

East Asia and Pacific Economic Update, April 2024

Firm Foundations of Growth

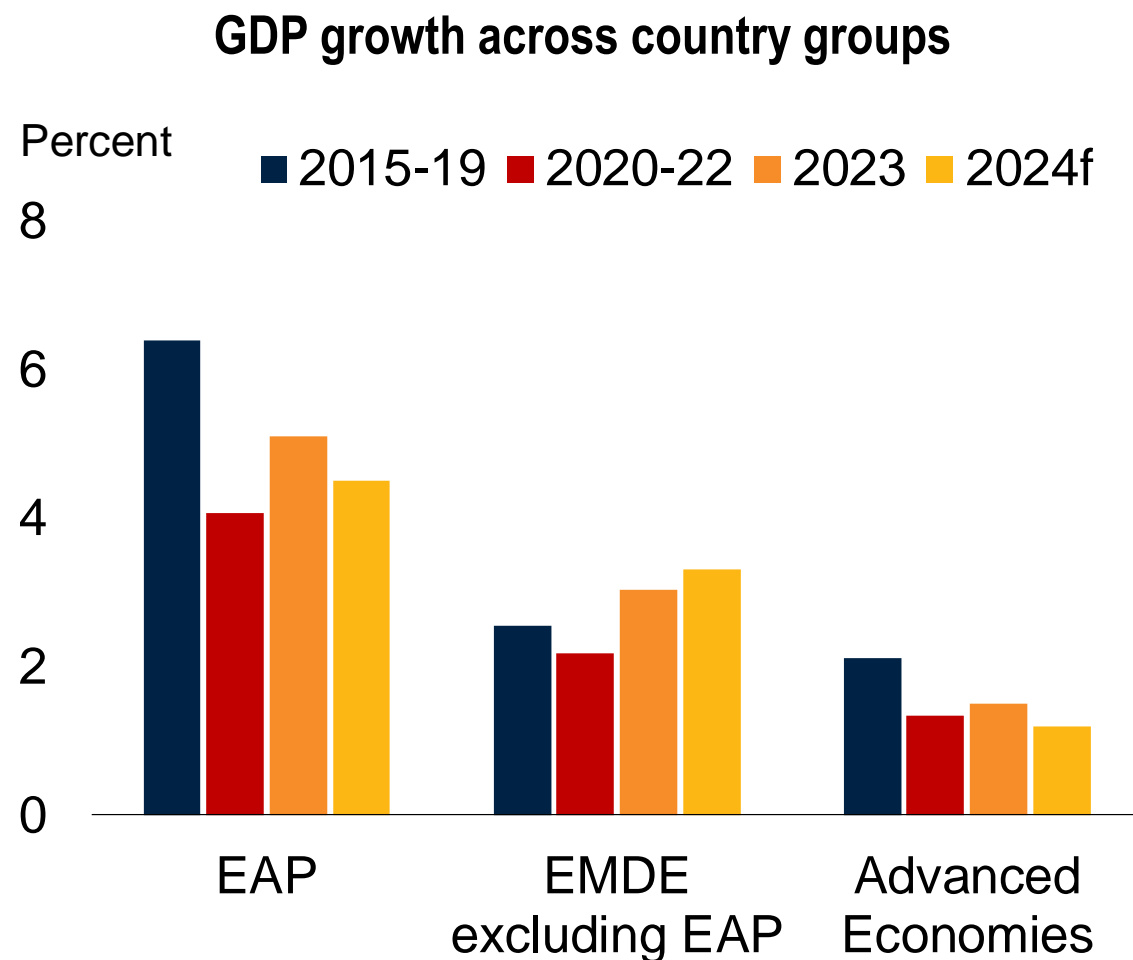


THE WORLD BANK
East Asia & Pacific · Chief Economist Office

Outline

1. Faster than others but slower than before
2. Key factors: Trade, finance and uncertainty
3. Firms: Leaders are not leading

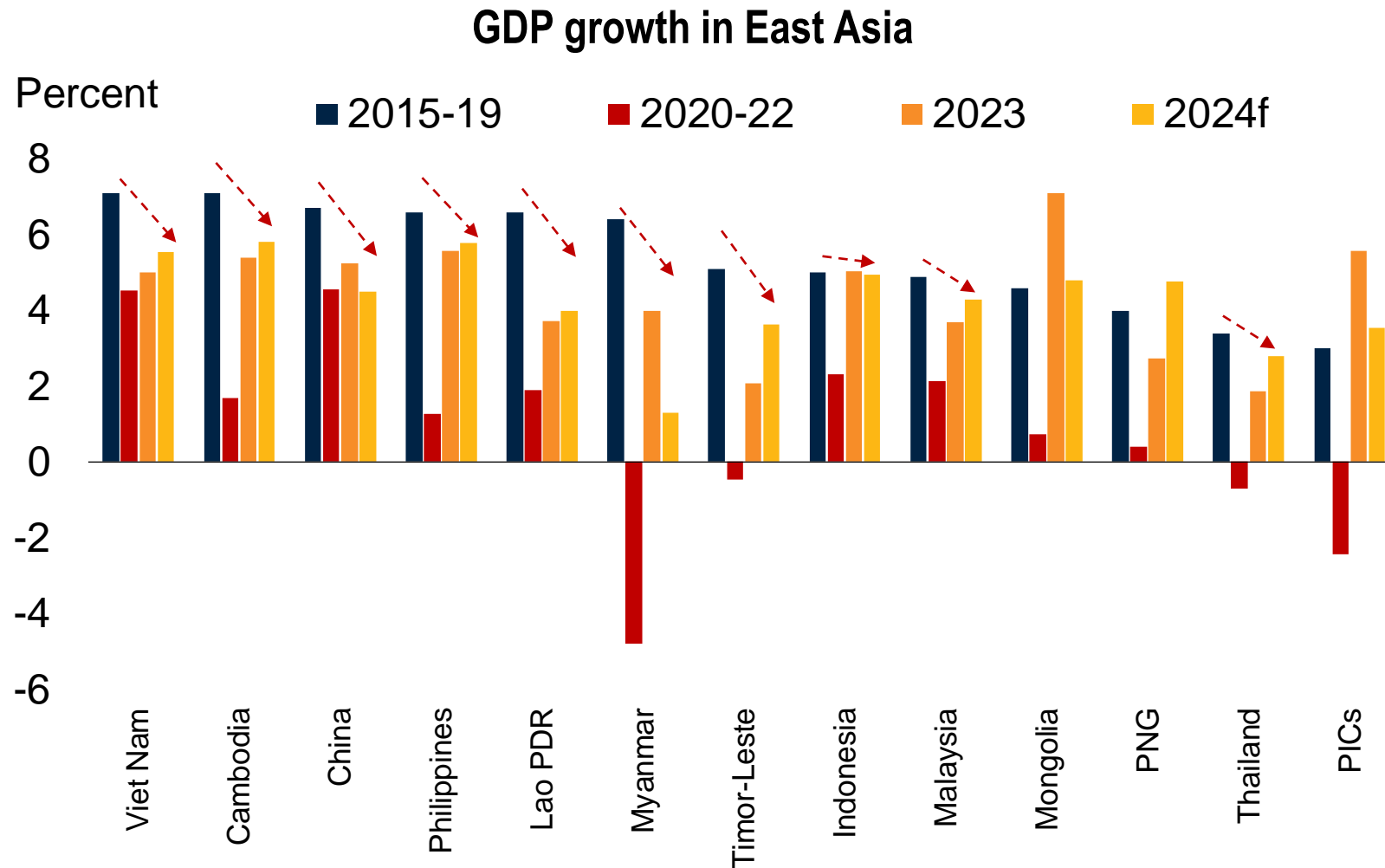
The EAP region is still growing faster than the rest of the world ...



Source: World Bank.

Note: EAP: East Asia and Pacific, EMDE: Emerging market and developing economies, 2024f shows forecast of 2024

...but growth is slower than before the pandemic in most major economies

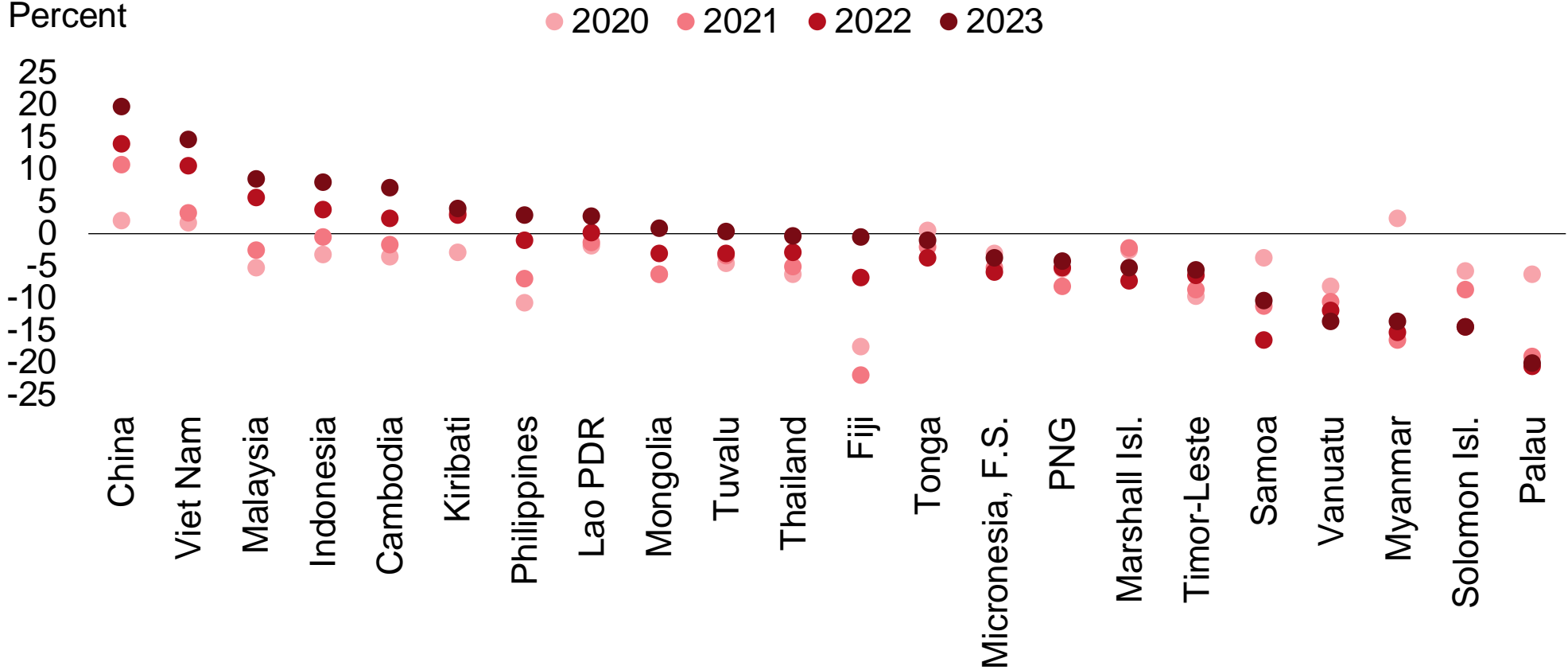


Source: World Bank.

Note: PNG: Papua New Guinea, PIC: Pacific Island Countries

Output per capita is still below pre-pandemic levels in most Pacific Island countries and declined further in some

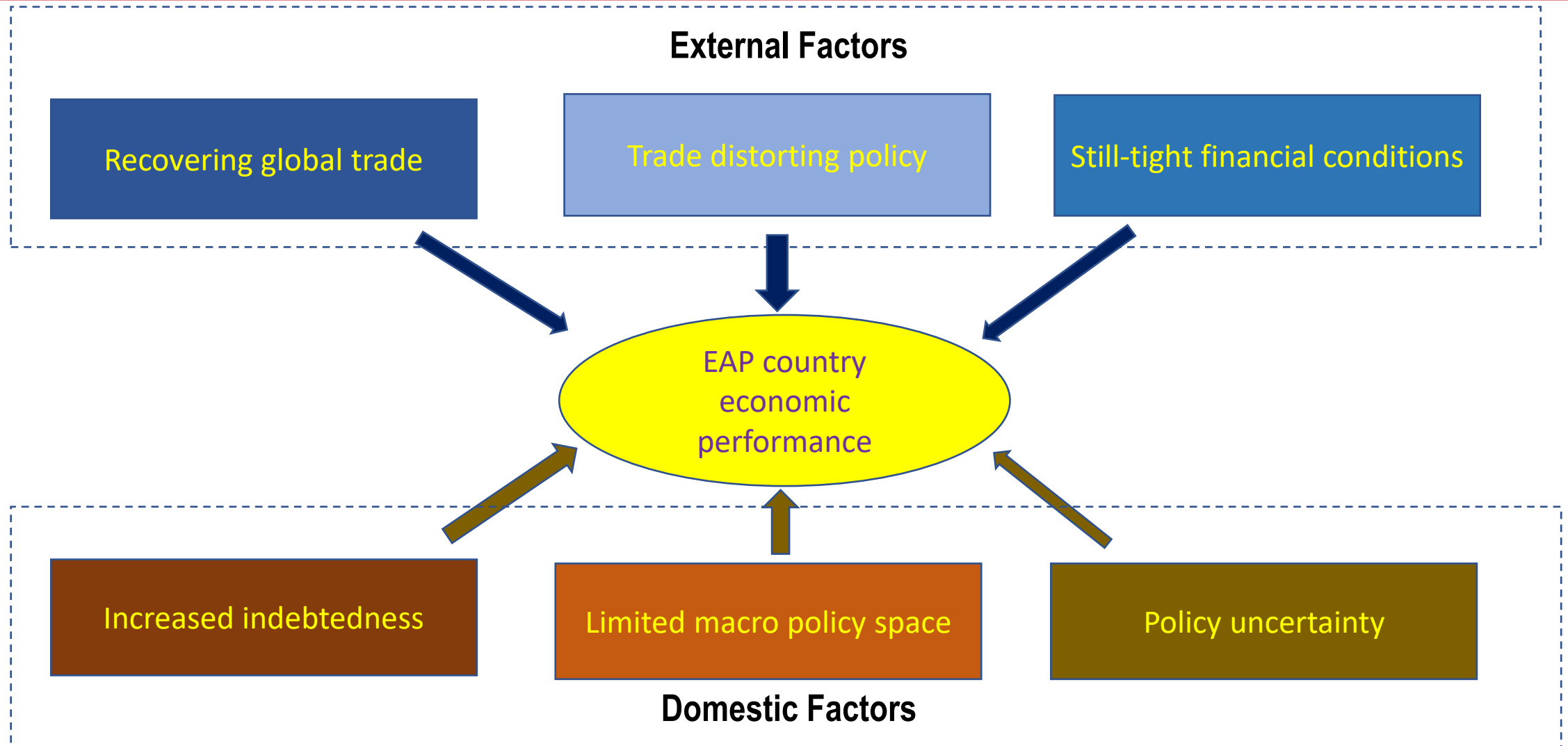
Evolution of GDP per capita compared to 2019



Source: World Economic Outlook database; United Nations; World Bank.

2. Trade, finance and uncertainty

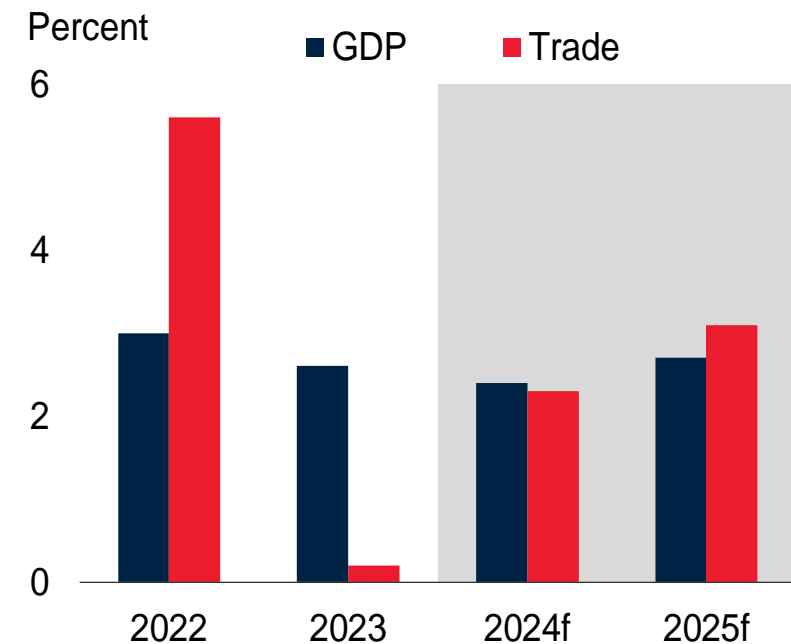
External and domestic factors affecting economic growth



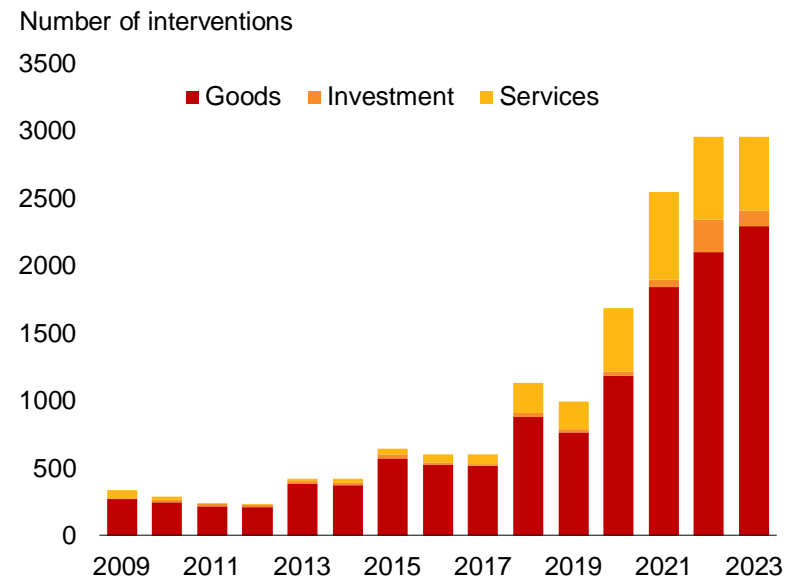
External

Three linked international developments will shape economic performance in EAP: recovering global trade; increasing trade-distorting measures; tight financial conditions

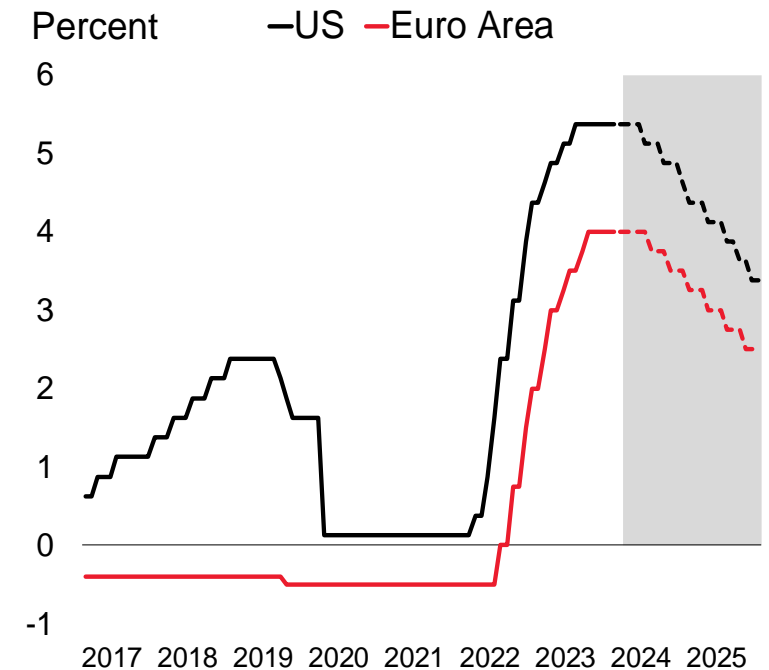
GDP and trade growth



New trade-distorting measures



Interest rates

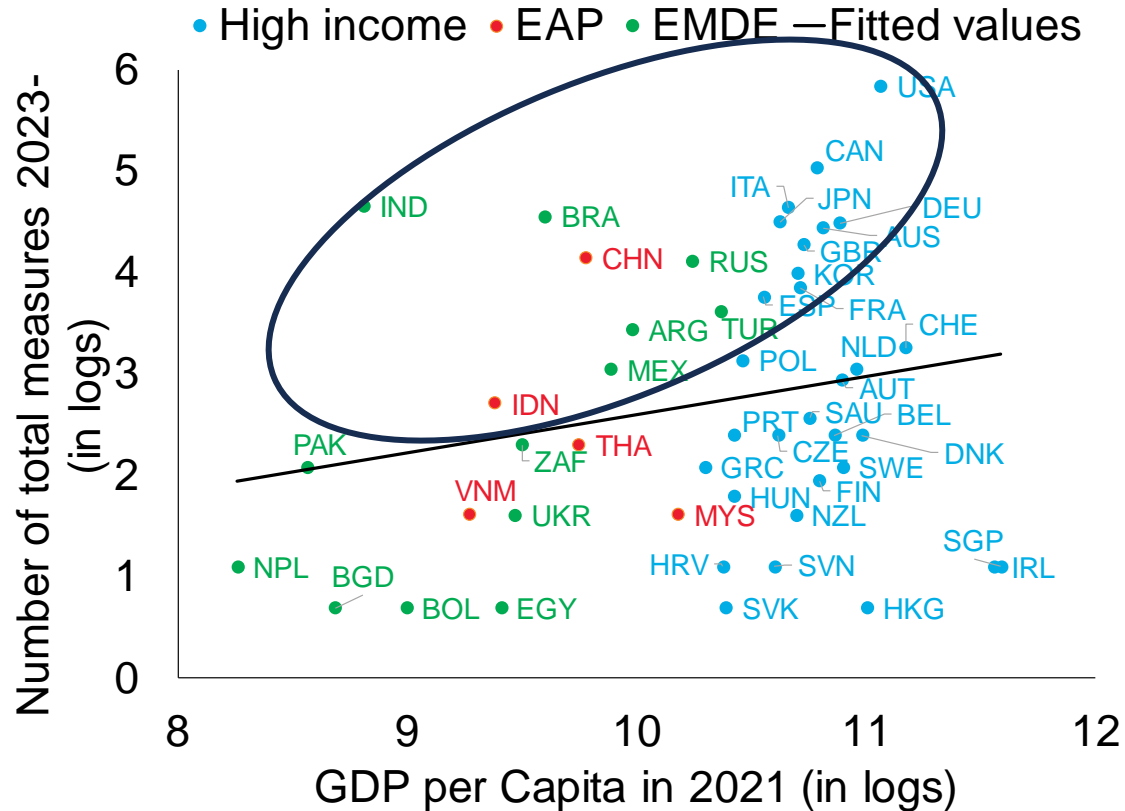


Source: World Bank, Global trade alert, Haver Analytics, Fed watch.

Note: B. figure shows the number of new harmful measures implemented by all WTO members, adjusted for reporting lag.

The rich and large are the prime practitioners of industrial policy

Industrial policy measures and income per capita



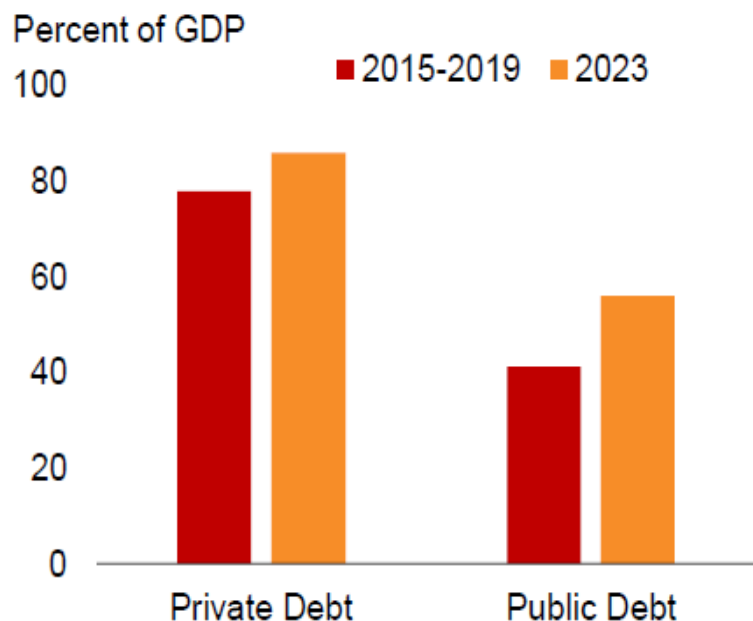
Sources: EAP Chief Economist Office elaborations on data from NIPO (Evenett et al, 2024) and World Development Indicators.

Note: New industrial policies, as defined by the NIPO, include both domestic industrial policies, as well as export promotion schemes and import trade barriers. All the potentially trade distortive measures are included.

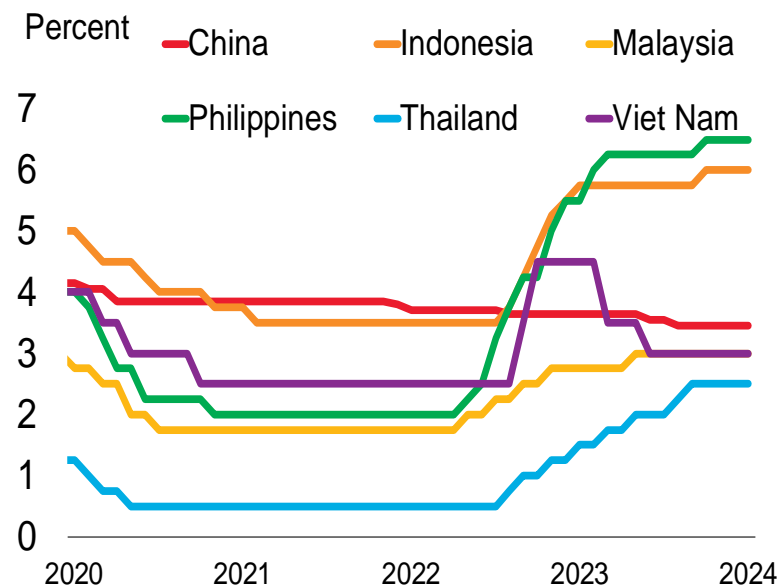
Domestic

Three domestic factors will shape economic performance in EAP: amplified public and private debt; limited policy space; increased policy uncertainty

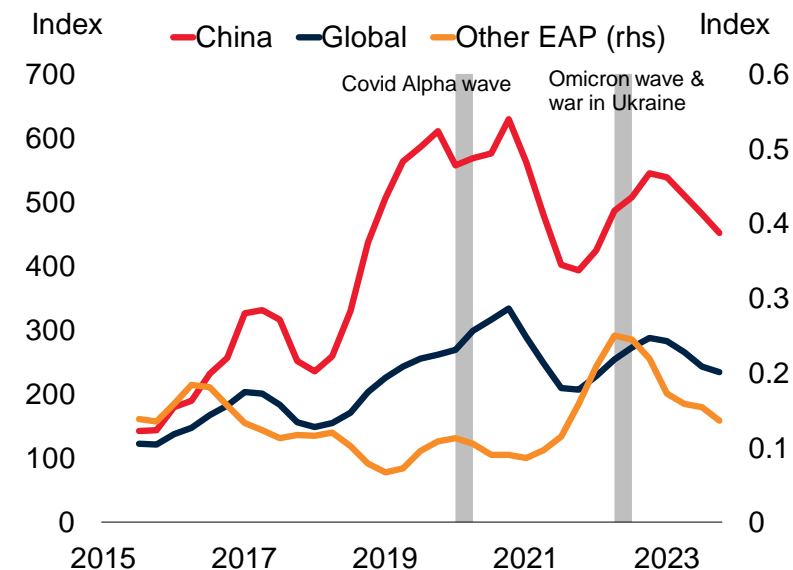
Private and public debt



Interest rates



Uncertainty index

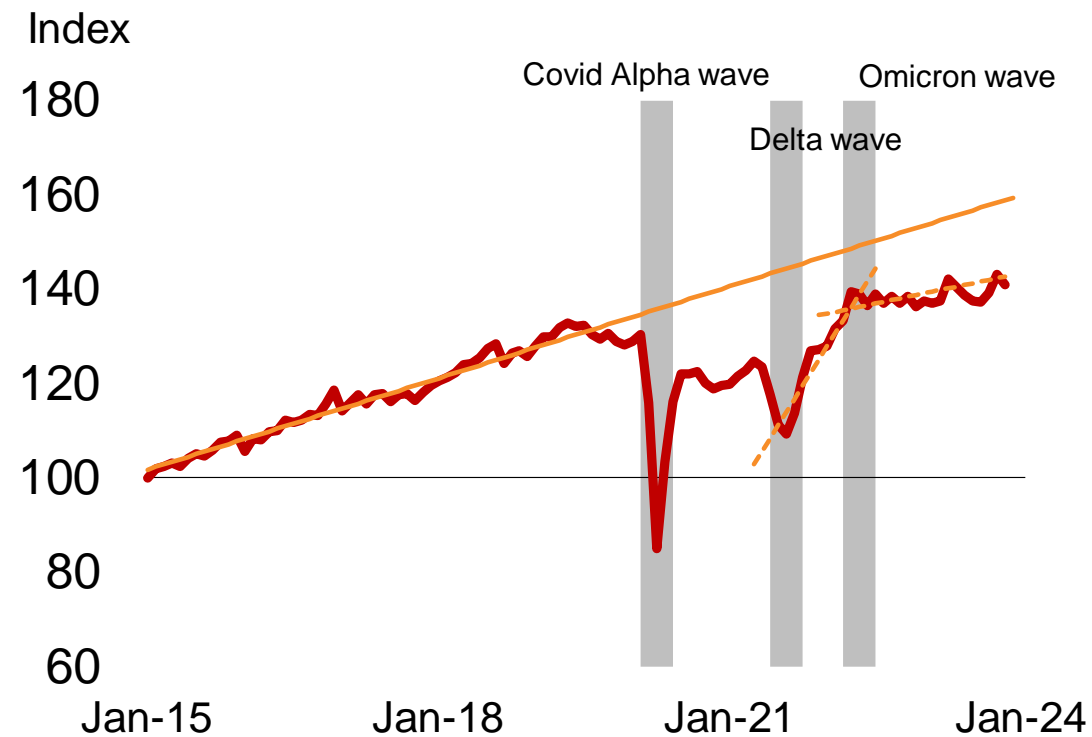


Source: Institute of International Finance; World Economic Outlook; World Bank staff estimates; Haver Analytics; World Uncertainty Index; Economic Policy Uncertainty Index
 Note: Left. Median of China and ASEAN-5 countries, private debt shows nonfinancial corporate debt. Middle. Policy rate: Right. "China" shows Economic Policy Uncertainty index based on South China Morning Post and China's mainland newspapers. "EAP" shows median of Indonesia, Thailand, Philippines and Viet Nam using World Uncertainty Index. "Global" shows global Economy Policy Uncertainty index.

The impact of external and domestic factors

Trends in private goods consumption are flatter than in the pre-pandemic period

Real retail sales, EAP excluding China



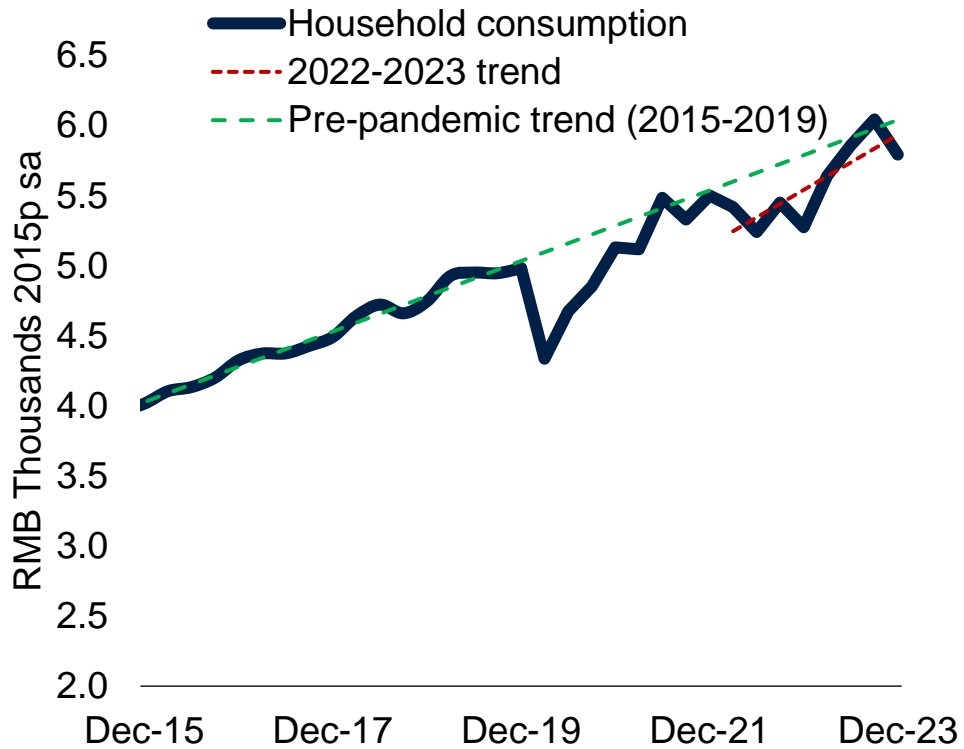
Source: Haver Analytics.

Note: Figure shows seasonally adjusted real retail sales indexed to January-2015. When volume-based retail sales data were not available, value-based retail sales were adjusted by the consumer price index. China's retail sales include limited services sectors. Straight line shows pre-Covid trend and dashed line shows the trend since January 2021.

A. Unweighted average of Indonesia, Malaysia, Philippines (manufacturing sales), Thailand, and Viet Nam.

In China, consumption of goods and services is approaching pre-pandemic trends, but the share of household consumption in GDP remains low

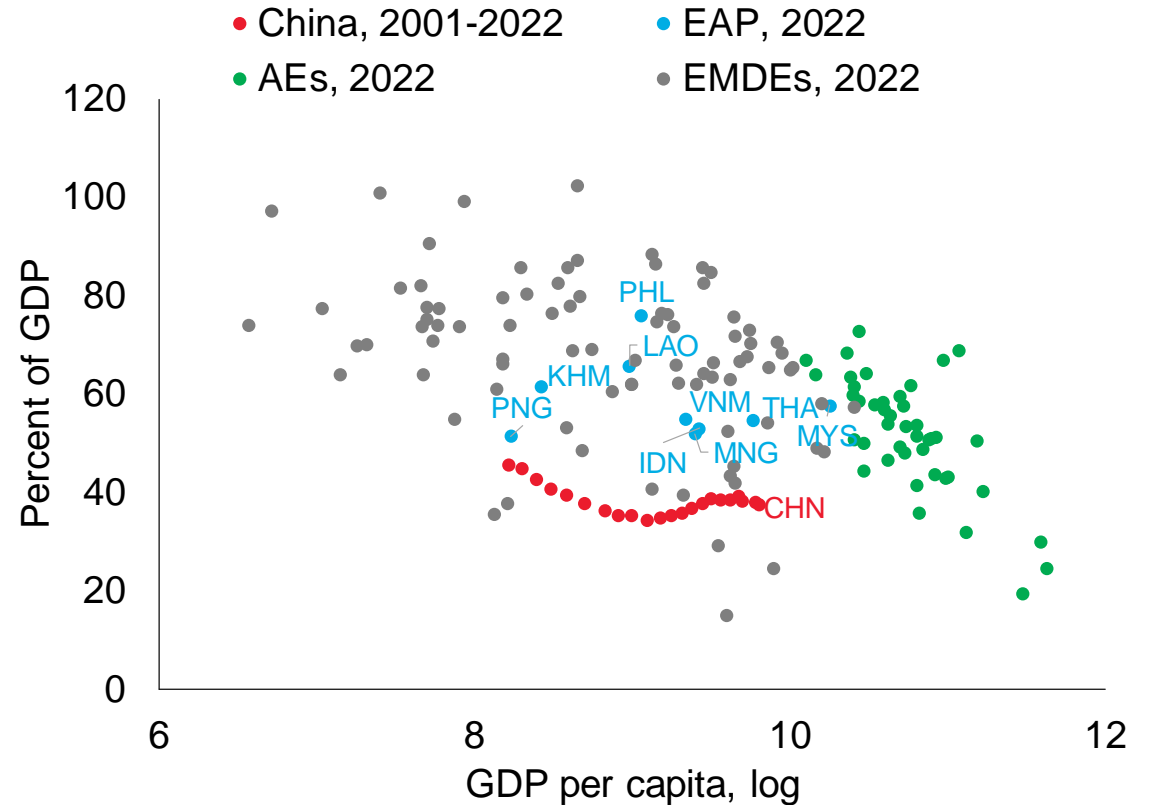
Real household consumption



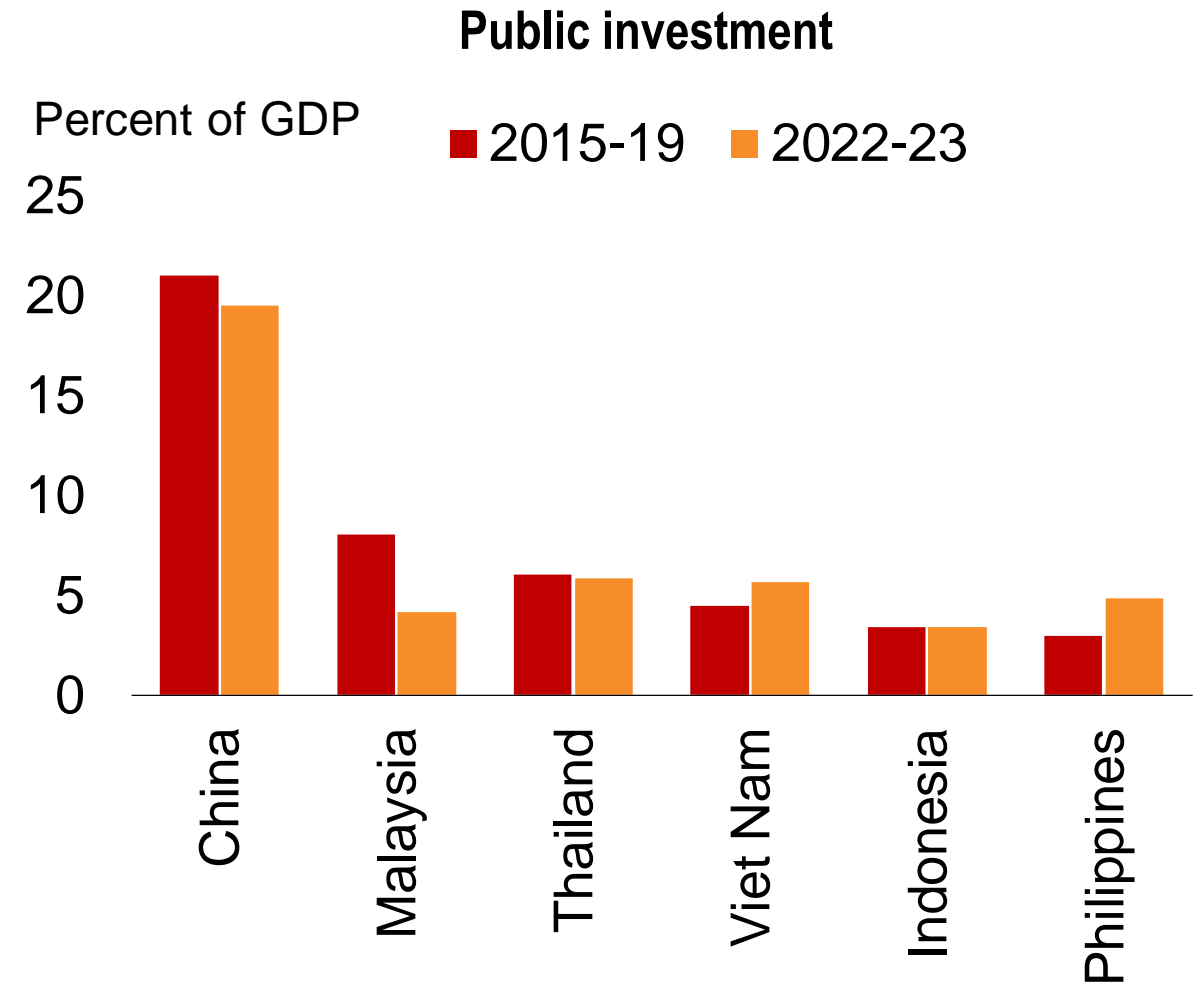
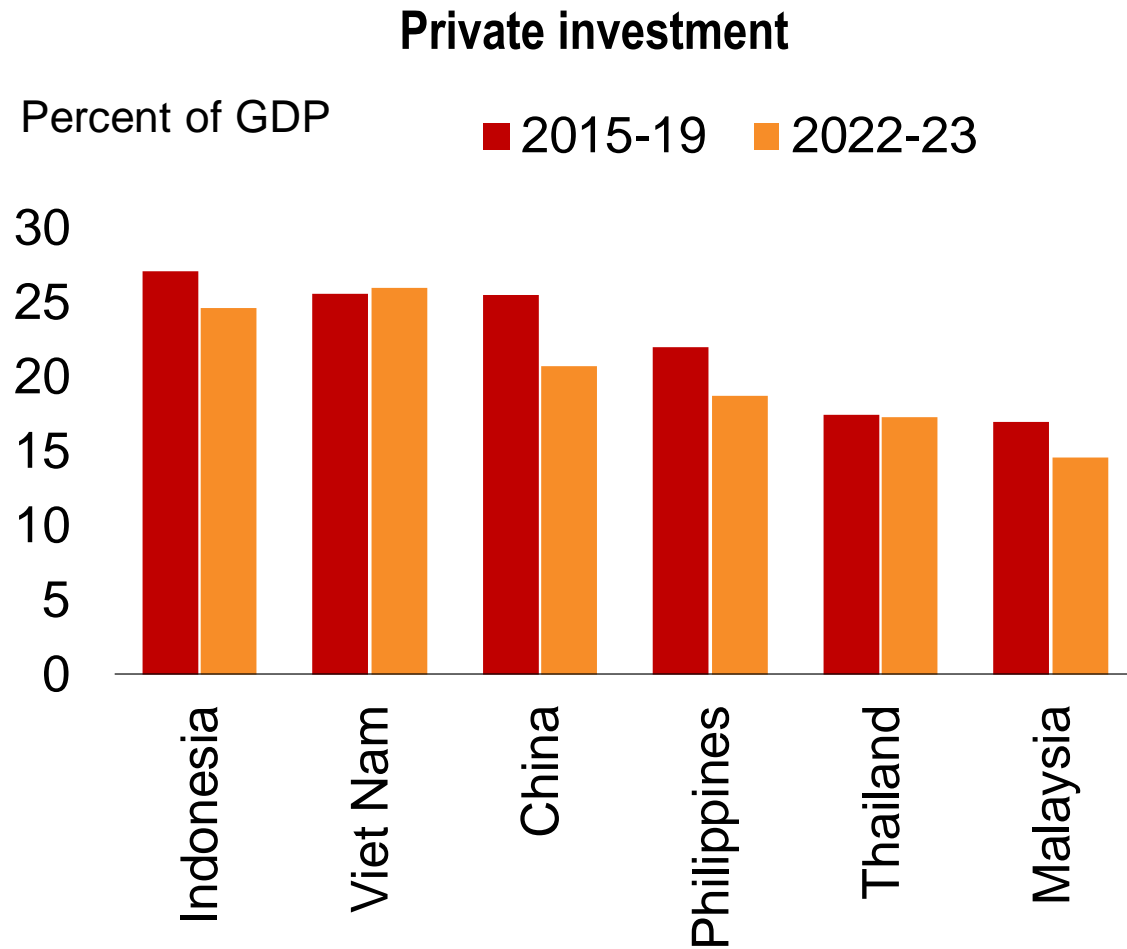
Sources: Haver Analytics, WDI, OECD.

Note: B. Countries with more than 1.5 million population are shown.

Share of household consumption in GDP and GDP per capita



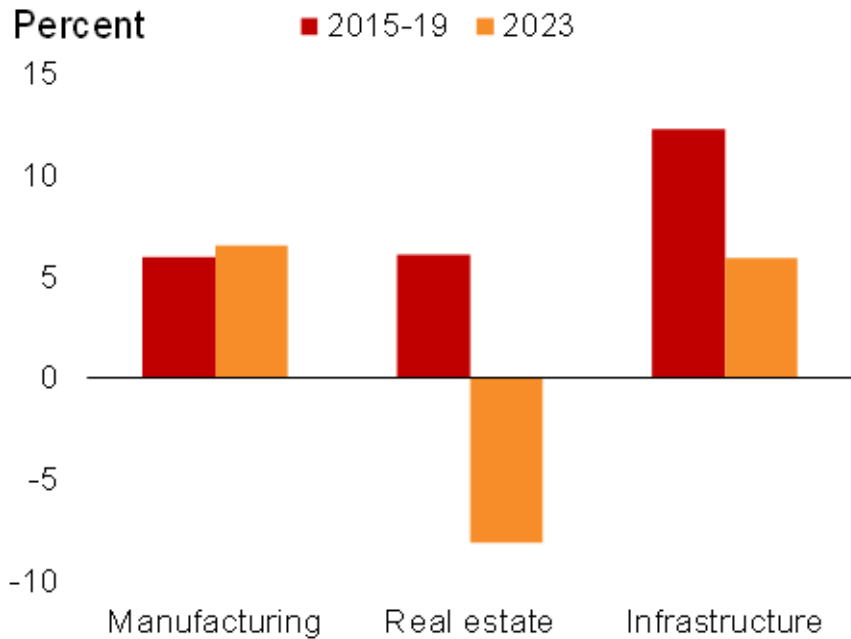
Private investment as a share of GDP is lower than before the pandemic and so, in some countries, is public investment



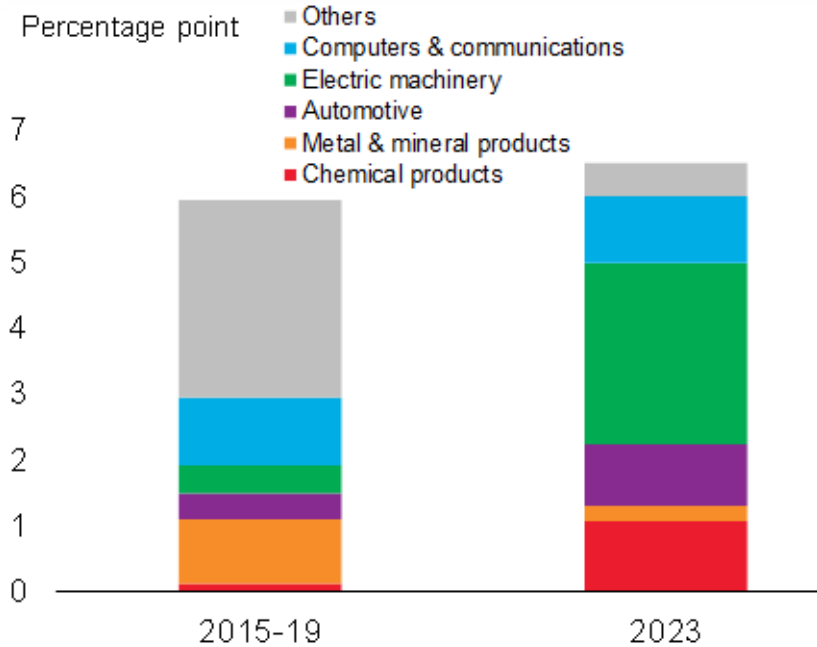
Source: World Bank staff estimates.

Manufacturing investment has been expanding in China, especially in electronics and automotives, supported by privileged access to finance

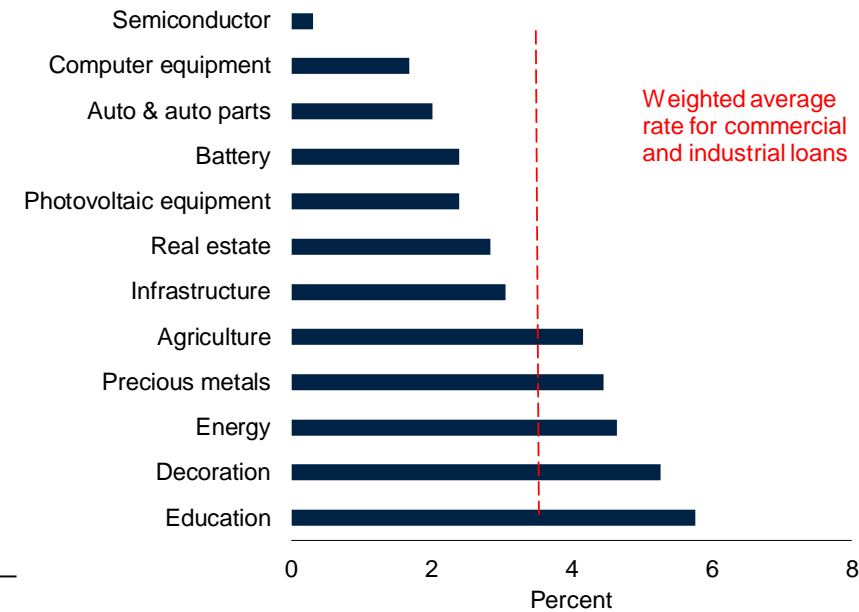
China's investment growth by sector



Contribution to manufacturing investment growth



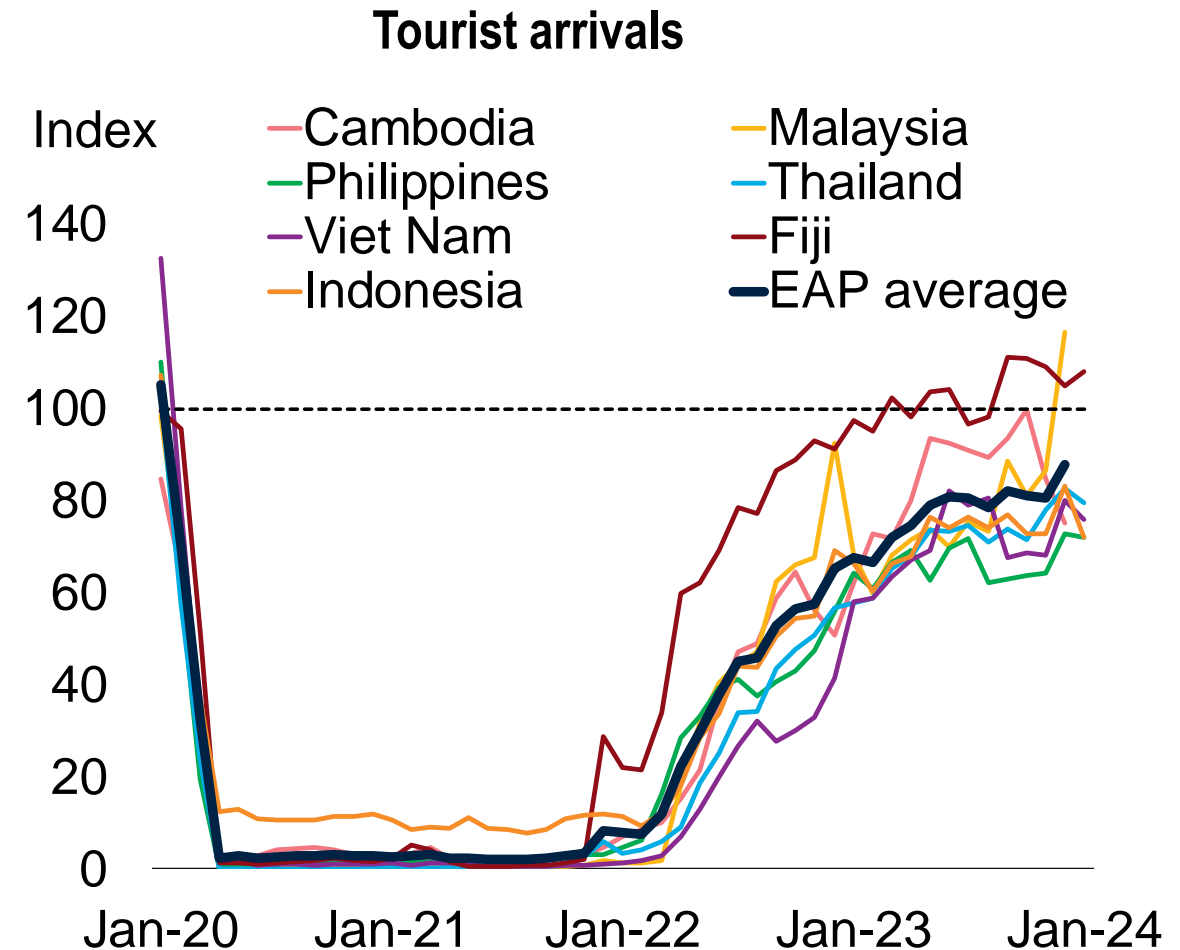
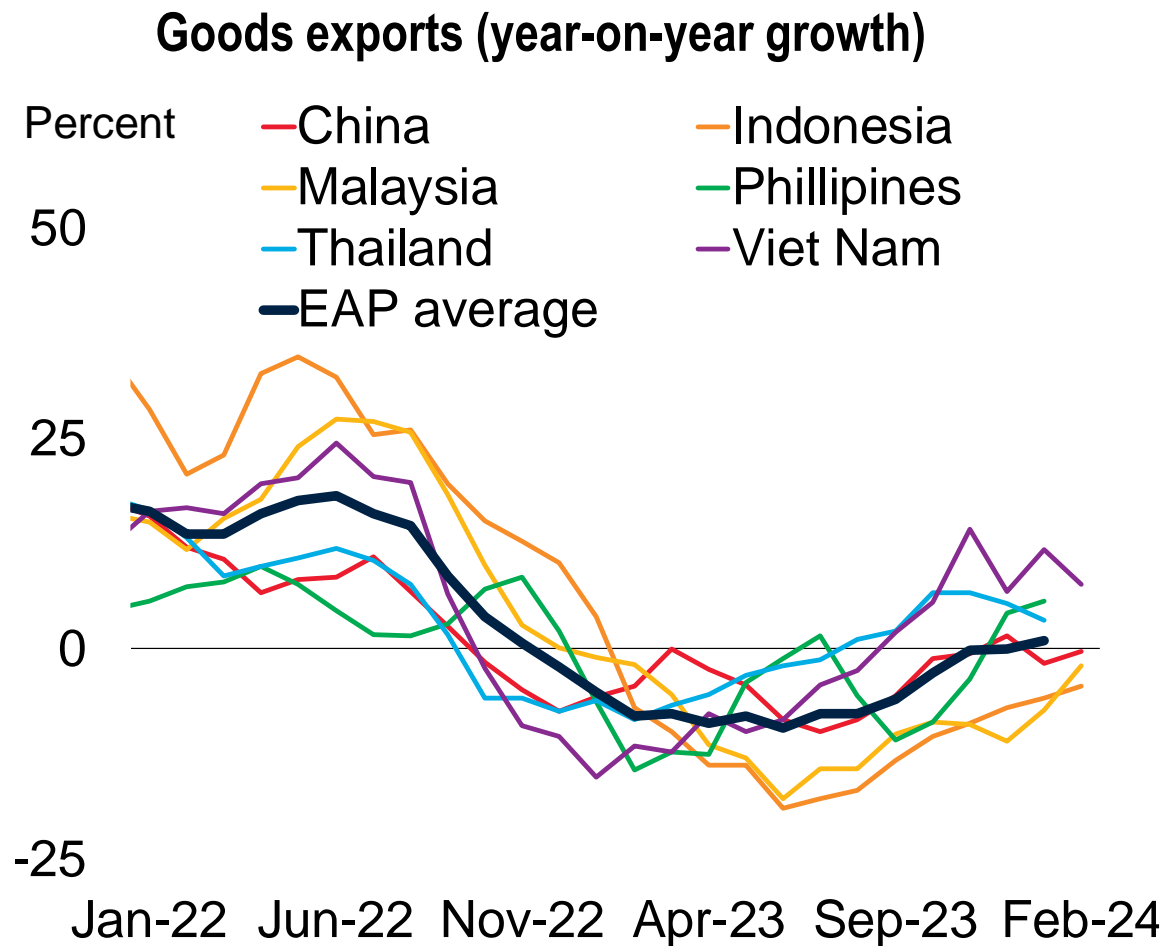
Interest rates



Source: Haver Analytics; PBC; Wind

Note: B. Level data are calculated by applying the year-over-year percentage growth rates to the published year-to-date level data. C. Implied interest rate is calculated using interest expense/interest-bearing liabilities, and median value for each industry is reported.

Goods exports are beginning to recover but slowly; tourist arrivals have plateaued below pre-pandemic levels in several economies.

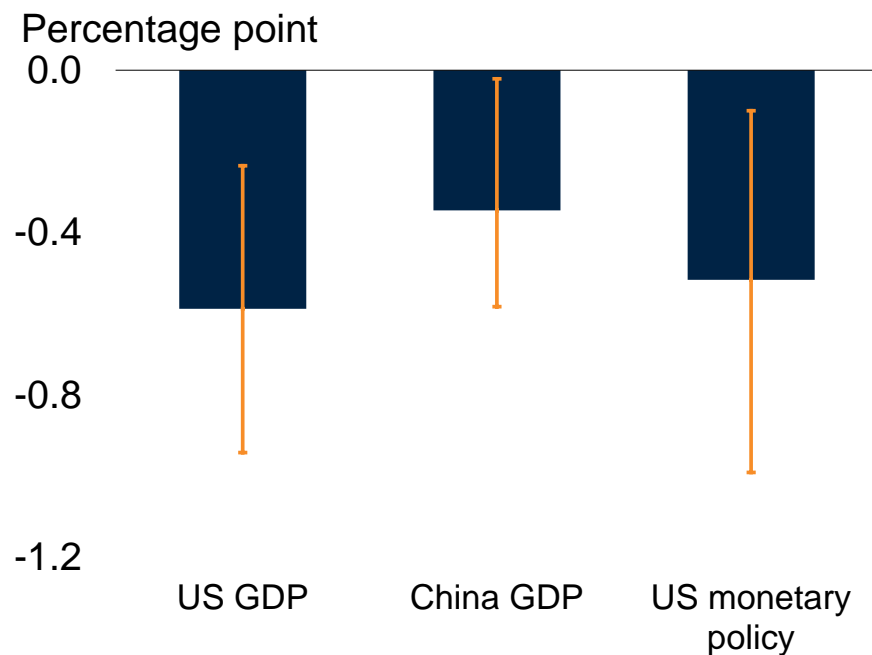


Source: Haver Analytics.

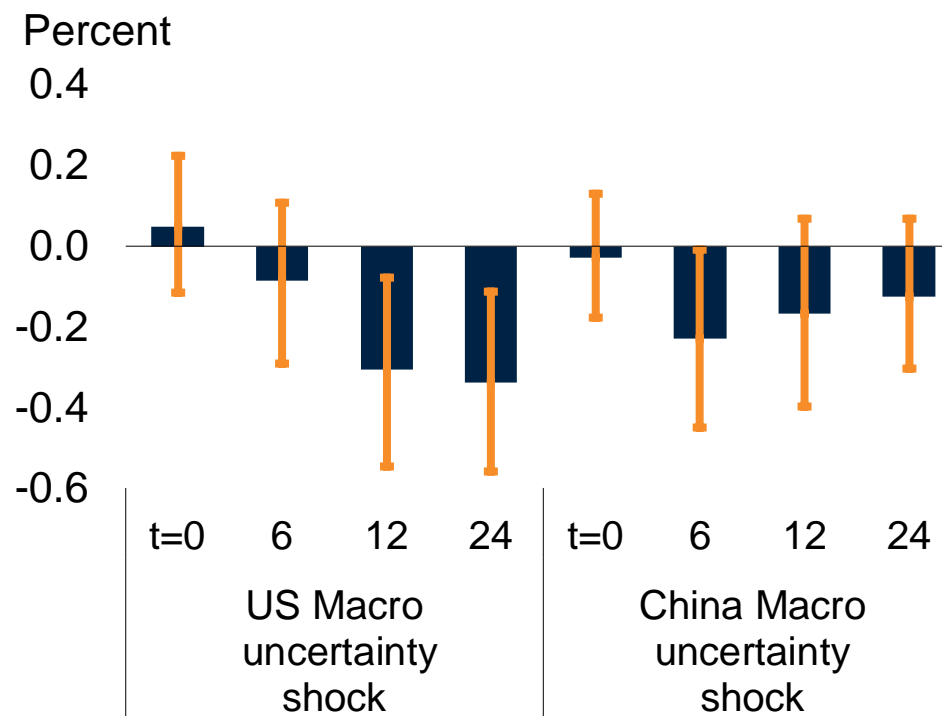
Note: A. three-month moving average. B. figure shows tourist arrivals indexed to the corresponding month in 2019

Growth in the region is influenced by developments in the region's largest trading partners

Impact of 1 pp decrease in China and US GDP growth, and 25 bps increase in US 2-year yield to EAP GDP



Impact of 1 std uncertainty shock in US and China to EAP industrial production



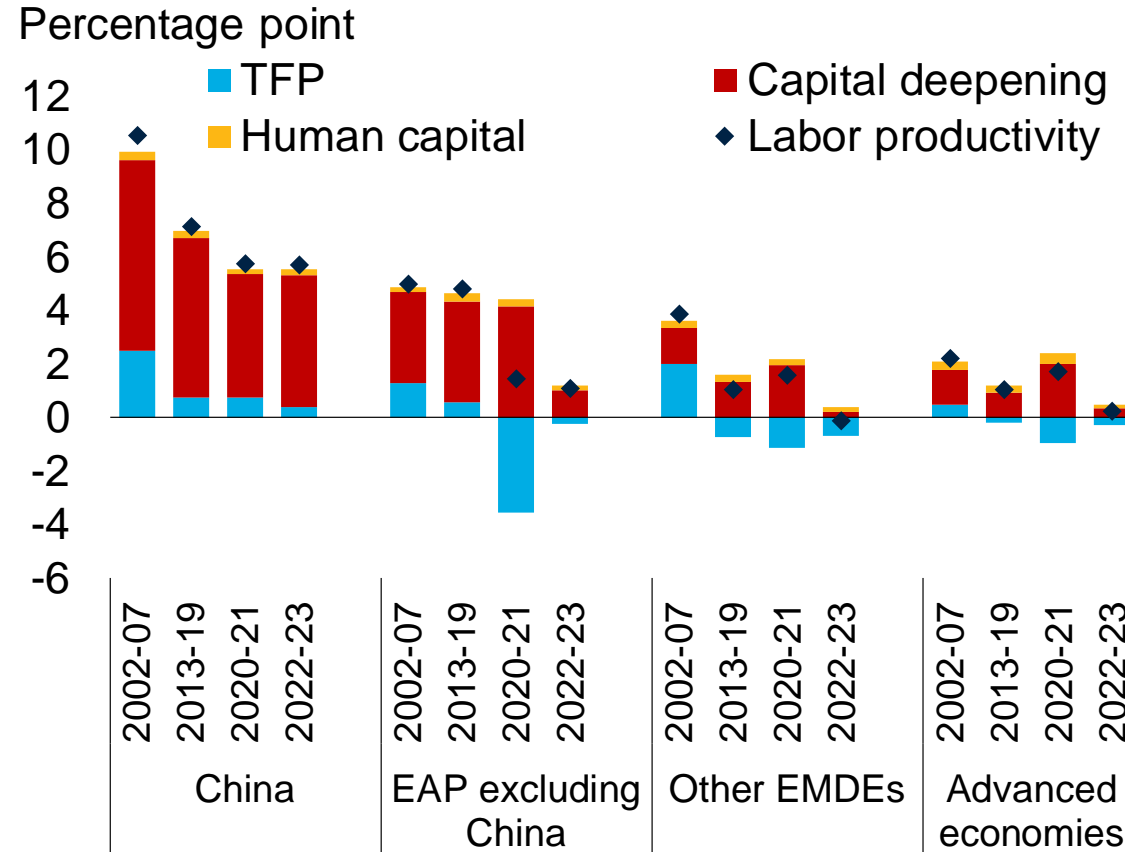
Source: World Bank staff's estimations.

Notes: A. Bars show impact of the one percentage point decrease in China and US growth, and 25 bps increase in US 2-year interest rate yield. Effects estimated using a structural Bayesian VAR model that includes the following variables: US monetary policy reaction shock, U.S real GDP growth, China real GDP growth, commodity weighted prices for recipient country, recipient country real GDP growth, and recipient country exchange rate to the US dollar. Countries included in the estimation are IDN, MYS, PHL and THA. B. Bars show dynamic responses of EAP productions to a one-standard-deviation increase in macroeconomic uncertainty in the U.S. and China. The results are based on a panel Vector autoregressions for MYS, IDN, PHL, THA and KOR. The model includes, in this order, the US production, US CPI, US uncertainty, China production, CPI, uncertainty measure, and domestic (EAP) industrial production, prices, stock prices, exchange rates, and uncertainty measures.

3. Firms: Leaders are not leading

Regional growth has been driven by capital accumulation rather than TFP growth

Labor Productivity Decomposition

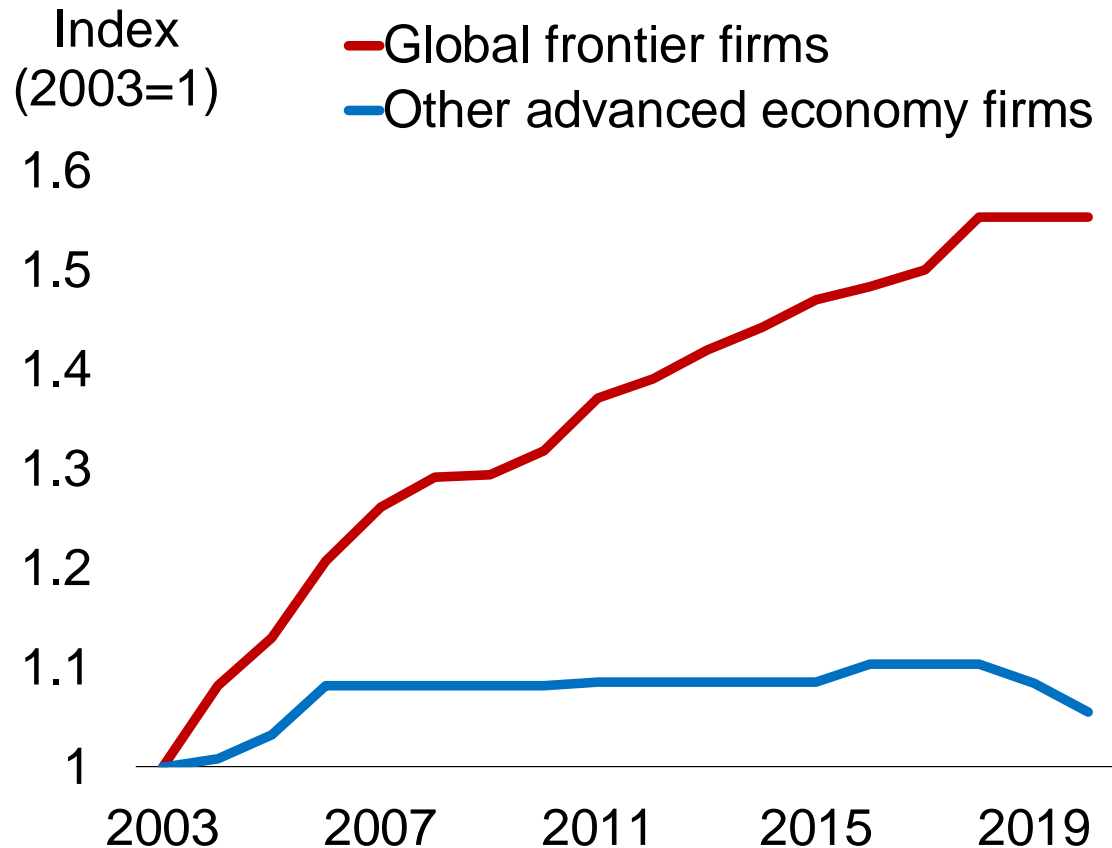


Source: Conference Board, total economy database

Note: Figure shows unweighted median (EAP excluding China reflects 7 countries). TFP: Total factor productivity.

In advanced economies, frontier firms are growing at a faster pace than other firms...

TFP growth firms in advanced economies, all sectors

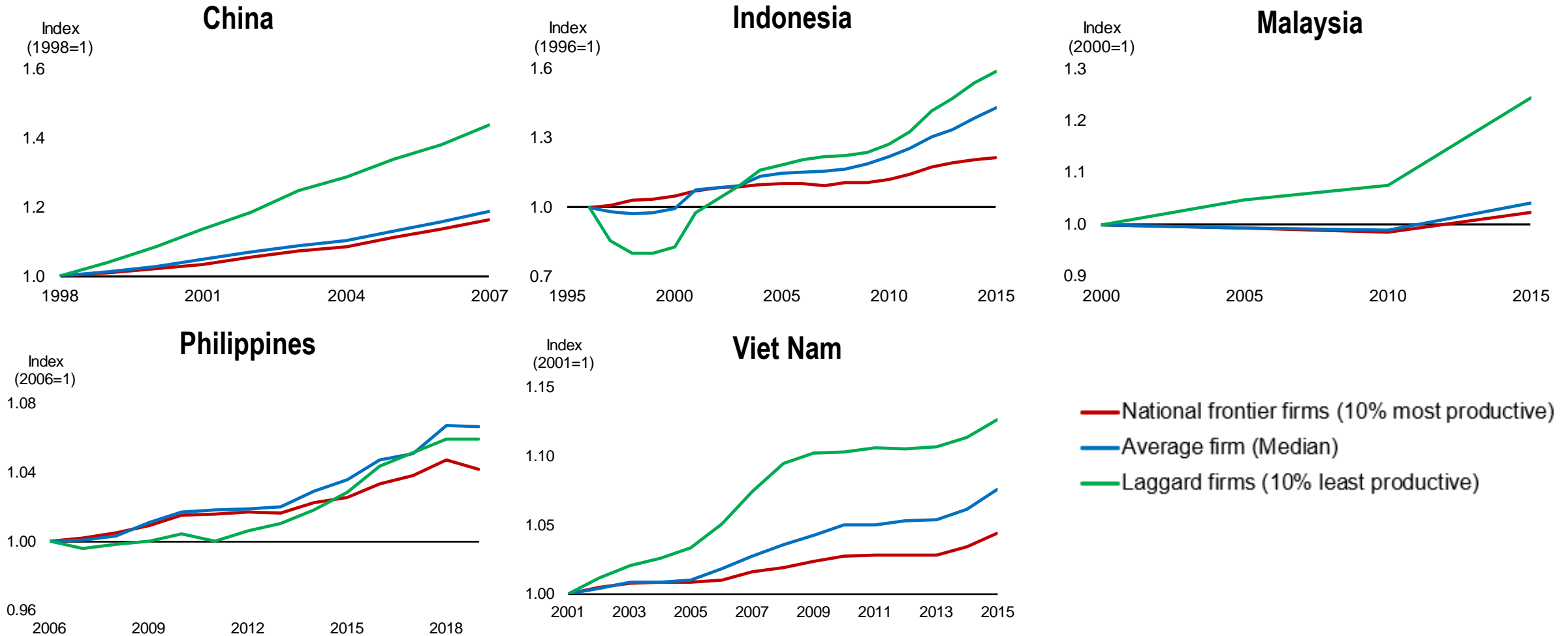


Source: Criscuolo et al. (2023)

Notes: Global frontier reflects the top 5% globally most productive firms within each 2-digit manufacturing and services sector, other firms reflects the remainder. Unweighted average of industries. Based on Orbis data for 24 OECD economies.

...but in the EAP region, productivity growth of frontier firms has been slower than that of other firms in manufacturing ...

Changes in TFP Distribution Over Time – Manufacturing Sectors



Source: Authors' calculations using Statistical Office micro-data

Notes: Reflects cross-sectional percentiles of the firm productivity distribution within country-industries over time, P90 reflects the 90th percentile of the firm productivity distribution (the national frontier) and P10 the lowest 10 per cent productivity firm.

Firms at the national frontier in EAP countries are falling behind the global frontier, especially in the digital sectors

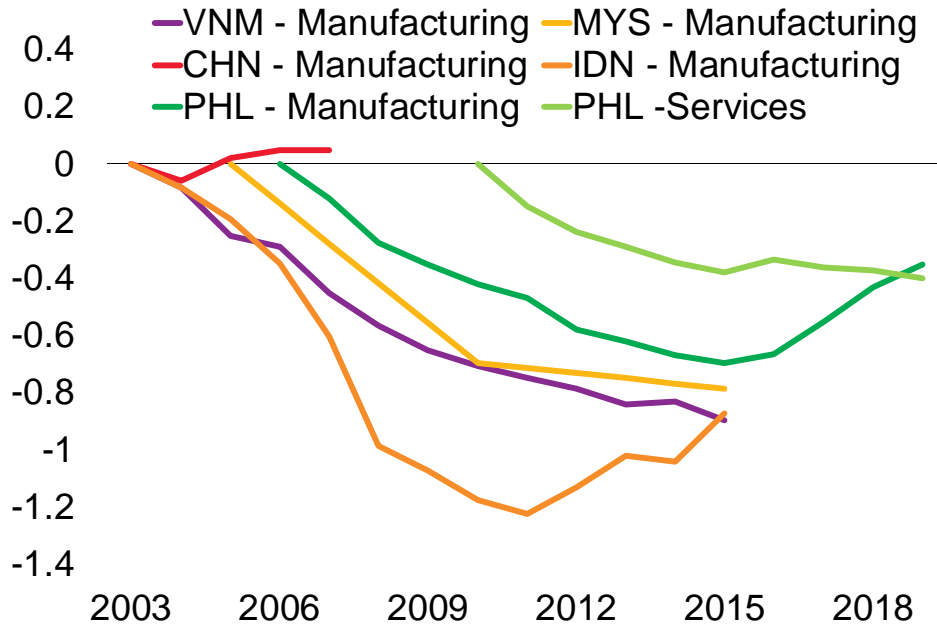
Distance between national and global frontier

A. Digital-intensive sectors

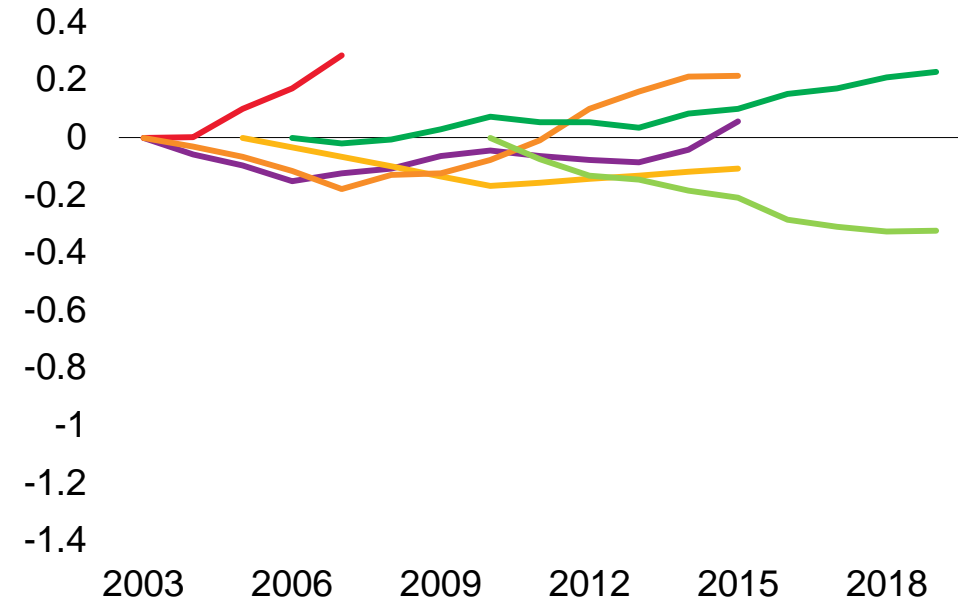
B. Less digital-intensive sectors

Distance between National and Global Frontier

Index (First Year = 0)



Index (First Year = 0)



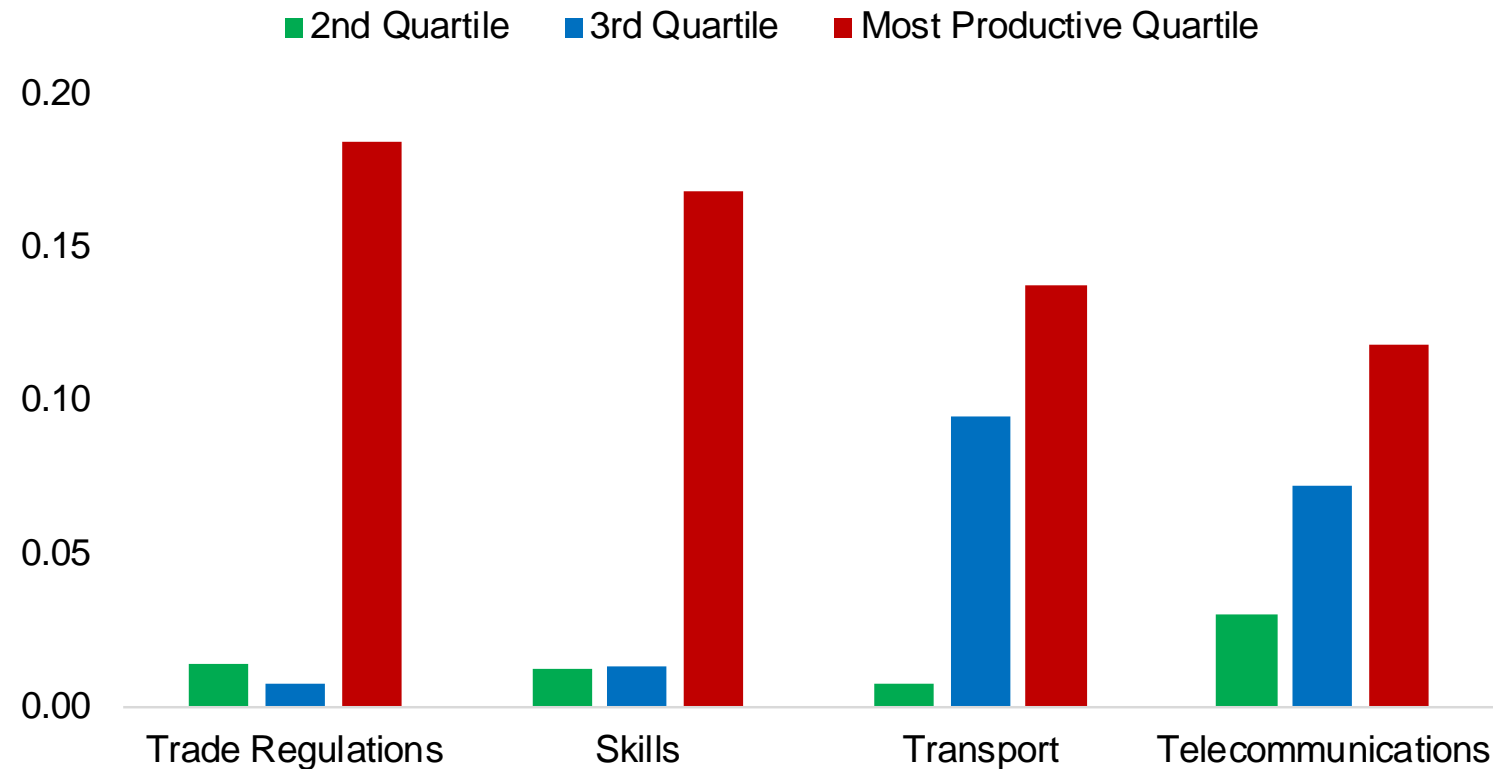
Source: Authors' calculations using Statistical Office micro-data and Criscuolo et al. (2023) for global frontier

Notes: National frontier is defined as in the previous figure (the 90th percentile firm productivity for each country and industry). Digital intensity of sectors is defined according to Eurostat.

Why are the leaders not leading and what can be done?

More productive firms report trade regulations, workforce skills and transport or telecommunication infrastructure, as important constraints to business operations

Constraint severity by labor productivity quartile (versus bottom quartile)

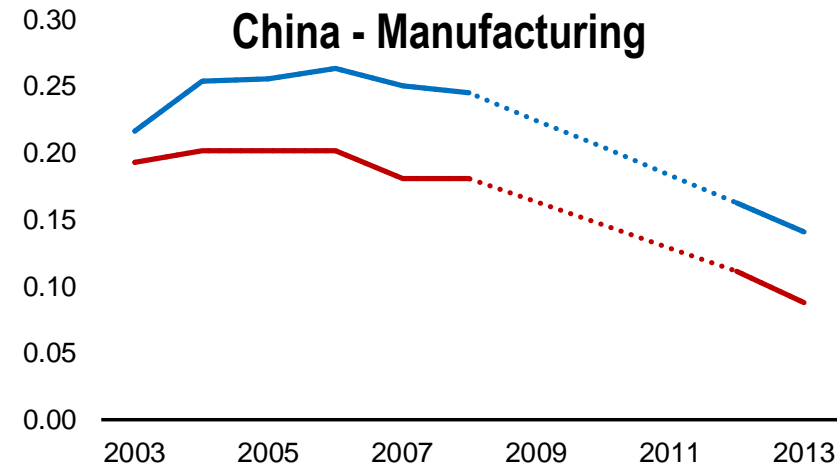


Source: World Bank Enterprise Surveys.

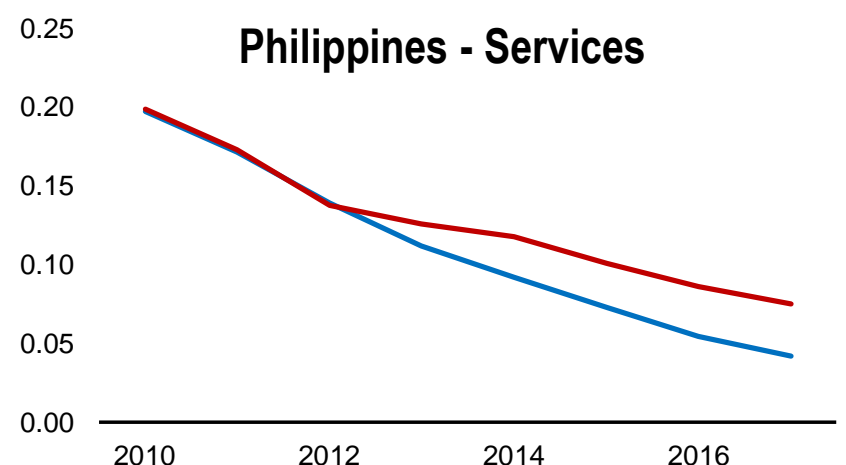
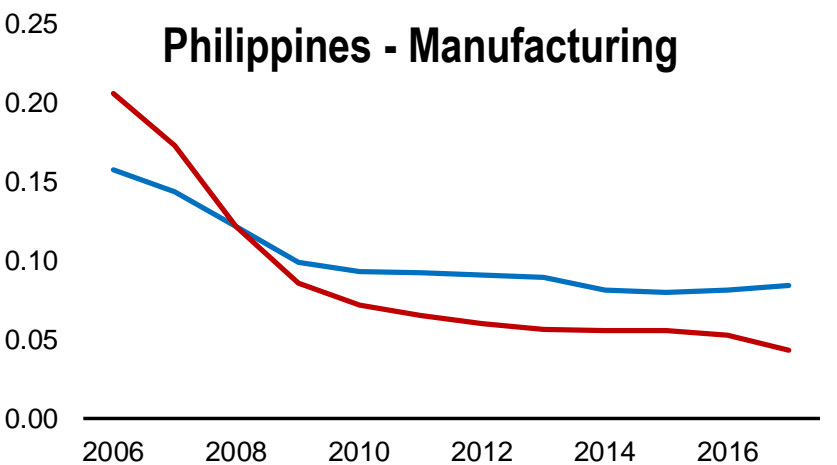
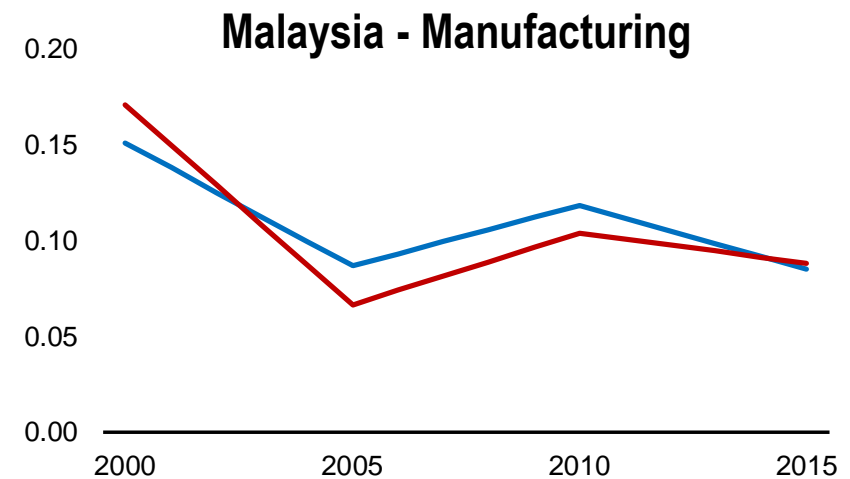
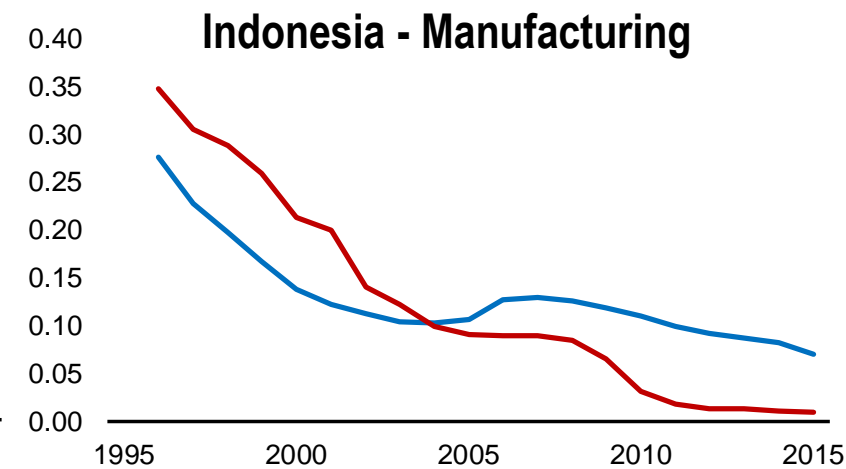
Notes: Manufacturing labor productivity quartiles are calculated within each country and year (applying sampling weights). Scores reflect the severity of constraint (0-4 scale) to current business operations reported by firms within each quartile, relative to the bottom quartile least productive firms. Presents the results of firm-level regressions of reported constraints on labor productivity quartiles, controlling for firm size and country and year fixed effects. Reflects data for 13 low-and-middle-income East Asia and Pacific countries.

Firm entry has slowed in EAP, especially in digital sectors

Young Firm Employment Share (0-1)



Changes in Firm Entry Over Time



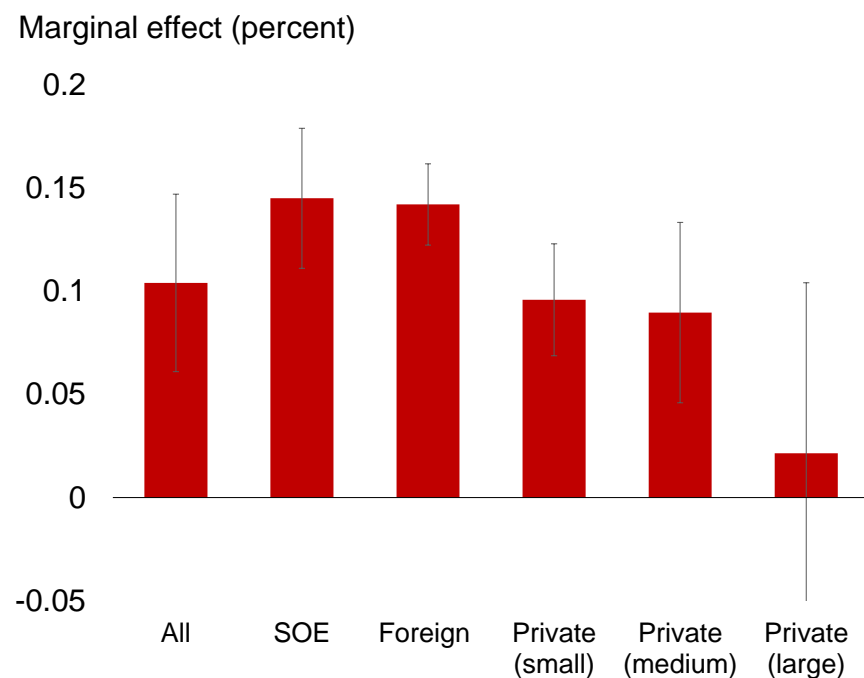
— Digital-Intensive Sectors
— Less Digital-Intensive Sectors

Source: Authors' calculations using Statistical Office micro-data

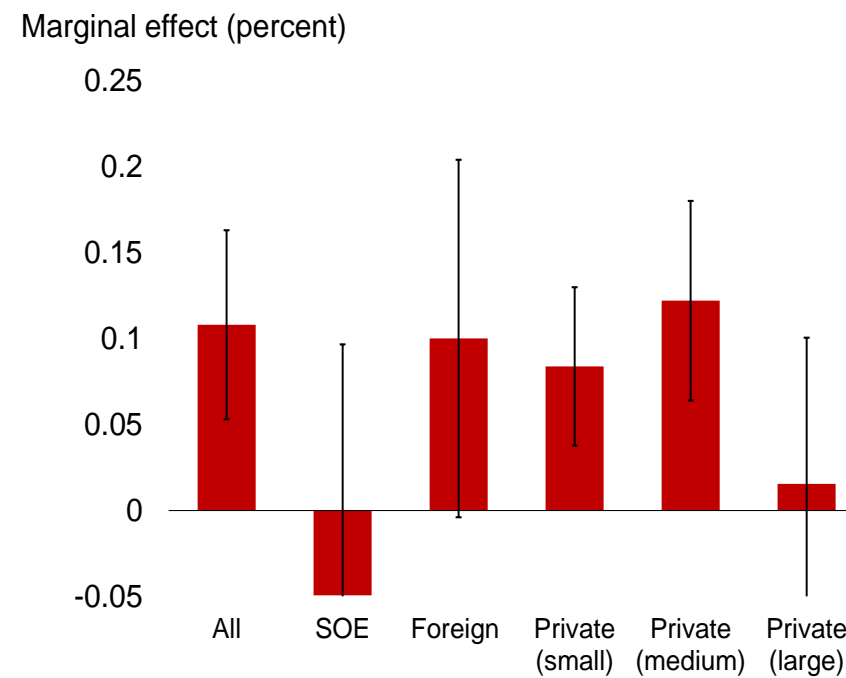
Notes: Reflects young firm (<=5 years old) employment share within each industry. Digital intensity defined according to Eurostat.

In addition, opening services to competition can increase productivity of services firms and downstream manufacturing firms

A. Productivity effects of service reform on services firms (own-effect)



B. Productivity effects of services reform on manufacturing firms (downstream effect)

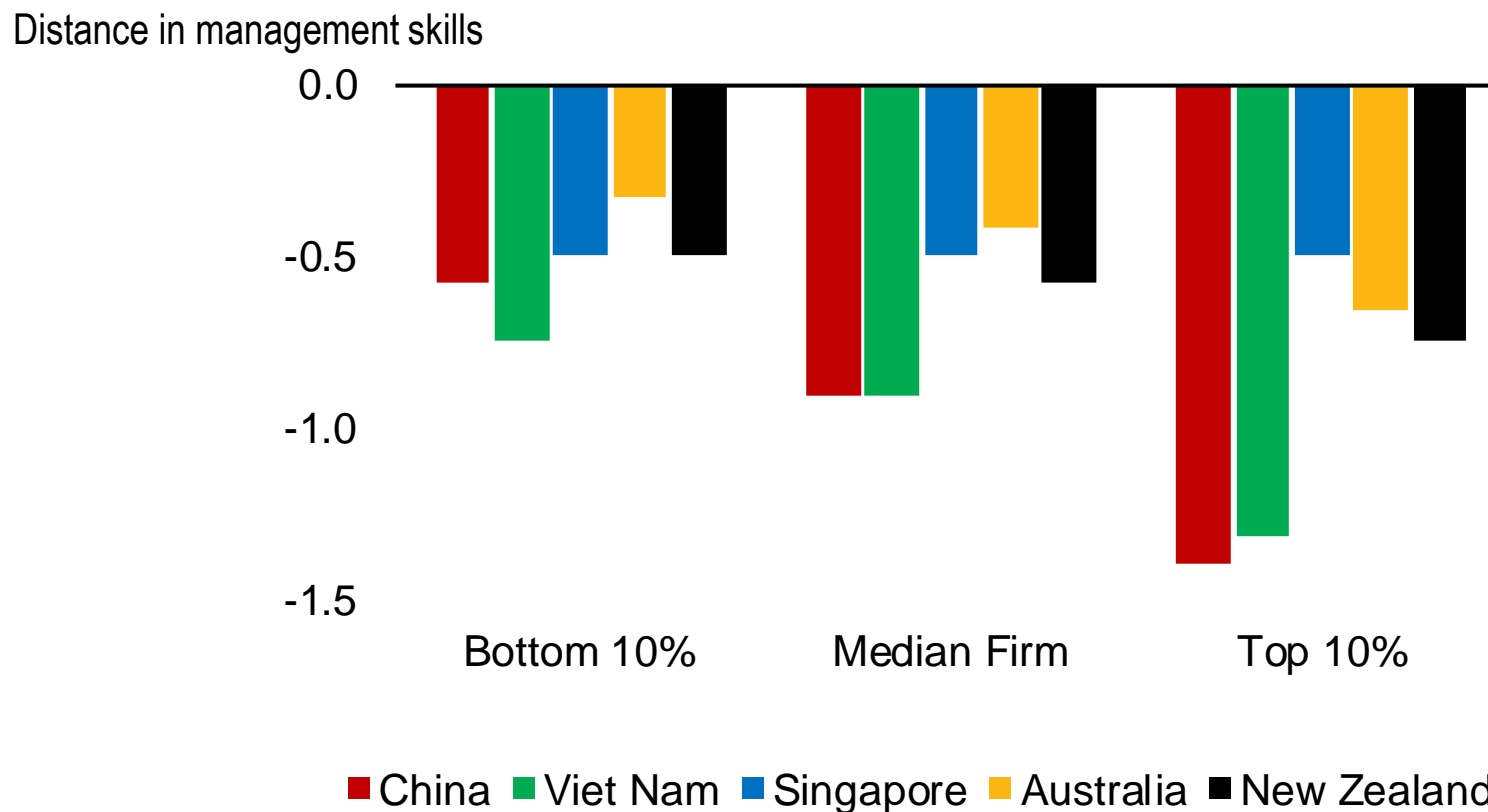


Source: World Bank staff estimation based on data from Vietnam enterprise surveys 2008 and 2016.

Note: OLS regression results. The dependent variable is the change in log value-added per worker between 2016 and 2008. The main explanatory variable is the change in STRI values in Trade, Transport, Finance, Professionals, and Telecommunication sectors between 2016 and 2008 in Panel A, and the change in the “downstream” STRI for manufacturing sectors in Panel B. The downstream STRI is a sector-specific measure for each 2-digit manufacturing sector, calculated by the average STRI of the above five services sectors weighted by the corresponding purchasing value from each manufacturing sectors. The regression sample in panel A consists of all enterprises operating in Trade, Transport, Finance, Professionals, and Telecommunication sectors, and all manufacturing enterprises in Panel B, in 2008 and 2016. All regressions control for firms’ baseline revenue and employment. Standard errors clustered at the industry level.

The best managed firms in developing EAP have skills far below the best in advanced economies

Distance in management skills versus the US for different levels of management sophistication



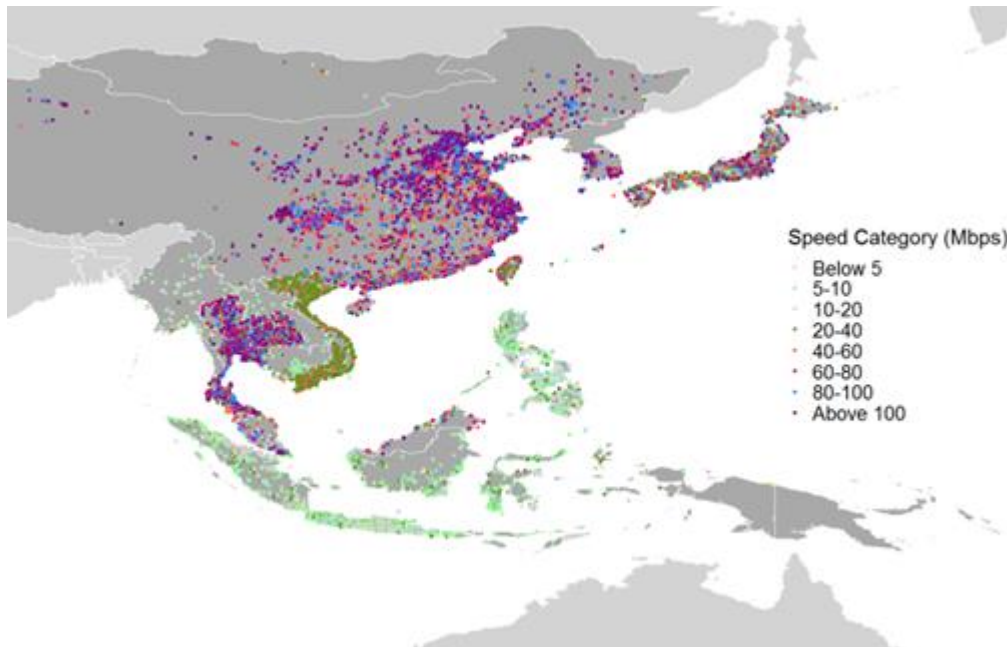
Source: Maloney and Sarrias (2017) using World Management Surveys.

Note: The charts reflect the gap in management scores between the top 10 per cent best managed firms in EAP compared to the top 10 per cent best managed firms in US. Bottom 10 per cent and median are defined similarly.

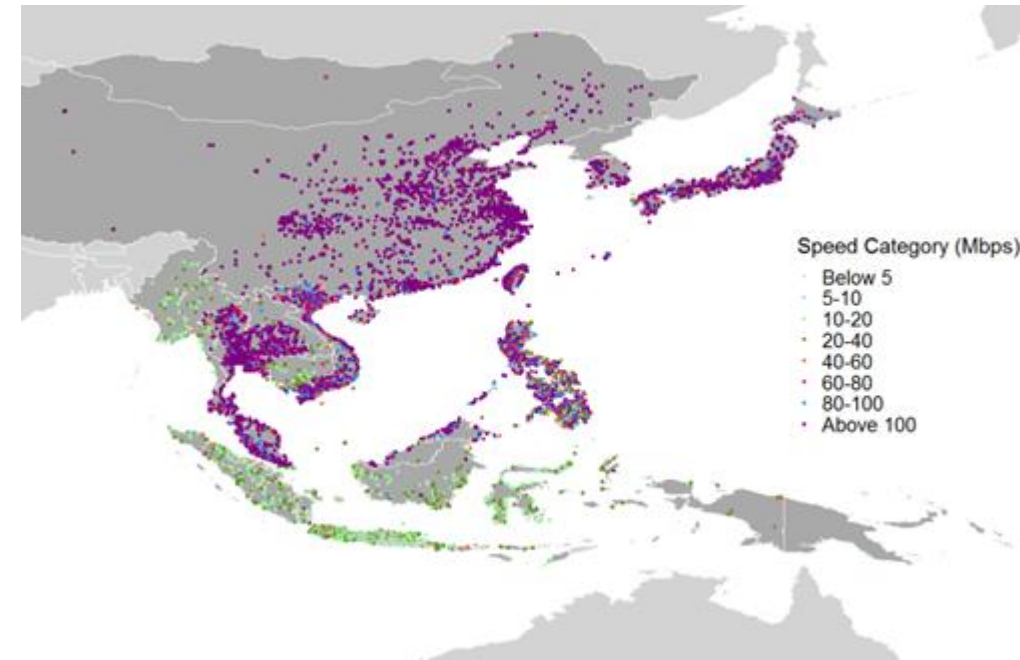
High-speed broadband access has improved but availability within and across EAP countries is still uneven

Variation in broadband speeds within and across EAP countries

Broadband fixed line internet speed 2019Q4



Broadband fixed line internet speed 2023Q2



Source: Ookla fixed broadband speedtest data at 2023 Q2.

Policies to boost productivity



Increased competition



Stronger skills

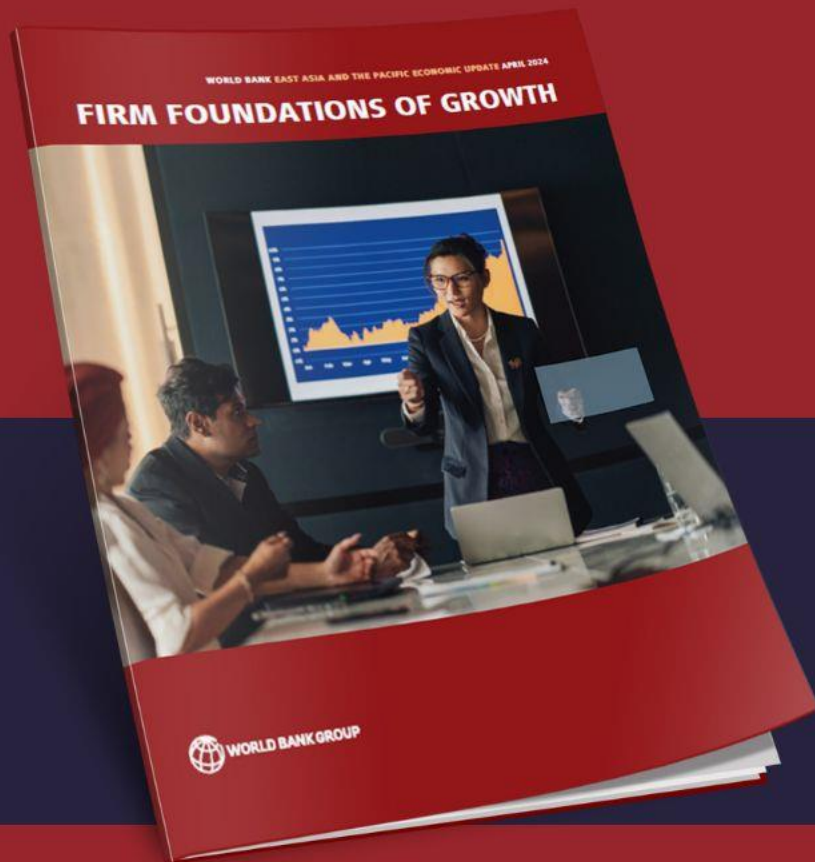


Adequate infrastructure

Conclusion

1. Outperforming but underachieving
2. Firms: Leaders are not leading
3. Policy: macro-predictability, micro-competition;
Capacity: digital and educational

Firm Foundations of Growth



Thank you

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