

Interview with Dr. Abdul Abiad, Director, Macroeconomic Research Division at the Asian Development Bank (ADB)

Developing Asia to Be Driving Force for Global Growth Under Continuing Geopolitical Crises

By Japan SPOTLIGHT

What are the prospects for Developing Asia's economy against the background of geopolitical crises? Dr. Abdul Abiad, Director of the Macroeconomic Research Division at the Asian Development Bank (ADB), offers his views on the issue from a long-term perspective.

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Key Factors Affecting Developing Asia's Growth Prospects

JS: My first question is about rising geopolitical crises such as the Ukraine war and the US-China confrontation. These will likely continue for a while and have an impact on the mid-term to long-term prospects for the economies in Asia. What would likely be the most influential factors from a mid-term macroeconomic perspective for these Asian economies?

Abiad: Let me start with the biggest factor for our region. We are a development bank and focus on Developing Asia. Perhaps the biggest factor that will affect the prospects for the region in the coming years is the slowdown that we've already seen in China. 2022 is going to be the first year in more than three decades that China will be a drag on Developing Asia's growth, in that it will be growing slower than the rest of Developing Asia.

We have already been seeing this trend of a decline in China's growth over the past decade, but it slowed down very sharply this year. There are many factors behind this slowdown, some in the short run and others that will continue to play out in the medium term. Given how big China is – it's 60% of Developing Asia – and given how tightly it links other economies outside of China, this really matters. In the short run perhaps the most important factor is the lockdowns that we have seen because of China's zero Covid policy. Our expectation had been that given how economically costly this was that this would be lifted soon; in fact, we were hoping that after the Party Congress last October there would be indications that



Dr. Abdul Abiad

they would start lifting it. The Party Congress has come and gone and there have been no indications of the zero Covid policy going away. So it looks like it's set to continue and now the expectations have shifted. It could well be that the zero Covid policy stays in place through 2023, for example ["Editor's note: In early December, Chinese authorities started easing pandemic restrictions."]. Therefore, if China continues to have these recurrent outbreaks and they continue these localized lockdowns that will continue to disrupt the Chinese economy, so that's factor number one that matters in the near term but also into next year.

Other factors that are also affecting China are problems in the property sector. The property sector was an important contributor to growth over the past 10-15 years but that will be more difficult in coming years. The property sector is in decline with prices falling. There's obviously also the risk that if it is not managed properly you will have a disorderly working out of the debt problems there, which Chinese authorities are well aware of. That's another reason where the outlook for China is challenging. Then you have the longer-term factors that have already been at play for many years and will continue to be at play for many years to come. One is China's aging population. The working age population is on the decline and China is set to see the sharpest demographic transition in the coming years. The second factor is the need for a new growth model. China for the past two to three decades has really relied on the model of being a low-cost center for manufacturing, but incomes have risen there and they need a growth model that relies more on homegrown innovation and moving up the value chain. For all of these are reasons we can't take China's growth for granted.

One other factor challenging the outlook is tightening global

financial conditions. Both the Federal Reserve and the European Central Bank (ECB) have been tightening very sharply because of inflationary pressures and as a result the United States and European Union are expected to slow sharply next year with the recession a strong possibility. That obviously will affect demand for Asia's exports and we're already seeing those effects in the exports of say South Korea where you are seeing sharp falls in export numbers and in new export orders. This is often a bellwether to what happens to the rest of Asia so it's really going to be a tough period going forward.

JS: In terms of the impact of food and energy prices, in particular the rise in food prices, would that seriously affect personal consumption in Asia overall?

Abiad: The Russian invasion of Ukraine was definitely a major factor in the rise of food and energy prices, and yes, it's affecting the outlook directly; as you say there are higher energy and food prices and lower purchasing power and therefore this has a dampening effect on consumption. In addition, because central banks have to raise interest rates in response, it then means financial conditions become tighter and that also has a dampening effect on both consumption and investment.

JS: You mentioned the negative consequences of China's lockdown policy and while there are many negative consequences for the economy, are there any positive aspects of the pandemic? Asian countries including Japan are very enthusiastic about promoting digitalization and so how do you assess this enthusiasm impacting the long-term prospects of the Asian economy?

Abiad: The pandemic is creating a divergence within developing Asia. You have China on the one hand which because of its recurrent lockdowns is still being affected. We expect China to grow just 3.0% in 2022 and 4.3% in 2023. Then there is the rest of Developing Asia which is re-opening, and that is providing a big boost. If you look at Southeast Asia and South Asia, these economies are actually growing faster – so in South Asia growth is forecast at 6.5% in 2022 and 6.3% in 2023, and for Southeast Asia it is 5.5% in 2022 and 4.7% in 2023, precisely because they are learning to live with Covid and they have really opened up. This has been allowed by good progress on vaccination and natural immunity coupled with the decision of policymakers to reopen borders and economic activity. So on the pandemic front you are seeing good developments for the rest of the region.

Turning now to digitalization, you're absolutely correct – one positive thing that came out of this pandemic was an acceleration of digitalization. We definitely think this will continue to be a boost to productivity and it has allowed for many different things: increased digital payments, as well as new ways of working – which is a potential boost to productivity. One of the interesting things is that digitalization improves resilience. So if you compare entrepreneurs and SMEs that had a digital presence with a website versus those that did not, many of those in the first camp weathered the pandemic much better than those that did not. Assuming we move beyond the pandemic, what digitalization does is that it expands markets that were previously unreachable for many smaller enterprises. Now it's easier for them to find markets where they can sell their products. It improves efficiency because you can outsource some of your back-office marketing and other costs. Lastly, especially for entrepreneurs, what digitalization does is to facilitate low-cost experimentation. It used to be very costly to get started because you needed a physical bricks and mortar store. But now you can find out what works and what doesn't more easily, and then pivot towards what works. So because of this we expect productivity to be higher and the potential for innovation will be higher because of increased digitalization.

Long-Term Impact of Digitalization on Developing Asia's Development

JS: Do you have a rough estimation on how much digitalization will affect Total Factor Productivity or labor productivity in Asia?

Abiad: We don't have that analysis on the macro level yet, that's quite tough to do. We look at things more on the micro level because it's hard to identify causal effects at the macro level. So in our report on "Entrepreneurship in the Digital Age," (<https://www.adb.org/sites/default/files/publication/825166/ado2022-update-theme-chapter.pdf>) for example, we look at things like the likelihood that a firm will export or the likelihood that the firm will introduce a new product and things like that.

JS: You mentioned SMEs – perhaps agriculture would be as positively affected as well by digitalization. In many Asian countries agriculture is still a very important sector in terms of sources of economic growth, so whether this sector is rationalized by digitalization or not should have a big impact upon the total economy.

Abiad: Agriculture definitely remains an important sector, even in cases where it has shrunk as a share of GDP. A substantial share of

employment in developing Asia is still in agriculture. There are many ways in which you can get efficiency gains through digitalization and automation but also there are other ways in which agriculture can benefit from the newer technologies including using remote sensing for improving insurance markets and for planning purposes. There are many areas of potential gain for agriculture; last year's Asian Development Bank Outlook's theme chapter (<https://www.adb.org/sites/default/files/publication/726556/ado2021-update-theme-chapter.pdf>) was on agriculture in Asia and there we talked about where Asian agriculture stands, including the fact that the sector is aging. Also, that there is an increasing proportion of women in the sector and how digital and new technologies can boost agricultural productivity.

JS: The food processing industry must also be very important for the Asian economy and in that regard is also important in promoting the economy as a whole.

Abiad: It's the same factors at play here but we don't have a specific analysis on the food processing industry.

JS: The reason I'm asking this question about agriculture and the food processing industry is that while I'm not an expert on the Asian economy, there must be lots of SMEs in those sectors and that means there could be some big income inequalities between those sectors and banking or other service sectors. So this inequality issue could be another concern.

Abiad: While digitalization can provide a boost to growth, it is definitely the case that it can also exacerbate inequality both within and across economies. A lot of this has to do with digital infrastructure. There is the digital divide across economies. Some economies have better digital infrastructure, while some have parts of the population that don't have access to the Internet and don't have computers. Just to give you one example, in the education sector you have many school closures during the pandemic and a shift to remote learning and one of the studies shows the extent of these learning losses due to these school closures in the countries without good digital infrastructure, but as we show in our report (<https://www.adb.org/sites/default/files/publication/784041/ado2022-learning-losses.pdf>), there is a distributional component to that.

Among many poorer households because of lack of access to computers or the Internet we'll see a large loss in percentage terms to their learning and therefore this would result in their lifetime loss of wages as a result of those school closures. But in general, it can

boost digitalization and can boost productivity for those SMEs and entrepreneurs, and for those parts of the population that have access to it, unfortunately that access is inequitable.

Education a Key Factor in Developing Asia's Long-Term Prospects

JS: Perhaps this explains the widening income inequality as well in Asia. Could you share some thoughts on improving education policy in order to overcome the digital divide?

Abiad: We first did a study on learning losses due to school closures in the pandemic in April of last year (<https://www.adb.org/sites/default/files/publication/692111/ado2021-special-topic.pdf>). We estimated that school closures reduce learning and will affect productivity and wages of the cohort who are currently in school; this will affect them not just now but for their whole working lives. So our estimate is that this will reduce their learning and productivity by about 7% and their future lifetime earnings by about 6% – and if you take the present value of those lost lifetime earnings it comes out to something like 13% of regional GDP so it's quite a large number.

So what policies can you implement to address this? Well, there are ways to remediate the lost learning. The key first of all is to bring students back to school as quickly as possible because as of now, including here in the Philippines, some schools are still not full-time face to face. So the learning loss continues. The second point is that there are low-cost diagnostics and ways of identifying learning loss. You don't need fancy tests, and you basically go around asking students simple arithmetic or reading questions so you can identify which students have fallen behind and in which areas, and you target those specific learning losses directly.

In addition, you want to be prepared for future disruptions to education because this COVID pandemic will not be the only time that you will have these disruptions. So another important element is ensuring that you start closing the gap in digital access, to ensure that when there are disruptions poor households don't fall behind further.

Concerns About Stagflation in Developing Asia

JS: There are serious concerns about stagflation in 2023 all over the world and in particular in the US. In light of the robust supply side of the Asian economies, would this concern not be so serious in Asia?

Abiad: In much of the world growth is slowing and inflation is rising, but the extent varies greatly. The US and Europe are flirting with recession even as inflation is very high. Now as to whether you will have stagflation – which technically means stagnant or contracting growth alongside high inflation – in our region, definitely that is not where developing Asia is. While growth is going to slow, we expect it will be 4.6% in 2023, the highest of any region in the world. Growth in Developing Asia is still reasonably robust, especially when you compare it to growth elsewhere, not just the advanced economies but also other developing regions.

Also, inflation is not that high. Inflation for Developing Asia in 2023 is projected to be 4.2% which is high relative to let's say the 2.8% average inflation from 2015-2019, but it's still nowhere as high as inflation in the US or in Europe, and in other developing regions.

So yes, Asia faces the same challenges as the rest of the world in terms of slowing growth and rising inflation but in large part because of prudent policies it's nowhere near what you would refer to as stagflation.

Trade Could Be Downside Risk to Robust Growth

JS: Would there be in your estimation some downward pressures on this predicted robust economic growth? What are the potential factors causing downward pressure on the economy?

Abiad: Weakening global growth is definitely a downside risk, especially if inflation continues to be high in advanced economies and requires further tight monetary policy. What is clear is that growth in 2023 will be slow for many of Asia's partner countries and therefore demand for exports will be low. Another challenge is high energy and food prices as we already discussed.

You mentioned geopolitical risks and that's also a big downside risk. We've seen tensions in Europe, tensions in Asia, and those can definitely be a damper not least because higher uncertainty leads to lower investment. One more risk factor is a reorientation of global production chains. A lot of corporations are thinking about their exposure to China and whether they should move production facilities out of China. That may be a drag or a challenge for China but it is already proving to be a boost to other developing Asian economies. Vietnam is a clear beneficiary and has already gained during the trade conflict between the US and China during the Trump administration and it has continued to see increased FDI and a lot more production being relocated there. India is another country that is gaining. The low-cost Southeast Asian economies such as Cambodia and Laos are also seeing positive effects from this reorientation of global value chains.

JS: Global value chains are closely related to the question of global trade and investment policy. How do you assess the overall role of trade policy or trade and investment policy on reducing downward pressure on economic growth in Asian economies?

Abiad: I would say it is of growing importance because one of the risks to the outlook for the region and for the global economy is the risk of deglobalization or increasing fragmentation. Asia was perhaps the region that benefited the most from the global economic integration that we've seen over the past decades. Therefore, it is one of the most vulnerable if that process of globalization stagnates or reverses. In that regard, international cooperation can provide a counterweight to such risks. That could come in many forms: larger global agreements, but also even regional ones and bilateral ones can help in ensuring more cooperation. Also to avoid harmful behaviors – things like export bans that countries might be tempted to take in response to let's say higher food prices or higher energy prices. Many of the other challenges facing the regional and global economy over the coming years such as climate change are global in nature, and for that reason the role of international cooperation and coordination has really increased.

JS: Asia is a region that has taken advantage of liberalized trade and that is a driving force of economic growth. In that sense do you think Asian countries can get together to take the initiative in consolidating a rules-based international economic order ?

Abiad: Yes, we should take the initiative for global cooperation and coordination wherever it comes, and Asian economies are capable of leading the way. By all means I think we should do it. A fair number of the current initiatives, whether it is the RCEP or others, are playing a substantial part and heavily involve Asian economies, so I think Asia has to again play a big role in terms of ensuring the fostering of greater international cooperation. **JS**

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