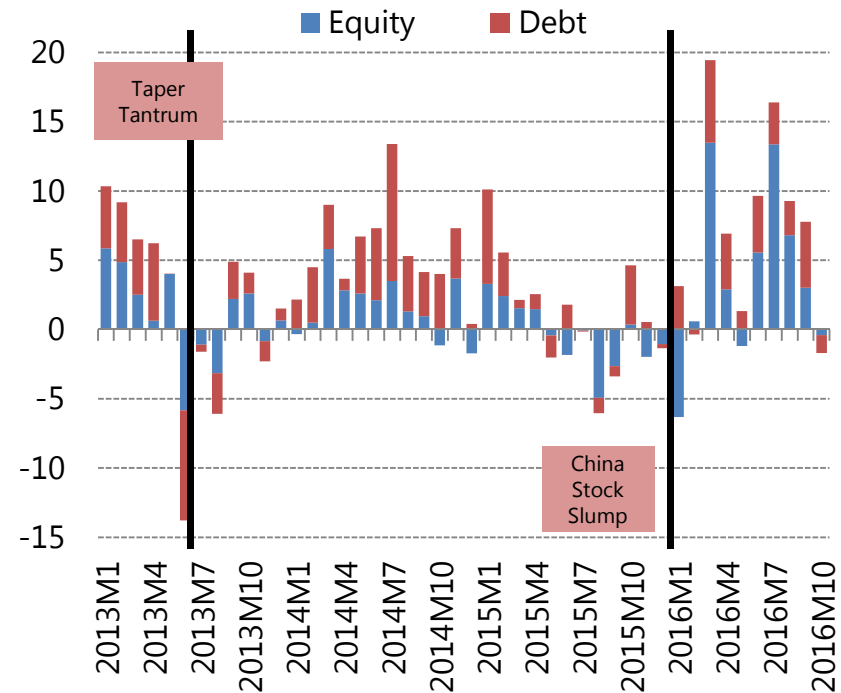
(In billions of U.S. dollars; positive = capital inflow)



Sources: IMF, *IFS* database; CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations. Data as of 2015Q4.

Emerging Asia excl. China: Portfolio Flows

(In billions of U.S. dollars)



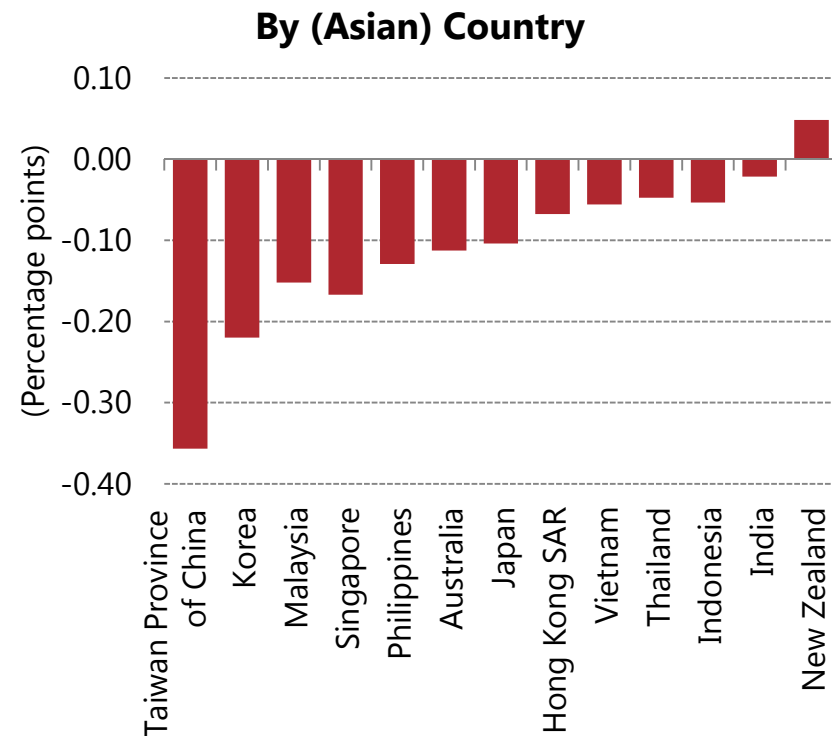
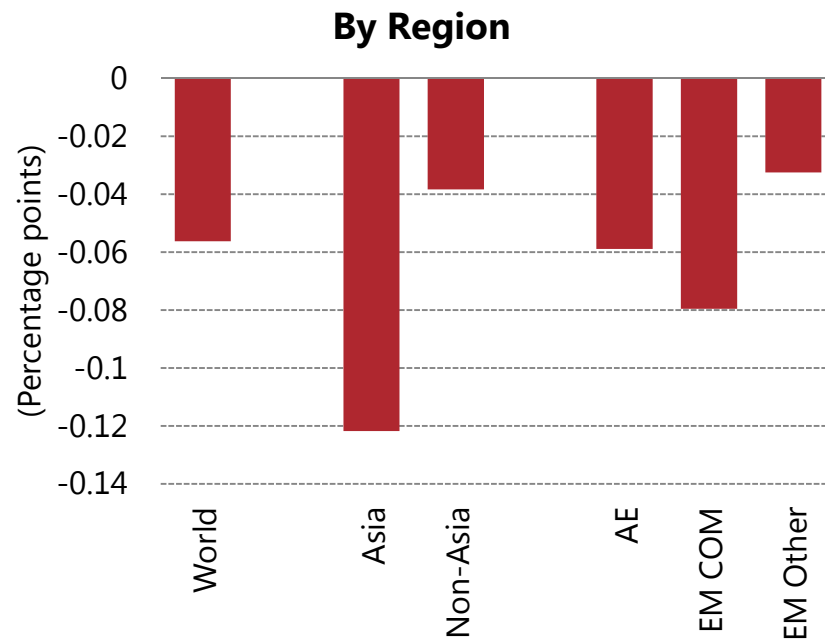
Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations. Note: Equities coverage: India, Indonesia, the Philippines, and Thailand; Bonds coverage: India, Indonesia, and Thailand.

Growth implications of trade spillovers from China's rebalancing since 2011 have been significant

Average Impact on Partner-Country GDP Growth

(3.1 percentage point increase in Chinese **consumption** growth

and 2.5 percentage point decrease in Chinese **investment** growth over non-rebalancing scenario)



Source: IMF staff estimates.

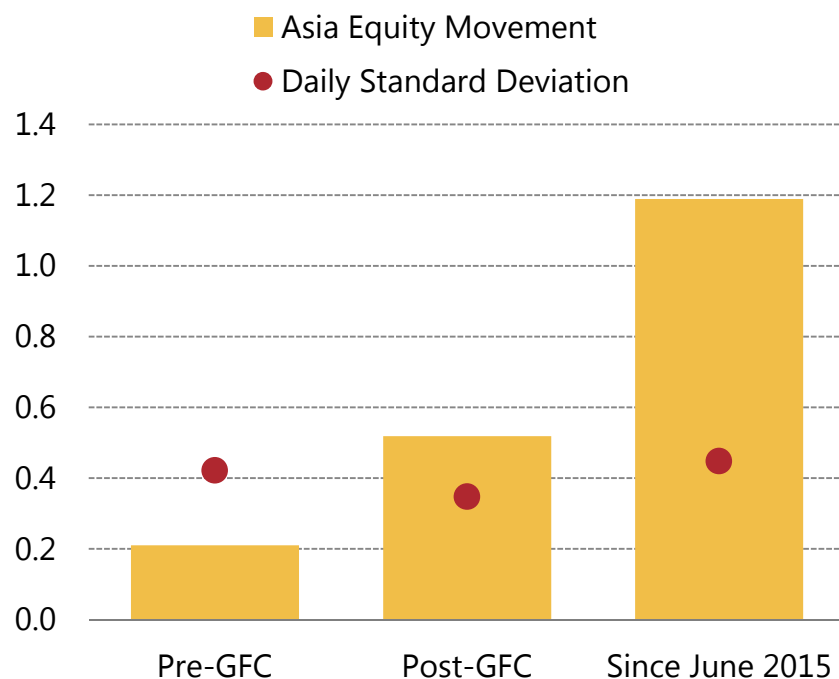
Note: AE = advanced economies; EM COM = commodity-exporting emerging markets; EM Other = other emerging markets.

Source: IMF staff estimates.

Financial spillovers: Rising and stronger for economies with greater trade links with China

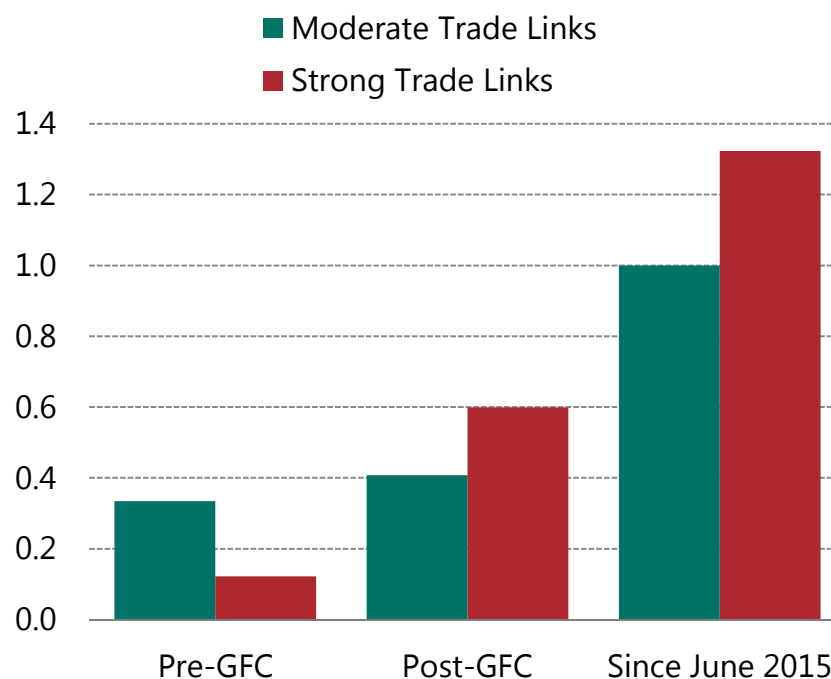
Regional Stock Market Movements Due to Shocks from China

(Percent change)



Regional Stock Market Movements Due to Shocks from China, by Trade Links with China

(Percent change)



Source: April 2016 APD REO (forthcoming).

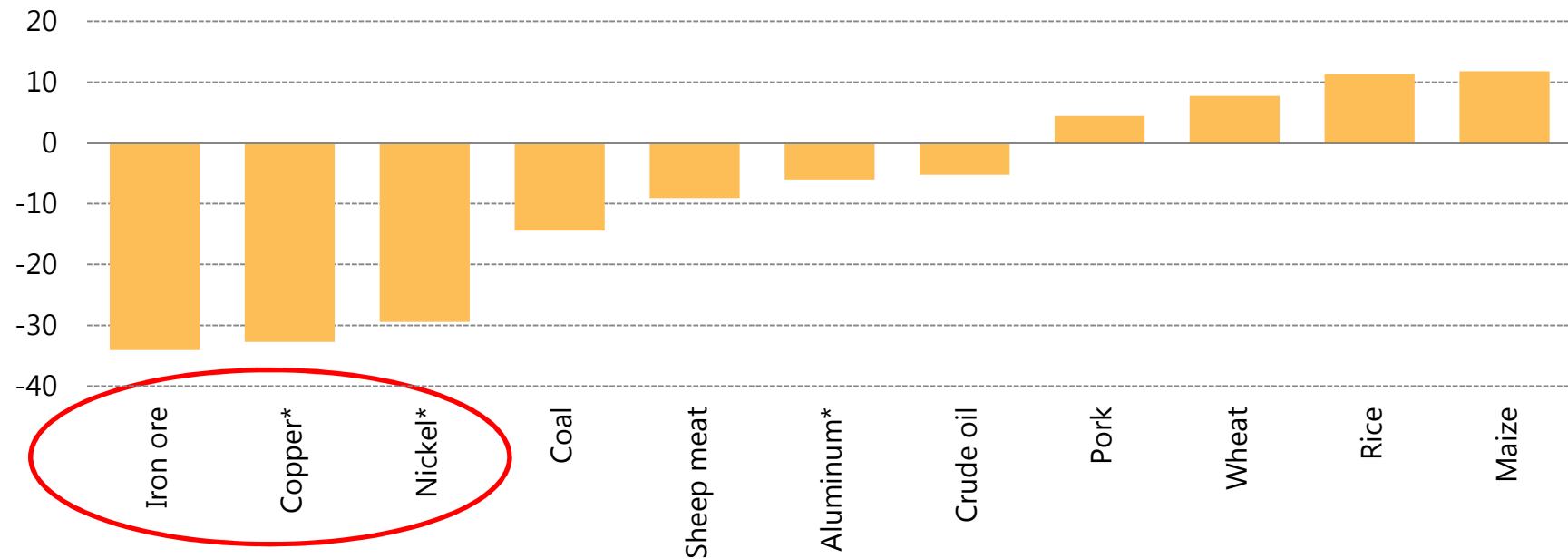
Note: Pre-GFC = January 2001-December 2007; Post-GFC = June 2010-June 2015; Since June 2015 = July 2015-January 2016.

Trade links based on exports for China's final demand in value added terms.

China's impact on commodity markets mainly on metals, not oil

China: Deviations of Actual Consumption from Counterfactual

(In percent)



Source: April 2016 APD REO (forthcoming).

Note: The chart shows the deviations between the latest actual data (2014 or 2015*) and the counterfactuals, based on regressions of commodity consumption on GDP and prices.



What Does the “New Mediocre” Mean For Asia?

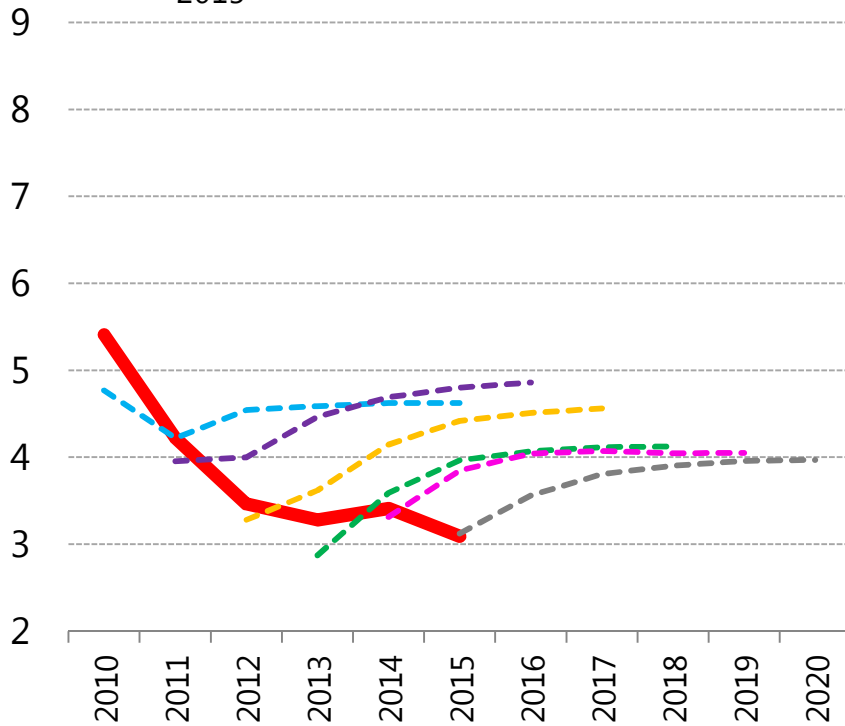


Asia's growth has moderated in recent years...

World: GDP Growth Outturns vs. WEO

Projections 1/ (Year-over-year percent change)

- Outturn
- - - 2010
- - - 2011
- - - 2012
- - - 2013
- - - 2014
- - - 2015

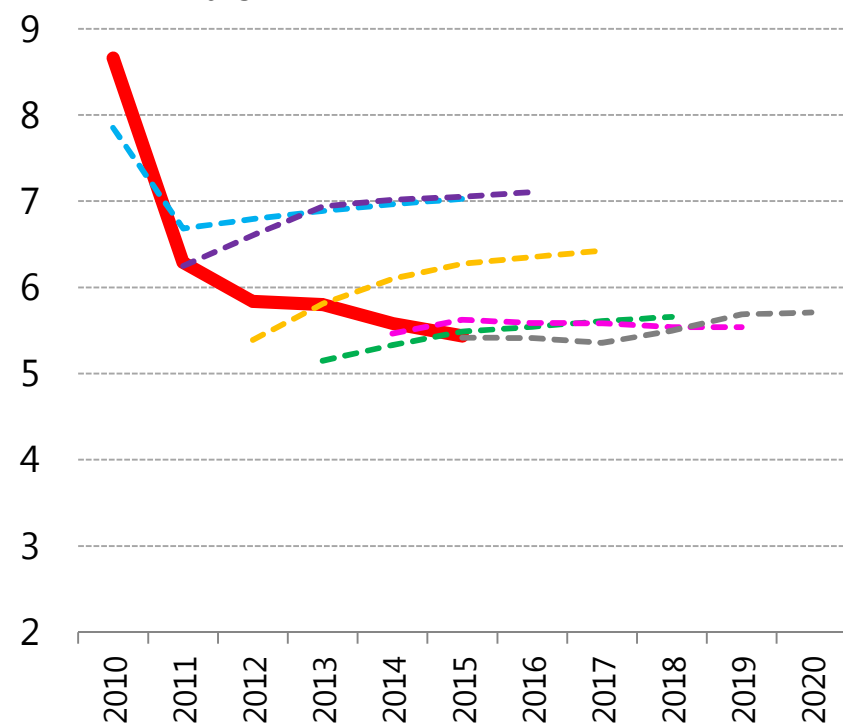


Sources: IMF, WEO database; and IMF staff calculations.
1/ 5-yr forward projections from October WEO in each year.

Asia: GDP Growth Outturns vs. WEO

Projections 1/ (Year-over-year percent change)

- Outturn
- - - 2010
- - - 2011
- - - 2012
- - - 2013
- - - 2014
- - - 2015

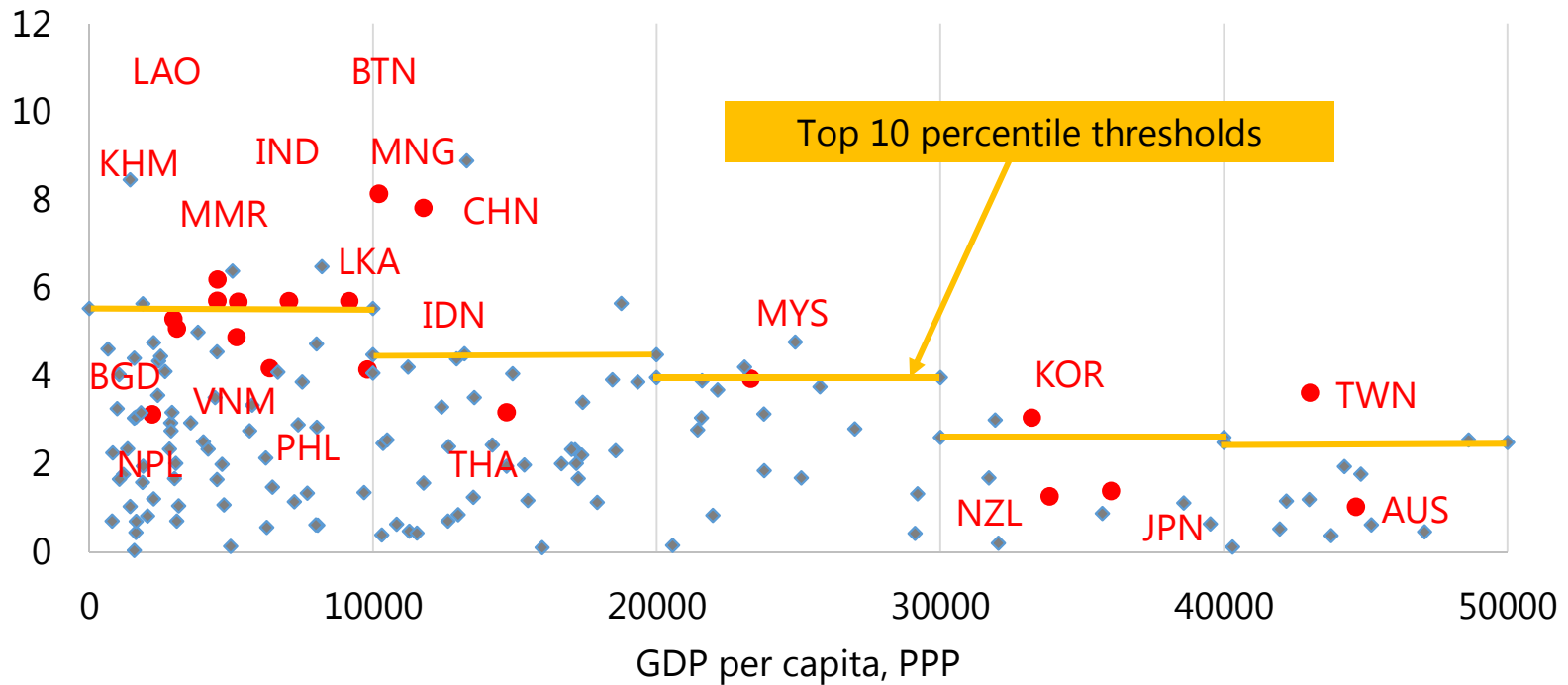


Sources: IMF, WEO database; and IMF staff calculations.
1/ 5-yr forward projections from October WEO in each year.



... which may be due to growth convergence, but other factors as well

Real GDP per Capita Growth: 2010-2015 (percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Red dots represent major Asian countries, and yellow lines indicate top 10 percentile GDP growth rate within each income group.



Asia is diverse but there are three broad groups in relation to the “new mediocre”

- **Group 1 (Japan):** stagnation has been present for more than two decades, well before other advanced economies were hit.
- **Group 2 (China, Korea, Singapore, and Thailand):** looming rapid aging and demographics pressures; slowdown in productivity growth.
- **Group 3 (India and other fast growing economies, such as Indonesia, Malaysia, Vietnam):** not at risk of stagnation domestically but can be affected through spillovers.



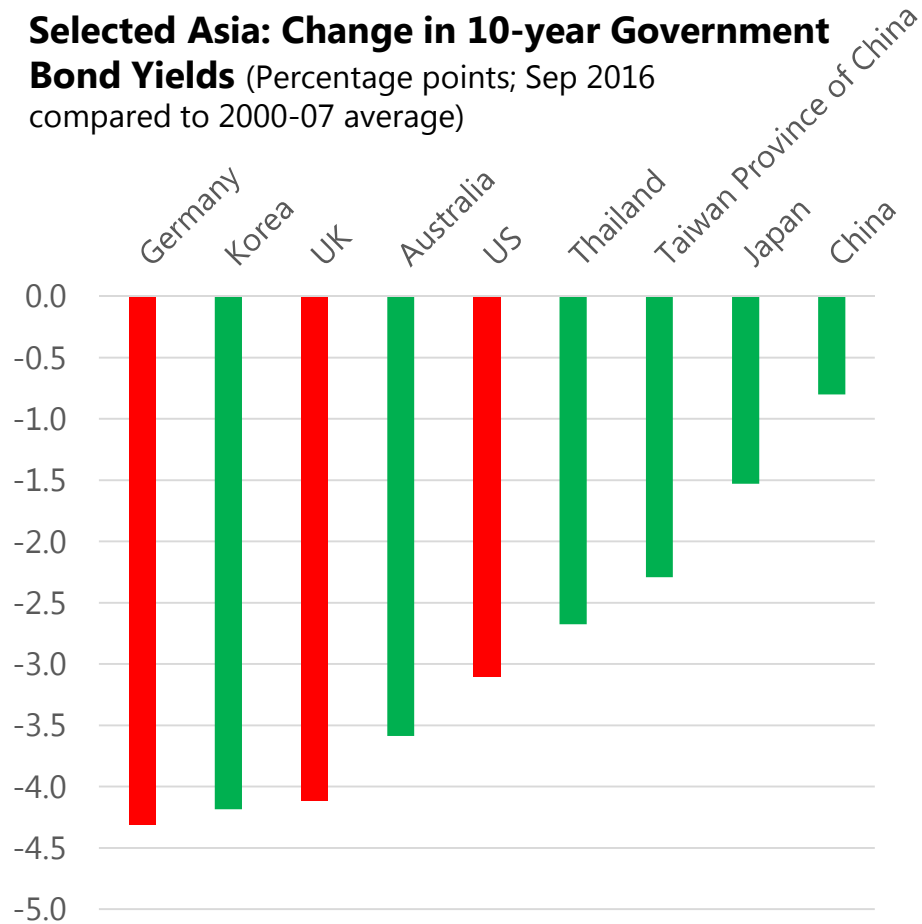
Signs of the “new mediocre” in Asia?

- Long-term interest rates declining?
- Natural (or neutral) interest rates declining?
- Low inflation becoming more common?
- Demographics becoming a headwind?
- Productivity growth declining?

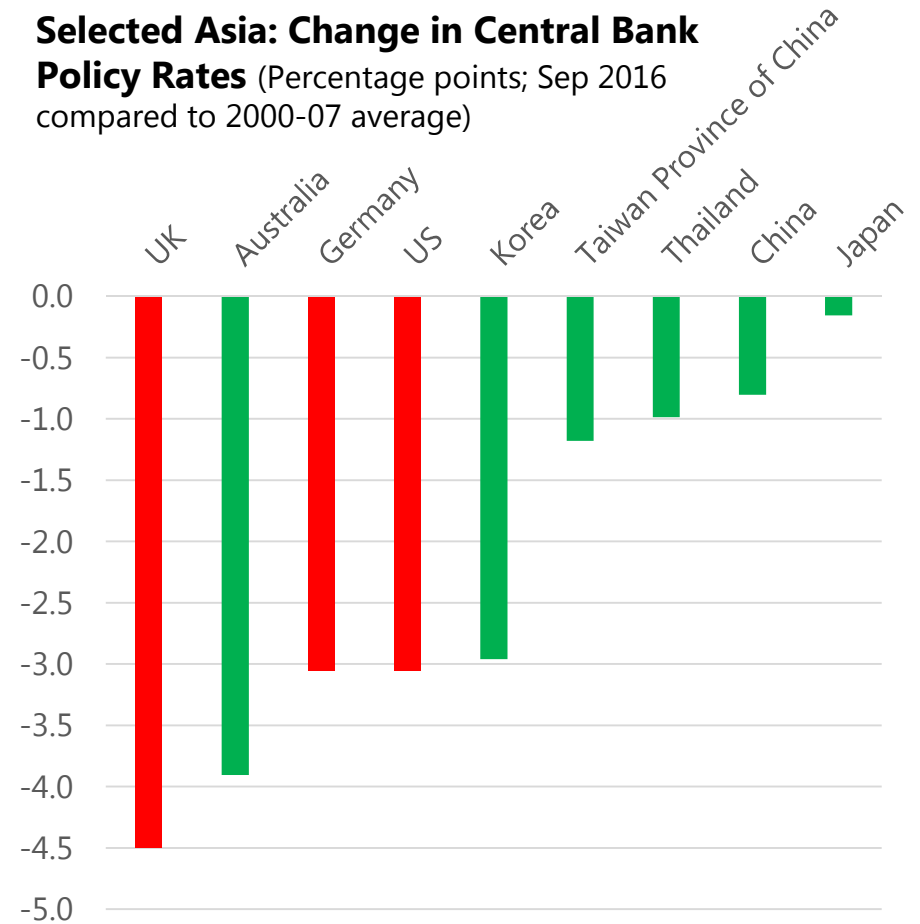


Long-term rates have fallen significantly in some cases, but not everywhere

Selected Asia: Change in 10-year Government Bond Yields (Percentage points; Sep 2016 compared to 2000-07 average)



Selected Asia: Change in Central Bank Policy Rates (Percentage points; Sep 2016 compared to 2000-07 average)



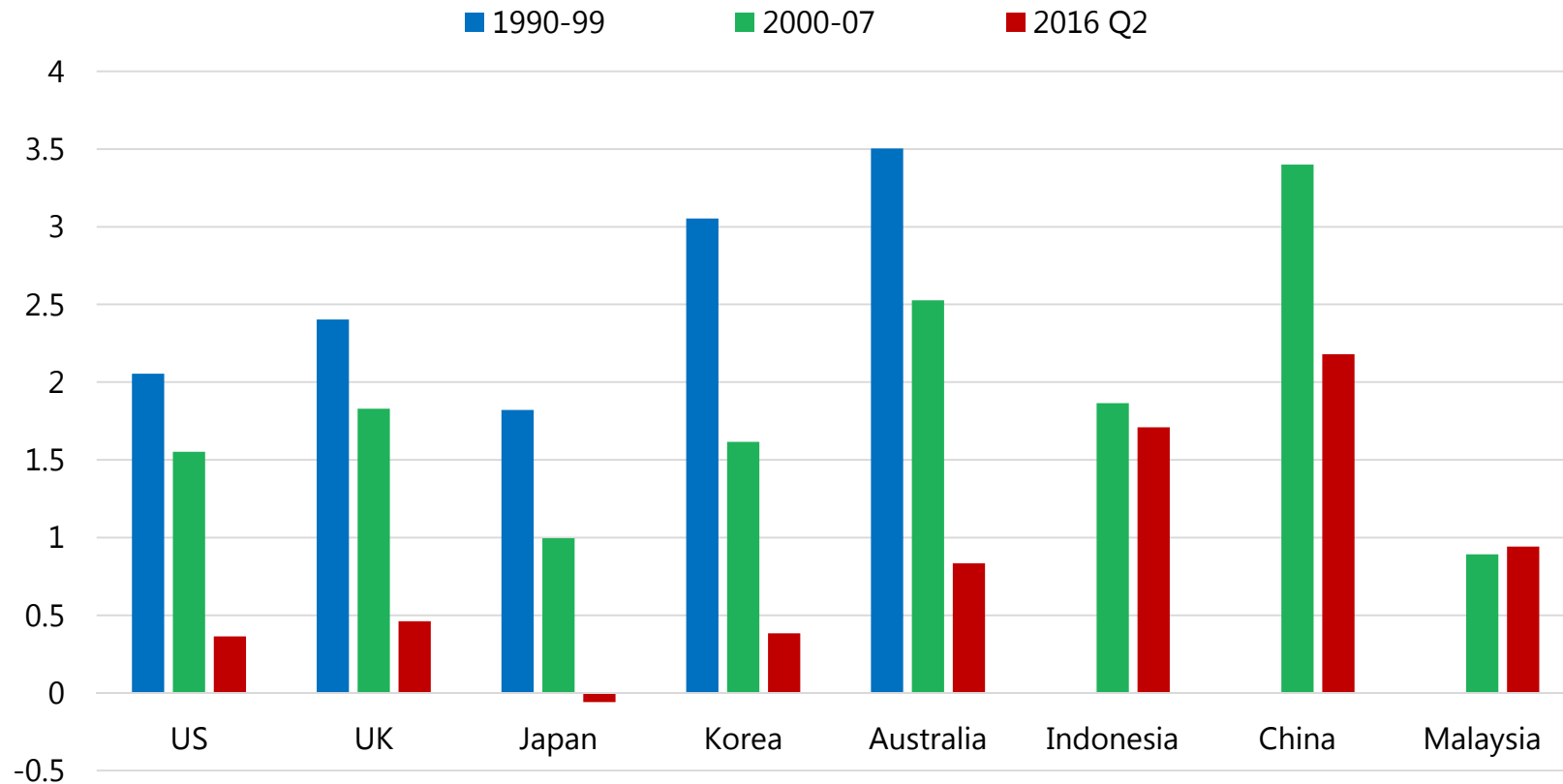
Sources: Bloomberg; and IMF staff calculations.



Natural interest rates have declined in some cases, but not everywhere

Selected Asia: Estimated Natural Real Interest Rates

(Percent)

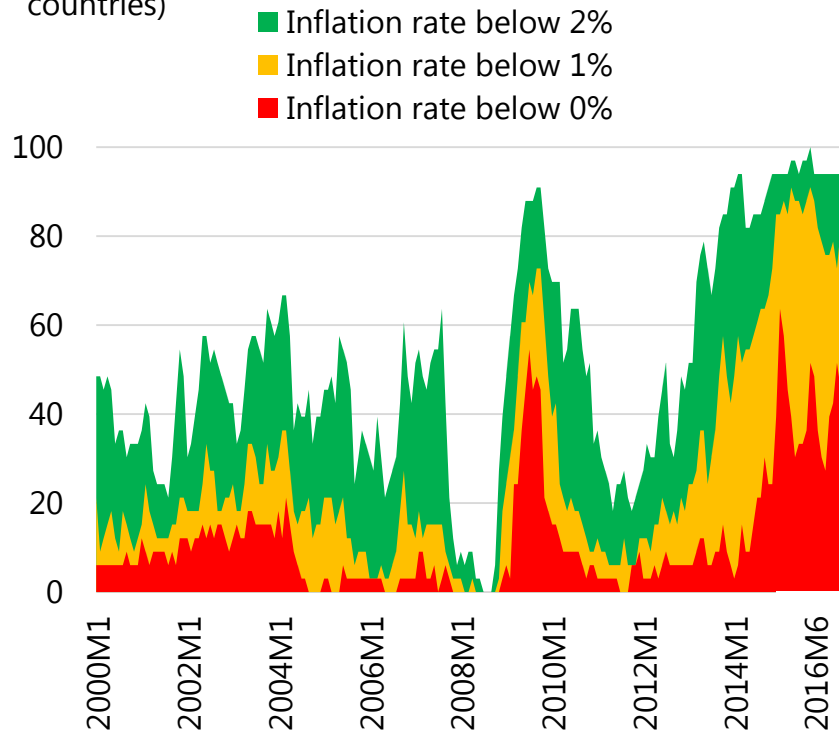


Source: Staff estimates based on a TVP-VAR for three variables – real GDP growth, inflation and a measure of real rate.
Note: The conditional long horizon forecast (over 5 years) of the observed real rate is used as a measure of neutral rate.



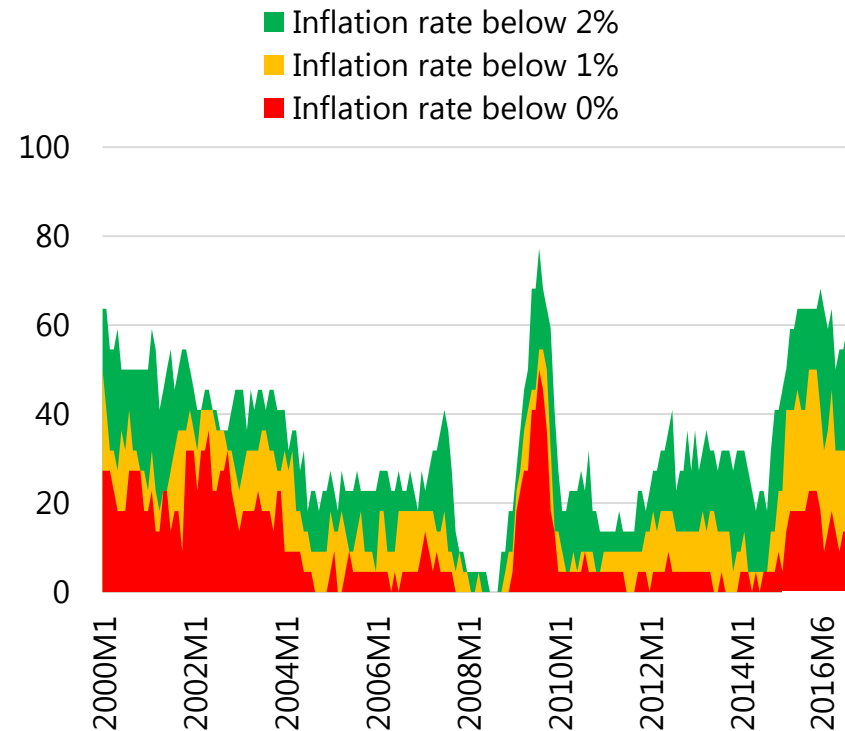
Low inflation becoming more common across the region

Advanced Economies: Number of Countries by Headline Inflation Rates (Percent of 33 countries)



Sources: IMF, *Global Data Source*; and IMF staff calculations.

Asia: Number of Countries by Headline Inflation Rates (Percent of 22 Asian countries)



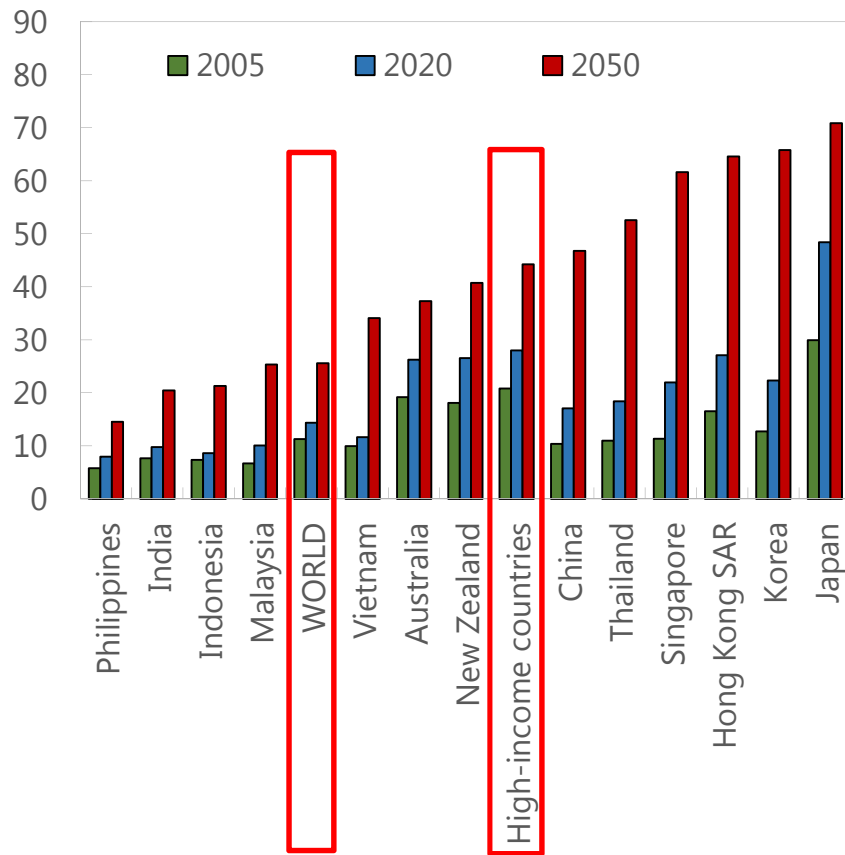
Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations.



Demographics: A headwind for some, a dividend for others

Asia: Old-Age Dependency Ratios

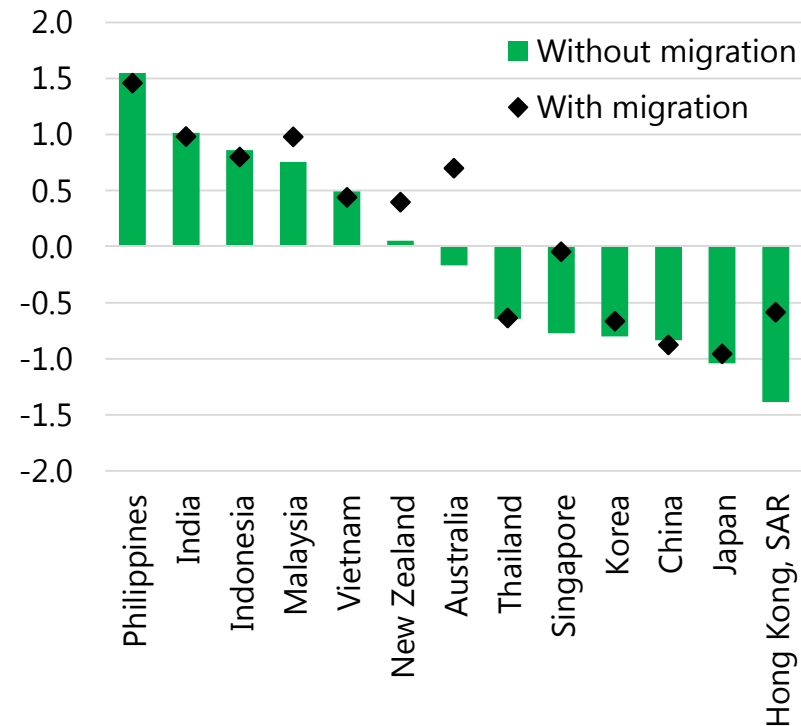
(Percent)



Source: UN Population Prospects: 2015 Revision. Based on the medium-fertility variant scenario (with migration).

Asia: Growth Impact of Demographics Trends

(Percentage point impact on real GDP growth; average over 2020-50)



Source: Staff estimates based on UN Population Prospects: 2015 Revision (medium-fertility variant) and IMF (2016).

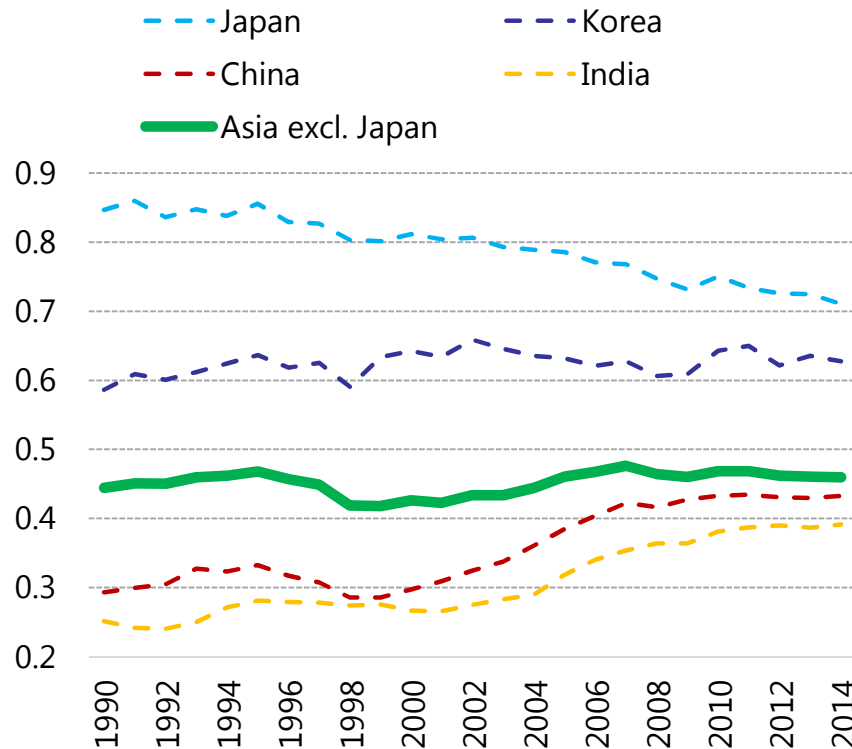
Note: Migration projections follow historical trends. The growth impact estimates are based on the assumptions of unchanged labor force participation by cohort, constant capital-to-labor ratio, and TFP growth unchanged from historical average.



Asia is catching up in terms of GDP, but not in productivity levels

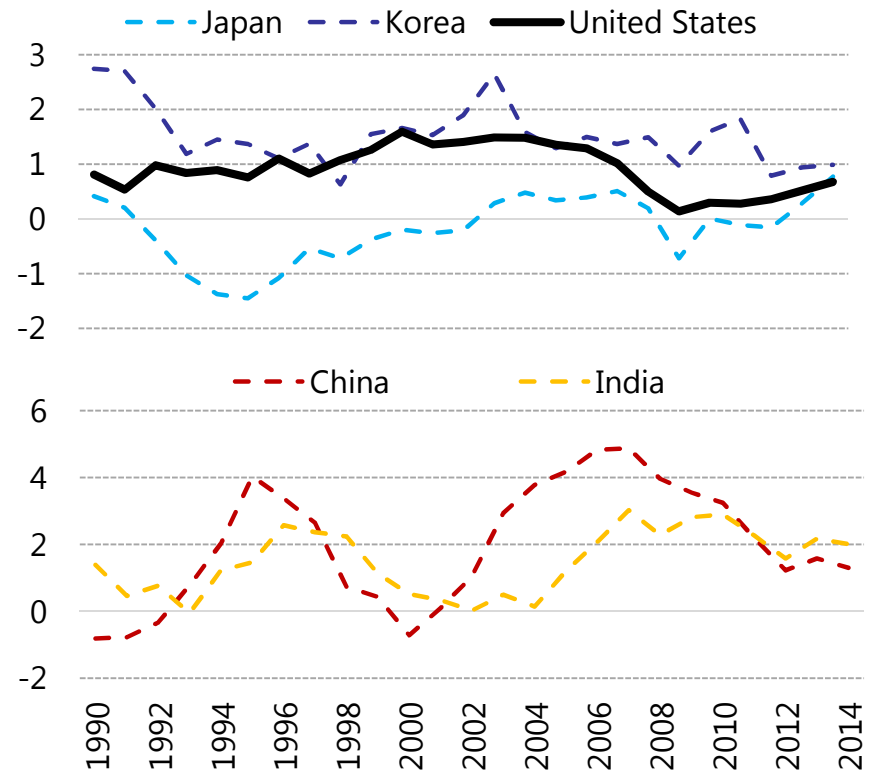
Total Factor Productivity Level Compared to the United States

(At current PPPs; normalized as United States=1)



Total Factor Productivity Growth

(Percent; 5-year moving average)



Sources: Penn World Table 9.0; and IMF staff calculations.

Peak and current manufacturing shares

Selected countries

	Employment Shares (%)				Output Shares (%)			
	Peak		Latest		Peak		Latest	
	Year	Level	Year	Level	Year	Level	Year	Level
United Kingdom	1970	34.7	2008	12.0	1970	28.9	2010	10.7
United States	1970	26.4	2009	10.4	1972	23.8	2010	12.9
Argentina	1970	22.6	2005	11.5	1976	38.7	2010	20.5
The Philippines	1971	11.3	2008	8.6	1973	28.9	2008	21.4
Japan	1973	27.5	2008	18.4	1973	32.4	2010	19.4
Brazil	1986	16.4	2007	13.4	1980	33.3	2010	16.2
Korea	1989	27.8	2008	16.8	2010	30.3	2010	30.3
Mexico	1990	20.0	2008	16.9	1988	23.2	2010	18.3
India	2001	14.8	2005	13.6	1995	18	2010	14.7
Indonesia	2002	12.9	2008	12.0	1997	29.4	2010	24.8
China	2010	16.9	2010	16.9	1978	40.5	2010	29.6

Manufacturing employment is a better predictor of subsequent prosperity than manufacturing output

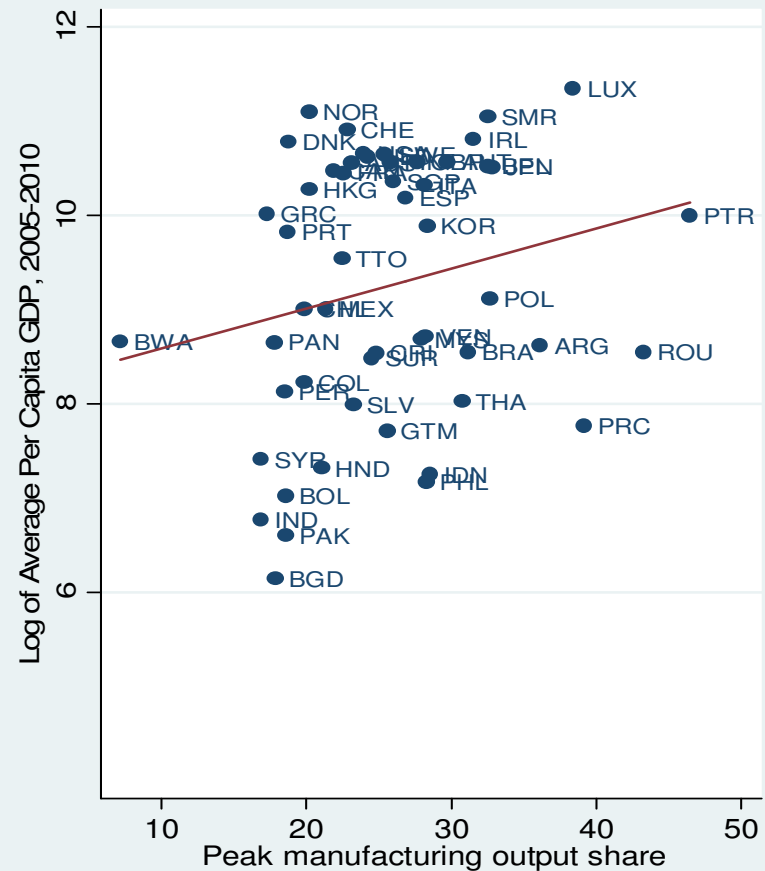
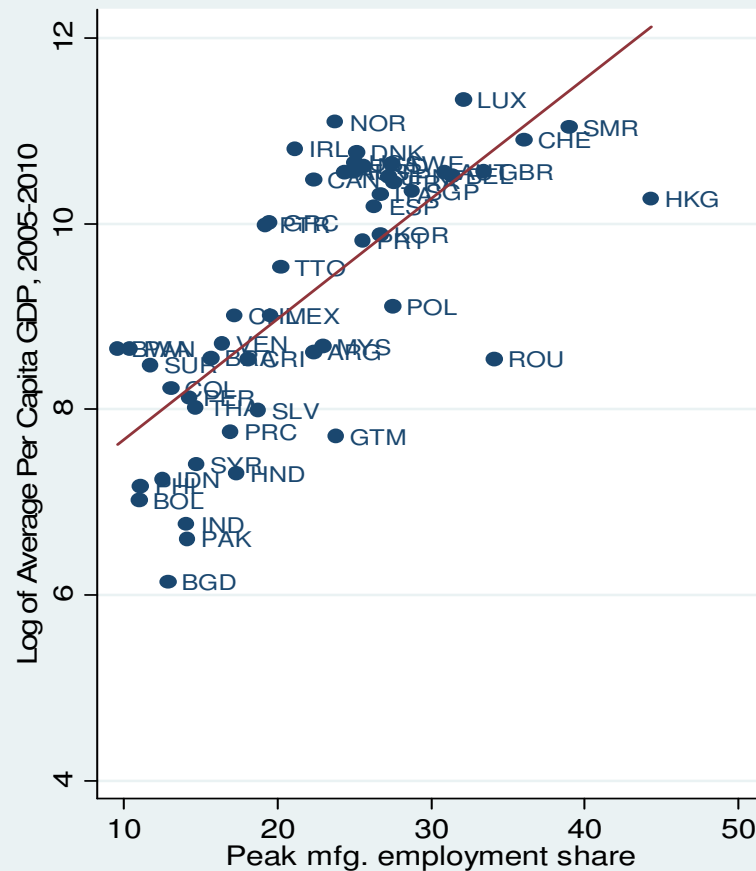


Figure a uses the maximum 7-year moving average employment share the country reports between 1970 and 2010. Figure b. uses the analogously calculated manufacturing output share.

“Manufacturing Jobs and Development”, Felipe, Mehta and Rhee (2015)

Table 5: Countries categorized by industrialization in output and employment (in bold if GDPPC in 2005-10 exceeds \$12K):

		Employment Share relative to 18%	
		Not Industrialized (0/18 Countries is rich)	Industrialized (26/34 Countries are rich)
Output Share Relative to 22%	Not Industrialized (6/18 countries are rich)	Bangladesh, Bolivia, Botswana, Chile, Colombia, Honduras, India, Pakistan, Panama, Peru, Syria (0/11 countries are rich)	Canada, Denmark, Greece, Hong Kong, Mexico, Norway, Portugal (6/7 countries are rich)
	Industrialized (20/34 countries are rich)	Brazil, China, Indonesia, Philippines, Suriname, Thailand, Venezuela (0/7 countries is rich)	Argentina, Australia, Austria, Belgium, Costa Rica, El Salvador, Finland, France, Guatemala, Ireland, Italy, Japan, Korea, Luxembourg, Malaysia, Netherlands, Poland, Puerto Rico, Romania, San Marino, Singapore, Spain, Sweden, Switzerland, Trinidad & Tobago, United Kingdom, United States (20/27 countries are rich)



Signs of the “new mediocre” in Asia?

To summarize:

- Long-term interest rates declining? → **Some**
- Natural (or neutral) interest rates declining? → **Some**
- Low inflation becoming more common? → **Yes**
- Demographics becoming a headwind? → **Some**
- Productivity growth declining? → **No catch-up**



Why should we be worried about the “new mediocre”?

Lower growth can aggravate:

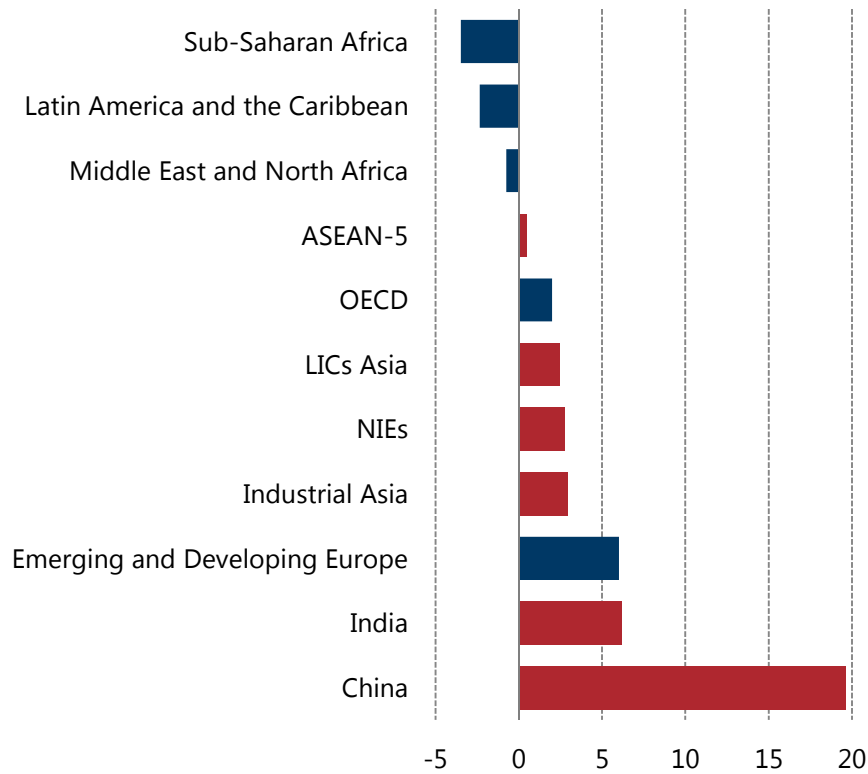
- Social and demographics pressures
- High leverage
- Trade tensions



Income inequality in Asia has already risen and social spending in Asia is relatively low

Change in Income Inequality

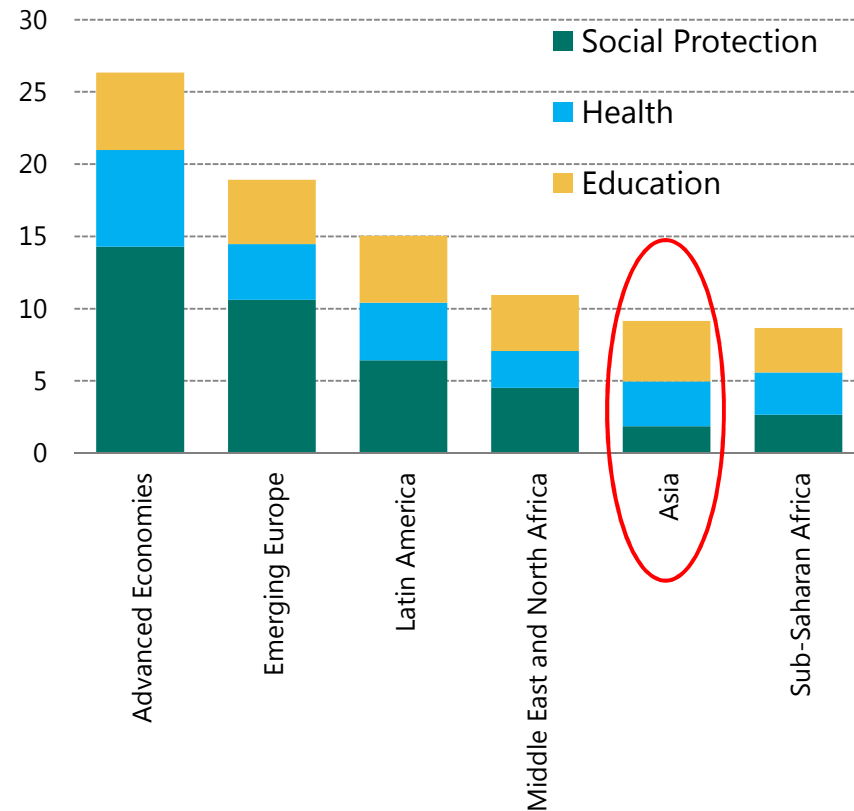
(Net Gini Index; change from 1990 to 2013; simple average across regions)



Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

Composition of Social Spending

(Percent of GDP; year of 2010 or latest)



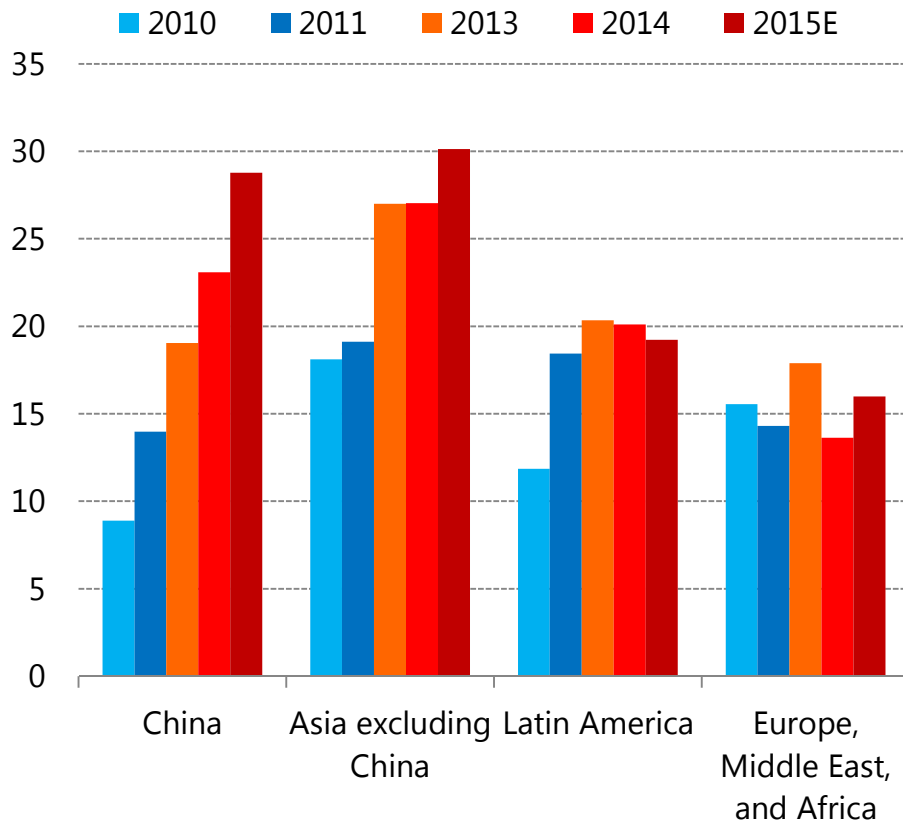
Sources: Organization for Economic Cooperation and Development; Eurostat; Asian Development Bank; IMF, *World Economic Outlook*; United Nations; World Health Organization; World Bank; and IMF staff calculations.



Corporate debt is relatively high in emerging Asia and household debt has risen rapidly in several cases

Emerging Market Firms: Debt-Potentially-at-Risk

(Percent; share of total debt if ICR<2)

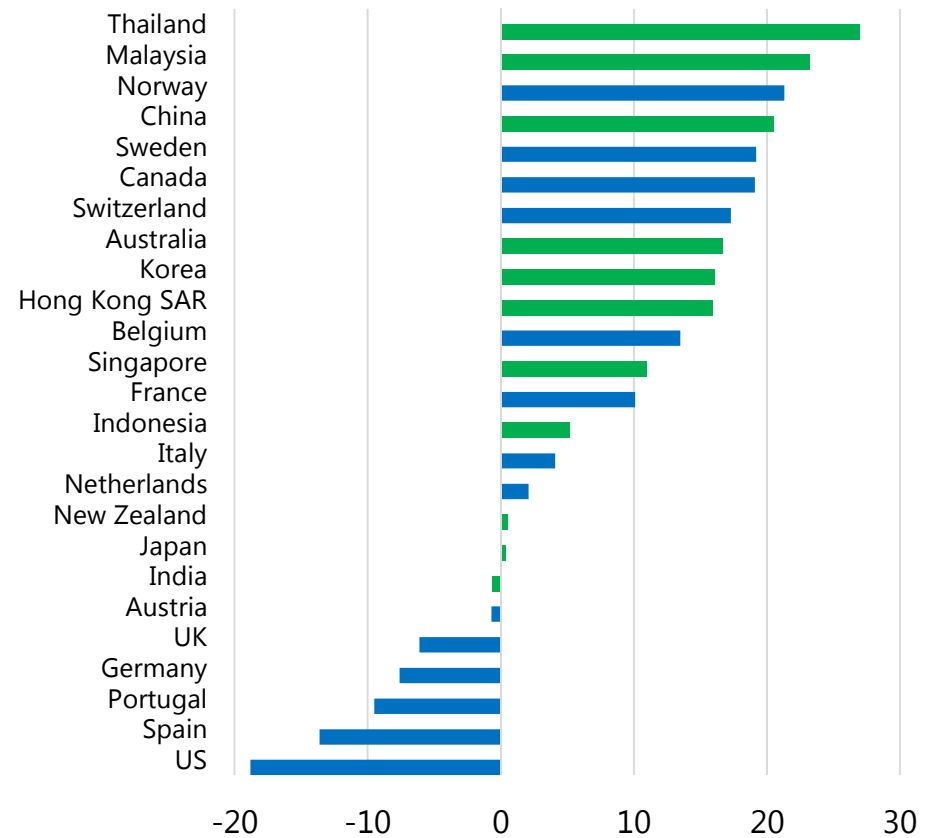


Source: April 2016 GFSR.

Note: Asia excluding China= India, Indonesia, Malaysia, the Philippines, and Thailand.

Change in Household Debt to GDP Ratio

(Percentage points; from end-2007 to end-2015)



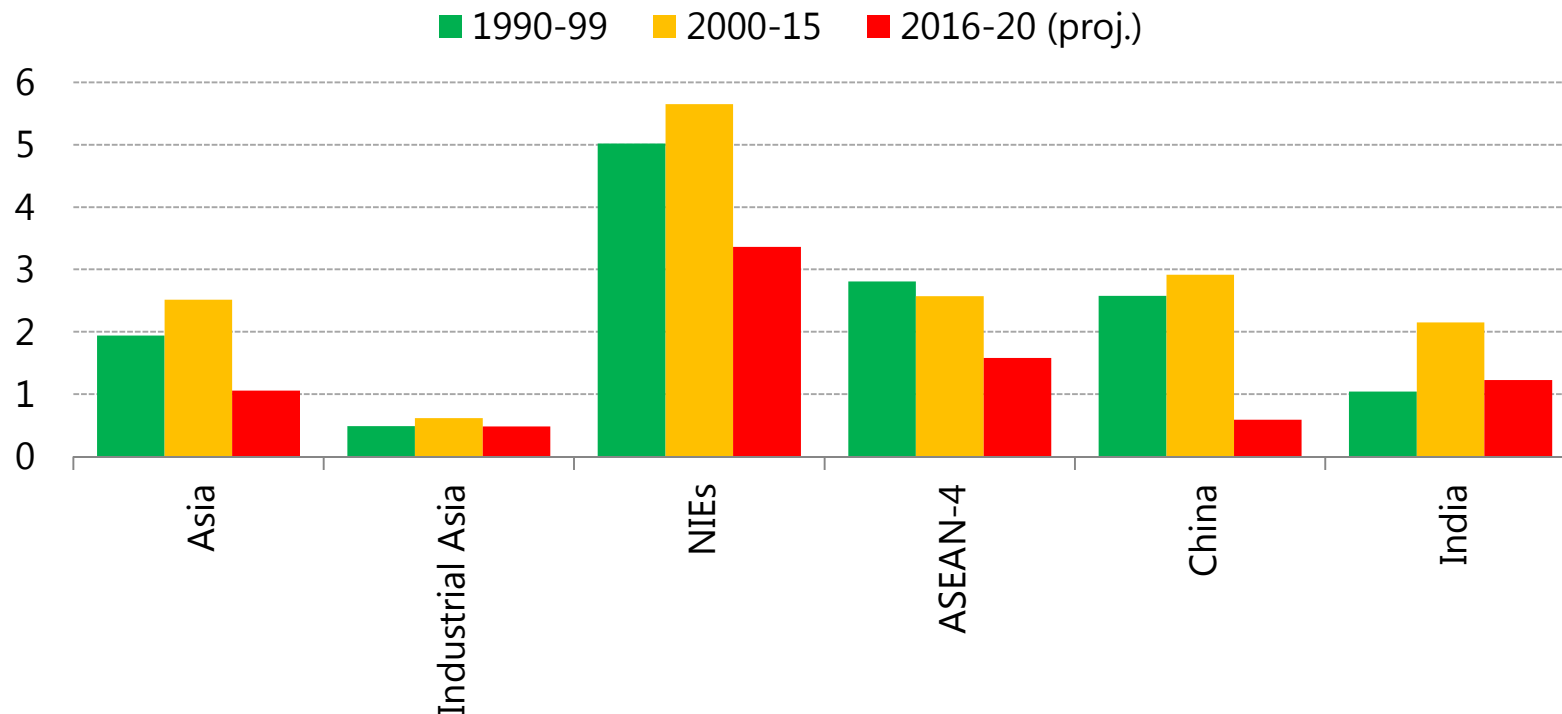
Sources: BIS and IMF staff estimates.



The global trade slowdown and anti-trade sentiment could hit Asia hard

Selected Asia: Contribution of Exports to Real GDP Growth

(Year-over-year; percentage points)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: ASEAN-4 includes Indonesia, Malaysia, the Philippines, and Thailand. Industrial Asia includes Australia, Japan, and New Zealand. NIEs include: Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.



Implications for Monetary, Fiscal, and Structural Policies



Monetary Policy in Anticipation of the “New Mediocre”: Some Issues to Consider?

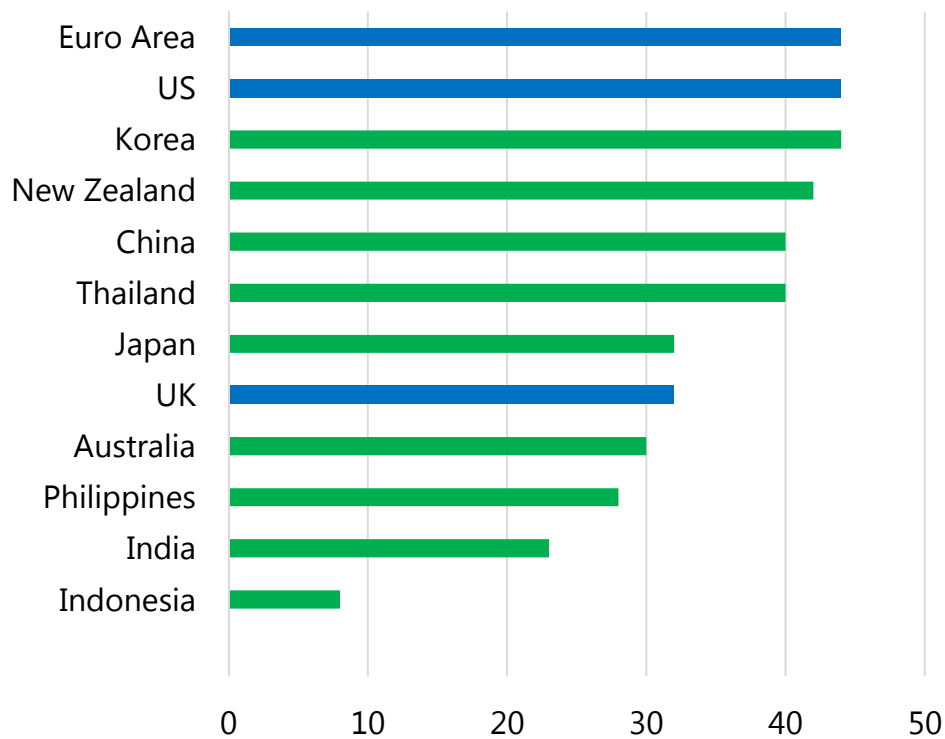
- How to anchor **inflation expectations**?
- How to prepare for **unconventional monetary policies (UMPs)**?
 - **QE**: Implementation challenges (enough assets to buy in EMs)?
 - **Negative rates**: Effective in bank-dominated financial systems?
- How to deal with “**side effects**” of UMPs, in case undertaken?
 - Could UMPs undermine **financial stability** (asset/credit bubbles)?
 - How effective are **macro-prudential policies** to deal with side effects?



Additional monetary accommodation?

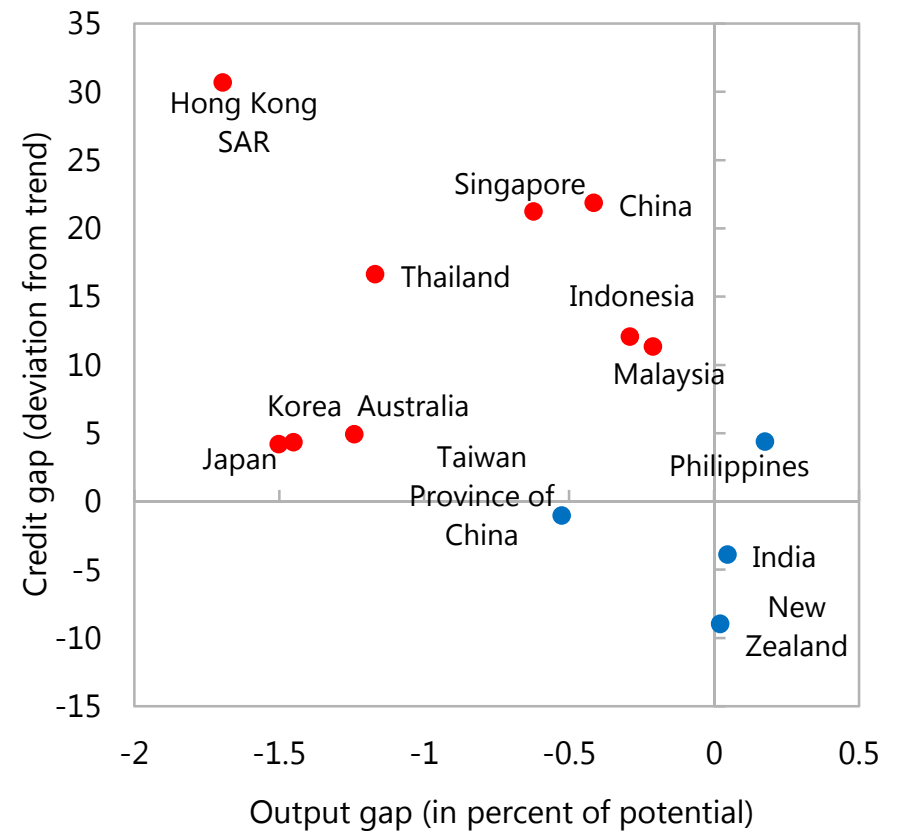
Selected Asia: Months Below Inflation Target

(number of months; from Jan 2013 to Aug 2016)



Source: IMF staff estimates.

Selected Asia: Output and Credit Gaps

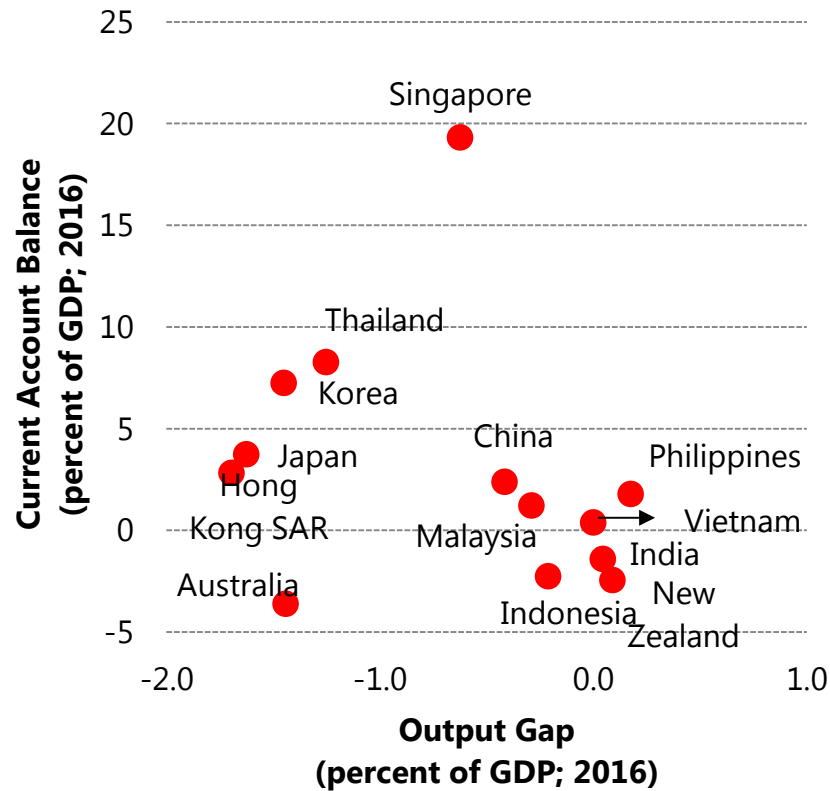


Sources: BIS; CEIC Data Company Ltd.; IMF, World Economic Outlook database; and IMF staff calculations.



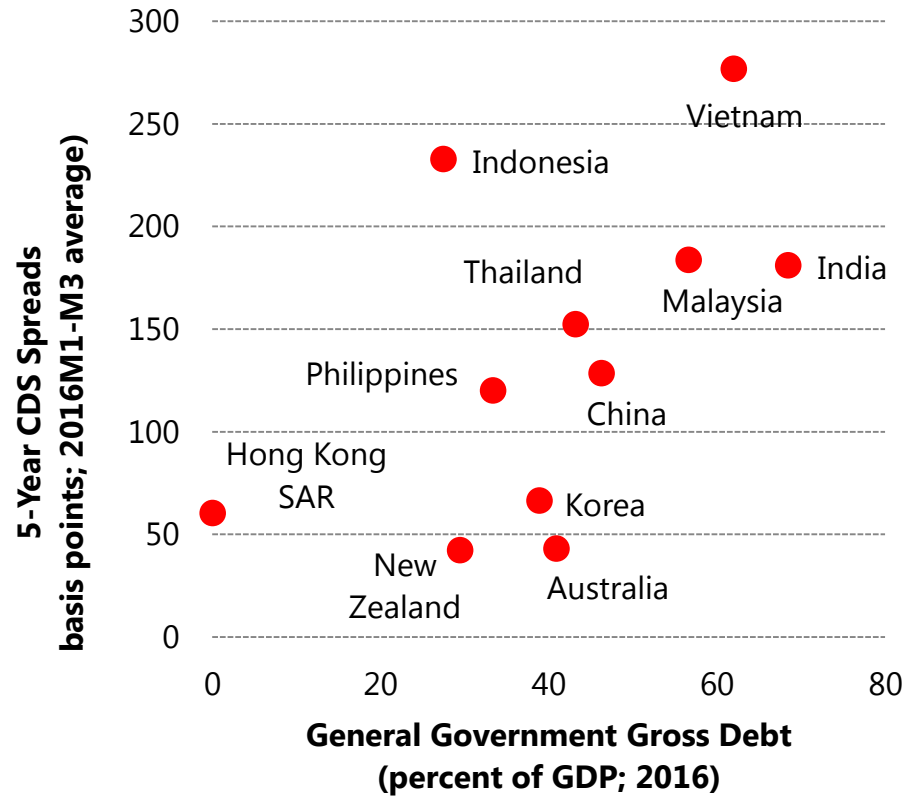
Fiscal policy for demand support?

Selected Asia: Need for Demand Support



Sources: IMF WEO database; and IMF staff calculations.

Selected Asia: Fiscal Space



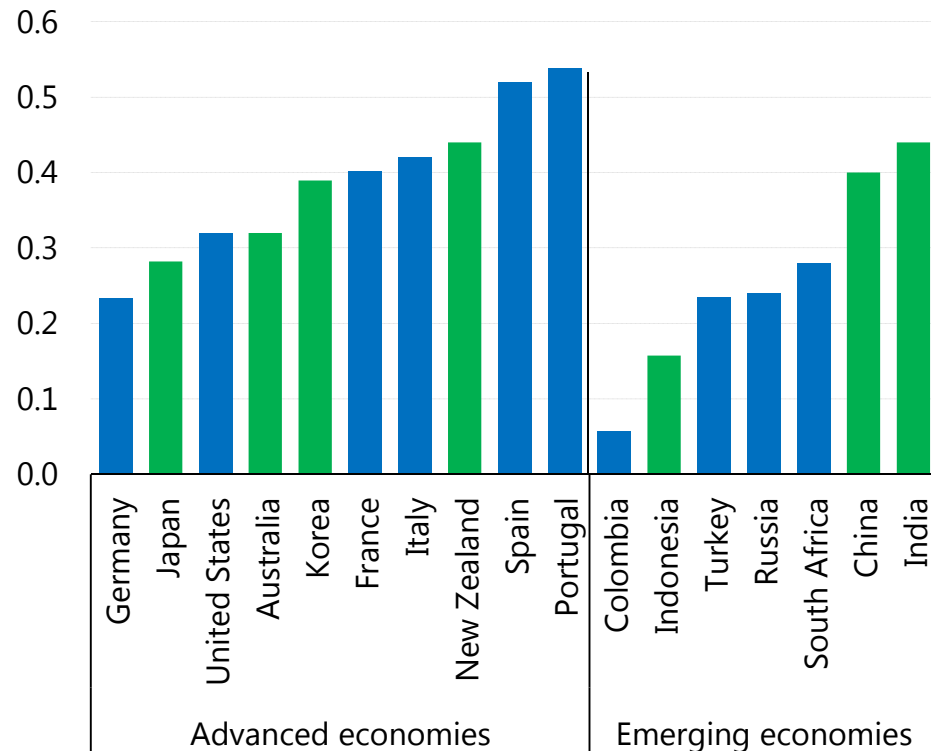
Sources: IMF WEO database; and IMF staff calculations.
Note: Japan is not shown due to scale.



Structural reforms to boost productivity growth?

- **Advanced Asia:** Infrastructure investment (**Australia**); product market reforms (**Australia, Japan, and Korea**); labor market reforms (**Japan, and Korea**).
- **Emerging Asia:** Raising public investment efficiency (**India**); labor market reforms (**India, Indonesia**); product market reforms (**China, India**); resolving corporate debt overhang (**China**);

Reforms Responsiveness Indicator
(2011-15 average)



Source: OECD.

Note: The reform responsiveness indicator reflects the share of policy recommendations from the OECD's "Going for Growth" reports on which the country has taken significant action.



Concluding remarks

- Asia remains the main engine of global growth.
- But the region is facing a number of short-term risks.
- In the medium-term, Asia needs to prepare for the risk of a “new mediocre” in advanced economies.
- The global trade slowdown and anti-trade sentiment can hit Asia hard—Asia needs more balanced and inclusive growth.