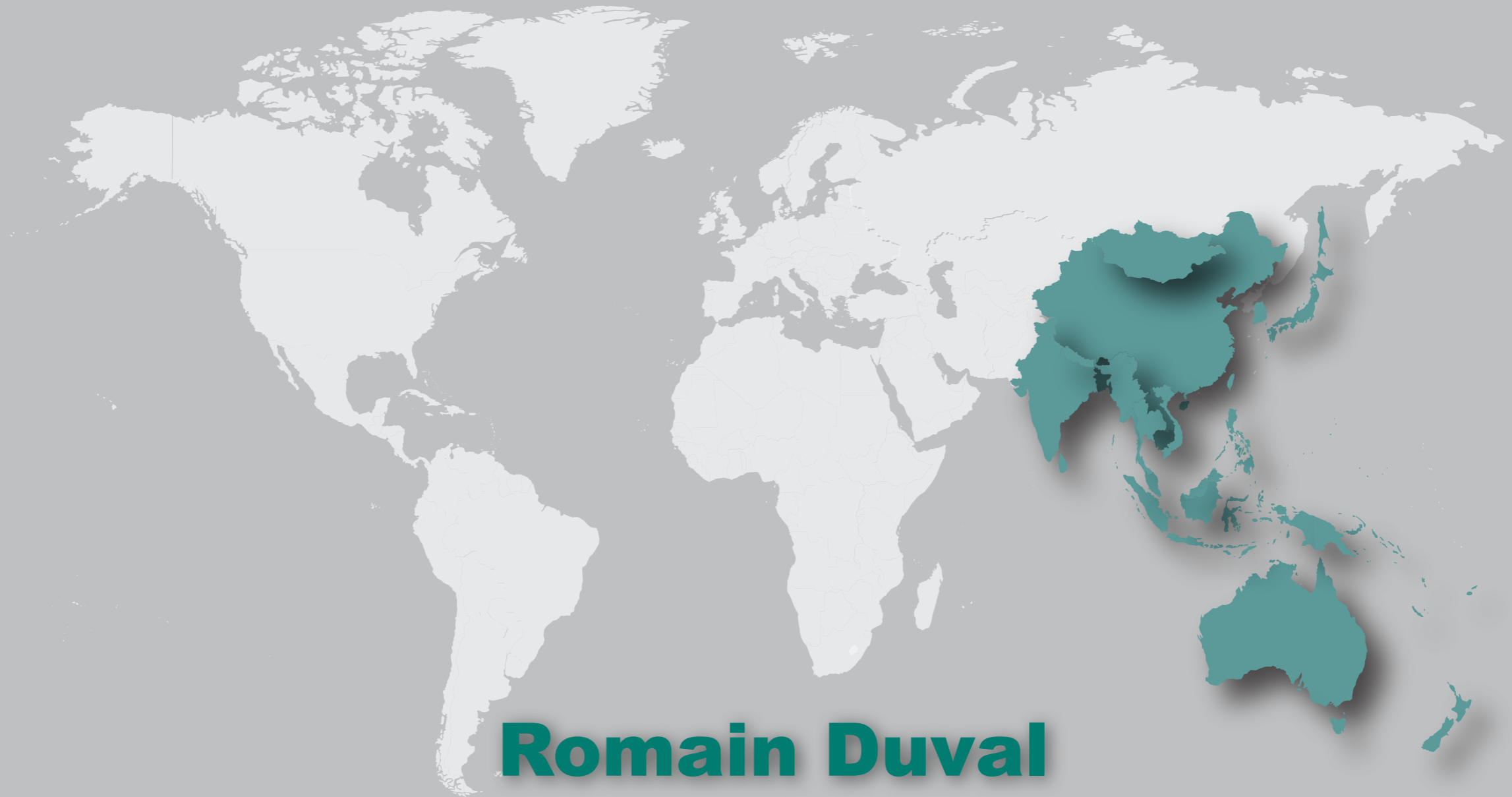


Asia and Pacific Regional Economic Outlook

Sustaining the Momentum: Vigilance and Reforms



Romain Duval

Asia and Pacific Department, IMF

Tokyo, May 8, 2014



Key Messages

- **Asia will remain the most dynamic region**
- **Risks from outside Asia have receded**
- **Actions taken to address vulnerabilities bearing fruit**
- **But need for vigilance and reforms**



Roadmap



Outlook and broad policy challenges

Key Regional Themes

1: Leverage— a fault line?

2: Responding to financial risks— what role for Macro-prudential policies?

3: China's reforms— What impact?

4: Abenomics— temporary stimulus or break with the past?

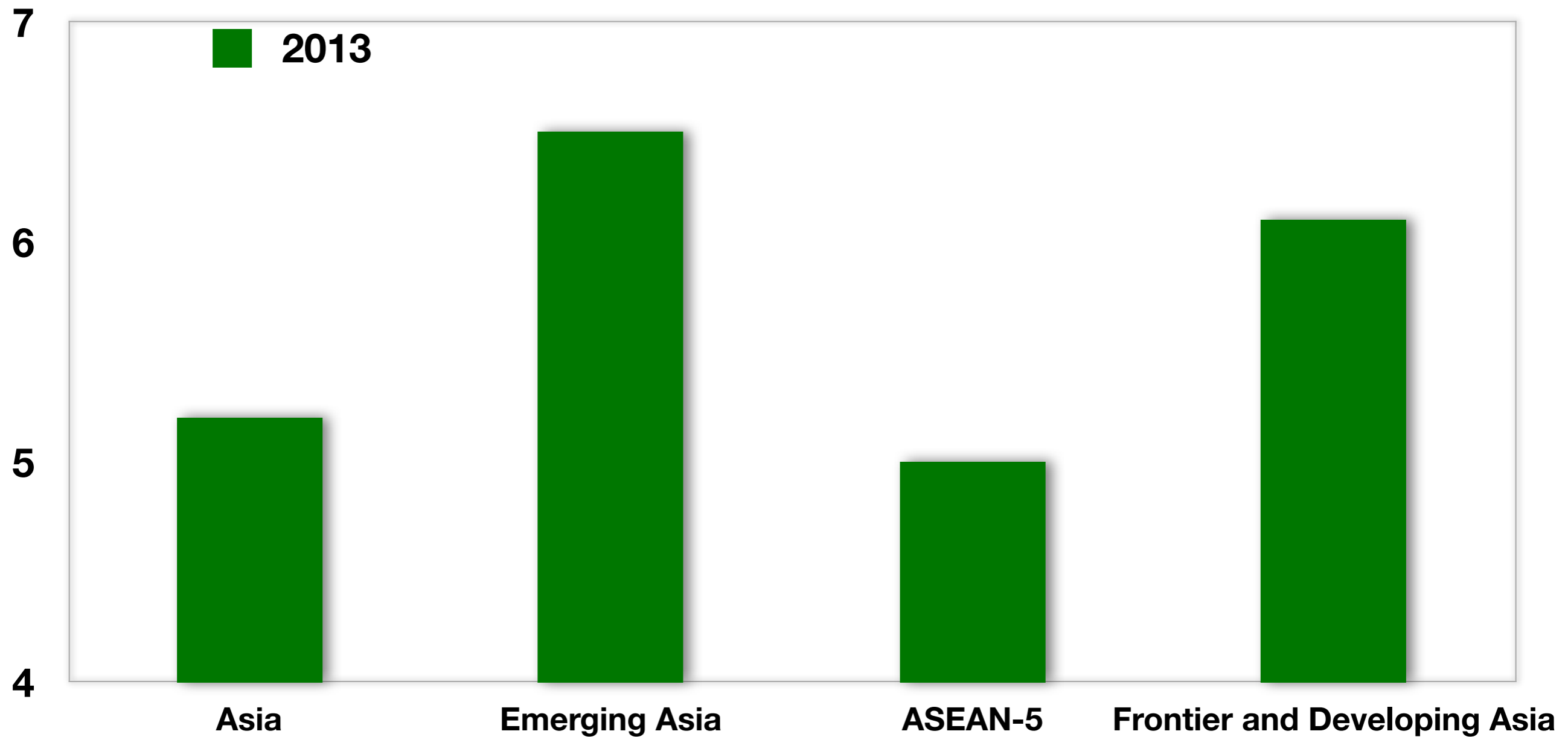
5: ASEAN— what is happening to growth?

6: Regional integration — Growing source of spillovers?



Steady growth ahead...

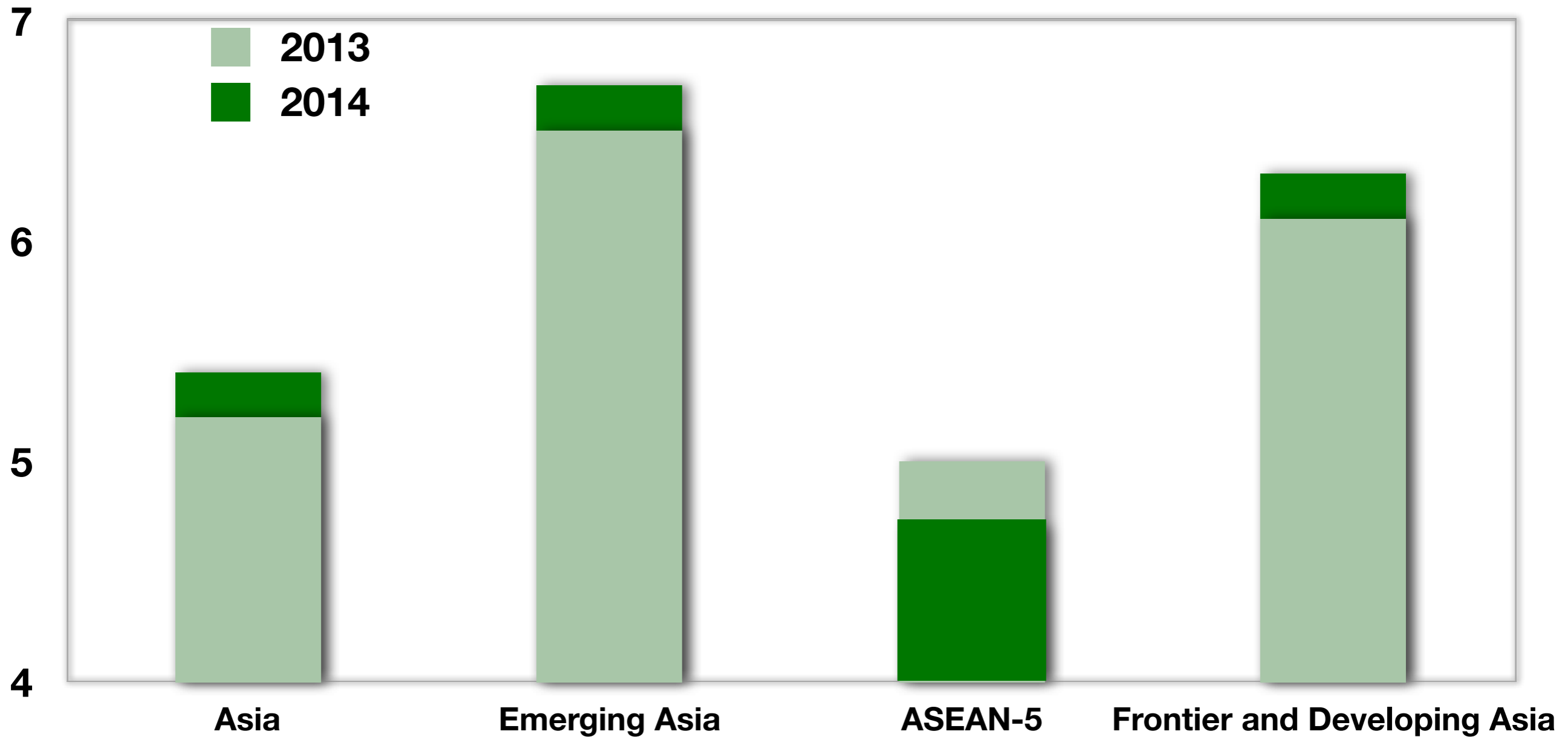
Asia: Real GDP Growth by Region





Steady growth ahead...

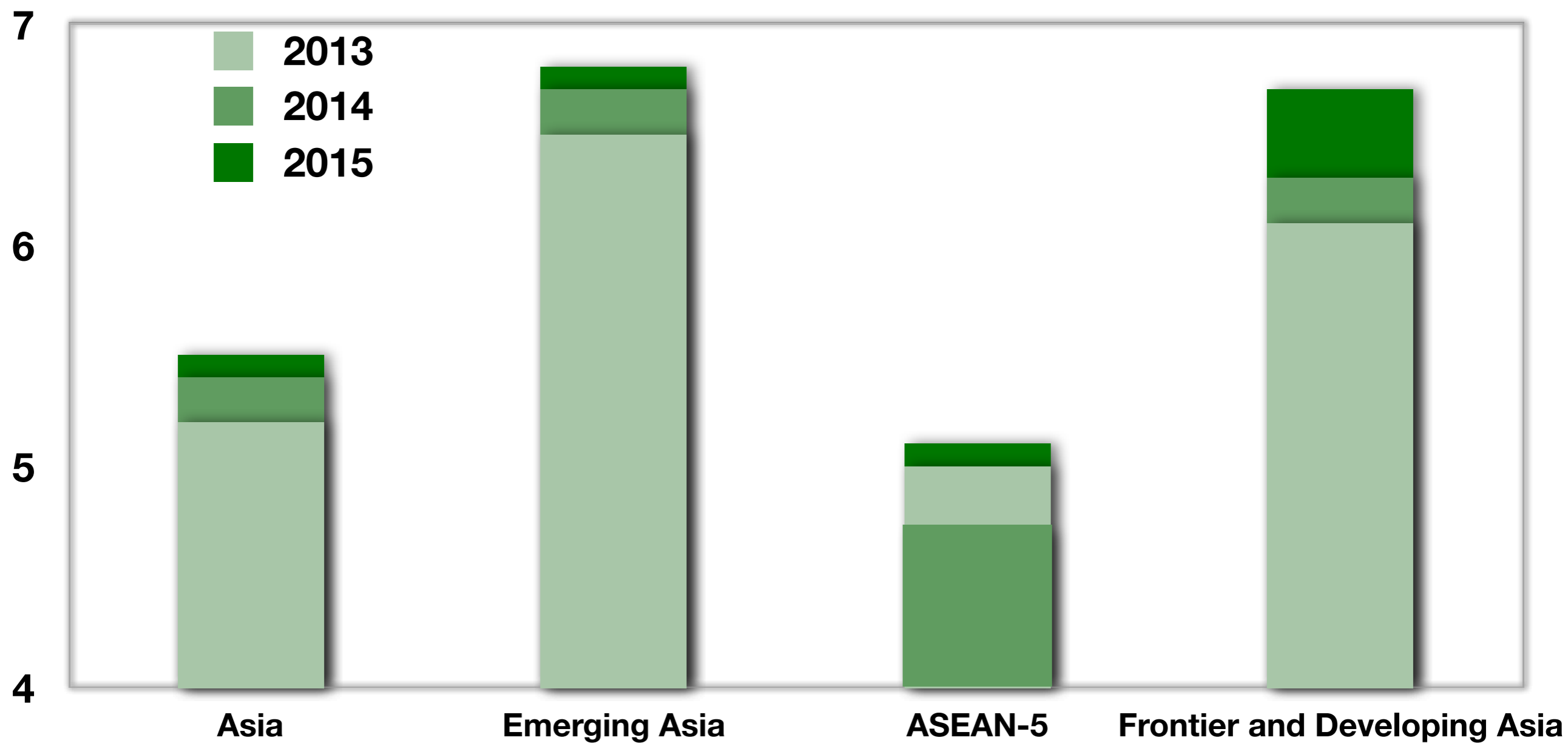
Asia: Real GDP Growth by Region





Steady growth ahead...

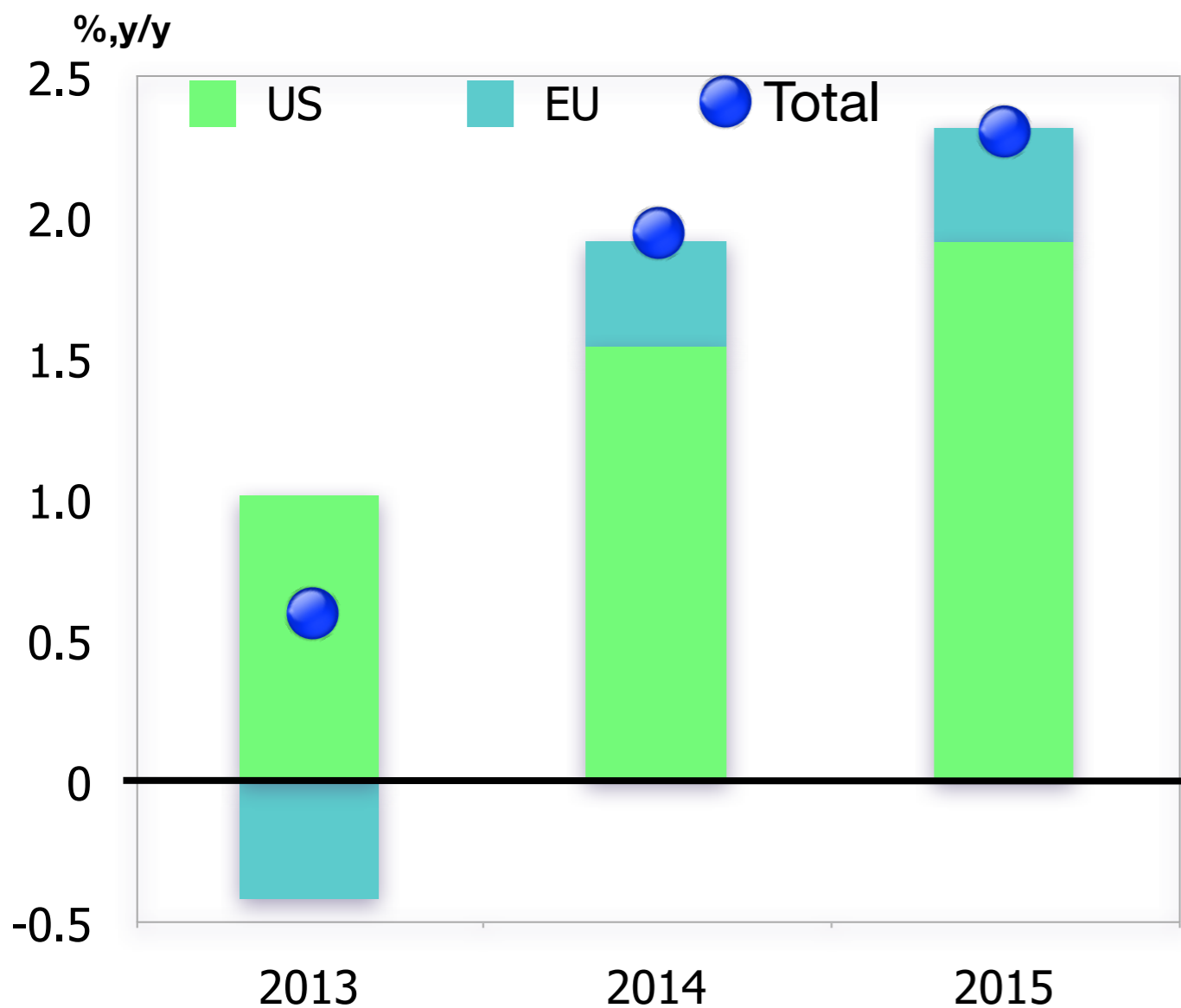
Asia: Real GDP Growth by Region



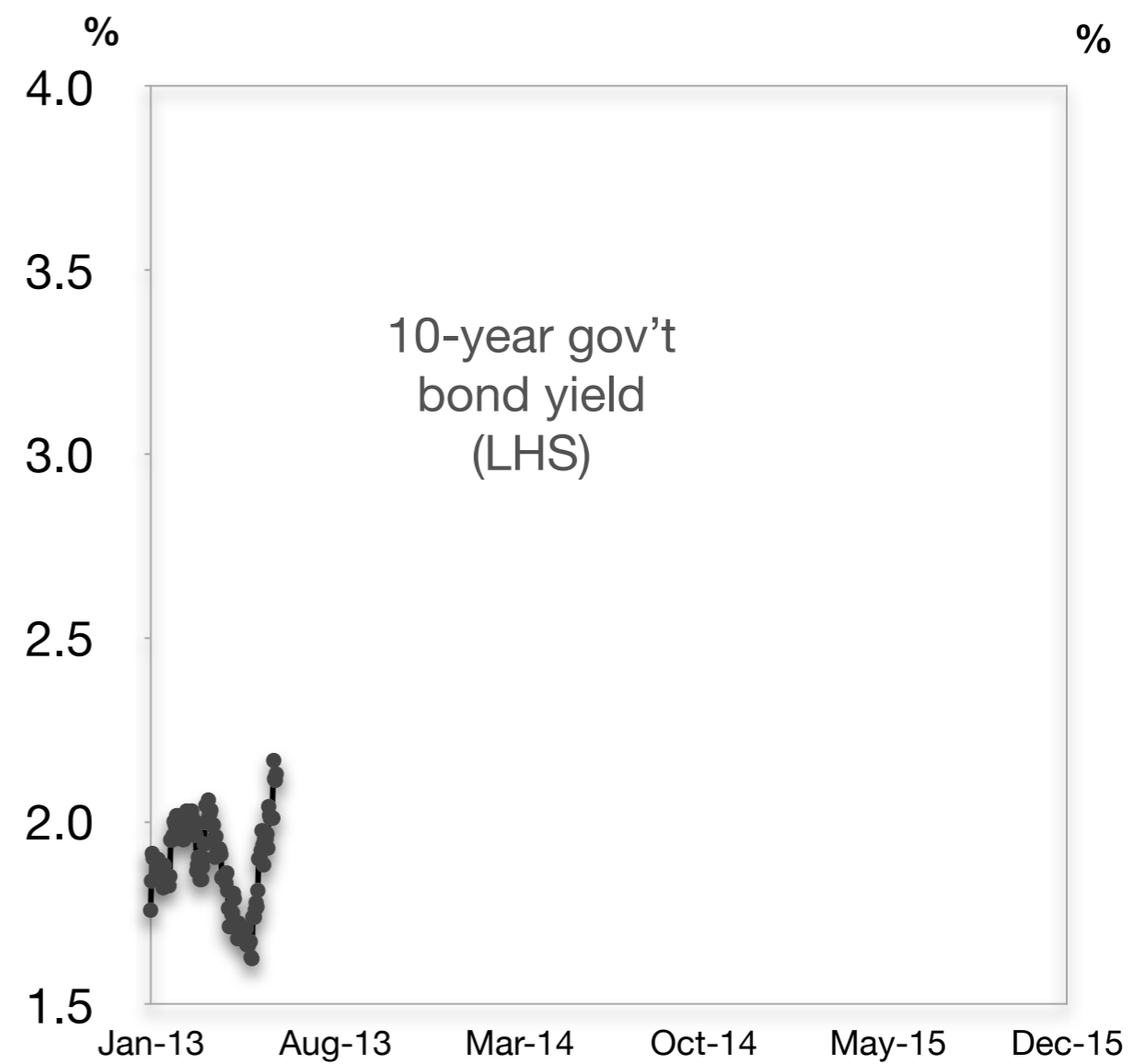


Global environment: supportive on balance

Domestic Demand from EU and US



US Interest Rates

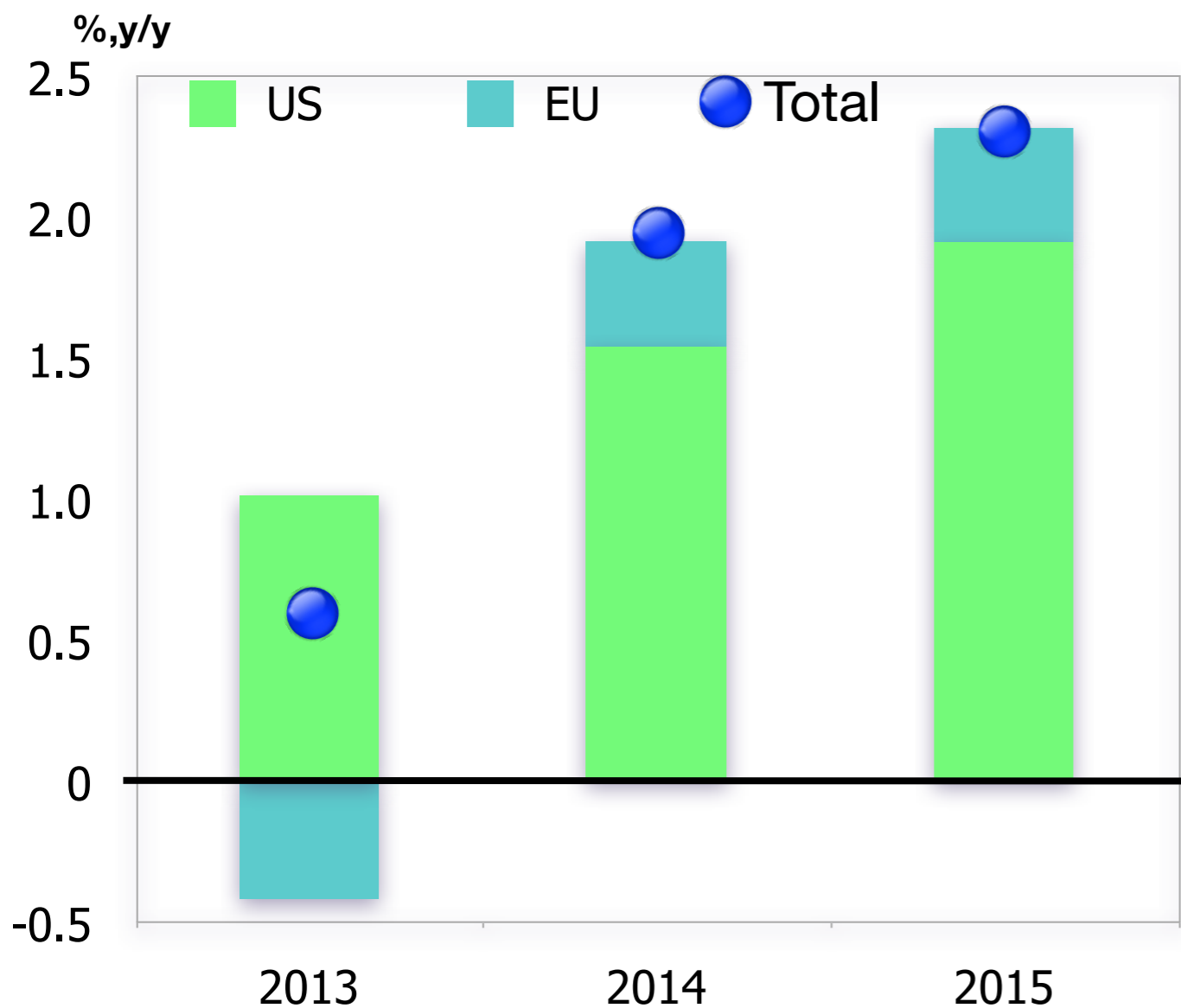


Outlook and broad policy challenges

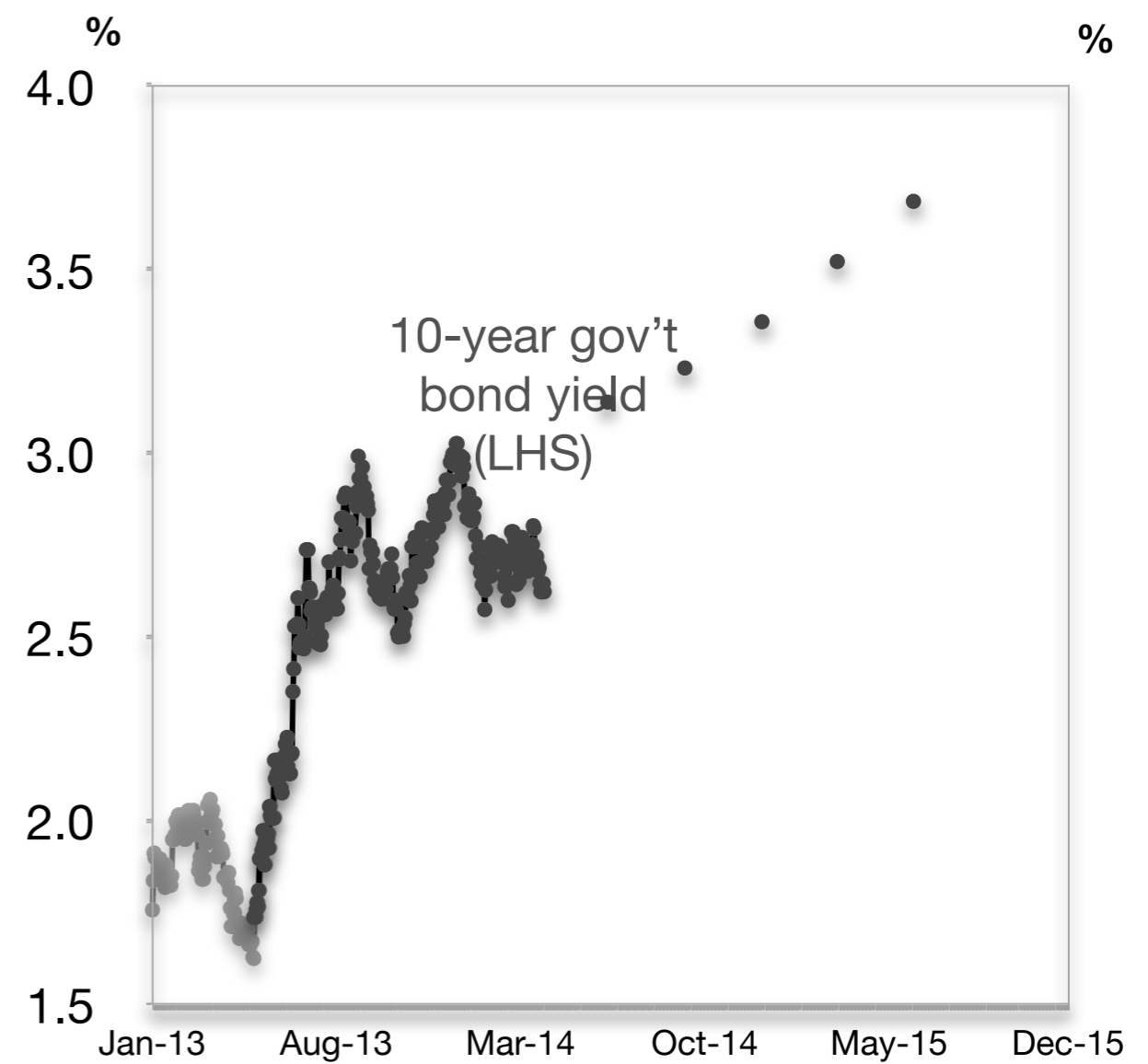


Global environment: supportive on balance

Domestic Demand from EU and US



US Interest Rates

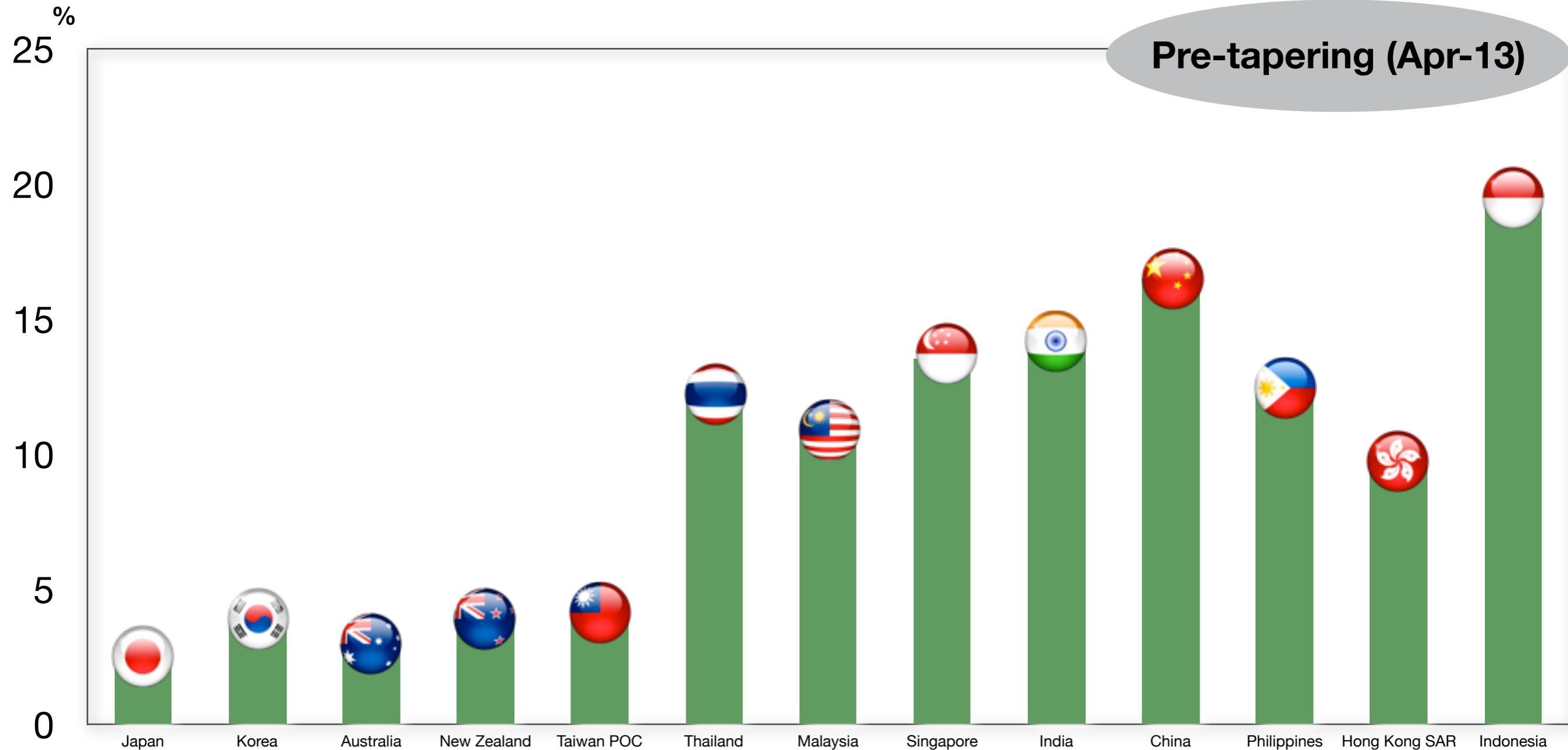


Outlook and broad policy challenges



Domestic demand: supported by still accommodative financial conditions

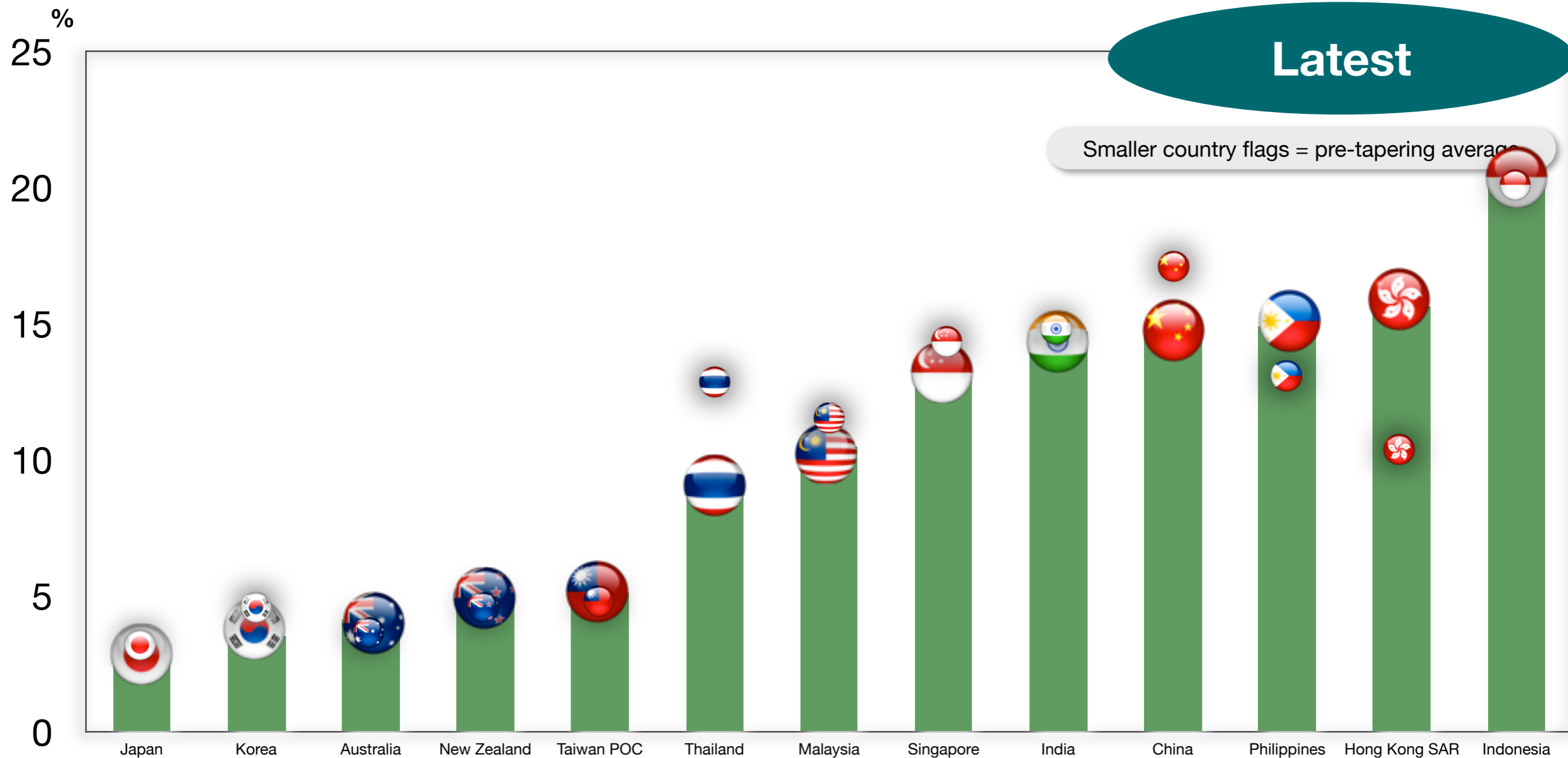
Credit to Private Sector Growth





Domestic demand: supported by still accommodative financial conditions

Credit to Private Sector Growth

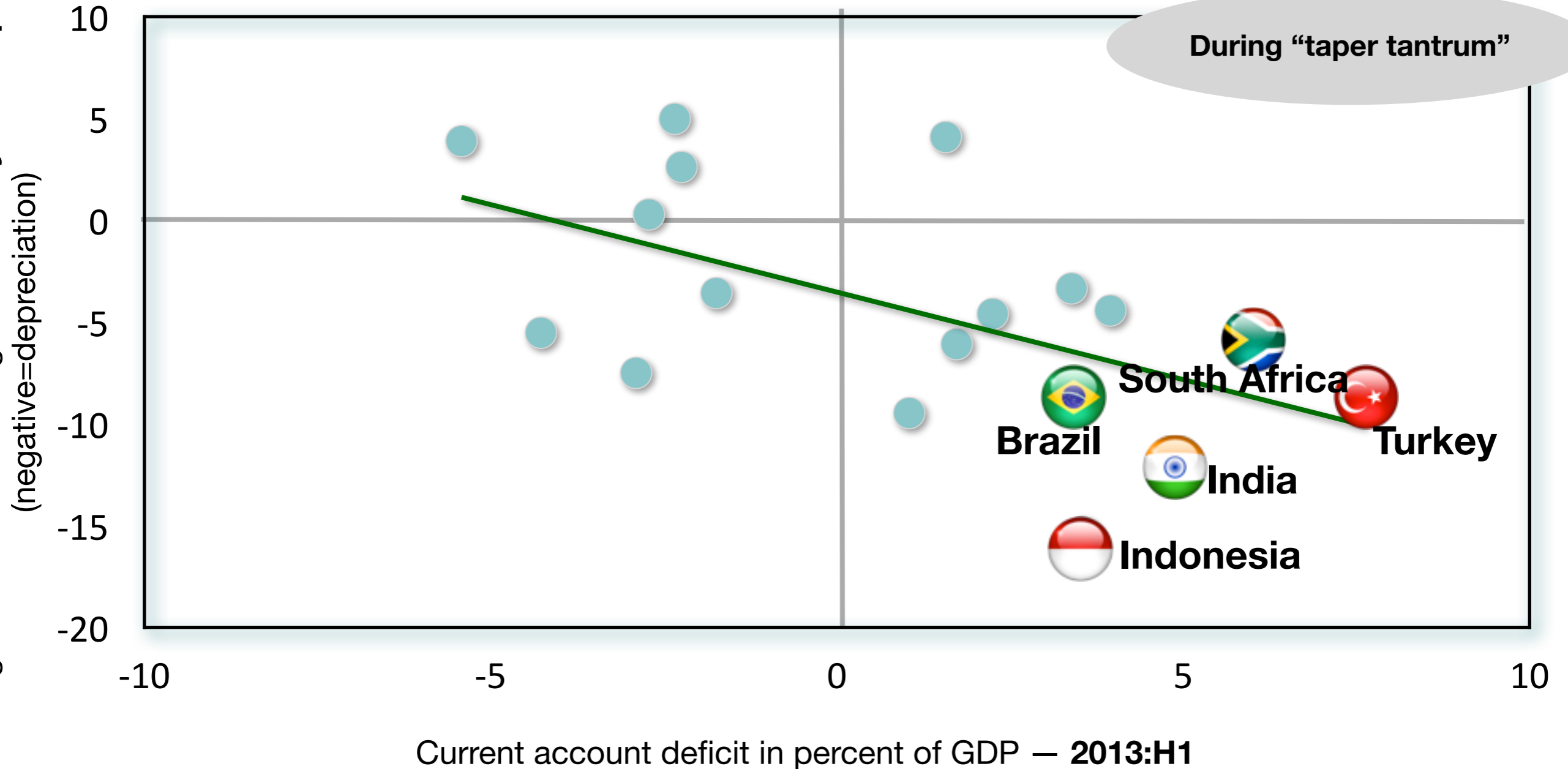




Vulnerabilities: actions taken to reduce them are bearing fruit

Current Account Deficit and Exchange Rate

Change in bilateral exchange rate – May 22 - Sep 2013

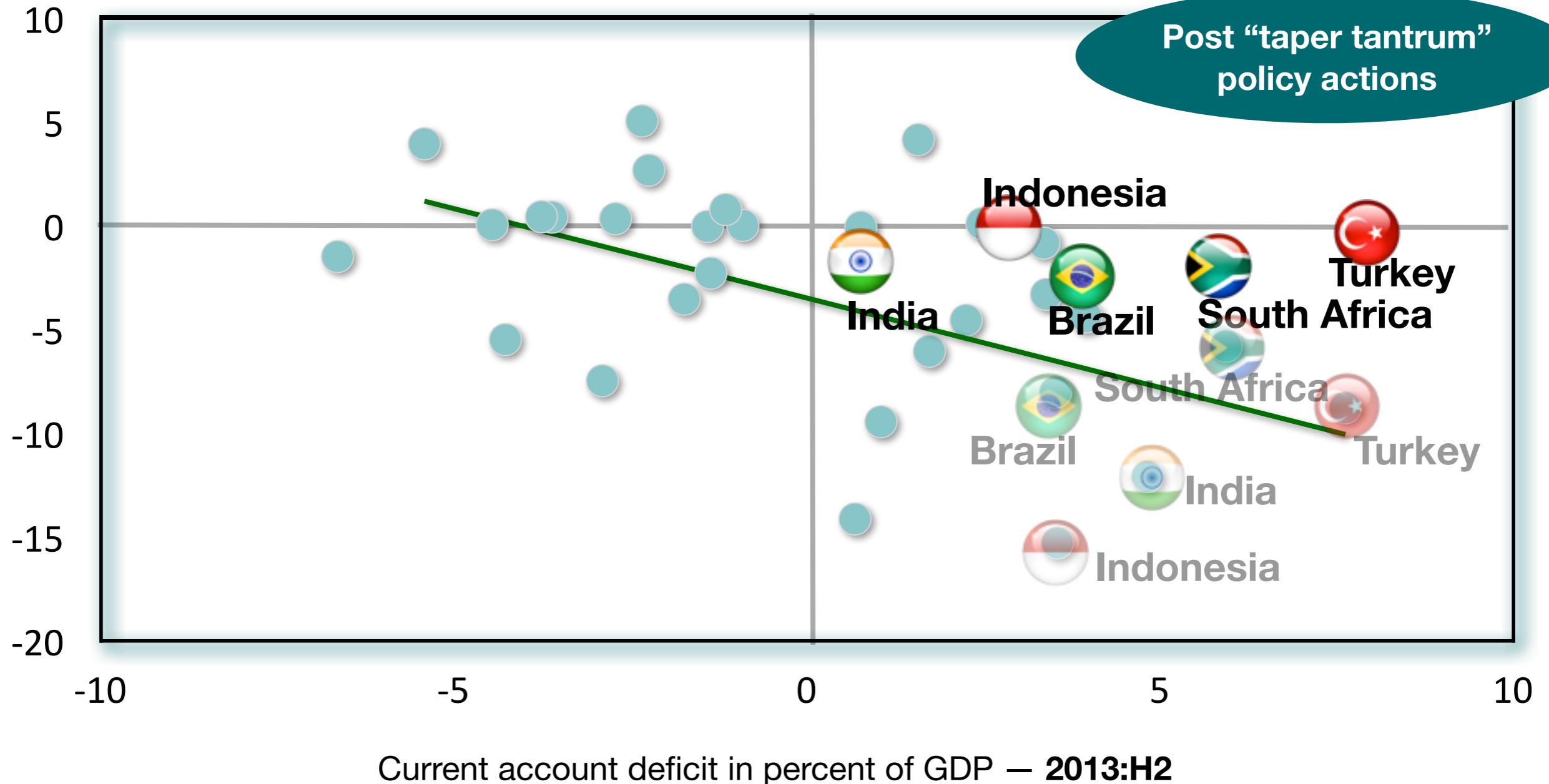




Vulnerabilities: actions taken to reduce them are bearing fruit

Current Account Deficit and Exchange Rate

Change in bilateral exchange rate – Jan 21-28 2014
(negative=depreciation)





Policy settings and challenges

- Monetary: progressive normalization as conditions warrant
- Fiscal: gradual consolidation
- Macroprudential: remains part of the toolkit
- Structural: key for both short-term financial stability and medium-term growth
- But no one size-fits-all: subregional specificities



Theme 1: Leverage: a fault line?

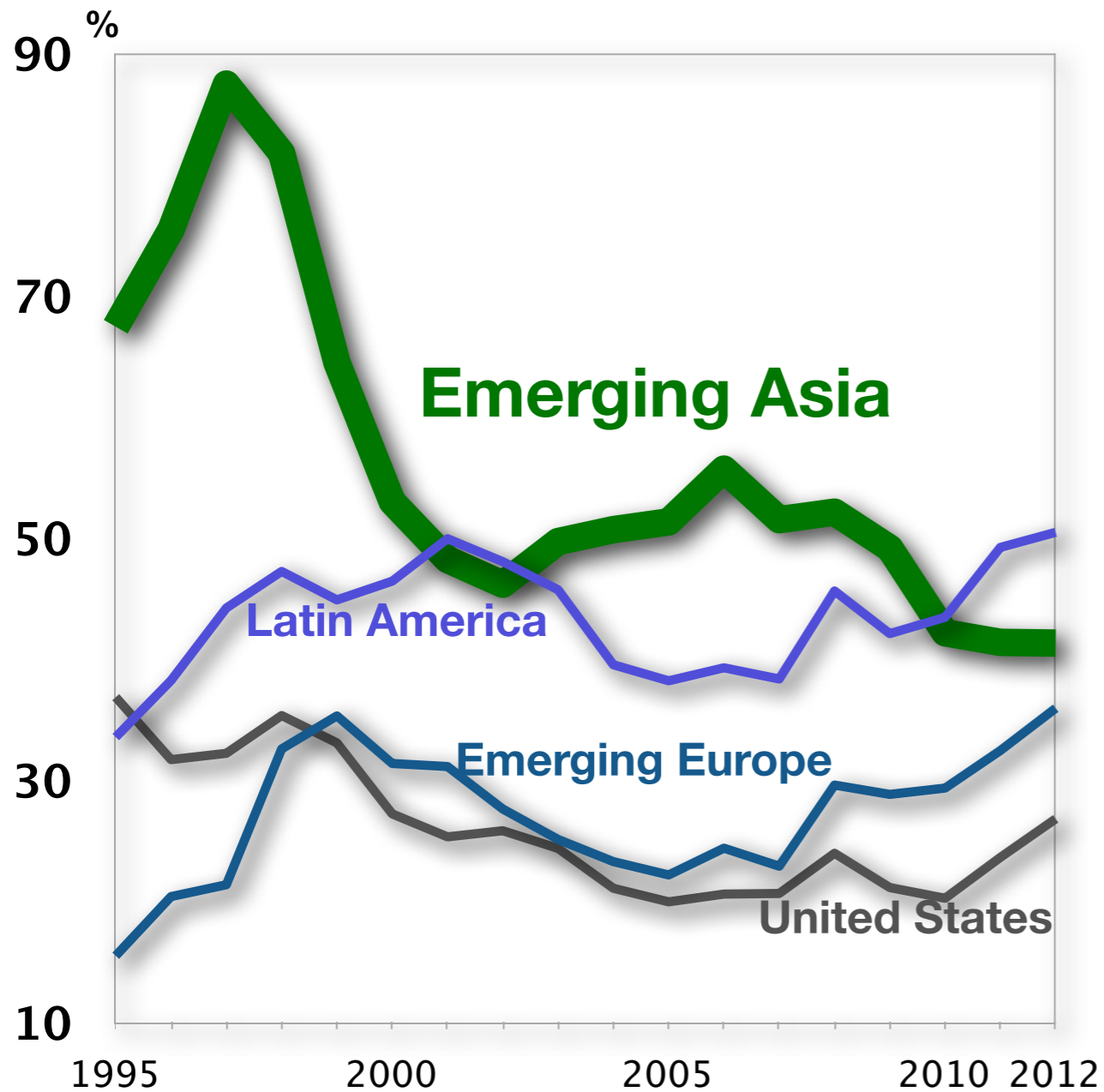
- *Aggregate* corporate leverage has remained stable in recent years
- But pockets of vulnerability: leveraged firms tend to be the weakest
- Leverage could amplify corporate stress created by higher global interest rates
- Leverage likely have adverse implications for investment



No alarming build-up in overall leverage

Debt to Equity Ratio

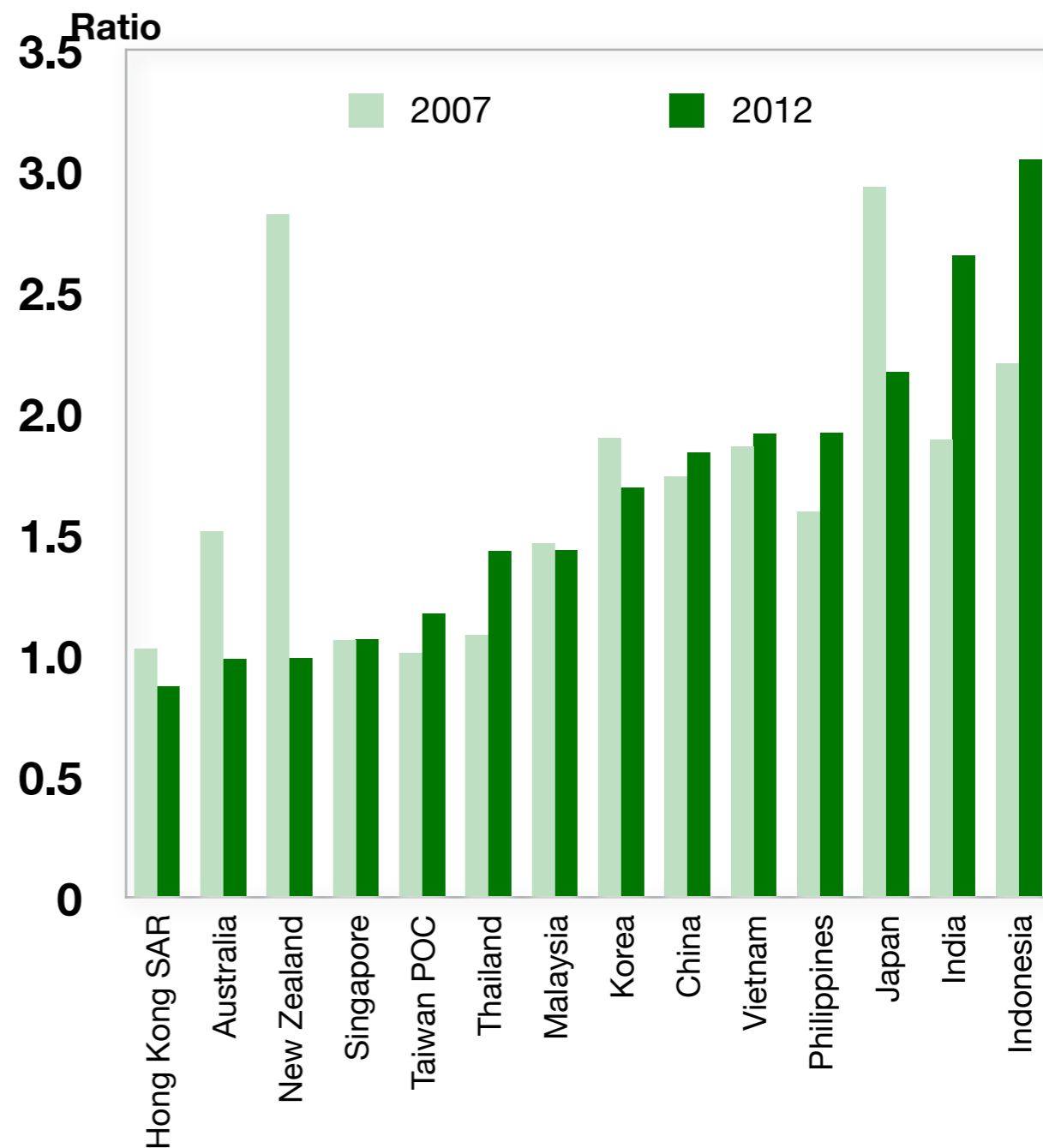
(In percent; median for non-financial corporates)



Sources: Corporate Vulnerability Utility, IMF.

Asia: Debt to Equity Ratio

(Ratio, total debt-weighted average)



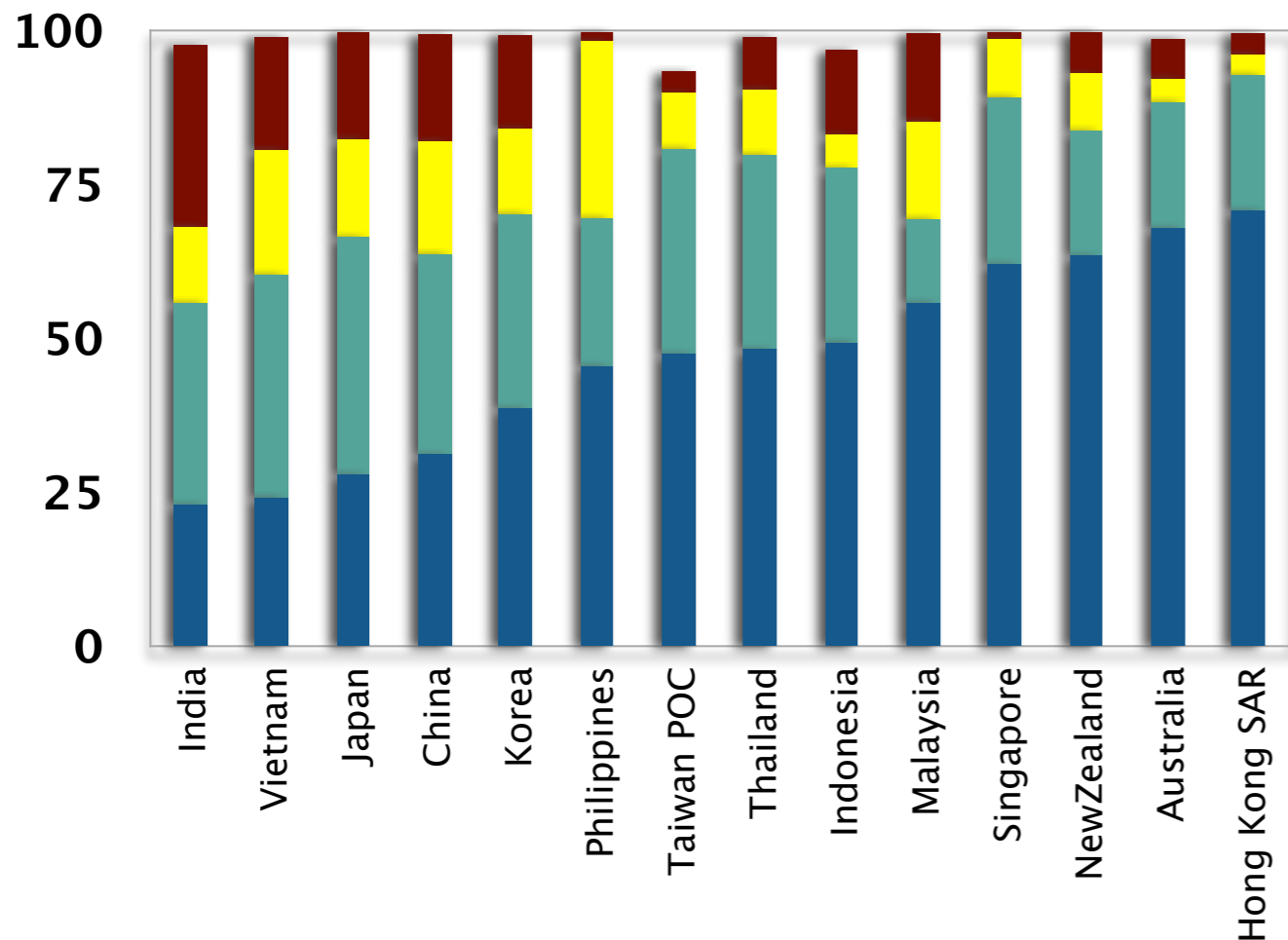


But there are pockets of vulnerability

Corporate Debt by Leverage Ratio¹

(In percent of total corporate debt, 2012)

- Less than 1
- Between 2 - 3
- Between 1 - 2
- Greater than or equal to 3

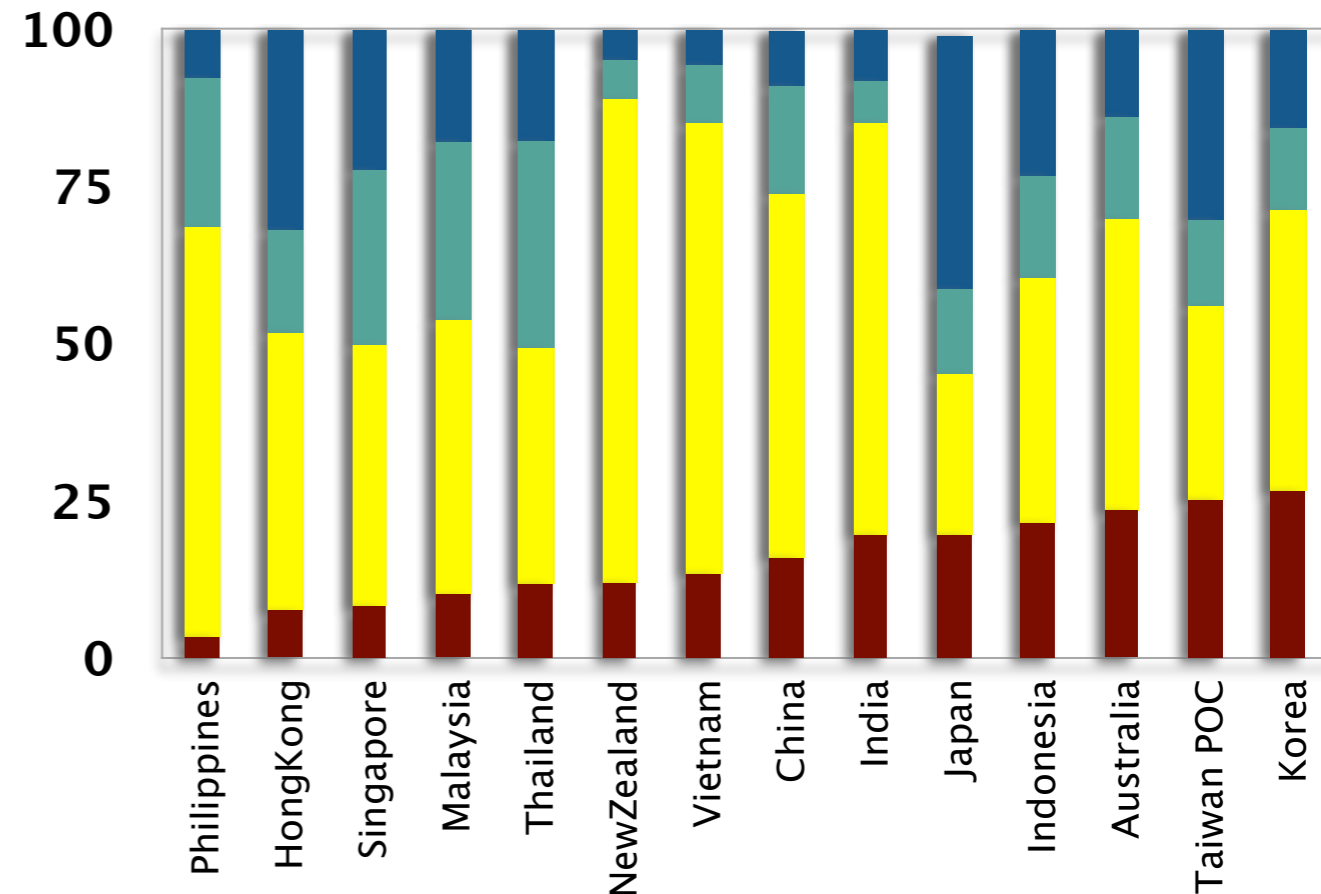


Sources: Thomson Reuters Worldscope; and IMF staff calculations.
¹ Leverage Ratio is measured by Total Debt/Common Equity.

Corporate Debt by ICR¹

(In percent of total corporate debt, 2012)

- Less than 1
- Between 5 - 10
- Between 1 - 5
- Greater than or equal to 10



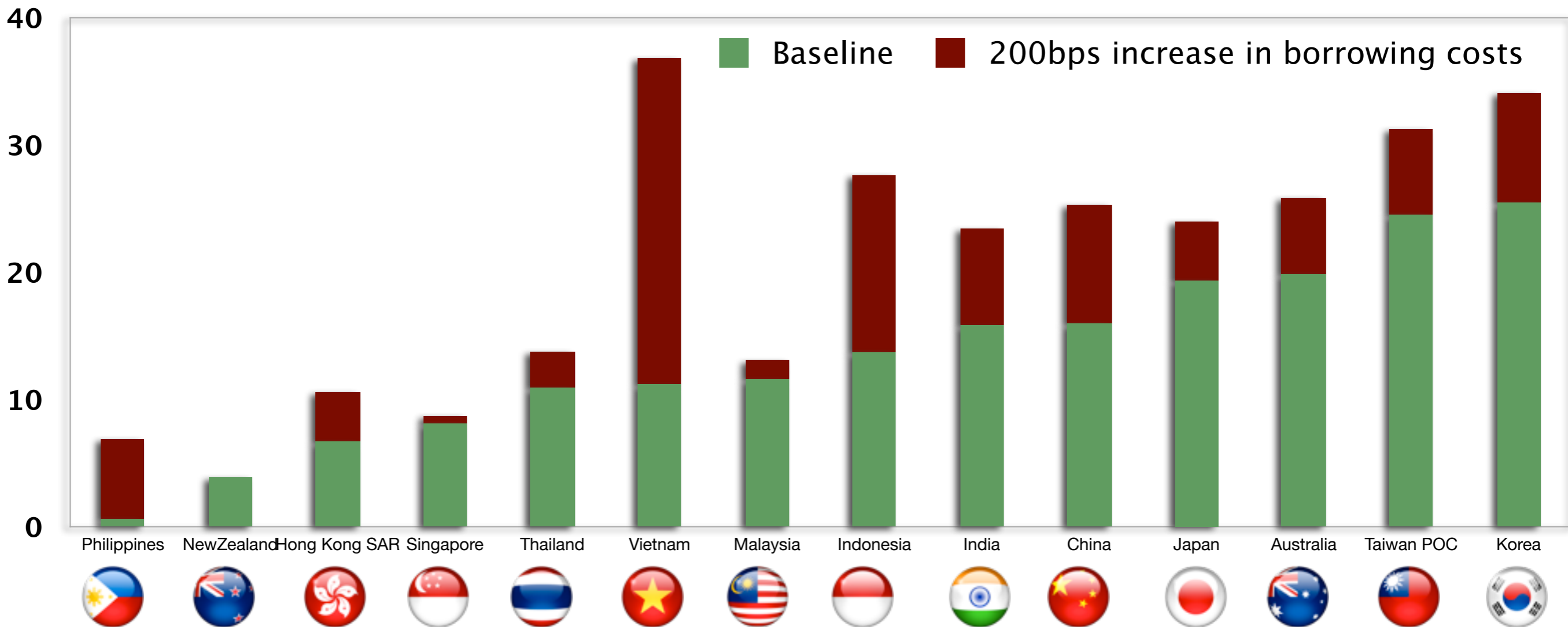
Thomson Reuters Worldscope; and IMF staff calculations.
¹ ICR is measured by EBIT/Total Interest Expense.



Corporate stress could be amplified by tightening of global financial conditions

Stress Test: Debt of Corporates with ICR<1 under Baseline and Stress Scenario¹

(In percent of total corporate debt, 2012)



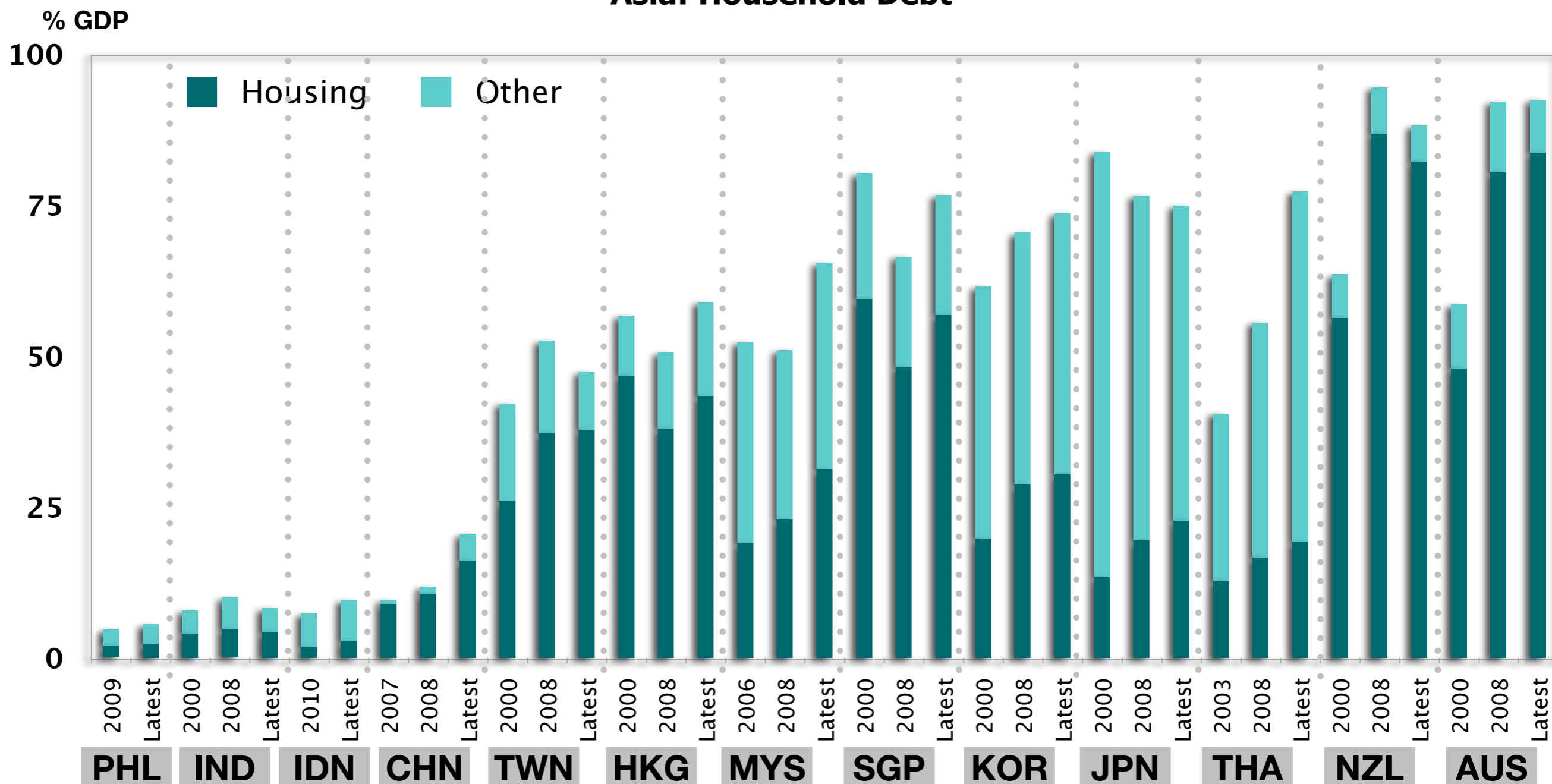
Sources: Thomson Reuters Worldscope; and IMF staff calculations.

¹ ICR is measured by EBIT/Total Interest Expense



Household debt: also a growing concern in some economies

Asia: Household Debt



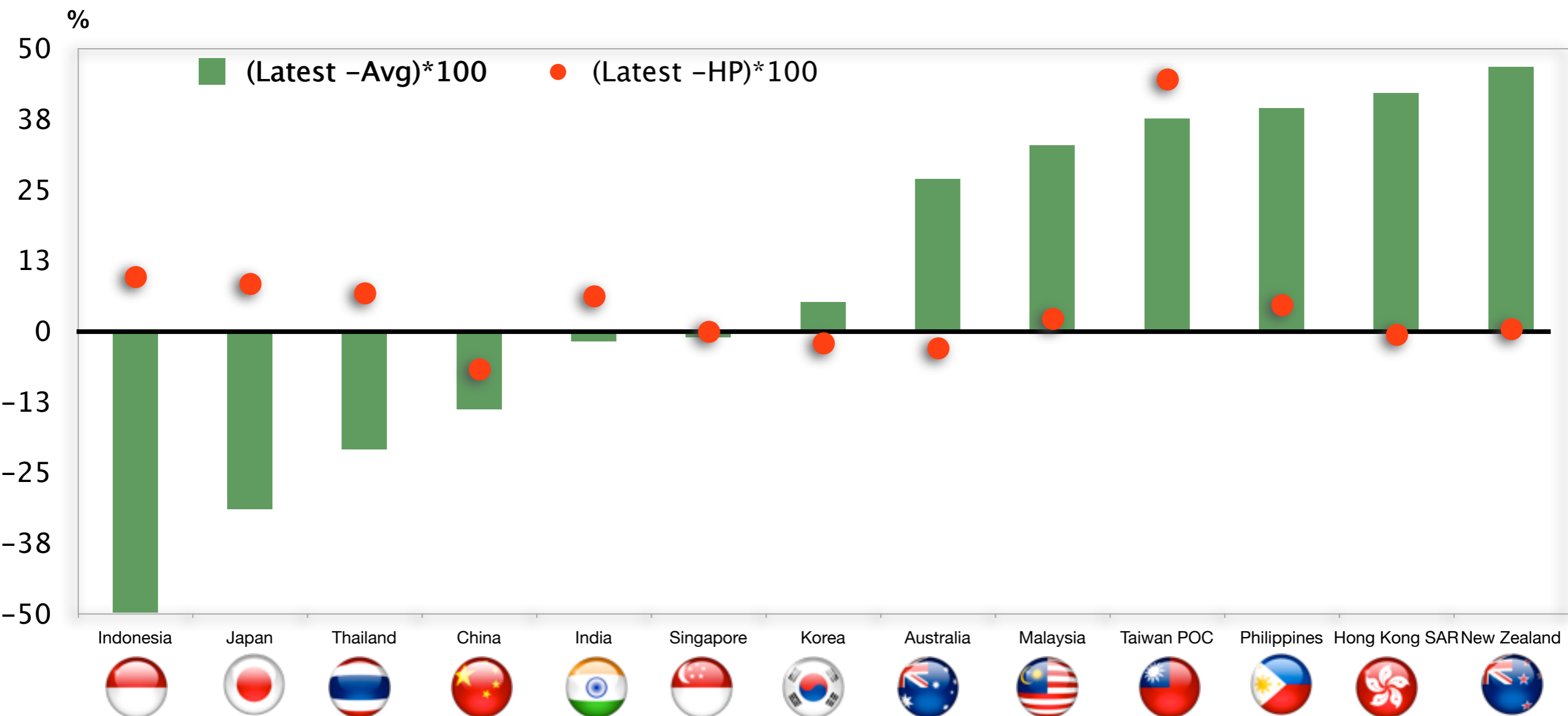
Sources: CEIC Co. Ltd.; Haver Analytics; World Economic Outlook; OECD; National Authorities; and staff calculations.

PHL=the Philippines, IND=India, IDN=Indonesia, CHN=China, TWN=Taiwan POC, HKG=Hong Kong SAR, MYS=Malaysia, SGP=Singapore, KOR=Korea, JPN=Japan, THA=Thailand, NZL=New Zealand, AUS=Australia.



House prices have been high relative to historical trends

House Prices Deviation from Alternative Benchmarks



Source: IMF staff estimates.



Theme 2: Responding to financial risks— what role for Macro-prudential policies?

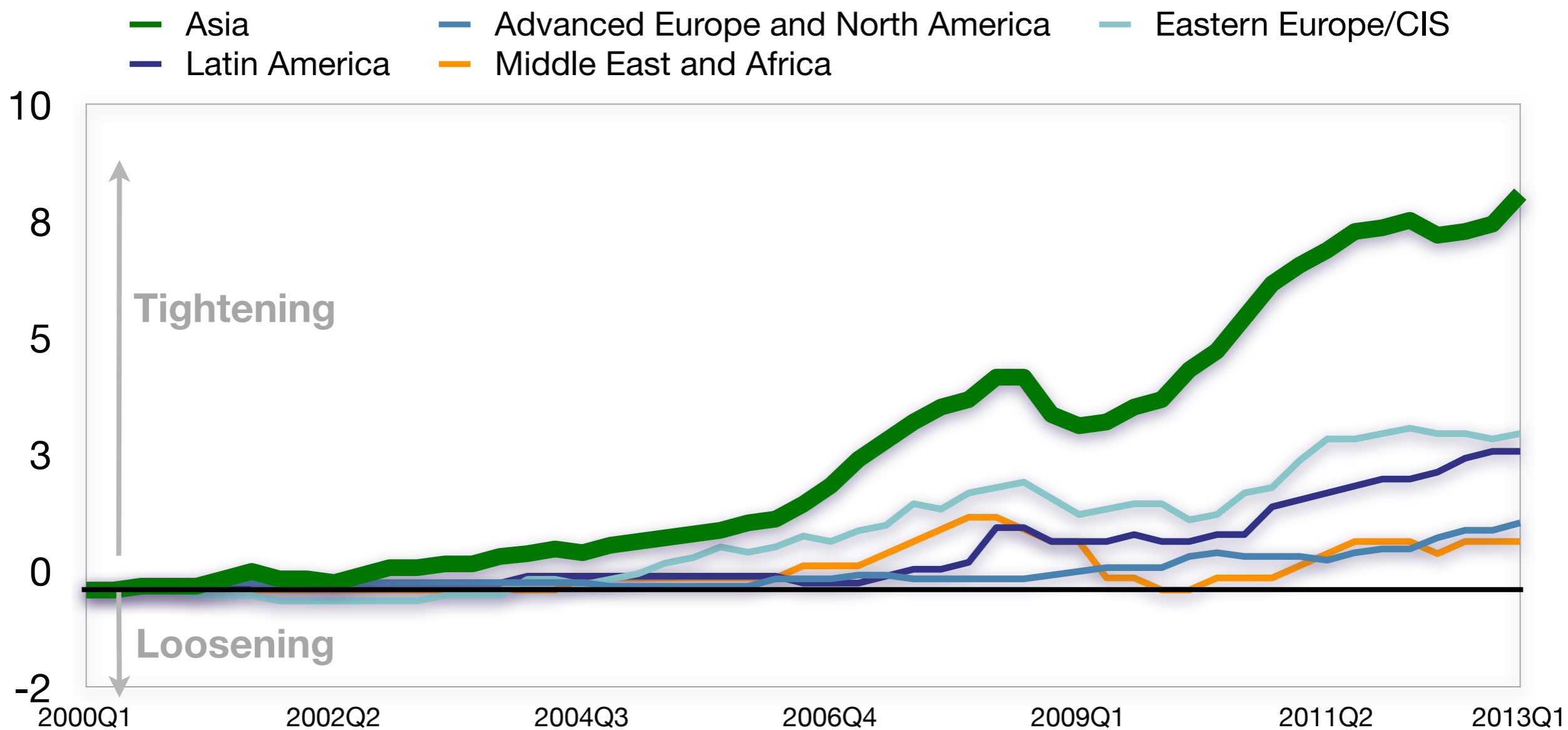
- Asia has used MPPs more than other regions
- Some measures are effective, particularly in housing
- Should they be eased in case of downturn in financial cycle?



Macro-prudential policies: used extensively to manage risks and will provide a buffer

Macro-prudential Policies: Cumulative Actions by Region

(Average per country in each region; 2000:Q1-2013:Q1)¹



Source: IMF staff calculations, Asia and Pacific Regional Economic Outlook-Chapter 4 (2014).

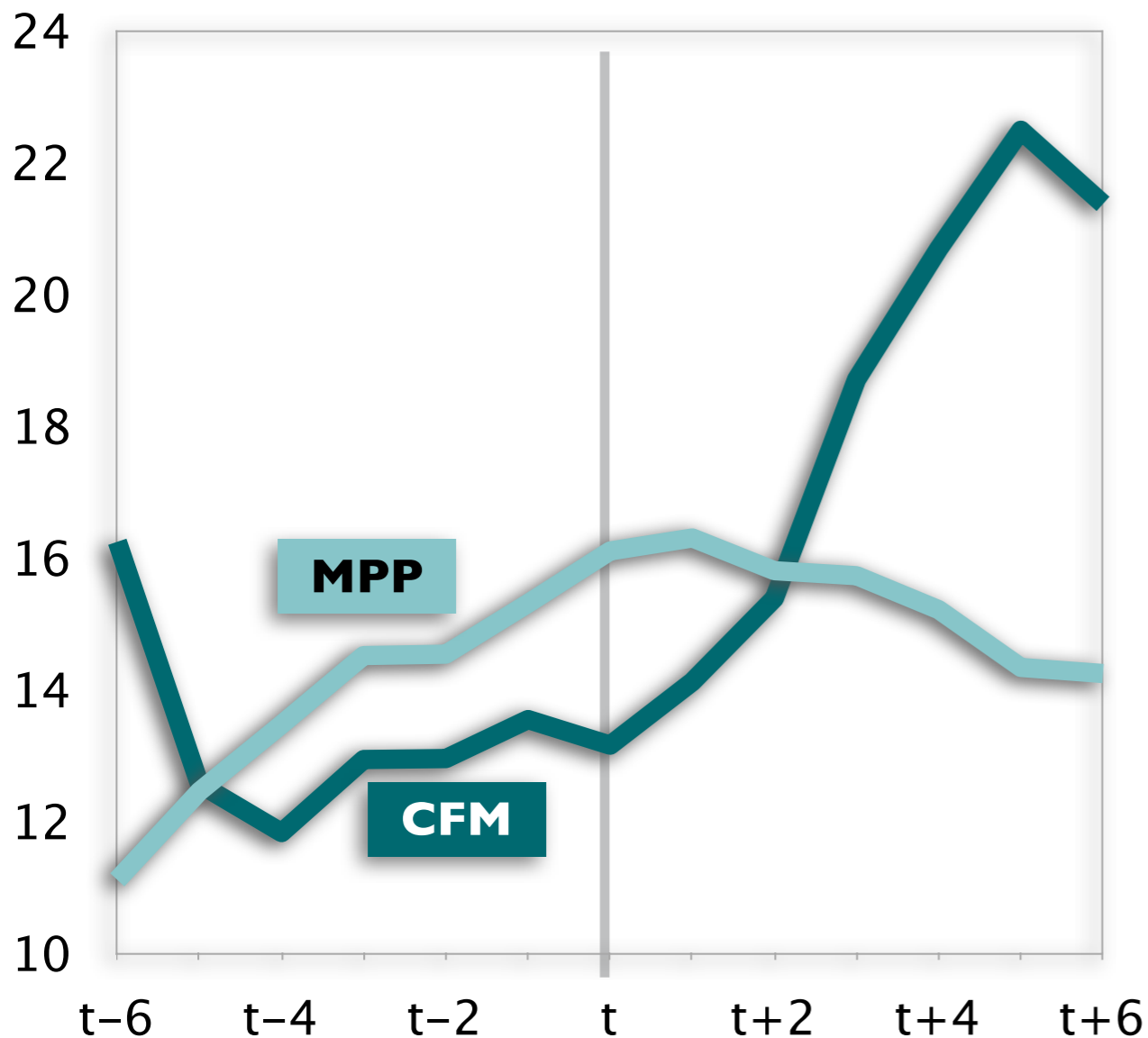
¹ Index summing up housing-related measures, credit measures, reserve requirements, dynamic provisioning and core funding ratio. Simple average across countries within country groups.



Some MPPs have helped so far, notably in housing

Asia: Credit Growth¹

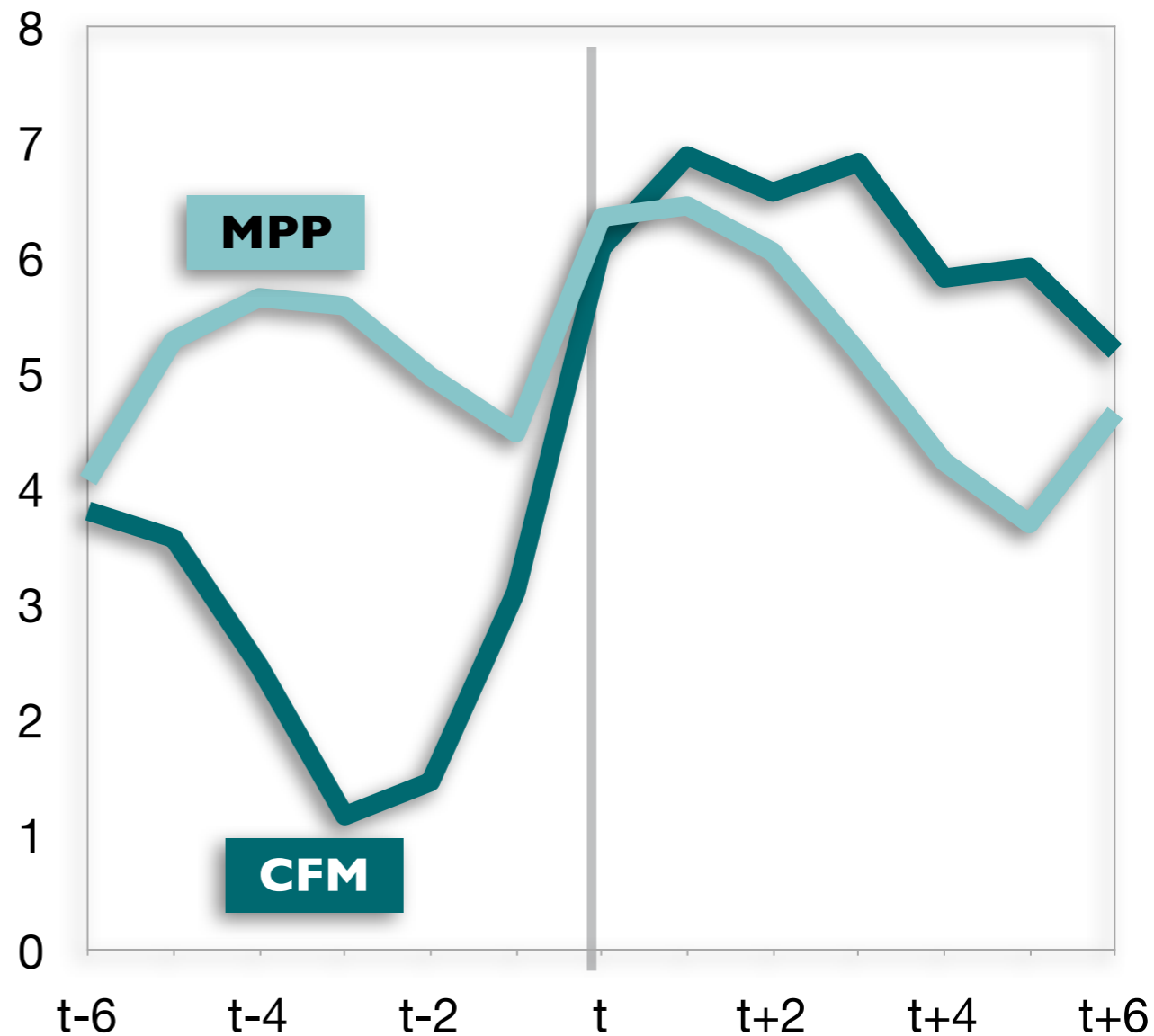
(Average across all episodes; year-over-year percentage change)



¹ Relevant tightening policies introduced over the period 2000:Q1–2013:Q1. Excludes overlapping episodes within four quarters.

Asia: Housing Prices¹

(Average across all episodes; year-over-year percentage change)



¹ Relevant tightening policies introduced over the period 2000:Q1–2013:Q1. Excludes overlapping episodes within four quarters.

Sources: IMF, World Economic Outlook; CEIC Data Co Ltd.; Haver Analytics; and IMF staff estimates, Asia and Pacific Regional Economic Outlook-Chapter 4 (2014).

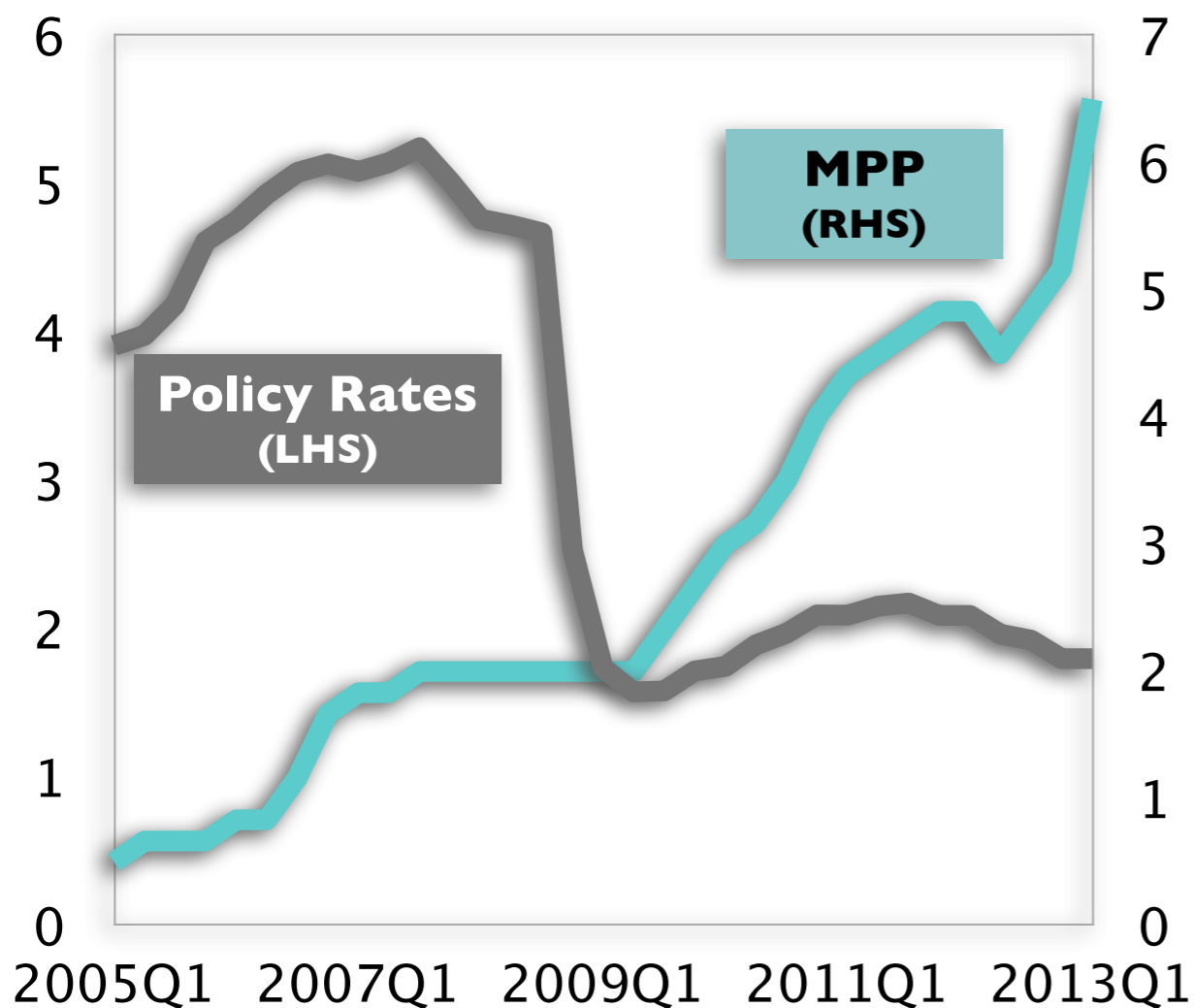


Question of whether MPPs should be eased in event of downturn in financial cycle

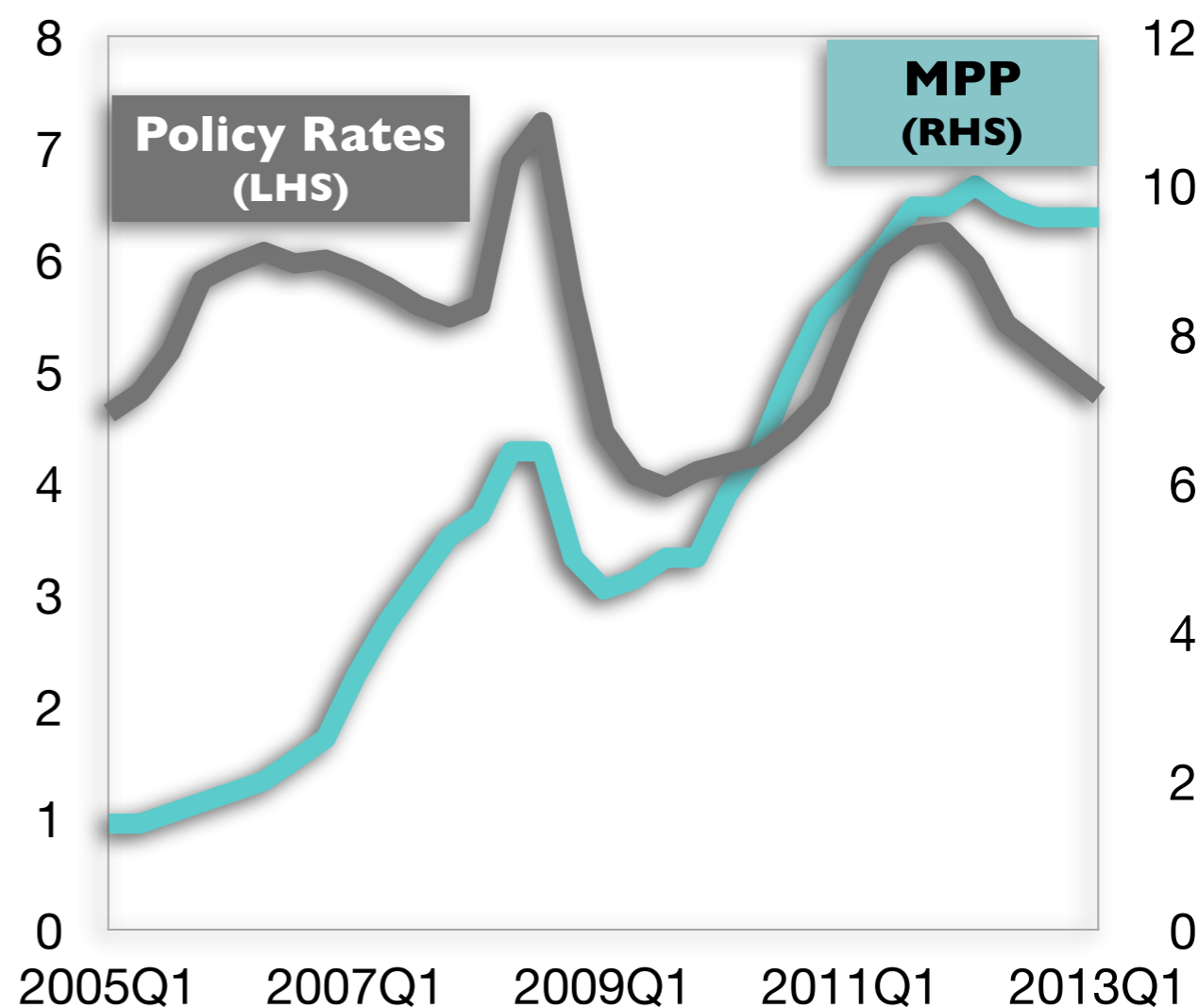
Use of Monetary Policies vs. Macroprudential Measures¹

(Policy rates - simple average in percent; index - cumulative)

Advanced Asia



Emerging Asia



Source: IMF staff estimates, Asia and Pacific Regional Economic Outlook-Chapter 4 (2014).

¹Advanced economies include Australia, Hong Kong SAR, Korea, New Zealand, Singapore and Taiwan Province of China. Emerging economies include China, India, Indonesia, Malaysia, Philippines, Thailand, Vietnam.



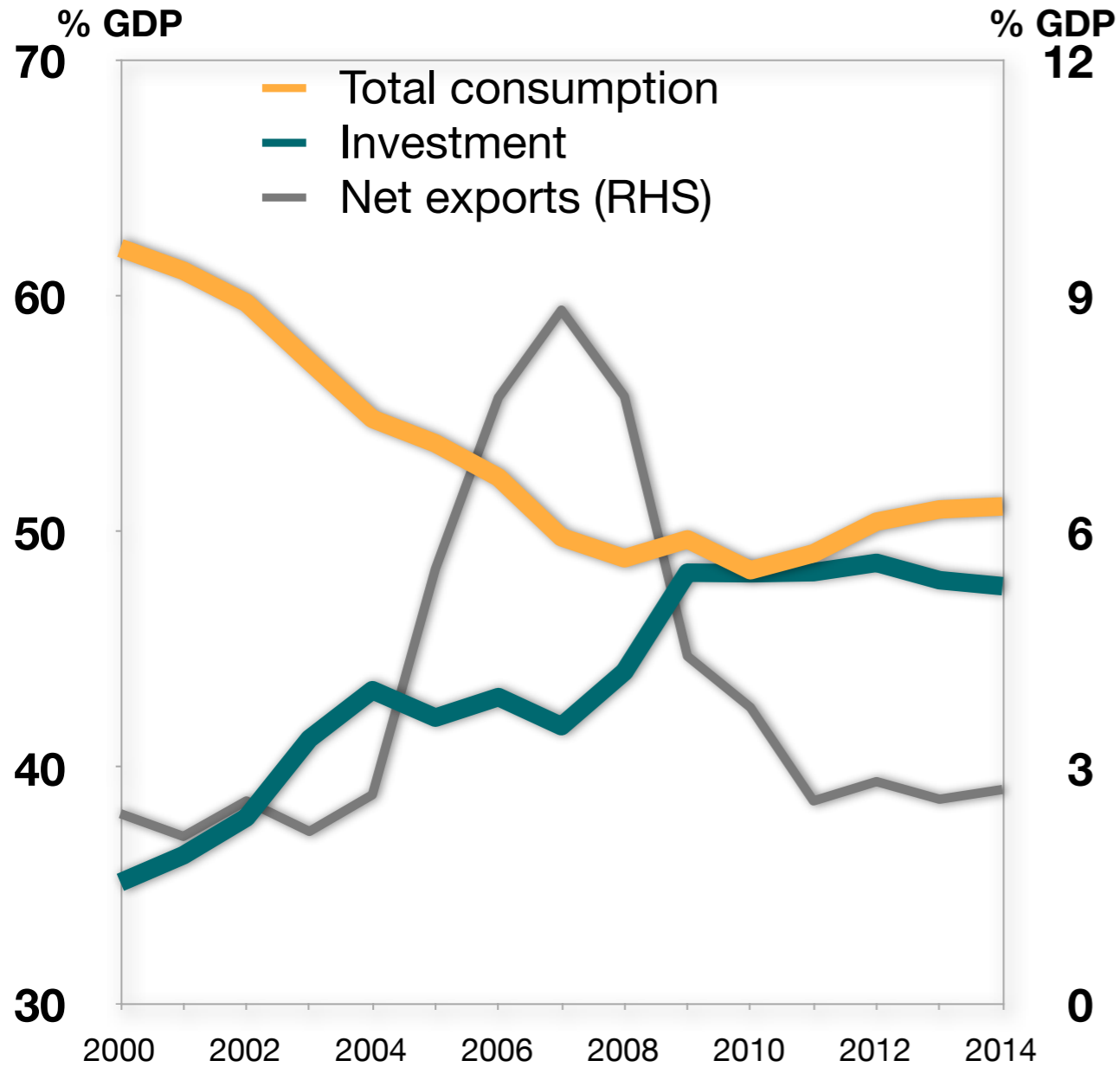
Theme 3: China's reforms— what impact?

- Risks are building up...
- ...and any sharp slowdown would affect Asia twice as much as non-Asia
- Reform blueprint should make growth more balanced and sustainable...
- ...and benefit region despite short-term transitional costs

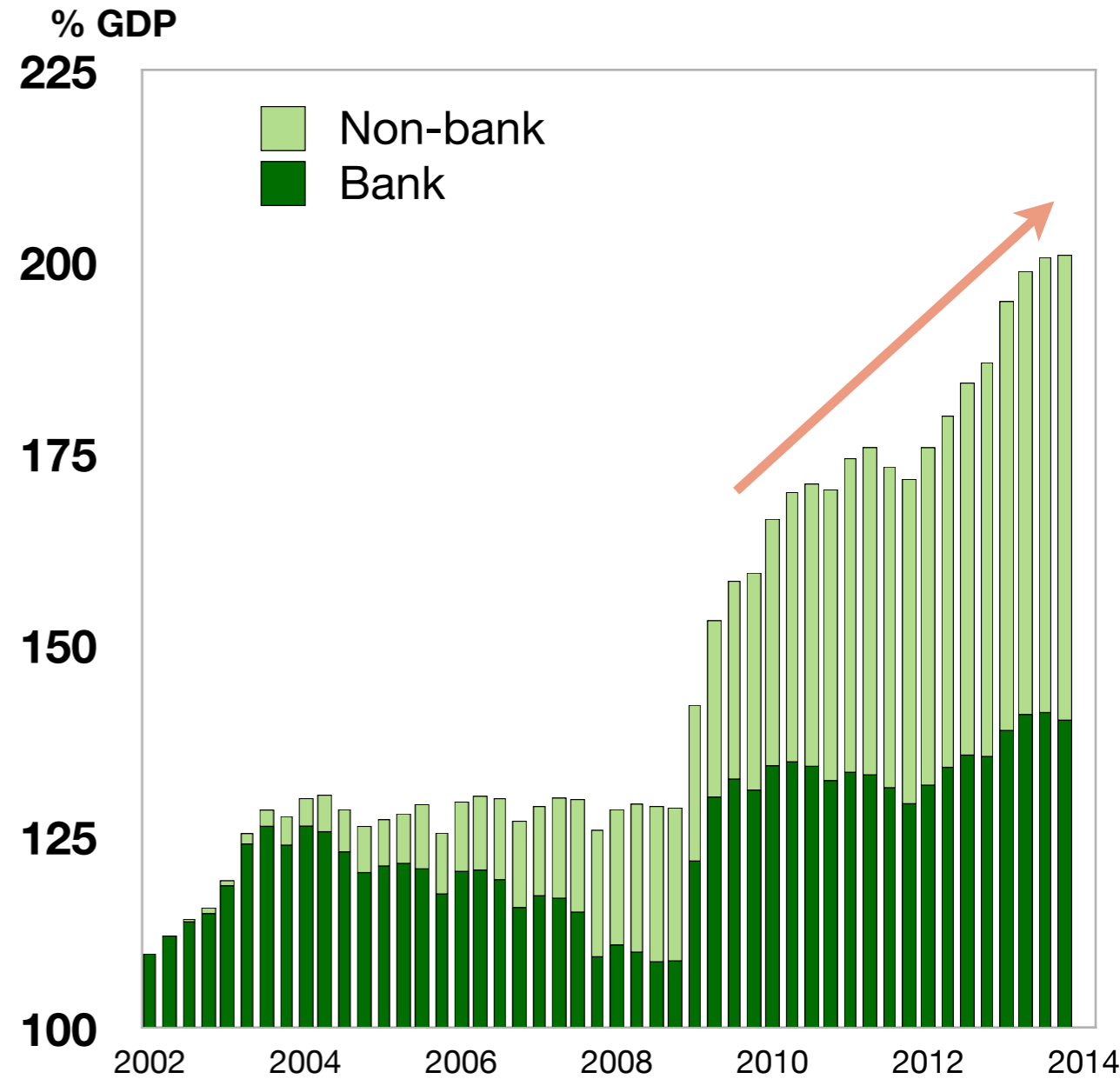


Need to put growth on a more sustainable path

China: GDP Expenditure Components



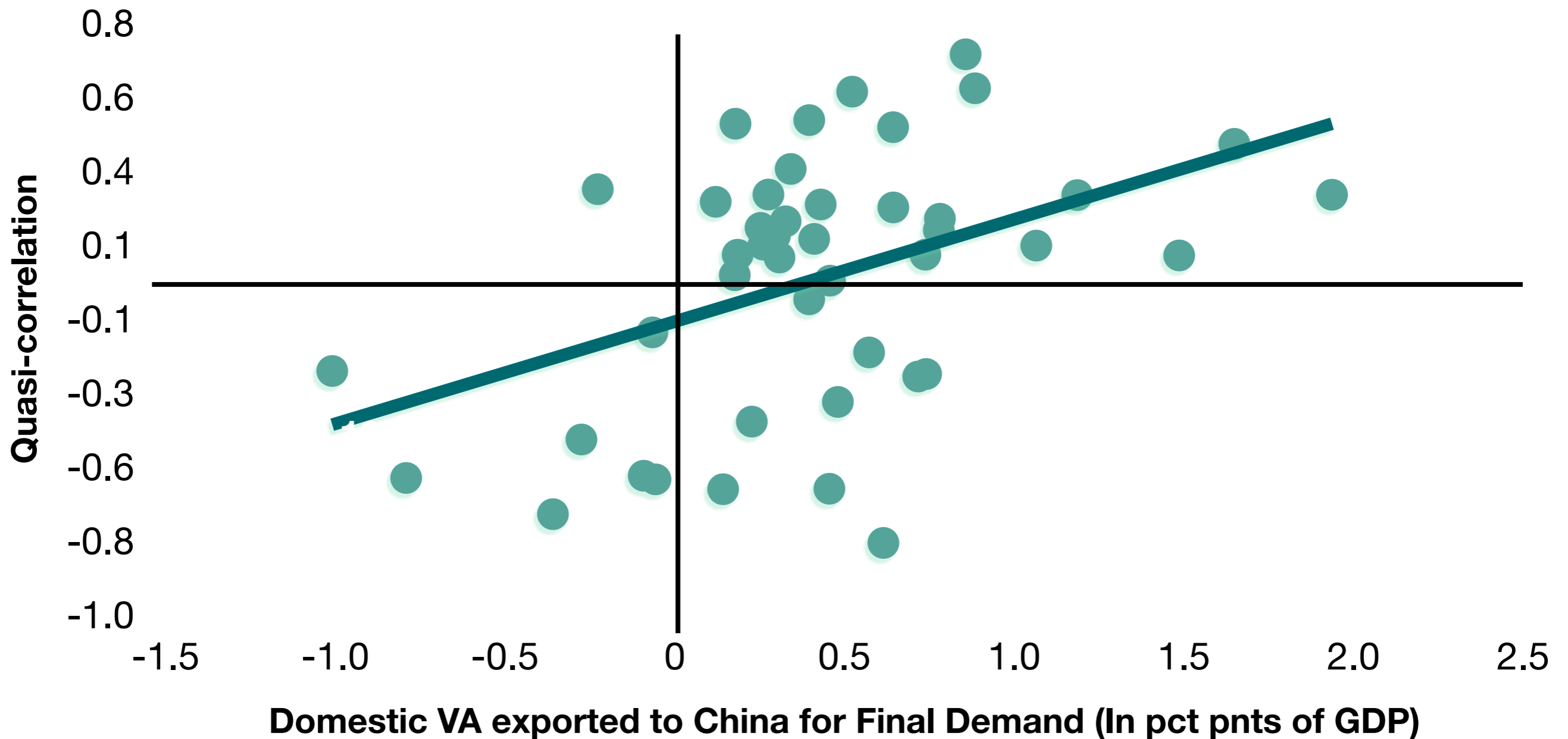
China: Social Financing Outstanding





Other Asian economies exposed due to growing dependence on final demand from China

Change in Output Co-movement with China and Value-added Exported to China for Final Demand
(Change from early 2000s to latest)

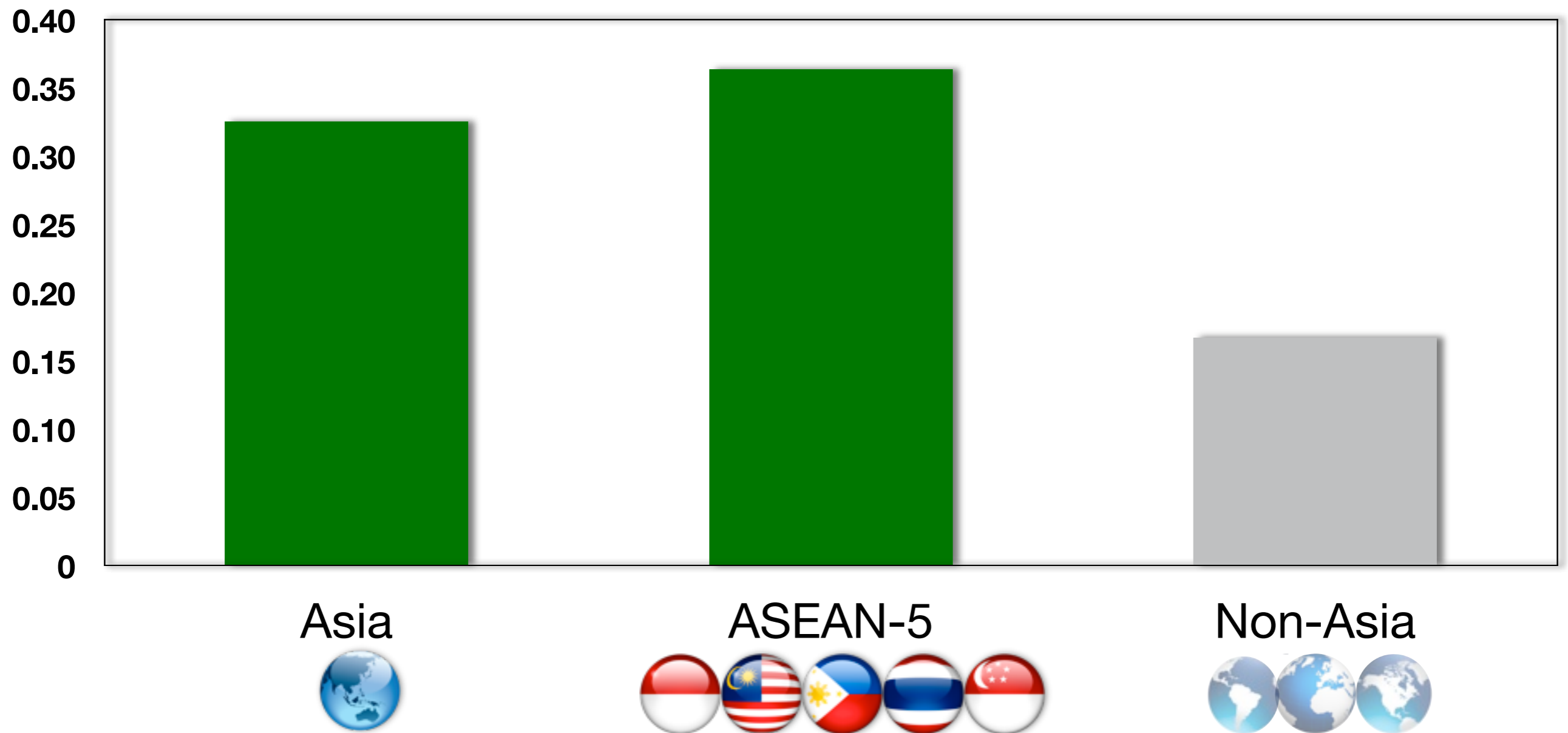




Asia twice as exposed as non-Asia to spillovers from China (new IMF estimates)

Estimated Impact of 1% Growth Surprise in China on Partner Country Growth

(GDP growth impact after one year, in percentage points: Median)

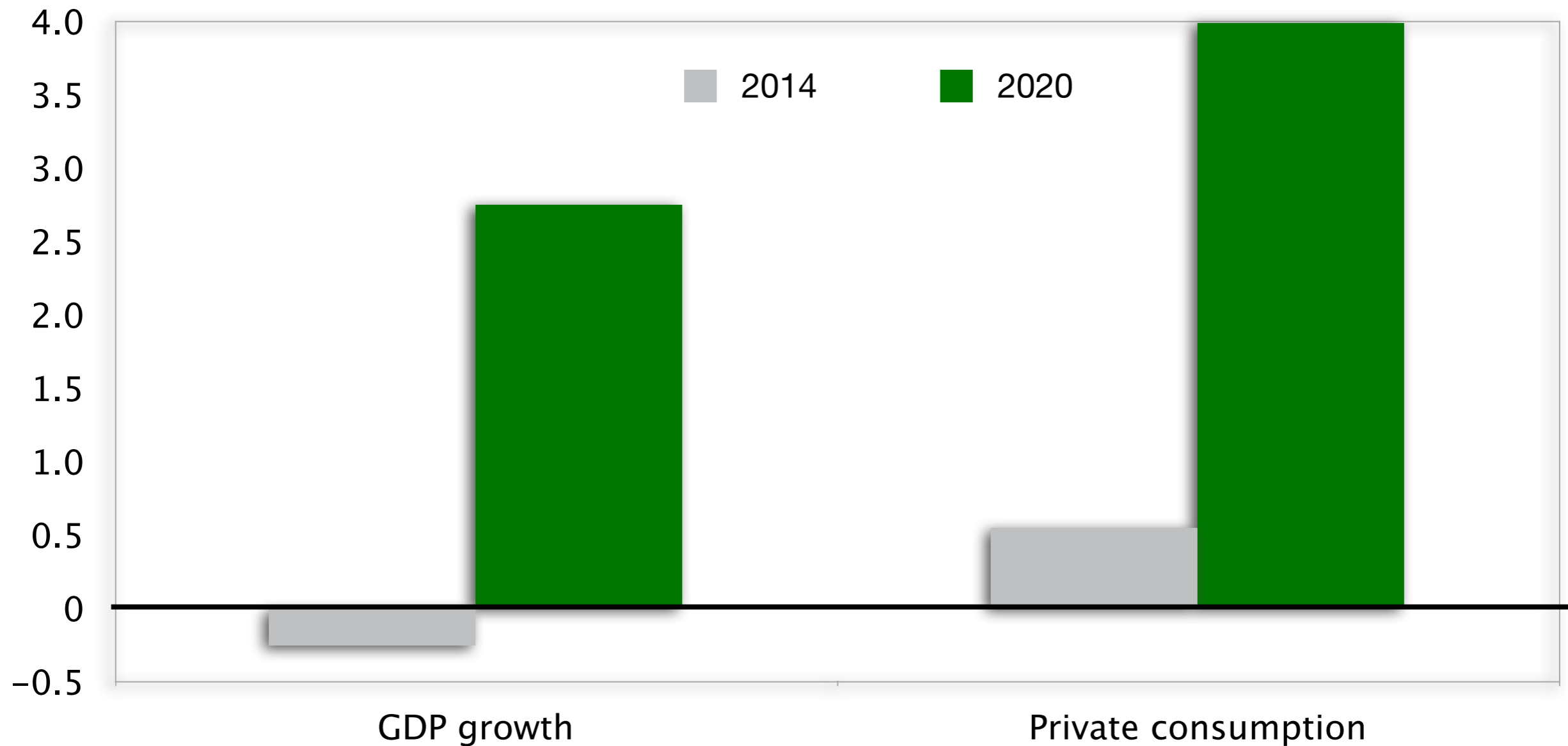




Reforms hold the promise of more stable and more sustainable growth

China: Illustrative Impact of Reform Implementation

(Deviation from baseline; GDP level: year-over-year percentage change; private consumption: percentage of GDP)



Source: IMF staff estimates.



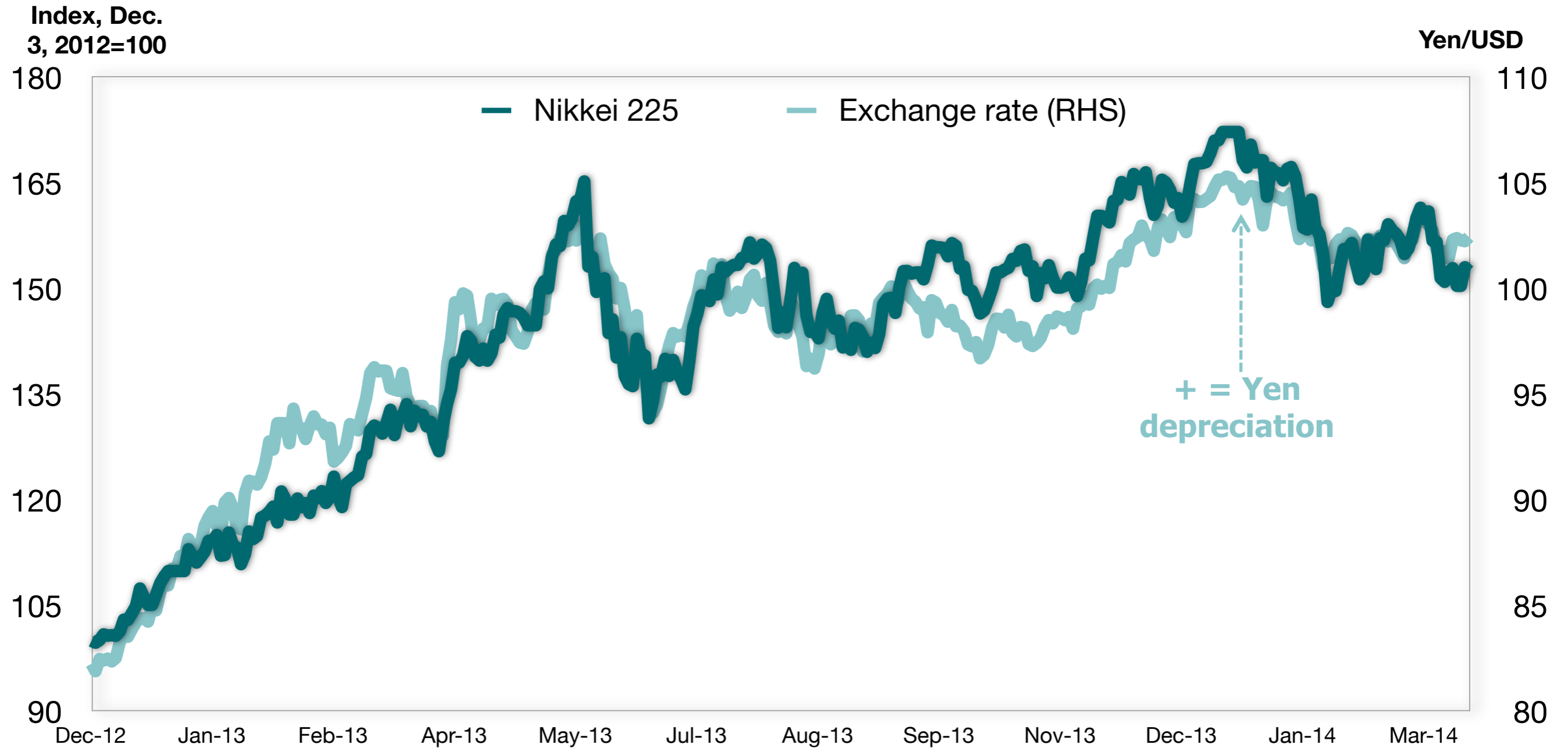
Theme 4: Abenomics— temporary stimulus or break with the past?

- Abenomics has provided a boost but major challenges remain
- Need for further decisive reforms to achieve private-sector-led growth and durable exit from deflation



Depreciation has provided a boost,...

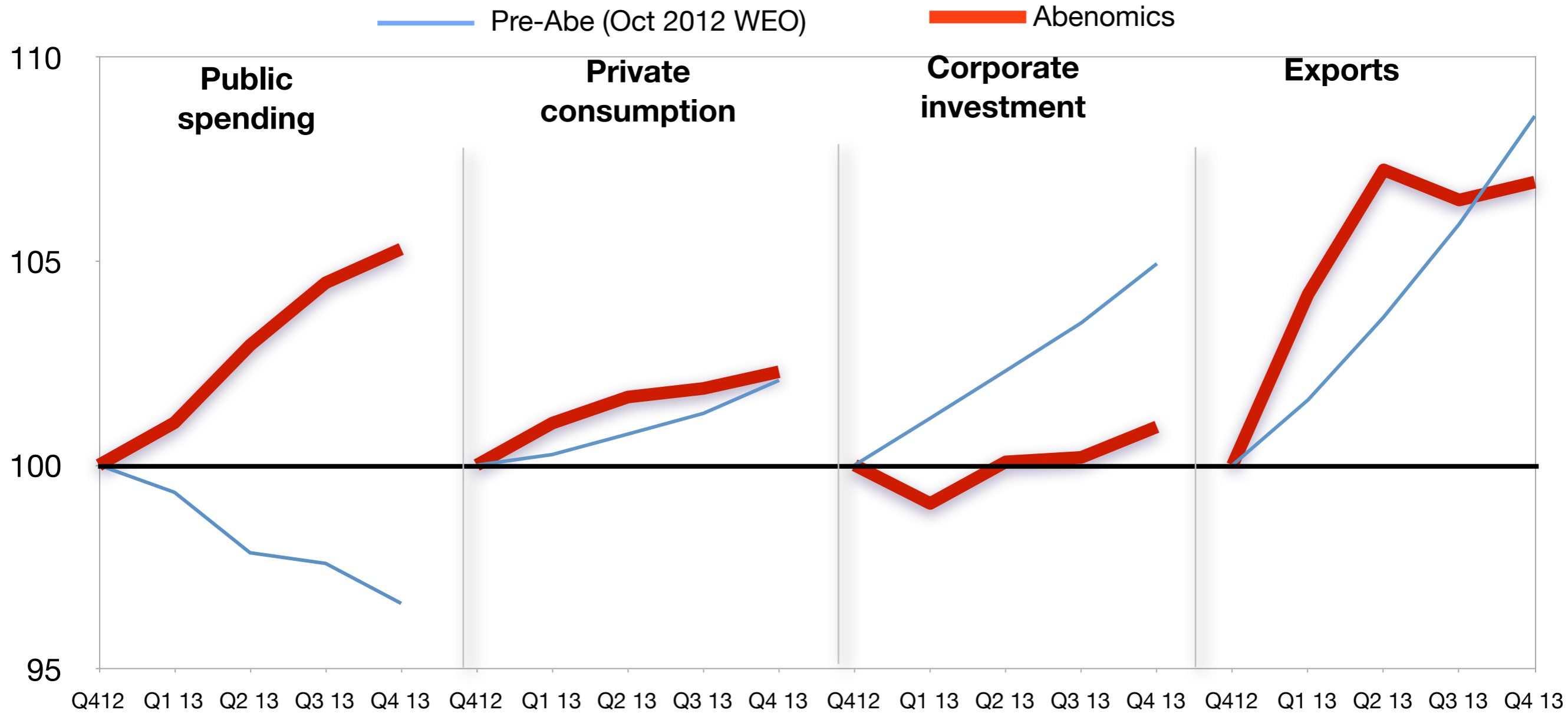
Japan: Financial Markets





...however challenges remain.

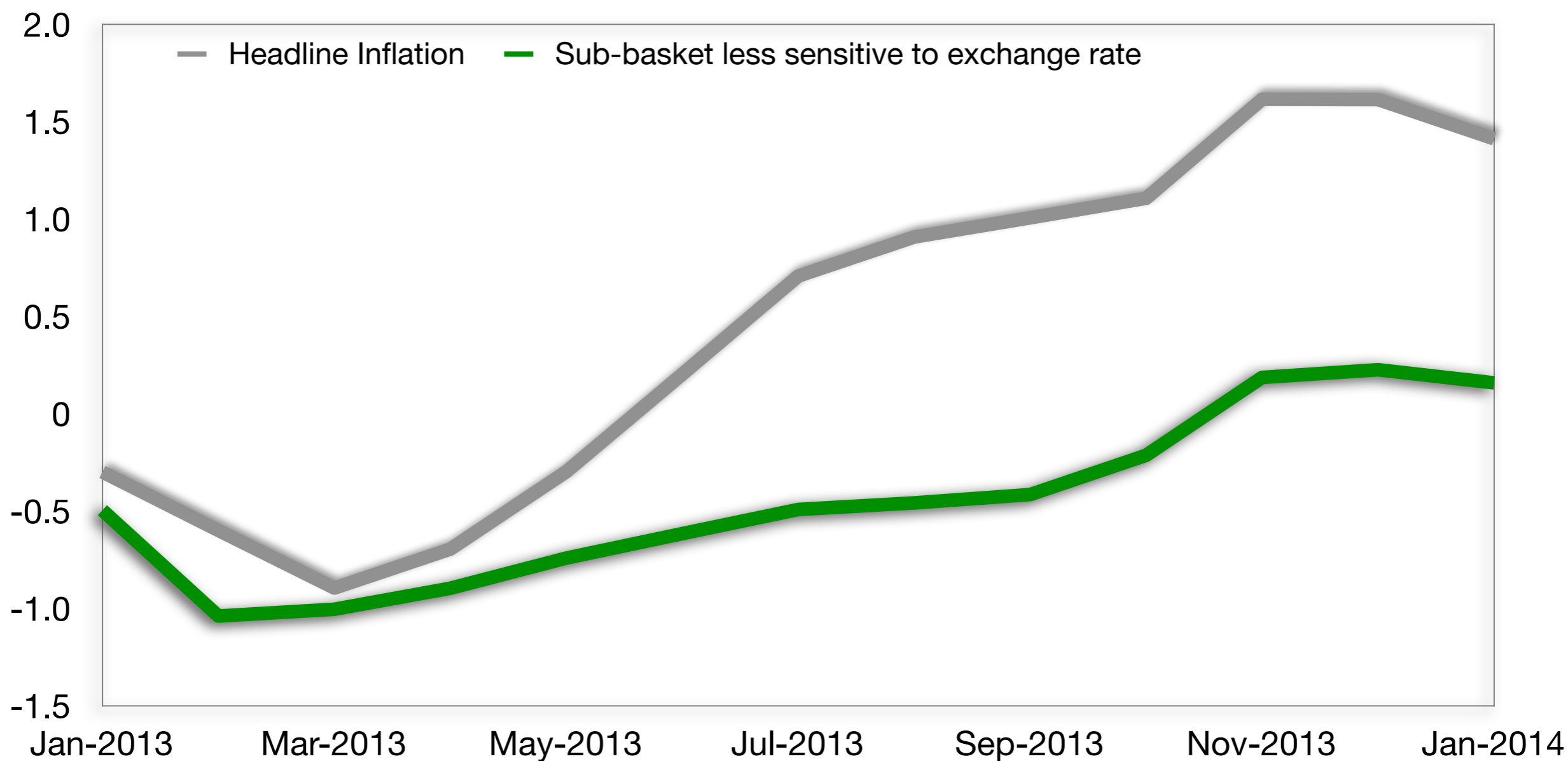
Japan: Components of Real GDP





Inflation pick-up so far: primarily the effect of yen depreciation?

Japan: Inflation
(year-over-year percent change)

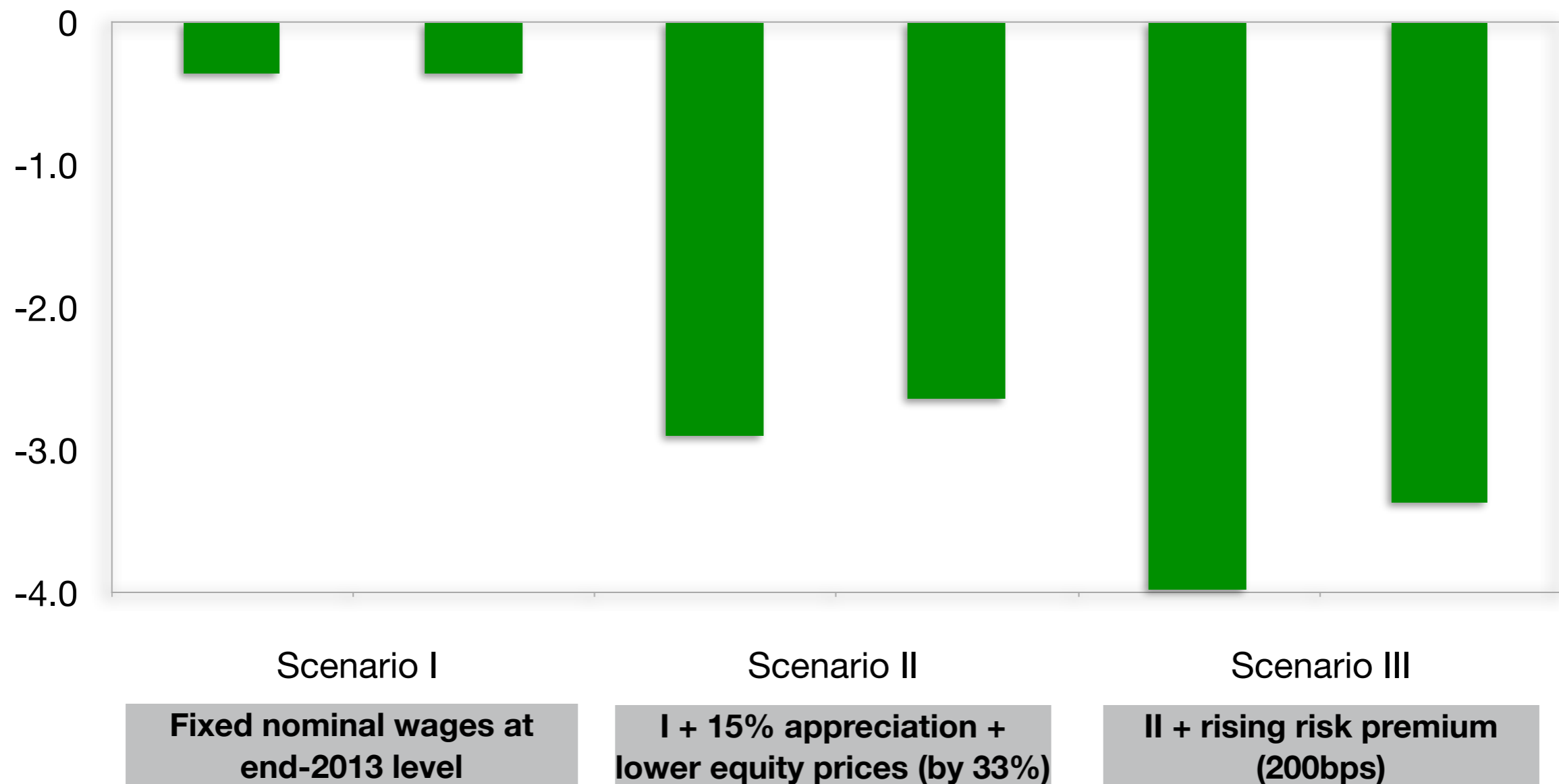


Sources: IMF staff estimates.



Need for further decisive reforms to achieve private-sector-led growth and durable exit from deflation

Impact on Japan's GDP growth
(in percentage points)



Sources: IMF staff estimates.



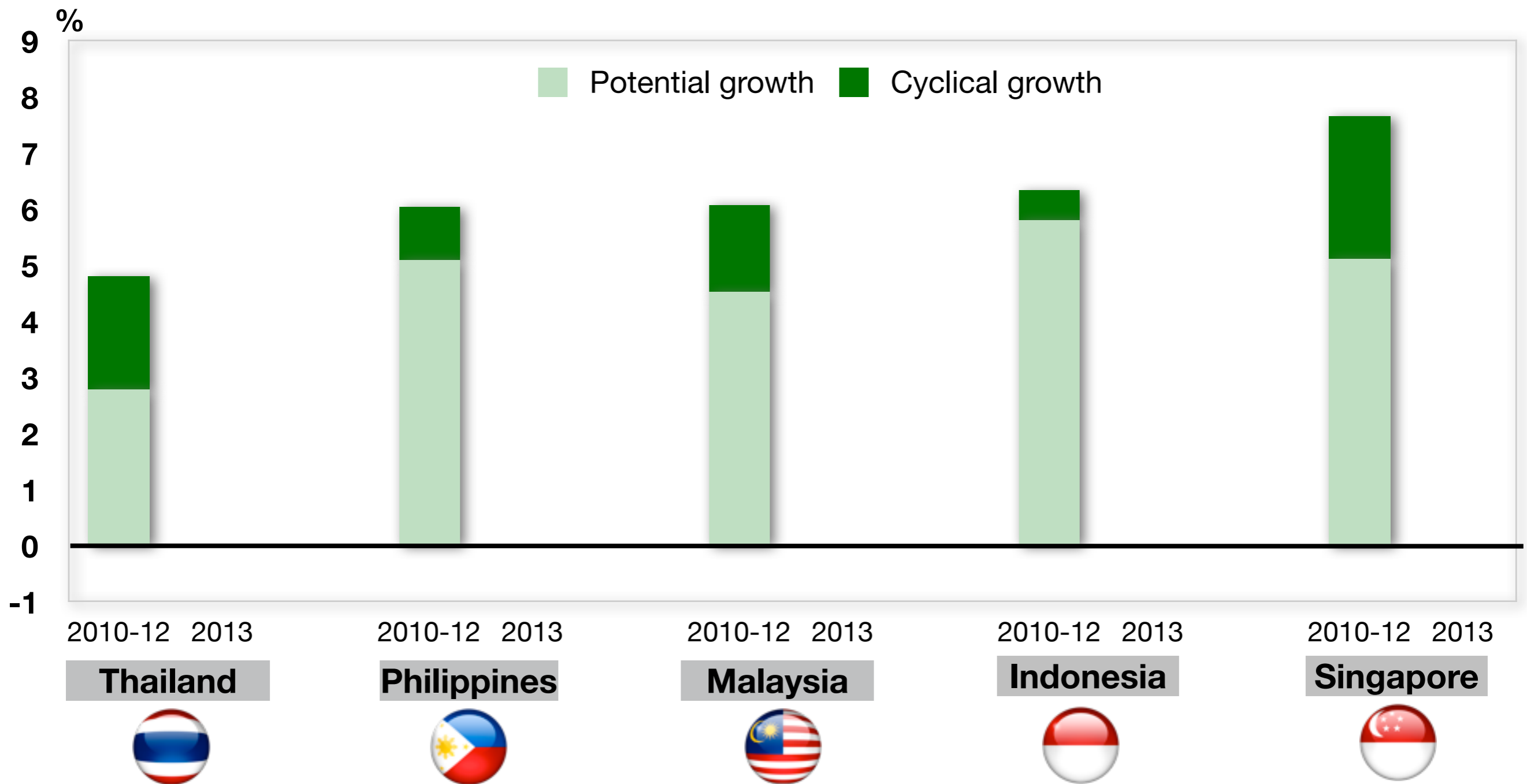
Theme 5: ASEAN— what is happening to growth?

- The recent growth slowdown in ASEAN-5 has been more cyclical than structural
- Domestic factors have played a bigger role
- But the pickup in global demand will help



A cyclical slowdown

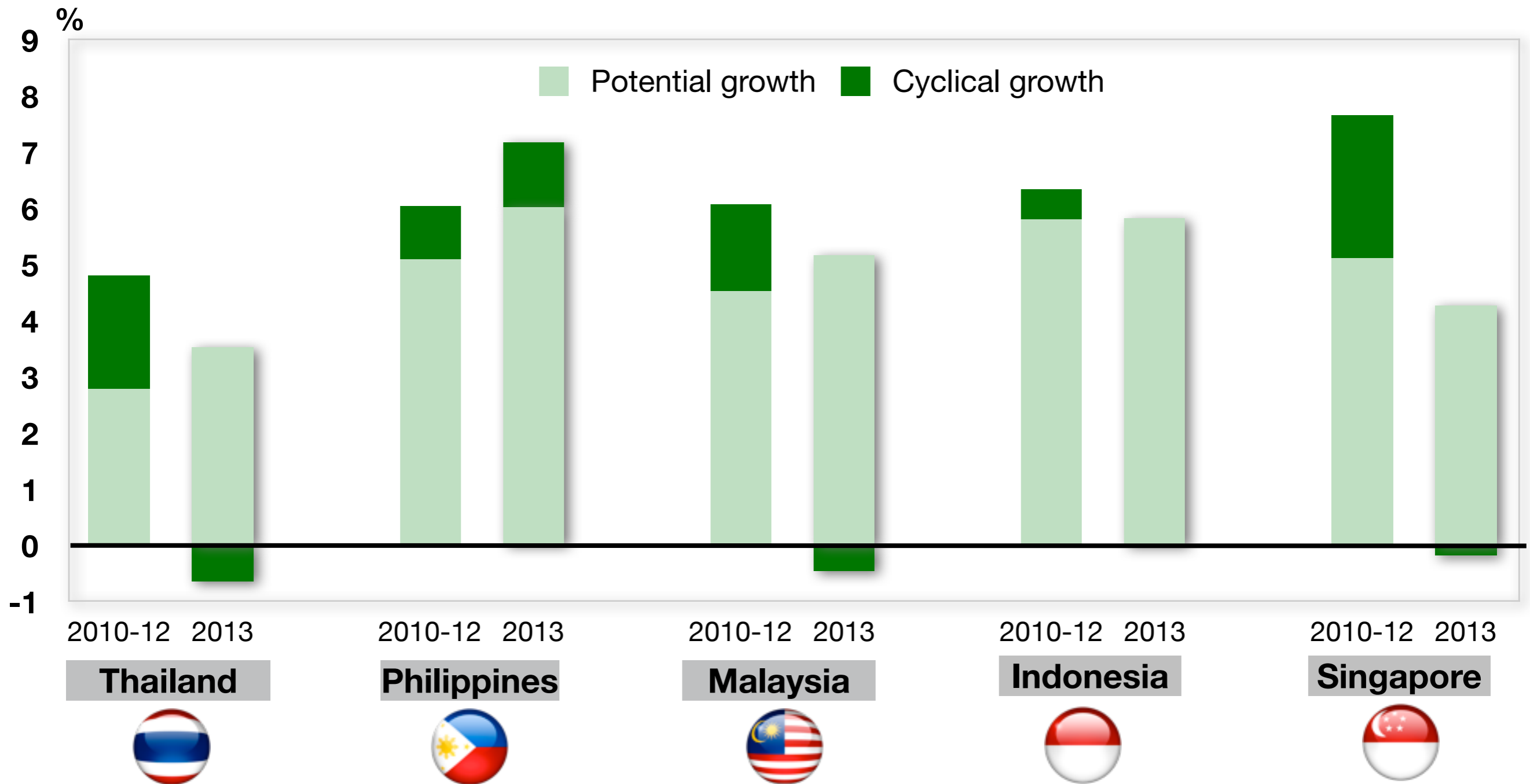
ASEAN-5 Growth: 2010-12 vs. 2013





A cyclical slowdown

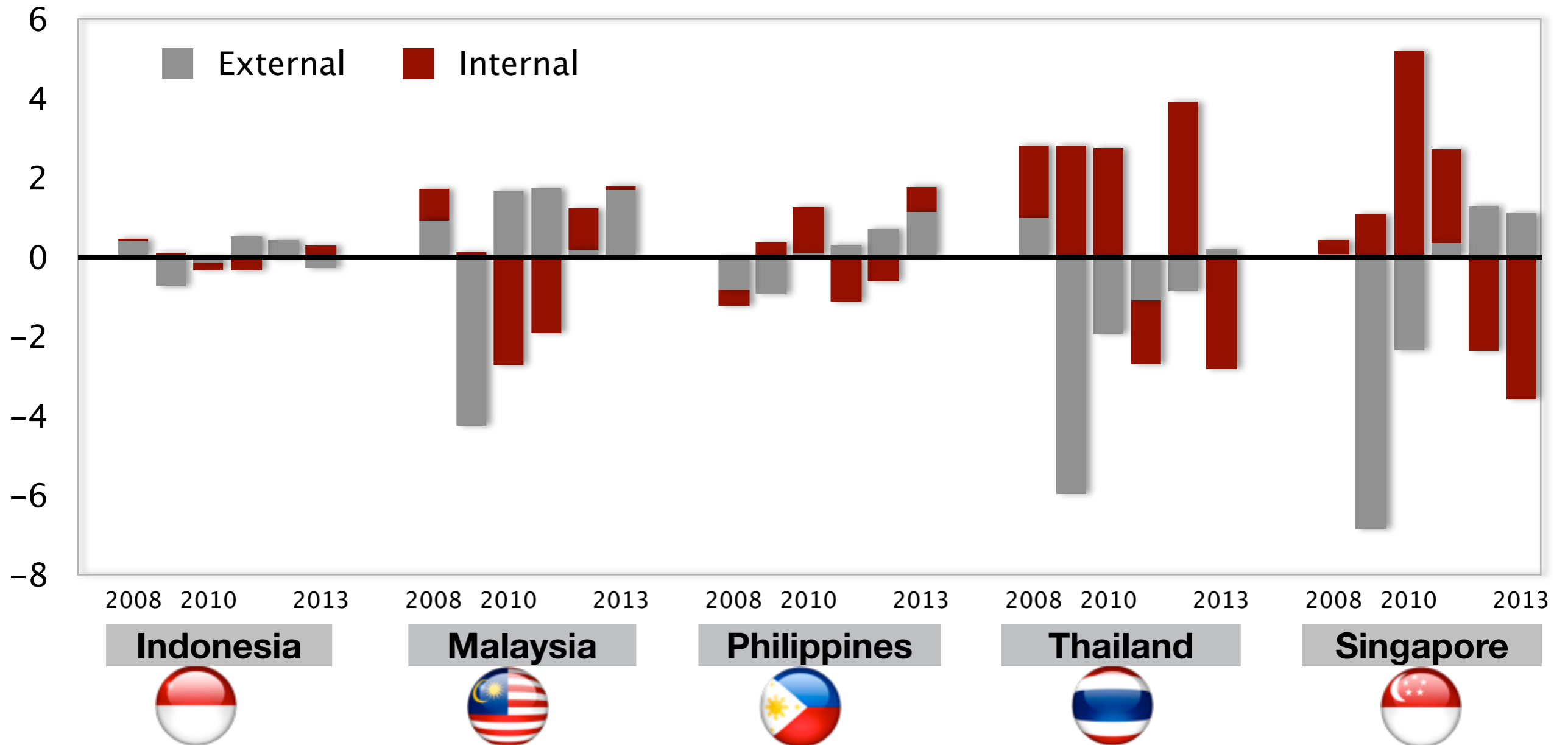
ASEAN-5 Growth: 2010-12 vs. 2013





Domestic factors have been the main culprit

Historical Decomposition of Output Deviation
(In percent)



Source: IMF staff estimates.

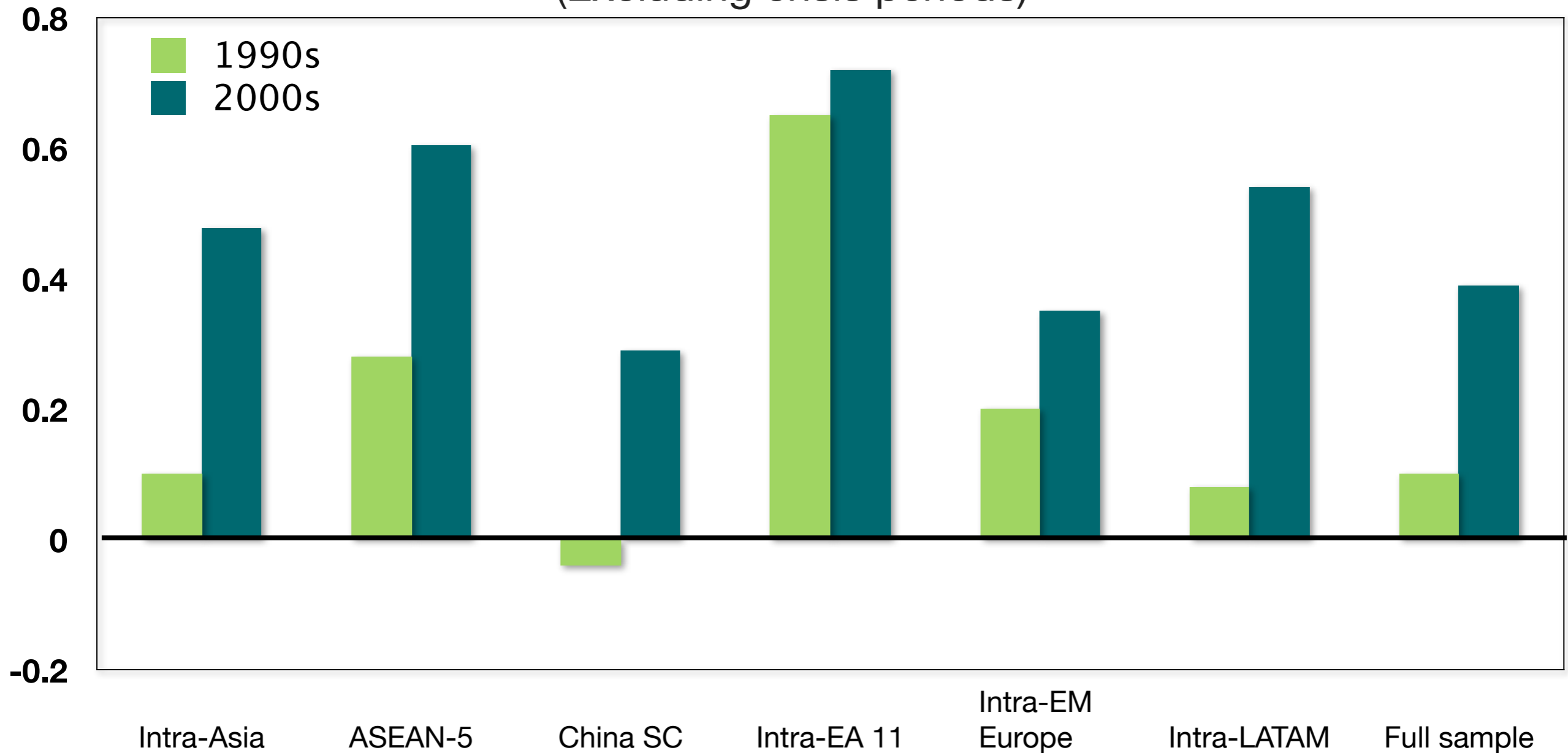
Theme 6: Regional integration— growing source of spillovers?

- Asian economies are moving increasingly in synch...
- ...partly due to growing trade integration (~ 1/4 of rise in comovement)
- ...which in turn reflects build-up of supply-chain linkages
- ...particularly around China, with Japan's role declining
- The future: greater integration => greater growth comovement
=> role for regional and global financial safety nets

Growth co-movement spikes in crises but is also on the rise in normal times



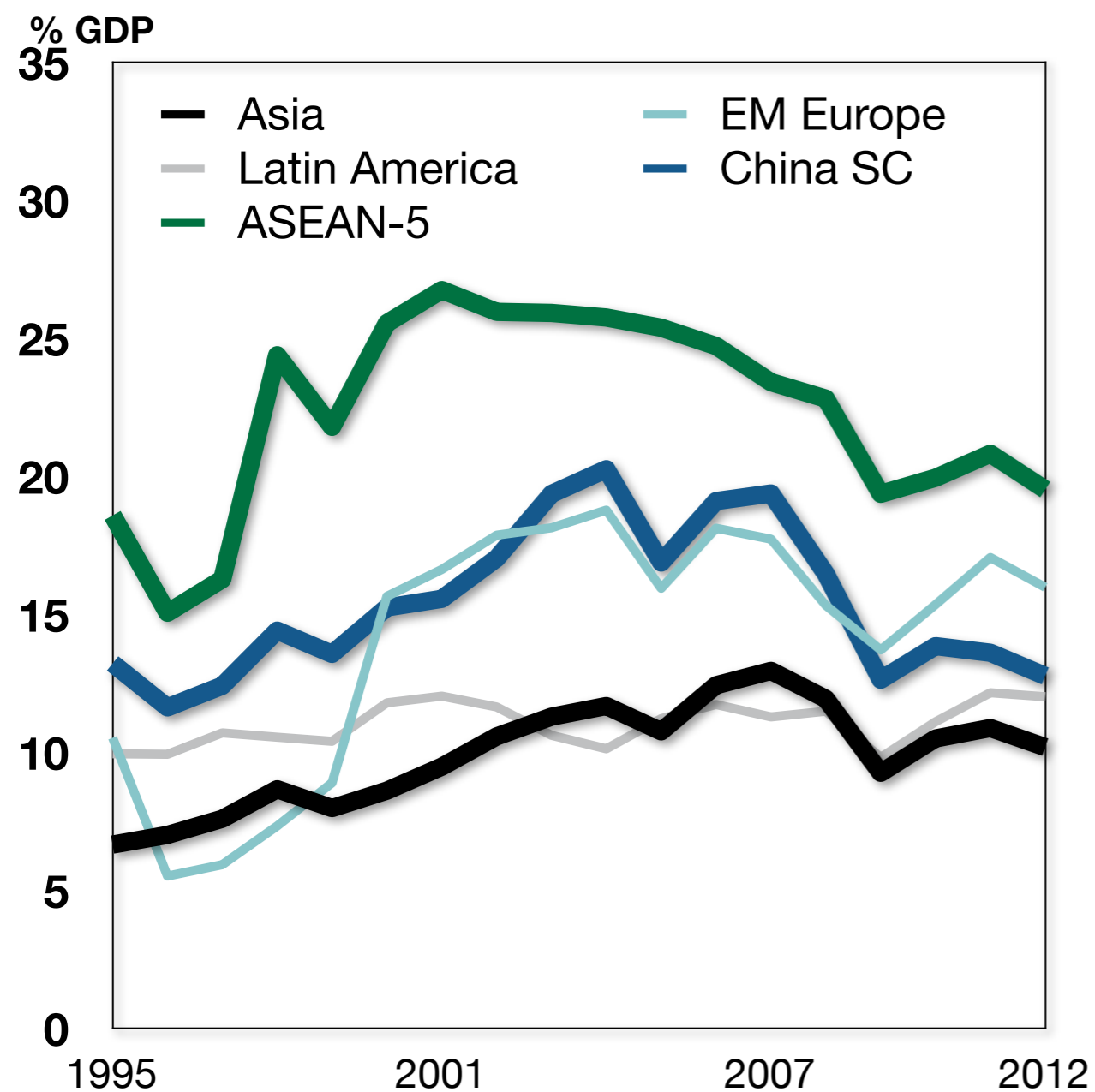
Instantaneous Quasi-Correlation by Region (Excluding crisis periods)



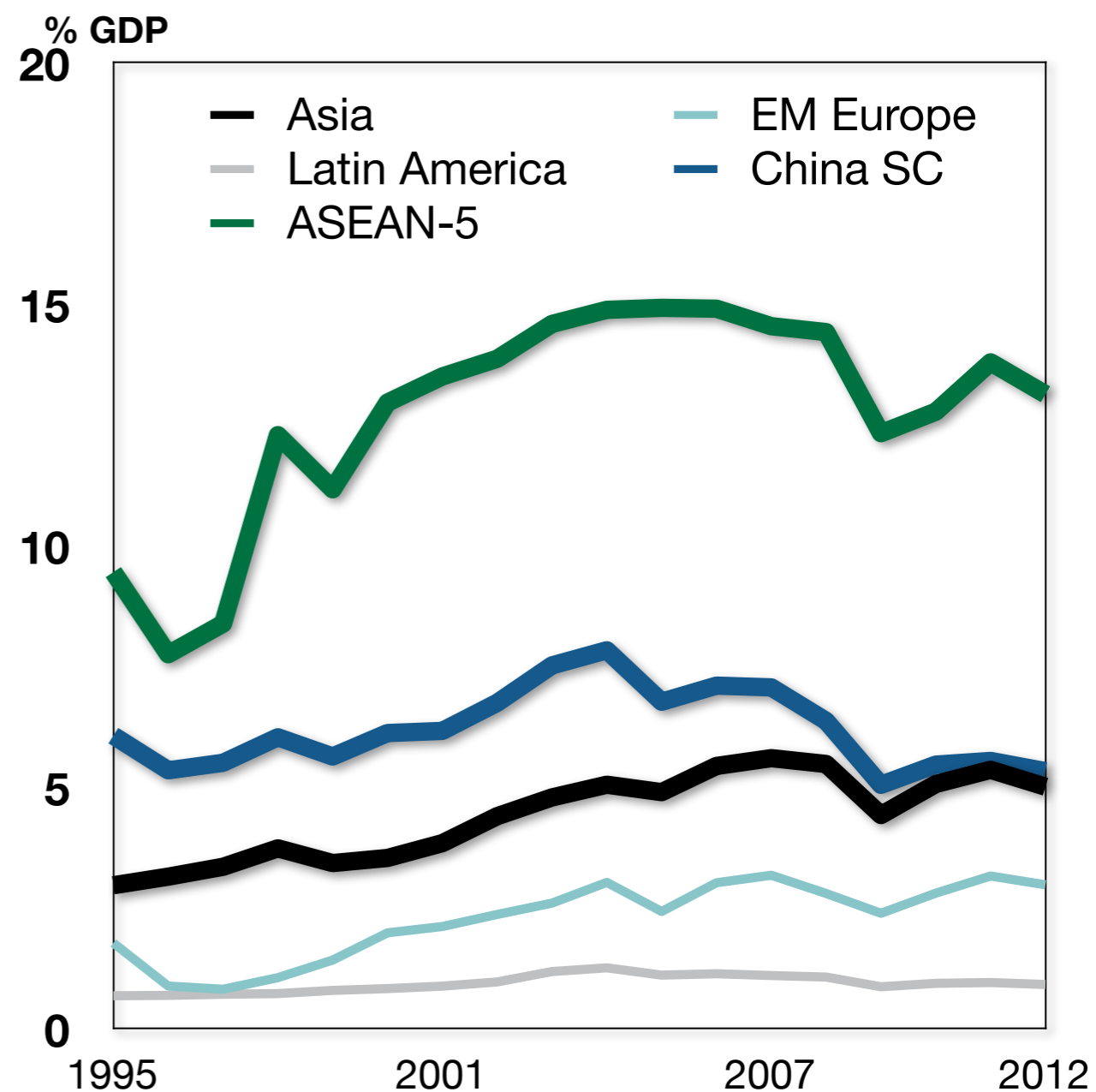


Asia's degree of trade integration: high and rising, although not since the 2000s

Trade Intensity with the World



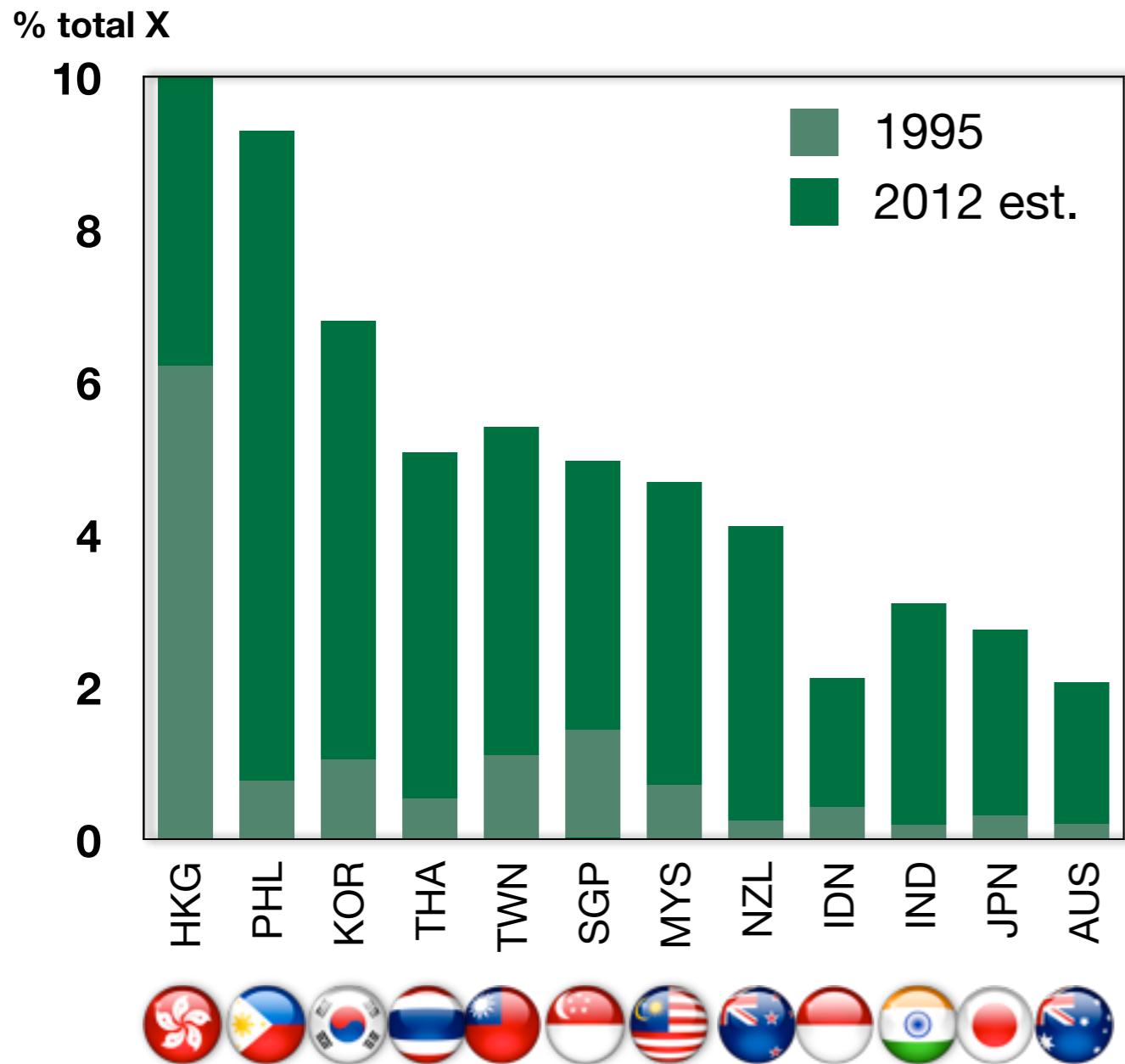
Intra-regional Trade Intensity



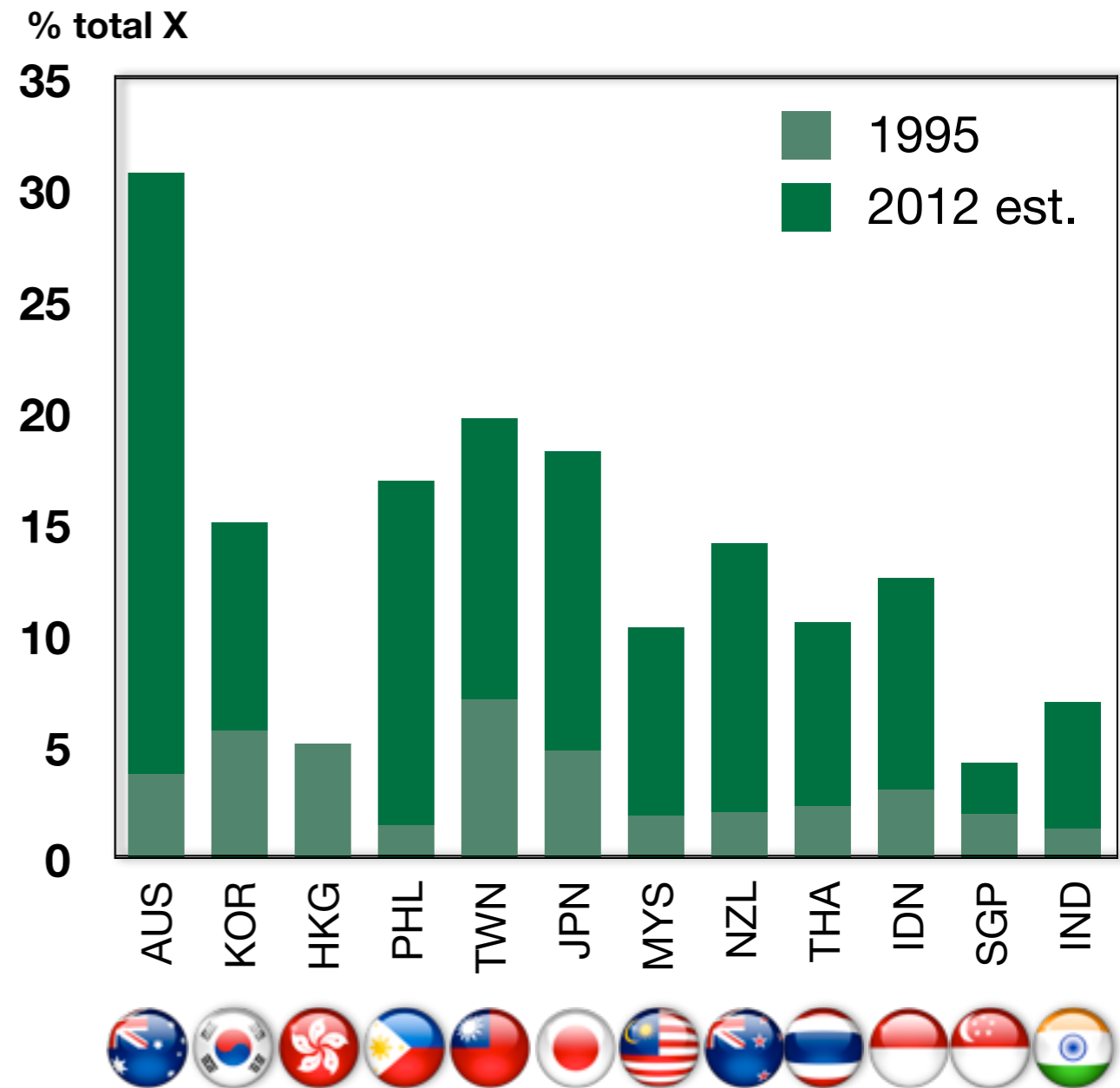


Growing integration with, and dependence on, China...

Foreign Value Added Embodied in each Economy's exports that come from China



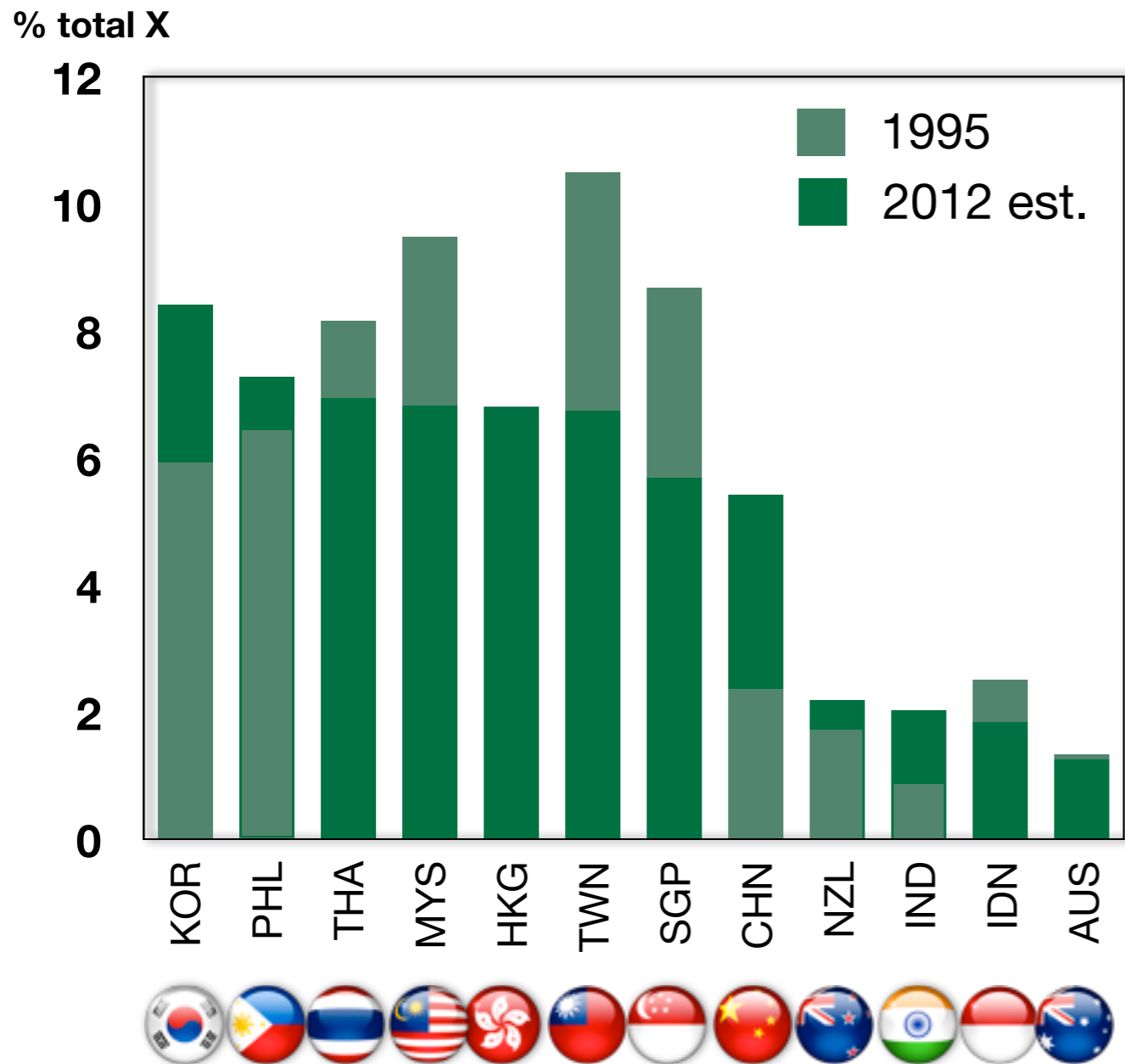
Domestic Value Added Embodied in each Economy's exports to China



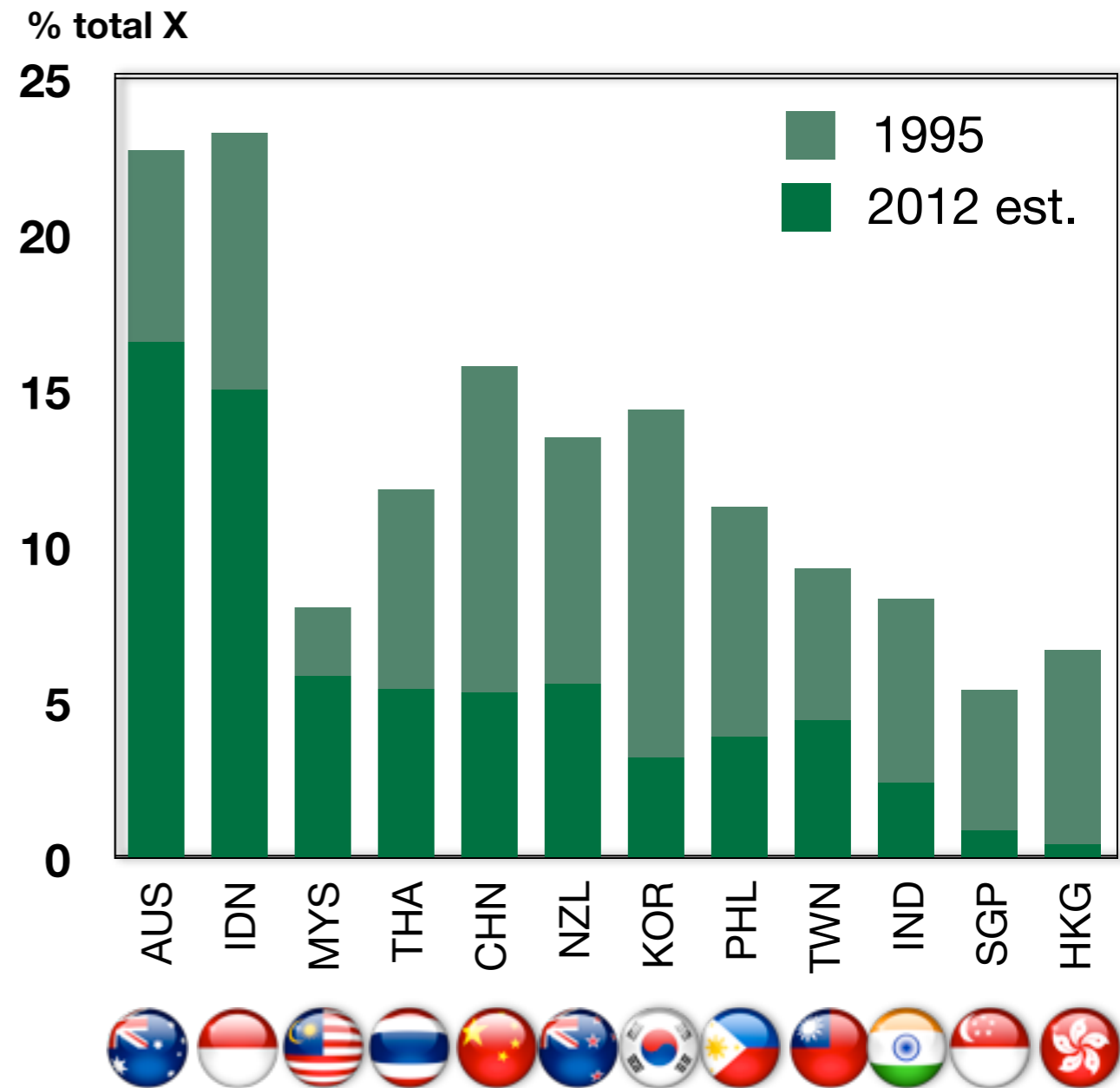


...and declining integration with, and dependence on, Japan

Foreign Value Added Embodied in each Economy's exports that come from Japan



Domestic Value Added Embodied in each Economy's exports to Japan

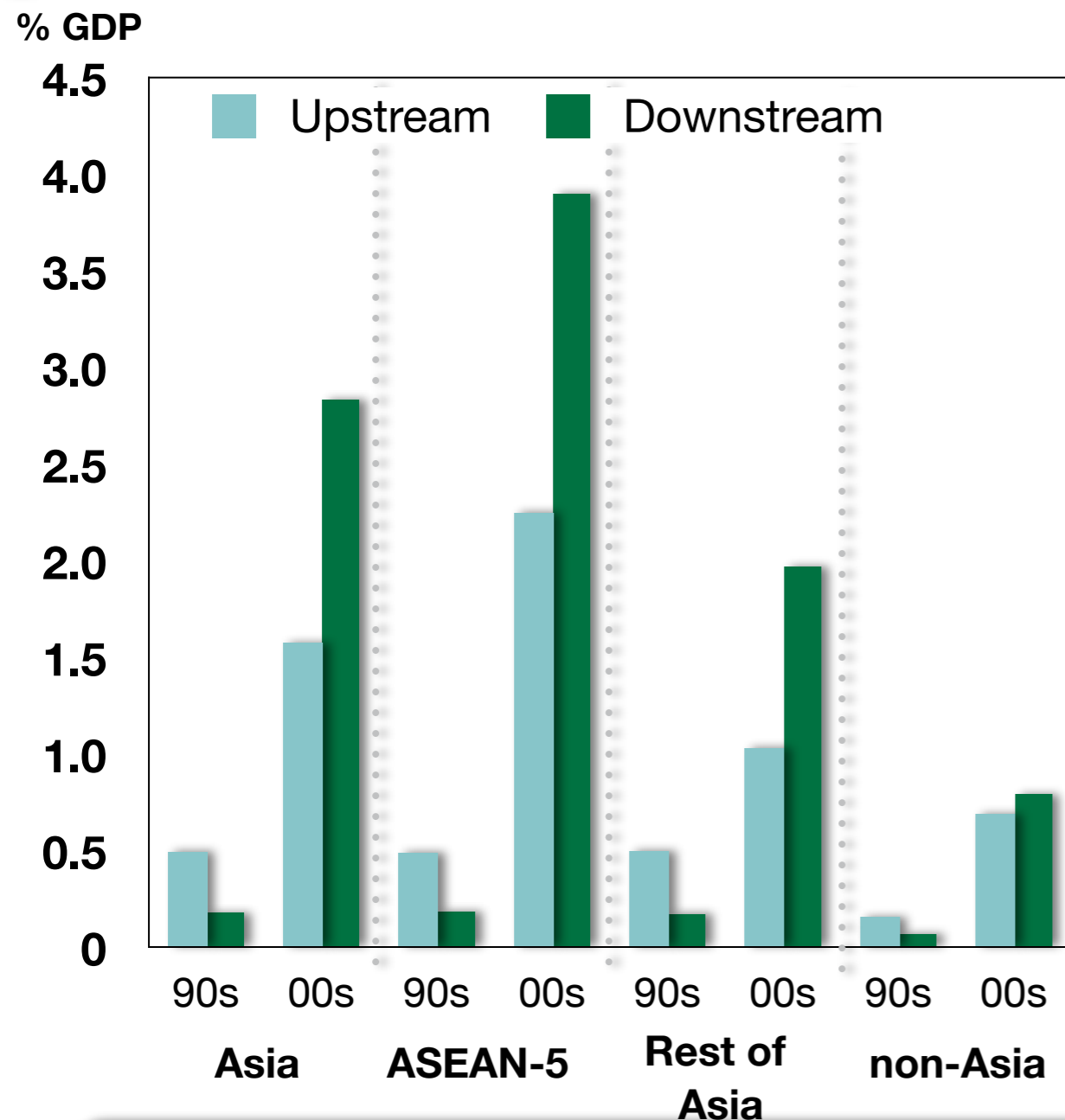




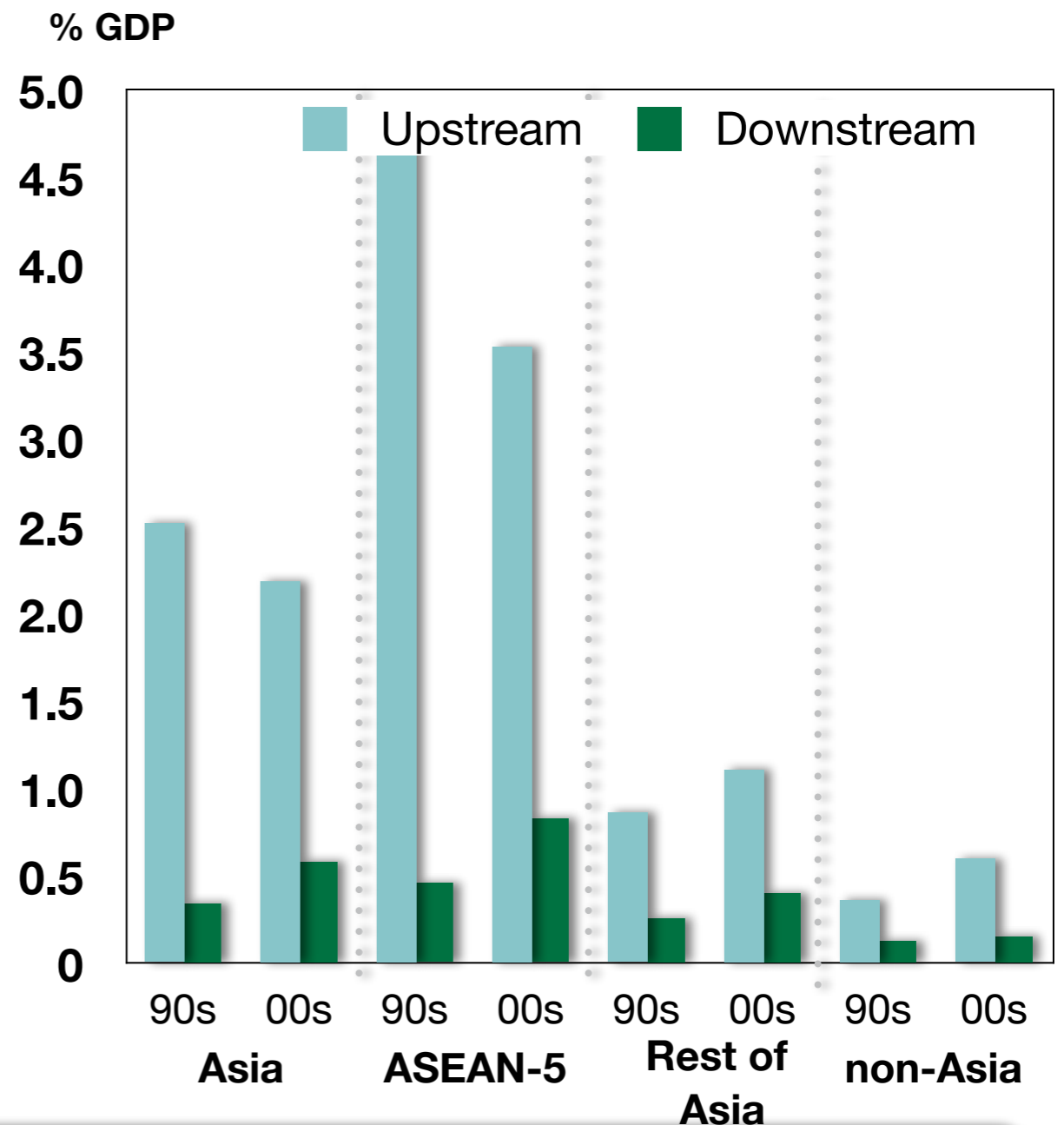
China's and Japan's positions in regional supply chain have also diverged



Median Vertical Trade with China



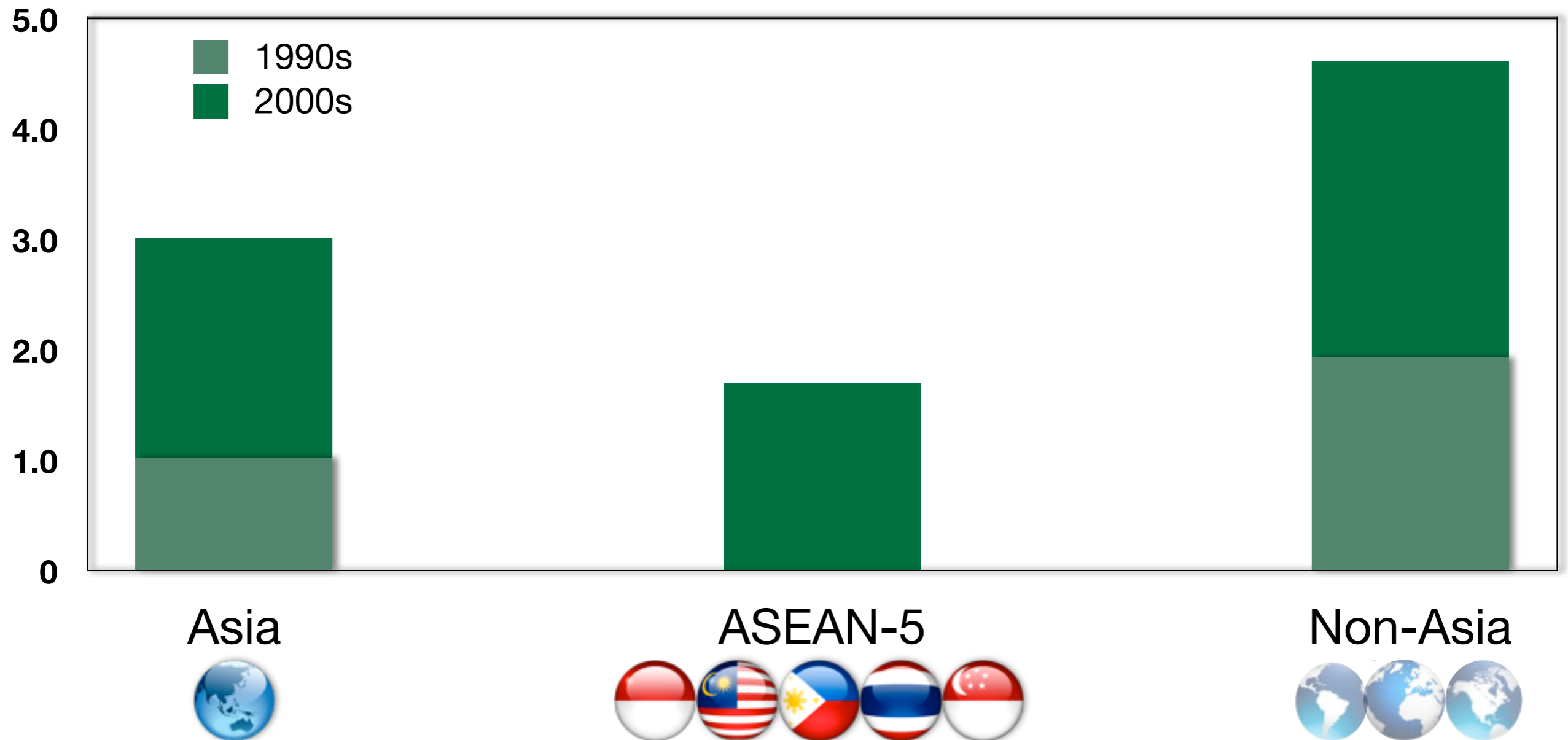
Median Vertical Trade with Japan



Financial integration in Asia: still lagging behind, but on the rise



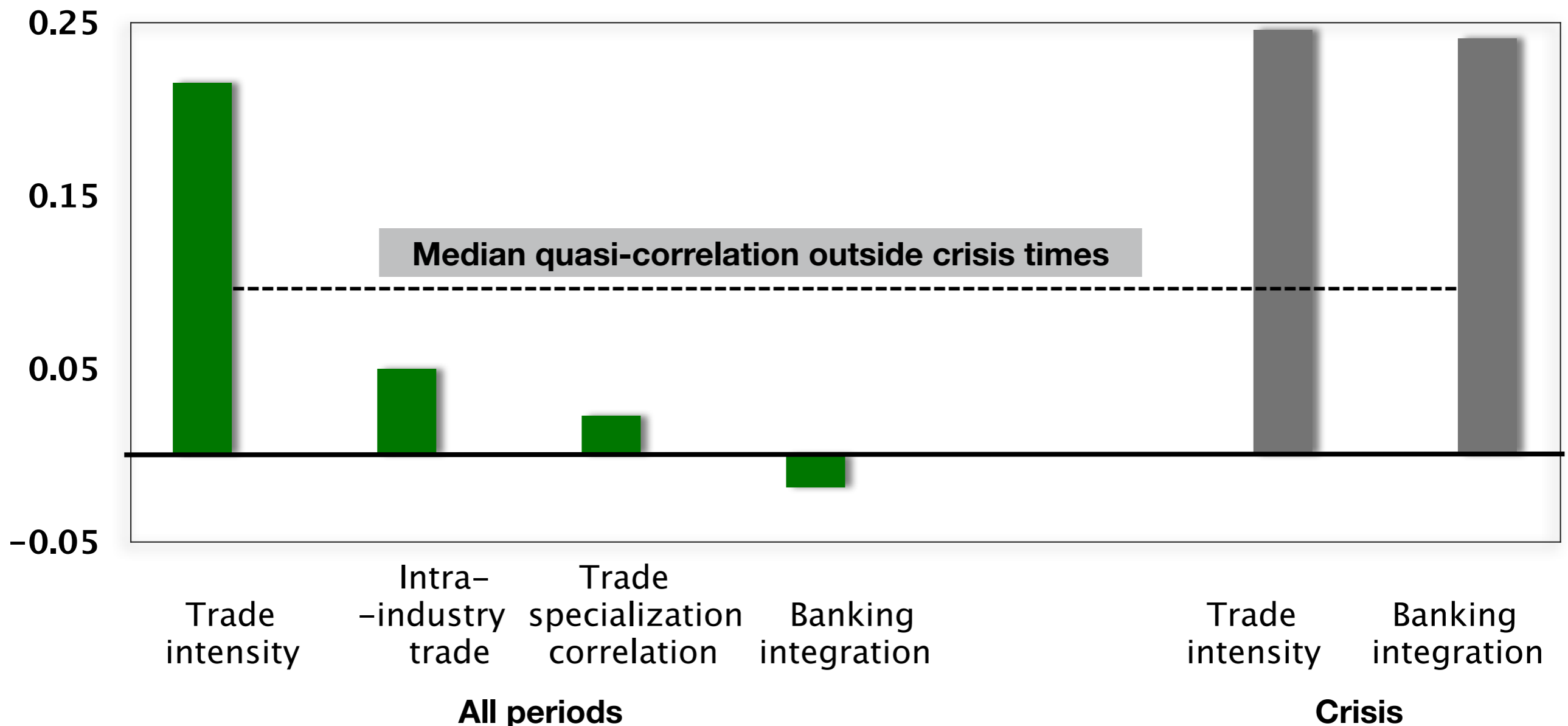
Median Bilateral Banking Integration (In percent of total external position with the world)



Large impact of trade and financial integration on growth comovement



Illustrative Impact of Explanatory Variables on Co-movement: Crisis vs. Non-crisis Times
 (Estimated Impact on BCS of Moving from the 25th Percentile to 75th Percentile of the Cross-country Distribution of the Variable Considered)





Implications: The Future

- **BCS to rise if economic integration increases further, especially in crisis times (financial integration)**
- **Role of China:** increasing as a final demand source, declining as “assembly hub” → greater spillovers from China shocks, but China less of a conduit for global shocks
- **Higher BCS:** bad for risk sharing → need for individual policies to strengthen resilience and broad (regional and global) safety nets; global safety net especially useful in event of regional shocks/shocks originating from China

Thank You

Asia and Pacific Department, April 2014

