GLOBAL ECONOMIC PROSPECTS | June 2013 | Annex

EAST ASIA and the PACIFIC REGION

Overview

Growth in the East Asia & the Pacific region slowed to 7.5 percent in 2012, which nevertheless represented 40 percent of global growth. The slowdown was due to slower growth in China, which has started to shift away its economy from excessive reliance on investment and net exports.

Growth in the rest of the region accelerated to 6.2 percent, 1.6 percentage points faster than the average of the preceding decade and comparable to growth during the boom and bounce-back years of 2007 and 2010.

With virtually all countries in the region having recovered from the 2008 crisis—largely thanks to domestic stimulus—rising debt levels and asset bubbles are increasingly a source of concern especially in the context of strong capital flows and weak external demand environment.

Economic outlook: GDP growth in the region is projected to slow to 7.3 percent in 2013 reflecting weak global conditions and waning effects of stimulus measures. China is projected to slow to 7.7 percent rate in 2013 but accelerate to about 8 percent in 2014 and 2015 as global conditions improve.

Growth in the rest of the region is expected to slow to 5.7 percent in 2013 due to fiscal tightening, capacity constraints and a negative contribution from net exports reflecting exchange rate movements and weak external demand. Growth is projected to firm up to about 6 percent in 2014 and 2015 as external conditions improve.

Risks and vulnerabilities: The risk of a serious crisis emanating from high-income countries has declined, but the strength and timing of recovery in Europe remains uncertain.

Developments throughout the region will remain sensitive to outturns in China and Japan. The main risk related to China remains the possibility that high investment rates prove unsustainable, provoking a disorderly unwinding and sharp economic slowdown.

The depreciation of the Japanese yen in response to loose monetary policy is likely to affect some developing-country exports and growth in the short-term. The effects are expected to be balanced overall due to potential gains through supplies of inputs, including parts and components as well as imports of competitive technology, machinery and equipment.

Japanese quantitative easing is likely to exacerbate capital inflows, potentially contributing to demand price pressures, asset price inflation and a further rise in domestic debt encouraged by low borrowing costs. Although net capital flows are not expected to generate sustained pressures on regional exchange rates, low Japanese interest rates could increase capital flows and exchange rate volatility.

The recent decline in global commodity prices may reflect a turning point as past investments came on stream. Should this easing accelerate, fiscal and current accounts, and incomes and growth in commodity exporters like Indonesia, Malaysia, Mongolia, Papua New Guinea (PNG), Timor Leste and Solomon Islands could come under pressure, even as lower prices would benefit importers. The negative impact is expected to be muted in Malaysia and Indonesia where the decline in oil prices will contribute to an improvement of budget balances through a reduction in fuel subsidies.

Policy recommendations: With most of the region having fully recovered from the financial crisis, and many countries growing at historically high rates, policies could become less accommodative. Should capital flows make adjusting monetary policy difficult a larger share of the burden may have to be borne by fiscal tightening, while macro-prudential measures would gain in importance to safeguard financial stability. Fiscal consolidation can perhaps be achieved by rationalizing current spending, which would allow structural reforms and growth enhancing infrastructure investment programs to continue.

Rebuilding buffers to absorb future shocks, remains a priority in Cambodia, Lao PDR, Vietnam, the Pacific islands and Mongolia where gradual global and regional integration has benefitted growth, but also made these economies more vulnerable to global and regional business cycles and commodity price fluctuations.

Recent developments

Although growth in the East Asia and the Pacific region slowed to 7.5 percent in 2012, its contribution to global growth was still an impressive 40 percent

The growth slowdown was largely due to slower growth in China as it started to reduce its reliance on net-exports and investment. China's growth declined to 7.8 percent in 2012—the weakest rate since 1999.

Outside China, regional growth accelerated from 4.6 percent in 2011 to 6.2 percent in 2012. This was 1.6 percentage points faster than the annual average growth rate attained over the preceding decade and comparable only to the growth rates observed during the boom and bounce-back years of 2007 and 2010.

This acceleration partly reflected Thailand's recovery from the devastating floods in 2011(figure EAP. 1). GDP grew 6.5 percent in 2012 versus only 0.1 percent in 2011. But the acceleration was more widespread, if less spectacular elsewhere. Sixty percent of countries in the region grew faster in 2012 than in 2011, and more than two thirds grew faster than 6 percent.

This strong annual performance came despite a mid-year slowdown, caused by slower growth in China and the mid-year ramp-up in Euro Area financial market tensions. After slumping sharply mid-year, real-side activity (industrial production, and exports) picked up pace in the fourth quarter (figure EAP.2).

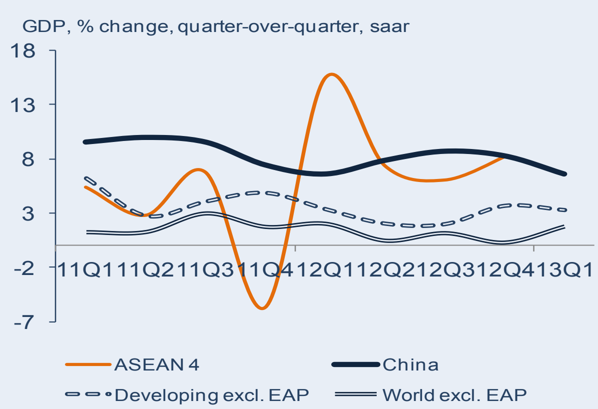
Many countries swiftly reacted to the mid-year slowdown and to the weak external demand by loosening macroeconomic policy

Monetary policy was relaxed, with the majority of the central banks—Malaysia being a notable exception—cutting policy rates during 2012. Vietnam implemented the most aggressive easing, cutting interest rates by 600 basis points, unwinding a tightening of equal magnitude implemented the year before.

Fiscal policy was broadly accommodative with many countries in the region, including Indonesia, Malaysia and Thailand accelerating public-sector investment programs through budget and state-owned enterprise activity, and local government investments, particularly China. Malaysia stepped-up its cash transfers and civil service bonuses, Thailand enlarged its rice subvention scheme and implemented the significant car buyer incentive programs.

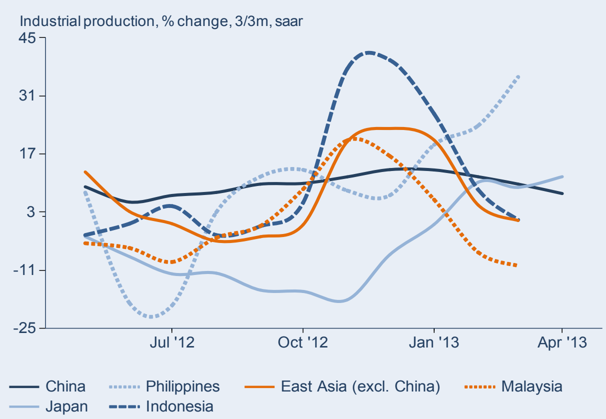
Partly as a result, real credit growth in the region accelerated sharply, reaching 20 percent rate in Indonesia, 14.6 percent in China and 10 percent in Malaysia and Thailand (figure EAP. 3).

Fig EAP.1 **Economic rebound of the East Asia and the Pacific region has been impressive**



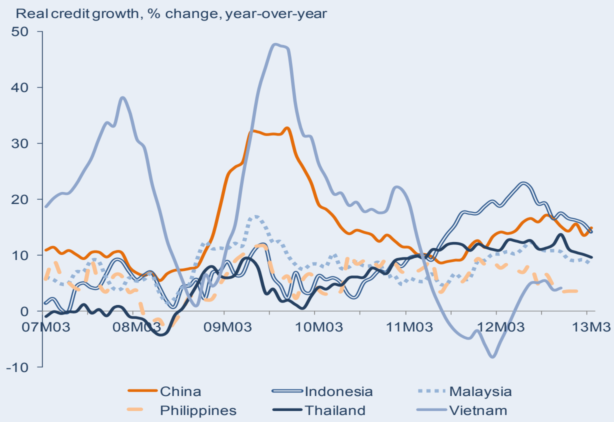
Source: World Bank; Datastream.

Fig EAP.2 **Diverging trends in industrial output growth across the region**



Source: World Bank; Datastream.

Fig EAP.3 **Credit growth accelerated across the region during 2012**



Source: World Bank; IFS; IMF.

The stimulus measures coincided with a revival in global capital flows and demand (see capital flow section below), partly because of the lags involved with macro policy, and contributing to a sharp acceleration in economic activity, with regional quarterly GDP rebounding at a 8.4 percent annualized rate in 4Q2012.

Reflecting the stimuli, central budget deficits deteriorated across the region exceeding 3 percent of GDP in all countries except China, Indonesia, PNG and the Philippines. Consolidated budget deficits, including local budget financing had exceed 3 percent of GDP in China.

The combination of the loose macro policy and fast growth has contributed to a significant rise in private and public-sector debt levels in the region

Government debt remains well below high-income levels (it exceed 100 percent of GDP in some European countries, including Greece, Italy and Portugal, the United States and Japan), but have continued to rise despite high rates of GDP growth in Thailand, Malaysia and China.

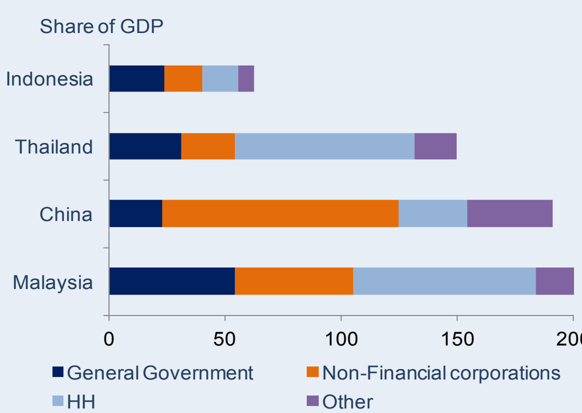
Non-government debt has also been rising in China, Malaysia and Thailand and now exceeds 150 percent of GDP in China and Malaysia and is above 100 percent of GDP in Thailand (figures EAP. 4 & 5).

Household debt represents the larger share of that total, at around 77 percent of GDP in Thailand (consolidated debt to deposit taking corporations and other financial corporations), and is estimated at around 80 percent of GDP in Malaysia.

Rapid growth of household debt resulted from a combined effect of low interest rates and strong demand. Present levels of household debt are about 2-3 times higher of their pre-1997 crisis levels in China, Malaysia and Thailand.

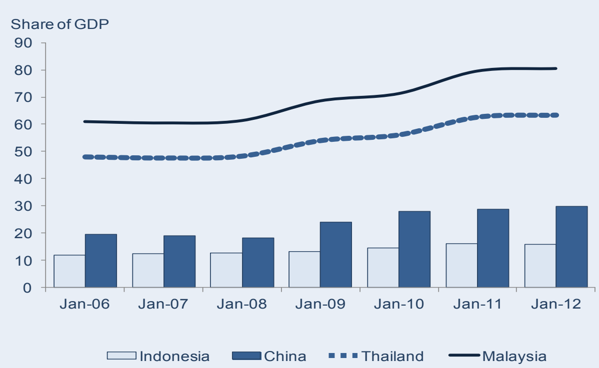
In China, non-Government sector debt is concentrated in the corporate sector (about 2/3s

Fig EAP.4 **Non-financial corporate debt is the largest portion of China's total debt**



Source: World Bank; BIS; IMF.

Fig EAP.5 **Household debt in Malaysia and Thailand is high and expanding**



Note: Decomposition of Malaysia's debt is an estimate. For Thailand, deposit taking corporations only.
Source: World Bank; BIS.

of total non-Government sector debt). The composition of non-Government debt is more balanced and corporate debt is lower than its pre-1995-1997 crisis levels in Indonesia, Malaysia and Thailand.

At the same time, the overall external position of the key Asian economies has been significantly strengthened over the past decades through build-up of foreign asset and strengthening of reserve base. The East Asia economies are also better prepared to cope with external headwinds in the context of the flexible exchange rate regimes that they have been increasingly adopting.

While fast growing Asian economies still have fiscal room to counter-act a possible financial crisis, the rapid build-up of debt during the low-interest rate period increased the exposure of the major regional developing economies and raises certain concerns. It is recommended that favorable growth period could be used to strengthen buffers to counteract future external shocks and reduce vulnerabilities.

Robust, policy-fueled demand conditions boosted import demand across the region while exports remained weak

This increased demand for imports was primarily driven by high rates of investment, which led to a surge in imports, including for capital goods. At the same time, the terms of trade of commodity exporting countries (Indonesia, Malaysia, Mongolia and Papua New Guinea) deteriorated on weaker commodity prices (figure EAP. 6).

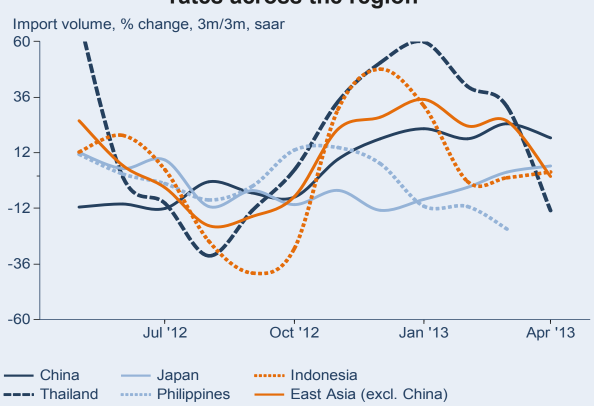
Regional exports meanwhile came under pressure from global weakness. A combined effect of those developments put further pressure on net-exports (exports-imports) which have been an increasingly large drag on growth (figure EAP. 7).

Net-exports subtracted 4 percentage points from overall GDP growth in Malaysia and about 1.5 percentage points in Indonesia and Thailand in 2012. In the Philippines, on the other hand the net-export contribution to growth was positive partly reflecting the post-Tokohu earthquake reconstruction related exports to Japan.

The bulk of developing countries in East Asia & the Pacific region have completed their recovery from the crisis

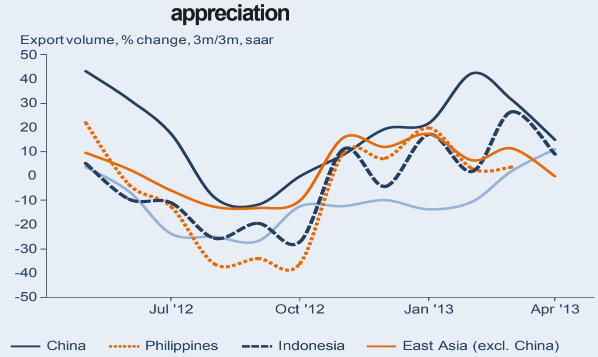
The relatively small hit to regional output in the immediate wake of the crisis and the strong growth since, means that the output gaps (the difference between demand levels and underlying supply potential) either only slightly negative or positive in three quarters of countries in the region in 2012. Less than 1/5th of the countries in the region have been operating at or above their potential since 2011.

Fig EAP.6 Imports expanded at double digit rates across the region



Source: World Bank; Datastream.

Fig EAP.7 Exporter landscape changes partly reflecting the REER moves, but China retains its lead exporter position despite renminbi appreciation



Source: World Bank; Datastream.

Strong growth in the last part of 2012 has contributed to some overheating pressures in a number of countries in the region

The overheating pressures manifested themselves in growing current account deficits (as domestic supply was unable to meet rapidly rising demand), in rising inflation, asset price pressures and high property prices depending on specific country circumstances and policy context.

Strong domestic demand, partly due to high investment rates has contributed to a deterioration in regional current account positions

This deterioration happened despite falling commodity prices, which should have worked in the other direction for the majority of countries in the region. For the ASEAN-4 countries, the deterioration was particularly marked (2.2 percent of GDP), although the group's current account remained in surplus.

Most of this decline was due to an $26 billion, or 3.0 percent of GDP adjustment in Indonesia's current account position reflecting a record trade deficit of $1.7 billion (figure EAP. 8).

In China, the current account surplus seem to have stabilized at around 2.6 percent of GDP, consistent with the earlier sharp adjustments from a peak level of 10.1 percent of GDP in 2007.

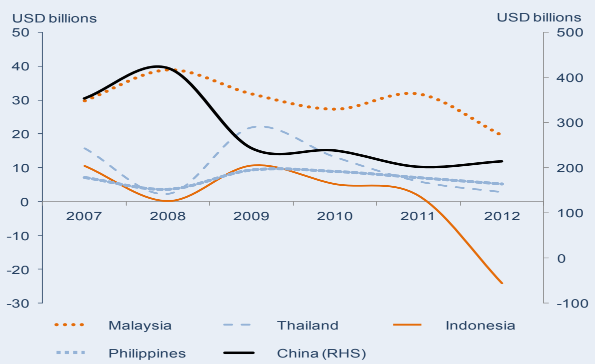
Along the region's smaller economies, Mongolia's current account deficit expanded further reaching about 1/3rd of the country's GDP reflecting both weaker commodity prices and increased investment (with high import content) in the mining sector. Lao and Cambodia continued to record large current account deficits (16 percent and 11.5 percent of GDP respectively).

Inflation in the region as a whole picked up in the first quarter of 2013, but at a 3.1 percent annualized pace remains relatively modest

This aggregate situation masks significant intra-regional variation and mainly reflects relatively modest inflation of 2.7 percent in China (3m/3m saar) versus the rest of the region where it has climbed to 5.1 percent (3m/3m saar) in the three months to April (figure EAP. 9).

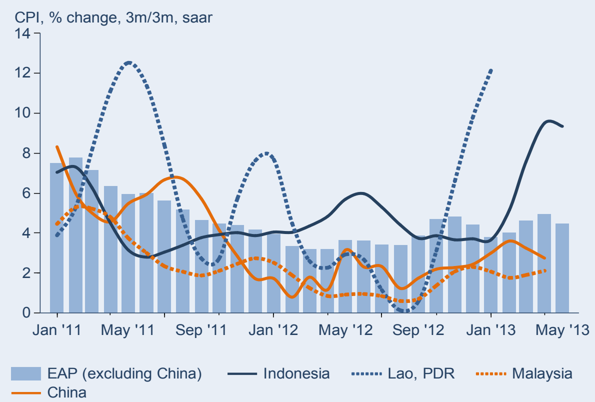
In Indonesia, the quarterly inflation rate accelerated to 9 percent (3m/3m saar) rate in the first quarter reflecting capacity constraints, but also currency depreciation and a rise in food prices due to trade restrictions. Inflation has also accelerated strongly in Lao, PDR and core inflation remains high and the headline inflation extremely volatile in Vietnam despite a slowing of growth.

Fig EAP.8 **Current account positions have generally deteriorated especially for the commodity exporters**



Source: World Bank; Datastream.

Fig EAP.9 **Selected countries in the region experience price pressures**



Source: World Bank; IMF; IFS; Datastream.

In China, where growth has been slowing, inflation pressures are less of a concern and the headline inflation rate remains anchored around the central bank's revised 3.5 percent inflation target. However price pressures are present in certain rapidly growing segments of the economy, including real estate.

Excess demand pressures and loose monetary conditions may also be contributing to asset price bubbles in the region

Overall, the region's stock market performance has been mixed. The regional stock market composite, the MSCI EMF Asia Index, up only about 10 percent since June 2012 and dropped by about 2 percent in the first four months of 2013. Nevertheless, it outperformed the global emerging market benchmark indicator which registered an overall 4 percent loss so far this year.

The modest performance of the regional index masks diverging trends i.e. underperformance of Chinese stocks and record highs reached by some ASEAN country stocks. ASEAN markets boomed with some markets (Indonesia, Thailand, Lao, PDR and The Philippines) advancing by 30-50 percent since last May (table EAP. 1).

The rapid increase in stock prices combined with high price-earnings ratios (between 17 and 22 still below those in high-income countries) are raising concerns about overvaluation of stocks. In fact, the top performing East Asian developing market stocks (Indonesia, the Philippines and Thailand) have seen about a 7-8 percent decline in past few weeks from this year —around mid-May—picks.

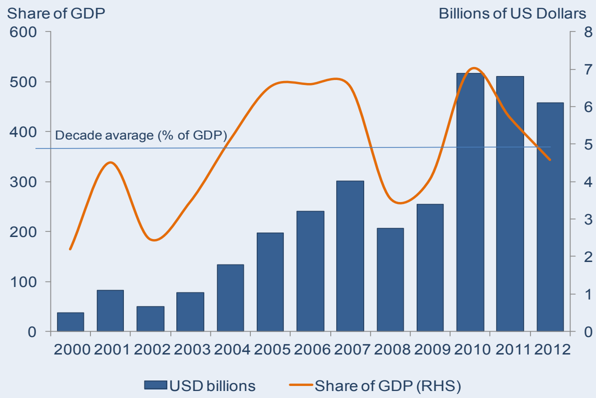
Property prices continued to increase with the average square meter prime property price about two times more than the average per capita income in Cambodia,[FN1] 1.3 times—of that in China and about 60 percent of the average per capita income in Indonesia and Thailand (compared with about 10 to 30 percent of the average per capita income in high income and developing countries).

Table EAP.1 **Asian stock performance**

	as of June 10, 2013			as of May 16, 2013		
	Value	Year To Date:	1-Year:	Value	Year To Date:	1-Year:
MSCI EMF Asia	651.267	-1.91%	9.70%	679.07	0.84%	10.00%
Philippines Stock Exchange PSEi Index	6,875.60	19.95%	38.43%	7,310.94	27.35%	53.84%
Vietnam Ho Chi Minh Stock Index / VN-Index	524.56	28.92%	25.81%	490.34	20.05%	13.21%
Jakarta Stock Exchange Composite Index	4,777.37	12.00%	26.28%	5,078.68	18.40%	30.62%
Stock Exchange of Thailand SET Index	1,528.55	11.81%	36.18%	1,617.89	18.32%	42.52%
Laos Securities Exchange Composite Index	1,338.82	10.21%	31.87%	1,376.45	13.31%	33.35%
FTSE Bursa Malaysia KLCI Index	1,787.80	7.71%	17.43%	1,766.72	5.94%	19.23%
Hong Kong Hang Seng Index	21,615.09	-3.01%	17.67%	23,082.68	2.43%	24.08%
Korea Stock Exchange KOSPI Index	1,932.70	-3.11%	4.75%	1,986.81	-0.51%	7.97%
Shanghai Stock Exchange Composite Index	2,210.90	-2.03%	-1.83%	2,251.81	-0.69%	-1.57%
Mongolia Stock Exchange Top 20 Index	14,998.14	-14.83%	-20.45%	13,543.99	-23.09%	-33.32%
Tokyo Stock Exchange Tokyo Price Index TOPIX	1,111.97	30.64%	55.80%	1,245.23	46.16%	72.01%
S&P 500 Index	1,642.81	16.30%	26.86%	1,654.90	16.96%	27.73%
NASDAQ Composite Index	3,473.77	15.68%	23.49%	3,479.36	15.84%	23.11%
Dow Jones Industrial Average	15,238.59	17.67%	24.69%	15,260.43	17.71%	24.45%

Source: Bloomberg.

Fig EAP.10 **Net capital flows recovered to their 2011 levels in nominal terms, but fell short of average levels as share of GDP observed over the past decade**



Source: World Bank; Datastream.

Gross rental yields increased to 9 percent in Indonesia[FN2] and 6-7 percent in the Philippines and Thailand, which is two-three times higher than high income and developing country average.

Capital flows

The improvement in global financial market conditions during the second half of 2012 (see GEP January 2013) combined with the strong growth in the East Asia and the Pacific region attracted increased capital flows to the region towards year-end. Overall net flows reached $457.8 billion—about 10 percent lower than in 2011 or about 4.6 percent of regional GDP (figure EAP. 10). The composition of the net capital flows to the region has changed reflecting local conditions. Equity flows, reached about 74 percent of the total inflows to the region reflecting a US$54.8 billion (about 38 percent y/y reduction) decline of short-term debt flows due to lower trade financing (table EAP.2).

FDI inflows, which represent the bulk (more than 90 percent) of total equity inflows declined by 8.3 percent (by US$ 27.9 billion in nominal terms), while net portfolio equity inflows quadrupled (from US$ 8.4 billion in 2011 to US$31 billion in 2012) recovering to their pre-2011 level in nominal terms. The Bond issuance in the region, rose

Table EAP.2 **Net capital flows to East Asia and the Pacific ($ billions)**

	2008	2009	2010	2011	2012e	2013f	2014f	2015f
Capital Inflows	206.9	255.1	516.5	510.1	457.8	471.8	481.9	515.3
Private inflows, net	207.3	251.2	513.5	508.7	457.6	471.9	483.2	517.2
Equity Inflows, net	203.8	183.9	329.5	343.2	337.9	325.6	327.7	331.6
Net FDI inflows	211.3	153.7	289.7	334.9	306.9	302.9	300.3	298.2
Net portfolio equity inflows	-7.6	30.2	39.8	8.4	31.0	22.7	27.4	33.4
Private creditors. Net	3.6	67.3	184.0	165.4	119.7	146.3	155.5	185.6
Bonds	1.2	8.4	20.8	18.9	35.4	39.6	33.7	29.6
Banks	17.9	-6.1	13.2	1.8	-2.4	8.1	10.3	12.3
Short-term debt flows	-13.3	65.0	148.9	144.9	90.1	98.3	111.3	143.2
Other private	-2.3	0.03	1.1	-0.2	-3.4	0.3	0.2	0.5
Official inflows, net	-0.4	3.9	3.0	1.4	0.2	-0.1	-1.3	-1.9
World Bank	1.2	2.2	2.7	0.9	0.3			
IMF	-0.05	0.1	-0.02	-0.03	-0.2			
Other official	-1.5	1.6	0.3	0.6	0.1			

Source: The World Bank

Note : e = estimate, f = forecast

insignificantly to $35.4 billion in 2012 (a 16.5 percent increase) from what was a robust pace of issuance ($18.9 billion) in 2011.

Economic outlook

While signs of overheating appeared in several economies in 2012, the pace of expansion has eased in 2013Q1 reflecting fiscal tightening, and slow recovery of external demand

Output growth slowed in China and in the other fast growing ASEAN-4 economies, particularly in Malaysia and Thailand following a sharp acceleration in the second half of 2012. In Malaysia, first quarter GDP growth came at a negative 2.5 percent saar, slowing from 8 percent rate in 2012Q4 mainly reflecting fiscal consolidation but also negative contribution from net-exports. Thailand's output has contracted sharply in Q12013 following a revised 11.7 percent quarter-on-quarter saar growth in 2012Q4.

In China and Indonesia, the slowing was less pronounced. China's first quarter GDP growth declined to a 6.6 percent quarter-over-quarter saar, from 8.7 percent in 2012Q4. In Indonesia, GDP expanded at an estimated 5.3 percent (q/q saar) in the first quarter of 2013, after a brisk 6.9 percent increase in 2012Q4 (figure EAP. 11).

Regional industrial production activity also slowed to 6.0 percent (q/q, saar) in the first quarter, reflecting modest slowdown in China and a much sharper correction among ASEAN economies.

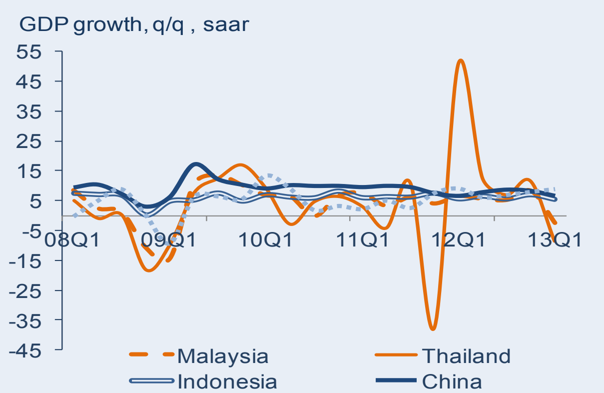
Prospects for the region going forward point to a modest acceleration in activity during the rest of 2013, but annual growth is projected to be lower than in 2012

Forward looking indicators suggest positive and broadly-based, if somewhat weaker, growth going forward. For instance, Purchasing Managers' Indexes (PMI) for all countries in the region recovered above the 50 threshold in April, but remain volatile showing some recent strengthening for Indonesia and weakening for Vietnam (figure EAP. 12).

The projected pick up in activity will nevertheless deliver somewhat slower growth in the region with China estimated to growth at 7.7 percent in 2013 slightly below a 7.8 percent rate of 2012.

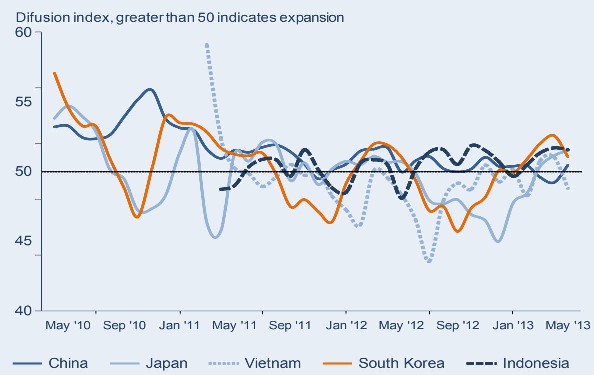
This will be combined with some quite significant easing in ASEAN economies (5.7

Fig EAP.11 Quarterly growth eased in Malaysia and Thailand



Source: World Bank; Datastream.

FigEAP.12 East Asia & Pacific PMIs signal economic expansion



Source: World Bank; Datastream.

percent in 2013 versus 6.2 percent in 2012) (table EAP.3). Output growth pattern in ASEAN reflects a combination of continued strong growth in Indonesia and certain easing in Malaysia, Thailand and the Philippines from record high levels achieved in 2012.

Regional growth is projected to recover to 7.5 percent in 2014 and 2015 on improved external conditions, but the dramatic change in Japanese policy introduces significant uncertainty into the forecast for developing East Asian and the Pacific region

The projected slowdown of economic growth in these three countries is reflecting capacity constraints and an expected fiscal tightening of policy in response to inflationary and asset price pressures and growing debt levels, but also weak recovery of global demand, including a projected decline in demand for imports from Japan due to yen depreciation.

Monetary conditions remain relatively loose with the majority of the central banks on hold or easing, including recent rate cuts in Mongolia, Vietnam and Thailand.

Cambodia, Lao, Mongolia and Myanmar are projected to continue to deliver strong growth benefiting from a dynamic economic transformation, although the prospects for the region's small(er) economies are mixed.

Output gains from the completion of a new gold mine in Lao PDR have already been realized and so growth is projected to slow. In Cambodia, a rebound in global trade should support further improvements in garment production and exports.

Table EAP.3 East Asia and Pacific forecast summary

(annual percent change unless indicated otherwise)	00-09[a]	2010	2011	Est. 2012	Forecast 2013	2014	2015
GDP at market prices [b]	8.1	9.6	8.3	7.5	7.3	7.5	7.5
(Sub-region totals-- countries with full NIA + BOP data) [c]							
GDP at market prices [c]	8.1	9.7	8.4	7.5	7.3	7.6	7.5
GDP per capita (units in US$)	7.3	8.9	7.6	6.8	6.7	6.9	6.9
PPP GDP	8.0	9.6	8.3	7.5	7.3	7.5	7.5
Private consumption	6.0	7.3	8.0	8.2	8.0	8.0	7.9
Public consumption	7.4	9.7	9.0	8.4	8.2	8.1	7.5
Fixed investment	10.8	11.4	8.8	8.2	6.8	6.4	5.6
Exports, GNFS [d]	10.3	23.7	8.6	4.4	8.7	9.5	10.1
Imports, GNFS [d]	9.6	19.5	6.2	5.4	8.4	8.9	9.3
Net exports, contribution to growth	0.8	2.7	1.5	0.0	0.8	1.0	1.1
Current account bal/GDP (%)	4.6	3.8	2.7	2.2	2.0	1.9	1.9
GDP deflator (median, LCU)	5.4	5.3	5.6	4.4	3.9	5.1	4.0
Fiscal balance/GDP (%)	-1.8	-1.6	-1.4	-1.9	-2.3	-2.5	-2.4
Memo items: GDP							
East Asia excluding China	4.4	6.9	4.6	6.2	5.7	5.9	6.0
China	9.4	10.4	9.3	7.8	7.7	8.0	7.9
Indonesia	4.6	6.2	6.5	6.2	6.2	6.5	6.2
Thailand	3.5	7.8	0.1	6.5	5.0	5.0	5.5

Source: World Bank.
a. Growth rates over intervals are compound weighted averages; average growth contributions, ratios and deflators are calculated as simple averages of the annual weighted averages for the region.
b. GDP at market prices and expenditure components are measured in constant 2005 U.S. dollars.
c. Sub-region aggregate excludes Fiji, Myanmar and Timor-Leste, for which data limitations prevent the forecasting of GDP components or Balance of Payments details.
d. Exports and imports of goods and non-factor services (GNFS).

Table EAP.4 East Asia and Pacific country forecasts

				Est.	Forecast		
	00-09[a]	2010	2011	2012	2013	2014	2015
Cambodia							
GDP at market prices (% annual growth) [b]	7.2	6.0	7.1	7.3	7.0	7.0	6.2
Current account bal/GDP (%)	-10.7	-10.1	-8.7	-11.5	-10.1	-9.3	-9.0
China							
GDP at market prices (% annual growth) [b]	9.4	10.4	9.3	7.8	7.7	8.0	7.9
Current account bal/GDP (%)	5.0	4.1	2.8	2.6	2.5	2.5	2.4
Fiji							
GDP at market prices (% annual growth) [b]	1.3	0.1	1.9	2.1	2.2	2.3	2.3
Current account bal/GDP (%)	-7.7	-7.7	-7.8	-7.5	-22.5	-7.8	-7.5
Indonesia							
GDP at market prices (% annual growth) [b]	4.6	6.2	6.5	6.2	6.2	6.5	6.2
Current account bal/GDP (%)	2.5	0.7	0.2	-2.4	-2.5	-1.9	-1.9
Lao PDR							
GDP at market prices (% annual growth) [b]	6.2	8.5	8.0	8.3	8.0	7.7	8.3
Current account bal/GDP (%)	-2.5	-6.4	-10.6	-16.0	-21.8	-20.9	-20.2
Malaysia							
GDP at market prices (% annual growth) [b]	3.9	7.2	5.1	5.6	5.1	5.1	5.3
Current account bal/GDP (%)	12.6	11.1	11.1	7.7	4.6	3.1	2.4
Mongolia							
GDP at market prices (% annual growth) [b]	5.8	6.4	17.5	12.3	13.0	11.5	9.9
Current account bal/GDP (%)	-6.3	-14.3	-30.3	-30.5	-22.8	-19.4	-19.4
Myanmar							
GDP at market prices (% annual growth) [b]	9.7	5.3	5.5	6.3	6.5	6.6	6.7
Current account bal/GDP (%)	-0.7	-1.3	-2.6	-4.1	-4.2	-4.8	-5.1
Papua New Guinea[c]							
GDP at market prices (% annual growth) [b]	3.0	7.6	9.0	9.0	4.0	7.4	20.0
Current account bal/GDP (%)	-0.1	-25.6	-36.4	-28.4	-20.2	-13.0	9.0
Philippines							
GDP at market prices (% annual growth) [b]	4.0	7.6	3.6	6.8	6.2	6.4	6.4
Current account bal/GDP (%)	1.5	4.5	3.1	2.8	2.8	2.7	2.6
Solomon Islands							
GDP at market prices (% annual growth) [b]	4.3	7.8	10.5	4.8	4.0	4.0	5.1
Current account bal/GDP (%)	-19.8	-30.8	-6.0	-5.8	-10.6	-8.7	-8.5
Thailand							
GDP at market prices (% annual growth) [b]	3.5	7.8	0.1	6.5	5.0	5.0	5.5
Current account bal/GDP (%)	3.3	3.1	1.7	0.7	0.0	0.0	0.1
Timor-Leste							
GDP at market prices (% annual growth) [b]	3.3	9.5	10.6	10.6	10.4	10.2	9.0
Current account bal/GDP (%)	18.4	48.1	55.0	43.5	36.2	25.0	24.0
Vietnam							
GDP at market prices (% annual growth) [b]	6.6	6.4	6.2	5.2	5.3	5.4	5.4
Current account bal/GDP (%)	-8.8	-3.8	0.2	5.9	5.6	3.3	1.0

Source: World Bank.

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

Samoa; Tuvalu; Kiribati; Democratic People's Republic of Korea; Marshall Islands; Micronesia, Federated States; N. Mariana Islands; Palau; and Tonga are not forecast owing to data limitations.

a. GDP growth rates over intervals are compound average; current account balance shares are simple averages over the period.

b. GDP measured in constant 2005 U.S. dollars.

c. The start of production at Papua-New-Guinea-Liquefied Natural Gas (PNG-LNG) is expected to boost PNG's GDP growth to 20 percent and shift the current account to a 9 percent surplus in 2015.

Source: World Bank.

Projections for Mongolia have been revised downwards, due to delays in major mining projects and lower commodity prices. In Myanmar, the reform momentum and continued improvements in the international environment are projected to drive growth gradually toward 6.5 percent in 2013/14 and 6.6 percent in 2014/15.

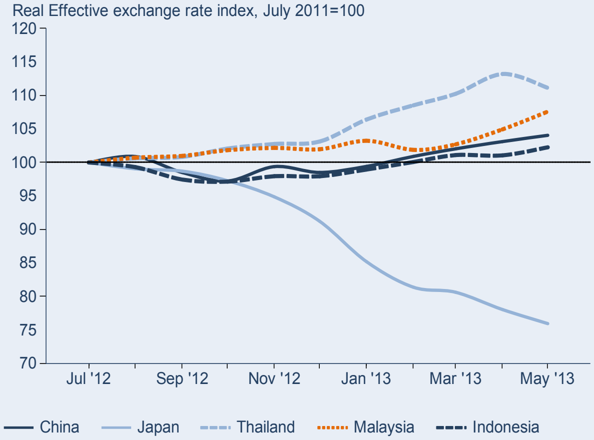
The outlook for the Pacific Islands is positive, but given the small size of many economies, the precise shape of the forecast will depend on the timing with which ongoing and planned investment projects in the extractive sector come on stream (table EAP.4).

Countries in East Asia and the Pacific region which have close direct trade ties with Japan have seen their currencies hit harder by yen's depreciation than other developing economies

Thailand experienced a sharp 13.4 percent real-effective appreciation of its currency since July 2012 as the yen depreciated in real effective terms by over 22 percent (figure EAP. 13). In the short-term, exchange rate depreciation is likely to hurt the exports of countries that compete in the same kinds of markets as Japan (South Korea, Singapore, Taiwan, China) and those linked to those economies through supply chains, especially in generally weak demand environment.

Fig EAP.13 **East Asia & Pacific regional REER moves**

Real Effective exchange rate index, July 2011=100



Source: World Bank; Datastream.

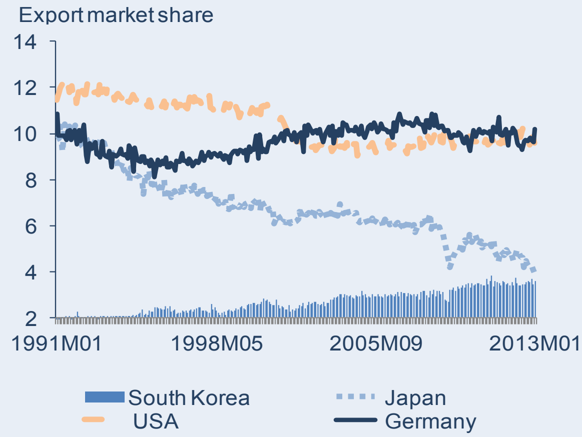
Those negative impacts are expected to be balanced by potential gains through supplies of parts and components. The economies, such as the Philippines, and Thailand that are important suppliers of parts and components to Japan in regional production networks, could benefit from gains by Japanese exporters in global markets. In addition, increased demand for a number of key regional export commodities (e.g. gas from Malaysia) despite the overall deceleration of Japan's import demand, are also expected to benefit the region. Additional benefits are expected through competitive imports, which would allow the regional firms and businesses to benefit from the ability to import Japanese technology, machinery and equipment at lower costs.

If sustained over time, the depreciation of the yen could eventually alter the dynamics of trade in the region. It would help cut the region's trade deficits even further, especially between the EAP region and Japan, as Japan is EAP's largest source of imports and fourth largest export destination. In the medium-term and assuming that Japan's growth accelerates and imports eventually pick-up, trade partners in the region would benefit from an increase in Japan's demand for regional imports.

In general, Japan's recovery as well as recovery of its exports will depend on depth of the structural reforms and its ability to boost productivity (figure EAP. 14). Overall, as competitive pressures increase, the developing economies in the East Asia and the Pacific region should continue to focus on financial stability and accelerate structural reforms to alter their productivity and competitiveness.

Less certain is the likely impact of Japanese quantitative easing on Japanese capital flows toward regional economies. For countries already operating at close to full capacity, additional capital inflows can be expected to increase upward pressure on currencies, or if monetary authorities intervene upward

Fig EAP.14 Selected country shares of global exports over the past two decades



Source: World Bank; Datastream.

pressure on money supply, credit and inflation. How large these effects may be will depend on the extent to which outward flows increase and the extent to which developing countries are destinations for these flows (see discussion in main text and for more detail in the exchange rate annex).

Risks and vulnerabilities

Uncertainties related to economic recovery in high income countries have subsided, but are still present. Regional risks have gained importance.

The regional outlook remains sensitive to outturns in China, with the main risk stemming from the possibility of an abrupt decline in China's high investment rates (see World Bank, 2013a for more).

In addition, as discussed above, there are considerable uncertainties surrounding the impact of Japan's shift in macroeconomic policy. Overall, weak yen could affect the dynamics of trade in manufactures in the region in the short-term. By extending periods of low interest rates and boosting capital flows, Japanese QE could also contribute to further pressures on asset prices and may encourage further risk taking and credit growth. Rising debt levels and asset prices in the emerging East Asia & Pacific economies are already the growing source of vulnerability (see discussion on page 4-5). Should these trends intensify, a disorderly unwinding of these pressures, including perhaps a domestic banking-sector crisis, cannot be ruled out, potentially. In ordered to reduce the likelihood of such an outturn fiscal policy likely needs to be tightened already in 2013 and monetary policy focus should be shifted to financial stability and tail risk considerations. In the medium-term, if Japan manages to escape its deflation and rekindle growth with the measures taken, all developing economies in the region would benefit through various channels, including through an increase in Japan's demand for imports (see also EAP Economic Update and Main text).

A strong supply increase in extractive commodity markets following a quintupling in capital expenditures globally has already put downward pressure on prices. If these were to intensify, commodity exporting countries, including Indonesia, Malaysia, Mongolia, PNG could see government revenues and current account balances, which are in some cases already very high (e.g. more than 30 percent of GDP in Mongolia) come under significant pressure — even as lower prices would benefit importers. In such a lower price scenario, if investment projects are cancelled and anticipated increases in output not materialized, countries could find themselves in financial difficulty. External debt is especially high in Mongolia (more than 130 percent of GDP), and in Papua New Guinea (about 100 percent of GDP).

Policy recommendations

Ensuring strong and stable consumption through raising household incomes to sustain growth is a priority in China along with the reorientation of investments toward agriculture, human capital and services and increased efficiency of investment. The process of rebalancing also involves a gradual shift in the structure of China's debt toward a reduction of corporate sector debt, including through reduction of non-performing assets accumulated during the years of investment-led growth.

Policymakers in fast-growing-close to (or above) full capacity ASEAN economies where policies have been relaxed in recent years, including Indonesia, Malaysia, Thailand and the Philippines should be focusing their actions on avoiding overheating and rebuilding fiscal and monetary buffers which will be challenging in a continued weak external demand environment. Slower growth in conditions of overheating may be desirable.

However, while there are clear costs associated with overheating, especially when fast growth has been accompanied by rapid credit expansion, there are equally clear opportunity costs associated with prematurely slowing an economy and potentially forgoing fast growth and rising incomes. Countries that are too quick to respond to changes in the global environment, risk the of inadvertently running pro-cyclical policies. A balanced approach in implementing policy tightening is recommended. Macroeconomic policy needs to be more closely driven by local economic conditions, including the level of activity, building on the previous efforts toward de-coupling the economies from external demand.

Over the medium-term, the East Asia & Pacific economies will benefit from continued efforts to deepen structural reforms and to keep their global competitive edge in the context of intensifying global and regional competition. Countries need to place greater emphasis on ensuring that market forces are given sway to incite investment flows into the most productive assets, including human capital which will over time boost potential output.

Rebuilding buffers to deal with future shocks, including with commodity shocks remains a priority in Lao PDR, Vietnam, the Pacific islands and Mongolia where gradual global and regional integration has benefitted growth, but also made these economies more vulnerable to global and regional business cycles and commodity price fluctuations. The effectiveness of the on-going economic transformation in Myanmar, establishing a track record of reforms under the WTO accession framework by Lao, and progress in implementing market oriented reforms in Cambodia and Vietnam are also important elements of ensuring sustainable growth.

Notes:

1 Footnote 1 (Price per square meter / GDP per capita)*100

2. The gross annual rental income, expressed as a percentage of property purchase price. This is what a landlord can expect as return on his investment before taxes, maintenance fees and other costs.

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