Economic Outlook and Progress of Regional Cooperation and Integration in Asia and the Pacific

Cyn-Young Park
Direction of Regional Cooperation and Integration
Economic Research and Regional Cooperation Department
Asian Development Bank

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Key messages

• Developing Asia to continue solid growth at 6.0% in 2018 and 5.9% in 2019

• PRC growth moderates with greater focus on financial stability; India rebounds from temporary reform related setbacks

• Key risks stem from escalating trade tensions, rising US interest rates, and accumulating domestic private debt

• Heightened global financial interconnectedness poses risks to financial stability
Developing Asia’s growth to remain solid

GDP growth (%)

NIEs = newly industrialized economies of Hong Kong, China; Republic of Korea; Singapore; and Taipei, China

Source: Asian Development Outlook database.
… amid continued robust growth in major advanced economies

<table>
<thead>
<tr>
<th>GDP growth (%)</th>
<th>2017 Actual</th>
<th>2018 projection</th>
<th>2019 projection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major industrial economies $^a$</td>
<td>2.3</td>
<td>2.3</td>
<td>2.0</td>
</tr>
<tr>
<td>United States</td>
<td>2.3</td>
<td>2.7</td>
<td>2.4</td>
</tr>
<tr>
<td>Euro area</td>
<td>2.6</td>
<td>2.2</td>
<td>1.9</td>
</tr>
<tr>
<td>Japan</td>
<td>1.7</td>
<td>1.1</td>
<td>1.0</td>
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</tbody>
</table>

$^a$ Average growth rates are weighed by gross national income, Atlas method.
Synchronized trade resurgence

Growth in nominal exports

-60 -40 -20 0 20 40 60

Bangladesh
Cambodia
Nepal
Pakistan
Hong Kong, China
Brunei Darussalam
People's Rep. of China
Japan
Philippines
Sri Lanka
Thailand
Singapore
New Zealand
India
Taipei, China
Kyrgyz Republic
Myanmar
Malaysia
Rep. of Korea
Indonesia
Lao PDR
Australia
Viet Nam
Armenia
Mongolia
Georgia
Kazakhstan
Tajikistan
Azerbaijan

Sources: CEIC Data Company (accessed August 2018).
Trade recovery expected to moderate

Nominal Export Growth
(%, y-o-y, 3-month moving average)

Note: Trade values for months with no data were estimated using average growth rate during the preceding three years.
Domestic demand still the main growth driver…

Demand-side contributions to growth, selected economies, 2017

Notes: ASEAN = Association of Southeast Asian Nations; NIEs = newly industrialized economies; GDP = gross domestic product; HKG = Hong Kong, China; IND = India; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PHI = the Philippines; PRC = People’s Republic of China; SIN = Singapore; TAP = Taipei, China; THA = Thailand. IND data refers to H1 FY2017. Components do not add up to total due to a statistical discrepancy.

Sources: Haver Analytics and CEIC Data Company (accessed 2 March 2018); Asian Development Outlook database.
...and strong consumption set to continue

Consumer confidence index, % change

Notes: Data for Hong Kong, China; Malaysia and Philippines are on a quarterly basis. For the Philippines, the index refers to consumer expectations, computed as the percentage of households that answered in the affirmative less the percentage of households that answered in the negative. A positive (negative) CEI indicates a favorable (unfavorable) view.

Source: Haver Analytics; CEIC Data Company (accessed 13 August 2018).
## 2018 and 2019 should consolidate gains

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<tbody>
<tr>
<td><strong>East Asia</strong></td>
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<tr>
<td>China, People’s Rep. of</td>
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<td>6.6</td>
<td>6.4</td>
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<tr>
<td>Hong Kong, China</td>
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<td>4.0</td>
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<tr>
<td>Taipei, China</td>
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<td>Malaysia</td>
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<tr>
<td>Singapore</td>
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<td>3.1</td>
<td>2.9</td>
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<tr>
<td>Thailand</td>
<td>3.9</td>
<td>4.2</td>
<td>4.1</td>
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<tr>
<td>Viet Nam</td>
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<td>7.1</td>
<td>6.8</td>
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<tr>
<td><strong>South Asia</strong></td>
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<td>6.5</td>
<td>7.0</td>
<td>7.2</td>
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<tr>
<td>India</td>
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<td></td>
<td>6.7</td>
<td>7.3</td>
<td>7.6</td>
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<tr>
<td><strong>Central Asia</strong></td>
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<td>4.3</td>
<td>4.2</td>
<td>4.3</td>
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<td>Kazakhstan</td>
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<td>3.7</td>
<td>3.9</td>
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<td><strong>The Pacific</strong></td>
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<td>2.2</td>
<td>2.2</td>
<td>3.0</td>
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<tr>
<td><strong>Developing Asia</strong></td>
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<td></td>
<td></td>
<td>6.1</td>
<td>6.0</td>
<td>5.9</td>
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<tr>
<td><strong>Excluding NIEs</strong></td>
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<td></td>
<td></td>
<td>6.6</td>
<td>6.5</td>
<td>6.4</td>
</tr>
</tbody>
</table>
PRC growth will sustain moderation in favor of reforms

Demand-side contributions to growth

- Growth will dampen over 2018–2019 as planned
- Government priorities to improve quality of growth:
  1. Heading off financial risks
  2. Controlling environmental pollution
  3. Targeted intervention to eliminate poverty

Sources: Bloomberg; Haver Analytics; and CEIC Data Company (accessed 19 February 2018).
Downside risks to the outlook

- Escalation of trade tensions
- Interest-rate induced capital flow shifts
- Impact of private debt and leverage on growth

Improved fiscal and financial positions bolster developing Asia’s resilience to shocks
Potential domestic financial risks

- **Elevated private debt and leverage** driven by an extended period of easy monetary policy and global liquidity

- **Deteriorating bank assets**—with potential spillover to real economy

**Credit to Private Sector—Selected EMEAP Economies** (% of GDP)

**NPL Ratios of Selected Asian Economies** (%)

Source: Bank for International Settlements.

Source: ADB calculations using data from Bank of Mongolia; and World Bank World Development Indicators.
Asia’s regional integration deepens

Intraregional Shares—Asia and the Pacific (% of total)

<table>
<thead>
<tr>
<th></th>
<th>Trade</th>
<th>FDI</th>
<th>Equity</th>
<th>Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>53%</td>
<td>47%</td>
<td>12%</td>
<td>8%</td>
</tr>
<tr>
<td>2017</td>
<td>58%</td>
<td>53% (2016)</td>
<td>19%</td>
<td>16%</td>
</tr>
</tbody>
</table>

FDI = foreign direct investment (flows data); Equity = equity asset holdings (stock data); Debt = debt asset holdings (stock data).

Note: Asia and the Pacific includes ADB’s 45 regional developing members plus Australia, Japan, and New Zealand, where data is available.
Global financial market interconnectedness intensifies

**Pre- AFC**
(1 Mar 1995–1 Jul 1997)

**Post-GFC**
(1 Apr 2010–30 Dec 2016)
Banking network can transmit shocks across borders

Impact of direct and indirect banking exposures to the crisis-affected countries on capital outflows during the GFC

<table>
<thead>
<tr>
<th>Variables</th>
<th>Without Control Variables</th>
<th>With Control Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1) Outflows</td>
<td>(2) Outflows</td>
</tr>
<tr>
<td>Direct exposure of banking sector</td>
<td>0.257*** (0.075)</td>
<td>0.282*** (0.078)</td>
</tr>
<tr>
<td>Indirect exposure of banking sector</td>
<td>0.722** (0.285)</td>
<td></td>
</tr>
</tbody>
</table>

*** = significant at 1%, ** = significant at 5%. Robust standard errors in parenthesis. Coefficients for the control variables are not shown for brevity.
Investors too complacent toward risk?

ADB Financial Stress Index—Asia


Note: Based on (i) banking sector price index, (ii) sovereign yield spreads, (iii) stock market volatility, (iv) stock price index and (v) exchange market pressure index and using the principal components analysis.

Policy considerations

☑ Further develop LCY bond markets for long-term finance and greater financial resilience

☑ Urgently strengthen macroprudential regulation and supervision

☑ Enhance regional financial cooperation to address growing financial interconnectedness

☑ Time to review and strengthen existing financial safety nets