

WEATHERING GROWING RISKS

Weathering Growing Risks

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| | |
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| ADB | Asian Development Bank |
| AIC | African Island countries |
| AML/CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| ASEAN | Association of Southeast Asian Nations |
| bbl | Per Barrel |
| BRF | Belt and Road Forum |
| BRI | Belt and Road Initiative |
| CBPR | Cross-Border Privacy Rules |
| CBRs | Correspondent Banking Relationships |
| CCICED | China Council for International Cooperation on Environment and Development |
| CGIAR | Consultative Group on International Agricultural Research |
| CIC | Caribbean Island countries |
| CIF | Consolidated Investment Fund |
| CPI | Consumer Price Index |
| CPI | Corruption Perceptions Index |
| CPTPP | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| CSP | Concentrating Solar Power |
| DSA | Debt Sustainability Analysis |
| E&E | Electronics and Electrical |
| EBRD | European Bank of Reconstruction and Development |
| ECB | European Central Bank |
| EMDE | Emerging Market and Developing Economy |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FTTH | Fiber to the Home |
| FX | Foreign Exchange |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GHG | Greenhouse Gas |
| GIN | Global Innovation Network |
| GVC | Global Value Chains |
| ICOR | Incremental Capital-Output Ratios |
| ICT | Information and Communication Technology |
| IFC | International Finance Corporation |
| IFI | International Financial Institution |
| IMF | International Monetary Fund |
| IRENA | International Renewable Energy Agency |

| | |
|--------|--|
| IRRI | International Rice Research Institute |
| ITU | International Telecommunications Union |
| LPI | Logistics Performance Index |
| m/m | Month-on-Month |
| MLEC | Model Law on Electronic Commerce |
| MTO | Money Transfer Operator |
| NBS | Chinese National Bureau of Statistics |
| NDC | Nationally Determined Contributions |
| OECD | Organisation for Economic Co-operation and Development |
| OPEC | Organization of the Petroleum Exporting Countries |
| PBOC | People's Bank of China |
| PDR | People's Democratic Republic |
| PIC | Pacific Island countries |
| PMI | Purchasing Managers' Index |
| PPG | Publicly Guaranteed Debt |
| Q1 | First Quarter |
| Q2 | Second Quarter |
| Q3 | Third Quarter |
| Q4 | Fourth Quarter |
| R&D | Research and Development |
| RCEP | Regional Comprehensive Economic Partnership |
| RCM | Rice Crop Manager |
| RERF | Revenue Equalisation Reserve Fund |
| RPC | Regional Processing Centre |
| RPW | Remittance Prices Worldwide |
| SDG | Sustainable Development Goal |
| SME | Small and Medium-sized Enterprise |
| SOE | State-Owned Enterprise |
| SRI | Sustainable and Responsible Investment |
| STEP | Skills Toward Employment and Productivity |
| TSF | Tuvalu Survival Fund |
| TTF | Tuvalu Trust Fund |
| TVET | Training and Vocational Education |
| UMIC | Upper Middle-Income Countries |
| UNCTAD | The United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| UNESCO | United Nations Educational, Scientific and Cultural Organization |
| y/y | Year-on-Year |

List of Abbreviations continued

| <i>Regions, World Bank Classification and Country Groups</i> | |
|--|---------------------------------|
| EAP | East Asia and Pacific |
| ECA | Eastern Europe and Central Asia |

| | |
|-----|---------------------------------|
| LAC | Latin America and the Caribbean |
| MNA | Middle East and North Africa |
| SAR | South Asia |
| SSA | Sub-Saharan Africa |

| <i>Country Abbreviations</i> | |
|------------------------------|----------------------------------|
| AUS | Australia |
| BRA | Brazil |
| BRN | Brunei Darussalam |
| CAN | Canada |
| CHN | China |
| FJI | Fiji |
| FSM | Federated States of Micronesia |
| IDN | Indonesia |
| IND | India |
| JPN | Japan |
| KHM | Cambodia |
| KIR | Kiribati |
| KOR | Republic of Korea |
| LAO | Lao People's Democratic Republic |
| MEX | Mexico |
| MNG | Mongolia |
| MMR | Myanmar |

| | |
|-----|----------------------------------|
| MYS | Malaysia |
| NRU | Nauru |
| PHL | Philippines |
| PLW | Palau |
| PNG | Papua New Guinea |
| RMI | Republic of the Marshall Islands |
| RUS | Russia |
| SGP | Singapore |
| SLB | Solomon Islands |
| THA | Thailand |
| TLS | Timor-Leste |
| TON | Tonga |
| TUR | Turkey |
| TUV | Tuvalu |
| UK | United Kingdom |
| USA | United States |
| VNM | Vietnam |
| VUT | Vanuatu |
| WSM | Samoa |

| <i>Currency Units</i> | |
|-----------------------|-----------------------|
| A\$ | Australian dollar |
| \$NZ | New Zealand dollar |
| B | Thai baht |
| CR | Cambodian riel |
| D | Vietnamese dong |
| F\$ | Fiji dollar |
| K | Myanmar kyat |
| K | Papua New Guinea kina |

| | |
|------|---------------------------|
| Kip | Lao kip |
| ₱ | Philippine peso |
| RM | Malaysian ringgit |
| RMB | Chinese renminbi |
| Rp | Indonesian rupiah |
| SIS | Solomon Islands dollar |
| Tog | Mongolian tugrik |
| US\$ | Timor-Leste (U.S. dollar) |
| US\$ | United States dollar |

Preface and Acknowledgments

East Asia and Pacific Economic Update is a joint product of the World Bank office of the Chief Economist, East Asia and Pacific Region, and the Macro Economics Global Prospects Group prepared in collaboration with the Poverty and Equity Global Practice, Prospects Group, and the Finance and Markets Global Practice. The report was prepared by Ergys Islamaj (Co-Task Team Leader) and Kevin Chua (Co-Task Team Leader), under the guidance of Andrew Mason (Acting Chief Economist, East Asia and Pacific Region). Ndiamé Diop, Aaditya Mattoo, Deepak Mishra, Hassan Zaman, and Salman Zaidi provided valuable advice to the team.

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Preface continued

Throughout the report, geographic groupings are defined as follows:

Developing East Asia and Pacific comprises Cambodia, China, Indonesia, Lao People's Democratic Republic (PDR), Malaysia, Mongolia, Myanmar, Papua New Guinea, the Philippines, Thailand, Timor-Leste, Vietnam, and the Pacific Island Countries.

The **Pacific Island Countries** comprise Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

The **ASEAN** member countries comprise Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

The **ASEAN-5** comprise Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

This report is based on data available through October 4, 2019, inclusive.

Executive Summary

Regional growth decelerated in the first half of 2019. Growth in developing East Asian and Pacific economies slowed to 6.0 percent year-on-year in the first half of 2019 from 6.5 percent in the first half of 2018. The slowdown reflected a broad-based decline in export growth and manufacturing activity. Weakening external demand combined with global trade policy uncertainty have been weighing on the regional activity through declining exports, deteriorating business confidence, and weakening investment. In China, heightened trade tensions with the United States have contributed to the gradual economic slowdown. Growth in the region's other large economies has also moderated and the recovery in manufacturing observed at the beginning of the year proved to be short-lived. Growth in the smaller economies in the region picked up in the first half of 2019, reflecting their relatively weak global economic linkages, and robust growth in the tourism, real estate, and extractive sectors. Despite the overall deceleration, the region remains a key driver of global economic activity, due to its strong fundamentals, accounting for over one-third of global growth.

Exports growth declined sharply amid weak global demand and trade policy uncertainty. Global growth decelerated in the first half of 2019, reflecting moderation of economic activity in major economies, including China, India, Euro Area, and the United States. Sluggish global growth against the backdrop of heightened global trade policy uncertainty has led to weaker global demand and a sharp decline in export growth. The slowdown in exports has been broad-based, but the emerging market and developing economies (EMDEs) in East Asia and the Pacific, including China, have been particularly affected. Global activity has remained subdued in the third quarter of 2019, with continued deterioration. Business confidence and trade indicators point to further weakness, with September data showing new export orders contracting for twelve successive months.

Investment growth has slowed in many of the region's large economies. The sharp slowdown in exports and the uncertainty created by the escalating trade disputes between China and the United States affected the investment behavior of firms in export-oriented industries leading to a slowdown in aggregate investment growth. In China, the slowdown in investment was largely driven by weaker private investment growth. In Malaysia, increased uncertainty weighed on business confidence which, together with a review of major infrastructure projects and near completion of several multi-year projects, led to the first decline in investment in nearly four years in the first two quarters of 2019. In the Philippines, the delayed approval of the 2019 national government budget and the public spending ban during the election period tempered public investment, while uncertainties around the tax reform program and the external environment slowed private investment. Political uncertainty in Thailand also delayed decision-making and weighed down public investment.

Global economic conditions remain fragile with significant downside risks. Global growth is expected to dip to 2.5 percent in 2019, down from 3.0 percent in 2018, reflecting broad-based weakness in advanced economies and in major EMDEs. Growth in advanced economies is projected to moderate from 2.2 percent in 2018 to 1.5 percent on average in 2019–21, while growth in EMDEs is projected to slow to 3.7 percent in 2019, from 4.3 percent in 2018, before recovering to 4.3 on average in 2020–21 as previous headwinds in some key EMDEs ease. This forecast is predicated on the waning impact of earlier financial pressures currently weighing on activity in some large EMDEs, including Argentina and Turkey, and assumes no major deterioration in global conditions.

Growth in developing East Asia and Pacific economies is projected to decelerate over the forecast horizon.

Regional growth is projected to decline from 6.3 percent in 2018 to 5.8 percent in 2019, and to 5.7 and 5.6 percent in 2020 and 2021, respectively. Growth projections have been downgraded from the April 2019 EAP Economic Update for the majority of the region's economies. Downside risks identified in April 2019, including the protracted trade tensions, weaker global demand, and a slowdown of manufacturing activities, have materialized or intensified. China's growth is projected to ease to 6.1 percent in 2019, and further to 5.9 percent in 2020 and 5.8 percent in 2021, reflecting rising structural constraints including a shrinking labor force, diminishing returns to investment and weak productivity growth amid less benign external conditions. Growth in the other large economies will decline in 2019, but some are expected to recover in succeeding years, while growth in the small economies is projected to pick up slightly in 2019 reflecting idiosyncratic conditions.

As growth moderates, the pace of poverty reduction will also slow. The 2019 estimate of the poverty rate in developing East Asia and the Pacific, measured using the Upper-middle Income Class (UMIC) poverty threshold (US\$5.5/day 2011PPP), has been revised upward to 24.0 percent, compared with 23.7 percent in the April 2019 EAP Economic Update. This translates into an additional 6.6 million people in developing East Asian and Pacific countries predicted to remain below the UMIC poverty threshold, based on the latest growth projections compared with April 2019 estimates. UMIC poverty rates in 2020 and 2021 are estimated to be 0.6 and 0.8 of a percentage point higher, respectively, than April estimates had suggested.

Downside risks to the region's growth prospects have intensified. First, increasing trade tensions between China and the United States could lower regional growth further, as trade remains sluggish and heightened uncertainty weighs on investment growth. A protracted trade dispute could lead to a reconfiguration of the global trade landscape that would entail both risks and opportunities for the region's developing economies. Global value chains are relatively inflexible, however, limiting the potential benefits for neighboring countries in the short run. While companies are already searching for ways to avoid U.S. tariffs by either moving entire production lines out of China or complementing existing operations with production in other countries, developing East Asian and the Pacific countries face limited absorptive capacity due to their relatively small size and inadequate infrastructure. Therefore, other countries in the region are unlikely to replace China in global supply chains in the short to medium term.

Second, a sharper-than-expected slowdown in China, the Euro Area, and the United States, as well as a disorderly Brexit, could further decelerate global activity. A downturn in global growth would lead to lower overall demand for exports from developing East Asian and Pacific countries that would hamper growth. A simultaneous, sharp slowdown could also substantially lower commodity prices, negatively affecting commodity exporters. Smaller economies in the region are especially dependent on commodity exports, and tourists and direct investments from China. Besides the growth slowdown, a disorderly Brexit could weaken the trade link between the region and the United Kingdom, with some smaller economies in the region potentially losing preferential access and facing much higher tariff rates to enter the U.K. market.

Third, the region remains vulnerable to the risk of an abrupt change in global financial conditions. Unanticipated developments in recent months, including the on-and-off trade disputes, geopolitical tensions, and fears of recession, have brought a return of financial market volatility. Emerging market currencies are again under pressure as investors rebalance their portfolios with traditional safe-haven assets such as U.S. Treasuries. Higher bond yields, and consequently higher borrowing costs, could dampen credit growth and further weigh on private investment and economic growth in the region. In addition, crises in other countries, such as in Argentina, could re-ignite fears of contagion and lead to sharp reversals in capital inflows.

Fourth, high and rising debt levels in some economies constrain fiscal and monetary policies. Economies with high domestic debt face the prospect of further debt accumulation from the easing of interest rates. In China, policymakers' reliance on credit to support growth may worsen domestic risks by adding more leverage to the already highly-leveraged corporate and household sectors. High household debt in Malaysia and Thailand has encouraged central banks to use macroprudential measures specifically to target and manage household debt growth.

How can EAP countries weather growing risks? Where policy space is available, countries should prudently use policy tools to support economic growth. Amid weak private investment and external demand, countries with fiscal space can expand their fiscal programs to stimulate the domestic economy. There is scope to increase public spending, especially on growth-enhancing infrastructure projects in some economies (e.g., Cambodia, Indonesia, Myanmar, the Philippines, Thailand), given their relatively low public debt ratios. While the current low-interest rate environment presents an opportunity to borrow for public investment projects, countries must strike a balance between taking advantage of low interest rates and avoiding excessive debt accumulation. While some economies have space to lower interest rates and cut reserves ratios to support economic growth, central banks should use monetary policy prudently, lest they exacerbate already over-leveraged household or private sectors.

In the face of pressure to expand spending, it will be important to improve the quality of spending and guard fiscal sustainability. Managing expenditures requires budget discipline and a focus on directing scarce budget resources toward effective priority programs. Budget tools, such as medium-term expenditure frameworks and integrated financial information systems, can provide useful information to support sound decision-making. At the same time, effective public investment management is needed to ensure that projects are delivered on time, on budget, and with quality. Moreover, strengthening coordination across government institutions can help improve the efficiency of project implementation. Countries should also consider new revenue and better tax administration measures to boost government revenues in their efforts to ensure fiscal sustainability.

Pacific Island countries (PICs), in particular, need to prudently manage and control expenditures within their medium-term revenue envelopes. Enhancing public investment management and expenditure efficiency is even more important for the PICs, where revenues are subject to frequent shocks. PICs face substantial risks of declines in revenue growth, including through the depletion of fishery and forestry resources, as well as through the anticipated expiration of Compact-associated grants and programs to the North Pacific islands in fiscal years 2023 and 2024. It is thus important to save windfall gains, build up sovereign wealth funds, and consolidate and mobilize domestic revenues, including through efforts to develop growing industries such as fisheries and tourism. Managing natural resources while safeguarding the environment is a priority if the PICs are to increase resource revenues in a sustainable manner.

Developing sound debt management strategies will be important to governments managing risk exposure from their debt portfolios. Developing debt management strategies would help governments manage variations in debt servicing costs and roll-over risks, support fiscal and monetary policy, and reduce macro-financial risk. Such strategies may include the use of macroprudential regulations to help address the high and rising debt levels. Central banks must be focused on their approaches, implementing strict liquidity coverage, capital adequacy, and appropriate loan-to-value and debt-to-income limits. Supporting banks in their assessment of borrowers, including through the collection of data on households' assets and liabilities, would help the region's governments to monitor for signs of distress in the financial sector.

As the China-United States trade disputes dampen global trade, countries in the region should focus on deepening regional integration. Two options include concluding the Regional Comprehensive Economic Partnership (RCEP), which would bring together the ASEAN countries and six Indo-Pacific states, and expanding the membership of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) to include other developing East Asian and Pacific countries. These international trading platforms are opportunities to raise productivity growth by addressing the remaining barriers to trade in goods and services and enhancing policy predictability. Closer economic integration can help the ASEAN bloc achieve its own target of a single economic market—the ASEAN Economic Community, or AEC—by 2025.

In the medium to long run, structural reforms that raise competitiveness, enhance trade and investment, and encourage innovation are needed to boost productivity and growth. Potential growth is expected to fall across the developing East Asia and Pacific region over the next decade, due to the declining pace of capital accumulation and, in some economies, due to an aging population. Enhancing total factor productivity would increase long-term economic growth in a sustainable manner. This can be achieved through regulatory reforms that improve the ease of doing business, helping to raise competitiveness, and enhanced trade and investment climate that not only facilitates the movement of goods and capital but also of technology and know-how. The current global economic slowdown, coupled with rising risks, only increases the urgency of undertaking such reforms.



Part I. Recent Developments and Outlook

I.A. Recent Developments

Growth in the developing East Asia and Pacific region slowed in the first half of 2019 given weakening global demand and heightened policy uncertainty amid ongoing trade tensions. Steady consumption growth helped to partly offset the effects of weakening exports and investment on growth. Many countries, including China, have stepped up their fiscal and monetary policy support measures to counter trade-related headwinds. Despite a widespread easing of monetary policy, including by the U.S. Federal Reserve and other major central banks, the regional financial markets have been volatile. Extreme poverty in East Asia and the Pacific continues to decline. However, in recent years, income growth at the bottom of the distribution has been lower than at the top in some East Asian and Pacific countries.

Regional growth slowed amid weakening global demand and heightened trade policy uncertainty

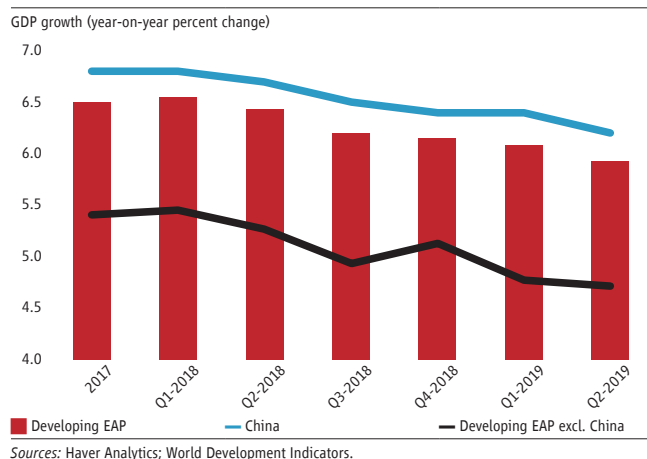
Global growth is expected to slow to 2.5 percent in 2019. The global economy has continued to falter. Growth in several major economies, including China, India, and the United States, has slowed. A number of other large economies, including Brazil, Germany, the Russian Federation, and the United Kingdom, experienced negative per capita growth in recent quarters. Reflecting the sluggish global growth, global trade in goods contracted 1.4 percent in June (year-on-year). The slowdown in trade has been broad-based, but emerging market and developing economies (EMDEs) in East Asia and the Pacific, including China, have been particularly affected. Incoming data suggest global activity remains subdued in the third quarter of 2019, with sustained deterioration in both business confidence and the global manufacturing purchasing managers' index (PMI). Trade indicators also point to further weakness, with September data showing new export orders contracting for twelve successive months. While the services sector had been more resilient earlier in the year, activity has begun to slow down in tandem with declining consumer confidence and retail sales growth.

Global trade policy uncertainty induced by China-United States trade tensions is exacerbating the impact of weakening global demand on business confidence and investment growth. The United States and China have increased tariffs further on each other's products, to the extent that virtually all of their bilateral trade is now subject to tariffs. These abrupt changes in the rules of global commerce are contributing to elevated global policy uncertainty, leading to weakening business confidence and investment growth. In response to weakening activity and generally low inflation, central banks around the world, including the U.S. Federal Reserve and the ECB, have loosened monetary policy, helping push global yields to extremely low levels, with yields on some advanced economy bonds reaching negative values. Prospects of persistently low monetary policy rates alongside weak investment growth are lowering global yields, while elevated policy uncertainty raises fears of a global recession.

Developing East Asia and Pacific (EAP) region economies are at the epicenter of these adverse global developments. Regional exports have declined sharply, and investor confidence across the region has weakened. The resilience of the region is being tested in the face of challenging global conditions. The region is experiencing a broad-based deceleration. Regional growth declined from 6.5 percent year-on-year in the first half of 2018 to 6.0 percent in the first half of 2019, with growth decelerating in all the major developing economies of the region (Figure I.A.1). Trade tensions with the United States weighed down on China's economic activity speeding up its ongoing gradual slowdown. Most of the other major regional economies have also experienced a moderation in activity. Growth in the

smaller economies, however, remained robust, reflecting relatively weak global spillovers. In the region excluding China, consumption growth remained steady, albeit slightly lower than the same period last year, supported by accommodative monetary and fiscal policies. Export growth, however, declined due to weakening external demand, including from China. Election-related uncertainties in Indonesia and Thailand, and the delayed passage of the national budget in the Philippines resulted in weaker investment growth in early 2019. Monetary policy loosening, benign financial conditions related to external push factors and fiscal spending in some countries helped weather the decrease in exports and investment growth. Despite the overall downturn, the region remains a key driver of global economic activity, accounting for over one-third of global growth, with China contributing the lion's share.

Figure I.A.1. Growth in developing EAP moderated in the first half of 2019



Leading indicators suggest that the slowdown has continued in recent months. The manufacturing Purchasing Managers' Index (PMI) shows that activity in almost all major region's economies softened against the backdrop of escalating trade tensions in recent months (Figure I.A.2). Sluggish growth in the manufacturing sector reflects an uncertain global trade policy environment, and weakening global demand and investment. New export orders have contracted to a six-year low, while activity in the services sector has begun to slow down in tandem with declining consumer confidence and retail sales growth in many East Asian and Pacific countries (see Box I.A.1)

Box I.A.1. Recent Global Developments

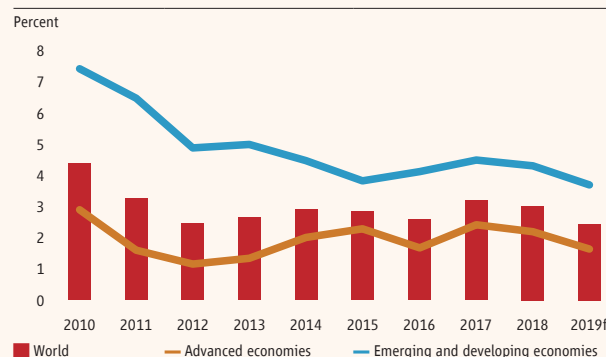
Global growth has been declining in 2019 (Figure BI.A.1.1). Incoming data suggest activity has remained subdued in the third quarter of 2019, with a sustained deterioration in both business confidence and the global manufacturing PMI (Figure BI.A.1.2). Global industrial production slowed to 1.1 percent (y/y) in September, its slowest pace since December 2015. Consumer sentiment and services activity is also slowing. Inflation in advanced economies has fallen further below targets, contributing to major central banks implementing more accommodative monetary policy. Unpredictable changes in the rules of global commerce are contributing to elevated policy uncertainty, slowing international trade, reduced business confidence, and weak investment. Global uncertainty is also being exacerbated by the Brexit process.

Activity is slowing markedly in major economies. In the United States, growth decelerated to 2.0 percent in the second quarter of 2019 (q/q saar), amid moderating investment and exports. In light of muted inflation and rising risks from the external environment, the U.S. Federal Reserve lowered the target range for the federal funds rate by 25 basis points in both July and September. The Euro Area economy remains weak, with much of this

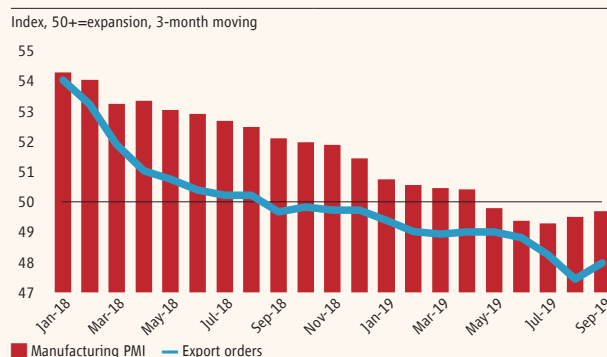
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(Box I.A.1 continued)

weakness stemming from the German industrial sector. GDP growth in the Euro Area declined to 0.9 percent in the second quarter of 2019 (q/q saar), while the German economy contracted by 0.3 percent due to falling exports. The U.K. economy contracted by 0.8 percent in the second quarter of 2019 (q/q saar), its worst performance since the 2007–09 global financial crisis amid broad-based weakness. The country is scheduled to exit the European Union on October 31, and currently has no agreement in place to avoid a potentially costly no-deal Brexit.

Figure BI.A.1.1. Global economic growth, 2010–19

Sources: Haver Analytics, World Bank.

Figure BI.A.1.2. Global manufacturing activity, 2018–19

Recent indicators point to sluggish growth in EMDEs. EMDEs continue to experience broad-based weakness in industrial production and exports in the second half of the year. Services activity, which had until recently remained resilient, has also slowed despite supportive policies. All major EMDEs are moderating or slowly rebounding from a sharp deceleration in activity over the past few quarters. In China, growth decelerated to 6.2 percent (y/y) in the second quarter of 2019 because of weakening manufacturing activity and exports. In India, growth has softened, reflecting a broad-based slowdown in domestic demand amid tight credit conditions. Activity remains weak in a number of large commodity exporters, including Brazil, Russia, and South Africa.

Global trade continues to show broad-based weakness. Global trade in goods contracted 0.4 percent in June. Cyclical headwinds and sustained trade policy uncertainty continued to weigh on global trade growth in the third quarter of 2019. Weak global manufacturing activity and the steady deceleration of new export orders into July point to slowing momentum in Q3. The slowdown has been broad-based but EMDEs in East Asia and the Pacific, including China, have been particularly affected. The United States and China have recently announced tariffs on close to all remaining bilateral trade. Although negotiations between the two countries continue, prospects of a lasting trade agreement are dim. Recent developments are expected to weigh on activity in both economies and could also have severe repercussions for the global economy. Tensions have also escalated elsewhere, such as between Japan and the Republic of Korea. The ratification of MERCOSUR countries (Argentina, Brazil, Paraguay, and Uruguay) may also be delayed by policy disagreements.

Global financing conditions have eased further. Persistently low inflation, softening global economic prospects, and heightened downside risks have prompted additional monetary easing by central banks around the world,

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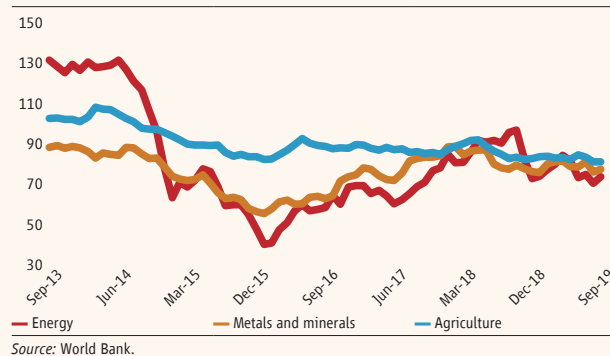
most notably by the U.S. Federal Reserve and the European Central Bank (ECB). Bond yields have dropped substantially in recent months. The stock of negative-yielding bonds peaked at US\$17 trillion, about 30 percent of global debt, before declining to US\$13 trillion more recently. The decline has followed a widespread easing of monetary policy and market expectations of more to come, as well as flight to safety.

EMDE financing conditions have been volatile. Despite low international borrowing costs, demand for EMDE assets cooled substantially on trade and policy uncertainty, heightened volatility at the global financial markets, renminbi depreciation, and slowing global activity. Following a strong rebound at the start of the year, in August, capital flows to emerging markets saw the biggest monthly outflow since late 2016. Equity prices and currencies weakened across EMDEs, while Argentina—where currency depreciated by almost 30 percent and equity markets fell by over one-third since July—had to impose capital controls and defer debt repayments to stem capital flight. Nevertheless, a shift toward a more accommodative policy stance in the United States helped contain the appreciation of the U.S. dollar and allowed several large EMDEs with subdued inflation to cut policy rates in the second half of 2019.

The prices of most commodities fell in 2019, reflecting the deterioration in the global growth outlook. Commodity markets have been volatile, especially during periods of escalating trade tensions. Oil prices rose in the first half of 2019, supported by supply constraints as OPEC and its partners, including Russia, agreed to extend their production cuts. Supply concerns have been exacerbated by geopolitical tensions in the Middle East. In the second half of the year, supply issues have been outweighed by concerns about slowing global growth and growing trade tensions, resulting in prices trending downward, with Brent falling below US\$60/bbl. More recently, oil prices posted a sharp temporary increase due to fears of a prolonged supply disruption following attacks on an important oil processing center in Saudi Arabia.

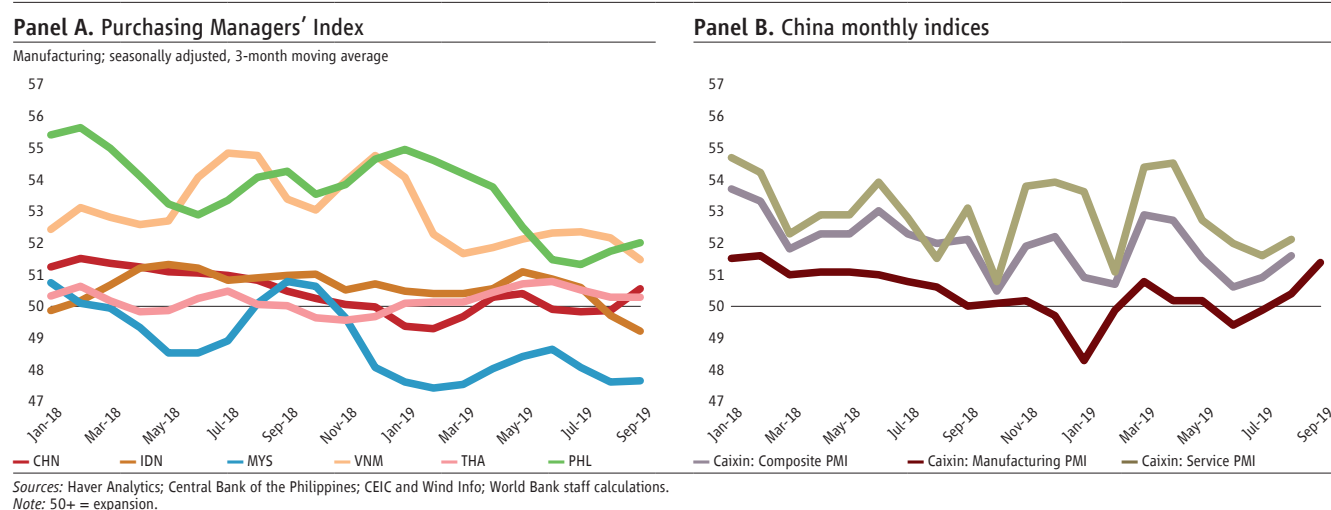
Oil prices are forecast to decline slightly from 2018 levels, to an average of US\$60/bbl in 2019 and 2020. Similarly, supply bottlenecks for metals, including copper, nickel, lead, and zinc, supported prices in the first half of 2019. Although iron ore prices have continued to rise amid ongoing supply concerns, other base metals have declined, partly reflecting the re-escalation of trade tensions. Prices for copper dropped to a two-year low and soybean prices also fell following renewed trade tensions between the United States and China. In contrast, other agricultural prices, particularly grains, rose on worries that poor weather for some major producers may reduce harvests, but fell in the second half of 2019 amid improved conditions, balancing ongoing trade concerns. Agricultural prices are forecast to remain broadly flat in 2020 (Figure BI.A.1.3).

Figure BI.A.1.3. Commodity price indices



China's economic growth slowed in the first half of 2019. Growth moderated to 6.3 percent year-on-year in the first half of 2019 from 6.8 percent in the first half of 2018, reflecting weaker exports and private investment growth. The growth moderation has been broad-based, with slowdowns across industries such as car manufacturing, real estate, and wholesale and retail trade. In August, industrial production growth fell to the lowest level in the past seven years, suggesting that the escalating trade disputes are adversely affecting production activities. High-frequency indicators point to a continued deceleration of activity in recent months, with both the manufacturing and services Purchasing Managers' Indices (PMI) falling in the summer months despite earlier stimulatory policy initiatives.

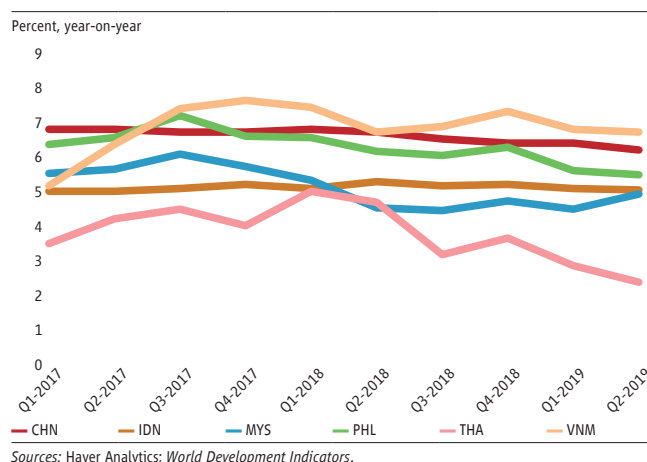
Figure I.A.2. Manufacturing activity softened in most major economies in the region



Growth in most of the region's other larger economies also declined in the first half of 2019 (Figure I.A.3).

The growth variation was wide across the region's other larger economies, ranging from 2.6 percent in Thailand to 6.8 percent in Vietnam in the first half of 2019. Growth declined in Thailand mainly due to weaker net exports, and the delayed public investment resulting from the lack of decision-making following the late election results, while growth rates in Indonesia, Malaysia, and the Philippines were dragged lower by weaker investments. While Malaysia and Vietnam experienced some gains from trade diversion for the products under tariff following the China-United States trade disputes, their total exports growth declined amid the weak global demand.¹ Private consumption growth remained supportive to growth in the region's larger economies, helped by increased public spending prior to elections in Indonesia and Thailand, inflation moderation and supportive monetary policy in the Philippines, and rising employment and incomes in Malaysia.

Figure I.A.3. Growth softened in most of the region's largest economies



¹ Malaysia's exports of tariff-affected products to the United States and China have increased in value by more than US\$1 billion since the tariffs were imposed, while the value of Vietnam's exports to the United States grew by about 35.8 percent year-on-year in the first five months of 2019, accounting for about a fifth of the country's total export earnings.

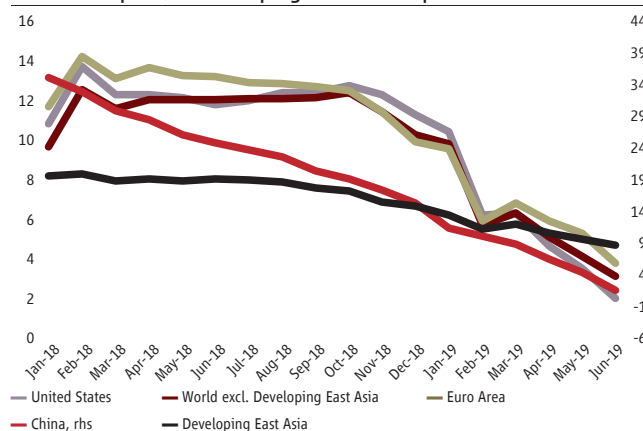
Central to the region's economic slowdown is the sharp deterioration in trade

Regional export growth sharply declined in the first half of 2019 amid elevated trade policy uncertainty. Exports growth declined in the developing East Asia and Pacific region, and this slowdown was broad-based across trading partners (Figure I.A.4). Vietnam, in particular, faced a reduced net trade surplus arising from generally weaker foreign demand, which offset the short-term gains from trade diversion. Imports growth also weakened, reflecting a decline in trade in intermediate products and weaker investment growth across the region.² While exports and imports growth contracted across most of the large economies, differing paces of contraction resulted in mixed current account performances in the first half of 2019. In China, the general weakness in domestic demand and in processing trade, and possibly import substitution, resulted in import contraction which, together with slower but still positive export growth, led to a current account surplus in the first half of 2019. Indonesia's deficit in the first half of 2019 increased from the first half of 2018 on the back of large imports of raw materials and capital goods needed for infrastructure investments, while the Philippines' deficit increased on the back of export contraction driven by a slowdown in electronics, its main export product. In Malaysia, the current account surplus widened in the first half of 2019, with imports of goods and services contracting more than exports, while in Thailand the current account surplus narrowed as exports contracted more than imports.

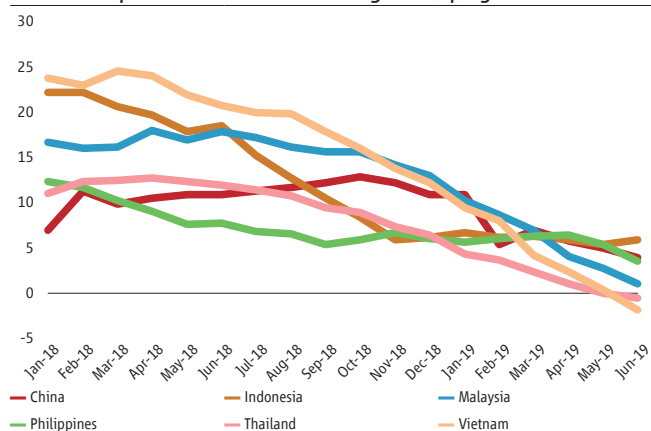
Figure I.A.4. Exports growth deteriorated in line with the moderation in global trade

Exports value growth (12-month moving average, year-on-year percent change)

Panel A. Exports of developing East Asia to partner countries



Panel B. Exports to the world excluding developing East Asia



Sources: IMF Direction of Trade Statistics; Haver Analytics; World Bank staff calculations.

Note: Developing East Asia includes Cambodia, China, Indonesia, Lao PDR, Malaysia, Mongolia, the Philippines, Thailand, and Vietnam.

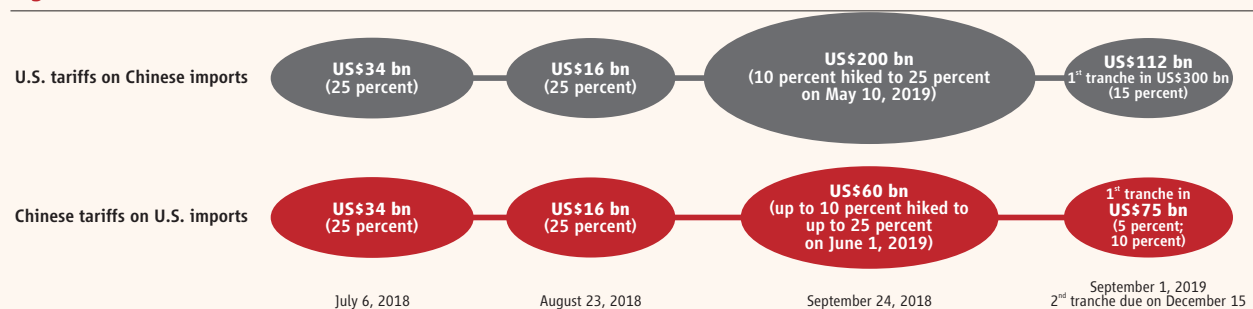
The uncertainty related to global trade continued. After some easing of trade tensions between the United States and China at the G20 summit in June, the announcement in August of another 10 percent tariff increase on China's imports from the United States led to renewed trade policy uncertainty, only to again subside with the postponement of its intended implementation in September. Tensions, however, further escalated with China declaring tariffs on US\$75 billion of U.S. imports, and on U.S. car and auto parts imports. Rising tariffs between the United States and China has become the principal cause for the increased global protection since 2018. These tariffs have depressed the bilateral China-United States trade in affected goods and increased demand for substitutes from other countries, significantly disrupting global supply chains (see Box I.A.2).

² Some governments actively took steps to limit imports. For example, Indonesia increased the withholding tax rate on over one thousand imported consumer goods, mandated the use of biodiesel to reduce dependency on imported fuel, and prioritized the use of local crude oil production for domestic demand. In some economies of the region, imports contracted faster than exports.

Box I.A.2. Implications of the China-United States Trade Tensions on Trade of Developing East Asian Countries¹

The rising tariffs between the United States and China are the principal cause of the increased global protection since 2018. Tit-for-tat tariffs between China and the United States implemented in 2018 affected 2.0 percent of world merchandise trade in 2018, or more than half of the 3.8 percent of world merchandise trade affected by tariffs. These tariffs have already depressed China-United States bilateral trade in the affected goods and increased demand for substitutes from other countries. They are likely to significantly disrupt global supply chains.² The largest effects of trade tensions, however, are likely to be driven by firms delaying investments because of uncertainty over market access and the negative impacts of trade tensions on economic growth.

Figure BI.A.2.1. A timeline of China-United States trade tensions



Source: World Bank.

The tariffs already in effect imposed by the United States and China against each other cover most of their bilateral trade. Beginning in July 2018, the United States and China introduced tariffs covering an increasing share of their bilateral trade (Figure BI.A.2.1).³ Pending new rounds of negotiations, a few concessions were granted, but new tariff increases have been scheduled for December 15 and the threat of further ones remains. From January to July 2019, U.S. imports from China (as reported by the United States) and China's imports from the United States (as reported by China) of tariff-affected products were respectively 25 and 35 percent lower than in the corresponding period in 2018. In contrast, U.S.-China bilateral trade of products not affected by tariffs remained broadly stable or declined by much less.

Trade has diverted amid escalating China-United States trade tensions.⁴ As bilateral China-United States trade of tariff-affected products has declined, Chinese and U.S. imports of such products from other destinations has grown. Not surprisingly, countries from which China and the United States were sourcing large imports to begin with experienced relatively larger increases in absolute terms (Figure BI.A.2.2).⁵ Developing East Asian exporters also benefited: Vietnam and Malaysia feature among the top five beneficiaries in Chinese and U.S. markets, respectively, while Cambodia (from the United States) and Mongolia (from China) enjoyed relatively small gains in absolute terms but significant gains relative to their GDP (Figure BI.A.2.2).

(continued)

¹ Prepared by Cristina Constantinescu and Maryla Maliszewska.

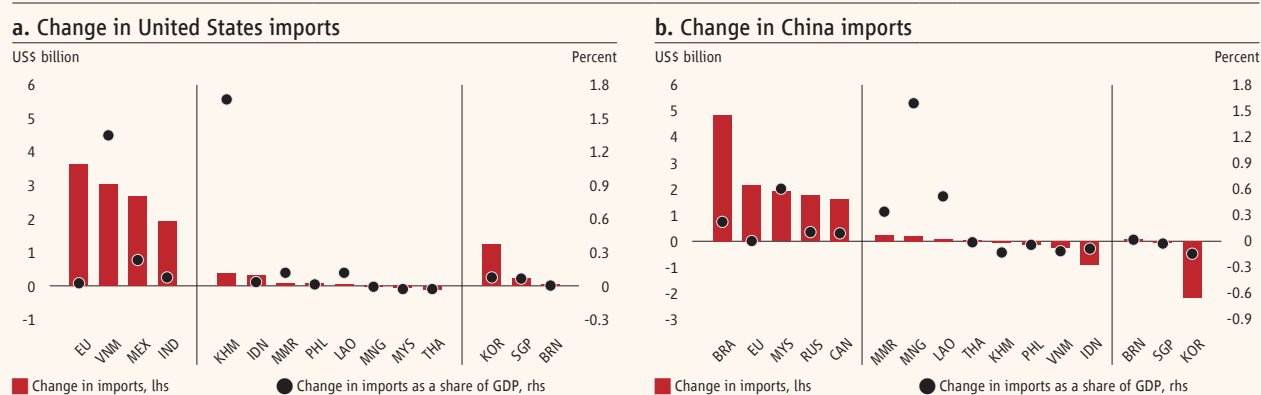
² See Hoshi et al. (2019) for anecdotal evidence that disruption may already be occurring.

³ This analysis does not include the tariffs imposed by the United States on various goods against almost all trading partners earlier in 2018, nor the retaliatory responses from some trading partners, including China.

⁴ See Constantinescu et al. (2019) for further details.

⁵ Note that greater scrutiny is required to establish causality with certainty.

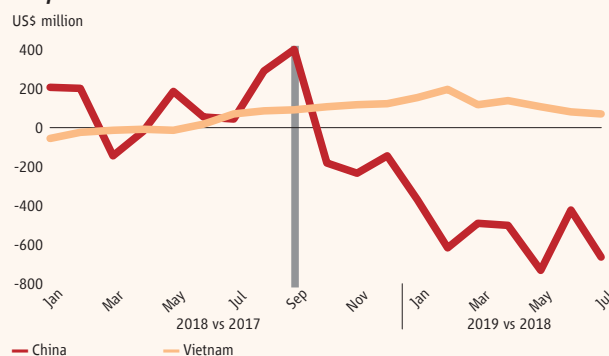
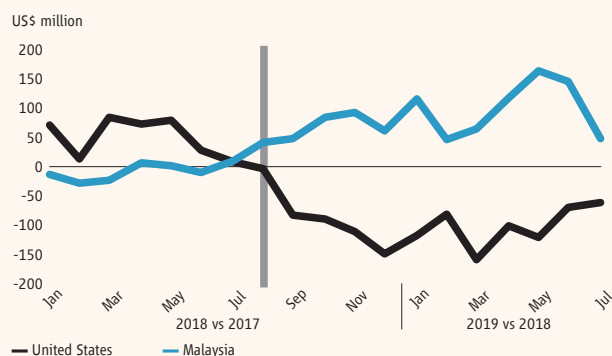
(Box I.A.2 continued)

Figure BI.A.2.2. Change in China and United States imports of tariff-affected products: post tariff period versus pre-tariff period

Sources: U.S. Census Bureau, China Customs Statistics, UN Comtrade and the authors' calculations.

Notes: For imports of products affected by tariffs imposed in July and August 2018, periods being compared are August 2018 to May 2019 with August 2017 to May 2018. For imports of products affected by tariffs imposed in September 2018, periods being compared are January 2019 to May 2019 with January 2018 to May 2018. Calculations exclude products that account for less than 5 percent of GDP in trade with China and the United States.

Developing East Asian countries experienced gains in various products affected by the tariffs between China and the United States. For example, as U.S. imports of communication apparatus (excluding telephones) from China declined following the tariff implementation, Vietnam's sales of such products to the United States increased steadily (Figure BI.A.2.3). Similarly, China's declining imports of copper, and waste and scrap from the United States were accompanied by a surge in such imports from Malaysia since the tariff imposition.⁶

Figure BI.A.2.3. Products with increases in U.S. imports from developing East Asia: year-on-year monthly change**United States imports of communication apparatus excluding telephones****China's imports of copper waste and scrap**

Sources: U.S. Census Bureau and authors' calculations.

Note: Vertical bars denote months when tariffs were imposed on the China-United States bilateral trade of the represented products.

World Bank modeling scenarios point to significant risks if the trade tensions escalate and trigger a reduction in investor confidence.⁷ Under two scenarios limited to tariff increases (Scenario 1: China-United States tariff increases on bilateral trade as of May 2019 covering US\$253 billion of U.S. imports from China and US\$113 billion of Chinese imports from the United States, and Scenario 2: a 25 percent surcharge on all products

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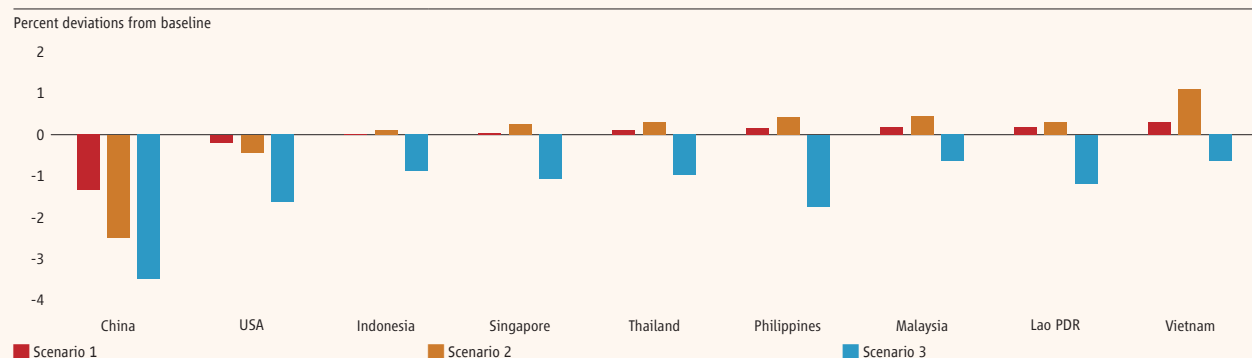
⁶ Other examples include the post-tariff increase in the United States imports of machinery parts and accessories from the Philippines or Malaysia, of automatic data processing machines from Thailand, and of handbags and other cases and containers from Cambodia, Indonesia, and Myanmar, as well as the increase in China's imports of liquefied natural gas from Malaysia and Indonesia, wood pulp from Indonesia and Lao PDR, precious metal ores and concentrates from the Philippines, ethylene polymers from Thailand, and electrical apparatus from Vietnam. During the same period, all these products have experienced a significant drop in the China-United States bilateral trade.

⁷ For details about the global dynamic computable general equilibrium model on which this analysis is based see Freund et al. (2018).

(Box I.A.2 continued)

traded between the United States and China), East Asian countries would be expected to achieve some net gains in terms of exports and income, which translate in welfare benefits (Figure BI.A.2.4). In fact, the direction of changes in trade and sectoral impact so far appears to be consistent with the first scenario. However, if in addition investor confidence declines as a result of the trade war (Scenario 3: a 25 percent tariff on all products traded between the United States and China, plus a 0.5 of a percentage point drop in the investment-to-GDP ratio), the negative impact on countries' exports and imports would heavily outweigh any short-term gains from trade diversion as a result of tariffs alone.

Figure BI.A.2.4. Welfare implications of the trade war

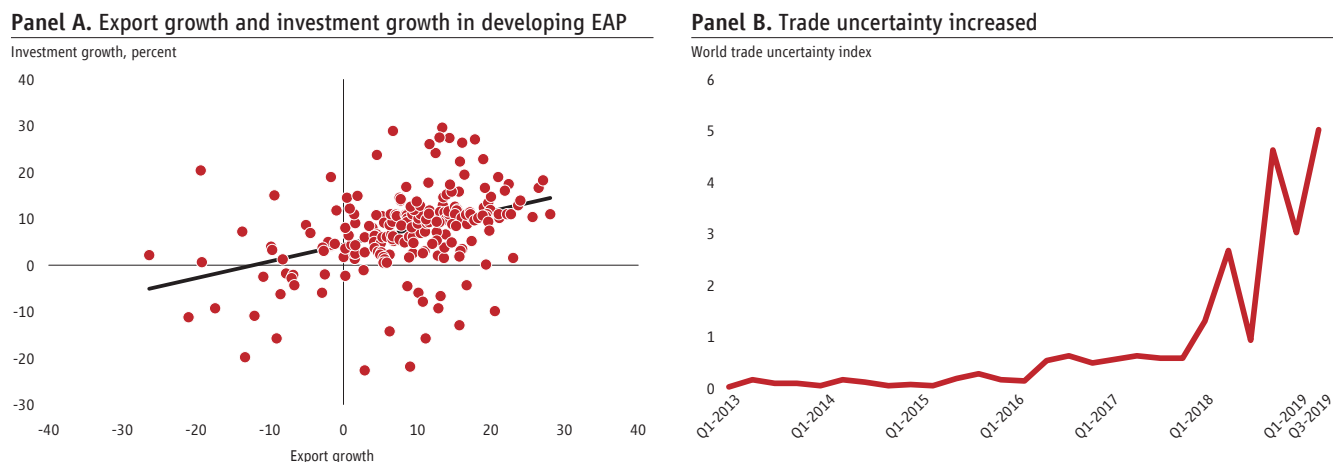


Source: World Bank staff calculations using LINKAGE model and GTAP dataset. Scenario 1: China-United States tariff increases on bilateral trade as of May 2019 covering US\$253 billion of U.S. imports from China and US\$113 billion of China's imports from the United States; Scenario 2: a 25 percent surcharge on all products traded between the United States and China; Scenario 3: a 25 percent tariff on all products traded between the United States and China, plus a 0.5 of a percentage point drop in the investment-to-GDP ratio.

To help mitigate the risks associated with rising trade tensions, East Asian and Pacific countries should redouble their commitment to an open, rules-based international trade and investment system. This system is critical to the efficient allocation of production and the diffusion of technology, having served ASEAN countries well for many years. The deepening of regional integration, through mechanisms such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership, would also help to bolster opportunities. Meanwhile, deeper reform in areas that have tended to see limited coverage under preferential trade agreements, such as public procurement, subsidies, state trading companies, non-tariff measures and treatment of services trade, would help enhance competition and promote the deepening of global value chains.

Weaker trade and trade-related uncertainty dampened investment

Investment in the region mirrored the weakness in the global investment environment. In China, the slowdown in investment was largely driven by weaker private investment growth, while state sector capital spending has rebounded somewhat. In Malaysia, increased uncertainty weighed on business confidence, which together with a review of major infrastructure projects and the near completion of several multi-year projects, led to the first decline in investment in nearly four years in the first two quarters of 2019. Public investment in Thailand expanded tepidly as the implementation of large public infrastructure projects slowed amid the political transition.

Figure I.A.5. Weaker trade weighed on investment growth as uncertainty increased

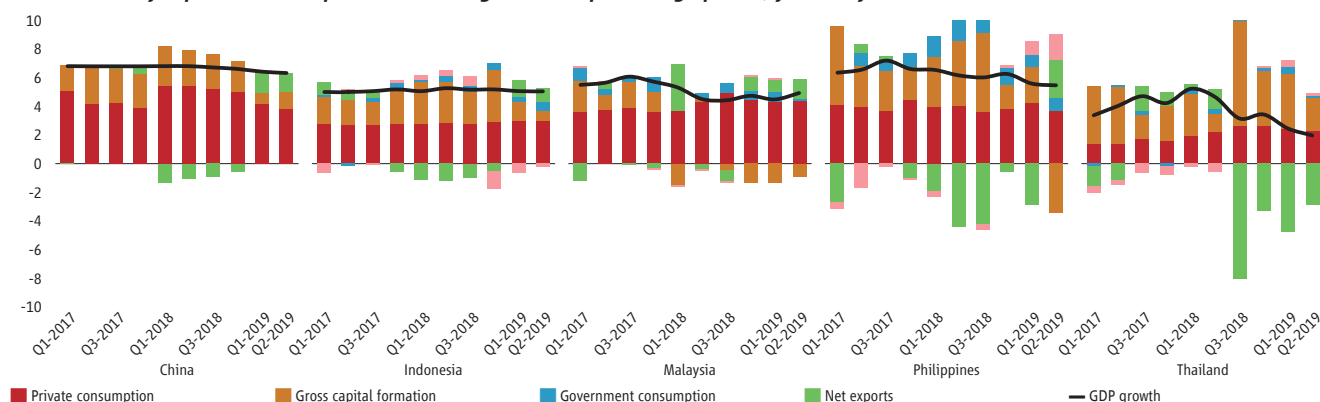
Sources: World Development Indicators; Ahir, Bloom and Furceri, "The World Uncertainty Index".

Note: Panel A: each dot represents country-year observations. Panel B: The index of trade uncertainty is constructed using frequency counts of "uncertainty" (and its variants) in the quarterly Economist Intelligence Unit (EIU) country reports for 143 countries. Unweighted average.

Trade uncertainty has increased, weighing down on investment confidence. The prospects of sluggish export growth directly affect the investment behavior of firms engaging in exporting or producing intermediate goods, leading to a slowdown in investment growth (Figure I.A.5). Trade uncertainty has increased, while business and investor confidence suggested a deteriorating outlook in China, Malaysia, and Thailand in the second quarter of 2019. In countries for which quarterly data are available, including in Indonesia, Malaysia, Thailand, and the Philippines, investment growth declined in the first two quarters of 2019 compared with 2017 and 2018. Moreover, in Malaysia and the Philippines, the contribution of investment to growth turned negative (see Box I.A.3 and Figure I.A.6).

Figure I.A.6. Domestic demand supported growth in the first half of 2019

Contribution of expenditure components to change in GDP (percentage points, year-on-year)



Source: Haver Analytics; Thailand Office of the National Economic and Social Development Board; World Bank staff calculations.
Note: For China, consumption refers to both government and private consumption.

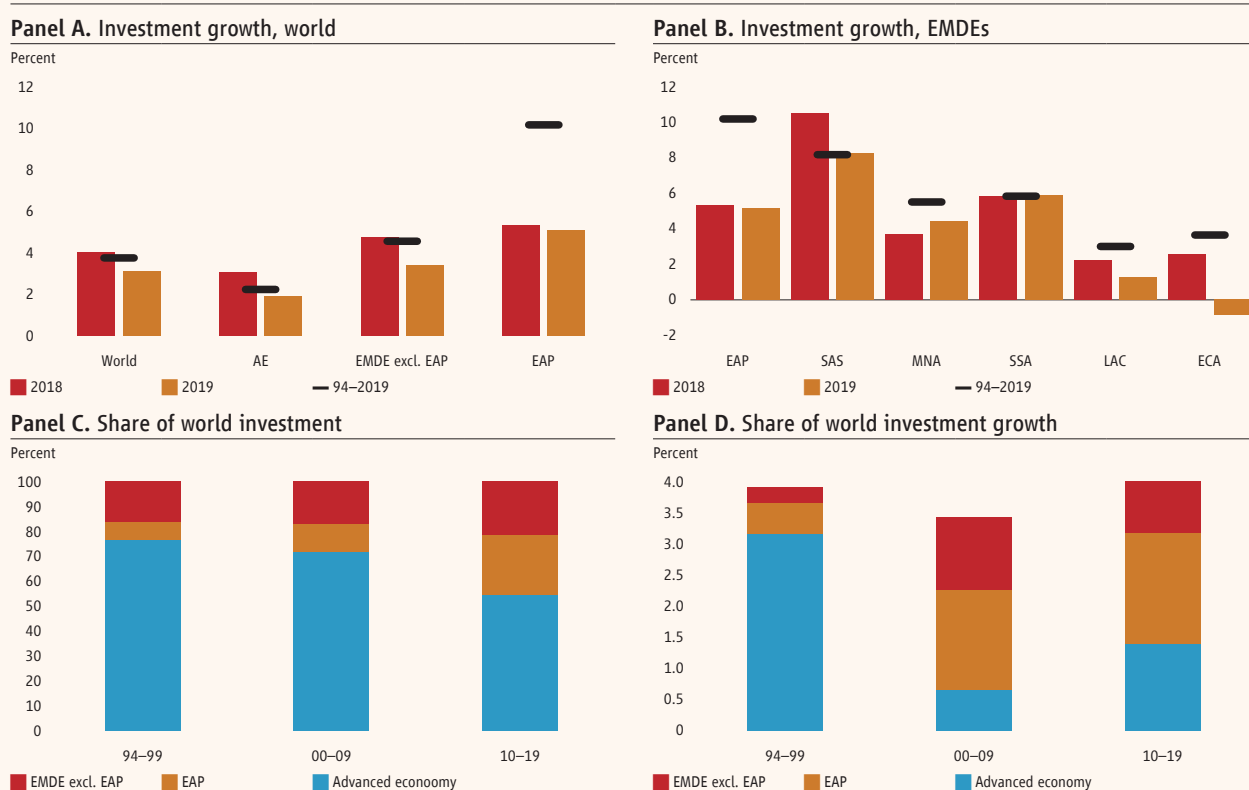
Private consumption supported growth for many economies in the region. In an environment of generally benign inflation and accommodative monetary policy, private consumption was supportive of growth in several major economies in the region (Indonesia, Malaysia, and the Philippines) (Figure I.A.6). Election-related spending in Indonesia, the Philippines, and Thailand provided an added boost to consumption in early 2019. In China, consumption continued to drive economic activity, but consumption growth has declined since the second quarter of 2018, with real expenditure growth generally weaker than real disposable income growth. The decline in consumption growth occurred despite a modestly accommodative fiscal policy stance, which included tax incentives to boost household spending.

Box I.A.3. Investment in Developing East Asia and the Pacific: Evolution and Prospects¹

Long-term investment trends in developing East Asian and Pacific countries: the global context

Investment growth rates in developing East Asian and Pacific countries have been significantly higher than in advanced economies, and emerging market and developing economies (EMDEs) during the past two decades (Figure BI.A.3.1, panels A and B). This resulted in a gradual increase of developing East Asia and the Pacific's share in global investment from less than 10 percent in 1994–99 to almost one-quarter in 2010–19 (Figure BI.A.3.1, panel C). The developing East Asia and Pacific region became the main contributor to global investment growth with its share increasing from around 12 percent in 1994–99 to over 40 percent on average in 2010–19 (Figure BI.A.3.1, panel D). These high investment rates led to a rapid accumulation of physical capital and expansion of productive capacity, and contributed to the region's fast GDP growth.

Figure BI.A.3.1. Investment trends



Sources: Haver Analytics; World Economic Outlook.

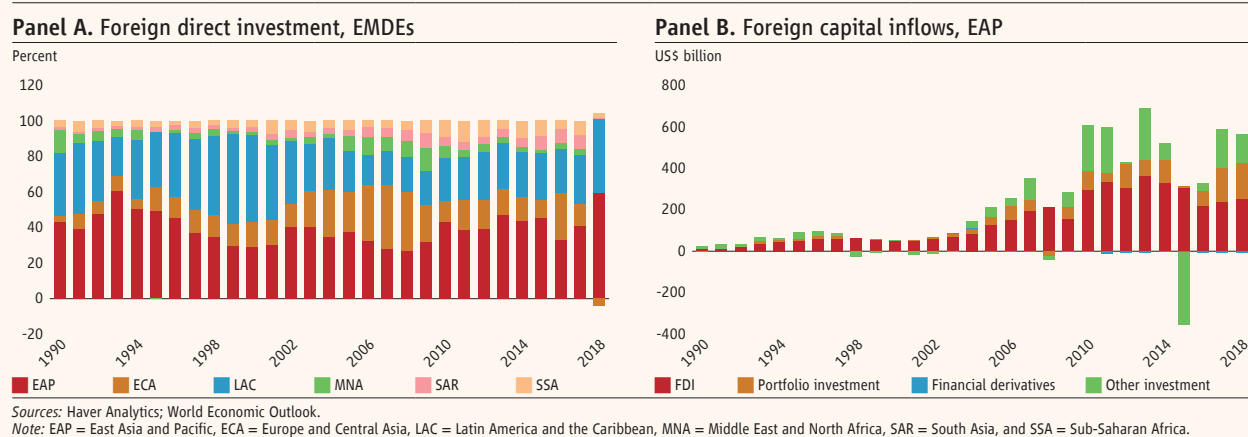
Note: GDP-weighted averages, using 2010 real GDP at constant prices and market exchange rates as weights. Panel C: each column shows the period-average share of global investment contributed by the various developing regions. Panel D: each column shows the period-average share of global investment growth contributed by the various developing regions. These developing regions comprise 95 countries. The remainder is contributed by 30 advanced economies. AE = Advanced Economies, EMDE = Emerging markets and developing economies, EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

(continued)

¹ Prepared by Ekaterine Vashakmadze and Ergys Islamaj with research assistance provided by Jinxin Wu.

(Box I.A.3 continued)

High saving rates and foreign direct investment supported investment growth in the East Asia and Pacific region. Investment growth was supported by high domestic saving rates, which in developing East Asia and the Pacific have been significantly higher than in other developing regions. That said, foreign capital played an important role in various key aspects of investment growth in developing East Asia and the Pacific, including transfer of new technologies and know-how, formation of human resources, integration in global markets, increase of competition, and firms' development and reorganization (Moura and Forte 2013). Developing East Asia and the Pacific has been successful in attracting a large share of global FDI in the post-global financial crisis period (Figure BI.A.3.2, panels A and B).

Figure BI.A.3.2. Foreign capital inflows

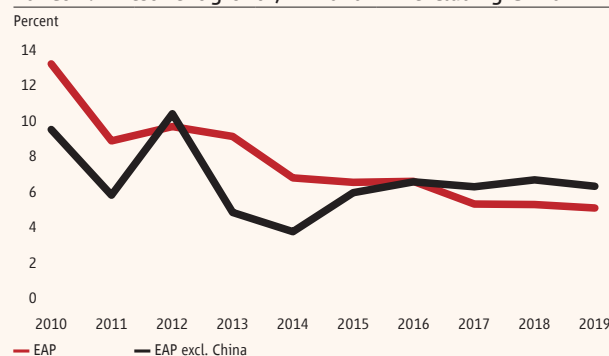
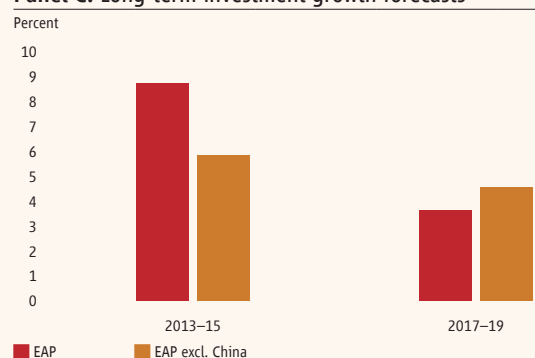
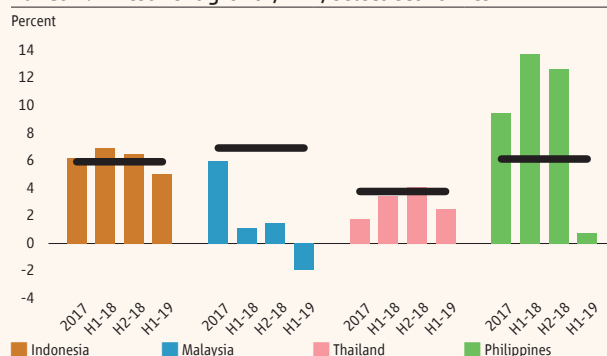
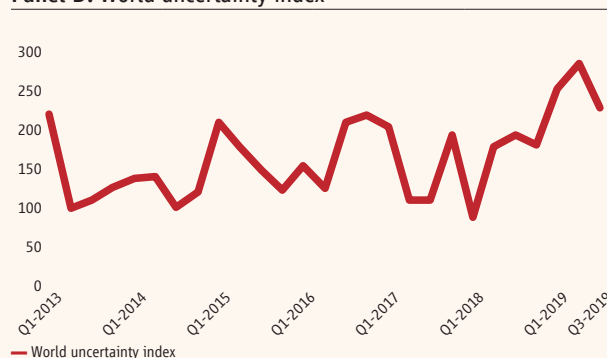
Recent investment trends and outlook

Following a prolonged, broad-based slowdown that began after the global financial crisis, investment growth in EMDEs reached a modest 4.7 percent in 2018 and is expected to slow further to 3.9 percent in 2019. In more than half of EMDEs, investment growth has been below its long-term average since 2012. China accounted for a large portion of the EMDE investment slowdown after 2010, but commodity-exporting economies also contributed. The investment growth slowdown in EMDEs was, in almost equal measure, a reflection of weakening domestic output growth, a sharp deterioration in terms of trade for commodity exporters, and elevated private debt burdens.

Investment growth in the developing East Asia and Pacific region also declined from around 10 percent in 2013 to around 5 percent in 2019 (Figure BI.A.3.3, panel A). This slowdown, especially in China, partly represents a correction from high pre-crisis investment growth and the immediate post-crisis fiscal and monetary stimulus. Relatedly, investment efficiency, as measured by incremental capital-output ratios (ICORs), has been deteriorating until recently. In China, ICORs were particularly high, reflecting large investment in infrastructure and real estate. In Malaysia and Thailand, investment as a share of GDP has been declining in recent years as growth rates have stumbled (Figure BI.A.3.3, panel B).

(continued)

(Box I.A.3 continued)

Figure BI.A.3.3. Investment growth**Panel A. Investment growth, EAP and EAP excluding China****Panel C. Long-term investment growth forecasts****Panel B. Investment growth, EAP, select economies****Panel D. World uncertainty index**

Sources: Consensus Forecasts; Haver Analytics; World Economic Outlook, International Monetary Fund.

Note: Panel A: GDP-weighted averages, using 2010 real GDP at constant prices and market exchange rates as weights. Panel B: Horizontal bars represent average investment growth rate over 1990–2019 period. Panel C: 10-year-ahead forecasts surveyed in indicated year. Constant 2010 U.S. dollar investment-weighted averages. Sample includes China, Indonesia, Malaysia, the Philippines, and Thailand. Panel D: The index of economic uncertainty is constructed using frequency counts of “uncertainty” (and its variants) in the quarterly Economist Intelligence Unit (EIU) country reports for 143 countries.

The slowdown of investment growth in the East Asia and Pacific region has coincided with a sharp decline in trade. Trade liberalization during the past few decades gave a boost not only to final goods trade, but also contributed to an increase in the fragmentation of the production process. In a globalized world, tradeable goods are often produced through complex global value chains, a process that entails intermediate inputs being produced in more than one country and exported to the final destination for assembly. The prospects of sluggish exports growth directly affect the investment behavior of firms engaging in exporting or producing intermediate goods, leading to a slowdown in aggregate investment growth.

Investment growth in the East Asia and Pacific region is expected to be subdued and below historical averages. The long-term prospects for investment growth remain weak and have been persistently downgraded since 2010. The 10-year-ahead outlook for EMDE investment growth was 3.6 percent, on average, in the 2017–19 period, significantly lower than the 8.7 percent investment growth projected during 2013–15 (Figure BI.A.3.3, panel C).

In the medium term, several cyclical factors are likely to limit investment growth in EMDEs, including in the East Asian and Pacific region. The external growth outlook has become increasingly unfavorable amid the continuing trade between China and the United States. Growth is projected to ease in several major

(continued)

(Box I.A.3 continued)

economies—the United States, the Euro Area, and China—in 2019–21, with potential negative implications for investment and exports in EMDEs, especially in the East Asia and Pacific region, that rely on them as sources of export demand. Heightened economic and political uncertainty and increasing debt stocks continue to weigh on investment growth in China, Malaysia, Mongolia, Papua New Guinea, and Thailand (Figure BI.A.3.3, panel D).

Structural factors are also expected to curb investment growth in the medium term. Already, there is evidence that the global trade cycle has turned, particularly for capital goods. These products are deeply embedded in international production networks and illustrate the interconnectedness of global investment and trade growth. Financial sector development and oversight, demographic change, and economic diversification, can also weigh down on investment in the medium to long term (World Bank 2017a). On the other hand, increased FDI flows, better regional integration, and better institutional environment can lift up private investment. Addressing shortcomings in fiscal processes, such as inefficient public investment management systems and weak fiscal transparency, could also boost public investment.

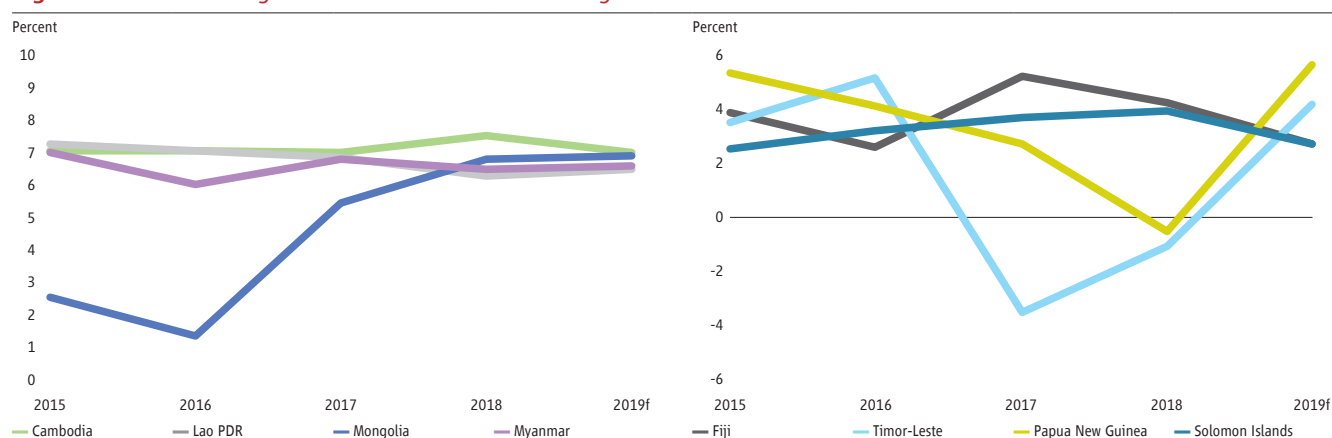
Comprehensive policy efforts could help countries in the region improve their investment growth and speed up income convergence. China faces the challenge of completing its transition to a slower but more sustainable and balanced growth path led by consumption and services. In some countries with high investment needs, a wide range of policy efforts could improve investment outlook (see Section I.C of this report).

Economic growth has held up in the region's smaller economies

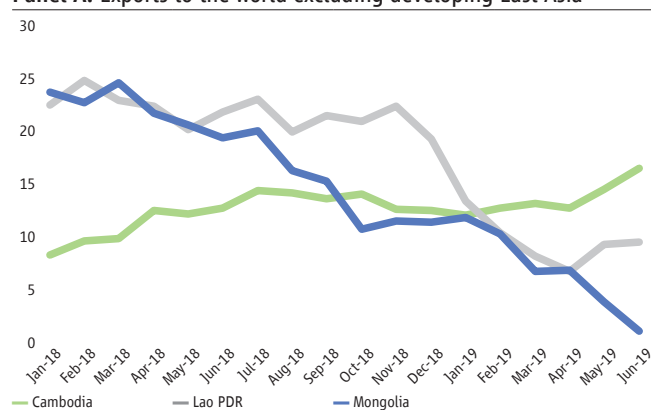
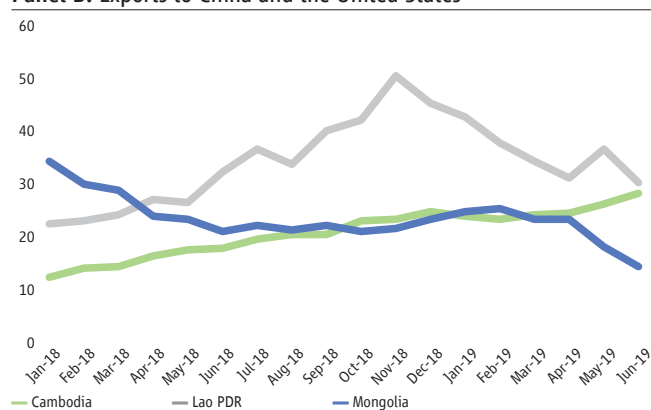
Economic growth in smaller economies has been mostly robust (Figure I.A.7). Cambodia, Lao PDR, Myanmar, Mongolia, and Papua New Guinea witnessed robust economic growth in the first half of 2019. Domestic demand has remained buoyant, and foreign direct investment has remained steady in the real estate sector in Cambodia and the mineral sector in Mongolia.³ Economic growth in Lao PDR is being mainly driven by growth in the construction sector, wholesale and retail trade growth associated with construction and some base effects due to the downturn in the agriculture sector caused by the flooding in 2018. Activity in Papua New Guinea has rebounded from its sharp earthquake-related contraction in 2018, led by expansion in the extractive sector combined with a modest acceleration in the non-extractive and construction sectors. And in Timor-Leste, the 2019 state budget raised the resource envelope to US\$1.5 billion—a 16 percent increase from the 2018 budget—which contributes to a recovery in economic activity.

Exports growth to China and the United States has increased in some smaller economies. In contrast to the major economies, export growth outcomes—both goods and services exports (tourism receipts)—have been robust in some smaller economies in the region. Exports of garments, furniture, and light travel merchandise increased in Cambodia, which has seen steadily rising export growth with its main trading partners, China and the United States, since early 2018 (Figure I.A.8). In Lao PDR, export growth to the world (excluding developing East Asia) has decelerated, but this has been partly offset by the higher export growth to China and the United States. Mineral exports of coal and iron ore supported export growth in Mongolia in the first half of 2019.

³ These small economies have partly relied on foreign investments to spur development of key sectors that generate employment and income for their people.

Figure I.A.7. Economic growth was solid in most of the region's smaller economies

Source: World Bank staff estimates.

Figure I.A.8. Some smaller economies have seen higher exports growth to China and the United States*Exports of goods and services (year-on-year percent change, 12-month moving average)***Panel A. Exports to the world excluding developing East Asia****Panel B. Exports to China and the United States**

Sources: IMF Direction of Trade Statistics; World Bank staff calculations.

The impacts of the trade tensions on smaller economies are more muted. The fewer linkages to global value chains (GVCs) are among the possible factors that insulate the smaller economies from the impact of the trade tensions. Smaller economies show relatively lower participation in the GVC compared with the larger economies in the region.⁴ They are more involved with commodities (Lao PDR and Mongolia) and limited manufacturing (Cambodia) in their participation in GVCs, compared with advanced manufacturing and services in many of the larger economies. For countries such as Lao PDR and Mongolia, their participation in agricultural GVCs appears to have withered over time, making them even less susceptible to the diffusion of global shocks (World Bank 2019i). These linkages tend to be associated with greater synchrony of economic activity across countries. Thus, weaker trade growth in China, which is at the core of the regional value chains, will have negative spillovers in the region's trading activities, especially in those closely linked to its value chains (World Bank 2019d).

Growth in the Pacific Island countries (PICs) has been supported by reconstruction efforts and development assistance flows. Growth fluctuations in the PICs are to a large extent driven by natural disasters and aid flows, with economic activity bolstered by the construction of donor-funded projects, including for disaster recovery and

⁴ World Bank staff calculations using the UNCTAD-Eora GVC database. GVC participation is measured as the ratio of the sum of foreign value-added (to capture backward participation in the GVC) and indirect value-added (to capture forward participation in the GVC) to gross exports.

reconstruction. Current growth trends in Vanuatu, Fiji, and Tonga, for instance, are related to reconstruction efforts following major disasters in 2015, 2016, and 2018. In the Federated States of Micronesia, the Marshall Islands and Palau, negotiations are currently underway to extend the Compact of Free Association with the United States, due to expire in 2023/24, whereby the United States military gains exclusive access to airspace and territorial waters in exchange for financial assistance for infrastructure, education and health projects.

Growth in PICs has also been supported by goods and services exports, some of which may be affected by the global demand slowdown. Growth in PICs has also been supported by tourism receipts (Fiji, Palau, Solomon Islands, Vanuatu), agricultural and fisheries exports (Fiji, Kiribati, Samoa, Solomon Islands), and activities in the information and communications technology (ICT) and construction sectors (Fiji, Tonga, Vanuatu). The global demand slowdown will likely moderate economic activity in key export markets. These include Australia and New Zealand, which are important markets for agricultural and tourism exports from the South Pacific, and China, which is a key importer of logs and timber from the Solomon Islands and is the main source of tourists to Palau, as well as a growing source of tourists to other PICs. Volatile prices of the PICs' substantial commodity imports have a direct impact on external positions, and thus growth. Remittances are also an important source of foreign exchange for many PICs, although the costs of remittance transfers are high and the significant dependence on a few remittance-sending countries is a source of potential vulnerability (see Box I.A.4 on remittances).

Box I.A.4. Remittance costs in Pacific Island countries¹

Pacific Island countries (PICs) are some of the most remittance-dependent economies in the world. In 2018, formal remittance receipts in Tonga were 35.2 percent of GDP, the highest share in the world, in Samoa they were 16.1 percent of GDP, in the Marshall Islands 13 percent, in Tuvalu 9 percent, in Kiribati 8.9 percent, in the Federal States of Micronesia 7.3 percent, and in Fiji 5.5 percent. Migration to Australia, New Zealand, and the United States provides an important source of income and remittances for Pacific Island nationals.² While such movements capitalize on established migrant networks that facilitate the process of securing jobs and settling in a foreign place, this makes remittance flows vulnerable to shocks arising from economic fluctuations in the few remittance source countries.³

The cost of sending remittances to PICs exceeds regional and global averages.⁴ The average cost of sending US\$200 to four Pacific island countries was 9.4 percent in the second quarter of 2019, higher than the average for other countries in the East Asia and Pacific region (6.9 percent), the average for other small island countries in the Caribbean (CICs) and Africa (AICs) (7.5 percent and 5.3 percent, respectively),⁵ and the Sustainable Development Goal (SDG) target of 3.0 percent set to be attained by 2030 (SDG target 10.c).

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¹ This box was prepared by Supriyo De, Ganesh Seshan and Immaculate Nafula Macha.

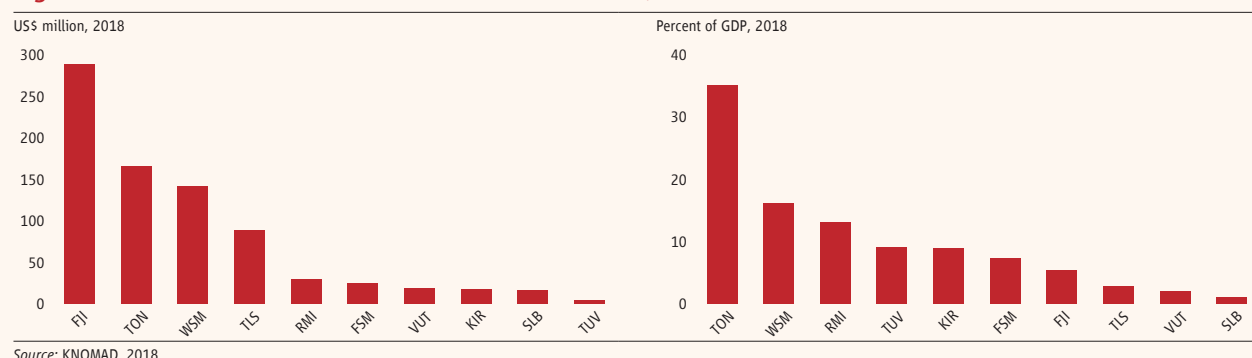
² KNOMAD, 2017 Bilateral Migration Matrix.

³ This box focuses on inward remittances.

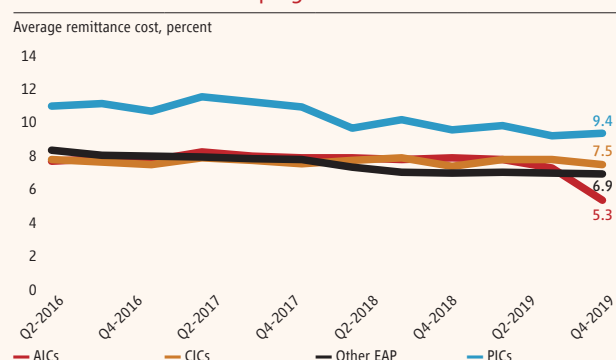
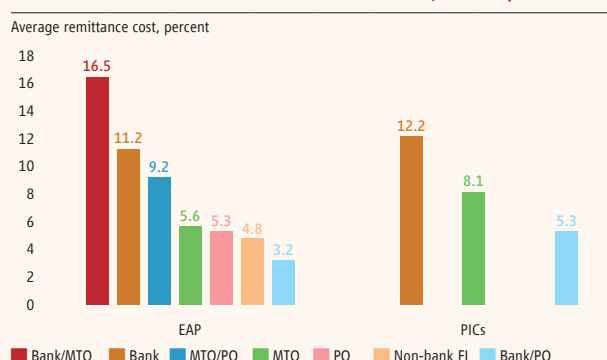
⁴ Total remittance costs include fees and foreign exchange margins, where the latter is the difference between the exchange rate provided by the money transfer operator and the interbank exchange rate. Data are from the World Bank's Remittance Prices Worldwide (RPW) database.

⁵ Cost data are not available for all countries in the RPW database. In the sample AICs are selected African Island countries (Comoros and Cabo Verde), CICs are Caribbean Island countries (Cuba, Dominican Republic, Guyana, Haiti, Jamaica and Suriname), and PICs are Pacific Island countries (Fiji, Samoa, Tonga and Vanuatu).

(Box I.A.4 continued)

Figure BI.A.4.1. Remittance inflows in Pacific Island countries, 2018

Competition in the remittances market in PICs is limited. Migrants' options for sending remittances to the four PICs (with data on costs) through formal channels are limited to banks (average cost of 12.2 percent), money transfer operators (MTOs) (average cost of 8.1 percent), or tie-ups between banks and post-offices (average cost of 5.3 percent) (Figure BI.A.4.3). Other East Asia and Pacific countries offer a wider selection, including non-bank financial institutions (average cost of 4.8 percent) and post offices (average cost of 5.3 percent).⁶

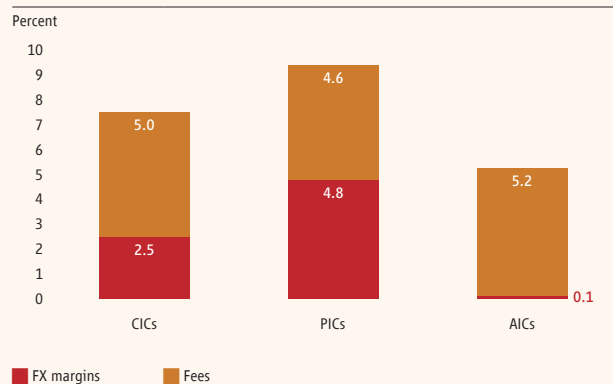
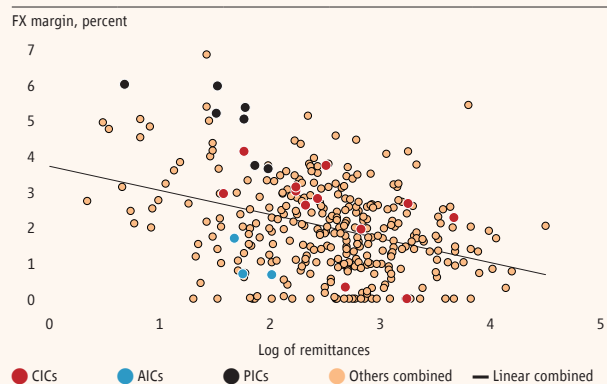
Figure BI.A.4.2. Remittance costs in small island developing states and other EAP countries**Figure BI.A.4.3. Cost comparison among channels in PICs and other EAP countries, 2019Q2**

High foreign exchange (FX) margins of remitting to PICs are increasing costs. The FX margin amounted to around 51 percent of the total (average) remittance costs, according to RPW data in the second quarter of 2019 (Figure BI.A.4.4). This exceeds the margins found in other small islands in the Caribbean (33 percent) and in Africa (under 2 percent), and are typically greater than margins associated with comparable remittance volumes seen in other corridors (Figure BI.A.4.5).

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⁶ The high cost depicted as "Bank/MTO" is associated with remittances channeled through Postbank via Western Union. This is indicative of the adverse impacts of exclusivity partnerships, especially between national post offices and large MTOs, which is widely evidenced in other regions (World Bank 2019a).

(Box I.A.4 continued)

Figure BI.A.4.4. Remittance costs in small island developing states, 2019Q2**Figure BI.A.4.5.** Association between FX margins and remittance volumes globally, 2018

Sources: Authors' calculations using the Remittance Prices Worldwide database, World Bank.

Note: FX = foreign exchange. FX margins are for remitting US\$200 or equivalent. PICs are Pacific Island countries, CICs are Caribbean Island countries and AICs are African Island countries.

De-risking has likely contributed to high remittance costs. The global financial crisis and stricter Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regulations have resulted in the termination of correspondent banking relationships (CBRs), including those with money transfer operators (MTOs).⁷ The impact has been more pronounced in the PICs due to the limited number of banks and the dependence on Australia, New Zealand and the United States, where the process has intensified in recent years through blanket account closures for various MTOs. This has resulted in many MTOs exiting the PICs market, and the loss of numerous collection and disbursement points (and agents), which has hampered the pace of cost reduction.⁸

Various policies could reduce remittance costs in the PICs. Encouraging new technologies such as blockchain for compliance, using post office networks for remittances (while avoiding exclusivity partnerships), providing consumer education regarding alternative channels, and accommodating the use of mobile payments for remittances would help boost competition in the remittance market.⁹ Finally, the digitization of the remittance value chain, by applying a range of technologies to different segments of the transaction process between the sender and the recipient, as well as eliminating the dependence on agents, could further reduce costs.

⁷ CBRs are bilateral arrangement between onshore and offshore banks that allow concerned parties to settle transactions across jurisdictions.

⁸ See Box I.C.3 in World Bank (2018d).

⁹ The World Bank is currently engaged with the region in supporting the creation of a know-your-customer (KYC) utility and integration of the payment system infrastructure.

Higher revenues in some PICs have led to increased government spending that may not be sustainable over the long run without ongoing attention to fiscal management. This is particularly the case in countries that have benefited from higher fishing license fees in recent years (Federated States of Micronesia, Kiribati, Nauru, and the Marshall Islands). Improvements in tax administration and compliance have also supported revenue growth in Samoa, Tonga, Vanuatu, and Palau (World Bank 2018d). Critical to long-term fiscal sustainability, a number of PICs (Federated States of Micronesia, Palau, Kiribati, Nauru, Tuvalu) manage sovereign wealth funds, whose returns are affected by global financial market conditions.

Inflationary pressures remained subdued in the larger economies in the region but elevated in some smaller economies

Price pressures remained generally subdued across the larger economies in the region but have slowly increased since the start of the year. Headline inflation in the region's larger economies was lower in the first half of 2019 compared with the first half of 2018. Inflation, however, has started to increase since the start of the year, except in the Philippines, which experienced a steady decline in inflation from a peak in the third quarter of 2018 (Figure I.A.9). In the Philippines, inflation weakened due to lower food and energy prices. This is largely driven by easing rice prices following the enactment of the Rice Liberalization Law and lower international crude oil prices. In Thailand, inflation remained near the low end of the central bank's 1 to 4 percent target range, reflecting lower demand pressures with the slowdown of domestic activity. In Malaysia, headline inflation turned temporarily negative in the first quarter of 2019, due to lower fuel prices after the reintroduction of the managed float fuel pricing mechanism, and the base effect from the removal of the goods and services tax last year. In contrast, in China, while weaker energy prices exerted downward pressure on inflation in early 2019, strong food price growth contributed to higher inflation, especially in March and April. The increase in food prices was driven by a supply shortfall caused by bad weather and an outbreak of swine flu. Inflation levels are elevated in Mongolia in part due to supply-side shocks, strong pass-through of the impact of oil and food prices, and currency depreciation. (Figure I.A.10).

Figure I.A.9. Inflationary pressures have picked up in major economies since January...

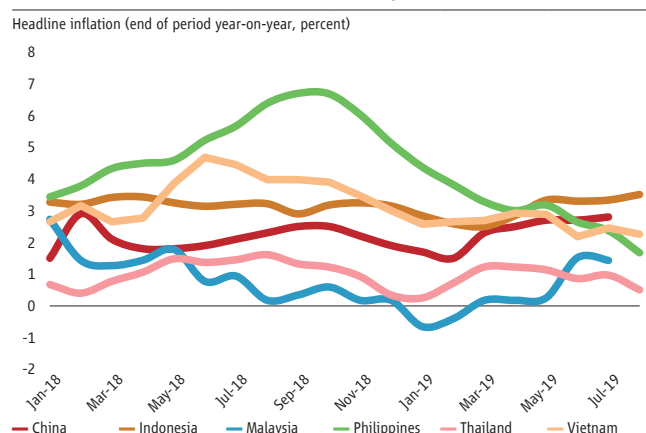
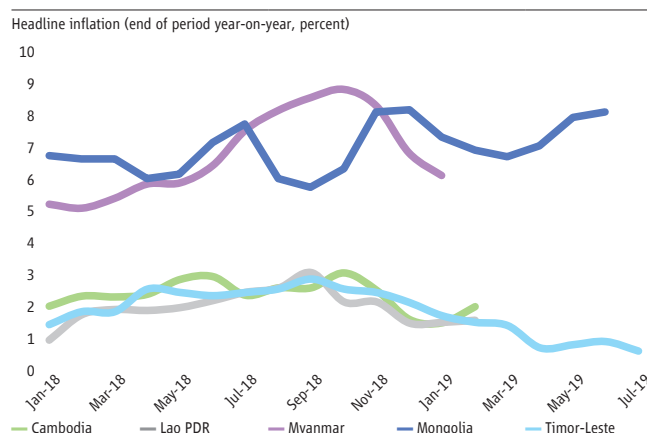


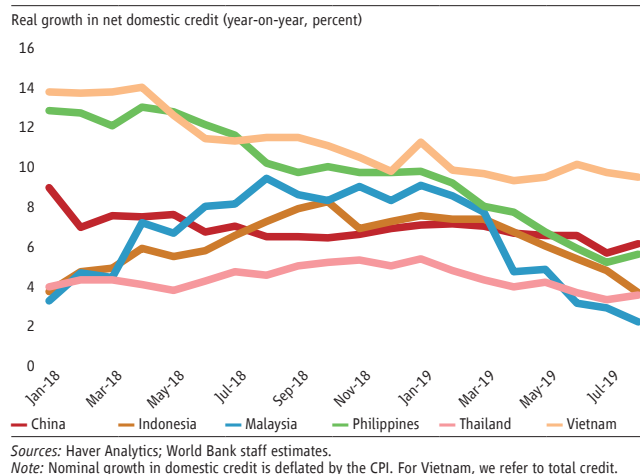
Figure I.A.10. ...and remained elevated in some smaller economies



Monetary policy has remained accommodative or eased further amid subdued inflationary pressures. A handful of central banks (Indonesia, Malaysia, the Philippines, Thailand) eased their key policy rates in early 2019, amid subdued inflationary pressures and a bid to lift deteriorating growth. The cuts came as central banks in advanced economies, including Japan, the European Union, and the United States, signaled a more dovish policy approach. Malaysia's central bank cut the interest rate by 25 basis points in May, the first reduction since 2016. In the Philippines, besides lowering the key policy rates, the central bank also reduced the reserve requirement by 200 basis points for banks and non-bank financial institutions. In Vietnam, local and state-owned banks reduced their rates for loans to firms included in the government priority sectors. Despite inflationary pressure in China, the People's Bank of China in January cut reserve requirements for all banks by 1 percentage point of liquid liabilities to soften the impact of the trade tensions in economic activity. Another targeted cut in the required reserve ratio for about 1,000 smaller banks became effective in May.

Credit growth in many economies in the region has declined since the start of 2019. Accommodative monetary policies have yet to translate to higher credit growth in the region's economies so far in 2019. Credit growth followed a declining trend in the Philippines and Vietnam, pulling away from the high double-digit growth in the past two years (Figure I.A.11). While credit growth has been moderating in China since 2016, it increased at the start of 2019 because of higher bank loans, and corporate and government bond issuance to bolster infrastructure spending. In Malaysia, growth in net financing moderated slightly to 5.1 percent in the first quarter of 2019, from 5.8 percent in the last quarter of 2018, driven both by lower growth of outstanding loans and of issuances of corporate bonds. In Myanmar, credit growth continued to slow in 2018/19, as banks sought to comply with prudential regulations. Meanwhile, a few countries are actively using macroprudential measures to curb household debt growth, such as imposing loan-to-value caps for high-end housing, and tighter credit limits for credit cards and personal loans.

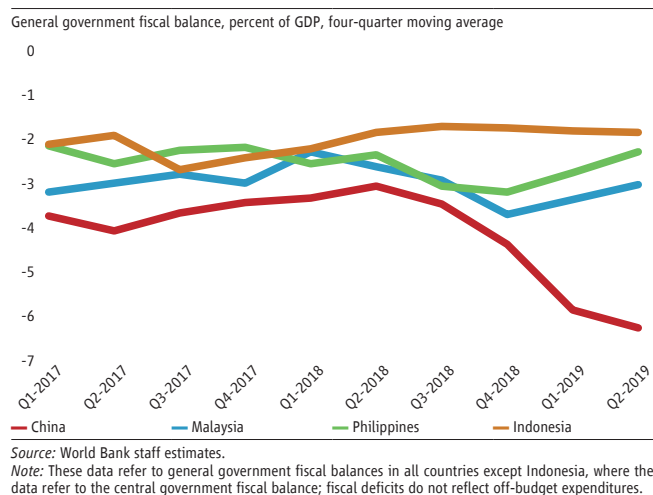
Figure I.A.11. Credit growth has moderated in the region's larger economies since January 2019



Several countries in the region stepped up fiscal policy measures to support economic growth

Fiscal policy has been oriented toward supporting growth in a number of countries in the region (Figure I.A.12). Since the beginning of the year, a number of countries have employed stimulative measures to address a moderation of activity amid weakening external demand. China introduced new tax and fee reductions, and a higher limit for local government on-budget borrowing in March 2019, which is expected to increase the consolidated deficit to 5.9 percent of GDP in 2019, from 3.9 percent in 2018 (World Bank 2019e). Thailand announced a broad range of economic stimulus measures, including a tax deduction for spending on tourism services, and is preparing a fiscal stimulus package aimed at farmers, SMEs, and low-income households. In several countries, public spending has also increased due to election cycles (the Marshall Islands), and higher social spending (Indonesia). Nonetheless, concerns around debt sustainability led to more fiscal consolidation in some economies (Lao PDR, Mongolia, Papua New Guinea, the Solomon Islands, Vietnam).

Figure I.A.12. Fiscal policy stances have been generally supportive of growth



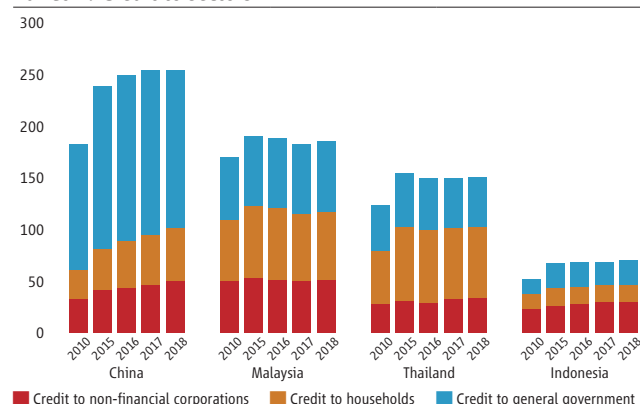
Most economies ran budget deficits in the first half of 2019. In line with the expansionary fiscal stance, expenditures as a share of GDP have increased in many countries in the region (Malaysia, Indonesia, Thailand), but not in the Philippines, where a pre-election spending ban and delay in budget approval hampered public infrastructure spending. Revenue as a share of GDP weakened in some economies in the first quarter of 2019 on the back of additional VAT rate cuts and a lower corporate social security contribution rate (China), and weaker VAT, lower commodities-linked revenues, and reduced non-oil and gas income taxes (Indonesia). Revenue collection improved in other economies, however, with better tax administration through electronic payment systems and the use of the banking system for tax payments (Cambodia, Lao PDR), and additional excise taxes from a tax reform package (Philippines). Most economies ran budget deficits in the first half of 2019, but the deficits widened in China and Indonesia and narrowed in the Philippines compared with the first half of 2018.

Debt levels are high and rising in some of the region's economies. Domestic debt is high in some economies in the region, especially in China, Malaysia, and Thailand (Figure I.A.13). In China, total private sector debt is above levels seen at the peak of previous credit booms in other major EMDEs and advanced economies. Household debt is high in Malaysia and Thailand, encouraging central banks to use macroprudential measures to specifically target and manage household debt growth. In Cambodia, combined bank and microfinance credit now account for over 100 percent of GDP after a prolonged construction and property boom resulted in rising indebtedness. Meanwhile, in Vietnam, domestic credit to the private sector as a percentage of GDP has risen in the past few years, with the ratio estimated at 133.1 percent at the end of 2018.

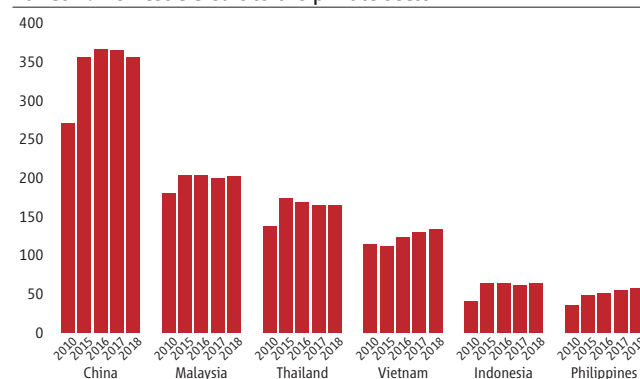
Figure I.A.13. Private sector debt remains high in China and Malaysia

Credit to sectors (end-year, percent of GDP)

Panel A. Credit to sectors



Panel B. Domestic credit to the private sector



Source: Bank for International Settlements; World Bank, Cross-Country Database of Fiscal Space.

Note: On Panel A, credit comprises financing from all sources, including domestic banks, other domestic financial corporations, non-financial corporations, and non-residents.

Financial markets volatility picked up in the third quarter of 2019

Benign global financing conditions led to capital flows into the region, except China, in the first half of 2019. Major central banks in advanced economies have adopted a more accommodative policy stance in response to deteriorating economic prospects and subdued inflation. This has resulted in an increase in foreign capital inflows to

the region except for China, leading to some easing of external financing conditions that allowed several economies in the region to cut policy rates or put tightening cycles on hold. The capital flows helped major currencies in the region to regain the ground lost last year against the U.S. dollar, and central banks to accumulate international reserves in the first half of 2019.

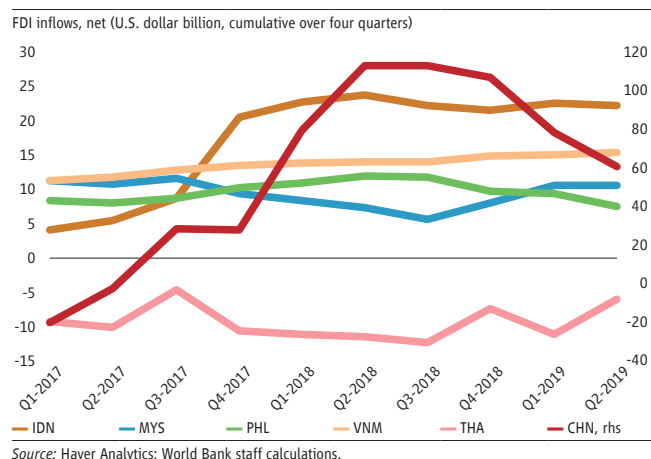
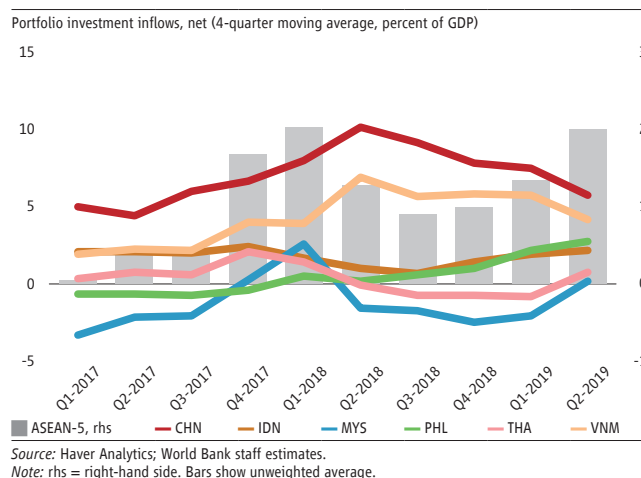
But the region witnessed renewed financial market volatility in the third quarter. Financial market volatility has intensified in recent months on the back of the on-and-off escalation of the China-United States trade tensions, fears of recession and a disorderly Brexit, emerging trade disputes between Japan and the Republic of Korea, and geopolitical tensions in the Middle East. Market pressures reignited after the U.S. administration announced an additional 10 percent tariff on US\$300 billion additional Chinese imports after a short-lived truce reached during the G-20 summit.⁵ Yields fell to 10-year lows and yuan offshore declined to its weakest level in 11 years on the day of the announcement. Equities markets in advanced economies in the region, including Japan, Republic of Korea, and Australia, were also affected negatively; Australia's three-year yield dropped to a three-year low. Macro-financial assets such as currencies, bonds, and equities all suffered losses due to the escalation of trade tensions. Tensions further escalated with China declaring on August 23 tariffs ranging from 5 to 10 percent on US\$75 billion of U.S. goods in two batches effective September 1 and December 15; and a 25 percent tariff on U.S. cars and 5 percent on auto parts and components to go into effect on December 15. The United States signaled that it would counteract by raising the tariffs on US\$250 billion worth of Chinese products from 25 to 30 percent starting October 1, and raising the tariffs on the remaining US\$300 billion in imports from 10 to 15 percent on September 1.⁶

Investors' appetite for risks in the region returned in early 2019, as spreads in large economies in the region declined from their peaks in January. However, since hopes of reaching a trade agreement between China and the United States faded with renewed tensions in July and August, investor confidence weakened, and bond spreads widened in August before declining somewhat in early September following news that China and the United States are scheduled to continue negotiations in October. In the first half of the year, the average spread in most large economies in the region widened, especially in Indonesia and Malaysia, compared with the same period last year. The average spread rose only marginally in Vietnam but declined in the Philippines at a time when the government was ramping up borrowing. In China, bond spreads rose further in the first half of 2019 from an already significant increase in the first half of 2018, signaling continued and increased level of risk perception.

Despite the global investment slowdown, a few economies in the region experienced increased foreign direct investment (FDI). Net FDI inflows slowed down in the first half of 2019 in China due to market uncertainty owing to the trade dispute. However, an expansion in FDI was experienced in Malaysia and Vietnam, with anecdotal reports of investment diversion away from China (Figure I.A.14). Net portfolio flows to the region except China rose in the first quarter of 2019 from the fourth quarter of 2018 (Figure I.A.15). In the Philippines, inflows were partly driven by the government's higher foreign borrowing activities early in the year. Some countries are taking steps to attract new investors by establishing the framework for bond issuance tied to projects that support environmental sustainability (see Box I.A.5).

⁵ The implementation of the new tariff was eventually postponed from its September 1 deadline, providing temporary relief to the market.

⁶ From January to August 2018, protectionist announcements accounted for about half of the total stock market decline in China and as much as 80 percent of the decline in the Republic of Korea. China being at the center of the trade dispute, its financial market fell by 0.6 percent after a negative announcement. The effect is halved for higher income countries (0.36 percent) and is even smaller for middle-income countries, which are less integrated with China. See World Bank (2019f).

Figure I.A.14. Several countries witnessed higher net FDI inflows while flows have slowed down in others**Figure I.A.15.** Net portfolio flows to the region rose in H1 2019, except to China**Box I.A.5. The Rise of Green Finance in ASEAN¹**

Green finance has developed rapidly in East Asia and Pacific countries over the past few years. China has been leading the way, by essentially jumpstarting its green finance agenda in 2015 with the release of two flagship reports on green finance² and the adoption of green bond guidelines.³ Issuance of green bonds in China rose from around US\$1 billion in 2015 to US\$36.2 billion in 2016, and to more than US\$42.8 billion in 2018,⁴ making China the biggest market for green bonds in the world. The appetite for green finance in general, and green bonds in particular, has also been expanding in ASEAN countries.⁵

Green bonds, pioneered by the European Investment Bank and the World Bank in 2007 as part of their climate finance initiative, are a market-based approach to addressing climate change. They function identically to traditional bonds and are backed by the issuer's entire portfolio, but their proceeds are earmarked for projects with positive environmental or social outcomes. Green bonds have steadily grown in popularity and, besides financial institutions, are now also issued by state and local governments, and private companies. In 2018, global green bond issuance reached US\$167 billion. Most green bond activity remains concentrated in North America and Europe, but emerging markets in Latin America and Asia are catching up.

Green bonds are an essential tool for integrating environmental sustainability into the structure of the world economy, as they funnel financing into environmentally sustainable projects. Green bonds do not differ from standard bonds in price but, as the use of their proceeds needs to be verified, they generate additional transaction costs for the issuer. However, they also highlight the issuer's part in green finance/projects. In addition, as more investors become conscious of their portfolio's carbon footprint and move toward

(continued)

1 Written by Ana Maria Aviles, Ashraf Arshad, Mohamed Rozani Mohamed Osman, Elizaveta Sukhinenko and Radu Tatucu (all from World Bank Finance, Competitiveness and Innovation Global Practice, East Asia and Pacific Region).

2 CCICED (2015) and PBOC & UNEP (2015).

3 PBOC (2015).

4 <https://www.climatebonds.net/resources/reports/china-green-bond-market-2018>

5 Alcozeba Fernandez (2018).

(Box I.A.5 continued)

preferring investments consistent with environmental, social and corporate governance goals, so green bonds can help issuers diversify their investor base. The monitoring of bonds' environmental sustainability is a consistent challenge, with international financial institutions (IFIs) such as the World Bank pioneering the development of green bond standards and definitions globally.

An Overview of Green Bonds in ASEAN

The combination of impressive economic growth and heightened vulnerability to climate change makes the ASEAN countries a fertile ground for green finance. Green finance can help traverse East Asia's US\$3 trillion financing gap in achieving a transition to low carbon by 2030, as well as provide corporations and governments in emerging markets with a more diverse and, eventually, cost effective source of financing. Indeed, taking a longer-term view, increasing demand for green bonds should provide a more diversified and larger pool of investors than non-green bonds, which should eventually lead to lower funding costs for green issuers. To date, ASEAN countries represent 11 percent of the global green bond market, but only 1 percent of the value of amounts issued;⁶ however, their share is rising. The first green bond in the region was issued in 2016 by the Philippine AP Renewables, which financed geothermal assets for PHP 10.7 billion (US\$226 million). The bond was backed at 75 percent by the Asian Development Bank (ADB). Since then, 19 green bonds have been issued in the ASEAN region, representing a total of 3 percent of global green bond issuers to date (Table BI.A.5.1).⁷ Thirty percent were issued by non-financial corporates. Indonesia has the largest share of green bonds within ASEAN, at 39 percent, followed by Singapore (35 percent) and Malaysia (19 percent).

Table BI.A.5.1. Summary of ASEAN green bond market

| <i>Region</i> | <i>Green bond markets</i> | <i>Issuers</i> | <i>Issued</i> |
|---------------------------------|---------------------------|----------------|-----------------|
| ASEAN | 6 | 19 | US\$5 billion |
| Asia-Pacific | 17 | 206 | US\$108 billion |
| ASEAN share of APAC (percent) | 35 | 9 | 5 |
| ASEAN share of global (percent) | 11 | 3 | 1 |

Source: Climate Bond Initiative, data as of November 2018.

ASEAN green finance is popular with the private sector. The largest category of green bond issuers is non-financial corporates (2018), with green loans (22.5 percent of the ASEAN green financial market) also being a prominent feature of regional green finance. However, sovereign and state-backed issuers form an important backbone to the industry. While the majority of bonds are U.S. dollar-denominated, local currency issues are gaining popularity, including with foreign banks, such as Crédit Agricole, which has issued several Indonesian rupiah-denominated notes. For instance, local currency denominated green bonds in ASEAN amounted to US\$3.2 billion in 2018, led by Singapore (40.7 percent), Malaysia (30.5 percent) and the Philippines (18.5 percent). Green bonds issued in Thai baht accounted for 4.7 percent of the total, those issued in Indonesian rupiah for 4.6 percent, and those issued in Vietnamese dong for 0.8 percent.⁸

(continued)

⁶ https://www.climatebonds.net/files/reports/asean_sotm_18_final_03_web.pdf

⁷ https://www.climatebonds.net/files/reports/asean_sotm_18_final_03_web.pdf

⁸ <https://www.theborneopost.com/2019/03/19/green-bonds-gain-traction-as-responsible-investing-takes-centre-stage/>

(Box I.A.5 continued)

ASEAN countries are working toward a unified green bond framework. The ASEAN Green Bond Standards—a set of voluntary guidelines for regulators and bond issuers—were developed in 2017 by the ASEAN Capital Markets Forum.⁹ The guidelines are compliant with the Paris Agreement and the Green Bond Principles published by the International Capital Markets Association, and focus on project selection, good reporting standards and external review. In adopting the ASEAN Green Bond Standards, Malaysia also introduced a Sustainable and Responsible Investment (SRI) Sukuk or Islamic Bond Framework in 2014 to spur sustainable and responsible financing initiatives, while Indonesia introduced its own green bond regulations in December 2017.

IFIs have played a significant role in developing the green bond market in ASEAN. Along with investing in and underwriting private green bond issuances, the World Bank, International Finance Corporation (IFC), ADB and European Bank for Reconstruction and Development (EBRD) have issued local-currency denominated green bonds in Indonesia, Malaysia and the Philippines. The IFIs have also been instrumental in facilitating the adoption of green bonds in ASEAN, particularly through supporting regulation and standard-setting. In 2017, the World Bank supported the Indonesian government in adopting the ASEAN Green Bond Standards through capacity-building workshops, with a particular focus on impact reporting. In 2018, PT Sarana Multi Infrastruktur (Persero) (PT SMI) issued Indonesia's first corporate bond for Rp 500 billion (as the first tranche of a Rp 3 trillion program).¹⁰ In addition, the World Bank, in collaboration with UNDP, is providing joint technical support to Indonesia's Ministry of Finance for impact reporting on its sovereign green sukuk (Islamic bond) issuance. Earlier, the World Bank alongside the Securities Commission of Malaysia and Bank Negara Malaysia facilitated the issuance of the world's first green sukuk by Tadau Energy (a Malaysian corporation) in July 2017, raising RM 250 million (about US\$59 million).¹¹ The proceeds of the sukuk issuance were to finance the construction of a 50-megawatt solar photovoltaic plant. This innovative financial instrument was realized by leveraging on Malaysia's experience as a leader in the Islamic finance sector, issuing more than 60 percent of the world's infrastructure sukuk. Subsequent to this ground-breaking initiative, several additional green sukuk have been issued in Malaysia.

Opportunities and Challenges for the Development of Green Bonds in ASEAN

Green bond growth trends are accelerating in ASEAN economies, but remain dominated by issuances from Singapore, Indonesia and Malaysia. While adoption of the Green Bond Standards has contributed much to supporting the work of regulators and increasing the adoption of green bonds by issuers, detailed country frameworks still need to be developed and tested in most ASEAN economies. IFIs will need to continue acting as facilitators and supporters of ASEAN green bonds, particularly as a signaling mechanism for emerging market issuers seeking investors from outside the region.¹² While high performers' financial markets are more developed and readier to undertake the opportunities brought by green bonds, less developed financial markets in the region could learn from the experience of their more developed neighbors to leap frog and advance in this area. For example, countries such as Lao PDR, Myanmar and Cambodia are currently locked out of the opportunities presented by green bonds.¹³

⁹ Arshad, A. and J. De Luna-Martinez (2018).

¹⁰ World Bank (2018a).

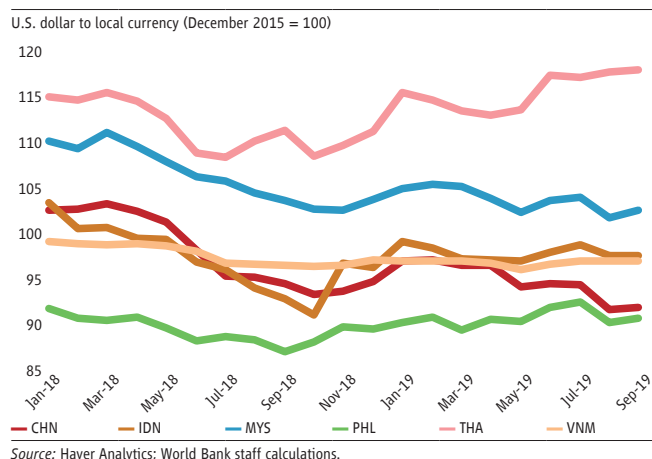
¹¹ World Bank (2017c).

¹² World Bank and Sustainable Banking Network (2018).

¹³ Indeed, these countries have rather nascent capital markets and they do not have broad bond markets, let alone green bond markets. They first need to develop their capital markets to a much greater extent if they are to take full advantage of what green bonds have to offer.

Recent trade tensions raised volatility and dampened equity prices in the region's major stock markets. Equities in China declined by around 7 percent this year in early August compared with the same period last year. All major countries in the region faced decreasing equity prices, due mostly to rising trade tensions. The resulting lower bond yields are kept under pressure from an environment in which central banks have continued to lower interest rates, to close to zero. Stock market volatility has begun to increase in the developing East Asia and Pacific region and all advanced and emerging markets, primarily as a result of the newly announced tariffs between China and the United States, and rising fears of recession in major economies.

Figure I.A.16. Major currencies have regained ground lost in 2018



Major currencies in the region have regained the ground lost last year against the U.S. dollar. Major regional currencies have strengthened since the beginning of the year after reaching a trough in the third quarter of 2018 (Figure I.A.16). On a yearly basis, the best-performing currencies in the first half of 2019 were the Thai baht and the Philippine peso. In Thailand, thanks to the balance of payment surplus, the baht has continued to appreciate against the U.S. dollar, rising from THB 33.17/US\$ at end-June 2018 to THB 30.79/US\$ by end-June 2019 (Figure I.A.20). Similarly, in the Philippines, U.S. dollar inflows through the stock market and the government's foreign borrowing lifted demand for the peso. Consequently, central banks in Indonesia, Thailand, and the Philippines re-accumulated foreign reserves after significant drawdowns in the third quarter of 2018. In contrast, the renminbi dropped to an 11-year low, slipping to the RMB 7.00/US\$ level in early August at the height of the U.S. tariff threat. The renminbi has been weakening on fears of weak Chinese economic growth.

The pace of poverty reduction has declined

Strong income growth in the bottom 40 percent of the population has supported the reduction in extreme poverty in East Asia and the Pacific over the past couple of decades. High levels of shared prosperity⁷ in developing East Asia and Pacific countries represent a continuation of over a quarter of a century of strong and broadly shared economic growth driven by labor-intensive development, combined with investment in human capital that particularly benefited people in the lower part of the income distribution. Following a history of strong economic growth, developing East Asia and the Pacific is now a region comprised of exclusively middle-income countries. Poverty rates at the Lower-Middle and Upper-Middle income class poverty lines show consistent poverty reduction at the regional level (Figure I.A.17).⁸

However, in recent years, income growth at the bottom of the distribution has been lower than at the top in some East Asia and Pacific countries. Growth incidence curves (GICs), which show growth along the entire income distribution, suggest that the extent to which growth has benefited the bottom 40 percent of the populations in Mongolia,

⁷ The shared prosperity measure captures the annualized growth rate of the mean household per capita consumption or income of the poorest 40 percent of the population (the bottom 40), where the bottom 40 are determined by their rank in household per capita consumption or income.

⁸ The International Poverty Line (IPL) was first derived from the national poverty lines of the world's poorest countries, at a time when 60 percent of the global population lived in low-income countries. In 2013, the share of population living in low-income countries was much lower at 8 percent (Fantom and Serajuddin 2016).

Philippines, Thailand, and Vietnam has declined in recent years (Figure I.A.18).⁹ In Thailand, the most recent data show that the lowest two deciles experienced a decline in household consumption. Observing shared prosperity over available periods, the growth of the bottom 40 was higher in earlier years. The period 2008–13, showed a high consumption/income growth rate in the bottom 40 in Thailand, and much of this was driven by growth in farm income (Badiani-Magnusson et al. 2015; Sondergaard et al. 2016). The reversal in growth among the bottom 40 in 2015–17 is related to absolute declines in all forms of market incomes, including stagnant wage growth and declines in net farm and net business income. Poverty increased in Mongolia in 2016 due to a sharp decline in commodity prices, and household consumption declined across the entire distribution. From 2010–14 in Vietnam, growth in household consumption was highest among the 2nd to 4th deciles. Growth in Vietnam from 2014–16 favored the upper part of the consumption/income, as growth of the bottom 40 is now lower than the mean.

Figure I.A.17. Poverty has continued to decline across the region

Poverty rate and number of poor (size of bubble, million), for the International Poverty Line, Lower-Middle Income Class Poverty Line, and Upper-Middle Income Class Poverty Line¹⁰

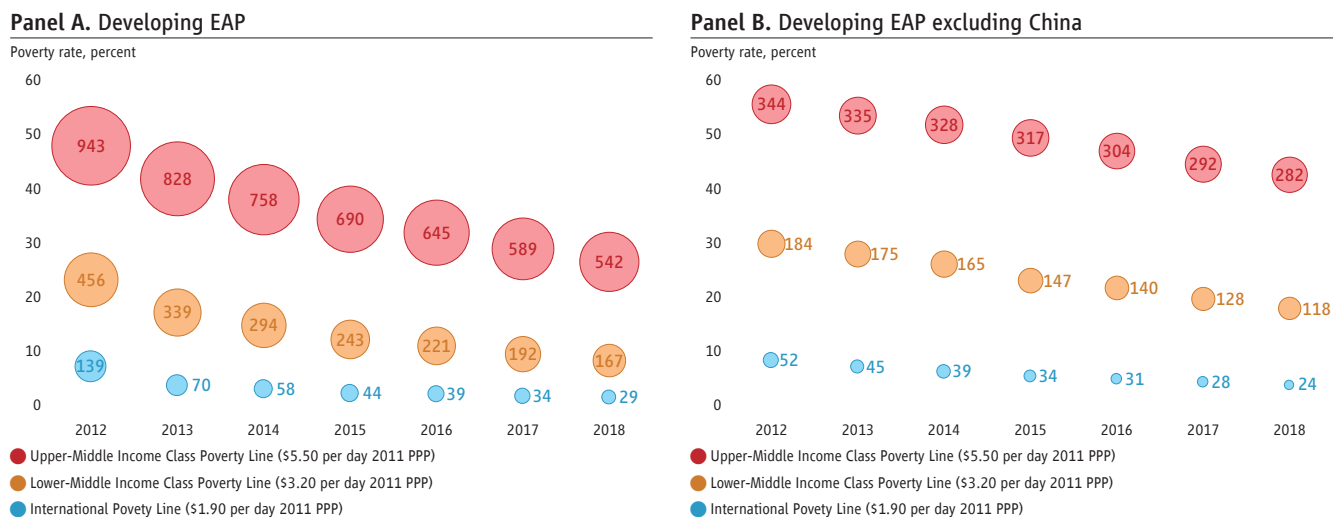


Figure I.A.18. In recent periods, growth in household per capita consumption in some countries is lower among the bottom of the distribution



Source: Authors' calculations using PovcalNet.

Notes: Each bar represents one decile. The lowest decile is on the left, and the richest decile is on the right. The orange bars represent the bottom 40. Data are growth in household per capita consumption, with the exception of the Philippines, which is growth in household per capita income.

⁹ This section focuses on large and medium economies in developing EAP with two comparable data points. Shared prosperity cannot be calculated for Myanmar because there is only one data point.

¹⁰ See the 2018 Poverty and Shared Prosperity flagship for definitions and derivations of the Lower Middle and Upper Middle Income class poverty lines.

Nevertheless, consumption by the bottom 40 percent continued to grow strongly in some East Asia and Pacific countries. Not all countries experienced lower growth at the bottom of the distribution. The Philippines, for example, experienced higher overall growth from 2012–15 than from 2009–12. China and Malaysia had some of the highest consumption/income growth rates of the bottom 40 percent of the population in the world, based on data circa 2010–15 (World Bank 2018f). Strong shared prosperity growth in Malaysia has been linked with the minimum wage increase in 2012. In China, strong growth among the bottom 40 percent of the population is linked with farm incomes boosting the welfare of rural households. Alongside consumption growth by the bottom 40 percent, a recent Gallup poll suggests that households in the region feel optimistic about higher living standards, but household vulnerabilities may be rising (see Box I.A.6 on perceptions of living standards).

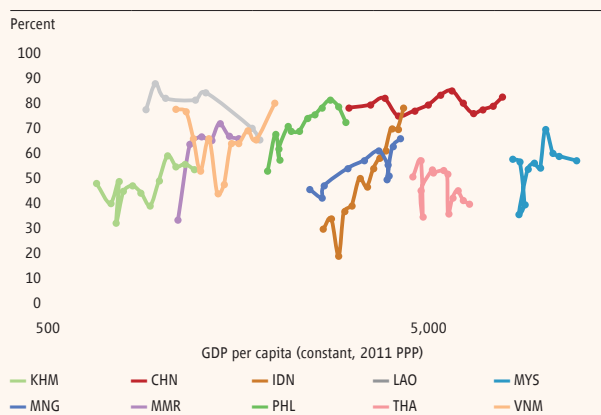
Box I.A.6. Recent household perceptions of living standards¹

Individual perceptions about living standards are an important indicator that can signal changes to economic well-being or insecurities. Perception indicators can reflect a mix of consumer confidence, happiness, optimism, and personal expectations about future well-being. As such, they can help identify shifts in economic growth, but also suggest vulnerabilities that households face as they cope with changes in living standards. Both the economic structure of an economy, as well as the existence of social safety nets to support households during economic downturns, can be correlated with perception indicators.²

High GDP growth rates during the past decade in East Asian economies have contributed to progress in poverty reduction; today all economies in developing EAP are middle-income countries. In 2018, 69 percent of respondents to a Gallup World Poll in developing East Asia and Pacific³ economies felt their living standards have been getting better, ranging from 39 percent in Thailand to 82 percent in China (Figure BI.A.6.1). In most countries, more respondents indicated that living standards were getting better as GDP per capita rose, though there are some cases where perceptions deteriorated despite rising GDP per capita. When focusing on the past few years, this was the case in Lao PDR, Cambodia, the Philippines, Thailand, and Malaysia. While Thailand's GDP per capita rose from US\$4,426 to US\$6,362 from 2006 to 2018, the share of respondents that felt their standards of living were getting better declined from 50 to 39 percent.

Most recently, respondents from Vietnam, China, and the Philippines have the most positive sentiments that their living standards and city's economy are getting better. In 2018, 82 percent of respondents in China reported that their living

Figure BI.A.6.1. Individual perceptions of living standards and GDP



Source: World Bank staff calculations using Gallup and WDI.

Notes: Gallup World Poll interviews at least a thousand respondents in each country, aged 15 and over, and asks a variety of questions about how they feel about economic, political, and social issues. For most countries, the data series ranges from 2006 to 2018. In some countries, polls are not conducted every year. Myanmar's polling started in 2012.

(continued)

¹ This box was prepared by Judy Yang.

² In Thailand one-third of the labor force works in the agriculture sector, while the agricultural sector is 8 percent of GDP. In Mongolia, the mining sector is a large share of GDP at 21.9 percent in 2018, while the sector employs 5.8 percent of the labor force.

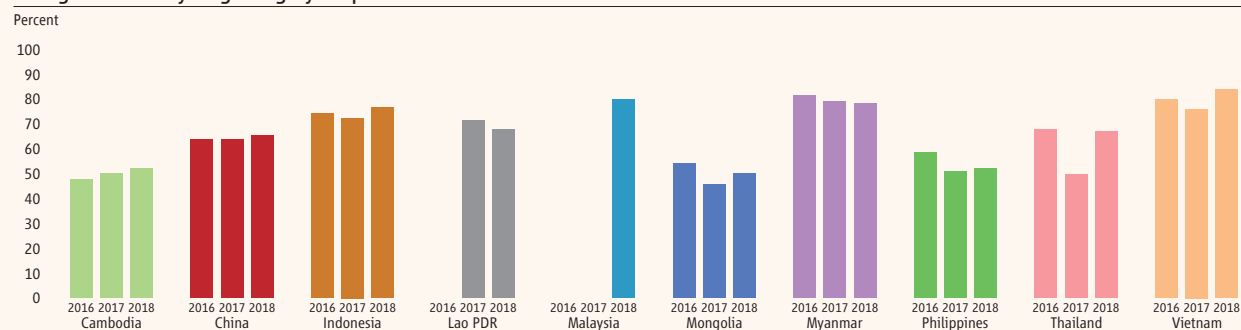
³ Developing EAP economies surveyed by Gallup World Poll include: Cambodia, China, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, the Philippines, Thailand, and Vietnam.

(Box I.A.6 continued)

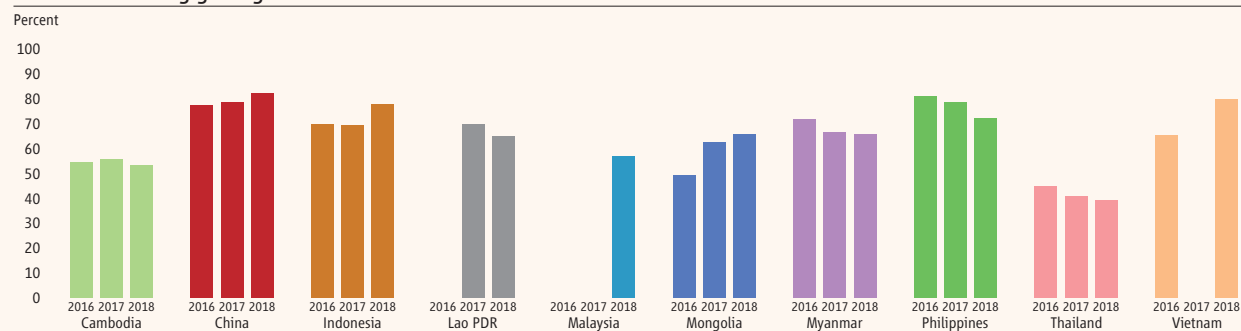
standards were improving, the highest rate in the region. China also consistently has the largest share of respondents who feel their standards of living are improving over the past decade. In 2018, Vietnam had the highest share of respondents who report they are living comfortably or getting by on present household income.

Figure BI.A.6.2. Perceptions on income and well-being 2016–18, by country

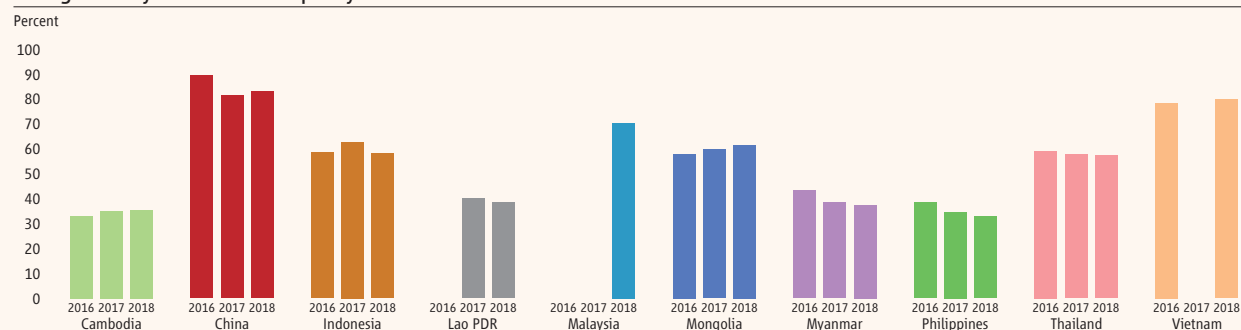
Living comfortably or getting by on present income



Standards of living getting better



Enough money for food in the past year



Source: World bank staff calculations using Gallup World Poll data.
Notes: Percent of respondents.

Over the past decade, Indonesia had one of the largest transformations and improvements in sentiment. Sentiment on standards of living in Indonesia started from a low of 18.6 percent in 2008. However, this percentage rose to 77.8 percent in 2018. Indonesia shows similar improvements in sentiment across several indicators: whether it is a good time to find a job, and if the city economy and standards of living is getting better or worse.

(continued)

(Box I.A.6 continued)

Some objective measures reveal households are vulnerable despite optimism or hopeful outlooks. In 2018, more than half of respondents in Cambodia, Lao PDR, Myanmar, and the Philippines reported that there was at least one instance in the past year when they did not have enough money for food (Figure BI.A.6.2). In the Philippines, this was the case despite 72 percent of respondents indicating their living standards were getting better. In Indonesia, while perceptions have improved in some indicators, a growing share of respondents who reports that they did not have enough money for food at least once in the past year.

Some changes in responses correlate with real economic downturns. For example, in Thailand in 2016–17, there was an increase in the share of respondents who state that they are finding it difficult to get by on their present household income or not having enough for food. This change corresponds to increase in poverty and declining household incomes seen in household survey data.

Perception data can be useful to gauge changes in well-being in a more frequent manner. Household survey data are not collected annually in most countries and, even when they are, data processing usually delays their release to monitor the status of households in a timely manner. Perception indicators, while subjective, are simpler to collect and can be useful serve as complementary indicators when household survey data are unavailable.

I.B. Outlook and Risks

The growth outlook for many of the region's economies has been downgraded since the April 2019 East Asia and Pacific Economic Update. Growth in the developing East Asia and Pacific region is now expected to decelerate from 6.3 percent in 2018 to 5.8 percent in 2019, 5.7 percent in 2020 and 5.6 percent in 2021, respectively. Growth in China, the region's largest economy, is expected to decline over the forecast horizon. The region's other large economies will also slow in 2019, although some are expected to recover in succeeding years. GDP growth in the small economies, in contrast, is projected to accelerate in 2019 reflecting country-specific conditions. The region's growth prospects face intensified downside risks, including further escalation of trade disputes, a sharper-than-expected slowdown in China, the United States and the Euro Area, along with a disorderly Brexit, and an abrupt change in global financing conditions. In some countries, rising indebtedness and other vulnerabilities, such as the constrained capacity for foreign debt rollover, could amplify the negative effects of external shocks. In a number of countries, political uncertainty represents another source of risk.

Regional growth is expected to moderate across the three-year forecast horizon

Global economic conditions will remain fragile throughout 2019, before moderately improving in the next two years, barring the materialization of the significant downside risks. Global growth is expected to dip to 2.5 percent in 2019, reflecting broad-based weakness in advanced economies and major emerging market and developing economies (EMDEs) at the start of the year. The current softness will continue, with the world economy projected to grow at 2.5 percent in 2020 and marginally increase to 2.6 in 2021. Growth in advanced economies is projected to moderate from 2.2 percent in 2018 to 1.5 percent on average in 2019–21 toward its potential rate, as capacity constraints become more apparent and labor markets tighten. On the other hand, growth in EMDEs is projected to slow to 3.7 percent in 2019 before recovering to 4.2 percent in 2020. This forecast is predicated on the waning impact of earlier financial pressures currently weighing on activity in some large EMDEs (e.g., Argentina and Turkey) (Box I.B.1).

Box I.B.1. Global Outlook and Risks¹

Global growth is expected to remain subdued over the forecast horizon. The global economic growth rate is projected to slow to 2.5 percent in 2019, reflecting broad-based weakness in advanced economies and major emerging market and developing economies (EMDEs). Global growth is projected to remain anemic in 2020 before strengthening insignificantly to 2.6 percent in 2021 (Figure BI.B.1.1). Growth in advanced economies is projected to moderate from 2.2 percent in 2018 to 1.5 percent on average in 2019–21, reflecting a sharp deceleration in trade, investment, and manufacturing.

Growth in EMDEs is projected to slow to 3.7 percent in 2019 before recovering to 4.2 percent in 2020 as previous headwinds in some key EMDEs ease. This forecast is predicated on the waning impact of earlier financial pressures currently weighing on activity in some large EMDEs (e.g., Argentina, Brazil, Russia, and Turkey)

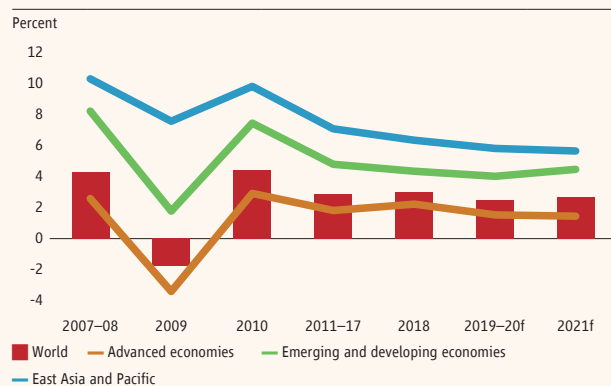
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¹ This box was prepared by Ekaterine Vashakmadze.

(Box I.B.1 continued)

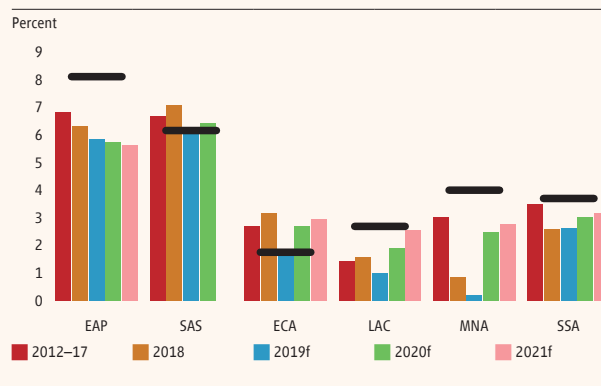
and no major deterioration in the global environment. Weak EMDE growth in 2019 reflects the lingering effects of 2018 financial market stress on several large economies, a lackluster and notably softer-than-envisioned cyclical recovery in commodity exporters, and a further deceleration in commodity importers. Economic activity is forecast to slow but remain robust in EMDE regions with large numbers of commodity importers, including South Asia, and East Asia and the Pacific, though support from exports is expected to diminish. The cyclical upswing in regions with many commodity exporters, including Latin America and the Caribbean, and the Middle East and North Africa, is projected to be weaker than expected, partly reflecting the impact of lower price forecasts and domestic challenges in many large commodity-exporting economies (Figure BI.B.1.2).

The long-term drivers of EMDE growth are expected to continue to weaken during the coming decade, unless significant policy changes boost potential growth rates effectively. EMDEs face a subdued pace of capital accumulation, slowing productivity growth and maturing demographic transitions. While demographic trends will continue to support growth in South Asia, ageing populations and rising dependency ratios are expected to weaken growth in East Asia and the Pacific (e.g., China and Thailand), and Europe and Central Asia (e.g., Poland and the Russian Federation).

Figure BI.B.1.1. Aggregate GDP growth rates

Source: World Bank.

Note: Horizontal lines in the right panel indicate long-term average growth rates. EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, and SSA = Sub-Saharan Africa.

Figure BI.B.1.2. Regional GDP growth rates

Global economic conditions are expected to remain challenging over the forecast period. The increase in tariffs by China and the United States that were announced over the course of 2019 will have more severe effects than the tariff hikes implemented in 2018. Beyond economic losses for the affected exporters, the re-escalation of trade tensions is contributing to heightened policy uncertainty, which is expected to dent confidence and investment. Barring a renewed escalation of trade tensions, global trade growth is projected to weaken from 4.1 percent in 2018 to 1.9 percent in 2019, and then recover modestly to 2.2 percent in 2020. This forecast is predicated on policy support measures implemented in major economies and firmer domestic demand in some EMDEs. This modest rebound notwithstanding, global trade is expected to be weaker than previously envisaged over the forecast horizon, reflecting a softer outlook for global investment and evidence of a lower income elasticity of trade.

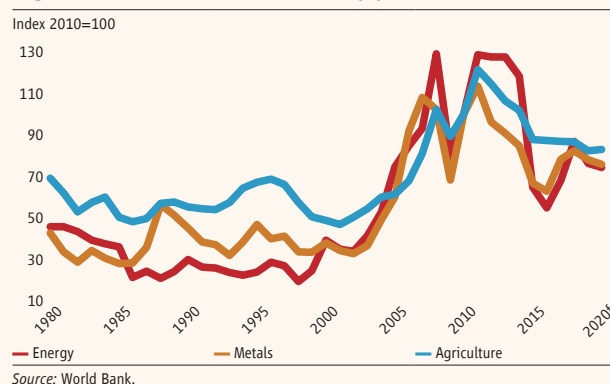
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(Box I.B.1 continued)

Global financing conditions are expected to remain volatile, even if generally more supportive. This reflects more accommodative monetary policy stances adopted by the major central banks in the near term due to the deteriorating global growth prospects. Despite the recent recovery of EMDE markets from the 2018 correction episode, there is still a considerable risk of “monetary shocks” associated with the global policy uncertainty. Financial market volatility will continue to have the strongest impact on countries with high vulnerabilities, weak growth prospects, and elevated policy uncertainty. The eventual rise of advanced-economy yields will have a negative impact on capital flows to EMDEs. Policy uncertainty, geopolitical risks, and security concerns could also continue to adversely impact EMDE capital inflows.

Modest declines are forecast for global commodity prices. Oil prices are expected to average US\$60/bbl in 2019 and 2020, with high uncertainty around the outlook. Overall, metals prices are expected to decline slightly in 2019 and 2020, reflecting a weaker outlook for global metals demand. Agricultural prices are expected to remain broadly flat in 2020 (Figure BI.B.1.3).

Risks continue to be firmly on the downside. There is considerable uncertainty around the outlook for the global economy. The balance of risks remains firmly on the downside and has recently intensified, reflecting the re-escalation of trade tensions amid heightened global uncertainty. Although unlikely in the near term, the simultaneous occurrence of a sharper-than-expected slowdown in China, the Euro Area, and the United States could trigger a significant downturn in global activity. The further escalation of trade tensions could be highly disruptive to global activity amid the presence of complex value chains. The risk of severe and broad-based financial stress adversely affecting the outlook for EMDEs remains high amid elevated debt levels in many countries. Policy uncertainty and geopolitical risks remain high, and could negatively impact confidence and investment in both affected countries and globally. Policy uncertainty is particularly elevated in a number of European countries, including the United Kingdom as it transitions out of the European Union.

Figure BI.B.1.3. World commodity price forecasts

The growth outlook is downgraded in many economies in the region, as downside risks identified in the April 2019 outlook have materialized or intensified. Given the protracted trade tensions, weaker global demand, and the slowdown of manufacturing activities in the region, the growth outlook for nine of the 14 economies in the region has been revised downward from the April growth forecast, including five of the six large developing East Asian and Pacific economies. Growth in developing East Asia and Pacific region is expected to slow from 6.3 percent in 2018 to 5.8 percent in 2019, 5.7 percent in 2020, and 5.6 percent in 2021, respectively (Table I.B.1). All of the region’s larger economies face lower growth prospects in 2019 compared with 2018, while most of the smaller economies will generally grow faster in 2019. Thailand’s downward-revised growth forecast reflected a combination of the larger-than-expected decline in exports, the drag on public investment resulting from the lack of decision-making following the delayed election results,

and the worst drought in decades; whereas in the Philippines, the revision was due to weaker-than-expected investment growth in the first half of 2019. Across the region, export growth is projected to decline in line with softening global demand, while imports are also expected to moderate over the medium term, in line with declining investment growth. Further delays in large planned public and private infrastructure projects could further suppress investment growth.

Table I.B.1. East Asia and Pacific economic outlook

| | <i>Forecast</i> | | | | | | <i>Change from April 2019 Update^a</i> | |
|---|-----------------|-------------|-------------|-------------|-------------|-------------|--|-------------|
| | <i>2016</i> | <i>2017</i> | <i>2018</i> | <i>2019</i> | <i>2020</i> | <i>2021</i> | <i>2019</i> | <i>2020</i> |
| Developing EAP ^d | 6.4 | 6.5 | 6.3 | 5.8 | 5.7 | 5.6 | -0.2 | -0.3 |
| China | 6.7 | 6.8 | 6.6 | 6.1 | 5.9 | 5.8 | -0.1 | -0.3 |
| Developing EAP excl. China ^d | 5.0 | 5.3 | 5.2 | 4.9 | 4.9 | 5.0 | -0.3 | -0.3 |
| Developing ASEAN ^d | 5.0 | 5.4 | 5.3 | 4.8 | 5.0 | 5.0 | -0.4 | -0.3 |
| Indonesia | 5.0 | 5.1 | 5.2 | 5.0 | 5.1 | 5.2 | -0.2 | -0.2 |
| Malaysia | 4.4 | 5.7 | 4.7 | 4.6 | 4.6 | 4.6 | -0.1 | 0.0 |
| Philippines | 6.9 | 6.7 | 6.2 | 5.8 | 6.1 | 6.2 | -0.6 | -0.4 |
| Thailand | 3.3 | 3.9 | 4.1 | 2.7 | 2.9 | 3.0 | -1.1 | -1.0 |
| Vietnam | 6.2 | 6.8 | 7.1 | 6.6 | 6.5 | 6.5 | 0.0 | 0.0 |
| Cambodia | 7.0 | 7.0 | 7.5 | 7.0 | 6.8 | 6.8 | 0.0 | -0.1 |
| Lao PDR | 7.0 | 6.9 | 6.3 | 6.5 | 6.7 | 6.6 | -0.1 | 0.0 |
| Myanmar | 6.0 | 6.8 | 6.5 | 6.6 | 6.7 | 6.8 | 0.1 | 0.1 |
| Mongolia | 1.4 | 5.4 | 6.8 | 6.9 | 6.3 | 5.9 | -0.3 | -0.6 |
| Fiji | 2.6 | 5.2 | 4.2 | 2.7 | 3.0 | 3.0 | -0.7 | -0.3 |
| Papua New Guinea | 4.1 | 2.7 | -0.5 | 5.6 | 3.1 | 3.5 | 0.5 | 0.0 |
| Solomon Islands | 3.2 | 3.7 | 3.9 | 2.7 | 2.9 | 2.7 | -0.2 | 0.1 |
| Timor-Leste ^b | 5.1 | -3.5 | -1.1 | 4.2 | 4.6 | 4.9 | 0.3 | 0.0 |
| Assumptions about the external environment: ^c | | | | | | | | |
| World | 2.6 | 3.2 | 3.0 | 2.5 | 2.5 | 2.6 | -0.2 | -0.3 |
| Advanced economies | 1.7 | 2.4 | 2.2 | 1.6 | 1.4 | 1.4 | -0.1 | -0.2 |
| Emerging and developing economies | 4.1 | 4.5 | 4.3 | 3.7 | 4.2 | 4.4 | -0.5 | -0.4 |
| Crude oil (spot, US\$/barrel) | 43 | 53 | 68 | 62 | 60 | 61 | -2 | -5 |
| Non-energy commodities (index, 2010=100) | 79 | 84 | 85 | 81 | 81 | 82 | -2 | -4 |
| Food (index, 2010=100) | 90 | 90 | 90 | 86 | 86 | 87 | -2 | -3 |

Source: World Bank data and staff estimates.

Note: a. World Bank East Asia and Pacific Economic Update, April 2019 (World Bank 2019f). b. Nonoil GDP. c. Global growth and commodity price forecasts represent preliminary working assumptions. Myanmar data are fiscal year growth rates (2018 = FY2018/19). Changes from April 2019 are calculated with one decimal point precision and rounded to one decimal point. d. Estimate.

China's growth trajectory is projected to slow down as the economy continues to rebalance amid unfavorable external conditions. China's growth is projected to ease to 6.1 percent in 2019, and further to 5.9 percent in 2020 and 5.8 percent in 2021, reflecting rising structural constraints including a shrinking labor force, diminishing returns to investment and weak productivity growth. Intensifying trade disputes, on top of a subdued global outlook, are depressing business confidence, which will weigh on investment and export growth. Domestic demand, particularly household consumption will remain the main driver of growth in China, but will also need to play an even stronger role in sustaining growth given the less benign external conditions. This baseline projection reflects the direct effect of the

latest U.S. 10 percent tariffs on US\$300 billion of imports from China, which is estimated to lower China's GDP growth by around 0.2 percent per year compared with a no-additional-tariffs scenario, although the impact may be offset by currency depreciation and export diversion.

Growth in the region's other large economies is expected to decline in 2019, but some are expected to recover in succeeding years. In 2019, economic growth in Indonesia, Malaysia, the Philippines, Thailand, and Vietnam is expected to be lower than in 2018. Moderating global demand and the prolonged weakness in commodity-related sectors are likely to constrain export growth. Governments are attempting to support growth through new spending measures (Thailand), public infrastructure investment programs (the Philippines, Thailand) and accommodative monetary policies, mainly through lower policy rates. Lower policy rates may help boost private investment, which remains generally subdued as investors take a more cautious stance. Economic growth will likely draw strength from private consumption amid a low inflation environment, and positive credit growth.

Growth is expected to remain robust in the smaller economies. In Cambodia, strong export performance is expected to continue to propel growth, accompanied by strong construction activity.¹¹ In Myanmar, growth is expected to pick up slightly in 2019/20, driven by stronger performance in manufacturing and services supported by market reforms. Timor-Leste is expected to recover from the recession of the past two years with continued political and economic stability, such that growth is expected to rise in 2019 and 2020. Growth in Papua New Guinea is also expected to rise in 2019 and remain higher than in recent years in 2020, following a recovery in extractive-sector production, supported by proposed investments in several large resource projects. The medium-term macroeconomic outlook in Mongolia is positive, with growth estimated to average more than 6 percent over 2019–21 due to robust FDI inflows and relatively strong developments in the mineral sector (copper and coal). Growth in Lao PDR is also expected to remain strong, with the potential for increased trade beyond the forecast period if the Lao-China Railway Project under the Belt and Road Initiative is completed on schedule and requisite measures such as reforms to enhance trade facilitation and productivity are undertaken (see Box I.B.2).

Box I.B.2. The Belt and Road Initiative Network: Lessons from the Lao-China Railway Project¹

Part of six international economic corridors under the Belt and Road Initiative (BRI), the Lao-China Railway will connect Lao PDR (and later Thailand, Malaysia, and Singapore) to the vast BRI network. Designed as a high-speed railway, the 1,009 km track will carry both passenger and freight trains, with trains between Kunming and Xishuangbanna running on double tracks, followed by a single track from there to the border and to Vientiane. The 414 km section in Lao PDR will connect four northern provinces to Vientiane along 10 stops, and will pass through the World Heritage City and tourism center of Luang Prabang. Vientiane and surrounding areas account for nearly 30 percent of the country's GDP, as well as more than 40 percent of industrial activity. The connection of Vientiane to Kunming, with the latter's more than 6 million inhabitants and an economy larger than Lao PDR, will offer significant economic opportunities for Lao PDR.

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¹ This box was prepared by Mombert Hoppe.

¹¹ In February, the EU started the process that could lead to the temporary suspension of Cambodia's preferential access to the EU market under the Everything But Arms (EBA) scheme in August 2020. To mitigate the potential negative impacts of EBA withdrawal, the authorities will be introducing a fiscal stimulus in their 2020 budget.

(Box I.B.2 continued)

While the section from Kunming to Vientiane is expected to be operational by the end of 2021, the connection to Bangkok will take another five years to complete. Agreements to construct the sections between Vientiane and Bangkok have only recently been reached, and no tentative date for the completion of the corridor to Singapore has been set. It is expected that passenger trains will use the new standard gauge tracks between (Kunming and) Vientiane and Bangkok, while cargo will be transloaded to the existing meter gauge slow-speed network that already connects the border between Thailand and Lao PDR to the large port south of Bangkok. A decision as to where exactly this transshipment will take place has still to be made, or has not been made public.

The railway connection to the BRI network is expected to bring significant economic benefits to Lao PDR if important complementary economic reforms are undertaken in tandem. Using a global model developed by the World Bank (2019c), the study estimates that the connection to the BRI network through the railway could increase Lao PDR's aggregate income by up to 21 percent over the long term, if all countries implement reforms to reduce border delays (with small additional benefits from reducing preferential tariffs). Lao PDR would be one of the largest beneficiaries, relative to GDP, from the BRI network. Without complementary reforms, the impact of the global infrastructure investments alone is expected to increase income between 3.1 and 13 percent over the long term.

However, the high construction costs at US\$ 5.9 billion, which are shared between Lao PDR and China at a ratio of 30/70 percent, present risks. Forty percent of the investment is funded from equity, although Lao PDR is borrowing from China on concessional terms for part of its equity share. The remaining 60 percent of the costs are debt funded through subsidized commercial borrowing by the Lao-China Railway Company, a joint venture between one Lao and three Chinese state-owned enterprises. The debt incurred by the Lao government to purchase equity in the project is US\$480 million (or 2.1 percent of GDP when fully disbursed by 2021) on highly concessional terms. With the inclusion of the railway-related public debt, based on the Debt Sustainability Analysis (DSA) 2019, the public and publicly guaranteed debt (PPG) of Lao PDR, although relatively high at 58 percent of GDP in 2018, is expected to decline in the medium and long term. It remains to be seen how economically profitable the railway will be and how the operating costs will be funded once construction is complete. The Lao government has stated that it has not issued a guarantee for these costs.

Success of the railway will depend on attracting enough cargo and passenger traffic, which will require a shift of transit flows between China and ASEAN toward rail. Currently, 99 percent of trade flows between China and ASEAN use maritime routes, and trade between Lao PDR and China represents less than 2 percent of total China-ASEAN trade. Efficient railway transport options will be critical to attract cargo flows. While bilateral trade is expected to grow, given the relatively small size of the Lao economy it will be critical to attract more transit trade to use railways to achieve volume. While it will be more challenging to attract cargo from beyond Bangkok, supply chain linkages and trade relationships between the north of Thailand and China have been increasing in the recent past.

The railway is expected to reduce transport prices significantly if Lao PDR implements complementary logistics and trade facilitation reforms. Compared with using the current road network and (inefficient)

(continued)

(Box I.B.2 continued)

trucking services, per ton transport costs for rail shipment from Laem Chabang (the port south of Bangkok) to Kunming are expected to be almost 60 percent lower, and from Kunming to Vientiane (Luang Prabang) 50 percent lower, assuming a 20 km feeder transport, or 40 percent lower assuming a 100 km feeder transport in Lao PDR.² Domestic transport prices between Luang Prabang and Vientiane are expected to fall by 40 percent as well.

The price competitiveness of the railway will depend on improvements in roads and more efficient logistics services, making it easier and cheaper to connect economic activity and consumption centers to the railway, while some additional infrastructure investments will also be important. While the backbone road infrastructure connecting five provinces in the northern part of the country is in fair condition,³ the quality of secondary roads to production areas away from primary corridors is poorer and road maintenance remains a challenge, increasing road transport prices. Road transport prices are also high because of limited competition in the logistics sector (World Bank 2018e). Developing logistics services and the roads serving such sub-corridors along the railway will facilitate tourism and link agricultural production to the railway, increasing demand for railway usage.

The railway will initially end in Vientiane, requiring the development of efficient multi-modal transport solutions by the private sector, which are currently unavailable. Restrictions to entry and competition in the Lao transport market, especially for cross-border transport services, limit competition. As a result, transport prices are roughly twice as expensive on a per-ton-km basis compared with Thailand, and many value-added services such as integrated door-to-door multimodal transport, container leasing, inventory management, order fulfilment, purchase order management, and cold chain services are either limited or entirely unavailable.

Encouraging competition by improving the regulatory framework and enforcement capacity will be critical in allowing private sector operators to provide efficient multi-modal transport services. Such services could connect the railway to production and consumption centers, especially in Lao PDR and Thailand, and could increase volumes on the railway. Allowing public access to rail heads and rail infrastructure, and establishing regulations for the use of containers would also be important in supporting competition.

Attracting additional flows from neighboring countries will also require establishing an efficient transit system and implementing further trade facilitation measures to reduce the costs of moving goods through (as well as into and out of) Lao PDR. In particular, customs and other border agencies will need to modernize operational practices, deepen existing regulatory transparency initiatives such as the Lao Trade Portal, improve coordination, and introduce effective risk management systems. Once processes, procedures and non-tariff measures are simplified, increasing the use of Information and Communication Technology (ICT) (including moving to an electronic customs declaration that does not require hard copies) could further improve the predictability of customs and other border agency requirements and processes, as well as reduce border clearance times and increase the predictability of processes. Establishing an effective transit system for goods will be critical.

(continued)

² As the railway only represents a transport backbone, goods will have to be transported to and from the railway to where they are produced or consumed, referred to as “feeder transport”.

³ Roads are, however, designed with lower axle load compared with ASEAN standards, can only be traveled at low speed due to difficult geographical conditions (mostly mountainous) and are vulnerable to landslides and flooding, which often cut off roads during the rainy season.

(Box I.B.2 continued)

Improved border controls for passengers will be needed to avoid lengthy delays undermining the attractiveness of the railway for tourists and business travelers. Based on discussions with officials at borders, all train passengers will have to first exit the train to complete emigration and customs formalities, board the train and repeat this process for immigration at the next station. The train will have to wait for all passengers to clear both checkpoints before continuing the journey. Simplifying procedures and ensuring that enough customs and immigration officials are available to quickly process all passengers and their luggage will be essential. For example, according to the official schedule, the time to cross the border on the train from Hanoi to Nanning takes 5 hours and 20 minutes, more than 40 percent of the total travel time, reducing the attractiveness of rail compared with other modes of transport including cars.

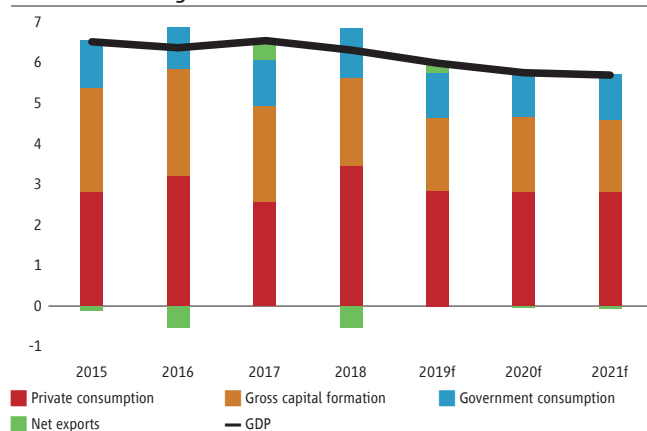
Adopting the railway consignment note to act as the transit document, and allowing electronic submission of customs declarations, would improve the effectiveness of the transit system for goods. The ability to provide smooth transit services will be key in confirming the corridor's value-for-money, and making it an attractive option for the transport of goods between parts of ASEAN countries and China. Without attracting such transit flows, which are expected to account for more than 50 percent of traffic on the railway over the medium term, making the railway a sustainable economic success will be significantly more challenging.

With weak external demand, developing East Asia and the Pacific will rely on domestic demand to power growth. Private consumption is expected to remain the key driver of economic growth in most of the economies in the region (Figure I.B.1). A few factors will support consumption growth, including a generally low inflation environment in large economies, and improvements in income and labor market outcomes, on top of accommodative policy stances. However, heightened uncertainty may yet again temper private investment growth. Achieving the projected growth levels will depend on governments' stepping up their delivery of public investment in infrastructure and human capital. Notwithstanding the contribution of domestic demand to overall growth, growth is still anticipated to moderate, in line with the broader global economic moderation.

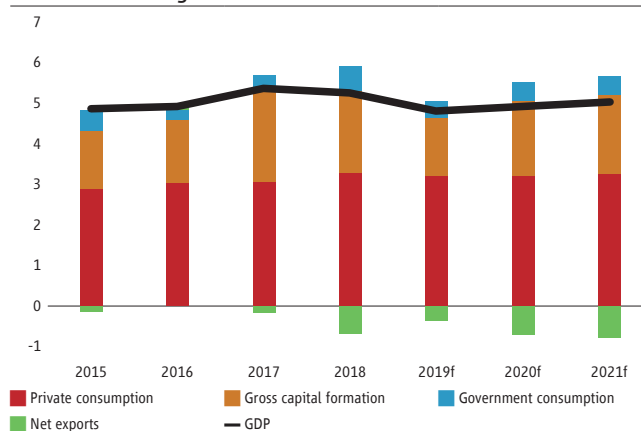
Figure I.B.1. Domestic demand will continue to drive growth over the forecast period

Contribution of expenditure components to GDP growth among developing East Asian and Pacific countries (percentage points)

Panel A. Including China



Panel B. Excluding China



Source: World Bank staff estimates.

As growth moderates, the pace of poverty reduction will also slow

The pace of poverty reduction is decelerating amid lower growth rates.¹² The current 2019 Upper-Middle Income Class (UMIC) poverty rate estimate for developing East Asia and the Pacific is 24.0 percent, compared with a previous estimate of 23.7 percent in the April 2019 East Asia and Pacific Economic Update (Table I.B.2).¹³ A higher poverty rate means that the estimated number of UMIC poor is 6.6 million higher compared with April 2019 estimates. In 2018–19, changes to estimates of the number of poor are primarily driven by countries other than China since these countries collectively had larger growth downgrades during this period. Larger growth downgrades from China have a more noticeable adjustment effect on the number of the poor estimated in 2020 and 2021.

Table I.B.2. Poverty in developing EAP is projected to continue falling, based on the Upper-Middle Income Class Poverty Line

US\$5.50/day 2011 PPP

| | Fall 2019 Estimates | | | | Difference from April 2019 Estimates | | | |
|--------------------------|--|-------|-------|-------|--|------|------|------|
| | Upper-Middle Income Class Poverty Line: US\$5.50/day 2011 PPP | | | | Upper-Middle Income Class Poverty Line: US\$5.50/day 2011 PPP | | | |
| | <i>Developing EAP</i> | | | | <i>Developing EAP</i> | | | |
| | 2018 | 2019 | 2020 | 2021 | 2018 | 2019 | 2020 | 2021 |
| Poverty rate (percent) | 26.4 | 24.0 | 22.0 | 20.0 | 0.2 | 0.3 | 0.6 | 0.8 |
| Number of poor (million) | 541.9 | 495.8 | 456.7 | 418.3 | 3.6 | 6.6 | 13.7 | 16.9 |
| | <i>Developing EAP Ex-China</i> | | | | <i>Developing EAP Ex-China</i> | | | |
| | 2018 | 2019 | 2020 | 2021 | 2018 | 2019 | 2020 | 2021 |
| | 2018 | 2019 | 2020 | 2021 | 2018 | 2019 | 2020 | 2021 |
| Poverty rate (percent) | 42.5 | 40.6 | 38.7 | 36.8 | 0.6 | 1.0 | 1.3 | 1.5 |
| Number of poor (million) | 282.0 | 272.0 | 261.8 | 251.4 | 3.7 | 6.6 | 8.9 | 10.4 |

Source: World Bank East Asia and Pacific Team for Statistical Development.

Note: Current estimates differ from April 2019 due to changes in population, CPI, and actual and forecasted GDP growth rates. The most recent household income and expenditure surveys vary from 2006 in Kiribati to 2017 in Indonesia and Thailand. Estimates are extrapolated based on per capita GDP growth and historical estimates of the growth elasticity of poverty. PPP = purchasing power parity.

Downside risks to the outlook have intensified

Further escalation of China-United States trade disputes will dampen growth prospects for countries in developing East Asia and the Pacific. The escalation of China-United States trade tensions has heightened uncertainties surrounding global trade policy, posing risks to regional trade and investment flows. Further escalation could lower regional growth due to the impact of U.S. trade measures on China's growth, and the impact on business sentiment and investor risk aversion across the region. Developing East Asia and the Pacific is especially susceptible to the negative impact of the trade disputes, considering its trade openness and a relatively high level of integration in global value chains. Trade tensions are brewing between Japan and the Republic of Korea over technology goods, the United States and the European Union over the EU's aircraft subsidies and the United States and India over steel and aluminum.

Beyond trade measures, the China-United States tensions can spill over into other areas of the economy. Recent developments in the China-United States tensions demonstrate that the dispute between the two economic giants can go beyond trade issues. The U.S. ban of chip sales to Chinese phone makers and the threat of withdrawing sales of rare earth minerals all illustrate how the trade dispute between these two countries could have negative spillovers in other

¹² Changes in population estimates also affected forecasts. China's estimated population in 2019 is almost 2 million higher than in April.

¹³ The Upper-Middle Income Class (UMIC) poverty line is US\$5.5/day 2011PPP per person per day. To derive this line, medians of the national poverty lines of countries in upper-middle income class countries were calculated. Therefore, the US\$5.5/day 2011PPP is the median of national poverty lines from UMIC countries (Jolliffe and Prydz 2016). The line is applied to all countries in developing EAP, not just UMIC countries.

areas. News of visa restrictions on students and researchers suggest that cross-country knowledge-sharing may also be hampered. Escalation of tensions into new areas will make it more difficult to resolve the China-United States dispute.

A protracted trade dispute could permanently alter the global trade landscape, with consequences on the market shares of the region's economies. In the recent G-20 summit in Japan that brought the United States and China back to the negotiating table, no substantive progress was recorded on the main dispute issues of market access, technology transfer, government subsidies, and intellectual property protection. So, as long as these underlying issues remain unresolved, policy uncertainty hangs over the situation, with the possibility of a further escalation of trade disputes. A quick resolution of the China-United States trade tension appears nowhere in sight; and the longer it takes for it to be resolved, the greater the possibility that the trade landscape will be permanently altered, with little chance of returning to pre-trade tension arrangements. A global reconfiguration of trade or a new value chain system could emerge that would entail both risks and opportunities for the region's developing economies.

However, limited technical and absorptive capacity hinders regional neighbors from fully capturing trade and investment opportunities moving out of China in the short term. Global value chains are sticky in the short run, and relatively inflexible in the long run as complementarities in production persist (Bayoumi et al. 2019). Anecdotal accounts suggest that global and Chinese firms are taking measures to avoid the risks of U.S. tariffs by either moving entire production lines out of China or complementing existing operations with production in another country (Hoshi et al. 2019). Nonetheless, developing East Asia and Pacific countries face limited absorptive capacity due to relatively low labor supply and infrastructure inadequacy. In Vietnam, for instance, global manufacturers are confronting labor shortages as they rush to set up operations in the country (Mandhana 2019). Moreover, the absence of a fully-developed supply chain, along with research and development networks, make it difficult for firms to replace China in the global supply chains without significant business disruption.

A sharper-than-expected slowdown in China, the Euro Area, and the United States could further decelerate global activity. A downturn in global growth would lead to lower overall demand for exports from the East Asia and Pacific region that would hamper growth. A simultaneous, sharp slowdown could also substantially lower commodity prices, negatively affecting commodity exporters such as Indonesia, Lao PDR, Malaysia, and Mongolia. Smaller economies in the region are especially dependent on commodity exports to China (Mongolia, Papua New Guinea, and the Solomon Islands), tourism (Cambodia and Palau), and direct investment to the real estate sector (Cambodia). Estimates suggest that a 1-percentage-point slowdown in China's growth alone could reduce growth in the region by around 0.5 of a percentage point, on average, after two years (World Bank 2018d). Besides the growth slowdown, a disorderly Brexit may also weaken the trade link between the region and the United Kingdom, with some smaller economies in the region potentially losing preferential access and facing far higher tariff rates to its market.

Developing East Asia and the Pacific remains vulnerable to the risk of an abrupt change in global financial conditions. A tightening of global financing conditions remains a risk despite a generally benign global financing environment in the first half of 2019. Borrowing costs in emerging markets and developing economies have so far benefited from declining bond yields in advanced economies (World Bank 2019g). However, unanticipated developments in recent months, including the on-and-off trade disputes, geopolitical tensions including the Saudi Arabia oil facility attack, and fears of recession, have seen the return of the financial market volatility. After a solid recovery, emerging market currencies are again under pressure as investors rebalance their portfolios with traditional safe-haven assets such as U.S. treasuries in lieu of emerging market assets. Higher bond yields and the consequently higher borrowing costs

could dampen credit growth and further, weigh on private investment and economic growth. In addition, crises in other countries, such as in Argentina, could re-ignite fears of contagion effects and lead to sharp reversals in capital inflows.

High and rising debt levels in some economies in the region constrain fiscal and monetary policies. Economies with high domestic debt face the prospect of further debt accumulation from policy loosening. In China, policymakers' reliance on credit to support growth may worsen domestic risks by adding more leverage to already highly-leveraged corporate and household sectors. Nonetheless, the authorities recognize the challenge, thus emphasizing tax cuts as opposed to more local public investment and borrowing for the majority of fiscal stimulus. High household debts in Malaysia and Thailand have encouraged central banks to use macroprudential measures to specifically target and manage household debt growth.

Political uncertainty has been rising in a number of countries. In countries that held recent elections, post-election political uncertainty may lead to delay in decision-making, which could hamper public investment or policy formulation going forward, and negatively impact both investor sentiment and consumer confidence. In Mongolia, increased public spending in the run-up to the 2020 elections could risk a deterioration in the positive fiscal stance established over the past two years. In Timor-Leste, plans for upstream and downstream development of the Greater Sunrise fields remain unclear, especially regarding financing modalities. Recent amendments to petroleum-related laws suggest that the government is considering the use of the Petroleum Fund to finance these multi-billion-dollar investments, which could jeopardize fiscal sustainability.

I.C. Policy Considerations

The regional growth moderation underscores the need to address key vulnerabilities and preserve economic dynamism among developing East Asia and Pacific economies. In the short run, countries with sufficient policy space should use available policy tools to stimulate domestic activities. Better quality spending, together with prudent debt management, is needed to safeguard fiscal sustainability. Deepening regional integration would help offset the negative impact of global protectionism. In the medium to long term, pursuing structural reforms that raise competitiveness, support trade and investment, and encourage innovation is critical to boosting productivity and growth. Investing in learning outcomes, along with strengthening social protection programs, will help ensure people's basic welfare and help position them to participate effectively in future growth.

Where policy space is available, countries should prudently use policy tools to support economic growth

Countries with fiscal space can expand their fiscal programs to stimulate the domestic economy. Weak private investment and external demand require that governments step up their fiscal programs to spur activities amid faltering growth. Implementing fiscal stimulus in the form of tax and fee reductions can encourage business operations, while expanded public spending can directly boost domestic activities. There is scope to increase public spending especially on growth-enhancing infrastructure projects in some economies (Cambodia, Indonesia, Myanmar, the Philippines, Thailand) given their relatively low levels of public debt ratios (Table I.C.1). While the central government in China has fiscal space, any needed short-term fiscal stimulus should be designed to reinforce shifts toward consumption and private sector investment. If fiscal stimulus involves public investment, the Central Government should explicitly provide the financial resources through transfers to local governments for the additional envisioned investment, which could target national priorities such as addressing air and water pollution and other public goods of national importance and benefit. Other economies, however, may be more constrained on concerns of debt sustainability (Lao PDR, Mongolia, Vietnam), and would thus resort to other appropriate policy measures to support growth. While the current low-interest rate environment presents an opportune time to borrow for public investment projects, countries must strike a balance between taking advantage of low interest rates and avoiding excessive debt accumulation.

While most economies in the region have room for more accommodative monetary policy, an overleveraged private sector in some countries could increase vulnerabilities in the financial sector. Many regional central banks have the scope to lower interest rates and cut reserves ratios to support economic growth. This is because inflation has remained generally subdued in the region, where it stayed within central banks' target range in a number of economies (Indonesia, the Philippines, Thailand). Only a few economies have little monetary space for policy to act, such as Mongolia and Myanmar, which are experiencing high inflation in 2019. Lowering interest rates could lead to an acceleration of credit growth meant to spur business borrowings. While some economies have monetary space, central banks should use monetary policy measures prudently lest they exacerbate an already over-leveraged household or private sector.

In China, the scope for monetary easing is constrained by external and domestic factors, while the government has more flexibility to use fiscal policy to respond to a larger-than-expected slowdown. Despite the lower U.S. Federal Reserve rate, the scope for interest rate cuts in China is limited because of external risks, currency pressure,

and debt distress in some smaller banks. Keeping exchange rate flexibility, with limited interventions to smooth excess volatility, is an important tool to mitigate external risks. Nevertheless, there is fiscal space at the central government level to respond to a larger-than-expected growth slowdown. Any increases in local government spending should be appropriately funded, however, either through on-budget borrowing or by higher fiscal transfers from the central government, targeting investments in areas with high returns (World Bank 2019e).

Maintaining ample foreign reserves can help buffer adverse external shocks. Monetary authorities are well-advised to maintain an ample amount of reserves to buffer potential shocks from the poor external environment. The appropriate level of reserves, however, may differ among countries. For countries with less open capital accounts, a three months' import coverage is typically used as a benchmark. Meanwhile, for countries that have opened up financially, a larger import coverage is warranted. Vietnam needs to accumulate foreign reserves given its relatively high trade exposure but low import coverage (Table I.C.1). Moreover, some countries have the benefits of a flexible foreign exchange regime, which allows for the automatic adjustment of exchange rates in response to external shocks.

Table I.C.1. Policy space across developing East Asia and Pacific economies

| Period | Fiscal Space | | | Monetary Space | | Reserves buffer | |
|-------------------|---|--------------------------------|---|-----------------------------|-------------------------------------|------------------------------|-----------------------------|
| | 2018 | 2018 | 2018 | June 2019 | June 2019 | 2019 | Q2 2019 |
| Select Indicators | General government gross debt, percent of GDP | Fiscal balance, percent of GDP | Domestic credit to private sector, percent of GDP | Key policy rate, in percent | Headline inflation rate, in percent | Inflation target, in percent | Reserves, months of imports |
| Cambodia | 30.0 | -1.9 | 105.3 | - | 2.1 | - | 5.0 |
| China | 36.9 | -3.9 | 204.1 | 4.31 | 2.7 | 3.0 | 15.3 |
| Indonesia | 29.8 | -1.8 | 39.5 | 6.0 | 3.3 | 2.5 - 4.5 | 6.8 |
| Lao PDR | 57.2 | -4.4 | 49.5 | 10.0 | 2.48 | - | 1.2 |
| Malaysia | 51.8 | -3.7 | 129.1 | 3.0 | 1.5 | - | 7.3 |
| Mongolia | 74.4 | 2.6 | 66.0 | 11.0 | 8.1 | 8.0 | 5.3 |
| Myanmar | 35.0 | -3.5 | 24.9 | 10.0 | 9.5 | - | 3.2 |
| Philippines | 36.0 | -3.2 | 49.8 | 4.5 | 2.7 | 2.0 - 4.0 | 9.1 |
| Thailand | 42.4 | 0.3 | 114.7 | 1.75 | 0.9 | 1.0 - 4.0 | 8.9 |
| Vietnam | 55.7 | -4.4 | 133.1 | 4.25 | 2.2 | 4.0 | 3.2 |

Sources: Fiscal data come from country teams. Domestic credit data come from Kose A., et al, "Cross-Country Data of Fiscal Space," World Bank, Spring 2019, IMF Article IV (Myanmar and Vietnam), Bank of Lao PDR (Lao PDR), and the National Bank of Cambodia (Cambodia). Monetary data come from World Bank country reports, and various central banks websites. Monetary data for Cambodia refer to April 2019. Foreign reserves data come from World Bank country reports, IMF Data mapper, IMF Article IV (Myanmar), and various central bank websites. Reserves data for China, Myanmar and Thailand refer to 2018.

Notes: The following thresholds serve as guides in determining the degree of available policy space: Fiscal space - Debt-to-GDP ratio of less than 60.0 percent. Fiscal deficit of less than 3.0 percent. Private sector credit of not more than 80-100 percent; Monetary space - Inflation is low, and within target range (for countries following an inflation-targeting framework); Reserves buffer - Import coverage of three months for countries with less open capital accounts.

Ensuring fiscal sustainability is important in the face of pressures to expand spending

Managing expenditures requires budgetary discipline and the allocation of budget resources to priority and effective programs. The recent rise in public expenditures amplifies the need to strengthen budgetary discipline to keep expenditures within agreed limits. A medium-term expenditure framework that provides a baseline to measure and project the budgetary impacts of policy changes would support effective budget decisions. Building budget management capacity through establishing an integrated financial information system would provide useful information to support decisions. Some countries in the region are pursuing reforms to improve budget management. For example, Thailand

enacted its 2018 Budget Procedures Law and the Fiscal Responsibility Act to introduce fiscal rules targeting annual budget allocations and debt levels. Papua New Guinea adopted a medium-term fiscal strategy that targets achieving a non-resource primary balance of zero by 2021–22, restraining the rise in recurrent spending (chiefly the government wage bill). And China is addressing off-budget borrowing with a new investment rule that prohibits government departments from illegal borrowing and investing beyond their pre-determined budgets.

Improving public investment management (PIM) systems is critical to ensuring the quality and efficiency of spending in the medium term. As many countries in the region undertake expansionary fiscal policies to address infrastructure and human capital deficits, government policy actions should safeguard the quality of spending and investment. Stronger public investment management is needed to ensure that projects are delivered on time, on budget, and in good quality. Rigorous, transparent, and accountable processes for project selection, appraisal, procurement, and evaluation, and for the efficient operation and sustained maintenance of assets need to be developed and strengthened across the region. Limited PIM capacity is cited as a major bottleneck to obtaining and strategically allocating government resources, hindering the rapid increase of public infrastructure in developing economies (JICA 2018). Moreover, institutional fragmentation poses challenges for efficiency in implementation that can stem from a variety of factors, including weak coordination, and overlapping responsibilities among government agencies, as well as from large numbers of reporting units.¹⁴ China has announced efforts to improve the sustainability and transparency of investments under the Belt and Road Initiative which, if carried through, could help improve the quality of public investments in the region (see Box I.C.1).

Pacific Island countries (PICs) need to prudently manage and control expenditures within their medium-term revenue envelopes. Enhancing public investment management and expenditure efficiency is even more important for the PICs, where revenues can be volatile and are often dependent on a single sector. PICs face substantial risks of declines in revenue growth, including the depletion of natural resources in fisheries and forestry, as well as the anticipated expiration in fiscal years 2023 and 2024 of Compact-associated grants and programs to the North Pacific islands (the Federated States of Micronesia, the Marshall Islands, and Palau).¹⁵ It is thus important to save windfall gains, build up sovereign wealth funds, and consolidate and mobilize domestic revenues, including through efforts to develop growing industries such as fisheries and tourism. Managing natural resources while safeguarding the environment is a priority to increase resource revenues in a sustainable manner.

Moreover, building fiscal buffers against natural disaster shocks will help the PICs to insulate the national budgets from large disruptions. The PICs are highly vulnerable to natural disasters and climate change risks. Estimates show that the main fiscal impact of natural disasters is on expenditures, and that, on average, a severe disaster imposes a fiscal cost of around 14 to 21 percent of GDP over three years (Nishizawa et al. 2019). Such vulnerability of government balances requires the building of contingency funds for natural disasters for self-insurance.¹⁶ Because there is an opportunity cost of holding fiscal buffers, governments must determine the appropriate scale of the fund. Governments need to consider the investment in resilient infrastructure, the extent of external donor finance following a disaster, the available risk transfer mechanisms including the issuance of catastrophe bonds, or insurance of physical assets, the budget contingency provisions, and the scope for domestic and external borrowings to finance rebuilding.

¹⁴ In Vietnam, for instance, the government faces challenges in preparing final consolidated budget and debt reports, given its many reporting agencies—with 63 provinces and various spending agencies that include economic groups and line ministries—and the corresponding system of nested budgets.

¹⁵ The U.S. provides Compact funding to the Republic of the Marshall Islands, Federated States of Micronesia, and Palau to assist in their efforts to promote the economic advancement, budgetary self-reliance, and economic self-sufficiency.

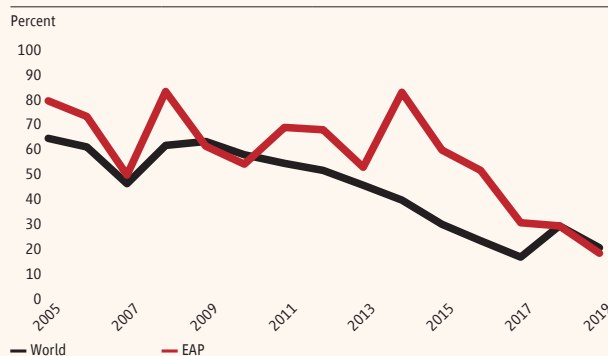
¹⁶ Currently, there are six PICs with contingency funds for natural disasters: Fiji, the Marshall Islands, the Federated States of Micronesia, the Solomon Islands, Tonga, and Tuvalu.

Box I.C.1. Cleaner, Greener and Sustainable Investment: the Belt and Road Initiative¹

At the Second Belt and Road Forum (BRF) held in Beijing in April 2019, China stressed the need for high-quality development of Belt and Road Initiative (BRI) projects to ensure that they are clean, green and sustainable. Clean BRI calls for implementation that promotes transparency and integrity, and combats corruption. Green BRI encourages investment projects that promote environmental friendliness, climate resilience and social inclusiveness. Sustainable BRI seeks to promote sustainable economic and social development while ensuring debt sustainability. These three strategic directions aim to address international and domestic concerns regarding the viability of BRI projects and their environmental, governance and political impacts on BRI partners.

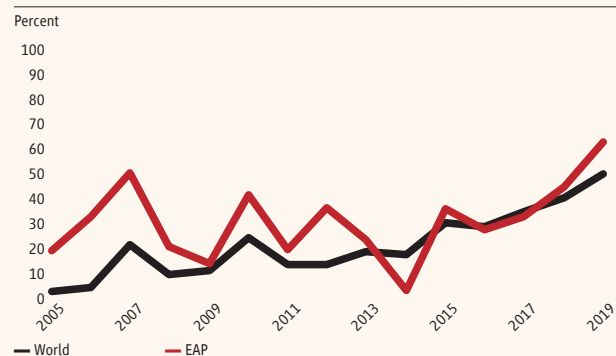
China is progressing toward green BRI. China's outward investment has already shifted away from pollution-intensive industries. According to the China Global Investment Tracker database, the share of new Chinese investments in pollution-intensive industries, notably metals, chemicals and non-renewable energy, has gradually decreased from over 60 percent in 2005–06 to less than 30 percent in 2017–1H19. Among East Asia and Pacific countries, the share of investment in metals, chemicals and non-renewable energy in China's total outward investment dropped from over 60 percent in 2014–15 to less than one-third in 2017–1H19 (Figure BI.C.1.1). Meanwhile, China's outward investments in hydroelectric power and other alternative energy have risen as a share of energy sector investment in recent years (Figure BI.C.1.2). China, which is taking a leading position in renewable energy outputs, as well as in related technologies, is moving parts of its production base out of the country.

Figure BI.C.1.1. Share of metals, chemicals and non-renewable energy investment in China's total outward investment



Source: China Global Investment Tracker Database, published by the American Enterprise Institute.

Figure BI.C.1.2. Share of hydroelectric power and other alternative energy investment within the energy sector in total outward investment



China has yet to move toward clean BRI. Previously, Chinese investments, which were undertaken mostly by the Chinese government, state-owned companies, or state-controlled banks, did not place recipient countries' government transparency or political stability as the highest priority. A significant proportion of China's investments was allocated to countries with weak institutional frameworks—places that other commercial investors are more

(continued)

¹ This box was prepared by Luan Zhao and Gary Xie.

(Box I.C.1 continued)

cautious to enter. Since the announcement of the BRI in 2014, on average 83 percent of China's outward BRI investments were allocated to countries defined by Transparency International as having "serious corruption problems" (Figure BI.C.1.3).² Furthermore, 90 percent of troubled BRI investments since 2014 occurred in these corruption-prone countries (Figure BI.C.1.4). In this regard, pursuing open and clean BRI would also contribute to the promotion of high-quality development of the BRI in the future.

Figure BI.C.1.3. Share of China's BRI outward investments in countries with "serious corruption problems"

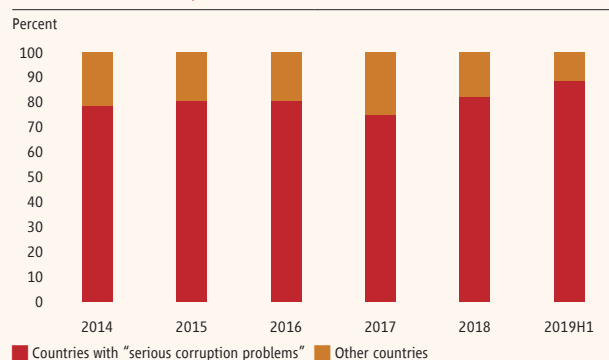
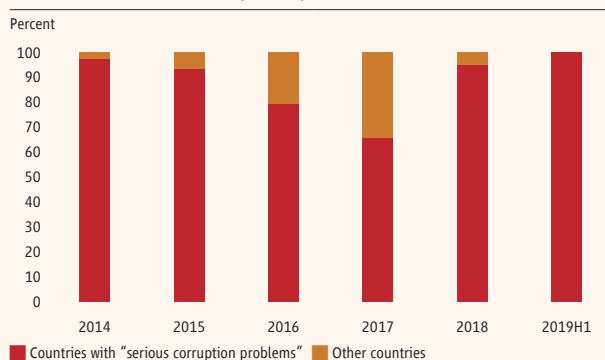
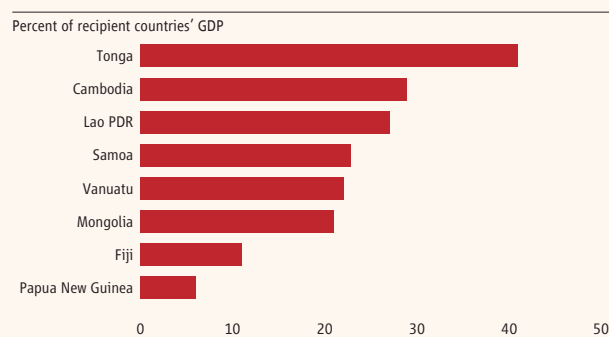


Figure BI.C.1.4. Share of China's troubled BRI outward investments in countries with "serious corruption problems"



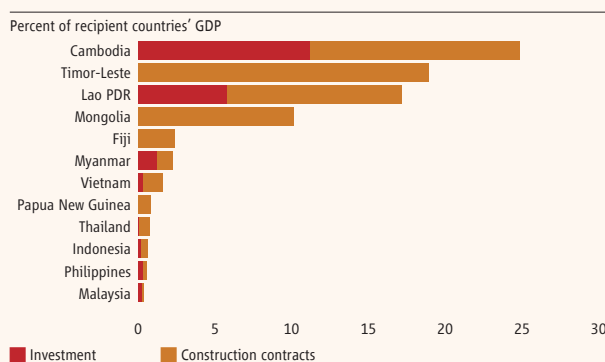
Sources: WDI; China Global Investment Tracker Database, published by the American Enterprise Institute; Transparency International.

Figure BI.C.1.5. The stock of total external debt from direct loans owed to China in 2017



Source: Horn et al. (2019).

Figure BI.C.1.6. China's new outward investment and construction announced during 2018–1H19



Source: China Global Investment Tracker Database, published by the American Enterprise Institute.

China is set to pursue sustainable BRI. Estimated BRI debt financing is significant in some EAP countries that already have elevated debt vulnerabilities. As of 2017, external debt stocks accounted for 86 and 54 percent of GDP for Lao DPR and Cambodia, respectively, and 245 percent of GDP for Mongolia. The stock of total external debt from direct loans owed to China reached about 30 percent of GDP for Cambodia and Lao DPR, and about

(continued)

² Transparency International's Corruption Perceptions Index (CPI) releases annual country corruption ratings from 1 (most corrupt) to 100 (least corrupt) based on surveys. Transparency International defines countries with "serious corruption problems" as those with a CPI score lower than 50. In 2017, for instance, 122 out of 176 countries were defined as countries with "serious corruption problems".

(Box I.C.1 continued)

25 percent of GDP for Mongolia (Figure BI.C.1.5).³ In addition, China's new outward investment and construction projects announced during 2018–1H19 amount to 25 percent of GDP for Lao DPR, 10 percent of GDP for Mongolia and 17 percent of GDP for Cambodia, according to the China Global Investment Tracker database (Figure BI.C.1.6). China's investments are also significant in some small island countries, such as Timor-Leste. These planned projects, if implemented in an expeditious manner and financed with sovereign loans or guarantees, would exacerbate fiscal and external vulnerability risks for weak sovereigns. Concerned with excessive external debt, some EAP recipient countries have already pushed back against Chinese investments.⁴ Chinese outbound direct investments have not been as profitable as before. While overseas investments are rising, the return on those investments declined from about 15 percent in 2014 and turned negative to -0.4 percent in 2018.

Promoting cleaner, greener and sustainable BRI holds important implications for selected developing East Asia and Pacific countries. While China is expected to continue to expand its lending and investments in the region, it is likely to become more selective and prudent in pursuing the BRI by taking into account the level of corruption, investing in less pollution-intensive industries, and being mindful of domestic and foreign debt liabilities. Lao PDR and Cambodia could be severely affected by the new BRI focus because of their high levels of government corruption, as well as high share of external debt. While the debt level in Mongolia is also high, the bulk of the external debt is inter-company borrowing in the mining sector. In many cases such borrowing can be considered as FDI (when the contracting companies are affiliates). However, Mongolia would be affected by a green BRI strategy as its investments from China are heavily concentrated in pollution-intensive industries.

³ Horn et al. (2019).

⁴ In August 2018, two Chinese mega projects in Malaysia, the East Coast Rail Line (ECRL) and two gas pipelines worth US\$29.3 billion in total, were deferred. In November 2018, China and Myanmar reached an agreement to scale down the investment for an expanded seaport at Kyaukpyu, on the Bay of Bengal, to US\$1.3 billion, from US\$7.0 billion previously.

Countries may consider new tax or administrative measures to boost revenues in the medium term. Revenue mobilization has remained low across much of the region, with commodity-exporting countries such as Indonesia, Malaysia, Mongolia, Papua New Guinea, and Timor-Leste partly reliant on commodity-related fiscal revenues (World Bank 2016). Countries may improve revenue mobilization through new tax revenue policies and better tax administration measures. This year, Malaysia announced its sugar tax on sweetened beverages, a tourism departure levy, and digital services tax to cover imported services provided by foreign digital service providers effective in January 2020. The Philippines embarked on a series of tax reform packages to rationalize fiscal incentives and broaden the tax base, while Mongolia instituted tax reform packages revising its corporate income tax law, personal income tax law, and VAT law. However, there is evidence to show that increasing the intensity of tax administration may be more effective than increasing tax rates. In Indonesia, a tax administration reform that moved the largest firms of each region into specialized tax offices with higher staff-to-taxpayer ratios more than doubled tax revenue from target firms over a six-year period. The impact of this reform was equivalent to raising the marginal corporate tax rate on target firms by about 23 percentage points (Basri et al. 2019).

Macroprudential regulations can aid in debt management

A sound debt management strategy will help governments manage risk exposure from the debt portfolio. The aim of debt management is to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk (IMF-World Bank 2019). Developing a debt management strategy would help governments manage variations in debt servicing cost and roll-over risk, support fiscal and monetary policy, and reduce macro-financial risk. Developing such a strategy is important in the region, where debt stocks have risen in many countries. Facing the risk of high debt distress, the government of Lao PDR approved a public debt management law and committed to limit new borrowings and to speed up the formulation of a public debt management strategy.

Macroprudential regulations can help address the high and rising debt levels of some economies in the region. In countries with high debt levels, central banks must be targeted on their approach, implementing strict liquidity coverage, capital adequacy, and appropriate loan-to-value and debt-to-income limits. Supporting banks in their assessment of borrowers, including through the collection of data on households' assets and liabilities, would help monitor for signs of distress in the financial sector. Thailand, for example, imposes loan-to-value caps for high-end housing, and tighter credit line limits for credit card and personal loans. Meanwhile, Mongolia implements a debt-to-income ratio for consumer loans, lowers the maturity on non-mortgage household loans, and raises the risk rating on unhedged foreign currency borrowing. China may strengthen macroprudential regulations to keep financial institutions in check amid distress in smaller banks. Macroprudential tightening is associated with lower bank credit growth; targeted policies seem to be more effective in economies where bank finance is important (Akinci and Olmstead-Rumsey 2018).

Strengthening rules-based trade, including through deeper regional integration, will preserve trade dynamism

With growing protectionist tendencies in other parts of the world, the developing East Asia and Pacific region must redouble its commitment to a rules-based international trade system. A rules-based trade system ensures openness, predictability, and non-discrimination in the conduct of trade across countries. Such a system has contributed to the cross-country movements of goods and capital, streamlined manufacturing and organizational processes, and supported the diffusion of technology. Despite the benefits, trade and non-trade barriers have become more prominent during the past couple of years, with some economies raising barriers against trading partners cloaked under national security concerns or the protection of strategic sectors. Countries in the region will be served well by resisting the calls for more protectionist measures and committing to a rules-based trade system. Safeguarding trade relations and trade rules across countries is pivotal in the developing East Asia and Pacific region where trade has served as a key engine of growth.

Countries in the region should focus on deepening regional integration. Greater regional integration is important in its own right, but especially at a moment where deepening of trade integration at the global level is not possible. Two actionable options for the region are to conclude the Regional Comprehensive Economic Partnership (RCEP), which will bring together the ASEAN countries and six Indo-Pacific states, and to expand the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) to include other developing East Asia and Pacific countries. These international trading platforms are opportunities to deepen traditional trade cooperation, address the remaining barriers

to trade in goods and services, and widen economic cooperation. Closer economic integration can help the ASEAN bloc achieve its own target of a single economic market—the ASEAN Economic Community, or AEC—by 2025, although the economic benefits to East Asia and Pacific countries would be widely shared.

Structural reforms that raise competitiveness, enhance trade and investment, and encourage innovation are needed to boost productivity and growth

In the medium to long run, structural reforms that boost productivity would increase the potential growth rate. Potential growth is expected to fall across the developing East Asia and Pacific region over the next decade, due to population aging (China and Thailand) and a declining pace of capital accumulation. Enhancing total factor productivity would increase long-term economic growth in a sustainable manner. Policy options for increasing productivity include raising economic competitiveness, enhancing the trade and investment climate, and improving the enabling environment for innovation.

Regulatory reforms that improve the ease of doing business will help raise competitiveness. The region has gained some improvement in Doing Business 2019, with China and Malaysia moving up the rankings (Figure I.C.1). While performance varies across countries, the region on average does well in dealing with construction permits, and getting electricity, but lags in starting a business and enforcing contracts (World Bank 2019h). New regulatory measures are being taken to improve competitiveness, including the issuance of a new foreign investment law that addresses unfair treatment and intellectual property protection in China, and the development of the Eastern Economic Corridor, a special economic zone in Thailand offering tax incentives, improved logistics connectivity, and streamlined regulations. Improving the ease of doing business is also important to help develop new markets (see Box I.C.2 on Green Industries). The global slowdown, trade disputes, uncertainty, and other global risks raise the urgency for developing East Asia and Pacific countries undertaking structural reforms to increase their competitiveness, and maintain or improve incentives for trade and investment in a difficult external environment.

Enhancing the trade and investment climate not only facilitates the movement of goods and capital but also of technology and know-how. Preserving a vibrant trading and investment environment by shunning protectionist measures and safeguarding smooth trade facilitation make it easier for goods, capital, and technology to move across countries. An important, and perhaps under-recognized, example of the value of an open trading system is how trade networks promote collaboration on inventions and thus boost the supply of technology (see Box I.C.3 on Trade and Co-invention). Studies have shown that firms with foreign ownership tend to be more productive than purely domestically-owned firms, on average (World Bank 2018b). Key recommendations to enhance the investment climate include eliminating restrictions on foreign investors, as well as among domestic investors in sectors where such regulatory restrictions create an uneven playing field, continuing to lower tariff and non-tariff barriers, eliminating procedural obstacles, and reducing trade costs by improving port and logistics infrastructure. Such policy considerations are reflected in the recent decisions to ease trade restrictions and open the financial sector to greater foreign competition in Myanmar and plans to revisit the foreign negative investment list in the Philippines.

Box I.C.2. Nurturing Green Industries in Indonesia¹

At the global level, climate change concerns and actions to address those concerns are creating substantial growth of climate-related markets, with corresponding opportunities for the private sector. Motivated by the historic Paris Agreement and the Nationally Determined Contributions (NDCs) ratified by 185 states and the European Union participating in COP21, green markets have experienced tremendous growth. Sectors such as renewable energy, climate-smart agriculture, green infrastructure, and water supply and management are all growing rapidly, thanks to expanded and robust financial investment environments, an increase in concessional and commercial green financing, technological advancement, cleantech innovations, and regulations encouraging green industries. It is estimated that climate-related investment potential will be worth US\$23 trillion in 21 emerging market economies, representing 62 percent of the global population and 48 percent of its global emissions, between now and 2030.² The East Asia and Pacific region will be a major driver of global growth for climate smart technologies (Figure BI.C.2.1).³

Figure BI.C.2.1. Climate-smart investment potential by region and sector

| | Wind | Solar | Biomass | Small Hydro | Geo-thermal | All Renew-ables | Electric Transmission & Distribution | Industrial Energy Efficiency | Buildings | Transport | Waste | Subtotal |
|---|------|-------|---------|-------------|-------------|-----------------|--------------------------------------|------------------------------|-----------|-----------|-------|----------|
| East Asia Pacific | 231 | 537 | 48 | 34 | 16 | 866 | 392 | 143 | 13,235 | 1,357 | 53 | 16,046 |
| Latin America and Caribbean | 118 | 44 | 45 | 11 | 14 | 232 | 0 | 21 | 901 | 1,460 | 26 | 2,640 |
| South Asia | 111 | 211 | 16 | 0 | 0 | 338 | 0 | 85 | 1,543 | 255 | 13 | 2,234 |
| Europe and Central Asia | 51 | 39 | 6 | 7 | 6 | 109 | 0 | 57 | 410 | 78 | 11 | 665 |
| Sub-Saharan Africa | 27 | 63 | 3 | 3 | 27 | 123 | 0 | 0 | 153 | 499 | 8 | 783 |
| Middle East and North Africa | 50 | 46 | 0 | 1 | 0 | 97 | 21 | 1 | 92 | 50 | 4 | 265 |
| Total Climate Smart Investment Potential by Sector (\$ billion) | 588 | 940 | 118 | 56 | 63 | 1,765 | 413 | 307 | 16,334 | 3,699 | 115 | 22,633 |

Source: IFC (2016).

The Asia-Pacific region's projected population growth and infrastructure needs can create significant opportunities for green sectors, such as renewable energy, green buildings and sustainable transportation systems. Based from the International Finance Corporation (IFC) analysis, the total estimated climate-smart investment potential in China, Indonesia, the Philippines, and Vietnam is more than US\$16 trillion by 2030. Indonesia has an estimated investment potential of over US\$274 billion across several green sectors.⁴

Developing and emerging countries are keen to take advantage of the potential for employment creation of new climate sector markets. As economies become more climate smart, it is anticipated that new markets for climate sector-related jobs will be created. The renewable energy sector employed 9.8 million people in 2016 and

(continued)

¹ Prepared by Derek H. C. Chen based on World Bank (2019).

² IFC (2016).

³ Ibid.

⁴ Ibid.

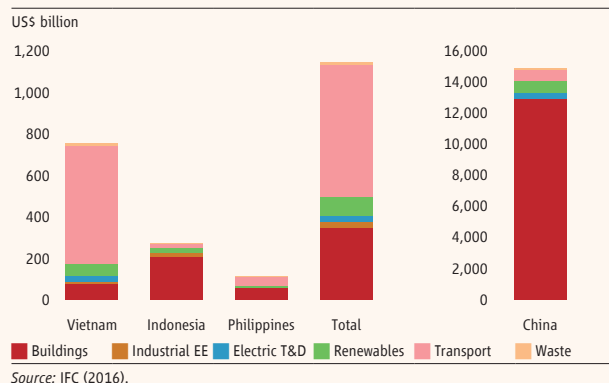
(Box I.C.2 continued)

this is estimated to reach 24 million by 2030, more than offsetting fossil fuel job losses and becoming a major economic driver across the world.⁵ As investments in climate-smart food and agriculture sectors grow every year, they are expected to create almost 80 million jobs by 2030, which represents almost 2 percent of the global labor force,⁶ with 90 percent of these jobs likely to be in developing countries.⁷

An increasing number of developing and emerging countries are supporting domestic industries in climate markets as a channel of economic growth and development.

With financial support and regulations, countries are taking steps for their private sectors to pro-actively participate in green markets rather than remaining on the sidelines. The Republic of Korea, for example, has been a leader in this space, with its 2009 Green Growth Strategy that included measures supporting Small and Medium-sized Enterprises (SMEs) in climate sectors that have allowed Korean companies to gain global market share. Both China and India have ambitious solar plans that also have resulted in growth of domestic industries. Also, in solar power, Morocco has built its Noor-Ouarzazate Concentrating Solar Power (CSP) plant, one of the largest concentrating solar power (CSP) facilities in the world.⁸ Colombia's National Climate Policy is paired with the creation of a new fund, Sostenible, to raise public, private and international funding for NDC implementation, and South Africa's Western Cape government has launched GreenCape with the vision to make South Africa the green economic hub of Africa.

Figure BI.C.2.2. Climate-smart investment potential in the East Asia Pacific region, 2016–30



Three climate-related sectors in Indonesia have the potential for strong growth in the medium to longer term. Using a methodology that focuses on desirability,⁹ feasibility,¹⁰ and climate impact,¹¹ three climate-related markets were identified as having good potential for growth in Indonesia. These include solar power, certification systems for climate-smart agriculture, and green, efficient buildings.

Solar Power

Although the focal point of renewable energy development in Indonesia has been geothermal and hydropower, solar power has gained new attention recently as a viable resource. Indonesia has the potential for around 50 GW of installed solar capacity by 2030, which could generate more than 500,000 jobs. A substantial solar power sector can contribute significantly to Indonesia's climate mitigation and adaptation efforts as it has

(continued)

5 IRENA (2017).

6 AlphaBeta (2016).

7 Ibid.

8 Concentrating solar power (CSP) plants use mirrors to concentrate the sun's energy to drive traditional steam turbines or engines that create electricity. The thermal energy concentrated in a CSP plant can be stored and used to produce electricity when it is needed, day or night.

9 Defined as the market size and employment potential of each subsector.

10 Defined as technological readiness, current policies in place to encourage growth in a given subsector, and links to the Indonesian private sector.

11 Defined as the ability of each subsector to contribute to reduction in GHG emissions (mitigation), as well as to build climate resilience (adaptation).

(Box I.C.2 continued)

widespread applications, particularly in agriculture. With appropriate policy support, solar has the potential to be an inexpensive and clean form of power.¹²

Sustainable Crop Certification

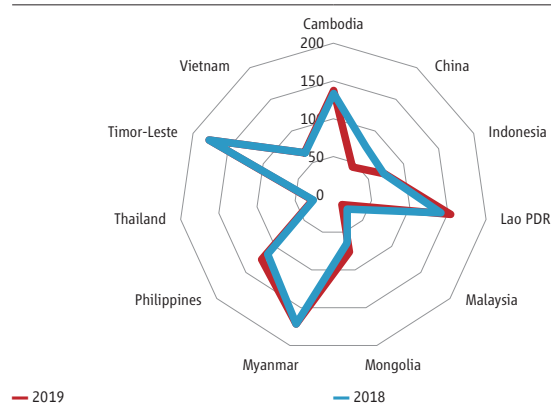
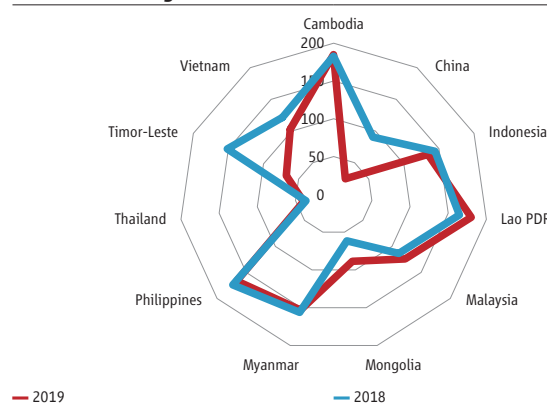
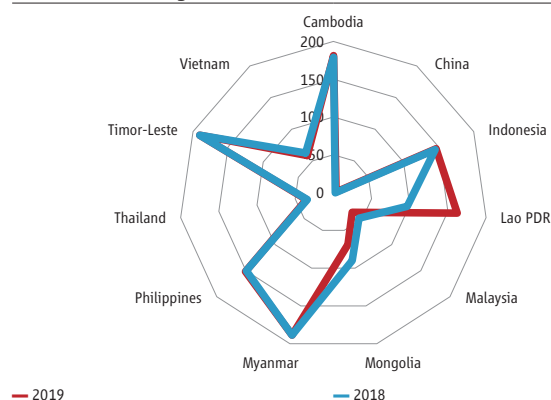
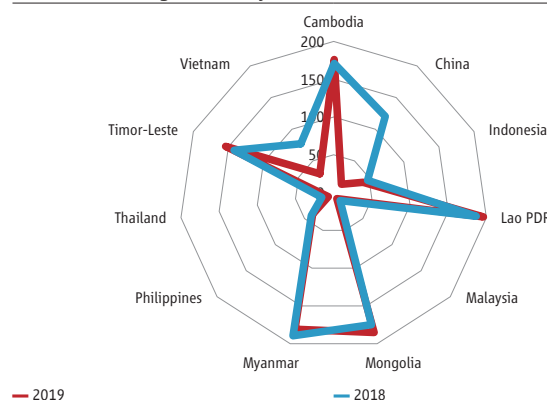
Crop certification programs set out standards that farmers must meet in terms of protecting the environment, such as reducing water use, using fewer pesticides, avoiding deforestation and protecting biodiversity. At the same time, they can offer a price premium and improve farmers' access to market. Crop certification can be used to address many climate changes related to both mitigation and adaptation. Indonesia has a huge untapped market for sustainability certification of its major agricultural commodities that are traded in the international market. Smallholder farmers are pivotal in Indonesia's agriculture. Certification programs can ensure that they remain profitable and employed in agriculture through the ability to negotiate premium prices for certified crops and access to international markets.

Green Buildings

Buildings are vital to mitigation efforts as they generate 19 percent of greenhouse gas (GHG) emissions globally and consume 40 percent of total electricity. By 2050, the built environment is expected to double, with most of this growth occurring in emerging economies due to growing populations, increased urbanization and rising incomes. The adoption of green building practices offers an important solution to reduce emissions, while at the same time locking in energy and water savings for decades. Markets for green buildings are expected to grow fastest in East Asia. The total regional investment opportunity in Asia is projected to be over US\$3 trillion into 2025. Indonesia's green building sector represents a US\$23 billion investment opportunity by 2030. Jakarta's green building regulation, considered the first and strongest in Indonesia, could act as a push factor for companies to innovate to meet the set standards.

Climate sectors have specific advantages and challenges compared with other sectors that can require targeted public intervention. Green companies and technologies must overcome incumbent, non-climate-friendly paradigms. Technologies require commercialization support and favorable regulatory environments. In addition, green companies tend to be smaller and at earlier stages of development than their established competitors, placing them at a disadvantage. Government intervention to temporarily support nascent green industries could therefore be crucial. There is a suite of policy actions available to governments to create robust green and climate-related markets in which the local private sector is able to participate and compete. For example, governments have an important role in providing a conducive environment that will support growth and development of these climate markets. Additional measures to help young firms, such as incubation periods, commercialization support, and education and training can also be considered. Given that financial systems supporting green initiatives are likely to be relatively shallow, governments can look into public actions such as issuing green bonds, investing in capacity building for investors and setting up dedicated green funds. Lastly, governments can also stimulate public demand for green products through information campaigns, and mandating standards and labels.

¹² The development of the solar industry in Indonesia is currently being hindered by high local content requirements. The Ministry of Industry (MOI) has implemented a regulation which states that companies can build solar plants only if they meet the 60 percent local content requirement (LCR). This LCR is difficult to fulfill because solar panels and much of the additional equipment used for solar power plants needs to be imported (Global Data Energy 2019, Sulaiman 2019).

Figure I.C.1. Doing Business rankings across developing East Asia and Pacific**Comparison between 2019 and 2018****Panel A. Overall****Panel B. Starting a business****Panel C. Enforcing contracts****Panel D. Getting electricity**

Source: Doing Business 2019, Training for Reform; and Doing Business 2018, Reforming to Create Jobs.

Note: Ranking (1 = Best, 190 = Worst). Higher Doing Business rank signifies better performance of the indicator.

Box I.C.3. Are Trade and Co-invention Related? Evidence from Developing East Asia¹

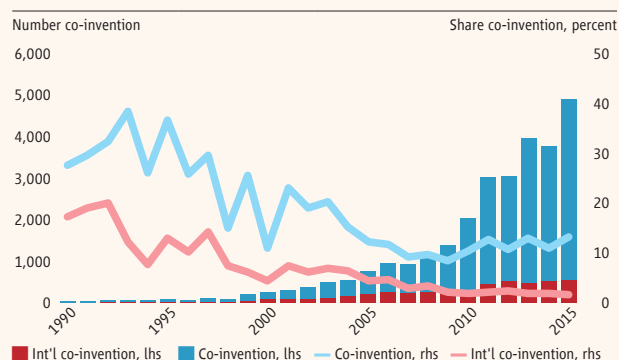
Collaboration in innovations has increased over time, both within and across countries.² The number of patent applications filed with the European Patent Office and under the Patent Cooperation Treaty that reflect collaboration among inventors (referred to as co-inventions) has increased, but at a slower pace than overall growth in patent applications (Figure BI.C.3.1). Developing East Asia's share of co-inventions fell from the peak of 38 percent in 1993 to 13 percent in 2015, and the share of international co-invention plummeted from the peak of 20 percent in 1992 to less than 2 percent in 2015.

(continued)

¹ This box was prepared by Francesca de Nicola.

² The box refers to co-inventions and international co-inventions. Both refer to patent applications filed by multiple inventors. The difference regards whether applicants reside in the same country (co-inventions) or in different countries (international co-inventions).

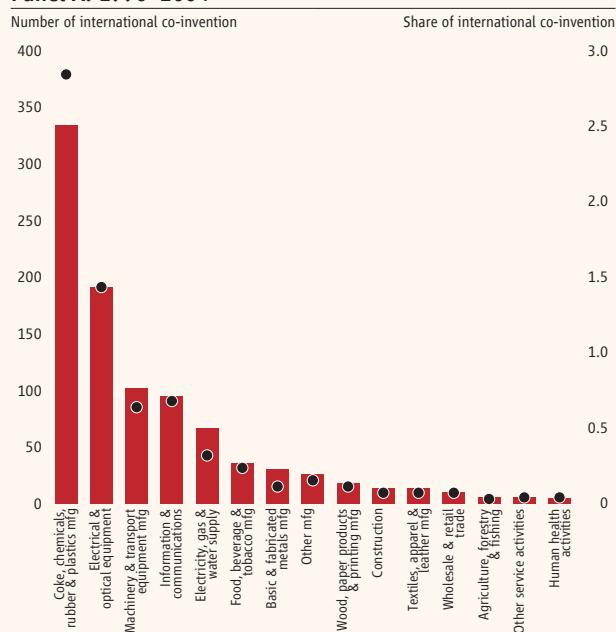
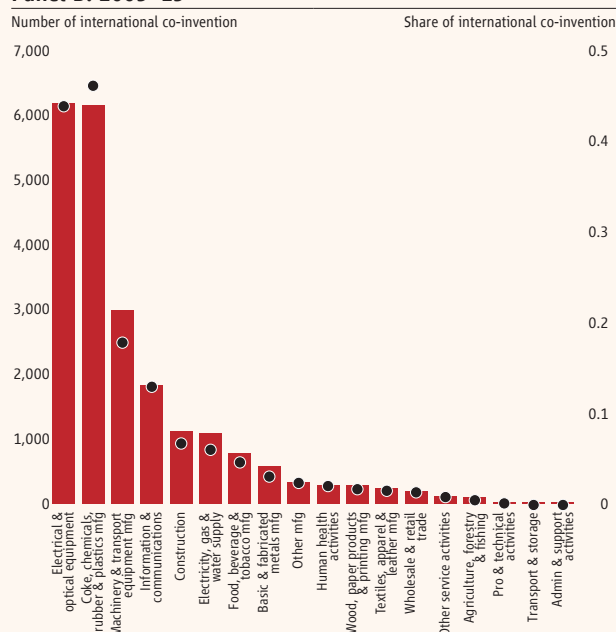
(Box I.C.3 continued)

Figure BI.C.3.1. Co-inventions over time in developing East Asia

Source: OECD REGPAT data, 2018.

Note: A patent application is classified as co-invention if it includes multiple applicants; international co-inventions are a subset of co-inventions where applicants are from at least two countries. Data for the following countries are available: Cambodia, China, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

Most international co-inventions in developing East Asia have been concentrated in just a few sectors since the 1990s (Figure BI.C.3.2). The bulk of international co-inventions are in: (i) petroleum products, chemicals, rubber and plastic manufacturing; and (ii) electrical and optical equipment. A significant, albeit much smaller, number of co-inventions are in information and communication services, as well as in machinery and transport equipment.

Figure BI.C.3.2. International co-inventions across industries in developing East Asia**Panel A. 1990–2004****Panel B. 2005–15**

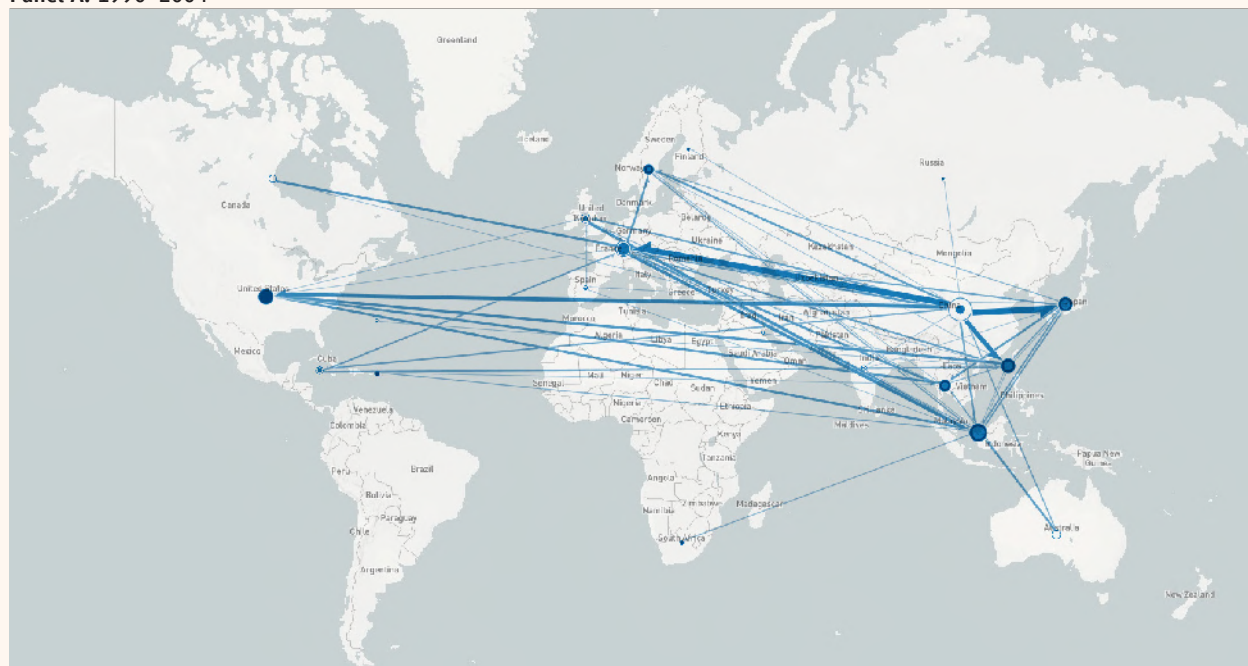
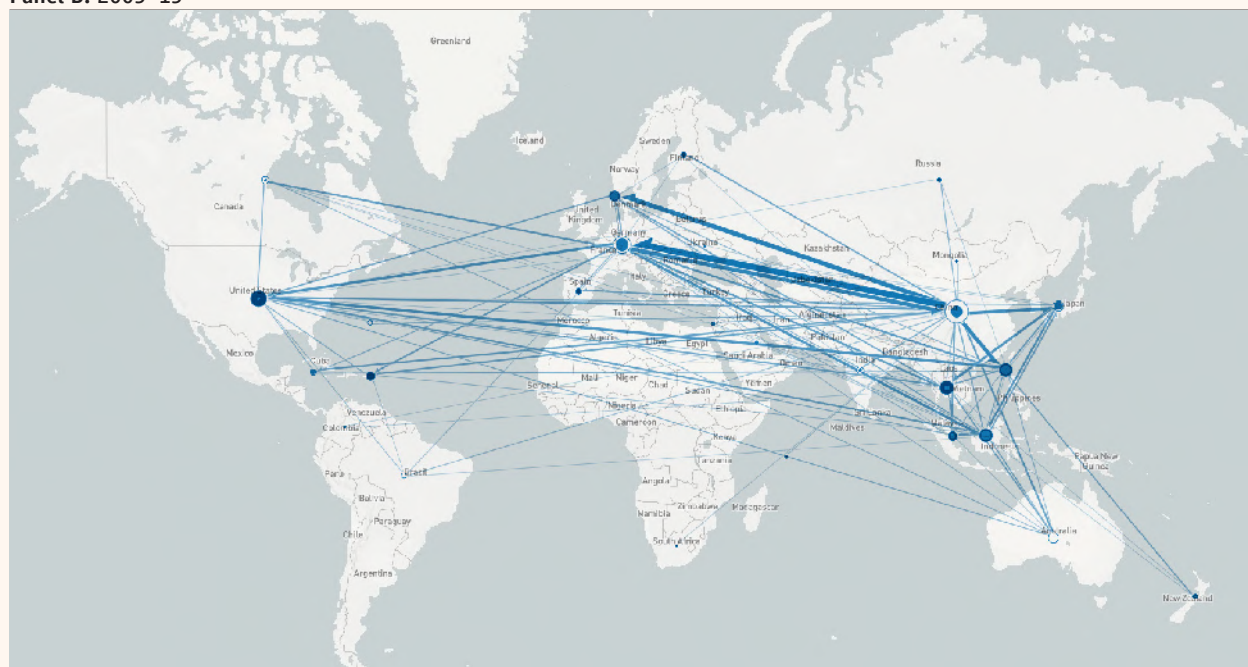
Source: OECD REGPAT data, 2018.

Note: The horizontal bars represent the total number of international co-inventions by sector (primary x-axis); the scatter dots represent the share of international co-inventions (out of all inventions in a given sector) by sector (secondary x-axis). Data for the following countries are available: Cambodia, China, Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

Global innovation networks (GINs) have grown denser in developing East Asia over time (Figure BI.C.3.3). The numbers of: (i) the international co-invention linkages from a given country; and (ii) the countries involved in international co-inventions, increased from 1990–2004 to 2005–15. This suggests an improvement in the ability to collaborate and produce innovation across the region.

(continued)

(Box I.C.3 continued)

Figure BI.C.3.3. Mapping global innovation networks in developing East Asia**Panel A. 1990–2004****Panel B. 2005–15**

Source: OECD REGPAT data, 2018.

Note: Flows correspond to the number of international co-inventions by country pairs during the selected period. Data for the following countries are available: Cambodia, China, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

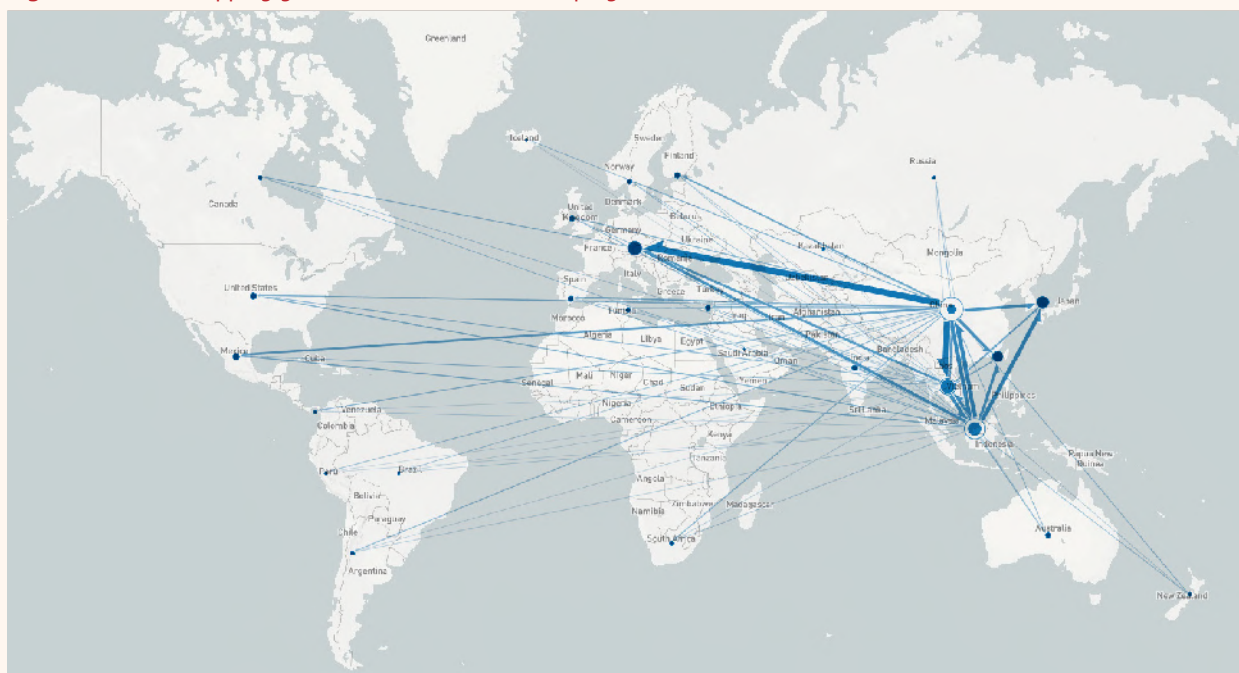
(continued)

(Box I.C.3 continued)

Global value chains (GVCs) may promote co-invention.³ By trading in goods and services, firms can build a rapport that may later induce collaboration on R&D and ultimately co-invention. When co-invention and GVCs are related, policies that promote trade may also indirectly encourage collaboration on innovation. However, GVC networks appear more dispersed than Global Innovation networks (GIN) (compare Panel B of Figure BI.C.3.3 with Figure BI.C.3.4).⁴ GVC networks in developing East Asia tend to have twice as many linkages between countries as do networks of cross-country collaborations on patents (overlaps between GVC and GIN networks are more significant for more advanced East Asian economies). It appears that, while China is well integrated in regional value chains, it tends to favor collaboration on patents with higher-income economies.

While the geography of GVC and GIN networks has become more similar over time, some differences persist. Even if GINs are still not as developed as GVC networks, hubs in GVCs tend to be key nodes also in GINs. These overlaps suggest that developing an effective innovation strategy requires recognition that domestic companies participate in the global innovation process. Thus, the impact of domestic science, technology and innovation policies may exceed national borders. Put differently, government support for R&D may not fully or exclusively benefit individual countries, due to the global nature of technology and knowledge.

Figure BI.C.3.4. Mapping global value chains in developing East Asia, 2005–15



Source: OECD TiVA data, 2018.

Note: Flows correspond to the GVC index averaged over time (2005–15), by country-pairs. Data for the following countries in developing East Asia are available: Cambodia, China, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

³ WDR 2020 provides a detailed review of key issues and empirical regularities related to GVCs.

⁴ Differences in how TiVA data are collected over time prevent us from building GVC networks for previous periods.

Initiatives should be undertaken to improve the enabling environment for technology and innovation. Technology is pivotal to bringing renewed momentum to faltering growth in the region. The use of digital technologies can stimulate new business models such as e-commerce and provide new avenues for activities away from their traditional domains such as massive online open courses. Digital technologies can also increase operational efficiency, reduce transaction and information cost, and improve service delivery. To reap the advantages of digital technologies, countries must ensure digital connectivity by improving the quality of technology infrastructure. Countries should also improve the digital payment system, and enhance cybersecurity to foster technology adoption and public trust. Reducing barriers to FDI can attract global and regional players, while setting up innovation hubs and support programs can nurture local start-ups and SMEs.

Building human capital through investments in learning, along with enhanced social protection programs, will help secure the workforce of the future

Investments to improve learning outcomes should be a priority. Children born in developing East Asia and the Pacific today will be 53 percent as productive as they could be at age 18 if they benefited from complete education and full health.¹⁷ Across the region, several countries are experiencing substantial learning gaps.¹⁸ Learning gaps can be narrowed by improving the quality of learning outcomes in an equitable manner. Governments can improve learning outcomes by gauging the health of the education system through the use of well-designed student assessments, using evidence to guide innovation and practice to make teaching more effective, preparing children and the youth for learning, and aligning actors to make the whole system work for learning.

Promoting lifelong learning will help prepare workers on the impact of technological change in the labor market. Rapid technological advancement is changing the employment landscape with job transitions throughout the working lives becoming the norm. Such changes entail the need to upskill workers to make them suitable for the changing demands of the job. Investments in lifelong learning systems to develop higher-order cognitive, socioemotional and technical skills will help prepare workers to find and transition between jobs. Training needs to be responsive to the diverse age and experience profiles of workers; and in many cases, developing modular competencies-based training may be appropriate for adult workers who need to learn job-related skills quickly.

Strengthened social assistance and insurance measures are needed to ensure household resilience from adverse shocks. Heightened economic risks in the current global environment, alongside the slowdown in the pace of poverty reduction in the region, call for the strengthening of social protection systems. Countries with high shares of poor and vulnerable populations (Papua New Guinea, Timor-Leste, Lao PDR) need to generally prioritize instituting, strengthening and better targeting of social assistance programs, while countries with higher proportions of the economically secure and middle class (China, Malaysia, Thailand) can focus on expanding coverage of social insurance (World Bank 2018c). In the former, reaching the poorest and disadvantaged groups would benefit from better targeting schemes for cash transfer programs through the use of digital technology and national identification schemes. In the latter, expanding coverage of unemployment insurance and public pensions can help address the challenges of frictional unemployment,

¹⁷ The region's human capital index (HCI) of 53 percent is relatively low compared to the performance of other regions (63 percent for Eastern Europe and Central Asia; and 55 percent for Latin America and the Caribbean). The HCI predicts the impact of human capital formation on both economic growth and individual income generation. It encompasses key health measures, such as the under-five mortality rate, the under-five stunting rate, and the survival rate for adults aged 15 to 60. It also estimates both the quantity and quality of education by measuring learning-adjusted years of schooling—the expected number of years of schooling received by age 18, adjusted to reflect education quality as proxied by standardized test scores. See World Bank (2019k).

¹⁸ On average, children born in developing EAP are expected to complete almost 11.2 years of education by the age of 18. However, when adjusted for learning, they have only completed 7.4 years, suggesting a learning gap of 3.8 years.

job loss stress, and aging populations. The development of adaptive safety nets, such as a rapidly expanding cash transfer, can enhance program flexibility in cases such as natural disasters. These social protection programs help households manage risks and respond to adverse shocks to prevent them from falling into poverty.

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Part II. Medium-Term Development Agenda

II.A. The Digital Economy in Southeast Asia: Building the Foundations for Future Growth^{1,2}

Southeast Asia's digital economy is expanding at an unprecedented pace. The signs of the region's digital transformation range from the emergence of technology "unicorn" companies and transnational e-commerce platforms to the entrepreneurs and small firms that are innovating and using technology to grow. The use of digital technologies has the potential to transform, indeed disrupt, all sectors, notably services such as logistics and finance, but also industrial production, agriculture and social services. All of this is driving a growing level of interest from the region's governments in promoting faster and more inclusive digitalization. Despite this excitement, the full potential of technology as a driver of private sector and wider economic growth is not yet being realized. Southeast Asia still faces significant barriers to growing the digital economy, many of which need to be addressed through enabling policies, as well as greater regional cooperation.

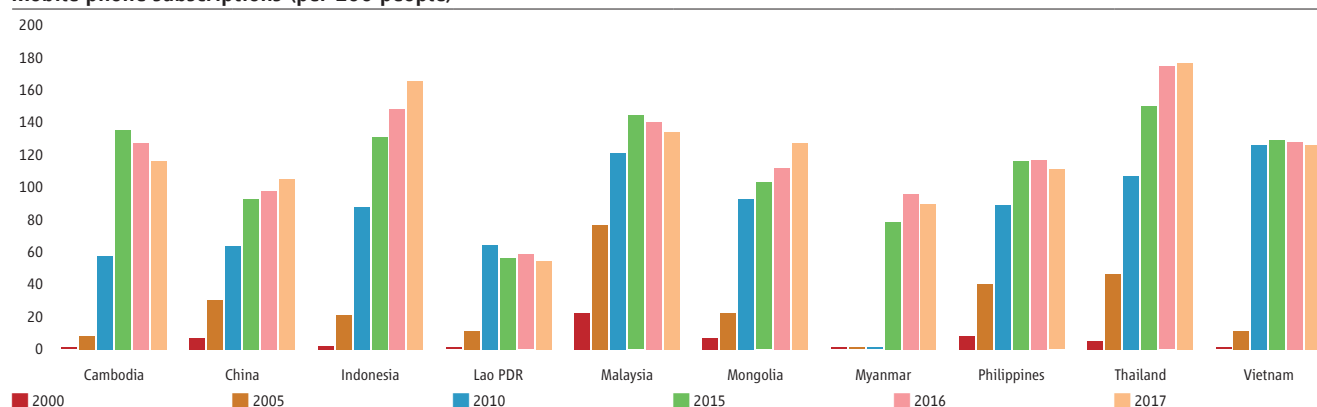
Regional digital economy snapshot

The emergence and growth of the digital economy in Southeast Asia has been spurred by improved connectivity across the region. The percentage of people with access to telecommunications and internet services, particularly mobile, has increased dramatically in the past two decades (Figure II.A.1).

Individuals in Southeast Asia are spending substantial amounts of time online (Figure II.A.2). According to recent surveys on internet usage, about 80 percent of consumers regularly obtain information on products and services from social media (We Are Social and Hootsuite, 2017). E-commerce spending is also rising, facilitated by the surge of marketplaces where SMEs sell to consumers online (Figure II.A.3). In big cities, the use of smartphones for messaging and social media has become ubiquitous. Ride-sharing services and delivery riders using apps to obtain their next booking are changing the face of urban transport and other services.

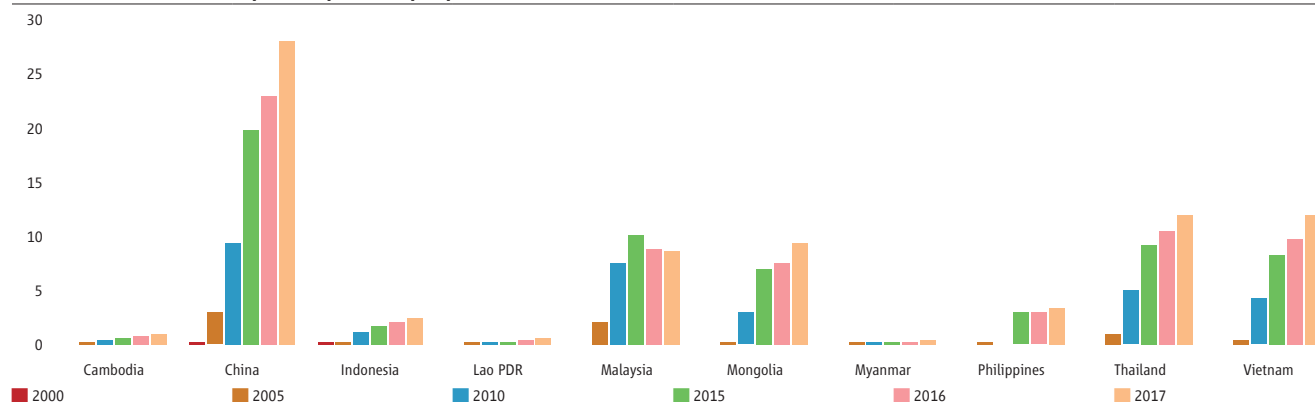
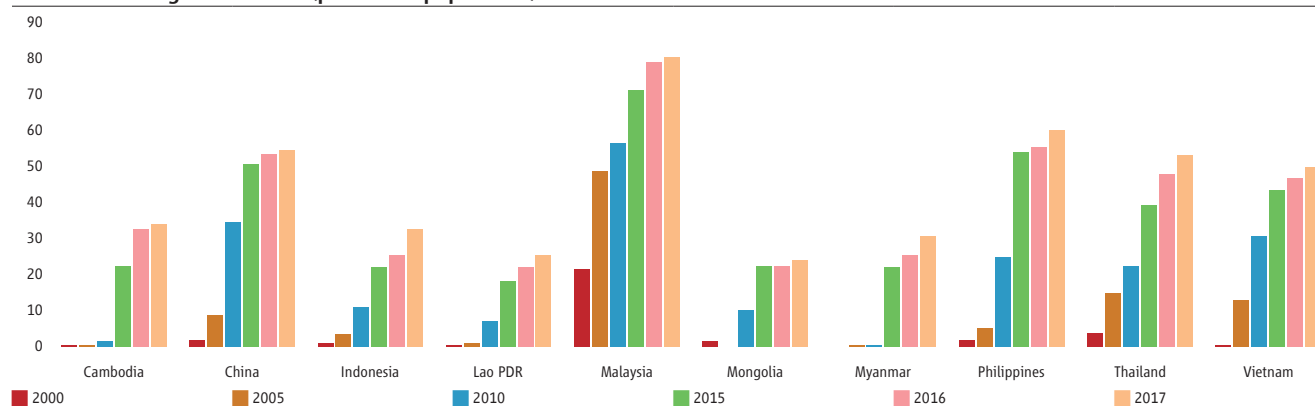
Figure II.A.1. Evolving digital connectivity, selected Southeast Asian countries, 2000–17

Mobile phone subscriptions (per 100 people)

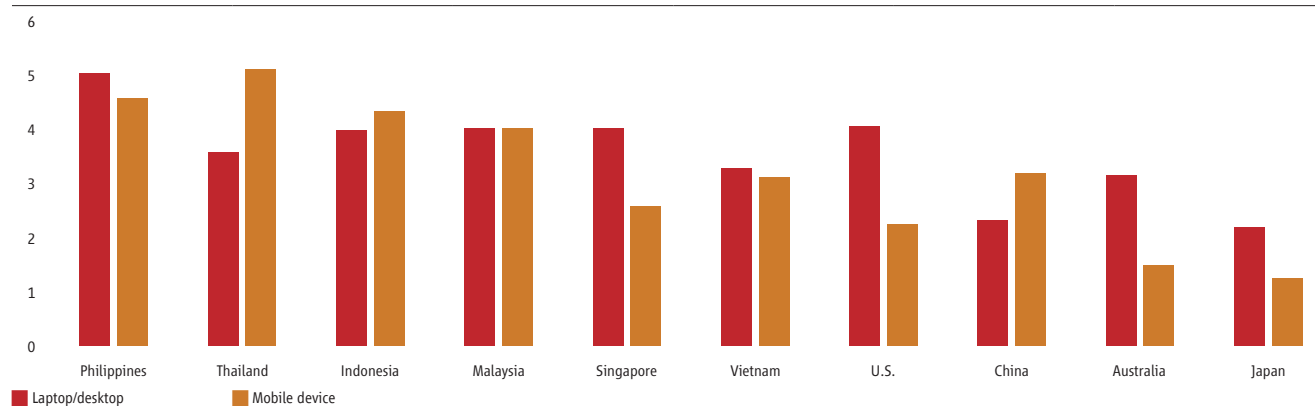


1 This chapter summarizes the findings of a recent World Bank Report on *The Digital Economy in Southeast Asia: Building the Foundations for Future Growth*, focusing on key policy enablers. See World Bank (2019).

2 The term "digital economy" is used to refer to private sector utilization of digital technologies as a driver of economic growth, innovation, and other means of transforming the economy. In this sense, the digital economy is not restricted to the information and communication technology (ICT) sector, but rather encompasses the adoption of digital technology in all sectors of the economy.

Figure II.A.1. Evolving digital connectivity, selected Southeast Asian countries (2000–2017) continued**Fixed broadband subscriptions (per 100 people)****Individuals using the internet (percent of population)**

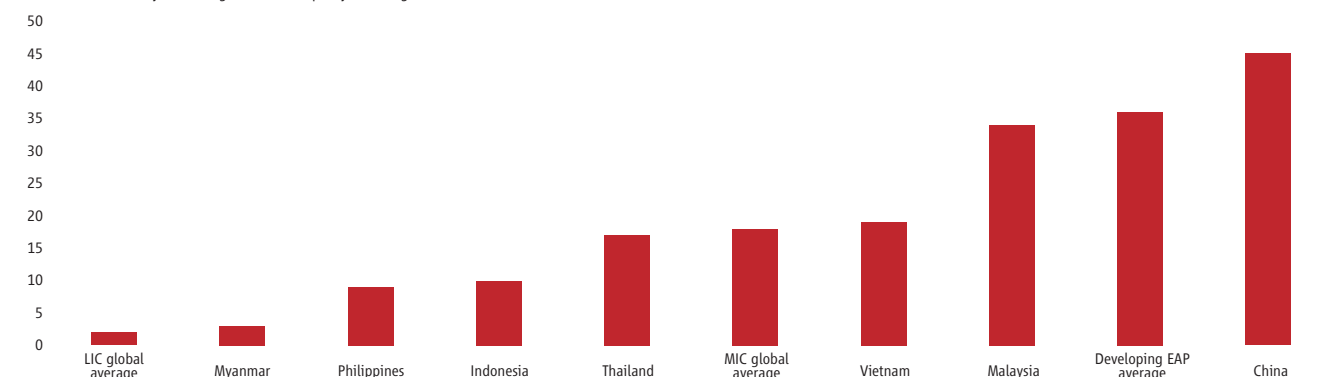
Sources: World Bank staff calculations using the World Development Indicators database.

Figure II.A.2. Time spent on the internet, selected countries (2019, average hours per day for internet users)

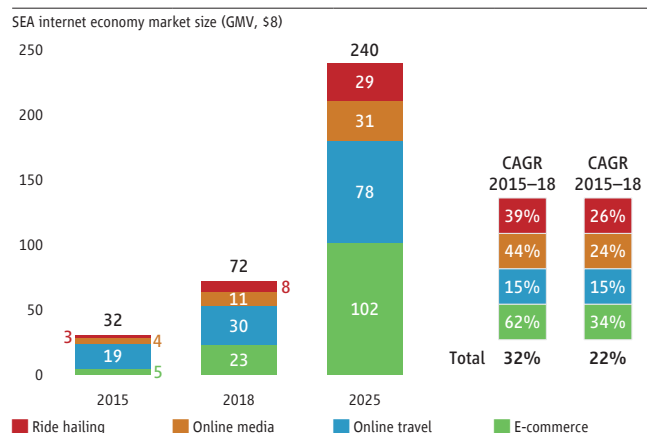
Source: We are Social and Hootsuite (2019). Based on a global survey of internet users in the cited countries aged 16–64.

Figure II.A.3. E-commerce adoption by country, 2017

Used the internet to buy something online in the past year (% age 15+)

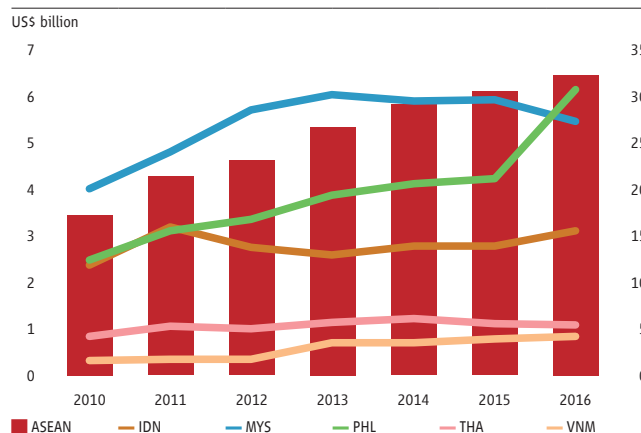
Source: Global Index Database 2017 <https://globalindex.worldbank.org/>

Digital platforms—a combination of technical innovation, new business models and value proposition—in the private and in some cases the public sector, offer a range of products and services via digital channels. Platform-based business have experienced remarkable growth and further expansion is projected (Figure II.A.4).

Figure II.A.4. The market size of various industries involved in digital commerce, US\$ billion

Source: Google-Temasek (2018).

Note: Data for 2025 are projections.

Figure II.A.5. Telecommunications, computer and information services trade, ASEAN member countries

Source: ASEAN Secretariat, Authors' calculations

Note: Figure shows exports plus imports, for trade with all countries, to indicate the overall growth of trade rather than in one direction or another. The bars refer to the scale on the right axis, the lines to the scale on the left axis.

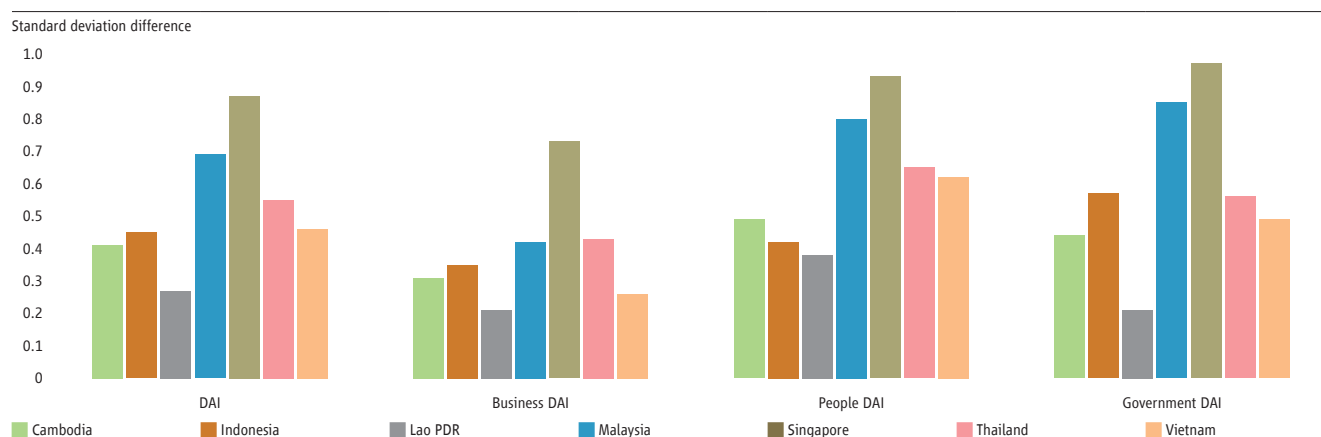
The internet has dramatically lowered the cost of delivering services, as well as marketing, ordering, and paying for them. Total Association of Southeast Asian Nations (ASEAN) trade in telecommunications, computer and information services (adding exports and imports), almost doubled between 2010 and 2016 (Figure II.A.5), and its share of total ASEAN services trade grew by 28 percent.

Digital technologies are facilitating payment and lending, promoting financial inclusion. In 2016, investments in the Southeast Asian fintech market increased to US\$252 million, up one-third from 2015. This upward trend continued in 2017, the last year for which data are available. The fintech landscape is dominated by payments and mobile wallets (43 percent), followed by financial comparison platforms (15 percent) and retail investment portals (11 percent) (UOB 2017).

Digital content development is another significant growth area. Ad-based video-on-demand (AVOD) or user-generated content platforms such as YouTube are very popular in Southeast Asia, with Vietnam and Thailand ranking among the 10 markets with the highest viewership globally (Fujita 2017). The growing volume of local content highlights the increasing adoption of digital platforms for the delivery of news and entertainment by local media companies.

In contrast to the high level of digital media use, the broader diffusion of digital technologies among businesses in Southeast Asia remains low as illustrated by the World Bank's Digital Adoption Index (DAI) in Figure II.A.6. The DAI measures the relative adoption of digital technologies by people, businesses and governments, based on a standard set of indicators across 180 countries relative to their income level. For example, Malaysia performs well in overall digital adoption in comparison to some OECD countries, but scores below the expected score for its income level for digital adoption by businesses. These findings are also confirmed by the results of World Bank Enterprise Surveys. The limited use of digital technology by firms in Southeast Asia may reflect the digital divide between large firms and smaller firms, as globally SMEs lag in technology adoption at all levels of economic development (OECD 2017).³ Other factors include the lack of necessary digital skills or limited availability of affordable broadband internet.

Figure II.A.6. Digital adoption by individuals, governments and businesses relative to the world average, ASEAN member countries⁴



Source: World Bank (2018a). Data at <http://wbfiles.worldbank.org/documents/dec/digital-adoption-index.html>

Note: The diffusion of digital technologies among businesses uses proxy data such as a proportion of businesses with websites, use of secure servers, internet bandwidth and mobile broadband.

Looking ahead, digital technologies offer significant new opportunities for firms, including in lowering barriers to entry, particularly to global value chains. SMEs may benefit disproportionately, as once-unaffordable computing power, storage, and development platforms become cheaper (for example, via cloud computing), identifying talent becomes easier and markets become easier to reach (OECD 2017).

Digital economy enabling environment

This brief regional snapshot highlights the following: while there are still limitations in measuring the extent to which the digital economy has transformed the economic landscape of the region, there are strong signs that the digital

³ OECD (2017).

⁴ The overall DAI is the simple average of three sub-indexes. Each sub-index comprises technologies necessary for the respective agent to promote development in the digital era: increasing productivity and accelerating broad-based growth for *business*, expanding opportunities and improving welfare for *people*, and increasing the efficiency and accountability of service delivery for *government*. See World Bank (2016).

economy has gathered momentum in Southeast Asia. This can be seen by the growth of e-commerce, the adoption of fintech, the rise in digital content, and the gradual digitalization of companies and government services. **However, for the digital economy to have a significant impact on poverty reduction and inclusion, its key enablers or “foundations” need to be better understood.**

These foundations, underpinned by a stable macroeconomic environment and supportive business environment overall, include: affordable and consistent internet **connectivity**; secure **payments** systems and mechanisms; availability of appropriate and adaptable workforce **skills**; reliable **logistics** services to facilitate the delivery of goods; and a series of **cross-cutting policies and regulations** supporting and securing online transactions and protecting consumers (Figure II.A.7). This is essentially what the *World Development Report 2016* refers to as the “analogue complements” needed to enable the digital economy and discussed in more detail in *The Digital Economy in Southeast Asia: Building the Foundations for Future Growth, 2019*. These can be monitored through indicators such as those summarized in Table II.A.1 and are discussed in more detail in Section 3.

Figure II.A.7. Digital economy foundations at a glance

| | |
|--------------------------------------|--|
| Connectivity | Affordable broadband internet access is a prerequisite and a physical underpinning to the digital economy |
| Payments | Access to safe and secure digital payment services provide the opportunity to engage in electronic transactions either as consumers or entrepreneurs, domestically or overseas |
| Digital skills | In a digitally-driven economy, skills needs range from basic digital and data literacy, to specialized skills to harness the productivity benefits of digital innovation |
| Logistics | The expansion of the digital economy highlights the importance of a developed and cost-effective logistics sector given the higher demand for delivery of goods, especially at low values, both within and across borders |
| Digital policy and regulation | Cross cutting policies and regulations shape the digital economy, including: those which relate to cross-border data flows, data privacy, cybersecurity, consumer protection, electronic transactions and e-commerce laws and taxation |

Table II.A.1. Digital economy indicators in selected Southeast Asian countries

| | | <i>Indonesia</i> | <i>Vietnam</i> | <i>Thailand</i> | <i>Malaysia</i> | <i>Cambodia</i> | <i>Lao PDR</i> | <i>Philippines</i> |
|--------------|---|------------------|----------------|-----------------|-----------------|-----------------|----------------|--------------------|
| Connectivity | Mobile broadband subscribers (percent of population) | 100 | 82 | 170 | 116 | 67 | 51 | 40 |
| | Mobile broad-band prices (500MB/month) as a percent of GNI per capita | 1.4 | 1.4 | 1.2 | 0.9 | 1.1 | --- | 1.5 |
| | Fixed broad-band subscribers (percent of population) | 3.1 | 12 | 11 | 8 | 1.5 | 1 | 3 |
| Payments | Made or re-ceived digital payments in the past year | 34 | 22 | 62 | 76 | 16 | 12 | 23 |
| | Paid online for internet purchase | 49 | 10 | --- | 52 | --- | --- | 52 |
| | Percent of Online Firms Using Digital Payments | 51 | 51 | --- | 57 | --- | --- | 52 |

Table II.A.1. Digital economy indicators in selected Southeast Asian countries (continued)

| | | <i>Indonesia</i> | <i>Vietnam</i> | <i>Thailand</i> | <i>Malaysia</i> | <i>Cambodia</i> | <i>Lao PDR</i> | <i>Philippines</i> |
|-----------------------|---|------------------|----------------|-----------------|-----------------|-----------------|----------------|--------------------|
| Skills | Human Capital Devt Index Global Rank (out of 120, 1 is highest) | 69 | 68 | 57 | 52 | 97 | 105 | 46 |
| Logistics | Logistics Performance Index Score (out of 5, 1 is lowest) | 2.98 | 2.98 | 3.26 | 3.43 | 2.8 | 2.07 | 2.86 |
| | Integrated index for postal development (100=highest) | 49.4 | 47.8 | 66.1 | 66.0 | 19.7 | 41.4 | 33.9 |
| Policy and regulation | Cross-Border Data Flow Restrictions | Yes | Yes | No | Yes | No | No | No |
| | Data Privacy Regulations | Yes | Draft | Yes | Yes | No | No | Yes |
| | Consumer Protection Regulations | Yes | Yes | Yes | Yes | Yes | Draft | Yes |
| | Cybersecurity Expenditure as percent of GDP | 0.02 | 0.04 | 0.05 | 0.08 | --- | --- | 0.04 |

Sources: ITU (2017); GSMA (2018); Telegeography (June 2018), Global Findex (2017); A.T. Kearney (2015); World Bank (2016); UPU (2016); WEF (2017); World Bank, OECD and Facebook (2018).

Note 1: — = not available.

Note 2: The Integrated Index for Postal Development is a newly developed composite index that benchmarks four different aspects of postal services, namely the reliability, reach, relevance and resilience, which was developed through an analysis of UPU postal big data, UPU postal statistics database and surveys. 100 = higher performance.

How do Southeast Asian economies compare? There are significant differences across and within Southeast Asian countries in access to the internet along with speed and cost. Differences within countries between urban and rural/remote internet access and quality can be especially large. The extent of utilization of digital payments varies across countries. Significant gaps also exist between traditional models of education and training, and the evolving demands for digital skills in the workforce. Policies and regulations for managing data, especially the flow of data across borders, are still evolving.

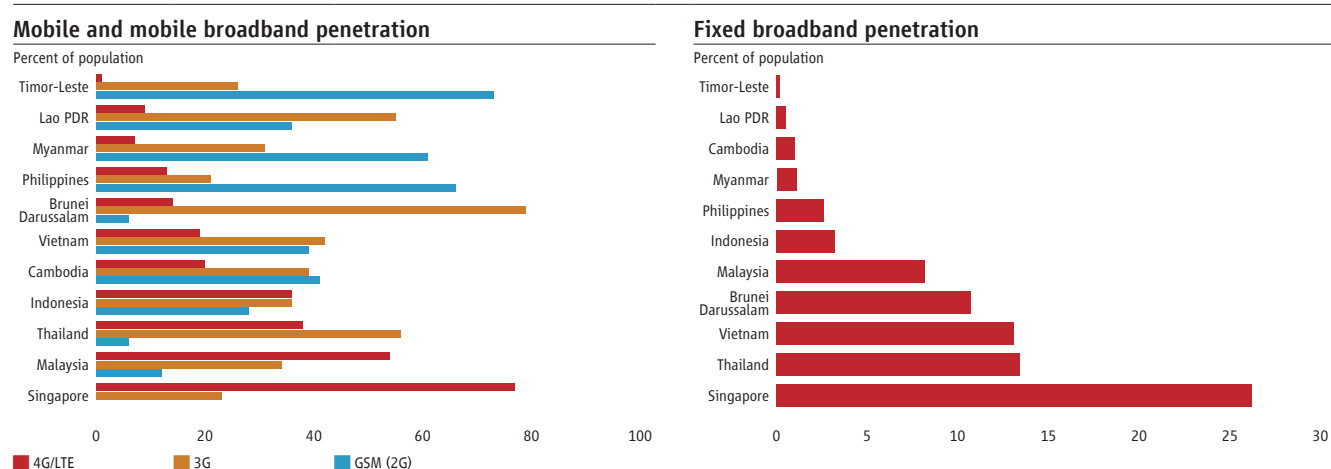
Key digital economy foundations

▸ Connectivity

Digital connectivity in Southeast Asia is improving, with substantial investment primarily by the private sector. Broadband internet penetration grew by an average 13 percent per year in Southeast Asia between 2011 and 2016 (ITU 2017). However, as of mid-2019 about half the population of this region still lacks broadband access (Figure II.A.8). Mobile broadband access (notably 4G and prospectively 5G) is improving as is the proliferation of smartphones, but quality and affordability remain challenging in many areas. Fixed broadband access, for example, through optical fiber connections to the premises, essential for data intensive transactions required by many businesses, is lagging.

Internet speeds, key determinants of quality of service, in the largest Southeast Asian economies, fall short of the global leaders, although the gap is closing. The largest middle-income developing countries in Southeast Asia all fall below the Organization for Economic Co-operation and Development (OECD) average speeds over mobile and fixed broadband. Thailand is the only economy ranked within the top 20 countries globally measured as the proportion of the population with broadband plans at 15 Mbps or faster speeds (Akamai 2017). Although Indonesia, the Philippines, and Vietnam are currently behind, the year-on-year growth rates—520 percent, 509 percent and 1,222 percent, respectively, for 2016–17—are encouraging.

Figure II.A.8. Broadband internet penetration in ASEAN member countries, 2018



Sources: ITU (2018), GSMA, Telegeography (2018).

Note: Mobile broadband means access to internet using a 3G or (faster) 4G enabled device. A GSM 2G connection means that the user only has basic data service i.e. text messaging. Fixed broadband means access to internet using fixed line networks such as xDSL (digital subscriber lines) or optical fiber connected to the premises. These data show the number of mobile and fixed broadband internet subscribers as a percentage of the population for each country.

Affordability of internet, both in absolute terms and as a percentage of income, has seen steady improvement globally and in the Southeast Asian region (ITU 2016; 2018). However, while mobile broadband is becoming more affordable (being less than 5 percent of gross national income [GNI] per capita⁵), fixed broadband is typically less affordable. There are also significant variations in availability, quality, and pricing of broadband services within countries, attributable to geography and population distribution (particularly in Indonesia and Philippines), technical factors (such as the type of backhaul technologies available, i.e., fiber, microwave or satellite), overall costs of service deployment, expected revenues for service providers, local constraints such as permits and rights-of-way requirements, and lower levels of competition in particular regions.

Governments have an important role in facilitating faster broadband rollout through regulatory reforms that can, for example, improve competition in the broadband value chain (wholesale and retail) and help to optimize investments in unserved and under-served locations, as well as increasing uptake of services. Regulatory authorities also have an important role in quality of service oversight.

Priority policy and regulatory reforms for improved digital connectivity include:

- **Open access and non-discriminatory pricing:** Regulations that help to create a more level playing field for telecommunications/internet service providers to access critical infrastructure/networks at all levels of the

⁵ Gross national income (GNI) is defined as the sum of value added by all producers who are residents in a nation, plus any product taxes (minus subsidies) not included in output, plus income received from abroad such as employee compensation and property income.

broadband value chain. This includes the “first mile”, or international gateway, as well as the “middle mile” or “backbone” networks and last mile fixed networks, for example, Fiber to the home (FTTH). Open access at the wholesale level helps to promote more equitable competition among retail service providers, lowering the cost of internet services at the retail level.

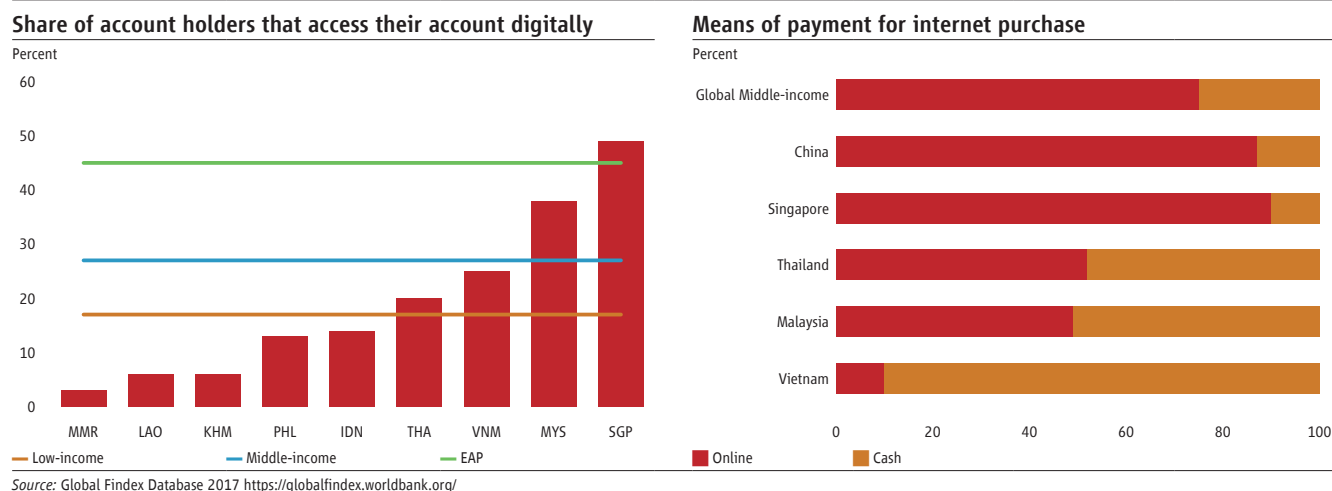
- **Passive infrastructure sharing:** Regulations that encourage or, in some cases, mandate, service providers to share tower networks (for wireless backbone infrastructure e.g. microwaves and mobile base stations) and/or fixed broadband facilities to enable more efficient utilization of resources and reductions in the cost of network installation and maintenance. Passive infrastructure may account for up to 80 percent of digital infrastructure investment costs, so the savings are potentially significant. There are further opportunities for sharing digital infrastructure across sectors (e.g., optical fiber cables collocated with power, transmission networks, roads and pipelines).
- **Radio spectrum management:** Spectrum is a scarce resource, particularly in densely populated urban environments, that governments allocate, for example to telecoms and broadcasting service providers, among others, to enable them to provide communications services across designated frequencies. Evolving communications technologies may require the review and/or reallocation of spectrum among service providers to maximize efficient utilization. For example, the 700 megahertz (MHz) band, typically allocated for analogue broadcasting, is being progressively phased out globally as countries migrate to digital TV. The spectrum can then be freed up for additional mobile broadband (e.g., 4G) deployment.
- **Foreign ownership restrictions** that still apply in some countries in the telecommunications/internet sector: A review/revision of these may enable greater foreign investment in connectivity infrastructure and promote more competition in service delivery.
- **National broadband plans.** Several governments in the region have published such plans with indicative targets for coverage and internet speeds. Given the rapidly increasing demand there is scope to set more ambitious targets for reducing the digital divide, and to strengthen monitoring and evaluation mechanisms.

► Payments

Finance is both an enabler of the digital economy, as well as one of the main sectors where digitalization is supporting significant changes in business models and available services. For example, digital financial services can potentially offer a new pathway into the formal financial system for “unbanked” people in the region.

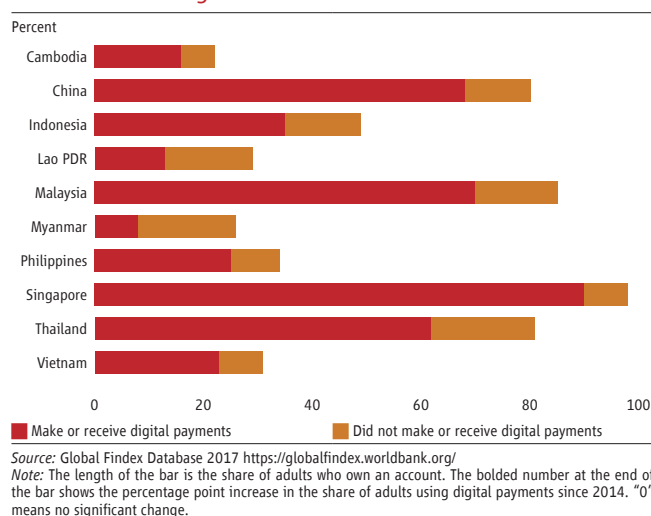
Digital payments use in Southeast Asia is still lagging, constrained by low consumer awareness and lack of trust in the security and reliability of online transactions. Vietnam, Thailand, Indonesia and the Philippines fall below the middle-income country average (27 percent) for account holders using the internet or mobile phones to access their accounts (Figure II.A.9).

The level of online payments for internet purchases in Thailand and Malaysia is roughly one-third lower than the average for middle-income countries (around 71 percent), and around half of the level in Singapore. In Vietnam, the use of online payments is 14 percent that of the average for middle-income countries. About 85 percent of account owners (70 percent of adults) had made or received digital payments in the year under review in Malaysia, but only around 35 percent for Indonesia and 22 percent for Vietnam (Figure II.A.10).

Figure II.A.9. Digital payments use is lagging...

Policymakers face a variety of challenges in facilitating the expansion of digital payments, while managing the consumer and other regulatory issues involved:

- Consumer protection.** Digital financial services and products are being delivered through new channels and business models. These challenge traditional thinking about disclosure and recourse, and raise other consumer protection issues. In addition, in the event the consumer suffers a loss, liability can be unclear due to the multiple parties involved in service delivery, namely agents and third-party providers of communications and technology services. Policymakers will need to consider how to update conventional product standards and guidelines to address these concerns.
- Increased need for cross-sectoral coordination and communication.** Digital financial inclusion—which involves new providers, services and consumers—requires significant cross-sectoral coordination and communication among regulators and supervisors, both at country and global levels.
- Customer identity/digital ID.** Financial identity for poor people when services are delivered digitally carries the potential for both inclusion and anti-money laundering/countering the financing of terrorism (AML/CFT) gains, but also raises privacy and fraud risks. Meaningful and manageable laws based on privacy principles—at both the national and global levels—and effective enforcement thereof offer the prospect of win-win solutions. Policymakers, donors and other stakeholders worldwide are also recognizing the need to develop comprehensive ID programs to enable access to financial and other services.

Figure II.A.10. ...but has the potential to increase across the region

- **Monitoring systems.** Reporting and monitoring systems need to become more sophisticated, with a greater focus on direct linkages to financial institutions' information systems (where feasible), and development of real-time monitoring capabilities, to enable implementation of appropriate privacy and data protections for users.
- **Interoperability of digital services** across service providers and points of service, including agents and service providers. This issue is critical for national efforts to broaden the reach of financial services into previously underserved, often rural, areas as well as for other funds transfers, for example, for government services delivery.

▸ Digital Skills

Growth of the digital economy is placing a premium on certain skills and reducing returns to others. Recent literature shows an emerging consensus around three “tiers” of skills, outlined in Table II.A.2, that are considered essential in the digital economy.⁶

Table II.A.2. High-level digital skills categories

| <i>Types</i> | <i>Description</i> | <i>Target</i> | <i>Examples</i> |
|----------------------------------|--|---|--|
| Basic digital/ICT skills | Ability to use digital technologies (for example, send email, find work-related information on the internet, use digital apps and non-specialized software, awareness and ability to stay safe in cyberspace) | All citizens and workers | EU: Digital Competence Framework for Citizens, also known as DigComp |
| Digital/ICT complementary skills | Soft skills required to work in a technology-rich environment and to participate in ICT-enabled collaborative work (for example, communicate on social networks, brand products on e-commerce platforms or analyse data gathered from the web) | Middle-skill to high-skill professionals | US: Partnership for 21st Century Skills US: Agenda for New Skills for Jobs |
| Advanced and specialist skills | Skills needed to drive innovation, support digital infrastructure and the functioning of the digital ecosystem | Industry and occupation specific (for example, program software, develop applications, manage networks, data analytics) | Skills Framework for the Information Age (SFIA https://www.sfia-online.org/en) Singapore's Workforce Qualification scheme |

Structural changes in countries' economies in Southeast Asia have already been raising the demand for workers to have more advanced skills.⁷ But, the digital economy is leading to more rapid changes in business models and activities. As a result, specific occupational skills are likely to become obsolete more quickly than in the past. Thus, skills policies should build adaptability among workers, not just focus on specific occupational skills (World Bank 2016). The skill set for the digital economy is a combination of “soft” skills of critical thinking and problem solving, communication, teamwork, and creativity for the digital economy, beyond the traditional focus on “hard” skills such as programming and coding, science, and technology. This underlines the importance of governments investing in human capital, not only to build basic literacy and numeracy, but also to develop socio-behavioral skills, which also reinforce adaptability in a rapidly-changing environment (World Bank 2019).

⁶ See for example OECD (2016) and OECD and UNESCO (2018).

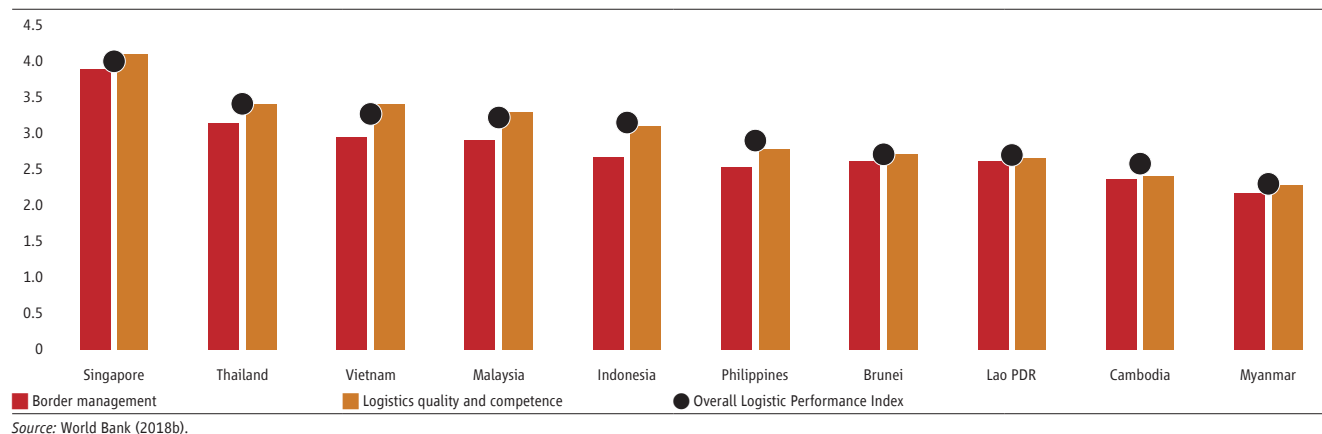
⁷ See the accompanying article, “Technological Change, Skills and Jobs in Developing East Asia, Part II.B in this issue. For recent evidence on changing skills demands, see for example, figures 2-4.

Key policy priorities include the following:

- **Digital skills strategy development and curriculum updates.** This will need to be undertaken at all levels of the education systems, as well as for lifelong learning programs. Some governments in Southeast Asia are already implementing programs to build up a bedrock of core skills to help workers meet the demands of increasingly technology-driven economic environments. Examples include Singapore's SkillsFuture for the Digital Workplace initiative and Malaysia's #mydigitalmaker movement and Thailand's Net Pracharat skills awareness and digital literacy program. Given the rapid pace of changing skills needs, more systematic collaboration between governments and the private sector can help identify and anticipate what these needs are.
- **Regional skills mobility.** Regional efforts to promote talent mobility within ASEAN member countries, including providing for the transferability and recognition of education and skills through common protocols of certification, will be important to reaping the full benefits of technology and facilitating increased regional integration. Joint skills training and mutual recognition of occupational qualifications and standards between ASEAN nations also can promote talent flows from economies with specific skills surpluses to those where such skills are in short supply. This needs to be coupled with policies that support the regional movement of skilled personnel, which may require the lifting of restrictive policies in some country contexts.

► Logistics

Figure II.A.11. Logistics Performance Index selected key indicators, 2018



Improved connectivity, the spread of digital payments, and adoption of e-commerce are all leading to higher demand for delivery of goods within and across borders, raising the importance of logistics (trade facilitation and fulfilment) services. E-commerce consumers, whether firms or individuals, are demanding delivery services that are fast, efficient, reliable and traceable. Recent Logistics Performance Index (LPI) data indicate improved overall performance from 2016 to 2018 in Thailand, Vietnam, Indonesia, the Philippines, and Lao PDR.⁸ In absolute terms, performance overall for ASEAN is not especially strong: only Thailand and Vietnam placed in the top 25 percent of performers in the LPI in 2018, and Malaysia, Indonesia, and the Philippines placed in the top 50 percent. Figure II.A.11

⁸ The LPI collects perceptions of logistics service providers about several aspects of logistics performance: (a) efficiency of customs and border management clearance; (b) the quality of trade- and transport-related infrastructure; (c) the ease of arranging competitively priced international shipments; (d) the competence and quality of logistics services; (e) the ability to track and trace consignments; and (f) the frequency with which shipments reach consignees within the scheduled or expected delivery time.

illustrates comparative performance on two key indicators from the LPI across selected countries: customs and border management, and the competence and quality of logistics services.

Key policy and regulatory issues for governments on logistics include the following:

- *Harmonization of “de minimis” thresholds.* A particular feature of e-commerce growth is that it is leading to an increase in shipments of low-value, small consignments, both within and across borders. At present, most governments have “de minimis” thresholds in place, setting a value for individual shipments under which customs duties and other taxes are not charged. As the volume of goods falling below these thresholds grows, many governments perceive that this generates risks, for community protection and safety, revenue collection, and intellectual property enforcement, among other areas. This has led to widely varying standards across countries. A common approach in Southeast Asia (e.g., by ASEAN), and governments could facilitate cross border e-commerce.
- *Maintaining risk-based approaches to managing border clearances,* including simplified procedures for low-value, low-risk goods and “trusted trader” schemes for frequent traders with strong compliance records. Efficiency and control can be facilitated by ensuring that logistics operators or e-commerce firms provide data to customs agencies in advance of a parcel’s arrival. The overwhelming majority of small parcels crossing borders through e-commerce are likely to be legitimate shipments and inspecting all or most parcels will not only impede trade but entail high administrative costs for customs and other agencies
- *Reducing internal regulatory barriers.* These include phasing out fragmented licensing arrangements for logistics services and reducing market entry barriers, for example, foreign equity limits and minimum capital require that increase logistics costs in some countries, e.g. Indonesia.
- *Facilitating provision of space,* especially in urban areas, for warehousing and distribution facilities would enable more timely delivery of small parcels (e-commerce companies require up to three times the inventory space compared with “offline” retailers).⁹
- *Facilitating last-mile delivery* in those Southeast Asian economies that still have large gaps in postal addressing, such as Indonesia and Myanmar, is critical, given the heavy reliance on postal networks for e-commerce deliveries. In Indonesia, for example, the lack of standardization in addressing systems and parcel sizes requires the use of manual rather than automatic sorting, which is likely to push costs up as e-commerce demand grows. Alternative solutions (for example, pick-ups at supermarkets or parcel lockers) will be needed and in some cases have already been developed by private sector firms and consumers.

▸ Cross-cutting digital economy policy and regulation

Policies to promote trust in the internet and digital activities are essential for growing participation in the digital economy, and for managing risks associated with technologies such as cloud computing, big data analytics, the Internet of Things (IoT) and prospectively artificial intelligence (AI)/machine learning. This includes policies and regulations on electronic transactions more broadly, but also specific measures addressing: data protection/privacy—particularly the issue of cross-border data flows—cybersecurity, and consumer protection. Other relevant cross-cutting policies relate to digital entrepreneurship, digital government and digital identity programs.

⁹ Prologis (2016).

Policies and regulations pertaining to e-commerce have generally been adopted by Southeast Asian governments. This focus is also evident in ASEAN's regional digital agenda, which has a strong focus on e-commerce rather than the digitalization of industries. ASEAN member countries have adopted two UNCITRAL instruments, the Model Law on Electronic Commerce (MLEC) and, more recently, the Convention on Electronic Contracting. Both instruments prohibit discrimination against contracts originating in electronic form, and disparity of treatment between electronic communications and paper documents.¹⁰ These prohibitions are regarded as “enabling” e-commerce by removing doubts about the enforceability of online contracts. While multiple ASEAN jurisdictions have enacted domestic legislation based on either the MLEC or the Convention, the adoption of the MLEC has not been uniform across ASEAN jurisdictions.

Most Southeast Asian countries—except Cambodia, Lao PDR and Myanmar—have general legal frameworks for secure electronic transactions, data protection and privacy, and consumer protection for online purchases (Table II.A.3). Challenges include implementation/enforcement and development of subsidiary legislation and regulations to address the detailed issues outlined above.

Table II.A.3. Legal frameworks in ASEAN countries for electronic transactions, data protection/privacy, and online purchases

| | <i>Does the country have a legal framework for electronic transactions/e-signature?</i> | <i>Does the country have a legal framework for data protection/privacy online?</i> | <i>Does the country have a legal framework for consumer protection when purchasing online?</i> | <i>Does the country have a legal framework for cybercrime prevention?</i> |
|-------------------|---|--|--|---|
| Brunei Darussalam | Yes | No | Yes | Yes |
| Cambodia | Draft | No | Draft | Draft |
| Indonesia | Yes | Yes | Yes | Yes |
| Lao PDR | Yes | Yes | Draft | Yes |
| Malaysia | Yes | Yes | Yes | Yes |
| Myanmar | Yes | No | Yes | Yes |
| Philippines | Yes | Yes | Yes | Yes |
| Singapore | Yes | Yes | Yes | Yes |
| Thailand | Yes | Yes | Yes | Yes |
| Vietnam | Yes | Yes | Yes | Yes |

Source: UNCTAD Global Cyberlaw Tracker (2019).

The sections that follow elaborate on some of the key policy and regulatory challenges facing Southeast Asian countries as they seek to enable development of their digital economies.

Data protection and data privacy

The use of data is central to the digital economy. Accordingly, a robust legal and regulatory regime that addresses issues of data ownership, protects personal data and builds trust, while allowing its legitimate use, is a critical requirement. The extent to which countries in the region have legal and regulatory frameworks on data ownership, data governance and data privacy varies. Malaysia, Singapore, and the Philippines adopted comprehensive data protection laws earlier in this decade. Thailand's personal data protection law will come into force in May 2020. In Indonesia, sectoral regulations applicable to electronic service providers are already in place and a draft law on data protection is pending presidential approval. Vietnam has a variety of specific regulations in place but no cross-cutting data protection law. Cambodia,

¹⁰ MLEC Article 8, Explanatory Note, paragraph 129.

Brunei Darussalam, Lao PDR and Myanmar lack publicly-announced plans to introduce comprehensive data protection frameworks.

The ease of transmitting data across borders is central to growth of cross-border business models. At the transactional level, data underpin the flow of goods and services within countries around the region, and between Southeast Asia and its major trading partners. Effective use of data is also a necessary condition for the adoption of cloud technologies that can reduce up-front capital costs and boost productivity (Meltzer and Lovelock 2018). Cross-border data flows generate more economic value than traditional flows of traded goods, according to some estimates. These flows accounted for US\$2.8 trillion of global GDP in 2014 and have the potential to reach US\$11 trillion by 2025 (McKinsey and Company 2015).¹¹ Indeed, the ability to move data rapidly and globally is the new growth engine for many businesses.

The region has seen a push by some governments to restrict cross-border data flows, especially of sensitive personal data. The regulatory regime in Indonesia and Vietnam includes data localization requirements under which businesses are obliged to ensure that various forms of data are processed and stored in servers/facilities physically located within national borders, or that at least a copy of the data is available locally and accessible for law enforcement purposes (data mirroring). The arguments for such regulations include enhancing national security, protecting personal privacy, aiding law enforcement, and preventing foreign surveillance, in addition to appeals to the principle of sovereignty. But governments have also imposed restrictions to support domestic technology sectors or to promote the construction of in-country data centers and the creation of highly-skilled technical jobs (FTI Consulting 2017). Such restrictions have economic and trade costs, and according to the European Centre For International Political Economy (ECIPE) may reduce GDP by 0.5 percent in Indonesia, by 0.4 percent in the Republic of Korea, and by 1.7 percent in Vietnam (Bauer et al. 2014).

Blanket data localization restrictions can have widespread impacts beyond the digital economy, because of the increasingly central importance of data to economic activity. For example, the use of data to monitor the efficiency of production processes or the performance of engineering parts to identify needs for maintenance or replacement. Moreover, many services critical for increasing productivity (including for SMEs), for example R&D services provided from a subsidiary to a domestic manufacturing firm, design services for an engineering company, or marketing for an agricultural producer, are accessed through cross-border data transfers.

Data localization regulations should be designed to reduce risk—whether to privacy, from cyberattack from delays to law enforcement—to an acceptable level relative to economic and social benefits, including innovation, expected from the use of the data.¹² In most cases legitimate regulatory goals can be achieved at lower costs to growth and trade than those involved in blanket requirements on data localization. For example, in most countries only certain types of data are required to be held on local servers (e.g., data of national security importance), rather than mandating a blanket requirement. Such approaches should avoid excessive regulatory complexity, for example by introducing multiple categories of data that are not clearly defined or relying on provisions that may be imprecise.

The negative impact of regulations that impede data flows often goes unobserved, as many governments do not have the capacity to adequately measure the contributions of data to the digital economy. Governments could improve their measurement of the effects of cross-border data flows, and thus the impact of data localization

¹¹ There is no consensus on estimates on the value and impact of data flows and gathering data on the scale of data flows or their economic value is highly challenging.

¹² This principle has been adopted by the OECD. See OECD (2015), Principle 5.

requirements, by increasing the sample sizes used when measuring trade in services, collecting data more often, and at a more granular level. They could also collect more detailed and specific data on cross-border data flows and develop better measures to capture how the digital economy contributes to GDP, job growth, and productivity. ASEAN could support measurement and data collection by developing a standard nomenclature for terms, standard metrics and indicators related to the digital economy.

A key challenge is finding ways for data to flow freely between countries in the region with different regulatory approaches to privacy. There are ongoing efforts to facilitate data flows through self-regulatory instruments, notably through APEC's Cross-Border Privacy Rules (CBPR) system, which enables personal data to flow freely even in the absence of both governments having recognized each other's privacy laws as equivalent. Instead, APEC relies on businesses to ensure that data sent to third parties, either domestically or abroad, continue to be protected consistent with APEC privacy principles. The APEC CBPR regime also requires accountability agents (AA) accredited by their local government to monitor and hold businesses accountable for privacy breaches.¹³ To date, in Asia only Japan has effectively joined the scheme. But it will soon be operational in Singapore and Republic of Korea once their governments appoint AAs. Philippines and Vietnam have expressed an interest in joining the scheme.

Another complementary approach is to work toward the convergence of data privacy laws across countries. Some Southeast Asian jurisdictions have effectively implemented the high-level principles and concepts embedded in various international legal instruments, frameworks, or guidelines (including the OECD Privacy Principles, EU Directive 95/46/EC, now EU GDPR, APEC Privacy Framework, ASEAN Data Protection Framework) into their national legal systems. However, divergence has increased as jurisdictions have prescribed more and more detailed requirements to ensure enforcement and compliance.¹⁴ Local or regional actions seeking to promote the convergence of existing data protection laws should be encouraged.

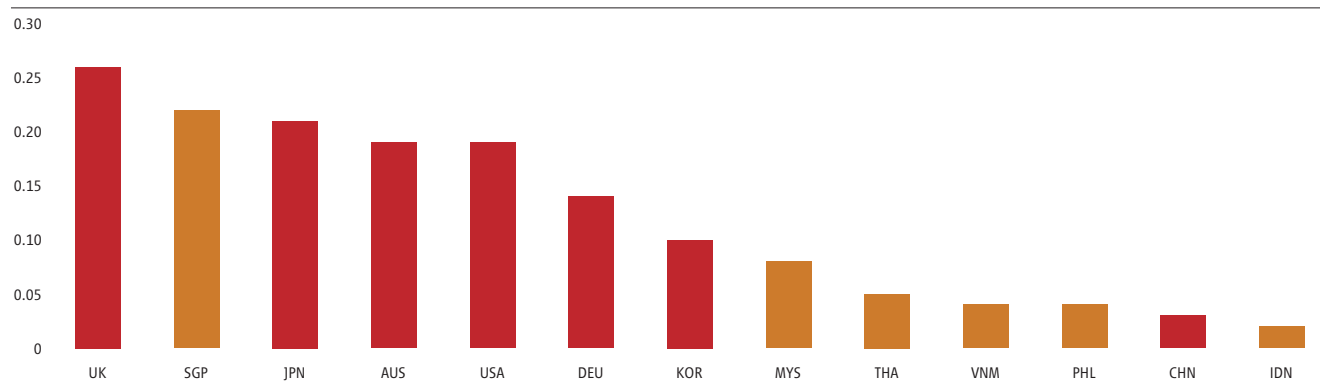
Cybersecurity

Cybersecurity threats have wide-ranging implications for commercial activities and personal privacy and have triggered a range of regulatory responses. Cybersecurity is a function of multiple elements—technical, financial, physical, and human resources.

Countries in the region have under-invested in the “hard” and “soft” infrastructure of cybersecurity to date. In 2017, expenditures on cybersecurity ranged from 0.22 percent of GDP in Singapore (third-highest globally) to 0.02 percent in Indonesia (Figure II.A.12). Overall, ASEAN member countries spent about 0.07 percent of GDP on cybersecurity, below the global spending average of 0.13 percent (A.T. Kearney 2018). According to an assessment by A.T. Kearney, ASEAN member countries need to increase spending on cybersecurity to between 0.35 and 0.61 percent of its collective GDP—or to about US\$171 billion—between 2017 and 2025.

¹³ Trustarc and JIPDEC have been recognized as Accountability Agents in the United States and Japan respectively.

¹⁴ Hogan Lovells (2018).

Figure II.A.12. Benchmarking cybersecurity expenditure—share of GDP spent on cybersecurity in 2017: selected countries

Source: Gartner and A.T. Kearney analysis, 2017 (see A.T. Kearney 2018). Note: ASEAN member countries highlighted.

Only Singapore, Malaysia, Thailand, and the Philippines have established national cybersecurity strategies and agencies to coordinate cybersecurity agendas, but specific governance mechanisms and policies are still underdeveloped. One major contributing factor is the global and regional shortage of skills in these areas.

To address current and emerging threats, Southeast Asian governments will need to accelerate the development of national cybersecurity strategies with a well-defined vision, scope, objectives, and a practical road map for implementation. An approach based on risk identification, risk analysis, and risk evaluation will be crucial.

A regional governance framework to address cybersecurity is also yet to be established. The focus to date has been on including cybercrime in existing frameworks, particularly ASEAN mechanisms. ASEAN is working on a more coordinated approach to develop a comprehensive cybersecurity framework that establishes regional cybersecurity standards and encourages intelligence sharing.

Consumer protection

Complementing e-commerce and e-transaction laws, consumer protection laws and regulations are essential for building an ecosystem of trust and confidence in electronic transactions. Concerns about potentially greater consumer vulnerabilities through the rise of the digital economy have driven a growing focus on consumer protection related to e-commerce and other aspects of the digital economy. For example, online consumer protection has featured in several ASEAN initiatives and is also a theme in Indonesia's E-commerce Roadmap (2017).

Consumer concerns about trust and reliability in e-commerce appear to be a barrier to further growth. The overall lack of trust in online transactions is demonstrated by the fact that, despite increase in the use of some digital payments, for example, in Thailand and Malaysia, cash on delivery remains the preferred payment mode in emerging Southeast Asian markets, as noted in the previous section.

The main effort at the regional level to address these issues is the ASEAN Strategic Action Plan for Consumer Protection (ASAPCP) 2025, the implementation of which has focused on information-sharing between regulators, although there are also more ambitious goals, such as creating a cross-border redress system and a rapid alert system

on product safety. However, ASEAN's initiatives can only advance as far and as quickly as the members themselves can enforce laws and regulations that protect transactions both online or offline, and not all countries have consumer protection laws in place.

Digital Entrepreneurship

Many governments in Southeast Asia are considering options to improve the “digital entrepreneurship ecosystem” through strengthening the wider business environment and facilitating access to staff with skills appropriate for the digital economy. In addition, governments are increasingly interested in issues specific to digital start-ups, including access to finance for entrepreneurs, awareness-raising on the potential of the digital economy, or targeted financial or other support to help firms grow.

Support to strengthen the foundations for the digital economy, along with the wider business environment, must be balanced with providing targeted support for digital start-ups. For example, a recent World Bank report on Malaysia's digital economy¹⁵ recommends that the government shift its role from providing a wide range of support programs for entrepreneurship to addressing structural reforms, especially to address supply-side factors such as access to skills and finance, while avoiding crowding out private investment, channeling government funds into ineffective programs, or putting burdensome regulations in place.

Digital government and digital ID¹⁶

The provision of online services to citizens and businesses, typically via a digital government “platform” or portal (such as www.gov.sg in Singapore or www.malaysia.gov.my in Malaysia), can boost growth of the digital economy. Developing online business registration platforms and shifting from paper-based to online systems for government approvals of cross-border trade shipments can encourage firms to adopt digital technologies. The provision of digital services can help raise digital awareness and literacy. And the digitization of government payments can increase financial inclusion. Fourteen percent of bank account holders in Thailand, for example, opened their account to enable receipt of a government transfer. There is considerable potential for increasing financial inclusion through digitizing government payments. For example, in the Philippines, 6 million unbanked people receive government payments in cash, even though 58 per cent of them already own a mobile phone (Demirgüç-Kunt, et al. 2018). The adoption of government-issued digital IDs can boost financial inclusion by helping to meet “know-your-customer” and other regulatory requirements.

Digital ID systems are widely-recognized as a foundation for the development of e-government, e-commerce and the digital economy (World Bank 2016). Digital ID systems facilitate reliable authentication of a person's identity on demand and bind users of online transactions with their ‘real world’ or legal identities. E-commerce and the IoT have

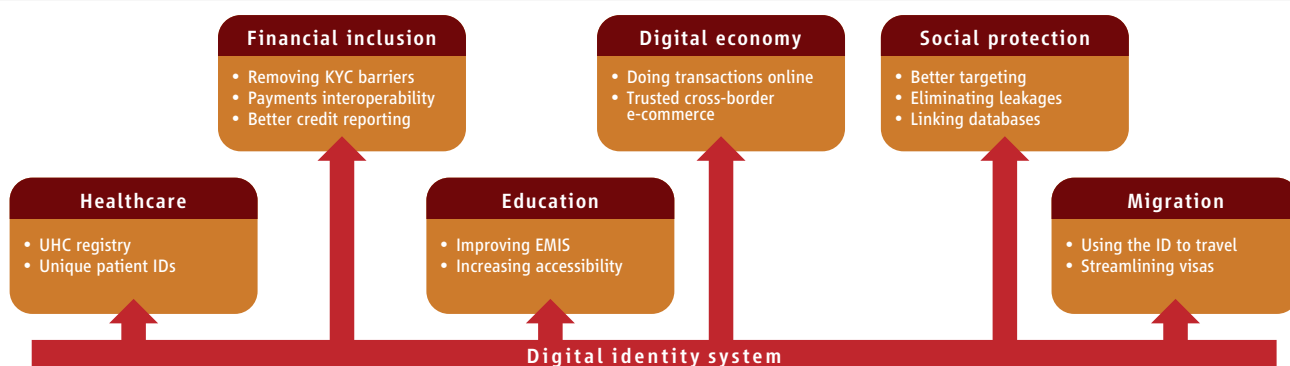
¹⁵ World Bank (2018c).

¹⁶ There are numerous definitions for this concept. The term “e-government” is used to refer to the use of information and communication technologies, specifically the internet, to deliver services to individuals and businesses. The term “digital government” is used more holistically to refer to “the use of digital technologies, as an integrated part of governments’ modernisation strategies, to create public value” (OECD 2014).

also created a need for verifiable digital identities for legal entities and devices. Interoperability of digital IDs across borders can accelerate economic integration and create opportunities for new markets.

Digital ID is also associated with advancing a range of other development outcomes, including comprehensive social safety nets, streamlined public administration, financial inclusion and the empowerment of women and girls (Figure II.A.13). Five ASEAN member states (Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand) have fully digitized their foundational ID system and have established an associated public key infrastructure (PKI). The foundational ID is widely used in public and private sector face-to-face transactions, including ubiquitous use of the unique ID number. All these systems, except for Singapore's, use smartcards with data such as private keys and biometrics stored on the chip. Cambodia, Lao PDR and Vietnam are currently piloting digitized foundational ID systems. Myanmar has listed the development of a digital ID system as one of 12 priorities in its national economic policy.¹⁷

Figure II.A.13. Digital ID in the digital economy ecosystem



From strategy to implementation. Toward a regional digital economy?

Almost all governments in the Southeast Asia region have developed national strategies or high-level plans, endorsed at head of government or similar level, for growing the digital economy—but implementation remains a challenge. A robust assessment of where the market is adjusting well to digital transformation would help determine where government intervention would be most useful and where it is not required. Such a more targeted approach to intervention would be less challenging to implement and would help establish a logical sequence for the implementation of various initiatives. Furthermore, more effective consultation and feedback mechanisms are required for policymakers to gain the perspectives of private sector firms at every stage of national digital economy strategies—from conception to implementation and monitoring. Government strategies on the digital economy will need to include implementation plans with concrete targets, timelines, and institutional coordination to ensure delivery and accountability.

Given a range of potentially important cross-country dimensions of the digital economy, regional cooperation, for example through ASEAN, could be leveraged to strengthen the enabling environment for digital economy

¹⁷ Foundational ID system: This is an ID system used for general purposes (e.g. national IDs and birth certificates) as the root of someone's identity. By comparison, a functional ID system is intended for a specific purpose (e.g. a passport is for travel, a driving license is for permission to drive). Public Key Infrastructure (PKI): This is widely-known in digital ID and ICT circles. Essentially, it is a technology for authenticating people or things by using cryptography to match a private key (digital certificate held by a user) and a public key (held by an authority). Unique ID number: A unique ID number (e.g. a national ID number) is one type of credential issued by a foundational ID system. Other examples of credentials include a card or a username. Source: World Bank-ID for Development (ID4D) <https://id4d.worldbank.org/>

growth in individual Southeast Asian countries, as well as to facilitate deeper integration between national economies. Digital platforms, for example, for e-commerce, transport, and financial services are increasingly trans-national. Greater regional cooperation could help address many of the issues identified in this article, including data privacy (to improve coherence of legal frameworks), cybersecurity (to prevent and respond to threats), and consumer protection (to improve cross-border appeal and redress mechanisms), among others. Identifying concrete measures that can be taken in these areas is an important area for future analysis and policy cooperation in Southeast Asia.

ASEAN could encourage its members to develop the necessary infrastructure for ICT development, reduce barriers to participation in digital markets, and harmonize regulations. Supporting development of the digital economy will also strengthen ASEAN's overall objective of promoting regional economic integration. ASEAN has adopted initiatives to support growth of the digital economy, including the first and second ASEAN ICT Masterplans (AIM2015 and AIM2020) and the Master Plan on ASEAN Connectivity 2025, while high-level ASEAN agreements, notably the 2015 and 2025 Economic Blueprints, demonstrate a broadening of the vision for the digital economy in the region.

However, there is scope to go further in cooperation on the digital economy at the ASEAN level, especially in terms of detailed actions, timelines, and targets. There are no monitoring or ranking mechanisms to evaluate progress at the national or regional level in developing critical enablers, such as the impact of privacy laws, data protection, or incentives to support universal broadband access, mobile financial services, e-commerce, and other key areas of the digital economy. Though the current approach recognizes the importance of regulatory harmonization, it offers no concrete principles for how regulations need to be extended and harmonized to create a single digital market, including by taking interim steps such as developing a common standard that applies to digital services, like the EU's privacy directive or the streamlined sales tax system in the United States for cross-state e-commerce transactions. Clearer links could be drawn between digital economy efforts and longstanding ASEAN priorities in areas such as trade facilitation. The ASEAN E-commerce Consultative Committee offers a forum to pursue this. ASEAN is currently developing a Digital Data Governance Framework for consideration by member states.

APEC has made more rapid progress than ASEAN in developing specific, in-depth guidelines, principles, and capacity-building programs to facilitate the adoption of digital economy principles (namely in key areas such as data privacy, cybersecurity, electronic trade, digital infrastructure, and MSME development). ASEAN could learn from this experience in developing a common, unified approach to issues like data privacy.

Conclusion

The digital economy is widely seen as presenting significant opportunities to propel future growth in Southeast Asia. The region already has rapidly rising internet usage, although business, and indeed governments' use of digital technology remains below its potential.

A concerted effort by the region's governments, both individually and collectively, to strengthen the foundations for the digital economy could address five key foundations: connectivity, digital payments, digital skills, logistics, and cross-cutting digital policies and regulations. Some regulatory gaps need to be filled (such as on consumer protection or data privacy), and some regulations could be adjusted to more effectively achieve policy goals

(such as on cross-border data localization). In some areas, the government should step back and allow the private sector to innovate and invest in digitalization. The development and implementation of national and regional digital economy plans could be improved by shifting from high-level planning to strengthened implementation and coordination across governments, by fostering greater private sector participation in planning, implementation and monitoring of plans, and pursuing concrete initiatives to address policy and regulatory blockages. Beyond setting the overall policy and regulatory framework for the digital economy, governments have a direct role to play, including through support to digital entrepreneurship and digital government initiatives.

Governments, businesses and citizens alike are increasingly concerned with various risks associated with digitalization. Some—such as inadequate protection of personal data, cybersecurity threats—are directly linked to the technologies associated with the digital economy. Others relate to the new types of business models developing in the digital economy, for example, the challenges to the protection of consumer rights when buyers and sellers are physically separated and, increasingly, in different countries. Similarly, the slow pace of consumer adoption of digital payments is in part due to perceived risks and lack of trust of new payments systems. While thinking has begun on potential responses to these challenges, further analysis at the country level is required on these risks and the appropriate responses.

Other risks are longer term, with the nature of the risk and the appropriate responses less well-defined. For example, automation is widely perceived as presenting risks to workers, although concrete evidence on this in Southeast Asia is still limited. Further analysis is requested to understand how skills demand and jobs change as the digital economy grows, and what the implications are for national education systems, training and skills upgrading initiatives, and countries' social protection schemes.¹⁸ Growing concerns about the risks presented by using the internet to spread misinformation could lead to responses that restrict the potential of the internet as a means of open exchange of ideas and information. The discussion on data flows and cybersecurity highlighted that heavy restrictions on the use of the internet, for example, through data localization requirements, is not necessary to protect citizens' interests and would impair growth of the digital economy.

Finally, digitalization offers various ways to boost inclusiveness. The rapidly decreasing cost of broadband (especially mobile broadband) is helping more people access information and connect to economic opportunities. For example, e-commerce platforms are bringing new entrepreneurs into international trade. At the same time, there are still significant disparities in the cost and quality of internet access—most visible between central and more remote regions of large, geographically-dispersed countries such as Indonesia, but also between urban and rural areas of countries such as Thailand, Vietnam, and Malaysia. Similarly, the wide discrepancies in quality and affordability of internet access between countries also need to be addressed to boost the inclusiveness of the digital economy in the region. While the digital economy can help create new opportunities to overcome barriers in the offline economy, those that lack adequate connectivity or the skills to participate risk being left behind.

¹⁸ Another area for future analysis is the issue of digital economy taxation. Governments in Southeast Asia are becoming concerned that e-commerce could be eroding the tax base and creating disadvantages for locally based firms. As policy responses in the region are evolving this article does not address this topic in detail.

Table II.A.4. Policy priorities summary for developing Southeast Asian countries

| | <i>Cambodia, Lao PDR, Myanmar</i> | <i>Indonesia, Malaysia, Thailand, Vietnam, Philippines</i> | <i>Regional cooperation</i> |
|----------------------------------|---|--|---|
| Connectivity | Addressing barriers and strengthening enabling conditions for accelerated private investment in broadband | Allowing greater competition along the broadband value chain | Cross-border connectivity including regulatory harmonization |
| | | Management of radio spectrum (frequencies for mobile communications) | |
| | | Passive infrastructure sharing and rights-of-way | |
| Payments | Facilitate innovation in digital payments | Promote use (for example, payment for government services) and address regulatory gaps | Promoting interoperability |
| Skills | Continue upgrading basic education, including a focus on building digital skills at the primary level | Integrate digital skills development across the curriculum including technical as well as “soft” skills. Implement approaches for lifelong learning through education system | Enabling greater regional mobility of skilled workers, including through mutual recognition of qualifications |
| | Targeted digital skills training, especially for small and medium enterprises (SMEs) | Deepen industry-business collaboration to identify future skills needs and meet short-term gaps | |
| Logistics | Issue clear regulations for small parcel trade | Risk-based approach to facilitating small parcel trade | Harmonized regional <i>de minimis</i> thresholds and simplified procedures |
| | Address regulatory barriers to entry in logistics | Enable innovation in digitized logistics services | |
| Data policies | Ensure legal regime exists for data privacy and data protection | Build regulatory capacity and raise consumer and business awareness | Pathway to regulatory coherence |
| | Caution on introducing data localization | Roll back blanket data localization policies and introduce data classification-based approaches | Open regional regime on data |
| Cybersecurity | Ensure laws cover cybercrime and build enforcement capacity | Boost public and private spending on cybersecurity and address skills gaps | Regional regulatory and enforcement collaboration, including overarching governance framework |
| Consumer protection | Legal regime for consumer protection | Strengthen regulatory capacity for consumer protection, awareness and outreach | Regional complaint and enforcement mechanisms |
| Supporting digital entrepreneurs | Providing targeted support for skill upgrading, technology adoption as overall digital foundations are strengthened | Ensuring coordination of SME support programs while still focusing on structural reforms | Supporting internationalization of SMEs through regional integration |
| Digital ID | Consolidate implementation of digital ID | Digital ID as a basis for transactions | Regional compatibility of digital IDs |
| Plans and strategies | Develop actionable digital economy strategies with the participation of government and private sector stakeholders | Identify concrete actions and institutional responsibilities to implement and monitor digital economy strategies or masterplans | Regional vision for open, integrated digital economy |

Source: Authors.

II.B. Technological Progress, Skills and Inclusive Growth in Developing East Asia¹⁹

Technological progress is essential for sustained growth, but appropriate policies are essential to ensure that future growth in developing East Asian countries is inclusive. New technologies hold considerable promise for increasing firms' productivity and individuals' economic opportunities, but they will also change what is required for people to be successful in the new economy. The digital revolution and advanced robotics are leading to dramatic shifts in the demand for skills, increasing the need for workers to interact with new technology and raising demand for more advanced skills. This places a high premium on policies to strengthen people's skills, foster digital literacy, and support lifelong learning and skills upgrading. Enacting policies focused specifically on inclusion will also be important, including developing stronger, more nimble systems of support for workers who find it difficult to adapt to changing technologies and ensuring that all people have affordable access to digital technologies.

Changing technology is creating both challenges and opportunities for inclusive growth

Technological progress is critical to sustained growth, but rapid changes in technology have raised concerns about whether future growth will be inclusive. The prospects for rapid industrial automation—whether through the adoption of industrial robots, 3D printing or the Internet of Things (i.e., Industry 4.0)—have raised concerns that low-skilled workers may find themselves replaced by machines as countries in the region continue to develop. The fact that China has been rapidly expanding its stock of industrial robots (World Bank 2018d) has contributed to such concerns, both because of the potential implications of automation on jobs in China itself, and because of what industrial automation in China might mean for the offshoring of manufacturing elsewhere in the region. China has indicated its intention to increase the domestic content of its exports (19th National Party Congress; Xi 2017). While the extent and pace of this shift is uncertain, if “reshoring” by China serves to shorten regional and global value chains, it could put a drag on the creation of new manufacturing jobs elsewhere in the region.

Rising concerns about the impact of automation on jobs have spawned a number of studies attempting to quantify the potential effects of automation on jobs, including in developing East Asia. Adopting different methodologies and defining the risk of automation in different ways, these studies have produced an extraordinarily wide range of estimates of the employment risks associated with automation. For China alone, estimates of the extent to which jobs may be automated over the next 10 to 15 years range from as low as 7 percent to as high as 77 percent (Table II.B.1).

The considerable differences in estimates reflect several factors. Some estimates focus purely on the technological feasibility of automation, while others account for a broader set of economic, regulatory and implementation-related factors that affect the extent and pace at which industrial automation takes place. There is general agreement that automation will happen more quickly in wealthy, high-capacity countries than in poorer, low-capacity environments. The estimation approach also matters. Estimates that focus on tasks within occupations and incorporate factors affecting the pace of technology adoption are considerably lower than those that focus on pure technical feasibility or on occupations

¹⁹ This article is adapted from World Bank (2018d) and Mason et al. (2018).

as a whole. Nonetheless, there is still considerable uncertainty about how—and how quickly—industrial automation may displace workers in developing East Asia.

Table II.B.1. There is a wide range of estimates of the probability of jobs being automated in developing East Asian countries

| Percent | <i>Hallward-Driemeier and Nayyar (2017)^a</i> | <i>McKinsey Global Institute (2017b)^b</i> | <i>McKinsey Global Institute (2017a)^c</i> | <i>World Bank (2016)^d</i> |
|-------------|---|--|--|--------------------------------------|
| Cambodia | -- | -- | -- | 41 – 78 |
| China | 7 ^e | 16 | 51 | 55 – 77 |
| Indonesia | -- | 12 | 52 | -- |
| Lao PDR | < 1 | -- | -- | -- |
| Malaysia | -- | 23 | 51 | 49 – 68 |
| Mongolia | -- | -- | -- | 43 – 60 |
| Philippines | -- | 10 | 48 | -- |
| Thailand | -- | 18 | 55 | 52 – 72 |
| Vietnam | 1 | -- | -- | -- |

Sources: Hallward-Driemeier and Nayyar 2017; Manyika, Chui, et al. 2017; Manyika, Lund, et al. 2017; World Bank 2016.

Note: — = not available. Studies shown adopt varying methodologies and definitions in estimating job automation. Although the time frame for automation impacts are not modeled explicitly in all the studies, the discussions generally focus on a 10- to 20-year time horizon.

a. Share of current jobs at high risk of automation, based on the “automatability” of their constituent tasks, where “high risk” is defined as a greater than 70 percent probability of a job being automated based on task automatability.

b. Percentage of current work activities displaced by automation, 2016–30, based on midpoint adoption scenario.

c. Percentage of time spent on activities with technical potential for automation by adapting currently demonstrated technology.

d. Upper-bound estimates reflect unadjusted probabilities of automation for occupation, based on Frey and Osborne (2013); lower-bound estimates are adjusted to account for the slower pace of technology adoption in lower-income countries.

e. Yunnan Province, China.

Job displacement is only one of several possible labor market effects of automation. While some jobs may disappear, many jobs will evolve in ways that allow workers to adapt and undertake tasks that are complementary to technology. And, new jobs will be created. Just how these different forces will net out is uncertain, however, and evidence on the effects of technology on aggregate employment is mixed. A recent study of robotization in the United States finds significant and sizable negative effects of robot use on employment (Acemoglu and Restrepo 2017). Other studies of technology adoption and robotization in the United States and Europe find no significant effects on overall employment, although there is evidence of declines in employment among low- or middle-skilled workers (Autor et al. 2015; Graetz and Michaels 2018). In contrast, evidence from middle-income Latin America indicates that net employment effects can be positive, even for low-skilled workers, when technology raises firm productivity and higher firm productivity leads to expanded firm output (Dutz et al. 2018). Limited evidence from developing East Asia suggests that technology is “labor saving”, although the magnitude of the employment effects does not appear to be large (Darko and Viollaz 2018; Poole and Santos-Paulino 2017).

New technologies—whether digital technologies (Industry 3.0) or advanced robotics (Industry 4.0)—are, with some exceptions, increasing the demand for workers with more advanced skills that are not easily automated. Such effects of technology adoption are already being observed in developing East Asia. In Vietnam, for example, increases in computers in 2002–12 were associated with a rising demand for nonroutine manual skills (Poole and Santos-Paulino 2017). Increases in computers in Indonesia during the 2005–10 commodity boom were also associated with higher demand for nonroutine skills, although in this case demand increased for nonroutine analytical and interpersonal skills (Darko and Viollaz 2019). Technology adoption is not always associated with increased demand for higher-order skills; for instance, similar effects were not observed in Indonesia in 2011–15. This is because the effect of technology on demand for workers’ skills reflects a number of factors, including countries’ economic structures, countries’ policies, and the specific types of technologies being adopted. Nonetheless, the relationship between technological progress and the demand for more-advanced skills is observed in a growing body of global evidence (Box II.B.1).

Box II.B.1. Global evidence on technology and jobs: Raising the bar on workers' skills

Until recently, much of the evidence on the effects of technology adoption on labor market outcomes had focused on the United States and other high-income countries. While this literature recognizes the productivity gains associated with technology adoption—investment in ICT is credited with the increase in labor productivity in the United States in the 1990s¹—a central concern has been on how new technologies, whether ICT or robot-related automation, affect employment, especially among low- and middle-skilled workers.

The increased use of industrial robots in 17 high-income countries between 1993 and 2007 contributed about 0.37 of a percentage point to annual labor productivity growth during the period, accounting for just over one-tenth of aggregate economy-wide growth (Graetz and Michaels 2018).² Increased robot utilization was also associated with increases in total factor productivity and wages, as well as with reductions in output prices. While the authors find no significant impact of robot adoption on overall employment levels, their estimates suggest that robotization in these countries was “skills-biased”, reducing the employment share of *low-skilled* workers.

Studies focusing specifically on the United States reinforce concerns about skills-bias, but also potentially about the overall employment effects of automation. For example, Autor, Dorn and Hanson (2015) find that computerization in the United States from 1980 to 2007 had a negative effect on employment among middle-skilled workers involved in routine-task intensive occupations (e.g., production jobs, clerical and administrative support, and sales occupations). The study finds no adverse effect of technology adoption on aggregate employment, because declines in routine employment were largely offset by increases in more abstract-intensive occupations—especially among younger, college-educated workers—and in more manual-task intensive occupations—particularly among older, less educated workers. This “hollowing out” of middle-skilled jobs has come to be known in the literature as “job polarization”.

Acemoglu and Restrepo (2017) find significant and sizable negative effects of greater robot use on both employment and wages in the United States between 1990 and 2007. One additional robot per thousand workers is found to reduce employment as a share of the local population by about 0.18 to 0.34 of a percentage point (the equivalent of 3.0 to 5.6 jobs per robot), and to reduce wages by around 0.25 to 0.50 percent. Employment effects are found to be most pronounced in manufacturing; in routine manual, blue collar, assembly and related occupations; among men; and among workers with less than college education. In contrast to Autor, Dorn and Hanson, Acemoglu and Restrepo find no offsetting employment gains among other occupational categories. The authors also find that the impact of robotization is distinct from that of other types of IT capital, suggesting that the precise labor market effects depend on the type of technology being adopted.

Research on developing and emerging economies has not provided strong evidence of job polarization to date (Maloney and Molina 2016; Das and Hilgenstock 2018). Nonetheless, a growing number of country studies

(continued)

1 See, for example, Draca et al. (2007) for a survey of empirical findings.

2 The sample of countries included 14 European countries, the United States, Australia and the Republic of Korea. The data on robots come from the International Federation of Robotics.

(Box II.B.1 continued)

find evidence that technology adoption raises relative demand for skilled workers. A new study of technology and jobs in Latin America (Dutz et al. 2018) brings together new evidence on information and communication technology (ICT) adoption in Argentina, Brazil, Chile, Colombia and Mexico. This evidence generally reinforces the idea that technology adoption favors workers with higher skills. In contrast to the studies from the advanced economies, however, the evidence from Latin America paints a more salutary picture of the impacts of technology adoption on low-skilled employment. Investments in ICT raised firm productivity and enabled firms to expand their output, and this in turn led to net employment growth for low-skilled, as well as high-skilled, workers.

Not all studies find that technology adoption favors higher-skilled workers, however. In Chile, adoption of complex software induced shifts in firm employment away from skilled workers toward administrative and unskilled production workers (Almeida et al. 2017). In contrast to more general investments in ICT, for example, computers, internet connectivity, company websites, and complex software served to substitute for workers carrying out higher-order tasks and, as such, increased demand for lower-skilled workers performing more routine and manual tasks. An important insight from this work, consistent with the Acemoglu and Restrepo finding on non-robotic IT capital, is that the precise effect of technology adoption on jobs and skills is, in part, a function of the nature of the technology being adopted.

Source: Mason et al. (2018).

While technology adoption tends to raise demand for workers with more-advanced skills, technological progress also holds significant potential to enable inclusive growth (World Bank 2016, 2019). Cross-country evidence highlights multiple channels through which digital technologies, if accessible and affordable, can contribute to growth that is broadly shared. Digital technologies can help reduce the cost of accessing markets, particularly for smaller firms and entrepreneurs living in more remote areas of a country. They can also lower the cost of getting information about job opportunities, especially outside one's immediate locality (Packard and Montenegro 2017).

Digital technologies can improve market access because online trading platforms reduce transaction costs, helping to level the playing field between smaller and larger firms, and across geographic distances. Transactions over the internet benefit smaller firms, which also tend to hire relatively low-skilled workers, by enabling these firms to reach new consumers and reap productivity gains. By lowering the costs of obtaining information about job openings beyond that typically available through one's personal networks or countries' public employment services, digital technologies can help increase labor mobility and improve matches between workers' skills and employers' needs. Instances in which new technologies are supporting inclusive growth are already seen across the region, not just with respect to people's livelihoods but also in better access to goods and services (Box II.B.2).

Box II.B.2. Digital technology: The potential for promoting inclusive growth in developing East Asia

Digital technologies—if broadly available and affordable—hold significant potential to enable inclusive growth in developing East Asia. New technologies are reducing the costs of access to markets and information. They are improving access to goods in remote, difficult-to-reach areas. And they are helping governments identify poor and vulnerable populations, and deliver services where needed. Rigorous impact evaluations of the impacts of technology on inclusive growth are still scarce. Nonetheless, promising initiatives can already be seen across the region, as the examples below illustrate.

Strengthening herders' and farmers' livelihoods. Mobile phones are enabling rural farmers and herders in Mongolia, whose livelihoods are crucially dependent on weather patterns, to access “timely and accurate localized weather forecasts as a means to reduce risk and improve planning of key livelihood activities” (Hijaba, Vernooy and Jamba 2013). In the pilot phase of this project, communities reported improvements in pasture management and in social, health, and ecological indicators.

Smartphones offer opportunities that go well beyond weather information, including access to agricultural extension services. For example, the International Rice Research Institute (IRRI) of the Consultative Group on International Agricultural Research (CGIAR), under its Climate-Smart Agriculture Advisory Services, has developed Rice Crop Manager (RCM), a web-based smartphone application currently deployed in many parts of the Philippines and Vietnam.¹ The RCM enables agricultural extension staff to ensure sustainable productivity gains for poor rice farmers through cost-effective crop management.

Private companies are also experimenting in this area. Unilever, in collaboration with Vodafone, has piloted a project with coconut sugar farmers in Indonesia “to enhance their livelihoods by helping implement best practices, increase access to markets and reduce transactional costs”, while reaping the benefits of enhanced traceability of raw materials and greater security of future supply.²

Enabling small entrepreneurs. Digital solutions are also helping small entrepreneurs improve their livelihoods and provide better services. Uber-like smartphone applications are proliferating in the region. PassApp, for example, is helping taxi drivers in Phnom Penh, Cambodia, earn higher incomes and provide more reliable services to their riders (World Bank 2018d). Other digital solutions are helping people address specific constraints (cultural or otherwise). For instance, the Sister Ojek app in Jakarta, Indonesia, is helping to connect female motorbike drivers with women and children riders, thereby helping to address a gender bias on traditional ridesharing apps reported by some female drivers (Karbailail 2018).

Facilitating “last-mile” goods delivery. Technology is also increasing access to goods for people living in remote areas. In China, where the share of e-commerce in total retail sales is the second highest in the world, significant disparities remain in access to e-commerce. So, the government has partnered with Alibaba to address the “last-mile” challenges of providing access to the Taobao e-commerce platform—increasingly used in richer coastal regions—to poorer inland areas (World Bank 2018g). In addition, the internet shopping site JD.com is

(continued)

(Box II.B.2 continued)

experimenting with deliveries by drone to facilitate goods delivery to more isolated, difficult-to-reach locations, where delivery costs would otherwise be prohibitive (Bloomberg News 2018).

Supporting more effective service delivery. Digital technology is also enabling governments in the region to strengthen their “social information systems”—tools to collect information on beneficiaries, determine program eligibility, manage payments, and implement case management, and grievance and redress systems. These digitized social registries are helping to strengthen countries’ abilities to identify those in need and to more reliably deliver support services.

Specifically, these social registries are helping to systematize information on program applicants, supporting the processes of intake, registration, and determination of beneficiary eligibility, based on applicants’ socioeconomic data. They are generally designed as multi-use platforms to connect people to a range of public services, including social protection, health, pro bono legal services, and banking services. Digitized social registries are already operational in China (Dibao Registry), Indonesia (UDB), and the Philippines (Listahanan).

Sources: Bloomberg News (2018); Hijaba et al. (2013); Karbalaii (2018); World Bank (2018e); World Bank (2018f).

1. “Climate-Smart Agriculture Advisory Service.” Adaptation Projects, IIRRI website: <http://climatechange.irri.org/projects/adaptation/climate-smart-agriculture-advisory-service>.

2. “Improving Livelihoods for Smallholder Farmers through Mobile Technology,” Unilever.com website: <https://www.unilever.com/sustainable-living/enhancing-livelihoods/inclusive-business/connecting-with-smallholder-farmers-to-enhance-livelihoods/mapping-our-farmers-programmes/improving-livelihoods-through-mobile-technology.html>.

Technological progress is changing the nature of work

Technological progress, combined with changes in countries’ economic structures, is changing what it will take for people to be productive and to succeed in developing East Asia’s labor markets. Demand for more advanced skills—higher-order cognitive skills, socioemotional skills and higher-order technical skills—is rising (Box II.B.3). While the specific nature and pace of these changes differ across countries, labor markets tend to move away from occupations intensive in manual tasks toward those with more cognitive tasks as they develop, including nonroutine analytical and interpersonal skills (Figure II.B.1; see also Macdonald 2018; Hardy et al. 2018). Moreover, demand for more advanced skills has generally been increasing over time. In 2000–12, for example, the share of employment in occupations that were intensive in nonroutine cognitive and socioemotional skills increased from 19 to 23 percent in low- and middle-income countries, while the share of occupations intensive in nonroutine cognitive and socioemotional skills in high-income countries grew from 34 to 41 percent (World Bank 2016). As countries in developing East Asia seek to move from middle- to high-income, this process will only continue. As technology continues to change, rising demand for advanced skills will likely only accelerate.

The changing task and skill content of jobs can be seen in data from Indonesia, Malaysia, Mongolia, the Philippines, Thailand, and Vietnam. Figure II.B.2 shows how the task and skill intensity of occupations has evolved from the early 2000s to the present. Patterns are largely consistent across countries. Tasks intensive in cognitive skills have tended to increase over time, whereas tasks intensive in manual skills have tended to decline.²⁰ These patterns reflect the combination of factors that have accompanied development: movement of labor out of agriculture and into manufacturing and services, shifts to higher value-added manufacturing and services, and adoption of new technologies.

²⁰ Similar patterns are also seen for Cambodia for the 2011–15 period. Those two countries are not presented in the figures, however, given the short time period over which the analysis was possible.

In Indonesia and Thailand, jobs intensive in cognitive tasks—and, in particular, nonroutine analytical and interpersonal tasks—are only observed to increase after 2006 and 2010, respectively. In Vietnam, jobs intensive in routine manual tasks did not decline over the period, likely reflecting the large share of the country’s labor force still in agriculture and its continued specialization in low-skilled, labor-intensive manufacturing.²¹

Box II.B.3. Skills for the new economy

With economic growth and development comes demand for a labor force with more advanced skills.

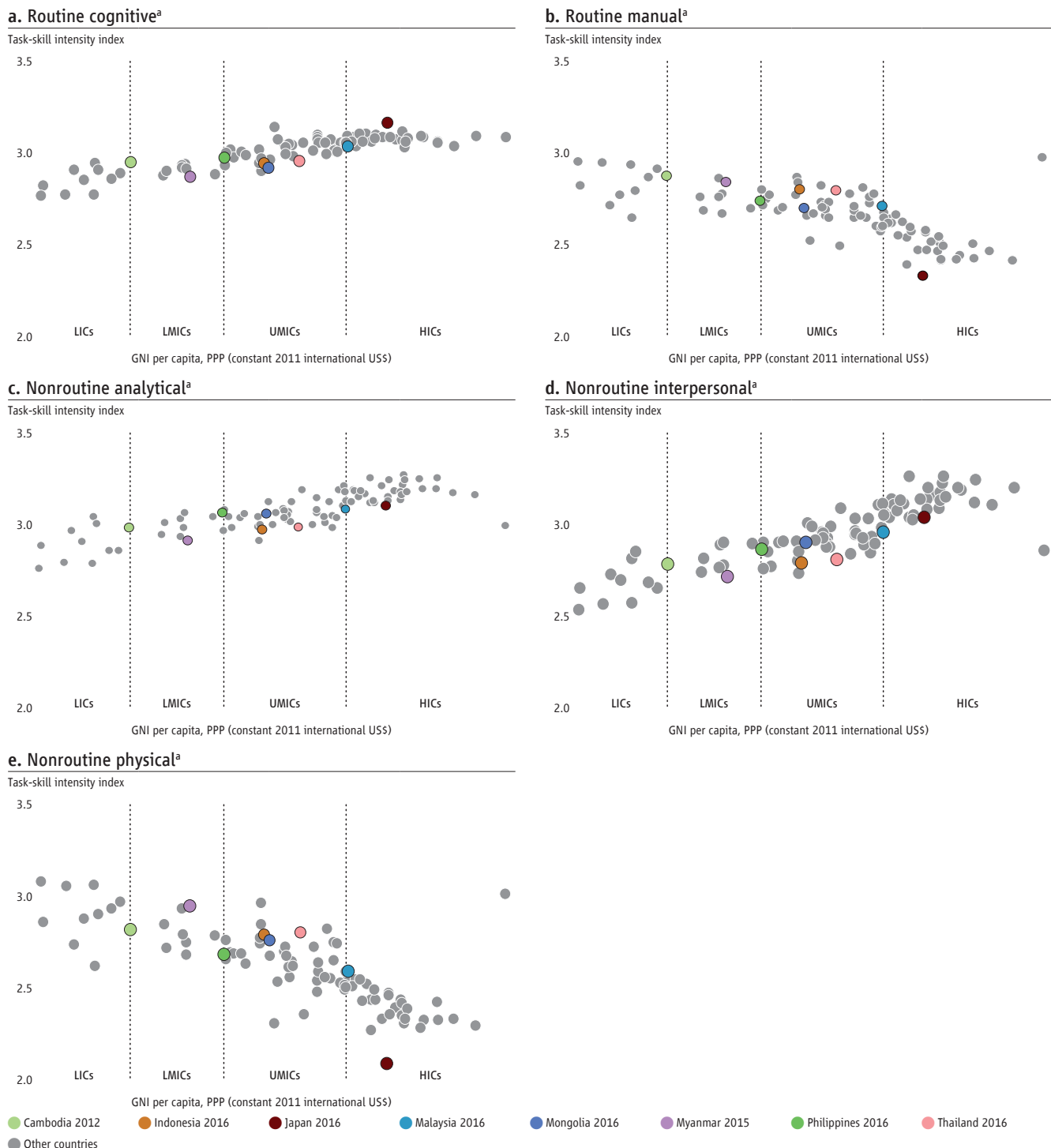
Not only does employment shift toward occupations that require higher skills levels, but even within jobs tasks become more skills intensive. While basic cognitive skills, such as basic literacy and math, may be sufficient at lower levels of income, several types of skills become increasingly important as countries move from middle- to high-income: higher-order cognitive skills, socioemotional skills, and higher-order technical skills. These skillsets can be defined as follows:

- **Cognitive skills** include the use of logical, intuitive, and creative thinking, as well as problem-solving using acquired knowledge. *Basic—or foundational—cognitive skills* include literacy and numerical ability, whereas *nonroutine, higher-order cognitive skills* refer to the ability to understand complex ideas, learn from experience, adapt effectively in the workplace, analyze problems using logical processes, and overcome obstacles using critical thought.
- **Socioemotional skills** embody the various personality traits that are crucial to one’s performance and effectiveness in the workplace. Sometimes referred to as *nonroutine interpersonal*, or “*soft*”, skills, these encompass a broad range of malleable skills, behaviors, attitudes and personality traits that enable people to navigate workplace and social situations. These include such attributes as motivation, perseverance, organization and effort, as well as one’s ability to communicate and to work effectively with others.
- **Technical skills** reflect learned knowledge in particular domains. They are often discipline-specific and are reflected in information and capabilities that are directly applicable to particular employment and occupational settings, such as a plumber’s ability to fix a water leak, a factory worker’s ability to operate or maintain a machine, or an office worker’s ability to use a computer. Increasingly, basic digital literacy may also be counted as a critical technical skill.

While the need for an increasingly skilled workforce has always accompanied development, rapid technological change is only serving to accelerate the rate at which workers will require higher-order skills to be successful in the labor market.

Sources: World Bank (2016); Mason et al. (2018).

21 Consistent with the global evidence, the developing East Asian countries with lower per capita income levels (e.g., Cambodia, Lao PDR, and Vietnam) demonstrate lower intensities of non-routine and analytical tasks measured in absolute terms (Mason et al. (2018); Macdonald 2018).

Figure II.B.1. The cognitive task-skills content of jobs increases with development

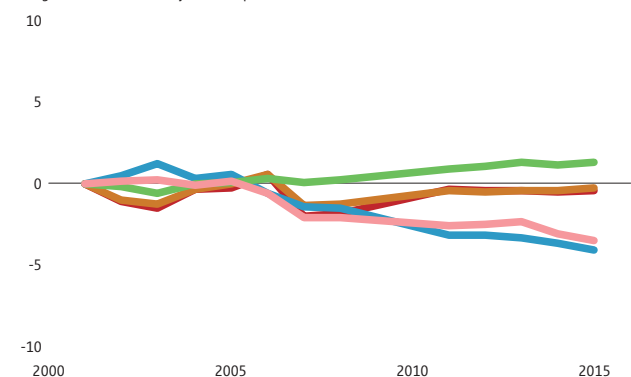
Source: Macdonald 2018.

Note: Analysis includes 92 countries using International Labour Organization (ILO) data for the most recent available year; Macdonald (2018) finds similar patterns in analyzing 44 countries using data from Integrated Public Use Microdata Series (IPUMS) International, Minnesota Population Center, University of Minnesota. Country income classifications reflect countries' status in the year the data were collected. GNI = gross national income; LICs = low-income countries; LMICs = lower-middle-income countries; UMICs = upper middle-income countries; HICs = high-income countries; PPP = purchasing power parity. "Other economies" refers to non-East Asian economies.

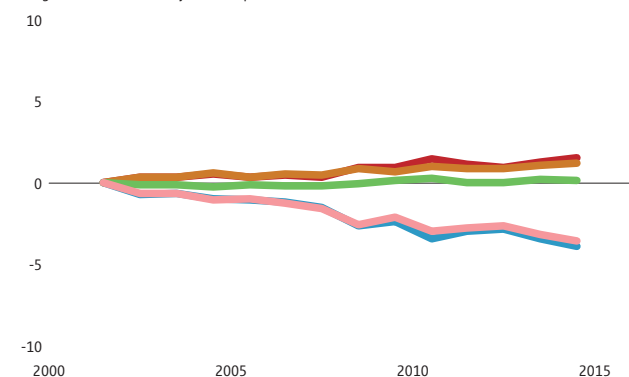
a. Tasks are categorized as "routine" or "nonroutine" based on how repetitive or structured they are, and as "manual-physical" or "cognitive" (including analytical and interpersonal) based on the type of work involved (see Autor, Levy, and Murnane 2003). More-routine tasks are more susceptible to automation. The task-skill intensity indexes are then created for the five task-skill categorizations using the Occupational Information Network (O*NET) dataset (<https://www.onetcenter.org/database.html>) and mapped to country-level occupational data. For technical details, see Macdonald (2018) and Mason et al. (2018).

Figure II.B.2. Jobs in developing East Asia are becoming more intensive in cognitive tasks and less intensive in manual tasks**a. Indonesia**

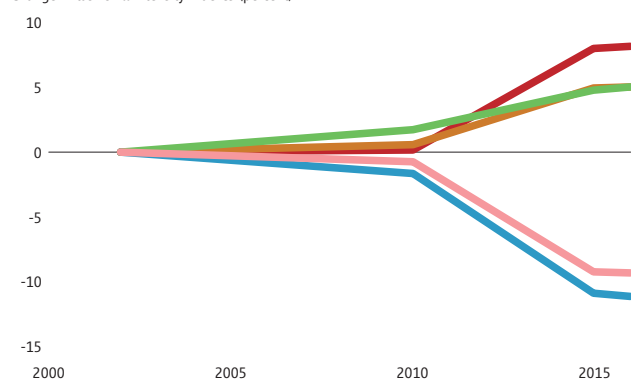
Change in task-skill intensity indexes (percent)

**b. Malaysia**

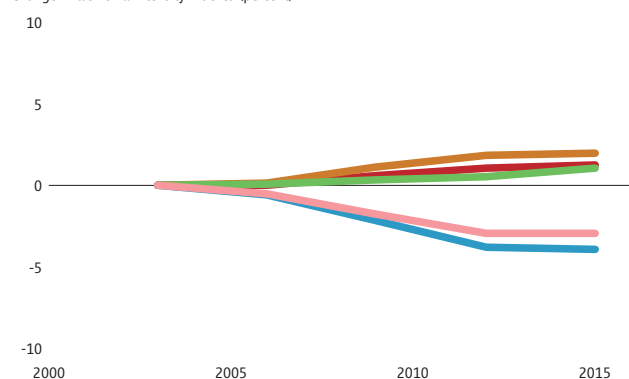
Change in task-skill intensity indexes (percent)

**c. Mongolia**

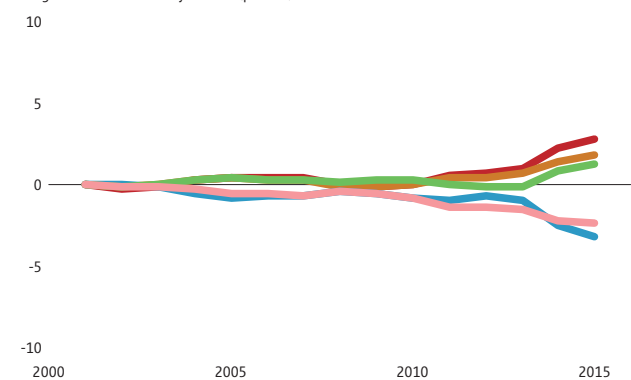
Change in task-skill intensity indexes (percent)

**d. Philippines**

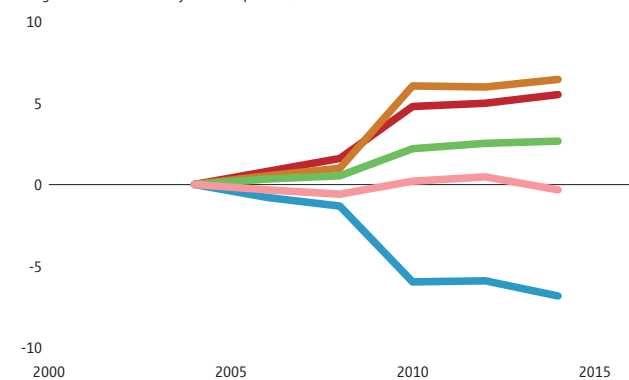
Change in task-skill intensity indexes (percent)

**e. Thailand**

Change in task-skill intensity indexes (percent)

**f. Vietnam**

Change in task-skill intensity indexes (percent)



— Nonroutine analytical — Nonroutine interpersonal — Nonroutine manual physical — Routine cognitive — Routine manual

Source: Mason et al. (2018).

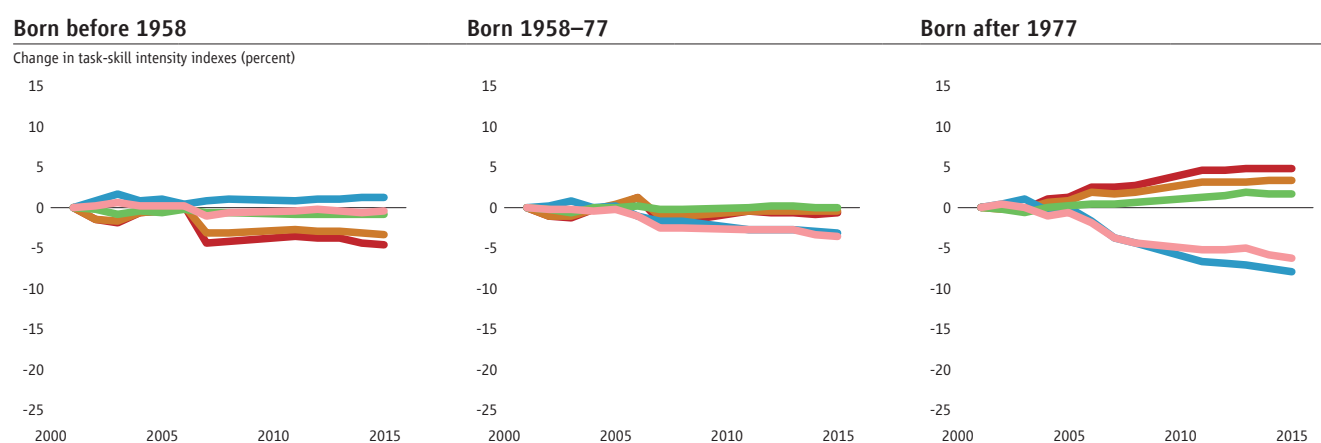
Note: Figure presents percentage changes in the task-skill intensity indexes for jobs between the early 2000s and 2015. The exact time horizon for each country reflects data availability in that country. Tasks are categorized as “routine” or “nonroutine” based on how repetitive or structured they are, and as “manual-physical” or “cognitive” (including interpersonal or analytical) based on the type of work involved. Task-skill intensity indexes are then constructed mapping Occupational Information Network (O*NET) dataset task classifications (<https://www.onetcenter.org/database.html>) to occupational data from surveys in each country. Indexes for each country are normalized to zero for the first year of the data to show changes in the task-skill composition of jobs over time. For additional methodological details, see Mason et al. (2018).

In all six countries, task-skill intensities have changed most rapidly among relatively younger cohorts of workers. This can be seen in Figure II.B.3, which shows the evolution of task-skill combinations for three different age cohorts: those born before 1958; those born between 1958 and 1977; and those born after 1977. Tasks intensive in cognitive skills—especially nonroutine analytical and interpersonal skills—have increased and tasks intensive in manual skills

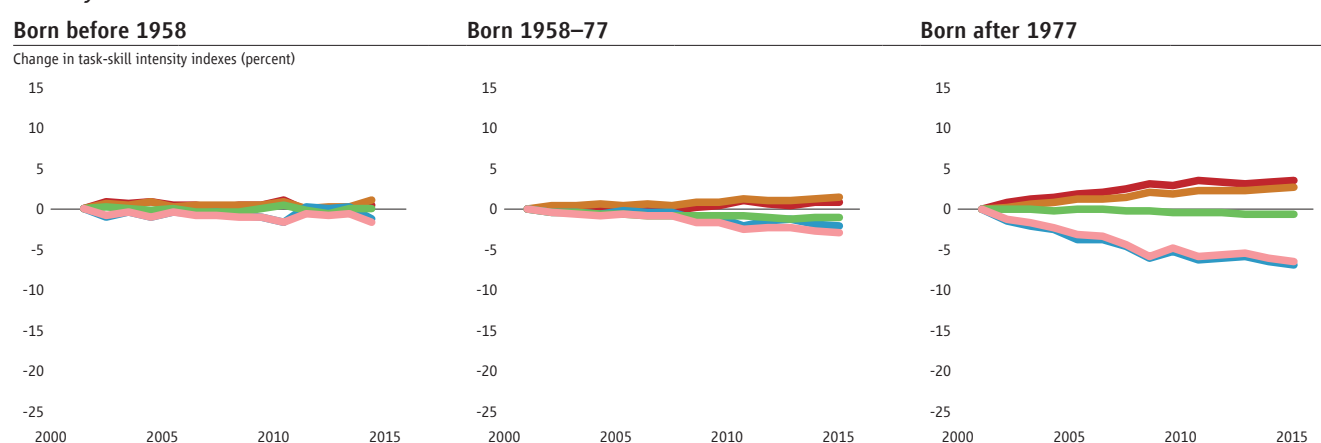
have declined most among the cohort of workers born after 1977. As in Figure II.B.2, these patterns reflect the economic structural changes in the region, along with rising educational attainment among subsequent cohorts of workers. While similar, albeit more modest, shifts in task-skill intensities are seen among older cohorts in Mongolia, the Philippines, and Vietnam during the period, very little change is observed among older cohorts in Indonesia, Malaysia, and Thailand.

Figure II.B.3. Jobs are becoming more intensive in cognitive tasks fastest among younger cohorts

a. Indonesia



b. Malaysia



c. Mongolia

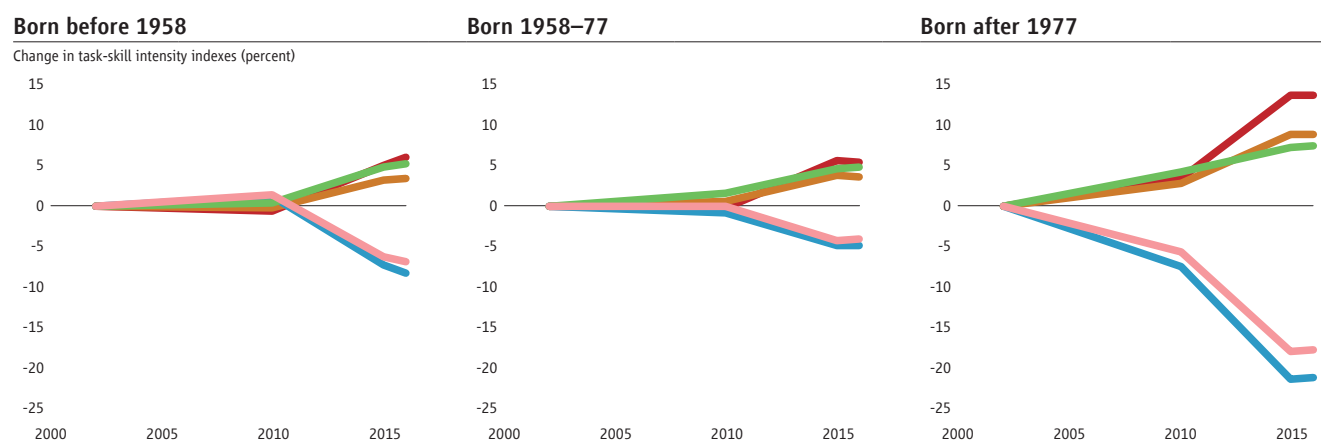
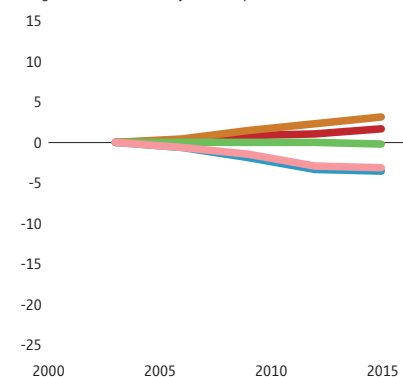
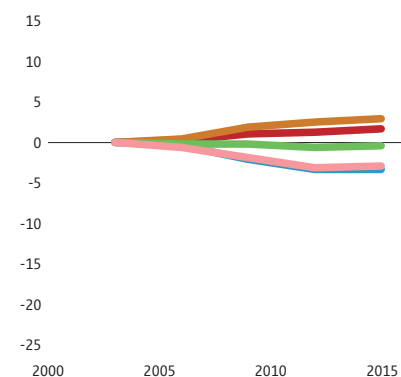
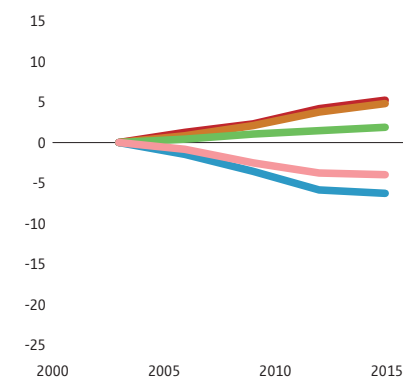
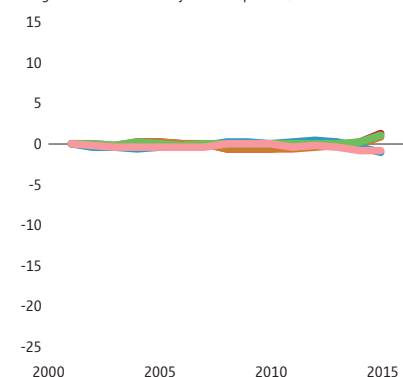
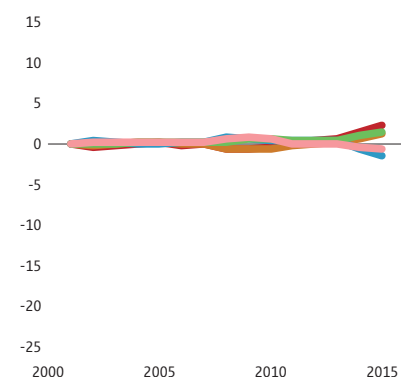
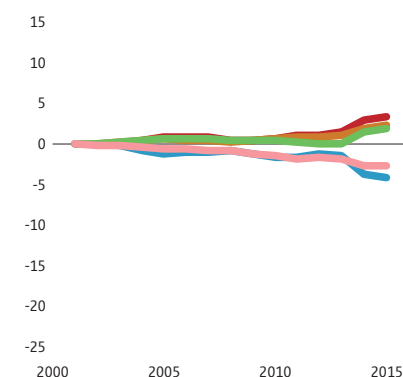


Figure II.B.3. Jobs are becoming more intensive in cognitive tasks fastest among younger cohorts (continued)**d. Philippines****Born before 1958**

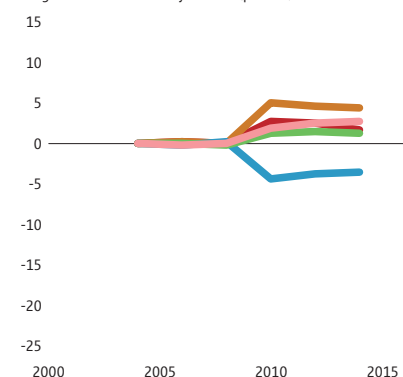
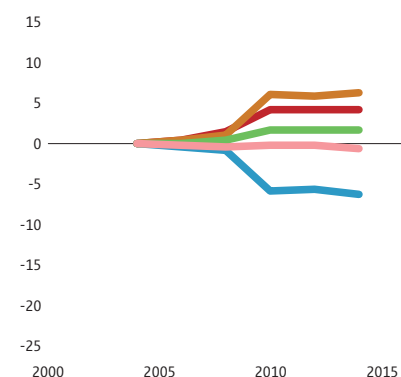
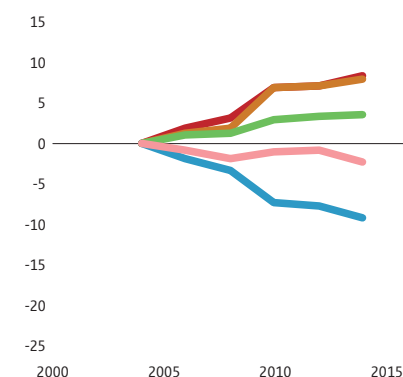
Change in task-skill intensity indexes (percent)

**Born 1958–77****Born after 1977****e. Thailand****Born before 1958**

Change in task-skill intensity indexes (percent)

**Born 1958–77****Born after 1977****f. Vietnam****Born before 1958**

Change in task-skill intensity indexes (percent)

**Born 1958–77****Born after 1977**

— Nonroutine analytical — Nonroutine interpersonal — Nonroutine manual physical — Routine cognitive — Routine manual

Source: Mason et al. (2018).

Note: Figure presents percentage changes in the task-skill intensity indexes for jobs between the early 2000s and 2015. The exact time horizon for each country reflects data availability in that country. Tasks are categorized as “routine” or “nonroutine” based on how repetitive or structured they are, and as “manual-physical” or “cognitive” (including interpersonal or analytical) based on the type of work involved. Task-skill intensity indexes are then constructed mapping Occupational Information Network (O*NET) dataset task classifications (<https://www.onetcenter.org/database.html>) to occupational data from surveys in each country. Indexes for each country are normalized to zero for the first year of the data to show changes in the task-skill composition of jobs over time. For additional methodological details, see Mason et al. (2018).

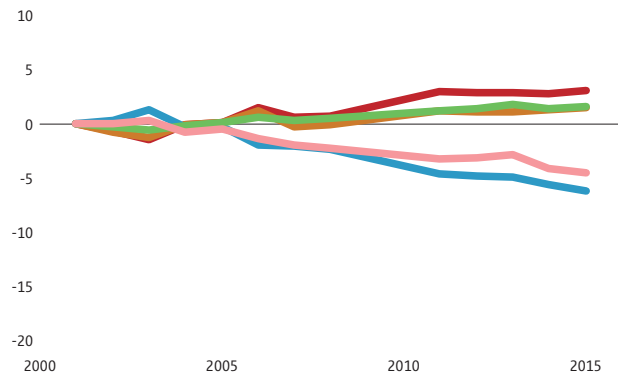
Task-skill intensities also appear to differ systematically by gender across the region. In general, women work in occupations with lower manual task content than men. Moreover, in most countries, task-skill intensities have evolved more rapidly away from manual toward cognitive tasks for women than for men (Figure II.B.4). In fact, in Indonesia and Malaysia, virtually *all* of the shift toward cognitive tasks over the period is observed among women.

Figure II.B.4. Jobs are becoming more intensive in cognitive tasks faster among women

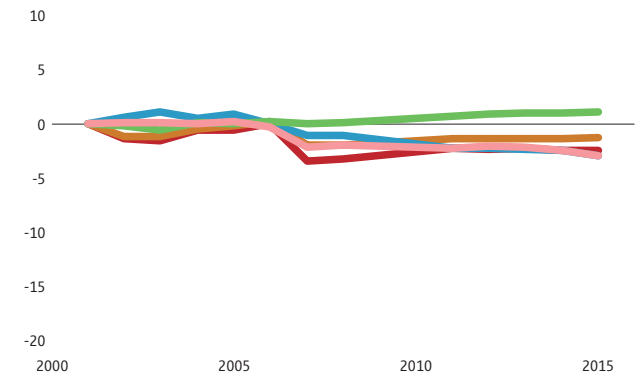
a. Indonesia

Female

Change in task-skill intensity indexes (percent)



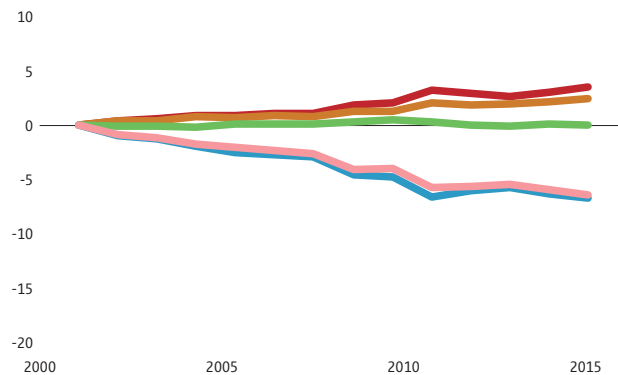
Male



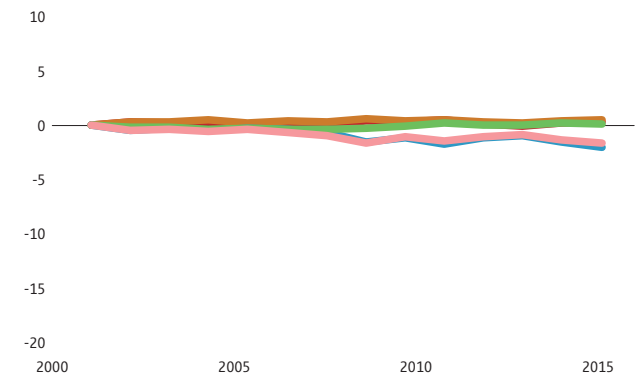
b. Malaysia

Female

Change in task-skill intensity indexes (percent)



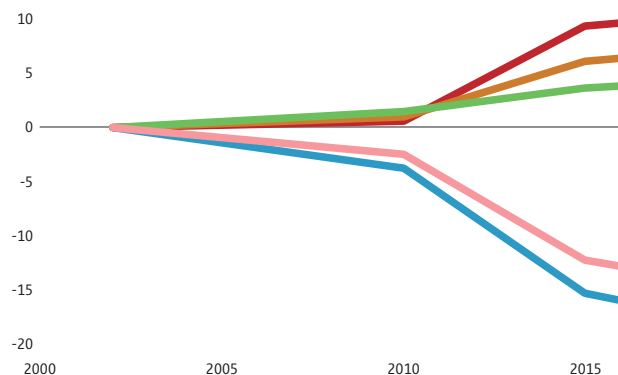
Male



c. Mongolia

Female

Change in task-skill intensity indexes (percent)



Male

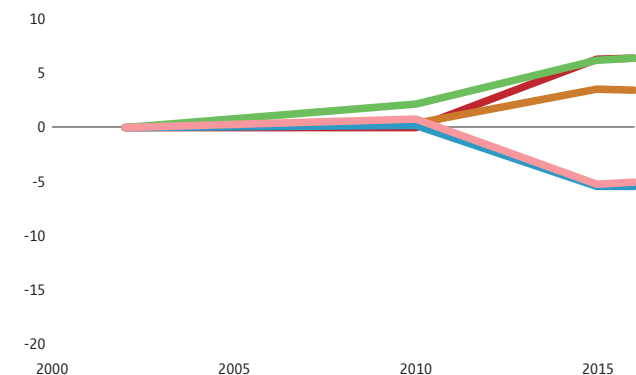
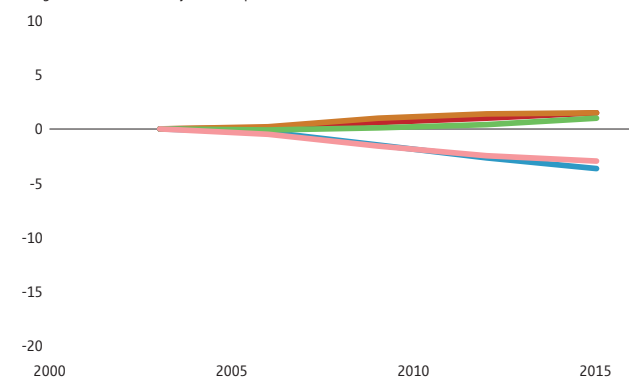
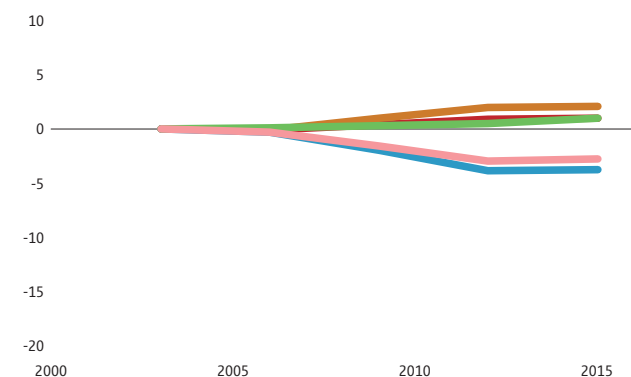
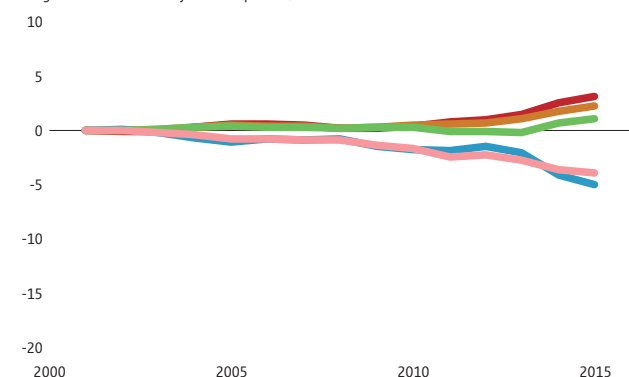
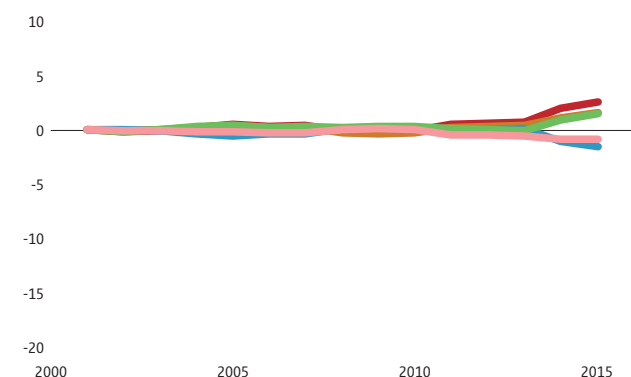


Figure II.B.4. Jobs are becoming more intensive in cognitive tasks faster among women (continued)**d. Philippines****Female**

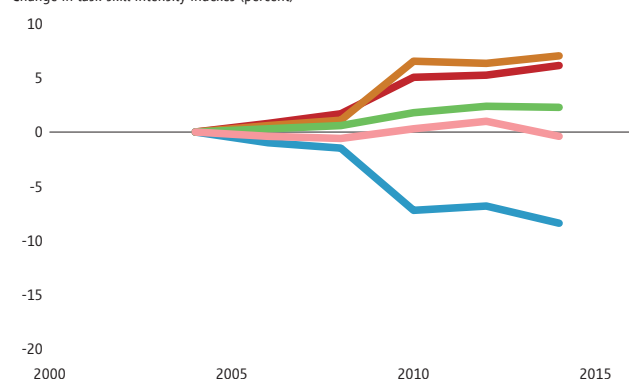
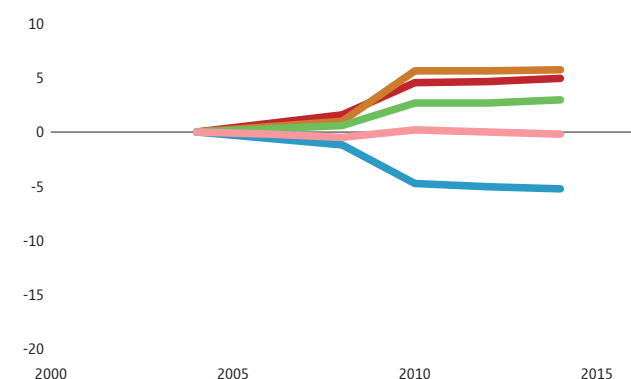
Change in task-skill intensity indexes (percent)

**Male****e. Thailand****Female**

Change in task-skill intensity indexes (percent)

**Male****f. Vietnam****Female**

Change in task-skill intensity indexes (percent)

**Male**

— Nonroutine analytical — Nonroutine interpersonal — Nonroutine manual physical — Routine cognitive — Routine manual

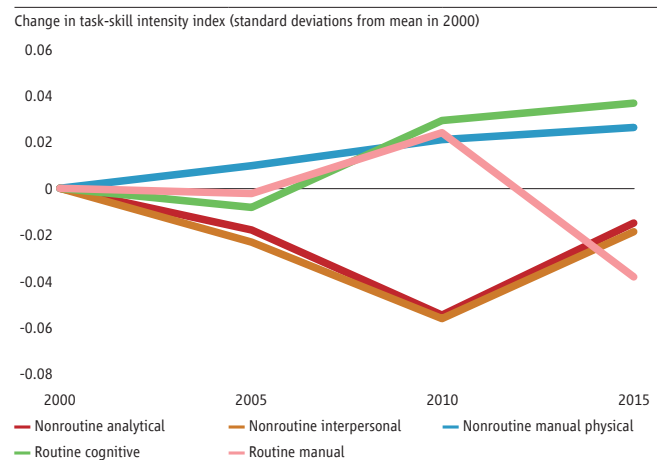
Source: Mason et al. (2018).

Note: Figure presents percentage changes in the task-skill intensity indexes for jobs between the early 2000s and 2015. The exact time horizon for each country reflects data availability in that country. Tasks are categorized as "routine" or "nonroutine" based on how repetitive or structured they are, and as "manual-physical" or "cognitive" (including interpersonal or analytical) based on the type of work involved. Task-skill intensity indexes are then constructed mapping Occupational Information Network (O*NET) dataset task classifications (<https://www.onetcenter.org/database.html>) to occupational data from surveys in each country. Indexes for each country are normalized to zero for the first year of the data to show changes in the task-skill composition of jobs over time. For additional methodological details, see Mason et al. (2018).

Shifts in task and skill intensities in China are somewhat different than those found for other countries in developing East Asia (Figure II.B.5). Census and intercensal data show that whereas tasks intensive in routine cognitive skills increased in 2000–15, so did tasks intensive in nonroutine manual tasks (Du and Park 2017). In contrast to most other countries in the region, tasks intensive in nonroutine cognitive analytical and interpersonal skills declined in the 2000–10 period, before increasing in 2010–15. Indeed, tasks intensive in both nonroutine analytical and interpersonal registered a net decline over the full 15-year period. Moreover, tasks intensive in routine manual skills increased in 2000–10, before falling post-2010.

The observed reversals in trends for different task-skill combinations over the period suggest that the dynamics of the Chinese labor market have shifted in recent years (Du and Park 2017). In fact, if one looks solely at the 2010–15 period, the patterns of evolving task-skills intensities in China look much closer to those observed elsewhere in developing East Asia since 2000, with nonroutine cognitive tasks increasing and routine manual tasks decreasing most rapidly. In contrast to other countries, however, nonroutine manual tasks continue to rise throughout the period. In analyzing patterns of occupational change in China over the 2000–15 period, Du and Park find that structural changes—and especially significant growth of retail jobs during the period—contributed significantly to the observed increase in routine cognitive skills and the reduced demand for more abstract skills. Structural changes in the economy have not yet contributed to an overall increase in demand for more nonroutine cognitive skills among Chinese workers, although post-2010 trends suggest that is changing.

Figure II.B.5. In China, jobs have become more intensive in routine cognitive and non-routine manual tasks since 2000, and in non-routine cognitive tasks since 2010



Source: Adapted from Du and Park 2017.

Note: Figure presents changes in the task-skill intensity indexes for jobs from 2000 to 2015. Tasks are categorized as “routine” or “nonroutine” based on how repetitive or structured they are, and as “manual-physical” or “cognitive” (including interpersonal or analytical) based on the type of work involved. Task-skill intensity indexes are constructed mapping task classifications to occupational data from Chinese census data (2000, 2010) and mini census data (2005, 2015). Indexes for each country are normalized to zero for the year 2000 to show changes in the task-skill intensity of jobs over time.

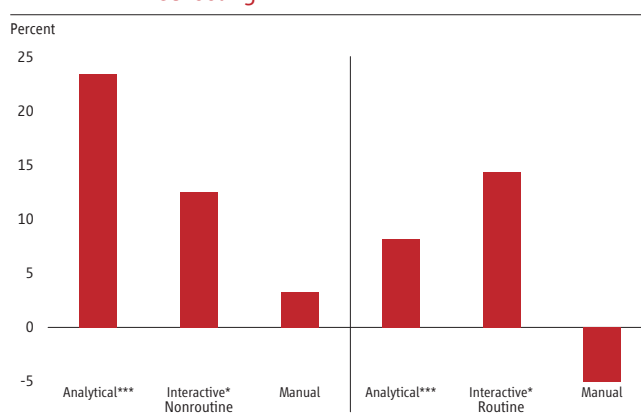
Returns to higher-order skills are rising

Employers in developing East Asia are looking for workers with more advanced skills. School enrolment rates and educational attainment have increased sharply throughout the region (World Bank 2018h). Nonetheless, the demand for higher-order skills is rising among firms in the region, and this demand for more advanced skills is likely to rise even more quickly in the future as new technologies are adopted by firms seeking to remain competitive in a changing global and regional economic environment. Employers across developing East Asia already report finding it difficult to find the right skills to fit their needs. In Vietnam, for example, nearly half of the employers surveyed as part of the Skills Toward Employment and Productivity (STEP) survey indicated that graduates did not have the skills needed in their workplace (Bodewig et al. 2014). In the Philippines, about one-third of employers surveyed report being unable to fill vacancies because of a lack of applicants with requisite skills (Acosta et al. 2017). And, in China, as many as three-quarters of respondents of a recent survey of entrepreneurs indicated that finding adequate technical and managerial skills was difficult (Development Research Center and World Bank Group 2019).

Skills premia, along with skill scarcity, are reflected in rates of return to higher levels of education. Labor market returns to tertiary education in Indonesia are not only higher than those at the primary or secondary level, but are increasing over time, suggesting a growing scarcity value associated with higher-order skills (Fasih et al. 2018). A study of urban China finds a 17 percent wage premium for high school graduates and a 55 percent wage premium for college graduates (and above), compared with middle school graduates or below (Du and Park 2017). In Vietnam, hourly earnings of university-educated workers in the private sector are found to be 60 percent higher than those who graduated lower secondary school (Demombynes and Testaverde 2017). While these wage premia may reflect higher productivity among university-educated workers, since employers are most concerned about skills gaps in those occupations that university workers hold (technical, professional and managerial professions), higher returns to tertiary education most likely reflect a shortage of those with (even limited) university education (Cunningham and Pimhidzai 2018).

Demand for analytical and interpersonal skills is growing. There is evidence that such tasks command wage premia in the labor markets of developing East Asia, even controlling for education. In Vietnam, nonroutine analytical and interpersonal tasks command particularly high wage premia (Figure II.B.6). Analyzing data on urban labor markets in China, Du and Park (2017) come to similar conclusions, finding significant and positive returns to nonroutine cognitive analytical tasks (although they find negative wage premia associated with routine cognitive tasks once education is independently accounted for). New analysis on Mongolia, the Philippines, and Vietnam indicates, moreover, that returns to nonroutine analytical tasks are increasing over time (Macdonald 2018).

Figure II.B.6. Rates of return are highest for non-routine analytical tasks and lowest for routine manual tasks in Vietnam, controlling for years of schooling



Source: Bodewig and others 2014.

Note: Estimates use Skills Toward Employment and Productivity (STEP) household survey data. Jobs are divided into categories based on the type of tasks that people reported doing in their jobs. A job is first divided into routine or nonroutine tasks, then further classified into those that are analytical (requiring continuous thinking and problem solving); interactive (requiring interaction with others); and manual. Jobs can be classified into more than one category; for example, jobs can include both nonroutine analytical and interactive tasks. The return displayed is the wage premium associated with working in a job in which the specified task type is performed relative to working in a job that is nonanalytical, noninteractive, and nonmanual, such as an office clerk. The returns are estimated using a Mincerian wage regression that controls for education (years of schooling), sex, experience, and sector as well as the task content of the job. Significance level: * = 10 percent, ** = 5 percent, *** = 1 percent.

Policies can help foster inclusive growth in the face of rapid technological change

Policies that help people develop more advanced skills will be critical to ensuring that future growth is inclusive. Successfully promoting inclusive growth in a rapidly changing technological environment will require that countries' populations are prepared to interact with new technologies and, increasingly, to have the skills needed to navigate technology-enabled work environments. The nature of work is already shifting, with rising demand for higher-order skills, and these shifts are likely to proceed at an increasingly rapid pace in the future, as technology continues to change. This puts the skills challenge at the center of any inclusive growth agenda. Policies will be needed to promote skills development along several fronts, including:

- *Continuing to strengthen people's foundations skills.* While countries in the region have made great strides in increasing access to primary and secondary education, basic learning outcomes remain variable across the region, both across and within countries. While the most advanced areas perform at or close to OECD levels, other areas perform well below what would be expected, given their per capita income levels (World Bank 2018h). A key challenge, therefore, will be to strengthen the quality of national education systems to ensure that all students, regardless of their socioeconomic status, are able to develop strong "foundational" skills (i.e., reading, math, basic cognitive skills). Indeed, for most countries in developing East Asia, building a workforce with more advanced skills will require a continued focus on measures to strengthen people's basic cognitive skills, especially among those from poor and vulnerable families, and in remote areas.
- *Ensuring digital literacy.* As technology changes and workplace demands become more sophisticated, ensuring that people develop the necessary digital and technical capabilities to navigate the new economy will also be critical. While there will be a growing need for people with sophisticated technical expertise in the design, operation, and maintenance of digital and other advanced technologies, a more basic priority from the perspective of inclusive growth is to ensure that all people have at least basic digital literacy. Special efforts should be made to foster digital literacy among groups whose economic prospects are currently (and will be increasingly) limited by lack of access to the digital economy.
- *Fostering higher-order cognitive and socioemotional skills.* Building higher-order cognitive and socioemotional skills will be increasingly important to ensure that workers are productive and competitive as technology advances. Development of these skills needs to start early, implying that efforts to broaden access to early childhood development remain important. The foundations for more-advanced skills can then be further developed and nurtured over the learning lifecycle. In recognition of evolving skills needs, several countries in the region, including the Republic of Korea and Singapore, are placing greater emphasis on developing problem-solving, creative thinking, socioemotional, and other higher-order skills. Given the likely speed of economic and technological changes, it will also be important for countries to explore innovative approaches to skills development, including through technology-enabled learning platforms.
- *Enabling lifelong learning and skills upgrading.* As technology increases the demand for more advanced skills, it will be important for countries to find ways to support continued learning and skills upgrading over people's entire working lives. Technical and vocational education and training (TVET) programs can play a part in countries' broader skills development strategies, as can other programs that support lifelong learning. To be effective, such programs must have greater market relevance and closer links to private sector employers than has generally been the case in the past. Building public-private partnerships that foster enterprise leadership in curricular design and program delivery will be critical. Governments still have a key oversight role, however, including monitoring program quality, encouraging firm accountability, and ensuring a results orientation in public financing.

Policies focused specifically on inclusion will also be important to ensure that low-skilled workers and those living in remote regions are not left behind as technology changes. This means putting in place stronger and more nimble systems to support workers who have difficulty adjusting to the economic changes associated with technological progress, and ensuring that there is broad and affordable access to digital technologies. Specifically, it will be important for policymakers to focus on:

- *Strengthening employment support services to assist workers displaced by technology.* Employment services are among the active labor market programs (ALMPs) that link beneficiaries with income-generating opportunities. Expanding their scope can complement the traditional personal and family network-based process of job search and matching, which can disadvantage poor and vulnerable workers. The relevance of ALMPs is likely greater in economies with higher shares of wage earners and greater administrative capacity. Such economies can consider providing “extended” services that link employment support to training and skills development programs, as well as to unemployment assistance or insurance. Even countries with lower capacity can focus on providing a “core” set of employment services, including information on job market conditions and vacancies, basic job search assistance, and job placement services.
- *Broadening unemployment benefit schemes, linking them to economic transitions.* Unemployment insurance is relatively new in developing East Asia, with severance programs being the usual approach to dealing with unemployment (Betcherman and Moroz 2018). Nevertheless, countries should consider developing or expanding unemployment insurance systems, including by progressively broadening coverage to include self-employed workers, as has been done in the Republic of Korea. Unemployment insurance programs could be linked not only to ALMPs to support workers’ reemployment but also, importantly, to expanded and strengthened systems of social assistance to help prevent those who cannot make the skills transition from falling into poverty. Development of such integrated and “adaptive” social protection systems can be enabled using digital technologies—in some cases, by building on countries’ existing social registry platforms.
- *Enabling broad and affordable access to digital technologies.* Increasing access to affordable digital technologies to those who currently lack it will also be critical to fostering inclusion—helping them obtain real-time weather and price information, access markets, purchase consumer goods, engage in mobile banking, and, when needed, receive social benefits. Two sets of actions will be particularly important to increasing affordable access to digital technology. First, promoting market competition, private investment, and independent regulation has generally been effective in extending coverage and making digital technology access affordable. Second, where markets do not work well enough in extending digital infrastructure, for example in remote rural locations, mechanisms such as targeted incentives to operators, or licensing of mobile and internet service providers with specific network rollout obligations, are worth considering (World Bank 2016).²²

Conclusion

It is possible for policymakers in developing East Asia to foster inclusive growth in an era of rapid technological change. The widespread adoption of new technologies holds the promise of boosting firms’ productivity. New technologies, if broadly available and affordable, can also reduce the cost of people accessing markets and information, and improve their access to goods and services, particularly in remote, difficult-to-reach locations. Nonetheless, by increasing demand for more advanced skills, technological progress may also put at risk the employment of many low-skilled workers. Meeting the challenges associated with technological progress thus requires policymakers to act to ensure that future growth is inclusive. Policies should focus on ensuring that people have the types of more-advanced skills needed to compete and be productive in the new economy. At the same time, it will be important to enact policies focused specifically on inclusion, including developing stronger and more nimble systems of support for workers who find it difficult to adjust to changes in technology, and ensuring that all people have affordable access to digital technologies.

²² For more on enabling broad, affordable access to digital technologies, see “The Digital Economy of Southeast Asia: Building the Foundations for Future Growth,” Part II.A in this issue.

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Part III. Country Summaries and Key Indicators



CAMBODIA

2018

| | |
|---|-------|
| Population, million | 16.3 |
| GDP, current US\$ billion | 24.5 |
| GDP per capita, current US\$ | 1,500 |
| School enrolment rate, primary (% gross) ^a | 107.8 |
| Life expectancy at birth, years ^a | 69.3 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent WDI value (2017).

After experiencing better-than-expected growth of 7.5 percent in 2018, the economy is projected to moderate to 7 percent in 2019. While remaining strong, export performance eased slightly. Bustling construction activity, however, continues. Risks include heightened uncertainty over Cambodia's preferential access under the EBA to the EU market, which accounts for about 40 percent of exports. A sharp slowdown in the Chinese economy caused by the ongoing trade war would dampen growth prospects, due to Cambodia's dependency on FDI and tourists from China.

Recent Developments

Solid merchandise export performance continued to propel growth above 7 percent in 2018 (Figure 1). Garment and footwear exports, accounting for about 70 percent of total merchandise exports, grew at 17.7 percent in 2018, but eased slightly to 15.3 percent (y/y) in June 2019 (Figure 2). Bustling construction activity has continued, reflecting sustained appetite for investment. As a result, import growth of steel skyrocketed to 63.5 percent (y/y) in volume

terms, up from 27.7 percent in 2018. The reported value of newly approved investment projects (financed by FDI and domestic funds) accelerated during the first half of 2019. Roughly 40 percent of FDI inflows comes from China. The tourism sector remained resilient; international arrival growth accelerated to 11.2 percent (y/y) in June 2019 compared to 10.7 percent in 2018, with almost 40 percent of international arrivals coming from China.

Rising domestic consumption drove import growth. Imports of petroleum products and motor vehicles rose by 91.0 percent and 18.5 percent, respectively. Thanks mainly to depressed food and oil prices, inflation continued to be subdued, declining to 1.4 percent (y/y) in mid-2019, down from 1.6 percent in 2018. While being softly pegged at around riel 4,000 per US dollar, the local currency depreciated slightly to riel 4,089 per US dollar in August 2019, up from riel 4,018 per US dollar in December 2018, likely due to slower capital inflows.

The financial sector is playing an increasingly important role in the economy. Bank credit growth accelerated to 28.3 percent (y/y) in June 2019, up from 24.2 percent in December 2018. Reflecting the tapering of capital inflows, foreign currency deposits decelerated, growing at 21.7 percent (y/y) in June 2019, down from 25.8 percent in December 2018. However, accumulation of gross international reserves accelerated, reaching US\$11.3 billion (more than 5 months of import coverage) or 24.7 percent (y/y) in mid-2019, up from US\$10.1 billion or 15.8 percent (y/y) at the end of 2018.

Fiscal performance continued to be characterized by strong revenue collection, due largely to improve customs and tax administration and bustling economic activity. Total revenue (including grants) reached 22.3 percent of GDP in 2018 and is projected to further accelerate to 23.5 percent of GDP in 2019. Despite continued pressures from a rising public wage bill, government outlays are expected to remain contained at 24.2 percent of GDP in 2019. As a result, overall balance that widened to 1.9 percent of GDP in 2018 is anticipated to shrink to 0.6 percent of GDP in 2019, thanks to rising revenue.

Outlook

As Cambodia's exports will moderate with the easing of global demand, while investment decelerates with sluggish capital inflows due to slower projected growth in China, the economy is expected to decelerate gradually in the short to medium term. Growth is projected to ease to 7.0 percent in 2019, compared to 7.5 percent in 2018.

The easing of exports and continued strong growth in imports will result in a widening of the country's current account deficit to 9.8 percent of GDP in 2019, up from 9.4 percent of GDP in 2018, but remains fully financed by foreign direct investment.

In February 2019, the EU launched the process that could lead to the temporary withdrawal in 2020 of Cambodia's preferential access to the EU market through the Everything But Arms (EBA) initiative. A relatively large fiscal stimulus (over 3 percent of GDP) is expected to be introduced in 2020 to mitigate potential negative impacts of the withdrawal of EBA, if the latter occurs. The stimulus will help growth to remain robust in the short term. In the medium term, the economy is projected to ease gradually as further efforts will be needed to address the existing structural bottlenecks by facilitating trade and businesses, while reducing logistics and energy costs, and upgrading skills.

Poverty reduction is expected to continue. Economic growth, particularly growth in labor income in the form of higher wage income, is the main driver of poverty reduction. Most of the poor have wage income with low paying jobs, signaling challenges with low skills and productivity. Inequality is on the rise in both urban and rural area—the largest increase is in rural areas.

Risks and Challenges

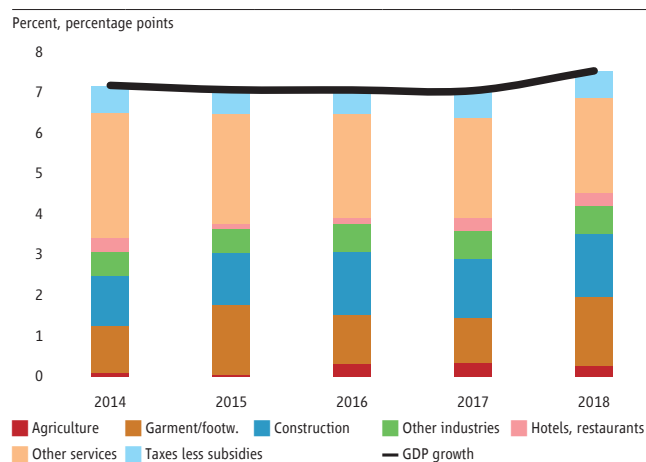
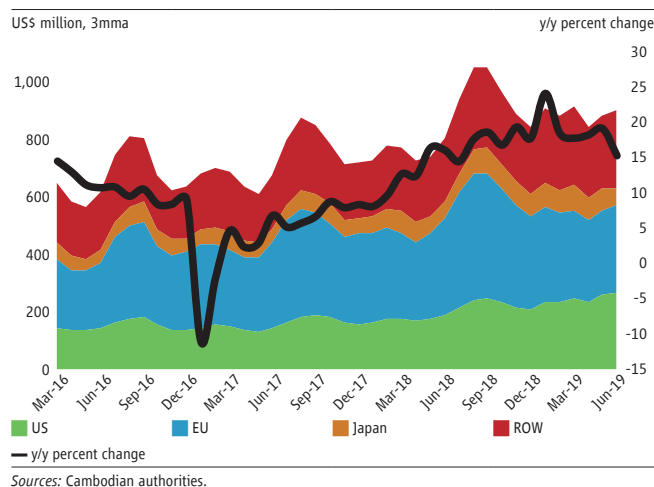
Heightened uncertainty underpins increased risks to Cambodia's economic outlook. Possible withdrawal of the EBA initiative, as well as a sharp slowdown in the

Chinese economy (a potential outcome of continued US-China trade tensions), could substantially dampen growth prospects, given Cambodia's increased reliance on exports to the EU and Chinese FDI inflows and tourists.

A prolonged construction and property boom as well as the increase of credit provided to the construction and real estate sectors alongside rising indebtedness—where combined bank and microfinance credit now accounts for over 100 percent of GDP—also present a downside risk for Cambodia.

It is an imperative to improve the country's external competitiveness through increased productivity in the presence of rising minimum wages. The authorities recently introduced measures to facilitate trade by lowering logistics costs and support businesses with a reduction in number of public holidays. Successful implementation of the measures, together with more efforts to address the high electricity costs and large skills gaps, will further promote investment in high-value-added products, especially the newly emerging electrical appliances and components, and auto parts which remain to be further nurtured.

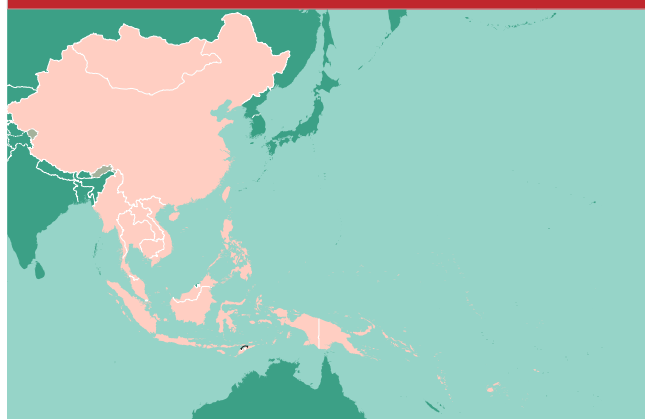
Strengthening oversight capacity and crisis preparedness in the financial sector is an important first step. Large foreign inflows that Cambodia has experienced over the past several years may not be sustained, especially in a context of increased global uncertainty and a slowdown in China.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2.** Destination of Cambodia garment and footwear exports

| CAMBODIA Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|--|--|-------------|-------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 7.0 | 7.0 | 7.5 | 7.0 | 6.8 | 6.8 |
| Private Consumption | 6.9 | 4.4 | 4.4 | 4.8 | 5.8 | 5.1 |
| Government Consumption | 5.7 | 6.5 | 8.5 | 7.5 | 11.3 | 10.1 |
| Gross Fixed Capital Investment | 10.1 | 6.1 | 6.1 | 8.0 | 7.2 | 6.9 |
| Exports, Goods and Services | 8.6 | 5.3 | 5.3 | 9.3 | 8.2 | 8.9 |
| Imports, Goods and Services | 8.6 | 4.1 | 4.1 | 7.7 | 7.7 | 7.7 |
| Real GDP growth, at constant factor prices | 6.9 | 6.9 | 7.4 | 6.8 | 6.6 | 6.6 |
| Agriculture | 1.3 | 1.7 | 1.2 | 0.7 | 0.8 | 0.9 |
| Industry | 10.9 | 9.8 | 11.6 | 10.5 | 9.1 | 8.7 |
| Services | 6.8 | 7.0 | 6.7 | 6.3 | 6.8 | 6.9 |
| Inflation (Consumer Price Index) | 3.4 | 3.3 | 3.1 | 2.1 | 3.1 | 3.0 |
| Current Account Balance (% of GDP) | -11.6 | -10.6 | -9.4 | -9.8 | -12.5 | -12.0 |
| Net Foreign Direct Investment (% of GDP) | 12.0 | 12.2 | 12.5 | 11.8 | 11.9 | 11.4 |
| Fiscal Balance (% of GDP) | -1.4 | -1.6 | -1.9 | -0.6 | -4.9 | -4.5 |
| Debt (% of GDP) | 29.1 | 30.6 | 30.0 | 30.4 | 30.5 | 31.4 |
| Primary Balance (% of GDP) | -1.0 | -1.3 | -1.5 | -0.1 | -4.4 | -4.1 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
 Notes: e = estimate, f = forecast.

CENTRAL PACIFIC ISLANDS



2017

| | |
|------------------------------|-------|
| Population, million | |
| Kiribati | 0.12 |
| Nauru | 0.01 |
| Tuvalu | 0.01 |
| GDP, US\$, billion | |
| Kiribati | 0.19 |
| Nauru | 0.11 |
| Tuvalu | 0.04 |
| GDP per capita, current US\$ | |
| Kiribati | 1,594 |
| Nauru | 8,344 |
| Tuvalu | 3,550 |

Sources: WDI, World Bank staff estimates.

Economic activity and government revenues in the Central Pacific countries—Kiribati, Nauru and Tuvalu—are highly reliant on rents from a few key sources. In 2018, public spending and donor-funded projects helped to fuel moderate growth in Kiribati and Tuvalu, but Nauru experienced an economic contraction. In the face of volatile revenues, it is important for the Central Pacific countries to focus on expenditure quality and maintain fiscal discipline.

Recent Developments

In Kiribati, recent economic performance has been subject to swings in donor-driven construction activity, but generally stronger than the historical average. Overall, real GDP growth averaged 3.9 percent over 2013–17,

compared with 0.8 percent in the preceding five-year period. Growth dipped to just 0.3 percent in 2017, with construction and trade both remaining flat according to preliminary estimates, but stronger growth of 2.3 percent is estimated in 2018, based on an uptick in government and donor spending in the 2018 budget. Inflation has been low and stable, averaging 1.4 percent over 2016–2018.

Fishing license fees, investment income from the Revenue Equalisation Reserve Fund (RERF) and current transfers have more than offset Kiribati's significant trade deficit (over 90 percent of GDP on average), leading to current account surpluses averaging 26 percent of GDP over the past three years. High fisheries revenues have allowed the government to accumulate large reserves (A\$170m) while also making major capital investments and significantly increasing recurrent spending (including a 30 percent pay rise for public servants in 2018). In late 2018 the government announced an ambitious expansion of the national airline at a cost of circa A\$120m (47 percent of GDP) over 2018–2020. Despite the continued strength of fisheries revenues, spending increases saw the budget surplus decrease to 3 percent of GDP in 2018, compared with a surplus of 23 percent of GDP in 2017.

After doubling in size in the early part of the decade, Nauru has grown much more slowly in recent years, due to a decline in phosphate exports—with phosphate reserves now almost completely depleted—as well as a slowdown in activity associated with Australia's Regional Processing Centre (RPC) for asylum-seekers, which in recent years has been the main driver of economic activity in Nauru. The economy is expected to have contracted by around 2.5 percent in FY18 (from growth of 4 percent the previous year) with the RPC scaling down and refugees being resettled elsewhere. In FY2019, a more modest contraction is expected, with the commencement of construction works on a more reliable and climate-resilient port providing some support for growth.

Government revenue has increased about five-fold in real terms since FY2012 due to RPC-related revenues and fishing license fees, as well as the implementation of

employment and services taxes and improvements in tax administration. Government spending has also increased rapidly, particularly on the wage bill. Nevertheless, recent budget estimates indicate that surpluses averaging around 14 percent of GDP were realized in FY2017 and FY2018, with the government continuing to make contributions to the Nauru Trust Fund and to its cash buffers. In FY2019, a windfall deposit of fishing revenues (accruing from prior years) has allowed for further increases in expenditure alongside the building up of cash buffers.

Tuvalu's macro-economic performance over the past few years has been favorable mainly due to increased capital investment. Real GDP growth is estimated to have accelerated to 4.3 percent in 2018, up from 3.2 percent in 2017, reflecting the implementation of large infrastructure and housing projects. Inflation climbed to 4.4 percent in 2017 due to higher food and transportation costs but is estimated to have fallen back to 4 percent in 2018. The banking sector remains fragile, and credit provides very modest support to growth. The current account continues to be in a surplus of 5 percent of GDP, and reserve coverage remains adequate: an estimated 10 months of imports at end-2018. Tuvalu maintained fiscal surpluses despite high expenditure in recent years thanks to revenue from fishing license fees and the ".tv" domain, and grants. The resulting post-grant surpluses have been used to replenish the Consolidated Investment Fund (CIF) and, more recently, to capitalize the Tuvalu Trust Fund (TTF) and the newly established Tuvalu Survival Fund (TSF). The combined value of the TTF, TSF and CIF reached almost 400 percent of GDP at end-2018. Tuvalu's 2018 budget included windfall revenue of A\$18.7 million in fishing licenses, contributing to a sizable budget surplus of A\$8.2 million, or 19 percent of GDP.

Outlook

In Kiribati GDP growth of around 2 percent is expected over the medium term, fueled by construction projects. Foreign fishing license revenues are expected to moderate, causing GNI growth to level off and turn slightly negative

in per capita terms. Lower fishing revenues and one-off large outlays for the national airline are expected to push the budget into deficit in 2019 and 2020, before returning to surplus in 2021.

Little to no economic growth is expected in Nauru in FY2020, and only modest growth averaging around 2 percent per annum is expected over the medium term. Growth remains dependent on the uncertain outlook for the RPC and the extent to which donor support compensates for any revenue shortfalls and acts to stimulate domestic incomes and output. Port construction work is likely to continue to support overall economic activity over the next two to three years. Fishing license fees have remained above 20 percent of GDP in recent years and should remain an important source of revenue, although they are likely to fall from exceptionally high levels in FY2019.

In Tuvalu, growth is forecasted to remain around 4 percent in 2019, and inflation is expected to moderate as oil price pressures ease. The government is expected to register a fiscal deficit of A\$1.4 million, or 2.9 percent of GDP, in 2019 as revenues normalize in the face of a moderate rise in infrastructure spending. The government's projections show moderate surpluses for 2020 and beyond reflecting a moderation in fishing revenues as the El Nino cycle wanes and declining grant allocations. Despite external income inflows, the current account is expected to record deficits over the medium-term on the back of large trade deficits.

Risks and Challenges

Kiribati is contending with a large deficit in access to essential services, with growing strain from internal migration, population growth and climate change. Increasing the quality of expenditure and strengthening project prioritization is vital to addressing these challenges and reducing poverty.

Nauru faces significant challenges in sustaining growth and ensuring fiscal and debt sustainability going forward. In the medium-term, Nauru is highly vulnerable to the

expected scaling-down of the RPC. The biggest challenge is to diversify the economy beyond phosphate exports and refugee processing, neither of which are sustainable drivers of growth in the long run.

In Tuvalu, the medium-term outlook for the economy is broadly positive but is also subject to downside risks and

challenges. These stem from the country's geographic remoteness, heavy dependence on foreign aid and volatile fishing revenues, and a fragile and under-regulated banking system. The impact of climate change and mitigation efforts will impose additional long-term fiscal costs, calling for ongoing reforms to enhance resilience and secure development assistance.

Figure 1. Sources of domestic revenue—projections to 2020

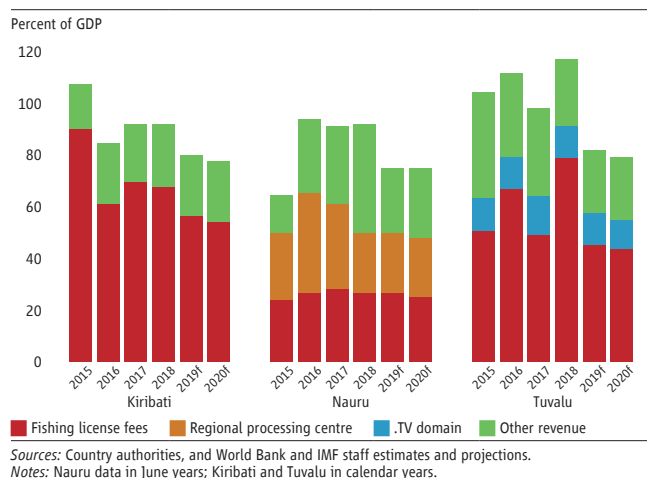
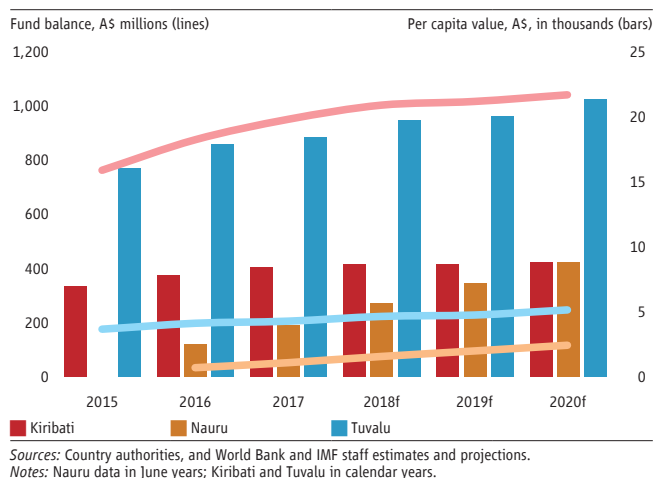


Figure 2. Sovereign wealth fund balances—projections to 2020



| CENTRAL PACIFIC ISLANDS Macro Poverty Outlook Indicators | 2015 | 2016 | 2017 | 2018p | 2019p | 2020p |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | | | | | | |
| Kiribati | 10.4 | 5.1 | 0.3 | 2.3 | 2.3 | 2.3 |
| Nauru | 2.8 | 10.4 | 4.0 | -2.5 | -1.0 | 0.0 |
| Tuvalu | 9.1 | 3.0 | 3.2 | 4.3 | 4.1 | 4.4 |

Sources: Country authorities and World Bank and IMF staff estimates.

Notes: p = projection. 2017 estimates are preliminary for Kiribati. Nauru data are based on the fiscal year ended June; Kiribati and Tuvalu are calendar years.



2018

| | |
|---|----------|
| Population, million | 1,388.7 |
| GDP, current US\$ billion | 13,376.2 |
| GDP per capita, current US\$ | 9,632 |
| International poverty rate (\$1.9) ^a | 0.7 |
| Lower middle-income poverty rate (\$3.2) ^a | 7.0 |
| Upper middle-income poverty rate (\$5.5) ^a | 27.2 |
| School enrolment, primary (% gross) ^b | 102.1 |
| Life expectancy at birth, years ^b | 76.4 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2015), 2011 PPPs. b. Most recent WDI value (2017).

Growth is projected to slow to 6.1 percent in 2019 and moderate further to 5.9 and 5.8 percent in 2020 and 2021. The outlook is subject to significant downside risks including further escalation of trade tensions, sharp deterioration of business confidence and a significant global slowdown. Slower growth notwithstanding, extreme poverty rate is projected to fall below 0.2 percent by 2020–21. Facing a less favorable external environment, China will have to increasingly rely on domestic demand to sustain growth.

Recent Developments

GDP growth moderated to 6.3 percent yoy in the first half of 2019 from 6.6 percent in 2018 reflecting weaker exports and investment. The slowdown in investment was largely driven by a weaker private investment growth, while state sector capital spending has rebounded somewhat. Consumption growth has normalized and is estimated at around 7 percent in the first half of 2019.

A stronger contribution from net exports reflecting a sharp deceleration of import growth, has partly offset the impact of weakening domestic demand on growth. On the production side, the slowdown has been broad based but particularly pronounced in car manufacturing, real estate, wholesale and retail trade.

Despite moderating GDP growth, average real household income growth per capita was 6.5 percent yoy in the first half of 2019, unchanged from 2018. Robust growth in disposable incomes notwithstanding, growth in real consumption expenditure per capita declined to 6.2 percent yoy in the first half of 2019 from 6.5 percent in 2018 while household savings accelerated amidst rising uncertainty.

Reflecting trade tensions and lackluster global growth, trade flows have weakened. Goods exports grew by just 0.4 percent yoy in the first eight months of 2019, compared with 9.9 percent in 2018. The slowdown in goods import growth was sharper: a decline of 4.6 percent yoy in the first eight months of this year compared to an increase of 15.8 percent last year. The deceleration was led by a sharp decline in intermediate goods imports likely reflecting supply chain disruptions in the wake of higher bilateral tariffs with the US. The current account surplus widened to 1.6 percent of GDP in the first half of 2019, from 0.4 percent in 2018 reflecting a widening trade balance.

In response to weaker domestic demand and less favorable external conditions, the government stepped up fiscal stimulus through a combination of tax incentives and increased public investment including a higher limit for local government on-budget borrowing. As a result, the consolidated fiscal deficit increased to 2.3 percent of GDP in the first half of 2019, significantly higher than the deficit of 0.5 percent of GDP during the same period last year. Higher on-budget deficit was only partially offset by lower off-budget infrastructure spending by SOEs, which the government continued to rein in.

Monetary policy became more accommodative since the second quarter of 2019 responding to the deteriorating

external environment. The central bank has implemented a series of cuts in the bank required reserve ratio (RRR), with the latest broad-based 50 bp cut effective on September 16. Amid monetary easing, credit growth picked up to 10.8 percent yoy in the first eight months of 2019, having slowed through 2018.

Ongoing trade tensions have been contributing to heightened financial market volatility. The Renminbi weakened exceeding RMB 7 per dollar for the first time since 2008 following the new US import tariffs announced on August 1. Amid heightened uncertainty, net capital outflows (including errors and omissions) increased to US\$ 91 billion in the first half of 2019 compared to US\$ 30 billion in 2018.

Outlook

Growth is forecast to moderate to 6.1 percent in 2019, and moderate further to 5.9 percent in 2020 and 5.8 percent in 2021. The baseline projections reflect a weaker global outlook and the effect of the latest US tariffs which will weigh on exports and investor confidence. The initial negative shock will be partially offset by currency depreciation, price adjustment, and the redirection of exports to other countries.

Poverty rates are expected to continue to decline reflecting projected broad-based improvement in household incomes. The international poverty line poverty rate is forecasted to fall from 0.33 percent of the population in 2018 to 0.18 in 2021. Thus, China is well on track to meet the national goal of eliminating extreme poverty by 2020. The poverty rate for people living on less than \$5.5/day is projected to decline from 18.7 percent in 2018 to 11.9 percent in 2021.

Risks and Challenges

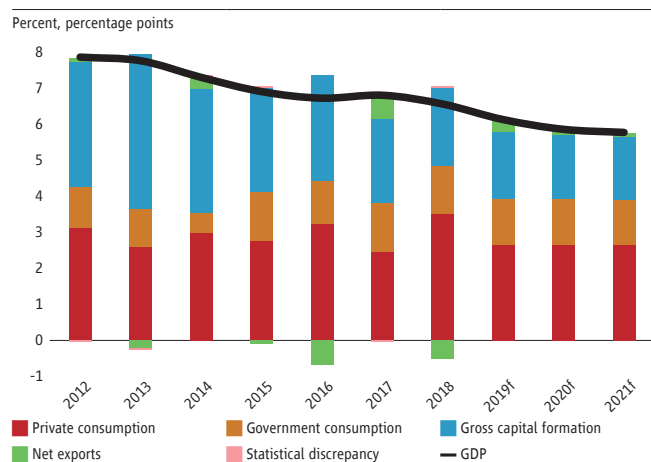
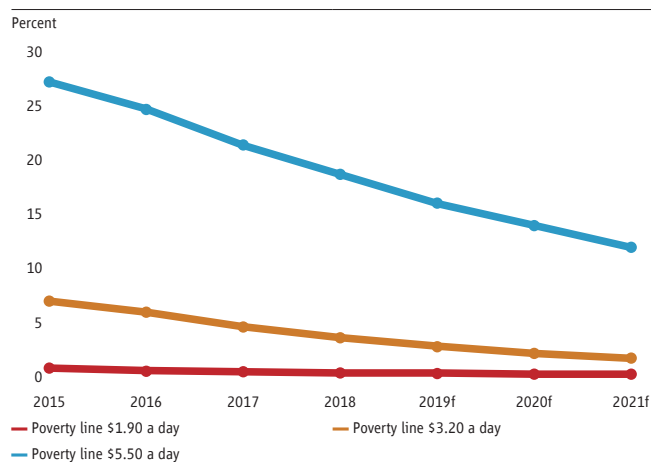
Downside risks to the outlook are high, stemming from a further escalation of China-US trade tensions and a weaker-than-expected global outlook. While the direct economic

impact of the recent US trade measures is expected to be manageable, the indirect effect of higher investor risk aversion and weaker business confidence could be larger than currently expected. A protracted period of high uncertainty and continuing deterioration in China's access to foreign markets could lead to a shift of global value chains to other countries and a much more significant and longer-term adverse impact on investment.

There is fiscal space at the central government level to respond to a larger-than-expected growth slowdown. However, lower returns to public investment suggests the room for supporting growth in this manner has already greatly diminished in recent years. Fiscal stimulus could target higher and more efficient spending on health, education, and social protection which in turn would help boost private consumption.

The scope for additional monetary easing is constrained by both domestic and external factors. The debt to GDP ratio, especially for corporations, is rising again. Additional stimulus, if it becomes necessary, should be undertaken in a way that will not reverse the success of the government's campaign to limit financial risks. While monetary easing of the US Federal Reserve and other systemically important central banks may provide some space for monetary easing in China, currency depreciation pressure and risks of capital outflows limit the scope for interest rate cuts.

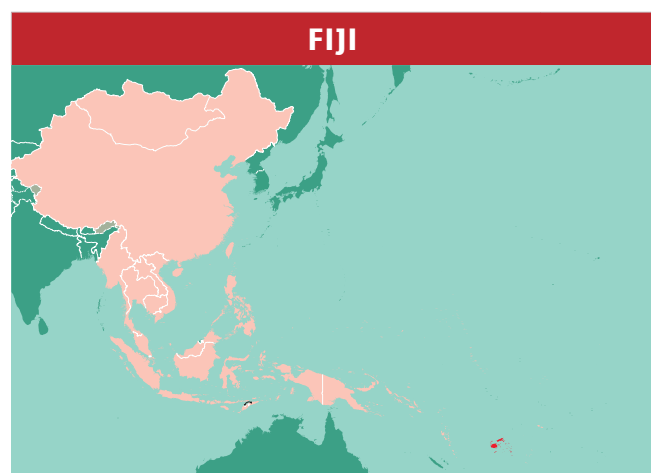
Given heightened external risks, China's medium-term growth will depend even more on deepening supply side reforms to raise productivity growth including through an increased role of markets, competition and the private sector. Building on the business climate reforms introduced in 2018, enforcing fair competition and financial discipline while easing the regulatory burden would encourage private sector investment. These policies will reduce inefficiencies in the allocation of resources and drive productivity-led growth in the future. Sustaining rapid catch-up growth will also depend on efforts to preserve and deepen China's integration in world markets, while alleviating current tensions around trade and investment.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Poverty estimates and projections**

| CHINA Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|--|-------------|-------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 6.7 | 6.8 | 6.6 | 6.1 | 5.9 | 5.8 |
| Private Consumption | 8.6 | 6.4 | 9.1 | 6.8 | 6.8 | 6.7 |
| Government Consumption | 8.8 | 9.5 | 9.4 | 8.4 | 8.2 | 8.1 |
| Gross Fixed Capital Investment | 6.8 | 5.2 | 4.9 | 4.5 | 4.3 | 4.2 |
| Exports, Goods and Services | 1.8 | 8.9 | 4.0 | 2.5 | 1.7 | 1.8 |
| Imports, Goods and Services | 5.7 | 6.6 | 7.5 | 1.0 | 1.2 | 1.3 |
| Real GDP growth, at constant factor prices | 6.7 | 6.8 | 6.6 | 6.1 | 5.9 | 5.8 |
| Agriculture | 3.3 | 3.9 | 3.5 | 3.3 | 3.3 | 3.3 |
| Industry | 6.3 | 5.9 | 5.8 | 5.5 | 5.2 | 5.0 |
| Services | 7.7 | 7.9 | 7.6 | 7.0 | 6.7 | 6.7 |
| Inflation (Consumer Price Index) | 2.0 | 1.6 | 2.1 | 2.4 | 2.5 | 2.5 |
| Current Account Balance (% of GDP) | 1.8 | 1.6 | 0.4 | 0.7 | 0.6 | 0.5 |
| Net Foreign Direct Investment (% of GDP) | -0.4 | 0.2 | 0.8 | 0.9 | 1.0 | 1.1 |
| Fiscal Balance (% of GDP) ^a | -3.1 | -2.5 | -3.9 | -5.9 | -5.5 | -5.4 |
| Debt (% of GDP) | 37.0 | 36.5 | 36.9 | 39.9 | 42.5 | 44.9 |
| Primary Balance (% of GDP) | -2.0 | -1.2 | -2.7 | -4.7 | -4.2 | -4.1 |
| International poverty rate (\$1.9 in 2011 PPP) ^b | 0.6 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^b | 5.9 | 4.6 | 3.5 | 2.7 | 2.1 | 1.6 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^b | 24.7 | 21.4 | 18.7 | 16.0 | 13.9 | 11.9 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) The adjusted fiscal balance adds up the public finance budget, the government fund budget, the state capital management fund budget and the social security fund budget. b) 2015 is actual based on group data provided by China NBS, 2016 onwards are projections using neutral distribution with pass through 0.72.

**2018**

| | |
|---|-------|
| Population, million | 0.9 |
| GDP, current US\$ billion | 5.5 |
| GDP per capita, current US\$ | 6,008 |
| Basic Needs Poverty Rate ^a | 28.1 |
| International poverty rate (\$1.9) ^a | 1.4 |
| Lower middle-income poverty rate (\$3.2) ^a | 14.1 |
| Life expectancy at birth, years ^b | 70.4 |

Sources: WDI, Macro Poverty Outlook, and official data.

Notes: a. Fiji Bureau of Statistics. Based on income-based National Poverty Line in 2013–14. b. Most recent WDI value (2017).

Fiji's economy is estimated to grow by 2.7 percent in 2019, down from the earlier projection of 3.4 percent, reflecting the moderation of growth in consumption, and investment while the tourism sector continues to outperform expectations. As Fiji's external environment weakens and Fiji remains exposed to frequent and costly natural disasters, building fiscal space through expenditure-based fiscal consolidation remains the key policy priority. Structural reforms, focusing on a more supportive environment for private sector development, could help Fiji reach 4–5 percent growth, as envisaged in its National Development Plan (NDP).

Recent Developments

Fiji posted its ninth consecutive year of economic growth in 2018 despite the challenges arising from frequent natural disasters in recent years. The economy grew by an estimated 4.2 percent in 2018, supported by tourism, agriculture, ICT and the construction sectors.

The agricultural sector remains as the main source of livelihood for nearly half of Fijians, while its contribution to the economy is low at around 8 percent. Services is the largest sector, representing 70 percent of the economy and providing employment for nearly forty percent of Fijians. Tourism remains a critical industry with combined direct and indirect contribution to GDP estimated at 30 percent.

Inflation was 2.8 percent at end-June, lower than the 4.1 percent registered at end-2018, reflecting stabilization of prices for alcoholic beverages and tobacco. The Reserve Bank of Fiji (RBF) has maintained its Overnight Policy Rate at 0.5 percent since 2011. Liquidity in the banking system (measured by commercial banks' demand deposits) has been growing over the past few months exceeding FJD600 million at the end of end-August thanks to the increase in foreign reserves and a decline in statutory reserve deposits. The RBF's June Business Expectations and Retail Sales Surveys show that business and investor confidence sentiments for the next year are relatively weaker than the previous Surveys at end-2018. Domestic credit growth to the private sector has been sluggish, at 7.2 percent at end-June, reflecting a slowdown in lending to businesses. The Fijian dollar has remained broadly stable against a basket of currencies of its main trading partners. The REER increased over June (1.6 percent) and on an annual basis (0.7 percent), higher domestic inflation over the month underpinning the loss in trade competitiveness.

The recent fiscal policy has been expansionary; however, in FY19, the deficit declined to an estimated 3.4 percent of GDP from 4.4 percent in FY2018 as lower than expected revenue levels were more than compensated by the reduction in expenditure. Government debt slightly increased to 47 percent of GDP, owing to additional borrowing for post-Winston reconstruction. Despite higher tourism and transport receipts, the external balance deteriorated in 2018 due to a sharp increase in the trade deficit driven by higher oil prices, low global sugar prices and a strong import demand for capital equipment. The current account deficit as a result widened to 9.4 percent of GDP. The larger current account deficit, combined with

lower FDI, primarily because of repatriation of investment dividends, resulted in an 18 percent reduction of foreign reserves, which were US\$940 million at end-2018, equivalent to 4.4 months of imports. Reserves have been building up gradually this year, reaching US\$987 million at end-August.

Using the international poverty line of US\$1.90 (2011 PPP US\$ per person per day), Fiji's extreme poverty rate in 2013/2014 was estimated at 1.4 percent, which is one of the lowest in the Pacific. Inequality in Fiji is also among the lowest in the East Asia and Pacific, with the Gini index estimated at 36.4 in 2013/2014. However, using the US\$5.50 Upper Middle-Income Class Poverty Line, which reflects living standards across all upper middle-income countries, the incidence of poverty was at 49.5 percent, which is higher than most other upper middle-income countries.

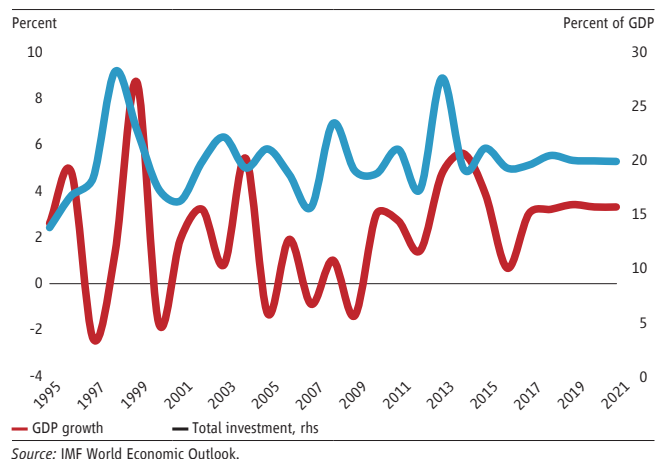
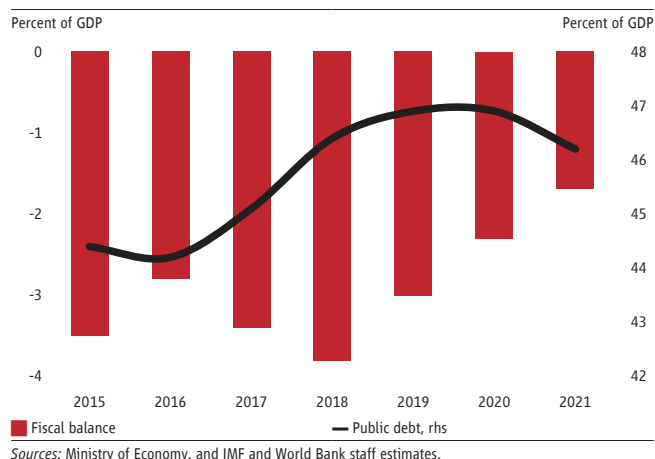
Outlook

GDP growth is projected to moderate to 2.7 percent in 2019. Inflation is expected to remain at 3.2 percent, in line with the RBF's end-year forecast. The FY2020 budget, the government's first budget since its re-election for a second term in November 2018, reflects the commitment to consolidation and is expected to narrow the net fiscal deficit from a projected 3.4 percent of GDP in FY2019 to 2.7 percent in FY2020. This is going to be driven primarily by expenditure measures: a stabilization of capital spending at pre-TC Winston levels and tighter control over recurrent spending. The government's medium-term fiscal strategy outlines an ambitious fiscal consolidation program, expected to result in a substantial reduction of the net fiscal deficit to 1.5 percent by FY2022. The government's planned fiscal consolidation is expected to bear fruit and reduce public debt relative to GDP gradually to 46.7 percent in FY2021 and 45.9 percent in FY2022. The current account deficits are expected to decline gradually in the projection period.

Risks and Challenges

Potential upside risks include lower-than-expected import commodity prices and stronger-than-expected tourism. Downside risks include another natural disaster and a sharp slowdown in China, which could hit Fiji's main export and tourism source markets such as Australia, New Zealand, and Japan. Risks on the domestic front include any setback to fiscal consolidation, and slowing down of the structural reform agenda, which could lead to a further weakening in business confidence.

Fiji is exposed to frequent natural disasters, causing an average loss of 2–5 percent of GDP per year. The disasters and rising expenditures have eroded Fiji's fiscal space in the last five years. Therefore, it is important for the government to start rebuilding fiscal space to respond to future shocks. While continuing to pursue ambitious social and investment programs, the government's focus has been greater revenue mobilization, improved management of public debt, greater accountability through internal audit, and more frequent and comprehensive public financial reporting. Going forward, expenditure measures will help the government achieve the medium-term fiscal targets. The structural reform agenda includes building climate resilience and creating a more supportive environment for private-sector-led growth. Attracting more FDI and expanding the role of the private sector in the economy will require modernizing the legal and regulatory framework.

Figure 1. Real GDP growth and total investment as a share of GDP**Figure 2.** Fiscal balance and public debt

| FIJI Macro Poverty Outlook Indicators | 2016 | 2017 | 2018e | 2019f | 2020f | 2021f |
|--|--|-------------|--------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 2.6 | 5.2 | 4.2 | 2.7 | 3.0 | 3.0 |
| Agriculture | -8.7 | 12.0 | 4.5 | 4.3 | 3.9 | 3.7 |
| Industry | 5.3 | 3.3 | 2.3 | 2.5 | 2.3 | 2.3 |
| Services | 0.3 | 3.6 | 3.1 | 1.6 | 2.0 | 2.0 |
| Inflation (Consumer Price Index) | 3.8 | 3.3 | 4.1 | 3.2 | 3.0 | 3.0 |
| Current Account Balance (% of GDP) | -4.0 | -7.1 | -9.4 | -7.7 | -7.7 | -7.5 |
| Fiscal Balance (% of GDP) | -2.8 | -3.4 | -3.8 | -3.0 | -2.3 | -1.7 |

Sources: Ministry of Economy, World Development Indicators, and staff estimates.
 Notes: e = estimate, f = forecast.



| | 2018 |
|---|---------|
| Population, million | 266.4 |
| GDP, current US\$ billion | 1,042.2 |
| GDP per capita, current US\$ | 3,913 |
| International poverty rate (\$1.9) ^a | 5.7 |
| Lower middle-income poverty rate (\$3.2) ^a | 27.3 |
| Upper middle-income poverty rate (\$5.5) ^a | 58.9 |
| Gini index ^a | 37.9 |
| School enrolment, primary (% gross) ^b | 103.5 |
| Life expectancy at birth, years ^b | 69.4 |

Sources: WDI, Macro Poverty Outlook, and official data.
Notes: a. Most recent value (2017), 2011 PPPs. b. Most recent WDI value (2017).

Indonesia's sound macroeconomic policy framework continues to underpin economic growth, which has been broadly stable. However in 2019, the drivers of growth have shifted with investment growth decelerating from multi-year highs registered in 2018 and consumption picking up. Inflation has remained low, labor market conditions have strengthened and poverty has declined. The current account deficit remains substantial as export growth lagged. The economic outlook continues to be solid on strong domestic demand. International trade tensions and global financial volatility pose substantial risks.

Recent Developments

Indonesia's economy grew by 5.0 percent yoy in Q2, broadly unchanged from the pace in Q1 (Figure 1). Investment growth was flat from Q1 and slower than in 2018 on electoral uncertainty and lower commodity

prices. In contrast, private and government consumption growth accelerated from Q1. Exports contracted for the second consecutive quarter because of slower world trade and structural constraints to Indonesia's exports. Net exports made a positive contribution to growth as imports contracted more than exports, partly due to slowing investment. On the production side, gross value-added rose 5.0 percent in Q2, also broadly flat from Q1. Notably, the mining sector contracted after 8 consecutive quarters of growth, while growth in the agricultural sector surged to a nine-quarter high.

The current account deficit (CAD) remained stable as a share of GDP at 3.1 percent for the four quarters through Q2 2019, but widened in nominal terms to USD 8.4 billion in Q2 from USD 7.0 billion in Q1. Seasonal trends, such as dividend repatriation and external debt service interest payments, resulted in a higher primary income deficit. Meanwhile, the goods and services trade balance also worsened with easing world trade, higher oil prices and rising import demand for oil and gas during Hari Raya Festivities and school holidays. The capital and financial account recorded a lower but still substantial surplus supported by foreign capital inflows. Overall, with the wider CAD and a smaller capital and financial account surplus, the balance of payments registered a deficit in Q2. Consequently, Bank Indonesia's international reserves fell to USD 123.8 billion by the end of June, still sufficient to cover 6.8 months of imports and government external debt service.

Inflation continued to be relatively muted in Q2 as food prices remained in check despite Hari Raya Festivities during the quarter. Robust capital flows have also supported the Rupiah which has stabilized at around at 14,100, enabling Bank Indonesia to cut its policy rate by 25 basis points each in July, August and September, in line with the easing by the U.S. Federal Reserve.

The Government's overall fiscal position complemented prudent monetary and exchange rate policies to ensure stability. Revenue growth slowed in the first half of 2019, while growth of expenditures strengthened modestly. Total

revenue growth softened as value-added tax collections and commodity-linked revenues contracted. Meanwhile, spending growth was driven by higher disbursements for social spending, civil servant salaries and bonuses. Capital spending contracted in part due to its smaller budget allocation this year.

In line with robust economic growth and strong domestic demand, Indonesia's labor market conditions remained buoyant at the beginning of 2019. The employment rate rose to another record high of 65.8 percent yoy in February 2019, while the unemployment rate fell to a record low of 5.0 percent. With the labor force growing more rapidly than the working-age population, the labor force participation rate rose to a four-year high in February 2019. At the same time, employee wages saw a recovery with average net monthly employee wages up by 5.2 percent after a decline last year. In line with low inflation rates and reduced prices of basic food commodities, strong labor market conditions and recent expansions in social assistance programs, the poverty rate fell to a record low of 9.4 percent in March 2019.

Outlook

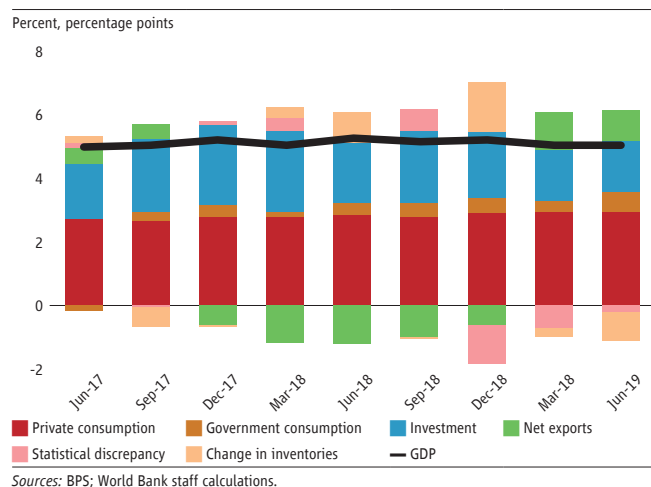
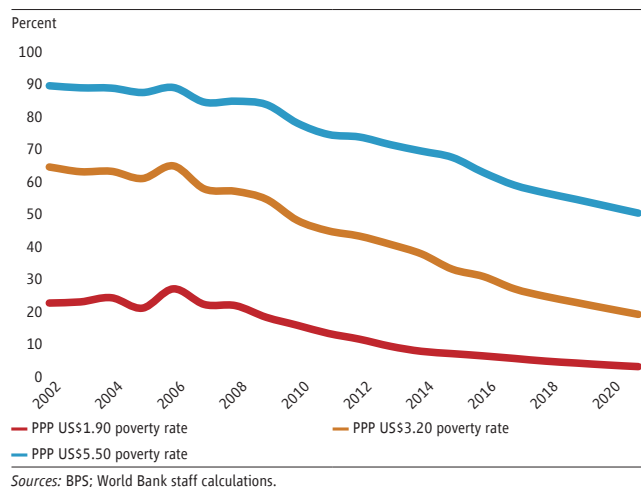
In light of unfavorable external conditions, economic growth is forecast to ease to 5.0 percent in 2019 and then recover gradually to 5.2 percent in 2021. Private consumption is expected to continue to be robust as inflation remains low and labor markets are strong. The fiscal position is expected to improve, allowing government investment to strengthen as infrastructure projects come back online. Though slower, investment growth is expected to remain robust, especially after the elections, with reduced political uncertainty and an improvement in business sentiment due to proposed reforms to attract FDI. Amid external headwinds, export growth is forecast to be weak. Import growth is also expected to be weaker in line with slower investment growth. The current account deficit is expected to gradually narrow in near term from 2.8 percent of GDP in 2019.

Based on the international poverty line, the extreme poverty rate (population living below \$1.9 per day) declined by 0.8 percentage point from 2017 to 4.9 percent in 2018, lifting nearly 2 million people out of extreme poverty (Figure 2). Extreme poverty is expected to continue falling in the medium term, but at a slower rate of the reduction. The extreme poverty rate is projected to fall to 4.3 percent in 2019, 3.7 percent in 2020 and 3.2 percent in 2021.

Risks and Challenges

Downside risks to the growth outlook have increased amid renewed global uncertainty. With the recent re-escalation of trade tensions, uncertainties surrounding global trade policy have again heightened and pose risks to world trade and China's growth outlook. Further escalation of trade disputes could weigh on regional growth and commodity prices, and therefore on Indonesia's economic growth and current account balance through weaker export receipts. The scope for further import compression is limited and is likely to have a toll on output growth as investment requires the import of capital goods. After a solid recovery last year, emerging market currencies are again under pressure as investors rebalance their portfolios with traditional safe-haven assets such as U.S. treasuries in lieu of emerging market assets. Higher bond yields and the consequent higher borrowing costs could dampen the recent credit recovery and further weigh on private investment and economic growth.

Despite recent progress in poverty reduction, one continuing challenge is to reduce inequality among regions in the country. From March 2018 to March 2019, 28 provinces successfully reduced the number of poor, whilst 6 provinces saw an increase. Eastern Indonesia, in particular, lags significantly. While Jakarta has the lowest poverty rate at 3.5 percent, Papua has the highest at 27.5 percent.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Poverty rates, actual and projected**

| INDONESIA Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|--|-------------|-------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 5.0 | 5.1 | 5.2 | 5.0 | 5.1 | 5.2 |
| Private Consumption | 5.0 | 5.0 | 5.1 | 5.2 | 5.1 | 5.2 |
| Government Consumption | -0.1 | 2.1 | 4.8 | 5.1 | 5.3 | 5.4 |
| Gross Fixed Capital Investment | 4.5 | 6.2 | 6.7 | 5.0 | 5.5 | 6.0 |
| Exports, Goods and Services | -1.7 | 8.9 | 6.5 | -1.0 | 1.5 | 2.8 |
| Imports, Goods and Services | -2.4 | 8.1 | 12.0 | -3.5 | 2.0 | 3.7 |
| Real GDP growth, at constant factor prices | 4.6 | 4.8 | 5.0 | 5.0 | 5.1 | 5.2 |
| Agriculture | 3.4 | 3.9 | 3.9 | 3.3 | 3.7 | 3.6 |
| Industry | 3.8 | 4.1 | 4.3 | 3.8 | 4.4 | 4.2 |
| Services | 5.7 | 5.7 | 5.8 | 6.7 | 6.1 | 6.5 |
| Inflation (Consumer Price Index) | 3.5 | 3.8 | 3.2 | 3.1 | 3.5 | 2.8 |
| Current Account Balance (% of GDP) | -1.8 | -1.6 | -3.0 | -2.8 | -2.7 | -2.5 |
| Net Foreign Direct Investment (% of GDP) | 1.7 | 1.8 | 1.3 | 1.8 | 1.8 | 1.9 |
| Fiscal Balance (% of GDP) | -2.5 | -2.5 | -1.8 | -2.0 | -2.1 | -2.1 |
| Debt (% of GDP) | 28.0 | 29.4 | 29.8 | 30.1 | 30.1 | 29.9 |
| Primary Balance (% of GDP) | -1.0 | -0.9 | -0.1 | -0.3 | -0.4 | -0.3 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 6.5 | 5.7 | 4.9 | 4.3 | 3.7 | 3.2 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 31.1 | 27.3 | 25.0 | 23.1 | 21.3 | 19.5 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 62.8 | 58.9 | 56.5 | 54.4 | 52.3 | 50.2 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2011-SUSENAS and 2017-SUSENAS. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021. b) Projection using annualized elasticity (2011–2017) with pass-through = 1 based on GDP per capita in constant LCU.



| | 2018 |
|---|-------|
| Population, million | 7.0 |
| GDP, current US\$ billion | 18.1 |
| GDP per capita, current US\$ | 2,603 |
| International poverty rate (\$1.9) ^a | 22.7 |
| Lower middle-income poverty rate (\$3.2) ^a | 58.7 |
| Upper middle-income poverty rate (\$5.5) ^a | 85.0 |
| Gini index ^a | 36.4 |
| School enrolment, primary (% gross) ^b | 107.0 |
| Life expectancy at birth, years ^b | 67.0 |

Source: WDI, Macro Poverty Outlook, and official data.
Notes: a. Most recent value (2012), 2011 PPPs. b. Most recent WDI value (2017).

Economic growth in Lao PDR is projected to rebound to 6.5 percent in 2019, driven by investments in large infrastructure projects, and a resilient services sector. This is expected to improve earnings and reduce poverty. The Government remains committed to fiscal consolidation and contain public debt. The medium-term outlook remains quite favorable, but subject to downside risks. A key priority is to create the necessary fiscal space as well as build up foreign currency reserves to respond to shocks.

Recent Developments

Economic growth in Lao PDR is expected to recover to 6.5 percent in 2019, from 6.3 percent in 2018. Notwithstanding the continued fiscal tightening and uncertainty in the global economy, growth is projected to rebound in 2019 due to: (i) the low base effect in 2018 due to the impact of severe flooding last year; (ii) robust

growth in the construction sector, estimated at 18 percent (yoy), driven by strong investment inflows to large infrastructure projects, including the Lao-China railway; and (iii) a resilient services sector led by wholesale and retail trade. Growth in the services sector is expected to improve job and earning prospects especially among the poor, contributing to poverty reduction. Poverty (using the international poverty line) is projected to decline to 18.4 percent in 2019, from 18.9 percent in 2018.

Continued fiscal consolidation contributed to a slowdown in the accumulation of public debt in 2019. Tighter control on spending lowered the fiscal deficit to 4.4 percent of GDP in 2018 from 5.5 percent in 2017. The 2019 Budget plan underscores the Government's commitment to reducing the deficit further to 4.3 percent of GDP. Total expenditures declined by 14 percent (yoy) in Q1-2019 due to tight control on investment spending and wages. Strengthening tax administration contributed to 10 percent (yoy) increase in domestic revenues in Q1-2019. Public debt to GDP ratio is estimated at 58 percent of GDP in 2019, slightly up from 57.2 percent in GDP in 2018. The risk of debt distress remains high. However, fiscal consolidation is expected to curb the debt to GDP ratio to 55.5 percent by 2021.

The current account deficit is expected to slightly widen in 2019 reflecting strong demand for imports related to investments in the large infrastructure projects. Exports earnings in the first half of 2019 remained stable (at USD 2.5 billions), as the rise in agriculture exports, which grew by 28 percent (yoy), and wood pulp, which grew by ten-fold from a low base, offset the sharp fall in copper and electronic products exports in the first half of 2019. Lower copper prices and maturity of the major mines contributed to the decline in the value of copper exports. Electricity exports remained stable compared to the same period last year. Strong demand for machinery, equipment and vehicles to support construction of large infrastructure projects contributed to large imports. The current account deficit is mainly financed by foreign direct investment (FDI) associated with large infrastructure projects. The continued appreciation of US dollar against regional currencies, strong Thai baht and large current

account deficit resulted in notable depreciation of the Lao Kip. Reserves remained stable at US\$ 870 million in June 2019, at 1.2 months of imports, below the prudent level. The authorities would face difficulty in responding to future economic shocks such as a faster than expected slowdown in global economy given the low level of foreign currency reserves and elevated external public debt.

Price pressure started to mount in July 2019. The headline inflation rose to 3 percent in July 2019 from 2.4 percent last July while core inflation is contained under 2 percent. The increase in headline inflation was driven by: (i) higher food prices, particularly rice prices due to unfavorable weather condition and the 2018 floods; (ii) the depreciation of the kip against the Thai baht and the U.S. dollar, which increased the price of imported goods; and (iii) the gradual pick up in private sector credit growth. Credit growth, although still moderate, picked up slightly from 3 percent at the end of 2018 to 5.2 percent in July 2019.

Outlook

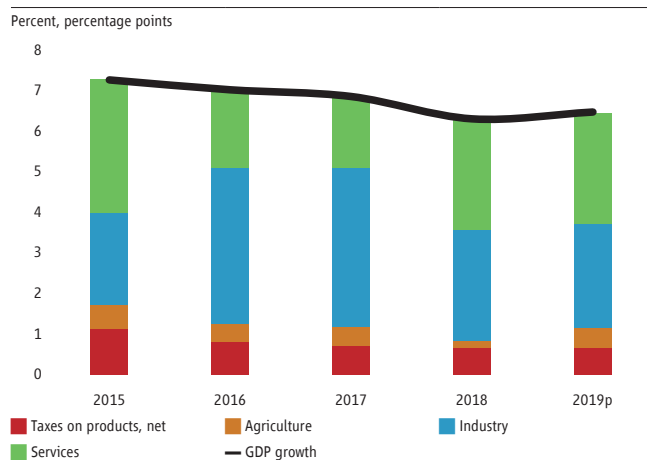
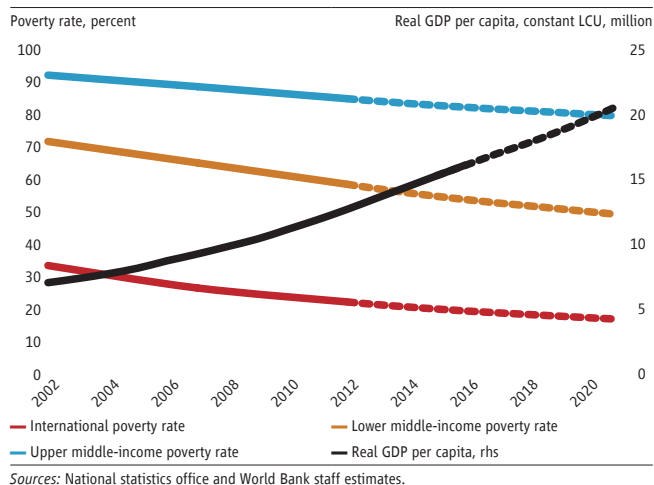
Growth is expected to rebound to an average of 6.7 percent in 2020-21 period. Growth in the construction and service sectors is expected to remain robust in the medium term due to continued infrastructure investment. Sustained growth is expected to provide favorable conditions for poverty reduction, particularly a recovery in the agricultural sector and continued infrastructure investment. Poverty (using the international poverty line) is projected to continue to decline and fall below 18 percent in 2020-21.

The completion of several hydropower projects, which include the Sayaboury (1,285 MW), Nam Ngiep 1 (290 MW), Xe-Pian Xe-Namnoy (410 MW), are expected to add an extra 2,200 MW of capacity (primarily for export) by 2020. Improvement in power export and reduction of imports after the completion of large projects are likely to bring down the current account deficit in the medium term.

The fiscal deficit is expected to decline to below 4 percent by 2021, which is expected to reduce public debt to GDP ratio. To achieve this deficit target, the Government will focus on improving revenue mobilization and further rationalizing public expenditure. The fiscal consolidation, coupled with the recently approved public debt management law and upcoming debt management strategy, is expected to reduce public debt levels to below 56 percent of GDP in 2021 from an estimated 57.2 percent of GDP in 2018. The containment of the fiscal and external deficits is necessary for maintaining macroeconomic stability and lowering the pressure on the foreign currency reserves.

Risks and challenges

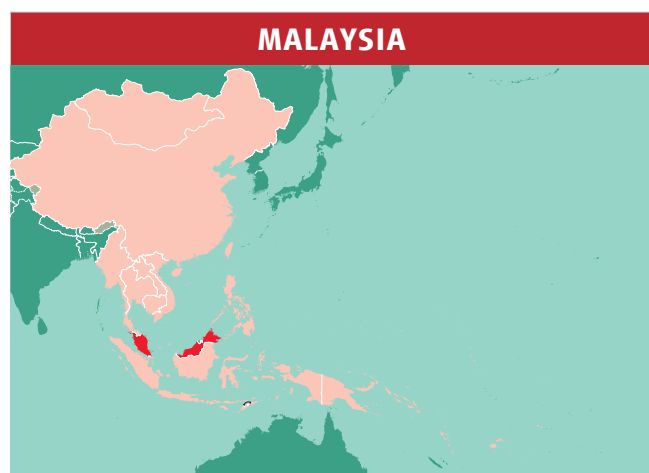
The medium-term outlook is subject to downside risks from heightened uncertainty in the global and domestic environments. Prolonged trade tensions among major economies could dampen growth in Lao PDR's major trading partners, spilling over to the domestic economy through lower trade and investment, and reduced prices for key export commodities. The authorities may face difficulty in responding to such economic shocks given the low level of foreign currency reserves and limited fiscal space. Domestic risks include more frequent and severe weather-related shocks and limited progress on reforms, particularly fiscal consolidation. Commodity prices and weather-related shocks are a major risk among poor and vulnerable population. The issue continues to be a challenge towards sustainable poverty reduction in Lao PDR. A priority is therefore to create fiscal space as well as build up foreign currency buffers to respond to shocks. Continued efforts in complementing existing programs with a focus on agricultural resilience and job creation would contribute to further reducing poverty and supporting inclusive growth.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Actual and projected poverty rates and real GDP per capita**

| LAO PDR Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|-------|-------|-------|-------|-------|-------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 7.0 | 6.9 | 6.3 | 6.5 | 6.7 | 6.6 |
| Real GDP growth, at constant factor prices | 6.9 | 6.8 | 6.3 | 6.5 | 6.7 | 6.6 |
| Agriculture | 2.8 | 2.9 | 1.3 | 2.7 | 2.8 | 3.2 |
| Industry | 12.0 | 11.6 | 7.8 | 7.6 | 8.5 | 8.0 |
| Services | 4.6 | 4.4 | 6.9 | 6.9 | 6.5 | 6.5 |
| Inflation (Consumer Price Index) | 1.6 | 0.8 | 2.0 | 2.1 | 2.5 | 2.3 |
| Current Account Balance (% of GDP) | -12.5 | -12.1 | -11.0 | -12.1 | -11.8 | -11.1 |
| Fiscal Balance (% of GDP) | -4.6 | -5.5 | -4.4 | -4.3 | -4.0 | -3.8 |
| Debt (% of GDP) | 56.4 | 55.8 | 57.2 | 58.0 | 56.2 | 55.5 |
| Primary Balance (% of GDP) | -3.4 | -4.1 | -2.9 | -2.5 | -2.2 | -2.1 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 20.0 | 19.4 | 18.9 | 18.4 | 17.9 | 17.4 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 54.0 | 53.0 | 52.2 | 51.3 | 50.4 | 49.5 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 82.3 | 81.7 | 81.2 | 80.6 | 80.1 | 79.5 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2007-LECS and 2012-LECS. Actual data: 2012. Nowcast: 2013–2018. Forecast are from 2019 to 2021. b) Projection using annualized elasticity (2007–2012) with pass-through = 1 based on GDP per capita in constant LCU.



| | 2018 |
|---|--------|
| Population, million | 32.0 |
| GDP, current US\$ billion | 358.1 |
| GDP per capita, current US\$ | 11,178 |
| International poverty rate (\$1.9) ^a | 0.0 |
| Lower middle-income poverty rate (\$3.2) ^a | 0.2 |
| Upper middle-income poverty rate (\$5.5) ^a | 2.7 |
| Gini index ^a | 41.0 |
| School enrolment, primary (% gross) ^b | 103.1 |
| Life expectancy at birth, years ^b | 75.5 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2015), 2011 PPPs. b. Most recent WDI value (2017).

Malaysia's economy grew moderately at 4.5 and 4.9 percent in the first two quarters of 2019. While private consumption has remained resilient, overall economic activity has been weighed down by softer-than-expected investment growth and weakening export demand. GDP growth of 4.6 percent is projected for 2019, with risks to growth outlook tilted towards the downside. There are no new poverty data in 2019, but an active public debate on the appropriate level of the poverty line has recently emerged.

Recent Developments

Malaysia's economic activity has continued to expand at a relatively moderate pace in the first half of 2019, growing at 4.5 and 4.9 percent in Q1 and Q2 2019, respectively. Household spending, the primary driver of growth, has remained robust, supported by continued wage growth

and by a moderation in consumer price inflation. Overall economic activity, however, was constrained by softer than expected growth in investment activity. Private investment slowed materially during the period, with continuing uncertainty arising from both domestic and external factors appearing to have weighed on business confidence. The recent weakness in business investment spending was further dampened by the continued contraction in public investment amid the ongoing reviews of major infrastructure projects.

On the external front, net trade contributed positively to growth despite softening export expansion, as the subdued export performance was more than offset by a contraction in import demand during the period. The moderation in the export growth of electronics and electrical (E&E) products was particularly noticeable, consistent with the cyclical slowdown in the global technology cycle. Meanwhile, much of the decline in import demand was attributable to the contraction of capital imports, in line with the recent slowdown in investment activity.

Domestic financial markets have been affected by heightened risk aversion, mainly reflecting concerns regarding weakening global growth and the ongoing trade tensions among major economies. Malaysia's open economy is closely integrated into global value chains, making it particularly susceptible to changes in external demand. Domestically, speculation that Malaysia would be excluded from the FTSE Russell World Government Index also contributed to a relatively sizable unwinding of non-resident holdings of Malaysia Government Securities in April. The Central Bank of Malaysia took the decision to lower its policy rate to 3.0 percent in May to preserve the current degree of monetary accommodativeness. The current account surplus widened to 4.5 and 3.8 percent in Q1 and Q2 2019, largely reflecting a narrower deficit on primary income.

Labor market conditions have been stable, with unemployment remaining at 3.3 percent over the past three quarters and labor force participation increasing marginally to 68.6 percent in Q2 2019. Wage growth in the

manufacturing sector continued to moderate in Q2 2019 and was lower than wage growth in the services sector. Inflation has been subdued, with the CPI increasing only 0.2 percent in the first half of 2019, though somewhat higher for food & non-alcoholic beverages and housing & utilities. The addition of a child benefit to the main cash transfer program potentially increases the progressivity of benefits, but the benefit levels remain small relative to recipients' incomes.

Federal government debt as a share of GDP increased slightly to 51.2 percent in 2018 to accommodate several fiscal policy changes, which resulted in the upward adjustment in the fiscal deficit to 3.7 percent of GDP last year. Total committed government guarantees, serviced by the government to finance the ongoing infrastructure projects, also increased in 2018 to 9.2 percent of GDP.

Outlook

The World Bank's GDP growth forecast is maintained at 4.6 percent in 2019, underpinned by the continued robust growth in private consumption amid stable labor market conditions. The weakness in the external sector is likely to persist over the near term, with heightened uncertainty surrounding the external environment and softening global demand for E&E products constraining export growth. Investment activity is projected to remain subdued over the year, with both the public and private sectors continuing to adopt a cautious stance towards capital spending. The government remains committed to fiscal consolidation, with a continued expectation of the 3.4 percent fiscal deficit target being achieved in 2019. The planned conversion of the universal fuel subsidy to a cash transfer targeted to the bottom 40 percent (B40) has been delayed because of administrative hurdles.

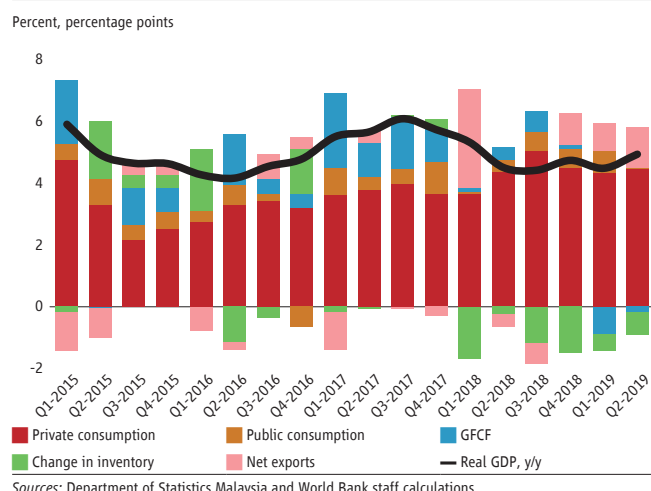
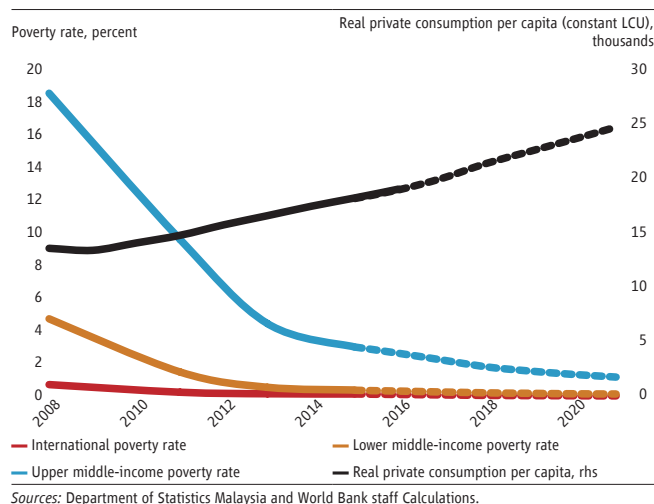
Despite low consumer price inflation, concerns about the rising cost of living persist among the public and government. The leading issues are shortages of affordable housing, the extent of household debt, lagging wages in some sectors and higher than average food price inflation.

Policies to ease the availability and financing of housing are being expanded and a national financial literacy program has been launched.

Monetary poverty is projected to continue its downward trend in 2019, with a projected decline to 1.3 percent based on the World Bank's upper middle-income countries (UMIC) poverty line of USD5.50 (2011 PPP) per person per day. At Malaysia's high GNI per capita, especially in PPP-adjusted terms, even the UMIC poverty line is of diminishing usefulness and a public debate has emerged about whether Malaysia should increase its nationally-defined poverty line.

Risks and Challenges

Risks to Malaysia's growth outlook continue to tilt towards the downside. On the external front, sharper than expected slowdowns in major economies, unresolved trade tensions and a maturing global technology cycle could weigh on Malaysia's export demand in the near term. Increased uncertainty could also lead to more subdued business sentiment and to a moderation in private sector activity. Meanwhile, Malaysia's comparatively high level of government liabilities will continue to exert constraints on fiscal space available in the event of macroeconomic shocks. More could be done to diversify sources of revenue, including through a realignment of tax incentives, an expansion of personal income taxes, and a broadening of the sales and services taxes in order to rebuild fiscal buffers. In the private sector, elevated household debt in the context of property market excesses remains a source of risk to macro-financial stability, as well as acting a constraint on household spending.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Actual and projected poverty rates and real private consumption per capita**

| MALAYSIA Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 4.4 | 5.7 | 4.7 | 4.6 | 4.6 | 4.6 |
| Private Consumption | 5.9 | 6.9 | 8.0 | 7.1 | 6.6 | 6.3 |
| Government Consumption | 1.1 | 5.5 | 3.3 | 1.8 | 1.7 | 1.7 |
| Gross Fixed Capital Investment | 2.6 | 6.1 | 1.4 | -1.1 | 0.5 | 1.4 |
| Exports, Goods and Services | 1.3 | 8.7 | 2.2 | 0.5 | 0.5 | 0.4 |
| Imports, Goods and Services | 1.4 | 10.2 | 1.3 | -1.1 | 0.0 | 0.1 |
| Real GDP growth, at constant factor prices | 4.4 | 5.6 | 5.0 | 4.6 | 4.5 | 4.6 |
| Agriculture | -3.7 | 5.8 | 0.1 | 4.2 | 2.8 | 2.7 |
| Industry | 4.3 | 4.7 | 3.2 | 2.7 | 3.1 | 3.2 |
| Services | 5.7 | 6.4 | 6.9 | 6.0 | 5.7 | 5.7 |
| Inflation (Consumer Price Index) | 2.1 | 3.8 | 1.0 | 0.8 | 1.7 | 1.8 |
| Current Account Balance (% of GDP) | 2.4 | 2.9 | 2.3 | 3.1 | 2.7 | 2.6 |
| Net Foreign Direct Investment (% of GDP) | 1.1 | 1.2 | 0.8 | 0.8 | 0.7 | 0.7 |
| Fiscal Balance (% of GDP) | -3.1 | -2.9 | -3.7 | -3.4 | -3.1 | -2.9 |
| Debt (% of GDP) | 51.9 | 50.1 | 51.2 | 51.4 | 51.5 | 51.3 |
| Primary Balance (% of GDP) | -1.0 | -0.9 | -1.6 | -1.4 | -1.2 | -1.0 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 2.3 | 1.9 | 1.5 | 1.3 | 1.1 | 1.0 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2011-HIS and 2015-HIS. Actual data: 2015. Nowcast: 2016–2018. Forecast are from 2019 to 2021. b) Projection using point-to-point elasticity (2011–2015) with pass-through = 1 based on private consumption per capita in constant LCU.



MONGOLIA

2018

| | |
|--|-------|
| Population, million | 3.2 |
| GDP, current US\$ billion | 13.0 |
| GDP per capita, current US\$ | 4,103 |
| National Official Poverty Rate ^a | 28.4 |
| Gini index ^b | 32.0 |
| School enrolment, primary (% gross) ^c | 104.5 |
| Life expectancy at birth, years ^c | 69.5 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. National Statistics Office. Most recent value (2018). b. Most recent WDI value (2016). c. Most recent WDI value (2017).

Mongolia's growth momentum has continued in 2019H1 led by mineral exports, robust private investment and improved market sentiments. This has helped to reduce poverty, though high inflation rate has diminished the overall effect. Growth outlook remains positive in the near to medium term, driven by private consumption, and mining sector investment. Risks to the outlook include political uncertainty, commodity price shocks, cross-border bottlenecks, implementation delay involving mega projects and slower implementation of banking sector reforms.

Recent Developments

The growth momentum continued in 2019 H1, as real GDP at market price rose to 7.3 percent from 6.8 percent in 2018 and 6.6 percent in 2018 H1. This robust economic performance has largely been supported by a strong coal sector (boosted by higher prices and volume) and

increased private investment. Improved market confidence following a \$5.5 billion multi-donor support package, skillful management of the macroeconomy, especially on the fiscal side, and steady progress on structural reforms have contributed to this strong economic performance. The solid recovery of private consumption, which started in 2017-18, continued in 2019 H1, largely on the back of positive developments in the labor market (e.g., decline in the unemployment rate) and accommodative credit policy. Meanwhile, inflation accelerated to 8.1 percent in 2019 H1 (close to the central bank target of 8 percent), driven by rising food and oil prices and strong domestic demand. However, the gradual tightening of the monetary stance since late-2018 has sharply decelerated credit growth (particularly individual loans), which fueled inflation and imports in most of 2018. The average real household income has also continued to grow strongly by 10.3 percent in 2019 H1, mainly driven by the public sector wage increase, and strong rural income growth.

The fiscal overperformance continued in 2019 H1, supported by a robust revenue performance and a steady implementation of fiscal consolidation reforms. The capital budget under-execution also played a role. Overall fiscal balance turned around from a record high deficit of 15.3 percent of GDP in 2016 to a surplus of 2.6 percent in 2018 and 3.4 percent in 2019 H1. Substantial improvements in the fiscal balance contributed to the sharp reduction in government debt in 2017-18.

After an escalation in 2018, external sector pressures have eased, largely driven by a rapid deceleration of import growth (goods and services), bank credit growth and robust FDI and portfolio investment inflows. The current account balance improved to a deficit of 4.9 percent of GDP in 2019 H1 from 6.7 percent in 2018 H1. Mineral exports (mainly coal and iron ore) supported exports growth of 2019 H1. Strong FDI inflows and a bond issuance of US\$300 million by private sector in 2019 H1 resulted in a moderate surplus in the balance of payments (BoP). Gross international reserves continued to rise, reaching US\$ 4 billion (about 5 months of imports) in 2019 H1. Despite limited reserves, extensive BoM foreign exchange

interventions of 2018 have continued in 2019 H1. Increased foreign exchange interventions has led to only a moderate depreciation of the tugrug against the US\$ in 2019 H1 and a slight appreciation against the Chinese RMB, unlike many regional peers.

Meanwhile, with a higher inflation compared to major trading partners (China and Russia), real effective exchange rate appreciated by 4.2 percent in 2019 H1, which may affect the export competitiveness of the non-mining sector.

Outlook

Supported by strong domestic demand, sustained FDI flows, and robust commodity exports, real GDP growth at market price is projected to slightly accelerate to 6.9 percent in 2019 (revised downward from our initial projections of 7.2 percent), from 6.8 percent in 2018. The latest downward revision can be explained by recent fall in copper prices and expected lower gold content of Oyu Tolgoi (OT)'s copper production. Growth will decelerate to about 6 percent in 2020–21, as OT's first production date is delayed beyond 2022. Private investment supported by FDI and domestic credit (particularly corporate loans) will remain a key driver for growth in the medium-term, especially in mining, manufacturing, and transport services. Inflation is likely to remain elevated in 2019, before moderating gradually in 2020–21. Private consumption will be a key driver of medium-term growth and poverty reduction. The base case assumes a gradual tightening of monetary policy to contain inflation.

Agriculture sector growth is projected to average 4.7 percent in the medium term. Meanwhile, industry would grow by about 5.5 percent in 2019–21, due to declining commodity prices and potential implementation delay of mega mining projects. Strong linkages with mining would continue to support the services sector growth.

The base case assumes that fiscal deficit would average about 1.5 percent of GDP in 2019–21, consistent with a

lower debt path. The growth of investment related imports is expected to moderately decelerate in 2020–21, gradually reducing current account deficit. Foreign exchange market pressures will likely ease with the disbursement of donors' support and further inflows of FDI. Gross international reserves would continue to improve to 5.3 months of imports in 2019 from 4.9 months in 2018. In this context, BoM should encourage greater flexibility of the exchange rate through limited interventions to support economic diversification.

The robust medium-term macro outlook is expected to contribute to further poverty reduction.

Risks and Challenges

The risks to the medium-term growth outlook include political uncertainty with the 2020 election, the escalation of the trade war between China and USA, climate shocks (drought/flooding, harsh winter), bottlenecks at the China border and lack of progress on recapitalization of the banking sector and anti-money laundering (AML) issues.

Growing political uncertainty could induce a sudden relaxation of the government's commitment to reforms, thereby affecting market sentiments and FDI flows. So far, the government has made an unprecedented effort to break-out of the stimulus and austerity cycle surrounding past elections. Growth prospects could be adversely affected by an escalation of the trade war and its impact on the price of key exporting commodities (particularly copper).

Weather related shocks and resumption of non-trade barriers at the border with China could affect Mongolia's coal exports. Inability to recapitalize the banking sector adequately could create instability and delay the disbursement of official support.

Mongolia's limited progress on AML issues (particularly in implementation part) is an additional risk, given its potential effect on FDI, and the financial sector. An

emerging upside risk to the outlook is the accelerated progress on the construction of the oil-refinery project and progress on US-Mongolia trade agreement following the July 2019 visit of the Mongolian President to the USA.

Figure 1. Real GDP growth and contributions to real GDP growth

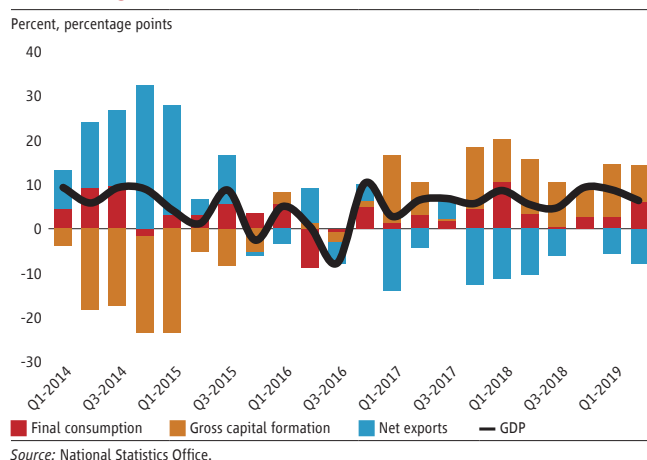
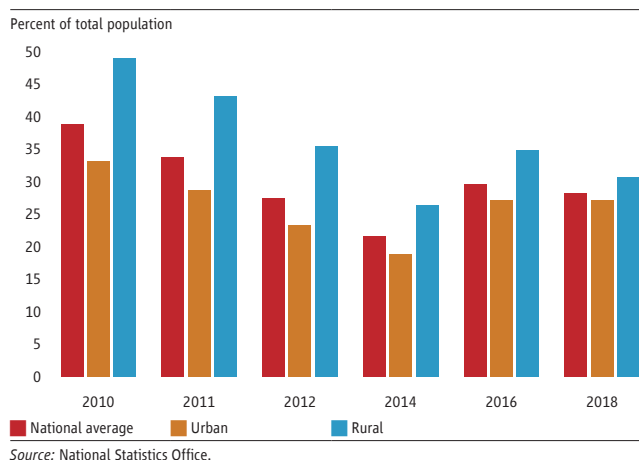
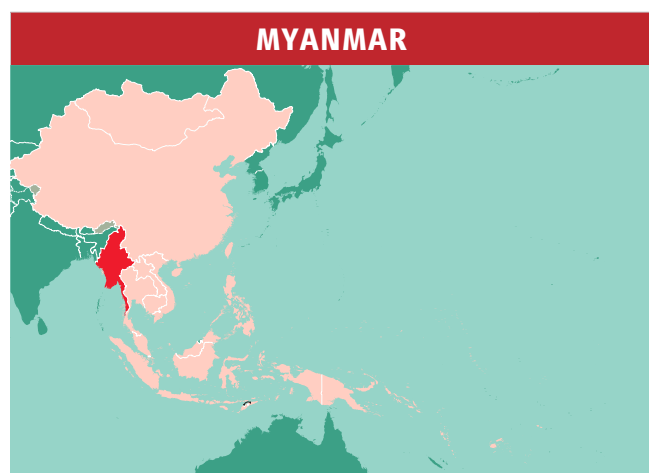


Figure 2. Poverty rate (official poverty line): 2010–18



| MONGOLIA Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|--|--|-------------|-------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 1.4 | 5.4 | 6.8 | 6.9 | 6.3 | 5.9 |
| Private Consumption | -2.2 | 5.3 | 6.2 | 5.7 | 6.0 | 6.3 |
| Government Consumption | 10.6 | -1.8 | 0.5 | 5.4 | 6.3 | 7.8 |
| Gross Fixed Capital Investment | 0.5 | 35.6 | 22.4 | 10.0 | 5.7 | 4.5 |
| Exports, Goods and Services | 13.8 | 14.8 | 13.4 | 5.4 | 2.6 | 4.9 |
| Imports, Goods and Services | 12.7 | 24.8 | 20.8 | 4.8 | 1.9 | 4.4 |
| Real GDP growth, at constant factor prices | 1.2 | 5.3 | 7.2 | 6.9 | 6.3 | 5.9 |
| Agriculture | 6.2 | 1.8 | 4.5 | 5.0 | 4.5 | 4.5 |
| Industry | -0.4 | 0.7 | 7.4 | 6.2 | 5.3 | 5.0 |
| Services | 1.0 | 11.0 | 7.9 | 8.2 | 7.8 | 7.1 |
| Inflation (Consumer Price Index) | 1.3 | 6.4 | 8.1 | 8.5 | 8.3 | 7.2 |
| Current Account Balance (% of GDP) | -6.3 | -10.1 | -17.0 | -14.4 | -12.5 | -11.9 |
| Net Foreign Direct Investment (% of GDP) | 1.3 | 12.6 | 15.8 | 13.0 | 11.4 | 11.2 |
| Fiscal Balance (% of GDP) | -15.3 | -3.5 | 2.6 | -1.3 | -1.7 | -1.5 |
| Debt (% of GDP) | 87.6 | 84.7 | 74.4 | 71.4 | 68.0 | 62.4 |
| Primary Balance (% of GDP) | -11.4 | 0.3 | 5.7 | 1.2 | 0.5 | 0.7 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate; f = forecast.



MYANMAR

2018

| | |
|---|-------|
| Population, million | 53.9 |
| GDP, current US\$ billion | 71.6 |
| GDP per capita, current US\$ | 1,329 |
| International poverty rate (\$1.9) ^a | 6.2 |
| Lower middle-income poverty rate (\$3.2) ^a | 29.5 |
| Upper middle-income poverty rate (\$5.5) ^a | 67.2 |
| School enrolment, primary (% gross) ^b | 113.0 |
| Life expectancy at birth, years ^b | 66.7 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2015), 2011 PPPs. b. Most recent WDI value (2017).

GDP growth slowed to 6.5 percent in 2018/19 from 6.8 percent in 2017/18. This moderation reflects weaker growth in services. High inflation impacted private consumption by eroding real private income. The medium-term outlook continues to be positive with projected growth of 6.8 percent by 2021/22, driven by investment in manufacturing, insurance and construction sectors. The positive outlook is expected to support poverty reduction through job creation. However, downside risks to growth outlook are significant on account of global economic uncertainty, the Rakhine crisis and domestic conflicts.

Recent Developments

Growth is projected to ease to 6.5 percent in 2018/19 from 6.8 percent in 2017/18 driven by a slowdown in services sector. Wholesale and retail trade, which accounts for 17 percent of GDP, has been impacted by recent price hikes. High inflation and related cost pressures have eroded real private income, impacting domestic

trade performance and reducing private consumption. The Industry sector, which represents 29 percent of the economy, is expected to continue to grow, driven by new investments in manufacturing sector. The average headline Purchasing Managers Index (PMI) has been firmly above 50 in H1, indicating expansion in manufacturing output. Headline inflation is expected to jump to 8.4 percent in 2018/19 from 5.4 percent the previous year. In June 2019, inflation reached 9.5 percent (yoy) reflecting rising food prices and, transport prices including the passthrough effect from the recent increase in energy tariffs. Although the impact of monsoon on agriculture are yet unknown, seasonal flooding displaced an estimated 150,000 people and raised food prices.

Myanmar Kyat has been stable at an average of 1,522 Kyat per USD in H1 2018/19 since December, allowing the central bank to gradually replenish foreign exchange reserves. With inflation higher compared to its trading partners, the appreciation of the real effective exchange rate is likely to have affected export competitiveness. The current account deficit has narrowed due to a decline in import growth while export growth has eased to 12 percent in H1 2018/19, from 15 percent in the same period previous year. Meanwhile, cumulative approved foreign direct investment increased to USD 3.2 Billion in Q3 2018/19 Q3 to USD 2 Billion in the same period last year. International reserves have accumulated to USD 5.4 Billion by February 2019, from USD 5.3 Billion in December of last year. The budget deficit is projected at 3.5 percent in 2018/19, considerably lower than the original budget target of 5.4 percent of GDP, driven by significant underspending. The original budget deficit target is underpinned by a planned increase in capital expenditure, from 4.3 percent of GDP in 2017/18 to 5.4 percent of GDP in 2018/19. However, this increase is unlikely to materialize as budget execution remains a challenge.

Ongoing reforms to strengthen the financial and tourism sectors are expected to encourage further private investment. In May 2019, the Central Bank of Myanmar tightened the interest rate margin on credit card and microfinance lending which is expected to slow down high

risk consumer lending. At the same time MOPF lowered interest rate cap on microfinance institutions, encouraging micro businesses to invest and expand the non-resource economy. Other notable reforms include relaxation of visa restrictions to six EU countries to boost tourism and expansion of tax base by collecting commercial taxes on mobile phones and its accessories. Advance income taxes on trade have been reinstated after a one-year exemption.

Outlook

Growth is expected to pick up gradually in the medium term. Growth is estimated to gradually increase to 6.8 percent in 2021/22 driven by broad-based pick-up in activity, particularly in the agriculture sector. Policy measures to encourage investment, such as those introduced in the energy sector, opening the insurance sector to foreign players, free visa allowance etc., are likely to significantly boost growth in manufacturing, insurance and construction sectors.

Inflationary pressures are expected to remain high in the medium term, with inflation forecast between 7–8.5 percent driven by supply side constraints and passthrough effects from increased electricity tariffs. A more expansionary fiscal stance towards elections in October 2020 expects to create demand side inflationary pressures.

The fiscal deficit is forecasted to increase modestly despite budget execution challenges, due to weak revenue mobilization. Revenue collection are projected to stagnate in the medium-term unless tax policy and administrative reforms are accelerated. The impact of declining revenues on the deficit is likely to be counterbalanced by continued challenges in budget execution, despite ambitious spending plans in the energy, education and health sectors, and reduced subsidy burden.

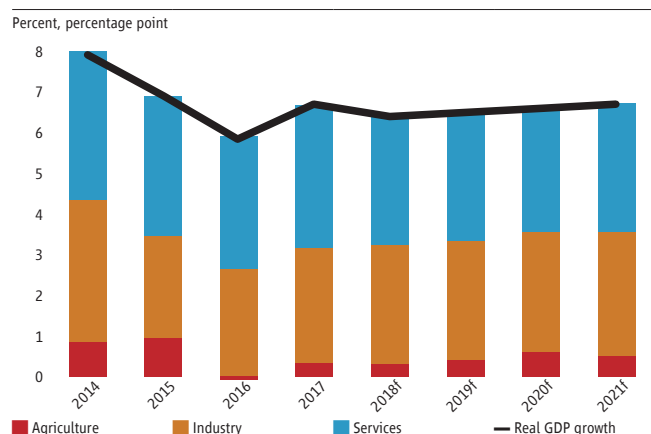
The positive trend in poverty reduction is expected to continue. Poverty was halved between 2005 and 2017 (from 48 to 25 percent), based on the national poverty line. Strong growth likely decreased poverty further, although

unevenly across the country. Poverty is 2.7 times higher in rural than urban areas, and limited agricultural growth suggests that poor agricultural households continue to see slower progress. The expected pick-up in manufacturing and construction could further accelerate poverty declines in urban areas, through low-skill employment opportunities for members of poor households.

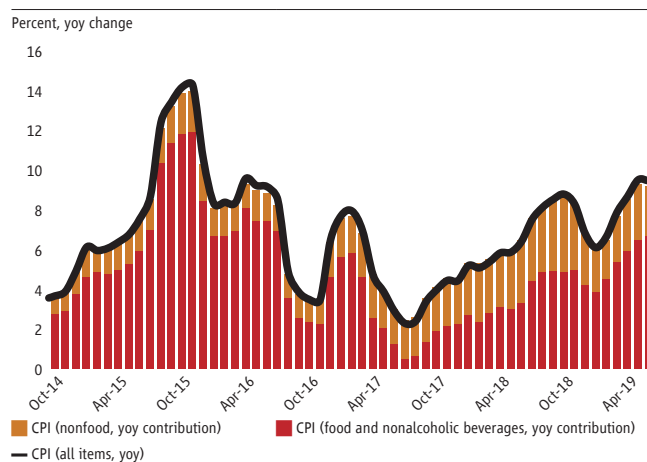
Risks and Challenges

Downside risks dominate Myanmar's economic outlook, which include natural disasters, global trade policy uncertainty and the slowdown in China. The agriculture sector is highly exposed to natural disasters and fluctuations in demand from major trading partners and supply shocks that could ripple through supply chains involving businesses from farms to trading companies. Frequent disasters can create considerable fiscal pressures and the government needs to have sufficient fiscal buffers and financing instruments available to appropriately respond to future shocks. The external sector is exposed to the heightened uncertainty surrounding the global trade policy environment, especially as China is the largest export destination for Myanmar. Persistent domestic conflicts, including the Rakhine crisis, remains a downside risk through their effect on investor sentiments and tourism related services and uncertainty surrounding the possible revocation of preferential trade access for the EU market.

Policy instruments to address the macro-stability risks arising from external and internal imbalances are limited. The impact of inflationary pressures from supply shocks needs to be monitored, as poorer households tend to devote a high share of monthly expenditure to food. Electricity tariffs were increased in a way that is expected to affect poor and near-poor households proportionately less than better-off households, given prices remain low for households with more limited electricity consumption. Nevertheless, it will be important to monitor the actual impact of increased tariffs on vulnerable households and take preemptive actions to protect their welfare.

Figure 1. Real GDP growth and contributions to real GDP growth

Sources: Ministry of Planning and Finance, and World Bank staff estimates.

Figure 2. CPI inflation

Sources: Central Statistical Organization and Wakhema exchange rate centre.

| MYANMAR Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|--|-------------|-------------|--------------|--------------|--------------|
| | Annual percent change unless indicated otherwise | | | | | |
| Real GDP growth, at constant market prices | 6.0 | 6.8 | 6.5 | 6.6 | 6.7 | 6.8 |
| Real GDP growth, at constant factor prices | 6.0 | 6.8 | 6.5 | 6.6 | 6.7 | 6.8 |
| Agriculture | -0.5 | 1.3 | 1.2 | 2.0 | 2.3 | 2.4 |
| Industry | 8.9 | 9.4 | 9.5 | 9.5 | 9.0 | 8.5 |
| Services | 8.4 | 8.3 | 7.5 | 7.0 | 7.3 | 7.8 |
| Inflation (Consumer Price Index) | 7.0 | 5.4 | 8.4 | 7.5 | 7.0 | 7.0 |
| Current Account Balance (% of GDP) | -2.8 | -5.7 | -2.0 | -2.5 | -3.0 | -3.5 |
| Fiscal Balance (% of GDP) | -2.5 | -3.0 | -4.1 | -3.7 | -3.9 | -4.2 |
| Primary Balance (% of GDP) | -1.1 | -1.3 | -2.2 | -2.0 | -2.2 | -2.4 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 5.9 | 5.7 | 5.3 | 5.1 | 4.8 | 4.5 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 28.7 | 27.6 | 26.6 | 25.4 | 24.4 | 23.3 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 66.4 | 65.1 | 64.0 | 63.0 | 61.8 | 60.7 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2015-MPLCS. Actual data: 2015. Nowcast: 2016–2018. Forecast are from 2019 to 2021. b) Projection using neutral distribution (2015) with pass-through = 0.3 based on GDP per capita in constant LCU.



2018

| | |
|----------------------------------|--------|
| Population, million | |
| Federated States of Micronesia | 0.11 |
| Republic of the Marshall Islands | 0.06 |
| Palau | 0.02 |
| GDP, US\$, billion | |
| Federated States of Micronesia | 0.34 |
| Republic of the Marshall Islands | 0.21 |
| Palau | 0.31 |
| GDP per capita, current US\$ | |
| Federated States of Micronesia | 3,058 |
| Republic of the Marshall Islands | 3,621 |
| Palau | 17,317 |

Sources: WDI, World Bank staff estimates.

Growth in the Federated States of Micronesia and Republic of the Marshall Islands is projected to have remained stable in FY2019 supported by donor-funded construction, while a recovery in the tourism sector is expected to have driven a further rebound in growth in Palau. While high fishing revenues have bolstered fiscal balances, substantial fiscal risks remain, including due to the scheduled expiry of Compact-related grants and programs from the U.S. Government (predominantly for infrastructure, health and education) in 2023–2024.

Recent Developments

The economy of the Federated States of Micronesia (FSM) is expected to have grown by 1.4 percent in FY2019 following growth of 1.2 percent in FY2018. This marks a

fifth consecutive year of positive growth, and the longest period of sustained economic expansion since 2003. Nevertheless, output is only slightly higher than it was in 2003, highlighting the economy's uneven performance over the past 15 years. Growth in FY2019 was likely driven by higher production in the fisheries sector and increased construction activity related to infrastructure projects. The sluggish growth performance over recent years has weighed on formal sector employment, which—according to the latest available data (2017)—was around 15,600 employees; 3 percent below its FY2011 level. This is likely to have exacerbated poverty in basic needs, because consumption tends to be lower for those who are economically inactive or engaged in informal activities. The latest estimates indicate that 41.2 percent of the population were unable to afford the cost of basic needs in 2013/14. Inflation has been subdued in recent years and is expected to have remained below 2 percent in FY2019, due to lower domestic fuel prices and a stronger US dollar (the official currency of the FSM) holding down prices for some imports. After traditionally registering large deficits, the current account is projected to have registered its fifth consecutive surplus in FY2019, reflecting higher fishing license receipts and grant inflows related to the Compact of Free Association with the United States.

FSM's fiscal performance has improved significantly in recent years. Substantial increases in fishing license fees resulting from the introduction of the Vessel Day Scheme (a regional agreement that establishes the minimum price of a vessel day and limits the total number of vessel days sold), combined with one-off tax payments by captive insurance companies in FY2014, FY2017 and FY2018, resulted in average annual fiscal surpluses of 14 percent of GDP during FY2014–FY2018. While general tax revenue (excluding irregular captive insurance industry payments) has remained steady at around 12 percent of GDP, which is low relative to other countries in the Pacific, non-tax revenue (excluding grants) have more than doubled as a percent of GDP since 2011 to around 24 percent of GDP reflecting higher fishing license fees. Another sizeable fiscal surplus is projected for FY2019 following another large captive insurance tax payment. The government has

prudently transferred fiscal surpluses to the FSM Trust Fund aimed at mitigating external shocks and potential future revenue shortfalls from the scheduled end of Compact grants from 2024. Nevertheless, further transfers of fiscal surpluses will be needed to build adequate fiscal buffers, as the combined corpus of the nation's two trust funds (the Compact Trust Fund and the FSM Trust Fund) are projected to be less than sufficient to deliver an annual investment income that can fully replace the expiring grants. The central government retains cash reserves of around USD 64 million (5 months of general government current spending). With no central bank or foreign exchange reserves, these serve as a means to absorb short-term liquidity shocks.

Economic growth in the Republic of Marshall Islands (RMI) is also expected to have remained stable in FY2019 at 2.3 percent, driven by continued strong fisheries activity and public infrastructure investment, following growth of 2.5 percent in FY2018. The current account has remained in surplus in recent years, with foreign grants and higher fishing license receipts more than offsetting a fall in exports and an increase in service imports. Inflation is projected to have remained low in FY2019, continuing the trend of recent years, as the stronger US dollar (the official currency of the RMI) has held down the prices of some imports. The combination of solid economic growth (assuming it is equitable across the income distribution), public infrastructure investment, and low food price inflation are likely to have accelerated poverty reduction, though the extent of this is not known due to lack of data on household incomes and expenditures in the RMI.

High fishing license fees underpinned small fiscal surplus over the five years FY2014 to FY2018, a trend which is expected to have continued in FY2019. However, larger fiscal surpluses will be required to build adequate buffers to sustain government spending following the scheduled end of Compact grants in 2023, as current projections indicate that the corpus of the RMI Trust Fund will not be sufficient to generate an annual income stream that can fully replace the expiring grants. In addition, government cash reserves are expected to have remained low at around

1 month of recurrent spending, although the steady flow of external grants has shielded the RMI from liquidity squeezes.

The Palauan economy is projected to have continued its expansion in FY2019 to 2.0 percent following growth of 1.7 percent in FY18, as tourism activity recovered with the entry of new hotels, and construction picked up. This follows a 3.5 percent contraction in FY2017 as the government implemented its structural reform of the tourism sector away from a high-volume model and towards a high-quality model of sustainable ecotourism development. Following explosive growth in tourist arrivals of over 52 percent between FY2013 and FY2015—driven by a 10-fold increase in Chinese tourists—authorities clamped down on package tourism and charter flights, as part of a new 'Pristine Paradise Palau' strategy to target the luxury tourism market and protect the environment. The result was a 31 percent fall in tourist arrivals from FY2015 to FY2018, although this was partially offset by a 15 percent increase in spending per tourist. Lower overall tourism receipts, combined with higher imports for transport and fuel, also weakened the external position, with the current account deficit reaching almost 17 percent of GDP in FY2018. The recent rebound in growth has helped the economy continue to create jobs (up 0.5 percent in FY2018), meaning formal employment has increased by 20 percent since FY2012. Consumer prices rose by 2 percent in FY2018 and are expected to have risen only marginally in FY2019, as the stronger US dollar (the official currency of Palau) held down local prices for food and transport services. The combination of strong formal employment growth and low food price inflation is likely to have reduced the poverty risk for many Palauan households.

Palau's fiscal position has strengthened in recent years, with FY2018 registering a fiscal surplus (including grants) of 6.5 percent of GDP, the eighth consecutive annual surplus, underpinned by increased revenues from tourist departure taxes and higher Compact grants. These were partially offset by increased capital transfers to state governments, while higher tourist arrival fees were channeled to an

independent, non-profit organization that serves as the financial trustee to protect areas that have environmental or ecological significance. The government has retained a healthy cash balance, with reserves estimated to increase from around 3 months of government spending in FY2015 to about 6 months of spending by FY2021. However, the Compact Trust Fund remains below its pre-Global Financial Crisis level as a percent of GDP. Greater fiscal consolidation and revenue mobilization is necessary to ensure long-term fiscal sustainability.

Outlook

In FY2020 growth is expected to register 0.8 percent and 2.2 percent, respectively, in the FSM and RMI, reflecting an easing in investment growth in the FSM and still-solid

infrastructure investment activity in the RMI. In Palau, the rebound in growth is expected to continue, driven by a recovery in tourism activity and ongoing tourism-related construction. Overall, the outlook for the North Pacific countries is subject to substantial risks due to their reliance on grants, tourism, and commodity imports. A slow-down in key trading partners, a further U.S. dollar appreciation, and natural disasters could impact negatively on tourism activity. Higher commodity prices could make food and fuel imports costlier and inflation higher. These countries will have to rely on fiscal and structural policies should the above-mentioned risks materialize. Global financial sector volatility could also affect returns on the various trust funds and their ability to provide fiscal space for priority spending or respond to future shocks, given the limited space for additional debt and the lack of monetary policy levers.

Figure 1. Formal sector employment

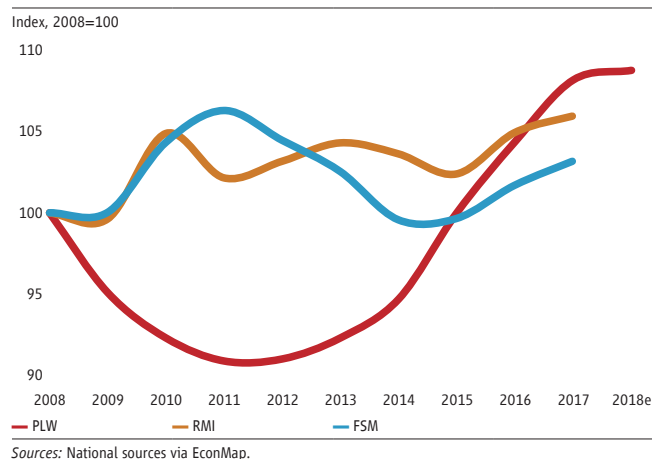
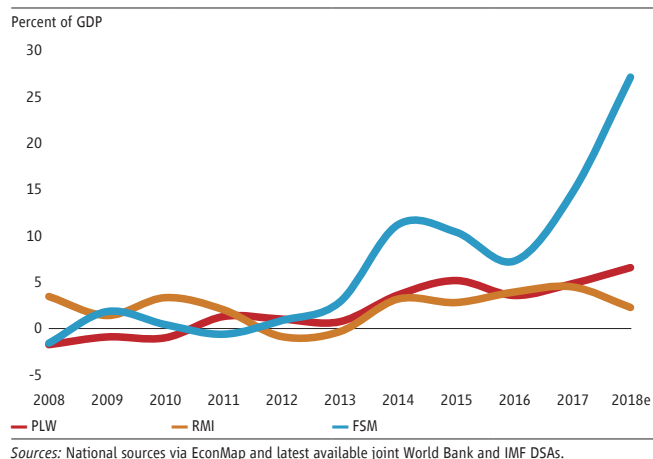


Figure 2. Overall fiscal balance



| NORTH PACIFIC ISLANDS Macro Poverty Outlook Indicators | 2016 | 2017 | 2018e | 2019f | 2020f | 2021f |
|---|-------------|-------------|--------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | | | | | | |
| Republic of the Marshall Islands | 1.8 | 4.5 | 2.5 | 2.3 | 2.2 | 2.0 |
| Federated States of Micronesia | 0.7 | 2.4 | 1.2 | 1.4 | 0.8 | 0.7 |
| Palau | 0.8 | -3.5 | 1.7 | 2.0 | 2.5 | 2.2 |

Sources: EconMAP; IMF and World Bank MTI Global Practice.
Notes: e = estimate; f = forecast.



2018

| | |
|---|-------|
| Population, million | 8.6 |
| GDP, current US\$, billion | 23.3 |
| GDP per capita, current US\$ | 2,705 |
| Poverty rate (\$1.90/day 2011 PPP terms) ^a | 38.0 |
| National poverty rate ^a | 39.9 |
| Gini coefficient ^a | 41.9 |
| Life expectancy at birth, years ^b | 65.7 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2009/10). b. Most recent WDI value (2017).

Papua New Guinea's economy has started recovering from a series of external shocks. Its growth outlook remains positive but fragile due to rising economic uncertainties. These uncertainties are ranging from the domestic political economy to the recent escalation of trade tensions between the United States and China. To mitigate downside risks and better weather external shocks, the government should adjust its macroeconomic policy and focus on structural transformation of the economy.

Recent Developments

After a series of external shocks, growth bottomed out and started recovering. The recovery is being observed in the resource sector, mainly in its extractive segment dominated by liquefied natural gas (LNG), while growth in the non-resource economy remains subdued due to sluggish domestic demand. Real GDP growth dropped gradually from 13.5 percent in 2014 to a contraction of 0.5 percent in 2018, following the end of the LNG-led construction

boom by 2014, the commodity-price shock and a negative El Niño impact in 2014–16, and a 7.5-magnitude earthquake that led to a temporary production shutdown in the extractive sector in the first half of 2018.

The authorities' response to external shocks has led to mixed results and will require adjustments. The successful placement of a US\$500 million 10-year sovereign bond and the attraction of bilateral and multilateral budget-support loans has created some breathing space for both government and businesses since late-2018, allowing some of the foreign currency backlog to be cleared and imports to resume in the first half of 2019.

However, these gains are at risk of being lost if the authorities do not return to the earlier-adopted fiscal-consolidation path and refocus on establishing a more flexible exchange rate regime. The central bank focused on strengthening monetary policy and addressing the backlog of foreign exchange orders, while the exchange rate adjustment has slowed. The fiscal policy stance became expansionary in 2018–19, following higher revenue from the resource sector and higher government spending (compared to the low base of 2017). Recently, public expenditure saw large unbudgeted increases in the government's wage bill and budget arrears, leading to substantial upward adjustments in supplementary budgets in 2018 and 2019. As a result, the fiscal picture has worsened, with the overall fiscal deficit jumping from a low of 2.5 percent of GDP in 2017 to over 3 percent (estimated) in 2019. If this trend continues, it risks undermining the positive efforts the authorities have made to stabilize public finances and the macroeconomy. A reinvigorated fiscal consolidation strategy requires mobilizing non-resource revenue, instituting fiscal discipline over the public-sector wage bill, and raising efficiency in public investment.

From global as well as regional perspectives, prevalence of extreme poverty in PNG is high. About 38 percent of the population in 2010 (the latest household budget survey available) lived under the internationally recognized extreme poverty line of US\$1.90 per day (2011 PPP terms). This incidence of poverty is by far one of the highest rates

in the East Asia and Pacific region. It is also higher than in many of PNG's lower middle-income, resource-rich peer countries. Broadly consistent with the high proportion (87 percent) of the population living in rural areas, almost 90 percent of the country's poor are located in rural PNG and are more likely to be engaged in agricultural activities.

Outlook

The medium-term economic outlook remains positive, supported by the extractive sector. Economic growth is forecast to recover in 2019–21, after bottoming out in 2018 when output in the extractive sector was affected by the earthquake in the highlands area. Real GDP growth is projected to jump to about 5.6 percent in 2019 and then hover between 3.1–3.5 percent in 2020–21.

This baseline scenario assumes a resumption of strong output from the construction sector in 2020–21, following preliminary agreements signed for the Wafi-Golpu project (a gold and copper mine in Morobe province) in December 2018 and the new Papua LNG project (the Elk-Antelope gas field in Gulf province) in April 2019. Consequently, the contribution from the construction sector to GDP growth is expected to rise from 2020 onward.

The rest of the non-extractive economy is expected to show stable average annual growth rates over 2019–21, with agriculture, forestry, and fishery growing by 3 percent per year, manufacturing by 3.5 percent, and the services sector by 3 percent.

The medium-term fiscal consolidation should lead to better fiscal and debt sustainability. As the government improves its budgeting realism and enhances the counter-cyclical fiscal policy framework, the fiscal deficit should begin to narrow from 2020. This would require instituting proper budget controls over the wage bill and better efficiency in capital transfers to the sub-national level. A renewed focus on the revenue strategy implementation should spur reforms aimed at revenue mobilization. Consequently, the debt-to-GDP ratio is estimated to remain at elevated

levels and might start decreasing over the medium term, from a peak of over 36 percent of GDP in 2019 to below 35 percent by 2021.

The construction boom is expected to benefit PNG's external accounts over the medium term. While revenue from merchandise exports is anticipated to stabilize, import spending on goods and services will rise gradually, reflecting the construction phase in the resource sector and, more generally, the economic recovery. As a result, the current account balance will narrow and be financed by additional inflows of foreign direct investment and external borrowing for the implementation of the new resource projects. As observed during the previous LNG-led construction boom, the current pressure on the exchange rate may reverse and lead to an accumulation of international reserves at the central bank.

Risks and Challenges

PNG's medium-term macroeconomic outcomes remain subject to downside risks. Although domestic GDP growth will resume, the growth rate may be volatile owing to external and domestic factors. This growth volatility is subject to the challenging external environment and an uncertain performance of the major (existing and new) resource projects in the country. Commodity-price and natural-disaster shocks may continue to impact extractive sector performance, with negative implications for the rest of the economy. Potential delays in the implementation of new resource projects may also impact macroeconomic outcomes, affecting the current underlying assumptions of the baseline scenario.

The medium-term fiscal and debt sustainability agenda may be undermined by a challenging implementation of the fiscal consolidation strategy. Inability to reinstitute fiscal discipline and bring fiscal consolidation back on track may lead to higher debt-to-GDP ratios (above the legislated threshold of 35 percent of GDP) than assumed in the baseline scenario. Externally, if economic growth in Australia, China, and Japan—PNG's main trading

partners—slows more dramatically than anticipated, demand for PNG's key commodity items may be affected, placing downward pressure on the Kina and eroding external buffers.

To mitigate downside risks and strengthen economic resilience for absorbing shocks, the government should

focus on its diversification agenda. The recently-adopted Medium-Term Development Plan for 2018–22 (MTDP III) sets the stage for more inclusive and sustainable national development. The MTDP III focuses on the development of physical and human capital and the strengthening of governance and institutions as the most critical cross-cutting areas for development.

Figure 1. Real GDP growth and contributions to real GDP growth

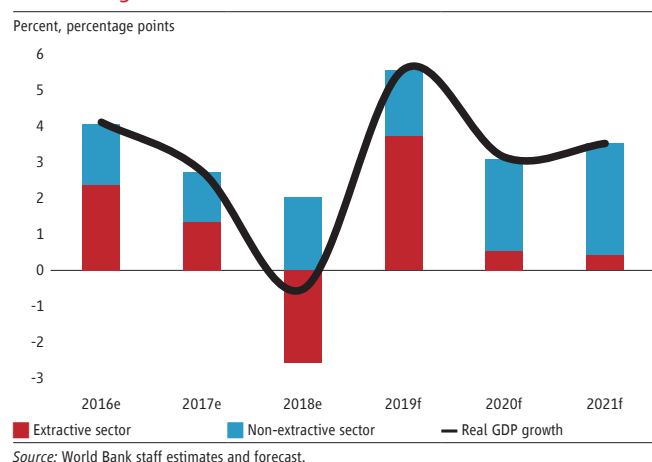
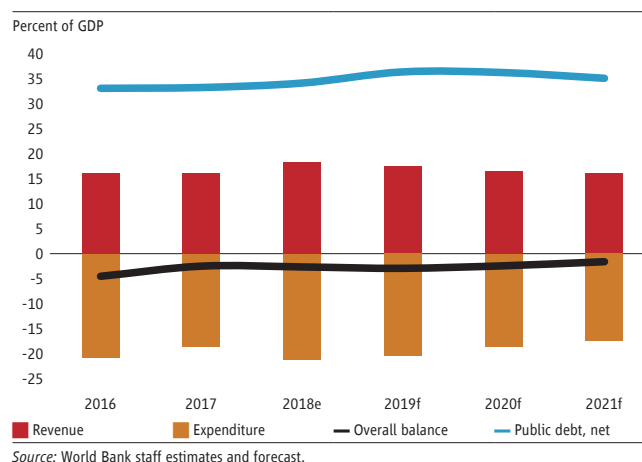


Figure 2. Key fiscal and debt indicators



| PAPUA NEW GUINEA Macro Poverty Outlook Indicators | 2016 | 2017e | 2018e | 2019f | 2020f | 2021f |
|--|-------------|--------------|--------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 4.1 | 2.7 | -0.5 | 5.6 | 3.1 | 3.5 |
| Extractive sector ^a | 9.8 | 5.7 | -9.6 | 14.1 | 2.2 | 1.8 |
| Non-extractive sector | 2.2 | 1.8 | 2.8 | 2.5 | 3.4 | 4.0 |
| Inflation (Consumer Price Index period average) | 6.7 | 5.4 | 4.5 | 4.4 | 4.8 | 5.0 |
| Current Account Balance (% of GDP) | 22.2 | 21.9 | 25.0 | 22.3 | 22.1 | 19.2 |
| Extractive sector ^a | 23.7 | 25.7 | 27.5 | 26.3 | 25.6 | 22.4 |
| Non-extractive sector | -1.5 | -3.8 | -2.5 | -4.0 | -3.5 | -3.2 |
| Overall fiscal balance (% of GDP) | -4.7 | -2.5 | -2.7 | -3.0 | -2.2 | -1.2 |
| Non-resource primary balance (% of non-extractive GDP) | -4.5 | -1.6 | -2.7 | -3.5 | -1.8 | -0.4 |
| Public debt, net (% of GDP) | 33.2 | 33.3 | 34.2 | 36.4 | 36.1 | 34.6 |

Sources: World Bank staff estimates and forecast.

Note: e= estimate; f= forecast. a) The extractive sector includes mining, quarrying, petroleum and gas production.



PHILIPPINES

| | 2018 |
|---|-------|
| Population, million | 106.5 |
| GDP, current US\$ billion | 330.9 |
| GDP per capita, current US\$ | 3,107 |
| International poverty rate (\$1.9) ^a | 6.1 |
| Lower middle-income poverty rate (\$3.2) ^a | 26.0 |
| Upper middle-income poverty rate (\$5.5) ^a | 55.1 |
| Gini index ^a | 44.4 |
| Life expectancy at birth, years ^b | 69.2 |

Sources: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2015) 2011 PPPs. b. Most recent WDI value (2017).

A temporary pause to fiscal expansion, coupled with elevated headwinds on the external front led to a slowdown in investment and external demand, dampening economic growth in 2019. Monetary policy turned accommodative as inflation moderated, while planned fiscal expansion is expected to accelerate. While the country's growth prospects weakened, the Philippines is expected to recover gradually in the medium-term, and progress on shared prosperity is likely to continue.

Recent Developments

In the first half of 2019, economic growth slowed to 5.5 percent year-on-year, the lowest in eight years. The slowdown was driven by the deceleration in investment growth, as public investment was tempered by the delayed approval of the 2019 national government budget and a public spending ban during the election period, and as private investment slowed due to uncertainties around

the tax reform program and the external environment. External demand weakened further amid a moderation in global activity and the uncertainties in the global trade environment. Private consumption drove growth, supported by moderating inflation, a healthy labor market, and steady remittance growth. The challenging domestic and external environment dampened industry growth as softer external demand led to manufacturing growing at its slowest pace in eight years, while the construction sector struggled amid a sharp reversal in public infrastructure spending growth.

Headline inflation fell to 3.3 percent year-on-year in the first seven months of 2019 from 4.5 percent in the previous year, driven by stabilizing prices of food and energy items. Core inflation, which excludes volatile food and energy items, averaged 3.6 percent for the second consecutive year—an indication of a latent upward inflationary pressure from aggregate demand. Both headline and core inflation returned within the Central Bank's target range of 2-4 percent in 2019. The Central Bank adopted a more accommodative policy stance in 2019, reducing the key policy rate by a cumulative 50 basis points, while lowering the reserve requirement ratio by a total of 200 basis points.

The budget deficit shrunk to 0.5 percent of GDP in the first half of 2019 from 2.3 percent of GDP a year ago as a result of substantial underspending in the first half of the year largely due to the delayed passage of the 2019 national government budget and the public spending ban during the election period. Meanwhile, revenue growth remained robust, driven partly by the second round of increases in excise tax rates and improved tax administration. Although the public debt ratio increased compared to a year ago, debt metrics remain favorable toward maintaining long-term fiscal sustainability as the country's debt portfolio is composed largely of long-term peso denominated debt.

Large capital inflows have resulted in the appreciation of the Philippines' currency and rebuilding of foreign reserves. The more dovish stance of the U.S. Federal Reserve since the start of the year contributed to an inflow of capital to the Philippines where declining inflationary pressure

helped improve confidence in the domestic economy. Overall, the performance of the Philippines' capital and financial accounts made up for the deterioration in its current account, leading to a larger balance of payment surplus of 2.8 percent of GDP in the first half of 2019—compared to the deficit of 2.1 percent of GDP in the first half of 2018.

Poverty incidence for the first half of 2018 has declined significantly. The latest official estimates show that poverty has declined to 21 percent from 27.6 percent in the same period in 2015, as real wages continue to rise, and employment continues to expand towards non-agriculture wage employment. However, the high inflation experienced in the second half of 2018, especially among lower income households, may have dampened the gains from higher wage and salary incomes. Poverty estimates for the full year 2018 are expected to be released in December 2019.

Outlook

The Philippines' growth outlook is weakened by a difficult external environment and domestic challenges. The World Bank projects the country's real GDP growth at 5.8 percent in 2019, before accelerating to 6.1 percent in 2020 and 6.2 percent in 2021. The downward revision considers slower investment growth in 2019, hampered by the delayed approval of the 2019 national budget, and the adverse impact of global developments, including weak global manufacturing activity and trade, as well as heightened uncertainty from escalating trade tensions. Private consumption growth is expected to accelerate in 2019 as inflation eases further. Philippine economic growth is expected to gradually accelerate in 2020–2021 as global growth is expected to improve and as the domestic policy environment remains supportive of the economy.

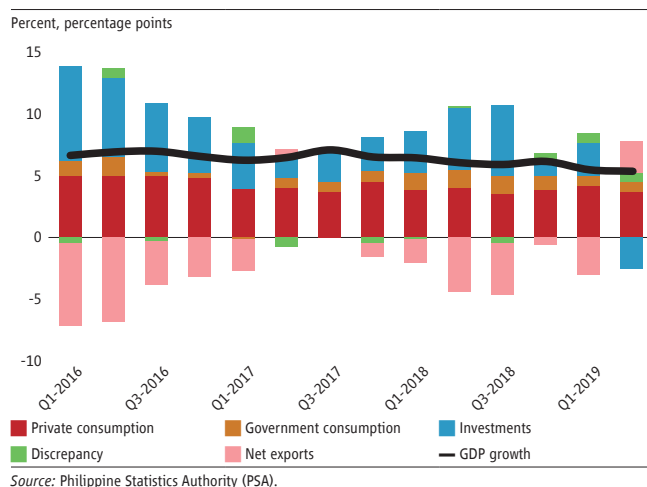
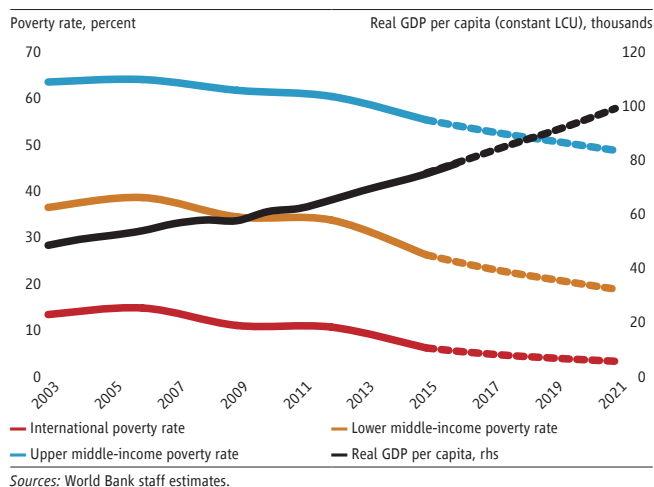
Despite a temporary growth slowdown in the first half of 2019, progress on shared prosperity is likely to continue. Partial estimates of the 2018 Family Income and

Expenditure Survey showed that incomes of households in lower income deciles grew at a much faster pace than the average. Meanwhile, cash transfer schemes from the government will continue to help cushion the impact of negative shocks. Given the continuous expansion of non-agriculture wage employment, rising real wage, continuation of social programs, and stabilizing inflation, the declining trend in poverty is likely to continue. Medium-term poverty projections based on the middle-income poverty line of \$3.20/day show the poverty rate declining from 26 percent in 2015 to 20.8 percent in 2019, 19.8 percent in 2020 to 18.7 percent in 2021.

Risks and Challenges

Downside risks to growth have intensified. The Philippines faces heightened external risks due to the slowdown in global growth and demand, and rising global protectionism, which weaken external demand for the country's main exports. Domestically, a slow recovery in the pace of public investment spending constitutes the main downward risks, as capacity constraints, procurement difficulties, and implementation bottlenecks continue to slow the pace of public spending. Moreover, ensuring complementary reforms to revenue generation as fiscal expansion continues is crucial in ensuring the long-term fiscal sustainability.

Fostering high-quality job creation and boosting human capital investment will enhance the impact of economic growth on poverty reduction and shared prosperity. To increase the growth impact on poverty and inequality, targeted investments and supportive business regulations are needed in industries and sectors that generate high-quality jobs. Likewise, human capital investments in education and health must be fortified, including training and skills development, which will be needed for workers to stay competitive in a fast-changing global work environment. Finally, improving social-protection programs, including the 4Ps, will support the incomes of poor households and help build their resilience against adverse shocks.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Actual and projected poverty rates and real GDP per capita**

| PHILIPPINES Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 6.9 | 6.7 | 6.2 | 5.8 | 6.1 | 6.2 |
| Private Consumption | 7.1 | 5.9 | 5.6 | 5.9 | 5.9 | 6.0 |
| Government Consumption | 9.0 | 6.2 | 13.0 | 7.4 | 10.6 | 10.2 |
| Gross Fixed Capital Investment | 26.1 | 9.4 | 12.9 | 6.1 | 13.6 | 13.7 |
| Exports, Goods and Services | 11.6 | 19.7 | 13.4 | 5.9 | 8.0 | 8.3 |
| Imports, Goods and Services | 20.2 | 18.1 | 16.0 | 6.5 | 11.3 | 11.7 |
| Real GDP growth, at constant factor prices | 6.9 | 6.7 | 6.2 | 5.8 | 6.1 | 6.2 |
| Agriculture | -1.2 | 4.0 | 0.9 | 0.9 | 1.0 | 1.0 |
| Industry | 8.1 | 7.1 | 6.7 | 5.2 | 5.8 | 5.8 |
| Services | 7.5 | 6.8 | 6.8 | 6.8 | 7.0 | 7.0 |
| Inflation (Consumer Price Index) | 1.3 | 2.9 | 5.2 | 2.9 | 3.0 | 3.0 |
| Current Account Balance (% of GDP) | -0.4 | -0.7 | -2.4 | -2.0 | -2.7 | -2.8 |
| Net Foreign Direct Investment (% of GDP) | 2.7 | 3.2 | 3.0 | 2.9 | 2.9 | 2.8 |
| Fiscal Balance (% of GDP) | -2.4 | -2.2 | -3.2 | -2.0 | -2.7 | -2.8 |
| Debt (% of GDP) | 34.6 | 36.6 | 36.0 | 35.8 | 35.8 | 35.7 |
| Primary Balance (% of GDP) | -0.3 | -0.3 | -1.2 | 0.2 | -0.6 | -0.9 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 5.4 | 4.7 | 4.2 | 3.7 | 3.3 | 2.9 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 24.5 | 23.1 | 21.9 | 20.8 | 19.8 | 18.7 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 53.9 | 52.7 | 51.7 | 50.7 | 49.8 | 48.8 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2006-FIES and 2015-FIES. Actual data: 2015. Nowcast: 2016–2018. Forecast are from 2019 to 2021. b) Projection using annualized elasticity (2006–2015) with pass-through = 1 based on GDP per capita in constant LCU.



2018

| | |
|--|-------|
| Population, million | 0.6 |
| GDP, current US\$ billion | 1.4 |
| GDP per capita, current US\$ | 2,133 |
| National basic needs poverty rate (%) ^a | 12.7 |
| School enrolment, primary (% gross) ^b | 114.3 |
| Life expectancy at birth, years ^c | 70.7 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Solomon Islands National Statistics Office. Most recent value (2013). b. Most recent WDI value (2016). c. World Health Organization (2016).

Economic growth is projected at 2.7 percent in 2019, reflecting slowing log exports from a record high in 2018. Domestic increases in the prices of food and beverages pushed inflation from 0.5 percent in 2017 to 2.8 percent in 2018. Fiscal consolidation efforts included revenue mobilization and expenditure restraint. The 2019 budget continues the fiscal consolidation path. Parliamentary elections took place in April 2019. Risks include a sharper than expected downturn in the Chinese economy, and ongoing uncertainties, particularly in the logging and mining sectors.

Recent Developments

Economic growth is expected to moderate to around 2.7 percent in 2019, down from 3.9 percent in 2018, reflecting a deceleration of log exports following the government's efforts to place the industry on a more sustainable footing, and weaker international demand in the first half of the year. Agriculture, ongoing large

infrastructure investments and services remain important contributors to growth.

Between 2015 and 2017, the government pursued expansionary fiscal policy resulting in fiscal deficits, which were financed through the government's cash reserves. The large draw-down in reserves severely limited the government's ability to absorb price or natural disaster shocks and, coupled with broader public financial management problems, resulted in substantial domestic payment arrears (1.4 percent of GDP), impeding private sector activity. A newly-formed government in end-2017 eliminated the payment arrears and returned to fiscal prudence with the passage of a balanced budget in 2018. This was achieved through a substantial reduction in development expenditures, possibly affecting the already thin levels of service delivery in rural areas. The fiscal deficit, which declined to 0.1 percent of GDP down from 3.9 percent in the previous year, was financed by stronger than expected revenues and a domestic development bond. In 2019, the government continues the fiscal consolidation efforts of 2018, targeting a fiscal balance of zero. In the first half of the year, however, pro-rata revenue collections underperformed against budget estimates by around 19 percent on the back of slower logging activity, and a temporary slow-down in economic activity during small-scale public unrest associated with the national general elections in April. Similarly, expenditures also tracked under budget estimates by an estimated 14 percent over the same period, owing to a freeze in development spending in the first quarter ahead of the elections. Total PPG external debt increased from 7.6 percent of GDP in end-2017 to an estimated 9.3 percent in 2018. International reserves fell marginally from US\$577 million in 2017 to US\$559 million in 2018, although import cover remains ample, equivalent to 8 months of forward spending. The current account deficit widened from 4.8 percent of GDP in 2017 to 5.2 percent in 2018, reflecting heightened levels of imports related to large infrastructure projects—most of which are partly or fully externally financed. Inflation (period average) is projected to have accelerated from 0.5 percent in 2017 to 2.8 percent in 2018, mainly on account of increases

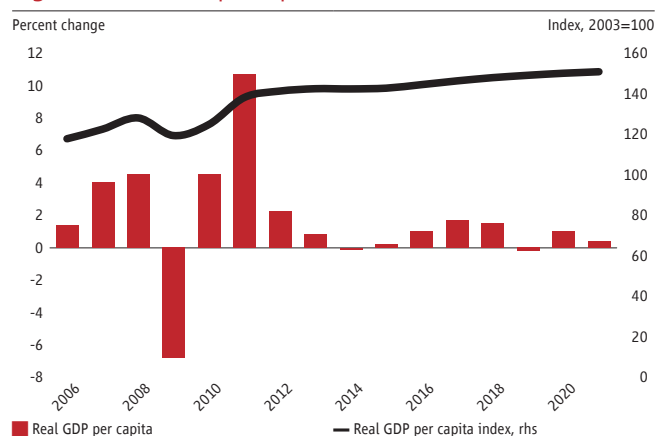
in the prices of food and beverages, higher excise duties introduced on alcoholic beverages and tobacco products throughout the year.

Outlook

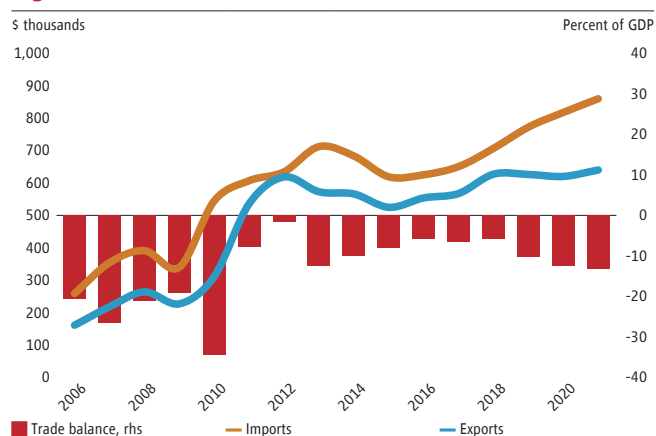
Despite current fiscal consolidation efforts, growth is projected to remain at current levels, averaging around 3 percent per year over the medium-term, and continue to be driven by major infrastructure investments in the roads, air transport, telecommunications and energy sectors. This baseline scenario also assumes resumed gold-mining activity, the exploitation of large nickel deposits, and sustained levels of foreign direct investment averaging between 2–3 percent of GDP. A new sustainable forestry policy seeks to gradually curb log output and is expected to impact on fiscal space going forward. However, the continuation of sound fiscal management in 2019, complemented by key public financial management reforms and a tax review, are expected to somewhat ease fiscal pressures. The recent payment of expenditure arrears instilled confidence. Enhanced commitment control and cash management will be essential to avoid the recurrence of arrears. Cash reserves will need to be rebuilt to ensure effective cashflow management and buffer against external shocks. Expenditure pressures associated with large unmet expenditure needs for infrastructure and public service delivery, increases to the public service payroll, and the hosting of the 2023 South Pacific Games continue to pose a risk to medium-term fiscal consolidation. The current account deficit—financed through large aid flows in the capital account—is expected to widen to further to around 7.1 percent of GDP in 2019, reflecting a continued increase in imports, and the underlying long-run decline in logging exports. The Honiara Consumer Price Index is expected to remain at around 3 percent over the medium term.

Risks and Challenges

The outcome of the national general elections in April 2019 brought about short-lived riots in Honiara. The continued lack of a political settlement between the main political and economic power holders in favor of investing in effective institutions, combined with the economic geography of Solomon Islands, challenges the reach of the state and continues to discourage significant levels of foreign direct investment. The economic policy stance of the new government remains appropriate, particularly with regard to the continued momentum in the fiscal consolidation path set out in the 2018 and 2019 budgets, and efforts to enhance the quality of public spending. With logging sources expected to be depleted in the long run and uncertainty around the exploitation of the country's mining potential, Solomon Islands faces the challenge of developing new sources of growth. In the near term, growth will be supported by infrastructure projects and logging may not decline significantly. This outlook is subject to considerable risks, particularly from any contraction in log demand in China (the main export destination for logs), or delays in infrastructure projects. Thereafter, the impending decline of the logging industry will impact on growth and a vital source of government revenue and foreign exchange reserves. The new sustainable forestry policy may risk being undermined and result in foregone revenues, if insufficient resources are dedicated to its implementation. Mining could become a key driver of growth but developments in the sector hinge on the adoption of a legal and regulatory framework conducive to mining, and on clear procedures for the acquisition of land (for the exploration and exploitation). Such frameworks and procedures, which are currently being put in place, will also ultimately impact the extent to which forthcoming benefits from mining are shared across the population. In the context of a constrained fiscal environment, a sustained effort will be required to strengthen public financial management, and a heightened focus on the quality of public expenditures could maximize their effectiveness for the most vulnerable.

Figure 1. Real GDP per capita

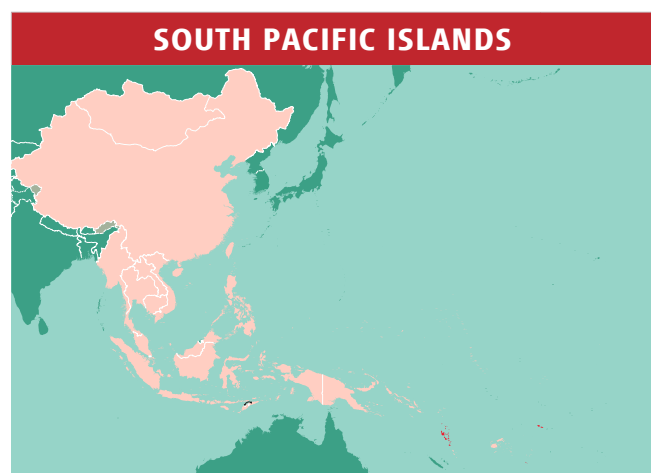
Sources: World Bank staff estimates, IMF.

Figure 2. Trade balance

Sources: Central Bank of Solomon Islands, World Bank staff estimates, IMF.

| SOLOMON ISLANDS Macro Poverty Outlook Indicators | 2016 | 2017 | 2018e | 2019f | 2020f | 2021f |
|---|-------------|-------------|--------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 3.2 | 3.7 | 3.9 | 2.7 | 2.9 | 2.7 |
| Inflation (Consumer Price Index end of period) | -2.2 | 2.1 | 3.2 | 3.2 | 3.5 | 3.6 |
| Balance of Payments | | | | | | |
| Current Account Balance (% of GDP) | -4.0 | -4.8 | -5.2 | -7.1 | -8.2 | -8.5 |
| Imports, Goods and Services | 50.7 | 50.4 | 50.4 | 51.9 | 51.5 | 50.6 |
| Exports, Goods and Services | 44.9 | 44.0 | 44.7 | 42.1 | 39.1 | 37.7 |
| Foreign Direct Investment | 2.9 | 3.9 | 3.1 | 2.2 | 2.1 | 2.1 |
| Fiscal Balance (% of GDP) | -3.9 | -3.8 | -0.1 | -2.2 | -2.5 | -2.7 |
| External Debt (% of GDP) | 7.5 | 7.6 | 9.3 | 11.6 | 14.3 | 16.6 |

Sources: Solomon Islands Government 2019 Budget Strategy; World Bank ; International Monetary Fund.
Notes: e = estimate; f = forecast.



2018

| | |
|------------------------------|-------|
| Population, million | |
| Samoa | 0.20 |
| Tonga | 0.11 |
| Vanuatu | 0.29 |
| GDP, US\$ billion | |
| Samoa | 0.82 |
| Tonga | 0.43 |
| Vanuatu | 0.93 |
| GDP per capita, current US\$ | |
| Samoa | 4,184 |
| Tonga | 4,095 |
| Vanuatu | 3,170 |

Sources: WDI, World Bank staff estimates.

Economic activity in Samoa, Tonga, and Vanuatu has been affected by recent natural disasters and adverse economic shocks. Tonga continues to recover from Tropical Cyclone (TC) Gita which hit in February 2018, while several large reconstruction projects that have supported growth in Vanuatu since TC Pam struck in 2015 are now nearing completion. Given fiscal pressures and the risk of further natural disasters, continued efforts are necessary to mobilize revenues, control current spending, and prioritize capital spending.

Recent Developments

Recently revised GDP statistics indicate that the economy of Samoa contracted in FY2018 (year ended June) by 2.2 percent, following growth of 1.0 percent in FY2017.

The weak outcomes over the past few years have been primarily attributable to the closure of a major manufacturer of automotive wire harnesses in late 2017, a slowdown in fishing exports, and the impact of TC Gita on the agriculture sector. These factors were partially offset by higher construction spending and Samoa's hosting of regional meetings. A rebound in growth to around 3.5 percent is expected in FY2019, due to preparations for the Pacific Games (held in July 2019) and continued impetus from construction, tourism earnings and remittances. The current account has been close to balance since FY2016, with strong growth in tourism-related services exports and remittances offsetting higher imports for construction.

Due to significant increases in domestic revenue collection, prudent controls on budgeted spending, and in some cases weaker-than-expected spending execution, the government ran only small fiscal deficits in FY2016 and FY2017 (averaging less than 1 percent of GDP) and a budget that was close to balance in FY2018. Spending is estimated to have picked up in FY2019, in part due to preparations for the Pacific Games, but the deficit is expected to have remained contained at around 1 percent of GDP.

Tonga continues to recover from Cyclone Gita which hit in February 2018, caused widespread damage and losses estimated to total US\$164 million, or 38 percent of GDP. Growth slowed to 0.3 percent in FY2018 due to the impact of the cyclone on agricultural production, tourism, and the commercial sector, although is expected to have picked up to around 3.4 percent in FY2019 as reconstruction spending ramped up. Inflation is expected to have eased somewhat in FY2019 (to 5.5 percent from around 7 percent in FY2017 and FY2018), although relatively fast inflation has persisted longer than expected due primarily to policy-driven tax increases and the impact of TC Gita on domestic food prices. The current account deficit is expected to have widened to around 8 percent of GDP in FY2019 (from 4.1 percent of GDP in FY2018) due to an increase in reconstruction-related imports.

In recent years the authorities have maintained a generally prudent fiscal stance, underpinned by careful expenditure management and ongoing efforts to improve revenue mobilization. Despite the substantial recovery and reconstruction needs associated with TC Gita, a small fiscal surplus was realized in FY2018 and another is expected for FY2019, due to delays in the roll-out of cyclone-related spending; substantial government efforts to create fiscal space by limiting other expenditures; and ongoing donor support.

Vanuatu is close to full recovery from Tropical Cyclone Pam, which struck in March 2015. Continued work on infrastructure projects—including roads, ports, and airports—as well as a strength in tourism arrivals are expected to have driven GDP growth of around 3.4 percent in CY2018, although disruptions to agriculture caused by storms and volcanic eruptions have caused growth to ease from 4.4 percent the previous year. Annual inflation is estimated to have been relatively stable at around 3 percent in 2017 and 2018, a pick-up from previous years reflecting the impact of increased construction activity and higher food and transport prices.

The advancement of several major reconstruction and rehabilitation projects following Tropical Cyclone Pam in 2015 has resulted in significant fiscal pressures in recent years. In 2018, however, a fiscal surplus estimated at around 5 percent of GDP was achieved, due to a sharp increase in revenue from citizenship schemes, an increase in the VAT rate, and underspending of the capital budget. The surplus—some of which was used to pay down public debt ahead of schedule—was achieved despite a large increase in the wage bill resulting from the first public sector wage rise for over a decade.

Outlook

In Samoa, economic growth is projected to pick up further in FY20 before settling between 2 and 3 percent per year in the medium term. Growth of around 5 percent is expected for FY20, driven by the July 2019 Pacific Games

and the hosting of regional conferences, which will drive further increases in tourism and related activities, while construction of public infrastructure projects will continue to provide support. Over the medium term, the economy should be supported by continued growth in the tourism and agriculture sectors, which should directly create formal job opportunities for Samoa's more vulnerable people (including its youth who tend to experience particularly high levels of unemployment), while also spurring related activity in the informal sector.

In Tonga, reconstruction and repair activity for housing, public buildings, and schools is projected to continue over the next two to three years, which, together with the recovery in the agriculture and services sector, is expected to drive growth of around 4 percent in FY20. Nevertheless, public-sector cyclone recovery needs estimated at around a quarter of GDP have only been partially covered by donor pledges, which may lead to some pressure on government finances and/or mean that some recovery needs remain unmet.

In Vanuatu, GDP growth is expected to remain around 3.4 percent in 2019, and then ease to around 3 percent over the medium-term, as large infrastructure projects are completed. Nevertheless, the government's substantial public investment and cyclone reconstruction program will help to raise the productive capacity of the economy over the medium to long term, and activity in the agriculture and tourism sectors should continue to expand. The fiscal deficit could be contained to around 3 percent of GDP over the next two to three years, but this will depend on the extent to which revenue reforms are implemented and capital spending winds down.

Risks and Challenges

For each of these small South Pacific nations, natural disasters and external economic shocks pose a constant threat to economic growth and fiscal sustainability. Efforts to expand and maintain fiscal buffers are important to help manage these risks.

In **Samoa**, continued fiscal restraint is important to keep public debt in check, which remains relatively high despite significant declines in recent years. It is therefore important that overall fiscal restraint is maintained, consistent with recent government efforts to increase domestic revenues, control spending, and pursue only high-priority and concessionally-funded capital investments.

In general, the key challenge facing **Tonga** in the next few years is to maintain its prudent fiscal stance in the face of several competing pressures. The government should carefully prioritize cyclone-reconstruction and development spending, mindful of budget and local capacity constraints, and continue to strengthen management of the government wage bill.

In **Vanuatu**, revenue mobilization and public investment management remain important challenges. Much-needed public investments in infrastructure have led to a sharp increase in public debt since 2015. Reforms are needed to broaden the tax base and reduce reliance on volatile revenue streams such as the economic citizenship program. Public investments need to be carefully prioritized, financed where possible with domestic revenues, grants, or highly-concessional loans, and implemented with due regard to domestic capacity constraints.

Figure 1. Incidence of poverty at international poverty lines and national hardship thresholds

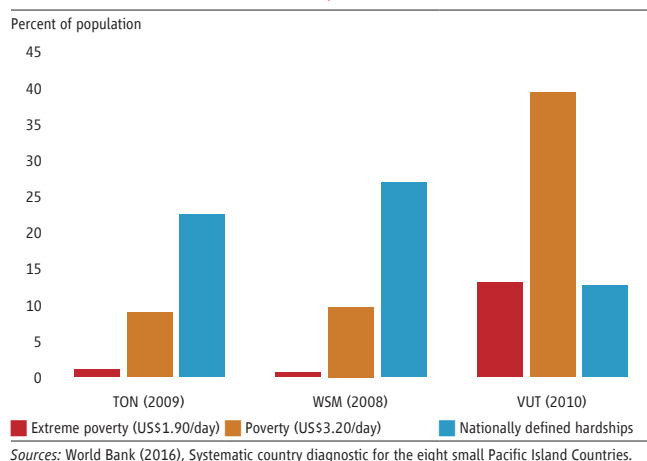
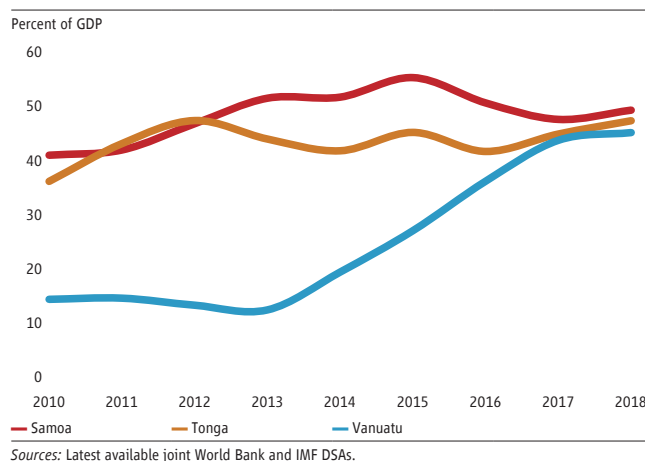


Figure 2. Public and publicly guaranteed external debt



| SOUTH PACIFIC ISLANDS Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019f | 2020f | 2021f |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | | | | | | |
| Samoa | 8.1 | 1.0 | -2.2 | 3.5 | 5.0 | 2.5 |
| Tonga | 3.4 | 3.0 | 0.3 | 3.4 | 4.0 | 2.6 |
| Vanuatu | 3.5 | 4.4 | 3.4 | 3.4 | 3.2 | 3.0 |

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: Financial years for Samoa and Tonga are Jul–Jun, for Vanuatu is Jan–Dec. e = estimate; f = forecast.



2018

| | |
|---|-------|
| Population, million | 69.2 |
| GDP, current US\$ billion | 493.2 |
| GDP per capita, current US\$ | 7,129 |
| Upper middle-income poverty rate (\$5.5) ^a | 7.8 |
| Gini index ^a | 36.5 |
| School enrolment, primary (% gross) ^b | 99.6 |
| Life expectancy at birth, years ^b | 75.5 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2017), 2011 PPPs. b. Most recent WDI value (2017).

Economic growth decelerated to 2.3 percent in Q2 2019, the lowest quarterly growth rate since 2014. Exports contracted sharply for two consecutive quarters in the context of a weaker global and regional economic outlook and weakening domestic demand. A new coalition government has announced fiscal stimulus policies to boost short-term growth and policies to address long-term structural issues. Risks are tilted to the downside and include political uncertainty, delays in public investments and continued external headwinds from global trade.

Recent Developments

The Thai economy moderated for the second consecutive quarter driven by a contraction in exports and weakening domestic demand. Exports of goods and services contracted by 6.1 and 7.0 percent respectively in Q1 and Q2 2019. Domestic demand drivers are showing signs of weakness. Private consumption growth moderated from 4.9 percent in Q1 2019 to 4.4 percent in Q2

2019. Consumer confidence fell to a 22-month low in July 2019 over concerns about the economic slowdown, political instability, the US-China trade tensions, and low farm prices. Private investment growth fell by half from 4.4 percent in Q1 2019 to 2.2 percent in Q2 2019 amid depressed investor sentiment. Public investment expanded moderately by 1.4 percent in Q2 2019 as the implementation of large public infrastructure projects slowed amid an almost four-month-long political transition from national elections to government formation in July 2019. Agricultural production declined by 1.1 percent in Q2 2019 and manufacturing contracted by 0.2 percent in Q2 2019 (0.6 percent growth in Q1 2019) in line with export contraction.

Monetary and fiscal buffers remained ample, reflecting subdued public spending and low inflation and debt to GDP. The fiscal deficit remained low and stable in the first half of 2019 despite declining fiscal revenues, because of subdued public spending growth. In this context, the Bank of Thailand unexpectedly cut rates by 25 bps to 1.50 percent on August 7, 2019 to ease the impact of the global slowdown. Weak export performance led to a narrower current account surplus in Q2 2019, but foreign exchange reserves remain adequate to cover imports and short-term external debt. The Thai Baht has surged against the US dollar reaching a six-year high end-August 2019. Financial sector stability has been maintained with strong capital buffers, but high household debt remains a concern particularly for low-income households.

While extreme poverty is low, poverty reduction has stalled and poverty in certain regions increased between 2015 and 2017. Recent declines in agricultural employment, the agricultural price index, and the farm income index will negatively impact the welfare of households in the bottom 40 percent of the income distribution. Government policies under consideration include increased funding for elderly care, expanding enrollment for those eligible for the welfare card, subsidies for pregnant women and new mothers, subsidies to farmers, and lowering public transportation costs. Droughts once again threaten the well-being of many given that one-third of Thailand's labor

force still work in agriculture. The North and Northeast regions are most affected by drought and significant impacts are being felt by rice, corn, and fish farmers.

Outlook

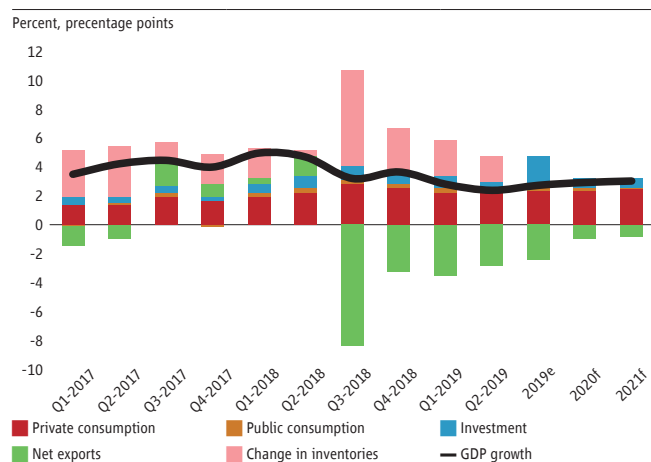
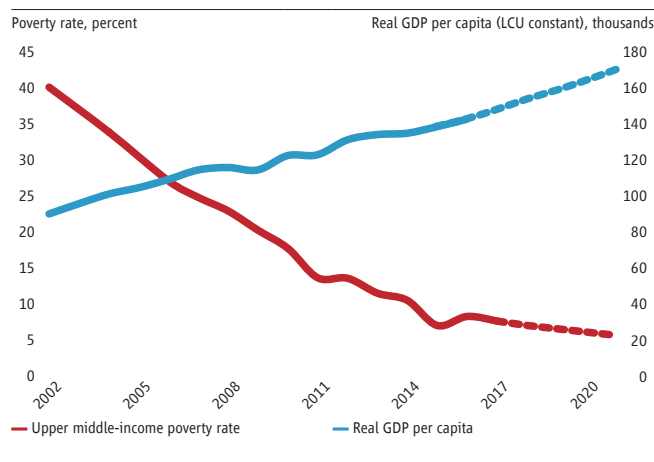
The Thai economy is projected to expand by only 2.7 percent in 2019 and by 2.9 percent in 2020. The growth forecast for 2019 has been downgraded from 3.5 percent to 2.7 percent for several reasons, notably that (i) the decline in exports in the first half of 2019 was larger than expected; (ii) Thailand is currently experiencing the worst drought in a decade; and (iii) low disbursement rate of the capital budget continues to be drag on public investment.

The fiscal stimulus package announced in August 2019 by the government targets farmers, small and medium-sized enterprises (SMEs) and low-income households, in the form of cash transfers, postponement of debt repayment and tax rebate on specific tourist activities. Additional visa exemption measures were also announced for citizens of certain countries. These measures are being rolled out and are unlikely to have a significant impact on growth in 2019. In the medium term, the impact will depend on the strength of the fiscal multiplier.

The new government's non-fiscal policy platform focuses on competitiveness, spatial development and overall, there is continuity in major policies and projects such as the flagship Eastern Economic Corridor (EEC). There is an enhanced focus on agriculture including commitments for income support, crop price stability and upgrading agrobusiness productivity across the value chain. In the baseline, private consumption and investment are expected to pick up to drive growth in the medium term, particularly reinforced by an anticipated pick-up in public investments with the implementation of large public infrastructure projects. Regional trade and investment flows, particularly in Cambodia, Laos, Myanmar, and Vietnam (CLMV), could help potentially compensate for some of the external headwinds.

Risks and Challenges

The balance of risks is tilted to the downside. Political uncertainty remains a major risk with lingering doubts about the cohesiveness of the newly established 19-party coalition government. Potential delays in the implementation of large planned public infrastructure projects could negatively impact both investor sentiment and consumer confidence, thereby weakening domestic demand. Although major EEC-related projects have made progress, some risks of implementation delays remain. Escalating trade tensions between the U.S. and China could further weaken demand for Thailand's exports and discourage private investment, especially in export-oriented industries. The Thai Baht has been the strongest performing currency in the region as of mid-2019 as foreign investors sought refuge in Thai bonds. Further appreciation could impede Thailand's export competitiveness with regards to both manufacturing and tourism.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Actual and projected poverty rates and real GDP per capita**

| THAILAND Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 3.3 | 3.9 | 4.1 | 2.7 | 2.9 | 3.0 |
| Private Consumption | 3.0 | 3.2 | 4.8 | 4.4 | 4.5 | 4.6 |
| Government Consumption | 2.2 | 0.5 | 5.2 | 1.7 | 1.2 | 1.0 |
| Gross Fixed Capital Investment | 2.8 | 0.9 | 4.8 | 8.6 | 2.9 | 2.8 |
| Exports, Goods and Services | 2.8 | 5.5 | 5.9 | -5.3 | 0.2 | 1.1 |
| Imports, Goods and Services | -1.0 | 6.8 | 7.2 | -2.5 | 1.7 | 2.5 |
| Real GDP growth, at constant factor prices | 3.5 | 4.2 | 4.2 | 2.7 | 2.9 | 3.0 |
| Agriculture | -1.3 | 3.7 | 5.0 | 2.0 | 2.2 | 2.2 |
| Industry | 2.7 | 1.8 | 2.7 | 2.6 | 2.7 | 3.0 |
| Services | 4.6 | 5.8 | 5.1 | 2.9 | 3.1 | 3.2 |
| Inflation (Consumer Price Index) | 0.2 | 0.7 | 1.1 | 1.1 | 1.1 | 1.1 |
| Current Account Balance (% of GDP) | 11.7 | 11.0 | 8.1 | 5.4 | 3.9 | 2.7 |
| Net Foreign Direct Investment (% of GDP) | -0.1 | -2.3 | -0.2 | 0.1 | 0.2 | 0.5 |
| Fiscal Balance (% of GDP) | 0.4 | -0.3 | 0.3 | -1.1 | -1.2 | -1.3 |
| Debt (% of GDP) | 41.2 | 40.9 | 42.4 | 43.0 | 43.4 | 43.8 |
| Primary Balance (% of GDP) | 1.2 | 0.6 | 1.3 | -0.1 | -0.2 | -0.4 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 8.4 | 7.8 | 7.2 | 6.7 | 6.2 | 5.8 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate; f = forecast. a) Calculations based on EAPPOV harmonization, using 2014-SES and 2017-SES. Actual data: 2017. Nowcast: 2018. Forecast are from 2019 to 2021. b) Projection using average elasticity (2014–2017) with pass-through = 0.7 based on GDP per capita in constant LCU.



TIMOR-LESTE

2018

| | |
|--|-------|
| Population, million | 1.3 |
| GDP, current US\$ billion | 1.6 |
| GDP per capita, current US\$ | 1,229 |
| School enrolment, primary (% gross) ^a | 100.6 |
| Life expectancy at birth, years ^a | 69.2 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent WDI value (2017).

Following two successive years of recession, economic growth is expected to resume in 2019. Public spending is returning to previous levels and there is evidence that household consumption is also recovering. However, medium-term growth prospects remain constrained by a weak domestic private sector. Upholding political and macroeconomic stability, improving the policy and regulatory environment, and investing in both connective infrastructure and relevant skills will be crucial to encourage private sector activity.

Recent Developments

The 2017–2018 economic recession was predominately caused by lower government spending in a context of political uncertainty. Parliamentary elections held in May 2018 contributed to end the year-long political stalemate and helped normalise public spending, which remains the key driver of economic activity. Despite the late approval of the 2019 budget, public expenditure in the first half of 2019 was 16 percent higher than in the same period in 2018. This has contributed to boost consumer confidence,

as evidenced by increases in relevant tax receipts—such as excise and sales taxes—as well as household credit levels. Private investment is also expected to benefit from greater political and economic stability. Non-oil gross domestic product (GDP) is thus expected to grow by 4.2 percent in 2019, from an estimated -1.1 percent in 2018.

The Petroleum Fund balance increased to \$17.4 billion (as of June 2019) due to limited withdrawals and large investment returns in early 2019. Asset revaluations provided a windfall of \$1.3 billion in the first half of 2019—accounting for nearly 90 percent of total investment returns—compared to the \$0.4 billion accrued from petroleum-related revenues (mainly taxes and royalties). Nonetheless, larger withdrawals in the second half of 2019 and an uncertain outlook for international equities will likely reduce the value of the Petroleum Fund by the end of the year.

Consumer price inflation declined to 0.8 percent (year-on-year) in the second quarter of 2019, as price increases decelerated in most categories of goods and services. International food prices, which are typically a key driver of domestic inflation, have been relatively subdued (especially rice prices). Appreciation pressures have also eased in 2019, as domestic inflation declined and the nominal (effective) exchange rate has remained relatively stable.

Credit to the private sector grew by 13 percent (year-on-year) in June 2019, mainly as lending to individuals increased. Nonetheless, domestic credit to the private sector only represents 14 percent of non-oil GDP, which is one of the lowest levels in the world. Commercial bank lending rates are high—at around 15 percent—and the banking sector is highly liquid, with a loan-to-deposit ratio of 22 percent.

The trade balance improved in the first quarter of 2019—when compared to the homologous period in 2018—especially owing to lower service imports. Imports have not picked up yet in 2019 because of a slow increase in public

capital spending. The current account also improved due to higher primary income.

Outlook

GDP growth is expected to accelerate to 4.9 percent by 2021. However, this is still far from the 7 percent target envisaged in the government programme. Domestic inflation is predicted to remain low, especially since international food prices are forecast to remain broadly stable. The fiscal balance is forecast to deteriorate, as public spending grows faster than government revenue, widening the financing gap. Domestic revenue mobilization will remain hindered by the current low-tax regime and delays in implementing fiscal reforms—such as the introduction of the value added tax. The Estimated Sustainable Income will gradually decline, partly because of the depletion of the Petroleum Fund.

The current account deficit is projected to widen, owing to a growing trade deficit and lower primary income – mainly petroleum-related revenues. Imports of goods and services will bounce back due to higher domestic demand (that is not met by domestic production), while primary income will gradually decline as petroleum production from the existing field in operation is expected to cease in early 2022. The financial account surplus will increase, although mainly due to divestments in the Petroleum Fund. Hence, both fiscal and current account balances are expected to deteriorate, despite the improvements observed in 2017–2018—which were mainly induced by lower public spending that, in turn, contributed to a lower import bill.

Risks and Challenges

The recent ratification of the Maritime Boundary Treaty between Timor-Leste and Australia paves the way for the development of the offshore Greater Sunrise gas and condensate fields—which are thought to hold reserves worth between \$40–\$60 billion. The Government of Timor-Leste plans to pipe the gas to its south coast and process it into

liquefied natural gas (LNG) for export. However, the project is both technically and economically challenging, while requiring large upfront capital expenditures—in addition to operation & maintenance costs. Recent amendments to petroleum-related laws enable the Petroleum Fund to invest directly in Timor Gap—the national oil company. This weakens the safeguards and governance arrangement of the Petroleum Fund by circumventing Parliamentary scrutiny and pre-audit oversight by the Court of Audit. Given Timor-Leste's considerable development needs, it is vital to protect the Petroleum Fund from the commercial risks that are inherent to international energy markets.

Public spending levels have increased considerably since petroleum revenues started to flow in 2005. While the 2017–2018 political stalemate led to a forced fiscal consolidation, spending is expected to gradually increase in the coming years—with a tentative budget envelope of \$1.6 billion for 2020. Budget allocations to the priority sectors (i.e. education, health, water & sanitation, and agriculture) are expected to rise, but there are concerns regarding the lack of sizeable economic returns from large-scale public investments (in electricity, airports and roads) as well as generous public transfers. Containing public spending and strengthening domestic revenue mobilisation is key to secure medium-term fiscal sustainability, while improving public investment management will help ensure an adequate use of public resources.

Despite the ongoing economic recovery, medium-term growth prospects are hampered by a weak private sector. Domestic demand is ultimately driven by public spending, which also supports private consumption through public sector wages and personal benefit transfers. However, much of this demand leaks into imports of goods and services—as the domestic economy is unable to overcome key supply-side constraints. The ambitious targets stated in the government program for 2018–2023—which include an average economic growth rate above 7 percent, an increase in private investment by at least 10 percent per annum, and the creation of at least 60,000 new jobs per year—will require a change towards a more private

sector-driven model. Developing productive capabilities and energising the incipient private sector will require continued political and macroeconomic stability, strong investments in high-return connective infrastructure and relevant skills, as well as policy and regulatory reforms that improve the business environment. These will contribute to a more dynamic and thriving private sector, which is key to accelerate and sustain economic growth in the medium-term.

Figure 1. Real GDP growth and contributions to real GDP growth

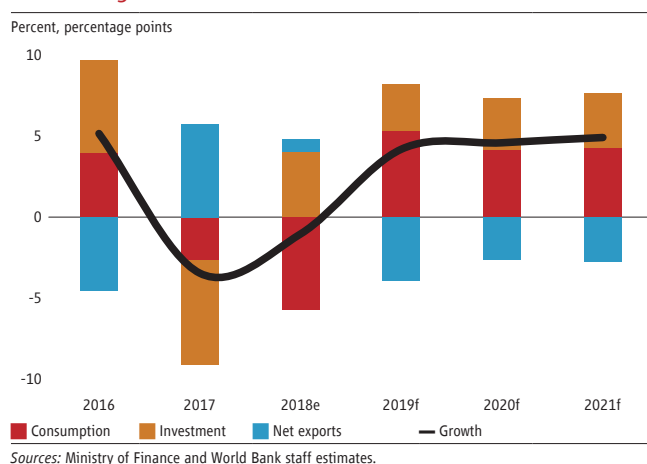
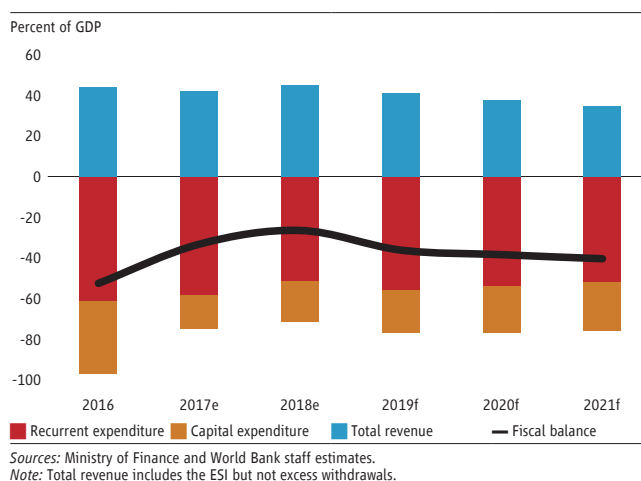


Figure 2. Fiscal aggregates



| TIMOR-LESTE Macro Poverty Outlook Indicators | 2016 | 2017e | 2018e | 2019f | 2020f | 2021f |
|---|-------------|--------------|--------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 5.1 | -3.5 | -1.1 | 4.2 | 4.6 | 4.9 |
| Private Consumption | 7.9 | 0.9 | -3.7 | 3.5 | 4.4 | 4.5 |
| Government Consumption | -1.2 | -5.8 | -6.5 | 6.3 | 2.9 | 3.0 |
| Gross Fixed Capital Investment | 15.3 | -16.7 | 11.9 | 7.4 | 8.0 | 8.4 |
| Exports, Goods and Services | 6.6 | -37.7 | 9.3 | 3.7 | 4.4 | 5.1 |
| Imports, Goods and Services | 8.4 | -11.6 | -1.1 | 7.6 | 5.1 | 5.2 |
| Real GDP growth, at constant factor prices | 4.7 | -3.3 | -1.1 | 4.2 | 4.6 | 4.9 |
| Agriculture | -1.3 | -3.2 | 1.5 | 1.9 | 2.1 | 2.3 |
| Industry | 7.6 | -23.4 | -1.2 | 4.1 | 4.3 | 4.4 |
| Services | 5.5 | 2.5 | -1.6 | 4.7 | 5.2 | 5.6 |
| Inflation (Consumer Price Index) | -1.3 | 0.6 | 2.2 | 1.7 | 2.6 | 2.8 |
| Current Account Balance (% of GDP) | -32.3 | -17.8 | -11.8 | -14.5 | -19.2 | -22.3 |
| Fiscal Balance (% of GDP) ^a | -52.6 | -32.8 | -25.9 | -35.8 | -38.1 | -40.2 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) The ESI is part of total revenue, while excess withdrawals from the Petroleum Fund is a financing item.



| | 2018 |
|---|-------|
| Population, million | 96.5 |
| GDP, current US\$ billion | 244.9 |
| GDP per capita, current US\$ | 2,538 |
| International poverty rate (\$1.9) ^a | 2.0 |
| Lower middle-income poverty rate (\$3.2) ^a | 8.4 |
| Upper middle-income poverty rate (\$5.5) ^a | 29.0 |
| Gini index ^a | 35.3 |
| School enrolment, primary (% gross) ^b | 107.9 |
| Life expectancy at birth, years ^b | 76.5 |

Source: WDI, Macro Poverty Outlook, and official data.

Notes: a. Most recent value (2016), 2011 PPPs. b. Most recent WDI value (2017).

Amid rising global headwinds and an outbreak of swine fever at home, Vietnam's economic growth moderated in to 6.8 percent in the first-half of 2019 compared to 7.1 percent in the same period last year. The medium-term outlook is broadly positive, despite persistent downside risks. Vietnam remains heavily exposed to global economic sentiments, given its high trade openness and limited policy buffers. Bolder implementation of structural, fiscal, and banking sector reforms would help to mitigate downside risks and support sustained high growth.

Recent Developments

Real GDP growth is estimated to have increased by 6.8 percent (y/y) in 1H-2019, down slightly from 7.1 percent in 1H-2018. The moderation in growth reflects both domestic and external factors. On the domestic front, the deceleration in agricultural output largely stemmed

from a widespread outbreak of African swine fever and severe weather conditions that reduced livestock and crops production. Industrial growth also moderated, given slower growth in export-oriented manufacturing sector. A modest decline in the pace of growth in the construction sector reflected a less sanguine real estate sector, in part due to less expansionary credit conditions and ongoing consolidation of public investment. In contrast, the services sector continued to benefit from strong household consumption buoyed by real wage growth.

Resilient GDP growth continues to support a dynamic labor market with strong job creation and real wage growth. Job creation remains buoyant in high productivity sectors, such as manufacturing and modern services. Reflecting favorable labor market conditions, the monthly average wage is estimated to have expanded by 7.4 percent in nominal terms, or by about 3.6 percent in real terms in 2018.

Monetary policy continues to balance growth and stability objectives. Driven by a moderation in food prices, headline CPI inflation remained subdued at 2.3 percent (y/y) in August 2019, down from 3 percent in December 2018. Credit growth continued to expand at an average of about 13 percent (y/y), slightly below the State Bank of Vietnam's (SBV) target of 14 percent for 2019. With moderate inflation, the SBV in mid-September eased monetary policy stance, cutting its discount rate and refinancing rate by 25 basis point to 4 and 6 percent, respectively. The rate cut is expected to ease liquidity for banks in order to provide more credit to the economy. Given the weak monetary policy transmission in Vietnam, the SBV continues to manage financial risks through non-interest rate measures, such as caps on credit growth and other macro-prudential measures.

The SBV continues to carry out a market-driven management of the exchange rate—a key step to enhance responsiveness to external volatility. While maintaining a crawling exchange rate peg, the SBV has been setting a daily reference rate in line with the market, instead of periodic one-off devaluations that had been the case

in the past. The dong has depreciated slightly, by about 1.4 percent, since the beginning of 2019 through mid-September, while foreign reserves has recovered to the equivalent of about 3.2 months-of-imports at the end of June 2019 from 2.8 months in December 2018.

While Vietnam's trade performance remains relatively resilient, it has not been insulated from the escalating global trade tensions. During 1H-2019, exports are estimated to have slowed from 16.3 percent in 1H-2018 to 7.2 percent (y/y, value-terms), the slowest pace since 1H-2016 (5.8 percent)—albeit well the above global trade growth. Vietnam's trade balance, nevertheless recorded a surplus of US\$1.6 billion in H1-2019, given the moderation in import growth more than offset the deceleration in export growth.

Vietnam appears to be benefitting from export diversion following the escalation of the China-U.S. trade dispute. During 1H-2019, the U.S. imports from Vietnam grew by about 33 percent (y/y) and accounted for roughly 22 percent of Vietnam's total exports, an increase from 19 percent share in 1H-2018. The U.S-China trade tension could lead to Vietnamese exports replacing some of the Chinese exports in the U.S. markets, as well as some U.S. exports to China being affected by China's retaliatory tariffs. Vietnam seems to be gaining in market share for those goods where the higher tariff imposed by the United States has caused Chinese exports to contract, such as phones and parts, computers, apparel, footwear, furniture, steel and plastics. Concurrently, with a trade to GDP ratio of close 200 percent (in 2018), Vietnam is exposed to heightened uncertainty and potential disruptions to global supply chains. Further, given the widening trade surplus with the U.S., Vietnam could also become a target for tariff and other trade-related protection measures from the United States.

Sustained fiscal discipline and robust growth have supported a further decline in Vietnam's public debt-to-GDP ratio from a peak of 59.6 percent in 2016 to an estimated 54.6 in 2019, and is now well below the legislated debt-ceiling of 65 percent. Taking advantage of

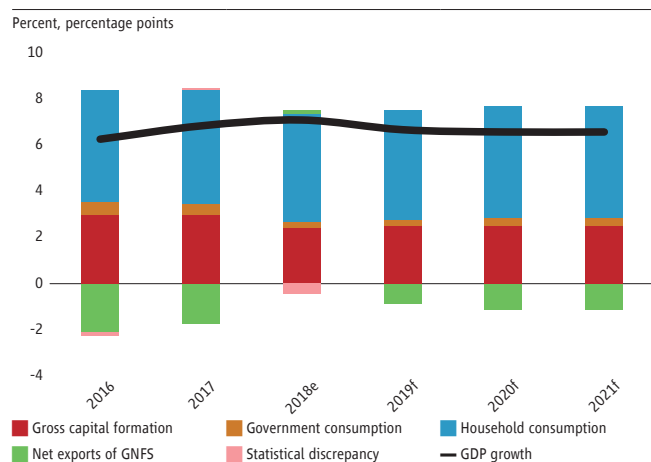
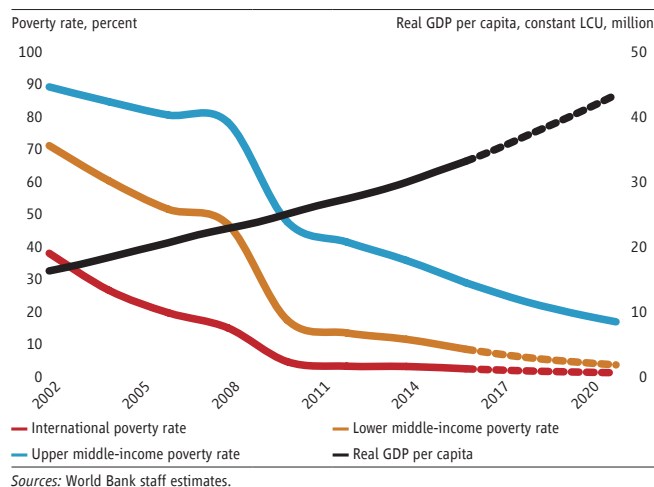
favorable domestic market conditions, improved investor confidence and lower yields, the government has continued to shift into longer-dated domestic debt instruments, and lower average interest rate on its debt portfolio.

Outlook

Vietnam's medium-term outlook remains positive. Real GDP growth is projected to decelerate from 7.1 percent in 2018 to 6.6 percent in 2019, reflecting slower export growth and weaker agricultural production growth. Growth is expected to further moderate in 2020 and 2021 to a more sustainable pace of 6.5 percent, in line with potential output. Over the forecast horizon, inflation is projected to stay below the government's 4 percent target, and the current account is estimated to sustain a smaller surplus. The fiscal deficit is projected to decline through 2021, reflecting ongoing fiscal consolidation efforts.

Risks and Challenges

Vietnam remains susceptible to changing global economic conditions, given its high trade openness and relatively limited fiscal and monetary policy buffers. An escalation of trade tensions and a sharper than expected global downturn could weigh on Vietnam's growth. On the domestic front, a slowdown in the restructuring of the state-owned enterprises and banking sectors could adversely impact the macro-financial situation and undermine long-term growth prospects.

Figure 1. Real GDP growth and contributions to real GDP growth**Figure 2. Actual and projected poverty rates and real GDP per capita**

| VIETNAM Macro Poverty Outlook Indicators | 2016 | 2017 | 2018 | 2019e | 2020f | 2021f |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Annual percent change unless indicated otherwise | | | | | | |
| Real GDP growth, at constant market prices | 6.2 | 6.8 | 7.1 | 6.6 | 6.5 | 6.5 |
| Private Consumption | 7.3 | 7.4 | 7.3 | 7.3 | 7.3 | 7.2 |
| Government Consumption | 7.5 | 7.3 | 6.3 | 4.2 | 6.5 | 6.0 |
| Gross Fixed Capital Investment | 9.9 | 10.2 | 8.2 | 8.2 | 8.1 | 8.0 |
| Exports, Goods and Services | 13.9 | 16.7 | 14.3 | 10.0 | 12.6 | 13.6 |
| Imports, Goods and Services | 15.3 | 17.5 | 12.8 | 10.4 | 13.0 | 13.8 |
| Real GDP growth, at constant factor prices | 6.2 | 6.9 | 7.2 | 6.6 | 6.5 | 6.5 |
| Agriculture | 1.4 | 2.9 | 3.8 | 2.4 | 2.0 | 2.0 |
| Industry | 7.6 | 8.0 | 8.9 | 8.0 | 8.0 | 8.0 |
| Services | 7.0 | 7.4 | 7.0 | 6.8 | 6.7 | 6.7 |
| Inflation (Consumer Price Index) | 3.2 | 3.5 | 3.5 | 3.7 | 3.8 | 3.8 |
| Current Account Balance (% of GDP) | 2.9 | 2.1 | 2.3 | 1.9 | 1.4 | 1.3 |
| Fiscal Balance (% of GDP) | -3.9 | -4.7 | -4.4 | -4.4 | -4.2 | -3.9 |
| Debt (% of GDP) | 59.6 | 58.3 | 55.7 | 54.6 | 53.6 | 52.7 |
| Primary Balance (% of GDP) | -2.0 | -2.7 | -2.4 | -2.3 | -2.1 | -1.9 |
| International poverty rate (\$1.9 in 2011 PPP) ^{a,b} | 2.0 | 1.6 | 1.4 | 1.2 | 1.0 | 0.8 |
| Lower middle-income poverty rate (\$3.2 in 2011 PPP) ^{a,b} | 8.4 | 7.1 | 5.9 | 5.0 | 4.3 | 3.6 |
| Upper middle-income poverty rate (\$5.5 in 2011 PPP) ^{a,b} | 29.0 | 25.8 | 22.9 | 20.4 | 18.3 | 16.4 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast. a) Calculations based on EAPPOV harmonization, using 2014-VHLSS and 2016-VHLSS. Actual data: 2016. Nowcast: 2017–2018. Forecast are from 2019 to 2021. b) Projection using annualized elasticity (2014–2016) with pass-through = 1 based on GDP per capita in constant LCU.

