

Executive Summary

Asia is rebounding fast from the depths of the global crisis. Initially, the region was hit extremely hard, with output in most countries contracting by more than even those nations at the epicenter of the crisis. But now Asia is leading as the world pulls out of recession. What explains this remarkable comeback? And what challenges does the recovery pose to Asian policymakers?

Asia's impressive recovery from the global downturn, even as output elsewhere remains sluggish, has prompted some observers to revive the notion that the region has "decoupled" from the rest of the world. But, as Chapter 1 explains, careful consideration of the forces behind the rebound reveals that the primary driver of Asia's recovery has been a return toward normalcy following the abrupt collapse in global trade and finance at the end of 2008. Just as the U.S. downturn triggered an outsized fall in Asia's GDP because international trade and finance froze, now their normalization is generating an outsized Asian upturn. For this reason, the rebound in economic activity has been fastest in the export-dependent Asian economies that were hit most severely at the end of 2008.

The other key driver of Asia's recovery has been the region's rapid, forceful, and comprehensive policy response. This vigorous reaction was made possible by Asia's relatively strong initial conditions: in many countries, government fiscal positions were sounder, monetary policies more credible, and corporate and bank balance sheets sturdier than at any time in the past. These conditions gave Asia the space to cut interest rates sharply and adopt large fiscal stimulus packages. As a result, overall domestic demand has held up remarkably well, despite weak private demand.

What lies ahead for the region? Global conditions are expected to continue to improve in 2010. But the recovery is expected to be a sluggish one. According to the IMF's latest forecasts, output in the large G-7 economies is forecast to grow by just 1¼ percent next year, recouping only half of the loss estimated for 2009. In essence, the problem is that private demand in these countries remains hobbled by the legacy of the crisis. Households will find it difficult to spend and banks to provide credit since they must focus instead on repairing their balance sheets after the sizable destruction of wealth that occurred during the recession. G-7 consumption is consequently likely to remain weak for some time, limiting external demand for Asia's products. As a result, the region's GDP growth is forecast at 5¾ percent in 2010, well below the 6⅔ percent average recorded over the past decade.

Overall in Asia, policymakers consequently face two major challenges. In the near term, they will need to manage a balancing act, providing support to economies until it is clear that the recovery is sufficiently robust and self-sustaining, while ensuring that it is not maintained for so long that it ignites inflationary pressures or concerns about fiscal sustainability. Striking the right balance will be difficult. But the key is clear: policymakers will need to assess the state of private demand and the extent to which it can substitute for a withdrawal of public sector demand. As discussed in Chapter 2, Japan's experience with the crisis in the 1990s shows that a durable recovery may emerge only when "green shoots" spread from industrial production and exports to employment and private

REGIONAL ECONOMIC OUTLOOK: ASIA AND PACIFIC

domestic demand. So far, private demand remains weak, and the outlook far from encouraging, both in Asia and abroad. Consequently, Asian countries will likely need to maintain policy support for some time.

The other major policy challenge will be to devise a way to return to sustained, rapid growth in a new global environment of softer G-7 demand. In this “new world,” Asia’s longer-term growth prospects may be determined by its ability to recalibrate the drivers of growth to allow domestic sources to play a more dynamic role. This type of successful rebalancing will require action on a broad front. Better social safety nets will be needed to reduce private precautionary savings and, as discussed in Chapter 3, continued efforts at financial sector and corporate governance reforms would also allow households to offset higher corporate saving by increasing consumption. At the same time, structural reforms could raise productivity and allow for a smooth reallocation of resources across the economy to compensate for the lower momentum from exports. Finally, Asia will need to be willing to live with smaller current account surpluses and more flexible exchange rate management.