

ANNUAL OUTLOOK 2023

Executive Summary



About Asia House

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Asia House enables commercial, political, and economic engagement between Asia, the Middle East and Europe.

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Executive summary

Global economic prospects have dimmed for 2023, with many economies heading towards recession, accompanied by persistently high inflation and rising interest rates. Asia's economies look brighter, however, and some may defy the global trend.

This will hinge on factors that include an acceleration in digital transformation, greater regional coordination, and striking the right balance in monetary policy.

As elsewhere, the region faces both multiple and multi-faceted shocks, such as energy-price volatility, geopolitical conflict, and higher borrowing costs. Developing countries and emerging markets in Asia are especially vulnerable to seeing their economies contract.

We see three major risks.

The first is central banks making policy mistakes – by either under- or over-tightening. The former may prove costly, as it risks

causing inflation to become entrenched. The latter risks prolonged recession.

To date, monetary policy responses across Asia have varied, with a general sensitivity to growth. The range of Taylor Rules calibrated in this report for analysing central bank policies suggests this has been the case with the People's Bank of China, the Reserve Bank of India, and Bank Indonesia. But there remains a danger that unforeseen interest-rate jumps from unsettled bond markets, or sudden stops¹ in investment flows in more vulnerable countries, could materialise.

The step-up in inflation, meanwhile, has dimmed the prospects for a robust turnaround in activity across Asia, including – crucially – in China.

¹ Calvo, G.A., (1998), "Capital Flows and Capital Market Crises: The Simple economics of Sudden Stops" Journal of Applied Economics, 1:1, 35–54.

Although we anticipate a limited rebound in growth in China following the relaxing of restrictions, risk remains over the spread of COVID-19 and its impact on productivity, which constitutes the second major risk in 2023.

The overall economic impact of COVID-19 will be less of an issue than it was in 2020 and 2021, moderating in most countries. But it is likely to persist in China, even with the scaling back of the zero COVID-19 strategy. The country is likely to balance the competing pressures of maintaining economic growth, providing stimulus measures to bolster domestic consumption, and improving health care capability in post-zero-COVID transition.

But the stresses remain, as do China-centred geopolitical risks.

While the risk of armed confrontation in the South China Sea cannot be overlooked, our 2023 report also notes some of the opportunities in relation to the cooperation between China, the US, and the claimant states in South East Asia. Both China and the US could strengthen existing crisis management mechanisms to prevent unanticipated incidents, given that encounters between the two militaries have become increasingly frequent.

US financial developments are likely to constitute the third key risk for 2023. Renewed risk aversion globally, or unexpectedly strong rate increases in the US, or both, would lead to currency markets elevating the safe-haven status of the US dollar at the expense of other currencies, including Asia's. How currencies fare in this climate could be decisive in dictating growth outcomes across Asia, given that, in net terms, lower domestic purchasing power (including for productive inputs) would restrain output. These could be offset by positive competitiveness effects, however.

Asia countries' progress in meeting their climate-change targets has been disappointing.

Without prompt action, the climate crisis will be catastrophic for health, social well-being, and economic growth. More extensive digitalisation is needed to fight the climate crisis *and* to increase Asia's productivity. Asia's regionalism, in the form of enhanced economic integration, will help meet these challenges.

The *Asia House Annual Outlook 2023* presents updated readings for Asia's economic readiness indices for green finance and digitalisation. Despite the financial volatility that has occurred, the eight economies tracked by the indices – China, Japan, India, Indonesia, Vietnam, Thailand, Malaysia and the Philippines – are likely to show continued improvement in their green finance ecosystems. Although South East Asia is likely to see further improvement in digitalisation from a low base, China, India and Indonesia could see a dip in their readings in 2023.

The eight economies tracked by the indices are likely to show continued improvement in their green finance ecosystems

Key among the recommendations made in this report are those relating to prioritising innovation – to spur carbon pricing, lower green premiums for zero-carbon alternatives, and boost underfunded and high-impact projects with blended finance. Our indices suggest that prioritising economic readiness to tackle both climate change and digitalisation, and the policies that link the two, will create a higher growth trajectory. The Asia House country readings for 2023 indicate that new innovations in digitalisation, e-commerce and in innovative trading solutions will help Asia's growth resilience.

Key messages:

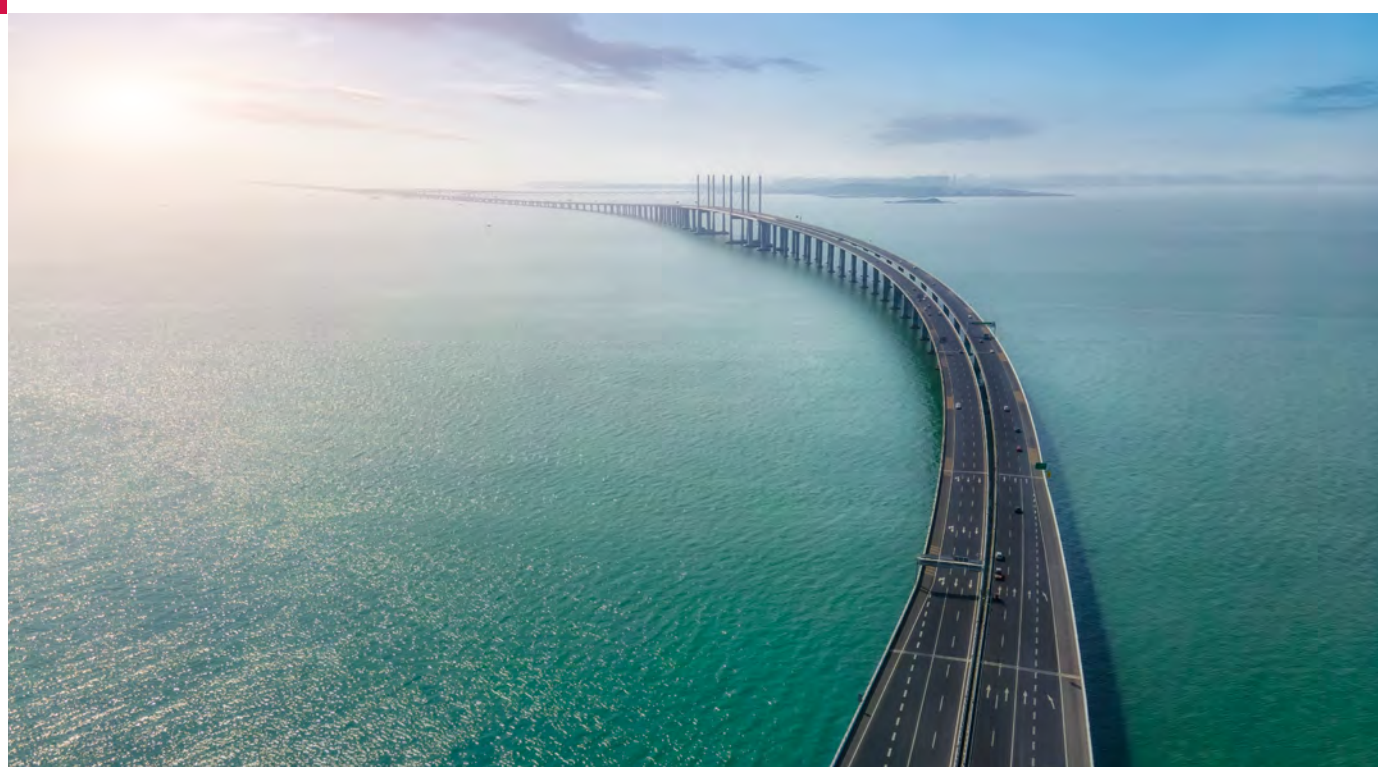
- **A resilient Asia will drive global economic growth in 2023**, despite the prevailing headwinds of monetary tightening and weak global growth. The region's economic momentum will come from strength in domestic demand.
- **Inflation has meant that, globally, central banks are more focused on restoring price stability** than boosting growth; accordingly, a quicker pace of global monetary tightening would weigh heavily on Asia's outlook.
- Notwithstanding **China's expected sluggish growth for 2023**, Asia is likely to prove resilient if investment and financial flows are directed to digital and green innovation to underpin sustainable growth and investment.
- **Asia House Economic Readiness Indices for 2023 indicate improvements** in green finance and digital transformation. Declines in Japan (for green finance) and in India (for both) were the exceptions.
- **Within South East Asia, digital development is likely to be scaled up in 2023**, although the outlook is comparatively less upbeat for China, India and Indonesia, owing, in part, to lags in the Industry 4.0 development.
- **Intermittent flare-ups in financial volatility could be triggered by rising borrowing costs**, high debt levels, and reduced global liquidity. Uncertainties in China and the risk of monetary policy errors also constitute risks.

Key policy recommendations:

- **The centre of global economic gravity continues to shift to Asia. Scaled-up regional coordination is necessary** to bolster economic integration further, particularly in the form of more economic zones and investment corridors.
- **Enhanced and coordinated reserve management is needed** at a time when Asia's reserves are declining. Supporting digital currency development and digital platforms for early-warning systems will catalyse coordination.
- **By adopting carbon-pricing mechanisms, the 'green premium', or the additional costs of opting for green technology, will be reduced.** Pricing mechanisms can account for the cost of fossil-fuel emissions, thus making net-zero alternatives cheaper.
- **The leveraging of private investment and risk absorption will support scaled-up sustainable finance** for borrowers and investors through an enhanced role for development banks and development finance institutions.
- **Innovations in blended finance – using development funds to spur private investment – need to funnel capital** into high-impact and under-capitalised green projects. We spotlight emerging-market green-bond funds.
- Asia's broader digital access and digital skills, particularly in the rural sectors in its larger economies, is a policy gap. **By addressing digital inequality, job market vulnerabilities will be mitigated among the rural poor across Asia.**

Country outlooks: Key messages

- **China** is likely to see continued sluggish growth, after having slowed significantly in 2022. It will see an improvement in economic readiness for green finance, which might not be mirrored in its digital development.
- **Japan** is likely to continue to bear the brunt of multiple financial shocks, including a weak yen and higher energy prices – both of which reduced its Readiness Index for green finance. Its digital readiness improved for 2023.
- **India** will see continued economic recovery, which will depend on myriad factors. Financial volatility points to deterioration in India's green finance; it has the lowest readings in readiness in both green finance and digitalisation.
- **Indonesia** will show economic resilience in 2023. Given the decline in its digital readiness reading, continued efforts to diversify away from energy towards digital transformation and sustainable growth are essential.
- **Vietnam** is likely to register one of the strongest economic growth rates in 2023 when compared with its Asian (and developed-country) counterparts. Its green finance and digital readiness readings are up significantly, although its digitalisation scores come from a low base.
- **Malaysia** is expected to make significant strides in 2023, given the likelihood of strength in domestic demand and digitalisation. In addition to robust economic growth in the year ahead, its economic readiness for both green finance and digitalisation should improve.
- **Thailand's** economic growth will remain resilient but is likely to slow. Overall, domestic inflation pressure remains comparatively muted. Encouragingly, Thailand's economic readiness readings for green finance registered the largest rise in our Asia sample.
- **The Philippines** will continue to see economic growth, surpassing many of its regional neighbours. Policymakers should use the resilience of the economy to improve the domestic ecosystem for green finance and digitalisation, given the lagging readings in our indices for both.



Report authors




Lead author

Phyllis Papadaavid is Director of Research at Asia House. She leads Asia House's Research and Advisory work, driving the organisation's research agenda and directing projects. Before joining Asia House, Phyllis was a Research Associate and formerly head of international macroeconomics at the Overseas Development Institute, and held leadership roles at BNP Paribas and Societe Generale CIB, and has advised the Government of Mongolia. She has also advised multilateral organisations including the World Bank and the United Nations. Phyllis is an associate faculty member in Applied Analytics and Strategy at Columbia University. Phyllis's recent research has focused on the management of financial shocks, the economic impact of COVID-19 on emerging markets, and the rising role of the renminbi, which was featured in Barron's Asia's Best Minds. She has a strong interest in financial inclusion, economic transformation and spatial economics.



Contributing author on China

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