World Economic Situation and Prospects

2019

United Nations

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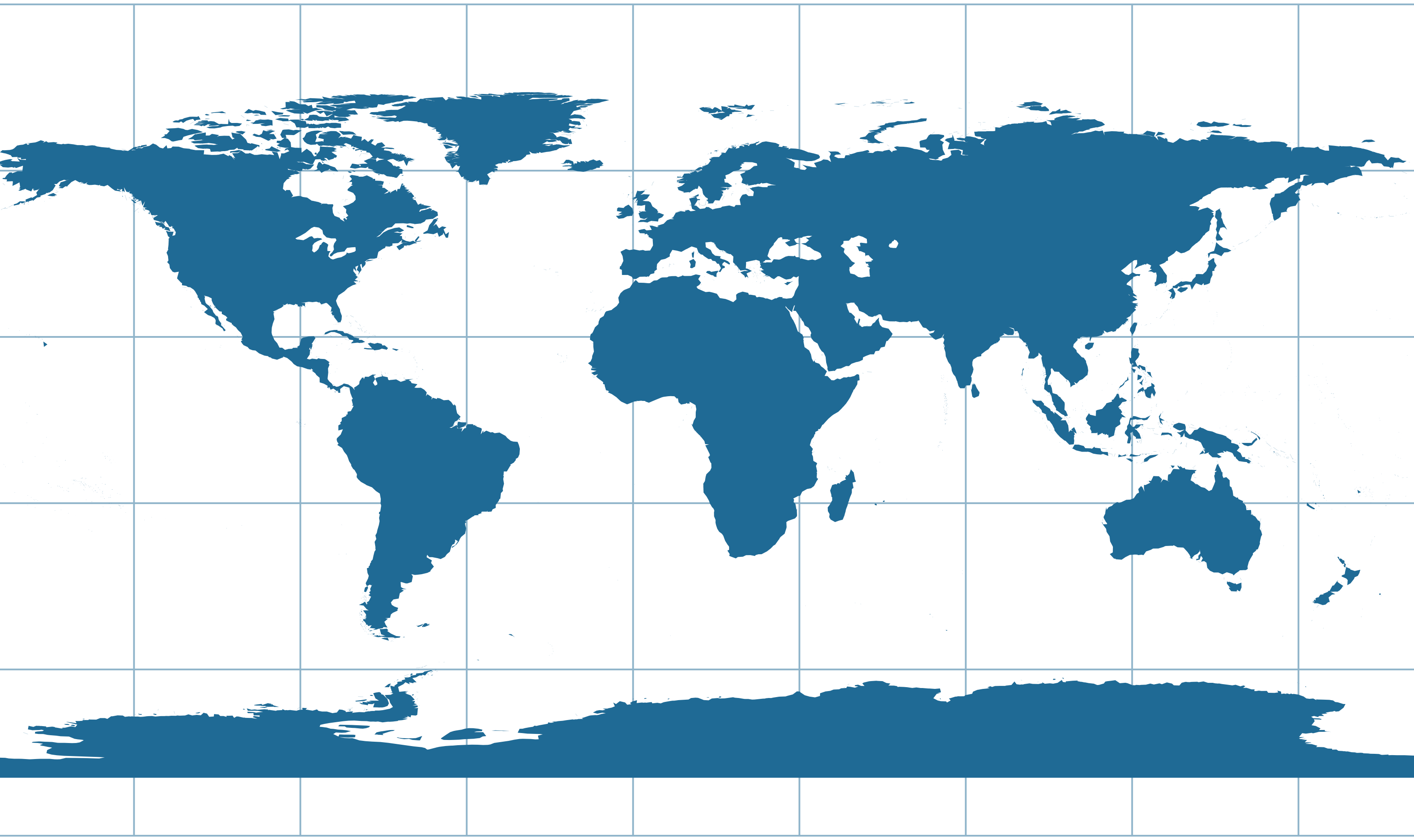
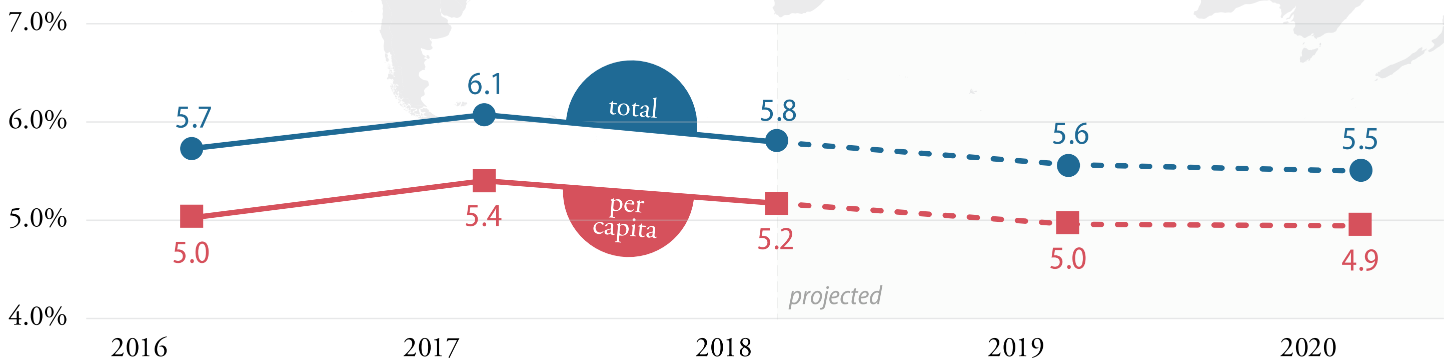


United Nations
New York, 2019

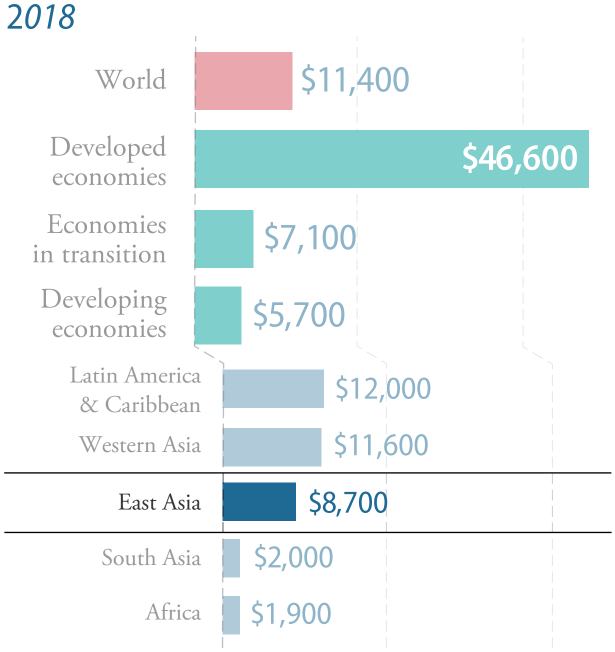
East Asia

GDP Growth



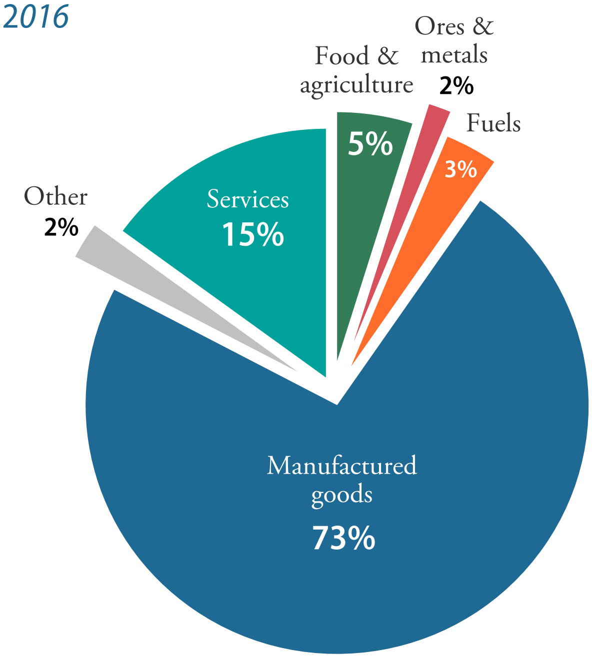
GDP per capita

2018



Exports structure

2016



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East Asia: growth outlook remains robust, but downside risks are high

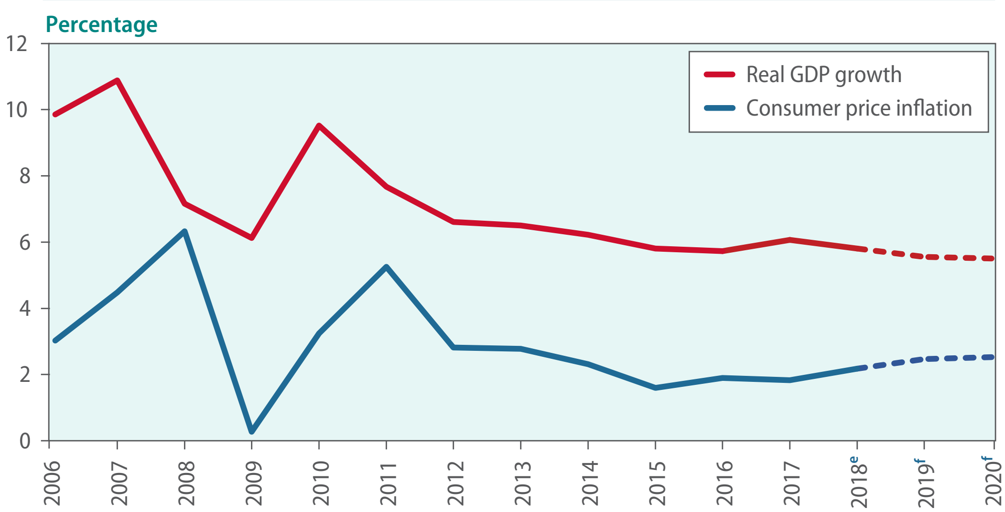
- Robust short-term growth characterizes the outlook, buoyed by resilient domestic demand and accommodative policies
- Escalation in trade tensions could disrupt existing supply chains, hurting the region's growth prospects
- East Asian economies have relatively stronger policy buffers to weather an external shock

The short-term growth outlook for East Asia remains robust, bolstered by resilient domestic demand and accommodative policies in most economies. On the external front, however, export growth is likely to slow, amid elevated trade tensions between China and the United States. Against this backdrop, regional GDP growth is projected to moderate to 5.6 per cent in 2019 and 5.5 per cent in 2020, from 5.8 per cent in 2018 (figure III.19). Downside risks to the region's growth outlook are high, arising mainly from a potential further intensification of trade disputes, which could disrupt existing regional supply chains. In addition, a sharp tightening of global financial conditions could lead to a large reversal of capital flows, posing a risk to financial stability. Nevertheless, compared to other developing regions, the East Asian economies are in a better position to weather an external shock, given relatively stronger macroeconomic fundamentals and policy buffers.

Robust private consumption growth is underpinned by healthy job creation and rising incomes

Private consumption remains the key driver of growth in East Asia, supported by healthy job creation, rising incomes, and moderate inflationary pressures. Despite some recent tightening in financial conditions, borrowing costs in the region remain relatively low. For several countries, including Myanmar, Thailand and the Republic of Korea, consumer spending will be lifted by substantial increases in the minimum wage in 2018.

Figure III.19
GDP growth and inflation in East Asia, 2006–2020



Source: UN/DESA.
Note: **e** = estimate, **f** = forecast.

Infrastructure investment remains strong in many countries

Public spending on infrastructure is likely to remain strong in most countries, as Governments continue to focus on easing critical structural bottlenecks and expanding productive capacity. In 2018, public investment growth accelerated in the Philippines and Thailand, driven mainly by the implementation of large transport development projects. The region's strong export performance since 2017 has also contributed to a pickup in private investment, particularly in the export-oriented sectors. However, persistently high uncertainty surrounding the imposition of tariffs may weigh on investor sentiment going forward.

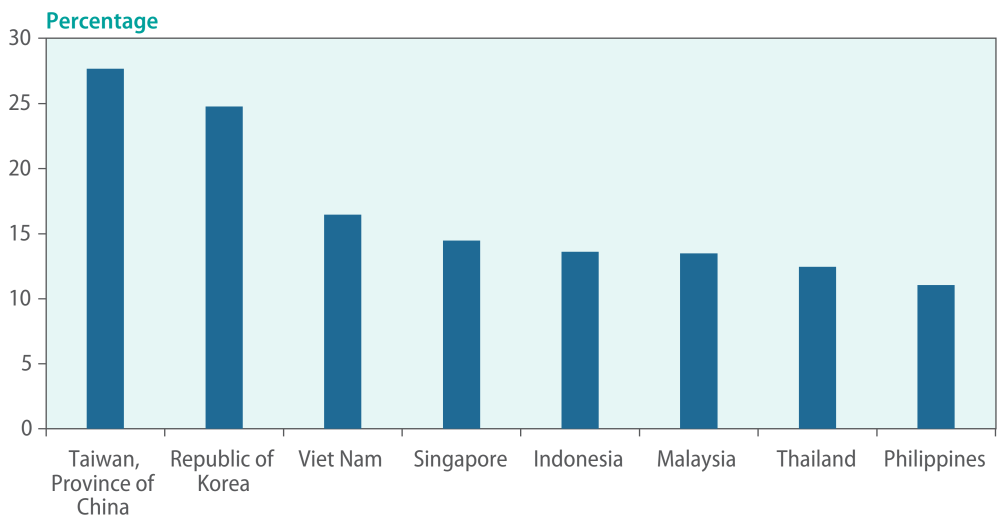
The trade outlook in East Asia is clouded by elevated trade tensions between China and the United States

The region's strong export performance in 2017 extended into 2018, but the growth momentum moderated in most countries. In Malaysia, the Republic of Korea and Taiwan Province of China, exports remained driven by buoyant global demand for semiconductors and consumer electronics. In Brunei Darussalam, Indonesia and Malaysia, export revenue also benefited from the increase in global crude oil prices.

Recent indicators suggest that trade tensions are starting to weigh on the region's exports. In October, new export orders contracted in several economies, including China, the Philippines, the Republic of Korea and Taiwan Province of China. In 2019, exports are likely to provide less impetus to the region's growth, given a slower global growth momentum and a softening of the global electronics cycle. The protracted trade dispute between China and the United States is further weighing on the region's export outlook. In 2018, the United States imposed tariffs on more than $250 billion worth of Chinese goods, including solar panels, aluminium, steel, electrical and electronic (E&E) products, and a wide range of household items. These tariffs were met with retaliatory measures by China.

For China, exports to the United States account for almost 20 per cent of total merchandise exports. A decline in China's exports could have significant ramifications on the region, as many East Asian economies are deeply integrated into regional production networks, with China often at the centre of these networks. This is in part reflected in the high share of exports to China for many economies (figure III.20). Of note, the Republic of Korea, Singapore and Taiwan Province of China are particularly vulnerable to United States tariffs on Chinese E&E products and components, given the strong cross-border production linkages of these economies with the E&E industry in China.

Figure III.20
Share of selected East Asian countries' total exports sent to China, 2017



Source: National authorities, CEIC.

Note: Figure based on total merchandise exports.

Several Southeast Asian economies may benefit from some production diversion, as higher tariffs could potentially prompt firms to shift manufacturing operations away from China. However, any major relocation of production is unlikely in the short term, given that firms would need time to assess other aspects of operations in a new country, such as the availability of labour, infrastructure, and domestic regulations. Notwithstanding elevated China-United States trade frictions, the region has continued to progress on several initiatives to enhance intraregional trade activity. This includes the Regional Comprehensive Partnership Agreement (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

East Asia remains subject to persistent, high volatility in international financial markets

Amid elevated policy uncertainty in the international environment, financial markets in East Asia will remain subjected to periodic episodes of heightened volatility in the outlook period. In 2018, expectations of a faster pace of monetary policy adjustment in the United States contributed to a significant rise in 10-year Treasury yields and a strengthening of the dollar. This induced some global portfolio rebalancing, which in turn drove short-term capital outflows from the emerging regions, including most East Asian economies. For China, however, the inclusion of Chinese stocks into the MSCI Emerging Markets Index contributed to strong foreign portfolio inflows during the year. MSCI also announced that it might raise the weight of Chinese stocks in its indices beginning in 2019, which is likely to support inflows in the near term.

Regional financial markets were also affected by escalating trade tensions between China and the United States, as concerns arose over the impact of higher tariffs on China's growth prospects and the potential spillovers to the region. Compared to the beginning of 2018, major stock markets in China have seen declines of more than 20 per cent while the renminbi has weakened by about 6 per cent against the dollar. Most other East Asian economies also experienced equity market losses and currency depreciations but to varying extents, as investors increasingly differentiated between countries based on their strength of macroeconomic fundamentals. Despite heightened financial market volatility, however, financial intermediation generally remained undisrupted in the region, supported by sufficient liquidity in domestic banking systems.

Inflationary pressures rise, amid higher global energy prices and weaker domestic currencies

Inflation is expected to pick up in the region, following higher global energy prices and weaker domestic currencies. Given limited capacity pressures, however, inflation is likely to remain moderate in most economies. In Indonesia and Malaysia, the reintroduction of fuel price subsidies will also mitigate the pass-through from higher global oil prices onto domestic inflation. In 2018, higher prices of oil and food contributed to rising inflation in several countries, including Cambodia, China, Singapore and Thailand. Meanwhile, in the Republic of Korea, inflation slowed, in part reflecting the lack of domestic demand pressures. In all these countries, inflation rates remained below their national targets. In contrast, the Philippines experienced a rapid increase in consumer prices, fuelled by agriculture supply bottlenecks, higher excise taxes on several goods, and an increase in the cost of oil imports. A key risk to East Asia's inflation outlook stems from a possible escalation of tariff measures, driving up the cost of intermediate inputs and exerting upward pressure on product prices.

Monetary policy is likely to remain accommodative, given high uncertainty in the external environment

Given moderate inflationary pressures and rising downside risks to growth, monetary policy is expected to remain accommodative in most East Asian economies. However, as the developed countries continue to normalize monetary policy, the region is likely to face stronger capital outflow pressures, making it more challenging for central banks to maintain low policy rates. Furthermore, several central banks have reiterated concerns over the need to reduce the degree of monetary accommodation, in order to prevent the further build-up of financial imbalances.

In 2018, Indonesia raised interest rates by a cumulative 175 basis points, in efforts to stem capital outflows and the sharp depreciation of the rupiah. Malaysia and Singapore tightened monetary policy earlier in the year, following strong growth and labour market conditions. Meanwhile, surging inflationary pressures in the Philippines prompted its central bank to increase rates at a sharp pace. In contrast, China loosened monetary policy during the year, to mitigate the effects of intensifying trade frictions on the economy. While likely to provide some support to short-term growth, this may contribute to a further increase in already high domestic debt levels, raising the risk of a disorderly deleveraging process in the future.

Fiscal policy will play a larger role in supporting domestic demand

As monetary policy space narrows, most East Asian economies are likely to maintain expansionary fiscal stances to support domestic demand. The Republic of Korea has announced plans for a sharp increase in fiscal spending in 2019, which will be focused on job creation and expanding social welfare. As risks to growth increase, China has also introduced several pro-growth fiscal measures, which include lowering personal income taxes and accelerating infrastructure investment. Boosting infrastructure spending has also been the focus of Governments in several other large economies, including the Philippines and Thailand. Meanwhile, in Indonesia, the authorities are focusing on reforms in order to enhance the efficiency and effectiveness of public expenditure on growth.

China's growth is projected to remain solid despite rising trade tensions

Amid rising external headwinds and ongoing economic rebalancing, China's GDP growth is projected to moderate at a gradual pace, from 6.6 per cent in 2018 to 6.3 per cent in 2019 and 6.2 per cent in 2020. Domestic demand growth is expected to remain solid, supported by a looser monetary policy stance and pro-growth fiscal measures. In 2018, China's growth momentum moderated from the previous year, due mainly to a deceleration in fixed asset investment. In particular, infrastructure investment growth was dampened by tighter regulatory restrictions aimed at reining in local government debt. Household spending remained robust in 2018, but expanded at a more moderate pace, amid a weakening of consumer confidence. Nevertheless, private consumption will remain the key driver of growth in the outlook period. Alongside healthy income growth, consumer spending will also be boosted by the increase in the minimum threshold for personal income tax exemption and several additional tax deductions, including on childcare and education.

China's export performance remained solid in 2018, buoyed by strong demand from the developed countries and intraregional trade activity. However, recent leading indicators suggest that the imposition of United States tariffs may have a more significant impact on the Chinese economy going forward. In October, China's manufacturing Purchasing Managers' Index weakened to its lowest reading in two years, as new export orders and business confidence declined.

As trade tensions with the United States intensified, the Chinese authorities announced a wide range of pre-emptive measures to support growth. On the financial front, the central bank reduced reserve requirement ratios for large banks and raised bank lending quotas in efforts to enhance domestic liquidity and stimulate credit growth. In addition, restrictions on local government bond issuances were eased to stimulate infrastructure investment. These measures, however, may exacerbate financial imbalances, thus increasing risks to domestic financial stability. At the same time, Chinese policymakers have announced several strategies geared towards lifting China's medium-term growth prospects. These include the easing of business regulation to foster stronger entrepreneurship and innovation. Ongoing plans to attract more high technology investment will also

Box III.4

China's economic transition and its potential impacts on Asia and the Pacific

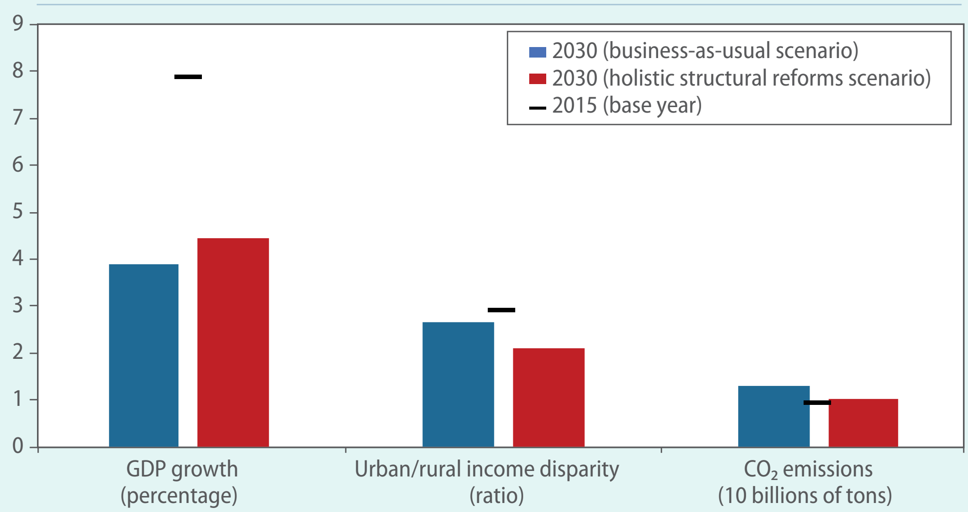
In the last four decades, the Chinese economy has grown at an unprecedented speed, transforming from a predominantly agricultural economy to an industrial powerhouse, and is now increasingly services oriented. However, it is now confronting headwinds, including weakening external demand, rising import tariffs imposed by the United States of America, decelerating productivity growth along with high private debt, diminishing demographic dividends, increasing inequality and a deteriorating natural environment. Given such strains, a slowdown in China's economic growth is most likely to occur in the coming decade. However, different policy pathways could result in considerably different outcomes in terms of quality of economic growth.

Model simulation results, which consider different policy pathways, suggest that if China pursues a holistic approach to structural reforms that includes innovative, inclusive and sustainable growth paths simultaneously, the country could maintain relatively high rates of economic growth—even as external demand remains sluggish, the labour force shrinks and capital accumulation slows—and experience a decline in urban-rural income disparity and CO_2 emissions (figure III.4.1). However, the Government of China might still face difficult policy trade-offs. For example, policy priorities on technology and innovation could boost growth in GDP but might worsen inequality. Similarly, policy responses that address an increasingly uncertain external environment (especially trade) need to be carefully designed to avoid undermining longer-term social inclusiveness or environmental sustainability.

Due to closer regional economic integration, China's structural transformation is expected to have important ramifications for the Asia-Pacific region. Compared with a scenario wherein China continues to follow the current policy trends (baseline), a holistic structural reforms scenario generates positive impact on economic growth, exports and imports, and welfare gains in the Asia-Pacific economies (figure III.4.2). Japan, the Republic of Korea and South-East Asian countries are predicted to benefit the most from deepening trade links, while countries in the Pacific are expected to benefit the least. Growth in trade of heavy manufacturing products could outpace that of all other tradable goods between China and the rest of the region, thanks to China's manufacturing sector having moved up the value chain, whereas services exports to China could decline, as China develops its own services sector (e.g., health care or education). To maximize opportunities and mitigate risks arising from China's structural transformation, policymakers could consider policy options based on their economic conditions and degree of trade integration with China.

Figure III.4.1

Computable General Equilibrium (CGE) model simulation: the impact of China's economic transition on its development in 2030



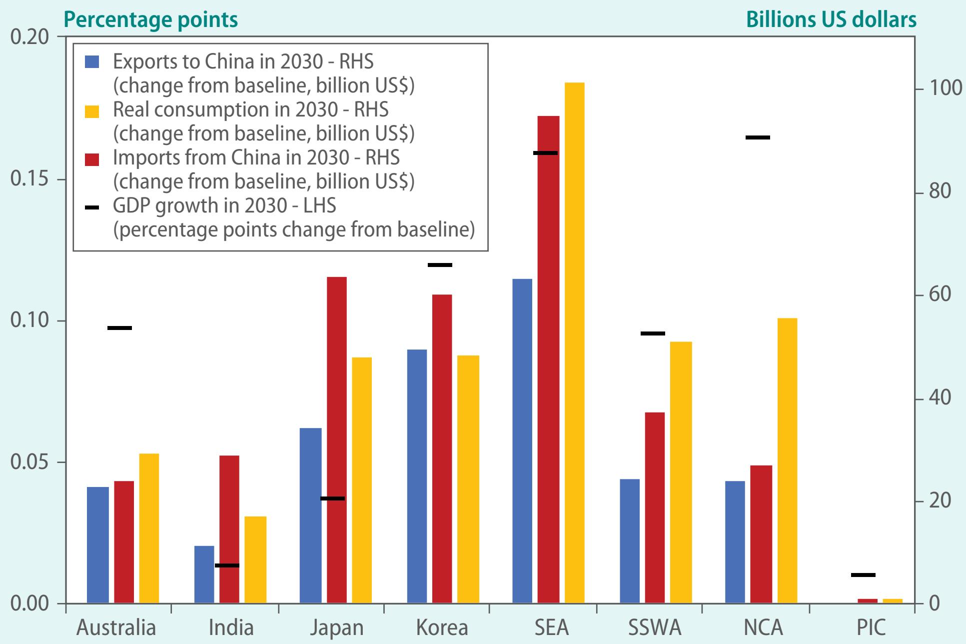
Source: ESCAP calculation.

Note: Urban/rural income disparity is measured by the ratio of urban income to rural income. If the ratio goes up, it indicates higher income inequality; if down, lower income inequality. Detailed assumptions for different scenarios are available in ESCAP (forthcoming).

(*continued*)

Box III.4 (*continued*)

Figure III.4.2
CGE model simulation: the impact of China's holistic structural reforms on the Asia-Pacific region in 2030



Source: ESCAP calculation.

Note: SEA = South-East Asia; SSWA = South and South-West Asia; NCA = North and Central Asia; PIC = Pacific; RHS = right-hand scale; LHS = left-hand scale. Regional aggregations are defined by ESCAP (http://data.unescap.org/escap_stat/#methodDefinition) and are not strictly comparable to regional definitions used elsewhere in the report. Baseline scenario assumes that China follows the current policy trends.

Countries with low labour costs, such as Cambodia and Nepal, will appear more attractive for labour-intensive manufacturing activities as wages rise in China. In order to further enhance their attractiveness to foreign investment, these countries need to strengthen domestic infrastructure and improve their business environments. Meanwhile, to continue to advance their transformation they will also need to promote the development and accumulation of new capabilities, promote a more diversified production and export base for more complex goods and services, and become more integrated into global value chains with access to a wider range of expanding suppliers and markets. For existing technology exporters, such as Japan and the Republic of Korea, China's industrial upgrading could lead to stronger competition. They could consider specializing their technologies further to maintain their upstream position in the value chain of high-technology industry and engage in greater intra-industry trade with China. This will require enhanced rules, including on intellectual property rights, technology transfers and non-tariff trade barriers.

Resource-rich economies could face lower long-term demand as China improves economic efficiency and reduces reliance on fossil fuels. This could have adverse implications for their revenue earnings and financial flows, leading to exchange-rate volatility. To avoid this, resource-rich economies may need to strengthen monetary policy frameworks to allow for more flexible exchange rates; diversify to lower risks of revenue and financial flow volatility; and boost employment in higher value-added sectors. As China is undertaking efforts to reduce inefficient and polluting activities, countries such as Mongolia, with its high export dependence on mining and markets in China, could face more urgent pressures. Commodity exporters could leverage investment links of the Belt and Road Initiative to enhance industrial diversification.

China is expected to continue to dominate the Asia-Pacific regional economy for the foreseeable future. China's structural transformation process presents new risks and opportunities for the region. Amid a rapidly evolving external environment, China will continuously fine-tune its policy mix in order to advance structural reforms while supporting short-term growth. This balancing act will have effects on regional economies. Policy responses must continue to evolve accordingly, both domestically and through regional cooperation efforts.

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contribute to productivity and employment gains, while boosting competitiveness. China's gradual move up the value chain and ongoing structural transformation will have implications on the rest of the region (box III.4).

Exports will provide less support to growth in the Republic of Korea, Singapore and Taiwan Province of China

Growth in the Republic of Korea is projected to moderate from 2.6 per cent in 2018 to 2.5 per cent in 2019. An expected slowdown in export growth will be partly offset by a pickup in private consumption in the outlook period. Household spending will benefit from the significant increase in minimum wages, policy measures to boost employment and higher social spending. Following growth of 2.7 per cent in 2018, Taiwan Province of China is also expected to expand at a slower pace of 2.4 per cent in 2019, as export growth is tempered by a maturing global consumer electronics cycle and waning base effects. The current trade frictions are also likely to have a visible impact on trade, given that China and the United States account for almost 40 per cent of total exports. In Singapore, GDP growth is projected to ease from 3.2 per cent in 2018 to 2.6 per cent in 2019, as manufacturing activity expands at a more moderate pace. Growth in the domestic-oriented industries, including retail and food services, will remain robust, underpinned by improving labour market conditions and positive consumer confidence.

Domestic demand in the ASEAN economies will remain resilient

Growth in the large economies in the Association of South East Asian Nations[4] (ASEAN) will continue to be supported by resilient domestic demand. In the Philippines, GDP growth in 2018 was affected by a slowdown in household spending due to a rapid increase in inflation. Going forward, growth is projected to rebound slightly, from 6.3 per cent in 2018 to 6.5 per cent in 2019. Growth will be mainly driven by strong government spending and infrastructure investment. However, the economy faces the risk of persistently high inflationary pressures, prompting a more aggressive stance on monetary policy tightening, thus further constraining private consumption. Following growth of 4.6 per cent in 2018, Malaysia is expected to grow at a more moderate pace of 4.4 per cent in 2019. Private consumption will be supported by steady increases in wages and employment. Consumer spending will also benefit to some extent from the replacement of the Goods and Services Tax with the Sales and Services Tax, given that the latter is imposed on a narrower range of goods. Public sector spending will pose a drag on GDP growth as the new Government reprioritizes expenditure. The decision to cancel or suspend several large infrastructure projects will weigh on public investment growth.

Following exceptionally strong growth of 4.1 per cent in 2018, Thailand's GDP is projected to moderate to 3.8 per cent in 2019. Private consumption will be underpinned by a significant rise in non-agriculture wages and an improvement in consumer sentiments. Public investment growth will be driven by the implementation of large infrastructure projects. This includes the launch of the Eastern Economic Corridor, which aims to develop Thailand's eastern provinces into a manufacturing and services hub. In Indonesia, the economy is expected to continue expanding at a steady pace of 5.1 per cent in 2019. Private consumption will remain the key driver of growth, amid rising incomes in the formal sector and higher social welfare spending. However, recent policies to stabilize the rupiah, including interest rate hikes and the postponement of infrastructure projects to reduce capital imports, will weigh on the pace of expansion in domestic demand in the near term.

ASEAN LDCs will continue growing at a rapid pace

The least developed countries in ASEAN, namely, Cambodia, Lao People's Democratic Republic and Myanmar, will continue to expand at a rapid pace of between 6.5 to 7.5

4 Association of South East Asian Nations (ASEAN) member countries consist of Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

per cent in 2019 and 2020, as incomes rise from relatively low bases. Private consumption growth is expected to remain strong, while continued infrastructure investment, particularly in the energy and transportation sectors, will also boost economic growth in these economies. Nevertheless, low productivity levels—amid still poorly diversified economic structures and large infrastructure bottlenecks—remain a challenge to boosting competitiveness and achieving stronger medium-term growth prospects.

Meanwhile, growth in the Pacific Island countries, including Kiribati, Papua New Guinea, the Solomon Islands and Vanuatu, will be supported by rising tourist arrivals, higher commodity prices and stronger fishing revenues. The outlook, however, is highly susceptible to commodity price fluctuations and weather-related shocks.

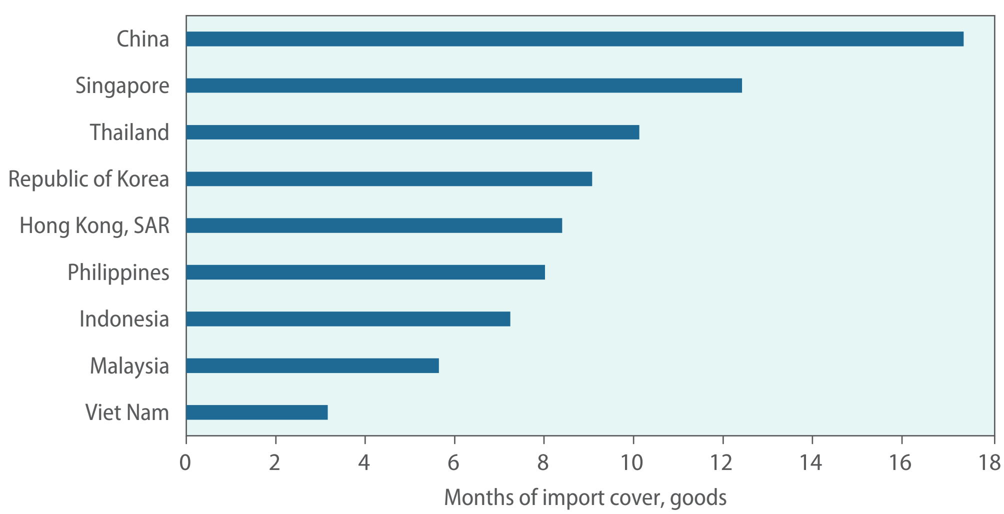
Key downside risks to the region's growth outlook stem from a potential deterioration in global trade and financial conditions

Downside risks to East Asia's growth outlook have increased considerably over the past year. A further intensification of trade frictions between China and the United States will have adverse spillovers on regional growth through trade, investment, and financial channels. In addition, an abrupt tightening of monetary policy in the United States may trigger sudden and large capital outflows from the region, posing a risk to financial stability. On the domestic front, financial sector vulnerabilities, particularly high corporate and household debt, will continue to weigh on investment prospects in several countries.

Most East Asian economies have some degree of policy space to mitigate an external shock

Compared to other developing regions, the East Asian economies have a more optimistic growth outlook. This is in part due to stronger macroeconomic fundamentals as well as relatively less severe external and domestic vulnerabilities. Importantly, most economies in the region have some degree of policy flexibility and buffers to effectively mitigate an external shock. Foreign-exchange reserves in the region remain ample, with high import coverage ratios (figure III.21). Many countries have also been utilizing macroprudential tools as an additional policy instrument to manage financial stability risks. In addition, fiscal positions in East Asia are relatively stronger, attributed in part to robust GDP growth and more prudent fiscal management. Over the past five years, fiscal deficits in the region averaged only 1.8 per cent, while the region's public debt-to-GDP ratio is relatively low, amounting to 46 per cent of GDP in 2017. In a few countries, however, high government-contingent liabilities will likely constrain the Government's ability to embark on large fiscal stimulus measures.

Figure III.21
International reserves of selected East Asian economies, months of import coverage



Source: World Bank's Global Economic Monitor database.
Note: A common rule of thumb used to guide reserve adequacy suggests that countries should hold reserves equivalent to more than 3 months worth of imports. Data on each country is based on latest available data in 2018.