

FOR RELEASE:

In Washington, D.C.: 8:00 A.M., October 13, 2017

Making the Most of the Upswing

The pickup in growth in Asia anticipated in the April 2017 Regional Economic Outlook: Asia and Pacific remains broadly on track, with stronger-than-expected growth in China, Japan, Korea, and Association of Southeast Asian Nations economies helping to compensate for the weaker outlook in Australia and India. Regional output is projected to grow by 5.6 percent in 2017 and 5.5 percent in 2018, 0.1 percentage point higher than expected in April, driven by strong consumption and investment. Capital inflows to the region continued to be sizable in the first half of 2017, and financial conditions are expected to remain supportive. Inflation has been weaker than projected, partly on account of lower commodity prices, and projections have been revised downward in most countries. The region is thus currently in a favorable position, but how long this will last is uncertain. Near-term risks to the regional outlook are broadly balanced, but medium-term risks are skewed to the downside. Key downside risks include geopolitical tensions, sudden capital outflows, a shift toward inward-looking policies, policy uncertainty, and a sharp adjustment in China. In addition, the region continues to face serious longer-term challenges including population aging and lagging productivity. Overall, the favorable combination of circumstances provides a window of opportunity to pursue difficult structural reforms to boost growth and make it more inclusive, while addressing imbalances and risks. Fiscal policy recommendations vary across countries, depending on their cyclical positions and fiscal space, while subdued inflation pressures allow for continued accommodative monetary policies in much of the region. Stronger financial policies, however, may be needed in some countries to reduce vulnerabilities, especially from capital flow reversal.

Recent Developments: Stronger Growth and Benign Inflation

Growth outturns in the first half of 2017 surprised on the upside in many Asian countries and European countries, supported by a cyclical upturn in

manufacturing and investment, and stronger trade growth. Looking ahead, the global economy remains healthy, but key drivers have shifted. Relative to the April 2017 *World Economic Outlook (WEO)*, the previous assumption of fiscal stimulus in the United States has been revised to a more neutral stance, but momentum in Europe appears to be stronger than previously envisaged. The China forecast now incorporates increased policy support and therefore higher near-term growth.

Note: Prepared by Pablo Lopez Murphy under the guidance of Koshy Mathai. Xinhao Han, Ananya Shukla, and Qianqian Zhang provided invaluable research assistance. Alessandra Balestieri and Socorro Santayana assisted with production.

The APD *Regional Economic Update* is published annually in the fall to review developments in the Asia and Pacific region. Both projections and policy considerations are those of the IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.



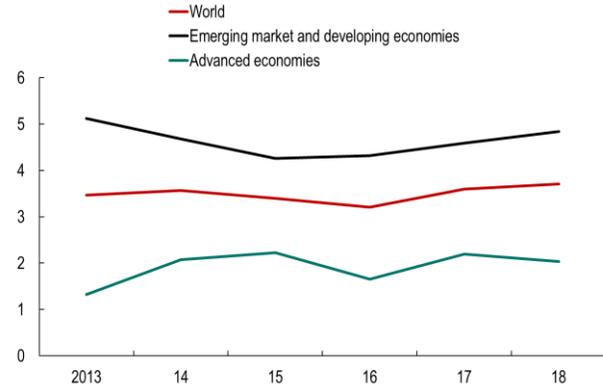
Global growth is projected to accelerate to 3.6 percent in 2017 and further to 3.7 in 2018, up 0.1 percentage point in both years from the April WEO, with improved prospects for both advanced and emerging economies (Figure 1). With the notable exceptions of India and Australia, most countries in the Asia and Pacific region have seen growth outturns in the first half of 2017 that were better than anticipated in the April 2017 *Regional Economic Outlook: Asia and Pacific*, on the back of strong domestic demand. Asia's exports rebounded, partly as a result of restocking in high-tech sectors (see Box 1), and current account balances have remained strong in most countries.

Global financial conditions remain accommodative, amid market optimism and low volatility. Equity markets in advanced economies are at record highs, bond spreads are tight, and market volatility is unusually low (Figure 2). The US Federal Reserve raised its monetary policy rate in June 2017 to 1.25 percent, but with large fiscal stimulus less likely and the US growth outlook consequently weaker, markets expect a more gradual normalization of monetary policy. Most other advanced-economy central banks have kept policy rates unchanged. Asian stock markets have strengthened during 2017 (Figure 3), while sovereign bond yields have generally declined, except in China (Figure 4), and credit growth in the region has moderated but remains robust (Figure 5). Financial conditions are assumed to remain accommodative as the gradual normalization of policy rates in the United States is offset by further strengthening in risk appetite.

Commodity prices have fallen by about 10 percent this year—about 14 percent for fuels and 5 percent for other commodities (Figure 6)—driven by a mix of supply and demand factors including stronger-than-expected US shale production and lower metals demand from China. Headline inflation in the Asia-Pacific region has softened, influenced by the path of commodity prices (Figure 7) and stronger local currencies, and unlike in most other regions, core inflation is now above headline. Weak inflation pressure allows room for continued accommodative monetary policy.

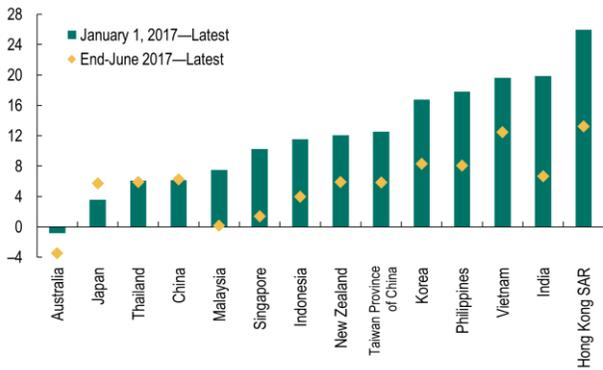
The US dollar has depreciated by about 7 percent in real effective terms since end 2016 given lower interest rates, while the euro has strengthened by a similar amount on increased confidence in the euro area recovery and a decline in political risk. Asian currencies have generally appreciated against the US dollar this year, but the picture is more mixed in real effective terms: while the Australian dollar and the Malaysian ringgit appreciated by about 2 percent, the Vietnamese dong and the Philippine peso depreciated by more than 4 percent (Figure 8). The region experienced a brief period of net capital outflows following the US election in late 2016, but inflows resumed in early 2017 reflecting the region's strong fundamentals, including favorable growth differentials (Figure 9). These inflows, combined with still strong current account balances, and sizable valuation effects, resulted, in part, in an increase in foreign exchange reserves in most countries in the region, including China, during 2017 (Figure 10).

Figure 1. Real GDP Growth
(Percent)



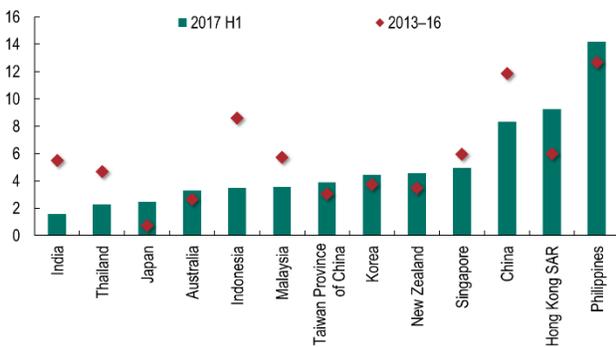
Source: IMF World Economic Outlook.

Figure 3. Equity Price Movements During 2017
(Percent change in stock market index)



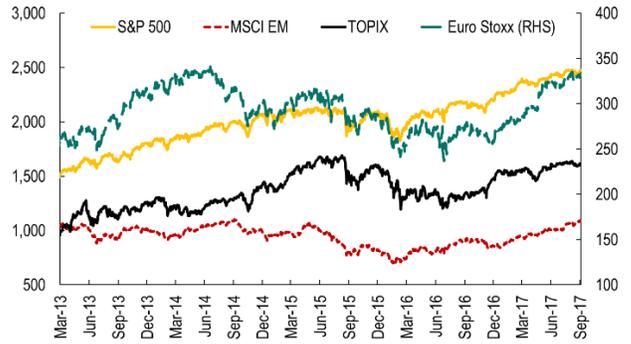
Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Data are as of September 22, 2017.

Figure 5. Real Private Sector Credit Growth
(Year-over-year, percent average)



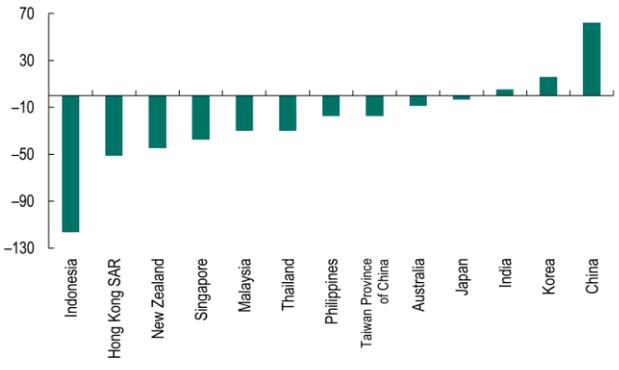
Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations.
Note: Private sector credit is based on the depository corporations survey.

Figure 2. Stock Market Indices
(Index)



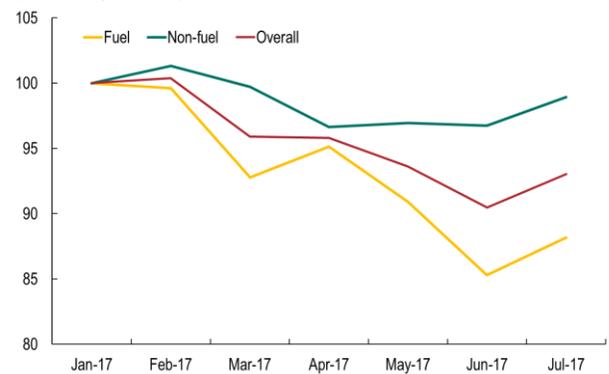
Source: Thomson Reuters Datastream.
Note: MSCI EM = Morgan Stanley Capital International Emerging Markets; RHS = right hand side; S&P 500 = Standard&Poor 500; TOPIX = Tokyo Price Index.

Figure 4. Ten-Year Sovereign Bond Yields Movements During 2017
(Basis points change)



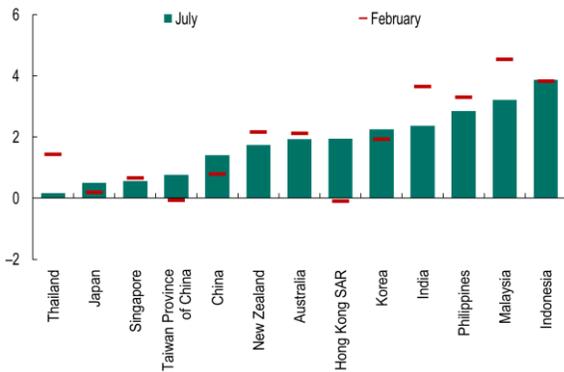
Sources: Bloomberg Finance L.P.; and Haver Analytics.
Note: Data are as of August 30, 2017.

Figure 6. Commodity Prices
(Index, January 2017 = 100)



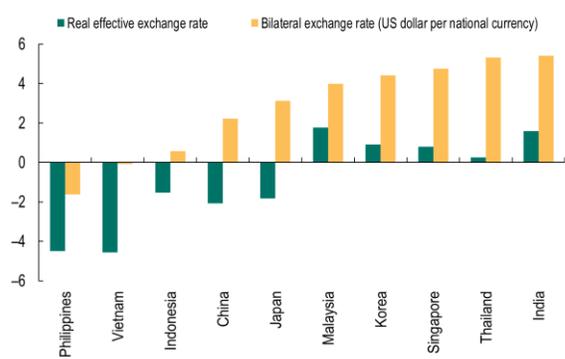
Sources: IMF data and staff calculations.

Figure 7. Headline Inflation in 2017
(Year-over-year percent change)



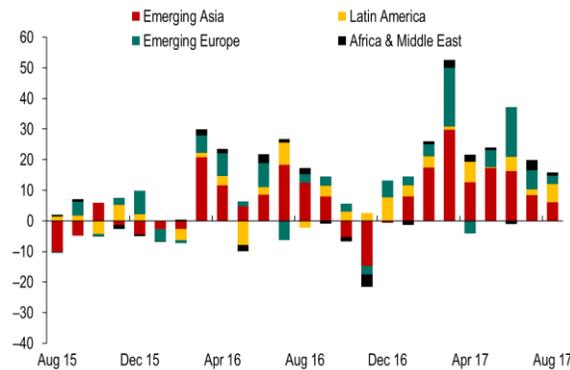
Sources: Haver Analytics; and IMF staff calculations.

Figure 8. Exchange Rates
(Percentage changes since 2017; positive = local currency appreciation)



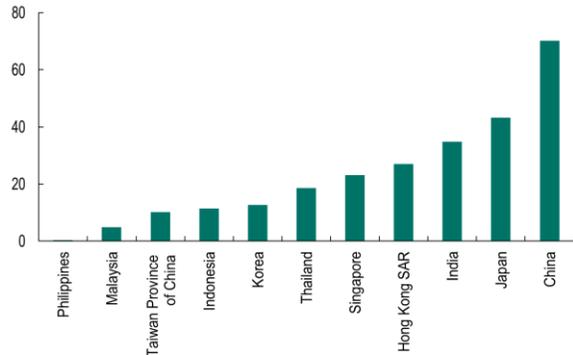
Sources: CEIC Data Company Ltd.; Haver Analytics; OECD TIVA database; and IMF staff calculations. Note: Latest data are as of July 2017.

Figure 9. Total Portfolio Flows
(Billions of US dollars)



Sources: Bloomberg Finance L.P.; Institute of International Finance; and National Sources.

Figure 10. Foreign Exchange Reserve Accumulation Change Since 2017
(Billions of US dollars)



Sources: CEIC Data Company Ltd.; Haver Analytics; and IMF staff calculations. Note: Latest data are as of July 2017.

Recent Developments: Country highlights

- In **China**, growth accelerated to 6.9 percent in the first half of 2017, reflecting recovering global trade, continued strong infrastructure spending, and resilience in the real estate sector. Economic activity surprised on the upside despite tighter financial conditions stemming from policies to contain financial stability risks, especially in the shadow banking and real estate sectors. Core inflation edged up slightly amid buoyant activity, while overall inflation pressure remains contained, with headline consumer price inflation low.

- In **India**, growth slowed in recent quarters on account of disruptions from the currency exchange initiative (“demonetization”) in November 2016 and, more recently, the rollout of the goods and services tax, a landmark tax reform that is expected to unify the domestic market and encourage businesses to move from the informal to the formal sector. Inflation has been low compared with the mid-point target in recent months, driven by lower food prices, allowing the central bank to cut its policy rate in August.
- **Japan** sustained above-potential growth for six consecutive quarters through the second quarter of 2017, underpinned by a pickup in external demand and fiscal

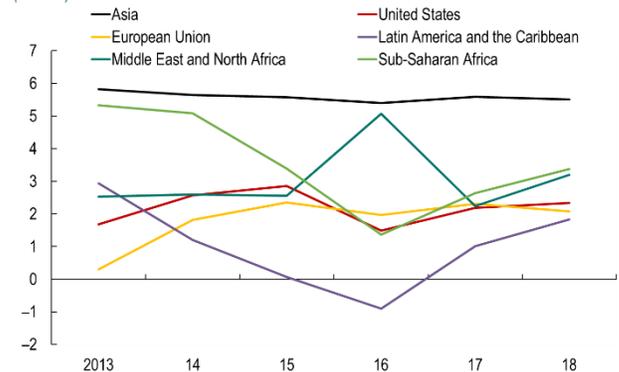
support. The labor market continued to tighten, with unemployment falling to a 25-year low and the job-to-applicant ratio at an all-time high. Nevertheless, wages have yet to respond, and overall inflation pressure remains subdued: headline inflation average about 0.4 percent in the first seven months of 2017, and core inflation hovered around zero.

- **Korea** is recovering, as domestic political tensions ceased following the elections, and business investment has picked up. Exports and imports of goods increased substantially in the first quarter of 2017 but decelerated in the second quarter. Private consumption growth started to pick up in the second quarter from a low base. Inflation has been hovering around 2 percent since the beginning of the year, staying close to the central bank target.
- In the **ASEAN-5**,¹ growth in the first half of 2017 accelerated in most countries compared with 2016. The Philippines—where growth slowed from 6.9 percent in 2016 to 6.4 percent in the first half of 2017—was the exception, but it was still the fastest growing country in the group. In all countries, exports of goods and services were buoyant during 2017. Given subdued inflation pressure, Bank Indonesia cut its policy rate in August.

Outlook: The Upswing Continues

The near-term outlook for the Asia-Pacific region remains strong, supported by the pickup in the global economy and broadly accommodative policies and financial conditions. Asia continues to be the main growth engine of the world (Figure 11) and is projected to grow by 5.6 percent in 2017 and 5.5 percent in 2018, 0.1 percentage point higher in both years compared with April (Table 1). Strong global growth momentum should support Asian exports (though the tech cycle could lose steam, dampening prospects somewhat), and accommodative policies should underpin domestic demand, offsetting a tightening in global financial conditions (Figure 12).

Figure 11. Real GDP Growth Across Regions
(Percent)



Source: IMF World Economic Outlook.

¹ The ASEAN-5 countries are Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Table 1. Asia: Real GDP
(Year-over-year change; percent)

	Estimates and Latest Projections					Difference from April 2017 <i>World Economic Outlook</i>		
	2014	2015	2016	2017	2018	2016	2017	2018
Asia	5.6	5.6	5.4	5.6	5.5	0.1	0.1	0.1
Advanced economies (AEs)	1.8	1.6	1.7	2.1	1.7	0.0	0.2	0.1
Australia	2.8	2.4	2.5	2.2	2.9	0.1	-0.9	-0.1
Japan	0.3	1.1	1.0	1.5	0.7	0.0	0.3	0.1
New Zealand	2.8	3.2	3.6	3.5	3.0	-0.4	0.4	0.1
Hong Kong SAR	2.8	2.4	2.0	3.5	2.7	0.1	1.2	0.1
Korea	3.3	2.8	2.8	3.0	3.0	0.0	0.3	0.1
Taiwan Province of China	4.0	0.7	1.5	2.0	1.9	0.1	0.3	0.0
Singapore	3.6	1.9	2.0	2.5	2.6	0.0	0.3	0.1
Emerging markets and developing economies (EMDEs)¹	6.8	6.8	6.5	6.5	6.5	0.1	0.0	0.1
Bangladesh	6.3	6.8	7.2	7.1	7.0	0.3	0.2	0.0
Brunei Darussalam	-2.5	-0.4	-2.5	-1.3	0.6	0.7	0.0	0.0
Cambodia	7.1	7.2	7.0	6.9	6.8	0.0	0.1	0.0
China	7.3	6.9	6.7	6.8	6.5	0.0	0.2	0.3
India ²	7.5	8.0	7.1	6.7	7.4	0.3	-0.5	-0.3
Indonesia	5.0	4.9	5.0	5.2	5.3	0.0	0.1	0.0
Lao P.D.R.	7.6	7.3	7.0	6.9	6.9	0.1	0.1	0.2
Malaysia	6.0	5.0	4.2	5.4	4.8	0.0	0.9	0.1
Myanmar	8.0	7.0	6.1	7.2	7.6	-0.2	-0.3	0.0
Mongolia	7.9	2.4	1.0	2.0	2.5	0.0	2.2	0.7
Nepal	6.0	3.3	0.4	7.5	5.0	-0.1	2.0	0.4
Philippines	6.1	6.1	6.9	6.6	6.7	0.1	-0.2	-0.2
Sri Lanka	5.0	4.8	4.4	4.7	4.8	0.1	0.2	0.0
Thailand	0.9	2.9	3.2	3.7	3.5	0.0	0.7	0.2
Vietnam	6.0	6.7	6.2	6.3	6.3	0.0	-0.2	0.0
Pacific island countries and other small states	8.5	6.5	3.1	3.7	4.4	-0.2	0.1	-0.2
Bhutan	4.0	6.1	6.2	5.9	11.2	0.0	0.0	0.0
Fiji	5.6	3.8	0.4	3.8	3.5	-1.6	0.1	-0.2
Kiribati	0.4	7.5	4.2	2.8	2.3	1.0	-0.1	0.3
Maldives	7.6	3.3	3.9	4.6	4.7	0.0	0.4	0.0
Marshall Islands	-0.4	1.9	2.0	1.9	1.8	0.2	0.1	0.2
Micronesia	-2.4	3.7	3.0	2.0	1.4	1.1	0.0	-0.1
Nauru	36.5	2.8	10.4	4.0	-4.0	0.0	0.0	0.0
Palau	5.4	11.4	1.9	1.0	5.5	1.9	-4.0	0.5
Papua New Guinea	12.5	9.2	2.4	3.1	2.9	-0.1	0.1	-0.3
Samoa	1.2	1.6	7.1	2.1	0.9	0.6	0.0	0.0
Solomon Islands	2.3	2.5	3.3	3.0	3.1	0.0	0.0	0.1
Timor-Leste	4.3	4.0	5.0	4.0	6.0	0.0	0.0	0.0
Tonga	2.9	3.5	3.1	3.1	3.2	-0.5	-0.8	-0.4
Tuvalu	1.3	9.1	3.0	3.2	2.5	-0.9	1.0	0.2
Vanuatu	2.3	1.6	4.0	4.5	4.0	0.0	0.0	0.0
ASEAN³	4.7	4.7	4.8	5.1	5.1	0.0	0.2	0.0
ASEAN-5⁴	4.4	4.5	4.6	4.9	4.9	0.0	0.3	0.0
EMDEs excluding China and India	4.9	5.1	5.1	5.4	5.4	0.0	0.2	0.0

Sources: IMF, World Economic Outlook database; and IMF staff estimates and projections.

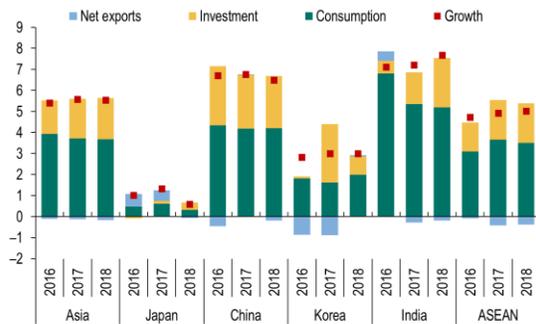
1/ EMDEs excluding Pacific island countries and other small states.

2/ India's data are reported on a fiscal year basis. Its fiscal year starts from April 1 and ends on March 31.

3/ ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

4/ ASEAN-5 comprises Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Figure 12. Contributions to Projected Growth
(Year-over-year, percentage points)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

While the growth outlook has been revised upward, inflation has been marked down to 2.3 percent in 2017, 0.6 percentage point lower than in April, and to 2.8 percent in 2018, as the drag from low commodity prices wanes (Table 2). Current account balances are expected to narrow as countries gradually adjust their external positions to the underlying fundamentals (Figure 13; Table 3). The region is thus currently in a sweet spot, but as described below, the need to place the cyclical upswing on a sustainable trajectory in some countries remain, notably in China. In addition, medium-term risks are to the downside, and over the longer term the region faces secular headwinds, including population aging and slow productivity growth.

Figure 13. Current Account Balances
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations and projections.
Note: ASEAN includes Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

Outlook: Country Highlights

- In **China**, growth was revised up in the near and medium term. Specifically, GDP growth is projected to reach 6.8 percent in 2017 (6.6 percent in April) and average 6.3 percent during 2018–2020 (6.0 percent in April). The 2017 revision largely reflects stronger growth momentum in the first half of the year, while the medium-term upgrade is based on the revised expectation that the government will keep policies (for example, fiscal and credit policies) sufficiently accommodative to achieve its objective of doubling 2010 GDP by 2020. As discussed below, however, these policies also contribute to increased downside risks over time. Headline inflation was revised down and is projected to decline to 1.8 percent in 2017, helped by lower non-core inflation, before gradually reaching 2.6 percent in the medium term.
- In **India**, growth was revised down to 6.7 percent in FY2017 and to 7.4 percent in FY2018, reflecting the recent slowdown in economic activity. Growth will be underpinned by private consumption, which has benefited from low food and energy prices, as well as civil service allowance increases. Headline inflation is projected to stay close to the midpoint of the target band (4 percent \pm 2 percent) in FY2017, while moving to the upper half of the target band in the medium term as food prices recover. The current account deficit should remain modest, financed by robust foreign direct investment inflows.

Table 2. Asia: Consumer Prices*(Year-over-year change; percent)*

	Estimates and Latest Projections					Difference from April 2017 <i>World Economic Outlook</i>		
	2014	2015	2016	2017	2018	2016	2017	2018
Asia	3.2	2.3	2.3	2.3	2.8	-0.1	-0.6	-0.1
Advanced economies (AEs)	2.3	0.8	0.5	1.0	1.2	0.0	-0.4	-0.1
Australia	2.5	1.5	1.3	2.0	2.2	0.0	0.0	-0.2
Japan	2.8	0.8	-0.1	0.4	0.5	0.0	-0.6	-0.1
New Zealand	1.2	0.3	0.6	2.2	2.0	0.0	0.7	0.0
Hong Kong SAR	4.4	3.0	2.6	2.0	2.2	0.0	-0.6	-0.5
Korea	1.3	0.7	1.0	1.9	1.9	0.0	0.1	-0.1
Taiwan Province of China	1.2	-0.3	1.4	1.0	1.4	0.0	-0.4	0.1
Singapore	1.0	-0.5	-0.5	0.9	1.3	0.0	-0.1	-0.5
Emerging markets and developing economies (EMDEs)¹	3.5	2.7	2.8	2.6	3.2	-0.1	-0.7	-0.1
Bangladesh	7.0	6.2	5.7	5.7	5.8	-0.7	-0.7	0.0
Brunei Darussalam	-0.2	-0.4	-0.7	-0.2	0.0	0.0	-0.1	0.0
Cambodia	3.9	1.2	3.0	3.7	3.5	0.0	0.5	0.4
China	2.0	1.4	2.0	1.8	2.4	0.0	-0.6	0.1
India ²	5.8	4.9	4.5	3.8	4.9	-0.4	-1.0	-0.2
Indonesia	6.4	6.4	3.5	4.0	3.9	0.0	-0.5	-0.6
Lao P.D.R.	4.1	1.3	2.0	2.3	2.7	0.0	0.0	0.0
Malaysia	3.1	2.1	2.1	3.8	2.9	0.0	1.1	0.0
Myanmar	5.1	10.0	6.8	6.5	6.1	-0.2	-0.4	-0.6
Mongolia	12.9	5.9	0.6	4.4	6.0	0.0	0.4	0.9
Nepal	9.0	7.2	9.9	4.5	6.0	0.0	-2.2	-1.6
Philippines	4.2	1.4	1.8	3.1	3.0	0.0	-0.5	-0.3
Sri Lanka	2.8	2.2	4.0	6.0	5.0	0.3	0.2	0.0
Thailand	1.9	-0.9	0.2	0.6	1.0	0.0	-0.8	-0.6
Vietnam	4.1	0.6	2.7	4.4	4.0	0.0	-0.5	-1.0
Pacific island countries and other small states	4.0	3.9	4.1	4.2	4.2	-0.3	-1.1	-0.6
Bhutan	9.9	6.3	3.9	3.5	4.2	-0.2	-0.6	-0.3
Fiji	0.5	1.4	3.9	3.8	3.5	0.0	-0.2	0.0
Kiribati	2.1	0.6	1.9	2.2	2.5	0.0	0.0	0.0
Maldives	2.5	1.4	0.8	2.5	2.1	-0.1	0.0	0.2
Marshall Islands	1.1	-2.2	-1.5	0.7	1.1	-2.4	-0.4	-0.7
Micronesia	0.7	-0.2	0.5	0.9	2.0	-0.8	-1.7	-0.4
Nauru	0.3	9.8	8.2	5.1	2.0	0.0	-0.9	0.0
Palau	4.1	0.9	-1.0	1.5	2.0	0.0	-0.5	0.0
Papua New Guinea	5.2	6.0	6.7	5.7	5.5	-0.3	-1.7	-1.0
Samoa	-1.2	1.9	0.1	1.8	1.9	0.0	0.0	0.0
Solomon Islands	5.2	-0.6	0.5	-0.5	1.7	0.1	-2.9	-0.9
Timor-Leste	0.7	0.6	-1.3	1.0	2.7	0.0	0.0	0.0
Tonga	1.2	-1.1	2.6	7.5	2.7	1.2	3.8	-0.8
Tuvalu	1.1	3.2	3.5	2.9	2.8	0.0	0.0	0.0
Vanuatu	0.8	2.5	0.9	2.6	2.8	-1.3	0.0	0.0
ASEAN³	4.4	3.3	2.4	3.3	3.1	0.0	-0.3	-0.5
ASEAN-5⁴	4.4	3.3	2.2	3.0	2.9	0.0	-0.3	-0.5
EMDEs excluding China and India	4.8	3.8	3.0	3.7	3.6	-0.1	-0.4	-0.5

Sources: IMF, World Economic Outlook database; and IMF staff estimates and projections.

1/ EMDEs excluding Pacific island countries and small states.

2/ India's data are reported on a fiscal year basis. Its fiscal year starts from April 1 and ends on March 31.

3/ ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

4/ ASEAN-5 comprises Indonesia, Malaysia, Philippines, Singapore, and Thailand.

Table 3. Asia: Current Account Balance
(Percent of GDP)

	Estimates and Latest Projections					Difference from April 2017 World Economic Outlook		
	2014	2015	2016	2017	2018	2016	2017	2018
Asia	1.9	2.7	2.5	2.1	1.9	0.0	0.0	-0.1
Advanced economies (AEs)	2.2	3.8	4.4	4.1	4.0	-0.1	-0.3	-0.4
Australia	-2.9	-4.7	-2.6	-1.6	-2.4	0.0	1.2	0.5
Japan	0.8	3.1	3.8	3.6	3.8	-0.1	-0.6	-0.5
New Zealand	-3.2	-3.4	-2.8	-3.6	-3.8	0.0	-1.1	-0.6
Hong Kong SAR	1.4	3.3	4.6	3.0	3.1	-0.4	0.1	-0.1
Korea	6.0	7.7	7.0	5.6	5.4	0.0	-0.7	-0.7
Taiwan Province of China	12.0	14.5	14.0	13.8	13.9	-0.2	-1.0	-1.1
Singapore	19.7	18.1	19.0	19.6	19.5	0.0	-0.5	0.4
Emerging markets and developing economies (EMDEs)¹	1.5	2.0	1.4	0.9	0.7	0.0	0.1	0.0
Bangladesh	1.2	1.6	0.6	-0.7	-1.3	-0.3	-0.2	-0.3
Brunei Darussalam	30.7	16.0	9.6	4.8	-2.1	0.1	-3.5	-6.4
Cambodia	-9.8	-9.3	-8.8	-8.6	-8.6	-0.2	0.0	-0.2
China	2.2	2.7	1.7	1.4	1.2	0.0	0.1	-0.1
India ²	-1.3	-1.1	-0.7	-1.4	-1.5	0.3	0.1	0.0
Indonesia	-3.1	-2.0	-1.8	-1.7	-1.8	0.0	0.2	0.2
Lao P.D.R.	-18.3	-16.5	-10.6	-9.6	-10.9	6.4	9.2	8.2
Malaysia	4.4	3.0	2.4	2.4	2.2	0.3	0.6	0.4
Myanmar	-3.3	-5.2	-5.9	-6.6	-6.6	0.7	0.1	0.1
Mongolia	-11.5	-4.0	-6.3	-4.9	-8.7	-2.3	-0.5	0.9
Nepal	4.5	5.0	6.3	-0.4	-0.7	0.0	-0.1	0.6
Philippines	3.8	2.5	0.2	-0.1	-0.3	0.0	0.0	0.0
Sri Lanka	-2.5	-2.4	-2.4	-2.5	-2.3	-0.1	0.3	0.0
Thailand	3.7	8.1	11.5	10.1	8.1	0.1	0.3	0.3
Vietnam	4.9	-0.1	4.1	1.3	1.4	-0.6	-2.8	-2.0
Pacific island countries and other small states	1.6	8.6	4.5	4.5	3.9	0.6	-0.4	0.8
Bhutan	-26.4	-28.3	-29.1	-29.4	-16.6	0.0	0.0	0.0
Fiji	-7.6	-1.5	-5.1	-5.0	-4.7	-2.0	0.7	1.4
Kiribati	25.1	35.2	15.4	-4.6	-5.9	10.4	1.1	3.8
Maldives	-3.2	-7.3	-19.6	-17.2	-17.0	-1.7	-0.5	-2.1
Marshall Islands	1.9	16.5	8.5	5.9	4.5	-5.1	-4.9	-4.9
Micronesia	1.2	4.2	3.2	3.4	3.0	-5.0	-3.3	-2.6
Nauru	-13.5	-9.5	1.7	0.7	-1.3	8.0	8.4	7.5
Palau	-15.0	-7.7	-10.3	-12.1	-14.4	-4.1	-4.4	-5.6
Papua New Guinea	2.9	19.8	20.1	18.6	17.3	4.9	2.7	3.1
Samoa	-8.1	-3.0	-6.1	-5.7	-5.0	0.0	0.4	0.9
Solomon Islands	-4.3	-3.0	-3.9	-5.0	-5.0	-2.3	-1.0	0.2
Timor-Leste	27.0	7.7	-19.3	-5.6	-15.9	-14.7	-18.6	-6.3
Tonga	-10.7	-14.7	-12.8	-13.5	-13.6	-10.6	-5.7	-2.1
Tuvalu	-23.1	-27.0	-34.0	-37.7	-39.0	-29.6	-32.2	-35.2
Vanuatu	-0.3	-10.5	-3.7	-14.4	-13.6	8.4	0.5	-1.0
ASEAN³	3.2	3.3	3.8	3.3	2.7	0.0	0.1	0.2
ASEAN-5⁴	3.3	3.9	4.2	3.9	3.4	0.0	0.3	0.4
EMDEs excluding China and India	0.8	1.1	1.5	0.9	0.4	0.0	0.0	0.0

Sources: IMF, World Economic Outlook database; and IMF staff estimates and projections.

1/ EMDEs excluding Pacific island countries and other small states.

2/ India's data are reported on a fiscal year basis. Its fiscal year starts from April 1 and ends on March 31.

3/ ASEAN comprises Brunei Darussalam, Cambodia, Indonesia, Lao P.D.R., Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam.

4/ ASEAN-5 comprises Indonesia, Malaysia, Philippines, Singapore, and Thailand.

- In **Japan**, momentum will carry through and growth is forecast at 1.5 percent in 2017, bolstered by short-term fiscal support and external demand. However, the scheduled expiration of fiscal stimulus and weaker private consumption growth should slow growth in 2018 to 0.7 percent, amid the anticipated pickup in Olympics-related private investment. Despite a narrowing output gap and higher energy prices, average inflation is not expected to surpass 1 percent in 2017. Over the medium term, inflation is expected to rise gradually but remain below target, underpinned by weak wage pressures and persistently low inflation expectations.
- In **Korea**, growth is projected at 3.0 percent in 2017–18, supported by investment. Consumption growth will likely pickup reflecting fiscal support and a higher minimum wage. Headwinds to medium-term growth include demographics, labor market distortions, and lagging productivity. Inflation is expected to remain around the target of 2 percent in 2017 and over the medium term. The current account surplus is projected to decline but remain large at just below 6 percent of GDP in 2017–18.
- ASEAN-5** growth is projected to accelerate, on account of higher investment and exports. Inflation has been revised down in 2017 and 2018 following lower-than-expected outturns in the first half of 2017. Projected current account balances have been revised up based on faster export growth. In Indonesia, growth is projected to pick up modestly to 5.2 percent in 2017 (from 5.0 percent in 2016), led by external demand and fiscal spending. In Malaysia, growth in 2017 is expected to increase to 5.4 percent, supported by strong domestic and external demand. In the Philippines, growth is projected to remain close to potential at 6.6 percent in 2017 and 6.8 percent in the medium term, driven by robust domestic demand. In Singapore, growth is projected to rise to 2.5 percent in 2017, reflecting strong performance of the export-oriented sector, and to 2.6 percent in 2018 as private domestic demand recovers. In Thailand, projected growth has been revised up from 3.2 to 3.7 percent in 2017 and from 3.3 to 3.5 percent in 2018 on the back of strong private consumption and increased dynamism in exports of goods and services.
- In **Australia**, growth in 2017 was revised down to 2.2 percent (from 3.1 percent in April) after a disappointing outturn in the first half of the year, mostly because of weather-related disruptions to production. Underlying demand momentum remains below trend, as nonmining business investment and wage income are still lackluster. In **New Zealand** growth in 2017 was revised up to 3.5 percent (from 3.1 percent in April) driven by restocking and supportive fiscal policy.
- Other emerging market and developing economies** (Bangladesh, Cambodia, Lao P.D.R., Myanmar, Vietnam) continue to grow at an impressive rate, well above the average for the region as a whole and supported

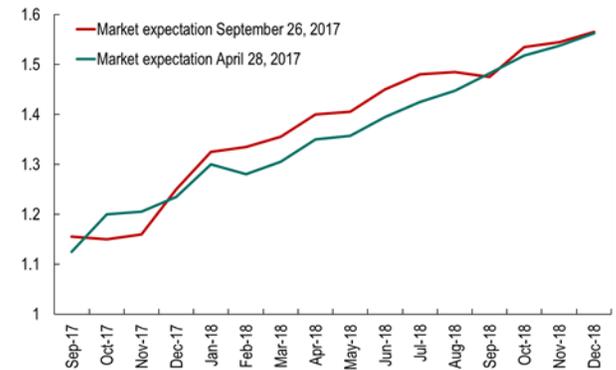
by positive growth momentum in key trading partners. Nepal is recovering in the aftermath of an earthquake and trade disruptions.

- In countries with IMF-supported programs, the outlook is favorable. **Mongolia** is doing well, underpinned by strong performance in the coal sector and related spillovers, and projected growth for 2017 has been revised up from $-1/4$ percent to 2 percent or higher. In **Sri Lanka** growth is expected to reach 4.7 percent in 2017 as buoyant construction and services offset weak and weather-affected agriculture.
- In the **small states**, growth is expected to pick up somewhat in 2017. A moderate recovery in oil prices (compared with 2016) should support growth in Papua New Guinea, and reconstruction efforts from Cyclone Winston will drive growth in Fiji. Tourism is expected to be a dynamic sector, especially in Fiji, Palau, and Vanuatu.

Risks: Balanced, for Now

Near-term risks are broadly balanced. On the upside, the cyclical recovery in China and Japan could be stronger and more sustained than expected, driven by growing confidence and favorable market conditions. On the downside, sudden capital outflows could be felt disproportionately more by emerging market and developing economies with external vulnerabilities (especially those with foreign-exchange-leveraged firms and high sovereign borrowing). Although the normalization of US monetary policy is likely to be gradual (Figure 14), it could still trigger disruptive shifts in asset prices and

Figure 14. United States: Federal Funds Rate
(Percent)

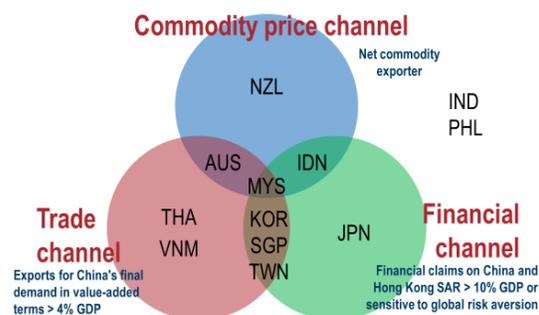


Sources: Bloomberg Finance L.P.; and IMF staff calculations.

financial market volatility. Beyond the near term, overall risks to the regional growth forecast are tilted to the downside, especially from a sharp adjustment in China. Key medium-term downside risks include the following:

Sharp adjustment in China. Risks to growth in China are balanced in the near term, but tilted to the downside over the medium term. In the near term, upside risks stem from continued resilience in the real estate sector despite tightening measures and from a more sustained recovery of exports and the global economy. Downside risks come from a larger-than-expected impact of recent financial tightening and from resurging capital outflow and exchange rate pressures, as well as from potential trade friction with the United States and rising global protectionism. Contributing to heightened medium-term risks are overly ambitious growth targets supported by unsustainable policies, further increases in debt, and mounting financial imbalances. Should a sharp adjustment occur, domestic demand would take a hit, which in turn would roil global financial markets, lower commodity prices, and reduce global and regional growth (Figure 15).

Figure 15. Channels of Spillovers from a Slowdown in China



Source: IMF staff estimates.

Note: AUS = Australia; IDN = Indonesia; IND = India; JPN = Japan; KOR = Korea; MYA = Malaysia; NZL = New Zealand; PHL = the Philippines; SGP = Singapore; THA = Thailand; TWN = Taiwan Province of China; VNM = Vietnam.

Geopolitical risks: Asia faces risks stemming from rising geopolitical tensions within the region, with the United States, and from discord between main trading partners within the region. An escalation of such tensions could hurt foreign direct investment and trade, disrupting major sources of growth and disturbing financial markets. Financial markets in Asia have not been significantly affected by heightened geopolitical risks in recent months (Figure 3).

Inward-looking policies. Gains from globalization have not been shared equally. Weak economic growth, stagnant wages, and high and long-term unemployment, accompanied by rising income inequality, have made inward-looking policies increasingly popular, especially in advanced economies. These policies could reduce the cross-border flow of trade and labor (including remittances), hurt productivity and longer-term growth, and slow the pace of global economic convergence and poverty reduction. Such policies would be especially damaging for highly trade-dependent economies such as those in Asia.

Climate change and natural disasters: The recent wave of cyclones in the Pacific was highly

disruptive and is a permanent threat to sustained growth in the small states.

Correspondent banking relationships: Derisking could significantly curtail cross-border payments, especially trade finance and remittances in small states.

Policies: Sustaining the Growth Momentum

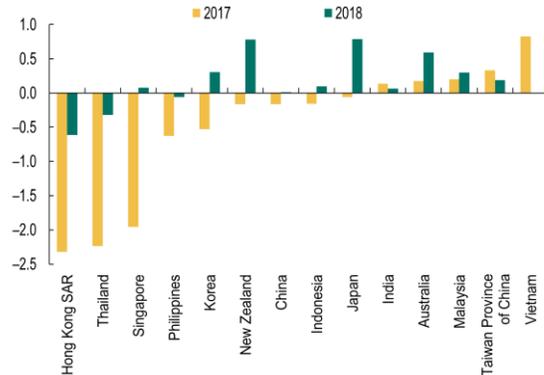
Policies should aim to sustain the growth momentum while reducing vulnerabilities. The combination of subdued inflation and persistent capital inflows provides scope for continued accommodative monetary policies and tighter financial sector policies to mitigate financial stability risks. At the same time, the robust recovery provides an opportunity to pursue fiscal, financial, and structural reforms to lift long-term growth, make it more inclusive, and build resilience. This calls for tailored measures to boost productivity and investment, narrow gender labor force participation gaps, deal with the demographic transition, and support those affected by shifts in technology and trade.

Fiscal Policy

Fiscal policy across countries should be set to cyclical conditions, which vary substantially across the region, and to the need to reduce vulnerabilities. At the same time, fiscal reforms are needed to lift trend growth, and promote greater inclusion. Available fiscal space should be used to frontload the gains of structural reforms and build public support by easing their distributive effects. In countries where domestic demand is weak, the current account surplus is large, and there is fiscal space, fiscal policy should play a more active

role in supporting activity and rebalancing the economy (**Korea, Thailand, Singapore**) (Figure 16).

Figure 16. Change in Cyclically Adjusted Fiscal Balance
(Percent of GDP)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

- In **China**, where the economy is growing faster than is sustainable—with limited or no domestic slack—and the fiscal position has been significantly relaxed in recent times, a gradual withdrawal of fiscal support is warranted to ensure fiscal sustainability. Available fiscal space should be used only to support more decisive structural reform efforts; for example, increased reliance on the market mechanism.
- When there is slack combined with fiscal sustainability risks, near-term fiscal support should be embedded in a credible medium-term fiscal consolidation plan (**Japan**). This plan could include a preannounced path of gradual hikes in consumption taxes to reduce policy uncertainty and protect growth.
- In countries where large fiscal imbalances entail risks to macroeconomic stability, consolidation should continue, relying on high-quality measures to reduce the short-term drag

on economic activity and to contain any adverse distributional implications (**India**).

- When fiscal credibility needs to be enhanced and/or current account deficits are large, delivering on medium-term fiscal consolidation plans is essential (**Cambodia, Mongolia, Sri Lanka**).
- In economies prone to natural disasters, governments should rebuild fiscal buffers in good times so they can use them in bad times (**small states**).
- Eliminating disincentives to full-time work, such as spousal income tax deductions, could encourage greater female labor force participation (**Japan, Korea, Thailand**), lifting trend growth and social inclusion. Excise taxes on carbon and fuel could help raise revenue and lower pollution (**China, India**). Public spending should be reallocated from untargeted subsidies toward capital and social spending and should be supported by quality tax reforms (**India, Indonesia**).

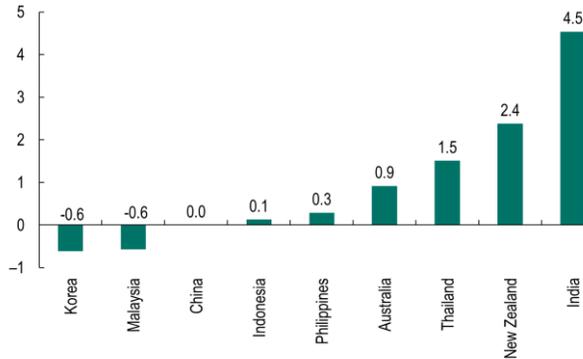
Monetary and Exchange Rate Policy

Monetary policy should focus on maintaining price stability and in some cases, the risk of de-anchoring inflation expectations, be attuned to cyclical conditions, and consider financial stability risks. Given low inflation (Table 2) and negative output gaps in most economies in the region, monetary policy should generally remain accommodative (Figure 17). This accommodative stance should help compensate for any tightening in financial conditions as a result of expected tighter US

monetary policy. Monetary policies should be calibrated according to local circumstances:

Figure 17. Real Policy Rates

(Percent, adjusted for inflation)



Sources: Haver Analytics; and IMF staff estimates.

Note: Policy rate data are as of August 2017; inflation data are as of 2017:Q2.

- In countries where inflation has been below target for some time (**Thailand**) there is a risk of a downshift of long-term inflation expectations, so the monetary policy stance should be relaxed. With real policy rates above natural real interest rates, there is room to lower policy rates further.
- In **Japan**, continued accommodative monetary policy combined with income policies and labor market reform should help lift inflation and inflation expectations. If downside risks materialize, the Bank of Japan should maintain an accommodative monetary stance (combined with fiscal stimulus) and carefully calibrate its yield curve policy.
- In **China**, a gradual removal of monetary policy accommodation would help slow credit growth and would be justified if core inflation continues to pick up.
- In cases of inflation expectations that remain high compared with the inflation target, the monetary policy stance should have a tightening bias to achieve durable disinflation (**India**).
- In countries where inflation is close to target, the current monetary stance should be maintained but, the authorities should be ready to tighten it if signs of inflation pressure emerge (**Indonesia, Philippines**).
- Some countries should upgrade their policy frameworks, anchoring monetary policy to price stability and allowing greater exchange rate flexibility (**China, Vietnam**).

Exchange rate flexibility should continue to be the main shock absorber in Asian emerging market economies, especially when balance sheet risks such as foreign exchange mismatches are manageable. Foreign exchange intervention should be limited to cases of disorderly market conditions.

Financial Policies

Financial sector regulation and supervision should be enhanced to guard against the risks of capital flow reversals and to ensure that easy monetary conditions do not fuel a buildup of financial stability risks. The implementation of Basel III reforms should be calibrated to the characteristics of the financial sector in each country. Fintech could enhance financial inclusion and policymakers should upgrade regulatory frameworks while balancing benefits (financial inclusion) with risks (regulatory arbitrage and potentially unexpected

ramifications). Macroprudential frameworks should be upgraded to contain systemic risks and build up buffers. Since the manifestations of systemic risk may be country specific, the adequate macroprudential response will vary from country to country:

- In countries where credit is growing rapidly, countercyclical macroprudential measures should be deployed or strictly enforced (**China, Philippines**). If nonfinancial corporate debt is rising, the rapid growth of corporate leverage should be contained through a combination of macro- and micro-prudential policies. Where necessary, pre-emptive measures such as debt restructuring, capital requirements, and non-core asset disposal should be undertaken, particularly for highly leveraged corporations with low interest coverage ratios.
- In countries where high household debt entails potential macroeconomic and financial stability risks (**Australia, Korea, Malaysia, New Zealand**), real estate markets will need to be closely monitored and appropriate macroprudential measures implemented.
- In **China**, debt reliance by the nonfinancial sector should be reduced with continued regulatory and supervisory tightening and greater recognition of bad assets. Putting in place and enforcing budget constraints on state-owned enterprises, and cutting off-budget public investment are keys to reducing the further buildup of nonperforming assets. Implicit subsidies to state-owned enterprises should be

reduced to motivate investors to price risk more accurately and improve credit allocation over time.

- In **India**, priorities should be strengthening public banks' loss-absorbing buffers, implementing further public banking sector structural reforms, and enhancing public banks' debt recovery mechanisms.
- In **Japan**, supervisors need to modernize supervision to keep pace with the more sophisticated activities emerging across banks, insurers, and securities firms.
- In countries where the importance of shadow banks is increasing, efforts should be made to broaden the regulatory perimeter and prevent regulatory arbitrage (**China, Thailand**).

In some circumstances, capital flow measures could be useful to manage inflow surges, but they should be targeted, transparent, and temporary. As for outflows, capital flow measures should be used only in crisis situations or when a crisis is considered imminent—or when necessary supporting reforms, including in the financial sector, have not kept pace with capital account liberalization (**China**). In any case, capital flow measures should not be used as a substitute for macroeconomic adjustment or for sound macroeconomic and financial stability policies.

Structural Reforms

The robust recovery, combined with adequate fiscal support, provides an opportunity to offset the short-term costs and help build political consensus for

ambitious structural reforms to tackle the challenges from an aging population, rising inequality, and the persistent decline in productivity growth (Box 2). Policies aimed at stimulating labor supply are essential. These include measures to promote labor force participation of women and the elderly, such as expanding child-care facilities and raising the retirement age. Strengthening pension systems, including through minimum pensions, can provide an adequate safety net for the vulnerable elderly. As discussed in the April 2017 *Fiscal Monitor*, reducing tax and other distortions can ensure that resources are allocated to the most efficient firms, thus boosting aggregate total factor productivity and economic growth (Box 2).

- In **China**, growth targets should be de-emphasized focusing more on the quality and sustainability of growth. Consumption should be boosted, barriers to entry removed (especially in the services sector), and market forces given a greater role in allocating resources—for example, by removing implicit subsidies to state-owned enterprises.
- In **India**, reform efforts should aim at tackling supply bottlenecks, enhancing the efficiency of labor and product markets, and modernizing the agricultural sector. Labor market reforms such as rationalizing labor market regulations should be a priority to facilitate greater and higher-quality job creation.
- In **Japan**, a comprehensive policy package of structural reforms, combined with income and demand policies, should help reflate the economy and lift potential growth. Structural efforts should aim to boost labor market flexibility, investment, and labor supply. The government’s new Work Style Reform recognizes the need for broad labor market reform.
- In **Korea**, productivity gains could be achieved by reducing the regulatory burden and promoting competition in the service sector. There is scope for increasing female labor force participation by enhancing active labor market policies and strengthening childcare. Labor market duality should be discouraged.
- In many **ASEAN** countries, there is a case for revamping infrastructure, enhancing regulatory frameworks, and further opening services sector to private investment.
- Continued efforts to advance global trade integration are important to the region, but further high-quality regional trade integration (especially in areas such as services) can also help lift living standards.

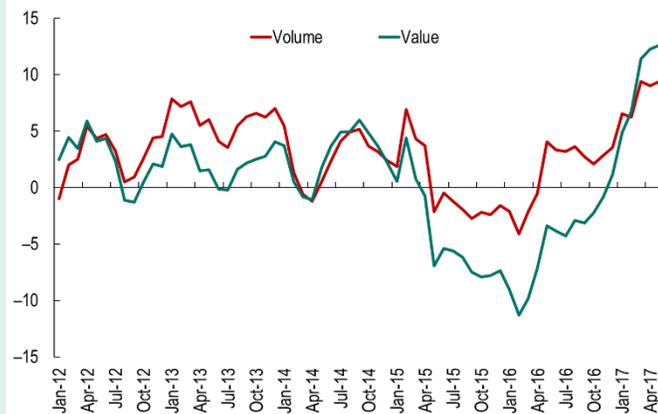
Box 1. Drivers of Export Growth in Asia

The recent recovery in Asia's goods exports has been broad based across countries, products, and trading partners. Various factors have contributed to these cyclical developments: continued growth in China and more broadly across emerging Asia, increased import demand from commodity exporters, and the global re-stocking of tech products, which constitute a major part of Asia's exports. The sustainability of this cyclical upturn depends on near-term developments in commodity prices and the tech cycle.

The pace of Asia's export recovery has been impressive so far in 2017. Following a period of sharp declines, most notably during 2015 and the beginning of 2016 (Figure 1.1), Asian exports returned to positive growth in 2016, and even surpassed GDP growth in early 2017, before losing some momentum in mid-2017. At the same time, global growth has strengthened, including in Europe, Japan, the United States, and some large emerging markets, and commodity prices recovered after hitting post-crisis lows in early 2016. Understanding the drivers behind the recovery, and whether the strong growth can be sustained beyond the near term, is important for policymaking.

Figure 1.1. Asia: Merchandise Exports

(Year-over-year percent change; 3-month moving average)



Sources: Haver Analytics; and IMF staff estimates.

Export growth has been broad-based across Asian countries. In the first months of 2017, China, Japan, Korea, and ASEAN countries all returned to positive export growth. With its large share in Asian exports, Chinese export growth has contributed strongly to overall trends, but the recent recovery in exports has been broad based across Asia and not concentrated in any small set of countries.

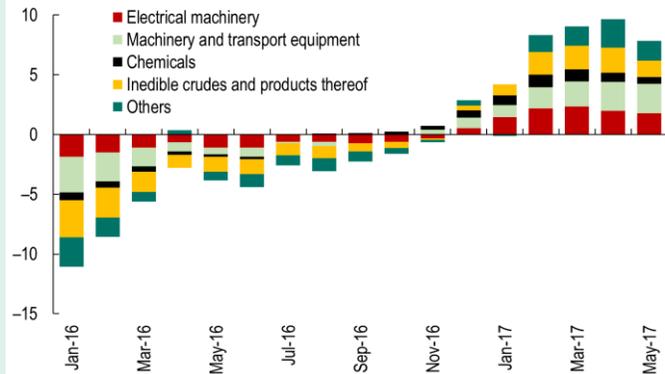
The recovery has been driven by Asia's traditional main export products. The composition of exports has not changed much in recent years, and products with the highest share in Asia's non-oil and gas exports contributed the most to the recent surge in export growth. These exports include electrical products, machinery, and transportation equipment, which together constitute almost half of Asia's nonenergy exports (Figure 1.2). Overall, positive export growth has taken place across a wide range of product groups, suggesting differing underlying drivers.

Prepared by Minsuk Kim and Anne Oeking (both Asia and Pacific Department).

Box 1 (continued)**A large part of the export increase continues to come from intra-Asian trade, driven by demand in Asia's emerging markets.**

More than half of exports by Asian countries are sold within Asia. The resumption of export growth has been supported largely by sales to Asian countries, notably China, India, and ASEAN countries. In China, the share of imports from major Asian countries went up from 9 percent of all imports to almost 12 percent between mid-2015 and mid-2016, and in India from 27 to 30 percent during the same period. At the same time, export growth to regions outside Asia, such as the European Union and the United States, also contributed to total growth, though to a smaller degree, with Asia's share in imports increasing only marginally over the same time horizon.

Figure 1.2. Contributions to Export Growth by Product
(Year-over-year percent change; 3-month moving average)



Sources: Haver Analytics; and IMF staff calculations.
Note: Exports measured as non-oil and gas exports.

The region's export expansion also coincided with a rise in commodity prices and the bottoming out of the global tech inventory cycle.

The gradual recovery in global commodity prices, such as for petroleum and metals, since early 2016 has helped many commodity-exporting countries recover from years of weak growth, leading to stronger import demand through a wealth effect.¹ Meanwhile, the inventory of tech goods in major export destinations accumulated over the recession years finally reached its trough during the second half of 2015 and the first half of 2016. Tech exports are sizable in China, Japan, Korea, and Singapore. This start of the tech re-stocking cycle, partly fueled by the pickup in business investment in advanced economies and the anticipated launch of new mobile devices in the second half of 2017, helped boost Asia's tech exports, including semiconductors and other mobile equipment components.

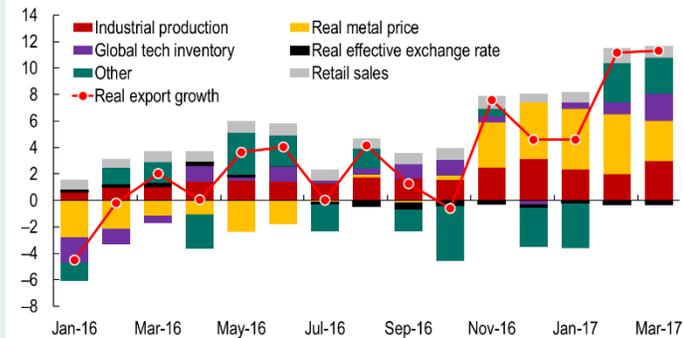
¹ Of course, higher commodity prices would impose a negative income effect on commodity importers, but the net effect on global demand and global imports would likely be positive unless higher prices reflect supply disruptions. Commodity prices declined during 2017 but, on average, they have been higher than in 2016.

Box 1 (continued)

A regression analysis indicates that both the upswing in commodity prices and the re-stocking of tech inventories were key drivers of Asia's export recovery.² The acceleration in industrial production and retail sales in trading partners contributed to strong export growth in the second half of 2016 and the first quarter of 2017 (Figure 1.3). At the margin, however, the rise in metal prices and tech restocking played more significant roles in raising the region's exports, first led by the restocking cycle that began in mid-2016 and later by metal prices since late 2016. Regarding the magnitude of the effect, metal prices had a larger impact on export growth during most of the sample period. Furthermore, similar results hold when other commodity prices are used instead, such as the *World Economic Outlook* commodity fuel index.³

Figure 1.3. Cyclical Drivers of Asia's Exports

(Year-over-year percent change)



Sources: Haver Analytics; and IMF staff estimates.

Note: The bars above are calculated by multiplying the estimated regression coefficients to the cross-country average of each variable in a given period. All the estimated coefficients are statistically significant at the 5 percent level or lower. The sample consists of nine Asian economies over the period of January 2011-June 2017.

The momentum may not last, however. Despite the ongoing recovery in main trading partners, the global tech inventory cycle could lose steam once the pent-up demand for new mobile phones is met. Furthermore, commodity price growth (year over year) could moderate in 2018 as projected in the October 2017 *World Economic Outlook*, partly owing to the base price effect from 2017. Potential intensification of geopolitical tensions or a rise in trade barriers poses additional downside risks to the outlook.

² To the extent that commodity prices affect the cost of productive inputs, higher commodity prices could push up export prices of non-commodity exporters and thereby exert a dampening effect on export volumes. As such, the coefficient for the commodity price variable captures the net effect of the higher import demand by commodity exporters and the higher export prices associated with more expensive commodity inputs.

³ In addition, the coefficient estimates for the other variables remain similar without the commodity price variable.

Box 2: Closing the Productivity Gap in Asia

There is plenty of room for productivity gains in Asia at the firm level. In several Asian countries, different treatment of firms—as a result of government policies or poorly functioning markets—distorts the allocation of labor and capital. Gradually eliminating those distortions could help spur significant transitional real GDP growth.

Asia has experienced a sharp productivity slowdown since the global financial crisis. The April 2017 *Regional Economic Outlook: Asia and Pacific* documented a significant decline in total factor productivity (TFP) growth in most countries in the region during 2008–14 (Figure 2.1), in line with what was observed in the rest of the world. Moreover, most Asian countries have much lower TFP than the United States (Figure 2.2), which is usually the benchmark country for maximum or potential TFP.

Aggregate productivity shown in Figures 2.1 and 2.2 ultimately reflects developments at the firm level. More precisely, aggregate TFP depends on firms' individual TFP and on how resources (labor and capital) are allocated across firms. Well-established literature has found that poor use of existing resources within countries is an important determinant of differences in aggregate TFP across countries.

In a well-functioning economy, firms that are more productive than their competitors should win market share over time, expanding their production by hiring more labor and acquiring more capital. However, distortions—which arise from government policies (such as poorly designed regulations or tax regimes) or poorly functioning markets (such as underdeveloped financial markets)—give rise to misallocation because they prevent the expansion of more productive firms and promote the survival of less productive ones. In other words, in the presence of distortions, aggregate TFP suffers because efficient firms produce too little output and inefficient firms produce too much.

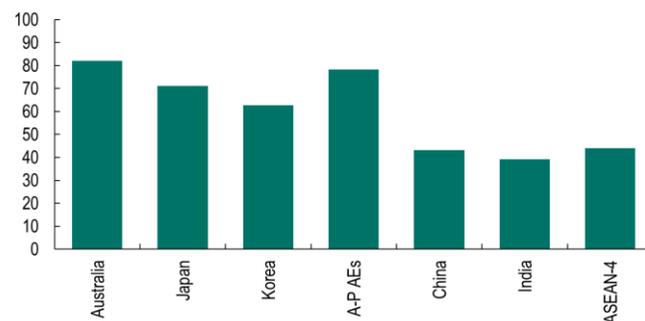
Prepared by Laura Jaramillo (Fiscal Affairs Department), Pablo Lopez Murphy (Asia and Pacific Department), and Florian Misch (Fiscal Affairs Department).

Figure 2.1. Total Factor Productivity Growth
(Percent)



Sources: IMF *World Economic Outlook*; Penn World Tables 9.0; and IMF staff calculations.
Note: Asia-Pacific advanced economies (A-P AEs) are Hong Kong SAR, New Zealand, Singapore, and Taiwan Province of China; ASEAN-4 are Indonesia, Malaysia, the Philippines, and Thailand.

Figure 2.2. Total Factor Productivity Gaps
(At current purchasing power parity, United States = 100)



Sources: Penn World Tables 9.0; and IMF staff calculations.
Note: All total factor productivity is weighted by purchasing-power-parity GDP. Asia-Pacific advanced economies (A-P AEs) are Hong Kong SAR, New Zealand, Singapore, and Taiwan Province of China; ASEAN-4 are Indonesia, Malaysia, the Philippines, and Thailand.

Box 2 (continued)

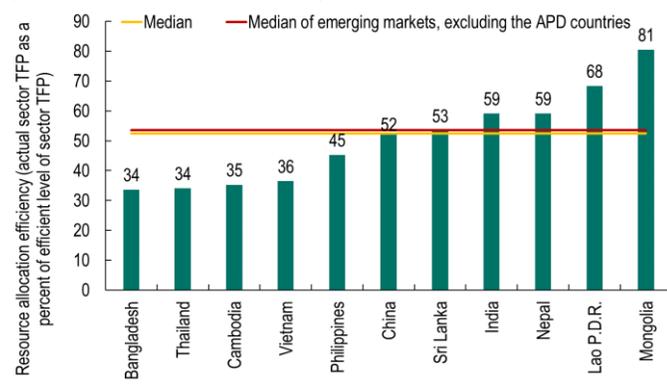
The April 2017 *Fiscal Monitor* uses firm-level data to estimate the size of resource misallocation across a broad set of countries and analyzes how the tax system contributes to resource misallocation across firms. The analysis considers a sample of 54 emerging market economies that includes 10 Asian countries (Bangladesh, Cambodia, China, India, Lao P.D.R., Nepal, Philippines, Sri Lanka, Thailand, Vietnam). This box focuses on the sample of Asian countries. The firm-level data come from the World Bank Enterprise Surveys and cover 18 manufacturing industries (at the two-digit International Standard Industrial Classification level).

According to the *Fiscal Monitor*, there is ample room to improve TFP at the country level by reducing resource misallocation across firms in many Asian emerging market economies. Figure 2.3 shows the gap between actual and potential productivity in the manufacturing sector in each country.¹ The median TFP level for Asian countries is only what could be achieved absent distortions. Removing distortions offers potentially significant transitional real GDP growth effects.

Assuming a transition path of 20 years, reducing resource misallocation (by moving to the efficiency level of a top performer) translates into a higher annual real GDP growth rate of 1.4 percent.²

Figure 2.3: Resource Allocation Efficiency in Asia

(+ implies more efficient allocation of resources)



Sources: IMF Fiscal Monitor, and IMF staff calculations.
Note: TFP stands for total factor productivity.

¹ A country may have a highly productive manufacturing sector compared with other countries but may still fall far short of its potential productivity.

² These estimates are for the median country. Calculations are made under the assumption that the estimated TFP gains in the manufacturing sector could be similarly achieved across other sectors (which is reasonable, as there is broad consensus that resource misallocation is worse in services and agriculture) and that there are no adjustment costs. Moreover, the estimates are limited to first-round effects because they do not consider that higher TFP growth will also result in higher investment, which would feedback into higher productivity.