Chapter 1

Macroeconomic assessment and economic outlook

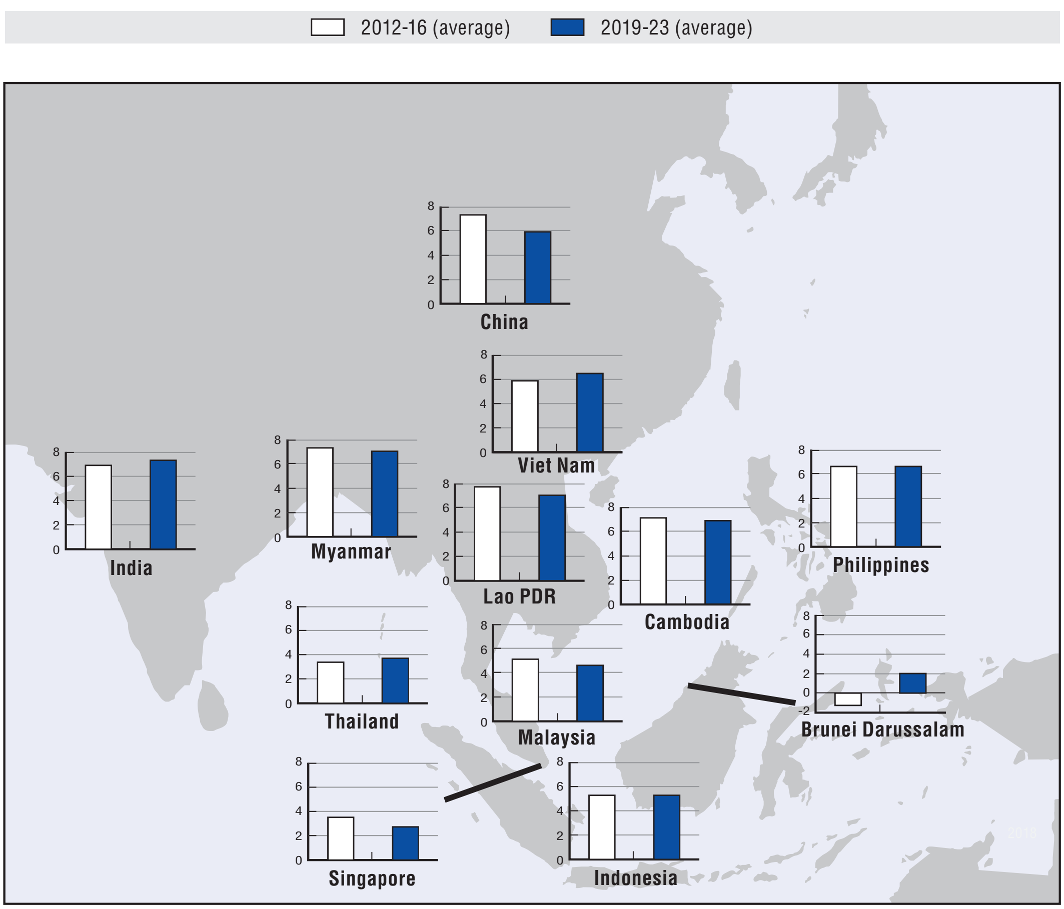
Gross domestic product (GDP) growth in Emerging Asia – Southeast Asia, China and India – held up in 2018 despite external and domestic headwinds. In Southeast Asia, economic expansion rates remained robust in general, although the trends by country diverged somewhat. While China's economic growth is gradually slowing, GDP growth in India is expected to remain robust. As for the region's private consumption story, resilience continued, underpinned by stability in labour markets and overseas transfers in some cases. Growth in gross exports likewise withstood trade policy uncertainties rather well. Several monetary authorities in the region have raised interest rates to address monetary normalisation of advanced economies as well as price and exchange rate pressures. These moves have been accompanied by policies to provide liquidity to support growth. Fiscal positions in the region are generally stable. The main risks to growth are related to the financial technologies (Fintech), constraints to international trade and the management of natural disaster risks.

Introduction

Gross domestic product (GDP) growth in Emerging Asia – Southeast Asia, China and India – held up in 2018 despite external and domestic headwinds. In Southeast Asia, economic expansion rates remained robust in general, although the trends by country diverged somewhat. While China's economic growth is gradually slowing, GDP growth in India is expected to remain robust. As for the region's private consumption story, resilience continued, underpinned by stability in labour markets and overseas transfers in some cases. Growth in gross exports likewise withstood trade policy uncertainties rather well. Several monetary authorities in the region have raised interest rates to address monetary normalisation of advanced economies as well as price and exchange rate pressures. These moves have been accompanied by policies to provide liquidity to support growth. Fiscal positions in the region are generally stable.

In the medium term– 2019 to 2023 –Southeast Asian countries will maintain solid growth momentum, while Emerging Asia's pace of economic growth is projected to be slower than the annual average between 2012 and 2016 average (Figure 1.1)

Figure 1.1. **Real GDP growth of Southeast Asia, China and India**



Source: OECD Development Centre, MPF-2019 (Medium-term Projection Framework).

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Overview and main findings

GDP in Emerging Asia is estimated to grow by an annual average of 6.1% in 2019-23, based on the OECD Development Centre's *Medium Term Projection Framework* (MPF-2019) (Table 1.1) (Box 1.1). Domestic demand is expected to sustain its momentum, particularly household spending, as job markets are expected to remain vibrant. However, trade is facing more uncertain prospects as tariff measures broaden. Southeast Asia is forecast to continue to grow solidly at 5.2% in 2019-23, faster than the rate posted in 2012-16. China is forecast to have an average growth of 5.9% in 2019-23, slower than its 2012-16 average of 7.3%. Investment and government spending are likely to offset substantial weakness in trade. India's medium-term growth is projected to be 7.3%, surpassing the average of 6.9% in 2012-16.

Table 1.1. **Real GDP growth in ASEAN, China and India**

Annual percentage change

	2017	2018	2019	2019-23 (average)	2012-16 (average)
ASEAN-5 countries					
Indonesia	5.1	5.2	5.2	5.3	5.3
Malaysia	5.9	4.9	4.8	4.6	5.1
Philippines	6.7	6.4	6.5	6.6	6.6
Thailand	3.9	4.5	4.1	3.7	3.4
Viet Nam	6.8	6.9	6.7	6.5	5.9
Brunei Darussalam and Singapore					
Brunei Darussalam	1.3	2.0	2.3	2.0	-1.3
Singapore	3.6	3.5	2.9	2.7	3.5
CLM countries					
Cambodia	7.0	7.0	6.9	6.9	7.1
Lao PDR	6.9	6.6	6.8	7.0	7.6
Myanmar	6.8	6.6	6.9	7.0	7.3
China and India					
China	6.9	6.6	6.3	5.9	7.3
India	6.7	7.5	7.3	7.3	6.9
Average of ASEAN-10	5.3	5.3	5.2	5.2	5.1
Average of Emerging Asia	6.5	6.6	6.3	6.1	6.8

Note: The cut-off date for data used is 21 November 2018. ASEAN and Emerging Asia growth rates are the weighted averages of the individual economies in those groupings. Data for India and Myanmar relate to fiscal years. Myanmar's 2018 data refers to the interim 6-month period, from April 2018 to September 2018 while the 2019 data refers to the period from October 2018 to September 2019. The 2018 and 2019 projections for China, India and Indonesia are based on the OECD Economic Outlook 104 (database).
Source: OECD Development Centre, Medium-term Projection Framework (MPF-2019).

ASEAN-5

- In the medium term, **Indonesia**'s GDP growth is projected to average 5.3%, the same rate as in 2012-16. Considering the vibrant health of the labour market, private consumption should expand robustly, consistent with the trend since 2007. Continuous improvement in the investment climate bodes well for expanding the production base and job opportunities. Public debt-to-GDP ratio is arguably manageable.
- **Malaysia** is estimated to grow by 4.6% in 2019-23, 50 basis points slower than growth in 2012-16. Private consumption will likely remain strong, supported by an absorptive labour market that maintains a low unemployment rate as the labour participation rate and real wages rise.

- In the next five years through 2023, the **Philippines** is estimated to grow annually by 6.6%, equalling the rate in 2012-16. Overseas remittances will still be an important component of private consumption. The underemployment rate, which has recently risen again despite the decline in the labour participation rate, requires attention. Robust public budgetary spending should help buoy the economy, albeit the quality of spending can still be improved.
- Between 2019 and 2023, **Thailand**'s economy is projected to grow 3.7% a year, up from 3.4% in 2012-16. Fixed investment should benefit from changes in key legislation in the last two years. It helps that investment climate indicators have also generally improved. The effective implementation of an East Economic Corridor (EEC) infrastructure will be crucial to continuing the growth momentum.
- **Viet Nam**'s medium-term growth is projected to grow to 6.5% on average in 2019-23 from 5.9% in 2012-16. Exports are expected to continue to anchor economic activity, supported by the influx of Foreign Direct Investment (FDI). Keeping the momentum going necessitates continued efforts to improve the quality of labour. The resolution of non performing loans (NPL) is also crucial.

Brunei Darussalam and Singapore

- **Brunei Darussalam's** economy is projected to rise annually by 2.0% from 2019-23, reversing the average of -1.3% in 2012-16. The current oil price level augurs well for the country's export earnings and domestic demand. Improvements in FDI inflows and private sector development will be critical.
- **Singapore** is forecast to post 2.7% GDP annual growth in the medium term, almost a percentage point slower than its average of 3.5% in 2012-16. Fixed investment is expected to pick up in line with various infrastructure plans. The steady investment inflow into information and communication technology ventures will also help. Various initiatives to retool labour force skills are critical.

CLM countries

- **Cambodia's** economy is projected to expand by 6.9% in the next five years until 2023, more moderate than the 7.1% growth in 2012-16. The steady influx of foreign capital and the country's involvement in multilateral infrastructure projects bode well for infrastructure, exports and the job market. Capital market development ought to be pursued.
- **Lao PDR's** expected economic growth rate of 7.0% annually in 2019-23 will be down from 7.6% in 2012-16. The large energy-related deals, special economic zones and broader fiscal incentives are engines for growth. Policies and management related to hydroelectoricity will be key for sustainable growth.
- **Myanmar's** GDP growth is estimated to average 7.0% annually in 2019-23, marginally slower than the 7.3% growth in 2012-16. Planned transportation investment, the gradual improvement in investment climate indices and recent investment liberalisation measures should strengthen the economy in the coming years. Managing inflation and resolving banking sector fragilities are challenges.

China and India

- **China** is projected to register 5.9% average annual GDP growth in 2019-23, down from 7.3% in 2012-16. The willingness of the national government to stimulate domestic activity amid trade tensions and the resurgence of investment are reassuring signals for domestic demand. Improving the relatively high level of corporate debt-to-GDP ratio and wealth inequality are challenges.

- The economy of **India** is forecast to grow by 7.3% in the medium term, up from 6.9% in 2012-16. Labour market conditions point to solid growth in private consumption, although rising inflation and interest rates can be drags. The push for consolidation will most likely limit the government's spending flexibility as well. How infrastructure projects are carried out will be key. Maintaining banking sector health is another challenge.

Other key points of the economic outlook and assessment

- Inflation trends remain divergent. Inflation is on an uptrend in China, the Philippines, Thailand and CLM countries, while it is relatively stable or even declining in other Emerging Asian countries. The increase in global oil prices and domestic factors affect these trends, although the moderation of global food prices provides some respite.
- Several monetary authorities in the region have raised interest rates to address monetary normalisation in advanced economies as well as price and exchange rate pressures. Some of them have introduced other liquidity measures to support growth. Meanwhile, the banking systems are generally stable, albeit asset quality issues persist.
- Overall, the external positions of Emerging Asia are sound. Trade performance is relatively stable in Emerging Asia amid rising protectionism while regional trade agreements are progressing. FDI inflows into Emerging Asia remains positive.
- A number of economies in the region look to rein in their respective fiscal deficit ratios in the near term, though fiscal positions in the region are generally stable. The persistence of deficits in current accounts and the fiscal positions in some countries could raise a concern to growth momentum.
- There are several risks and challenges confronting the region's economic prospects. They include; i) stabilising and developing financial markets, and, in particular, maximising opportunities related to financial technology; ii) strengthening export performance amidst rising protectionism; and iii) mitigating natural disaster risks to growth from natural disasters. In addition, Emerging Asian countries need to monitor the pace of monetary normalisation in advanced economies, while geopolitical tensions and trends in global oil prices also need to be carefully monitored.

Box 1.1. **Key assumptions of the medium-term outlook to 2023**

Projections over 2018-23 are produced using the OECD Development Centre's Medium-term Projection Framework (MPF), which includes the following assumptions:

- The output gap – the gap between actual and potential GDP – will converge to zero by 2023.
- Inflation-targeting countries will continue to pursue stability and to adjust monetary policies to support their targets.
- The national medium-term development plans of Emerging Asia countries will largely be implemented, subject to budgetary and other policy considerations.
- Regional economic integration initiatives and projects will advance at the same pace as before.
- Unanticipated economic events and other external factors will not significantly alter the situation beyond the cut-off date.
- The cut-off date of data for the projection is 21 November 2018. For more detailed information on MPF, please see www.oecd.org/dev/asia-pacific/mpf.htm.

Recent developments and near-term outlook

ASEAN-5

Indonesia

Indonesia's gross domestic product (GDP) grew 5.2% year-on-year (YOY) in the third quarter (3Q) of 2018, equalling the rate in the first half (1H) (Table 1.2). The rise in demand was driven by the brisk expansion in public and private spending (Figure 1.2), with expenditure during the run-up to the local elections held in the last week of June 2018 partly contributing to the momentum. Gross fixed capital (GFC) growth rose to 7.0% in 3Q 2018 from 6.9% in 1H 2018 and capital inventory increased sharply–up 58% in 3Q 2018. Investment expansion in buildings and other structures increased to 5.7% in 3Q 2018 from 5.6% in the 1H 2018. Separately, gross export growth inched up to 7.5% in 3Q 2018 from 6.9% in 1H 2018. On the supply side, growth in agricultural output increased to 4.8% in 2Q 2018 and 3.6% in 3Q 2018, up from 3.3% in 1Q 2018, thanks to the good weather. Stronger export sales have helped crude petroleum, gas and geothermal production to post growth in 2Q 2018, the first time in seven quarters, though it declined again in 3Q 2018. By comparison, production of metal ores and construction materials has expanded markedly since 1Q 2018. Meanwhile, manufacturing growth rebounded in 3Q 2018 after it slowed in 2Q 2018. Services growth had been steady in 2018, anchored by information and communication technology (ICT), wholesale and retail trade (WRT), and transport and storage (TAS).

Table 1.2. **Recent real GDP growth in ASEAN, China and India, 2017-18**

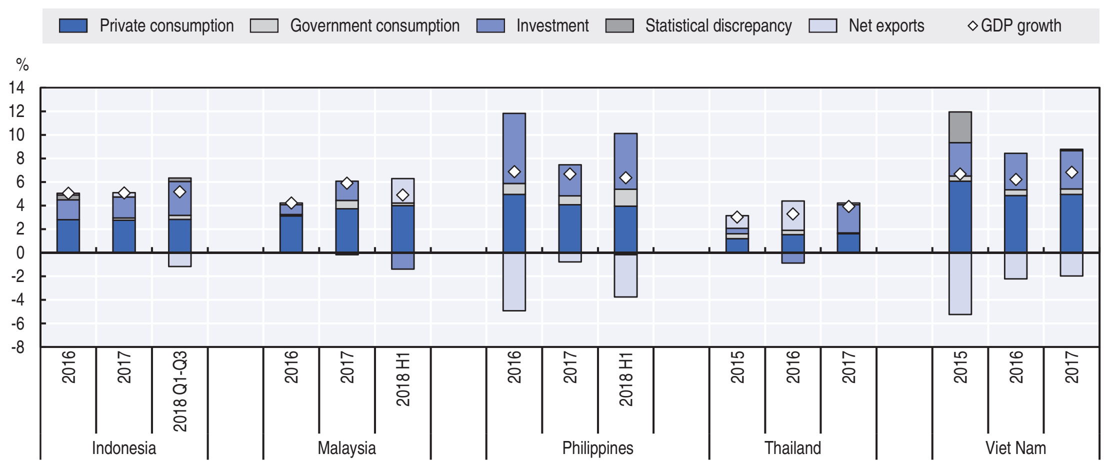
Quarterly year-on-year percentage changes

	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3
ASEAN-5 countries							
Indonesia	5.0	5.0	5.1	5.2	5.1	5.3	5.2
Malaysia	5.6	5.8	6.2	5.9	5.4	4.5	—
Philippines	6.5	6.6	7.2	6.5	6.6	6.2	—
Thailand	3.4	3.9	4.3	4.0	4.9	4.6	—
Viet Nam	5.2	6.3	7.5	7.7	7.5	6.7	6.9
Brunei Darussalam and Singapore							
Brunei Darussalam	-1.3	0.2	1.3	5.2	2.6	-2.8	—
Singapore	2.5	2.8	5.5	3.6	4.6	4.1	2.6
China and India							
China	6.9	6.9	6.8	6.8	6.8	6.7	6.5
India	5.6	6.3	7.0	7.7	8.2	—	—

Note: The cut-off date for data used is 7 November 2018. Data for India and Myanmar relate to fiscal years.
Source: OECD Development Centre, CEIC Data and national sources.

Figure 1.2. **Contributions to real GDP growth in the ASEAN-5 countries, 2016-18**

Percentage points



Note: Thailand uses chain volume measures. The sum of contributions to growth is not necessarily equal to GDP growth.

Source: OECD Development Centre calculations based on data from CEIC Data.

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Indonesia's GDP is expected to increase to 5.2 % in 2018 and in 2019. Retail sales growth in 3Q 2018 accelerated relative to 1H 2018, possibly benefitting from the one-off boost from the Asian Games (Box 1.2). The consumer spending outlook has also remained positive though the level of optimism in 3Q 2018 receded relative to 1H 2018 as interest and core inflation rates rose. The national elections scheduled for April 2019, however, should lift spending. The reconstruction and rehabilitation of areas affected by the recent earthquakes also provide impetus for increased spending in the coming months, partially compensating for the negative impact on productivity and the socio-economic cost due to household and firm displacement. That being said, the series of policy rate hikes since 17 May 2018 – totalling 150 basis points – could be a drag on consumer spending. There are also uncertainties about the inflation pass-through of new import tariffs on consumer goods and the decision to curb oil imports.

Box 1.2. **Asian Games 2018 economic impact**

Between the 18th of August and 2nd of September 2018 the 18th Asian games were held in Jakarta and Palembang with 45 nations participating, marking a sportive but also an economic success for Indonesia. The Ministry of National Development Planning of Indonesia (BAPPENAS) estimated the total effect on 2015-19 GDP at USD 2.80 billion (US dollars), slightly below the predicted USD 2.97 billion. This led to an impact on economic growth estimated at 0.05% on top of baseline growth over 2015-19, with USD 540 million in value added created in 2018 only. Specifically, in Jakarta the Asian Games of 2018 contributed to a 0.23% increase from the baseline growth.

The number of tourists amounted to 1.78 million, of which 1.7 million were domestic visitors and 78 854 foreign visitors. This is below the expected 154 069 expected foreign tourists for Jakarta alone. However, in terms of tourist spending, the Games outperformed expectations by generating USD 244 million instead of the forecasted USD 234 million, which indicated that per head spending was significantly higher than planned. The

Box 1.2. **Asian Games 2018 economic impact** *(cont.)*

distribution of spending between foreign and domestic visitors was balanced, with the foreigners slightly outspending their domestic counterparts. Asian Games' foreign visitors mostly came from China, Japan and Korea, and stayed on average for 13 days, nearly spanning the full duration of the event.

The direct economic impact of the 18th edition of Asian Games over 2015-19 is estimated at USD 2.68 billion slightly above the initially projected USD 2.66 billion due to higher visitor spending. The main contributors to the above mentioned figure were investment in infrastructure (USD 1.9 billion), followed by operating spending (USD 514 million) and finally tourism spending (USD 244 million). The effects on employment were also positive, with the employment of 108 780 people over the country and an associated increase of real wages by 0.03%. Finally, the implementation of odd-even policies for road traffic led to decreased traveling times, in line with a 4.7% decrease in congestions during the Games.

The rise in Indonesia's GDP in the medium term – 2019 to 2023 – is projected to average 5.3%, the same rate recorded in 2012-16. Considering the vibrant health of the labour market, private consumption, which accounts for 58.8% of the economy in current prices and 55.4% in constant prices, should expand robustly during the period in line with the trend that has prevailed since 2007. The improvements in investment climate metrics (e.g. ease of doing business, investment competitiveness and perceptions of corruption) since 2016 bode well for expansion of the production base and an increase in job opportunities.[1] Presidential Instruction No. 7 (November 2017) and Presidential Regulation 91 (September 2017) institutionalised inter-ministerial coordination in the policy-making process. The two pieces of legislation, part of efforts to further enhance the business climate, promote the practices of impact evaluation and public consultation and streamline the business licensing regime.

The ongoing infrastructure programme is promising though the net benefits it yields will depend on the quality of execution. Currently, though, timeliness of delivery and the government's ability to attract partners remain key challenges. About 245 projects, with a value of about USD 327 billion, were initially included in the list of National Strategic Projects signed in January 2016. Six projects had been completed by the end of 2017, while 14 had been dropped by April 2018 according to the Committee for the Acceleration of Priority Infrastructure Delivery for failing to meet specifications.

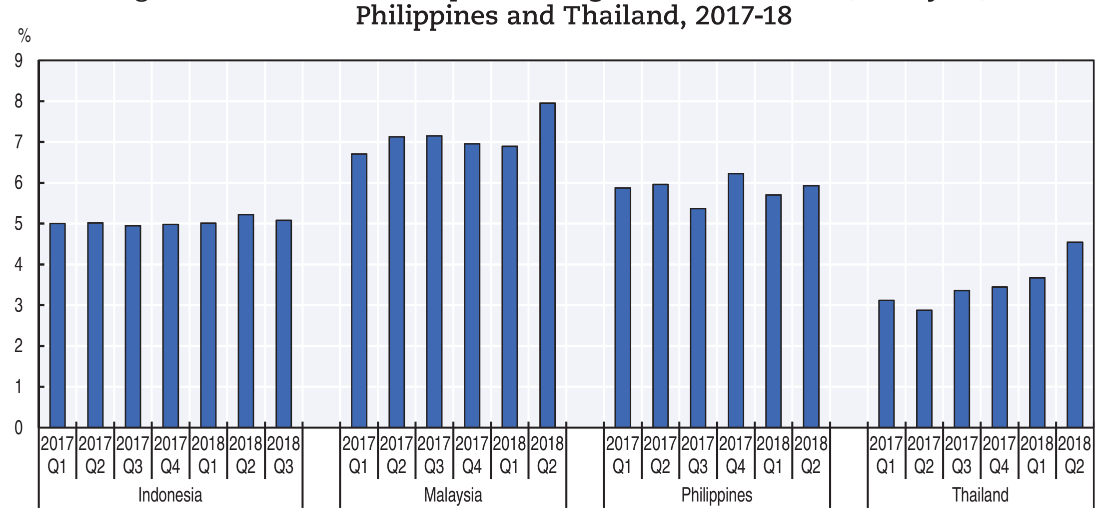
While tax-to-GDP and revenue-to-GDP ratios have been showing signs of improvement since 4Q 2017, thanks to recent reform measures, the expansion of fiscal capture of economic activity still requires attention. The public debt-to-GDP ratio, which stood at around 29% of GDP in 2Q 2018, is manageable by regional standards. Worries centre chiefly on the high share of foreign-held debt in total central government debt, estimated at just under 58% of the total value or roughly 17% of GDP.

Malaysia

GDP growth in Malaysia slipped from 5.4% in the first quarter to 4.5% in 2Q 2018. Household consumption, however, grew faster in 2Q 2018 than in the first quarter, attributable to the repeal of the goods and services tax (GST) in June 2018 and the extension of gasoline subsidies until the end of 2018 (Figure 1.3). Public spending growth also picked up, while private sector outlay, particularly on machinery and equipment, drove growth in GFC that was faster in the second than the first quarter of 2018. The acceleration in consumption and investment in turn prompted 2.1% growth in imports (chiefly of capital goods) in 2Q 2018 after a 2% contraction in 1Q. Gross export growth, by contrast, weakened over the same period (Figure 1.4), weighed down by poor sales of machinery, agricultural products (like live animals, vegetable oils and fats), beverages and tobacco, and crude inedible goods.

The first contraction in agricultural output (down 2.5%) since 4Q 2016 mirrors the lethargic external demand for agricultural products on the supply side. Low prices prompted a year-on-year decline in the production of palm oil, rubber and other forestry goods in 2Q 2018. Mining and quarrying output also dipped by 2.2% in 2Q 2018. Manufacturing, driven by the electronics, metal product and transportation equipment segments, took up some of the slack as it grew 4.9%, which was marginally slower, however, than the 5.4% recorded in 1Q 2018. Services held up relatively well in 2Q 2018, especially WRT, utilities, TAS and communication, while growth in financial services (excluding insurance) was more measured.

Figure 1.3. **Private consumption YOY growth in Indonesia, Malaysia, the Philippines and Thailand, 2017-18**



Source: OECD Development Centre calculations based on CEIC Data and national sources.

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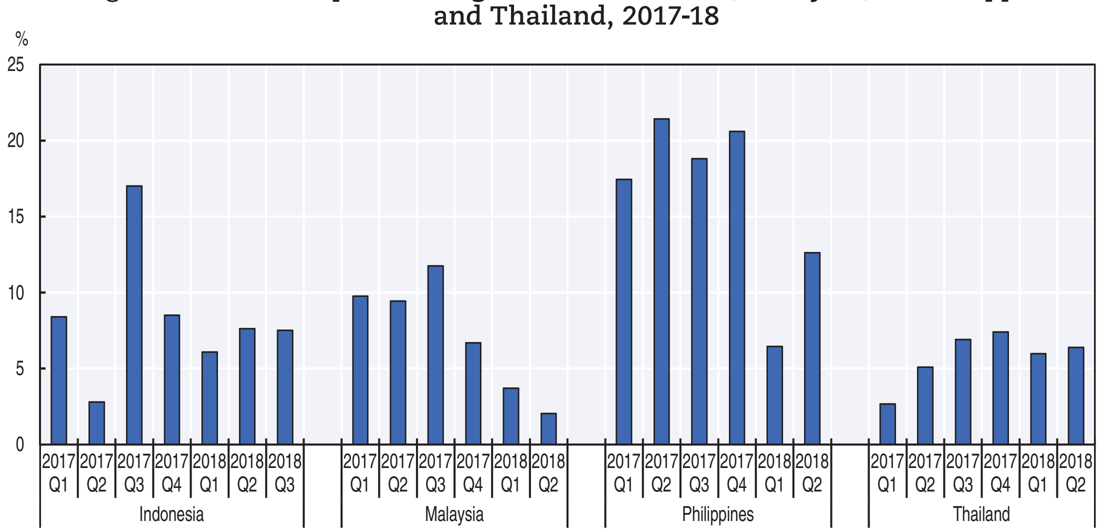
Figure 1.4. **Gross exports YOY growth in Indonesia, Malaysia, the Philippines and Thailand, 2017-18**



Source: OECD Development Centre calculations based on CEIC Data and national sources.

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Malaysia's growth outlook for 2018 and 2019 is 4.9% and 4.8%, lower than the June 2018 projections on the Update of Outlook 2018. Nor are investment prospects very upbeat, as FDI inflows in 2Q 2018 fell to their lowest quarterly level since 4Q 2012. The shelving of some infrastructure projects may also add to the slow-down. Moreover, the lack of fiscal space and concerns over the build-up of debt suggest that levels of public spending will be modest until the end of the year.

Export growth in nominal terms has slightly eased in 3Q 2018 from 1H 2018. The manufacturing production index performed modestly in 3Q 2018 relative to 1H 2018. The mining production index also stayed on a downtrend in the same period, while palm oil production continued to decline in 3Q 2018. The spikes in consumer and business confidence appear to have been fuelled by the easing of fears over inflation, coupled with the abolition of GST and the extension of fuel subsidies. However, the reintroduction of consumption taxes in September 2018 has somewhat lessened the optimism.

As for Malaysia's medium-term economic prospects, GDP is forecast to grow 4.6% between 2019 and 2023, 50 basis points lower than the average rate in 2012-16. Private consumption is likely to remain strong, supported by an absorptive labour market that maintains a low unemployment rate as labour participation rate and real wages rise.

One of the key challenges is containing any possible downturn in gross exports, which account for 72.9% of GDP in constant prices. Business climate indicators – such as ease of doing business and perceptions of corruption – have generally improved since 2017, but the country could be in a stronger position if it brought greater clarity to its infrastructure policy after a number of projects were placed under review. The Digital Free Trade Zone, which opened in November 2017 (in collaboration with Alibaba), is one of the government's promising new investment approaches to cross-border trading and e-commerce.

As part of systemic reform, the offices that report to the Prime Minister's Department have also been reorganised, with their number being cut from more than 90 to 26 to promote transparency. Meanwhile, continuing budgetary reform will help make spending more efficient and keep fiscal risk in check – particularly in light of public liabilities, which re-evaluation shows to be substantially higher than originally estimated. The government expenditure growth will likely be pinned to around its average in the last 5 to 6 years.

Philippines

In the Philippines, GDP growth came in at 6.2% in 2Q 2018, the thirteenth consecutive quarter in which it had posted a rate of 6% or higher. Private consumption grew 5.9%, higher than the previous quarter's rate of 5.7%, despite the rising inflation pressures and interest rate. Growth in government spending eased in 2Q 2018, though it was still brisk at 11.9% on the back of strong revenue performance. With public project rollouts gathering pace, GFC growth surged to 21.2% in 2Q 2018 from 8.8% in 1Q 2018, arresting the declining trend since 2Q 2016. Gross exports also rose strongly, doubling between the first and second quarters thanks to increasing demand for electronic products.

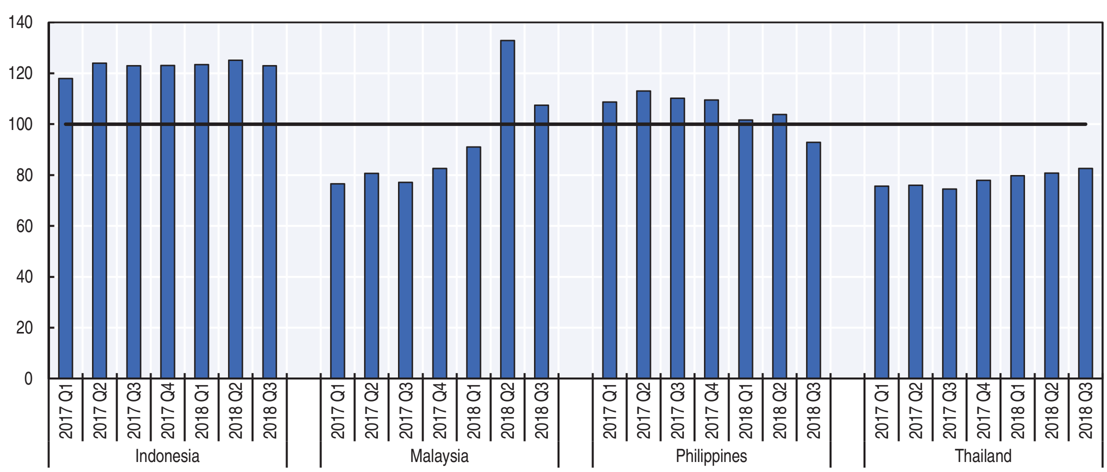
On the supply side, agriculture output growth fell to 0.3% in 2Q 2018, the slowest rate since the contraction in 4Q 2016. Changes in the planting cycle of some crops and reduced harvested areas probably affected the volume of output in some staples (PSA, 2018). Manufacturing growth also slowed for the third straight quarter while the mining sector's value added shrank by almost 7% in 2Q 2018. The construction industry was one of the bright spots. Buoyed by the growth momentum in gross fixed capital, it expanded by

14.1% in 2Q 2018 from 8.8% in 1Q. Both public and private construction value added grew faster in the second than the first quarter of 2018. The services sector too maintained a strong rate of expansion, led by public services, financial services and transport, communication and storage (TCS).

GDP growth is forecast to come in at 6.4% and 6.5% in 2018 and 2019 respectively, slightly down from the June 2018 projections. The continuing rise in inflation and the interest rate will likely temper household consumption growth more in coming months. As it is, consumer and business sentiment indices have weakened markedly between 3Q and 1H 2018 (Figure 1.5). Foreign tourist arrivals growth in 3Q 2018 was slower than in the same period in 2017 and was weaker than the year-to-date (YTD) average. Remittances from overseas workers contracted again in August 2018, reversing the 5.2% YOY growth posted in July 2018. The decision to increase rice imports and allocate fuel subsidies to certain sectors should help lessen the burden, although calls for higher transport fares and wages are gaining traction, which will feed back into inflation.

Meanwhile, government expenditure grew more firmly in the third quarter than in the first half of 2018 thanks to the rising revenue-to-GDP ratio. GFC growth is on track to sustain its quarterly average rate, as indicated by the 22.4% rise in the nominal value of capital imports in 3Q 2018 and following the 13.3% growth in 1H 2018. Anecdotal evidence also suggests sustained momentum in project rollouts. Growth in the nominal value of goods exports turned positive, albeit weak, in 3Q 2018, driven primarily by the electronics subsector, which has high import content.

Figure 1.5. **Consumer confidence indices in Indonesia, Malaysia, the Philippines and Thailand, 2017-18**



Note: All indices are adjusted to set 100 as neutral confidence point.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

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In the next five years to 2023, the Philippines is forecast to post an average GDP growth rate of 6.6%, just as it did in 2012-16. Private consumption will continue to be fuelled by overseas remittances that accounted for about 9% of GDP in 2017. The relatively steady unemployment rate since the April 2017 round of the labour force survey will support household consumption. However, the underemployment trend (based on 4-quarter moving average) that has risen since 4Q 2017, despite the persistent downward trend in the labour participation rate, suggests that there is a glut in the availability of quality jobs. Public budgetary spending continues to be robust thanks to the stable fiscal position, which should help buoy the economy. That being said, it is just as important to increase the quality of spending – by strengthening post-construction project quality audits, for example.

The timeline for the subsequent instalments of tax reform legislation may be pushed back. Indeed, the limitations of social safety nets and delays in additional measures to soften the impact of rising inflation since the first reform package have combined with rice supply management issues, global oil prices and exchange rate weakness to produce one of the main pressure points. Meantime, the pace of delivery of infrastructure projects before the national elections in 2022 will be crucial for the momentum of investment. The Investor Relations Office (IRO, 2018) reported that infrastructure spending is programmed to rise from 5.4% of GDP in 2017 to 7.3% in 2022, as the pace of project rollout seems to have accelerated in recent months.

On the regulatory side, the signing of the Ease of Doing Business Law in May 2018 brought with it hopes to improve investment competitiveness. The ease of doing business and competitiveness indices have been mixed since 2016 and the corruption perception index has deteriorated between 2014 and 2017. Concerning trade, policy uncertainties could, in coming years, dent the growth of gross exports, which make up 31% of GDP in current and 57% in constant prices.

Thailand

Thailand recorded GDP growth of 4.6% in the second quarter of 2018. Though it was slightly down from the first quarter's 4.9%, it was still commendable compared to the trend since 2013. Private consumption drove domestic demand, supported by steady expansion in fixed investment as government expenditure marginally receded. Household spending on food and non-alcoholic beverages, housing and utilities, and household items were higher than in 1Q 2018. Investment in construction (private and public), machinery and equipment also grew briskly. As for goods exports, which account for roughly three-quarters of gross exports, they rose 7.4% in the second quarter against 4.7% in the first, while growth in services export fell back. Nominal customs data reveal that overseas sales of agricultural commodities and manufactured and mineral goods have maintained particularly encouraging trends.

On the supply side, agricultural output rose 10.4% in 2Q 2018, up from 6.5% in 1Q, driven by the increase in overseas demand, generally good weather and the clearing of the domestic stockpile of rice. The construction industry's growth rate climbed to 2% in 2Q 2018 from 1.2% in the first quarter. However, growth in manufacturing and the utilities slowed, while mining contracted for the second straight quarter. In the services sector, WRT expanded at a faster rate in 2Q 2018, as did financial services. Growth in TCS and hotel and restaurant services also remained robust, although it was slower than in 1Q 2018.

GDP growth rates in 2018 and 2019 are forecast to be 4.5% and 4.1%, respectively, higher than the June 2018 projections. In August 2018, the consumer confidence index recorded its highest score since April 2013, before waning marginally in September and October 2018. The sentiment was bolstered in part by the fuel and natural gas price controls announced by the government in May 2018. The upward trend in outstanding bank credit to individuals and the robust growth in tourist arrivals (Figure 1.6) are also upsides private spending.

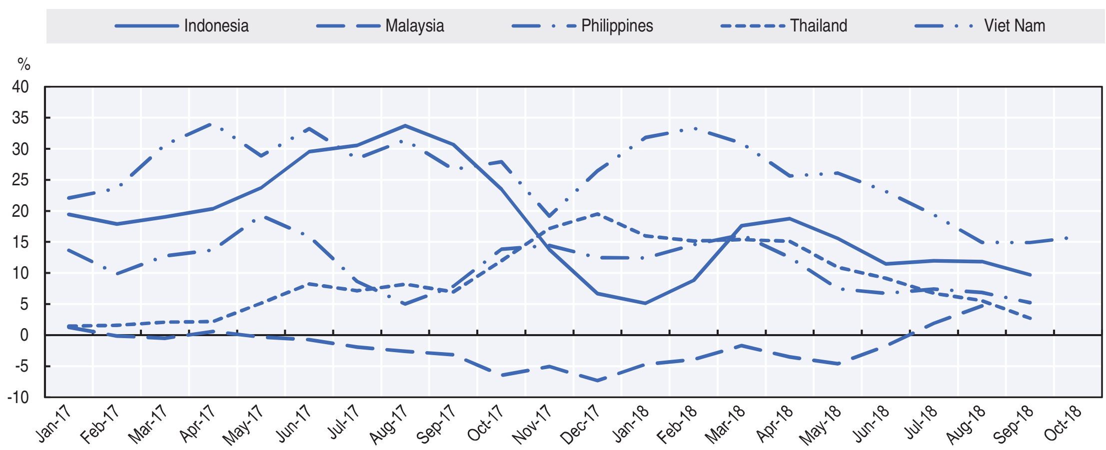
Central government nominal data in July-September 2018 show that public expenditure YOY growth was faster than in January-June 2018. The scheduled general elections in February 2019, should it take place, could relaunch it. Infrastructure investment outlays should accelerate between October 2018 and March 2019 as the government draws down undisbursed allotments in fiscal year (FY) 2017/18 (i.e. fiscal year ending September 2018).

The initial public offering of the Thailand Future Fund announced in 2015, which seeks to amass THB 100 billion, or USD 3.1 billion, in capital, was also set for October 2018.

External trade prospects are slightly down, as evidenced by the YOY decline in monthly export value in September 2018, which maintained a trend set in train in May 2018. Moreover, the manufacturing purchasing manager's index (PMI) dipped for the third consecutive month in August 2018 before rising slightly in September 2018 to a neutral level of 50. Rice producers and exporters, by contrast, are looking to finish the year on a high thanks to government-to-government deals made earlier this year.

Figure 1.6. **Tourist arrivals (3-month rolling sum) in ASEAN-5 countries, 2017-18**

Year-on-year growth



Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886455

Between 2019 and 2023, Thailand's economy is projected to grow by 3.7% on average, an improvement on the 3.4% figure for 2012-16. Fixed investment should benefit from the introduction over the last two years of investment-related legislation – e.g. National Competitiveness Enhancement Act for Targeted Industries and amendments to the Investment Promotion Act. It helps that investment climate indicators – like ease of doing business, competitiveness and perceived corruption – are also more positive according to the latest data from the previous year. How swiftly implementations in building EEC infrastructure are addressed however, will be a vital determinant of the magnitude of capital inflows. An equally important factor will be bringing to fruition infrastructure projects outside the scope of the EEC – e.g. rail projects in Phuket, Chiang Mai, Nakhon Ratchasima and Khon Kaen.

With regard to private spending, household debt – estimated at over 77% of GDP in 2Q 2018– remains a concern though it has gradually declined since 2015. The low unemployment rate should help sustain private consumption. Tourism, as in the past, could also be another driver of consumption, with Thailand's 2017 standing in the Travel and Tourism Competitiveness showing an improvement over 2015. The government aims to attract 40 million international tourists in 2019, compared to 35.4 million in 2017. Meanwhile, gross exports, which account for 78% of GDP in constant prices, have been recovering strongly since 2015.

Viet Nam

Viet Nam's economic growth dipped to 6.7% in 2Q 2018 from 7.5% in the first, before picking up to 6.9% in the third quarter. The improvement in the nominal growth of retail sales of consumer goods and services indicates that private consumption has firmed up. Nominal government spending also gathered pace in 2Q and 3Q 2018, while growth in the state's placement of capital in social investment programmes held steady. Non-state capital placements also gained traction, as did inflows of foreign capital. Separately, nominal growth in exports of goods – especially phones and related parts, electrical computer parts and garments – recovered in 3Q 2018 after a sharp decline between the first and second quarters.

Although not quite as strong as 1Q's 13.6%, supply-side disaggregation shows that growth in manufacturing value added stayed robust in the second and third quarters of 2018 at over 12%, supported by demand from the offshore market. The same goes for utilities, while construction also grew between the second and third quarters. In the services sector, growth in the value added of WRT, TAS, information and communication, and financial services was brisk in 3Q 2018. Meanwhile, agricultural growth eased somewhat in 2Q and 3Q 2018 compared to 1Q 2018, but was still stronger than in the same periods in 2017. Growth in farming output benefitted from the generally favourable monsoon and robust export demand. Nonetheless, the heavy rains leading to floods and landslides in the three months to September 2018 badly affected some parts of the country.

Viet Nam's GDP is forecast to rise by 6.9% in 2018 and 6.7% in 2019. The main indicators are sending mixed signals, however. Nominal growth in retail sales continued to gain momentum in October 2018. As for state investment, which is still under budget, it was on an upward trend in 3Q 2018, though still 39% below the annual target, which leaves the government with ample budgetary space for the rest of the year. Credit growth in September 2018 stayed slack, however, in line with central bank policy, coming in at its slowest pace since September 2014. Growth in the industrial production index was sturdy in 3Q 2018, though monthly data show signs of it having eased up since July 2018, much like the manufacturing and utilities indices. Mining and quarrying production index reverted to a contractionary cycle in August-October 2018 after rising in July 2018. The fall is attributable partly to tighter regulations and partly to the weak financial standing of many large mining firms resulting from subdued global metal prices.

Viet Nam's economy is forecast to grow 6.5% in 2019-23,compared to 5.9% in 2012-16. Exports, which accounted for 101.6% of GDP in current and 119.7% in constant prices in 2017 (ADB, 2018), are expected to continue to be the mainstay of medium-term economic growth. FDI, which maintained its upward trend and posted a new record high in 2017 of USD 14 billion, has provided the country with capital ammunition over the years. However, amid the changing global export and investment policy landscape, keeping the momentum going necessitates continued efforts to improve the quality of labour.

Initiatives to widen the scope and institutional framework of some economic zones (by converting them into special economic zones) could further bolster the improving investment competitiveness and help the country as it seeks to increase the domestic value added content of its output. The official NPL ratio fell to less than 2% in 4Q 2017 from almost 5% in 3Q 2012 (excluding the holdings of Vietnam Asset Management Company), which should ease the strain on banks and free up some capital for lending. Bad debt resolution, however, is gaining ground slowly in the absence of a well-structured market for troubled assets. Resolution 42 has been instrumental in making settlements easier, though lack of clarity concerning tax matters, the length of foreclosure proceedings, legal unpredictability and fragmented processing system deter investors. Meanwhile, the elevated public debt-to-GDP ratio, which is expected to come within 1 percentage point of the legal ceiling of 65% in 2018, will limit fiscal expansion in the coming years. The country must address that issue through a combination of domestic private sector and foreign participation, if it is to meet its large capital requirements, especially for infrastructure.

Brunei Darussalam and Singapore

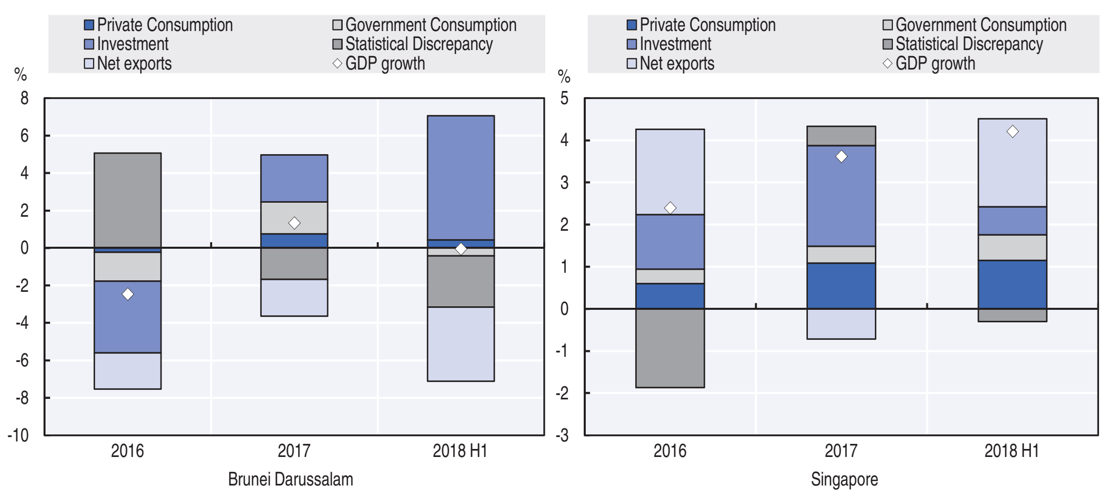
Brunei Darussalam

Brunei Darussalam's economy grew by 2.6% in 1Q 2018, a substantial improvement over the same period the previous year, but contracted by 2.8% in 2Q 2018. Household consumption grew by 4.6% in 2Q 2018 after a modest 0.2% increase in 1Q, while private GFC too was buoyant in in both quarters, increasing by 29.9% on average, though slower than the 44.9% YOY growth in 4Q 2017 (Figure 1.7). Gross exports, government consumption and public GFC, which all expanded in 1Q 2018 contracted in 2Q 2018.

On the supply side, reduced output in vegetable farming and fisheries saw agricultural production decline further to 5.7% in the 2Q 2018 after a 1.1% drop in the previous quarter. The industrial sector likewise retreated by 2.0% in 2Q 2018 following a growth of 5.0% in 1Q 2017, due to broad-based decline across subsectors except electricity and construction in spite of the rising global oil prices and the construction of several key downstream industrial projects such as the refinery on Pulau Muara Besar and a fertilizer production plant. The services sector contracted for the third straight quarter as finance declined by 37% in 2Q 2018 following a 5.9% contraction in 1Q 2018.

Figure 1.7. **Contributions to growth in Brunei Darussalam and Singapore, 2016-18**

Percentage points



Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886474

In 2018 and 2019, Brunei Darussalam is expected to grow by 2.0% and 2.3%, respectively. The prevailing global oil price trend still works in the country's favour. Outstanding commercial bank loans rose 3.1% in 2Q 2018 after seven consecutive quarters of decline, which bodes well for household spending. Furthermore, goods exports (in local currency) displayed a healthy increase of 41.6% in July 2018, compared to the 9.2% rise in 1H 2018, compared to the 11.1% rise in the same period in 2017 (Figure 1.8). The increase in sales was led by mineral fuel exports (up 7.4%) and by strong expansion in manufactured goods exports, up 149.6%.

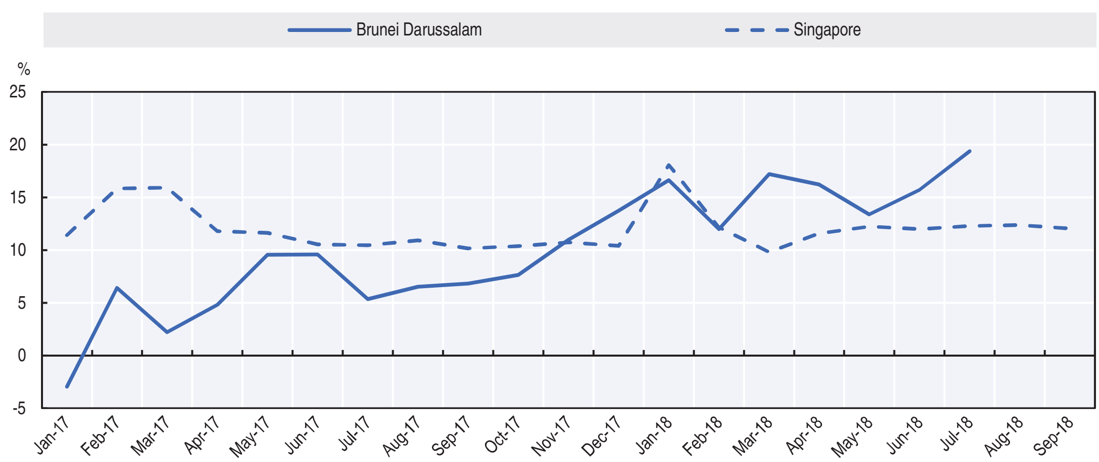
Brunei Darussalam's economy is projected to grow by 2% in 2019-23 in a rebound from an average annual contraction rate of 1.3% in 2012-16. Oil prices, which almost doubled between mid-June 2017 and end-September 2018, augur well for the country's export earnings, domestic personal consumption and the government's fiscal space.

Investment prospects, too, are looking up. The upward reversal in the annualised (four-quarter moving sum) FDI trend in 4Q 2017 is also indicative of brightening prospects after the net outflow for five consecutive quarters from 3Q 2016. Improved business climate indices (ease of doing business and perceptions of corruption) in data for 2017-18 is another upside to the country's investment potential.

The government formally created the Muara Export Zone in September 2017 in a move to attract investment for industries outside oil. The government's intent to diversify its economic growth sources – a policy priority since the early 2000s – has so far met with limited success. Halal food and eco-tourism industries are two of the key areas that the government aims to strengthen in the coming years. Capital market depth is another area that it could harness further to increase private sector involvement in enterprises. It should also look more closely at adjusting its monetary framework if it is to improve its policy toolkit as part of the move to gradually open up its domestic market.

Figure 1.8. **Goods exports of Brunei Darussalam and Singapore, 2017-18**

Year-on-year and year-to-date growth



Note: Calculations are based on levels data in US dollars.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886493

Singapore

According to the government's advance estimates, the rate of expansion of Singapore's economy slipped back to 4.1% in 2Q 2018 and 2.6% in 3Q from 4.6% in 1Q 2018. Manufacturing growth slowed markedly to 4.5% from 10.6% and 10.8% in the second and first quarters of 2018, respectively. The services sector grew 2.9% in 3Q 2018 – the same as in 2Q but less than in 1Q 2018. The decline in the construction industry's output continued for the eighth straight quarter though less steeply (shrinking by 3.1%) than in the previous seven quarters.

On the demand side, data from 2Q 2018 show that YOY growth in private consumption slowed for the second straight quarter, possibly due to rising interest rates, growing property prices and overall headline inflation against a background of weaker growth in real wages. Government expenditure growth slowed sharply to 2.2% in 2Q 2018 from 8.7% in 1Q 2018. Investment in transportation equipment jumped 31.8% in 2Q 2018 to reverse the contraction of the previous quarter and make up for the weakness in capital outlays in construction, machinery and intellectual property items. Gross export growth was relatively steady, borne by sales of mineral fuels, chemical products and manufactured goods.

Singapore's economy is forecast to grow by 3.5% in 2018 and 2.9% in 2019, lower than the rates projected in June 2018. Growth in the value and volume of goods exports in 3Q 2018 showed improvement over the first two quarters, even though it was weaker than in 3Q 2017. While growth in the volume of non-oil exports has picked up since June 2018, it has dwindled in oil exports since February 2018, falling by 16.7%, in September 2018. Furthermore, the decline in the purchasing managers index for manufacturing in September indicates that offshore orders are falling off.

Singapore is forecast to post 2.7% GDP growth in the medium term, less than the 3.5% average in 2012-16. Fixed investment, which declined in 2016 and 2017, is expected to pick up in line with various infrastructure plans, e.g. Singapore to Kuala Lumpur high-speed rail link, the Tuas Megaport and Changi Airport Terminal 5. The steady inflow of investment into ICT and other Research and Development (R&D) ventures can also boost productivity and efforts to diversify the earnings of the services sector. Increases in public spending on healthcare and other social services are also anticipated, which should give economic growth an additional boost. The opening of an infrastructure office in October 2018 to facilitate infrastructure financing in Asia, particularly in Southeast Asia, will provide the financial services sector with a further line of business.

Although its impact has been muted in recent months, protectionism is likely to hobble trade, which drives a number of manufacturing and services segments. Balancing the pace of technological development and job market vibrancy remains another concern, despite various initiatives to reskill the labour force.

Other issues in the longer term are the fertility rate, which declined from 1.6 in 2000 to 1.16 in 2017, and the old-age support ratio – the proportion of 15 to 64 year-olds to the over 65s, which fell from 9.9 in 2000 to 5.2 in 2018. Keeping the older generation productive has been one approach to supporting the country's competitiveness. To that end, the government and academia have introduced a number of lifelong learning programmes as part of the Industry Transformation Maps strategy. Programmes include SkillsFuture and the School of Continuing and Lifelong Education run by the National University of Singapore. Encouraging firms to adopt programmes is seen as a crucial next step. Challenges related to income disparity are taken into consideration. The government had been tackling the issue by addressing concerns related to wages, education, immigration and social integration.

CLM economies

Cambodia

Cambodia's growth has firmed up in recent months, supported by private consumption, investment and exports as the underlying drivers. Personal lending rose by 27.1% in June 2018 from 25.8% in the previous month, while growth in total credit reached 18.3% in June 2018, down marginally from 19.9% in the previous three months.

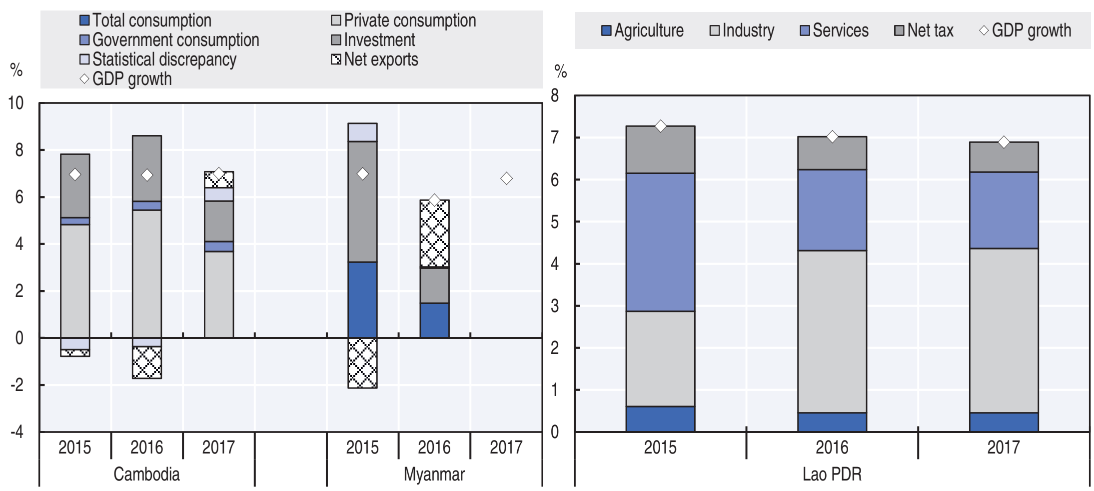
The sectors that saw the biggest rises in credit were real estate (48.2%), transport and storage (42.15%) and utilities (37%). Tourist arrivals also showed increased YTD growth of 11.7% YTD in August 2018, so sustaining the 11.8% showing in the same period in 2017. Year-on-year year-to-date growth in approved fixed investment assets was up 38.4% in June 2018 from 17.3% in June 2017. As for FDI growth, it rose to 38.7% in 2Q 2018 from 8.23% in 1Q 2018. The banking, assembly, electronics and real estate sectors saw inflows increase in 2Q 2018, while there were declines in the garment industry and agriculture. Goods exports in nominal terms climbed by a robust 18.4% in 2Q 2018 from 13.3% in 1Q

2018, driven by garments (20.1%) and agricultural products (43.2%), but pulled back by electrical and vehicle parts and rubber.

Government expenditure, which rose by an average of 16.3% between January and August 2018, is expected to rise faster for the remainder of the year. Furthermore, thanks to favourable conditions, the rice harvest yield in February 2018 was 10.4 million tonnes, about 4% up on the previous year, while growth in rubber production increased for the third successive quarter in 2Q 2018. Against that backdrop, GDP growth in Cambodia is estimated to be 7% in 2018 and 6.9% in 2019, broadly in line with the June 2018 forecast and much the same as the growth rate in 2017 (Figure 1.9).

Figure 1.9. **Contributions to growth in CLM countries, 2015-17**

Percentage points



Notes: Data for Myanmar relate to fiscal years. Lao PDR does not publish demand-side data. Total consumption is private consumption plus government spending. Net tax is taxes minus subsidies.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886512

Cambodia's economy is projected to expand by 6.9% in the next five years to 2023, a more moderate rise than the 7.1% growth in 2012-16. The steady inflow of foreign capital, which reached a new high of almost USD 11.4 billion in 1Q 2018 on an annualised basis (i.e. four-quarterly moving sum) bodes well for the country's ability to create quality jobs (job informality is widespread) and, ultimately, for the resilience of household spending.

Cambodia's participation in infrastructure projects – like those that are part of the Greater Mekong Subregion (GMS) and Belt and Road (B&R) initiatives – affords it opportunities to improve existing public capital stock. (Box 1.3) Reform measures such as the updated Law on Financial Management, which offered small businesses incentives to formalise their operations, paved the way for the tax-to-GDP ratio's climb from less than 10% in 2010 to over 16% in 2017.

Promoting listing and trading in the nation's stock market and developing its capital market institutional framework, as outlined by the Securities and Exchange Commission (Cambodia SEC, 2018), will bring sizeable benefits, as long as safeguards against systemic risks are not set aside. However, measures to promote the use of the local currency need to be strengthened to increase the efficacy of the central bank's monetary policy. The ratio of foreign currency deposits to total deposits (i.e. demand, time and foreign currency deposits) exceeded 90% between January 2000 and June 2018.

Box 1.3. Importance of the spill-over effects of infrastructure

Infrastructure investment decisions must include a full evaluation of externality effects. This means going beyond an evaluation of the financial feasibility of an individual project to make an effort to judge the positive and negative economic, social and environmental effects over the different time periods of the planned investments (OECD, 2018a).

During construction, infrastructure projects provide stimulus to the local and wider economy. Over the longer term, transportation infrastructure can lead to local efficiency gains, increased demand and economic activity, while also producing a combination of positive and negative health, environmental and other effects. Quality infrastructure investment has positive spillover effects that range from job creation and increased FDI, improved tax revenues through an expanded tax base, to improved well-being and inclusive growth while also addressing environmental impacts. According to a study of spillover externalities by the Asian Development Bank Institute (ADBI), the STAR highway in the Philippines had "a significant impact not only on business taxes, but also on property taxes and regulatory fees". In a similar study on the Tashguzar–Boysun–Kumkurgon railway line in Uzbekistan, ADBI identified a 2% increase in the growth rate of regional GDP in affected regions, 5% value added in industry and 7% value added in services because of the project. On the other hand, low-quality infrastructure imposes lasting costs, even when the up-front price is significantly lower. Poorly planned and constructed infrastructure may not function as intended and can lead to long-term public debt, accidents and environmental damage.

To develop quality infrastructure, senior levels of government need to adopt a comprehensive perspective. This requires sufficient political support and institutionalised practice within government, including at the local level. While the ideal division of responsibilities between local, regional and national authorities on any given project is shaped by a number of factors, including the respective capacities of the different levels of government and the need to consider projects' wider spillovers and synergies, new forms of co-ordination may be required over time. New approaches may also be needed to finance quality infrastructure. A variety of revenue and financing tools are available to governments to raise funds for infrastructure investment. These tools should be dedicated not only to increase infrastructure investment, but also to finance project needs throughout their life-cycle. Finally, quality infrastructure principles should be integrated into development planning, and aligned with budget priorities, including at local and regional levels. In this way they will remain at the forefront of investment decisions.

Lao PDR

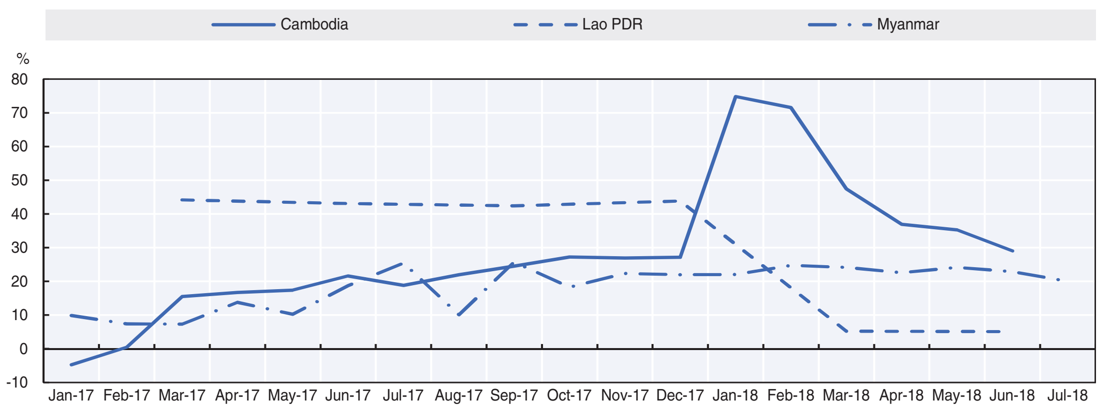
In 2018, the economy of Lao PDR is projected to remain robust at 6.6% growth rate. Electricity consumption increased by 5% in 1Q 2018 following an uptick of 7% in 1Q 2017. That increase, along with greater volumes of oil imports and improved tax collection, point to resilient consumption. Nominal export growth year-on-year tumbled to 5.1% in 1H 2018 in sharp contrast to the rise of 43.1% in 1H 2017 (Figure 1.10). Sales of electronic parts and electricity strengthened while agricultural exports stagnated in line with falling rubber and coffee prices.

Notwithstanding the dam collapse in July, key dam projects are likely to be maintained and the construction of the Vientiane to Kunming rail link will continue to support capital formation. Meanwhile, public spending surged by 33% in 1Q 2018, thanks to a significant increase in loan-financed public investment in the power sector. Government debt, for its part, remained broadly stable with only a slight increase of 0.35%.

On the production side, power generation increased significantly, as indicated by the 70% growth of energy exports to Thailand in 1Q 2018 and the commissioning of the 86 MW Nam Phay dam in January 2018. The electronic parts and components industry has also continued to fare well in 2018, growing by 13% in the first four months of the year. Nonetheless, the decline of mining continued in H1 2018, as resources dwindled in the main active mines. Some agricultural products, which included rubber and vegetables, suffered a slight downturn in 1Q 2018 due to low prices and persistent flooding in certain areas. Lao PDR is forecast to grow by 6.6% in 2018 and 6.8% in 2019, less than in 2017, though still faster than other countries in the region.

Figure 1.10. **Goods exports of CLM countries, 2017-18**

Year-on-year and year-to-date growth



Notes: Data for Lao PDR are quarterly. Data of Myanmar relate to fiscal years. Calculations are based on levels data in US dollars.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886531

Lao PDR is expected to grow by 7% in 2019-23, down from 7.6% in 2012-16. Apart from the large electricity deals in the offing, capital inflow will also be attracted by the new special economic zones (SEZs) coupled with broader fiscal incentives and the simplification of business procedures specified in the amendments to the investment promotion law issued in April 2017. The outlay on infrastructure that comes with the development of SEZs as well as those related to the GMS and B&R initiatives should support medium-term growth as long as they do not weigh on fiscal stability.

On the downside, the persistence of informal business practices is cited as a key business climate impediment (World Bank, 2018a). In the financial sector, resolving banks' legacy assets and strengthening solvency and liquidity positions are the chief challenges. Another concern is public and publicly guaranteed debt, which exceeded 61% of GDP in 2017 (IMF, 2018c) compared to 56.3% in 2013. Regarding land usage, energy industry expansion plans around the Mekong River have to be carefully re-examined following the dam collapse in July 2018. Surveillance of built structures in the vicinity of the river could be improved with the participation of local people, who are directly affected by any incident. The river is a source of food and ensures a livelihood for many households in a number of Southeast Asian countries.

Myanmar

In Myanmar, the main indicators point to robust, albeit more moderate, economic expansion in 2018. Private consumption is on an upward trend, as indicated by the substantial 49.7% rise in commercial taxes collected in January 2018 and confirmed by car registrations which were up 8.2% and the 13.1% increase in private electricity consumption over the same period. The simplified entry conditions for Chinese tourists, along with visa-free entry permits for Korean and Japanese visitors implemented in October 2018, should also reinvigorate flagging growth in tourist arrivals over coming months.

Foreign investment in permitted enterprises saw a year-on-year increase of 5.5% between April and September 2018. Less than the 13.5% rise for the same period in 2017 of 13.5%, it chiefly benefitted manufacturing, transport and communication and real estate. Goods exports posted a healthy year-on-year increase of 24.2% in April and May 2018. More than twice the growth rate of 10.3% for the same period in 2017, it was driven by brisk agricultural and garment sales.

On the supply side, the purchasing managers' index for manufacturing has steadily declined since April 2018 and fell to below 50 between July and September 2018. Natural gas output continued to fall in January 2018 – down 4.5% after a 6.1% contraction in FY 2016 (i.e. fiscal year ending March 2017). The drop was attributable to low energy prices. Agricultural output, despite a good harvest, was affected by severe flooding between June and August 2018.

Projections point to Myanmar's economy growing by 6.6% during the six-month period ending September 2018 and by 6.9% in FY 2019 (i.e. fiscal year ending September 2019). Its medium-term GDP growth between 2019 and 2023 is forecast to average 7%, marginally slower than the rate of 7.3% in 2012-16. Investment is likely to get a boost in coming years from infrastructure projects, particularly the big ones that are part of the National Transport Master Plan. The gradual improvement in investment climate indices provide additional impetus, particularly when coupled with investment liberalisation measures. Such measures include the relaxation of business ownership regulations, the opening of equities market to foreign players, new SEZs and townships, and the easing of restrictions on business operations in areas like gaming and entertainment. FDI inflows more than tripled to about USD 4.7 billion in 2017 from USD 1.3 billion in 2012, when the reform got underway. The new Companies Law, which came into effect on August 2018, is seen as a step in the right direction in the support of small local enterprises.

The sustainability of economic growth is hampered by underdeveloped electricity infrastructure and unstable power supply. Importing electricity from Lao PDR and India, leveraging the domestic natural gas supply and building facilities to develop renewables (such as solar energy) are some stop-gap measures proposed as the government targets 100% electrification in 2030.

How fast the technical functions of the central bank and securities commission can be developed is also essential to government efforts to deepen the financial market. Managing inflation and addressing banking sector fragilities are further concerns that are tied to the technical capacity of the central bank. The interplay between volatile inflation on one hand and the persistently high budget deficit on the other is a downside of growth – especially when the local currency is under pressure due to weaknesses in current account position. Separate anecdotal evidence suggests that local banks are struggling to meet the standards set by new central bank regulations in line with the recent Financial Institutions Law.

China and India

China

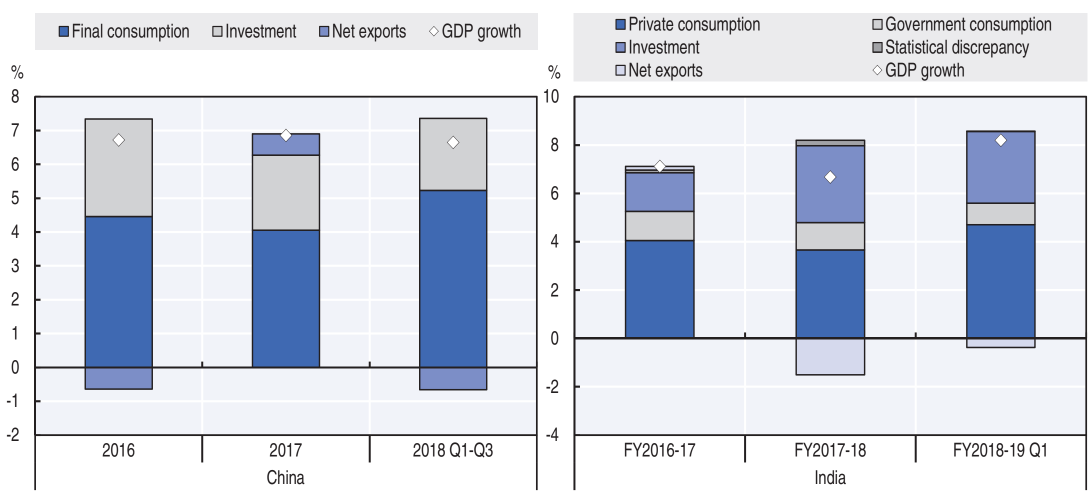
China's GDP growth inched down from 6.8% in 1Q 2018 to 6.7% in 2Q and 6.5% in 3Q. However, the annual growth rate is still likely to surpass the government target of 6.5%. Domestic demand has accounted for almost 80% of the expansion in output over the last two quarters (Figure 1.11). Growth in retail sales and real estate stabilised as automobile sales declined in 3Q 2018. Although balance of payments data point to continued healthy growth in gross exports, net exports were a drag on GDP growth for the third straight quarter due to faster growth in imports.

The contribution of investment to GDP growth continued to fall, in line with the trend that has prevailed since 3Q 2017. While completed investment in state-owned-and-controlled corporations continued at a more moderate rate in 2Q and 3Q 2018, outlays in private fixed assets picked up.

On the supply side, manufacturing grew 6.6% and 6.0% in the second and third quarters, almost unchanged from the 6.7% in 1Q 2018. By comparison, construction growth retreated more markedly after the inventory of unoccupied residential and office spaces was drawn down. Accordingly, the year-on-year increase in newly built house prices accelerated in 3Q 2018. The steady growth of the services sector (4% in both 2Q and 3Q 2018) was driven by the expansion of 31.7% in IT-related services, 9.4% in leasing and commercial services, and 8.1% in transport and storage. Growth in WRT declined for the seventh straight quarter whereas financial services growth recovered in 2Q and 3Q 2018 following a dip in 1Q 2018.

Figure 1.11. **Contributions to growth in China and India, 2016-18**

Percentage points



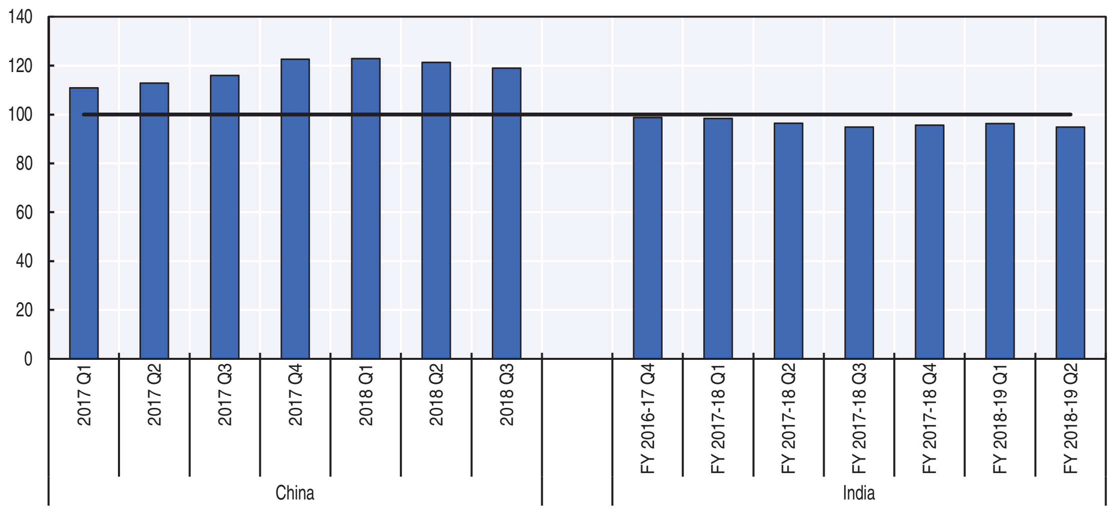
Note: Data for India relate to fiscal years.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

StatLink https://doi.org/10.1787/888933886550

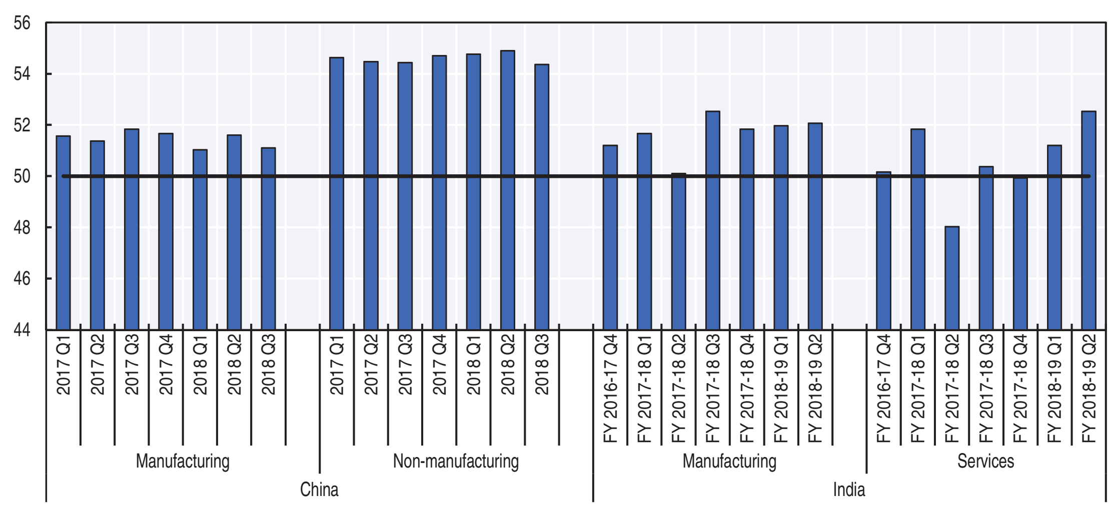
In 2018 and 2019, China's economy is forecast to grow by 6.6% and 6.3%, respectively, lower than projections made in June 2018. The willingness of the government to take monetary and fiscal action to counter trade-related headwinds (e.g. cutting reserve requirement ratios) will keep domestic demand buoyant at least in the near term. Nevertheless, the consumer confidence index, though positive, has weakened (Figure 1.12). Fixed asset investment year-on-year growth also moderated in September 2018 even though the FDI utilisation had been gaining momentum since January 2018. On the external front, the PMI relative to new export orders for manufacturing goods contracted for the fourth straight month in September 2018, mirrored by the declining overall trend in the PMI for manufacturing. By contrast, the PMI for non-manufacturing business activity expanded briskly over the same period (Figure 1.13).

Figure 1.12. **Consumer confidence indices in China and India, 2017-18**



Note: All indices are adjusted so that 100 is the neutral confidence point.
Source: OECD Development Centre calculations based on CEIC Data and national sources.
StatLink https://doi.org/10.1787/888933886569

Figure 1.13. **Purchasing managers' indices in China and India, 2017-18**



Note: The neutral point of the indices is 50.
Source: CEIC Data, national sources and Nikkei Asian Review.
StatLink https://doi.org/10.1787/888933886588

China is projected to register an average growth of 5.9% in 2019-23. The private consumption outlook remains encouraging, with the central bank showing its willingness to take measures when needed to stimulate domestic activity. In the longer term, the government's increased focus on education over the years will prove valuable as the labour market adjusts to more technology-driven global affairs.[2]

Investment, which saw its share in nominal GDP decline from 2013 to 2017, appears to be surging back. When it comes to FDI, inflows annualised over four quarters rose steadily between 2Q 2017 and 2Q 2018 after two years of decline. The trend was supported by the consistent improvement from 2014 to 2017 in investment climate indices like the ease of doing business, competitiveness and perceived corruption. New investment liberalisation measures have also been implemented in sectors such as finance, manufacturing, transportation and ICT.[3] Trade, by contrast, is beset with uncertainties. There is a possibility that trade frictions could weaken corporate balance sheets and consequently exacerbate overall credit risk at a time when interest rates are rising.

India

India's economy expanded 8.2% in 1Q 2018 (i.e. 1Q of the fiscal year ending March 2019). It was the fastest rate since 1Q 2016 and the fifth straight quarter that GDP growth had risen since stabilising at 5.6% in 1Q 2017. Private spending accounted for more than half of that growth, increasing by 8.6%, up from 6.7% in 4Q 2017 as headline inflation receded despite weakness in the local currency and rising oil prices. Nominal growth in personal loans was brisk. Gross exports, too, lent strong support, growing 12.5%, up from 3.6% in the previous quarter, on the back of petroleum and manufactures sales.

Fixed investment growth stayed strong at 10% in 1Q 2018, though slower than the 14.4% growth in 4Q 2017. Growth in public spending, by contrast, decreased to 7.6% from 16.9% in the same period in line with the government's intention of trimming the deficit for the fiscal year.

Reflecting the strength of offshore sales in manufactured goods, the manufacturing sector's output growth rose to 13.5% in 1Q 2018 from 9.1% in 4Q 2017 to lead supply-side components. Construction grew 8.7%, following the rate of 11.5% in 1Q 2018, though well above the average of the previous five years. Growth in utilities was just as robust, even though activity in mining and quarrying was subdued.

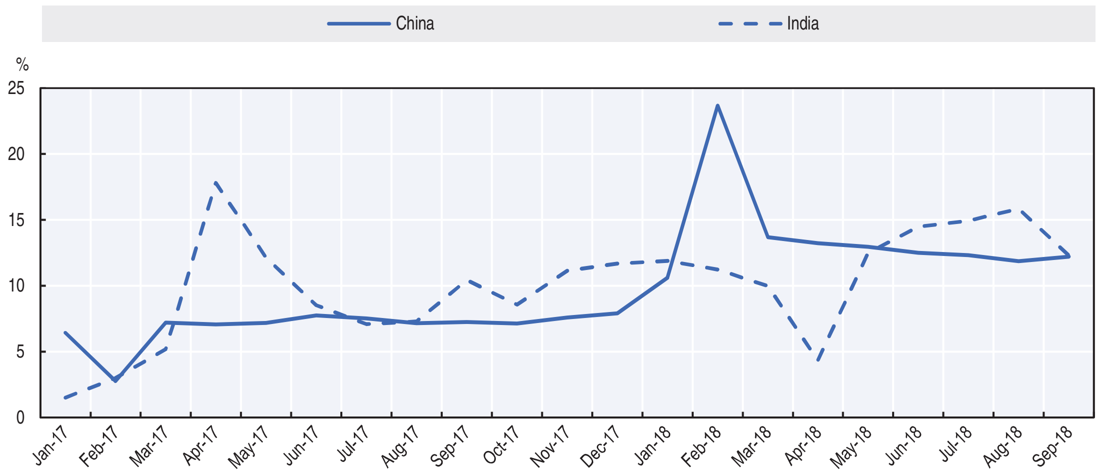
The services sector was resilient, growing 7.3% in 1Q 2018 in the wake of a 7.7% expansion in 4Q 2017, driven by buoyancy in a range of subsectors – particularly trade, transport, communication, finance, real estate and professional services, and not forgetting public services. Benefitting from relatively good weather, the agricultural sector also posted higher output growth during the period, climbing from 4.5% to 5.3%.

Economic growth forecasts point to 7.5% in FY 2018 and 7.3% in FY 2019. Positive near-term factors include sturdy bank credit growth in 2Q 2018 and the recovery in the year-on-year growth in tourist arrivals to 4.1% in 2Q 2018 from 1.6% in 1Q 2018, which indicate the strengthening of private spending. It is also unlikely that government price stability mechanisms will be scaled back until the end of the fiscal year.

Factors such as the continuous climb in global oil prices, weak currency and rising interest rate do not bode well for consumption. Consumers remained generally pessimistic in 1H 2018 though the extent of pessimism has declined marginally from 4Q 2017. Fixed investment prospects, too, are dimmer. Apprehensions were compounded by the decline in the growth of infrastructure industries index. Hikes in central bank policy rates supporting uptick short- and long-term bond yields also present challenges to resolution of bad debts. However, nominal growth in goods exports (denominated in the local currency) averaged 20.7% 3Q 2018. Sales of crude petroleum and manufacturing products also continued to register large increases during the third quarter (Figure 1.14).

Figure 1.14. **Goods exports of China and India, 2017-18**

Year-on-year year-to-date growth



Note: Data for India relate to fiscal years. Calculations are based on levels data in US dollars.

Source: OECD Development Centre calculations based on CEIC Data and national sources.

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India's economy is projected to grow by 7.3% in the medium term from 2019 to 2023. Infrastructure projects, which number more than 1 300 and were originally valued at INR 15,72,066.02 crore, or USD 216 billion, will be key to India's medium term economic performance.[4] The manner in which the projects will be delivered is equally crucial to the mitigation of credit and fiscal risks. Incidentally, a government assessment noted that delays had already affected 263 projects in May 2018 due to issues related to land acquisition, forest clearance, supply of equipment, fund constraints and geological surprises, for example (MOSPI, 2018). Another 348 projects had logged cost overruns, which carry excess cost amounting to INR 3,00,135.5 crore (USD 41 billion) and are equivalent to more than 19% of the initial total cost.

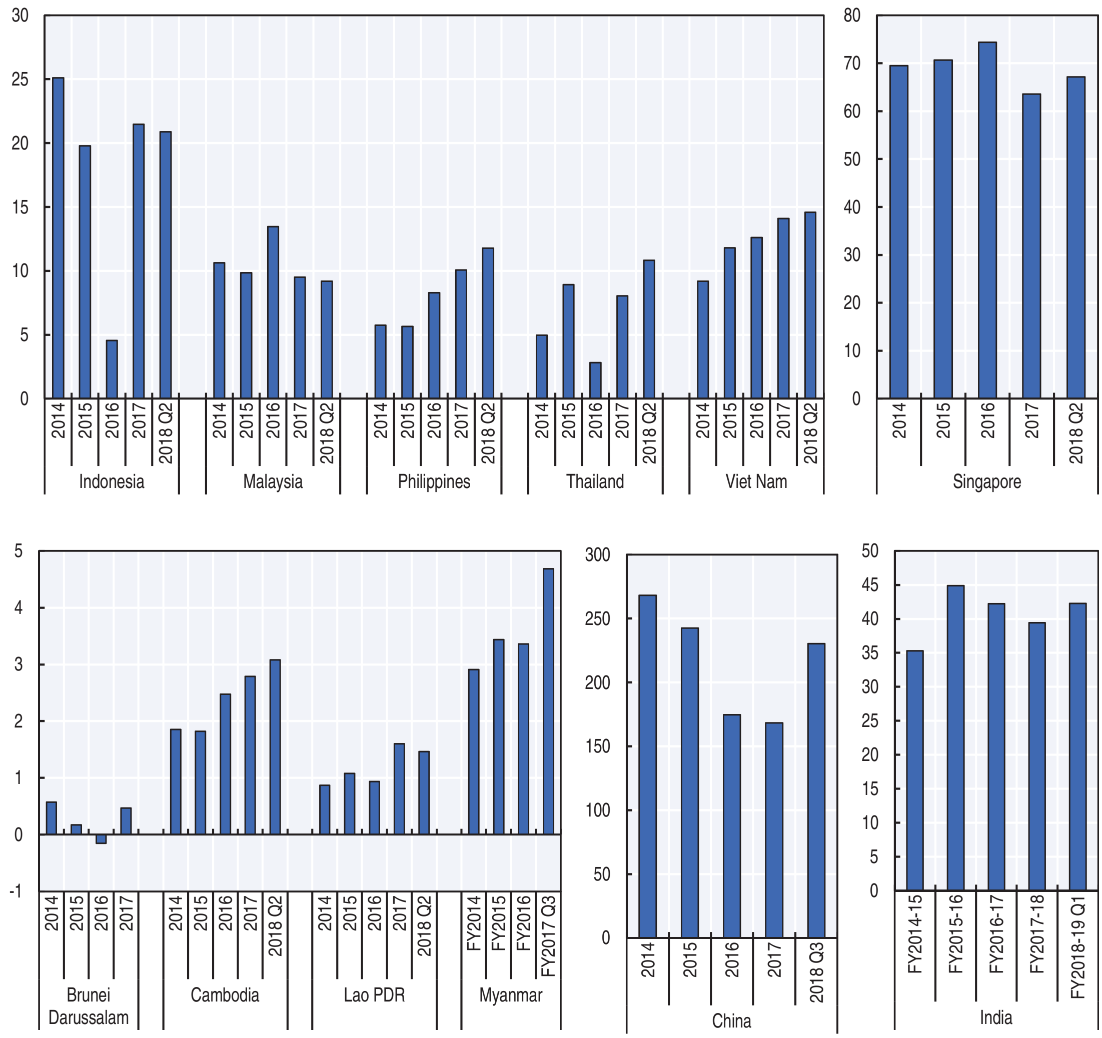
Investment in areas outside infrastructure will just be as crucial and it is encouraging that FDI inflows have continued to rise. Four-quarter moving sum of inflows reached at a multi-year high in 3Q 2017 and remained robust through 2Q 2018. Since 2017, India has gradually opened up further sectors to foreign participation. They include the retail, private security, construction, air transport and pharmaceutical sectors. Private consumption will likely remain buoyant during the period given the positive labour market situation, as long as the inflation and interest rates do not pick up steeply in the coming months.

Foreign direct investment continues to flow into Emerging Asia

FDI in Emerging Asia stayed positive in 2Q 2018, and have generally risen across countries from a year earlier (Figure 1.15). The exceptions were Indonesia and Malaysia, which experienced slight declines in annualised FDI inflows in 2Q 2018 over the same period in 2017. Quarterly annualised trends had been mostly upward since mid-2017 across the region, with levels posting new historic highs in the Philippines, Viet Nam and the CLM countries. Malaysia was the odd one out with its continued decline in inflows in 2Q 2018 – a trend that began in 3Q 2017.

Figure 1.15. **Foreign direct investment in Emerging Asian countries, 2014-18**

USD billion



Notes: Data for India and Myanmar relate to fiscal years. Quarterly data are annualised (i.e. four-quarter sum as of the period indicated). The asset/liability principle is followed in the presentation of FDI data. FDI inflows data refer to foreign placements minus foreign withdrawals (Balance of Payments liability side).

Source: OECD Development Centre calculations based on CEIC data, national sources and IMF (2018b), International Financial Statistics (database).

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Equities accounted for at least 72% of total annualised placements in Cambodia, China, India, Indonesia and Thailand in 2Q 2018 with the rest going to debt instruments, presumably driven by investment liberalisation measures. By contrast, FDI in debt in the Philippines outstripped FDI in equities during the same period by 53.7% to 46.3%, partly attributable to bond issuances to finance the infrastructure drive.

FDI flowed chiefly into manufacturing and partly into financial and insurance services, particularly in ASEAN-5 and China, while capital placements in computers and technology also picked up in China and India.

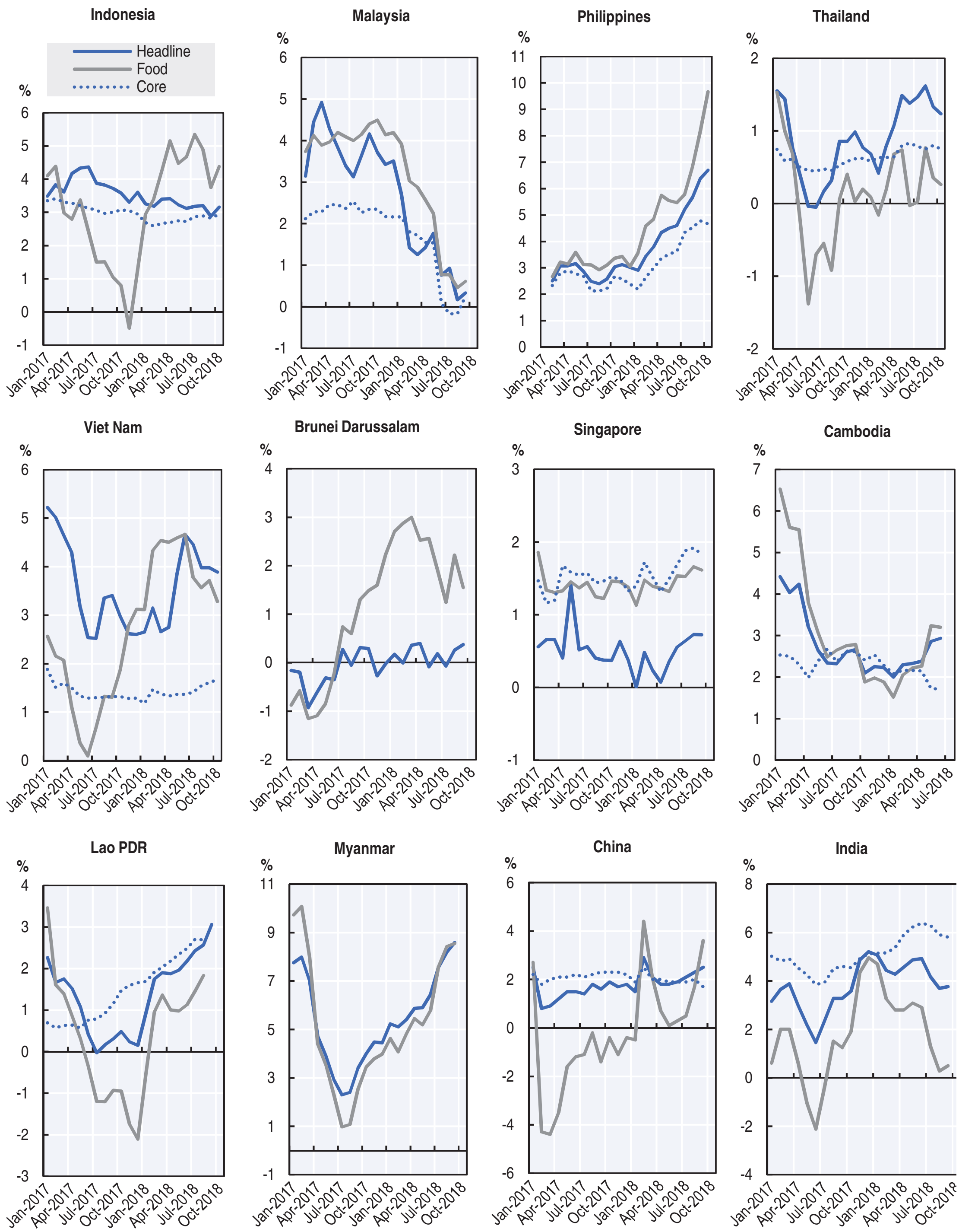
In Indonesia, manufacturing and the wholesale and retail trade accounted for 74% of FDI inflows in the four quarters through to 2Q 2018. Annualised FDI in manufacturing rose year-on-year by over 50% in 2Q 2018, compared to the 46% increase in 2Q 2017. Growth in annualised FDI in WRT was even more impressive at close to 109% year-on-year in 2Q 2018, compared to a 69% climb the previous year. In Malaysia, over 70% of FDI inflows between 3Q and 2Q 2018 went into manufacturing (40%), mining and quarrying (18.6%) and finance and insurance (12%). However, while annualised inflows into manufacturing grew year-on-year by 28.4% in 2Q 2018, FDI declined in mining and quarrying by 8.3% and in finance and insurance by 3.9%. In the Philippines, more than 71% of annualised equity FDI in 2Q 2018 was channelled into the electricity, gas, steam and air-conditioning (EGSA) segment (36.6%) and manufacturing (34.7%). The value of placements in EGSA was USD 1.4 billion, which reversed the USD 190 million outflow in 2Q 2017. As for inflows into manufacturing, they were more than seven times higher in 2Q 2018 than in 2Q 2017. Among other segments, financial and insurance services accounted for 7.8% of inflows and real estate 7%. In Thailand, annualised FDI in manufacturing rebounded by more than a factor of six in 2Q 2018 after declining by close to 70% year-on-year in 2Q 2017. The sector accounted for 42.4% of inflows in the last four quarters. Annualised inflows into financial and insurance activities and real estate activities respectively climbed to 60.1% and 20.4% from the previous year, thus making up 39.5% and 17.8% of total FDI. In Viet Nam, although annualised FDI registered in manufacturing fell by 15.7% year-on-year in 2Q 2018, the sector still took in the largest share at 38.7% of total inward foreign investment. By contrast, annualised registered capital in real estate, construction, accommodation and food services, WRT and professional scientific technology, grew substantially from a year before and accounted for a combined 41.4% of the total. In Cambodia, on an annualised basis, 45% of approved fixed assets were placed in tourism-related enterprises in 2Q 2018. Other services accounted for some 35%. The respective figures were 26% and 42% in 2Q 2017, with the rest going to agriculture and industry.

In China, manufacturing, real estate, leasing and commercial services and financial intermediation captured over 57% of utilised FDI in 2Q 2018 in annualised terms, even though their aggregate share had dropped steadily from almost 78% in 2Q 2015. By comparison, ICT's share in utilised FDI jumped from 2.1% to 14.3% over the same period. In India, telecommunications, computer software and hardware (CSH), wholesale trade, construction and financial, banking and insurance services together accounted for close to 58% of total annualised FDI inflows in 2Q 2018 – substantially higher than their 40.3% aggregate share in 2Q 2017. The segments where FDI increased the most between the two periods were telecommunications, CSH and wholesale trade.

Inflation picture is still mixed

Inflation trends vary. It is upward in China, Philippines, Thailand and the CLM countries but relatively stable or even downward in other Emerging Asian countries (Figure 1.16). All countries in the region have been affected by global oil prices, which almost doubled in the last 15 months (i.e. Brent oil futures price rose from around USD 45 per barrel in mid-June 2017 to USD 85 per barrel by the end of September) before falling marginally. The scale of impacts, however, varies from country to country, chiefly because of differences in relative exchange rate stability, fuel tax regimes and subsidy schemes. In some countries, changes in domestic tax frameworks and food-related policies have contributed to seasonal price push factors. Moderate global food prices (FAO, 2018) provide some respite.

Figure 1.16. **Inflation in Emerging Asia, 2017-18**



Note: Core price index in Emerging Asian countries is generally defined as headline CPI excluding prices of food, energy and other administered goods and services. In Singapore, core price index excludes accommodation and private road transport.

Source: OECD Development Centre calculations based on data from CEIC and national sources.

StatLink https://doi.org/10.1787/888933886645

In Indonesia, year-to-date headline and core inflation rates have been lower in 2018 than they were in 2017, with trends relatively stable in the first ten months of the year. Growth in the housing and utilities index as well as in transport, communication and finance, which respectively account for 25.4% and 19.2% of the consumer price index (CPI), had been on a downtrend since June 2017, due in part to government support measures. Food price inflation, for its part, which makes up 18.9% of the CPI, saw a build-up in prices in the early part of the year that ran out of steam in recent months. As for growth in the prices of processed food, beverages and tobacco (16.2% of CPI), it was steady at around 4.1% in January-October 2018 – about 50 basis points lower than in 2017. In Malaysia, headline and core inflation have eased markedly since mid-2017. All CPI subindices recorded weaker year-to-date growth in 2018 through to September than in the same period in 2017. Some prices even fell, such as those of alcoholic beverages, garments, communication and durable goods. Core inflation also receded in July and August 2018 before rising slightly in September 2018. The high base effect,the reintroduction of caps on diesel and gas prices, and the scrapping of GST in June 2018 have all been factors in the slowing of CPI growth. In the Philippines, headline inflation in September rose to its highest level since February-March 2010 at 6.7%, which was maintained in October 2018 to peg the year-to-date rate at 5.1%. The increase was attributable to the climb in subindices across the board led by food and transport.[5] The surge in the prices of rice, corn, meat, fish and vegetables drove the index of food and non-alcoholic beverages (38.3% of CPI) up to a year-on-year average increase of 9.6% in September-October 2018 and a year-to-date rise of 6.7%. The rates in the same periods in 2017 were 3.2% and 3%. The prices of alcoholic beverages and tobacco inflation, though smaller components of CPI, also rose year-on-year by an average of 21.7% in September-October 2018 and by 19.5% year-to-date, almost three times higher than in the same period in 2017. As for transport, which accounts for 8.1% of CPI, it climbed to 8.4% year-on-year on average in September-October 2018 and 6.5% year-to-date from 5.8% and 5%, respectively, one year earlier. The strong climb in consumer price inflation is attributable chiefly to the changes in rice importation policy that commenced early 2017, the rise in global oil prices, the weakening exchange rate, the increase in tax rates on a number of goods and services and inadequate safety nets (Box 1.4).

In Thailand, the uptick in inflation in 2018 was relatively mild at 1.1% year-to-date through to October 2018 from 0.6% a year earlier. Non-core raw food and energy prices (27.4% of the CPI) supplied much of the momentum, rising 2.3% year-to-date from 0.9% between January and October 2017. By contrast, average core inflation moved up only marginally, from 0.5% to 0.7%, over the same period. Of the sub-components, tobacco and alcoholic beverages (1.4% of CPI) rose markedly in 2018, up 5.2% year-to-date from 2.5% in the same period in 2017 presumably due to the increase in excise tax rates and continued tightening up of digital stamp inspection. Similarly, transport and communication prices have increased by between 3.3% and 4.4% respectively since May 2018, after more measured showings between January and April 2018. In Viet Nam, although headline inflation eased slightly, it was still high at 3.9% in October 2018 and 3.6% year-to-date, compared to 3.7% between January and October 2017. The price of food and foodstuffs (36.1% of the CPI), rose 5.2% in September 2018, the highest increase since August 2015, before tapering slightly to 5.1% in October 2018. The agricultural sector grappled with heavy rains and floods in 3Q 2018. Rises in the prices of health and personal care, by contrast, eased substantially in 3Q 2018 as the base effects of the readjustment in medical fees in 2016 and 2017 waned. Increases in the cost of education also leveled out.

Box 1.4. **Oil price pass through to inflation**

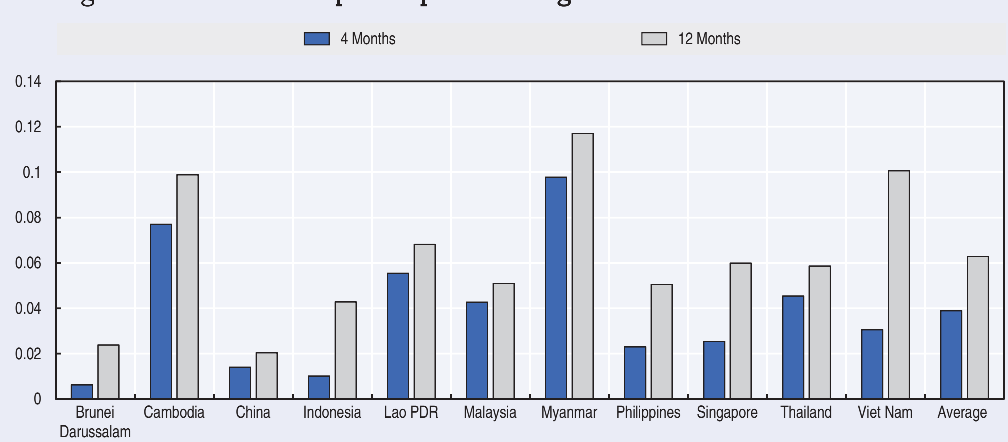
Oil demand increased by approximately 60% during 2000-16 in Southeast Asia, while production declined by 13.8%, causing net imports to increase by 400% over the period (IEA, 2017). This has caused a greater interlink between global fuel inflation and domestic headline inflation even if the connection between price levels in Emerging Asia and global oil prices is lower relative to advanced economies (Kpodar and Abdallah, 2017). More recently, high oil prices and depreciation pressures have made fuel imports more costly and caused higher fuel-driven inflation in some Southeast Asian countries. Energy subsidies and price controls prevailing in Emerging Asia explain the difference in spillover effects across countries. These artificially lower end-user prices to below international market levels (Choi et. al., 2017). Countries such as Brunei Darussalam, India, Indonesia, Malaysia, Myanmar, Thailand and Viet Nam employ such policies. However, due to their cost and distortionary effects, initiatives to reduce them have been taken (IEA, 2017).

As shown in Figure 1.17, there are large disparities between countries regarding oil price pass through. Cambodia, Lao PDR and Myanmar have the higher pass through both in the short and long term. This indicates a large degree of dependence on fuel. These results were obtained using the local projections method proposed by Choi et al. (2017) based on Jorda (2005). The following equation is estimated:

$$\pi_{t+k} = \alpha_k + \sum_{i=1}^{12} \gamma_{k,t-i}\pi_{t-i} + \beta_k \pi_t^{oil} + \sum_{i=1}^{k} \theta_j \pi_{t+i}^{oil} + \varepsilon_{k,t}.$$

where ϖ_{t+k} stands for headline inflation at period t and horizon k, ϖ_t^{oil} global oil inflation and $\varepsilon_{k,t}$ is the error term. We take $\sum_{k=1}^{l} \varepsilon_k$, for l=4,12 as our measure for global oil price pass through. It is the cumulative effect over 4 and 12 months after the shock.

Figure 1.17. **Global oil prices pass through relative to headline inflation**



Note: Crude oil prices used are the European Brent spot prices, in USD per barrel.
Source: OECD Development Centre calculations based on CEIC data and U.S Energy Information Administration (2018).
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In Brunei Darussalam, headline inflation rose but stayed muted at 0.4% in September 2018 and 0.2% YTD. While the prices of food and non-alcoholic beverages (19.1% of the CPI) went up by 2.3% YTD from 0.2% fall in the same period in 2017, monthly rates have been generally easing since March 2018. Transport prices, by contrast, which account for 18.3%

of the CPI, contracted between May and August 2018, before turning positive in September, resulting in a YTD rate of -0.4%, compared to the 1.1% rise in the same period in 2017.

In Singapore, headline inflation was steady, at between 1.3% and 1.9% from January to September 2018. Housing and utilities prices (26.3% of the CPI) declined for the 49th time in the previous 50 months (the exception being May 2017). The decline was also the 16th in straight month between June 2017 and September 2018, though it has lessened steadily since April 2018. Transport prices (15.8% of the CPI) also fell 0.2% on average in July-September 2018, driving the year-to-date index down to about the same level as in the same period the year before. As for food prices (21.7% of the CPI), where the trend has been upward since May 2018, the increase was still arguably mild at 1.6% in September 2018 and at 1.4% year-to-date, which matched the rate in the same period in 2017.

In Cambodia, headline inflation inched upwards to 2.9% in June 2018, continuing its steady rise since it recorded its 22-month low of 2% in January 2018. The inflation uptick had been driven by the prices of food and non-alcoholic beverages (44.8% of the CPI) which rose from 1.5% in January to 3.2% in June 2018. Transportation prices (12.2% of CPI) were also a factor, rising, to 4.9% in June 2018 from 2.5% in March 2018. Housing and utilities, which account for 17.1% of CPI, increased at a steady rate in 2018 after generally contracting the previous year. In Lao PDR, the uptick in inflation was relatively pronounced, with the headline CPI rising 2.6% in August from 0.1% in December 2017 and the YTD rate rising to 2% from 1.1% between January and August 2017. Core inflation more than tripled to 2.3% year-to-date over comparable periods in 2017. The prices of clothing and garments, up 5.1% from 2.4%, and those of transport and communication, which climbed from 2.8% to 4.3%, have gathered the most momentum, partly as a result of external factors and the weakness of the exchange rate. Although the pace of increases in food prices had also been rising, it was still modest at 1.8% in August 2018 despite the flooding caused by the dam collapse in July 2018. In Myanmar, headline inflation recorded a fresh 26-month high in September 2018 at 8.6%, driving YTD inflation up to 6.5% from 4.7% in the same period in 2017. The prices of food and non-alcoholic beverages, alcoholic beverages and tobacco, communication, housing and utilities, restaurants and accommodation, education and health have all posted faster rates of increases in 2018 than in comparable months in 2017. The considerable weakness of the kyat against the United States dollar and the dollar's extensive penetration in the domestic economy appear to be two key factors in inflation's upward trend.

In China, in September 2018, inflation rose for the fourth month in a row, reaching 2.5% headline inflation. This translated into a year-to-date rise of 2.1% compared to 1.5% over the same period in 2017. If Chinese New Year months are excluded, the September 2018 inflation rate was also the steepest since May 2014, with 80% of it attributable to current price factors and 20% to previous year carry-over factors. The prices of food, tobacco and liquor had been increasing at a faster pace since May 2018 and those of transport and communication since March 2018. By comparison, the housing and education inflation rates had been stable since the start of the year, whereas health prices had grown at a slower rate for the twelfth month in succession – from 7.6% in September 2017 to 2.7% in September 2018 – as the impact of measures to make medical prices more market-oriented faded. India experienced an upsurge in inflation that started in June 2017. It slowed down to some extent in 3Q 2018, declining to 3.8% in September 2018 from 4.9% between May and June 2018, even as year-to-date remained high at 4.4% compared to 2.9% between January and September 2017. Growth in food prices (39.1% of CPI) fell to 0.5% in September 2018 from 3.1% in May 2018. The rises in the prices of housing, clothing and footwear, and pan, tobacco and intoxicants (which together account for 19% of the CPI) have lessened slightly in recent months, even though rates remain higher than in 2017. By contrast, the fuel and light price index (6.8% of CPI) exceeded 8% for the third straight month in September 2018, while growth in the prices of miscellaneous items (28.3 % of CPI) steadied at over 5% since April 2018. In July 2017, the government introduced a goods and sales tax system in lieu of federal and state taxes and improved the coverage of sales taxation, which also lowered effective rates of tax on some commodities.

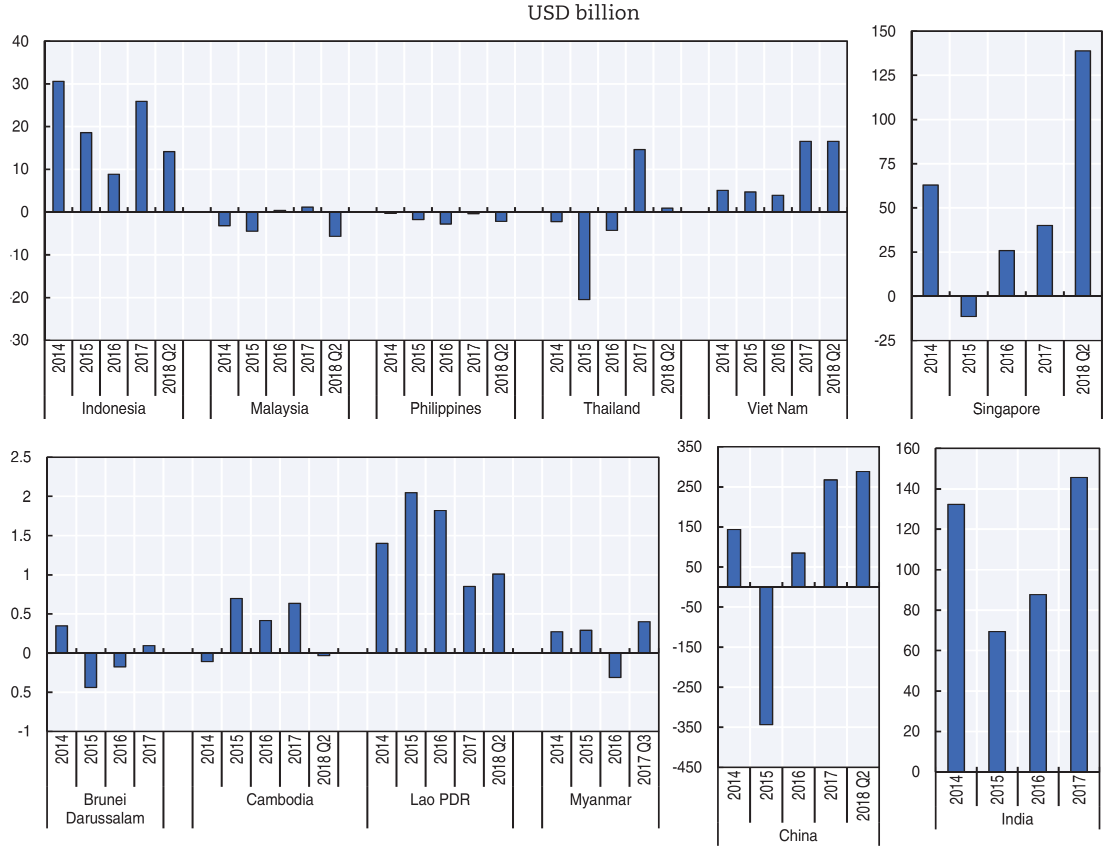
Non-FDI inflows uneven and pressure mounts on some currencies

Uneven non-FDI inflows

Portfolio and other investment inflows in Emerging Asia have been uneven (Figure 1.18). With the exception of Viet Nam, annualised intake in 2018 has weakened in the ASEAN-5 economies. In Indonesia, the decline in portfolio investment and the net outflow in public sector cross-border loans accounted for the fall in capital inflows in the four quarters to 2Q 2018. Portfolio investment outflows in 2Q 2018 in Malaysia were also substantial, exceeding the inflows of the previous two quarters. As for the Philippines, non-FDI outflows in 1H 2018 were greater than in 2H 2017, with negative figures in all three subcomponents – i.e. portfolio, derivatives and other investments. Very similar trends were at work in Thailand. The sole exception was other investments that exclude portfolio capital and derivatives, which turned positive in 2Q 2018 thanks to cross-border loans and trade credits. Meanwhile, the increase in annualised inflows to Viet Nam was driven by the rise in portfolio and cross-border loans.

Figure 1.18. **Portfolio and other investment inflows in Emerging Asian countries, 2014-18**

USD billion



Note: Data for India and Myanmar relate to fiscal years. Quarterly data are annualised, i.e. 4-quarter moving sum. Portfolio and other investment inflows data refer to foreign placements minus foreign withdrawals (Balance of Payments liability side).

Source: OECD Development Centre calculations based on CEIC, IMF (2018b) and national sources.

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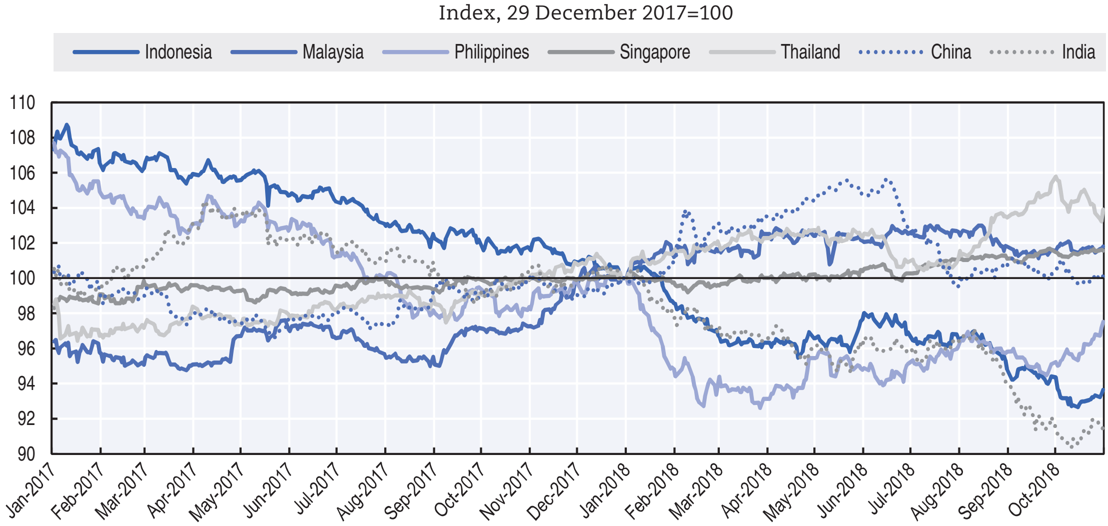
Inflows in 2017 were positive for the first time in three years in Brunei Darussalam, thanks mainly to strong capital investment in debt instruments in 4Q 2017. Similarly, Singapore's annualised non-FDI intake in 2Q 2018 also rose from 2017 as placements in debt instruments picked up substantially. Among the CLM economies, figures for 2017 generally made good reading, though Cambodia posted an annualised outflow in Q2 2018 while Lao PDR continued to take in capital (Myanmar does not have 2018 data yet). China's annualised intake in 2Q 2018 continued to rise on the back of relatively large portfolio investment in the last four quarters. As for India, its position in 2017 was an improvement on 2016, driven by inflows into "other" investments, chiefly debt instruments.

Depreciation pressures on Emerging Asian currencies persist while equity prices slump

The currencies of a number of Emerging Asian economies have been under pressure in 2018. Chiefly responsible are trade uncertainties and the direction of US monetary policy. Worries over possible emerging market contagion stemming from instability in other countries like Argentina and Turkey have also been a contributory factor. Of countries with available data, the Indian rupee, Indonesian rupiah and the Philippine peso have weakened most this year in terms of nominal effective exchange rates (Figure 1.19). In addition, performances between July and September 2018 reveal that pressure on the rupee and the rupiah continued to mount, even as the depreciation pull against the peso eased off. The yuan, too, also lost ground over the three months. Exchange rates against the US dollar further showed that the Myanmar kyat has weakened markedly in the last few months while depreciation has been modest for the Brunei dollar, Singaporean dollar, Malaysian ringgit and Vietnamese dong since June 2018.

Figure 1.19. **Nominal effective exchange rate in Emerging Asia, 2017-18**

Index, 29 December 2017=100



Source: OECD Development Centre calculations based on BIS (2018).

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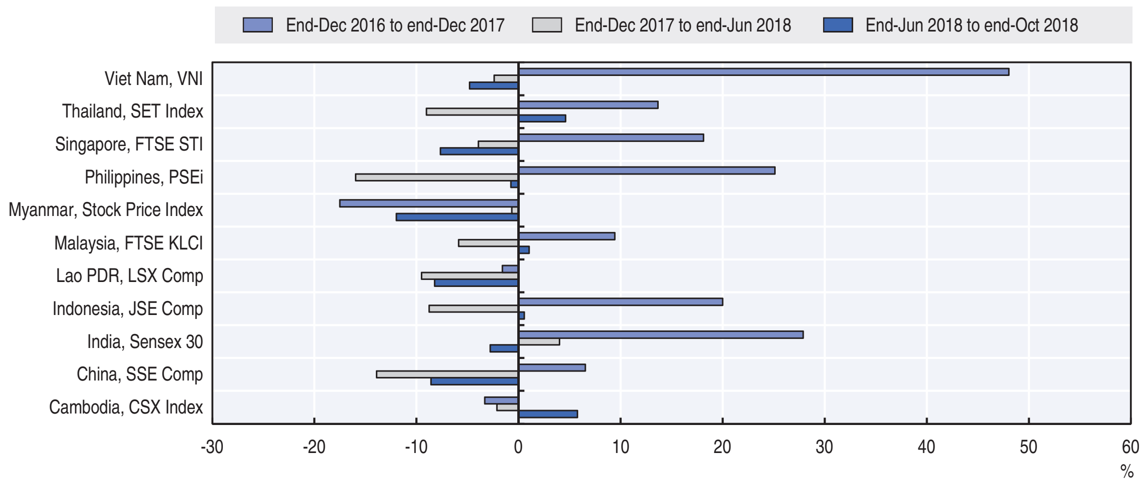
The equity markets in the region have similarly struggled to maintain investor optimism (Figure 1.20). In October 2018, the Shanghai Composite Index experienced the steepest decline of Emerging Asia's bellwether indices – down 26.9% on its peak between November 2017 and April 2018. The Vietnamese, Philippine and Lao PDR stock indices were close behind after declining by somewhere between 21.2% and 24% against their recent peak values. Reassurances from the authorities tempered downbeat sentiments to some extent, with gradual recoveries in the main stock indices of Indonesia, Malaysia, Singapore, Thailand and Viet Nam from June-July 2018 to September 2018. However, investor appetite faltered in October 2018.

Figure 1.20. **Stock market returns in Emerging Asian countries, 2016-18**



Source: OECD Development Centre calculations based on Fusion Media Ltd (2018), www.investing.com.
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Central banks move to reassure the market

Some of the central banks in Emerging Asia have signaled their willingness to tighten their policy stances. The central banks of India, Indonesia and the Philippines (all of which target inflation), for instance, have raised their policy rates by another 25 to 50 basis points since June 2018 (Figure 1.21). Increases in policy rates have supported the upward yield movement in both short- and long-term benchmark bonds in most Emerging Asian countries' secondary markets. In a similar fashion, the Monetary Authority of Singapore increased the slope of the nominal effective exchange rate bands in October while the State Bank of Viet Nam moved to reduce credit growth.

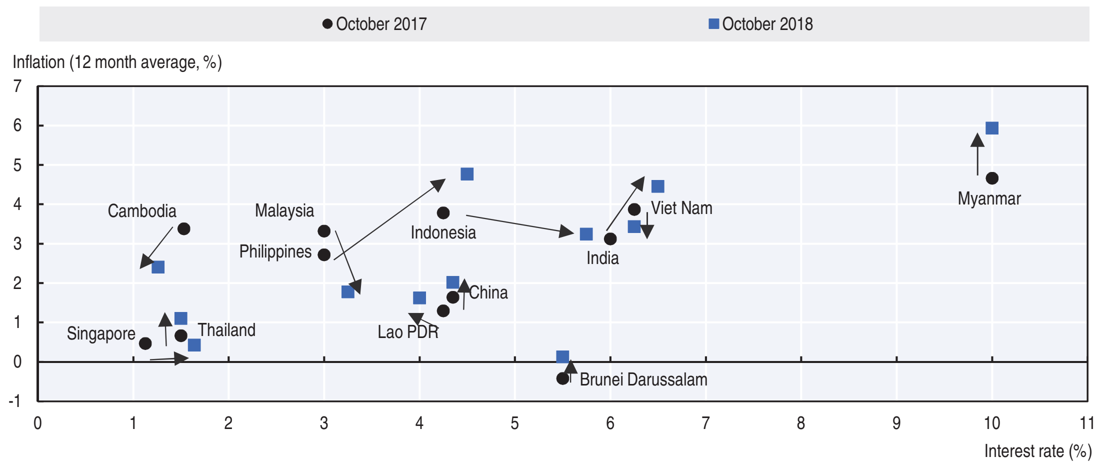
However, the central banks also showed their openness to calibrating other instruments so as to limit the liquidity impact of higher interest rates. As the OECD (2018b) points out, central banks in India, Indonesia and the Philippines accompanied their policy rate hikes with liquidity-enhancing measures such as reductions in their commercial bank reserve requirement ratios (RRRs) earlier this year. More recently, the People's Bank of China (PBoC) cut its RRR by another 100 base points (the third time it has done so in 2018), releasing into the system an estimated CNY 1.2 trillion (Chinese yuan), or USD 173.3 billion, that will more than offset the maturing medium-term lending facility valued at CNY 450 billion, or USD 65 billion.

By comparison, monetary policy is somewhat restrained in containing inflation and exchange rate pressures in CLM countries resulting from greater usage of foreign currencies in domestic transactions (Box 1.5).

In addition to monetary policy measures, India and Indonesia have implemented capital controls – mainly through import restrictions – to contain outflows of hard currencies.

Since February 2018, the direction of spreads in five-year senior credit default swap (CDS) spreads have diverged from one country to another, suggesting contrasting evolution in risk perception (Figure 1.22). While the CDS spreads in China and Thailand stayed at multi-year lows, they rose sharply in Indonesia and Viet Nam (to their levels prior to the 2016 United States presidential elections). In Malaysia and the Philippines rises were moderate.

Figure 1.21. **Evolution of inflation and benchmark interest rates in Emerging Asia, 2017-18**



Note: The policy and benchmark interest rates used in the chart are as follows: prime lending rate (Brunei Darussalam), saving deposit rate as provided by IMF (Cambodia), nominal lending rate ≤1 year (China), repo rate (India), BI 7-day reverse repo rate (Indonesia), BOL short-term lending rate (Lao PDR), overnight policy rate (Malaysia), central bank 1-year fixed deposit rate (Myanmar), reverse repo rate (Philippines), monthly average of SIBOR (Singapore), repo rate (Thailand) and refinancing rate (Viet Nam). Annualised inflation pertains to the 12-month average of monthly inflation rates up to the latest data. Latest available data between June 2018 and October 2018.

Source: OECD Development Centre calculations based on CEIC and national sources.

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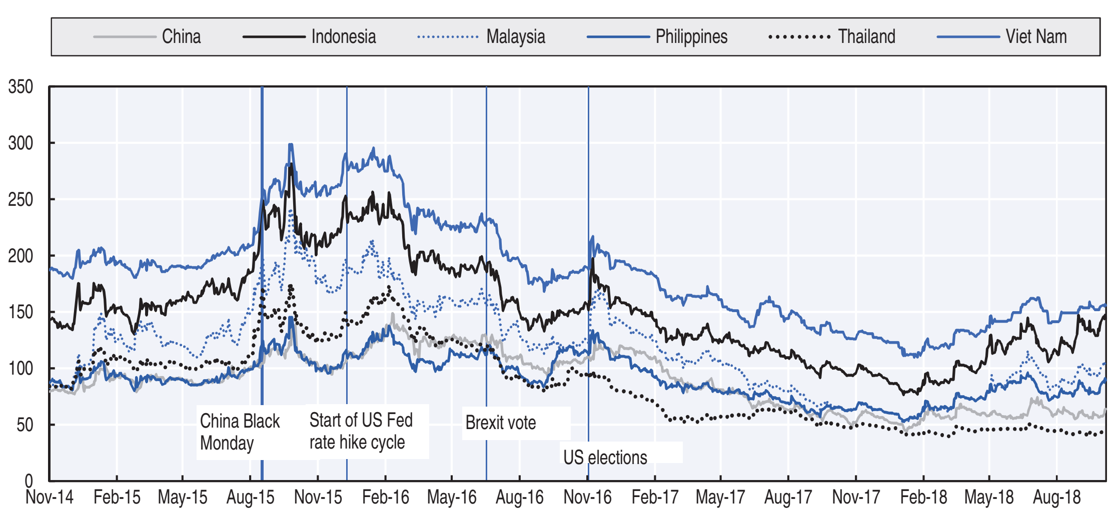
Figure 1.22. **Credit default swap spreads (5-year senior) in Emerging Asia, 2014-18**

Mid-spread in basis points



Source: OECD Development Centre and Thompson Reuters.

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Box 1.5. **Dollarisation in Cambodia, Lao PDR, Myanmar**

Foreign currency denominated assets still represent a large share of the assets held and used for transactions by residents in the CLM countries. This is known as “dollarisation”. In the literature, two main motives for holding foreign currencies emerge: asset substitution, where the foreign currency assets are held to shield against inflation, and currency substitution, where foreign currencies are used as a stable unit of account and exchange (Duma, 2011). The former is prevalent in CLM countries and is measured through the ratio of foreign currency deposits (FCD) over broad money (M2). Trends in dollarisation vary substantially across CLM countries (Table 1.3). Lao PDR had the highest level in the region until roughly 2003. The level of dollarisation has dropped steadily over the last 20 years, although the use of the Thai baht remains strong in border regions and is under-reported in general. In Cambodia, the level of dollarisation increased and Myanmar has seen its level fall, from 41.7% in 2007 to 19.4% currently.

Table 1.3. **Level of dollarisation in CLM countries**

Ratio of foreign currency deposits over broad money M2

Country	Cambodia	Lao PDR	Myanmar
FCD/M2	84.75%	37.60%	19.39%

Source: OECD Development Centre calculations based on national sources.

In Cambodia, a stable macroeconomic and political environment has been achieved and the banking sector significantly developed over time, but dollarisation has remained large, especially in the cities. Measures have been taken, such as requiring a minimum of 10% of the loan portfolio to be in Riel by 2019 and obliging businesses registered with the government to post prices in Riel (IMF, 2017). Dollarisation in Myanmar has different characteristics as it is mainly driven by administrative rigidities which are gradually being removed (Kubo, 2014). Recent measures include allowing private firms to buy and sell foreign exchange at banks. This gives firms an alternative to the usual direct FCD trading amongst importers and exporters, which required large amounts of foreign currency holdings. But conversion through banks is still less prevalent due to shortages of foreign currencies and high fees.

Recent normalisation of US monetary policy will provide an opportunity to consider de-dollarisation, but the process must be gradual and market-oriented to prevent adverse effects related to forced transitioning to a domestic currency. Switching to a domestic currency should not represent a cost for businesses. Convertibility should be easy and cheap. Firms should also be assured that they can switch between currencies at all times, and the government should hold a large cushion of foreign reserves to deal with convertibility scares. Furthermore, financial literacy concerning monetary policy could be improved to avoid unfounded worries about holding domestic currency. Central banks could be given more independence. This could drive down inflation expectations and reinforce the credibility of convertibility. These measures would underline that doing business in a local currency does not represent a higher risk or cost and should promote their use.

Deficits in current account and fiscal position need to be monitored

The persistence in some countries of deficits in both current account and fiscal positions relative to GDP is raising some concerns. India, Indonesia, Lao PDR, Myanmar and the Philippines are among the Emerging Asian countries that have recorded generally low but persistent twin deficits in the last few years – the same countries that have had to contend with relatively stronger asset sell-off pressure in the last two quarters, as indicated by the direction of exchange rates and bond yields.

Current account balance outlooks are mixed as fiscal consolidation gains traction in many Emerging Asian economies. The extent to which trade will be affected by protectionist measures may also impact the inflow of hard currencies and government revenue. Global oil prices, which can raise the import bill and the cost of related social safety nets, are another factor. Domestically, on top of subsidy payouts, governments may also restrict the rollout of infrastructure programmes as they consider their bottom lines.

Current account balance trends not synchronous

In Indonesia, the current account balance (CAB) deepened to about -2.3% of GDP in 2Q 2018 on an annualised basis (four-quarter moving sum) from about -1.9% in 2017 (Figure 1.23).[6] The annualised goods trade surplus in 2Q 2018 narrowed to about half of the level in the previous year, whereas deficits in the services trade and income transfer widened during the same period. The slippage in the goods trade balance was largely due to the sharp rise in growth of non-oil merchandise imports, matched by a more moderate uptick in the growth of non-oil exports. Oil shipments in both directions rose robustly, though the net deficit widened. In a move to contain vulnerabilities, oil contractors were instructed to sell all their output to the government-owned Pertamina company, so affording the country's palm crop fund greater leeway in narrowing the price gap between biodiesel and diesel. In Malaysia, the annualised CAB inched up to about 3.3% of GDP in 2Q 2018 from 3% in 2017. The goods trade annualised surplus increased by 16% year-on-year in 2Q 2018 despite the slow-down in the growth of both goods exports and imports. As for current account deficits, they deepened in trade in services. In the Philippines, the annualised CAB further declined to a negative 1.6% share of GDP in 2Q 2018 from -0.7% in 2017. The goods trade deficit grew by more than a quarter, with growth in goods exports declining substantially more than in goods imports. The gap in goods trade was partially offset by gains in the services trade, primary income and secondary income – fuelled by remittances from overseas workers and the earnings of outsourcing firms. In Thailand, though lower than the 11% of 2017, the annualised CAB stayed robust at about 10% of GDP in 2Q 2018. The goods trade's annualised surplus in 2Q 2018 was down 8.7% year-on-year, while the primary income deficit increased by the same amount year-on-year. Over the same period, however, the services trade surplus rose by 28.7% year-on-year, bolstered by the 24.9% increase in travel services receipts. The secondary income surplus also rose, by 12.3% YOY. In Viet Nam, driven by the strong 116% year-on-year rise in the annualised surplus of the goods trade, the annualised CAB almost doubled to 5.4% of GDP in 2Q 2018 from 2.9% in 2017. The services trade deficit persisted, although it was less pronounced than the previous year. Over the same period, the net secondary income surplus showed further improvement on the year before, though the margin was more than offset by the increase in the net primary income deficit.

In Brunei Darussalam, an improved trade position was the main factor in the CAB's recovery from 12.9% in 2016 to 16.7% of GDP in 2017 (roughly the same as in 2015). The goods trade surplus rose by more than 11%, whereas the services trade deficit declined by some 37%. In Singapore, the annualised CAB held up well at 18.9% of GDP in 2Q 2018, marginally higher than 2017's 18.8%. The trade in goods maintained the surplus of the previous four quarters. It inched up by 1.2% year-on-year, which was more than enough to compensate for the wider trade services deficit.

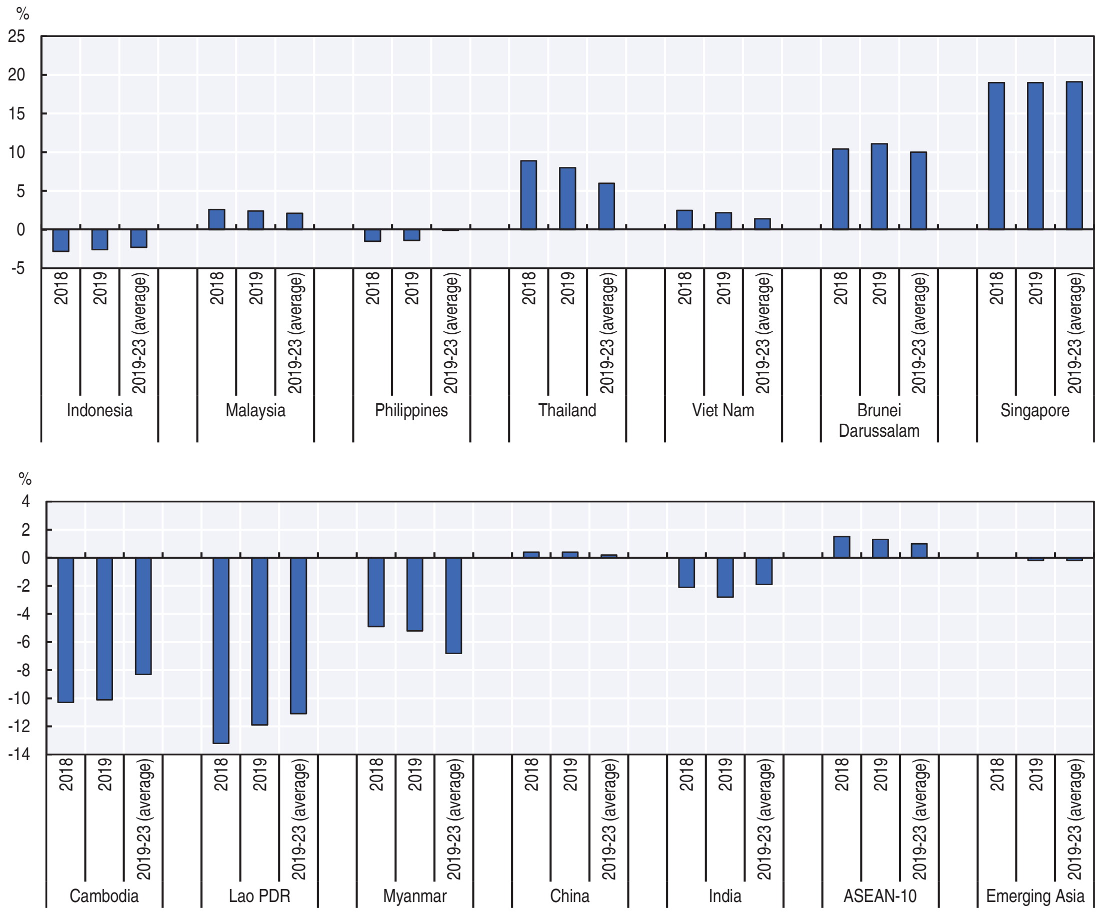
In Cambodia, the CAB was a negative 8.1% of GDP in 2017, continuing the deficit trend of at least 8% of GDP since 2012. Annualised CAB in 2Q 2018 also declined, recording a deficit that was about 46% wider than a year earlier.[7] Goods trade deficit also worsened in 2Q 2018 on an annualised basis compared to the previous year, which had been partially buttressed by the improvement in the services trade surplus. During the same period, the surplus in current transfers increased by about 1% year-on-year thanks to the resilience of overseas workers' remittances. However, that improved showing was more than cancelled out by the rise in the current income deficit, which grew by about 8% year-on-year during the same period. In Lao PDR, the CAB came in at a negative 7.2% of GDP in 2017. That deficit was nevertheless an improvement on those of 7.8% and 15.8% in 2016 and 2015 respectively. That being said, the deficit was still the second largest in Emerging Asia. Although trade in goods saw its deficit shrink, so did the surplus in the services trade. The combined current transfer and income deficit, which has doubled since 2016, was an additional negative factor. In Myanmar, the annualised current account deficit in the third quarter of FY 2017 swelled by over 124% from a year earlier, putting the CAB-to-GDP ratio on track to exceed 4.5% by end of the fiscal year, compared to 3.9% in FY 2016. The trade in goods deficit of the previous four quarters widened by over 67% year-on-year, while the trade in services surplus fell slightly. On the upside, combined primary and secondary income surplus increased by more than 43% during the same period, fuelled by international remittances.

In China, the annualised CAB slipped to 0.5% of GDP in 2Q 2018 from 1.3% in 2017, which suggests that the 2018 annual figure could be the lowest in more than 20 years. The annualised trade in goods surplus posted a modest uptick, while the annualised trade in services deficit declined minimally. However, the annualised primary income deficit surged more than nine-fold year-on-year as payments held steady, while income fell by close to 18% as offshore earnings from investment and the offshore compensation of domestic employees tumbled sharply. In India, the annualised CAB deteriorated to a negative 3.4% of GDP in 1Q of FY 2018 from negative 2.5% of GDP in FY 2017. The annualised deficit of trade in goods increased by more than 25% year-on-year in 1Q FY 2018, driven by the large imbalance in general merchandise trade. Gold imports, which had been a central current account issue in the past, saw their four-quarter cumulative amount decline by about 11.5% year-on-year in 2Q 2018. The primary income annualised deficit also widened due to the repatriation of investment earnings. By contrast, the annualised surplus of trade in services grew by close to 10% year-on-year on the back of computer-related services. Overseas workers' remittances similarly propelled secondary income to a year-on-year growth rate of about 15%.

Over the medium term, the CAB-to-GDP ratio of most of the surplus countries in the region is projected to narrow slightly, with the exception of Singapore (Figure 1.23). At the same time, the CAB-to-GDP ratio of most of the deficit countries will likely improve (i.e. deficit will lessen), with the exception of Myanmar.

Figure 1.23. **Current account balances of Emerging Asian countries**

Percentage of GDP



Note: The cut-off date for data used is 21 November 2018. The weighted averages are used for ASEAN average and Emerging Asia average. Data for India and Myanmar relate to fiscal years. Myanmar's 2018 data refers to the interim 6-month period, from April 2018 to September 2018 while the 2019 data refers to the period from October 2018 to September 2019. The 2018 and 2019 projections for China, India and Indonesia are based on OECD Economic Outlook 104 (database).

Source: OECD Development Centre, MPF-2019 (Medium-term Projection Framework).

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Fiscal consolidation is generally gaining a foothold

Indonesia's central government's annualised fiscal deficit-to-GDP ratio (deficit ratio) declined to 2% in 2Q 2018, well below the 2.5% recorded in 2017 and the statutory limit of 3%. The annualised total revenue-to-GDP ratio (revenue effort) and the tax revenue-to-GDP ratio (tax effort) continued to rise, after hitting multi-year lows in 3Q 2017. The annualised expenditure-to-GDP ratio (expenditure ratio) also fell, albeit marginally, from 2017. In August 2018, the national government set its fiscal deficit target at 2.1% of GDP for 2018 and 1.8% for 2019. Malaysia's annualised deficit ratio eased to 2.6% in 2Q 2018 from 3% in 2017, just within government's target of 2.8%. Annualised revenue and tax efforts improved between 2Q 2018 and 2017 after a continuous decline since 2Q 2015, while the annualised expenditure ratio had been steady since 2017. However, with revenues under pressure, the deficit ratio could still overshoot in the wake of the scrapping of the goods and service tax (GST) in June 2018 and despite the introduction of a sales and service tax (SST) in September 2018. The SST is expected to yield an annual revenue of

MYR 21 billion, less than half of revenue collected from the GST, estimated to be about MYR 44 billion in 2017. The government has also scrapped its plan of balancing the budget in 2020 and has projected a 3% deficit ratio target. It will set its 2019 fiscal target in November 2019 with debt-related concerns figuring prominently in the background. As for the Philippines, it saw its annualised fiscal deficit ratio climb to 2.4% in 2Q 2018 from 2.2% in 2017. Between 2017 and 2Q 2018, annualised revenue rose from 15.6% to 16.4% and tax efforts from 14.2% to 14.7%. Accordingly, annualised expenditure ratio went up by 80 base points to 18.7% compared to 4Q 2017. While the first instalment of the tax reform programme improved the intake of revenue, the resulting inflationary push – compounded, among other things, by limited safety nets – will be a concern. Thailand, for its part, also saw its annualised fiscal deficit ratio decline to 3.3% in 3Q FY 2018 from 3.5% at the end of FY 2017. Furthermore, monthly data from August 2018 (one month before the end of the fiscal year) showed that the deficit level was about THB 100 billion below the target of THB 550 billion set for the period. The annualised revenue effort rose marginally, while the tax effort and expenditure ratio were by and large steady.[8] For FY 2019, the legislative assembly has set a target deficit level of THB 450 billion, some 26% lower than the revised target in fiscal year 2018. The situation in Viet Nam was more upbeat, as central government's annualised budget deficit ratio of 4.7% in 3Q 2018 was not only a improvement on 2017's 6.7%, it was also the country's lowest since 3Q 2013. Revenue and tax efforts posted modest gains between 2017 and 3Q 2018, matched by a marginal decline in the annualised expenditure ratio. In addition, the government's annualised primary deficit ratio in 3Q 2018 was substantially lower than the target of 3.7%, though the gap is expected to narrow in the last quarter of the year. For 2019, the government has set a lower primary deficit ratio target of 3.6%.

The fiscal deficit ratio of Brunei Darussalam settled at 10.9% in FY 2017 (i.e. fiscal year ending March 2018) after following a steep 18.3% slide in FY 2016. The recovery in oil prices was instrumental in the revenue effort's first year of improvement after five consecutive years of decline. It also helped that the government was able to rein in the expenditure ratio in FY 2017, so halting a three-year climb. For FY 2018, the government proposed the same budget as in the previous fiscal year to hedge against the volatility of oil prices. Singapore posted a surplus in FY 2017 (i.e. fiscal year ending March 2018) equivalent to about 2.1% of GDP. It was the second year running it had done so, after ending FY 2016 with a surplus ratio of 1.4%. In line with the rising trend since FY 2015, total revenue (including net investment) and tax efforts increased over the previous year, while the expenditure ratio (including transfers) again fell after also edging downwards the previous year. For FY 2018, the government is looking at reduced total revenue and tax efforts which, coupled with a higher expenditure ratio, should yield a deficit ratio of about 0.1%.

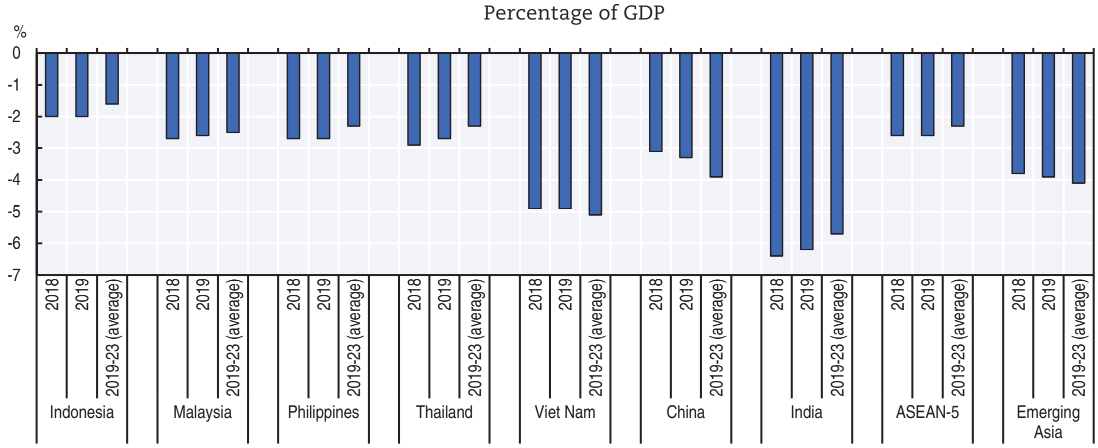
In Cambodia, the fiscal balance reverted to a deficit of about 0.9% of GDP in 2017 following a slight surplus of 0.4% in 2016. The uptick in spending, driven by both current and capital outlays, outstripped the improvement in revenue collection. Data from January to August 2018 reveal that the country's year-to-date fiscal balance stayed positive, though its level was lower than in the same period a year earlier. As with the previous year, however, spending is expected to gain some momentum before the end of the year. Lao PDR's fiscal deficit ratio logged in at 5.5% in 2017 from 5.2% in 2016, the third straight year that the deficit exceeded 5% of GDP. The annualised expenditure ratio rose minimally in 2017, while the revenue and tax efforts declined more pronouncedly to continue a trend that goes back to 2014. In 2018, the government programmed a deficit level that is almost 21% lower than in 2017. The assumption is that revenues will rise by 11.2%, whereas expenditure will increase by only 2.8%. Although Myanmar's deficit level declined by about 10% between fiscal years 2017 and 2018, its deficit ratio remained elevated at around 5%. The spending plan submitted in July 2018 expects expenditure to pick up, taking into account projects that have been brought forward during the interim six-month period. Revenues are also expected to rise, but they are projected to do so at a slower pace.

China's annualised deficit ratio narrowed to 3.4% in 3Q 2018 from 3.7% in 2017. The revenue effort declined by about 10 base points during the period. The decline was attributable chiefly to the fact that weaker collection of non-tax revenues cancelled out the increase in the tax effort, which rose by about 40 basis points. The expenditure ratio also declined to contain the slippage. By comparison, India's annualised deficit ratio steadied at 3.5% between 1Q FY 2018 and FY 2017 and was thus slightly higher than the target of 3.3% set for the year. The revenue effort nudged downwards by about 20 basis points despite the similar magnitude of the increase in the tax effort. The expenditure ratio compensated, however, thanks to a fall of roughly 20 basis points, mainly due to a contraction in capital account spending.

In the medium term, overall, the general government fiscal deficit of the larger Emerging Asian economies is estimated to deepen slightly (Figure 1.24). Fiscal risks will require close monitoring in India and Viet Nam as well as Lao PDR and Myanmar among smaller economies in the region.

Figure 1.24. **General government fiscal balance in Emerging Asia**

Percentage of GDP



Note: The cut-off date for data used is 21 November 2018. ASEAN and Emerging Asia are weighted averages of the individual economies. Data for India and Thailand relate to fiscal years. The 2018 and 2019 projections for China, India and Indonesia are based on the OECD Economic Outlook 104 database. General government balances data are not necessarily comparable to the budget balances published by national governments. Emerging Asia in this chart is comprised of ASEAN-5, China and India.

Source: OECD Development Centre, MPF-2019 (Medium-term Projection Framework).

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Box 1.6. **Managing taxpayers' compliance**

Many factors influence the level of tax revenues in an economy. These include economic structure and conditions, tax policy and tax administration, and the level of taxpayers' compliance and government enforcement. In the management of taxpayers' compliance, it is important to pay more attention to ensuring effective compliance risk management, managing the compliance of large taxpayers, addressing international tax avoidance and evasion, optimising the use of tax withholding at source and third party reporting requirements, and the use of voluntary disclosure policies and programs.

Effective compliance risk management processes are an integral part of a revenue body's strategy for improving taxpayers' compliance. The approach should be systematic and cyclical, focusing on the overall compliance environment rather than on individual

Box 1.6. **Managing taxpayers' compliance** *(cont.)*

taxpayers. By identifying and assessing the main compliance risks and their drivers, the process can assist revenue bodies to establish overall priorities for their compliance activities across all segments of taxpayers.

In the Asia-Pacific region, the trend has been to organise revenue bodies' compliance programmes around "taxpayer segments", in particular, large corporate taxpayers. Most tax administrations in the region say they have an organisational division or unit that manages the tax affairs of designated large taxpayers. The Inland Revenue Board of Malaysia created a large taxpayer branch in 2015 that will handle large and high- profile taxpayers, while the Bureau of Internal Revenue of the Philippines has a criterion based on size for each type of tax it collects. A level above an indicated threshold implies being serviced by the large taxpayer unit.

As for international tax avoidance and evasion, promoting transparency and the exchange of information among jurisdictions for tax purposes - exchange of information on request, and automatic exchange of information - and tackling tax avoidance with the OECD/G20's Base Erosion and Profit Shifting (BEPS) project, have been the two key components of international efforts to address weaknesses in the international tax system.

Withholding-at-source arrangements are regarded as the cornerstone of an effective personal income tax system. Imposing the obligation on intermediaries such as employers and financial institutions to withhold tax from payments of income generally ensures that the large bulk of tax due on such income is paid to government in a timely manner, and that taxpayers meet their income tax obligations. The benefits of withholding mechanisms are particularly important to developing and emerging economies where the level of tax morale and understanding may be low, and where most taxpayers are not required to file annual tax returns. In Viet Nam for instance, employers must withhold the income taxes of their employees and deposit them with the State Treasury before the 20th of the following month. Employers also fill in the personal income tax declarations on behalf of their employees if they are their sole source of revenues. They then submit them before the end of the year. In the Philippines, revenues are withheld from passive incomes such as interest and dividends at levels of 20% and 10% respectively. Lao PDR has a similar system but at a flat rate of 10%.

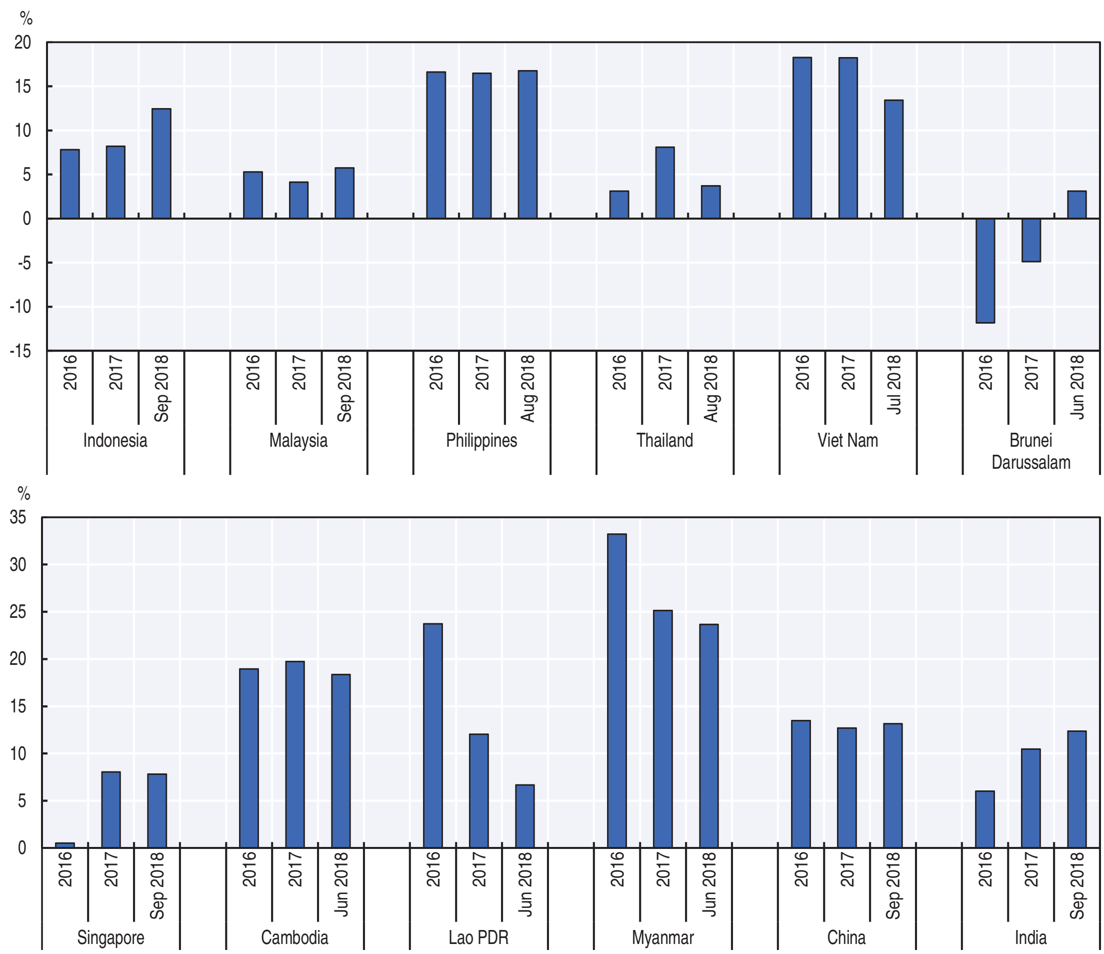
Voluntary disclosure mechanisms can be an important part of compliance programmes as part of a broad approach to facilitating compliance outcomes. Such programmes offer non-compliant taxpayers the opportunity and incentive to put their tax affairs in order. As well as being less resource-intensive than investigations, they may generate significant insights into the reasons for evasion (including through accident) and the structures used to facilitate deliberate evasion.

Banking sector is generally stable even though risk factors

The banking systems in Emerging Asia have generally remained steady despite the spread of risk factors. Loan growth widely sustained its momentum in 2017 through 2Q and 3Q 2018 and rates are still brisk by and large (Figure 1.25). Capitalisation remains sufficient by global standards even if adequacy rates have declined in much of the region since 2017. Profitability trends vary, with half of the countries which have data showing improvement in returns since 2017 in line with the global picture. Asset coverage of short-term liabilities is also ample and continues to increase. However, although the proportion of stale assets to total portfolio is relatively low in most Emerging Asian countries, asset quality issues persist. While national frameworks have made progress in resolving stale assets and developing a market for them, concrete policy action at national and regional levels must address issues of clarity and asset valuation standards.

Figure 1.25. **Bank lending in Emerging Asian countries, 2016-18**

YOY growth



Note: Indonesia-Commercial and rural bank loans; Malaysia-Total banking sector loans; Philippines-Total banking sector loans; Thailand-Outstanding commercial bank credit; Viet Nam-Total outstanding bank credit; Brunei Darussalam-Commercial bank loans; Singapore-Loans and advances, ACU and DBU; Cambodia-Deposit money bank total gross loan; Lao PDR-Commercial bank total loans; Myanmar-Other depository corporation claims on private sector; China-Total loans; and India-Scheduled bank credit.

Source: OECD Development Centre calculations based on CEIC and national sources.

StatLink https://doi.org/10.1787/888933886816

Bank lending has kept up its strong momentum in much of Emerging Asia. In Cambodia, China, India, Indonesia and Viet Nam rates were in double digits and still rising through to August/September 2018. Though slower, rates had also risen in Brunei Darussalam, Malaysia and, before its August 2018 pullback, in Singapore too. In Myanmar, the direction has been downward since April 2016. Yet the rate of growth in lending still exceeded 23% in May 2018. In the Philippines, rates remained between 15% and 20% from May 2016 to August 2018. Lao PDR and Thailand, where loan growth rates have declined more pronouncedly in recent months are the two exceptions in the region.

The capital adequacy ratio (CAR) of banking systems in Emerging Asia economies is sufficient. Most recent figures point to a CAR average of 16.4% between 4Q 2016 and 2Q 2018 in the 11 economies with data available.[9] The regional average is above the Basel 3 requirement of 8%, but lower than the global average of 19.2% (or 18.2% median) for 133 economies. Only three of the region's economies have CARs above the 50th percentile of the 133-country sample. Cambodia presently has the most capitalised banking system in the region with a CAR of 22.5%. In Myanmar's fledgling banking system, by contrast, it is 12.3%. Capital adequacy ratios of the banking sector in five countries out of nine with data fell between 2017 and 1Q/2Q 2018. The countries were Indonesia, Malaysia, Myanmar, Singapore and Thailand. Four countries, by contrast, boast improved CARs – Brunei Darussalam, Cambodia, India and the Philippines. The narrower Tier 1 CAR metric reveals a similar overall picture. Cambodia's banking system remains the most capitalised of the Emerging Asian economies, though it is Viet Nam that brings up the rear.

Returns on equity (ROEs) data from the period between 4Q 2016 and 2Q 2018 reveal that Emerging Asia's average ROE was lower than the global mean – 10.9% for the 11 countries with data against 13.8% for a 132-country global sample. Only 4 of the 11 boast ROEs above the global median of 13.7%. With its 16.1% ROE in 2Q 2018, Indonesia's banking system leads the Emerging Asia, while India's banking sector, still struggling with non-performing assets, offered a negative ROE of 1.2% over the same period. Of the 9 Emerging Asian countries with data in 2018, 5 have seen their ROEs increase since 2017. They are Indonesia, Malaysia, Myanmar, Singapore and Thailand. The other 4 – Brunei Darussalam, Cambodia, India and the Philippines – have posted declines.

Data on the ratio of liquid assets to short-term liabilities or the asset coverage ratio (ACR) between 4Q 2016 and 2Q 2018 reveal that, although the Emerging Asian average was lower than the global mean, 6 of the 10 countries with data have an ACR above the global 50th percentile. However, their ACRs range widely. Malaysia posted the highest – 151.7% in 2Q 2018. Cambodia's ratio, which has historically been low, was only 25.7% in 2Q 2018 – the lowest in the region. Between 2017 and 1Q/2Q 2018, ACRs rose in 6 of the region's 9 countries – Cambodia, India, Indonesia, Malaysia, Singapore and Thailand – but declined in 3 of them, i.e. Brunei Darussalam, Myanmar and the Philippines).

Arguably, the NPL ratios of Emerging Asian economies are largely benign. Between 4Q 2016 and 2Q 2018, they averaged less than 3.5%, compared to the 7.4% average of a global sample of 131 economies (IMF, 2018a).[10] However, NPL ratios did edge upwards in 2018 in 7 of the 8 countries in the region. In India, government projections point to the estimated gross non-performing asset (GNPA) increasing strongly – from 11.6% in March 2018 to between 12.2% and 13.3% in March 2019 depending on levels of financial stress (RBI, 2018). Most troubled assets are to be found in the books of public sector banks whose GNPA ratio was 15.6% in March 2018. Most such assets are loans incurred by the manufacturing sector with a GNPA ratio of 22.8%. In Thailand, the official NPL ratio in 2Q 2018 was below 3% and had hardly changed since 1Q 2017. However, a number of sectors continue to have NPL ratios of 5% or more – e.g. mining and quarrying (12.2%), construction (5.6%), WRT (5.6%), agriculture (5.3%) and manufacturing (5.2%). In China, Lao PDR and Viet Nam, the official NPL ratios are also low, due to mechanisms like asset sales to public asset management companies and/or delayed the recognition of stale debts. Governments have sought to improve national institutional frameworks for resolving bad debt and have made progress. They have also worked to make public asset management companies (AMCs) more responsive to the needs in developing the market (Deloitte, 2018). However, they have room for improvement when it comes to asset disposal and value recovery. In general terms, the lack of clarity in parts of the regulatory frameworks and the limited acceptability of standards used in asset valuation are two of the factors that constrain market development.

Challenges to robust growth

Overall, growth projections in the near and medium term are favourable for Emerging Asia – Southeast Asia, China and India. If countries were to maintain their robust growth momentum, however, appropriate policies are needed to:

- maximise the opportunities and mitigate the risks of financial technology;
- strengthen export performance amidst rising protectionism;
- mitigate the risks of natural disaster.

Maximising opportunities and mitigating the risks of financial technology

The growing influence of technology in financial services (Fintech) in Emerging Asia carries with it economic opportunities of deeper financial inclusion. By the same token, however, it could also be an economic pitfall if the regulatory environment fails to appropriately guide future developments in the sector. Governments in Emerging Asia are aware of the importance of such a trade-off. Both public and private institutions have launched domestic and cross-border initiatives focusing on various dimensions of Fintech. However, progress on the regulatory front has been uneven and policy gaps related to potential risks remain.

Fintech has penetrated almost every node of the system over the years. It has transformed mechanisms related to the deposit and storage of financial assets, credit transfers, accountancy, trade, payment and settlement, and asset management.[11] Prominent examples of Fintech-enabled innovations include automated teller machines and online banking, debit and credit cards, and electronic payment and settlement.[12] Transactions have become faster and cheaper, financial markets have extended their reach and improved transparency – all of which has contributed to substantial growth in the business of financial institutions.

More recently, mobile devices, together with web- and cloud-based financial functionalities, have become the focus of development. Among the new arrangements that have emerged are open banking, digital wallets, peer-to-peer (P2P) lending and crowdfunding, and robo-advisors. Blockchain technology arguably underpins most innovations, which includes cryptocurrency transactions.

The Fintech in Emerging Asia is gradually expanding

The Fintech by and large comprises payment and transfer systems (both cross-border and domestic), tech-driven insurance (insurtech), asset and wealth management, financial service comparison platforms, data and security systems, mobile banking, cryptocurrency and regulation technology. Global investment in Fintech – through general mergers, acquisitions, venture financing and private equity buyouts – was estimated to be about USD 31 billion in 2016 and 2017 (KPMG, 2018). Though it was more modest than the capital injection in 2015, prospects are promising. Innovation in banking services has attracted the most capital globally and interest in insurance and asset management technologies is growing apace (KPMG and City of London Corporation, 2017). Within banking services, global investment has flowed chiefly into lending services followed by personal finance and payments.

Geographically, investment has focused largely on the United States, the United Kingdom and China in the last few years, though India is gradually making a case for itself as a destination (KPMG, 2018). In Southeast Asia, Singapore, the region's financial centre, leads the way in raising capital and has the most active and sophisticated market in Southeast Asia at the moment. However, the ASEAN-5 economies are slowly catching up (EY, 2018).

Just as they are globally, banking services are currently attracting most capital in Emerging Asia, with alternative lending and payments as the top two subsectors (EY, 2018, 2017b; PWC, 2017a). And as investment flows continue, business is picking up markedly. A study by the Cambridge Centre for Alternative Finance, the Australian Centre for Financial Studies and Tsinghua University (2017) shows that alternative finance credit volume in China grew almost 44 fold to more than USD 243 billion between 2013 and 2016. Although by much less, credit volume in the rest of Asia Pacific also increased over the same period – by more than 14 fold to over USD 2 billion.

Fintech market coverage has gradually widened from enterprises to include e-commerce for farmers, social housing providers, students and even bank clients seeking to restructure debt. Fintech sub-industries have also widened in Emerging Asia (Table 1.4). Moreover, in Indonesia, Malaysia, Singapore and Brunei Darussalam, Sharia-compliant Islamic Fintech services have caught investors' attention. Incidentally, Fintech project return-on-investment in Asia, estimated to be about 25%, surpasses the global average of 20% and the rates in other regions (PWC, 2017b).

Table 1.4. **Examples of Fintech services in Emerging Asia**

Service	Description
Remittance, money transfer and mobile payments	• Web-based or application-based electronic platforms for local or overseas monetary transfers or payments for goods and services acquired • Remittance fees, if any, are generally more competitive than those offered by traditional financial institutions • Widespread in Emerging Asia
Alternative risk assessment for insurance and lending	• Alternative insurance and credit scoring services using machine learning tools and big data to assess the risks involved • Used to obtain tailored insurance policies or loan packages even in the absence of traditional documentary requirements • Relatively at its nascent stage in Emerging Asia
Lending and capital raising platforms	• Platforms that support peer-to-peer lending services as well as donation, debt and equity crowdfunding, which link investors and capital recipients directly • Gaining ground in many Emerging Asian countries
Wealth management	• Utilises machine learning tools for managing various types of financial assets, which include but are not limited to robo advisors and algorithmic trading • Relatively at its nascent stage in Emerging Asia
Platforms comparing features of financial products	• Data aggregators focusing on the characteristics of financial products that are available in the market such as loan packages and insurance policies • Compare interest rates, premiums and charges, among other features, that potential clients will likely get from different insurers and lenders based on the data they provide • Available in many Emerging Asian countries

Note: The table does not aim at providing a comprehensive coverage of Fintech services in Emerging Asia. Data are as of September 2018.

Source: OECD Development Centre.

Fintech offers opportunities for financial inclusion

Fintech could be a way to deepen financial inclusion – chiefly by widening access to credit and insurance services through the inclusion of sectors with limited credit history, patchy financial documentation and minimal collateral. As it currently stands, financial market development in Emerging Asia is uneven. Although banks are the primary intermediaries, a number of constraints make them less responsive to the financial needs of marginalised segments of the economy such as micro, small and medium enterprises (MSMEs) and individuals who have few dealings with financial institutions even when lending quotas are in place (Abraham and Schmukler, 2017; Creehan, 2014; Khor et al., 2015).

As the OECD (2018b) points out, Fintech has the potential for plugging the gap in inclusive lending, particularly in light of deepening technology penetration. Technology has improved credit assessment tools, deepened know-your-customer databases, broadened credit scoring frameworks and made lending arrangements more fit for purpose. Initiatives like open banking have also facilitated the growth of a system in which Fintech firms and traditional financial institutions collaborate through standardised application programming interface. Lower cost and greater efficiency are other key facets of Fintech. They come to the fore in P2P digital money transfers and cross-border remittances and platforms that automate underwriting procedures for MSMEs (BNY Melon, 2015; WEF, 2015). Similarly, mobile e-wallets and mobile banking firms (not to be confused with online banking) have also made it easier and faster to open accounts for parking and transferring funds.

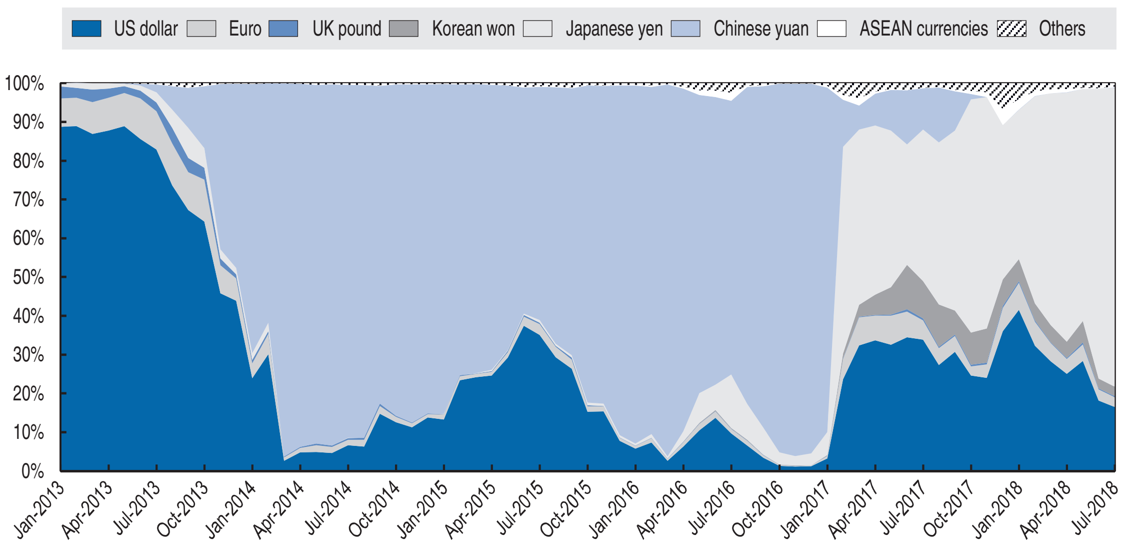
Fintech's potential in fostering insurance and reinsurance market development catch-up in many Emerging Asian countries (particularly the non-life segment) is also highly promising, even though insurtech is still nascent in the region (Willis Towers Watson, 2018). It is estimated that, as a proportion of GDP, insurance premiums in Emerging Asia, excluding Singapore, are less than half those of OECD countries based on the data of SwissRe Institute (2018).[13] By contrast, the premium-to-GDP ratios of Singapore, Japan, Korea, Hong Kong, China and Chinese Taipei all exceed the OECD average. Insurtech offers the prospect of using big data to produce tailored products such as the usage-based policies "pay-as-you-drive" and "pay-how-you-drive". Agriculture also stands to gain from insurtech (Smit, Denoon-Stevens and Esser, 2017) – of particular interest to the many Emerging Asian economies that regularly have to cope with natural disasters.

Asia plays an important role in the cryptocurrency sphere

In spite of tightening regulations and well-publicised instances of fraud, cryptocurrencies, or "cryptos", and their trading platforms have managed to thrive since the introduction of the bitcoin in late 2008 and the first transaction in January 2009. Interest in cryptos initially stemmed from the anonymity enjoyed by the parties in a transaction and the supposedly decentralised exchange system.[14] That interest has since gathered impetus as other uses have emerged. These include the gains to be made from speculative trading and cheaper cross-border transactions cost since payments no longer have to go through banks and there is no need for currency exchange.[15]

Asia is an important player in the crypto market. Currencies such as the Chinese yuan (between mid-2013 and end 2016) and the Japanese yen (more recently) have accounted for large portions of Bitcoin acquisitions globally (Figure 1.26). Bitcoin exchanges in the Korean won, Vietnamese dong, Malaysian ringgit and Philippine peso also increased dramatically until around early 2018, before momentum has ebbed somewhat. Similarly, governments have recently shown greater interest in issuing their own cryptos. Dubai became the first state to launch a government-backed crypto (emCash) in October 2017, while Venezuela was the first to issue a sovereign crypto (the petro) in February 2018. Ecuador, Tunisia and Senegal also have national digital currencies and are slowly migrating their systems to blockchain.[16][17],

Figure 1.26. **Share of selected fiat currencies in total volume of Bitcoin purchases, 2013-18**



Note: Total volume refers to the sum of bitcoins bought and sold using the major fiat currencies included in the chart. Trading between cryptocurrencies, such as the USD-backed tether, is not taken into account. ASEAN currencies in the chart include the Indonesian rupiah, Malaysian ringgit, Philippine peso, Singaporean dollar, Thai baht and Vietnamese dong. "Other" currencies are the Australian dollar, Canadian dollar, Polish zloty, Russian rubble, Swiss francs, Indian rupee and Taiwan New Dollar. While additional currencies are used as payment and settlement currencies for bitcoin, their shares are arguably small.

Source: OECD Development Centre based on CryptoCompare.

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The regulatory environment is catching up

Supervision and regulations have grown in all Emerging Asian countries, although they vary in scope and depth. Nonetheless, comparison reveals that some existent services are operating in relatively unregulated environments, such as P2P lending (Table 1.5). Central banks have mainly assumed the role of focus points in Fintech-related matters, with many of them creating dedicated entities (Table 1.6). In some countries, the economy and telecommunications ministries as well as the securities and insurance commissions also support central banks, thus forming inter-agency supervisory bodies.

Table 1.5. **Regulations or guidelines associated with Fintech in Emerging Asia**

Country	Regulatory sandbox	Lending and capital raising	Data protection and cyber security
Brunei Darussalam	✓	✓	✓
Cambodia	*1	nci	*1
China	*2	✓	✓
India	*3	✓	✓
Indonesia	✓	✓	✓
Lao PDR	nci	nci	✓
Malaysia	✓	✓	✓
Myanmar	nci	nci	*4
Philippines	*5	*5	✓
Singapore	✓	✓	✓
Thailand	✓	✓	*6
Viet Nam	*7	*7	✓

Note: "✓" means existent and mentions issues related to Fintech though not necessarily a standalone law, regulation or guideline. "nci" means that there is no clear information based on desktop research of official documents but it is possible that there are existing regulations that cover these areas at least in part. Lending and capital raising include services that offer a platform for debt or equity financing (e.g. P2P lending and crowdfunding).
*1 In Cambodia, the government utilises a *watch, learn and execute approach* as its version of sandbox in its regulation of financial technology. There is also a draft cybercrime law as of September 2018.
*2 In China, there is no national regulatory sandbox yet as of September 2018. But, Ganzhou, Jiangxi has reportedly established its own mechanism.
*3 In India, the government is still preparing for a national regulatory sandbox as of September 2018 although the state of Maharashtra has launched its own sandbox.
*4 In Myanmar, the *Law Protecting the Privacy and Security of Citizens* has general data protection provisions.
*5 In the Philippines, the central bank has established internal mechanisms following a *test and learn approach* to financial innovations. There is also a draft of rules for crowdfunding as of September 2018.
*6 In Thailand, the government is in the process of laying out standalone legislation or regulation on data protection and cyber security as of September 2018 though it has an existing *Computer Crimes Act*.
*7 The central bank in Viet Nam indicated that it would formulate a Fintech regulatory sandbox and is also working on its regulation for P2P lending as of September 2018.
Data are as of September 2018.

Source: OECD Development Centre based on official documents, laws, regulations and guidelines.

Table 1.6. **Fintech regulatory agencies in Emerging Asia**

Country	Main Regulatory Agencies	Fintech-Focused Unit
Brunei Darussalam	Autoriti Monetari Brunei Darussalam	Fintech Office (AMBD)
Cambodia	National Bank of Cambodia and Ministry of Economy and Finance	---
China	People's Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, Ministry of Public Security's Research Institute and Financial Stability and Development Committee	Fintech Committee (PBoC)
India	Reserve Bank of India, Securities Exchange Board of India, Insurance Regulatory and Development Authority and Telecom Regulatory Authority of India	Working Group on Fintech and Digital Banking (RBI); Committee on Financial and Regulatory Technology (SEBI)
Indonesia	Bank Indonesia, Financial Services Authority and Ministry of Communication and Informatics	Fintech Office (BI), OJK Innovation Center for Digital Financial Technology
Lao PDR	---	---
Malaysia	Bank Negara Malaysia, Securities Commission and Companies Commission	Fintech Enablement Group (BNM)
Myanmar	Central Bank of Myanmar	
Philippines	Bangko Sentral ng Pilipinas (BSP), Securities and Exchange Commission and National Privacy Commission	Financial Technology Sub-Sector (BSP)
Singapore	Monetary Authority of Singapore, Ministry of Law and International Enterprise Singapore	Fintech & Innovation Group (MAS)
Thailand	Bank of Thailand, Securities and Exchange Commission, Ministry of Finance and Electronic Transactions Development Agency	---
Viet Nam	State Bank of Viet Nam	Steering Committee on Fintech (SBV)

Note: Data are as of 14 September 2018.
Source: OECD Development Centre compilation based on various sources.

Regulatory sandboxes

A regulatory sandbox is one of the tools utilised by supervising agencies to incubate Fintech firms in a controlled environment. It is a way of protecting intellectual property and can serve as a laboratory for regulations as they seek to keep pace with developments in the market. As of July 2018, Brunei Darussalam, Indonesia, Malaysia, Singapore and Thailand have implemented national sandboxes. Local governments in China (e.g. Ganzhou Jiangxi) and India (e.g. state of Maharashtra) have launched similar mechanisms, pending national frameworks (which were still under study at the end of July 2018). It should be noted, however, that sandboxes' rules and industry coverage tend to differ from country to country.

Consumer protection

Most Emerging Asian countries introduced consumer protection legislation a number of years ago. They have recently extended their legislation to e-commerce transactions and some countries have put in place agencies to promote consumer welfare. In 2012, the central bank of Thailand even formed a Financial Consumer Protection Center that serves as both a grievance and information desk. However, few countries have explicit Fintech-related consumer protection provision and they are typically contained in broader non-bank lending regulations.

P2P lending and crowdfunding

P2P and crowdfunding regulatory frameworks are still at an early stage. China has been the most active in this sphere after a series of high profile fraud cases involving over 200 lending platforms came to light. The Ministry of Commerce has recently implemented a record filing system to tighten up licensing that includes mergers and acquisitions. The government has also introduced more frequent checks and mandated self-reviews to rein in the build-up of risk in its Fintech industry valued at USD 200 billion. Elsewhere in the region, India, Indonesia, Malaysia, Singapore and Thailand have lately issued their own P2P lending and crowdfunding rules, while the other Emerging Asian economies continue to deliberate over their oversight frameworks.

Data privacy protection

Governments have taken steps to improve coverage of data protection regulations. The Philippines' National Privacy Commission, created in 2012, administers and implements the law on data privacy. The law was also passed in 2012, while its implementing rules and regulations were finalised in 2016. Indonesia's Ministry of Communication and Informatics issued the Data Protection Regulation. Effective since December 2016, it is an implementing regulation of the Electronic Information and Transactions Law of 2008 and Government Regulation No. 82 of 2012. Meanwhile, key regulations are under review in India (Data Protection Framework), Singapore (Personal Data Protection Act of 2012), and Thailand (Data Protection Bill). The European Union's General Data Protection Regulation, particularly its data breach protocols, has served as one of the bases of regulations in the Philippines, China and India (Hogan Lovells, 2018; Blackmore, 2018).

Money laundering, terrorism financing and cybercrime

Similarly, anti-money laundering and combating financing of terrorism (AML/CFT) measures have been fortified. All countries in Emerging Asia have their own AML/CFT legislation and continue to engage through platforms such as the Asia/Pacific Group on

Money Laundering, established in 1997.[18] Some governments have adopted standards set by the intergovernmental Financial Action Task Force, while others have entered into bilateral agreements, e.g. the Brunei Darussalam-Singapore Fintech Cooperation Agreement to strengthen surveillance and promote innovation in payments networks.

Cybersecurity laws, too, are slowly catching up with practices. China passed a law in November 2016, which became effective in June 2017. As for Singapore and Viet Nam, they enacted their legislation in 2018. In Indonesia, Lao PDR, Malaysia and the Philippines, cybersecurity regulations are embedded in cybercrime or in personal data protection legislation. In Thailand, the regulation issued by the office of the Prime Minister in 2017 on National Cybersecurity Preparation provides monitoring guidelines while the cabinet approved a separate cybersecurity bill in 2015, which is currently under legislative deliberations.

Digital identity systems

Although countries in Emerging Asia widely use national identity cards, digital ID systems are not yet as common as in developed economies. In 2016, Singapore unveiled CorpPass, a digital identity system for corporations and organisations transacting with the government. CorpPass is intended to slowly replace the earlier digital ID mechanisms like SingPass for individual users launched in 2003 and the eServices Authorisation System for businesses and organisations that was introduced in 2002. In 2009, India launched its Aadhaar project, a 12-digit biometric digital ID system. Though designed chiefly for the transfer of benefits such as social welfare and unemployment allowances, it can be linked to other digital systems (e.g. SIM cards, provident funds, electronic know-your-customer systems). The Chinese government moved to convert national ID cards to a digital system in 2018 in order to streamline business processes and is working with Tencent's WeChat on data hosting. Malaysia, which was the first country to issue a chip-based national ID card in 2004, looks to follow suit in digitalising its platform.

Regulating cryptocurrency

Emerging Asian countries' stances on cryptocurrency regulations are diverse. Although none consider any crypto as legal tender, the authorities in Malaysia, Philippines, Singapore and Thailand are relatively more open to fostering a viable business environment for the issuance and trading of such currencies. Indonesia's central bank gave cryptos a legal standing similar to that of a commodity in June 2018, but continues to warn the public about the risks of trade in cryptocurrencies. By comparison, central banks in Cambodia and India have prohibited financial institutions from crypto-related activities, even though crypto-denominated trade and payments are not technically considered illicit. As for China, it has outlawed initial coin offerings (ICOs) and severely restricts trading and mining,[19] while Viet Nam barred public companies and financial firms from engaging in crypto activities.

Fintech development comes with risk factors

Fintech, just like other innovations, could change the prevailing market conditions in terms of ways of delivering services, quickness of transaction turnover, manner of risk assessment, etc. At the same time, it may cause new financial system vulnerabilities. Fintech firms are arguably not yet systemically important. However, the steady inflow of capital and sizeable expansion of operations every year might change the picture in the next few years. Policy areas that necessitate focus include regulatory risk management, financial literacy and cybersecurity.

Regulating financial and banking service risks

Forcing Fintech firms involved in banking services to follow the fraction reserve system for consumer protection will be an area of debate. In January 2017, for instance, the People's Bank of China (PBoC) announced that it was requiring third-party payment platforms to hold 20% of customer deposits in one dedicated non-interest-bearing custodial account at a commercial bank. The PBoC subsequently raised the mandated ratio to 50% in April 2018 and is expected to hike it to 100% by January 2019. At the same time, proper disclosure of equity and debt investment and the participation of traditional financial institutions in the management of Fintech companies is worth a consideration.

In the cryptocurrency area, cross-border agreements may be needed to increase flows of information on crypto transactions. Cryptos can be a means of moving financial assets across national borders outside the traditional channels monitored by the authorities. Although there have been initiatives on self-regulation within the crypto domain – by the Waves Platform and the Virtual Commodity Association Working Group, for example – explicit guidelines can mitigate the build-up of crypto-related risks. Where financial institutions stand in this asset class should also be clarified. If institutional investors are allowed to participate in any way, the extent of their exposure and participation ought to be part of standard disclosures.

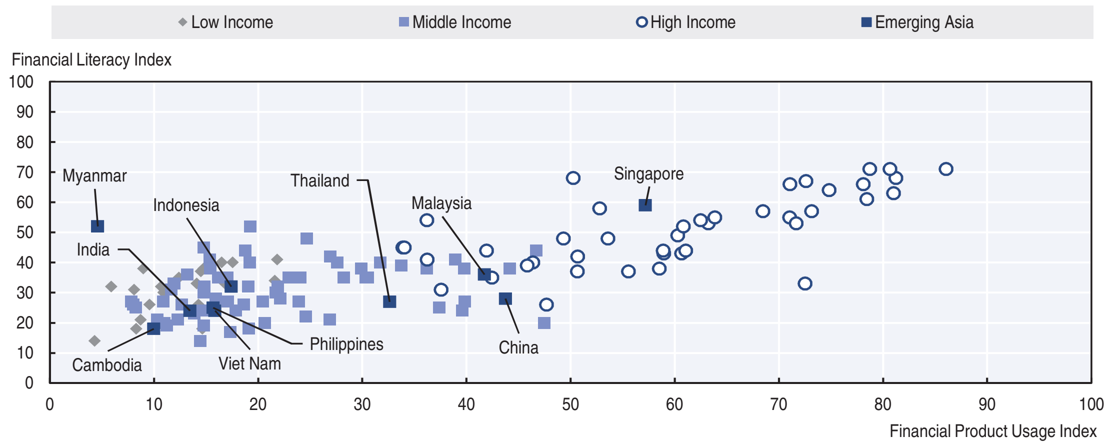
Improved financial literacy maximises the use of technology and financial inclusion

Improved financial literacy could, at household level, help maximise the use of Fintech products and manage the attendant risks. Conversely, deeper Fintech penetration could help improve financial literacy as more people get involved in the industry. Grohmann, Klühs and Menkhoff (2017), who examined the link between financial literacy and financial inclusion, also argued that impact of financial literacy on access to financial services is significant and comparatively higher in lower-income economies.

As it is, global trends show that literacy is positively correlated with the use of traditional financial products in every income group (Figure 1.27). With the exceptions of Singapore, Malaysia, China and Thailand, financial literacy in Emerging Asia generally lags behind levels in many middle income countries. Incidentally, financial literacy in Myanmar is notably high even by the standards of advanced economies, despite low usage of financial products. Many Emerging Asian economies have national strategies for financial education, which is a step in the right direction (OECD, 2015a). Nonetheless, the data suggest that there is ample room for improvement in advancing the objectives of such strategies.

The degree of Fintech adoption varies widely across countries in the region. At 69% and 52%, respectively, China and India are well above the 33% average of the 20 countries surveyed by Ernst & Young (EY, 2017a). Korea and Hong Kong, China are mid-ranking with adoption rates of about 32%, good for 11th and 12th places, respectively. Singapore, the only ASEAN economy included in the assessment, has an adoption rate of about 23%, putting it in 17th place. As for Japan, the survey estimated its adoption rate at about 14% (19th).[20] The report noted that in all six countries with data (including Singapore and Hong Kong, China), adoption rates have increased between 2015 and 2017 in line with the rise in awareness and that the future use of Fintech in these economies is expected to rise further. In a separate assessment, EY (2018) finds that Fintech adoption in ASEAN has also been growing robustly.

Figure 1.27. **Financial Literacy Index and Financial Product Usage Index, 2014-17**



Note: The Financial Product Usage Index is simple average of the proportion of the population aged over 15 who used the internet to pay bills or make a purchase in the past year, own a debit card, sent or received domestic remittances in the past year, used a mobile phone or the internet to access an account held in a financial institution in the past year, own a credit card, and made or received digital payments in the past year. Only countries with complete data in all the categories of financial product usage are included in the calculation. The Financial Literacy Index is based on a survey on respondents' understanding of risk diversification, inflation, simple interest and compounded interest. Data are not available for Brunei Darussalam and Lao PDR.

Source: OECD Development Centre based on data from the World Bank (2017), *Global Findex Database* and Klapper, et al. (2015).

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Cybersecurity and AML/CFT are cross-border issues

Weakness in cybersecurity is a threat to the potential of Fintech. Cybersecurity, being a nonpoint source issue, requires cross-border coordination, particularly as some countries are still in the process of building their national frameworks. The ASEAN-Japan Cybersecurity Center, established in Thailand in 2018 to boost regulatory capacity, is a valuable step. Fully using and building on the gains of initiatives such as the ASEAN Cyber Capacity Programme and ASEAN Ministerial Conferences on Cybersecurity will be crucial. Key challenges in this respect are financial resources and the ability of the public sector to attract the talent needed to build and maintain cyber security systems. On the legal front and against the background of institutional credibility issues in some countries, one source of friction is striking the right balance between censorship and the free flow of legitimate information.

Much can be done to strengthen AML/CFT measures. Statutes are well developed and some institutional cross-border arrangements are in place. However, there is room to improve legitimate surveillance, monitoring and dispute resolution frameworks. The cyber-heist in 2016 concerning the central bank of Bangladesh and a Philippine commercial bank provides a relevant backdrop. As regards to data protection, there has been a concerted effort to develop guidelines and build institutions capable of handling related issues. Nevertheless, the harmonisation of cross-country data privacy regulations, even if partial, will be a boon for cross-border electronic transactions. The voluntary Cross-Border Privacy Rules System of the Asia-Pacific Economic Cooperation (APEC) is one model that Emerging Asian countries may be able to work with (APEC, 2018).[21]

Strengthening export performance amidst rising protectionism

In the first half of 2018, positive trade growth was recorded in all regions worldwide, albeit at different levels. North America led the way in export volume growth with 4.8%. Asia came next at 4.2%, while Europe trailed behind at 2.8%. As for imports, Asia came at the top with a 6.1% growth rate, followed by South America, North America and Europe at 5.5%, 4.8% and 2.9%, respectively (WTO, 2018).

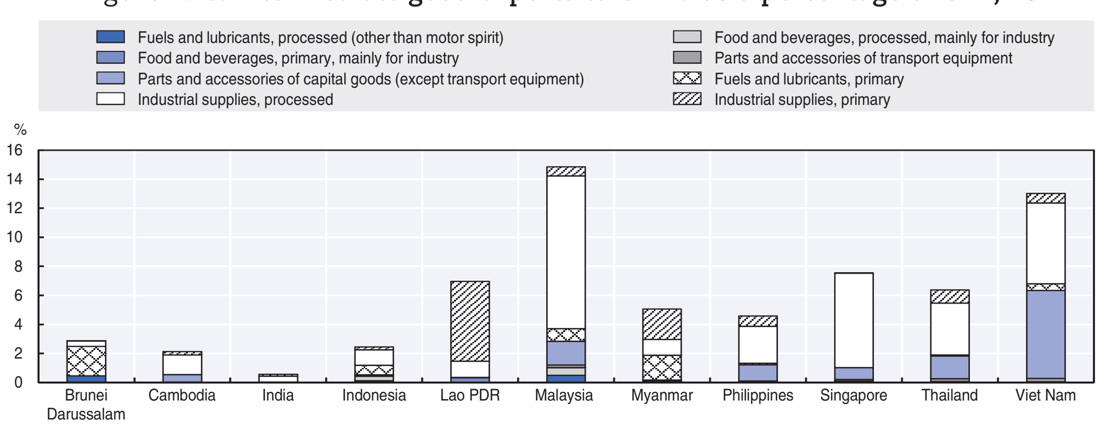
At the beginning of the ongoing trade war between two large economies, bilateral trade between China and the ASEAN economies reached USD 232.64 billion in the first five months of 2018, up by 18.9% over the same period in 2017, the year in which trade hit a record high of USD 514.8 billion.

For now at least, trade data have yet to show any significant impact from the trade war. That, however, may change. In September, the United States extended tariff hikes of 10% to USD 200 billion worth of Chinese imports (which accounts for half of the products China exports to the United States). It will further raise the rate to 25% in January 2019.

Due to the fact that countries in the region are intertwined in global value chains and production networks, they are expected to feel the heat. ASEAN countries are also at risk because of their trade openness and exposure to the supply chain. For instance, escalating trade friction caused by the trade war could dent Viet Nam's export opportunities. The same is true of other countries in the region which, like Viet Nam, are an integral part of GVCs and production networks. In the medium term, Southeast Asian countries and newly industrialised economies stand to gain from trade in global supply chains being redirected to economies producing similar goods (ADB, 2018).

As export-related activity in China slows down due to a slump in demand from the United States, intermediate goods exports from Emerging Asia could well be affected (Figure 1.28). Malaysia, Viet Nam and Singapore are most at risk through the GVC channel, as their intermediate goods exports to China account for 14.9%, 13% and 7.5% of their GDP, respectively. The composition of intermediate goods exports is also an important factor. Viet Nam, for example, being a large supplier of inputs for the production of capital goods in China, could experience a delayed impact in the event of a slowdown in Chinese exports to the United States. The reason is that investment plans generally take longer to adjust than consumption (Fuss and Vermeulen, 2004). Vietnamese exports could therefore be more resilient at first than, for example, Malaysia's, which chiefly comprise processed industrial supplies.

Figure 1.28. **Intermediate good exports to China as a percentage of GDP, 2017**



Note: The calculations made use of BEC commodity classification.

Source: OECD Development Centre calculations based on UN Comtrade.

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Rethink export strategies to head off impact of growing trade war

Countries become part of GVCs through backward or forward participation. The former denotes the import of inputs for goods and services that are later exported, the latter denotes the export of locally produced goods to countries involved in downstream production. However, countries' GVC participation is generally both forward and backward. The most recent available data show that China trades with ASEAN and India more through forward than backward GVC participation. In 2011, the domestic value added of the Philippines, Malaysia and Indonesia embodied in China's exports respectively made up 8.9%, 5.9% and 5.8% of their total exports. In other words, China's value added embodied in their total exports is relatively less than their domestic value added embodied in China's exports as a share of their total exports. This comparison of trade in value added further strengthens the theory of China as the factory of the world, which imports, processes, then reassembles raw and intermediary goods as final products for re-export worldwide.

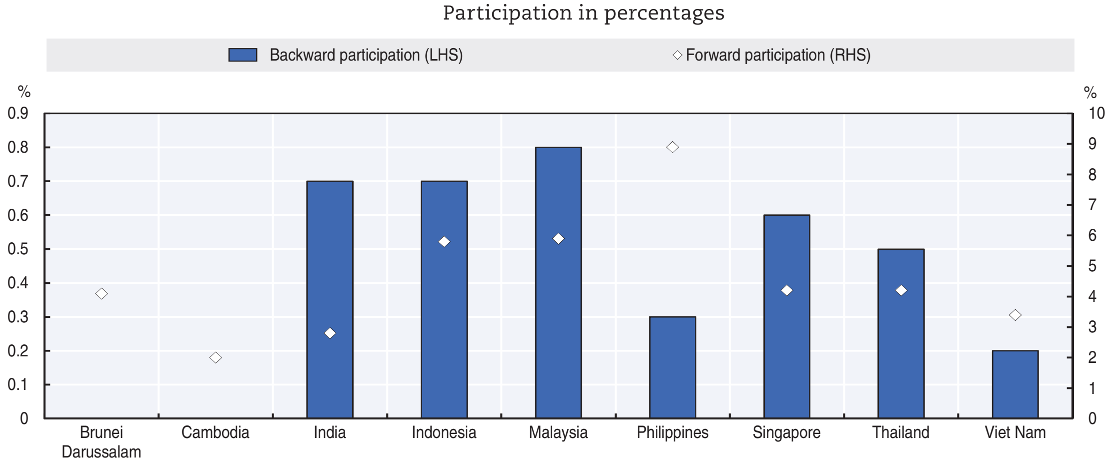
Backward GVC participation in the region's trade with China is less intense, as no more than 0.8% of China's value added is embodied in total ASEAN and Indian exports, which suggests that their export sectors are less dependent on products from China. The United States' increase in tariffs on Chinese goods thus translates into higher prices for Chinese goods which embody the region's value added. These goods' higher prices may dampen United States demand for China's exports and curb China's imports of intermediary goods from South East Asia and India (Figure 1.29).

Nevertheless, to survive and even benefit from the redirection of trade to their partners in GVCs, countries should identify the determinants of export in order to strategise in the medium to long-term amidst global uncertainty. In this way, they may pre-empt the next round of tariff hikes on a wider range of goods in the new year.

To date, China remains the top trading partner of neighbouring Southeast Asian countries. Dependency on a major trading partner involved in a trade war may impact the region negatively. To survive amidst the protectionist sentiments, countries need to focus on strengthening their supply capacity. A restricted supply capacity will limit their ability to improve their trade performance and reap all the benefits that come with trade within the ASEAN Free Trade Agreement and its plus–one agreements. Factors such as transport costs affect the cost of production and limit supply capacity. Apart from a stable macroeconomic environment and accountable institutions, the availability of domestic transport infrastructure and attracting the right type of FDI in the region are also important in strengthening the supply capacity.

Figure 1.29. **Emerging Asia's forward and backward GVC participation in trade with China, 2011**

Participation in percentages



Note: Forward GVC participation denotes domestic value added embodied in foreign (China's) exports as shares of a countries' total gross exports shown on the right-hand y axis. Backward GVC participation denotes foreign (China) value added embodied in countries' exports as a percentage of its total gross exports shown on the left-hand y axis.

Source: OECD Development Centre data compiled from TiVA database, https://stats.oecd.org

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Strengthening supply capacity is key to improving trade performance

Build transport and energy infrastructure

Efficient physical infrastructure is essential if ASEAN countries are to increase the size and growth rate of their supply capacity. For example, the CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) still lack transport infrastructure, which negatively affects their trade activities with regional partners. A case in point is the trade between the CLMV countries and India. Over 17 years, it grew considerably from a mere USD 460 million in 2000 to USD 14.5 billion in 2017.

Inadequate energy infrastructure in a number of countries also impairs the growth of supply capacity. Therefore, extending grid connections to those without access to electricity is a top priority. Countries across the region have made great strides in addressing the issue. The electrification rate has risen by 28 percentage points since 2000 and is now at 90% across ASEAN. Nevertheless, achieving universal access in a very diverse region requires carefully considering the specific situation of different communities.

Attract greater FDI and nurture SMEs to create jobs and diversify

Another supply-side factor that countries must address if they are to improve their trade performance is greater FDI. Countries that are starting to export or are trying to expand their export capacity, need FDI to contribute to their capital formation. SMEs continue to play a significant part in the development of new products and new markets, even across the developing world. Beck, Demirguc-Kunt and Levine (2005) examined the link between SMEs, income inequality and poverty and found that there is a strong, positive link between the number of SMEs and GDP per capita growth. Governments need therefore to nurture their home-grown SMEs to make them competitive, viable businesses both domestically and internationally. They make a strong contribution to the diversification of the economy and job creation.

Governments should support SMEs through appropriate investment plans. There is a need for a greater diversity of SME financing models to offset the difficulty of obtaining traditional bank loans without proper collateral. SMEs in emerging economies are increasingly turning to asset-based finance for their working capital needs, the expansion of domestic and international business and, in part, as a source of investment. Asset-based finance enables firms to obtain funding based on the value of specific assets – e.g. accounts receivables, inventory, machinery, equipment and real estate – rather than on their own credit standing. Additionally, tapping into crowd-funding is one way of financing SMEs that has grown rapidly and encouragingly since the middle of 2000s. However, it accounts for only a minor share of financing options for businesses, as it serves to finance specific projects rather than enterprises themselves (OECD, 2015b).

Increasing market access is essential to enhance exports

Access to foreign markets is a critical determinant of export performance. In general, there has been widespread improvement in foreign market access since the early 1980s, which correlates with an improvement in export performance. An UNCTAD analysis pointed out that the East Asian and Pacific countries were among the main beneficiaries of the observed increase in foreign market access. Their greater access to markets both within and outside the region coincides with their successful diversification efforts and participation in the more dynamic sectors of world trade through GVCs (UNCTAD, 2005).

Countries in the region are parties to many bilateral and multilateral trade agreements which have expanded their markets beyond their borders. Schott (2017) has emphasised that bigger is better when it comes to the Asia-Pacific trade agreements. Apart from ASEAN and ASEAN-plus-one frameworks, some countries in the region are also part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Amidst growing protectionist sentiment in global trade, CPTPP was successfully signed in March 2018.

Pressure is also mounting on member countries to conclude negotiations on the proposed free trade pact, called the Regional Comprehensive Economic Partnership (RCEP), by the end of 2018. The RCEP covers both traditional and non-traditional FTA chapters that include provisions on goods, services, investment, economic and technical cooperation, competition and intellectual property rights. Talks have progressed steadily, albeit slowly, as the member countries continue to discuss by how much to reduce customs duties on a maximum number of traded products. RCEP comprises 10 ASEAN members and their 6 FTA partners – India, China, Japan, South Korea, Australia and New Zealand. The involvement of more countries than in the CPTPP adds to the complexity of negotiations.

The economic gains of CPTPP are projected to reach USD 147 billion by 2030 (in 2015 dollars). Malaysia and Viet Nam will be Southeast Asia's biggest beneficiaries in the CPTPP, with exports that look set to reach USD 42 and USD 31 billion (in real terms by 2030). Countries who are not party to the agreement are expected to lose out as a result of trade diversion. As for the RCEP, which comprises a bigger number of countries, the model assumes the elimination of 85% of tariff lines and the reduction of non-tariff barriers by 10%. It should generate welfare gains of USD 286 billion in real terms by 2030, with the exports of the region's biggest beneficiaries, China and India, reaching USD 101 billion and USD 57 billion, respectively. They are followed by Thailand, Viet Nam and Malaysia (Petri et al., 2017).

Mitigating natural disaster risks to growth

Natural disasters pose serious challenges to Emerging Asia. Indeed, all countries in the region are affected (Table 1.7), though costs vary substantially with the type and size of the disaster. For instance, the recent succession of disasters in Indonesia on the islands of Lombok (August 2018) and Sulawesi (September 2018) are a case in point. The earthquakes and tsunami exacted a large human toll and an estimated economic cost of USD 523 million for Lombok and USD 1 billion in Sulawesi (Aon, 2018). The floods in the state of Kerala in India in August 2018 – the worst in the region since 1924 – are another example. Their economic impact, estimated at USD 4.6 billion, could inhibit growth in the short term by a projected 1% for the year. The final growth outcome will depend on the swiftness of rehabilitation in the services sector (63% of total gross value added), especially in tourism, which represents 40% of gross value added in services (CARE, 2018).

The Philippines, too, have been hit. Typhoon Mangkhut in early September 2018 caused damage estimated at USD 641 million. The second-round effects of the disaster on prices could be detrimental, given that the country was already struggling with high inflation in July and August 2018. Inflation was driven partly by the prices of vegetables (a rate of 19.3%), corn (12.6%) and fish (12.4%). Moreover, the hardest hit regions were precisely the ones that produce vegetables (Cordillera), corn (Cagayan) and fish (Pangasinan and Ilocos). The prices of cabbages and carrots rose steeply during the first three weeks of September by 81.9% and 33.3% respectively in Metro Manila. There was, however, no evidence of effects on fish and rice prices, probably due to the availability of alternative suppliers. In most ASEAN countries, floods are the most costly and frequent natural disaster. Due to their geographic locations, the Philippines and Viet Nam are affected chiefly by storms and Indonesia by earthquakes (Figure 1.30).

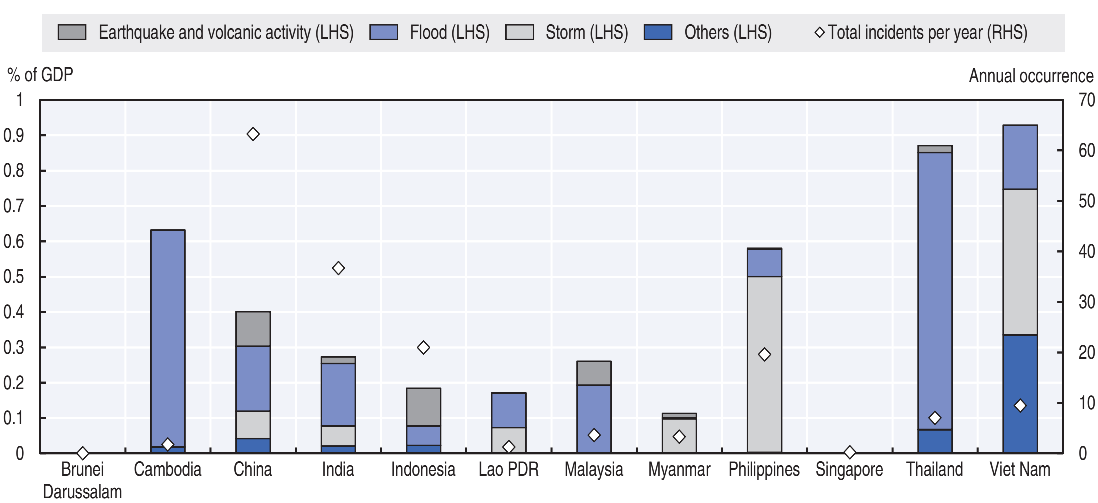
The high economic costs of disasters takes the form of damage to infrastructure, physical capital, inventories, agricultural and natural resources and the disruption of normal economic activity. Relative to GDP, Viet Nam, Thailand and Cambodia are the worst affected. Viet Nam experiences yearly damage approaching 1% of GDP. The countries with the highest number of incidents every year are actually China and India. The economic impact relative to their GDP impact is, however, weaker than in some other countries in the region.

Table 1.7. **Selected cases of natural disasters in Emerging Asia**

Country	Month and year	Disaster	Estimated cost (USD million)
Brunei Darussalam	Feb/Apr-98	Wildfires	2
Cambodia	Sep/Oct-13	River floods in north-west and along the Mekong River in central and southern Cambodia	521
China	Jul-18	Floods in central and northern China	1 300
India	Aug-18	Floods in Kerala State	4 600
Indonesia	Aug-18	Earthquake in Lombok	500
Lao PDR	Jul/Aug-18	Floods in many provinces associated to tropical storm Sonca	6.5
Malaysia	Dec-16	Floods across eastern peninsular Malaysia	132
Myanmar	Jul/Aug-15	Flooding in 12 states and regions	119
Philippines	Sep-18	Typhoon Mangkhut in northern Philippines	641
Singapore	Oct-17	Bishan MRT tunnel flooding	2
Thailand	Aug/Dec-11	Floods in Bangkok and surroundings	40 000
Viet Nam	Aug-18	Typhoon Hato in Lao Cai	1 450

Source: EM-DAT and OECD Development Centre based on various sources.

Figure 1.30. **Average annual damage and average annual occurrence, 1998-2018**



Source: OECD Development Centre calculations based on Centre for Research on the Epidemiology of Disasters Emergency Events Database and World Bank (2018c), *World Development Indicators Database*.

StatLink https://doi.org/10.1787/888933886265

The effect of natural disasters on growth is complex and wide-ranging

Beyond the initial impact, the effects of natural disasters on growth can be more complex. To some extent, they depend on the type of event. Disasters, like drought, that primarily disrupt the supply of intermediate inputs in production typically curb growth. By contrast, disasters that chiefly reduce capital to-labour ratios (e.g. earthquakes) can, in some circumstances, promote growth by increasing returns to labour inputs and spurring investment. Severe disasters tend not to be good for growth, however, particularly in developing countries. Disasters may also affect different sectors in different ways. The positive effects of moderate earthquakes on growth, for example, come mostly in the non-agricultural sector (Fomby, Ikeda and Loayza, 2009).

The effects of large-scale disasters on growth can be significant. Shortly after Typhoon Haiyan, which struck the Philippines in 2013, it was estimated that the effects of the storm would reduce GDP growth by 0.3 percentage points in both 2013 and 2014 (NEDA, 2013). How growth is affected also depend on the reconstruction efforts. It is estimated that government-led reconstruction in the wake of the 2008 Sichuan earthquake reduced the gap between actual and hypothetical provincial GDP in a no-earthquake scenario to 3% by the end of the reconstruction period – that was four years faster than would have been the case had no programme been undertaken (Xi et al., 2014). Other research, however, finds more ambiguous connections between reconstruction and economic recovery, or at least suggests that the form of assistance offered matters (Xu and Mo, 2013).

Natural disaster risks also affect longer-term growth prospects indirectly through their impacts on investment and savings, though the evidence on the net effect is mixed. Higher levels of exposure to natural disasters is associated with lower levels of FDI inflows, with investment decisions more likely to be affected by recent events and disasters that cause large-scale damage (Escaleras and Register, 2011). Conversely, the risk of natural disaster may benefit growth by increasing precautionary savings (Bakkensen and Barrage, 2016).

The damage to livelihoods and supply chains caused by natural disasters takes multiple forms

In general, the agricultural sector is highly vulnerable to natural disasters (OECD, 2015c). Vulnerability is attributable to the fact that land mass in the region extends through a number of ecological and climatical zones. Countries consequently have to cope simultaneously or in short sequence with excesses and lack of water and other extreme weather events (OECD, 2018c). Natural disasters damage crops and sorely affect livelihoods. Between 2004 and 2014, for example, Southeast Asia lost 3% of its potential agricultural production to natural disasters (FAO, 2017). The result is a twin threat to food security in rural areas – the destruction of the crops can cause food shortages and farmers lose their livelihoods when they have no other income.

Although insurance could offset such threats, the high frequency of agricultural losses makes agriculture insurance economically unviable. It is therefore up to governments to intervene and provide such a public good. Thailand, for example, has introduced a partly government-funded programme, the Rice Disaster Relief Top-up Crop Insurance Scheme. It covers damages to rice crops, when growing or being harvested, in the event of floods, drought, windstorms, frost, hail or bushfires (OECD, 2015c).

Small entrepreneurs are particularly exposed to risks associated with natural disasters as they seldom have the financial capacity to rebuild after an extreme weather event. In Emerging Asia, small businesses are often uninsured and struggle to raise new funds when a disaster destroys their existing capital. Indeed, micro finance and local credit institutions have to contend with liquidity issues, poor loan performance and capital base erosion issues in the wake of natural disasters, which restrict their capacity to provide credit (OECD, 2015c). However, micro insurance providers may be a viable solution. In

India for instance, the All India Disaster Mitigation Institute protects property (dwellings and their contents), stock in trade and insures against personal accident and death from 19 natural disaster risks, including earthquakes, fires and floods (OECD, 2015c).

Companies that have not suffered from capital losses or which do business with firms that have, may be harmed by supply chain disruptions caused by a natural disaster. Indeed, if infrastructure is destroyed or the production of other firms in the value chain disrupted, economic activity may well be sorely hampered (G20/OECD, 2012). The World Economic Forum has found that natural disasters are one of the greatest threats to global value chains (WEF, 2012).

Lack of planning makes emerging Asian cities among the world's most disaster-prone

Urban areas host an average of 44.5% of populations in Emerging Asian countries (excluding Brunei Darussalam and Singapore) and are located in areas where multi-hazard risks are growing rapidly. Indeed, Emerging Asian cities make up half of the 10 cities in the world where most inhabitants are at risk from natural disasters. Metro Manila ranks second (SwissRe Institute, 2014).

A number of coastal mega-cities in Asia are also expected to face a substantial escalation of losses due to once in 100 year floods attributable to population growth and economic development (OECD, 2016). Informal urban sprawl in vulnerable locations such as river beds, drainage channels or steep slopes increases exposure to natural hazards among the poor, whose substandard housing conditions already put them at greater risk.

Also, the lack of urban planning and construction in disaster-prone areas is a serious challenge to future disaster mitigation policies (OECD, 2015c). Risk assessment is a prerequisite for a disaster-aware urban planning. Indonesia, for example, has developed a hazard impact modelling tool for emergency planning – the Indonesia Scenario Assessment for Emergencies. It is designed to improve the understanding of the likely impacts of disasters such as floods, earthquakes or tsunamis (APEC/OECD, 2013).

Policy options for promoting resilience

Mitigating the risks of natural disaster is critical to inclusive growth and development. While actual exposure to most natural hazards is beyond the control of policy makers, vulnerability is certainly affected by institutional and other factors that stem from policy. Increasingly, governments have been focusing on improving resiliency rather than merely responding to disasters. They have taken longer-term perspectives in capacity building and widening access to resources as part of policies to prepare for, resist, cope with and recover from disasters. The principles that underpin resilience – which include disaster risk reduction, climate change adaptation and the integration of risk management in development planning – have been recognised in international documents such as the Sendai Framework for Disaster Risk Reduction 2015-30 (Box 1.7), the Sustainable Development Goals, the Paris Agreement on Climate Change, and the New Urban Agenda.

Box 1.7. **Sendai Framework for Disaster Risk Reduction 2015-2030**

The Sendai Framework for Disaster Risk Reduction 2015-30 was adopted at the Third UN World Conference held in Sendai, Japan, in 2015. It is the successor to the Hyogo Framework for Action 2005-15: Building the Resilience of Nations and Communities to Disasters. It includes four priorities for action: understanding disaster risk; strengthening disaster risk governance to manage disaster risk; investing in disaster risk reduction for resilience; and enhancing disaster preparedness for effective response and better build-back in recovery, rehabilitation and reconstruction.

Box 1.7. **Sendai Framework for Disaster Risk Reduction 2015-2030** *(cont.)*

- The framework sets seven global targets:
- Substantially reduce global disaster mortality by 2030 with the objective of making the 2020-30 average global mortality rate lower than between 2005 and 2015.
- Substantially reduce the number of people affected globally by 2030, with the objective of making the average 2020-30 global figure lower than between 2005 and 2015.
- Reduce direct, disaster-related economic loss relative to global GDP by 2030.
- Substantially reduce disaster-related damage to critical infrastructure and the disruption of basic services, such as health and education by 2030. Efforts should include building resilience.
- Substantially increase the number of countries with national and local disaster risk reduction strategies by 2020.
- Substantially enhance international cooperation with developing countries through adequate, sustainable support measures that complement national action to implementing the Sendai Framework by 2030.
- Substantially increase the availability of and access to multi-hazard early warning systems and disaster risk information and assessments by 2030.

Source : UNISDR (2015), *Sendai Framework for Disaster Risk Reduction 2015-2030*, United Nations International Strategy for Disaster Reduction, Geneva.

Countries in the Emerging Asia region could do more to improve resilience. According to the World Risk Index, half of them are in the list of the top 50 countries that are most at risk from natural disasters (Table 1.8). The Philippines has the region's highest overall ranking and exposure score, which measures exposure to natural hazards. Cambodia comes top in vulnerability, which indicates the population's exposure to natural hazards, and in susceptibility, an indicator that measures the quality of infrastructure, nutrition, income and general economic framework. As for Myanmar, it has the worst coping capacity, an indicator of governance, medical care and material security. It also has the poorest adaptive capacity, an indicator that rates the ability to adapt to future natural events and climate change. Like most countries around the world, Emerging Asian countries perform the worst in the coping capacity indicator.

Table 1.8. **How Emerging Asian countries score on World Risk Index, 2012-16**

Mean scores

Ranking (out of 171)	Country	Overall score	Exposure	Vulnerability	Susceptibility	Lack of coping capacities	Lack of adaptive capacities
3	Philippines	27.7%	52.5%	52.8%	33.0%	80.9%	44.5%
8	Cambodia	16.9%	27.7%	61.2%	41.7%	86.8%	55.0%
12	Brunei Darussalam	16.2%	41.1%	39.5%	16.4%	64.0%	38.0%
18	Viet Nam	12.8%	25.4%	50.7%	27.2%	76.7%	48.0%
33	Indonesia	10.5%	19.4%	54.2%	32.4%	80.9%	49.3%
42	Myanmar	9.1%	14.9%	61.0%	36.2%	88.1%	58.6%
74	India	7.0%	11.9%	58.6%	38.2%	80.5%	57.2%
80	China	6.8%	14.4%	47.2%	26.4%	70.4%	44.7%
89	Malaysia	6.5%	14.6%	44.3%	19.9%	68.2%	44.8%
91	Thailand	6.35%	13.7%	46.3%	20.3%	75.6%	43.1%
100	Lao PDR	5.7%	9.55%	59.6%	40.9%	84.9%	53.1%
158	Singapore	2.4%	7.8%	30.1%	14.2%	48.8%	27.4%

Note: Risk is measured in ascending order – 0% denotes no risk and 100% high risk.
Source: Bündnis Entwicklung Hilft (2017).

Strengthening resilience-building policies

If natural disaster risk management is to foster resilience, it should take a long-term, comprehensive view of preparedness, disaster response and rebuilding. Coordinated risk assessment is therefore fundamental (G20/OECD, 2012), as are capacity building and effective planning. Similarly, regional conditions should be factored into the development of recovery strategies. The OECD (2013) sets out some principles for rebuilding resilient regions in the wake of disasters. They include:

- making sure that short-term decisions do not constrain longer-term options;
- identifying social and economic drivers specific to the region;
- strengthening dialogue between stakeholders to develop an integrated strategy;
- ensuring local leadership in decision making;
- introducing appropriate reforms;
- fostering public participation;
- making public deliberation a regular component of regional development strategies;
- building trust, increasing accountability and improving capacity in local administration.

Investments are likely to be needed to build resilient infrastructure, early warning and response systems, and other preparatory measures. Downstream, assistance programmes can help to inject post-disaster economic stimulus and to address some of the challenges to longer-term growth. To be effective, however, disbursements should be timely and closely targeted and use clear, transparent administrative procedures (OECD, 2015d).

Government compensation and financial assistance programmes for victims of natural disaster in the region include Malaysia's National Disaster Trust Fund. It compensates farmers whose agricultural assets and buildings were damaged or destroyed and people who have to shoulder burial costs or relocate. While the fund covers a variety of types of disaster, money is allocated chiefly to flood victims. The Philippines' National Disaster Risk Reduction and Management Fund provides financial assistance for relief, recovery and reconstruction and for prevention and preparedness. As for India, its National Disaster Response Fund and State Disaster Response Fund provides relief to disaster victims, helping them to meet their immediate needs and rebuild livelihoods. However, the funds operate on a case-by-case basis and only in response to disasters deemed severe, a designation with no legislative definition.

Governments may be best placed to address less severe but more frequent hazards, and market-based instruments high-severity, low-frequency events (Cummins and Mahul, 2010). Ideally, countries should harness a range of financing and risk transfer instruments to control the costs of natural disaster risk management. Government reserve funds, though available immediately and often at low cost, do have opportunity costs and require time and institutional capacity to build and maintain. While contingent credit facilities, too, can also be called upon with little delay and may be more useful for large-scale disasters, they also involve opportunity costs and counterparty credit risks. Insurance, which covers a small share of losses from disasters in much of the region, may be useful in the event of loss of wealth. However, it takes time to release payments and may have counterparty credit risks and other limitations. Catastrophe bonds and similar securities are effective in transferring risk to the capital markets.

Over the longer term, governments should take exposure to natural disaster hazards and the effects of climate change into consideration when developing economic diversification strategies – particularly in economies highly dependent on vulnerable sectors, such as agriculture and fisheries, forestry, tourism, energy and the production of energy-intensive goods. Articles 4 and 7 of the Paris Agreement, signed in 2016, acknowledge the need for diversification. A green economy is conducive to diversification for resilience. However, it can also be fostered through openness to investment and increased participation in global value chains, which offer opportunities for product, process, functional and chain upgrading in new areas of economic activity.

Notes

1. These indicators are from WEF (2018), World Bank (2018b) and Transparency International (2018).
2. Between 2000 and 2015, average annual growth in government spending on education was about 17.6% (nominal compound growth) or 14.9% (real compound growth). The proportion of students in higher education to the total population also went up markedly from 7.2:1000 in 2000 to 25.3:1000 in 2016.
3. New investment regulations are set out in Special Administrative Measures on Access to Foreign Investment 2018, Special Administrative Measures for Foreign Investment Access to Pilot Free Zones, and State Council Circulars 5 and 39 in 2017 and State Council Circular 19 in 2018.
4. This estimate only covers projects that cost INR 150 crore, or USD 20.6 million.
5. The observation concerning CPI inflation time series is based on a roughly reconstructed series which use growth in indices that follow the old series (2006=100) and the weights for the new series (2012=100).
6. In this section, unless stated otherwise, levels are expressed in annualised terms (annualised by the fourth-quarter moving sum) as are growth rates and ratios with respect to GDP.
7. Cambodia does not publish quarterly GDP data.
8. Revenue is defined as gross revenue net of tax rebates from the Revenue Department, duty rebates from the Customs Department, VAT allocation for provincial administrative organisations, VAT allocation for local administrative organisations and export duty compensation.
9. Data used in this section (relating to CAR, ROE, ACR and NPLs) were sourced from IMF (2018a), unless indicated otherwise.
10. The official NPL ratio of Lao PDR is 3.1% according to World Bank (2018a).
11. In certain cases, fintech is defined as internet-based finance (PWC, 2017b). It is also sometimes construed as a subset and not synonymous with financial innovation.
12. Household names like PayPal, VISA and MasterCard, and the likes of Euroclear and Clearstream in securities clearing and settlement, are to a certain extent the first big movers.
13. Data are not available for Brunei Darussalam, Cambodia, Lao PDR and Myanmar.
14. There remain some differences in views over the decentralised nature of cryptocurrencies.
15. Calculations based on purpose-related ICO data compiled by Coinschedule Ltd. (2018) reveal that about a quarter of the capital raised between March 2016 and July 2018 went to cryptos that offer improvements in exchange infrastructure. Specific infrastructure areas identified include processing time, scalability, accessibility, security and connectivity with other systems. About a fifth of the capital went to cryptos that tokenise assets and services related to finance, investing and trading. More than 11% of the capital went to cryptos tokenising access to communication-related services like internet protocols and messaging applications that double as, for example, digital wallets, smart contracts and the storage of smart documents. The remaining 40% of the capital raised was distributed across various categories, e.g. payments, advertising, energy, legal, gaming, gambling, government transactions, travel, charity.
16. Tar (2017) explains the similarities and differences between digital and crypto currencies.
17. Governments that have declared plans to follow suit include Estonia (Estcoin), Japan (J coin), Russia (Cryptoruble) and Sweden (E krona) as well as Israel, Iran and Turkey. In a separate development, the Chicago Board of Exchange Global Markets and the Chicago Mercantile Exchange rolled out bitcoin futures (XBT and BTC) for the first time in December 2017, while a bitcoin exchange traded fund is expected to go live in 2019.
18. This is discussed in International Bar Associations Anti-Money Laundering Legislation Implementation Working Group (2018).
19. China's policies since the latter part of 2016 have had considerable impact on cryptocurrency prices and the mining and exchange business, forcing operators to relocate outside the mainland.
20. The measure follows Everett Rogers' Adoption Innovation Curve.
21. Refer to APEC (2018) for the details.

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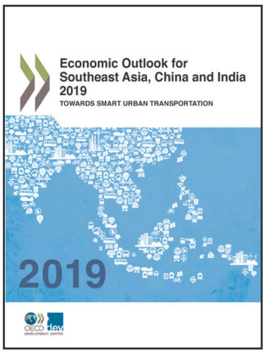

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