

**All China Economics (ACE)
International Conference**

**Hong Kong SAR
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Global and Regional Economic Outlook

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1/ These are the views of the author and not those of the IMF, its Executive Board, or its management.

Overview

- The global recovery and outlook
- Asia's recovery and policy challenges
- Mainland China
- Hong Kong SAR

I. World Economy

- + “Green shoots” emerging,
 - but point to a sluggish and protracted recovery, as households and firms need to repair balance sheets and labor markets remain weak.

Following a deep plunge, signs of “green shoots” are emerging, particularly in Asia

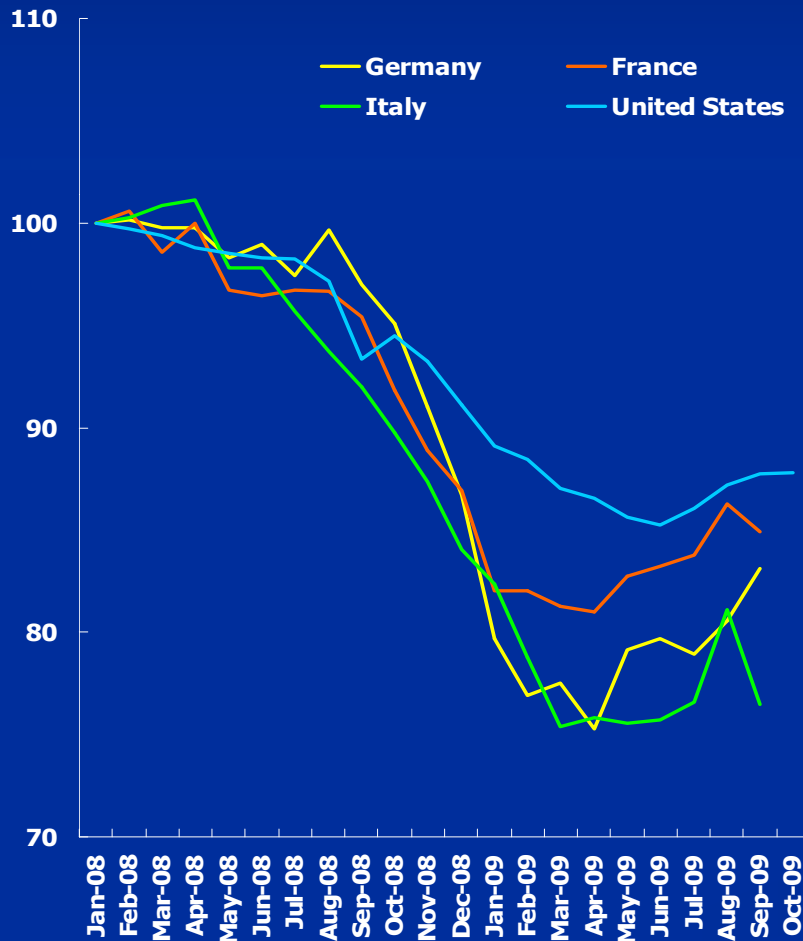


Note: The above chart is based on the four economic indicators, including industrial production, real retail sales, merchandise exports, and purchasing managers index (PMI).

Global production recovering and leading indicators point to further improvements ahead

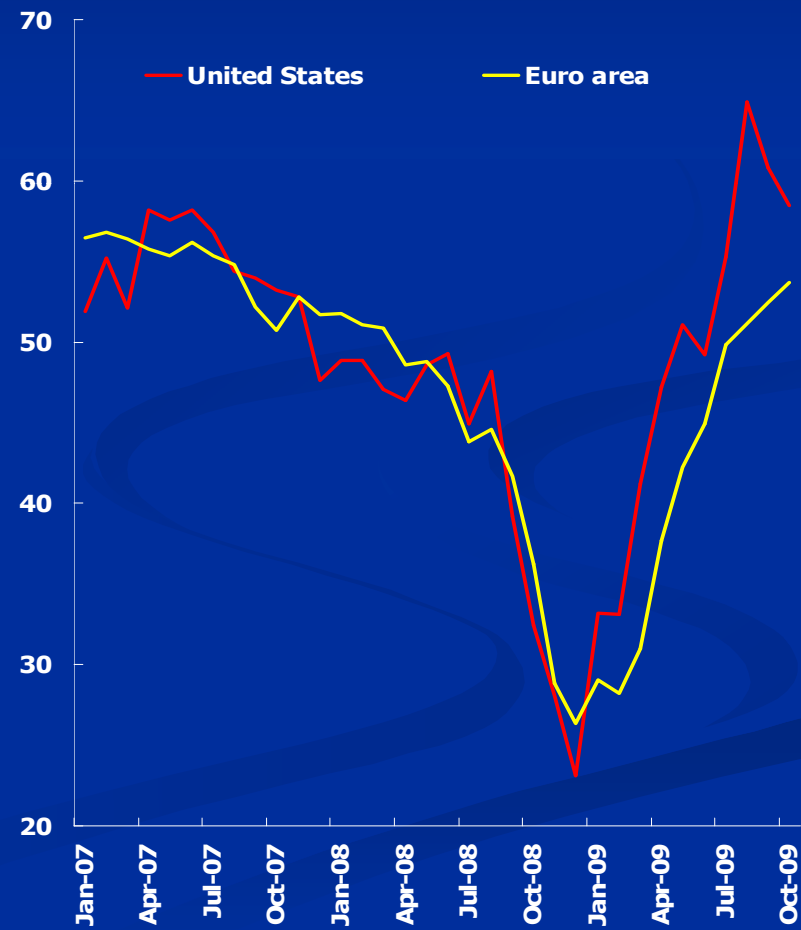
Industrial Production

(January 2008=100; seasonally adjusted)



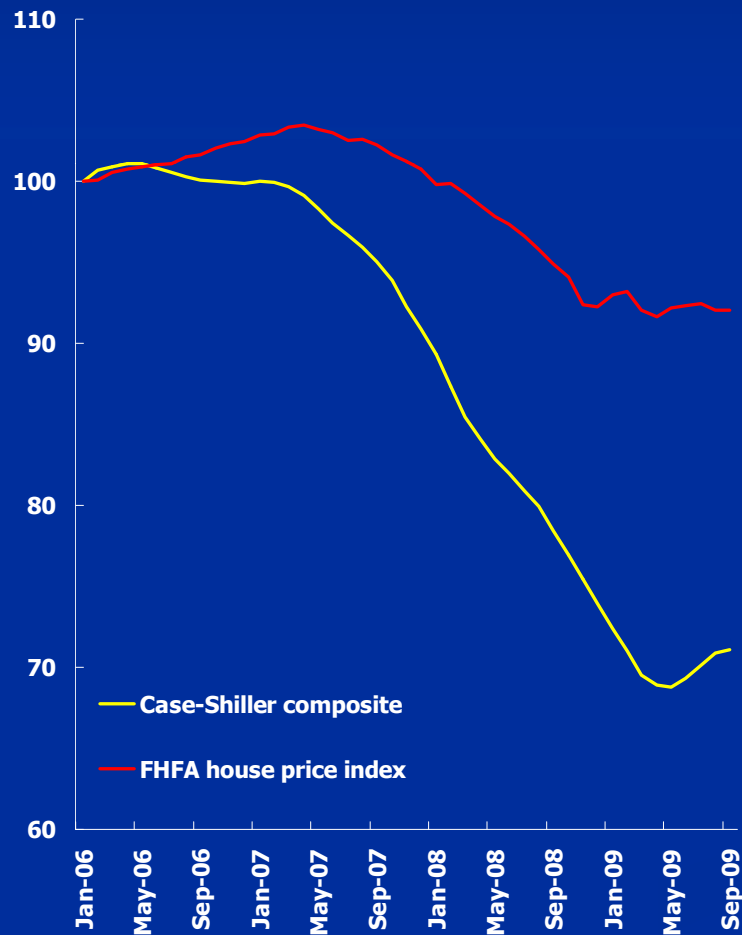
Manufacturing Outlook: New Orders

(index; seasonally adjusted; 50=neutral)



U.S. housing sector stabilizing, and market confidence returning...

United States: Housing Prices
(January 2006=100; seasonally adjusted)



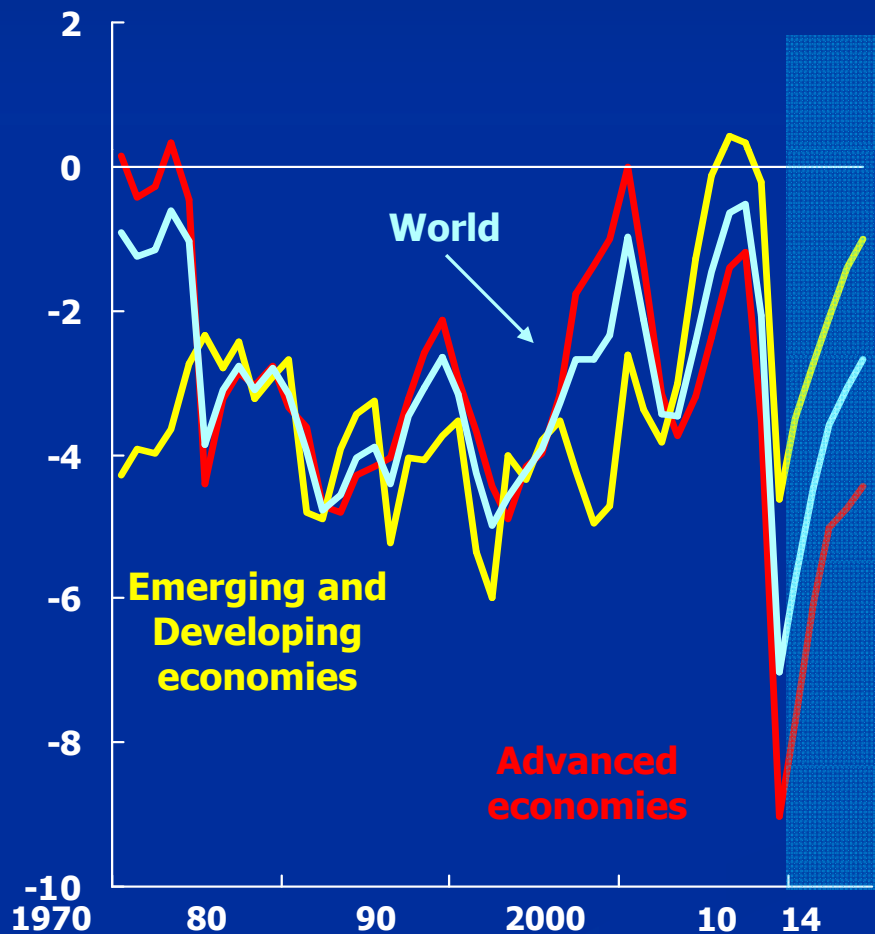
Asset Prices
(index, 1/1/2009=100)



...bolstered by unprecedented fiscal support and financial repair measures.

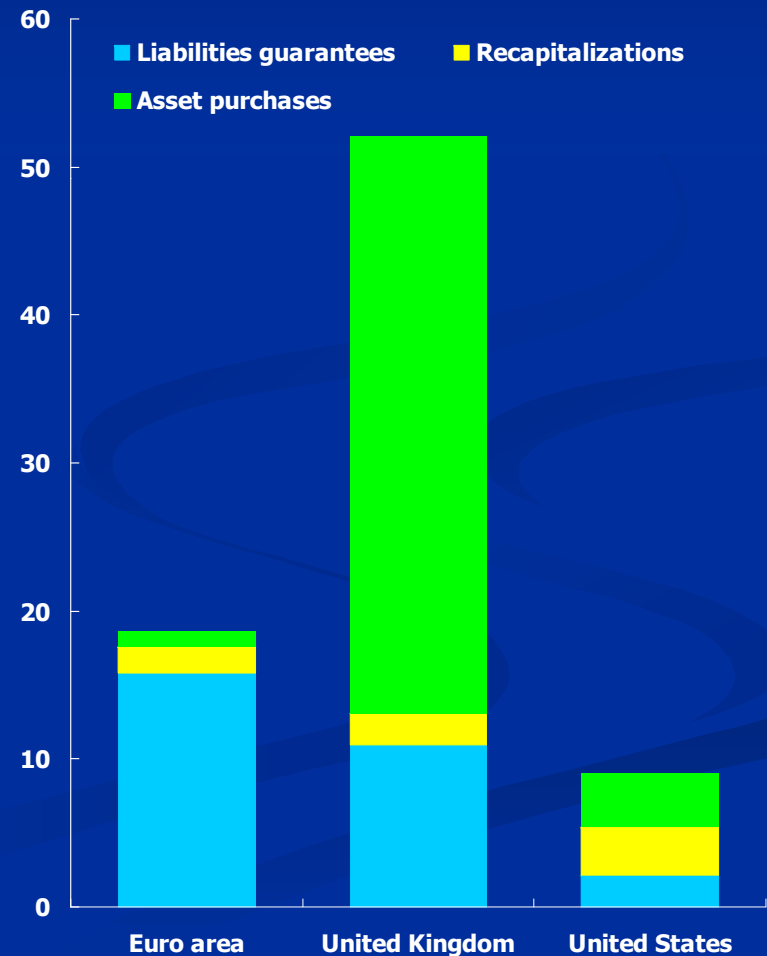
Fiscal Balance

(percent of GDP)



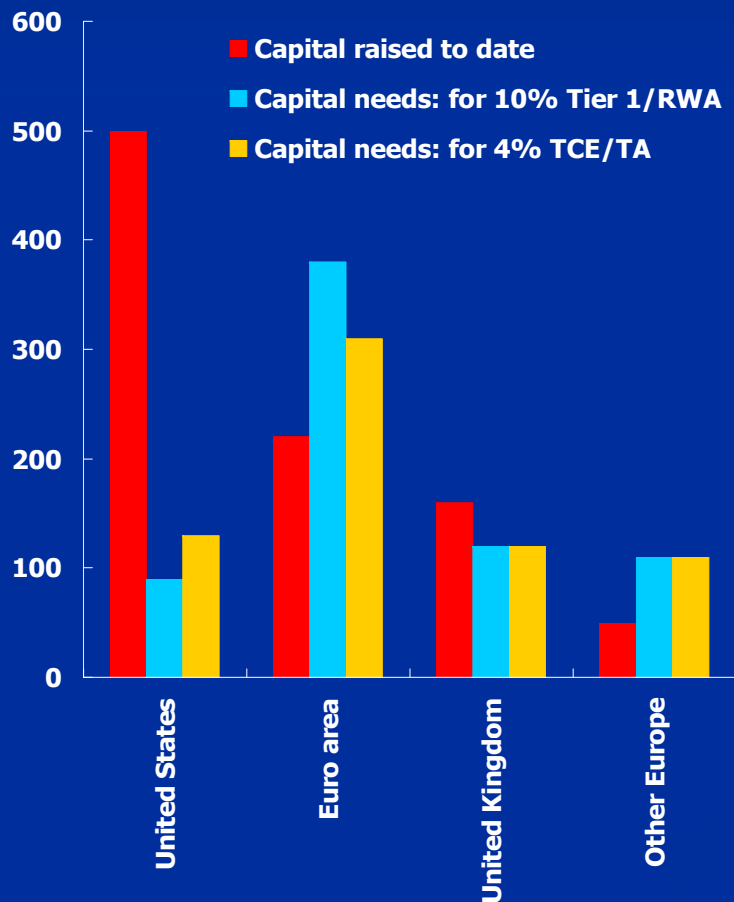
Financial Sector Interventions

(percent of GDP)

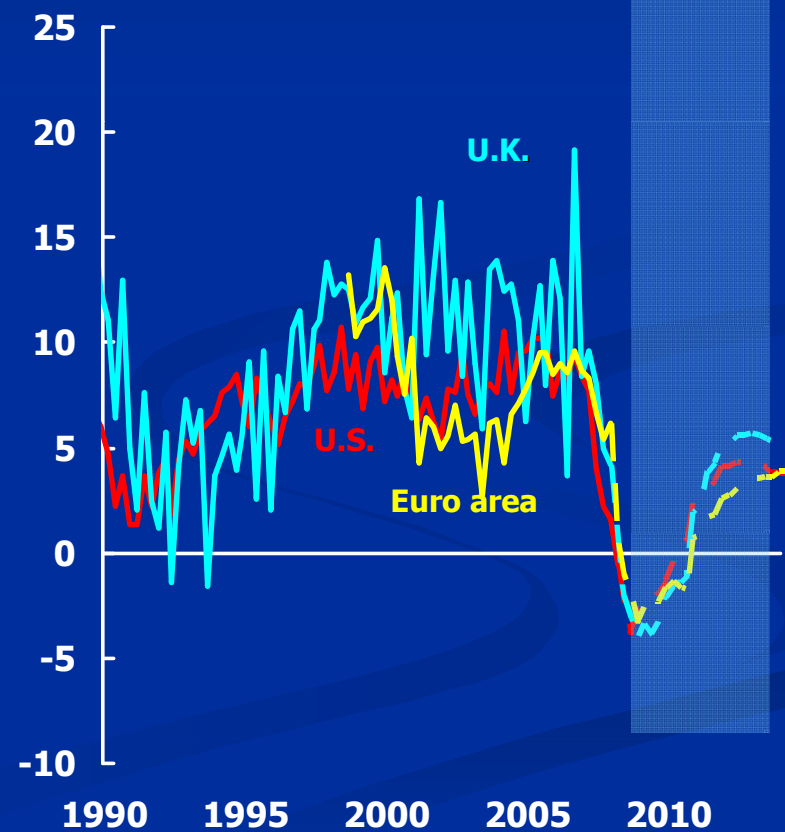


But credit growth still anemic in U.S. and Europe as banks seek to repair balance sheets...

Bank Capital
(billions of U.S. dollars)

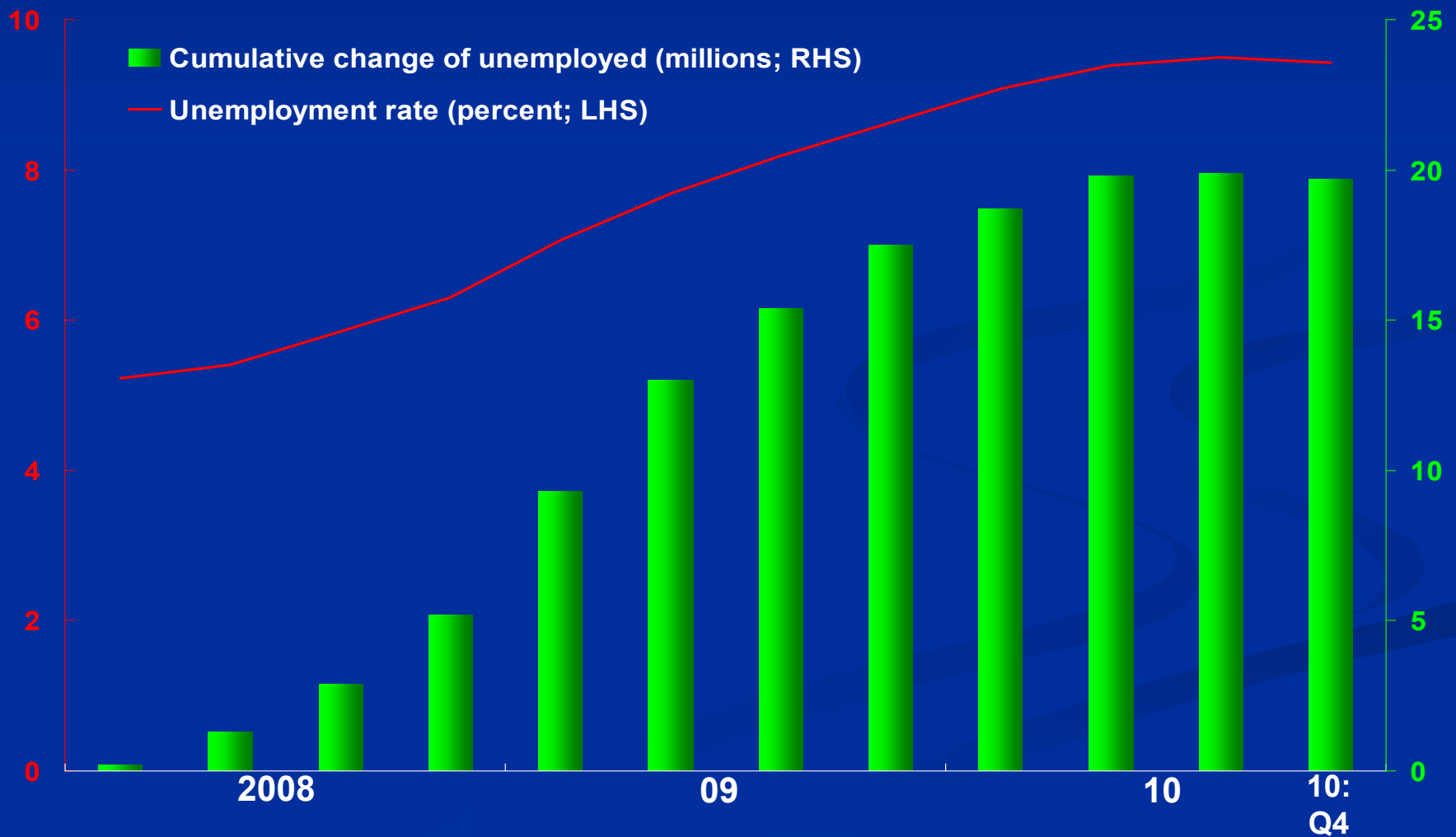


Private Sector Credit Growth
(percent of debt outstanding; q/q SAAR)



...and labor markets remain weak: a “jobless recovery”?

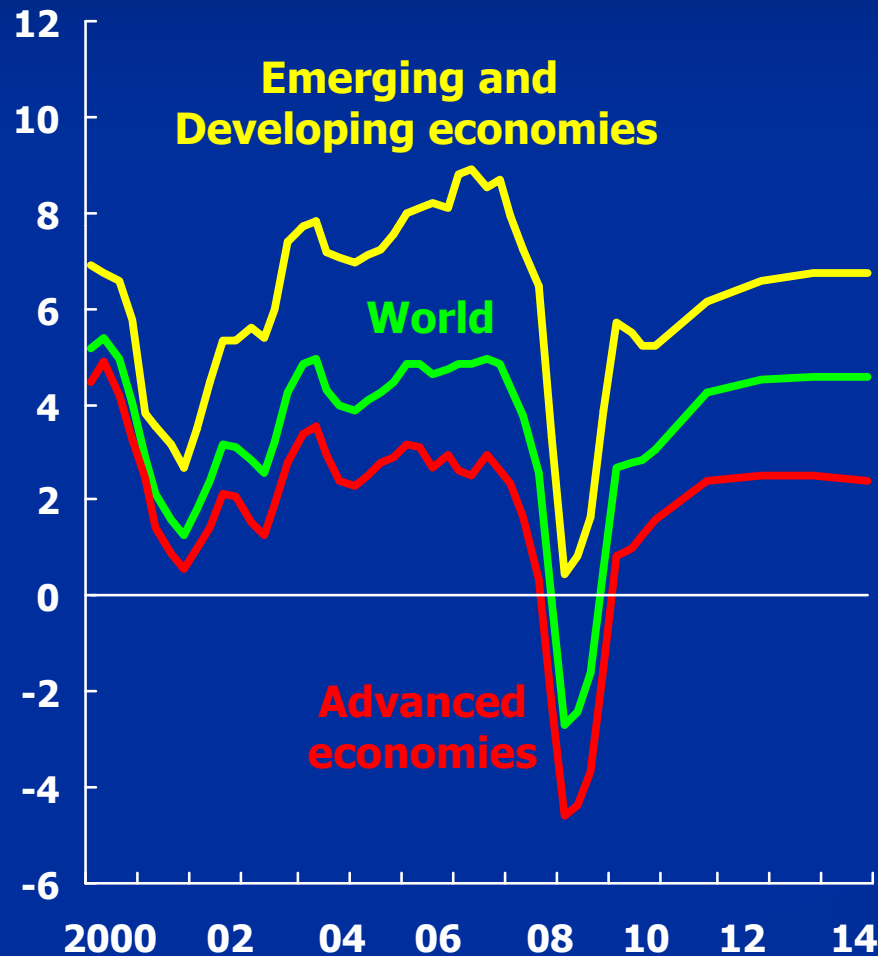
Unemployment in Advanced Economies



Bottom line: global recovery likely to be sluggish

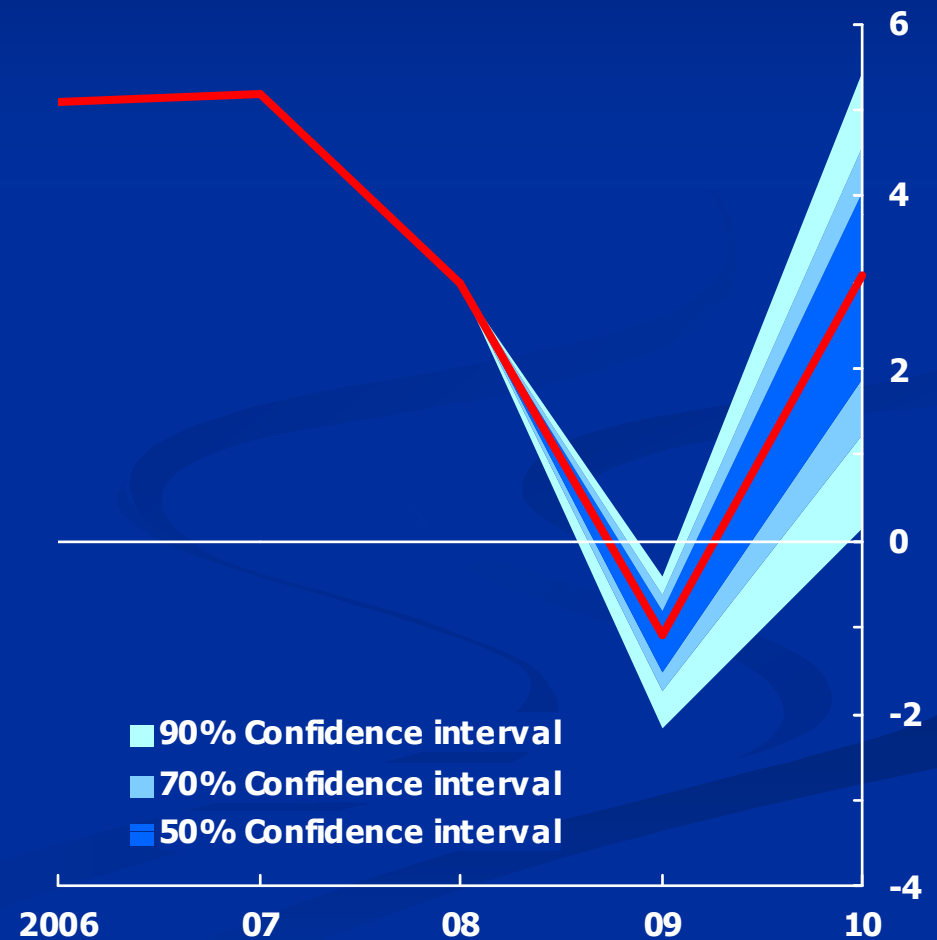
Real GDP Growth

(percent change from a year earlier)



Prospects for World GDP Growth

(percent change)



And picture varies across countries

	Real GDP Growth (in percent)	
	2009	2010
World	1.1	3.1
United States	-2.7	1.5
Euro area	-4.2	0.3
Japan	-5.4	1.7
China	8.5	9.0
Hong Kong SAR	-2.0	5.0
India	5.4	6.4

Sources: IMF World Economic Outlook, October 2009. (Hong Kong SAR: 2009 Article IV Staff Report, December 2009.)

II. Asia

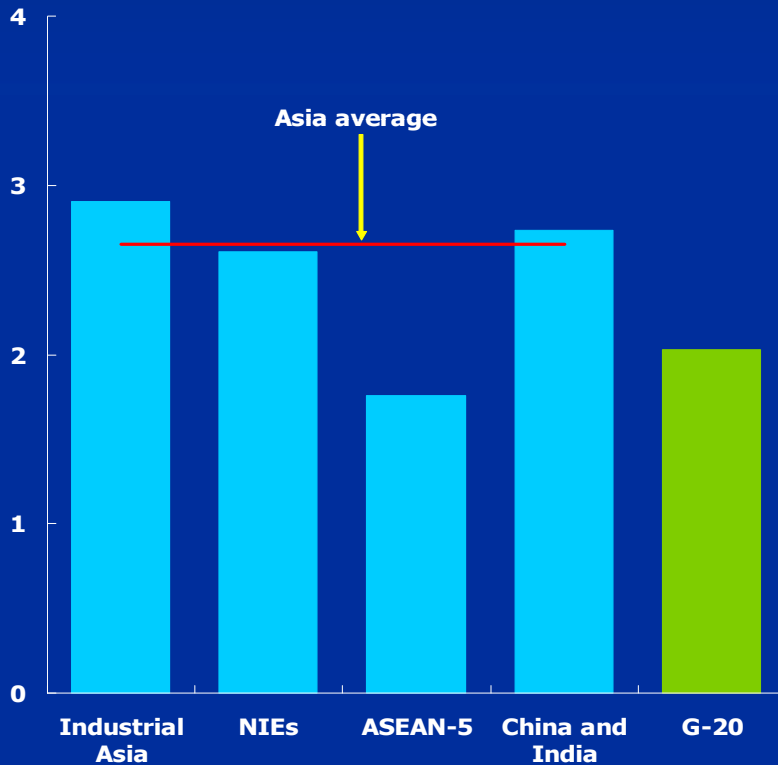
Asia is leading the global recovery. Decisive policy response has helped.

Key policy challenges:

- **Short-term:** maintain policy stimulus in order to secure recovery,
- **Medium-term:** shift drivers of growth to domestic sources.

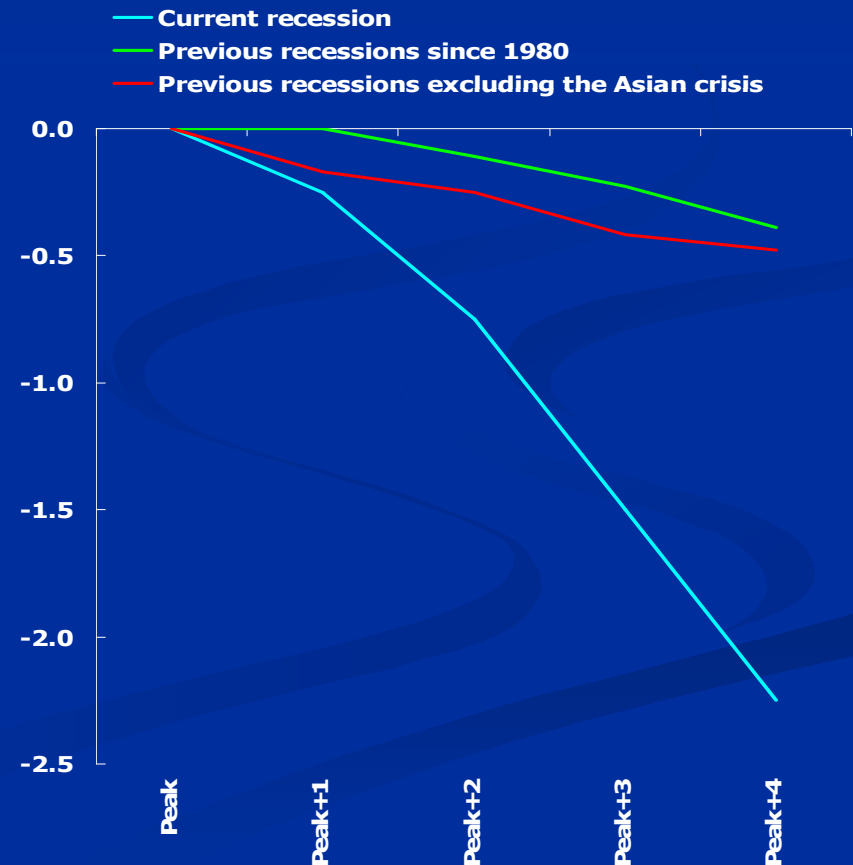
Asian policymakers responded decisively on both fiscal and monetary policy...

Discretionary Fiscal Measures: 2009¹ (percent of GDP)



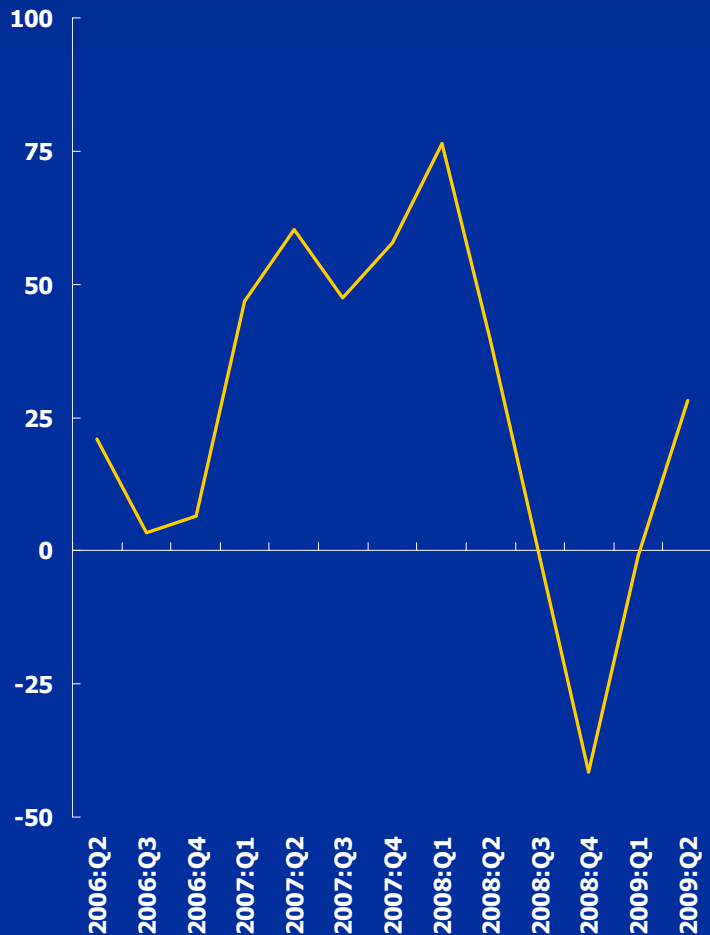
¹ Defined as fiscal impulse (i.e. change in structural fiscal balances relative to 2008, related to measures taken in response to the crisis).

Asia Business Cycle: Central Bank Policy Rate (median=0 at peak; quarters on the x-axis)

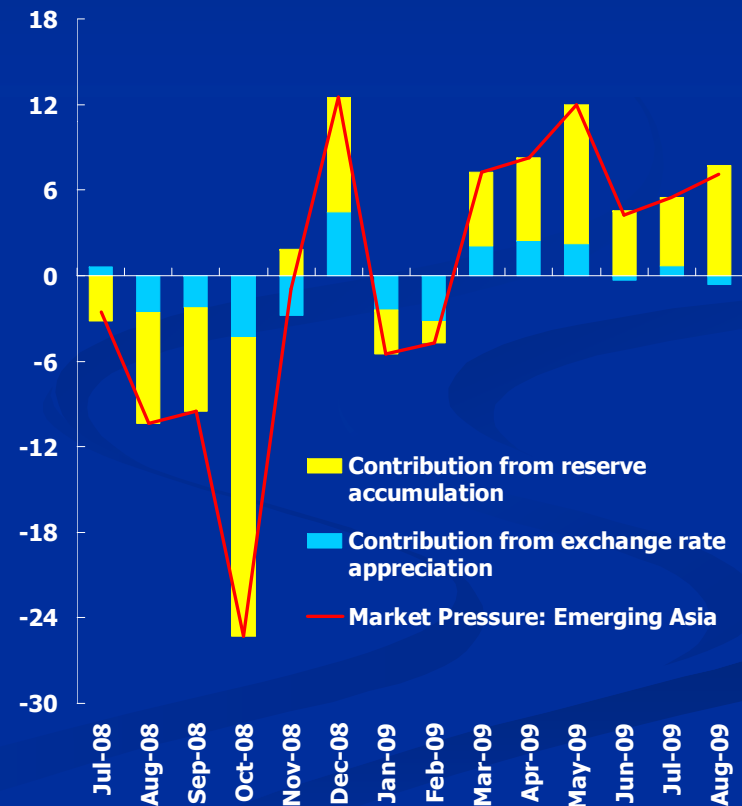


...while responding to exchange rate appreciation pressures mainly by accumulating reserves

Emerging Asia: Net Capital Inflows
(In billions of US dollars)

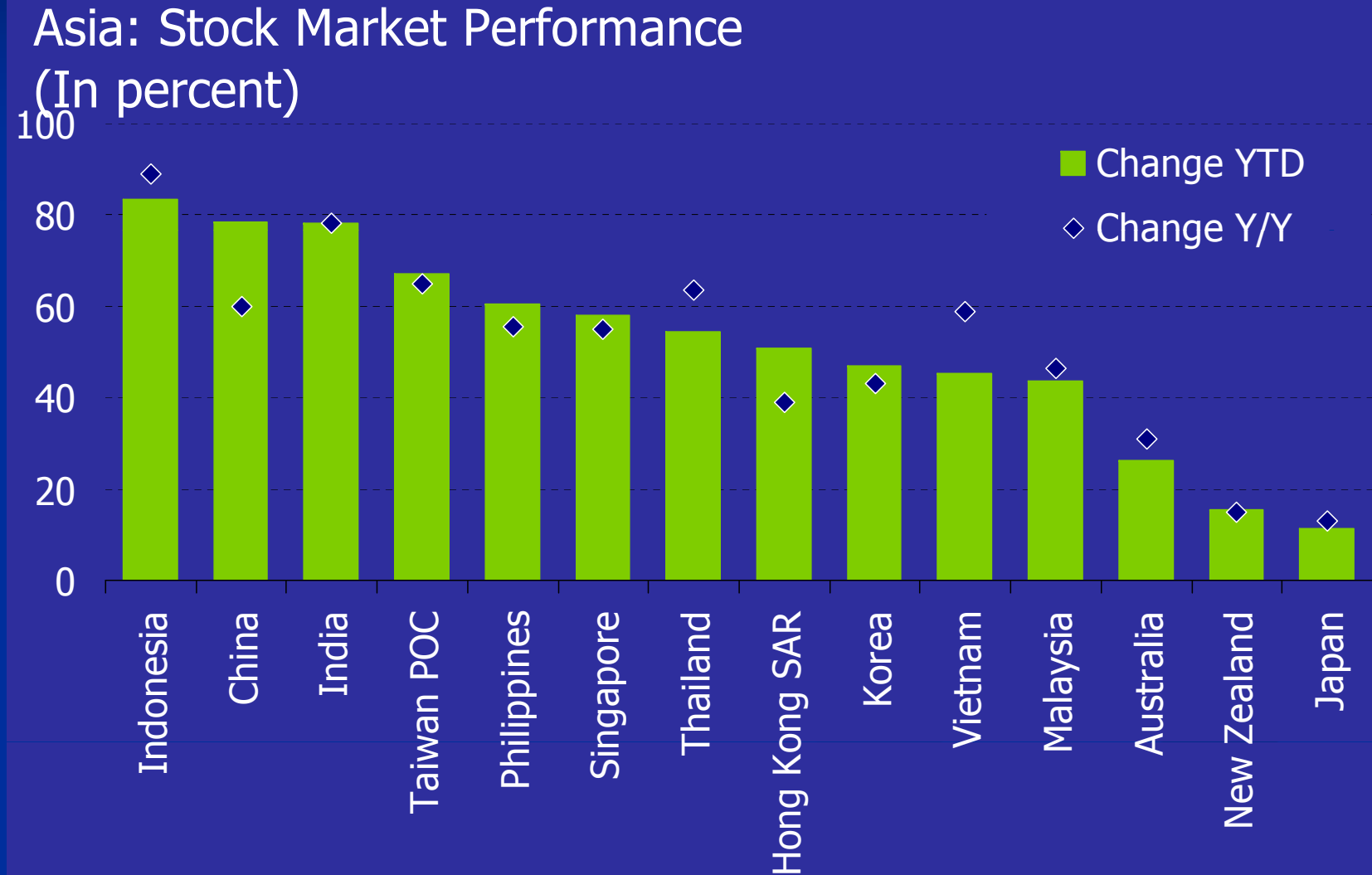


Emerging Asia: Exchange Market Pressure Index¹



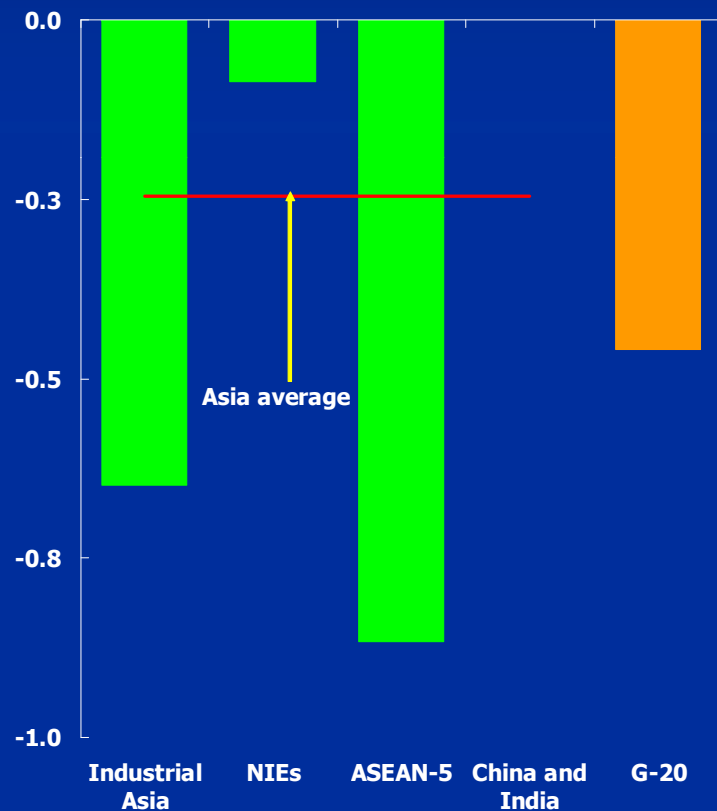
¹The exchange market pressure (EMP) index is defined as: change in nominal exchange rate + (change in international reserves / monetary base).

High liquidity has helped boost asset prices



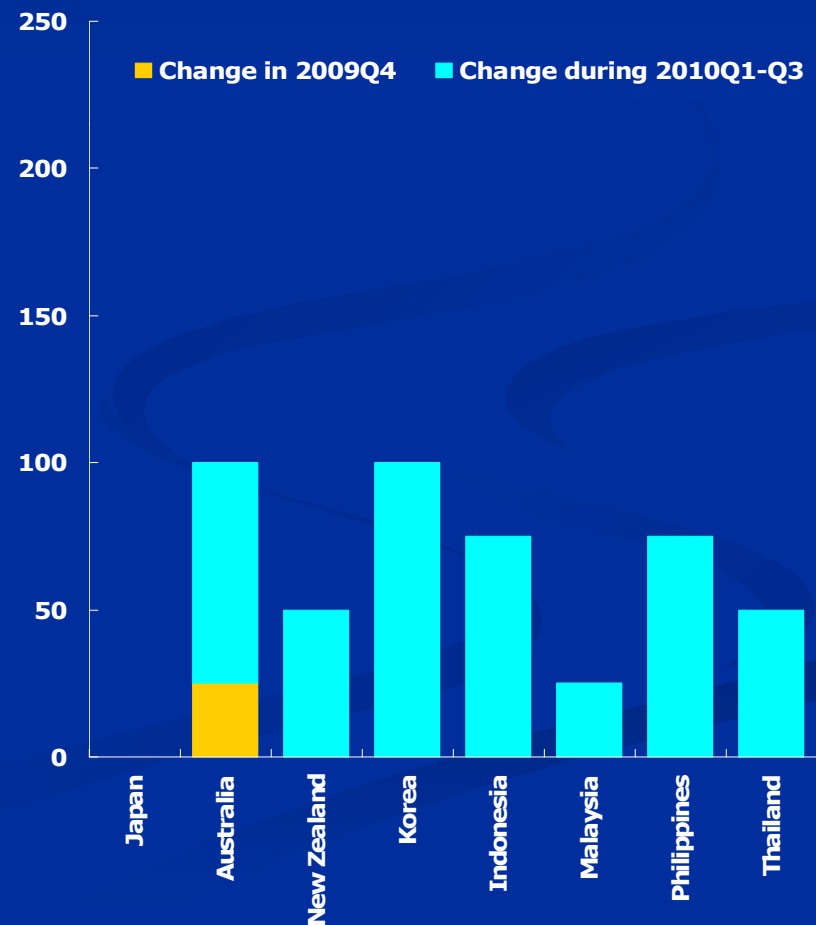
The economic rebound has led to expectations of withdrawal of stimulus in 2010

Fiscal Impulse: 2010¹ (percent of GDP)



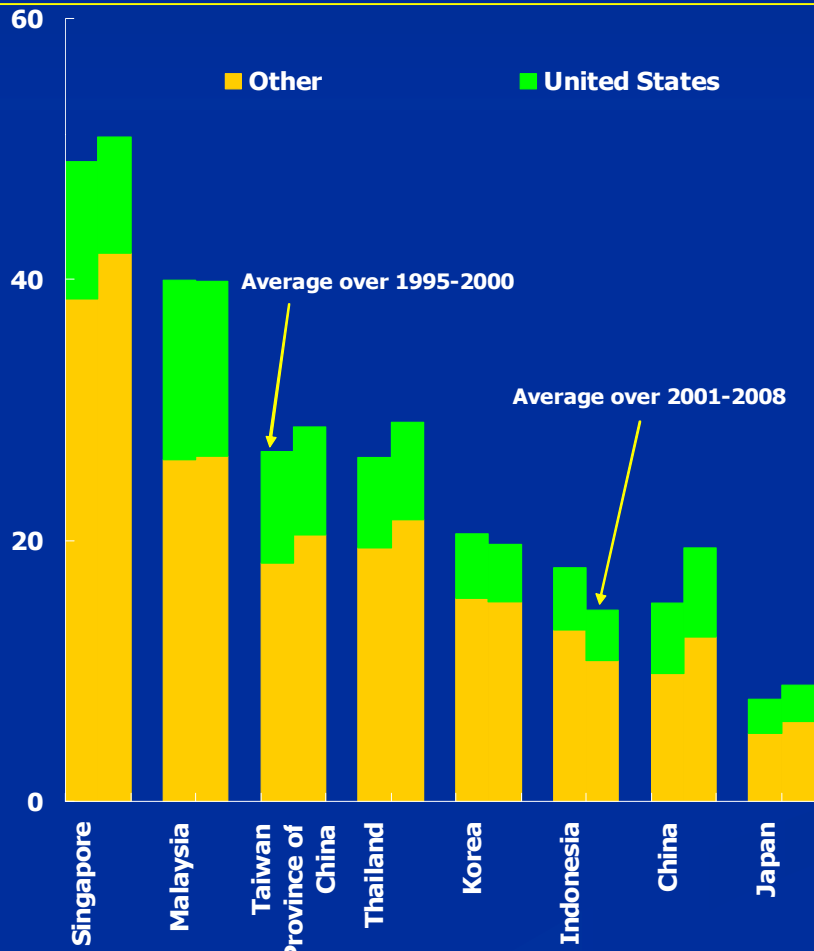
¹ Change in structural fiscal balances relative to 2009, related to measures taken in response to the crisis.

Asia: Bloomberg Survey of Policy Rate Changes (basis points; as of October 22)

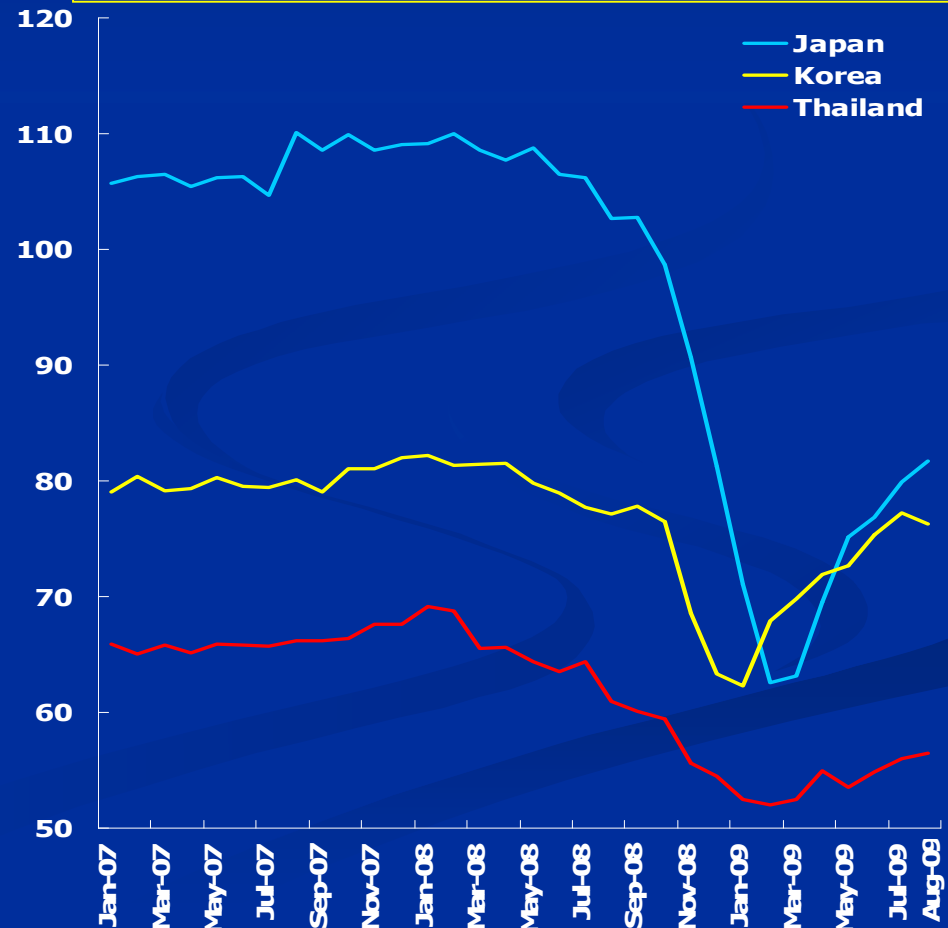


But as Asian prospects depend on the (fragile) global recovery, accommodative policies may still be needed

Asia: Contributions of Non-Asia Final Demand to Value-Added
(percent)



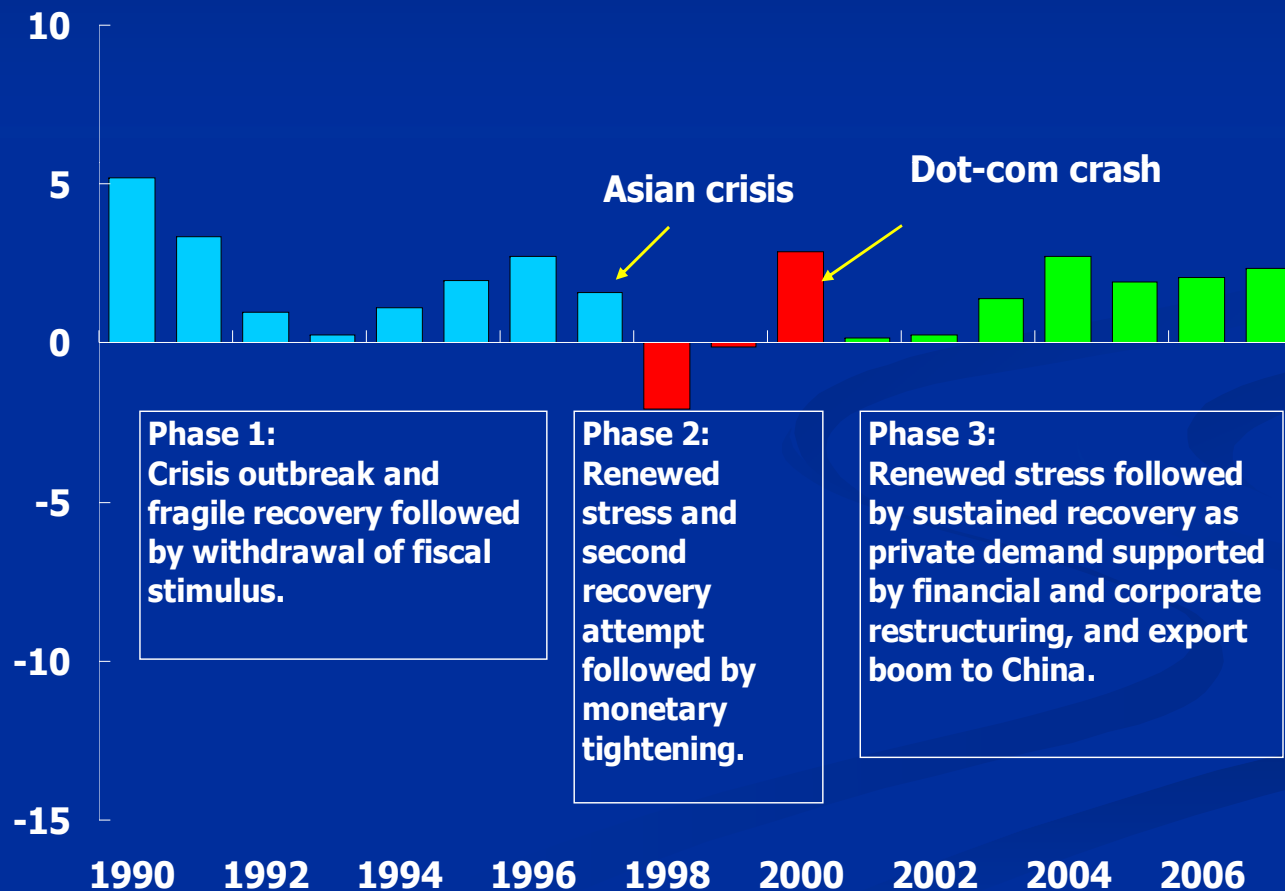
Selected Asia: Manufacturing Capacity Utilization
(percent, seasonally adjusted)



Japan's 1990s experience is a cautionary example

Phases in Japan's Banking Crisis

(Real GDP growth; y/y percent)



III. China

Recovery well under way, as policy stimulus has boosted domestic demand. Growth close to 8% in Q1-Q3 2009.

To maintain strong, stable growth need to:

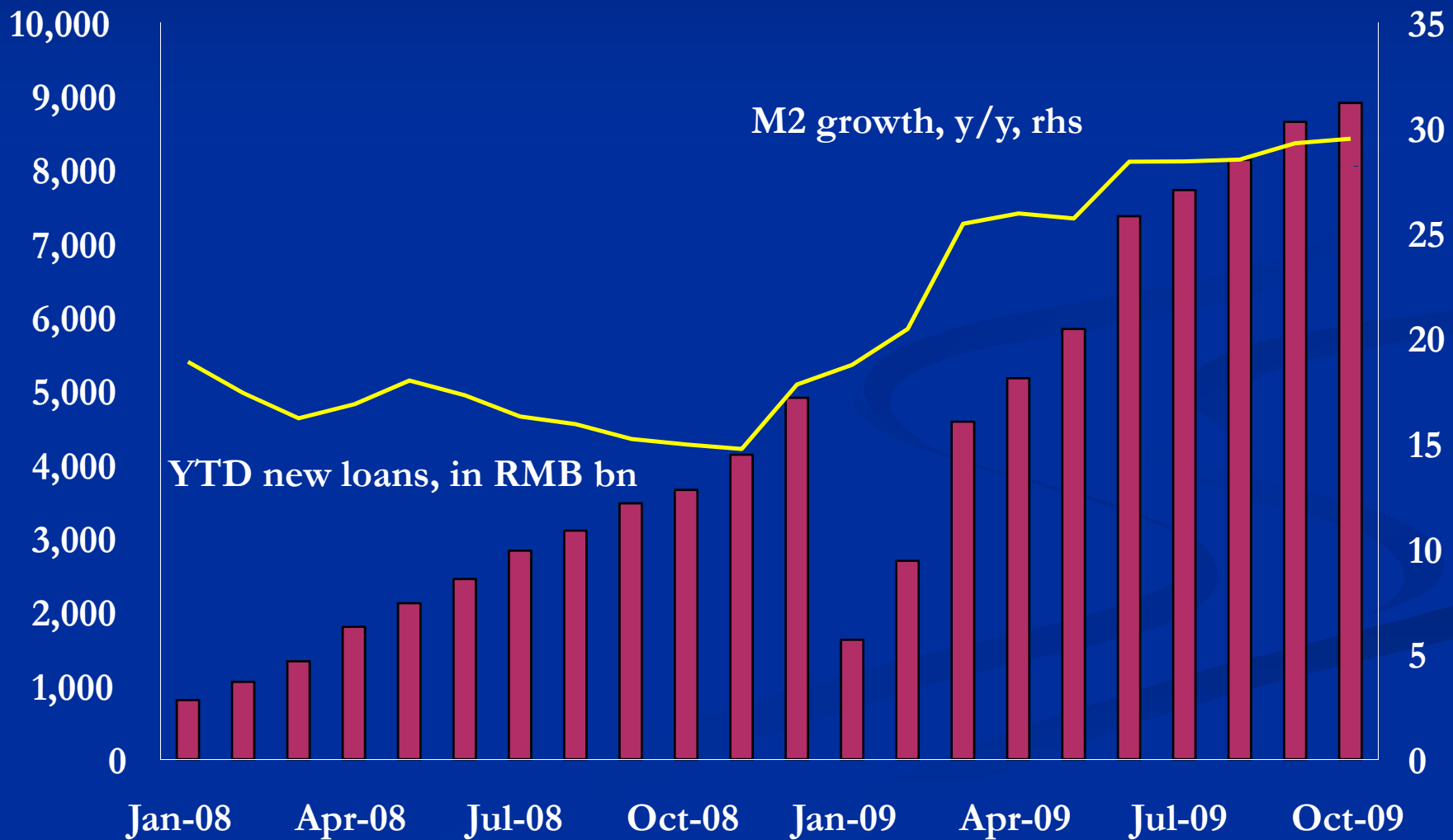
- achieve “hand-off” from public to private demand,
- avoid/manage overcapacity and NPLs. Time to start unwinding credit stimulus,
- attain fundamental rebalancing, with higher consumption and reorientation of investment towards domestic production.

Proactive policies boosted demand

- Fiscal stimulus (4 trillion yuan through 2010)
- Tax measures to boost consumption of durables
- Expansion of social safety net (pensions, income transfers, healthcare)
- Support measures for individual sectors
- And...

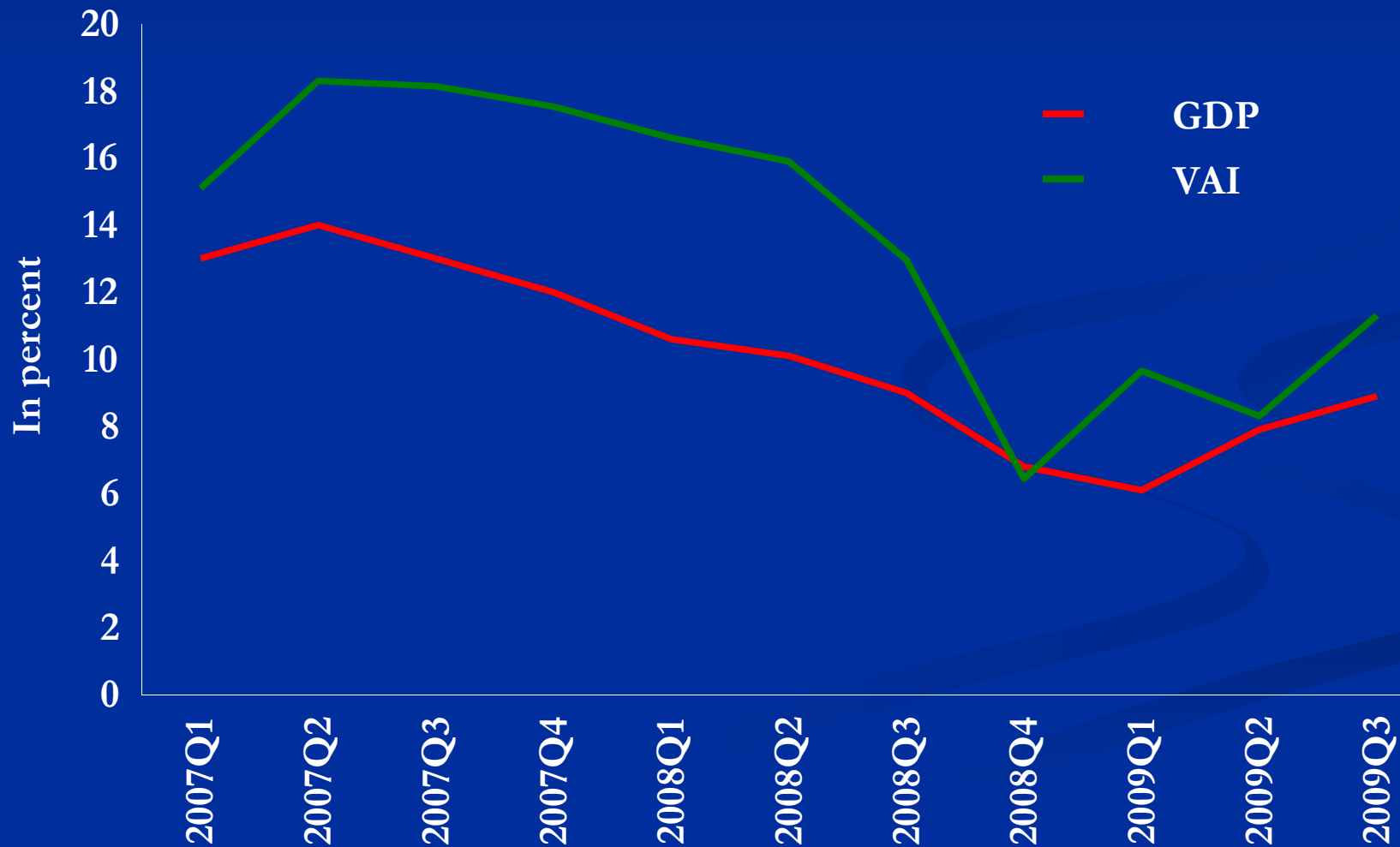
...credit has surged.

Money and Credit



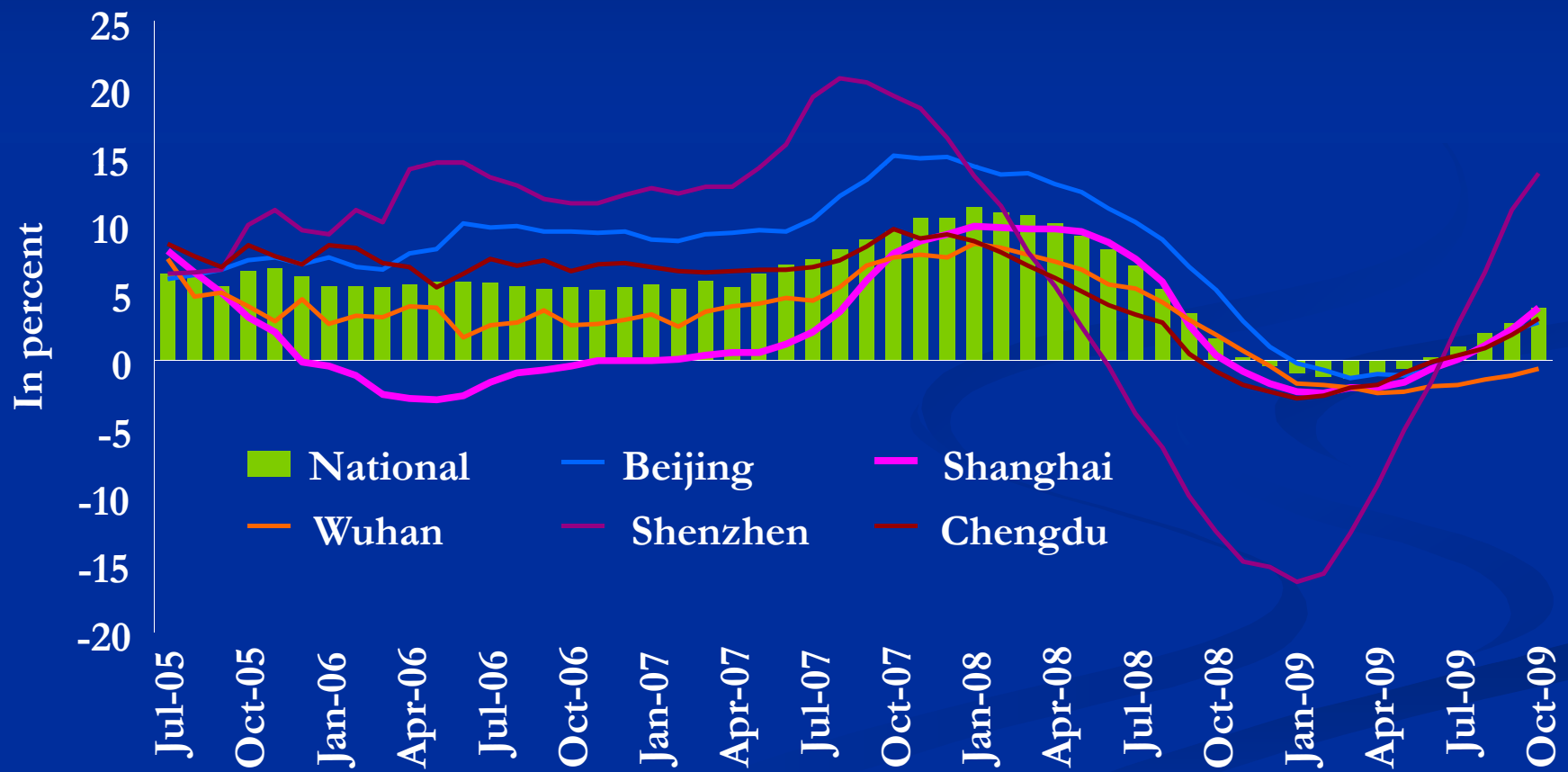
Recovery underway since Q1 2009

GDP and VAI growth (quarterly data, y/y)



Property sector rebound since mid-2009...

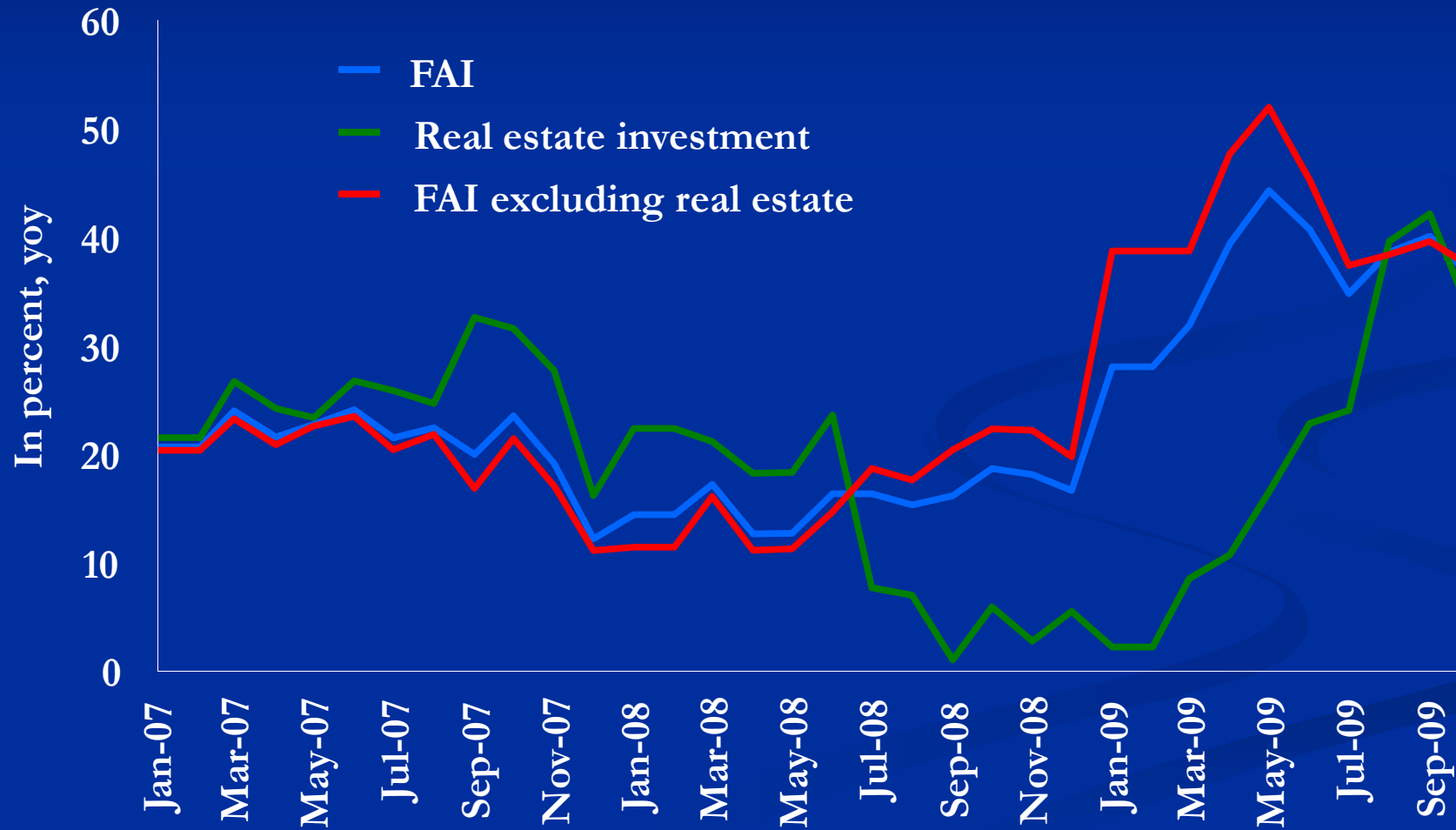
Building Property Price Index (yoy growth)



Source: CEIC, IMF Staff Calculations

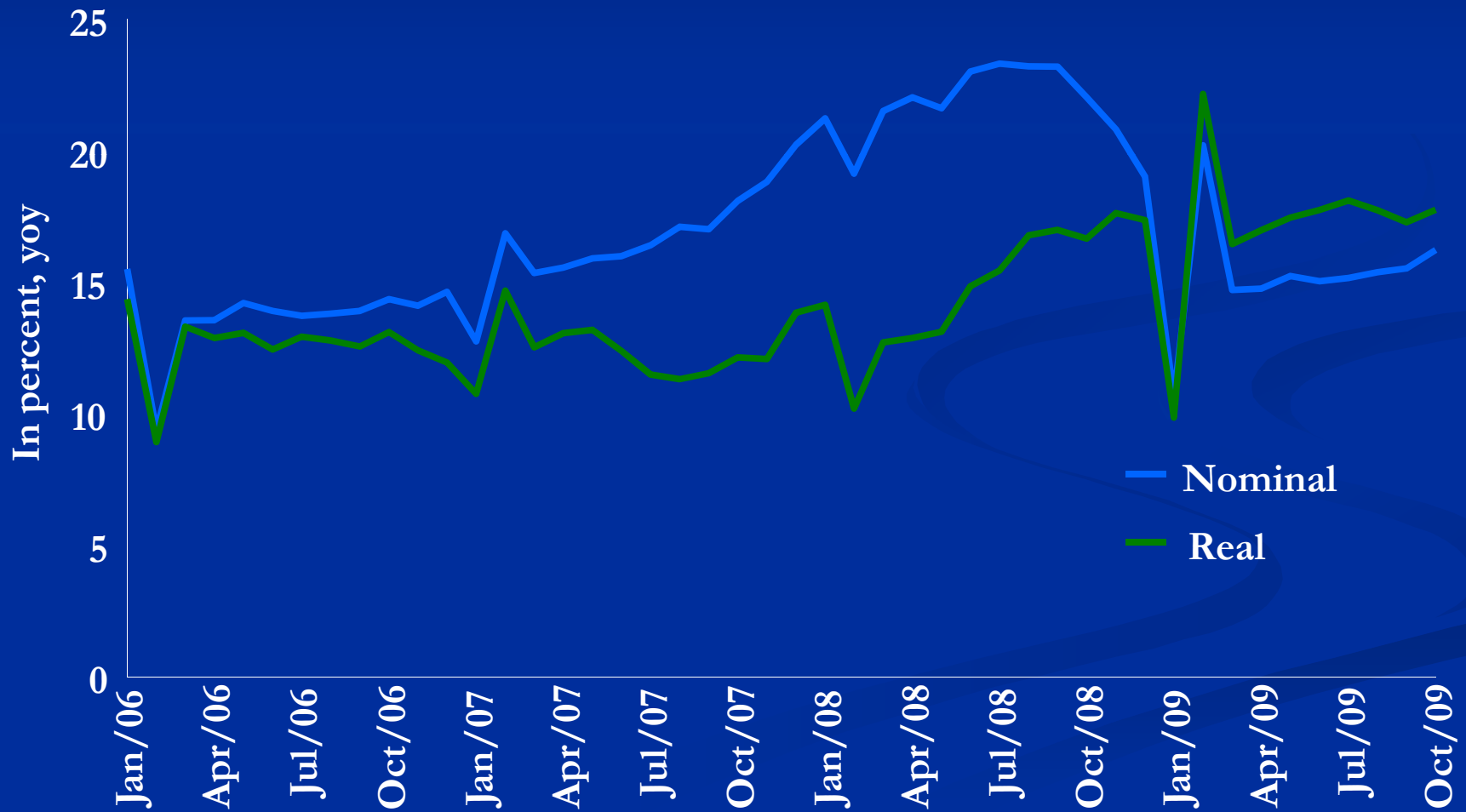
...contributing to investment boom, along with non-real estate FAI.

Real FAI growth



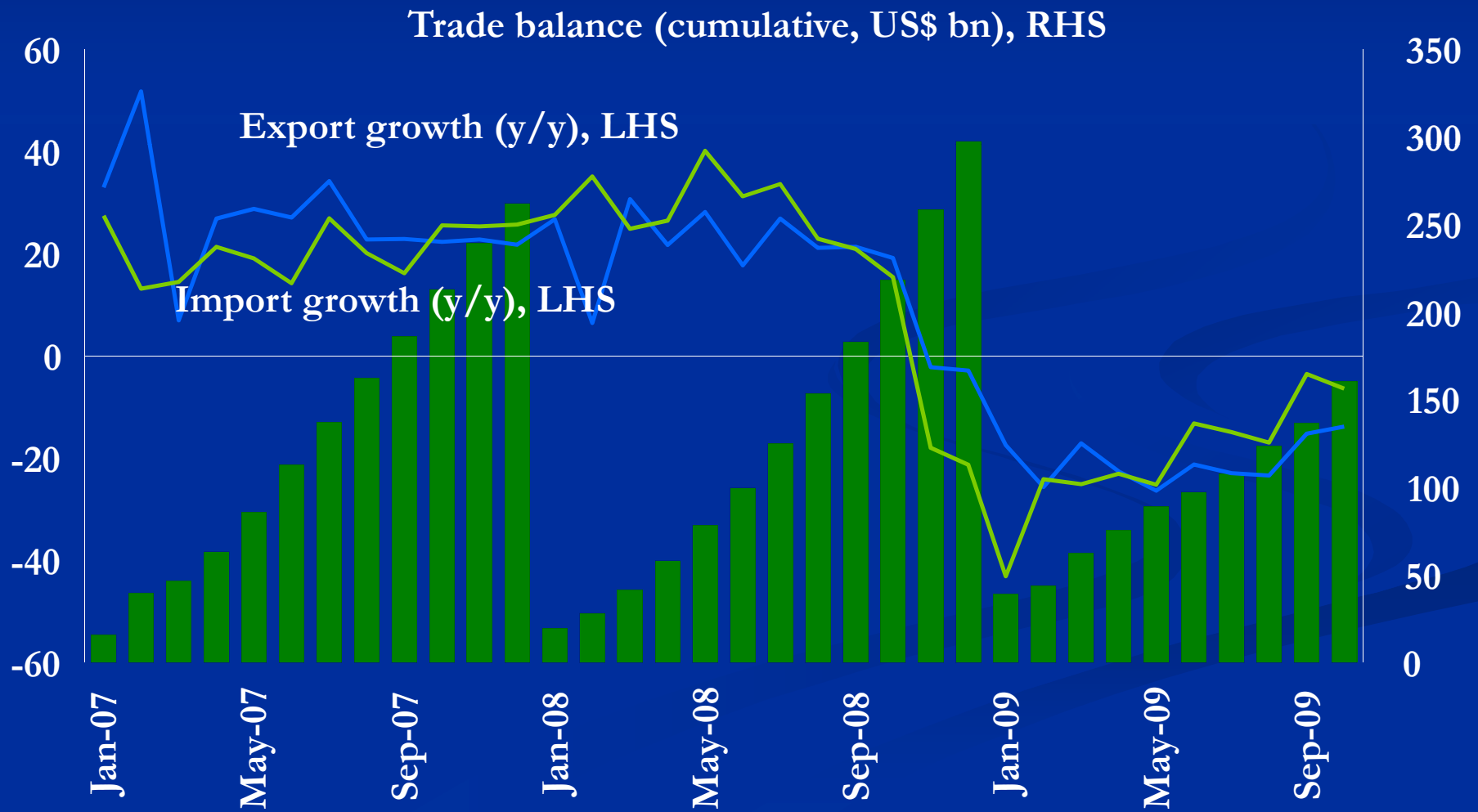
Retail sales robust

Monthly Growth in Retail Sales



Trade surplus has declined as exports have fallen.

China: Trade Balance



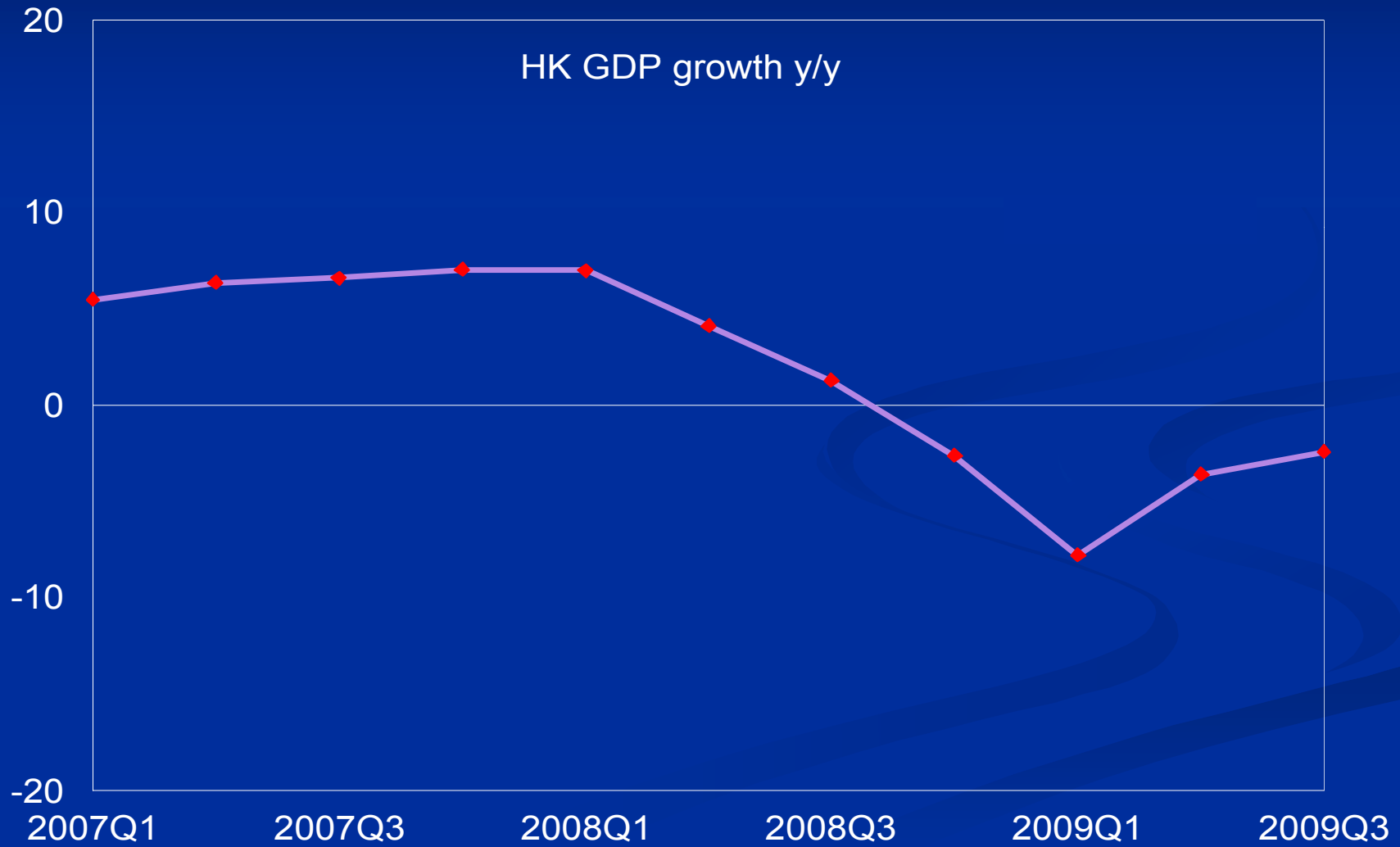
Strong retail sales + Falling NX = Rebalancing?

- Too soon to say. May be cyclical / temporary.
- For fundamental rebalancing, need further measures to:
 - Catalyze household consumption;
 - Reorient investment away from exportables toward domestic production.

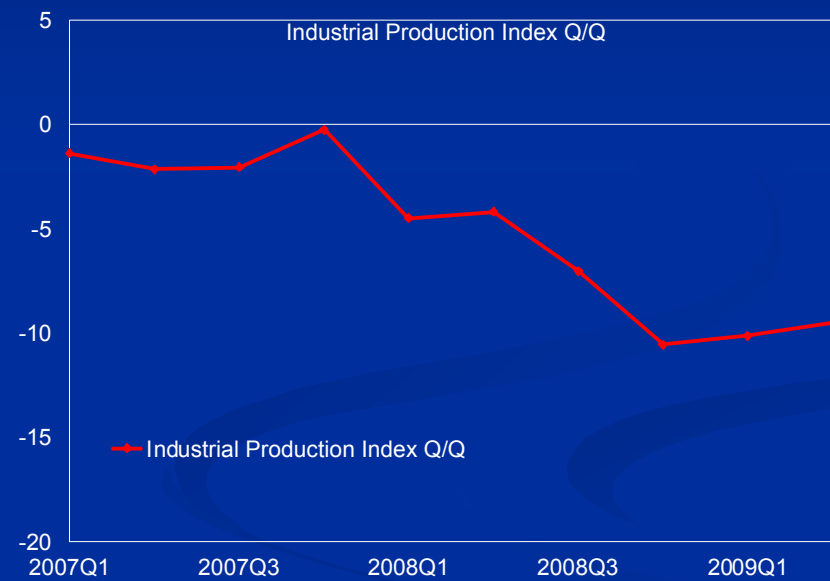
IV. Hong Kong SAR

- Recovery underway, driven by supportive policies, Mainland growth, U.S. credit easing.
- Financial system withstood the downturn well.
- Challenges:
 - Capital inflows and liquidity overhang could fuel asset prices. Recent countervailing measures useful.
 - Manage exit from blanket guarantee.
 - Provide enough policy support in 2010.
 - Set stage for long-term growth (maintain competitiveness, develop additional services).

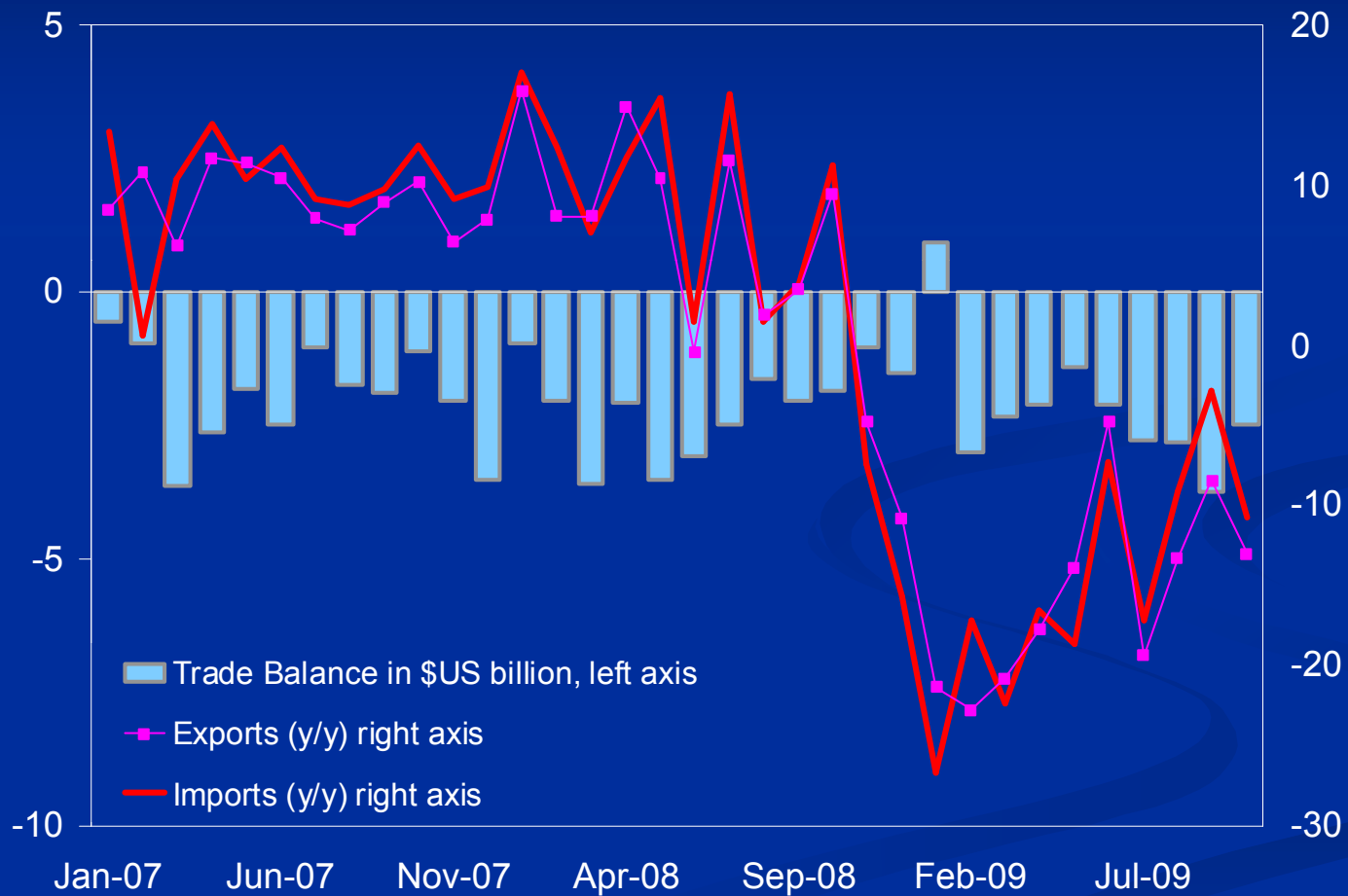
Recovery in recent quarters...



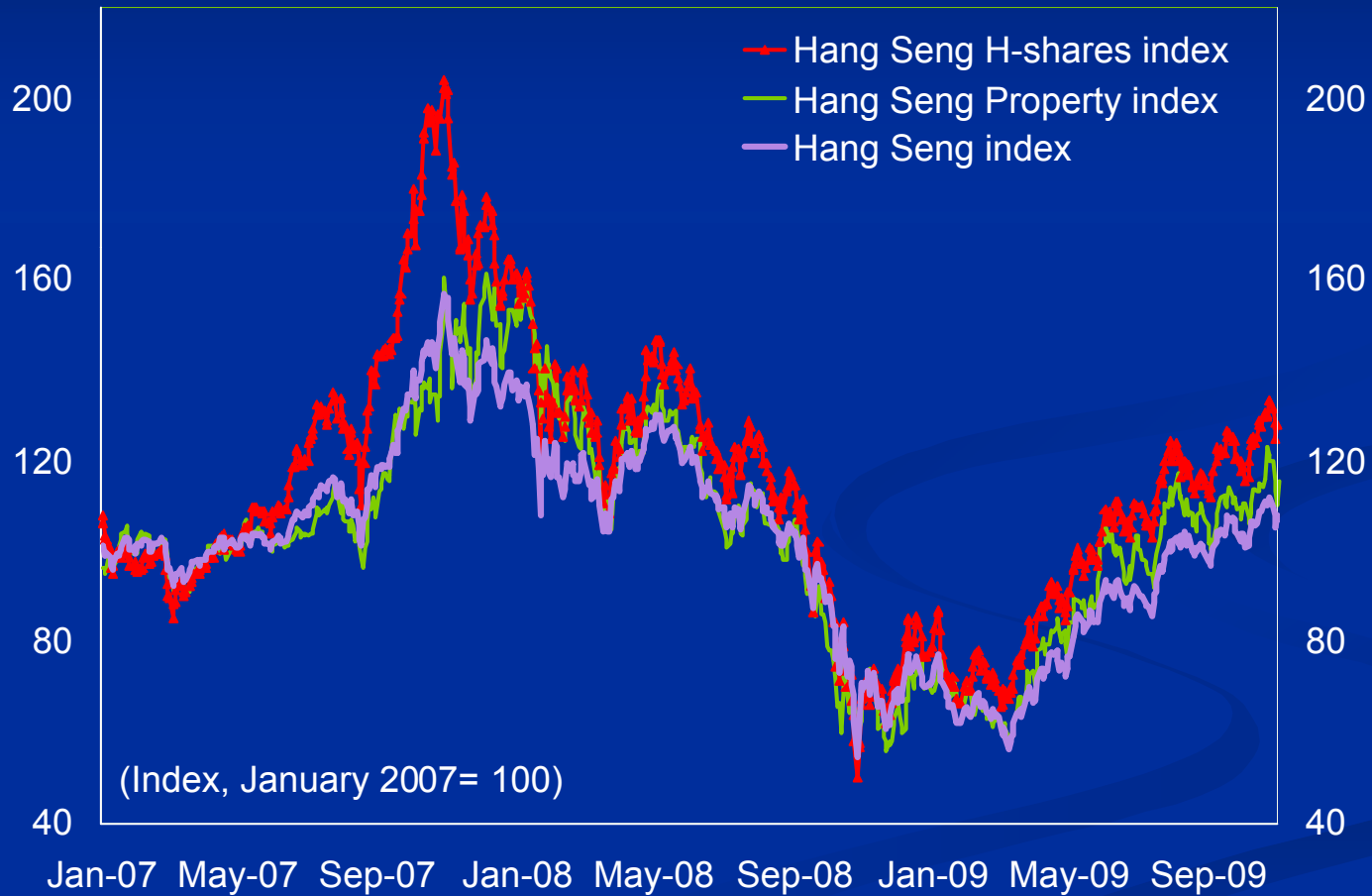
Retail sales coming back. Industrial production bottoming out...



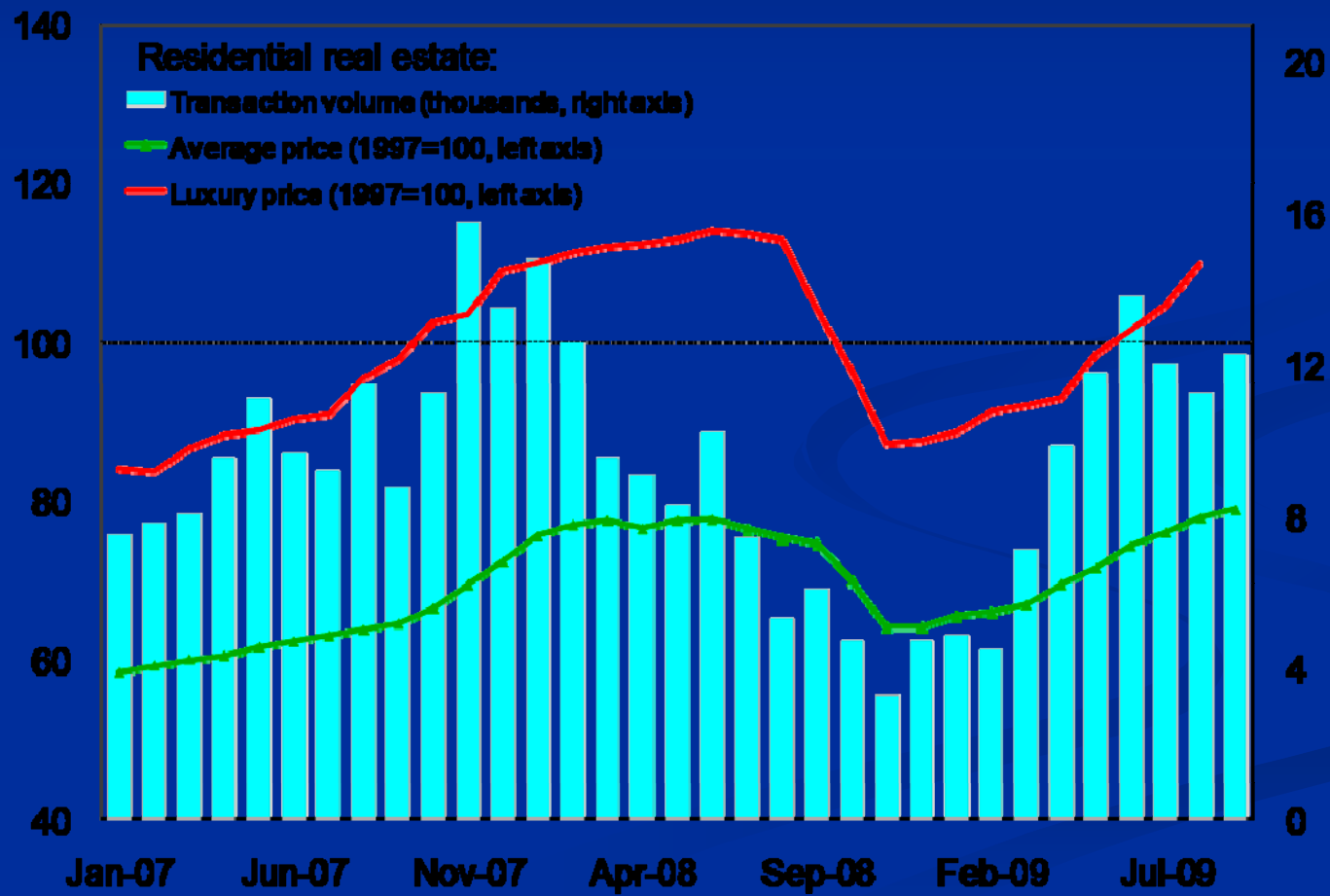
...but prospects depend on world economy.
Exports dipped again.



At same time, asset markets are booming: both equities...



...and property



Longer-term issues to sustain growth

- Maintaining competitiveness
- Managing aging/demographics
- Developing new services

Conclusions

- “Green shoots” in global economy, but sluggish recovery ahead.
- Asia a bright spot. Supportive policies need to continue, and, looking ahead, domestic demand needs to play a bigger role.
- China’s recovery increasingly well established. Signs of rebalancing, but further measures for a fundamental rebalancing.
- Hong Kong SAR recovery underway. Policy challenges: capital inflows create risk of asset price cycle; new external environment creates need for new engines of growth.