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Firming industrial economies to support Asia's outlook

- Developing Asia is set to benefit as further signs emerge of growth momentum in the advanced economies. The region is poised to meet the 2013 and 2014 growth forecasts in *Asian Development Outlook 2013 Update*, though the subregional contributions to growth have changed.

- Infrastructure investments boost the outlook for the People's Republic of China by 0.1 percentage points to 7.7% in 2013 and 7.5% in 2014. This raises the forecast for East Asia as a whole by the same magnitude, as indicators in the subregion's other economies generally align with assumptions in the *Update*.

- South Asia is on track to meet growth expectations of 4.7% in 2013 and 5.5% in 2014. After bottoming out in the first fiscal quarter, India's economy seems to have recovered on the back of rebounding exports and higher industrial and agricultural output.

- Southeast Asia's growth forecast is tempered by 0.1 percentage points in both 2013 and 2014. Typhoon damage will moderate rapid growth in the Philippines before major reconstruction gets under way, and the unfolding political turmoil in Thailand is expected to undermine its growth over the forecast horizon.

- Inflation forecasts in developing Asia are unchanged amid softer international oil prices and lower global food prices.

ADB's Regional Economic Outlook Task Force led the preparation of the revised outlook for this ADO Supplement. The Task Force is chaired by the Economics and Research Department and includes representatives from the Central and West Asia Department, East Asia Department, Pacific Department, Office of Regional Economic Integration, South Asia Department, and Southeast Asia Department.

Outlook for major industrial economies

As 2013 draws to a close, the prospects for 2014 in the United States (US) and Japan look more upbeat, but recovery in the euro area may not be as strong as previously thought. Data on gross domestic product (GDP) through the third quarter suggest that the major industrial economies are on track to meet the 0.9% growth rate forecast for 2013 in *Asian Development Outlook 2013 Update*. Industrial production indicators in the US and further fiscal stimulus in Japan suggest somewhat stronger growth in 2014 than forecast in the *Update* despite softening in the euro area. Growth in the major industrial economies is expected to reach 1.9% in 2014 (Table 1).

Table 1 Baseline GDP growth (%)

	2012	2013		2014	
		ADO 2013 Update	*Revised*	*ADO 2013 Update*	*Revised*
Major industrial economies[a]	1.3	0.9	0.9	1.8	1.9
United States	2.8	1.7	1.7	2.4	2.6
Euro area	−0.7	−0.5	−0.5	1.2	1.0
Japan	1.4	1.9	1.7	1.4	1.6

ADO = Asian Development Outlook, GDP = gross domestic product.

[a] Average growth rates are weighed by GNI, Atlas method (current US dollars).

Sources: Asian Development Bank. 2013. *Asian Development Outlook 2013 Update.* Manila; ADB estimates.

US growth momentum strengthened in the third quarter of 2013. GDP grew solidly at a seasonally adjusted annualized rate (saar) of 3.6% quarter on quarter, for 1.8% output expansion in the year to date. Investments—which saw a high jump in inventories—accounted for much of the growth, but all other components contributed positively. Notably, the

US trade deficit narrowed slightly as export growth outpaced that of imports.

Consumption in the third quarter recorded the slowest growth of the year. The consumer confidence index fell substantially in October and into November, but retail sales bounced back quite remarkably in October after a slight slowdown in September. The industrial production index regained in September and October its average recorded in 2007, before the global financial crisis. Intensifying industrial activity and the upward trend in the purchasing managers' index since June 2013 bodes well for further increases in private investment in the coming months.

The labor market continued to recover as unemployment fell to 7.0% in November—the lowest rate since November 2008—despite the partial shutdown of the federal government in October. Inflation remains moderate with both headline and core measures below 2%. In light of this, the Federal Reserve is expected to maintain its low policy interest rate to the forecast horizon and may not begin to ease back its unconventional monetary expansion until near the end of the first quarter of 2014.

Looking ahead, inventory drawdown and the impact of the government shutdown will likely slow growth somewhat in the fourth quarter of 2013, but momentum should pick up in light of strong industrial indicators. As such, this Supplement retains the US GDP growth forecast at 1.7% for 2013 but adjusts the 2014 projection up to 2.6%. Fiscal policy remains a risk, as uncertainty lingers over legislators' willingness to compromise on a budget deal before the current agreement runs out on 15 January.

The euro area appears to have turned the corner, pulling out of recession as a whole in the second quarter of 2013, but the outlook remains fragile. Preliminary estimates show growth slowing, with third quarter GDP rising at a saar of just 0.3% over the previous quarter, after 1.2% expansion in the second quarter. Germany reported softer third quarter growth at 0.3%, as did Greece at 0.2%. France's economy actually shrank by 0.1% on account of weak trade. On the brighter side, Spain ended its recession and recorded growth at 0.1% in the third quarter of 2013, while recession in Italy slowed to −0.1%.

Consumer confidence in the euro area reversed in November after improving since January 2012. Retail sales dropped by a seasonally adjusted 0.2% in October from the previous month. The purchasing managers' index across the euro area fell in November to 51.5, down from a 27-month high of 52.2 in September. However, trends vary across countries, as Germany's composite index rose to its highest since January and France's declined to a 6-month low.

Aggregate demand and price pressures remain subdued. October's unemployment rate is, at a seasonally adjusted 12.1%, unvaried since April, and inflation remains well below the European Central Bank ceiling of 2%. Consistent with its "forward guidance" of keeping rates at the present level or lower for an extended period, the bank cut in November its main refinancing rate by 25 basis points to a record low of 0.25% and extended its unlimited short-term funding to banks until mid-2015.

The outlook for the euro area is still dragged down by fiscal burdens and credit conditions that remain constrained in several economies. Contraction year on year in loans to nonfinancial corporations extended further in October, reflecting heightened credit risk and unresolved balance sheet problems in the financial sector as broadly varying financing conditions in euro area countries continue to frustrate central bank monetary policy. As forecast in the *Update*, this Supplement sees the euro area economy contracting by 0.5% for the year. Modest expansion in 2014 is still envisaged, but the forecast pace is revised down by 0.2 percentage points to 1.0%.

Bolstered by monetary and fiscal stimulus, Japan registered broad-based growth in the first 9 months of 2013. Following the robust first half with a saar of 3.3%, third quarter GDP growth at 1.1% was lower than assumed in the *Update*, as demand for Japanese goods was softer than anticipated in the US and developing Asia. After picking up in the first half of the year, exports of goods and services contracted by 2.4%, leaving a large trade deficit of $31.9 billion in the third quarter of 2013.

The public sector contributed much of third quarter demand. In particular, public investment has been on a rising trend as public works that are part of the large supplementary budget approved early this year have now been implemented. Private demand growth in the third quarter was driven mainly by a resurgence in private home investment as consumers anticipate the value-added tax (VAT) hike in April next year. This surge in demand should wane in the fourth quarter with the passing of the deadline at the end of September to pay only the current 5% VAT.

Calls for fiscal consolidation mean that Japan's growth in 2014 will have to rely on sources outside of the public sector, namely private demand and exports. Weakening external demand is therefore a concern. Building momentum in private demand depends on whether rising stock prices and consumption can translate into new investment, new hiring, and higher wages.

Given weaker growth in the third quarter, growth in 2013 is now projected at 1.7%, which is 0.2 percentage points lower than anticipated in the *Update* but still much higher than Japan's long-term potential growth rate of about 0.8%. Assuming the announced fiscal stimulus helps mitigate the impact of the higher VAT on domestic consumption, and assuming a pickup in export demand as US and euro area growth improves, 2014 growth could hit 1.6%, outpacing the *Update* forecast.

Regional economic outlook

Growth outlook

Recently released data support the average GDP growth projections for developing Asia in *Asian Development Outlook 2013 Update* released in October. The region's growth is still expected to hover around 6% this year and next, with a marginal decline to 6.0% this year from 6.1% in 2012 before improvement to 6.2% in 2014 (Table 2). The composition of subregional contributions to this average growth changed slightly, however, with some downward revisions in Southeast Asia and the Pacific and upward adjustments in Central and East Asia.

Table 2 GDP growth, developing Asia (%)

	2012	2013		2014	
		ADO 2013 Update	*Revised*	*ADO 2013 Update*	*Revised*
Developing Asia	**6.1**	**6.0**	**6.0**	**6.2**	**6.2**
Central Asia	5.6	5.4	5.7	6.0	6.1
East Asia	6.5	6.6	6.7	6.6	6.7
China, People's Rep. of	7.7	7.6	7.7	7.4	7.5
South Asia	5.1	4.7	4.7	5.5	5.5
India	5.0	4.7	4.7	5.7	5.7
Southeast Asia	5.6	4.9	4.8	5.3	5.2
ASEAN-5	6.2	5.2	5.1	5.6	5.5
The Pacific	7.1	5.2	5.0	5.5	5.4

ADO = Asian Development Outlook, ASEAN = Association of Southeast Asian Nations.
Note: **Developing Asia** refers to the 45 members of the Asian Development Bank. **Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. **East Asia** comprises the People's Republic of China; Hong Kong, China; the Republic of Korea; Mongolia; and Taipei,China. **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. **Southeast Asia** comprises the ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam) plus Brunei Darussalam, Cambodia, the Lao People's Democratic Republic, Myanmar, and Singapore. **The Pacific** comprises the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Papua New Guinea, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Sources: Asian Development Bank. 2013. *Asian Development Outlook 2013 Update*. Manila; ADB estimates.

Despite uncertainties in the global environment, indicators in East Asia are positive, boosting growth forecasts for both 2013 and 2014 to 6.7%, up 0.1 percentage points from the *Update*. This revision is driven mainly by unexpectedly strong performance in the People's Republic of China (PRC). For 2013, the PRC's growth projection is raised 0.1 percentage points to 7.7%, as infrastructure investment boosted third quarter growth above the rate assumed in the *Update*. The structural reforms proposed by the Third Plenary Session of the 18th Central Committee of the Communist Party of China in November 2013 will likely have a positive impact on private consumption and private investment starting in 2014. However, the upside potential for growth is limited by the reining in of credit growth in line with recent central bank statements about deleveraging and somewhat decelerated public investment intended to curtail local government borrowing. PRC growth in 2014 is likely to be somewhat stronger than previously forecast and hit 7.5%, supported by structural reforms and better economic conditions in the industrialized economies.

Elsewhere in East Asia, the Republic of Korea posted in the third quarter its strongest saar of growth since the first quarter of 2011 thanks to robust private consumption and machinery investment. In contrast, growth slowed in the third quarter in Taipei,China and Hong Kong, China as slower export growth and internal factors dragged on these two economies. Growth trends in the newly industrial economies are in line with *Update* forecasts. Mongolia is set to achieve double-digit growth this year and next, driven by a pickup in coal and copper production as well as fiscal and monetary stimulus begun in the fourth quarter of 2013.

South Asia is on track to meet growth expectations in 2013 and 2014 as projected in the *Update*. India, the dominant economy in the region, is still anticipated to grow at 4.7% in FY2013 (ending 31 March 2014) and 5.7% in FY2014. Suggesting that the Indian economy has bottomed out, economic growth accelerated to 4.8% in the second fiscal quarter from 4.4% in the first. Growth was spurred by higher output in both industry and agriculture and a rebound in exports. However, domestic demand remains weak as both consumption and investment continue to grow only sluggishly. Although growth will remain soft in the first quarter of FY2014 owing to delayed investment announcements in the run-up to general elections, it will be supported by export recovery and likely sustained growth in capital expenditure after the second quarter of FY2014, once political stability has been reestablished.

While more recent data for other South Asian economies show trends in the subregion in line with assumptions in the *Update*, there is some downward pressure on growth in Bhutan and the Maldives. In Bhutan, credit tightening implemented by the Royal Monetary Authority is especially affecting construction, and five new hydropower projects are experiencing delays. Although the Maldives recently installed a new president, the volatile political situation and uncertainty in the run-up to elections undercut manufacturing and construction, as well as slowed tourist arrivals.

Southeast Asia's growth is anticipated to moderate slightly, bringing the forecasts down by 0.1 percentage points, to 4.8% for 2013 and 5.2% for 2014. The revision reflects political tensions in Thailand in the last quarter of 2013 and their adverse impact on consumption and tourism. Devastation wrought by Typhoon Haiyan is undermining Philippine growth in 2013, though this is mitigated by the relief efforts under way and transfers from abroad supporting consumption. The ramping up of reconstruction should boost economic activity there in 2014. Meanwhile, growth in Singapore is expected to be more rapid in 2013 in light of strong third quarter growth supported by externally oriented sectors including exports. Growth forecasts for the rest of the subregion's economies are generally in line with previous assumptions. Indonesia, where private consumption is buoying growth, anticipates that recent increases in interest rates will moderate domestic demand as exports recover slowly. Thailand expects some recovery in exports and disbursements from government investment programs, but political turmoil this year may still dampen growth.

Growth in Central Asia is gradually recovering. Aggregate growth projections for the subregion are revised up from *Update* forecasts, from 5.4% to 5.7% for 2013 and from 6.0% to 6.1% for 2014. These revisions reflect stronger performances in Kazakhstan and Turkmenistan. In Kazakhstan, improved performance is driven mainly by services but supported as well by moderate growth in industry, construction, and agriculture. Turkmenistan is benefiting from large public construction projects and increased gas exports to the PRC. In contrast, drag caused by slowing in the Russian Federation is affecting Armenia more than previously anticipated. Factors undermining Georgia's growth outlook for this year are falling government spending and investors' wait-and-see stance due to a political transition.

Economic growth in the Pacific is now seen to moderate from 7.1% in 2012 to 5.0% in 2013 before beginning to recover to 5.4% in 2014. These projections are weaker than the forecasts in the *Update*. In Timor-Leste, a year-on-year drop of roughly 30% in government expenditures through the first 3 quarters of 2013 prompts a downgrade to that country's growth forecast. Weak international commodity prices are adversely affecting export earnings from agriculture, minerals, and forestry in some of the larger Pacific economies such as Papua New Guinea and Solomon Islands. Growth expectations for the rest of the region remain in line with earlier projections as revenue prospects from tourism improve in major South Pacific destinations. Fishing license revenues are above budget targets because of rising rates under a subregional scheme by which foreign vessels pay fees based on the number of days they spend there. This has buoyed growth in the smaller Pacific island economies of Kiribati, the Republic of the Marshall Islands, the Federated States of Micronesia, Nauru, and Tuvalu.

Inflation outlook

International commodity prices continue to provide a benign inflation environment for the region. Although geopolitical uncertainties in the Middle East have kept oil prices elevated, the price of Brent crude receded from its peak of $117 per barrel in early September to an average of $105 in the first week of November 2013. Meanwhile, improved supply has pushed down global food prices. The agriculture price index contracted again in October for a cumulative decline of 16.3% from its peak in the second half of 2012. Year-on-year price changes for beverage and raw material commodities have been negative since November 2011.

Average inflation in developing Asia remains as forecast in the *Update*—3.6% in 2013 and 3.7% in 2014—but subregional contributions change. Inflation in East Asia is expected to be 0.1 percentage points higher in 2013 than previously forecast, as rising vegetable prices accelerate inflation somewhat in the PRC and

Table 3 Inflation, developing Asia (%)

	2012	2013		2014	
		ADO 2013 Update	*Revised*	*ADO 2013 Update*	*Revised*
Developing Asia	**3.7**	**3.6**	**3.6**	**3.7**	**3.7**
Central Asia	5.1	6.7	6.3	6.8	6.8
East Asia	2.6	2.4	2.5	2.7	2.7
China, People's Rep. of	2.6	2.5	2.7	2.7	2.7
South Asia	7.8	6.7	6.6	7.0	6.9
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The Pacific	4.3	5.7	6.0	6.0	6.4

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Sources: Asian Development Bank. 2013. *Asian Development Outlook 2013 Update.* Manila; ADB estimates.

currency depreciation ratchets up consumer prices in Mongolia. In contrast, inflation is adjusted down in South Asia for both 2013 and 2014 because of a change in the consumption basket underlying the consumer price index in Bangladesh. Inflation nevertheless continues to be problematic.

Declining food prices are dampening inflationary pressures in Southeast and Central Asia, prompting slight downward adjustments to inflation projections for both subregions. Destruction from the typhoon in the Philippines has brought inflation to affected localities but no big impact on the national average. Inflation in the Pacific, on the other hand, is expected to reach 6.0% in 2013 and 6.4% in 2014, higher than earlier projected mostly because the rate is stubbornly elevated in Timor-Leste.

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