



# Economic Recovery and Policy Challenges in Asia

Asia Economic Forum  
Phnom Penh, July 31, 2011

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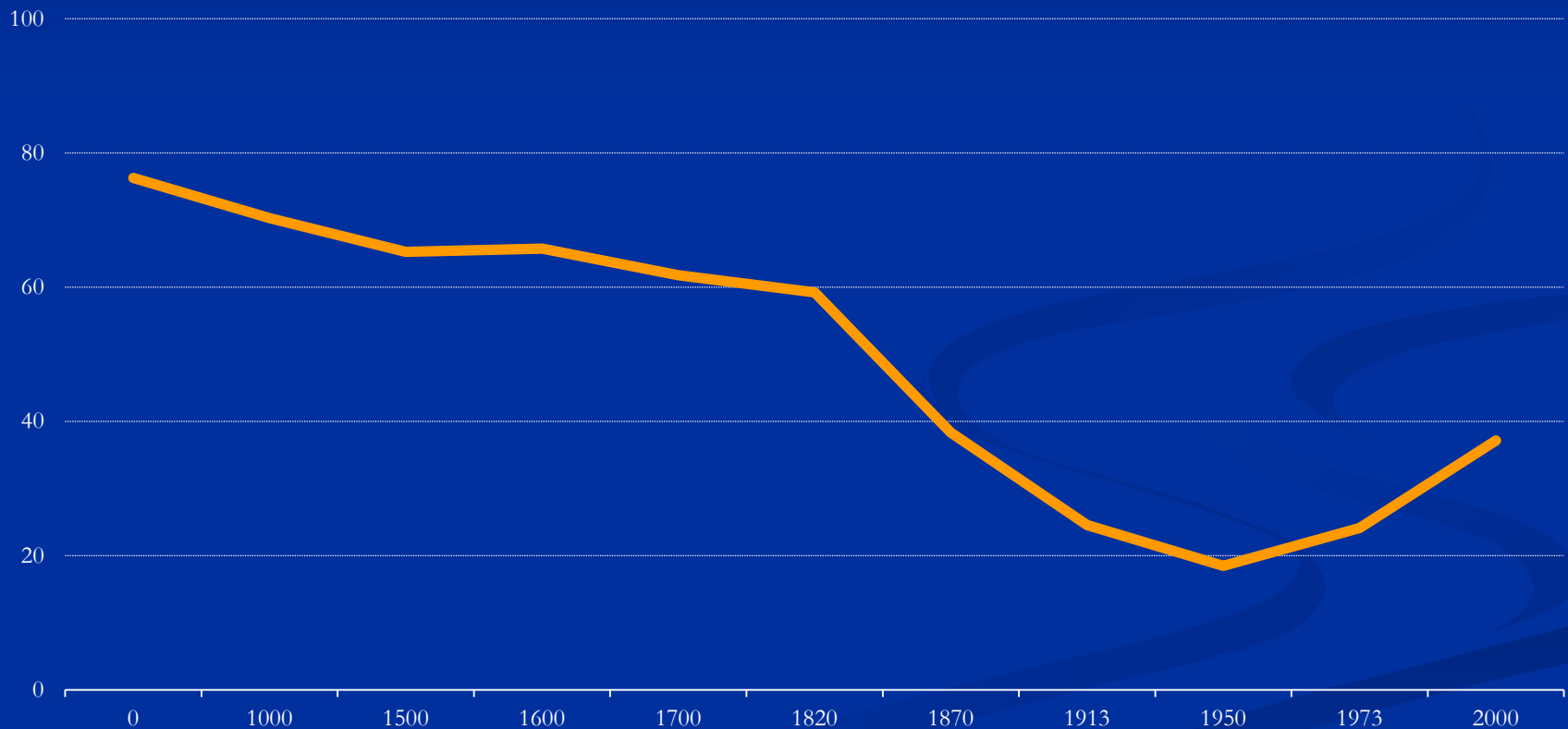
IMF Resident Representative, Cambodia

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# On the theme of the 2011 Asia Economic Forum: Is it the “rise” or “resurgence” of Asia?

(During the Khmer empire era, Asia produced three-fourths of world GDP)

Asian Share of World GDP during the Past 2000 Years  
(In percent)



# Plan of the presentation

## Global Recovery

- The global recovery has continued in 2011-Q1
- The slowdown in Q2 appears to be a bump on the road
- But downside risks have intensified since April

## Growth Outlook

- Strong growth outlook in Asia
- Concerns on quality of growth
- Main risks are from volatile capital inflows and global slowdown

## Overheating: How Serious Are the Risks?

- Inflationary pressures in many Asian EMs have extended from food and energy prices to other prices, and expectations
- A few signs of overheating in asset markets

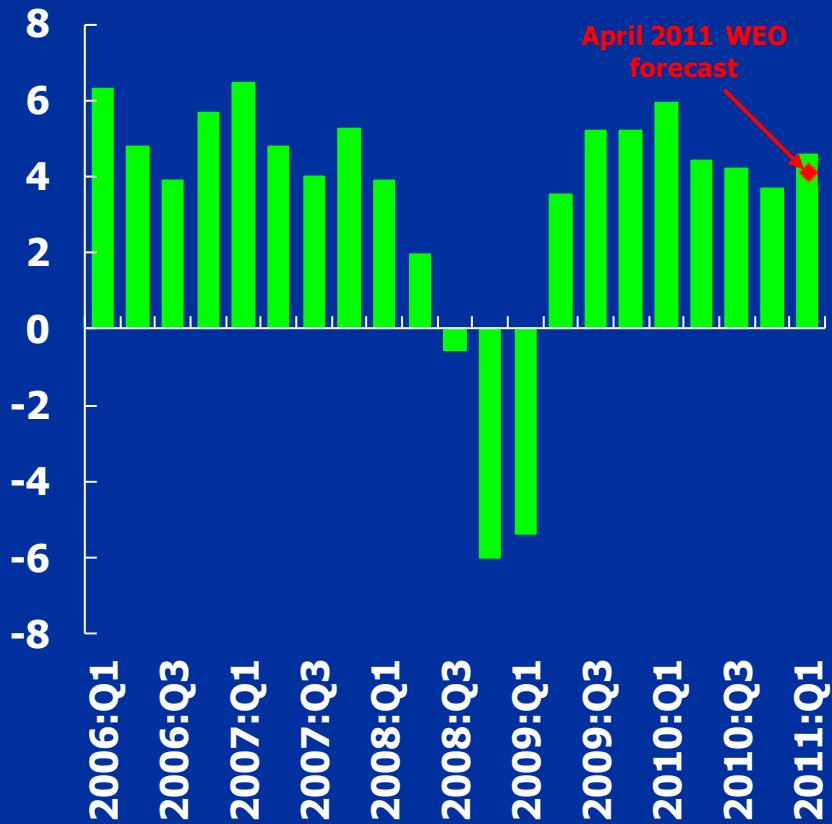
## Policy Challenges: Engineering a Smooth Landing

- Macro policy stances should be tightened further in Asian EMs facing inflationary pressures
- Macro prudential measures a useful complement, not a substitute
- Beyond the short-term: need to rebalance demand, and make growth more inclusive

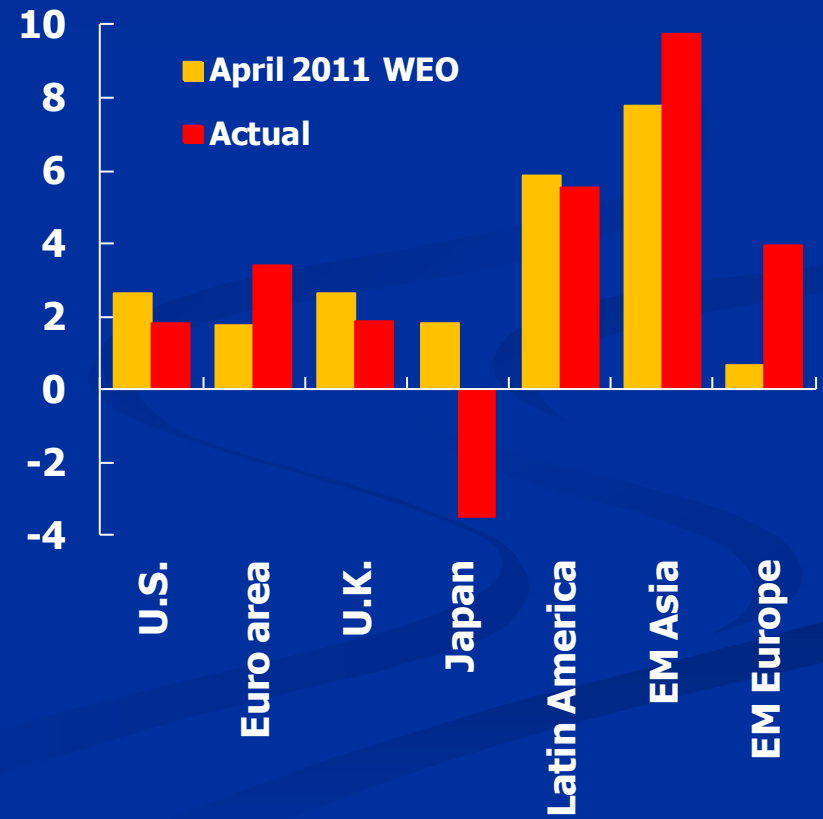
# Global Recovery

# The global economy has continued to advance in Q1 despite some negative surprises

**Global GDP Growth**  
(q/q, in percent; SAAR)



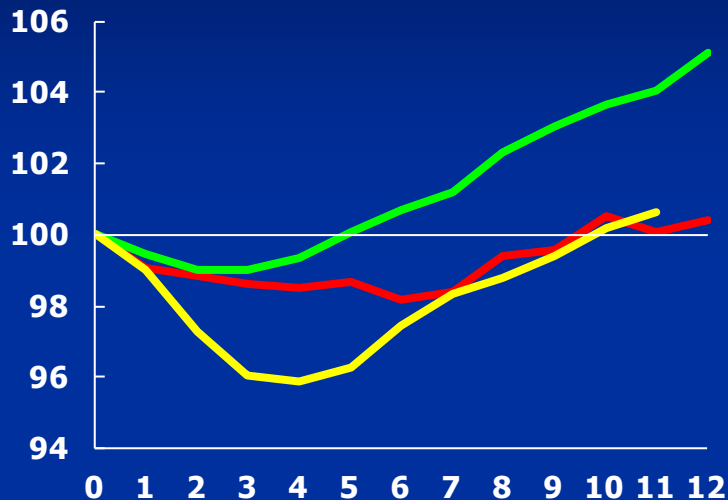
**Selected Economies: GDP Growth in 2011:Q1**  
(q/q, in percent; SAAR)



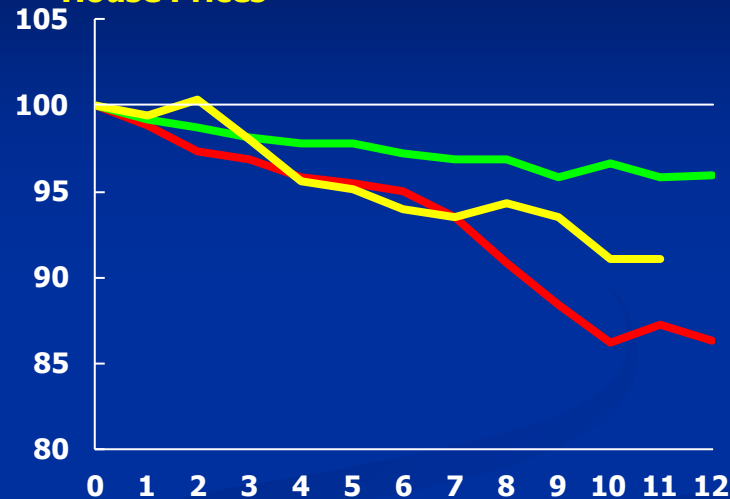
# A sluggish recovery so far, as expected

— AE recessions following financial crises 
 — Other AE recessions 
 — Current U.S. path

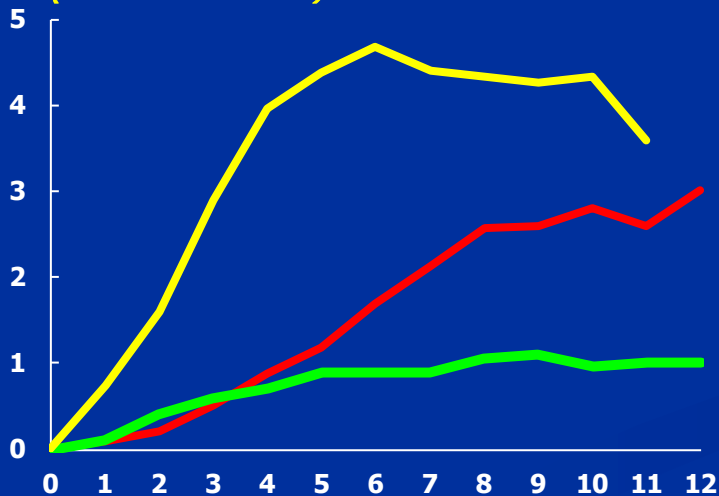
**Output**



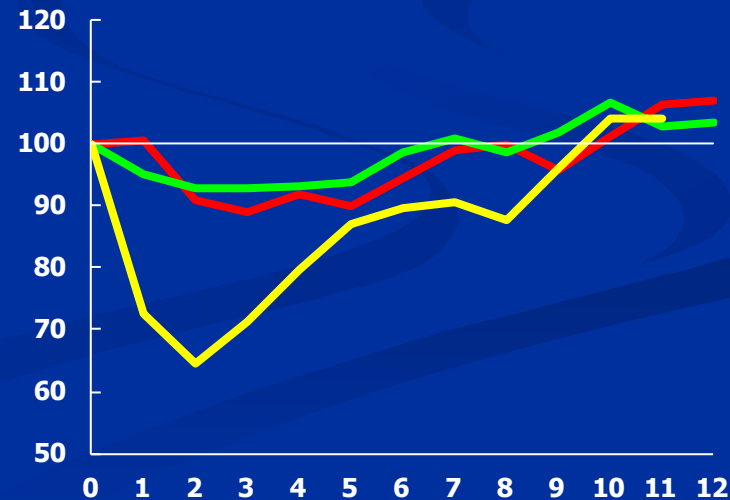
**House Prices**



**Unemployment Rate**  
(normalized at 0)



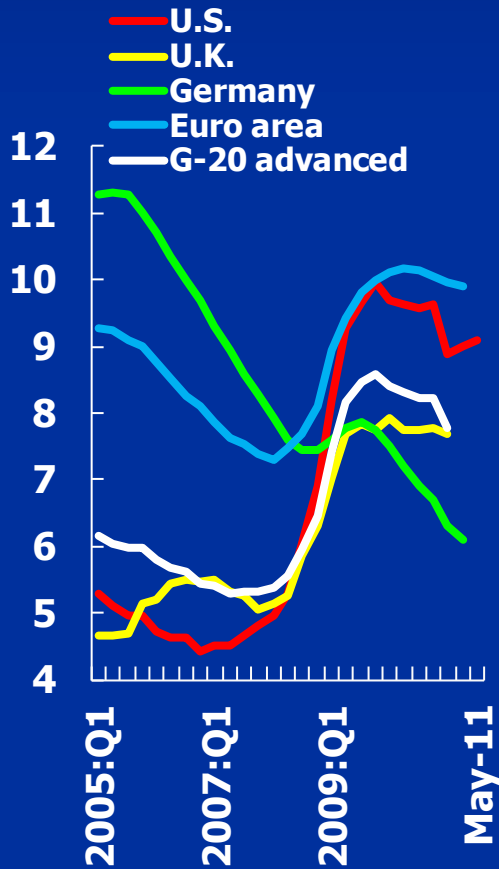
**Equity Prices**



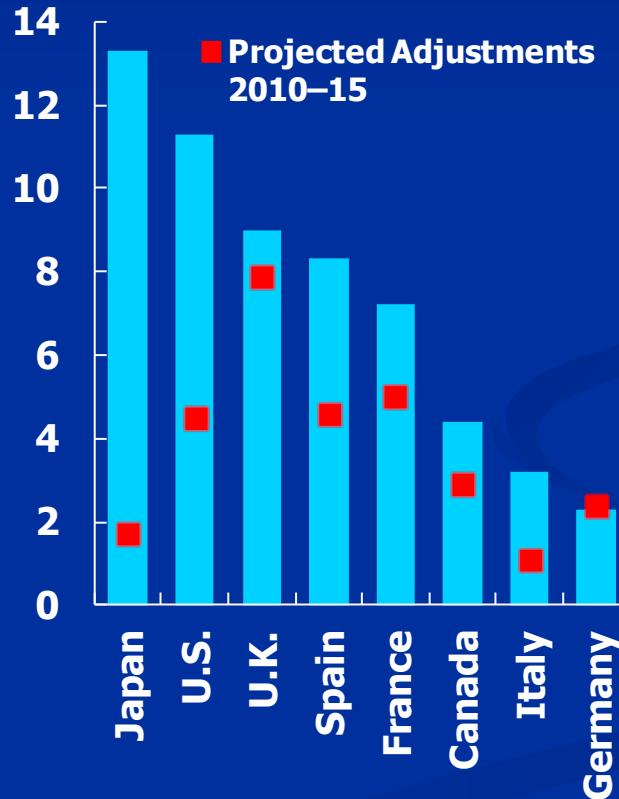
(Indices; quarters after peak in real GDP on x-axis)

# Risks remain from slow progress in reducing unemployment and insufficient fiscal and financial adjustment in AE

**Unemployment Rate**  
(Percent)

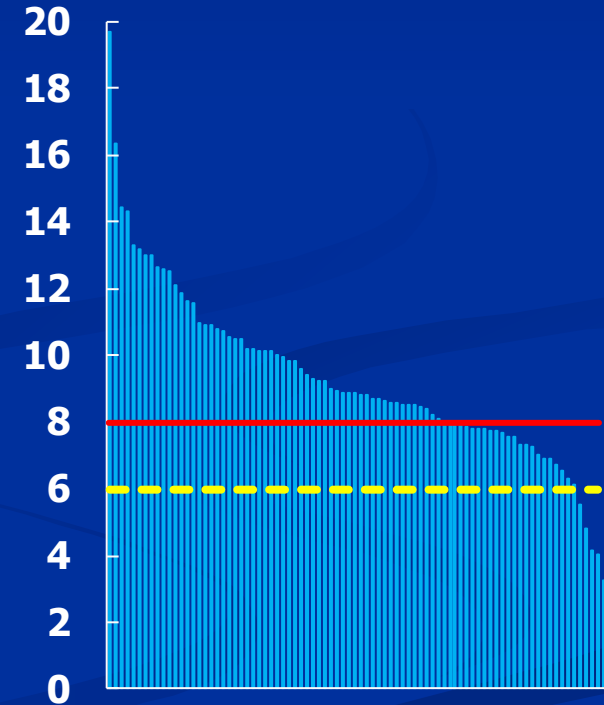


**Required Fiscal Adjustment**  
(In percent of GDP)



Note: Cyclically adjusted primary balance adjustment needed to bring the debt ratio to 60 percent in 2030, except for Japan.

**EU Banks: Core Tier-1 Ratios**  
(In percent; end-2010)

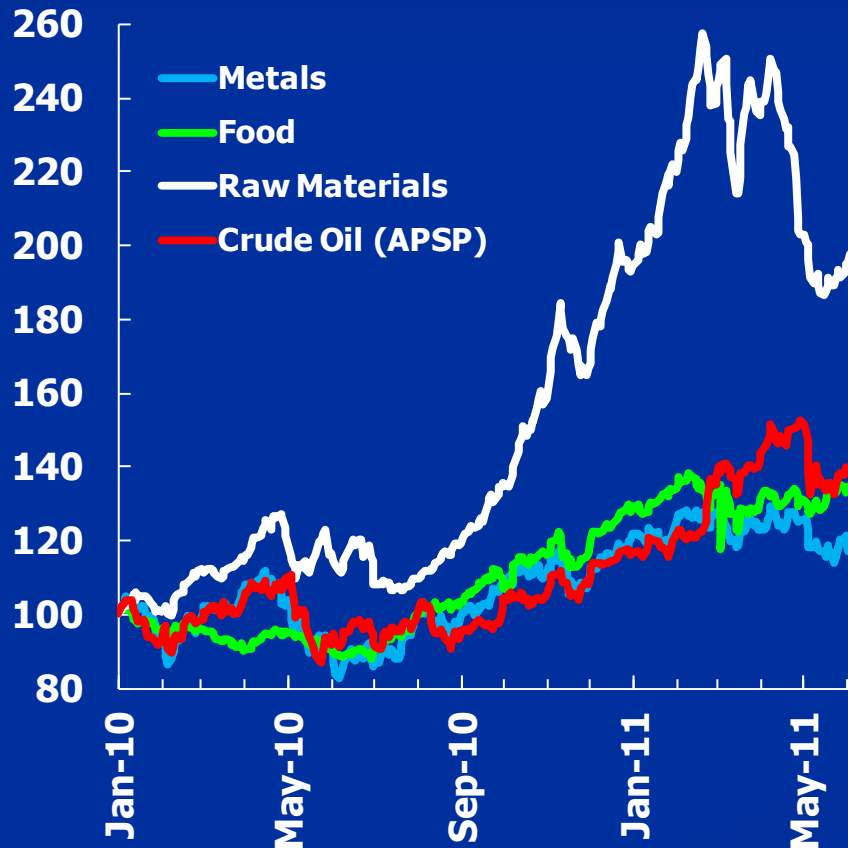


Source: GFSR, April 2011.  
Note: Includes 84 EU banks.

# Commodity prices have declined since April and supply disruptions from Japan should soon fade

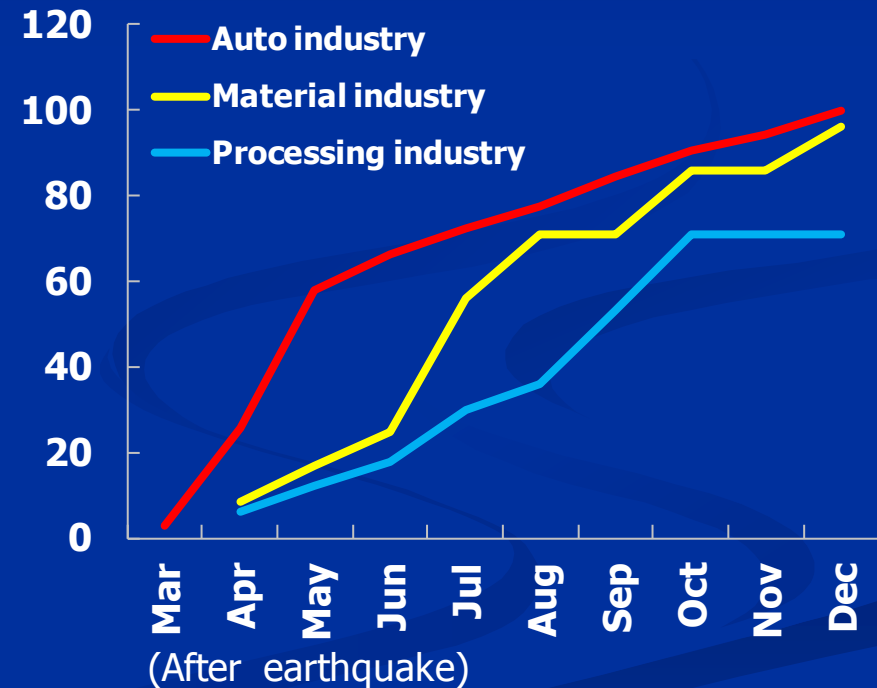
## Commodity Price Indices

(January 2010 = 100)



## Japan: Restoration of Capacity in Different Sectors

(Percent of firms with restored capacity)



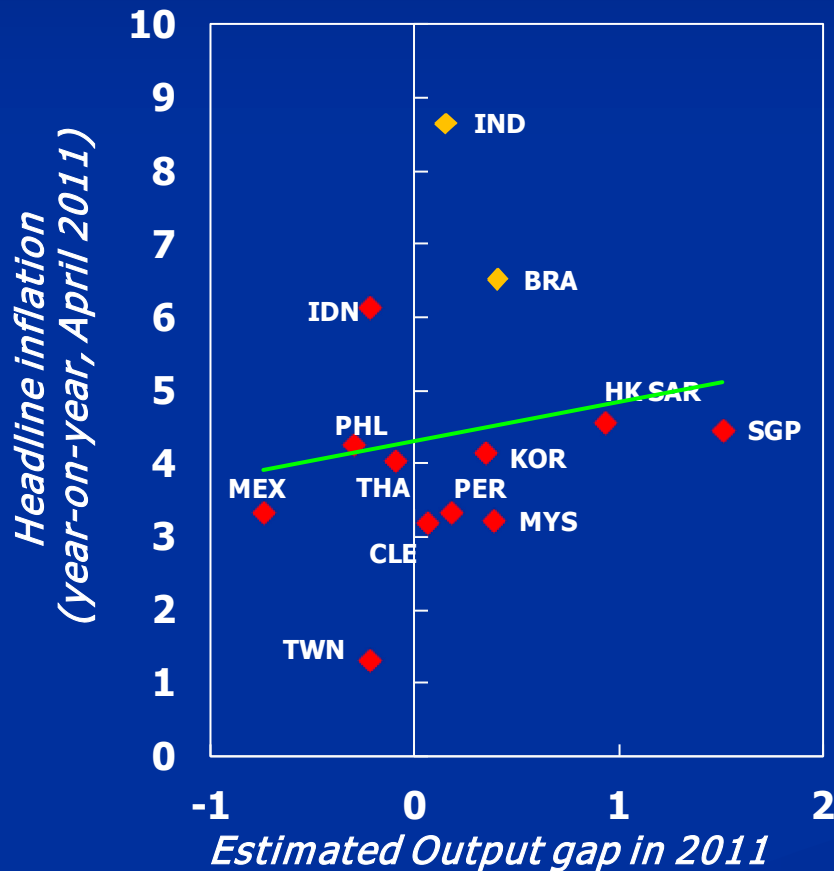
Source: METI and IHS Automotive.

Note: The chart is from April and restoration plans have been moved up by 1-2 months, but no new comprehensive survey data are available.

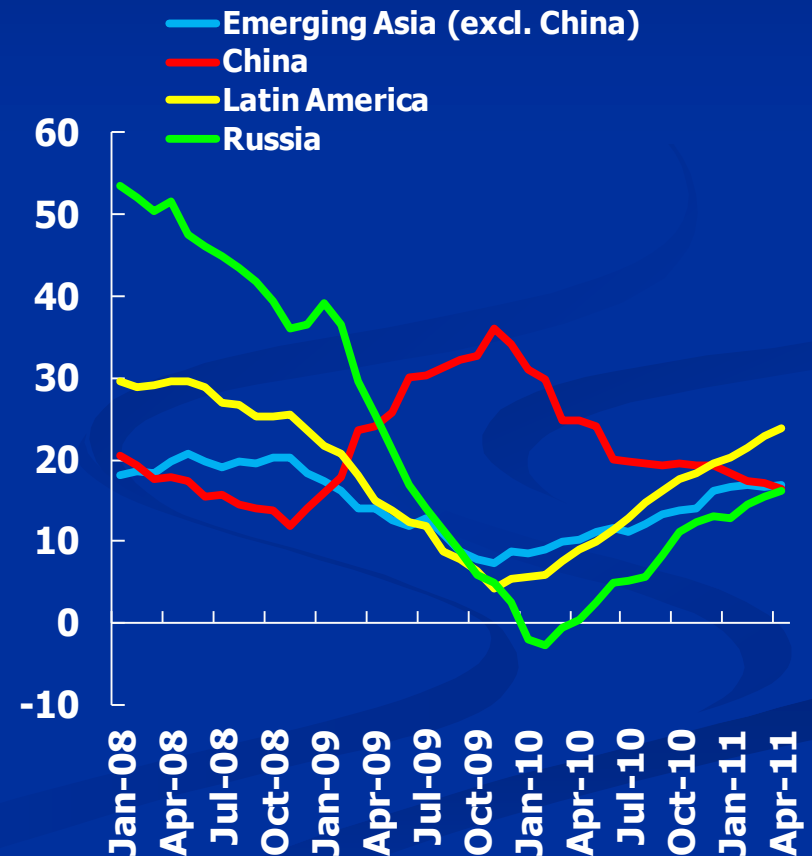


# Overheating is a concern in many EMs

**Output Gap and Inflation**  
(In percent)



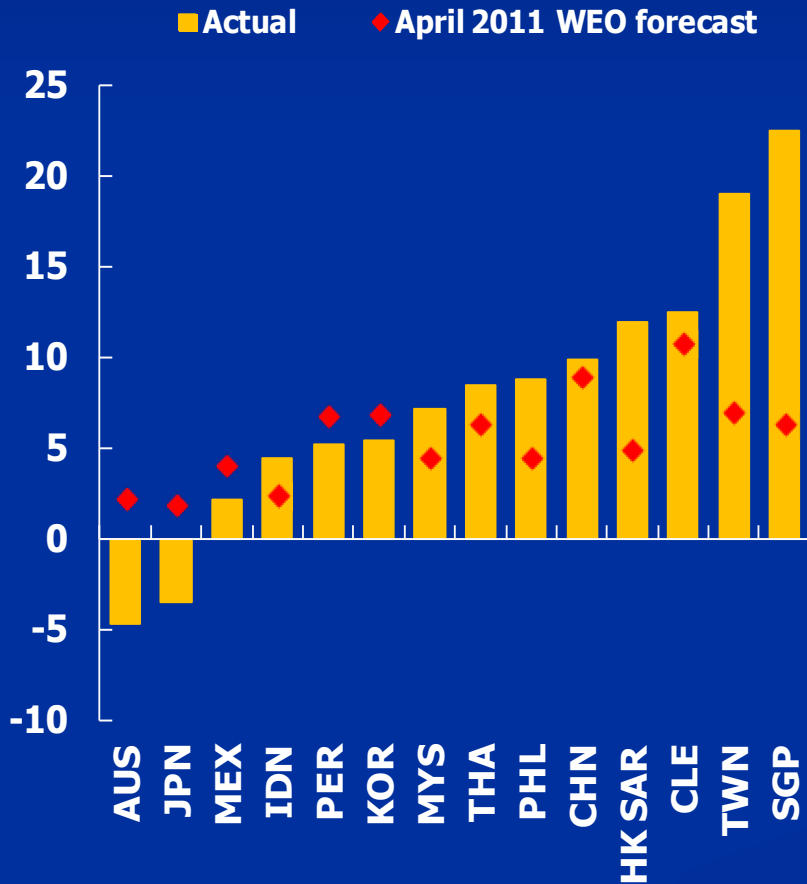
**Credit to Private Sector**  
(Year-on-year percent change)



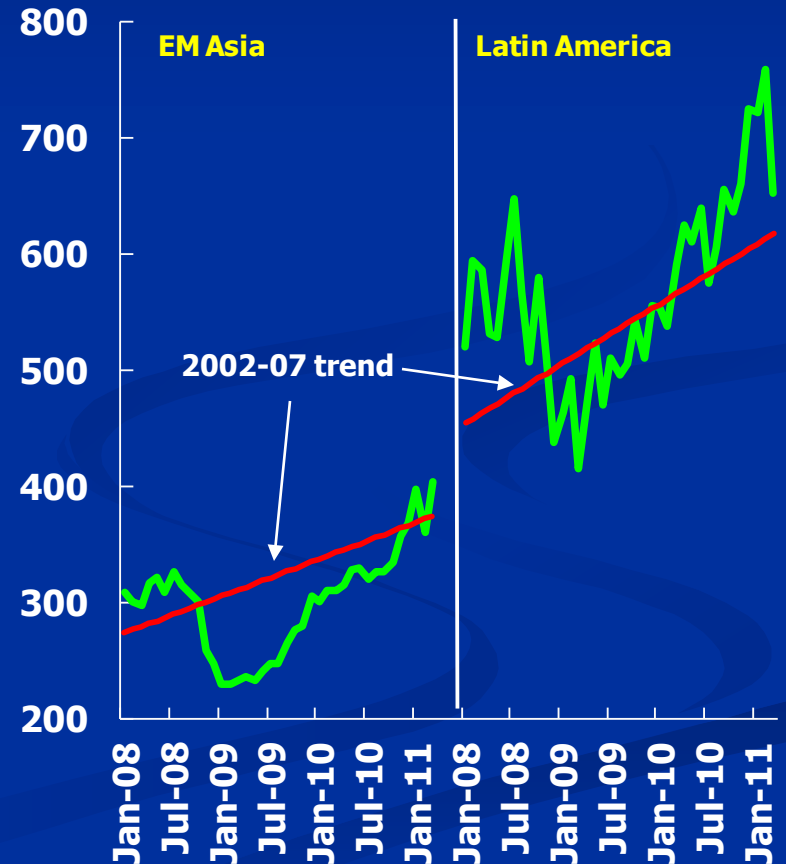
# Asian Growth Outlook

# Asian EMs started 2011 with strong momentum

**2011:Q1 GDP Growth**  
(q/q, in percent; SAAR)

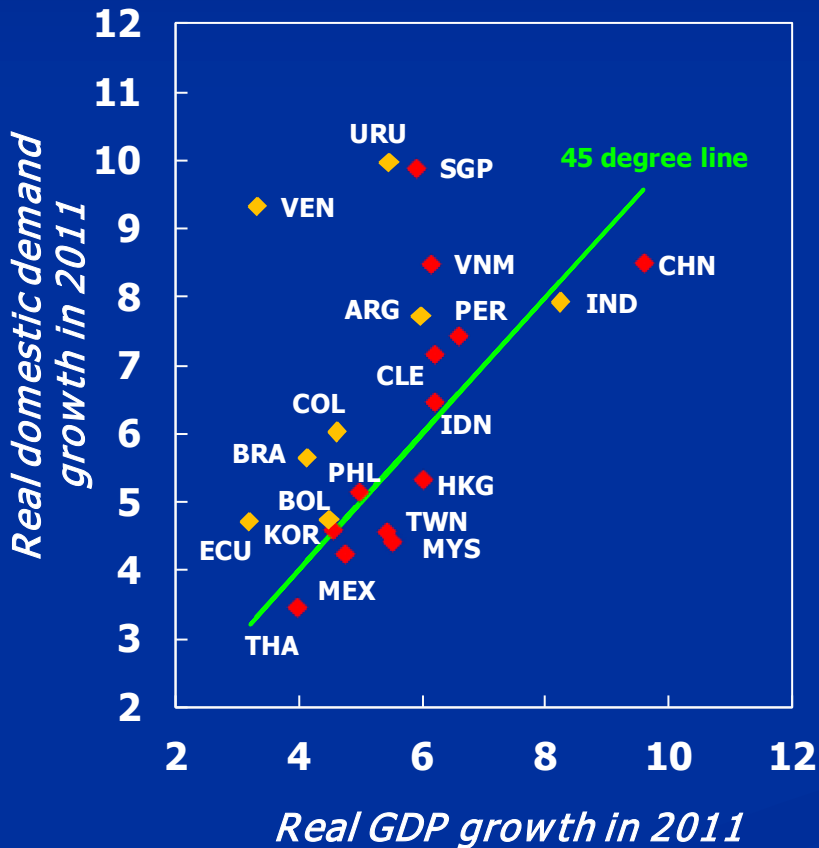


**Exports of Goods**  
(In billions of U.S. dollars, seasonally adjusted)

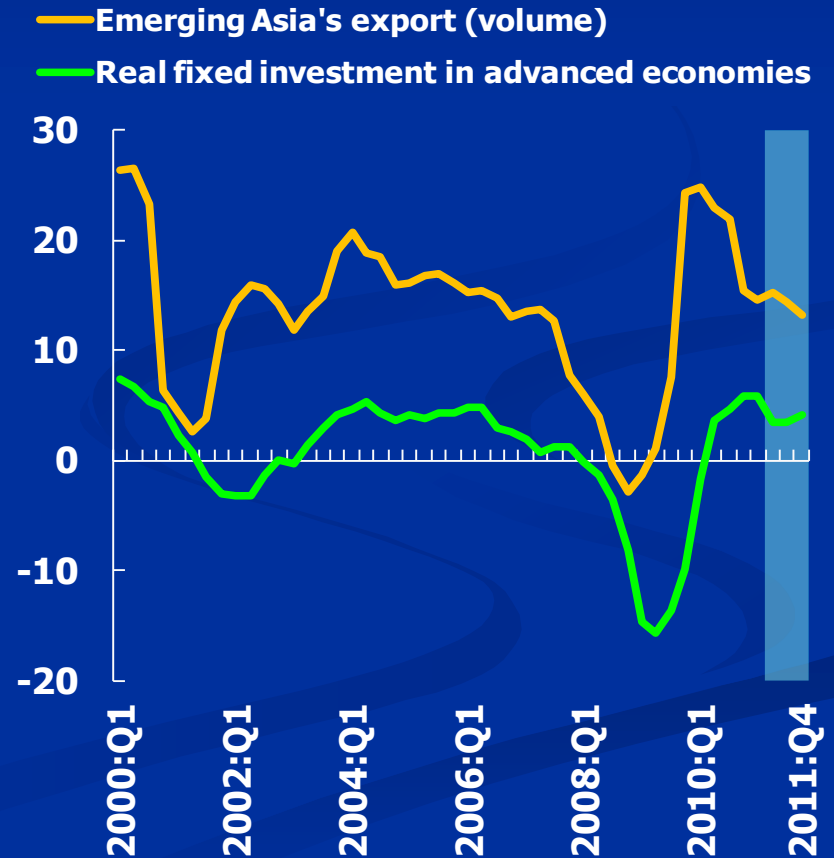


# Growth will be driven by exports in EM Asia and domestic demand in LATAM

**Domestic Demand and GDP**  
*(Year-on-year percent change)*

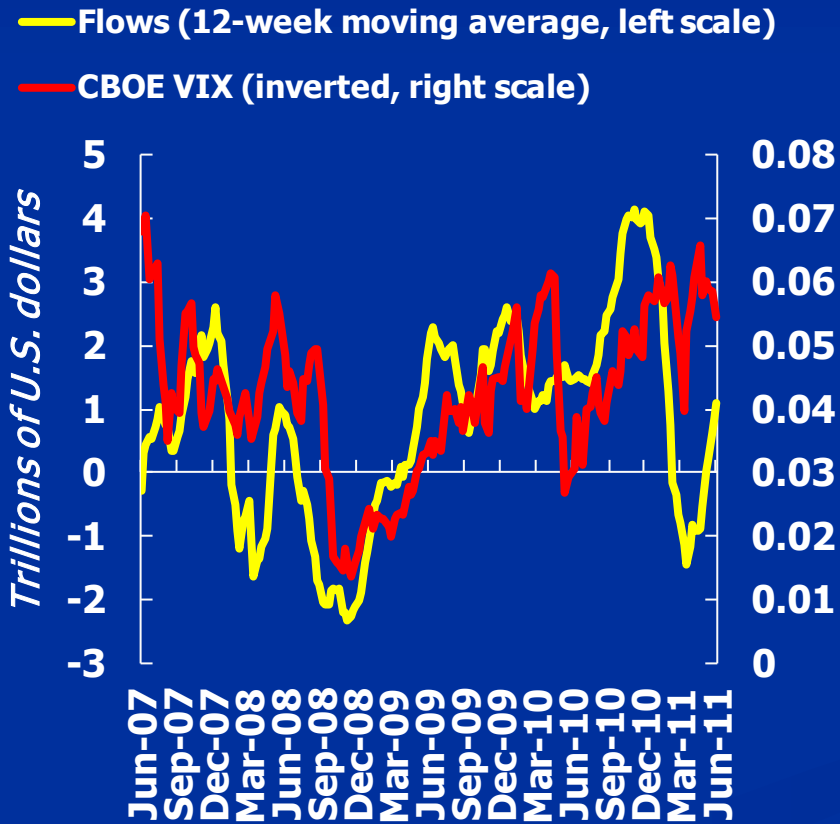


**Emerging Asia: Exports of Goods and Global Investment Cycle**  
*(Year-on-year percent change)*



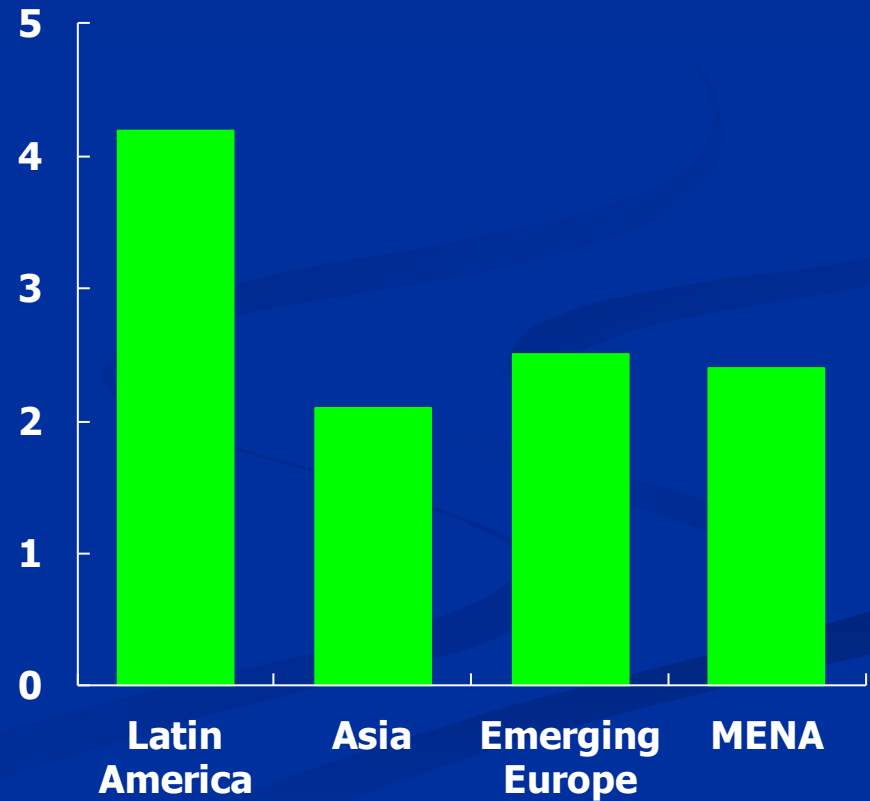
# Risks from capital inflows volatility...

**Weekly Flows into EM Equity and Bond Funds and Global Risk Aversion**



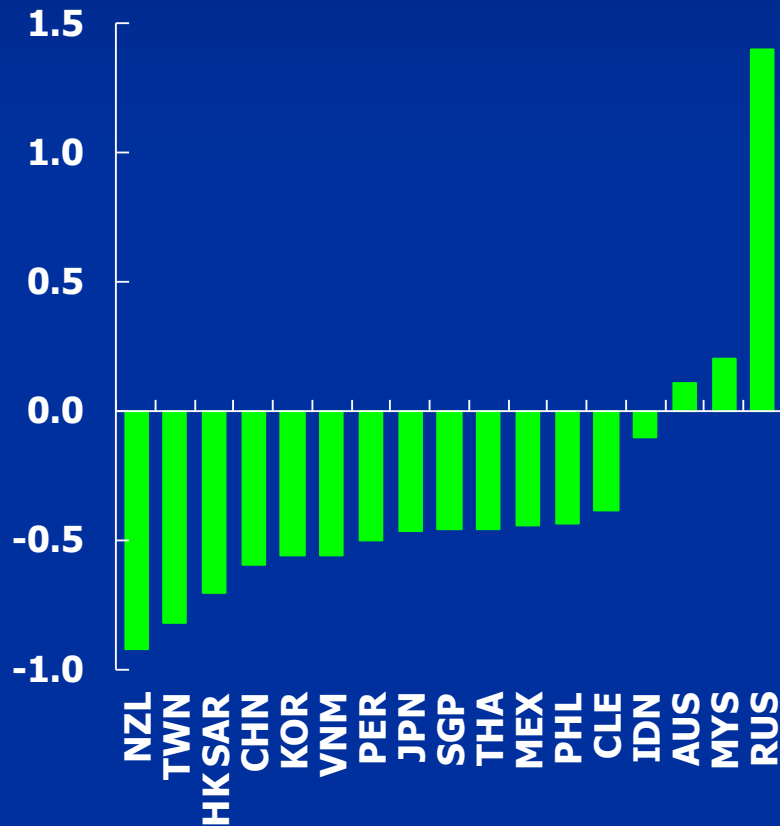
**Domestic Demand Growth in Episodes of Easy External Financing**

*(Difference of growth rates relative to non-episode years)*



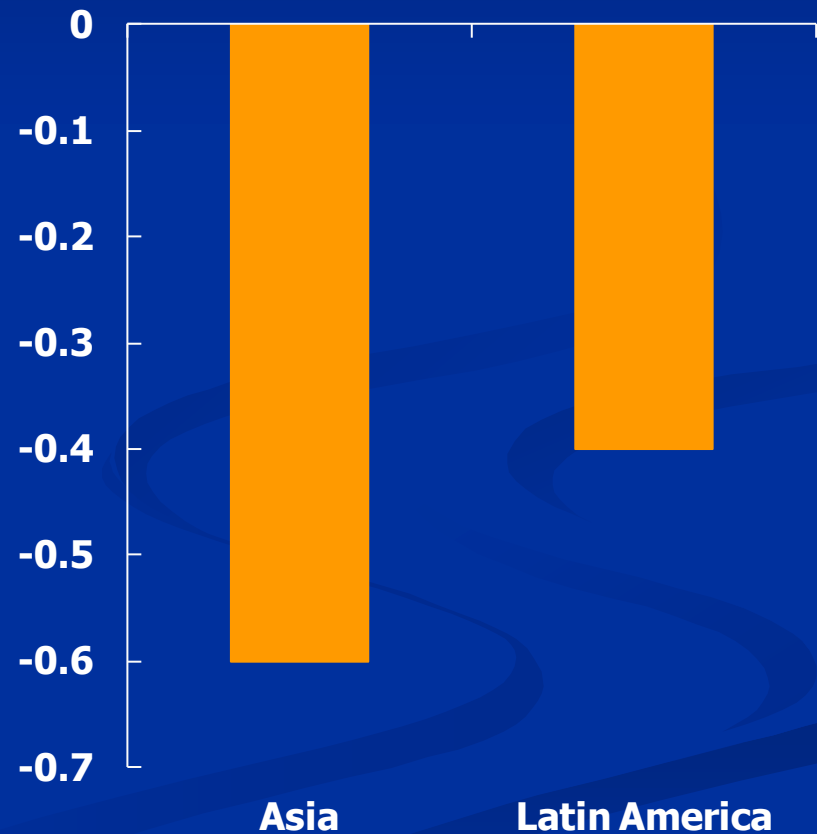
# ...further increases in oil prices, and a global slowdown

**Impact of Oil Price Shock on 2011 Growth**  
*(Deviation from baseline; in percentage points)*



Note: Impact of a 40 percent rise in oil prices from April 2011 WEO baseline assumption.

**Impact of Slowdown in U.S. Growth**  
*(In percentage points)*



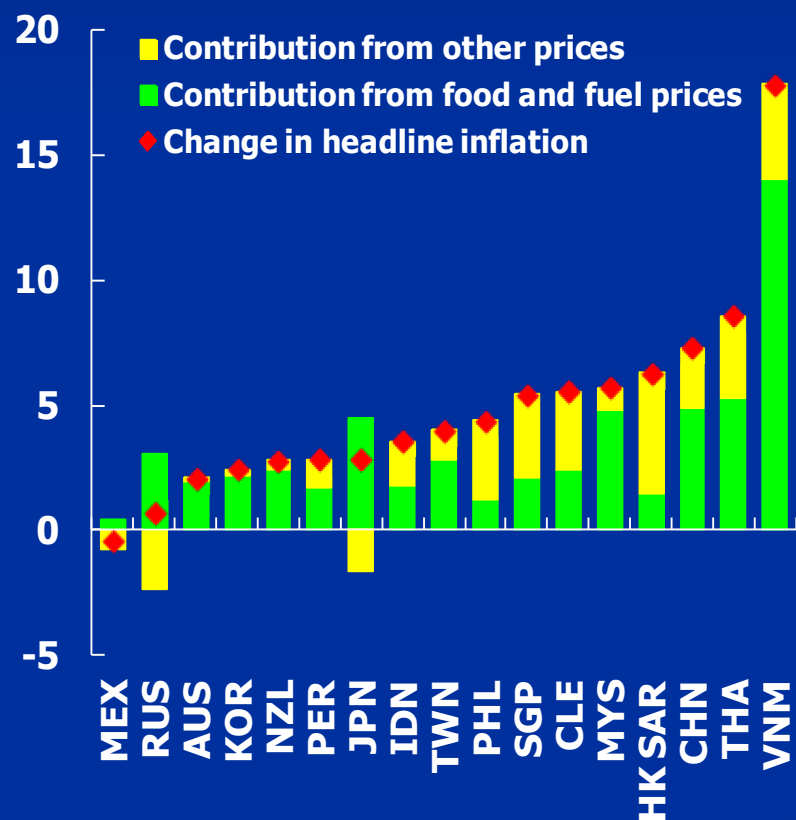
Note: Impact of a 1 percentage point slowdown in U.S. growth.

## Overheating: How Serious Are the Risks?

# A key risk for EMs is overheating: higher food and energy prices have spilled over to generalized inflation...

## Changes in Headline Inflation

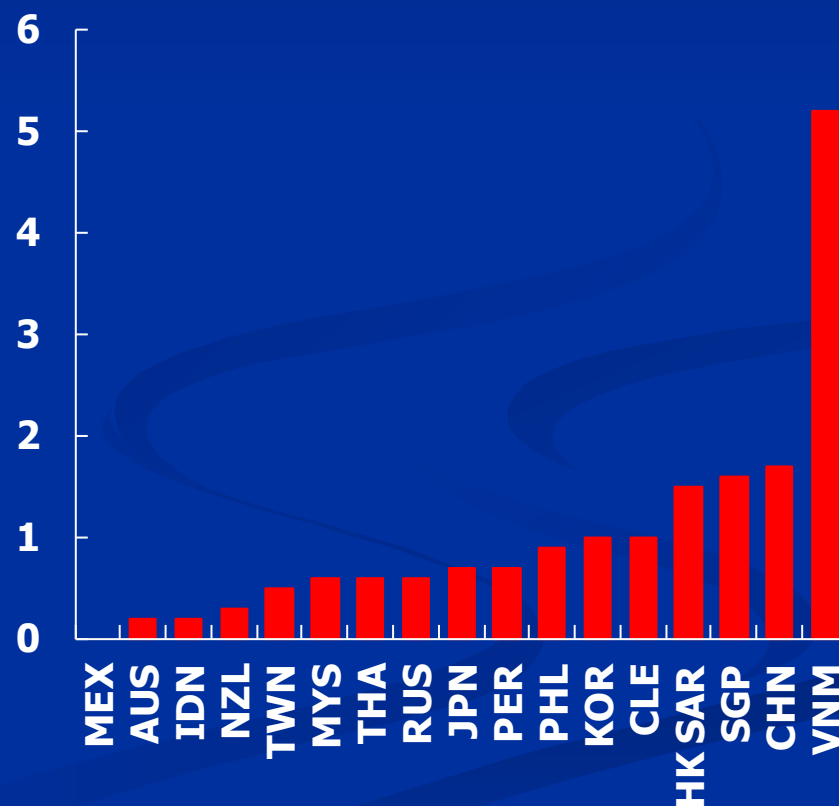
(As of May 2011; change since minimum inflation rate in 2009, in percentage points)



Note: Data for Hong Kong SAR, Japan, Malaysia, and Singapore are as of April 2011; and Australia and New Zealand are as of March 2011.

## Expectations of Annual Average Inflation in 2011: Change since October 2010

(In percentage points; as of May 2011)



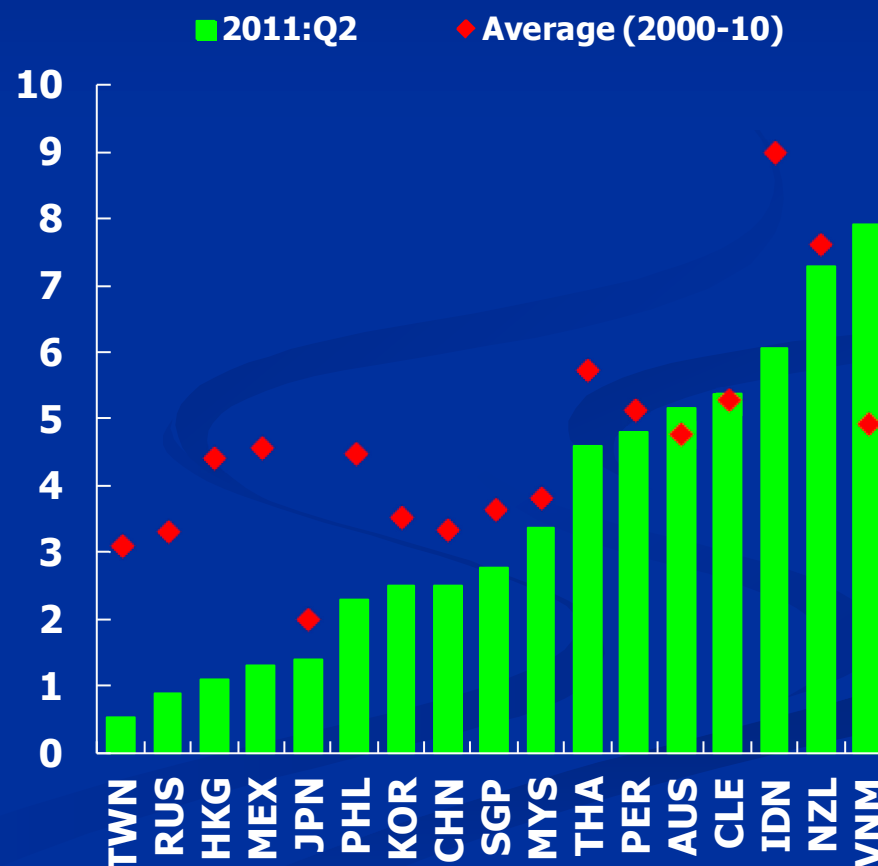


...as output gaps have closed and macroeconomic policies remained accommodative

Estimated Output Gap Closing Dates

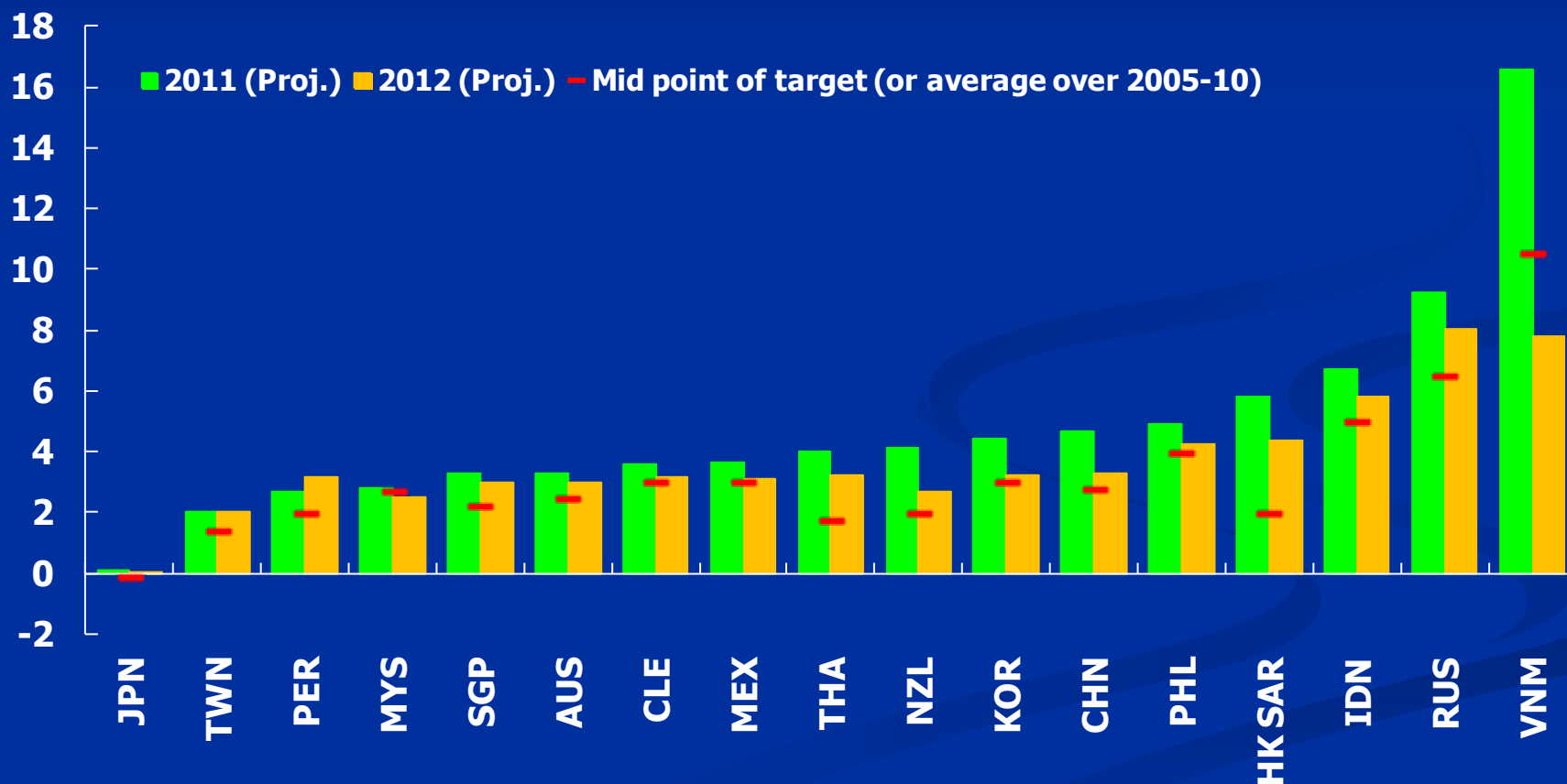


Real Lending Rates  
(In percent)



# Inflation is expected to generally peak in 2011 but to remain high

**Consumer Price Inflation**  
(Year -on-year; in percent)

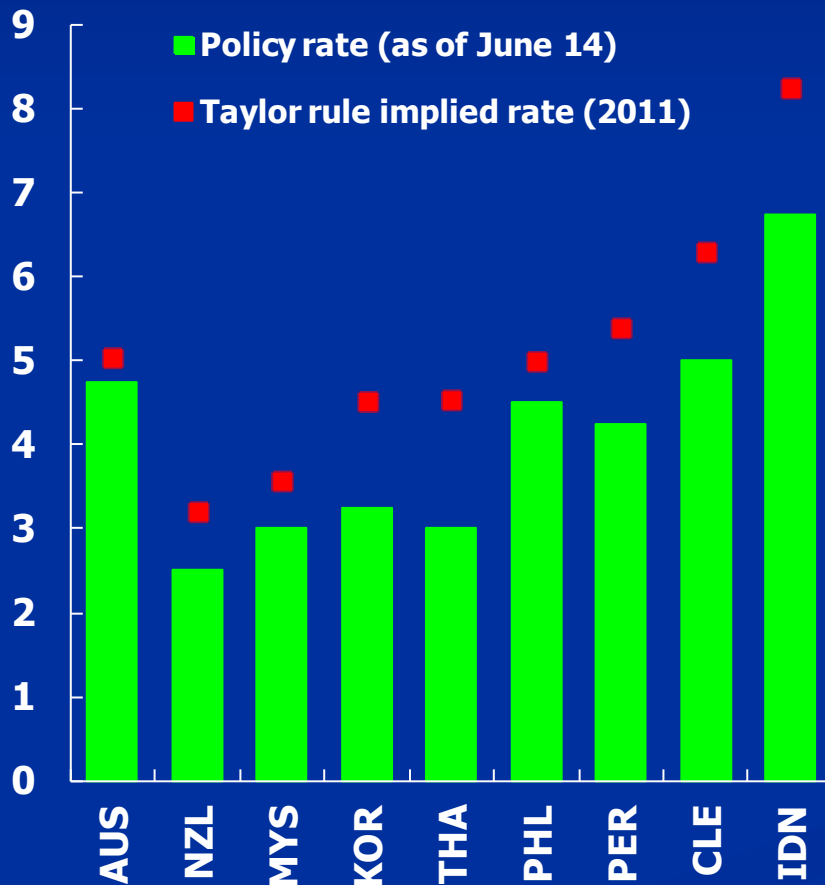


Note: Core inflation targets for Indonesia and Thailand.

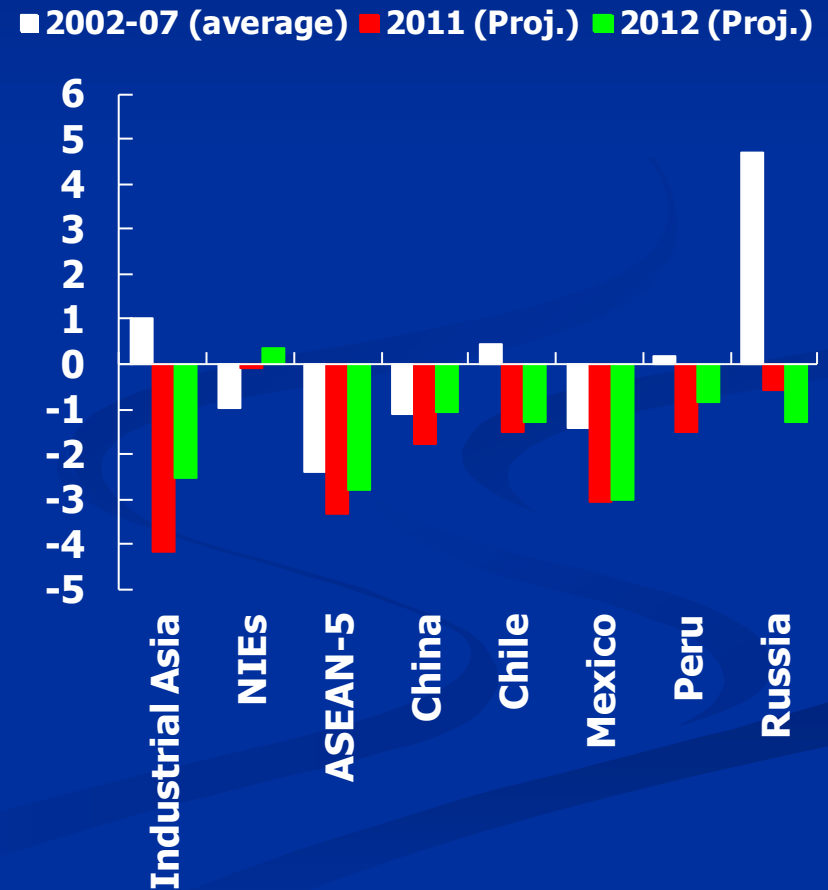
# Policy Challenges: Engineering A Smooth Landing

# Both monetary and fiscal policy tightening is warranted in economies facing generalized inflationary pressures

**Policy Interest Rates**  
(In percent)



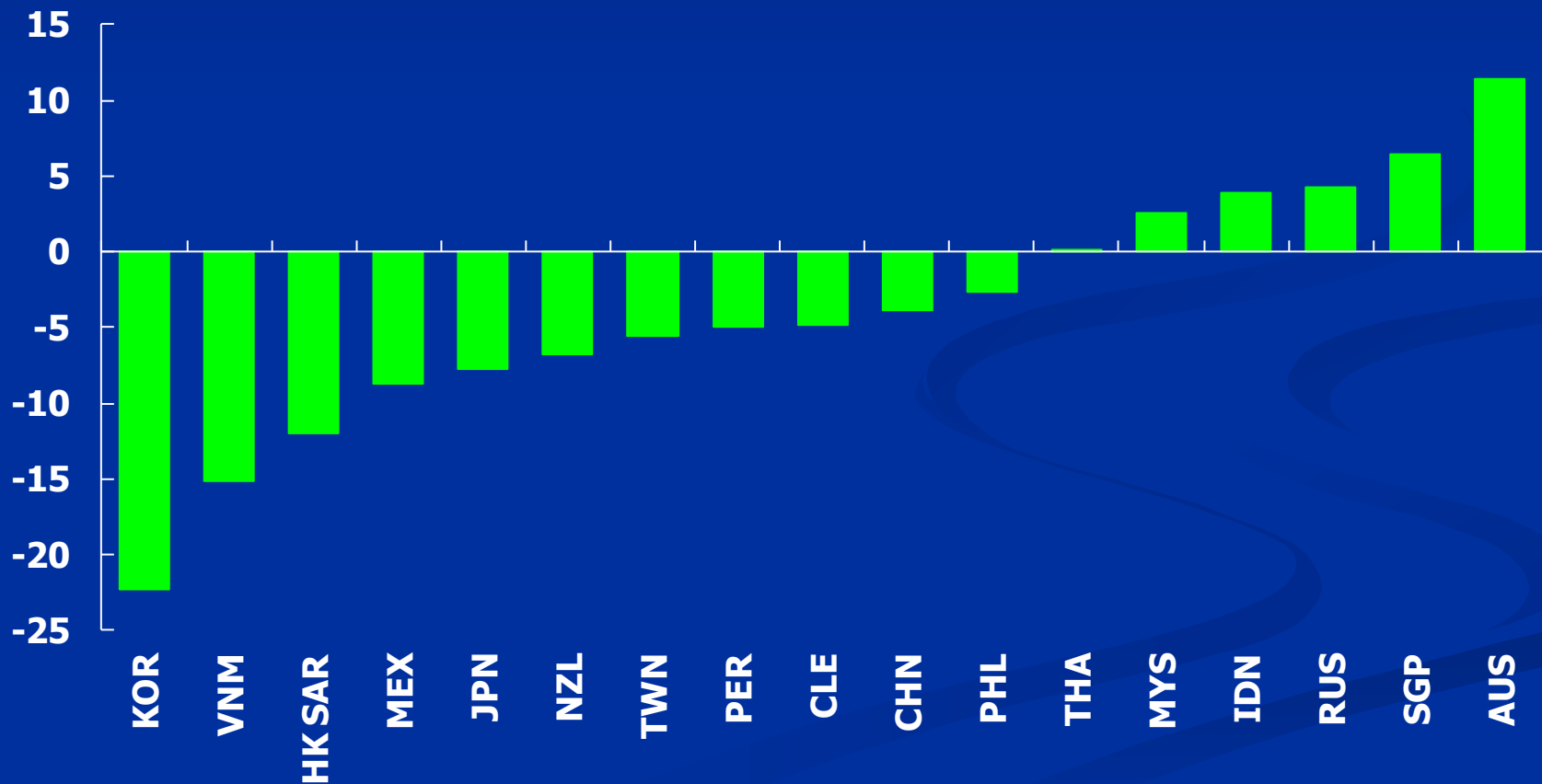
**Cyclically Adjusted Fiscal Balances**  
(In percent of GDP)



There is also room for further exchange rates appreciation, especially for a number of Asian economies

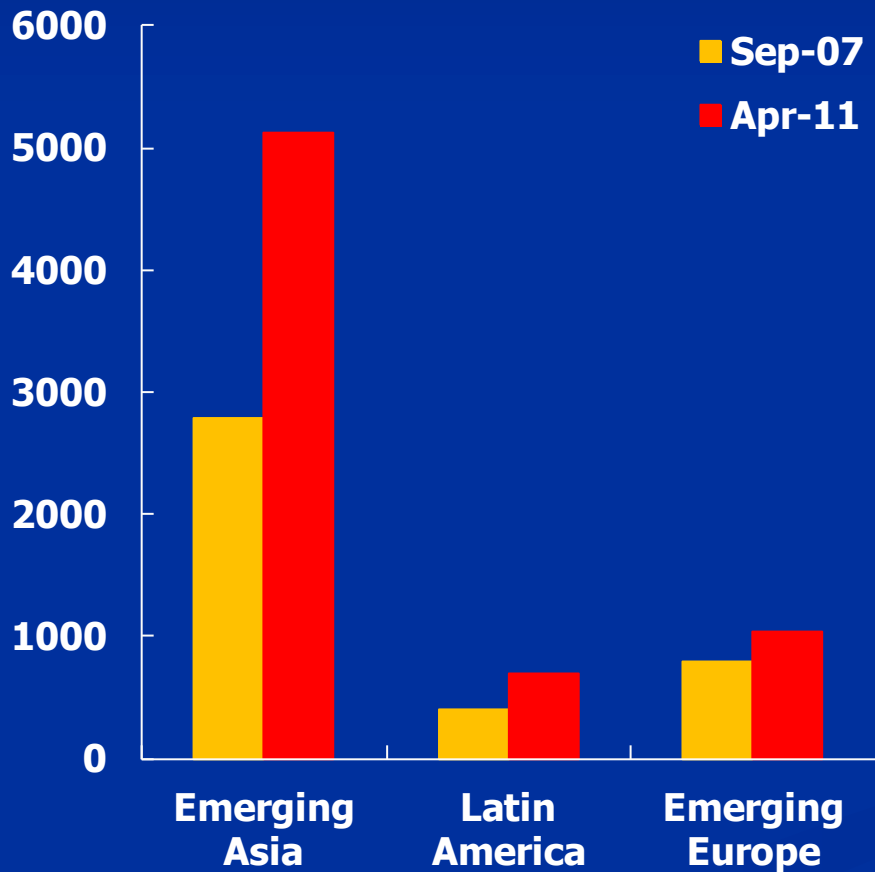
### Real Effective Exchange Rates

*(Percent change between peak during 2007-08 and April 2011; increase = appreciation)*

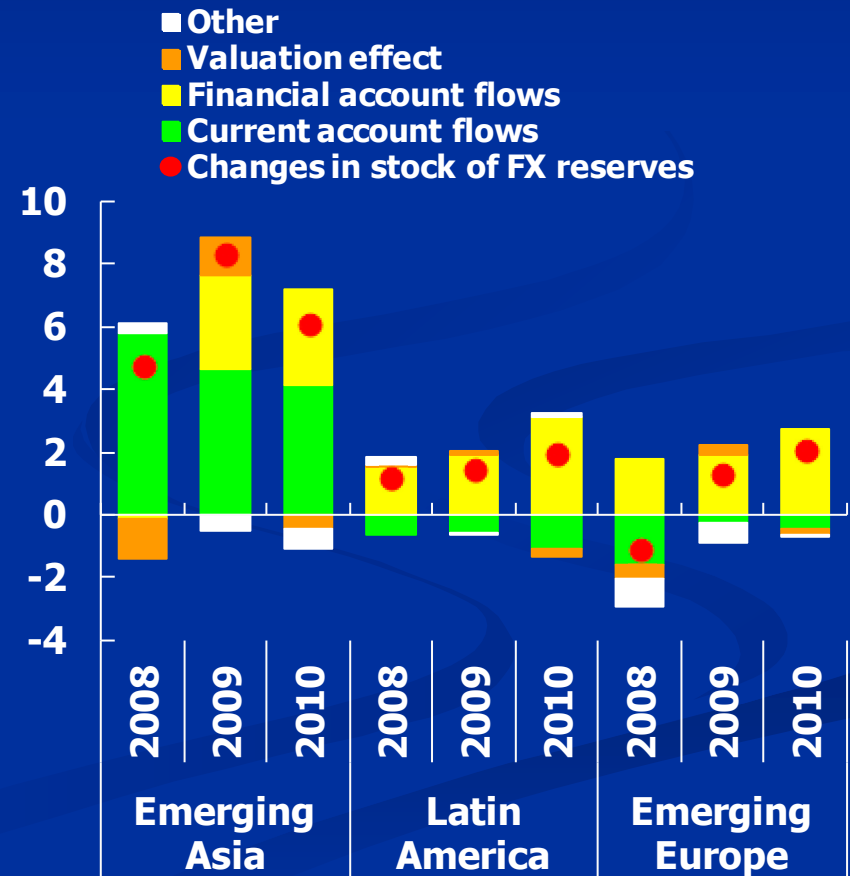


# Asian economies have generally reacted to large capital inflows by accumulating reserves

**Stock of FX Reserves**  
(In billions of U.S. dollars)

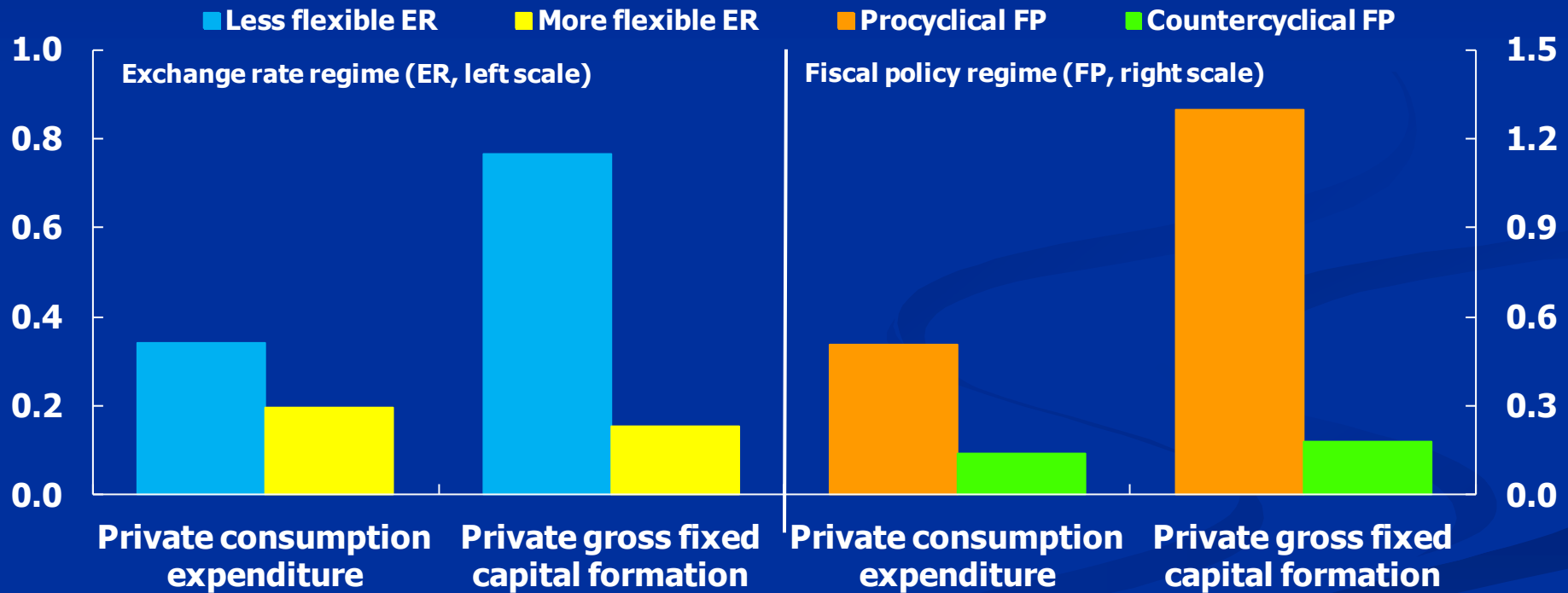


**Sources of Change in Stock of FX Reserves**  
(In percent of GDP)



# More exchange flexibility and fiscal prudence would also provide a buffer against risks from volatile capital inflows

**EM Asia: Response of Private Domestic Demand to Non-FDI Net Capital Flows by Policy Regimes**  
(In percentage points, 4-quarter cumulative response)



**Note:** Average response of quarter-on-quarter seasonally adjusted growth rate to an increase in portfolio and other investment flows by 1 percentage point of GDP. Emerging Asia includes ASEAN-4, India, Korea, and Chinese Taipei.

## Conclusions

- In many Asian economies growth outlook remains strong but overheating pressures have surfaced. Need to remain vigilant against the risk of credit/property prices cycles in a few regional economies.
- Dealing with these pressures requires tightening fiscal stances and stronger currencies. Higher policy interest rates should be part of the policy mix.
- Macro-prudential measures are a useful complement, not a substitute
- In addition to dealing with overheating risks, policymakers need to make sure that growth will be balanced and inclusive.





Thank You.