



Economic Outlook for Southeast Asia, China and India 2023 - UPDATE

RESILIENCE UNDER UNCERTAINTY



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Executive summary

Growth in Emerging Asia needs to cope with external headwinds

Emerging Asian economies will face challenges in coping with a persistent downturn in external demand. Exports in ASEAN experienced a substantial contraction amid a prolonged economic slowdown in advanced economies. Robust private consumption will remain the key driver of economic growth in the region. The expanding services sector will also drive growth from the supply side, fuelling the region's labour markets. The complete removal of travel restrictions is expected to stimulate rapid growth in the region's tourism sector. Deeper integration of export markets within Emerging Asia and intraregional trade has helped the region cope with the impact of global economic slowdowns on its exports, though weakened external demand continues to pose a risk. Other persistent risks include geopolitical tensions, climate change and natural hazards.

Overall, real GDP growth in ASEAN will weaken in 2023, but outlooks will vary among countries. For instance, GDP growth in Indonesia should remain vigorous, while Myanmar's growth momentum remains weak.

Regional and domestic demand supports growth

Domestic demand, in particular, private consumption, supported by high consumer confidence and an expanding middle-class, drives economic growth. Robust regional demand is keeping buoyant intraregional trade, helping the region sustain economic growth amid the slump in merchandise exports. The share of service exports will continue to expand in the region, underpinned by the recovery of international tourism and the rapid development of emerging industries such as supply chain-linked services and cross-border services. Inflows of foreign direct investment (FDI) are expected to give a boost to the depressed export sector.

Financial markets are relatively stable but monetary policy manoeuvres must be conducted carefully

Despite headline inflation declining, core inflation persists in several countries in the region. Timely and appropriate monetary policies will help to tame consumer price index (CPI) pressures and sustain economic growth. Financial markets in Emerging Asia exhibit relative stability, though evolving monetary policies in advanced economies and global market volatility might pose challenges. For instance, currencies in the region are recovering from a decline in their values in 2022, though risks of possible capital flight and continued portfolio outflows remain. Monetary policy makers must be mindful of this and handle policy adjustments carefully to ensure financial market stability and buoyant growth.

Labour markets show signs of recovery

The positive aspects of the outlook are all working together to stimulate labour markets in Emerging Asia. Unemployment is declining across the region, especially where populations are young and better educated. Policies to promote FDI for integration into global supply chains and global value chains will prove helpful, particularly in the electronics, textile and automotive sectors.

Introduction

Emerging Asian economies will face challenges in coping with a prolonged downturn in external demand in 2023. Exports are showing substantial contraction following the slump in external demand and continued downturn of global trade conditions. Robust private consumption will continue to drive economic growth in many ASEAN economies. The complete removal of travel restrictions is expected to stimulate rapid growth in the region's tourism sector. The service sector is expanding, fuelling the region's labour markets, though growth in merchandise exports declined. Deeper integration of export markets within Emerging Asia and sustained intraregional trade, however, helped the region cope with the impact of weak external demand on goods exports. Timely and appropriate monetary policies will support economic growth and tame inflationary pressures, while strong consumer confidence will continue to boost spending.

Risks and challenges persist, including global economic uncertainties, geopolitical risks, inflationary pressures, climate change and natural hazards. Weak external demand will continue to put pressure on the region's exports. Emerging Asia's financial markets will remain vulnerable to global financial market volatility and the monetary policy stance in advanced economies. Consumer price index (CPI) inflation is expected to stabilise in 2023, but elevated core inflation will pose a challenge in the region.

This *Update* presents Emerging Asia's macroeconomic outlook for the remainder of the year. It then discusses the challenges and risks affecting economic growth in the region.

Overview and main findings

Economic growth in Emerging Asia will remain vulnerable to external headwinds in 2023. Real GDP growth for the member countries of the Association of Southeast Asian Nations (ASEAN) will weaken and is forecast at 4.2% in 2023 and 4.7% in 2024. Emerging Asian economies are projected to grow by 5.3% on average in 2023 and by 5.5% in 2024, according to the projections of the OECD Development Centre. Robust private consumption will continue to propel economic growth in major ASEAN economies, supported by an improving labour market. At the country level, the growth outlook will vary depending on the robustness of economic fundamentals amid global headwinds and various risks to growth. For instance, among Southeast Asian countries, GDP growth in Indonesia is expected to be robust, while Myanmar's growth momentum remains weak. China's growth will display resilience in 2023, but it will be weaker than expected amid the slowdown in global demand. India is expected to see sustained economic expansion, driven by strong domestic demand.

The main findings in this year's update to the *Economic Outlook for Southeast Asia, China and India 2023* are the following:

- Emerging Asia will face challenges in coping with persistent global headwinds in 2023. Export growth experienced substantial contraction following a prolonged downturn in external demand. Robust private consumption and the thriving services sector will remain the key drivers of economic growth. Growth is expected to average 4.2% in Southeast Asia and 5.3% in Emerging Asia as a whole (the ten ASEAN countries plus China and India).
- The region's services sector will maintain robust growth momentum, driven by factors including an upsurge in services industries across areas such as tourism, retail trade, services exports, supply chain-linked services, e-commerce and other digital-based

services. Robust domestic demand is expected to sustain the expansion of the services sector, while increasing cross-border tradability of services will fuel the sector's rapid rise. The region's merchandise exports market experienced a downturn though regional demand and intraregional trade helped sustain export activity.

- Financial markets in Emerging Asia remain relatively stable in general, with positive sentiment, supported by cautious monetary policies. Equity markets experienced fluctuations but are expected to maintain a positive outlook, driven by emerging sectors, particularly in the services industry, such as e-commerce, digital-based services and the services arm of the manufacturing industry. However, financial markets need to be monitored carefully.
- Headline inflation in Emerging Asia is declining, but core inflation remains high in most countries. Elevated core inflation could persist in the region, driven by sticky prices in sectors like clothing, health care, education, and household goods and services.
- Although capital outflow and portfolio investment outflows weakened local currencies in some economies last year, currency values in the region are recovering as appropriate monetary policies work their way into the economy. Bond markets outperformed equity markets during the first half of the year.
- The travel and tourism sector is a significant source of employment in countries like China, India, Indonesia, the Philippines, Thailand and Viet Nam. The reopening of domestic and international tourism boosted the region's economies, supporting employment growth.
- Amid global supply-chain reconfiguration, countries in the region are implementing policies to strengthen their manufacturing and industrial sectors, supported by policy reforms and infrastructure development. This has catalysed inflows of FDI, which is expected to boost the export sector, creating more jobs, particularly in electronics, textiles and the automotive sector.

Table 1. Real GDP Growth in ASEAN, China and India, 2022-24 (%)

	2022	2023	Changes from the previous forecast (March 2023)	2024	Changes from the previous forecast (March 2023)
ASEAN-5					
Indonesia	5.3	4.7	-	5.1	-
Malaysia	8.7	3.9	↓	4.2	-
Philippines	7.6	5.6	↓	6.1	-
Thailand	2.6	2.8	↓	3.5	↓
Viet Nam	8.0	4.9	↓	5.9	↓
Brunei & Singapore					
Brunei Darussalam	-1.5	2.1	↓	2.3	↓
Singapore	3.6	1.4	↓	2.5	-
CLM countries					
Cambodia	5.1	5.1	↓	5.9	-
Lao PDR	3.1	3.4	↓	3.8	-
Myanmar	2.0	2.0	-	*	
China and India					
China	3.0	5.4	↑	5.1	↑
India	6.9	6.0	↑	7.0	↓
Average of ASEAN 10	5.6	4.2	↓	4.7	↓
Average of Emerging Asia	4.4	5.3	-	5.5	↑

Note: Data cut-off date is 25 August 2023. Data for India and Myanmar relate to fiscal year. 2024 projection for Myanmar is not available. Projections of regional average (both ASEAN and Emerging Asia) for 2024 exclude Myanmar. The 2023 and 2024 projections for China, India, Indonesia are based on OECD Economic Outlook No.113, June 2023.

Source: OECD Development Centre.

Recent developments and near-term outlook

ASEAN-5

Indonesia

Indonesia's economy grew by 5.3% in 2022, supported by recovery in private consumption and robust export performance benefitting from high commodity prices. In addition, policies to encourage investment and efforts to bolster downstream industries started bearing fruits. This growth momentum continued into 2023, with growth of 5.2% in the second quarter, marking seven consecutive quarters of year-on-year growth above 5%. Economic expansion is mainly driven by household spending, investments and government spending, which offset a slowdown of exports. Household consumption recorded 5.2% growth in the second quarter of 2023, supported by a surge in personal mobility and strong consumer confidence. Government spending rose 10.6% in the same period supported by personnel expenditure and the government accelerating construction of roads and irrigation systems. Overall investment growth rebounded in the second quarter, posting a year-on-year growth of 4.6% from a weak expansion of 2.1% in the previous quarter. Despite strengthened services exports following a significant increase in international tourist arrivals, growth of exports of goods and services experienced a huge drop from 12.2% in the first quarter down to -2.75% in the second quarter, amid a global economic slowdown and declining prices of major export commodities, such as coal, palm oil and metals.

On the supply side, while most sectors recorded growth in Q2 2023, the manufacturing and services industries both stood out as the major drivers of growth. The services industry expanded 7.4% year-on-year following the complete removal of all remaining mobility restrictions and a robust recovery of the tourism sector. The manufacturing sector grew by 4.9%. Indonesia's real GDP growth will be steady in 2023 at 4.7% and growth is projected to improve to 5.1% in 2024. Activities leading up to the Q1 2024 general elections and local elections in Q4 2024 should contribute to spending.

Headline inflation began easing in March this year and declined to 3.1% year-on-year in July 2023, settling into the central bank's target range for three months in a row. As of July 2023, Bank Indonesia had held its seven-day repo rate at 5.75% for six consecutive months after a rise in January 2023. On the fiscal side, commodity windfall and tax reform packages have contributed to the government returning to its fiscal rule, with a deficit of 2.4% of GDP in 2022, achieving the fiscal consolidation goal ahead of target. Government external debt also declined in the second quarter of 2023 at USD 192.5 billion, down from USD 194.0 billion in the first quarter. Indonesia implemented a tax harmonisation law in 2022 that brought about changes in income tax and the value-added tax rate. Several other policy reforms followed the implementation of this law. The fiscal deficit is expected to stay below the mandated ceiling in 2023 as the tax measures continue and as the need for pandemic-related spending gradually eases following the government's decision to end the national emergency status of the COVID-19 pandemic.

Malaysia

Malaysia's economy continued its trend of slowing growth in the second quarter of 2023, recording real GDP growth of 2.9%. This brings down growth in the first half of 2023 to 4.2%, mainly due to the prolonged decline in exports which have dropped 9.4%, as weak external demand persists amid a global economic slowdown. Domestic demand remains the key growth driver underpinned by private consumption and investment. The latter is supported by capacity expansion, developments of multi-year projects and higher fixed asset spending by the government. Meanwhile, government spending also rebounded, posting 3.8% year-on-year growth in the second quarter, after a decline of 2.2% in the first quarter.

While growth in the services sector moderated in the second quarter to 4.7% from 7.3% in the first quarter, the continued recovery in inbound tourism will ensure that the sector remains a major source of economic activity. The construction sector recorded the highest annual growth of 6.2%. Both sectors are expected to bring more employment opportunities and further increases in wages, which will reinforce consumer consumption. Expansion of the job market will help a substantial proportion of household borrowers with risky debt-to-service ratios. Domestic demand will thus continue to support growth in 2023, underpinned by the strengthening job market. Fiscal policy for 2023 is appropriately contractionary, which will result in a contraction of the budget deficit in the near term. The value of the Malaysian ringgit against the dollar is expected to improve for the rest of the year contingent on the monetary policy stance in the United States and the momentum of recovery in China.

External headwinds will impact Malaysia's economic performance in 2023. Real GDP growth is expected to moderate to 3.9% in 2023, but is expected to improve to 4.2% in 2024. The downturn of the global electronics industry will continue to weigh on the electrical and electronics sector, which accounts for about 40% of total merchandise exports, and this will impact overall manufacturing exports. A rebound in China's economy should help to mitigate the contraction in the electronics industry, although the effect may be limited as recovery in China is not strong as expected. Core inflation is slightly easing estimated at 2.8% in July but upside risks remain. The ringgit's depreciated value will continue to exert pressure on import prices although Bank Negara Malaysia's presence in the foreign exchange market will help mitigate excessive currency movements. At the same time, dry weather caused by El Niño will likely decrease crop yields causing food prices to rise, while crude palm oil production could drop by 1-3 million tonnes by next year, which would further depress exports.

Philippines

Strong pent-up demand propelled economic expansion in the first quarter of 2023, though the impact was limited by higher inflation and massive borrowing costs owing to aggressive monetary tightening by the central bank. These factors dragged down private consumption and investments in the following months which led to a weakening of the economy in the second quarter. This was further exacerbated by the contraction in government spending resulting in real GDP growth of 4.3% in the second quarter, the lowest in nearly 12 years.

Real GDP growth is forecast to reach 5.6% in 2023 and 6.1% in 2024. A key growth driver in the second half of 2023 will be a strong rebound in government spending, from its 7.1% contraction in the recent quarter, executed through catch-up plans and frontloading of programmes and projects. Fiscal stimulus activities are also being implemented which should fuel activities of both the public and private sectors. Domestic demand is expected to continue to underpin economic growth in the remaining semester of 2023 and up to 2024, supported by labour market expansion, personal income tax cuts, stable inflows of remittances and the steady recovery of tourism. However, private investment is forecast to continue to weaken amid high interest rates and a subdued global economy, though improving business sentiment and the implementation of investment reforms should encourage investor confidence and attract more foreign direct investment (FDI). On the supply side, the services sector will continue its steady upward trajectory and will remain a reliable source of economic activity, boosting GDP growth, due to the improved outlook of tourism as well as rapid growth of the business process outsourcing industry. The manufacturing Purchasing Managers' Index (PMI) continues an expansionary trend in the sector, although at a slower pace amid sluggish external demand. Meanwhile, fiscal consolidation is underway, and the deficit is forecast to narrow in 2023-25.

Prolonged weak external demand from the United States and China, the country's top trading partners, will continue to drag down exports in the coming months. Another major downside risk to the growth outlook is lingering high global inflation, which could spur a further tightening of global financial conditions across advanced economies, possibly triggering capital outflows. This could push down the value of the Philippine peso, which is forecast to recover mildly from a sharp depreciation episode in 2022. The persistent global financial turmoil could translate into higher borrowing costs for the government, adding pressure to its public debt. On the domestic front, while headline inflation continues to decelerate, core inflation remains elevated though it is moderating slightly. Upside risks to inflation remain, such as the looming threat that El Niño will impact agriculture output, wage increases in the urban sector and the lingering restrictive policy stance of the US Federal Reserve (the Fed) and the European Central Bank (ECB). The Philippine central bank is likely to maintain a high interest rate regime, which will dampen GDP growth should pent-up demand ease.

Thailand

Thailand's real GDP growth moderated to a slower-than-expected pace of 1.8% in Q2 2023, bringing growth in the first half of 2023 to 2.2%. The global economic slowdown pulled down export growth to only 0.7% while falling investor confidence led to a significant contraction of investments from 3.1% in the first quarter to just 0.4% in the second quarter. Merchandise exports fell by 5.7% in real terms, mainly due to a reduction in agricultural products such as rubber and manufacturing products such as electronics and computer parts. Economic growth in the second quarter of 2023 was largely driven by robust domestic demand, particularly private consumption which rose to 7.8%, in line with the continued recovery of inbound tourism. This, in turn, fuelled steady expansion in the services sector which grew by 4.1% in the same period.

Real GDP growth is projected to expand at a lower rate of 2.8% in 2023 amid the continued slowdown in export activity, but growth is expected to improve to 3.5% in 2024. A large and

steady inflow of tourists from both China and other countries within Emerging Asia will be a key component in the solid recovery of Thailand's tourism sector. Over the short term, Thailand's economy will continue to be bolstered by private consumption and international tourism arrivals. Goods exports will weaken, held back by sluggish external demand due to a slow recovery of global manufacturing.

El Niño also poses downside risks to Thailand's growth, as unusually low average rainfall may lead to drought. Apart from the direct impact on the agriculture sector, droughts and water shortages could also impact manufacturing and tourism. The effects of El Niño could also pose upside risks to inflation along with increased consumption and possible higher spending by the new government. A high level of public debt poses yet another risk.

Viet Nam

Viet Nam saw growth that was weaker than expected in the first half of 2023 due to the persistent downturn in external demand from major global markets, and elevated core inflation pushing down consumers' purchasing power. Real GDP growth was recorded at 3.3% and 4.1% year-on-year in the first and second quarters of the year respectively, as the country struggles to buoy up its export-dependent economy amid a continued slowdown in demand from its major trading partners. Economic activity in the first half of the year was underpinned by moderate growth in final consumption which increased by 2.7% and investments by 1.2%. Exports in goods and services dropped by 10%.

Viet Nam's industrial production index continued to contract for the seventh consecutive month, falling by 12.3% in July and signalling a sustained contraction of the export-driven manufacturing sector, further exacerbated by power shortages resulting from the heatwave that affected the country in June. With the external environment remaining unfavourable, Viet Nam's growth is expected to remain subdued for the rest of the year. The real GDP growth forecast for 2023 is revised downwards to 4.9% but is expected to pick up to 5.9% in 2024. In the near term, private consumption will continue to moderate because of businesses scaling back their employment amid declining business confidence.

CPI inflation will continue to decline in 2023 as global commodity prices ease further. With inflation cooling down, it is likely that the State Bank of Viet Nam will continue its series of interest rate cuts to spur lending and investment, which could help build growth momentum along with the increase in government spending. Government policies to raise domestic consumption should also contribute to sustaining growth in the coming months, such as a lower VAT on some sectors, and an extension of the validity of e-visas to improve tourism. The services sector will remain a key driver of growth, especially in areas such as retail trade, accommodation, catering service, entertainment, and passenger transport. A continued recovery in the tourism sector will provide support to growth, though this will not be enough to offset the imminent headwinds for the balance of the year. A sustained recovery in the manufacturing sector will remain the key driver in boosting the country's economic activity and headwinds to exports are forecast to gradually ease from late 2023 to 2024 as the US and EU economies start to recover. Another downside risk to the country's growth outlook in the near-term is the impact of El Niño on the country's agricultural sector, particularly for crops such as rice, palm oil and coffee.

Brunei Darussalam and Singapore

Brunei Darussalam

Brunei Darussalam's economy improved slightly in Q1 2023, posting real GDP growth of 0.8%, year-on-year mainly driven by robust expansion in private consumption despite declines in government spending, investment, and exports. From the production side, the services sector grew by 10% supported by growth in air transport and other transport services following the end of travel restrictions, as well as growth in finance and other private services. Meanwhile, the oil and gas sector contracted by 5% amid the decline in the production of crude oil, natural gas, and liquefied natural gas following the COVID-19 pandemic which caused delays in exploration, development, and manufacturing. An increase is expected in the coming months as production challenges are overcome, although the recent cancellation of a large export contract with Japan may hinder this. FDI recorded a net outflow of BND 403.2 million (Bruneian dollars) in 2022, mostly due to falls in the manufacturing, mining and quarrying sectors due to the production challenges mentioned above.

The downstream petrochemical and fertiliser sectors saw growth of 14.3% in 2022 following the completion of major oil refineries and a petrochemical complex, and a full year of production at the new Brunei Fertiliser Industries plant. Increased imports in both sectors, especially in March, show that they continue to be a driver of growth and will support government budget if revenues from oil and gas continue to dwindle. Real GDP growth is forecast to moderate to 2.1% in 2023 and will slightly improve to 2.3% in 2024.

Inflation returned to pre-pandemic levels in March and further decreased to 0.8% in May due to the decrease in the prices of various modes of passenger transport and continued moderation across categories such as food and non-alcoholic beverages and housing, electricity, gas and other fuels. This will bolster private spending and support the services sector. Government subsidies are further contributing to the reduction of inflation.

Singapore

Singapore's GDP growth momentum was weak in Q1 and Q2 2023, with year-on-year growth of 0.4% and 0.5%, respectively. Reduced manufacturing output resulted from low external demand in key markets following the global economic slowdown, but robust services growth supported GDP. Outside of a slight spike in March, there was a dip in growth of Singapore's important electronics manufacturing and net exports, with a decline in annual growth predicted for 2023. Growth of domestic consumption has continued to fall despite decreasing year-on-year inflation in recent months. External pressures have played a role, with weakening sentiments amidst elevated global food, electricity and petrol prices. FDI saw a contraction of 20.9% year-on-year in Q1 as a result of increased borrowing costs following monetary tightening, but infrastructure investments to ensure resilience remain a policy focus of the government for the financial year.

Large growth in the services sector is providing much-needed support to GDP. Following the ending of restrictions last year, air travel and inbound tourism have seen an increase. Total retail sales were up 1.8% in latest data, from May. Most industries recorded year-on-year increases in sales due to increased domestic and tourism demand. All areas of food and beverage services recorded year-on-year growth in April, especially food caterers. The construction sector has also seen growth thanks to a strong labour market.

Singapore's economy is forecast to moderate in 2023 to 1.4% amid a continued slowdown in external demand though growth is expected to improve to 2.5% in 2024.

Inflationary pressures have eased thanks to monetary policy tightening by the Monetary Authority of Singapore. Food inflation has decreased and this should ease price pressures since Singapore is highly reliant on food imports. Housing inflation has also decreased thanks to macroprudential measures to cool the property market. Singapore's current account surplus increased to SGD 31 billion (19% of GDP) in Q2 2023, driven mainly by surpluses in goods and services balances.

CLM countries

Cambodia

Real GDP growth in Cambodia is projected to be at 5.1% in 2023 but pick up again to 5.9% in 2024. Growth in Cambodia's main exports, garments and footwear, will moderate in 2023 due to weakened demand from major importers in the advanced economies, leading to a manufacturing sector slowdown and a contraction of employment in the sector. Tourism is enjoying a strong rebound with travel restrictions no longer in place and 2023 projections for Cambodian tourism have already been surpassed in terms of both volume and spending. This will allow the services sector to make up for some of the decline in growth via manufacturing. Agriculture may take a step back, however, because of the expected El Niño conditions in 2023.

The Cambodian riel continues to face depreciation pressures with respect to the US dollar. Slow progress in Cambodia's de-dollarisation blunts the effectiveness of monetary policy actions. Fiscal policy will remain focused on combatting the effects of inflation. Private sector debt loads remain high, particularly in real estate. In addition, household debt as a share of GDP rose from 2019 to 2022.

Cambodia's trade deficit will likely remain elevated due to a combination of the need to import petroleum products and weakened export demand. This is the case even though gasoline and diesel prices have nearly fallen back to levels seen at the start of Q4 2021, after peaking in Q2 2022. Exports of fish and agricultural products grew nearly twentyfold quarter-on-quarter from Q4 2022 to Q1 2023 driven by exports to China enabled by the recent China-Cambodia FTA and an increase in rice exports to the European Union, even as rice exports to China have softened through 2023. Furthermore, Cambodia's large current account deficit remains a risk. The deficit stems from high demand for imported goods and slow tourism recovery, though tourism has picked up and visitor arrivals in the first half of 2023 came in at 77% of the volume observed in the first half of 2019. Current account deficits have historically been supported by FDI, but approved FDI contracted in the first two months of 2023, partly due to China's growth being weaker than expected.

Lao PDR

Real GDP growth in Lao PDR is projected to be at 3.4% in 2023 and improve to 3.8% in 2024. Lao PDR is caught in simultaneous high inflation and sharp currency depreciation, each of which strains households and firms. Year-on-year inflation decelerated slightly in Q2 2023, for the first time in eight quarters, but remained above 35%, while the Lao kip lost more than half of its value from June 2021 to June 2023. To combat these problems, the

country's central bank has aggressively raised the policy rate. An increasing debt load is another major concern.

Lao PDR's exports show signs of improvement, even as a year-on-year decline in Q1 2023 ended ten consecutive quarters of year-on-year growth. FDI increased year-on-year in Q1 2023 after five quarters of year-on-year decline. Agriculture accounts for nearly 70% of employment in Lao PDR and contributes more than a quarter of its GDP. El Niño weather conditions, projected for 2023, could reduce agricultural yields. Recoveries in agriculture and manufacturing could be hindered by labour shortages driven by workers seeking higher wages in neighbouring countries. Hydroelectricity is Lao PDR's largest export. After delays due to the COVID-19 pandemic response, a dam in Luang Prabang will come under construction in the second half of 2023. However, concerns abound over the dam's proximity to the Luang Prabang UNESCO World Heritage site, a fixture of the country's tourism sector, and the effects that flooding resulting from the dam could have on the site and the people who live nearby or depend on it for employment.

Public expenditure remains well below pre-pandemic levels, especially in key areas such as health and education as fiscal austerity measures are being used to rein in Lao PDR's sovereign debt stock. Furthermore, rising prices of materials have increased construction costs for public expenditure projects, leading the government to postpone or cancel several planned ones.

Myanmar

Real GDP growth in Myanmar is projected to remain weak in 2023 and 2024. The country's trade deficit has widened as imports have increased while exports have declined. Manufacturing has slowed amid frequent electricity shortages and heightened administrative hurdles, especially in international commerce. Cyclone Mocha struck Myanmar in May 2023, flooding cropland and fisheries, harming livestock through loss of grazing land, and negatively affecting the economy. Fiscal deficits will likely remain larger than they were prior to the COVID-19 pandemic. The coup in Myanmar and the resulting political and safety uncertainty pose risks to growth, especially in tourism and foreign direct investment.

China and India

China

China's sudden decision to abandon its stringent zero-COVID policy in late 2022 has brought changes that reshape the short-term outlook for the Chinese economy. The strong recovery was led by in-person services, while goods sales and online services sales remained stable. Sales of domestic tourism services shot up due to pent-up demand after the opening. However, judging from recent high-frequency data, the recovery has started to lose momentum. The PMI's manufacturing component has begun to contract, and the services component has weakened as well. New export orders are weak, as indicated by the contraction of the respective PMI component, owing to weak global demand. The employment component has remained in contractionary territory for most of the time since the outbreak of the pandemic, reflecting high uncertainty and translating into higher household savings.

Economic growth in 2023 is likely to be lower than initial forecast of 5.4% and will continue to decline to 5.1% in 2024. Exports are expected to remain weak until global demand

recovers. Consumption has also been weaker than expected since the beginning of the COVID-19 pandemic. While demand-side stimulus measures aim to bolster consumption, their impact is likely to be short and frontload consumption without changing its overall volume substantially. For consumption to reach its potential, more fundamental structural reforms are needed. In particular, the social safety net needs to be strengthened to reduce precautionary savings. A wider range of medicine and treatment need to enter the scope of reimbursement to make sure that no one falls into poverty due to high medical costs. Furthermore, all workers should be covered by unemployment insurance to provide for living costs during business cycle downturns or economic transformations.

With the recent default on coupon payments of another large property company, property sector debt problems are gradually coming to the surface. While these credit events may imply greater risk aversion and thus more restricted financing conditions for property companies in general, they do not constitute systemic risk as the regulations governing mortgage financing are stringent. Moreover, debt renegotiation and restructuring appear to be feasible ways to resolve debt issues. Similarly, recent defaults by a trust company do not pose a threat to financial stability as asset management rules have become more stringent since 2018. In addition, a Trust Protection Fund was established to buy risky assets in 2021 and the trust industry's exposure to real estate has fallen significantly.

Amid weaker-than-expected growth momentum, China implemented policies to shore up growth in June. The central bank lowered short- and medium-term policy rates by 10 basis points on 13 and 15 June, respectively, and on 20 June it cut the benchmark rate, the one-year loan prime rate, by 10 basis points to 3.55%. Continued weaknesses confirmed by data release necessitated further cuts: on 15 August, medium-term policy rates were cut by 15 basis points and on 21 August the one-year loan prime rate by 10 basis points to 3.42%. The cuts are implemented in an incremental manner to protect banks' net interest margins and are expected to trigger lowering of deposit rates. Lower interest rates are expected to ease the debt burden on households and coupled with easing measures on the demand side (e.g. relaxing some restrictions on buying and reselling real estate or lowering down payments) could potentially facilitate property sales and investments. A large carryover of infrastructure projects is expected in 2023, as the proceeds of bonds issued were not used in 2022, while tax exemption and reduction measures have been announced for small and micro enterprises. High global energy and food prices did not pass through to the Chinese economy. In contrast, recent CPI data exhibit a dive into negative territory. As this reflects movements in food prices, which have traditionally been the major driver of CPI inflation trends due to a high Engel coefficient, deflationary concerns arise, but they are not yet a cause for worry. In any case, measures to revive consumer confidence and to support the economy need to be adopted. China's large oil and grain reserves will mitigate the impact of rising global energy and food prices. Structural reforms aiming to boost growth should be stepped up. The country issued a "guideline on improving the market-based allocation mechanism of production factors" in April 2020, with a pilot plan released in January 2022. This principle should be pursued along with a greater role for the private sector in allocating capital to achieve greater efficiency and revive growth.

India

India's economy has fared better than expected despite global headwinds affecting the region. The country ended fiscal year 2023 with surprisingly robust growth of 6.1% in the last quarter, largely fuelled by private consumption and investment on the demand side. The economic outlook for fiscal year 2024 appears to be positive, though certain external and domestic factors indicate a moderate pace of growth. Pent-up consumer demand is expected to dissipate gradually, weighed down by high inflation in energy and food prices which will persist in the second half of 2023 with July inflation hitting a 15-month high at 7.4%, up sharply from 4.8% in June.

Investment will remain a key driver of growth, though appetite for investment will moderate as earlier domestic monetary tightening progressively takes effect. However, the Reserve Bank of India is expected to start easing policy rates in early 2024, subject to a decline in headline inflation. Government spending will increase on the back of substantial frontloaded capital expenditure on infrastructure and its rapid execution, as earmarked in the 2023/24 fiscal budget. Barring slow progress on regulatory reforms, steady inflow of FDI should bolster the manufacturing sector, particularly electronics, chemicals, automobiles and textiles. Overall, real GDP is forecast to grow well above the regional average projected at 6.0% in 2023 and rising to 7.0% in 2024.

The agriculture, manufacturing, mining, construction and services sectors all recorded solid growth in the last quarter of the fiscal year. Downside risks are a contraction in the agriculture sector caused by weather disturbances such as El Niño and heatwaves. The advent of El Niño is expected to cause erratic or insufficient rainfall, which will reduce agricultural output and farmers' incomes and push up food prices. This could impact plans to cut the policy repo rate in early 2024. Energy disruptions caused by El Niño may trigger energy price volatility, though the impact will vary across regions. The urgency for fiscal consolidation may put pressure on government spending, though this may be delayed with national elections upcoming in 2024. Nonetheless, the fiscal burden on the central government remains high. Downside risks to consumption demand include the impact of export slump to the labour market in export-oriented industries; food inflation; the rise in home loan equated monthly instalments amid rate hikes; and the impact of all this on the budgets of middle-class families.

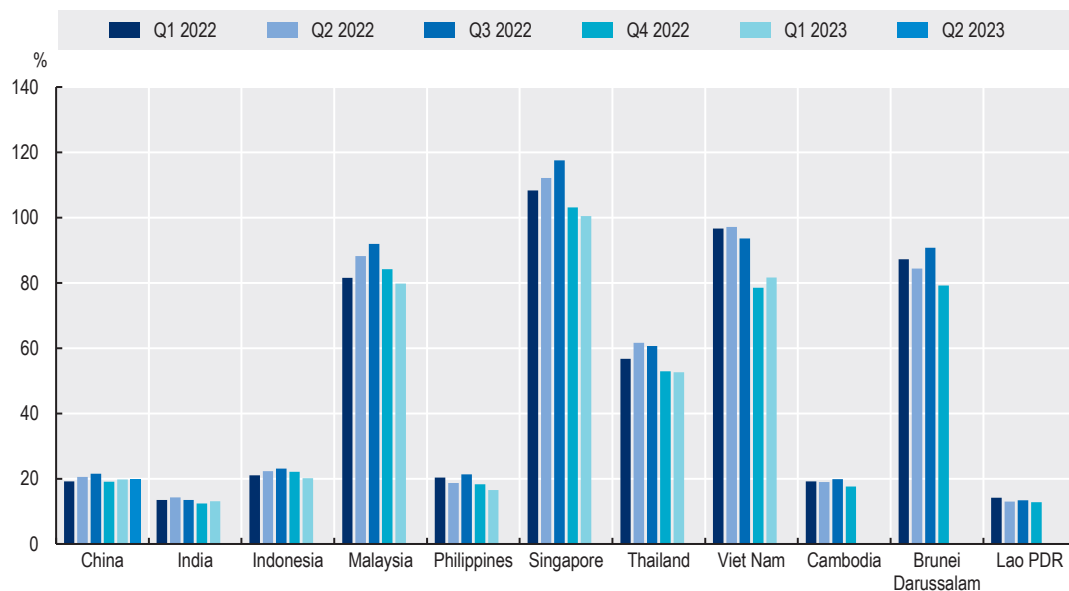
Export growth contracted owing to a decline in demand for exported goods

Export growth in many countries in the region experienced substantial contraction in Q2 2023. In China, the modest growth in goods exports in Q1 2023 was driven by gains in the global market share for industrial machinery, petrochemical products and automotives. However, exports dropped in the second quarter following the continued slowdown in global demand.

In other countries, exports registered a decline due to a slowdown in demand for goods exports from major trading partners exacerbated by limited export diversification (Figure 1). For example, the Philippines recorded a decline in exports in the first and second quarter of this year owing to its heavy reliance on electronics products and dependence on the United States and China as major trading partners. Indonesia recorded a marginal contraction in exports in the same period due to China's weaker-than-expected growth momentum and

lower commodities prices. Export growth also contracted in Malaysia owing to weaker economic recovery of China, its major trading partner, and a slowdown of demand from the United States.

Figure 1. Exports in selected Emerging Asian economies, Q1 2022-Q2 2023 (% of GDP)



Source: CEIC.

StatLink <https://stat.link/cp6xl1>

Persistent global headwinds will continue to be felt in Emerging Asia. High inflation and restrictive monetary policy in the United States will continue to slow down its economy in 2023 and 2024. The decline in demand for imports from the United States will persist in 2023 and 2024, and the decline in the volume of imports of goods and services will persist. The technology industry will experience a continued downturn, compounded by the tight monetary and financial conditions. Such slowdown has caused a substantial drop in exports from Emerging Asian economies, particularly for countries exporting electronics and semiconductors, such as the Philippines, Malaysia, Indonesia, Thailand, Singapore and Viet Nam. Economic growth in the European Union is also expected to be marginal in 2023 and 2024, causing imports to remain at low levels. These trends in advanced economies will continue to put pressure on exports in Emerging Asia.

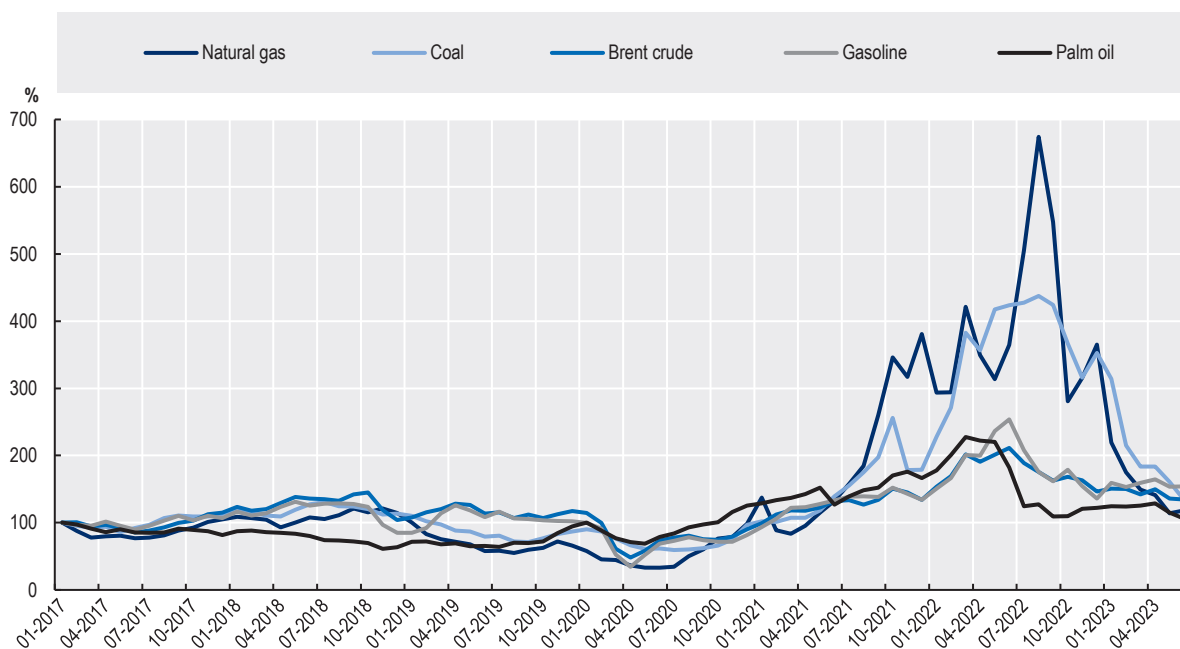
Impact of global uncertainty on countries will depend on their degree of export dependency

Goods exports will continue to provide a large share of the contribution of exports to GDP growth in Emerging Asia, though services exports are on the rise. For some economies in the region, export growth will remain a fundamental driver of economic expansion and a slowdown in exports will result to a direct contraction of GDP growth. An example is Thailand, which depends significantly on exports of manufactured goods and services, particularly in the tourism sector. Between Q1 2022 and Q1 2023, Thailand posted a substantial share of

manufacturing exports as a percentage of GDP, while sectors such as agriculture, fishery and forestry posted marginal shares in the same period. This has also exposed the economy to heightened and lingering vulnerabilities to external shocks, including fluctuations in external demand and economic downturns in major trading partner countries.

Economies rich in natural resources are also vulnerable to commodity price volatility, which can disrupt their export earnings and overall economic stability. Export prices for commodities and goods can be highly volatile, subject to fluctuations in the dynamics of global supply and demand. For instance, energy commodity prices such as crude oil, gasoline, and coal are projected to significantly drop in 2023. Such a decline in commodity prices contributed to the dampening of commodity exports for resource-rich economies. For example, a surge in coal prices in 2022 led to a healthy current account balance in Indonesia in the latter half of the year, and this in turn strengthened its currency. In contrast, a continued decline in coal prices in 2023 will impact Indonesia's export revenues and trade balance (Figure 2). A similar trend is observed in Malaysia as palm oil prices fluctuate.

Figure 2. Evolution of selected primary commodity prices, January 2017 to June 2023



Source: IMF, Primary Commodity Price System database.

StatLink <https://stat.link/xmk687>

Meanwhile, some economies in Emerging Asia that lack export diversification and are heavily focused on specific industries or sectors are vulnerable to sector-specific risks. For example, the slump in external demand for electronics and semiconductors weighed heavily on electronics exports in the Philippines, Malaysia, and Viet Nam, given that China, the United States and the European Union are their main trading partners.

Finally, export-dependent countries also face challenges due to exchange rate-fluctuations. A notable case is Malaysia's deepening struggle to support the ringgit exchange rate. The value of the ringgit started to slide during the first half of 2022 amid policy tightening in the United States, while the simultaneous weakening of the Chinese yuan against the dollar

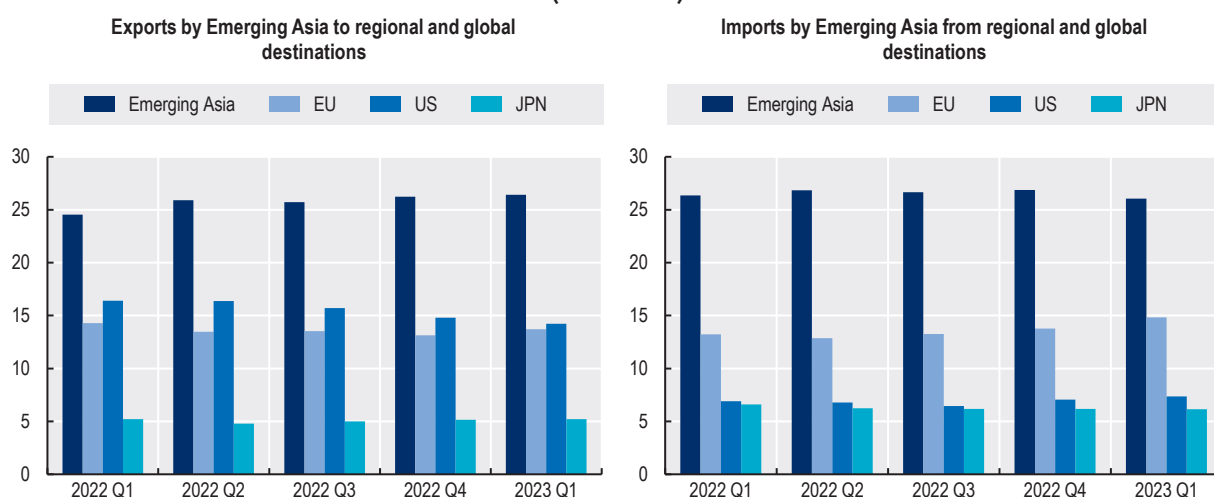
exacerbated the ringgit's depreciation. During the second half of 2022, aggressive rate hikes by the Fed outweighed the impact of higher palm oil exports. By the first half of 2023 the ringgit had not recovered. This has prompted the monetary authority to intervene in the foreign exchange market to stabilise the currency.

The varied nature of export dependency among countries in Emerging Asia will translate into uneven effects. How economies cope will depend both on the diversity of their export base and on their overall economic strength. Some economies, such as those of Thailand, Singapore and Malaysia, are mainly export driven, while others, such as Indonesia and the Philippines, may have higher export shares in specific sectors or commodities but with a broader economic base. Countries will therefore need varied policy responses in combatting the impact of global uncertainty on trade.

Regional demand helped sustain exports

Despite persistent external shocks and waning external demand over the first half of 2023, Emerging Asia's exports will continue to be supported by robust regional demand, which has helped buffer against global downside risks. Access to multiple markets within closer geographic range has broadened the regions' export destinations beyond the United States, European Union, and Japan. In the first quarter of 2023, intraregional exports and imports (Emerging Asia to Emerging Asia) are at 26.4% and 26%, continuing to surpass the region's exports to and imports from the United States, European Union or Japan (Figure 3). ASEAN records an even larger share of exports to Emerging Asia, with ASEAN-to-ASEAN exports estimated at 23.4%, ASEAN to China exports estimated at 14.9% and ASEAN to India exports at 3.7%, for a total of approximately 42% for the region (Figure 4). Meanwhile, ASEAN's exports to the United States, European Union and Japan are substantially lower, at 30.1%.

Figure 3. Emerging Asia's exports to and imports from regional and global destinations (% of total)

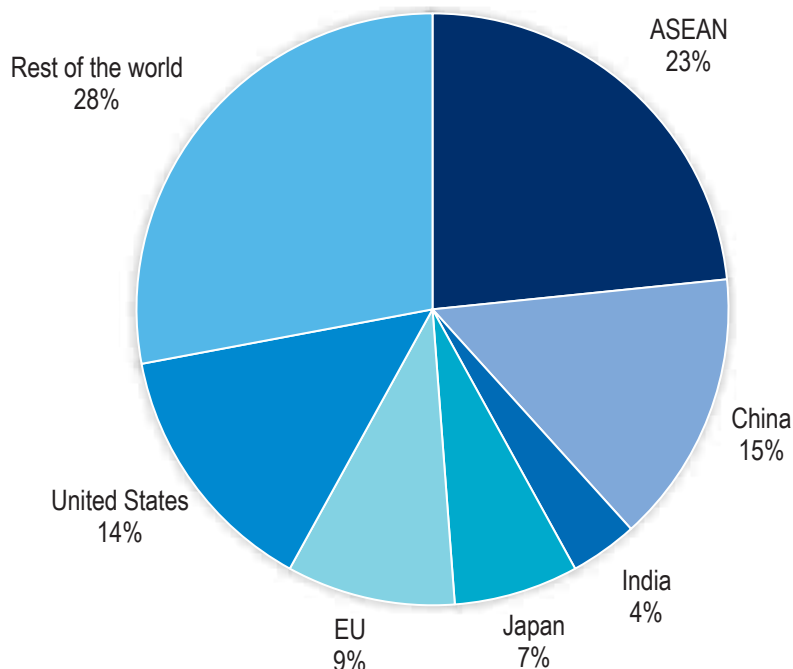


Notes: 1) Exports: Emerging Asia as area of origin includes China, India, Indonesia, Malaysia, Singapore, Thailand and Viet Nam. Emerging Asia as destination includes China, India and the ASEAN member countries. 2) Imports: Emerging Asia importer countries include China, India, Indonesia, Malaysia, Singapore, Thailand and Viet Nam. Emerging Asia as area of origin includes China, India and the ASEAN member countries.

Source: CEIC.

StatLink  <https://stat.link/uq9z0m>

Figure 4. ASEAN exports to selected Asian and global destinations (% of total)



Note: ASEAN as area of origin includes Indonesia, Malaysia, Singapore, Thailand and Viet Nam (Thailand's exports exclude India). ASEAN as destination includes the ten ASEAN member countries.

Source: CEIC.

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Another key factor in Emerging Asia's exports sector is that the dynamic of intraregional trade has shifted, with the region changing from being merely the source and destination of intermediate goods to becoming the main export destination for final goods. Such trade scenario is expected to persist brought about by the region's sustained expansion in economic growth, income and working population, fuelling the rapid rise of the consumer class. This, in turn, is expected to sustain regional and domestic demand. In particular, the major economies in ASEAN are projected to expand their share of final demand, with their growing middle-class populations driving the consumer market. As an example, Indonesia is projected to become a large consumer market by 2030, with almost 76 million people (Statista, 2021). The Philippines' consumer class is also expected to post rapid growth (Statista, 2021).

Robust intraregional trade dynamics are also cushioning the region from an increase in protectionist policies. In the first half of 2023 alone, Emerging Asia was affected by about 220 protectionist trade policies enacted by different countries and regions worldwide. Stronger ties among Emerging Asian economies will strengthen regional integration and foster stability in trade relations among economies. The Regional Comprehensive Economic Partnership (RCEP) free trade agreement, signed in 2020, will become instrumental in accelerating regional integration in Emerging Asia in the long term. Meanwhile, the Indo-Pacific Economic Framework for Prosperity (IPEF), launched in 2022, involves 12 initial partners, including eight countries from Emerging Asia: Brunei Darussalam, India, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam. Key areas expected to be developed under the trade initiative are: i) the development of small and medium-sized

enterprises (SMEs) and their integration into the digital economy; and ii) the strengthening of supply chain commitments that aim to cushion regional trade from disruptions in supply chains and rising geopolitical risks.

Growth in services exports is expanding and has overtaken growth in goods exports

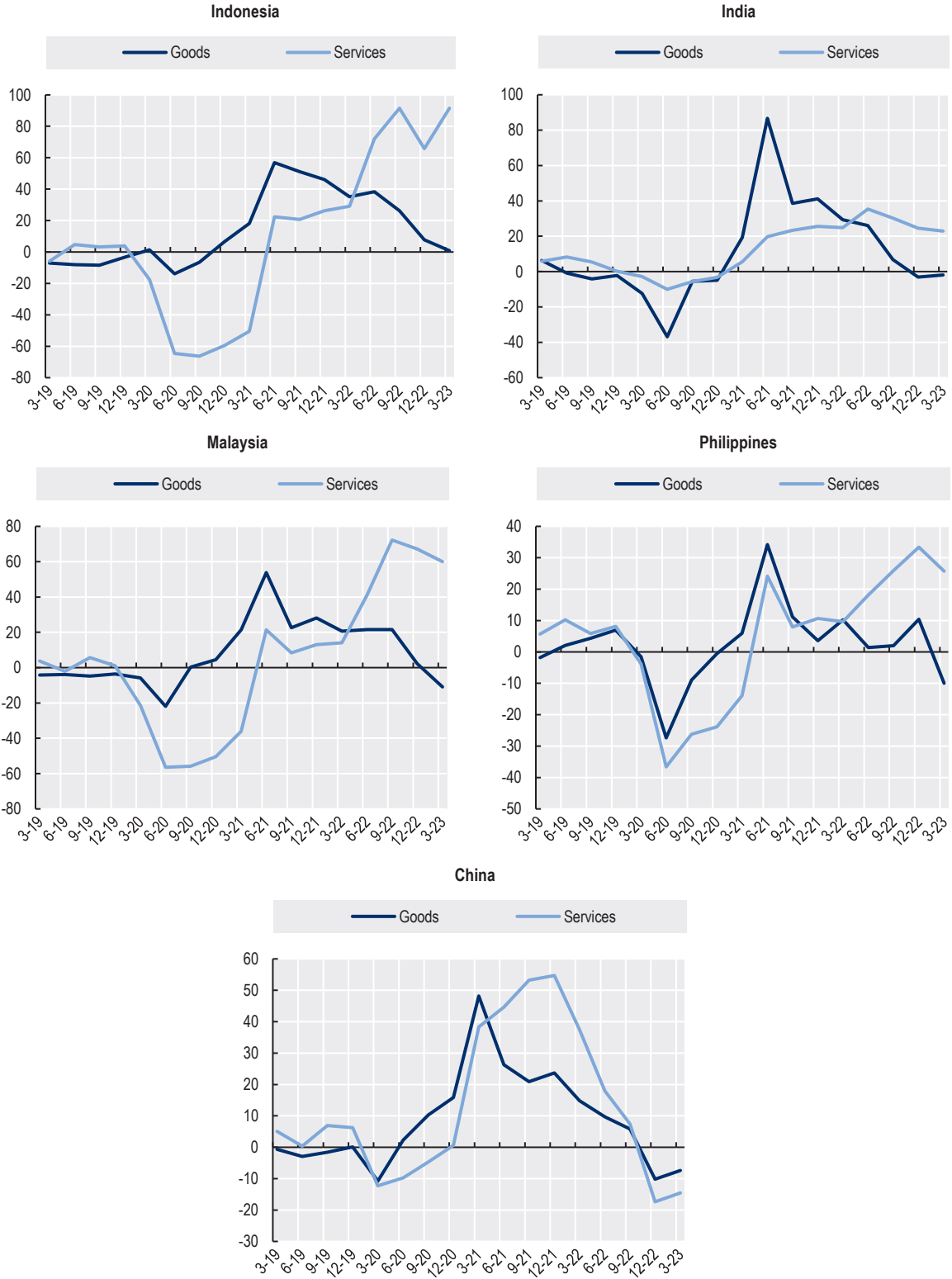
A positive trade outcome in 2023 is that while the world is struggling with a slowdown in demand for manufactured goods and commodities, exports in tourism, ICT, finance and other professional services continued to strengthen. Services exports have been rapidly expanding worldwide, underpinned by robust demand, rising prices of services, and the increasing digital integration of economies. In 2022, world services exports reached USD 7.2 trillion, an annual increase of 15.3% (UNCTAD, 2023). International travel receipts increased by 92% on the back of pent-up demand and rising prices (UNCTAD, 2023). Asia and the Pacific registered the highest services export growth among the world's regions, largely driven by international travel receipts.

In Emerging Asia, services exports rose strongly in the first half of 2023, helping keep export activity afloat in most of the region's economies amid the substantial decline in merchandise goods. Annual growth of services exports has outpaced growth in merchandise exports in most major economies in Emerging Asia (Figure 5). This gap is expected to widen in the near term amid the rapid expansion of services exports globally and continued weakening demand for goods exports from advanced economies. In India, the upsurge of export growth was mainly driven by the stronger than expected performance of services exports, underpinned by robust retail trade, software services, commercial real estate and tourism. Thailand's services exports will continue to support overall export growth for the rest of 2023, aided by China's reopening, while the development of subsectors such as finance and logistics will contribute to the expansion of services exports. Singapore's modern services sector, including logistics and other advanced services such as finance, insurance, telecommunications, ICT and professional services, will remain a key contributor to GDP growth in the near term. In China, services exports are also forecasted to rise as the economy recovers from zero-COVID policy. These exports are now fuelling the revival of overseas construction projects.

Figure 5. Export growth in goods vs. services in selected Emerging Asian countries (%)



Figure 5. Export growth in goods vs. services in selected Emerging Asian countries (%) (cont.)



Source: CEIC.
 StatLink  <https://stat.link/hlxm2n>

While services exports are rapidly expanding globally and regionally, they still account for a relatively smaller share of total trade than merchandise exports do. Hence, despite the gains achieved by the subsector, the considerable slump in merchandise exports led to an overall decline in exports. Nevertheless, the share of services exports will continue to expand across most major economies in Emerging Asia going forward. Although current estimates indicate that international tourism is the major driver of growth, the development of other forms of services exports will ensure the continued expansion of the subsector such as the imminent supply chain reconfiguration directed towards ASEAN and India. Moreover, the rapidly developing cross-border e-commerce sector, including its complementary services such as transport, warehousing and other logistics operations, will continue to fuel demand for services exports in the near term.

FDI inflows will boost the region's export sector

The competitiveness of export industries in Emerging Asia, such as electronics, the automotive industry, machinery, textiles, agriculture and consumer goods, is projected to drive export growth by a large fraction. Governments are implementing policies and initiatives to strengthen and diversify the export base and develop infrastructure such as transportation networks, ports and logistics. These, plus a stable political environment, should lead to an increase in FDI inflows. Looking ahead and barring the impact of a prolonged slowdown in external demand, countries in the ASEAN will continue to reap export benefits thanks to large inflows of FDI in 2021 into manufacturing, finance and some service industries. These countries are broadening their export base to include electric vehicles (EV), pharmaceutical goods, electronics, ICT and fintech services. Malaysia is strengthening its competitiveness as a global electronics hub through investments from multinational companies such as Intel's USD 7 billion investment in a semiconductor packaging plant and another investment valued at MYR 8 billion, or about USD 1.7 billion, on a wafer fabrication module facility which will add significant manufacturing capacity in power semiconductors. Indonesia also benefits from an upsurge in FDI inflows as it implements the job creation law and the government's industrial downstreaming strategy for processing raw minerals. The latter strategy aims at helping create Indonesia's production capacity along the electric vehicle supply chain and help establish itself as an EV battery production hub. Major EV makers in the United States and China are finalising investment deals in Indonesia to boost its nickel-based EV battery industry. In the Philippines, amendments to foreign ownership regulations and reform measures that reduce corporate income tax by at least five percentage points are expected to attract more FDI. The RCEP is also expected to boost garment exports from the country by broadening its export market.

Meanwhile, Cambodia's Export Diversification and Expansion Programme is gearing towards diversification to higher value-added segments in manufacturing, such as semiconductor production. It is also strengthening export capacity in the garment, tourism and agriculture sectors. In India, a substantial capital outlay in the 2023/24 budget will be channelled towards improving infrastructure, strengthening connectivity and enhancing the overall export value chain. Along with advantageous demography and a steady growth trajectory, this is expected to lead to greater flows of FDI into the manufacturing sector.

Monetary policies will remain tight amid high inflation and upside risks

Headline inflation across most economies worldwide moderated in the first half of 2023 due to a highly synchronised and intense tightening of monetary policies. However, much of the cooling in inflation is attributed to the decline in commodity prices and the easing of pressure on global supply chains as the impact of external shocks, such as pandemic-related activity restrictions and Russia's invasion of Ukraine, has diminished. Price levels in most jurisdictions remain elevated, and core inflation figures are still above target. The rate of inflation in the United States is at 3.2% in July, still higher than the Fed's benchmark target of 2%, while the job market is gradually slowing down. The rate of inflation in the Euro area, at 5.3% in July, is more than the European Central Bank's medium-term target of 2%. Average headline and core inflation in the OECD member countries is higher than in most countries in Emerging Asia (Table 2). The advanced economies are therefore likely to raise policy rates further or maintain a tight monetary stance this year. This poses a major risk to Emerging Asia's efforts to sustain economic growth momentum while ensuring price stability.

Table 2. Consumer price inflation and core inflation in the OECD and Emerging Asia, July 2023

	Consumer price inflation (%)	Core inflation (%)
OECD average	5.7	6.6
ASEAN-5		
Indonesia	3.1	2.4
Malaysia	2.0	2.8
Philippines	4.7	6.7
Thailand	0.4	0.9
Viet Nam	2.1	2.6
Brunei Darussalam and Singapore		
Brunei Darussalam	0.8	–
Singapore	4.1	3.8
CLM countries		
Cambodia	0.1	0.6
Lao PDR	27.8	–
Myanmar	19.5	–
China and India		
China	-2.9	0.0
India	7.4	5.1

Note: Latest data as of July 2023. OECD average and Cambodia data as of June 2023. Brunei Darussalam CPI data as of May 2023; Myanmar data as of July 2022.

Source: CEIC.

Meanwhile, inflation in Emerging Asia is more restrained than elsewhere on the back of governments in the region actively implementing policies such as subsidies, export restrictions, tax cuts and price controls to contain the impact of rising global food and energy prices (OECD, 2023). Recent estimates show headline inflation declining, although the rate of decrease varies across the region. Core inflation is proving stickier and appears to be either stabilising, as in Indonesia, or surpassing the level of CPI inflation, as in Malaysia, Philippines, Thailand and Viet Nam (Figure 6). In India, headline inflation projection for

fiscal year 2023-2024 has been revised up to 5.4% owing to the recent upsurge in food inflation fueled by the price shock from vegetables. Core inflation remains high due to sticky prices in sectors such as clothing and footwear, health, personal care, education, and household goods and services. Malaysia's headline inflation is expected to moderate, though, the gap between core and CPI inflation continues to widen. Inflation in Singapore and Thailand is expected to moderate, but core inflation remains elevated. Meanwhile, Indonesia has performed better than other economies in the region, with inflation forecast to be within the central bank's target range of $3.0\% \pm 1\%$ in 2023.

Monetary policies will remain tight given that the region will continue to exhibit robust domestic demand, underpinned by solid labour market expansion and rapid growth in the services sector. The threat of weather-related disturbances due to El Niño could exacerbate the problem and push food inflation higher. Upside risks to inflation that persist outside the region include tight financial conditions, geopolitical tensions, and uncertainty over the future trajectory of monetary policy in advanced economies.

Figure 6. Consumer Price Index and core inflation in selected Emerging Asian countries, January 2021 to July 2023 (%)

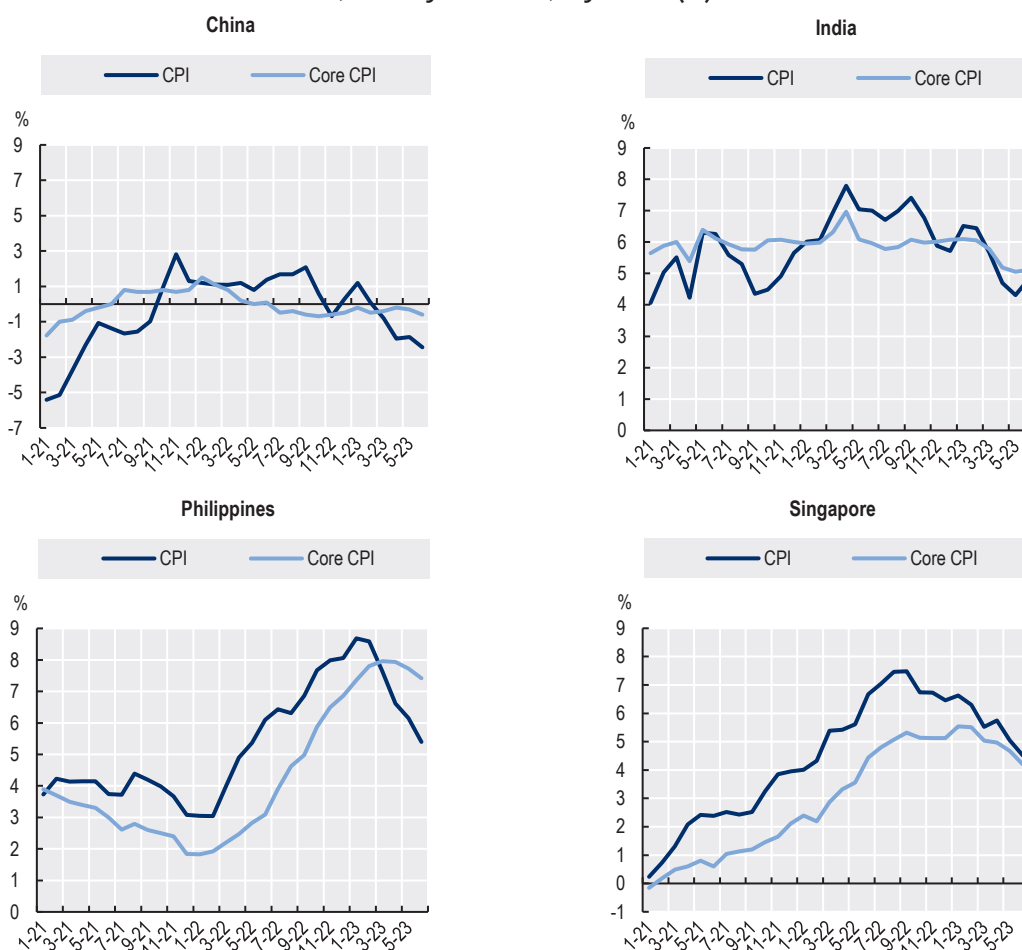
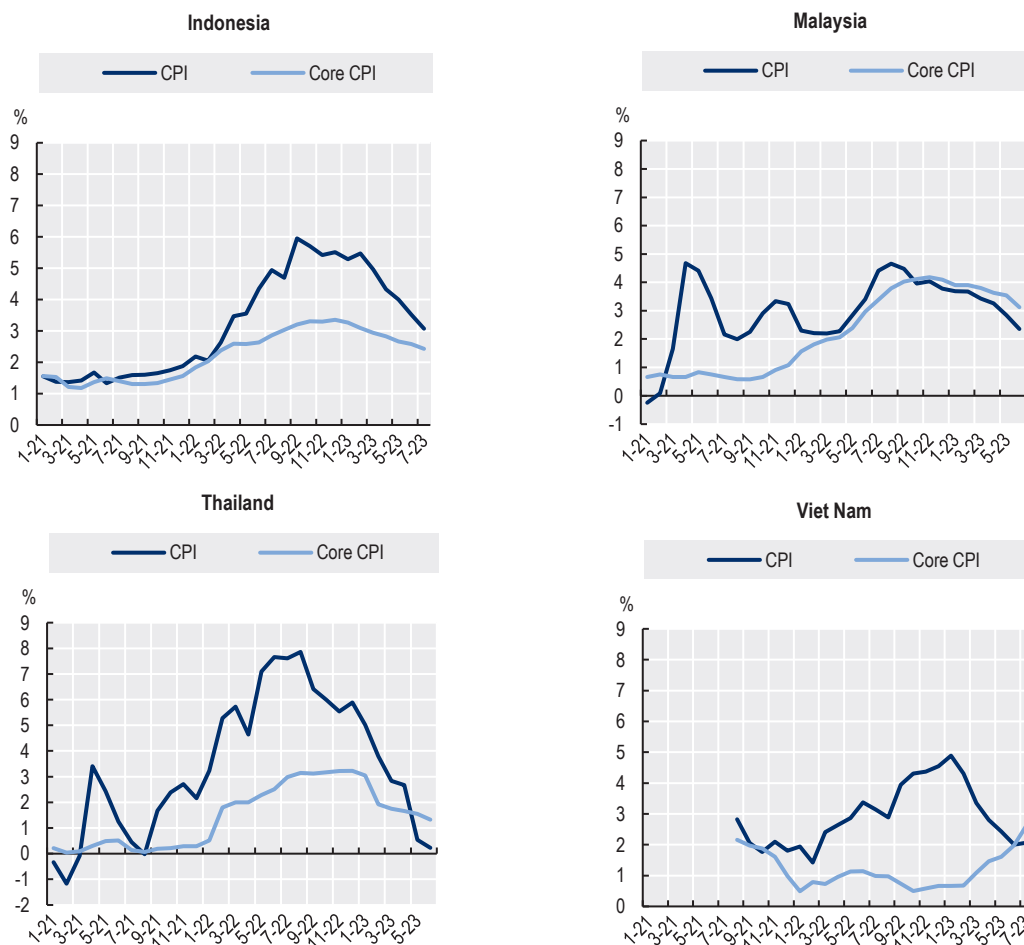


Figure 6. Consumer Price Index and core inflation in selected Emerging Asian countries, January 2021 to July 2023 (%) (cont.)



Note: Data for China, India, Philippines, Singapore, Malaysia and Thailand as of June 2023.

Source: CEIC.

StatLink  <https://stat.link/veg0n1>

A recent report from the Bank for International Settlements suggested that the factors that initially triggered the surge in inflation have weakened and been replaced by mounting prices for services. This rise of services as the main driver of inflation has become evident in the United States and other advanced economies, as well as in Latin America and Emerging Asia, and is likely to persist in the near term. In Emerging Asia, services inflation is expected to be anchored to the region's expansion of the services sector and is likely to persist.

On a positive note, previous monetary policy actions are yielding the desired results, and barring upside risks, most monetary authorities are well on the way to anchoring inflation expectations. The threat of a wage-price spiral in the region is counterbalanced by the continued implementation of public policies aimed at increasing disposable income. These policies include personal income tax cuts in the Philippines; household power subsidies in Thailand; subsidies for essential goods, fuel, and electricity in Malaysia; and housing and public health care subsidies in Singapore.

Looking ahead, it is imperative to have clear public communication of tightening measures in the face of upside risks to inflation. This also minimises the uncertainty of future path of monetary policy and helps to improve forecasts of the monetary authorities' objectives and understanding of the rationale behind their policy decisions.

Financial markets in the region are relatively stable, but reactions to stress vary across countries

Financial markets in Emerging Asia appear relatively stable despite signs of stress in the financial system, and market sentiment remains mildly positive. This is attributed to the cautious suspension of restrictive monetary policies, sustained economic expansion driven by robust domestic demand and declining headline inflation.

Financial markets in Emerging Asia are diverse in terms of business climate, institutional or political developments, fiscal and monetary policies, and sector strengths, among other factors. Therefore, financial markets exhibited mixed reactions at the country level to the tight monetary-financial-fiscal nexus worldwide.

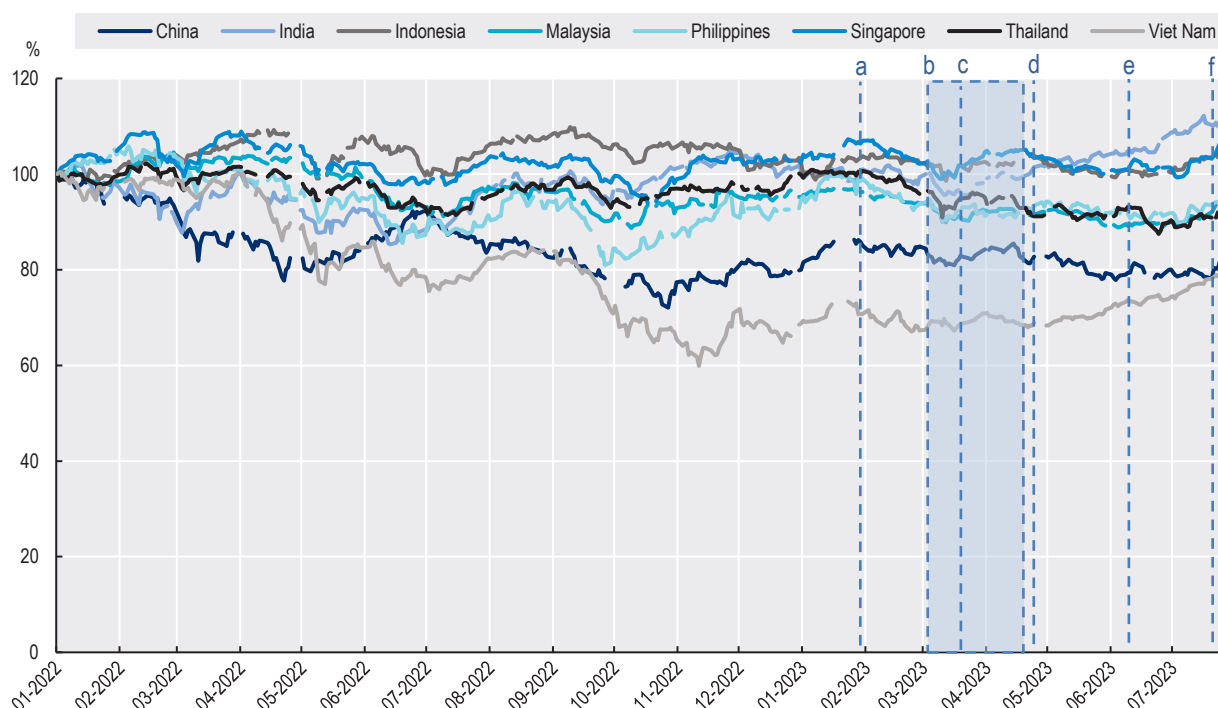
Some equity markets in the region weakened slightly in the first half of the year as they struggled to keep pace with unfavourable conditions. Benchmark equity indices were observed to rise and fall monthly, with significant fluctuations particularly in the first quarter, following more restrictive monetary policy rate decisions, both internationally and domestically. However, the financial market turmoil in early March in the banking sector in the United States and Europe had limited impact, as banks in the region demonstrated strong capitalisation, high liquidity coverage ratios, sticky deposit bases and well-diversified corporate deposits across industries. The impact on benchmark equity indices in China and the major ASEAN economies (Indonesia, Malaysia, Philippines, Singapore and Thailand) was minimal.

The second quarter of 2023 witnessed a cautious pause by some monetary authorities, which helped to stabilise the impact of elevated interest rates worldwide. China's equity markets continued to weaken in April as economic indicators belied expectations of a strong economic rebound this year. In the same month, markets in India, Indonesia and the Philippines rallied as monetary authorities in advanced economies and Emerging Asia showed no signs of further interest rate hikes, and inflation started to moderate. In May, however, major economies in the ASEAN region, namely Indonesia, Malaysia, Philippines and Singapore, accumulated losses as risk sentiment weakened ahead of the US debt ceiling negotiations and further tightening of benchmark interest rates by the Fed and the European Central Bank (ECB). By the middle of June, equity markets had begun to recover, with major benchmark indices posting moderate to significant positive gains (Figure 7).

Equity markets in the region are expected to maintain a positive outlook in the near term, underpinned by factors including a bullish outlook for emerging sectors, particularly in the services arena, such as e-commerce, other digital technology-based services and the services arm of the manufacturing industry. Most governments in the region are increasing their capital outlay to bolster infrastructure development, which should boost business expansion in supply chain-related industries, the manufacturing sector and the labour market. Furthermore, the impact of El Niño is expected to be mild, with the expectation

that government policies to cushion food price inflation will be in place. For example, the Philippines has rolled out a 2023 El Niño Mitigation and Adaptation Plan, while Indonesia plans to prepare approximately 500 000 hectares of agricultural land targeting six regions to ensure the availability of national rice supplies and control the potential impact of El Niño.

Figure 7. Benchmark stock market indices of selected Emerging Asian economies, January 2022 to August 2023



Note: a) The Fed raised interest rates by 25 basis points on 1 February 2023. b) A banking crisis in the United States that began in March triggered reaction on markets worldwide. c) the Fed raised interest rates by 25 basis points on 22 March 2023; d) the Fed raised interest rates by 25 basis points on 3 May 2023; e) the Fed maintained interest rates on 14 June 2023; f) the Fed raised interest rates by 25 basis points on 26 July 2023.

Source: CEIC.

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Finally, stock market reforms should also boost financial markets in the region and contribute to steady FDI inflows. As an example, Viet Nam's continuing business reforms to upgrade its stock market to emerging economy status by 2025 are projected to boost stock prices by up to 3%. Meanwhile, Malaysia will undertake reforms in its capital market, expediting the initial public offering process and reducing time-to-market to enhance market competitiveness and attractiveness. In July, the government reduced stamp duty charges for shares traded on Bursa Malaysia from 0.15% to 0.10% of the contract value, subject to a maximum of MYR 1 000 per trade.

Going forward, mild losses are expected as external headwinds persist and impact financial markets in the region. While some regional monetary authorities have relaxed monetary tightening in recent months, they may reverse this stance if upside risks to inflation materialise in the short term. For instance, more interest rate hikes by the US Federal

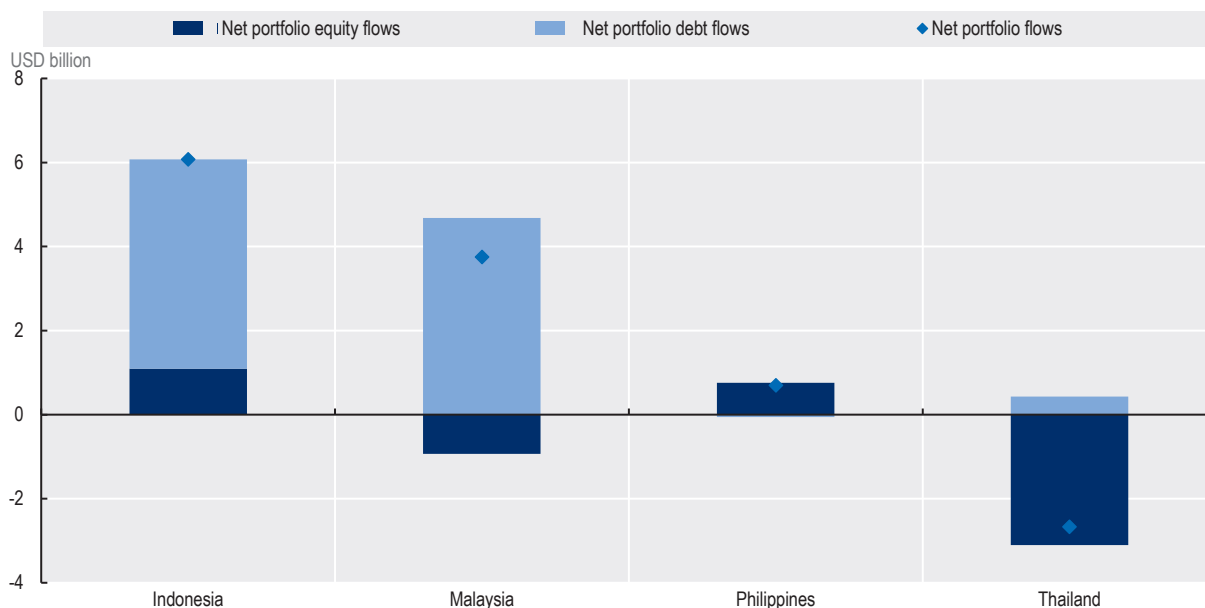
Reserve are expected to impact policy rates in the region and weaken its equity markets. Policy makers therefore need to monitor and track financial volatility closely, given the uncertainties and near-term risks in the macroeconomic environment.

Regional bond markets outperform equity markets

Bond markets in Emerging Asia experienced mild volatility over the first half of the year. Month-on-month yield differentials of 1-year and 10-year government bonds showed fluctuations as bond yields responded to monetary decisions in advanced economies and central banks within the region. The significant impact, particularly for short-term government bonds, was observed in the first quarter of the year. Monetary authorities retained a tight position in February, with the Fed and the ECB raising their policy rates by 25 and 50 basis points, respectively. Combined with similarly tight benchmark rates in the region, this led to substantial hikes in bond yields across major economies in the first half of the year.


Despite the volatility, bond markets in the region recorded better returns than equity markets during the first half of the year amid tight monetary policies and turmoil in the global banking sector. Bond markets offered more attractive investment values in a macroeconomic environment characterised by high interest rates, high inflation, and depressed risk premiums on financial assets. While the region experienced net portfolio equity outflows during the first half of the year, Emerging Asia mostly recorded net portfolio debt inflows in the same period (Figure 8).

Figure 8. Net portfolio equity and debt flows in selected ASEAN economies, January to June 2023 (USD billion)



Note: Equity and debt estimates are based on preliminary data.

Source: Institute of International Finance and CEIC.

StatLink  <https://stat.link/56i20a>

Recent government measures in the region supported the performance of bond markets through increased issuances of government bonds from the public sector in some economies. In Indonesia, outstanding local-currency bonds reached USD 410.9 billion by the end of March, primarily driven by treasury and other government bonds, which accounted for close to 92% of total bonds outstanding (ADB, 2023a). The upsurge of bond markets continued during the first half of the year, as the government adopted a frontloading policy for the issuance of treasury bonds. In addition, the Bank of Indonesia was able to increase its holdings of treasury bonds through a legislation passed in December 2022, allowing the central bank to buy bonds directly from the government during a crisis. In India, the Securities and Exchange Board approved a USD 4.01 billion fund in March to provide liquidity to the corporate debt market during periods of financial stress, helping to stem panic selling and ease redemption pressures. The government also entered the sovereign green bond market in January with a USD 1 billion two-tranche deal. The Philippine bond market also experienced rapid growth in the first quarter, driven by an expansion of government bonds from increased issuances, which is the result of the government's frontloading policy. In Malaysia as well, the government remains the top issuer of bonds, which in turn, were the most actively traded debt security during the first half of 2023. Meanwhile, the government of Thailand announced in April a triple-tranche offering of savings bonds amounting to 40 billion baht to help finance the government's budget deficit for fiscal year 2023.

Overall, the current global financial conditions proved favourable to Emerging Asia's bond markets during the first half of the year. Nevertheless, uncertainties in global financial markets in the near term may impact the direction of debt flows in the region. On the upside, with bond markets primarily comprised of government bonds, the region will remain a safer investment destination. However, persistently high interest rates could put more pressure on economies in the region, with elevated levels of both public and private debt. In developing economies, the public sector will need to navigate carefully to ensure debt sustainability amid the increase in borrowing costs. Additionally, persistently high interest rates deteriorate asset quality and valuations in debt securities.

Portfolio outflows in some economies will weaken local currencies

Most regional benchmark stock indices entered a bull market in January 2023 following the reopening of China and the weakening of the US dollar. This resulted in an appreciation of local currencies across major economies in the region. The situation changed in February when the Fed and the ECB raised policy rates by 25 and 50 basis points, respectively. In an atmosphere of prolonged global economic uncertainty, these policy rate hikes drove down the value of regional currencies, but the banking turmoil that started in March attracted liquidity back to the relative safety offered by the region's equity and bond markets.

Country-level portfolio outflows in the region also weakened local currencies during the first half of the year. In terms of equity markets, several economies in the region experienced significant sell-offs of stocks in the first half of the year as foreign investors reacted to domestic and global triggers. This resulted in considerable amounts of equity

leaving the financial markets, leading to a net outflow of portfolio equity investments. For example, India accrued equity outflows estimated at USD 2.5 billion from January to March, largely driven by a huge sell-off of stocks in January. However, this trend was reversed in the second quarter of the year as the country's stock markets rebounded, generating net equity inflows of up to USD 13.6 billion from foreign portfolio investors. Similarly, Thailand experienced a prolonged equity market slump resulting in equity outflow equivalent to USD 3.7 billion from February to June. This was exacerbated by uncertainty and tight policy rates in the United States, with sell-offs of electronics stocks by foreign investors leading to an 80-point, or 5%, drop in Thailand's benchmark index. Malaysia also recorded net portfolio equity outflows between January and June, estimated at USD 929 million.

Meanwhile, the region's bond markets are sensitive to variations in the monetary policy stances of both Emerging Asian economies and the United States. Yield spreads between 1-year US government bonds and 1-year government bonds in some of the region's major economies have been declining since May and dropped further in the middle of June (Figure 9). These trends in yield spreads coincided with the weakening of currencies in the region (except for Singapore). The drop in yield spreads between 1-year US government bonds and 1-year local government bonds provides insight into the susceptibility of currency markets to changes in financial markets (ADB, 2023b). For example, the upsurge of US bond yields in August caused bond yields in Indonesia and India to rise as well. The currencies of both countries slightly weakened during the period.

Figure 9. 1-year government bond yield spread and foreign exchange rates in selected Emerging Asian economies, January 2022 to August 2023

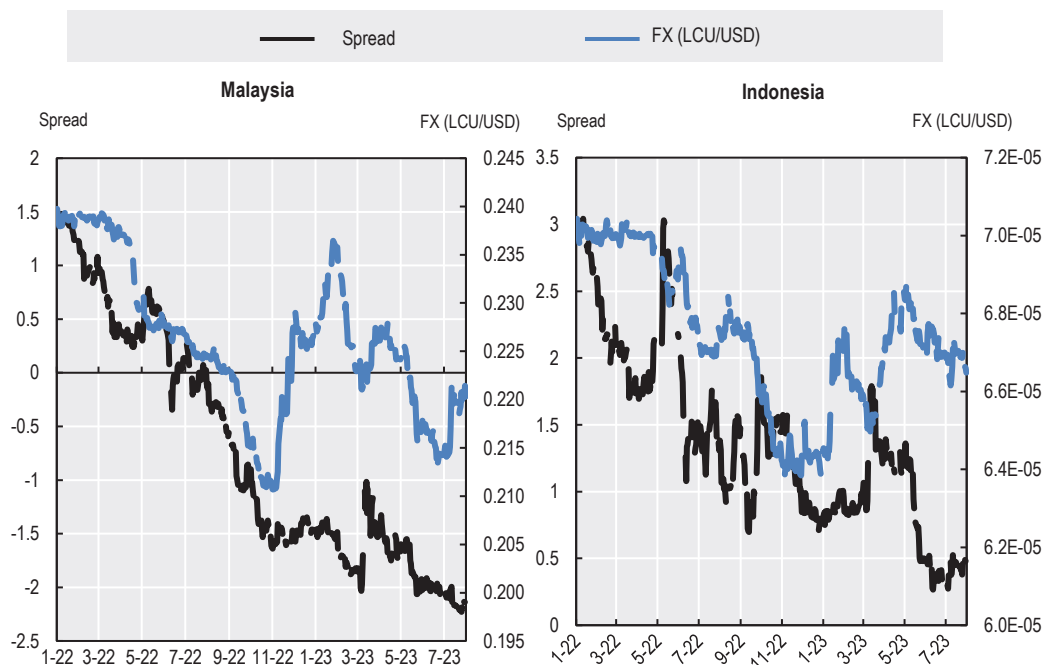
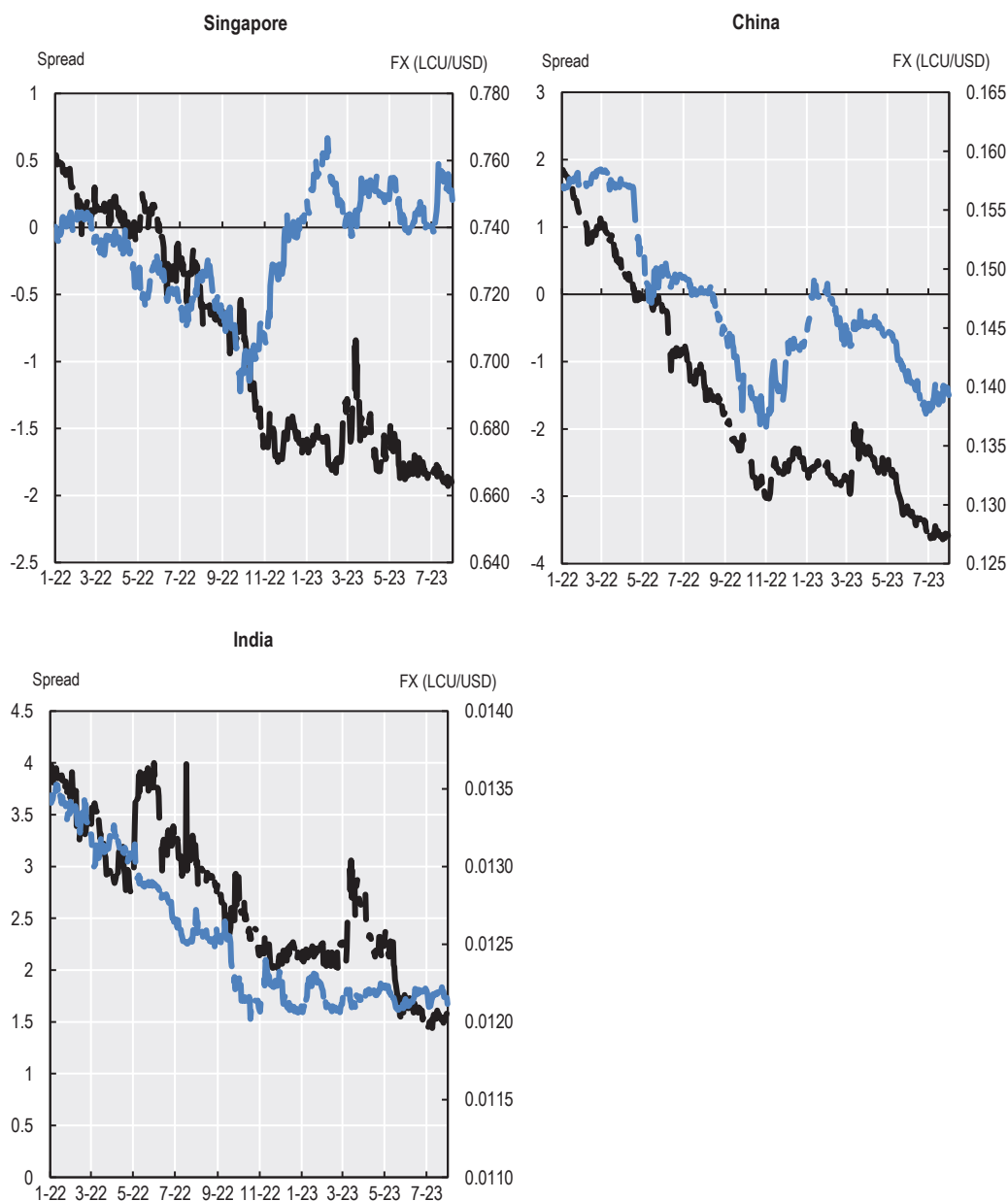


Figure 9. 1-year government bond yield spread and foreign exchange rates in selected Emerging Asian economies, January 2022 to August 2023 (cont.)



Note: Bond yield spread refers to the difference between 1-year US government bond yield and 1-year local bond yield. The drop in yield spreads signifies the narrowing of yield differentials between 1Y US bonds and 1Y Asian bonds at the end of the period, 2 August 2023. A positive value for the foreign exchange rate, FX (LCU/USD), indicates appreciation of the local currency against the US dollar. Source: CEIC.

StatLink  <https://stat.link/szfm7a>

Fostering stronger regional financial linkages can reduce Emerging Asia's exposure to and dependence on the US dollar and mitigate the impact of fluctuations in its value. Some countries are already taking regional currency co-operation initiatives. In April, India and Malaysia signed an agreement that paves the way for trade between the two countries in Indian rupees. Indonesia has also made considerable progress in implementing its Local

Currency Settlement Framework (LCS) for bilateral trade transactions. The country reached USD 2 billion worth of transactions in the first half of 2023 and has bilateral agreements with Malaysia, Thailand, India, China, Japan and Korea, among others. Another initiative is the memorandum of understanding on regional cross-border payments signed last November by ASEAN's five major economies, namely Indonesia, Malaysia, the Philippines, Singapore, and Thailand. A cross-border QR-code payment system is still in its initial stages but allows for cross-border transactions without any fees. This system is already active in Malaysia, Thailand, Indonesia, and Singapore, with the Philippines joining soon.

Labour markets in most Emerging Asian economies show signs of recovery

Emerging Asia's labour markets are showing signs of steady recovery, supported by growing intraregional trade, recovery in international trade and a strong inflow of investments. International, regional, and bilateral trade initiatives continue to develop more efficient and cost-effective trade within Emerging Asia, which expands the export market and creates more jobs across different industries and along the supply chain.

The travel and tourism sector has also been an invaluable source of employment for several countries in Emerging Asia. In 2021, China recorded the highest total contribution of travel and tourism to employment, generating 73.31 million jobs, directly or indirectly (Statista, 2022). India and Indonesia place second and third, recording 32 million and 11 million jobs contributed by tourism, respectively (Statista, 2022). The Philippines, Thailand and Viet Nam follow close behind. The gradual reopening of domestic and international tourism in 2022 gave a significant economic boost to countries in the region. This was sustained by a strong recovery of the tourism sector in the first half of 2023. Tourism is expected to remain a significant source of employment, especially for countries such as Cambodia, Indonesia, Thailand, Malaysia, the Philippines, and Viet Nam. Domestic and intraregional travel are also on the rise throughout the region. The reopening of China, the region's biggest source of tourists, will contribute to the rapid tourism expansion, and thus help to support employment.

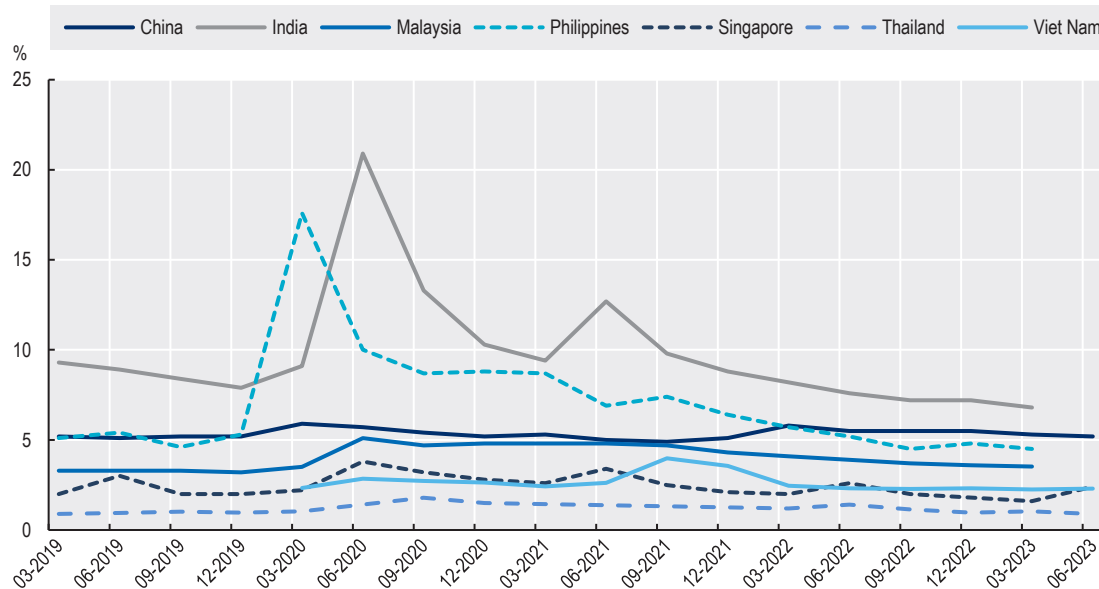
Other industries are also driving the expansion of the services sector and boosting employment in the region. For example, services linked to growing sectors such as manufacturing remain robust. In addition, the acceleration of digitalisation has changed the services sector landscape in Emerging Asia. Digital technologies have helped develop and expand service industries linked not only to tourism but also to trade, transport, communication, financial services, real estate, and retail services, and this has further expanded the employment market. Robust domestic demand is expected to sustain expansion of the services sector, while the increasing tradability of services will also fuel its rapid rise.

Labour markets are also benefitting from the fact that the region is attracting substantial FDI due to its young and increasingly skilled population, low labour costs and better infrastructure supporting the workforce. The supply-chain reconfiguration of companies to protect their businesses from rising geopolitical tensions and international trade disruptions is driving the restructuring of production chains to ASEAN countries and India. As a result, FDI inflows in India, Indonesia, Malaysia, Philippines, Thailand and Viet Nam amounted to USD 1.3 trillion in 2022 and reached USD 352 billion in the first quarter of 2023. This has

catalysed the expansion of businesses across the region, creating more jobs, particularly in electronics, textiles and the automotive sector.

Meanwhile, the unemployment rate has steadily declined for most major economies in the region and shows substantial improvement year-on-year. In India, the Philippines and Singapore, unemployment is below pre-pandemic levels thanks to country-level factors that underpin economic growth, fuelling a tighter labour market. India is experiencing the fastest GDP growth among the world's major economies and will require more labour to meet the needs of its expanding economy. The country is relying on its large labour force and improved infrastructure to support the expansion of its labour market, especially in the manufacturing and services sectors. India's services sector will remain resilient, buoyed by strong demand in retail trade, the logistics industry, software services, commercial real estate, and tourism. Anticipated large inflows of FDI will boost India's manufacturing sector and generate more jobs in the near term and improve the overall employment environment in the long term. On annual terms, India's unemployment rate is forecast to drop to 7.1% in 2023 from 10.5% in 2022.

Figure 10. Unemployment rate in selected Emerging Asian economies, Q2 2019 to Q2 2023 (%)



Note: Q1 2023 data for India, Malaysia and the Philippines.

Source: CEIC.

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Employment also continued to rise in ASEAN countries, where the labour market outlook is promising given an expanding middle class and a young, dynamic and increasingly well-educated population. ASEAN's increasing integration in global supply chains is contributing to greater wage employment and highly skilled employment in some sectors. Within global supply chains, manufacturing accounted for the largest share of employment, while agricultural jobs are also increasing in share. Malaysia and the Philippines have posted increases in annual employment growth since 2021, while Singapore posted a strong rebound from its sluggish employment data in 2022. Notably, weak transmission of monetary policy

in the Philippines limited the impact of interest rate hikes on private sector demand over the first half of the year. This translated into continued expansion of the job market in the country. Meanwhile, China's annual employment growth declined by 5% in March along with a surge in youth unemployment, with its rate reaching a record high of 20.8% in May 2023. Some economies in the region – particularly those heavily involved in apparel and footwear manufacturing, such as Cambodia, Bangladesh, Myanmar and Viet Nam – are expected to experience a labour market deterioration as shipments fall.

Global factors pose the greatest challenges to the growth outlook for Emerging Asia

The main challenges to Emerging Asia's growth momentum include prolonged global economic slowdown leading to weak external demand, persistent inflationary pressures, geopolitical risks, climate change and natural disasters. A major risk to the region's growth is the economic slowdown in advanced economies, which is causing a decline in demand for export goods from Emerging Asia. While the global supply-chain reconfiguration will benefit most Emerging Asian economies in the long term, the looming near-term impact on China's exports sector will resonate across the region. Meanwhile, the region's financial and currency markets remain vulnerable to imminent interest rate hikes in the United States and European Union. Inflation rates have moderated globally, driven primarily by declines in commodity prices and improved supply chains. However, core inflation figures are projected to remain elevated, underpinned by the rapid growth of services prices. Given the region's robust growth in private consumption and the rapid rise of the services sector, elevated core inflation will likely persist. Finally, the impact of El Niño is expected to affect different sectors and components of the economy, including agriculture, trade, commodity prices, energy and water resources. The extent of the economic impact on each country will depend on geographical location, policy responses to climate change and capacity to mitigate and adapt to the repercussions of El Niño.

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The *Economic Outlook for Southeast Asia, China and India* is a regular publication on regional economic growth and development in Emerging Asia. It focuses on the economic conditions of the Association of Southeast Asian Nations (ASEAN) member countries: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. It also addresses relevant economic issues in China and India to fully reflect developments in the region. This Update presents the region's economic outlook, depicting rapidly changing trends and macroeconomic challenges amidst external headwinds.



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