

# EXECUTIVE SUMMARY

The recovery in advanced economies is more sluggish than anticipated at the time of our April 2011 Asia and Pacific *Regional Economic Outlook* and the global outlook has become increasingly uncertain. The handover from public stimulus to private demand has stalled in the United States, and euro area financial turbulence has intensified. While the outlook for advanced economies is for a continuing, although weak, expansion over the remainder of 2011 and 2012, the risk of a renewed slowdown is greater now than six months ago, especially if structural fragilities remain unresolved.

Growth in Asia has also moderated since the second quarter of 2011, mainly as a result of weakening external demand. Domestic demand has been generally resilient, and overheating pressures remain elevated in a number of economies, with credit growth still robust and inflation momentum generally high. In line with the weaker global outlook, growth in Asia is expected to be slightly lower in 2011–12 than forecast in April 2011, but the expansion should remain healthy, supported by domestic demand, and inflation is expected to recede modestly after peaking in 2011. Nevertheless, risks for the Asia and Pacific region are also decidedly tilted to the downside. The sell-off in Asian financial markets in August and September 2011 underscores that an escalation of euro area financial turbulence and a renewed slowdown in the United States could have severe macroeconomic and financial spillovers to Asia.

The downside risks to growth amid persistent overheating pressures present Asian policymakers with a delicate balancing act, as they need to guard against risks to growth but also limit the adverse impact of prolonged easy financial conditions on inflation and balance sheet vulnerabilities. In economies where overheating pressures are more elevated and monetary conditions still accommodative, the return to more neutral monetary stances should continue, through both higher interest rates and more flexible exchange rates (Chapter II). However, in economies where inflation is within central banks' target ranges and the exposure to severe external shocks is greater, a pause in monetary tightening may be warranted until the global uncertainties have lessened. Meanwhile, the normalization of fiscal policy stances should run its course: in many economies, fiscal positions remain accommodative, with structural deficits higher than their precrisis levels. If the downside risks to the global outlook were to materialize, Asian economies have the scope to reverse course and use a range of measures to cushion the impact on economic activity, as many did in response to the global crisis in 2008.

At the same time, the weakness in global demand only confirms that Asia would greatly benefit from further progress in rebalancing growth by developing domestic sources of demand. In addition to structural reforms, this would require a reprioritization of fiscal spending, in order to create fiscal space for critical infrastructure investment and social priority expenditure. These measures would help increase domestic demand over time, as well as make the region more resilient to external shocks, and they would also help to make growth in Asia more “inclusive.” Chapter III shows that despite fast growth and progress in poverty reduction, income inequality in Asia has increased over the last decade. Measures that deepen regional financial integration would also help with rebalancing, by improving access to finance and strengthening domestic demand (Chapter IV).

Asian low-income and Pacific Island economies face particular challenges in the near and medium term (Chapter V). In low-income countries, the fight against inflation is complicated by strong second-round effects, the need to phase out subsidies, and less well anchored inflation expectations. Pacific Island economies need to undertake further structural reforms to lift potential growth.