INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/201
FOR IMMEDIATE RELEASE
September 16, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Asia and Pacific Regional Outlook Cites Region's Strong Growth Prospects, Highlights Global Risks and Medium-Term Challenges

The International Monetary Fund (IMF) today released the September 2006 *Asia and Pacific Regional Economic Outlook.* David Burton, Director of the IMF's Asia and Pacific Department, highlighted the report's key findings:

"Asia appears poised to continue its strong economic performance of recent years. Growth in emerging and industrial Asia is expected to reach 7.3 percent this year, declining slightly to about 7 percent in 2007. The projected moderation next year reflects a modest decline in export growth, as growth in industrial countries, while remaining quite strong, slows. At the same time, with the interest rate cycle in Asia likely nearing its peak and the prospect of stability in oil prices, domestic demand should hold up well, even as export growth moderates. The external current account for the region as a whole is expected to remain broadly unchanged this year and next, at about 3½ percent of GDP.

"Inflation remains well contained, at less than 3 percent on average. Proactive monetary policy tightening and exchange rate appreciation have helped offset the impact of higher oil and other commodity prices. Inflation expectations remain in check, and a similarly benign inflation outlook is projected for next year. Nevertheless, upside risks to inflation remain, and central banks in the region will need to continue to monitor developments closely.

"Prospects for capital flows to emerging Asia also remain good. Global financial market volatility in May and June illustrated the region's resilience, as it came through less affected than emerging markets in other regions. Investors do not appear to have altered their positive view of the region, which bodes well for the continuation of strong FDI flows, but portfolio flows may moderate as global monetary tightening continues.

"Although the outlook is positive, there are some important near-term risks. The key risk for Asia is a more-rapid-than-expected slowdown in the United States economy. A sharper than expected slowdown in the US—owing, for example, to a large correction in the US housing market--would have a significant impact on the region's exports and, indirectly, on domestic demand. Second, higher oil prices could also affect both growth and inflation. Third, a more fundamental turn away by investors from emerging markets than that seen in mid-year could also slow growth and weaken regional currencies. On the whole, however, the region seems well-placed to deal with any risks that may materialize.

"The boom in Asia is now in its fifth year, and the region faces important challenges in the medium term as it seeks to sustain its impressive economic performance. Our *Regional Economic Outlook* examines these challenges and suggests some policy approaches that could continue to keep Asia's engine of strong growth humming.

"The *Regional Outlook* suggests that sustaining Asia's impressive economic performance over the medium term will require a shift from dependence on exports and toward more autonomous domestic demand. Such rebalancing of growth would also contribute to an orderly unwinding of current global imbalances. The *Regional Outlook* addresses a particular aspect of this issue: the scope for raising consumption in emerging Asia, which remains low by international standards and has failed to keep up with rapid GDP growth. The prospective aging of Asia—which will bring many of its own challenges—will likely raise consumption over the medium term. But policies can also play a supporting role. While the appropriate response will vary by country, reducing the need for precautionary savings—for example by ensuring adequate provision of education, health care and social safety nets—and enhancing household access to bank lending and capital markets would be helpful.

"The *Regional Outlook* also examines the development of Asian equity markets. In general, the continued development of the financial sector in Asian countries is critical to sustainable rapid growth. In this context, Asian equity markets have grown significantly since the early 1990s, driven by strong international interest, greater regional integration, capital account liberalization and structural improvements to markets. Nevertheless, market capitalization in relation to GDP in most countries remains well below industrial country levels, and equity market corrections are unlikely to have major macroeconomic effects in Asia. Continued equity market development will allow for greater efficiency of financial intermediation and investment and greater robustness in the face of shocks. But growing equity markets also pose new challenges to regulators and raise new potential issues for monetary policy.

"A growing divide between rich and poor also raises important issues for policymakers. We find that, after an extended period in which emerging Asia experienced the best of both worlds—rapid growth and increased equality—more recent years have seen rising inequality and polarization, including along geographic and urban/rural lines. This is a matter of concern, not only because rising inequality makes it more difficult to reduce poverty, but also because there is a body of evidence linking large income disparities to lower growth and higher macroeconomic volatility. No single factor can explain the trend of rising inequality, and no one policy measure alone can reverse it. However, policymakers may need to consider a number of policy initiatives, including increased—and more effective—spending on education; increased provision of economic infrastructure, in particular in less well-off regions; reforms in labor markets; and elimination of barriers that the poor face in accessing the financial sector.

The full text of the September 2006 *Asia and Pacific Regional Economic Outlook* can be found on the IMF's website, www.imf.org.