WORLD BANK EAST ASIA AND PACIFIC ECONOMIC UPDATE OCTOBER 2016

Reducing Vulnerabilities

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Reducing Vulnerabilities

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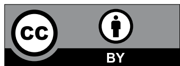

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Contents

List of Abbreviations xii

Preface and Acknowledgments xv

Executive Summary xvii

Part I. Recent Developments and Outlook 1

I.A. Recent Developments 2

Growth in developing East Asia and Pacific has proved resilient, in the face of a mixed external environment 2

Net export demand weakened across the region 7

Domestic demand across much of the region was buoyant, supported by fiscal stimulus and accommodative monetary policy 9

The stock of private sector credit is high and continues to rise rapidly in several large economies 12

Inflation has been muted, reflecting sustained low commodity prices 13

Capital flows and exchange rates have stabilized 14

Recent developments in the Pacific Island Countries 16

Poverty and inclusiveness: successes and challenges 17

I.B. Outlook and Risks 21

Growth will decrease gradually in China, but pick up in the rest of the region 21

Poverty will continue to fall across much of the region, including in China 25

Domestic demand will support growth, with at most a modest contribution from net exports, across much of the region 27

Fiscal stimulus is projected to continue, raising risks to sustainability in some countries 30

A sharp global financial tightening or a further slowdown in world growth would test the region’s resilience 31

High and rising private sector leverage is an important source of vulnerability in some large economies 35

Outlook and risks for the Pacific Island Countries 37

I.C. Policy Considerations 39

Subdued global prospects make it critical to address underlying financial and fiscal vulnerabilities, and to maintain fiscal space 39

Sustaining growth and inclusion 48

References 67

Contents continued

Part II. Medium-Term Development Agenda **71**

II.A. Tackling Malnutrition in East Asia and Pacific–An Agenda for Growth and Inclusion **72**

I. Investment in Nutrition in EAP: An Essential Foundation for Sustained Economic Growth 72
II. Malnutrition in East Asia and Pacific 73
III. The Impact of Malnutrition on Health and Growth 76
IV. Drivers of Undernutrition 79
V. Drivers of Overnutrition: Urbanization and Changing Lifestyles 81
VI. Routes to Better Nutrition: From Drivers to Actions 84
VII. Conclusions 89
References 90

II.B. How Will Technology Disrupt Financial Services in East Asia and Pacific? **96**

The context for fintech and alternative finance in EAP 97
Case Study 1. Digital payments 100
Case Study 2. Can crowdfunding (marketplace finance) contribute to innovation and jobs in EAP? 103
Conclusions 108
References 110

Part III. Country Pages and Key Indicators **111**

Cambodia 112
China 115
Fiji 118
Indonesia 121
Lao PDR 124
Malaysia 127
Mongolia 130
Myanmar 133
Papua New Guinea 136
Philippines 139
Small Pacific Island Countries 142
Solomon Islands 148
Thailand 151
Timor-Leste 154
Vietnam 157

List of Figures

Part I. Recent Developments and Outlook

I.A. Recent Developments

Figure I.A.1. Growth in developing EAP held steady in the first half of 2016 5
Figure I.A.2. Growth performance varied across the region's large economies 5
Figure I.A.3. The manufacturing PMI points to continued expansion in China, Indonesia, and Vietnam, but a slowdown in Malaysia 6
Figure I.A.4. Weak external demand was largely offset by robust domestic demand 7
Figure I.A.5. Most large economies saw slowdowns in net export demand 7
Figure I.A.6. Export volumes have been declining in several countries 8
Figure I.A.7. Regional export values fell sharply in 2015 and remain depressed, especially among commodity exporters 9
Figure I.A.8. Indonesia, Lao PDR, Malaysia, Mongolia, Papua New Guinea, and Timor-Leste remain relatively commodity-dependent 9
Figure I.A.9. The majority of developing EAP's gross exports serve the regional market 9
Figure I.A.10. Exports by source of final demand 9
Figure I.A.11. Fiscal deficits in the major regional economies have been widening 10
Figure I.A.12. The fiscal positions in Mongolia and Lao PDR are particularly challenging 10
Figure I.A.13. Indonesia, Malaysia, and the Philippines cut policy rates in the second quarter 11
Figure I.A.14. Real interest rates in large economies have been declining and in most cases are significantly below their long-term average 11
Figure I.A.15. Longer-term (local currency) government bond yields have been dropping 11
Figure I.A.16. Domestic private sector credit has grown rapidly across most large regional economies 12
Figure I.A.17. Private sector credit continues to rise rapidly in several economies 12
Figure I.A.18. Inflation has been muted across most of the region 13
Figure I.A.19. Producer price deflation is subsiding in the large economies 13
Figure I.A.20. Consumer price inflation in the region has followed the trend in oil prices 13
Figure I.A.21. Capital flows to developing EAP are stabilizing 14
Figure I.A.22. China recorded net negative FDI flows in the first half of 2016… 14
Figure I.A.23. …as did Thailand, but FDI is recovering elsewhere 14
Figure I.A.24. Corporate and sovereign risk spreads have eased across the region 15
Figure I.A.25. Regional currencies have broadly appreciated against the U.S. dollar since their late-2015 lows 15
Figure I.A.26. Trade-weighted nominal and real exchanges rates have moved little in 2016, with the exception of depreciation in China 15
Figure I.A.27. Flows of remittances to EAP grew in 2015 16
Figure I.A.28. Reserve coverage for the major economies in the region remains broadly adequate 16

List of Figures continued

Figure I.A.29. The bottom 40 percent of the population across most of the region experienced relatively rapid consumption growth over the past few years 18
Figure I.A.30. Inequality is on a downward trend in most but not all countries in the region 18

I.B. Outlook and Risks

Figure I.B.1. Domestic demand will support growth, with at most a modest contribution from net exports, across the region as a whole… 28
Figure I.B.2. …across most large economies 29
Figure I.B.3. …and in the smaller economies 29
Figure I.B.4. Fiscal deficits are expected to widen across much of the region 30
Figure I.B.5. Government debt is projected to rise rapidly in Mongolia and, to a lesser degree, Vietnam, and remain elevated in Malaysia 30
Figure I.B.6. Government capital expenditure had been trending down in most large economies until 2016 31
Figure I.B.7. U.S.-dollar-denominated debt accounts for a large and rising share of external debt 32
Figure I.B.8. In Malaysia and Thailand, a significant share of external debt is short term 32
Figure I.B.9. Debt service ratio of private nonfinancial sector 35
Figure I.B.10. Interest coverage ratio of listed firms 35
Figure I.B.11. Return on assets, listed firms 36
Figure I.B.12. Incremental capital-output ratio (ICOR) 36
Figure I.B.13. Corporate loans by sector 36
Figure I.B.14. Return on assets in the banking sector 37
Figure I.B.15. Return on equity in the banking sector 37

I.C. Policy Considerations

Figure I.C.1. Quality of infrastructure, and efficiency of public investment management 49

Part II. Medium-Term Development Agenda

II.A. Tackling Malnutrition in East Asia and Pacific–An Agenda for Growth and Inclusion

Figure II.A.1. The stunting-income relationship 74
Figure II.A.2. Changes in stunting prevalence between 1990 and 2014 in selected EAP countries 74
Figure II.A.3. Overweight rate (Body Mass Index > 25), adult females[1] > 20 years (age adjusted), by region, 1980–2008 75
Figure II.A.4. Typology of malnutrition in EAP countries 75
Figure II.A.5. Expected relative change in working-age population, 15–64, 2010–40 78
Figure II.A.6. Child (<5) stunting by wealth quintile, low- and lower-middle-income countries 2008–14 79
Figure II.A.7. Consumption of a nutritionally acceptable diet among infants and young children (age 6 to 23 months) by household wealth quintile, select EAP countries 80

List of Figures continued

Figure II.A.8. Share of dietary energy supply from cereals, roots, and tubers, select EAP countries, 1980–2008 80
Figure II.A.9. Adult (18+) overweight (BMI ≥25) by GNI per capita, developing countries, 2014 81
Figure II.A.10. Adult (18+) overweight by degree of urbanization 81

II.B. How Will Technology Disrupt Financial Services in East Asia and Pacific?
Figure II.B.1. Use of technology and financial services in EAP, 2014 97
Figure II.B.2. Adults with debit cards 98
Figure II.B.3. Adults with credit cards 98
Figure II.B.4. Active accounts on top social media site 99
Figure II.B.5. Sources of firm finance 104
Figure II.B.6. Data available from credit bureaus 107

Part III. Country Pages and Key Indicators

Cambodia
Figure 1. Contributions to real GDP growth 114
Figure 2. Income group 114

China
Figure 1. Contributions to real GDP growth 117
Figure 2. Poverty Rates Estimates and Projections 117

Fiji
Figure 1. Real GDP growth 120
Figure 2. Recurrent spending breakdown 120

Indonesia
Figure 1. Higher public spending supported investment and growth in the second half of 2015 123
Figure 2. Social assistance expansion could help poverty reduction in the short-term 123

Lao PDR
Figure 1. Contributions to annual GDP growth 126
Figure 2. Growth incidence curve, 2002/03–2012/13 126

Malaysia
Figure 1. Contributions to annual GDP growth 129
Figure 2. Annual salaries and wage growth 129

Mongolia
Figure 1. Contributions to annual GDP growth 132
Figure 2. Growth incidence curve: 2010–14 132

List of Figures continued

Myanmar

Figure 1. Real GDP growth and sector contributions 135

Figure 2. Contributions to yearly inflation 135

Papua New Guinea

Figure 1. Contributions to annual GDP growth 138

Figure 2. Key fiscal indicators 138

Philippines

Figure 1. Growth increased to 6.9 percent in H1 2016 which is the fastest in the region 141

Figure 2. Poverty reduction is expected to continue as per capita income increases 141

Small Pacific Island Countries

Figure 1. Primary balances 147

Figure 2. Public and publicly guaranteed external debt 147

Solomon Islands

Figure 1. Trade balance 150

Figure 2. GDP per capita 150

Thailand

Figure 1. Contributions to annual GDP growth 153

Figure 2. Poverty rate and GDP per capita 153

Timor-Leste

Figure 1. Gross domestic product, expenditure components 156

Figure 2. Projected petroleum fund balance 156

Vietnam

Figure 1. Contributions to annual GDP growth 158

Figure 2. Poverty rate and GDP per capita 158

List of Tables

Part I. Recent Developments and Outlook

I.B. Outlook and Risks

Table I.B.1. East Asia and Pacific: GDP growth projections 24

Table I.B.2. Compared with recent years, poverty will decline slightly more slowly in China, but at a similar pace in the rest of the region 27

Part II. Medium-Term Development Agenda

II.A. Tackling Malnutrition in East Asia and Pacific–An Agenda for Growth and Inclusion

Table II.A.1. Rank of key nutrition-related risk factors for death and disease in select EAP countries, 2013 77

Table II.A.2. Benefit-cost ratio per child for nutrition investments in 10 countries for individuals working to age 36 85

Table II.A.3. The NOURISHING Framework 87

II.B. How Will Technology Disrupt Financial Services in East Asia and Pacific?

Table II.B.1. Percentage of Adults Who Used Cash for Transactions, 2014 99

Table II.B.2. Guidelines for digital financial services—comparing three global frameworks 102

Table II.B.3. Heat Map of Relevant Regulatory Environment for Crowdfunding 106

Part III. Country Pages and Key Indicators

Cambodia Selected Indicators 114

China Selected Indicators 117

Fiji Selected Indicators 120

Indonesia Selected Indicators 123

Lao PDR Selected Indicators 126

Malaysia Selected Indicators 129

Mongolia Selected Indicators 132

Myanmar Selected Indicators 135

Papua New Guinea Selected Indicators 138

Philippines Selected Indicators 141

Solomon Islands Selected Indicators 150

Thailand Selected Indicators 153

Timor-Leste Selected Indicators 156

Vietnam Selected Indicators 159

List of Boxes

Part I. Recent Developments and Outlook

I.A. Recent Developments

Box I.A.1. Recent Global Developments 3
Figure BI.A.1.1. Global GDP growth 3
Figure BI.A.1.2. Regional GDP growth 3
Figure BI.A.1.3. Regional GDP: Cumulative change 2007–15 3
Figure BI.A.1.4. Global trade growth 4
Figure BI.A.1.5. International commodity prices 4
Figure BI.A.1.6. Emerging market stocks and currencies 5
Box I.A.2. Poverty in Developing East Asia and Pacific 6
Figure BI.A.2.1. The prevalence of poverty has continued to decline across the region 6
Box I.A.3. Inclusive Growth in Vietnam 18
Figure BI.A.3.1. A strong record of shared prosperity 19
Figure BI.A.3.2. Vietnam's growth has been job-intensive 19
Figure BI.A.3.3. Ethnic minorities are being left behind 20
Figure BI.A.3.4. Growth is driven by factor accumulation rather than productivity growth 20

I.B. Outlook and Risks

Box I.B.1. Global Outlook and Risks 22
Figure BI.B.1.1. Global GDP growth 22
Figure BI.B.1.2. Regional GDP growth 22
Figure BI.B.1.3. World commodity prices forecast 23
Box I.B.2. Cambodia's Garment Sector 25
Figure BI.B.2.1. Garments account for most merchandise exports, and a large share of GDP 25
Figure BI.B.2.2. Ownership of garment factories, percent of total, 2015 25
Table BI.B.2.1. Export growth has largely reflected increasing volumes, with more recent signs of a move toward high-value-added products 26
Box I.B.3. The Impact of Brexit on Developing EAP 33
Figure BI.B.3.1. Share of U.K. in total exports 33
Figure BI.B.3.2. Cross-border lending claims 33

I.C. Policy Considerations

Box I.C.1. Sovereign Wealth Funds in Small Commodity-Dependent EAP Countries 43
Table BI.C.1.1. Population, GDP per capita, and major resources, 2014 43
Figure BI.C.1.1. Resource and non-resource revenues 43
Figure BI.C.1.2. Revenues, expenditures, and net SWF withdrawals (withdrawals less deposits) 46
Figure BI.C.1.3. SWF balances and withdrawals 47

List of Boxes continued

Box I.C.2. The Trade Effects of the Belt and Road Initiative 50
Map BI.C.2.1. Overview of the Belt and Road Initiative 50
Map BI.C.2.2. Existing and proposed/improved rail routes along the Belt and Road 51
Figure BI.C.2.1. Percentage decreases in time to trade after Belt and Road railway improvements, by region (average across trade partners) 52
Figure BI.C.2.2. Percentage decreases in time to trade after Belt and Road railway improvements by country (East Asia and Pacific) 52
Figure BI.C.2.3. Percentage increase in export values in Belt and Road by region (direct and indirect effects) 52
Figure BI.C.2.4. Percentage increase in export values in Belt and Road by country, East Asia and Pacific (direct and indirect effects) 52
Box I.C.3. Special Economic Zones and Economic Performance: Lessons from East Asia 55
Figure BI.C.3.1. Correlation among nightlights, number of firms, and SEZ employment 55
Figure BI.C.3.2. The performance of SEZs in EAP varied considerably between 2007 and 2012 56
Table BI.C.3.1. Performance of 149 SEZs in China, Korea, the Philippines, and Vietnam 57
Figure BI.C.3.3. China, Korea, the Philippines, and Vietnam had a combination of well-performing and less-well-performing SEZs 57
Box I.C.4. How Adaptive Safety Nets Can Mitigate the Impact of Natural Disasters 59
Figure BI.C.4.1. Increasing frequency and severity of natural disasters in EAP 59
Figure BI.C.4.2. The majority of assistance in Fiji was spent on “essential items” 61
Figure BI.C.4.3. Beneficiaries of adaptive safety nets are quicker to recover from shocks 61
Box I.C.5. Harnessing the Riches of Pacific Tuna Fisheries 62
Figure BI.C.5.1. Tuna purse seine access fees received by Pacific Island Countries 62
Table BI.C.5.1. Net economic gains from reform of tuna fisheries, in 2040 64
Box I.C.6. Boosting Labor Mobility in the Pacific 65
Figure BI.C.6.1. Growth in populations and employment rates in the Pacific, 2005–11 65
Figure BI.C.6.2. Stock of Pacific migrants under the business-as-usual, partial reform, and full reform scenarios 66
Figure BI.C.6.3. Income (“GNI +”) per capita in 2040 under the three scenarios 66

Part II. Medium-Term Development Agenda

II.A. Tackling Malnutrition in East Asia and Pacific–An Agenda for Growth and Inclusion
Box II.A.1. What exactly is malnutrition? 74
Box II.A.2. Drivers of overweight and obesity in the Pacific Island Countries 83
Box II.A.3. Peru’s success in reducing chronic undernutrition 84
Figure II.A.3.1. Trends in child (<5) stunting in Peru, 1990–2014 84

List of Abbreviations

ASEAN	Association of Southeast Asian Nations
B&R	Belt and Road Initiative
BMI	Body Mass Index
BNM	Bank Negara Malaysia
CIF	Consolidated Investment Fund (Tuvalu)
DALYs	disability-adjusted life years
DTI	debt-to-income
EAP	East Asia and Pacific
EBA	Everything but Arms preferences
EM	emerging market
EMDEs	emerging market and developing economies
ESI	Estimated Sustainable Income (Timor-Leste)
EU	European Union
4Ps	Pantawid Pamilyang Pilipino Program (the Philippines)
FDI	foreign direct investment
FHF	Future Heritage Fund
FSF	Fiscal Stabilization Fund (Mongolia)
GDP	gross domestic product
GIS	geographical information systems
GNI	gross national income
GST	Goods and Services Tax
G2P	government-to-person
H1	first half
H2	second half
HDF	Human Development Fund (Mongolia)
ICOR	Incremental capital-output ratio
ICT	information and communications technology
Kcal	kilocalorie (1 kilocalorie = 1,000 calories)
LDCs	least developed countries
LTV	loan-to-value
MDGs	Millennium Development Goals
MFA	Multi-Fiber Agreement
NBS	National Bureau of Statistics (China)
NCDs	noncommunicable diseases
NEER	nominal effective exchange rate
NPLs	nonperforming loans
OPEC	Organization of the Petroleum Exporting Countries
P2P	peer-to-peer
PAFI	Payment Aspects of Financial Inclusion
PF	Petroleum Fund (Timor-Leste)
PICs	Pacific Island Countries
PKH	cash transfer program (the Philippines)
PNA	Parties to the Nauru Agreement
PPP	purchasing power parity
Q1	first quarter
Q2	second quarter
Q3	third quarter
Q4	fourth quarter
q-o-q	quarter-on-quarter
RBF	Reserve Bank of Fiji
REER	real effective exchange rate
RERF	Revenue Equalization Reserve Fund (Kiribati)
SBV	State Bank of Vietnam
SEZ	Special Economic Zone
SIM	Subscriber Identity Module
SMEs	small and medium enterprises
SOEs	state-owned enterprises
SWF	sovereign wealth fund
T&C	Trade & Competitiveness Global Practice (World Bank)
TTF	Tuvalu Trust Fund
UNICEF	United Nations International Children's Emergency Fund
VAT	value-added tax
WDI	World Development Indicators
WHO	World Health Organization
WMPs	wealth management products
y-o-y	year-over-year

List of Abbreviations continued

Regions, World Bank Classification and Country Groups	
ASEAN-4	Indonesia, Malaysia, Philippines, and Thailand
ASEAN-5	Indonesia, Malaysia, the Philippines, Thailand, and Vietnam
EAP	East Asia and Pacific
EAP nei	Cambodia, Lao PDR, and the rest of Southeast Asia; Hong Kong SAR, China; Taiwan, China
G7	Canada, France, Germany, Italy, Japan, the United States, and the United Kingdom
ECA	Europe and Central Asia
G20	Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and European Union
LAC	Latin America and the Caribbean
MENA	Middle East and North Africa
MNA	Middle East and North Africa
P4 Agreement	Pacific 4 free trade agreement among Brunei Darussalam, Chile, Singapore, and New Zealand
PIC-8	Kiribati, the Marshall Islands, the Federated States of Micronesia, Palau, Samoa, Tonga, Tuvalu, and Vanuatu
PICs	Pacific Island Countries
SAR	South Asia
SSA	Sub-Saharan Africa
TPP signatories	Australia, Canada, Chile, Brunei, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam

Country Abbreviations	
AGO	Angola
ALB	Albania
ARG	Argentina
AUS	Australia
AUT	Austria
BGD	Bangladesh
BGR	Bulgaria
BOL	Bolivia
BRN	Brunei Darussalam
BWA	Botswana
CAN	Canada
CHE	Switzerland
CHL	Chile
CHN	China
CRI	Costa Rica
CZE	Czech Republic
DEU	Germany
DNK	Denmark
DOM	Dominican Republic
ECU	Ecuador
EGY	Egypt
ESP	Spain
ETH	Ethiopia
FIN	Finland
FRA	France
FSM	Federation States of Micronesia
GBR	United Kingdom
GEO	Georgia
GMB	Gambia, The
GRC	Greece
GTM	Guatemala
GUF	Guiana, French
HND	Honduras
HKG	Hong Kong SAR, China
HUN	Hungary
IND	India
IDN	Indonesia
IRL	Ireland
ISL	Iceland
ISR	Israel
ITA	Italy
JOR	Jordan
KGZ	Kyrgyz Republic
KHM	Cambodia
KIR	Kiribati
KOR	Korea, Rep.

List of Abbreviations continued

LAO	Laos People's Democratic Republic
LKA	Sri Lanka
LUX	Luxembourg
MEX	Mexico
MHL	Marshall Islands
MKD	Macedonia, FYR
MNG	Mongolia
MMR	Myanmar
MUS	Mauritius
MYS	Malaysia
NGA	Nigeria
NIC	Nicaragua
NLD	Netherlands
NOR	Norway
NPL	Nepal
NZL	New Zealand
PAK	Pakistan
PAN	Panama
PHL	Philippines
PLW	Palau
PNG	Papua New Guinea
POL	Poland
PRT	Portugal
PRY	Paraguay

PSE	Palestinian Territory
ROU	Romania
RUS	Russia
SLB	Solomon Islands
SLV	El Salvador
SRB	Serbia and Montenegro
SGP	Singapore
SWE	Sweden
THA	Thailand
TJK	Tajikistan
TMP	Timor-Leste
TON	Tonga
TUR	Turkey
TUV	Tuvalu
TWN	Taiwan, China
TZA	Tanzania
UKR	Ukraine
USA	United States
UZB	Uzbekistan
VNM	Vietnam
VUT	Vanuatu
WSM	Samoa
ZAF	South 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 Islands dollar
Tog	Mongolia
US$	Timor-Leste
US$	United States

Preface and Acknowledgments

The *East Asia and Pacific Economic Update* is a joint product of the Office of the Chief Economist, East Asia and Pacific Region, and the Macroeconomic and Fiscal Management Global Practice, prepared in collaboration with the Poverty Global Practice, the Development Prospects Group, and the Finance and Markets Global Practice. The report was supervised by Nikola Spatafora, under the guidance of Sudhir Shetty (Chief Economist, East Asia and Pacific Region).

Chapter I was prepared by David Knight (lead), Ekaterine Vashakmadze, and Vera Kehayova. Contributions were received from the Chapter III team (listed below), Ana Maria Aviles, Suprabha Baniya, Johanne Buba, Reno Dewina, Jesse Doyle, Kim Alan Edwards, Susanne Frick, Andres F. Garcia, Keith Garrett, Delfin Sia Go, Virginia Horscroft, Eung Ju Kim, Csilla Lakatos, Sodeth Ly, Siobhan Murray, Obert Pimhidzai, Elliot Rasmuson, Nadia Rocha, Andres Rodriguez-Pose, Michele Ruta, Manohar Sharma, John Virdin, Michael Wong, Judy Yang, and Luan Zhao.

Chapter II was prepared by Nkosinathi Vusizihlobo Mbuya and Anne Marie Provo (Part II.A), and Margaret Miller and Jiyoung Song (Part II.B).

Chapter III was prepared by staff from the Macro and Fiscal Management Global Practice and Poverty Global Practice: Magda Adriani, Kiatipong Ariyapruchya, Reena Badiani-Magnusson, Davaadalai Batsuuri, Hans Beck, Noel del Castillo, Shaohua Chen, Karl Chua, Kevin Chua, Kevin Cruz, Masyita Crystallin, Somneuk Davading, Gabriel Demombynes, Reno Dewina, Viet Tuan Dinh, Ndiame Diop, Sebastian Eckardt, Kim Edwards, Fitria Fitrani, Samuel Freije-Rodriguez, Imogen Halstead, Min Ye Paing Hein, Linh Hoang Vu, Mizuho Kida, Jae Kyun Kim, David Knight, Nandini Krishnan, Chandana Kularatne, Taehyun Lee, Joseph Louie Limkin, John Litwack, Sodeth Ly, Sandeep Mahajan, Miguel Martin, Carolina Mejia-Mantilla, Elitza Mileva, Shabih Ali Mohib, Rafael Munoz, Evgenij Najdov, Lucy Pan, Keomanivone Phimmahasay, Obert Pimhidzai, Ririn Purnamasari, Habib Rab, Julio Revilla, Carlos Romero, Frederico Gil Sander, Shakira Sharifuddin, Manohar Sharma, Altantsetseg Shiilegmaa, Kenneth Simmler, Adisorn Sitdhipol, Karlis Smits, May Thet Zin, Christoph Ungerer, Robert Utz, Matthew Wai-Poi, Maria Monica Wihardja, Judy Yang, and Luan Zhao. The work was managed by Ndiame Diop and Mathew Verghis for the Macroeconomic and Fiscal Management Global Practice, and by Salman Zaidi for the Poverty Global Practice.

Assistance with communications and outreach was provided by Diana Chung, Dini Djalal, Ngan Hong Nguyen, Livia Pontes, Anissa Amador Tria, and Jane Zhang (External Communications, East Asia and Pacific Region). The report was edited by Diane Stamm, and designed and typeset by Budy Wirasmo. Administrative support was provided by Cecile Wodon.

Throughout the report, geographic groupings are defined as follows:

East Asia and Pacific comprises Developing East Asia and Pacific, and the Newly Industrialized Economies.

Developing East Asia and Pacific comprises Cambodia, China, Indonesia, Lao People’s Democratic Republic (PDR), Malaysia, Mongolia, Myanmar, Papua New Guinea, the Philippines, Thailand, Timor-Leste, Vietnam, and the Pacific Island Countries.

Preface continued

The **Pacific Island Countries** comprise Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Palau, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

The **Newly Industrialized Economies** comprise Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan, China.

The **ASEAN** member countries comprise Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

The **ASEAN-4** comprise Indonesia, Malaysia, the Philippines, and Thailand.

The **ASEAN-5** comprise Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

This report is based on data available through September 22, 2016, inclusive.

Executive Summary

In the six months since the previous *East Asia and Pacific Economic Update*, developing East Asia and Pacific (EAP) has faced a mixed external environment. Momentum in advanced economies continues to be generally sluggish, and growth in most emerging market and developing economies remains subdued. Global trade continues to stagnate, while commodity prices have stabilized at historically low levels. At the same time, external financial conditions are more accommodative and stable than was projected in April. Advanced economy central banks have maintained loose monetary conditions or, as in Japan and the United Kingdom, engaged in further easing. Capital flows, exchange rates, and bond spreads across most of the region have steadied, following several bouts of market volatility, including soon after the U.K. Brexit vote.

Growth in developing EAP was broadly stable in the first half of 2016, in line with our projections in April. Weak external demand was largely offset by robust domestic demand, supported by the stabilizing external financial conditions and accommodative monetary and fiscal policies. Developing EAP continues to perform well relative to other developing regions. And, adopting a longer perspective, growth in the region has been particularly resilient since the global financial crisis. Budget deficits have increased across much of the region, largely reflecting increased public expenditure, which is being used partly to scale up investment but also to meet growing current expenses. Inflation remains muted across most of the region.

Growth in the region is expected to remain resilient during 2016–18, with some differences across countries. This outlook is in line with what was projected last April, and remains more positive than in most other developing regions. China is expected to continue its gradual transition to slower but more sustainable growth. In most of the large Association of Southeast Asian Nations (ASEAN) economies, growth will likely pick up slightly. Across most countries, the impact of weak external demand is expected to be offset by continued domestic demand growth. Favorable external financing conditions will be complemented by monetary and fiscal accommodation, with budget deficits projected to increase across much of the region. Continued low commodity prices will support domestic demand in the commodity importers, and contribute to a muted outlook for inflation across the region.

In China, growth is likely to continue easing steadily to 6.3 percent in 2018. The ongoing reform process seeks to facilitate the rebalancing of the economy toward consumption, services, and higher-value-added activities as part of a program to increase overall productivity. Output growth will moderate as excess industrial capacity is reduced, including by slowing the growth in credit to these sectors. Nevertheless, tightening labor markets will support continued growth in disposable income and private consumption.

Among other large economies, growth prospects are strongest in the commodity importers. In the Philippines, growth will likely accelerate, reflecting fiscal stimulus, rising public investment, and strong growth in services (business process outsourcing). In Vietnam, growth will fall in 2016, owing to the temporary effects of the severe drought on agricultural output, but will then recover. In Indonesia, growth will increase steadily, despite low commodity prices, conditional on a pick-up in public investment and the success of efforts to improve the investment climate and increase revenues. In Thailand, growth will recover gradually, reflecting the effects of increased public investment, improving consumer confidence, and continued expansion in services including

tourism. In Malaysia, however, growth will fall sharply in 2016, as oil and manufactured exports are affected by weaker global demand, with a gradual recovery thereafter.

Among the smaller economies, the growth outlook has deteriorated markedly in some commodity exporters. Mongolia is projected to stagnate in 2016, despite a large fiscal stimulus, as mineral exports weaken. Efforts to control the ballooning debt will act as a drag on growth in subsequent years. In Papua New Guinea, growth will fall sharply: production of copper is declining, the output of liquefied natural gas has reached a peak, and prices of both remain depressed. In contrast, growth will remain buoyant in Cambodia, assuming that garment exporters face off competitive threats from other low-cost producers; Lao PDR, as power exports continue expanding; and Myanmar, supported by increased investment and strong growth in transportation, banking, and telecommunications. The outlook for the small Pacific Island Countries will rely significantly on the development of regional fisheries and growth in tourism, but they remain vulnerable to risks arising from natural disasters, climate change, and terms-of-trade shocks.

Poverty in the region has declined rapidly in recent years, and is projected to fall further with continued growth; however, there remain significant challenges to inclusiveness. In 2015, the share of the region's population living in poverty fell to 2.6 percent (or, excluding China, to 5.6 percent), from approximately 18 percent a decade earlier, reflecting continued rapid growth. Poverty fell most sharply in China, Vietnam, and Cambodia, but has also decreased appreciably in Indonesia and Lao PDR. Still, there remain large numbers of increasingly hard-to-reach poor in middle-income China, Indonesia, and the Philippines. And, in countries such as Vietnam, even though poverty has been almost eliminated, disadvantaged groups such as ethnic minorities are lagging behind by an often increasing margin.

The positive outlook for growth and poverty reduction in the region in this base case is subject to significant risks. A sharp global financial tightening, stemming from a more rapid-than-expected normalization of monetary policy in the United States, or rising global risk aversion, would be associated with reduced capital inflows, U.S. dollar appreciation against regional currencies, and likely with increased financial volatility. As a result, debt-service burdens and debt-rollover risks would increase, especially for the large, financially integrated regional economies with sizable external, foreign-currency-denominated, and/or short-term debt, most notably Indonesia, Malaysia and, to a lesser degree, Thailand. In addition, growth fluctuations in high-income economies would have a significant impact on output in the more open regional economies. The ongoing slowdown and rebalancing process in China remains an important short-term risk to growth in the rest of the region, although over the longer term China's rebalancing will also generate opportunities for other countries. Rapidly rising levels of credit are an additional source of vulnerability across most large economies, most notably China, Malaysia, and Thailand. There is a growing risk of financial stress among corporates and households, which could spill over to the banking sector and lead to protracted slowdowns. Shocks to external financial conditions or to global growth would exacerbate these existing financial vulnerabilities.

Subdued global prospects make it critical for policy makers to address underlying financial and fiscal vulnerabilities, and to maintain fiscal space. The deteriorating outlook in high-income economies will have a persistent effect on regional exports, depressed world commodity prices will intensify challenges in commodity exporters, and significant risks to global activity could spill over into the region. At the same time, unexpectedly accommodative global financial conditions are temporarily extending the window of opportunity to address

regional vulnerabilities. Against this backdrop, preserving macrofinancial stability, by reducing financial and fiscal imbalances that have built up in recent years, is critical to maintaining the region's resilience.

China would need to advance reforms in the corporate sector, measures to bring credit growth under control, and efforts to strengthen the intergovernmental fiscal system. Reforms to address excess industrial capacity have been initiated, and could usefully be accelerated and deepened. The continued rapid expansion of credit to state-owned enterprises has increased macroeconomic risks with steadily decreasing returns. Recent measures to strengthen financial regulations, including those pertaining to shadow banking activities such as wealth management products and peer-to-peer lending, should also be expanded. Household credit has been rising rapidly, aided by a loosening of prudential policies, particularly for first-time homebuyers, and needs to be managed carefully. As the economy rebalances, lower public investment growth at the subnational level could facilitate efforts to strengthen the responsibility and capacity of local governments to manage debt, including contingent liabilities from off-budget activities.

Among the other large economies, where private sector credit has grown rapidly, or where external debt is large, the build-up of risk can be reduced through enhanced microprudential regulation and increased use of macroprudential policies. In Malaysia and Thailand, leverage has reached significant levels, including through sharp increases in household debt; in the Philippines and Vietnam, debt continues to grow rapidly. Risks are heightened by the potential for significant external shocks, and by the sizable foreign-currency-denominated debt and short-term external financing requirements, including foreign liabilities of the banking sector, in Malaysia and Indonesia. In several countries, including the Philippines, Thailand, and Vietnam, there is significant scope to strengthen regulatory oversight and microprudential risk management. Enhanced macroprudential regulation would also help mitigate the risks to financial stability from leverage, including among households. Countries with a significant nonbank financial sector, including Thailand, should step up its regulatory oversight and supervision.

Across the region, and especially among commodity producers, maintaining fiscal buffers in the context of a robust medium-term fiscal framework should receive priority over countercyclical stabilization efforts, especially given the continued resilience of regional growth. Countries across the region must preserve room for fiscal manoeuver should risks, including due to deterioration in the external environment, materialize. In this context, broadening revenue sources remains a priority for most countries. Revenue constraints are particularly binding for commodity producers, where low commodity prices have already had a significant impact on public revenue, and which need to reduce their reliance on commodity-related fiscal revenues. Continued low world energy prices also extend the window of opportunity for countries to reform energy pricing policies, including by cutting remaining energy and fertilizer subsidies, increasing fuel taxes, and moving toward greater cost recovery in electricity. That said, among noncommodity producers, and in particular Cambodia, the Philippines, and Thailand, the risks associated with a limited widening of the deficit should prove manageable, as long as this expansion finances efficient efforts to build up the economy's long-term productive capacity.

Fiscal deficits pose a risk to sustainability in some regional economies, primarily commodity producers, and substantial consolidation is needed. In Mongolia, large fiscal imbalances have emerged, and public debt is set to rise rapidly in the coming years in the absence of adjustment. The announced measures to contain expenditure need to be significantly strengthened and domestic revenue sources broadened. In Timor-Leste, the emergence of large structural deficits demands efforts to prioritize the use of sovereign wealth fund assets to

finance essential investments that raise domestic supply potential and support diversification efforts. In these and other resource-rich economies, the use of sovereign wealth funds can support short-term expenditure stabilization and long-term fiscal sustainability, provided that the funds' operational rules are simple, transparent, and allow only limited discretion. In Vietnam, elevated debt levels, and the contingent liabilities associated with banking sector recapitalization, also call for fiscal reforms to stabilize public finances.

The longer-term challenge across the region is to achieve faster, more inclusive growth. While priorities will necessarily be country specific, some are important across the region.

In China, the commitment to facilitate the rebalancing from investment-led to consumption-led growth, as part of a program to increase overall productivity, needs to be complemented by continued efforts to reduce poverty and promote inclusion. The role of market discipline in allocating resources and credit should be enhanced to ensure that resources are allocated toward the most productive uses, including through financial sector reforms. Despite China's success in reducing poverty, a large share of its population remains vulnerable to poverty, and significant rural-urban gaps in income and basic public services persist. Tackling this will require improvements in access to services for the rural population, and for the still growing number of migrants to the cities.

Across the rest of the region, more and better infrastructure holds the potential to promote domestic and international connectivity, facilitate integration into regional value chains and the shift to higher-value-added activities, and ensure gains from continued urbanization. Most of the region, and in particular Indonesia, the Philippines, and Vietnam, suffers from significant infrastructure gaps across all sectors. A rebalancing of public expenditure, and greater public-private cooperation, will help address infrastructure deficits. But increased infrastructure expenditure must be accompanied by reforms to improve the efficiency of public investment management, including developing and entrenching rigorous, transparent, and accountable processes for project selection, appraisal, procurement, and evaluation, and for the efficient operation and sustained maintenance of assets once these are in place.

Such efforts to enhance productivity must be complemented by a renewed focus on boosting inclusion. Research highlights the importance of three issues.

First, undernutrition leads to lifelong disadvantage; reducing it would significantly increase human welfare, promote inclusion, and foster growth in much of developing EAP. Despite the economic success of the region, high levels of undernutrition persist in many countries, even relatively affluent ones. Infant and child undernutrition, in particular, generate health and cognitive deficits that are difficult to reverse. Addressing the problem will require coordinated measures across a range of areas. Particular promise attaches to early childhood development programs, including behavior change and communication interventions to ensure optimal nutrition and care during pregnancy and early childhood, micronutrient interventions and deworming to enhance the consumption of essential vitamins and minerals, and complementary feeding interventions to reduce acute malnutrition.

Second, technological developments hold great promise for transforming financial services across low- and middle-income economies, with significant implications for financial inclusion and productivity. Digital

technologies accessed via mobile platforms, big data, and cloud computing are enabling the rapid emergence of new financial products and business models, including crowdfunding and mobile payments. Developing EAP is well placed to benefit from such developments. The region is technologically advanced, with a high level of mobile phone penetration, but lags in terms of access to financial services, raising the economic and social payoff to successful innovation. To realize these opportunities, countries will need to strengthen the relevant legal and regulatory frameworks; improve their financial infrastructure, including the breadth and depth of borrower credit data; and address challenges related to financial capability, consumer protection, and privacy.

Third, innovations in social protection can significantly reduce vulnerability to shocks and minimize their long-run impact among the poor. In the face of major shocks, the poor and vulnerable often have to cut their spending on education and health care or sell productive assets, with a permanent impact on their human development and income-earning potential. Natural disasters are a particular concern, both because of their relative frequency in the region, and because the poor often live in vulnerable areas. Policy makers should therefore build on ongoing efforts to develop "adaptive safety nets". These systems flexibly take into account the exposure of households to different risks by, for instance, rapidly expanding conditional cash transfer programs while waiving their conditions in the wake of natural disasters. In turn, these features help increase resilience at both the household and macroeconomic levels.

The long-term outlook for growth and inclusion in the Pacific Island Countries hinges on their ability to maximize the benefits from their limited opportunities, including fisheries, migrant workers, and tourism. Three priorities stand out. First, recent policy measures have already sharply increased revenue from tuna fishing fees and enhanced sustainability. Further reforms could yield significant additional revenue gains, but need to be underpinned by improvements in the capacity of the agencies that regulate tuna fishing, including through expanded staffing, training, and partnerships with regional and international organizations. Second, to expand opportunities for residents to work abroad, policy must focus on providing potential migrants with marketable skills, offering better employment intermediation services to both workers and employers, and introducing social support services to mitigate the impact of the temporary separation of family members. Finally, the tourism sector, currently reliant on its traditional Australian and New Zealand markets, could be significantly boosted by improvements in connections and facilities to serve the potentially much larger East Asian market.

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Part I. Recent Developments and Outlook

I.A. Recent Developments

In the six months since the previous East Asia and Pacific Economic Update*, developing East Asia and Pacific has faced a mixed external environment. Momentum in advanced economies continues to be generally sluggish. At the same time, external financial conditions are more accommodative and stable than was previously projected. Capital flows, exchange rates, and bond spreads across most of the region have steadied, following several bouts of market volatility, including soon after the U.K. Brexit vote. Overall, growth in developing East Asia and Pacific has proved resilient, in line with our projections in April, and remains high relative to other developing regions. Weak external demand was largely offset by robust domestic demand, supported by the stabilizing external financial conditions and accommodative monetary and fiscal policies. Budget deficits have increased across much of the region, largely reflecting increased public expenditure, which is being used partly to scale up investment but also to meet growing current expenses.*

Growth in developing East Asia and Pacific has proved resilient, in the face of a mixed external environment

Global growth continued to disappoint in 2016. Momentum in advanced economies has continued to be generally sluggish since April, reflecting softer-than-expected second quarter (Q2) growth, particularly in the United States (Box I.A.1). Growth in most emerging market and developing economies remains subdued, and many large natural resource exporters face continued falls in output. Global trade continues to stagnate, while commodity prices have stabilized at historically low levels, with oil, food, and nonenergy commodity indexes all lower than was expected in April.

External financial conditions have stabilized. Financial conditions are more accommodative and stable than was projected in April. Advanced economy central banks have maintained loose monetary conditions or, as in Japan and the United Kingdom, engaged in further easing, as weaker growth expectations have become entrenched. Capital flows, exchange rates, and bond spreads across most of the region have steadied, following several bouts of market volatility, including soon after the U.K. Brexit vote.

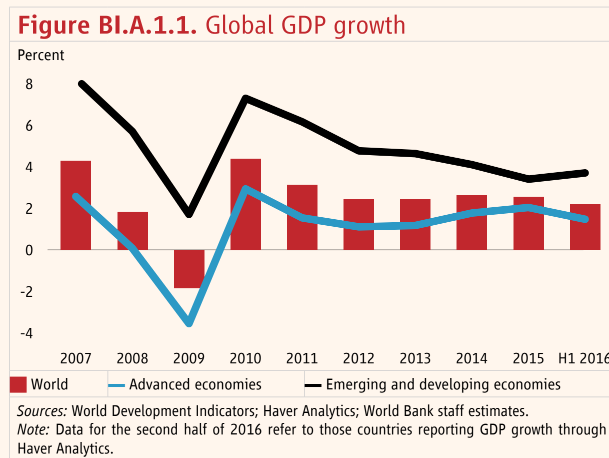
Growth in developing East Asia and Pacific (EAP) was broadly stable in the first half of 2016, in line with our projections in April, as weak external demand was largely offset by robust domestic demand. China continued its gradual transition toward slower but more sustainable growth, with policy stimulus helping to support activity (Figure I.A.1). In the rest of the region, growth was on average stable. Developing EAP continues to perform well relative to other developing regions. Adopting a longer perspective, growth in the region has proved particularly resilient since the global financial crisis (Box I.A.1), and developing EAP has maintained its long track record of remarkable success in reducing poverty (Box I.A.2).

However, performance varied across the large economies other than China. In Thailand, growth has quickened in the first two quarters, as strengthening private and public consumption, a scaling-up of public investment, and buoyant tourism offset slowing manufactured exports (Figure I.A.2). The Philippines registered

Box I.A.1. Recent Global Developments

Global growth continued to disappoint in 2016. Global growth in the second quarter of 2016 remained below the already subdued postcrisis average of 2.5 percent for the third consecutive quarter (Figure BI.A.1.1). Conditions in advanced economies have on average deteriorated since April, reflecting softer-than-expected second quarter growth, particularly in the United States. Nevertheless, U.S. labor markets have remained resilient; unemployment is falling in the euro area, albeit from elevated levels, and with significant variations across countries; and there is little labor market slack in Japan. The uncertainty associated with the U.K. Brexit vote in late June has been reflected in a significant deterioration in key economic indicators in the United Kingdom, but global financial market repercussions and confidence spillovers to the euro area have so far been limited.

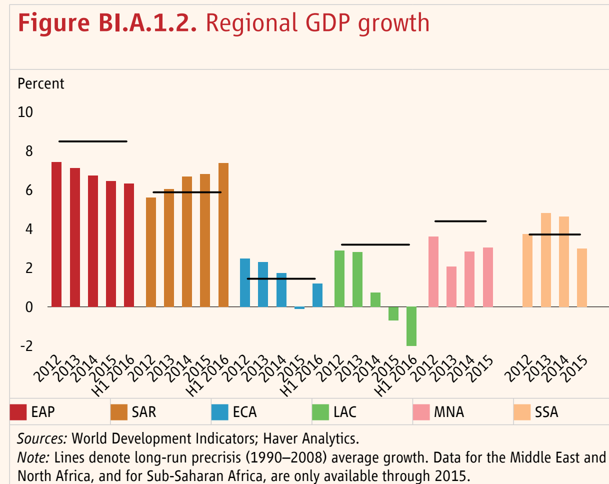
Figure BI.A.1.1. Global GDP growth



Sources: World Development Indicators; Haver Analytics; World Bank staff estimates.
Note: Data for the second half of 2016 refer to those countries reporting GDP growth through Haver Analytics.

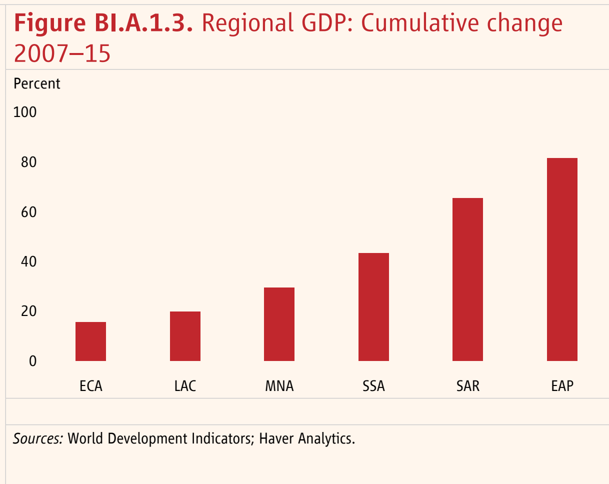
Growth remains subdued in emerging market and developing economies (EMDEs), in particular among commodity exporters. Commodity exporters are still markedly underperforming commodity importers, despite stabilizing commodity prices. While some large commodity exporters, such as Brazil and Russia, appear to be bottoming out, others are facing further weakness, in part reflecting idiosyncratic factors, including delayed adjustment to low commodity prices and domestic challenges. Meanwhile, growth in some commodity importers, particularly in Asia, is accelerating, helped by generally accommodative policies amid low inflation. For instance, growth in India remains robust, as the government continues to implement reforms. Relatedly, activity is relatively weak in commodity-dependent regions, notably Latin America and the Caribbean, the Middle East and North Africa, and Sub-Saharan Africa, but remains dynamic in commodity-importing South Asia and East Asia and the Pacific (Figure BI.A.1.2). Adopting a longer perspective, developing countries in South Asia and East Asia and the Pacific have proved resilient in the wake of the Global Financial Crisis—their real GDP is now well above precrisis levels (Figure BI.A.1.3).

Figure BI.A.1.2. Regional GDP growth



Sources: World Development Indicators; Haver Analytics.
Note: Lines denote long-run precrisis (1990–2008) average growth. Data for the Middle East and North Africa, and for Sub-Saharan Africa, are only available through 2015.

Figure BI.A.1.3. Regional GDP: Cumulative change 2007–15



Sources: World Development Indicators; Haver Analytics.

(continued)

(Box I.A.1 continued)

Global trade continues to stagnate. Global trade growth was subdued in 2015 for the fifth consecutive year, and proved particularly weak in the first half of 2016 (Figure BI.A.1.4). Global goods trade volumes contracted in the first quarter and stagnated in the second quarter, driven by weak import demand in advanced economies and major EMDE commodity exporters. These developments were compounded by longer-term structural factors, including the transition to slower and more domestically oriented growth in China, a slower pace of trade liberalization, and a maturing of global value chains. In contrast, import demand from commodity-importing and manufacturing-focused EMDEs in Asia (excluding China) and Central and Eastern Europe remained robust.

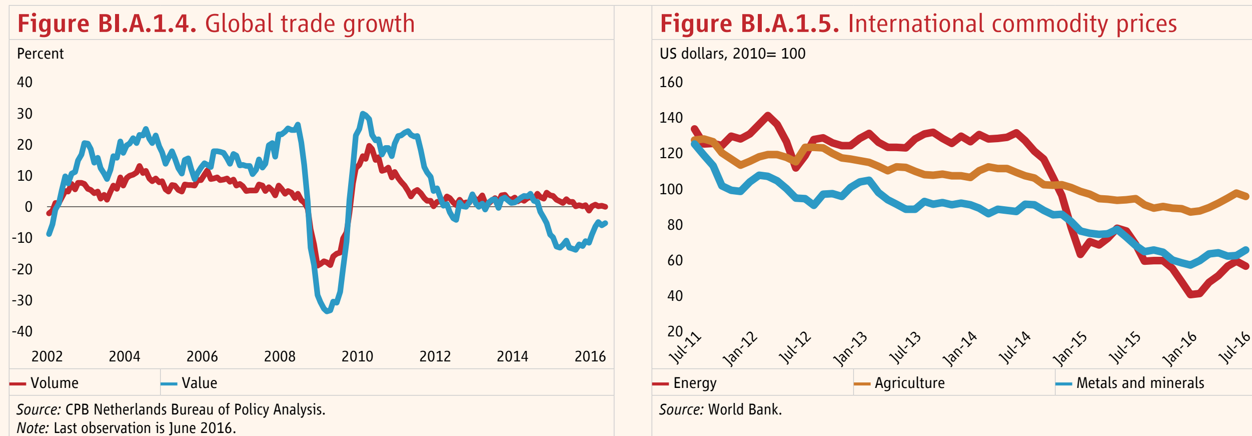


Figure BI.A.1.4. Global trade growth

Source: CPB Netherlands Bureau of Policy Analysis.
Note: Last observation is June 2016.

Figure BI.A.1.5. International commodity prices

Source: World Bank.

Commodity prices have stabilized at historically low levels. Crude oil prices recovered to US$45 per barrel in July (a 51 percent year-to-date increase), but remain almost one-quarter below their April 2015 level (Figure BI.A.1.5), as well as the year-average levels forecast in April. Global oil inventories remain high and the Organization of the Petroleum Exporting Countries (OPEC), including Saudi Arabia, continues to produce at record levels. However, the oil market is gradually rebalancing as consumption strengthens and non-OPEC supply shrinks, notably in the United States, where oil output is down 11 percent from its peak in 2015. Metals prices, still recovering from steep falls in the second half of 2015, have increased by 12 percent since January on stronger demand, production cuts, and continued inventory declines.

Global financial conditions are more accommodative than was projected in April. Global long-term interest rates reached historically low levels during the summer of 2016, amid deteriorating growth prospects in advanced economies and expectations of continued monetary policy accommodation by major central banks. The decrease in yields was visible across most advanced economies, and was particularly pronounced in the United Kingdom, following the unexpected Brexit vote in June and a package of monetary easing measures announced in August. Falling long-term rates in advanced economies renewed the appetite for riskier, previously underperforming emerging-market assets.

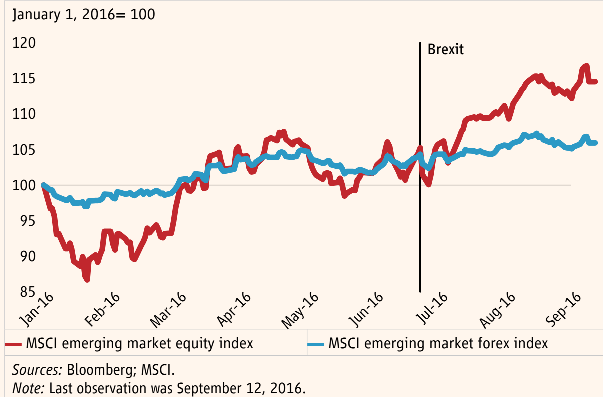
Capital flows to EMDEs and local asset prices have steadied, reflecting global financial accommodation and the observed stabilization in commodity prices. Financial conditions in EMDEs improved in July and August, following net capital outflows in 2015 and several bouts of market volatility at the start of 2016 and around the time of the Brexit vote. The MSCI Emerging Market stock index is 32 percent above its January 2016 low, and 15 percent above its immediate post-Brexit level (Figure BI.A.1.6). Emerging

(continued)

(Box I.A.1 continued)

market bond spreads have fallen by almost 80 basis points since the Brexit vote. The narrowing was most significant among commodity exporters, despite continued concerns about economic fundamentals. Russia, Brazil, and South Africa have been among the largest beneficiaries of the renewed appetite for emerging market assets, while flows to Eastern European and some Asian markets remain stable. In July, emerging market equity funds received US$7 billion in inflows, the largest level in almost two years, and bond funds received more than US$14 billion, a new single-month record led by retail investors.

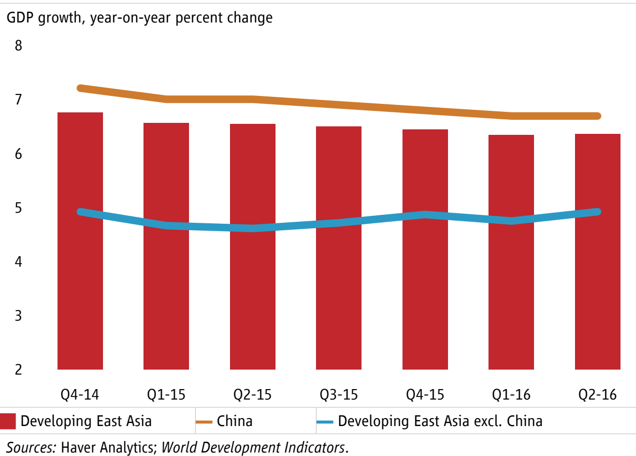
Figure BI.A.1.6. Emerging market stocks and currencies



Sources: Bloomberg; MSCI.
Note: Last observation was September 12, 2016.

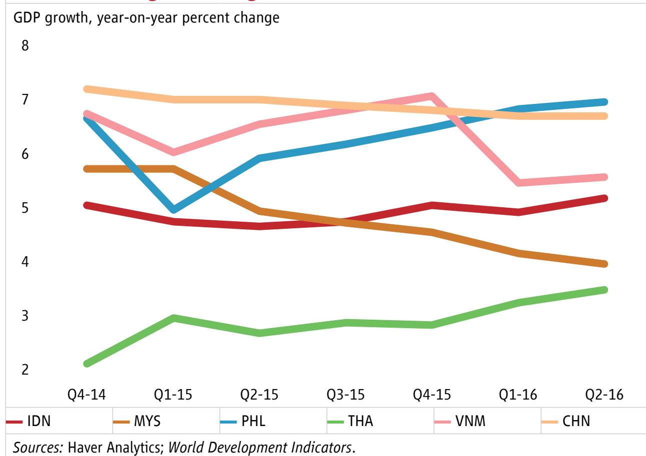
International bond issuance by EMDEs for the year through August is 16 percent higher than in 2015, at US$234 billion, reflecting an increasing number of first-time issuers, and the pace has accelerated in recent months. In particular, bond issuance picked up in Latin America and the Caribbean and the Middle East and North Africa, more than offsetting a substantial decline in East Asia and Pacific (driven by China, Indonesia, and Malaysia). However, the credit ratings of major EMDEs continue to deteriorate, in line with their fiscal conditions. Credit downgrades, including of Turkey, are significantly outnumbering upgrades; and Colombia, Poland, South Africa, and to a lesser extent Mexico and Brazil, are all facing downgrade pressure to varying degrees.

Figure I.A.1. Growth in developing EAP held steady in the first half of 2016



Sources: Haver Analytics; *World Development Indicators*.

Figure I.A.2. Growth performance varied across the region's large economies



Sources: Haver Analytics; *World Development Indicators*.

its fifth consecutive quarter of accelerating, broad-based growth in Q2 2016: public consumption and investment increased, and the services and industrial sectors recorded strong growth, offsetting shocks to agricultural exports. In Indonesia, growth picked up slightly in the second quarter, as public spending recovered and monetary policy

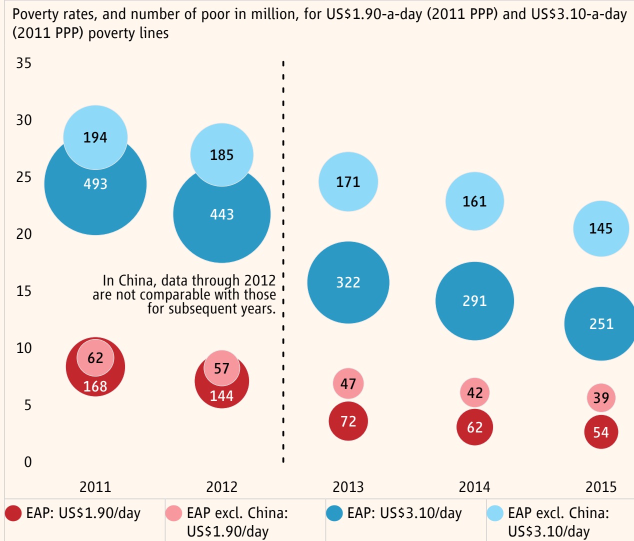
Box I.A.2. Poverty in Developing East Asia and Pacific

Developing EAP maintained its long track record of remarkable success in reducing poverty, but significant challenges remain. Overall, in 2015, the share of the region's population living in poverty[1] is estimated to have decreased to 2.6 percent (or excluding China, to 5.6 percent) (Figure BI.A.2.1), from approximately 18 percent a decade earlier, reflecting continued rapid growth. Poverty fell most sharply in China and Vietnam, but has also decreased appreciably in Indonesia and Lao PDR. Still, there remain large numbers of increasingly hard-to-reach poor in middle-income China, Indonesia, and the Philippines.

1 Defined as living on less than the international poverty line of US$1.90-a-day (2011 purchasing power parity).

Figure BI.A.2.1. The prevalence of poverty has continued to decline across the region

Poverty rates, and number of poor in million, for US$1.90-a-day (2011 PPP) and US$3.10-a-day (2011 PPP) poverty lines



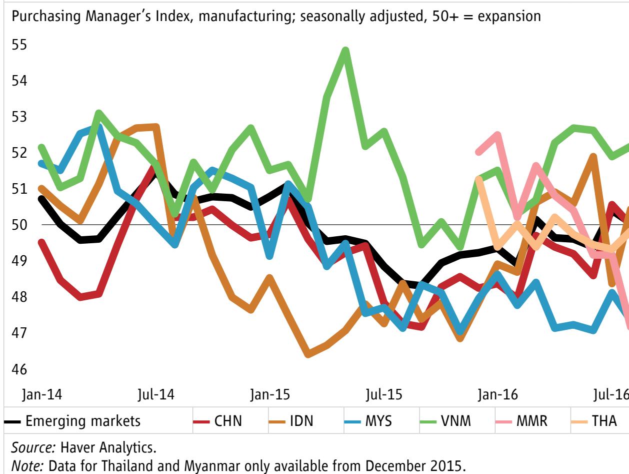
Source: World Bank East Asia and Pacific Poverty Portal.
Note: The most recent household income and expenditure surveys vary from 2006 in Kiribati to 2015 in Indonesia. Estimates are either (i) interpolated between existing surveys; or (ii) extrapolated based on per-capita GDP growth and historical estimates of the growth elasticity of poverty, except for China where the distribution is assumed to remain constant.
In China, data through 2012 are not comparable with those for subsequent years, owing to a change in the survey methodology which acted to lower reported poverty, and may account for nearly half of the reported decrease in the poverty headcount between 2012 and 2013. In late 2012, separate urban and rural household surveys were replaced with a single national household survey, which uses stratified, multi-stage sampling methods. There were significant changes in the collection of information from migrants (now treated as part of the urban population when measuring aggregate disposable income), and the treatment of net taxes and transfers in rural areas; and rents from home ownership are now imputed. This latter factor in particular may have had a substantial effect on reported poverty.

remained accommodative. In contrast, activity slowed in Malaysia, owing to weaker oil and gas exports and investment, and in Vietnam, where the agriculture sector was hit by a severe drought. In recent months, the manufacturing Purchasing Manager's Index has been broadly consistent with these trends (Figure I.A.3), pointing to continued expansion in China, Indonesia, and Vietnam, but a slowdown in Malaysia.

Among the smaller economies, commodity producers have seen a broad slowdown, in line with continued low commodity prices. In Mongolia, growth dropped to 1.4 percent in the first half of 2016, as both manufacturing and agriculture contracted. In Papua New Guinea, production at a major copper mine was halted in the first half of the year, and formal

Figure I.A.3. The manufacturing PMI points to continued expansion in China, Indonesia, and Vietnam, but a slowdown in Malaysia

Purchasing Manager's Index, manufacturing; seasonally adjusted, 50+ = expansion



Source: Haver Analytics.
Note: Data for Thailand and Myanmar only available from December 2015.

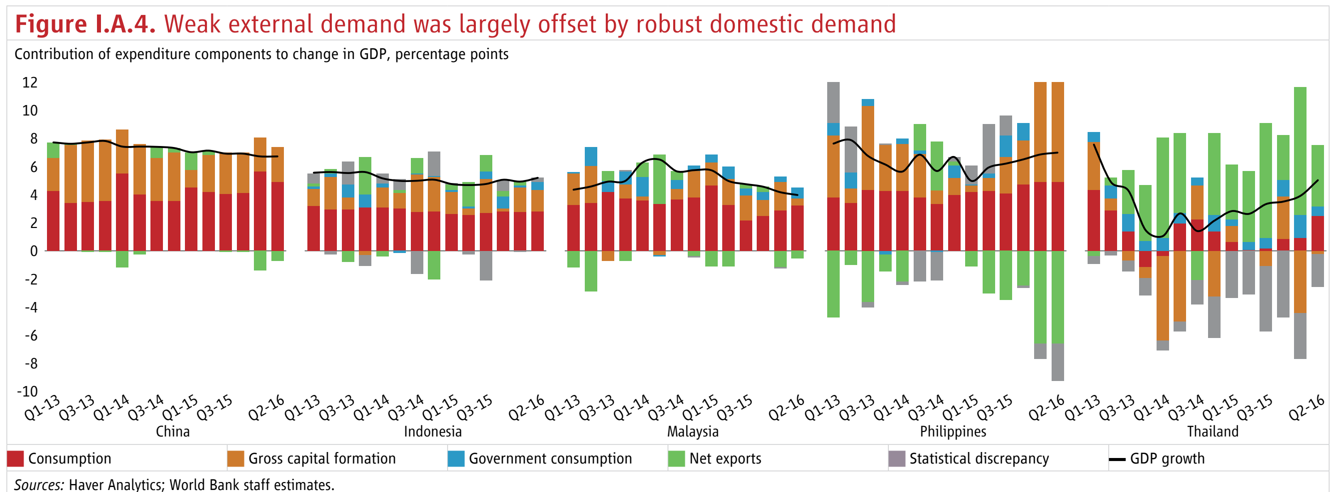
employment was 3.8 percent lower than the previous year,[1] as publicly financed construction activity has been hit by cash shortages. However, non-commodity-dependent economies remain buoyant. Cambodia continued to expand rapidly, as the garment sector grew by over 10 percent year-on-year.

Net export demand weakened across the region

Across most large economies, weak external demand was largely offset by robust domestic demand (Figure I.A.4). Subdued global activity fed through to slackening regional exports. In China, the contribution of net exports to growth has been decreasing over time, and became appreciably negative in the first half of 2016 (Figure I.A.5). Net export demand was stagnant in Indonesia and dropped in Malaysia, reflecting weak growth or contractions in exports. In the Philippines, net export demand was already shrinking in 2015 and fell further in 2016, as export growth slowed and strong domestic demand drove up imports. Net export demand, in contrast, continued to expand in Thailand, reflecting buoyant tourism and shrinking imports.

Figure I.A.4. Weak external demand was largely offset by robust domestic demand

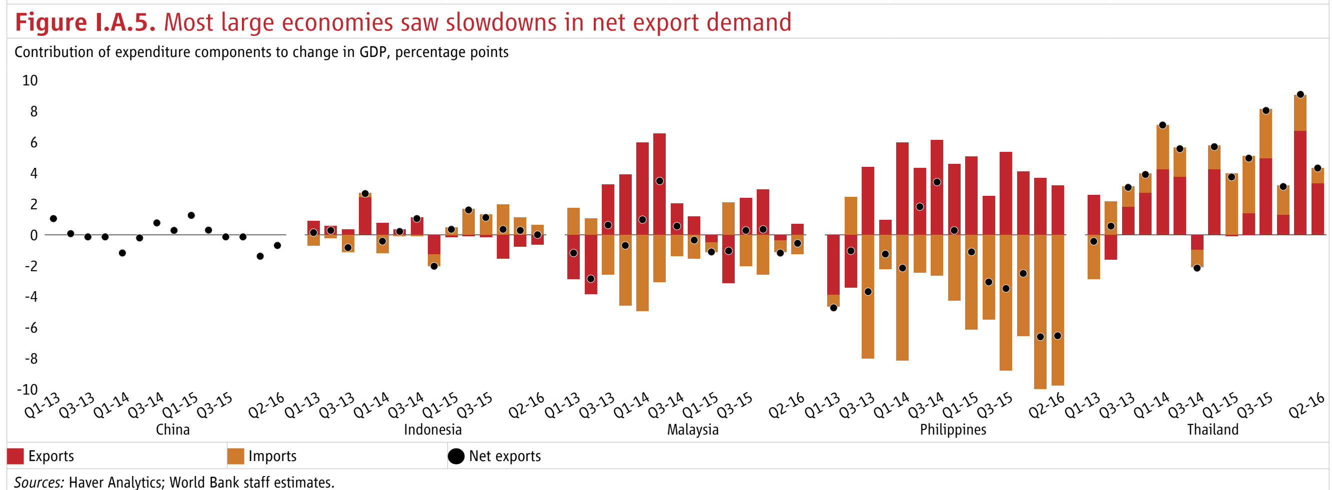
Contribution of expenditure components to change in GDP, percentage points



Sources: Haver Analytics; World Bank staff estimates.

Figure I.A.5. Most large economies saw slowdowns in net export demand

Contribution of expenditure components to change in GDP, percentage points

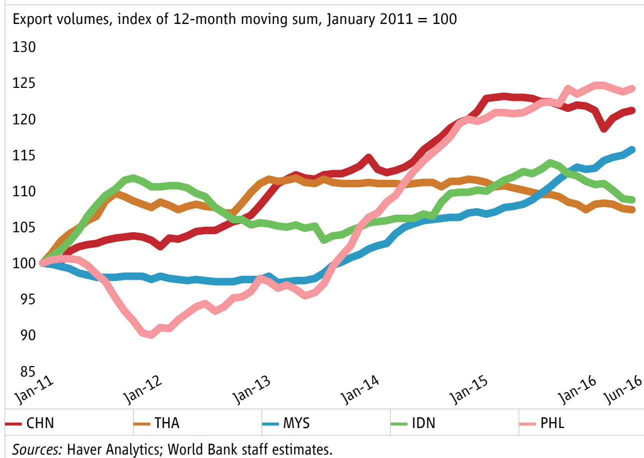


Sources: Haver Analytics; World Bank staff estimates.

1 Estimates of GDP in Q1 2016 or Q2 2016 are not yet available.

Export volume growth has been slowing, or turned negative, across much of the region. Export performance was weaker than expected in April 2016, reflecting subdued activity in high-income economies. In China, exports of goods began falling in 2015, although with a partial recovery in 2016 (Figure I.A.6). In Indonesia, exports have been declining sharply since late 2015, reflecting both weaker demand for manufactured exports and lower commodity exports. That said, in both China and Indonesia exports account for a relatively low share of total production, mitigating the overall adverse impact. In Thailand, exports of goods continued to decline, reflecting ongoing competitiveness challenges. Conversely, export volumes have been rising in Malaysia, where growth of manufactured (and particularly electrical and electronics) exports offset dropping oil and gas shipments. Similarly, in the Philippines, buoyant exports of electronics, including semiconductors, offset the impact on agricultural exports of adverse weather and a new phytosanitary ban on banana exports to China. Export growth, while still positive, slowed in Vietnam as oil exports fell and demand for manufactures was weak. Exports from the Lao People's Democratic Republic (Lao PDR) have rebounded in 2016 to date as electricity exports have increased. Export volumes from Cambodia are strengthening as garment exports continue to rise rapidly. Export volumes declined in Papua New Guinea and Timor-Leste owing to reductions in copper and oil production, respectively. However, and despite continued depressed prices, Mongolian commodity exports benefited from expanded production at one large copper mine, and continued weakness in China's coal sector.

Figure I.A.6. Export volumes have been declining in several countries

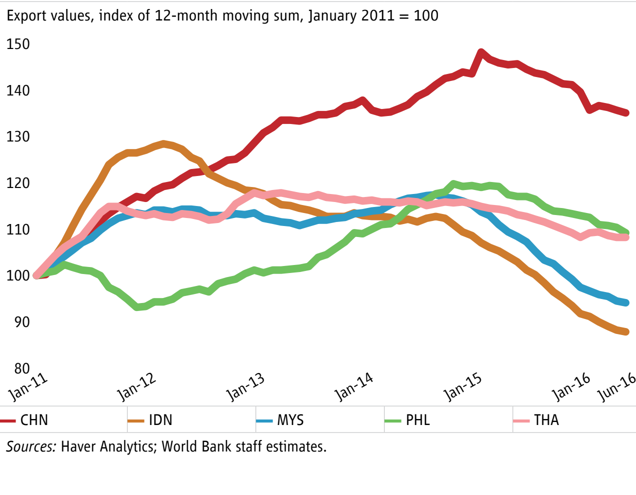


Sources: Haver Analytics; World Bank staff estimates.

Export values remain depressed, especially among commodity exporters. Across the larger economies, export values fell sharply in 2015 and have continued to fall into 2016 in most countries, although they have leveled off in Thailand (Figure I.A.7). Energy exporters such as Indonesia, Malaysia, Myanmar, Papua New Guinea, and Timor-Leste (Figure I.A.8) continue to be affected by depressed prices. These are leading to both sustained losses in export earnings, and cutbacks in supply volumes. Lao PDR and Mongolia are being affected by depressed prices for copper and coal.

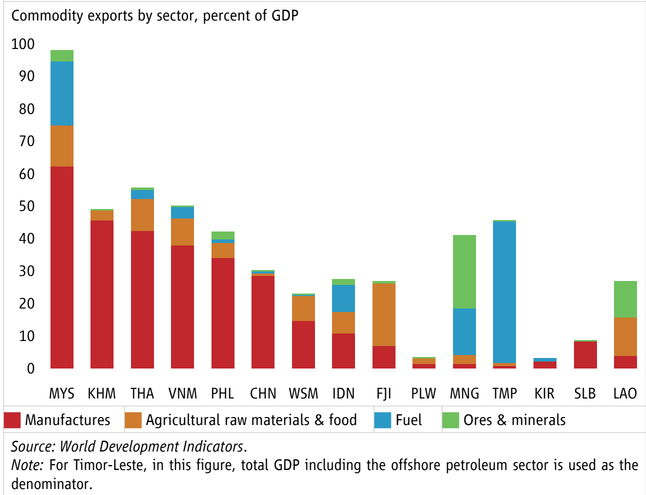
A significant share of the region's gross exports serve the regional market, moderating the impact of weakening activity in advanced economies (Figure I.A.9). Among high-income economies, Europe accounts for an important share of exports, and its imports have proved relatively resilient. Domestic demand within the region has likewise held up (see below), again helping to cushion the impact on manufacturing exports. Data for 2011 indicate that high-income economies account for a large share, and in several cases a majority, of final demand for exports; however, the role of China and the rest of the region as a source of final demand remains significant (Figure I.A.10), and is likely to have grown over time.

Figure I.A.7. Regional export values fell sharply in 2015 and remain depressed, especially among commodity exporters



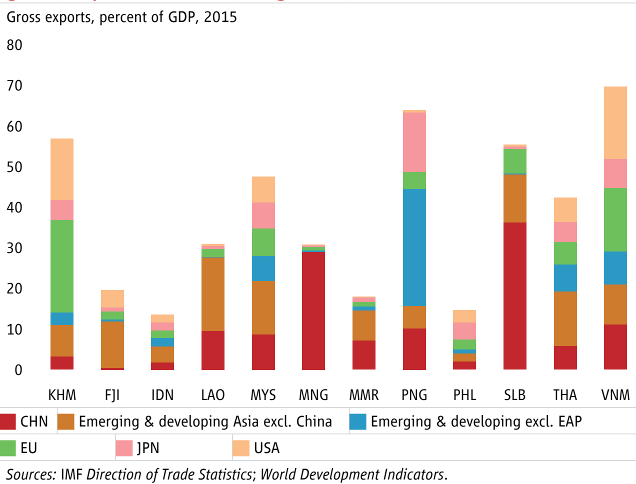
Sources: Haver Analytics; World Bank staff estimates.

Figure I.A.8. Indonesia, Lao PDR, Malaysia, Mongolia, Papua New Guinea, and Timor-Leste remain relatively commodity-dependent



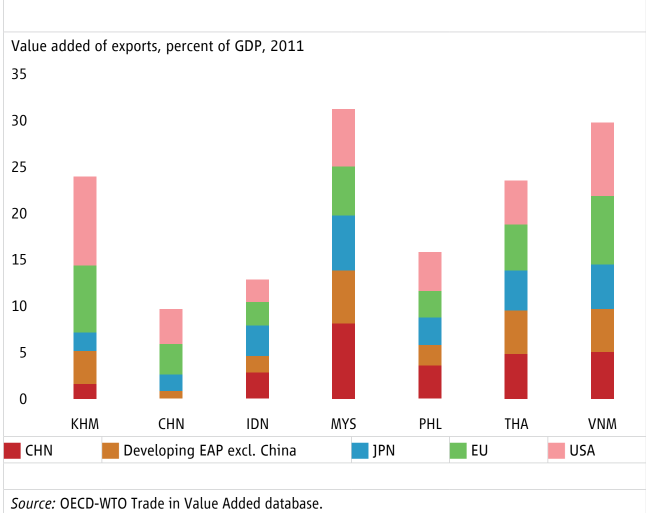
Source: World Development Indicators.
Note: For Timor-Leste, in this figure, total GDP including the offshore petroleum sector is used as the denominator.

Figure I.A.9. The majority of developing EAP's gross exports serve the regional market



Sources: IMF *Direction of Trade Statistics*; *World Development Indicators*.

Figure I.A.10. Exports by source of final demand



Source: OECD-WTO Trade in Value Added database.

Domestic demand across much of the region was buoyant, supported by fiscal stimulus and accommodative monetary policy

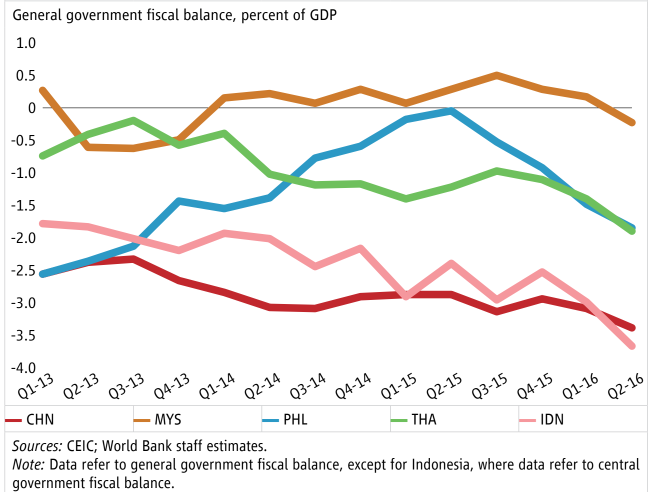
Private consumption in the large economies was buoyant in the first half of 2016. Consumption growth accelerated in the Philippines and especially in Thailand, and remains rapid in both Indonesia and Malaysia. In China, combined private and public consumption[2] contributed more than 5 percentage points to first-half growth, more than at any stage in 2015 (Figure I.A.4).

2 Data are not available on a quarterly basis for private and public consumption separately.

Investment is also holding up. In the Philippines, investment growth has steadily accelerated since 2014. In Indonesia, Malaysia, and Thailand, investment is growing at a pace comparable to 2015, although it remains volatile in Malaysia. In China, the contribution of investment to growth has fallen in 2016 to date compared to the second half of 2015.

Fiscal deficits in the major regional economies have been widening since the start of the year (Figure I.A.11). In the Philippines, the deficit (on a four-quarter moving average basis) has increased steadily from overall balance in Q2 2015 to a 2 percent of GDP deficit in Q2 2016. Deficits widened also in China, Indonesia, Malaysia, and Thailand, and are estimated to have remained stable in Vietnam. That said, in most countries, the overall fiscal boost to demand has proved relatively modest so far: private consumption remains a much larger driver of growth in most large economies (Figure I.A.4).

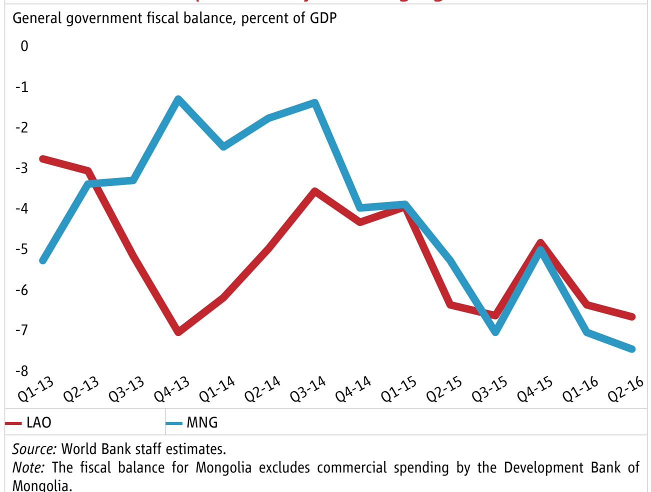
Figure I.A.11. Fiscal deficits in the major regional economies have been widening



Sources: CEIC; World Bank staff estimates.
Note: Data refer to general government fiscal balance, except for Indonesia, where data refer to central government fiscal balance.

The increased fiscal stimulus largely reflects increased public expenditure, with revenue also weakening in commodity-producing Indonesia and Malaysia. Public consumption increased in Indonesia, Malaysia, the Philippines, and Vietnam; in China, government expenditure in the second quarter (seasonally adjusted, as a share of GDP) was at its highest level since 2012. Malaysia raised public transfers to civil servants, pensioners, and low-income households, and reduced employees' contributions to the pension fund. Indonesia allocated a one-month salary bonus to public servants, and the Philippines significantly increased public wages. Public investment also increased in several countries, including China, the Philippines, Thailand, and Vietnam. Fiscal revenue has held steady as a share of GDP in China, the Philippines, and Thailand, but has declined sharply in Indonesia and Malaysia,[3] reflecting falling receipts from commodity-related sectors. In Vietnam, and adopting a longer perspective, revenue has declined by a cumulative 4 percentage points of GDP over the past five years.

Figure I.A.12. The fiscal positions in Mongolia and Lao PDR are particularly challenging



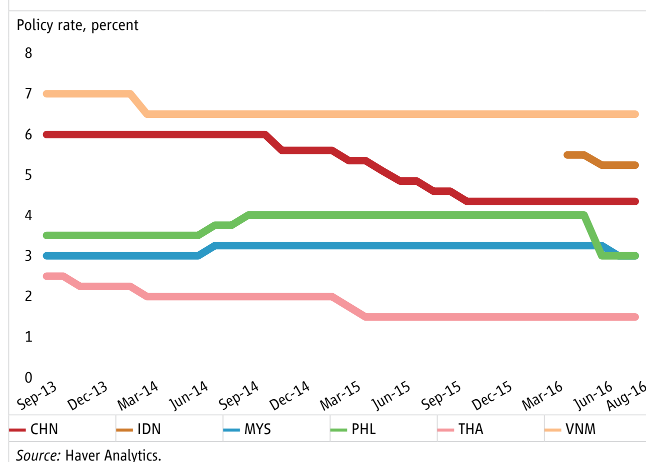
Source: World Bank staff estimates.
Note: The fiscal balance for Mongolia excludes commercial spending by the Development Bank of Mongolia.

There are large, rising deficits across the small resource-dependent economies. In Mongolia, in particular, the deficit has more than doubled, reflecting both large election-related expenditures on policy lending and other

3 In Indonesia, from 13 percent of GDP in 2015 to 12.3 percent of GDP in Q2 2016; in Malaysia, from 14 percent to 13.3 percent of GDP over the same period.

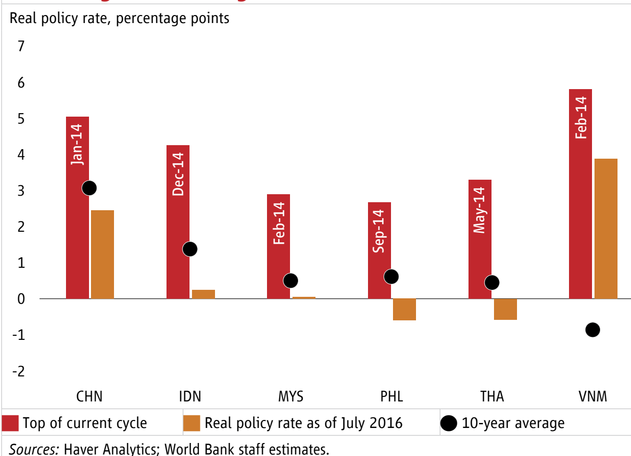
programs and weak revenues. In Lao PDR, the fiscal position has been deteriorating over time, as natural resource revenues have declined. Resource revenues have fallen and deficits increased in Myanmar and Papua New Guinea, as well. In Timor-Leste, a large structural deficit has opened up, as the impact of declining petroleum production has been compounded by low world energy prices. Deficits have increased to a lesser degree in non-commodity-dependent Cambodia.

Figure I.A.13. Indonesia, Malaysia, and the Philippines cut policy rates in the second quarter



Source: Haver Analytics.

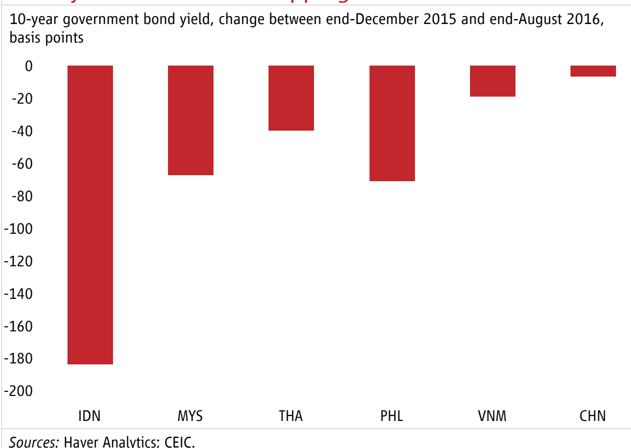
Figure I.A.14. Real interest rates in large economies have been declining and in most cases are significantly below their long-term average



Sources: Haver Analytics; World Bank staff estimates.

Monetary policy in many countries is increasingly accommodative. Indonesia, Malaysia, and the Philippines cut policy rates in the second quarter, in some cases unexpectedly (Figure I.A.13), and Malaysia lowered central bank reserve requirements in 2016 for the first time in five years. Real interest rates in large economies have been declining, and in most cases are significantly below their long-term average (Figure I.A.14). Longer-term (local currency) government bond yields have been falling, especially in Indonesia and the Philippines (Figure I.A.15). Relatedly, the exchange rate, which can be an important transmission mechanism for monetary policy, has appreciated slightly (on a nominal trade-weighted basis) during the year to date in Malaysia and Thailand, but is unchanged in the Philippines and Indonesia, has depreciated in China, and in all cases remain significantly depreciated relative to its level 18 months ago (see below). Underlying all this, continued low interest rates in advanced economies have allowed for monetary loosening without significant capital outflows (see below).

Figure I.A.15. Longer-term (local currency) government bond yields have been dropping

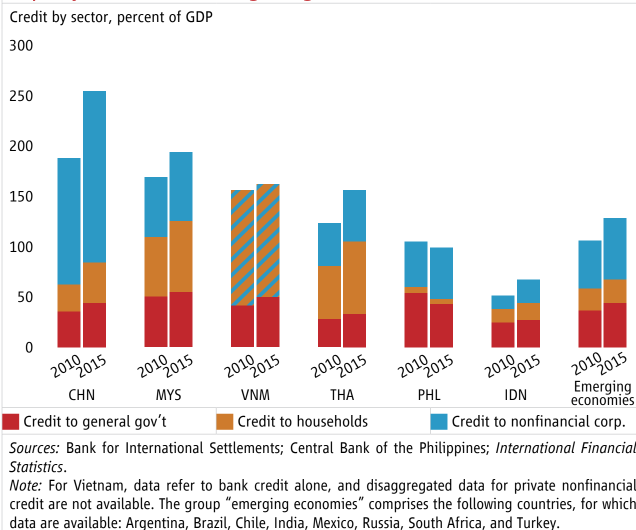


Sources: Haver Analytics; CEIC.

The stock of private sector credit is high and continues to rise rapidly in several large economies

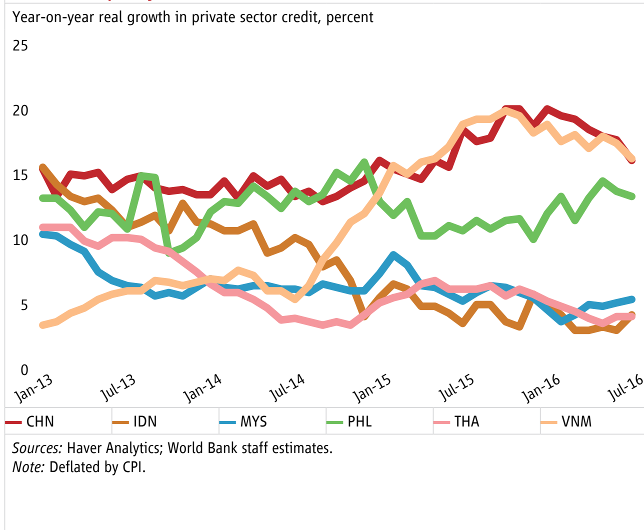
Private sector credit is high and continues to rise rapidly in several economies. Since the global financial crisis, domestic credit has grown rapidly across most large regional economies, including, in particular, China, Malaysia, and Thailand (Figure I.A.16). The majority of credit has been supplied by domestic banks, but over time there has been some diversification toward nonbank financial institutions, cross-border bank lending, issuance of debt securities,[4] and activities in the shadow banking sector.[5] Bank credit alone now stands at more than 100 percent of GDP in China, Malaysia, Thailand, and Vietnam. The pace of credit growth has slowed somewhat over the past year, but without significantly altering the trend (Figure I.A.17). Real credit growth for the year to date exceeds 15 percent per year in China and Vietnam,[6] and has accelerated in the Philippines. Real credit growth has decreased to 5 percent per year in Malaysia and Thailand where, however, the stock of outstanding credit is already high, and in Indonesia. In recent years, credit growth has been especially rapid in some smaller economies; in Cambodia, bank credit has been growing by close to 10 percent of GDP per year since 2011, and in Myanmar credit is also rising rapidly, albeit from a small base.

Figure I.A.16. Domestic private sector credit has grown rapidly across most large regional economies



Sources: Bank for International Settlements; Central Bank of the Philippines; *International Financial Statistics*.
Note: For Vietnam, data refer to bank credit alone, and disaggregated data for private nonfinancial credit are not available. The group "emerging economies" comprises the following countries, for which data are available: Argentina, Brazil, Chile, India, Mexico, Russia, South Africa, and Turkey.

Figure I.A.17. Private sector credit continues to rise rapidly in several economies



Sources: Haver Analytics; World Bank staff estimates.
Note: Deflated by CPI.

The private nonfinancial sector accounts for most debt across the large economies; corporate debt is particularly significant, but household indebtedness has been rising rapidly. Corporates account for the bulk of outstanding private sector debt in both China and the ASEAN-4. However, household credit accounts for the majority of credit expansion over the past five years in the ASEAN-4,[7] continues to grow rapidly in China, and currently represents the majority of private sector debt in both Malaysia and Thailand.

4 The stock of outstanding corporate bonds in emerging East Asia almost quadrupled between end-2008 and end-2015, to reach US$3.5 trillion (Asian Development Bank 2016).

5 In China, for instance, overall credit to the economy continued to expand as lending activity migrated to the nonbank system, including a diverse set of institutions and instruments comprising wealth management products, trusts, entrusted loans, and informal lending.

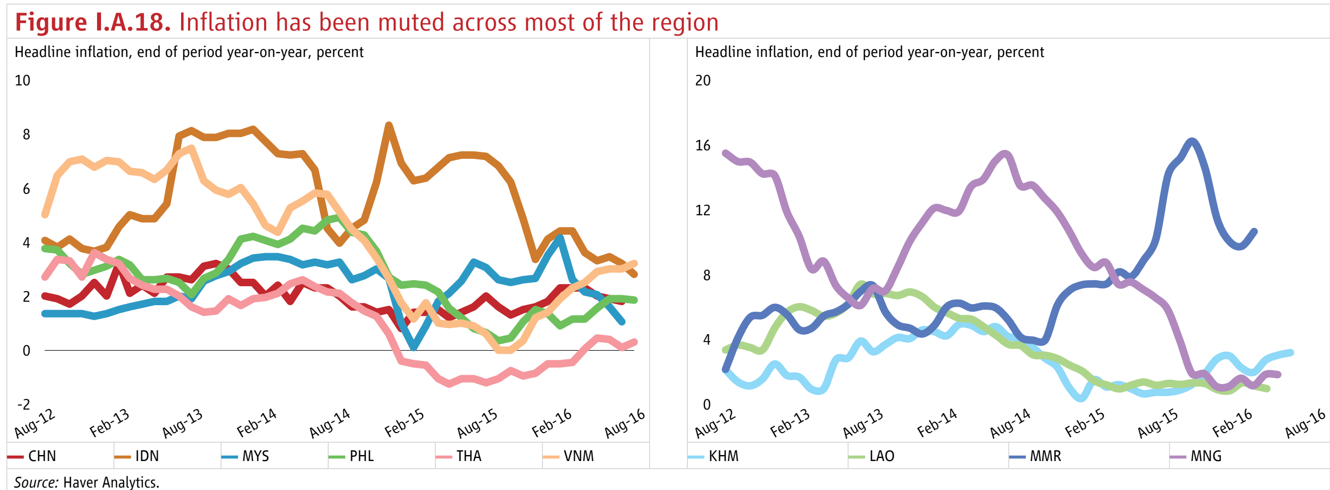
6 In China, credit to both the government and nonfinancial sector has grown twice as fast as the overall economy for the year to date, issuance of bonds by local governments and local government financing vehicles has increased rapidly since the second half of 2015, and the outstanding debt stock now exceeds 250 percent of GDP.

7 Overall, in Indonesia, Malaysia, the Philippines, and Thailand, between 2010 and 2015, the ratio of credit to GDP grew by 32.9 percentage points for households, 30.6 percentage points for nonfinancial corporates, and 1.6 percentage points for government credit.

Inflation has been muted, reflecting sustained low commodity prices

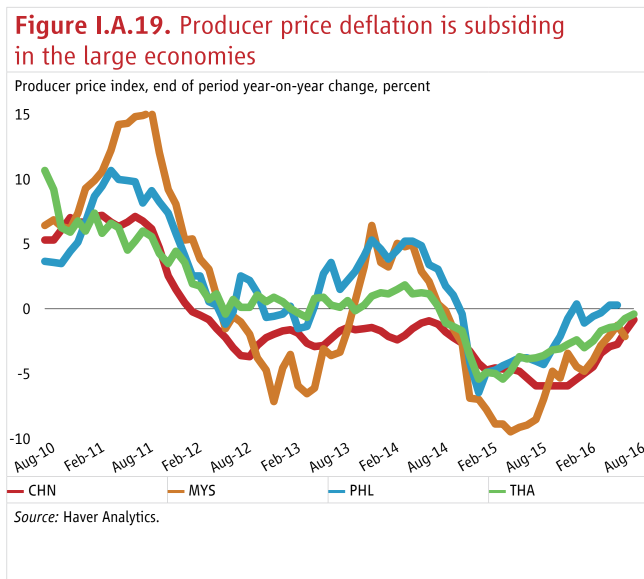
Inflation was muted across most of the region in 2016. In Indonesia, from May onward, consumer price inflation has been at its lowest levels since 2009, reflecting low world energy prices and a stabilizing exchange rate. Inflation has also been decreasing in Malaysia (Figure I.A.18), following a peak in February driven by a rise in electricity tariffs. Inflation remains stable in China. Deflation is subsiding in Thailand, and several other countries, including the Philippines and Vietnam, which recovered from near-deflation at end-2015. Among the smaller economies, over the year to date, inflation has remained low and stable in Cambodia and Lao PDR, but has dropped sharply in Mongolia, as consumer spending has collapsed and policy rates have been hiked. Inflation picked up sharply in Myanmar in late 2015, and remains elevated, driven by increases in food prices. Producer price deflation is close to subsiding in the large economies (Figure I.A.19). That said, China has been experiencing falling producer prices since early 2012, reflecting also an adjustment to overcapacity. While the sharp drops in regional consumer and producer price inflation through end-2015 partly reflected falling world energy prices, the latter's partial recovery in 2016 has not yet led to price increases (Figure I.A.20).

Figure I.A.18. Inflation has been muted across most of the region



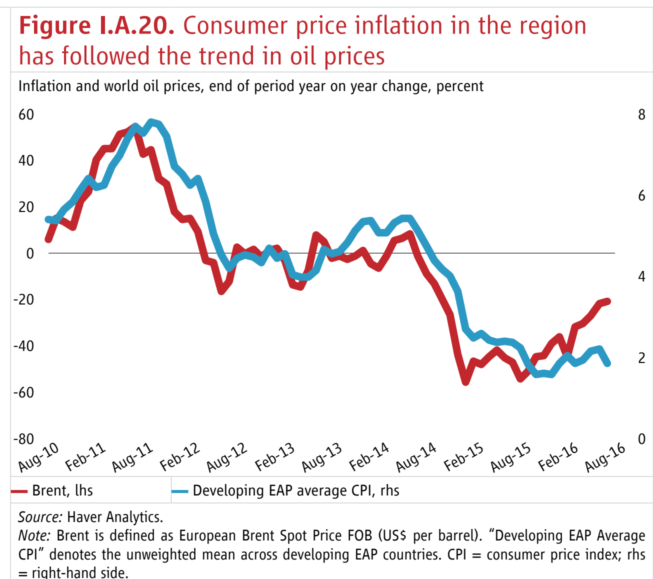
Source: Haver Analytics.

Figure I.A.19. Producer price deflation is subsiding in the large economies



Source: Haver Analytics.

Figure I.A.20. Consumer price inflation in the region has followed the trend in oil prices

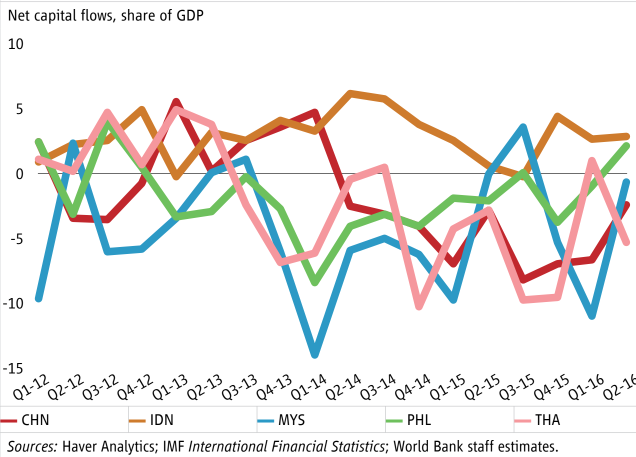


Source: Haver Analytics.
Note: Brent is defined as European Brent Spot Price FOB (US$ per barrel). "Developing EAP Average CPI" denotes the unweighted mean across developing EAP countries. CPI = consumer price index; rhs = right-hand side.

Capital flows and exchange rates have stabilized

Capital flows have stabilized, reflecting expected continued policy accommodation by major advanced economy central banks. Capital flows to emerging markets have steadied, following net capital outflows in 2015 and several bouts of market volatility at the start of 2016 and around the time of the Brexit vote (Box I.A.1). The renewed appetite for emerging market assets reflects both expected continued monetary accommodation in high-income economies, and the observed stabilization in commodity prices. In particular, developing EAP faced volatile external financing conditions in early 2016, but capital flows have been stabilizing since February. Net capital outflows have been easing in China (Figure I.A.21). The rest of developing EAP as a whole received net inflows in the second quarter of 2016, after six consecutive quarters of net outflows. Indonesia, with a relatively tight monetary policy, has enjoyed net inflows over most of the past 18 months. There were net inflows in the Philippines for the first time since 2012. Net outflows in the second quarter eased sharply in Malaysia, and resumed in Thailand but remain significantly below recent peaks.[8]

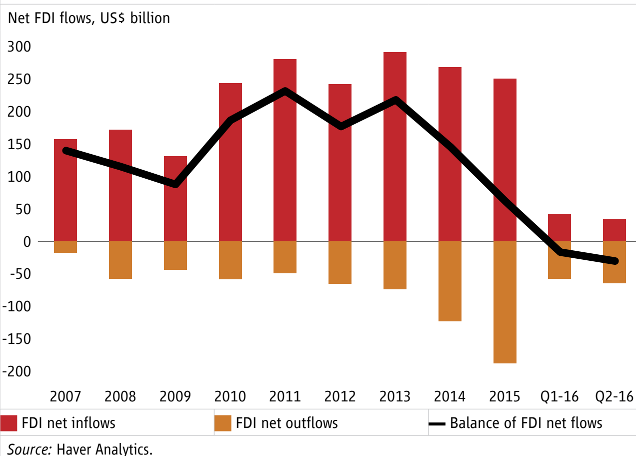
Figure I.A.21. Capital flows to developing EAP are stabilizing



Sources: Haver Analytics; IMF *International Financial Statistics*; World Bank staff estimates.

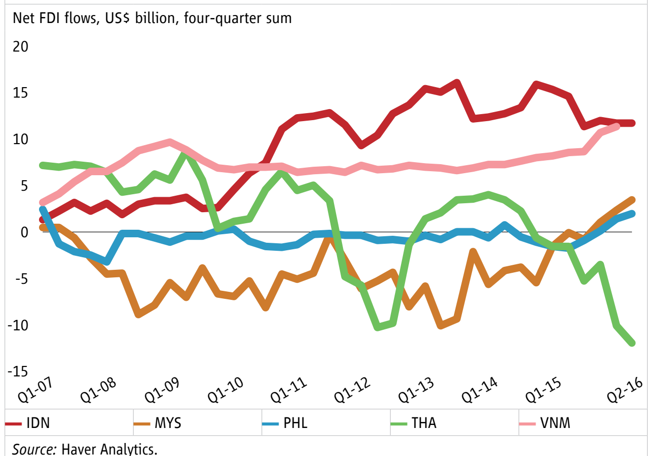
Net foreign direct investment (FDI) flows are diminishing in China and Thailand, but growing in Malaysia, the Philippines, and Vietnam. China recorded net negative FDI flows in the first half of 2016, for the first time since before the global financial crisis (Figure I.A.22), consistent with a gradual relocation of manufacturing to lower-cost regional locations. FDI continues to trend downward in Thailand (Figure I.A.23), reflecting impaired

Figure I.A.22. China recorded net negative FDI flows in the first half of 2016…



Source: Haver Analytics.

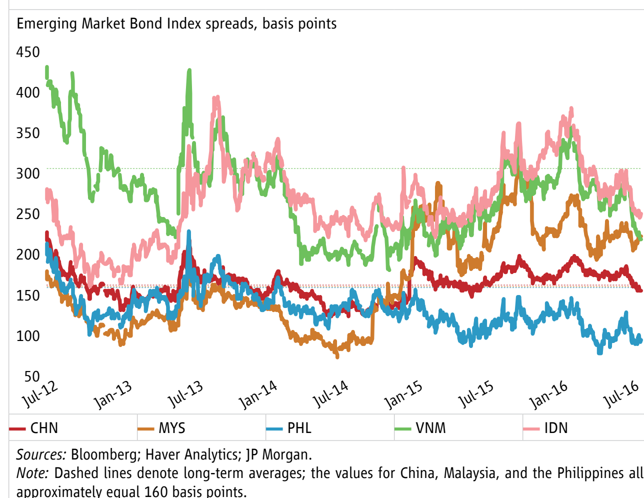
Figure I.A.23. …as did Thailand, but FDI is recovering elsewhere



Source: Haver Analytics.

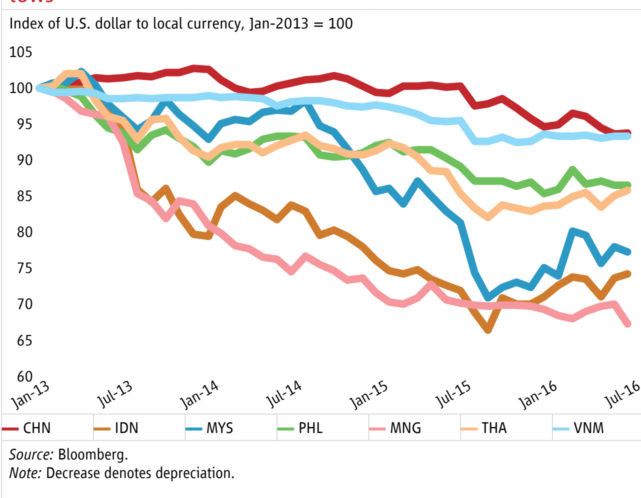
8 The region has accounted for the bulk of flows into emerging market bond and equity funds in 2016. It has also seen a sharp rise in cross-border bank lending, especially to Chinese companies raising funds to finance overseas acquisitions. Partly offsetting this, international bond issuance by developing EAP borrowers for the year through August is approximately 20 percent lower than in 2015.

Figure I.A.24. Corporate and sovereign risk spreads have eased across the region



Sources: Bloomberg; Haver Analytics; JP Morgan.
Note: Dashed lines denote long-term averages; the values for China, Malaysia, and the Philippines all approximately equal 160 basis points.

Figure I.A.25. Regional currencies have broadly appreciated against the U.S. dollar since their late-2015 lows

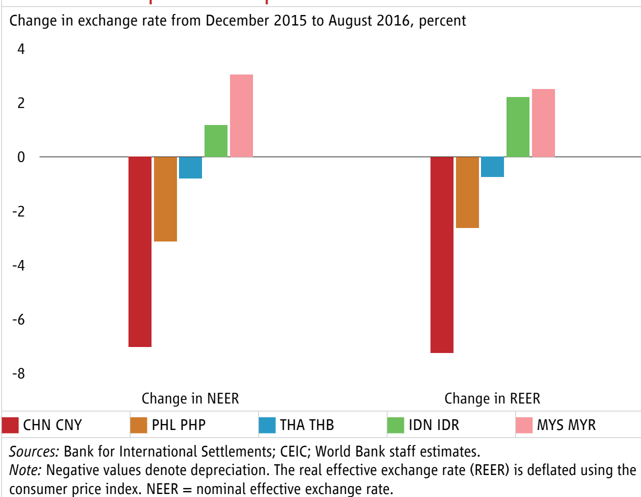


Source: Bloomberg.
Note: Decrease denotes depreciation.

investor confidence. In contrast, net FDI flows are at an eight-year high in the Philippines, are accelerating in Malaysia and Vietnam, and are stable in Indonesia.

Regional asset prices have stabilized since February, in line with the increase in net capital inflows. Equity and bond markets have generally recovered. Corporate and sovereign risk spreads, which rose across the region in late 2015 and early 2016, have eased and, with the exception of Malaysia, are below their six-year average levels (Figure I.A.24). Regional currencies, with the exception of China, have broadly ceased depreciating against the U.S. dollar, and some currencies including, in particular, in Indonesia and Malaysia have experienced bilateral appreciation since their late-2015 lows (Figure I.A.25). However, there has been little change in trade-weighted nominal or real exchanges rates (Figure I.A.26), largely reflecting the sharp appreciation of the yen against the U.S. dollar and regional currencies in 2016. Exceptions include China, which has experienced significant depreciation, and above all Mongolia, where rapid monetary and fiscal expansion led to a sharp depreciation.

Figure I.A.26. Trade-weighted nominal and real exchanges rates have moved little in 2016, with the exception of depreciation in China

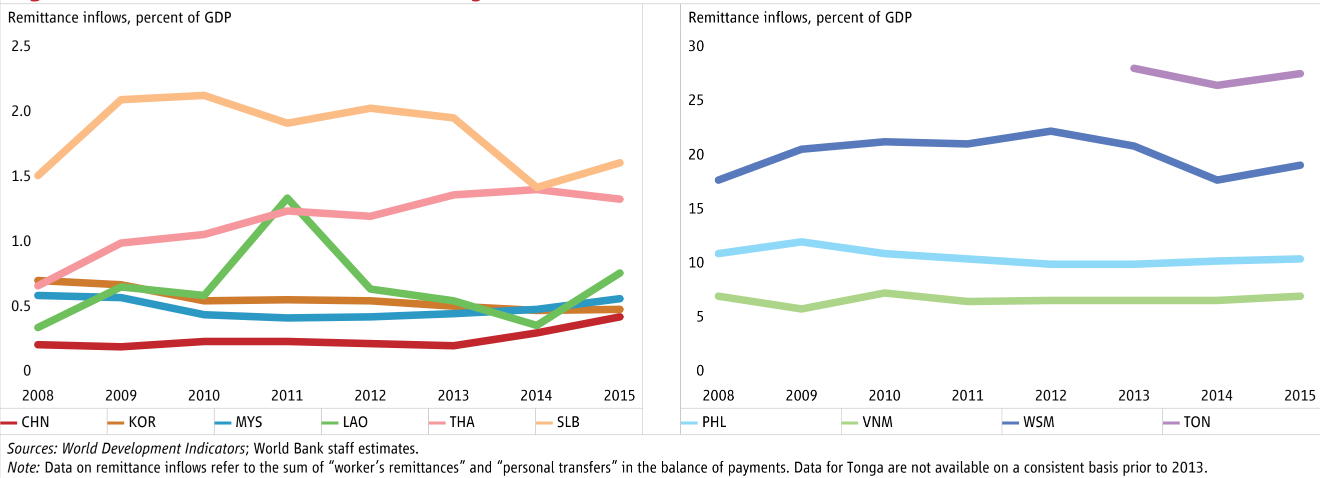


Sources: Bank for International Settlements; CEIC; World Bank staff estimates.
Note: Negative values denote depreciation. The real effective exchange rate (REER) is deflated using the consumer price index. NEER = nominal effective exchange rate.

Flows of workers' remittances to the region have been growing, after flattening or declining in the wake of the global financial crisis (Figure I.A.27). This partly reflects the strengthening of labor markets in some advanced economies. Remittances are of considerable significance to several countries in the region, including, in particular, small Pacific Island Countries (PICs) such as Samoa and Tonga, as well as the Philippines and Vietnam.[9]

9 Remittances amount to more than 20 percent of GDP in Samoa and Tonga, 10 percent of GDP in the Philippines, and 7 percent of GDP in Vietnam.

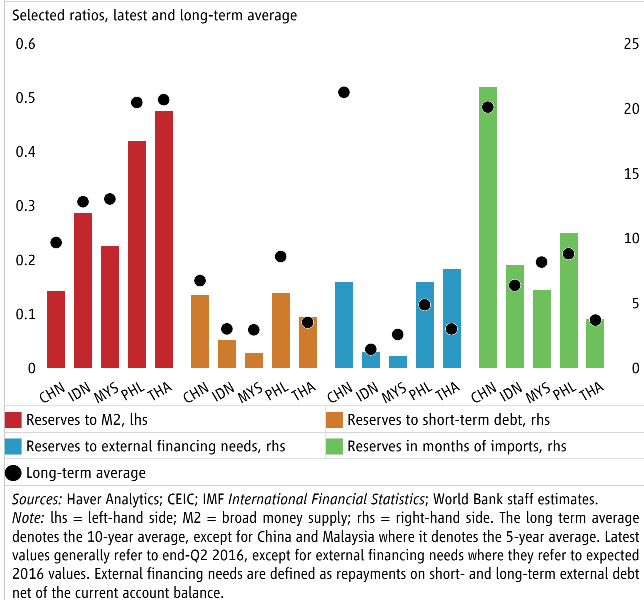
Figure I.A.27. Flows of remittances to EAP grew in 2015



Sources: World Development Indicators; World Bank staff estimates.
Note: Data on remittance inflows refer to the sum of "worker's remittances" and "personal transfers" in the balance of payments. Data for Tonga are not available on a consistent basis prior to 2013.

Reserve coverage for the major economies in the region remains broadly adequate, although in Indonesia and Malaysia it has been falling relative to external financing needs (Figure I.A.28). In Malaysia, foreign exchange reserves fell below standard recommended benchmarks in 2015, reflecting significant interventions in the face of market pressure, but they have since started recovering. In China, the large reserves also decreased during 2015, but have since stabilized. Over time, reserves have fallen relative to annual external financing needs in China, Malaysia, and marginally in Indonesia, but increased in the Philippines and Thailand; external financing coverage is currently relatively low in Indonesia and Malaysia.

Figure I.A.28. Reserve coverage for the major economies in the region remains broadly adequate



Sources: Haver Analytics; CEIC; IMF *International Financial Statistics*; World Bank staff estimates.
Note: lhs = left-hand side; M2 = broad money supply; rhs = right-hand side. The long term average denotes the 10-year average, except for China and Malaysia where it denotes the 5-year average. Latest values generally refer to end-Q2 2016, except for external financing needs where they refer to expected 2016 values. External financing needs are defined as repayments on short- and long-term external debt net of the current account balance.

Recent developments in the Pacific Island Countries

Recent growth in the PICs has been volatile, reflecting their dependence on undiversified income sources and significant exposure to shocks. Growth in the PICs is both low on average and extremely volatile. In Tonga and Samoa, GDP growth for the year to date reached around 3 percent, supported by a scaling-up of private sector investments, including the reconstruction of Tonga's largest hotel and a new fish processing plant in Samoa. Economic activity was adversely affected in Vanuatu by an uncertain political environment, and in Fiji by a major cyclone. In many of the Northern PICs, bumper revenues from regional tuna fisheries (see below) supported increased public spending. In Nauru, a new member of the World Bank Group, the limited data available suggest an

economic boom during 2011–14, as Australia opened an offshore asylum-seeker processing center and phosphate mining resumed. Since then, problems with phosphate shipping have negatively affected growth.

Regional fisheries boosted public finances in many PICs in the past year. Record tuna catches delivered large budget windfalls in Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, and Tuvalu. Several of these countries placed part of the surpluses into sovereign wealth funds, to finance the budget in future years. Vanuatu also recorded a large budget surplus in 2015, as political uncertainty delayed implementation of cyclone recovery and infrastructure projects. And, in Samoa, the budget deficit fell, despite a drop in grants, as domestic revenues increased and expenditure was contained. In contrast, the budget deficit increased in Fiji, as the authorities began implementing a cyclone recovery program, and in Tonga, where lower-than-expected development grants and higher wage spending more than offset higher revenue collection.

Continued low commodity prices have significantly dampened inflation and boosted domestic demand in the PICs. All the PICs are heavily dependent on imports, in particular, for food and fuel. They also incur significant transportation costs, whose level is strongly affected by fuel prices. As a result, low world commodity prices have helped suppress inflation, support household spending, and reduce balance-of-payments pressures.

Poverty and inclusiveness: successes and challenges

New household surveys indicate an even lower incidence of poverty in the region than previously estimated. In China, data from the integrated 2013 household survey show a much lower incidence of poverty than the separate rural and urban household surveys of 2012. This reflects both improvements over time in living conditions, and a more accurate measurement of household consumption patterns. New data from household surveys in Indonesia (2015), Vietnam (2014), Mongolia (2014), Timor-Leste (2014), Cambodia (2013), and the Solomon Islands (2013) show that the incidence of poverty declined also in these countries.

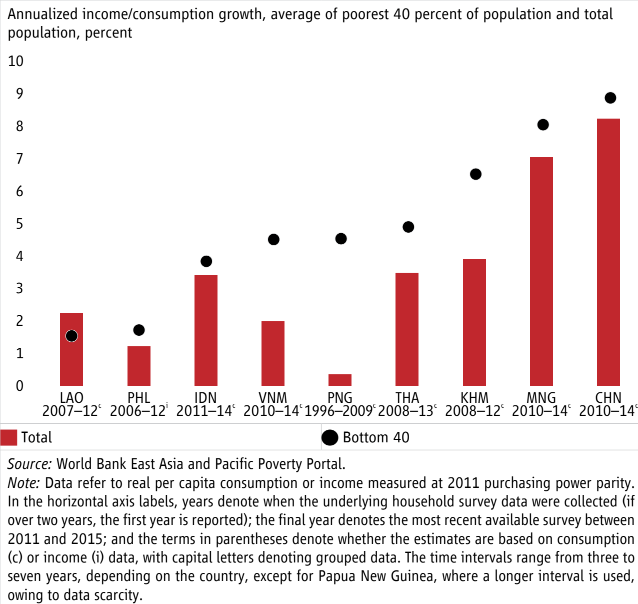
Natural disasters and extreme weather events occurred in several EAP countries and likely adversely impacted the poor, including through lower growth and higher food prices. Over the past year, the extreme weather patterns associated with El Niño and La Niña have led to delayed planting and harvesting, and significant crop losses, in several countries.[10] Again, large parts of Fiji's population have been affected by the severe Tropical Cyclone Winston of early 2016.

Across much of the region, growth has proved relatively inclusive over the past few years, but challenges remain. The bottom 40 percent of the population has experienced relatively rapid income growth (Figure I.A.29). Since 2000, inequality has decreased in most countries, except Indonesia[11] and the Philippines (Figure I.A.30). Nevertheless, there remain significant challenges to inclusiveness; even in countries such as Vietnam, where poverty has been almost eliminated, disadvantaged groups such as ethnic minorities are lagging behind by an often increasing margin (Box I.A.3).

10 Including Papua New Guinea, the Philippines, and Vietnam. In Vietnam, severe drought and saltwater intrusion across key agricultural regions caused agricultural output to contract by 0.2 percent.

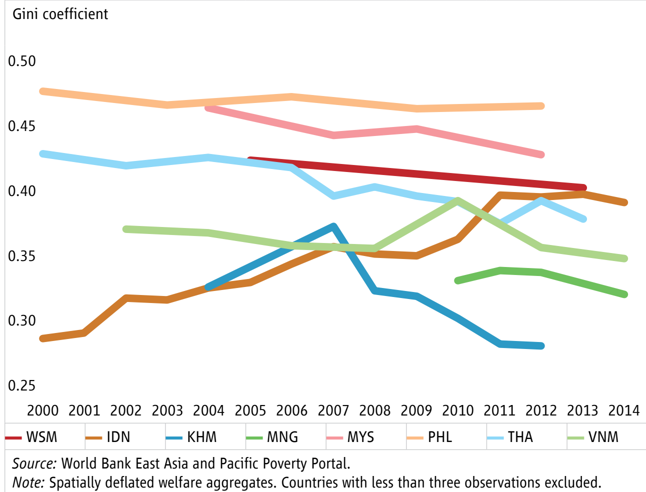
11 For a discussion of rising inequality in Indonesia, see World Bank (2016a), Box I.A.3.

Figure I.A.29. The bottom 40 percent of the population across most of the region experienced relatively rapid consumption growth over the past few years



Source: World Bank East Asia and Pacific Poverty Portal.
Note: Data refer to real per capita consumption or income measured at 2011 purchasing power parity. In the horizontal axis labels, years denote when the underlying household survey data were collected (if over two years, the first year is reported); the final year denotes the most recent available survey between 2011 and 2015; and the terms in parentheses denote whether the estimates are based on consumption (c) or income (i) data, with capital letters denoting grouped data. The time intervals range from three to seven years, depending on the country, except for Papua New Guinea, where a longer interval is used, owing to data scarcity.

Figure I.A.30. Inequality is on a downward trend in most but not all countries in the region



Source: World Bank East Asia and Pacific Poverty Portal.
Note: Spatially deflated welfare aggregates. Countries with less than three observations excluded.

Box I.A.3. Inclusive Growth in Vietnam[1]

Vietnam has enjoyed tremendous success in reducing poverty and achieving shared prosperity. Extreme poverty has been almost eliminated. Between 1993 and 2014, the share of the population living below the national poverty line fell from approximately 80 percent to 13.5 percent (Figure BI.A.3.1), and the consumption of the bottom 40 percent of the income distribution grew by 6.8 percent per year. Inequality has remained substantially lower than in other fast-growing East Asian developing countries (the Gini coefficient was 0.348 in 2014). This progress has been mirrored in nonmonetary dimensions of well-being. Between 1993 and 2012, under-five mortality declined from 45 per 1,000 live births to 24, and the incidence of stunting from 61 percent to 23 percent. On most indicators, Vietnam performed better than its peers.[2]

Vietnam's success reflects rapid economic growth that has created more and better jobs (Figure BI.A.3.2). First, the launch of the *Doi Moi* reforms in 1989 ushered in a period of increasing agricultural productivity. Then, rapid structural transformation became the engine of growth, as the country transitioned from an agrarian economy to labor-intensive manufacturing and services.[3] Labor rapidly moved away from agriculture, with the manufacturing and service sectors contributing 15 million of the 20 million new jobs created in the past 20 years. This shift accounted for 40 percent of the overall increase in labor productivity. The growing export sector helped accelerate the transformation, especially as FDI flowed into Vietnam after

(continued)

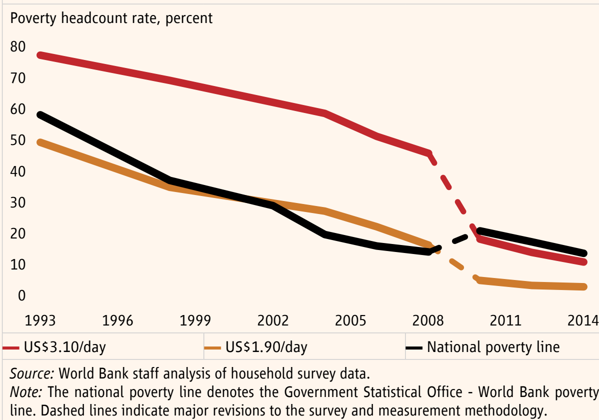
1 Prepared by Obert Pimhidzai. Based on the forthcoming World Bank report, *Vietnam Systematic Country Diagnostics: Sustaining Success – Priorities for inclusive sustainable growth*.

2 The analysis uses Bangladesh, China, Egypt, India, Mexico, Pakistan, the Philippines, Thailand, and Turkey as peers for Vietnam. They have similar structural characteristics: they are mainly lower- or else upper-middle-income countries, they are neither fragile states nor commodity exporters, and they have populations exceeding 35 million.

3 The share of agriculture in GDP decreased from 40 percent in the 1980s to 20 percent currently.

(Box I.A.3 continued)

Figure BI.A.3.1. A strong record of shared prosperity



Source: World Bank staff analysis of household survey data.
Note: The national poverty line denotes the Government Statistical Office - World Bank poverty line. Dashed lines indicate major revisions to the survey and measurement methodology.

Figure BI.A.3.2. Vietnam's growth has been job-intensive

Source: World Bank staff estimates.

its accession to the World Trade Organization. Growth of cities generated agglomeration economies, fostered innovation, and contributed to industrialization and modernization. Migration to these cities presented rural households with nonfarm opportunities. Reflecting these factors, households diversified their income sources from agriculture; those earning a higher share of income from nonagricultural enterprises and nonagricultural wages are less likely to be poor.

Impressive progress in service delivery significantly improved human development outcomes. This both facilitated growth and enabled broad participation by households in the growth process. The country's basic education system stands outs globally, and enrollment is near universal. Between 1993 and 2012, net enrollment in upper secondary education increased from 6 percent to 64 percent for girls, and from 8 percent to 56 percent for boys. Net enrollment in tertiary education also significantly increased. The attainment of tertiary education has proved an important pathway to better jobs, because having a college degree increases the likelihood of having a wage job (by 52 percent compared to only lower secondary education), especially one with a written contract (by 72 percent). Access to infrastructure and amenities also improved. The share of households using electricity as their main energy source jumped from 48 percent to 98 percent between 1993 and 2012, access to sanitation improved from 43 percent to 75 percent, and rural access to clean water increased from 17 percent to 61 percent.

But even as overall poverty declines, significant challenges to inclusiveness and shared prosperity are emerging. Growth and improvements in basic service delivery have benefited all population subgroups, but initially disadvantaged groups are lagging behind by an often increasing margin. More than half of ethnic minority households still live in poverty, and the gap in poverty rates relative to the ethnic majority has widened sharply since 1993 (Figure BI.A.3.3), reflecting minorities' lower income and consumption growth. Ethnic minorities account for 14 percent of the population but 60 percent of the poor, a share that at current trends will rise to 80 percent by 2020. Similar gaps are observed in the prevalence of stunting (which is twice as high among ethnic minorities), and in education.[4] Lower educational attainment and low migration to cities (reflecting language barriers, the household registration system, and poor social networks) have contributed to ethnic minorities lagging behind.

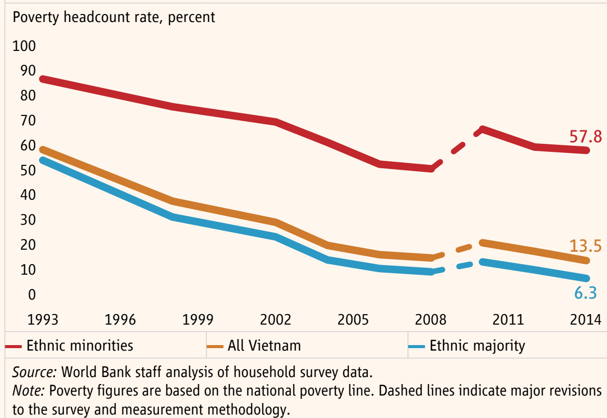
(continued)

4 Vietnam enjoys near universal lower secondary enrollment. However, upper secondary enrollment stands at only 39 percent among ethnic minorities, compared to 67 percent among the ethnic majority. Likewise, tertiary enrollment stands at only 7 percent among ethnic minorities, compared to 31 percent among the ethnic majority (VHLSS 2014).

(Box I.A.3 continued)

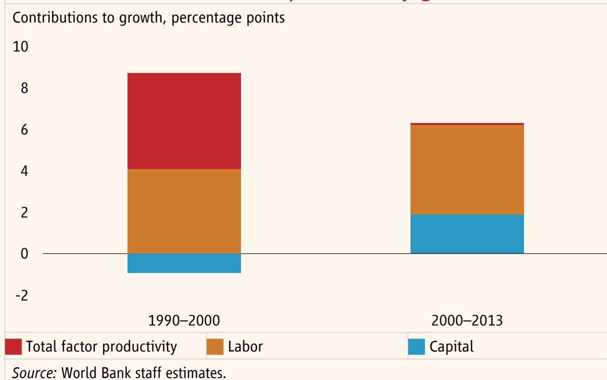
More broadly, the current growth model is reaching its limits, raising other challenges for poverty reduction and shared prosperity. First, growth has imposed significant environmental costs. Pollution affects more than 83 percent of the population, a share that will rise further if current energy generation and use patterns are maintained. Second, structural transformation is slowing. Growth in both labor productivity and employment has decreased significantly.[5] The small- and medium-sized private-sector enterprises that dominate the labor market are failing to expand. Thus, new jobs reflect mainly the formation of new firms rather than growth in existing ones, except in the export-oriented manufacturing sectors that are recipients of FDI. An uneven regulatory environment depresses productivity and encourages speculative investment,[6] leading to inefficient allocation of capital. Productivity growth is also hampered by weak links between the export sector and the private domestic sector, partly reflecting skill deficiencies in highly specialized areas. Overall, growth is now primarily driven by labor and capital accumulation, in contrast to earlier years when it was driven by total factor productivity growth (Figure BI.A.3.4).

Figure BI.A.3.3. Ethnic minorities are being left behind



Source: World Bank staff analysis of household survey data.
Note: Poverty figures are based on the national poverty line. Dashed lines indicate major revisions to the survey and measurement methodology.

Figure BI.A.3.4. Growth is driven by factor accumulation rather than productivity growth



Source: World Bank staff estimates.

Concerted effort is required in several areas to mitigate challenges and take advantage of opportunities to continue reducing poverty and boost shared prosperity. Targeted interventions to assist marginalized groups, and in particular ethnic minorities, are a priority. So is improving service delivery in social protection, the quality of health care, and the tertiary education system to meet the needs of an aging population and a growing middle class, as well as the skills needs of the next phase of Vietnam's growth. Reinvigorating productivity growth is essential, given also the challenges of an aging population, and requires adjustments to the growth model. These include delivering productive infrastructure and supporting efficient urbanization; strengthening governance to even the playing field for the private sector; strengthening economic management, especially managing the rising public debt and financial sector vulnerabilities; and creating more efficient factor markets for capital and land. Agriculture needs to be transformed to enhance rural livelihoods, for instance by fostering forward linkages with food processing industries. A more sustainable use of natural resources, reductions in pollution, and increased resilience to climate change are also needed to ensure that growth remains sustainable.

5 For instance, manufacturing employment growth slowed from 12 percent in 2001 to less than 3 percent in 2013.

6 The real estate sector has expanded by 29 percent per year over the past decade.

I.B. Outlook and Risks

Growth in the region is expected to remain broadly resilient during 2016–18. This outlook is in line with what was projected last April, and remains more positive than in most other developing regions. China is expected to continue its gradual transition to slower but more sustainable growth. In the large ASEAN economies, excluding Malaysia, growth will likely pick up slightly. Among the smaller economies, the growth outlook has deteriorated markedly in some commodity exporters. Across most countries, the impact of weak external demand is expected to be offset by continued domestic demand growth. Favorable external financing conditions will be complemented by monetary and fiscal accommodation, with budget deficits projected to increase across much of the region. Continued low commodity prices will support domestic demand in the commodity importers, and contribute to a muted outlook for inflation across the region.

The positive outlook for growth and poverty reduction in the region in this base case is subject to significant risks. A sharp global financial tightening would be associated with reduced capital inflows and likely with increased financial volatility. In addition, growth fluctuations in high-income economies would have a significant impact on output in the more open regional economies. The ongoing slowdown and rebalancing process in China remains an important short-term risk for the rest of the region, although over the longer term China's rebalancing will also generate opportunities for other countries. Further, rapidly rising levels of credit are a key source of vulnerability across most large economies, notably China, Malaysia, and Thailand. There is a growing risk of financial stress among corporates and households, which could spill over to the banking sector and lead to protracted slowdowns. Shocks to external financial conditions or to global growth would exacerbate these existing financial vulnerabilities.

Growth will decrease gradually in China, but pick up in the rest of the region

Prospects for global growth and commodity prices are more subdued, but global financial conditions are expected to remain more accommodative than previously projected (Box I.B.1). Global growth is projected to fall in 2016, and recover slowly through 2018. This downward revision from the April 2016 projections is driven by the advanced economies, and reflects stalling global trade, weak investment, and ongoing policy uncertainties. Commodity prices are projected to recover gradually, but remain at historically low levels for a protracted period; the outlook for both energy and nonenergy prices has been revised down since April.

Growth in the region is expected to remain resilient during 2016–18, with some differences across countries. This outlook is in line with what was projected last April, and remains more positive than in other developing regions (Box I.B.1). China is expected to continue its gradual transition to slower but more sustainable growth (Table I.B.1). In most of the large ASEAN economies, growth will likely pick up slightly. Across most countries, the impact of weak external demand is expected to be offset by continued domestic demand growth. Favorable external financing conditions will be complemented by monetary and fiscal accommodation, with budget deficits projected to increase across much of the region. Continued low commodity prices will support domestic demand in the commodity importers, and contribute to a muted outlook for inflation across the region.

Box I.B.1. Global Outlook and Risks

Global growth prospects remain subdued. Global growth in 2016 is set to be even lower than the 2.5 percent projected in April, reflecting weak investment and international trade, as well as ongoing policy uncertainties, including those associated with the U.K. Brexit process, doubts about the effectiveness of unconventional monetary policies, and elections in several countries (Figure BI.B.1.1). In the United States, short-term prospects have deteriorated, and lackluster productivity is leading to further downward revisions to medium-term potential growth. In the euro area, recent developments are broadly in line with previous expectations for 2016, but the lagged repercussions of Brexit are likely to depress activity in 2017. In contrast, in Japan, the delay in the tax hike (from April 2017 to October 2019) and the new fiscal stimulus package are likely to support growth in 2017. In the East Asian Newly Industrialized Economies (NIEs), growth is expected to increase slightly in 2017–18 but remain below its long-term average, reflecting weak global growth and trade prospects, partly offset by more robust domestic demand.

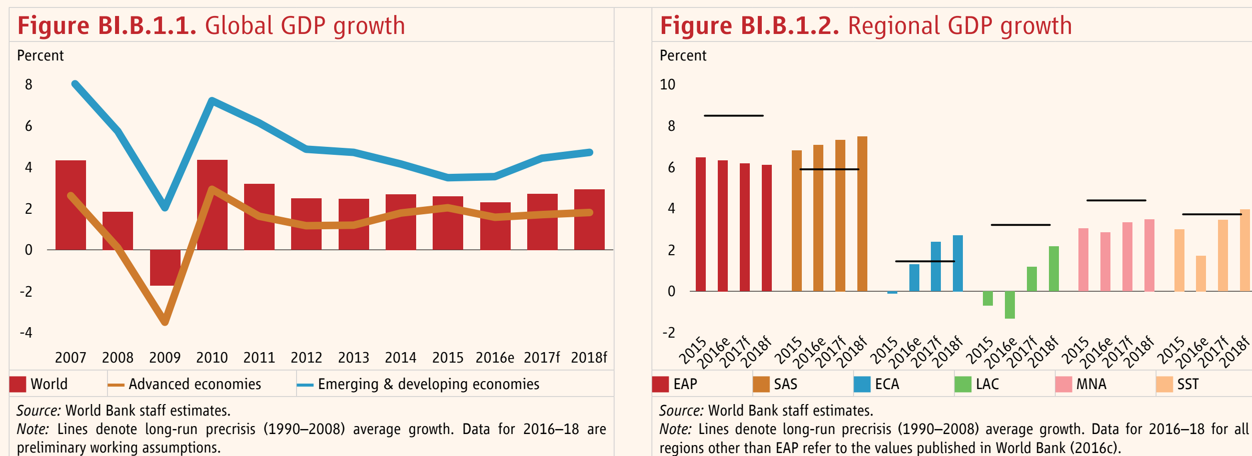


Figure BI.B.1.1. Global GDP growth

Source: World Bank staff estimates.
Note: Lines denote long-run precrisis (1990–2008) average growth. Data for 2016–18 are preliminary working assumptions.

Figure BI.B.1.2. Regional GDP growth

Source: World Bank staff estimates.
Note: Lines denote long-run precrisis (1990–2008) average growth. Data for 2016–18 for all regions other than EAP refer to the values published in World Bank (2016c).

The outlook for emerging market and developing economies (EMDEs) is also subdued, given weaker advanced-economy growth prospects and stagnant global trade. Differences in outlook across EMDE regions continue to reflect in part the divergence between commodity exporters and importers, with prospects particularly favorable in South Asia and in East Asia and the Pacific (Figure BI.B.1.2). Prospects for some of the larger EMDEs, including Brazil and Russia, have shown signs of improvement, and for India are becoming even more positive. However, this is being offset by weakness in other countries (including Mexico, Nigeria, South Africa, and Turkey), partly reflecting idiosyncratic factors in a context of continued fragility. The divergence in prospects between commodity exporters and importers is projected to narrow, given the expected stabilization in commodity prices.

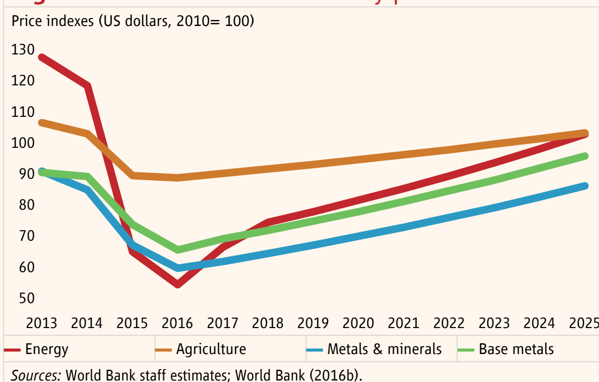
Global trade growth is likely to remain depressed. Trade in goods is likely to grow by less than 3 percent in 2016. Subdued activity in advanced economies, weakening demand from key commodity exporters, and China's slowing industrial sector all exert a drag. This is compounded by longer-term structural factors, including a slower pace of trade liberalization and a maturing of global value chains.

(continued)

(Box I.B.1 continued)

Commodity prices are projected to recover gradually, but remain low for a protracted period. Crude oil prices are projected at US$43 per barrel for 2016, approximately 15 percent lower than forecast in April, and lower than average 2015 values (Figure BI.B.1.3). Oil prices are expected to rise to US$53 per barrel in 2017, as the current stock overhang gradually unwinds. Metals prices are projected to fall by 11 percent for 2016, but increase by 4 percent in 2017. Agricultural prices are projected to remain broadly stable in 2016 and 2017, reflecting adequate supplies for most commodities and the pass-through of lower energy costs (agricultural production is relatively energy-intensive).

Figure BI.B.1.3. World commodity prices forecast



Sources: World Bank staff estimates; World Bank (2016b).

The rebound in capital flows to EMDEs seen since March 2016 might prove fragile and, as observed in recent years, rapidly reverse in an episode of market volatility. Changing expectations regarding the pace of U.S. monetary policy normalization could have particularly significant repercussions for capital flows. The U.S. Federal Reserve remains committed to a gradual normalization of policy interest rates, but has continued to revise downward its expected interest rate path. However, a faster-than-expected resurgence of inflation as the labor market tightens could trigger a significant readjustment in market expectations.

In China, growth is likely to continue easing steadily to 6.3 percent in 2018. The ongoing reform process seeks to facilitate the rebalancing of the economy toward consumption, services, and higher-value-added activities as part of a program to increase overall productivity. Output growth will moderate as excess industrial capacity is reduced, including by slowing the growth in credit to these sectors.[1] Nevertheless, tightening labor markets will support continued growth in disposable income and private consumption.

Among other large economies, growth prospects are strongest in the commodity importers. In the Philippines, growth will likely accelerate to 6.4 percent in 2016, reflecting fiscal stimulus, rising public investment, and strong growth in services (business process outsourcing). In Vietnam, growth will fall in 2016, owing to the temporary effects of the severe drought on agricultural output; it will then recover to 6.3 percent, in line with rising consumer demand and credit, and as exporters continue gaining from the recent free trade agreement with the European Union. In Indonesia, growth will increase steadily to 5.5 percent in 2018, despite low commodity prices, conditional on a pick-up in public investment and the success of efforts to improve the investment climate and increase revenues. In Thailand, growth will recover gradually to 3.3 percent in 2018, reflecting the effects of increased public investment, improving consumer confidence, and continued expansion in services including tourism. In Malaysia, however growth will fall sharply in 2016, as oil and manufactured exports are affected by weaker global demand, with a gradual recovery thereafter.

1 The growth projection for 2018 has been lowered from the 6.5 percent projected last April, reflecting the continuation of this process.

Table I.B.1. East Asia and Pacific: GDP growth projections

Percent change from a year earlier, unless otherwise noted

			Forecast			Change from April 2016[a] (percentage points)		
	2014	2015	2016	2017	2018	2016	2017	2018
East Asia & Pacific (EAP)[b]	6.2	5.9	5.8	5.7	5.7	0.1	0.0	-0.1
Developing EAP	6.8	6.5	6.4	6.2	6.0	0.1	0.0	-0.2
China	7.3	6.9	6.7	6.5	6.3	0.0	0.0	-0.2
Developing EAP excl. China	4.7	4.8	4.8	5.0	5.1	0.0	0.1	0.0
Developing ASEAN	4.6	4.8	4.9	5.0	5.2	0.1	0.1	0.0
Indonesia	5.0	4.8	5.1	5.3	5.5	0.0	0.0	0.0
Malaysia	6.0	5.0	4.2	4.3	4.5	-0.2	-0.2	-0.2
Philippines	6.2	5.9	6.4	6.2	6.2	0.0	0.0	0.0
Thailand	0.8	2.8	3.1	3.1	3.3	0.6	0.5	0.3
Vietnam	6.0	6.7	6.0	6.3	6.3	-0.2	0.0	0.0
Cambodia	7.1	7.0	7.0	6.9	6.9	0.1	0.1	0.1
Lao PDR	7.5	7.4	7.0	7.0	6.8	0.0	0.0	0.0
Myanmar	8.5	7.0	7.8	8.4	8.3	0.0	0.0	0.0
Mongolia	8.0	2.3	0.1	2.0	3.5	-0.6	-0.7	-2.7
Fiji	5.3	4.1	2.4	3.9	3.7	0.0	0.1	0.2
Papua New Guinea	7.4	6.8	2.4	3.0	3.2	-0.6	-1.1	0.3
Solomon Islands	2.0	3.3	3.0	3.3	3.0	0.0	0.0	0.0
Timor-Leste[c]	5.9	4.3	5.0	5.5	6.0	0.0	0.0	0.5
Assumptions about the external environment:[d]								
World	2.6	2.6	2.3	2.7	2.9	-0.2	-0.2	-0.1
Advanced economies	1.8	2.1	1.5	1.7	1.8	-0.4	-0.3	-0.2
Emerging and developing economies	4.1	3.4	3.5	4.4	4.7	0.0	0.0	0.0
Excluding EAP[e]	2.6	1.5	1.6	3.2	3.7	—	—	—
Crude oil (spot, US$/barrel)	96	51	43	53	60	-8.0	-1.8	1.9
Non-energy commodities (index, 2010 = 100)	97	82	79	81	83	-4.9	-4.3	-4.5
Food (index, 2010 = 100)	107	91	91	93	94	-0.8	-1.3	-0.7

Sources: World Bank data and staff estimates.
Note: a. World Bank *East Asia and Pacific Economic Update, April 2016*; b. Developing East Asia and Pacific and Newly Industrialized Economies; c. Nonoil GDP; d. Global growth forecasts are preliminary working assumptions. Commodity price assumptions are based on World Bank (2016b); e. Country classification not used in previous issues of the *East Asia and Pacific Economic Update*; — = not available.

In commodity-dependent Mongolia and Papua New Guinea, the outlook has deteriorated markedly. Mongolia is projected to stagnate in 2016, despite a large fiscal stimulus, as mineral exports weaken. Efforts to control the ballooning debt will act as a drag on growth in subsequent years. In Papua New Guinea, growth will fall sharply in 2016: production of copper is declining, the output of liquefied natural gas has reached a peak, and prices of both remain depressed. In Timor-Leste, growth is projected to remain robust, as the impact of falling oil production on public revenue and expenditure is cushioned by large withdrawals from the sovereign wealth fund.

The other smaller developing East Asian economies will continue to enjoy rapid growth as competitive sectors develop. In Cambodia, growth will remain around 7 percent, assuming that garment exporters face off competitive threats from other low-cost producers, including by continuing to increase value added (Box I.B.2). Lao PDR enjoys a similarly strong outlook, as its power generation and exports continue expanding. In Myanmar, growth will accelerate to above 8 percent in 2017–18, supported by increased investment and by rapid expansion in the services sector, including transportation, banking, and telecommunications..

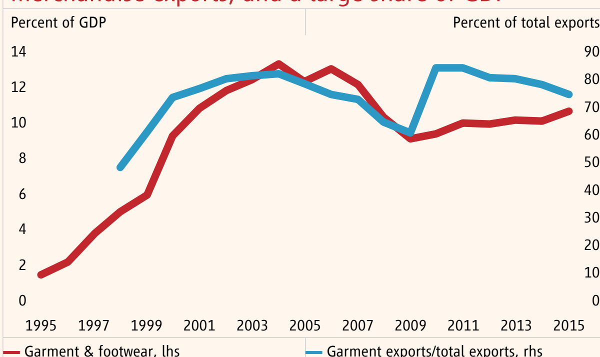
Poverty will continue to fall across much of the region, including in China

Poverty is projected to continue falling across much of the region (Table I.B.2). In China, poverty reduction will be supported by rapid income growth, falling inequality, and rebalancing toward more labor-intensive services. While overall growth may moderate, continued reforms will translate into disposable income rising more quickly than GDP. In particular, with growth shifting to more labor-intensive services, and the labor force shrinking, job creation and wages will remain buoyant. In Indonesia, the second-most-populous country in the region, poverty reduction is expected to be modest, but may be boosted by the 2016 expansion of the conditional cash transfer program. And prospects remain positive in Vietnam, as rapid economic growth continues to create more and better jobs.

Box I.B.2. Cambodia's Garment Sector[1]

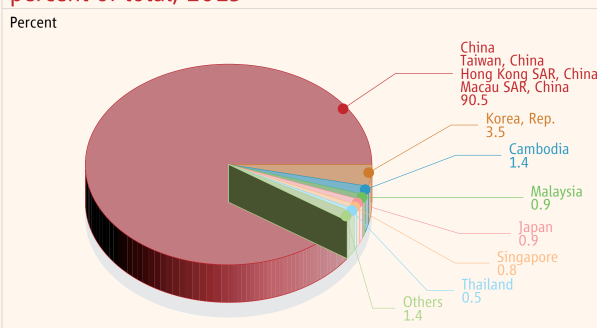
Cambodia's outward-oriented garment sector has prospered, despite increasing competition in world markets. Largely established in the mid-1990s, it now accounts for most of the country's merchandise exports,[2] and more than 10 percent of total employment[3] and GDP (Figure BI.B.2.1).

Figure BI.B.2.1. Garments account for most merchandise exports, and a large share of GDP



Source: World Bank staff estimates.
Note: The garment sector includes footwear. lhs = left-hand side; rhs = right-hand side.

Figure BI.B.2.2. Ownership of garment factories, percent of total, 2015



Source: Garment Manufacturers' Association of Cambodia.

The garment sector is almost entirely financed by rising foreign direct investment (FDI), mostly from China. China, together with Hong Kong SAR, China; Macau SAR, China; and Taiwan, China, accounts for 91 percent of total investments in the garment sector (Figure BI.B.2.2). Chinese FDI in the clothing industry started as early as mid-1990, attracted by the Multi-Fiber Agreement (MFA) quota system, and has expanded significantly since 2000. Total FDI stock in the garment sector currently exceeds 20 percent of GDP.

The sector's success has been underpinned by low wages and a liberal trade and investment regime. Garments are labor-intensive. The increase in FDI since 2000 partly reflects rising domestic wages in China,

(continued)

1 Prepared by Sodeth Ly.

2 Garment exports grew by 11 percent per year during 2010–15. The largest export markets are the European Union and the United States, accounting for 42 percent and 31 percent of total exports, respectively, in 2015.

3 Employment in the sector grew by more than 10 percent per year during 2010–15.

(Box I.B.2 continued)

which encouraged relocation of factories to lower-cost Cambodia.[4] Foreign direct investors have contributed improved technology and management, helping to overcome Cambodia's relatively weak infrastructure and human capital. Raw material inputs, including fabric, are also largely imported from China, reducing reliance on the small domestic manufacturing sector. In addition, in 2011 the European Union (EU) relaxed its rules of origin requirements for duty-free access under the "Everything but Arms" (EBA) preferences, enabling Cambodia to increase its share of the EU garment market.[5] Also, frequent public-private consultations have helped solve specific sectoral obstacles.[6]

Export growth has largely reflected increasing volumes, but more recently rising wages are encouraging a move toward higher-value-added products. Wages have been rising quickly in recent years, (from US$61 per month in 2012, to US$140 per month in 2016), partly in the wake of labor unrest. This has forced factories to gradually move away from mass production of basic garments toward more specialized, higher-value-added products. Also, the more relaxed EU rules of origin encouraged garment producers to focus on relatively more value-added tasks. As a result, and after some fluctuations, in 2015 the industry witnessed a significant increase in the average export price of garments, accounting for more than one-quarter of total growth in export values (Table BI.B.2.1).

Table BI.B.2.1. Export growth has largely reflected increasing volumes, with more recent signs of a move toward high-value-added products

Growth in exports, percent

	2012	*2013*	*2014*	*2015*
Growth in export values	7.0	17.6	9.2	12.4
Growth in export volume	10.5	13.4	11.2	8.9
Growth in export price	-3.1	3.7	-1.8	3.2

Source: World Bank staff estimates.

Looking ahead, the sector's "footloose" characteristics and its sizable foreign ownership share translate into significant exposure to rising input costs, competition from regional low-wage economies, political uncertainty, higher taxes, and/or erosion of trade preferences. For instance, Myanmar is an emerging low-cost producer whose minimum wage is only two-thirds of Cambodia's.[7] Cambodia enjoys duty-free access to the EU market, but its competitive position will be eroded once Vietnam receives similar access under the EU-Vietnam Free Trade Agreement. Similarly, Cambodia's exports to the U.S. market may be undermined once Vietnam enjoys duty-free access under the planned Trans-Pacific Partnership.[8] Reinforcing this, there are few barriers to rapid relocation of factories to other countries, and less than 7 percent of the 600 garment factories are majority-owned by Cambodians.[9]

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4 See ERIA 2015.

5 EBA preferences are automatically extended to least developed countries (LDCs) such as Cambodia, without time limits (http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150983.pdf). The relaxation of rules of origins allows single transformation of LDC exports, for instance, turning fabric into clothing (see http://eeas.europa.eu/delegations/cambodia/press_corner/all_news/news/2011/20110801_01_en.htm).

6 The government engages in regular dialogue with private sector organizations, including the Garment Manufacturers' Association of Cambodia, through the Government-Private Sector Forum. The discussions cover issues including governance, laws and regulations, and taxes. They focus on both garments and other sectors, such as agriculture, tourism, and banking (see www.camfeba.com/en/representative.html and http://ibccambodia.com/ibc-role).

7 See http://www.nwpc.dole.gov.ph/pages/statistics/stat_comparative.html.

8 For an analysis of the Trans-Pacific Partnership and its potential impact on both members and nonmembers, see World Bank (2016a), Part II.B, "The Trans-Pacific Partnership and its Potential Economic Implications for Developing East Asia and Pacific".

9 Source: Garment Manufacturers' Association of Cambodia.

Table I.B.2. Compared with recent years, poverty will decline slightly more slowly in China, but at a similar pace in the rest of the region

Poverty estimates and projections, US$1.90-a-day (2011 PPP)

	2015	2016	2017	2018
Developing EAP				
Poverty rate (percent)	2.6	2.2	1.9	1.6
Number of poor (millions)	54	46	39	34
Developing EAP excluding China				
Poverty rate (percent)	5.5	4.8	4.3	3.8
Number of poor (millions)	39	35	31	28

Poverty estimates and projections, US$3.10-a-day (2011 PPP)

	2015	2016	2017	2018
Developing EAP				
Poverty rate (percent)	12.1	10.6	9.3	8.3
Number of poor (millions)	251	223	197	175
Developing EAP excluding China				
Poverty rate (percent)	20.3	19.0	17.7	16.4
Number of poor (millions)	145	137	129	121

Source: World Bank East Asia and Pacific Poverty Portal.
Note: The most recent household income and expenditure surveys vary from 2006 in Kiribati to 2015 in Indonesia. Estimates are extrapolated based on per capita GDP growth and historical estimates of the growth elasticity of poverty. PPP = purchasing power parity.

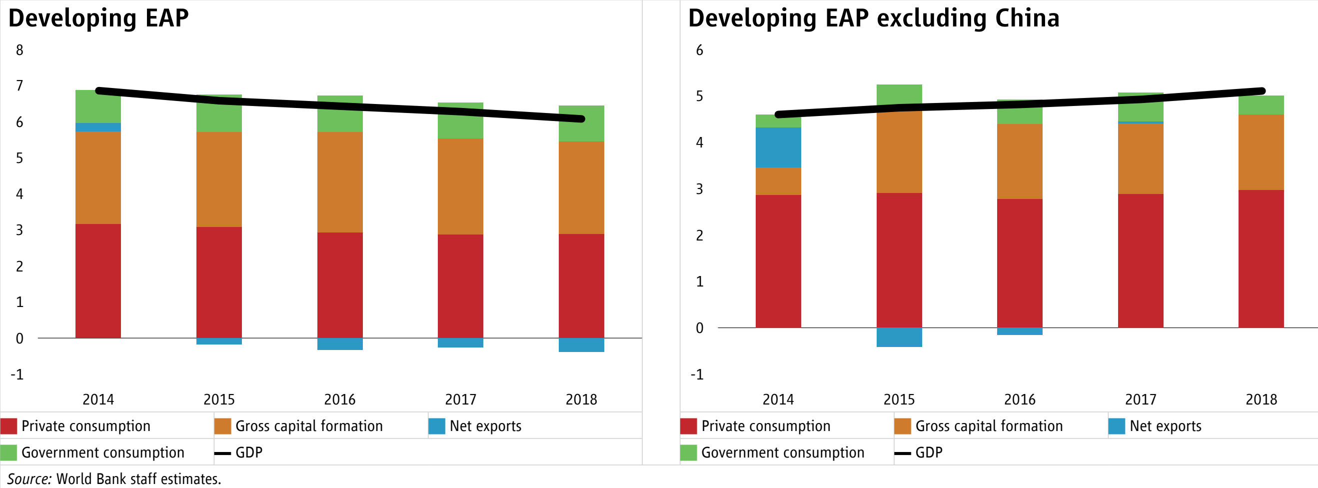
However, the outlook for poverty reduction is mixed in several countries. In Lao PDR, rapid economic growth has so far been associated with rising inequality and relatively little poverty reduction, although the link may strengthen given the recent expansion of manufacturing and the attendant boost to job creation. In Cambodia, the stagnant agricultural sector is likely to hamper the pace of poverty reduction, although growing industrial and service sectors should support progress in urban areas. In Mongolia, poverty conditions will likely deteriorate in the near term, given weak growth and labor market conditions.

Domestic demand will support growth, with at most a modest contribution from net exports, across much of the region

Net exports will provide at most a modest contribution to growth across the large economies, reflecting more subdued global activity than previously projected (Figure I.B.1). In China, net exports are now expected to exert a small drag on growth, in line also with the continued sectoral shift from industry toward services (Figure I.B.2). In Indonesia and Malaysia, net export demand will remain broadly neutral, given the subdued outlook for both manufacturing and commodity exports. In the Philippines, exports of both goods and services will rise, and imports are set to expand sharply to meet the needs of a fast-growing construction sector and rising private consumption. In Thailand, exports will continue recovering from depressed levels, and in Vietnam they are projected to continue expanding, but sustained growth in both countries will require structural reform and innovation.

Figure I.B.1. Domestic demand will support growth, with at most a modest contribution from net exports, across the region as a whole…

Contribution of expenditure components to GDP growth, percentage points



Source: World Bank staff estimates.

Consumption across much of the region is projected to continue growing rapidly, supported by low commodity prices and monetary and fiscal accommodation. Private consumption will remain buoyant in the Philippines, Vietnam and, to a lesser degree, Indonesia and Malaysia. It will gradually recover in Thailand, as confidence returns, and remain stable in China. Reinforcing this, the direct contribution of government consumption to growth is projected to nearly double between 2014 and 2016 in the region, excluding China. In particular, the projections for the Philippines and Thailand reflect significant expected fiscal stimulus in 2016 and 2017.

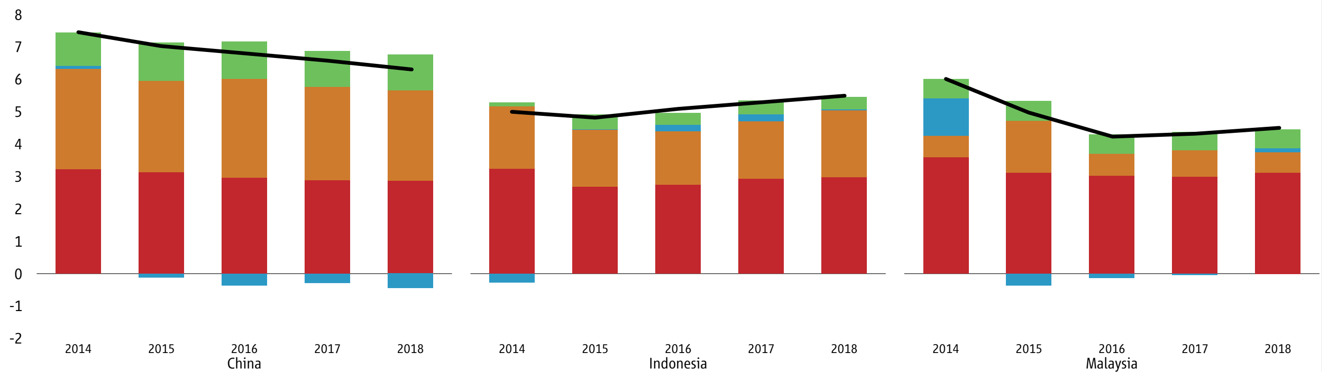
Investment growth will quicken or remain elevated in many large economies in 2016, and drop back only gradually. Investment is anticipated to make a significant contribution to growth in Indonesia and the Philippines, and to recover in Thailand, in all cases supported by a scaling up of public investment and the projected ongoing stabilization in capital flows. It will also continue growing rapidly in Vietnam. However, investment growth will continue falling in China, in line with rebalancing efforts, and in Malaysia, as new developments in the oil and gas sector are postponed given unfavorable prevailing prices.

Among the smaller economies, trends will diverge between commodity exporters and other countries. In Mongolia, consumption will decline sharply in 2016, as stabilization measures and weak confidence take hold, and mining exports are projected to continue declining in 2017, as copper production becomes increasingly dependent on lower-quality ores (Figure I.B.3). In Papua New Guinea, external demand is expected to weaken, although much uncertainty surrounds the potential development of new mining and petroleum projects. In contrast, export growth will remain robust in Cambodia, driven by the garments sector, and in Lao PDR, where rising electricity exports will offset a slump in the copper sector. In both countries, investment is expected to remain robust, while consumption slackens.

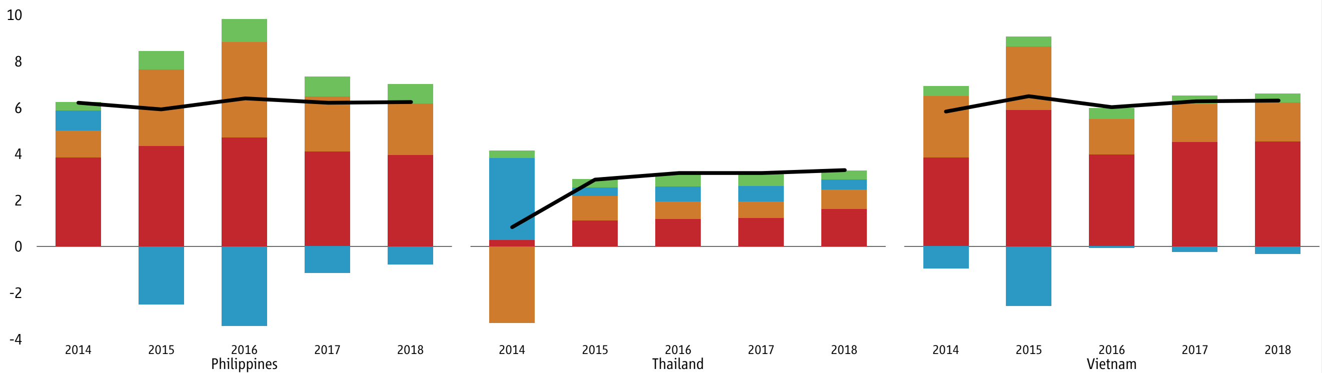
Figure I.B.2. …across most large economies

Contribution of expenditure components to GDP growth, percentage points

China, Indonesia, and Malaysia



The Philippines, Thailand, and Vietnam



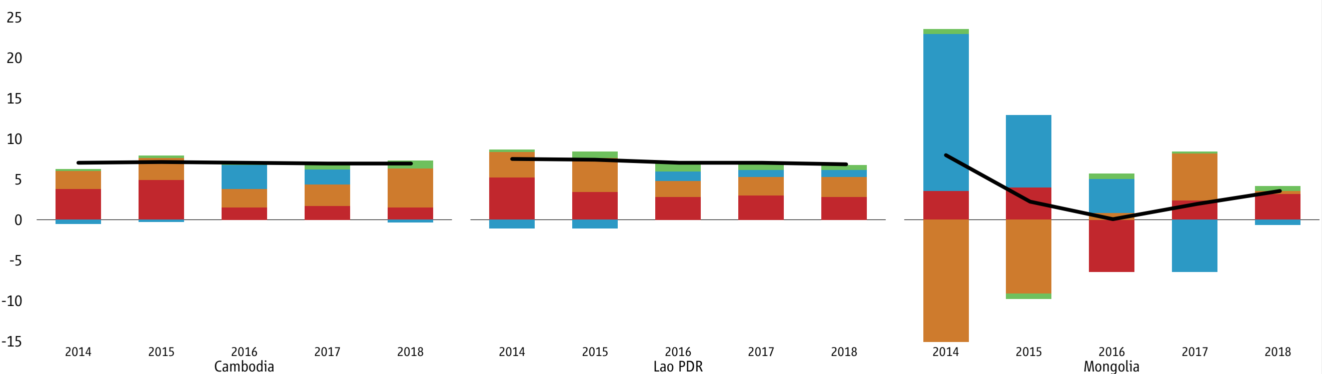
Private consumption | Gross capital formation | Net exports | Government consumption | GDP

Source: World Bank staff estimates.

Figure I.B.3. …and in the smaller economies

Cambodia, Lao PDR, and Mongolia

Contribution of expenditure components to GDP growth, percentage points



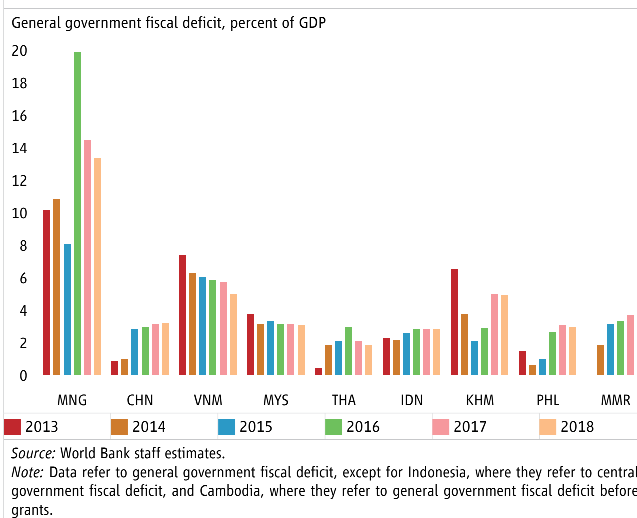
Private consumption | Gross capital formation | Net exports | Government consumption | GDP

Source: World Bank staff estimates.

Fiscal stimulus is projected to continue, raising risks to sustainability in some countries

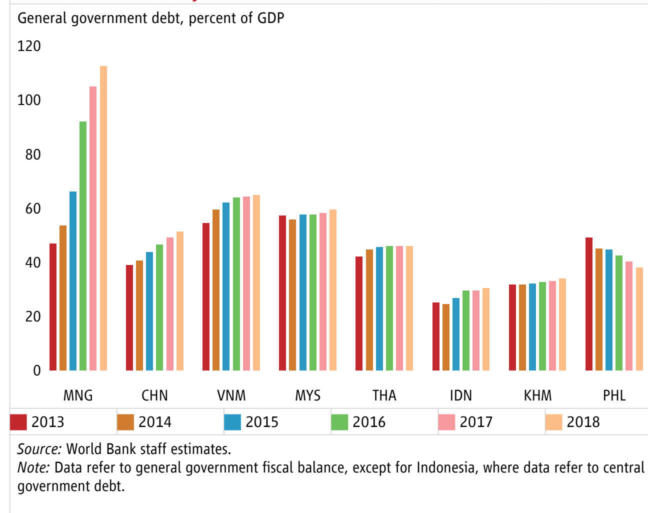
In 2016, fiscal deficits are expected to widen and public debt to increase across much of the region. In China, the deficit is projected to expand as recent tax measures, including tax breaks, lower pension rates, and a switch from an enterprise tax to the value-added tax, adversely affect collections (Figure I.B.4). Among the other large economies, the increase in the deficit will be particularly marked in the Philippines, largely reflecting increased expenditure. However, rapid growth will maintain the public debt burden on a declining trajectory (Figure I.B.5). The deficit is also projected to rise in Thailand in 2016, reflecting new spending measures and increased tax exemptions. In Indonesia, the deficit will increase in 2016, reflecting the negative impact of continued low commodity prices on revenue, but the proposed 2017 budget reins in further expansion. In Malaysia, where the revenue envelope has also tightened, expenditure consolidation is expected in the second half of 2016 to meet the deficit target of 3.1 percent of GDP, which will contribute to the muted growth outlook. Nevertheless, debt levels will remain elevated. In Vietnam, the deficit is projected to remain elevated, but fall from 6 to 5 percent over the forecast window, with further increases in the debt stock, to around 65 percent of GDP.

Figure I.B.4. Fiscal deficits are expected to widen across much of the region



Source: World Bank staff estimates.
Note: Data refer to general government fiscal deficit, except for Indonesia, where they refer to central government fiscal deficit, and Cambodia, where they refer to general government fiscal deficit before grants.

Figure I.B.5. Government debt is projected to rise rapidly in Mongolia and, to a lesser degree, Vietnam, and remain elevated in Malaysia



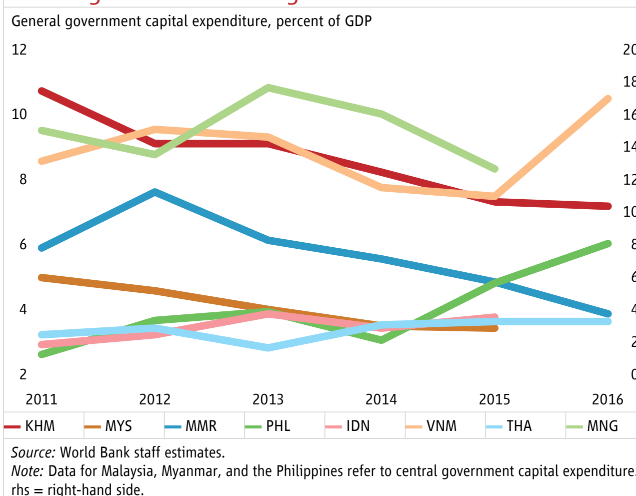
Source: World Bank staff estimates.
Note: Data refer to general government fiscal balance, except for Indonesia, where data refer to central government debt.

Among the smaller economies, Mongolia and, to a lesser degree, other commodity exporters, face the greatest deterioration in public finances. In Mongolia, the deficit is expected to balloon from 8 percent of GDP in 2015 to 20 percent of GDP in 2016, reflecting large increases in pre-election expenditures in the first half of the year, revenue shortfalls stemming from the sharp slowdown in mineral exports and domestic demand, and the limited corrective measures announced so far. As a result, government debt is set to rise sharply over the next two years. Large external debt repayments due in 2017 and 2018 will present significant challenges. In Lao PDR, the deficit is projected to increase in 2016 to 6.2 percent of GDP in 2016, reflecting declining mineral revenues. In Timor-Leste, a large structural deficit has emerged, projected to reach 24 percent of GDP in 2016 and 30 percent of GDP in 2017, reflecting the exhaustion of its oil reserves. Its large sovereign wealth fund can finance this deficit

through the forecast period, but is being steadily depleted. In Cambodia, the deficit after grants is expected to increase to 1.2 percent of GDP in 2016 and 5 percent of GDP in 2017, but concessional financing and rapid growth will help reduce the debt burden.

The worsening fiscal outlook for natural resource exporters has been reflected in credit rating adjustments. To date in 2016, all credit rating changes from Moody's and Standard & Poor's have been on the downside. Credit ratings for Mongolia and Papua New Guinea were downgraded (in August and April, respectively), and the credit rating outlook for Malaysia was revised downward to "stable" in January.

Figure I.B.6. Government capital expenditure had been trending down in most large economies until 2016



Source: World Bank staff estimates.
Note: Data for Malaysia, Myanmar, and the Philippines refer to central government capital expenditure. rhs = right-hand side.

Much of the increased expenditure will involve current spending. In recent years, a number of economies, including Cambodia, Malaysia, Myanmar, and Vietnam, had seen a decline in capital expenditure (Figure I.B.6). Looking ahead, only part of the planned additional public spending is being directed toward reversing this trend. In Thailand, this year's fiscal stimulus package involves increases in policy lending to SMEs and targeted tax exemptions, as well as increased capital expenditure. In the Philippines, 70 percent of the planned expansion in spending in 2016 will be on current expenditure, much of it wages and salaries, although public investment is also expected to increase. In Malaysia, most of the fiscal stimulus so far has involved targeted transfers to low-income groups and temporary tax breaks. In Cambodia, the public wage bill is expected to increase rapidly through 2018. In Myanmar, public investment is expected to fall in 2016 despite higher spending.

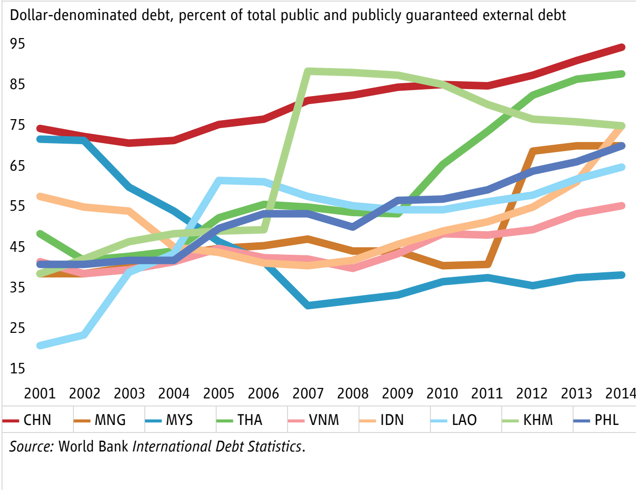
A sharp global financial tightening or a further slowdown in world growth would test the region's resilience

The eventual normalization of monetary policy in high-income economies will test the resilience of regional growth. Global financial conditions are expected to remain more accommodative than projected last April, with only gradual, modest adjustments over time in policy rates in high-income economies. And, so far, the region has proved relatively resilient to repeated bouts of global financial volatility, associated in particular with changing expectations regarding the pace and extent of monetary policy normalization in the United States, and the prospects for emerging markets as a whole. Nevertheless, a more rapid-than-expected normalization, or rising global risk aversion, could have significant repercussions, especially for the large, financially integrated regional economies. Such shocks would be associated with reduced capital inflows, U.S. dollar appreciation against regional currencies, and likely with increased financial volatility driven by uncertainty at key turning points. As a result, debt-service burdens and debt-rollover risks would increase, especially for unhedged borrowers with short-term, foreign-currency-denominated debt. Amplifying exposure, Indonesia, Malaysia, the Philippines, and

Thailand all have sizable external debt stocks;[2] in Indonesia, Malaysia, and Thailand, a significant amount of debt is denominated in foreign currency,[3] including in U.S. dollars (Figure I.B.7); and, in Malaysia and Thailand, a significant share of external debt is short term (Figure I.B.8).[4]

Figure I.B.7. U.S.-dollar-denominated debt accounts for a large and rising share of external debt

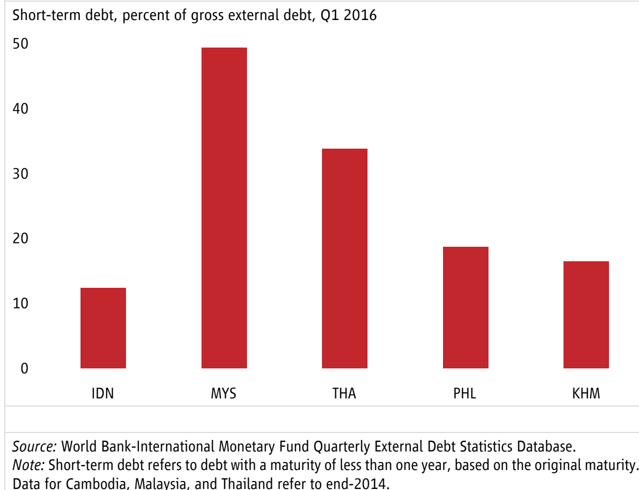
Dollar-denominated debt, percent of total public and publicly guaranteed external debt



Source: World Bank *International Debt Statistics*.

Figure I.B.8. In Malaysia and Thailand, a significant share of external debt is short term

Short-term debt, percent of gross external debt, Q1 2016



Source: World Bank-International Monetary Fund Quarterly External Debt Statistics Database.
Note: Short-term debt refers to debt with a maturity of less than one year, based on the original maturity. Data for Cambodia, Malaysia, and Thailand refer to end-2014.

Risks to global activity persist, with potentially significant implications for regional exports (Box I.B.1). Growth fluctuations in high-income economies would have a significant impact on output in the more open regional economies, even though the majority of developing EAP exports serve the regional market. On the positive side, the U.K.'s Brexit vote, and the upcoming Brexit process, are likely to have only a small impact on developing EAP, given the region's limited direct trade and financial links with the United Kingdom, with the possible exception of Cambodia and Fiji (Box I.B.3).

In China, the ongoing slowdown and rebalancing process remains an important short-term risk to growth in the rest of the region. China accounts for a large and rising share of demand for goods and services from the region, both to meet its own final demand and as inputs into further exports. As a result, China's orderly slowdown to date has been an important factor behind the region's resilience in the face of weakening global growth. However, rising private leverage and debt service burdens, especially in excess capacity sectors, raise the risk of financial stress among corporates. This could lead to a faster-than-anticipated slowdown in activity, especially if the strains spilled over to the banking sector and led to generalized reductions in credit. That said, the country continues to have significant fiscal, institutional, and reserve buffers (World Bank 2016c).

However, over the long term, China's rebalancing will also generate opportunities for the rest of developing EAP. The ongoing transformation in China's economic structure will open up new export opportunities for its trade partners, through two important channels. First, it will increase China's consumption of and demand for many products, including agricultural commodities and services. Second, it will create space for other countries to

2 External debt at end-2015 equaled 66 percent of GDP in Malaysia, 36 percent in Indonesia, 34 percent in Thailand, and 27 percent in the Philippines.

3 Foreign-currency-denominated debt at end-2015 equaled 49 percent of GDP in Malaysia, 30 percent in Indonesia, 34 percent in Thailand, and 14 percent in the Philippines.

4 As a result, a 30 percent exchange rate depreciation would be associated with external debt rising to 84 percent of GDP in Malaysia, and 54 percent of GDP in Thailand.

Box I.B.3. The Impact of Brexit on Developing EAP[1]

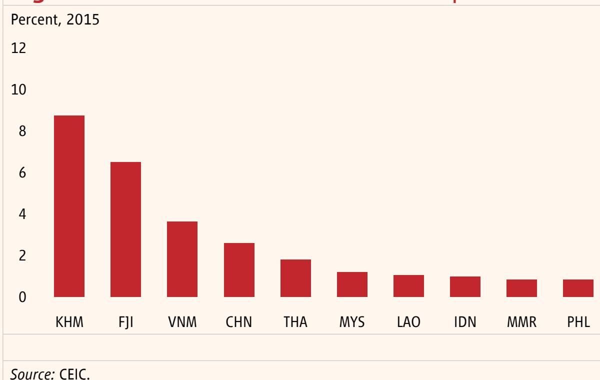
Brexit is likely to have a limited impact on developing EAP, but could add considerable uncertainty to an already fragile global environment. In the short term, Brexit is not expected to have a large impact on developing EAP, given its limited direct trade, investment, and financial links with the United Kingdom. In the medium term, Brexit will imply a renegotiation of developing EAP's trade and investment agreements with the United Kingdom, and may also affect their trade relations with the European Union. Further, there is a risk of sustained financial market stress around key decision dates in the upcoming Brexit process, which could affect EAP countries with large foreign participation in financial markets, such as Indonesia, Malaysia, and Thailand.

The financial markets' reaction in EAP following the Brexit vote was relatively calm. In the immediate aftermath, equity prices and exchange rates against the dollar fell across the board. Malaysia, by far the most exposed to lending from U.K. banks, experienced the sharpest depreciation among regional currencies, consistent with the notion that much of the selling was by foreigners seeking a safe haven. However, financial markets stabilized after two days of turbulence; equity markets rapidly recovered their losses, and Malaysia's dollar exchange rate quickly bounced back to the level before the Brexit vote.

The direct impact on developing EAP from any recession in the United Kingdom is likely to be small, given the limited direct trade and FDI links. The United Kingdom accounts for less than 2 percent of total exports across most of developing EAP; Cambodia, Fiji, and to a lesser degree Vietnam and China are relatively more exposed (Figure BI.B.3.1). On a value-added basis, in most cases final demand from the United Kingdom accounts for less than 1 percent of GDP. As a result, the trade channel is likely to reduce growth in most of the region by at most 0.1 percent, even after factoring in slightly weaker EU growth. The United Kingdom also accounts for only a limited share of total FDI flows to developing EAP.[2]

Figure BI.B.3.1. Share of U.K. in total exports

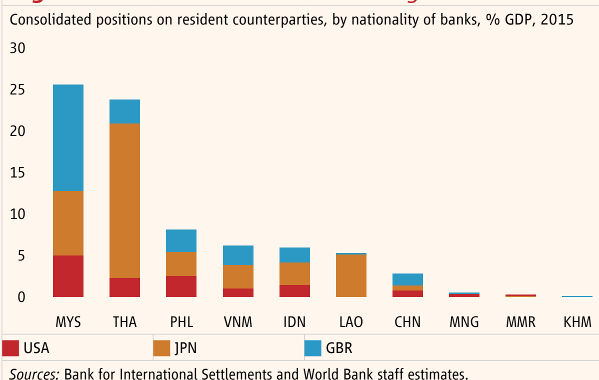
Percent, 2015



Source: CEIC.

Figure BI.B.3.2. Cross-border lending claims

Consolidated positions on resident counterparties, by nationality of banks, % GDP, 2015



Sources: Bank for International Settlements and World Bank staff estimates.

The impact through financial channels is also expected to be small, since direct financial links with the United Kingdom are in general limited. Most portfolio flows to developing EAP originate from the United States, Japan, and other EAP countries. Similarly, bank loans from the United States and Japan exceed

(continued)

1 Prepared by Luan Zhao, Kevin Thomas Garcia Cruz, Sebastian Eckardt, Virginia Horscroft, Mizuho Kida, David Knight, Elitza Mileva, Evgenij Najdov, Habib Rab, and Shakira Binti Teh Sharifuddin.

2 Less than 5 percent in 2015 (UNCTAD 2015). Only 10 percent of the U.K.'s outward FDI stock is located in developing EAP, mostly in China.

(Box I.B.3 continued)

those from the United Kingdom. Loans from U.K. banks, including both cross-border loans and domestic loans from local subsidiaries, are concentrated in the regional financial centers of Hong Kong SAR, China; Singapore; and Malaysia.[3] The risk of a lending squeeze is limited, because U.K. banks mainly finance their operations through local deposits.[4] In all other developing EAP economies, loans from U.K. banks account for less than 3 percent of GDP (Figure BI.B.3.2).

The region could be affected by general risk aversion in the wake of Brexit. One source of risk is the post-Brexit appreciation of the Japanese yen as a safe haven. Thailand and Malaysia have high exposure to Japanese banks; these might respond to continued yen appreciation by pulling funds back to Japan, tightening local financial conditions in the process. Yen appreciation could also raise debt-servicing costs for countries with significant unhedged yen-denominated external debt.[5]

Brexit will imply a renegotiation of developing EAP's trade and investment agreements with the United Kingdom, and may also affect their trade relations with the European Union, with unclear effects. On the positive side, it may be easier to negotiate free trade and investment agreements with an independent United Kingdom than with the European Union. On the negative side, future agreements with the European Union could become more difficult, reflecting the absence of the United Kingdom's voice. China's growing financial services relationship with the United Kingdom, partly based on London's role as a gateway to the European Union, may be affected.[6] Malaysian firms also rely on the United Kingdom as a gateway to the European Union; their cost of doing business could increase if new agreements have to be negotiated with the European Union post-Brexit. For Indonesia, Brexit is likely to postpone negotiation of the Indonesia-EU Comprehensive Economic Partnership Agreement. More broadly, Brexit could be associated with a revival of protectionist sentiments that could obstruct trade with the United Kingdom and possibly the remaining EU countries.

The trade and investment relationship of some smaller EAP countries with the United Kingdom could be significantly affected. In Fiji, the sugar industry, which accounts for 15 to 20 percent of merchandise exports and total employment, benefits from duty-free, quota-free access to the highly protected EU sugar market, and Britain's Tate and Lyle is among the biggest purchasers. Fiji will likely continue enjoying preferential access to the EU sugar market for some time, but this access would not automatically apply to a post-Brexit United Kingdom. In Timor-Leste, all residents born before 1998 enjoy the right to Portuguese passports. As a result, since independence there have been large flows of migrants toward the European Union, including, in particular, the United Kingdom. After Brexit, their right to work in the United Kingdom may be affected.

3 Such loans account for, respectively, 117 percent, 32 percent, and 12 percent of their GDP.

4 Correspondingly, a large share of their assets consists of local positions denominated in local currencies.

5 For instance, 30 percent of Vietnam's external debt, equivalent to 12 percent of GDP, was denominated in yen at end-2015.

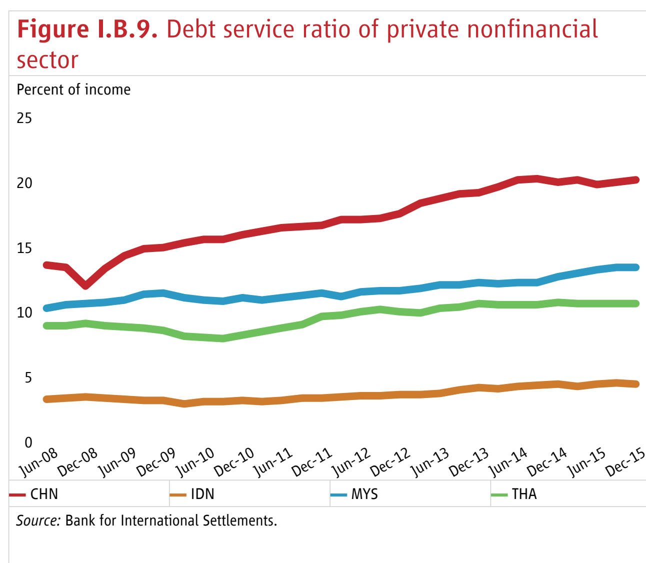
6 Plans included a London-Shanghai equity trading link, a mutual recognition scheme for distributing funds products, cooperation on cross-listing exchange products, measures to strengthen London as a yuan clearing hub, and a commitment on the part of several Chinese financial firms to set up bases in London.

expand their production of labor-intensive manufactures, including by encouraging relocation of existing factories from China to lower-cost regional economies. Those economies that can flexibly adapt their production and export structure in response to China's rebalancing could reap a growth dividend (Abiad et al. 2016).

High and rising private sector leverage is an important source of vulnerability in some large economies

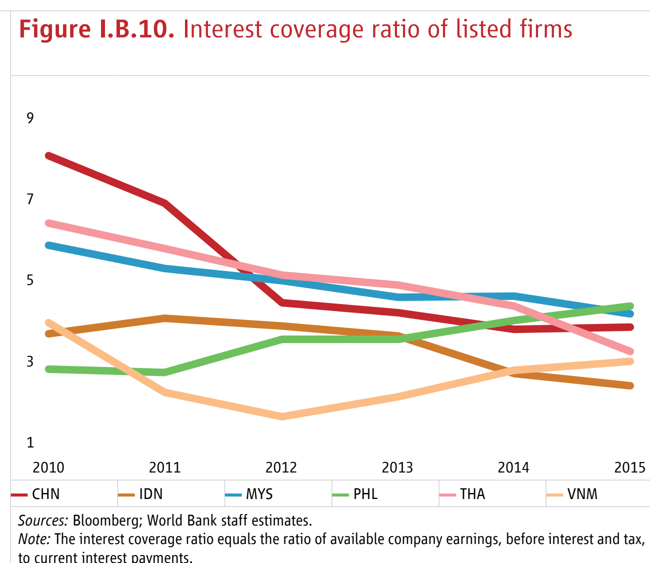
Rapid growth in private-sector credit and leverage across the large economies has already led to a gradual deterioration in debt-servicing capacity, raising the risk of financial stress among corporates and households. Debt service ratios for the private nonfinancial sector have been rising steadily over the past five years, and are now particularly high in China, Malaysia, and Thailand (Figure I.B.9). Likewise, interest coverage ratios (the ratios of available company earnings to current interest payments) have weakened significantly over the past five years in several countries, suggesting a deterioration in the financial health of corporates (Figure I.B.10). This partly reflects a trend decline in corporate profitability (Figure I.B.11) and broader economy-wide returns to investment (Figure I.B.12). Furthermore, economy-wide aggregates may present a misleadingly optimistic picture of financial risks. Across the region, corporate debt is often concentrated in relatively weak or risky sectors, including construction, real estate, utilities, and the oil, mining, and gas sectors (Figure I.B.13), which raises vulnerability to macroeconomic or commodity price shocks (IMF 2014, 2015).

Figure I.B.9. Debt service ratio of private nonfinancial sector



Source: Bank for International Settlements.

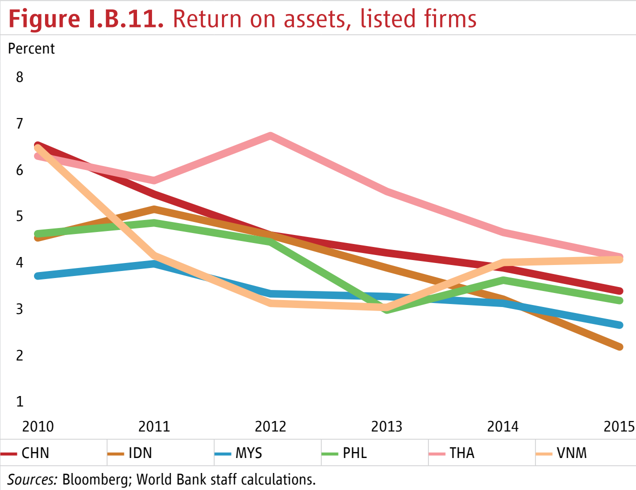
Figure I.B.10. Interest coverage ratio of listed firms



Sources: Bloomberg; World Bank staff estimates.
Note: The interest coverage ratio equals the ratio of available company earnings, before interest and tax, to current interest payments.

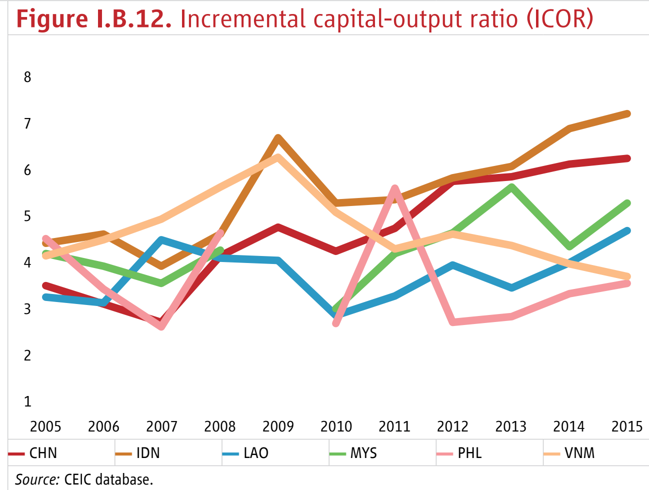
Rising private sector leverage is also increasing the vulnerability of the region's financial systems including, in particular, its banks. Financial difficulties among corporates and households could spill over to domestic banks, which still supply the majority of credit. Overall, the region's banking sector is relatively well capitalized and profitable, and far less vulnerable than in the run-up to the 1997 Asian crisis. Banks hold significant

Figure I.B.11. Return on assets, listed firms



Sources: Bloomberg; World Bank staff calculations.

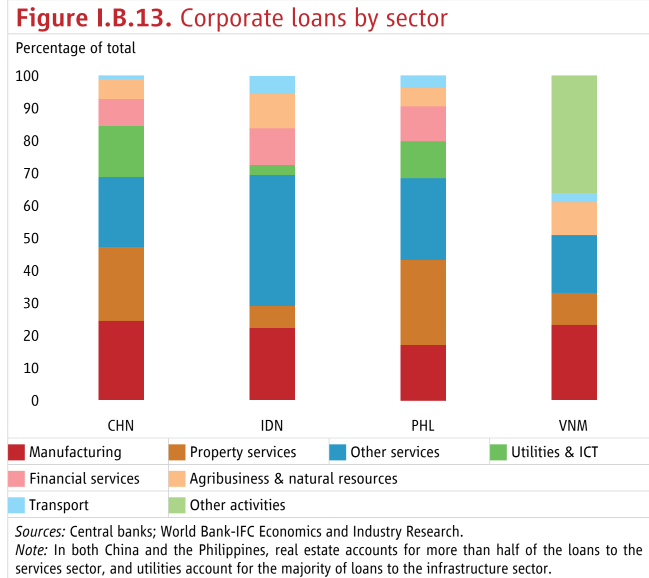
Figure I.B.12. Incremental capital-output ratio (ICOR)



Source: CEIC database.

amounts of capital that could act as a cushion against potential losses.[5] However, weaker corporate balance sheets, as well as deteriorating prospects for exporters, and in particular commodity exporters, have increased banks' asset-quality risks. Increased provisioning and nonperforming loans would affect banks' earnings. In addition, greater corporate sector risks could trigger sell-offs of corporate bonds, leading to trading losses for financial firms. All this would generate broader financial stability risks. Already, banks' profitability is falling across most of the region (Figure I.B.14 and Figure I.B.15). And, in Vietnam, the banking sector continues to be hampered by unresolved impaired assets.[6]

Figure I.B.13. Corporate loans by sector

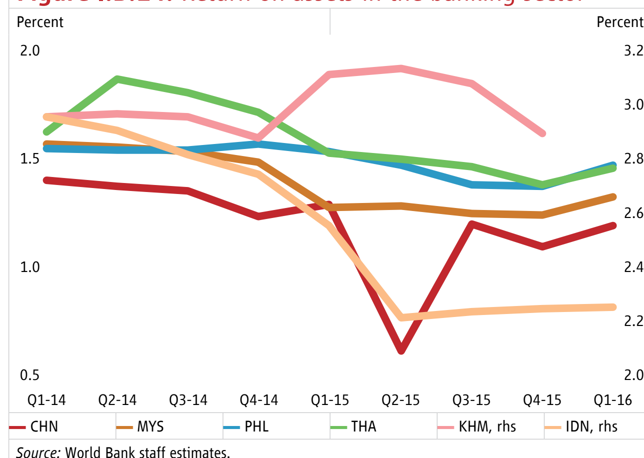


Sources: Central banks; World Bank-IFC Economics and Industry Research.
Note: In both China and the Philippines, real estate accounts for more than half of the loans to the services sector, and utilities account for the majority of loans to the infrastructure sector.

5 Across developing EAP countries with available data, the ratio of regulatory Tier 1 capital to risk-weighted assets, a standard measure of capital adequacy, ranges from 11 percent (in China) to 25 percent.

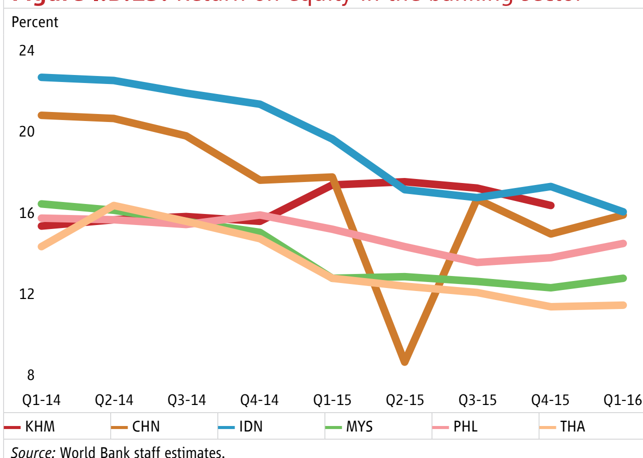
6 The level of nonperforming loans has been estimated at 7.5 to 12 percent of total banking sector assets, including approximately US$10 billion in impaired loans held by the state-owned Vietnam Asset Management Company.

Figure I.B.14. Return on assets in the banking sector



Source: World Bank staff estimates.

Figure I.B.15. Return on equity in the banking sector



Source: World Bank staff estimates.

Past experience, both in the region and more widely, confirms that rapid private sector credit growth significantly increases the risk of future financial distress and protracted economic slowdowns. Rapid credit expansions are often followed by a prolonged period of deleveraging and lackluster economic growth, or indeed outright crises.[7] Underlying this, borrowing booms facilitate the accumulation of latent nonperforming loans that are revealed after the boom subsides.[8] More broadly, rapid credit growth may lead to a deterioration in the efficiency and profitability of investment.

Shocks to external financial conditions or to global growth could trigger or hasten the realization of existing financial risks. The share of firms with "debt at risk"[9] across the region would increase significantly under a range of plausible financial shocks.[10] Relatedly, renewed financial volatility would significantly aggravate short-term financial stresses among the more leveraged corporates. The risks would be further magnified if weaker global activity were simultaneously to affect profitability in export-oriented sectors, including commodity producers.

Outlook and risks for the Pacific Island Countries

Growth in PICs will rely significantly on fisheries and tourism. Coordinated reforms across PICs have already proved successful in increasing sustainably the rents from the regional tuna fisheries (most notably in Kiribati, the Federated States of Micronesia, Nauru, Papua New Guinea, the Solomon Islands, and Tuvalu), and this resource will continue to support growth in the medium term. Tourism is also expected to expand, especially in Fiji, Samoa, Tonga, and Vanuatu. Inflation is expected to remain moderate, reflecting muted commodity prices.

7 About 60 percent of credit booms are followed by economic underperformance, and one-third of credit booms are followed by banking crises (Dell'Ariccia et al. 2014).

8 A typical borrowing boom raises nonperforming loans from 2.5 percent to 10 percent of gross loans (Mendoza and Terrones 2008). See also World Bank (2016c).

9 Debt at risk is defined as debt held by firms with an interest coverage ratio of less than 1.5 (that is, firms whose earnings, before interest and tax, are less than 1.5 times current interest payments).

10 In Malaysia, the share of firms with debt at risk would increase from 26 percent to 35 to 42 percent, assuming three concurrent shocks of varying magnitudes: (a) simultaneous depreciation against the U.S. dollar and the euro (by, respectively, 20 to 40 percent and 10 to 20 percent); (b) a 20 percent decline in earnings before interest and tax; and (c) a 200-to-300-basis-point increase in interest rates. In Vietnam, the share of firms with debt at risk would increase from 15 percent to 25 percent in response to a 200-basis-point increase in interest rates.

The main risks for PICs arise from natural disasters, climate change, and terms-of-trade shocks. Nearly every year, at least one country is hit by a major natural disaster; vulnerability will remain high even with an increased policy focus on disaster risk management. In the long run, many PICs are also highly vulnerable to sea-level rise. Shocks to world commodity prices significantly affect livelihoods across the PICs, because they are highly dependent on imports, and face transportation costs that are both large and heavily influenced by oil prices.

I.C. Policy Considerations

Subdued global prospects make it critical for policymakers to address underlying financial and fiscal vulnerabilities, and to maintain fiscal space. China needs to advance reforms in the corporate sector, implement measures to bring credit growth under control, and strengthen its intergovernmental fiscal system. Among the other large economies, where private sector credit has grown rapidly, or where external debt is sizable, the build-up of risk can be reduced through enhanced microprudential regulation and increased use of macroprudential policies. Among the other large economies, where private sector credit has grown rapidly, or where external debt is sizable, the build-up of risk can be reduced through enhanced microprudential regulation and increased use of macroprudential policies. Across the region, and especially among commodity producers, maintaining fiscal buffers should receive priority over countercyclical stabilization efforts. In this context, broadening revenue sources remains a priority. Fiscal deficits pose a risk to sustainability in some regional economies, primarily commodity producers, and substantial consolidation is needed. In resource-rich economies, the use of sovereign wealth funds can support short-term expenditure stabilization and long-term fiscal sustainability, provided that the funds' operational rules are simple, transparent, and allow only limited discretion.

The longer-term challenge across the region is to achieve faster, more inclusive growth. In China, the commitment to facilitate the rebalancing from investment-led to consumption-led growth, as part of a program to increase overall productivity, should be complemented by continued efforts to reduce poverty and promote inclusion. Across the rest of the region, more and better infrastructure holds the potential to promote connectivity and facilitate the shift to higher-value-added activities. A rebalancing of public expenditure, and greater public-private cooperation, will help address infrastructure deficits, but increased expenditure must be accompanied by reforms to improve the efficiency of public investment management. Such efforts to enhance productivity must be complemented by a renewed focus on boosting inclusion, with a focus on reducing still-high levels of undernutrition across much of the region, harnessing the full potential of new technology for financial development and inclusion, and developing "adaptive safety nets" that respond rapidly and flexibly in the wake of shocks such as natural disasters. The long-term outlook for growth and inclusion in the Pacific Island Countries hinges on their ability to maximize the benefits from their limited opportunities, including fisheries, migrant workers, and tourism.

Subdued global prospects make it critical to address underlying financial and fiscal vulnerabilities, and to maintain fiscal space

Subdued prospects for the global economy are generating headwinds across the region. The deteriorating outlook in high-income economies will have a persistent effect on regional exports. Depressed world commodity prices will intensify challenges in commodity exporters. And significant risks to global activity persist.

At the same time, unexpectedly accommodative global financial conditions are temporarily reducing pressures. The delayed normalization of monetary policy in high-income economies has stabilized capital flows and

reduced exchange-rate pressures. The window of opportunity to address regional vulnerabilities has extended—but the reprieve is likely to prove temporary.

China needs to advance reforms in the corporate sector and implement measures to bring the current rapid credit growth under control. Reforms to address excess industrial capacity have been initiated, and could usefully be accelerated and deepened. The continued rapid expansion of credit to state-owned enterprises (SOEs), including those involved in public investment, has increased macroeconomic risks with steadily decreasing returns. Recent measures to strengthen financial regulations, including those pertaining to shadow banking activities such as wealth management products and peer-to-peer lending, should also be expanded. Household credit has been rising rapidly, aided by a loosening of prudential policies, particularly for first-time homebuyers,[1] and needs to be managed carefully.

As China's economy rebalances from investment-led to consumption-led growth, the intergovernmental budgetary and public finance system also needs to be strengthened. The adoption by the State Council of a new framework to address the current imbalance in revenues and expenditure responsibilities at different levels of government appears to be a positive step in that direction. Lower public investment growth at the subnational level could also facilitate efforts, building on the recent budget reform, to strengthen the responsibility and capacity of local governments to manage debt, including contingent liabilities from off-budget activities.

Among the other large economies, where private sector credit has grown rapidly, or external debt is sizable, the build-up of risk can be reduced through enhanced microprudential regulation and increased use of macroprudential policies. In Malaysia and Thailand, leverage has reached significant levels, including through sharp increases in household debt; in the Philippines and Vietnam, debt continues to grow rapidly. Risks are heightened by the potential for significant external shocks, including faster-than-anticipated global financial tightening, renewed global financial volatility, and further downturns in high-income economies. The impact of such shocks could be magnified by the sizable foreign-currency-denominated debt and short-term external financing requirements, including foreign liabilities of the banking sector, in Malaysia and Indonesia. In response, in several countries, including the Philippines, Thailand, and Vietnam, there is significant scope to strengthen regulatory oversight and microprudential risk management. Enhanced macroprudential regulation would also help mitigate the risks to financial stability from leverage, including among households (IMF 2015). Focus areas for micro- and macroprudential reform should include risk-informed pricing, rigorous borrower affordability assessments, supervisory vigilance over underwriting practices and capital adequacy, elevated reserve requirements, higher liquidity ratios or loan-loss provisions, and appropriate loan-to-value (LTV) and debt-to-income (DTI) limits (World Bank 2016c). Countries with a significant nonbank financial sector, including Thailand, should enlarge financial regulatory perimeters, with robust oversight and close supervision of nonbank financial institutions, to avoid regulatory arbitrage. Across the region, strengthened collection of data, including granular data on household assets and liabilities, will help monitor the build-up of financial stability risks. A number of countries, including Thailand, the Philippines, Vietnam, Cambodia, and Myanmar, are already introducing measures along these

1 The minimum down payment on a first-time homebuyer mortgage was lowered in October 2015 for the first time since 2010, from 30 percent to 25 percent. In February 2016 it was further reduced to 20 percent, and the minimum down payment for second home mortgages was lowered from 40 percent to 30 percent

various dimensions.[2] These efforts should be strengthened, especially in economies with large credit markets, while continuing to promote desirable financial deepening. In Vietnam, consolidating the banking sector and restructuring the large banks to improve efficiency and overall asset quality are also important measures for consideration.

The experience of the Republic of Korea illustrates how a timely policy response, tailored to country-specific circumstances, can cool overheated credit markets and reduce the risk of loan defaults; Malaysia is starting to follow this example. In Korea, mortgage loans and housing prices began rising sharply in 2000–01. In response, authorities introduced a series of countercyclical macroprudential policies, including LTV and DTI limits for housing loans[3]; and tightened caps on leverage (as a multiple of bank capital). They also introduced a "stability levy" on banks' nondeposit foreign exchange liabilities (which raised foreign exchange funding costs). As a result, the growth in housing prices, the number of loan defaults, and the growth of new loans decreased by 2008. In Malaysia, in response to rising household indebtedness, macroprudential measures, including limits on LTV ratios and maturities of housing loans,[4] have been strengthened since 2010, and the authorities have enhanced the framework for risk-based pricing, stress testing, and supervision. As a result, house price growth has been moderating since 2014,[5] the share of borrowings by highly leveraged lower-income households has declined,[6] loan applications and approvals have decreased, and personal credit growth has slowed. That said, both household and corporate debt remains elevated.

Across the region, and especially among commodity producers, maintaining fiscal buffers in the context of a robust medium-term fiscal framework should receive priority over any countercyclical stabilization efforts, especially given the continued resilience of regional growth. Countries across the region need to preserve room for fiscal manoeuver should risks, including due to deterioration in the external environment, materialize. In addition, debt-servicing costs can crowd out high-priority investment and social expenditures. That said, among noncommodity producers, and particularly Cambodia, the Philippines, and Thailand, the risks associated with a limited widening of the deficit should prove manageable, as long as this expansion finances efficient efforts to build up the economy's long-term productive capacity (see below).

To maintain fiscal buffers, broadening revenue sources continues to be a priority for most countries. Revenue mobilization remains low across much of the region.[7] Revenue constraints are particularly binding for commodity producers; in Indonesia and Malaysia, low commodity prices have already had a significant impact on

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2 In Thailand, the authorities have established a Financial Stability Committee to monitor and mitigate systemic risk, and publish financial stability reports. Also, the specialized financial institutions, which hold over 20 percent of financial sector assets, will now be supervised by the central bank, promoting more comprehensive oversight and transparency. In the Philippines, the authorities have enhanced monitoring of real estate and credit conditions, including through the introduction of the residential real estate price index, and are addressing data and regulatory gaps related to the real estate sector and rising corporate leverage. In Vietnam, macroprudential regulation of credit markets was strengthened in April, with a particular focus on real estate. In Cambodia, minimum capital requirements for financial institutions were recently increased, and the required liquidity coverage ratio was raised to 60 percent in September 2016. In Myanmar, the recent adoption of the financial sector law is expected to help manage risks from credit growth.

3 The LTV limit for housing loans was lowered to 60 percent in 2002, and to 50 percent for loans with a maturity of three years or less in 2003. In the Seoul metropolitan area, the maximum DTI ratio was limited in 2006 to 40 percent for single households under 30 years old and for married borrowers in speculation-prone areas. See also Chang (2010) and Kim (2014).

4 A maximum 70 percent LTV ratio for the third and subsequent housing loans to individuals (2010), a maximum 60 percent LTV ratio for housing loans to nonindividuals (such as business enterprises and sole proprietors), and a maximum maturity on loans given by banks and nonbanks of 10 years for personal loans, and 35 years for both residential and nonresidential property loans (2013).

5 From 9.6 percent per year during Q1 2010–Q2 2014, to 8 percent per year since Q2 2014. However, it remains above the long-term growth rate of 5.5 percent observed during 1990–2009.

6 Between 2013 and 2015, from 28.4 percent to 23.6 percent of total household debt, and from 25.1 percent to 20.4 percent of total bank financing to households. "Lower income" is defined as earning RM 3,000 or less per month.

7 See World Bank (2016a), Box I.C.1.

public revenue and public finances. In general, commodity producers need to reduce, or continue reducing, their reliance on commodity-related fiscal revenues. In Indonesia, a series of tax-compliance measures combined with modest base-broadening measures could raise revenues by almost 2.5 percent of GDP.[8] In Malaysia, which already introduced a goods and services tax in 2015, current priorities include reducing exemptions and expanding the base for the personal income tax. In Thailand, tax reforms will introduce wealth and asset-transaction taxation, supporting both revenue and equity. In the Philippines, the proposed tax policy reforms, with their focus on broadening the tax base, lowering tax rates, and raising overall revenue, represent a step in the right direction.[9] They will need to be accompanied by continued efforts to improve tax administration.[10] In Vietnam, the revenue base should be broadened through new taxes on capital gains, property and interest income, and by raising rates or reducing exemptions with appropriate measures to mitigate the impact on the poor. Timor-Leste would benefit from introducing a VAT as a pillar of domestic revenue, and Vanuatu from introducing an income tax. In addition, continued low world energy prices extend the window of opportunity for countries to reform energy pricing, including by cutting remaining energy and fertilizer subsidies, increasing fuel taxes, and in some cases moving toward greater cost recovery in electricity (World Bank 2015a). Public transfers should target low-income or vulnerable groups, to maximize their impact on inclusion; and permanent commitments, including public service wage settlements, should be approached cautiously.

In Mongolia and Timor-Leste, commodity producers that have failed to adjust to lower commodity revenues, and to a lesser degree in Vietnam, high or rising fiscal deficits pose a risk to fiscal sustainability; substantial consolidation is needed. In Mongolia, large fiscal imbalances have emerged, and public debt is set to rise rapidly in the coming years in the absence of adjustment. The announced measures to contain expenditure must be significantly strengthened and domestic revenue sources broadened. In Timor-Leste, the emergence of large structural deficits demands efforts to prioritize the use of sovereign wealth fund assets to finance essential investments that raise domestic supply potential and support diversification efforts. These need to be coupled with the development of a stronger domestic revenue framework, and a targeted program of institutional and policy reform to improve the regulatory environment and broader investment climate. In Vietnam, elevated debt levels, and the contingent liabilities associated with banking sector recapitalization,[11] also call for fiscal reforms to stabilize public finances. Reversing the significant erosion of fiscal revenue over the past few years is a priority. SOE reform, including measures to enhance transparency and governance, will help reduce public financial liabilities.

In resource-rich countries, there is significant scope to enhance institutions for managing commodity-price volatility. The effective use of sovereign wealth funds can support short-term expenditure stabilization and, relatedly, long-term savings, while ensuring that key development needs are met. However, the operation of sovereign wealth funds, especially in thin-capacity environments, is likely to prove most effective when the operational rules are simple, transparent, allow only limited discretion, and enjoy broad political support (Box I.C.1).

8 Important potential tax administration measures include improvements in VAT administration, income tax e-filing, the introduction of a unique taxpayer identifier, reductions in exemptions, replacing the vehicle sales tax with an excise tax, and measures to counter base erosion and profit shifting by multinationals.

9 Measures to expand the VAT base, increase fuel excises, tax sugary products, and reduce the elevated personal income tax rates, with a net positive expected impact on revenue, have already been submitted to the legislature. Future measures are expected to include a rationalization of fiscal incentives, a reduction in corporate income tax rates, a simplification of property taxes, and a harmonization of capital income tax rates.

10 Measures may include simplifying tax procedures and processes, strengthening internal and external audits of the revenue agencies, to enhance their transparency and accountability, and relaxing bank secrecy laws in cases involving tax fraud.

11 On the order of 2.5 percent of GDP for the state-owned commercial banks alone.

Box I.C.1. Sovereign Wealth Funds in Small Commodity-Dependent EAP Countries[1]

The smaller commodity-dependent EAP countries face a number of challenges in increasing their resilience to changes in commodity prices, and ensuring that resource revenues benefit both current and future generations.[2] This box examines the institutional mechanisms that have been employed to manage resource revenues in a selection of small EAP commodity exporters—Kiribati, Mongolia, Papua New Guinea, Timor-Leste, and Tuvalu (Table BI.C.1.1). Resource revenues, which tend to be highly volatile, comprise a substantial proportion of total revenues in each of these countries (Figure BI.C.1.1). In some cases, these resources are not projected to last indefinitely: for instance, in Timor-Leste, petroleum production is forecast to end by 2022.

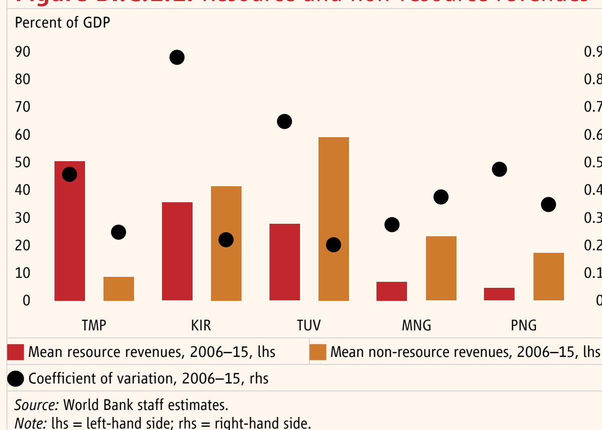
Table BI.C.1.1. Population, GDP per capita, and major resources, 2014

	Population, in millions	*GDP per capita, current US$*	*Major sources of commodity revenue*
Kiribati	0.112	1,668	Fishing license fees
Mongolia	2.925	4,169	Copper, coal, gold, crude petroleum products
Papua New Guinea	7.530	2,211	Gold, copper, oil
Timor-Leste	1.145	3,807	Crude petroleum products
Tuvalu	0.011	3,452	Fishing license fees

Source: World Bank staff.

Each of these five countries has established one or more sovereign wealth funds (SWFs) that have objectives relating to short-term expenditure stabilization, long-term savings, and/or development (for instance, funding public infrastructure). In Mongolia, Papua New Guinea, and Timor-Leste, these funds have been established specifically to manage commodity revenues. SWFs in Kiribati and Tuvalu are now being used to receive revenues from fishing license fees, which have grown rapidly in recent years, although Kiribati's SWF was originally capitalized using tax revenues from now-depleted phosphate reserves, while the Tuvalu Trust Fund SWF was established with contributions from the Tuvalu government and external donors. The SWF objectives are implemented through rules, some based in legislation, which govern fund contributions and withdrawals (Table BI.C.1.2).

Figure BI.C.1.1. Resource and non-resource revenues



Source: World Bank staff estimates.
Note: lhs = left-hand side; rhs = right-hand side.

(continued)

1 Prepared by Kim Alan Edwards, with contributions from Davaadalai Batsuuri, Mizuho Kida, David Knight, Chandana Kularatne, and Lucy Pan.

2 For a broad discussion of the challenges facing commodity exporters in East Asia and Pacific, with a focus on Lao PDR, Mongolia, Papua New Guinea, and Timor-Leste, see Kularatne (2016).

(Box I.C.1 continued)

Table BI.C.1.2. Sovereign wealth fund objectives and contribution and withdrawal rules

	Fund objectives	*Contribution rules*	*Withdrawal rules*
Kiribati Revenue Equalization Reserve Fund (RERF)	Stabilization, intergenerational equity	No formal rule, but the RERF is intended to receive budget surpluses.	No formal rule, but target real per capita RERF balance of A$4,700 (in constant 1996 A$).
Mongolia Fiscal Stabilization Fund (FSF)	Stabilization	Mineral revenue in excess of structural revenue, unspent budget allocations from some special funds in the previous year.	Withdrawals are allowed if mineral prices drop below the estimated structural price,[a] or if GDP growth is negative.
Mongolia Human Development Fund (HDF)[b]	Development and intergenerational equity	State dividends from mineral projects, 65 percent of royalties from mineral projects (after FSF distribution), 50 percent of additional mining revenues generated by changes in tax regulations, 20 percent of mineral revenues in excess of structural revenue (beginning 2018).	No withdrawals until 2030, at which point 10 percent of net investment income will be transferred to the budget each year.
Papua New Guinea Sovereign Wealth Fund – Stabilization Fund	Stabilization	50 percent of mining and petroleum taxes, 60 percent of proceeds from sale of mineral/ petroleum assets, 75 percent of any distribution from state-held interests in mining/petroleum projects, a proportion of mining/ petroleum dividends due to the state, all withdrawals from the Savings Fund.	Withdrawals shall not exceed the 5-year moving average of the ratio of mineral and petroleum receipts to non-resource receipts, multiplied by actual non-resource receipts two years prior to the drawdown fiscal year.
Papua New Guinea Sovereign Wealth Fund – Savings Fund	Intergenerational equity	Any surplus of the Stabilization Fund after its balance reaches US$1 billion, 40 percent of proceeds from sale of mineral/ petroleum assets, 25 percent of any distribution from state-held interests in mining/petroleum projects, the remainder of mining/petroleum dividends due to the state, proceeds from the sale of any non-resources assets.	No withdrawals until 2024. Transfers to the Stabilization Fund are limited to those that ensure that the inflation-adjusted value of the Savings Fund is maintained.
Timor-Leste Petroleum Fund (PF)	Stabilization, intergenerational equity	All petroleum sector revenues.	Withdrawals up to the value of the Estimated Sustainable Income (ESI)[c] are allowed (with exception clause for higher withdrawals "in the long-term interests of Timor-Leste")

(continued)

(Box I.C.1 continued)

Table BI.C.1.2. Sovereign wealth fund objectives and contribution and withdrawal rules

	Fund objectives	*Contribution rules*	*Withdrawal rules*
Tuvalu Consolidated Investment Fund (CIF)	Short-term stabilization	The CIF receives transfers from the Tuvalu Trust Fund (see below) when the latter's balance exceeds its real maintained value, and a rule has been established so that all fishing revenues above the 3-year historical average are placed in the CIF.	The CIF can be drawn on to finance budget deficits, but has a minimum target balance of 16 percent of the maintained (real) value of the Tuvalu Trust Fund.
Tuvalu Trust Fund (TTF)	Long-term fiscal independence	No formal rule, but the government can make contributions using budget surpluses.	Transfers to the Tuvalu CIF (see above) only when the market value of the TTF exceeds the real maintained value (indexed to the Australian Consumer Price Index).

Note: a. 16-year moving average (previous 12 years, current year, and 3-year projections). b. To be replaced by the Future Heritage Fund (FHF) in January 2017. c. The ESI equals 3 percent of the sum of the current Petroleum Fund balance and the present value of estimated future revenues from proven reserves. It is designed to ensure that the level of the Petroleum Fund is maintained in real terms.

In a number of cases, SWFs have had some success in meeting their stabilization objectives, with a broadly negative correlation between net withdrawals and resource revenues (Figure BI.C.1.2). In Kiribati and Tuvalu, governments have readily drawn down SWF balances to finance fiscal deficits over the past decade, and more recently have begun to make contributions on the back of marked increases in fishing license fee revenues. However, Kiribati has generally been more willing to make withdrawals than contributions: while the funding of persistent fiscal deficits and low returns on investment halved the value of Kiribati's SWF between 2000 and 2008, only around half of the large recent fiscal surpluses have been allocated to the SWF (the remainder has been saved as cash reserves). In Timor-Leste, government spending has continued to grow steadily over the last decade, despite a pronounced rise and fall in petroleum revenues over the same period, owing to disbursements from the SWF.[3]

In Mongolia, SWF withdrawal decisions have been somewhat ad hoc, with declining copper, coal, and gold prices complicating macro-fiscal management. The government has made only one drawdown from the SWF (of 0.5 percent of GDP, in 2014), despite structural budget deficits averaging 6.4 percent of GDP over the last five years. Instead, budget deficits have been financed by domestic and sovereign borrowings as well as prepayments of large mineral royalties. Moreover, while the SWF was intended to support the operation of the Fiscal Stability Law, which was passed in 2010 and established rules on the structural deficit, expenditure growth, and public debt, each of these rules has been breached regularly in recent years.[4]

In Papua New Guinea, while experience with the SWF is limited, questions have arisen about the contribution and withdrawal rules, as well as the relationship with fiscal policy. The 2015 SWF legislation includes some best practice features: it ensures that all SWF inflows and outflows are recorded on-budget, mandates that the SWF invest only in foreign assets, and sets out a governance structure to

(continued)

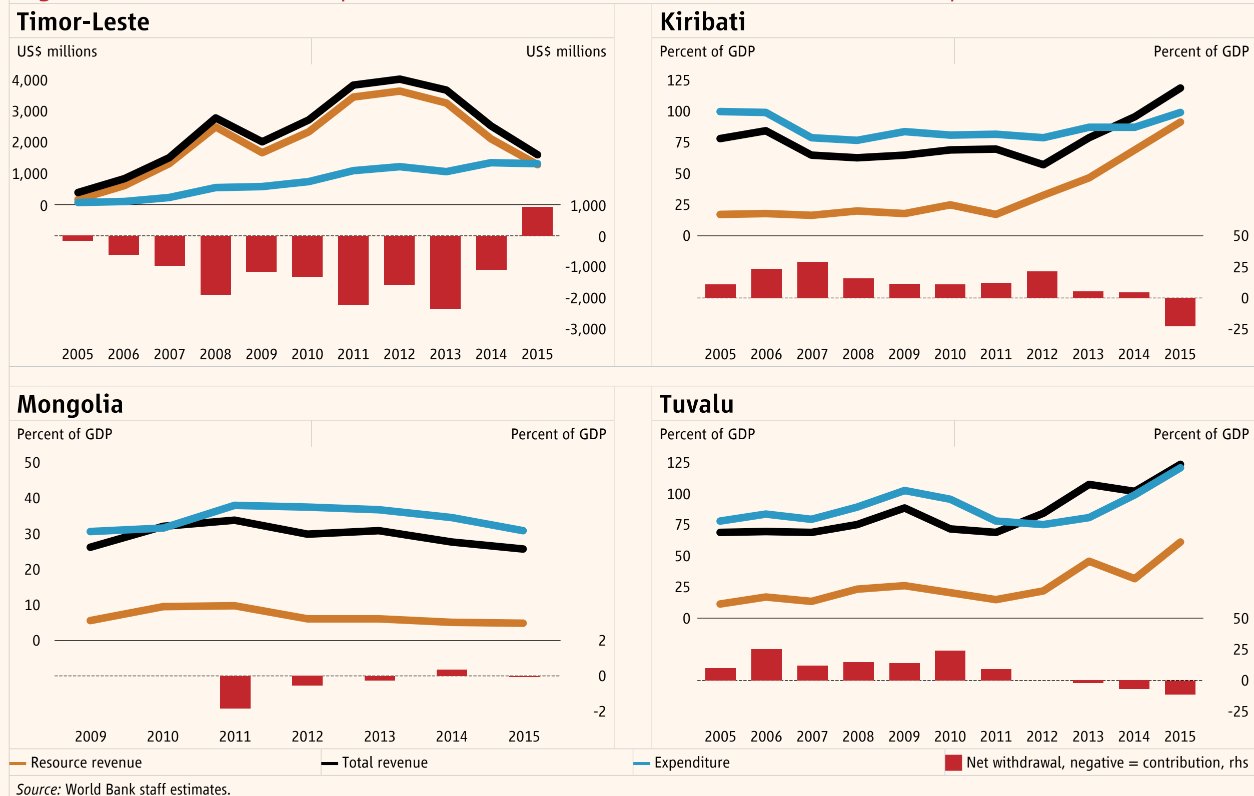
3 These withdrawals (Figure BI.C.1.3) are reflected in the fact that over the past decade, the *net* contributions to the SWF (Figure BI.C.1.2) have regularly been less than total petroleum sector revenues, which by law must be deposited in the SWF.

4 The Fiscal Stability Law had three key provisions: (1) a ceiling on the structural deficit of 2 percent of GDP; (2) a cap on expenditure growth based on the nonmineral GDP growth rate; and (3) a ceiling on the net present value of public debt of 40 percent of GDP. It came into force in 2013, but a subsequent amendment temporarily loosened these rules for 2015–18.

(Box I.C.1 continued)

prevent conflicts of interest. However, the contribution rules do not account for all resource revenues: for instance, the legislation currently requires only 50 percent of mineral and petroleum taxes to be transferred to the SWF. The withdrawal rule is complex and not clearly countercyclical in all circumstances. There is also no explicit link between the SWF rules and the broader fiscal policy framework, potentially weakening the traction of and support for these rules.

Figure BI.C.1.2. Revenues, expenditures, and net SWF withdrawals (withdrawals less deposits)



Source: World Bank staff estimates.

The operation of most SWFs has not been fully compliant with savings rules and objectives, despite some limited success in stabilizing expenditure, calling their longer-term sustainability into question. Savings rules are often calibrated to maintain the real value of the SWF over time, to ensure that future generations can also benefit from current resource revenues or aid flows. However, in Timor-Leste, the exception clause allowing withdrawals above the Estimated Sustainable Income has been heavily used in recent years. As a result, withdrawals have generally been at a level inconsistent with long-term SWF sustainability, and have instead allowed expenditures to rise steadily over the past decade (Figure BI.C.1.3).

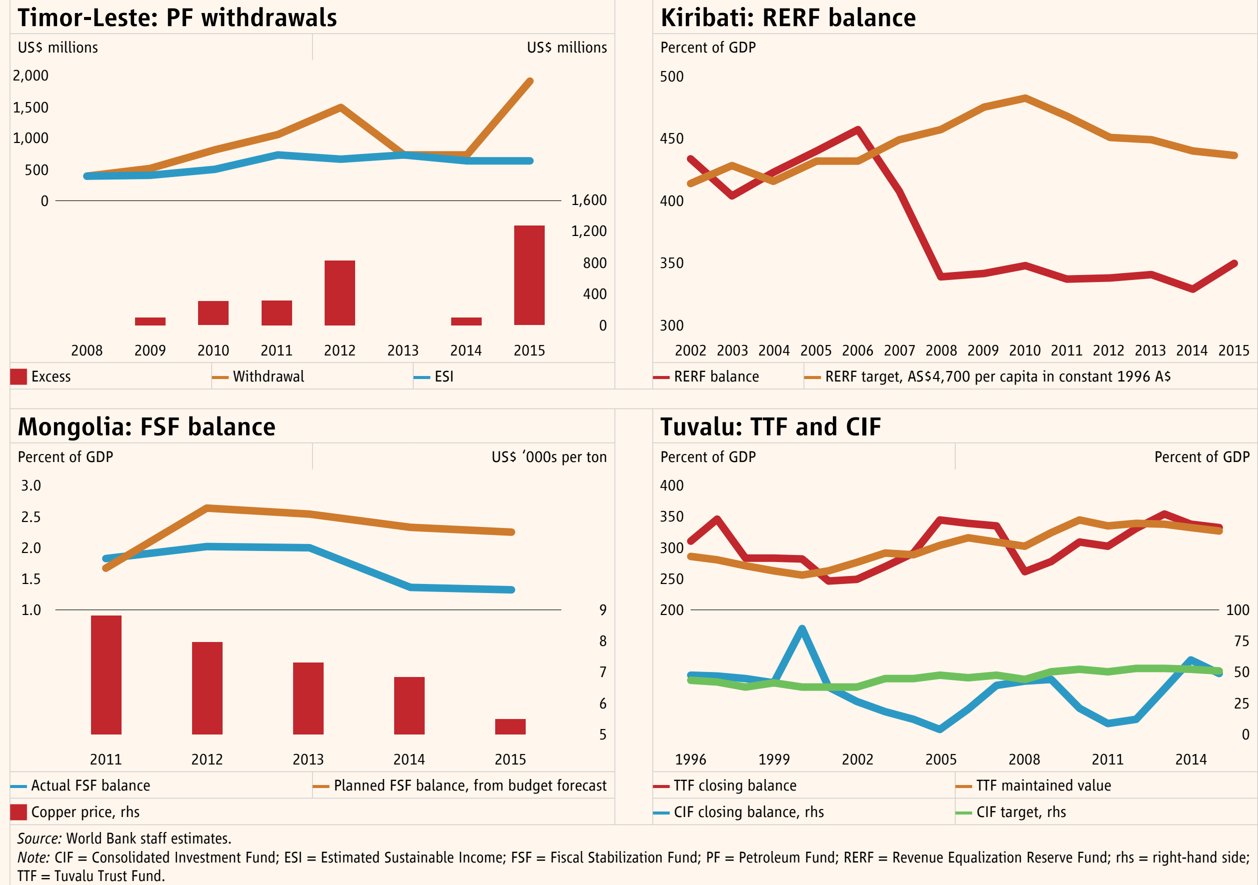
In **Kiribati**, annual SWF withdrawals continued until 2014, even though the SWF fell below its target per capita value since the mid-2000s. In **Tuvalu**, the Tuvalu Trust Fund rules—which do not allow transfers directly to the budget, and only allow transfers to the Consolidated Investment Fund when the Tuvalu Trust Fund exceeds its target real value—have been and continue to be effective in ensuring that the fund maintains its value in real terms. Nevertheless, the Consolidated Investment Fund, which has regularly been

(continued)

(Box I.C.1 continued)

used to finance budget deficits, has previously fallen to very low levels and has at times required donor injections to maintain a positive balance.

Figure BI.C.1.3. SWF balances and withdrawals



Source: World Bank staff estimates.
Note: CIF = Consolidated Investment Fund; ESI = Estimated Sustainable Income; FSF = Fiscal Stabilization Fund; PF = Petroleum Fund; RERF = Revenue Equalization Reserve Fund; rhs = right-hand side; TTF = Tuvalu Trust Fund.

In **Mongolia**, cumulative budgetary contributions to the Fiscal Stabilization Fund (FSF) have been around 40 percent below planned contributions, due mainly to the continued decline in copper prices since 2011. As a result, the FSF balance was only around 1.3 percent of GDP at end-2015. The new Future Heritage Fund will not allow withdrawals until 2030, which should allow for the buildup of a substantial pool of funds. However, saving through this SWF while simultaneously borrowing, in some cases at high interest rates, to fund large fiscal deficits would not be an optimal strategy. The **Papua New Guinea** Savings Fund also does not allow withdrawals until 2024, although it is not clear whether and how the rules determining the respective contributions of resource revenues to the Savings Fund and the Stabilization Fund SWFs have been calibrated to serve the objective of intergenerational equity.

To the extent that resource revenues are used to finance public expenditures rather than saved, the type and quality of these expenditures is also critically important for longer-term outcomes. Using resource revenue for development expenditure (even if that means running down the value of the SWF)

(continued)

(Box I.C.1 continued)

may be justified if this expenditure is likely to produce a positive long-term social return. There may also be a case for using resource revenues for current spending, rather than development spending or saving, especially in relatively low-income countries, if future generations are expected to be wealthier than the current generation or if resources are projected to provide a steady long-term source of revenue. But in both cases, ensuring the quality of expenditure is key. In Timor-Leste, excess SWF withdrawals in recent years have been used to finance projects with no clear assessment of economic benefits and with seemingly ad-hoc project selection and fiduciary processes.[5] This undermines transparency, accountability, and efficiency.

Overall, the experiences of these five countries suggest that SWFs in thin-capacity environments are most effective when the operational rules are simple, transparent, allow only limited discretion, and enjoy broad political support. While the overall design of Timor-Leste's SWF framework is seen as best practice, the exception clause allowing withdrawals in excess of the Estimated Sustainable Income has provided the government with a high degree of discretion, which it has used at the cost of longer-term sustainability and which it now has little incentive to forego. In Tuvalu, in contrast, the robust governance structure of the TTF—with two of the three board seats occupied by representatives independent of government—has helped ensure that its real value has been maintained over time. In Kiribati, the government has avoided introducing formal rules governing SWF contributions and withdrawals, in part because SWF withdrawals are viewed as politically costly, creating an incentive to avoid saving in the SWF in the first place. Nevertheless, despite varying degrees of success in meeting savings objectives, SWFs in Timor-Leste, Tuvalu, and Kiribati have at least assisted in insulating public expenditures from swings in resource revenues. To date, SWFs appear to be less successful in meeting both stabilization and savings goals in Mongolia and Papua New Guinea. In these cases, the established SWF rules are overly complex and not closely integrated with the overall fiscal framework, and in Mongolia the political commitment to effectively implement these rules (which may mean, for instance, forgoing shorter-term spending priorities) has been weak.

5 Funds are nominally appropriated by the budget, but executed by autonomous entities such as the Infrastructure Fund and the Oecusse Special Economic Zone, which are not subject to standard government fiduciary rules and are able to transfer funds between existing or new projects within a budget year.

Sustaining growth and inclusion

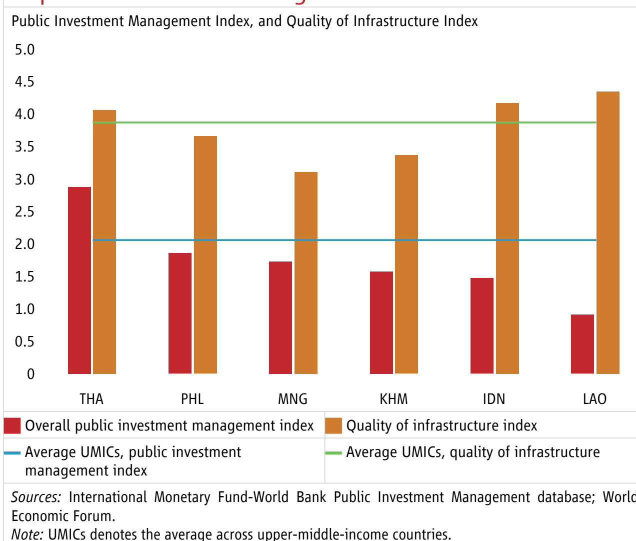
Over the longer term, sustaining growth and ensuring that its fruits are widely distributed will require redoubled efforts across a range of areas. While priorities will necessarily be country specific, some are important across the region.

In China, the commitment to facilitate the rebalancing from investment-led to consumption-led growth, as part of a program to increase overall productivity, needs to be complemented by continued efforts to reduce poverty and promote inclusion. Measures to address financial and fiscal vulnerabilities, as discussed above, will also support long-term growth. More broadly, the role of market discipline in allocating resources and credit, including through financial sector reforms, should be enhanced to ensure that resources are allocated toward the most productive uses. Despite China's success in reducing poverty, a large share of its population remains

vulnerable to poverty, and significant rural-urban gaps in income and basic public services persist. Tackling this will require improvements in access to services for the rural population, and for the still growing number of migrants to the cities. In addition, there is scope to better target and monitor social assistance programs, and to promote vocational training and business opportunities in rural areas. Reforms to land management and institutions would both improve the efficiency of rural and urban land use, and reduce rural-urban income disparities (World Bank and Development Research Center of the State Council, P. R. China 2014).

Across the rest of the region, more and better infrastructure holds the potential to promote domestic and international connectivity, facilitate integration into regional value chains and the shift to higher-value-added activities, and ensure gains from continued urbanization. Most of the region, and in particular Indonesia, the Philippines, and Vietnam, suffers from significant infrastructure gaps across all sectors (Figure I.C.1). Examples of transportation bottlenecks include inefficient port facilities in most of the region excluding China, poor-quality roads in lower-income countries such as Vietnam, and inadequate inter-island transportation in Indonesia, the Philippines, and the Pacific Islands. Power generation and distribution issues include persistent power shortages in Vietnam, and approximately 100 million (mainly rural) people lacking access to electricity across the region. In addition, water, sanitation, and housing services are facing significant strains across the region,[12] including in higher-income Indonesia, the Philippines, and Thailand, reflecting both urban-rural divides in service delivery, and the challenges of rapid urbanization.

Figure I.C.1. Quality of infrastructure, and efficiency of public investment management



Sources: International Monetary Fund-World Bank Public Investment Management database; World Economic Forum.
Note: UMICs denotes the average across upper-middle-income countries.

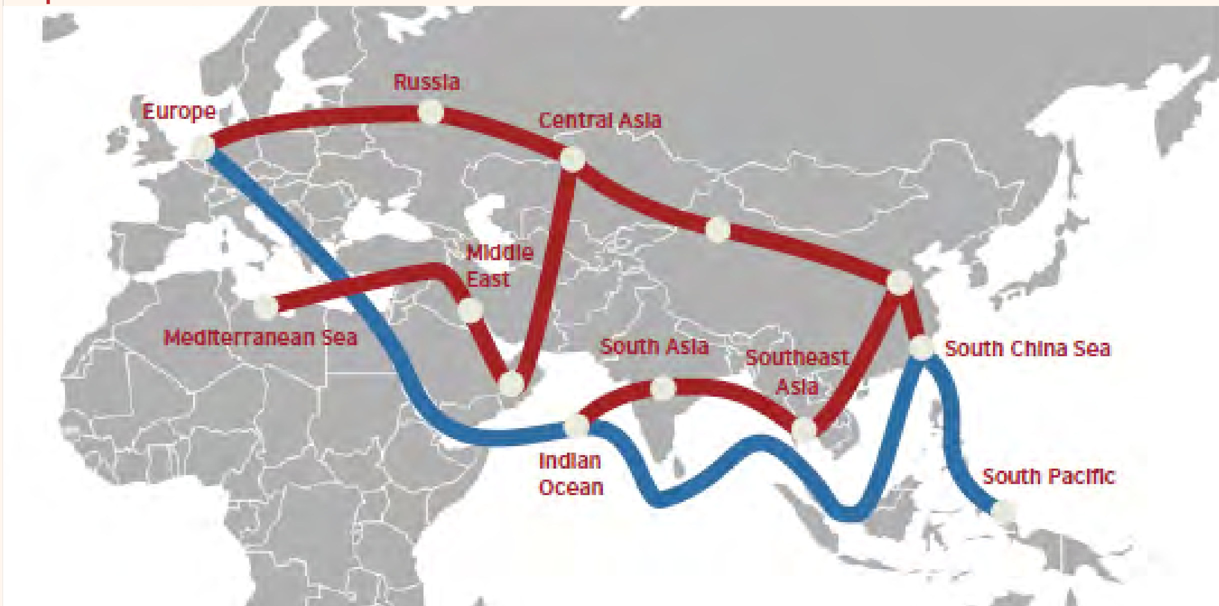
Infrastructural investment, including transportation improvements in the context of the Belt and Road initiative, or appropriate infrastructure for special economic zones, may yield significant gains. Across much of the region, public capital expenditure is relatively low and has been on a downward trend in recent years. Several countries, and in particular Indonesia and the Philippines, have underinvested in infrastructure for decades. Increased expenditure could yield large returns, especially given continued low borrowing costs. The Belt and Road initiative may serve as a useful framework to coordinate investments across countries both inside and outside the region, and potentially as a source of additional finance. The planned new and improved railways alone would significantly reduce average freight transportation times, yielding large trade gains for most countries in developing EAP (Box I.C.2). The benefits would be particularly large for countries that are more integrated in regional and global value chains, where producers would enjoy more timely delivery of inputs; exports would increase by 6 percent or more in China, Thailand, Cambodia, and Malaysia. Quality infrastructure also plays a critical role in enabling special economic zones to grow, generate jobs, and contribute to poverty reduction, export diversification, and regional development (Box I.C.3). Indeed, well designed infrastructure has a much

12 In developing EAP excluding China, fully one-third of households living on between US$3.10-a-day and US$5.50-a-day (2011 PPP), and even 15 percent of households living on between US$5.50-a-day and US$15-a-day (2011 PPP), lack access to one or more of clean water, good-quality housing and, to a lesser degree, sanitation.

Box I.C.2. The Trade Effects of the Belt and Road Initiative[1]

In 2013, President Xi of China proposed the Belt and Road Initiative to boost economic integration in the Eurasia region. This ambitious project aims at improving transport infrastructure, lowering trade barriers, deepening financial cooperation, and building stronger people-to-people bonds. The pillars of this initiative are the Silk Road Economic Belt and the 21st Century Maritime Silk Road (Map BI.C.2.1). The "Belt" focuses on building four new land corridors: the Eurasian Land Bridge, and the China-Mongolia-Russia, China-Central Asia-West Asia, and China-Indochina Peninsula economic corridors. The "Road" focuses on improving the maritime connectivity of China's coast with Europe, through the South China Sea and the Indian Ocean, and with the South Pacific. Related to the Belt and Road Initiative are the land corridors China-Pakistan and Bangladesh-China-India-Myanmar. Available estimates indicate that the plan, if fully implemented, would cost between US$4 trillion and US$8 trillion.

Map BI.C.2.1. Overview of the Belt and Road Initiative



Source: China-Britain Business Council.

This box analyzes the potential trade effects of the new and improved rail infrastructure proposed as part of the Belt and Road Initiative, using a combination of geographic and economic analysis. First, georeferenced data and geographical information systems (GIS) analysis are used to compute the reduction in bilateral trade time induced by the proposed (new or improved) railway infrastructure (Map BI.C.2.2).[2] This analysis incorporates information on the relative share of different transportation modes

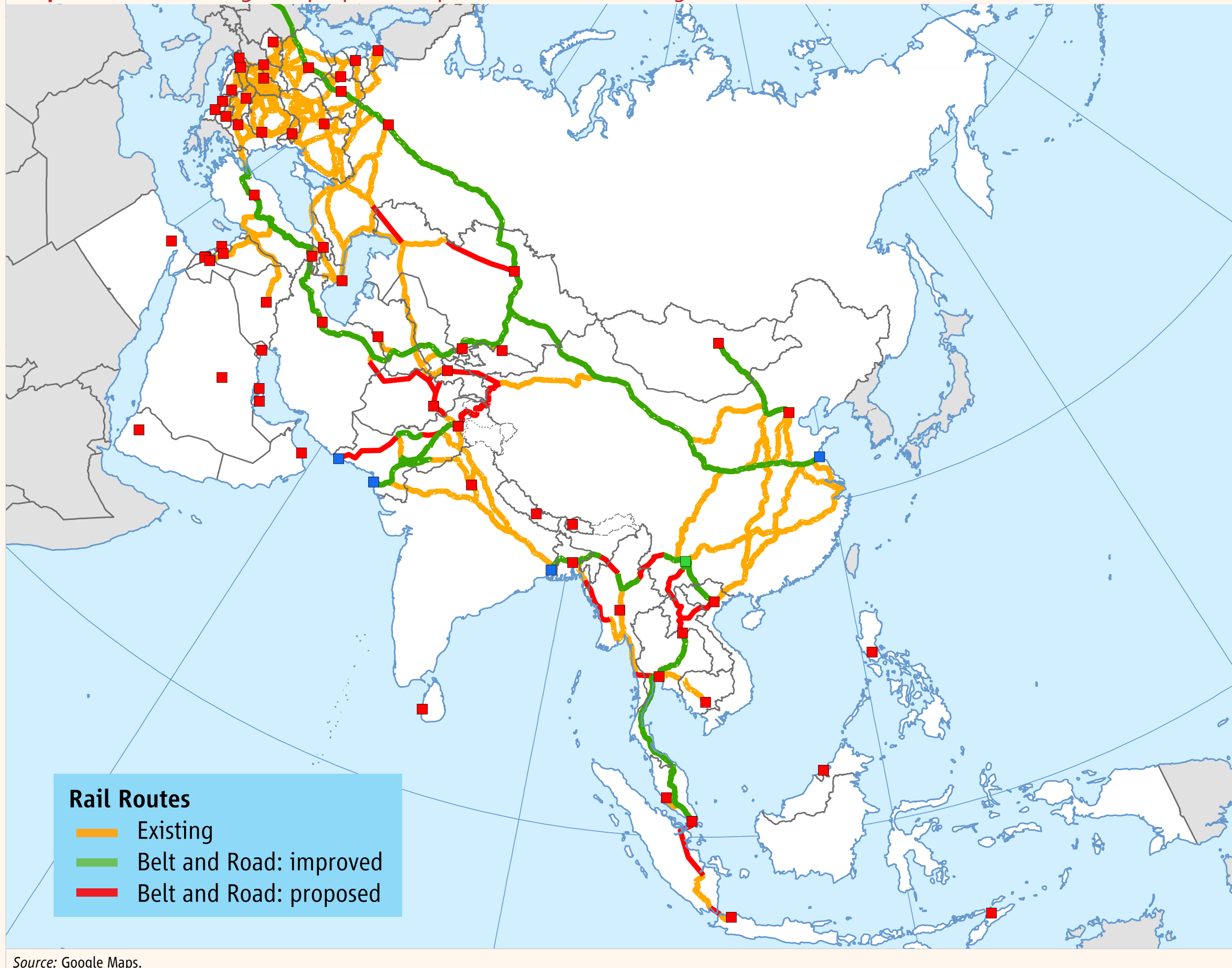
(continued)

1 Prepared by Suprabha Baniya (Department of Economics, Purdue University), Siobhan Murray (DECDG, World Bank), and Nadia Rocha and Michele Ruta (Trade and Competitiveness Global Practice, World Bank). Based on Baniya et al. (Forthcoming).

2 The impact of the Belt and Road (B&R) Initiative is estimated by measuring connectivity (defined as the bilateral travel time in hours by rail) between capitals and major cities in the Eurasian countries under two scenarios: before the proposed interventions (pre-B&R) and after the interventions (post-B&R). Routing is determined by minimum travel time, computed as a function of distance and speed. Speed along the new and improved railroads is assumed to equal 75 kilometers per hour, while speed in the pre-B&R scenario is assumed to equal 50 kilometers per hour. Improvements in sea, air, or road networks are not explicitly included in the analysis, owing to lack of information. Instead, the estimates control for the fact that goods can be shipped using different transportation modes, and that for certain products there is scope to switch transportation modes (see Baniya et al., Forthcoming, for details).

(Box I.C.2 continued)

Map BI.C.2.2. Existing and proposed/improved rail routes along the Belt and Road



Source: Google Maps.

in the export of different products. Second, econometric analysis is used to estimate the total effect of any given improvement in bilateral trade time on bilateral export values. This analysis captures the impact of both consumers' preference for faster delivery of final goods, and producers' need for timely delivery of inputs. It also takes into account that different products are affected differently by changes in trade times.[3]

(continued)

3 The analysis adopts the specification:

$$lnX_{ijg} = \beta_0 + \beta_1 GisTime_{ij} * t_g + \beta_2 GisTime_{ij} * \tilde{t}_g + Fixed\ Effects$$

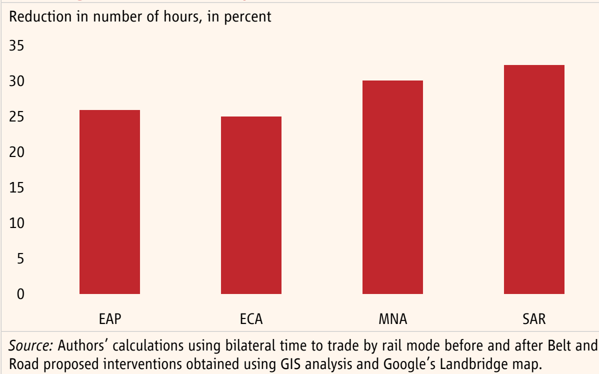
X_{ijg} is the bilateral export value of product *g* from country *i* to country *j* in 2013 (that is, pre-B&R).
$GisTime_{ij}$ is the shortest travel time from country *i* to country *j* using rail transportation in 2013 from the GIS analysis. For those country pairs ij for which there is no rail connection in 2013, a matching technique is adopted: pre-B&R bilateral travel times are computed as the average of the travel times of a set of "nearest neighbor" trade pairs, which are matched to the pair *ij* based on the physical distance between the trade partners.
t_g is the consumption time sensitivity of product *g*, which captures how much consumers are willing to pay for fast delivery of this product (direct effect). $\tilde{t}_g$ is the production time sensitivity of product *g* and reflects how intensely producers demand the timely delivery of their inputs (indirect effect). The direct and indirect time sensitivities are computed in Hummels and Schaur (2013) and in Baniya (Forthcoming), respectively.
The specification also includes a large set of fixed effects, and a number of other variables suggested by the relevant literature. The estimation technique addresses potential endogeneity problems.

(Box I.C.2 continued)

Finally, the actual impact of the Belt and Road on bilateral trade flows is calculated by combining the above GIS and econometric estimates.[4]

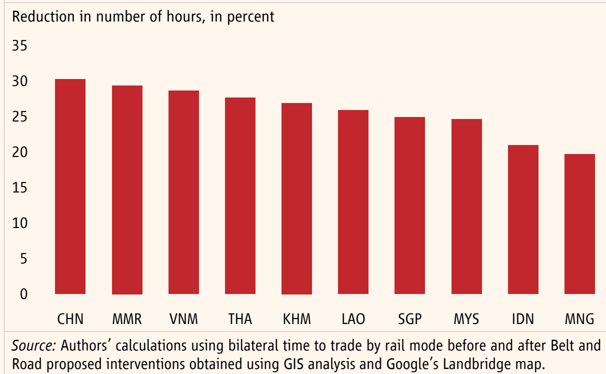
The Belt and Road rail initiative would both create new connections in the Eurasian region and reduce trade time along existing rail links by 26 percent, on average. Average trade time reductions for individual developing regions range between 25 percent and 32 percent (Figure BI.C.2.1). Within developing EAP, trade time is reduced most, by around 30 percent, for China, and by 25 percent or more for Cambodia, Lao PDR, Myanmar, Thailand, and Vietnam (Figure BI.C.2.2).

Figure BI.C.2.1. Percentage decreases in time to trade after Belt and Road railway improvements, by region (average across trade partners)



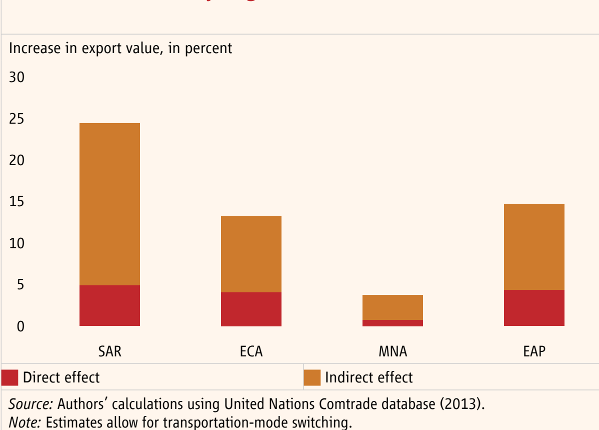
Source: Authors' calculations using bilateral time to trade by rail mode before and after Belt and Road proposed interventions obtained using GIS analysis and Google's Landbridge map.

Figure BI.C.2.2. Percentage decreases in time to trade after Belt and Road railway improvements by country (East Asia and Pacific)



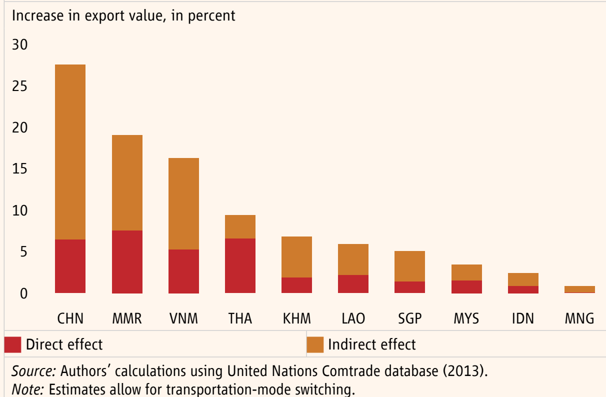
Source: Authors' calculations using bilateral time to trade by rail mode before and after Belt and Road proposed interventions obtained using GIS analysis and Google's Landbridge map.

Figure BI.C.2.3. Percentage increase in export values in Belt and Road by region (direct and indirect effects)



Source: Authors' calculations using United Nations Comtrade database (2013).
Note: Estimates allow for transportation-mode switching.

Figure BI.C.2.4. Percentage increase in export values in Belt and Road by country, East Asia and Pacific (direct and indirect effects)



Source: Authors' calculations using United Nations Comtrade database (2013).
Note: Estimates allow for transportation-mode switching.

(continued)

4 The impact is estimated by calculating:

$$\Delta lnX_{ijg} = 100 * ((\beta_1) t_g + (\beta_2) \tilde{t}_g) * \Delta GisTime_{ij}$$

(β_1) and (β_2) are the estimated coefficients of the direct and indirect effects of timeliness. $\Delta GisTime_{ij}$ is the change in trade time between the pre-B&R and post-B&R scenarios for countries *i* and *j*. The estimates are aggregated across products to obtain the effect of B&R on export values across sectors and countries.

(Box I.C.2 continued)

Belt and Road rail improvements would significantly increase total Eurasian trade. A plausible upper-bound estimate is that trade would increase by 13 percent. This assumes that faster trade times benefit both consumers (direct effect) and producers (indirect effect), and that trade in all products can switch transportation modes relatively easily to take advantage of the improved rail links. A lower-bound estimate is that trade would increase by 1.3 percent. This assumes that faster trade times benefit consumers alone, and that there is no switching between different modes of transportation.

Belt and Road rail improvements would lead to significant trade gains for most countries in EAP. All developing regions would experience substantial trade gains (Figure BI.C.2.3). Within developing EAP, the gains would be largest for China, Thailand, Cambodia, and Malaysia, where exports would increase by more than 6 percent (upper-bound estimates) (Figure BI.C.2.4). Differences across countries reflect both the extent of improved connectivity, and the export structure of the country—time-sensitive products and products that require time-sensitive inputs into production are more strongly impacted. In general, the biggest trade gains stem from improvements in trade times for inputs whose timely delivery is highly valued by producers. Put differently, countries that are more integrated in regional and global value chains tend to benefit more from reductions in trade times.

Significant uncertainty attaches to these estimates. First, Belt and Road is a fluid project: details of infrastructure investment are not known, and specifics will obviously affect the time to trade. Second, a full assessment would need to incorporate other factors (for instance, the potential for improved infrastructure to stimulate exports of new products). Third, infrastructure improvements are just one element of Belt and Road; reduction in trade barriers and other forms of international cooperation are likely to contribute further to the deepening of trade relations. This suggests that the above findings may provide a conservative estimate of the trade impact of Belt and Road.

greater impact on the success of special economic zones than tax incentives or regulatory exemptions. That said, the numerous examples of special economic zones that failed to thrive despite large investments point to the importance of a focus on the efficiency of investment (see below).

A rebalancing of public expenditure, and greater public-private cooperation, will help address infrastructure deficits. Even in countries where overall public expenditure has been increasing, such as Mongolia and the Philippines, there is significant scope to redirect spending toward productivity-enhancing areas. Likewise, in Cambodia, where the public service wage bill is rising rapidly, the policy focus should shift to raising public investment. The private sector can play a significant complementary role in addressing infrastructure deficits, but this will require improvements to the regulatory framework for public-private partnerships, aimed at curtailing regulatory risk and supporting fair, open competition.[13]

Increased infrastructure expenditure must be accompanied by a focus on ensuring value for money, and tackling underlying legal and regulatory barriers to project implementation. To meet the objectives of public infrastructure programs, increased expenditure allocations need to be complemented by reforms to improve the efficiency of public investment. Managing public investment programs already constitutes a significant challenge across much of the region (Figure I.C.1), and performance could deteriorate further in the face of rapid scale-

13 World Bank (2015a), Box I.C.1, "Public-Private Partnerships in Infrastructure in East Asia and Pacific".

ups of expenditure. In general, rigorous, transparent, and accountable processes for project selection, appraisal, procurement, and evaluation, and for the efficient operation and sustained maintenance of assets, need to be developed and strengthened across the region. In Indonesia, public infrastructure investment faces significant challenges with respect to project selection, project management, and procurement and budget processes. In Thailand, the currently fragmented planning and budgeting process would benefit from integration. In Vietnam, project implementation by local governments and SOEs is often significantly delayed. In Myanmar and Timor-Leste, among other countries, public investment management frameworks are still undeveloped and ambiguous. Several countries have manifested a commitment to reform, but the focus must now shift to implementation.

Such efforts to enhance productivity must be complemented by a renewed focus on boosting inclusion. Much of the region has seen broad-based growth in living standards over the past few years. But both poverty and challenges to inclusiveness remain elevated in several countries, especially in rural and lagging areas, for instance in Indonesia and the Philippines, and among disadvantaged groups, including ethnic minorities in Vietnam (Box I.A.2). Three issues are highlighted below.

First, undernutrition leads to lifelong disadvantage; reducing it would significantly increase human welfare, promote inclusion, and foster growth in much of developing EAP. High levels of undernutrition persist in many countries in the region, even relatively affluent ones.[14] Infant and child undernutrition, in particular, generate health and cognitive deficits that are difficult to reverse. As a result, undernutrition elevates the risk of infant and child morbidity and mortality, leads to increased expenditure on health care and social safety nets, lowers the efficiency of investments in education, and decreases lifelong income-earning potential and labor force productivity. Further, undernutrition and poverty are mutually reinforcing, with significant implications for equality of opportunity and the intergenerational transmission of inequality.

Reducing undernutrition will require coordinated measures across a range of areas; early childhood development programs hold particular promise. Undernutrition is the outcome of multiple factors including poor maternal, infant, and child caring and feeding practices; limited availability and affordability of nutritious foods; limited access to preventive and primary health care, clean water, and appropriate sanitation; and the low social status of women. But many high-return, operationally proven strategies are available to tackle the problem (Chapter II.A, "Tackling Malnutrition in East Asia and the Pacific–An Agenda for Growth and Inclusion"). For instance, early childhood nutritional interventions, targeting the critical window of opportunity from conception through the first two years of life, cost relatively little but have long-lasting effects on nutritional status. As a result, they also enhance long-term learning outcomes and labor market productivity, especially when combined with broader early childhood stimulation (Gertler et al. 2014; World Bank 2015b). Specific measures include behavior change and communication interventions to ensure optimal nutrition and care during pregnancy and early childhood; micronutrient interventions and deworming to enhance the consumption of essential vitamins and minerals; and complementary feeding interventions to reduce acute malnutrition.

Second, technological developments hold great promise for transforming financial services across low- and middle-income economies, with significant implications for financial inclusion and productivity. Digital technologies accessed via mobile platforms, big data, and cloud computing are enabling the rapid emergence of

14 Even in upper-middle-income countries, such as Indonesia and the Philippines, undernutrition rates exceed those found in some much poorer countries in Sub-Saharan Africa and South Asia.

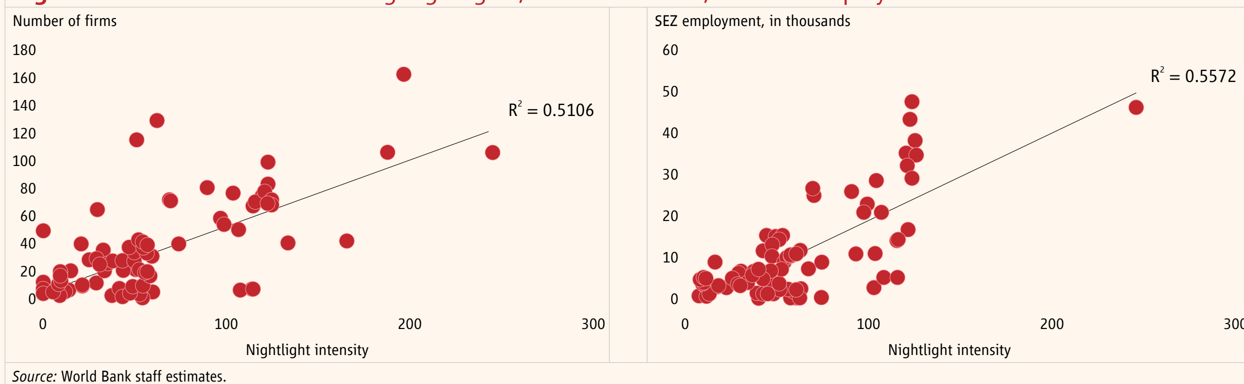
Box I.C.3. Special Economic Zones and Economic Performance: Lessons from East Asia[1]

Cities, regions, and countries across the emerging world are increasingly developing Special Economic Zones (SEZs). There are approximately 3,500 SEZs in more than 130 countries, directly employing approximately 68 million people. Their goal is to drive growth, generate employment, attract foreign direct investment, and narrow the technology gap with more developed countries. East Asia spearheaded the development of SEZs: the Republic of Korea introduced its first special economic zone in 1970 (Masan), the Philippines in 1975 (Bataan), China in 1980 (Shenzhen, Zhuhai, Shantou, and Xiamen), and Vietnam in 1991 (Tan Thuan).

SEZs share common characteristics, but differ in significant ways across countries, and even within (mostly large) countries. Key common factors include a geographically defined area; a specific regulatory and legal framework for firms within the zone (for instance, fast-track business registration, easier import and export licensing, and flexible application of labor laws); dedicated, subsidized infrastructure; and a special fiscal and incentive regime (for instance, duty-free status, tax holidays, and skills-training and land-rental subsidies).[2] However, the detailed application of these factors may differ across zones.

The policy objectives behind SEZs are largely similar. They include increased economic activity, job creation, increased household incomes, poverty reduction, export diversification, and regional/spatial development. Firm-level objectives are related to attracting foreign direct investment; boosting firms' investment, innovation, productivity, profitability, and growth; and enhancing cross-firm coordination and networks.

Figure BI.C.3.1. Correlation among nightlights, number of firms, and SEZ employment



Source: World Bank staff estimates.

Despite the proliferation of SEZs, there is surprisingly little evidence on their economic impact, or on the factors that determine their success. In particular, there is a dearth of large comparative quantitative analyses of the drivers of SEZ success. Previous studies have tentatively identified some determinants of success, such as the establishment of a clear policy objective and an institutional framework to implement an SEZ policy, experience in dealing with investors and understanding market demand, the location of economic zones and infrastructure planning within SEZs, and linkage programs to encourage spillovers to

(continued)

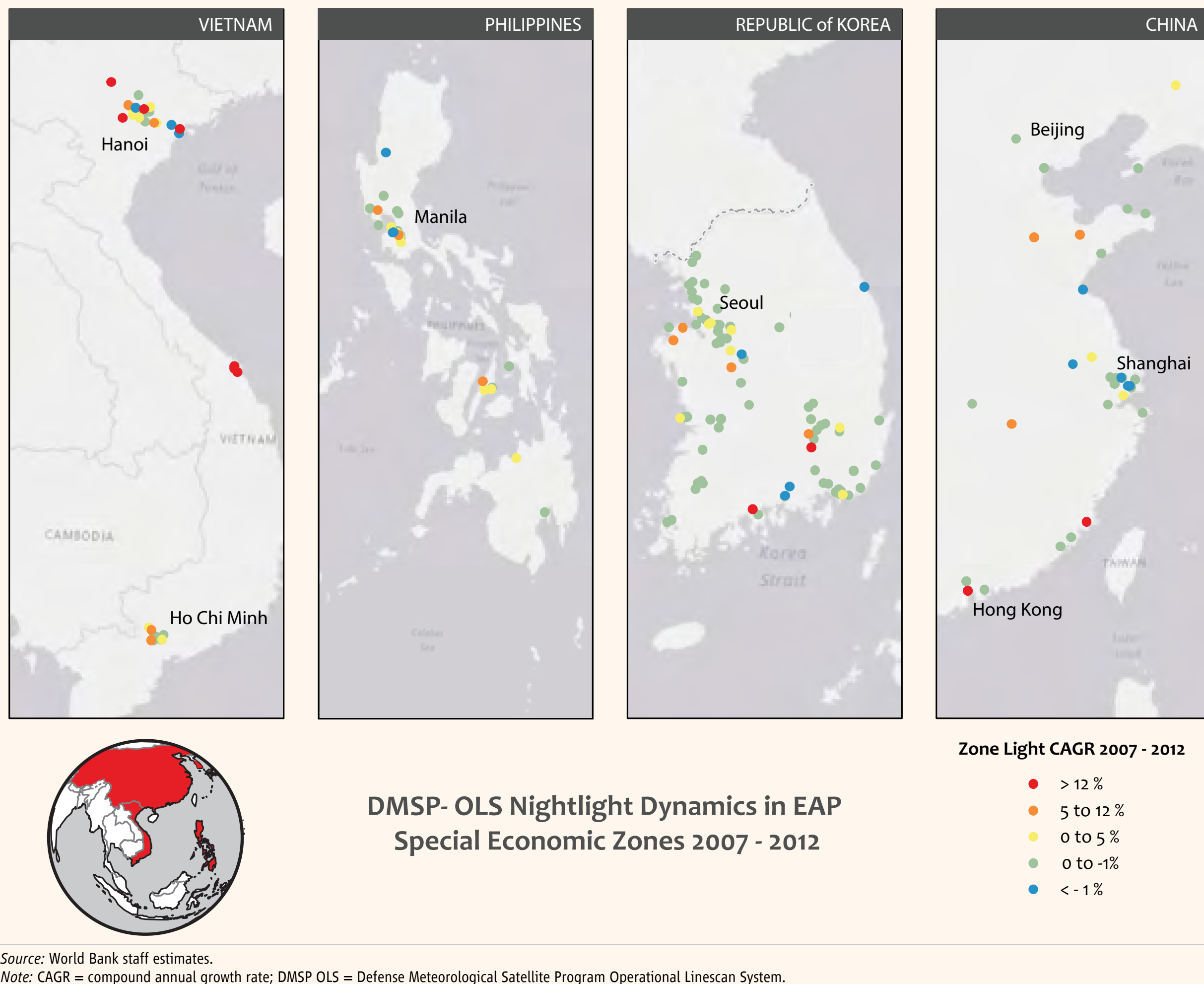
1 Prepared by Johanne Buba, Susanne Frick, Andres F. Garcia, Keith Garrett, Elliot Rasmuson, Andres Rodriguez-Pose, and Michael Wong (Trade & Competitiveness Global Practice, World Bank).

2 SEZs include free trade zones, export processing zones, industrial parks, and other types of zones. For precise definitions of these and related terms, see Akinci and Crittle (2008).

(Box I.C.3 continued)

the broader local economy (Farole 2011). However, the statistical evidence is typically weak. And case studies have tended to focus only on the most successful zones (for instance, Shenzhen). The scarcity of analyses is related partly to the relative novelty of SEZs, but more fundamentally to lack of adequate comparable data about their performance. Data on firm growth, export performance, and job creation in most SEZs across the emerging world are scarce and, when available, there are often questions about their reliability. Hence, alternative data sources on SEZ performance are needed.

Figure BI.C.3.2. The performance of SEZs in EAP varied considerably between 2007 and 2012



Source: World Bank staff estimates.
Note: CAGR = compound annual growth rate; DMSP OLS = Defense Meteorological Satellite Program Operational Linescan System.

Ongoing World Bank research[3] is filling this analytical gap, using changes in night-time light data ("nightlights") as a proxy for the economic performance of SEZs. The use of nightlights has become increasingly common in the social sciences, because they are available for areas of the world where standard economic data are not. Previous studies covering areas with sufficient conventional data have also shown that

(continued)

3 "Enhancing World Bank Group Support for SEZs," financed by the Competitive Industries and Innovation Program.

(Box I.C.3 continued)

there is a strong correlation between changes in nightlights and in economic activity. However, nightlights tend to underrate economic activities that emit less light, including, in particular, agriculture and services. The suitability of nightlights for this analysis was confirmed by collecting alternative performance measures, specifically data on the number of companies and on employment, for a number of SEZs. These alternative measures are clearly and positively associated with nightlights (Figure BI.C.3.1).

Table BI.C.3.1. Performance of 149 SEZs in China, Korea, the Philippines, and Vietnam

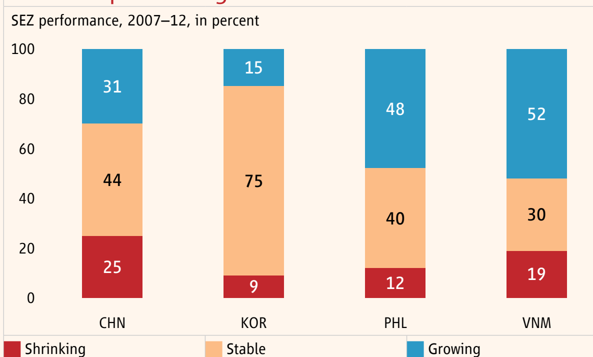
Country	*Number of zones*	*Average growth (%)*	*Economic performance (%)*		
			Shrinking	*Stable*	*Growing*
China	32	8	25	44	31
Korea, Rep.	65	1	9	75	15
Philippines	25	6	12	40	48
Vietnam	27	16	19	30	52

Source: World Bank staff estimates.
Note: The shrinking group includes those zones whose light emissions shrank by more than 5 percent during 2007–12, the stable zones are those that remained within a +/- 5 percent range over the entire period, and the growing group are those SEZs with an increase in nightlights by more than 5 percent.

This research focuses on 237 SEZs located in 17 countries, of which more than half were located in four East Asian countries—China, Korea, the Philippines, and Vietnam (Table BI.C.3.1). The initial sample included over 1,000 SEZs; strict criteria relating to the size, start-up date, type of activity in the zone, and data availability were used to determine the final sample.[4]

The performance of SEZs varies considerably between and within countries. Between 2007 and 2012, on average, zones in Vietnam were the most dynamic; those in Korea grew relatively slowly (Figure BI.C.3.2). However, each East Asian country had relatively well-performing and badly performing SEZs. This held true when looking at the 10 best-performing and worst-performing SEZs in East Asia.[5] Also, each country had some zones that grew, some that remained stable, and some that shrank, although Vietnam had a relatively large share of expanding zones, and Korea a significantly larger share of stable zones (Figure BI.C.3.3). The contrasts between the best and worst performers were at times staggering in Vietnam and China,[6] but smaller in Korea and the Philippines.[7]

Figure BI.C.3.3. China, Korea, the Philippines, and Vietnam had a combination of well-performing and less-well-performing SEZs



Source: World Bank staff estimates.
Note: Components may not sum to 100 owing to rounding.

(continued)

4 Some industrial parks are also included, because they provide different fiscal regimes.

5 Of the 10 best-performing SEZs in East Asia, 4 were located in China and 4 in Vietnam. But even relatively low-performing Korea had 2 zones among these top performers. At the same time, China had 2, Korea had 3, and Vietnam had 4 of the 10 worst-performing SEZs in East Asia. The Philippines had none of the 10-best performing SEZs, and 3 of the 10 worst-performing ones.

6 In Vietnam, the top 2 performers grew on average by 90 percent per year, but the 2 worst performers contracted by 9 percent. Similar trends were observed in China, where the top 2 performing zones grew by 75 percent per year, while the bottom 2 performers shrank by 11 percent.

7 Although in the Philippines the 2 least dynamic zones shrank by 21 percent per year.

(Box I.C.3 continued)

SEZ performance is critically influenced by the local and national contexts in which they operate. Zones operating in relatively low-cost locations, preferably in the vicinity of and well connected to large markets, and in areas with previous specialization in manufacturing have performed better. Given the low-tech nature of many successful zones, the role of factors such as local skills and levels of agglomeration has been more limited. Moreover, the economic growth of zones spilled over to neighboring areas, but this impact was in general limited to the immediate vicinity of the zone.

SEZ characteristics also play a significant role in the growth of zones and the surrounding area. In general, successful zones tend to build on local strengths. Relatedly, the technological component of the zone has an impact: low-tech, low-cost manufacturing zones on average performed better than those pursuing higher-tech, more research-intensive paths. Recent efforts to upgrade the technological component of zones have not yet paid off. Also, more recently established zones are on average characterized by significantly higher growth than older, more mature zones. However, there are exceptions; some of the most dynamic zones in Korea and the Philippines were already set up in the 1990s.

In contrast, incentive programs to attract investment have had an uneven impact on SEZ performance. Overall, these programs, in which East Asian countries have invested heavily, made little substantial difference to the economic trajectory of SEZs, implying that caution is required when setting up the programs. The most common type of incentive, corporate tax breaks, had a limited effect on performance; the impact was relatively larger in more developed countries. Similarly, neither exemptions from local labor regulations nor the presence of one-stop shops made a significant difference to zone dynamism. Utility subsidies, in contrast, played a considerable role in the initial growth of SEZs; however, they provide no guarantee that economic performance will be sustained beyond the initial years of operation.

new financial products and business models. Examples include marketplace finance (equity and debt crowdfunding), and cashless payment technologies, including mobile payments. Developing EAP is well placed to benefit from such developments. The region is technologically advanced, with a high level of mobile phone penetration (including in lower-income Cambodia, Lao PDR, and, increasingly, Myanmar) and internet access, widespread use of social media and electronic commerce, and a significant global role in ICT manufacturing and software development. At the same time, developing EAP still lags in terms of access to financial services (for instance, only 30 percent of individuals hold bank accounts), raising the economic and social payoff to successful innovation.

Significant reforms are needed to harness the full potential of new technology for financial development and inclusion. In particular, countries across the region will need to strengthen the relevant legal and regulatory frameworks; improve their financial infrastructure, including the breadth and depth of borrower credit data; and address challenges related to financial capability, consumer protection, and privacy (Chapter II.B, “How will technology disrupt financial services in EAP?”).

Third, innovations in social protection can significantly reduce vulnerability to shocks and minimize their long-term impact among the poor. In the face of major shocks, the poor and vulnerable often have to cut their spending on education and health care or sell productive assets, with a permanent impact on their human development and income-earning potential. Natural disasters are a particular concern, both because of

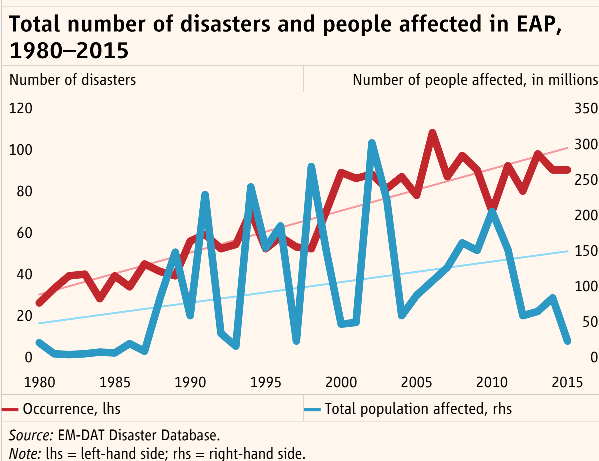
their relative frequency in the region, and because the poor often live in vulnerable areas. Policy makers should therefore build on ongoing efforts to develop "adaptive safety nets". These systems flexibly take into account the exposure of households to different risks by, for instance, rapidly expanding conditional cash transfer programs while waiving their conditions in the wake of natural disasters (Box I.C.4). In turn, these features help increase resilience at both the household and macroeconomic levels.

The long-term outlook for growth and inclusion in the Pacific Island Countries (PICs) hinges on their ability to maximize the benefits from their limited opportunities, including fisheries, migrant workers, and tourism. Three priorities stand out. First is fully harnessing the potential riches of tuna fisheries. Recent policy measures have already sharply increased revenue from fishing fees and enhanced sustainability. Further reforms could yield significant additional revenue gains, but need to be underpinned by expanded investments in policy delivery capacity, including partnerships with regional and international organizations (Box I.C.5). Second is expanding opportunities for PIC residents to work abroad. Remittance flows to the PICs as a share of GDP are already among the largest in the world, with very large diasporas relative to the size of their resident population. Nevertheless, existing regional seasonal worker programs, such as Australia's and New Zealand's, are heavily oversubscribed, and new or enlarged migration pathways could significantly increase income-earning opportunities. To that end, policy must focus on providing potential migrants with marketable skills, offering better employment intermediation services to both workers and employers, and introducing social support services to mitigate the impact of the temporary separation of family members (Box I.C.6). Finally, the tourism sector, currently reliant on its traditional Australian and New Zealand markets, could be significantly boosted by improvements in connections and facilities to serve the potentially much larger East Asian market.

Box I.C.4. How Adaptive Safety Nets Can Mitigate the Impact of Natural Disasters[1]

The EAP region is the most disaster prone in the world. Both the frequency and severity of disasters in EAP have been rising since 1980 (Figure BI.C.4.1). Over this period, more than 3.5 billion people have been affected by natural disasters, and the region has sustained some US$525 billion in losses (nearly a quarter of total global losses from natural disasters). The region is highly exposed to disasters of all types, from "black-swan" events such as Typhoon Yolanda (Haiyan) in the Philippines in 2013 and Tropical Cyclone Winston in Fiji in early 2016, to persistent smaller-scale disasters like flash floods and landslides. According to the World Risk Index, which characterizes disaster risk for 173 countries, 6 of the 10 most at-risk countries in the world are located in EAP: Vanuatu (1st), Tonga (2nd), the Philippines (3rd), the Solomon Islands (5th), Cambodia (8th), and Papua New Guinea (9th).

Figure BI.C.4.1. Increasing frequency and severity of natural disasters in EAP



Source: EM-DAT Disaster Database.
Note: lhs = left-hand side; rhs = right-hand side.

(continued)

1 Prepared by Jesse Doyle and Virginia Horscroft.

(Box I.C.4 continued)

Restoring aggregate economic growth is a significant macroeconomic policy concern in the wake of natural disasters, but natural disasters also have the potential to adversely affect poverty and shared prosperity. The poor are generally more exposed to negative impacts from natural disasters, because they live in more vulnerable areas and more vulnerable housing, hold a higher proportion of their assets in material—and thus physically vulnerable—forms, and depend on subsistence production for a higher proportion of their food consumption. Because the poor tend to have low savings and poor access to credit and insurance, they are more likely to have to rely on negative coping strategies in the face of major shocks, such as reducing essential food consumption, health care spending, or educational investment; and selling productive assets. These negative coping strategies adversely affect their human development and reduce their future income-earning potential. If not addressed, natural disasters can leave the poor with permanently lower productive capacities, undermining efforts to alleviate poverty and boost shared prosperity.

In recognition of the severe impact natural disasters can have on the poor, governments in the EAP region are increasingly investing in adaptive safety nets. Building on existing social protection programs, these take into account the exposure and vulnerability of households to different risks and how social protection can help them respond and cope. They are flexible in their ability to incorporate new design characteristics and scale, both vertically (higher benefit levels) and horizontally (reaching a wider segment of the population) following natural disasters. In the Philippines, following Typhoon Yolanda in 2013, the government waived the conditions (relating to school attendance and child health) of its conditional cash transfer program, the Pantawid Pamilyang Pilipino Program (4Ps), for a defined period in affected areas. This demonstrated the potential of social protection programs to deliver assistance quickly to affected populations in the wake of natural disasters, with existing beneficiaries receiving US$12.5 million. Moreover, other development partners, including the World Food Programme and UNICEF, were able to channel their assistance to the poor in affected areas more effectively through the 4Ps system. The government is actively looking to build on this experience through the adoption of an Emergency Cash Transfer program that is able to deliver cash transfers to an even larger share of affected households following natural disasters. It is also looking at measures that can help households prepare ex ante (the 4Ps, for instance, already included family development sessions aimed at addressing disaster preparedness).

This year, following Tropical Cyclone Winston, Fiji became the first Pacific Island Country to channel postdisaster assistance through its existing safety net. With wind speeds of up to 306 kilometers per hour, Tropical Cyclone Winston was one of the most powerful cyclones ever recorded in the Southern Hemisphere and the first Category 5 cyclone to directly strike Fiji. Total damage and losses to the productive, social, and infrastructure sectors were estimated at 22 percent of GDP, rising to 31 percent of GDP with damage to the environment and losses in ecosystem services. The highest per capita damage and losses were incurred in areas where average household incomes are lower, primarily because the cyclone struck a path across rural Fiji where average household incomes are lower—itself correlated with an increased propensity to use nonrobust housing materials—and where agriculture is of overwhelming importance to livelihoods. The government swiftly mobilized funds through its existing social protection programs to channel assistance to poor households and vulnerable groups. The 22,802 households covered by the Poverty Benefit Scheme were paid a lump sum of US$300 each, while a further 21,095 households and individuals covered by the Care & Protection Allowance for vulnerable households and the Social Pension Scheme for the elderly

(continued)

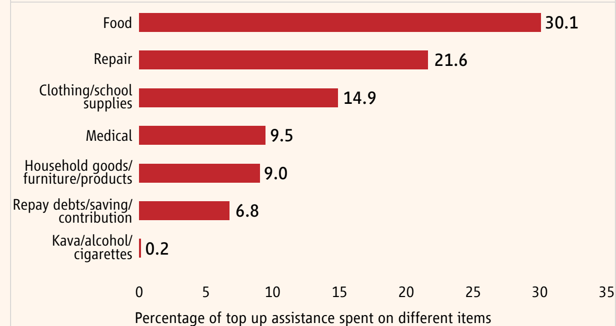
(Box I.C.4 continued)

received US$150 each. This was equivalent to three months of their regular benefits and was designed to help poor households and vulnerable groups meet their immediate expenses for basic needs.

In an initiative that will have global relevance, the Government of Fiji has supported a comprehensive impact evaluation of this postdisaster assistance. The initial results from the evaluation suggest that poor households did suffer severe losses in the wake of Tropical Cyclone Winston, and that adaptive safety nets were effective in assisting them to cope. Of all households that received additional cash assistance, 37 percent lost their entire dwelling, 74 percent sustained damage to their roofing, and 49 percent lost their crops or harvest. Within four weeks, the majority of households had spent their entire additional social assistance, with 99 percent of expenditure on "essential items." Food and materials to repair damaged dwellings formed the two most important categories of expenditure, followed by clothing and school supplies. Less than 1 percent of the assistance was spent on kava (a narcotic sedative drink), alcohol, and cigarettes, addressing a common concern that additional social assistance would be used unwisely for "nonessential items" (Figure BI.C.4.2).

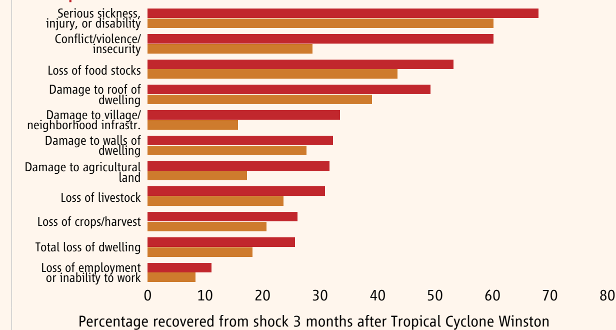
Three months after the cyclone, the preliminary analysis suggests that beneficiaries under the Poverty Benefit Scheme were more likely to have recovered from the shocks they faced, relative to comparable households that did not receive the additional assistance. This includes recovering from sickness or injury; repairing their dwelling; replenishing their food stocks; remedying damage to their agricultural land; repairing village or neighborhood infrastructure; and resolving problems of conflict, violence, or insecurity (Figure BI.C.4.3).

Figure BI.C.4.2. The majority of assistance in Fiji was spent on "essential items"



Sources: Fiji Bureau of Statistics; World Bank Tropical Cyclone Winston Impact Evaluation.

Figure BI.C.4.3. Beneficiaries of adaptive safety nets are quicker to recover from shocks



Sources: Fiji Bureau of Statistics; World Bank Tropical Cyclone Winston Impact Evaluation.

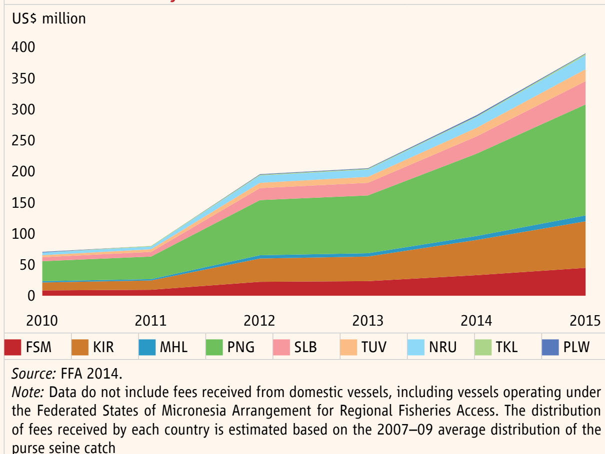
Investments in adaptive safety nets can help countries in the EAP region achieve their poverty alleviation goals, boost shared prosperity, and strengthen macroeconomic resilience. The experience to date in EAP demonstrates that in the wake of natural disasters, adaptive safety nets have the potential to mitigate the impact of natural disasters on poor households and vulnerable groups. By reducing their need to resort to negative coping strategies, adaptive safety nets can help to protect their investments in human development and preserve their income-earning potential. By helping to maintain the productive capacities of the least well-off in the wake of natural disasters, adaptive safety nets contribute to the postdisaster recovery of aggregate economic growth, but they do so in a way that also helps to keep poverty alleviation efforts on course and that preserves the share of the bottom four deciles in aggregate prosperity.

Box I.C.5. Harnessing the Riches of Pacific Tuna Fisheries[1]

Pacific Island Countries (PICs) enjoy abundant tuna resources. Their waters supply some 34 percent of the world's tuna, with an estimated delivered value to processors of around US$3.4 billion in recent years (FFA 2014). Their three key fisheries (purse seine, tropical longline, and southern albacore longline) form the basis of several global supply chains, with tuna caught in PIC waters ending with consumers in Europe, Japan, or North America (Gillett 2014). PICs can charge harvesters fees for access to the fish stocks found in their waters. The greater the profitability of fishing, the higher the fees that harvesters can afford to pay.

Recent policy reforms in PICs have dramatically increased the revenue they receive from the purse seine fishery. Before 2009, PICs received relatively constant access fees of approximately US$60 million per year from (largely foreign) harvesters, typically amounting to less than 10 percent, and in some cases 5 percent, of the value of the fish when sold to processors (FFA 2014). In 2009, the eight PIC members of the Parties to the Nauru Agreement (PNA),[2] where the vast majority of purse seining takes place, agreed to establish a new access regime called the vessel day scheme.[3] Access fees paid to PICs have increased to approximately US$400 million per year since the introduction of the vessel day scheme (Figure BI.C.5.1), and in 2014 equaled 13 percent of the value of the catch at sale to processors (FFA 2014). The impact on public revenue has been significant for a number of PICs.[4] The reforms are now being extended; arrangements similar to the purse seine vessel day scheme have recently been introduced by PICs for longline fisheries.[5]

Figure BI.C.5.1. Estimated tuna purse seine access fees received by Pacific Island Countries



Source: FFA 2014.
Note: Data do not include fees received from domestic vessels, including vessels operating under the Federated States of Micronesia Arrangement for Regional Fisheries Access. The distribution of fees received by each country is estimated based on the 2007–09 average distribution of the purse seine catch

These reforms have also enhanced sustainability. The expansion of global tuna fishery supply chains had led to growing concerns about overexploitation. The vessel day scheme sets a cap on total fishing activity in line with scientists' recommendations for maintaining a stock that can support the maximum sustainable yield, thereby protecting the region's natural capital asset base. This cap has remained relatively constant since the introduction of the vessel day scheme. However, a key challenge emerging in recent years has been the change in the status of the bigeye tuna stock to overfished.[6]

(continued)

1 Prepared by John Virdin, Director of Ocean and Coastal Policy, Nicholas Institute for Environmental Policy Solutions, Duke University. Based on a background study for the forthcoming World Bank *Pacific Possible* report.

2 The Federated States of Micronesia, Kiribati, the Marshall Islands, Nauru, Palau, Papua New Guinea, the Solomon Islands, and Tuvalu.

3 The vessel day scheme sets a collective cap on purse seine fishing in PNA waters, translates that cap into a common currency ("vessel day," that is, a fishing day by a vessel), agrees on a minimum benchmark price that countries will charge harvesting units for vessel days (though countries may charge more, in some cases testing auctions), and allocates the cap of vessel days to countries according to an agreed formula (Havice 2013). The eight members of the PNA were subsequently joined in the scheme by Tokelau.

4 In 2014, access fees amounted to 36 percent of GDP in Tuvalu, 32 percent in Kiribati, 10 percent in the Federated States of Micronesia, 4 percent in the Marshall Islands, and 3 percent in the Solomon Islands.

5 In 2015, the PNA countries began a vessel day scheme for the tropical longline fishery, and in late 2014, 10 countries signed the Tokelau Arrangement to implement a similar scheme for access to the southern albacore longline fishery (Havice McCoy, and Campling 2014).

6 Bigeye tuna have traditionally been harvested by the tropical longline fishery. They are increasingly harvested by the purse seine fishery (41 percent of bigeye catch in 2014), with juveniles being unintentionally caught in the nets.

(Box I.C.5 continued)

There are five key priorities for further policy reforms to sustainably enhance the contribution of the region's tuna resources to its economic growth in the coming decades:

1. **Broadened regional cooperation.** Existing coalitions of PICs could be expanded to include other key resource owners, such as Indonesia and the Philippines in the purse seine arrangements, and Indonesia in the tropical longline arrangements. This would place most of the world's skipjack tuna stock under one cooperative, robust management scheme. This should be coupled with continued restrictions on fishing in the high seas for vessels that want to fish in the waters of PNA members.
2. **Hard limits on fishing effort and catch.** This will ensure sustainability of tuna stocks, as well as constrain supply, and hence increase price. Rebuilding the bigeye tuna stock before further declines will require proactive efforts and upfront investments, including research and development to reduce by-catch coupled with regulations on fishing gear.
3. **Increased flexibility of fishing access rights,** for instance, by increasing the duration of access rights, pooling access rights (that is, offering rights to access multiple countries' waters), eventually denominating access rights in terms of catch quota rather than inputs (that is, days that a vessel may fish), and potentially allowing auctions of rights. This will provide fishing companies with enhanced flexibility and security, in turn enhancing the value of the fisheries without increasing production. It will also afford interested PICs a tool to leverage greater foreign investment in processing, trading off access fees for foreign investment in local processing.
4. **Significant investment in skills and capacity for fisheries management.** The goal is to develop highly skilled tuna managers, improve compliance with catch limits and access rights, and prevent illegal fishing.
5. **Inclusion of coastal communities in the fisheries.** This will require targeted investments to maintain food security, given stagnating coastal fish supplies and growing populations.

Continued, expanded investment in policy delivery capacity must underpin such reforms. The focus should be on increasing the capacity of the regional agencies that support the information base underlying fishing limits and compliance monitoring, of the secretariats of regional coalitions that set fishing limits, and of the national agencies developing and implementing policy within countries' waters. Tools include expanded staffing, training, partnerships with regional and international organizations, and dedicated regional programs and activities.

Such a coordinated reform package would yield significant economic benefits to PICs, largely in the form of increased public revenues received from foreign operators. By 2040, public revenues would increase on a sustainable basis by US$177 million to US$345 million per year (55 to 107 percent of 2014 public revenues), even after deducting required investments, including in administration, monitoring, and surveillance (Table BI.C.5.1).[7] And, in the PICs with local processing clusters, aggregate local value added would increase by US$88 million per year (specifically, by 8 percent, 0.3 percent, and 1.3 percent of 2014 GDP in the Marshall Islands, Papua New Guinea, and Solomon Islands, respectively), and 7,500 to 15,000 additional jobs (less than 0.5 percent of the regional labor force) would be created.

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7 The analysis employs all data available through 2015 on trends in the growth of Pacific tuna fisheries since the 1950s, the structure and extent of current value chains, and current contributions to GDP, employment, and sustainability. It controls for the impact of trends in key exogenous factors, including climate change, global macroeconomic outcomes, science and technology, demography, and external governance. It largely draws on databases and published reports from the Western and Central Pacific Fisheries Commission and the Secretariat of the Pacific Community, supplemented by consultations with experts.

(Box I.C.5 continued)

Table BI.C.5.1. Net economic gains from reform of tuna fisheries, in 2040

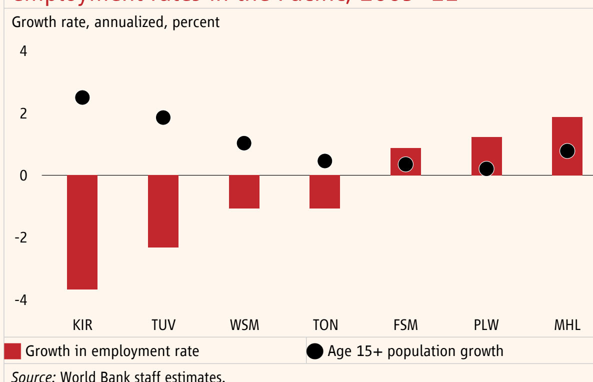
	Public revenue		*GDP*		*Employment*	
	US$ million	*% of est. 2014 tuna revenue*	*US$ million*	*% of 2014 GDP*	*Number of jobs*	*% of 2014 labor force*
Fiji	5.3	—	0	0	0	0
Federated States of Micronesia	26.1–48.7	77.9–145.4	0.7	0.2	0	0
Kiribati	56.1–104.5	100.5–187.3	0	0	0	0
Marshall Islands	-1.4–+5.0	-28.6–+100.2	15.3	8.0	1,275–2,550	—
Nauru	10.0–19.0	59.9–113.8	0	0	0	0
Palau	3.2–6.0	228.6–428.6	0	0	0	0
Papua New Guinea	32.8–84.0	24.8–63.4	57.0	0.3	4,950–9,900	0.1–0.3
Samoa	3.9	—	0	0	0	0
Solomon Islands	14.7–29.1	52.7–104.3	15.3	1.3	1,275–2,550	0.6–1.1
Tokelau	4.4–8.4	314.3–600.0	0	0	0	0
Tonga	2.0	—	0	0	0	0
Tuvalu	14.5–23.6	104.3–169.8	0	0	0	0
Vanuatu	5.1	—	0	0	0	0
Total	***176.7–344.6***	***60.9–118.8***	***88.3***	***0.4***	***7,500–15,000***	***< 0.5***

Sources: World Bank staff estimates; World Development Indicators.
Note: For the purse seine fishery, the distribution of gains is indicative, and is estimated from the distribution of the location of catches, extrapolating from the moving average for 2007–09. For the southern albacore fishery, the distribution of revenues is based on MRAG (2015).

Box I.C.6. Boosting Labor Mobility in the Pacific[1]

Given the geography, size, and changing demographics of the Pacific, labor mobility offers an important pathway to poverty reduction and shared prosperity. The Pacific Island Countries face a triple burden of economic geography as a result of their small size, remoteness, and internal dispersion. Kiribati, for example, is set out across 3.5 million square kilometers of ocean (approximately the land mass of India), but with a population equivalent to less than 1 percent of Mumbai's. These structural characteristics coupled with a high exposure to natural disasters have limited the region's ability to generate economic growth and jobs. Moreover, many Pacific Island Countries are witnessing rapidly growing populations and a youth bulge—the fertility rates across the Pacific are almost double the EAP average. As a result, many parts of the region have seen employment rates decline at a time when working-age populations are increasing (Figure BI.C.6.1). Employment rates are estimated to be less than 50 percent of the working-age population across most Pacific Island Countries. When these countries are unable to bring jobs to the people, it becomes necessary to bring the people to where jobs are located.

Figure BI.C.6.1. Growth in populations and employment rates in the Pacific, 2005–11



Source: World Bank staff estimates.

While access to overseas job opportunities varies across the Pacific, it remains severely constrained for the vast majority, especially those who live in poorer countries. There are three groups of countries, with differing access to overseas labor markets. First are the Marshall Islands, Micronesia, and Palau, which enjoy free and unhindered access to labor markets in the United States, under the Compact of Free Association. The number of emigrants equals about one-third of these countries' resident populations. Second are Fiji, Samoa, and Tonga, where the number of emigrants equals 26 percent of the resident populations, mostly as the result of historical ties with Australia and New Zealand and bilateral migration agreements with the latter. However, even in these two groups of countries, the poor face constraints on taking advantage of available migration opportunities, given the high costs of migration and their lack of tradable skills. Most important, the vast majority (95 percent) of the population of the Pacific live in the low mobility countries of Papua New Guinea, the Solomon Islands, and Vanuatu, and in the atoll countries of Kiribati and Tuvalu. Migration opportunities remain mostly out of reach in these economies, which on average are also relatively poor; the number of emigrants is less than 1 percent of their population.

The World Bank's forthcoming *Pacific Possible* report examines potential benefits over the next 25 years if both labor-sending and labor-receiving countries around the Pacific Rim were to significantly remove barriers to labor migration and undertake complementary measures. Key proposed reforms in the receiving countries include expanding access through existing migration pathways, such as the seasonal worker schemes and the working holiday programs in Australia and New Zealand; opening up access to new labor markets, such as in the Republic of Korea via its Employment Permit System; providing access to new sectors, like aged care, through programs tailored for the Pacific; and expanding opportunities for permanent migration, especially for the low mobility and atoll countries most impacted by

(continued)

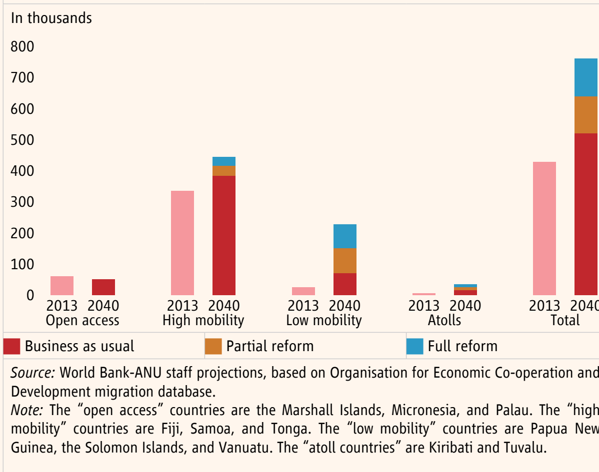
1 Prepared by Jesse Doyle and Manohar Sharma.

(Box I.C.6 continued)

climate change. The Pacific Island labor-sending countries can develop appropriate education and training systems that provide potential migrants with marketable skills; provide better employment intermediation services to both workers and employers; and introduce support services to mitigate the negative social impacts of labor mobility, especially those that arise from the temporary separation of family members working in seasonal employment schemes. Managing potential brain drain through sensible domestic wage policy will also be necessary.

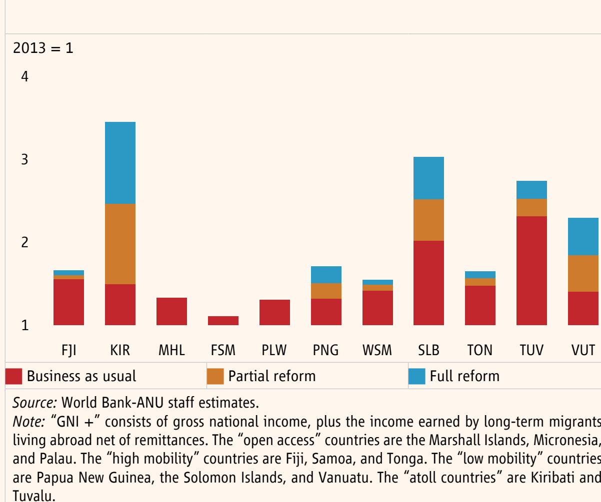
These migration reforms could lead to significant growth in the number of migrants and the employment opportunities they enjoy. The report considers three scenarios: business as usual, partial reform,[2] and full reform.[3] With full reform, the total number of Pacific migrants in 2040 would be approximately 50 percent larger than under business as usual (Figure BI.C.6.2). Relative to 2013, the migrant stock would increase ninefold in low mobility countries, and almost sixfold in atoll countries.

Figure BI.C.6.2. Stock of Pacific migrants under the business-as-usual, partial reform, and full reform scenarios



Source: World Bank-ANU staff projections, based on Organisation for Economic Co-operation and Development migration database.
Note: The "open access" countries are the Marshall Islands, Micronesia, and Palau. The "high mobility" countries are Fiji, Samoa, and Tonga. The "low mobility" countries are Papua New Guinea, the Solomon Islands, and Vanuatu. The "atoll countries" are Kiribati and Tuvalu.

Figure BI.C.6.3. Income ("GNI +") per capita in 2040 under the three scenarios



Source: World Bank-ANU staff estimates.
Note: "GNI +" consists of gross national income, plus the income earned by long-term migrants living abroad net of remittances. The "open access" countries are the Marshall Islands, Micronesia, and Palau. The "high mobility" countries are Fiji, Samoa, and Tonga. The "low mobility" countries are Papua New Guinea, the Solomon Islands, and Vanuatu. The "atoll countries" are Kiribati and Tuvalu.

The reforms would also yield significant welfare gains. With full reform, migrants' incomes would increase by around US$10 billion (approximately one-third of current gross national income), and remittances to the Pacific Islands by around US$800 million. The impacts would vary substantially across countries, and be relatively large in the low mobility and atoll countries (Figure BI.C.6.3). Moreover, the impacts of higher migration from the Pacific on receiving countries would be minimal, because employed Pacific migrants would account for an insignificant share of receiving country populations (for instance, about 1 percent in Australia). The gains with partial reform are half as large as with full reform. These findings suggest that labor mobility will prove critical in addressing the Pacific's unemployment challenge and raising living standards in the face of limited domestic growth.

2 Including, in particular, the introduction of a new resident visa program for Pacific Islanders in Australia, some opening up of new sectors for temporary workers in Australia and New Zealand, and improved access to jobs in Korea.

3 Including, in particular, further expansion of the programs considered under the partial reform scenario, and the introduction of an open access policy for Kiribati and Tuvalu in Australia.

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Part II. Medium-Term Development Agenda

II.A. Tackling Malnutrition in East Asia and Pacific–An Agenda for Growth and Inclusion[1]

Malnutrition, which encompasses both undernutrition and overnutrition, presents a significant challenge to continued economic growth in developing East Asia and Pacific (EAP). The persistence of high levels of undernutrition despite decades of economic growth and poverty reduction represents a staggering, yet avoidable, loss of human and economic potential. Undernutrition elevates the risk of infant and child morbidity and mortality, increases expenditure on health care and social safety nets, lowers the efficiency of investments in education, and decreases lifelong income-earning potential and labor force productivity, with the potential to be transmitted across generations. Overnutrition compounds the challenges. Overweight rates in Southeast Asia and the Pacific have risen rapidly in the last three decades. A continuation of this trend will lead to escalating costs of managing and treating overweight/obesity and diet-related noncommunicable diseases, and present immense challenges for financing health systems.

Appropriate policy responses to malnutrition will vary across the region, depending on the degree and type of malnutrition. Overall, many high-return, operationally proven strategies are available. But successfully addressing the challenge requires tackling the critical determinants across multiple sectors. In particular, undernutrition is not solely a function of poverty. Its drivers include maternal and child-caring practices, partly shaped by inadequate information; food security; access to health, clean water, and appropriate sanitation; and the social status of women. Comprehensive behavioral and nutritional interventions from conception through early childhood hold particular promise for ensuring that every child reaches his or her full physical and cognitive potential.

I. Investment in Nutrition in EAP: An Essential Foundation for Sustained Economic Growth

Malnutrition, encompassing both undernutrition and overnutrition, presents a significant development challenge across much of East Asia and Pacific (EAP). With the exception of the small Pacific Island Countries (PICs), all of the region's lower-income countries face an unfinished agenda with regard to undernutrition. In these countries, at least one in five children (under age five) will likely face lifelong learning and productivity impairments due to stunted physical and cognitive development. Simultaneously, the growing prevalence of overweight and obesity, among both children and adults, generates large societal and economic costs. The associated noncommunicable diseases (NCDs), the cost of managing and treating them, the inevitable premature deaths, and the impact on productivity (Bloom et al. 2011) are enormous challenges facing the region.

Widespread malnutrition in EAP is symptomatic of market failures that have a significant impact on welfare and urgently require corrective public action. Continued economic growth by itself will not solve all the underlying problems, certainly not for decades—a period during which much of the population would

1 Prepared by Nkosinathi Vusizihlobo Mbuya and Anne Marie Provo, with guidance from Toomas Palu and Meera Shekar (all with the Health, Nutrition, and Population Global Practice, World Bank).

suffer irreparable damage. There is a small window of opportunity—before age three—to provide the adequate nutrition and stimulation to maximize brain development. Further, growth itself will be undermined by persistent malnutrition. Also, some market failures reflect equity considerations. Malnutrition and poverty are mutually reinforcing, with the wealth disparities in reading, language, and cognitive performance emerging even before children enter primary school. Investing in early life can contribute to inclusive growth by addressing inequality in access to services, and giving poor children the greatest opportunity to break the cycle of poverty and improve adult outcomes. In addition, reductions in malnutrition rely on the provision of various public goods, including essential information (for instance, on healthy child-caring practices and diets) and public services. And much of the cost of malnutrition is borne by the wider community, through public financing of health systems, giving society a stake in reducing relevant risk factors, including by facilitating behavioral changes.

High-return, operationally proven investments in malnutrition are available; in many cases they require coordinated multisectoral strategies. Interventions targeted at the early years of life (between conception and transition into primary school) to reduce malnutrition and increase access to early childhood care, stimulation, and learning are necessary in order to ensure that from birth, every child in EAP has the greatest possible opportunity to reach his or her full potential to learn, earn, innovate, and compete. Global evaluations of development assistance have consistently shown that nutrition interventions are highly cost-effective, and are among the highest-return investments available to governments and donors.[2] Interventions in the child's first five years of life have much higher rates of return than interventions aimed at addressing skills and capacities in later life. The impact of interventions is magnified when they are undertaken early and are implemented across multiple sectors.

II. Malnutrition in East Asia and Pacific

***Undernutrition* remains prevalent in many EAP countries, despite decades of strong economic growth and poverty reduction.** Chronic undernutrition, as proxied by childhood stunting, is associated with severe and largely irreversible cognitive (brain) underdevelopment (Box II.A.1). The prevalence of stunting in several EAP countries remains high compared to levels observed in other developing countries, and what would be expected given average GDP per capita. For instance, Indonesia and the Philippines are on the verge of achieving upper-middle-income status, yet have stunting levels comparable to (or even exceeding) some South Asian and Sub-Saharan Africa countries with considerably lower levels of economic development (Figure II.A.1). Relatedly, progress over time has been uneven. Indonesia, Lao PDR, the Philippines, and several PICs have seen only limited reduction in stunting; conversely, China has experienced a sharp decline in stunting (Figure II.A.2).

In some countries, undernutrition is a generalized phenomenon; in others, it mirrors broader inequalities in income and status. In Cambodia, Lao PDR, Papua New Guinea, and Timor-Leste, undernutrition is a generalized phenomenon that affects all segments of the populations. In Indonesia, the Philippines, and Vietnam, wealthier households have experienced significant improvements in stunting, but stunting remains high among the poor, rural, and marginalized subpopulations, such as ethnic minorities.

2 See, for instance, the Copenhagen Consensus Project (http://www.copenhagenconsensus.com/copenhagen-consensus-iii).

Box II.A.1. What exactly is malnutrition?

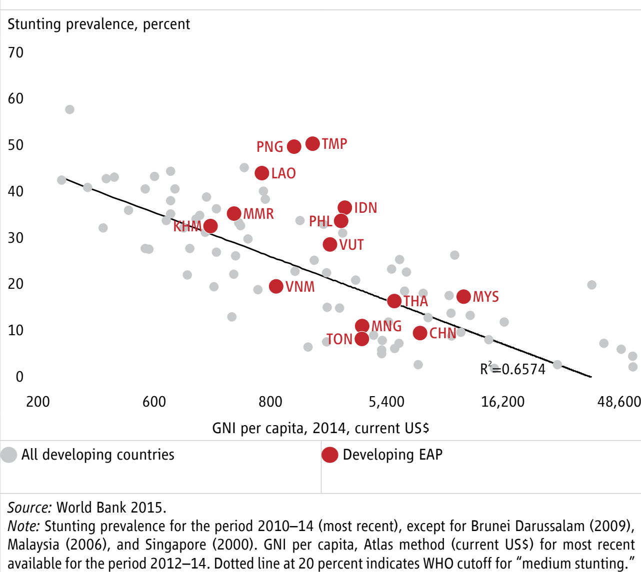
The term "*malnutrition*" refers to a deviation from optimal nutritional status, and includes both undernutrition and overnutrition.

Undernutrition refers to a state of nutritional deficiency and presents the most serious risks to health and development when experienced by women during pre-pregnancy/pregnancy/lactation and infant and young children. There are a variety of measures of undernutrition,[1] but child *stunting* (low height-for-age in children under five years of age) is the type of undernutrition of most concern for policy makers and the focus of this note. Stunting results from chronic undernutrition and indicates a failure of a child to attain the height expected among healthy children. Height growth and brain development not achieved during the first 1,000 days of life (from conception to two years of age) is largely irrecoverable and is associated with measureable negative consequences for health, cognition, productivity, and income across the life course (Horton and Hoddinot 2014; Victora et al. 2010).

Overnutrition represents an oversupply of nutrients (usually macronutrients) relative to the body's physiological needs. Overnutrition is often measured as high Body Mass Index (BMI), and a person is considered *overweight* if his or her BMI is equal to or greater than 25 kilograms per square meter (kg/m^2), and *obese* if BMI is equal to or greater than 30 kilograms per square meter.[2] Elevated BMI is a major risk factor for cardiovascular diseases, diabetes, musculoskeletal disorders, and some cancers.

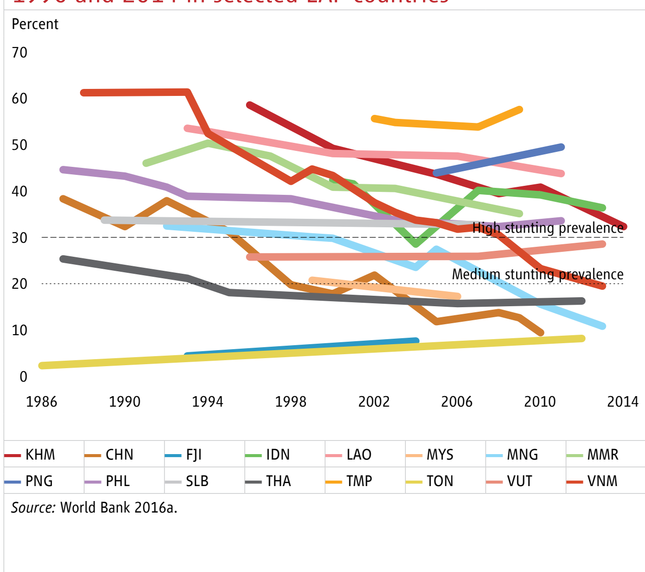
1. Additional measures of undernutrition at the population level include inadequate weight-for-height in children under five (wasting), low weight-for-age in children under five (underweight), short stature and thinness among pregnant women, and micronutrient deficiencies among adult and child subgroups, such as iron-deficiency anemia, iodine deficiency, and vitamin A deficiency.
2. BMI is calculated by dividing weight in kilograms by height in meters squared (kg/m2). BMI is a screening tool that provides the most useful population measure of increased health risks due to excess body fatness. However, it is not a perfect measure at the individual level because it does not measure body composition, that is, how much fat compared to muscle one has. Hence, the index can be misleading for individuals with high muscle tissue, which pushes up their weight. Nonetheless, BMI is highly correlated with gold standards of body composition measurement and, at the population level, BMI is still a reliable indicator of overnutrition.

Figure II.A.1. The stunting-income relationship



Source: World Bank 2015.
Note: Stunting prevalence for the period 2010–14 (most recent), except for Brunei Darussalam (2009), Malaysia (2006), and Singapore (2000). GNI per capita, Atlas method (current US$) for most recent available for the period 2012–14. Dotted line at 20 percent indicates WHO cutoff for "medium stunting."

Figure II.A.2. Changes in stunting prevalence between 1990 and 2014 in selected EAP countries



Source: World Bank 2016a.

Overnutrition presents a rapidly rising challenge. Globally, the prevalence of obesity and overweight has risen substantially in the past two to three decades. Within developing EAP, obesity has already reached pandemic levels in most PICs, where more than one-half of adult women are obese. In Southeast Asia, standard cross-country measures of overnutrition such as Body Mass Index (BMI) are low relative to other low- and middle-income regions (Figure II.A.3). However, such measures understate the magnitude of overnutrition-related health problems among East Asians.[3]

Figure II.A.3. Overweight rate (Body Mass Index > 25), adult females[1] > 20 years (age adjusted), by region, 1980–2008

Source: Haddad et al. 2014.
Note: "Asia, Southeast" comprises Indonesia, Malaysia, Myanmar, the Philippines, Sri Lanka, Thailand, and Vietnam. "Asia, East" comprises China; Taiwan, China; and Papua New Guinea.
1. We focus on female obesity because of its intergenerational consequences. Pre-pregnancy overweight or obesity is associated with increased risk of maternal and neonatal complications, including stillbirth and congenital anomalies. Moreover, offspring of obese women are more likely to develop obesity, diabetes mellitus, and cardiovascular diseases in their lifetime.

Figure II.A.4. Typology of malnutrition in EAP countries

Sources: Data from UNICEF-WHO-World Bank (2015) and World Health Organization (2015).
Note: ≥ 20 percent used as a cutoff for stunting because it is considered to indicate public health significance by WHO (2010). An internationally recognized population cutoff for adult overweight has not yet been established, so the threshold of 30 percent was chosen because it is higher than the 2014 global average for lower-middle-income countries.

Even based on standard measures, East Asia is "getting fatter, faster" than other regions. Overweight rates in Southeast Asia and the Pacific grew faster between 1980 and 2008 than anywhere else in the world. Between 2010 and 2014, Indonesia and Malaysia both experienced a 33 percent increase in the number of obese individuals, and Thailand a 27 percent increase. During the same period, the increase for the United Kingdom and the United States was only 10 percent and 8 percent, respectively.

Relatedly, several EAP countries demonstrate evidence of a growing problem of childhood overweight/obesity. Papua New Guinea (13.8 percent), Indonesia (11.5 percent), Thailand (10.9 percent), and Mongolia (10.5 percent) have childhood overweight prevalence similar to that of high-income countries such as Canada (10.4 percent), Argentina (9.9 percent), and Australia (7.7 percent) (UNICEF-WHO-World Bank 2015). The emergence of overweight at younger ages is a particular cause for concern. Without intervention, overweight infants and young children continue to be obese during childhood, adolescence, and adulthood and are at risk of premature onset of diet-related NCDs. Therefore, this spread of child overweight/obesity, combined with the rapid rise in adult overweight and obesity (albeit from a low base), suggests that the challenge will soon become much larger in the region.

Some EAP countries now face a *double burden of malnutrition*: both undernutrition and overnutrition occur simultaneously, sometimes within the same households, and even the same individual over time (Shrimpton and Rokx 2012). EAP countries

3 For instance, imaging technology that measures fat shows that Asians have more fat around their organs and in the belly area than do Europeans with the same BMI. As a result, for any given BMI, Asians face a greater risk than other races of developing overnutrition-related NCDs (such as type 2 diabetes mellitus and adverse cardiovascular outcomes) (Low et al. 2009; Wen et al. 2009). Consequently, alternative public health action cutoff points have been proposed for Asian populations, with a BMI of 23 to 27.5 denoting increased risk, and a BMI ≥ 27.5 denoting high risk (WHO Expert Consultation 2004).

demonstrate a high degree of heterogeneity in malnutrition, and can be classified into four categories based on their malnutrition burden (Figure II.A.4). "Red" countries, including Papua New Guinea, the Solomon Islands, and Vanuatu, face the dual burden of child stunting and adult overweight, that is, the seemingly paradoxical combination of undernutrition and overnutrition. "Orange" countries, including Indonesia, the Philippines, and Vietnam, have high stunting rates and lower but rising burdens of adult overweight. "Yellow" countries, including China, Malaysia, and many PICs, have high levels of adult overweight, but limited child stunting. And the "green" country of Thailand is experiencing neither challenge. The causes, consequences, and solutions to malnutrition vary by typology, and are discussed next.

III. The Impact of Malnutrition on Health and Growth

Malnutrition in developing EAP leads to a staggering loss of human and economic potential. Malnutrition affects health and economic growth through three key channels. It:

- Elevates the risk of morbidity and mortality, with the potential for transmission across generations.
- Decreases lifelong income earning potential and labor force productivity.
- Increases the costs of health care and social safety nets—largely borne by the public sector—and lowers the efficacy of investments in education.

As a result, the costs of child undernutrition in Asia may range from 4 percent to 11 percent of GDP (Horton and Steckel 2013).[4] Similarly, the global economic impact of obesity has been estimated at 2.8 percent of global GDP (Dobbs et al. 2014).

Morbidity, mortality, and disability

Undernutrition is the underlying cause of about 20 percent of maternal deaths and over 45 percent of child deaths globally each year (Black et al. 2008; Black et al. 2013). In many countries with high levels of stunting (orange and red countries including Cambodia, Lao PDR, Papua New Guinea, and Timor-Leste), child and maternal undernutrition remains among the top three risk factors for disability, morbidity, and premature mortality. At the regional level, child and maternal undernutrition were the greatest risk factors for death and disease in 1990, only to be displaced by dietary risks in 2013 (but still ranking ninth) (Table II.A.1). Undernourished children are more likely to suffer from serious infections and are at increased risk of death from common childhood illnesses such as diarrhea, measles, pneumonia, malaria, or HIV/AIDS.

Overnutrition, and in particular the loss of healthy life from high BMI, dietary risks, and the associated NCDs, are now the biggest health challenge facing the region, and in particular the high overweight burden countries. Excess fat accumulation is a known risk factor for cardiovascular disease (mainly heart disease

4 Undernutrition is estimated to yield annual losses of 2.5 percent of GDP in Cambodia (Bagriansky et al. 2014) and 2.4 percent of GDP in Lao PDR (Bagriansky and Voladet 2013). In Cambodia, nearly half of the damage accrues before the child is even born, and roughly one-third is due to stunting (Bagriansky et al. 2014). These estimates reflect the impact of child mortality, decreased productivity, and excess health care expenditures

and stroke), type 2 diabetes, and some cancers (endometrial, breast, and colon). In the region, healthy life years[5] lost due to high BMI increased by 81 percent between 1990 and 2013. Dietary factors (including diets high in sodium and low in fruits, vegetables, nuts and seeds, and whole grains) are the region's leading risk factor for death and disease; cardiovascular disease is the leading cause of death. In PICs such as Kiribati, the Federated States of Micronesia, Samoa, and Tonga, diabetes is the leading cause of death; at least one-quarter of deaths from NCDs in Tonga, Samoa, and Vanuatu are premature (IHME and World Bank 2013).

Table II.A.1. Rank of key nutrition-related risk factors for death and disease in select EAP countries, 2013

	High BMI	*Dietary risks*	*Malnutrition*	*Low physical activity*
Cambodia	8	1	3	13
China	6	1	12	9
Fiji	1	1	8	7
Indonesia	6	6	4	12
Lao PDR	9	9	1	13
Malaysia	3	1	12	8
Myanmar	7	4	5	14
Papua New Guinea	4	3	1	13
Philippines	7	1	4	13
Samoa	1	3	10	7
Thailand	5	1	13	12
Timor-Leste	14	2	1	12
Vietnam	9	1	6	13

Source: IHME and World Bank 2013.
Note: Risk factors are ranked 1 to 17 based on the total number of disability-adjusted life years per 100,000 in the country. High BMI refers to death and disease for which elevated BMI is a known risk factor. Dietary risks refers to diseases (mainly noncommunicable) for which a diet low in whole grains, fruits, and/or vegetables is a known risk factor.

The consequences of malnutrition can be passed from mother to offspring, resulting in the intergenerational transmission of impaired human capital. Stunted mothers are three times as likely to have undernourished infants, and between one-third and one-half of growth failure accrued by a child's second birthday can be attributed to poor growth as a fetus (Dewey and Huffman 2009). The scarcity of essential nutrients at key developmental points can trigger alterations to cell metabolism and a variety of tissues (including brain tissue). These metabolic alterations can cause permanent changes to the way in which sugars and fats are metabolized and accumulate in the body. Thus, early life undernutrition increases risk of later-life obesity and other NCDs (Godfrey et al. 2007). Similarly, obesity and hypertension among mothers is associated with higher infant mortality as well as obesity, hypertension, insulin resistance, and diabetes in later life (O'Reilly and Reynolds 2013).

Labor productivity

Malnutrition is associated with lower labor force productivity in both the short and long term. Many of the high stunting burden countries also experience a high burden of anemia among adults. Anemia[6] directly reduces work capacity, with a significant impact on agricultural labor capacity and output (Horton and Ross 2003).

5 Measured in disability-adjusted life years (DALYs): the sum of years lost due to premature death and years lived with disability.

6 Anemia (low number, size, and/or hemoglobin concentration of red blood cells) has multiple causes (including bacterial and parasitic infections, other nutritional deficiencies, genetic conditions, and blood losses), but the most common cause globally is iron deficiency

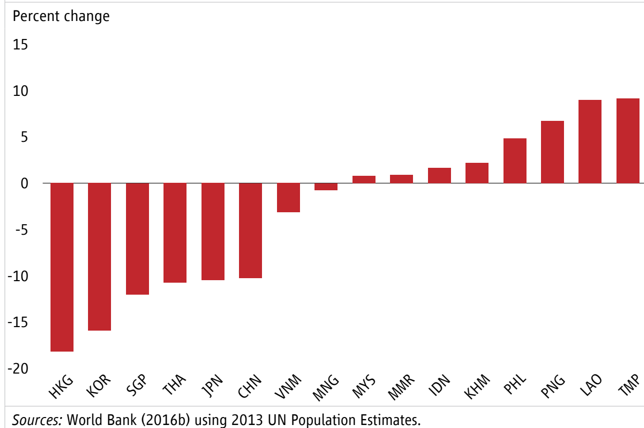
Similarly, obesity directly influences labor force productivity, owing to increased illness and lower productive output while working (Chenoweth 2005).

Poor early-life nutrition and childhood stunting lead to poorer learning outcomes in school, and decreased future productivity and earning potential. Stunting is associated with cognitive delays (Grantham-McGregor et al. 2007) and lower educational attainment.[7] Relatedly, stunting in childhood is associated with reduced height and productivity as an adult.[8] Conversely, children who are well nourished during their early years have 5 to 50 percent higher incomes as adults, and are 33 percent more likely to escape poverty (Hoddinott et al. 2011).

Malnutrition and poverty can generate a vicious cycle. Although many nonpoor people are undernourished, the prevalence of undernutrition is often two or three times—and sometimes many times—higher among the poorest income quintile than among the richest quintile. Poor people may therefore not be sufficiently well nourished and healthy to take advantage of broad improvements in income-earning opportunities. Conversely, creating an environment where children are not stunted increases the odds that they will escape poverty.

High childhood stunting will undermine the ability of countries to benefit from the demographic dividend. Countries with high stunting are in general also those that are yet to reap the full benefits of the demographic dividend, that is, the expansion in the relative size of the labor force (Figure II.A.5). New workers will be able to generate a demographic dividend, boosting growth and breaking the intergenerational cycle of poverty, only if they are well nourished.

Figure II.A.5. Expected relative change in working-age population, 15–64, 2010–40



Sources: World Bank (2016b) using 2013 UN Population Estimates.

Expenditure on health and social services

Malnutrition leads to increased, as well as less efficient, expenditure on health and social services, often borne by the public fiscal system. This reflects the impact of malnutrition on morbidity, mortality, and poverty (see above). Well-nourished populations are healthier and spend less on health care. In high stunting burden countries, maternal and child undernutrition translate into higher frequency and severity of illness, and therefore increased health care costs.[9]

In particular, overweight/obesity and the associated diet-related NCDs are a growing challenge from a health financing perspective. Direct health care costs related to treatment of obesity and associated chronic

7 On average, stunting and associated nutrient deficiencies can result in delays in starting school, loss of attained schooling (Hoddinott et al. 2013), and a higher likelihood of children dropping out of school. In addition, children suffering from iodine deficiency lose on average 13 IQ points, and iron deficiency anemia reduces performance on tests by 8 IQ points (World Bank 2006).

8 Several studies document associations between height and labor market outcomes (Hoddinott et al. 2013). For example, a 1 percent increase in adult height is associated with a 2.4 percent increase in productivity (Thomas and Strauss 1997). The effect may arise because adult height is a proxy for general health, social skills, and social class.

9 In Cambodia, for instance, undernutrition results in an additional US$10.3 million in public and private health care costs (Bagriansky et al. 2014).

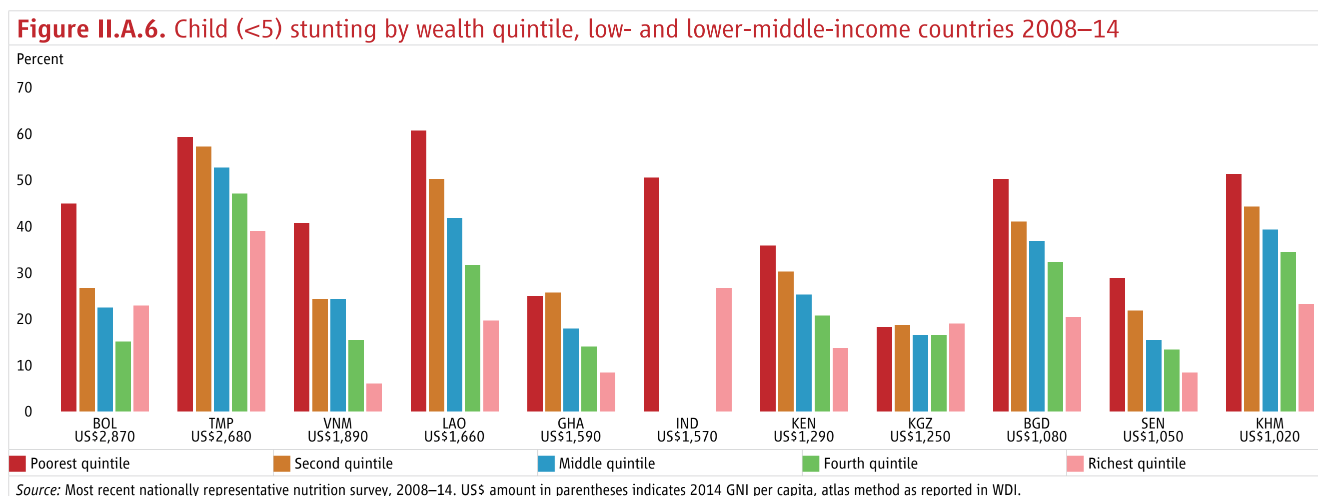
diseases are expected to increase in many EAP countries (Ng et al. 2014).[10] Relatedly, many countries with high stunting burden currently lack the capacity to identify overweight/obesity and treat associated diet-related NCDs. This may result in lower health care expenditures, but also in significantly increased disability and premature mortality.

Malnutrition also decreases the efficacy of spending on other social services, particularly education. As discussed, stunting is associated with cognitive delays, schooling deficits, and poorer learning outcomes. Therefore, in high stunting burden countries, between one-quarter and one-half of children are unable to realize the full benefit of public investments in education.

IV. Drivers of Undernutrition

Poor countries and poor households suffer from higher rates of undernutrition. At the country level, economic growth, particularly starting from low initial GDP, is associated with reductions in stunting.[11] Rising incomes enable improvements in access to sanitation, women's education, and the quantity and quality of food (Smith and Haddad 2015). Across most of the region, stunting rates are higher among poorer households (Figure II.A.6). Good nutrition is a long-term investment, and poor families lack the resources and knowledge to finance this investment.

Figure II.A.6. Child (<5) stunting by wealth quintile, low- and lower-middle-income countries 2008–14



Source: Most recent nationally representative nutrition survey, 2008–14. US$ amount in parentheses indicates 2014 GNI per capita, atlas method as reported in WDI.

However, undernutrition is not solely a function of poverty. Stunting rates vary widely even controlling for (country or household) income levels. In countries including Cambodia, Lao PDR, Indonesia, and Timor-Leste, stunting is prevalent even among the wealthiest quintile. This pattern is not unique to EAP: middle-income countries in Latin America, South Asia, and Africa display similar trends.

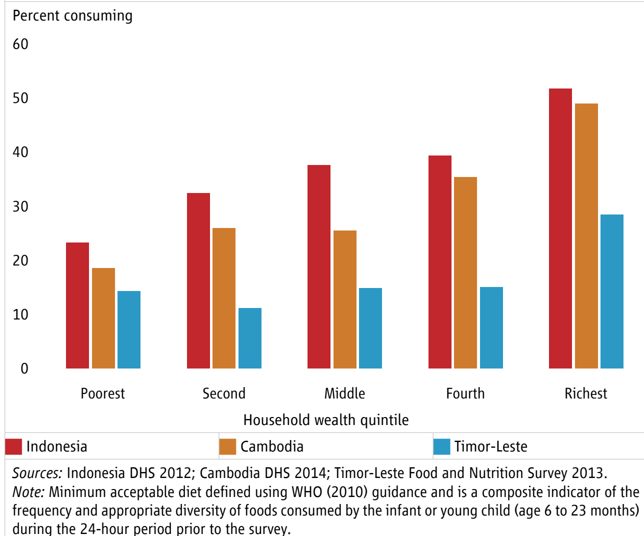
10 In the Republic of Korea, for instance, the socioeconomic costs of overweight and obesity among adults aged 20 and older were approximately 0.22 percent of GDP and 3.7 percent of national health care expenditures in 2005 (Kang et al. 2011). In Thailand, the total cost of obesity is estimated at 0.13 percent of GDP; health care costs attributable to obesity are estimated at 1.5 percent of national health expenditure (Pitayatienanan et al. 2014). The annual cost of glucose testing strips per individual exceeds Vanuatu's total health expenditure per capita (Anderson 2013).

11 On average, globally, a 10 percent increase in GDP per capita is associated with a 6.3 percent decrease in stunting in the long term, and a 1.7 percent decrease in the short term (Smith and Haddad 2015).

The underlying drivers of undernutrition are multisectoral. They relate to maternal and child caring practices; food security, that is, the availability and affordability of nutritious foods; access to health, clean water, and appropriate sanitation; and the social status of women. A key role is played by information: households do not always know which foods or feeding practices are best for their children or themselves, nor can they visually identify when children are stunted or micronutrient deficient (World Bank 2006). All these factors may be correlated with income, but are conceptually distinct from it.

- **Poor infant and young child feeding practices.** Early and exclusive breastfeeding up to six months is an important factor in promoting adequate nutritional intake and decreasing susceptibility to infection. Exclusive breastfeeding rates among children under six months range from 17 percent in Vietnam to 74 percent in Cambodia. In addition, complementary feeding practices are suboptimal in many EAP countries (Figure II.A.7). Infants undergo rapid growth and development between birth and two years of age, and upon introduction of complementary foods at six months, a diverse diet is necessary in order to achieve adequate intake of a wide variety of macronutrients and micronutrients.

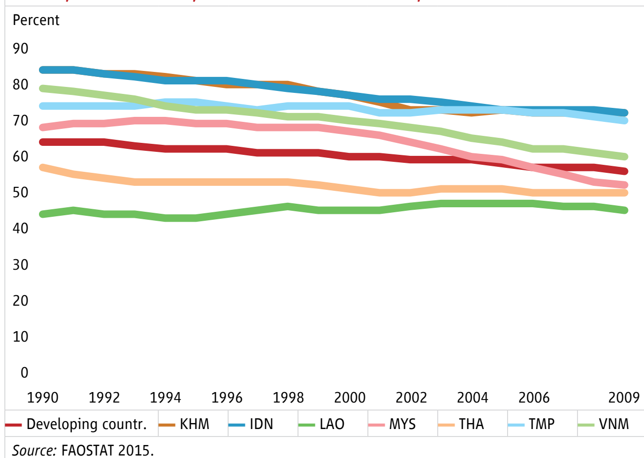
Figure II.A.7. Consumption of a nutritionally acceptable diet among infants and young children (age 6 to 23 months) by household wealth quintile, select EAP countries



Sources: Indonesia DHS 2012; Cambodia DHS 2014; Timor-Leste Food and Nutrition Survey 2013.
Note: Minimum acceptable diet defined using WHO (2010) guidance and is a composite indicator of the frequency and appropriate diversity of foods consumed by the infant or young child (age 6 to 23 months) during the 24-hour period prior to the survey.

- **Low access to nutritious foods.** Food security has improved across the region in the past decade. In particular, food balance sheets indicate growing availability of calories at the population level.[12] However, measures of caloric sufficiency do not capture the degree to which households can access an affordable, safe, and diverse diet that delivers the right mix of macro- and micronutrients needed to promote optimum growth. Many of the high stunting burden countries are characterized by poor diet composition, with a higher share of total dietary calories from staple foods than the average across developing countries (Figure II.A.8).

Figure II.A.8. Share of dietary energy supply from cereals, roots, and tubers, select EAP countries, 1980–2008



Source: FAOSTAT 2015.

- **Weak preventive and primary health care.** EAP is second only to Latin America and the Caribbean in terms of share of government expenditures on health, but has health systems that are generally characterized

12 The percentage of undernourished individuals (with insufficient [<2,100 kcal] caloric intake) is highest in Timor-Leste (38 percent) and Lao PDR (27 percent), but ranges from 8 to 16 percent across other countries in the region.

as low value, high cost (World Bank 2015). Health care tends to overemphasize hospital-based service delivery, with a lack of focus on the delivery of quality preventive and primary care services, which are essential for the prevention of undernutrition.

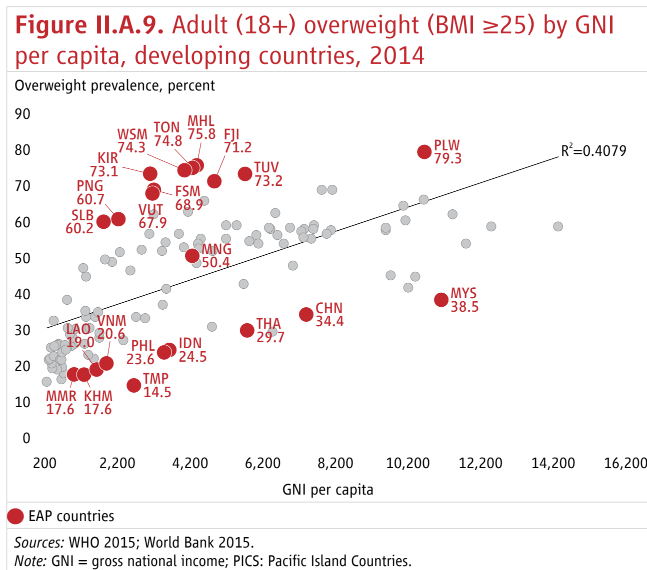
- **Unsafe drinking water and poor sanitation facilities.** Much of the region enjoys access to improved drinking water.[13] However, sanitation and hygiene are often inadequate, especially in rural areas and in high stunting burden countries. Open defecation, common across the region,[14] also contributes to stunting.

Women's social status. Gender disparities remain significant across much of the region.[15] The low status of women contributes to maternal and child undernutrition. Women with low status (defined as women's power relative to men) tend to have weaker control over household resources, tighter time constraints, less access to information and health and nutrition services, poorer mental health, and lower self-esteem. These factors are thought to be closely tied to women's own nutritional status and the quality of care they receive, and, in turn, the quality of health and nutritional care they provide to their children (Smith et al. 2003).

V. Drivers of Overnutrition: Urbanization and Changing Lifestyles

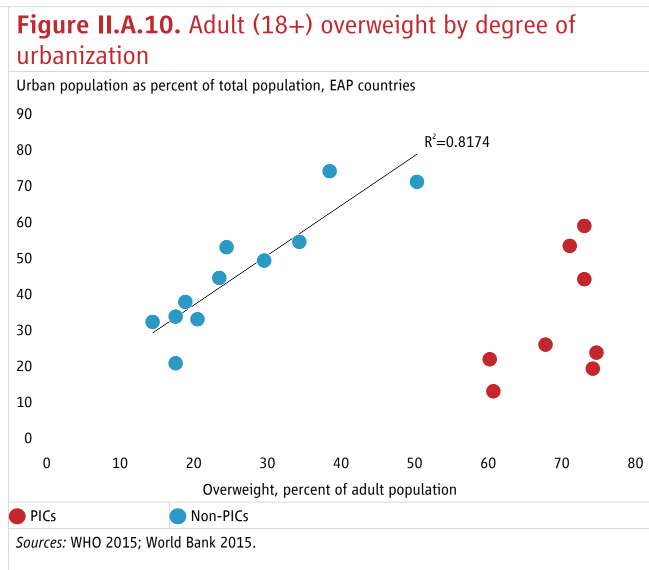
Adult overweight rates are strongly correlated with average income per capita; they are also much higher in Pacific Island Countries than East Asia (Figure II.A.9). The link between overweight and income, in turn, arises because the rapid income growth and economic transformation experienced by many Asian economies

Figure II.A.9. Adult (18+) overweight (BMI ≥25) by GNI per capita, developing countries, 2014



Sources: WHO 2015; World Bank 2015.
Note: GNI = gross national income; PICS: Pacific Island Countries.

Figure II.A.10. Adult (18+) overweight by degree of urbanization



Sources: WHO 2015; World Bank 2015.

13 The Eastern and Southeastern Asia Millennium Development Goal (MDG) regions have met the MDG target of 88 percent coverage of improved drinking water. However, Papua New Guinea is one of three countries in the world with less than 50 percent coverage of improved drinking water.

14 Roughly 100 million people in the region practice open defecation, with country prevalence rates ranging from zero to 72 percent, based on a 2013 review of 14 EAP countries. Cambodia, China, and Indonesia are among the 12 countries in the world with the largest population practicing open defecation (UNICEF 2013).

15 Women often enjoy less access to productive resources. For instance, in Indonesia, Timor-Leste, and Vietnam, female-headed households have less land than male-headed households (World Bank 2012). More broadly, Indonesia in particular performs poorly on gender equity in economic activity (Haddad et al. 2014).

has been accompanied by rapid urbanization, changing lifestyles, and hence changes in dietary patterns.[16] In the Pacific Island Countries, elevated overweight rates reflect the unfavorable food, sociocultural, and physical environments (Box II.A.2).

Urbanization is highly correlated with obesity and chronic diseases (Figure II.A.10),[17] though the relationship is strongest amongst countries at lower levels of GDP. This correlation reflects the impact of urbanization on several underlying risk factors, including diet, physical exercise, and exposure to mass media.

- **Changes in diet.** Urbanization alters the food environment (which includes the availability, affordability, convenience, and desirability of foods) and is associated with increased intake of refined carbohydrates, added sugars, fats, and animal-source foods. Rural dwellers are relatively self-reliant in obtaining food, and tend to eat traditional diets that are high in grains, fruit, and vegetables, and low in fat. Urban dwellers, in contrast, rely on supermarkets and fast-food stores, which offer a ready supply of processed foods, high-calorie and high-fat snacks, sweets, and sugary beverages, all of which have been linked to obesity.[18]

- **Physical exercise.** Urbanization is associated with reduced expenditure of energy on physical activity, with workers transitioning from farming to sedentary, professional, and mechanized jobs.[19] Furthermore, leisure time is spent on relatively sedentary activities owing to less outdoor recreational space, and transportation relies relatively more on cars and buses and less on walking or biking (Popkin, Adair, and Ng 2012).

- **Exposure to mass media.** Urbanites are more exposed to mass media marketing, which can shift preferences away from traditional diets to unhealthy processed foods. Widespread marketing of foods to children (overwhelmingly for foods high in fat, sugar, and/or salt) is a particular concern. A survey of six Asian countries (India, Indonesia, Korea, Malaysia, Pakistan, and the Philippines) reported that television advertising to children was widespread, and that the diets actively promoted on television ran counter to national nutrition guidelines (Escalante Cruz et al. 2004).

16 Urbanization increased from 18 percent in 1950 to 48 percent in 2014, with Asia experiencing the fastest pace of urbanization across major areas during 1985–2014 (United Nations 2014).

17 In a study of 42 countries, annual overweight/obesity prevalence increased during 1989–2007 by 0.8 percentage points among urban women in East Asian and Southern Asian countries, compared to 0.3 percentage points among rural women (Popkin, Adair, and Ng 2012).

18 In Indonesia, in 2013, urban households spent nearly 31 percent of their food expenditures on packaged and processed foods compared to only 18 percent for rural households (Labaste and Jaffee, forthcoming).

19 In China, between 1991 and 2000, energy expenditure from occupational and domestic sources declined by, respectively, 22 percent and 57 percent among men, and 24 percent and 51 percent among women. Lower occupational physical activity increased body weight among both men and women. Over this same period, China's adult overweight prevalence roughly doubled (Monda et al. 2007).

Box II.A.2. Drivers of overweight and obesity in the Pacific Island Countries

The 22 Pacific Island Countries (PICs) share a number of characteristics that make them particularly susceptible to growing burdens of overweight and obesity.

Food environment and unhealthy diets

The physical environment in PICs naturally constrains food production and food security. Smaller island nations, in particular, consist almost exclusively of atolls that are largely infertile and susceptible to sea level rise. Volcanic islands tend to be larger and mountainous, with more fertile soils and mineral deposits that make them better suited for agricultural production (Snowdon and Thow 2013). Agricultural food production is commonly conducted for subsistence but also for domestic and international markets, whereas fisheries play a critical role in economic development, food supply, and diets (Barnett 2011). Most Pacific countries are food dependent (Hughes 2005), and leaving aside fisheries, the value of agricultural imports tends to dwarf agricultural exports from PICs. Additional forces, such as urbanization and market penetration of processed imported foods have weakened domestic production of diverse, local production (Barnett 2011). Imported foods such as noodles, white bread and crackers, and fatty meats are now added to traditional diets, which consisted of large quantities of starchy roots, local fruits, and seafood (Hughes 2005). Fat and calories from imported foods have added to rather than replaced traditional sources.

Sociocultural environment and perceptions of body image

Social structures, values, and beliefs affect food consumption, activity, and self-image patterns and contribute to obesity-inducing behaviors among both youth and adults. Even more than media, families (and fathers, in particular) drive pressures to achieve a particular body type for adolescents. The large body is perceived to be ideal for both male and female adolescents, with larger youth believed to be well respected and cared for. In Fijian and Tongan households, the intrahousehold distribution of food is also found to reflect love and care, such that the best quality and highest volume of food is provided to those of relatively high status. Highly valued foods include those that are imported and less available, compared with local fish or fresh produce.

Physical environment and lack of physical activity

The physical environment of the PICs creates barriers to physical activity. Common environmental conditions such as lack of footpaths and lighting, wet weather, and high temperatures create barriers to physical activity even in better-connected and urban communities (Siefken et al. 2012). Among adolescents in Fiji and Tonga, lack of interest or motivation, lack of safety, study, and household responsibility inhibit female adolescents from participating in recreational activity.

Source: Shrimpton, Mbuya, and Provo 2016.

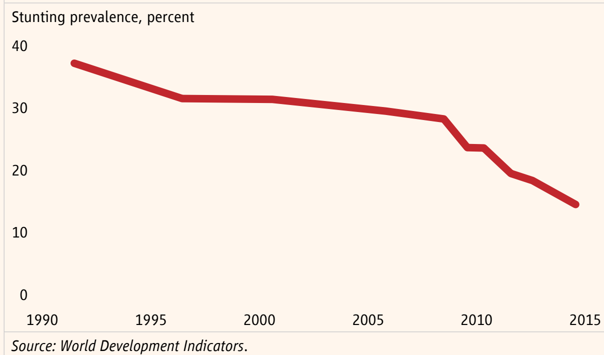
VI. Routes to Better Nutrition: From Drivers to Actions

Appropriate policy responses to malnutrition will vary across countries, depending on the type and degree of malnutrition they face (Figure II.A.4). Nonetheless, with strong political commitment and concerted action across multiple sectors, high stunting burden countries could achieve significant improvements in nutritional outcomes in the near future (Box II.A.3.).

Box II.A.3. Peru's success in reducing chronic undernutrition

In the early 2000s, over one in three Peruvian children under five years of age suffered from chronic malnutrition. These high levels of stunting remained virtually unchanged until 2008 (Figure II.A.3.1), despite rapid economic growth and significant expenditure on nutrition programs. Then, between 2008 and 2014, child stunting rates decreased dramatically. Peru's experience ranks among the most successful recent global achievements in child nutrition and is widely attributed to three main factors, which established a clear commitment and collaboration across sectors in tackling undernutrition.

Figure II.A.3.1. Trends in child (<5) stunting in Peru, 1990–2014



Source: World Development Indicators.

First, Peru rallied strong political commitment and set out a clear direction through measurable, time-bound goals. Alan Garcia, elected president in 2006, committed in his inaugural address to the "5-by-5-by-5 goal" of reducing stunting by 5 points in 5 years for children under five. This ambitious, yet feasible, goal was then translated into specific regional targets, and the focus then turned to achieving them.

Second, Peru adopted a multisectoral strategy supporting both the demand and supply of nutrition services. Peru empowered parents by providing them with information to identify a stunted child and make its consequences visible through a widely disseminated video ("My Future in my First Centimeters"). In addition, the government leveraged the existing conditional cash transfer program for poor families ("Juntos") to reduce child malnutrition, by conditioning transfers on children's receipt of health and nutrition services, including growth promotion checkups and early childhood stimulation. To respond to the increased demand, the government expanded maternal and child nutrition services. Relatedly, it improved the coverage of clean water and proper sanitation.

Third, the government used financing for results and targeted communities with the greatest need. Results-based budgeting through the evidence-based "Articulated Nutrition Program" was used to ensure that demand and supply efforts worked together to achieve established nutrition goals. Each agency was held accountable for improving specific indicators, such as the number of poor children enrolled in the conditional cash transfer program, and the number of child-growth checkups and nutrition counseling sessions to poor families in targeted communities.

Source: Extracted from Marini and Arias (2016).

Countries with elevated stunting levels

Countries with high stunting levels should focus on scaling up a package of evidence-based, direct health interventions that can be delivered through primary health care services targeting the critical 1,000-day window of opportunity (from conception through the first two years of life). These direct, nutrition-specific interventions include (a) behavior change and communication interventions to promote optimal nutrition and care during pregnancy and the early years of infants' and young children's lives (including nutritional supplements during pregnancy, breastfeeding within one hour of giving birth and exclusively through the first six months, and appropriate complementary/weaning foods from the age of six months); (b) micronutrient interventions and deworming to enhance the consumption of essential vitamins and minerals (through foods fortified with key micronutrients, and nutritional supplements); and (c) complementary and therapeutic feeding interventions to reduce acute malnutrition. In many EAP countries, the estimated benefit-cost ratios for this package of interventions is remarkably high, reflecting both their low cost and their large impact on labor productivity (Table II.A.2).

Table II.A.2. Benefit-cost ratio per child for nutrition investments in 10 countries for individuals working to age 36

Country	*Benefits to age 36*
Indonesia	47.7
Philippines	43.8
India	38.6
Vietnam	35.3
Pakistan	28.9
Yemen	28.6
Nigeria	24.4
Bangladesh	17.9
Kenya	15.2
Tanzania	14.6

Source: Hoddinott et al. 2013.

Improving supply-side delivery of nutrition-specific interventions may not necessarily require increased health investments, but rather a reprioritization of interventions and delivery platforms. Many EAP countries have made strong commitments toward achieving universal health coverage over the next 10 to 20 years. In lower-income EAP countries with high stunting burdens (including Cambodia, Lao PDR, and Papua New Guinea), health insurance coverage is generally low. However, even these countries have made strides in removing financial barriers to health services for targeted subgroups (the poor) and for specific services (maternal and child health). In addition to extending benefits to vulnerable groups, nutrition interventions must be included in the health benefits package, while community-based and outreach platforms may be necessary to ensure last mile delivery and availability of nutrition services for the poor, rural, and remote populations who shoulder much of the burden of malnutrition. Additional investments are also needed to strengthen human resource capacity and develop quality assurance mechanisms, particularly for counselling and behavior change interventions, such as promotion of breastfeeding and optimum maternal infant and young child feeding, and in lower-level facilities accessed by rural and poor populations.

Social transfers can stimulate demand for essential health and nutrition services, address the immediate and underlying determinants of undernutrition, and improve the nonincome dimensions of poverty. These social transfers should be targeted toward the disadvantaged groups who are at greatest risk of undernutrition (poor, rural, ethnic minorities, and/or other groups experiencing forms of social exclusion; pregnant women and children under 2 years old). Publicly funded social safety net programs play an important role in improving access to special complementary foods (Bloem et al. 2013) and fortified foods for the poor. For example, conditional cash transfers not only can have positive effects on poverty reduction, but have also been shown to improve household

food consumption, dietary diversity, and use of preventive and curative nutrition services (Ruel et al. 2013). They also provide a platform for reaching caregivers with programs that include not only nutrition interventions, but also information on health, growth, early learning, and stimulation, which can enhance overall development of young children. In addition, in EAP countries where rice is the primary staple food, social safety net programs that distribute fortified rice can provide a means of reaching the poor and those at greatest nutritional risk (Codling, Fabrizio, and Rosenzweig 2015).

Agricultural programs have a role to play in reducing malnutrition by improving the access to and affordability of adequate, nutrient-rich diets. In EAP, agricultural policies and programs have tended to encourage the production of cereals/staple foods and income generation through high-value export crops. While enhanced staple food productivity is, to a degree, necessary to meet the caloric needs of growing populations, programs are needed to explicitly target optimal nutrition (Ruel et al. 2013). For example, fiscal incentives (healthy food subsidies) can be used to improve the affordability of nutrient-rich foods—particularly for rural households—as can agricultural investments to incentivize the production of nutrient-rich foods (especially fruits, vegetables, pulses/legumes, and animal-source foods).

Improved water, sanitation, and hygiene practices are critical for reducing undernutrition. Interventions must be designed to address the full spectrum of related issues, among which are reducing human and animal fecal matter in the environment, including the soil and children's play areas; ensuring availability of water and soap for handwashing; and changing behavior, including instilling the habit of handwashing with soap at critical times (for instance, after using the toilet, before preparation of food, after cleaning babies, and before eating).

Countries with high stunting should also implement key measures to prevent obesity (see below). Proactively developing some relatively low-cost policies and regulations to improve the food environment and food system will help ensure that development is associated with movements to low stunting and low overweight, rather than low stunting but high overweight. Prevention of overweight/obesity is much more cost-effective than treatment.

Countries with high burden of overweight and obesity

Action at multiple levels is needed to halt the rise of overweight, including by changing social norms (Dobbs 2015; WHO 2016). A coordinated package of interventions is required to promote healthy diets, ranging from systems-level policy measures to sector-specific solutions that promote behavior change at the community and individual levels (Table II.A.3.).

At the systems level, a number of domains have been identified where regulatory and policy actions are warranted to reduce overweight/obesity, many of which fall outside of the purview of the health sector. Overconsumption of unhealthy foods reflects market failures. For instance, consumers are often provided with incomplete information. And products exploit biological, psychological, and socioeconomic propensities toward overconsumption of foods high in fat, sugar, and salt, with neither the producer nor the consumer bearing the full social, economic, or health care cost of overweight. This creates the need for interventions, including nutrition standards and labelling, restrictions on advertising, and use of economic and other incentives to influence food purchases and consumption. Other complementary policies may be needed, including supporting better consumer

nutrition knowledge, and counselling and equipping consumers with skills for healthier food consumption (Sassi 2016). Strong political will is needed for governments to take leadership and ownership over anti-obesity interventions.

Table II.A.3. The NOURISHING Framework

Domain	*Action*
Food Environment	Nutrition label standards and regulations on the use of claims and implied claims on foods
	Offer healthy foods and set standards in public institutions and other specific settings
	Use economic tools to address food affordability and purchase incentives
	Restrict food advertising and other forms of commercial promotion
	Improve nutritional quality of the whole food supply
	Set incentives and rules to create a healthy retail and food service environment
Food System	Harness food supply chain and actions across sectors to ensure coherence with health
Behavior Change	Inform people about food and nutrition through public awareness
	Nutrition advice and counselling in health care settings
	Provide nutrition education and skills

Source: Hawkes, Jewell, and Allen 2013.
Note: The framework was set out by the World Cancer Research Foundation, and many interventions have been affirmed by the WHO Commission on Ending Childhood Obesity (WHO 2016).

- **Regulating food marketing, improving food labelling, and scaling up nutrition education will help improve nutrition information.** The unregulated marketing of unhealthy foods and sugar-sweetened beverages is associated with childhood obesity (WHO 2016). Government regulation is warranted to prevent the marketing of unhealthy foods to children. Moreover, nutrition labelling will allow consumers to be better informed of the health implications of food choices. In all countries of Southeast Asia except Malaysia, nutrition labelling is voluntary unless nutritional claims are made (Kasapilla and Shaarani 2011). As individuals in EAP begin eating outside the home in greater numbers, municipalities may consider extending nutrition labelling to restaurants and ready-to-eat food retailers.

- **Mass media and behavior change communications can help improve nutrition education and literacy.** A variety of delivery mechanisms are possible, including mass media, health and education facilities, and community-based interpersonal communication. In China, policy makers produced Guidelines for Prevention and Control of Overweight and Obesity of Chinese Adults, as well as Guidelines on Snacks for Chinese Children and Adolescents. These guidelines were complemented by behavior change campaigns, including, in 2007, the 121 Health Action strategy, which called for individuals to take, "ten thousand steps a day, the balance of eating and activity and healthy life."

- **Targeted taxes and subsidies have great potential to prevent or mitigate overweight and obesity through dietary changes.** Fiscal measures have been proposed as a mechanism to influence consumer behavior by changing the relative prices of healthy compared to less healthy foods, or by manipulating incomes. Demand for food is generally inelastic, but observational and robust modelled studies have demonstrated the impact of taxes on target food consumption, with larger taxes and taxes on noncore food items (including confectionary and sweetened beverages) demonstrating the largest effects (Thow et al. 2011). Moreover, at both the country and household level, the response is strongest among the poor.[20]

20 Food demand is relatively more sensitive to price and income changes among low-income households, and in low-income countries.

While this might be interpreted as an example of regressive taxation, the impact of overweight through diabetes and premature deaths is also regressive.

More specifically, fiscal measures may be characterized according to their targeting of objects (for example, foods, nutrients, or meals), subjects (for example, entire population, children, or low-income mothers), and settings (home, food stores, or schools). For instance, tax schemes may target individual foods, or else nutrients (for example, depending upon a product's fat content) in an effort to encourage product reformulation.[21] Experimental and simulation tests suggest that taxes or subsidies on foods or beverages tend to be effective in changing diet consumption.[22] The evidence regarding taxation of nutrients is too scarce to draw firm conclusions. Also, there is not yet evidence regarding the ultimate impact of taxation on nutritional status.

- **Food composition regulations can also promote dietary change.** Industry self-regulation can achieve some changes, but in other cases government regulation will be required. Food composition targets for salt, trans fats, saturated fats, and sugar can be developed for both packaged/processed foods and food service retailers. The WHO has identified regulations to reduce trans fats as a "best buy" to prevent NCDs at the population level. However, experience with tobacco regulation, as well as early experiences with food industry regulation, make it clear that efforts at regulation will be challenged.

Countries facing both high stunting and high overweight/obesity

In addition to the measures recommended for countries facing either overweight/obesity or undernutrition, there are special considerations for countries experiencing the dual burden of malnutrition.

The key challenge is to address food insecurity without adding to the burden of overweight/obesity. Many EAP countries have adopted a food policy centered on self-sufficiency in rice. The exclusive policy focus on staple foods, also known as "cereals fundamentalism," has a distorting effect on the price of staples compared to nonstaples (Pingali 2015). Subsidies for rice and cereals result in the relatively low cost of starchy staple foods and edible oils—contributing to the pervasive availability of processed, energy-dense, and micronutrient-poor foods—compared to the relatively high cost of whole grains, fruits, vegetables, and low-fat animal source foods. In these countries, there are sufficient calories available to lead to the accumulation of excess body weight, but micronutrients and healthy protein sources may be beyond the economic reach of poor families. Food policy in these countries needs to be rebalanced to remove the distortionary effects of staple grain fundamentalist policies. Input subsidies, public agricultural advisory services, and irrigation investments must not create obstacles to farmers aiming to diversify production and specialize in higher-value, nutrient-dense foods.

Food-based safety nets must be rethought. Where countries provide complementary foods for young children, transfer programs have been found to contribute to increased overweight and obesity in mothers in Mexico (Leroy et al. 2013) and Columbia (Forde et al. 2012) as well as young children in Mexico (Leroy et al. 2010) and the United States (Akee et al. 2013). A variety of program design choices can help mitigate these risks. In Mexico, the

21 Mexico has tried both, taxing foods with energy content exceeding 275 Kcal per 100 grams (1 kilocalorie = 1,000 calories) as well as sugar-sweetened beverages.

22 Taxes on individual unhealthy food products were generally found to increase consumer prices and reduce consumption of the taxed products (OECD 2014).

benefits package of supplements and counselling was modified to respond to the different nutrient gaps of urban and rural populations (Neufeld et al. 2011). Fortified milk distribution continued in remote communities with low access to services; where risk of overnutrition was high, food supplements were modified to reduce calories but retain micronutrients. In addition, individual counselling sessions are being scaled up to promote breastfeeding, healthy complementary feeding, and the avoidance of excess weight gain in preschool-age children (Kroker-Lobos et al. 2014).

VII. Conclusions

Developing EAP faces significant challenges with respect to both undernutrition and overnutrition. Economic growth has been insufficient to eliminate undernutrition among the region's poorest. At the same time, an increasing propensity toward sedentary lifestyles, and changes in food availability that have facilitated a shift in diets toward greater intake of animal-source and processed foods, sugar and sweeteners, oils, and salt, have contributed to increased overweight and obesity rates.

The health sector alone cannot address these challenges and their social and economic costs. Countries in the region must make targeted investments in nutrition programs (particularly in early life), in health, social protection, agriculture, and education, and develop the frameworks to promote healthy diets and physical activity. In turn, this will help create a healthy workforce capable of adapting to the rapidly changing global economic landscape.

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II.B. How Will Technology Disrupt Financial Services in East Asia and Pacific?[1]

There is a growing sense that financial services may be the next major industry to experience a tectonic shift in how products and services are delivered and value created. Disruptive technologies, enabled by the internet and the spread of mobile phones (nearly all new internet users are joining via mobile platforms, not desktop computers), big data, and cloud computing are creating new business models every day. Examples include new payment technologies that use mobile phone networks, and crowdfunding.

Developing East Asia and Pacific (EAP) will almost certainly be at the forefront of this revolution. The region is advanced technologically, with a high level of mobile phone penetration and internet access, as well as widespread use of social media and electronic commerce. The region is also a global leader in information and communications technology (ICT) manufacturing and software development. The region is not as advanced, however, in terms of access to financial products and services—in developing EAP only about 30 percent of individuals have a bank account. This gap between advanced technology adoption and still limited financial inclusion creates a unique opportunity for financial technology solutions that apply ICT to financial intermediation, and for completely new business models, often referred to as "alternative finance". However, to take full advantage of these opportunities, countries in developing EAP will need to strengthen governance and the relevant legal and regulatory frameworks, improve their enabling infrastructure, and address challenges such as those related to privacy, consumer protection, and financial capability, so that consumers can make sound and informed financial decisions.

Technology is creating new opportunities in the financial sector, allowing existing players to become more efficient and tap new markets, and creating space for new business models and entrants. This chapter analyzes a few of the ways in which technology will alter the financial services landscape in developing EAP over the coming years, for countries at all income levels.

The potential for technology to "disrupt" the financial sector is gaining increasing attention globally. But there is confusion about the potential for truly transformative change, as opposed to marginal increases in efficiency or changes in the consumer experience. Two of the most popular terms used in this discussion are "fintech", or financial technology, and "alternative finance". These terms overlap but have important differences.

Fintech relates to the innovative application of technology to financial services through, for instance, data and analytics, online platforms, mobile apps, and the use of other ICT tools such as the Global Positioning System. Fintech can be deployed by incumbents (including large commercial banks, microfinance institutions, insurance companies, and brokers), or it can be the focus of stand-alone firms. The development of mobile banking, increased use of credit scoring tools by financial institutions, and application of new electronic data monitoring tools by insurers are examples of fintech.

Alternative finance relates to new business models and instruments that are developing outside the traditional regulated financial markets, and which overwhelmingly use fintech. Examples include "crowdfunding" platforms, and payment systems, including some mobile payment solutions, that operate outside

1 Prepared by Margaret Miller and Jiyoung Song, with research assistance from Michael Merriam, Lucy Oyer, Kimberly Wu Tan, and Victor Young Xu. Samuel Raymond facilitated access to experts, shared his experience, and provided extensive comments. Simon Bell, Jose de Luna Martinez, Douglas Pearce, and James Seward also provided comments.

traditional bank channels. Alternative finance is broadly a subset of fintech. Not all fintech applications are by alternative financial services providers, but all scalable alternative financial services providers use fintech to power new business models.

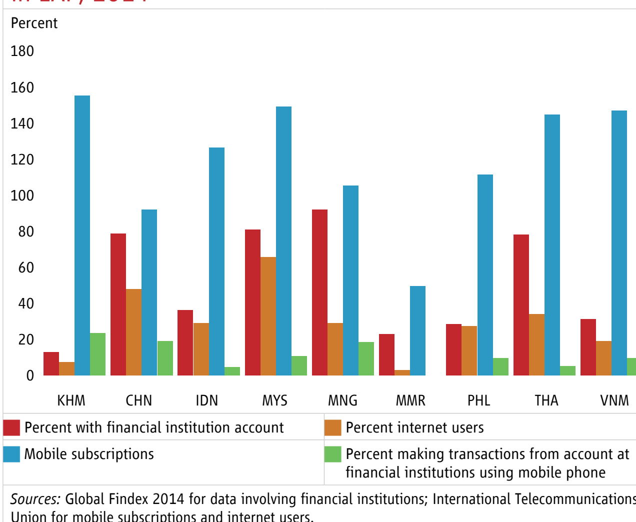
This chapter is organized as follows. The next section looks at the conditions that have made both fintech and alternative finance possible, and analyzes why developing EAP may be especially well suited to technology-enabled solutions in finance. Two case studies then provide examples of fintech and alternative finance that hold promise for growth in the region, and highlight key policy considerations. The chapter concludes with a discussion of the key challenges and suggested next steps.

The context for fintech and alternative finance in EAP

A strong environment for fintech is readily apparent in the higher-income countries in East Asia and Pacific (EAP). These countries already have advanced ICT infrastructures and a strong investment climate, including well-developed legal and regulatory frameworks for financial services. However, the opportunities for fintech and alternative finance also extend to many of the region's lower-income economies, where technology may help fill the current gap in financial services delivery.

Several factors, and especially a high mobile phone penetration rate, contribute to a potential fintech boom in developing EAP. Advanced technology is abundant in the region, starting with mobile phone penetration rates that exceed 100 percent of the population (owing to use of multiple phones and SIM cards) in many countries, including lower-income economies.[2] While many fewer consumers have internet access, the shares are still relatively high: more than 50 percent have internet access in the region's highest-income countries, and a quarter or more do in several middle-income countries including China, Thailand, and Indonesia (Figure II.B.1). Since most future internet connections are expected to come through mobile platforms, the broad use of mobile technology and trends toward adoption of 3G and 4G devices that can provide data services create a strong platform to rapidly expand web access in the coming years.

Figure II.B.1. Use of technology and financial services in EAP, 2014



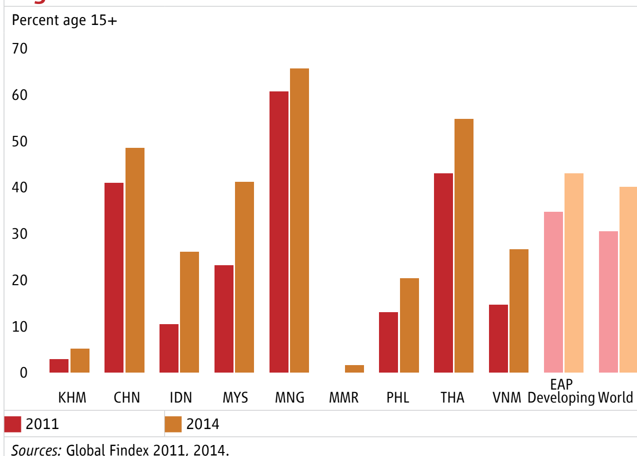
Sources: Global Findex 2014 for data involving financial institutions; International Telecommunications Union for mobile subscriptions and internet users.

2 The region on average boasts more than one mobile phone per person, with many countries above the advanced economy average (121 per 100), including higher-income economies such as Malaysia and Thailand, and lower-income economies such as Cambodia and Vietnam. China has the highest rates of mobile phone penetration among city centers (Hong Kong SAR, China and Macao SAR, China exceed 230 and 320 per 100, respectively), but still has room for growth in rural areas and among low-income populations, with a national rate of about 92 mobile phones per 100 people.

Technology penetration has outpaced access to financial services in developing EAP. Most countries make far greater use of mobile phones than banks, with less than half the population holding accounts in formal financial institutions. China and Mongolia are outliers, with especially high rates of financial accounts in the adult population. And only a relatively small percentage of people—fewer than one-quarter across developing EAP—use their mobile phones to execute financial transactions.

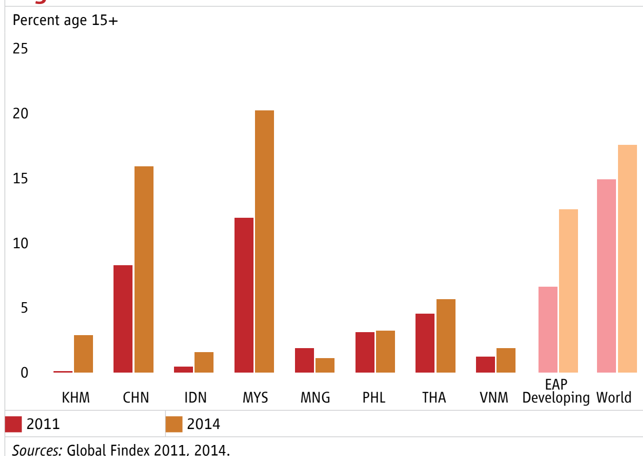
Some advances in digital payments have come from traditional sources, especially from increased access to both debit and credit cards, and this may help create a platform and payment solutions for some fintech applications. Many developing EAP countries compare favorably on access to debit cards (Figure II.B.2); however, this technology is still limited in lower-income economies such as Cambodia and Myanmar, and growth in the region lags global trends.[3] Developing EAP has witnessed a more dramatic increase in credit card ownership in recent years (Figure II.B.3). Ownership of credit cards increased globally by 18.1 percent between 2011 and 2014, but in developing EAP surged by 88 percent, with China responsible for much of this expansion. However, levels of credit card penetration remain limited to 20 percent or less; it is a payment solution typically available only to more wealthy consumers. One area where the region leads is savings rates; 37 percent of adults save at a formal financial institution compared with 15 percent or less in other developing regions.[4]

Figure II.B.2. Adults with debit cards



Sources: Global Findex 2011, 2014.

Figure II.B.3. Adults with credit cards



Sources: Global Findex 2011, 2014.

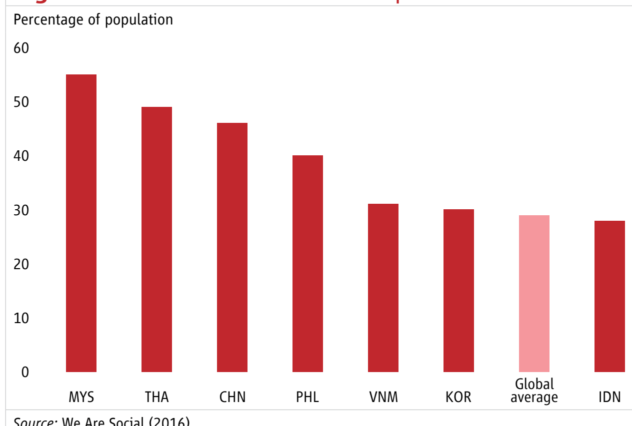
E-commerce in the region is also relatively strong. A global survey of e-commerce habits indicates that consumers are more likely to purchase through e-commerce in EAP than in other regions where rates of browsing without buying are higher (Nielsen Corporation 2014). The willingness of consumers in EAP to use the internet to conduct business is another positive factor for fintech in the region, especially in China, where online retail sales are already approximately 14 percent of total retail receipts. The economic muscle of new forms of retail commerce, and the data they have access to on shopping habits and business sales, can also create opportunities in the alternative finance space.

3 Global Findex 2014.

4 Global Findex 2014. Comparable figures for formal savings rates for other regions are Eastern Europe and Central Asia, 8.4 percent; Latin America and the Caribbean, 13.5 percent; and South Asia, 12.7 percent.

Finally, widespread social networking will also facilitate the expansion of fintech and alternative finance business models in developing EAP. Several countries, at varying income levels, exceed the global average in social media penetration (Figure II.B.4), already making it a focus for the industry (We Are Social 2016). In general, social media users in the region use social media for a larger average portion of their time; users in Malaysia, the Philippines, and Thailand average well over three hours per day (Go-Globe 2015). Beyond general entertainment use, social media in the region is already being used to bring new products to consumers. Fifty-two percent of users in Southeast Asia first hear about a new product, brand, or service through Facebook (Facebook IQ 2015). Payments between individuals and between individuals and firms, as well as crowdfunding, are poised to thrive in this highly interconnected environment.

Figure II.B.4. Active accounts on top social media site



Source: We Are Social (2016).

There are also important challenges to the expansion of fintech in the region, including the pervasive use of cash to pay bills. Even in e-commerce, many transactions are still conducted in cash using "cash-on-delivery" arrangements that add to costs and create barriers to entry for new market participants and reduce convenience for consumers. Around 90 percent of school fees and utility bills and nearly 100 percent of payments to farmers are paid in cash (Table II.B.1). The shift from cash to noncash payments will require both attractive alternative payment mechanisms and a change in consumer behavior and preferences.

Table II.B.1. Percentage of Adults Who Used Cash for Transactions, 2014

Percent

Country	Paid school fees	Paid utility bills	Received domestic remittances	Received government transfers	Received payments for agricultural products	Received wages	Sent domestic remittances
Cambodia	99.6	100.0	66.6	—	99.3	94.4	51.6
China	84.8	88.5	80.6	37.1	97.7	60.5	75.9
Indonesia	98.4	98.9	75.9	78.8	98.5	82.0	73.4
Malaysia	89.5	91.1	66.6	42.5	—	44.6	47.2
Mongolia	82.1	96.4	65.7	32.6	93.1	33.3	55.6
Myanmar	99.4	100.0	56.6	—	99.9	98.3	—
Philippines	94.5	98.1	52.4	63.2	95.4	82.0	44.4
Thailand	93.2	98.5	84.4	66.6	98.9	74.0	77.6
Vietnam	96.5	97.9	64.8	—	99.0	78.2	66.2
EAP (Developing)	88.0	90.6	77.1	47.0	97.8	64.5	72.8

Source: Global Findex 2014.
Note: — = not available.

The arms-length nature of technology-enabled financial services increases the importance of third parties having trust in the business/contractual relationship and in their ability to seek redress when problems occur. Key elements of the investment climate differ significantly across developing EAP, reflecting the broader

diversity in levels of economic and institutional development. In particular, for the region's poorest countries, where adherence to the rule of law is weakest, this impedes adoption of some fintech and alternative finance services. However, there may also be added incentives in some of these same countries to move toward fintech services such as cashless payments, which can reduce opportunities for corruption and theft.

This chapter focuses on two specific fintech/alternative finance opportunities: digital payments, in particular mobile payments; and crowdfunding. Mobile payments provide a critical gateway to broader financial inclusion for a wide spectrum of society, reaching even poor and rural consumers who already have mobile phones. Crowdfunding provides opportunities for financing small and medium-sized enterprises (SME), a widespread development priority across the region, and is relatively advanced in developing EAP, garnering the attention of both the business and regulatory communities.

Case Study 1. Digital payments

Why are digital payment services important?

The rapid expansion of mobile telephones over the past two decades has generated excitement about digital payments among several constituencies. These include policy makers interested in expanding financial access and reducing informality; businesses that see opportunities to reduce costs and compete in new markets; and consumers who seek convenience, and in some cases the increased security, of less reliance on cash. In many countries, the primary motivation is to expand financial inclusion, especially for lower-income consumers and those in rural or remote locations. The welfare impact of gaining access to payment services has been shown repeatedly to be significant and positive (World Bank 2014). Providing people with transaction accounts creates both a gateway to other financial products and services and a mechanism for storing value, even if not for long-term savings. Transaction accounts also create data about the financial lives of their owners—both flows in and out—which can be used to help gauge creditworthiness and demand for other types of financial products and services such as lines of credit or insurance.

Digital financial services also have a direct impact on the efficiency and operation of the national payment system, which is in turn linked to issues of financial sector stability and soundness. There are significant fixed costs with a national payment system, and therefore if the system is serving only a small portion of the economy and relatively few consumers—and few transactions—the costs per transaction will be relatively high and incentives to invest in new technology will be low. The more transactions that pass through a national payment system, the more efficient it becomes and the better the quality of information that may be gleaned on financial consumer behaviors and economic trends.

There are also broader development objectives served by the move to digital financial services. These include a shift toward greater formality and tax compliance when payments can easily be traced, and positive impacts for government expenditures when transfers go directly to beneficiary accounts, removing leakage in the system such as bribes paid to collect benefits (Rogoff 2016).

Digital payments may also help to reduce the impact of de-risking whereby jurisdictions seen as having transparency and security concerns are cut off from correspondent banking relationships. De-risking is a particular issue for small countries, including the Pacific Island Countries, where the volume of business is relatively low, making it harder to absorb high compliance costs. A pilot project for the New Zealand–Tonga remittance corridor, which is supported by the World Bank, uses digital payments and electronic client verification to reduce the impact of de-risking. Individual bank accounts are not required in this pilot, and the digital payments bypass traditional banking channels, with lighter Know Your Customer requirements and limits on the amount that can be sent to minimize risk. If successful, this approach could be replicated in other countries.

The status of digital payment services in developing EAP

Much of developing EAP is technologically well suited to taking advantage of digital payments, given the high mobile phone penetration rates, but this potential is far from being fully realized. Noncash payments are steadily increasing, but not at a rate commensurate with the expansion of mobile phones. And payments via mobile phones are still estimated to be small compared to those made online or through prepaid cards—less than 5 percent of the total value of noncash payments (McKinsey & Company 2012).

The legal and regulatory framework for digital payment services in developing EAP requires further adaptation and reform to reflect the rapidly changing technology and market landscape and permit mobile payment services to reach their potential. Pending issues include the respective roles of commercial banks, other formal financial institutions, and new entrants such as telecommunication companies or social media platforms; how to leverage payments to access other financial services such as savings or credit; how to ensure proportionality regarding, for instance, the customer due diligence required for using digital financial services; and how to provide effective consumer protection.

Across the world, it has not been financial institutions that have typically led progress on mobile payments. In China, two giant internet-based firms—Alibaba and Tencent—are in stiff competition to attract the mobile payment business. They are using payments to compete for customers, for page views, and for data. Instead of providing payments as a stand-alone source of revenue, payments are a way to support and strengthen other core business activities. This is similar to the Safaricom M-pesa model in Kenya, which was premised on locking in loyalty among mobile phone users in a services market where consumers tend to be highly price elastic.

Policy guidance

Over the past two years a number of leading organizations in the financial inclusion space have developed guidelines for the development of mobile payments that would create the policy environment for rapidly extending access. These include the Payment Aspects of Financial Inclusion (PAFI) document developed jointly by the Committee on Payments and Market Infrastructure and the World Bank, the High-Level Principles for Digital Financial Services developed by the Global Partnership for Financial Inclusion for the G20, and the Level One Project funded by the Bill and Melinda Gates Foundation (Table II.B.2).

Table II.B.2. Guidelines for digital financial services—comparing three global frameworks

Payment Aspects of Financial Inclusion (PAFI)	*High-level principles*	*Level One Project*
Commitment to financial inclusion	Promote a digital approach	Open international standards
Proportionate legal and regulatory framework balancing risk, consumer protection, and innovation	Provide an enabling and proportionate legal and regulatory framework	Tiered Know Your Customer
	Balance innovation and risk	
	Establish responsible digital financial practices to protect consumers	Shared fraud service
Financial and ICT infrastructure	Expand the digital financial services infrastructure ecosystem	Open loop
Transaction account and payment product design		Immediate funds transfer
		Same-day settlement
		Push payments
		Irrevocability
Financial literacy	Strengthen digital and financial literacy and awareness	
Other issues		
Large volume recurrent payment streams	Facilitate customer identification	
Readily available access points	Track digital financial inclusion progress	

Source: World Bank.

PAFI and the G20 High-Level Principles take a more comprehensive and strategic approach to supporting digital financial services than the Level One Project, which is more technical. All three address the issue of a legal and regulatory framework that can balance risk and innovation and that provides consumer protection. This includes:

- Know Your Customer requirements adapted to risk (tiered).
- Maximum amounts established for payments through alternative digital financial services.
- Different regulatory treatments for deposit transaction accounts (which provide access to full banking protections) and for transaction accounts linked only to payments.
- Regulations based on functionality, not on institutional type.
- Providers to provide consumers with clear information on payment products and fees and with an effective means of redress when problems occur.

All three approaches recognize the importance of the financial and ICT infrastructure and ecosystem. This includes the critical concept of interoperability, whereby consumers are not restricted to only sending payments within a network serviced by their provider. Good practices established by the G20 recommend open solutions including:

- A modern retail payment system infrastructure, with open payment platforms linked to both the clearing and settlement system and to different types of providers, including both banks and nonbanks.
- Interoperability of access points and channels, so that consumers benefit from greater convenience and competition and operators do not overinvest in payment infrastructure (as happened with ATMs in developed country markets).

Both PAFI and the Level One Project explicitly recognize the importance of specific product design features that will result in either uptake and use when done well, or many dormant accounts when done poorly. The Level One Project guidelines focus on creating digital financial services that mimic cash to the extent possible, to include:

- Immediate funds transfer
- Same-day settlement
- Push payments (such as automatic debits)
- Irrevocability.

Financial literacy is critical for the successful expansion of digital financial services, especially in environments where consumers may be moving from cash directly to mobile payments as a first form of financial inclusion. Other key policy issues include the importance of customer identification (and secure and reliable national identification), and the ability to quickly scale up through large volume recurrent payments such as government-to-person transfers or payment of wages by the public sector or taxes to the public sector.

Case Study 2. Can crowdfunding (marketplace finance) contribute to innovation and jobs in EAP?

Why is crowdfunding important?

Crowdfunding is a new technology-enabled approach to meeting the financial needs of both firms and individuals. It is a relatively nascent industry, working to fill a niche where traditional financial institutions have struggled—providing credit to SMEs and to consumers, including those who may have a limited financial history and weak credit data, known as "thin files" in markets with credit reporting infrastructures in place. Crowdfunding includes a range of financing arrangements, such as peer-to-peer (P2P) lending, with the unifying characteristic being the online platform used to conduct the transaction. The concept originated with online platforms to directly link individual lenders to borrowers—either individuals or firms. Interest on the part of financial institutions in this new way of reaching borrowers has led to institutional investment approaches where platforms raise or receive funds that they distribute to prospective borrowers based on credit scoring and credit analysis.

Policy makers are especially concerned about lack of access to credit for SMEs, owing to the relatively large contribution they make to employment and economic output. SMEs are one of the most opaque segments of credit markets, which impedes the ability of lenders to accurately assess and price risk and thereby extend credit. Further, the lack of reliable data on this market segment often leads to more onerous regulatory treatment in commercial banks, further depressing the ability of traditional lenders to serve these firms, even when they are profitable.

Among firms, especially SMEs, there is ample evidence of unmet financial needs in the region. Across the region, a high share of investments are financed internally by firms. In fact, the share of investments financed by

banks and supplier credit is even lower than in Sub-Saharan Africa (Figure II.B.5). Unmet credit demand from small firms amounted to US$241.5 billion in EAP (Stein, Goland, and Schiff 2010). Thus, there is a particular need in the region to focus on innovation in supporting the provision of finance to SMEs.

Figure II.B.5. Sources of firm finance

Source: World Bank Enterprise Surveys.
Note: OECD = Organisation for Economic Co-operation and Development countries.

Crowdfunding also widens individuals' saving options, by providing a mechanism for them to invest directly in businesses and to lend money (debt) to both firms and individuals. The investments are not guaranteed, however, and carry significantly more risk than bank deposits, albeit with a potential upside that might also be significantly greater. Typically, individual investors face limits on the amount of their exposure through crowdfunding channels.

The status of crowdfunding in developing EAP

Crowdfunding mobilizes funding through online platforms and is increasingly popular in developing EAP, and especially in China. China is by far the largest alternative finance market in the world. P2P lending, a subset of crowdfunding, is the biggest market segment, with consumer lending accounting for US$52 billion and business lending US$40 billion.[5] Even excluding China, the total market volume of alternative finance in developing EAP in 2015 was more than triple that of 2014 (Cambridge Center for Alternative Finance 2016).

Some of EAP's largest crowdfunding services are linked with networks such as social media platforms (Tencent) or e-commerce sites (Alipay). These relationships provide several advantages, starting with the ability of such networks to help reduce the information asymmetries in these credit markets. Data on e-commerce traffic or on an individual borrower's employment status or social capital can help to assess risk. The networks do more than provide information used in the loan decision. They also can facilitate mentoring, feedback, and support for small firms and form part of a broader ecosystem by, for example, building on social media relationships

5 Equity-based crowdfunding is not yet legalized in mainland China, although draft rules were released in 2015.

with clients and suppliers, creating a way for incubators and accelerators to quickly test interest in new business ventures, and developing links to traditional lenders who might invest through crowdfunding platforms.

Within EAP, laws or regulations specific to crowdfunding are not yet in place except in Malaysia, Thailand, and high-income economies such as Australia; New Zealand; Hong Kong SAR, China; and Singapore. Many other developing EAP countries, including China, Indonesia, and Vietnam, are in the process of developing laws and regulations to address crowdfunding. In the meantime, existing securities or banking laws and regulations provide the de facto legal and regulatory framework. In many cases, however, these more general statutes may not provide the assurances investors seek to enter the market.

Malaysia and Thailand have introduced regulations that focus on equity crowdfunding, but nothing specifically on debt crowdfunding for individuals. Crowdfunding is currently supervised and regulated under either central banks' banking laws or financial regulators' securities laws. In Thailand, for instance, equity crowdfunding is regulated by the Securities and Exchange Commission as of May 2015; the Bank of Thailand oversees P2P lending; and the Securities and Exchange Commission oversees other debt crowdfunding.

Policy guidance

The prospects for crowdfunding hinge critically on establishing laws and regulations that favor enterprise growth and investments in firms, and on the availability of a wide range of borrower credit data. Scaling up crowdfunding will almost certainly lead to increasing reliance for funding on institutional investors or balance sheet lending. Measures are needed to ensure that large investors gain confidence in crowdfunding as a viable and sustainable source of credit, especially for firms.

Business and investment laws and regulations

The quality of national legal and regulatory frameworks, and in particular their ability to support enterprise growth and third-party investments in firms, varies significantly across EAP. Key issues include the willingness of people to establish their businesses formally, the protections afforded to minority investors, the ability to enforce contracts (including financial contracts), and the efficiency of the process for closing or reorganizing firms, resolving their debts, and liquidating assets. A heat map of the existing legal and regulatory framework (Table II.B.3) shows where the policy environment is well developed (shades of green) and where reforms are needed (orange and red), and with countries listed in order of their overall score in the *Doing Business 2016* report. Countries in EAP range from mostly high-income countries with strong legal and institutional frameworks (green), to middle-income countries with relatively developed investment climates (such as Thailand and China), to lower-income countries with greater institutional challenges (including Cambodia, Indonesia, Lao PDR, and the Philippines), to the least developed countries (including Myanmar, Papua New Guinea, and Timor-Leste).

Table II.B.3. Heat Map of Relevant Regulatory Environment for Crowdfunding

Country	*Starting a business*	*Getting credit*	*Protecting minority investors*	*Enforcing contracts*	*Resolving insolvency*
Singapore	10	19	1	1	27
New Zealand	1	1	1	15	31
Korea, Rep.	23	42	8	2	4
Hong Kong SAR, China	4	19	1	22	26
Taiwan, China	22	59	25	16	21
Australia	11	5	66	4	14
Malaysia	14	28	4	44	45
Japan	81	79	36	51	2
Thailand	96	97	36	57	49
Mongolia	36	59	8	80	89
Tonga	53	42	115	97	131
Brunei Darussalam	74	79	134	113	98
China	136	79	134	7	55
Fiji	167	79	111	88	89
Vietnam	119	28	122	74	123
Vanuatu	147	28	134	139	110
Samoa	39	152	57	79	133
Philippines	165	109	155	140	53
Indonesia	173	70	88	170	77
Solomon Islands	95	79	105	160	137
Cambodia	180	15	111	174	82
Lao PDR	153	70	178	92	189
Palau	116	79	182	130	166
Marshall Islands	71	79	178	65	167
Papua New Guinea	138	167	99	169	138
Micronesia, Fed. Sts.	162	70	185	181	116
Kiribati	142	162	122	114	189
Myanmar	160	174	184	187	162
Timor-Leste	104	162	81	189	189
Key	Top 5%	6%–25%	26%–50%	51%–75%	76% or below

Source: Doing Business 2016.
Note: Countries listed in order of their overall *Doing Business 2016* score. Each column denotes a sub-component of the overall "ease of doing business" indicator; numbers within that column denote countries' rank order on that sub-component.

This typology provides important insights:

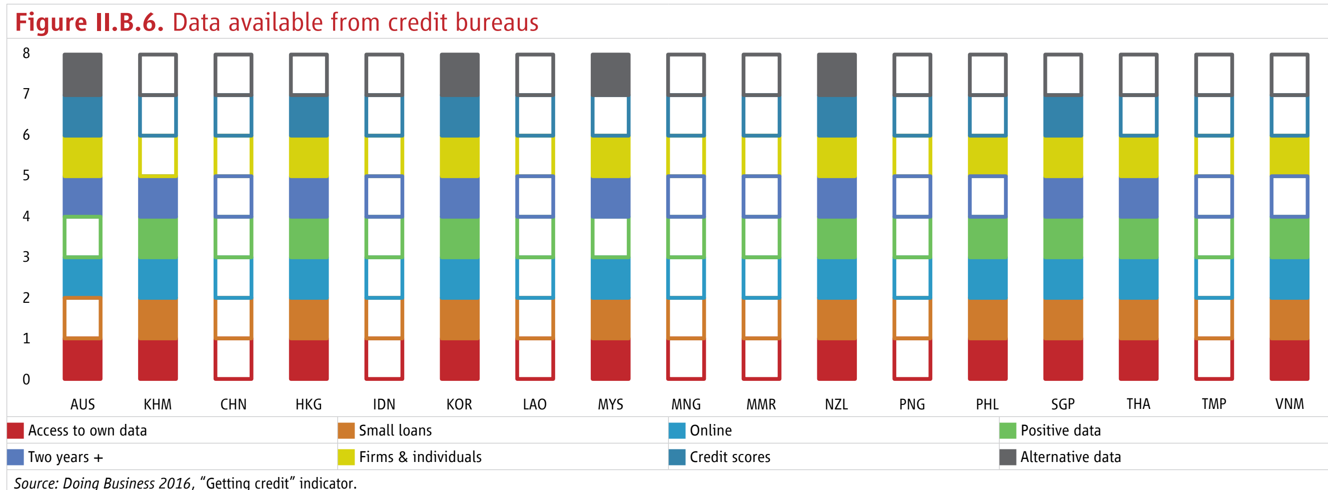
- **Crowdfunding is well suited to the sophisticated business climate in higher-income EAP** and helps explain the foothold it has gained in diverse countries including Hong Kong SAR, China; New Zealand; Korea; and Malaysia.
- **Many countries in developing EAP have at least some of the laws and institutions needed for crowdfunding.** However, in some countries it will require relatively extensive reforms, including of minority shareholder protection, contract enforcement, and insolvency.
- **Countries in developing EAP with the least developed legal and regulatory framework are not well placed to take advantage of crowdfunding.** They should focus on the reforms needed to establish effective basic banking.

▪ *Data*

Borrower credit data are a critical input for any kind of lending relationship, but are especially crucial for arms-length transactions such as those conducted via crowdfunding websites. One of the best predictors of a borrower's future payment behavior is their past credit behavior. Credit information typically includes basic identification data (name, address, birthdate) and payment history. Some systems only collect negative payment data (late payments, defaults), but most now follow international good practice and also collect positive data related to on-time payments. These data provide the basis for development of analytical products and decision tools used by financial institutions.

EAP countries perform well on the "getting credit" indicator, often with higher rankings than on overall "ease of doing business"; however, the quality and coverage of credit data potentially available for crowdfunding varies greatly across countries (Figure II.B.6). The "getting credit" indicator includes a "depth of credit information index", which covers eight items, equally weighted, for both private credit bureaus and public credit registries. EAP's high-income countries such as Australia; Hong Kong SAR, China; Korea; New Zealand; and Singapore, all have high ratings (7 or 8 out of 8) for credit bureaus. Thailand and Malaysia also have relatively well developed private systems, each with a score of 6, followed by Cambodia, the Philippines, and Vietnam (all at 5). Some countries that rely on public credit registries—typically administered by the central bank or bank supervisor—have little or no data available through privately run credit bureaus. This is the case for China, Mongolia, and Indonesia. And in some countries, such as Papua New Guinea and Myanmar, credit reporting has yet to be developed.

Figure II.B.6. Data available from credit bureaus



Source: Doing Business 2016, "Getting credit" indicator.

Fintech ventures need access to credit and payment data on firms and individuals to make sound credit decisions, but in many cases in EAP these data are either not collected or not available outside the regulated banking sector. In countries that rely on a public sector registry for credit data, access is typically restricted to regulated financial institutions that have mandatory reporting requirements. Crowdfunding platforms and other fintech ventures that are not considered regulated financial institutions lack access to these data, which are usually housed in the bank superintendent or central bank. In response, fintech companies have developed

alternative data sources, in some cases based on social media. However, the accuracy of credit risk analysis is almost certainly diminished when critical data, such as payment history with banks, are not available.

The inclusion in credit reports of alternative data, such as payment history with retailers and utility companies, and the availability of credit scoring tools through credit bureaus are other important but largely lacking aspects of the credit information infrastructure in EAP. Only Australia, Korea, and New Zealand have private credit bureaus that include both credit scoring and alternative data, and no developing economies have either element. This is important for crowdfunding and other new fintech activities, because credit scoring tools are more robust and accurate when based on more comprehensive data, such as credit bureau data from multiple sources rather than institutional data from only one lender. This is especially true for new market entrants or smaller volume lenders. The ability of crowdfunding platforms to buy a credit score from a bureau as part of their credit risk analysis offers greater reliability and reduces startup costs. In essence, access to a credit bureau score helps level the playing field among market participants, reducing the value of information rents to large, incumbent financial institutions, and fostering greater competition for good-quality customers.

The inclusion of alternative data in private credit bureaus is important for several reasons, both for the information value it carries and as an indicator of the potential for nonregulated financial institutions to access the credit bureau data. Alternative data refers to credit and payment data obtained from nonbank and often nonfinancial institutions such as utility companies, retailers and, in some cases, government agencies. These data are especially valuable for customers who might not have taken any bank loans but who do have a payment history that can be used as a starting point to gauge creditworthiness and to serve as reputation collateral. For startup firms, young borrowers, and low-income borrowers, the access to alternative data through a credit bureau is particularly important.

The other reason the alternative data indicator is important for this discussion of fintech is that it serves as a kind of proxy for the institutional structure of the credit bureau. Where regulated financial institutions are the owners of the private credit bureau, they may restrict access to the data, preferring to keep the bureau limited to the banking sector. In such instances, it is likely that the bureau would not be able to collect alternative data; nonbanks would be reluctant to share data if they do not have equivalent access to the data from banks. However, when a bureau is not limited to the banking sector, it is more likely to seek access to relevant data sources throughout the economy, as captured by the alternative data indicator in "Getting credit". This would likely include establishing relationships with fintech firms such as crowdfunding platforms—to both provide data and, if available, scores, as inputs to the lending decisions, and then collect data on borrower performance.

Conclusions

An advanced technology environment in most EAP countries creates an opportunity for the relatively rapid development of fintech and alternative finance. Much of the region enjoys extremely high mobile phone penetration rates, and internet penetration rates continue to grow, with the overwhelming majority of new connections via mobile platforms. In most countries the basic technological conditions for expansion exist. This fact alone, however, is not sufficient for market success.

Fintech solutions must offer value to both customers and the businesses that provide them. Solutions will have more success if they fulfill several objectives, such as promoting customer loyalty to mobile phone companies, as has been shown to be the case for mobile payment services. In Asia, e-commerce giants such as Alibaba, and social media platforms such as WeChat, have launched financial products that already reach hundreds of millions of customers, providing convenience to individuals and strengthening ties to businesses on these platforms. Any growth slowdown in the region will dampen incentives for new projects across the board, including for fintech, especially in cases where significant upfront investments are required.

The demand side creates another challenge for fintech in the region, particularly the persistent reliance on cash as a means of payment. Even when consumers in Asia buy online, they frequently continue to pay for their purchases in cash through cash-on-delivery arrangements. Supply-side limits to financial inclusion such as relatively low levels of account penetration are part of this dynamic, but these likely combine with other demand-side factors such as concerns over privacy and transparency. Shifting the demand side will take time and both private sector efforts through development and marketing of attractive and convenient products, and public policies that support them, and in some cases, such as government-to-person payments, consumers to adopt new financial behaviors.

Public policies, and especially the legal and regulatory frameworks that govern financial services, are a critical building block for fintech and alternative finance. Some of the private sector innovations discussed above, such as mobile payments led by mobile phone companies or short-term loans provided by e-commerce sites, were possible because of "trial and error" approaches by regulators that allowed innovation. In other cases, such as crowdfunding, the private sector is largely stalled, waiting for government to implement the legal and regulatory framework. Regulators face a delicate balancing act—how to encourage innovation and competition while also taking into consideration sometimes competing objectives of system stability and soundness and consumer protection. A holistic view of consumer welfare should be developed by regulators—one that takes into account benefits to be gained from improved access, convenience, and competition in financial markets, and the possible associated costs such as more aggressive marketing of financial products, opportunities for fraud, or greater dissemination of personal data. New business models will also likely force regulators to look beyond more narrow current definitions of licensed financial institutions and expand their scope of action (at times in coordination with other regulators such as those responsible for ICT) to keep pace with innovation in the sector.

Finally, the technological breakthroughs that make fintech and alternative finance possible can sometimes distract attention from traditional areas of financial and private sector development that continue to create obstacles to access. The arms-length nature of most technology-powered innovations increases the importance of confidence in institutions, firms, contracts, and courts. Broadly covered under rule of law, these issues include topics such as corporate governance for both firms and financial institutions, protection of minority shareholder rights, alternative dispute resolution mechanisms and, when those fail, confidence in an impartial and time- and cost-effective judiciary.

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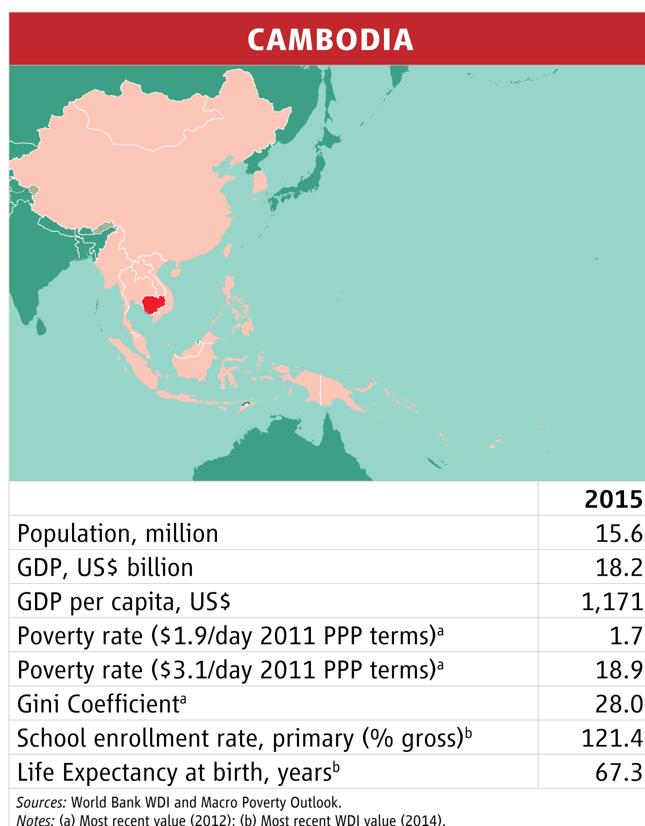
Part III. Country Pages and Key Indicators

CAMBODIA



	2015
Population, million	15.6
GDP, US$ billion	18.2
GDP per capita, US$	1,171
Poverty rate ($1.9/day 2011 PPP terms)[a]	1.7
Poverty rate ($3.1/day 2011 PPP terms)[a]	18.9
Gini Coefficient[a]	28.0
School enrollment rate, primary (% gross)[b]	121.4
Life Expectancy at birth, years[b]	67.3

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2012); (b) Most recent WDI value (2014).

Summary

Real growth is projected to reach 7.0 percent in 2016 (Figure 1), and 6.9 percent in 2017 and 2018, propelled by exports, construction, and government consumption. Downside risks, however, include forthcoming elections, fallout from rise in US interest rates, and slower global growth. Although severe drought caused by El Nino is a challenge, the downward trend of poverty is expected to continue over the next few years, but driven by different factors than before.

Recent Developments

Real growth is projected to reach 7 percent in 2016. Garment exports grew solidly, expanding at 10.5 percent (in value terms) year-on-year by mid-2016, compared with 7.8 percent during the same period last year. This trend is supported by stable industrial relations, introduction of washing, embroidery, and printing to add value, and moderate recovery in the Euro Area. Investor appetite in construction continues, with project approval value increasing to US$ 6.8 billion and imports of steel growing by 42.6 percent year-on-year by mid-2016. Meanwhile, tourist arrivals decelerated to 2.6 percent year-on-year in June 2016, compared with 6.1 percent in 2015. Better weather conditions this year may help the agriculture sector, although subdued agriculture commodity prices dampens agriculture exports.

Resilient exports and depressed oil prices have narrowed the trade deficit. In 2016, the current account deficit is projected to narrow to 10.2 percent of GDP, compared with 10.6 percent in 2015, mainly financed by FDI inflows (Table 2). Gross foreign reserves rose to US$6.4 billion (or 5.4 months of imports) by mid-2016, compared with US$5.6 billion in 2015.

Financial deepening is accommodating growth, while rising domestic demand has pushed up inflation. While there are some signs of moderation, domestic credit growth remains high, at 26.9 percent year-on-year by mid-2016. Deposits growth accelerated to 19.3 percent year-on-year by mid-2016. Inflation edged up to 3.3 percent year-on-year by mid-2016. The Cambodian riel (CR) depreciated slightly to CR 4,080 per US dollar in June 2016; so did the real effective exchange rate.

Fiscal expansion has begun, driven in part by the rising wage bill, while good revenue collection continues. The overall fiscal deficit is expected to widen to 1.2 percent of GDP in 2016, compared to 0.1 percent of GDP in 2015. Collections improved to 18.5 percent of GDP in 2015, compared to 18.1 percent in 2014. Cambodia's debt distress rating in the latest World Bank/IMF Debt Sustainability Analysis (2016) remained low.

While poverty reduction in rural areas is expected to have significantly decelerated in 2014 and 2015, in a context of sluggish agriculture performance and subdued commodity prices, better crops in 2016 are

expected to modestly resume poverty alleviation; dynamism in the garment and construction sectors would be the new drivers for poverty reduction. Over the past decade, Cambodia has attained dramatic gains in terms of poverty reduction, driven by higher agricultural prices, expansion of land under cultivation and increases in yields (Figure 2). Rural households reaped the benefits of the growth in the agricultural sector, while in recent years, urban households have benefited from the expansion of the garment and construction sectors.

Outlook

Growth is projected to be sustained at 6.9 percent in 2017-18, partly buoyed by rising government expenditure. Solid garment exports would continue, while the construction sector is expected to ease gradually. The tourism sector may benefit from new direct flights.

Poverty reduction in Cambodia has been resilient. Further reduction of poverty is thus expected for both urban and rural households throughout 2015–16 but with a different set of drivers. For urban households, poverty reduction will be driven by growth in the construction, garment and services sectors. For rural households there has been an increase in sources of non-agriculture income. Agriculture now constitutes only 25 percent of income of the bottom 40 percent in rural areas, and this diversification cushions households from the impact of declining food prices. However, the decline in food prices will still deprive households a previous source of income growth, thus the pace of poverty reduction is anticipated to be slower than in previous years.

Downside risks to this outlook include potential uncertainty related to forthcoming elections, fallout from rise in US interest rates, and slower global growth.

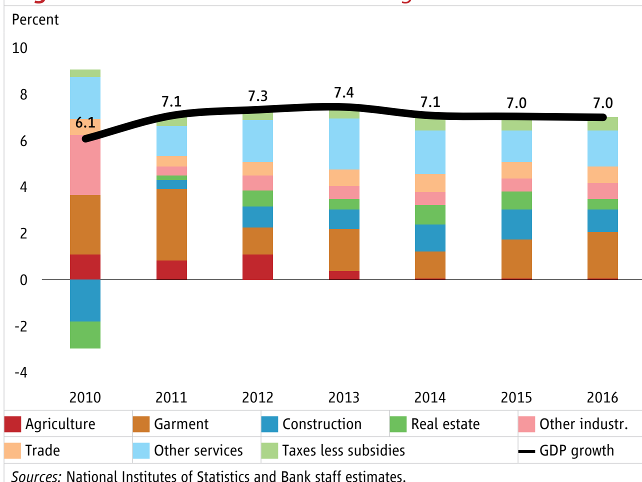
Risks and Challenges

Enhancing competitiveness is key. Addressing the high energy costs will facilitate expansion and diversification beyond garments to agro-processing, electronics, and vehicle parts, which may also require narrowing the skills gap. Cambodia is improving its connectivity to neighboring countries through better logistics, infrastructure, and transportation costs as the country has envisaged to progressively position itself as a regional logistics hub.

Maintaining financial stability is another priority. Successful implementation of the newly introduced macro-prudential measures will require enhancing supervision, coordination, and quality of information, in particular close supervision and monitoring of the microfinance sector to avoid unsustainable indebtedness.

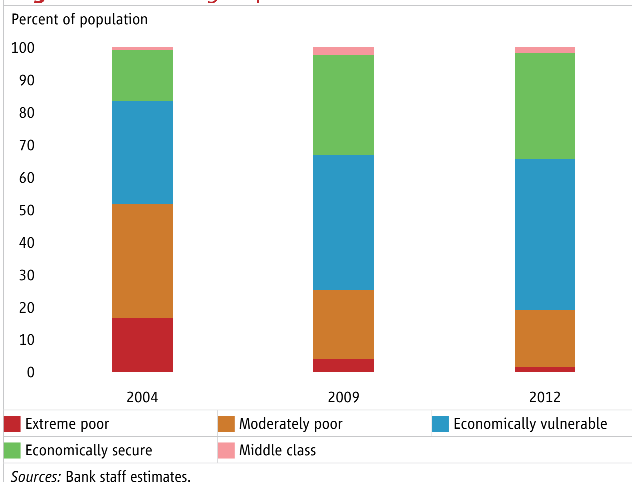
Despite the reduction in extreme poverty, the share of non-poor but economically insecure households has been growing. Mobility towards economic security has been limited since 2009, in part because of inadequate human capital or other assets like land. The challenge is to close gaps in human development and build a foundation for a middle class society, while investing in programs that promote resilience of households and minimize their vulnerability.

Figure 1. Contributions to real GDP growth



Sources: National Institutes of Statistics and Bank staff estimates.

Figure 2. Income group

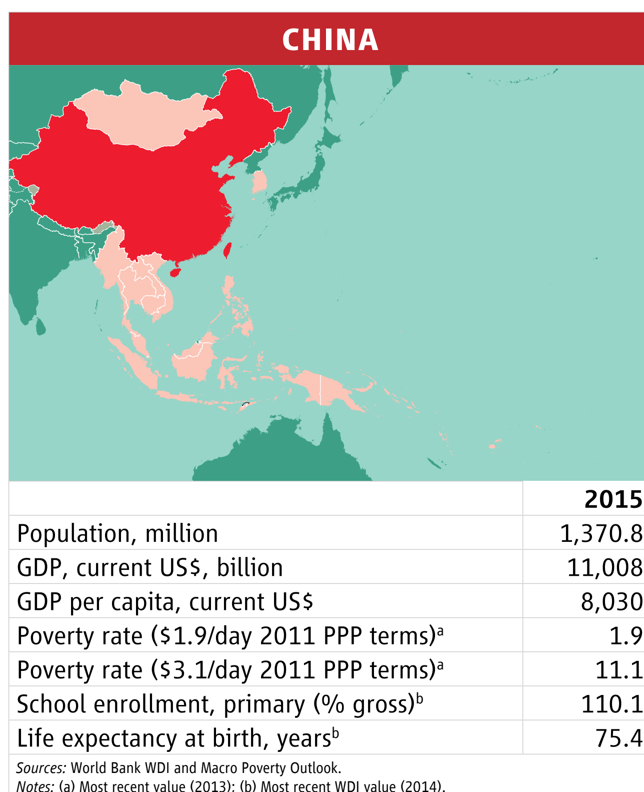


Sources: Bank staff estimates.

CAMBODIA Selected Indicators	2013	2014	2015	2016f	2017f	2018f
Real GDP growth, at constant market prices	7.4	7.1	7.0	7.0	6.9	6.9
Private Consumption	5.8	4.5	5.9	2.4	2.3	2.2
Government Consumption	5.2	2.4	4.4	3.8	10.3	14.5
Gross Fixed Capital Investment	15.3	9.1	10.6	8.1	9.7	16.8
Exports, Goods and Services	14.0	11.3	7.2	9.5	8.1	8.3
Imports, Goods and Services	15.1	10.1	6.5	5.9	5.8	7.9
Real GDP growth, at constant factor prices	7.4	6.9	6.9	6.9	6.9	6.9
Agriculture	1.6	0.3	0.2	0.4	0.3	0.7
Industry	11.0	9.8	11.7	11.4	9.0	7.7
Services	8.7	8.7	7.1	6.8	8.5	9.1
Inflation (Consumer Price Index)	2.2	1.7	1.3	3.2	3.4	3.5
Current Account Balance (% of GDP)	-9.5	-9.0	-8.5	-8.4	-8.5	-8.7
Financial and Capital Account (% of GDP)	15.2	14.6	14.1	13.4	12.0	10.8
Net Foreign Direct Investment (% of GDP)	11.8	10.0	9.1	8.5	8.2	7.0
Fiscal Balance (% of GDP)	-6.5	-3.8	-2.0	-2.9	-4.9	-4.9
Debt (% of GDP)	31.6	31.8	32.1	32.6	33.3	34.0
Primary Balance (% of GDP)	-5.8	-3.1	-1.7	-2.5	-4.6	-4.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: e=estimate and f = forecast.

CHINA



	2015
Population, million	1,370.8
GDP, current US$, billion	11,008
GDP per capita, current US$	8,030
Poverty rate ($1.9/day 2011 PPP terms)[a]	1.9
Poverty rate ($3.1/day 2011 PPP terms)[a]	11.1
School enrollment, primary (% gross)[b]	110.1
Life expectancy at birth, years[b]	75.4

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2013); (b) Most recent WDI value (2014).

Summary

China's GDP grew by 6.7 percent year-on-year in the first half of 2016, down from 6.9 percent in 2015. GDP growth is expected to moderate further in the near future as economic rebalancing to services, consumption, and higher value added production continues. New World Bank estimates suggest the poverty rate in China ($1.90 a day PPP) may be as low as 1 percent of the population, and should decline to 0.5 percent by 2018. In the context of growth stimulus policies, the expansion of credit in the Chinese economy continues to well outpace GDP growth, and is increasing macroeconomic risks.

Recent Developments

China's transition to slower but structurally rebalanced growth continues. GDP expanded by 6.7 percent in the first half of 2016. The services sector has replaced the manufacturing sector as the economy's primary driver of growth, constituting 54 percent of GDP in the first half of 2016. Growth of industrial production continued to moderate. Consumption is replacing investment as the main source of demand growth. Consumption contributed 73.4 percent to overall GDP growth in the first half of 2016, while fixed capital formation and net exports of goods and services contributed 37 percent and -10.4 percent, respectively.

Real household incomes have been growing a bit more slowly than GDP in the first half of 2016. Average real income growth registered at 6.5 percent for the first half of 2016, with urban incomes growing by 5.8 percent and rural incomes expanding by 6.7 percent. In the first half of 2016, average real income growth exceeded GDP growth at 7.6 percent. Higher inflation in food and some other products appear to explain part of the slowdown in real income growth. CPI inflation in the first six months of 2016 amounted to 0.9 percent as opposed to 0.6 percent in the first six months of 2015.

China continues to make remarkable progress in poverty reduction. But new data are not fully comparable to previous surveys before 2013. Since 2013, the National Bureau of Statistics (NBS) of China has collected household data using a new integrated household survey. This new survey introduces innovations in income and consumption aggregates for urban and rural households (called new "caliber" in some NBS publications). Using these new aggregates we project the poverty rate to decline from 1.9 to 0.5 percent between 2013 and 2018 (for a poverty line of US$1.90 a day at 2011 PPP exchange rates). Poverty rates using US$3.10 a day (perhaps more suitable for a middle-income country like China) are projected to decline from 11.1 to 3.9 percent between 2013 and 2018.

Significant fiscal and credit-based stimulus measures supported growth in 2015 and the first half of 2016. Credit to government and the non-financial sector has continued to grow at roughly twice the pace of the economy, and is now over 250 percent of GDP.

A large share of this credit has been concentrated in infrastructure, real estate, and lagging regions with declining marginal returns. The Chinese leadership has indicated a growing concern with the risks associated with this still very rapid credit growth both by commercial banks and non-bank financial institutions. In the context of some measures to strengthen regulation in the financial sector, credit growth moderated somewhat in June and July. The structure of credit growth has also changed significantly since May, with the expansion of credit to the corporate sector declining significantly and giving way to a new boom in mortgage lending in light of a recovering real estate market.

Despite a still strong current account surplus and a gross foreign reserve position of US$3.2 trillion at the end of June, China has faced the challenge of significant capital outflows and downward pressures on the Renminbi (RMB) since 2015. China's foreign-currency reserves dropped by a cumulative US$125.2 billion during the first half of 2016, compared with US$ 149.1 billion loss during the first half of 2015 and a US$ 513 billion loss for the entire year. Capital outflows moderated following the clarification of the PBOC in early 2016 of its intent to counteract exchange rate volatility and refrain from any strategic one-off devaluation. The RMB depreciated by 2.2 percent vis-a-vis the U.S. dollar in the first six months of the year, and by nearly 5.8 percent in trade-weighted terms.

On the external front, merchandize exports and imports growth remained weak, reflecting weak external demand. The US dollar value of Chinese goods exports declined by 7.7 percent in the first half of 2016 relative to the same period of 2015, while imports tumbled by 10.2 percent. Nevertheless, China's trade surplus strengthened marginally during this period compared to the previous year, exceeding US$ 2.5 trillion.

Outlook

China's GDP growth is expected to continue moderating, as structural adjustments and policy efforts to address the accumulated financial vulnerabilities move ahead. The government has announced an official growth target of 6.5 to 7.0 percent for 2016. Growth is expected to gradually moderate from 6.7 percent in 2016 and 6.5 percent in 2017, assuming continued reforms both to enable economic restructuring as well as to address the vulnerabilities built up since the global financial crisis. Poverty rates are projected to decline from 1.1 percent in 2015 to 0.5 percent in 2018.

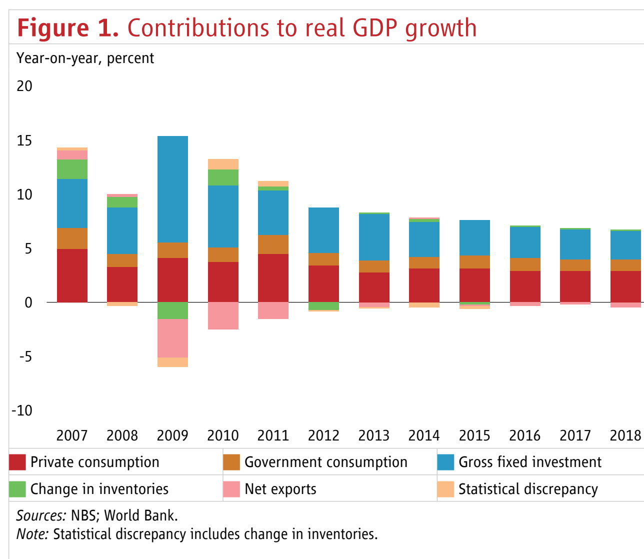
Challenges

A key short-to-medium term challenge is to address the buildup of financial risks and to facilitate orderly deleveraging of the economy. Policies to slow credit growth to SOEs and facilitate deleveraging in some areas of the economy may have a negative short-term impact on growth, but are essential for sustaining relatively rapid growth over the medium and longer term. Postponing these policies could likely increase their future costs.

The overarching challenge is to implement the necessary reforms to ensure a successful economic transition. China's leadership has articulated well the structural reforms needed to ensure the country's successful economic rebalancing and to sustaining strong economic growth under its 13th Five Year Plan, approved by the People's Congress in March 2016. Until now, reform implementation has been mixed. While significant progress has been achieved in some areas, deeper reforms are needed to increase the role of markets, the private sector, competition, and domestic consumption for driving productivity-led and greener growth in the future. The potential for future growth in China remains strong. In addition, Chinese authorities understand the challenges of poverty and inequality and have set poverty eradication and abating inequality

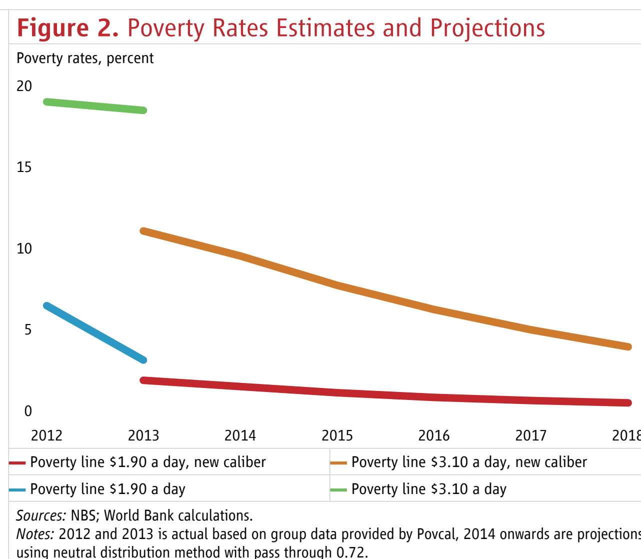
as fundamental objectives of the 13th Five-Year Plan. “Sharing” is one of the plan’s five guiding principles and includes as main objectives eradicating poverty, improving access to basic public services, and to reduce the income gap.

Figure 1. Contributions to real GDP growth



Sources: NBS; World Bank.
Note: Statistical discrepancy includes change in inventories.

Figure 2. Poverty Rates Estimates and Projections

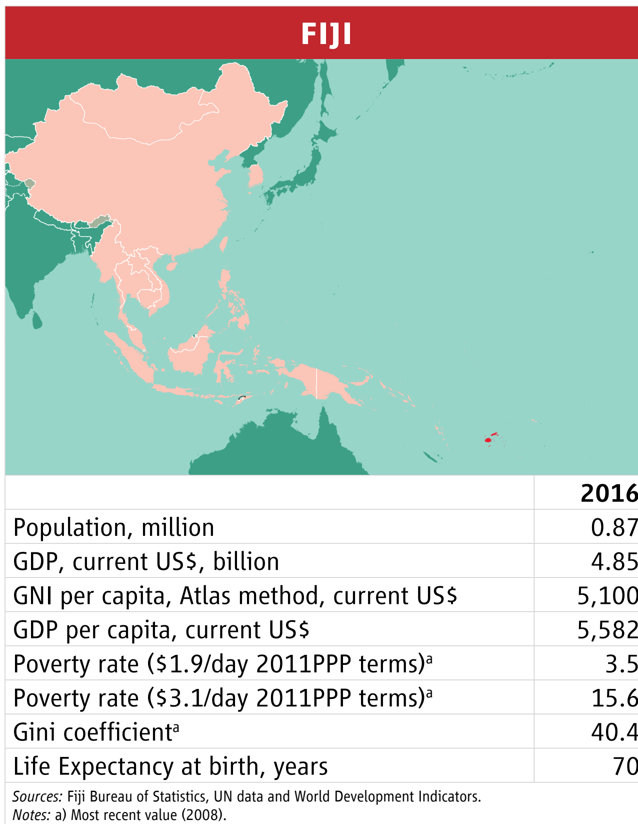


Sources: NBS; World Bank calculations.
Notes: 2012 and 2013 is actual based on group data provided by Povcal, 2014 onwards are projections using neutral distribution method with pass through 0.72.

CHINA Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	7.8	7.3	6.9	6.7	6.5	6.3
Private Consumption	6.8	7.9	7.6	7.2	7.0	6.9
Government Consumption	7.1	6.9	7.9	7.5	7.3	7.2
Gross Fixed Capital Investment	9.3	6.9	6.9	6.2	5.9	5.7
Exports, Goods and Services	4.0	5.4	-2.0	1.0	2.1	2.4
Imports, Goods and Services	4.6	4.0	-1.3	2.1	2.8	3.6
Real GDP growth, at constant factor prices	7.8	7.3	6.9	6.7	6.5	6.3
Agriculture	3.8	4.1	3.9	3.7	3.6	3.5
Industry	8.0	7.4	6.1	5.8	5.5	5.2
Services	8.2	7.7	8.4	8.3	8.1	7.8
Inflation (Consumer Price Index)	2.6	2.0	1.4	1.8	2.0	2.1
Current Account Balance (% of GDP)	1.5	2.6	3.0	3.0	2.9	2.8
Financial and Capital Account (% of GDP)	-0.9	-1.6	-1.6	-1.7	-1.7	-1.6
Net Foreign Direct Investment (% of GDP)	2.3	1.4	1.4	1.4	1.3	1.3
Fiscal Balance (% of GDP)	-0.8	-0.9	-2.7	-3.0	-3.1	-3.2
Debt (% of GDP)	39.1	40.9	43.8	46.4	49.1	51.6
Primary Balance (% of GDP)	-0.3	-0.4	-2.2	-2.2	-2.2	-2.2
Poverty rate ($1.9/day PPP terms)[a,b,c]	1.9	1.5	1.1	0.8	0.6	0.5
Poverty rate ($3.1/day PPP terms)[a,b,c]	11.1	9.5	7.7	6.2	5.0	3.9

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast. (a) 2013 is actual based on group data provided by Povcal, 2014 onwards are projections using neutral distribution with pass through 0.72. (b) 2013 survey is a break and not comparable with previous surveys.

FIJI



	2016
Population, million	0.87
GDP, current US$, billion	4.85
GNI per capita, Atlas method, current US$	5,100
GDP per capita, current US$	5,582
Poverty rate ($1.9/day 2011PPP terms)[a]	3.5
Poverty rate ($3.1/day 2011PPP terms)[a]	15.6
Gini coefficient[a]	40.4
Life Expectancy at birth, years	70

Sources: Fiji Bureau of Statistics, UN data and World Development Indicators.
Notes: a) Most recent value (2008).

Summary

Growth momentum remains strong despite the downward revision in growth forecasts following Tropical Cyclone Winston, boosted by strong visitor arrivals, inward remittances, and credit growth. Poverty has declined faster in rural areas than in urban centers, although the picture may have been partially reversed by the recent cyclone which disproportionately affected rural areas. The outlook is broadly favorable but with downside risks from external developments and the quality of domestic policy adjustments. Restoring fiscal sustainability remains a priority for maintaining strong and inclusive growth.

Recent Developments

Fiji's growth momentum remains strong despite the downward revision in growth forecasts to 2.4 from 3.5 percent following Tropical Cyclone (TC) Winston in February (Figure 1). Despite the cyclone, visitor arrivals have held up rising 5.2 percent in the year to May, as most tourist resorts escaped damage. Personal remittances also rose 6.8 percent on the year in January–May as families and relatives overseas responded to the cyclone. The government provided disaster-response social protection in the wake of the cyclone to cushion its impact on the poor and other vulnerable groups. Recovery-related construction activities and improving labor market conditions further boosted consumption and investment.

The annual inflation rose to 5.5 percent in July for the fourth consecutive month amid domestic supply shortages and temporary price hikes in some agricultural products caused by the cyclone, prompting the Reserve Bank of Fiji (RBF) to revise up the year-end inflation forecast to 3.5 percent.

The exchange rate remains largely stable against a basket of currencies, appreciating against the Australian and New Zealand dollars while depreciating against the US dollar, the Euro, and the Yen. Overall, both the Nominal Effective Exchange Rate and the Real Effective Exchange Rate fell by 1.6 percent and 1.3 percent, respectively, over the year to July.

The external deficit remains high at around 8 percent of GDP due to large structural deficits in the merchandise trade account. Strong remittances, a large services surplus (linked to tourism and Fiji's position as a transport hub), and inflows of donor financing for the reconstruction are providing a much needed offset. Foreign reserves continue to remain adequate in end-August at around 5.3 months of imports.

The fiscal deficit is expected to widen as the reconstruction activities pick up pace. The newly launched 2016/17 budget announced in end June[1] estimates the fiscal deficit to expand to 7.3 percent of GDP for the new

1 The government changed its fiscal year from the calendar to the August–July to better align timings of revenue and expenditure and to ease revenue collection at the end of the fiscal year which previously fell around Christmas holiday.

August-July fiscal year. Around 2.1 percentage points of the deficit is due to the Winston-related reconstruction spending. The government debt, which has been falling as a share of GDP, is expected to rise to 48 percent this year.

Extreme poverty is rare in Fiji, but many people still live below national benchmarks for basic-needs poverty.[2] Preliminary estimates from the 2013/14 Household Income and Expenditure Survey show a decline in the share of households with incomes below a basic-needs poverty line from 31 to 28 percent since 2008/09. Within this overall trend, rural poverty fell faster (from 43 to 37 percent) while urban poverty rose marginally (from 18 to 20 percent). Poverty rates are highest in the Northern and Eastern Divisions—areas that were hit hard by the TC Winston—at 48 and 40 percent, respectively.

Outlook

Growth outlook remains positive, supported by the continued strength of tourism, remittances, and public spending on recovery and reconstruction. Annual inflation is expected to rise to 2–3 percent as shortages in some agricultural products, strong domestic demand, and capacity constraints from reconstruction activities put upward pressure on prices. The Fiji dollar is expected to continue to depreciate relative to the US dollar in 2016–18, both as a result of a stronger US dollar and higher domestic inflation.

Current account deficits will likely remain elevated, as recovering oil prices and stronger import demand for reconstruction raise imports, while weak gold prices, crop losses, and lower EU preferential prices for sugar depress exports.

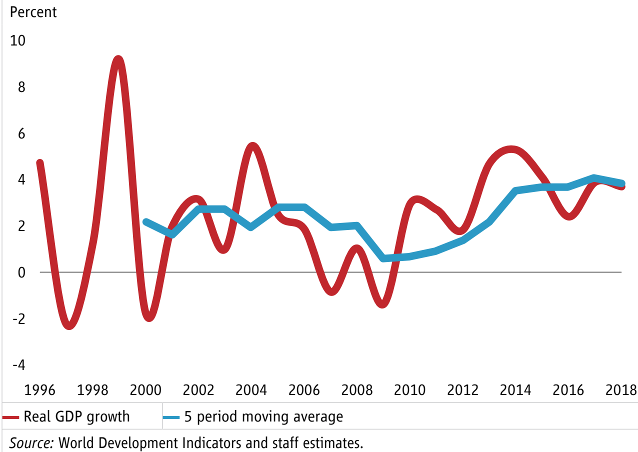
Public finances will remain firmly in deficit for the forecasting period, as the government focuses on reconstruction and assistance to the vulnerable households in the aftermath of the cyclone. The government is committed to maintaining the level of debt below 50 percent of GDP over the medium term and to reduce exposure to exchange rate shocks by expanding domestic sources of funding, with a target ratio of domestic to external debt of 70:30 (+/-5 percent).

Risks and Challenges

There are several risks to the outlook. Another natural disaster or a sharper-than-expected slowdown in growth in Fiji's major export or tourism source markets could sidetrack the timely completion of the recovery program and further delay the needed fiscal consolidation. A rising inflation, if not stemmed by prompt monetary tightening (the RBF has kept its policy rates at record low at 0.5 percent since 2011), could raise inflation expectation and lead to abrupt tightening in domestic interest rates which, after several years of double-digit credit growth, could result in wider disruptions in domestic demand. Putting in place a credible plan for fiscal consolidation is a priority. While government has understandably put strong focus on rehabilitation and reconstruction in the 2016/17 Budget, a credible plan for medium term fiscal consolidation should be in place to bolster confidence and manage inflation expectations. Capital spending might be easier to moderate from recent peaks, but operational spending could prove difficult to cut given that around 84 percent of the spending are in the hard-to-reduce categories (Figure 2). Ongoing civil service compensation surveys—a benchmarking of salary levels of more than 140 civil service positions against comparable positions in the private sector—are expected to result in upward revisions of civil service pays. Together with likely increases in spending pressure as the country prepares for the next election in 2018, the planned fiscal consolidation may prove difficult to implement.

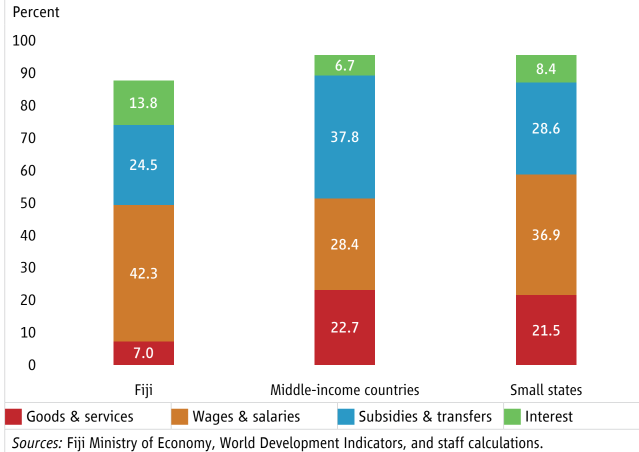
2 The figures discussed here are income-based estimates produced by the Fiji Bureau of Statistics. Preparation of consumption-based estimates are underway with the World Bank poverty team.

Figure 1. Real GDP growth



Source: World Development Indicators and staff estimates.

Figure 2. Recurrent spending breakdown

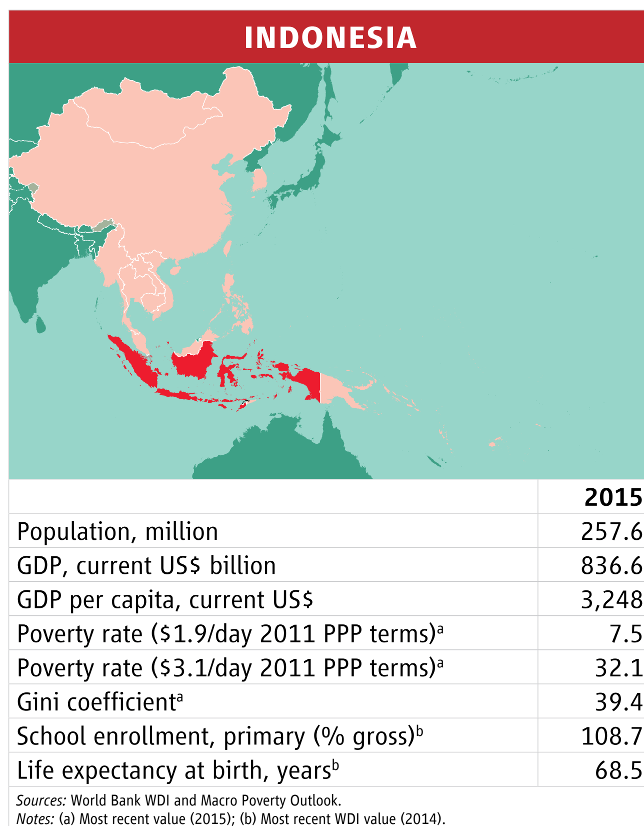


Sources: Fiji Ministry of Economy, World Development Indicators, and staff calculations.

FIJI Selected Indicators	*2012*	*2013*	*2014*	*2015e*	*2016f*	*2017f*	*2018f*
Real gross domestic product	1.8	4.7	5.3	4.1	2.4	3.9	3.7
Exports, Goods and Services	9.1	-6.7	10.2	5.2	2.8	3.9	3.4
Imports, Goods and Services	4.0	20.6	6.8	3.0	8.0	5.9	6.1
GDP, at market prices	1.8	4.7	5.3	4.1	2.4	3.9	3.7
Agriculture	3.5	-1.9	6.7	-0.3	-7.6	2.0	1.5
Industry	0.2	-1.7	4.1	1.9	1.1	1.4	1.2
Services	1.9	2.9	5.0	7.4	4.1	4.8	4.5
CPI inflation, period average	3.4	2.9	0.5	1.4	2.1	3.0	2.6
Current Account Balance (% of GDP)	-1.3	-9.8	-7.2	-5.4	-7.8	-8.2	-8.5
Fiscal Balance (% of GDP)[a]	-1.1	-0.6	-4.3	-4.6	-7.3	-5.0	-3.0

Sources: Fiji Bureau of Statistics, Reserve Bank of Fiji, World Development Indicators, and staff estimates.
Notes: e=estimate, f=forecast. (a) Fiji changed the government fiscal year from the calendar to the August–July fiscal year starting 2016.

INDONESIA



	2015
Population, million	257.6
GDP, current US$ billion	836.6
GDP per capita, current US$	3,248
Poverty rate ($1.9/day 2011 PPP terms)[a]	7.5
Poverty rate ($3.1/day 2011 PPP terms)[a]	32.1
Gini coefficient[a]	39.4
School enrollment, primary (% gross)[b]	108.7
Life expectancy at birth, years[b]	68.5

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2015); (b) Most recent WDI value (2014).

Summary

Indonesia's economy has remained resilient amid a persistently unfavorable global environment. Sound monetary policy and higher public investment have supported domestic activity, while robust private consumption remains the main growth driver. However, significant improvements in fiscal management and a more ambitious reform process are required for a sustained boost to growth. Expanded social assistance could accelerate poverty reduction from 2017. El-Niño and La-Niña have threatened agricultural production, but improved policy implementation has effectively stabilized rice prices to date.

Recent Developments

Supported by domestic spending, Indonesia's economy remains resilient amid a challenging international environment. GDP increased by 5.0 percent in the first half of 2016, a slightly higher pace of growth compared with 2015. Private consumption grew by an average of 5.0 percent in Q1 and Q2, driving overall growth. Government consumption and investment growth rose in the second quarter, but the slow start to the year highlights persistent challenges in public expenditure disbursement. However, the pickup in private investment, which is essential to achieve higher growth, has remained elusive. At the same time, moderate domestic demand and lower energy prices have resulted in consumer price inflation declining to an average of 3.8 percent so far this year, compared with 6.4 percent in 2015. As a consequence of slightly higher growth and lower inflation, the official poverty rate fell by 0.2 percentage points to 10.9 percent in March 2016.

With global growth and trade persistently weak, Indonesia's exports declined again in the first six months of 2016, but by less than in 2015 as the prices of coal, base metals, rubber, and palm oil have risen somewhat since then. Similarly, imports contracted in year-on-year terms this year, but by less than last year. The current account deficit—at about 2.1 percent of GDP since last year—has helped limit somewhat Indonesia's external vulnerabilities. Capital inflows have improved in recent months, with government bonds attracting the largest share, while much needed direct investment has remained subdued.

Indonesia's recent resilience has depended on a number of good policies, including prudent monetary and exchange rate management and higher public investment. Despite weak revenue collection and persistent planning and execution challenges, public infrastructure spending has become a priority for the government. In addition, the policy measures enacted in early 2016 as part of the new administration's reform drive are expected to yield meaningful medium-term improvements in trade policy and the business climate. However, more fundamental trade and investment policy changes, as well as effective implementation,

may be required to propel a sustained rise in private investment.

Outlook

Looking ahead, the World Bank projects GDP to increase by 5.1 percent in 2016 and 5.3 percent in 2017. Private consumption is forecasted to pick up slightly on account of moderate inflation and lower energy prices, a relatively stable Rupiah, and fiscal support in the form of a higher personal income tax threshold and an additional monthly salary for civil servants. Growth is expected to be supported also by an acceleration in government spending, in particular on capital, in the second half of the year in line with historical trend. Beyond 2016, the outlook depends on private investment growth picking up as it responds to the government's reforms and the gradual recovery in global growth.

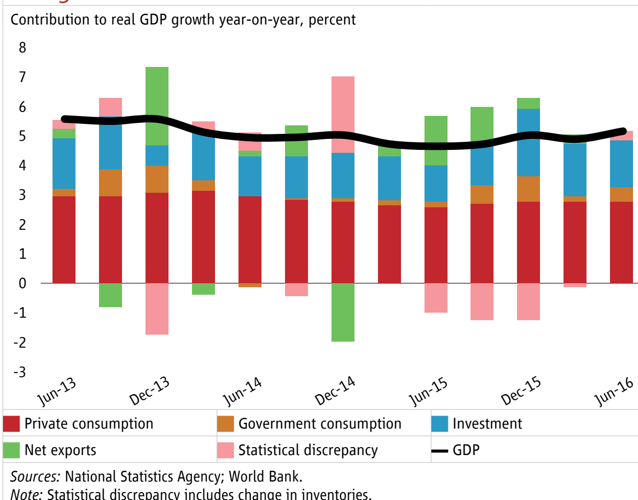
While strengthening growth and lower inflation should lower poverty, the pace of poverty reduction in recent years has been slow. On current growth and price expectations alone, extreme poverty (those living below US$1.90 per person per day in 2011 purchasing power parity terms), at 7.5 percent in 2015, is projected to show only slight declines to 6.5 percent in 2016 and 5.7 percent in 2017. Moderate poverty (those living on less than US$3.10 per person per day) is also expected to experience small declines to 30.7 percent in 2016 and 29.2 percent in 2017, from 32.1 percent in 2015. However, the significant expansion of the conditional cash transfer program (PKH) targeted at the poor and vulnerable, beginning in the second half of 2016 is expected to reduce March 2017 extreme poverty by an additional 0.5 percentage points to 5.2 percent, and continued expansion in late 2017 could contribute further. Nonetheless, PKH expansion will provide only a short-term reduction in poverty; sustained progress in the longer-term will depend not only on a stronger safety net, but also on job creation, better investments in health and education.

Risks and Challenges

Revenue collection remains a significant challenge for Indonesia. Natural resource revenues are projected to contract considerably in 2016 and tax collection remains weak, even after accounting for unfavorable macroeconomic conditions. In June, the government revised the 2016 budget but set a high target for revenues from a nine-month tax amnesty program. In July, the Finance Ministry announced further spending cuts of 1.2 percent of GDP and an expansion of the fiscal deficit to 2.5 percent of GDP. The large expenditure adjustments required both in 2015 and 2016, as well as the fact that most public spending, especially on infrastructure, occurs in the last quarter of the year, have limited the effectiveness of fiscal policy in supporting growth. Therefore, the draft 2017 budget submitted to Parliament in mid-August, which includes prudent revenue targets, is an important step towards improving fiscal planning and execution.

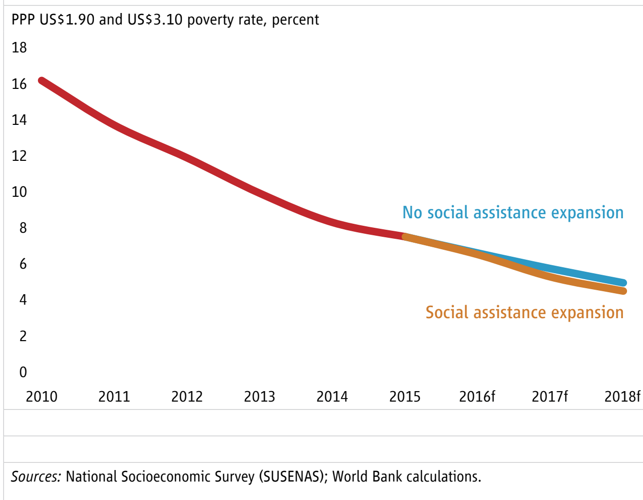
Turning to food price developments, dry weather due to El Niño delayed the planting of the 2016 main paddy crop and La Niña is expected to delay the second main harvest; this could adversely impact production although the effect is not yet known. However, effective implementation of rice price stabilization instruments—one of the largest rice import and market operations in the last decade, combined with improved stock management and an extra Raskin distribution—kept rice inflation low through the first half of 2016 in the lead up to Ramadan. Price inflation for other foods remained higher, as in previous years, reflecting an opportunity to extend effective price policies to other areas.

Figure 1. Higher public spending supported investment and growth in the second half of 2015



Sources: National Statistics Agency; World Bank.
Note: Statistical discrepancy includes change in inventories.

Figure 2. Social assistance expansion could help poverty reduction in the short-term

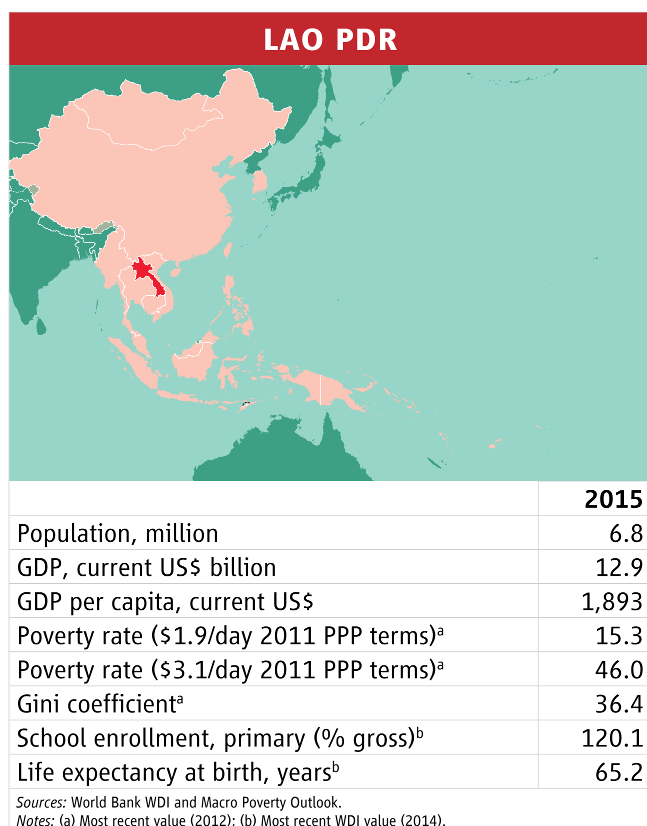


Sources: National Socioeconomic Survey (SUSENAS); World Bank calculations.

INDONESIA Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	5.6	5.0	4.8	5.1	5.3	5.5
Private Consumption	5.5	5.3	4.8	5.0	5.3	5.4
Government Consumption	6.7	1.2	5.4	4.2	5.1	4.5
Gross Fixed Capital Investment	5.0	4.6	5.1	4.7	5.2	6.0
Exports, Goods and Services	4.2	1.0	-2.0	-1.2	3.4	5.8
Imports, Goods and Services	1.9	2.2	-5.8	-2.3	2.7	6.2
Real GDP growth, at constant factor prices	5.2	5.0	4.1	5.1	5.3	5.5
Agriculture	4.2	4.2	4.0	4.0	4.2	4.3
Industry	4.3	4.3	2.7	4.2	4.5	4.6
Services	6.4	6.0	5.6	6.3	6.3	6.6
Inflation (Consumer Price Index)	6.4	6.4	6.4	3.9	4.5	4.6
Current Account Balance (% of GDP)	-3.2	-3.1	-2.1	-2.1	-2.3	-2.5
Financial and Capital Account (% of GDP)	3.4	3.3	2.2	3.2	3.2	3.0
Net Foreign Direct Investment (% of GDP)	1.3	1.7	1.1	1.2	1.3	1.5
Fiscal Balance (% of GDP)	-2.2	-2.2	-2.5	-2.8	-2.8	-2.8
Debt (% of GDP)	24.9	24.7	26.9	29.4	29.5	30.2
Primary Balance (% of GDP)	-1.0	-0.9	-1.2	-1.3	-1.2	-1.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast. All fiscal figures are for the central government. (a) Calculations based on EAPPOV harmonization, using 2011-SUSENAS and 2015-SUSENAS. (b) Projection using average elasticity (2011–15) with pass-through = 0.85 based on GDP per capita in constant LCU. (c) Actual data: 2013, 2014, 2015. Projections are from 2016 to 2018.

LAO PDR



	2015
Population, million	6.8
GDP, current US$ billion	12.9
GDP per capita, current US$	1,893
Poverty rate ($1.9/day 2011 PPP terms)[a]	15.3
Poverty rate ($3.1/day 2011 PPP terms)[a]	46.0
Gini coefficient[a]	36.4
School enrollment, primary (% gross)[b]	120.1
Life expectancy at birth, years[b]	65.2

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2012); (b) Most recent WDI value (2014).

Summary

Economic growth is projected to moderate, but still remain robust at around 7 percent in 2016 driven by the power sector, some recovery in agriculture and continued dynamism in manufacturing offsetting lower output from mining. Growing electricity exports helped improve the external balance; however, the low commodity prices negatively affected fiscal revenues and widened the deficit. While Lao PDR's past growth pattern was weakly linked to poverty reduction, the recent expansion of manufacturing and the low price pressures may have strengthened the link during 2016.

Recent Developments

The Lao economy is projected to grow at around 7 percent in 2016, a slight moderation from 7.4 percent last year. Around 1,350MW of installed capacity is expected to come on stream during 2016, increasing the capacity of the power system by more than 20 percent to around 6,200MW. Output in agriculture is expected to recover following last year's drought and output in manufacturing is to continue to expand, albeit from a low base and mostly confined to the Special Economic Zones. Construction activity moderated as few power projects were completed in 2015; however, it remains robust in 2016 supported by the pipeline power projects as well as real estate development. On the other hand, output in mining is expected to remain flat, while the number of tourist arrivals fell in the first half. Headline annual inflation averaged 1.3 percent during the first seven months of 2016 and is expected to pick up slightly as oil prices stabilize. Core inflation is at around 1.5 percent.

Lao PDR's high economic growth in the past was accompanied by a less than proportionate decline in poverty and by rising inequality. This was due to stagnant agriculture growth, where almost two-thirds of all workers remain engaged, and insufficient creation of off-farm jobs. Still, the recent expansion of manufacturing, and associated job-creation, as well as lower inflation may have strengthened the link during 2016.

The fiscal deficit is projected to widen to 6.2 percent in FY15/16. Revenues are expected to substantially decline from about 23 percent to 19 percent in FY15/16 due to lower commodity and oil prices (affecting royalties and taxes on mining, and excises and import duties on oil), and moderating economic activity and imports. In response, the authorities canceled tax exemptions on vehicles and fuel for investment projects. At the same time, spending cuts were less commensurate to the revenue shortfall, also due to spending related to Laos PDR's ASEAN Chairmanship during 2016 with the expenditure to GDP ratio declining from 27 percent to 25 percent in FY15/16. The deficit was financed by increased borrowing pushing public debt above 66 percent of GDP recorded at the end of 2015 and keeping Lao PDR at moderate but borderline to high

risk of debt distress. Furthermore, the issue of public sector arrears still remains.

Monetary conditions remained largely unchanged during 2016. By June 2016, credit growth picked up to 22 percent year-on-year, with increased lending to industry sector offsetting the decline in credit to construction and transport. Still, growth rates remain well below rates seen in earlier years. While the number of banking institutions increased, some banks, mostly the state-owned, may have low capital and weak loan portfolios. Exchange rate policy remained focused on tight management of the kip/US dollar exchange rate. With inflation pressures subdued and regional currencies stabilizing, the appreciation of the real effective exchange rate moderated during 2016.

The current account deficit is expected to improve in 2016 as higher exports of electricity and manufactures and lower fuel imports more than offset the impact of lower copper prices and the significant decline in timber exports in response to more stringent implementation of measures to reduce illegal logging. Foreign reserves were US$837 million in June 2016, covering less than 2 months of imports and about 25 percent of foreign currencies deposits implying limited buffers, particularly in the context of a tightly managed exchange rate of the kip to the US dollar.

Outlook

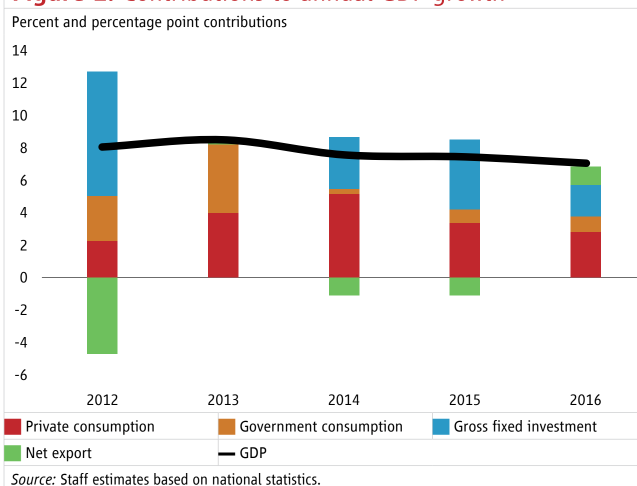
The economic prospects remain favorable overall but with increasing downside risks. GDP growth is projected to remain at around 7 percent in 2017 and 2018, supported by the healthy pipeline of power projects and growing opportunities for the non-resource sector resulting from closer ASEAN integration and efforts to improve investment climate reforms. Higher power exports and continuation of recent trends in agriculture and manufacturing is expected to improve the external balance.

However, risks have increased. The outlook on commodity prices and development needs may continue to weigh on the fiscal position and public debt in the near term. The Government's effort in strengthening non-resource taxation, reviewing exemptions and improving public finance management is expected to help improve the fiscal outlook in the medium term. The risks to the financial sector remains particularly from the health of some state-owned banks, which still account for about half of the sector assets. To fully reap the benefits of its hydropower potential, it is important to secure markets the rapidly growing power generation and develop the required transmission systems. Additional risks include a slowdown in key trading partners such as China and Thailand that might affect trade and investment.

Risks and Challenges

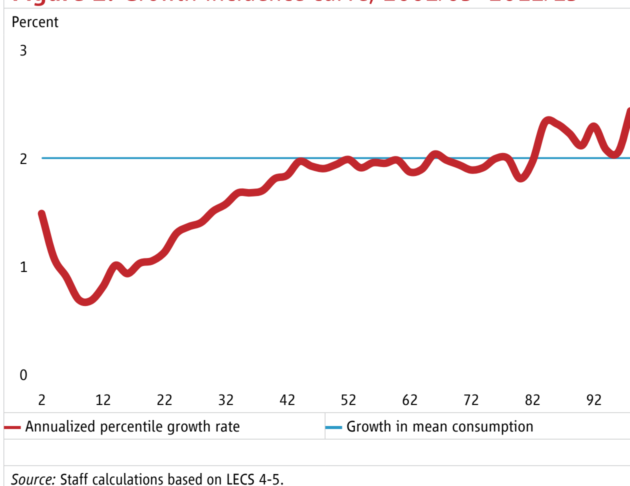
The current growth pattern ought to become more inclusive and sustainable. Improving agricultural productivity can significantly increase farmers' incomes. Converting more of natural resource rents into government revenues and effectively using these to build human capital and streamlining the business environment can help generate more attractive jobs in the non-resource sector. For the near term, systemic risks in the financial sector could be addressed. Furthermore, the fiscal pressure and limited reserves buffer could undermine the ability to mitigate adverse shocks.

Figure 1. Contributions to annual GDP growth



Source: Staff estimates based on national statistics.

Figure 2. Growth incidence curve, 2002/03–2012/13

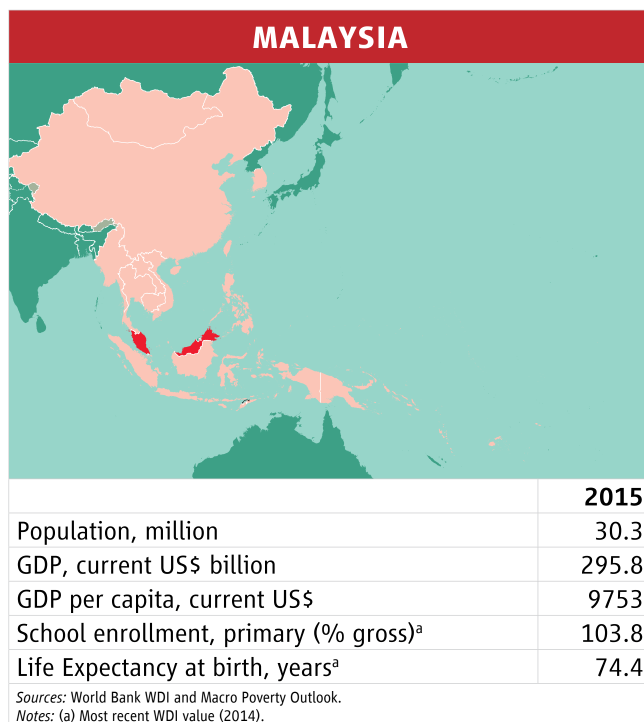


Source: Staff calculations based on LECS 4-5.

LAO PDR Selected Indicators	2013	2014	2015	2016f	2017f	2018f
Real GDP growth, at constant market prices	8.5	7.5	7.4	7.0	7.0	6.8
Private Consumption	6.1	8.0	5.2	4.5	4.9	4.6
Government Consumption	35.1	1.5	5.8	6.5	5.3	4.3
Gross Fixed Capital Investment	0.2	11.0	14.0	6.0	7.1	7.8
Exports, Goods and Services	4.1	16.6	-6.5	7.2	7.1	7.0
Imports, Goods and Services	2.8	15.8	-3.0	3.0	4.0	4.0
Real GDP growth, at constant factor prices	8.4	7.5	7.4	7.0	7.1	6.8
Agriculture	5.9	8.0	1.3	0.5	2.9	3.2
Industry	12.2	7.2	11.2	11.3	9.7	8.6
Services	6.8	7.5	8.2	7.2	7.0	7.3
Inflation (Consumer Price Index)	6.4	4.1	1.3	1.5	3.0	3.0
Current Account Balance (% of GDP)	-18.2	-17.9	-17.2	-14.2	-13.9	-13.2
Fiscal Balance (% of GDP)	-6.0	-3.9	-3.8	-6.2	-4.9	-4.4
Debt (% of GDP)	62.0	63.8	66.1	70.3	72.2	73.7
Primary Balance (% of GDP)	-4.9	-2.7	-2.6	-4.7	-3.2	-2.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast.

MALAYSIA



	2015
Population, million	30.3
GDP, current US$ billion	295.8
GDP per capita, current US$	9753
School enrollment, primary (% gross)[a]	103.8
Life Expectancy at birth, years[a]	74.4

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent WDI value (2014).

Summary

GDP growth in Malaysia moderated to 4.1 percent (y/y) in the first half of 2016, mainly supported by domestic demand despite slower external demand. Malaysia's economy is expected to grow at 4.2 percent in 2016 mainly driven by private consumption. Nevertheless, rising uncertainties over the global economic outlook could weigh on Malaysia's growth.

Recent Developments

Malaysia's GDP growth moderated from 4.5 percent in Q4 2015 to 4.2 percent (year-on-year) and 4.0 percent in the first and second quarter 2016, respectively. Private consumption remained the key contributor to growth, supported by government transfers to civil servants, pensioners, and lower income households, as well as temporary reduction in pensions' contribution. Growth was also backed by strong growth in public consumption and a moderate pick-up in public investment.

Strong domestic demand mitigated the decline in net exports growth amid subdued external demand and low commodity prices. Nonetheless, thanks to a well-diversified economy, non-commodity exports remained strong supported by a steady expansion in manufacturing exports, particularly in machinery and appliances, and electrical and electronics. Overall, the current account surplus has narrowed from 3.0 percent of GDP in Q4 2015 to 1.2 percent of GDP in the first half of 2016.

Following the high growth in public consumption, the first quarter of 2016 saw the fiscal public deficit increasing to 5.6 percent of GDP. This calls for constrained public expenditure growth in the second quarter to continue fiscal consolidation and achieve the government's public deficit target of 3.1 percent of GDP.

Inflation peaked at 4.2 percent in February reflecting electricity tariffs hikes and base effects from the decline in fuel prices in early 2015. Subsequently inflation has decelerated to 1.6 percent in June 2016 as the impact of the Goods and Services Tax (GST) introduced last year dissipates. Despite the slow growth in consumer prices there is widespread concern about increases in the cost of living.

Inflation has been marginally higher for low-income and urban consumers, in part because of fiscal consolidation measures such as the GST and increases in public transit fares. A likely more significant factor is stagnant incomes across the most vulnerable segments of the population as labor market conditions have deteriorated slightly. From June 2015 through June 2016 the unemployment rate increased from 3.2 to 3.4 percent while the labor force participation dropped from 67.9 to 67.7 percent. The share of the work force in informal employment has also grown slightly, increasing from 11.2 to 11.4 percent between 2013 and 2015. Growing consumer credit has also contributed to the perception of rising living costs, as households have less discretionary income after meeting debt obligations.

Portfolio inflows have returned to Malaysia as volatility subsided and sentiments improved in the financial markets. Foreign direct investments also grew, with RM31.8 billion net inflows since Q3 2015. Reflecting this, the ringgit appreciated by 7 percent against the U.S. dollar in the first half of 2016 and reserves have also increased from US$95.3 billion as at end-2015 to US$97.2 billion as at June 2016. Foreign portfolio flows and the exchange rate are expected to be mainly driven by external developments, particularly expectations over the U.S.'s interest rate normalization and volatility in the crude oil prices.

Banking sector indicators suggest that the overall banking system remains resilient with banks well-capitalized and net impaired loans at low levels. Moderation in household credit continues in the banking system, particularly in the riskier segments e.g. consumer lending. Also, banking system liquidity remains adequate and provides buffers against liquidity shocks.

Given the rising uncertainty over the global economic outlook, Bank Negara Malaysia (BNM) lowered the overnight policy rate from 3.25 percent to 3.00 percent in July 2016. This was facilitated by declining inflation and a positive assessment of the prudential measures that BNM introduced, which raised lending standards and contained speculative activities, reducing financial imbalances.

Outlook

Malaysia's GDP growth is expected to moderate to 4.2 percent in 2016, mainly driven by private consumption growth, which is expected to decelerate amid a softer labor market and ongoing adjustments to the rising cost of living. Private investment growth is expected to moderate given a less optimistic business sentiment, and subdued external demand. Export growth is projected to remain stagnant on low commodity prices and weaker growth outlook among Malaysia's main trading partners. The narrowing trend of the current account surplus is expected to continue from 3.0 percent in 2015 to 1.8 percent in 2016.

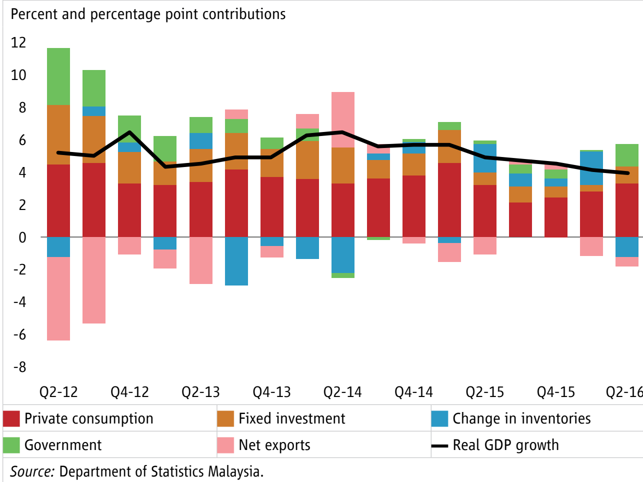
Going forward, the Malaysian economy faces risks emanating mainly from external developments. They include uncertainty over the trajectory of economic growth in the global economy, and potential volatility in financial markets. Furthermore, lingering public discourse surrounding 1Malaysia Development Berhad (1MDB) could impact investors' sentiments and divert government's focus from needed reforms. An unanticipated sharp adjustment among households to a higher cost of living or a more pronounced softening in labor market conditions could also affect private consumption.

Risks and Challenges

Malaysia's main challenge and opportunity going forward lies in accelerating structural reforms to accelerate the transition to a high income economy, with a focus on human capital development and liberalization and further competition in the economy. Malaysia has embarked on a wave of "new generation" trade agreements and the implementation of these trade agreements could open the door for moving forward on some of these areas.

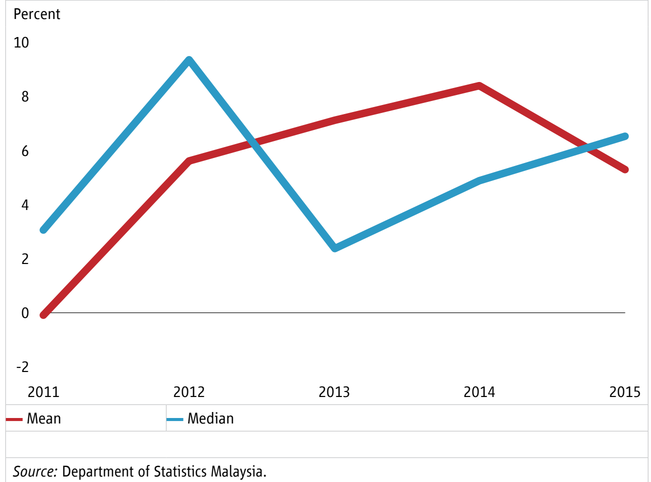
With limited fiscal and monetary policy leeway, targeted measures could be considered to support the most vulnerable households. Recent increases in the minimum wage and public sector salaries will difficult to sustain as fiscal consolidation continues, which calls for measures to boost labor productivity and raising the efficiency of the social protection system. Introducing unemployment benefits may also help to improve matching in the labor market and provide support as the labor market softens.

Figure 1. Contributions to annual GDP growth



Source: Department of Statistics Malaysia.

Figure 2. Annual salaries and wage growth

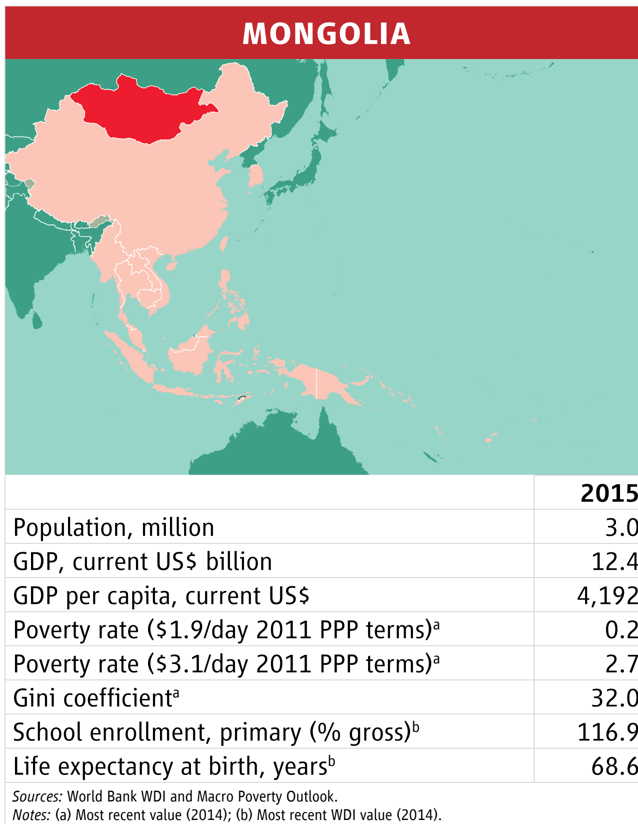


Source: Department of Statistics Malaysia.

MALAYSIA Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	4.7	6.0	5.0	4.2	4.3	4.5
Private Consumption	7.2	7.0	6.0	5.8	5.6	5.8
Government Consumption	5.8	4.3	4.4	4.4	4.1	4.3
Gross Fixed Capital Investment	8.1	4.8	3.7	3.2	3.6	4.1
Exports, Goods and Services	0.3	5.0	0.6	-1.0	2.0	3.5
Imports, Goods and Services	1.7	4.0	1.2	-0.9	2.4	3.7
Real GDP growth, at constant factor prices	4.6	6.3	5.0	4.2	4.3	4.5
Agriculture	1.8	5.2	0.8	-0.2	0.1	1.1
Industry	3.1	1.7	-0.9	-0.1	0.5	2.0
Services	6.0	9.6	9.3	7.2	6.8	6.1
Inflation (Consumer Price Index)	2.1	3.1	2.1	2.5	2.2	2.3
Current Account Balance (% of GDP)	2.9	4.0	2.3	1.8	2.2	2.4
Fiscal Balance (% of GDP)	-3.7	-3.1	-3.2	-3.1	-3.1	-3.0
Debt (% of GDP)	57.1	55.8	57.8	57.8	58.3	59.4
Primary Balance (% of GDP)	-1.7	-1.0	-1.0	-0.8	-0.7	-1.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: f = forecast.

MONGOLIA



	2015
Population, million	3.0
GDP, current US$ billion	12.4
GDP per capita, current US$	4,192
Poverty rate ($1.9/day 2011 PPP terms)[a]	0.2
Poverty rate ($3.1/day 2011 PPP terms)[a]	2.7
Gini coefficient[a]	32.0
School enrollment, primary (% gross)[b]	116.9
Life expectancy at birth, years[b]	68.6

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2014); (b) Most recent WDI value (2014).

Summary

Mongolia's macroeconomic conditions have deteriorated in the first half, with loose fiscal and monetary policies amidst slowing growth. Extra budgetary expenditures monetized by the central bank sharply increased the budget deficit and government debt, escalating pressure on the exchange rate. The balance of payments will come under growing pressure due to large external sovereign debt repayments in 2017 and low foreign exchange buffers. Strong and credible policy adjustment is urgently needed to achieve fiscal and macro-economic sustainability.

Recent Developments

Growth dropped to 1.4 percent (year-on-year [yoy]) in the first half of 2016. Mining GDP growth slowed to 9.1 percent, largely reflecting the lower grade concentrates produced by the Oyu Tolgoi (OT) mine. Non-mining production declined by 0.8 percent, with contraction in manufacturing by 12 percent and construction by 0.1 percent. Service sector growth remained stagnant at 0.6 percent. Agriculture growth sharply dropped to 3.5 percent in the aftermath of the harsh winter.

Weak growth in key labor-intensive sectors such as construction and services translated into deteriorating labor market and household welfare conditions. Unemployment rate climbed to 11 percent in the second quarter of 2016, the highest since 2010. Nominal average household income declined by 10 percent, reflected in an 11 percent drop in real household consumption in the first six months.

Lower coal and copper prices reduced export values by 9.6 percent (yoy) in the first seven months despite higher export volumes in key commodities. Continued import compression, however, kept the trade balance in a $708 million surplus. Imports fell by 17.4 percent (yoy), led by a large drop in imports of investment goods and oil products.

The current account turned into a $192 million deficit in May-July, from a $26 million surplus in the first four months. A $1,022 million net capital outflow was recorded in Jan–July, in the currency and deposit component and the net errors and omissions component. The overall balance of payments displayed a moderate $41 million deficit in the first seven months despite the growing deficit in May-July, on the back of a $750 million sovereign debt-financing in March and April. Gross international reserves declined to $1,275 million in July from $1,546 million in April.

Fiscal policy was loose in the run up to the election. The budget deficit jumped to MNT 1,974 billion in Jan–July, equivalent to over 8 percent of the annual GDP. Despite a 3 percent revenue drop (yoy), total expenditures rose by 33 percent (yoy), largely due to unbudgeted government programs monetized by the central bank (BoM). The government announced that the budget

deficit could reach 21.3 percent of GDP, following the inclusion of previously off-budget lending programs such as Good Programs and Housing Mortgage Program.

Corrective actions have been taken. The new government terminated Good Programs in August and adopted a supplementary budget which expected the budget deficit to reach 18 percent of GDP. However, the supplementary budget is yet to include the off-budget corporate loans of the DBM and the Housing Mortgage Program. Some of the fiscal consolidation measures, including revenue mobilization proposals, were rejected by the parliament.

Monetary policy also loosened. With no government securities auctions held since Apr, the BoM has provided over MNT 900 billion in Mar–July to the government, for the new Good Programs and the Housing Mortgage Program. As a result, the monetary base and M2 increased by 40 percent and 13 percent, respectively between March and July. Bank loan growth, however, remained subdued at 0.8 percent (yoy) in July, reflecting weak economic conditions. The lack of government bond issuance, the large liquidity injection and slow loan growth have substantially increased excess liquidity in the banking system since March.

Exchange rate volatility increased in July and August. After gradual appreciation in May–June with the influx of a $750 million sovereign borrowing, the togrog depreciated by almost 15 percent against the US$ in one and a half months from end-June to mid-August.

Facing the intensified pressure on the exchange rate and signs of currency speculation, the BoM raised the policy rate by 450 bps to 15 percent on August 19. The central bank also announced that it would strengthen togrog liquidity management. The market has stabilized since these measures were implemented.

Outlook

Growth will likely remain stagnant in 2016. Growth is projected to recover in 2017–18, but at a moderate pace, supported by OT's phase-2 investment. In the medium term, recovery in mining production and continued phase-2 investment of OT mine are expected to support growth momentum. Poverty conditions will likely deteriorate in the near term, with weak growth prospects and labor market conditions. The external and fiscal accounts would come under intensified pressure in the coming years from growing current account deficit and a 1,230 million sovereign debt repayment in 2017–18. The budget will remain under heavy strain, with the consolidated budget deficit reaching over 19 percent of GDP in 2016. The primary budget deficit is projected to reach 15 percent of GDP due to interest expenses, amounting to 4 percent of GDP.

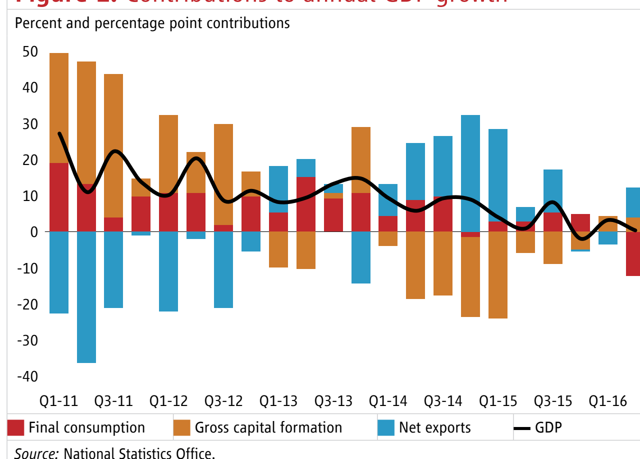
Risks and Challenges

The most pressing challenges is to prepare for the large external debt repayments in 2017-18 and to undertake fiscal consolidation.

Fiscal consolidation cannot be delayed, as general government debt is now projected to reach over 90 percent of GDP by end-2016. A strong and credible fiscal consolidation plan for 2017–20 should be prepared urgently, including all off-budget programs. The BoM should disengage itself from fiscal activities by stopping monetization, and refocus on maintaining price stability and safeguarding foreign exchange buffers. Strengthening social safety net, particularly targeting the vulnerable groups near or below the poverty line, would help mitigate the social costs of fiscal adjustment and support growth. Restoring sound macroeconomic management is crucial to build more favorable conditions for the debt repayment in 2017–18, and prepare for ensuing debt repayments in 2019–22.

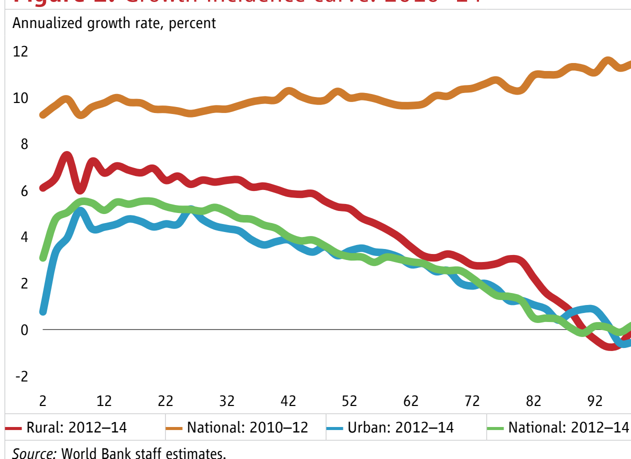
Swift actions have been taken by the new government, disclosing the accurate fiscal situation including all off-budget programs and stressing the urgent need for fiscal adjustment. The recent monetary policy adjustment including the policy rate hike helped ease exchange rate volatility. Substantial fiscal and external risks facing Mongolia, however, urgently call for further actions including a comprehensive and strong policy adjustment plan to bring the economy back on a sustainable growth path.

Figure 1. Contributions to annual GDP growth



Source: National Statistics Office.

Figure 2. Growth incidence curve: 2010–14

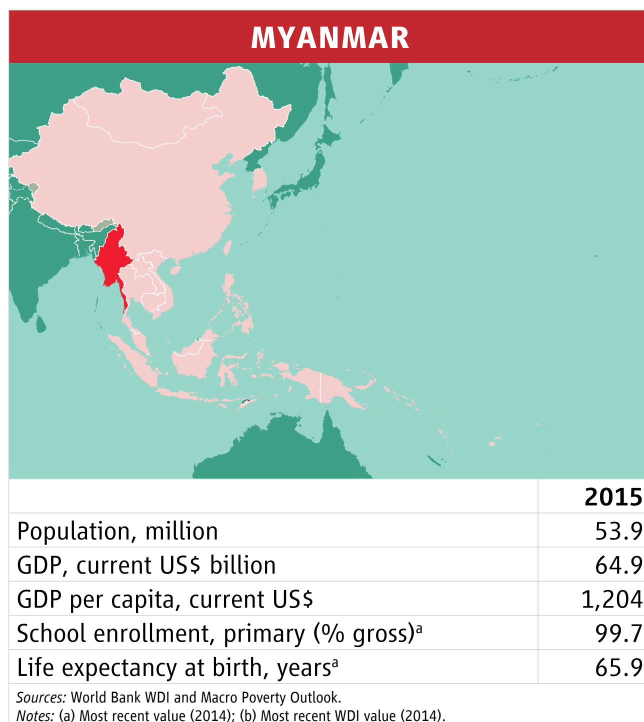


Source: World Bank staff estimates.

MONGOLIA Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	11.6	8.0	2.3	0.1	2.0	3.5
Private Consumption	15.4	6.3	7.2	-11.2	4.5	6.1
Government Consumption	27.8	3.4	-4.5	4.5	1.7	3.5
Gross Fixed Capital Investment	-10.5	-20.0	-32.9	2.5	26.6	0.2
Exports, Goods and Services	12.8	53.2	1.2	-1.6	-2.3	0.6
Imports, Goods and Services	7.6	6.8	-11.5	-8.5	9.0	1.7
Real GDP growth, at constant factor prices	11.4	10.8	5.5	0.2	1.9	3.6
Agriculture	19.3	14.4	9.9	7.0	7.1	7.2
Industry	15.3	12.0	9.7	-4.1	-2.4	2.3
Services	6.8	8.9	1.0	1.8	3.7	3.4
Inflation (Private Consumption Deflator)	12.3	11.0	1.9	1.8	4.5	5.6
Current Account Balance (% of GDP)	-25.1	-11.5	-4.8	-6.3	-10.4	-11.9
Financial and Capital Account (% of GDP)	26.0	12.5	5.7	6.3	10.4	11.9
Net Foreign Direct Investment (% of GDP)	16.3	2.1	1.5	0.1	12.6	12.7
Fiscal Balance (% of GDP)	-10.1	-10.9	-8.0	-19.8	-14.6	-13.4
Debt (% of GDP)	46.9	53.6	66.3	92.1	106.0	113.6
Primary Balance (% of GDP)	-8.8	-8.7	-5.0	-15.5	-10.0	-7.2
Poverty rate ($1.9/day PPP terms)[a,b,c]	..	0.2	0.2	0.2	0.1	0.1
Poverty rate ($3.1/day PPP terms)[a,b,c]	..	2.7	2.2	2.1	1.9	1.7

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast. (a) Calculations based on EAPPOV harmonization, using 2014-HSES. (b) Projection using neutral distribution (2014).

MYANMAR



	2015
Population, million	53.9
GDP, current US$ billion	64.9
GDP per capita, current US$	1,204
School enrollment, primary (% gross)[a]	99.7
Life expectancy at birth, years[a]	65.9

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2014); (b) Most recent WDI value (2014).

Summary

Myanmar successfully went through a major political transition between November 2015 and April 2016. Real sector activity in 2016–17 remains strong, though inflation has been high (10 percent year-on-year in July 2016). Growth is projected to rise to 7.8 percent in 2016–17, while inflationary pressures are expected to ease to 8.5 percent (annual average). Myanmar faces emerging challenges to short-term macroeconomic stability. A combination of fiscal prudence, enhanced monetary operations, exchange rate flexibility and strengthened banking supervision capacity could help manage these pressures.

Recent Developments

The first civilian government in decades assumed office on April 1, 2016, ending a five month handover period after the historic November 2015 elections. Economic growth in 2015–16 is estimated to have eased to 7 percent from 8.5 percent in 2014–15. Real sector activity in the first quarter of 2016–17 remained strong, though new investment flows are yet to pick up due to ongoing structural constraints. Construction slowed due to suspensions linked to government review of permits and compliance. The expansion of the telecommunications grid in recent months has reached some of the more isolated communities in poorer states and regions of Myanmar, although many of the most remote communities are yet to be covered.

Recent heavy rains and flooding, although not as bad as those linked to Cyclone Komen last summer, may affect the extent of agricultural sector recovery in 2016–17. An overlap in the populations affected by climatic events across the two years has resulted in some communities experiencing substantial losses in two successive monsoon seasons, with negative income and welfare implications for both smallholder and landless households in the affected areas. Increased rice prices are likely to pose challenges for poverty reduction, particularly in urban areas.

Inflationary pressures have remained strong over Q1 2016–17, with monthly inflation averaging 1.5 percent over this period, and reaching 10 percent in July 2016 (year-on-year). This was largely driven by food prices. Food accounts for just over 60 percent of the consumption basket among the bottom 40 percent in Myanmar, who also typically reduce the quality of their diets during scarce periods. The rural landless, smallholder and urban poor are likely to switch to more limited diets as a consequence of higher food prices.

Broad money growth picked up from 17 percent in 2014–15 to 26 percent in 2015–16, with credit to the private sector remaining high at 36 percent over the year. While this remains on the back of a low base, strengthened banking supervision is critical to mitigate financial sector risks from such rapid credit growth. The government recently expanded open market operations to help manage monetary pressures (extended

maturities on Treasury bill auctions, launch of Treasury bond auctions).

The latter is important to avoid an acceleration of core inflation, given emerging fiscal pressures. The general government deficit is expected to have increased from 1.8 percent of GDP to 3.1 percent of GDP. This was partly driven by external pressures including a near 20 percent depreciation in the Kyat and declining commodity prices, which have affected receipts from gas exports. The declining commodity prices, together with declining agricultural commodity exports, have also impacted trade and current account balances, which are expected to have widened to 7.9 percent of GDP in 2015–16.

Outlook

As the economy recovers from its 2015–16 supply shock, real GDP growth in Myanmar is projected to rise to 7.8 percent in 2016–17, and average 8.2 percent per year over the medium-term. The agricultural sector is expected to bounce back, though there are downside risks from recent flooding. Investor demand for services (transportation, distribution, information technology, communications, and logistics) is expected to be the main driver of growth over the short to medium-term.

Inflationary pressures are expected to ease relative to 2015–16, averaging 8.5 percent over 2016–17. This is linked to recovery from last year's agricultural supply shock, combined with projected low international commodity prices. The new administration has prioritized the need to limit Central Bank financing of the budget. A revised 2016–17 Union Budget targets expenditure cuts resulting from the consolidation of ministries, and improved revenue collections through rollout of self-assessment, and rationalization of tax exemptions by the Myanmar Investment Commission. Fiscal pressures however are expected to remain with declining oil and gas receipts, a growing infrastructure bill, and recurrent needs for public services, which are critical for better human development outcomes among poorer households.

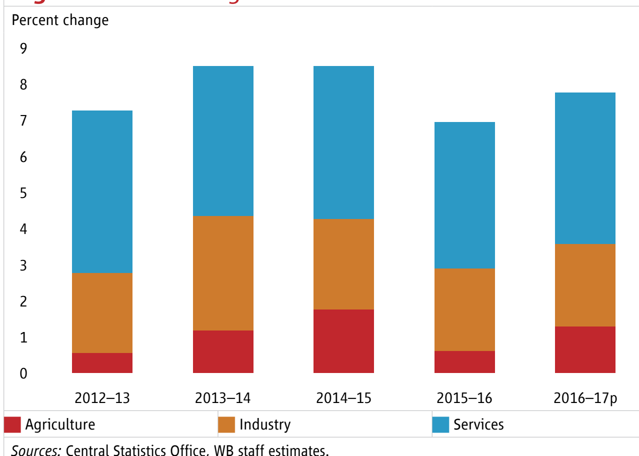
Risks and Challenges

The expansion of the public sector, increased capital inflows, and rapid growth in private sector credit are posing new policy and institutional challenges for short-term economic stability. These could be partially addressed through more proactive public debt management, including the gradual elimination of monetary financing of the budget deficit. The recent submission to Parliament of a debt strategy is in this regard an important step in the right direction.

Complementing this with enhanced open market operations and monetary policy capacity to manage monetary pressures will also be important. Linked to this is the need to strengthen banking sector supervision in light of the recent rapid increase in credit to the private sector. Priorities include issuance and implementation of prudential regulations under the Financial Institutions Law.

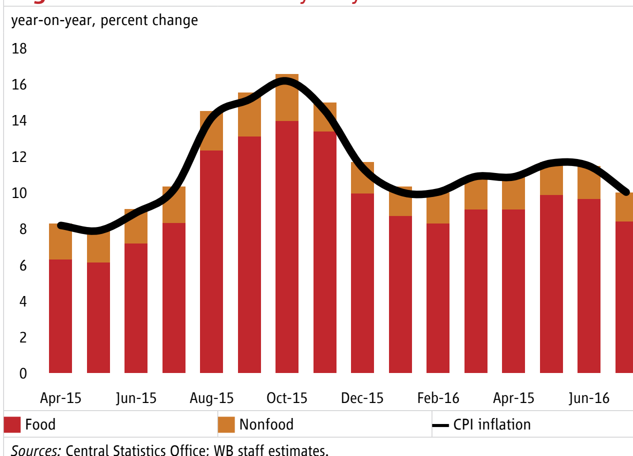
As the economy has become more vulnerable to external developments (such as exchange rate pressures, gas prices, climatic variation and natural disasters), it will be important to build buffers to manage risks and absorb economic shocks. This could include maintaining exchange rate stability, improved revenue mobilization to help with fiscal consolidation efforts, managing gas receipts to protect spending on public services from gas revenue volatility; and strengthening the overall fiscal framework for State Enterprises to reduce their fiscal burden.

Figure 1. Real GDP growth and sector contributions



Sources: Central Statistics Office, WB staff estimates.

Figure 2. Contributions to yearly inflation

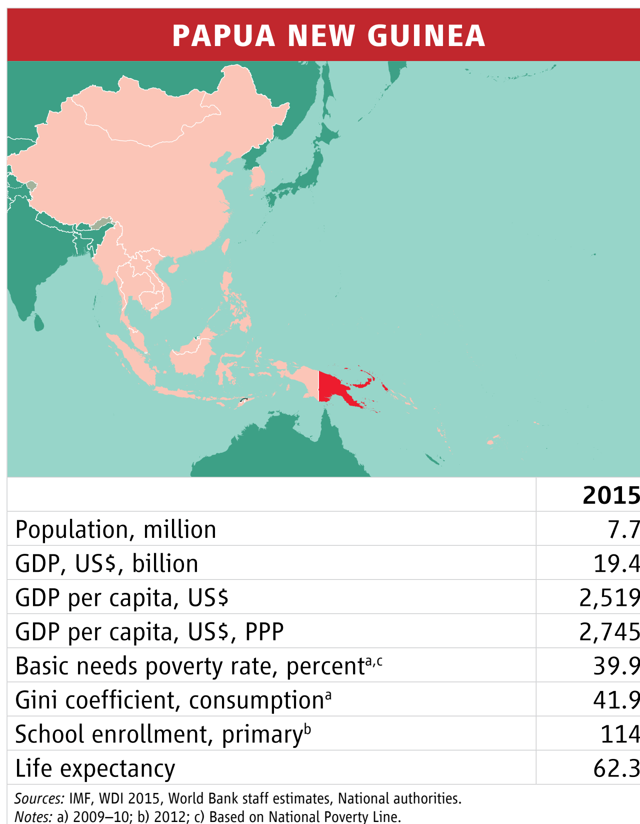


Sources: Central Statistics Office; WB staff estimates.

MYANMAR Selected Indicators	*2013*	*2014e*	*2015e*	*2016f*	*2017f*	*2018f*
Real gross domestic product	8.5	8.5	7.0	7.8	8.4	8.3
Agriculture	3.6	5.6	2.0	4.5	5.5	5.5
Industry	11.4	8.8	7.8	7.9	8.5	9.0
Services	10.5	10.5	10.2	10.0	10.1	9.9
CPI Inflation, period average	5.7	5.9	11.3	8.5	6.3	5.7
Current Account Balance (% of GDP)	-4.9	-6.3	-7.9	-7.0	-5.6	-5.4
Fiscal Balance (% of GDP)	-3.1	-1.8	-3.1	-3.3	-3.7	-3.5
Revenue	10.8	13.3	13.1	13.6	14.0	14.6
Expenditure	14.0	15.2	16.2	16.9	17.6	18.1

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: Fiscal year, April 1–March 31.; e = estimate, f = forecast.

PAPUA NEW GUINEA



	2015
Population, million	7.7
GDP, US$, billion	19.4
GDP per capita, US$	2,519
GDP per capita, US$, PPP	2,745
Basic needs poverty rate, percent[a,c]	39.9
Gini coefficient, consumption[a]	41.9
School enrollment, primary[b]	114
Life expectancy	62.3

Sources: IMF, WDI 2015, World Bank staff estimates, National authorities.
Notes: a) 2009–10; b) 2012; c) Based on National Poverty Line.

Summary

Papua New Guinea's economy continues to face challenges arising from subdued global commodity prices, which have dampened economic growth and created fiscal stress. Growth, in the medium-term, is expected to edge towards trend, which is estimated at 4 percent.

Recent Developments

With the persistence of strong headwinds facing PNG, namely subdued global commodity prices, a moderation in activity in the manufacturing, wholesale, retail and construction sectors, and possible La Niña weather effects coupled with base effects following the commencement of liquefied natural gas production, growth for 2016 is expected to decline to 2.4 percent from 6.8 percent in 2015.

The poor weather conditions in 2015 contributed to lower growth in both the agriculture and mining sectors. For instance, lack of rainfall affected the availability of water needed for processing and transport of minerals on barges. This led to the suspension of production at the Ok Tedi mine throughout the second half of 2015 and first quarter of 2016. The drought and frost-like conditions also adversely affected production in the agriculture sector, which is a source of livelihood for a significant majority of the economically active population. Recently, however, there has been some pick up in the agricultural sector as coffee production resurged.

A number of businesses are facing a challenging situation. For instance, in the construction sector, growth is expected to moderate further in light of the cash flow shortage faced by the government coupled with the shortage of foreign currency. This is reflected in the year-on-year decline to March 2016 in total non-resource sector formal employment by 3.8 percent.

Consequently, the World Bank estimates that growth in the non-resource sectors will remain modest and contribute, on average, 2.3 percentage points to overall growth in 2016 while the resource sector will contribute 0.1 percentage points. In addition to the cyclical downturn in non-resource sector growth, the relatively low growth rate in this sector reflects the need for structural reform.

It is likely that the sustained downturn in economic activity will have an adverse impact on poverty and will most likely lead to rising inequality, with Papua New Guineans in the lower end of the income distribution bearing the brunt of the economic downturn more severely. Based on the latest household survey data, the national basic-needs poverty rate in 2010 is 39.9 percent. The level of consumption inequality, measured by the Gini coefficient, is 0.42 in 2010.

The Mid-Year Economic and Fiscal Outlook (MYEFO), published in July 2016, forecasts a budget deficit of

5.9 percent of GDP (equivalent to PGK 4 billion) in 2016 vis-à-vis a projected deficit of 3.9 percent (equivalent to PGK 2.1 billion) in Budget 2016. The reason for the higher fiscal deficit is due primarily to lower revenue projections stemming from a significant downward revision in tax revenue primarily owing to lower global commodity prices adversely affecting tax revenue from the mineral and petroleum sectors coupled with lower personal income and corporate tax in the non-mineral sector given moderation of economic growth.

Given the higher-than-expected budget deficit, to its credit, the government passed a supplementary budget for the second consecutive year (in August 2016) in order to curtail expenditure by PGK 928 million. With the passing of the supplementary budget, the fiscal deficit is expected to be 4.7 percent of GDP.

The deficit is to be financed by a USD 500 million syndicated commercial loan, a possible issuance of USD 500 million international sovereign bond later this year and the issuance of domestic debt. In 2016, government debt (excluding contingent liabilities) is expected to reach 34.2 percent of GDP.

Notwithstanding the lower commodity prices, on the back of liquefied natural gas (LNG) exports and import compression due to the limited availability of foreign exchange, the current account is expected to remain in surplus (7.6 percent of GDP) in 2016. The surplus in the current account is largely offset by financial account outflows due to a build-up in foreign currency account balances of resident mineral companies coupled with net loan repayments by the government.

The preliminary balance of payments data for the four months to April 2016 show an overall surplus of PGK 330 million.

There is a shortage of foreign exchange in the interbank market with foreign exchange reserves held by the Central Bank rising slightly in 2016 to USD 2.0 billion (3.7 months of import coverage) after declining to USD 1.9 billion at the end of 2015.

With the decline in commodity prices, the depreciation of the Kina by 9 percent year-on year to June 2016 has contributed to the higher inflation. CPI inflation rate is expected to edge upwards in 2016 to 6.9 percent from 6 percent in 2015.

Outlook

Over the next five years, GDP growth is expected to edge towards trend, which is estimated at 4 percent.

Given the expected continuation of subdued commodity prices in 2017, domestic revenue generation and foreign currency inflows are expected to remain constrained in the near-term. There is also a risk that limited revenue generation will lead to monetization of the fiscal deficit, which would not only create inflationary pressure but also increase depreciation pressure on the Kina. Thus in the near-term, risks are weighted to the downside while in the medium-term the outlook is more sanguine with a number of mining and petroleum projects coming on stream.

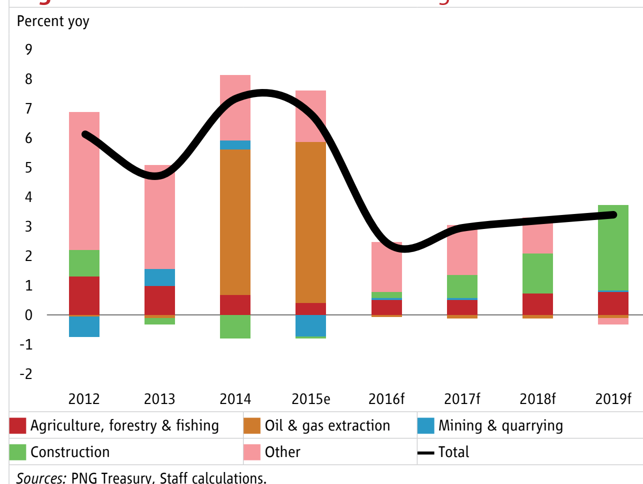
Risks and Challenges

There are a number of challenges both in the near-term and the medium to longer-term. External near-term challenges stem from a continuation of weak growth in advanced economies, a possible further slowdown in China coupled with a possible increase in the Federal funds rate in the US this year.

Domestic near-term challenges arise from the ability of government to maintain public service delivery (particularly infrastructure) in the face of revenue shortfalls owing to low commodity prices. The challenge would be to ensure quality expenditure in the face of a reduced budget envelope.

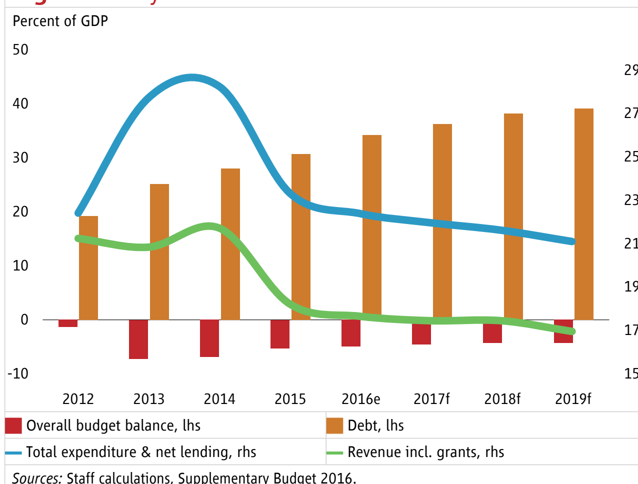
To preserve the foreign exchange reserve position, consideration should be given to improving the foreign exchange allocation mechanism in concert with improvements to the monetary policy framework. These reforms should be underpinned by measured fiscal and monetary policies. In particular, if rising debt servicing costs are not contained, interest expenditure could crowd–out expenditure on the development enablers such as health, education and infrastructure, which the government has prioritized.

Figure 1. Contributions to annual GDP growth



Sources: PNG Treasury, Staff calculations.

Figure 2. Key fiscal indicators



Sources: Staff calculations, Supplementary Budget 2016.

PAPUA NEW GUINEA Selected Indicators	*2014*	*2015*	*2016e*	*2017f*	*2018f*	*2019f*
Real						
GDP, at market prices	7.4	6.8	2.4	3	3.2	3.4
Mining and Petroleum	7	4.9	0.1	0.1	0.2	0.2
Non-mining and non-petroleum	0.4	1.9	2.3	2.9	3	3.2
CPI inflation, period average	5.2	6.0	6.9	7.5	7.0	6.5
Fiscal						
Revenue	21.7	18.3	17.7	17.5	17.5	17.0
Expenditure	28.3	23.4	22.4	22.0	21.7	21.1
Balance	-6.5	-5.1	-4.7	-4.5	-4.2	-4.1
Debt	28.1	30.4	34.2	36.0	37.9	39.0
External						
Current account balance	3	10	7.6	6.4	5.7	5.1
Resource	12.2	12.5	11.1	10.4	10	9.6
Non-resource	-9.2	-2.5	-3.5	-4	-4.3	-4.5

Sources: PNG Treasury, Bank of Papua New Guinea and Staff calculation.
Notes: e = estimate, f = forecast.

PHILIPPINES

	2015
Population, million	100.7
GDP, current US$ billion	292.5
GDP per capita, current US$	2,905
Poverty rate ($1.9/day 2011 PPP terms)[a]	10.6
Poverty rate ($3.1/day 2011 PPP terms)[a]	32.0
Gini coefficient[a]	46.5
Life expectancy at birth, years[b]	68.0

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: (a) Most recent value (2012); (b) Most recent WDI value (2014).

Summary

The Philippine economy grew 6.9 percent in H1 2016 up from 5.5 percent in H1 2015. This was the fastest among major East Asian economies. Growth for 2016 is projected at 6.4 percent and poverty is expected to fall gradually. While growth is strong with a robust outlook, there is lingering concern about its quality. The new administration has laid out a 10-point socio-economic agenda with the objective of supporting economic growth, which includes an equitable tax reform, enhanced public spending, continued investment in education, health and social assistance to the poor, and improved ease of doing business.

Recent Developments

In H1 2016, the Philippine economy was the strongest performer in the region, growing by 6.9 percent (Figure 1). On the supply side, the services and industry sectors remained the main engines of growth, while agriculture continued to underperform as farm output declined due to the lingering effects of El Niño. On the demand side, growth was driven by robust private consumption given a low-inflation environment and sustained remittance inflows; and higher capital formation given strong investments in durable equipment. Growth was further supported by public spending, which expanded by more than 10 percent, as the government frontloaded expenditures as part of the May 2016 presidential elections. Net exports, however, caused a drag on growth due to weak external demand.

Monetary policy continued to be supportive of growth with the Central Bank maintaining its monetary policy stance and inflation levels well below its target band. Since the start of the year, non-performing loans (NPLs) have roughly been maintained at 2.2 percent of total loans while the NPL coverage has been more than 110 percent. The banking system is sufficiently capitalized with capital adequacy ratio at a relatively high 15.9 percent. Overall, the financial market remains resilient with enough legroom to accommodate a hike in global interest rates.

Government spending continued to accelerate in H1 2016 after experiencing fast growth in H2 2015. Public expenditure increased by 14 percent to PHP 1.1 trillion (17.8 percent of GDP) in the first half of the year as a result of election-related spending and as the government addressed budget execution bottlenecks. On the revenue side, tax effort continued to improve, increasing to 14.3 percent of GDP in H1 2016 compared to 14.1 percent in the previous year. Nonetheless, the swifter pace of spending by the government led to a deficit of PHP120 billion for H1 2016 (1.7 percent of GDP), a sharp reversal from the PHP 14 billion surplus in the same period last year.

Recent estimates suggest that extreme poverty decreased gradually between 2012 and 2015. Household income in real terms reported continuous growth. Natural calamities, including, during 2013–

15, the highest number of typhoons witnessed in the country's history have muted these welfare gains. The government's social protection programs, in particular the Pantawid Pamilya conditional cash transfer program, have buffered some impact of these shocks. Extreme poverty, measured by the international poverty line of 1.9 dollars a day (2011 Purchasing power Parity) is estimated to have decreased from 10.6 percent in 2012 to 8.4 percent in 2015. The poorer segment of the population reported faster growth in household income compared with the average. Consequently, income inequality is decreasing.

High growth at the start of the year has translated into more jobs, as the unemployment rate decreased to 6.1 percent in April 2016 compared to 6.4 percent in the same period last year. Despite gains in employment, underemployment remains a persistent problem, increasing by 0.6 ppt to 18.4 percent. Moreover, among the employed, roughly 40 percent are considered vulnerable workers—an indicator of informality. These workers are less likely to have formal work arrangements, access to benefits and social security, and protection from income shocks or jobs losses. The persistently high underemployment and high informality are indicative that the quality of growth remains a concern.

Outlook

The medium term outlook for the Philippines continues to remain positive, bucking the global trend. The Philippine economy is expected to grow at 6.4 percent in 2016, before slowing slightly to 6.2 percent in 2017. Growth in the second half of 2016 is projected to be anchored by robust domestic consumption and could receive additional support from sustained improvements in public spending. Moreover, the Philippines is expected to continue to benefit from strong private investment as purchases on durable equipment have been strong since Q4 2015. Risks to growth include the slowdown of remittances from a weaker-than-expected global economy, slower consumption growth due to rising food prices, and lower net exports due to subdued external demand as advanced economies face timid growth prospects.

Poverty is expected to follow a downward trend if the country maintains the relatively high economic growth (Figure 2) and keeps investing in human development, e.g. health, education and social protection, in particular among the poor. Growth will be more inclusive if the agriculture sector, where the poor are highly concentrated would become more productive employing fewer people. What the Philippines needs is more of better, e.g. more productive and better paid jobs. It also needs better educated and skilled population, particularly among the poor. Under these assumptions, extreme poverty is projected to further decrease from 9.0 percent in 2014 to 6.7 percent in 2018.

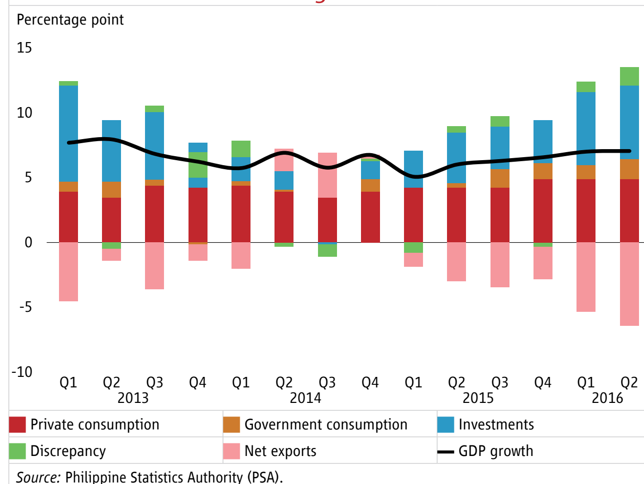
Risks and Challenges

Moving forward, as the government continues to emphasize preserving macroeconomic stability, achieving inclusive growth—growth that creates more and better jobs—remains the country's most pressing challenge. The Philippines has shown signs of the early beginnings of a more inclusive growth pattern, however more needs to be done. What is now needed is to strengthen, institutionalize, and build on the country's economic and human development reform agenda towards more inclusive growth. The government has laid out a 10-point socio-economic agenda meant to enhance key aspects of the economy and human development, which includes an equitable tax reform, enhanced public spending, continued investment in education, skills, health and social assistance to the poor, greater transparency and accountability, and improved ease of doing business, among others.

Equally relevant are reforms that enhance competition in sectors with a high impact on jobs; secure property rights through more systematic and administrative

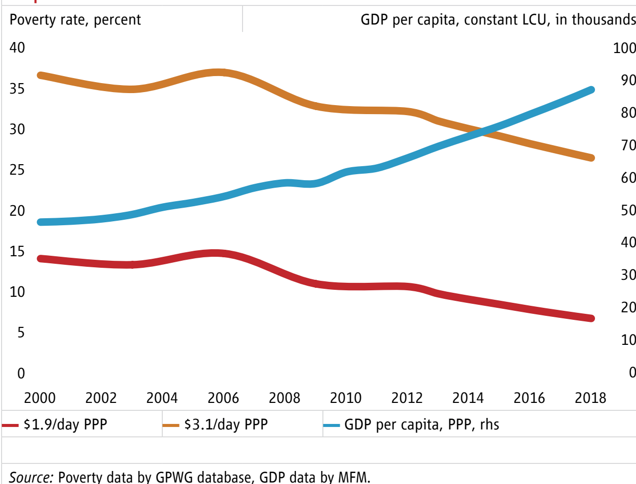
adjudication of land rights; and simplify business regulations to encourage the growth of firms of all sizes, while continuing to sustainably ramp up public investments in infrastructure and social services. Priority is needed in the key or largest province of Mindanao, where decades of conflict and neglect have kept it from reaching its potential. To this end, the government, business, labor, and civil society started to work together and agree on a package of reforms that will allow the country to follow a more inclusive growth path.

Figure 1. Growth increased to 6.9 percent in H1 2016 which is the fastest in the region



Source: Philippine Statistics Authority (PSA).

Figure 2. Poverty reduction is expected to continue as per capita income increases

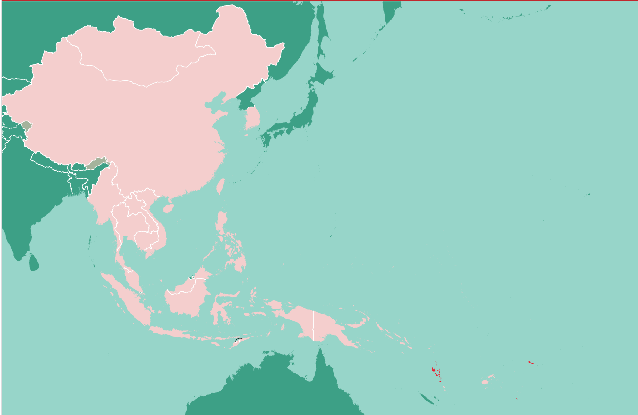


Source: Poverty data by GPWG database, GDP data by MFM.

PHILIPPINES Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	7.1	6.2	5.9	6.4	6.2	6.2
Private Consumption	5.6	5.5	6.3	6.8	5.9	5.7
Government Consumption	5.0	3.2	7.8	9.7	8.2	7.7
Gross Fixed Capital Investment	11.8	6.2	15.2	17.9	9.1	8.3
Exports, Goods and Services	-1.0	11.7	9.0	7.6	7.8	9.4
Imports, Goods and Services	4.4	9.3	14.0	13.7	8.9	9.6
Real GDP growth, at constant factor prices	7.1	6.1	5.8	6.4	6.2	6.2
Agriculture	1.1	1.7	0.1	0.5	1.2	1.9
Industry	9.2	7.8	6.0	7.0	6.5	6.4
Services	7.0	6.0	6.7	7.0	6.8	6.8
Inflation (Consumer Price Index)	3.0	4.1	1.4	2.0	2.5	3.0
Current Account Balance (% of GDP)	4.2	3.8	2.9	1.8	1.9	2.0
Financial and Capital Account (% of GDP)	0.9	3.4	0.9	0.9	0.7	0.5
Net Foreign Direct Investment (% of GDP)	1.4	2.0	2.0	1.7	1.2	1.2
Fiscal Balance (% of GDP)	-1.4	-0.6	-0.9	-2.7	-3.0	-3.0
Debt (% of GDP)	49.2	45.4	44.8	42.6	40.4	38.2
Primary Balance (% of GDP)	1.4	2.0	1.4	-0.4	-0.9	-0.9
Poverty rate ($1.9/day PPP terms)[a,b,c]	9.7	9.0	8.4	7.8	7.2	6.7
Poverty rate ($3.1/day PPP terms)[a,b,c]	30.8	29.9	29.0	28.1	27.2	26.3

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: e = estimate, f = forecast. (a) Calculations based on EAPPOV harmonization, using 2006-FIES and 2012-FIES. (b) Projection using annualized elasticity (2006–12) with pass-through = 1 based on GDP per capita constant LCU. (c) Projections are from 2013 to 2018.

SMALL PACIFIC ISLAND COUNTRIES



	2015
Population, million	0.88
GDP, US$, billion[a]	3.01
GDP per capita, current US$[ab]	4,406

Sources: WDI, World Bank staff estimates.
Notes: a) Data are for 2014; b) Simple average across countries.

Summary

Most small Pacific Island Countries are experiencing moderate growth, driven by stimulus from public and donor-funded investments, reconstruction from recent natural disasters, and relatively strong tourism receipts and remittances. Inflation remains moderate due to low commodity prices, which have also supported current account positions. Ensuring fiscal sustainability remains a challenge in most countries.

Recent Developments

Economic growth in the Federated States of Micronesia (FSM) is expected to have picked-up to about 3 percent in FY2015 (year ending September), on the back of strong fishing and service sector activities, and is expected to rise further in FY2016 with the resumption of US Compact related infrastructure projects. Year-end inflation was -1.1 percent in FY2015, due to lower global oil prices and the appreciation of the US Dollar (which FSM uses as its currency). Inflationary pressure is expected to remain negligible in FY2016. The current account is expected to have achieved a surplus in FY2015, with increased imports more than offset by the rise in fishing license fees. The government is estimated to have achieved a fiscal surplus of 6.7 percent of GDP in FY2015, on the back of the strong fishing revenues. Tax reforms to broaden the tax base and improve tax administration were repealed in FY2015, however, and tax collected as a share of GDP remains among the lowest in the Pacific at around 12 percent of GDP. The government has been prudent in saving its fiscal surpluses in the FSM Trust Fund, to mitigate potential future revenue shortfalls due to the scheduled end of Compact grants from 2024.

In Kiribati, growth remained strong in 2015—at 3.4 percent—well above the historical average of 1.7 percent. Growth is expected to moderate to 3.0 percent this year with the winding down of major donor-financed road, port, and airport infrastructure projects. Inflation has remained below 2 percent as lower food and commodity prices offset pressures from higher domestic demand and the weaker Australian dollar (which Kiribati uses as its currency). Despite large trade deficits, the current account balance has remained in surplus due to record fishing license fee revenue, as well as steady remittance inflows and solid investment incomes from the Revenue Equalization Reserve Fund (RERF), Kiribati's sovereign wealth fund. Fishing license fee revenue in 2015 was equivalent to about 90 percent of GDP, driven by the favorable El Nino effect, the implementation of the Vessel Day Scheme (a regional agreement establishing the minimum price of a vessel day and limiting the total number of vessel and fishing days sold) and the depreciation of the Australian dollar against the US dollar.

Reversing a decade-long trend of drawdowns, the government made a net transfer of AUD 50 million to the RERF in 2015, but kept over AUD 100 million outside the RERF as cash reserves, well above the level needed for crisis response. The new government, which came to power this year, made the decision to transfer an additional AUD 70 million to the RERF to

safeguard intergenerational equity. The remaining cash reserves, which are equivalent to about 3–4 months of the current spending, are consistent with the IMF's recommendations for crisis response.

Nauru—the newest member of the World Bank—experienced very rapid growth from FY2011–FY2014 (year ending June) as the resumption of phosphate mining, reopening of Australia's Regional Processing Centre (RPC) for asylum-seekers, and increase in revenues from fishing licenses, created jobs, spurred economic activity in the construction and services sectors, and provided substantial fiscal revenues. Estimates indicate that real GDP grew by around 25 percent annually over those four years. Payments to public servants and landowners from the liquidated Nauru Phosphate Royalties Trust also boosted domestic consumption, although much of this was reflected in increased imports. Nauru's economy is estimated to have undergone a substantial contraction in FY2015, however, after damage to port facilities disrupted phosphate exports as well as imports of fuel, food, and construction materials. Growth of around 2.5 percent is expected for FY2016, with phosphate exports recovering and RPC-related construction activity continuing.

To help support long term fiscal sustainability, Nauru has established a new Trust Fund to receive windfall revenues and provide an additional source of financing over the longer term. Government contributions to the Nauru Trust Fund of AUD 10.4 million were included in each of the FY2016 and FY2017 budgets, while other development partners also intend to make regular contributions and play a role in its governance. As well as increasing a range of customs and excise duties in FY2017, the government is also undertaking reforms to broaden its revenue base.

The Palauan economy grew by 9.4 percent in FY2015 (year ending September), led by robust tourism and construction activity. The economy is not expected to grow in FY2016, primarily due to the adverse impact on tourist arrivals of limits to charter flights. The external position improved in FY2015 due to lower commodity prices and stronger tourism receipts, but the trend is expected to have reversed thereafter due to weaker tourism receipts and larger infrastructure and related imports. Inflation fell to 2.2 percent in FY2015 and is expected to remain moderate in FY2016 with continued low commodity prices.

Palau's fiscal position strengthened in FY2015 due to spending restraint and the impact of strong economic growth. The current fiscal deficit declined to 5 percent of GDP in FY2015. The fiscal position is expected to improve further in FY2016, with continued spending restraint, and increases in the airport departure and visa fees offsetting lower tourist arrivals.

Overcoming the contraction of the previous year, the economy of the Republic of Marshall Islands (RMI) is estimated to have expanded by around 0.5 percent in FY2015 (year ending September), as the fisheries sector recovered. Growth is expected to rise to 1.5 percent this year, as the effects of drought are offset by a resumption of infrastructure projects. Inflation dropped to -2.2 percent in FY2015 due to falling oil and utility prices. Inflation is expected to rise to 0.5 percent in FY2016. The fiscal balance is estimated to have been a surplus of nearly 3 percent of GDP in FY2015, due to record fishing license fees. A smaller surplus is expected in FY2016. The current account deficit is likely worsen in FY2016 from an estimated deficit of 1.6 percent of GDP in FY2015.

Economic growth in Samoa is estimated to have been about 3 percent in FY2016 (year ending June), faster than originally forecast and higher than the 1.6 percent growth in FY2015. The increase was mainly attributable to strong growth in the transport and utilities sectors, which have benefitted from lower fuel prices, as well as scaled-up production from a recently-established fish processing and packing company. Average annual inflation was 0.7 percent in 2015, with substantial declines in fuel and transport prices keeping overall inflation modest. The current account deficit declined

to below 3 percent of GDP in FY2015 (from 8 percent in FY2014), due mainly to increased tourism-related services exports, lower oil and food prices, and the winding down of post-Cyclone Evan reconstruction imports.

The government made further progress on fiscal consolidation in FY2016, despite a decline in grants from development partners, with the deficit continuing to narrow and current expenditures falling by 3 percentage points of GDP over the last two years. Comprehensive policy and administrative reforms have also led to recent improvements in revenue collection. Nevertheless, Samoa's external public debt remains relatively high, at about 55 percent of GDP as at the end of 2015, up from around 30 percent of GDP in 2008.

Tonga has continued its relatively strong recent economic performance, with growth in FY2016 (year ending June) estimated at 3.1 percent, due to robust activity in both the public and private sectors. While economic conditions are substantially affected by frequent natural disasters, remoteness from markets and small size, prudent economic and fiscal management and a series of growth-supporting reforms have helped to increase business confidence and growth in recent years. Growth in FY2016 has been driven by a recovery in agriculture and an increase in construction activity in preparation for the South Pacific Games in 2019. Remittances are estimated to have been strong in FY2016, at nearly 30 percent of GDP, a critical driver of domestic demand.

The government's fiscal position has strengthened, with increased revenue and continued prioritization of expenditure. Domestic revenues have increased significantly from 18.0 percent of GDP in FY2012 to an estimated 23.7 percent in FY2016, supported by revenue policy and administration reforms. The deficit is estimated to have expanded in FY2016 to 3.1 percent of GDP, from 1.1 percent in FY2015, due to somewhat higher wage bill expenditure and somewhat lower grants. The containment of the deficit is critically dependent on the management of the wage bill and on the level of government financing for the construction of facilities for the SPG.

Inflation has been muted over the last five years, with the annual inflation rate for FY2016 standing at 0.1 percent, as imported food and fuel prices remained low and agricultural output increased. Private sector credit is growing again after many years of decline following an earlier severe credit crisis. The current account deficit in FY2016 is estimated at 3 percent of GDP. Foreign exchange reserves are adequate, at over six months of import cover.

Economic growth has picked up in Tuvalu in recent years, with 2.6 percent growth in 2015 and projected growth of 3.9 percent in 2016, partly due to recovery spending following Cyclone Pam. Government and donor funded investments, including in outer-islands schools and clinics, have also supported growth. Inflation picked up in 2015 to 3.3 percent and is expected to remain at 3.0 percent in 2016. It reflects higher government spending and a shortage of essential items due to Cyclone Pam-related disruptions in transport and the domestic supply of agricultural products, only partially offset by lower fuel prices.

Government expenditure has been rising in recent years, due to an expansion in capital spending and increased wages and transfers. Rising expenditure has been more than offset by rising fishing license fees, which reached over 60 percent of GDP in 2015 on the back of favourable exchange rates, weather conditions, and access fees. The fiscal surplus of around 4 percent of GDP in 2015 is expected to be maintained in 2016. These surpluses are being prudently reinvested into the corpus of the Tuvalu Trust Fund (TTF).

The current account is expected to move from a net surplus in 2015 to a moderate deficit in 2016, due to a widening trade deficit from increased imports for government and donor funded investment projects. Remittances, dominated by transfers from seafarers,

have been in long-term decline, and are now under 10 percent of GDP. Steady performance on the assets invested in the TTF, however, has resulted in higher income flows, as has the record fishing license revenue. Gross reserves remain adequate, covering around seven months of imports.

Vanuatu is still recovering from the impact of Cyclone Pam, which struck in March 2015 causing damages and losses of over 60 percent of GDP. In addition, unusually dry conditions triggered by El Niño throughout 2015 and early 2016 further curtailed the production of some agricultural commodities (including cocoa, kava, and beef), and led to reports of food and water shortages on some islands. The government allocated emergency funding for water, sanitation, hygiene and food to mitigate the impacts on hardship and vulnerability in the affected areas.

The number of air arrivals recovered in the second half of 2015 but remained 17 percent below the previous year. The suspension of a number of international flights into Port Vila in January, due to concerns over runway conditions, resulted in air arrivals declining by 10 percent year-on-year in the first quarter of 2016. Cruise ship arrivals fell sharply in the aftermath of the cyclone, but rebounded strongly thereafter, with arrivals in the first quarter of 2016 showing a 66 percent increase year-on-year. Overall, economic growth is expected to be 4 percent in 2016, driven by the commencement of large infrastructure projects, continuation of post-cyclone reconstruction, gradual recovery of agricultural production, and overall growth in visitor arrivals. The current account deficit is expected to widen in 2016 to around 17 percent of GDP, reflecting an increase in imports for post-cyclone recovery. Inflation was 2 percent in the first quarter of 2016, a marginal increase on the previous quarter, due to food and transport prices.

The dissolution of parliament in late 2015 and election of a new government in January 2016 delayed the passing of the 2016 budget until March. The incoming government has committed to advancing a number of major reconstruction projects, which had stalled in the latter half of 2015 (leaving a budget surplus of 7 percent of GDP). These projects, combined with ongoing post-cyclone recovery efforts, are expected to result in a significant budget deficit of above 10 percent of GDP in 2016.

Outlook and Emerging Challenges

The key challenge facing FSM is the creation of sufficient fiscal space to enable the government to respond to future shocks and ensure the long term sustainability of service delivery. Financial market volatilities affect the level of assets accumulated in the Compact Trust Fund, and thereby also FSM's long term fiscal sustainability.

The outlook for Kiribati remains positive, although fishing license fee revenue is expected to come down from recent peaks with the changing climate cycle and migration patterns of tuna. Growth is expected to gradually moderate toward its potential, around 2–3 percent per year, but if planned major donor-funded infrastructure projects are implemented, the medium term growth forecast will shift up.

Maintaining fiscal sustainability remains a challenge in Kiribati, despite recent surpluses, since revenue and expenditure are subject to large and frequent shocks. Kiribati's main sources of income—fishing license fees, seafarer remittances, RERF investment income, and foreign aid—will continue to be volatile, while disaster-related expenditure shocks could increase in frequency and severity with climate change. The large infrastructure deficit, widespread poverty, and young and growing population require further increases in spending on physical and human capital. Ongoing efforts to improve the performance and consolidate the number of state owned enterprises need to be accelerated to reduce fiscal risk and improve access to basic public services.

Over the next few years, Nauru is expected to return to faster rates of growth, supported by repairs and improvements to port facilities and the economic contributions of resettled refugees. Its biggest challenge is to diversify its economy beyond reliance on phosphate mining and the RPC, neither of which is a sustainable source of income long term. Fiscal sustainability requires that the revenue reforms underway be complemented with systematic efforts to contain the wage bill and recurrent spending, while preserving critical expenditures on health and education.

The growth outlook for Palau is positive, driven by a recovery in tourism activity and robust construction activity. This outlook is subject to substantial risks, however. A slowdown in key source markets, US dollar appreciation, or natural disasters could hurt tourism activity. Failure to adopt a comprehensive tourism strategy could also harm growth over the medium term, if excess strains are placed on infrastructure and environmental services. Notwithstanding recent improvements in the fiscal position, continued fiscal adjustment is needed to create space for public investment and to ensure adequate buffers are in place to respond to future climate events and Compact grant uncertainties.

The key challenge facing RMI is the drain on public resources by public enterprises. Improved public enterprise governance is needed. Without reforms, and given the steady decline in Compact grants, a sizeable fiscal deficit is likely to emerge, and large contingent liabilities will remain. Weak anti-money laundering and banking supervision policies are affecting the ability of the Bank of RMI to establish correspondence relationships with US banks, critical to ensuring the continued flow of US Dollars and financial sector stability.

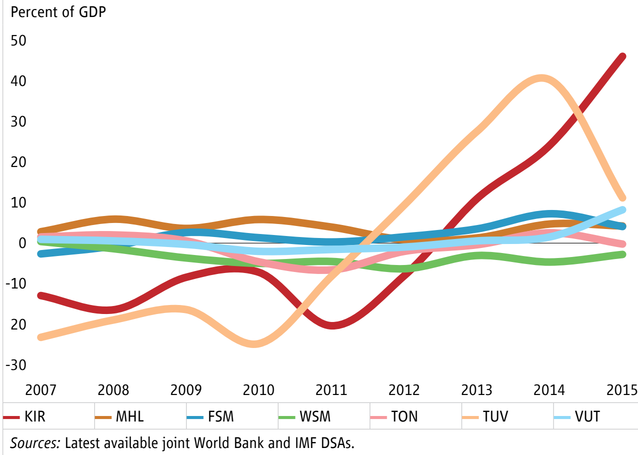
In Samoa, the pending exit of a major manufacturer is likely to temporarily lower growth in FY2017, although the opening of a number of major hotel developments and increased agricultural exports should provide a partial offset. Over the medium term, growth is expected to return to around 2 percent annually, reflecting a balance between increased productive capacity in the tourism and agriculture sectors and the dampening effect of fiscal consolidation and reduced construction activity. Nevertheless, as public debt remains high, it is important that fiscal consolidation proceeds as planned, and only high-priority, concessionally-funded capital investments are undertaken.

The key challenge for Tonga is to maintain its solid fiscal performance in the face of sizeable risks from civil service pay demands and the potential costs of hosting the SPG. If it can navigate these challenges successfully, it will retain the fiscal space it needs to respond quickly and effectively to the frequent shocks it encounters. Over the medium term, the tourism industry is expected to benefit from the redevelopment of a luxury hotel in FY2017, Tonga's largest hotel, marking a much-needed increase in high-end accommodation.

For Tuvalu, the positive growth outlook is subject to downside risks associated with uncertain fishing revenues and climate events. Volatility in international financial markets poses a significant risk to returns on the TTF, in turn affecting the replenishment of the reserve assets that are relied on to finance fiscal and external deficits.

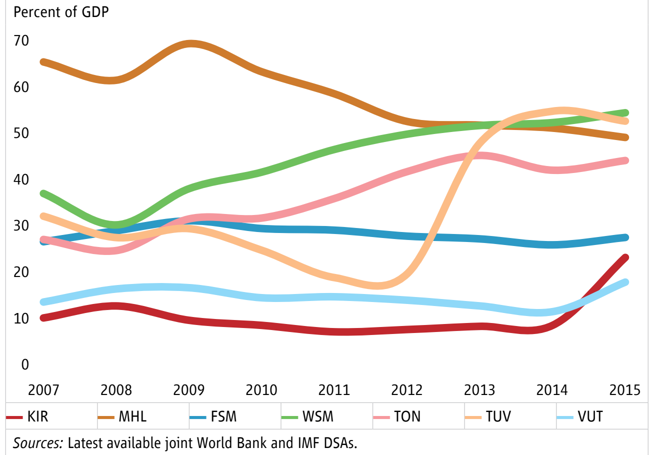
For Vanuatu, if planned public investments are undertaken efficiently they should boost the potential growth rate and ensure services are available to the poorest and most vulnerable. Vanuatu has some fiscal space to take on moderate levels of concessional debt to meet its post-cyclone recovery and broader development needs. The new government has affirmed its commitment to address deficiencies in anti-money laundering controls, which will see Vanuatu withdrawn from the Financial Action Task Force 'grey list' and may support foreign investment.

Figure 1. Primary balances



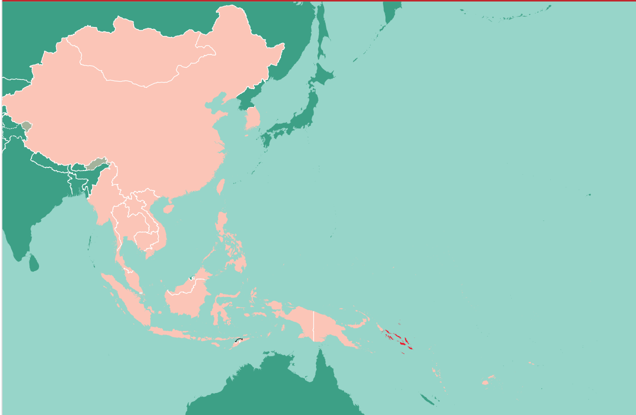
Sources: Latest available joint World Bank and IMF DSAs.

Figure 2. Public and publicly guaranteed external debt



Sources: Latest available joint World Bank and IMF DSAs.

SOLOMON ISLANDS



	2015
Population, million	0.6
GDP, current US$ billion	1.2
GDP per capita, current US$	2013
Basic needs poverty rate[a]	12.7
Gini coefficient[a]	37.1
School enrollment, primary (% gross)[b]	113.3
Life expectancy at birth, years[b]	67.5

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: a) Most recent value (2013); b) Most recent WDI value (2014).

Summary

In the 2016 budget, the Solomon Islands Government continues to prioritize rural infrastructure and development. Growth is expected to remain at trend of around 3 percent. In the medium term, continued strong and coordinated government action coupled with greater private sector investment to promote inclusive economic growth will be necessary to ensure improvements in living standards, particularly in rural areas where most of the population reside.

Recent Developments

The Solomon Islands continues to remain dependent on foreign aid flows and natural resource extraction, and is heavily exposed to natural disasters and external price shocks. After "the tension" period in the early 2000s, economic growth has primarily been driven by logging and a large influx of Official Development Assistance.

Economic growth is expected to remain at 3 percent in 2016 (a slight decline from 3.3 percent in 2015), reflecting the effects of El Niño weighing on agricultural production and fish catch, particularly during the first half of the year. Growth is expected to be driven by investments in construction, communications, and manufacturing. In the first half of 2016, production of logs, a key driver of growth, and palm kernel oil and meal surpassed 2015 Q2 output by 19.1 and 18.1 percent, respectively. While the production of copra increased marginally year-on-year over the same period (1.2 percent), production of all other key export commodities remained below that of the previous year, reflecting weaker demand in international markets (notably, cocoa production declined by 49.2 percent). Fish catch also saw a 3.6 percent decline year-on-year but is expected to recover in the second half of the year.

The national basic-needs poverty rate, estimated in 2012/13, is 12.7 percent, while the gini coefficient, a measure of inequality, is 37.1.

Formal employment indicators from the Solomon Islands National Provident Fund exhibited moderate growth in 2015, with estimates showing a 7 percent increase in active contributors in the first half of 2015 to 57,404 people.

Continued expansionary fiscal policy in 2016 has been driven be primarily by spending on infrastructure and rural development. The 2016 budget targets a deficit of 5.7 percent of GDP, financed through a draw-down in the government's cash balances. However, assuming similar levels of budget execution to previous years, the actual deficit at year-end is likely to be around 1.5 percent of GDP.

Total government debt at the end of 2015 fell from 13.3 percent of GDP to 10.4 percent, following the full repayment of all domestic bonds. As such, the Solomon Islands enjoys one of the lowest debt-to-GDP ratios in the EAP region and globally. The most recent Debt Sustainability Analysis, undertaken in early 2016,

classifies the Solomon Islands at a moderate risk of debt distress with the baseline scenario subject to significant risks, resulting from a lower-than-expected growth path and a shock to financing terms.

International reserves stood at US$532 million at end-Q2 2016, equivalent to just over 10 months of import cover. The current account is expected to widen from 2.6 percent of GDP in 2015 to 4.5 percent in 2016, to support imports related to large infrastructure projects.

The overall headline inflation rate declined over the first two quarters of 2016 from 3.3 percent in January to 2.9 percent by the end of Q2, driven largely by a fall in domestic food prices outweighing increases in the price of imported fuel.

Outlook

The Solomon Islands economy is projected to grow on average by 3.1 percent over the medium term. This baseline scenario is based on the assumption of resumed gold-mining activity, the exploitation of large nickel deposits, increased investments in key transport infrastructure, energy and telecommunications projects, and sustained levels of foreign direct investment of around 3.3 percent of GDP.

Despite the government targeting a budget deficit for the third consecutive year, the deficit is expected to improve from a projected 1.4 percent of GDP in 2016 to 0.6 percent in 2017. Total government revenues are projected to decrease by 0.6 percent against the 2016 revised budget, with a decline in external grants outweighing a 13 percent increase in domestically sourced revenues. Domestic revenues are expected to be driven by a 75 percent increase in non-tax revenue collected by ministries. Taxes on trade are expected to remain flat, and inland revenue collections are expected to increase by 9 percent. Planned government expenditures in 2017 are anticipated to decline by 4 percent against the 2016 revised budget.

The current account deficit is expected to widen to 7.8 percent of GDP by end-2017, reflecting an increase in capital imports related to much needed infrastructure and energy projects, and the underlying long-run decline in logging exports.

The Honiara Consumer Price Index (period average) is expected to remain at around 3 percent over the medium term.

Risks and Challenges

This outlook is subject to considerable downside risk, especially in relation to mining, in that future developments hinge on the development of a legal and regulatory framework conducive to mining, and on clear procedures for the acquisition of land for the exploration and exploitation of natural resources.

A sharper-than-expected downturn in the Chinese economy (the main export destination for logs), poses a key risk to government revenues. Going forward, with accessible logging sources expected to be fully depleted in the long run and uncertainty around the exploitation of the country's mining potential, the Solomon Islands faces the challenge of developing new sources of growth.

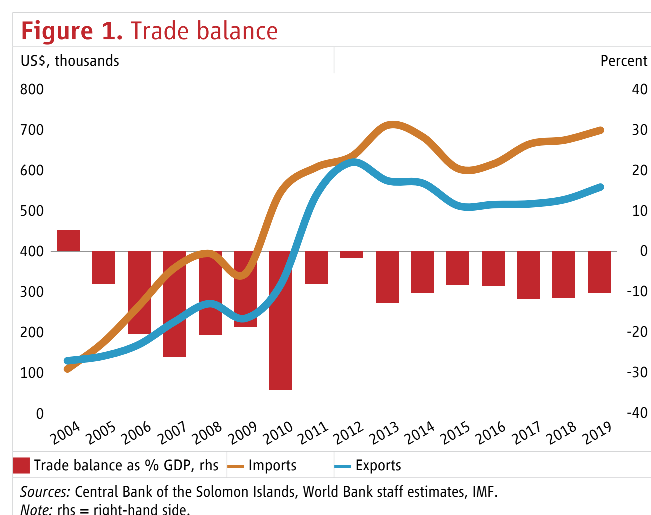
A number of challenges remain in the fisheries sector, including licensing, monitoring, and enforcing compliance in offshore fisheries. If sustainably managed, fisheries offer the potential to contribute to growth and government export earnings over the medium term.

Tourism, which is projected to increase by 5 to 6 percent per year in the Pacific region until 2020, could also make an important contribution to broad-based growth, although at this stage it is not very developed. Challenges in developing the tourism sector

include limited market exposure of tourism products, limited domestic transport infrastructure and services, and limited access to finance for small and medium enterprises operating in the sector.

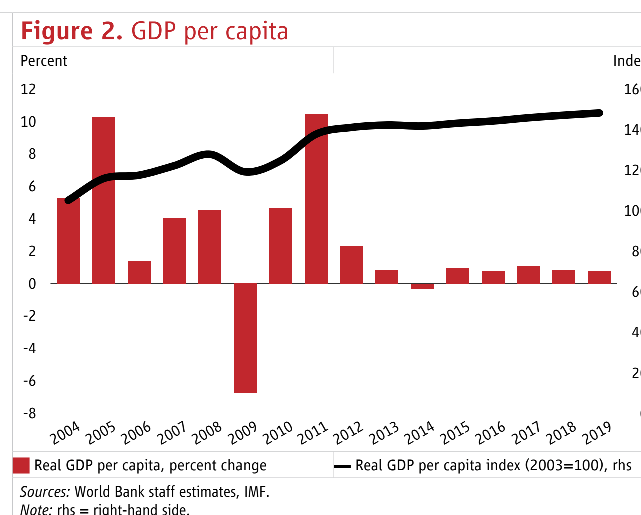
Further, should future formal employment opportunities continue to remain concentrated in Honiara and the immediate surroundings, this might exacerbate challenges associated with rapid population growth, rural to urban migration, and the growth of urban squatter settlements.

Figure 1. Trade balance



Sources: Central Bank of the Solomon Islands, World Bank staff estimates, IMF.
Note: rhs = right-hand side.

Figure 2. GDP per capita



Sources: World Bank staff estimates, IMF.
Note: rhs = right-hand side.

SOLOMON ISLANDS Selected Indicators	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real economy[a]					
Real GDP	2.0	3.3	3.0	3.3	3.0
Per capita GDP	-0.8	1.1	0.8	1.3	1.2
GDP deflator	3.2	1.6	4.3	1.8	1.8
CPI (eop)	4.2	2.9	2.7	2.5	3.6
Fiscal accounts[b]					
Expenditures	46.3	46.4	45.1	43.9	41.4
Revenues	48.0	46.1	43.8	43.3	43.0
Fiscal Balance	1.7	-0.3	-1.4	-0.6	1.6
Balance of Payments[b]					
Current account balance	-4.3	-2.6	-4.5	-7.8	-7.1
Imports (goods and services)	59.3	52.7	51.3	52.7	51.0
Exports (goods and services)	49.2	44.6	42.8	40.8	39.8
Foreign direct investment	1.8	2.0	3.1	3.5	3.4
Gross reserves (in US$ millions, eop)	514.3	519.6	545.9	581.8	627.5
In months of next year's imports	10.2	10.1	9.8	10.3	10.8
External debt	10.4	9.8	8.4	9.4	12.4
Exchange rate to US$ (average)	7.4	7.9	8.0	8.0	8.0
Nominal GDP (US$ millions)	**1,154**	**1,147**	**1,202**	**1,264**	**1,325**

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: f = forecast. a) Annual percentage change, unless otherwise indicated. b) percent of GDP, unless otherwise indicated.

THAILAND

	2015
Population, million	68.0
GDP, current US$ billion	395.2
GDP per capita, current US$	5815
Gini coefficient[a]	37.8
School enrollment, primary (% gross)[b]	97.5
Life expectancy at birth, years[b]	74.1

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: a) Most recent value (2013); b) Most recent WDI value (2014).

Summary

The Thai economy posted stronger-than-expected growth in the first half of 2016 but a broad-based and self-sustaining recovery has yet to take hold. The Thai economy expanded by 3.4 percent in H1 2016 showing positive momentum from fiscal stimulus, tourism and private consumption while goods exports contracted and private investment remained flat. Economic growth is expected to accelerate to 3.1 percent in 2016 from 2.8 percent in the previous year. Poverty rates are expected to fall at a slower rate, with poor households concentrated in rural areas affected by falling agricultural prices.

Recent Developments

Economic growth increased to 3.2 percent and 3.5 percent in Q1 and Q2 of 2016, compared to 2.8 percent in Q4 2015 (figure 1), with public consumption and investment, tourism and private consumption as the main contributors. The stronger-than-expected private consumption growth in Q2 2016 was driven by an uptick in the sales of new passenger car models, improved farm income and tourism. Tourism revenue also surged by 14.7 percent mostly due to the rising number of tourists from China and other Asian countries. Export of goods dropped by 2.2 percent as trading partner economies in Asia slowed. In addition, fiscal stimulus slowed on a quarter-on-quarter basis while private investment remained anemic.

On the production side, the performance of the services sector in H1 2016 improved noticeably. Growth in tourist arrivals registered 12.0 percent in H1 2016. As a result, the hotel and restaurant sector expanded considerably by 14.3 percent. Agriculture contracted slightly by 0.8 percent in H1 2016 but on a quarterly basis showed improvement as the impact of drought subsided. Industrial production expanded by 0.9 percent primarily due to car and machinery production. The Capacity Utilization Rate remained roughly stable at 64.4 percent.

The positive trade balance continued to expand in the first half of the year despite the decline in exports (-2.2 percent in H2 2016, year-on-year), due to a significant drop in imports (-11.1 percent) caused by low energy prices and weak demand for capital, raw materials and intermediate goods. The current account balance is estimated at end-2016 at 5.6 percent of GDP. In Q2 2016, foreign direct investment inflows continued to grow while net portfolio flows saw an outflow as foreign investors expected a Fed rate hike.

The nominal exchange rate averaged of 34.88 Thai baht per US dollar as of July 2016, compared to 36.07 end-2015. The baht has appreciated broadly in line with regional currencies due to concerns over a Fed rate hike and Brexit. Foreign currency reserves increased to US$180 billion end-July 2016 from US$157 billion end-Dec 2015. The policy interest rate has remained on hold since April at 1.5 percent as headline inflation

turned positive at 0.30 percent year-on-year in Q2 2016 on account of rising fresh food and retail oil prices.

On the fiscal side, net revenue collection grew by 9.6 percent year-on-year with non-tax revenue as a key contributor. The government deficit, estimated at around 1.9 percent of GDP in FY2015, has been budgeted at 2.8 percent of GDP in FY2016, in a context of fiscal stimulus.

Outlook

Real GDP growth is projected to be 3.1 percent in 2016. Consumption would continue to underpin growth, albeit modestly, in a context of improving consumer confidence, whereas private and foreign direct investment are likely to stay at low levels due to weak external demand and political uncertainty. The current account balance is expected to narrow in the following years as imports recover. The surge in passenger car sales and tourist arrivals observed in H1 2016 is expected to slow in the second half. Fiscal stimulus, a major driver of growth, is also expected to slow in the second half of 2016 due to long-standing implementation challenges of large public infrastructure projects as well as base effects from front-loaded fiscal stimulus in late 2015. The timely implementation of public infrastructure projects (dual track rail and rail upgrading) in 2016 and 2017 would help crowd in private investment and contribute to a more positive outlook.

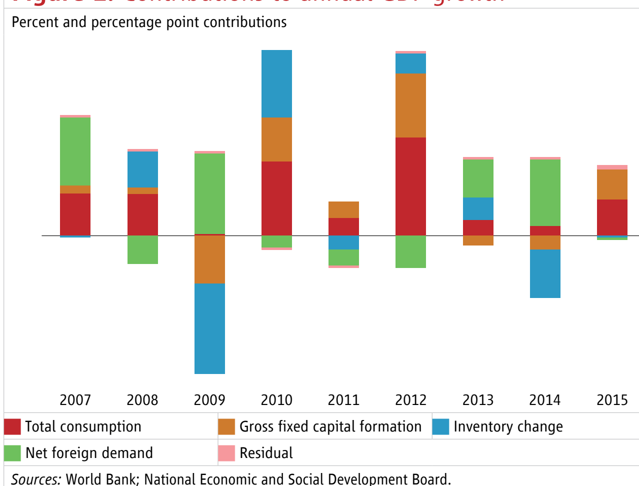
Rising agricultural income in the recent years mainly reflected a global commodity price cycle and not long-term productivity increases in agriculture. As the agricultural prices fall back to more normal levels, growth could become less inclusive, with the rural poor negatively affected. Constrained by education attainment and skills levels, a large share of the poor workers might not be able to reap the full benefit of the job opportunities in the high-end services sector. As a consequence, poverty is expected to decline at a slower rate in rural areas.

Risks and Challenges

The small risk of financial instability in the Chinese economy brought about by defaults of highly leveraged corporates, would affect Thailand through the trade and capital flows channels, as China accounts for 12 percent of total exports and 8 percent of total FDI inflows. Nonetheless, Thai exports are well diversified in terms of products and markets, authorities have ample monetary and fiscal buffers and a flexible exchange rate serves as a buffer against external shocks.

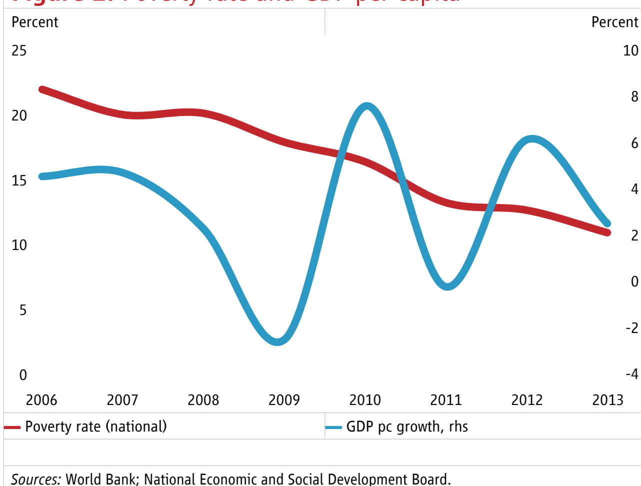
A second risk is a rise in political uncertainty if ongoing political reforms do not satisfy civil society at large or become postponed. In such a scenario, political uncertainty would delay public expenditure and weigh on consumer and investor confidence. However, the recent passing of the public referendum on the draft constitution and the government's reaffirmation to hold elections in 2017 help mitigates this risk.

Figure 1. Contributions to annual GDP growth



Sources: World Bank; National Economic and Social Development Board.

Figure 2. Poverty rate and GDP per capita

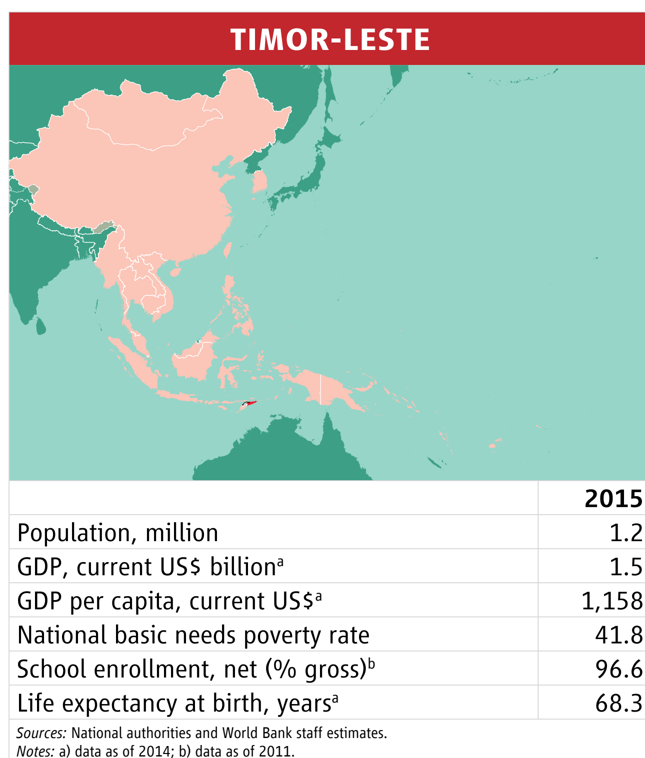


Sources: World Bank; National Economic and Social Development Board.

THAILAND Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	2.7	0.8	2.8	3.1	3.1	3.3
Private Consumption	1.0	0.6	2.1	2.3	2.4	3.2
Government Consumption	2.5	2.1	2.2	3.6	3.2	2.2
Gross Fixed Capital Investment	-1.0	-2.4	4.7	3.3	2.7	3.2
Exports, Goods and Services	2.7	0.2	0.2	0.4	0.5	1.5
Imports, Goods and Services	1.6	-5.3	-0.4	-0.5	-0.4	1.0
Real GDP growth, at constant factor prices	2.9	0.9	3.3	2.8	3.1	3.4
Agriculture	0.8	0.7	-3.8	5.3	2.7	2.5
Industry	1.4	-0.3	2.2	2.7	2.8	3.4
Services	4.1	1.7	4.9	2.5	3.4	3.5
Inflation (Consumer Price Index)	2.2	1.9	-0.9	0.5	2.0	2.5
Current Account Balance (% of GDP)	-1.4	3.9	8.1	5.6	4.2	2.6
Financial and Capital Account (% of GDP)	0.6	-3.8	-3.8	-2.3	0.9	5.2
Net Foreign Direct Investment (% of GDP)	0.9	-0.1	-0.1	-0.1	-0.1	-0.1
Fiscal Balance (% of GDP)	0.4	-1.8	-2.1	-2.9	-2.1	-1.8
Debt (% of GDP)	42.1	44.9	45.6	46.3	46.1	46.3
Primary Balance (% of GDP)	1.5	-0.7	-0.9	-1.8	-0.9	-0.6

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast.

TIMOR-LESTE



	2015
Population, million	1.2
GDP, current US$ billion[a]	1.5
GDP per capita, current US$[a]	1,158
National basic needs poverty rate	41.8
School enrollment, net (% gross)[b]	96.6
Life expectancy at birth, years[a]	68.3

Sources: National authorities and World Bank staff estimates.
Notes: a) data as of 2014; b) data as of 2011.

Summary

Timor-Leste is facing an outlook starkly different to its recent past. Previously one of the most oil-dependent countries in the world, it could become a post-oil country in as little as five years' time. The nation has invested heavily in domestic infrastructure using oil receipts that were prudently saved. While the domestic economy remains very underdeveloped, reform efforts are beginning to show results, with a pipeline of FDI emerging. Timor-Leste must employ its finite resource effectively and implement key reforms to support a more diversified economy.

Recent Developments

Recently completed estimates show that national poverty was 41.8 percent in 2014, down from 50 percent in 2007.

While production in the offshore petroleum sector peaked in 2013 and has begun to decline rapidly, the domestic economy is largely delinked from trends in this sector aside from the fiscal use of oil revenue. Economic developments in the non-oil economy have been driven to a large extent by the public sector investment program financed from oil revenues. The economy grew by 5.9 percent in 2014 and by a projected 4.3 percent in 2015. A nationwide program of public roadworks and other projects have boosted construction and related activity while recent improvements in electricity coverage around the country are likely to have supported more economic activity. Consumer price inflation hovered just above zero in 2014 and 2015 as the US$, the official currency of Timor-Leste, continued to appreciate which kept imported prices low and declining. While hurting existing export markets such as coffee and prospects for new export-oriented activities, the strong currency may also have brought a short-term growth dividend domestically.

Almost since independence, Timor-Leste has been an oil-dependent country, with oil production making up as much as 85 percent of total GDP and government revenues from the oil sector reaching 50 times the level of domestic revenues at its peak. By 2015, government receipts from the petroleum sector were just under US$1 billion, one-third their level in 2013. While receipts have been hit by the drop in oil prices, production from existing wells is also declining with production down from 60 million barrels in 2013 to a projected 40 million in 2016. Oil revenues, however, have been prudently saved in a sovereign-wealth fund, the Petroleum Fund, and the country now has US$16 billion invested. These resources are of critical value in financing the accelerated transition of Timor-Leste to a higher level of development if spent well.

The decline of the petroleum sector has meant that the government budget has moved rapidly moved from an overall budget surplus of 40 percent in 2013 to a deficit of 10 percent in 2015. According to law, the government publishes annually an independently-

audited estimate of the amount that can be sustainably drawn down each year from the Fund in perpetuity. That amount is currently around US$500 million, but will fall inexorably each year as government draws down on the principal of the Fund.

The government's expansionary spending program is driven by an ambition to overhaul the nation's public infrastructure in order to crowd-in private sector investment and boost long-term growth prospects. While this represents a viable economic strategy in principal, it is dependent on the quality of the investments being made, and that public investment is indeed the binding constraint to private sector development. There are indications of limited capacity to implement the program, with execution rates for the infrastructure budget low and increasingly high prices demanded for construction works. A combination of marginal investments and high costs also raise important questions of the quality and prioritization of the investment program. One 30km stretch of road currently under construction in an underpopulated, rural area of the country costs an average of US$10 million per kilometer (compared to a norm of US$1–2m).

Timor-Leste's only significant non-oil export product is coffee. Export values and volumes fell from US$18.8 million (34m kg) in 2012 to US$13.8 million (10.2m kg) in 2014 with production recovering in 2015 to US$15.2 million (19.2m kg). Overall, the current account surplus has declined along with falling oil exports, from 44 percent of GDP in 2013 to 13 percent in 2015.

Outlook

In 2016 and 2017, domestic growth is expected to continue in a similar range as the last two years, with growth forecast at 5.0 and 5.5 percent, respectively. While strong government spending, especially on infrastructure investment, will continue to stimulate growth, foreign direct investment is expected to increase as well. The Government recently signed the concession agreement for its first public-private partnership which will see a major international operator invest US$150 million for the construction of a new container port near the capital city. Construction has also begun on a Heineken factory, and other potential investors are showing interest in some sectors.

Development of the domestic economy will be essential. With no new oil fields under development and current wells depleting rapidly, Timor-Leste is expected to be a post-oil country in as little as five year's time. Oil production, exports and gross value added from the offshore oil sector will decline rapidly each year for the next few years.

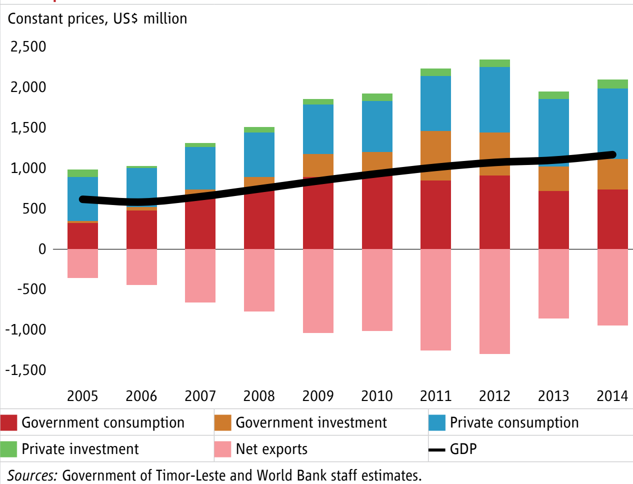
The Government recently submitted a supplementary budget for the current fiscal year to appropriate additional expenditure financed by excess drawdowns from the Petroleum Fund. As a result the budget deficit is expected to widen considerably in 2016 to more than 20 percent of GDP. In 2017 the budget deficit is forecast to widen even further as revenues from the oil sector decline.

Risks and Challenges

The government has focused a considerable amount of their resources and focused their political agenda on supporting improvements in physical infrastructure nationwide. Achieving the best results in terms of long-lasting economic and social impacts will require an effective management of the public investment program to ensure that projects are prioritized that have a high return and support steady and rapid progress along a viable path of economic development. This task requires careful planning, backed up by solid analysis, including of complementary investments in skill development and technology adoption required to ensure that infrastructure investments pay-offs are high. Introducing quality and productivity enhancing technologies in coffee production, for example, can

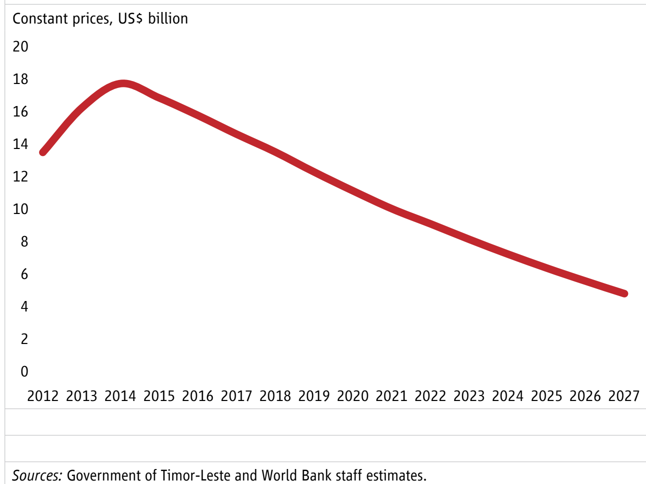
potentially benefit a large number of small farmers. Existing financial assets should also be used as effectively as possible. The investment strategy of the Petroleum Fund should be in line with the Government's use of the fund. A recent shift to invest more heavily in higher-risk equities is seemingly at odds with the Government's strategy of drawing down on the Fund's principal in the short-term. Securing a return, even a modest one, is a priority. Financial reports show the Petroleum Fund made a net loss on its assets in 2015. While Timor-Leste faces a daunting infrastructure gap, there are a variety of other constraints that would also need to be addressed to support private-sector-led, inclusive growth. Timor-Leste still ranks as having one of the least conducive regulatory environments for business in the world. A lack of functioning state systems of identification, registration, and dispute resolution over land title make it extremely difficult to secure a claim over land, and it is difficult to see how businesses could commit to investments in this context. The lack of laws governing the enforcement of commercial and credit contracts also make doing business much more difficult. While Timor-Leste has much to offer, concerted effort is needed to address these critical constraints before it can realistically expect to attract large-scale foreign investment and spur domestic enterprise.

Figure 1. Gross domestic product, expenditure components



Sources: Government of Timor-Leste and World Bank staff estimates.

Figure 2. Projected petroleum fund balance



Sources: Government of Timor-Leste and World Bank staff estimates.

TIMOR-LESTE Selected Indicators	*2013*	*2014*	*2015e*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	2.8	5.9	4.3	5.0	5.5	6.0
Exports, goods and services, US$ million[a]	87.9	89.3	91.6	100.0	113.0	128.0
Imports, goods and services, US$ million	1,139	1,286	1,198	1,297	1,605	1,668
Consumer Price Inflation (annual average % change)	9.5	0.7	0.6	0.5	3.0	4.0
Current Account Balance (% of GDP)	43.6	26.2	13.3	2.0	-11.9	-12.2
Fiscal Balance (% of GDP)[b]	41.7	21.8	-8.7	-23.7	-29.5	-27.7

Sources: National authorities and World Bank staff estimates.
Note: f = forecast. a) exports exclude offshore petroleum shipments; b) overall fiscal balance as a proportion of total GDP, including petroleum sector.

VIETNAM

	2015
Population, million	91.7
GDP, current US$ billion	193.2
GDP per capita, current US$	2,106
Poverty rate ($1.9/day 2011 PPP terms)[a]	2.8
Poverty rate ($3.1/day 2011 PPP terms)[a]	10.7
Gini coefficient[a]	34.8
School enrollment, primary (% gross)[b]	107.0
Life expectancy at birth, years[b]	75.3

Sources: World Bank WDI and Macro Poverty Outlook.
Notes: a) Most recent value (2014); b) Most recent WDI value (2014).

Summary

Economic activity in Vietnam moderated in the first half of 2016, due to the impact of a severe drought on agricultural production and slower industrial growth. While the broad poverty reduction trend continues, the contraction in agriculture poses short term risks to livelihoods, in particular among poor households which rely predominantly on farm income. The medium-term outlook is broadly positive, but downside risks remain. A bolder implementation of structural, fiscal and banking sector reforms would help to mitigate macroeconomic vulnerabilities and sustain higher medium term growth.

Recent Developments

After accelerating strongly in 2015, GDP growth slowed to 5.5 percent during the first half of 2016 (compared to 6.3 percent growth in the first half of 2015). The deceleration is partly due to a severe drought and saltwater intrusion which caused agricultural output to contract by 0.2 percent. Industrial growth also moderated on the back of weak commodity prices and sluggish external demand. In contrast, growth picked up further in the construction sector, driven by buoyant credit growth and a recovery in the real estate sector. The service sector also accelerated, driven by retail trade growth which benefited from resilient domestic consumption.

The impact of the drought on household livelihoods is likely to be greatest among the two million ethnic minorities living in the Central Highlands among which agriculture constitutes 80 percent of household income.

Driven by rising foodstuff and administratively-managed prices (mainly education and healthcare services), headline CPI inflation inched up moderately to 2.6 percent (year-on-year) in August. Meanwhile, credit growth continued to expand at an average of about 18 percent year-on-year (about three times nominal GDP growth). To address rising concerns about adverse impacts of rapid credit growth on lending quality, the SBV adopted tighter prudential regulations which are expected to mitigate potential systematic risks and moderate credit growth. Meanwhile, lingering asset quality and associated capital impairment risks have not been resolved, despite the transfer of most NPLs to the Vietnam Asset Management Company (VAMC).

At the beginning of the year, the SBV also moved towards more flexible management of the exchange rate—a key step to enhance responsiveness to external volatility. As a result the dong depreciated slightly by just about 1 percent since the beginning of the year while foreign reserves started to recover—albeit very gradually—to about 2.5 months of imports by the end Q1-2016 from two months in 2015.

While Vietnam's trade performance remains relatively strong, Vietnamese exports slowed to 6.4 percent (year-on-year) over the first eight months of the year—

still far above global trade growth but the lowest level for Vietnam since 2009. This is mainly due to a combination of declining oil exports and slower growth of manufacturing exports due to weaker external demand.

Foreign direct investment has accelerated in recent months, reflecting positive investor sentiment about Vietnam's deeper economic integration. In the first eight months of 2016, foreign investors committed US$ 14.4 billion to Vietnam—about 8 percent increase compared to the same period last year. The foreign-invested sector contributes about 18 percent of Vietnam's GDP, nearly a quarter of total investment, two thirds of total exports and millions of direct and indirect jobs.

Accumulated fiscal imbalances remain a cause of concern. A fiscal deficit (including off-budget items) of about 6 percent of GDP in 2015 pushed Vietnam's public debt to an estimated 62.2 percent of GDP, nearly 11 percentage points higher than in 2010 and inching quickly toward the legally-mandated ceiling of 65 percent of GDP. Fiscal outturns in the first half of 2016 suggest that budget pressures persist, as lower oil prices and weaker economic activity weigh on revenue performance.

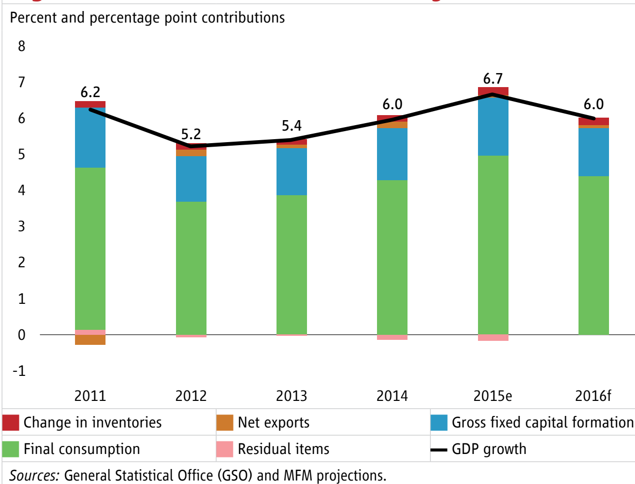
Outlook

Vietnam's medium term outlook remains positive. GDP is projected to moderate to 6 percent in 2016 accompanied by moderate inflation and a small current account surplus. The fiscal deficit is projected to remain high this year but then tighten over the medium term, reflecting the government's fiscal consolidation plans.

Risks and Challenges

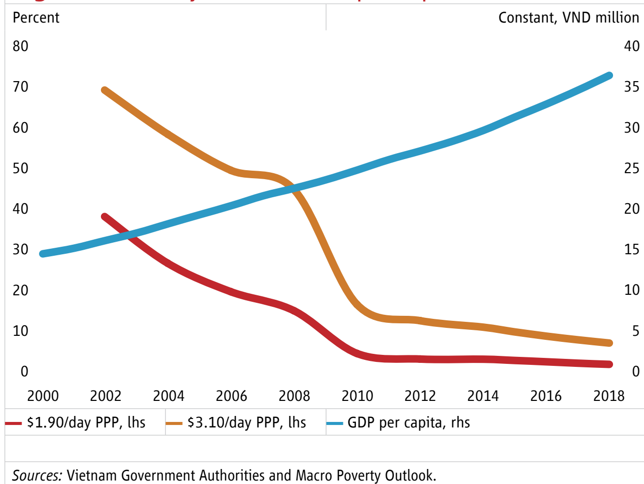
The baseline outlook is subject to external and domestic risks. A further weakening of external markets could dim Vietnam's export performance. On the domestic front, slow progress in implementing structural reforms to boost productivity could dampened medium-term growth, while delays in addressing lingering NPL problems and fiscal consolidation could pose risks to future macroeconomic stability and growth. Furthermore, the recent drought is reflective of the rising incidence of climate events and the risks they pose to Vietnam's gains in poverty reduction.

Figure 1. Contributions to annual GDP growth



Sources: General Statistical Office (GSO) and MFM projections.

Figure 2. Poverty rate and GDP per capita



Sources: Vietnam Government Authorities and Macro Poverty Outlook.

VIETNAM Selected Indicators	*2013*	*2014*	*2015*	*2016f*	*2017f*	*2018f*
Real GDP growth, at constant market prices	5.4	6.0	6.7	6.0	6.3	6.3
Private Consumption	5.2	6.1	9.3	6.0	6.8	6.8
Government Consumption	7.3	7.0	7.0	7.4	5.3	6.1
Gross Fixed Capital Investment	5.3	9.3	9.4	4.3	5.0	5.0
Exports, Goods and Services	17.4	11.6	12.6	6.4	9.9	10.7
Imports, Goods and Services	17.3	12.8	18.1	6.1	9.7	10.6
Real GDP growth, at constant factor prices	5.3	5.7	6.8	6.0	6.2	6.2
Agriculture	2.6	3.4	2.4	0.3	1.2	1.5
Industry	5.1	6.4	9.6	7.6	8.2	8.2
Services	6.7	6.2	6.3	6.9	6.4	6.1
Inflation (Consumer Price Index)	6.6	4.1	0.6	4.0	4.5	4.5
Current Account Balance (% of GDP)	4.5	5.1	0.5	0.5	0.4	0.4
Fiscal Balance (% of GDP)	-7.4	-6.2	-6.0	-5.9	-5.7	-5.0
Debt (% of GDP)	54.5	59.6	62.2	64.1	64.7	64.9
Primary Balance (% of GDP)	-6.1	-4.5	-4.0	-3.9	-3.6	-3.4
Poverty rate ($1.9/day PPP terms)[a,b,c]	..	2.8	2.5	2.1	1.8	1.5
Poverty rate ($3.1/day PPP terms)[a,b,c]	..	10.7	9.5	8.5	7.6	6.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: f = forecast. (a) Calculations based on EAPPOV harmonization, using 2014-VHLSS. (b) Projection using neutral distribution (2014) with pass-through = 0.87 based on GDP per capita in constant LCU. (c) Actual data: 2014. Projections are 2013 and from 2015 to 2018.

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