Part II. Slowing Growth and Trade Tensions

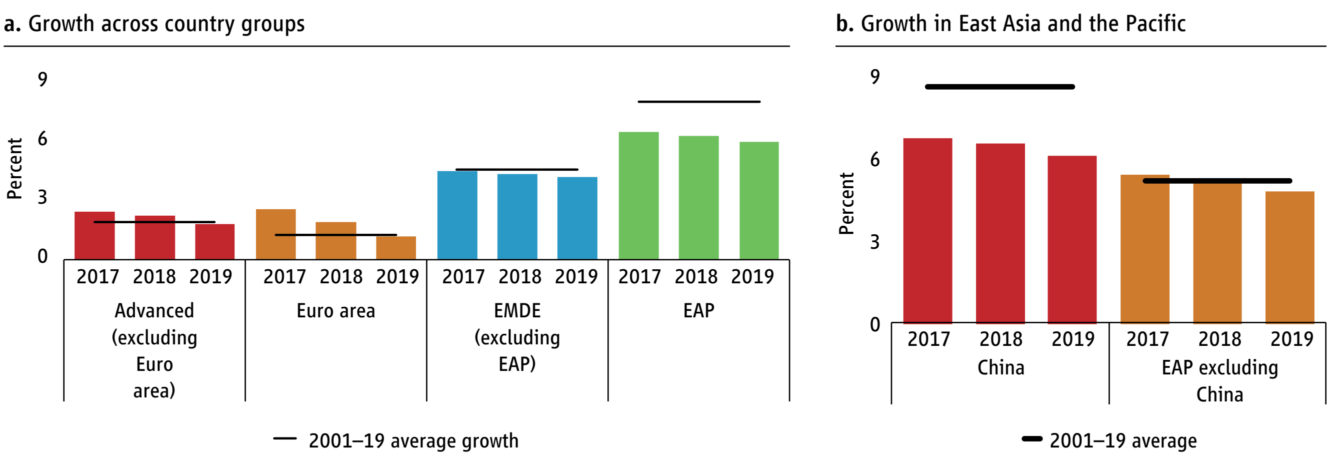
1. Chapter I. Trends in Growth, Poverty, and Policy

1. Growth trends

Growth in the region was slowing before COVID-19. Growth in the region's economies slowed, on average, to 5.8 percent in 2019 from 6.3 percent in 2018, with 10 out of 14 countries experiencing slower growth.[1] In China—the region's major economy—growth decelerated from 6.6 percent in 2018 to 6.1 percent in 2019. Growth in the rest of developing EAP slowed from 5.2 percent in 2018 to 4.7 percent in 2019. Despite the slowdown during the last few years, on average, growth in the EAP region remains higher than in other emerging and developing economies (Figure II.1.1).

The recent slowdown in growth was attributable in large part to developments outside the region and in China. Outside the region, the main adverse developments were reduced growth, especially in the Euro area; increased trade protection, especially in the United States; and augmented policy uncertainty. Slower global growth and higher protection meant lower external demand that negatively affected regional export growth (Figure II.1.2). Sluggish exports, resulting in a decline in domestic activity, and heightened policy uncertainty together inhibited regional investment growth. Meanwhile, private and government consumption has supported growth in the region (Figure II.1.3)

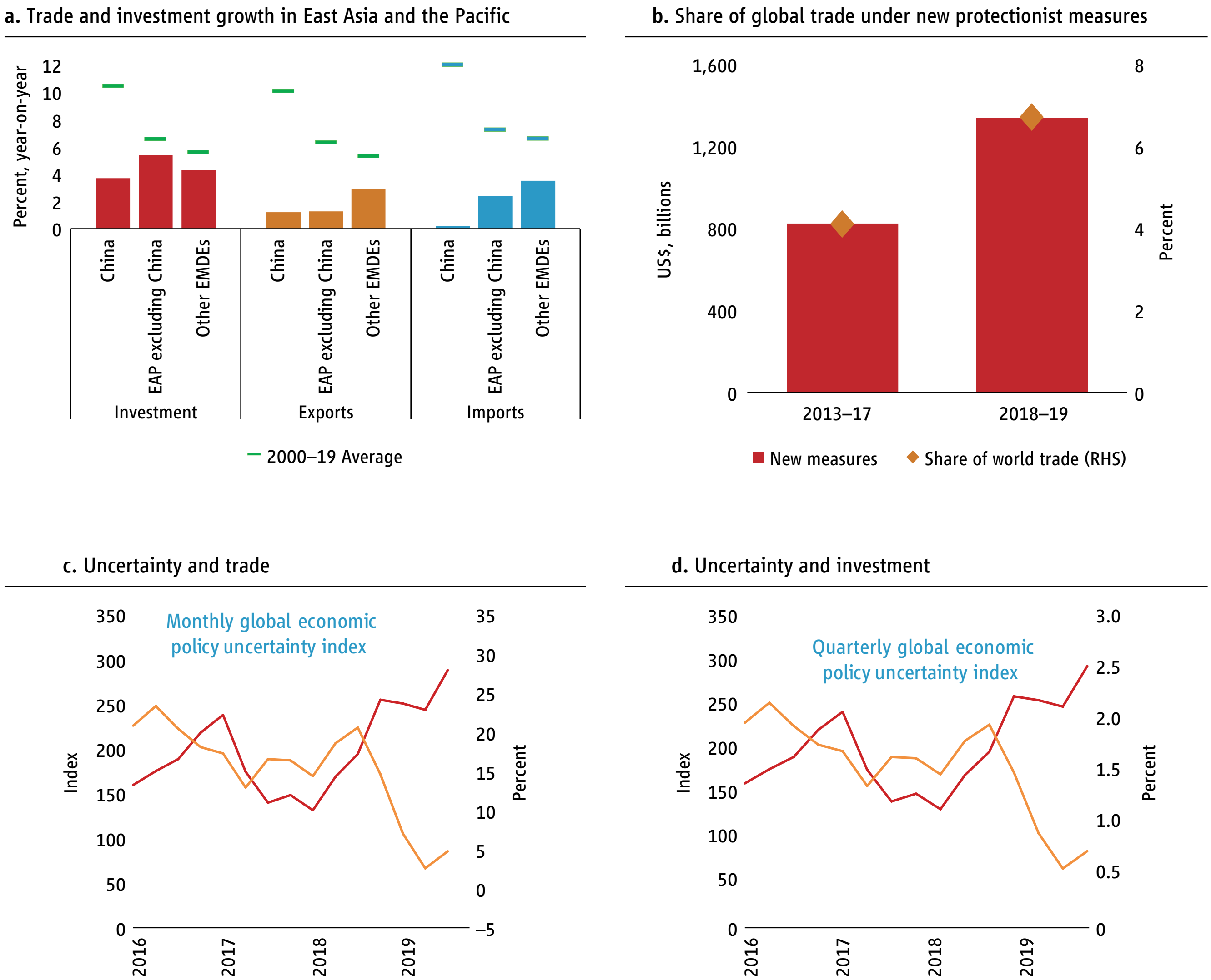
Figure II.1.1. Growth in advanced economies and developing EAP economies weakened in 2019



Source: World Bank.
Note: EMDE refers to Emerging Markets and Developing Economies. EAP refers to East Asia and the Pacific.

1 This excludes several small island economies for which data for 2019 is not available.

Figure II.1.2. Trade and investment growth declined amid increased trade protection and heightened policy uncertainty

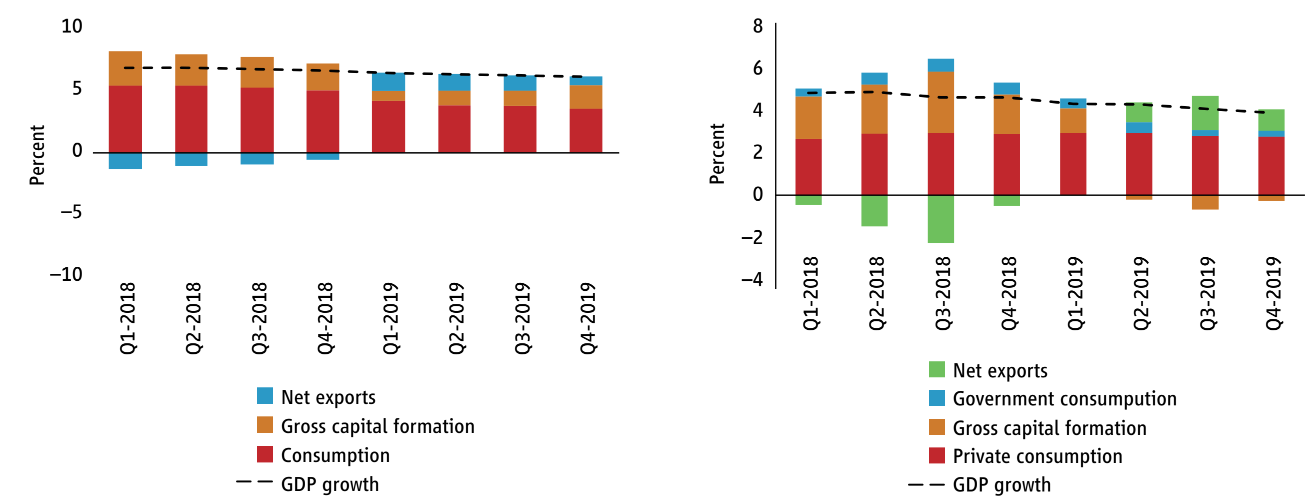


Sources: Baker et al. (2016); World Bank; World Trade Organization.
Note: Panel B. As shown in Global Economic Prospects, January 2020. The figure includes new import-restrictive measures, including tariff and nontariff trade barriers. Annual data are mid-October to mid-October.

Figure II.1.3. Steady consumption has supported growth in the region

a. China

b. EAP excluding China



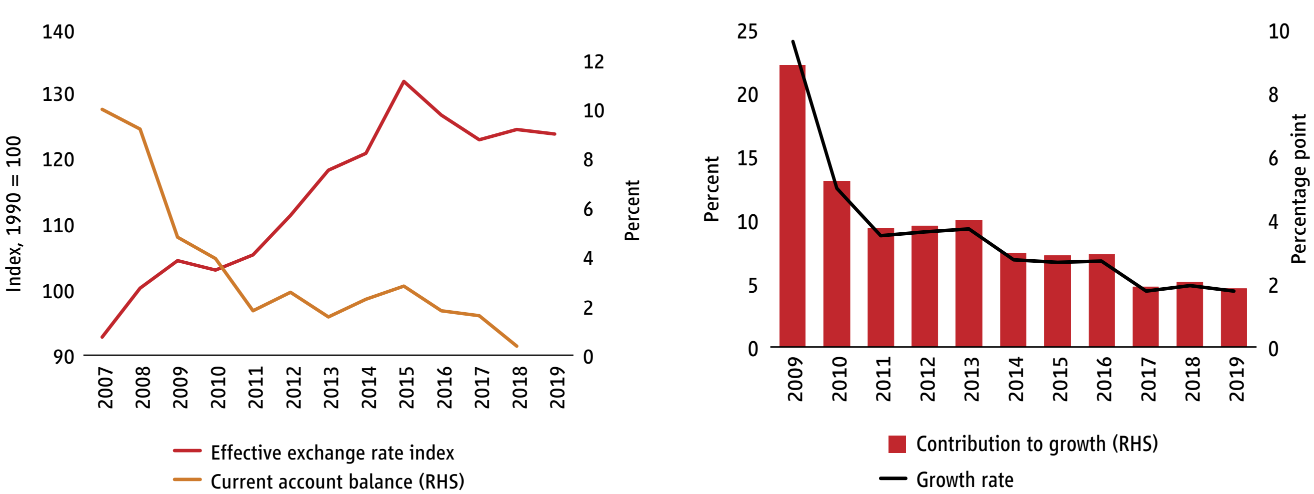
Source: World Bank staff calculations.
Note: For China, consumption includes both private and government consumption.

China's slowdown reflected adverse near-term factors as well as longer-term structural challenges (Figure II.1.4). China bore the brunt of some of the developments external to the region, especially increased trade protection. Growth also slowed down as China rebalanced its economy—from investment to consumption, from exports to domestic demand, and from manufacturing to services. Tighter regulations on nonbank credit during 2019—a result of de-risking efforts in the financial system—also weighed on domestic activity, especially private investment (Figure II.1.5).

Figure II.1.4. China has been rebalancing its economy

a. Real exchange rate and current account

b. Fixed asset investment

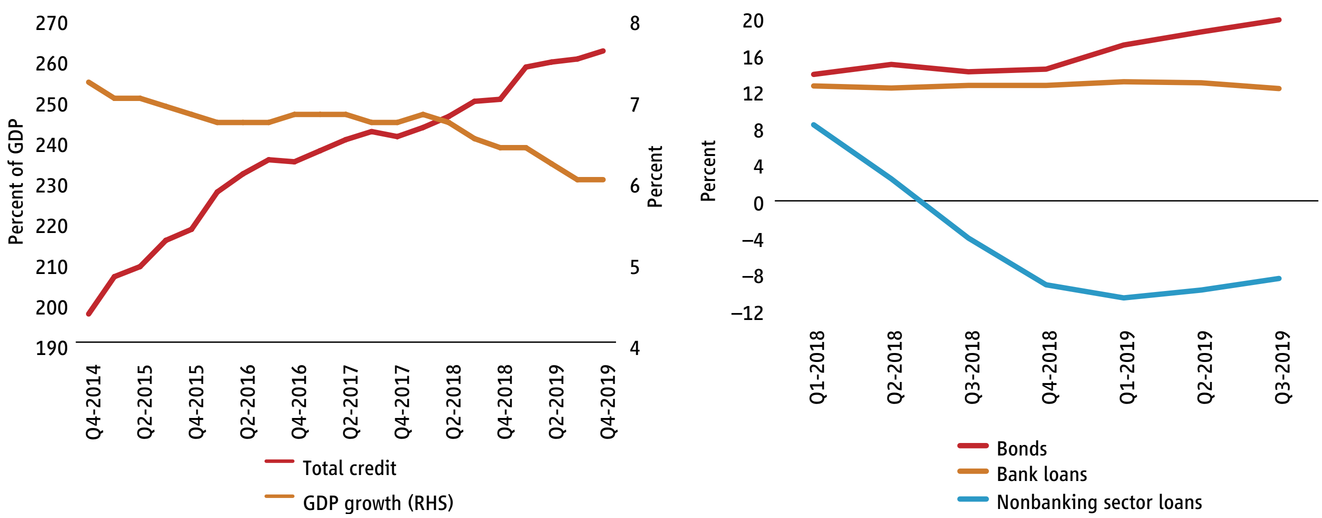


Sources: Haver Analytics; CEIC; World Bank staff calculations.
Note: Real Broad Effective Exchange Rate Index, CPI Based (2010 = 100).

Figure II.1.5. Total debt in China has been rising while de-risking curtailed nonbank lending

a. Total debt and GDP growth

b. Bank and nonbank lending



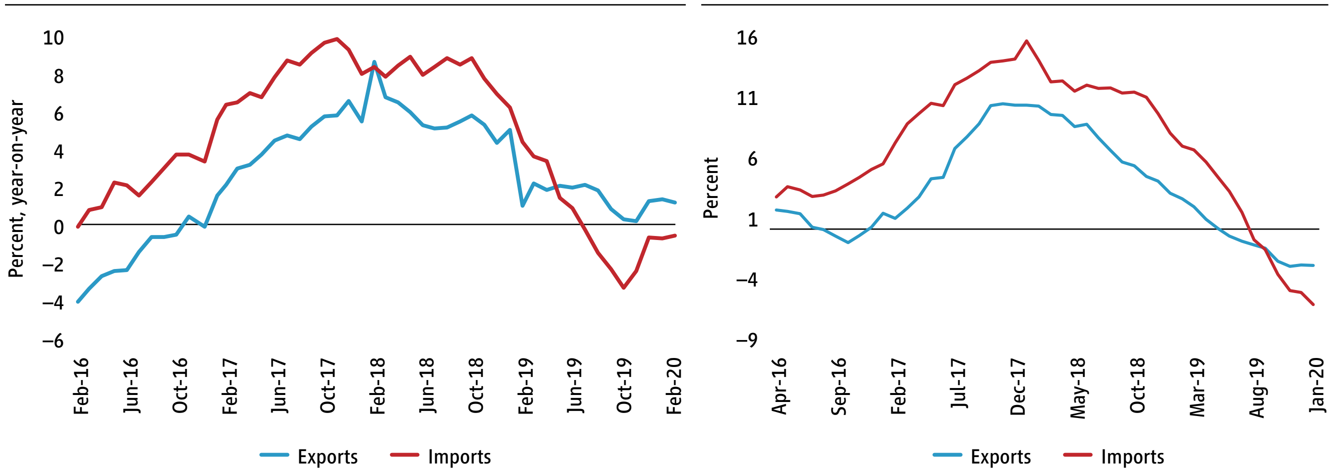
Sources: Haver Analytics; CEIC; International Monetary Fund; World Bank staff calculations.

Slowing growth in the rest of the world and China, as well as increased protection, have negatively affected exports of developing East Asian economies (Figure II.1.6). The thesis that the rest of the EAP region might be a beneficiary of China-U.S. trade tensions turned out to have limited validity, at least in the short term. China's growing importance as an export destination, for both consumption and intermediate goods, meant that protection that hurts China also hurts the region (Figure II.1.7). Therefore, any gains from trade diversion toward the region were offset by sluggish exports due to a slowing China and the adverse effects of uncertainty generated by the trade conflict. The December 2019 China-U.S. trade agreement has not entirely dispelled this uncertainty and may have created new risks of trade diversion away from the region (see Chapter II.2).

Figure II.1.6. Trade in developing EAP has been declining

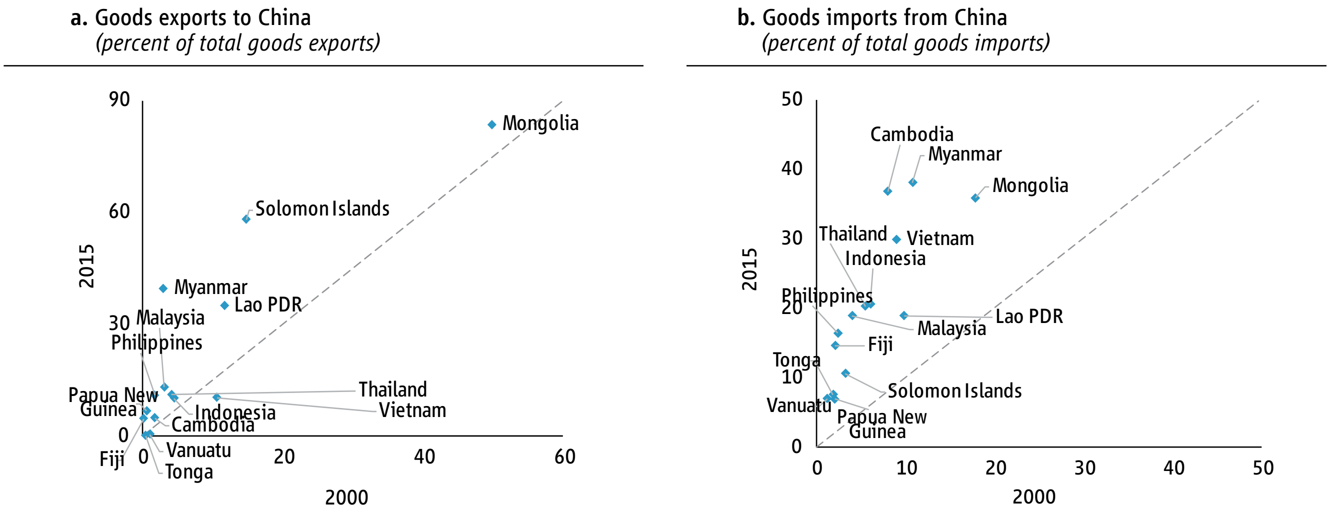
a. Export and import volumes, China
(year-to-year percent change, 12-month moving average)

b. Export and import volumes, EAP excluding China
(year-to-year percent change, 12-month moving average)



Sources: Haver Analytics; World Bank staff calculations.
Note: 12-month moving average. Data include only goods. January and February are estimates based on officially reported cumulative January–February trade flows. The last observation is in February 2020.

Figure II.1.7. China is an increasingly important export destination



Sources: World Integrated Trade Solutions (2018); Constantinescu et al. (2018).
Note: The dotted line signifies a 45-degree line.

Policy uncertainty and sluggish exports dampened regional investment growth for much of 2019. The contribution of gross capital formation to growth in developing EAP is estimated to have declined to 1.3 percentage point (pp) in 2019 from around 2.5 pp in 2018. Investment growth has been closely associated with export growth fluctuations in the EAP (Box II.1.1). Investment growth decelerated, particularly in those export-oriented and trade-intensive manufacturing sectors. The slowdown was particularly strong in automobile production, machines, and equipment industries (China, Indonesia, Malaysia), reflecting weaker trade prospects amid trade tensions, which weigh on the investment behavior of firms engaging in exporting or producing intermediate goods. Election-related domestic policy uncertainty and delays in large public infrastructure projects in several major economies also resulted in lower public investment growth (Indonesia, Malaysia, and Thailand).

Inventories made a negative contribution to both investment and GDP growth reflecting an accelerated pace of destocking. Investment growth weakened across large economies of the region (Figure II.1.8). Weak investment and destocking of inventories meant that imports contracted even faster than exports in several major economies of the region for much of 2019. In China, imports, especially intermediate goods imports contracted in 2019, partly reflecting a high base effect, the drawdown of inventories, disruptions in global and regional supply chains, and a weaker renminbi. In the region's other large economies, imports have also moderated, reflecting a drawdown of inventories (Indonesia, Malaysia, the Philippines, and Thailand).

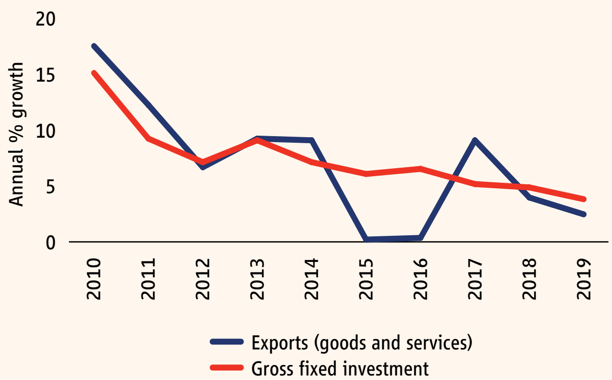
Growth in smaller economies decelerated more than expected in the second half of 2019, reflecting country-specific factors (Figure II.1.9). Growth in Lao PDR slowed to 5.2 percent in 2019 from 6.2 percent in 2018 due to the negative impact of severe floods on the agriculture sector combined with countercyclical fiscal policies implemented by the government to contain credit growth. In Mongolia, growth slowed to 4.9 percent in 2019 from 6.8 in 2018, reflecting multiple factors, including lower commodity prices, falling coal production, and a reduction in the quality of key mineral exports. Growth in Cambodia moderated to 7.1 percent in 2019 from 7.5 percent in 2018, partly reflecting weakened tourism activity and the easing of exports of selected garment and footwear products due to uncertainties with the "Everything But Arms" (EBA) trade preferential treatment granted by the EU. While Papua New Guinea's economic growth rebounded in 2019 driven by a rebound in the resource sector (mainly in its extractive segment earlier affected

Box II.1.1. Export growth and investment growth in developing EAP

The slowdown of investment growth in the East Asia and Pacific region has coincided with a sharp decline in trade (Box Figure II.1.1). In a globalized world, tradeable goods are often produced through complex global value chains, a process that entails intermediate inputs being produced in more than one country and exported to the final destination for assembly. Thus, it is not inconceivable that the prospects of sluggish exports growth have a direct negative impact on investment growth, especially in export-oriented sectors. Indeed, evidence suggests, that for a large number of countries including in the EAP, investment growth is positively and statistically correlated with exports growth.

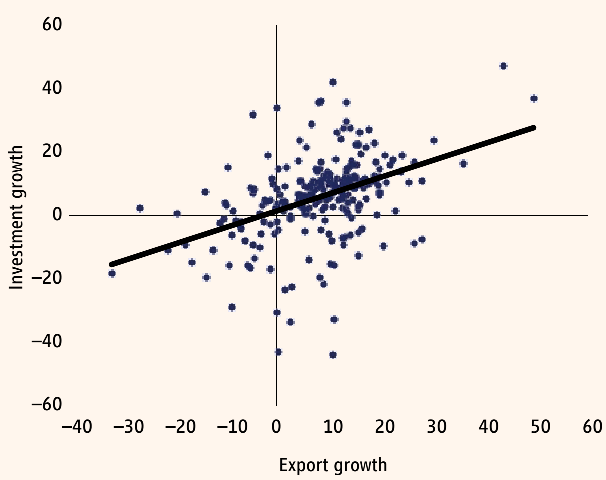
Box Figure II.1.1. The slowdown of investment growth in the East Asia and Pacific region has coincided with a sharp decline in trade

a. China

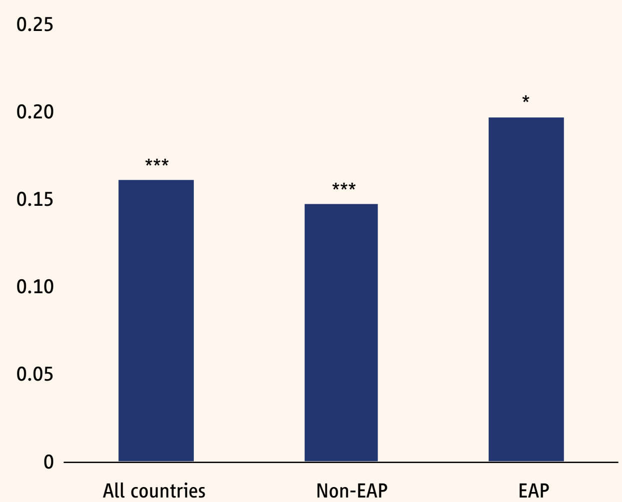


b. Developing EAP excluding China

c. Exports growth and investment growth

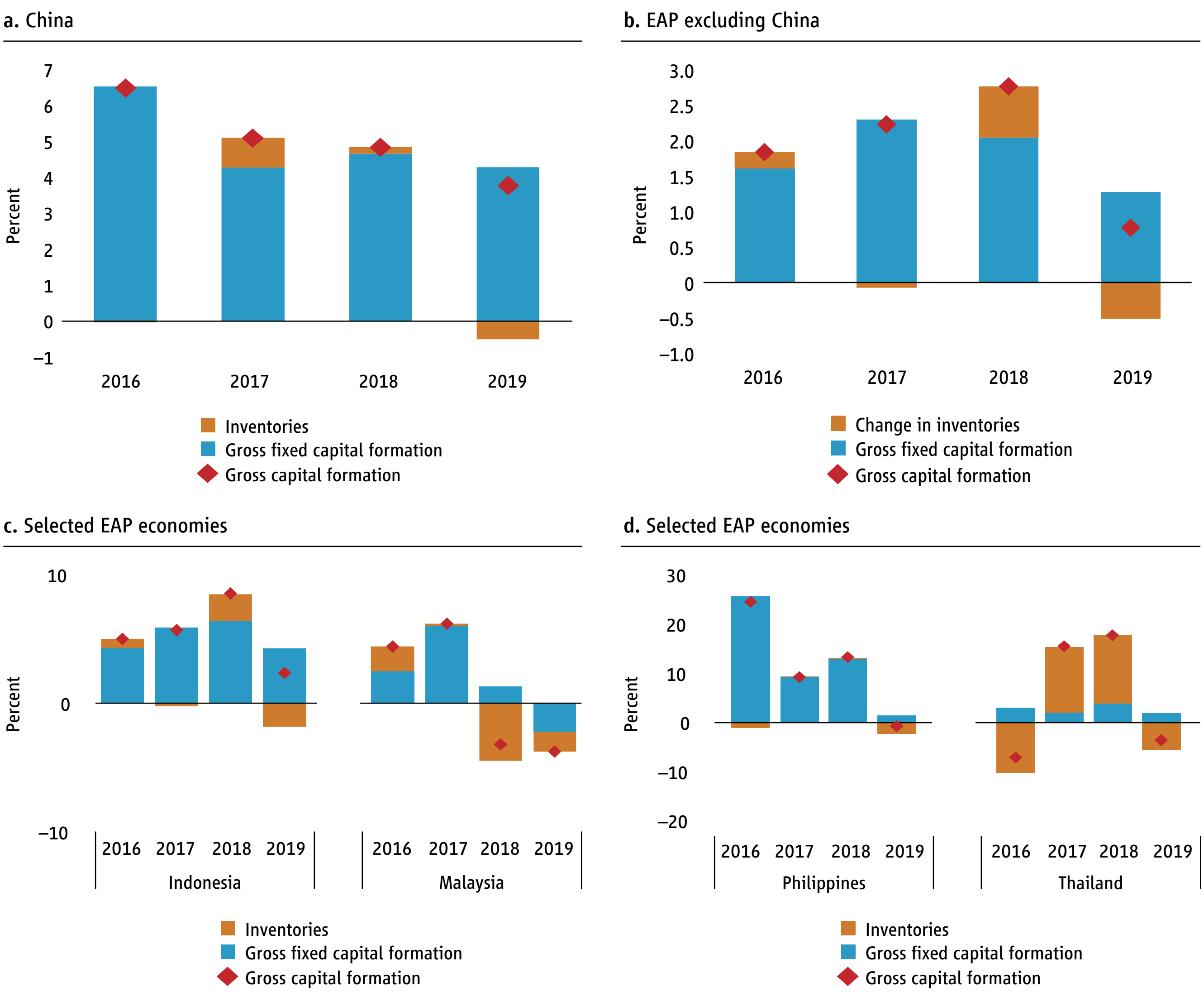


d. Codependence between investment and trade



Source: WDI.
Notes: Panel B. Weighted averages. Panel C. Country-year observations. Panel D. Coefficients from a fixed effects regression of investment growth on export growth. Includes year fixed effects. Other control variables include credit to GDP (and lag), FDI to GDP (and lag), lagged investment growth, and lagged imports growth. 155 countries, 1990–2017. *** p<0.01 .* p<0.1.

Figure II.1.8. Investment decline in the region, exacerbated by the inventory drawdown

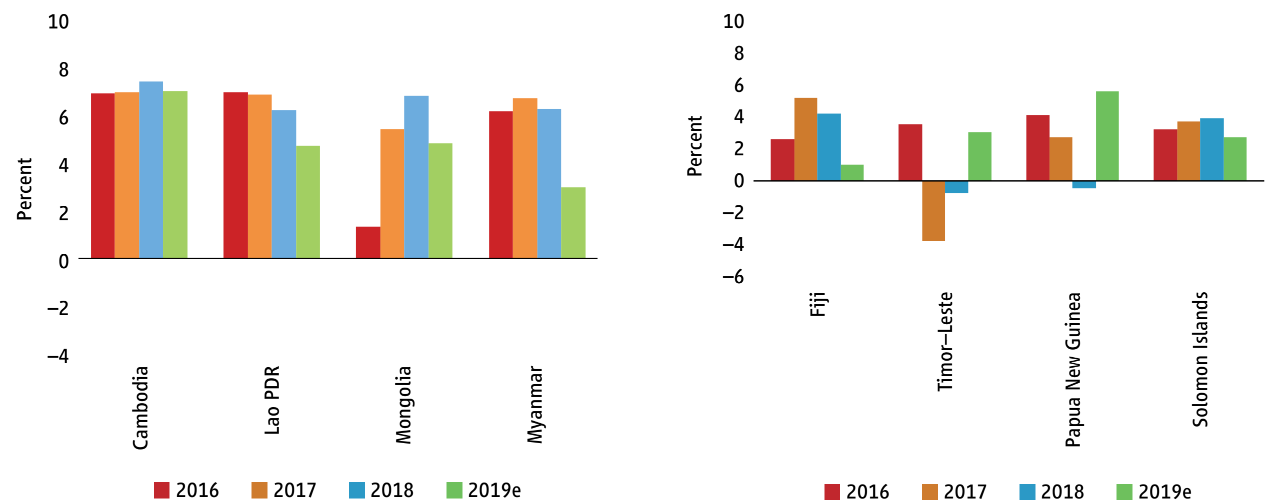


Source: World Development Indicators.

by an earthquake), this masked slower growth of the non-resource economy, which was owing to sluggish domestic demand as confirmed by a shortfall in non-resource tax revenue and lower inflation.

Growth in the Pacific Island countries (PICs) has been largely influenced by natural disasters, development assistance flows, and developments in the natural resource sector. Growth fluctuations in the PICs are to a large extent driven by natural disasters and aid flows, with economic activity bolstered by the construction of donor-funded projects, including for disaster recovery and reconstruction. Tino was the most recent severe tropical cyclone to hit the Pacific (in January 2020), with the largest impacts on Tuvalu, Fiji, and Tonga. In Fiji, other factors, including lower government spending following completion of reconstruction after Cyclone Winston, also weighed on activity and resulted in the sharp deceleration of GDP growth to a decade-low 1 percent in 2019. There have also been several health emergencies, including the measles outbreak in late 2019 in Samoa and a dengue outbreak in the Republic of the Marshall Islands (RMI).

Figure II.1.9. Growth in smaller economies in the region reflected country-specific factors



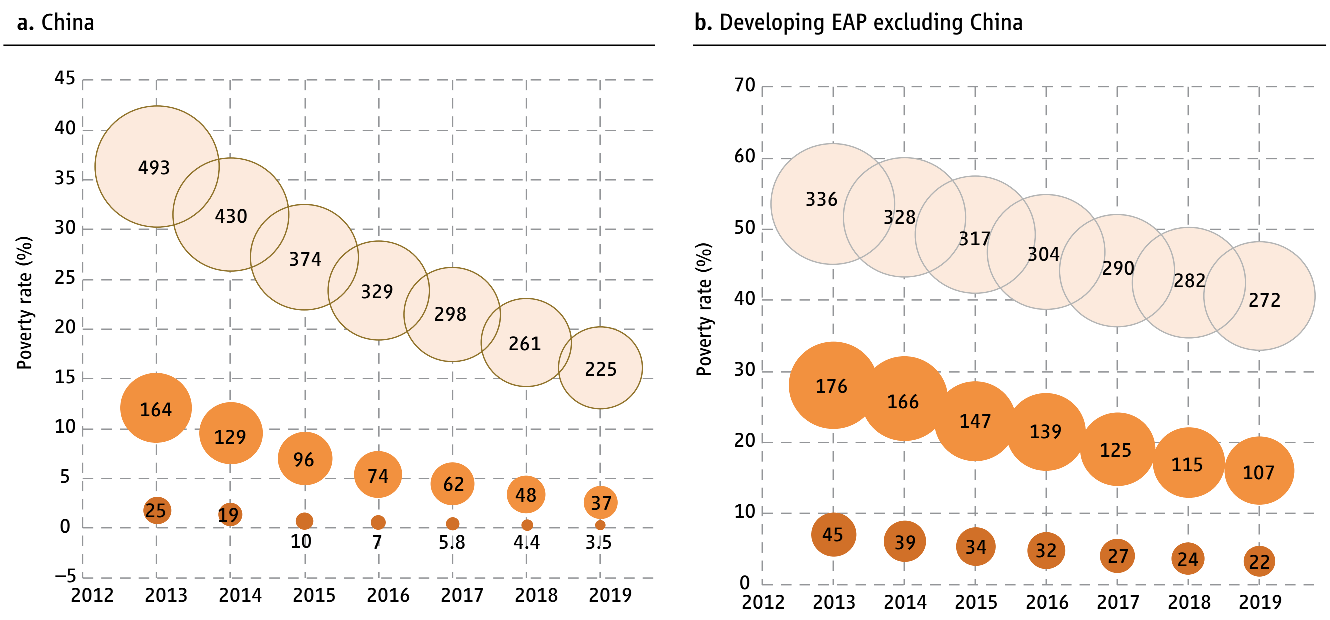
Source: World Bank.

Poverty trends

The pace of poverty reduction declined in 2019, reflecting slower GDP and household income growth. Slower growth in the region during 2019 meant that the pace of poverty reduction also slowed in developing East Asia and the Pacific during the year—although the incidence of poverty and the number of poor continued to decline across the region. In 2019, the estimated number of poor in the developing EAP region and excluding China was 271 million, based on the Upper-Middle Income Class poverty line of US$5.5/day 2011 PPP. In China, there were about 225 million poor people at this threshold in 2019, roughly 46 million fewer than in the rest of the region, even though China accounts for about 65 percent of the total population of developing East Asia. Moreover, the majority of poverty reduction in the region is still due to progress in China. If one excludes China, the pace of poverty reduction in the rest of the developing EAP region is much slower at the UMIC US$5.50/day 2011 PPP poverty line (Figure II.1.10).

One noteworthy exception to the region's recent accomplishments in poverty reduction has been seen recently in Thailand, where new household survey data indicate that poverty increased in 2018 despite positive growth rates. The increase in poverty in Thailand coincided with the emergence of several economic and environmental challenges in the country. Over the past few years, for example, Thailand's growth rate has been lower than other large economies in the developing East Asia and Pacific region (World Bank, 2019). At the end of Q3 2019, Thailand, along with Fiji and the Solomon Islands, had the lowest GDP growth rate in the region, at 2.7 percent. Declines in tourist arrivals and exports also affected the economic well-being of the Thai population, and droughts have affected the livelihoods of farmers who already experience lower average incomes and higher rates of poverty than others in the Thai economy. Wage data from Thailand show that earnings growth has also been relatively slow in Thailand, contributing to the weak links between growth and poverty reduction there.

Figure II.1.10. Actual and projected trends in poverty in developing East Asia and the Pacific[2]



Source: East Asia and Pacific Team for Statistical Development.
Note: The poverty rate shown on the vertical axis (in percent); the number of poor is represented by the size of the bubble (in millions). Poverty is shown for the International poverty line (US$1.90 per day 2011 PPP, dark orange bubbles), for Lower-Middle-Income Class poverty line (US$3.20 per day 2011 PPP, medium orange bubbles), and Upper-Middle Income Class poverty line (US$5.50 per day 2011 PPP, beige bubbles).[3]

2. Policy trends

Authorities were proactive engaging in expansionary monetary policy support in major regional economies. In China, the authorities have stepped up policies both to contain the spread of the epidemic and to mitigate its economic impacts. The PBOC has provided sizable liquidity support and cut policy rates to stem market sell-off, focusing on bolstering confidence and supporting affected businesses. Monetary policy in many countries has become more accommodative in response to slowing activity amid subdued inflation (Malaysia, the Philippines, Thailand) (Figure II.1.11). In Indonesia, continued capital inflows, a stable exchange rate, and low inflation have provided the necessary space for Bank Indonesia to continue policy easing. In Thailand, the Monetary Policy Committee voted to lower the interest rate to 1 percent on February 5, 2020, in light of COVID-19. In Malaysia, the central bank, BNM, lowered the policy rate by 25 basis points to 2.75 percent on January 22, 2020, as a pre-emptive measure to support the economy's growth trajectory.

Fiscal policy became more expansionary (Figure II.1.12) The fiscal expansion was announced as developments surrounding the COVID-19 outbreak continue to unfold. Several countries have also provided fiscal support (China, Malaysia, Thailand). China has introduced reductions in taxes and government fees, and a higher limit for local government on-budget borrowing. Targeted fiscal measures have been adopted to mitigate the spread of the virus and include tax breaks and subsidies to affected industries. The Ministry of Finance also increased the frontloaded quota for local government bond issuance by about 0.6 percent of GDP in 2020, Q1 compared to the same period last year.

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

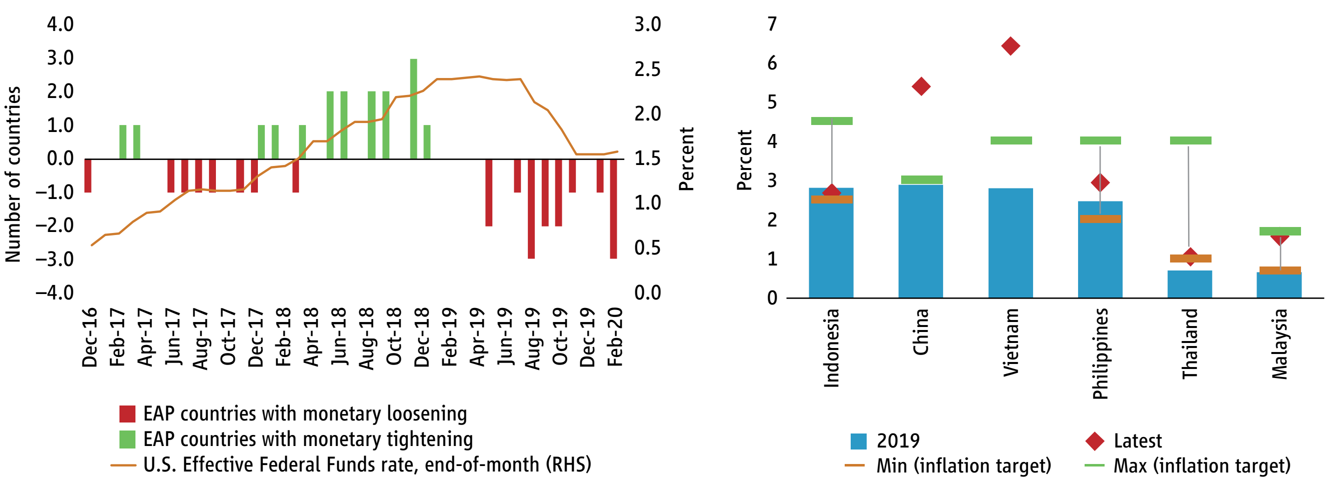
3 For a description of the Lower-Middle and Upper-Middle-Income Class poverty lines, see World Bank 2019, "A Broader View of Poverty in East Asia and the Pacific."

Thailand announced a broad range of stimulus measures, including a support package for farmers, SMEs, and low-income households. The economic cabinet led by the prime minister also approved various fiscal measures to support the Thai tourism industry and alleviate the effect of the outbreak. In Malaysia, an additional allocation of 0.2 percent of GDP will be channeled to revitalize public investment through infrastructure projects including the Mass Rapid Transit 2 (MRT 2) and the Pan Borneo Highway projects.

Figure II.1.11. Monetary policy has been supportive of growth

a. Monetary policy in developing East Asia (update to Jan 20)

b. Headline inflation *(year-on-year, period average)*

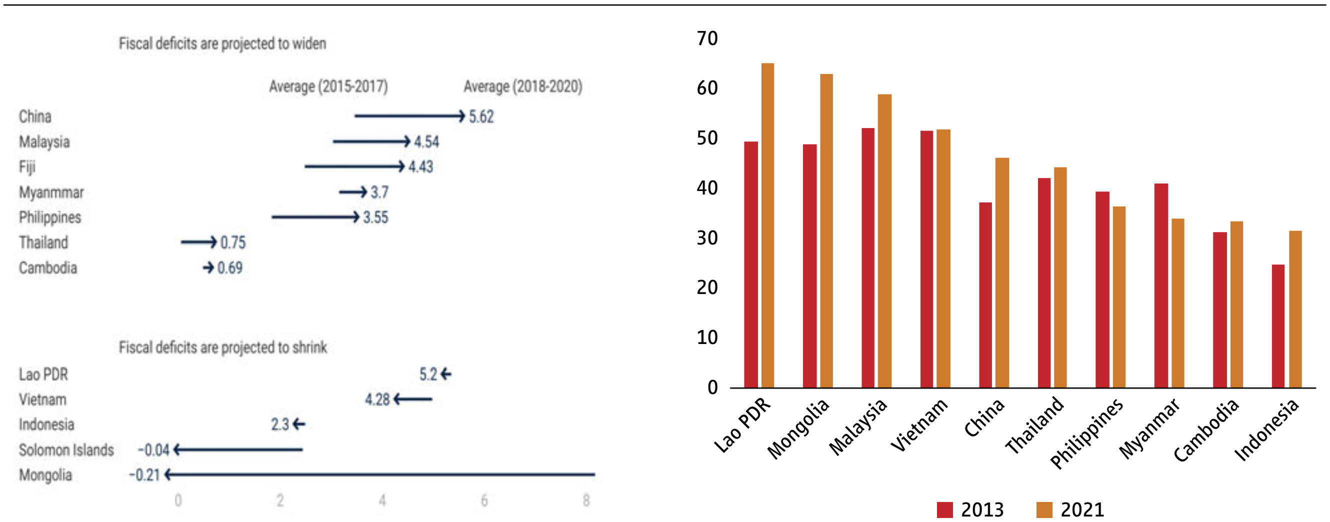


Sources: CEIC; Haver Analytics; World Bank.
Note: Panel A. The sample of countries for East Asia and Pacific includes China, Cambodia, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, the Philippines, Thailand, and Vietnam. Panel B. Average year-on-year consumer price inflation. Mid-point of inflation target for Indonesia, the Philippines, and Thailand. Inflation target for China and Vietnam. For Malaysia, the mid-point of Bank Negara's official forecast range of 0.7–1.7 percent in 2019. The last observation is in January 2020.

Figure II.1.12. Fiscal policy in the region has become more expansionary

a. Fiscal deficits are projected to widen in many countries

b. Government debt, percent of GDP



Source: World Bank staff estimates.
Note: Panel A. Data refers to general government fiscal deficit, except Indonesia: central government fiscal deficit, and Cambodia general government fiscal deficit before grants. Panel B. Data refer to general government debt, except Indonesia: central government debt. Data for China exclude off-budget debts for public investment accumulated since 2015.