

Asia Leads Global Recovery, Further Reforms Will Help Address Medium-Term Challenges, Says IMF's Asia- Pacific Economic Outlook

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Asia is set to grow at 5.7 percent in 2013 (with growth in emerging Asia reaching 7.2 percent), leading the global three-speed recovery, says the International Monetary Fund (IMF) in its latest Regional Economic Outlook (REO) for Asia and the Pacific released today in Singapore.

This pick up in growth, after a year of subdued economic performance, is driven largely by continued robust domestic demand. Consumption and private investment will be supported by favorable labor market conditions, with unemployment at multiyear lows in several economies. Relatively easy financial conditions, which include accommodative monetary policies, rapid credit growth particularly in China and some ASEAN economies, and the rebound of capital inflows since the latter half of 2012, are also key factors behind this expansion.

Chinese demand and Japanese stimulus should also provide a boost to the region. In fact, for some of the more advanced open economies, direct and indirect demand from China and Japan is as important as demand from the United States and Europe. In the case of ASEAN economies, growing integration in final consumer goods trade should further contribute to favorable intraregional demand dynamics.

The REO makes clear that the favorable outlook is not without risks. While the external risk of severe economic fallout from an acute euro area crisis has diminished, regional risks are coming into clearer focus. These include some ongoing buildup of financial imbalances and rising asset prices, although this has generally not been excessive so far and is occurring amid still strong corporate and banking sector balance sheets. Other risks include an unexpected slowdown in China, weaker-than-expected effects from ongoing stimulus in Japan, or trade disruptions from a natural disaster or geopolitical

tensions.

Policy makers in the region face a delicate balancing act in the near term: guarding against the potential buildup of financial imbalances while delivering appropriate support for growth. Monetary policy makers should stand ready to respond early and decisively to any prospective risks of overheating, and with macroprudential measures playing an increasing role, especially where credit growth is too rapid and accompanied by strong capital inflows. In many Asian economies, structural deficits that are higher than pre-crisis levels imply the need for greater efforts to rebuild fiscal space. Some fiscal consolidation could also help preempt the potential overheating pressures from continued strong capital inflows.

Looking ahead, the REO focuses on two important policy challenges: making growth more inclusive and, in particular for emerging Asia, avoiding the middle-income trap. Strengthening fiscal frameworks and implementing a comprehensive agenda of structural reforms can go a long way towards achieving these goals, suggests the report.

On fiscal policy, while bold discretionary action in Asia during the global recession has been effective, there remains much room to enhance the quality of expenditure and revenue policies, through spending on infrastructure, education and health, as well as by shifting towards a more growth-friendly tax structure that includes broader tax bases and reduced reliance on inefficient incentives.

The REO points out that Emerging Asia is potentially susceptible to the “middle-income trap” a phenomenon whereby economies risk stagnation at middle-income levels and fail to graduate into the ranks of advanced economies. In general, emerging economies from Asia appear to be less at risk than their counterparts in other regions. Nevertheless, to sustain high rates of per capita income growth across the region, the policy agenda will have to be ambitious and address a range of priorities. Specific actions will vary from country to country, but include economic rebalancing, greater infrastructure investment, reforms in goods and labor markets, and meeting the challenges from rapid demographic change.

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