

A Multi-Speed South Asian Recovery from the Pandemic Recession

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Summary

The COVID-19 pandemic represents a crisis like no other for South Asia with a collapse of growth and a rise in poverty. The advent of vaccines has led to cautious optimism about an uneven, multi-speed recovery. Adopting an effective mix of stimulus policies and structural reforms will help South Asia address the economic fallout from the pandemic and build momentum for pro-poor green growth.

Introduction

Once again Asia seems a bright spot in a recovering world economy. The region is expected to see a V-shaped recovery from the economic hit of COVID-19, which saw a collapse of regional growth in over five decades of successful economic development. This is the optimistic view of the International Monetary Fund's (IMF) World Economic Outlook Update of January 2021¹ which expects that growth in Emerging and Developing Asia (hereafter Asia) to decline to -1.0 per cent in 2020 and rebound sharply to 8.3 per cent in 2021 (IMF, 2021). China sees positive but much slower growth of 2.3 per cent in 2020 and a steep recovery to 8.1 per cent in 2021. India (-8.0 per cent) and ASEAN-5 (-3.7 per cent) see negative growth in 2020 and a sharp rebound in 2021 to 11.5 per cent and 5.2 per cent respectively. Meanwhile, the world economic growth is expected to move from -3.5 per cent to 5.5 per cent between 2020 and 2021.

Forecasts for the rest of South Asia are not provided in IMF's World Economic Outlook Update of January 2021 but revised estimates will be available in the April 2021 edition of the publication. Earlier forecasts made in the October 2020 edition² indicate an uneven multi-speed recovery trajectory across the rest of South Asia. Bangladesh sees little change in its positive growth trajectory of 3.8 per cent in 2020 which could rise modestly to 4.4 per cent in 2021 while Nepal's standstill growth of 0.02 per cent in 2020 could move to modest positive territory of 2.5 per cent in 2021. In contrast, three others could shift from negative to positive growth. The Maldives' could experience a large growth swing from -18.6 per cent in 2020 to 12.7 per cent in 2021, Sri Lanka could move from -4.6 per cent in 2020 and 5.3 per cent in 2021 and Pakistan from -0.4 per cent in 2020 and 1.5 per cent in 2021.

¹ World Economic Outlooks Report, 'Policy Support and Vaccines Expected to Lift Activity', January 2021. <https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update>. Accessed on 8 March 2021.

² International Monetary Fund, 'World Economic Outlook: A Long and Difficult Ascent', October 2020. <https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020>. Accessed on 8 March 2021.

The globalisation of the world economy, the advent of global travel and variations in the effectiveness of health systems enabled the infection to rapidly transmit across Asia.³ It also triggered an economic shock which saw a slowdown in Chinese growth; disruptions to China-centred global supply chains in South Korea, Malaysia, and Vietnam; capital outflows from stock markets in Southeast Asia and South Asia; and falling remittances and tourism receipts in India, Pakistan, Sri Lanka and the Maldives.

Moreover, with large losses to jobs and livelihoods occurring throughout Asia, poverty is likely to rise. Even before the pandemic, South Asia was noteworthy as the region containing the largest numbers of poor people. Preliminary estimates by the World Bank suggest that extreme poverty in South Asia (under the \$1.90-a-day poverty line) could rise by an additional 70 million or so people as a result of the pandemic.⁴ This figure is larger than the combined population of Afghanistan, Bhutan, Maldives and Nepal. Whether the IMF is right or not about Asia's growth recovery in 2021 gives rise to several interesting issues.

The IMF's V-shaped Asian recovery scenario makes several assumptions about key variables, including (a) access to medical facilities and an effective vaccine rollout across the region; (b) vaccine booster shots keeping pace with mutations of the virus; (c) an effective economic policy response particularly countries having sufficient room for fiscal stimulus; (d) a rapid return of business confidence to power private investment; and (e) structural characteristics of countries entering the crisis. Gaps in health capacity and the high degree of uncertainty on the ground in Asia raises questions about the validity of some of these assumptions. For instance, the pace of the vaccine rollout has been uneven across Asia with richer countries typically having more effective rollouts than poorer countries. Likewise, richer Asian countries with more fiscal space are generally able to mount larger fiscal stimulus packages than poorer countries.

The IMF has unparalleled access to macroeconomic data through its representative offices in Asia, yet it is difficult to assess the full economic impact of COVID-19 on the region. Monthly or even quarterly economic data is lacking for many Asian economies and macroeconomic forecasting models are not geared up to analyse the disruption from the pandemic. Moreover, the IMF's rather positive recovery scenario for 2021 may reflect country offices needing to make somewhat optimistic country forecasts to ensure some debt sustainability.

In order to predict significant changes in economic activity in the COVID-19 context, the projections of a study, which I recently co-authored,⁵ on the medium-term outlook for Asia's economic growth and the prospects for middle-income countries using leading indicators is

³ Asian Development Bank, 'Navigating COVID-19 in Asia and the Pacific', September 2020. <https://www.adb.org/publications/navigating-covid-19-asia-and-pacific>. Accessed on 8 March 2021.

⁴ Christoph Lakner *et al.* 'Updated Estimates of the Impact of COVID-19 on Global Poverty: Looking Back at 2020 and the Outlook for 2021', World Bank Data Blog, 11 January 2021. <https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-looking-back-2020-and-outlook-2021>. Accessed 11 March 2021.

⁵ Ganeshan Wignaraja, Judith Tyson, Annalisa Prizzon and Dirk Willem te Velde, 'Asia in 2025: development prospects and challenges for middle-income countries', Overseas Development Institute, September 2018. <https://www.odi.org/sites/odi.org.uk/files/resource-documents/12434.pdf>. Accessed on 8 March 2021.

being updated. This exercise suggests alternative scenarios to the IMF's V-shaped Asian recovery given the depth of the economic downturn linked to the effectiveness of measures in containing COVID-19 – also known as an 'L-shaped' trajectory or a 'W-shaped' trajectory.⁶ An L-shaped scenario is a pessimistic story for Asia. It premises a long virus outbreak and a prolonged economic impact on Asia. In this scenario, COVID-19 continues to spread rapidly throughout the region; containment measures are only partially successful; new mutations of the virus could bring a second and third wave; and the supplying of vaccines takes longer than expected. Moreover, in this L-shaped trajectory, Asia's growth could collapse to -1.5 to 2.0 per cent in 2020 and move into barely positive territory in 2021-2022. This scenario is worse than the 1997 Asian financial crisis and the 2008-2009 global financial crisis when Asian growth dropped to 2.8 per cent and 7 per cent, respectively.⁷ Meanwhile, global growth could be in the range of -4.0 per cent to -4.5 per cent in 2020 but may only slowly rebound in 2021 implying tepid external demand for Asian exports and inward investment hit by risk aversion. Combined, these predictions could constitute a lengthy economic recession in Asia.

The W-shaped scenario suggests a go-stop-go-stop business cycle and a high degree of uncertainty for Asia. It premises a short virus outbreak and a short output decline, followed by another short virus outbreak and another output decline. The middle section of the W could mean a significant growth spurt or a partial recovery that is hamstrung by a mutating virus and uneven rollout of vaccines leading to an additional economic downturn. It is possible that Asian growth could be in the range of -1.0 to -1.5 per cent on the decline and barely reach three to four per cent on the upside. A volatile Asian growth trajectory is likely to feed into negative expectations of economic activity and dampen investment. The pattern of growth across the region is likely to be uneven with a few reasonable performers alongside a long tail of under-performance.

Which of these scenarios will be the eventual outcome is an open question, given the set of fluid variables at play. Several factors facilitated Asia's relative resilience during the global financial crisis⁸: having a significant amount of Chinese and Japanese savings; restructured banks; a strong manufacturing capability; a youthful workforce in South Asia in particular; a large middle-class of Asian consumers; and reasonable policy making and coordination capability. These factors could in turn act in concert to boost Asia's economic growth in 2021-2022.

Recovery, as previous crises facing Asia have shown, is likely to originate in East Asia, particularly China⁹, South Korea, and Taiwan. India could be a significant outlier in South

⁶ Ganeshan Wignaraja, 'International Monetary Fund predictions: Asia's growth after Covid-19', Overseas Development Institute, 1 May 2020. <https://www.odi.org/blogs/16925-international-monetary-fund-predictions-asia-s-growth-after-covid-19>. Accessed on 8 March 2021.

⁷ International Monetary Fund, 'IMF Data Mapper', https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD. Accessed on 8 March 2021.

⁸ *Responding to Financial Crisis: Lessons from Asia Then, The United States and Europe Now*, Changyong Rhee and Adam S Posen (eds), (Asian Development Bank and Peterson Institute for International Economics, 2013).

⁹ George Magnus, 'China's Bittersweet Recovery From COVID-19', London School of Economics Blog, <https://blogs.lse.ac.uk/cff/2021/01/25/chinas-bittersweet-recovery-from-covid-19/>. Accessed on 8 March 2021.

Asia and could provide some growth impetus for smaller neighbouring economies such as Nepal, the Maldives and Sri Lanka through trade, foreign direct investment and tourism linkages. However, weak demand for Asian goods in Europe and the United States, rising protectionism globally and lengthy restructuring in supply chains and high debt burdens could constrain Asia's growth prospects.

The IMF's policy prescription – a combination of loosening monetary policy, flexibility in financial regulations, coordinated fiscal stimulus and increased health spending – seems insufficient to encourage growth for the benefit of those living in poverty in Asia. Clearly, mounting effective fiscal and monetary stimulus packages are necessary to offset the economic damage from COVID-19.

Richer countries in Southeast Asia have implemented multiple large stimulus packages to boost health spending, cash transfers to affected sectors and workers, low cost loans and temporary tax and social security relief. Malaysia implemented five fiscal stimulus packages totalling 5 per cent of gross domestic product (GDP) in 2020-2021 while Thailand implemented three fiscal stimulus packages totally 9.6 per cent of GDP.¹⁰ Southeast Asian countries such as these spent two decades after the Asian financial crisis building up their foreign reserves to deal with this type of external shock.

Taking advantage of fiscal space and foreign exchange reserves, India is mounting a significant fiscal response made up of two components: (i) above-the-line fiscal measures in the form of government spending; and (ii) below-the-line measures designed to shore up business and credit to several sectors. It is estimated that India's fiscal measures amount to about 8.4 per cent of GDP.¹¹ Interestingly, Bangladesh (with a debt to GDP ratio of only 39.6 per cent in 2020) may be able to mount some degree of fiscal stimulus due to the availability of fiscal space. But some poorer countries in South Asia with high debt to GDP ratios, such as Sri Lanka (98.3 per cent in 2020) and Pakistan (87.2 per cent), have limited fiscal space and foreign exchange buffers to follow suit.¹² Instead, they will need to stabilise their macroeconomies through new IMF programmes, negotiate a delay in debt payments to bilateral and multilateral lenders, higher taxes and better revenue administration. As the recovery takes hold, the potential risks of rising inflation and adding to debt levels in South Asia should be closely monitored.

Improving over-stretched health systems in South Asia is equally important. Decades of under-investment in public health means a shortage of doctors, medicine and hospital beds to handle the COVID-19 pandemic. Finding the resources to vaccinate at least 70 per cent of the region's population to reach the herd immunity threshold is also vital. For the poorer South Asian countries, this may mean efficiently combining public finance, private finance and foreign aid for a mass vaccination effort. South Asia should target a gradual increase in public health spending to around four per cent of GDP (which is about one per cent

¹⁰ International Monetary Fund, 'Policy Responses to COVID-19', <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#M>. Accessed on 8 March 2021.

¹¹ Ibid.

¹² International Monetary Fund, 'IMF Fiscal Monitor', <https://data.imf.org/?sk=061a17b2-7e6a-4b58-9b17-042af9e59a3d&sId=1409151544549>. Accessed on 8 March 2021.

increase from today) as well as telemedicine.¹³ Furthermore, there is a need for basic income support schemes and emergency food supplies for people living in poverty who have been crippled by the economic downturn and prolonged lockdowns.

After addressing the immediate pandemic threat, the South Asian countries should resist the temptation to stop at stabilisation and undertake pro-poor reforms to boost growth. Such reforms should address the complex issues of food security, targeted social safety nets, women's empowerment, and small businesses. At the same time, the investment climate needs further improvement by reducing the bureaucratic barriers affecting businesses, strengthening anti-corruption measures and promoting market access through trade agreements. A commitment to green energy through public-private sector partnerships for investments in renewable energy projects (including mini hydro, roof top solar and wind) would help the necessary transition to low carbon growth.

Only time will tell if Asia will see a V-shaped, L-shaped or W-shaped growth pattern from the pandemic. Although India is expected to see a rapid rebound, debt strung South Asian countries could experience slower growth. Putting in place an effective mixture of policy responses will help South Asia to deal with the economic fallout from the pandemic and build momentum for pro-poor green growth in the future. The IMF should work with major Asian countries and other development partners to ensure success.

The more important factor is that after shedding their stressed assets the public sector banks should not merrily begin their lending of the kind that got them into the mess. Hence, attendant governance and culture issues need to be simultaneously put in place.

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¹³ Selim Raihan, Ganeshan Wignaraja, Vaqar Ahmed, Puspa Sharma, Nazir Kabiri and Prabir De, 'The Pandemic and Economic Fallout in South Asia: Challenges and the Way Forward', *Economic & Political Weekly*, Vol. 55, No. 46, 21 November 2020. <https://www.epw.in/journal/2020/46/commentary/pandemic-and-economic-fallout-south-asia.html>. Accessed on 8 March 2021.