Event Report
A Recovery Takes Root in Developing Asia

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Developing markets in Asia are experiencing a firm recovery, according to a new report from the Asian Development Bank (ADB). The multilateral finance institution's chief economist, Jong-Wha Lee, shared the ADB's most recent findings with a diverse audience of academics and students at Columbia Business School in a talk sponsored by the Center on Japanese Economy and Business and the Jerome A. Chazen Institute of International Business. China and India, said Dr. Lee, are leading the way back to better-than-expected growth.

Among the key takeaways from Jong-Wha Lee's talk was that emerging Asian markets are expected to experience aggregate GDP growth of more than 7 percent in both 2010 and 2011. There are attendant risks as well. Inflation is on the rise, but manageable, according to the ADB. Capital flows to and from developing Asian nations have been volatile. Stimulus measures must be unwound as demand picks up. Finally, nations must enact prudent monetary and fiscal policies going forward — and not simply return to the pre-crisis state of affairs.

The ADB's forecast universe encompasses 45 economies subdivided into regions across Asia. The East Asia region, which includes China, is expected to grow fastest, at 8.3 percent in 2010, thanks to government stimulus and a pickup in global trade. Overall, for developing Asia, the ADB projects 7.5 percent GDP growth in 2010 and 7.3 percent GDP growth in 2011, a marked increase from the 5.2 percent advance seen in 2009, yet still below the heights of 2007, when the region saw an overall growth rate of more than 9 percent.

By comparison, developed nations are expected to see much more mild recoveries. The ADB projects 1.7 percent growth in 2010 for the major industrial economies — including the United States, the Eurozone and Japan — and 2.0 percent growth in 2011.

Economies more dependent on global trade felt the sting of the crisis more acutely. Dr. Lee pointed out that economies oriented toward exports, such as Singapore, Malaysia, Korea and Thailand, experienced a large drop in investment, helping depress GDP growth. In contrast, countries with more robust domestic demand, such as China and India, saw strong investment rates even during the crisis. To be sure, China and India spurred demand via policy decisions — cutting interest rates, providing liquidity and spending on stimulus. Still, Dr. Lee said, the crisis shows that economies can be "very volatile if you only depend on external demand."

As recovery takes root, Dr. Lee said, emerging Asian economies will have a major challenge in common with developed nations: how to develop an "exit strategy" after extraordinary government interventions. "During the crisis, Asian governments mobilized significant stimulus measures," he said. "The question is when and how they can withdraw these exceptional stimulus measures." The risk is that private demand will collapse if government spending does not prop it up.

Another challenge for this fast-growing region is maintaining high growth rates while keeping inflation in check. In 2009, with the global slowdown, inflation worries subsided. "This year, inflation pressure will increase as the economy proceeds," said Dr. Lee. The ADB forecasts inflation for developing Asia to be 4.0 percent in 2010 — close to the region's historical average and a manageable number, said Dr. Lee.

There are other external risks to the Asia recovery as well, such as the United States' continued weakness in its mortgage market and its high unemployment. Both factors could hurt demand for Asian exports, Dr. Lee said. He added that a mistimed pullback on expansive monetary and fiscal policy could stop the recovery in its tracks.

The deteriorating fiscal positions of some European nations, such as Greece, could provide another negative pressure to export demand. Finally, increased commodity prices pose a risk. Dr. Lee pointed out that the price of oil has been relatively stable of late, but said that food prices in particular bear watching.

Of course, no discussion of the Asia-led recovery would be complete without a nod to the looming risk of asset price bubbles — specifically, the Chinese housing market. Although precise data is hard to come by, by many measures Hong Kong house prices are back at pre-crisis levels, and mainland house prices have shown continued acceleration. Dr. Lee said that managing the risk of a bubble will require deft financial leadership.

In conclusion, Dr. Lee offered several policy recommendations. On the whole, major Asian economies have much lower debt-to-GDP ratios than their industrialized counterparts, and Dr. Lee urged developing Asian nations to maintain this fiscal discipline. But at the same time, he said, they should also focus on strategic spending on health, education and housing, to strengthen the safety nets and help the poor.

Dr. Lee called for coordinated monetary policy and financial regulation — with increased supervision and oversight to allay the threat of asset price bubbles as central banks focus on maintaining price stability. Also, Dr. Lee talked about the need for reduced exchange rate rigidity. Foreign exchange needs to reflect market fundamentals, he said, or else domestic distortions will result. As Asian nations seek to reduce their dependence on exports, gradual currency appreciation will bolster domestic demand.

Finally, Dr. Lee called for policy coordination and global cooperation, in order to give strength and stability to the recovery. To that end, he said, the “G20 is much better than the G7 or G8, no doubt.” But, he added, a “global crisis requires global cooperation,” and said that Asian nations must take more responsibility on the world economic stage. “We don’t know what will be the source of the next crisis,” said Dr. Lee. “But at least we need to adjust our macroeconomic policy frameworks to meet the challenges.”

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