JULY 2018

ASIAN DEVELOPMENT OUTLOOK SUPPLEMENT

HIGHLIGHTS

- Healthy domestic demand reinforces regional prospects detailed in *Asian Development Outlook 2018*. This *Supplement* maintains growth projections at 6.0% for 2018 and 5.9% for 2019, despite global rumblings. Excluding newly industrialized economies, regional growth is forecast at 6.5% in 2018 and 6.4% in 2019, as envisaged in April.
- East Asian growth is on track to meet April forecasts of 6.0% in 2018 and 5.8% in 2019. The People's Republic of China is still expected to grow by 6.6% in 2018 before moderating to 6.4% in 2019.
- South Asia remains the fastest expanding subregion, with growth projected at 7.0% in 2018 and 7.2% in 2019. India is expected to achieve April forecasts of 7.3% in 2018 and 7.6% in 2019 as bank-strengthening bolsters private investment and benefits kick in from a new goods and services tax.
- Southeast Asia continues to be buoyed by robust domestic demand, particularly for private consumption and investment. It is on track to meet forecasts of 5.2% growth this year and next.
- Central Asia has performed better than expected, prompting growth projection upgrades to 4.2% for 2018 and 4.3% for 2019. The Pacific will likely realize earlier forecasts.
- Despite rising commodity prices, domestic factors have kept consumer price pressures in check regionally, prompting downward revision to inflation forecasts from 2.9% to 2.8% for both years. As United States monetary policy normalizes, central banks in the region act to spare their currencies' sharp depreciation and to subdue inflation.
- Trade tariffs implemented so far in 2018 have not significantly dented buoyant flows, but ongoing friction remains a downside risk to the outlook for developing Asia.

THE OUTLOOK REMAINS STABLE

Growth outlook

Developing Asia is largely on track to meet growth expectations as set out in April in *Asian Development Outlook 2018* (*ADO 2018*). The regional gross domestic product (GDP) is forecast to expand by 6.0% in 2018 and 5.9% in 2019, the rate envisaged in April, with subregional forecasts upgraded for Central Asia. Regional growth forecasts are maintained at 6.5% for 2018 and 6.4% for 2019 when excluding the newly industrialized economies of Hong Kong, China; the Republic of Korea; Singapore; and Taipei,China (Table 1).

The combined growth forecast for the major industrial economies—the United States, the euro area, and Japan—is retained from *ADO 2018* as growth in the US and the euro area remains robust. In Japan, though, unanticipated contraction in the first quarter (Q1) prompts a slight revision of the 2018 growth forecast (Box 1).

The rise in protectionist trade measures from the US and countermeasures from the People's Republic of China (PRC) and other countries poses a clear downside risk to the outlook for developing Asia. *ADO 2018* noted in April that US tariffs on steel, aluminum, solar panels, and washing machines were unlikely in themselves to stymie the global trade rebound. In the first 5 months of 2018, the dollar value of trade in the region's 12 largest economies grew at rates almost double those of a year earlier, with exports up by a relatively strong 12.6% and imports up by 26.0%. However, on 6 July the US administration implemented tariffs on $34 billion worth of imports from the PRC, and the PRC countered in kind. The US also cancelled country exemptions from steel and aluminum tariffs, prompting countermeasures from Canada, the European Union, Mexico, and the Russian Federation. Tariffs imposed by 15 July 2018 are factored into the revised outlook, but the risk of further ratcheting up of protectionist measures could undermine consumer and business confidence and thus developing Asia's growth prospects.

The Asian Development Bank Regional Economic Outlook Task Force led the preparation of a revised outlook for this *Asian Development Outlook Supplement*. The task force is chaired by the Economic Research and Regional Cooperation Department and includes representatives of the Central and West Asia Department, East Asia Department, Pacific Department, South Asia Department, and Southeast Asia Department.

ADB

East Asia

The growth outlook for East Asia is maintained at 6.0% in 2018 and 5.8% in 2019, with slight upward revisions for two economies: Hong Kong, China and Taipei,China. Hong Kong, China started the year on a strong note with growth at 4.7% in Q1 of 2018 (year on year, here and below, unless otherwise specified), the highest rate in almost 7 years. Domestic demand remained strong, while external demand picked up as the global economy sustained broad-based momentum. Favorable labor markets and positive consumer sentiment, as well as higher asset prices, bolstered private consumption growth to 8.6%. Investment rose by 3.8%, reflecting growth in machinery and equipment acquisition and modest expansion in building and construction. The upswing in global investment and trade boosted growth in goods exports by 5.2%, while a strong recovery in inbound tourism, active global financial markets, and buoyant regional trade flows lifted exports of services by 7.5%. Hong Kong, China is expected to stay on a robust track this year, though growth has likely peaked and will slow in the coming quarters as global trade tensions escalate and US interest rates rise. Even so, exceptionally strong growth in Q1 pushes up the growth forecast to 4.0% for 2018 from 3.2% in *ADO 2018*. For 2019, the forecast is maintained at 3.0% in light of strengthening headwinds.

Taipei,China recorded economic growth at 3.0% in Q1 of 2018, down from 3.4% in Q4 of the previous year but slightly better than the 2.9% rate for the whole of 2017. Private consumption was the largest contributor to growth with 1.6 percentage points, followed by government consumption with 0.9 points and net exports with 0.8 points, while gross capital formation subtracted 0.4 points. Merchandise exports grew by 14.2% in May, exceeding expectations. Private consumption is likely to remain robust with accelerating wage growth. Public investment is expected to increase as the first stage of the government's infrastructure spending plan is now being executed. The growth forecast for 2018 is 3.0%, revised up from the 2.9% forecast in *ADO 2018* in April. This reflects unexpectedly high public consumption and a continuing strong performance in exports. The forecast for 2019 is unchanged at 2.8%.

In the PRC, the largest economy in the region, GDP expanded by 6.8% in the first half of 2018, supported by strong private consumption and robust investment in real estate and manufacturing. Nominal growth in retail sales was solid, bolstered by buoyant consumer confidence, higher disposable income, and a tight labor market. Exports remained strong as recovery in global demand continued. Healthy domestic demand prompted imports to rise faster than exports, thus reducing the contribution to growth from the external sector. Growth in nominal fixed asset investment decelerated from 7.2% in 2017 to 6.0% in January–June as growth in infrastructure investment declined sharply. This is the softest such expansion in decades. Industrial production growth edged from 6.6% in 2017 to 6.7% in January–June, driven by a robust pickup in manufacturing output and higher electricity generation. The purchasing managers' indexes for manufacturing and services are broadly unchanged from 2017, still indicating expansion. Production controls implemented for environmental reasons were relaxed in February, boosting heavy industry. As a slight moderation in growth is still expected in the second half of 2018, the PRC economy is still forecast to grow by 6.6% in 2018 and 6.4% in 2019, unchanged from *ADO 2018*. Downside risks stem from evolving foreign trade and investment conflicts with the US.

In the Republic of Korea, GDP expanded by 2.8% in Q1 of 2018, as in Q4 of last year. Private consumption grew strongly by 3.5%, benefitting from the hosting of the 2018 Winter Olympic Games. Government consumption likewise rose to 5.8% on expanded health care benefits. Investment

Table 1 Gross domestic product growth (%)

	2017	2018		2019	
		ADO 2018	*ADOS*	*ADO 2018*	*ADOS*
Developing Asia	**6.1**	**6.0**	**6.0**	**5.9**	**5.9**
Developing Asia excluding the NIEs	**6.6**	**6.5**	**6.5**	**6.4**	**6.4**
Central Asia	**4.3**	**4.0**	**4.2**	**4.2**	**4.3**
Kazakhstan	4.0	3.2	3.7	3.5	3.9
East Asia	**6.3**	**6.0**	**6.0**	**5.8**	**5.8**
Hong Kong, China	3.8	3.2	4.0	3.0	3.0
People's Republic of China	6.9	6.6	6.6	6.4	6.4
Republic of Korea	3.1	3.0	3.0	2.9	2.9
Taipei,China	2.9	2.9	3.0	2.8	2.8
South Asia	**6.5**	**7.0**	**7.0**	**7.2**	**7.2**
India	6.7	7.3	7.3	7.6	7.6
Southeast Asia	**5.2**	**5.2**	**5.2**	**5.2**	**5.2**
Indonesia	5.1	5.3	5.2	5.3	5.3
Malaysia	5.9	5.3	5.3	5.0	5.0
Philippines	6.7	6.8	6.8	6.9	6.9
Singapore	3.6	3.1	3.1	2.9	2.9
Thailand	3.9	4.0	4.2	4.1	4.1
Viet Nam	6.8	7.1	7.1	6.8	6.8
The Pacific	**2.2**	**2.2**	**2.2**	**3.0**	**3.0**

ADO = *Asian Development Outlook*, *ADOS* = *ADO Supplement*, NIEs = newly industrialized economies (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China).

Note: Developing Asia refers to the 45 members of the Asian Development Bank listed below. Central Asia comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. East Asia comprises Hong Kong, China; Mongolia; the People's Republic of China, the Republic of Korea, and Taipei,China. South Asia comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Southeast Asia comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. The Pacific comprises the Cook Islands, the Federated States of Micronesia , Fiji, Kiribati, the Marshall Islands, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Sources: Asian Development Bank. 2018. *Asian Development Outlook 2018*; ADB estimates.

Box 1 Outlook for the major industrial economies

The major industrial economies of the United States, the euro area, and Japan are on track to meet growth expectations in *ADO 2018*. Aggregate growth forecasts for the three economies are unchanged at 2.3% in 2018 and 2.0% in 2019. The US economy continued its healthy growth pace in Q1 of 2018, supported by private investment. Euro area growth remains healthy, despite a slowdown in Q1, with improving labor markets, accommodative monetary policy, and fiscal support. In Japan, however, recovery lost steam after 8 consecutive quarters of expansion.

Gross domestic product growth in the major industrial economies (%)

	2017	2018		2019	
Area	Actual	*ADO 2018*	*ADOS*	*ADO 2018*	*ADOS*
Major industrial economies	**2.3**	**2.3**	**2.3**	**2.0**	**2.0**
United States	2.3	2.7	2.7	2.3	2.4
Euro area	2.6	2.2	2.2	1.9	1.9
Japan	1.7	1.4	1.1	1.0	1.0

ADO = Asian Development Outlook, ADOS = ADO Supplement.

Note: Average growth rates are weighed by gross national income, Atlas method, in current US dollars.

Sources: Asian Development Bank. 2018. *Asian Development Outlook 2018*; ADB estimates.

After recording 2.3% annual GDP growth in 2017, the US economy grew at a seasonally adjusted annualized rate (saar) of 2.0% in Q1 of 2018. Private investment contributed more than half of growth, overtaking consumption in the role of top contributor. The surge in private investment was primarily driven by nonresidential fixed investment, which grew by 10.4% saar. The contribution of consumption declined mainly because of a drop related to motor vehicles. Consumer confidence and retail sales remained strong in the first half of 2018, indicative of a continuing rebound in consumption. The industrial production index continued to rise in the first 5 months of 2018, and the purchasing managers' index also remained strong to June, both suggesting that expansion in US production will continue. This momentum seemed to encourage domestic investment, as did new tax incentives, improving the unemployment rate to an historic low rate of 4.0% in June despite a 601,000 jump in the labor force as participation increased. Headline inflation reached 2.8% in May, with core inflation at 2.2%. Rising inflation and a falling unemployment rate may prompt the Federal Reserve to hasten its normalization of monetary policy and raise its benchmark rate in every quarter of 2018, bringing the Fed rate up to about 2.1% by the end of the year. With these developments, GDP is projected to grow by 2.7% in 2018, as envisaged in *ADO 2018*. In 2019, GDP growth is expected to slow to 2.4%, reflecting a higher base effect and an anticipated tightening of monetary policy to prevent economic overheating.

Economic activity in the euro area slowed to 1.5% saar in Q1 of 2018 from 2.8% in Q4 of 2017 as trade shrank, the export decline outpacing that of imports. Stronger private consumption was offset by softening fixed investment and plummeting government consumption. While Q1 estimates confirm a downshift, leading indicators have stabilized at values that support robust growth, suggesting a healthy euro area to the forecast horizon. Economic sentiment weakened from an index reading of 114.9 in January to 112.3 in June but remains optimistic owing to strong economic recovery. The purchasing managers' index edged down for 5 consecutive months but bounced back in June to 54.8, which reflected continued growth in business activity in the area. Industrial production contracted in the first 2 months of the year but recovered in March. The unemployment rate dropped to 8.4% in May, the lowest since the global financial crisis of 2008–2009. The latest flash estimate for inflation stood in June at a 16-month high of 2.0%, driven by higher energy prices, but core inflation inched down to 1.2% in June from 1.3% in May. A fall in the output price index suggests that firms still struggle to raise prices amid weak demand. Although the European Central Bank meeting in July is likely to stay the course with a slow exit from quantitative easing, and monetary policy is likely to remain loose, inflation will pick up only gradually as the year progresses. Assuming gradual growth acceleration to the forecast horizon, this *Supplement* maintains the *ADO 2018* growth forecast at 2.2% for 2018 and 1.9% for 2019.

After 8 consecutive quarters of expansion, the economy of Japan lost growth momentum when GDP shrank by 0.6% saar in Q1 of 2018, dragged down by slowing private investment and consumption. Other indicators paint a mixed picture. Industrial production declined by 0.2% in May from the previous month, after 3 consecutive months of increases, and core machinery orders dropped in May after a big jump in April. However, sentiment about business conditions remains elevated, with the Nikkei Japan purchasing managers' index registering a value above 50 in June, indicating that manufacturing activity is expanding. Retail sales declined sharply in May, by 1.7%, but consumer confidence remained strong in June. Labor market conditions remained favorable with the unemployment rate falling to 2.2% in May. The external sector continued its run of growth, with exports rising by 10.5% in May over the previous month, and imports growing at an even faster 16.6%. Headline inflation, which had risen in the first 2 months of the year to a 3-year high, started declining again and fell to 0.6% in May, while core inflation was 0.1%. The Bank of Japan maintained its accommodative monetary policy. The contraction in Q1 of 2018 was more pronounced than expected in *ADO 2018*, prompting a downward revision to the 2018 growth forecast from 1.4% to 1.1%. Growth is expected to slow further to 1.0% in 2019, partly from an impending consumption tax hike.

moderated in line with expectations to 4.1%, reflecting housing restrictions, reduced government social overhead capital spending, and the information technology business cycle. Growth in goods exports moderated somewhat, but exports of services rebounded to 2.5% after posting 4 quarters of declines. These latest indicators point to the economy growing in line with expectations. The year-old national administration continues its expansive fiscal policy, which will support consumption. The turnaround in tourism will continue to provide a boost to the economy. Robust export performance, spurred by the strong global outlook, will likewise contribute to growth. *ADO 2018* forecasts of 3.0% for 2018 and 2.9% for 2019 are therefore retained.

South Asia

The outlook in South Asia continues to be for a robust economy, with growth on track to meet *ADO 2018* forecasts of 7.0% for 2018 and 7.2% for 2019. Preliminary government estimates of GDP growth in fiscal year 2018 (FY2018) in Bangladesh (ended 30 June 2018), Nepal (ended 15 July 2018), and Pakistan (ended 30 June 2018) surpassed *ADO 2018* forecasts. Agriculture growth was higher than expected in Bangladesh as the authorities offset flood-induced losses to the summer and monsoon rice crops by quickly extending seedlings and other support services to farmers. Industry growth was higher on stronger performances in manufacturing and construction. In Pakistan, agriculture recorded notable improvement over the previous fiscal year and surpassed the annual growth target of 3.5% on stronger growth in major crops and a modest increase in livestock. An upward revision for Nepal reflects industry growth exceeding expectations with enhanced capacity utilization, as well as expansion in energy and construction. The service sector contributed to the upward revision as wholesale and retail trade, financial intermediation, and travel and tourism grew faster than expected. In Sri Lanka, economic growth slowed to 3.2% in Q1 of 2018 as construction shrank, but construction is expected to pick up over the rest of the year as work continues on flagship projects in the public sector. In Bhutan, hydropower production and tourism were lower than expected from July 2017 to April 2018. Maldivian imports of cement, wood, and metal surged by 62.5% in Q1 of 2018 to supply infrastructure construction projects, while tourism measured in bed-night occupancy expanded by 13.7% in the first 5 months of 2018.

In India, the subregion's dominant economy, growth gained momentum in Q4 of FY2017 (ended 31 March 2018) as GDP expansion reached 7.7%, the highest rate since Q1 of FY2016. This pushed full-year growth to 6.7%, a tad higher than estimated in *ADO 2018*. Growth was driven largely by government spending for both consumption and public administration. Investment grew by a significant 14.4% largely on substantial government spending to support its push for infrastructure creation. In the first half of FY2018, the growth rate is expected to benefit from a low base. Other key drivers of growth include an uptick in public consumption, which is typical before elections, and a recovery in exports following shortages of working capital related to a new goods and services tax. Private consumption is expected to grow at a healthy rate as disruption caused by demonetization in 2016 fades. Capacity utilization rates are at their highest in 4 years and should provide incentives to firms to invest. In sum, the GDP growth forecast for FY2018 is maintained at 7.3%. Growth in FY2019 is expected to rise to 7.6% as measures taken to strengthen the banking system bolster private investment and as benefits kick in from the goods and services tax. Any further increase in oil prices poses a downside risk to growth.

Southeast Asia

The growth outlook for Southeast Asia remains at 5.2% for both 2018 and 2019 as downward revision to the 2018 outlook for Indonesia counters upward revision for Thailand. Robust domestic demand, particularly for private consumption and investment, continued to support economies in the subregion. Higher public investment boosted Q1 growth in Indonesia, the Philippines, and Thailand, while private investment was strong in Viet Nam. Growth in exports added a further boost to the economies of Singapore, Thailand, and Viet Nam, but export growth moderated in Malaysia.

In Indonesia, GDP growth in Q1 of 2018 came in at 5.1% as investment strengthened and private consumption remained robust. Growth in investment accelerated to 8.0% in Q1 of 2018 from 4.8% in the same period in 2017, supported by higher allocations for public infrastructure and solid growth in machinery and equipment. Private consumption remained healthy, growing by 5.0% in Q1 of 2018 on job growth and low inflation. As capital goods imports accelerated during the quarter, growth in imports outpaced growth in exports. The *ADO 2018* GDP growth forecast of 5.3% for 2018 is revised down to 5.2% because export growth is expected to remain moderate, but the forecast of 5.3% for 2019 remains unchanged.

The Malaysian economy took a breather in Q1 of 2018 as GDP growth softened to 5.4% from 5.6% in 2017. A stable labor market and higher wages buoyed private consumption, while lower government spending eased public consumption. The completion of several large infrastructure projects dented both public and private investment, as many were public–private partnerships, and slashed total investment by 9.1% to a level lower than last year. As expected, growth in exports lost some steam, reflecting slower external demand, as did growth in imports. Policy changes effected by the new government elected in May—which include increasing the minimum wage by about RM500, effectively suspending the goods and services tax effective from 1 June 2018, and stabilizing fuel prices by reintroducing some subsidies—are expected to spur consumer spending toward the end of the year. Meanwhile, discussions to cancel big government investment projects could reduce investment spending originally slated for 2019. On balance, the *ADO 2018* growth outlook is maintained at 5.3% for 2018 and 5.0% for 2019.

The Philippine economy grew by 6.8% in Q1 of 2018. Industry recorded the fastest growth, at 7.9%, while services continued to expand strongly by 7.0%. Growth in agriculture slowed to 1.5%. Sustained growth momentum was attributed mainly to accelerated spending on government infrastructure development and other programs to develop human capital. Public construction grew by 25.1%, and government consumption by 13.6%. Recent trends align with expectations of strengthening investment and domestic consumption. Public spending on social services and infrastructure will be supported by better budget execution and higher revenue mobilization. Low unemployment and steady remittances continue to drive household consumption. As part of the ongoing tax reform, a reduction in personal income tax for most of the workforce will boost disposable income and consumption. With these assumptions, this *Supplement* maintains the growth outlook at 6.8% in 2018 and 6.9% in 2019.

Economic growth in Thailand picked up strongly in Q1 of 2018 to 4.8%. The surge was broad-based, with consumption, investment, and exports all expanding. Private investment looks to be gaining momentum with expansion by 3.1% on a rebound in construction investment. Public investment also picked up, growing by 4.0%. Export volume continued its rapid expansion, up by 5.0% with strong growth in manufacturing. Private consumption continued expanding at 3.6% as consumer confidence remained high. On the production side, agriculture and construction rebounded while manufacturing and wholesale and retail trade maintained momentum. The growth forecast for 2018 is upgraded from 4.0% in *ADO 2018* to 4.2%, and the forecast for 2019 is unchanged at 4.1%.

In Q1 of 2018, Singapore's economy grew by 4.3%, benefitting from sustained growth in manufacturing and expanded growth in services, particularly in finance and insurance. Construction declined further, however, by 5.2%, dragged down by weakness in private construction. The purchasing managers' index for manufacturing remained expansionary but moderated from 53.1 in January to 52.5 in June. Domestic demand grew, driven primarily by increased government consumption. Gross fixed capital formation recovered from a decline in 2017 with higher private investment spending on machinery and transport equipment. In real terms, exports of goods and services increased by 3.8% and imports by 3.0%, such that net exports contributed 2.4 percentage points to growth. Bearing in mind external risks to the outlook, the Singaporean economy is on track to meet growth forecasts from April for 3.1% in 2018 and 2.9% in 2019.

All sectors of the Viet Nam economy are experiencing, as foreseen in April, quicker growth in 2018 than in 2017. Industry and construction grew by 9.7% in Q1 of 2018, up from 4.5% a year earlier. Manufacturing output in particular expanded at a 7-year high of 13.6%, boosted by strong global demand for exports and continued foreign investment. Services grew by 6.7%, against 6.4% in Q1 of 2017, while agriculture almost doubled to 4.1% growth from 2.1%. With rising global interest in Viet Nam as a destination for foreign direct investment, combined with recent progress on major trade deals including a revised Comprehensive and Progressive Trans-Pacific Partnership, the outlook remains positive for this year and next. Growth forecasts remain unchanged at 7.1% in 2018 and 6.8% in 2019.

Central Asia

The outlook for Central Asia remains broadly positive. In Armenia, growth accelerated further in Q1 of 2018 on strong demand, both domestic and external, following a sharp rebound last year from virtually no growth in 2016. Growth in Azerbaijan continued to recover in the first 5 months of 2018 and is expected to pick up further with the start of production from the Shah Deniz II gas field later in the year. Georgia recorded growth in early 2018 that was higher than expected thanks to contributions from tourism, exports, and capital investment. Growth in the Kyrgyz Republic was modest in the first 5 months of the year, most prominently caused by in lower output from the large Kumtor gold mine. Tajikistan recorded robust growth in Q1 of 2018, and this trend is likely to continue against a background of recovery in the Russian Federation and improved ties with Uzbekistan, both key trading partners. In Turkmenistan, rising oil prices and gas exports to the PRC supported growth in the first half of 2018, though the pace may moderate under curtailed public investment later this year. Uzbekistan's economy grew robustly in Q1 of 2018, driven by exports and investments that partly offset weaker consumption. Growth in the subregion as a whole is expected to reach 4.2% in 2018 and 4.3% in 2019, slightly outpacing the 4.0% and 4.2% forecast in *ADO 2018*.

In Kazakhstan, Central Asia's largest economy, growth picked up to 4.1% in Q1 of 2018 from 3.6% a year earlier. Growth was supported by an unexpectedly strong recovery in industry, with improvements in mining driven by rising prices and volumes for oil and metals, and in manufacturing by a government industrialization program. In the first 5 months of 2018, industry expanded by 5.4%. After a prolonged decline since mid-2016, real income rebounded by 1.2% in January–April 2018. Growth prospects are further improved by a government plan to introduce a new scheme for pension payments from July 2018 and to lower taxes on modest wages from January 2019. As these initiatives target lower-income citizens, they are expected to stimulate future growth in private consumption. Growth in Kazakhstan is now expected to reach 3.7% in 2018 and 3.9% in 2019, considerably higher than earlier *ADO 2018* forecasts of 3.2% and 3.5%.

The Pacific

Growth in the Pacific is projected to remain at 2.2% in 2018, unchanged from *ADO 2018*, as expected recovery in Palau and Timor-Leste from economic contraction last year offsets weaker growth in the rest of the subregion. Economic activity in Papua New Guinea is still seen to slow considerably this year after earthquakes in February affected liquefied natural gas production and exports of this and other commodities, and as foreign exchange shortages hamper business activity. In addition, fiscal austerity measures, though prudent, have withdrawn stimulus from the economy. The growth forecast for this largest economy in the subregion is maintained for now, pending further clarity on the extent of lost exports of liquefied natural gas this year. In Nauru, the economy contracted in FY2018 (ended 30 June 2018), but the decline was slightly smaller than expected as the scaling down of the Regional Processing Centre for asylum seekers in Australia proceeded at a more gradual pace than previously scheduled. Some 31% of inmates were transferred from the facility in the first 10 months of the fiscal year. Aggregate subregional growth in 2019 is expected to accelerate to 3.0%, also unchanged from *ADO 2018*, on an expected rebound in Papua New Guinea and stable or improved economic performance in most of the smaller Pacific economies.

Inflation outlook

Despite rising international commodity prices, inflation projections for developing Asia are revised down from 2.9% to 2.8% for 2018 and from 2.9% to 2.7% for 2019 as domestic factors help contain inflationary pressures (Table 2). In response to US monetary policy normalization, central banks in the region have taken steps to spare their currencies sharp depreciation. Further, some governments have reintroduced subsidies to contain the effects of rising food and oil prices.

The price of Brent crude oil hovered above $70/barrel in Q2 of 2018, reaching in May its highest level since 2014. In the first week of July, it traded within a narrow range of $77–$79/barrel. Oil prices have been supported by geopolitical tensions, strong consumption growth, and production cuts agreed by the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC producers. Compliance with the OPEC accord has been high. Indeed, production cuts have exceeded agreed maximum levels primarily because of unplanned production losses in Venezuela, where output dropped to a record low of 1.4 million barrels per day (mbd) in April, or more than 0.5 mbd less than a year earlier. Oil prices rose as well on geopolitical concerns arising from the US withdrawal from the nuclear accord with Iran, military escalation in Syria, and tensions between Saudi Arabia and Iran. Strong growth in global oil demand has further supported oil prices. Upward pressure on oil prices has been countered by continued increases in US production. The US Energy Information Administration estimates that US crude oil production averaged a record high of 10.5 mbd in April, up 120,000 barrels per day from March production. The US rig count rose to 861 in the week ending 1 June, the highest since March 2015. The outlook for oil prices remains contingent on the balance between rising US oil production and the persistence and depth of OPEC production cuts. The futures market shows Brent crude trading at around $70/barrel to the forecast horizon. With the spot price averaging just under $71/barrel in the year to date, the price of Brent crude is now forecast to average $70/barrel in 2018 and 2019, up from *ADO 2018* forecasts of $65/barrel in 2018 and $62/barrel in 2019.

In the first 5 months of the year, global food inflation averaged 3.0%. Two of the three World Bank price indexes tracking food prices—one for grain and another for edible oil and meal—rose, while the index for "other food" prices continued its general downward trend, led by a supply glut in the sugar market. Prices for edible oil and meal increased by 2.1% from January to May of this year. The rise in edible oil prices primarily reflected an increase in international soybean values, led by strength in South American soybeans.

Table 2 Inflation (%)

	2017	2018		2019	
		ADO 2018	*ADOS*	*ADO 2018*	*ADOS*
Developing Asia	**2.2**	**2.9**	**2.8**	**2.9**	**2.7**
Developing Asia excluding the NIEs	**2.4**	**3.0**	**3.0**	**3.0**	**2.9**
Central Asia	**9.2**	**8.5**	**8.7**	**7.9**	**8.1**
Kazakhstan	7.4	6.8	7.0	6.2	6.5
East Asia	**1.6**	**2.3**	**2.1**	**2.2**	**2.1**
Hong Kong, China	1.5	2.2	2.3	2.1	2.2
People's Republic of China	1.6	2.4	2.2	2.3	2.1
Republic of Korea	1.9	1.9	1.9	2.0	2.0
Taipei,China	0.6	1.1	1.2	1.1	1.3
South Asia	**4.0**	**4.7**	**5.0**	**5.1**	**5.1**
India	3.7	4.6	5.0	5.0	5.0
Southeast Asia	**2.8**	**3.0**	**2.9**	**3.0**	**2.9**
Indonesia	3.8	3.8	3.6	4.0	3.7
Malaysia	3.8	2.6	2.5	1.8	1.8
Philippines	2.9	4.0	4.3	3.9	3.9
Singapore	0.6	0.9	0.9	1.4	1.4
Thailand	0.7	1.2	1.3	1.3	1.4
Viet Nam	3.5	3.7	3.7	4.0	4.0
The Pacific	**3.8**	**4.1**	**4.2**	**3.9**	**3.9**

ADO = *Asian Development Outlook*, *ADOS* = *ADO Supplement*, NIEs = newly industrialized economies (Hong Kong, China; Republic of Korea; Singapore; and Taipei,China).

Note: Developing Asia refers to the 45 members of the Asian Development Bank listed below. Central Asia comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. East Asia comprises Hong Kong, China; Mongolia; the People's Republic of China, the Republic of Korea, and Taipei,China. South Asia comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Southeast Asia comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. The Pacific comprises the Cook Islands, the Federated States of Micronesia , Fiji, Kiribati, the Marshall Islands, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

Sources: Asian Development Bank. 2018. *Asian Development Outlook 2018*; ADB estimates.

Firmer buying interest, mostly for Brazilian supplies, provided support, as did dwindling crop prospects in Argentina and associated strength in soybean meal values. Grain prices increased by 13.8% from January to May. The grain index has followed an upward trend for a fifth consecutive month, with price rises for wheat, maize, and rice all gaining momentum in recent months. Wheat prices found support in robust trade and weather-related risks, especially in the US. Turning to maize, expectations of lower planted area in the US and drought-reduced production in Argentina continued to push up international prices. Rice prices increased following a fresh round of public sector purchases by Indonesia and the launch of a state import tender by the Philippines. By contrast, the "other food" price index fell by 3.3% from January to May. While early indications for the 2018/19 crop season point to favorable crop production, higher projected oil prices and strong demand lead this *Supplement* to more than double the 2018 food price inflation forecast to 2.8% from 1.2% in *ADO 2018*, while keeping 2019 forecast unchanged at 1.2%.

By subregion, inflation forecasts for East Asia are revised down from 2.3% to 2.1% in 2018 and from 2.2% to 2.1% in 2019, as downgrades to PRC forecasts more than offset upward revisions for both Hong Kong, China and Taipei,China. In the PRC, the rebound in food prices was weaker than earlier anticipated. Pork, which occupies a large portion of the consumer price index basket, has been stable so far. As domestic prices are not likely to pick up as much as predicted in *ADO 2018*, the inflation forecast is revised down from 2.4% to 2.2% for 2018 and from 2.3% to 2.1% for 2019. By contrast, continued robust economic conditions are likely to exert upward pressure on inflation in Hong Kong, China over the course of 2018. Feed-through from the rise in home rents over the past year or so will likely become more visible within the forecast horizon. Prices are now projected to rise by 2.3% in 2018 and 2.2% in 2019, a tad higher than foreseen in *ADO 2018*. In Taipei,China, inflation forecasts are revised slightly upward on higher oil prices and expected depreciation of the local dollar. Elsewhere in the subregion, inflation projections are maintained as in *ADO 2018*.

The South Asia inflation forecast for 2018 is raised to 5.0% from 4.7%, mainly to accommodate an increase in the forecast for India, but kept at 5.1% for 2019. The upgrade in the FY2018 inflation forecast for India from 4.6% to 5.0% responds to higher oil prices, significant depreciation of the Indian rupee in the past few months, and generous increases announced on 4 July in minimum support prices for summer crops, by which the government intervenes in markets to protect agricultural producers from any sharp fall in farm prices. Elsewhere in the subregion, inflation in Bangladesh is estimated at 5.8% in FY2018, lower than the 6.1% forecast *ADO 2018*, with improved rice supply resulting from a surge in rice imports and the arrival on the market of the winter rice crop. The Government of Maldives reversed in April its 2016 decision to cut food subsidies, thereby lowering prices for staple foods. It also lowered ceilings on prices for imported staples, prompting lower inflation forecasts. Nepal's average annual inflation in the first 10 months of FY2018 was 4.1%, much lower than the 5.5% predicted in *ADO 2018*. In Sri Lanka, inflation dropped from a 12-month average of 7.7% in December 2017 to 5.7% in May 2018 with sharp deceleration in food inflation. The introduction of an automatic pricing formula for fuel in May and the possible introduction of automatic pricing for electricity later this year may push inflation higher.

The inflation outlook in Southeast Asia is revised down for both 2018 and 2019 on account of downgrades to Indonesia's inflation projections. Global oil prices above expectations and higher US interest rates have contributed to rising inflationary pressures in some subregional economies. In response, Indonesia, Malaysia, and the Philippines raised their policy interest rates in the first half of 2018. Bank Indonesia raised its policy rate twice in May and once in June, by a total of 100 basis points, amid depreciation of the Indonesian rupiah and pressure from the external account. Similarly, the Philippine central bank raised its policy rate in response to higher inflation. Malaysia raised its policy rate by 25 basis points in January 2018.

In the first 6 months of 2018, inflation in Indonesia averaged 3.3%, well within the target range of 2.5%–4.5% set by Bank Indonesia. From March to June, food and energy prices were well contained by staple food imports and government policy to keep fuel prices unchanged. As recent increases in the policy rate may help contain inflation, which averaged 3.3% in the first 6 months of the year, inflation is now expected to pick up to 3.6% in 2018, below the earlier forecast of 3.8%, and to 3.7% in 2019, revised down from 4.0%.

Inflation in Malaysia slowed to 1.7% in the first 5 months of 2018 from 4.1% a year earlier, largely thanks to lower transmission of global fuel price changes to domestic prices. Prices for transportation, which comprises 13.7% of the consumer price index basket, rose at only a tenth of the pace last year. Fuel subsidies in effect since June 2018 are expected to further contain inflation, prompting this *Supplement* to revise down the forecast for 2018 from 2.6% to 2.5%. The projection for 2019 is maintained at 1.8%.

Meanwhile, inflation in the Philippines reached 5.2% in June 2018, driven largely by price hikes for fuel and related items and by sporadic shortages of key food items. This outcome combines with expectedly high global oil prices, peso depreciation, and strong domestic demand to prompt this *Supplement* to revise the inflation forecast for 2018 to 4.3% from the *ADO 2018* forecast of 4.0%. Higher excise taxes on fuel and some commodities as part of the Tax Reform for Acceleration and Inclusion Act, which took effect in January 2018, are contributing factors. The impact of tax reform on inflation is expected to be transitory, however, and normalize in 2019. Also arguing for maintaining the inflation forecast for 2019 at 3.9% are upward adjustments to monetary policy rates anticipated in line with tightening monetary policy globally. The central bank raised its policy rate in May and June by a total of 50 basis points, bringing the overnight reverse repurchase rate to 3.5%.

In Thailand, higher global oil prices have contributed to higher headline inflation. However, government plans to subsidize diesel should help moderate future impact. Inflation forecasts for 2018 and 2019 are revised up slightly to 1.3% and 1.4%.

Headline inflation in Singapore eased to 0.2% in the first 5 months of 2018 with lower price increases for almost all items, on top of declines for housing and utilities. Global oil and food prices have increased, but the effect on overall inflation will remain moderate as housing and utility costs remain low. *ADO 2018* forecasts of 0.9% for 2018 and 1.4% for 2019 are therefore retained.

Inflation in Viet Nam edged up to reach an annual average of 3.3% in June 2018, but not enough to alter forecasts of 3.7% for 2018, accelerating to 4.0% in 2019. These forecasts assume that current policy settings are maintained and that the global recovery in commodity prices continues.

Most economies in Central Asia experienced slowing inflation rates in early 2018, but a number of economies in the subregion should anticipate higher inflation. In Uzbekistan, currency depreciation and higher government spending are expected to add inflationary pressure. Average annual inflation is expected to rise as well in Turkmenistan in 2018 on subsidy cuts, expansionary credit policy, and currency depreciation on the parallel market. In Kazakhstan, inflation in the first 5 months of 2018 reached 6.5% as prices for food increased by 5.4%, other products by 8.5%, and services by 5.9%. Reflecting continued economic growth and improvement in real income, inflation this year and next is forecast to be higher than projected in *ADO 2018*. In Armenia, a stable external environment and exchange rate plus favorable weather helped contain inflationary pressures from higher taxes in the first 5 months of 2018. Inflation was similarly low or moderate in Azerbaijan, Georgia, the Kyrgyz Republic, and Tajikistan. Inflation in the subregion as a whole is projected to reach 8.7% in 2018, revised up from 8.5% in *ADO 2018*, and 8.1% in 2019, revised up from 7.9%.

The 2018 inflation projection for the Pacific is revised to 4.2%, or 0.1 percentage points more than in *ADO 2018*, reflecting costs higher than expected for commodity imports to Samoa, increased duties on fuel imported to Solomon Islands, and local food supply constraints in Tonga since February, in the aftermath of Cyclone Gita. Inflation is still expected to ease to 3.9% in 2019, as forecast in *ADO 2018*, with the stabilizing of international food prices.

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