

Foreword

2022 could have been a bad year for the ASEAN+3 region but it turned out to be relatively good. The year started with two major shocks: a massive wave of COVID-19 infection and the Russia-Ukraine conflict which escalated into a crisis and sent commodity prices skyrocketing across the world. The Omicron variant threatened to shut down the region's economies once again and derail their nascent economic recovery, just like the Delta variant did in 2021. However, it did not because Omicron, although highly infectious, turned out to be quite mild and the population was well protected against severe illnesses by the high vaccination rates in most countries. As a result, the authorities initially imposed some mild restrictions to contain the spread of the virus. By Q2, most containment measures had been removed, including border controls, and the economies were fully opened.

The Ukraine crisis resulted in supply disruptions that caused fuel, grain, and other commodity prices to spike, leading to rising inflation across the world. This led the Federal Reserve and other major central banks to raise their policy rates sharply to contain the rapid rise in inflation. The higher interest rates led to a massive sell-off in financial markets, a strong US dollar, and large capital outflows from emerging markets. The tightening financial condition was a major threat to recovery in the region. However, thanks to strong economic fundamentals and skillful macroeconomic management, the region was relatively resilient and the economies grew robustly during the year.

An exception to the robust recovery of the regional economies was China which pursued a dynamic zero COVID-19 policy and imposed strict containment measures in response to the sporadic outbreaks across the country during the year, causing the economy to stall. In early December, however, the virus was reclassified as a mild disease and the authorities lifted almost all restrictions. Infections spiked across the country immediately but has since subsided and the economy is expected to rebound strongly this year.

Chapter 1 of the AREO report is devoted to analyzing the risks and vulnerabilities facing the region and assessing the outlook. Although the region performed well in 2022, it began 2023 with strong headwinds and uncertainties. The Ukraine crisis is ongoing and could escalate further with spillovers to the rest of the world. Inflation has come off its peak but it remains elevated and sticky. This has become a major challenge for central banks, especially those committed to bringing down inflation to the 2 percent target level. The Fed and the ECB may be forced to raise their policy rates much higher and keep it higher for longer, causing their economies to weaken sharply, reducing their demand for imports. This would be a major drag on the open economies of the region which are highly dependent on exports.

Fortunately, the expected strong rebound of China will provide a much-needed boost to the rest of the region and cushion the downside risk. Even in the region, the battle against inflation is not over yet. Some economies are still struggling with high and sticky inflation and policymakers must decide on what course of action to take. Should they continue to tighten policies to bring inflation under control or should they ease policies now to support their economies against the strong headwinds? The trade-off between inflation and growth has never been more acute.

Chapter 2 of the AREO report is, as usual, devoted to some longer-term structural issues that are of macro-critical importance. This year, in light of COP26, we have decided to focus on the topic of climate change, an existential issue for the region and the world. This is a very broad topic so we have decided to focus on the issue of climate change mitigation, taking stock of the commitments by the regional economies under the Paris Agreement to cap global warming to 2 percent or less. We analyze the challenges as well as the opportunities of transitioning to net zero emission and the implications for finance in making the transition.

Today's complex and rapidly evolving global landscape has made the work of AMRO more important and urgent, and AMRO has recently formulated our new long-term institutional strategy toward 2030—SD2030—to guide our journey into the future. AMRO will continue to make surveillance a cornerstone and AMRO must enhance our analytical and surveillance capacity to come up with ideas and strategies to address the challenges ahead.

We are living in precarious times. There are both short-term conjunctural risks as well as long-term existential challenges to the global economy; yet the world has never been more divided. The region must stay united and pull together to secure its macroeconomic and financial resilience and stability.

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