The Asia Economic Monitor (AEM) is a semi-annual review of emerging East Asia’s growth and policy issues. It covers the 10 members of the Association of Southeast Asian Nations; People’s Republic of China; Hong Kong, China; Republic of Korea; and Taipei, China. This issue includes a special chapter on regulatory reform in emerging East Asia.

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Highlights

Recent Economic Performance

- Economic growth in emerging East Asia dropped sharply in the first quarter of 2009, but early indicators suggest the pace of decline slowed during the second quarter.
- The slowdown in growth, coupled with lower oil and food prices, helped inflation to decline across the region.
- The balance of payments turned positive again in the first quarter of 2009 as current account surpluses grew and capital outflows moderated.
- Emerging East Asia’s stock markets rebounded strongly, rising 68% over their November 2008 troughs.
- Several currencies in the region appreciated against the US dollar as investors’ risk appetite began to return.
- Bond yield curves for most emerging East Asian economies shifted upward and steepened in recent months.
- With growth slowing and inflation falling, authorities continued to ease monetary and fiscal policies.
- The region’s banking systems appear capable of weathering the economic storm, with prudential indicators strong and lending continuing to grow.

Outlook, Risks, and Policy Issues

- The overall external environment for emerging East Asia remains difficult and uncertain, with the recession in advanced economies continuing and global financial conditions improving yet tight.
- Emerging East Asia has entered the transition from recession to recovery, with GDP growth sourced more from domestic stimulus than a resurgence in external demand.
- Emerging East Asia could see a V-shaped recovery, with growth dipping sharply in 2009 before regaining last year’s pace in 2010.
- Major risks to the outlook include (i) a more prolonged recession and weaker recovery than expected in developed countries; (ii) unintended consequences of economic stimulus or premature policy tightening; (iii) falling inflation becoming deflation; and (iv) non-economic events with low probabilities, but potentially large impacts.

Continued overleaf
Given the tentative nature of the expected recovery, it is critical that authorities stay the course in supporting domestic demand and growth.

Monetary policy in the region needs to remain expansionary until the recovery gains substantial traction or large inflationary pressures reemerge.

Ensuring that fiscal stimulus is implemented effectively and efficiently is key to bolstering domestic demand in the face of continued weakness in the external environment.

Even as the immediate impact of the global crisis works itself out, authorities should continue with deeper, more comprehensive structural reforms needed to rebalance growth toward greater domestic demand.

Beyond the Crisis: Regulatory Reform in Emerging East Asia

The unprecedented financial crisis has prompted a reassessment of regulatory systems worldwide—to cover a wider set of market segments and institutions, especially those deemed systemically important.

Emerging East Asia should actively participate in designing the new global financial architecture—particularly given the specific reform agendas that have emerged in forums such as the G20.

Regulatory reform should eliminate gaps and overlaps, avoid regulatory arbitrage, increase transparency, and improve coordination among relevant authorities.

There is no "one-size-fits-all" regulatory structure; yet there is growing acceptance that an integrated approach to macro-prudential oversight and financial stability is needed.

Capital adequacy requirements must be increased and supplemented by a forward-looking assessment of risks stemming from liquidity, high leverage, and pro-cyclicality.

System-wide, macro-prudential supervision must be developed to complement existing micro-prudential regulations.

A key challenge for the region’s regulators is how to encourage and manage financial market development without stifling innovation.

Emerging East Asian economies should reinforce cooperation on enhancing financial stability by accelerating regional initiatives.
About the Asian Development Bank

ADB’s vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to two-thirds of the world’s poor: 1.8 billion people who live on less than $2 a day, with 903 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.