

# Asia and Pacific Economic Outlook

## *Medium-Term Challenges in the Region: Implications of the “New Mediocre”*

### OAP Economic Issues Seminar

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## Key messages and roadmap

- Asia remains the main engine of global growth.
- In the medium-term, Asia needs to prepare for the risk of a “new mediocre” in advanced economies.
- The global trade slowdown and anti-trade sentiment can hit Asia hard—Asia needs more balanced and inclusive growth.
- May need to re-assess projections given developments since October projections.



# Growth Outlook in Asia






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Asia remains the global growth engine with mostly upward growth revisions

## Growth Projections: Selected Asia (October Projections)

(percent change from a year earlier)

	 World	 Asia	 China	 Japan	 India	Australia and New Zealand	ASEAN	APD Small States
<b>2015</b>	<b>3.1</b>	<b>5.4</b>	<b>6.9</b>	<b>0.5</b>	<b>7.6</b>	<b>2.6</b>	<b>4.7</b>	<b>3.3</b>
<b>2016</b>	<b>3.1</b>	<b>5.4</b>	<b>6.6</b>	<b>0.5</b>	<b>7.6</b>	<b>2.8</b>	<b>4.8</b>	<b>3.0</b>
Revision from Apr. 2016	-0.1	0.1	0.1	0.0	0.2	0.4	0.0	-0.3
<b>2017</b>	<b>3.4</b>	<b>5.3</b>	<b>6.2</b>	<b>0.6</b>	<b>7.6</b>	<b>2.7</b>	<b>5.1</b>	<b>3.3</b>
Revision from Apr. 2016	-0.1	0.1	0.0	0.6	0.1	-0.2	0.0	-0.1

Source: IMF staff.

Note: Figures for India are on a fiscal year basis.

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# Asia: Risks to the outlook

## Near-term:

- Weak global recovery and global trade slowdown
- Sudden tightening of global financial conditions (asynchronous monetary policies in AEs, de-risking)
- China rebalancing, if bumpy
- Natural disasters and geopolitical tensions

## Medium-term:

- “New mediocre” in advanced economies

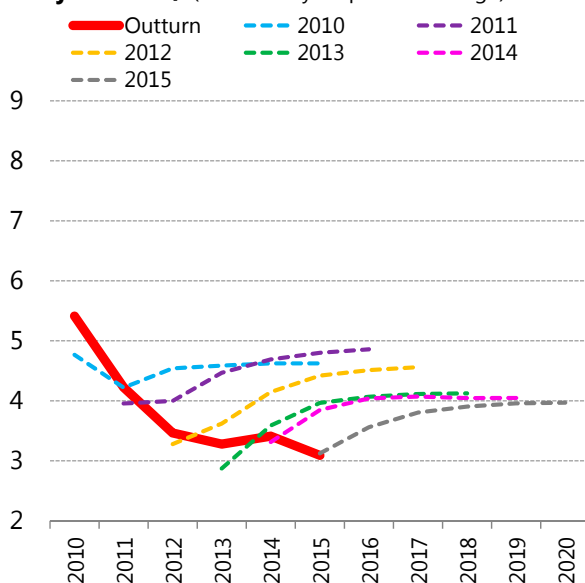
**Developments since October Projections:** e.g. Upside surprises in Q3 growth, U.S. elections, and India “demonetization”



# Asia’s growth has moderated in recent years...

**World: GDP Growth Outturns vs. WEO**

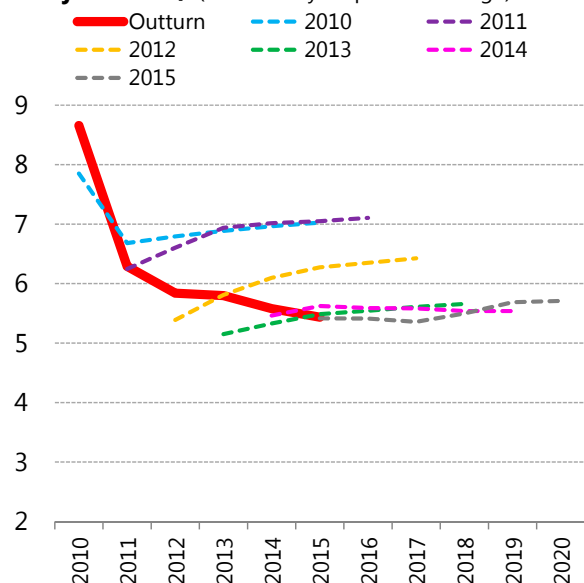
Projections 1/ (Year-over-year percent change)



Sources: IMF, WEO database; and IMF staff calculations.  
1/ 5-yr forward projections from October WEO in each year.

**Asia: GDP Growth Outturns vs. WEO**

Projections 1/ (Year-over-year percent change)

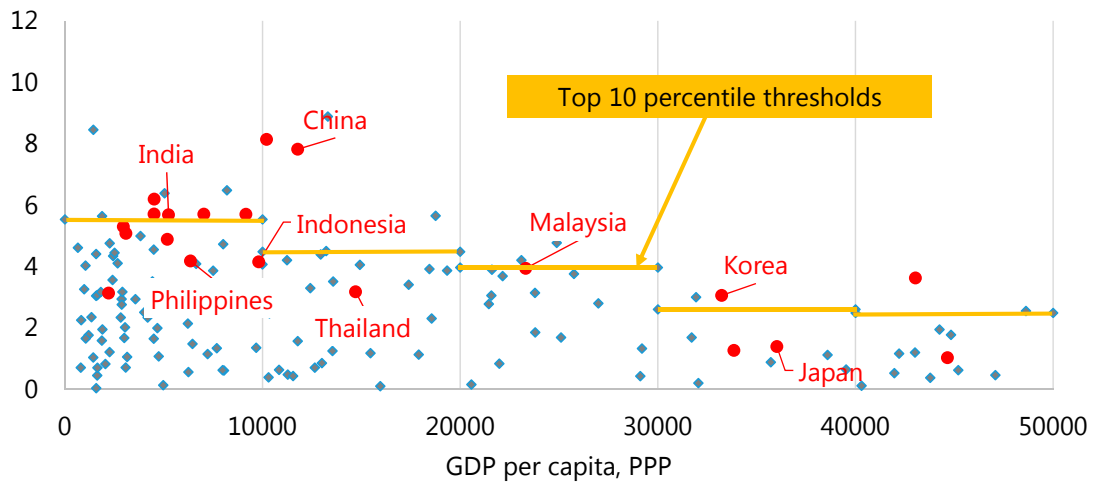


Sources: IMF, WEO database; and IMF staff calculations.  
1/ 5-yr forward projections from October WEO in each year.



... which may be due to growth convergence, but other factors as well

### Real GDP per Capita Growth: 2010-2015 (percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
Note: Red dots represent major Asian countries, and yellow lines indicate top 10 percentile GDP growth rate within each income group.

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## Recent Developments

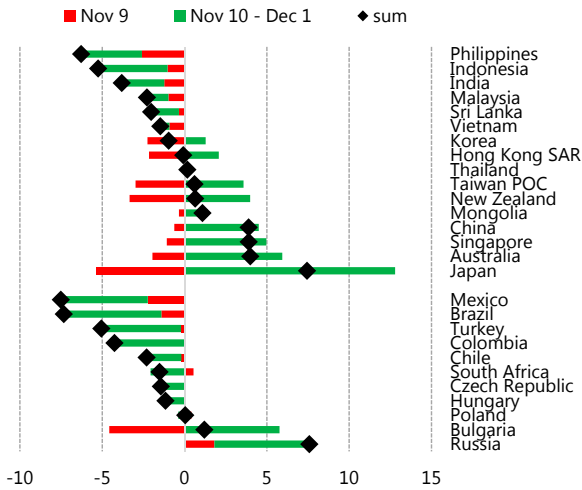
- Upside surprises in Q3 growth
  - Primarily in U.S. and Japan, but also in parts of emerging Asia
- U.S. elections
  - Tighter financial conditions
  - But too early to assess overall impact
- India “demonetization”
- Other: e.g., Japan and Korea

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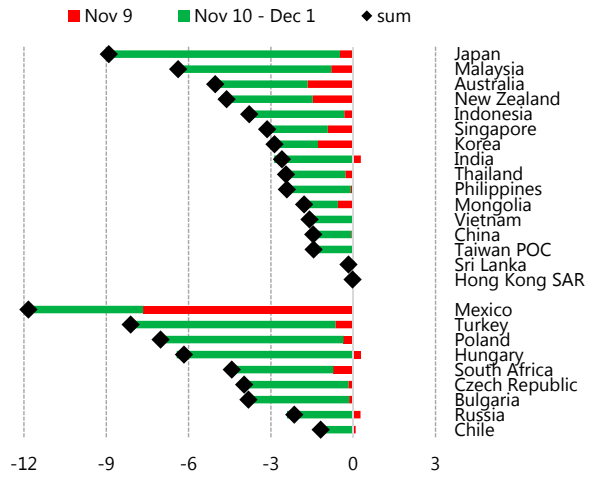


# Market reaction to U.S. presidential elections

**Selected Asia: Stock Market Index**  
(Percent change; in local currency)



**Selected Asia: Bilateral FX Rate against USD**  
(Percent change; positive=local currency appreciation)



Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations.



## What Does the “New Mediocre” Mean For Asia?



## Asia is diverse but there are three broad groups in relation to the “new mediocre”

- **Group 1 (Japan):** stagnation has been present for more than two decades, well before other advanced economies were hit.
- **Group 2 (China, Korea, Singapore, and Thailand):** looming rapid aging and demographics pressures; slowdown in productivity growth.
- **Group 3 (India and other fast growing economies, such as Indonesia, Malaysia, Vietnam):** not at risk of stagnation domestically but can be affected through spillovers.

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## Signs of the “new mediocre” in Asia?

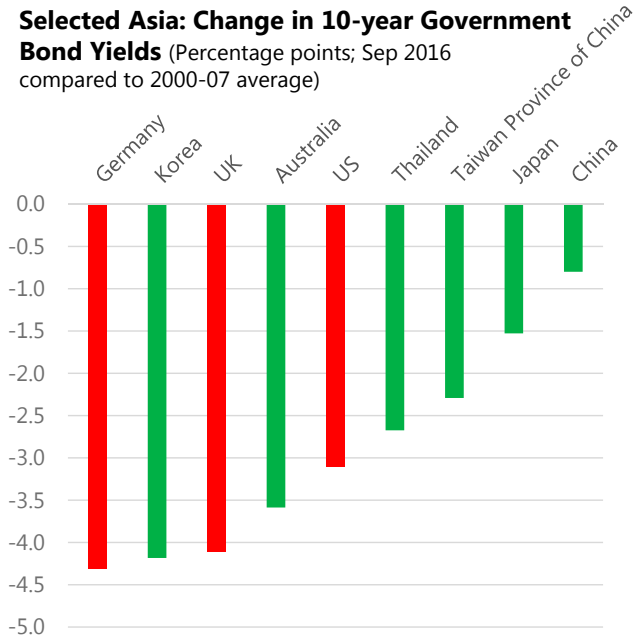
- Long-term interest rates declining?
- Natural (or neutral) interest rates declining?
- Low inflation becoming more common?
- Demographics becoming a headwind?
- Productivity growth declining?
- Trade slowdown in Asia?

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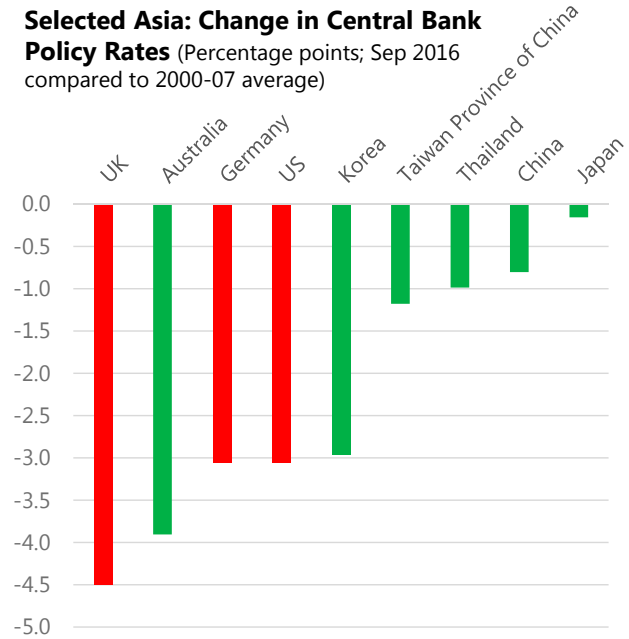


## Long-term rates have fallen significantly in some cases, but not everywhere

**Selected Asia: Change in 10-year Government Bond Yields** (Percentage points; Sep 2016 compared to 2000-07 average)



**Selected Asia: Change in Central Bank Policy Rates** (Percentage points; Sep 2016 compared to 2000-07 average)



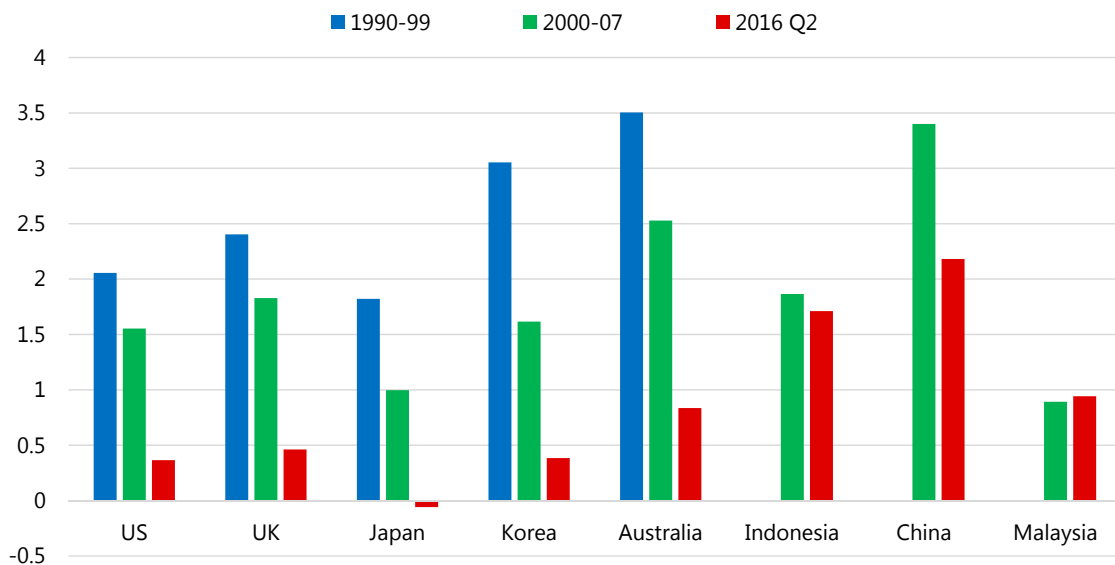
Sources: Bloomberg; and IMF staff calculations.

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## Natural interest rates have declined in some cases, but not everywhere

**Selected Asia: Estimated Natural Real Interest Rates** (Percent)



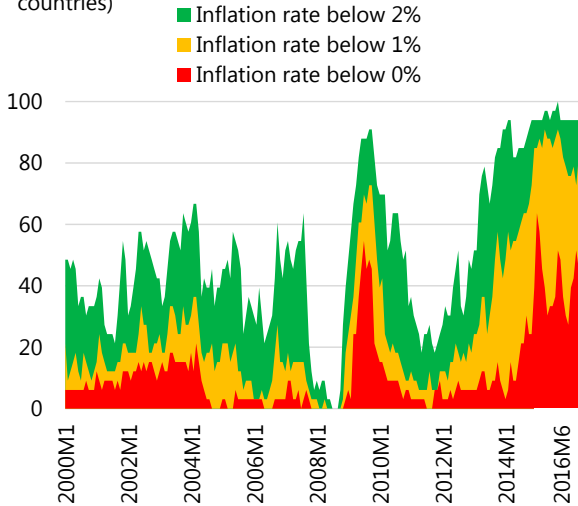
Source: Staff estimates based on a TVP-VAR for three variables – real GDP growth, inflation and a measure of real rate.  
 Note: The conditional long horizon forecast (over 5 years) of the observed real rate is used as a measure of neutral rate.

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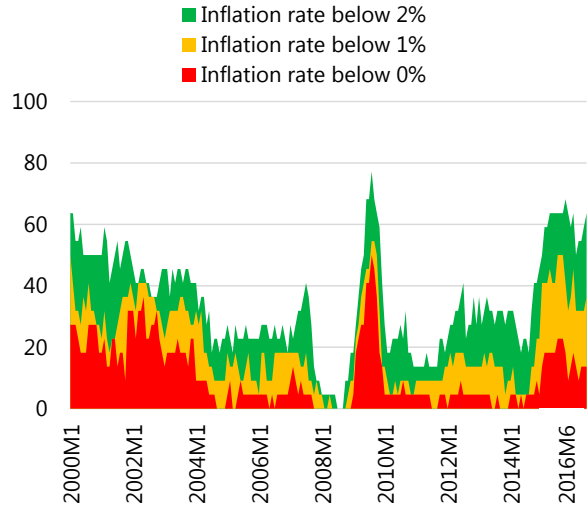
# Low inflation becoming more common across the region

**Advanced Economies: Number of Countries by Headline Inflation Rates** (Percent of 33 countries)



Sources: IMF, *Global Data Source*; and IMF staff calculations.

**Asia: Number of Countries by Headline Inflation Rates** (Percent of 22 Asian countries)

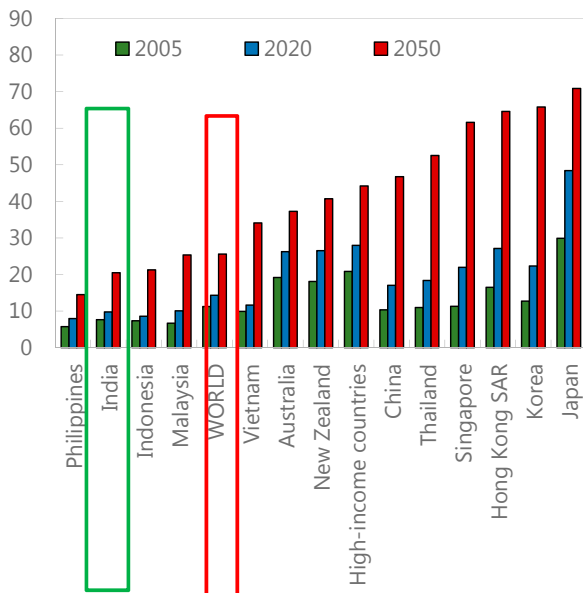


Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations.



# Demographics: A headwind for some, a dividend for others

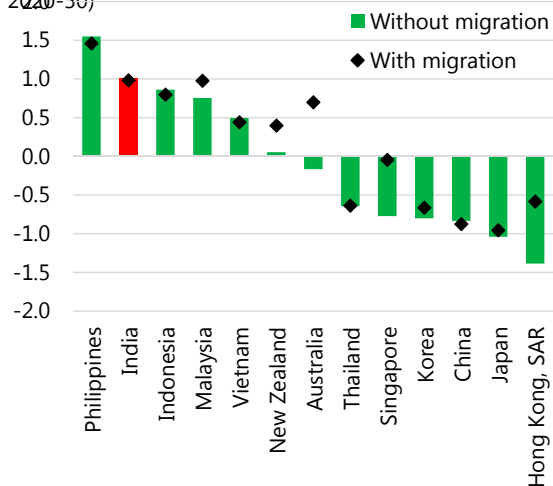
**Asia: Old-Age Dependency Ratios** (Percent)



Source: UN Population Prospects: 2015 Revision. Based on the medium-fertility variant scenario (with migration).

**Asia: Potential Growth Impact of Demographics Trends**

(Percentage point impact on real GDP growth; average over 2020-50)



Source: Staff estimates based on UN Population Prospects: 2015 Revision (medium-fertility variant) and IMF (2016).

Note: Migration projections follow historical trends. The growth impact estimates are based on the assumptions of unchanged labor force participation by cohort, constant capital-to-labor ratio, and TFP growth unchanged from historical average.

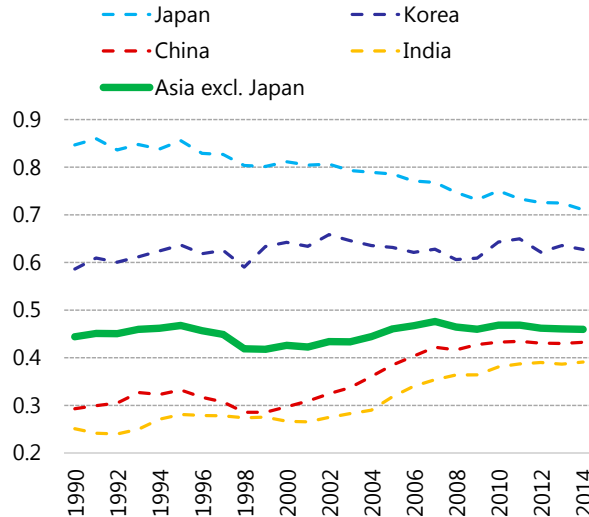




# Asia is catching up in terms of GDP, but not in productivity levels

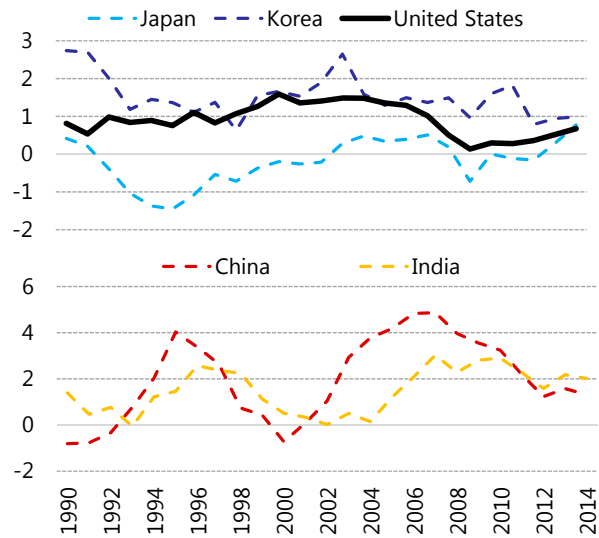
## Total Factor Productivity Level Compared to the United States

(At current PPPs; normalized as United States=1)



## Total Factor Productivity Growth

(Percent; 5-year moving average)



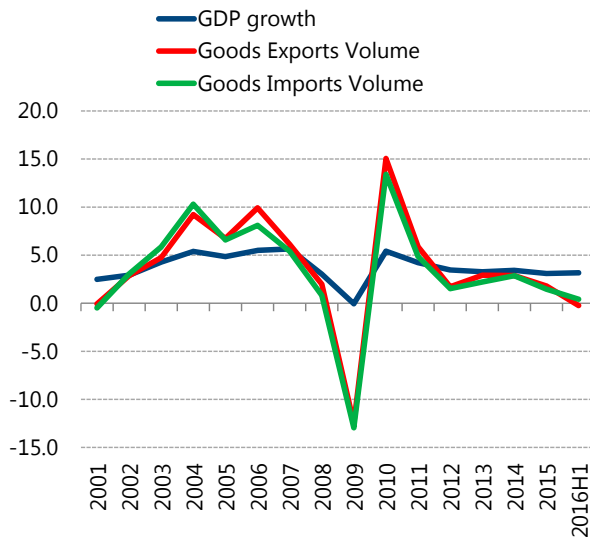
Sources: Penn World Table 9.0; and IMF staff calculations.



# Trade growth is weaker than GDP growth, especially in Asia

## World: GDP Growth and Trade Performance

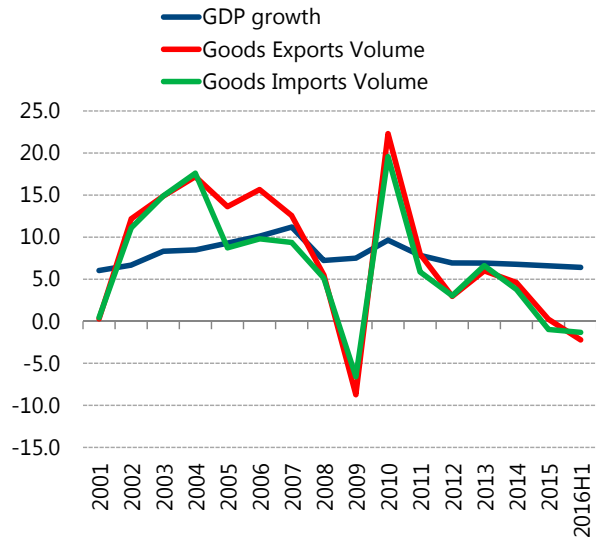
(Year-over-year percent change)



Sources: IMF, WEO database; CPB database; and IMF staff calculations.

## EM Asia: GDP Growth and Trade Performance

(Year-over-year percent change)



Sources: IMF, WEO database; CPB database; and IMF staff calculations.



## Signs of the “new mediocre” in Asia?

### To summarize:

- Long-term interest rates declining? → **Some**
- Natural (or neutral) interest rates declining? → **Some**
- Low inflation becoming more common? → **Yes**
- Demographics becoming a headwind? → **Some**
- Productivity growth declining? → **No catch-up**
- Trade slowdown in Asia? → **Yes**

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## Why should we be worried about the “new mediocre”?

### Lower growth can aggravate:

- Social and demographics pressures
- High leverage
- Trade tensions

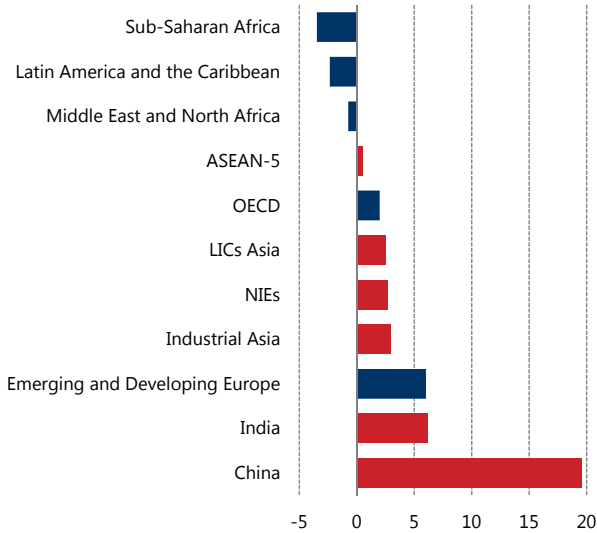
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# Income inequality in Asia has already risen and social spending in Asia is relatively low

## Change in Income Inequality

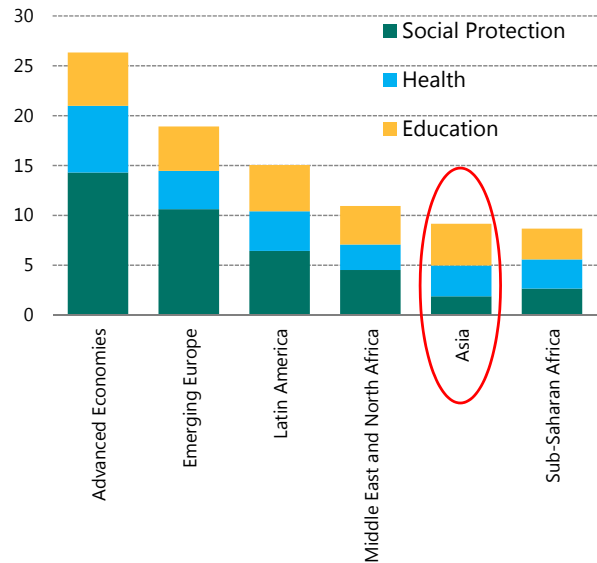
(Net Gini Index; change from 1990 to 2013; simple average across regions)



Sources: SWIID Version 5.0; IMF, WEO database; and IMF staff calculations.

## Composition of Social Spending

(Percent of GDP; year of 2010 or latest)



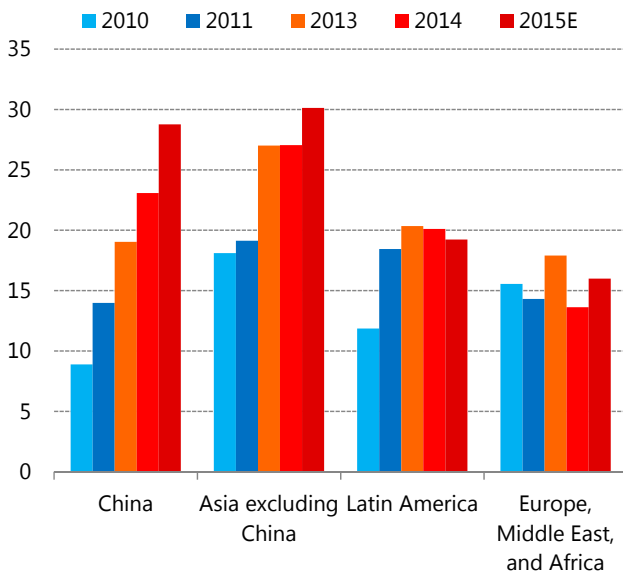
Sources: Organization for Economic Cooperation and Development; Eurostat; Asian Development Bank; IMF, *World Economic Outlook*; United Nations; World Health Organization; World Bank; and IMF staff calculations.



# Corporate debt is relatively high in emerging Asia and household debt has risen rapidly in several cases

## Emerging Market Firms: Debt-Potentially-at-Risk

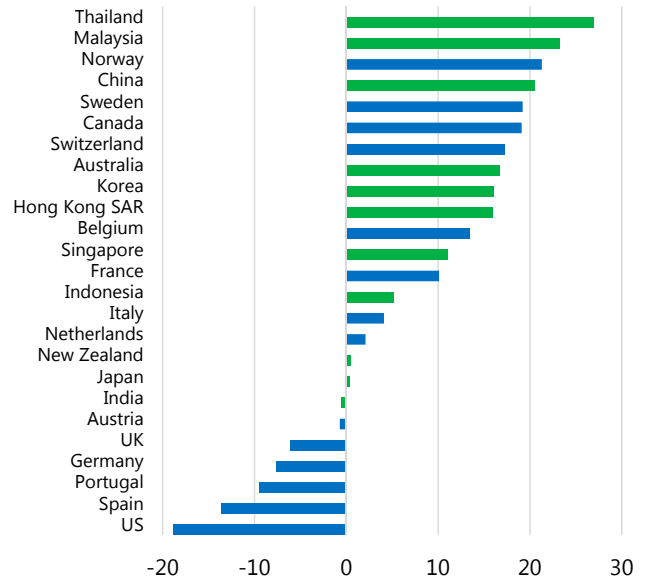
(Percent; share of total debt if ICR < 2)



Source: April 2016 GFSR.  
Note: Asia excluding China = India, Indonesia, Malaysia, the Philippines, and Thailand.

## Change in Household Debt to GDP Ratio

(Percentage points; from end-2007 to end-2015)



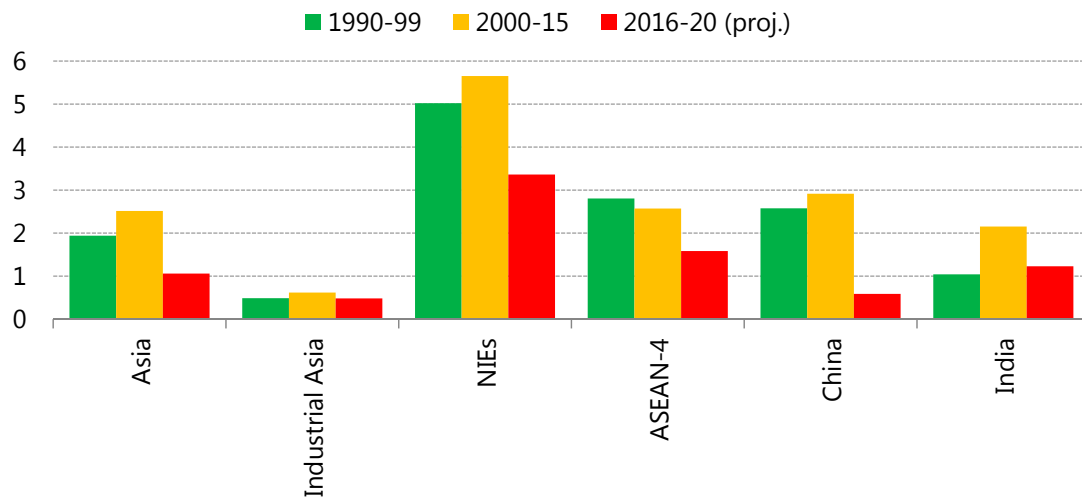
Sources: BIS and IMF staff estimates.



# The global trade slowdown and anti-trade sentiment could hit Asia hard

## Selected Asia: Contribution of Exports to Real GDP Growth

(Year-over-year; percentage points)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: ASEAN-4 includes Indonesia, Malaysia, the Philippines, and Thailand. Industrial Asia includes Australia, Japan, and New Zealand. NIEs include: Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.



# Implications for Monetary, Fiscal, and Structural Policies



## Monetary Policy in Anticipation of the “New Mediocre”: Some Issues to Consider?

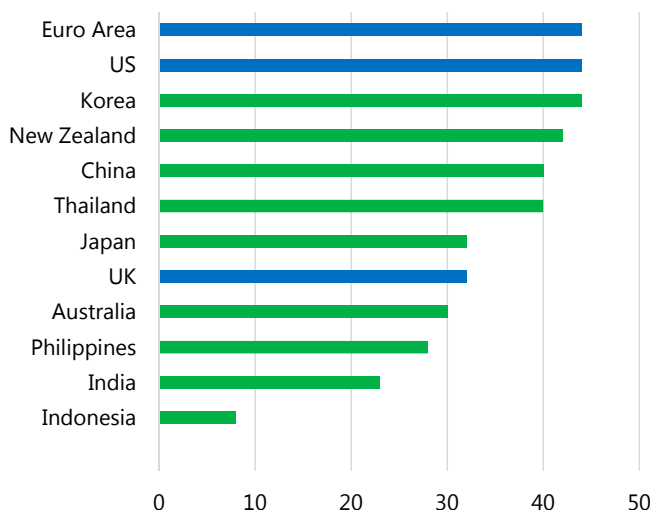
- How to anchor **inflation expectations**?
- How to prepare for **unconventional monetary policies (UMPs)**?
  - **QE**: Implementation challenges (enough assets to buy in EMs)?
  - **Negative rates**: Effective in bank-dominated financial systems?
- How to deal with “**side effects**” of UMPs, in case undertaken?
  - Could UMPs undermine **financial stability** (asset/credit bubbles)?
  - How effective are **macro-prudential policies** to deal with side effects?

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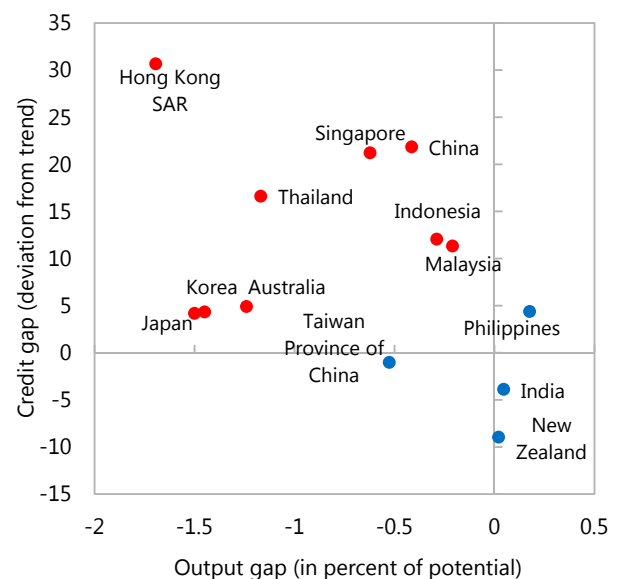
## Additional monetary accommodation?

**Selected Asia: Months Below Inflation Target**  
(number of months; from Jan 2013 to Aug 2016)



Source: IMF staff estimates.

**Selected Asia: Output and Credit Gaps**

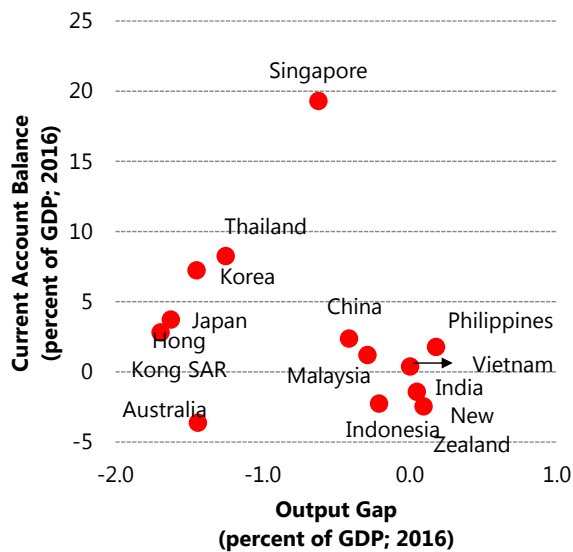


Sources: BIS; CEIC Data Company Ltd.; IMF, World Economic Outlook database; and IMF staff calculations.



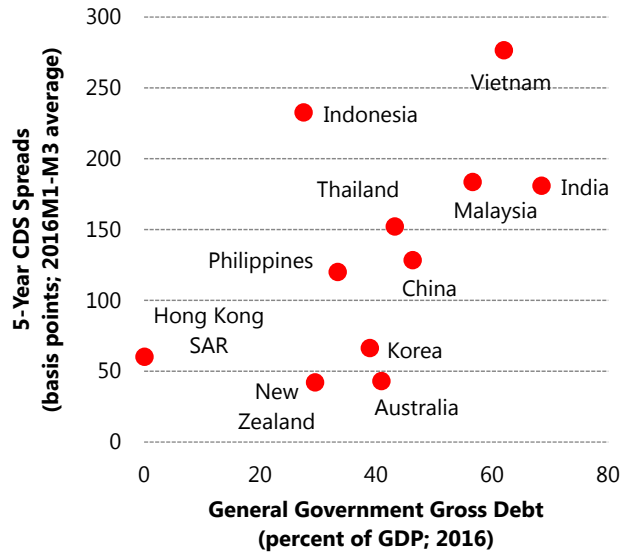
# Fiscal policy for demand support?

**Selected Asia: Need for Demand Support**



Sources: IMF WEO database; and IMF staff calculations.

**Selected Asia: Fiscal Space**



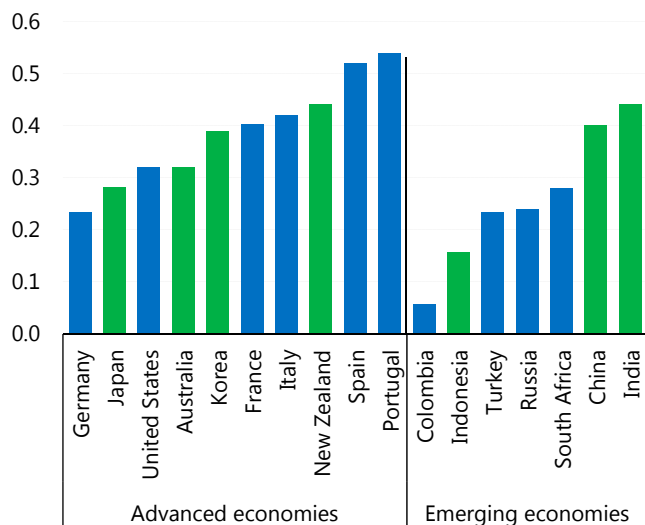
Sources: IMF WEO database; and IMF staff calculations.  
Note: Japan is not shown due to scale.



# Structural reforms to boost productivity growth?

- **Advanced Asia:** Infrastructure investment (**Australia**); product market reforms (**Australia, Japan, and Korea**); labor market reforms (**Japan, and Korea**).
- **Emerging Asia:** Raising public investment efficiency (**India**); labor market reforms (**India, Indonesia**); product market reforms (**China, India**); resolving corporate debt overhang (**China**);

**Reforms Responsiveness Indicator**  
(2011-15 average)



Source: OECD.  
Note: The reform responsiveness indicator reflects the share of policy recommendations from the OECD's "Going for Growth" reports on which the country has taken significant action.



# Country Specific Issues



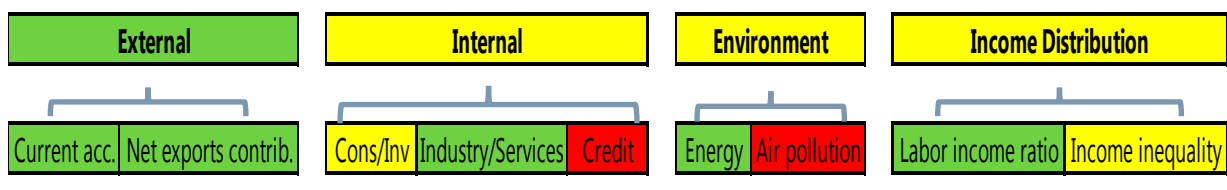
## Main Policy Challenges

	Main Challenge	Policy recommendations
China	Credit growth	Tackle the corporate debt problem; reduce reliance on credit/investment stimulus; guard against financial risks
Japan	Reflation and fiscal sustainability	A comprehensive and coordinated policy package
India	Corporate and banking sector strains	Continue to implement structural reform to boost potential growth; enhance resilience of corporates/banks
AUS and NZL	Adjust to lower commodity prices	Accommodative monetary and fiscal policies, structural reforms
ASEAN-5	Tighter external environment	Continue to build policy buffers and to implement structural reforms, and use macro prudential policies, as needed
Asian FDEs	Macro vulnerabilities	Strengthen macro policy frameworks further
Small States	Natural disasters/climate change and withdrawal of CBRs	Build resilience and enhance growth potential

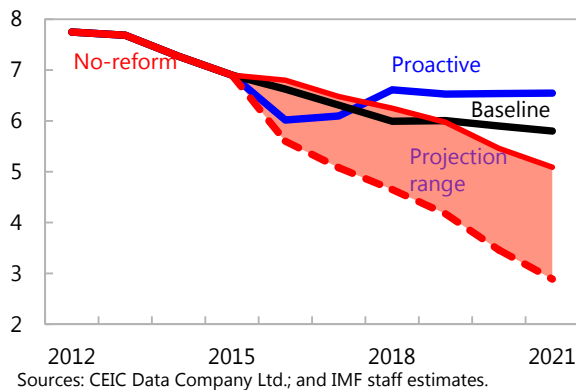


# China: Rebalancing in many areas but credit growth remains excessive and SOE reforms have lagged, threatening growth and financial stability

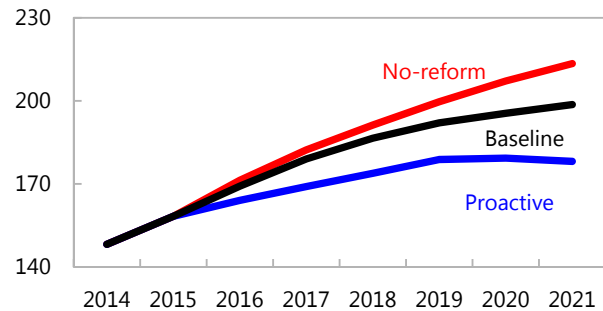
## Rebalancing Scorecard



**GDP Growth: Illustrative Scenarios**  
(Year-over-year percent change)



**Credit Ratio: Illustrative Scenarios 1/**  
(Percent of GDP)

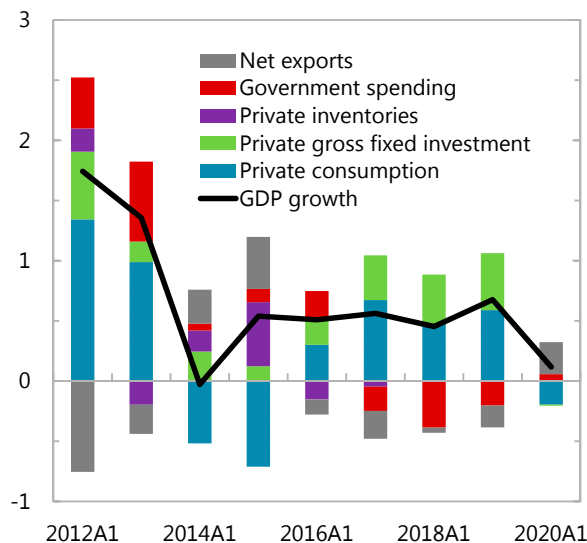


Sources: CEIC Data Company Ltd.; *World Economic Outlook (WEO)* and IMF staff estimates.  
1/ Nonfinancial private debt, calculated as total social financing stock adjusted for local government debt swap minus equity financing and LGFV borrowings.

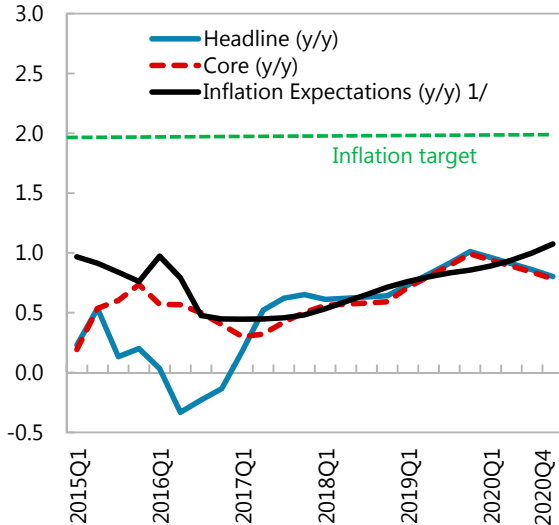


# Japan: Weak outlook calls for a significant policy reload to reach ambitious targets

**Components of GDP growth**  
(Percent)



**Baseline Inflation Outlook**  
(Year-over-year percent change)



Source: IMF staff estimates.  
1/ Average of one-year ahead expectations from Consensus, market based measures and Tankan Survey of firms until 2016Q2. Projections assume inflation expectations are based on a weighted average of past and future rates of inflation. Jump in 2016Q1-Q2 reflect the effects of the expected consumption tax rate hike in 2017.





# India: Structural reforms pave the road for stronger growth and continued macro stability

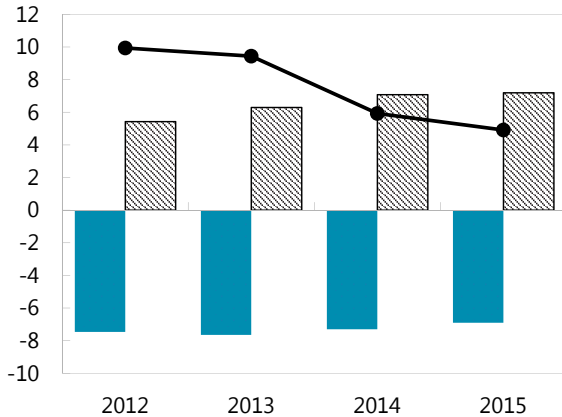
## GDP Growth, Inflation, and Fiscal Deficit

(Percent)

■ General government fiscal balance (in percent of GDP)

▨ Real GDP Growth

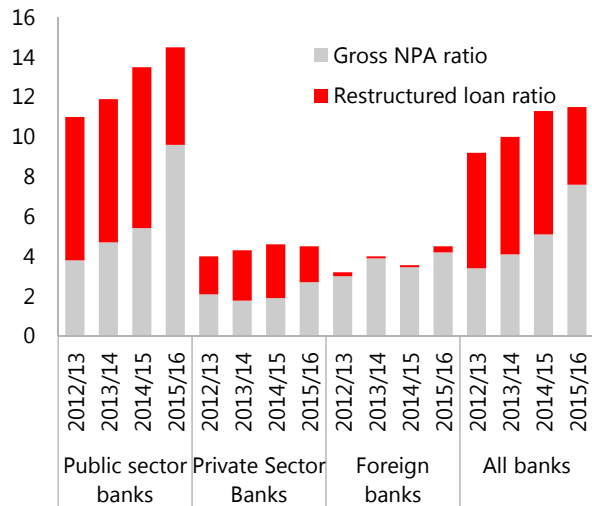
● Inflation



Source: IMF staff calculations.

## Bank Assets in Distress

(Percent of outstanding advances)



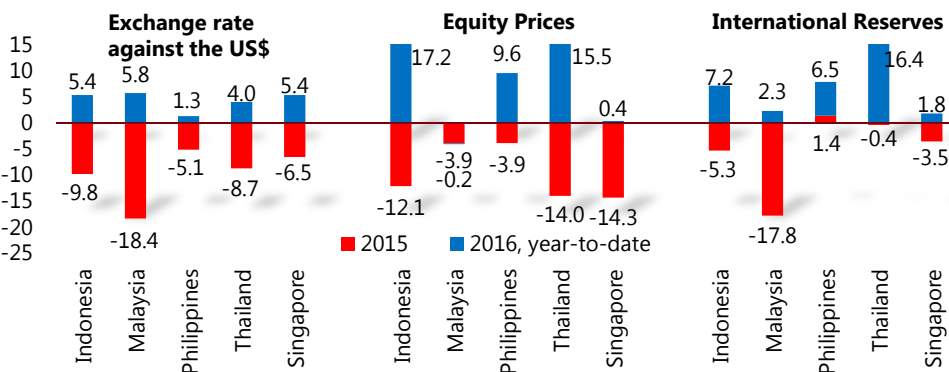
Sources: Reserve Bank of India; and IMF staff estimates.



# ASEAN-5 weathered the external shocks in 2015-16 well, but face different policy priorities to maintain strong growth

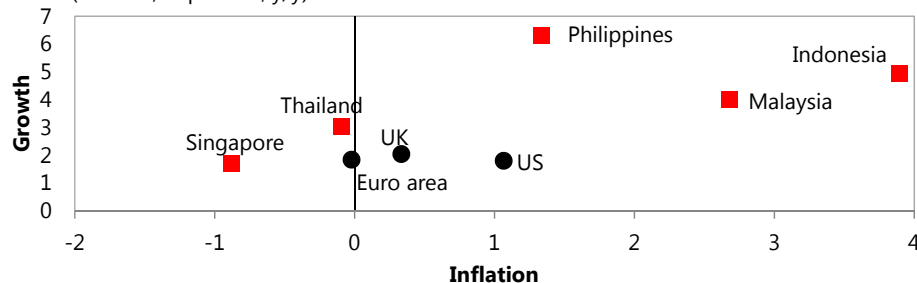
## Change in Exchange Rates, Stock Prices, and International Reserves

(Year-over-year percent change)



## Growth and Inflation

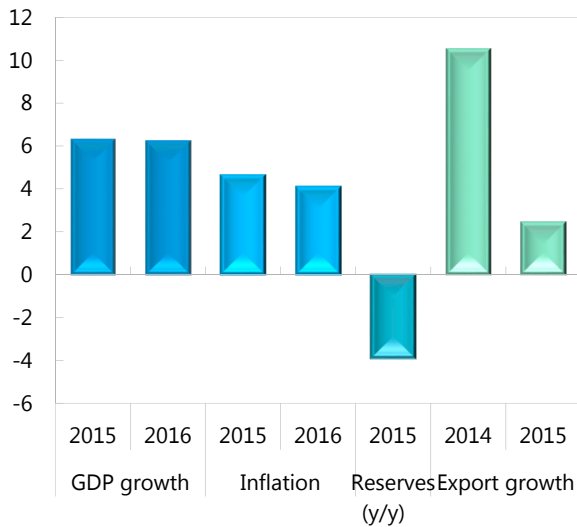
(2016H1; in percent, y/y)





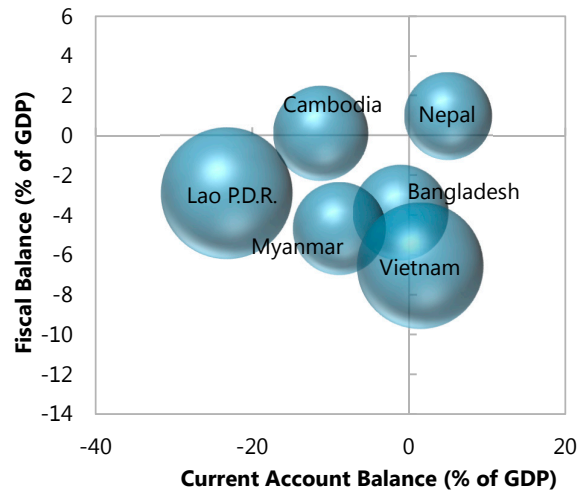
## Other Asian FDEs: Increasing vulnerabilities

**Selected Indicators**  
(Percent)



Sources: IMF World Economic Outlook database and IMF staff calculations.

**Fiscal and Current Account Balance, 2015**



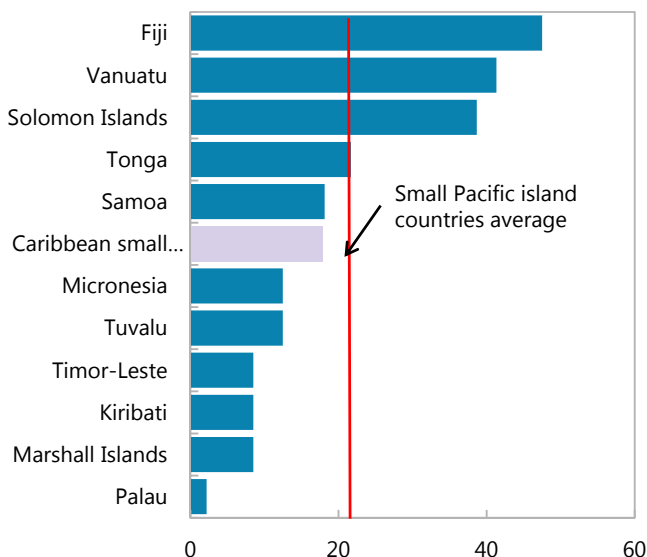
Sources: IMF World Economic Outlook database; and IMF staff calculations.

Note: The size of the bubbles represents public debt in percent of GDP.



## Small States of the Pacific: Need to build resilience to natural disasters and climate change

**Probability of Occurrence of Natural Disasters<sup>1</sup>**  
(Percent)



1/ During 1970-2014.

Sources: Center for Research on Epidemiology for Disasters, International Disaster Database; IMF staff estimates.

### Resilience and Growth in the Small States of the Pacific



EDITORS  
Hoe Ee Khor, Roger P. Kronenberg, and Patrizia Tumbarello



## Concluding remarks

- Asia remains the main engine of global growth.
- In the medium-term, Asia needs to prepare for the risk of a “new mediocre” in advanced economies.
- The global trade slowdown and anti-trade sentiment can hit Asia hard—Asia needs more balanced and inclusive growth.
- May need to re-assess projections given developments since October projections.