THE GLOBAL AND ASIA ECONOMIC CONTEXT

SEACEN CENTRAL BANK GOVERNORS MEETING

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December 5, 2022
Three headwinds facing Asia and the Pacific

1. Tightening global financial conditions

Federal Funds Rate
(In percent; y-o-y)

Sources: Bloomberg Finance L.P.; and IMF staff calculations. Data through November 14, 2022.

2. The War in Ukraine

Commodity Prices
(Index = 100 April 2021)

Source: Bloomberg Finance L.P. and IMF staff calculations. Metals index based on Bloomberg Base Metals Spot Price Commodity Index with the following weights: Aluminum (45%), Copper (25%), Nickel (2%), Lead (12%), Zinc (15%) and Tin (1%).

3. Slowdown in China

Revisions to China’s Growth
(Percent)

Source: IMF World Economic Outlook. Note: WEO = World Economic Outlook.
### GDP growth forecasts

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>Asia</th>
<th>AEs</th>
<th>EMDEs</th>
<th>Australia</th>
<th>China</th>
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<th>PICs</th>
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<td><strong>2021</strong></td>
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<td>6.5</td>
<td>3.7</td>
<td>7.2</td>
<td>4.9</td>
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<td>3.1</td>
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<td>3.2</td>
<td>4.0</td>
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<td>6.8</td>
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<td><strong>Revisions since Apr. 2022 WEO</strong></td>
<td>-0.4</td>
<td>-0.9</td>
<td>-0.4</td>
<td>-1.0</td>
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Source: IMF October 2022 *World Economic Outlook*. 

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**IMF | Asia and Pacific Department - Regional Economic Outlook**
Asia is a relative bright spot in the global economy

Growth is higher in Asia than in the rest of the world...

Real GDP growth forecast for 2022 and 2023
(In percent; y-o-y)

Sources: October 2022 World Economic Outlook.

... while inflation is more moderate

Inflation forecast for 2022 and 2023
(Period average)

Sources: October 2022 World Economic Outlook.
The recovery is underway but remains incomplete in EMDEs

Substantial output gaps remain in many economies...

Deviation of real output from potential
(Percentage)

Source: World Economic Outlook; and IMF staff calculations.
Note: Asia AE includes AUS, JPN, KOR, NZL, SGP, and TWN. Asia EMDEs includes CHN, IND, IDN, MYS, PHL, THA, and VNM.

... with a tight link between slack and core inflation

Core Inflation and Output Gaps
(Percent)

Source: Haver Analytics, World Economic Outlook, and IMF staff calculations.
Note: For inflation targeting economies, deviation from target or midpoint of the inflation target range is used. For economies without an inflation target (Hong Kong SAR, Malaysia, Taiwan Province of China, and Singapore), deviations are taken from the long-term average over 2010 -- 19. Dotted line is from fitted linear regression. Economies abbreviations are International Organization for Standardization codes.
Inflation is rising across Asia, but not as much as elsewhere...

Headline Inflation: Deviation from target
(Percentage)

Sources: Haver Analytics; and IMF staff calculations.
Note: Asia AE Excl. Japan includes AUS, HKG, KOR, MAC, NZL, SGP, and TWN. Asia EMDEs Excl. China includes IND, IDN, MYS, PHL, THA, and VNM. Rest of the world AEs include CAN, CHE, DEU, ESP, FRA, GBR, ITA, and USA. Rest of the world EMDEs include BRA, COL, CHL, CZE, HUN, MEX, PER, and ZAF.

... and while we are revising up our forecast substantially, we expect inflation to peak in late 2022
(Percent, year over year)

Note: Weighted average. Asia advanced economies includes Australia, New Zealand, Japan, Hong Kong SAR, Korea, Taiwan Province of China, and Singapore. Asia emerging market and developing economies includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam. WEO = World Economic Outlook; AE = advanced economies; EMDE = emerging market and developing economies.
Many Asia and Pacific countries have introduced fiscal support for households…

…many of which are untargeted and permanent…

... and the fiscal cost of shielding vulnerable households from these shocks is large, particularly for LICs

New fiscal measures in response to energy and food price shock
(Number of economies)

Sources: IMF desk survey and IMF staff calculations.
Note: Based on a survey of 16 Asian economies. Bars show the number of economies in the group that have introduced discretionary tax or spending measures in 2022 as a response to the rise in energy and food prices.

Coverage and duration of new fiscal measures
(Share of economies)

Sources: IMF desk survey and IMF staff calculations.
Note: Based on a survey of 16 Asian economies.

Cost of shielding vulnerable households
(Percent of 2021 GDP)

Sources: IMF staff calculations based on national household surveys.

Note: Based on a survey of 16 Asian economies.
Monetary policy is tightening, but shallow cycle expected

Asian central banks are in a highly synchronized hiking cycle...

Policy Rates
(Change since June 2021, percentage points)

... which is expected to be relatively shallow, with rate hikes generally smaller than the Federal Reserve

Source: Bloomberg L.P; Haver Analytics; Consensus Forecasts; and IMF staff calculations.
Note: Data through November 14, 2022.

Source: Bloomberg L.P; Haver Analytics; Consensus Forecasts; and IMF staff calculations.
Note: Data through October 26, 2022.
Inflation expectations aligned with CB targets despite real rates staying negative

Inflation running well above target, but expected to return to target by 2024…

…despite market-implied real policy rates remaining mostly negative

Professional forecasts of inflation in Asia
(Deviation from target; year-on-year)

Ex-post Real Interest Rates
(In percent)

Sources: Consensus Forecasts and IMF staff calculations.
Note: Asia AE includes Australia, Japan, Korea, New Zealand, Singapore, and Taiwan Province of China. Asia EMDE includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Source: Bloomberg Finance L.P; Haver Analytics; World Economic Outlook October 2022 and IMF staff calculations.
Note: Ex-post real interest rate is the difference between the implied policy rate at 3M, 6M and 1Y and the projected year-on-year inflation rate.
AE-Asia includes Australia, New Zealand, Japan, and Korea. EMDE-Asia includes China, India, Malaysia, Philippines, and Thailand. AE = advanced economy; EMDE = emerging market economy.
Headline inflation momentum has been easing, but will core follow suit?

Producer prices have moderated recently...

...and lower commodity prices have helped moderate headline inflation...

...while core inflation remains stronger.

Headline inflation (Percentage; month-on-month annualized rate; 3 month MA)

Core inflation (Percentage; month-on-month annualized rate; 3 month MA)

Sources: Haver Analytics; and IMF staff calculations.
Note: Simple average of KOR, JPN, IDN, PHL, MYS, THA, SGP, IND.

Source: Haver Analytics; and IMF staff calculations.
Note: Simple average of KOR, JPN, IDN, PHL, MYS, THA, SGP, IND.
Asian core inflation: some unpleasant arithmetic

Historically, Asian inflation has tended to be quite persistent…

Persistence of Inflation
(Coefficient on autoregressive term in Phillips Curve; deviation from global mean)

…and core inflation responds strongly to external shocks to non-core prices

Response of Asian core inflation to global shocks
(Percentage points)

In a scenario where core inflation stays high, monetary policy would need to tighten further

Impact on Policy Interest Rate
(Percentage points)

Source: IMF staff calculations; Haver Analytics.
Note: Estimations documented in Carrière-Swallow and others (2022), “Shipping Costs and Inflation”. Bars show the maximum response of core inflation (year-on-year) following a 1-standard-deviation increase in each global variable.

Source: IMF staff calculations.
Note: EM = emerging market economies; AE = advanced economies.
Recent pressure on exchange rates reflects fundamentals

Asian currencies depreciating sharply amid global dollar strength...

Change in Nominal Exchange Rate in 2022
(Percent; local currency per US dollar)

Sources: Information Notice System and IMF staff calculations. Note: Year-to-date percent change. Monthly average through October.

...with depreciation reflecting interest rate differentials...

Depreciation vs. interest rate differential
(Percent change, year to date)

Sources: Bloomberg Finance L.P.; and IMF staff calculations. Data thru October 12.

...and the deterioration of the terms of trade

Depreciation vs. commodity terms of trade
(Percent change, year to date)

Sources: Bloomberg Finance L.P.; Gruss and Kebhaj (2019), and IMF staff calculations. Data thru October 12.
Pass-through to inflation has been limited so far, but poses a risk going forward

Estimations find that core inflation rising due to import prices, shrinking output gaps, and to some extent currency depreciation...

Drivers of Core Inflation
(Percent; Deviation from target; Rolling Window Estimation)

- Output Gap
- Relative Import Prices (USD)
- Exchange Rate
- Other
- Core Inflation minus Target

... but pass-through could rise as the level of inflation increases

Exchange Rate Pass-Through by Level of Inflation
(Percent)

Sources: IMF staff calculations.
Note: Estimates show the response of headline CPI following a one standard deviation increase (depreciation) in local currency/USD in each quartile of the inflation distribution. Error bars denote the confidence intervals at 90% significance. Standard errors are clustered at country level.

Source: IMF staff calculations.
Note: AE Asia includes AUS, KOR, NZL, SGP.
EMDE Asia includes IDN, IND, MYS, PHL, THA. Decomposition is based on country-by-country Phillips Curve estimations using data since early 1990s. The figure shows simple average of contributions within country groups.
Macrofinancial concerns: Leverage has risen in Asia...

Public debt has been on the rise across Asia, spiking further during pandemic...

..with household debt rising substantially in many economies as well

Source: IMF Global Debt Database; and IMF staff calculations.

Note: Upper (lower) horizontal lines represent the 75th (25th) percentiles of the distribution. Bars represent the 50th percentile. AE= advanced economy; EMDE = emerging market developing economy.

Source: Bank for International Settlements and IMF staff calculations.
Financial conditions have tightened for high-yield corporates...

...and a rising share of corporate debt is held by vulnerable firms...

Real estate markets in advanced economies are showing signs of cooling

Source: Bank for International Settlements and IMF staff calculations.

Note: Country abbreviations are International Organization for Standardization country codes.
What keeps us awake at night?

- Inflation more persistent
- Debt vulnerabilities and market turbulence
- Short term stagflation risks and medium-term scarring
- Geo-economic fragmentation

Inflation more persistent is connected to all other factors.