DECEMBER 2018

ASIAN DEVELOPMENT OUTLOOK SUPPLEMENT

HIGHLIGHTS

- Backed by robust domestic demand, developing Asia continues to weather external headwinds. This *Supplement* maintains growth projections at 6.0% for 2018 and 5.8% for 2019, as detailed in *Asian Development Outlook 2018 Update* in September. Excluding the newly industrialized economies, regional growth is forecast at 6.5% in 2018 and 6.3% in 2019, as envisaged in September.
- East Asia growth projections are maintained at 6.0% for 2018 and 5.7% for 2019 despite lower forecasts for the newly industrialized economies. Growth in the People's Republic of China is still expected at 6.6% in 2018, moderating to 6.3% in 2019.
- India is maintaining growth momentum on rebounding exports and higher industrial and agricultural output. South Asia is largely on track to meet growth projections, still 7.0% for 2018 but revised down marginally to 7.1% for 2019.
- The Southeast Asia growth forecast is retained at 5.1% for 2018, assuming robust consumption and infrastructure investment. Adjustments for Indonesia, Malaysia, and Thailand lower the 2019 outlook by 0.1 percentage points to 5.1%.
- Realized and prospective performances in a number of large Central Asian economies prompt an upward revision to the growth forecast to 4.2% for 2018 and 4.3% for 2019. Projections for the Pacific are largely unchanged.
- Softer international commodity prices and domestic factors have kept consumer prices in check regionally, prompting downward revisions to inflation forecasts from 2.8% to 2.6% for 2018 and from 2.8% to 2.7% for 2019.
- A truce between the People's Republic of China and the US provides temporary respite from new tariffs, but the unresolved trade conflict remains the foremost downside risk to forecasts.

THE OUTLOOK FIRMS AS TRADE CONFLICT PAUSES

Growth outlook

Despite challenges brought about by trade conflict, growth forecasts for developing Asia remain unchanged at 6.0% for 2018 and 5.8% for 2019, as envisaged in September in *Asian Development Outlook 2018 Update*. East Asia and the Pacific are on track to meet growth projections. Unexpectedly strong expansion in Central Asia offsets small downward revisions for South and Southeast Asia in 2019. Excluding the newly industrialized economies of Hong Kong, China; the Republic of Korea (ROK); Singapore; and Taipei,China, the regional growth outlook is maintained at 6.5% for 2018 and 6.3% for 2019 (Table 1).

The collective growth projections for the major industrial economies of the United States, the euro area, and Japan are retained from the *Update*. Favorable outcomes in the US and the euro area confirm that the major industrial economies will realize growth forecasts in the *Update* at 2.3% for 2018 and 2.1% for 2019, though an unexpected contraction in Japan in the third quarter (Q3) warrants a slight downgrade to its 2018 growth projection (Box 1).

Risks to the outlook continue to be on the downside, with some added uncertainty to the forecast given recent developments. The *Update* identified the escalating trade conflict as the largest downside risk, but on 1 December the leaders of the People's Republic of China (PRC) and the US agreed to a 90-day truce precluding any new tariffs to allow time for bilateral negotiations—which also lends businesses a wider window for frontloading trade. Nonetheless, the threat looms on the horizon, given significant policy differences still to be reconciled by the PRC and US, and the negative effects on business sentiment and consumer confidence are reflected in recent stock market jitters. The risk of US interest rates rising higher than foreseen has subsided somewhat as early indicators suggest that the US economy is not overheating and that inflation expectations have not risen. Yet growth in the US economy has so far exceeded

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.

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the forecast for 2018, prompting a slight upward revision to US growth projections for both 2018 and 2019. Uncertainty over Brexit is a downside risk to the outlook for the European Union but should have only minor effects in developing Asia. Oil prices continue to drop as supply outpaces expectations, which reduces pressure on external balances in the region, particularly in India and the Philippines.

East Asia

Developing Asia's largest subregional economy is set to achieve growth as forecast in the *Update* despite downward revisions to projections for Hong Kong, China; the ROK; and Taipei,China. Growth forecasts for the subregion are maintained at 6.0% for 2018 and 5.7% for 2019. In line with expectations in the *Update*, growth in the PRC gradually slowed from 6.8% in Q1 of 2018 to 6.5% in Q3. A continuing clampdown on financing through shadow banks, restrictions on the housing market, and a sharp decline in infrastructure investment in the first 9 months of 2018 were domestic causes of the slowdown. In addition, the trade conflict with the US started to weigh on consumer confidence, contributing to a decline in retail sales growth in real terms. Monetary and fiscal policies were loosened in mid-2018 to ensure a smooth and gradual growth slowdown. Following a sharp increase in local government special bond issuance in August and September 2018, higher infrastructure investment fueled accelerated growth in fixed asset investment in October 2018. In the same month, industrial production growth edged up while growth in outstanding bank loans slightly softened. While PRC exports to the US have developed favorably so far this year as orders were frontloaded, this may entail a decline in exports to the US in 2019, especially if US tariffs on $200 billion in imports from the PRC increase, as publicly discussed, from 10% currently to 25% in March 2019. As the growth slowdown in Q3 of 2018 was in line with expectations in the *Update*, and with anticipated external headwinds likely to continue in 2019, gross domestic product (GDP) forecasts are kept at 6.6% for 2018 and 6.3% for 2019.

In Hong Kong, China, the economy grew by 2.9% in Q3, a solid pace but down from 3.5% in Q2. GDP growth averaged 3.7% in the first 3 quarters, propelled by expanding external demand and firm domestic demand. Private consumption expenditure increased by 5.2% in real terms, spurred by rising incomes and favorable job conditions with unemployment still at a 20-year low of 2.8%. Investment expenditure grew by 8.2% as machinery and equipment acquisition surged and as construction stabilized. However, worsening downside risks are starting to drag on the economy. Growth in goods exports decelerated in September as the impacts of PRC–US trade conflict slowed international trade and investment growth. Further pressures derive from tightening monetary policy in the US and elsewhere. Consumer sentiment and domestic demand remain solid but may eventually succumb to external uncertainties and weaker asset markets. The growth forecast is thus trimmed from 3.7% in the *Update* to 3.4% for 2018 and from 3.0% to 2.8% for 2019.

In the ROK, growth slowed to 2.0% in Q3 of 2018 after expanding by 2.8% in the first 2 quarters, pulled backed by a sharp 5.6% decline in investment as government measures discouraged property development and an uncertain trade environment since the start of the year upset firms' investment plans. This left consumption to support growth in Q1–Q3 of 2018. Private consumption rose by 3.0% (year on year, here and below, unless otherwise stated), while government consumption expanded by 5.1% as expansionary fiscal policy continued. Customs data showed export growth slowing to 7.1% in the first 10 months of 2018, a considerable

Table 1 Gross domestic product growth (%)

	2017	2018		2019	
		ADO 2018 Update	*ADOS*	*ADO 2018 Update*	*ADOS*
Developing Asia	**6.1**	**6.0**	**6.0**	**5.8**	**5.8**
Developing Asia excluding the NIEs	**6.6**	**6.5**	**6.5**	**6.3**	**6.3**
Central Asia	**4.3**	**4.1**	**4.2**	**4.2**	**4.3**
Kazakhstan	4.1	3.7	4.0	3.9	3.8
East Asia	**6.3**	**6.0**	**6.0**	**5.7**	**5.7**
Hong Kong, China	3.8	3.7	3.4	3.0	2.8
People's Republic of China	6.9	6.6	6.6	6.3	6.3
Republic of Korea	3.1	2.9	2.7	2.8	2.6
Taipei,China	2.9	3.0	2.6	2.8	2.6
South Asia	**6.5**	**7.0**	**7.0**	**7.2**	**7.1**
India	6.7	7.3	7.3	7.6	7.6
Southeast Asia	**5.2**	**5.1**	**5.1**	**5.2**	**5.1**
Indonesia	5.1	5.2	5.2	5.3	5.2
Malaysia	5.9	5.0	4.7	4.8	4.7
Philippines	6.7	6.4	6.4	6.7	6.7
Singapore	3.6	3.1	3.3	2.9	2.9
Thailand	3.9	4.5	4.3	4.3	4.1
Viet Nam	6.8	6.9	6.9	6.8	6.8
The Pacific	**2.3**	**1.1**	**1.1**	**3.1**	**3.1**

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 Update*; ADB estimates.

Box 1 Outlook for the major industrial economies

The growth outlook for the major industrial economies of the US, the euro area, and Japan is unchanged from *ADO 2018 Update*. Despite contraction in Japan in Q3, favorable outcomes in the US and the euro area confirm that the major industrial economies are on track to meet *Update* growth projections of 2.3% in 2018 and 2.1% in 2019.

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

	2017	2018		2019	
Area	Actual	*ADO 2018 Update*	*ADOS*	*ADO 2018 Update*	*ADOS*
Major industrial economies	**2.3**	**2.3**	**2.3**	**2.0**	**2.1**
United States	2.2	2.8	2.9	2.4	2.5
Euro area	2.5	2.0	2.0	1.9	1.9
Japan	1.9	1.1	0.8	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 Update*; ADB estimates.

The US economy grew at a seasonally adjusted annualized rate (saar) of 4.2% in Q2 before slowing to 3.5% in Q3. While a strong rebound in private investment added to solid contributions from private consumption and government spending, net exports subtracted from growth as a strong dollar caused a large surge in imports and a slowdown in exports. Growth in consumption continued unabated and remained the backbone of GDP expansion. Retail sales grew further in September, and consumer confidence strengthened from 130.9 in September to 133.4 in October, the highest index reading since September 2000. The purchasing managers' index remained strong at 60.0 in October after reaching a 21-year high of 61.4 in September, with anything above 50 indicating expansion. The industrial production index too suggests continuing moderate expansion in US production. A positive trend in the labor market persisted as the unemployment rate fell to a near 50-year low of 3.7% in September and October. Wage growth picked up, supporting a continued trend of rising core prices. The tightening labor market and the potential for inflation in core prices suggest that the Federal Reserve will continue to gradually normalize monetary policy to prevent overheating. GDP growth in Q2 and Q3 above expectations prompts an upward correction to projected US growth to 2.9% in 2018. With such strong momentum, the growth forecast for 2019 is also revised up, to 2.5%, despite some moderation anticipated in the wake of monetary tightening.

Euro area economic growth slowed to 0.7% saar in Q3 2018 from 1.8% in Q2 as a firm euro and slower global trade kept weighing down the external sector. Accommodative monetary policy has been driving growth in the region, and labor markets remain tight. The unemployment rate was, at 8.1% in September, the lowest since November 2008. Leading indicators in Q3 confirm a moderate downshift from Q2 but remain broadly supportive of a robust outlook. Industrial production returned to growth in August following contraction in June and July. After a rebound in June, the purchasing managers' index edged down again to 53.3 in October but continues to suggest healthy business expansion. Economic sentiment weakened slightly from 110.9 in September to 109.8 in October, but the index remained in optimistic territory. Although headline inflation at 2.2% in October breached the policy target, the European Central Bank left interest rates unchanged that month and reiterated its intention to end its asset-purchase program by December. The euro area economy remains solid at home, and its growth prospects positive, thanks to a still supportive monetary policy, buoyant investment, and expansionary fiscal measures that help buttress economic activity. The growth forecast for 2018 is thus maintained at 2.0% for 2018 and 1.9% for 2019, as in the *Update*.

In Japan, GDP growth, having recovered briefly in Q2, contracted again in Q3, by 2.5% saar. All expenditure components except government consumption dragged down growth. Reports suggest that Japan's economy shrank in Q3 as natural disasters hit domestic investment, spending, and exports. Other indicators suggest that growth may recover. Industrial production rebounded strongly in October to grow by 2.6% from the previous month. The purchasing managers' index edged further above 50 in October, suggesting that manufacturing continues to expand. On the negative side, machinery orders declined sharply by 18.3% in September following 2 months of growth, but they are expected to pick up in the next quarter. Consumer spending rebounded as retail sales spiked by 1.2% in October. Although consumer confidence weakened in the same month, the pickup in wage growth in September should, combined with low unemployment, continue to boost consumer income and spending power. Further, purchases ahead of a scheduled hike in consumption tax in 2019 is expected to raise expenditure in the short term. The Bank of Japan maintained its accommodative monetary policy at its latest meeting as inflation remained well below its target. After 27 consecutive months of growth, merchandise exports declined in September by 2.4% from the previous month but then rebounded to grow by 8.4% in October. The contraction in real GDP in Q3 prompts a sizable downward revision to the 2018 growth forecast from 1.1% to 0.8%. As trade tensions continue to threaten global trade and growth, the forecast for 2019 is maintained at a cautious 1.0%.

drop from 17.3% expansion a year earlier as demand softened. A bright spot remained as growth in exports to Japan, the PRC, and the US—together comprising 42% of ROK exports—accelerated from 9.9% to 14.8% despite tariff disputes this year. The trade truce announced by the PRC and the US in December may help to stabilize faltering consumer and business confidence in the coming months but is less likely to end the export growth slowdown any time soon, as growth in the PRC continues to moderate and world trade growth to decelerate. Weak employment growth coupled with higher household debt are seen to dampen consumption. As the ROK faces mounting external and domestic headwinds, this *Supplement* revises growth projections from 2.9% to 2.7% for 2018 and from 2.8% to 2.6% for 2019.

Taipei,China recorded economic growth at 2.3% in Q3 of 2018, down from 3.2% in the same quarter a year earlier. Gross capital formation was the largest contributor to growth, adding 3.6 percentage points, with increase in stocks contributing 2.2 points. Net exports subtracted from growth a large 2.5 percentage points, and government consumption subtracted a further 0.2 points. Growth in exports of goods and services slowed to 1.2% in Q3 from 6.3% in the previous quarter and 11.4% in Q3 of 2017. On the other hand, growth in imports of goods and services marginally increased from 4.5% in Q2 to 4.6% in Q3. The manufacturing purchasing managers' index fell to 48.7 in October from 50.8 in the previous month, crossing below the threshold of 50 to foretell contraction in the sector. The economy will be buoyed by resilient private consumption supported by a robust labor market and continuing increase in public expenditure, in particular with the approval of a NT$228 billion infrastructure program for the next 2 years. GDP growth in the next 2 years is expected to moderate, however, as exports weaken under the trade conflict between the PRC and the US, with electronics likely to be severely affected. Other downside risks are rising tensions with the PRC and the outward migration of skilled workers. The significant drop in export growth and the falling purchasing managers' index demand a reduced growth forecast for 2018 and 2019, to 2.6%.

South Asia

Still the fastest-growing subregion in developing Asia, South Asia is on track to meet the *Update* growth forecast of 7.0% for 2018, but the forecast for 2019 is revised down marginally from 7.2% projected in September to 7.1%. Bangladesh has maintained its growth momentum with exports growing by 19% in the first 4 months of fiscal year 2019 (FY2019, ending 30 June 2019), remittances also growing strongly in the period, and import growth slowing in Q1. Pakistan's external conditions have worsened in the past few months with foreign exchange reserves continuing to fall in Q1 of FY2019 (ending 30 June 2019) and the local currency depreciating by 14% from July to October. In Sri Lanka, GDP grew by 3.7% in Q2 of 2018, and the first half of 2018 saw revived private consumption, continued tightening of government current spending, and stagnant fixed investment. Recent political uncertainty will cloud Sri Lanka's growth prospects in the short term. Tourist arrivals continued to grow strongly in Maldives. Nepal saw in Q1 of FY2019 (ending 16 July 2019) exports surge by 16.1% and remittances hit a record of $2.1 billion, up by 24.5%. Growth in Bhutan in FY2018 (ended 30 June 2018) is now thought to have moderated more than estimated in the *Update* as weak water flows caused hydropower production to decline and hydropower plant construction started to scale down as it neared completion. Afghanistan made good progress on key reforms under the International Monetary Fund's Extended Credit Facility and is, according to the World Bank, among the world's top ten performers in improving the ease of doing business.

India saw GDP growth moderate to 7.1% in Q2 of FY2018 (ending 31 March 2019) from 8.2% in Q1, for 7.6% growth in the first half. The slowdown came mainly from weak food prices dampening rural consumption, higher oil prices delivering a negative shock in the terms of trade, and rising costs for raw materials. While a gradual slowdown across the quarters in FY2018 was forecast in the *Update*, the slowdown in Q2 was a bit steeper than anticipated. Nonetheless, growth forecasts of 7.3% for FY2018 and 7.6% for FY2019 are retained from the *Update* despite some downside risks: tighter credit as the nonbank finance sector experiences stress, limited fiscal space for public capital expenditure, and escalating trade tensions. Some of these risks could be offset by a recent decline in oil prices and by exports becoming more competitive as the Indian rupee weakens, down by 10% since the beginning of 2018 despite a recent rebound.

Southeast Asia

The pace of growth has been maintained since the release of the *Update* in September, but some downside risks for individual Southeast Asian economies have intensified. Robust domestic demand continued to drive growth in the subregion. Infrastructure spending remained strong in Brunei Darussalam, Indonesia, the Philippines, and Thailand but declined in Malaysia. Consumption was buoyant despite rising food and transport prices in some economies. Moderation in global demand for exports is, however, dampening growth prospects for the subregion, and particularly for Malaysia and Thailand, in 2018 and 2019. On the production side, Myanmar and Thailand benefitted from improved agricultural output, which languished in Indonesia, the Lao People's Democratic Republic (Lao PDR), and the Philippines in the wake of natural disasters and bad weather. Manufacturing in Malaysia and Thailand was undercut by weaker demand from trade partners, but it expanded in Cambodia and Viet Nam. Meanwhile, lower tourist arrivals dragged on service growth in Myanmar and Thailand. The forecast dip in subregional growth in 2018 is retained, but now growth is expected to remain at 5.1% in 2019 in light of downward revisions for Indonesia, the Lao PDR, Malaysia, and Thailand.

In Indonesia, strong domestic demand supported GDP growth at 5.2% in the first 3 quarters of 2018, in line with the *Update* forecast. Household consumption picked up, and fixed investment accelerated with several public projects completing their construction phase. Strong domestic demand expanded imports even as a weaker external environment slowed export growth. Weighing these developments, the growth forecast for 2018 is maintained at 5.2%. Private consumption is expected to remain robust in 2019, and government spending will add impetus to domestic demand ahead of national elections in April. However, private investors are expected to await developments, and private sector credit growth may languish as monetary policy prioritizes stability over growth. Net exports are expected to weigh on growth as imports of capital goods continue in support of infrastructure projects in the first half of 2019 and as earnings from commodities such as palm oil remain moderate amid soft demand. This *Supplement* downgrades the 2019 growth forecast slightly from 5.3% to 5.2%.

Malaysia's economy slowed to 4.4% in Q3 of 2018 as exports lost steam in line with weaker export demand for electronics, natural gas flows interrupted by pipeline repair, and palm oil earnings hit by softer commodity prices. The weakening impact of a recent tax holiday on consumer spending further prompted a downward revision to the GDP growth forecast for 2018 from 5.0% in the *Update* to 4.7%. Domestic and external factors similarly prompt a slight downgrade to the 2019 growth forecast from 4.8% to 4.7%. Government efforts to promote consumption growth that have been prominent in 2018 will likely give way to more prudent and targeted fuel subsidies, and some public investment projects previously planned have been cancelled. Exports should moderate as uncertainties from PRC–US trade tensions weigh on business investment.

Philippine GDP growth remained strong at 6.3% in the first 3 quarters of 2018, though moderating from 6.8% a year earlier. Investment was the biggest contributor to growth, followed by household consumption. Investment growth accelerated to 16.7% in the first 3 quarters from 9.8%. Public and private construction growth quickened, as did investment in durable equipment. Growth in government spending also picked up on higher social service expenditure and on salary hikes for government workers. Drag on GDP growth from net exports deepened, however, as strong domestic demand fueled a surge in imports, especially of capital goods, and as a weaker external environment slowed export growth. GDP growth is seen accelerating through 2019, supported by robust public and private investment. Growth forecasts are maintained at 6.4% for 2018 and 6.7% for 2019.

Thailand's economy expanded by 4.3% in January–September this year, supported by robust private consumption and investment. Private consumption was boosted by improved farm incomes, consistently low inflation and interest rates, and measures to support low-income groups. Private investment was supported by accelerated construction and purchases of machinery and equipment. Meanwhile, export volume fell in Q3 as the volume of agricultural exports dropped because of a high base effect but also pressure from PRC–US trade tensions, a decline in domestic aquaculture production, and weaker growth in manufacturing export volume as economic growth slowed in some trade partners and tensions rose over protectionist trade measures. The growth forecast for 2018 is adjusted down from 4.5% in the *Update* to 4.3% as economic growth in Q3 slowed to 3.3% from a strong 4.6% in Q2. Growth in consumption and private investment were offset by falling exports. On the production side, manufacturing growth decelerated by half to 1.6% in Q3 from 3.2% in Q2, mainly reflecting slower growth in vehicle production. The Nikkei Thailand manufacturing purchasing managers' index slipped to 48.9 in October from a 50.0 reading in September right on the line separating expansion from contraction. Growth in hotels and restaurants weakened as tourist arrivals from the PRC and the Russian Federation fell. The growth forecast for 2019 is likewise pared to 4.1% in response to a weaker global environment even as domestic demand is expected to remain robust.

Singapore grew by 2.2% in Q3 of 2018, bringing 9-month growth to 3.6%. Services maintained growth at 2.4% in the quarter with contributions largely from finance and insurance, while manufacturing growth slowed to 3.5%, weighed down by a decline in general manufacturing. Construction contracted as well, by 2.3%, with weakening public sector construction. The manufacturing purchasing managers' index is expected to moderate, reflecting slower exports, new orders, and production, but it remains expansionary. Service growth is expected to improve as business expectations for services in the next 6 months remain positive, particularly for information and communication and, in anticipation of the holidays, for accommodation and food services. Growth will be further supported by continuing expansion in domestic demand, which grew by 3.3% in the first 3 quarters of 2018, and in public consumption expenditure, up by 4.8%. With these developments and a revision to first half growth from 4.2% to 4.4%, the forecast for growth in 2018 is revised up from 3.1% to 3.3%. Prospects for 2019 remain as projected in the *Update*.

Viet Nam saw GDP growth in the first 3 quarters of 2018 reach 7.0%, improving on 6.4% a year earlier. Growth was propelled by solid performances in agriculture, industry, and services. Agriculture grew by 3.7% in the first 3 quarters, up from 2.9% last year thanks to robust production growth in fisheries, forestry, and farming. Industry expanded by 9.0%, accelerating from 6.9% expansion a year earlier on the strength of a 12.7% rise in manufacturing output. Construction grew by 8.5%. Driven by a hefty rise in tourist arrivals and robust banking activity, services expanded by 6.9%. On the demand side, retail and wholesale trade rose by 8.5%, indicating strong domestic consumption. Investment moderated to 7.7% as government capital expenditure slowed. The trade surplus expanded to $6.4 billion in the first 10 months, with exports outpacing imports on rapidly expanding sales of phones, components, textiles, and agricultural products. As these developments align with forecasts in the *Update*, growth projections are unchanged at 6.9% for 2018 and 6.8% for 2019.

Central Asia

Projected growth in Central Asia as a whole in 2018 is now raised from 4.1% in the *Update* to 4.2%, largely reflecting an improved outlook for Kazakhstan, the subregion's largest economy. Meanwhile, growth prospects slipped for a number of other economies in the subregion. Sluggish public investment has moderated growth in Azerbaijan. While economic activity in Georgia remained robust in the first half of the year, it is expected to moderate toward the end of the year due to slower-than-expected growth of capital expenditure in public investment and adverse impacts from an unfolding crisis in neighboring Turkey. The subregional growth projection for 2019 is raised from 4.2% in the *Update* to 4.3% as recovery in public investment and higher output from the Shah Deniz gas field enhance prospects in Azerbaijan.

In the first 9 months of 2018, Kazakhstan's growth rate reached 4.1%, higher than anticipated in the *Update* but down from 4.3% a year earlier. The latest data indicate robust construction growth at 4.4% in the first 9 months of the year, higher than earlier anticipated. Services grew by 3.9%, also higher than anticipated. Reflecting these developments outside of the large hydrocarbon sector, the growth projection for 2018 is raised from 3.7% in the *Update* to 4.0%. As oil prices are projected to moderate in 2019, this *Supplement* marginally lowers the growth projection for 2019 from 3.9% to 3.8%.

The Pacific

Growth in the Pacific is still projected to slow by half to 1.1% in 2018, as forecast in the *Update*, held back by natural disasters in Papua New Guinea and Tonga. Continuing uncertainty surrounding key growth drivers, notably tourism in Palau and public spending in Timor-Leste, also constrain economic activity this year. The 2018 growth projection for Fiji is reduced to accommodate the adverse impacts of cyclone damage on agriculture and subsequent dry conditions, and stimulus from construction that was weaker than expected. By contrast, economic activity in the Cook Islands significantly surpassed expectations in its recently concluded fiscal year as tourism performed well and public investment was sustained. In 2019, economic growth in the subregion is expected to accelerate to 3.1%, this forecast also unchanged from the *Update*. An expected rebound in Papua New Guinea, the Pacific's largest economy, is seen as the main driver of this acceleration, helped by stable or higher growth in most of the smaller economies. Consistent with trends observed in 2017–2018, the 2019 growth outlook for Fiji is revised down as slow implementation of capital projects is expected to continue, while projected growth in the Cook Islands is upgraded in view of continued momentum in tourism and public investment.

Inflation outlook

Commodity prices have been on a downtrend since the release of the *Update*. Central banks continue to implement measures to counter price and foreign exchange volatility resulting from a stronger US dollar, the impact of bad weather and natural calamities, slowing global demand for exports, and rising trade tensions between the PRC and the US. These and country-specific factors prompt downward revisions to regional inflation forecasts from 2.8% to 2.6% for 2018 and from 2.8% to 2.7% for 2019 (Table 2).

Crude oil prices exhibited significant volatility from August to November, reaching a low of $70 per barrel in August before peaking at $86 in early October and then declining below $60 in late November. The oil price decline in November was faster than in any month since October 2008. Prices reached 4-year highs in early October, as markets factored in possible impacts from US sanctions on Iranian oil exports, but have since declined on recent downgrades to global growth forecasts and increased supply from members of the Organization of the Petroleum Exporting Countries, notably Saudi Arabia. Fears of a supply shortfall receded further as the US allowed eight countries to continue buying oil from Iran. Recently, oil prices have been on the rise as major oil producers agreed to cut oil production and as the demand outlook brightens with the pause in the escalation of the trade conflict between the PRC and the US. The average price in the year to date is $72.3 per barrel. The Brent futures curve has flattened considerably in recent months, reflecting recent petroleum oversupply and lower demand. Forecasts for oil prices in the *Update* published in September are thus lowered to $72 per barrel in 2018 and $70 in 2019.

After gaining momentum earlier in the year, most food commodity prices weakened significantly from September to November. This was mostly in response to upward revisions to production estimates for maize, rice, and wheat. In the first 11 months of the year, food inflation averaged 0.5%. While grain prices continued their general upward trend, the other two World Bank food price indexes—for edible oil and meal and for "other food"—declined. Edible oil and meal prices decreased by 2.3% from January to November of this year, mainly reflecting falls in international prices for palm oil and soybeans. Palm oil prices fell because of large inventories held by major exporting countries as global import demand remained sluggish, and market prices for soybeans dampened with strong US production in the face of lower PRC demand in response to a 25% tariff imposed on US soybean imports. Similarly, the "other food" price index fell by 3.3% on account of declines in sugar and meat prices. Bucking the trend, grain prices increased by 10.3% in the same period. Bad weather, especially in Australia, the Russian Federation, and Ukraine, supported wheat prices while robust trade pushed up maize prices. By contrast, rice prices dropped as harvest pressure, competition among exporters, and currency movements weighed on rice price quotations. Early indications for the 2018/19 crop season point to favorable crop yields. Given recent major declines in food commodity prices, the food commodity price index is now expected to rise by only 0.3% in 2018 and 1.0% in 2019.

The East Asia inflation forecast is maintained at 2.1% for both 2018 and 2019, as in the *Update*. In the first 11 months of 2018, consumer inflation in the PRC averaged 2.1%. Consumer price inflation edged up temporarily to 2.5% in both September and October, mostly on higher food prices, but declined to 2.2% in November. Producer price inflation continued to decline in November. The inflation forecast for the PRC remains unchanged from the *Update* at 2.2% for 2018 and 2019.

Headline inflation in Hong Kong, China averaged 2.4% in the first 10 months of the year and may be subject to further mild upward pressure toward the end of the year as local prices, such as for fresh vegetables and home rent, increase with sustained economic expansion. Inflation is expected to remain moderate in 2019. This *Supplement* raises inflation forecasts only slightly to 2.4% in 2018 and 2.3% in 2019. In the ROK, inflation averaged 1.6% in the first 11 months of the year, exactly matching the central bank's target for the full year. Core inflation, which excludes food and energy prices, remained stable at 1.3%, but in November inflation nevertheless reached 2.0% on account of higher prices for farm goods and petroleum products. On 30 November, the central bank therefore decided on a rate hike of 25 basis points to 1.75%, the only increase since late last year. This *Supplement* revises inflation projections from 1.8% for both years in the *Update* down to 1.6% for 2018 and 1.7% for 2019.

Because inflationary pressures have receded in many South Asian countries, the inflation projection for South Asia in 2018 is cut from 4.9% in the *Update* to 4.3%. Falling food prices prompt a downgrade to India's inflation projection for FY2018 from 5.0% to 4.3%. In the first 7 months of FY2018, inflation in India averaged only 4.2%, but with economic activity remaining robust, inflation is forecast to rise gradually to 4.7% in FY2019. In Pakistan, consumer price inflation accelerated to 6.8% in October, raising the average in the first 4 months of FY2019 to 5.9%. Inflation in Bangladesh remained stable in the first 4 months of FY2019, but with headline inflation declining to 5.4% in October from 6.0% a year earlier. In Sri Lanka, inflation has slowed more than anticipated in the *Update*, largely because of falling food prices, to average 2.4% annually from January to October. Inflation in Bhutan, Maldives, and Nepal similarly moderated somewhat in recent months as food inflation eased. The subregional inflation forecast for 2019 is revised down from 5.2% to 5.0%.

In Southeast Asia, the central banks of Indonesia and the Philippines raised policy interest rates again in October and November. Indonesia aggressively tightened policy rates to ease pressure on the balance of payments. Government fuel subsidies kept inflation low in Indonesia and Malaysia. By contrast, higher fuel prices and depreciating local currencies built up inflationary pressure in the Lao PDR, Myanmar, and the Philippines, as did heavy rains that damaged agricultural production in the Lao PDR and the Philippines. In sum, the inflation forecast for the subregion is downgraded to 2.7% in 2018 and 2.8% in 2019.

In Indonesia, inflation averaged 3.2% in the first 10 months of 2018, well within the target range of 2.5%–4.5% set by the central bank. In the rest of this year and into next year, inflation is expected to remain relatively muted thanks to deft supply management and energy prices remaining unchanged. Imported inflation following recent rupiah depreciation is expected to be minimal. Inflation forecasts are revised down to 3.2% for both years. Inflation has been generally low in Malaysia, averaging only 1.1% in the first

Table 2 Inflation (%)

	2017	2018		2019	
		ADO 2018 Update	*ADOS*	*ADO 2018 Update*	*ADOS*
Developing Asia	**2.2**	**2.8**	**2.6**	**2.8**	**2.7**
Developing Asia excluding the NIEs	**2.3**	**2.9**	**2.8**	**3.0**	**2.9**
Central Asia	**9.2**	**8.4**	**8.0**	**7.7**	**7.8**
Kazakhstan	7.4	7.0	6.3	6.5	6.5
East Asia	**1.5**	**2.1**	**2.1**	**2.1**	**2.1**
Hong Kong, China	1.5	2.3	2.4	2.2	2.3
People's Republic of China	1.5	2.2	2.2	2.2	2.2
Republic of Korea	1.9	1.8	1.6	1.8	1.7
Taipei,China	0.6	1.4	1.4	1.3	1.3
South Asia	**4.0**	**4.9**	**4.3**	**5.2**	**5.0**
India	3.6	5.0	4.3	5.0	4.7
Southeast Asia	**2.8**	**2.9**	**2.7**	**2.9**	**2.8**
Indonesia	3.8	3.4	3.2	3.5	3.2
Malaysia	3.8	1.4	1.2	2.0	2.0
Philippines	2.9	5.0	5.3	4.0	4.0
Singapore	0.6	0.7	0.5	1.4	1.3
Thailand	0.7	1.3	1.1	1.4	1.2
Viet Nam	3.5	4.0	4.0	4.5	4.5
The Pacific	**4.2**	**4.2**	**4.3**	**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 Update*; ADB estimates.

10 months of 2018 thanks to unexpectedly lower food and transport prices. Inflation forecasts are thus revised down to 1.2% for 2018 before rising to 2.0% next year as the impact of the tax holiday fades and fuel subsidy coverage narrows. In Thailand, average inflation in the year to date is, at 1.2%, lower than the forecast 1.3% in the *Update*. With growth slowing and global oil prices falling, inflation forecasts are revised down to 1.1% for 2018 and 1.2% for 2019. Singapore's inflation was 0.5% in the first 10 months of 2018. Considering lower food and retail inflation, a steeper decline in private road transport costs, and the likely stabilization of global oil and food prices next year, inflation projections are revised down to 0.5% for 2018 and 1.3% for 2019.

In contrast, the Philippines saw inflation moderate to 6.0% in November from a high of 6.7% in October, for an average of 5.2% in the first 11 months, well up from 2.9% a year earlier. Food prices rose significantly owing to weak agricultural output, and high global oil prices early in the year and new excise taxes contributed to inflation. While inflation is expected to ease, the full-year average is still likely to exceed the projection in the *Update*. The inflation forecast for 2018 is therefore revised up from 5.0% to 5.3%. The recent buildup in inflationary pressure should moderate next year, with inflation still projected at 4.0%, as in the *Update*. Tight monetary policy will kick in following a cumulative rate hike of 175 basis points implemented from May to November 2018.

Central Asian inflation is now projected at 8.0% in 2018, lower than 8.4% in the *Update*, mainly reflecting downward revisions for Azerbaijan, Kazakhstan, and the Kyrgyz Republic. Meanwhile, the subregional inflation projection for 2019 is revised up on new developments in the three South Caucasus economies. In Kazakhstan, the central bank's strongly demonstrated commitment to its inflation target supports lowering the inflation projection for 2018 from 7.0% in the *Update* to 6.3%. Though inflation in the first 10 months of 2018 was only 6.2%, some seasonal upswing is expected toward the end of the year. The forecast for 2019 remains unchanged at 6.5%. Azerbaijan's inflation projections are revised down for 2018 and up for 2019 to conform with adjustments to growth projections. Inflation projections for Armenia are raised for both 2018 and 2019 because inflation in the first 10 months of 2018 was higher than a year earlier, as well as in anticipation of increases in excise tax and customs duties. Georgia's inflation rate is expected to edge up in 2019 as currency depreciation continues. Inflation projections for the other Central Asian economies are unchanged from the *Update*.

The 2018 inflation projection for the Pacific is revised up to 4.3%, or 0.1 percentage points higher than in the *Update*, reflecting unexpectedly sharp price increases in Fiji following tax hikes in June for alcohol and tobacco. Inflation is still expected to ease to 3.9% in 2019 as international food and fuel prices stabilize, and despite a higher forecast for Samoa reflecting increased education costs and taxes on alcohol and tobacco.

Asian Development Outlook Supplement

Asian Development Outlook is the main economic forecasting product from ADB. It is published each April with an *Update* published in September and brief *Supplements* published in July and December.

Asian Development Bank

ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 67 members—48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

Printed on recycled paper

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ISBN 978-92-9261-436-2 (print), 978-92-9261-437-9 (electronic)
Publication Stock No. FLS189772-3
DOI: http://dx.doi.org/10.22617/FLS189772-3

Notes:
In this publication, "$" refers to US dollars. ADB recognizes "China" as People's Republic of China and "Vietnam" as Viet Nam.