Challenges to Sustaining Growth and Disinflation

REO OUTREACH PRESENTATION

OCTOBER 24, 2023
Recent developments
Growth momentum in Asia and the Pacific is slowing

After a resilient start, signs of slowing momentum are rising, notably in export-oriented economies…

Contributions to GDP Growth

(Quarter on quarter annualized change in percentage points)

…with weak investment emerging as the main drag on the domestic demand side for many economies.

Source: GPM.
Note: * Year-on-year changes.
Weak external demand partly explains subdued investment

Import demand from Asia’s major trading partners is still weak…

…reflected in falling exports from Asia…

…and partly contributing to the incomplete investment recovery, particularly in EMs.

Global Import Volumes (year-on-year percent change)

Asia Electronics and Goods Exports (In percent; year-over-year)

Real Gross Fixed Capital Formation (Relative to Q4 2019)

Notes: Counterfactual assumes average 2014-2019 growth rate.
AEs include AUS, JPN, KOR, NZL, SGP.
EMs include CHN, IDN, MYS, PHL, THA, VNM
Private consumption and services have held up for now

The post-pandemic reopening has benefitted services...

...and retail sales are still growing...

...supported by household’s excess savings.

Asia: Service Sector PMI
(Diffusion index, 50 = no change)

- Services: Asia AE
- Services: Asia EMDE excl. China
- Services: China

Retail Sales
(Value, year-on-year % change)

Source: Haver Analytics.
Note: Asia AE include: Australia, Hong Kong SAR, Korea, New Zealand, Taiwan POC and Singapore. Asia EMDE includes India, Indonesia, Malaysia, Philippines and Vietnam.

Cumulative Excess Saving
(Percent of GDP, cumulative change since end-2019)

Sources: Haver Analytics and IMF staff calculations.
Note: Excess saving is defined as the difference between actual household saving and pre-pandemic projected household saving. AE (excl. Japan) includes Australia, Hong Kong SAR, New Zealand, Korea, Singapore. EM (excl. China) includes India, Indonesia, Philippines, Thailand.
Financial conditions in AEs and EMs are diverging...

Financial conditions have tightened in AEs but remain loose in EMs...

...and sovereign yields in EMs have not increased much despite monetary policy tightening

Change in 10-Year LCY Sovereign Yields
(In basis points)

Source: IMF staff calculations.

Note: LATAM includes: Brazil, Chile, Colombia, Peru and Mexico. Eastern Europe includes: Poland, Hungary, Croatia, Czech Republic and Slovakia. April WEO defined as date of WEO press release (11th April 2023).

Asian currencies have regained some value against the US dollar and Chinese Yuan this year

Nominal Effective Exchange Rate Changes in 2023
(Percent; Positive means appreciation)

Source: INS and IMF staff calculations.

Note: Data as of September 2023.
Inflation is below peak levels

Headline inflation has come down in most of the region…

…with core inflation stickier in some economies such as Australia, New Zealand, and Japan.

### Headline Inflation

(Deviation from target; year-on-year)

- China
- Asia EMDEs excl. China
- Asia AEs excl. Japan

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Source: Haver Analytics; and IMF staff calculations.
Note: Data as of October 18th, 2023. Country abbreviations are International Organization for Standardization of country codes.
Outlook
## GDP growth forecasts for Asia’s advanced economies

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**Revisions since April 2023 WEO**

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Source: IMF, *October 2023 World Economic Outlook*. 
GDP growth forecasts for Asia’s emerging market and developing economies

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Source: IMF October 2023 World Economic Outlook.
China’s post-COVID recovery is losing steam

The reopening boost is proving short-lived, especially in manufacturing and retail sales

...and the real estate sector is experiencing further pressure...

...the outlook is downgraded as investment is expected to fall further

China: Manufacturing and Services
(PMI indexes are subtracted by 50; Retail Sales y-o-y growth)

Real Estate Sector Indicators
(percent, 12 month moving average, y/y change)

China Revisions in Private Consumption and Investment
(In percentage points; since WEO April 2023)

Source: CNBS and IMF staff calculations.

Source: NBS and IMF staff calculations.

Source: IMF World Economic Outlook; and IMF staff calculations.
The upward revision to US growth may not provide as much of a boost

The growth outlook for the US has been upgraded while for China it has been downgraded.

Usually, these revisions would present a net benefit for the region…

…but the rotation from goods to services may limit the benefits this time.

Growth spillovers: net effect of USA upgrade and China downgrade
(In percent)

Source: Copestake et al (2023), IMF staff calculations.

Note: GDP Growth spillovers from 0.5pp upgrade in USA and 0.2pp downgrade in China.

Growth spillovers: Goods vs Services
(In percent)

Source: Copestake et al (2023), IMF staff calculations.

Note: GDP Growth spillovers from 0.5pp upgrade in USA and 0.2pp downgrade in China.
Inflation is projected to continue the decline towards central bank targets as output gaps close.

Inflation is projected to decline... and is expected to return to target ranges by end-2024...

...as output gaps narrow.

### Projected Inflation Paths

(Percent; year over year)

- Apr. 23 WEO
- Jul. 23 WEO
- Oct. 23 WEO

Source: IMF World Economic Outlook.

### Expected Inflation

(Percent)

- Inflation Target
- Latest Headline Inflation
- 2024 WEO forecast (eop, headline)

Source: Consensus Forecasts and IMF staff calculations.

Note: Data as of October 18th, 2023. Latest inflation and consensus forecasts are for headline inflation. Some countries do not have explicit inflation targeting regimes or target, while target ranges apply to core inflation.

### Core Inflation and Output Gaps

(Percent)

- Expected core inflation - target

Source: IMF World Economic Outlook.

Note: 2024(2023) Bubbles – Expected core inflation and output gap 2023(2022)
Japan: Strong inflationary pressures triggered YCC change

Continued recovery supported by pent-up demand, supply chain improvement, policy accommodation, and inbound tourism

Underlying core inflation has reached ~4.4 percent, and wage growth has accelerated

The BoJ has responded by allowing higher 10-year yields under YCC, triggering cross-border spillovers

Base Wage Growth Strengthens

| Output gap | GDP growth |

Real GDP Growth

(In percent)

Change in sovereign yields following BoJ policy announcements

(Basis points)

Sources: Haver Analytics and IMF Staff Estimates.

Sources: Refinitiv Eikon and IMF staff calculations.
Risks to the outlook
Risk of a further slowdown in China in the near-term would spillover into rest of Asia

China’s cyclical slowdown could have important growth spillovers and the impact varies by source of the shock…

With weaker medium term trend growth adding to the impact… especially, those countries most exposed to China’s investment and consumption.

Spillovers from China’s Growth by Drivers
(Peak cumulative decline in GDP, percent)

0.0 0.2 0.4 0.6 0.8 1.0 1.2 1.4 1.6

1pp Adding Trade exposure 1 Standard Deviation

(1) Overall Activity (2) Investment (3) Consumption (4) Property Sector

Export Value Added to China
(Percent of GDP)

Source: World Economic Outlook.

Source: OECD TiVA and IMF staff calculations.

Note: Peak response to the overall activity measure from Fernald and others (2021) (1) the supply component from a structural VAR decomposition (2), a shock to private final consumption (3), and value added in the property sector. Triangles represent mean response in a panel of 50 countries (excluding China), lines are 68 percent confidence intervals.
Uncertainty with commodity prices and labor market tightness pose inflation risks

Commodity price risks are skewed to the upside...

...while core inflation could face renewed upward pressure as commodity prices rise...

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

...and in advanced Asia, tight labor market could keep core inflation higher

Job vacancy to unemployment ratio
(Percent; higher = tighter job market)

Commodity Prices
(Index, 2022Q1 = 100)

Source: Bloomberg Finance L.P; and WEO GAS Assumptions.

Source: IMF staff calculations; Haver Analytics.
Note: Estimations documented in Carrière-Swallow and others (2022). Bars show the maximum response of core inflation (year-on-year) following a 1-standard-deviation increase in each global variable.
Financial conditions in the US and EM Asia are looser than historical averages and could revert abruptly…

Financial Condition Index
(Standard deviations from historical average; higher = tighter)

Source: Bloomberg; Haver; Datastream; IMF Staff.
Note: Financial conditions are constructed using equal weights of 14 financial market price and quantity indicators.

Growth spillovers from tighter US financial conditions
(Percent)

Source: Copestake et al (2023), IMF Staff.
Note: GDP spillovers from 1 standard deviation increase in US Financial Conditions in 2023Q4, similar to the increase between 2021Q3 and 2022Q3. Dotted lines are 90 percent confidence intervals.

…with tightened US financial conditions leading to adverse spillovers to Asia…

…and tightened Asian domestic financial conditions followed by greater growth-at-risk

Asia: Mean and Growth-at-Risk impact of tightening financial conditions
(In percent; due to one-standard deviation increase in FCI)

Source: Copestake et al (2023), IMF Staff.
Note: Solid bubbles indicate significant at 90 percent confidence interval. GDP spillovers from 1 standard deviation increase in Asia’s domestic financial conditions.
Policies
And monetary policy responded accordingly

The pace of monetary tightening in the region has been sharper in the current cycle…

…but real interest rates remain around the neutral level …

…and financial conditions remain loose particularly in emerging Asia.

Monetary Policy Rates
(In percent; T= 0 is first month of a monetary tightening cycle)

Real Interest Rates: Ex-ante
(In percent; T= 0 is first month of a monetary tightening cycle)

LCY 10-Year Sovereign Spreads over UST
(In percent; T= 0 is first month of a monetary tightening cycle)

Source: Haver; Bloomberg; and IMF Staff calculations.
Note: Dashed lines show 90% confidence intervals.
Loose financial conditions reduce the disinflationary impact of rate hikes…

While supportive fiscal policy improves transmission

Monetary policy transmission interactions
(Percent)

Financial Conditions

- Loosening financial conditions reduce the disinflationary impact of rate hikes.
- Supportive fiscal policy improves transmission.

Source: Deb et al. (2023).

Note: Light shaded areas indicate that results are not significant at 90% confidence intervals. Results shown for peak effect trough quarters.
Despite progress in fiscal consolidation, the fiscal burden of public debt is expected to remain above pre-pandemic levels...

Fiscal stance is projected to be contractionary in 2023, amid high debt and high inflation...

...but public debt burden as a share of revenue is still higher compared to pre-pandemic levels

Sources: IMF, World Economic Outlook; and IMF staff calculations.
Note: fiscal impulse is defined as negative changes in cyclically-adjusted primary balance.

Source: IMF World Economic Outlook.
Note: Public debt burden as the ratio of General Government Gross Debt to Fiscal Revenue.
Asia’s public revenue mobilization is still lower than peers in other regions…

...requiring reforms to enhance revenue mobilization and improve quality and effectiveness of expenditures

...and a comprehensive reform of subsidies hand-in-hand with strengthening weak social safety nets should be a priority.

**Government Revenue – Gap between Asia and Rest of the World**
*(Percent of GDP; Positive values: Asia is below rest of the world)*

Sources: IMF, World Economic Outlook; and IMF staff calculations.
Gap between Asia and rest of world is defined as Asia’s government revenue-to-GDP ratio minus rest of world government revenue-to-GDP ratio.

**Fuel Subsidies**
*(Million USD; Percent of GDP)*

Sources: IMF, Fossil Fuels subsidies database 2023; Black, Liu, Parry, and Vernon (2023); and IMF staff calculations.
Risks from higher interest rates to banks largely contained

Banking sector in Asia remains resilient with strong capital and profitability…

Although commercial real estate (CRE) prices in Asia are relatively modest…

…adjustment in commercial real estate prices and defaults could be a risk to some countries with high bank exposure

Sources: IMF, Financial Soundness Indicators; and IMF staff calculations.

Bank Capital Adequacy and Profitability
(In percent; latest observations)

商业房地产市场价格
(End-2019 = 100)

Although commercial real estate (CRE) prices in Asia are relatively modest…

Return on Equity  Tier 1 Capital Adequacy Ratio

Banking sector in Asia remains resilient with strong capital and profitability…

Sources: IMF, Financial Soundness Indicators; and IMF staff calculations.

Sources: Bank for International Settlements; and IMF staff calculations.

Sources: IMF, Financial Soundness Indicators; and IMF staff calculations.
A lot remains to be done in Asia to overcome scarring and ensure sustained and inclusive growth...

Advanced Asia has nearly recovered to pre-pandemic projections, but EMs are lagging.

Inequality is high than in the rest of the world…

Additional Spending Gap to Achieve SDG in 2030
(In Percentage Points of GDP)

Source: IMF World Economic Outlook.

...and Asia also faces challenges from managing the climate transition

Temperatures in Asia have been trending up as in the rest of the world...

…and Asia’s loss from natural disasters represents around half of world’s total

... but investment in adaptation is largely in line with other continents.

Temperature Change
(In celsius)

Source: IMF Climate Change Dashboard.
Note: Annual estimates of mean surface temperature change measures with respect to a baseline climatology, corresponding to the period 1951-1980.

Total Damage from Natural Disasters
(In billion USD; inflation adjusted)

Source: EM DAT and IMF staff calculations.

Climate Adaptation Needs
(percentage points of GDP)

Source: Alighieshev, Bellon and Massetti (2022) and IMF staff calculations.
Note: Empty circles as weighted average of country groups.
Policy priorities for Asia

Key drivers

China’s economic rebound is losing steam and the pace of recovery in Asia’s export engine will be key. Inflationary pressure is easing but upside risks remain and financial conditions are loose, providing scope for maintaining tighter stance for longer without hurting growth.

Fiscal Policy

- Consolidation should continue to support disinflation, with a greater emphasis on credible medium-term frameworks for debt sustainability.
- Rising debt service to revenue ratios call for enhanced tax mobilization measures and debt management strategies.
- For some EMDEs with debt distress, faster and more efficient coordination on debt resolution is needed.

Monetary, Exchange Rate and Financial Policy

- Maintain restrictive monetary policy until inflation is reliably within target
- Use macroprudential policies to tackle pockets of vulnerabilities. Strengthen bank resolution and insolvency frameworks.
- Higher for longer global interest rate environment requires and integrated policy response to cushion potential shocks.

Structural Policies

- China’s medium-term growth slowdown and risk from geo-economic fragmentation call for renewed mutual cooperation and efforts to boost regional integration and productivity.
- Priorities include education, digitization, product and labor market reforms, and facilitating a green transition.
Thank you