



ADB

ASIAN DEVELOPMENT

Outlook 2011

South–South Economic Links

Asian Development Bank

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Foreword

Developing Asia's economies proved their resilience in the face of a tremendous external shock. The *Asian Development Outlook 2011* shows that the region's recovery from the recent global economic downturn is firming with growth expected to reach nearly 8% in 2011 and 2012. This continued high growth follows the 9% expansion from the trough of the crisis.

The consolidation of the global recovery is, however, uneven. While developing Asia—and the economies of “the South” in general—have recouped the ground lost during the global downturn, the major industrial countries are progressing modestly. After the 2.6% rebound last year, the three economies of the United States, eurozone, and Japan are collectively expected to expand by 2.1% in 2011 and 2012.

Although the risk of these economies falling back into recession is receding, even this modest industrial-country recovery is fraught with risks. Tensions in the Middle East are pushing up oil prices. Japan is coping with the tragedy of the Tohoku earthquake and tsunami. Labor and housing market weaknesses are holding back recovery in the United States. The eurozone has not fully resolved the sovereign debt problems in its periphery.

The *Asian Development Outlook 2011* emphasizes two important challenges that developing Asia must resolve to sustain the inclusive growth that is needed to eliminate poverty in the region. The immediate problem is tackling rising consumer price pressures. Inflation's insidious effects call for preemptive action to contain it before it begins to accelerate. The poor are the most vulnerable, particularly from rising food prices.

Managing inflation is not easy. Because of the faster recovery, demand pressures are more intense in the region than among the major industrial economies. The recent surges in global oil and food prices are adding further pressures. Even though steps have been taken to reduce price pressures, inflation in the region is expected to pick up to 5.3% this year. Many countries may already be behind the curve in fighting inflation, and some countries are showing signs of overheating. The task is complicated because lifting interest rates may induce foreign capital inflows, which can add to price pressures.

Getting the policy response right depends on the problem. Where current account surpluses persist and exchange rates are misaligned with fundamentals, more flexible exchange rates may be the best option. For other economies, monetary tightening may be coupled with temporary capital controls, which should be coordinated internationally.

The second challenge is fostering new sources to sustain the region's growth into the future. In this regard, the trend of growing trade and investment with other developing countries—so-called South–South links—is encouraging. The share of world merchandise trade among

countries in the South has more than doubled in less than two decades, from 7% in 1990 to 17% in 2009.

Much of the rise in trade and investment between economies in the South can be accounted for by the rise of “factory Asia”—where parts and components move across borders in the region but the assembled final goods are exported to major industrial-country markets. Thus while developing Asia is at the forefront of the South’s emerging economic influence, current production arrangements are still, ultimately, highly dependent on the North.

At a time of modest growth in industrial countries, improved South–South relations can be a potential new driver for global growth. Fortunately, there is considerable scope to deepen economic links within the South, but these will not come automatically. To fully tap the potential of these markets as new sources of growth, policy makers must remove impediments to South–South trade and investment, which are still higher than those with the North; and much work needs to be done to reduce barriers within the South to promote global integration.

As South–South ties evolve, developing Asia can draw on insights stemming from its success in its own regional cooperation and integration—both for itself and for other regions of the world. These ties are supported by the Asian Development Bank as an effective approach to eliminate poverty.

A handwritten signature in black ink, appearing to read "H. Kuroda". The signature is fluid and cursive, with a long horizontal stroke at the end.

Haruhiko Kuroda
President
Asian Development Bank

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