Regional Economic Outlooks

Promising growth prospects for Asia and Middle East

The strengthened economic performance of Asia and the Middle East over recent years is expected to continue this year and next, although high oil and petroleum prices pose major risks in both regions, according to the IMF's *Regional Economic Outlooks*. The reports, launched by senior IMF staff of the Asia and Pacific (APD) and Middle East and Central Asia (MCD) Departments, urged oil-consuming countries to pass through higher oil prices to avoid mounting fiscal costs, and oil-producing countries to invest in physical and human capital to foster long-term growth. The regional outlooks are part of the IMF's enhanced regional surveillance and complement the biannual *World Economic Outlook*.

Asia. Growth in Asia has been impressive, averaging 5.5 percent a year during 1999–2004, and is forecast at 6.1 percent this year and 5.9 percent next year, propelled by vigorous exports and strong domestic demand in China and India. Inflation is expected to remain moderate as lower food prices offset higher oil prices, and the region's current account balance is forecast to remain in surplus at around 3 percent of GDP. Presenting the report in Tokyo, APD Director David Burton stressed that the growth outlook for Japan, in particular, has improved considerably—to 2 percent, from only about 0.8 percent in the spring—as domestic demand is regaining momentum.

High petroleum prices, however, remain a particular danger because many Asian economies are manufacturing-intensive and highly oil-dependent. Some governments have shielded consumers from higher costs by passing only a portion of the increases in world prices on to domestic prices, but some are now reconsidering this practice. Indonesia, for example, recently cut fuel subsidies. IMF Chief Economist Raghuram Rajan hailed this move as "an extremely good step in the right direction" and urged other countries to adopt similar measures. In a presentation in Singapore, Rajan and APD Deputy Director Wanda Tseng said governments must explain to their people that they do not control oil prices, while providing targeted help to the poor.

Additional risks in the region come from potential weaknesses in external demand and the rise of protectionist sentiment. Central banks have generally responded to large foreign exchange inflows by accumulating foreign exchange reserves, in some cases on a large scale. A further appreciation of Asian currencies will ultimately need to be part of the resolution of global imbalances, the report said.

Middle East and Central Asia. Economic growth in the Middle East and Central Asia is projected at 5.7 percent in 2005 and 5.9 percent in 2006, after growth of 5.9 percent in 2004. While real GDP growth in the region's low-income and emerging market economies is projected to slow somewhat in 2005 before rebounding in 2006, growth in the oil-exporting countries is expected to remain strong in 2005 before easing in 2006, in line with the outlook for oil prices.

As oil prices are expected to decline only gradually, the fiscal and external positions of oil-exporting countries are likely to improve even further, largely offsetting the slight worsening in the rest of the region. Inflation has been reasonably well contained, with governments limiting the pass-through of oil prices to the retail level, but inflationary pressures are expected to strengthen in the next 18 months.

Oil-producing countries should seize this opportunity to develop the non-oil sector and generate sustainable employment prospects for their rapidly growing labor forces. "The emerging market countries can create opportunities for the private sector to invest," MCD Director Mohsin Khan said in an interview in Beirut. At the same time, significant downside risks exist, including higher-than-expected inflation, major corrections in equity and real estate markets, a reversal of oil-fueled growth, and a global economic slowdown. ■

Board approves Policy Support Instrument

Meeting shortly after the IMF–World Bank Annual Meetings, the IMF's Executive Board approved the Policy Support Instrument (PSI)—one of a series of steps designed to bolster the organization's ability to support its low-income members. The PSI is intended to help countries that may not need, or want, IMF financial support but seek assistance in supporting, monitoring, and endorsing their policies. The Board welcomed the PSI as a sound approach that will help countries "design effective economic programs and provide signals to donors, the multilateral development banks, and markets."

The Board emphasized that the PSI is conceived as, and must remain, a "voluntary, demand-driven instrument supported by strong country ownership." It made clear that the PSI should serve as a complement to, and not as a substitute for, concessional financing available under the IMF's Poverty Reduction and Growth Facility (PRGF).

Directors underscored their intention to turn quickly to a proposed "shocks window" within the PRGF. An on-track PSI could provide the basis for rapid access to PRGF resources in the event of a shock.