*EMBARGOED: NOT FOR PUBLICATION, BROADCAST, OR TRANSMISSION UNTIL MONDAY, APRIL 7, 2014 at 11 A.M. SINGAPORE TIME (3 A.M. GMT, APRIL 7; or 11 P.M. EDT, APRIL 6)*

WORLD BANK EAST ASIA AND PACIFIC ECONOMIC UPDATE APRIL 2014

# Promoting Competitiveness and Sustainable Growth

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1 2 3 4 13 12 11 10



ISSN: 2079-5874

Key title: World Bank East Asia and Pacific Economic Update … (Print)

Abbreviated key title: World Bank East Asia Pac. Econ. Update (Print)

Cover photo: The World Bank Photo Collection

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# Abbreviations

| | |
|---|---|
| ACE | Asian Economic Community |
| ACIA | ASEAN Comprehensive Investment Agreement |
| AFAS | ASEAN Framework Agreement on Trade in Services |
| ASEAN | Association of Southeast Asian Nations |
| ATF | Agreement on Trade Facilitation |
| BOP | balance of payments |
| CPC | Communist Party of China |
| CPI | Consumer Price Index |
| DBM | Development Bank of Mongolia |
| eop | end of period |
| ESI | Estimated Sustainable Income |
| ETFs | exchange-traded funds |
| EU | European Union |
| FAI | fixed asset investment |
| FDI | foreign direct investment |
| FORs | foreign ownership restrictions |
| GATS | General Agreement on Trade in Services |
| GDP | gross domestic product |
| GST | goods and sales tax |
| GVC | global value chain |
| JBIC | Japan Bank for International Cooperation |
| LNG | liquefied natural gas |
| M&A | mergers & acquisitions |
| mom | month-over-month |
| MSMEs | micro, small, and medium-size enterprises |
| NAO | National Audit Office |
| NIL | Negative Investment List |
| NTMs | nontariff measures |
| p.a. | per annum |
| PE | price-earnings (ratio) |
| PIEs | Pacific Island Economies |
| PMI | Purchasing Manager Index |
| PNG | Papua New Guinea |
| PPG | public and publicly guaranteed |
| PPI | Producer Price Index |
| PPP | purchasing power parity |
| RERF | Revenue Equalization and Reserve Fund |
| SAR | special administrative region |
| SDA | Special Deposit Account |
| SITC | Standard International Trade Classification |
| SOE | state-owned enterprise |
| VAMC | Asset Management Company |
| WTO | World Trade Organization |
| yoy | year-on-year |

*Regions, World Bank Classification and Country Groups*

| | |
|---|---|
| ASEAN-4 | Indonesia, Malaysia, Philippines, and Thailand |
| EAP | East Asia and Pacific |
| ECA | Europe and Central Asia |

| | |
|---|---|
| LAC | Latin America and the Caribbean |
| Mekong-4 | Cambodia, Lao PDR, Myanmar, and Vietnam |
| MENA | Middle East and North Africa |
| SAS | South Asia |
| SSA | Sub-Saharan Africa |

*Currency Units*

| | |
|---|---|
| B | Thai bhat |
| CR | Cambodian riel |
| D | Vietnamese dong |
| F$ | Fiji dollar |
| K | Myanmar kyat |
| K | Papua New Guinea kina |
| Kip | Lao PDR |
| ₱ | Philippine peso |
| RM | Malaysian ringgit |
| RMB | Chinese renminbi |
| Rp | Indonesian rupiah |
| SI$ | Solomon Island dollar |
| Tog | Mongolia |
| US$ | Timor-Leste |
| US$ | United States |
| Y | Chinese yuan |

# Preface and Acknowledgments

The *East Asia and Pacific Economic Update* is a joint report of the East Asia Pacific Chief Economist's Office and the East Asia Pacific Poverty Reduction and Economic Management Department. Part I was prepared by Antonio Ollero, Ekaterine Vashakmadze, Wael Mansour and Deepak Mishra. Part II.A was prepared by Bingjie Hu. Part II.B was prepared by Montague Lord, Julian Clarke, Fabio Artuso, and Richard Record. Part II.C was prepared by Christine Ablaza, Andrew Beath, Karl Kendrick Chua, Brendan Coates, Tina Epetia, Louie Limkin, JC Punongbayan, Anthony Sabarillo, Sjamsu Rahardja, and Monica Wihardja. The work was supervised by Deepak Mishra and Nikola Spatafora. This report was prepared under the direction of Bert Hofman (Chief Economist, East Asia and Pacific Region) and Sudhir Shetty (Director, Poverty Reduction and Economic Management, East Asia and Pacific Region).

World Bank country economists throughout the East Asia and Pacific Region provided country write-ups and tables and assisted with the analysis. They include: Karlis Smits, Bingjie Hu, Min Zhao, Ashley Taylor, Alex Sienaert, Magda Adriani, Fitria Fitrani, Frederico Gil Sander, Intan Nadia Jalil, Karl Kendrick Tiu Chua, Kai Kaiser, Paul Mariano, Joseph Louie Limkin, Kirida Bhaopichitr, Habib Rab, Viet Tuan Dinh, Enrique Aldaz-Carroll, Sodeth Ly, Alain D'Hoore, Somneuk Davading, Keomanivone Phimmahasay, Tae Hyun Lee, Altantsetseg Shiilegmaa, Khwima Nthara, Douglas Addison, May Thet Zin, Min Ye Paing Hein, Hans Anand Beck, Timothy John Bulman, Virginia Horscroft, Tobias Haque, Lucy Pan, Martin Alton, and David Knight. The country economists worked under the supervision of lead economists Chorching Goh, James Brumby, Mathew Verghis, Rogier J. E. Van Den Brink, Sandeep Mahajan, Robert Johann Utz, and Ahmad Ahsan.

Other World Bank officers and staff provided inputs to the report, including Andrew Burns and Marc Stocker of the Development Prospects Group (DECPG), Swarmin Wagle of the International Trade Unit (PRMTR), and Carl Patrick Hanlon, Anissa Tria Amador, Claudia Gabarain, David Llorico Llorito, and Jane Zhang of East Asia and Pacific External Affairs (EAPXT). The report was edited by Diane Stamm and designed and typeset by Golden Sky, Vietnam.

Developing East Asia and Pacific as used in this report includes China, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Cambodia, Lao People's Democratic Republic (PDR), Mongolia, Myanmar, Timor-Leste, Fiji, Papua New Guinea, Solomon Islands and other island economies in the Pacific. The Newly Industrialized Economies (NIEs) include Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan, China. The ASEAN member countries are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. The ASEAN-4 are Indonesia, Malaysia, Philippines, and Thailand.

# Executive Summary

## PART I

***The global economic recovery remains on track.*** Following several years of subdued performance, global growth is projected to accelerate to 3.0 percent in 2014, 3.3 percent in 2015, and 3.4 percent in 2016. The recovery will be led by high-income countries, aided by reduced policy uncertainty, a slower pace of fiscal consolidation, and renewed private sector activities. Growth in high-income countries is projected to strengthen from 1.3 percent in 2013 to 2.1 percent in 2014 and 2.4 percent in both 2015 and 2016. Growth in developing countries is expected to pick up from 4.8 percent in 2013 to 5.0 percent in 2014, 5.4 percent in 2015, and 5.6 percent in 2016.

***Stronger global growth will help most developing East Asia Pacific (EAP) countries grow at a steady pace while they adjust to tighter global financial conditions.*** Developing EAP successfully navigated the stalled global economic recovery in the first half of 2013, and the expectations of a scaling back of quantitative easing in the second half, to grow by 7.2 percent in 2013 -- only marginally lower than the 7.4 percent in 2012. The region also remained the largest regional contributor to global growth and trade. Growth is expected to remain at 7.1 percent in 2014 as well as in 2015 and 2016. The tailwinds from improving global trade will offset the headwinds from the tightening of global financial markets.

***Growth is likely to ease moderately in most of the larger economies.*** Growth in China is expected to decrease marginally to 7.6 percent in 2014 and 7.5 percent in 2015, from its current pace of 7.7 percent in 2012 and 2013. The larger Association of Southeast Asian Nation (ASEAN) economies are operating close to potential and facing tighter global financial conditions and higher levels of household debt. In 2014, growth is expected to slow in Indonesia (5.3 percent) and the Philippines (6.6 percent), remain unchanged in Thailand (3.0 percent) and accelerate modestly in Malaysia (4.9 percent). Among the smaller economies, some, notably Mongolia, face risks of overheating, while the growth prospects for most of the Pacific Islands remain dependent on aid and remittances from the advanced economies.

***The structure of domestic demand is undergoing adjustment as countries are trying to unwind internal imbalances and respond to external vulnerabilities.*** Over the past quarters, domestic demand, particularly investment, has weakened in Indonesia and Malaysia, reflecting tighter credit, higher debt servicing costs, ongoing fiscal consolidation, reduced profits from commodities, and higher import costs due to weaker currencies. In Thailand, implementation delays and political uncertainties have been the major contributors. Unlike the ASEAN-4, which had limited room to ease policies, China launched an economic support program in mid-2013 centered on boosting government expenditures. The program helped stabilize growth, but also led to the reemergence of investment as the main driver of demand—thereby slowing the rebalancing of the economy.

***External positions have steadily improved in EAP countries, making them better prepared to manage further normalization of monetary policy in advanced economies.*** After deteriorating during the first half of 2013, the trade and current account balances of several EAP countries have improved on the back of rising external demand and weaker currencies. In addition, foreign direct investment flows into developing EAP countries have remained robust. These developments have helped the EAP countries offset the portfolio outflows associated with the scaling back of the quantitative easing program by the

United States. They have also further accumulated reserves to insure against temporary trade and external financial shocks.

***With the global policy cycle shifting, maintaining macroeconomic stability will remain high on the agenda*****.** Recent developments have reinforced the importance of having a flexible exchange rate regime to defend against external shocks, including capital flow reversals. While credit growth has started to decelerate, the legacy of past credit booms remains a concern, especially among the region's larger economies, including China. In some of the smaller economies, overheating is a bigger concern and will require further monetary tightening and fiscal consolidation. The authorities in some of the large economies have employed macro-prudential measures to contain the risks arising from asset price boom including in the real estate market. China's priority is to further reduce total credit growth in the economy, which is still well above nominal GDP growth. There are modest fiscal consolidation efforts underway in several countries, with an emphasis on rationalizing fuel and rice subsides, although more needs to be done to rebuild policy buffers and create space for priority spending.

***The downside risks to the economic prospects of developing EAP are evenly balanced with opportunities for more rapid growth, including through deeper structural reforms.*** At the global level, a slower-than-expected recovery in advanced economies or a steady rise in interest rates, coupled with increased volatility in commodity prices due to recent geopolitical tensions could mean a less hospitable environment for growth. On the other hand, continued steady recovery of the world economy could provide an opportunity for deeper reforms, including the steps needed to create the ASEAN Economic Community by 2015. Similarly, at the regional level, spillovers from a disorderly rebalancing in China could undermine growth prospects for commodity exporters. But, if rebalancing in China were to be successful, it could yield considerable payoffs for its regional trade partners who provide agricultural products, consumption goods, and modern services. And these benefits would be greater if countries were to undertake reforms to facilitate expansion of their services sector.

## PART II

This report also includes a special section focusing on three key emerging issues: China's reform agenda; how to further reduce trading costs in East Asia; and how to promote foreign direct investment, particularly in the service sector.

***China's reform roadmap*****.** The Government of China unveiled an ambitious and comprehensive reform agenda in November 2013. It is a significant policy move, indicating a political will to reduce state interventions and address government-led distortions in the economy. This section describes the content and potential impact of the proposed reform package. If implemented, the reforms will have a profound impact on China's land, labor, and capital markets, and enhance the long-term sustainability of its economic growth. Some reforms are also likely to support growth in the short term. For instance, removing entry barriers, simplifying approval procedures, and reducing regulatory and administrative burdens will enhance incentives for private investment, especially in currently monopolized or concentrated sectors. Likewise, consolidating the business tax with the value-added tax will lower the tax burden and promote investment, in particular in transportation and financial services. Making more land available for commercial activities will also improve the prospects for service sector growth. However, the reform process is likely to be gradual, with more specific follow-up implementation plans expected as the year goes on.

***Trading Costs in East Asia.*** The World Trade Organization's new Agreement on Trade Facilitation (ATF) has the potential to significantly reduce East Asia's trade costs along the entire supply chain. At present, the region's developing economies suffer from trade costs well above those of the newly industrialized countries and of developed economies, due to the large number of inefficient border and behind-the-border procedures. Countries have been adding to their stock of nontariff measures, which now account for as much as 90 percent of (nontransportation) trade costs. The ATF defines a new reform agenda for East Asia with potentially far-reaching effects on private sector development, especially for small businesses, which need greater transparency and simplification of procedures to enable them to readily access regional and global value chains.

***Foreign Direct Investment (FDI) and Foreign Ownership Restrictions in ASEAN.*** Despite the economic importance of FDI to ASEAN, many ASEAN countries restrict foreign equity, particularly in the service sector. Regional experience indicates that where countries have relaxed foreign ownership restrictions, FDI has increased, yielding significant economic benefits for the receiving country. In Cambodia and Vietnam, foreign investment reforms led to significant growth in FDI, as did financial sector liberalization in the Philippines and Thailand in the 1990s. The ASEAN Economic Community 2015 blueprint brings new challenges and opportunities for ASEAN countries. Countries that relax foreign ownership restrictions in services stand to attract more FDI, which will enhance the competitiveness of producers of both services and goods.

# Part I.

# Recent Developments and Outlook

# I.A. Recent Developments

*The developing East Asia and Pacific (EAP) region successfully negotiated the financial turbulence in the summer of 2013 and grew at a healthy 7.2 percent in 2013—contributing more than half of global GDP growth. The bulk of this growth was attributable to China, which grew at 7.7 percent in 2013, matching the rate in 2012 and exceeding the government target of 7.5 percent. However, growth in several of the other larger economies in the region, mainly Indonesia, Malaysia, and Thailand, slowed due to efforts to unwind domestic imbalances and to adjust to the volatile conditions in the global capital market. The smaller economies performed relatively better, though expansive policies are beginning to overheat their economies. Overall, growth in developing EAP (excluding China) fell to 5.2 percent in 2013 compared to 6.2 percent in 2012, bringing it to a lower but more sustainable level.*

## *Economic Growth: Modestly Lower but More Sustainable*

**The East Asia and Pacific (EAP) region grew at a more restrained but sustainable pace during 2013.** Sources of growth shifted from domestic demand during the first two quarters to net exports in the second half. Efforts to unwind domestic imbalances and tighten policies contributed to a sharp decline in economic activity in the first half of the year (figure 1). Investment weakened during the adjustment process, dragging down capital goods imports. Consumption came under pressure from fiscal consolidation efforts, including the expiry of previous consumer support programs and the rationalization of fuel subsidies. Growth lost further impetus from tepid external demand from the advanced economies and a slowdown in China, which hurt manufactured and commodity exports.

**Figure 1. Growth weakened in the first half of 2013, dragged down by domestic demand**
(GDP growth, in percent, year-on-year)

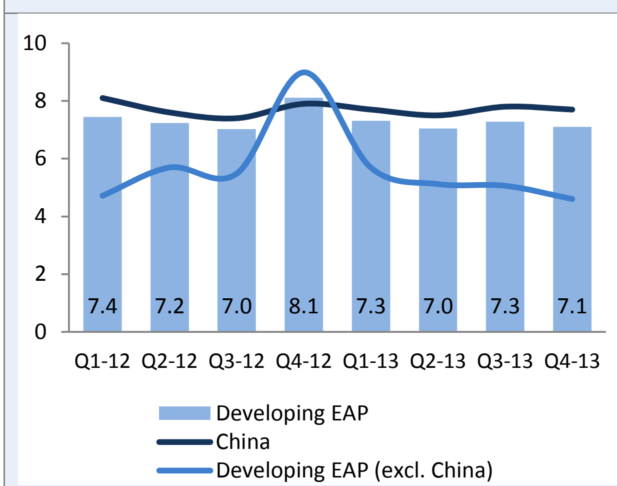
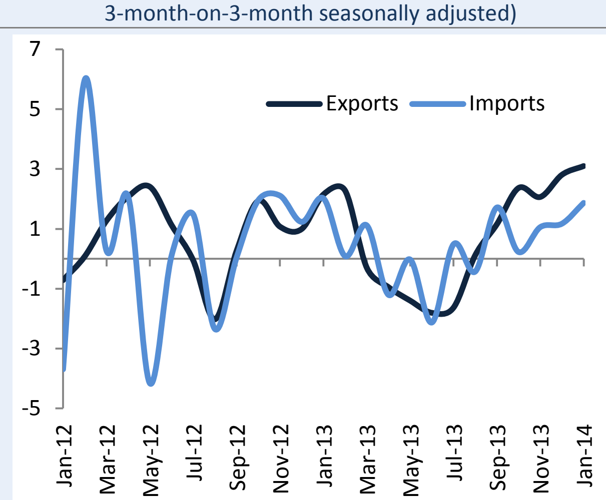



**Figure 2. Exports by developing EAP economies recovered beginning in the second half of 2013**
(Merchandise export and import nominal growth, in percent, 3-month-on-3-month seasonally adjusted)




*Source:* World Bank staff estimates.

**An incipient and simultaneous recovery in key advanced economies and growth-enhancing measures in China reversed outcomes in the second half of the year.** While domestic demand remained generally subdued, except in China, a stronger trade performance was the main driver of improved activity, particularly in the larger EAP economies in the second half of 2013. Exports rebounded with the recovery in the advanced economies and China, while imports growth was less buoyant on continued domestic adjustment (figure 2). Although this helped revive trade, the improved economic prospects in the high-income countries, the anticipation of a change in monetary policies in the United States, and the associated increase in interest rates ignited capital outflows from emerging markets. Appropriate monetary policy responses and flexible exchange rates helped the region withstand balance-of-payment pressures. Overall, regional growth was moderately weaker in 2013 than in 2012, as the effects of domestic adjustment in the first half of the year outweighed the gains from trade in the second. The first two months of 2014 got off to an uneven start, with key indicators unduly affected by weather and seasonal factors (box 1).

**Box 1. Global Recovery Remains Intact Despite the Bumpy Start to 2014**

There was a bumpy start to 2014, notably in China and the United States. In China, industrial production in January–February 2014, at 8.6 percent yoy, was weaker than in the same period in 2013. Exports were also weaker, growing 10.6 percent yoy in January but contracting 18.1 percent yoy in February. The Purchasing Managers Index (PMI) also fell to 49.5 in January and 48.5 in February, both below the index reading of 50+ that represents economic expansion. In the United States, incoming data also suggest that the economy lost momentum in the first quarter. Retail sales grew only 2.3 percent yoy in January and 1.5 percent yoy in February, from 3.9 percent yoy in the fourth quarter of 2013. In particular, auto sales slowed to 3 percent yoy in January and 2 percent yoy in February, from 9 percent yoy in the fourth quarter last year. Industrial production eased to 2.9 percent yoy in January and 2.8 percent yoy in February, compared to 3.3 percent yoy in the fourth quarter last year.

Nevertheless, the fundamental drivers of the recovery remain intact, both in the region and globally. The export performance in China in January–February was most likely distorted by the timing of the Chinese New Year, the effects of export overinvoicing from the year before (which distorted the base year values from which year-on-year growth rates are calculated), and poor external demand from the United States due to adverse weather conditions in the first quarter of 2014. In the United States, although harsh weather conditions closed factories, lowered auto sales, and slowed home sales, the economy managed to add 175,000 jobs in January and 129,000 jobs in February. Construction companies, which usually stop work in bad weather, added 15,000 jobs while manufacturing firms gained 6,000 jobs for the second month in a row. The government also added 13,000 jobs. The PMI, which dropped to 49.6 in January, bounced back strongly to 58.7 in February (the average monthly index reading in 2013 was 53.5).

Elsewhere, activity continues to firm in other high-income countries, while China has announced new measures to support growth. PMI readings in the first quarter of 2014 suggest further gains in momentum in the Euro area. Growth nearly doubled to 1.1 percent quarter-on-quarter Seasonally Adjusted Annual Rate in the fourth quarter of 2013. The recovery is broad-based, with four of the five high-spread economies exiting recession during 2013. In Japan, domestic demand remains robust with signs of further strengthening in the first quarter of 2014, despite unexpectedly weak exports toward the end of 2013. A planned sales tax will be a drag on growth in the second quarter. Some progress is being made on building consensus around structural reforms, however, and their implementation will sustain growth going forward. Meanwhile, China has signaled a readiness to speed up construction projects and initiate other measures in an effort to support growth. The growth target stands at 7.5 percent for 2014.

**The slowdown in growth was most pronounced in the economies that had to make the sharpest domestic demand adjustments or that faced the strongest external headwinds.** Confronting weaker terms of trade, a current account deficit, and capital outflows, Indonesia's economy slowed to 5.8 percent from an average growth rate of 6.3 percent during the previous three years. Hikes in policy rates and a depreciation of the currency helped Indonesia weather the "taper tantrum" over the summer of 2013. Thailand's economy stalled in all demand expenditure categories, posting a growth rate less than half of that the year before at 2.9 percent. The expiry of the car tax rebate scheme, rising levels of household debt, falling commodity incomes, arrears in government subsidy payments to rice farmers, and crumbling consumer sentiment in the face of political instability all crimped consumption. Malaysia cycled down to 4.7 percent, as investment decelerated from double-digit levels. In contrast to the other large Association of Southeast Asian Nation (ASEAN) countries, the Philippines advanced 7.2 percent from 6.8 percent the year before, notwithstanding a devastating earthquake and a deadly typhoon that displaced 4.1 million people and inflicted a combined ₱424 billion (US$9.6 billion or 3.7 percent of GDP) in damages to agriculture, housing, and infrastructure.

**A government support package lifted second-half growth in China.** China launched an economic support program at midyear, centered on boosting government expenditures on railway construction, but also including tax incentives for small businesses and reformed administrative procedures for exporters. Growth stabilized at 7.7 percent for the year, matching last year's rate and exceeding the government indicative target of 7.5 percent. Investment returned as the main driver of growth, helped by an uptick in both infrastructure and real estate investment.

**The smaller economies continue to grow rapidly, but their long-running expansionary policies are overheating their economies.** In Cambodia, the Lao People's Democratic Republic, and Mongolia, expansive fiscal and monetary policies kept growth buoyant but raised financial stability risks. Cambodia's economy, despite adverse effects of political uncertainty and labor unrest, grew at 7.4 percent, helped by rapid credit expansion and rising foreign bank financing. Lao PDR grew at 8.1 percent, the fourth straight year at or above 8 percent, on a doubling of public sector employee pay, higher capital spending, and rapid credit growth, in addition to higher foreign investment in the resource sector. Mongolia posted its third consecutive year of double-digit growth, at 11.7 percent in 2013, with off-budget infrastructure spending by the country's development bank rising to 10 percent of GDP and subsidized lending by the central bank surging to 20 percent of GDP.

**In other countries in the region, growth outcomes largely depended on progress on domestic reforms.** In Vietnam, macroeconomic stability improved with moderate inflation and stronger external accounts, but growth stalled at around 5.4 percent for the second straight year. Structural problems in the state-owned enterprise (SOE) and banking sectors and policy impediments to industrial competition and private investment have lowered its potential growth rate. Myanmar raced to 7.3 percent growth in fiscal year 2012/13 from 5.9 percent earlier. Following progress on its reengagement with the international community, Myanmar followed up with significant reform measures—a new telecommunications law, licenses to foreign mobile telecommunications service providers, a new central bank law, and unification of multiple exchange rates—triggering increased foreign investment.

**Despite subdued economic performance, the EAP region remained the most important driver of global growth in 2013.** The global economy expanded by 2.4 percent, of which 1.1 percentage points, or 45 percent of the total, originated in the EAP region (figure 3). China alone accounted for 28 percent of global growth—a significant increase from its contribution of 25 percent in 2012. The share of high-income EAP countries (Australia; Hong Kong SAR, China; Japan; the Republic of Korea; New Zealand; and Singapore[1]) in global growth increased from 11.5 percent in 2012 to 12.7 percent in 2013, while the

[1] Because comparable data are not available for Taiwan, China, it could not be included in the estimation.

corresponding numbers for the developing EAP region (excl. China) fell modestly from 5.0 to 4.5 percent.

**Figure 3. EAP remains a major driver of global growth**
(Contribution to global GDP growth, in percent)

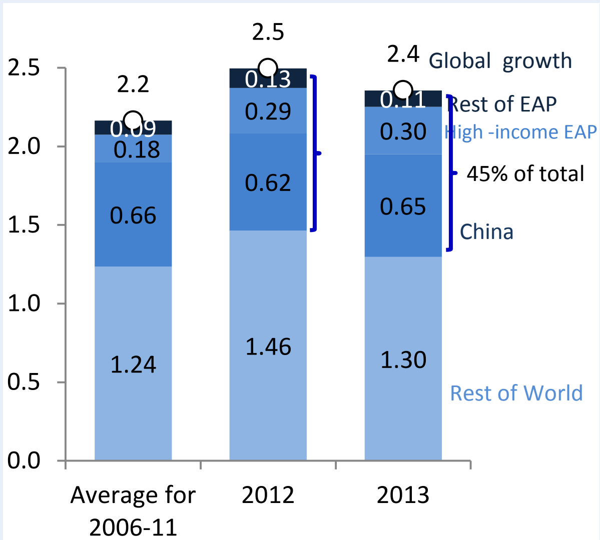
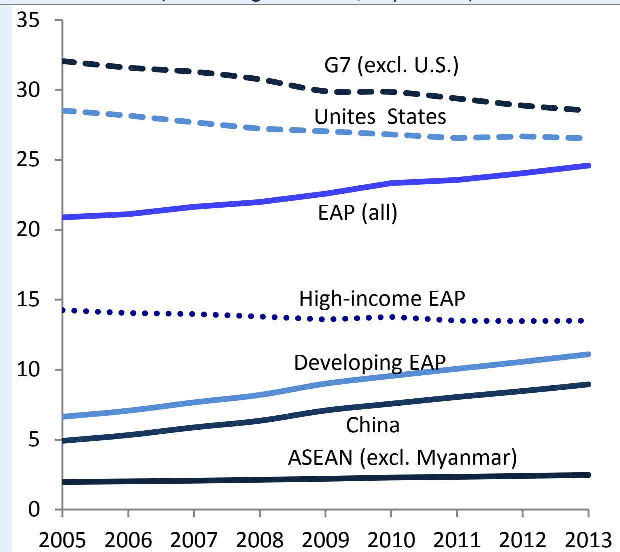



**Figure 4. With its share in global GDP steadily rising over time**
(Share in global GDP, in percent)




*Sources:* Global Economic Monitoring; World Development Indicators; World Bank staff estimates.
*Note:* GDP data are in 2005 constant U.S. dollars.

**The combination of relatively rapid growth in EAP and sluggish growth in the advanced economies has dramatically altered the global economic landscape.** The G7[2] countries' share in global GDP has steadily declined—from 61 percent in 2005 to 55 percent in 2013 (figure 4). The share in global GDP of high-income EAP countries also declined—from 14.2 percent in 2005 to 13.5 percent in 2013—albeit at a slower pace than the advanced countries outside the EAP region. The share in global GDP of the EAP region as a whole has risen from 21 percent to 25 percent during this period, driven to a large extent by continuing high growth in China. The ASEAN countries have also done well, raising their share from 2 percent in 2005 to 2.5 percent by 2013. If the recent growth trend persists, by 2017, we expect the output of the developing EAP to overtake that of the high-income EAP and the EAP region as a whole, to account for a larger share of global output than that of the United States.

**In the developing world, EAP has not only been the fastest-growing region, but also the one with the least volatility.** Even as most developing countries recovered rapidly from the 2008–09 global financial crisis, many of them could not sustain their growth momentum in the absence of a strong recovery in the advanced world. The South Asia (SAR) and Latin America and Caribbean (LAC) regions saw a decline in their growth rates, and growth in Eastern Europe and Central Asia (ECA) and the Middle East and North Africa (MENA) regions was relatively tepid and volatile between 2011 and 2013. In comparison, the slowdown in growth rate has been the smallest in the EAP region (figure 5).

[2] The G7 countries are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

**Figure 5. EAP remains the fastest-growing region in the developing world**
(Real GDP growth, in percent 4-quarter moving average)

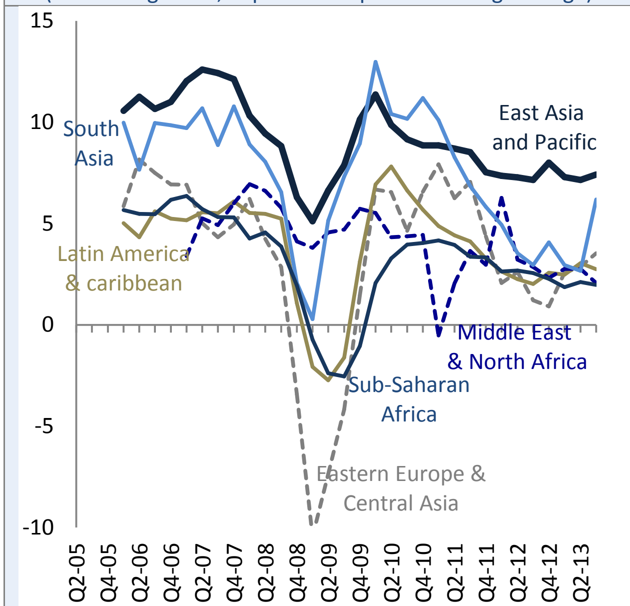
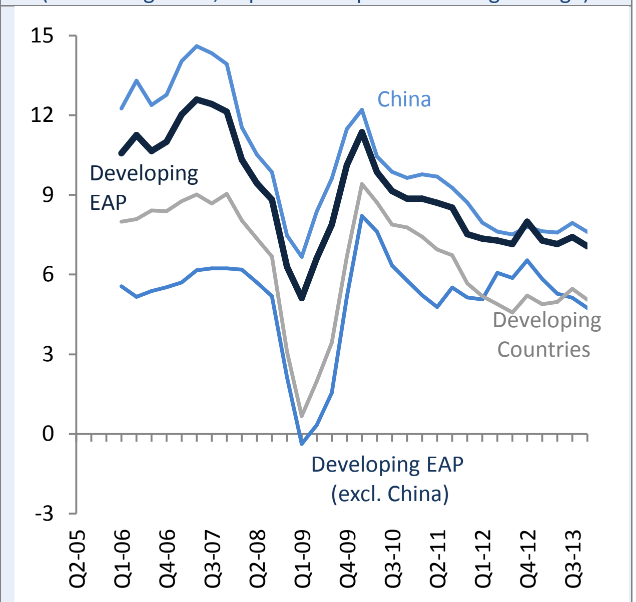



**Figure 6. With growth in developing EAP (excl. China) emerging as a key contributor**
(Real GDP growth, in percent 4-quarter moving average)




*Sources:* Global Economic Monitoring; World Development Indicators; World Bank staff estimates.

*Note:* GDP data are in 2005 constant U.S. dollars; Thailand's GDP series has been readjusted to remove the sharp fluctuation in output on account of floods in 2012 without affecting the trend growth rate.

**The impact of China's slowdown in the post-global financial crisis period on the rest of the EAP region has been much more muted than anticipated.**[3] Given the strong economic linkages within the EAP region, there has been a concern that export growth from the rest of the region to China would fall sharply as the latter's economy slows—particularly affecting the natural resource exporters (for example, Mongolia and Lao PDR). But so far, the developing EAP countries have withstood China's slowdown quite well, with the difference in the growth rates between China and developing EAP (excl. China) lessening considerably (figure 6). This has been mainly due to robust growth in private consumption in some of the large EAP countries, providing a much needed source of demand for their economies. But the growth gap again widened in 2013 because, first, private consumption growth fueled a rapid buildup in household debt in some of the large countries (for example Malaysia, and Thailand) and the prospect of rising interest rates is forcing the households to slow spending; and second, growth in private investment in the mining sector has started to decrease in some EAP countries.

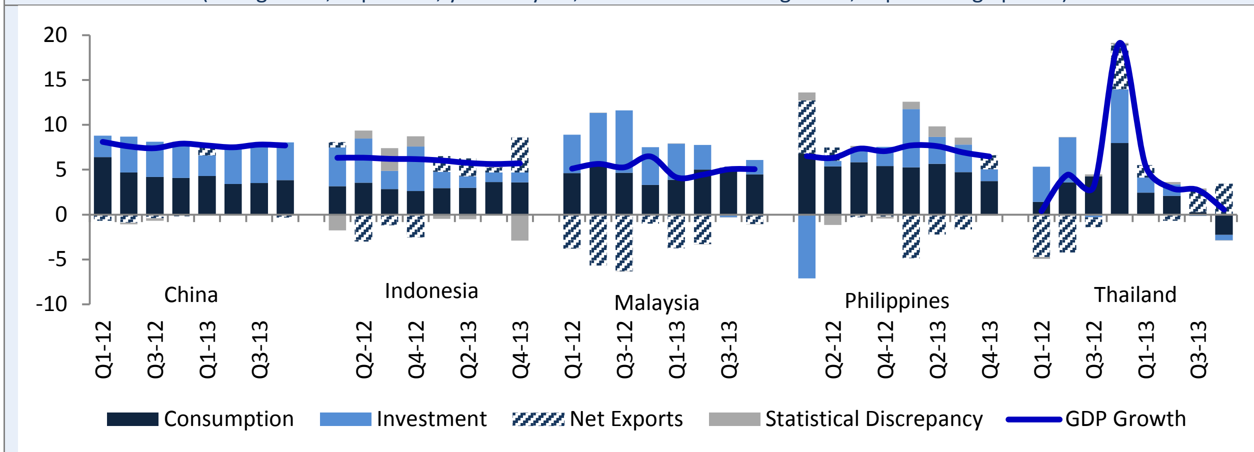
## *Domestic Demand Is Undergoing Adjustment*

**Investment weakened considerably in Indonesia, Malaysia, and Thailand on the completion of major projects, implementation bottlenecks, and funding constraints for newer ones.** Flat private spending on machinery, equipment, and transport goods dragged fixed investment growth lower in Indonesia in 2013 (figure 7). Public investment slowed significantly in Malaysia, driven by a further

[3] See *Global Economic Prospects* (World Bank 2013b) and *World Economic Outlook* (IMF 2013b) for more information on the impact of China's slowdown on rest of world, including the EAP region.

contraction in capital spending by the federal government, although the pipeline of public enterprise projects remains solid. In Thailand, implementation delays continued to hamper government plans for large infrastructure investments. A court ruling against a borrowing bill supporting the government's seven-year B 2 trillion (US$65 billion or 16.8 percent of 2013 GDP) infrastructure development plan will delay work on highway and motorway expansion and train projects. The Philippines managed to reverse the anemic investment growth in 2011 and 2012 with an 18 percent investment growth in 2013. However, investment levels continue to be low relative to output in the Philippines, averaging just 19 percent of GDP during 2009–13, compared to 32 percent in Vietnam.

**Figure 7. Investment weakened in 2013 in most of the large EAP countries**
(GDP growth, in percent, year-on-year, and contribution to growth, in percentage points)




*Source:* World Bank staff estimates.

**In China, investment reemerged as the main driver of growth.** The country's headline measure of investment, fixed asset investment (FAI), a broad measure that also includes land sales and purchases of used capital, grew by 19.6 percent in 2013, down slightly from 20.6 percent in 2012. Much of the slowdown came from investment in manufacturing, which grew 18.5 percent, compared to 22 percent in 2012. However, infrastructure investment accelerated, rising 16.9 percent during the year from 12.9 percent in 2012. Additional spending on high-speed railways offset the decline in capital spending in other sectors, helping, for instance, to absorb excess stock of steel. Real estate investment also picked up, increasing 19.8 percent in 2013 from 16.2 percent in 2012.

**Private consumption proved resilient, despite growing constraints, except in Thailand.** Consumption in 2013 grew more than in previous years in Indonesia, despite the reduction in the fuel subsidy program. A compensation package of Rp 30 trillion helped counter the adverse effects on consumption from the reduction in fuel subsidy. In Malaysia, household consumption picked up in the second and third quarters, despite slowing credit growth, softer commodity prices, the start of fuel subsidy rationalization, and a cut in civil service bonuses. Labor markets remained buoyant, with labor force participation by women jumping closer to 50 percent. Consumption growth remained robust in the Philippines, supported by remittances, which grew 6.4 percent from a year ago, equivalent to 8.4 percent of GDP. In Thailand, the expiry of consumer support programs, the cut in the fuel subsidy program, and the deterioration in consumer sentiment slashed consumption growth significantly in the second half of the year. Private consumption contracted 1.2 percent year-on-year in the third quarter and 4.5 percent in the fourth, taking the consumption growth rate down to 0.6 percent for the year.

**In China, domestic rebalancing continues to be very gradual.** China is making progress in balancing the sources of growth in domestic demand and increasing the important role of consumption in the economy, albeit tentatively. Consumption continued to grow robustly in 2013. Retail sales rose 13.1 percent, after 14.5 percent in 2012. Car sales jumped 15.7 percent from 6.9 percent in 2012. China, which became the world's largest car market in 2009, outpaced the United States in car sales in 2012 with 18 million units, compared to 15.6 million for the United States. Wholesale and retail sales of items associated with residential real estate continued to grow, including household electrical appliances and furniture. Yet, while consumption contributed more to GDP growth than investment in 2011 and 2012, the situation was reversed in 2013.

## *Trade and Current Account Balances Are Starting to Improve*

**The EAP countries are taking full advantage of the revival in global trade conditions.** Reversing outcomes of the year before, trade provided a positive contribution to growth in Indonesia and Thailand in 2013. In Malaysia, the drag on growth was less than in the previous year. And in the Philippines, fourth quarter net exports provided the first positive contribution to quarterly growth in a year and a half. The impetus came from a recovery in exports beginning in the third quarter in Malaysia and the Philippines and in the fourth quarter in Indonesia. Tepid import growth in Indonesia, Malaysia, the Philippines, and Thailand also helped boost the gains in net trade in these countries (figure 8). Quarterly current account balances improved from midyear, as well (figure 9).

**Figure 8. Trade balances …**
(Trade balance, in percent of GDP)

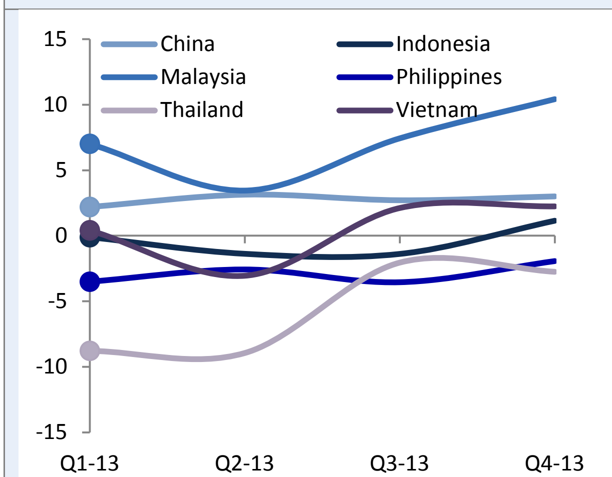
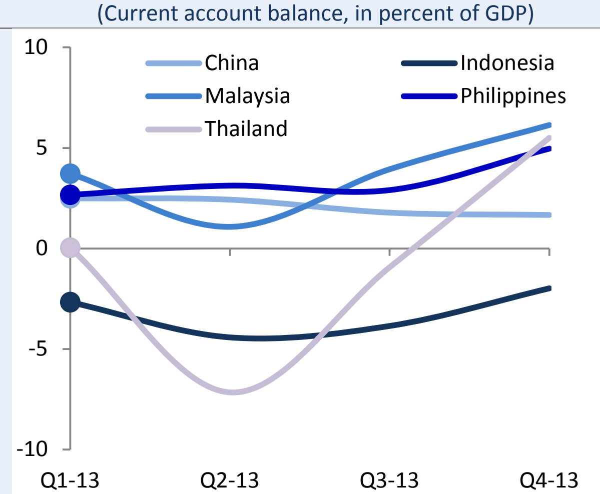



**Figure 9. … and current account balances improved over the course of 2013**
(Current account balance, in percent of GDP)




*Source:* Haver Analytics.

**An incipient recovery in the advanced economies lifted the region's manufactured exports beginning in the second half of 2013.** Manufactured exports from the region's three largest production networks, which comprise a combined 40 percent of the region's exports, performed remarkably well, considering that global trade barely grew last year (1.6 percent in nominal U.S. dollar terms). Electrical and electronic product exports[4] (31 percent of total developing EAP exports) grew 9.2 percent in 2013,

[4] Standard International Trade Classification (SITC) 75 (Office machines and computers) + SITC 76 (Telecommunications equipment) + SITC 77 (Electrical machinery, apparatus and appliances).

compared to 7.8 percent in 2012 and 8.7 percent in 2011. Apparel and clothing accessory exports[5] (7 percent of total exports) advanced 10.8 percent from 2.4 percent in 2012. And, road vehicle and parts exports[6] (4 percent of total exports) managed to rise 4.6 percent after growing 11.9 percent in 2012.

**From a global perspective, EAP dominated the export market, with the Mekong countries emerging as a new powerhouse of exports.** In 2013, EAP accounted for nearly two-fifths of global exports growth, with nearly one-half of this originating from China and the other half from the rest of EAP (figure 10). While China's strong export performance has long been acknowledged, an important development in recent years has been the rising exports from the Mekong 4 countries—Cambodia, Lao PDR, Myanmar, and Vietnam. Their exports have grown at 19 percent annually, exceeding even the performance of China (figure 11). Given their low wages, favorable demography, and advantageous geography, they have managed to attract significant new investments in sectors such as garments and leather, and in the case of Vietnam, increasingly in electronics and telecommunications (box 2). In contrast to the strong performance of the EAP countries, many developed countries saw their share in global exports tumble.

**Figure 10. EAP contributes two-fifth of global exports in goods and services…**
(Contribution to global export growth, in percent)

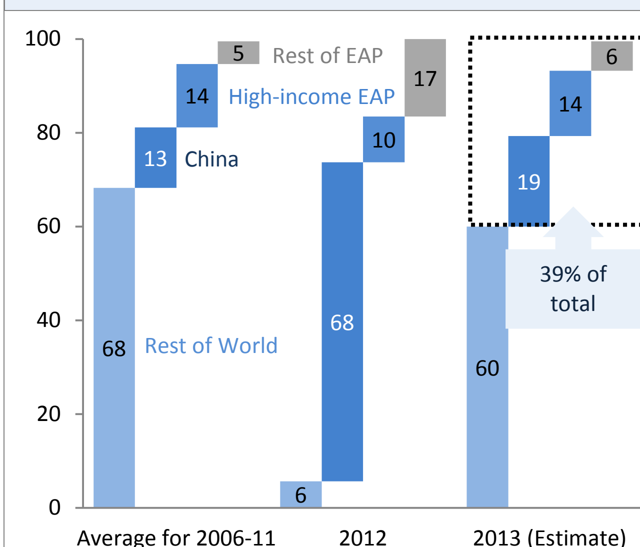
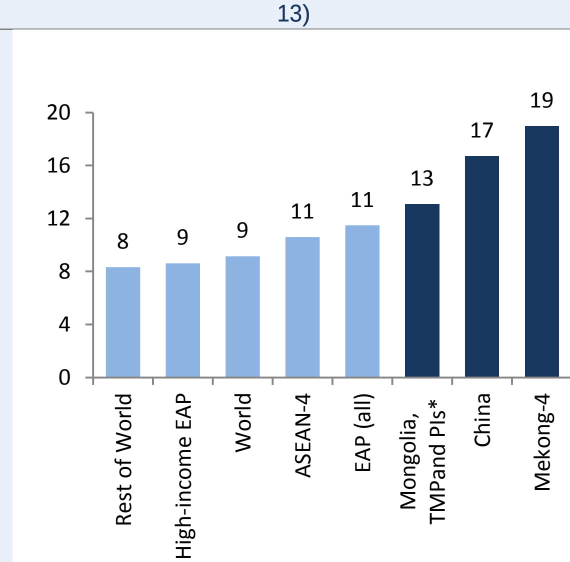



**Figure 11. … with exports from Mekong countries growing faster than China's**
(Average growth rate of exports, in percent, 2006-13)




*Sources:* Global Economic Monitoring; World Development Report; World Bank staff estimates.
*Note:* Exports include goods and services. Exports data are in current U.S. dollars.
TMP = Timor-Leste. PIs = Pacific Island countries.

**Meanwhile tepid global economic activities in the first half of 2013 and easing of global commodity prices kept commodity exports sluggish.** Overall, commodity exports comprise 16 percent of the region's total exports. Commodity exports are more important than average in Indonesia and Malaysia

[5] SITC 84 (Apparel and clothing accessories).
[6] SITC 78 (Road vehicles).

among the larger ASEAN countries, in Cambodia and Mongolia among the smaller economies, and in Fiji and the Solomon Islands among the Pacific Islands. Agricultural exports[7] (8 percent of total developing

**Box 2. Rapidly Evolving Export Landscape within EAP: The Case of Telecom and Computer Equipment**

One of the key factors behind China's rise has been its ability to gradually move up the value chain in the export market, producing mass manufacturing as well as high-tech products. This strategy has also facilitated the creation of an intra-EAP supply chain where the high-income countries provide foreign direct investment; ASEAN-4[a] supplies parts and intermediate inputs; and China, with its large labor force, assembles the final products and ships them to the rest of the world. Such a symbiotic relationship has worked well for all countries involved. But with rising wages in China, some of the foreign investment appears to have been gradually shifting to the Mekong countries.

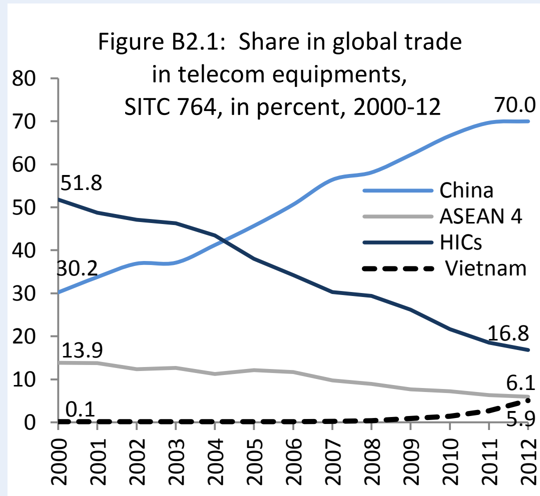


Figure B2.1: Share in global trade in telecom equipments, SITC 764, in percent, 2000-12

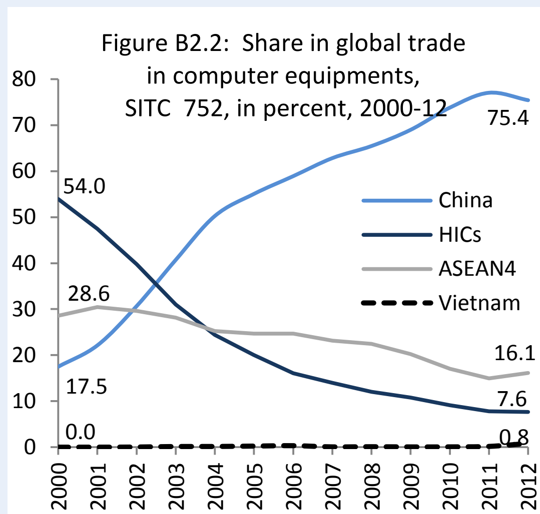


Figure B2.2: Share in global trade in computer equipments, SITC 752, in percent, 2000-12

Figure B2.1 and B2.2 show the changing share of global trade in two high-tech products, telecom and computer equipment. In both cases, in the last decade, China's share has increased rapidly, while that of the high-income countries (Japan, Korea, and Singapore) has fallen steadily. More surprising is the performance of the ASEAN-4, whose share has declined from 14 percent in 2000 to 6 percent in 2012 for telecom equipment and 28.6 percent to 16.1 percent for computer equipment. In telecom equipment, Vietnam has suddenly emerged as an important exporter, capturing nearly 6 percent of the market from zero. In fact, electronics exports are now Vietnam's top export item, overtaking traditional items such as garments, leather, coffee, and rice. However, these figures do not capture the increase in the exports of intermediate products from some of these countries to China, and hence do not capture the full extent of intra-industry regional trade for these two products.

Some of the ASEAN-4, especially Indonesia and the Philippines, have the endowments to emerge as assemblers of final products and not just as suppliers of intermediate items. This would, however, require deeper structural reforms including bringing down their trading costs through more effective infrastructure investment and trade facilitation reforms (see Part II.B, "Trading Costs in East Asia's Global Value Chain"), further liberalization of their foreign investment regime (see Part II.C, "Foreign Direct Investment and Foreign Ownership Restrictions in ASEAN"), and avoiding loss of competitiveness through sustained appreciation of the real effective exchange rate.

*Note:* a. The ASEAN-4 are Indonesia, Malaysia, Thailand, and the Philippines.

EAP exports) declined 4.4 percent in 2013, after contracting 5.2 percent in 2012. Most agricultural commodity prices—led by grains and followed by beverages, agricultural raw materials, and edible oils—

[7] SITC 0 (Food and live animals) + SITC 1 (Beverages and tobacco) + SITC 2 (Crude materials), excluding SITC 27 (Crude fertilizers and crude minerals) and SITC 28 (Metalliferous ores and metal scrap), + SITC 4 (Animal and vegetable oils, fats and waxes).

weakened last year, down 9 percent on average from the year before. The region's fuel exports[8] (6 percent of total exports) fell 3.7 percent last year; they barely grew in 2012 either, posting an anemic 0.3 percent growth. The region's ores and metals exports[9] (2 percent of total exports) managed to grow 7.4 percent in 2013. Indonesia reported metal ore exports at least 4.3 percent higher than in 2012, although the expansion may reflect the advance of ore exports by mining firms ahead of a government ban on the export of unprocessed minerals.[10] On the demand side, China, which accounted for 45 percent of global metal imports in 2012, increased its ore and metal imports by 3.8 percent last year.

**Weak domestic investment spending has kept a lid on imports.** Overall, import growth remained subdued in the region in 2013. Weak capital spending and falling foreign direct investment cut capital goods imports in Indonesia by 17.4 percent from 2012. In Malaysia, imports of capital goods other than transport equipment fell in the first and second quarters; imports of transport equipment dropped in the third quarter. In Thailand, capital goods imports contracted 4.5 percent after expanding 25.4 percent in 2012. In China, overall import growth improved to 7.2 percent in 2013 from 4.3 percent in 2012, which paled in comparison to the 23.6 percent average annual growth rate in imports in the decade leading to 2008, but was enough to catapult China to the world's leading trading nation. With exports and imports valued at a combined US$3.87 trillion, China passed the United States, whose exports and imports amounted to US$3.85 trillion in 2013.

**Nevertheless, EAP remains a significant source of global imports, with import growth from smaller economies outstripping the large ones.** In 2013, the EAP region contributed 44 percent of growth in global imports, considerably higher than its contribution of 32 percent during 2006–11 (figure 12). China was the biggest source of this import demand, accounting for nearly one-quarter of global import growth in 2013. The growth of imports of the Mekong-4 countries and the small island economies between 2006 and 2013 is similar in magnitude to that of China (figure 13). In contrast, the import growth in the ASEAN-4 has been relatively moderate, reflecting the growing slowdown in their economies.

**After deteriorating during the first half of 2013, the current account balances of several EAP countries are showing signs of improvement.** China's current account surplus narrowed to under 2 percent of GDP in the third and fourth quarters of 2013 as investment strengthened and imports advanced. The surplus had progressively shrunk from a peak 10.1 percent of GDP in 2007 to 1.9 percent in 2011 as China's investment-led stimulus response to the global financial crisis fueled imports. Malaysia's surplus also narrowed in 2013, to 3.8 percent of GDP from 6.1 percent in 2012. Malaysia had been reporting double-digit surpluses in most years from 1998 to 2011. Meanwhile, Indonesia recorded a larger current account deficit in 2013. The deficit could have been larger had Indonesia not been able to post a trade surplus in the fourth quarter. Thailand also reported a larger deficit than in 2012. Indonesia and Thailand incurred deficits in 2012, the first since the Asian financial crisis in 1997 for Indonesia, and the second for Thailand. Globally, imbalances continue to unwind, with the precrisis surplus economies in Asia

[8] SITC 3 (Mineral fuels).

[9] SITC 27 (Crude fertilizers and crude minerals) + SITC 28 (Metalliferous ores and metal scrap) + SITC 68 (Nonferrous metals).

[10] Indonesia originally planned to implement a 2009 law banning the export of unprocessed mineral ores starting in January 2014. Recently, the Finance Ministry said that, provided they paid special taxes, miners could still export copper, iron ore, manganese, lead, zinc, and ilmenite for the next three years, as long as the shipments also met minimum purity levels. Separately, the Energy Ministry announced that the mineral ore ban still applied to nickel and bauxite.

reporting lower surpluses, and the United States and the precrisis deficit countries in Europe reporting lower deficits.

**Figure 12. EAP accounts for almost half of growth in global imports …**
(Contribution to global import growth, in percent)

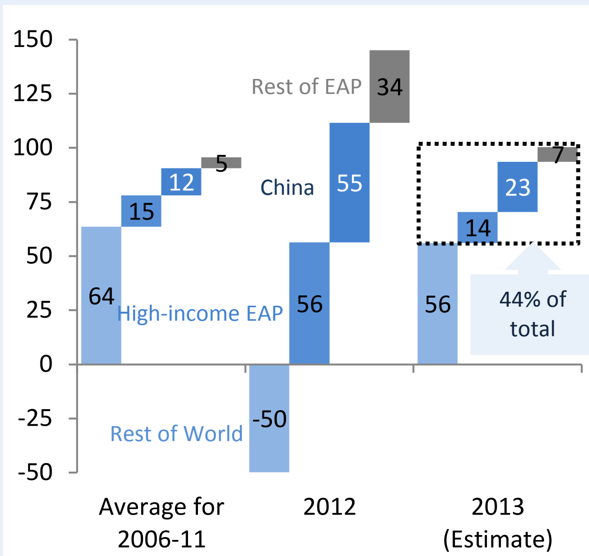
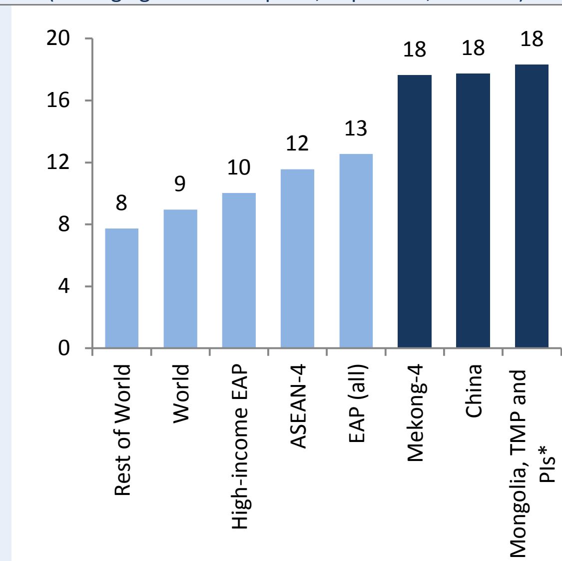



**Figure 13. … with smaller EAP countries expanding their imports at the same rate as China**
(Average growth of imports, in percent, 2006-13)



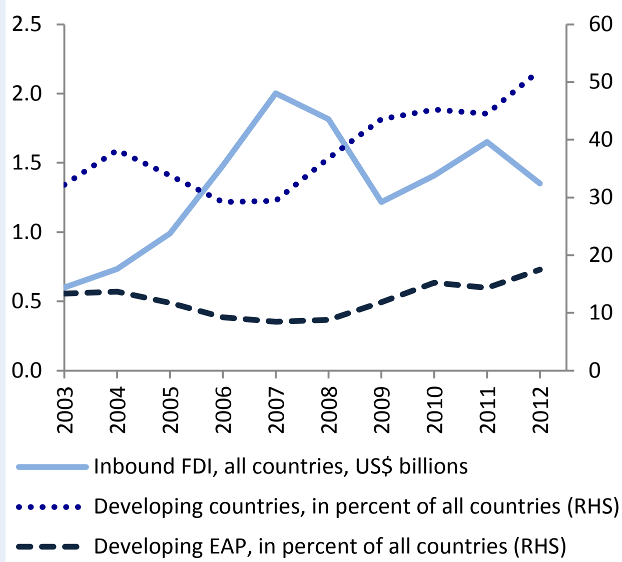

*Source:* Global Economic Monitoring; World Development Indicators; World Bank staff estimates.
*Note:* Imports include goods and services; all imports are current U.S. dollars.
TMP = Timor-Leste. PIs = Pacific Island countries.

## *Capital Flows Are Recovering, but Remain Volatile*

**Foreign direct investment (FDI) inflows into developing EAP countries remained healthy in 2013.** Global FDI flows have decreased sharply from their historical high in 2007.[11] Greenfield investments in 2012 were less than two-fifths their level in 2008, and mergers and acquisitions were under a third their value in 2007. Developing EAP has not been spared the contraction, with inbound FDI as a share of GDP falling from 2.6 percent in 2007 to 1.8 percent in 2012. Yet, the region has fared better than other developing areas or even the advanced economies, attracting 17.5 percent of all inbound FDI in 2012, from 8.5 percent in 2007 (figure 14). Last year's performance was relatively encouraging. For instance, in Malaysia, a country relatively more dependent on FDI than average (measured by the proportion of fixed investment funded by FDI), inflows rose to 3.7 percent of GDP in Malaysia, from 3.2 percent in 2012 (figure 15). In the Philippines, which is relatively less dependent on FDI, inflows grew to 1.4 percent of GDP from 1.1 percent in 2012. That said, inbound FDI remains artificially hampered by significant policy restrictions on foreign ownership, especially in the services sectors (see Part II.C).

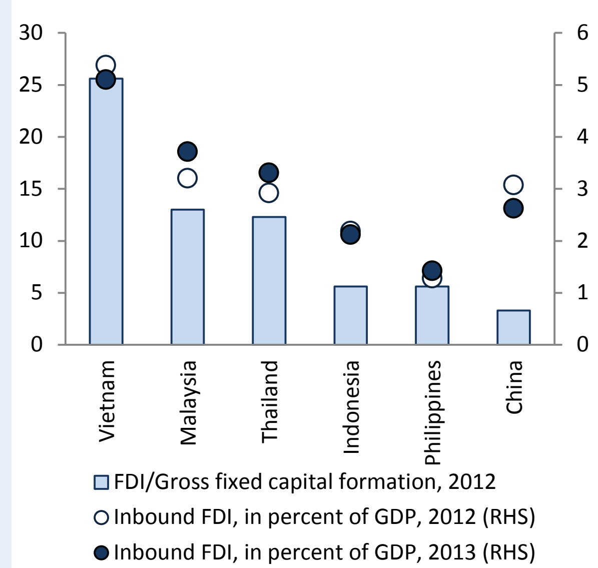
[11] The discussion on global FDI developments and patterns from 2007 to 2012 is derived from UNCTAD 2013.

**Figure 14. FDI flows remain subdued globally**
(Inbound FDI flows, in US$ trillions and percent of total)




*Sources:* UNCTAD 2013.
*Note:* RHS = right-hand side.

**Figure 15. FDI inflows into the region were steady in 2013**
(Inbound FDI flows, in percent of gross fixed capital formation, and in percent of GDP)




*Sources:* Haver Analytics; World Bank staff estimates.
*Note:* RHS = right-hand side.

**Portfolio flows turned volatile following the first steps toward policy normalization in the United States.** Expectations of a tapering of quantitative easing by the U.S. Federal Reserve spurred portfolio outflows from emerging markets, including from developing EAP, beginning in May 2013. Although the announcement in September to delay the taper reduced some pressure, the decision in December to finally begin the taper has reactivated portfolio outflows from emerging markets. Notwithstanding higher capital flow volatility and financial market turbulence, the impact of Fed tapering, and of the previous tapering talk, on EAP has generally been manageable so far. At the height of the outflows in the five-month period from May to September 2013, net sales by international mutual funds and exchange-traded funds (ETFs) of EAP equities and bonds were sizable (figure 16 and figure 17), but were in almost all cases lower than net purchases of these securities in the preceding five-month period. Moreover, developing EAP remained active in the new issues markets. Overall, on a balance-of-payments basis, inbound portfolio investment to the region was lower in 2013 than in 2012, measured relative to GDP, more so in the ASEAN-4, than in China. The EAP region, however, remains resilient to such decline in portfolio flows from a balance-of-payments perspective, as FDI exceeds portfolio flows by 2.5:1 (on a net flow basis), and the former has been reasonably buoyant and stable.

**Figure 16. Divestment from developing EAP equities**

(Monthly purchases and sales by international mutual funds and ETFs of developing EAP equities, in US$ billions)

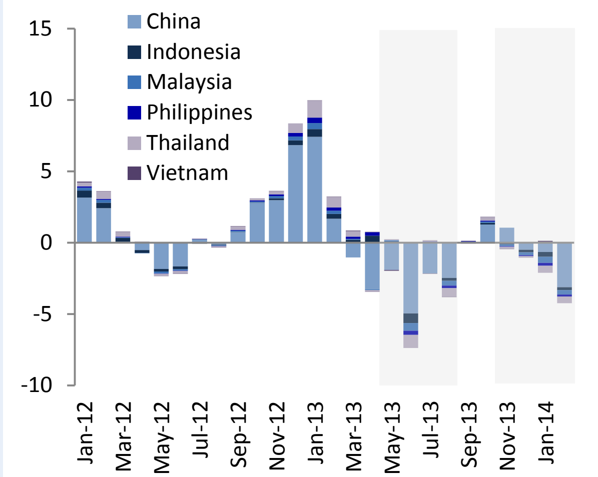
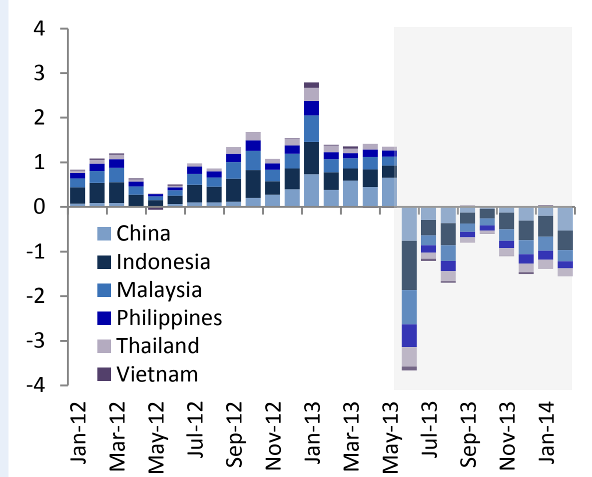



**Figure 17. … and bonds peaked during taper talk in 2013**

(Monthly purchases and sales by international mutual and ETF funds of developing EAP bond, in US$ billions)

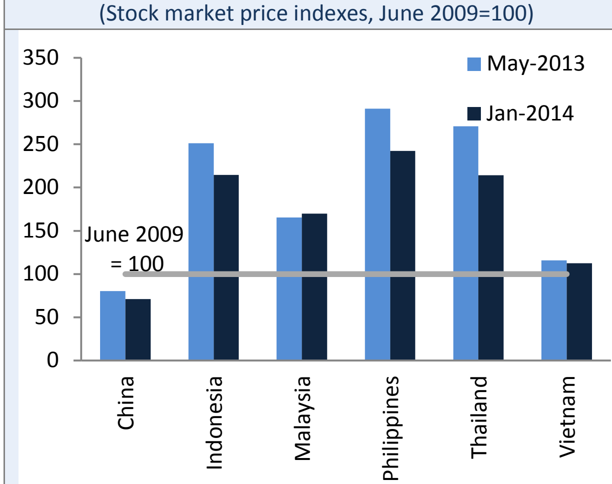



*Source:* EPFR Global.

**As in other emerging markets, the value of financial assets in the region adjusted as global investors rebalanced their portfolios in favor of the advanced economies.** The declines in share prices in the region have been the steepest in markets that had advanced the most from the troughs of 2009, namely Indonesia, the Philippines, and Thailand (figure 18). The adjustments are still underway. Even so, valuations remain rich in these markets. Price-earnings (PE) ratios in 2013 are higher than during the precrisis market peak in 2007 in the Philippines and Thailand, and higher than the historical average since 2000, including in Indonesia (figure 19). Similarly, bond yields in the region have increased since the talk of tapering, concurrent with the outflow of portfolio investment from developed and emerging market bond funds and into developed market equity funds and the rise in the U.S. 10-year Treasury yield (figure 20).

**Figure 18. Despite the market correction, stock prices in Indonesia, the Philippines, and Thailand are still more than twice their mid-2009 levels**

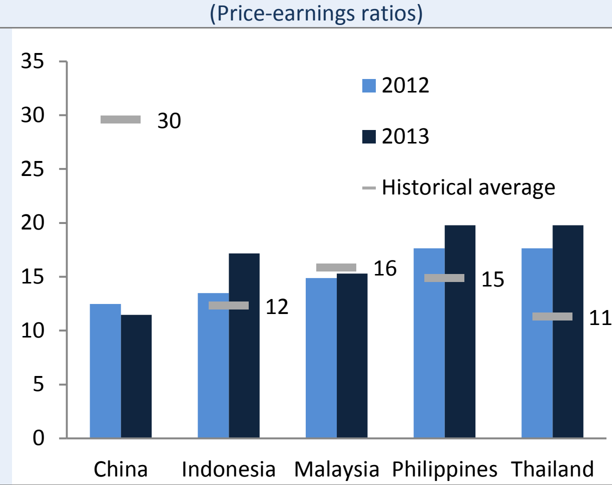
(Stock market price indexes, June 2009=100)




*Source:* Haver Analytics.

**Figure 19. … and command higher-than-historical-average valuations**

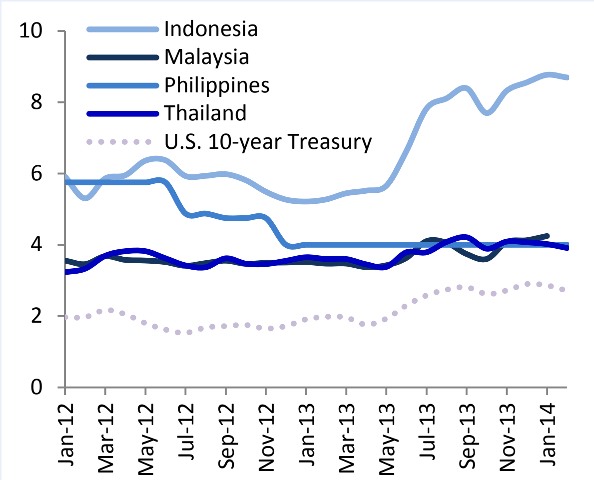
(Price-earnings ratios)




*Source:* CEIC.

**Figure 20. U.S. long-term interest rates have risen, taking developing EAP rates higher**

(Government bond yields, 10-year, in percent per year)

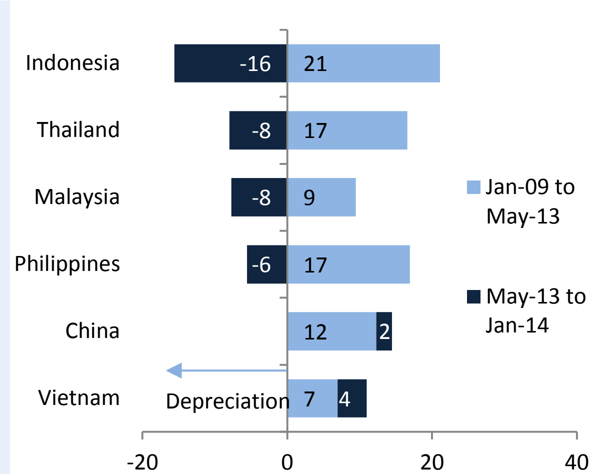



*Source:* Haver Analytics.
*Note:* RHS = right-hand side.

**Exchange rate depreciations have been orderly and should help trade competitiveness going forward.** Capital outflows have led to a real depreciation of the currencies of the ASEAN-4 countries (figure 21). The adjustments have been orderly so far. Signs of severe stress to banks or corporate balance sheets from the exchange rate depreciations have yet to emerge. Indonesia experienced more concerted exchange market pressure due to its deteriorating external accounts and large and liquid equity and bond markets. FDI flows have not been large enough to finance the deficit (figure 22), and Indonesia has grown increasingly dependent on portfolio flows, which have, however, reversed and turned volatile. To support the currency, the central bank responded by increasing the policy rates. The rupiah has depreciated 19 percent in nominal effective terms and 16 percent in real effective terms since May and through January 2014. Over time, a weaker currency should help strengthen the competitiveness of the Indonesian and the other ASEAN economies.

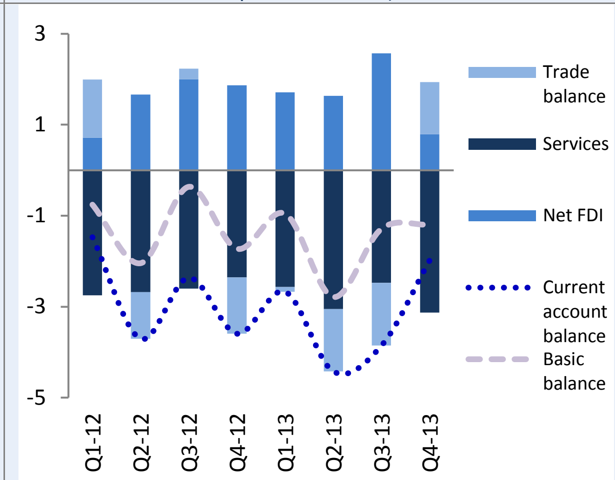
**The recent widening of the exchange rate trading band is consistent with broader financial sector reforms in China.** China widened the onshore trading band for the RMB from 1 percent to 2 percent in mid-March. The decision, which the central bank announced as a move to let market forces determine the value of the currency, followed a period of increased volatility of the currency. The RMB broke a long-running appreciation trend with a 1.5 percent fall to RMB 6.1 to the U.S. dollar in mid-to-late-February, the largest biweekly decline in the currency since China shifted from a tight peg to a crawl-like currency arrangement in 2005. Previously, speculative inflows into China had surged. But the RMB quickly bounced back and in early March posted its biggest one-week appreciation in two years. The volatility may, to some extent, help discourage one-way currency bets. Although the central bank has yet to abandon its practice of fixing the value of the currency daily, the band widening may be a prelude to more important currency reform, that is, a more market-based exchange rate system.

**Figure 21. Indonesia led the ASEAN-4 in real exchange rate depreciations since May 2013**
(Change in REER, in percent, - = depreciation)




*Source:* IMF.
*Note:* REER = real effective exchange rate.

**Figure 22. Indonesia posted trade, current account, and basic balance deficits in the last two years**
(Trade, current account, and basic balance deficits, in percent of GDP)



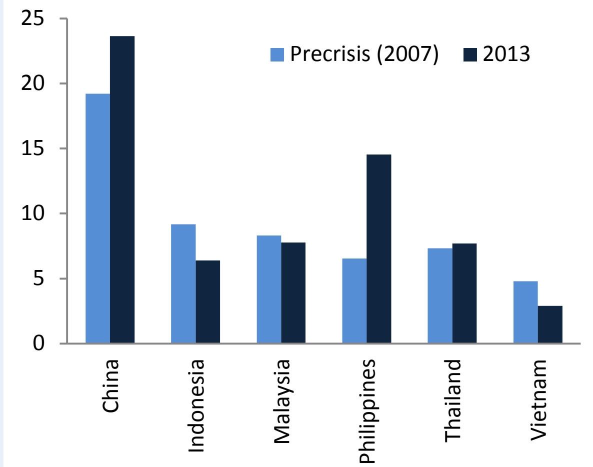

*Source:* Haver Analytics.

**Most of the countries in the region have adequate reserves to cover temporary trade and external financial shocks.** Current account deficits cut into reserves in Indonesia and Thailand in 2013, as did direct investment and portfolio outflows in Malaysia. Except in Indonesia and Vietnam, import covers are generally higher than before the global financial crisis (figure 23). Higher short-term debt-to-reserve ratios reflect the resort to external credit following more liquid global financial conditions after the crisis (figure 24). Standard import cover and reserve to short-term debt ratios, however, may understate the true buffers that central banks command against capital flow volatility risks. Central banks, like Bank Negara Malaysia, for example, have tended to reduce their net long forward positions[12] first before drawing on their international reserves (figure 25). Also, central banks have, since the crisis, expanded their access to currency swap arrangements,[13] which serve as backstop international liquidity facilities in tough times (figure 26). In 2013, Indonesia and the Philippines doubled their swap lines with the Bank of Japan.

[12] In a foreign exchange forward or swap transaction, a central bank buys foreign currency spot and then implements a foreign currency swap in which it sells the foreign currency spot and buys it forward. The resulting net long forward position is used by the central bank to hedge foreign currency exposures, influence liquidity in the foreign exchange market, or make foreign currency resources available in times of financial stress.

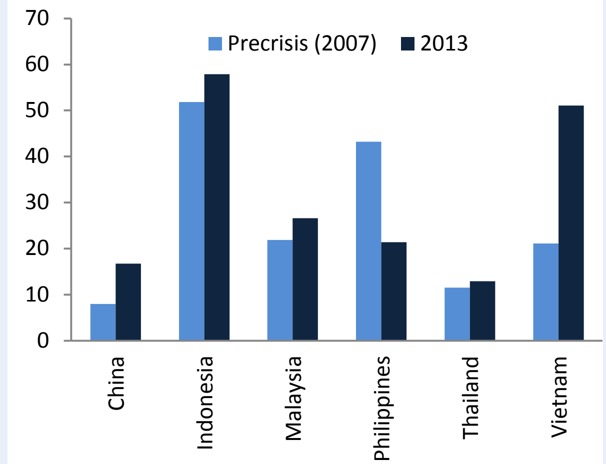
[13] A central bank liquidity swap is a currency swap used by a country's central bank (for example, the Bank of Japan) to provide liquidity of its currency (the Japanese yen) to another country's central bank (for example, Bank Indonesia). The swap line provides the foreign central bank (Bank Indonesia) the ability to deliver foreign currency funding (Japanese yen funding) to institutions within its jurisdiction in times of market stress.

**Figure 23. The region's international reserves provide ample cover against trade …**
(Reserves, in months imports of goods)



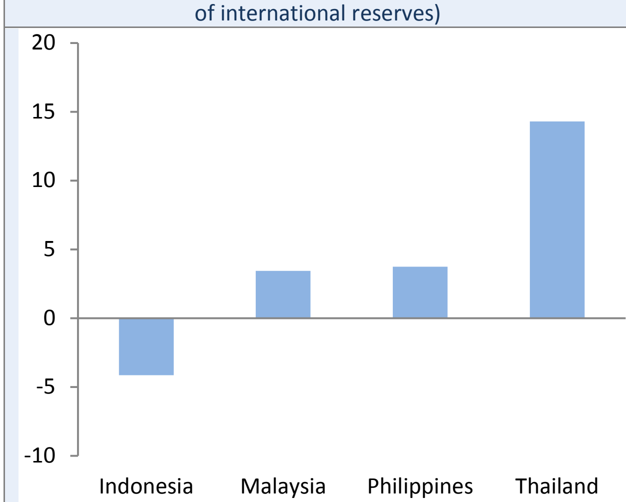

*Sources:* Haver Analytics; IMF.

**Figure 24. … and external financial shocks**
(Short-term debt,[a] in percent of reserves)



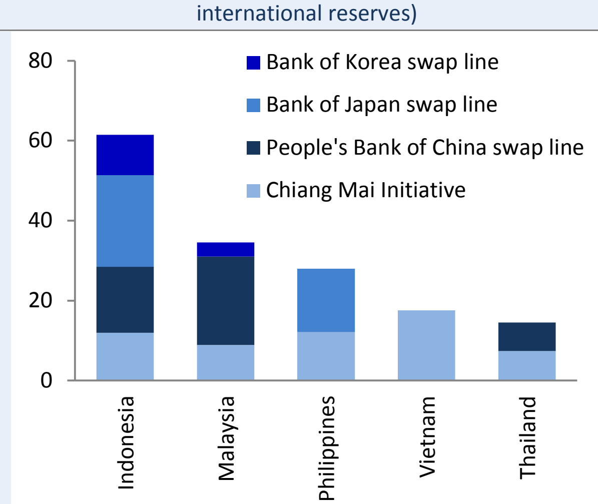

*Sources:* Haver Analytics; IMF-BIS-OECD-WB, Joint External Debt Hub.
*Note:* a. Debt due within one year, on a remaining maturity basis.

**Figure 25. Net long forward positions …**
(Net forward positions, average monthly in 2013, in percent of international reserves)




*Source:* IMF.

**Figure 26. … and currency swap lines should provide additional foreign currency resources during tough times**
(Multilateral and bilateral swap lines, in percent of end-2013 international reserves)




*Sources:* ASEAN; People's Bank of China; Bank of Japan.

## *Policy Stance Has Been Slow to Change and Legacy Problems Loom*

- *Credit levels remain elevated, but growth rates have climbed down*

**The legacy of past credit booms remains a concern throughout the region.** Strong credit growth in the last several years has built up some financial imbalances in the region. Debt ratios are generally higher than before the crisis (figure 27). Bank loans outstanding reached 135 percent of GDP in China in 2013, compared to 105 percent in 2007. The run-up in debt is much more dramatic if the broader measure of credit is used: estimates of the total stock of aggregate financing,[14] China's broadest measure of credit, exceeded 200 percent of GDP in 2013 from 124 percent in 2007. In Malaysia, domestic debt securities outstanding reached 115 percent of GDP in 2012, from 99 percent in 2007. Moreover, bank loans outstanding were 125 percent of GDP in 2013, compared to 97 percent in 2007. The last credit boom has also created pockets of overheating in some stock and real estate markets in the region.[15]

**Credit growth has started to decelerate among the region's larger economies.** Credit growth has started to slow in the region, although from the elevated rates of the last years (figure 28). In Vietnam, banks struggled to meet the government's lending target, not the least because many are saddled with bad debts following the previous lending boom. Similarly, liquidity growth steadily moderated in 2013. In the Philippines, although money supply (M2) grew 33 percent compared to an average 8.6 percent in the previous five years, that was apparently an aberration and the result of extraordinary action by the central bank to trim off funds parked in its liquidity management facility. Rate cuts in, and restricted access to, the Special Deposit Account (SDA)[16] released liquidity instead to bank time deposits and money markets funds and to real estate investments. The central bank expects money supply growth to normalize in 2014.

**Figure 27. Household debt is high in Malaysia and Thailand**
(Debt, by debtor, in percent of GDP, end-2012)

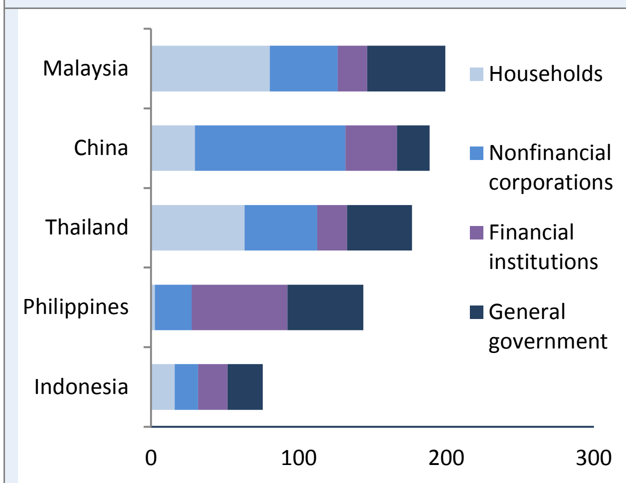
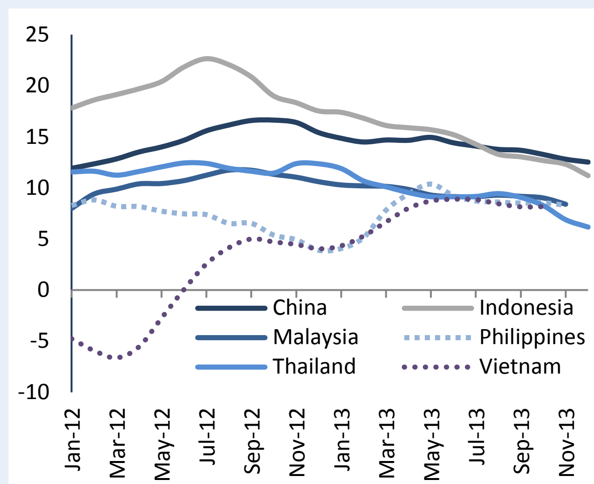



**Figure 28. Credit growth has started to decelerate in the region's larger economies**
(Real credit growth, in percent 3-month-on-3-month seasonally adjusted annual rate)




*Source:* World Bank staff estimates.

**Despite the intent of authorities, it has been difficult to curb credit growth in China.** The growth in aggregate financing is estimated to have decelerated to 17.8 percent in 2013, from 19.5 percent in 2012.

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[14] China reports aggregate financing, formerly called total social financing (TSF), as flows. The stock numbers are World Bank staff estimates.

[15] IMF 2013c.

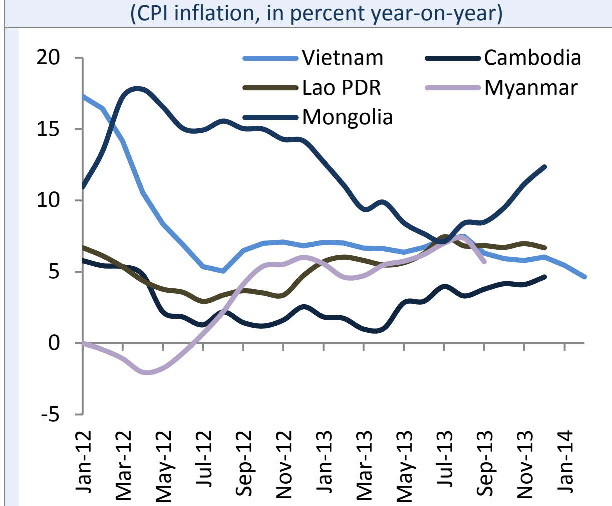
[16] A special deposit facility, the SDA serves as the Philippine central bank's alternative to open-market operations in managing liquidity in the economy. The central bank expanded access to the SDA in 2007 to get a handle on strong foreign exchange inflows, rapidly expanding money supply, and rising inflation at that time. Since 2011, it has been restricting access to the facility in a bid to lower foreign exchange sterilization costs, reduce potential currency speculation, and otherwise spur lending to the real economy. In January 2013, the central bank lowered the SDA rate significantly below the policy rate. In January 2014, it barred some trust funds from accessing the SDA altogether.

Bank loan growth (in RMB and in foreign currencies) moderated to 13.5 percent from 14.1 percent in 2012. But credit products associated with China's shadow banking system continue to grow rapidly, rising 31 percent in 2013. Trust loans increased 64.1 percent and entrust loans 44.3 percent. Barely available a decade ago, shadow banking credits now comprise a fourth of aggregate financing. The aggressive growth in 2013 came despite efforts by the authorities to address the risks posed by wealth management products, which fund the shadow banking sector. Similarly, liquidity conditions have not been easy to manage in China. Central bank efforts to restrain risky lending and credit product creation sent interbank rates spiking in June and December 2013 and again in January and February 2014. The authorities eventually injected cash in the market, but for short durations and at higher interest rates than in the past.

- *Inflation is rising in most of the smaller economies, but is subdued in others*

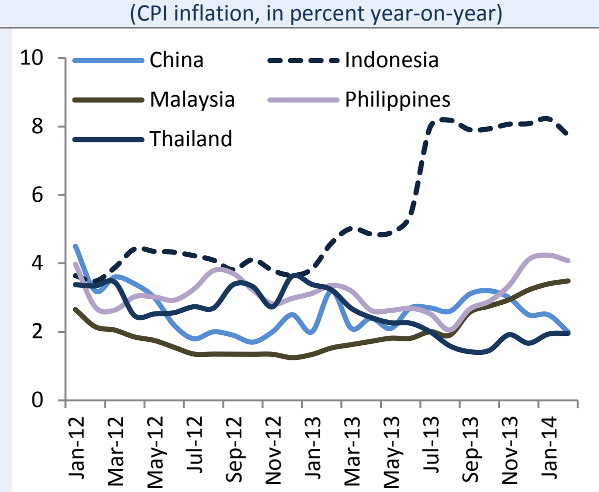
**Inflation increased in 2013 in most of the smaller economies in the region, except in Vietnam.** In Mongolia, the headline rate began accelerating at midyear to reach 12.5 percent in December 2013 and 12.5 percent in January 2014 (figure 29). The price level has come under pressure from expansionary policies including aggressive credit extension by the central bank. In Myanmar, headline inflation continued to build last year to 7.3 percent in August 2013 before easing somewhat in the following months. Commercial bank lending to the private sector expanded 50.5 percent during 2012–13 and 45.8 percent during 2013–14. In Cambodia and Lao PDR, inflation has been rising for the last six months, albeit from a low base. In contrast, annual CPI inflation slowed in Vietnam from 9.1 percent in 2012 to 6.6 percent in 2013. Subdued credit growth and lower food price increases contributed to this decline.

**Figure 29. Inflation has been creeping upward in the smaller economies …**
(CPI inflation, in percent year-on-year)




*Source:* IMF.

**Figure 30. … but the headline rates are still subdued in the larger economies**
(CPI inflation, in percent year-on-year)



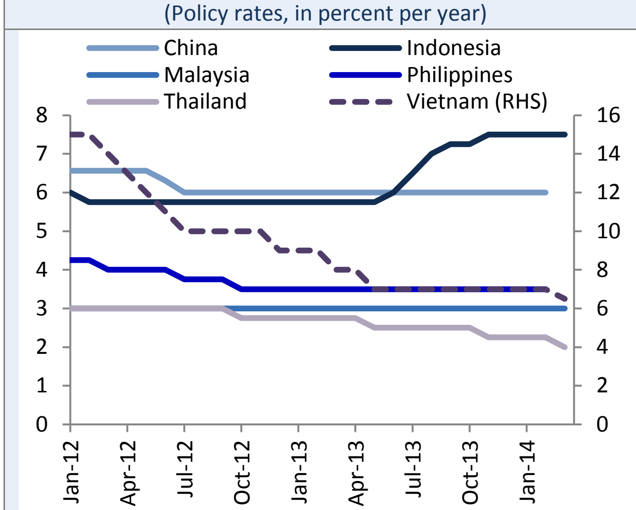

*Source:* Haver Analytics.

**Generally subdued inflation gave central banks in the larger economies room to loosen policy or to keep policy on hold in 2013, except in Indonesia.** In most of the larger economies, annual headline rates were lower in 2013 than in 2012 (figure 30). In Indonesia, a rise in subsidized fuel prices drove the headline rate higher to 7.0 in 2013, including 8.6 percent in the third quarter. Inflationary pressures are, however, starting to creep up elsewhere. Core inflation rates are on the upswing, in sequential terms, in the Philippines and Malaysia. In most cases, the higher rates are a pass-through from currency depreciation.

**Facing higher current account deficits and rising global interest rates, Indonesia tightened its policy stance in 2013.** Indonesia started to tighten monetary policy via five rate hikes between June and November totaling 175 basis points (figure 31). By the beginning of June, the rupiah had dropped 14 percent against the U.S. dollar since mid-2011, and by the beginning of September, 30 percent, forcing the central bank into the series of rate hikes. A narrower current account surplus in the fourth quarter of 2013 has given Bank Indonesia time to pause in subsequent policy meetings. The policy rate stood at 7.5 percent at the end of February, a stance consistent with tight monetary policy. In contrast, Vietnam loosened monetary policy, by 200 basis points in the first half of 2013 and by another 50 basis points in March 2014. Thailand has lowered its policy rates three times by a cumulative 75 basis points beginning last year in response to slower-than-expected growth and continued political tensions in Bangkok. Credit growth has been barely responsive to the rate hikes in either country, however. Elsewhere, policy rates remain steady, as do required reserve ratios (figure 32).

**Figure 31. Higher interest rates have helped Indonesia address inflation and balance-of-payment pressures**

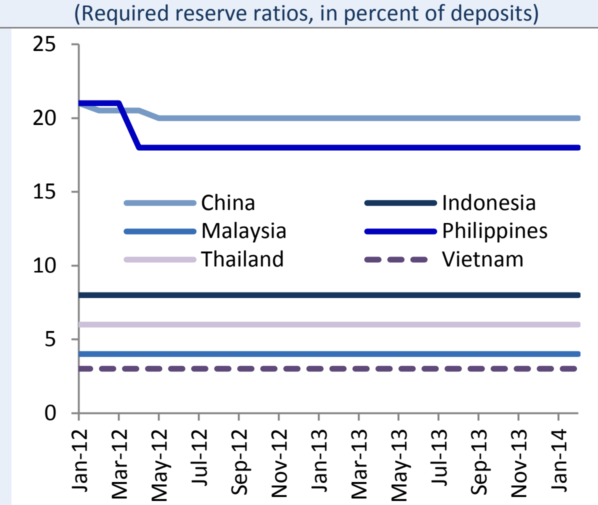
(Policy rates, in percent per year)




*Source:* Haver Analytics.
*Note:* RHS = right-hand side.

**Figure 32. Central banks have not changed bank reserve ratios in almost two years**

(Required reserve ratios, in percent of deposits)



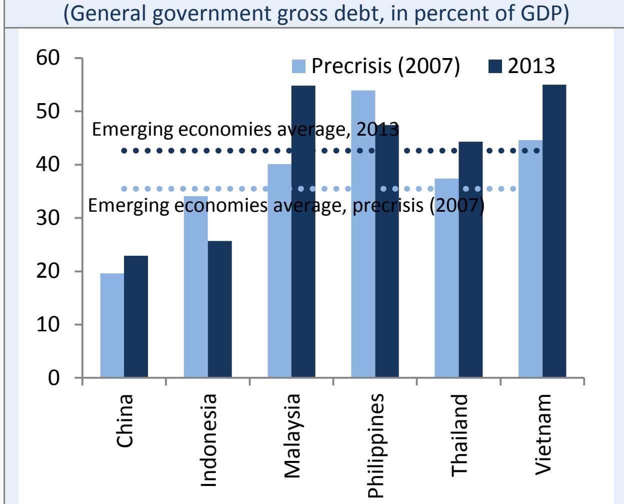

*Sources:* Haver Analytics; CEIC.

## ➢ *Modest Fiscal Consolidation Efforts Are Underway*

**Government debt has risen in Malaysia, Vietnam, and Thailand.** In these countries, the general government-debt-to-GDP ratio exceeds the average for emerging economies (figure 33). The Philippines has cut government debt relative to GDP, although nominal debt is still sizable. The Philippines received investment-grade ratings from Standard and Poor's, Moody's Investors Service, and Fitch Ratings Ltd. for the first time in 2013. It last issued dollar debt in January 2012 but returned to the market with a US$1.5 billion offering in February 2014, partly to buy back foreign currency bonds from previous, more expensive, issues.

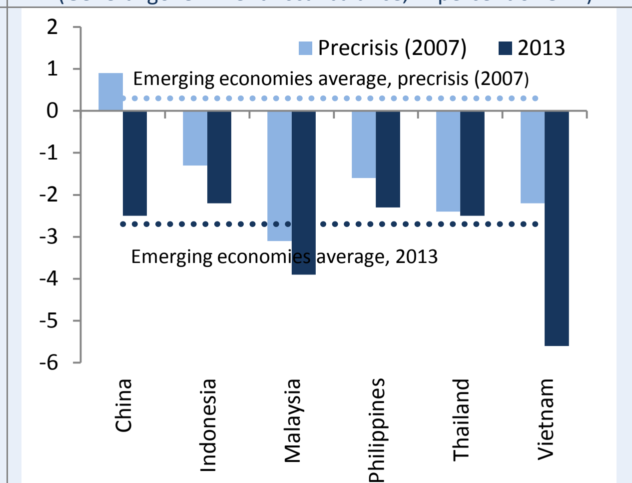
**Fiscal balances remain generally weaker than before the crisis.** Vietnam overshot its deficit target of 4.5 percent of GDP for 2011–15, revising its deficit target in 2013 to 5.3 percent of GDP, from 4.8 percent in 2012 (figure 34). Indonesia's fiscal deficit widened a third of a percentage point to 2.2 percent of GDP from 1.9 percent in 2012, as revenues dropped more than expenditures as a share of GDP. Thailand reported a lower deficit in 2013, 2.3 percent of GDP, than in 2012, 4.4 percent. Revenue remained steady, while expenditures contracted 2 percentage points of GDP following the phase-out of the car-buying scheme and completion of flood reconstruction work. Malaysia has reduced its fiscal deficit from 2009, but the deficit remains higher than before the crisis.

**Figure 33. Government debt has risen markedly in Malaysia, Thailand, and Vietnam**
(General government gross debt, in percent of GDP)




*Sources:* Haver Analytics; IMF Fiscal Monitor.

**Figure 34. Fiscal deficits are higher than average in Vietnam and Malaysia**
(General government fiscal balance, in percent of GDP)




*Sources:* Haver Analytics; IMF Fiscal Monitor.

**Fiscal consolidation in Indonesia and Malaysia is focused on fuel subsidies.** Indonesia voted in mid-2013 to cut fuel subsidies, which cost the government 13 percent of revenues (or 2 percent of GDP) in 2013. Without the reform, the government calculated that the deficit would balloon to 3.8 percent of GDP in 2013 (exceeding the legal limit of 3 percent), from 1.7 percent in 2012. Malaysia cut fuel subsidies in September. The government had spent more than RM 24 billion (2.5 percent of GDP) on fuel subsidies in 2012. The government expects to save RM 3.3 billion annually (0.3 percent of GDP in 2013) from the subsidy cut. Both Indonesia and Malaysia offered assistance to more vulnerable groups. Indonesia approved an Rp 30 trillion (0.2 percent of GDP) package, including compensatory cash assistance to 15.5 million poor households. Malaysia plans to increase welfare payments to low-income households by 29 percent in 2014.

**The costs of the rice subsidy scheme in Thailand are rising.** Begun in 2011, the scheme seeks to support rice farmers (two-fifths of the labor force work in agriculture) with direct government purchases of unmilled rice at prices 50 percent higher than the market rate. Unmilled rice has piled up in warehouses at twice the annual volume of the global rice trade (18 million tons at the end of the third quarter of 2013). With rice prices 12 to 15 percent lower at the end of 2013 than at the beginning of 2011, the government has not been able to auction the stock. Meanwhile, the quality of the stockpile is deteriorating. The subsidy has cost the government US$12.7 billion (3.5 percent of GDP) in its first year of operation, worsening the country's fiscal deficit to 4.4 percent of GDP in 2012 from 1.7 percent in 2011. The scheme cost the government another US$13.9 billion (3.6 percent of GDP) in 2013.[17]

**In China, the government appears to have at least a firmer measure, if not as yet better control, of local government debt.** The National Audit Office (NAO) reported that local government debt topped RMB 17.7 trillion (US$2.9 trillion, or 31.3 percent of 2013 GDP) in mid-2013, up 2.7 percent of GDP from just six months earlier. The NAO also stated that 60 percent of the debt will mature before the end of 2015. Less than three years ago, the NAO pegged local government debt at RMB 10.7 trillion (US$1.7 trillion or 28.6 percent of 2010 GDP) in end-2010 and estimated that 50 percent of the debt would mature before the end of 2013. The figures imply that vast amounts of local government have since been refinanced. In fact, a financial imbalance is inherent from the prevalent use by local government units (through local government financing vehicles) of bank and shadow bank debt, which are short-term liabilities in nature, to fund infrastructure projects, which are long-term assets that do not generate revenue until well into the future.

[17] In addition, the government is in arrears in its subsidy payment to rice farmers in the amount of 1 percent of GDP.

# I.B Outlook, Risks, and Policies

*The EAP region is expected to grow at a more stable and sustainable pace of 7.1 percent in 2014–2016. This constitutes a modest deceleration from the average growth rate of 8.0 percent achieved between 2009 and 2013, but high enough to ensure that EAP remains the fastest-growing region in the world. Growth in China is expected to ease to 7.6 percent in 2014 and further to 7.5 percent in 2015 from its current pace of 7.7 percent in 2012 and 2013. Growth accelerations are likely to be muted in the larger ASEAN economies, which are operating close to potential and facing tighter global financial conditions and higher levels of household debt. The smaller economies are expected to grow steadily, but could face overheating risks. And the island economies are likely to face subdued and variable growth prospects.*

## *A Recovery in High-Income Countries Will Lift Global Growth*

**Global growth is projected to accelerate gradually from 2.4 percent in 2013 to 3.4 percent by 2016, mainly reflecting a slow but steady improvement in high-income economies.**[18] Growth in the high-income economies is expected to rise to 2.1 percent in 2014 from 1.3 percent in 2013 and to increase to about 2.4 percent by 2016 (figure 35 and box 3). In the United States, the reduced drag from fiscal consolidation and from policy uncertainty and the recovery in residential investment and in equity prices are expected to boost household income and wealth, thereby propelling growth to 2.7 percent in 2014 from a subdued 1.9 percent in 2013. In the Euro area, continuing adjustments in private sector balance sheets and the lower cost of capital will ease the strain from fiscal consolidation and gradually improve growth to around 1.0 percent in 2014. Pent-up demand should further support growth to 1.5 percent in 2015. In Japan, where aggressive fiscal and monetary easing has sparked a strong cyclical recovery, the economy will moderate to about 1.2 percent in 2014. Fiscal tightening will weigh on growth in 2014, although accommodating monetary policy will continue to support domestic activity and, through a weaker yen, boost exports.

**Figure 35. Growth in high-income countries will accelerate in 2014 …**
(GDP growth, in percent year-on-year)

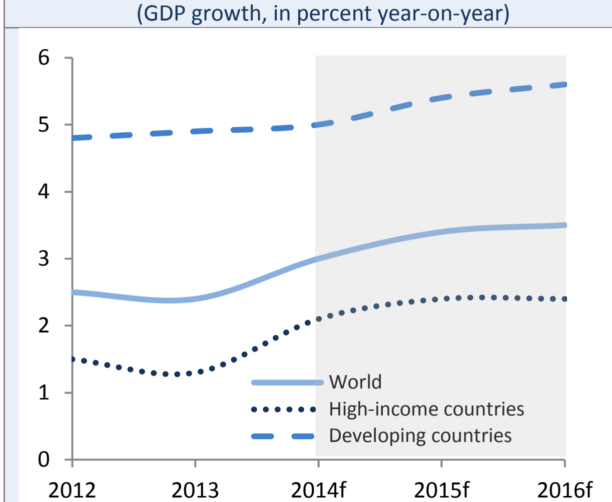
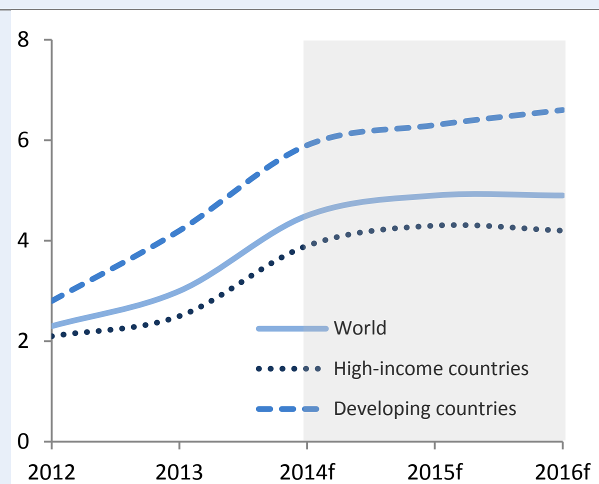



**Figure 36. … and strengthen global trade**
(Exports real growth, in percent year-on-year)




*Source:* World Bank staff estimates.
*Note:* f = forecast.

[18] World Bank 2014a.

**The pickup in growth in developing countries in the second half of 2013 will carry through the momentum into 2014.** Growth in developing countries is expected to improve to 5.0 percent in 2014, and then strengthen to 5.4 percent in 2015 and 5.6 percent in 2016. Although broadly in line with potential, the projected growth in 2014 is 2.3 percentage points lower than average growth of 7.3 percent achieved during the precrisis boom years. About two-thirds of the difference from the precrisis years represents a decline in the cyclical component of growth, and one-third, a decline in potential growth.

**Box 3. Key Assumptions Underpinning the Projections**

Our forecast for a recovery in global growth will be underpinned by favorable trade dynamics that will help offset the negative effects of higher interest rates and weaker capital flows:

(a) Global trade will revive with the recovery in high-income countries, rising from a 3.0 percent growth in 2013 to 4.4 percent in 2014, 4.8 percent in 2015, and 4.9 percent in 2016 (figure 36). Over the last several years, global trade has been subdued because of weak overall demand in high-income countries and because of shifts in demand toward less trade-creating government spending.

(b) Manufacturing-intensive economies should benefit from stronger demand in the high-income countries, but commodity exporters are likely to suffer from the ongoing decline in commodity prices. Moreover, slower demand from China for industrial raw materials, as it rebalances its economy, will weigh on the exports and fiscal revenues of commodity exporters.

(c) Policy normalization in the United States and other high-income countries will raise interest rates globally. U.S. long-term rates are expected to rise 100 basis points by 2016 in line with market expectations. Short-term rates are expected to start rising by 2015 and to increase by 150 basis points by the end of 2016. Higher interest rates are expected to boost the cost of capital.

(d) Capital flows to developing countries are expected to decline, by about 0.6 percent of developing-country GDP by 2016, as global asset portfolios are rebalanced toward high-income economies. Trade should, to some extent, help offset the negative effects from higher interest rates and weaker capital outflows to developing countries.

(e) As capital flows ease, a weakening of developing-country currencies will be an essential part of the rebalancing in these economies. Depreciations should help improve the competitiveness of the traded sectors, and for commodity exporters, help reverse some of the Dutch disease impacts associated with elevated commodity prices over the last decade.

*Sources:* World Bank 2014, updated March 27, 2014; World Bank staff estimates.

## *EAP is Expected to Grow at a Stable and Sustainable Pace*

**The outlook for the EAP region remains favorable.** Overall growth in developing EAP is expected to ease marginally to 7.1 percent in the forecast period (table 1). Growth for China is expected to moderate to 7.5 percent by 2015, with less reliance on policy-induced, credit-fueled, and investment-led growth. Regional output growth, excluding China, is estimated to settle at 5.4 percent by 2016 as external demand solidifies and adjustment comes to completion. A temporary acceleration to 5.6 percent in 2015 partly reflects some growth pickup in Malaysia, reconstruction efforts in the Philippines, and the start of production at the huge liquefied natural gas project in Papua New Guinea.

**Table 1. East Asia and the Pacific: GDP Growth Projections**

(Percent change from a year earlier)

| | | | Forecast | | | Changes from Oct. 2013[a] (in percentage points) | |
|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2014 | 2015 |
| **East Asia and Pacific (EAP)** | 5.9 | 6.1 | 6.2 | 6.3 | 6.4 | -0.2 | -0.1 |
| **Developing EAP** | 7.4 | 7.2 | 7.1 | 7.1 | 7.1 | -0.1 | -0.1 |
| China | 7.7 | 7.7 | 7.6 | 7.5 | 7.5 | -0.1 | 0.0 |
| Indonesia (ASEAN-4) | 6.3 | 5.8 | 5.3 | 5.6 | 5.6 | 0.0 | -0.2 |
| Malaysia (ASEAN-4) | 5.6 | 4.7 | 4.9 | 5.0 | 5.0 | 0.1 | 0.2 |
| Philippines (ASEAN-4) | 6.8 | 7.2 | 6.6 | 6.9 | 6.5 | -0.1 | 0.1 |
| Thailand (ASEAN-4) | 6.5 | 2.9 | 3.0 | 4.5 | 4.5 | -1.5 | -0.5 |
| Cambodia (Mekong-4) | 7.3 | 7.4 | 7.2 | 7.0 | 7.0 | 0.2 | 0.0 |
| Lao PDR (Mekong-4) | 8.2 | 8.1 | 7.2 | 7.9 | 9.1 | -0.5 | -0.2 |
| Myanmar (Mekong-4) | 7.3 | 7.5 | 7.8 | 7.8 | 7.8 | 0.9 | 0.9 |
| Vietnam (Mekong-4) | 5.3 | 5.4 | 5.5 | 5.6 | 5.8 | 0.1 | 0.2 |
| Mongolia | 12.4 | 11.7 | 11.4 | 9.2 | 7.6 | 1.1 | -0.8 |
| Fiji | 2.2 | 2.7 | 2.4 | 2.4 | 2.3 | 0.3 | 0.2 |
| Papua New Guinea | 8.7 | 4.4 | 10.0 | 20.0 | 4.0 | 0.0 | 0.0 |
| Solomon Islands | 4.9 | 3.1 | 3.5 | 3.5 | 3.5 | 0.0 | -0.2 |
| Timor-Leste | 8.3 | 8.1 | 8.0 | 7.7 | 8.6 | -2.2 | -3.8 |
| **Memo: Developing EAP excl. China** | 6.2 | 5.2 | 5.0 | 5.6 | 5.4 | -0.3 | -0.1 |
| **Memo: ASEAN** | 5.6 | 5.0 | 4.8 | 5.2 | 5.2 | -0.3 | -0.2 |
| *Assumptions about the external environment:* | | | | | | | |
| World | 2.5 | 2.4 | 3.0 | 3.3 | 3.4 | -0.1 | -0.1 |
| High-income countries | 1.5 | 1.3 | 2.1 | 2.4 | 2.4 | 0.0 | 0.1 |
| Developing countries | 4.9 | 4.8 | 5.0 | 5.4 | 5.6 | -0.3 | -0.2 |

*Sources:* World Bank data and staff estimates. a. World Bank 2013a.

**In China, growth will moderate to 7.6 percent in 2014 and to 7.5 percent by 2015.** The authorities are committed to embark on structural reforms that will deliver a more sustainable and inclusive growth path in the medium to long term (see Part II.A, "China's Reform Roadmap"). The reform program includes financial sector reforms, deregulation of the services sector, further improvements in social insurance, reforms to the fiscal framework, a more decisive role for the markets, and continuing SOE reform. Pursuing the reforms will not be easy because they may have short-term costs and entail moving to a slower growth path. Growth is expected to be 7.6 percent in 2014, slightly lower than our previous projection, and reflects the bumpy start to the year.[19] A planned decline in investment growth will be offset by a gradual increase in consumption growth, the latter supported by an increase in household incomes and a gradual narrowing of the urban-rural income gaps. The contribution of net exports is expected to increase gradually. Growth is expected to be 7.5 percent in 2015. The prospect of growth falling below the government target will likely be met with accommodative fiscal and monetary policies, for which it has room to maneuver. However, more accommodative policies, particularly those targeted at

[19] While the growth rate of industrial production has slowed, and exports contracted in the first two months of 2014, the trend is nevertheless strengthening, and we expect quarterly growth to rise at midyear as external demand from the high-income countries solidifies.

investment, will contribute to an increase in credit growth and local government debt. More importantly, focusing policies on meeting growth targets could distract from the implementation of structural reforms that would put long-term growth on a more stable footing.

**Growth in the ASEAN-4 will broadly track potential.** The slowdown in Indonesia will run its course. Growth will decelerate to 5.3 percent in 2014, before stabilizing at 5.6 percent in 2015 and 2016, due to tighter financial conditions and less supportive terms of trade. Private consumption, which has remained resilient, will likely come under more strain. Investment, particularly building investment, will slow in the face of tighter credit, reduced investable funds from commodity profits, and higher import costs. Election-related spending will add to domestic demand but will fade away in the second half of the year. Growth in Malaysia will accelerate modestly to 4.9 percent in 2014 and 5.0 percent in 2015 and 2016 supported by an expansion in exports. But domestic demand will face several headwinds, with households hard-pressed to maintain the spending growth considering higher debt servicing costs and higher prices (from subsidy rationalization and other fiscal consolidation measures). The Philippines is forecast to grow at 6.6 percent in 2014 and 6.9 percent in 2015, with reconstruction spending offsetting the drag on consumption from the effects of the 2013 earthquake and typhoon. In Thailand, a recovery in external demand will lift growth to 3.0 percent in 2014 following a particularly weak year in 2013.

**In the smaller economies in the region, growth is expected to remain steady and robust.** In Vietnam, growth is expected to rise modestly to 5.5 percent in 2014, 5.6 percent in 2015, and 5.8 percent in 2016. The baseline forecast assumes a phased withdrawal of fiscal stimulus, monetary policy caution, and a renewed focus on structural reforms, particularly in the SOE and banking sectors. Renewed reform momentum after the elections will help growth stabilize in Cambodia at 7.2 percent in 2014 and 7 percent in 2015 and 2016, although labor market instability may pose downside risks. In Lao PDR, growth will remain robust at 7.2 percent in 2014 and will pick up to 7.9 percent in 2015 and 9.1 percent in 2016, boosted by new power projects including a coal-fired power plant. Growth will likely remain robust in Mongolia at 11.4 percent in 2014 and 9.2 percent in 2015, helped by the start of production in the Oyu Tolgoi copper and gold mine, although spillover risks from China's rebalancing and the ability of authorities to reverse domestic policy stance need watching. In Myanmar, growth is expected to remain stable at 7.8 percent in 2014–16, following good progress made by the government in 2013 on macroeconomic reforms, including the establishment of an autonomous central bank, the adoption of a flexible exchange rate, and increases in spending on health and education.

**In the Pacific Islands, growth will be subdued and volatile.** Papua New Guinea faces a slowdown in the nonmineral sector as construction winds down on the huge liquefied natural gas project: GDP growth is projected to decline to 4 percent by 2016 after a one-off increase of 20 percent in 2015. The outlook for Timor-Leste's nonoil economy has moderated significantly as public spending plans have been brought down to more sustainable levels in order to curb inflation. Growth in Fiji is expected to moderate to 2.4 percent in 2014 and 2015, following stronger growth of 2.7 percent in 2013, as the recent fiscal expansion is reversed and tourism growth moderates. However, normalization of relations with Australia, following the prospective return of democratic government, could lead to increased access to development finance, which would provide additional support to growth over the medium term. In the Solomon Islands, growth may remain subdued at 3.5 percent, following lower timber and gold production and investment, amid weak commodity prices.

**The challenge is even more daunting among the smaller Pacific Island countries, where growth is expected to remain volatile and vulnerable to external shocks during the forecast period,** with uncertainty arising from potential natural disaster impacts, unpredictable aid flows, and frequent delays in implementing public infrastructure investments. Remittance flows to Kiribati and Tuvalu from maritime industry workers may pick up with global trade, but could also be adversely affected by reduced demand for seafarers, accompanying moves to increased vessel sizes across the industry and the high cost of the air transport services that deliver seafarers to work locations. Tourism revenues in Samoa, Tonga, and Vanuatu are at risk from the recent depreciation of the Australian dollar and from any slowdown in Australia. Continued growth in Australia, New Zealand, and the United States is expected to contribute to the continued recovery of remittance flows, which are particularly important to livelihoods in Samoa and Tonga. However, infrastructure investments in all of the small Pacific Island countries are susceptible to cycles in donor finances (box 4).

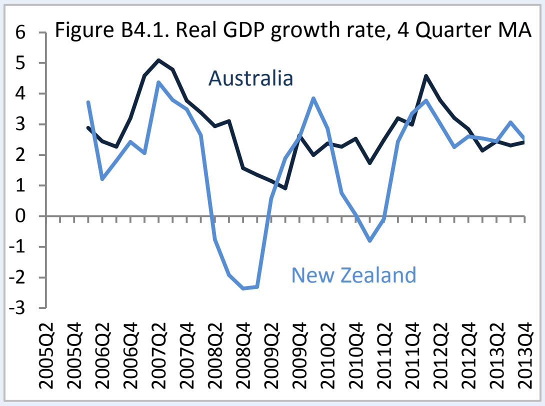
**Box 4. Economic Linkages between Pacific Island Economies and Australia, New Zealand, and the United States**

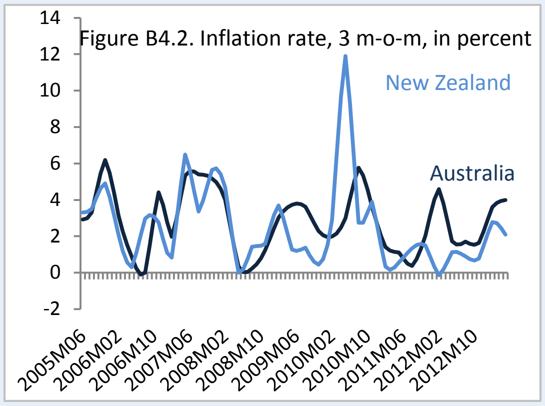
The Pacific Islands (PIs) share strong economic and social ties with Australia and New Zealand. The key channels of linkages include trade, tourism, remittances, FDI, aid, and financial channels. According to Sheridan, Tumbarello, and Wu (2012), trade with Australia and New Zealand accounts, on average, for one-third of PIs' trade. Tourists from Australia and New Zealand represent 60 to 70 percent of total arrivals in Fiji, Samoa, and Vanuatu. The PIs' financial sector is dominated by Australian banks, and Australia is by far the largest provider of aid. Among Organization for Economic Co-operation and Development countries, it is also the largest foreign investor.

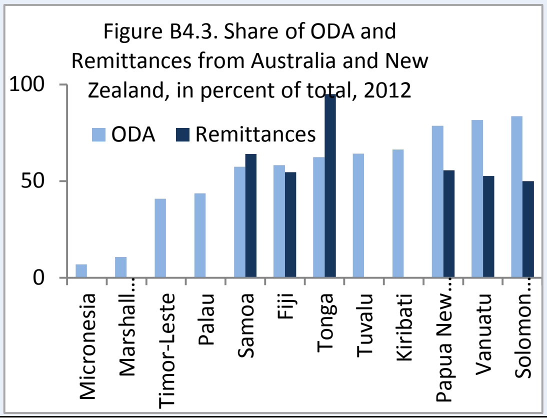
The economies of Australia and New Zealand are showing signs of recovery, with growth stabilizing between 2 and 3 percent and the inflation rate below 4 percent (see figures B4.1 and B4.2)—which bodes well for the PIEs.

Australia and New Zealand are also by far the largest aid providers for most of PI countries. In 2012, these two countries alone accounted for 63 percent of their total ODA. While this share exceeds 80 percent in countries like Vanuatu and Solomon Islands, Australian and New Zealand assistance plays a less important role in the northern pacific region namely in Marshall Islands and Federated State of Micronesia. There, the United States, and to a lesser extent Japan, are the larger contributors of aid (figure B4.3). Similarly, remittances from Australia and New Zealand are also significant for PIs. These exceed 50 percent in most PIs and could reach up to 95 percent in countries like Tonga.

The U.S. economy also has a significant impact on some of the PIs, particularly with those with which it has signed the Compact Agreement, namely the Marshall Islands, Micronesia, and Palau. Aid from the United States accounts over 65 percent of total aid in Palau and 90 percent in the Marshall Islands and Micronesia. Similarly, remittances from the United States



account for half of all the remittances to Tonga.

In a significant development, trade with China has increased 7 times on average for PIEs since the early 2000s, with China becoming the largest trading partner of the Solomon Islands.

*Sources:* Sheridan, Tumbarello, and Wu 2012; World Bank staff estimates.

## *Risks and Opportunities Are Evenly Balanced*

The headline external risks to EAP outlook include a slower-than-expected global recovery, a rise in global interest rates and a possible contagion effect from other emerging markets, and a disorderly rebalancing in China—although the first two risks are inversely related with one another. There are also opportunities that EAP countries could seize including progress on domestic rebalancing, and payoffs from the ongoing restructuring process in several countries.

### ➢ *At the Global Level: Speed of recovery, rising interest rates and commodity prices*

**Multiple vulnerabilities in the advanced economies pose downside risks to global growth.** Much of the anticipated upturn in developing areas hinges on the promise of a strong recovery in the advanced economies (figure 37) and an accompanying revival in global trade. Despite recent progress in addressing vulnerabilities across the industrial economies, however, legacy problems remain.[20] High unemployment rates, weak bank lending, and elevated public debt levels remain points of concern in the Euro area. High levels of government debt and related fiscal issues persist in Japan, with a planned sales tax likely to be a drag on growth. The structural reform agenda is highly complex and needs stronger consensus. Fiscal and financial risks remain in the United States. Moreover, new risks have emerged, including unusually low-level inflation, particularly in the Euro area, which may drag down longer-term inflation expectations and raise real debt burdens.

**Figure 37. Growth is forecast to be robust in the region's high-income trade partners …**
(GDP growth, in percent year-on-year)

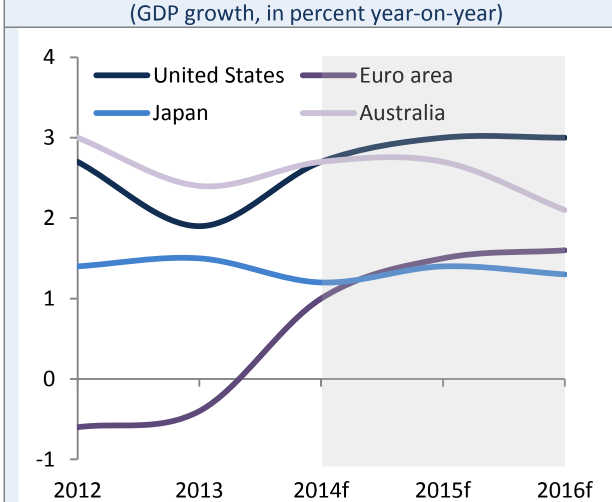
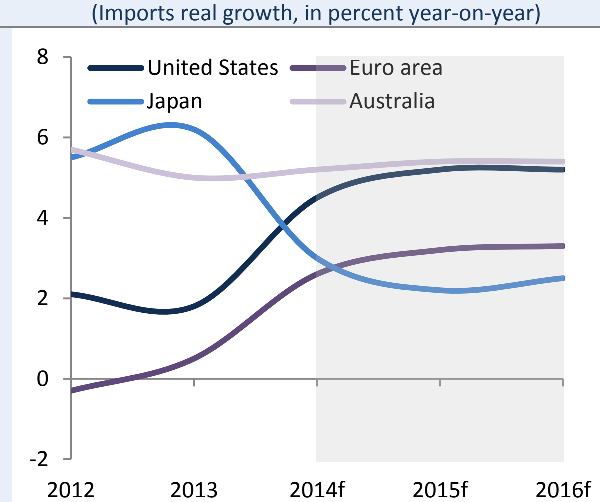



**Figure 38. … and should lead to higher high-income-country imports from the region**
(Imports real growth, in percent year-on-year)




*Source:* World Bank staff estimates.
*Note:* f= forecast.

[20] IMF 2013a.

**A softer-than-projected recovery in the advanced economies would affect developing EAP countries mainly through the trade channel.** Although the region is currently trading more with developing rather than advanced economies, the industrial countries remain major markets for the region's exports (figure 38). The United States, the Euro area, Japan, and Australia and New Zealand account for about two-fifths of the region's exports. The figure would be higher if trade in parts and components in production networks within the region were traced to their final market destinations.[21] The record during the global financial crisis shows episodes when imports fell more than industrial production (the United States in 2009) or recovered less than industrial production (the Euro area and Japan in 2010 and 2011). The implication is that a prolonged period of less than robust growth in the advanced economies may keep global trade depressed, more so if halting growth in the industrial countries is accompanied by protectionist sentiment or even by tight financial conditions, including inadequate trade finance.

**Direction-of-trade data provide some guidance on how EAP countries will be affected in the absence of a strong revival in global trade.** Exports account for a larger share of output in Malaysia and Thailand, among the large economies; in Cambodia, Mongolia, and Vietnam, among the smaller economies; and in the Solomon Islands and Papua New Guinea, among the Pacific Island Economies. The ASEAN-4 countries export more to Japan than they do to either the United States or the Euro area (figure 39). Among the smaller economies, Cambodia exports most to the United States, while Vietnam is well diversified across the three markets. The Pacific Island economies are mostly dependent on Australia and New Zealand and Japan (figure 40). Cross-linkages, not obvious from these trade accounts, provide another wrinkle. Considering that Malaysia, Thailand, and the Philippines export manufacturing parts and components to China, and China exports final consumer and industrial products to the United States and the Euro area, these ASEAN countries may be as much exposed to the United States and the Euro area as they are directly to Japan.

**Figure 39. Japan is a significant export market for the ASEAN-4 …**

(Exports, in percent of GDP; and direction of exports, in percent of total)

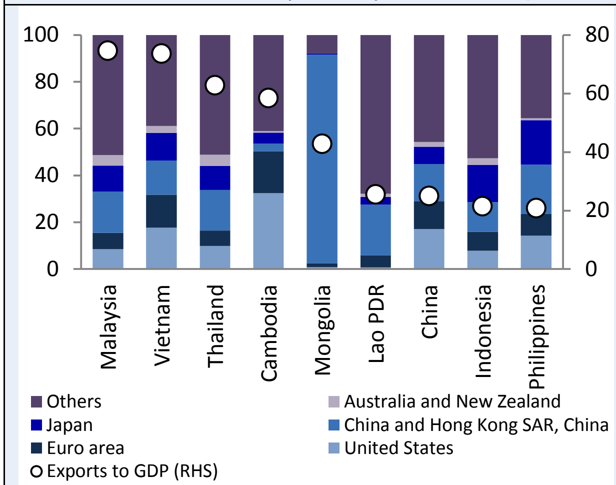
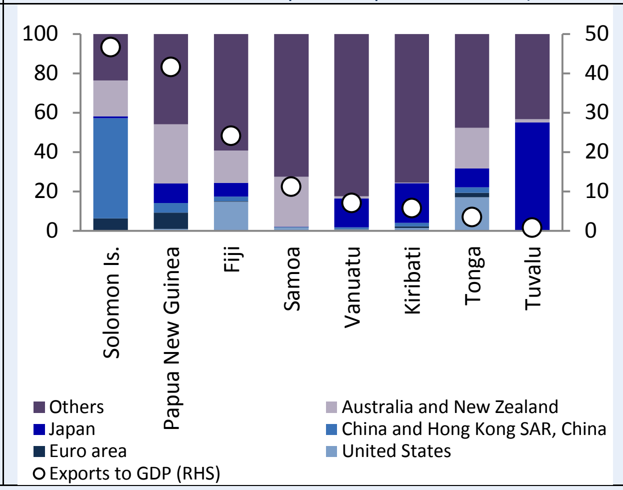



**Figure 40. … and Australia, for the Pacific Islands**

(Exports, in percent of GDP, and direction of exports, in percent of total)




*Source:* IMF, Direction of Trade Statistics.
*Note:* RHS = right-hand side.

[21] Up to 60 percent of total regional exports (Asian Development Bank 2007).

**FDI from advanced economies, which contracted sizably during the global financial crisis, may not recover should tepid economic conditions in the source countries persist.** Greenfield investments by the Euro area and the United States in 2012 were about a third to two-fifths their levels in 2008. Merger and acquisition (M&A) purchases by the Euro area have practically collapsed from 2007, while those by the United States have cycled downward after recovering in 2011. In contrast, global M&A purchases by China are on the upsurge. The ASEAN-4 and Vietnam, which have received large FDI from Japan, have also received large FDI from the Euro area (figure 41). In addition, Lao PDR, among the smaller economies, and Samoa and Tonga, among the Pacific Island Economies, have substantial FDI stock from the Euro area. Malaysia and Thailand, and to a lesser degree, Indonesia and the Philippines, have received significant FDI from the United States. Among the Pacific Island Economies, the Marshall Islands, Micronesia, Palau, and Vanuatu, have received practically all their FDI from the United States (figure 42).

**Figure 41. Japan and the Euro area …**

(FDI, in percent of gross fixed capital formation, and FDI stock, by source)

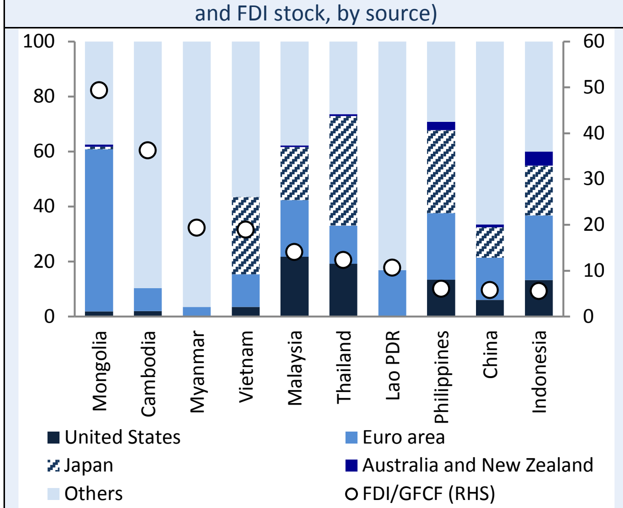
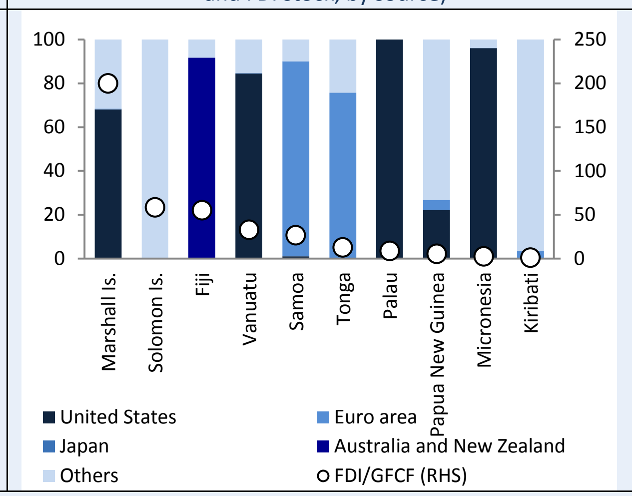



**Figure 42. … and the United States are important FDI investors in the region**

(FDI, in percent of gross fixed capital formation, and FDI stock, by source)




*Source:* IMF Consolidated Direct Investment Survey.
*Note:* FDI = foreign direct investment; GFCF = gross fixed capital formation; RHS = right-hand side.

**In developing EAP countries, as in other emerging markets, capital flow reversals and financial market volatility remain a concern, given the ongoing tapering by the U.S. Federal Reserve.** The response in the region's financial markets to tapering has been muted so far, helped in part by effective forward guidance from the Fed. Adjustments in asset prices and currency values may have also been previously front-loaded, during the market turmoil during May–September, when the prospect of tapering ignited capital outflows from emerging markets. Yet, renewed market volatility cannot be discounted as tapering progresses. The turbulence may not necessarily originate from the region, but may come from other parts of the developing world and spread to the region and elsewhere by contagion, as has been happening with the turbulence in Argentina, later Turkey, and more recently in Ukraine. Similarly, domestic problems like political conflicts or electoral uncertainty could reinforce external shocks and contribute to greater fragility than warranted by economic fundamentals.

**Going forward, higher global and domestic interest rates, rather than more volatile capital flows and financial markets, may be the greater concern.** Although further action by the Federal Reserve will depend on economic and financial conditions going forward, the prospects for a normalization of U.S. policy rates and a drawdown of the Federal Reserve balance sheet will exert further upward pressure on interest rates.[22] In weaker economies, the result could be more sizable capital outflows, sharper exchange rates adjustments, and higher domestic interest rates. In markets where asset valuations are elevated, asset prices could come under undue pressure if higher interest rates also dent investor sentiment. Moreover, in countries where leverage has risen, higher interest rates and tighter financial conditions will render debt management, including contracting for new debt, more difficult. Overall, as interest rates rise, developing countries will face higher capital costs, which will weigh on investment and growth in the medium term. In this regard, one calculation shows that a 100-basis-point increase in global interest rates could cut capital flows to developing countries by 50 percent and to developing EAP countries by 25 percent (box 5). The risk of slower global growth and higher global interest rates is, however, unlikely to materialize at the same time.

**Box 5. Capital Flows and Risks to EAP**

This year will mark a turning point in the global monetary conditions, as the U.S. Federal Reserve proceeds with the withdrawal of its quantitative easing policies. The most likely scenario remains for this "taper" to follow a relatively orderly trajectory, and for global interest rates to rise only slowly, reaching 3.6 percent by mid-2016. The impact of such orderly tightening of financial conditions would be modest, according to the econometric evidence presented in the World Bank's January 2014 *Global Economic Prospects* report, with capital flows to developing countries projected to ease from about 4.6 percent of GDP in 2013 to 4.1 percent in 2016.

Figure B5.1. Baseline impact of global interest rate normalization on capital inflows

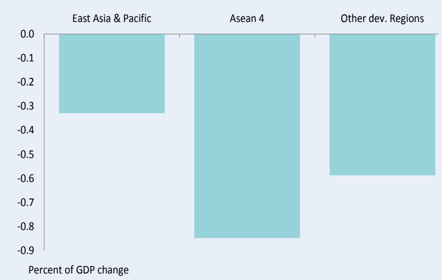
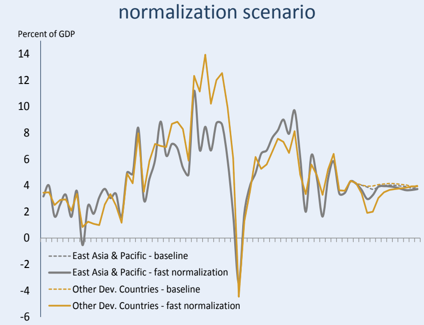



Figure B5.2. Capital inflow projections in a fast-normalization scenario




However, the impact on regional capital inflows may vary considerably, depending on the nature and size of past foreign investments, while risks of more disorderly adjustments remain significant. Sharper market reactions would affect especially middle-income countries with large exposures to portfolio inflows, compounded in some cases by growing current account deficits and/or overstretched domestic credit markets. In the baseline, portfolio inflows to developing countries will decline by around 30 percent compared with a "no policy change" scenario. The estimated impact on bank lending flows is considerably smaller, while FDI will hardly be impacted.

Partly as a result, regional patterns may be very different during the tapering period. In this respect, China could play a stabilizing role for the region: its relatively large reliance on FDI flows, and relatively limited exposure to foreign portfolio investments, reduce its vulnerability to the direct impact of tapering. However, the situation is noticeably different for the ASEAN region, where countries such as Indonesia, Malaysia, the Philippines, and Thailand have accumulated a considerable exposure to portfolio inflows in the postcrisis period, and are therefore more vulnerable to pullbacks (Figure B5.1). As a result, the expected resilience of capital inflows to China would be partially offset by risks of more significant adjustments in the rest of the region.

In a more disorderly scenario, where global interest rates increase suddenly by 100 basis points, resulting in

[22] According to estimates by the U.S. Congressional Budget Office (CBO), less than half the eventual rise in U.S. long-term interest rates has occurred thus far. The CBO forecasts U.S. 10-year Treasury rates to rise to 5 percent during 2018–24, from 3 percent in March 2014, and 1.6 percent in May 2013.

heightened market volatility and risk aversion, capital inflows to developing countries could decline by up to 50 percent across developing countries and more than 25 percent in the EAP region (Figure B5.2). The magnitude of these simulated effects is broadly consistent with the adjustments observed during the "taper tantrum" from May to September 2013.

For some countries, the effects of such rapid retrenchment of capital inflows could trigger balance-of-payment or domestic financial turmoil. Evidence from previous banking crises indicates that countries could be more at risk if they have experienced a substantial expansion of domestic credit in previous years, deteriorating current account balances, high levels of foreign and short-term debt, and overvalued exchange rates.

In the EAP region, rapid credit expansion over the last five years is the most common area of concern, particularly in Cambodia, China, Malaysia, Thailand, and Vietnam.

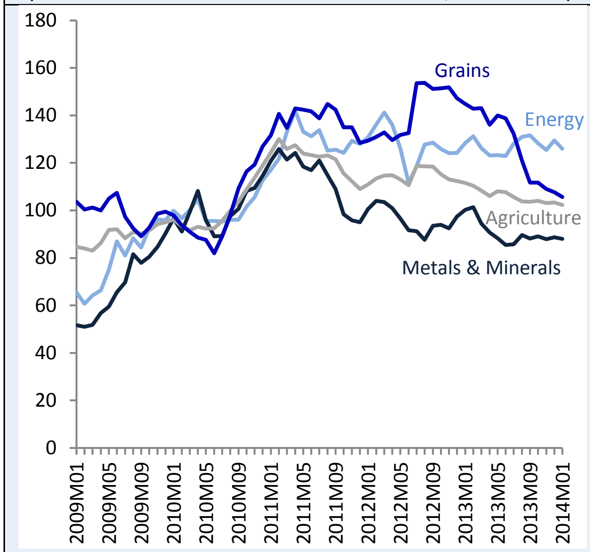
**Geopolitical tensions could upturn our baseline assumption of a moderate downward path for most commodity prices through 2014.** Assuming there were neither macroeconomic shocks nor supply disruptions, we had projected a continuing downward path for most commodity prices (figure 43) in 2014.[23] But as tensions in Eastern Europe now show, commodity prices could easily turn volatile yet again. Wheat and maize prices, for example, have jumped 4 to 6 percent following the outbreak of the crisis in Ukraine. An escalation of tensions in Ukraine, including stronger sanctions on or by Russia, could strongly impact global energy markets and the global economy. Russia is the world's second-largest producer (with a 12.6 percent share of global production in 2012) and second-largest net exporter (with a 12.5 percent share) of oil.[24] Russia is also the world's second-largest producer (with a 19.1 percent share of global production) and largest net exporter (with a 22.3 percent share) of natural gas. Moreover, it supplies 30 percent of natural gas demand of the high-income countries in Europe.

**Higher energy and food prices may boost the export receipts of many of the region's oil and gas suppliers and net food exporters.** Price hikes in the range of US$30 per barrel, for example, are possible under a range of scenarios. Energy exporters in the region will benefit from such a price increase (figure 44). However, the overall economic effects in the region and elsewhere will be more complex. Increased or prolonged geopolitical tensions may have more important adverse confidence effects globally, cutting consumer and firm spending worldwide, reducing international financial market flows, and increasing interest rates globally as investors seek safe havens. A large share of exports in many of the EAP countries, especially the Pacific Island and smaller economies, is food (for example, fisheries and rice), which would benefit from a firming up of food prices in the world market.

[23] In World Bank 2014b, we forecasted oil prices to come under 1 percent of the average in 2013, natural gas prices in the United States to increase on stronger demand from energy-intensive industries, natural gas prices in the Euro area and Japan to moderate on weaker demand, and coal prices to increase due to the substitution from nuclear power to coal in electricity generation. We had also projected agricultural prices to decline 2.5 percent in 2014 on the assumption that favorable crop conditions would continue through the rest of the year, and metal prices to decline 1.7 percent as new supplies came onboard.

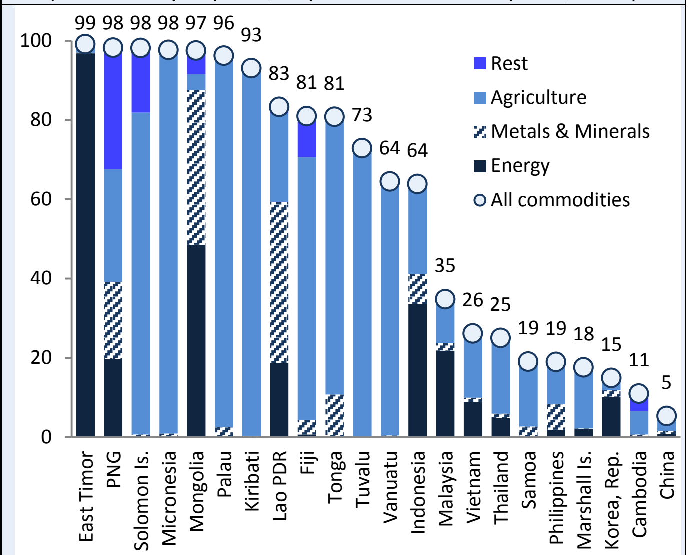
[24] International Energy Agency 2013.

**Figure 43. Global commodity prices have eased in recent years**
(Indexes based on nominal U.S. dollars, 2010=100)




*Sources:* World Bank Commodity Price Database.

**Figure 44. Commodity exports constitute more than one-half of total exports in 13 of 22 EAP countries**
(Commodity exports, in percent of total exports, 2012)




*Source:* World Bank staff estimates.

➢ *At the regional level: China's slowdown has upside and downside risks*

**To move forward with its comprehensive structural reform program, China must begin to address two near-term risks to financial stability.** The first is the rapid growth of credit in the economy, including credit from the less well-regulated shadow banking sector. And the second is the rapid accumulation of debt by local governments, operating through off-budget, quasi-fiscal platforms. China has significant buffers to address these growing risks. And it is assumed that the adjustments will be orderly and that progress will be steady. But, the transition could be abrupt and disorderly.

**Predicted effects of a disorderly adjustment in China vary widely, not least because the challenges are daunting and complex.** In one adverse scenario, local governments are forced to deleverage quickly. In another, property markets correct too sharply. In the first case, infrastructure investment growth falls off, and in the second, real estate development does so. In either case, there is a rapid rebalancing away from investment, which has been a key driver of growth and lower external balances in China since the global financial crisis. Previously, we had estimated that a 5-percentage-point decline in investment growth in China would cut GDP growth by 1.4 percent in China and by 0.6 percent in the EAP region.[25]

**As in the case of spillovers from the advanced economies, a slower-than-expected growth in China will hurt the region mainly through the trade channel.** Our previous analysis of the direction of negative spillovers remains.[26] First, a steep decline of investment growth in China will hurt commodity exporters the most, particularly those that have less well-diversified economies and are most reliant on exports to China. The negative impact will come from both lower imports by China of industrial raw materials and from lower prices internationally for these commodities. Second, the abrupt decline in investment will also affect manufactures exporters serving China's industrial supply chain. The spillovers

[25] World Bank 2013b.
[26] World Bank 2013a.

will include second- and third-round effects. Third, capital goods exporters will also be affected, although the spillovers for these mostly advanced economies will be small. At the same time, a slowdown in investment growth without commensurate pick-up in consumption growth will return China to a capital account surplus, thereby risking renewing trade tensions with the United States and Euro area.

**The upside to the region of a successful adjustment in China has not been emphasized enough.** Some of the reforms under consideration (see below) will enhance growth even in the short-term. More broadly, **s**uccessful efforts to contain the near-term risks posed by expansive credit and high debt to financial stability will help China begin transitioning to a more sustainable growth path. The domestic rebalancing from investment to consumption will undoubtedly be gradual and protracted, but the dynamics will be favorable. The transformation will lead to more moderate growth, but the structure of growth will improve and will result in more efficient sources of domestic demand, more inclusive distribution of growth dividends, and more sustainable use of resources. Demographic changes and a decline in excess employment in agriculture will put upward pressure on wages. Higher wages and higher household disposable income will strengthen the middle class and support the shift in domestic demand from investment to consumption. Consequently, China's growth will become increasingly dependent on services, as the emerging middle class in urban areas will create the demand for an increasingly diverse set of services. The implication for the region is that China's import structure will change in favor of consumption goods and services.

**China is bound to depend on imports to meet rising demand for particular agricultural goods.**[27] Although China has attained domestic self-sufficiency in major food grains including rice and wheat, it is unlikely to be able to replicate this feat across all food products. Overall demand for food in China is increasing with urbanization, with the demand for higher-cost items including animal products, fruits, and vegetables rising more quickly with income growth than the demand for basic staples. At the same time, China faces constraints to sustainable food production, including the conversion of farmland to urban uses; the rising intersector competition for water among domestic, industrial, and irrigation uses; and soil depletion and environmental pollution. Domestic self-sufficiency concerns notwithstanding, imports of soybeans and corn have surged in recent years.

**The creation of the ASEAN Economic Community (AEC) in 2015 could boost intraregional investment and exports, and thus provide an important source of growth to several EAP countries**. ASEAN members are working to form one of the largest regional markets in the developing world through creation of the ASEAN Economic Community (AEC) in 2015. Objectives include the free flow of goods, services, investment, and skilled labor (Paragraph 9, AEC Blueprint, 2007). According to the scorecard maintained by ASEAN, close to 80 percent of the policy and institutional targets set in the AEC blueprint have been met. Conservative estimates are that creating the AEC could increase annual income growth by about 0.5 to 1 percent of GDP and increase FDI stocks by 28 to 63 percent (or US$117 billion to US$264 billion relative to 2006 inward FDI stocks) (box 6).[28]

[27] World Bank and DRC 2014.
[28] Plummer and Yue 2009.

**Box 6. Countdown to the ASEAN Economic Community (AEC) 2015**

A 2013 joint report by the ASEAN Secretariat and the World Bank provides an assessment of the progress and impact of the AEC agenda, and highlights the following:

- ASEAN integration has achieved significant progress in **trade in goods**. Intra-ASEAN tariffs have been slashed to nearly zero in ASEAN middle-income countries and to below 2 percent on average in lower-income ASEAN economies. This has been accompanied by regional trade doubling to nearly US$500 billion over the last decade. ASEAN is now one of the most integrated regions as measured by the regional trade intensity indicator.

- Improvements in **trade facilitation** supported by ASEAN integration have led to greater trade and efficiency gains. Overall, trade costs, measured in aggregate terms, have been lowered by 15 percent on average in the ASEAN region over the last decade.

- ASEAN integration has helped **attract FDI** both from outside and particularly from inside the region, a key goal in forming AEC. FDI to ASEAN countries has increased from US$20 billion in 2001 to US$94 billion in 2010. Within the ASEAN region, FDI flows have also increased markedly from an average of US$5 billion in the 1990s to US$13 billion in the last three years. Attractive factor prices and good connectivity in the region have played a key role in drawing FDI to the region, although the destinations remain highly concentrated in particular areas.

- There is some evidence that AEC efforts are helping **narrow the development gap** between the ASEAN-6 and the lower-income CLMV group (Cambodia, Lao PDR, Myanmar, and Vietnam), whose share of GDP in ASEAN grew from 3.5 percent in 1990 to nearly 10 percent in 2011. The deep trade linkages of the CLMV countries with other ASEAN countries measured by direction of trade indicators suggest that regional integration has been an important driver for the development of these countries.

There are, however, two key areas where significant issues are impeding progress in forming the AEC: the use of nontariff measures and the services sector. The use of nontariff measures to impede trade, including regional trade, has markedly increased in recent years. ASEAN Member States have also recognized this as a key challenge. In the case of services trade, actual implementation of commitments to provide market access and national treatment to other ASEAN states' service providers has been slow. Progress in harmonizing domestic regulations that will address nontariff measures and services trade barriers is now the main pending agenda for regional integration.

*Source: ASEAN Integration Monitoring Report* 2013.

## *Policy Considerations*

### ➢ *Fiscal consolidation will help rebuild buffers and create space for priority spending*

**Weaker structural balances highlight the need for fiscal consolidation.** In the ASEAN-4 countries, further fiscal consolidation will help rebuild buffers and create the fiscal space for priority spending to support growth. Indonesia must search for a better alignment of its fuel subsidy program, since rupiah-denominated fuel costs are driving subsidy spending higher. The government has budgeted Rp 211 trillion for fuel subsidy spending in 2014, up from Rp 200 trillion in 2013. In Malaysia, the rationalization of energy subsidies (both for fuel and electricity) and the planned implementation of the goods and sales tax (GST) should not be delayed because the country has incurred comparatively larger fiscal deficits and higher public debt. The Philippines can only sustain increases in investment levels with new tax policy and administration measures to broaden the tax base while reducing tax rates. The authorities are aiming to double public investment spending by 2016, while maintaining the deficit at 2 percent of GDP in the medium term. And Thailand must return to fiscal consolidation, replacing generalized subsidies, such as its unsustainable rice pledging program, with targeted income support for vulnerable groups.

**Significant fiscal consolidation in the smaller economies, while warranted, will prove challenging.** Vietnam faces sluggish revenues and large contingent liabilities from the SOEs and the banks. Tax relief previously extended to enterprises has weakened the buoyancy of the value-added tax. Meanwhile, the share of concessional debt in public debt is falling as the country attains middle-income status. The fiscal consolidation agenda is wide-ranging: the authorities must strive to offset some of the tax losses, reduce subsidies, consolidate capital spending, and reemphasize recurrent spending in the social sectors. In Cambodia, the government must improve revenue collection, better manage contingent liabilities, and reform public financial management to safeguard the fiscal space. Fiscal consolidation is central to restoring macroeconomic stability in Lao PDR. The authorities should restrain increases in public sector compensation in 2014 (now 62 percent of recurrent expenditures) even as they emphasize human development spending, seek revenues from the nonresource sectors, and improve tax collection. Mongolia must bring fiscal policy in line with the original goals of the Fiscal Stability Law, which targets a structural deficit ceiling of 2 percent of GDP. Consequently, the authorities should bring the operations of the Mongolia Development Bank under the budget.

**Refinancing local government debt with bonds is a positive development in China.** The National Development and Reform Commission, the country's central planning authority, recently gave local governments the go-ahead to issue bonds as a way of refinancing debt. The bond financing of local infrastructure projects is a step in the right direction, because it would allow for the better matching of assets and liabilities. Moreover, refinancing with bonds should promote greater transparency to quasi-fiscal operations, clarify repayment responsibilities among local governments and their financing platforms, and spread risks from the banks and shadow banks to the capital markets.[29] A more fundamental reform going forward would involve an overhaul of the framework for local government finance in China, which should include strict rules on debt financing and debt resolution, since financial markets alone are unlikely to provide the discipline needed to avoid overindebtedness.

- *Need for monetary tightening in the smaller economies and greater use of macroprudential measures in others*

**In Cambodia, Lao PDR, Mongolia, and Myanmar, where credit growth has been overly expansionary, monetary policy will need to curb credit growth and mop up excess liquidity.** In Cambodia, rapid credit growth, increasing foreign bank financing, and a buoyant real estate market pose risks to financial and macroeconomic stability. Although deposit growth had slowed and squeezed bank liquidity on confidence issues in the immediate postelection period, renewed confidence had built up since early 2014, stoking prospects of renewed credit and liquidity growth. The risks are heightened by dollarization,[30] which limits the effective conduct of monetary and exchange rate policy. In Lao PDR, years of credit expansion also pose risks to financial stability. Moreover, the government's exchange rate

[29] This will require that local governments adhere to the same rules as already in place for enterprise bonds, i.e., rules on transparency and disclosure.

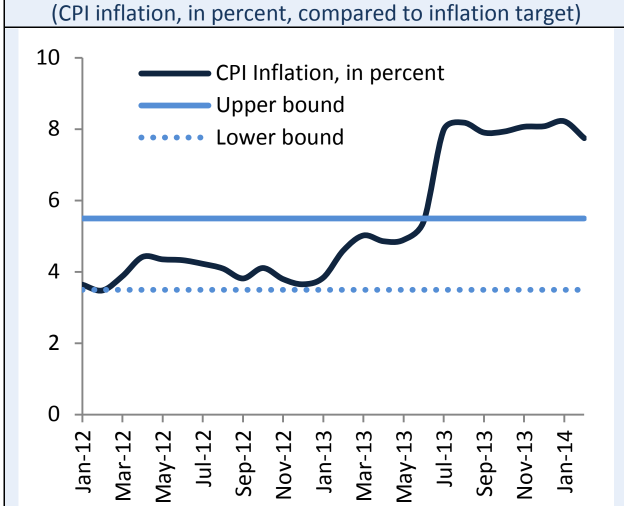
[30] Cambodia is the region's most dollarized economy, with the ratio of foreign currency deposits to broad money at 82 percent in 2013, up from 60 percent in the late 1990s.In comparison, the ratio is 50 percent in Lao PDR, 30 percent in Mongolia, and 20 percent in Vietnam.  Dollarization, combined with the decade-long practice of targeting the nominal exchange rate, limits Cambodia's options in its conduct of monetary policy.

anchor requires lower money and credit growth targets. In Mongolia, the ongoing large monetary stimulus, provided through central bank programs that seek to compensate for lower export earnings and FDI inflows, needs to be unwound to curb inflationary and balance-of-payment pressures. The rapid credit growth in recent months is not sustainable and risks leading to sustained pressure on financial and macroeconomic stability. In Vietnam, where high inflation has been a concern in the past, the authorities will have to keep a close watch on the inflationary impact of the recent monetary loosening.

**While inflation does not constitute an immediate risk for the region, the situation requires close monitoring.** The headline inflation rates are still subdued in most of the large economies, and globally, some large high-income countries, including the region's larger trading partners, are facing deflationary pressures; and international commodity prices, in particular food prices, remain depressed. In Indonesia, where monetary policy has been tightened through substantial increases in policy rates beginning in June 2013, we expect inflation to decline toward the end of the year, as the effects of the fuel price increase and the currency slide taper off (figure 45).

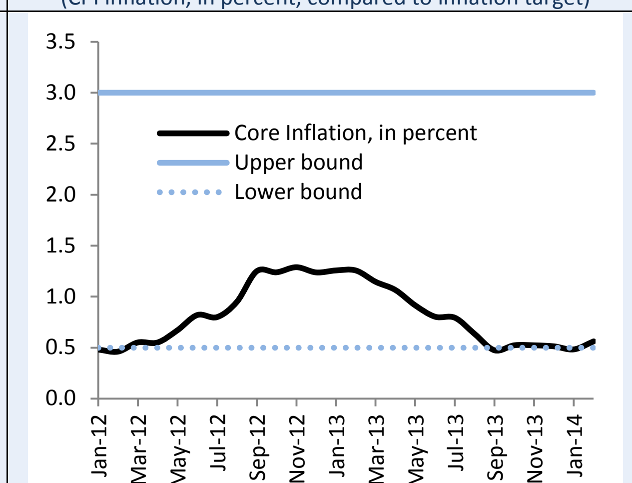
**Current monetary policy stances provide some insurance against downside risks in Malaysia, the Philippines, and Thailand, but creeping inflation needs careful monitoring.** In Thailand, slowing activity and subdued inflation leave the authorities some room to use monetary policy to support growth (figure 46) In Malaysia and the Philippines, where policy rates have long remained on hold (since May 2011 for Malaysia and October 2012 for the Philippines), headline inflation rates are creeping up (figure 47) . The real policy rates have recently turned negative in these countries (figure 48) and the authorities should closely monitor price developments. In Malaysia, in particular, possible second-round effects from the implementation of the minimum wage, the cut in fuel subsidies, and the planned introduction of the GST will require the vigilance of the monetary authorities.

**Figure 45. CPI inflation should decelerate in Indonesia**
(CPI inflation, in percent, compared to inflation target)




*Sources:* Haver Analytics; Bank of Thailand.

**Figure 46. Subdued core inflation allows room for rate easing in Thailand**
(CPI inflation, in percent, compared to inflation target)

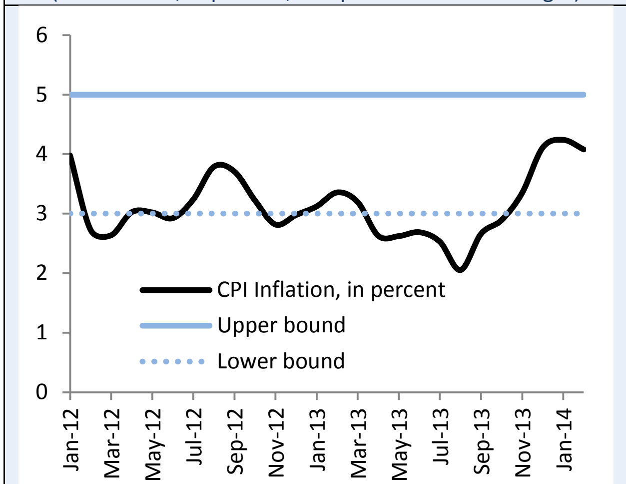



*Sources:* Haver Analytics; Central Bank of the Philippines.

**In China, slowing the growth of credit, especially in the shadow banking sector, remains a priority.** China responded to the global financial crisis with a massive investment-heavy stimulus program, supported by a vast credit expansion. The growth it triggered does not appear to be sustainable over the long term. Massive new lending has raised debt in all sectors of the economy, especially among local government units, posing risks to financial stability. The rapid expansion of shadow banking poses serious challenges, since shadow banking is closely linked to the banking system, is less well regulated, and operates with implicit guarantees from banks and local governments.

**Figure 47. CPI inflation needs monitoring in the Philippines**

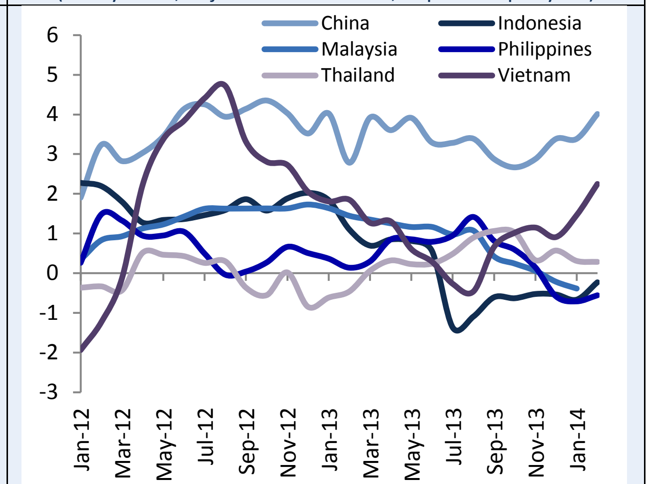
(CPI inflation, in percent, compared to inflation target)




*Sources:* Haver Analytics; Bank Indonesia.

**Figure 48. Indonesia, and recently, Malaysia and the Philippines, must contend with negative policy rates**

(Policy rates, adjusted for inflation, in percent per year)




*Sources:* Haver Analytics; World Bank staff estimates.

➢ *Greater exchange rate flexibility remains an important defense against external shocks*

**As recent developments demonstrate, flexible currencies offer the EAP economies better defense against external shocks, including capital flow reversals.** In Indonesia, exchange rate depreciations and macroeconomic policy tightening beginning in 2013 has helped the economy weather concerted capital outflows and balance-of-payment pressures. After the move to a managed floating rate regime in 2005 and following the liberalization of foreign exchange transactions in 2012, Malaysia has limited central bank intervention in the foreign exchange market to maintaining orderly market conditions and avoiding extreme movements in the ringgit that could destabilize the real economy. In principle, developing EAP countries should continue to allow exchange rates to depreciate in response to deteriorating external funding conditions, as could be expected during policy normalization by the United States and other high-income countries. They should limit the use of intervention to smooth the volatility of exchange rates. Moreover, where financial fragilities impose constraints on exchange rate adjustments, they should, instead consider tightening macroeconomic policies and strengthening the regulation and supervision of financial markets.

**In countries in the region where various types of managed and stabilized currency arrangements prevail, increased exchange rate flexibility will help dampen the effects of external shocks and support other objectives.** In Cambodia, where the exchange rate is pegged to the U.S. dollar, allowing more exchange rate flexibility will help the authorities to begin to address dollarization, which remains an entrenched problem. In Lao PDR, the commitment to a stabilized exchange rate within a wide and adjustable band has contributed to de-dollarization over time. At this time, allowing the exchange rate to move more in line with market conditions will enable the central bank to replenish international reserves. In China, a more market-based exchange rate system will facilitate further external and internal rebalancing.

**Commitments to greater exchange rate flexibility should be encouraged.** Mongolia should continue to maintain its floating exchange rate regime and auction system. It should limit intervention to smoothing excessive exchange rate volatility. In Myanmar, the adoption of a managed floating rate regime has since facilitated the convergence of the formal and informal exchange rates. Moreover, the recent depreciation of the exchange rate has helped align the exchange rate to longer-term fundamentals.

### ➢ *Raising potential output requires sustained structural reforms*

**In many economies, potential output growth has slowed, reflecting structural bottlenecks** (figure 49 and figure 50). Also, output gaps either are strongly positive or, if negative, lie within tight bounds of potential GDP (figure 51 and figure 52). The implication is that there will be some but little scope for countercyclical action.

**Figure 49. Potential GDP will trend downward during the forecast period especially in China and Indonesia …**

(Potential GDP growth, in percent, year-on-year)

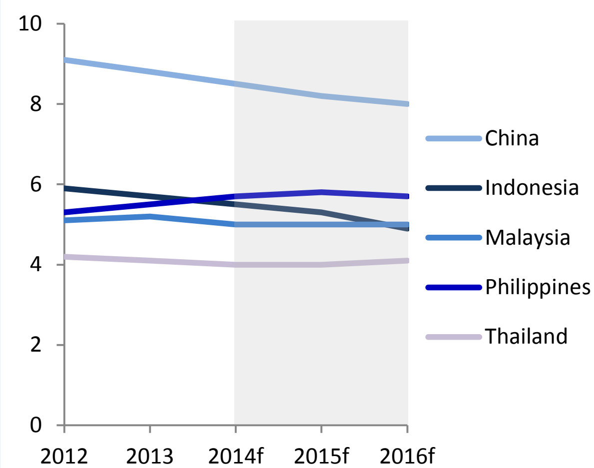
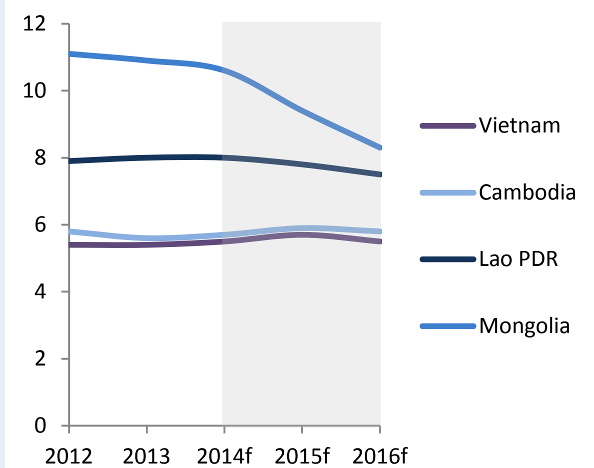



**Figure 50. … as well as in Mongolia and Lao PDR among the smaller economies in the region**

(Potential GDP growth, in percent, year-on-year)




*Source:* World Bank staff estimates.
*Note:* f = forecast.

**Figure 51. Strongly positive output gaps in the Philippines and Indonesia …**

(Output gap, in percent of potential GDP)

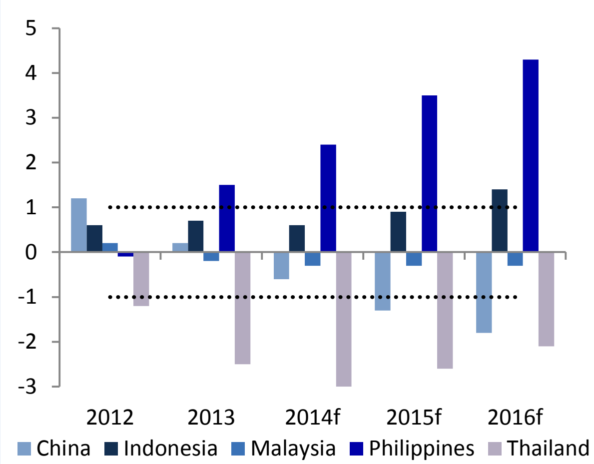
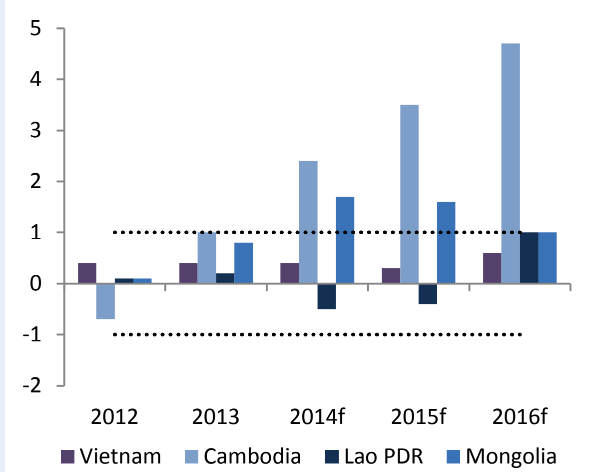



**Figure 52. … as well as in Cambodia and Mongolia will leave little space for countercyclical policy**

(Output gap, in percent of potential GDP)




*Source:* World Bank staff estimates.

*Note:* f = forecast.

**Therefore, any attempt to raise growth must focus on raising potential output through structural reforms.** This report focuses on three particularly topical areas of reform: (i) China's ambitious program to reform its land, labor, and capital markets; (ii) trade facilitation measures, in the context of the recent World Trade Organization agreement; and (iii) removing impediments to foreign direct investment, especially in the service sector. What follows is a brief overview of these issues. More detailed discussions can be found in Parts II and III of this report.

**China's reform program will make growth more sustainable in the long run.** China unveiled an ambitious and comprehensive reform agenda in November 2013 that will reduce state interventions and address government-led distortions in the economy. If implemented, the reforms will have a profound impact on China's land, labor, and capital markets and enhance the long-term sustainability of its economic growth. Some reforms are also likely to support growth in the short term. For instance, efforts to remove entry barriers, simplify approval procedures, and reduce regulatory and administrative burdens will enhance incentives for private investment, especially in currently monopolized or concentrated sectors. Likewise, consolidating the business tax with the value-added tax will lower the tax burden and promote investment, in particular in transportation and financial services. Making more land available for commercial activities will weaken constraints on private enterprise. However, the reform process is likely to be gradual due to challenges from vested interests. We expect to see more specific follow-up reform plans in the rest of 2014

**The Agreement on Trade Facilitation will reduce trade costs in developing EAP countries.** The region's developing economies suffer from trade costs well above those of the newly industrialized countries and of developed economies, owing to the large number of inefficient border and behind-the-border procedures. Countries have been adding to their stock of nontariff measures, which now account for as much as 90 percent of (nontransportation) trade costs. The World Trade Organization's new Agreement on Trade Facilitation has the potential to significantly reduce East Asia's trade costs along the entire supply chain, increasing regional GDP by 2.7 percent and employment by 1.2 percent. The Agreement on Trade Facilitation defines a new reform agenda for East Asia with potentially far-reaching effects on private sector development, especially for small businesses that need greater transparency and simplification of procedures to enable them to readily access regional and global value chains.

**Relaxing foreign ownership restrictions will increase FDI to the region.** Despite the economic importance of FDI to ASEAN, many ASEAN countries restrict foreign equity, particularly in the service sector. Regional experience indicates that where countries have relaxed foreign ownership restrictions, FDI has increased, bringing with it significant positive economic benefits for the receiving country. In Cambodia and Vietnam, foreign investment reforms led to significant growth in FDI, as did financial sector liberalization in the Philippines and Thailand in the 1990s. The ASEAN Economic Community 2015 blueprint brings new challenges and opportunities for ASEAN countries. Countries that relax foreign ownership restrictions in services stand to attract more FDI, which will enhance the competitiveness of producers of both services and goods.

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# China's Reform Roadmap[1]

*The Government of China unveiled an ambitious and comprehensive reform agenda in November 2013. It is a significant policy move, indicating a political will to reduce state interventions and address government-led distortions in the economy. This note describes the content and potential impact of the proposed reform package. If implemented, the reforms will have a profound impact on China's land, labor, and capital markets, and enhance the long-term sustainability of its economic growth. Some reforms, including efforts to reduce regulatory and administrative burdens, reform taxation, and make more land available for commercial activities, are also likely to support growth in the short term. However, the reform process is likely to be gradual, with more specific follow-up implementation plans expected as the year goes on.*

**China's reform agenda for the coming years through 2020 was released at the third Plenum of the 18th Central Committee of the Communist Party of China (CPC) in November 2013.** The major policy document entitled "Decisions regarding key issues on deepening reforms by the central committee of the Communist Party of China" described a comprehensive reform package, covering 16 areas and 60 individual items.

**The 2013 Plenum envisions a more ambitious reform plan than the 2003 Plenum in many policy areas,** including fiscal, demographic, migration, and land policies (table 1 and Annex 1). The "Decisions" document addresses six key areas of reforms, including economic, political, social, cultural, and environmental reforms, and reform of the Communist Party.

**The Plenum document proposes that the focus be on economic reforms.** This note likewise focuses on economics. Future economic reforms will be oriented toward reducing government interventions in the market economy. The document indicates that markets should play a "decisive" role in resource allocation and that both public and private sectors are key components of China's economy.

## Reducing government interventions in the market economy

**An important step to deepen economic reforms will be redefining the relationship between the government and the market.** The document calls for enforced protection for both state-owned and private property rights. In particular, the role of state-owned enterprises (SOEs) will be refined and more limited to sectors related to public services.

[1] This note was prepared by Bingjie Hu, with assistance from Jingyi Zhang.

**SOEs still play a large, if decreasing, role in the Chinese economy**. Forty-two percent of total assets were held by SOEs as of 2012 (figure 1). This share is declining as the private sector gains in importance. Critically, the profitability of SOEs is increasingly lower than that of private enterprises (figure 2). The decreasing dominance of SOEs is even more visible in the labor market; the share of SOE employment dropped from 60 percent in 1990 to 18 percent in 2012.

Figure 1. State-Owned Enterprises' (SOEs) Share of Total Assets

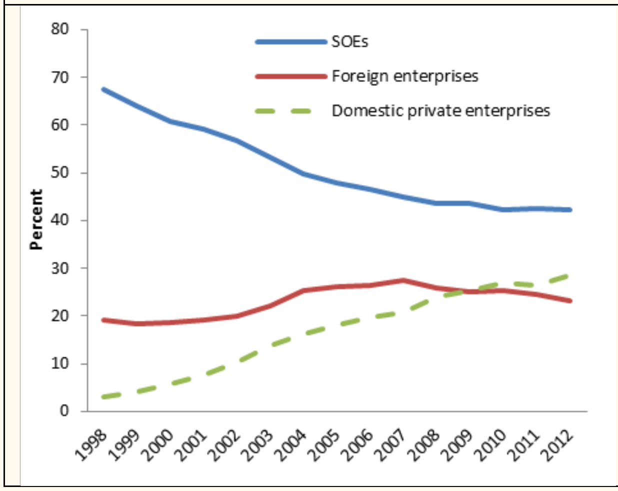
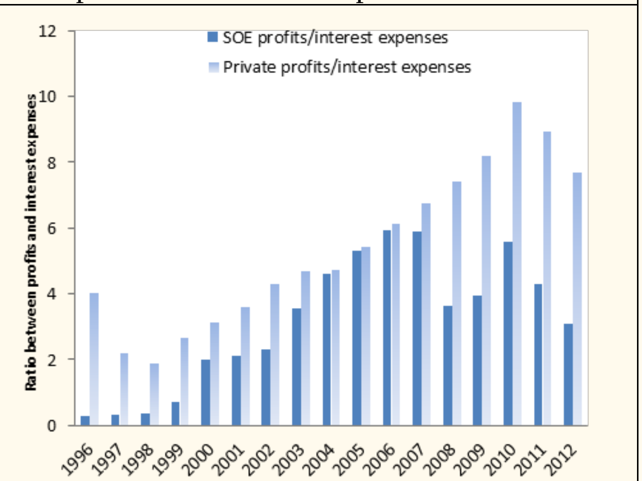



Figure 2. Profit-interest Expense Ratio: SOEs Compared to Private Enterprises




*Sources:* CEIC and World Bank staff calculations.

**The document offers a plan for SOE reforms.** The key principle is to limit SOE operations to national security, public services, science and technology, and environmental protection. The reforms will focus on breaking administrative monopolies in key industries. Selected SOEs will be restructured into state-owned investment companies. The private sector will be allowed to participate in state investment projects. Reforms of SOEs will involve giving private enterprises equal access to the factor market, a fair and transparent market environment, and equal legal protection and regulation. Also, an increasing share of SOE profits will be used to improve social welfare and livelihoods. In particular, the share of state-owned capital gains contributed to fiscal revenues will increase to 30 percent by 2020, from the current low levels of zero to 20 percent.

**Specific SOE reform measures may be very sensitive and likely to be opposed by vested interest groups.** The underlying challenges and resistance to reform implementation may be reflected by the inconsistency in the Plenum document itself. For instance, the document calls for a balance between the role of the government and that of the market, and letting the market play the decisive role in allocating resources. However, it also claims that China should maintain the dominant position of the state-owned sector and increase its control and influence. Nevertheless, the emphasis on SOE reforms in the Plenum document shows some political will to overcome the challenges.

## Reforms in land, capital, and labor markets

China's product market has become increasingly competitive after the 1978 opening up. In particular, China has become the key global player in manufacturing. However, continued economic progress is threatened by significant distortions in China's factor markets. In response, the Plenum document has proposed reforms in land, capital, and labor markets.

### Land reforms

**Currently, the land market is fragmented across rural and urban areas.** Urban land use may be classified as construction, industrial, commercial, or residential. Rural land is collectively owned by villages. Its use may be classified as agricultural, construction, or housing. It is difficult for farmers to sell their land at market price or to use it as collateral because there is no unified market for different types of land.

**Both rural and urban land use is strictly controlled by the government.** Prices for each type of land are regulated. Urban land for industrial use is subsidized, which leads to excessive expansion in urban periphery areas and inefficient land use for industrial parks. The stark differences in prices for industrial, commercial, and residential land point to the distortion introduced by government control of land use (figure 3). In addition, the current land acquisition system does not fairly compensate farmers whose land is expropriated. When the government acquires a piece of farmland and converts land use from agricultural to nonagricultural, farmers are often compensated according to the agricultural land value only.

Figure 3. Land prices for industrial, commercial, and residential land

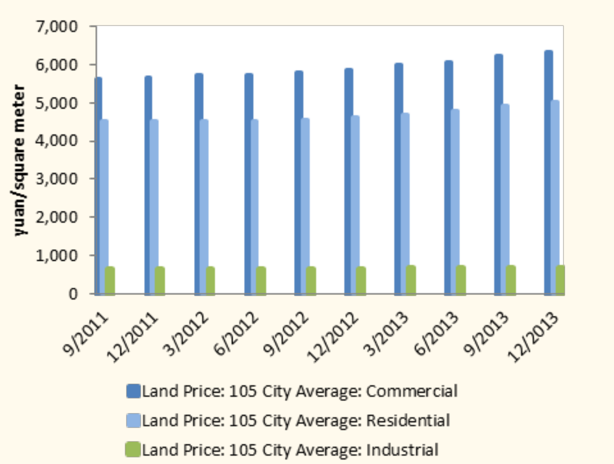
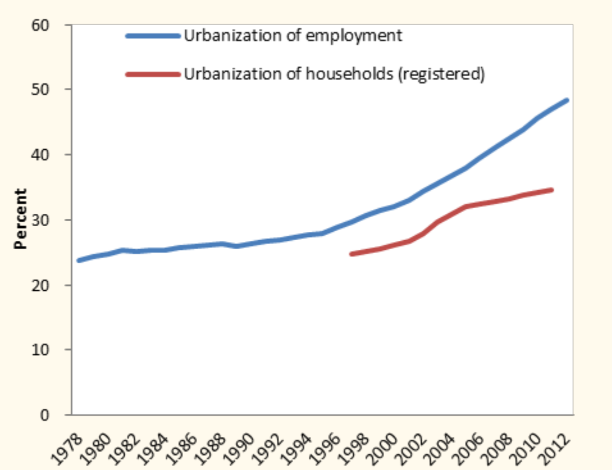



Figure 4. Share of urban workers in total employment, and share of registered urban residents in total population




*Sources:* CEIC and World Bank staff calculations.

**The Plenum document proposes significant land reforms.** Based on the current household responsibility system, farmers will enjoy clearer property rights over their contracted land through a land registration and titling system. On a pilot basis, a rural land-rights exchange market will be established, granting farmers collateral and transaction rights over their residential land. In some cities, such as Beijing, such a system is already being developed. Rural residents are allowed to transform their collectively owned land rights into a share of the property rights. The shares can be transferred or inherited, or used as collateral.

**A major step forward in land reforms is to unify the construction land market across urban and rural areas.** The integration of rural and urban land markets will enhance the mobility of migrant workers, since they will have the option of selling their farmland at market value. As institutional barriers in the land market are gradually removed, both land and labor markets will become more efficient.

## Financial sector reforms

**Currently, the state intervenes heavily in China's capital market.** Interest rates are regulated by the government. SOEs have easy access to finance, with an implicit guarantee by the government. However, small and medium-size enterprises find it difficult to access credit, since they are unable to meet the collateral requirements of commercial banks.

**The government has put forward a financial sector liberalization plan.** The Plenum document focuses on deregulation to allow the private sector to establish small and medium-size financial institutions. This will open up the financial industry to more competition from both domestic and foreign private businesses.

**More effort will be devoted to deepening the capital market.** Proposed reforms include promoting a registration system for initial public offerings instead of case-by-case official approval procedures. Future policies will support the development of the bond market and of innovative financial instruments to boost the share of equity financing.

**An explicit deposit insurance system and a market-driven exit mechanism for failed banks will be introduced.** Currently, depositors rely on an implicit guarantee by the government to protect their interests against bank defaults, and the boundary of this implicit deposit insurance is unclear. Once a nationwide deposit insurance scheme is established, it will serve as the foundation for further financial reforms to liberalize interest rates.

**The Plenum document also highlights the liberalization of the renminbi (RMB) exchange rate and the acceleration of RMB capital account convertibility.** There will be fewer restrictions on cross-border capital and financial transactions. However, short-term capital flows will still be regulated to contain volatility.

**The Government Work Report presented at the annual National People's Congress meeting, held in March 2014, sent a strong signal regarding financial reforms.** Premier Li Keqiang suggested that a deposit insurance scheme will be established by end-2014. He also expressed his support for the growth of e-finance companies and indicated that the first private banks may be established this year.

### Household registration reforms

**Government control of migration has created large labor market distortions.** More than 260 million rural-to-urban migrants work and live in cities where they do not have access to the same public services as other urban residents with a local household registration ("hukou"). The share of urban workers in total employment is significantly larger, and is rising faster, than the share of registered urban residents in the total population (figure 4). The expansion of cities has also outpaced the integration of rural-to-urban migrant workers and their families. As rural land is rapidly converted into urban built-up areas, rural residents who lose their land move to work in cities and towns. However, they are not integrated into the social welfare system enjoyed by urban residents with a local hukou. The hukou system imposes restrictions on access to public services according to one's birthplace instead of residence location. A residence-based social welfare system will encourage mobility and provide incentives for workers to move where they can earn the highest return on their labor. This will increase efficiency in the labor market and encourage human capital investment.

**The Plenum document calls for the acceleration of reforms in the household registration system.** In particular, rural-to-urban migrants will be included in the social protection system. In addition, central-to-local government fiscal transfers will be linked to the number of migrants, instead of the number of registered residents.

**The March 2014 National People's Congress meeting highlighted household registration reforms.** Premier Li pledged to grant urban residency status to about 100 million rural-to-urban migrants, rebuild rundown urban areas for 100 million residents, and promote the urbanization of 100 million rural residents of central and western regions in cities in those regions. The Premier vowed to reform the household registration system to extend basic public services, such as education and vocational skills training, to cover migrant workers in a manageable way.

## Fiscal reforms

**China's fiscal system is characterized by a mismatch between the centralization of revenue-raising power and the expenditure responsibilities of local governments** (figure 5). The Plenum document explicitly calls for a more transparent fiscal system with a focus on longer-term budget management rather than fiscal balance and deficit management. The Plenum document explains that the focus of budget review will be shifted from the magnitude of the deficit to the analysis of fiscal policies.

Figure 5. Split of Revenue and Expenditure among Central and Local Governments in 2012

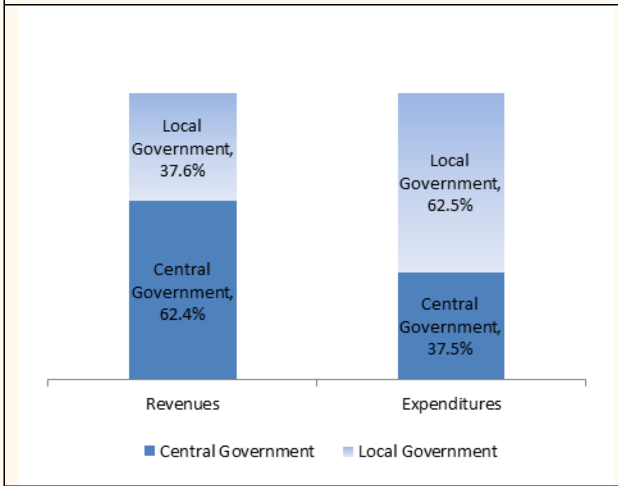
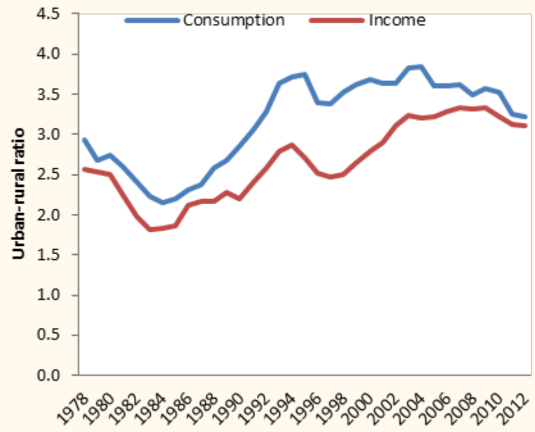



Figure 6. Ratios of Urban to Rural Income, and Consumption, per Capita




*Sources:* CEIC and World Bank staff calculations.

**The Plenum document also proposes establishing a debt- and risk-management system for central and local governments.** The Plenum document also calls for an increase in the authority of office and expenditure responsibility of the central government. An initial step will be for the central government to take on more expenditure responsibilities. The Plenum document states that the central government is responsible for national defense, diplomacy, national security, and issues related to nationwide regulations. Local governments are responsible for providing local public services. For major projects concerning social security or cross-regional construction, both central and local governments share the responsibilities for accounting for the externalities.

**To balance the interests between central and local governments, and to address the issues associated with local government debt, the Plenum document proposes several desirable reforms.** First, the central government will increase transfers to local governments, in line with fiscal expenditure assignments. Second, local governments will be allowed to issue bonds to finance infrastructure projects. Third, the tax system will be reformed to simplify and broaden the tax base for local governments. Value-added tax rates will be simplified. The coverage and rate of the consumption tax will be adjusted, with increases for items involving high energy consumption or high pollution. The personal income tax system will be improved by broadening the tax base and enhancing tax administration. Property taxes will be introduced in other cities besides Chongqing and Shanghai. In line with these reforms, at the National People's Congress meeting, the government pledged to extend VAT to cover railway, postal services and telecommunication industries in April 2014, as part of the effort to replace the inefficient business tax with VAT and to reduce the tax burden on the service industry.

## Supplementary reforms in other areas

**As part of an ambitious and comprehensive reform package, the Plenum document addresses areas such as education and health services, social security, the one-child policy, institutional governance, and further opening up of the economy.** Annex 1 describes all the components of this bold reform package.

**In particular, the authorities have pledged to promote reforms to enhance the social safety net and reduce income disparity.** Indeed, income inequality, and especially inequality between rural and urban citizens (figure 6), has become a prominent problem and could potentially lead to political instability and social unrest.

**The plan is to give priority to low-income groups and expand the size of the middle class.** Specific measures include increasing labor compensation and property-related income for rural households. Income redistribution through taxation, transfer payments, and the redistribution of SOE profits will also be considered.

## The reform package sounds promising, but implementation is key

**The government has established a Central Leading Group of Overall Reforms, headed by President Xi Jinping, to oversee the design and implementation of the reforms**. On January 22, 2014 the group held its first meeting to discuss reform implementation. The general public holds high expectations for the proposed reforms. As acknowledged by the President, vested interest groups will oppose many of the proposed measures. However, the President emphasized the importance and urgency of the reforms, and called for a specific timetable for the implementation of each reform item, indicating the political will to overcome the pressures. So far, most of China's provinces have set up Leading Groups to oversee the implementation of reforms.

**One important component of the reform package is the change in the evaluation system for government officials.** The third Plenum proposed that a comprehensive assessment system for officials should replace the current one that overemphasizes GDP growth. Under the current evaluation system, local government officials are keen to introduce large investment projects to boost GDP growth at the cost of heavy pollution. The new evaluation criteria will likely focus on the sustainability of economic development and take into account a broader range of areas such as education, employment, and environmental protection. If the change in evaluation criteria can be realized, reform measures are more likely to be executed effectively.

**Some of the reforms may take place sooner than others.** For instance, planning of financial reforms started well before the Plenum, and specific policy changes may be adopted soon. In other sensitive areas, such as land reforms, in the short run we may see only policy experiments on a pilot basis. In our view, the greatest challenge is resistance from vested interest groups, such as SOEs including state-owned banks, local governments, and well-connected large corporations.

For instance, the document proposes a greater contribution to fiscal revenues be made by SOEs. However, this reform measure will lead to a decline in local government tax revenues and may be subject to resistance from local governments. Likewise, the Plenum suggests giving farmers more land rights and fair compensation for land acquisition according to market values. This reform will significantly reduce fiscal revenues for local governments that profit from land transactions.

**Another challenge is that the policy document leaves out details regarding the proposed reforms.** Few specific measures were described in the document, and it is easy to interpret the messages in various ways. For example, the document mentions that more revenue sources will be created for local governments, such as the development of a municipal bond market and the property tax system. However, few details or guidance were given in the document. In the area of hukou reforms, the Plenum document clarifies that migration restrictions will be completely lifted in small and medium-size cities only. Eligibility criteria will be set for migration to large cities. The government will continue to strictly control rural-to-urban migration in megacities.

**A greater risk seems to be that the conflict between the government's desires to reduce its interventions in the market economy, but also to increase its controlling role, may impede the progress of reforms.** The lack of coordination among different government agencies may worsen this risk. The removal of market distortions will be gradual and path-dependent. As emphasized by the Plenum document, the market economy of China has a socialist nature, and the specific characteristics of China must be taken into account.

**The latest Government Work Report presented by Premier Li Keqiang at the National People's Congress meeting in March 2014 reflects the challenges in implementing reforms.** The report laid out reform priorities for 2014 in the areas of public administration and finance, the financial system and SOEs, which are consistent with the policies announced at the third Plenum. However, it only provided limited new details regarding implementation. In addition, the government left the GDP growth target unchanged at "about 7.5 percent" for 2014, while putting an emphasis on the need to contain financial risks and to slow down fixed asset investment growth. There may be a tension between these policy goals, since a moderation in investment growth will make it more difficult to achieve the growth target.

## Reforms and growth

**Some reforms are more likely to support short-term growth, and are therefore likely to be implemented first**. For instance, the government recently started an effort to streamline the administrative system by simplifying approval procedures. This will create more incentives for private investment by lowering costs for private enterprises. Likewise, removing entry barriers in monopolized industries will boost investment; examples include proposals to open up certain service sectors, such as healthcare and senior care, to private investment. Again, as part of the fiscal reform package, the proposed conversion of the business tax into a value-added tax on transportation and financial services will lower the tax burden for businesses in these sectors, and may promote investment in the short run. Making more land available for commercial activities will also improve the prospects for service sector growth.

**On the other hand, some reform measures may enhance long-term growth, but with an ambiguous or limited effect on short-term growth**. One example is the proposed liberalization of interest rates. In the near term, SOEs may face higher capital costs once their interest rate subsidies are removed, which will dampen their incentives for investment. However, in the long term, capital will be allocated in a more efficient manner and growth will likely become more sustainable. Similarly, in the long run the extension of public health and education services to cover rural-to-urban migrant workers should help reduce precautionary savings and boost consumption. Stronger property rights for farmers will also have a positive impact on household consumption. However, in the short term local governments will have limited incentives to implement these reforms, because their fiscal space would be narrowed.

Table 1. The Third Plenum of the 18th Central Committee of the Communist Party of China, 2013, as compared to the Third Plenum of the 16th Central Committee, 2003

| **Area** | **Policy Announced in the Third Plenum of the 18th CPC Central Committee, November 2013** | **Policy Announced in the Third Plenum of the 16th CPC Central Committee,** |
|---|---|---|
| Fiscal | Deepen fiscal and tax reform; reallocate fiscal revenue and social responsibility | Simplify the tax system |
| Finance | Further deregulate foreign exchange rate and interest rate regime, and further progress in capital-account liberalization | Gradually push forward interest rate and exchange rate liberalization |
| Government administration | Streamline government administration, delegate power, and outsource public goods | Transform its function to focus on serving the economy |
| State-owned enterprises | Both public and private sectors are important to the economy; gradually increase SOEs' profit contribution to fiscal revenue (30% of SOE profit in 2020) | Strengthen state asset management and supervision |
| Demographic policy | Allow urban families with either parent being a single child to have a second child | Not mentioned |
| Hukou | Gradually relax the control of hukou system to promote further urbanization | Deepen hukou reform (no further details) |
| Social safety net | Improve social insurance coverage, transfer, portability; study the progressive delay retirement policy | Promote employment and strengthen the social safety net |
| Health care | Enhance medical insurance, encourage private investment, and allow multisite practice for doctors | Improve medical coverage |
| Rural land | Grant farmers more property rights; establish unified urban and rural land market | Protect the household contract responsibility system |
| Resource prices | Set up market-based resource prices system on water, oil, gas, electricity, transportation, telecommunication | Not specifically mentioned |
| Service sector | Relax the entry barriers in service sectors (including financial services, education, culture, and health care) | Not specifically mentioned |
| Intellectual property rights protection | Enhance intellectual property rights protection and improve incentive mechanism for technology innovation | Not specifically mentioned |
| Environment and infrastructure investment | Draw a "red line" for ecological protection and build a system of paid use of resources and ecological compensation | Allow private capital to invest in infrastructure projects |

*Source:* Xinhua Agency and Morgan Stanley Research.

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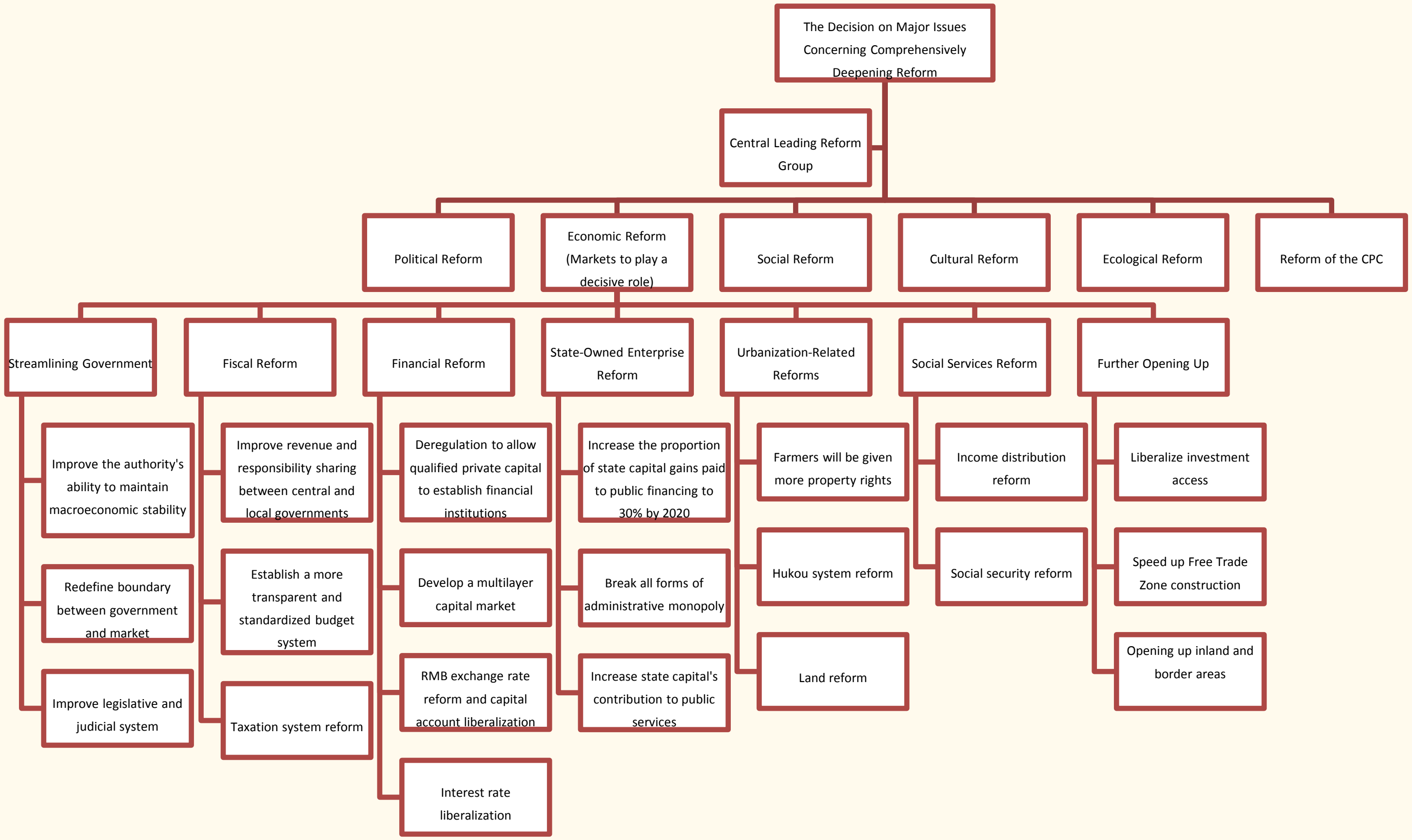
Annex 1. China's Reform Agenda Released at the Third Plenum of the 18th Central Committee of the Communist Part of China, November 2013




*Source:* Xinhua Agency.

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# Trading Costs in East Asia[1]

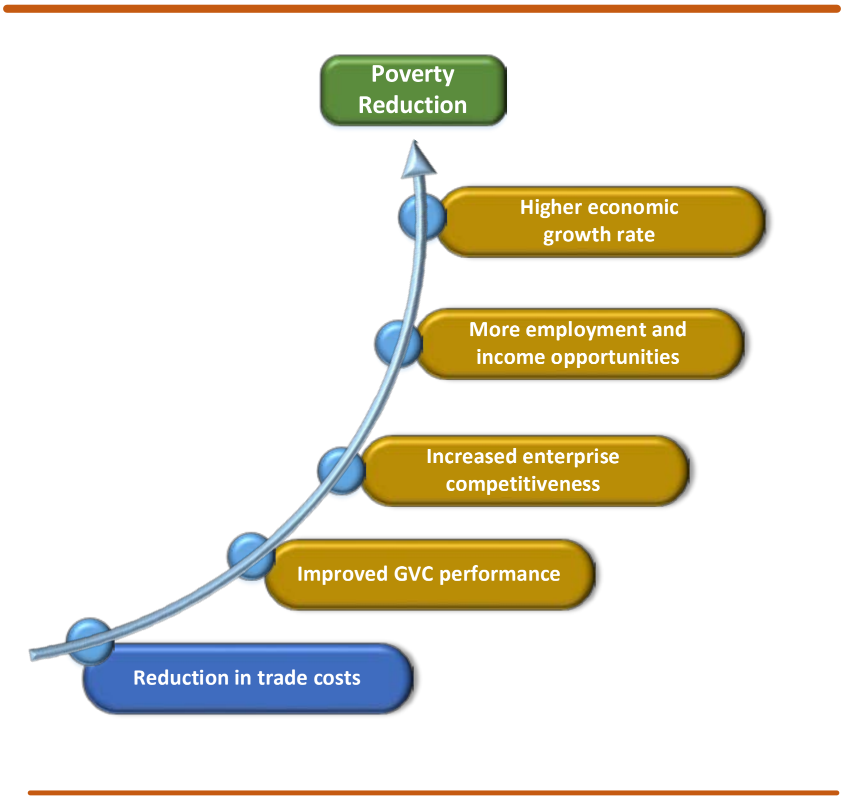
*The World Trade Organization's new Agreement on Trade Facilitation has the potential to significantly reduce East Asia's trade costs along the entire supply chain, increasing regional gross domestic product (GDP) by 2.7 percent and employment by 1.2 percent. At present, the region's developing economies suffer from trade costs well above those of the newly industrialized countries and of developed economies, owing to the large number of inefficient border and behind-the-border procedures. Countries have been adding to their stock of nontariff measures, which now account for as much as 90 percent of (nontransportation) trade costs. The ATF defines a new reform agenda for East Asia with potentially far-reaching effects on private sector development, especially for small businesses that need greater transparency and simplification of procedures to enable them to readily access regional and global value chains.*

## The WTO's New Agreement and What it Means for East Asia

**The Agreement on Trade Facilitation (ATF), concluded at the World Trade Organization's (WTO's) 9th Ministerial Conference in Bali, Indonesia, represents a major step toward reducing trade costs.** Trade facilitation may be narrowly defined as the simplification and harmonization of the procedures required to move goods across borders and to make the associated payments. Typically, the term also refers to a broader trade agenda, including the modernization of customs administration, the improvement of transport infrastructure, and the removal of other nontariff trade barriers. The ATF is the first major multilateral trade agreement concluded since the WTO was established in 1995. It goes well beyond the old view that trade facilitation should only focus on improving transactions at the border. Instead, the ATF covers the entire range of issues, including behind-the-border issues, that affect trade costs along the supply chain. It sets out globally applicable rules and prescribes detailed benchmarks. The ATF explicitly recognizes that the greater access to markets provided by bilateral, regional, and multilateral trade agreements needs to be complemented by measures that improve the ability of enterprises to compete on a level playing field if they are to effectively participate in international value chains. The ATF therefore has the potential to reduce trade costs significantly, helping East Asia generate increased employment and income and ultimately reduce poverty (figure 1).

[1] This note was prepared by Montague Lord, Julian Clarke, Fabio Artuso, and Richard Record.

**Figure 1.** The link Between trade facilitation and poverty reduction in East Asia's global value chains (GVC)




*Source:* Based on ITC 2013; Rippel 2011; and ITC 2013.

**The potential gains from the ATF are striking.** Greater trade facilitation, with each country improving its trading environment a quarter of the way toward the levels observed in the region's top performer, could conservatively expand the world economy by 4.5 percent, or US$1 trillion.[2] Analogously, concerted efforts to reduce just two key supply chain barriers (border administration, and transport and communications infrastructure and related services) halfway toward global best practice could increase global GDP by 4.7 percent.[3] The income-generating impact of these trade-cost reductions may have further multiplier effects on output and employment.

**Nontariff measures (NTMs) and other nontraditional forms of trade policy are important determinants of trade costs, and now play a stronger role than tariffs in determining economic performance.** The above estimates indicate that better trade facilitation and improved logistics would yield greater benefits than eradicating all remaining import tariffs. One important reason is that much progress has already been made in reducing tariffs. As a result, improved logistics reduce trade costs on average 10 times more than equivalent proportionate reductions in tariffs.[4] In addition, trade facilitation eliminates

[2] Hufbauer and Schott 2013; Hufbauer, Vieiro, and Wilson 2012.

[3] World Economic Forum 2013.

[4] See Arvis et al. (2013) for an analysis of the relationship between trade costs and factors such as tariffs, logistics performance, and maritime connectivity. Logistics performance is measured using the World Bank's Logistics Performance Index.

resource waste, whereas abolishing tariffs mainly reallocates resources. All this suggests that efforts to reduce NTMs and improve the performance of core services such as logistics should constitute a key policy focus.

**The trade facilitation measures having the greatest overall impact on trade volumes are information availability, simplification of documents, automated processes, streamlining border procedures, and more transparency in regulatory governance and oversight.**[5] By itself, improved governance and impartiality of border authorities[6] have the potential to reduce total trade costs by nearly 2 percent; the simplification of documents could reduce costs by a further 1.4 percent. For lower-middle-income countries, the harmonization and simplification of documents could lower costs by 1.9 percent, and streamlining procedures by 1.6 percent. In upper-middle-income countries, streamlining procedures could reduce costs by 1.8 percent, and the use of automated processes and risk management by 1.7 percent.

**At the sectoral level, agricultural trade costs in developing countries are twice as high as manufacturing trade costs.** Trade facilitation measures are especially important for trade in manufactures, since this involves both imports of intermediate and capital inputs, and exports of processed goods.[7] But since agriculture is critically important to poverty reduction and inclusive growth, agricultural trade costs must also be addressed.

**For East Asia, trade facilitation improvements under the ATF could boost two-way trade by 20 percent.** Conservatively, the region's real GDP would increase by 2.7 percent, and employment by 1.2 percent (table 1).

**Table 1.** Potential Impact of Agreement on Trade Facilitation in East Asia

| | | Value | Percent |
|---|---|---|---|
| Export Gains | Billion US$ | $267 | 9.9 |
| Jobs Supported | Thousand | 11,081 | 1.2 |
| Two-Way Trade Gains | Billion US$ | $534 | 19.8 |
| GDP Increase | Billion US$ | $246 | 2.7 |

*Sources:* ESCAP 2013a; Hufbauer and Schott 2013.

**The ATF also puts momentum back into the multilateral trading system, and could reverse the increasing fragmentation of international trade created by the intensification of regional trade negotiations.** The two proposed megaregional trade agreements (the Transatlantic Trade and Investment Partnership between the United States and the European Union [EU], and the Trans-Pacific Partnership), combined with the existing "noodle bowl" of Asian trade agreements, could generate considerable trade diversion.

**The cost of implementing the ATF is relatively low.** Some developing countries have expressed concerns about the large implementation costs associated with embracing the agreement.[8] Yet the estimated cost of implementing the commitments is relatively low,

[5] OECD 2013a.

[6] Governance and impartiality refer to an array of characteristics that include clearly established and transparent structures and functions of border authorities, the existence of a code of conduct and an ethics policy, internal audits, and transparent provisions for financing and for internal sanctions in the customs administration.

[7] OECD 2013a.

[8] ITC 2013.

roughly between US$7 million and US$11 million for each developing country, spread over a number of years.[9]

## Why Trade Costs Matter

**Trade within East Asia is increasingly shifting from trade in products to trade in tasks, as firms become more closely integrated into GVCs.** The share of GVCs in the region's total trade is nearly 40 percentage points greater than two decades ago,[10] and GVCs account for a greater share of trade in East Asia than in any other developing region.[11] This changing dynamic has driven much of the regional clustering of value chains and paved the way for closer regional integration.

**Decreasing trade costs are a key factor behind increased participation in GVCs.** While geographic distance remains an important factor in determining international transport and logistics costs, the long-term decline in international shipping costs has helped level the playing field and shifted attention to border and behind-the border trade costs.[12]

**Nontariff costs now account for as much as 90 percent of remaining (nontransportation) trade costs in East Asia.** With rapidly falling shipping costs, what remains are the large trade costs associated with indirect costs at the border and behind the border. These costs largely involve domestic, regional, or international regulations and standards (figure 2).[13] Tariffs, on average, account for no more than 10 percent of the direct and indirect costs associated with factors other than transportation. NTM costs, which include understanding and complying with a myriad of licenses, permits, and certificates associated with moving goods across border, affect the international competitiveness of businesses in the region. They also affect the ability of enterprises, including in particular small enterprises, to participate in regional and global value chains; trade in intermediate goods for production networks is especially sensitive to trade costs.[14]

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[9] World Bank 2013.

[10] OECD (2013b, 2013c). A country's integration in GVCs is measured as the share of imported intermediate inputs embodied in its exports following their incorporation in the production of goods and services. See the OECD-WTO Database on Trade in Value Added (TiVA), http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO; and "Measuring Trade in Value Added: An OECD-WTO Joint Initiative," www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm.

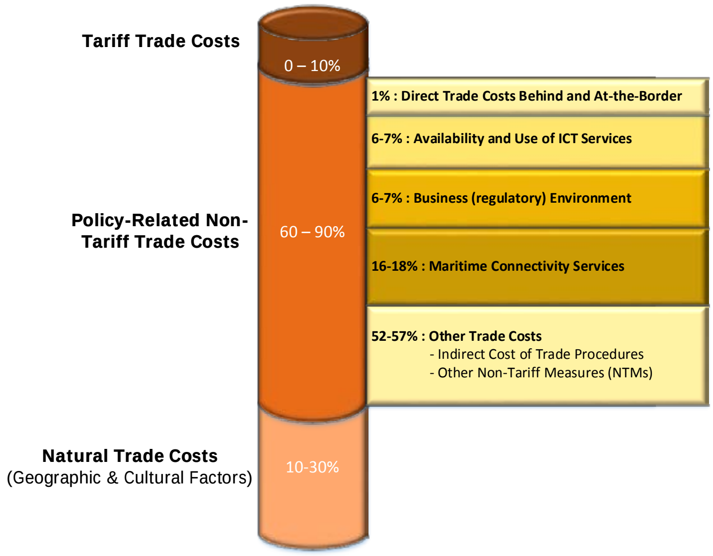
[11] Based on data reported in UNCTAD (2013) from the UNCTAD-Eora GVC database.

[12] Global trade-weighted average transport costs have declined from 6 percent to 4 percent over 30 years (Hummels 2007). See WTO (2008) for a detailed breakdown of the evolution of transportation costs by mode of transportation.

[13] See http://data.worldbank.org/data-catalog/trade-costs-dataset.

[14] Saslavsky and Shepherd 2012.

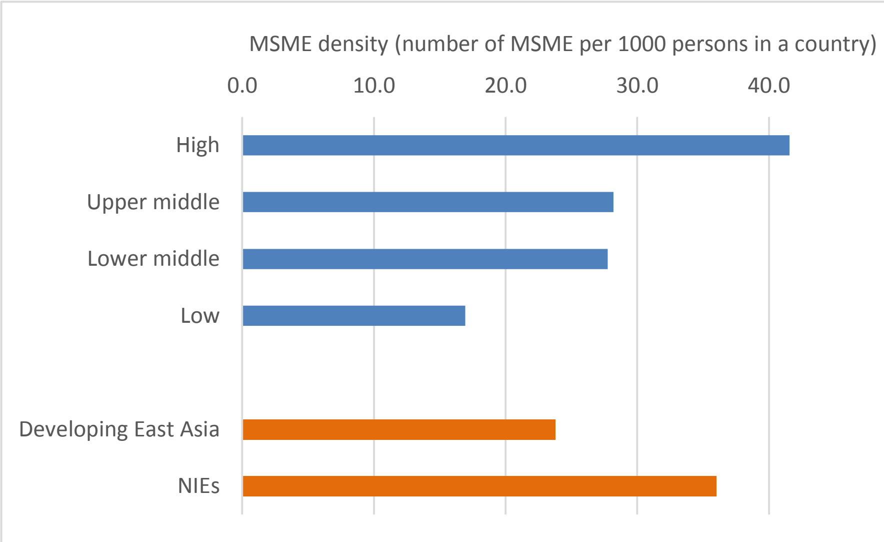
**Figure 2.** Nontariff Measures Account for as Much as 90 Percent of Nontransportation Trade Costs




*Source*: ESCAP (2012), based on data from Duval and Utoktham (2011b).

**The integration of small firms into high-value-added activities is essential to private sector development in East Asia, particularly in lagging regions.** The density of micro, small, and medium-size enterprises (MSMEs) in overall business activity, defined as the number of MSMEs per 1,000 persons, generally reflects a country's level of economic development. In developing East Asia, as expected, MSME density is low compared with both the more developed countries in the region, and the United States and EU (figure 3). But the East Asian less developed countries (Cambodia, Lao PDR, and Myanmar) have especially low MSME densities even among low- and lower-middle-income countries, as do China and the Philippines. In contrast, Indonesia, Malaysia, Thailand, and Vietnam are in line with the upper-middle- and high-income countries of the world.

**Figure 3.** Micro, Small, and Medium-Size Enterprise (MSME) Density is Closely Related to Level of Development




*Sources*: International Finance Corporation, World Bank Group, MSME database online; www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Industries/Financial+Markets/msme+finance/sme+banking/msme-countryindicators.

*Notes*: MSME density refers to the number of MSMEs per 1,000 persons in a country. NIEs = newly industrialized economies.

**Small enterprises in particular face what are often insurmountable obstacles when trying to export.** They usually lack the capacity to comply with complex customs and border procedures and to track down the information needed to trade with overseas markets. Trade costs therefore affect small businesses disproportionately, making them uncompetitive as suppliers and hampering their integration into regional and global value chains. Even in Indonesia, with one of the highest MSME densities in the region, businesses face major difficulties dealing with customs procedures and obtaining information on how to access overseas markets and participate in supply chains and distribution networks.[15] Yet recent evidence in East Asia suggests that small and medium size enterprises can make significant contributions to global value chains and, in so doing, help to boost their value-added activities in international trade.[16]

## Trade Costs in East Asia

**In Southeast Asia, total trade costs (including transport, border-related, and local distribution costs) remain high relative to other regions.**[17] They have recently escalated in

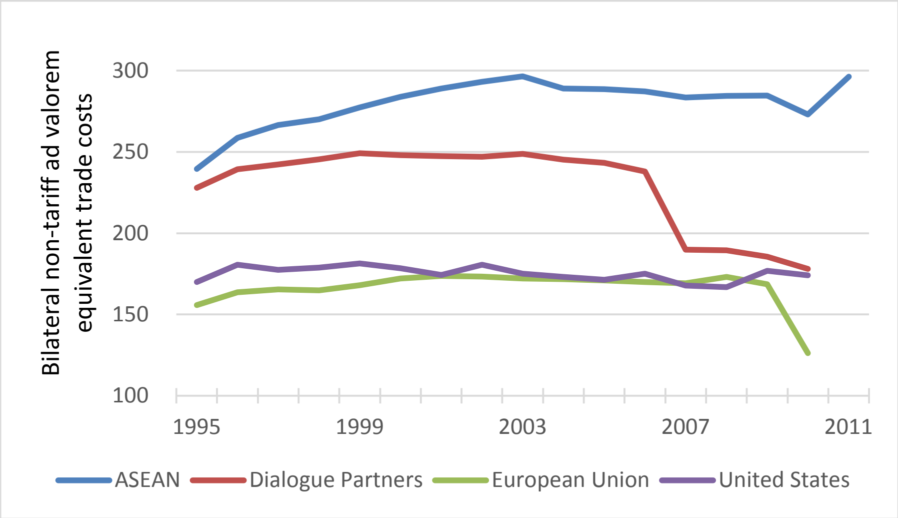
[15] Sipahutar 2013.

[16] ESCAP (2011b).

[17] Data on trade costs are drawn from the ESCAP-World Bank *Trade Cost Database* and ESCAP (2013c). This dataset captures bilateral trade costs between countries, including international transportation costs, tariffs, and

many countries, widening the gap even further.[18] This new trend represents a reversal of the gradual decline during the last decade (figure 4); box 1 illustrates the evolution of trade costs in Thailand and their impact on manufacturing. Although some countries had, until recently, made significant progress in reducing costs, nearly half the reductions were attributable to tariff cuts.[19] Further gains will need to come from addressing NTMs.

**Figure 4.** Total Trade Costs Have Recently Escalated in Nearly All Southeast Asian Countries (Ad Valorem Tariff Equivalent, Percent)




*Source*: ESCAP-World Bank *Trade Cost Database*, www.unescap.org/tid/artnet/db/usernote-2013.pdf.

*Notes*: The Dialogue Partners consist of Australia, China, India, Japan, New Zealand, and Republic of Korea.
ASEAN = Association of Southeast Asian Nations.

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other direct and indirect trade costs such as import and export procedures. For details on methodology, see Anderson and van Wincoop (2004), and the detailed explanatory note on database coverage in Arvis et al. (2013) and ESCAP and World Bank (2013). National and regional total trade costs represent unweighted averages of bilateral trade costs in each country; weighted averages might prove misleading, owing to missing bilateral trade costs in various years. The aggregation approach follows Duval and Utoktham (2011a, 2011b, 2012) and Sourdin and Pomfret (2009).

[18] From slightly over 150 percent to 166 percent of the value in the region's Dialogue Partners, and from 186 percent to more than double the EU-U.S. average. For an analysis of the recent growth of protectionism, see ESCAP (2013b).

[19] ESCAP 2011a.

### Box 1. Trade Costs and Trade Facilitation in Thailand

Thailand offers a useful example of how trade facilitation can impact trade, for three reasons. First, the country is representative of the larger developing countries in the region. Second, it has invested heavily in manufacturing activities for regional and global value chains. Third, a recent study[a] analyzes the cost of nontariff measures (NTMs) and the impact of remedies offered by the ATF. The study, which this box draws upon, exploits the new OECD-WTO Database on Trade in Value-Added (TiVA),[b] and information on the detailed components of trade costs.

Thailand's cost of trade in manufactures is high. For instance, the ad-valorem equivalent total trade cost with Australia is 110 percent, and with the EU 148 percent. Trade costs are nonetheless low for trade with China, Japan, and the Association of Southeast Asian Nation (ASEAN) countries. However, NTMs with ASEAN countries other than Singapore are more complex than those with Japan. As a result, the time needed to get exports to Indonesia (17 days), Malaysia (13 days), and the Philippines (15 days) is considerably greater than to Japan (10 days). In addition, the logistical performance and quality of port infrastructure in ASEAN countries other than Singapore lags far behind that of Japan. As a result, ease of exporting and importing weigh relatively heavily on Thailand's trade with other ASEAN countries.

Trade facilitation measures could have a large impact on Thailand's trade, and especially on its competitive strength in integrated regional and global markets. In particular, relatively small reforms that address the number of documents and the time involved in exporting and importing could yield large gains. Currently, exports of auto parts from Thailand to India require 29 documents covering more than 800 data inputs, and imports of electronic devices from China require 24 documents covering 700 data inputs.[c] Related to this, exporting auto parts to India can take as much as 51 days compared with an average of 9 days for other manufactures.[d] If the documentation required to process imports and exports were halved, manufacturing trade could expand by 10 percent. Similarly, if the time taken to process exports and imports were reduced by one-quarter, manufacturing trade could increase by 11 percent.

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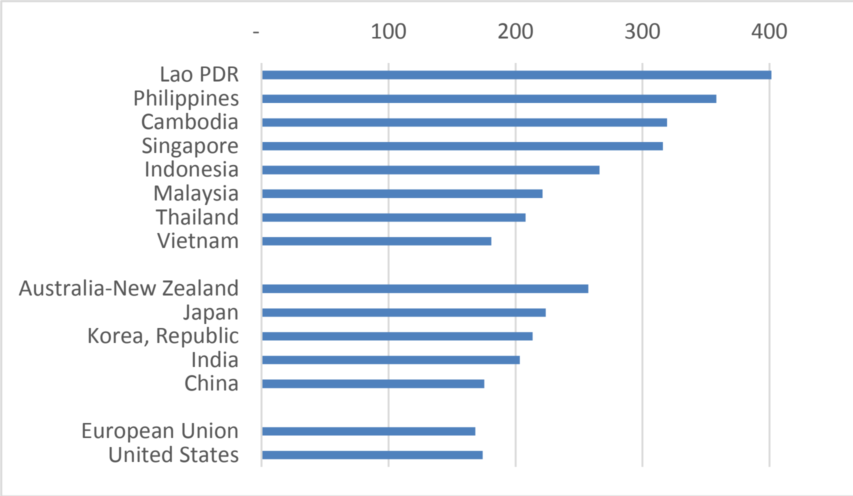
*Sources:* a. Wongpit 2013.
b. http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO.
c. Keretho and Naklada 2011.
d. Cheewatrakoolpong and Ariyasajjakorn (2012), based on a survey of 500 firms in Thailand.

**Within the region there are large differences in both the magnitude and evolution of trade costs.** The highest-cost countries are Lao PDR, the Philippines, and Cambodia; in contrast, Vietnam, Thailand, and Malaysia enjoy the lowest costs (figure 5). Among the ASEAN Dialogue Partners, China has the lowest costs. While Vietnam, China, Thailand, and Singapore have led the way in lowering costs, the Philippines and, to a lesser extent, Lao PDR and Indonesia, have experienced a growing use of NTMs (figure 6).

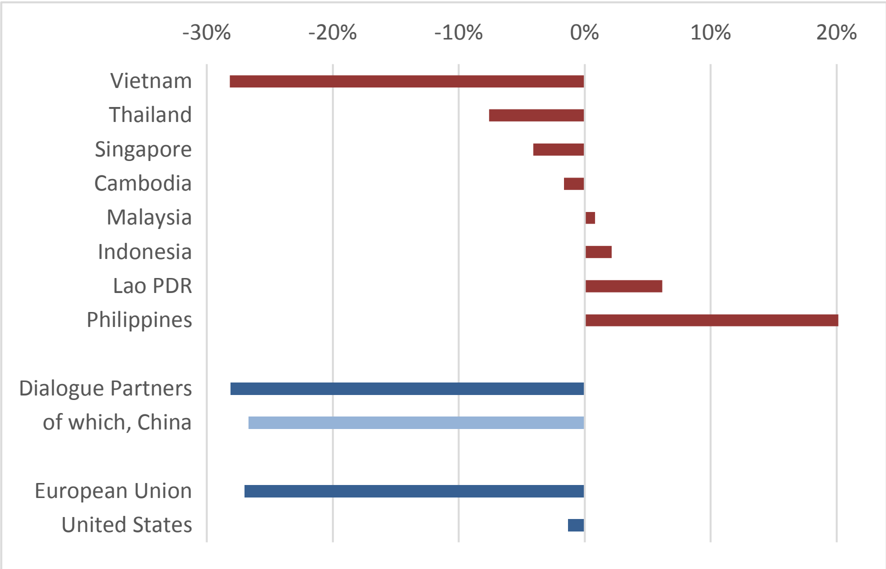
**Figure 5.** Over Half of Southeast Asian Countries Have Relatively High Total Trade Costs (Ad Valorem Tariff Equivalent, Percent)




*Source*: ESCAP-World Bank *Trade Cost Database*, www.unescap.org/tid/artnet/db/usernote-2013.pdf.

*Notes*: Total trade costs include transport, border-related, and local distribution costs (see also footnote 17).

**Figure 6.** The Evolution of Trade Costs Differs Markedly across Countries (Ad Valorem Tariff Equivalent, Percentage Point Change, 2010–11 compared to 2000–01)

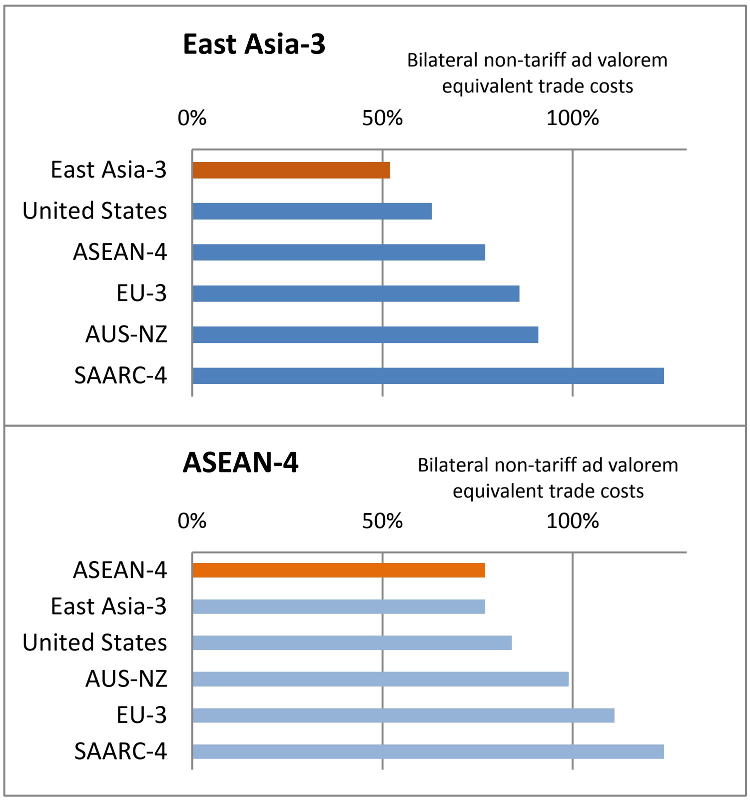



*Source*: ESCAP-World Bank *Trade Cost Database*, www.unescap.org/tid/artnet/db/usernote-2013.pdf.

*Notes:* "Dialogue Partners" consist of Australia-New Zealand, China, India, Japan, and the Republic of Korea. Total trade costs include transport, border-related, and local distribution costs (see also footnote 17).

**Costs are relatively low for East Asian intraregional trade.** In some of the larger East Asian countries,[20] NTM costs are relatively low (averaging 70 percent), and are especially low for intraregional trade (figure 7). In the larger ASEAN countries (Indonesia, Malaysia, the Philippines, and Thailand) the average NTM cost for intraregional trade is nonetheless 10 percent higher than a decade ago.

**Figure 7.** East Asia's Intraregional NTM Trade Costs are Much Lower than its Extraregional Costs (Ad Valorem Tariff Equivalent, Percent)




*Source*: ESCAP-World Bank *Trade Cost Database*, www.unescap.org/tid/artnet/db/usernote-2013.pdf.

*Notes*: ASEAN-4 refers to Indonesia, Malaysia, the Philippines, and Thailand; East Asia-3 to China, Japan, and the Republic of Korea; AUS-NZ to Australia and New Zealand; EU-3 to Germany, France, and the United Kingdom; SAARC-4 to Bangladesh, India, Pakistan, and Sri Lanka.

**Extraregional trade costs are remarkably high, particularly for trade with other Asian and Pacific areas.** High extraregional trade costs are encouraging the larger East Asian countries to favor intraregional trade. For these countries, NTM costs with North and Central Asia are 3.5 times greater than with the EU and the United States. Similarly, NTM costs with the Pacific Island Developing Countries are more than three times as high as with the EU and the United States.

[20] Throughout this section, "the larger East Asian countries" denotes China, Indonesia, Japan, Malaysia, the Philippines, the Republic of Korea, and Thailand.

**East Asia scores well in measures of international logistics and supply chain connectivity.**[21] The world's most connected economies are in East Asia: Singapore, Korea, China, and Malaysia, along with Hong Kong SAR, China (figure 8). Nevertheless, there are wide variations in country performance. Lao PDR and Cambodia, in particular, rank 117th and 138th, respectively, out of 179 countries in supply chain performance.

**Figure 8.** East Asia's Connectivity Performance


*Source*: ESCAP, *International Supply Chain Connectivity* index, www.unescap.org/tid/artnet/iscci.asp.

*Notes:* This index measures connectivity performance based on the average of trading-across-borders indicators for exports and imports in the World Bank's *Doing Business* Report, and on UNCTAD's *Linear Shipping Connectivity* Index.

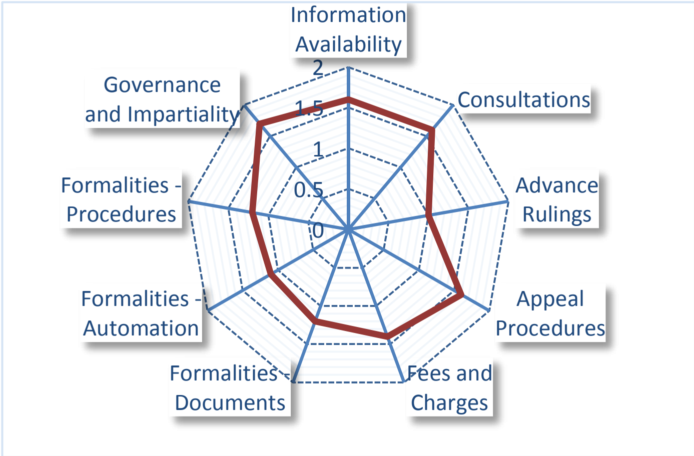
## Key Trade Facilitation Measures for East Asia

**The trade facilitation measures that matter most for East Asia are information availability, and fees and charges** (see figure 9 for a broader list of trade facilitation challenges). These measures correspond to the main policy areas covered by the ATF. For instance, the agreement improves information availability through increased publication of information, issuance of notifications, and the establishment of inquiry points. The ATF also promotes disciplines (that is, rules and constraints) on fees and charges imposed on imports and exports. It further covers the use of "single windows,"[22] disciplines on preshipment inspection and customs brokers, and the temporary admission of goods.

[21] Connectivity refers to the ease of importing and exporting and to shipping performance, which can be facilitated by international logistics in supply chain planning, implementation, and control.

[22] A single window is a facility that allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfill all import, export, and transit-related regulatory requirements.

**Figure 9.** Asia's Potential Reduction in Trade Costs from Trade Facilitation Measures is Large in Most Areas (Percent)




*Source*: OECD 2013a.

**It is important that a holistic approach to trade facilitation be adopted.** While each of the trade facilitation measures are in varying degrees important to countries in the region, inefficiency in one link of the value chain negatively impacts other links. For this reason, when trade facilitation measures are combined, their total effect is greater than the sum of the parts.[23] The Lao PDR Trade Portal provides an instructive example of how to integrate different trade facilitation measures (box 2).

**Box 2. ASEAN Efforts to Increase Transparency and Predictability of Trade Rules and Procedures**

As part of their effort to build the ASEAN Economic Community, ASEAN Member States are working toward improving the transparency and predictability of trade rules and procedures. For instance, the Lao PDR Trade Portal (www.laotradeportal.gov.la) was launched in 2012 as Lao PDR's National Trade Repository. It provides traders with access to trade laws, regulations, measures, restrictions, licensing requirements, and tariff rates. Traders can also access detailed process maps of business procedures and downloadable forms. Other countries, such as Indonesia (http://eservice.insw.go.id/), have launched similar initiatives with the objective of completing the ASEAN Trade Repository by 2015.

ASEAN countries are also committed to establishing a National Single Window that will enable traders to fulfill online all regulatory requirements of customs and noncustoms agencies. Eventually, each National Single Window will be integrated into a region-wide ASEAN Single Window, which will function as a platform for electronic data exchange and communication among participating countries. This process is expected to improve the overall efficiency of the current systems, providing time and cost savings for traders.

**In logistics, as well as in border and behind-the-border reforms, the wide variation in country performance suggests a number of country-specific areas for improvement.** For instance, shipping performance could be substantially strengthened in Cambodia, Indonesia, the Philippines, and Thailand. In China, there is considerable room to enhance the ease of

[23] OECD 2013a.

trading across borders. In Lao PDR, improving the effectiveness of border administration could help offset the disadvantages of being landlocked.

**Trade facilitation in East Asia is being supported by several subregional arrangements, most notably efforts to establish an ASEAN Economic Community by 2015.** At a broader level, the ASEAN free trade agreements with Dialogue Partners[24] include trade facilitation provisions that can help redress nontariff measures. To that end, the ASEAN Trade in Goods Agreement and its Trade Facilitation Work Program provide specific ways to ensure that progress is made in implementing the region's trade facilitation measures.

## Policy Conclusions: Beyond Stroke-of-Pen Reforms

**Given the rising trade flows of intermediate goods crossing borders multiple times, efficient access to imports matters as much to East Asia's trade network as does access to markets.** Since over half of East Asia's trade forms part of regional and global value chains, exports embody significant import content.[25] Trade costs therefore matter greatly to the entire production process. Of these trade costs, nontariff barriers account for as much as 90 percent of all direct and indirect trade costs other than transportation. Policy must therefore focus on the trade regulatory environment.

**The Agreement on Trade Facilitation covers the entire range of NTM issues affecting trade costs.** If East Asia were to implement fairly conservative trade facilitation measures, exports could expand by 10 percent, real GDP by 2.7 percent, and employment by 1.2 percent.

**The 12 types of trade facilitation measures covered by the ATF are comprehensive but not exhaustive.** Other issues will need to be addressed to further lower trade costs, including topics such as rules of origin in regional trade agreements, intermodal transport, and cross-border logistics services. Within the ATF, the trade facilitation measures with the most impact on developing East Asia are increased information availability on trading rules and regulations, improved fee structures, appeal procedures and consultations, and improved governance and impartiality of border authorities covering transparent structures and functions of border authorities, codes of conduct, and internal audits and sanctions in the customs administrations. While some of these measures involve stroke-of-pen reforms that would eliminate trade impediments within a short time, many NTMs require deeper reforms.

**Success in redressing the region's rising trade costs requires a holistic approach to trade facilitation.** Bottlenecks along supply chains will undermine piecemeal reforms. The ATF offers an opportunity to implement much-needed cost-cutting measures across a wide range of areas. If successfully adopted, these measures will allow developing East Asia to more fully participate in regional and global value chains and substantially improve the economic well-being of its peoples.

[24] The Dialogue Partners comprise Australia, China, India, Japan, New Zealand, and the Republic of Korea.

[25] In China, Malaysia, the Philippines, and Thailand the foreign value content of exports ranges from 33 percent to 38 percent, compared with a global average of 24 percent (Banga 2013; WTO 2013). Moreover, the share of foreign value added in exports is rising in almost all developing East Asian countries, especially Vietnam.

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EMBARGOED: NOT FOR PUBLICATION, BROADCAST, OR TRANSMISSION UNTIL MONDAY, APRIL 7, 2014 at 11 A.M. SINGAPORE TIME (3 A.M. GMT, APRIL 7; or 11 P.M. EDT, APRIL 6)

# Foreign Direct Investment and Foreign Ownership Restrictions in ASEAN[1]

*Despite the economic importance of FDI to ASEAN, many ASEAN countries restrict foreign equity, particularly in the service sector. Regional experience indicates that where countries have relaxed foreign ownership restrictions, FDI has increased, bringing with it significant positive economic benefits for the receiving country. In Cambodia and Vietnam, foreign investment reforms led to significant growth in FDI, as did financial sector liberalization in the Philippines and Thailand in the 1990s. The ASEAN Economic Community 2015 blueprint brings new challenges and opportunities for ASEAN countries. Countries that relax foreign ownership restrictions in services stand to attract more FDI, which will enhance the competitiveness of producers of both services and goods.*

## FDI and Foreign Ownership Restrictions in ASEAN

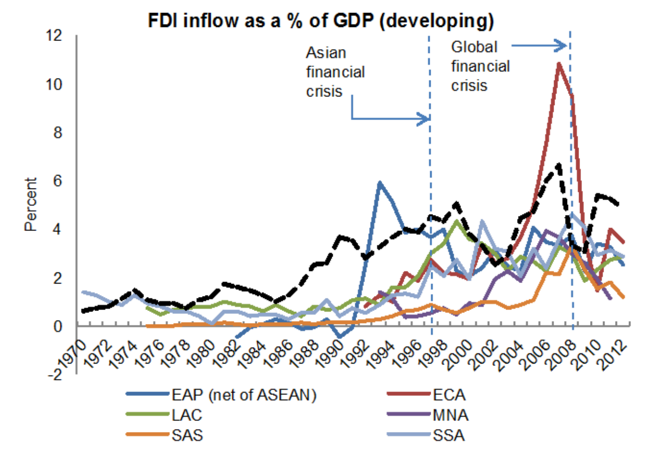
**FDI is particularly important to ASEAN economies.** ASEAN receives more FDI, relative to gross domestic product (GDP), than any other developing region (figure 1). FDI to ASEAN has grown steadily since the late 1980s,[2] although with sharp falls in the wake of the 1997–98 Asian financial crisis and the 2007–08 global financial crisis.[3] Currently, Singapore receives over 50 percent of total FDI to the region; Thailand, Indonesia, and Malaysia each account for about 10 percent (figure 2). The Philippines receives relatively low FDI inflows. Conversely, Vietnam has experienced rapid growth in FDI since the 1990s (table 1), and now receives 8 percent of total FDI to ASEAN.

[1] This note was prepared by the following World Bank staff: Brendan Coates, Sjamsu Rahardja, and Monica Wihardja (Jakarta Office); Christine Ablaza, Karl Kendrick Chua, Tina Epetia, Louie Limkin, JC Punongbayan, and Anthony Sabarillo (Manila Office); and Andrew Beath (Office of the Chief Economist, East Asia and Pacific).

[2] Triggered by the relocation of Japanese manufacturers following the 1985 Plaza Accord.

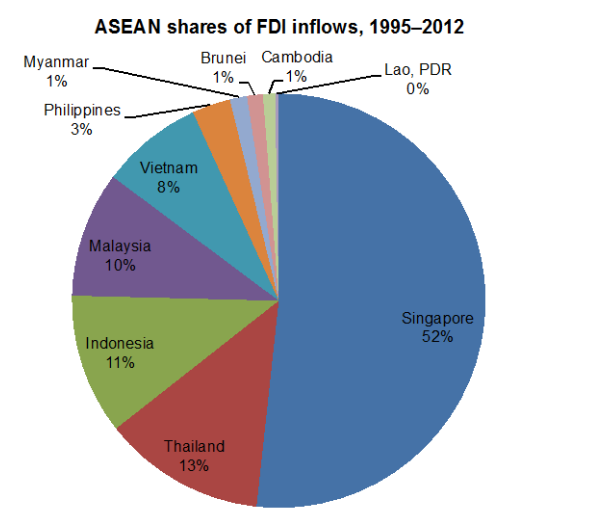
[3] During the Asian financial crisis, FDI contracted by 47 percent (peak to trough) and took five years to recover. During the global financial crisis, FDI contracted by 86 percent but took only about two years to recover.

**Figure 1.** The ASEAN region has generally been the largest recipient of FDI, relative to GDP




*Source*: *World Development Indicators*.
*Note:* ASEAN = Association of Southeast Asian Nations; EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin American and the Caribbean; MNA = Middle East and North Africa; SAS = South Asia; SSA = Sub-Saharan Africa.

**Figure 2.** Singapore accounts for half of total FDI to ASEAN




*Source*:ASEAN Secretariat.

**Table 1.** FDI as a share of GDP (period averages)

| | 1995–97 | 1998–2008 | 2009–12 |
|---|---|---|---|
| Indonesia | 2.3 | 0.1 | 1.8 |
| Malaysia | 6.7 | 3.4 | 2.9 |
| Philippines | 1.9 | 1.6 | 0.9 |
| Thailand | 1.7 | 4.1 | 2.5 |
| Vietnam | 8.4 | 4.9 | 6.0 |

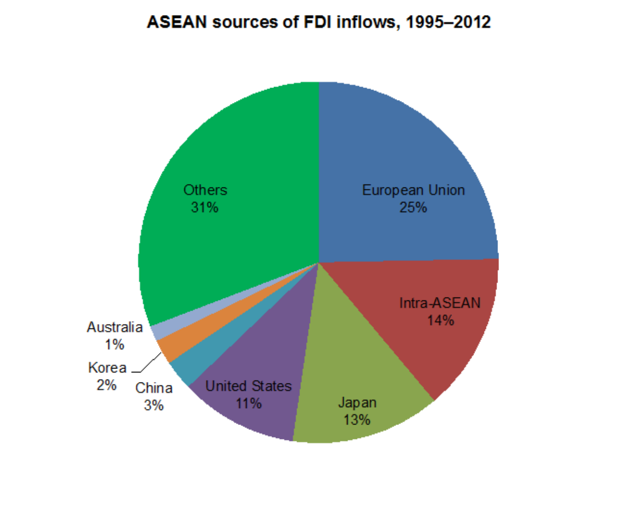
*Source*: ASEAN Secretariat.

**Intra-ASEAN FDI has grown rapidly in recent years.** From 1995 through 2012, the European Union (EU), Japan, and the United States accounted for half of FDI to ASEAN (figure 3). In recent years, however, Australia, the Republic of Korea, and other ASEAN countries have become increasingly important sources of FDI, while flows from the United States have decreased in relative importance. In particular, the historically low intra-ASEAN FDI has been growing sharply since the global financial crisis, in both overall volume and relative importance (figure 4).[4] Singapore is the main source of intra-ASEAN FDI, accounting for 45 percent of such flows between 2008 and 2012, although a significant portion of such flows may originate in other countries.[5]

[4] Since 2008, Indonesia has received more FDI from other ASEAN countries than from the rest of the world. Intra-ASEAN FDI is also increasing in Cambodia, Singapore, and Vietnam, although it remains marginal in the Philippines.

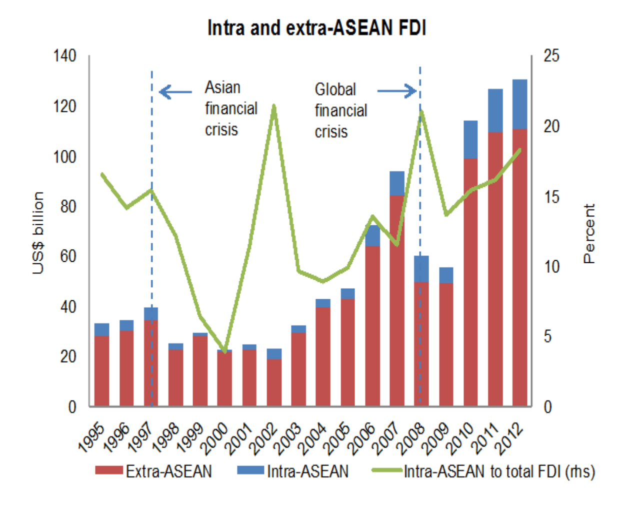
[5] Singapore's role as a global financial center creates challenges in tracing the ultimate destination of FDI to and from Singapore, given the number of foreign affiliates and holding companies based in Singapore that invest in other countries in the region. For instance, many Japanese manufacturing companies set up their regional offices in Singapore to oversee factories in other ASEAN countries.

**Figure 3.** The EU, Japan, and the United States are major sources of FDI for ASEAN




*Source*:ASEAN Secretariat.

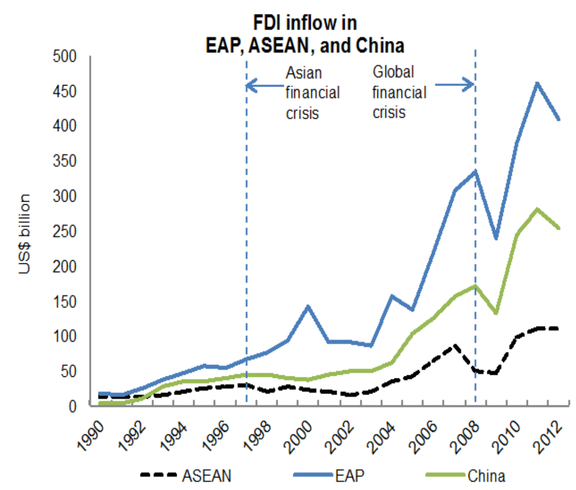
**Figure 4.** Intra-ASEAN FDI has grown rapidly in recent years, albeit from a small base




*Source*:ASEAN Secretariat.

**China largely complements ASEAN as a destination for FDI, and is itself becoming an important source of FDI for ASEAN.** China currently attracts three times as much FDI as ASEAN (figure 5), although FDI-to-GDP ratios are higher for ASEAN (figure 6). Flows to China and ASEAN are broadly complementary,[6] with FDI to ASEAN supporting production of parts, and FDI to China focusing on assembly. However, as labor-intensive manufacturing in China becomes more expensive, some flows to China are projected to shift to ASEAN. China is also emerging as a major source of FDI to ASEAN as it moves up the value chain, with flows growing from US$140 million in 2001 to US$7.3 billion (or 6.7 percent of all FDI to ASEAN) in 2011.

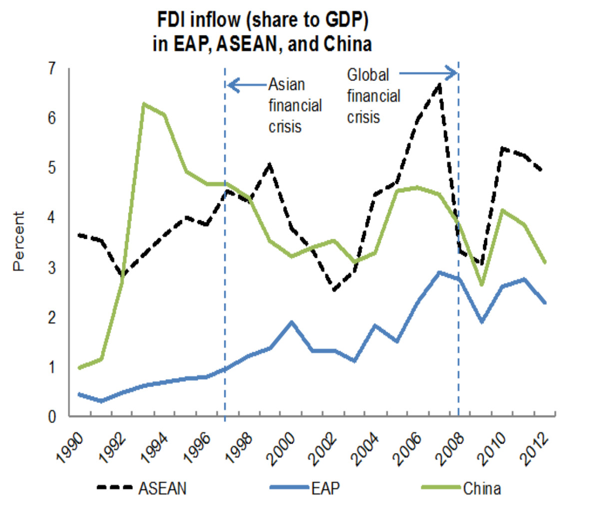
**Figure 5.** FDI to ASEAN is smaller than FDI to China in dollar terms…




*Source*: *World Development Indicators*.
*Note:* ASEAN = Association of Southeast Asian Nations; EAP = East Asia and Pacific.

[6] Mercereau (2005) finds that between 1984 and 2002, China did not have much impact on FDI to other Asian countries. Plummer and Cheong (2009) also find no significant impact of FDI in China on ASEAN FDI.

**Figure 6.** … But relative to GDP, ASEAN has received more FDI, especially in recent years




*Source*: *World Development Indicators*.
*Note:* ASEAN = Association of Southeast Asian Nations; EAP = East Asia and Pacific.

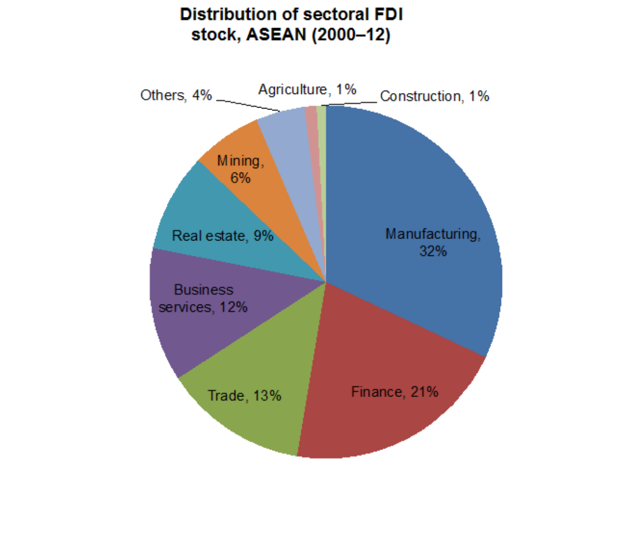
**Manufacturing and finance have historically attracted the most FDI in ASEAN** (figure 7).[7] Since 2000,[8] manufacturing has accounted for 32 percent of FDI, finance for 21 percent, and other services for 34 percent.[9] There is wide variation among ASEAN countries, however, in which sectors receive the most FDI (table 2). Manufacturing is relatively more prominent than services in Malaysia, Thailand, and Vietnam, while the reverse is the case in Indonesia, the Philippines, and Singapore. The global financial crisis caused some changes in the allocation of FDI among sectors. In Indonesia, for example, FDI in manufacturing and services was significantly higher after 2008 compared to previous years.

[7] Some countries, such as the Philippines, only report equity FDI, and not retained earnings or intracompany borrowings.

[8] 2000 is the earliest year when comparable data are available.

[9] FDI in manufacturing grew with the relocation of Japanese manufacturers in the late 1980s and with the implementation of the ASEAN Free Trade Agreement in 1993. FDI to the financial sector grew significantly following the sector's liberalization in the mid-1990s (see below for more detail).

**Figure 7.** Manufacturing is the most attractive sector for FDI in ASEAN, followed by financial services




*Source*: *World Development Indicators*.

**Table 2.** FDI stock by sector and by country, 2000–2008 and 2009–2012 (US$ billions)

| | Agriculture | | Manufacturing | | Other Industries | | Services | | Total | | Country Share | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2000–08 | 2009–12 | 2000–08 | 2009–12 | 2000–08 | 2009–12 | 2000–08 | 2009–12 | 2000–08 | 2009–12 | 2000–08 | 2009–12 |
| Singapore | 0.0 | 0.0 | 47.0 | 43.8 | -0.2 | 1.1 | 144.6 | 146.3 | **191.3** | **191.2** | **51.4** | **52.8** |
| Thailand | 0.1 | 0.0 | 29.4 | 16.8 | 2.4 | 1.1 | 28.3 | 15.8 | **60.2** | **33.7** | **16.2** | **9.3** |
| Malaysia | 2.0 | 0.1 | 17.6 | 13.6 | 5.0 | 7.4 | 15.9 | 10.8 | **40.6** | **32.0** | **10.9** | **8.8** |
| Vietnam | 1.0 | 0.2 | 15.1 | 13.3 | 4.7 | 2.7 | 6.8 | 15.3 | **27.6** | **31.5** | **7.4** | **8.7** |
| Indonesia | -0.1 | 1.9 | 7.5 | 23.7 | 6.9 | 8.9 | 9.1 | 23.2 | **23.4** | **57.7** | **6.3** | **16.0** |
| Philippines | 0.0 | 0.0 | 3.2 | 0.8 | 0.7 | 0.2 | 10.4 | 6.9 | **14.4** | **7.9** | **3.9** | **2.2** |
| Brunei | 0.0 | 0.0 | 0.5 | 0.1 | 5.7 | 1.9 | 0.8 | 0.2 | **6.9** | **2.2** | **1.9** | **0.6** |
| Myanmar | 0.0 | 0.0 | 0.1 | 0.0 | 2.6 | 1.0 | 0.7 | 0.0 | **3.5** | **1.0** | **0.9** | **0.3** |
| Cambodia | 0.4 | 0.7 | 0.9 | 1.1 | 0.0 | 0.0 | 2.0 | 1.9 | **3.2** | **3.8** | **0.9** | **1.1** |
| Lao PDR | 0.1 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 | 0.5 | 0.7 | **0.9** | **1.0** | **0.2** | **0.3** |
| **Total** | **3.5** | **3.0** | **121.4** | **113.4** | **28.0** | **24.3** | **219.1** | **221.0** | **372.0** | **361.8** | **..** | **..** |
| **Sector Share** | **0.9** | **0.8** | **32.6** | **31.3** | **7.5** | **6.7** | **58.9** | **61.1** | **..** | **..** | **100** | **100** |

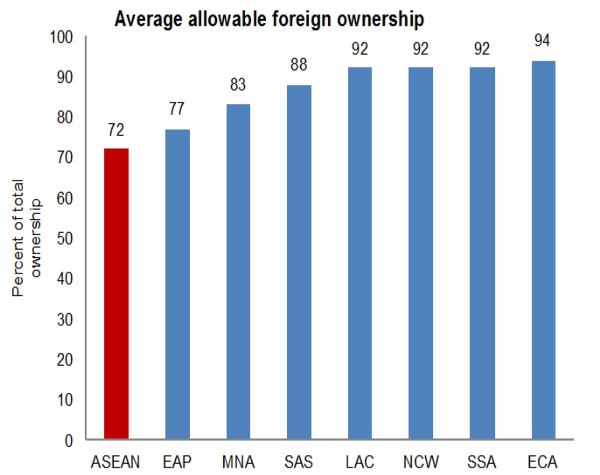
*Source*: ASEAN Secretariat.
*Note:* .. = negligible.

**Despite the importance of FDI, many ASEAN countries by law restrict foreign ownership.**[10] East Asian countries, and particularly ASEAN countries, impose more stringent de-jure foreign ownership

[10] Throughout this note, the term foreign ownership refers to foreign equity.

restrictions (FORs) than any other region (figure 8).[11] There is, however, significant variation among ASEAN countries in FORs (figure 9). Thailand is the most restrictive, followed by the Philippines and Malaysia. Cambodia—which allows 100 percent foreign ownership in most sectors—is the most open country in the region, followed by Singapore. There is also significant variation among sectors: manufacturing sectors (with the exception of publishing) are generally the most open, followed by construction, tourism, and retail.[12] In contrast, business services (particularly media) are heavily protected, as are telecommunications and transport.

**Figure 8.** East Asia and the Pacific imposes stringent de-jure FORs

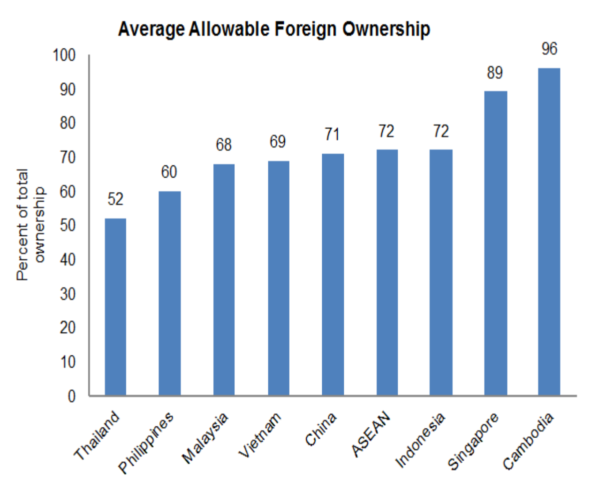



*Source:* World Bank *Investing Across Borders* database.
*Note:* ASEAN = Association of Southeast Asian Nations; EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; NCW = North America and Western Europe; SAS = South Asia; SSA = Sub-Saharan Africa.

[11] Data from the World Bank *Investing across Borders* Database, http://iab.worldbank.org/Data. This captures overt statutory restrictions on foreign ownership of equity in new investment projects (that is, greenfield FDI) and on the acquisition of shares in existing companies (that is, mergers and acquisitions). The average scores across 11 sectors for ASEAN and for East Asia Pacific are, respectively, 72 and 77, where 100 denotes complete openness. This compares to between 80 and 89 for the Middle East and North Africa and South Asia, and above 90 for all other regions.

[12] All ASEAN countries allow 100 percent ownership of light manufacturing (that is, manufacturing of consumer products) and food manufacturing.

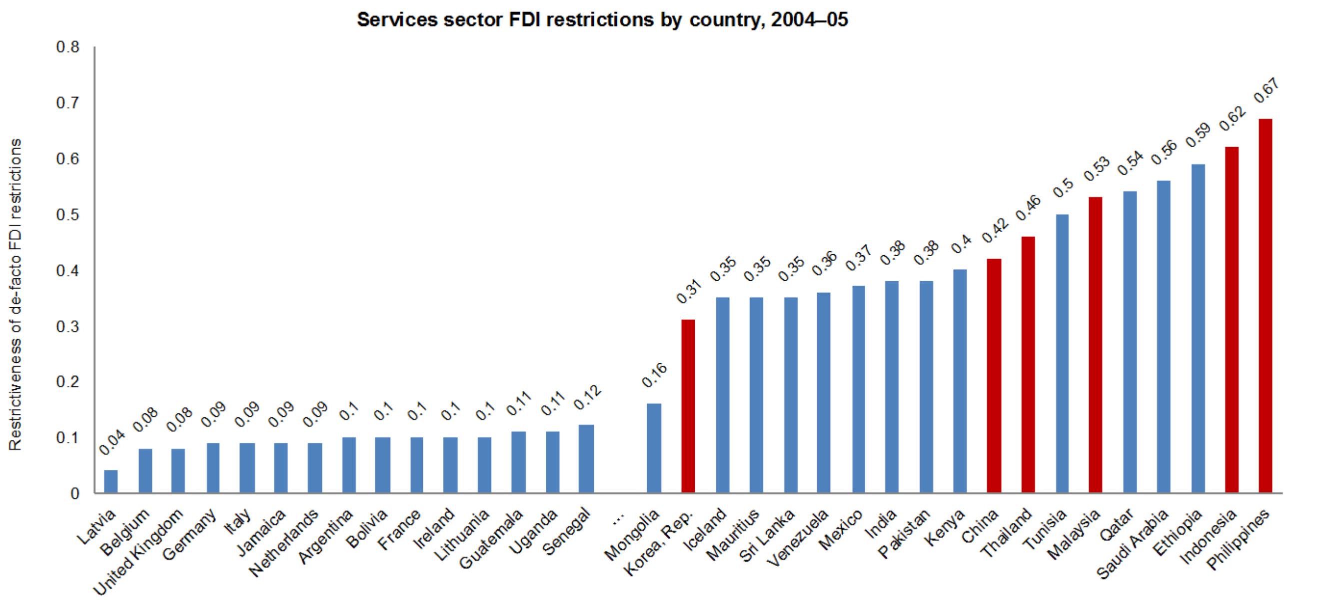
**Figure 9.** There is wide variation in de-jure FORs within ASEAN




*Source:* World Bank *Investing Across Borders* database.

**Measures of de-facto FORs also indicate that ASEAN countries are relatively restrictive.** East Asia is de facto the region least open to FDI in services (Golub 2009). The Philippines and Indonesia are the most restrictive of the 73 economies studied, while Malaysia, China, and Thailand also rank in the top 10 most restrictive economies (figure 10). In East Asia, the electricity industry has the most stringent de-facto FORs, while construction and retail distribution are the most open.

**Figure 10.** The Philippines and Indonesia impose the most stringent de-facto restrictions on FDI in services; China, Thailand, and Malaysia are not far behind




*Source:* Golub 2009.

## Economic Impact of FDI and Foreign Ownership Restrictions

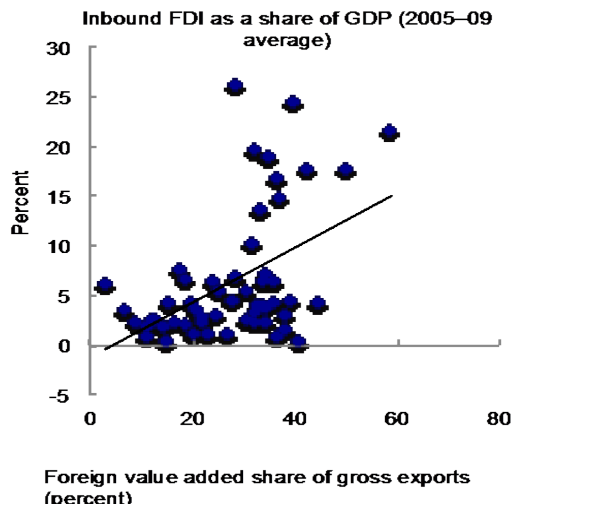
**FDI assists integration into global supply chains, improves export competitiveness by exposing local firms to foreign technologies, and increases economic growth.**[13] The nature of the effect of FDI, however, depends on the type of FDI. Horizontal FDI, in which firms seek access to markets by establishing local subsidiaries, increases imports of intermediate goods but generally does not increase exports. Vertical FDI, whereby components of a production chain are outsourced, boosts exports as well as imports of intermediate and capital goods, while increasing the share of foreign value added in exports (figure 11).[14] In this sense, vertical FDI—which accounts for most FDI to ASEAN[15]—is more effective in supporting economic integration.

[13] UNCTAD 2013. Also, evidence shows that increases in FDI in China and Singapore enabled firms to increase productivity and move up the value chain (Xu and Lu 2009).

[14] This normally happens through vertical specialization, where each stage of the production process is carried out in the economy with the biggest comparative advantage in that activity, resulting in large flows of intermediate goods between economies involved in the supply chain.

[15] Plummer and Cheong (2009) find that FDI into ASEAN seeks cheaper factors of production; related, Petri (2012) finds that FDI into Asia is dominated by investments from high-technology to mid-technology economies.

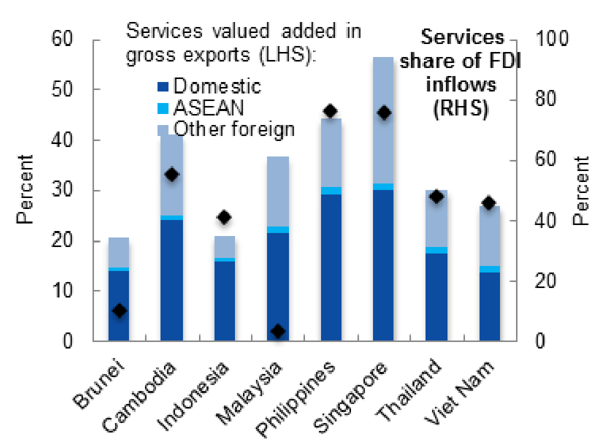
**Figure 11.** Participation in global supply chains is positively associated with FDI inflows




*Sources*: OECD TiVA database; *World Development Indicators*; and World Bank staff calculations.

*Note*: 2005–09 average for FDI inflows used to account for lags in impact of FDI inflows on trade flows.

**Figure 12.** Services account for one-third of ASEAN exports




*Sources*: OECD TiVA database and World Bank staff calculations.

*Note:* 2009 latest data available; excludes Lao PDR and Myanmar; services share of FDI inflows reflects 2000–12 average.

**Changes in the world economy in recent decades have heightened the importance of FDI to competitiveness.** The globalization of supply chains and fragmentation of production gives small and medium-size firms the ability to access global markets as suppliers of components, finished products, or services, without having to build an entire supply chain. However, the globalization of supply chains has also magnified the costs of protectionism in both trade and investment: the effects of barriers are multiplied when intermediate inputs are traded across borders multiple times. Barriers to FDI can further impede the competitiveness of exporters by reducing domestic firms' access to high-quality intermediate inputs and the associated productivity spillovers.

**FDI in services is particularly important for export competitiveness.** The ability to access high-quality services, both domestic and foreign, is a determinant of firms' export performance. Across ASEAN, services account for around 35 percent of the value of gross exports; of this, around 20 percent reflects value added by domestic services industries, and 15 percent the imports of intermediate services (figure 12). Firm-level evidence suggests that removing restrictions to FDI in services increases productivity.[16] Greater FDI in services would increase the competitiveness of ASEAN exports, while also raising the productivity of domestic service sectors.

**Fewer FORs are associated with greater FDI.**[17] Both cross-country and cross-sector data indicate a negative relationship between FORs and FDI inflows that is robust to the addition of various control variables and to different specifications.[18] The relationship is economically significant; for instance, a reduction in restrictiveness from the level of the Philippines to that of Malaysia is associated with an increase in the FDI stock, relative to GDP, of 6.7 to 10.4 percentage points. Other studies confirm that controls on FDI inflows, such as FORs, have a statistically significant negative effect on FDI.[19] The experiences of specific sectors and countries show that FDI is often highly sensitive to FORs.

<u>Financial Sectors in the Philippines and Thailand</u> (figure 13): In 1994, allowable foreign ownership in the Philippine banking industry was increased from zero to 60 percent. Within three years, 10 foreign banks invested US$4 billion. In Thailand, after the government in 1998 increased the allowable foreign equity from 25 to 100 percent, the share of financial sector FDI to total FDI rose from 3 to 16 percent.[20]

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[16] For instance, Duggan, Rahardja, and Varela (2013) find that relaxing impediments to FDI in the Indonesian services sector accounted for 8 percent of the total observed increase in manufacturers' total factor productivity.

[17] This section draws partly on Rillo et al. (2013).

[18] The relationship is apparent using cross-country data, cross-sectoral data, and also country-specific data for the Philippines. Specifically, a cross-country model for the FDI stock as a share of GDP was estimated over the 86 countries where data are available on both FDI and de-jure FORs from the *Investing across Borders* database. The FDI stock was defined as the sum of FDI inflows during 1980–2012.

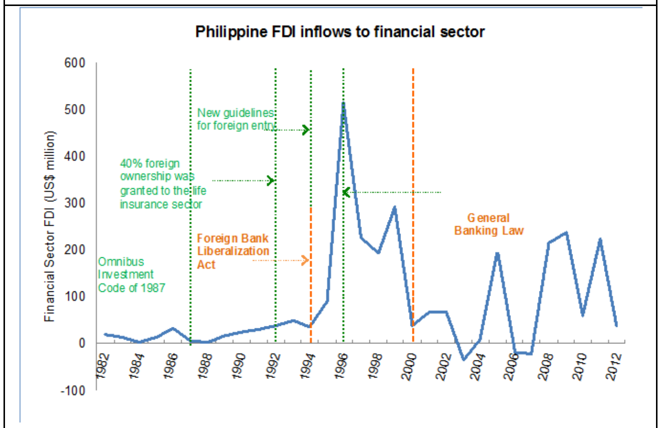
A cross-sectoral model for the FDI stock as a share of GDP was estimated over 4 major sectors (agriculture, manufacturing, other industry, and services) in each ASEAN country except Brunei Darussalam, Lao PDR, and Myanmar (where data are unavailable). The FDI stock was defined as the sum of FDI inflows during 1995–2012.

Also, panel regression for annual FDI inflows during 1982–2012 was estimated across disaggregated sectors in the Philippines. In all three models, FORs proved statistically significant determinants of FDI at the 10 percent or lower level, across a range of specifications. However, all three models had low explanatory power, indicating that other factors are also at play.

[19] See, for instance, Arbatli (2011) and Nicoletti et al. (2003).

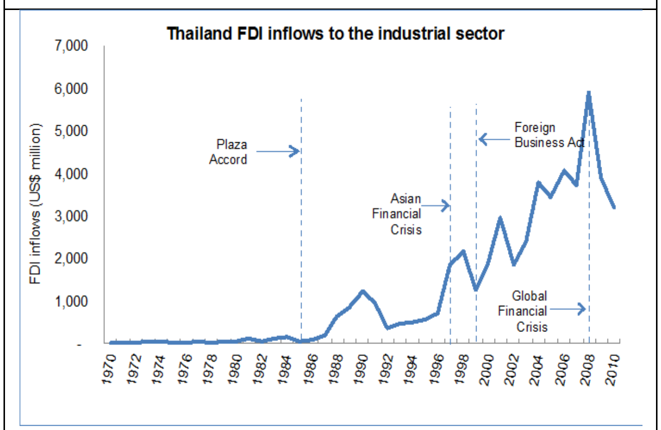
[20] See Brimble (2002) for further discussion.

**Figure 13.** Financial sector liberalization in the Philippines sharply increased FDI in the sector




*Source*: Bangko Sentral ng Pilipinas.

**Figure 14.** Thailand's 1999 Foreign Business Act increased FDI to industry




*Source*: CEIC.

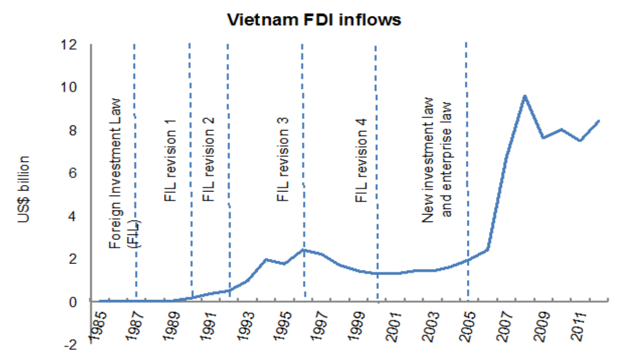
Thailand (figure 14): FDI to industry grew significantly after the 1999 passage of the Foreign Business Act. Previously, foreign ownership was restricted in cement manufacturing, pharmaceuticals, alcohol, textiles, garments, footwear, retail trade, and securities brokerage.

Vietnam (figure 15): Reform of FORs between 1990 and 2005 led to an exponential growth in FDI.[21] In 1987, Vietnam passed a Foreign Investment Law, which allowed up to 100 percent foreign equity

[21] In 2005, the Foreign Investment Law was replaced by the Unified Investment Law, which covers both domestic and foreign investment.

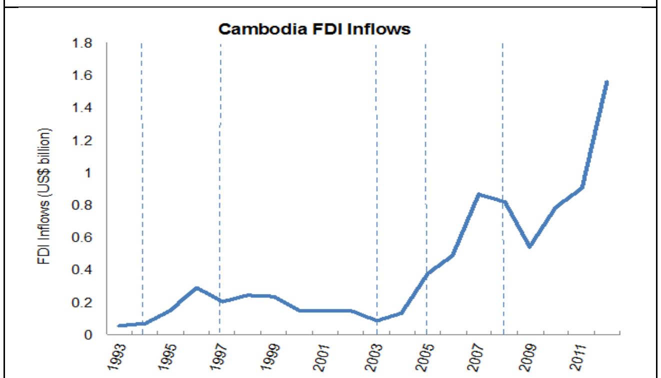
participation, although licenses for wholly foreign-owned projects were initially issued only to projects with significant benefits.[22] In 1991, Vietnam approved a larger share of wholly foreign-owned projects; by end-1992, around 13 percent of FDI projects were wholly foreign owned. By around 2000, wholly foreign-owned projects accounted for over 60 percent of projects.

**Figure 15.** After Vietnam's 1990 and 2005 investment reforms, FDI grew exponentially




*Source*: *World Development Indicators*.

**Figure 16.** FDI flows to Cambodia increased sharply following amendments to the Foreign Investment Law




*Source*: *World Development Indicators*.

[22] See Freeman (1994) for more discussion.

Cambodia (figure 16): In 2003, Cambodia amended its 1994 Law on Investment, encouraging FDI inflows through incentives such as full exemption on import duties on inputs used to produce final products for exports, renewable land leases of up to 99 years, no discrimination between foreign and local investors, and no price controls.

China: FORs have been gradually relaxed since 1979, when the joint venture law was passed to attract FDI into special economic zones. In 1986, in response to slower FDI growth, China permitted wholly foreign-owned enterprises in special economic zones. By 1989, wholly foreign-owned projects accounted for over 25 percent of total pledged FDI;[23] by 2004, their share had increased to over two-thirds.

## Case Studies: Indonesia and the Philippines

**We now turn to more detailed case studies of Indonesia and the Philippines.** We focus on the structure of FDI in those countries, and how it is affected by FORs. The two countries impose particularly stringent FORs, and regular changes in policy create significant uncertainty for investors. While FDI to Indonesia has nevertheless grown in recent years, FDI to the Philippines remains lower—both in dollar terms and relative to GDP—and more volatile.

### Indonesia

**Since 2010, Indonesia has experienced strong FDI inflows.** Gross FDI inflows grew from US$4.9 billion (1.4 percent of GDP) in 2006 to US$18.4 billion (2.1 percent of GDP) in 2013 (figure 17). A 2013 survey of Japanese investors finds that Indonesia has overtaken China as the leading investment destination in Asia for Japanese manufacturers.[24] The growth in FDI is generally attributed to favorable changes in commodity prices (especially for coal and palm oil), relative costs (such as rising real wages in China), improved macroeconomic stability, and strong domestic demand.[25] FDI increases were particularly concentrated in the primary (that is, agriculture, forestry, mining, and minerals) and secondary (that is, manufacturing) sectors (table 3). But despite this recent growth, FDI, at 1.8 percent of GDP in 2009–12, remains lower than in China (3.4 percent), Malaysia (3.2 percent), and Thailand (2.5 percent).

[23] "Pledged FDI" refers to investors' intention to invest, as captured by investment promotion agencies.

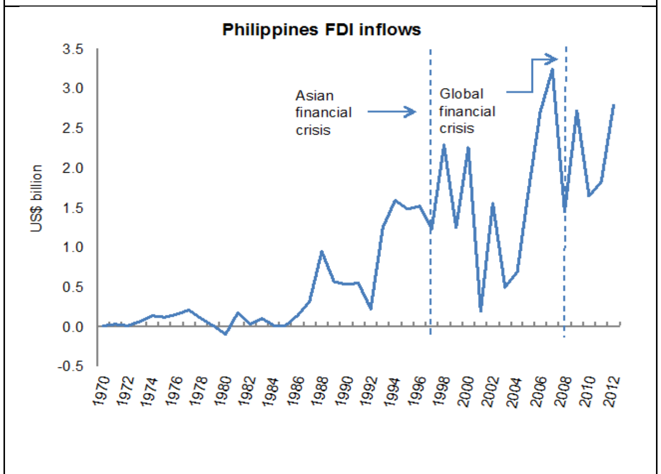
[24] Japan Bank for International Cooperation (JBIC), "Outlook for Japanese Foreign Direct Investment (25th annual survey)," (JBIC 2013).

[25] For instance, the above JBIC survey finds that the leading reason for Japanese manufacturing companies' positive perception of Indonesia is the future growth potential of the domestic market.

**Figure 17.** FDI to Indonesia has been on an uptrend since 2010


*Source*: *World Development Indicators*.

**Figure 18.** FDI to the Philippines has been relatively low




*Source*: *World Development Indicators*.

**Indonesia adopts a negative list approach to regulate FDI.** Indonesia's Investment Law requires that all FORs be promulgated by a single comprehensive Negative Investment List (NIL) issued by the president. Sectors that are not on the list are in theory not subject to FORs.[26] The 2010 NIL, revised from the first 2007 NIL, ruled that FORs imposed by lower-order ministerial decrees were no longer

[26] By law, sectoral guidelines should only regulate specific or technical restrictions. In practice, this is not always the case. For instance, the Horticulture Law No. 13, 2010, limits foreign ownership to 30 percent by 2014.

valid unless they conformed to the NIL. While the 2010 NIL relaxes FORs in construction and health care, it imposed new FORs on cellular phone towers, security, and inspection services.

**The imposition of FORs in telecommunications significantly reduced FDI to the tertiary sector.** Between 2010 and 2013, FDI to the tertiary sector dropped by US$3 billion, or over 30 percent (table 3). This decrease, which contrasts with a 250 percent increase in FDI to the primary and secondary sectors, was a direct response to the imposition of FORs on telecommunications in the 2010 NIL, which mandated 100 percent domestic ownership in the construction, management, and ownership of cellular phone towers and forced existing foreign investors to exit the market within two years. Policy uncertainty concerning the imposition of further FORs also reduced FDI to the tertiary sector.

**Table 3.** FDI by sector (US$ billion)

| | 2010 | | 2011 | | 2012 | | 2013 | |
|---|---|---|---|---|---|---|---|---|
| **Sector** | **Amount** | **Share (%)** | **Amount** | **Share (%)** | **Amount** | **Share (%)** | **Amount** | **Share (%)** |
| **Primary** | 3.0 | 18.8 | 4.8 | 24.9 | 5.9 | 23.9 | 6.5 | 22.6 |
| **Secondary** | 3.3 | 20.5 | 6.8 | 35.0 | 11.8 | 48.0 | 15.8 | 55.3 |
| **Tertiary** | 9.8 | 60.7 | 7.8 | 40.1 | 6.9 | 28.1 | 6.3 | 22.1 |

*Source:* Badan Koordinasi Penanaman Modal (BKPM), the Investment Coordinating Board of Indonesia.

## The Philippines

**Compared to other major ASEAN economies, the Philippines attracts relatively little FDI.** Between 1970 and 2012, FDI inflows averaged less than US$500 million per year (figure 18). The country's long history of political and macroeconomic instability, its weak institutions, poor infrastructure, and stringent FORs explain the low FDI.[27] Since 2009, the Philippines exhibited macroeconomic stability, but many other constraints remain unresolved. In particular, as discussed, de-jure FORs are the second most stringent in the region (after Thailand), while the Philippines ranks last among 77 countries in de-facto restrictions on FDI in services. Restrictions on foreign landownership also pervasively discourage investment.[28]

**A complex legal framework imposes FORs.** The 1987 Constitution explicitly restricts ownership and management in a number of sectors. For natural resources, public utilities, and nonsectarian educational institutions, corporations must be at least 60 percent owned by Filipinos. Advertising is restricted to corporations 70 percent owned by Filipinos, while mass media and all professions are generally reserved for Filipinos. In addition to the constitutional restrictions, the Foreign Investment Act gives the president

[27] In the 2005 World Bank *Enterprise Survey*, firms identified macroeconomic instability, corruption, and the high cost and unreliability of power supply as the main constraints. See Asian Development Bank and the World Bank (2005).

[28] According to Joint Foreign Chambers of the Philippines (2013), foreign chambers of commerce cite land access (that is, allowing foreign ownership of factory sites) as a major constraint to the revival of labor-intensive manufacturing.

of the country the authority to impose FORs in other sectors through a biannual Foreign Investment Negative List. The latest order, in October 2012, expanded the number of restricted sectors and activities. Since 2000, only large retailers and casinos have experienced reductions in FORs.

**In addition to de-jure restrictions, various de-facto restrictions create barriers to FDI.** [29] Investment requirements and promotion schemes are not standardized across sectors. This, and the lack of a central body to coordinate investment promotion agencies, creates confusion for prospective investors. Investors face complex procedures in acquiring permits and licenses, with some investment promotion agencies characterized by red tape,[30] a lack of transparency in guidelines and procedures, slow processing, and allegations of corruption. Existing enterprises also face high costs of doing business, owing to poor infrastructure, the high cost and irregular supply of power, insecure property rights, inconsistent tariff and nontariff barriers, and policy inconsistency.

## The ASEAN Economic Community (AEC) 2015

**The ASEAN Economic Community 2009–2015 roadmap highlights the importance of FDI:** "A free flow of investment regime is key to enhancing ASEAN's competitiveness in attracting FDI and intra-ASEAN investment. Sustained inflows of new investments and reinvestments will promote and ensure dynamic development of ASEAN economies." To support this vision, ASEAN has introduced two agreements: the ASEAN Comprehensive Investment Agreement (ACIA) and the ASEAN Framework Agreement on Trade in Services (AFAS).

**ACIA promotes liberalization of FDI in goods** through a negative-list approach in which member countries self-select sectors they wish to keep closed, with all those sectors not on the list being opened. ACIA also contains provisions to protect investors, a clear dispute-settlement mechanism, and transparent rule making. It covers manufacturing, agriculture, fishery, forestry, and the mining and quarrying sectors, and all services incidental to these sectors. It focuses on phasing out three types of restrictions: foreign ownership restrictions, national treatment, and inflows of key foreign managerial and senior management personnel.

**AFAS promotes liberalization of FDI in services** through a positive-list approach, which explicitly spells out sectors to be opened. It focuses on removing discrimination against foreign service suppliers, for instance through limits on market entry, or limits on the scope and nature of operations after entry. Liberalization can also target specific barriers to market access, as covered in the General Agreement on Trade in Services (GATS) under the World Trade Organization.

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[29] Aldaba 2013.

[30] For instance, investors must deal with around 10 government agencies to obtain the necessary permits to set up a business.

**The AFAS liberalization process follows a phased approach.** Four priority sectors—air transport, health care, e-ASEAN,[31] and tourism—were targeted to achieve 70 percent foreign equity participation by 2010. For logistics and for other services, the 70 percent target was to be achieved by, respectively, 2013 and 2015 (table 4). For each group of sectors, liberalization commitments are to include cross-border trade (mode 1 trade); consumption abroad (mode 2 trade); commercial presence (mode 3 trade); and movement of natural persons (mode 4 trade). However, ASEAN member states that are not ready to comply with liberalization thresholds and deadlines can set their own targets—the "ASEAN minus X" formula.

**Table 4.** Service liberalization: Foreign equity participation target under the AEC blueprint

| | 2008 | 2010 | 2013 | 2015 |
|---|---|---|---|---|
| Priority sectors:<br>Air transport, health care, e-ASEAN, and tourism | 51 | 70 | 0 | 0 |
| Logistics | 49 | 51 | 70 | 0 |
| Other services | 49 | 51 | 0 | 70 |

*Source*: ADB 2013.

**Progress so far has been mixed.** With respect to ACIA and liberalizing FDI in goods, the AEC Blueprint 2012 midterm report finds that four ASEAN countries have foreign investment liberalization rates[32] of about 90 percent, three are above 80 percent, two are near 80 percent, and one is at 75 percent. There remains room for further liberalization. In this respect, the agriculture and oil and gas sectors will prove the most challenging.

**As for AFAS and liberalizing FDI in services, the negotiation rounds and commitment packages undertaken since 1995 have led to progress, but there remain pending issues.** The scope and depth of commitments have expanded significantly. However, some studies argue the commitments may not translate into further actual liberalization;[33] in some sectors, such as air transport, telecommunication, and banking, the gap between commitments and actual policies is particularly wide. For some countries, including Indonesia, AFAS commitments are marginal relative to those made under the GATS.[34] Table 5 summarizes the remaining gaps between AFAS commitments and policies.

**Removing remaining FORs in services would increase the competitiveness of ASEAN exporters.** The AEC 2015 provides an opportunity to address the remaining restrictions and help ASEAN become

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[31] The e-ASEAN initiative is envisioned as a holistic electronic action plan based on existing work on the ASEAN Information Infrastructure (AII), electronic commerce, telecommunications, and other relevant sectors such as trade, tourism, science, and technology (see ADB 2013).

[32] The overall foreign investment liberalization rate is a weighted average of the foreign equity liberalization rate (60 percent weight), national treatment (24 percent weight), and other market access restrictions (16 percent weight).

[33] Nikomborirak and Jitdumrong 2013; Stephenson and Nikomborirak 2003.

[34] ADB 2013; ESCAP 2009.

more competitive globally. In Indonesia, reforming and clarifying the role of the NIL will help attract FDI. In the Philippines, the constitutional limitation on foreign equity needs to be reviewed, and the negative list can be shortened. More broadly, reform of FORs will need to be complemented by measures to improve logistics and trade facilitation, and to reduce the cost of doing business (see accompanying note on "Trading Costs in East Asia").

**Table 5.** Remaining restrictions relative to ASEAN Framework Agreement on Trade in Services (AFAS) commitments

| Sector | Indonesia | Philippines |
|---|---|---|
| Tourism | As of July 2011, Indonesia is one of three countries that are still restricting FDI in hotel and lodging services below the 70 percent foreign ownership target. | The retail sector, including restaurants, is largely closed to foreign ownership, except for very large retailers and luxury stores. Retail establishments must be at least 60 percent Filipino owned. |
| Telecommunication | Foreign equity share for mobile telephone companies is limited to 65 percent and for fixed-line networks to 49 percent. | Both sectors are considered public utilities, hence foreign equity is limited to 40 percent by the Constitution. Increasing the limit requires a constitutional amendment. |
| Air transport | Foreign operators of scheduled domestic air transport services are required to enter into a joint venture, in which foreign ownership of up to 49 percent is allowed. Foreign airline companies may carry international and domestic passenger on international but not domestic point-to-point services. | |
| Health care | Indonesia had not raised the foreign equity share limit in certain services to 70 percent by 2010 as prescribed in the AEC Blueprint. Foreign equity share limit in hospital services, clinics of specialist doctors, clinic laboratories, and medical check-up clinics is at 67 percent. | For hospitals, foreign equity ownership is capped at 40 percent. No cap currently exists for health maintenance organizations (HMOs). |

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# Part III. Country Pages and Key Indicators

## Cambodia

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| | |
|---|---|
| Population | 14.9 million |
| Population growth | 1.8 percent |
| GDP (PPP, int'l US$) | 36.5 billion |
| GDP per capita (PPP, int'l US$) | 2,454 |
| Surface area | 181, 040 sq. km. |
| Capital | Phnom Penh |

*Source: World Development Indicators.*

### Summary

**The Cambodian economy has managed to withstand strong domestic pressures and to maintain high economic growth.** Growth is holding up reasonably well despite the adverse effects of political uncertainty and labor unrest since the second half of 2013, while inflation has picked up only marginally. Real economic growth is estimated to reach 7.4 percent in 2013, driven mainly by the garment and tourismsectors. With the expectation of renewed confidence and the return of political stability, bolstered by a strengthening global economy, Cambodia's real economic growth rate for 2014 is projected to reach 7.2 percent. The banking sector is expanding, and financial sector deepening is continuing to occur. Fiscal performance remains sustainable, although domestic revenue performance has recently slowed. However, potential further labor unrest and adverse impacts of "tapering" by the U.S. Federal Reserve pose downside risks.

### Recent Economic Developments

**Cambodia's economy currently must withstand political and social domestic pressures, while at the same time protecting its high economic growth rate.** Economic growth performed better than expected in 2013, despite the adverse effects posed by political uncertainty and labor unrest. Fortunately, the 2012 floods inflicted only limited damage on rice production. With an acceleration of garment exports, and continued growth in the tourism sector, real growth is expected to hit 7.4 percent in 2013. The prospects for sustaining high growth appear favorable, and real growth for 2014 is projected to reach 7.2 percent, given expectations of renewed confidence and stability, and underpinned by the strengthening of slow economic recovery in developed economies. Downside risks, however, include potential continuing labor unrest and adverse impacts from tapering by the U.S. Federal Reserve. Initial impacts of tapering have resulted in most emerging markets suffering significant currency depreciations, rendering their exports more competitive. However, this works against Cambodia's exports, because of the country's highly U.S. dollarized economy.

**Cambodia's current account deficit has improved amidst moderated FDI inflows.** Caused mainly by dampened domestic demand, import growth slowed while export growth advanced. This contributed to a narrowing of the current account deficit to around 9.4 percent of GDP in 2013, compared with 10.1 percent of GDP in 2012. Inflows of FDI have continued, but given the political uncertainty, we estimate 2013 inflows to be well below the 2012 peak. Gross international reserves, therefore, increased marginally, reaching US$3.6 billion or 3.8 months of imports, in 2013 compared with US$3.5 billion in 2012.

**Inflation is picking up marginally.** While prices of staple food items remain broadly stable, inflationary pressure is steadily rising due to the recent pickup of prices from some food and beverage items. Inflation rose to 4.7 percent year-on-year at the end of 2013, up from 2.5 percent at the end of 2012. Inflation is projected to remain in single digits over the short term.

**Private deposit growth has slowed while credit growth has remained elevated.** The adverse impact of political uncertainty on confidence caused private sector deposit growth to slow considerably, decelerating to 14.2 percent year-on-year by December 2013, from 25.2 percent by end-2012. In contrast, credit growth remained strong, expanding at 26.6 percent year-on-year in 2013, only slightly below the 2012 growth rate of 28.0 percent. This raises the risk of Cambodia experiencing a squeeze on bank liquidity. Broad money supply growth also slowed as foreign currency deposits modestly expanded, reaching US$6.7 billion, or a 14.6 percent year-on-year increase in 2013, compared with US$5.9 billion, or 20.9 percent, in 2012.

**Fiscal space has expanded despite domestic revenue growth moderating.** After a sharp increase in 2012, domestic revenue growth moderated, expanding 8 percent year-on-year in 2013, compared with 27 percent in 2012, due largely to lower import tax and nontax revenue collection. The 2013 revenue is estimated to reach 14.8 percent of GDP, below the 2012 peak of 15.3 percent. The outlays were contained at around 21.3 percent of GDP in 2013, broadly similar to the 2012 level. The 2013 overall fiscal deficit including grants is estimated to reach 3.9 percent of GDP, slightly higher than the 2012 deficit of 3.3 percent, and continues to be overfinanced by external funding. Government reserves rose to US$760 million in 2013, up from US$690 million in 2012.

**Cambodia's debt-distress rating remains low.** Joint World Bank/International Monetary Fund debt-sustainability analysis conducted in 2013 shows that Cambodia's debt-distress rating remains low, with all debt burden indicators projected to be below their respective thresholds. Similar to last year's assessment, the results indicate that debt sustainability remains vulnerable to growth, exports, and fiscal shocks, indicating the need for continued structural reforms to diversify growth and improve revenue collection. The stock of Cambodia's external debt (including arrears) was US$4.5 billion, or 32 percent of GDP, at end-2012.

## Outlook and Emerging Challenges

**Appropriately managing domestic pressures, while coping with adverse impacts of U.S. Fed tapering, help to safeguard macroeconomic stability.** Addressing labor unrest by successfully negotiating wage issues would serve the interest of both workers and firms. Likewise, improving banking supervision would further strengthen the financial sector. Enhancing regional integration will enable Cambodia to benefit more from growth dynamics throughout the ASEAN region.

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## China

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| | |
|---|---|
| Population | 1.4 billion |
| Population growth | 0.5 percent |
| GDP (PPP, int'l US$) | 12.3 trillion |
| GDP per capita (PPP, int'l US$) | 9,083 |
| Surface area | 9,6000,000 sq. km. |
| Capital | Beijing |

*Source: World Development Indicators.*

### Summary

**China's economic growth remained robust in 2013—GDP increased by 7.7 percent, matching the outcome in 2012.** Monetary policy stance remained neutral, but credit impulse weakened slightly in the second half of 2013. Fiscal policy has remained supportive to growth, and local government off-budget activities have continued to play a significant role in supporting demand. However, recent activity data point toward deceleration of growth momentum in early 2014. Annual GDP growth in 2014 is expected to be 7.6 percent. There are downside risks to our 2014 projection risks related to local government.

### Recent Economic Developments

**China's economic growth remained robust in 2013.** GDP increased by 7.7 percent in 2013, matching the outcome in 2012. Tertiary industry grew the fastest (8.3 percent year-on-year [yoy]), followed by the secondary (7.8 percent yoy) and the primary industries (4.0 percent yoy). Favorable monetary and fiscal conditions continued to support investment growth, the key driver of growth. Targeted growth support measures introduced midyear helped to boost growth in the second half of 2013. Domestic rebalancing from investment- to consumption-led growth continues to be very gradual. Investment contributed 4.2 percentage points to GDP growth, followed by consumption (3.9 percentage points). While the external environment continued to improve, net exports dragged growth down by 0.3 percentage points.

**However, recent activity data point toward deceleration of growth momentum.** Growth moderated from 7.8 percent (yoy) in Q3 2013 to 7.7 percent (yoy) in Q4 2013. Industrial production growth moderated to 9.7 percent yoy in December from 10.0 percent yoy in November 2013. Recent indicators point to a moderation in economic activities in Q1 2014. Retail sales data suggest that consumption growth may have decelerated recently. In the first two months of 2014, nominal retail sales growth dipped to 11.8 percent (yoy) from 13.6 percent (yoy) in December 2013. Industrial production (IP) growth decelerated, mainly driven by a moderation in the state sector. In January and February, IP growth edged down to 8.6 percent (yoy) from 9.7 percent (yoy) in December 2013. Moreover, the Purchasing Managers Index (PMI) inched down to 50.2 percent in February from 50.5 percent in January. The decomposition of PMI shows that the decline was in nearly all phases of production, except for finished product inventory (47.8 percent in February from 46.5 percent in January).

**Monetary policy stance remained neutral, but credit impulse weakened slightly in the second half of 2013.** The growth of aggregate financing (estimated stock) decelerated from 19.4 percent (yoy) in 2012 to 17.8 percent in 2013. The slowdown in credit impulse weakened growth in fixed asset investments (FAI). FAI growth slowed in the second half of 2013. In nominal terms, growth in FAI decelerated from 20.6 percent in 2012 to 19.6 percent in 2013.

**Inflation stabilized in 2013.** The annual Consumer Price Index (CPI) eased from 2.7 percent in 2012 to 2.6 percent in 2013, largely due to moderation of price increases of food products. CPI inflation fell to 2.0 percent (yoy) in February from 2.5 percent (yoy) in January 2014. Meanwhile, Producer Price Index (PPI) deflation continued. The PPI declined by 1.9 percent in 2013, compared to 1.7 percent in 2012. PPI also declined in early 2014, by 2.0 percent (yoy) in February and 1.6 percent (yoy) in January. A declining PPI indicates that manufacturing activity remains weak.

**Fiscal policy has remained supportive to growth, and local government off-budget activities have continued to play a significant role in supporting demand.** Infrastructure investments have remained robust (increasing in nominal terms by 19.8 percent in 2013), albeit easing a bit at the end of 2013. An increase in transport infrastructure investments in Q3 provided a necessary boost to investment activities. However, according to our estimates, FAI growth slowed in Q4 2013. The yoy nominal growth rate of monthly FAI moderated from 19.6 percent in September to 17.2 percent in December 2013. In January and February 2014, the yoy nominal growth rate of FAI remained moderate at 17.9 percent.

**Local government off-budget activities have contributed to an increase in local government debt levels.** A recent National Audit Office report indicates that in the first half of 2013, local government debt and contingent liabilities increased by 2.6 percentage points of GDP to 33.2 percent of GDP as of June 30, 2013. While the local government debt levels remain manageable, a rapid buildup of local government debt has increased the fiscal vulnerabilities.

**China's current account surplus declined slightly to 2.1 percent of GDP in 2013 from 2.3 percent of GDP in 2012.** But China's merchandise trade balance continued to improve, reaching 3.9 percent of GDP in 2013. China's exports grew by 7.9 percent and imports by 7.3 percent in 2013. While goods trade balance remained positive, service balance continued to deteriorate, registering a deficit of 1.3 percent of GDP in 2013. Recently released trade data indicate a deterioration of trade balance; however, a decline in export growth is also affected by the large base effect in the previous year and distortions related to the Chinese New Year. In February exports declined by 1.8 percent, in contrast to a 10.5 percent increase in January. As a result, China registered a trade deficit of US$23.0 billion in February, compared to a trade surplus of US$31.9 billion in January.

**Net FDI inflows to China reached US$170.8 billion in 2013, down from US$190.1 billion in 2012.** The central bank continues to accumulate foreign exchange reserves, with an annual increase of US$432.7 billion in 2013, compared to US$98.7 billion in 2012. As of end-2013, the balance of foreign exchange reserves held by the People's Bank of China (PBOC) stood at US$3.82 trillion. In March, 2014, the PBOC widened the RMB's daily trading band against the U.S. dollar from +/-1 to +/-2 percent, increasing two-way movement of the currency in the future.

## Outlook and Emerging Challenges

**China's economic outlook remains stable.** The growth in 2014 is expected to be 7.6 percent. On the demand side, a decline in investment growth will be offset by a gradual increase in consumption supported by an increase in household incomes and a gradual narrowing of urban-rural income gaps. The contribution of net exports is expected to increase gradually due to economic recovery in advanced economies. Growth in 2015 is expected to be 7.5 percent, assuming a robust but slightly moderating growth path.

**In March, the government released its official growth target of about 7.5 percent for 2014.** Monetary policy will likely remain neutral, but measures to strengthen the regulation and promote the transparency of shadow banking activities are expected to be introduced gradually. Fiscal policy is expected to remain supportive to growth, especially using public investments as a policy lever to maintain a stable growth trajectory. But the government could introduce steps that limit quasi-fiscal activities of local governments. Thus, a moderation of growth in Q1 could likely result in the introduction of policy measures to support domestic demand.

**There are downside risks to our 2014 projection.** Risks related to local government finances and rapid credit growth may continue to bring uncertainties to growth prospects. First, a disorderly deleveraging could trigger a collapse in investment growth. Second, any policy mistakes and lack of coordination among different government agencies in the implementation of the bold reforms proposed by the Third Plenum last November may have an adverse impact on growth. The implementation of reforms announced in late 2013 remains of critical importance to address these emerging vulnerabilities and to put China's growth on a more sustainable footing.

<INSERT CHN COUNTRY TABLE>

## Fiji

<insert map>

| | |
|---|---|
| Population | 874,742 |
| Population growth | 0.8 percent |
| GDP (PPP, int'l US$) | 4.3 billion |
| GDP per capita (PPP, int'l US$) | 4,877 |
| Surface area | 18,270 sq. km. |
| Capital | Suva |

*Source: World Development Indicators.*

### Recent Economic Developments

**The Fijian economy is estimated to have grown by 2.7 percent in 2013.** The economy was supported by additional investment in the tourism and mining sectors, and by publicly funded infrastructure projects such as roads. Private consumption growth is driven by tax cuts, increases in public sector pay, and low interest rates. Growth is expected to remain at around 2.5 percent in 2014.

**Investment is estimated to have reached 28 percent of GDP.** According to the Reserve Bank of Fiji, total investment is estimated to have reached the highest level in more than 20 years driven by purchases of airplanes by Fiji Airways. The value of projects implemented in 2013 is estimated to have risen from F$280 million in 2012 to around F$350 million in 2013. Foreign investment strengthened with a doubling of registered new applications from foreign investors during the first nine months of 2013. Although overseas investors' interest in Fiji is rising, commitment and implementation may be delayed until after the 2014 elections.

**Tourist arrivals is preliminarily estimated to have grown by around 2 percent to reach 670,000 in 2013, despite adverse weather conditions at the beginning of the year.** Growth in tourist arrivals is partly explained by favorable weather conditions (after the cyclones in the first quarter of 2013), and by an increase in the number of conference events and cruise ship arrivals. Growth in tourist arrivals is projected to remain moderate in 2014.

**Inflation is expected to remain moderate.** In December 2013, inflation fell to 3.4 percent, with annual average inflation at 2.6 percent, the lowest level since 2006. Inflation is expected to remain at a moderate level of 3 percent in 2014, although exposed to downside risks stemming from commodity price shocks and weather-related events.

**The current account deficit increased to 16 percent of GDP in 2013 due to aircraft purchases, but is expected to narrow to around 6 percent of GDP in 2014.** A 9.0 percent decline was noted for export earnings to October 2013, partly explained by declines in gold, sugar, and textile exports. Imports grew by 10.8 percent for the same period, together leading to a 34.6 percent widening of the trade deficit. Inward remittances rose by 6.9 percent cumulative to October 2013 compared to the same period in 2012, and tourism receipts fell by 2.2 percent. Foreign reserves stood at US$931million at the end of January 2014, equivalent to 4.7 months of imports of goods and nonfactor services.

**Fiscal expansion is continuing in the run-up to the elections scheduled for September 2014.** Operating expenditure is expected to rise from F$1,481 million (21.5 percent of GDP) to F$1,803 million (23.4 percent of GDP) explained by further increases in the salaries and wages of all staff, expected costs associated with the 2014 elections, and increasing expenditure allocation to make primary and secondary education free. Capital expenditure is expected to further increase from F$723 million (10.1 percent of GDP) to F$1,011 million (13.1 percent of GDP) to fund energy and roads projects. Total government revenue is expected to rise from F$2,052 million (27.9 percent of GDP) to F$2,722 million (35.4 percent of GDP) on the back of F$475 million (6.2 percent of GDP) of divestments associated with the government's stake in the airports, ports, and electricity authority. As a result, excluding one-off divestment, the budget deficit is expected to widen from around 2.7 percent of GDP in 2013 to 8.2 percent of GDP in 2014 (2.0 percent of GDP including one-off divestment).

**Outlook and Emerging Challenges**

**The return to a democratically elected regime is expected to result in increased access to development funding, providing additional support to the economy over the medium term.** Since the government unveiled its fourth constitution and announced the seven-member Electoral Commission, development partners such as Australia have restored full diplomatic ties with Fiji. This could lead to increased access to financing for development, from both bilateral and multilateral agencies, providing some support to the economy in the medium term. Given Fiji's central role in the Pacific region, its return to democracy and the normalization of relations with its neighbors would also have a positive impact on the region.

**An orderly windup of recent fiscal expansion would be necessary to ensure sustainability, especially in light of upcoming bond repayment in 2016, and the tighter global financial market conditions.** Fiscal expansion, including investment in public assets, had been a key driver of growth in recent years. However, this has resulted in persistent increases in debt levels. Public debt has remained above 50 percent of GDP. Although the 2014 budget indicates the government's plans on fiscal consolidation, the projected increase in government borrowing unveiled in the 2014 budget will add to public debt. Furthermore, according to Standard and Poor's 2013 ratings assessment of Fiji, the state's guarantee on debt to fund the purchase of the new fleet of airplanes will increase contingent liabilities to nearly 30 percent of GDP. However, reforms to the national pension fund have significantly reduced the financial risk to the government from this entity.

<INSERT FJI COUNTRY TABLE>

## Indonesia

<insert map>

| | |
|---|---|
| Population | 246.9 million |
| Population growth | 1.2 percent |
| GDP (PPP, int'l US$) | 1.2 trillion |
| GDP per capita (PPP, int'l US$) | 4,876 |
| Surface area | 1,904,570 sq. km. |
| Capital | Jakarta |

*Source: World Development Indicators.*

### Summary

**The adjustment of Indonesia's economy to weaker terms of trade and less favorable external funding conditions is underway, facilitated by tighter monetary policy and a flexible exchange rate.** In the base case, economic growth is expected to moderate further as this adjustment continues to play out, but to remain above 5 percent year-on-year (yoy) at its near-term cyclical low. However, there is a significant risk of a more marked deterioration in growth, particularly if downward pressures on domestic demand were to intensify due to further adverse financial market or policy developments. Fiscal space is being compressed by weaker revenue growth, coupled with upward pressure on subsidy spending from higher rupiah-denominated fuel costs. Thus, there continues to be a pressing need to reorient spending in support of higher, sustainable, and inclusive growth, and to take more steps to support competitiveness. This includes addressing the mixed quality of recent regulatory and legal developments so as to support the climate for productive investments.

### Recent Economic Developments

**Economic growth moderated in the second half of 2013, to 5.7 percent yoy in Q4, taking GDP growth for 2013 to 5.8 percent, down from 6.2 percent in 2012.** The moderation in growth has been driven largely by a slowdown in fixed investment, which has seen a sustained deceleration since mid-2012 and grew by only a modest 4.4 percent yoy in Q4 2013 in real terms, due especially to subdued machinery and equipment spending. The weakness in fixed investment is likely concentrated in the resources sector following the downturn in international commodity prices in recent years, but may also reflect weaker investment demand growth in other parts of the economy due to spillovers from reduced commodity-related profits and, in recent quarters, tighter credit conditions and higher import costs. Weaker investment demand, alongside currency depreciation, has caused import volumes to decelerate, with capital goods imports contracting sharply over 2013, while export volume growth strengthened in the second half of 2013. Total expenditure growth has thus shifted away from domestic spending and toward net exports, narrowing Indonesia's investment-savings gap.

**Consistent with the direction of change in Indonesia's national accounts, the current account deficit narrowed to US$4 billion in Q4 2013 (2 percent of GDP), from its recent peak of US$10 billion (4.4 percent of GDP) in Q2 2013, to US$28.5 billion (3.3 percent of GDP) for 2013.** Some of this narrowing is due to a one-off surge in mineral exports in Q4, ahead of the imposition of restrictions on raw mineral exports in January, but export revenues more broadly have also been helped by a stabilization in the prices of Indonesia's key commodity products, which were close to flat over the second half of 2013, following approximately two years of fairly steady decline that has lowered Indonesia's terms of trade by roughly a quarter since 2010. On the capital account side, inbound foreign direct investment has been relatively stable, totaling US$4.1 billion in Q4 and US$18.4 billion for 2013 as a whole. Portfolio inflows, however, have been choppy, with solid net inflows to Indonesian domestic bonds through the end of 2013 partly offset by sustained net foreign selling of Indonesian equities. The overall balance of payments returned to surplus in Q4, and official gross reserves have risen since our last update in October, to US$100.7 billion in January.

**Monetary and exchange rate policies have underpinned much of these adjustments.** Bank Indonesia lifted its policy interest rate corridor by 175 basis points from June to November 2013, contributing to an easing of bank credit growth to 21.4 percent yoy in December 2013 (17.4 percent yoy, stripping out exchange rate effects). Bank Indonesia also reduced its currency market interventions after August, following which the rupiah fell sharply, bringing its depreciation over 2013 to 26 percent against the U.S. dollar. The fiscal policy stance has remained broadly neutral, with the provisional budget deficit outturn for 2013 at 2.2 percent of GDP, lower than the amount under the revised 2013 budget of 2.4 percent of GDP, but slightly above the 2012 outturn of 2.1 percent of GDP. Total nominal revenue growth slowed to 7 percent in 2013, from 11 percent in 2012, on the back of slower nominal GDP growth and subdued commodity-related revenues.

**Outlook and Emerging Challenges**

**In the base case, GDP growth in 2014 is projected to continue to slow, to 5.3 percent.** Private consumption, which so far has remained resilient, is expected to moderate to just below 5 percent yoy, as it faces ongoing headwinds from tighter credit and less favorable wealth effects. The investment outlook hinges on building investment, which in the face of tighter credit, reduced investable funds from commodity-related profits, and increased imported input costs, appears likely to slow, keeping overall fixed investment growth subdued in coming quarters. The investment outlook is also clouded by the failure to address regulatory issues and uncertainties in some areas, notably mining. Election-related spending in 2014 will likely add to domestic demand, but is temporary in nature and may in part substitute for other spending. The projection of a gradual pickup in growth through 2016 is based on expectations of some recovery in investment growth beginning in the latter part of 2014, and stronger export growth helped by stronger external demand as the global economy continues to pick up steam. However, less supportive terms of trade and tighter financing conditions, coupled with ongoing supply-side constraints, suggest it will be difficult in the near term to return to the above 6.0 percent growth rates seen since 2007 (excluding the 2009 slowdown due to the global financial crisis). Under the influence of a weaker currency and moderation in domestic demand, against the backdrop of strengthening global growth led by high-income economies through 2015, the overall current account deficit is expected to narrow modestly, from US$28.5 billion or 3.3 percent of GDP for 2013, to US$24.4 billion or 2.9 percent of GDP for 2014. Mineral export restrictions imposed in January 2014 add to near-term external balance risks, and compound regulatory uncertainties in the mining sector, in particular, and the predictability of investment policy in general.

**In the base case, inflation pressures are expected to remain contained, consistent with the downshift in domestic demand growth compared with recent years, with headline inflation declining gradually through Q2 2014 to approximately 7.5 percent.** Headline inflation is then expected to fall sharply as the impact of the June 2013 fuel price change drops out of the annual base in Q3 2014, following which the headline Consumer Price Index should return to below the ceiling of Bank Indonesia's current target band of 3.5 to 5.5 percent yoy. Core inflation, however, is expected to remain somewhat elevated in Q1 2014, impacted especially by the exchange rate depreciation of H2 2013. Higher wage costs are another significant source of cost-push inflation pressure, notably from the impact of new minimum wage increases for 2014 which, while modest compared with the increases for 2013, were still significant in some areas, including an 11 percent increase agreed for Jakarta.

**The 2014 fiscal deficit is likely to exceed the original budgeted amount, and improving the quality of spending remains a key challenge.** For 2014, the approved budget deficit is 1.7 percent of GDP, implying a fiscal contraction from the 2.2 percent of GDP provisional figure for 2013. However, a revision to reflect less favorable GDP and revenue growth assumptions is likely, and a somewhat higher deficit, on the order of 2.5 percent of GDP, is more probable in the absence of further reform measures. On the expenditure side, risks of higher rupiah-denominated fuel prices driving up fuel subsidy spending remain significant. Despite the June 2013 price increase, the budget allocation to fuel subsidies for 2014 is Rp 211 trillion (or 2.0 percent of GDP), up Rp 11 trillion over the 2013 revised budget, since the weaker rupiah over the second half of 2013 pushed up fuel costs. Fuel subsidies and institutional constraints also continue to impede improvements in the composition of spending. Capital spending is targeted to reach Rp 206 trillion in 2014, up 9.3 percent from the 2013 allocation but flat relative to GDP, at 2.0 percent, and enhancing the ability to execute high-quality infrastructure investments, by both the public and private sector, will be necessary to make major inroads into Indonesia's significant infrastructure gap.

**The key reasons for the uncertainty of the near-term forecast are the difficulty of quantifying the impact of parliamentary and presidential elections (in April and July, respectively), and the difficulty in predicting how consumer and investor sentiment will continue to respond to significant, ongoing economic and policy adjustments, including monetary policy transmission.** Much also depends on the future course of external demand from key trading partners such as China and the United States, international commodity prices, and external financing conditions, particularly in the context of Indonesia's significant gross external financing needs, including US$25.7 billion in external debt repayments from January to September 2014 (according to Bank Indonesia).

**Indonesia's macroeconomic policy settings, interest rates, and the exchange rate, have adjusted significantly since mid-2013 to changes in the external environment. Economic growth is moderating, and in the base case this is projected to stabilize at a pace that is still solid but more commensurate with available current account deficit financing in the context of tighter global liquidity conditions.** The challenge is to supplement the recent, necessary focus on near-term macroeconomic adjustment and stability with more measures to lift the sustainable rate of growth, to ensure that Indonesia capitalizes on powerful, positive structural factors, such as its large young and increasingly urban and middle-class population, and rich natural resource endowment.

**Concerted effort will be required to overcome supply-side constraints, notably by addressing the infrastructure and skills gaps, and by supporting high-quality private investment, including foreign investment.** However, the government's recent business regulation measures send mixed signals and reveal contradictory aspirations. On the one hand, a comprehensive action plan to address the regulatory environment for small and medium enterprises, announced in October 2013, strongly signals a willingness to address some key weaknesses in the business environment. On the other hand, a large number of sector-specific laws and measures announced recently are either inconsistent with previous laws or create confusion about the direction of investment climate reforms in Indonesia, notably including in the mining sector.

<INSERT IDN COUNTRY TABLE>

## Lao People's Democratic Republic

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| | |
|---|---|
| Population | 6.6 million |
| Population growth | 1.9 percent |
| GDP (PPP, int'l US$) | 19.1 billion |
| GDP per capita (PPP, int'l US$) | 2,879 |
| Surface area | 236,800 sq. km. |
| Capital | Vientiane |

*Source: World Development Indicators.*

### Summary

**Economic growth is projected to moderate to 7.2 percent in 2014, reflecting a projected slowdown in some real sectors, in particular due to slowed activity in the resource sector.** Key growth drivers in the year ahead are expected to come from services, food processing, and beverages, supported by continued strong domestic demand, as well as the construction sector and related spillovers. The resource sector is expected to provide a smaller direct contribution to growth in 2014 because new commercial operations of major power projects are not expected, and due to a halt in gold mining at a key mining operation in the country. Inflation over the last year has been largely driven by food price inflation, but more recently seems to show signs of a slight slowdown. After a sharp expansion in the fiscal deficit in FY12/13 resulting from substantial increases in the public sector wage bill, the fiscal deficit in FY13/14 is expected to narrow somewhat. The final outturn, however, will largely depend on revenue performance through the year and on close management of spending items. In an effort to curb the enlarged fiscal deficit, the government has suspended some benefits paid to public officers in an attempt to slow spending increases in FY13/14. This has been offset, however, by further increases in the base multiplier against which civil service salaries are calculated. With sustained domestic demand and accommodative macroeconomic policies in 2013, reserves and net foreign assets substantially declined in the year to November 2013, leaving the country with very thin buffers against adverse shocks. To help address the issue, the Bank of Lao PDR recently issued regulations to regulate foreign currency lending.

### Recent Economic Developments

**Growth is projected to moderate to 7.2 percent in 2014, reflecting a projected slowdown in some real sectors, mainly mining and construction.** Key growth drivers are expected to come from services (wholesale and retail, transportation, and telecommunication), and food processing and beverages, supported by continued strong domestic demand and robust activity in the construction and construction-related industry. The resource sector is expected to provide a smaller direct contribution to growth in 2014, since new commercial operations of major power projects are not expected, and the halt in one of the gold mining operations is likely to offset some gains due to higher-than-expected copper production.

**Overall inflation was driven primarily by food inflation throughout 2013.** The headline inflation rate in 2013 averaged 6.4 percent compared to 4.3 percent in 2012. This was due to fast-growing meat prices earlier in the year associated with a mismatch in local demand and supply conditions, and followed by a pickup in rice prices in the second half, which is broadly in line with strengthening of glutinous rice prices in Thailand. Food price inflation has decelerated since the peak of 14.5 percent in July 2013 but remained high at around 11 percent in January 2014. Energy inflation has remained negative while core inflation moderated slightly in January.

**After a sharp expansion in the fiscal deficit in FY12/13 resulting from substantial increases in the public sector wage bill, the FY13/14 budget plan indicates a narrower fiscal deficit.** However, the actual budget outturn will depend on the ability of the authorities to achieve an unusually strong performance in revenue collection and on maintaining tight control over spending across categories. As a ratio to GDP, overall spending is projected to moderately decline from 24.9 percent to 23.6 percent in FY13/14. Spending remains high, however, because of a combination of a further 40 percent increase in the public sector wage index and new recruitment, despite cuts in benefits to civil servants and capital spending. Moreover, the deficit as measured on a cash basis could be higher and as much as 6 percent of GDP (above the FY12/13 level) if arrears such as unpaid wages carried over from FY12/13 are included.

**On the revenue side, authorities are focusing on strengthening revenue administration as part of efforts to manage the expanded fiscal deficit.** Total revenue to GDP is projected to rise slightly from 19.1 percent to 19.3 percent in FY13/14. However, the contribution of mining revenues remains uncertain due to projected lower commodity prices and lower total gold production in 2013–14, despite an expected increase in copper output over the same period. Continued efforts to raise revenue from nonresource sectors will remain a significant challenge. The large outlays on public sector wages are also expected to put continued strain on the government's cash position, and will require careful monitoring and control of all expenditure, across government levels and agencies.

**The risk of debt distress remains moderate.**[1] Although all external debt distress indicators remain below the policy-dependent indicative thresholds during the period of projection under the baseline scenario, the thresholds are breached under certain shocks. The nominal stock of external public and publicly guaranteed (PPG) debt rose from US$3.7 billion at end-2011 to US$4.2 billion at end-2012, mainly due to a rapid increase in borrowing from China and Thailand. As a result, the ratio of PPG external debt to GDP increased from 44.8 percent to 46.1 percent in 2012, while the net present value of PPG rose from 29.8 percent of GDP to 32.5 percent over the same period. Nonconcessional borrowing has also risen, from a low base, due to state-owned enterprises and government borrowing to finance equity stakes in hydropower projects. More recently, government bonds were issued in the Thai market in May 2013 in the amount of US$50 million (about 0.5 percent of 2013 GDP) and again in December 2013 in the amount of US$100 million, to finance the general public investment program. Debt service ratios remain within the policy-dependent indicative thresholds mainly due to the high level of concessionality of official borrowing, although the share of concessional loans has started to decline—a trend which is expected to continue in the future. Therefore, strengthening fiscal and debt management capacity is of crucial importance.

**While the Bank of Lao PDR maintains nominal exchange rate stability of the Lao kip against major currencies, foreign exchange policy should give more consideration to reserve management and competitiveness.** In nominal terms, the kip depreciated 0.5 percent against the U.S. dollar during 2013 while it appreciated against the Thai baht by about 5.7 percent over the same period, as the baht weakened against the U.S. dollar in the wake of political turmoil in Thailand. The effective exchange rate appreciated by 2 percent in nominal terms and by 5.5 percent in real terms during January–November 2013. The continued real appreciation of the exchange rate implies a deterioration of competitiveness for Lao PDR's tradable exports, which exacerbates pressure on the external balance.

**Foreign exchange reserves and net foreign assets continued to fall during the year to November 2013.** Reserves were recorded at US$550 million in November, down by 22 percent year-on-year (yoy) while net foreign assets declined by 63 percent yoy. A widened current account deficit fueled in part by accommodative fiscal and monetary policies and a continued real appreciation of the exchange rate have contributed to the pressures on the overall external balance and foreign reserves. Reserves coverage is

[1] According to the 2013 Joint International Monetary Fund-World Bank Debt Sustainability Analysis.

expected to reach the lowest level in a decade with only 1.3 months of goods and services imports. The declining reserve buffers raise concerns over the country's resilience in absorbing any adverse shocks. In response, the Bank of Lao PDR recently issued an instruction to discourage lending in foreign currencies to businesses that have insufficient foreign currencies earnings and to limit cash withdrawals from foreign currency accounts. The effect of these measures remains to be seen.

**Domestic banking credit growth has slowed somewhat but remained high to November 2013.** Credit grew at 32.4 percent yoy, driven mainly by private sector credit, which grew by about 36 percent yoy in the same period. This trend has primarily come about from broadly accommodative policy—both monetary and structural banking policy—in the face of buoyant growth in demand for credit in the construction, commerce, and service sectors. Broad money growth was slightly slower at 23 percent yoy in November 2013 due to slower growth in deposits.

**Outlook and Emerging Challenges**

**In the near term, meeting the expansionary spending principally associated with continued public sector wage increases will depend largely on the revenue performance and the careful management of public expenditures across budgetary items.** Despite the suspension of benefits paid to civil servants (introduced in FY12/13), underlying wages continue to increase as does the aggregate number of civil servants, keeping overall spending relatively high. Wages and benefits (after the suspension of new benefits) are expected to account for about 62 percent of recurrent expenditure in FY13/14 and 65 percent of nonresource domestic revenue—one measure of stable revenue sources on which to fund stable, hard-to-compress spending. The implementation of further increases in public wages per the initial three-year plan implies a further sizable increase in the wage bill (in absolute and relative terms) in FY14/15, which will require exceptionally strong revenue measures, or harsh spending cuts in other categories. Faced with such a choice, a reassessment of the structure and affordability of civil service pay and compensation has become a new priority for the government.

**With regard to prospects for longer-term inclusive growth, shortages of labor, especially skilled labor, has emerged as one of the top investment climate constraints in Lao PDR and is a potential hindrance to nonresource sector growth.** Businesses, particularly in the manufacturing and services sectors, are reporting difficulty in finding labor (even unskilled labor) due to demand and supply mismatches, relatively high labor turnover, and migration. In an economy where the majority of people are engaged in subsistence and low-productivity agriculture, the structural transformation that will underpin development is likely to require a significant shift in population out of agriculture. The government is working on updating its Human Resource Development Strategy, which will provide an important framework for education and labor market development going forward.

<INSERT LAO COUNTRY TABLE>

## Malaysia

<insert map>

| | |
|---|---|
| Population | 29.2 million |
| Population growth | 1.7 percent |
| GDP (PPP, int'l US$) | 494.7 billion |
| GDP per capita (PPP, int'l US$) | 16,919 |
| Surface area | 330,800 sq. km. |
| Capital | Kuala Lampur |

*Source: World Development Indicators.*

### Summary

Domestic drivers of growth started to moderate in 2013, leading GDP growth to decline from 5.6 percent in 2012 to 4.7 percent in 2013. Green shoots of recovery in the external sector supported economic expansion in the second half of the year and prevented a more significant slowdown. Domestic activity faces growing headwinds in 2014 from fiscal consolidation, higher inflation, and tighter credit conditions. Malaysia's near-term growth outlook will therefore hinge on the ability of the external sector to take advantage of the recovery in advanced economies. In particular, expanding productive capacity for manufacturing exports, mainly electrical and electronics (E&E) manufacturing, will be critical to sustain the growth momentum. Meanwhile, the central bank has signaled that it is keeping a guarded watch on potential financial imbalances emanating from a prolonged low interest rate environment domestically (the policy rate has remained at 3 percent since mid-2011), the implications of the normalization of monetary policy globally, and price pressures as a result of subsidies rationalization. The fiscal outlook is expected to remain on an improving trend, driven by concrete measures announced for 2014 (subsidy rationalization) and 2015 (introduction of a goods and sales tax).

### Recent Economic Developments

GDP growth recovered in the second half of 2013 from a soft patch in the first half (H1 2013: 4.3 percent; H2 2013: 5.1 percent), and ended the year on a high note (Q4 2013: 5.1 percent, 8.6 percent on a sequential, Seasonally Adjusted Annual Rate [SAAR] basis). While domestic demand, especially household consumption and public investments, continued to moderate, green shoots in external demand helped lift the economy. Of note, E&E manufacturing, which is targeted for export markets, expanded in the third and fourth quarters after 11 consecutive quarters of contractions (Q3: +5.3 percent; Q4: 13.1 percent, year-on-year).

Despite a buoyant job market characterized by rising employment and wages, the weak performance of agricultural commodities along with the effects of fiscal consolidation and slower credit growth led household consumption expenditure to contract by 3.9 percent on a sequential basis (quarter-over-quarter (qoq), SAAR) in the fourth quarter of 2013, the lowest sequential growth rate since mid-2009. Lower prices and output in agriculture (especially palm oil and rubber) likely affected consumption by smallholder households, while the government's efforts to reduce its budget deficit through subsidy cuts and lower bonuses for civil servants were also a drag on consumption. Credit growth also moderated, as the Central Bank's macroprudential policies tempered further increases to the already high household debt (87 percent of GDP).

Although robust for the year as a whole, investment growth also slowed given the high base in 2012, the uncertainties around elections in May, and the volatility induced by tapering talk. Public investment slowed significantly (up only 0.7 percent from 2012) driven primarily by a further contraction in capital spending by the federal government, but also by the completion of several large projects by nonfinancial public enterprises. Following a strong performance in the previous eight quarters, private investment contracted on a sequential basis in the second half of 2013 (-4.0 percent qoq SAAR in H2 compared to +11.2 percent qoq SAAR in H1). On a year-on-year basis, gross fixed capital formation decelerated from 19.9 percent in 2012 to 8.2 percent in 2013.

The external sector turned around toward the end of the year as global demand conditions improved. Export growth turned positive in the third quarter after a full year of negative outturns. Reflecting growth in E&E exports and an expansion of petroleum storage activities, exports accelerated in the fourth quarter despite weak performance in the mining and agricultural sectors. These same developments also led to an acceleration of intermediate and energy imports. Overall, the trade balance marginally improved, and net trade was less of a drag on growth in 2013 compared to 2012.

Despite the improvement in trade indicators in the second half of the year, the current account posted its smallest annual surplus in 15 years in 2013 (3.8 percent of GDP compared to 6.1 percent in 2012). On a quarterly basis, the current account surplus and steady FDI inflows were insufficient to offset short-term capital outflows, and as a result the overall balance of payments recorded a deficit of RM 2.9 billion in the fourth quarter, although still a surplus for the year (RM 14.5 billion compared to RM 3.9 billion in 2012).

Fiscal policy became less accommodative as the government continued to reduce the budget deficit through solid revenue performance and some spending offsets to sharply higher expenditure on subsidies. Operating (current) expenditures are estimated to have exceeded their 2013 budget allocations by RM 14.9 billion (7.4 percent), mainly due to higher spending on subsidies. The government nonetheless slightly outperformed its headline deficit target for 2013 (3.9 percent of GDP compared to a 4.0 percent target and 4.5 percent in 2012). Revenues exceeded budget projections by RM 11.8 billion, although of this amount, RM 5.6 billion would normally be considered financing items. The government has also continued to spend below the budget (by RM 3.2 billion) on development (capital) expenditures. Wages were expected to increase by only 2.7 percent in 2013, the lowest annual growth rate in the last 10 years, which helped offset a surge in subsidy spending, resulting in overall lower growth in total current expenditure, down to a modest 5 percent in 2013 compared to 12.6 percent in 2012.

Consumer price inflation accelerated from an average of 1.7 percent for the first eight months of 2013 to 2.9 percent in September–December, driven in large part by the cuts to subsidies on gasoline and diesel fuel. Food inflation during the period accelerated to 4.1 percent, while tobacco prices increased in October due to a 14 percent hike in excise duties. Core inflation (excluding food, beverages, and energy) also picked up in the last two months of 2013 but from very low levels, rising to 1.4 percent in November and 1.5 percent in December, up from a 10-month average of 1.0 percent. Producer Price Index inflation, which had been negative for the 16 consecutive months, turned positive in October, likely due to the increase in diesel prices. Strong wage growth of 6.9 percent, in part from the implementation of the minimum wage, did not appear to have been passed through to prices in 2013, but adds to price pressures in 2014, although supply-side conditions appear benign with commodity prices stable.

Monetary authorities emphasized macroprudential regulation as the policy stance continued to be pulled in two directions. Ongoing risks to the global economy, low inflation, and some moderation in domestic demand and credit growth offset concerns about possible second-round effects from subsidy cuts and the minimum wage implementation, as well as high levels of household indebtedness and rising property prices despite significant supply growth. These countervailing forces have led policy makers to keep policy rates unchanged since July 2011. Recently, however, the central bank signaled that the balance of risks to inflation might tilt to the upside in the medium term as global economic conditions improve in 2014 and fiscal consolidation continues apace. The financial system remains healthy in the face of ongoing rebalancing of global portfolios, with capital reserve levels well above statutory requirements, low levels of impaired loans (below 2 percent), significant liquidity in the domestic financial markets, and comfortable external reserves to accommodate further outflows.

**Outlook and Emerging Challenges**

As the advanced economies continue to recover, Malaysia's external position looks set to improve in 2014, with export growth projected to pick up to 5.8 percent from a contraction of 0.3 percent in 2013. Export growth should also be supported by higher energy commodity and petrochemical production, as new investments come online. Furthermore, Malaysia's E&E exports have begun to show signs of improvement after nearly three years of contraction. This soft recovery in the external sector provides room for the government to continue rebuilding its domestic buffers through prudent fiscal policy, including a transition of broad-based subsidies toward targeted transfers and broadening of the tax base through introduction of a goods and services tax in 2015. This shift toward external demand is expected to keep growth robust at 4.9 percent in 2014 and 5.0 percent in 2015.

The outlook for the Malaysian economy faces downside external and domestic risks. External risks include renewed weakness in the global economy, especially slower growth in China, a sharp decline in commodity prices and, to a lesser extent, further volatility in global capital markets leading to capital outflows. Domestic risks include larger-than-expected second-round effects from fiscal and credit tightening on domestic demand, and especially a resumption of weak export performance due to supply constraints. A more decisive improvement in advanced economies, however, combined with a second wind to Malaysia's investment boom attracting high-tech manufacturing and knowledge-intensive FDI, could boost growth rates above 5 percent into the medium term. The implementation of the very large Refinery and Petrochemical Integrated Development (RAPID) Project by PETRONAS, Malaysia's national oil company, in 2014, also presents a near-term potential upside for growth, estimated at some 0.3 to 0.5 percentage points.

<INSERT MYS COUNTRY TABLE>

## Mongolia

<insert map>

| | |
|---|---|
| Population | 2.8 million |
| Population growth | 1.5 percent |
| GDP (PPP, int'l US$) | 15.0 billion |
| GDP per capita (PPP, int'l US$) | 5,374 |
| Surface area | 1,564,120 sq. km. |
| Capital | Ulaanbaatar |

*Source: World Development Indicators.*

### Summary

**Mongolia's economy recorded another period of double-digit growth in 2013.** The high economic growth was due to stronger mineral production led by the start of production in the Oyu Tolgoi mine and the government's stimulus policy. Expansionary fiscal policies created an additional off-budget deficit of 9 to 10 percent of GDP on top of the official budget. Monetary policy turned accommodative in 2013, injecting fresh liquidity equivalent to 20 percent of GDP into commercial banks through policy lending programs. The high economic growth buoyed by a policy stimulus was accompanied by rising inflation and growing external imbalances. Inflation accelerated to 12.5 percent at end-2013, while the current account deficit reached 28 percent of GDP. In light of the growing economic imbalances, the primary objective of economic management should be to restore macroeconomic stability, sustainable fiscal policy, and an adequate level of international reserves. Continuous efforts are needed to restore strong and stable foreign capital inflow.

### Recent Economic Developments

**Mongolia's economy recorded another period of double-digit growth of 11.7 percent in 2013, led by stronger copper and gold production.** The economy grew 12.3 percent in the fourth quarter of the year, a slight pickup from 11.9 percent in the third quarter. Accelerating growth in mineral production—amidst the ramp-up of copper and gold production in Oyu Tolgoi (OT) mine—led the double-digit growth of the economy. Mineral GDP growth picked up to 33.8 percent in the second half of the year from 6.1 percent in the first half, registering 20.7 percent annual growth. Mineral GDP accounted for 18.5 percent of total economic output in 2013. Nonmineral GDP growth also remained double digit, buoyed by economic stimulus measures, driven by strong growth in construction (66.5 percent year-on-year) and wholesale and retail (17 percent year-on-year). The robust nonmineral growth was led by large off-budget public infrastructure spending through the Development Bank of Mongolia (equivalent to 9 to 10 percent of GDP) and subsidized lending programs by the Bank of Mongolia (equivalent to 20 percent of GDP).

**Economic policies have been focused on growth stimulus through large off-budget spending and loose monetary policy.** Fiscal policy remained highly expansionary in 2013 due to continued off-budget spending through the Development Bank of Mongolia (DBM). The structural budget deficit was kept under the 2 percent ceiling of the Fiscal Stability Law. However, a large portion of capital expenditure—which was carried out through the DBM—remained outside the official budget, which is estimated to be around 9 to 10 percent of GDP. Monetary policy also turned accommodative in 2013, through large subsidized lending programs of the central bank. The central bank continued its policy lending programs including the Price Stabilization Program and low-interest-rate mortgage lending, injecting 3.4 billion Tog into commercial banks over the year. Outstanding central bank lending to commercial banks reached 24 percent of GDP at end-2013.

**National headline inflation has been accelerating since July, reaching 12.5 percent (year-on-year) in December 2013 and 12.3 percent in January 2014.** The price level has been under mounting pressure from expansionary economic policies throughout the year as the central bank implemented aggressive monetary easing programs to spur economic growth. Core inflation—which largely reflects demand-side pressure—increased to 12.7 percent in December 2013 from 7.7 percent in June, the highest level over the last two years.

**The annual current account deficit in 2013 was US$3.2 billion—equivalent to 28 percent of GDP—following the deficit of US$3.4 billion in 2012.** The large current account deficit continued over the last three years as mineral export growth stagnated, while the adjustment of imports was limited due to continuous policy stimulus and slow adjustment of the real exchange rate. Total exports declined by 2.6 percent from a year ago, due to a 41 percent drop in coal exports. As the foreign capital inflow dropped in 2013, the large current account deficit posed a significant challenge to the economy due to a widening gap in the balance of payments. The net foreign capital inflow (US$1.5 billion) in 2013 slowed considerably from the previous year (over US$4.9 billion), reflecting a drop in FDI of nearly 50 percent from US$4.4 billion to US$2.3 billion.

**The large financing gap in the balance of payments has led to a continuous decline in international reserve levels and a sliding exchange rate throughout the year.** The gross international reserves of the central bank fell over 47 percent during the year to US$2.2 billion in December 2013, from its peak of US$4.1 billion a year ago. The local currency depreciated 24 percent since July 2013 through February 2014. The slide in local currency value was also fed by loose monetary policy and weak confidence in the local currency amidst the diminishing foreign capital inflow.

**Outlook and Emerging Challenges**

**In 2014, economic policies are likely to repeat the expansionary path of the last year in light of continued political emphasis on double-digit economic growth.** Off-budget spending through the DBM will remain the main financing vehicle for many infrastructure projects, bypassing the control of the Fiscal Stability Law. It would likely create an additional budget deficit of 7 to 8 percent of GDP on top of the official budget. Monetary policy will also likely remain loose, including the Price Stabilization Program and the politically popular housing mortgage program.

**Continued economic stimulus relying on external borrowing and liquidity injection will likely add to economic imbalances.** Underlying inflationary pressure is high since the rising cost of imported goods has been only partially reflected in retail prices due to the price control of the central bank. The international reserve level and exchange rate will likely remain under continued pressure from the large gap between the current and financial/capital accounts. The objective of economic management at the current stage should be to ensure a stable and sustainable growth path, minimizing the possibility of boom-bust cycles and addressing the balance-of-payments situation. The immediate policy priority is to counter rising balance-of-payments pressure and inflation through regaining foreign capital inflow and tighter economic management.

<INSERT MNG COUNTRY TABLE>

## Myanmar

<insert map>

| | |
|---|---|
| Population | 52.8 million |
| Population growth | 0.8 percent |
| GDP (PPP, int'l US$ billions) | .. |
| GDP per capita (PPP, int'l US$) | .. |
| Surface area | 676,590 sq. km. |
| Capital | Nay Pyi Taw |

*Source: World Development Indicators.*

### Summary

**The Myanmar economy continues to be strong and the economic outlook remains positive.** Real growth in 2012/13 reached 7.3 percent and is projected to increase further to 7.5 percent in 2013/14. Average price inflation in 2012/13 was very low at 2.8 percent but projected to accelerate to 5.8 percent in 2013/14. The rate of nominal market exchange rate (end-of-period) depreciation therefore increased from 6 percent in 2012/13 to an estimated 12 percent in 2013/14. Weaker-than-expected revenue performance in 2013/14 led to an increase in the overall fiscal deficit to 4.9 percent of GDP, from 3.9 percent of GDP the previous year. While gross international reserves continue to accumulate, the portion under the direct control of the central bank is not adequate to ensure macroeconomic stability. At least five months of imports are needed. The current account deficit is projected to widen to 4.8 percent of GDP in 2013/14, mainly due to a continued surge in imports in response to the relaxation of many restrictions in 2012/13. Following the resolution of arrears to bilateral and multilateral creditors, Myanmar has recently been classified as being at low risk of debt distress by a joint World Bank-International Monetary Fund Debt Sustainability Analysis. The continuing reform momentum points to a positive outlook in the short to medium term, although two key challenges will be the capacity of the government to remain focused on the economic agenda in the run-up to the 2015 elections, particularly with regard to managing consumer price inflation, and building the stock of central bank reserves.

### Recent Economic Developments

**Real growth in 2012/13 reached 7.3 percent and is projected to increase further to 7.5 percent in 2013/14, driven mainly by gas production, construction, and services. Gas exports are estimated to have reached US$3.7 billion in 2012/13 and US$4.3 billion in 2013/14, surpassing the 2011/12 record of US$3.5 billion.** In the services sector, growth was strong in the tourism and financial sectors. The economy also showed strong performance in other areas. Foreign direct investment grew from 3.7 percent of GDP in 2011/12 to 5.0 percent in 2012/13 and an estimated 4.4 percent of GDP in 2013/14. Most of this investment was in the energy sector, garment industry, information technology, and food and beverages. In agriculture, rice production in 2012/13 declined slightly due to flooding in some areas and drought in others, but exports doubled to 1.4 million tons. This was due to a significant increase in exports to China, where demand for imported rice surged after the introduction of a government price support scheme saw domestic rice prices increase from US$272 per ton in 2010 to US$421 in 2013. The high rice prices are driving farmers to switch out other crops in favor of rice. Rice exports for 2013/14 are expected to reach approximately the same volume. In 2014/15, real GDP growth in Myanmar is projected at 7.8 percent due to continued strong growth in construction, services, and foreign investment.

**Average price inflation in 2012/13 was very low at 2.8 percent but accelerated to 5.8 percent in 2013/14 following flooding and a large increase in the stock of money.** Year-on-year inflation rates, which had been close to zero throughout most of 2012, began to accelerate in August 2012 following the pass-through of an earlier depreciation in the market exchange rate between May and July and reached 6.0 percent by the end of the calendar year. Inflation continued to accelerate in 2013, reaching a peak of 7.3 percent by August 2013 before slowing somewhat in the following months. The price increases were most visible in food, housing rental costs, and fuel. Broad money is estimated to have grown by almost 46.6 percent in 2012/13 and an estimated 37.4 percent in 2013/14. Most of the growth in 2012/13 was due to a revaluation of foreign currency deposits following the introduction of a managed float exchange rate regime. By contrast, in 2013/14, the accumulation of reserves, credit to the private sector, and credit to the government were each major contributors to monetary growth. Commercial bank lending to the private sector grew by 50.5 percent in 2012/13 and 45.8 percent in 2013/14. The stock of broad money is forecast to expand by almost 27 percent in 2014/15, with period average inflation reaching 6.6 percent driven by increased electricity tariffs and demand.

**The rate of nominal market exchange rate (end-of-period) depreciation increased from 6 percent in 2012/13 to an estimated 12 percent in 2013/14.** Monthly market exchange rate movements showed a burst of depreciation in May through August 2012 followed by a second burst between April and June 2013. The exchange rate subsequently stabilized at a rate just under 1,000 kyats per U.S. dollar during November 2013 through March 2014. Some of this stability came at the expense of the stock of official reserves: the central bank sold a large volume of reserves in November and December 2013 in the face of increased demand for foreign exchange. Central bank reserves at the end of 2013/14 are expected to be only 2.8 months of imports.

**Weaker-than-expected revenue performance in 2013/14 led to an increase in the overall fiscal deficit to -4.9 percent of GDP, from -3.9 percent of GDP the previous year.** This outcome was the consequence of a drop in revenues of 1 percentage point of GDP; the expenditure share of GDP remained constant. All of that loss can be traced to lower-than-expected receipts from state economic enterprises. While the expenditure share of GDP did not change, the composition did. One percentage point of GDP was shifted from expenditures on capital to recurrent goods and services. The 2013/14 deficit was financed by 1.1 percent of GDP in net external financing and 3.3 percent of GDP in net domestic credit and 0.5 percent of GDP in nonbank and other financing sources. The fiscal deficit in 2014/15 is forecast to fall to -4.5 percent of GDP due to expected large one-off revenues from telecommunication licenses. Early indications are that both recurrent and capital allocations would increase and the expansion in shares allocated to health and education initiated in 2012/13 would be continued into 2014/15.

**The external current account deficit is estimated to have widened to around -4.8 percent of GDP in 2013/14, up from -4.4 percent in 2012/13.** The widening of the current account deficit is mainly due to increased net outflows in net services by an estimated US$409 million: the trade balance improved by approximately US$75 million. Gross international reserves are estimated to have increased to US$4.9 billion in 2013/14. The growing reserves indicate that the current account deficit is more than covered through capital account inflows. Yet, as mentioned above, the portion of reserves under the direct control of the central bank, US$4.1 billion or 2.8 months of forward imports, will need to be further increased to at least five months of forward imports to fully ensure macroeconomic stability. External account movements in 2014/15 will mirror those of 2013/14 with a narrowing trade deficit, increased services outflows, and a continued build-up of reserves. The current account balance in 2014/15 is forecast to widen again to -5.1 percent of GDP.

**Following the resolution of arrears, total external debt ended at 19.0 percent of GDP in 2013/14, and a recent World Bank-International Monetary Fund Debt Sustainability Analysis assessed Myanmar as being at low risk of debt distress.** In January 2013, arrears to multilateral institutions (the World Bank and the Asian Development Bank) amounting to US$932 million were cleared, while an agreement was reached on the resolution of the US$10 billion arrears to Paris Club creditors, which included a 50 percent write-off of arrears and restructuring of the remainder. This has resulted in a decline in Myanmar's total external debt, from 27.3 percent of GDP in 2011/12 to 24.2 percent in 2012/13 and 19.0 percent in 2013/14. Further, a recent World Bank-International Monetary Fund Debt Sustainability Analysis concluded that Myanmar was at low risk of debt distress.

**Outlook and Emerging Challenges**

**The outlook remains positive in the short to medium term, but there are also challenges, particularly on the political front.** Gas production is expected to increase significantly, with new fields coming onstream driving export volumes up by 21.1 percent in 2013/14 and 35.5 percent in 2013/13. Many development partners, including the World Bank, are likely to ramp up their support to Myanmar following progress in the country's reengagement process with the international community. Further, opportunities for increased exports recently improved with the reinstatement of trade preferences to Myanmar under the European Union's (EU's) Generalized System for Preferences for least-developed countries, which will give Myanmar duty- and quota-free access to the EU market for all its exports, except arms and ammunition. The continued momentum for economic reforms is expected to result in higher foreign investment and trade. Significant recent reforms include the enactment of a new Central Bank Law that provides for a more autonomous Central Bank, further progress on exchange rate unification by phasing out Foreign Exchange Certificates, the award of licenses to two foreign mobile telephone service providers, and the passage of a new telecommunications law. However, as in most countries,  a likely challenge in the coming months will be the capacity of the government to remain focused on the economic reform agenda in the run-up to the elections of 2015.

<INSERT MYR COUNTRY TABLE>

## Papua New Guinea

<insert map>

| | |
|---|---|
| Population | 7.2 million |
| Population growth | 2.2 percent |
| GDP (PPP, int'l US$) | 20.4 billion |
| GDP per capita (PPP, int'l US$) | 2,851 |
| Surface area | 462,840 sq. km. |
| Capital | Port Moresby |

*Source: World Development Indicators.*

### Summary

**The slowdown in Papua New Guinea's (PNG's) economy that started in late 2012 continued through 2013.** The slowdown reflects weaker commodity prices and production continuing to weaken domestic demand, while the PNG LNG (Liquefied Natural Gas) and smaller construction projects moved toward completion, without being replaced by a new series of investment spending. The government, however, has continued to accelerate spending, which has outpaced revenue growth, leading to expanding fiscal deficits and financing needs, largely met through domestic sources. The 2014 budget allocated the bulk of the additional spending to rehabilitating and building capital projects across the social sectors, with smaller increments to develop the ongoing capacity of the public sector. It also relaxed the medium-term fiscal strategy, shifting from a projection of budget balance by the end of the forecast period to a projection of ongoing deficits, amplifying risks that the limits on public debt in the medium-term debt strategy may be exceeded. After the exchange rate's sharp depreciation against most currencies though October 2013 and slower depreciation through February 2014, the decline in foreign exchange reserves has continued, suggesting ongoing balance-of-payment pressures.

### Recent Economic Developments

**Papua New Guinea's economic growth slowed to around 4 percent in 2013, the slowest rate since 2006.** Activity stabilized across most of the nonresource economy, due to the ongoing effects of weaker commodity prices and as various construction projects progressed toward completion, most notably the PNG LNG investment. The start of production at a nickel and cobalt mine provided some support to overall activity. The retreat in international commodity prices in 2012 and the first part of 2013 plus various production shocks continue to drag rural incomes, although the weaker kina provided some support. Since late 2012, private sector operators have reported poorer conditions, with turnover lower than a year or two earlier, new investments delayed, and some current production facilities being closed. The government argues that its deficit-financed 23 percent real increase in budgeted spending in 2013 would offset some of these external and domestic weaknesses. However, domestic firms are yet to report any significant support from this spending.

**Kina prices for all of Papua New Guinea's soft commodity exports were below their five-year average through 2013, before rebounds in some key prices in early 2014.** Agriculture production, including subsistence activities, is the key income source for the majority of Papua New Guineans, and grew by only 0.5 percent in 2013, after contracting by 1.6 percent in 2012. Export volumes of coffee over the four quarters to the June quarter 2013 were down by half compared with a year earlier, and cocoa exports were 30 percent lower. The low volumes, combined with lower prices, reduced the kina value of coffee and copra exports by almost two-thirds and cocoa exports by 40 percent, despite the support to kina receipts from the currency's depreciation. Palm oil has performed better, and while export volumes have weakened since the peaks of 2011, they are still 10 percent above longer-term averages.

Bank lending accelerated into mid-2013. Growth in lending to businesses and households jumped to 22 percent in the year to June 2013, compared with average annualized growth of 2.5 percent during the previous two years, and growth was broad based. Anecdotally, lenders reported that much of the increased demand for credit is from customers who had in recent years financed investments and working capital through retained earnings and cash flow. Since late 2012, as profitability and cash flow have been compressed, these businesses have turned to banks for financing. The central bank did not adjust its various policy instruments between September 2013 and February 2014, and short-term interest rates were stable.

**The Papua New Guinean kina (K) stabilized from October to February, after sharply depreciating over the previous year, with continuing support from the central bank through the sale of foreign exchange reserves.** By early March 2014, the kina was over 26 percent below its level of 12 months earlier, although the exchange rate had broadly stabilized since October 2013. The extent to which this stabilization reflects underlying transactions as opposed to further intervention by the central bank is unclear due to lack of data. The most recent foreign exchange reserve figures for January 2014 show that reserves fell by US$200 million since September 2013 to US$2.8 billion.

**Government revenues in 2013 were only modestly lower than budget forecasts, notwithstanding sharp downward adjustments to assumed export prices.** For example, average prices in 2013 of gold revised down US$280 to US$1,409 per ounce; copper prices revised down US$809 to US$7,238 per ton. The government expects stronger domestic tax receipts (notably, goods and services tax receipts and personal income taxes), achieved through improved collections and compliance to partially offset the impact of weaker commodity prices, despite the reports of lower turnover and worsening labor market conditions across the economy. In contrast, its spending exceeded budgeted levels, due to overruns in payments for personnel administered by provincial governments. The government expects to fully disburse its expanded development budget, despite significant delays in the first half of the year and the usual lags in preparing more complex projects of the type included in the 2013 budget. Overall, weaker revenues and stronger spending raise the government's projection of its deficit toward 8 percent of GDP.

**The 2014 budget presents larger deficits for 2013 and 2014, reflecting strong expenditure growth outpacing ambitious revenue targets.** After accounting for financing transactions relating to the state's PNG LNG equity and various adjustments to spending, the budget deficit rose from 1.5 percent of GDP in 2012 to 7.0 percent in 2013, and is expected to rise to at least 7.8 percent of GDP in 2014. The budget also loosens the government's medium-term fiscal strategy 2013–18, although it maintains the medium-term debt strategy's targets. Rather than targeting a balanced budget by 2017, the government is now projecting deficits below 2 percent of GDP by the end of its forecast horizon (2018), and a slower pace of deficit reduction. However, it has affirmed its commitment to its medium-term debt strategy targets, of 35 percent of GDP in 2014 and 2015 falling to 30 percent of GDP from 2016, and debt including contingent and other off-balance-sheet liabilities remaining below 50 percent of GDP.

**The government budgets spending 18.4 percent more in 2014 than in 2013, following almost 30 percent nominal spending growth in 2013.** It then projects real per capita spending to decline after 2014. The 2014 budget again allocates 30 percent more resources to capital, despite the ongoing difficulties in implementing the existing capital budgets. These funds have generally been allocated to building or rebuilding roads and airports, and to rehabilitating hospitals and educational facilities. There is notable additional spending for education, although most of the additional funds will be used to keep pace with the growth in enrollments following the introduction of the tuition fee subsidy policy. K 372.6 million (37 percent) of additional funding for health is largely for the rehabilitation and development of various hospitals around the country. A larger share of the K 273.4 million (27 percent) of additional funds for law and order is allocated to building staff capacity. The transfers to provinces, districts, and local-level governments under the respective service improvement programs that were increased substantially in the 2013 budget are maintained in 2014 (at K 5 million to each province, K 10 million to each district, and K 0.5 million to each local-level government). Further directions have been provided on how these grants can be used, with prescribed shares to be spent on education, health, and other services, although it is unclear how effectively these allocations can be enforced.

**Outlook and Emerging Challenges**

**Lower international commodity prices have been the key factor weakening activity across Papua New Guinea's economy, and the decline in international commodity prices is likely to be a larger drag on the country's economy than other commodity exporters.** To date, the reported slowdown appears to reflect long-expected cyclical factors related to project development and global commodity price cycles. However, if macroeconomic and fiscal stresses reemerge and policy actions detract from the positive domestic private sector dynamic that has driven much of the economy's growth in recent years, the current slowdown may be the start of a return to structurally slower rates. In 2014 and 2015, overall nonresource activity is expected to stabilize near current levels, while construction activity will reverse some of the very strong PNG-LNG-related growth of recent years. This follows a decade of strong growth in Papua New Guinea's nonresource economy, and an immediate challenge will be to ensure that the additional business and workforce capacity developed over recent years is utilized once the impulse from PNG LNG and related construction ends. Meanwhile, movements in aggregate GDP will be overwhelmingly driven by the start of LNG production and exports in the second half of 2014.

**PNG LNG exports are now expected to commence in July 2014, but the impact of the start of production on the broader Papua New Guinea economy will be modest.** Only a fraction of receipts will be retained in the domestic economy. The impact on gross national income will be far smaller than the impact on domestic production. The project is approximately four-fifths owned by nonresidents, and three-quarters of the construction costs were funded through international debt, which needs to be serviced. Employment benefits will also be limited, with ongoing employment on the project less-than one-tenth of its levels during construction. The key channel from PNG LNG production to broader economic activity and living standards across Papua New Guinea will be through the quality of spending by the national and relevant provincial governments and how well landholder groups use the funds they receive. In due course, the national government will receive revenues directly through taxes paid by the project, indirectly through taxes paid on consumption and income by individuals and associated firms, and through dividend payments on its 16.8 percent total equity interest in the project. Royalty payments will be allocated directly to landowners, while the dividend payments may not be available to pay into the sovereign wealth fund as a buffer against future negative macroeconomic shocks or to be spent on the government's development enablers. Rather, reports suggest that the dividends will first be used to service the loans that funded the state's equity holdings in PNG LNG through a facility established with UBS, and then to finance equity in future resource projects.

**While the economy has generally evolved as anticipated, the risks to the forecasts for resource and nonresource activity have tilted more to the downside.** In the short term, there are reports of disruptions to production at some key mines since late 2013, and uncertainty around the legal status of the major Ok Tedi mine creates further risks, while other reports suggest cash crop production remains weak. International risks around the PNG LNG project are mitigated by the precontracted sale of gas using a pricing formula fixed in line with the relatively high LNG prices prevailing in northern Asia. In the medium term, there is the risk that the current long-anticipated cyclical slowdown in the economy will become a return to the structurally slower growth rates Papua New Guinea experienced through much of the 1980s and 1990s. This risk emanates from both the project investment cycle and from the need for policy to ensure that Papua New Guinea maintains a stable macroeconomic and fiscal framework, and a supportive business environment. For example, in late 2013, Total SA agreed to purchase 61.3 percent of InterOil's exploration licenses for fields estimated to hold between 5.4 trillion to 9 trillion cubic feet of gas. Total proposes to develop a liquefaction facility, but the final investment decision may not be made until 2016, with construction starting only thereafter. Meanwhile, despite its enormous potential, the agricultural sector remains in poor health, with falling cash crop production in recent years and little investment in the complementary extension and marketing services required to improve farmers' incentives and productivity.

<INSERT PNG COUNTRY TABLE>

## The Philippines

<insert map>

| | |
|---|---|
| Population | 96.7 million |
| Population growth | 1.7 percent |
| GDP (PPP, int'l US$) | 419.6 billion |
| GDP per capita (PPP, int'l US$) | 4,339 |
| Surface area | 300,000 sq. km. |
| Capital | Manila |

*Source: World Development Indicators.*

### Summary

**The Philippines remained one of the fastest-growing economies in the East Asia region.** Real GDP growth accelerated to 7.2 percent in 2013, despite the two major natural disasters in the fourth quarter. The immediate impact of Yolanda, a category 5 typhoon, and the magnitude 7.2 earthquake that hit the Central Visayas, was less severe than initially projected. The robust performance of the consumption and services sectors continued to be the key driver of growth, supported by the expansion of investments and manufacturing. Strong growth is expected to be sustained at 6.6 percent in 2014 and 6.9 percent in 2015, amid a challenging global environment and the impact of Typhoon Yolanda. These projections are contingent on the immediate implementation of the reconstruction and recovery program in typhoon-affected areas.

### Recent Economic Developments

**Typhoon Yolanda struck the central Philippines in November 2013 and inflicted severe damage on the social and economic fabric of the Visayas and the MIMAROPA region.**[2] The typhoon displaced 4.1 million people and destroyed over half a million houses. The loss of capital and assets and the disruption in electricity and irrigation services has led to the collapse of local economies in the severely affected areas. Since most of the areas affected are largely agricultural, local economies saw large-scale destruction of crops, equipment, and other physical assets that has disrupted the industry and pushed up unemployment and underemployment. Severe damage to critical infrastructure, particularly electricity networks, has slowed business recovery, exacerbating the impact on jobs.

**Notwithstanding the impact of Typhoon Yolanda and the earthquake in Bohol and Cebu in the fourth quarter, Philippine economic growth remained robust at 7.2 percent in 2013.** This was higher than the 6.8 percent recorded in 2012. GDP growth in 2013 was underpinned by the robust performance of consumption and services, and was supported by the expansion of investments and manufacturing. Sustained inflow of remittances continued to help boost private consumption, which grew by 5.6 percent. Private construction growth remained robust at around 8 percent, supported by low interest rates and strong demand for office and residential space by the booming business processing outsourcing industry and its 900,000-strong workforce. Improved efficiency of infrastructure spending also contributed to higher growth. Exports, while improving, remained lackluster, given slack demand for electronic products by key trading partners. On the production side, both the services and manufacturing sectors were drivers of growth.

**Like other emerging markets, Philippine financial markets experienced large volatilities as investors responded to the tapering of the U.S. stimulus program.** Stock and bond prices fell

[2] MIMAROPA is a portmanteau of the names of its five Philippine provinces: Occidental Mindoro, Oriental Mindoro, Marinduque, Romblon, and Palawan.

significantly in June, August, and December 2013. In August, when volatility was most pronounced, the Philippine Stock Exchange index lost 30 percent of its value, while bond prices fell by 20 percent. The outflow of portfolio investment contributed to the peso's 12 percent depreciation by year end. However, confidence in the domestic economy remained high and the country was globally recognized with a third rating upgrade to investment grade.

**Monetary and fiscal policy remained supportive of growth. In 2013, Consumer Price Index inflation eased to 3 percent, equivalent to the low end of the central bank's inflation target of 3 to 5 percent.** With low and stable inflation, policy rates were kept at historically low levels of 3.5 percent and 5.5 percent for overnight borrowing and lending rates, respectively. Government finances continued to improve, thanks to improvements in tax administration and spending efficiency. Public spending was supported by strong growth in infrastructure spending despite slowdowns in other spending categories. Revenue collection grew by about 12 percent, driven by improved tax administration and incremental revenues from the "sin tax." Further public finance reforms are underway. These include rationalizing fiscal incentives, improving customs administration, and enhancing the accountability and transparency of the budget through the reform of budget execution.

**Outlook and Emerging Challenges**

**Amid the challenging global environment and the impact of Typhoon Yolanda, the Philippines is likely to sustain high growth in the medium term.** The damage brought about by Typhoon Yolanda is likely to pull down consumption growth, but reconstruction spending can partially offset the decline in GDP growth. Taking these into account, growth is now projected at 6.6 percent in 2014 and 6.9 percent in 2015. These projections crucially depend on the speed and scope of the reconstruction program. In the short term, a well-designed and rapidly executed recovery and reconstruction program to "build back better" can boost economic growth beyond current projections. This means explicitly mandating standards for safe and resilient buildings and infrastructure and for risk-informed land-use planning, and ensuring that these are implemented well. Over the medium term, growth prospects can be enhanced by a sustainable ramping up of infrastructure spending.

**Downside risks to growth include a slower global recovery, financial market volatilities following the tapering of the U.S. stimulus program, potential bubbles in the real estate sector, slower post-typhoon reconstruction, and domestic reform lags.** As seen in 2013 and despite the Philippines' strong macroeconomic fundamentals, the country will be affected by regional contagion, given the large share of financial market assets held by foreigners. Slower global recovery in high-income countries and financial market volatility could slow growth through weaker external demand, large capital outflows, and higher interest rates. Unchecked growth of the real estate sector, including shadow financing for real estate, is a source of risk. A slower pace of reconstruction spending could pull down 2014 growth by up to 0.6 percentage points. Finally, domestic reform lags, in particular reforms to raise tax revenues, could undermine a fiscally sustainable acceleration of the ambitious infrastructure spending program.

**Notwithstanding higher growth in recent years, the poverty incidence, according to official statistics, declined only moderately between 2009 and 2012.** In December 2013, the National Statistical Coordination Board reported that poverty incidence of the population barely improved from 26.3 percent in 2009 to 25.2 percent in 2012, suggesting that the gains from higher growth were not fully benefiting the poor. In addition, more frequent occurrences of calamities owing to climate change have pushed millions of Filipinos into poverty.

**Underlying the slow progress in poverty reduction is the lack of good jobs, which could have reduced the vulnerability of millions of Filipinos who are likely targets of calamities.** As of 2012, around 10 million Filipinos were either unemployed (3 million) or underemployed (7 million). In addition, around 1.15 million Filipinos enter the labor force every year. However, only a fourth of them find good jobs in the country.

**Moving forward, the country needs to continue to focus on generating higher, sustained, and more inclusive growth—the type that creates more and better jobs and reduces poverty.** With good jobs, Filipinos can increase their income, save more, and invest for rainy days, thereby reducing vulnerabilities to calamities.

**More and better jobs can be created by accelerating reforms to protect property rights, promote more competition, and simplify regulations, while sustainably ramping up public investments in infrastructure, education, and health.** However, fiscally sustainable increases in investment levels are only possible through a combination of more efficient government spending and increased revenues from new tax policy and administrative measures. With these reforms, the private sector will have the incentive to invest more and create jobs, and the country can attract more investments as the economic rebalancing in the world's most dynamic region takes place.

<INSERT PHL COUNTRY TABLE>

## Small Pacific Island Countries

<insert map>

**Kiribati**

| | |
|---|---|
| Population | 100,786 |
| Population growth | 1.5 percent |
| GDP (PPP, int'l US$) | 263.9 million |
| GDP per capita (PPP, int'l US$) | 2,618 |
| Surface area | 810 sq. km. |
| Capital | South Tawara |

**Samoa**

| | |
|---|---|
| Population | 188,889 |
| Population growth | 0.8 percent |
| GDP (PPP, int'l US$) | 848.6 million |
| GDP per capita (PPP, int'l US$) | 4,493 |
| Surface area | 2,840 sq. km. |
| Capital | Apia |

**Tonga**

| | |
|---|---|
| Population | 104,941 |
| Population growth | 0.4 percent |
| GDP (PPP, int'l US$) | 512.2 million |
| GDP per capita (PPP, int'l US$) | 4,881 |
| Surface area | 750 sq. km. |
| Capital | Nuku'alofa |

**Tuvalu**

| | |
|---|---|
| Population | 9,860 |
| Population growth | 0.2 |
| GDP (PPP, int'l US$) | .. |
| GDP per capita (PPP, int'l US$) | .. |
| Surface area | 30 sq. km. |
| Capital | Funafuti |

**Vanuatu**

| | |
|---|---|
| Population | 247,262 |
| Population growth | 2.2 percent |
| GDP (PPP, int'l US$) | 1.1 billion |
| GDP per capita (PPP, int'l US$) | 4,531 |
| Surface area | 12, 190 sq. km. |
| Capital | Port Vila |

*Source: World Development Indicators.*

### Summary

**Growth in the Small Pacific Island economies (Kiribati, Samoa, Tonga, Tuvalu, and Vanuatu) continues to be quite volatile,** in response to economic conditions in remittance-sending countries and tourist markets, natural disasters, and the project cycles of donor-funded infrastructure investments.

Governments are working to consolidate public expenditure, strengthen revenue, and maintain debt sustainability in order to expand their fiscal space to respond to future shocks.

**Recent Economic Developments**

The economy of **Kiribati** grew by 2.9 percent in 2013, with similar growth of 2.7 percent expected in 2014. Growth during 2013 was driven by infrastructure project expenditure, including major donor-financed investment in the airport and road sectors, and strong fishing license revenue income. Inflation reached 2.0 percent in 2013, reflecting increased import prices with the decline in the value of the Australian dollar (which Kiribati uses as its currency), and supply constraints on some domestic services, including shipping, arising from increased infrastructure spending. These factors are expected to maintain inflation at around 2.9 percent in 2014.

**The current account deficit narrowed slightly to 26.9 percent of GDP in 2013, but is expected to widen to 36 percent of GDP during 2014 as fishing license fees fall from their unusually high recent levels and infrastructure projects fuel increased imports.** Declining remittances are expected to continue to negatively affect the current account balance, reflecting continued weak demand for international shipping services and constraints to the employment of I-Kiribati seafarers arising from the high cost of air transport to shipping hubs.

**Despite record fishing license fee income, the fiscal deficit grew to 8 percent of GDP in 2013 and is expected to reach 18 percent of GPD in 2014 as fishing license fees return to normal levels.** The fiscal deficit was financed mostly from the Revenue Equalization and Reserve Fund (RERF),[3] with total drawdowns of 8 percent of GDP in 2013. Drawdowns of more than 13 percent of GDP—well beyond sustainable levels—are likely to be required in 2014, given the expected decline in fishing license income and allowing for budget support expected from the World Bank and the Asian Development Bank.

**Samoa**'s economy has been hit hard by the cyclone that buffeted the country in December 2012, causing damage and losses estimated at 30 percent of GDP. The economy contracted by 0.6 percent in FY13 (relative to a precyclone projection of 2 percent growth), largely due to the impact of the cyclone on agriculture. The economy is expected to recover in FY14 as a result of the implementation of post-disaster reconstruction work and a recovery in agricultural production. Led by agriculture, growth in the September quarter was 1.5 percent, year-on-year.

**Expenditure on reconstruction and recovery in the wake of the repeated major natural disasters that have hit Samoa in recent years has combined with subdued economic growth to place considerable pressure on the fiscal situation.** Budget deficits averaged 6.1 percent of GDP in the five years to FY13. In FY14, the deficit is expected to fall to between 4 and 5 percent of GDP, in part due to additional grant assistance from development partners for reconstruction and recovery work. The expansion of borrowing in recent years to finance both post-disaster spending and other government construction projects has resulted in a rapid accumulation of public debt, with Samoa now at high risk of debt distress.

Largely as a result of post-disaster reconstruction work, the current account deficit widened in FY13 and is expected to remain above 13 percent of GDP in FY14. In the five months to November 2013, remittances were 1.4 percent above their level the previous year, while visitor arrivals and earnings were 1.5 and 0.2 percent lower, respectively. Inflation has dropped to an average of 0.6 percent in the 12 months to December 2013, from 2 percent a year earlier.

[3] The RERF, a sovereign wealth fund originally capitalized from the proceeds of phosphate mining, serves two functions: providing a vehicle for intergenerational equity, and as a vital source of budget financing.

**Tonga** was struck by a cyclone on January 11, 2014, which caused massive devastation to parts of the country, particularly the Hapai'i island group. Prior to that, the economy had been on track to recover from the lower growth of FY12 and FY13 that had resulted from a drop in government construction activity. In FY14, construction activity has normalized while remittances have rebounded—projected to increase by 8 percent over FY13. The post-cyclone outlook for FY14 is for growth of about 1.2 percent, taking into account both production losses suffered due to the cyclone and increased activity as a result of reconstruction and recovery work.

**Inflation in FY2013 remained moderate, ending the fiscal year at 3 percent compared to 2.3 percent over FY2012.** Private credit growth still remains negative, as commercial banks continue to reduce loan books and repair balance sheets damaged by the unwinding of a speculative lending bubble in 2008. Recent data suggest that deleveraging may soon be complete, with the equity-to-asset ratio now reaching 20 percent and loan loss provisioning stabilizing. The National Reserve Bank of Tonga has continued an accommodative policy stance to support banks to resume lending while managing risks. The current account deficit narrowed to 6 percent of GDP in FY2013, but is likely to expand again in FY14 as post-cyclone reconstruction activity increases demand for imported materials. Foreign exchange reserves are equal to more than eight months of import cover.

**The fiscal deficit for FY2013 was around 1 percent of GDP, compared to a forecasted small surplus.** In the absence of significant grant support from development partners, it seems likely that the costs of the cyclone recovery operation will move the budget further into deficit in FY2014 and future years.

Economic growth in **Tuvalu** was an estimated 1.1 percent in 2013, and is expected to be somewhat higher in 2014 as a result of donor-funded airport and road upgrading projects. The Government of Tuvalu is estimated to have achieved a balanced budget in 2013, with higher recurrent spending offset by higher-than-expected fishing license revenues. The 2014 budget is also projected to result in a surplus despite a nearly 24 percent rise in recurrent expenditures. The rising expenditure is more than offset by rising fishing license fees and one-off grants. With the moderate recovery of global financial markets, the national Trust Fund has begun to make distributions to rebuild government reserves, an important buffer given Tuvalu's extreme vulnerability to external shocks.

**Inflation is expected to rise from around 1.25 percent to 2.75 percent by the end of 2014, due to the recent depreciation of the Australian dollar (which Tuvalu uses as its currency) and rising oil prices.** The current account deficit is expected to have widened slightly to around 3 percent of GDP in 2013, from a small surplus in 2012. Remittances from seafarers continue to decline from their peak over a decade ago.

Economic growth in **Vanuatu** has been on an upward trend since 2011, and is estimated to have risen from 2.3 percent in 2012 to 3.3 percent in 2013. This growth has been supported by a steady expansion in tourism. In the first half of 2013, visitor arrivals by air were 4 percent higher than in the same period in 2012, and cruise tourist arrivals were 11 percent higher over the same period. The commencement of new public investments is expected to provide a further boost over the course of the next year.

**Consumer inflation remains low, having increased from 0.8 percent at end-2012 to 1.5 percent at end-2013.** The Reserve Bank of Vanuatu has effectively maintained inflation between zero and 3 percent since the second half of 2009. Private sector credit growth remains muted. Credit-to-deposit ratios and nonperforming loan ratios are relatively high and are being monitored closely. Over 2013, the vatu depreciated against the U.S. dollar, the euro, and the New Zealand dollar, but appreciated substantially against the Australian dollar. Foreign exchange reserves are relatively high, at seven months of import cover, which is considered to be appropriate given Vanuatu's vulnerability to exogenous shocks.

**The Government of Vanuatu maintains a conservative fiscal stance.** The overall fiscal deficit has declined from 2.2 percent of GDP in 2011 to 1.0 percent of GDP in 2013. The risk of debt distress is low, with total public external debt standing at 14 percent of GDP. Domestic revenue collections have fallen over the last decade and are on the low side, with tax revenues bringing in 16.6 percent of GDP in 2013 and other domestic revenues a further 1.8 percent of GDP. Although development partner grants increased from 3.0 percent of GDP in 2012 to 4.3 percent of GDP in 2013, the government continues to face tight fiscal constraints.

### Outlook and Emerging Challenges

**The outlook for economic growth among the Small Pacific Island economies presents a mixed picture.** While public sector investment is expected to support growth, in several instances this is largely dependent on donor-funded projects proceeding according to schedule. Remittance flows to Samoa and Tonga appear to be strong, but those in Kiribati and Tuvalu are particularly vulnerable to a further decline in global shipping, which would affect demand for their seafarers. Tourism is critical to Vanuatu especially, and also to Samoa and Tonga, but is subject to downside risks. An economic slowdown in Australia, their major source of tourists, may lead to a moderation in demand for tourism. Added to this, accommodative monetary policy in Australia has led to a depreciation of the Australian dollar against major currencies. With the currencies of Samoa, Tonga, and Vanuatu pegged to a basket of major currencies, this means they have appreciated relative to the Australian dollar, which threatens to dent their appeal in the Australian tourist market.

**Fiscal sustainability is heavily dependent on consolidation in Kiribati, Samoa, Tonga, and Tuvalu.** In Tonga, strong efforts at fiscal consolidation have already been made, but this fiscal discipline needs to be maintained in the face of post-cyclone reconstruction work, an upcoming national election, and a planned public service remuneration review. In Samoa, the challenge is to narrow the fiscal deficit, mainly through expenditure rationalization, in order to rebuild the buffers required to respond to future shocks. In Kiribati and Tuvalu, there are long-term challenges of fiscal sustainability to address, including weak revenue performance and considerable growth in recurrent expenditure in recent years—particularly subsidies. In Kiribati, RERF drawdowns have far exceeded sustainable levels. A key priority for structural reform in Kiribati is effective implementation of regional fisheries agreements, which would support increased and more stable fisheries revenues through the trading of quota permits. Progress with revenue policy and administration reforms to reverse long-term declines in tax revenue as a proportion of GDP is also important, as is progress with public enterprise reforms, given that state-owned enterprises currently represent a substantial fiscal drain through a range of explicit and implicit subsidies.

## The Solomon Islands

<insert map>

| | |
|---|---|
| Population | 549,598 |
| Population growth | 2.1 percent |
| GDP (PPP, int'l US$) | 1.7 billion |
| GDP per capita (PPP, int'l US$) | 3,076 |
| Surface area | 28,900 sq. km. |
| Capital | Honiara |

*Source: World Development Indicators.*

### Summary

**Economic growth in the second half of 2013 remained subdued, leaving annual growth at 3 percent.** Although international prices of Solomon Island exports stabilized in the second half of 2013, domestic activity generally outpaced the externally focused sectors over the year. Both domestic and foreign investment continued to be noticeably weaker than in the first years of the decade, and weaker overall growth was reflected in a slowing of employment growth. Although the Solomon Islands recorded a modest trade deficit, foreign exchange reserves reached a new peak in December 2013. Inflation moderated over the second half of 2013, and was 2.5 percent over the year.

**The government's fiscal position deteriorated over the second half of 2013, contrasting with a relatively strong performance during the first half.** Expenditures rose to above-budgeted levels by the second quarter of 2013, largely due to higher payroll spending. Notable shifts in spending plans throughout 2013 included a rapid growth in payments for scholarships for overseas tertiary study, and in "Constituency Development Funds". The trends in the second half of 2013 of slower growth in production and revenues, and tighter investment conditions, are expected to continue into the medium term. Significant risks continue to be centered on the outlook for logging, and have emerged around the outlook for gold production.

### Recent Economic Developments

**Economic growth in the second half of 2013 remained subdued, and growth over the whole of 2013 is estimated by the Central Bank to have been 3 percent.** The slowdown was driven by unsupportive export prices and associated weakening of key commodities production, as well as declining foreign investment amidst a general withdrawal of funds from emerging economies. The slowdown has resulted in a continuation of the trade deficit, which emerged in the first half of 2013, and a slowing of government revenue growth in 2013 to an estimated 5.8 percent, from an average of 24 percent during 2006–12.

**Timber and gold production, key drivers of growth in 2010, 2011, and 2012, increased slightly in the second half of 2013 compared to the first half.** However, this was not enough to offset strong declines in the first half of the year, and left annual timber production 3 percent and annual gold production 13 percent below 2012 volumes. The decline in timber production over the year reflects a mixture of lower prices, adverse weather conditions, and possibly stock depletion. The large contraction in gold production over the year is due to ongoing disputes between St Barbara Limited and landowners disrupting production, the depletion of the mine's most productive pits, and illegal mining. The 2013 output of 59,000 ounces falls significantly short of the 100,000 ounces envisaged when the mine started operating, which together with the impact of the nearly 30 percent fall in international gold prices from their 2012 peak to December 2013 throws into doubt the mine's profitability.

**International prices of Solomon Island exports stabilized in the second half of 2013, and rose slightly in early 2014.** This still leaves prices 22 percent below their historic peak in 2011, but at the average level of the last five years. Most notably, the second half of 2013 saw an increase in the prices of coconut oil (42 percent) and cocoa (24 percent). Cash crop production also stabilized in the second half of 2013, following sharp declines in the first half of the year. This stabilization in prices and production, and the stable exchange rate, have also stabilized rural incomes, but at significantly lower levels than earlier in the decade. For example, receipts from copra and coconut oil were 57 percent lower in the first three quarters of 2013 compared to the same period in 2012, while the equivalent figures for logs and palm oil and kernels were -10 percent and -20 percent, respectively.

**Fisheries production was an important exception to the general weakness in externally focused sectors in 2013, with production estimated to have risen by 20 percent.** This resulted from a doubling of canning capacity at Soltuna, and a new policy requiring vessels that fish in national waters to offload at least 20 percent of their catch for processing in the Solomon Islands.

**Investment, both domestic and foreign, also continued to be noticeably weaker than in the first years of the decade, with foreign direct investment applications 6 percent lower in the first half of 2013 on a year-on-year basis, and significantly below the levels seen in 2009–11.** Bank lending to the private sector—largely driven by personal borrowing—is estimated to have increased by 4 percent in 2013.

**Domestic activity generally outpaced the externally focused sectors.** Manufacturing and construction output grew at 9 percent and 8 percent, respectively, in 2013. The increase in manufacturing was mostly driven by Honiara-based food and beverages companies, and by tobacco processing. The increase in construction was mostly driven by government- and donor-funded development projects.

**Weaker growth in overall activity was reflected in slower formal sector employment growth of 2.7 percent to December 2013, compared with average annual growth of 5.1 percent between 2010 and 2012.** Despite the slowdown in the domestic economy, import values (in Solomon Island dollar [SI$] terms) in the first three quarters of 2013 were 8 percent greater than in the equivalent period of 2012. The major contributors to the increase in import values were mineral fuels (17 percent), followed by machinery and transport equipment (12 percent), and food and live animals (16 percent).

Overall, the stronger export production in the second half of 2013 compared to the first half was not enough to offset the effects of lower export prices and the robustness of imports, leaving the trade balance in deficit throughout 2013.

**The modest trade deficit was financed mostly through foreign aid.** With the resulting slightly positive balance-of-payments position, the exchange rate remained at around SI$7.1 per U.S. dollar, notwithstanding the central bank's shift to peg the exchange rate against a basket of currencies rather than the U.S. dollar alone, and the strengthening of the U.S. dollar against most currencies over the second half of 2013.

**Foreign exchange reserves reached a new peak in December 2013 at US$487 million, compared to US$470 million at the end of 2012.** This covers more than 11 months of forward imports, a solid buffer to protect the Solomon Islands from external shocks.

**Inflation moderated further over the second half of 2013, leaving Honiara consumer prices at the end of the period only 2.5 percent higher than in December 2012.** Food prices fell by 1 percent over this period, largely due to lower imported food prices, and many other import prices were also weaker. However, this was offset by the relative strength in domestic prices.

**The government's fiscal position deteriorated over the second half of 2013, in contrast with a relatively strong performance during the first half of the year.** In the second half of the year, government spending accelerated, leading to a decline in the government's deposits, to SI$1.16 billion compared with SI$1.26 billion at the end of Q2. The weakness of externally focused sectors and a relatively more robust domestic economy were reflected in revenue collection. Inland revenues collections, more related to domestic activity, rose to SI$1.68 billion over the whole of 2013, exceeding the budget by SI$40 million, or 2.5 percent.

**In contrast, customs and excise collections, which are dominated by excise and export duties, totaled SI$0.80 billion in 2013, under budget by around SI$10 million, or 1.2 percent.** This was due mainly to an increase in excise taxes on tobacco, which reduced consumption, and lower collections of export duties from round logs. Preliminary figures for nontax revenue derived from other government ministries reveal that collections from other ministries totaled SI$223 million, SI$5 million above original budget estimates, or 2.3 percent.

**Expenditures rose to above-budgeted levels by the second quarter of 2013, largely due to higher payroll spending with the "relevelling" of teachers' salaries to incorporate a long-delayed pay adjustment.** After the usual very slow start, development spending accelerated in May.

**Notable shifts in spending plans throughout 2013 included a rapid growth in payments for scholarships for overseas tertiary study, and in various streams of funds directly administered by individual members of parliament (loosely termed "Constituency Development Funds").** This additional spending was partly funded by redirecting funds allocated to development projects. As a result, a supplementary budget amounting to around 2 percent of GDP was passed in September 2013 to cover mostly commitments to tertiary education scholarships. As a consequence of this increased spending, the fiscal surplus in 2013 is estimated to be 0.3 percent of GDP in 2013, down from 4 percent in 2012.

**In 2014, the government plans to spend SI$3,503 million.** This includes donor funding amounting to SI$664 million and a contingency provision of SI$34.6 million. SI$2,862 million has been allocated through the recurrent budget and SI$641 million through the development budget. Total domestically sourced revenue is projected to increase by 7.2 percent, reflecting modest economic growth and ongoing improvements in revenue collection and compliance. Notably, a cyclical increase in funding is required to cover the 2014 election costs, including Terminal Grants to politicians amounting to SI$76.4 million. To fund this, the government has reduced constituency and discretionary funding to members of parliament by one-third in 2014, saving SI$62.2 million. In addition, to mitigate the fiscal risk posed by tertiary education scholarships, the government recently agreed to (i) discontinue funding of terminated and suspended overseas students; (ii) discontinue funding of all scholarships awarded for the Solomon Islands National University, except those for teachers; and (iii) discontinue funding for those teachers whose scholarships were not awarded through the official process. This reduces the overall cost of scholarships funded by the Solomon Island Government to SI$155 million (SI$55 million for domestic students and SI$100 million for overseas students).

## Outlook and Emerging Challenges

**Significant risks continue to be centered on the outlook for logging, and have emerged around the outlook for gold production, given the retreat in international gold prices and the mine's reportedly high operating costs.** Some upside risks to the medium-term outlook emanate from continued fast growth in tuna processing due to a new law requiring 20 percent offloading of catch for processing domestically, and the start of construction of a hydroelectric plant in the next two years. Significant potential nickel mining investments, however, are unlikely to materialize in the medium term due to uncertainty around the mining regulatory and tax regimes. There is scope for raising the Solomon Islands' long-term growth potential by addressing some important structural constraints, such as the high cost of fuel resulting from high tariffs and a lack of competition in fuel import and distribution.

**The trends of the second half of 2013 of slower growth in production and revenues, and tighter investment conditions, are expected to continue into the medium term.** Projected growth rates are expected to stabilize at 3 to 4 percent, only modestly above population growth, giving rise to the challenge of further improving collections and finding new sources of revenue while improving the quality of spending to increase the return on expenditures on public services.

<INSERT SLB COUNTRY TABLE>

## Thailand

<insert map>

| | |
|---|---|
| Population | 66.8 million |
| Population growth | 0.3 percent |
| GDP (PPP, int'l US$) | 645.2 billion |
| GDP per capita (PPP, int'l US$) | 9,661 |
| Surface area | 513,120 sq. km. |
| Capital | Bangkok |

*Source: World Development Indicators.*

### Summary

### Summary

**Thailand's real GDP growth in 2013 was 2.9 percent following slower-than-expected performance in all components of GDP—**consumption, investment, net exports, and government spending. While some of the weakness in exports can be explained by the structure of production—falling global personal computer sales relative to tablets may have reduced exports of hard disk drives—sectors such as agroproducts and metals have also performed poorly. The weakness in household consumption is partially explained by tax incentives for car purchases that expired at the end of 2012 and led to preponing of consumption. The fast-growing levels of household debt, more rigorous macroprudential measures by the Bank of Thailand, and arrears in payments on the Paddy Pledging Program[4] have also been contributing factors. The slowdown was evident by the third quarter, before the protests began. The protests had little significant macroeconomic impact in 2013, except on the tourism sector in the last quarter of the year.

**Real GDP growth is projected to be 3.0 percent in 2014 as domestic demand remains dampened due to the ongoing political unrest.** Household consumption should recover from last year, but only slightly as household debt levels remain high and the state finds it increasingly difficult to function due to the political turmoil. Tourism receipts, public investment, and investor confidence are all also affected. Export growth, on the other hand, should accelerate this year as the recovery in Thailand's major markets continues. If the political situation stabilizes sufficiently to allow provide comfort to investors or allow clearance of the arrears of the Paddy Pledging Program (amounting to 1 percent of GDP) in 2013, growth will be stronger in 2014.

### Recent Economic Developments

**In 2013, the Thai economy expanded by 2.9 percent, with slower growth of household consumption, investment and merchandise exports.** Household consumption expanded by only 0.2 percent in 2013 compared to its 6.7 percent growth in 2012. Consumption turned negative in the fourth quarter as the arrears to the Paddy Pledging scheme were not made. Private investment contracted by almost 3 percent partly due to the fact that many firms had invested in 2012 to rehabilitate themselves from the 2011 floods, and partly due to decreased confidence. As a result, domestic demand expanded by less than 1.5 percent in 2013, compared to 9.4 percent in 2012. With the slowdown in production and consumption, imports grew by only 2.9 percent, resulting in a 12.4 percent growth in net foreign demand, which supported growth in 2013.

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[4] As of February 10, 2014, the program, which allows rice farmers to pledge their paddy with the Government at a stated higher-than-market prices, owed farmers B 130 billion or around 1 percent of GDP, of which B 700 million is for paddy pledged in the 2012/13 harvest year and B 129.3 billion for paddy that has been pledged since October 2013.

**Exports of services in 2013 were robust, with record-high tourist arrivals until China's new tourism law and political unrest took their toll toward the end of the year.** Tourism receipts have contributed to the rise of the export of services in real GDP in the first three quarters of the year by 25 percent year-on-year (yoy), the highest in a decade. Tourist arrivals in 2013 increased by 22 percent yoy in the first three quarters. There was, however, a significant slowdown in tourist arrivals in the last quarter of 2013, growing by only 10.7 percent yoy, as China announced a new tourism law and political unrest broke out at the end of October in Bangkok. Nevertheless, tourist arrivals in 2013 were at a record high of 26.6 million.

**Exports of merchandise have been recovering more slowly than that of other countries in the region.** In 2013, exports of goods in U.S. dollar terms contracted by 0.2 percent[5] from the previous year. Exports of most other countries in East Asia have either not contracted or have recovered more quickly than that of Thailand in 2013. By the end of the year, only Thai exports were still contracting. Particularly affected were agricultural products, hard disk drives, and metal and steel. Agroexports fell due to the decrease in rice exports, since rice stocks from the Paddy Pledging Program have been marginally released, and there was a decline in shrimp production following a disease outbreak. The fall in rubber prices by almost 10 percent in 2013 has reduced the export value of rubber (which comprises almost half of Thailand's agricultural exports). Exports of hard-disk drives contracted by 5.6 percent in 2013 as demand for computers fell, stemming from the decline in global purchasing power and competition from tablets.

**Capital inflows were volatile in 2013.** Net capital inflows into Thailand had been high, starting in the third quarter of 2012, adding up to US$8.7 billion in the second half of 2012, and were US$9.0 billion in the first half of 2013. However, by June 2013, the trend had reversed at the news of a possible tapering of the U.S. quantitative easing. There was a net outflow of more than US$7.7 billion in the second half of 2013, particularly from the capital market and to deposits abroad. Hence, net capital flows in 2013 were only US$1.5 billion compared to US$14.4 in 2012.

**Foreign direct investment continued to rise in 2013 and does not appear yet to have been affected by political turmoil.** Total net foreign direct investment stood at US$12.8 billion in 2013 compared with US$10.7 billion in 2012, and is at the highest level since 2005. Foreign direct investment in 2013 came particularly from Japan, ASEAN, and the United States.

**International reserves in 2013 stood at US$167.2 billion compared to US$181.6 billion in 2012.** The Bank of Thailand is believed to have intervened to slow the depreciation of the baht during the year. International reserves at the end of 2013 were equivalent to 2.8 times Thailand's total external debt. The current account was in a US$2.8 billion deficit in 2013 (0.7 percent of GDP) compared to the US$1.5 billion deficit in 2012 (0.4 percent of GDP). Similarly, there was only a US$1.5 billion capital account surplus in 2013 compared to a US$14.4 billion surplus in 2012.

**Inflation remained subdued.** Headline inflation and core inflation declined to 2.2 and 1.0 percent yoy in 2013, respectively. Food and beverage prices rose 3.4 percent yoy in 2013, led by an increase of around 6.6 percent in the prices of meat, poultry, and fish. Prices of nonfood and beverage products rose by only about 1.5 percent yoy, however. The fall in import prices (including oil prices) by 2 percent yoy since the beginning of the year have also contributed to the slower increase in nonfood prices in 2013. The government had also continued to subsidize energy retail prices, especially of diesel and natural gas. The policy rate was reduced in November 2013 and March 2014 in response to weak economic outturn and low inflation.

[5] Based on a balance-of-payments basis.

**Fiscal policy was contractionary as the political protests began to affect the functioning of the government.** Public investment in real terms grew by more than 15 percent yoy in the first two quarters of the year before contracting by 16 percent and 4.7 percent in the third and fourth quarters, respectively. The implementation of the B 350 billion Water Management Project has been delayed. The payments for the paddy pledging scheme could not be made. The total deficit (including off budget spending such as the paddy pledging scheme) was 2 percent of GDP compared to 3 percent of GDP in 2012.

**Outlook and Emerging Challenges**

**The Thai economy is projected to grow by 3.0 percent in 2014.** Consumption and investment are expected to remain subdued as the political unrest continues, while exports are projected to slowly recover. If the political situation stabilizes to give investors comfort, and allow functioning of the state, the 2014 should see stronger growth.

**With the recovery in the global economy, exports of goods are projected to recover in 2014, with a higher trade surplus and lower current account deficit.** Exports should accelerate as the global economy recovers and may well be helped by the tapering of the U.S. quantitative easing as the baht depreciates. Exports are expected to grow by 6 percent (in U.S. dollar terms) in 2014 after a slight contraction last year, with the recovery of Thailand's major export markets, particularly the United States and EU, larger shrimp exports after the shrimp disease outbreak was controlled, and larger rice exports as rice stock is released by the government. As exports recover, import growth should also accelerate to around 3 percent. The trade surplus is projected to be 3.5 percent of GDP, higher than last year's 1.6 percent. The increase in trade surplus will contribute to a slight current account surplus this year of 0.9 percent of GDP compared to the 0.7 percent deficit in 2013.

**Household consumption is projected to grow slowly as household financial balances begin to strengthen.** Households have begun to adjust their consumption since the second quarter of last year, when the impact of the consumption stimulus measures that ended since end-2012 started to dwindle. The reduction in personal income tax that is effective in 2014 would also help raise effective incomes of households. However, households are likely to be more cautious in their spending this year due to several uncertainties around the impact of the political turmoil, global recovery, and the disbursements of the Paddy Pledging Program. At the same time, their debt levels remain high with household debt to GDP at close to 80 percent. Household consumption is therefore expected to expand by 1.5 percent over last year, a slight acceleration from its 1.3 percent growth in 2013.

**Public investment will likely expand at a rate similar to that of 2013 as large public investments continue to be delayed.** The disbursement from the Water Management Project will likely be delayed this year as consultations have to be completed before the project commences. Moreover, the off-budget borrowing bill for seven-year B 2 trillion transport infrastructure investment program was recently ruled unconstitutional by the Constitution Court. Hence, projects under the program will be delayed as they will be revised with alternative sources of financing. Hence, public investment in 2014 should grow at a rate similar to last year, at around 1 percent.

**The most immediate risks to Thailand's future growth are the pace of recovery of the global economy and the political situation.** A slower-than-expected recovery in the global economy and a faster slowdown in the Chinese economy will have a negative impact on Thai exports. The political gridlock has already led to deteriorating confidence and difficulty in routine tasks such as passport issuance. Delays in the long-awaited large public infrastructure projects will affect growth not only this year but also in the long run, since better water management and logistics improvements are crucial for

Thailand's future growth. Moreover, continued political instability have been distracting governments from focusing on long-term development issues such as improving skills and competitiveness.

<INSERT THA COUNTRY TABLE>

## Timor-Leste

<insert map>

| | |
|---|---|
| Population | 1.2 million |
| Population growth | 2.9 percent |
| GDP (PPP, int'l US$) 1/ | 2.0 billion |
| GDP per capita (PPP, int'l US$) 2/ | 1,660 |
| Surface area | 14,870 sq. km. |
| Capital | Dili |

*Source: World Development Indicators.*
1/ The equivalent in 2011 nonoil GDP at current market prices is US$1.128 billion.
2/ The equivalent in 2011 nonoil GDP at current market prices is US$1,007.

### Summary

**Timor-Leste's economy remains heavily dependent on petroleum.** The recently approved FY14 budget is 89 percent financed by petroleum revenues. The budget is also nearly 10 percent lower than in FY13, lowers medium-term spending plans, and hence reduces the outlook for nonoil economic growth. Estimates of petroleum production from current fields have been reduced, which lowers estimates of petroleum wealth and the sustainable income from that wealth. However, the Petroleum Fund continues to grow, passing US$15 billion in January 2014. Headline inflation dropped sharply in the fourth quarter of 2013 after peaking at 13.5 percent in the second quarter.

### Recent Economic Developments

**Parliament unanimously approved an FY14 budget of US$1.5 billion on January 24, 2014.** This is nearly US$150 million less than the 2013 budget in an attempt to return to fiscal sustainability, ease aggregate demand pressures and inflation, and improve budget credibility. Despite smaller budgets, budget execution is deteriorating. Nominal spending fell for the first time in 2013. Given the importance of public spending for growth, the government in November 2013 sharply lowered its 2012 and 2013 nonoil GDP (Timor-Leste's preferred measure of economic activity) growth estimates from 10.4 percent and 10.6 percent to 8.2 percent and 8 percent, respectively. Final numbers will depend heavily on estimates of agricultural and private sector activity. Long-term petroleum revenue forecasts, and the Estimated Sustainable Income Timor-Leste earns on its petroleum wealth, fell as production forecasts from fields currently under development fell. Inflation fell sharply in the final quarter of 2014, but the 2013 average is likely to remain in the double digits, well above the 7.6 percent estimate, despite falling global food prices, and an appreciation of the U.S. dollar (Timor-Leste's currency). This reflects continued demand pressures and supply bottlenecks.

#### *Growth*

**The significant downward revisions in November to the government's 2012 and 2013 nonoil growth estimates were driven largely by an upward revision in 2011 nonoil GDP, recently published in the 2000–2011 National Accounts, and lower than anticipated growth in public spending, agriculture, and private investment.** The estimate for 2013 may need to be revised further downward in light of the confirmed decline in 2013 nominal spending, although a 15 percent increase in vehicle ownership in 2013 and a 6 percent increase in electricity consumption provides some upside potential.

#### *Fiscal*

**The 64 members of Parliament voted unanimously in favor of the US$1.5 billion FY14 budget.** While US$200 million higher than the May 2013 fiscal envelope, the budget is nearly US$150 million lower than the FY13 budget, which itself was US$150 million lower than the FY12 budget. The medium-term spending plan has also been reduced in relation to the medium-term spending plan proposed in the FY13 budget. While the budget is planned to grow to US$1.9 billion in 2016, the 2018 budget will return to the same size (in nominal terms) as the 2014 budget. The overall reduction is both a step toward greater fiscal sustainability and budget credibility, and an attempt to reduce demand-driven inflationary pressures. However, within the budget, the recurrent budget has risen by 32 percent in relation to the 2013 budget, driven by a 22 percent increase in transfers. The capital and development budget has been scaled back by 55 percent, as the government seeks to overcome administrative challenges related to procurement and contracting, and ultimately to improve the quality of public infrastructure spending.

**Overall budget execution deteriorated in 2013.** In absolute terms, nominal spending fell for the first time, with only US$1.076 billion spent compared with US$1.198 billion in 2012. During the last seven weeks of the year, US$403 million, representing 38 percent of total 2013 spending, was spent. Execution also deteriorated in relative terms. Despite a smaller 2013 budget, only 65 percent was executed, compared with 66 percent in 2012, weighed down by a 40 percent execution rate on capital and development. Furthermore, execution was only 37 percent on the portion of capital and development financed from the Infrastructure Fund (compared with 45 percent in 2012)—a ring-fenced, multiyear part of the budget with dedicated large-project management institutions. Some of this underperformance can be explained by project profiles, since smaller projects, for instance, roads, have followed lumpy investments in electricity in 2011 and 2012. But most of the underperformance is explained by thin administrative capacity.

The government stuck to its de-facto fiscal anchor in 2013, withdrawing US$57 million less than the US$787 million Estimated Sustainable Income (ESI) from the Petroleum Fund, and instead ran down unspent cash balances from previous excess withdrawals. However, the government plans to make excess withdrawals in 2014. In total, excess withdrawals are planned to finance 45 percent of total public spending between 2014 and 2018.

More specifically, the 2014 budget includes US$166 million of domestic revenues, representing 11 percent of estimated 2014 nonoil GDP, roughly equivalent to the budget. Remaining financing will come from ESI of US$632 million, US$270 million in excess withdrawals, US$380 million from cash balances, and US$51 million in loans.

ESI, which is sensitive to petroleum production and global oil prices, has fallen by around 20 percent in relation to 2013 estimates, since fields currently under development are now forecast to end by 2020 rather than 2023. This emphasizes the importance of improving the domestic tax effort with both policy reform (a value-added tax is being discussed) and administrative reform. Audits of the taxpayer database have recently been completed and the new one-stop shop for business registration can provide a more orderly registration process, also for tax purposes.

The 2013 nonoil fiscal deficit (domestic revenue less total spending) was 61 percent of nonoil GDP, but overperformance on petroleum revenues lifted this to an overall surplus (including petroleum revenues) of 88 percent of estimated 2013 nonoil GDP, well above the original 54 percent forecast.

### *Inflation and Financial Sector Issues*

**The government will miss its 2013 inflation target of 7.6 percent (headline inflation is the year-on-year Consumer Price Index in Dili).** Estimated average year-on-year inflation for 2013 is 11.3 percent, driven largely by a 14.6 percent average rise in the price of food. Inflation peaked at 13.5 percent in May, although falling global food prices and an appreciation in the U.S. dollar (Timor-Leste's official currency) may have contributed with a lag to the sharp fall in inflation in the last quarter of 2013. The fourth quarter peak in public spending and a related increase in aggregate demand may have a lagged upward impact on inflation in the first quarter of 2014, as supply bottlenecks persist.

**Net credit to the private sector picked up in the second half of 2013, from 4 percent growth in the first half, contributing to a full-year expansion of 13 percent, to US$177 million.** This represents 11.5 percent of estimated 2013 nonoil GDP. Of total credit, 41 percent was held by individuals, and 23 percent was extended to trade and finance and 22 percent to construction. Credit to industries and manufacturing contracted by 29 percent in 2013 relative to 2012. Spreads widened, as lending rates rose from 12.13 percent in January 2013 to 12.48 percent in December while deposit rates remained flat at 0.56 percent. The share of nonperforming loans, a legacy from the period around the 2006 security crisis, continues to decline, to 28 percent at end-December 2013 from 31 percent at end-2012. Loan loss provisions were US$58.4 million, or 118 percent of the value of nonperforming loans, effectively mitigating the risk to the banking system.

### *External Balance*

**The trade balance deteriorated in 2013 in relation to 2012.** Coffee exports fell to US$15.8 million in 2013, compared to US$18.8 million in 2012, as both production and global Arabica prices fell. Official trade data showed a 27 percent increase in imports over the same period to US$843 million, mostly related to pharmaceuticals and machines and parts. The resulting US$827 million trade deficit, or 54 percent of estimated 2013 nonoil GDP, was lifted to a current account surplus of US$1.97 billion by petroleum revenues, which are recorded as income on the current account.

**The Petroleum Fund, Timor-Leste's Sovereign Wealth Fund, reached US$15 billion in value at the end of January 2014, nearly 10 times estimated 2013 nonoil GDP, and up from US$11.8 billion at end-2012.** The government transferred US$730,000 from the Petroleum Fund to the Treasury to finance spending during 2013. In strong performance, revenue inflows to the Fund were US$2.8 billion, well over the full-year estimate of US$2.3 billion. At the end of December, official reserves were US$675 million, or nearly nine months of imports. This fell from nearly 15 months of import cover at end-2012, as average monthly imports picked up. But adding the Petroleum Fund increases cover to 223 months of imports.

### Outlook and Emerging Challenges

**Prime Minister Kay Rala Xanana Gusmao formally announced in his January 2014 budget speech that he would step down from his post by September.** Preparations are underway for an orderly handover, but reports in the press of cabinet reshuffles and ministerial departures may affect budget execution, and could fuel investor uncertainty.

**The ongoing arbitration between Timor-Leste and Australia over the Greater Sunrise field became contentious as Timor-Leste accused Australia of spying during the negotiation of the treaties governing the field.** The case increases uncertainty around revenue potential from fields not currently under development. This may also have implications for the next exploration licensing round, which has yet to be launched.

**The FY14 budget expenditure circular was issued in February, for the first time as a formal decree of the council of ministers.** It contains measures to improve the quality of spending, such as a ceiling on the share of budget appropriations that can be spent by single-sourced procurement. This may also slow spending. Given continued challenges to budget execution, growth will depend on the prospects for an uptick in private sector activity that is not directly linked to government contracts. Recent private projects under discussion include a cement plant, an international hotel, and a retail and housing complex.

**The leader of the opposition has been appointed as head of an authority to develop the enclave of Oecusse as a special economic zone for social markets.** The district of Oecusse lies within West Timor, Indonesia, and has the most challenging human development indicators in Timor-Leste, itself a lagging country. An integrated development plan that builds on relative strengths in agriculture and informal financial intermediation to address competitiveness, infrastructure, and service delivery constraints, can help transform the lives of Oecusse's roughly 65,000 inhabitants.

<INSERT TMP COUNTRY TABLE>

## Vietnam

<insert map>

| | |
|---|---|
| Population | 88.8 million |
| Population growth | 1.1 percent |
| GDP (PPP, int'l US$) | 336.2 billion |
| GDP per capita (PPP, int'l US$) | 3,787 |
| Surface area | 330,957 sq. km. |
| Capital | Hanoi |

*Source: World Development Indicators.*

### Summary

While macroeconomic performance further improved during 2013, economic growth continued to come in below its potential in the face of structural problems in state-owned enterprises and the banking sector, and due to policy distortions that continue to thwart domestic private investment and competition in key sectors. Gains in macroeconomic stability were underpinned by moderating inflation and strengthening external accounts. Growth is estimated at 5.4 percent in 2013—a slight improvement from 5.3 percent in 2012. The government is facing growing fiscal challenges due to sluggish revenue collection. Growth is likely to remain moderate in 2014 in the absence of visible progress in addressing the mentioned structural problems.

### Recent Economic Developments

**Vietnam's economy returned to a relatively stable macroeconomic environment during the last two years compared to the tumultuous period of 2007–11.** Stabilization measures implemented in 2011 and 2012 helped Vietnam restore macroeconomic stability by reducing inflation, strengthening external accounts, and stabilizing the foreign exchange market. Headline Consumer Price Index inflation eased to 6.6 percent in 2013 compared to 18.1 percent in 2011 and 9.1 percent in 2012. Subdued credit growth and easing of food price increases contributed to declining inflation. The spread of sovereign bonds and Credit Default Swaps for Vietnam have also narrowed, currently at around the levels preceding the 2009 crisis. The dong/U.S. dollar exchange rate has remained relatively stable since a 1 percent official readjustment in July 2013. The spread between the official and parallel exchange rate markets has narrowed since then.

**Strong exports and a sustained flow of external capital and remittances have helped Vietnam turn around its external balances.** Exports continue to grow at a rapid clip thanks to the strong performance of the foreign invested sector. While earnings from commodity exports are declining, due to falling prices, Vietnam's traditional labor-intensive manufacturing exports such as garments, footwear, and furniture continue to sustain rapid growth. Noteworthy additions to the export basket have been hi-tech and high-value products (for example, cell phones and parts, computers, electronics and accessories, automobile parts), that emerged as the largest and fastest-growing export items in 2013. The current account balance turned from a huge deficit of 11 percent of GDP in 2008 to a record-high surplus equaling 6.5 percent of GDP in 2013. However, the current account surplus is projected to narrow over the medium term as imports pick up pace with expectations of accelerated economic recovery.

**Despite the improved macroeconomic balances and strengthened external accounts, a sustained recovery in GDP growth remains hampered by slow-moving structural reforms and global uncertainty.** Domestic demand in Vietnam remains weak on account of subdued private sector confidence, overleveraged state-owned enterprises, undercapitalized banks, and shrinking fiscal space. On the supply side, cross-country competitiveness assessments show that Vietnam is falling behind relative to comparator economies. Reenergizing medium-term growth will require renewed attention on a number of structural reforms—with emphasis on restructuring the country's state-owned banks and enterprises and removing barriers to domestic private investment.

**The decline in inflation has provided the State Bank of Vietnam (SBV) the space to ease policy interest rates in an attempt to boost private demand.** Credit growth, however, is picking up only gradually: total credit to the economy from the banking system is estimated to have grown by about 9 percent in 2013 compared to the annual target of 12 percent. Credit activity remains subdued because banks, with balance sheets saddled by high levels of nonperforming loans, are increasingly risk averse and looking to deleverage. Credit demand also remains weak, reflecting low business confidence among the private sector.

**Important financial sector vulnerabilities remain, creating a drag on overall economic performance.** Nonperforming loans in the banking sector continue to be a major concern, although poor quality data and limited disclosure requirements preclude accurate estimation of their magnitude. In an effort to deal with nonperforming loans of the banking sector, the government has established a Vietnam Asset Management Company (VAMC), which is responsible for the purchase, recovery, and restructuring of the bad debt of banks. However, there are concerns over the operational capacity of the VAMC, the lack of resources (including fiscal) to meet banking sector capitalization needs, and the pace of implementation, among other issues. The issues of bankruptcy, insolvency, and creditor rights will also need to be addressed to facilitate corporate debt restructuring.

**The government is facing growing fiscal challenges due to sluggish revenue collection.** The fiscal deficit target for 2013 was revised from 4.8 percent of GDP to 5.3 percent of GDP (government accounting standards), thereby overshooting the government's indicative deficit target of 4.5 percent of GDP (2011–15). A combination of slower growth and tax relief for enterprises has led to lower buoyancy of the corporate income tax and the value-added tax over the last two years. The government is working on strengthening tax administration to help offset some of the losses. It continues to consolidate capital spending, which is estimated to have fallen from around 10.8 percent of GDP in 2011 to an estimated 7.3 percent in 2013. The growth in recurrent spending declined during 2012–13, although recurrent spending on the social sectors has remained a priority in the State Budget. There are now stricter provisions on spending of revenue collected over what was planned in the original budget. Several measures have been introduced to cut subsidies, goods and services spending, and nonessential spending.

**The government is faced with some crucial fiscal policy choices, as it seeks to balance the twin objectives of economic expansion and macroeconomic stability.** Attention is also needed to the changing composition of public debt. The share of concessional external debt in Vietnam's total public and publicly guaranteed external debt has already started to fall with its graduation to middle-income-country status. This has important implications for long-term fiscal sustainability, since domestic bonds carry considerably higher interest rates and are of much shorter maturity relative to concessional external debt.

### Outlook and Emerging Challenges

**Vietnam's economy is projected to grow at a moderate pace of around 5.5 percent by 2014.** This assumes macroeconomic prudence through the continuation of monetary policy caution and a renewed focus on structural reforms (with particular attention on restructuring the state-owned enterprise and banking sectors and unleashing domestic private sector investment). The trade and current accounts are expected to remain in surplus in 2014, although by a smaller amount than in 2013. Inflation is likely to stay within the government target of 7 percent in 2014 given the modest credit growth and assuming that no major supply-side shocks materialize.

**With the restructuring agenda gaining momentum, some important progress is expected in 2014.** Efforts to divest noncore assets and equitize a large number of state-owned enterprises could send a positive signal to investors about the government's commitment to this agenda. There is an urgent need to resolve the bad debt problem in the banking sector, although given the complexity of the issues involved, it is likely to be a much more drawn-out process. Many of these actions would involve costs, and it is unclear how these will be met.

Vietnam's gains on the macroeconomic front are, however, still fragile and face several downside risks: (i) private sector demand remains sluggish and highly susceptible to any further negative news; (ii) although diminished, the risk remains that authorities could depart from fiscal and monetary discipline to offset weak private sector demand; and (iii) the momentum on structural reforms could further slow, putting GDP growth on a lower trajectory and undercutting fiscal sustainability.

<INSERT VNM COUNTRY TABLE>

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at 11 A.M. SINGAPORE TIME (3 A.M. GMT, APRIL 7; or 11 P.M. EDT, APRIL 6)

## Cambodia: Key Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 7.3 | 7.4 | 7.2 | 7.0 | 7.0 |
| Domestic demand (% change yoy) | 11.9 | 8.5 | 9.7 | 10.2 | 11.0 |
| Industrial production index (2000=100) | 315.9 | 341.1 | 368.4 | 396.1 | 420.0 |
| (% change yoy) | 5.0 | 8.0 | 8.0 | 7.5 | 6.0 |
| Unemployment (%) | | | | | |
| Real wage growth (%) | | | | | |
| Consumer price index (% change yoy) | 2.5 | 4.7 | 5.0 | 5.5 | 6.0 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 15.3 | 14.8 | 15.0 | 15.0 | 15.2 |
| Government expenditures (% GDP) | 21.0 | 21.3 | 20.3 | 20.0 | 20.0 |
| Government balance (% GDP) 1/ | -5.7 | -6.5 | -5.3 | -5.0 | -4.8 |
| Domestic public sector debt (% GDP) | | | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -1,949 | -1,984 | -2,096 | -2,509 | -2,793 |
| Exports of goods (millions US$) | 6,016 | 6,778 | 7,979 | 9,229 | 10,706 |
| (% change yoy) | 15.3 | 12.7 | 17.7 | 15.7 | 16.0 |
| Key export (% change yoy) 2/ | 7.0 | 17.6 | 17.5 | 15.5 | 15.0 |
| Imports of goods (millions US$) | 7,965 | 8,761 | 10,076 | 11,738 | 13,499 |
| (% change yoy) | 18.7 | 10.0 | 15.0 | 16.5 | 15.0 |
| Current account balance (millions US$) 3/ | -1,437 | -1,451 | -1,620 | -1,825 | -2,120 |
| (% GDP) | -10.1 | -9.4 | -9.7 | -10.0 | -10.3 |
| Foreign direct investment (millions US$) | 1,410 | 1,200 | 1,230 | 1,450 | 1,520 |
| External debt (millions US$) | 4,486 | 5,052 | 5,559 | 5,949 | 6,311 |
| (% GDP) | 31.6 | 32.6 | 33.2 | 32.5 | 30.8 |
| Short-term debt (millions US$) | | | | | |
| Debt service ratio (% exports of g&s) | 1.2 | 1.3 | 1.5 | 1.5 | |
| Foreign exchange reserves, gross (millions US$) | 3,463 | 3,643 | 3,879 | 4,267 | 4,609 |
| (months of imports of g&s) | 3.1 | 3.8 | 3.5 | 3.4 | 3.3 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | 29.6 | 28.5 | 26.0 | 25.2 | 24.8 |
| Short-term interest rate (% p.a.) | 13.7 | 13.0 | 13.0 | 12.5 | 12.2 |
| Exchange rate (Riel/US$, eop) | 3,995 | 4,000 | 4,065 | 4,076 | 4,100 |
| Real effective exchange rate (2000=100) | 128.6 | 131.0 | 132.9 | 134.7 | 136.9 |
| (% change yoy) | 3.0 | 1.8 | 1.5 | 1.3 | 1.7 |
| Stock market index (end-period, Aug 88=100) | | | | | |
| Memo: Nominal GDP (millions US$) | 14,196 | 15,491 | 16,722 | 18,291 | 20,486 |

*Sources:* National data sources; IMF; and World Bank staff estimates.
e = estimate.
f = forecast.
p = projection.
1/ Excluding grants.
2/ Garments.
3/ Excluding official transfers.

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**China: Key Indicators**

| | | | | | | 2013 | | | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2012** | **2013** | **2014f** | **2015f** | **2016f** | **Q1** | **Q2** | **Q3** | **Q4** | **Nov** | **Dec** | **Jan** | **Feb** |
| | **Year** | **Year** | **Year** | **Year** | **Year** | | | | | | | | |
| **Output, Employment, and Prices** | | | | | | 7.7 | 7.5 | 7.8 | 7.7 | | | | |
| Real GDP (% change yoy) | 7.7 | 7.7 | 7.6 | 7.5 | 7.5 | | | | | | | | |
| Domestic demand (% change yoy) | 8.1 | 8.3 | 7.7 | 7.5 | 7.5 | | | | | | | | |
| Industrial production index /1 | | | | | | 9.5 | 9.1 | 10.1 | 10.0 | 10.0 | 9.7 | 8.6 | 8.6 |
| (% change yoy) | 10.0 | 9.7 | 9.3 | 9.0 | 9.0 | 4.1 | 4.1 | 4.0 | 4.1 | | | | |
| Unemployment (%) 2/ | 4.1 | 4.1 | 4.1 | 4.1 | 4.1 | | | | | | | | |
| Real wages (% change yoy) | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 2.4 | 2.4 | 2.8 | 2.9 | 3.0 | 2.5 | 2.5 | 2.0 |
| Consumer price index (% change yoy) | 2.6 | 2.6 | 2.8 | 3.1 | 3.2 | | | | | | | | |
| **Public Sector** | | | | | | | | | | | | | |
| Government revenues (% GDP) | 22.6 | 22.7 | 22.0 | 21.6 | 21.1 | | | | | | | | |
| Government expenditures (% GDP) | 24.3 | 24.6 | 23.9 | 23.6 | 23.1 | | | | | | | | |
| Government balance (% GDP) | -1.5 | -2.1 | -1.9 | -2.0 | -2.0 | | | | | | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | | 42.0 | 66.1 | 61.0 | 90.1 | 33.8 | 25.3 | 31.9 | -23.0 |
| Trade balance (billions US$) | 230.3 | 259.2 | 292.2 | 324.9 | 351.2 | 508.9 | 533.1 | 562.2 | 595.4 | 202.2 | 207.7 | 207.1 | 114.1 |
| Exports of goods (billions US$) | 2,048.7 | 2,209.6 | 2,390.8 | 2,589.3 | 2,799.0 | 18.3 | 3.7 | 3.9 | 7.4 | 12.7 | 4.3 | 10.5 | -18.1 |
| (% change yoy) 4/ | 7.9 | 7.9 | 8.2 | 8.3 | 8.1 | 19.2 | 3.5 | 3.8 | 7.4 | 13.3 | 3.9 | 10.7 | |
| Key export (% change yoy) 5/ | 8.4 | 7.9 | 8.0 | 8.2 | 8.3 | 465.4 | 478.4 | 500.7 | 504.8 | 168.4 | 182.1 | 175.3 | 137.1 |
| Imports of goods (billions US$) | 1,818.4 | 1,950.4 | 2,098.6 | 2,264.4 | 2,447.8 | 8.5 | 5.0 | 8.4 | 7.2 | 5.4 | 8.6 | 10.8 | 10.4 |
| (% change yoy) 4/ | 4.3 | 7.3 | 7.6 | 7.9 | 8.1 | 47.6 | 50.9 | 40.4 | 49.8 | | | | |
| Current account balance (billions US$) | 193.1 | 188.6 | 219.8 | 250.8 | 284.5 | | | | | | | | |
| (% GDP) | 2.3 | 2.1 | 2.1 | 2.2 | 2.2 | 29.9 | 32.1 | 26.6 | 29.0 | 8.5 | 12.1 | 10.8 | 8.5 |
| Foreign direct investment (billions US$) /6 | 121.1 | 117.6 | | | | | | | | | | | |
| External debt (billions US$) | 737.0 | | | | | | | | | | | | |
| (% GDP) | 8.9 | | | | | | | | | | | | |
| Short-term debt (billions US$) | 540.9 | | | | | | | | | | | | |
| Debt service ratio (% exports of g&s) | 1.6 | | | | | | | | | | | | |
| Foreign exchange reserves, gross (billions US$) | 3,311.6 | 3,821.3 | 4,192.8 | 4,586.9 | 4,995.9 | | | | | | | | |
| Foreign exchange reserve ($US billion) | | | | | | | | | | | | | |
| **Financial Markets** | | | | | | 17.2 | 16.3 | 16.4 | 15.1 | 16.0 | 15.1 | 15.6 | |
| Domestic credit (% change yoy) | 17.1 | 15.1 | | | | 3.4 | 3.4 | 3.8 | 4.0 | 4.1 | 4.1 | 4.1 | 4.1 |
| Short-term interest rate (% p.a.) 7/ | 3.4 | 3.6 | | | | 6.27 | 6.18 | 6.15 | 6.10 | 6.13 | 6.10 | 6.11 | 6.12 |
| Exchange rate (RMB/US$, eop) | 6.29 | 6.10 | 6.01 | 5.96 | 5.90 | 122.6 | 124.8 | 126.2 | 127.6 | 126.4 | 127.6 | 130.3 | 129.7 |
| Real effective exchange rate (2000=100) | 118.4 | 127.6 | | | | 5.3 | 6.8 | 9.3 | 7.8 | 7.3 | 7.8 | 8.4 | 6.2 |
| (% change yoy) | 2.2 | 7.8 | | | | 2,237 | 1,979 | 2,175 | 2,116 | 2,221 | 2,116 | 2,033 | 2,056 |
| Stock market index (Dec. 19, 1990=100)/8 | 2,269 | 2,116 | | | | | | | | | | | |
| Memo: Nominal GDP (billions US$) | 8,229.2 | 9,185.0 | 10,331.5 | 11,436.9 | 12,665.4 | | | | | | | | |

*Source:* National data sources.

f = forecast.

1/ Annual data are not comparable with the quarterly and monthly data. Annual data cover all industrial enterprises while the quarterly and monthly data only refer to those enterprises with sales above RMB 5.0 million.

2/ Official urban unemployment only, not including laid-off workers.

3/ Central government only. Includes treasury bonds, policy financial bonds, and other financial bonds (end-period outstanding).

4/ Nominal growth rate.

5/ Manufactured exports.

6/ Gross FDI utilized.

7/ Central Bank loans to financial institutions, less than 20 days.

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## Fiji: Key Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 2.2 | 2.7 | 2.4 | 2.4 | 2.3 |
| Tourist arrivals (thousands) | 661 | 670 | 670 | 690 | 710 |
| (% change yoy) | -2.1 | 1.4 | 0.0 | 3.0 | 2.9 |
| Unemployment rate (%) | | | | | |
| Consumer price index (% change yoy) | 1.5 | 3.4 | 3.0 | 3.0 | 3.0 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 26.7 | 26.9 | 32.7 | 26.9 | 26.9 |
| Government expenditures (% GDP) | 27.7 | 29.7 | 34.7 | 29.4 | 29.3 |
| Government balance (% GDP) | -1.0 | -2.8 | -2.0 | -2.5 | -2.4 |
| Domestic public sector debt (% GDP) | 37.0 | 34.7 | 33.3 | 33.7 | 34.1 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -744 | -1,369 | -942 | -985 | -1,027 |
| Exports of goods (millions US$) | 625 | 555 | 581 | 608 | 636 |
| (% change yoy) | 12.7 | -11.1 | 4.6 | 4.6 | 4.6 |
| Key export (% change yoy) 1/ | 7.3 | -2.5 | -0.6 | 0.2 | 0.0 |
| Imports of goods (millions US$) | 1,950 | 2,508 | 2,109 | 2,185 | 2,262 |
| (% change yoy) | 2.7 | 28.6 | -15.9 | 3.6 | 3.5 |
| Current account balance  millions US$) | -41 | -666 | -256 | -280 | -300 |
| (% GDP) | -1.0 | -16.4 | -6.3 | -6.6 | -6.9 |
| Foreign direct investment (millions US$) | 266 | 198 | 322 | 354 | 378 |
| Total external debt (millions US$) | 679 | 1,034 | 1,105 | 1,107 | 1,107 |
| (% GDP) | 16.7 | 26.2 | 27.2 | 26.6 | 26.0 |
| Debt service ratio (% exports of g&s) | 2.6 | 3.1 | 4.2 | 4.1 | 13.7 |
| Foreign exchange reserves, gross (millions US$) 2/ | 853 | 974 | 1,013 | 1,045 | 1,077 |
| (months of imports g&s) | 4.0 | 4.7 | 4.5 | 4.5 | 4.5 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) 3/ | 6.6 | 9.3 | | | |
| Short-term interest rate % p.a.) | 0.6 | 0.2 | | | |
| Exchange rate (FJ$/US$, eop) | 1.77 | 1.88 | | | |
| Real effective exchange rate (2005=100) | 95.0 | 96.0 | | | |
| (% change yoy) | 3.1 | 1.1 | | | |
| Memo: Nominal GDP (millions US$) | 4,013 | 4,061 | 4,099 | 4,222 | 4,345 |

*Source:* National data sources.
e = estimate.
f = forecast.
1/ Sugar.
2/ Rise in debt service ratio in 2011 and 2016 reflects the maturity of the US$150 million and US$250 million global bond, which may be refinanced.
3/ Domestic credit to the private sector.

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**Indonesia: Key Indicators**

| | 2012 | 2013 | 2014f | 2015f | 2016f | 2013 | | | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year | Year | Year | Year | Year | Q1 | Q2 | Q3 | Q4 | Nov | Dec | Jan | Feb |
| **Output, Employment, and Prices** | | | | | | | | | | | | | |
| Real GDP (% change yoy) 1/ | 6.3 | 5.8 | 5.3 | 5.6 | 5.6 | 6.0 | 5.8 | 5.6 | 5.7 | | | | |
| Domestic demand (% change yoy) | 6.1 | 5.1 | 4.7 | 5.4 | | 5.0 | 4.7 | 5.5 | 5.1 | | | | |
| Industrial production index (2000=100) | 108.4 | 114.5 | | | | 112.9 | 114.4 | 115.0 | 115.6 | | | | |
| (% change yoy) | 4.1 | 5.6 | | | | 9.0 | 6.8 | 7.2 | 0.1 | | | | |
| Unemployment (%) | 6.3 | 6.1 | | | | | | | | | | | |
| Real wages (% change yoy) | | | | | | | | | | | | | |
| Consumer price index (% change yoy) 2/ | 4.3 | 7.0 | 6.2 | 5.2 | | 5.3 | 5.6 | 8.6 | 8.4 | | | | |
| **Public Sector** 3/ | | | | | | | | | | | | | |
| Government revenues (% GDP) | 16.2 | 15.3 | 15.5 | | | | | | | | | | |
| Government expenditures (% GDP) | 18.1 | 17.5 | 18.1 | | | | | | | | | | |
| Government balance (% GDP) | -1.9 | -2.2 | -2.6 | | | | | | | | | | |
| Government debt (% GDP) | 24.0 | 25.7 | | | | 23.1 | 22.9 | 21.9 | 22.2 | | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | | | | | | | | | |
| Trade balance (billions US$) 4/ | -1.7 | -5.3 | | | | -0.9 | -3.9 | -2.5 | 2.0 | 0.8 | 1.5 | | |
| Exports of goods (billions US$) 5/ | 188.5 | 183.5 | | | | 45.2 | 45.6 | 44.1 | 48.6 | 15.9 | 17.0 | | |
| (% change yoy) | -6.1 | -2.6 | | | | -6.5 | -4.2 | -3.1 | 3.3 | -2.4 | 10.3 | | |
| Key export (% change yoy) 6/ | -6.6 | -5.6 | | | | -13.4 | -13.1 | 5.0 | 1.3 | .. | .. | | |
| Imports of goods (billions US$) 5/ | 179.9 | 178.9 | | | | 43.6 | 46.1 | 44.0 | 43.7 | 15.1 | 15.5 | | |
| (% change yoy) | 8.4 | -0.5 | | | | -2.1 | -1.4 | 3.9 | -5.5 | -10.5 | -0.8 | | |
| Current account balance (billions US$) | -24.4 | -28.5 | | | | -5.9 | -10.0 | -8.5 | -4.0 | | | | |
| (% GDP) | -2.8 | -3.3 | -2.9 | -2.1 | | -2.7 | -4.4 | -4.0 | -2.0 | | | | |
| Foreign direct investment (billions US$) | 19.1 | 18.4 | | | | 4.0 | 4.6 | 5.8 | 4.1 | | | | |
| External debt (billions US$) | 252.4 | 264.1 | | | | 254.3 | 258.0 | 260.6 | 264.1 | 261.4 | 264.1 | | |
| (% GDP) | 28.8 | 30.4 | | | | 29.0 | 29.1 | 29.6 | 30.6 | | | | |
| Short-term debt (billions US$) | 44.3 | 47.4 | | | | | | | | | | | |
| Debt service | 5.7 | 7.7 | | | | | | | | | | | |
| (% exports of g&s) | 3.0 | 4.2 | | | | | | | | | | | |
| Foreign exchange reserves, gross (billions US$) | 112.8 | 99.4 | | | | 104.8 | 98.1 | 95.7 | 99.4 | 97.0 | 99.4 | 100.7 | 102.7 |
| (months of imports of g&s) | 6.3 | 5.6 | | | | 5.9 | 5.5 | 5.4 | 5.6 | | | | |
| **Financial Markets** | | | | | | | | | | | | | |
| Domestic credit (% change yoy) | 24.2 | 22.1 | | | | 22.9 | 21.2 | 22.5 | 22.0 | 22.2 | 21.6 | | |
| Short-term interest rate (% p.a.) 7/ | 5.8 | 6.5 | | | | 5.8 | 5.8 | 6.9 | 7.4 | 7.5 | 7.5 | 7.5 | |
| Exchange rate (Rupiah/US$, ave) | 9,387 | 10,461 | | | | 9,695 | 9,818 | 10,938 | 11,800 | 11,977 | 12,189 | 12,226 | 11,634 |
| Real effective exchange rate (2000=100) | 99.0 | 97.2 | | | | 99.9 | 101.8 | 96.8 | 90.2 | 90.8 | 88.5 | 89.1 | 90.2 |
| (% change yoy) | -0.9 | -1.8 | | | | -0.2 | 1.9 | -1.9 | -7.4 | -7.0 | -9.4 | -9.8 | -9.8 |
| Stock market index (Aug. 1982=100) 8/ | 4,119 | 4,605 | | | | 4,730 | 4,974 | 4,374 | 4,347 | 4,256 | 4,274 | 4,419 | 4,620 |
| Memo: Nominal GDP (billions US$) | 876.7 | 868.4 | | | | 221.1 | 225.4 | 215.7 | 200.7 | | | | |

*Sources:* National data sources and World Bank staff estimates.

f = forecast.

1/ Based on GDP 2000 base.

2/ End of period.

3/ Central government data. World Bank estimates for 2012.

4/ Goods and services trade balance.

5/ Goods trade on BOP basis from Bank Indonesia with exception of monthly figures from BPS.

6/ Crude oil and gas exports.

7/ Policy rate.

8/ Jakarta Composite Index, end of period.

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## Lao PDR: Key Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 8.2 | 8.1 | 7.2 | 7.9 | 9.1 |
| Consumer price index (% change yoy) | 4.3 | 6.4 | 6.5 | 6.5 | 6.5 |
| **Public Sector** 1/ | | | | | |
| Government revenues (% GDP) | 19.7 | 19.1 | 19.3 | 19.9 | 20.6 |
| Government expenditures (% GDP) | 21.0 | 24.9 | 23.6 | 24.9 | 23.6 |
| Government balance (% GDP) 2/ | -1.3 | -5.8 | -4.3 | -5.0 | -3.0 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -1,477 | -2,393 | -2,461 | -2,494 | -2,262 |
| Exports of goods (millions US$) | 2,892 | 2,901 | 3,030 | 3,319 | 3,742 |
| (% change yoy) | 10.0 | 0.3 | 4.4 | 9.5 | 12.7 |
| Key export (% change yoy) | 11.8 | -2.5 | 4.0 | 4.6 | 5.2 |
| Imports of goods (millions US$) | 4,369 | 5,294 | 5,491 | 5,813 | 6,004 |
| (% change yoy) | 29.0 | 21.2 | 3.7 | 5.9 | 3.3 |
| Current account balance (millions US$) | -1,440 | -2,313 | -2,385 | -2,468 | -2,499 |
| (% GDP) | -15.0 | -20.8 | -19.9 | -18.2 | -16.4 |
| Foreign direct investment (millions US$) | 1,764 | 2,697 | 2,608 | 2,681 | 2,543 |
| External debt (millions US$) | 9,687 | 12,347 | 15,170 | 17,509 | 18,792 |
| (% GDP) | 89.9 | 109.1 | 125.7 | 131.5 | 125.7 |
| Debt service ratio (% exports of g&s) | 52.2 | 70.7 | 69.8 | 62.3 | 104.5 |
| Foreign exchange reserves, gross (millions US$) 3/ | 739 | 598 | 621 | 710 | 789 |
| (months of imports of g&s) | 1.9 | 1.3 | 1.3 | 1.4 | 1.5 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) 4/ | 26.6 | 24.3 | 23.2 | 21.3 | 20.0 |
| Short-term interest rate (% p.a.) 5/ | 7.8 | 7.8 | | | |
| Exchange rate (Kip/US$, ave) | 7,982 | 7,862 | 8,000 | 8,000 | 8,000 |
| Real effective exchange rate (2000=100) | 133.7 | 141.3 | | | |
| (% change yoy) | 5.1 | 5.7 | | | |
| Memo: Nominal GDP (millions US$) | 9,418 | 11,120 | 11,984 | 13,568 | 15,260 |

*Source:* National data sources.
e = estimate.
f = forecast.
1/ Fiscal year basis.
2/ After grants.
3/ Excluding gold.
4/ Excludes government lending funds.
5/ Treasury bill rate.

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## Malaysia: Key Indicators

| | 2012 | 2013 | 2014f | 2015f | 2016f | 2013 | | | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year | Year | Year | Year | Year | Q1 | Q2 | Q3 | Q4 | Nov | Dec | Jan | Feb |
| **Output, Employment, and Prices** | | | | | | | | | | | | | |
| Real GDP (% change yoy) | 5.6 | 4.7 | 4.9 | 5.0 | 5.0 | 4.1 | 4.3 | 5.0 | 5.1 | | | | |
| Domestic demand (% change yoy) | 11.3 | 7.3 | 6.8 | 6.4 | | 8.7 | 8.3 | 5.3 | 6.7 | | | | |
| Industrial production index (2000=100) | 113.1 | 116.2 | | | | 111.8 | 115.7 | 116.4 | 120.9 | 119.9 | 120.4 | | |
| (% change yoy) | 4.4 | 2.7 | | | | -0.1 | 3.7 | 3.7 | 3.4 | 3.7 | 4.8 | | |
| Unemployment (%) | 3.0 | 3.1 | | | | 3.2 | 3.0 | 3.1 | 3.2 | 3.4 | 3.0 | | |
| Real wages (% change yoy) 1/ | 4.7 | 5.6 | | | | 5.3 | 4.4 | 7.3 | 5.4 | 3.6 | 6.0 | | |
| Consumer price index (% change yoy) | 1.7 | 2.1 | 3.2 | 3.0 | | 1.5 | 1.8 | 2.2 | 3.0 | 2.9 | 3.2 | | |
| **Public Sector** | | | | | | | | | | | | | |
| Government revenues (% GDP) 2/ | 22.1 | 21.7 | 22.2 | 22.4 | | | | | | | | | |
| Government expenditures (% GDP) 2/ | 26.5 | 24.7 | 26.1 | 25.9 | | | | | | | | | |
| Government balance (% GDP) 2/ | -4.5 | -3.0 | -3.9 | -3.5 | | | | | | | | | |
| Domestic public sector debt (% GDP) 2/ | 53.3 | 54.8 | 53.2 | 52.0 | | 53.8 | 54.6 | 54.9 | 54.8 | | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | | | | | | | | | |
| Trade balance (billions US$) 3/ | 36.2 | 27.8 | 30.1 | 39.3 | | 6.9 | 4.9 | 6.6 | 9.3 | 3.0 | 2.9 | | |
| Exports of goods (billions US$) | 227.9 | 219.3 | | | | 55.0 | 53.1 | 54.3 | 56.9 | 19.3 | 20.0 | | |
| (% change yoy) | -0.4 | -3.8 | | | | -2.6 | -8.5 | 0.8 | 3.1 | 6.7 | 14.4 | | |
| Key export (% change yoy) 4/ | -5.0 | 9.3 | | | | 0.9 | -2.9 | 14.7 | 24.3 | 27.3 | 24.3 | | |
| Imports of goods (billions US$) | 187.2 | 186.7 | | | | 47.0 | 47.1 | 46.3 | 46.4 | 16.3 | 17.1 | | |
| (% change yoy) | 4.4 | -0.3 | | | | 4.8 | -2.6 | 0.9 | 4.3 | 6.4 | 14.5 | | |
| Current account balance (billions US$) | 18.6 | 11.8 | 12.6 | 20.4 | | 2.8 | 0.8 | 3.0 | 5.1 | | | | |
| (% GDP) | 6.4 | 3.8 | 3.5 | 5.1 | | 3.7 | 1.1 | 3.9 | 6.1 | | | | |
| Foreign direct investment (billions US$) 5/ | 9.4 | 8.8 | | | | 3.0 | 2.9 | 0.0 | 0.0 | | | | |
| External debt (billions US$) | 82.6 | 96.9 | | | | 85.6 | 89.6 | 94.1 | 96.9 | | | | |
| (% GDP) | 27.1 | 31.0 | | | | 28.0 | 29.0 | 30.4 | 31.0 | | | | |
| Short-term debt (billions US$) | 30.4 | 39.0 | | | | 32.8 | 36.0 | 36.9 | 39.0 | | | | |
| Debt service ratio (% exports of g&s) | 10.1 | 10.3 | | | | 10.4 | 11.1 | 10.4 | 9.4 | | | | |
| Foreign exchange reserves, gross (billions US$) | 139.7 | 134.9 | | | | 139.7 | 136.1 | 136.5 | 134.9 | 136.3 | 134.9 | | |
| (months of imports of g&s) 3/ | 9.6 | 9.2 | | | | 9.7 | 9.1 | 9.4 | 9.5 | 9.5 | 9.5 | | |
| **Financial Markets** | | | | | | | | | | | | | |
| Domestic credit (% change yoy) 6/ | 12.0 | 10.0 | | | | 11.1 | 9.6 | 9.4 | 10.1 | 9.9 | 10.6 | | |
| Short-term interest rate (% p.a.) 7/ | 3.0 | 3.0 | | | | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | | |
| Exchange rate (Ringgit/US$, eop) | 3.06 | 3.28 | | | | 3.09 | 3.18 | 3.26 | 3.28 | 3.23 | 3.28 | | |
| Real effective exchange rate (2000=100) 8/ | 99.7 | 100.1 | | | | 100.4 | 102.5 | 98.1 | 99.4 | 99.8 | 98.9 | | |
| (% change yoy) | -0.2 | 0.4 | | | | 0.0 | 3.3 | -0.9 | -0.6 | -0.5 | -1.1 | | |
| Stock market index (Jan. 1, 1997=100) 9/ | 1,610 | 1,746 | | | | 1,672 | 1,774 | 1,769 | 1,867 | 1,813 | 1,867 | | |
| Memo: Nominal GDP (billions US$) | 305.1 | 312.5 | | | | 75.4 | 77.2 | 77.1 | 82.4 | | | | |

*Sources:* National data sources; World Bank staff estimates.
f = forecast.
1/ Manufacturing wages only.
2/ Federal government only.
3/ Balance of goods and services.
4/ Thermionic valves & tubes, photocells, etc.
5/ Inward FDI.
6/ Total loans in the banking system.
7/ Overnight Policy Rate (OPR).
8/ *Source:* BIS.
9/ FTSE Bursa Malaysia Composite, end-period.

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## Mongolia: Key Economic Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 12.4 | 11.7 | 11.4 | 9.2 | 7.6 |
| Mineral GDP (%, yoy) | 8.0 | 20.7 | 32.4 | 13.8 | 1.1 |
| Consumer price index (% change yoy) 1/ | 14.2 | 12.3 | 12.5 | 9.9 | 8.0 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 35.5 | 33.8 | 31.9 | 31.7 | 32.4 |
| Government expenditures (% GDP) | 46.7 | 44.7 | 41.0 | 37.1 | 35.6 |
| Government balance (% GDP) | -11.1 | -10.9 | -9.1 | -5.4 | -3.2 |
| Total public sector debt (% GDP) | 62.7 | 58.7 | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -2,354 | -2,082 | -1,122 | -819 | -768 |
| Exports of goods (millions US$) | 4,384 | 4,273 | 5,366 | 6,150 | 6,758 |
| (% change yoy) | -9.0 | -2.6 | 25.6 | 14.6 | 9.9 |
| Imports of goods (millions US$) | 6,738 | 6,355 | 6,488 | 6,969 | 7,526 |
| (% change yoy) | 2.1 | -5.7 | 2.1 | 7.4 | 8.0 |
| Current account balance (millions US$) | -3,362 | -3,155 | -2,435 | -2,270 | -2,087 |
| (% GDP) | -32.8 | -27.5 | -20.8 | -16.9 | -13.7 |
| Foreign direct investment (millions US$) | 4,407 | 2,342 | | | |
| Foreign exchange reserves, gross (millions US$) | 4,126 | 2,242 | | | |
| (month of imports of g&s) | 6.4 | 3.5 | | | |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | -7.5 | 146.0 | | | |
| Reserve money (% change yoy) | 30.5 | 54.0 | | | |
| Short-term interest rate (% p.a.) 2/ | 13.3 | 10.5 | | | |
| Exchange rate (Tugrik/US$, eop) | 1,392 | 1,674 | | | |
| Real effective exchange rate (2000=100) | 140.0 | 136.5 | | | |
| (% change yoy) | 5.1 | -2.5 | | | |
| Stock market index (Dec. 2000=100) 3/ | 17,714 | 16,736 | | | |
| Memo: Nominal GDP (millions US$) | 10,067 | 11,471 | 11,725 | 13,398 | 15,277 |

*Sources:* Bank of Mongolia; National Statistical Office; Ministry of Finance; IMF; World Bank staff estimates.
e = estimate.
f = forecast.
1/ Ulaanbaatar.
2/ Base policy rate.
3/ Top-20 index.

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## Myanmar: Key Economic Indicators

| | 2012/13e Fiscal Yr. | 2013/14f Fiscal Yr. | 2014/15f Fiscal Yr. | 2015/16f Fiscal Yr. | 2016/17f Fiscal Yr. |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) 1/ | 7.3 | 7.5 | 7.8 | 7.8 | 7.8 |
| Consumer price index (% change yoy) | 2.8 | 5.8 | 6.6 | 6.9 | 6.5 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) 2/ | 23.3 | 22.3 | 24.1 | 23.0 | 23.3 |
| Government expenditures (% GDP) 2/ | 27.2 | 27.2 | 28.6 | 28.8 | 28.0 |
| Government balance, official (% GDP) 2/ | -3.9 | -4.9 | -4.5 | -5.8 | -4.7 |
| Domestic public sector debt (% GDP) 3/ | 22.5 | 23.1 | 23.0 | 23.3 | 22.9 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -2,119 | -2,045 | -1,654 | -2,003 | -2,195 |
| Exports of goods (millions US$) | 10,345 | 11,947 | 14,678 | 16,428 | 18,479 |
| (% change yoy) | 1.1 | 15.5 | 22.9 | 11.9 | 12.5 |
| Imports of goods (millions US$) | 12,464 | 13,992 | 16,332 | 18,431 | 20,674 |
| (% change yoy) | 19.4 | 12.3 | 16.7 | 12.9 | 12.2 |
| Current account balance including grants (millions US$) | -2,429 | -2,713 | -3,051 | -3,078 | -3,328 |
| (% GDP) | -4.4 | -4.8 | -5.1 | -4.8 | -4.7 |
| Foreign direct investment (millions US$) | 2,800 | 2,461 | 2,450 | 2,950 | 3,469 |
| External debt arrears (millions US$) | 2,372 | 0 | 0 | 0 | 0 |
| Total external debt including arrears (millions US$) | 13,500 | 10,700 | 11,700 | 13,200 | 14,700 |
| (% GDP) | 24.2 | 19.0 | 19.4 | 20.4 | 20.8 |
| Debt service ratio (% exports of g&s) 4/ | 2.3 | 2.9 | 2.7 | 2.5 | 2.3 |
| Foreign exchange reserves, gross (millions US$) 5/ | 4,591 | 4,913 | 6,027 | 7,420 | 9,087 |
| (months of imports of g&s) 6/ | 3.6 | 3.3 | 3.6 | 4.0 | 4.3 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | 5.1 | 33.5 | 23.2 | 23.6 | 8.6 |
| Official exchange rate (Kyat/US$) 7/ | 880.00 | | | | |
| Parallel effective exchange rate 7/ | 878.00 | 965.00 | | | |
| (% change yoy) | 6.8 | | | | |
| Memo: Nominal GDP (millions US$) 8/ | 55,800 | 56,400 | 60,300 | 64,800 | 70,800 |

*Sources:* Myanmar Central Statistical Organization; Ministry of Finance; Central Bank of Myanmar; IMF staff estimates; and, World Bank staff estimates.

e = estimate.

f = forecast.

1/ Staff estimates.

2/ Consolidated public sector including Union Government and State Economic Enterprises.

3/ Domestic public sector debt.

4/ Assumes exports of nonfactor services are 7 percent of exports F.O.B.

5/ Includes official reserves held outside the central bank.

6/ Assumes imports of nonfactor services are 10 percent of imports C.I.F.

7/ Authorities adpopted a managed float on April 1, 2012.

8/ Before FY2012/13, GDP converted at a weighted exchange rate, where the official and FEC market rates are weighted with about 8 and 92 percent, based on the respective shares of public and private sectors in GDP.

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## Papua New Guinea: Key Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 8.7 | 4.4 | 10.0 | 20.0 | 4.0 |
| Real nonmineral GDP (% change yoy) | 9.0 | 3.8 | 0.0 | 2.0 | 4.0 |
| Formal employment (BPNG index, % change yoy) | 5.8 | 2.0 | -2.0 | 1.0 | 2.0 |
| Consumer price index (% change yoy) | 1.6 | 6.0 | 6.0 | 5.5 | 5.5 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 29.6 | 27.6 | 25.9 | 22.4 | 22.8 |
| Government expenditures (% GDP) | 32.8 | 34.6 | 33.9 | 25.0 | 24.8 |
| Government balance (% GDP) | -3.2 | -7.0 | -8.0 | -2.6 | -2.0 |
| Nonmineral government balance (% GDP) | -3.2 | -7.0 | -8.0 | -2.6 | -2.0 |
| Public and publicly guaranteed debt (% GDP) 1/ | 26.7 | 31.6 | 35.0 | 26.7 | 27.7 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (millions US$) | -1,207 | 609 | 2,719 | 16,900 | 16,664 |
| Exports of goods (millions US$) | 6,144 | 5,965 | 7,154 | 12,063 | 11,799 |
| (% change yoy) | -11.0 | -2.9 | 19.9 | 68.6 | -2.2 |
| Key export (% change yoy) 2/ | -7.9 | 0.2 | 22.1 | 86.2 | -2.8 |
| Imports of goods (millions US$) | -7,351 | -5,355 | -4,435 | -4,837 | -4,865 |
| (% change yoy) | 17.1 | -27.2 | -17.2 | 9.1 | 0.6 |
| Current account balance (millions US$) | -7,717 | -4,355 | -357 | 3,021 | 2,323 |
| (% GDP) | -51.0 | -27.0 | -2.0 | 12.3 | 9.3 |
| Foreign direct investment (millions US$) | 1,883 | 904 | 1,800 | 1,000 | 1,000 |
| External debt (millions US$) | 23 | 21 | 21 | 20 | 20 |
| (% GDP) | 152.8 | 132.8 | 116.5 | 81.7 | 80.1 |
| Debt service ratio (% exports of g&s) 3/ | 0.7 | 1.4 | 1.2 | 0.8 | 0.7 |
| Foreign exchange reserves, gross (millions US$) | 3,804 | 2,800 | 3,000 | 3,500 | 4,000 |
| (months of imports of g&s) 4/ | 12.7 | 8.4 | 7.7 | 9.2 | 10.0 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | 15.0 | 12.0 | 10.0 | 10.0 | 10.0 |
| Short-term interest rate (% p.a.) | 7.00 | 6.25 | 6.75 | 7.00 | 7.00 |
| Exchange rate (Kina/US$, eop) | 2.06 | 2.53 | 2.64 | 2.73 | 2.83 |
| Real effective exchange rate (2005=100) | 147.0 | 153.0 | 153.0 | 153.0 | 153.0 |
| (% change yoy) | 15.3 | 4.1 | | | |
| Memo: Nominal GDP (millions US$) | 15,134 | 16,095 | 18,062 | 24,489 | 24,977 |

*Sources:* National data sources; IMF; World Bank staff estimates.
e = estimate.
f = forecast.
1/ Not including debts of state-owned enterprises, or assets of Bank of Papua New Guinea.
2/ Mineral exports.
3/ Public debt service ratio.
4/ Months imports of nonmining goods and services.

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## Philippines: Key Indicators

| | 2012 | 2013 | 2014f | 2015f | 2016f | 2013 | | | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year | Year | Year | Year | Year | Q1 | Q2 | Q3 | Q4 | Nov | Dec | Jan | Feb |
| **Output, Employment and Prices** | | | | | | | | | | | | | |
| Real GDP (% change yoy) 1/ | 6.8 | 7.2 | 6.6 | 6.9 | 6.5 | 7.7 | 7.6 | 6.9 | 6.5 | | | | |
| Industrial production index (2000 = 100) | 100.2 | 115.4 | | | | 101.7 | 108.3 | 119.0 | 132.4 | 133.3 | 134.3 | | |
| (% change yoy) | 7.7 | 15.1 | | | | 4.5 | 12.5 | 17.7 | 24.7 | 25.4 | 26.5 | | |
| Unemployment (%) 2/ | 7.0 | 7.1 | | | | 7.1 | 7.5 | 7.3 | 6.5 | | | | |
| Nominal wages (% change yoy) 3/ | 4.7 | 4.6 | | | | 7.0 | 5.4 | 2.2 | 3.7 | 4.5 | 2.2 | 2.2 | 2.2 |
| Real wages (% change yoy) 3/ | 1.8 | 2.9 | | | | 4.7 | 3.6 | 1.5 | 1.8 | 2.5 | -0.3 | -0.5 | -0.6 |
| Consumer price index (% change yoy) | 3.2 | 3.0 | 5.0 | 4.5 | 4.0 | 3.2 | 2.6 | 2.5 | 3.5 | 3.3 | 4.1 | 4.2 | 4.1 |
| **Public Sector** | | | | | | | | | | | | | |
| Government revenues (% GDP) | 14.5 | 14.9 | 15.2 | 15.6 | 16.0 | 13.8 | 16.7 | 15.3 | 13.8 | | | | |
| Government expenditures (% GDP) | 16.8 | 16.3 | 17.3 | 18.0 | 18.2 | 16.4 | 16.2 | 17.1 | 15.8 | | | | |
| Government balance (% GDP) 4/ | -2.4 | -1.6 | -3.0 | -2.8 | -2.4 | -2.6 | 0.4 | -1.9 | -2.0 | | | | |
| Domestic public sector debt (% GDP) 5/ | 52.9 | | | | | | | | | | | | |
| **Foreign Trade, BOP, and External Debt** | | | | | | | | | | | | | |
| Trade balance (billions US$) 6/ | -14.8 | -18.0 | -22.8 | -24.7 | -27.2 | -2.3 | -1.8 | -2.3 | -1.6 | -0.9 | -0.8 | -1.4 | |
| Exports of goods (billions US$) 6/ | 51.6 | 53.7 | 57.5 | 62.1 | 67.4 | 12.1 | 13.5 | 14.5 | 13.9 | 4.3 | 4.6 | 4.4 | |
| (% change yoy) | 8.5 | 4.1 | 7.0 | 8.0 | 8.5 | -6.0 | -2.7 | 8.7 | 16.1 | 18.9 | 15.8 | 9.3 | |
| Key export (% change yoy) 6/, 7/ | -1.0 | | | | | -28.0 | -2.1 | 4.9 | 19.4 | 15.5 | 28.1 | 22.7 | |
| Imports of goods (billions US$) 6/ | 66.4 | 71.7 | 80.3 | 86.8 | 94.6 | 14.4 | 15.3 | 16.7 | 15.5 | 5.2 | 5.4 | 5.8 | |
| (% change yoy) | 5.1 | 7.9 | 12.0 | 8.0 | 9.0 | -7.4 | 0.0 | 8.5 | -1.6 | 0.5 | 3.2 | 21.8 | |
| Current account balance (billions US$) 6/ | 7.0 | 5.4 | 2.9 | 3.9 | 5.5 | | | | | | | | |
| (% GDP) | 2.9 | 2.0 | 1.0 | 1.2 | 1.5 | | | | | | | | |
| Foreign direct investment (billions US$) 6/ | 2.0 | 3.9 | 4.2 | 4.5 | 5.5 | | | | | | | | |
| External debt (billions US$) 8/ | 60.3 | | | | | 2.1 | 0.0 | 1.0 | 0.7 | 0.3 | 0.2 | | |
| (% GDP) | 28.8 | 27.7 | 29.8 | 28.9 | 27.7 | 59.0 | 58.0 | 59.1 | | | | | |
| Short-term debt (billions US$) 8/ | 8.5 | | | | | | | | | | | | |
| Debt service ratio (% exports of g&s) | 9.0 | | | | | 9.8 | 9.5 | 9.9 | | | | | |
| Foreign exchange reserves, gross (billions US$) 8/ | 83.8 | 83.7 | 85.2 | 86.1 | 86.6 | 84.0 | 81.3 | 83.5 | 83.2 | 83.6 | 83.2 | 78.9 | 80.3 |
| (months of imports of g&s) 9/ | 11.9 | 11.0 | 10.2 | 9.6 | 8.9 | 12.2 | 11.8 | 11.9 | 11.9 | 11.9 | 11.9 | 11.3 | |
| **Financial Markets** | | | | | | | | | | | | | |
| Domestic credit (% change yoy) 10/ | 7.3 | 11.6 | | | | 14.8 | 11.0 | 10.6 | 10.8 | 10.2 | 10.8 | 14.6 | 14.3 |
| Short-term interest rate (% p.a.) 11/ | 4.1 | 2.2 | | | | 2.8 | 2.2 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Exchange rate (PHP/US$, ave) | 43.3 | 42.4 | | | | 40.7 | 41.7 | 43.7 | 43.6 | 43.6 | 44.1 | 44.9 | 44.9 |
| Real effective exchange rate (2005=100) 12/ | 132.8 | 138.2 | | | | 141.5 | 140.4 | 135.0 | 135.8 | 135.8 | 136.0 | | |
| (% change yoy) 13/ | 4.8 | 4.0 | | | | 9.9 | 6.8 | 0.1 | -0.3 | -0.6 | -0.8 | | |
| Stock market index (Jan. 2, 1985=100) 14/ | 5,168 | 6,479 | | | | 6,418 | 6,850 | 6,391 | 6,248 | 6,268 | 5,942 | 6,008 | 6,161 |
| Memo: Nominal GDP (billions US$) | 243.9 | 272.3 | 288.7 | 326.0 | 366.0 | 65.0 | 68.3 | 64.1 | 74.5 | | | | |

*Source:* National data sources.
f = forecast.
1/ The GDP series has a break in 2000.
2/ Figures are from the Labor Force Survey.
3/ Nonagriculture minimum wage, National Capital Region. *Source:* CEIC.
4/ IMF Government Financial Statistics basis.
5/ Total consolidated nonfinancial public sector domestic debt.
6/ Yearly data are central bank data, balance-of-payments BPM5 format; monthly and quarterly data are National Statistics data.
7/ Electronic products and other electronics.
8/ Central bank data, % of annual GDP for quarterly figures.
9/ Based on end-of-period gross international reserves.
10/ Based on Depository Corporations Survey.
11/ Interbank call rate.
12/ IMF, IFS data.
13/ World Bank staff estimates.
14/ PSEi Composite, period average for annual figures.

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## Solomon Islands: Key Indicators

| | 2012<br>Year | 2013e<br>Year | 2014f<br>Year | 2015f<br>Year | 2016f<br>Year |
|---|---|---|---|---|---|
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) | 4.9 | 3.1 | 3.5 | 3.5 | 3.5 |
| Consumer price index (% change yoy) | 5.9 | 2.5 | 5.0 | 5.0 | 5.0 |
| **Public Sector** | | | | | |
| Government revenues and grants (% GDP) 1/ | 53.7 | 53.5 | 49.6 | 49.2 | 48.0 |
| Government expenditures (% GDP) 1/ | 49.8 | 53.2 | 49.3 | 49.9 | 48.5 |
| Government balance (% GDP) | 3.9 | 0.3 | 0.3 | -0.7 | -0.5 |
| Public and publicly guaranteed debt (% GDP) | 17.5 | 14.6 | 14.1 | 14.5 | 15.2 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance of goods and services (millions US$) | -16 | -110 | -185 | -204 | -224 |
| Exports of goods and services (millions US$) | 635 | 598 | 614 | 675 | 743 |
| (% change yoy) | 14.1 | -5.9 | 2.7 | 10.0 | 10.0 |
| Key export (% change yoy) 2/ | 14.5 | -8.8 | -8.0 | -8.0 | -8.0 |
| Imports of goods (millions US$) | 651 | 708 | 799 | 879 | 967 |
| (% change yoy) | 6.7 | 8.8 | 12.9 | 10.0 | 10.0 |
| Current account balance (millions US$) | 2 | 46 | -157 | -163 | -170 |
| (% GDP) | -15.0 | -12.0 | -13.0 | -12.4 | -11.9 |
| Foreign direct investment, net (millions US$) | 66 | 49 | 100 | 120 | 130 |
| Total external debt (millions US$) 3/ | 130 | 124 | 138 | 163 | 191 |
| (% GDP) | 13.0 | 11.3 | 11.5 | 12.4 | 13.4 |
| Debt service ratio (% exports of g&s) | 2.4 | 2.5 | 2.8 | 3.4 | 3.5 |
| Foreign exchange reserves, gross (millions US$) 4/ | 500 | 520 | 528 | 538 | 545 |
| (months of imports g&s) | 8.5 | 7.8 | 7.6 | 7.4 | 7.1 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) 5/ | 4.1 | 13.9 | 5.5 | 5.5 | 5.5 |
| Exchange rate (SBD$/US$, eop) | 7.30 | 7.29 | 7.30 | 7.53 | 7.76 |
| Real effective exchange rate (2005=100) | 127.6 | 125.0 | 125.0 | 125.0 | 125.0 |
| (% change yoy) | 2.1 | -2.0 | 0.0 | 0.0 | 0.0 |
| Memo: Nominal GDP (millions US$) | 1,000 | 1,097 | 1,206 | 1,317 | 1,432 |

*Source:* National data sources; IMF; World Bank staff estimates.
e = estimate.
f = forecast.
1/ estimate.
2/ Logs.
3/ External public and publicly guaranteed debt.
4/ Includes foreign assets of nonbank financial institutions.
5/ Domestic credit to the private sector.

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**Thailand: Key Indicators**

| | 2012 | 2013 | 2014f | 2015f | 2016f | 2013 | | | | 2013 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year | Year | Year | Year | Year | Q1 | Q2 | Q3 | Q4 | Nov | Dec | Jan | Feb |
| **Output, Employment, and Prices** | | | | | | | | | | | | | |
| Real GDP (% change yoy) | 6.5 | 2.9 | 3.0 | 4.5 | 4.5 | 5.4 | 2.9 | 2.7 | 0.6 | | | | |
| Domestic demand (% change yoy) | 9.4 | 1.3 | 0.2 | 3.7 | | 5.0 | 3.8 | | | | | | |
| Industrial production index (2000=100) | 181.6 | 175.8 | | | | 184.8 | 174.4 | 173.6 | 170.5 | 171.9 | 168.3 | 169.1 | |
| (% change yoy) | 2.2 | -3.1 | | | | 2.9 | -4.9 | -3.5 | -7.1 | -10.7 | -6.3 | -6.4 | |
| Unemployment (%) | 0.7 | 0.7 | | | | 0.7 | 0.7 | 0.7 | 0.8 | 0.7 | 0.7 | | |
| Real wages (% change yoy) 1/ | 19.6 | 9.3 | | | | 13.7 | 7.0 | 9.1 | 7.2 | 9.9 | 7.8 | | |
| Consumer price index (% change yoy) | 3.0 | 2.6 | 2.5 | 2.8 | | 3.1 | 2.3 | 1.7 | 1.7 | 1.9 | 1.7 | 1.9 | 2.0 |
| **Public Sector** | | | | | | | | | | | | | |
| Government revenues (% GDP) | 18.2 | 18.0 | 18.1 | | | 15.9 | 21.9 | 17.7 | 19.3 | 15.2 | 16.4 | | |
| Government expenditures (% GDP) 2/ | 21.5 | 20.5 | 19.0 | | | 19.8 | 16.6 | 18.0 | 21.8 | 25.5 | 31.6 | | |
| Government balance (% GDP) 2/ | -3.3 | -2.5 | -0.9 | | | -3.9 | 5.3 | 6.0 | 3.9 | -9.1 | -8.5 | | |
| Public sector debt (% GDP) | 43.6 | 44.3 | | | | 43.8 | 44.6 | 44.2 | 44.2 | 44.2 | 44.2 | 46.3 | |
| **Foreign Trade, BOP, and External Debt** | | | | | | | | | | | | | |
| Trade balance (billions US$) 3/ | 6.0 | 1.8 | 12.3 | 12.7 | | -1.6 | -1.0 | -0.6 | -0.9 | 1.5 | 2.0 | -0.7 | |
| Exports of goods (billions US$) | 225.9 | 225.4 | 24.2 | 259.3 | | 56.0 | 55.6 | 58.8 | 56.6 | 18.6 | 18.3 | 17.7 | |
| (% change yoy) | 3.1 | -0.2 | 7.5 | 7.0 | | 4.1 | -1.9 | -1.7 | -1.0 | -4.0 | 1.8 | -1.5 | |
| Key export (% change yoy) 4/ | 3.4 | -1.6 | .. | .. | | -1.3 | -13.8 | | | -0.1 | 1.5 | 2.7 | |
| Imports of goods (billions US$) | 219.9 | 219.0 | 230.0 | 246.6 | | 57.6 | 56.5 | 60.7 | 59.2 | 17.1 | 16.3 | 18.4 | |
| (% change yoy) | 8.8 | -0.4 | 5.0 | 7.2 | | 8.5 | 1.0 | -2.0 | -7.9 | -9.3 | -9.3 | -12.9 | |
| Current account balance (billions US$) | -1.5 | -2.8 | 2.3 | 0.7 | | 0.1 | -7.2 | -0.9 | 5.2 | 2.3 | 2.5 | 0.2 | |
| (% GDP) | -0.4 | -0.7 | 0.6 | 0.2 | | 0.1 | -7.2 | -1.0 | 5.5 | | | | |
| Foreign direct investment (billions US$) 5/ | 10.7 | 12.8 | | | | 2.5 | 3.1 | 5.7 | 1.6 | 1.0 | -0.1 | | |
| External debt (billions US$) | 130.7 | 139.8 | | | | 138.6 | 141.2 | 139.1 | 139.8 | 139.1 | 139.8 | | |
| (% GDP) | 35.7 | 35.7 | | | | 35.4 | 36.0 | 35.5 | 35.7 | 35.5 | 35.7 | | |
| Short-term debt (billions US$) | 58.2 | 60.1 | | | | 60.3 | 63.5 | 62.1 | 60.1 | 60.0 | 60.1 | | |
| Debt service ratio (% exports of g&s) | 4.2 | 3.7 (Sep) | | | | 4.9 | 3.4 | 3.7 | | | | | |
| Foreign exchange reserves, gross (billions US$) | 171.1 | 159.0 | | | | 167.7 | 162.5 | 163.5 | 159.0 | 159.0 | 159.0 | 158.3 | 159.3 |
| (months of imports of g&s) | 7.5 | 7.2 | | | | 7.2 | 7.0 | 7.4 | 7.3 | | | | |
| **Financial Markets** | | | | | | | | | | | | | |
| Domestic credit (% change yoy) 6/ | 15.3 | 9.9 | | | | 15.8 | 15.3 | | | | | | |
| Short-term interest rate (% p.a.) 7/ | 2.9 | 2.5 | | | | 2.75 | 2.58 | 2.50 | 2.33 | 2.25 | 2.25 | 2.25 | 2.25 |
| Exchange rate (Baht/US$, ave) | 31.05 | 30.73 | 32.50 | 32.50 | | 29.78 | 29.88 | 31.44 | 31.72 | 31.64 | 32.35 | 32.94 | 32.65 |
| Real effective exchange rate (2000=100) 8/ | 102.6 | 107.5 | | | | 109.5 | 111.7 | 105.8 | 103.1 | 103.4 | 101.5 | 100.1 | |
| (% change yoy) | 0.6 | 4.8 | | | | 8.5 | 9.4 | 2.8 | -1.3 | -0.9 | -3.2 | -7.0 | |
| Stock market index (Dec. 1996=100) 9/ | 1,392 | 1,299 | | | | 1,561 | 1,452 | 1,383 | 1,299 | 1,371 | 1,299 | 1,274 | 1,325 |
| Memo: Nominal GDP (billions US$) | 366.4 | 392.0 | 386.4 | 412.5 | | 100.7 | 98.9 | 93.0 | 95.1 | | | | |

*Sources:* National data sources; World Bank staff estimates.
f = forecast.
1/ Average monthly wage
2/ Cash balance of the central government, including off-budget expenditure
3/ Balance of goods
4/ Electronics
5/ Non-bank FDI
6/ Bank of Thailand, end-of-period
7/ Policy rate, average
8/ Bank of Thailand, trade-weight broad 23, average
9/ Stock Exchange of Thailand (SET) index, end-of-period

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## Timor-Leste: Key Indicators

| | 2012 Year | 2013e Year | 2014f Year | 2015f Year | 2016f Year |
|---|---|---|---|---|---|
| **Output, Employment and Prices** | | | | | |
| Real GDP (% change yoy) | 5.7 | -3.2 | -6.9 | 1.7 | -2.1 |
| Real nonoil GDP (% change yoy) | 8.3 | 8.1 | 8.0 | 7.7 | 8.6 |
| Consumer price index (% change yoy, annual average) | 13.1 | 10.6 | 9.5 | 8.1 | 7.1 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 69.1 | 59.7 | 63.6 | 60.9 | 63.4 |
| Government expenditures (% GDP) | 22.1 | 23.5 | 26.5 | 27.5 | 27.5 |
| Government balance (% GDP) | 47.0 | 36.2 | 37.1 | 33.4 | 35.9 |
| Nonoil government balance (% GDP) | -15.8 | -17.2 | -19.0 | -19.6 | -19.1 |
| Nonoil government balance (% nonoil GDP) | -73.7 | -65.2 | -56.7 | -51.8 | -43.5 |
| Public sector debt (% GDP) /1 | 0.0 | 0.7 | 5.6 | 11.1 | 16 |
| **Foreign Trade, BOP and External Debt** | | | | | |
| Trade balance (millions US$) | -639 | -731 | -829 | -904 | -976 |
| Exports of goods (millions US$) | 33 | 37 | 42 | 46 | 57 |
| (% change yoy) | 32.0 | 12.1 | 13.5 | 9.5 | 23.9 |
| Imports of goods (millions US$) | 672 | 769 | 871 | 950 | 1,033 |
| (% change yoy) | 79.7 | 14.4 | 13.3 | 9.1 | 8.7 |
| Current account balance (millions US$) | 2,738 | 2,105 | 1,819 | 1,551 | 1,588 |
| (% GDP) | 43.5 | 34.3 | 32.1 | 27.0 | 27.7 |
| Foreign direct investment (millions US$) | 6 | 53 | 116 | 139 | 182 |
| External debt (millions US$) | 8 | 44 | 275 | 319 | 278 |
| (% GDP) | 0.1 | 0.7 | 4.8 | 5.5 | 4.9 |
| Debt service ratio (% exports of g&s) | 0.0 | 0.0 | 0.1 | 0.2 | 0.3 |
| Public foreign assets, gross (millions US$) 2/ | 12,659 | 14,419 | 16,543 | 18,526 | 20,644 |
| (months of imports of g&s) | 91 | 93 | 95 | 98 | 103 |
| Foreign exchange reserves, gross (millions US$) | 884 | 213 | 213 | 213 | 213 |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | 20.5 | 21.2 | 21.7 | | |
| Short-term interest rate (% p.a.) | 12.20 | | | | |
| Real effective exchange rate (2005=100) (period average) | 118.1 | 134.5 | | | |
| (% change yoy) | 11.8 | 13.9 | | | |
| Memo: Nominal GDP (millions US$) | 6,300 | 6,129 | 5,673 | 5,748 | 5,730 |

*Sources:* National data sources; IMF; World Bank staff estimates.
e = estimate.
f = forecast.
1/ External debt.
2/ Central bank foreign exchange reserves + Petroleum Fund balance.

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## Vietnam: Key Economic Indicators

| | 2012 | 2013 | 2014f | 2015f | 2016f |
|---|---|---|---|---|---|
| | Year | Year | Year | Year | Year |
| **Output, Employment, and Prices** | | | | | |
| Real GDP (% change yoy) 1/ | 5.3 | 5.4 | 5.5 | 5.6 | 5.8 |
| Domestic demand (% change yoy) | 4.3 | 5.4 | 5.4 | 5.5 | 5.7 |
| Industrial production index | | | | | |
| (% change yoy) | 4.7 | 5.9 | 6.1 | 6.3 | 6.6 |
| Unemployment (%) 2/ | 3.2 | 3.5 | | | |
| Consumer price index (% change yoy) | 9.1 | 6.6 | 6.5 | 6.3 | 6.0 |
| **Public Sector** | | | | | |
| Government revenues (% GDP) | 22.9 | 22.1 | 19.6 | 19.7 | 20.0 |
| Government expenditures (% GDP) 3/ | 27.7 | 27.7 | 26.0 | 25.7 | 25.2 |
| Government balance, general (% GDP) | -4.8 | -5.6 | -6.4 | -6.0 | -5.2 |
| Public sector debt (% GDP) 4/ | 50.0 | 55.0 | 59.2 | 60.8 | 60.5 |
| **Foreign Trade, BOP, and External Debt** | | | | | |
| Trade balance (billions US$) | 9.8 | 10.6 | 9.8 | 8.5 | 6.4 |
| Exports of goods (billions US$) | 114.5 | 132.1 | 152.0 | 175.1 | 202.0 |
| (% change yoy) | 18.2 | 15.4 | 15.0 | 15.2 | 15.3 |
| Imports of goods (billions US$) | 113.8 | 132.1 | 154.6 | 181.2 | 212.6 |
| (% change yoy) | 6.6 | 16.1 | 17.0 | 17.2 | 17.3 |
| Current account balance (billions US$) | 9.0 | 11.1 | 8.3 | 5.7 | 3.4 |
| (% GDP) | 5.8 | 6.5 | 4.5 | 2.8 | 1.5 |
| Foreign direct investment (billions US$) | 8.4 | 8.7 | 9.0 | 9.6 | 9.8 |
| External debt (billions US$) | 44.9 | 49.1 | 52.4 | 55.3 | 58.8 |
| (% GDP) | 28.8 | 28.8 | 28.1 | 27.4 | 26.7 |
| Debt service ratio (% exports of g&s) | 3.3 | 3.2 | 3.2 | 3.2 | 2.5 |
| Foreign exchange reserves, gross (billions US$) | 25.4 | 28.5 | | | |
| (months of imports of g&s) | 2.7 | 2.6 | | | |
| **Financial Markets** | | | | | |
| Domestic credit (% change yoy) | 8.7 | 8.8 | 12.0 | 14.0 | 15.0 |
| Short-term interest rate (% p.a.) 5/ | 9.0 | 6.5 | 6.0 | | |
| Exchange rate (Dong/US$, eop) 6/ | 20,828 | 21,036 | 21,036 | | |
| Real effective exchange rate (2000=100) | 127.5 | 136.1 | | | |
| (% change yoy) | 4.1 | 6.7 | | | |
| Stock market index (Jul. 2000=100) 7/ | 414 | 506 | 597 | | |
| Memo: Nominal GDP (billions US$) | 155.6 | 170.4 | 186.7 | 202.2 | 220.4 |

*Sources:* Vietnam Government Statistics Office; State Bank of Vietnam; IMF; World Bank staff estimates.
e = estimate.
f = forecast.
1/ The national accounts have been rebased to 2010 from 1994 by General Statistical Office.
2/ Urban areas.
3/ Includes off-budget items.
4/ Public and public guaranteed debt. Forecast by the latest Debt Sustainability Analysis 2013.
5/ Three-month deposit, end-of-period.
6/ Central Bank's interbank exchange rate for 2014 is as of March 14.
7/ Ho Chi Minh Stock Exchange Index (VN index) for 2014 is as of March 14.