Asia: Sailing in Turbulent Times

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Asian economies are sailing in choppy waters, facing severe headwinds from an uncertain and challenging global environment. First, the global recovery has been uneven and weaker than expected. On top of that, global trade has been sluggish and financial conditions have been volatile. The rise of China as a global economic superpower has also created challenges of its own, as China's necessary rebalancing from manufacturing towards services and investment to a consumption-driven economy—critical for both China's and global growth over the medium term—remains bumpy. As elsewhere, many Asian economies face risks associated with natural disasters and geopolitical and domestic political uncertainty. But all is not doom and gloom, as Asia remains the major engine of the global economy: it continues to provide nearly two-thirds of global growth. In addition, the region has policy buffers such as current account surpluses and high reserve levels and is likely to benefit from further economic integration and regional and multilateral trade agreements such as the Trans-Pacific Partnership.

Asia's growth is moderating slightly, in line with the rest of the global economy. According to the most recent IMF World Economic Outlook, activity in the region moderated in the second half of 2015, and is expected to continue decelerating in the near term. GDP growth for the region is forecast at 5.3 percent in both 2016 and 2017, a mere 0.1

percentage points lower than in 2015. In addition to weaker global growth and sluggish trade, the moderation in regional growth also reflects the ongoing rebalancing in China. But while external demand is relatively weak, domestic demand, particularly consumption, is expected to remain resilient across most of the region. The relative strength of domestic demand is due to generally low unemployment, lower commodity prices (which is a boon to oil and commodity importers), economic stimulus in some countries, and ongoing secular trends, including steadily rising disposable income.

The moderation in Asia's growth masks important differences within the region. In *China*, GDP growth is expected to continue to moderate to 6.5 percent this year and 6.2 percent in 2017. This reflects ongoing rebalancing and other structural reforms, which are expected to continue to boost consumption and the services sector, while investment and manufacturing remains relatively weak until excess capacity is resolved. *India*, on the other hand, is expected to remain the fastest-growing large economy in the world, with GDP expanding by 7.5 percent in 2016–17, underpinned by strong private consumption and helped by lower oil prices. In *Japan*, GDP growth is projected to remain at 0.5 percent in 2016, slowing to -0.1 percent in 2017 as the widely anticipated consumption tax rate hike (from 8 to 10 percent) kicks in, though this forecast does not incorporate likely offsetting measures to support activity. *Indonesia*, which is exposed to commodities, is expected to benefit from a large infrastructure push. *Vietnam's* GDP growth is expected to ease to around 6 percent in 2016 from 6¾ percent in 2015, mainly reflecting weaker external demand and severe drought and salination of arable land that have adversely affected agriculture. For 2017, growth is

expected to firm to around 6¼ percent, supported in part by investment driven by recently-concluded trade agreements.

Despite a robust outlook, downside risks continue to dominate the economic landscape. Global growth could slow by more than expected or financial conditions could tighten suddenly. As many economies in the region have seen debt levels rise rapidly over the last decade, a combination of slower growth and higher borrowing costs could tip some corporates and households over the edge and further constrain growth.

In addition, regional growth is more dependent on China than ever before. While rebalancing in China is a price worth paying, in terms of durable and resilient growth over the longer term, the short-term transition is likely to be bumpy and the impact on countries and markets is likely to vary. Countries that export goods that support China's investment and construction (producers of metals, for example) would be adversely affected, while others that export consumer goods to China or are destinations for rapidly-growing Chinese tourism could benefit. In addition, China's move to higher value-added production will provide opportunities for low-income Asian countries, particularly in labor-intensive sectors, such as apparel, footwear, furniture, and plastic toys. Already Bangladesh, Cambodia, and Vietnam have seen market share gains in these sectors. Financial linkages are also growing with regional markets becoming more sensitive to shocks from China after the global financial crisis. Over time, though, as economic rebalancing makes China's growth model more resilient and sustainable, the region is likely to benefit.

A range of policies can be used to harness Vietnam's potential and bolster its ability to manage shocks. A growth-friendly fiscal consolidation, with a focus on broadening the

revenue base while safeguarding spending on high-quality public investment in education, health and infrastructure, will support debt sustainability, confidence, and quality sustainable growth. Making use of the new flexible exchange-rate mechanism and strengthening monetary policy instruments, while moving gradually toward using inflation as the nominal anchor for monetary policy, will allow the country to safeguard macroeconomic stability while buffering external shocks. Accelerating banking sector and SOE reforms—including through improvements in operational management, the resolution of non-performing loans and recapitalization of banks, and more rapid equitization and divestment of non-core assets—will strengthen the foundation for higher sustainable growth over the medium term.