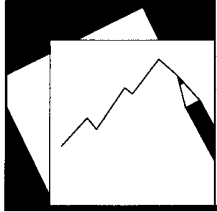


# Potential Growth in Emerging Asia



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# IMF Working Paper

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## Potential Growth in Emerging Asia

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**IMF Working Paper**

Asia and Pacific Department

**Potential Growth in Emerging Asia**

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**Abstract**

Using three distinct approaches—statistical filtering, production function, and multivariate model— this paper estimates potential growth for China, India, and five ASEAN countries (Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) during 1993–2013. The main findings include: (i) both China and India have recently exhibited a slowdown in potential growth, largely reflecting a decline of total factor productivity (TFP) growth; (ii) by contrast, trend growth for the five ASEAN countries has been rather stable and might even have increased marginally, with the notable exception of Vietnam; (iii) over the longer term, demographic factors will be much more supportive in India and some ASEAN economies than in China, where working-age population should start shrinking, with the overall dependency ratio climbing by the end of this decade. Improving or sustaining potential growth calls for broad structural reforms.

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## I. INTRODUCTION

Medium-term growth prospects for China, India, and other emerging Asian economies have recently become a focus of economic debates in the region. Both China and India have shown a declining growth trajectory since the global financial crisis (GFC): growth in China has slowed from a rate of over 10 percent in the 2000s to below 8 percent in the past two years while growth in India has slowed from around 8 to below 6 percent during the same period. For other emerging Asian economies, while there has been no obvious slowdown in the past few years, growth rates have been significantly lower than those observed prior to the Asian crisis.

A key policy issue is whether some of these recent growth patterns may reflect structural factors, and what they hold for the future. As a region with a high share of rapidly growing middle-income countries, emerging Asia is particularly susceptible to the “middle-income trap,” a phenomenon of rapidly growing economies stagnating at middle-income levels and failing to graduate into the ranks of high-income countries. Indeed recent papers find that middle-income economies are significantly more at risk of experiencing a sustained growth slowdown than their lower- and higher-income counterparts (Aiyar and others, 2013; Eichengreen and others, 2013).

Furthermore, there is concern that sluggish growth in advanced economies in recent years partly is structural and would continue over the medium term, spilling over to emerging Asian economies through trade and technology diffusion linkages. Assessing the trend growth of the countries in the region can help diagnose early signs of such a slowdown, identify the drivers and thereby provide further support for policy actions to fend it off.

Existing literature on the potential growth in emerging economies in the post-GFC era is relatively small, although there have been numerous studies on the impact of crisis on potential growth in advanced economies and emerging economies in other regions. For example, Barrera and others (2009) find that potential output in the United States has been reduced by about 6 percent since the GFC. Furceri and Mourougane (2009) find similar evidence on loss of potential output after the financial crisis for OECD countries based on pre-GFC data. This begs the questions of whether emerging countries are also affected. Based on pre-GFC data, Cerra and Saxena (2008) find that emerging market economies would also suffer from a loss of potential output after a financial crisis. Sosa and others (2013) study potential growth in Latin America, finding that the recent pickup in growth is mainly driven by higher TFP growth. Recently, Lee and Hong (2010) have studied the drivers of potential growth in Asia using a growth accounting framework, but based on pre-crisis data.

This paper shed light on potential growth in selected emerging Asian economies, including China, India, and five ASEAN economies (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) before and after the GFC. It also touches on broad reform priorities to minimize

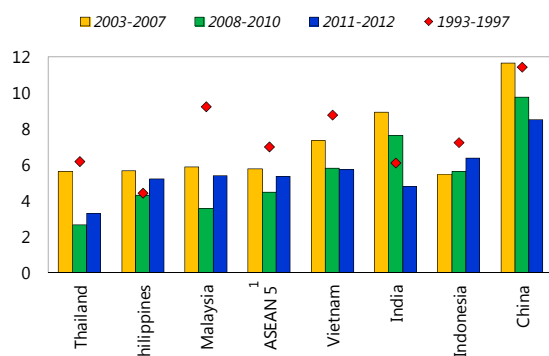
the risk of a sustained slowdown in trend growth in the future. Given that potential growth is unobservable and the various existing approaches are conceptually different and could yield different results, a large set of standard estimation techniques are used to cross-check each other and ensure robustness of the findings.

The rest of the paper will be organized as follows: Section II presents stylized facts about growth and inflation in emerging Asia; Section III lays out various techniques and results; Section IV interprets the findings; while Section V concludes with some policy implications.

## II. STYLIZED FACTS ABOUT TREND GROWTH AND INFLATION

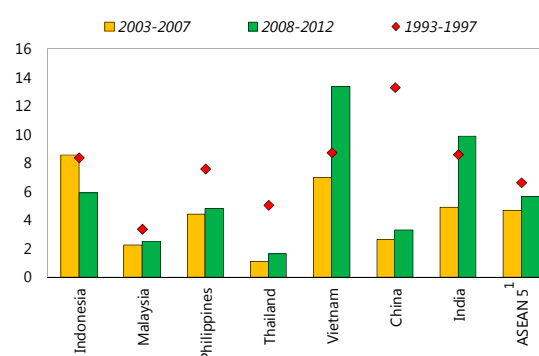
Since the GFC, headline growth has slowed substantially in both China and India, although the inflation picture differs. Growth in China has slowed from 12 percent in 2010:Q1 to around 8 percent, while growth in India has decelerated more sharply from above 10 percent to 4 percent during the same period (Figure 1). Despite much lower growth, India's inflation has come down only little (Figure 2). One explanation for why inflation has remained high and sticky could be that potential growth has come down. In China, the slowdown in GDP growth has been milder and largely policy engineered, and inflation has declined since mid-2011. It is therefore less clear whether the observed slowdown reflects lower potential growth.

**Figure 1. Stylized Fact: GDP Growth Rate**  
(In percent; year-over-year average)



Sources: IMF, *World Economic Outlook*; and IMF Staff Calculations.  
<sup>1</sup> PPP GDP weighted average used for ASEAN 5.

**Figure 2. Stylized Fact: Consumer Price Inflation**  
(In percent; year-over-year average)



Sources: IMF, *World Economic Outlook*; and IMF Staff Calculations.  
<sup>1</sup> Simple Average used for ASEAN 5.

Growth developments in the five ASEAN economies are more nuanced with a mixed inflation picture. On the one hand, since the GFC, most of these economies have not gone back to their pre-2008 growth rates, and even less so to their pre-Asian crisis growth performance. On the other hand, most recently, in contrast to the sustained slowdown in China and India, some of the ASEAN economies—particularly Indonesia, the Philippines and Malaysia as well as, to a lesser extent, Thailand—have shown a modest pickup of growth. The only exception is Vietnam, where growth has been very sluggish since the GFC. On the inflation front, the picture in ASEAN economies is mixed but inflation declined in















































