

Comments on IMF Regional Economic Outlook: Asia and Pacific

Two-Speed Recovery under Tectonic Effect?

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Two-Speed Recovery

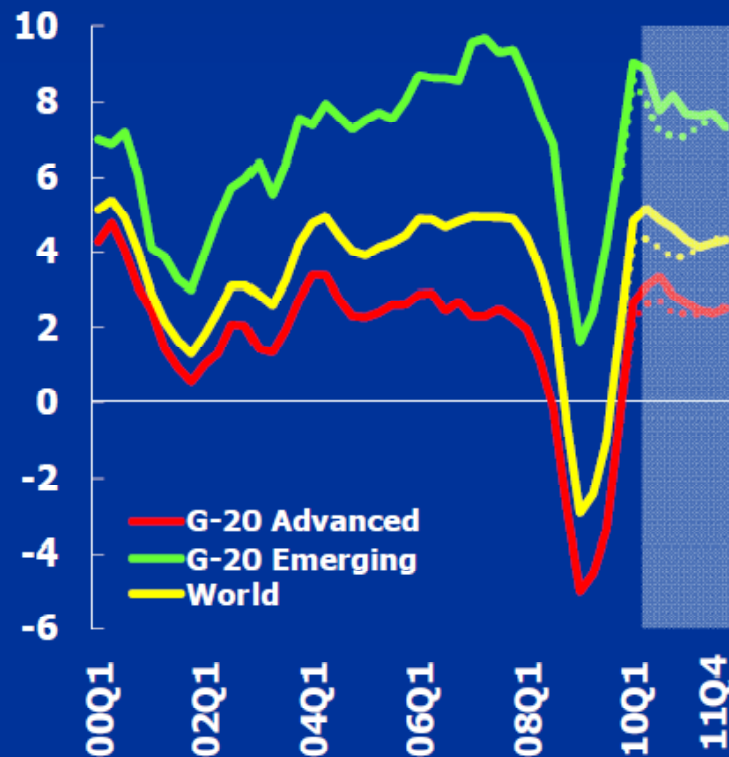
- A succinct summary is provided concerning the two-speed (or multi-speed) recovery in the global economy in the short term, highlighting the driving factors, the upside, and more importantly, the downside risks.
- The policy recommendations are broadly within IMF norms, favouring fiscal consolidation, monetary tightening, exchange rate adjustments; plus macro-prudential and curbing measures on the credit and asset markets. There are warnings about hard landing in case of continued overheating in some Asian economies and an emphasis on rebalancing demand and promoting inclusive growth over the medium-term.

Tectonic effect between/among developed and developing economies?

- The key question is: What have the financial tsunami and the subsequent QEs and fiscal loosening unleashed?
- A tectonic effect that takes many years to rebalance or just a short/medium run glitch? How should one explain the very uneven, bifurcate “recovery”, as well as the surprising rise in commodity prices?
- Have the “tectonic plates” among economies moved like after earthquakes of over magnitude 8?
- If yes, econometric and statistical models might turn out to be misleading without incorporating systemic breaks/changes.
- It would then be de-coupling or shift in growth centre, which began before the financial tsunami, in a new context.

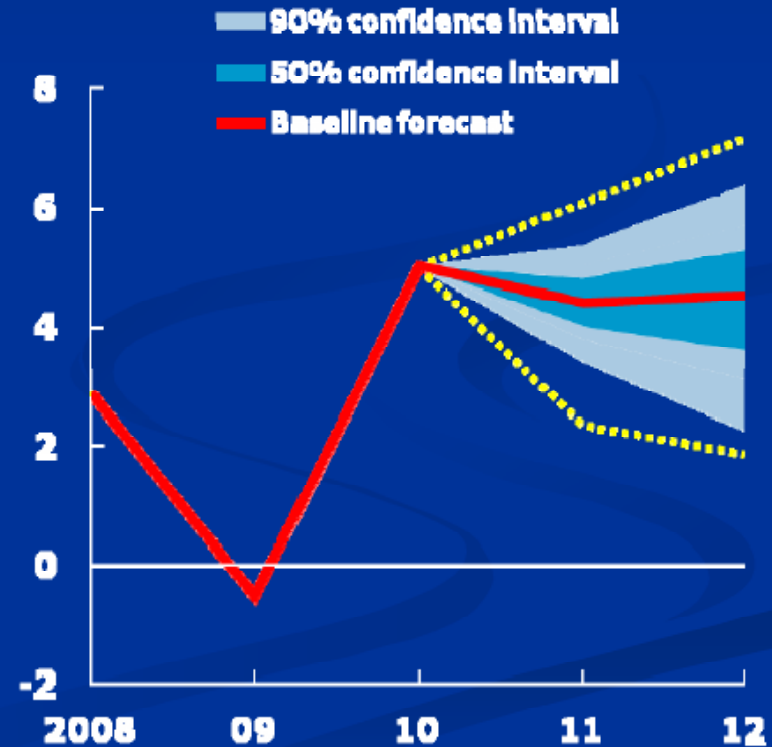
Tectonic effect between/among developed and developing economies?

Global GDP Growth
(Year-on-year; in percent)



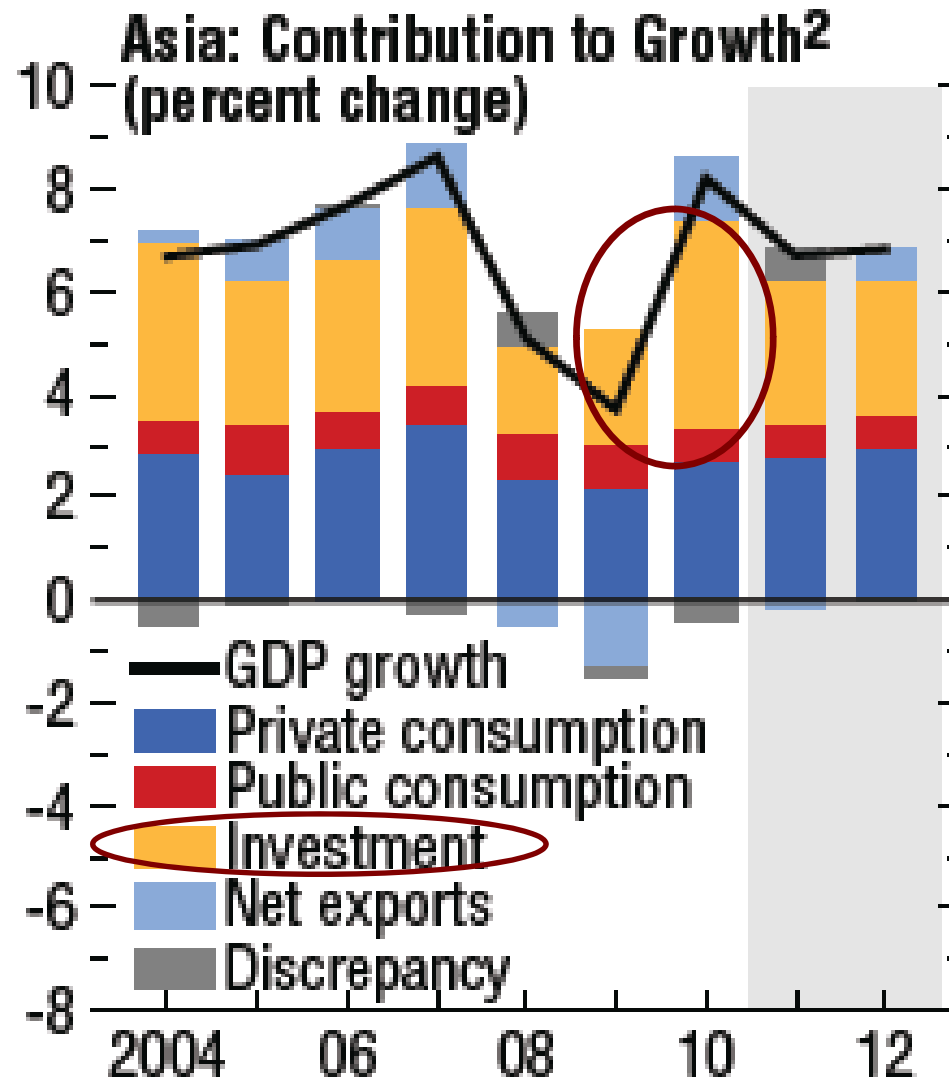
Note: Dotted lines denote April 2010 WEO forecasts.

Prospects for World GDP Growth
(Year-on-year; in percent)

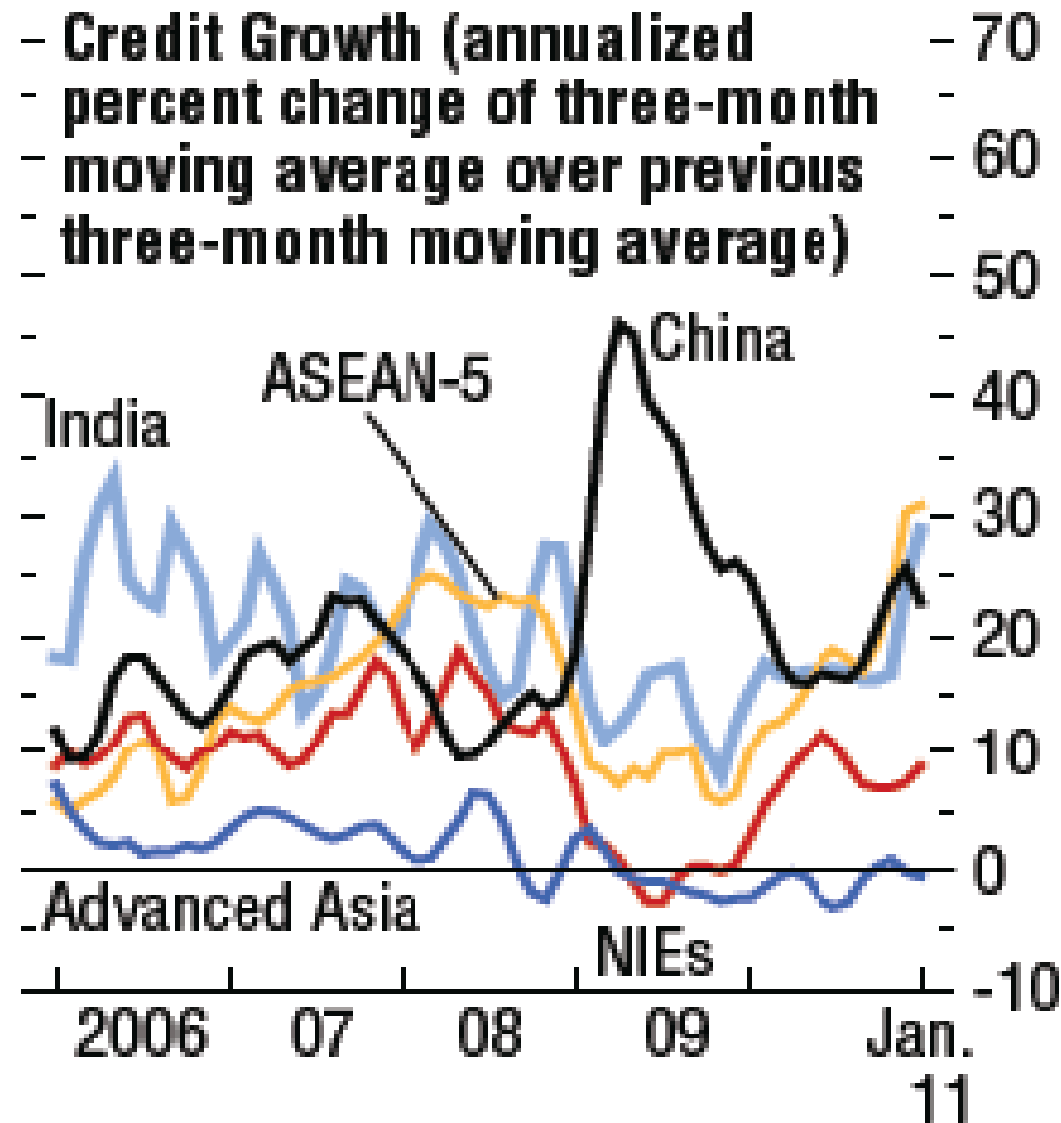


Note: Dotted lines denote the span of April 2010 WEO fan chart.

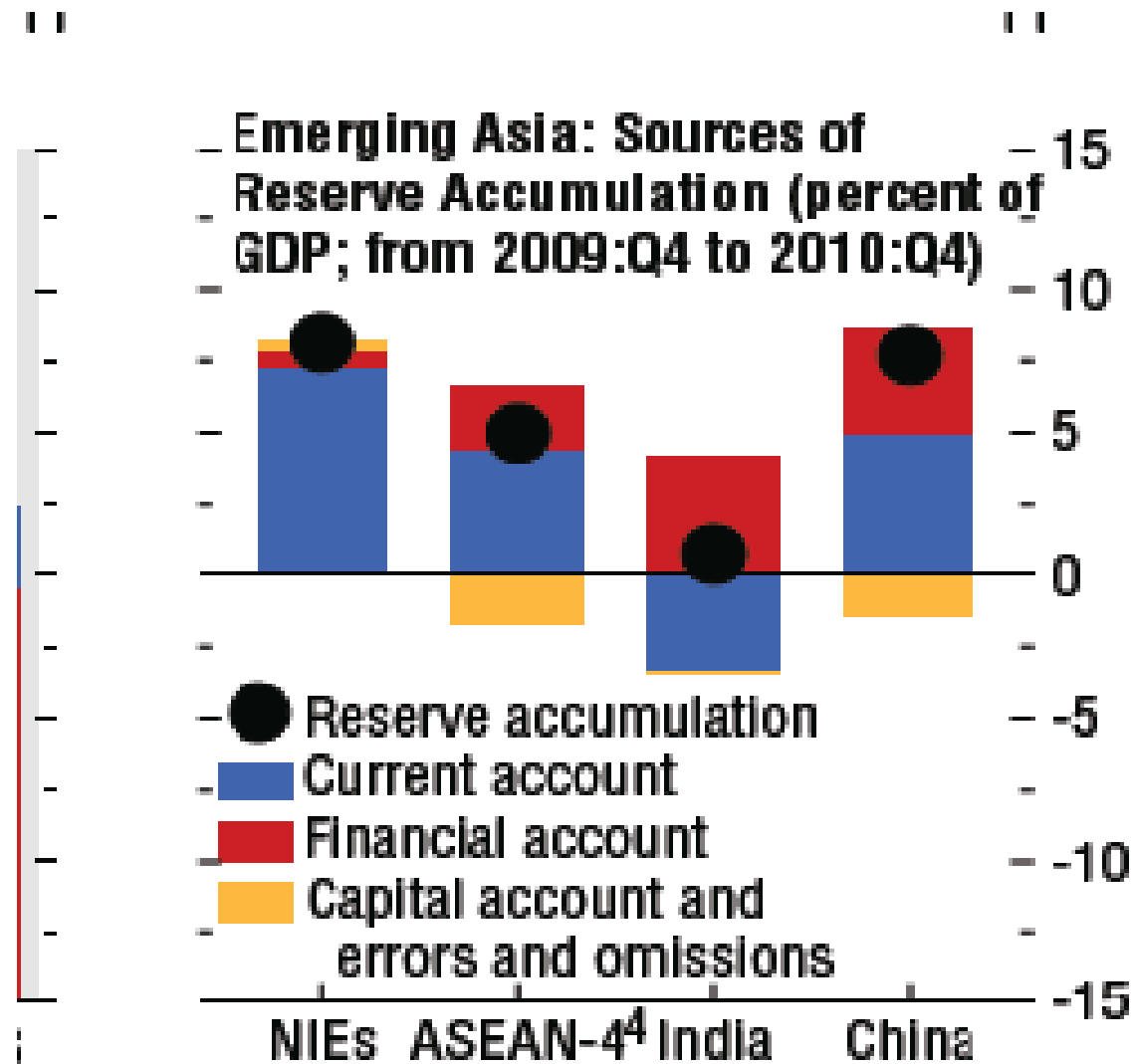
What drive recovery in Asia: investment?



What drive recovery in Asia: credit?



What drive recovery in Asia: BOP surplus?



Asia's challenges

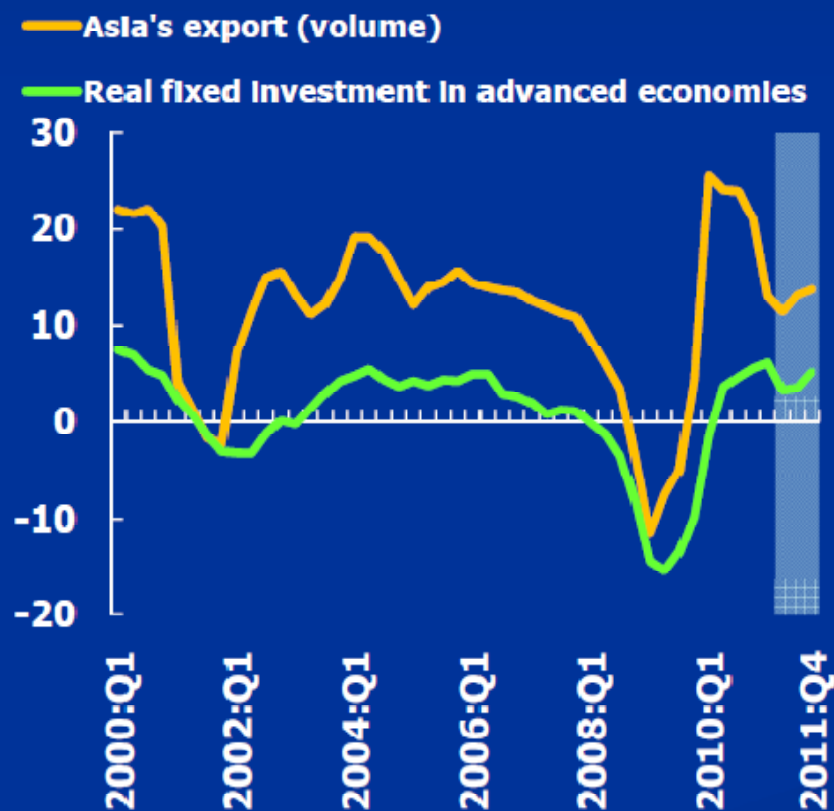
- To a more **robust** Asian economy, the present may represent the opportunity of a decade to reinforce de-coupling and shift in growth centre. This applies to BRICS as an extra-Asian entity.
- A temptation is to use the “tectonic” effect and further boost long-term growth by investment (or stopping the fall in and holding the share of investment in GDP). Rebalancing, consumption promotion, and the concern about sustainability are important, but can be taken care of as supplementary measures.
- These latter problems would assume priority when an economy reaches a certain development level, and when the global economic and financial system still dominated by the US and Europe moves to a “sustainable” trajectory after meaningful reforms.
- Rebalancing requires efforts from both sides. If the advanced economies do not clean their own houses, emerging economies could not do it alone.

Asia's challenges

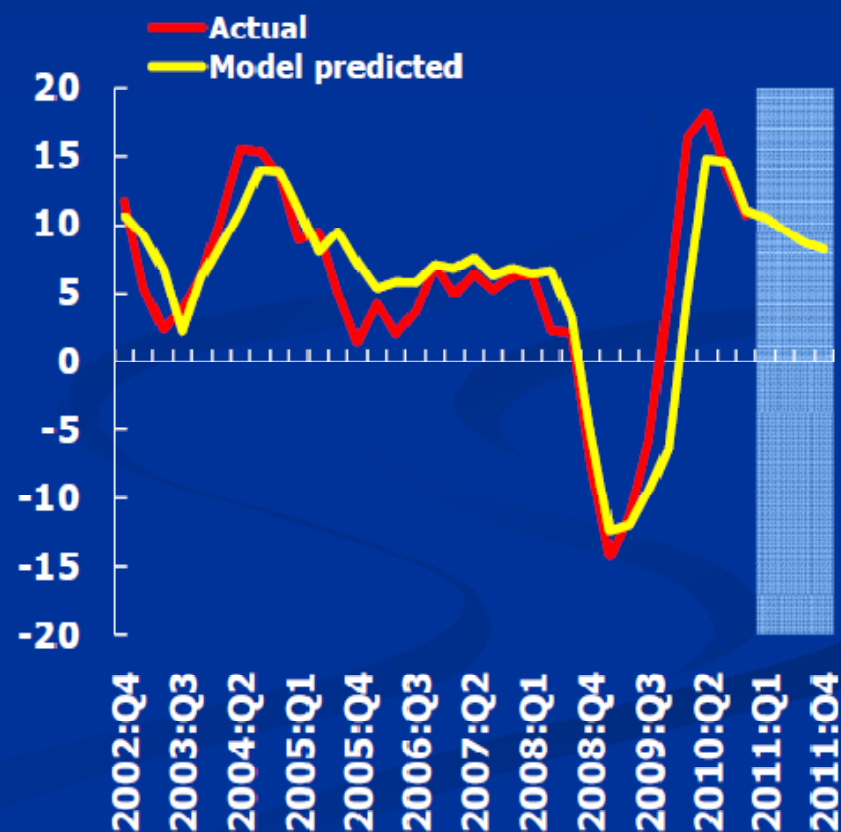
- Nevertheless, temptation is temptation. Asian economies should note that the recent rebound has also been due to strong external demand. Two-thirds of the final demand for Asian exports still comes from outside the region, despite initiatives to promote an intra-regional trade bloc.
- Capital inflows can at the same time be rather volatile, although there is a debate whether net or gross flow is more relevant.
- In any case, as far as inflation dynamic is concerned, more attention should be paid to the transmission from asset inflation to retail inflation. When property prices and rentals are driven up, partly by inflows and partly by domestic accommodative policies, the costs of business operation will rise, adding to the pressure of higher food and oil prices. On top of these, there is also the wealth effect.

Asia's challenges

Asia: Exports of Goods and Global Investment Cycle
(Year-on-year percent change)



Selected EM Asia: Private Investment
(Year-on-year percent change)



Asia's challenges

- Economic shifts are unlike natural disasters, at least not to such an abrupt degree. Even robust Asian economies, not to mention less robust ones, need to pay attention to cyclical issues of overheating. Macroeconomic policies cannot be too “accommodative” for the sake of growth.
- The long run has to be distinguished from the short run.
- As Keynes said, “In the long run, we are all dead.” But if one dies in the short run, there will not even be a long run
- The warning about the possibility of a hard landing by the IMF, if things are allowed to go to the limit, should be well taken.
- What are the optimal short-term policies to deal with overheating?

Asia's challenges

- In the monetary-fiscal mix, I suppose greater emphasis needs to be placed on the fiscal variable in the equation against asset inflation, including transaction taxes, as well as quantitative curbs on speculation.
- Monetary policies are in a dilemma, as higher interest rates and exchange rate appreciation would tend to attract more capital inflows and hence aggravate asset inflation in the short run.
- Take exchange rate appreciation as an example. Most Asian economies practice managed float, a gradual process of appreciation would induce systematic expectations of further appreciation, obviously a counter-productive result. Only a drastic appreciation can kill off the systematic expectations; but then can the economy stand the adverse impact?

Asia's challenges

- Hence, fiscal and quantitative measures have to be implemented in an appropriate mix with monetary tightening.
- The developments in 2010-2011Q1 have aggravated asset and retail inflation as well as income/wealth inequality in, for example, China and HKSAR. Capital inflows and asset inflation have played a notable role.
- The suggestion of “inclusive growth” by the IMF is laudable. How to implement “social protection policies” could however be a headache, politically and economically. The implementation of minimum wage in HKSAR has been a testimony.
- In the longer run, we will be back to the issue of de-coupling and shift of growth centre.