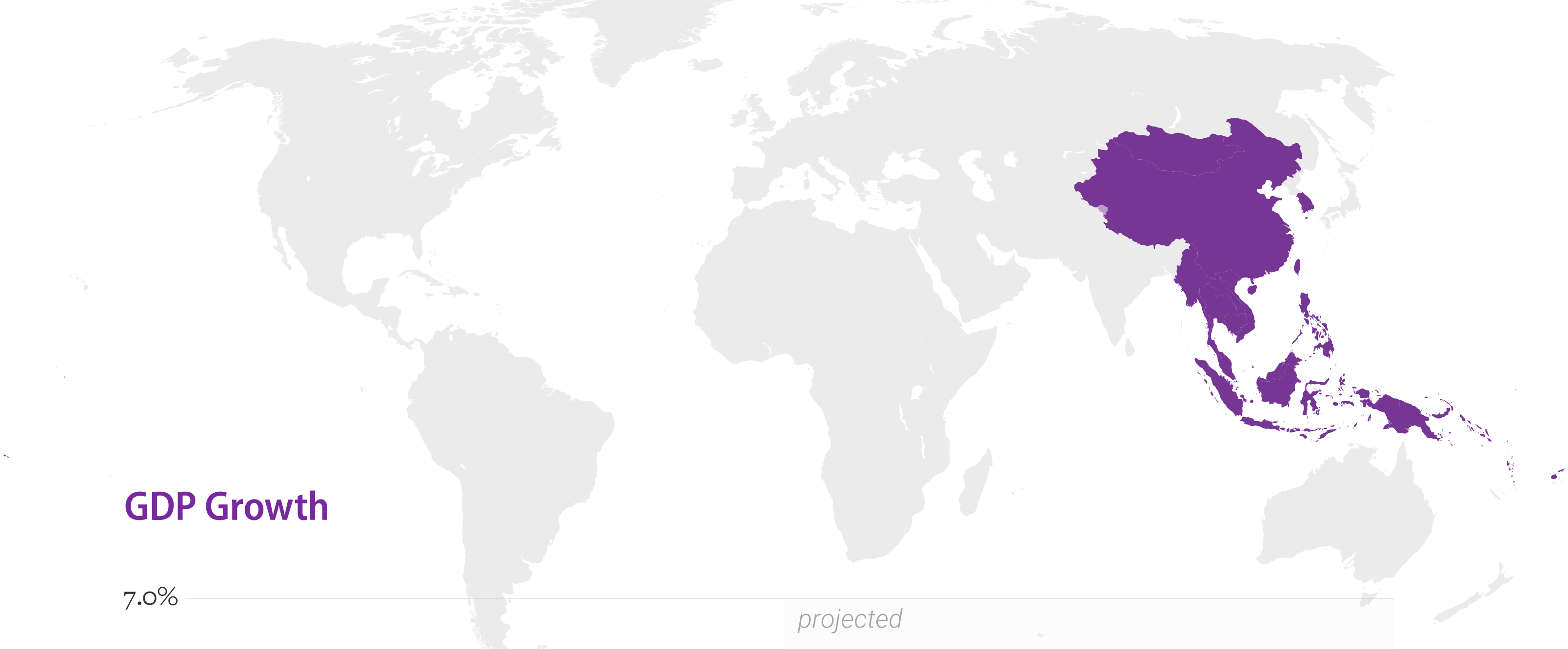
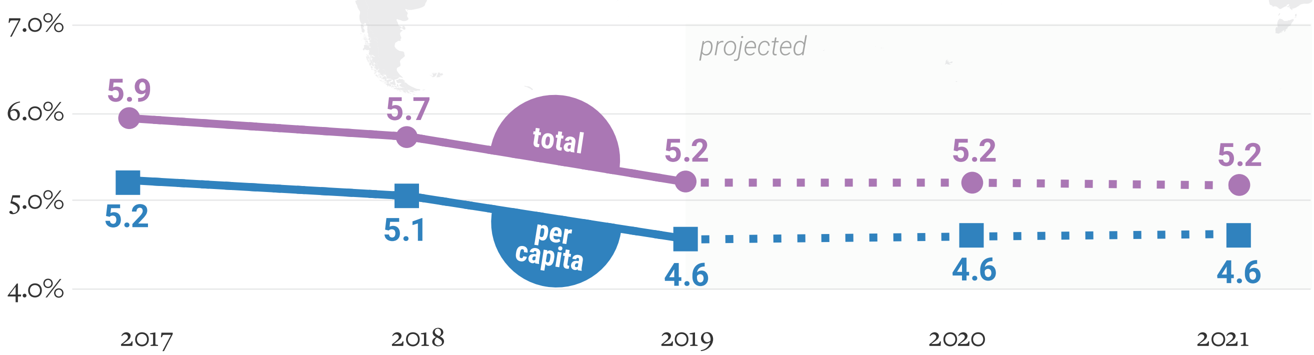
World Economic Situation and Prospects

United Nations
New York, 2020

East Asia

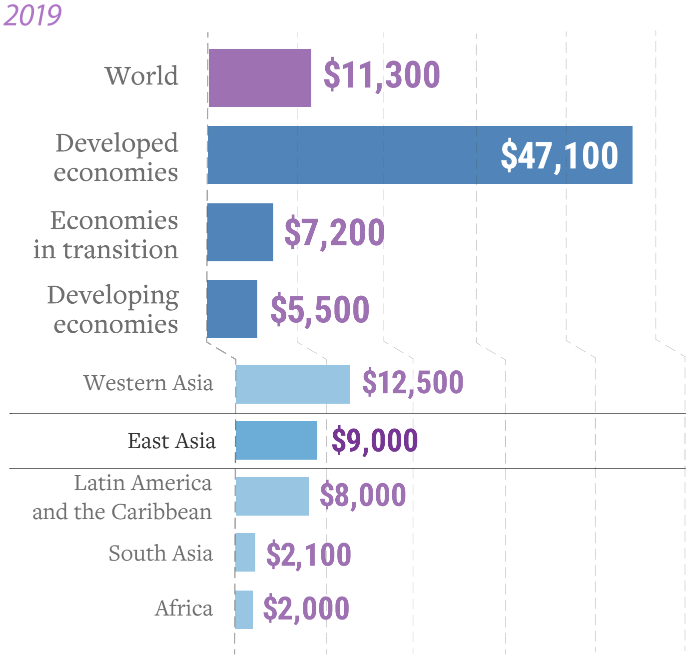


GDP Growth



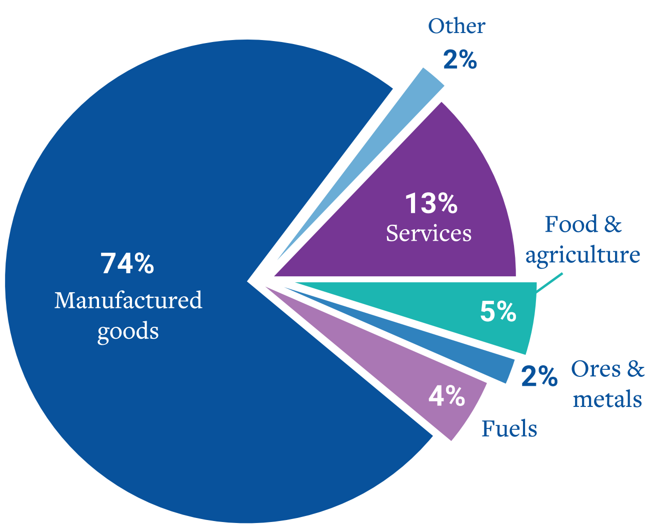
GDP per capita

2019



Export Structure

2018



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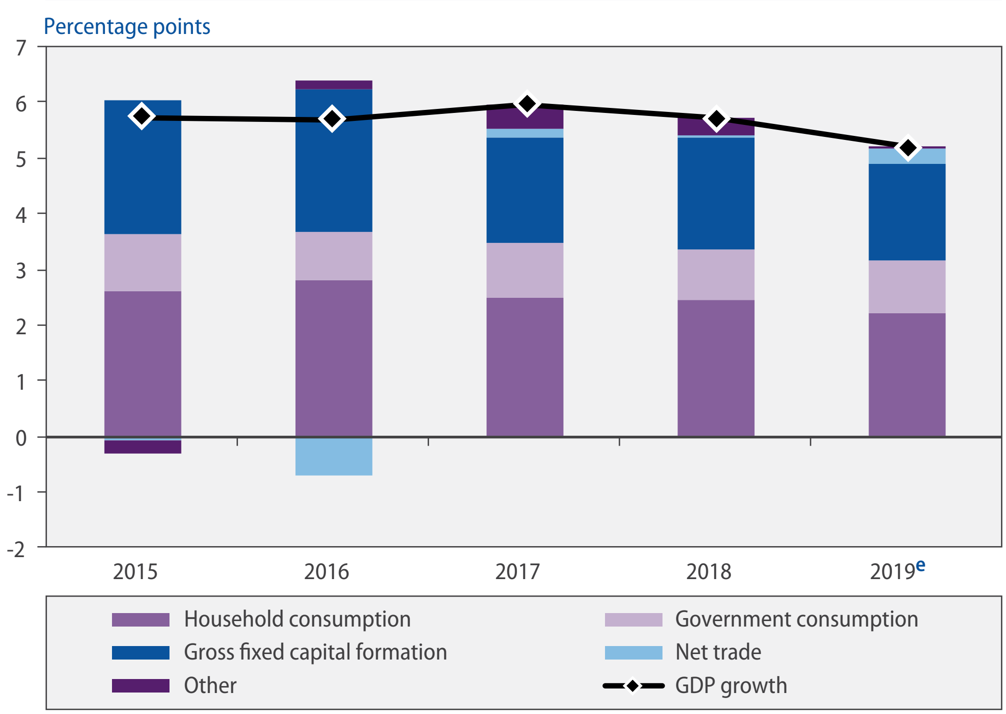
East Asia: growth prospects have softened amid strong external headwinds

- The short-term growth outlook is dampened by persistent trade tensions and high policy uncertainty.
- More accommodative monetary and fiscal policies will support domestic demand.
- Strong short-term headwinds may set back policy efforts geared towards tackling the region's development challenges.

Against the backdrop of an increasingly challenging external environment, the short-term growth outlook for East Asia has weakened. In 2019, regional GDP growth slowed considerably to 5.2 per cent from 5.7 per cent the previous year (see figure III.9). Softening global demand and protracted trade tensions have dampened the region's export growth. As policy uncertainty continues to weigh on business confidence, private investment is likely to remain subdued. Nevertheless, the easing of monetary policies and more expansionary fiscal stances across many East Asian economies will mitigate the effects of external headwinds on domestic demand. Against this backdrop, the region is projected to sustain the more moderate growth pace of 5.2 per cent in 2020 and 2021. Downside risks to the growth outlook have intensified, however, stemming mainly from a potential further deterioration in trade and financial conditions. As policymakers increasingly shift their focus towards supporting short-term growth, there is also a risk that essential resources will be diverted away from efforts to achieve the region's development objectives.

Figure III.9
Contribution to GDP growth in East Asia, by expenditure component



Source: UN DESA.
Note: e = estimates.

Private consumption is likely to remain the key driver of growth

Private consumption is projected to remain the principal driver of growth in East Asia, supported by resilient labour markets, low borrowing costs and modest inflationary pressures. In several countries, including China, the Republic of Korea and Thailand, consumer spending will also be supported by new government measures (such as tax incentives and cash transfers) aimed at boosting household disposable income.

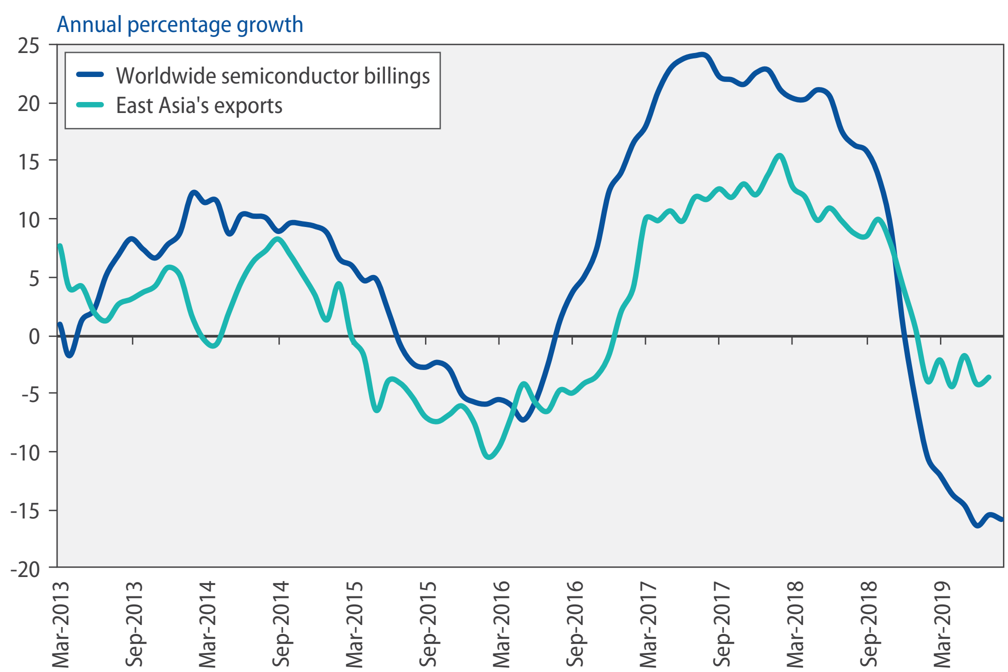
The outlook for private investment has weakened, but public infrastructure spending is likely to strengthen

Despite looser monetary conditions, the slowdown in private investment activity is expected to extend into 2020. Alongside bleak world trade prospects, high uncertainty surrounding the strength of global demand is likely to weigh on investor decisions to embark on large-scale capital expenditure plans, particularly in the export-oriented manufacturing sector. In contrast, public investment is likely to strengthen over the outlook period as Governments in the region continue to pursue infrastructure projects that are mostly geared towards improving transport connectivity. In Indonesia, the Philippines and Thailand, public spending on infrastructure is likely to regain strong growth momentum following the relatively low realization of capital expenditure linked to elections or budget delays in 2019.

Trade performance in East Asia has deteriorated amid ongoing trade tensions

The protracted high trade tensions between China and the United States significantly impacted the region's export performance in 2019. In the first nine months of the year, nominal merchandise exports contracted across almost all economies in the region, with Indonesia, the Republic of Korea and Singapore experiencing the largest declines. In addition, the continuing trade disputes exacerbated an ongoing cyclical downturn in global electronics demand (see figure III.10). In Malaysia, the Republic of Korea, Singapore and Thailand, shipments of electrical and electronics (E&E) products contracted, largely reflecting the strong integration of these economies in global and regional electronics production networks.

Figure III.10
Global semiconductor billings versus export growth in East Asia



Sources: World Semiconductor Trade Statistics; IMF Direction of Trade Statistics.
Note: Growth figures calculated based on three-month moving average, nominal dollar levels.

Recent leading indicators such as new export orders and business sentiment point towards continued weakness in regional trade going forward. While there are signs that the global electronics cycle may have reached a trough, the timing and strength of a turnaround remain uncertain. The high level of uncertainty surrounding the future direction of trade policies and the environment of elevated trade tensions continue to cloud the region's export outlook. Following a series of trade actions in 2018, the United States further expanded tariffs on China in 2019. Notably, in August 2019, the United States announced that it would impose 10 per cent tariffs on an additional $300 billion of Chinese imports, adding to the 25 per cent already levied on $250 billion of Chinese goods. This announcement was met with retaliatory measures by China, fuelling higher trade policy uncertainty. The trade conflict threatened to become more pervasive as disputes expanded to include the technology and telecommunications industries. In October 2019, however, the two parties reached a tentative agreement to delay some of the planned tariffs, and some tariffs were reduced by the end of the year. While this reflects some progress towards an improved bilateral trade relationship, trade tensions could re-escalate if negotiations over the next phase of a trade deal are protracted.

For most parts of the region, the downturn in exports has been due mainly to slower intraregional trade—primarily weaker exports to China. The imposition of United States tariffs on Chinese E&E products and components has had adverse spillover effects on many East Asian economies, given the strong cross-border production linkages of these economies with the E&E industry in China. However, several South-East Asian economies are benefitting from some trade and production diversion away from China due to the trade conflict. The Republic of Korea, Taiwan, Province of China and Viet Nam have experienced a surge in exports to the United States, and FDI inflows into the Philippines, Thailand and Viet Nam have strengthened, suggesting that some rerouting of manufacturing production away from China to other economies is taking place. In the short term, however, this is unlikely to offset the adverse impact from unresolved trade conflicts, as supply chain reconfigurations are likely to proceed at a gradual pace.

The region remains vulnerable to bouts of heightened financial market volatility

As policy uncertainty continues, investor sentiment is likely to remain fragile in East Asia over the outlook period. Financial market conditions in the region improved in 2019 following strong market turbulence that affected most emerging economies the previous year. To a certain extent, the shift towards more accommodative monetary policies by the major developed countries has supported a resumption of short-term capital flows into the emerging regions, including East Asia. Nevertheless, the sharp escalation in trade tensions, particularly in May and August, triggered heightened investor risk aversion and periodic spikes in market volatility during the year.

Equity markets and currencies in the region exhibited a mixed performance throughout 2019 as investors assessed the impact of the trade conflict on the growth prospects of individual economies. In China, stock market performance was dampened by concerns over intensifying trade actions and an ongoing slowdown in the domestic economy. During the year, the renminbi depreciated beyond RMB 7 to the United States dollar, hitting its lowest level since the global financial crisis. Notwithstanding trade-related uncertainties, China's gradual inclusion in major global bond and equity indices is likely to support portfolio inflows in the outlook period. Meanwhile, the escalation in trade tensions also resulted in marked currency depreciations in the Republic of Korea and Taiwan, Province of China. In contrast, Thailand experienced a strengthening of its domestic currency, buoyed by a large current account surplus, and the Philippine peso also appreciated against the United States dollar, supported by an increase in foreign capital inflows.

Inflation is expected to remain modest, dampened by subdued global energy prices

Inflationary pressures are expected to remain modest in most East Asian economies, reflecting softening domestic demand and a weak outlook for global energy prices. In 2019, inflation fell further below central bank targets in the Republic of Korea, Taiwan, Province of China and Thailand. Several other countries, such as Cambodia, Singapore and Viet Nam, also experienced more modest consumer price growth, mainly owing to subdued oil prices. Meanwhile, inflation slowed considerably in the Philippines as the improvement of the agricultural supply led to lower food prices in comparison with the previous year. In contrast, headline inflation rose in China, driven by a significant increase in domestic food prices due to severe weather (which hurt crop production) and the outbreak of African swine flu (which resulted in a pork shortage). Myanmar also experienced an increase in inflation during the year, fuelled in part by a further weakening of its domestic currency and higher electricity tariffs. Nevertheless, in most countries core inflation remains low, reflecting the absence of demand pressures in the region. As trade tensions continue, the inflation outlook in East Asia faces risks from a potential increase in product prices as a result of higher tariffs and more severe supply chain disruptions. Several countries also remain vulnerable to negative domestic supply shocks, which would drive up food prices.

High external risks and slowing growth have prompted an easing of monetary policy stances across the region

Against a backdrop of subdued inflation and rising headwinds to growth, central banks across the region eased monetary policy in 2019. The United States Federal Reserve decision to cut interest rates during the year also created some room for the region to lower policy rates without raising capital outflow risks. As trade tensions worsened, China reduced the reserve requirement ratio for all banks and implemented reforms to its benchmark lending rate in order to boost domestic liquidity and stimulate credit growth. At the same time, central banks in several of the region's export-oriented economies, including Malaysia, the Republic of Korea, Singapore, Thailand and Viet Nam, loosened monetary policy to support economic activity. Slowing growth also prompted Indonesia and the Philippines to embark on a monetary easing cycle, partly reversing a series of rate hikes implemented the previous year.

Given the highly challenging external environment, monetary policy in East Asia is likely to remain accommodative in the outlook period, with further monetary easing expected in parts of the region. However, monetary space is fairly limited in several countries where borrowing costs are already near historic lows; in the Republic of Korea, Taiwan, Province of China and Thailand, key policy rates are currently at or below 1.5 per cent. Furthermore, while a more prolonged period of low interest rates is likely to provide some support to short-term growth, it could potentially exacerbate financial vulnerabilities, in particular high corporate and household debt levels.

The region is expected to embark on more expansionary fiscal policies

Faced with relatively limited monetary policy space, countries in the region are likely to introduce more expansionary fiscal policies to mitigate the effects of persistent trade tensions on domestic demand. In 2019, several countries, including China, Hong Kong SAR, the Republic of Korea and Thailand, announced a range of fiscal and pro-growth measures that include lowering taxes, improving access to finance for small and medium-sized enterprises, promoting job creation and enhancing social welfare. In Indonesia, the Philippines and Thailand, public investment is expected to strengthen as Governments step up infrastructure projects aimed at boosting productivity growth and alleviating structural bottlenecks.

China is projected to expand at a more moderate pace

In China, the protracted trade dispute with the United States will continue to dampen export growth while also weighing on consumer and business sentiment. In an environment of high policy uncertainty and modest global growth, a significant rebound in manufacturing investment appears unlikely over the outlook period. Nevertheless, the further easing of monetary and fiscal policies is expected to support domestic demand going forward. Given these factors, GDP growth is projected to moderate gradually from an estimated 6.1 per cent in 2019 to 6.0 per cent in 2020 and 5.9 per cent in 2021.

In the first three quarters of 2019, the Chinese economy expanded by 6.2 per cent, slowing from 6.7 per cent growth over the same period in 2018. Export growth decelerated sharply, driven mainly by weaker shipments to the United States and to most East Asian economies. However, net exports contributed positively to overall GDP growth, as disruptions to production networks and weaker domestic investment contributed to an even larger decline in import growth. Consumer spending remained solid in 2019, but the growth momentum moderated, as the rise in external headwinds affected consumer confidence. Notably, retail sales growth slowed during the year, attributed in part to a deeper contraction in automobile sales. Going forward, however, private consumption is expected to remain the key driver of growth for the Chinese economy, supported by resilient labour markets, steady job creation, and policy measures to lift disposable incomes.

In 2019, the Chinese authorities announced several additional policy-easing measures aimed at cushioning the adverse effects of the trade conflict. On the financial front, the central bank further lowered bank reserve requirement ratios to boost liquidity and introduced a new benchmark lending rate aimed at reducing corporate borrowing costs. In addition, the Government raised the cap for issuing special-purpose local government bonds to increase the availability of funds for infrastructure investment. It also allowed local authorities to issue bonds earlier than usual in 2019 to help facilitate progress on projects. These measures, however, may exacerbate domestic financial vulnerabilities, leading to higher financial stability risks. In an effort to bolster domestic enterprises, the Government lowered the social security contribution rates for employers and reduced the VAT rate for firms in the manufacturing, transport and construction sectors. To raise medium-term productivity growth and move up the value chain, China has also continued to prioritize efforts to boost the growth of high-technology industries; recently, the Government announced its intention to accelerate the development of blockchain technology.

Deterioration in the external environment has significantly dampened the growth outlook in the Republic of Korea and Singapore

Following a sharp decline in exports and investment, growth in the Republic of Korea is projected to experience a modest rebound, rising from 2.0 per cent in 2019 to 2.3 per cent in 2020. The Government's planned 8 per cent increase in fiscal expenditure for 2020 will provide an impetus to domestic demand, in particular private consumption. Nevertheless, export growth will likely remain sluggish amid high downside risks arising from the slowdown in the electronics cycle and lingering trade tensions with Japan. In Singapore, the economy almost stagnated in 2019, as manufacturing output contracted sharply during the year, buffeted by strong external headwinds. Looking ahead, GDP growth is expected to pick up from 0.4 per cent in 2019 to 1.2 per cent in 2020. The weakness in the electronics sector is likely to persist, dampening export-oriented industries. However, domestic demand is expected to remain resilient, supported by favourable labour market conditions and more accommodative macroeconomic policies.

Meanwhile, growth in Taiwan, Province of China is projected to remain relatively steady at 2.5 per cent in 2020, supported by resilient private consumption and strong infrastructure spending. Business investment is also likely to remain solid, supported by policy initiatives to encourage the reshoring of manufacturing production. While overall export growth moderated in 2019, shipments to the United States grew at a double-digit pace, supported by strong growth in exports of telecommunication and machinery products. This suggests that the economy could benefit from further demand substitution going forward. In Hong Kong SAR, the economy contracted by 1.0 per cent in 2019. The negative effects of trade tensions were compounded by local social unrest, which caused severe disruptions to tourism activity and retail sales. As sentiment deteriorated, private consumption and investment experienced sharp declines during the year. Going forward, economic activity is expected to recover, with GDP projected to expand by 1.6 per cent in 2020. Recent fiscal measures, which include tax reliefs, an increase in social welfare spending, and training schemes for the jobless, will help to boost domestic demand. The baseline growth projections, however, are contingent on domestic headwinds subsiding in the outlook period.

Domestic demand in the ASEAN economies is likely to remain resilient

Despite significantly weaker export performance, growth prospects for the large economies in the Association of Southeast Asian Nations[5] (ASEAN) remain favourable, underpinned by resilient domestic demand. In the Philippines, GDP growth decelerated slightly in 2019 as budget delays contributed to a significant slowdown in public investment. As spending on infrastructure projects picks up, growth is expected to rebound from 5.9 per cent in 2019 to 6.2 per cent in 2020. Private consumption, which accounts for almost 70 per cent of GDP, is expected to remain robust, supported by improving employment, lower inflationary pressures and solid remittance inflows.

As the effects of past expansionary fiscal measures wane, GDP growth in Malaysia is expected to moderate slightly from 4.5 per cent in 2019 to 4.3 per cent in 2020. Household spending will remain the key driver of GDP growth, but the momentum is likely to ease somewhat given slowing wage growth and weakening consumer sentiment. Meanwhile, public investment is expected to pick up following the resumption of large transport infrastructure projects. Nevertheless, given the deep integration of Malaysia in global and regional value chains, a further deterioration in the external environment poses a key downside risk to its growth outlook.

In Thailand, GDP growth slowed considerably to 3.0 per cent in 2019 amid broad-based weaknesses across most economic sectors. During the year, agricultural production was adversely affected by severe drought conditions, while manufacturing activity contracted in tandem with the decline in external demand. Public investment was affected by election-related delays. As some of these factors dissipate, the economy is projected to grow at a slightly stronger pace of 3.1 per cent. The recently announced fiscal stimulus package, which includes measures to support farmers, small and medium-sized firms and low-income households, will also provide some support to domestic demand. Following slower growth of 5.0 per cent in 2019, GDP growth in Indonesia is projected to pick up slightly to 5.1 per cent in 2020. Private consumption is expected to remain robust, buoyed by healthy labour market conditions, subdued inflation and the expansion of social assistance programmes. Infrastructure spending is expected to strengthen over the outlook period, and planned reforms to improve the business environment will support increased FDI inflows going forward. Meanwhile, growth prospects for Viet Nam remain strong, with the economy projected to expand by 6.6 per cent in 2020. Private consumption is expected to remain solid, given rising incomes and moderate inflation. The economy is also benefiting from increasing FDI inflows due in part to investment diversion related to the trade conflict.

Short-term growth prospects for ASEAN least developed countries remain strong

Despite formidable external headwinds, the short-term growth prospects for LDCs in the ASEAN region remain favourable. Buoyed by resilient domestic demand and strong FDI inflows, the economies of Cambodia, Lao People's Democratic Republic and Myan-

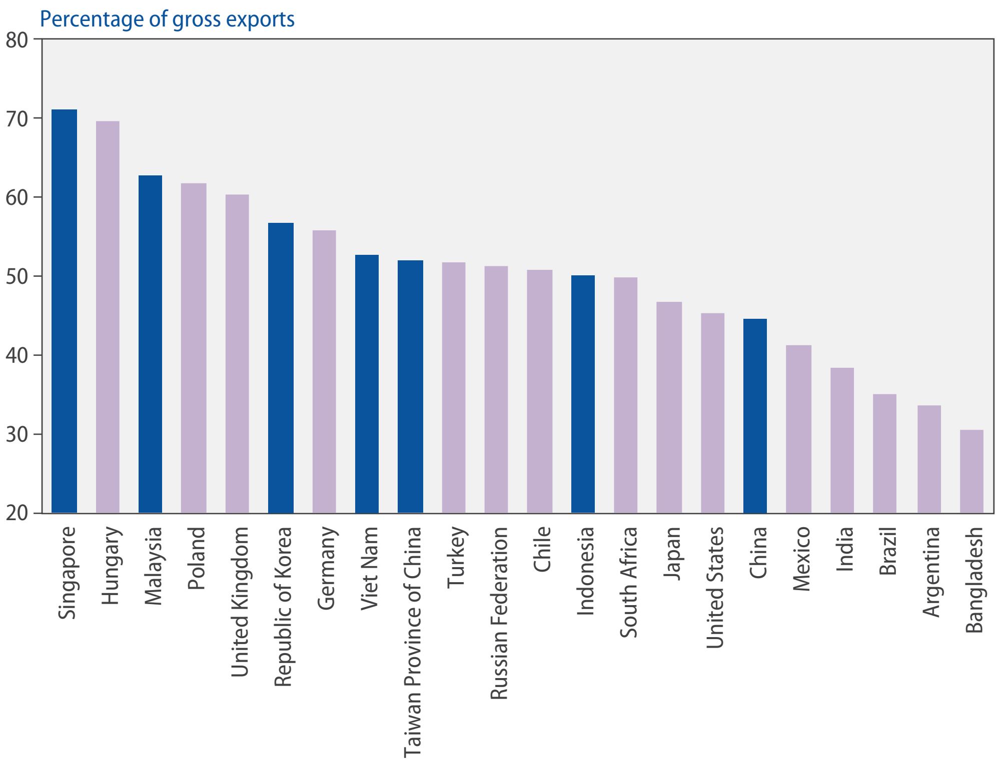
5 ASEAN member countries include Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

mar are projected to sustain strong GDP growth of between 6 and 7 per cent in 2020 and 2021—close to the Sustainable Development Goal growth target of at least 7 per cent for the LDCs. Nevertheless, the region's LDCs continue to face serious structural impediments, in particular poorly diversified economic structures and critical deficits in essential infrastructure, making it extremely difficult for them to boost productivity levels and enhance competitiveness.

Downside risks to the region's growth outlook have intensified

Risks to the growth outlook in East Asia are tilted to the downside. Continued high uncertainty surrounding global trade policies would prolong weaknesses in the external sector but could also generate significant spillovers to the domestic economy. Notably, economies that are deeply integrated into global value chains, in particular those that are centred upon the production of Chinese exports to the United States, are highly vulnerable to a further escalation of trade tensions (see figure III.11). In addition, financial markets in the region remain susceptible to abrupt changes in investor sentiment, potentially triggering large capital outflows. In several economies, high indebtedness—especially corporate and household debt—also poses a risk to domestic financial stability.

Figure III.11
Global value chain participation of selected economies



Source: UNCTAD-Eora Global Value Chain Database.

Note: Countries in blue are part of East Asia. Global value chain participation is estimated based on the share of exports that are imported intermediate inputs and the share of exports that are used by another country in the production of its exports.

While tackling short-term headwinds, policymakers also need to remain focused on addressing the region's development challenges

As policymakers in East Asia continue to unveil measures to boost short-term growth, they also need to remain focused on advancing the region's development agenda. Over the past two decades, most of the East Asian economies have made tremendous strides in improving development outcomes, thanks to strong and relatively stable economic growth. However, progress towards achieving the Sustainable Development Goals has been either insufficient or uneven.

On the social front, the region has made relatively solid headway in eradicating poverty, ensuring healthy lives and promoting well-being. However, pockets of weaknesses remain. For example, vulnerable employment still accounts for around half of total employment in Cambodia, Indonesia, Myanmar and Thailand. Amid insufficient job creation, high youth unemployment is also a growing concern for many countries, including Indonesia, the Republic of Korea and the Philippines. In countries such as Cambodia, Papua New Guinea and Timor-Leste, the share of the working poor (those employed but living on less than $1.90 a day at 2011 PPP) remains in the double digits. These challenges not only constrain productivity growth but also hold the region back from effectively tackling inequality and achieving further reductions in poverty rates.

Importantly, the region's rapid economic growth over the years has come at a high cost to the environment. The Asia-Pacific region, which includes the East and South Asian economies, is home to several of the world's largest carbon emitters—and to 97 of the 100 most air-polluted cities (AirVisual, 2018). For many countries, industrialization and a rising middle class are likely to translate into higher demand for resources and rising emissions in the absence of effective mitigation methods. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP, 2016) warns that climate change and its impact on the environment and ecosystems could force more than 100 million people in the Asia-Pacific region back into extreme poverty by 2030. This highlights the urgent need for countries to incorporate environmental sustainability objectives into their national development strategies, and to understand the resource implications of achieving the Sustainable Development Goals by 2030 (see box III.3).

Box III.3

What is the cost of achieving the Sustainable Development Goals?

An assessment for the Asia-Pacific region

While many countries have mainstreamed the Sustainable Development Goals into their national development plans, only a few have conducted a comprehensive assessment of their resource implications to determine how much additional investment will be required to achieve the Goals by 2030. Such an assessment could help countries effectively mobilize public, private, domestic and external resources and allocate them to priority areas, including through the budgetary process.

UNESCAP, in collaboration with relevant United Nations and other specialized agencies, undertook this assessment for Asia-Pacific countries. The *Economic and Social Survey for Asia and the Pacific 2019: Ambitions beyond growth* estimates that Asia-Pacific developing countries need to invest an additional $1.5 trillion per year to achieve the Sustainable Development Goals by 2030— equivalent to about 5 per cent of their combined GDP in 2018 (UNESCAP, 2019b).

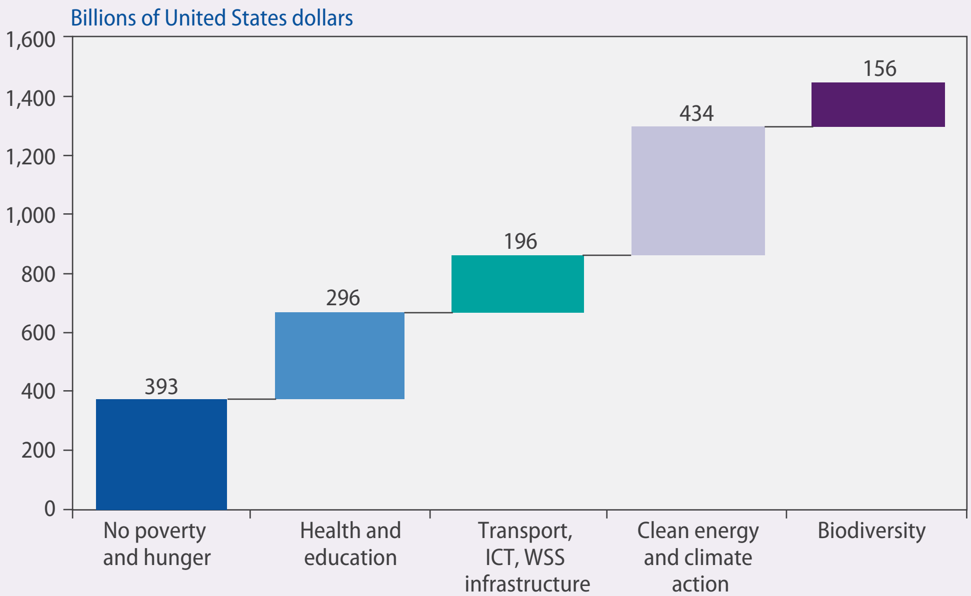
Overall, about 62 per cent of additional investment needs would be capital expenditures and 38 per cent would be current expenditures. The consideration of certain current expenditures as investment is based on a broad definition of investment that includes expenditures if they deliver clear social returns. The investments address interventions along three dimensions to deliver the following:

- ***People:*** protect and promote basic human rights to give more than 400 million people the opportunity to escape from extreme poverty and malnutrition (Goals 1 and 2); build human capacities to provide basic health care for all and a quality education for every child and youth (Goals 3 and 4);
- ***Prosperity:*** provide improved access to transport, information and communications technology, and water and sanitation (Goals 6, 9, 11 and 17);

(*continued*)

Box III.3 (*continued*)

Figure III.3.1
Total annual investment gap for achieving the Sustainable Development Goals in the Asia-Pacific region



Source: UNESCAP (2019b).
Notes: ICT – information and communication technology; WSS – water supply and sanitation.

- ***Planet:*** secure humanity's future by providing clean energy (Goals 7 and 13) and climate-resilient infrastructure (Goals 9 and 13); ensure that humanity can live in harmony with nature by protecting biodiversity (Goals 14 and 15).

The most expensive commitment is transitioning to clean and affordable energy (Goals 7 and 13), for which the region requires an additional investment of $434 billion per year (see box figure III.3.1). Despite significant efforts, progress towards meeting clean energy targets has thus far been uneven. The share of renewable energy in the overall energy mix remained largely unchanged between 2000 and 2018, in spite of the substantial headway made by several countries. The potential for energy efficiency gains is high in the region because of the large amount of infrastructure that will be built and the new technologies that will be adopted in the coming decades. Many of the efficiency innovations are also economically attractive, as they reduce costs, especially over the medium to long term. For example, in 2009 the Government of India distributed 1.41 million energy-efficient compact fluorescent bulbs to replace incandescent lamps, resulting in a reduction of 90,000 tons of carbon emissions per annum, as well as a reduction in costs given the much longer lifespan of the compact fluorescent bulbs.

Financing the Sustainable Development Goals is well within reach for many countries as long as they undertake manageable fiscal reforms, including improved fiscal efficiency, a shift in spending priorities, and enhanced revenue mobilization. However, some countries face daunting challenges; the 2019 *Survey* reveals that the additional investment needs represent more than 16 per cent of GDP for least developed countries in the region and more than 10 per cent of GDP for countries in South and South-west Asia, in comparison with the regional average of 5 per cent. Given their extreme vulnerability to climate change and catastrophic weather events, the Pacific island developing States will need substantial additional investment in disaster-resilient infrastructure, as their annual losses associated with natural disasters are nine times higher than the regional average. The far higher investment requirements for some countries highlight the continuing need for international development support as well as greater South-South cooperation.

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