Reviving Growth

East Asia and Pacific
Economic Update, April 2023
Structure

1. Recent developments
2. Prospects for 2023
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Recent developments
Most major EAP economies have recovered and are growing, but output in most Pacific Island Countries is still not back to pre-pandemic levels.

Source: World Bank, Haver Analytics
Note: right panel: Bars show the latest quarterly or annual GDP in 2022 relative to 2019 level.

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Domestic demand was strong but is now moderating; goods exports were robust but are now declining.

Source: Haver Analytics
Note: left panel: Philippines refers to auto sales

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**Retail sales (year-on-year growth)**

- China
- Indonesia
- Malaysia
- Philippines
- Vietnam
- Thailand

**Goods exports (2019=100)**

- China
- Indonesia
- Malaysia
- Philippines
- Thailand
- Vietnam

World excluding EAP

Source: Haver Analytics
Note: left panel: Philippines refers to auto sales
Fiscal policy became less expansionary in most countries, and monetary policy began to tighten in 2022.
Prospects in 2023
Three linked international developments will shape economic performance in the EAP countries

Global growth

Commodity prices

Financial tightening

GDP growth

Oil price futures

Expectation of interest rate

Source: World Bank staff illustration

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China will grow faster in 2023 than in 2022 but much of the rest of the region will slow down.

GDP growth in 2022 and 2023 forecast

Source: IMF, World Bank

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A long view of growth and structural change
EAP countries have seen two decades of higher and more stable growth than other economies

Source: PWT
Note: Bar height shows average annual growth rate; whiskers show average standard deviation over the period.

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Consequently, EAP countries have all transitioned either to lower or upper middle-income status.
But EAP convergence with high income countries, which was faster than in other countries, has recently stalled.

Note: x-axis denotes initial year. $\gamma$ represents the marginal effect of convergence in developing EAP while $\gamma + \beta$ represents the total effect.

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And productivity growth has been declining

Labor productivity growth and drivers

Source: APO Productivity Database; Penn World Tables World Bank
Note: EAP excl. China shows weighted average of ASEAN-4 countries.

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In recent years, the share of manufacturing in GDP declined in EAP economies (other than Cambodia and Vietnam), and the share of services in GDP increased.

Source: GGDC/UNU-WIDER Economic Transformation Database
Note: Other EMDE shows 25-75 percentile of 20 major EMDEs outside EAP

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New digital technologies could boost productivity growth in services

Adoption of E-commerce technologies after COVID-19

Percent of firms

Correlation between website use and labor productivity of retail firms

Note: Website data for 2016 or most recent available year.

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But countries will need to address the reform gap in the services sectors.

**Services Trade Restrictiveness Index (2021; 1=most liberalized)**

**Distribution Services (Wholesale and retail trade)**

**Transportation**

**Construction**

**Telecom**

**Financial Services**

**Professional Services**

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Looming challenges

Decoupling?; Aging; Adaptation
Decoupling?
Some developing EAP economies have reaped the export benefits of US-China trade tensions.

Sectoral decomposition of changes in the share of US and China’s imports during 2018-2022

Changes in share of US imports, 2018-2022

Changes in share of China’s imports, 2018-2022

Source: Customs data

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Uncertain politics rather than reliable economics are now molding trade patterns

- Friend-shoring may lead to a less predictable environment for third-countries than rules-based trade

Divergent standards for goods and services; e.g., different approaches to data governance in China and the US, could segment markets...

- Segmentation of large markets prevents third country exporters from reaping economies of scale

Export restrictions on ultimate destination as well as import restrictions on ultimate source, can disrupt GVCs and third country trade

- EAP countries differ in how they participate in GVCs, but most are significantly integrated with the world and with China, especially in electronic products

Decoupling?
Policy-induced innovation decoupling?

Measures taken after 2018 adversely affected innovation of Chinese firms which had prior collaborations with the US, and of US firms which had prior collaborations with China.

Bilateral restrictions on technology flows and collaboration between large countries could reduce the global availability of knowledge.
The US and, increasingly, China are important sources of knowledge for other East Asia and Pacific countries.

Notes: The chart shows the source of backward citations (on the left-hand scale) for patent applications to EPO/USPTO/WIPO patent offices by assignees in EAP countries (on the right-hand scale).

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The adverse effects of a trade and technological rift between large countries can be reduced by third countries forming (separate) trade agreements that ideally include each large country.

Global Income effects of Asia-Pacific trade policies in 2030

Business as before

Under sustained trade war

Third countries benefit from being “hubs” rather than “spokes” or members of exclusive trade blocs.

Source: Drawing on Petri and Plummer (2020)

Note: “Business as before” assumes a return to a pre-trade war path. “Sustained trade war” assumes path defined by post-phase one tariffs. Bars show incremental effects of adding each policy to all previous policies. The policy denoted “India” involves adding India to the RCEP15 agreement to form RCEP16.

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Aging
EAP countries are aging faster than rich countries did, and the working age population will peak at lower levels of income per capita.
Aging

Aging will impact economic activity, fiscal balances and health services

Lower share of the conventional “working age” population, unless older people (especially women) continue to work

Higher burden of pensions, unless the gap is narrowed between actual and actuarially fair contribution rates

Higher burden of age-related non-communicable diseases, unless efforts are made to prevent, control and manage these diseases across the life-cycle
Adaptation
EAP countries are highly exposed to climate change impacts

Global Climate Risk Index: Ranking 2000 – 2019
Investing in adaptation will deliver a triple dividend

**Avoided Losses**
- Early warning systems save lives and assets and are worth at least 10 times their cost.
- Climate-resilient new infrastructure typically adds 3% to upfront costs but has benefit-cost ratios of 4:1.

**Induced Economic Benefits**
- Reduced flood risks lower financial costs, increase security, and help induce high-value investment in cities.
- The Thames barrier induced development of Canary Wharf and East London.
- Drip irrigation increases yields as well as reduces drought risk.

**Social and Environmental Benefits**
- Nature-based flood protection also increases biodiversity, makes air and water cleaner, offers recreation, and improves health.
- Mangrove protection and restoration abate coastal surges, support local fisheries and forestry, and store carbon. Combined benefits are up to 10 times greater than the costs.

= Triple Dividend
Policy priorities
Four types of policy action are needed

- **Macro-financial reforms to support recovery today and inclusive growth tomorrow**
- **Structural reforms to boost innovation and productivity across the economy**
- **Climate-related reforms to enhance resilience through efficient adaptation**
- **International cooperation to address climate change, and to ensure openness to trade, investment, and technology flows**
Aging, deglobalization and climate change can reduce potential growth, but reforms can offset the impact.

Potential GDP growth

- Boost from increased labor force participation
- Boost from structural reforms
- Boost from adaptation to climate change

- Human capital
- Total factor productivity
- Employment

- Capital deepening

No aging | Aging | Deglobalization | Climate change | Policy reforms

Percent

Potential GDP growth
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