Developing economies of the Asia-Pacific region grew by an estimated 4.5 per cent in 2015, the lowest rate since 2010, with only a modest rebound to 5 per cent growth projected for 2016. While global trade and China’s economy explain much of the recent slowdown, there are also signs of weakening productivity growth in the region. Compared to the past, lower interest rates and exchange rate depreciations have had less noticeable impact on domestic activity and exports. Meanwhile, rapid increases in household and corporate debt in some countries pose risks for financial stability. At the same time, growth has not been sufficiently inclusive. This is a concern as robust and inclusive growth is important for creating jobs and improving broader development outcomes as envisioned in the 2030 Agenda for Sustainable Development.

The Year-end Update of ESCAP’s annual flagship publication, Economic and Social Survey of Asia and the Pacific, provides the latest macroeconomic forecasts, identifies emerging risks and challenges, and takes stock of fiscal, monetary and structural policy developments in the Asia-Pacific region. Against the recent slowdown, a key message is the need to reinvigorate domestic and regional sources of demand instead of relying primarily on external demand. This would entail rebalancing towards consumption in some cases and boosting investment in others, including in infrastructure. Given weakening and uneven productivity growth, the report calls for greater attention to small and medium-sized enterprises and the agricultural sector, the contribution of which to total value added is disproportionately small compared with their total employment share. In this vein, fiscal policy has a critical role to play.
ESCAP is the regional development arm of the United Nations and serves as the main economic and social development centre for the United Nations in Asia and the Pacific. Its mandate is to foster cooperation between its 53 members and 9 associate members. ESCAP provides the strategic link between global and country-level programmes and issues. It supports Governments of countries in the region in consolidating regional positions and advocates regional approaches to meeting the region’s unique socio-economic challenges in a globalizing world. The ESCAP office is located in Bangkok, Thailand. Please visit the ESCAP website at www.unescap.org for further information.

The shaded areas of the map indicate ESCAP members and associate members.
ECONOMIC AND SOCIAL SURVEY OF ASIA AND THE PACIFIC 2015: YEAR-END UPDATE
The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

Bibliographical and other references have, wherever possible, been verified.

Mention of firm names and commercial products does not imply the endorsement of the United Nations.

References to dollars ($) denote United States dollars unless otherwise indicated.

Reproduction and dissemination of material in this publication for educational or other non-commercial purposes are authorized without prior written permission from the copyright holder, provided that the source is fully acknowledged.

Reproduction of material in this publication for sale or other commercial purposes, including publicity and advertising, is prohibited without the written permission of the copyright holder. Applications for such permission, with a statement of purpose and extent of the reproduction, should be addressed to the Macroeconomic Policy and Development Division at escap-mpdd@un.org.
Economic growth in the Asia-Pacific region is markedly less robust compared to the years before and immediately after the global financial and economic crisis that started in 2008. Developing economies in the Asia-Pacific region grew by an estimated 4.5 per cent in 2015, the lowest rate since 2010, and only a modest rebound to 5 per cent growth is forecast for 2016 – marginally lower than the previous ESCAP forecast reported in the Economic and Social Survey of Asia and the Pacific 2015, published in May 2015. Although deceleration in international trade coupled with decline in demand from China are the main factors behind economic slowdown in developing economies in the region, total factor productivity growth has also weakened.

This slowdown, which comes at a time when advanced economies are undergoing mild recovery, highlights the need for reinvigorating domestic and regional sources of demand. Countries are taking positive steps – with China rebalancing towards consumption and India and Indonesia building their capital stock through greater investment – but many obstacles remain, including infrastructure bottlenecks and slow progress on regulatory reform initiatives. Moreover, the international community has just adopted a historic, universal and transformative development agenda for the next 15 years. Reviving economic growth will be critical to support the 2030 Agenda for Sustainable Development.

The projected improvement in 2016 compared with estimates for 2015 is based on China's continued slowdown being offset by smaller contraction in the Russian Federation as oil prices stabilize, albeit at a low level, stronger consumer spending in South Asia supported by moderate inflation and increased public social and infrastructure spending in South-East Asia. Growth in the Pacific island developing economies, some of which are recovering from the impact of natural disasters, is expected to remain moderate.

Headline inflation has declined significantly in most commodity-importing economies owing to lower international commodity prices, particularly oil prices, and slower economic activity. For some commodity-exporting economies, however, there have been upticks in inflation due to exchange rate depreciation. Nevertheless, in taking advantage of low inflation many economies have lowered their interest rates to support economic growth. However, just as with concurrent exchange rate depreciations in many export-oriented economies, this measure has had only a limited impact so far.

While slower economic growth and lower inflation favour further interest rate reductions, capital outflow and exchange rate considerations, together with financial stability concerns in some countries, call for prudence. The recent increase in the interest rate in the United States of America is likely to create external pressure for capital outflows and may lead to a rise in domestic financing costs, a situation which poses a particular challenge for countries with weak external positions and those that have accumulated significant household and corporate debt through external financing.

Given smaller manoeuvering room for monetary policy, a more proactive fiscal stance is recommended to provide countercyclical support and strengthen the foundations for robust and inclusive growth. In this vein, an important consideration, beyond stabilization, is the potential impact of fiscal policy on the distribution of income and opportunities and on long-term economic growth. While there may be some country-specific economic reasons to consider pursuing fiscal austerity, it is important to highlight that there are no mechanical and universally accepted thresholds. A constant assessment,
which incorporates country-specific features, is needed for fiscal policy to optimally respond to short- and long-term needs. National budgets for 2016 indicate that many countries are moving in this direction. Although most economies have adequate fiscal space, considerations to balance national development priorities and fiscal/debt sustainability remain important and should be accompanied by tax reforms.

**Rapid increases in household and corporate debt in some economies pose risks for financial stability and economic growth prospects.** Thailand’s household debt is on a par with OECD levels and China now holds more corporate debt than the United States. Given the likely increases in domestic financing costs at a time when income growth is slowing, comprehensive measures are needed, with attention paid to debt service ratios and exposure to such sectors as real estate and energy.

**Overarching medium-term priorities include making economic growth more inclusive and strengthening productivity.** Despite much progress having been achieved in poverty reduction, significant inequalities of incomes and opportunities remain in many economies of the region, hampering the achievement of broader development goals. A low or declining share of wages in total income and slowdown in total factor productivity call for greater attention to small and medium-sized enterprises and the agricultural sector, the contribution of which to total value added is disproportionately small compared with their total employment share. In the context of economic growth in developing economies in the region plateauing at about 5 per cent, it is critical that productivity growth is accelerated and that its benefits are passed on to the labour force. Rather than relying excessively on debt to support growth, such steps will foster more sustainable growth by strengthening domestic demand and assisting countries in pursuing the 2030 Agenda for Sustainable Development.
The *Economic and Social Survey of Asia and the Pacific Year-end Update 2015* contains analyses of economic developments and emerging challenges for the Asia-Pacific region since the release of the *Survey 2015* in May and provides recommendations on appropriate responses for policymakers in the region.

This report was prepared under the overall direction and guidance of Shamshad Akhtar, Under-Secretary-General of the United Nations and Executive Secretary of the Economic and Social Commission for Asia and the Pacific (ESCAP). The report was coordinated by a core team under the direction of Aynul Hasan, Director of the Macroeconomic Policy and Development Division. The core team, led by Hamza Malik, Chief, Macroeconomic Policy and Analysis Section, included Shuvojit Banerjee, Steve Gui-Diby, Pannipa Jangvithaya, Achara Jantarasaengaram, Daniel Jeongdae Lee, Oliver Paddison, Kiatkanid Pongpanich, Vatcharin Sirimaneetham and Sutinee Yeamkitpibul. ESCAP staff who made substantive contributions included Ram Tiwaree, Hongpeng Liu and Jun Tian of the Environment and Development Division, Lorenzo Motta, Marco Roncarati and Vanessa Steinmayer of the Social Development Division, Witada Anakoonwattaka of the Trade and Investment Division, and Michael Williamson of the Office of the Executive Secretary.

John Loftus edited the manuscript. Layout and printing services were provided by Clung Wicha Press.

Katie Elles of the Strategic Communications and Advocacy Section coordinated the launch and dissemination of the report.
CONTENTS

KEY MESSAGES ....................................................................................................................... iii
ACKNOWLEDGEMENTS ........................................................................................................ v
ACRONYMS ........................................................................................................................... viii
INTRODUCTION ..................................................................................................................... 1

1. Macroeconomic performance and outlook ........................................................................ 3
   1.1. Growth dynamics ........................................................................................................... 3
   1.2. Trade prospects and commodity prices ........................................................................ 9
   1.3. Developments in domestic demand ........................................................................... 11
   1.4. Inflation, exchange rates and monetary policy ............................................................. 13
   1.5. Fiscal policy and reform initiatives ............................................................................. 17

2. Selected economic challenges and policy considerations ............................................. 23
   2.1. Rising private debt and coping with potentially higher financing costs ..................... 23
   2.2. Making growth more inclusive and strengthening productivity .................................. 28

BOXES
Box 1. Youth unemployment rising in the wake of ongoing economic slowdown ............... 8
Box 2. Inclusion of the Chinese Renminbi in the special drawing rights basket of currencies …. 15
Box 3. Transition in energy systems in support of the recently adopted Paris Agreement ....... 29

FIGURES
Figure 1. Real GDP growth in developing Asia and the Pacific, advanced economies and the world, 2006-2016 ......................................................................................................................... 3
Figure 2. Quarterly growth of selected Asia-Pacific economies, 2012-2015 .......................... 4
Figure 3. Industrial production index and purchasing managers’ index for China, 2012-2015 ...... 6
Figure 4. Monthly export growth for selected Asia-Pacific economies, 2010-2015 ................ 9
Figure 5. Contributions of private consumption to economic growth in selected Asia-Pacific economies, 2012-2014 ................................................................................................. 11
Figure 6. Contributions of fixed investment to economic growth in selected Asia-Pacific economies, 2012-2014 ................................................................................................. 12
Figure 7. Inflation rate for selected Asia-Pacific economies and for subregions, 2006-2016 .......... 13
Figure 8. Exchange rate indices in selected Asia-Pacific economies, 2013-2015 ......................... 14
Figure 9. Estimated percentage point changes in GDP growth and fiscal balance-to-GDP ratio in 2014/15 ................................................................................................................................. 17
Figure 10. Fiscal balance, regional average, 2001-2016 ................................................................ 18
Figure 11. Fiscal space – fiscal balance and public debt as a percentage of GDP, 2014-2016 .......... 19
Figure 12. Selected current and capital expenditures as a percentage of GDP ................................ 21
Figure 13. Natural resources revenue, percentage of total government revenue excluding grants (average for period 2005-2014) ................................................................................................................................. 21
Figure 14. Asia-Pacific policy rate and United States federal funds rate, 2005-2018 ....................... 23
Figure 15. Household, corporate and sovereign debt, 2014 .............................................................. 24
Figure 16. Debt service ratios for the private non-financial sector, 2007 and 2015 ......................... 27
Figure 17. Labour income share in Asia and the Pacific, 1991-2011 ............................................... 30
Figure 18. Annual percentage growth rate of total factor productivity and labour productivity, 1991-2013 .............................................................................................................................................. 31

TABLES
Table 1. Selected economies in the ESCAP region: rates of economic growth and inflation, 2014-2016 .................................................................................................................................................... 5
Table 2. ESCAP scores (and ranking) of inclusiveness index, 1990s and 2000-2012 .................... 28
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ESCAP</td>
<td>Economic and Social Commission for Asia and the Pacific</td>
</tr>
<tr>
<td>FAO</td>
<td>Food and Agriculture Organization of the United Nations</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>GHG</td>
<td>greenhouse gas</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>INDCs</td>
<td>intended nationally determined contributions</td>
</tr>
<tr>
<td>NEET</td>
<td>not in employment, education or training</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>SDRs</td>
<td>special drawing rights</td>
</tr>
</tbody>
</table>
The adoption of the 2030 Agenda for Sustainable Development has come at a time when global policymakers are still struggling to revive economic growth despite having taken extraordinary monetary, financial and fiscal measures for that purpose. Global aggregate demand remains sluggish, world trade grows but disappointingly and financial fragility continues to persist. Beset by a weak propensity to invest, by the slowdown in productivity growth and by demographic shifts, the growth in potential output also seems to have stagnated. At the same time, widening inequalities in terms of incomes and opportunities and declining real wages are undermining the prospects for a sustained and inclusive economic recovery.

Given the export-led growth orientation of many developing economies in the Asia-Pacific region, reviving and sustaining high levels of economic growth, experienced before the global economic and financial crises that started in 2008, will be a considerable challenge. Many economies in the region have also experienced a significant slowdown in their export performance due to lower demand from China, which is being affected by weaknesses persisting in the developed economies in the same manner as in other economies in the region. Furthermore, China is demanding less industrial goods and commodities from the region as the Government reorients the economy towards consumption. Domestic constraints, such as weak infrastructure, dependence on a few commodities and slower implementation of reform measures in some economies, are also holding back the growth potential of the region.

As a result, the growth forecast for the region has been pared back for many economies since that published in the Economic and Social Survey of Asia and the Pacific 2015 (Survey 2015) in May 2015. The economic growth estimates for developing economies in the region for 2015 have now been revised to 4.5 per cent compared with earlier projections of 4.9 per cent. Similarly, for 2016, economic growth is forecast to be 5 per cent, down from the previous forecast of 5.2 per cent. This slowing growth trajectory of the region is a continuation of a declining trend since 2010. It seems that economic growth in developing economies in the region has reached a plateau at about 5 per cent.

Slowing economic growth in the region does not necessarily have to be a “bad” outcome, provided that economies continue to strive to make such growth more inclusive. However, as highlighted in Survey 2015, economic growth has not been sufficiently inclusive, even though significant progress has been made over the years. The unprecedented pace of economic growth in the last few decades, especially in many Asia-Pacific economies, has exerted enormous pressure on social stability and brought about dramatic changes in the climate and biosphere. The 2030 Agenda is an acknowledgment of these realities. In that agenda, sustainable development is recognized as involving much more than just economic growth; it also is aimed at promoting a broader concept of human welfare.

Reviving economic growth, nevertheless, remains important for creating jobs, increasing the financial resources of Governments and improving overall development outcomes. Towards these ends, the Asia-Pacific developing economies will have to adjust their growth strategies in a manner that gives relatively more weight to domestic and intraregional demand and less to extraregional trade. At this point in time, however, it is not clear whether domestic and intraregional demand will grow sufficiently to counteract the lower extraregional demand.

The economic slowdown has contributed to lower international commodity prices. This has helped many commodity-importing economies in the Asia-Pacific region in terms of easing inflationary concerns and
supporting domestic consumption. In taking advantage of low inflation and keeping in view slowing economic growth, many economies in the region have lowered their interest rates. However, just as is the case with concurrent exchange rate depreciations in export-oriented economies, these developments have had a limited impact on boosting growth, which has increased the challenges of monetary policy in going forward. While slower growth and lower inflation clearly favour further reductions in interest rates, prudence is called for in the face of capital outflow and exchange rate considerations, as well as the financial stability concerns that exist in some economies in the region.

The positive impact of lower international commodity prices on trade balances has been counteracted for economies exporting manufactures owing to the gradual slowdown in the Chinese economy. This situation has reduced the likely positive boost to economic growth that should be expected because of lower oil prices. On the other hand, the commodity-exporting economies have been negatively affected by lower commodity prices. Apart from upticks in inflation and lower exchange rates, the fiscal positions of those economies have also experienced significant pressure. Similarly, domestic investment has been curtailed in many economies in the region due to “credit cooling” measures in some and lack of supply-side improvements in others, such as initiation of reforms to remove regulatory barriers or adoption of policies to promote infrastructure development.

Asset markets in the region continue to be under pressure due to the changing global monetary policy landscape as well as due to domestic policy concerns. Equity and bond markets in many economies in the region were negatively affected in 2015, a situation that has led to significant currency depreciations. The recent increase in interest rates by the United States is likely to create external pressure for capital outflows. Domestically, an outflow of capital is a particular concern for some economies because of their high levels of household and corporate debt. If their currency depreciates, debt servicing costs would increase, putting further pressure on corporates and households. This situation could result in heightened instability in domestic banking sectors through increases in the number of non-performing loans. Governments should therefore undertake measures to reduce the levels of private debt as well as create risk-reducing measures for banks.

The region has the capacity and possesses the tools necessary to engineer an increase in economic growth from within and simultaneously make that growth inclusive. Other than removing barriers to business, removing bureaucratic hurdles and improving governance, some economies that have adequate fiscal space could undertake expansionary fiscal measures. It is worth highlighting that while there may be some country-specific economic reasons to consider pursuing fiscal austerity, it is important to recognize that there are no mechanical and universally accepted thresholds. A constant assessment, which incorporates country-specific features, is needed for fiscal policy to respond optimally to short- and long-term needs. Governments should redouble their efforts to remove logistical barriers to domestic and regional production and trade by improving their physical infrastructure. In this vein, boosting regional economic cooperation and integration could go a long way in enabling countries in the region to tap their own sources of demand.

Importantly, the region’s economies can benefit tremendously by focusing on and improving productivity. Over recent decades, there have been significant increases in productivity in the Asia-Pacific region. Yet, growth in total factor productivity has declined in the aftermath of the global economic and financial crises that started in 2008; that productivity is now below the level registered in the 1990s. Reversing this decline is an important undertaking, especially in economies eager to move beyond “middle-income” status. Economies will therefore have to introduce policies that will strengthen productivity growth and pass the gains on to the labour force in the shape of increases in real wages. Doing so would lay a more resilient and stronger foundation for growing from within by enabling economies in the region to shift gradually to a development model in which domestic and regional factors play a larger role, rather than one that relies primarily on extraregional exports.

While strengthening productivity will contribute to reviving economic growth and supporting the 2030 Agenda, countries will also be able to improve productivity through greater investment in support of the Sustainable Development Goals, thereby creating a virtuous cycle between economic growth, the Goals and productivity.
1. MACROECONOMIC PERFORMANCE AND OUTLOOK

1.1. Growth dynamics

*Economic growth in developing economies in the region has plateaued at about 5 per cent annually*

Economic growth in the region is currently experiencing a “new normal” in terms of somewhat lower growth than had been the case previously. While economic growth in Asia and the Pacific still remains higher than that of any other region in the world, after a strong initial recovery in 2010/11 from the global financial and economic crises that began in 2008, growth has been considerably lower compared with the pre-crisis average (see figure 1). Economic growth in the period 2012-2014 averaged 5.2 per cent annually, whereas the average in the period 2005-2007 was 9.4 per cent. The lower growth rate in the region since 2013 stands in contrast to the trend of somewhat higher growth in the advanced economies since that year (see figure 1), which suggests that the downturn in the region is related not only to sluggish global trade but also, to some degree, to domestic and regional factors as well.

After incorporating available quarterly growth data (see figure 2), it can be seen that the economic growth estimates for developing economies in the Asia-Pacific region for 2015 have been revised to 4.5 per cent compared with earlier projections of 4.9 per cent (see table 1). Similarly, the current and updated forecast for 2016 for the developing economies in the region is for economic growth to increase to 5 per cent, down from the earlier forecast of 5.2 per cent reported in Survey 2015. The projected improvement in economic performance in 2016 compared with 2015 is largely due to a smaller expected contraction in the Russian Federation, which will also result in positive growth for the North and Central Asian subregion.

![Figure 1. Real GDP growth in developing Asia and the Pacific, advanced economies and the world, 2006-2016](image)

*Sources: ESCAP forecasts and International Monetary Fund, World Economic Outlook Databases. Available from www.imf.org/external/data.htm. Note: Developing Asia and the Pacific group comprises of economies listed in Table 1 excluding Australia, Japan and New Zealand. Advanced economies group includes the European Union, the United States as well as Australia, Japan and New Zealand.*

1 Average is for developing ESCAP economies, including those in North and Central Asia.

2 All ESCAP GDP growth and inflation estimates are as of 15 December 2015. Estimates include North and Central Asian economies.
The forecast decrease in contraction in the Russian Federation stems from stabilizing oil prices, albeit at low levels, as compared with the falling oil price in 2015, which will reduce pressure for depreciation of the currency, as well as from falling inflation.

Most developing economies in the subregions of South and South-West Asia and South-East Asia are also expected to experience a marginal pick-up in economic growth in 2016. In South and South-West Asia, the upturn is expected to be led by private consumption amid gradual fiscal tightening and weak exports. Consumer spending should be supported by moderate overall inflation, steady employment growth, especially in services sectors, and rising workers’ remittances. In South-East Asia, the forecast of a modest rebound is due to increased government expenditures and further progress on infrastructure investments, particularly in Indonesia, the Philippines and Thailand. Private consumption will benefit from lower inflation in Indonesia but will remain constrained by high household debt in Thailand.

Gradual economic slowdown in China is a major factor influencing growth prospects of developing economies in the region

In fact, almost all larger economies, except China, are expected to experience a moderate increase in economic growth in 2016. The gradual economic slowdown in China, which is largely a reflection of the country’s ongoing efforts to rebalance the economy towards domestic consumption, is expected to continue in 2016; the country’s growth rate is projected to drop to 6.5 per cent in 2016 from an estimated 6.9 per cent in 2015. Given the large weight of China in the GDP of the developing Asia-Pacific region – 40 per cent of the total – even a small change in its GDP growth estimates will result in a considerable impact on the region’s growth outlook.

Industrial production in China is slowing due to both external factors, such as sluggish demand from developed economies, and internal factors, such as restrained investment, including by State-owned enterprises and local governments that had borrowed heavily in recent years. Since investment accounts for a much larger share of GDP – 44 per cent – than exports, its slowdown is more important. Investment growth has slowed primarily in the large real estate sector, with previous construction activity having led
Table 1. Selected economies in the ESCAP region: rates of economic growth and inflation, 2014-2016

<table>
<thead>
<tr>
<th>(Percentage)</th>
<th>Average pre-crisis</th>
<th>Real GDP growth</th>
<th>Inflationb</th>
<th>Survey 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>East and North-East Asia1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timor-Leste</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East and North-East Asia (excluding Japan)2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macao, China</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mongolia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Republic of Korea</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North and Central Asia1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North and Central Asia (excluding Russian Federation)3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Armenia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Azerbaijan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Georgia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russian Federation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turkmenistan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uzbekistan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pacific4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cook Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kiribati</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marshall Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Micronesia (Federated States of)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Palau</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Samoa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solomon Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tuvalu</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vanuatu</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed countries (Australia and New Zealand)4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South and South-West Asia5,a</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Afghanistan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bhutan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iran (Islamic Republic of)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maldives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nepal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sri Lanka</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South-East Asiaa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brunei Darussalam</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cambodia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lao People's Democratic Republic</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Myanmar</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total ESCAP</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Note: A blank space indicates that the item is not applicable.

a Changes in the consumer price index.
b Estimates.
c Forecasts (as of 15 December 2015).
d GDP figures at market prices in 2010 United States dollars (at 2005 prices) are used as weights to calculate the subregional aggregates.
e The estimates and forecasts for countries relate to specific fiscal years; 2015 refers to fiscal years spanning: from 1 April 2015 to 31 March 2016 in India; from 21 March 2015 to 20 March 2016 in Afghanistan and the Islamic Republic of Iran; from 1 July 2014 to 30 June 2015 in Bangladesh, Bhutan and Pakistan; and from 16 July 2014 to 15 July 2015 in Nepal.

Average pre-crisis growth is not available for India due to rebasing of GDP data in 2014.

a Samoa is excluded from the calculation for 2014 onwards due to its graduation from the least developed country category.

h Developed ESCAP economies group consists of Australia, Japan, and New Zealand.
to high levels of supply; therefore, there is less need for new projects. Encouragingly, the Government has shown commitment by sticking to its stated aim of rebalancing the economy away from investment, even as GDP growth has slowed. Consumer spending continues to expand, as reflected in strong retail sales, despite downward adjustments in the real estate and equity markets in 2015.\textsuperscript{3} By sector, services are assuming a greater role, both in output and employment. The declining role of industrial production since mid-2014 may be observed in the trend in the industrial production index, and that of manufacturing in the purchasing managers’ index (PMI) (see figure 3). For example, the PMI for November 2015 was at its lowest level since August 2012.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure3.png}
\caption{Industrial production index and purchasing managers’ index for China, 2012-2015}
\end{figure}

Growth prospects of most economies are expected to be slightly better in 2016 as compared with 2015, provided the implementation of reform initiatives continues

The relatively improved economic outlook for 2016 as compared with 2015 for a number of economies is due mostly to domestic factors. For instance, growth for Viet Nam has been upgraded by 0.4 per cent for both 2015 and 2016. Viet Nam is forecast to grow at the robust rate of 6.6 per cent in 2016, up from 6.5 per cent in 2015. Low inflation led by lower food and fuel prices has enabled monetary policy to be accommodative and has spurred both consumption and investment on the back of higher lending by banks. Investment has also benefited from the relocation of low-cost labour-intensive manufacturing from China.

Meanwhile, the Russian Federation is forecast to experience a smaller contraction in growth in 2016 as compared with the forecast projection in Survey 2015, with an upgrading of 1.1 per cent. The economic growth rate of the Russian Federation is now projected at $-0.5$ per cent in 2016. The growth rate of the economy in 2015 was $-3.9$ per cent. A more stable oil price, albeit at low levels, is expected to contribute

\textsuperscript{3} Private consumption contributed 4.3 percentage points to GDP growth in the first half of 2015.
to a reduction in depreciation pressure on the currency and to contribute to a decline in inflationary pressures. Thus, it is anticipated that the monetary policy stance will be moderately eased and that banks, while remaining prudent, will be less adverse to providing loans to the real sector. Nevertheless, it should be noted that growth in the Russian Federation is still expected to contract in 2016, though much less than in 2015. The continued inability to achieve positive growth is due to the low oil price, which will have an adverse impact on exports as well as on government spending.

The continued contraction will also have an impact on poverty reduction in the Russian Federation. Thus, in the first 9 months of 2015, an additional 2.3 million people in that country fell into poverty, using the national poverty line of 9,662 rubles (about $140) per month as the designated benchmark. This increase was due largely to high inflation of more than 15 per cent, declining real wages and higher unemployment. The increase in the number of poor people means that the poverty rate, measured at the national poverty line, in the Russian Federation increased to 14.1 per cent of the population, or 20.3 million people, in the first 9 months of 2015, compared with 12.6 per cent registered during the same period of 2014. Lower growth in most other economies in North and Central Asia has also impacted on their labour markets, with higher rates of unemployment registered in 2015 in Armenia, Kazakhstan and Tajikistan, for instance. Tackling unemployment, particularly among the young, remains an important challenge in many countries in the region (see box 1).

The potential for even higher economic growth in some other major economies in the region has been held back due to slow progress in implementing reform policies. For instance, although India is expected to experience higher growth than China in 2015, this situation is due more to a change in the methodology of computing GDP in recent years rather than an increase in the growth rate. Indeed, instead of any significant acceleration, India is forecast to record growth that is largely unchanged from that recorded in 2014. The main reason is related to delays in implementation of reform policies proposed by the new administration. While the Government eased restrictions on foreign direct investment and introduced online government services to enhance the business environment, there have been delays in instituting some major reforms which had been expected. These include reform of land acquisition and labour laws and establishment of a nationwide goods and services tax, measures which were not enacted due to legislative hurdles and opposition from sections of the public. Implementation of such reforms can lead to significant growth acceleration in India.

Indonesia’s experience has not been much different from that of India in terms of slow implementation of reforms although there remains an expectation of better performance in 2016. The country is estimated to have recorded its slowest growth rate since the start of the global financial crisis, at 4.8 per cent in 2015. One important priority for the Government has been infrastructure investment, for which the budget was increased in 2015. However, a significant proportion of spending has been delayed due to regulatory and bureaucratic barriers. Investment began to improve in the second half of 2015, however, led by more public infrastructure outlays as well as private investments. This trend, together with lower inflation, is expected to lift GDP growth to 5.3 per cent in 2016.
Box 1. Youth unemployment rising in the wake of ongoing economic slowdown

Youth unemployment is a growing socioeconomic challenge in Asia and the Pacific, having increased by almost 5 per cent between 2011 and 2013 to the rate of 11.3 per cent, representing 33 million unemployed youth. Reasons for the rising youth unemployment include sluggish economic growth and technological advances requiring jobs to be shifted from one industry to another, as well as skill mismatches, for instance due to more youth getting tertiary education but not possessing the qualifications required for work in a changing labour market. Other concerns include greater labour market inequalities and longer and more insecure school-to-work transitions. Regionally, the female youth unemployment rate is 0.9 percentage points lower than the rate for males, yet females continue to be paid less than males for the same work.

Barriers to accessing the formal job market mean that most youth land precarious jobs, marked by low wages, poor working conditions and a lack of social protection. For example, in Cambodia informal employment accounts for 98.3 per cent of total youth employment, while the figures are 76.4 per cent in Viet Nam and 67.7 per cent in Samoa. Young adults not in employment, education or training (NEET) remain the most detached from the labour market and society. In 2014, the NEET rate for those aged 15–17 in the region was 11.4 per cent. Low youth labour force participation is caused by, among other factors, youth giving up looking for work due to repeated disappointment, a situation that is exacerbated by discrimination based on sociodemographic factors, such as age, sex, disability, religion and race.

In seeking productive employment opportunities and decent work, migration, either from rural to urban areas or even outward to another country, is a popular choice among youth. Migration can be a positive experience for youth, often contributing to better education and greater skills development. However, it can also enhance the risk of exploitation, abuse, social exclusion, adverse health issues, human trafficking and death, with variability in risk between the sexes. Female youth, for instance, are especially vulnerable to human trafficking for sexual exploitation, while male youth are susceptible to forced labour, including in the fishing industry.

Among subregions, in South and South-West Asia, social attitudes and norms tend to suppress the female labour force participation rate, especially in rural areas. In India, labour force participation rates for female youth are about 30 per cent in urban areas and a little under 20 per cent in rural areas. South and South-West Asia is also the most youthful subregion, having experienced a demographic transition characterized by falling fertility and mortality rates, an increasing number of youth and a lower share in the young- and old-age dependency groups. The growing proportion of the population in the economically productive age group represents an opportunity to be seized in order to support economic growth and foster inclusivity, thus improving overall well-being. In contrast, East and North-East Asia is ageing faster than other subregions, thus putting pressure on a shrinking youth population to shoulder future socioeconomic challenges, even though there may be opportunities for innovation. Evidence shows that investing in improved and secure job opportunities for young people, along with enhanced education, matters for economic growth. It can promote health and life satisfaction, prevent civil unrest and, as in the case of focusing on green jobs, engender environmental sustainability.

---

f In 2013, approximately one quarter (58 million) of the world’s international migrants were in Asia and the Pacific, of whom a quarter were persons younger than 29 years of age, and 48 per cent were females; they moved both South to North and South to South, according to the Regional Coordination Mechanism/United Nations Development Group Asia-Pacific Thematic Working Group on Youth, which met in Bangkok in 2015.
1.2 Trade prospects and commodity prices

Declining trends in global trade as well as China’s trade are driving the broader economic growth trends of the region

Given the export-oriented growth strategies of many economies in the region, economic growth prospects are broadly a reflection of trends in trade. Many exporting economies in the region are experiencing a significant slowdown in their export performance (see figure 4) due to lower demand from developed economies and from China. In fact, data on global trade in 2015 are expected to show the slowest expansion since 2009. In terms of developed economies, somewhat better growth in the United States is being offset by slow growth in the European Union and in Japan. China is being affected by weakness in the developed economies in the same manner as other regional economies. In October 2015, Chinese exports experienced a year-on-year contraction of 6.9 per cent, representing the fourth consecutive month of contraction. This situation has led to decreased demand from China for imports as there is less demand for intermediate inputs for processing in China before onward export to developed economies. China is also demanding fewer final goods from the region as the role of investment in the economy declines, a phenomenon that can be observed from data on monthly import contractions, which have been significantly higher than export contractions. This global scenario means that both global and regional trade is likely to remain weak for some time to come.

Since China is a major export destination for many regional economies, this gradual slowdown is posing a considerable challenge to the region’s economic growth. Amongst manufacturing economies in the region, China is the largest export market for Singapore, Taiwan Province of China, Thailand and the Republic of Korea, and the second largest market for Japan and Viet Nam. Exports of the Republic of Korea, Singapore and Thailand have contracted since July 2015 on a year-on-year basis. While an extraregional slowdown contributed to these contractions, slowing exports to China played an important role as well. For example in November 2015, exports from the Republic of Korea to China contracted by 6.8 per cent, while non-oil exports from Singapore contracted in the third quarter by 7.7 per cent.

Figure 4. Monthly export growth for selected Asia-Pacific economies, 2010-2015


---

Indeed, this is one key reason for the downward revision in growth estimates for many economies in 2015. For Thailand, economic growth estimates have been downgraded by 1.3 per cent for 2015 and by 0.5 per cent for 2016. Similarly, as compared with data contained in *Survey 2015*, growth estimates for Singapore and the Republic of Korea for 2015 have been reduced by 1.1 per cent and 0.8 per cent respectively, while forecast growth for 2016 has been reduced by 1.3 per cent and 0.8 per cent respectively. China is the largest trading partner for both countries, accounting for 25 per cent of the exports of the Republic of Korea and 13 per cent of the exports of Singapore. Similar downgrades in forecasts have also been made for other economies where exports play an important role, such as the Philippines and Malaysia.

*Lower international commodity prices are a reflection of the economic slowdown and are having a mixed impact on trade balances*

The slowdown in China has contributed to a decline in the global demand for commodities, which has had differing impacts on economies in the Asia-Pacific region. While the decline in oil prices – by more than 50 per cent since mid-2014 – has been most dramatic, leading to the lowest prices for Brent crude since 2009, there has also been a sustained downward trend in prices of other major commodities. In August 2015, the FAO Food Price Index\(^5\) stood at its lowest level since 2007, and the S&P GCSI Industrial Metals Index\(^6\) was at its lowest level since 2009; in October 2015, the benchmark Australian thermal coal price was at an eight-year low. Apart from slowing demand from China, another reason for the decline in oil prices is the increase in global supply due to shale oil production in the United States. Apart from the continuation of current supply and demand trends, a factor encouraging low oil prices for the near future is the lifting of sanctions on the production of oil by the Islamic Republic of Iran following the 2015 agreement on the country’s nuclear programme.

For commodity-importing countries, the positive impact on trade balances of lower commodity prices has been counteracted by the slowdown in export demand from developed economies and China. The ensuing negative effect on the trade balance of other economies in the region is reflected in the 6.2 per cent, or $117 billion, decline in a number of key Asian emerging market importers – Indonesia, Malaysia, Thailand, the Philippines, the Republic of Korea and Singapore – in the first half of 2015, with China accounting for 73 per cent of that total. For economies exporting manufactures while also importing commodities, the impact of China's slowdown has led to a lower advance in their trade balances despite the lower commodity prices, thus providing them with only a weaker boost to economic growth. This was the case with Singapore, the Philippines, Indonesia and Taiwan Province of China in the first half of 2015, where the decline in non-oil exports exceeded the decline in the value of oil imports, with the Republic of Korea being only slightly better off under this measure.\(^7\)

The economies most severely affected by lower commodity prices are exporters of commodities that are also exporters of manufactures, such as Malaysia. Such economies have experienced contraction in both oil and non-oil exports. Declining commodity prices have led to lower growth for commodity-exporting economies as corporate and government incomes have declined. Economies particularly affected have been the Russian Federation, a number of other North and Central Asian economies, Indonesia and Malaysia. For Indonesia, exports of thermal coal to China fell by 49 per cent year on year in the first half of 2015.\(^8\)

---

\(^5\) Updates are posted monthly and may be accessed from www.fao.org/worldfoodsituation/foodpricesindex/en/.

\(^6\) Formerly known as the Goldman Sachs Commodity Index (GSCI), it was transferred to Standard and Poor's (S&P) in 2007. Updates of the index are posted daily and may be accessed from http://us.spindices.com/index-family/commodities/sp-gsci.


1.3 Developments in domestic demand

Weak trade prospects highlight the need to focus on domestic demand as a primary source of economic growth

In the wake of weak export prospects, it will be even more important for the region’s developing economies to stimulate domestic demand as a source of economic growth. In a number of major developing economies, there is considerable potential for growth in domestic demand over a sustained period, as these economies benefit from favourable demographics in terms of younger populations, rapid urbanization and an expanding middle class. Rising incomes in such economies are reflected in increases in real wages in recent years. For example, monthly real wages in Indonesia increased by 13 per cent between 2013 and 2014,9 while those in Bangladesh increased by 7.5 per cent in 2013.10 This situation offers considerable potential for growth in private consumption. Furthermore, many economies in the region have large investment needs, which afford potential for growth in fixed investments. Increasing urbanization in the region is creating additional demand for infrastructure, with one estimate putting the infrastructure investment required to meet this need at more than $11 trillion over the next 15 years.11

Despite the considerable potential for domestic demand to contribute to economic growth in the region, the actual performance of domestic demand over recent years in many major developing economies has not been positive. For example, domestic consumption in Indonesia, Malaysia, the Russian Federation and Thailand has been on a downward trend between 2012 and 2014 (see figure 5). Malaysia and Thailand are examples of economies in the region which share the problem of high household debt, a factor which prevents domestic consumption from being more robust. High debt has arisen in a number of such economies due to an easy credit environment. In these cases, monetary policy as well as macroprudential measures to reduce household debt will be required for the long-term sustainable growth of consumption. For Indonesia and the Russian Federation, high inflation due to their falling currencies has had adverse

---

9 Indonesia, Central Bureau of Statistics.
impacts on consumption, a problem shared by other economies that have experienced significant currency depreciation. For such economies, resolving the factors underlying depreciation, through strengthening such macroeconomic fundamentals as trade and budget balances, will be important for promoting consumption.

The contribution to economic growth from fixed investment has also declined for several major developing economies in the region in recent years. One reason for this has been relatively high interest rates in some countries due to both inflation and the need to preserve capital inflows, factors which have hampered borrowing for investment. This has been the case, for example, in Indonesia and the Russian Federation (see figure 6) where there has been a declining trend in the contribution of fixed investment to economic growth between 2012 and 2014. In such cases, it will be necessary to improve macroeconomic fundamentals to allow for a more supportive monetary policy environment.

In other countries, such as Malaysia and Thailand, weak investment is linked to sluggish prospects for the leading export sector. For middle-income countries such as these, it will be necessary to take measures to boost productivity, as discussed later in the Update. The other major element of fixed investment which is a concern in the region is the lack of sufficient spending on infrastructure despite the enormous needs in many developing economies. This situation has been a major concern in Indonesia, for example, with the current administration having pledged to increase spending significantly. Apart from increasing the use of government resources, the factors which will need to be addressed to boost infrastructure spending, both by the Government and the private sector, is improvement in regulatory and governance structures which are clouding the investment climate.

Figure 6. Contributions of fixed investment to economic growth in selected Asia-Pacific economies, 2012-2014

1.4. Inflation, exchange rates and monetary policy

Consistent with slowing economic growth, inflation has declined in most economies in the region

Headline inflation in many economies has declined significantly due to lower international commodity prices as well as weaker economic activity. Consistent with revisions in the economic growth estimates for 2015, inflation estimates have also been revised downward, from 4.3 per cent earlier to 4.2 per cent now. Similarly, current ESCAP forecasts show that inflation is likely be at the low level of 4 per cent in 2016, which is considerably lower than the earlier forecast of 4.4 per cent published in Survey 2015. Among subregions, inflation outlooks diverge significantly, partly based on countries’ dependence on either importing or exporting commodities and partly due to the relative strength of domestic and external demand.

For instance, the East and North-East Asian subregion is forecast to continue to experience a very low inflation rate of 1.4 per cent (see figure 7), although it is somewhat higher compared to the estimated level of 1.1 per cent in 2015. South-East Asian and Pacific developing economies are also forecast to experience low rates of inflation, at 3.1 per cent and 4.3 per cent respectively, although both rates are somewhat higher than those of 2015. On the other hand, North and Central Asia is forecast to continue to experience a relatively high rate of inflation, at 8.7 per cent in 2016, although this rate is considerably lower than the rate of 14.3 per cent that had been expected in 2015. Commodity-exporting economies in the region have suffered from higher imported inflation due to depreciating exchange rates. South and South-West Asia is forecast to experience relatively high inflation by regional standards, 6.5 per cent in both 2015 and 2016, although inflation is lower than what had been observed in recent years. Large domestic-demand-led economies in the region continue to suffer from supply bottlenecks that prevent them from satisfying buoyant demand without price rises.

Of all the commodity prices, declining oil prices have helped the most in lowering headline inflation in oil-importing countries in the region. The decline in inflation has been less pronounced for economies that have capitalized on lower oil prices to reduce fuel subsidies. This policy, while being beneficial for the fiscal position of economies, has resulted in a decline in domestic fuel prices not feeding through.

Figure 7. Inflation rate for selected Asia-Pacific economies and for subregions, 2006-2016

completely to general prices. For example, in India, although global prices came down by 44 per cent since January 2013, retail prices in Mumbai only fell by 6.5 per cent. The outlook for inflation remains benign in the short term for commodity-importing economies as commodity prices are likely to remain weak and global growth subdued.

For commodity-exporting economies, there has been a sustained upward impact on inflation as a result of falling commodity prices. For example, inflation in the Russian Federation in 2015 is estimated to have been 15.7 per cent, up significantly from 7.8 per cent in the previous year. Similarly for Indonesia, inflation in 2015 is estimated to have increased to 6.6 per cent, up from the previous year and also higher than the estimate of 5.5 per cent published in Survey 2015. Lower commodity prices have had negative impacts on the trade balances of these commodity-exporting countries, by depreciating exchange rates and increasing the prices of imports. The effects of lower exchange rates have been exacerbated by portfolio capital outflows in response to growing current account and budget deficits in some of the economies affected.

Apart from the impact of commodity prices on inflation, core inflation trends also support the view of a generally benign inflation outlook for non-commodity-exporting countries. Core inflation and price changes for goods other than food and fuel have been on a generally downward trajectory over the past two years for most such economies. This is a reflection of slower growth in these economies, with lower demand pressure from both external and domestic sources. In countries with historically higher levels of inflation, such as economies in the South Asian subregion, the relatively tight monetary policy adopted by central banks in recent years has also contributed to keeping inflation low.

Currency depreciation has increased in the region, keeping inflation relatively high in some economies

A major economic development in 2015 has been the accelerating trend towards depreciating currencies across the region. This phenomenon has, however, been ongoing since 2013 (see figure 8). One reason

![Figure 8. Exchange rate indices in selected Asia-Pacific economies, 2013-2015](chart)


---

for the depreciations has been a general outflow of portfolio capital from the region’s economies. This situation has stemmed from the actual and anticipated divergence in the direction of growth and interest rate prospects of many of the region’s economies with those of the United States. The United States already increased its policy rate in December 2015. Another reason for the depreciations has been the willingness of Governments to allow for currency weakness due to concerns about export prospects. Indeed, some Governments have encouraged depreciation by decreasing interest rates as inflation concerns have receded. Another important economic development will be the inclusion of the Chinese Renminbi effective 1 October 2016 in the basket of currencies on which the special drawing rights – SDRs – of the International Monetary Fund (IMF) are based (see box 2).

Box 2. Inclusion of the Chinese Renminbi in the special drawing rights basket of currencies

Special drawing rights, or SDRs, were initially created by the International Monetary Fund (IMF) in 1969 to supplement the official international reserve assets of IMF member countries if a lack of global liquidity occurs because the country issuing primary reserves, the United States, has excess savings. The broader objective was to help member countries maintain fixed exchange rates under the Bretton Woods system. However, as more countries adopted a floating exchange rate regime and gained access to international capital markets, the need for SDRs declined. Also, the economy of the United States started running current account deficits which led to an excess of dollar liquidity, a problem SDRs were unable to solve. However, such a trend has been reversed somewhat in the wake of the global financial and economic crises that began in 2008.

As of November 2015, SDR 204.1 billion, equivalent to about $285 billion, had been allocated, which is still a very small amount relative to global reserves. Since such allocation is in proportion to IMF quotas, which are determined largely by the size of GDP, the majority of SDRs is being held by large economies. Moreover, any new allocations must be voted by member countries and passed with an 85 per cent majority. This essentially gives the United States veto power as it holds close to 17 per cent of the votes.

Based on a scheduled review of the composition of the SDR currency basket, IMF announced in December 2015 that the Chinese Renminbi will be included in the SDR currency basket, effective 1 October 2016. For inclusion, a currency must be considered freely usable and issued by a country whose exports of goods and services are sizeable. As a result of the inclusion, the composition of the SDR will be based on a basket of five currencies: the United States dollar, the euro, Chinese Renminbi, Japanese yen and pound sterling. The weight of these currencies in the basket, which reflects their relative importance in the global trading and financial systems, will be 41.73 per cent, 30.93 per cent, 10.92 per cent, 8.33 per cent and 8.09 per cent respectively. The direct impact on demand for the Renminbi as a result of this move will be to require reserve managers to buy about $29 billion of the currency, representing 10.92 per cent of the total SDR allocation of $285 billion. The sum itself, while large in absolute terms, is not a particularly large number for an economy of the size of China.

The inclusion of the Renminbi in the SDR basket is an acknowledgment by the international financial community of the effectiveness of the reform process of the financial system in China to make it more open and market-based. Recent reforms have included the removal in July 2015 of the need for international sovereign-linked institutions to gain approval to invest in onshore bond markets in China, the more market-based setting of the exchange rate since August 2015 and the liberalization of deposit interest rates in October 2015.

The inclusion in the basket also signals that reforms have been sufficiently comprehensive to elevate the Renminbi to the status of an international currency which is “freely usable” under the criteria of IMF. The move also serves to increase the representativeness of SDRs in reflecting the changing economic weights of countries in the global economy, with that of China having increased in comparison to other SDR countries. Furthermore, the volatility of SDRs may decrease as the Renminbi, being the only developing country currency in the basket, may have a different trajectory compared with the currencies of developed countries in the basket.

In terms of challenges, internationalization of the Renminbi will lead to some degree of loss of monetary control by the authorities. With capital account liberalization being one of the next steps in the reform process, it will also be important to monitor the impact on asset markets of likely capital outflows from the domestic market. In going forward, China will need to continue undertaking reforms to ensure: (a) deep, liquid and stable financial markets supported by open capital account and currency convertibility; and (b) sustained macroeconomic stability to ensure confidence in the Renminbi’s long-term purchasing power and its wide use in international private sector transactions.


The formula is based on exports, official holdings of foreign exchange, foreign exchange turnover, international bank liabilities and international debt securities.
The managed depreciation of the Chinese Renminbi in 2015 has also had important implications for currency movements in the region. The de facto depreciation of 4.4 per cent over three days in August 2015 – with the stated aim of allowing the currency to follow market forces more closely within its trading band – has encouraged competing exporting economies to allow further depreciations. A number of currencies subsequently weakened to reach multi-year lows. Managed currencies have also experienced significant falls in value. The tenge of Kazakhstan was floated in August 2015 and subsequently depreciated by one third against the United States dollar. The Vietnamese dong was devalued by the Government three times in 2015, and the trading band of the currency was widened in August 2015.

While currency depreciation is unlikely to stoke inflation in the current environment, it is also unlikely to assist growth significantly. Depreciating currencies have the potential to put upward pressure on inflation by increasing the price of imports, but this factor has been offset by weak economic growth and lower commodity prices. For example, the Philippine peso depreciated by more than 15 per cent since March 2013, but monthly year-on-year inflation in October 2015 stood at 0.3 per cent. Currency depreciations also pose risks to economies if those changes in value lead to a cycle of competitive devaluations. Competitive devaluations are not beneficial to economies as there is no net gain for any country and yet every country suffers a loss in export value and therefore in their export receipts.

Given the increasing importance of China as an export destination for countries in the region, the concern about depreciation of the Chinese currency possibly leading to pressure for competitive devaluations elsewhere needs to be re-evaluated. It may increasingly be the case that depreciation by China will not result in increased competition for exporters in the region, which may be due to the increasing integration of regional economies with that of China through production networks. As China is growing in importance as an export destination, the positive impact of depreciation by China for the country’s exports translates into increased demand for regional intermediate inputs. Furthermore, if economic growth in China is boosted as a result of depreciation, China’s demand for final goods from the region would also increase.

Most economies have lowered their policy rates, but lower interest rates and currency depreciations are unlikely to have the desired impact in current circumstances

As inflation concerns receded and export weaknesses came to the fore, a number of economies in the region lowered their policy rates in 2015. However, policy rates have become less supportive of economic growth in recent months as real interest rates have increased due to declining inflation in many commodity-importing economies. Economies vulnerable to capital outflows also sought to pre-empt the rise in the interest rate in the United States, which took place in December 2015, by increasing their interest rate differentials with that country. Countries which have lowered their rates include China, India, the Republic of Korea, Pakistan, Thailand and Turkey. India, for example, has reduced rates 4 times in 2015 by a total of 125 basis points to reach the lowest level in 4.5 years, that is, 6.75 per cent. Even in the case of some commodity-exporting economies, such as Indonesia and the Russian Federation, policy rates have been reduced to support growth, although inflation remains at relatively higher levels than in other economies. Nevertheless, in such countries, policy rates are still at relatively elevated levels, at 7.5 per cent for Indonesia and 11 per cent for the Russian Federation, and may not be able to support growth sufficiently.

In the current environment, monetary policy has not been very effective in supporting growth in many export-oriented economies because of the major role of declining export demand in GDP. Similarly, currency depreciation, partly due to lower interest rates, has also not had impacts on growth in view of the fact that competing economies have done the same. Furthermore, with interest rates already quite low in many economies, a further reduction is likely to have only a limited effect on increasing the rate of

---

borrowing. For example, in the Republic of Korea and Thailand, policy rates are now at 1.5 per cent. In view of the current ineffectiveness of monetary and exchange rate policies, fiscal policy potentially could play a greater role in stimulating growth in the economy, provided that fiscal and debt positions are strong.

Concern about capital outflows has also led to countries using non-monetary policy-related tools, including the spending of foreign exchange reserves, as well as macroprudential measures. In North and Central Asia, for example, countries have reacted to pressure on currencies and inflation by increasing reserve requirements for foreign currency deposits (Armenia and Tajikistan), higher provisioning for foreign currency lending (Kyrgyzstan) and tightening consumer and mortgage lending (Azerbaijan). In South-East Asia, Viet Nam reduced the upper limit of interest on United States dollar deposits, leading banks to reduce annual interest rates for corporate dollar deposits to 0 per cent from 0.25 per cent, while rates for individuals were reduced to 0.25 per cent from 0.75 per cent. Macroprudential measures can be an important part of the toolkit of policymakers as they enable capital outflow pressures to be moderated while still preserving some monetary policy independence. This factor is particularly important in a situation, as now, where the growth of many economies is sluggish and monetary policy could play an important role in supporting domestic demand.

1.5. Fiscal policy and reform initiatives

Most developing economies in the region have rightly used countercyclical fiscal policies

Given the gradually declining trend in economic growth in the developing economies in the region, countercyclical fiscal policy can play an important supporting role. Indeed, the stance of fiscal policy in the region in 2015 was largely countercyclical and expansionary. Roughly 40 per cent of economies had wider fiscal deficits or narrower surpluses along with slower GDP growth, while about 20 per cent of economies had improving fiscal balances along with faster GDP growth (see figure 9). Fiscal deficits, on average, are estimated to have widened in 2015 to levels last seen in 2009/10 (see figure 10).

Figure 9. Estimated percentage point changes in GDP growth and fiscal balance-to-GDP ratio in 2014/15


Note: Of 48 regional economies, 30 had a countercyclical fiscal stance (19 with a worsening fiscal balance and slower GDP growth, plus 11 with an improving fiscal balance and faster GDP growth). Not shown are economies with very large changes in fiscal balance-to-GDP ratios (Brunei Darussalam, Kiribati, Timor-Leste and Tuvalu, of which only Brunei Darussalam has a countercyclical stance).
A number of economies undertook significant fiscal spending programmes in 2015. Among the major economies, China took a proactive fiscal stance to counteract the economic growth slowdown emanating from weak external demand and investment decline. Measures introduced or expanded by China in 2015 include acceleration of major infrastructure projects and wider adoption of public-private partnerships as well as tax breaks and other relief measures for corporations.\textsuperscript{14} Government spending grew by an estimated 10 per cent in 2015, although actual fiscal support is likely to have been larger due to sizable off-budget activities.\textsuperscript{15,16}

In the aftermath of the outbreak of the Middle East Respiratory Syndrome, or MERS, the Republic of Korea passed a $13 billion supplementary budget in July 2015, about two thirds of which had been disbursed through September 2015. Under the proposed 2016 budget, it is foreseen that spending growth would be only 3 per cent annually; spending on job creation and social security is set to rise faster.\textsuperscript{17} Despite sharp revenue shortfalls due to lower international oil prices, the Russian Federation maintained an expansionary fiscal stance in 2015, with increased support for the manufacturing sector and higher social sector payments. Given the persistently lower oil prices, however, a medium-term consolidation seems inevitable. Other economies with expansionary fiscal stance include Fiji and the Philippines. Fiji’s expansionary fiscal stance in recent years was maintained in 2015 despite a shortfall in asset sales and a widening fiscal deficit. In the Philippines, government spending picked up in the second quarter of 2015 after half a year of slow budget disbursement due to a Supreme Court ruling. The proposed 2016 budget is targeted at achieving double-digit growth in education, health and infrastructure spending.\textsuperscript{18}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fiscal_balance Regional Average 2001-2016.png}
\caption{Fiscal balance, regional average, 2001-2016}
\end{figure}


\textit{Note:} The data reflect the average of 44 economies in Asia and the Pacific, excluding a few outliers with large standard deviations.

\textsuperscript{14} These measures were announced successively through the State Council and the Ministry of Finance in February, June and September 2015. In September alone, two railway projects with a total value of nearly $11 billion were approved by the National Development and Reform Commission. Such measures are partly offsetting or slowing the overall decline in industrial, real estate and construction activity.

\textsuperscript{15} Based on a statement by China at the IMF International Monetary and Financial Committee meeting, held in Lima on 9 and 10 October 2015. This is an estimated 10 per cent growth rate in expenditures compared with 7 per cent growth in revenues in nominal terms.

\textsuperscript{16} IMF has estimated a much wider fiscal deficit of 10 per cent of GDP in 2015 (compared with the official rate of 2.5 per cent) once social security expenses, transfers to the State-administered fund for State-owned enterprises, and adjustments for local government spending have been added. Some of these off-budget items are recorded as private credit. For instance, borrowing by local government financing vehicles show up in total social financing.

\textsuperscript{17} According to the Ministry of Strategy and Finance, the “2016 budget [is] planned to increase youth employment and support economic innovation”, 8 September 2015. Available from http://english.mosf.go.kr/pre/view.do?bcd=N0001&seq=3919&bPage=3.

\textsuperscript{18} According to “President Aquino’s message on the National Budget for Fiscal Year 2016”, 28 July 2015. Available from www.gov.ph/2015/07/28/president-aquino-budget-message-2016/. Spending on education, health and infrastructure is targeted to increase by 21, 38 and 29 per cent respectively.
Although most economies have adequate fiscal space, considerations to balance national development priorities and fiscal/debt sustainability remain important.

Different fiscal stances can be adopted by countries depending on their economic growth and debt profiles. Fiscal policy can play a role even in the context of faster economic growth, if the growth momentum is deemed fragile, such as in the case of Thailand, or conditional on being invested in areas of particular economic need, such as for infrastructure in India. Thailand introduced a $4 billion stimulus package in September 2015 that included soft loans for farmers, village projects and tax relief measures for small businesses. The Government has committed to faster budget disbursement in the future, including for infrastructure projects. Similarly, India saw the government spending-to-GDP ratio edge up in 2015, albeit in the context of ongoing deficit-reduction efforts. Capital expenditures were particularly strong, in line with the emphasis of the fiscal 2015/16 budget.\(^{19}\)

On the other hand, a countercyclical stance has been important for economies if GDP growth is relatively strong and driven by private demand while public debt is relatively high, as in the case of Malaysia. However, in the case of Pakistan, a wide fiscal deficit, despite somewhat stronger GDP growth, is due largely to low tax buoyancy and indicates the need to widen the tax base. In Mongolia, the decision to narrow the fiscal deficit through expenditure cuts in 2015 amidst severe economic slowdown was followed by years of rapid government expenditure growth during the commodity boom.\(^{20}\)

As Governments seek to increase development expenditures or cope with revenue shortfalls, the degree of fiscal space will determine the room they have for manoeuvring, especially with respect to public debt. Public debt levels remain relatively low in the region, although some countries seem to have persistently wide fiscal deficits, largely due to narrow tax bases (see figure 11). This group includes a number of

---

\(^{19}\) The budget allocated an additional 700 billion rupees, or $11 billion, on roads, railways, ports and other projects. Capital expenditure grew by 38 per cent from April to June (Q1 of fiscal year).

\(^{20}\) In local currency, general government total expenditures increased by more than 10 times in a decade, from 752 billion togrog in 2005 to 8,518 billion togrog in 2014, or from around 22 per cent of GDP to 39 per cent of GDP.
South Asian and South-East Asian economies that are trying to balance national development priorities and fiscal sustainability considerations. For these economies, undertaking reforms to improve their tax revenues is an important challenge.

On the whole, most countries appear to have adequate fiscal space to adopt a countercyclical and development-oriented fiscal position, including countries which have adopted fiscal rules, such as deficit ceilings. While there may be some country-specific economic reasons to consider pursuing fiscal austerity, it is important to recognize that there are no mechanical and universally accepted thresholds. A constant assessment, which incorporates country-specific features, is needed for fiscal policy to optimally respond to short- and long-term needs. In 2015, for instance, Indonesia and the Philippines widened their deficit targets slightly to accommodate higher spending on health and infrastructure.

Further fiscal space for social and infrastructure spending and thus long-term economic growth remains contingent upon tax and other reform initiatives

With the adoption of the 2030 Agenda, Governments will need to increase or reprioritize expenditures. In this vein, an important consideration, beyond stabilization, is the potential impact of fiscal policy on the distribution of income and opportunities and on long-term economic growth. In general, low levels of taxes and social spending limit the redistributive impact of fiscal policy in developing economies. Government programmes, such as conditional cash transfers and employment guarantee schemes, widely used in South Asia and South-East Asia, can provide targeted support for low-income households. At the same time, education and health expenditures could be scaled up, with attention given to access and affordability issues. Public expenditure on health in particular seems to be quite low in the region (see figure 12), given the still high incidence of child mortality in many countries and the demands arising in some cases as a result of population ageing. For long-term economic growth, adequate and efficient spending on education and infrastructure are particularly important. Moreover, given the long gestation periods and potential crowd-in effects, early investment is needed. Infrastructure investment in particular has gained increased attention in recent years, not least as a result of rapid urbanization.

Many Governments are taking measures to create more space for social and infrastructure spending, including fuel subsidy reforms. For instance, countries such as India, Indonesia and Malaysia took advantage of lower oil prices in 2015 and phased out fuel subsidies. Effectively channeling the savings from these reforms to infrastructure and other priorities can be challenging, however, due to differences in implementation capacities. For instance in Indonesia, only 11 per cent of the targeted capital expenditure

---

21 Countries in the region which have adopted fiscal rules include (adoption year): Australia (2009); Georgia (2013); India (2004, but abandoned in 2009); Indonesia (2004); Japan (2006); Malaysia (1980s); Maldives (2013); Mongolia (2013); New Zealand (1994); Pakistan (2005); Russian Federation (2013); Singapore (1980s); and Sri Lanka (2003).

22 There are different types of fiscal rules. In order to allow sufficient flexibility to pursue countercyclical fiscal policy, it is generally recommended that fiscal rules, if adopted, be based on structural fiscal balance figures, as in the case of Chile, Germany and Mongolia. At the same time, there are some scholars who question the value of fiscal rules at all. For a review, see Anis Chowdhury and Iyvaniatul Islam, “Fiscal rules – help or hindrance?” Vox CEPR's Policy Portal. Available from www.voxeu.org/debates/commentaries/fiscal-rules-help-or-hindrance.


24 Also referred to as “human and physical capital” in the economic literature, including growth-accounting studies.

25 Crowd-in effect may include greater private investment from skilled labour and efficient public infrastructure.

was disbursed in the first half of 2015. Nevertheless, thanks to such reforms, Indonesia’s proposed 2016 budget contains ambitious measures to double the number of households covered by conditional cash transfers and to increase spending on health by 40 per cent.27

More Governments have experienced revenue shortfalls in 2015 compared with 2014 owing to weaker domestic activity, wider tax incentives and earlier tax cuts (some of which were introduced in response to the global financial crisis and kept in place after it was over), and lower natural resource revenues.28 In particular, countries with a large share of natural resource revenues (see figure 13) have been undergoing...
severe adjustments from further declines in commodity prices in 2015 and the revised outlook for coming years, which in turn is affecting domestic investment activities and the general tax base. Non-commodity exporters, such as Pakistan and the Republic of Korea, are also experiencing shortfalls owing to weaker domestic activity or a narrower tax base.

Governments were engaged in various tax policy and administration reforms in 2015. China is introducing a value-added tax for the services sector and a national property tax, which is recurrent and based on market value. India is deliberating on a unified nationwide goods and services tax. Malaysia introduced a goods and services tax in April 2015 in order to broaden its tax base and rely less on revenue from resources. The Philippines is rationalizing redundant tax incentives and exemptions while strengthening tax administration. Thailand plans to introduce an inheritance tax in early 2016. With a view to lower compliance costs, Fiji has introduced self-assessment, and Azerbaijan launched online filing and payment systems. At the international level, the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, adopted in July 2015 and endorsed by the United Nations, calls for strengthening revenue administration through modernized, progressive tax systems, tackling non-compliance and scaling up international tax cooperation.

Structural reforms are under way in a range of economies in order to boost private consumption, investment and employment generation, among other aims. China continues to be prominent in the region in undertaking economic reforms to improve development potential. Since late 2013, China has been opening up more sectors to private investment, including railways and small financial institutions, while streamlining administrative requirements, such as the registration and licensing of firms. Despite expectations of expedient implementation by new administrations, the major economies of India and Indonesia have already undertaken a number of significant economic reforms. In India, the Government has had considerable success in improving financial inclusion, which will help to spur domestic consumption. In the case of Indonesia, there have been a number of reforms aimed at improving the climate for business. For instance, in September 2015 it was announced that new companies making a minimum investment of about $70 million in “pioneer” industries, including energy, telecommunications, maritime transport and agricultural processing, would receive tax cuts of between 10 and 100 per cent for up to 15 years. Such measures, however, erode the tax base and should be used only sparingly.

To enhance efficiency, Viet Nam has been privatizing a number of State-owned enterprises. The Government of the Republic of Korea is pushing to liberalize key service industries, including healthcare. Kazakhstan set aside $2.8 billion to capitalize its problem loan fund and launched other schemes to maintain financial market liquidity and financial access by small and medium-sized enterprises. To boost employment, a number of Governments of countries in the region are also trying to ease overly restrictive or burdensome labour market rules and practices. For example, in mid-2014 Turkey introduced a new national employment strategy to strengthen links between education and employment, and to balance security and flexibility in the labour market.

29 See General Assembly resolution 69/313, annex, paras. 20-34.
2. SELECTED ECONOMIC CHALLENGES AND POLICY CONSIDERATIONS

2.1. Rising private debt and coping with potentially higher financing costs

Financing costs for many developing economies in the region may increase as a result of the recent increase in interest rates in the United States

After several years of extraordinarily loose monetary policy in the United States, the policy interest rate was increased in December 2015, which was the first increase in almost a decade and may be a beginning of a new tightening cycle. In December 2015, the Federal Reserve estimated that the federal funds rate could rise from the current rate of virtually 0 to 3.3 per cent by the end of 2018 (see figure 14). Consequently, part of the foreign funds that have been invested in Asia-Pacific economies in search of higher yields would likely be withdrawn from the region.

Figure 14. Asia-Pacific policy rate and United States federal funds rate, 2005-2018

Whether domestic interest rates in Asia-Pacific economies will increase accordingly depends on several country-specific factors. For instance, countries that have fixed exchange rate regimes will be more likely to raise rates compared with those that are pursuing flexible exchange rates or are willing to depreciate their currencies. Furthermore, rate hikes may not be needed if: (a) currency depreciation is expected to boost exports but is unlikely to raise external account vulnerability through higher external debt burden; and (b) lower asset prices are not expected to undermine private consumption and increase the risk of financial instability through rising loan defaults. Similarly, in countries that are effectively pursuing macroprudential and capital flow management measures, the risk of capital outflow and thus the likelihood of raising domestic interest rate would be smaller.30

Household and corporate debt has risen rapidly in some economies, which may have adverse implications in the wake of likely increases in the region’s interest rates

Nevertheless, the vulnerability of economies to higher interest rates has increased considerably in recent years, especially when the rapid increase in household and corporate debt is taken into account. Since the global financial crisis and partly as a result of expansionary and liquidity-generating policies pursued

Sources: ESCAP, based on CEIC Data and the United States Federal Reserve.

---

30 Xuehui Han and Shang-Jin Wei, “Policy choices and resilience to international monetary shocks”, presentation made at the Asian Development Bank in Manila on 14 June 2015. Published article of same title is available from www.tandfonline.com/doi/pdf/10.1080/1226508X.2014.982297.
by major advanced economies, household and corporate debt has grown rapidly in many Asia-Pacific countries, even as sovereign debt has remained relatively stable (see figure 15). Based on data from the Bank for International Settlements, non-financial private debt, as a share of GDP, surged some 75 percentage points in China and 30-37 percentage points in Malaysia, the Republic of Korea, Thailand and Turkey between 2007 and 2014. In all these economies, except for the Republic of Korea, growth of loans extended to households and businesses relative to GDP accelerated in the years following the start of the global financial crisis in 2008.

Such rapid credit creation took place through various channels, such as domestic and cross-border loans and issuance of corporate bonds. Domestic banks provided the bulk of the total credit while non-bank financial institutions, or the “shadow banking” sector, also played a prominent role in countries such as China. In addition, owing to relatively easy global liquidity conditions, reliance on cross-border financing has risen in several economies in the region. For example, in Malaysia, Thailand and Turkey, the size of cross-border funding is more than 30 per cent that of GDP. Finally, as a result of regional initiatives to develop local currency bond markets, corporate bond issuance also expanded rapidly. While corporate bonds have helped to curb currency and maturity mismatches, vulnerabilities remain, particularly in countries where the domestic institutional investor base is small.

While it is a common tendency for household debt to increase with rising income levels, the rapid pace in the growth of such debt in some economies raises concerns. Higher interest rates will raise the debt burden, thus weakening the repayment ability of existing borrowers while discouraging new consumer credits. Among developing Asia-Pacific economies with available data, household debt levels are rather high in Hong Kong, China; Malaysia; the Republic of Korea; Singapore; Taiwan Province of China; and Thailand, with household debt-to-GDP ratios having ranged between 61 and 88 per cent in 2014. In Malaysia and Thailand, a disproportionate amount of debt is held by households with low capacity to service that debt; much of household assets and debt is tied to the real estate sector, which makes households vulnerable to fluctuations in housing prices. More broadly, the impact of large household debt on the overall economy could be noteworthy when private consumption accounts for a large share of GDP. Available data show that in Hong Kong, China; Malaysia; Taiwan Province of China; and Thailand, both the household debt-to-GDP ratio and the private consumption-to-GDP ratio exceed 50 per cent.

Figure 15. Household, corporate and sovereign debt, 2014

Sources: ESCAP, based on data from the Bank for International Settlements, International Monetary Fund, CEIC Data, and World Bank (accessed on 2 September 2015).

Note: Numbers in the bottom row indicate change in indebtedness since 2007 (in percentage points). Number in the first row indicates change in private debt and the second row change in government debt. Debt held by financial institutions are not included.
As is the case with household debt, corporate debt has increased at a rapid pace. In addition to its level and trajectory, there are concerns over the sectoral composition of corporate debt and its distribution over companies with varying capacities to service their debt. A recent study revealed that the business sectors in India and Indonesia are more leveraged than others, with the debt-to-equity ratios in 2012 being at about 260 per cent and 300 per cent respectively. This situation represents a steep increase relative to the level recorded in 2007 prior to the start of the global financial crisis. In China, the Philippines, the Republic of Korea and Viet Nam, the debt-to-equity ratio is lower but still relatively high at between 150 and 200 per cent. A more leveraged corporate sector may find it difficult to adjust to higher financing costs, although the strength of firms’ balance sheets, which determines their ability to repay, is also shaped by other country-specific factors.

In addition to increasing borrowing costs, the rate hike recently announced by the United States Federal Reserve may affect firms through the exchange rate channel. Currencies in the region may face sharp depreciation after the rate hike announcement as a result of capital outflows. In this regard, economies particularly at risk are those whose short-term external liability as a share of foreign exchange reserves is relatively large, including India, Indonesia and Malaysia. Similarly, countries with large private external debts and low export earnings are more at risk. In such economies, the debt burden in the local currency will increase but more competitive export prices will benefit overall economic growth to a limited extent. Available data show that in Mongolia the private, external, non-guaranteed debt-to-GDP ratio is higher than the export of goods and services-to-GDP ratio by more than 60 percentage points.

Higher borrowing costs may also have an impact on non-financial corporations through access to finance by smaller enterprises. In economies where small and medium-sized enterprises are already faced with constrained access to credit, tighter domestic financial liquidity conditions could lead to even more stringent bank lending standards and further dampen their access to finance. Available data show that in Afghanistan, Azerbaijan, Myanmar, Pakistan and Tajikistan, less than 15 per cent of all small and medium-sized firms have outstanding loans or lines of credit.

A prudent fiscal and monetary policy stance is needed to cope with vulnerabilities associated with rising private debt and likely increases in interest rates in the region

So far, the analysis has suggested that economies, such as Hong Kong, China; Malaysia; the Republic of Korea; Thailand; and Turkey, are more exposed to higher borrowing costs than other Asia-Pacific economies. In these economies, credit growth has generally been rapid in recent years; household debt levels are high despite the important role of consumer spending in driving economic growth. Reliance on cross-border funds, which could be partly withdrawn amid tighter global financial liquidity conditions, has increased. For these five economies, adequate fiscal and monetary policy space would help them to maintain macroeconomic and financial stability, thus contributing towards steady economic growth.

On the fiscal side, public debt sustainability analysis suggests that all economies considered here have reasonable fiscal space to cope with adverse shocks. The risk of public debt distress is relatively low. Public debt levels should remain manageable under various shock scenarios, including higher real interest rates. Nonetheless, for Malaysia and Thailand, the analysis points to the sensitivity of the public debt profile to contingent liabilities in view of both countries’ high credit-to-GDP ratio. These liabilities are explicit or implicit guarantees given to, for example, the banking system in the event of bankruptcy in order to restore public confidence. In Turkey, the exercise highlights the large external financing requirements that are associated with high external debt.

32 This exercise is carried out by the International Monetary Fund; the results are typically published as part of IMF Article IV country reports.
On the monetary side, a key question is whether the previously mentioned five economies will be able to maintain their domestic interest rates at low levels following the recent announcement by the United States of higher interest rates. Interest rates may be kept low if projected near-term economic growth is below the past trend or an official target, the inflation outlook is benign and further currency depreciation is not expected to increase pressure significantly on external account stability and/or inflation. Other considerations are the risk of financial instability in the event of sudden capital outflows, the availability and effectiveness of capital flow management and macroprudential measures, and whether currency depreciation recorded in the past several quarters has helped to boost merchandise exports and tourism revenue.

Based on these criteria, the monetary policy space appears mixed. In Malaysia, the Republic of Korea and Thailand, inflation in 2016/17 is expected to remain low relative to the past trend. In contrast, although Turkey's inflation outlook has improved, the price increase is still estimated to be close to 6 per cent during 2016/17. In terms of room for further currency depreciation and its impact on external account vulnerability, Malaysia and Turkey appear to be in a more constrained situation. Both countries have experienced much higher external debt-to-GDP ratios since the global financial crisis began, with external debt in 2014 having been measured at 68 and 50 per cent of GDP respectively. In Malaysia, close to half of this proportion is short-term debt, while it is one third in Turkey. In addition to high debt, the currencies of Malaysia and Turkey faced steep depreciation of 22 and 28 per cent respectively in the first three quarters of 2015, which will further push up the external debt burden in local currencies. On the other hand, the boosting impact of a weaker exchange rate on goods exports is not clear. While Malaysia's exports resumed positive growth in mid-2015, Turkey's exports continued to decline.

Overall, the key message is that the Asia-Pacific region as a whole should be able to endure higher financing costs in coming years. However, two important caveats are worth highlighting. First, owing to the limited availability of data, several least developed countries and small Pacific island developing economies were not covered in the analysis. However, these are precisely the economies that tend to be more exposed to higher interest rates because they rely heavily on foreign capital to finance their investment needs. Second, higher borrowing costs are only one of the headwinds facing developing economies in the near term. Other developments are lower commodity prices and weaker demand and exchange rates in China, which could dampen growth prospects in economies that are already exposed to higher financing costs.

Rapid increases in private debt also pose risks for financial stability and economic growth prospects, reinforcing the need for effective supervision and regulation of the financial sector

In going forward, there is a higher risk of problems related to financial stability because, as debt levels increase, borrowers’ ability to repay becomes more sensitive to drops in income and sales and increases in interest rates. Stability concerns would be mitigated if borrowers and lenders have adequate buffers, for instance household deposits and other financial assets, corporate cash holdings, and bank capital and

34 As Hong Kong, China has a different monetary policy strategy (i.e. a currency board with fixed exchange rate against the United States dollar), it is not covered here.

35 For example, the average current account deficits during the period 2012-2014 amounted to 15-34 per cent of GDP in Afghanistan, Kyrgyzstan, Mongolia and Papua New Guinea. These economies typically have shadow financial markets, a weak regulatory framework and poor macroeconomic fundamentals, which limit their ability to cope with adverse shocks.

36 For example, studies show that export products in Hong Kong, China; Malaysia; the Republic of Korea; and Thailand are similar to those in China, so their export performance will likely be dampened by the weaker Chinese yuan. For more details, see an analysis on the export similarity index in Nagwa Riad and others, ‘Changing patterns of global trade’, Departmental Paper, No. 12/1, Strategy, Policy, and Review Department, International Monetary Fund (Washington, D.C., 2012). Note however that some sectors in these economies may also benefit from the currency depreciation in China if they are part of China’s production networks.

liquidity. Inspection of data as of mid-2015 suggests that banks in the Asia-Pacific region are generally well capitalized, with regulatory capital ranging from about 13 per cent of risk-weighted assets in China, Kazakhstan, Nepal, the Russian Federation and Taiwan Province of China to up to 21 per cent of assets in Indonesia and Kyrgyzstan. However, financial instability risk is greater in the non-bank sectors, as those sectors typically cater to poorer and riskier borrowers and are less regulated than the banking sectors, which suggests that appropriate supervisory and regulatory measures are needed.

Rising private debt also has significant implications for future economic growth. Typically, financial booms go hand in hand with significant resource misallocations, with a damaging effect on productivity growth. While it is too early to say whether this was the case, given that the region’s stock of physical capital is still fairly low, it seems that at least some of the credit-driven investments in housing and infrastructure were not wasted and would ultimately result in higher productivity. The immediate growth outlook is somewhat more subdued as household and corporate deleveraging affects private consumption and investment and dampens domestic demand. However, the case is less clear for corporate debt, as the causes behind the recent build-up are not yet fully understood. For instance, low interest rates may have increased the attractiveness of debt finance relative to equity, or encouraged firms to build cash buffers for future investments.

While the accumulation of private debt has slowed somewhat since 2014, output growth has also eased in many economies. This situation poses a challenge for policymakers in terms of balancing the objectives of achieving economic growth and financial stability. For instance, while macroprudential and other measures to rein in debt are generally recommended, at a time when corporates are struggling with lower sales growth and households face lower income growth, abrupt tightening measures could further push up debt-service ratios (see figure 16) or limit funding and refinancing options, eventually increasing the risk or probability of default. It is recommended therefore that countries take phased yet comprehensive measures to address debt-related risks. Such measures may include better monitoring of private debt, targeted macroprudential policies, greater public disclosure and reporting of corporate balance sheets, and restructuring of State-owned enterprises. Governments should also be prepared to intervene if the need arises.

Figure 16. Debt service ratios for the private non-financial sector, 2007 and 2015

Source: Bank for International Settlements.

Note: Debt service ratio reflects the share of income used to service debt. 2015 = average Q2:2014−Q1:2015

38 For example, while stress tests on banking capital adequacy in the Republic of Korea yielded favourable results, the tests showed that capital adequacy of the non-bank sectors would fall short of the requirement if the default loan ratios were to increase by 6-8 percentage points. For more details, see International Monetary Fund, “Republic of Korea: Financial Sector Assessment Program – stress testing and financial stability analysis – technical note”, IMF Country Report, No.15/6 (Washington, D.C., 2015). Available from www.imf.org/external/pubs/ft/scr/2015/cr1506.pdf.


2.2. Making growth more inclusive and strengthening productivity

Despite significant progress, economic growth has not been inclusive in the region and serious development challenges remain to be addressed

The Asia-Pacific region made tremendous progress towards achieving the Millennium Development Goals before the 2015 deadline, but significant development challenges still remain. With millions of people having been lifted out of extreme poverty, the region reached the first target of the Millennium Development Goals of halving by 2015 the proportion of people whose income is less than $1 a day.41 However, the region is still home to two thirds of the world’s extremely poor. Moreover, the region still faces unfinished development in the areas of health, education, gender equality, decent employment and access to safe sanitation and drinking water. For instance, an estimated 21 million children are not enrolled in primary school, and 1 in 5 children under age 5, representing 75 million children in total, are underweight. A staggering 1.7 billion people still lack access to safe sanitation.42 Such statistics suggest that development has not always been sufficiently inclusive despite the success of the region as a whole in increasing its economic growth rate.

As a multidimensional concept that spans the economic, social and environmental dimensions of development, inclusiveness cannot be easily expressed by considering only individual development indicators that relate to any of the three dimensions individually. In attempting to overcome this difficulty, in the Survey 2015 16 countries, which accounted for 92 per cent of the region’s population and 88 per cent of its GDP, were ranked by presenting them in a composite index of 15 indicators across the three dimensions of development – economic, social and environment (see table 2).

Closer inspection of these indicators reveals that the development gains have often been unevenly spread throughout the region. For instance, although the region is responsible for 52 per cent of global greenhouse gas emissions and is home to 6 out of the 10 top emitters in the world (see box 3), 40 per cent of the approximately 4 billion people in the region rely mainly on traditional biomass for their cooking and heating needs while nearly 1 billion people lack electricity. Moreover, while women and rural people are usually worse off than men and urban people, there are also significant differences in people’s access to critical public goods, such as education and health services, across income quintiles. Thus, despite

### Table 2. ESCAP scores (and ranking) of inclusiveness index, 1990s and 2000-2012

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>0.54 (12)</td>
<td>0.6 (12)</td>
<td>Nepal</td>
<td>0.48 (15)</td>
<td>0.6 (13)</td>
</tr>
<tr>
<td>Cambodia</td>
<td>0.51 (14)</td>
<td>0.56 (15)</td>
<td>Pakistan</td>
<td>0.46 (16)</td>
<td>0.55 (16)</td>
</tr>
<tr>
<td>China</td>
<td>0.65 (10)</td>
<td>0.73 (7)</td>
<td>Philippines</td>
<td>0.66 (7)</td>
<td>0.7 (10)</td>
</tr>
<tr>
<td>India</td>
<td>0.53 (13)</td>
<td>0.6 (14)</td>
<td>Russian Federation</td>
<td>0.77 (2)</td>
<td>0.8 (2)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.58 (11)</td>
<td>0.68 (11)</td>
<td>Sri Lanka</td>
<td>0.71 (6)</td>
<td>0.77 (5)</td>
</tr>
<tr>
<td>Iran (Islamic Republic of)</td>
<td>0.66 (8)</td>
<td>0.73 (6)</td>
<td>Tajikistan</td>
<td>0.72 (5)</td>
<td>0.73 (8)</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>0.8 (1)</td>
<td>0.82 (1)</td>
<td>Thailand</td>
<td>0.73 (3)</td>
<td>0.79 (3)</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.72 (4)</td>
<td>0.78 (4)</td>
<td>Turkey</td>
<td>0.65 (9)</td>
<td>0.72 (9)</td>
</tr>
</tbody>
</table>

Source: ESCAP, Economic and Social Survey of Asia and the Pacific (Bangkok, 2015).

Note: Scores between 0 and 1, where higher scores are associated with more inclusiveness. Number in brackets refers to ranking out of 16 countries with available data.

41 Since the adoption of the Millennium Declaration in 2000, the lines of extreme poverty were updated in 2008 to $1.25 a day measured at 2005 international prices adjusted for purchasing power parity (PPP). In October 2015 the poverty line was adjusted to $1.9 a day at 2011 international prices adjusted for PPP.

Despite the recent slowdown in economic growth, high economic growth in the Asia-Pacific region over recent decades has resulted in increasing demand for energy. By 2030 energy consumption in the region is expected to have doubled. The current energy mix in the region is dominated by fossil fuels, such as coal, gas and oil, which provide 85 per cent of the primary energy supply. However, the imperative to address the issue of climate change, now backed by the framework of the Paris Agreement to restrict global warming to less than 2 degrees Celsius, requires that all countries adopt low carbon development paths. Doing so will require technological innovation, new infrastructure, changes to consumer behaviour and supportive, long-term policy frameworks.

The global centre of gravity is shifting increasingly to Asia, in terms of economic activity, population, urban growth, trade and innovation. This region is responsible for 52 per cent of global greenhouse gas (GHG) emissions and is home to 6 of the 10 top emitters of GHG in the world. Therefore, the progress of the Asia-Pacific region in this transition will have wider global implications.

Energy use is responsible for more than 73 per cent of GHG emissions in the Asia-Pacific region. Accordingly in the process of “decarbonizing” the energy sector, the focus of national efforts must be on reduction of emissions in line with each country’s pledge through the intended nationally determined contributions, or INDCs, submitted as part of the Paris Agreement. Addressing emissions from the production or use of energy in the face of continued economic growth requires three basic strategies: (a) reducing the energy consumption per unit of GDP; (b) switching fuels to lower carbon intensity sources, such as gas; and (c) greater use of renewable energy resources. Elements of these strategies can include expanding the use of renewable energy sources, adopting more energy-efficient buildings, vehicles and manufacturing processes, changing consumer behaviour, using smart grids and switching from the burning of coal to gas.

Many of these strategies produce benefits which are additional to mitigating climate change. For instance, reducing fossil fuel use through different approaches can ameliorate air pollution, which is adversely affecting people’s health and disrupting daily life in many Asia-Pacific urban centres. Greater energy efficiency can enhance productivity for industry and reduce costs for households. The expansion of renewable energy use can offset imported energy in many countries, leading to greater energy security and an improved balance of payments position. Many of the renewable energy technologies play an important role in rural electrification, bringing the benefits of modern energy to the rural poor.

Technological advances and scale-up in renewable energy technologies have led to “learning curve” cost reductions in such technologies as solar, wind and energy storage. According to Deutsche Bank AG, the cost of solar photovoltaic systems has declined by 15 per cent annually for the past 8 years, with a further 40 per cent reduction expected over the next 4-5 years. The proliferation of these technologies will play an important role in meeting the growing energy demand of many Asia-Pacific countries, particularly the developing countries with high-quality solar and wind resources.

Transition in energy systems and the underlying policy and governance structures is critical, but the approach will vary depending on national circumstances, including geography, resource endowments, trade, subregional dynamics and financing capacities. Each country will have to manage competing factors, such as energy security, balance of trade and improving access to more than 1.3 billion people globally who lack access to electricity: while decarbonizing the energy mix in order to address the targets established under INDCs.

The energy transition is already under way in many countries throughout the region. For example, China is promoting the efficiency of materials and energy, and increased use of hydropower, solar and wind energy. In both 2014 and 2015 coal consumption declined suggesting that peak coal use has already passed and a phase of structural decline has commenced. China’s plan to commence a national emissions trading scheme in 2017 will provide long-term price signals for a shift to low carbon energy. Globally, clean energy investments – including renewable energy and energy efficiency – totalled $310 billion in value in 2014, growing fivefold in the past decade. The Asia-Pacific region accounts for 50 per cent of this total and its growth rate in clean technology investment outstripped that of other regions. Moreover, investment in renewable energy generation now exceeds investment in fossil fuel generation, with this gap set to widen following the adoption of the Paris Agreement in 2015.

Continued progress in the regional energy transition will need to be driven by technological breakthroughs and supportive policies through incentives, competition, behaviour change and carbon pricing. There is no “one size fits all” prescription to address energy challenges. Each country will have to manage competing factors, such as energy security, balance of trade and improving energy access, while decarbonizing the energy sector in line with its INDC. South-South cooperation will play an enormous role in the region in transferring the capacities and technologies of the leading countries to the least developed countries.

a Adopted by the twenty-first session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, or COP21, which was held in Paris from 30 November to 12 December 2015.
having made significant progress in making access to primary education universal, more than half the children of secondary school age in several countries in the region are not enrolled in school. In Sri Lanka, for example, almost all children in the primary school age group are attending school, whereas educational opportunities available to children in Pakistan are few and largely determined by the economic circumstance of parents.43

Gender differences are also prevalent across income groups, with girls in the lowest income quintile in India, for example, receiving only about half the average 5.5 years of schooling for boys (although gender equality is reached in the highest income quintile). In Pakistan, girls in the lowest income quintile receive an average of less than a third of the 3.8 years of schooling for boys, although the gender gap decreases significantly (to less than 5 per cent) in the highest income quintile. Such differences are also observable in access to health services.

Declines in the share of labour income and total factor productivity growth have increased the challenges of reviving economic growth and meeting development needs

One reason for the uneven progress is that economic growth has not created enough decent jobs. In this regard, the development of small and medium-sized enterprises and rural industrialization is crucial for generating adequate livelihoods for the majority of people. In addition, significant increases in labour productivity have not always translated into commensurate increases in real wages in the region, to the extent that the share of wage income in output has declined in recent years for the region as a whole (see figure 17). This is a further cause for concern.

Differences in access to public services are particularly worrying in view of the widening income inequalities that have been observed in many countries, particularly the region’s more populous economies (Bangladesh, China, India and Indonesia). Moreover, the inequalities are worrying given that declines in

Figure 17. Labour income share in Asia and the Pacific, 1991-2011


43 In Pakistan, only 57.4 per cent of children from the lowest-income quintile attended primary school in 2007/08 compared with 93.2 per cent of those in the top quintile. Similarly, only 34.1 per cent of children from the lowest-income quintile attended secondary school compared with 83.2 per cent of those from the richest quintile.
Economic growth and in productivity have taken place in the developed and developing countries in the region in recent years. While total factor productivity of 18 developing Asia-Pacific economies grew at an average annual rate of 1.9 per cent per annum since the 1990s, annual total factor productivity growth declined from 2.8 per cent during the period 2000-2007 to 1.25 per cent during the period 2008-2013. The slowdown in the growth of total factor productivity and of labour productivity (see figure 18) can be explained partially by the impact of the global economic slowdown in the wake of the global financial and economic crises that started in 2008. Yet other factors also have played a role.

With developed countries in the Asia-Pacific region facing low economic growth, it is important that productivity growth be accelerated and that its benefits be passed on to the labour force. Doing so will foster more sustainable growth by strengthening domestic demand thereby reducing the reliance of the region on exporting to developed markets. Making economic growth more inclusive and fostering productivity requires public expenditure that promotes equality of opportunity. Moreover, broadening access to education and health services and strengthening social safety nets, for example, to strengthen productivity and make growth more inclusive, will enable the region to rebalance towards a more sustainable growth model and will assist countries in pursuing the 2030 Agenda for Sustainable Development.

---

44 These countries are: Armenia; China; Fiji; India; Indonesia; Iran (Islamic Republic of); Kazakhstan; Kyrgyzstan; Malaysia; Mongolia; Philippines; Republic of Korea; Russian Federation; Singapore; Sri Lanka; Tajikistan; Thailand; and Turkey.

---

Note: Data are for Armenia, Australia, China, Fiji, India, Indonesia, the Islamic Republic of Iran, Japan, Kazakhstan, Kyrgyzstan, Malaysia, Mongolia, New Zealand, the Philippines, the Republic of Korea, the Russian Federation, Singapore, Sri Lanka, Tajikistan, Thailand and Turkey.
Developing economies of the Asia-Pacific region grew by an estimated 4.5 per cent in 2015, the lowest rate since 2010, with only a modest rebound to 5 per cent growth projected for 2016. While global trade and China’s economy explain much of the recent slowdown, there are also signs of weakening productivity growth in the region. Compared to the past, lower interest rates and exchange rate depreciations have had less noticeable impact on domestic activity and exports. Meanwhile, rapid increases in household and corporate debt in some countries pose risks for financial stability. At the same time, growth has not been sufficiently inclusive. This is a concern as robust and inclusive growth is important for creating jobs and improving broader development outcomes as envisioned in the 2030 Agenda for Sustainable Development.

The Year-end Update of ESCAP’s annual flagship publication, Economic and Social Survey of Asia and the Pacific, provides the latest macroeconomic forecasts, identifies emerging risks and challenges, and takes stock of fiscal, monetary and structural policy developments in the Asia-Pacific region. Against the recent slowdown, a key message is the need to reinvigorate domestic and regional sources of demand instead of relying primarily on external demand. This would entail rebalancing towards consumption in some cases and boosting investment in others, including in infrastructure. Given weakening and uneven productivity growth, the report calls for greater attention to small and medium-sized enterprises and the agricultural sector, the contribution of which to total value added is disproportionately small compared with their total employment share. In this vein, fiscal policy has a critical role to play.