

Interview with Dr. Yasuyuki Sawada, Chief Economist of the Asian Development Bank

Asia to Lead a Global Economic Recovery in 2021 After the Pandemic Recession

By Japan SPOTLIGHT

The Asian Development Bank (ADB) released its latest economic forecast for the Asian region on Dec. 10, 2020, as shown in “GDP growth rate and inflation, % per year” (Page 7 of Asian Development Outlook Supplement, December 2020, <https://www.adb.org/sites/default/files/publication/658721/ado-supplement-december-2020.pdf>). Japan SPOTLIGHT interviewed Dr. Yasuyuki Sawada, the ADB’s chief economist on this outlook, as the Asian economy is now considered the main engine of the global economy, in particular during the pandemic crisis.

(Dec. 10, 2020)

Key Features of the Outlook

JS: How do you think growth rates in developing Asia will affect its presence in the global economy?

Sawada: If we decompose global growth rates into regional contributions – Asia, Latin America, etc. – we can see that developing Asia’s contribution has been more than half of global growth over the last decade. The continued growth of Asia is critical as it will be the main driver of global growth. According to 2021 global growth forecasts, more than half of global growth will be supported again by developing Asia and the Pacific region. In this respect, Asia has been and will be a core global driver of the world economy.

JS: There has been a diversity of economic performance among the nations in Asia during the pandemic. What do you think has made this difference? Do you think the public health policy measures to contain the virus or macroeconomic policy measures have made the difference?

Sawada: We are now seeing divergent paths of recovery within the region, with different sub-regions showing different speeds of recovery. Both public health measures to contain the pandemic and macroeconomic policy can explain this diversity, i.e., public health containment policies and the adoption of fiscal policy to support households as well as especially micro and small-scale enterprises. Health and the economy are interrelated but I think the former, health containment, is more critical. Those countries that successfully controlled the pandemic can reopen their economies, leading to better economic prospects. So, I think health containment is a decisive



Dr. Yasuyuki Sawada

element.

Basically, divergent paths can be explained by how successful each country or sub-region is in containing health risks. East Asia is doing well and recovering faster than expected in the health arena; China is leading this. South Asia is expected to contract significantly this year. In the last quarter, India was seriously affected but recently we see strong recovery. Accordingly, we have upgraded our growth forecast for India this year. In contrast, we have revised down our growth forecast for Southeast Asia, from a 3.8% contraction in our September forecast to a 4.4% contraction this time, mainly because these economies in Southeast Asia are still hampered

by the Covid-19 pandemic.

Expected Structural Reforms

JS: Do you think structural economic reforms to raise productivity would also be useful in getting their economies back to normal?

Sawada: In the medium term, I think structural economic reforms are necessary to help economies rebound. The pandemic will have long-lasting impacts on the growth potential of countries, and physical capital is affected because investment has been decreased. Investor sentiment has been adversely influenced and has gone down. Also, some capital became obsolete because firms closed, or business models changed under the sharp digitalization of the economy during lockdown. Human capital is also affected, on health, education and unemployment. Productivity growth may slow as innovation activity is also hampered. Therefore, structural economic reforms are essential to support the recovery and sustain long-lasting growth.

For example, competition policies will be needed to guard against

increasing risks of protectionism.

In order to maximize the benefits of digitalization or the evolution of digital economic transactions, I think lowering the entry barrier in digital platforms will be very important particularly for small and micro enterprises. Overall, competition policies to promote fair competition are critical in this regard. Labor markets should be made more flexible to facilitate adjustments in employment with proper safeguards. Also, regulatory frameworks should be flexible enough to allow firms to adapt to rapidly changing business environments, including digitalization. Public investments in physical infrastructure will be indispensable to facilitate these structural reforms, digitalization, and support robust recovery. These would be sensible policies in normal times, but their urgency is amplified by the current situation.

JS: Inflation would seem to be moderate in general. Are there any concerns about inflation rising in the future?

Sawada: According to our forecasts, inflation is not necessarily a major concern. Depressed demand due to Covid-19 and low oil prices are likely to dampen inflation pressures. So our forecast for inflation for developing Asia was revised slightly down to 2.8% from 2.9% in September. The impact from falling demand and lower oil prices will continue next year, so this could go down to 1.9% for next year's forecast. African swine flu was a problem in China last year, pushing up pork and meat as well as food prices overall. However, this impact has more or less disappeared. So, lower demand and lower oil prices seem to have offset this potential food price hike due to African swine flu. Supply-side disruptions may increase inflation but, overall, the inflationary effect seem to be dominated by falling demand and lower oil prices, hence the 2.8% forecast this year and 1.9% for next year for inflation.

What Happens to Global Supply Chains?

JS: Turning to global supply chains, Chinese people in particular are concerned over disruptions to global supply chains; some economists indicate that this should not be a major concern and that supply chains have been preserved in spite of the pandemic.

Sawada: After all, there are no big concerns about the pandemic's impact on global supply chains.

Even before the pandemic, supply chains were changing and some manufacturing industries in China were moving out of the country. One element is labor costs: China has been the base for low-cost labor-intensive manufacturing since it joined the World Trade Organization (WTO) in the early 2000s. As a result of successful growth, however, wages have gone up and, accordingly, labor-intensive industries have started relocating to other countries. This process of supply chain change seems to be accelerated when the US-China trade conflict intensified in 2018-2019. This promoted the process of firms shifting from China to other Asian countries, especially in the labor-intensive industries. Examples include the electronics industry moving

from China to Vietnam as well as the labor-intensive apparel industry moving to Bangladesh.

Policies should not aim to restore or stop this transformation in production and trade but rather facilitate it in a good direction because overall Asia seems to be gaining from these changes in supply chains. China in the last decade has transformed from an export-driven economy into a more domestic demand-driven economy. So-called "rebalancing" has been ongoing which is not necessarily bad news for China because it is an indication of welfare improvements among Chinese people. Policy should not aim to stop these natural, productive changes based on an exogenous, global environment but should rather facilitate and promote healthy business investment and trade by relaxing investment restrictions and removing red tape. Indeed, this would be another important role playing out in structural reform. The pandemic, of course, has disrupted global value chains at least temporarily, but in the second half of 2020, we observed a rebound in trade and supply chains, especially with Chinese exports of personal protective equipment (PPE), leading to a strong rebound of China's production and exports. Also, electronics products have been showing a strong rebound in East Asian countries due to increasing demand from people working at home.

JS: The digital economy is now expanding. Some economists are saying that we have a global service chain and not a global manufacturing value chain. In that sense, India might be in a better position for growth in the medium term rather than China.

Sawada: If we use exports of commercial services as one measure, in the last 10-12 years, Asia's exports of commercial services have increased sharply – more than doubling from \$500 billion in 2005 to \$1.33 trillion in 2017 (latest figures). This indicates a deepening of global service chains in Asia, as well as connections to the global economy. At the same time, we should note that global service chains and global manufacturing value chains are interrelated and, actually, there is a synergy between the two chains. That is very important. We see the emergence of a global value chain fueling trade in services and the deepening of the global service chain, which further induces a deeper global manufacturing value chain. I think that is very important in particular for Asia, and regional integration has combined advanced technology like 5G with an expansion in trade in services. Your question about India's position in the mid-term is an interesting one, but I am not sure about India being in a better position in the medium term because China's leading role in innovations will also be strengthened due to the synergy of manufacturing and services. We will see five to 10 years from now whether India dominates, but I think both countries will continue to gain from the synergies between the two chains of global manufacturing and services.

Main Risk to Predicted Recovery

JS: What is the main risk which could derail recovery in this region?

Sawada: A prolonged pandemic is probably the largest source of risk, and recurrent waves such as the third wave happening in the United States, and there is another wave in Japan too. These are the most prominent risks, but at the same time we see developments with vaccines that temper this risk. Three vaccines have announced positive results from large scale trials, and this enhances hopes for rolling out in 2021. For developing Asia, not only vaccine development but also safe and effective delivery is important. The largest risk, then, is whether we can secure safe and timely delivery of vaccines. There are also geopolitical tensions between the US and China over trade as well as technology. That is another big risk. The recent US election outcome may result in more predictability. Tension between these two largest economies in the world had generated uncertainty with which private sector entrepreneurs might have taken a wait-and-see strategy which undermines business investments. But I think that the US election result will decrease uncertainty, enhance private investment and increase overall productivity. Also, we can expect a more multilateral approach in resolving bilateral trade conflicts. Having said this, it is unlikely to fully resolve the tension between US and China instantaneously. I think that will take some time to see major progress.

Impact of Asia's Regional FTAs on Global Economy

JS: Regional trade agreements will be very important when the WTO does not work so well. The Regional Comprehensive Economic Partnership (RCEP) was recently concluded. China seems to be interested in joining the CPTPP, and the US may come back to the TPP under a new administration. In that sense, this region's international cooperation efforts, mainly in the area of regional FTAs, will be key to achieving stability in global growth. Would you agree with this?

Sawada: I agree. Regional cooperation initiatives are critical to support Asian growth, which will then support the global economy because Asia is a key driver of the global economy as I mentioned before. The RCEP is the largest FTA in the world, and participating countries in the RCEP agreement account for about 30% of global GDP and 30% of the world's population. So this is a major achievement and will also be a building block towards a more open global economic system that facilitates multilateralism. The RCEP does not include the European Union or the US, but this doesn't mean they will not gain from it. There was one study by Peter Petri of Brandeis University (now with the Brookings Institution) and Michael Plummer of Johns Hopkins University, and according to their simulation analysis both the EU and the US stand to gain from the RCEP. This will be a push towards a more global open economy. In the short term, the RCEP contribution to Asian trade and income may be rather modest. This is because the RCEP is confined to tariff measures and these tariff cuts will take some time to come into effect, and tariffs overall in Asia are not so high. After all, there is not much more room for cutting them further. So the effect will be positive but limited in the short term, but it is a stepping stone towards a broader, more open economic system which is critical

for Asia's role in supporting global growth in the post-pandemic economy.

Wellness as a Key Factor for Sustainable Recovery

JS: What motivated you to highlight the role of wellness in development in the September 2020 outlook and retain it in your new outlook?

Sawada: We prepared this wellness report before the pandemic, considering wellness to be a key to achieving robust development and also achieving Sustainable Development Goal No. 3, so we made it a core concept. Wellness is the pursuit of activity, choices, and lifestyles that leads to stable holistic health. We look from the physical and mental dimensions as the key aspects, but it also includes emotional and social dimensions.

We have seen lots of reports stating that during the pandemic, people stayed at home and thus their physical and mental health was negatively affected. So in this respect I think recovering wellness, especially physical and mental health, is critical. On the economic importance, we computed wellness, industry size and growth, finding that it is a large and growing part of the economy. Before the pandemic, 11% of regional GDP was accounted for by wellness or wellness-related activities (2017) and the wellness economy was growing more than 10% annually. So it is a large and growing part of the regional economy and will be vital as a core element for supporting the post-pandemic recovery in the Asia and Pacific region.

Concerns About Japanese Economy in 2021

JS: According to your estimates, the Japanese economy will not be in such a good state in 2021 ("Gross domestic product growth in the major advanced economies (%)", Page 3, <https://www.adb.org/sites/default/files/publication/658721/ado-supplement-december-2020.pdf>). The growth rate for 2021 looks lower than in European countries, but how can this be given that the spread of infection in Japan is relatively small?

Sawada: In terms of statistics, for 2020, the extent of the drop for the eurozone economy is deeper – our revised estimate is -7.4%, so a deeper GDP decline and then recovery. Because of this contraction, we will see a higher growth rate next year. Japan had a milder drop compared to the eurozone economy and that is why the growth rate for 2021 looks smaller. We envision robust recovery for Japan next year, but the slope will be flatter because Japan has been relatively successful in containing the epidemic and the Japanese government has committed to large-scale financial stimulus to support the economy, such as households and businesses. **JS**

Written with the cooperation of Joel Challender who is a translator, interpreter, researcher and writer specializing in Japanese disaster preparedness.