Executive Summary

One year after the deepest recession in recent history, Asia is leading the global recovery. The pace of the recovery in advanced economies has been held back by high unemployment rates, weak household balance sheets, and anemic bank credit, and it remains heavily dependent on macroeconomic policy support. By contrast, activity in many emerging and developing markets has continued to rebound swiftly over the course of 2009 and in the first quarter of 2010, particularly in Asia. The pattern of economic recovery has varied within Asia, with the more domestically oriented economies (China, India, and Indonesia) and Australia escaping a recession, and the more export-oriented economies experiencing a sharply V-shaped business cycle. By the end of 2009, output in most of Asia had returned to pre-crisis levels, even in those economies hit hardest by the crisis.

Asia's faster recovery relative to the rest of the world seems to mark a break from the past. Although Asia's GDP trend growth has exceeded that of advanced economies over the last three decades, this is the first time that Asia's contribution to a global recovery has outstripped that of other regions. Furthermore, while in past recessions Asia's recovery generally was driven by exports, this time it has also been reinforced by resilient domestic demand, particularly household consumption. Finally, while in past recoveries capital was slow to return to Asia, this time net capital inflows to the region have surged, a reflection of extremely high levels of global liquidity but also a testament to Asia's improved resilience and economic framework.

As discussed in Chapters I and II, over the near term, Asia is expected to continue leading the global recovery, for two main reasons. First, the global and domestic inventory cycle is likely to boost Asia's industrial production and exports further for most of 2010 as demand finally recovers in advanced economies. Second, although macroeconomic policies may become less accommodative, private domestic demand is expected to remain robust. With the recovery of economic activity becoming more entrenched, many governments are now planning a gradual withdrawal of both fiscal and monetary policy stimulus. In many regional economies, however, private domestic demand appears to have sufficient momentum to sustain near-term growth, as high asset values, strong consumer confidence, and a gradual improvement in employment conditions are expected to sustain consumption, while the return of capacity utilization to more normal levels is expected to boost investment.

The pace of the recovery will, nonetheless, remain uneven across Asia. In China, growth is expected to return to double digits in 2010, with private domestic demand boosted by measures to increase consumption and private investment. This is having positive spillovers for the rest of the region, as Chinese demand boosts imports, particularly of commodities and capital goods. Given this strength in demand, the authorities have begun to stem the very rapid growth of credit in order to safeguard the quality of bank balance sheets. In Japan, private sector demand continues to face severe headwinds despite the recovery in the export sector, and inflation has fallen back into negative territory, requiring the authorities to reiterate their commitment to prolonged policy accommodation.

Asia's relatively strong cyclical position may pose near-term risks to this outlook, particularly if bright growth prospects and widening interest rate differentials with advanced economies lead to further capital inflows to the region. These inflows could lead to overheating in some economies and increase their vulnerability to a strong upswing in the credit and asset price cycles, with the propensity for a subsequent abrupt reversal. Although asset-price inflation in Asia has so far been generally contained, the increase in excess liquidity in many regional economies over the course of 2009 raises concerns. Policymakers will need to be attentive to safeguarding the macroeconomy and financial system against the build-up of imbalances in local asset and housing markets.

Over the medium term, Asia's main policy challenge will be to ensure that private domestic demand becomes a more prominent engine of growth. Once the adjustment in inventories has run its course, Asia's exports to advanced economies should moderate somewhat, as domestic demand in these economies is expected to remain below pre-crisis levels, undermining global demand. Even in a best case scenario, China will provide only a partial offset to the weaker demand from advanced economies, given the relatively small size of Chinese consumption and its import of consumer goods. The global crisis has highlighted the importance for Asia of a second, domestic "engine of growth" that can substitute for lost demand from the industrialized world and lessen the impact of external shocks on Asian economies. This private domestic demand will need to be nurtured primarily through a range of structural reforms in the region.

Indeed, Chapter III suggests that Asia has remained heavily dependent on external demand—more than other regions. Rebalancing toward domestic demand will require many regional economies to act across a range of areas. Some economies may need to increase consumption, others will need to increase investment, and many will need to boost productivity in service sectors. A comprehensive package of measures adopted in the region—including fiscal measures, reforms in product, labor, and financial markets and more exchange rate flexibility—will critically contribute to the rebalancing of global demand.