EAST ASIA and PACIFIC

Growth in the East Asia and Pacific region is projected to slow from 6.3 percent in 2018 to 5.9 percent in 2019-20, and to ease further to 5.8 percent in 2021. This will mark the first time since the 1997-98 Asian financial crisis that EAP growth dropped below 6 percent. In China, growth is expected to decelerate from 6.6 percent in 2018 to 6.2 percent in 2019, and gradually decline to 6.0 percent by 2021, reflecting softening manufacturing activity and trade amid domestic and external headwinds. In the rest of the region growth is also expected to moderate to 5.1 percent in 2019, before rebounding modestly to 5.2 percent in 2020-21, as global trade stabilizes. Risks to regional growth remain tilted to the downside and have intensified with the re-escalation of trade tensions. They include a sharper-than-expected slowdown in major economies, including China; an intensification of global trade tensions; and an abrupt change in global financing conditions and investor sentiment.

Recent developments

Growth in the East Asia and Pacific (EAP) region is slowing, largely reflecting a deceleration in China. Growth in the rest of the region is also moderating, but less sharply, albeit with notable heterogeneity (Table 2.1.1; Figure 2.1.1.A). Regional trade, especially exports, has plummeted amid weakening global investment and elevated trade policy uncertainty related to ongoing U.S-China trade tensions. Export growth has declined sharply, in line with the slowdown in global growth of manufacturing, investment, and trade. Import growth has also decelerated, but is still solid, aided by robust domestic demand growth (Figure 2.1.1.B). Inflation is generally below targets across the region, but has been trending up recently, reflecting higher food prices (Figure 2.1.1.C). External financing conditions have been generally supportive, with narrowing bond spreads and improved net capital inflows (Figure 2.1.1.D). Regional currencies and equity markets, however, are under renewed pressure, most recently following the re-escalation of trade tensions (World Bank 2019a; Figures 2.1.1.E-F).

Note: This section was prepared by Ekaterine Vashakmadze. Research assistance was provided by Liu Cui.

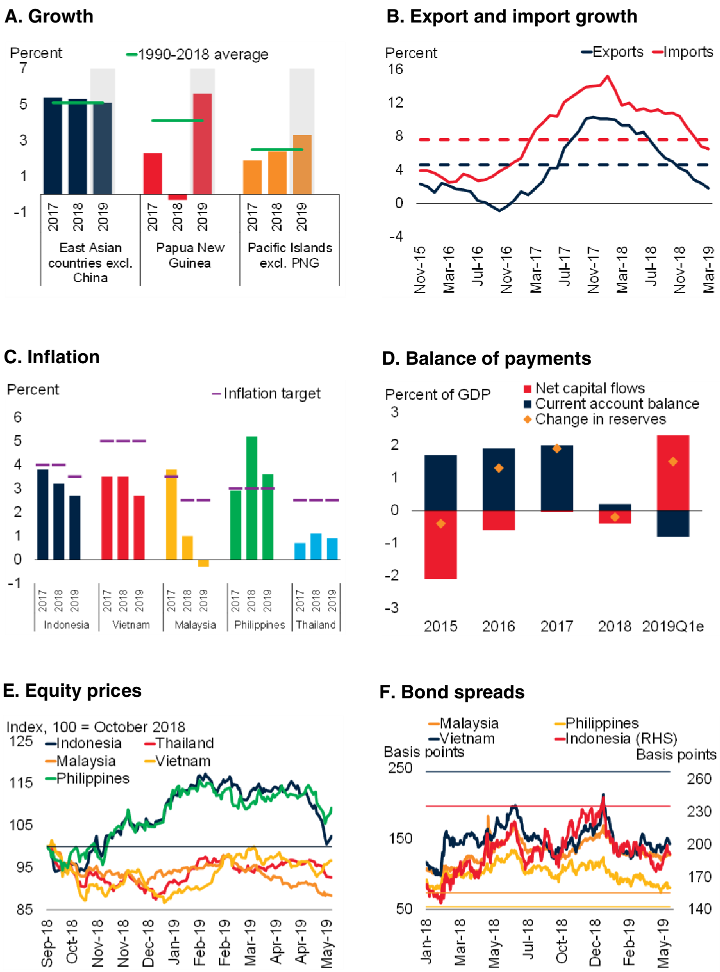
In China, the economy continues to slow and rebalance. Decelerating industrial production growth has been partly offset by more resilient activity in the services sector (Figure 2.1.2.A). Fiscal policies have eased and monetary policies have been generally supportive, helping to balance the impact of external and domestic headwinds (Chapter 1).

China's consumer price inflation has been trending up, but remains below the 3 percent target, while producer price inflation has bottomed out, partly reflecting some stabilization in the industrial sector. The current account surplus widened in 2019Q1 (Figure 2.1.2.B). Both export and import growth slowed sharply in late 2018, and despite some signs of stabilization, recent high-frequency indicators point to continuing broad-based weakness in trade (Figure 2.1.2.C).

Asset prices came under renewed pressure most recently, following a re-escalation of trade tensions in early May (Figures 2.1.2.D-E). Sovereign bond spreads remain above their long-term averages, reflecting slowing growth prospects amid lingering domestic vulnerabilities and ongoing trade disputes with the United States.

FIGURE 2.1.1 EAP region excluding China: Recent developments

Growth in the EAP region is slowing, albeit with notable heterogeneity. Regional export growth has declined sharply, while domestic demand remains robust. Inflation has been trending downward across the region and is generally below targets. Net capital flows improved in 2019Q1. Regional equity markets, however, are under renewed pressure, most recently following the re-escalation of trade tensions. Financial conditions remain supportive with bond spreads generally narrowing or below their long-term averages.



Source: Haver Analytics, International Monetary Fund, World Bank.

A. East Asian countries excl. China includes Cambodia, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Palau, Philippines, Thailand, and Vietnam. Pacific Island excl. PNG includes Fiji, Kiribati, Marshall Islands, Micronesia, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu. 1990-2018 average for East Asian countries excl. China excludes Myanmar and 1990-2018 average for Pacific Island excl. PNG excludes Marshall Islands, Micronesia, Palau, Timor-Leste, and Tuvalu due to data limitations. Aggregate growth rates are calculated using 2010 U.S. dollar GDP weights. Data in shaded areas are forecasts.

B. Export and import volumes. Data include only goods. 12-month moving average. Regional aggregate excludes Cambodia, Fiji, Lao PDR, Mongolia, Myanmar, Solomon Islands, Papua New Guinea, Timor-Leste, Vanuatu, and Vietnam due to data limitations. Dotted lines indicate January 2000-March 2019 averages. Last observation is March 2019.

C. Average year-on-year consumer price inflation. Mid-point of inflation for Indonesia, Philippines, and Thailand. Inflation target for China and Vietnam. For Malaysia, the low point of Bank Negara's official forecast range of 2.5-3.5 percent in the 2019 budget is used. Last observation is April 2019.

D. e=estimate. The aggregate includes Indonesia, Malaysia, Philippines, and Thailand. Net capital flows and change in reserves are staff estimates. Net capital inflows include net capital and financial account balance, errors and omissions. 2019Q1 data is not available for Philippines and Thailand.

E. Equity index stands for the respective country composite index. Last observation is May 21, 2019.

F. The spread of a country's sovereign debt as measured by J.P. Morgan's Emerging Markets Bond Index over their equivalent maturity U.S. Treasury bond. Horizontal lines denote January 2000-May 2019 average rates. Last observation is May 21, 2019.

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Regulatory tightening has helped reduce leverage in some segments of the non-bank sector; however, bank credit growth remains robust and bond issuance has accelerated (Figure 2.1.2.F). Total leverage of the economy—measured as the ratio of total credit (general government and non-financial private sector) to gross domestic product—is estimated to have increased by about 2 percentage points of GDP in the year to 2018Q4. Total debt has surpassed 250 percent of GDP.

Growth in commodity importers remains robust but continues to moderate, reflecting weakening exports amid resilient domestic demand. Inflation is subdued or declining in most countries (Cambodia, the Philippines, Thailand, Vietnam), allowing monetary authorities to keep policy rates steady, generally at accommodative levels. In Thailand, domestic demand is supported by more accommodative fiscal policy. However, weakening export growth is weighing on activity. In the Philippines, private consumption is rebounding amid slowing inflation and improving employment conditions. In addition, election-related spending in the first half of 2019 is giving the economy an additional boost and is partly mitigating the impact of weakening exports.

In commodity exporters, the cyclical recovery is maturing, and the pace and composition of growth increasingly reflect country-specific factors. In larger and more diversified economies, where past terms-of-trade shocks were less acute and macroeconomic fundamentals are strong, steady growth has continued at rates of around 4.5-5 percent per year (Indonesia, Malaysia). In Indonesia, growth has been supported by robust private consumption and investment. In Malaysia, investment is rebounding, reflecting improved financing conditions and business confidence, offsetting the impact of moderating but still robust consumption growth. In smaller commodity exporters, the subdued recovery from the 2015-16 downturn is resuming at a stronger-than-expected pace, helped by investments in new mining projects (Mongolia) and a rebound in the extractive sector following a devastating earthquake in 2018 (Papua New Guinea).

Outlook

After moderating from 6.3 percent in 2018 to 5.9 percent a year in 2019-20, regional growth is projected to ease further to 5.8 percent in 2021 (Tables 2.1.1 and 2.1.2; Figure 2.1.3.A). Growth in China is projected to slow to 6.2 percent in 2019 amid continued domestic and external headwinds. The recent increase in tariffs on trade with the United States is projected to weigh on growth in 2020, which has been revised down to 6.1 percent.

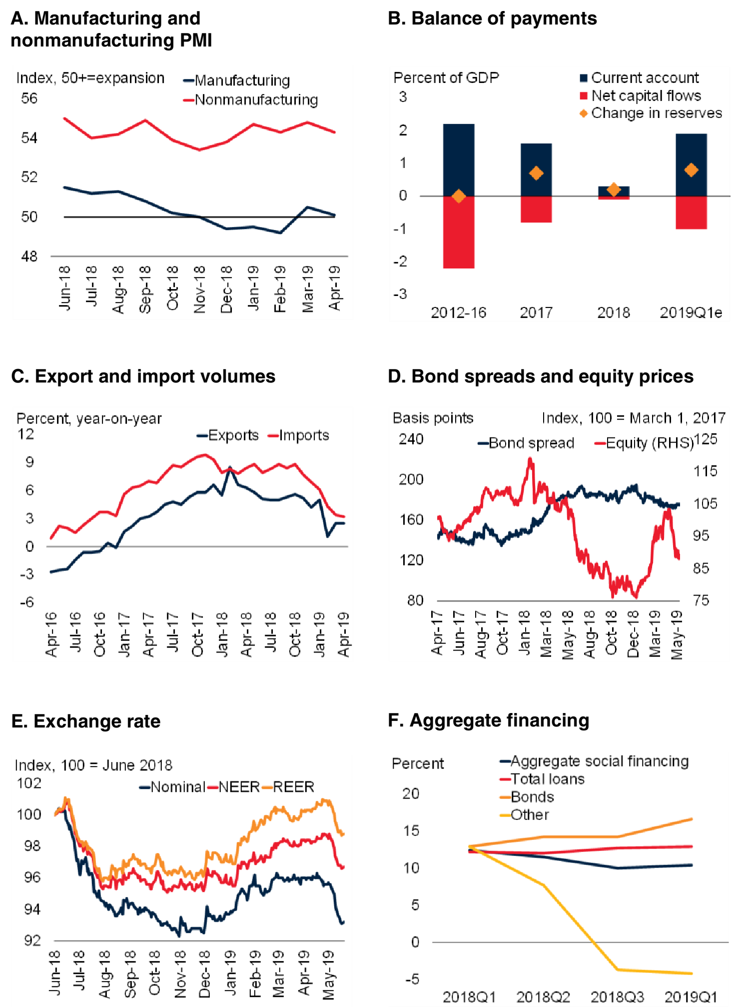
This outlook is predicated on a deceleration in global trade, no further escalation of trade tensions between China and the United States, broadly stable commodity prices, and supportive global financing conditions, especially in the near term. The baseline also assumes that authorities in China continue to calibrate supportive monetary and fiscal policies to address the challenging external environment and any other headwinds to activity (SCPRC 2019).

Regional growth excluding China is projected to decline to 5.1 percent in 2019 before inching up to 5.2 percent in 2020-21 as global trade rebounds. Growth among commodity importers is expected to moderate in 2020-21, reflecting capacity constraints and subdued external demand. Domestic demand will continue benefiting from favorable financing conditions amid low inflation and rising capital flows (Cambodia, the Philippines, Thailand, Vietnam). Regional economies will continue to benefit from pan-Asian infrastructure investments and expanding intra-regional trade, despite weaker-than-expected global growth and investment. The investment outlook is favorable in commodity-importing economies. Some countries will benefit from large public infrastructure projects coming onstream in 2020-21 (Thailand, the Philippines).

Growth in commodity exporters is expected to remain stable at about 5.1 percent a year in 2019-21, in line with potential, but with significant cross-country differences. In particular, growth is projected to diverge slightly between the two largest commodity exporters in the region. In Indonesia, which is less open to trade, growth is

FIGURE 2.1.2 China: Recent developments

China's growth continues to slow, reflecting a deceleration in manufacturing activity and trade. The current account surplus widened in 2019Q1. Recent high-frequency indicators point to a continuing broad-based weakness in trade. Equities and the renminbi have largely recovered from losses incurred in 2018, but have come under renewed pressure recently. Growth of bank lending has remained strong, bond issuance has accelerated, but growth of other debt instruments has slowed.



Source: Haver Analytics, National Bureau of Statistics of China, World Bank.

A. Manufacturing and nonmanufacturing are measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Horizontal line indicates expansionary threshold. Last observation is April 2019.

B. e=estimate. Net capital flows and change in reserves are estimates. Net capital inflows include net capital and financial account balance, errors and omissions.

C. Data include only goods. 12-month moving average. Export and import volumes are calculated as export and import values deflated by export and import price deflators. Export and import indices for some missing values and for April 2019 are estimates. Last observation is April 2019.

D. Bond spread denotes the average spread of China's sovereign debt (measured by J.P. Morgan's Emerging Markets Bond Index) over its equivalent maturity U.S. Treasury bond. Equity index is represented by the Shanghai Stock Exchange Composite. Last observation is May 21, 2019.

E. Nominal=exchange rate vis-à-vis U.S. dollar. NEER=Nominal Effective Exchange Rate. REER=Real Effective Exchange Rate. Increase denotes appreciation. Last observation is May 20, 2019.

F. Bonds include local government special bonds and net financing of corporate bonds. Other instruments include entrusted loans, trust loans and other instruments. Last observation is March 2019.

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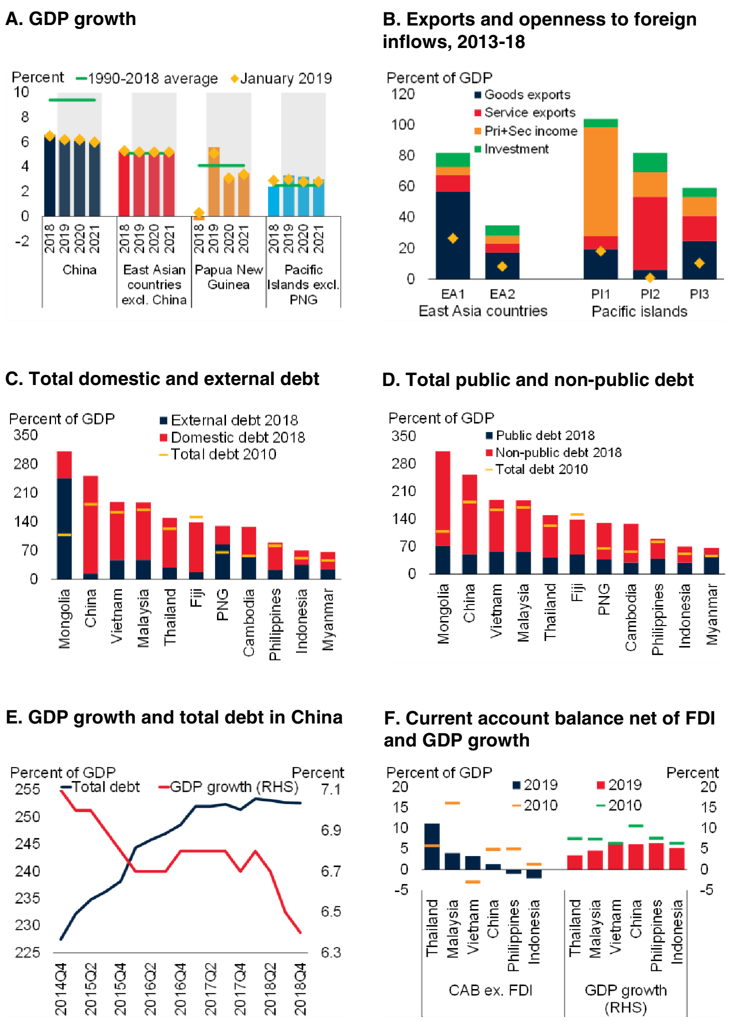
FIGURE 2.1.3 EAP region: Outlook and risks

EAP growth is projected to gradually decline, mainly reflecting the continuing structural slowdown in China. Excluding China, is also slowing, albeit with notable heterogeneity. The region is characterized by deep global integration, which makes countries vulnerable to external trade or financial shocks. Domestic and external vulnerabilities would amplify the impact of such shocks, especially where policy buffers are limited.



Source: Bank for International Settlements, Haver Analytics, International Monetary Fund, The Institute of International Finance, World Bank.

A. East Asian countries excl. China includes Cambodia, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Palau, Philippines, Thailand, and Vietnam. Pacific Island excl. PNG includes Fiji, Kiribati, Marshall Islands, Micronesia, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu. 1990-2018 average for East Asian countries excl. China excludes Myanmar and 1990-2018 average for Pacific Island excl. PNG excludes Marshall Islands, Micronesia, Palau, Timor-Leste, and Tuvalu due to data limitations. Yellow diamonds denote forecasts published in the January 2019 edition of the *Global Economic Prospects* report. Aggregate growth rates are calculated using 2010 U.S. dollar GDP weights. Data in shaded areas are forecasts.

B. EA=East Asia. PI=Pacific Islands. EA1 comprises Brunei Darussalam, Cambodia, Malaysia, Mongolia, Thailand, and Vietnam; EA2 comprises Indonesia, Lao PDR, Myanmar and Philippines. PI1 comprises Kiribati, Marshall Islands, Micronesia, Timor-Leste, Tonga, and Tuvalu; PI2 comprises Palau and Vanuatu; PI3 comprises Fiji, Papua New Guinea, Samoa, and Solomon Islands. The linkages estimated in this chart only represent direct channels: spillovers may also propagate via indirect channels such as global and regional value chains. Diamonds denote direct cumulative exposure to China, Euro Area, and United States.

C. Total debt is defined as a sum of domestic and external debt. Data for 2018 are estimates.

D. Non-public debt includes all debt excluding public debt. The general government debt data for Mongolia is based on World Bank staff estimates. Data for 2018 are estimates.

E. Total debt is defined as a sum of domestic and external debt.

F. CAB ex. FDI=Current Account Balance excluding Foreign Direct Investment. Orange dashes denote GDP growth in 2010; green hyphen—CAB ex. FDI in 2010. Data for 2019 are estimates.

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projected to accelerate marginally in 2020-21, reflecting continued support from high infrastructure spending, robust private consumption. and solid growth of the working-age population. In Malaysia, growth is expected to moderate slightly but remain robust, with weakening export growth largely offset by strong domestic demand on the back of favorable financing conditions and low inflation. In smaller commodity exporters, growth is expected to remain strong in 2020, supported by continued investment in new mining projects (Mongolia, Papua New Guinea).

While growth in the region is projected to remain robust in the near term, underlying potential growth—which has fallen considerably over the past decade, in part reflecting slowing productivity—is likely to decline further over the long term. This largely reflects deteriorating demographic trends, especially in China, Thailand, and Vietnam, combined with a projected slowdown in capital accumulation in China as credit growth is reined in (World Bank 2018a, 2018b).

Risks

Risks to the forecast remain tilted to the downside. They include the possibility of a sharper-than-expected downturn in large economies, a further slowing of global trade, a possible intensification of trade tensions, and an abrupt change in global financing conditions and investor sentiment. Most of the region managed to weather the deterioration of external conditions in 2018. However, worsening conditions would place additional pressure on policymakers even though most countries having reasonably sound economic fundamentals and robust domestic demand (World Bank 2019a). The baseline also assumes that global trade policy uncertainty will remain elevated over the forecast horizon.

Around 80 percent of advanced economies, as well as China, are expected to register slower growth in 2019. In the baseline scenario, the impact of slower global growth and external demand on the EAP region is assumed to be offset by more supportive financing conditions and stronger policy stimulus in China. However, a sharper-than-expected deceleration of activity in large economies—the Euro Area, China, and the United States—could have adverse repercussions across the EAP region, mainly through weaker demand for exports and disruption of global value chains, as well as through financial, commodity, and confidence channels (Chapter 1; World Bank 2016; Figure 2.1.3.B).

In particular, risks of a sharper-than-expected slowdown in China remain significant because of a difficult external environment alongside notable domestic challenges. Total non-financial-sector debt in China is above levels seen at the peak of previous credit booms in other major EMDEs and some advanced economies. High corporate indebtedness in sectors with weak profitability is of particular concern. Policymakers' continued reliance on credit expansion to support growth may exacerbate domestic risks by adding further leverage to its already highly leveraged corporate sector, while also contributing to rising debt in the household sector. In addition, a sizable portion of recent stimulus has taken the form of expanding local government special bond quotas. This form of stimulus may eventually become less effective because of diminishing returns to investment, and may further amplify domestic risks. More than half of the 2019 stimulus has taken the form of tax and fee cuts, whose impact on growth may be less predictable than that of changes in public investment.

A renewed spike in global policy uncertainty, including renewed trade tensions between major economies, could cause a further deterioration in confidence, investment, and trade. Policy uncertainty in the region remains high amid unresolved trade dispute between the United States and China, as demonstrated by the most recent escalation of trade tensions. Commitments by China to purchase U.S. goods as part of an interim agreement could lead to further global trade policy uncertainty and trade diversion for other countries. Failure to reach a long-term agreement between these two economies could lead to a further escalation in tariffs, with broad-ranging global and regional consequences. In the extreme case scenario, it could reduce global exports by up to 3 percent and global income by 1.7 percent over the medium term, with the largest decline (3.5 percent) occurring in China (Freund et al. 2018).[1] The region may also be negatively affected by a disorderly exit of the United Kingdom from the European Union. The U.K. is an important trading partner for several regional economies, especially Cambodia and Malaysia. The materialization of a combination of downside risks could trigger an even sharper slowdown in regional growth.

Notwithstanding the region's strong fundamentals—solid growth, diversified economic base, sound policy frameworks, and strong buffers—EAP economies remain vulnerable to risks related to abrupt changes in global financial conditions. Many countries have pockets of vulnerabilities, including elevated debt (China, Lao People's Democratic Republic, Malaysia, Mongolia, Vietnam), sizable fiscal deficits (Cambodia, Lao PDR, Mongolia, Vietnam), or significant reliance on potentially volatile capital flows (Cambodia, Indonesia; Figures 2.1.3.C-F). Renewed episodes of financial market stress could have pronounced and widespread effects on countries with high indebtedness (Chapter 1). Vulnerabilities among some EAP countries could amplify the impact of external shocks, such as a sudden stop in capital flows or a rise in borrowing costs.

[1] Assumes a 25 percent tariff surcharge on all products traded between China and the United States, combined with a decline in investor confidence, resulting in a 0.5 percentage point drop in global investment to GDP.

TABLE 2.1.1 East Asia and Pacific forecast summary

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

	2016	2017	2018e	2019f	2020f	2021f	Percentage point differences from January 2019 projections: 2019f	2020f	2021f
EMDE EAP, GDP[1]	**6.3**	**6.5**	**6.3**	**5.9**	**5.9**	**5.8**	**-0.1**	**-0.1**	**0.0**
(Average including countries with full national accounts and balance of payments data only)[2]									
EMDE EAP, GDP[2]	6.3	6.5	6.3	5.9	5.9	5.8	-0.1	-0.1	0.0
GDP per capita (U.S. dollars)	5.6	5.8	5.7	5.4	5.3	5.3	0.0	-0.1	0.0
PPP GDP	6.3	6.4	6.3	5.9	5.9	5.8	0.0	0.0	0.0
Private consumption	7.1	6.5	8.1	7.0	7.0	7.0	-0.4	-0.1	-0.2
Public consumption	9.3	7.4	9.4	7.6	7.5	7.4	0.3	0.4	0.3
Fixed investment	6.6	5.3	5.3	5.1	5.1	4.9	-0.2	-0.1	-0.2
Exports, GNFS[3]	2.6	9.4	4.7	3.3	3.9	4.3	-1.4	-0.5	0.0
Imports, GNFS[3]	5.4	7.9	7.8	4.7	5.0	5.7	-1.8	-0.9	-0.1
Net exports, contribution to growth	-0.8	0.4	-0.9	-0.4	-0.4	-0.5	0.1	0.1	0.0
Memo items: GDP									
East Asia excluding China	4.9	5.4	5.2	5.1	5.2	5.2	-0.1	0.0	0.0
China	6.7	6.8	6.6	6.2	6.1	6.0	0.0	-0.1	0.0
Indonesia	5.0	5.1	5.2	5.2	5.3	5.3	0.0	0.0	0.0
Thailand	3.4	4.0	4.1	3.5	3.6	3.7	-0.3	-0.3	-0.2

Source: World Bank.

Note: e = estimate; f = forecast. EMDE = emerging market and developing economies. 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).

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TABLE 2.1.2 East Asia and Pacific country forecasts[1]

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

	2016	2017	2018e	2019f	2020f	2021f	Percentage point differences from January 2019 projections: 2019f	2020f	2021f
Cambodia	7.0	7.0	7.5	7.0	6.9	6.8	0.2	0.1	0.1
China	6.7	6.8	6.6	6.2	6.1	6.0	0.0	-0.1	0.0
Fiji	0.7	3.0	3.2	3.4	3.3	3.3	0.0	0.0	0.0
Indonesia	5.0	5.1	5.2	5.2	5.3	5.3	0.0	0.0	0.0
Lao PDR	7.0	6.9	6.5	6.6	6.7	6.6	0.0	0.0	0.0
Malaysia	4.2	5.9	4.7	4.6	4.6	4.6	-0.1	0.0	0.0
Mongolia	1.4	5.4	6.9	7.2	6.9	6.2	0.6	0.6	0.0
Myanmar	5.9	6.8	6.2	6.5	6.6	6.8	0.0	0.0	0.0
Papua New Guinea	4.1	2.3	-0.3	5.6	3.1	3.5	0.5	0.0	0.1
Philippines	6.9	6.7	6.2	6.4	6.5	6.5	-0.1	-0.1	-0.1
Solomon Islands	3.3	3.0	3.5	2.9	2.8	2.7	0.0	0.0	0.0
Thailand	3.4	4.0	4.1	3.5	3.6	3.7	-0.3	-0.3	-0.2
Timor-Leste[2]	5.1	-3.5	-0.7	3.9	4.6	5.0	0.6	-0.3	0.0
Vietnam	6.2	6.8	7.1	6.6	6.5	6.5	0.0	0.0	0.0

Source: World Bank.

Note: 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.

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