

# Asia and Pacific Regional Economic Outlook Update

## Steady Growth Ahead



October 16, 2014

1



## Key Messages

- **Steady growth in the *near term* amid a challenging global environment**
- **Downside risks have increased and medium-term challenges remain**
- **Reform implementation critical to revert *deteriorating medium-term* growth prospects**
- **Policies should also focus on rebuilding buffers**

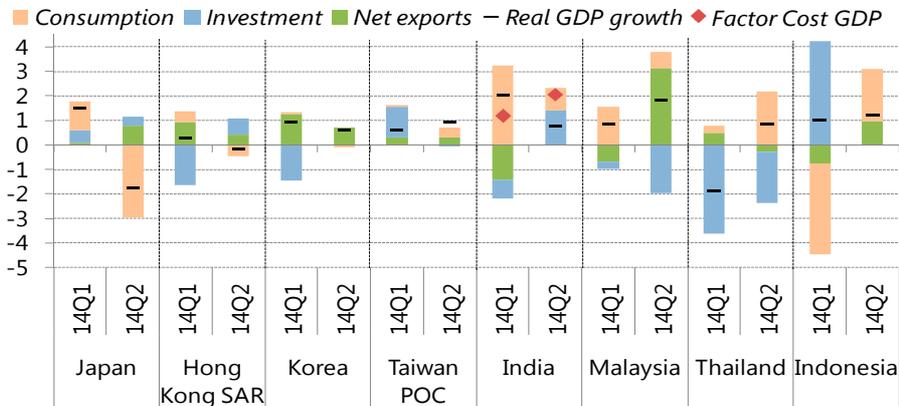
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# Asia: lackluster growth in 2014H1, but small revisions to annual forecasts

## Contribution to Quarter-on-Quarter Real GDP Growth<sup>1</sup>

(In percent; seasonally adjusted)



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

<sup>1</sup> Statistical discrepancy is not included above.

For India, the data are based on GDP at market prices.

## Outlook

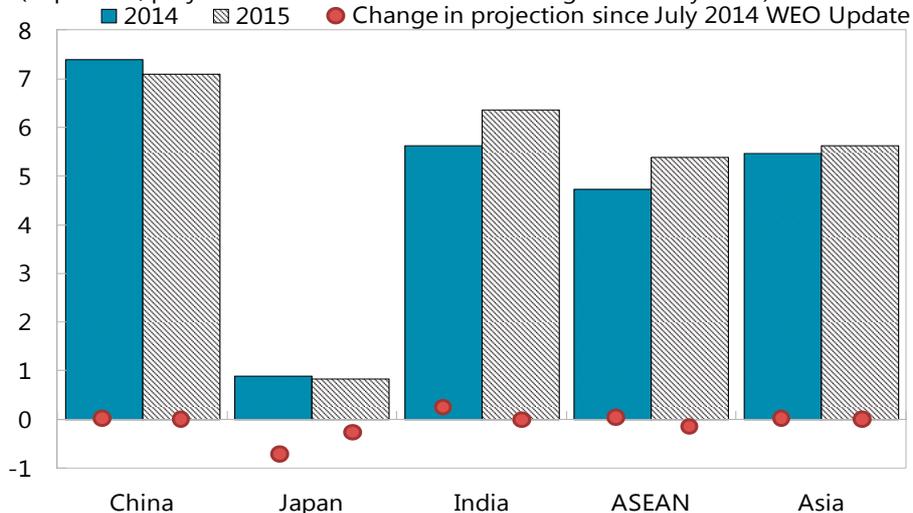
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# Forecasts revisions small compared to other regions, with exceptions (Japan)

## Change in Growth Projections

(In percent, projection in October 2014 and change since July 2014)



Sources: IMF, World Economic Outlook database.

## Outlook

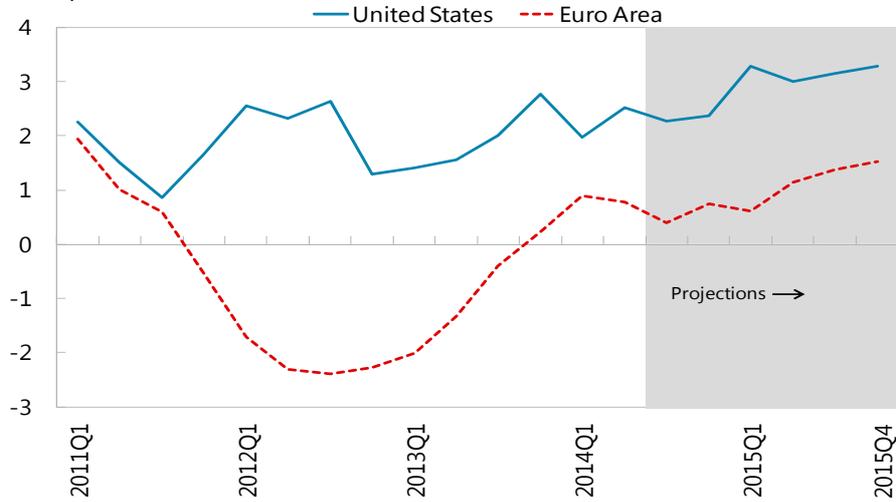
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# Why? Stronger external demand going forward...

## G-2: Real Domestic Demand Growth

(In percent; Y/Y)



Sources: WEO

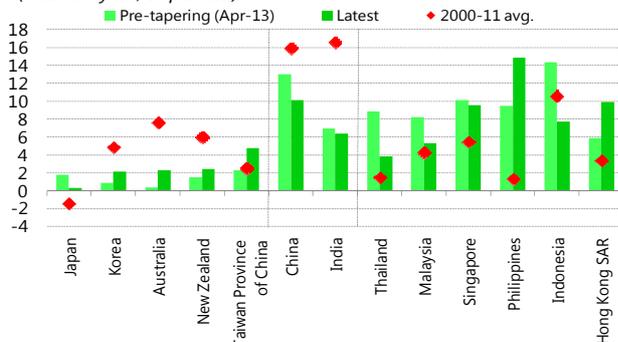
### Outlook



# ...and still accommodative financial conditions.

## Selected Asia: Real Private Sector Credit Growth

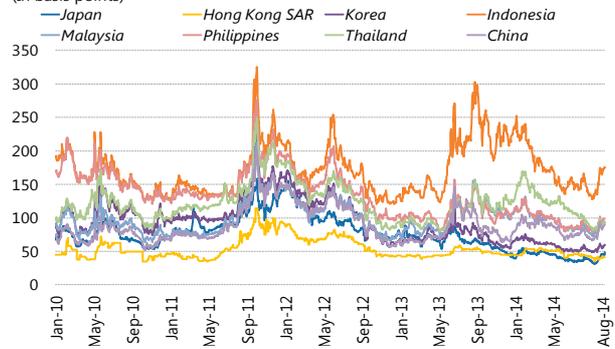
(Year-on-year; in percent)



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

## Selected Asia: Sovereign CDS Spreads

(In basis points)



Sources: Thomson Reuters; CEIC Data Company Ltd.; and Haver Analytics.

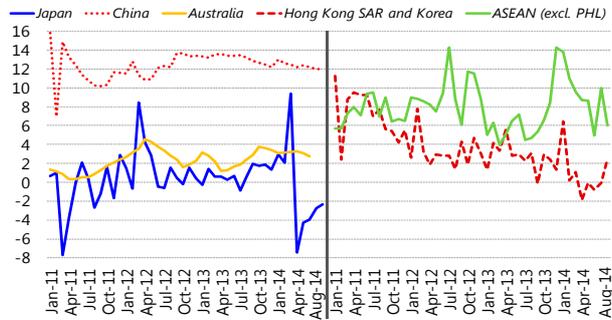
### Outlook



# Exports picking up; consumption solid in most economies

## Asia: Retail Sales Volumes

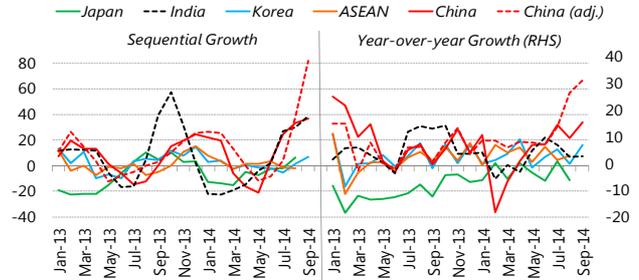
(Year-over-year change; in percent)



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

## Asia: Exports by Economies

(Year-over-year growth; 3-month percent change of 3mma, SAAR)



Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations. ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand. China (adj.) is adjusted with Hong Kong's mirrored data to account for overinvoicing.

## Outlook

7



## Risks

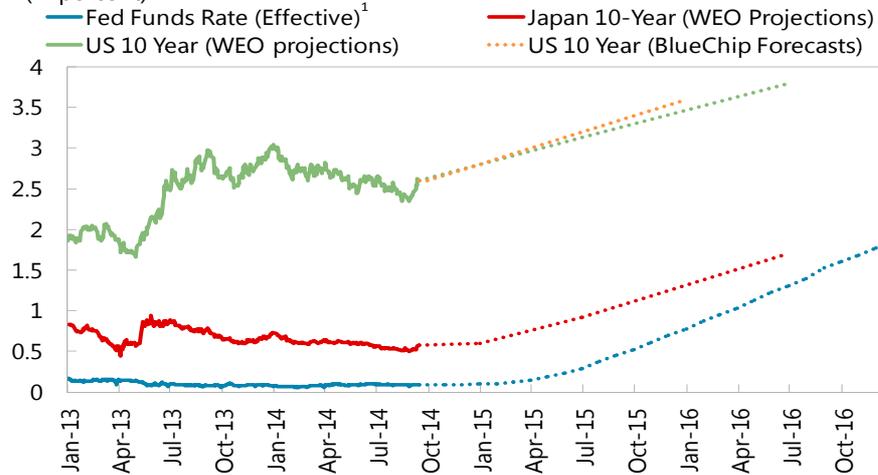
- Disorderly adjustment to higher global interest rates
  - spikes in capital flows and asset price volatility
  - adverse impact on growth amplified by leverage?
- Weak growth in AMs and EMs
  - will trend growth recover?
- China: sharper-than-envisaged slowdown
- Japan: reform implementation?



# Global interest rates are expected to rise

## Selected Interest Rates and Projections

(In percent)



Sources: Aspen Publishers; Bloomberg L.P.; Haver Analytics; and IMF, *World Economic Outlook* database  
1/ Projections calculated using futures contract prices.

Outlook

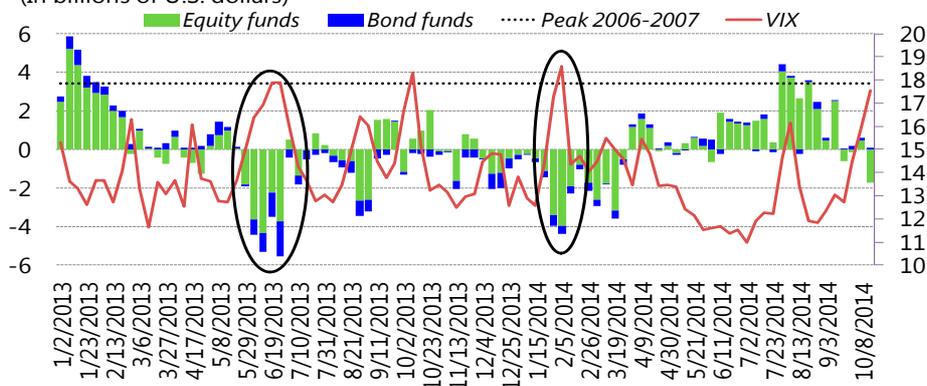
Risks



# Capital flows reversals are likely...

## Asia (ex JPN)<sup>1</sup>: Equity and Bond Funds<sup>2</sup> — Weekly Net Flows during 2013–14

(In billions of U.S. dollars)



Sources: EPFR Global; and Haver Analytics.

<sup>1</sup> Includes exchange traded fund flows and mutual fund flows.

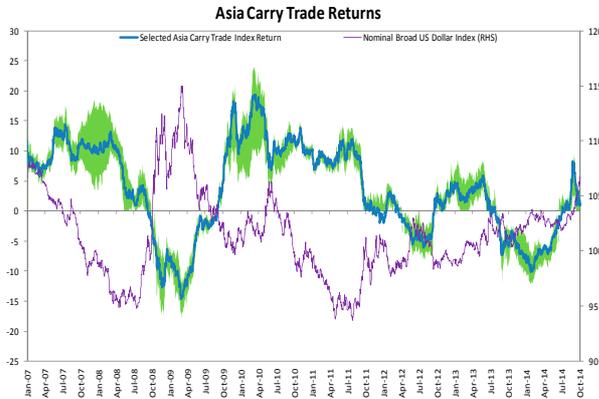
<sup>2</sup> Asia includes Australia, New Zealand, China, Taiwan Province of China, Korea, Hong Kong SAR, India, Indonesia, Malaysia, Philippines, Vietnam, Thailand, and Singapore.

Outlook

Risks

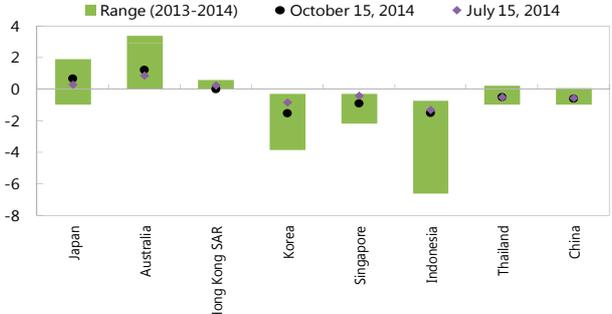


...and FX markets will adjust.



**Currency Risk Reversal**

(Negative risk reversal implies disproportionate probability of depreciation of local currencies against the U.S. dollar)

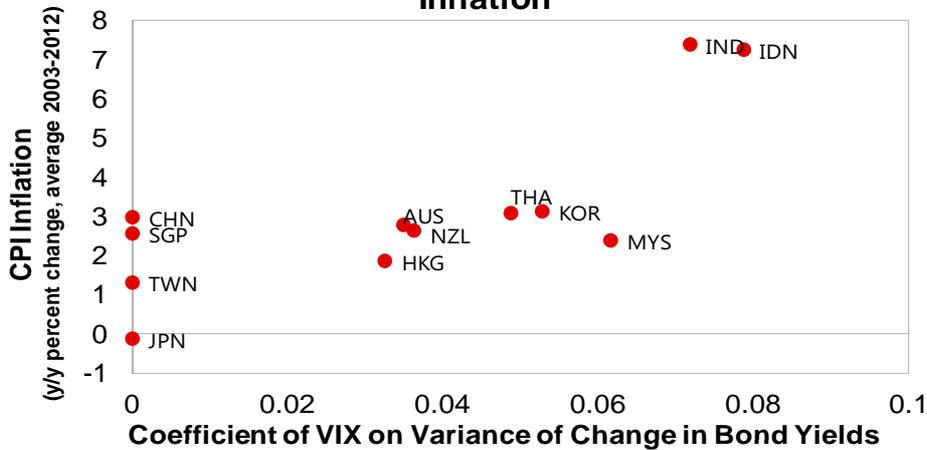


Sources: Bloomberg L.P., and IMF staff calculations.



Domestic interest rates could rise more in countries with weaker fundamentals.

**Impact of VIX on Bond Volatility versus Inflation**

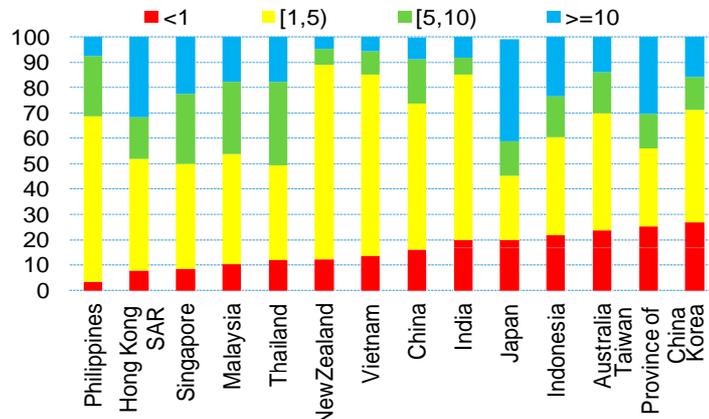




# Leverage could amplify the effect of higher interest rates on investment.

## Corporate Debt by Interest Coverage Ratio

(In percent of total corporate debt, 2012)



Sources: Thomson Reuters Worldscope; and IMF staff calculations.

Outlook

Risks

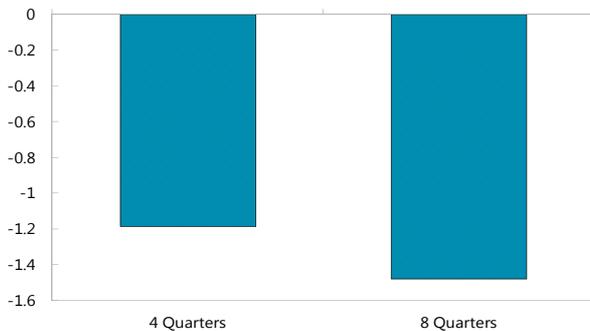
13



# Higher interest rates could also hit house prices and consumption

## Impact of Interest Rate Shock on Real House Prices

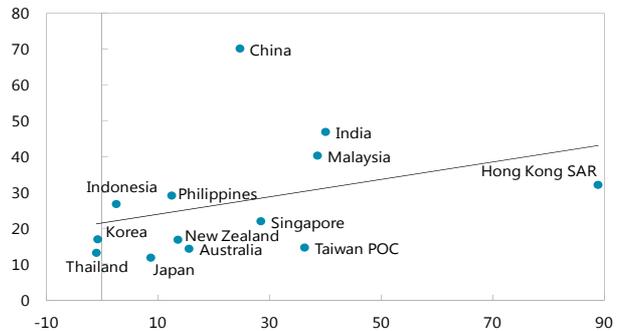
(In percent; one standard deviation shock in interest rate = 165bp)



Sources: IMF staff calculations.

## Real House Prices and Real Consumption Growth

(In percent)



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

Outlook

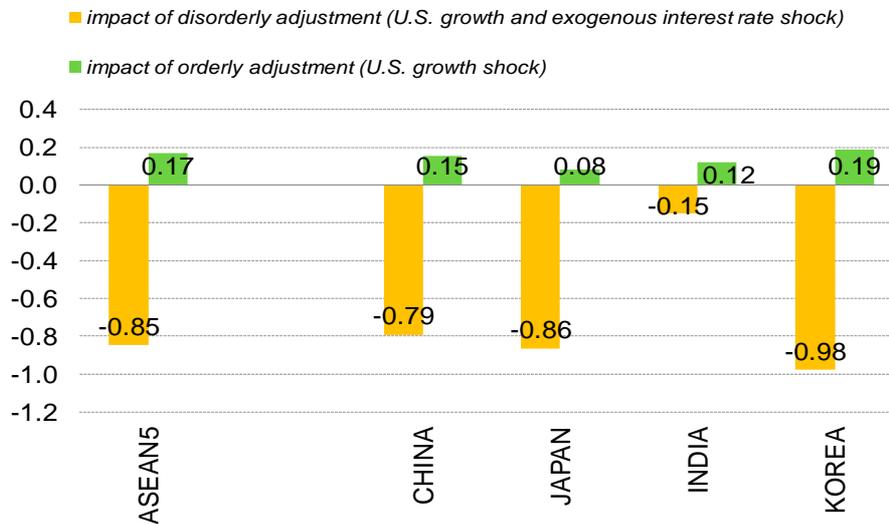
Risks

14



# Overall, disorderly adjustment could dent growth in the near term

## Impact of U.S. monetary policy normalization on Asia



Outlook

Risks

15



## Medium-term challenges

- Lower trend growth has already impacted China and India
  - demographic trends also likely to hit other economies
- Less support from export model
- Sustainability of credit-driven domestic demand

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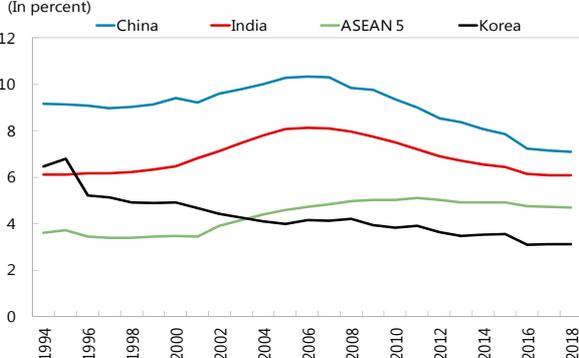
Risks

16

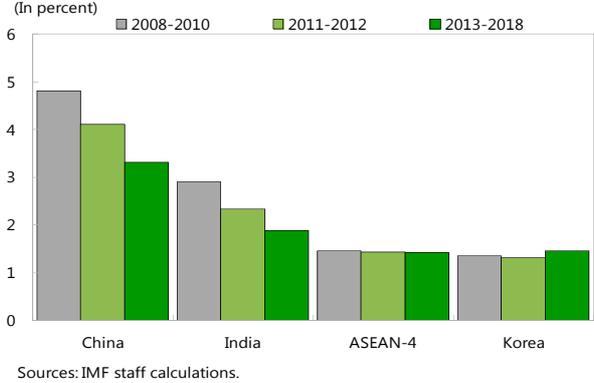


# Medium-term growth prospects have deteriorated...

## Potential Growth



## Contribution to Potential Growth from TFP



Outlook

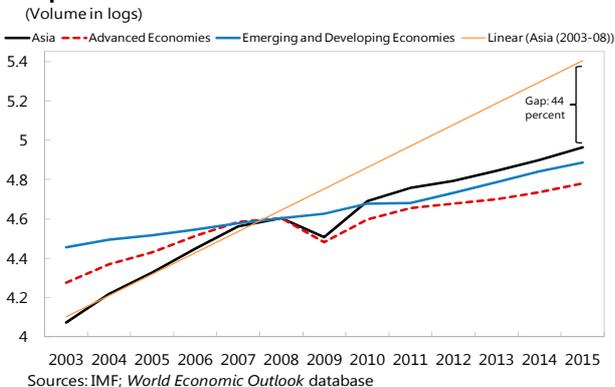
Risks

17

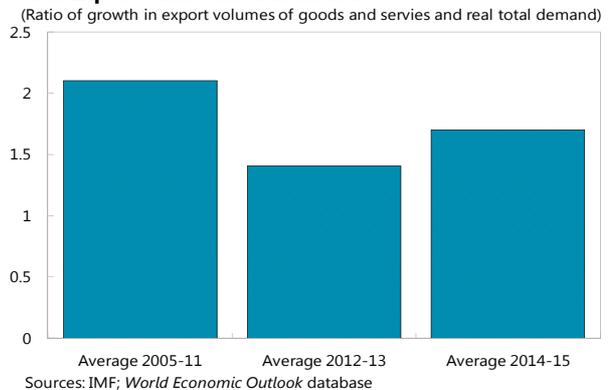


# Support from external demand could be limited...

## Exports of Goods and Services



## Asia Exports and Global Demand



Outlook

Risks

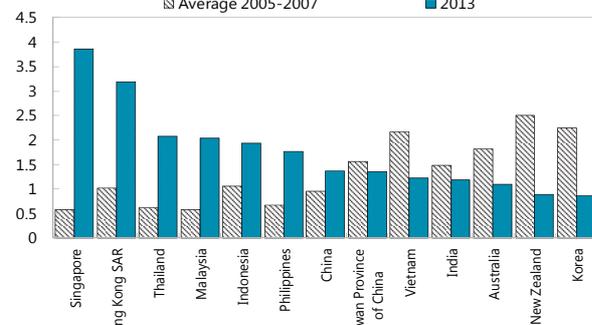
18



## ...and sustainability of growth is also a concern.

### Credit Intensity of GDP

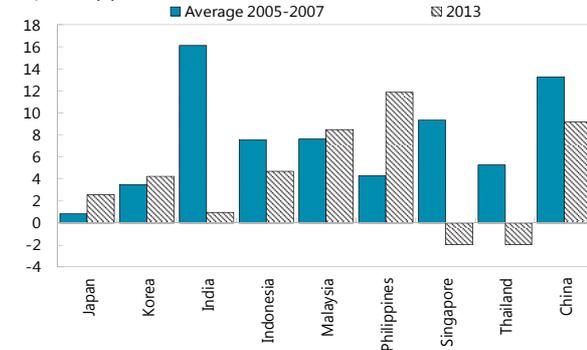
(In percent; nominal credit growth/nominal GDP growth)



Sources: IMF, *World Economic Outlook* database; and Haver Analytics

### Real Investment Growth

(In percent; y/y)



Source: Haver Analytics

Outlook

Risks

19



## Sub-regional issues

- China: housing and credit slowdown
- Japan: a fragile recovery
- India: will current turnaround prove durable?
- Indonesia: rising indebtedness
- Frontier and developing economies: large imbalances, small buffers

Outlook

Risks

Policies

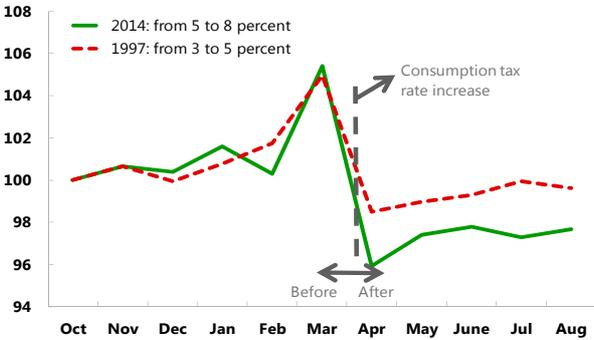
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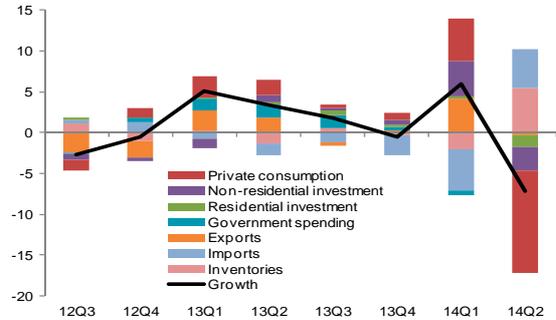


# Japan: a disappointing outturn in 2014 Q2...

### Private consumption before and after the tax increase (Monthly index; October = 100)



### Contribution to Growth (SAAR) (Percent, q/q)

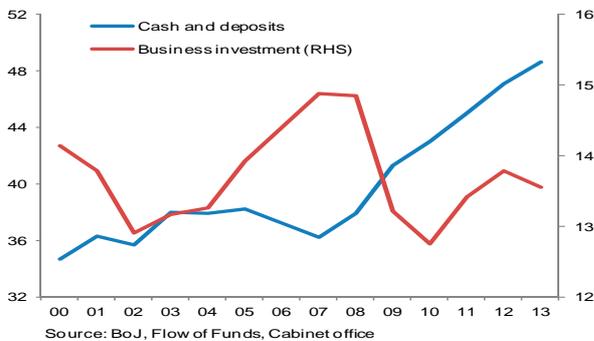


Outlook
Risks

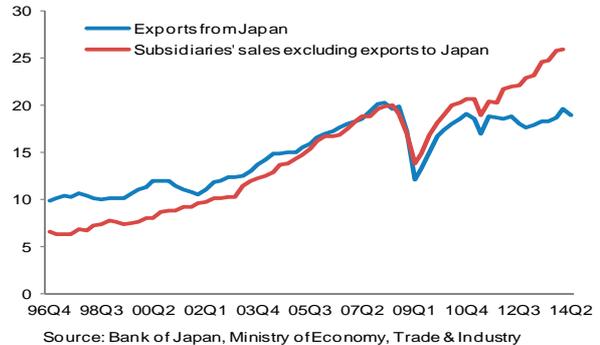


# ...and concerns about the durability of the recovery.

### Corporates: cash holdings and investment (in percent of GDP)



### Real exports of goods (in 2005 prices, trillion yen)

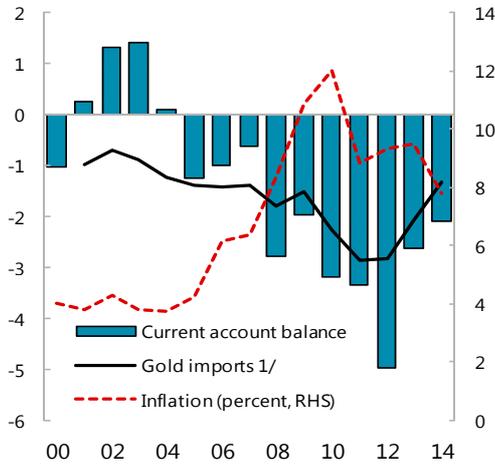


Outlook
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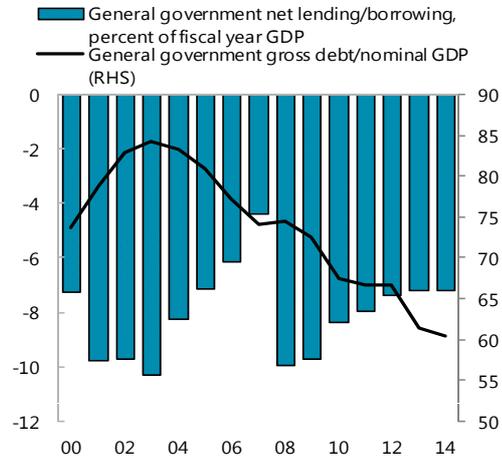


# India: vulnerabilities have receded...

### CA Deficit, Gold, Inflation (percent of GDP)



### Public Finances (percent)



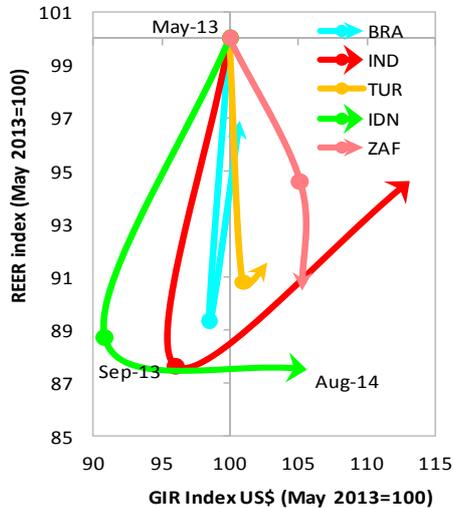
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Risks

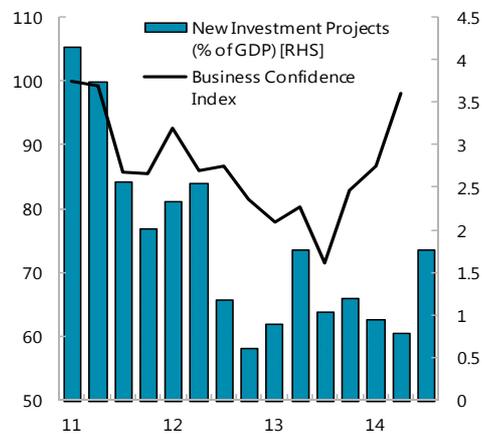


# ...and amid external adjustment, confidence has returned.

### Gross Reserves vs. REER (Index, May 2013=100)



### Business Confidence Index (index, 2011Q1=100)



Outlook

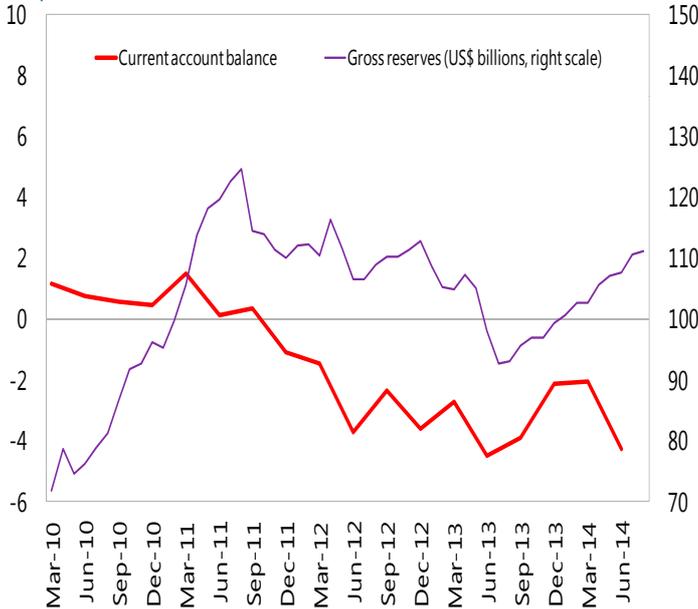
Risks



# Indonesia: progress on external imbalances but signs of liquidity pressures

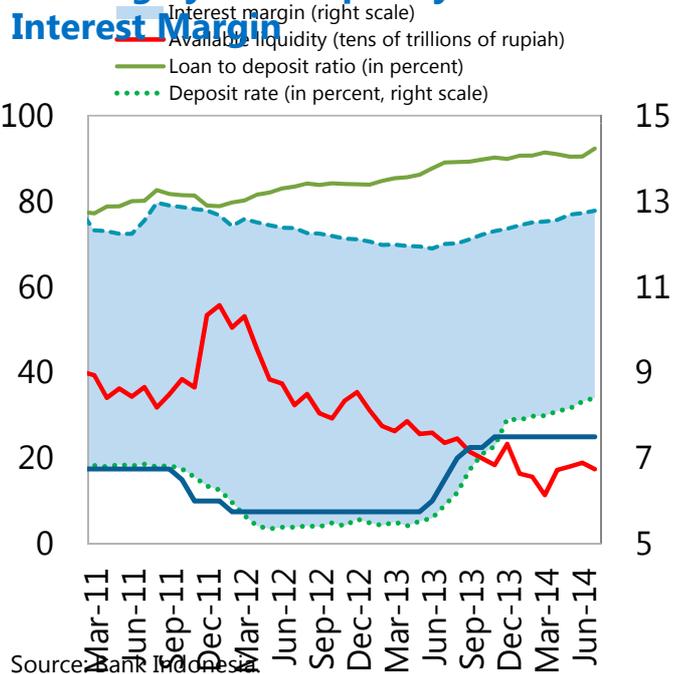
## Current Account Balance and Gross Reserves

(In percent of GDP, unless otherwise indicated)



Sources: CEIC Data Company Ltd.; and IMF staff estimates.

## Banking System Liquidity and Interest Margin

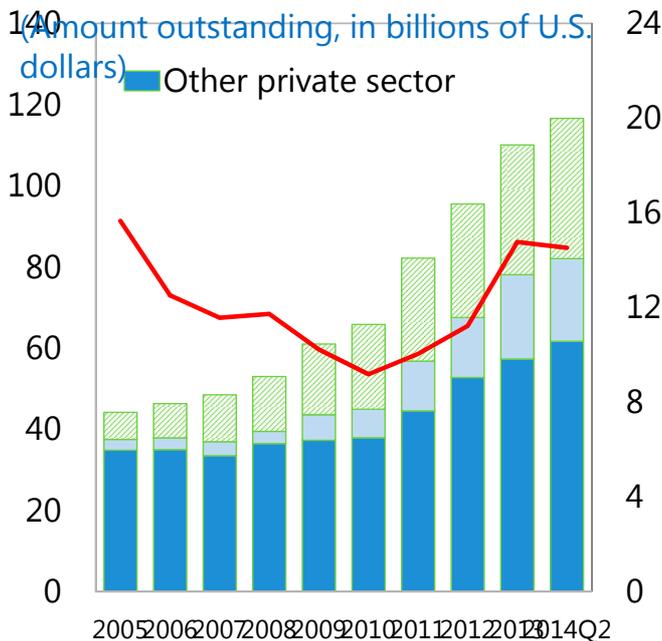


Source: Bank Indonesia

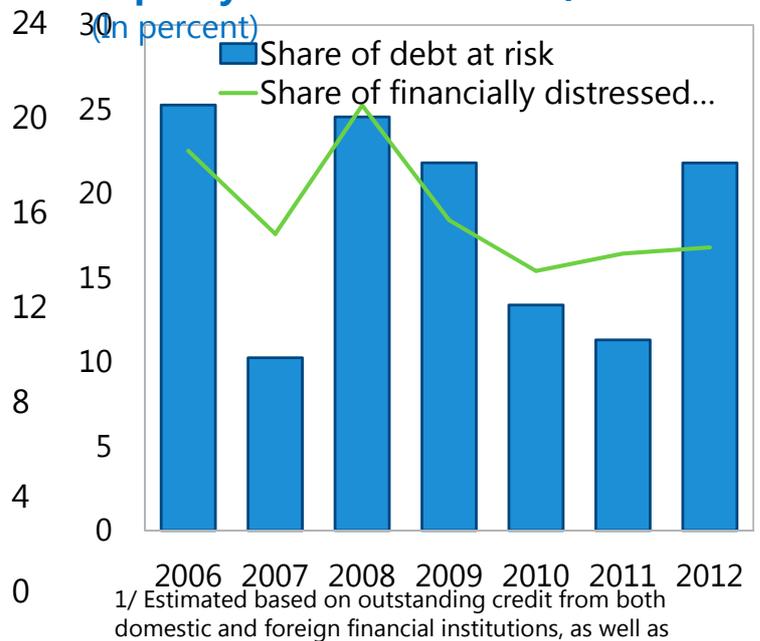


# Indonesia: corporate sector indebtedness has risen rapidly

## Nonfinancial Private Sector External Debt



## Companies with Low Debt Servicing Capacity and Debt at Risk 1/

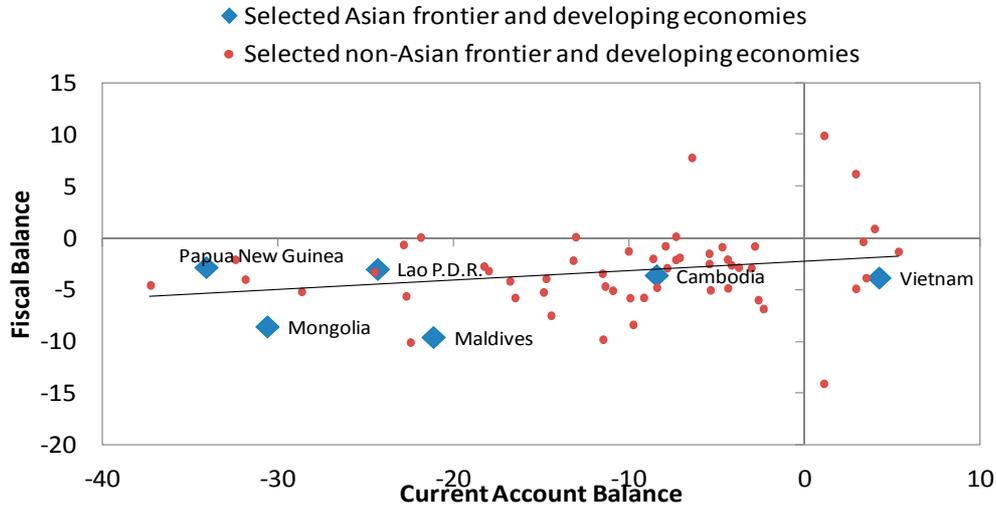


1/ Estimated based on outstanding credit from both domestic and foreign financial institutions, as well as



# FDEs: large imbalances

## Current Account Balance vs. Fiscal Balance



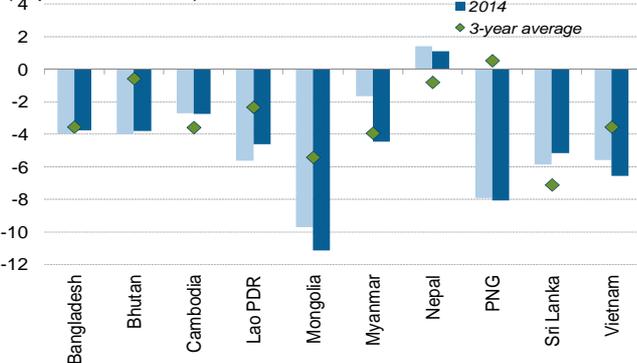
Outlook

Risks

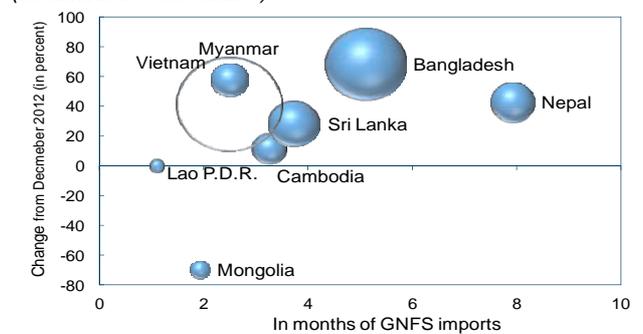


# FDEs: large imbalances, small buffers

## Fiscal Balance



## Official FX Reserves



Data as of July/June 2014 or latest available.

Outlook

Risks



# Policy Settings

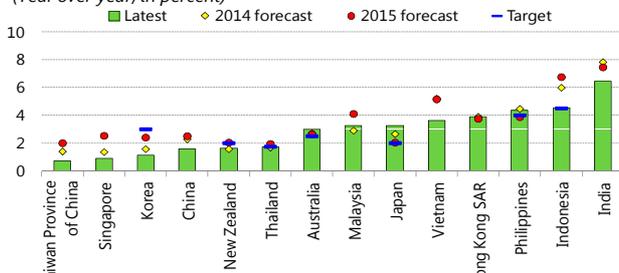
- Monetary: *gradual* normalization as conditions warrant
  - major exception: Japan
- Fiscal: *gradual* consolidation
  - priority in Japan, India, Malaysia, Vietnam
- FX intervention: smooth volatility and address dislocations in FX market
- Macroprudential policies: *complement* monetary/fiscal mix
- Structural reforms: bolster medium-term growth



# Generally stable inflation and policy rates in line with past behavior by CBs.

## Asia: Headline Consumer Price Inflation<sup>1</sup>

(Year over year; in percent)

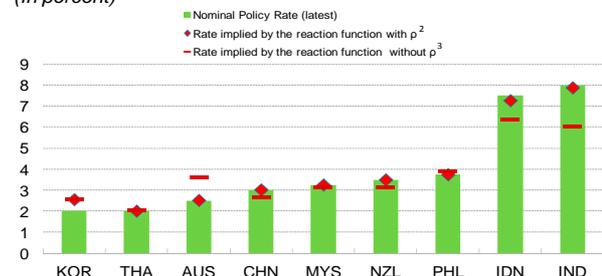


Sources: CEIC Data Company Ltd.; Haver Analytics; Country authorities; IMF, *World Economic Outlook*; and IMF staff projections.

<sup>1</sup> Target refers to mid-point of headline inflation target band (Australia, Korea, New Zealand, Indonesia, Japan and Philippines). Core inflation and core inflation target band mid-point (Thailand). For India WPI is used. Japan 2014 projection includes effects of consumption tax increase.

## Estimated Central Bank Reaction Functions

(In percent)



Sources: Haver Analytics; and IMF staff estimates.

<sup>1</sup> As of September 08, 2014 with monthly data.

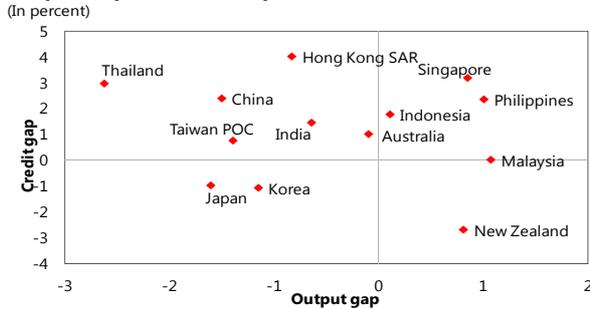
<sup>2</sup> Estimated as  $i_t = \rho^2 i_{t-1} + (1-\rho^2)(\alpha + \gamma_1 E_t[\pi_{t+1} - \pi^*] + \gamma_2 E_t[\text{OutputGap}_{t+1}] + \delta_1 \text{REER}_t + \delta_2 \text{US\_3Myield}_t) + \varepsilon_t$

<sup>3</sup> Estimated as  $i_t = \alpha + \gamma_1 E_t[\pi_{t+1} - \pi^*] + \gamma_2 E_t[\text{OutputGap}_{t+1}] + \delta_1 \text{REER}_t + \delta_2 \text{US\_3Myield}_t + \varepsilon_t$



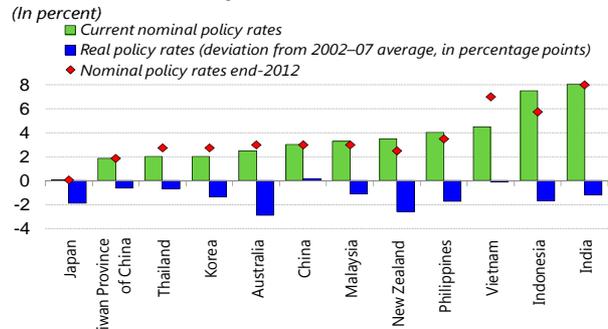
# Conditions are ripe for a gradual normalization of monetary conditions

## Output Gap vs. Credit Gap, Latest



Sources: CEIC Data Company Ltd.; IMF, *World Economic Outlook*; and IMF staff calculations. Credit-to-GDP as of May 2014 or latest available. Credit gap is calculated as a percent deviation from the trend credit-to-GDP ratio (approximated using the H-P filter over the period 2000-2012). Output gap is based on country estimates for 2014.

## Selected Asia: Policy Rates



Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations. Note: Data is the latest available for each country.

Outlook

Risks

Policies

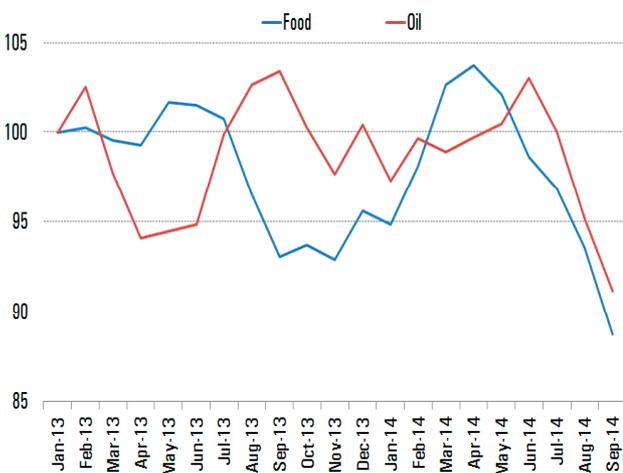
33



# Recent decline in oil and food prices would help lower inflation.

## Global Food and Oil Prices

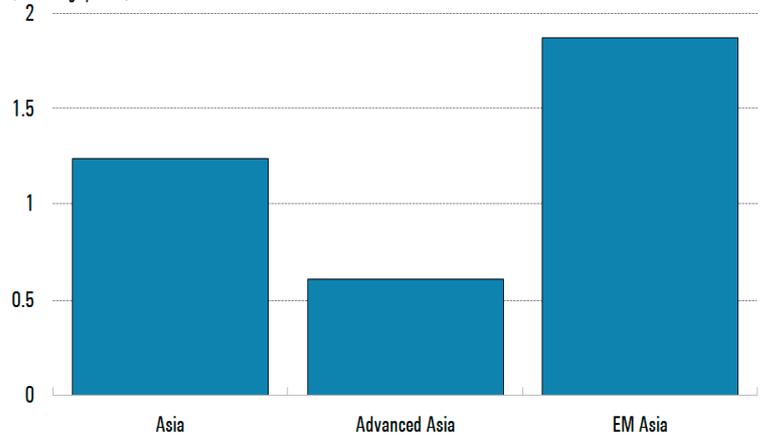
(2013 January = 100)



Source: IMF, *Global Data Source* database.

## Long-run pass-through on headline CPI from International Oil and Food Price Decline in 2014<sup>1</sup>

(Percentage points)



Source: IMF staff estimates

<sup>1</sup> Based on observed decline in pass-through between December 2013 and September 2014.

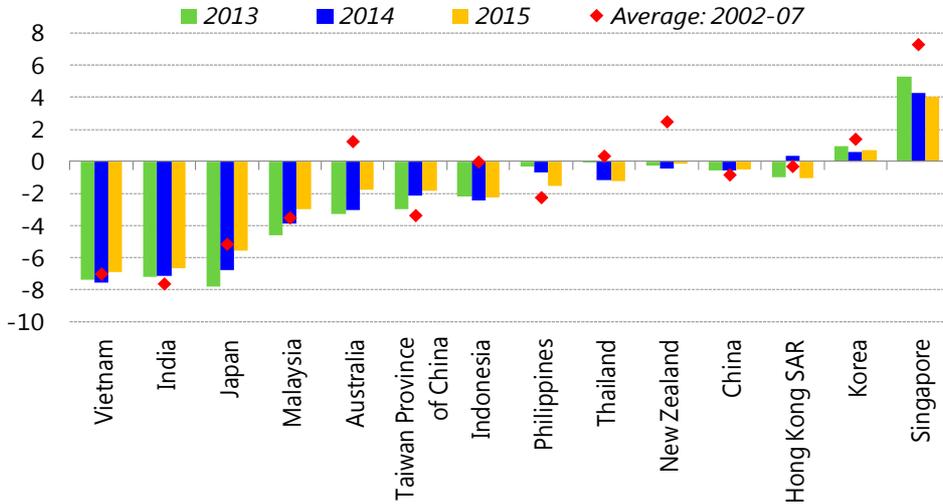
34



# Gradual fiscal consolidation remains appropriate

## Selected Asia: Cyclically Adjusted Fiscal Balance

(In percent of GDP)



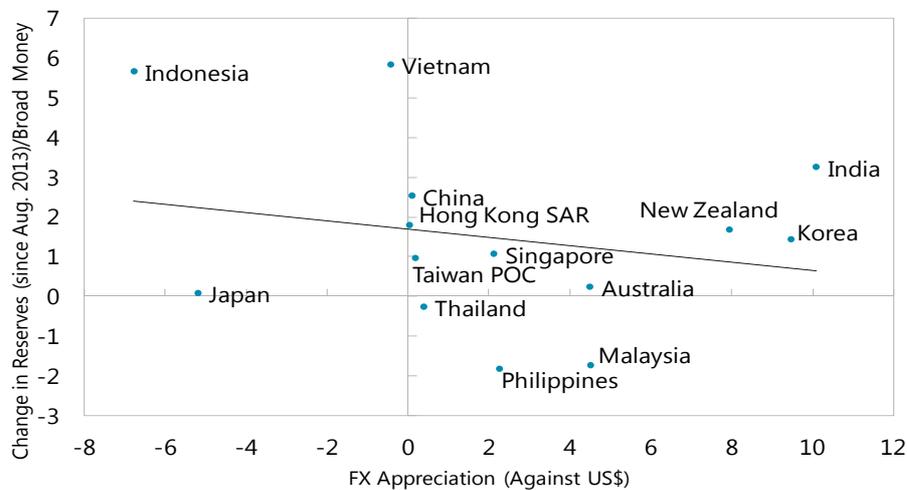
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.



# Exchange rates have been a shock absorber, but reserve accumulation has continued

## Change in Reserves and Currency Appreciation

(In percent)



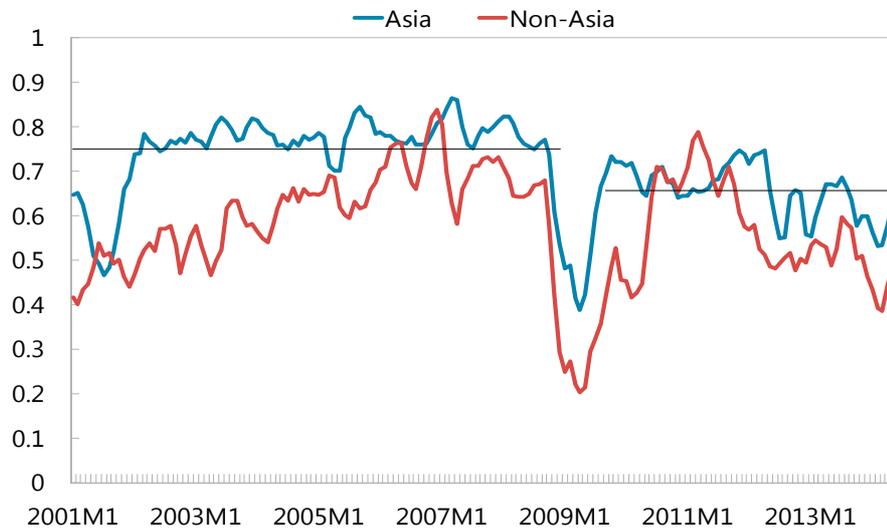
Sources: CEIC Data Ltd.; and Haver Analytics



## FX intervention has been used less to counter exchange market pressure.

### Asia: Resistance Index

(Larger=more intervention; 3-month moving average)



Sources: Haver Analytics; IFS; and IMF staff calculations.

Outlook

Risks

Policies

37



## Key Messages

- **Asia's outlook: steady growth**
- **Downside risks have increased**
- **Medium-term challenges are significant**
- **Reforms needed to secure Asia's growth leadership in more challenging global environment**

38

# Thank You

Asia and Pacific Department, October 2014



## Forecasts revisions small, with exceptions (Japan, Singapore)

**Table 1. Asia: Real GDP**  
(Year-on-year percent change)

	Actual Data and Latest Projections					Difference from April 2014 WEO		
	2011	2012	2013	2014	2015	2013	2014	2015
Australia	2.6	3.6	2.3	2.8	2.9	-0.1	0.2	0.2
Japan	-0.5	1.5	1.5	0.9	0.8	0.0	-0.5	-0.1
New Zealand	1.9	2.5	2.8	3.6	2.8	0.5	0.3	-0.2
<b>East Asia</b>	<b>8.4</b>	<b>6.7</b>	<b>6.9</b>	<b>6.8</b>	<b>6.6</b>	<b>0.2</b>	<b>0.0</b>	<b>-0.1</b>
China	9.3	7.7	7.7	7.4	7.1	0.0	-0.2	-0.2
Hong Kong SAR	4.8	1.5	2.9	3.0	3.3	0.0	-0.7	-0.6
Korea	3.7	2.3	3.0	3.7	4.0	0.2	0.0	0.2
Taiwan Province of China	4.2	1.5	2.1	3.5	3.8	0.0	0.3	-0.1
<b>South Asia</b>	<b>6.7</b>	<b>4.9</b>	<b>5.1</b>	<b>5.7</b>	<b>6.4</b>	<b>0.6</b>	<b>0.2</b>	<b>0.0</b>
Bangladesh	6.5	6.3	6.1	6.2	6.4	0.3	0.2	-0.1
India <sup>1</sup>	6.6	4.7	5.0	5.6	6.4	0.7	0.2	0.0
Sri Lanka	8.2	6.3	7.3	7.0	6.5	0.0	0.0	0.0
<b>ASEAN</b>	<b>4.9</b>	<b>6.0</b>	<b>5.3</b>	<b>4.7</b>	<b>5.4</b>	<b>0.1</b>	<b>-0.2</b>	<b>0.1</b>
Brunei Darussalam	3.4	0.9	-1.8	5.3	3.0	-0.5	-0.1	0.0
Cambodia	7.1	7.3	7.4	7.2	7.3	0.4	-0.1	0.0
Indonesia	6.5	6.3	5.8	5.2	5.5	0.0	-0.2	-0.3
Lao P.D.R.	8.0	7.9	8.0	7.4	7.2	-0.2	-0.1	-0.6
Malaysia	5.2	5.6	4.7	5.9	5.2	0.1	0.7	0.2
Myanmar	5.9	7.3	8.3	8.5	8.5	0.8	0.7	0.7
Philippines	3.7	6.8	7.2	6.2	6.3	0.0	-0.2	-0.2
Singapore	6.1	2.5	3.9	3.0	3.0	-0.2	-0.7	-0.6
Thailand	0.1	6.5	2.9	1.0	4.6	0.0	-1.5	0.8
Vietnam	6.2	5.2	5.4	5.5	5.6	0.0	-0.1	-0.1
<b>Pacific island countries and other small states<sup>2</sup></b>	<b>5.4</b>	<b>1.9</b>	<b>1.3</b>	<b>2.1</b>	<b>4.7</b>	<b>-0.4</b>	<b>-0.3</b>	<b>0.6</b>
<b>Emerging Asia<sup>3</sup></b>	<b>7.8</b>	<b>6.7</b>	<b>6.6</b>	<b>6.5</b>	<b>6.6</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.2</b>
<b>Asia</b>	<b>6.2</b>	<b>5.5</b>	<b>5.5</b>	<b>5.5</b>	<b>5.6</b>	<b>0.3</b>	<b>0.0</b>	<b>0.1</b>

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

<sup>1</sup>For India, data and forecasts are presented on a fiscal year basis and output growth is based on GDP at market prices. Corresponding growth forecasts for GDP at factor cost are 5.6 and 6.4 percent for 2014 and 2015, respectively.

<sup>2</sup>Simple average of Pacific island Countries and other small states which include Bhutan, Fiji, Kiribati, Maldives, the Marshall Islands, Micronesia, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

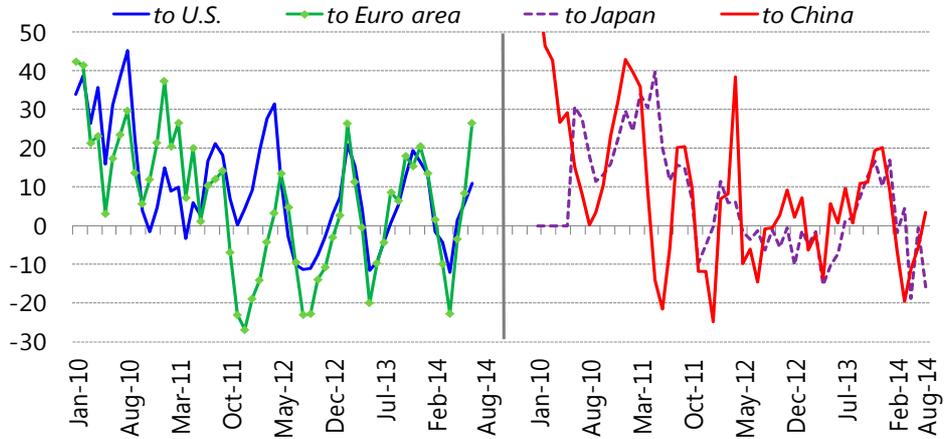
<sup>3</sup>Emerging Asia includes China, India, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.



# Background slides

## Selected Asia: Exports to Major Destination<sup>1</sup>

(3-month percent change of 3-month moving average; SAAR)



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

<sup>1</sup> Selected Asia includes Japan, Malaysia, Thailand, the Philippines, Singapore, and East Asia. Vietnam is excluded owing to data lags.

Outlook

Risks

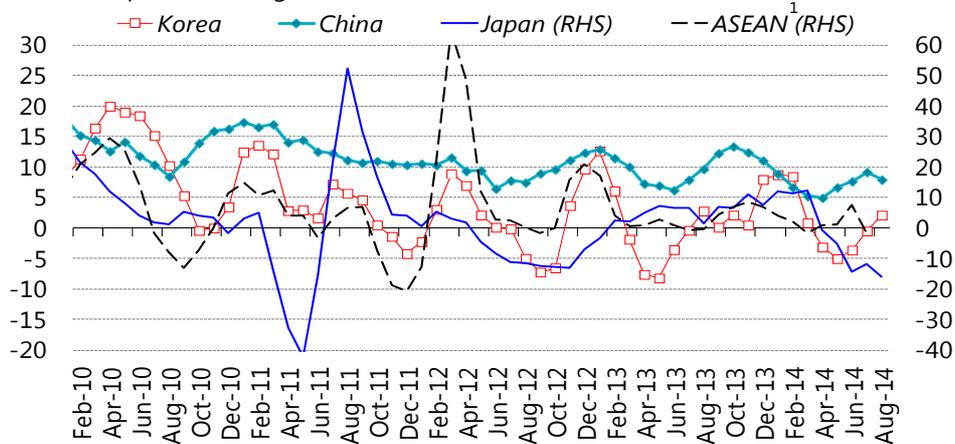
41



# Background slides

## Asia: Industrial Production

(3-month percent change of 3-mma, SAAR)



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

<sup>1</sup> ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Outlook

Risks

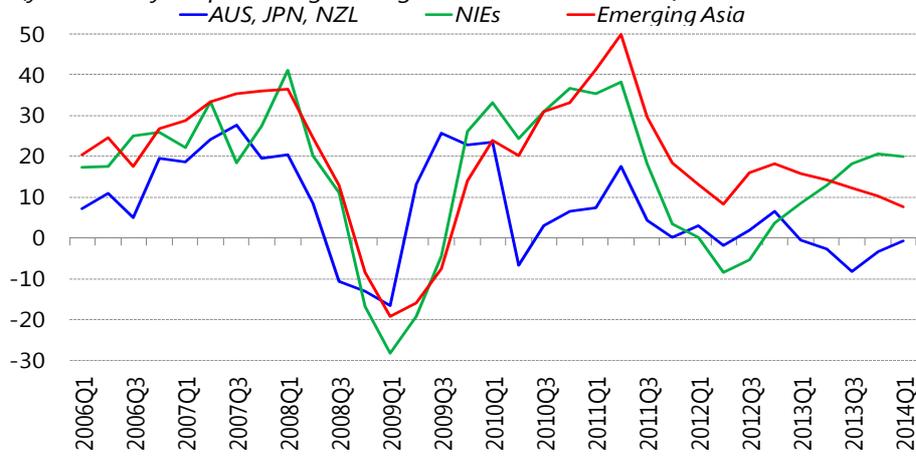
42



# Background slides

## Consolidated Foreign Claims

(year-over-year percentage change; immediate risk basis)



Source: BIS, and IMF staff calculations.

<sup>1</sup> NIEs include Korea, Hong Kong SAR, Singapore, Taiwan Province of China