EAST ASIA and PACIFIC

Growth in the East Asia and Pacific region is expected to remain solid, slowing marginally to 6.3 percent in 2018 and to an average of 6.1 percent in 2019-20, broadly as previously projected. This modest easing reflects a structural slowdown in China that is only partly offset by a maturing cyclical pickup in the rest of the region. While upside surprises to global activity could lead to stronger-than-expected regional growth, risks to the forecast remain tilted to the downside and include intensified trade restrictions and an abrupt tightening of global financing conditions.

Recent developments

Growth in the East Asia and Pacific region accelerated slightly to 6.6 percent in 2017, reflecting solid exports and strong domestic demand (World Bank 2018a; Figure 2.1.1). Conditions are mostly favorable for the region in 2018, including robust global trade, moderate borrowing costs, and sustained capital inflows.

Regional financial markets have generally remained buoyant, despite volatility in early and mid-2018 related to the prospects of faster monetary policy tightening in advanced economies and escalating trade tensions. Bond spreads in some countries have increased, following bouts of volatility in stock markets, but remain close to the low levels that prevailed in 2017.

Domestic monetary conditions have tightened somewhat and tighter prudential policies have kept credit growth in check. Several major economies have renewed their fiscal consolidation efforts in 2018 (e.g., China, Indonesia, the Lao People's Democratic Republic, Malaysia, Vietnam).

Growth across the region remains solid. Exports continue to increase both in volume and value terms, benefiting from the recovery in global investment and trade, as well as stronger trade and investment integration within Asia and between Asia and Eurasia (Chapter 1). Private consumption continues to be supported by solid consumer confidence and rising household wealth, amid moderate inflation.

While inflation has generally picked up among commodity importers, it has been on a downward trend in commodity exporters as the impact of past currency depreciations wane. Output gaps have generally closed, but economic slack remains in several commodity exporters (e.g., Mongolia, Papua New Guinea). With the exception of China, where investment continues its policy-guided deceleration, investment spending in the region has remained strong, partly reflecting improved business confidence, continued capital inflows, and higher earnings (e.g., Cambodia, Lao PDR, Vietnam).

In China, a solid rebound of exports amid robust consumption growth helped output to expand in 2017 at a slightly faster-than-expected pace (Figure 2.1.2; World Bank 2017a). Domestic demand has remained solid in 2018, reflecting robust consumption growth and recovering private fixed asset investment. Tighter regulations, especially of the shadow banking sector, have

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Note: The author of this section is Ekaterine Vashakmadze. Research assistance was provided by Brent Michael Harrison and Jinxin Wu.

(e.g., China, the Philippines, Vietnam), high foreign participation in local-currency sovereign bond markets (e.g., Indonesia, Malaysia), and sizable fiscal deficits (e.g., Cambodia, Lao PDR, Mongolia, Vietnam).

Outlook

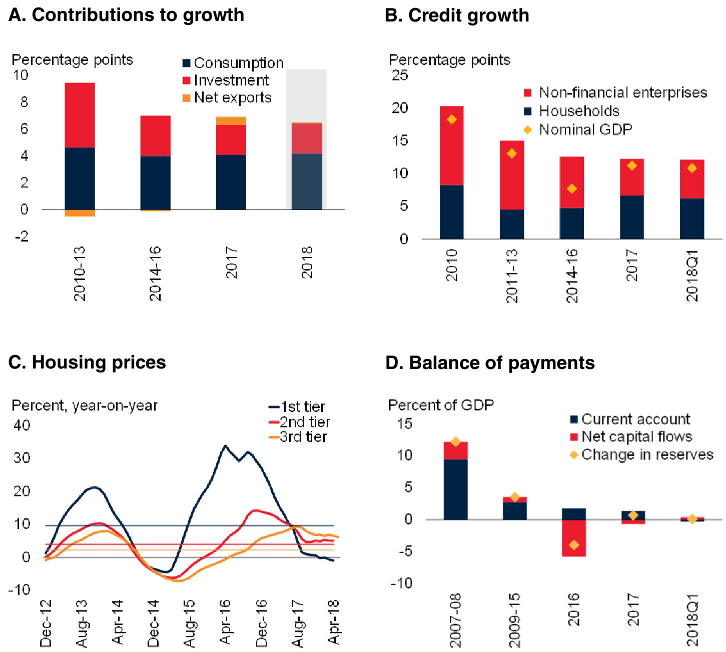
Regional growth is expected to gradually moderate from 6.3 percent in 2018 to 6.1 percent on average in 2019-2020, broadly unchanged from January forecasts (Tables 2.1.1 and 2.1.2; Figure 2.1.3). The slowdown in regional growth is largely due to the gradual structural slowdown in China, the region's largest economy. Activity in the rest of the region is expected to peak in 2018 and remain steady around its potential rate in 2019 and 2020. The outlook is predicated on broadly stable commodity prices in the next two years, solid but moderating global demand, and a gradual tightening of global financing conditions.

Growth in China is projected to slow from 6.5 percent in 2018 to 6.3 percent on average in 2019-20. Policy support is expected to ease, led by regulatory and macroprudential tightening. Fiscal policies are expected to become less accommodative to contain financial risks and encourage a continued rebalancing of the economy from investment to consumption and from industry to services. Growth in the rest of the region is projected to reach 5.4 percent in 2018 and remain broadly unchanged at 5.3 percent in both 2019 and 2020, as the cyclical recovery in these economies matures.

Growth in commodity exporters is expected to remain broadly stable at about 5.3 percent in 2019, in line with its potential, with significant cross-country divergence. This forecast is slightly above that of January, reflecting an upward revision to a number of commodity exporters (e.g., Malaysia, Mongolia), which more than offset a downgrade in some other economies (e.g., Papua New Guinea, Timor-Leste). The downgrade in growth projections for Papua New Guinea is due to a massive earthquake that hit the country in February and led to the temporary suspension of production of natural gas at the Hides gas field. Output gaps in most commodity exporting

FIGURE 2.1.2 China

In China, a strong rebound of exports amid robust consumption growth helped output to expand in 2017 at a slightly faster-than-expected pace. Tighter macroprudential policies have continued to reduce housing price growth and moderate credit growth in 2018. China recorded its first current account deficit since 2001 in the first quarter of 2018, consistent with ongoing external rebalancing.



Sources: Haver Analytics, The People's Bank of China, World Bank.

A. Investment refers to gross capital formation, which includes change in inventories. Data in shaded area are forecasts.

B. Total social financing by uses. Last observation is 2018Q1.

C. The National Bureau of Statistics of China surveys house prices in 70 cities and divides them into three tiers. The first tier includes Shanghai, Beijing, Guangzhou, and Shenzhen. The second tier includes 31 provincial capital and sub-provincial capital cities. The third tier includes 35 other cities. Lines indicate February 2011-April 2018 averages. Last observation is April 2018.

D. Current account balance is based on seasonally adjusted data. Last observation is 2018Q1. Net capital flows and change in reserves are estimates.

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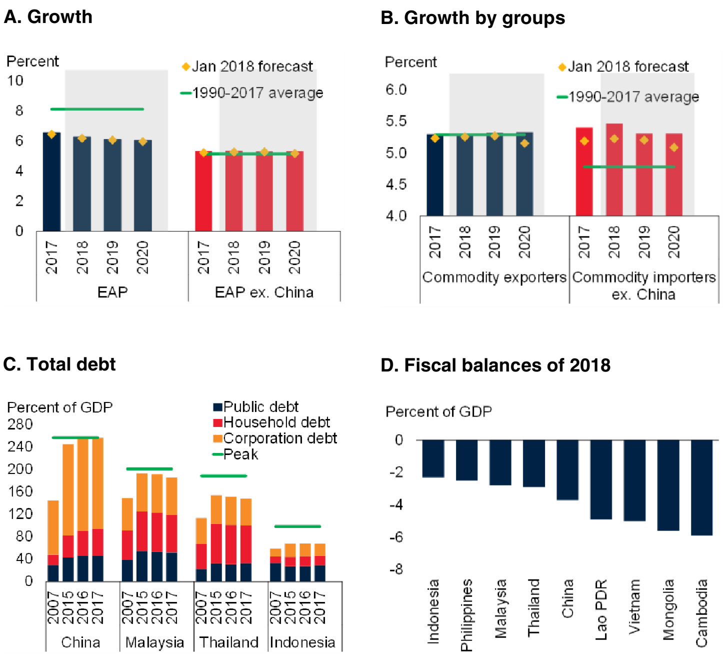
economies are expected to close over the forecast horizon, as the adjustment to low commodity prices runs its course and investment growth stabilizes.

Growth in commodity importers is projected to moderate and converge with its potential rate of about 5.3 percent in 2019 and 2020. In commodity importers excluding China, an upgrade to growth projections in 2018 reflects an upward revision to Thailand due to stronger exports, which are nevertheless projected to remain below the regional average.

For both commodity exporters and importers, capacity constraints and price pressures are

FIGURE 2.1.3 EAP: Outlook and risks

Regional growth is expected to moderate from 6.3 percent in 2018 to 6.1 percent on average in 2019-20, largely due to the gradual structural slowdown in China. Activity in the rest of the region is projected to stabilize as the cyclical rebound matures. Growth in commodity importers is projected to converge with its potential rate of about 5.2 percent and remain around this level in 2019-20. Domestic vulnerabilities, related to elevated domestic debt and external financing needs in some countries, would amplify the impact of external shocks, especially where policy buffers are limited.



Sources: Bank of International Settlements, Haver Analytics, International Monetary Fund, World Bank.

Note: EAP stands for East Asia and Pacific.

A.B. Commodity importers ex. China include Cambodia, Fiji, Philippines, Solomon Islands, Thailand, Vietnam, and Vanuatu. Commodity exporters include Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Papua New Guinea, and Timor-Leste. Shaded areas are forecasts. 1990-2017 average for commodity exporters excludes Myanmar and Timor-Leste due to data limitations. Aggregates are calculated using 2010 U.S. dollar GDP-weights.

C. The highest debt-to-GDP ratio since 1995Q1. The peak occurred in 1997Q4 in Thailand, 1998Q4 in Malaysia, 2001Q4 in Indonesia, and 2016Q4 in China. Last observation is 2017Q3.

D. Data reflect World Bank staff forecasts.

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expected to intensify over the forecast horizon, in part reflecting higher oil prices, leading to further tightening of monetary policy in the region.

Despite the projected robust activity in the region in the near term, underlying potential growth—which has fallen considerably over the past decade—is likely to decline further over the long term, reflecting increasingly adverse demographic patterns and a projected slowing pace of capital accumulation, which is needed to rein in credit growth (World Bank 2018a, 2018b).

Risks

While upside surprises to global activity could lead to stronger-than-expected regional growth, risks to the outlook remain tilted to the downside. Increased protectionist tendencies in some large economies continue to create uncertainty about the future of established trading relationships. The imposition of trade restrictions by advanced economies would disproportionately affect the more open economies in the region.

The economic impact of tariffs on imports to China, that have been discussed by the U.S. administration would likely be manageable provided they do not lead to escalation (Chapter 1; World Bank 2018a). However, there is a risk that such measures, may trigger retaliatory action and lead to broader trade restrictions. A significant disruption to activity in China would have large regional effects (World Bank 2016, 2018c). Rising geopolitical tensions, including in the Korean Peninsula and the South China Sea, could weigh on investor sentiment, leading to financial market volatility and softer regional investment (World Bank 2018a).

In addition, a faster-than-expected tightening of global financing conditions and associated financing stress—triggered, for instance, by changes in market expectations of advanced-economy monetary policy—could reduce capital inflows, heighten financial market volatility, and place pressure on regional exchange rates and asset prices. Rising borrowing costs could substantially increase the burden of debt servicing, which was contained in recent years by low global interest rates and risk premiums.

If a combination of downside risks were to materialize, it could trigger a sharper-than-expected slowdown in regional growth. Domestic vulnerabilities—elevated domestic debt and large external financing needs in some countries—would amplify the impact of external shocks, especially where policy buffers are limited, and dampen growth.

TABLE 2.1.1 East Asia and Pacific forecast summary

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2015	2016	2017e	2018f	2019f	2020f	Percentage point differences from January 2018 projections: 2018f	2019f	2020f
EMDE EAP, GDP[1]	**6.5**	**6.3**	**6.6**	**6.3**	**6.1**	**6.0**	**0.1**	**0.0**	**0.0**
(Average including countries with full national accounts and balance of payments data only)[2]									
EMDE EAP, GDP[2]	6.5	6.3	6.6	6.3	6.1	6.0	0.1	0.0	0.0
GDP per capita (U.S. dollars)	5.8	5.6	5.9	5.7	5.5	5.5	0.1	0.0	0.1
PPP GDP	6.4	6.3	6.5	6.2	6.1	6.0	0.1	0.1	0.1
Private consumption	6.7	6.8	6.9	7.0	6.8	7.0	-0.1	-0.2	0.1
Public consumption	8.9	9.3	7.5	7.6	7.5	7.4	-0.2	0.9	0.9
Fixed investment	6.5	6.6	5.8	5.5	5.3	5.5	-0.3	-0.5	-0.2
Exports, GNFS[3]	0.5	3.2	7.3	5.7	6.0	5.8	1.6	1.5	1.1
Imports, GNFS[3]	0.8	5.4	5.7	5.8	6.1	6.4	0.6	0.8	1.1
Net exports, contribution to growth	-0.1	-0.6	0.5	0.0	0.0	-0.2	0.2	0.2	-0.1
Memo items: GDP									
East Asia excluding China	4.9	4.9	5.3	5.4	5.3	5.3	0.1	0.0	0.1
China	6.9	6.7	6.9	6.5	6.3	6.2	0.1	0.0	0.0
Indonesia	4.9	5.0	5.1	5.2	5.3	5.4	-0.1	0.0	0.1
Thailand	3.0	3.3	3.9	4.1	3.8	3.8	0.5	0.3	0.4

Source: World Bank.

Note: e = estimate; f = forecast. EMDE = emerging market and developing economy. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

1. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Democratic People's Republic of Korea and dependent territories.

2. Sub-region aggregate excludes Democratic People's Republic of Korea, dependent territories, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Myanmar, Nauru, Palau, Papua New Guinea, Samoa, Timor-Leste, Tonga, and Tuvalu, for which data limitations prevent the forecasting of GDP components.

3. Exports and imports of goods and non-factor services (GNFS).

For additional information, please see www.worldbank.org/gep.

TABLE 2.1.2 East Asia and Pacific country forecasts[1]

(Real GDP growth at market prices in percent, unless indicated otherwise)

	2015	2016	2017e	2018f	2019f	2020f	Percentage point differences from January 2018 projections: 2018f	2019f	2020f
Cambodia	7.0	7.0	6.8	6.9	6.7	6.6	0.0	0.0	-0.1
China	6.9	6.7	6.9	6.5	6.3	6.2	0.1	0.0	0.0
Fiji	3.6	0.4	3.8	3.5	3.4	3.3	0.0	0.1	0.1
Indonesia	4.9	5.0	5.1	5.2	5.3	5.4	-0.1	0.0	0.1
Lao PDR	7.3	7.0	6.7	6.6	6.9	6.9	0.0	0.0	0.0
Malaysia	5.0	4.2	5.9	5.4	5.1	4.8	0.2	0.1	0.1
Mongolia	2.4	1.5	5.1	5.3	6.4	6.5	2.2	-0.9	1.0
Myanmar	7.0	5.9	6.4	6.7	6.9	7.1	0.0	0.0	0.2
Papua New Guinea	5.3	1.9	2.2	-1.7	4.0	3.0	-4.2	1.6	-0.4
Philippines	6.1	6.9	6.7	6.7	6.7	6.6	0.0	0.0	0.1
Solomon Islands	3.7	3.5	3.2	3.0	2.9	2.8	0.0	0.1	0.1
Thailand	3.0	3.3	3.9	4.1	3.8	3.8	0.5	0.3	0.4
Timor-Leste[2]	4.0	5.3	-1.8	2.2	4.2	4.0	-2.0	-0.8	-1.0
Vietnam	6.7	6.2	6.8	6.8	6.6	6.5	0.3	0.1	0.0

Source: World Bank.

Notes: e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

1. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

2. Non-oil GDP. Timor-Leste's total GDP, including the oil economy, is roughly four times its non-oil economy and is highly volatile as a result of sensitivity to changes in global oil prices and local production levels.

For additional information, please see www.worldbank.org/gep.