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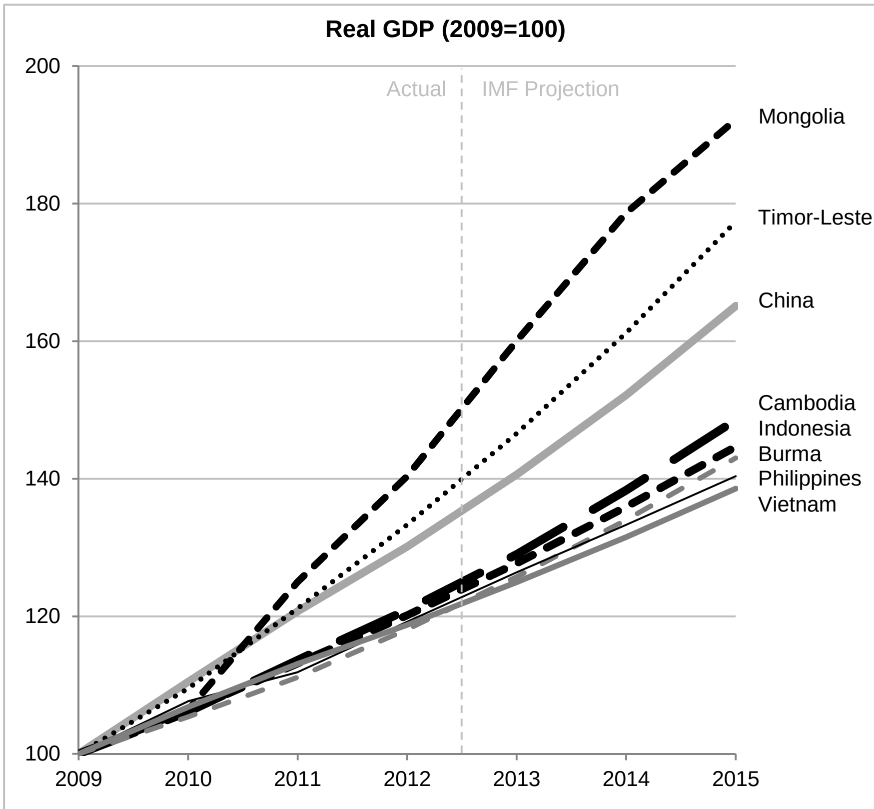
EADS Economic Trends Report

East Asia

May 2013

Economic Overview



SOURCE: IMF, *World Economic Outlook*, April 2013.

For years the fastest growing developing region, East Asian economic growth moderated only slightly in 2012 and projected growth rates in 2013 will remain robust.

China's economy grew by at least 9.0 percent each year 2002–2011 (with double-digit growth six times in that span) and the 7.8 percent growth rate in 2012 seems "mild" only in that context. The IMF is projecting that the Chinese economy will remain in a growth trend of around 8.0 percent each year for the 2013–2015 period. As the real estate market has cooled and the government has imposed restrictions on investment in properties, fixed asset investment spending lost some of its vitality, and consumption spending decelerated. Fiscal policy moves in 2012 included subsidies to consumption and tax reform plans; the net impact was to lower the cyclically-adjusted primary fiscal surplus by a modest amount. Monetary policy in 2012 was accommodative, with two cuts in the one-year benchmark interest rate and the reserve requirement ratio.

Vietnam is at an important transition point in its economic development. A long run of rapid economic growth can only be sustained by a resolution of banking sector problems and structural reforms to the state-owned enterprise (SOE) sector. While foreign direct investment (FDI) continues to flow into Vietnam at high levels, domestic investment growth will need progress on banks and SOEs, along with improvements to the business environment. The World Economic Forum's *Global Competitiveness Index* ranking for Vietnam is now at 75th out of 144 countries—down 16 places in just two years. Fiscal tightening pushed real GDP growth down to 5.0 percent for 2012, the slowest growth rate since 1999, but inflation was cut sharply, the exchange rate stabilized, foreign reserves rose, and the current account surplus hit a record level. The government began to implement banking reforms last year, announced a plan to develop the bond market in February 2013, and plans to announce SOE reforms by mid-2013. Vietnam's government is working with the IMF and World Bank on a comprehensive finance sector assessment to be completed during 2013.

Countries covered in this report include Burma, Cambodia, China, Indonesia, Mongolia, Philippines, Timor-Leste, and Vietnam. Due to data limitations and space constraints, not all countries are represented in every graph or analytical section.

Despite a decline in exports, Indonesia's economy expanded by more than 6 percent in 2012 for the third straight year and the IMF projects a similar pace through 2015. Private consumption led the charge, with auto sales up by 25 percent despite an increase by banks of the minimum down payment on vehicles. Investment spending was also brisk, with outlays on infrastructure and buildings up nearly 8 percent and on machinery and equipment up nearly 13 percent. The central government aggressively pushed infrastructure improvements and raised its capital spending by nearly 19 percent. Strong overall economic growth happened despite a slowing growth rate in manufacturing and growth in mining output of less than 2 percent. The services sector is buoyant, with demand for cell phone and internet service rapidly rising. The unemployment rate dropped by a half percentage point to 6.1 percent last year and the rate of formal sector employment was up as workers continued to shift out of agriculture. To offset the anticipated weakness in exports, the Indonesian government relaxed fiscal policy and raised the target deficit to 2.2 percent of GDP, from 1.1 percent the prior year. As it turned out, the deficit was up to only 1.8 percent of GDP, and the debt-to-GDP ratio fell to 24.0 percent. The economic outlook for Indonesia 2013–2015 is favorable and based on consumption and investment spending. If world trade picks up, the export sector will boost the robust economy even further.

The Cambodian economy remained in high gear in 2012, growing by more than 6 percent a year as it has done since 2010. All three sectors—agriculture, industry, and services—showed strength in 2012. Crop production was up by more than 4 percent despite floods in some areas and droughts in others. Tourism was boosted by an increased number of direct flights from foreign cities. In 2013, the government remains committed to fiscal consolidation, but national elections in July will tempt some loosening of the reins on spending.

East Timor is riding an oil boom to double-digit economic growth rates and even a planned fiscal tightening 2013–2014 will only temper the pace slightly. Petroleum revenues are enabling large gains in government spending, while keeping the fiscal balance in surplus. Investment is also rising in the non-oil sector of the economy. Capacity constraints related to infrastructure are keeping actual expenditures lagging behind the planned outlays, but the national electrification program has advanced sufficiently so that the system has excess capacity. With double-digit GDP growth rates projects to continue through 2015, the excess capacity will be rapidly taken up.

With Burmese-U.S. relations on a new footing in 2012, the economy responded to reforms in general by accelerating to a growth rate over 6 percent. The IMF is projecting similar growth rates 2013–2015, as the EU reinstates favorable market treatment for Burmese exports while the coming online this year of two large gas fields will more than double gas production. The government formerly limited foreign investment to energy or mining, but in 2012 greatly expanded the number of projects in manufacturing. In addition to the foreign inflows, the number of new domestic company registrations has more than doubled in four years. The Burmese government is proposing to simplify the tax system, broaden the tax base, and shift revenues away from natural resources to a value-added tax. The future of a newly liberalizing Burma has uncertainties, but the Asian Development Bank (ADB) notes that "the government's ambitious reform agenda is commensurate with the catching up necessary to align policies with current international practice after [a] long period of isolation."

The Philippine economy was running on all gears in 2012, with strong private consumption, government spending, investment, and net exports pushing up the growth rate to 6.6 percent. With inflation in check, remittances from overseas up by 6.5 percent in dollar terms, and higher employment levels, private consumption was the leading contributor to economic growth. Higher worker remittances mostly reflect a larger number of workers employed overseas, along with the financial recovery of many Middle Eastern oil economies. The services sector remains strong, with retail trade accounting for a major part of the expansion. Manufacturing, led by food processing, was up more than 5 percent, while expanded rice and maize production boosted the agriculture sector by nearly 3 percent. Government spending on infrastructure had been slowed by policy reforms in 2011, but surged ahead by 58 percent in 2012. Despite higher spending, the fiscal deficit only widened to 2.3 percent of

GDP as the ratio of tax revenue to GDP improved. Economic growth above 5 percent annually is projected for 2013–2015. If the government can achieve a settlement with a militant group in Mindanao, the restoration of peace could jumpstart economic growth in that large southern region of the country.

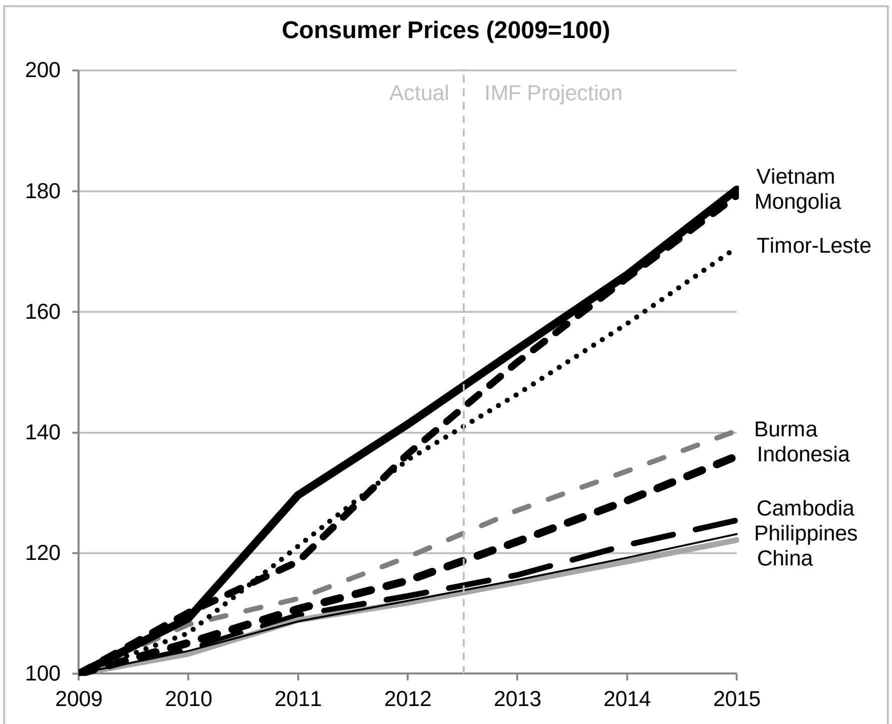
The economy is feeling chipper in Mongolia, with real GDP up by 12.3 percent in 2012 after an ebullient gain of 17.5 percent in 2011. Although the mining sector can lay claim to leading the charge, it is not alone in this hectic pace. Construction is booming while memories of the 2004–2008 bubble in real estate remain fresh. Agriculture, in which a third of the labor force is engaged, has now finally emerged after a disastrous 2009/2010 in which nearly a fifth of the country's livestock was lost. Mongolia's government has been pursuing a pro-cyclical fiscal policy, with rising budget deficits. Monetary policy has been mildly counter-cyclical, but has yet to tame inflation. A tighter fiscal policy is expected during 2014–2015, assuming the government follows the long-term mechanisms established under the 2010 Fiscal Stability Law.

East Asia has for many years been a leading source of rapid economic growth among developing economies, but the high flyers were relatively few in number. The widespread quickening of the pace in this region is an impressive achievement, even given the track record of East Asia over the past several decades.

Real GDP Growth, 2013 (IMF Projections)	East Asia 7.8%	Central Asia 6.9%	South Asia 4.7%

Inflation

Inflation moderated throughout East Asia in 2012, with Burma and Mongolia being two contrary examples. In Burma, inflation gained two percentage points to 6.1 percent in 2012, but it remains well below the levels above 20 percent seen in 2008 and before. Food prices drove inflation in 2012, at first to lower levels and then up higher by year's end. In Mongolia, overall inflation nearly doubled in 2012 to 15 percent, but the underlying core inflation rate was only about two-thirds as high as that overall rate. Food prices are up and the rapid rise in government spending is fortifying price pressures.



SOURCE: IMF, *World Economic Outlook*, April 2013.

Inflation in China slowed from 5.4 percent in 2011 to 2.7 percent last year. Good weather and a bumper crop tamed prices pressures, but more stable housing prices also turned the corner on inflation.

Inflation in Vietnam doubled in 2011 to over 18 percent, but fiscal and monetary tightening, along with a bountiful agricultural season, got inflation back down to single digits in 2012. The improvement was swift enough that by mid-year 2012, the central bank was comfortable lowering its key policy rates. Inflation is expected to remain in the single digits through the projection period out to 2015, but staying in the high single digits will leave Vietnam with inflationary pressures matched only by Mongolia in the East Asia region.

Indonesian inflation eased in 2012, down to 4.3 percent as global food prices fell, the domestic harvest was strong, and the government delayed hiking fuel prices. Indonesia adopted inflation targeting in 2005 and a declining trend has followed. Bank Indonesia lowered its policy interest rate and the overnight deposit facility rate in February 2012 and only partly reversed the easing later in the year. Credit growth stayed strong throughout 2012, rising by more than 23 percent.

In Cambodia, higher yields for paddy rice and the fisheries helped to tame food prices. The overall rate of inflation was cut in half during 2012. Good weather so far in 2013 suggests continued mild inflation, but the outlook for 2014 includes the possibility of price pressures arising from supply constraints as the economy stays in up tempo mode.

Timor-Leste remains with double-digit inflation rates, but the 11.8 percent for 2012 was down from 13.5 percent in 2011. Easing world food prices helped, as did U.S. dollar appreciation. Timor-Leste is a dollarized economy and a stronger U.S. dollar keeps its import prices in check. The outlook for inflation is partly dependent on the extent to which capacity constraints can be eased; planned government expenditures will add to price pressures otherwise.

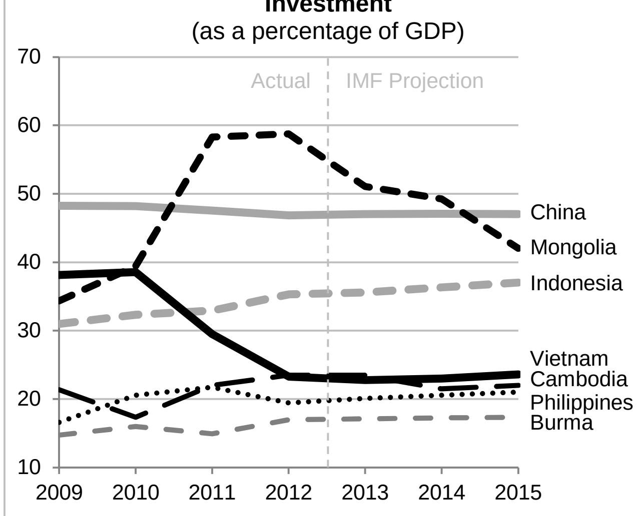
Despite the quickening pace of the economy, inflation in the Philippines moderated to 3.1 percent in 2012. A favorable harvest kept food price pressures at bay while an appreciating peso kept the traded goods sector in line. Improved price stability prompted the central bank to cut policy interest rates. Credit to the private sector was up nearly 18 percent last year.

CPI Inflation, 2013 (IMF Projections)	East Asia 6.1%	Central Asia 8.0%	South Asia 8.1%

Investment

Investment remains robust in China, despite any uncertainties over future growth rates for the overall economy. Large infrastructure projects by the government remain on track through 2015, keeping the investment ratio among the highest in the region.

As a percent of GDP, total investment in Vietnam dropped sharply in 2012 and is projected to remain relatively stable at close to 23 percent. FDI into Vietnam remained strong last year, but mild growth in domestic credit was reflected in reluctance by domestic investors to expand capital outlays. The government did push up some public investment projects, but the overall outcome was a drop in the investment ratio.



SOURCE: IMF, *World Economic Outlook*, April 2013.

FDI into Indonesia remains strong, with large capacity increases by automakers and other industries planned. The investment-to-GDP ratio is projected to trend above 35 percent as upgrades to the country's credit rating, lower interest rates, higher public budgets for infrastructure, and steps by the government to improve its budget execution all point toward more capital outlays. The government is also reviewing restrictions on foreign investment and is likely to lift some of them this year.

Cambodia's investment ratio continued to increase slightly in 2012, as FDI picked up and domestic bank lending surged. Building approvals in 2012 rose sharply, suggesting that investment activity will remain robust in 2013. Future offshore oil exploration will add to Cambodia's investment sector, but the timing of a big impact is not clear. To foster more infrastructure spending, the government is strengthening the legal, regulatory, and institutional environment for public-private partnerships.

Timor-Leste's petroleum funds will sustain high investment spending for several years, but the longer term challenge is to promote a greater role by the non-oil private sector. The government is developing a new law to govern land titles, establishing a one-stop shop for new business start-ups, and implementing a new framework for public-private partnerships, all of which will facilitate private sector growth.

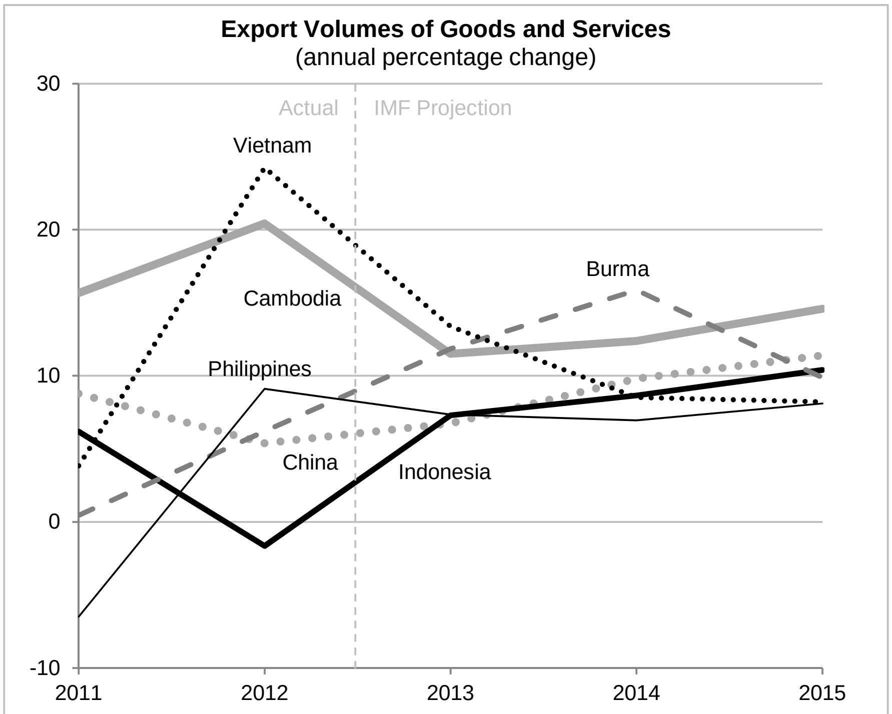
Although Burma's investment-to-GDP ratio remains the lowest in the region, investment spending is rising along with the economy. Government reforms have fostered greater foreign investment, as well as gains for domestic company outlays.

The Philippines economy will continue to be led by consumption spending, but a February 2013 survey of local businesses showed a positive outlook, with hiring plans afoot. There is a high demand for housing and office space. Imports of capital goods were up by 14 percent in 2012 and higher stock prices are fostering corporate growth. Bank lending for production purposes in February 2013 was more than 15 percent higher than the year-earlier month. In March 2013, the Philippines received its first ever investment grade credit rating, which will further bolster the investment climate. Fitch raised its sovereign rating for debt, citing the Philippines resilient economy, strong external balance sheet, improved fiscal management savvy, and the drop in the government debt-to-GDP ratio.

Mining is the leading sector for investment in Mongolia, but a relatively new Development Bank of Mongolia, funded by government sale of bonds, is becoming an increasingly important source of infrastructure spending. In addition, the government is planning to expand public-private partnerships in boosting electricity generation. At the present time, Mongolia is heavily dependent on Russian and Chinese coal for its energy needs, but those needs are growing rapidly. Increased investment is needed to tap the country's own proven reserves of coal and oil.

Investment, 2013 (as a percentage of GDP) (IMF Projections)	East Asia 31.0%	South Asia 28.8%	Central Asia 27.1%

Trade



SOURCE: IMF, *World Economic Outlook*, April 2013.

Chinese exports grew relatively slowly in 2012, but even weaker demand for imports pushed the trade surplus up by around 1 percent of GDP. Exports to the European Union (EU), China's largest market, contracted in 2012 as the EU remained economically subdued, a sobering reminder of China's vulnerability to global malaise.

During 2012, Vietnam became the world's largest exporter of rice and coffee as agricultural harvests were generally very favorable. Manufacturing exports were also up sharply in 2012, with numerous new foreign-owned factories starting production last year. The proportion of high-tech products in total exports hit 18 percent in 2012, up from 4 percent in 2002. Continued economic growth in China is expected to keep demand for Vietnamese exports strong. Import demand, squeezed by the fiscal tightening 2011–2012, is also likely to accelerate in the next few years. But during 2012, at least, robust exports and tepid imports helped generate a current account surplus of about 6.4 percent of GDP, a sharp reversal from 2008 when the current account was in a deficit equal to nearly 12 percent of GDP.

Indonesia's exports declined in dollar terms during 2012, as its major markets were lackluster and the prices for its main commodities sagged. On the import side, capital goods were up sharply while consumer goods were flat as the rupiah depreciation made spending for foreign goods more costly. Looking forward, demand for exports to China and to other major markets is expected to rise as the world economy gains momentum.

Despite the economic woes in Europe, Cambodian garment and footwear exports to the EU were up by 11 percent in 2012. Milled rice exports were up 5 percent in 2012 to all markets, with most of the strength also in the EU. Exports are projected to continue expanding at double-digit rates during 2013–2015, while tourism receipts continue to surge and help narrow the current account deficit.

In Timor-Leste, the non-oil export sector expanded by nearly 11 percent in 2012 as coffee shipments remained robust. Import demand was lower, as particularly large imports of construction equipment in 2011 were not repeated.

Burmese exports surged in 2010, but their growth rates were relatively tame in 2011 and 2012, as demand in Thailand and China was more subdued. Natural gas exports (38 percent of total exports) last year were flat. Garment exports, however, were up by 18 percent in 2012 and tourism has been on an upswing. The kyat has appreciated in nominal and real terms over the past few years, signaling that the Burmese government will need to monitor the impact of the exchange rate on export competitiveness.

Exports in the Philippines rebounded sharply from a decline in 2011, increasing 9 percent in 2012. Processed food, transport equipment, furniture, and machinery exports were all up sharply. For the year, electronics exports were down, but the trend was reversing itself by the end of 2012 and the outlook for semiconductor and electronics exports in 2013 is favorable. Markets in Southeast Asia are growing rapidly and claiming a higher share of Philippine exports, from 13 percent in 2008 to 19 percent last year. In its *Global Competitiveness Ranking* last year, the World Economic Forum raised the Philippines ten spots, leaving the country in 65th place out of 144 economies. This upbeat news is tempered by the fact that the Philippine economy remains behind regional rivals Thailand, Malaysia, and Indonesia in the rankings.

Exports from Mongolia, which are mostly minerals, were down for 2012 as Chinese demand turned soft. The outlook for 2013 is favorable, as new copper and gold mines start production mid-year. Looking further out, much of the prognosis rests on the tempo of the Chinese economy. With China accounting for the lion's share of Mongolian exports, a sneeze in its large neighbor would give the Mongolian economy a bad case of the flu.

The East Asian economies remain dynamic exporters of goods and services, with export volume growth rates in 2013 that are projected to outpace most of the rest of Asia. The advantage of East Asia on those growth rates is particularly notable with respect to goods exports. The nine East Asian economies for which the IMF projects the growth rate of export volumes of goods all have growth of at least six percent for 2013. Of the 12 other Asian economies, only four are at or above that mark.

Additional Information

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For country-specific data and additional information about the countries covered in this report, please visit the ESDB Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal.

Sources used in compiling this report include the semi-annual *World Economic Outlook* (April 2013) from the International Monetary Fund (http://www.imf.org/), the *World Economic Situation and Prospects 2013* from the United Nations (http://www.un.org/en/development/desa/publications/wesp2013.html), and the annual *Asian Development Outlook* (April 2013) from the Asian Development Bank (http://www.adb.org).