



2018 Asia and Pacific Regional Economic Outlook

Good Times, Uncertain Times: A Time to Prepare

Outlook

Uncertainties

Policies

Asia and Pacific Department
May 9, 2018






Key Messages

1. The short-term outlook for Asia is strong, in line with expectations.
2. But the outlook is subject to considerable uncertainty.
3. In such a moment, policymaking should be conservative and aimed at building buffers and increasing resilience.

Outlook

Asia remains the world's fastest growing region...

Growth Projections: Selected Asia
(Percent change from a year earlier)

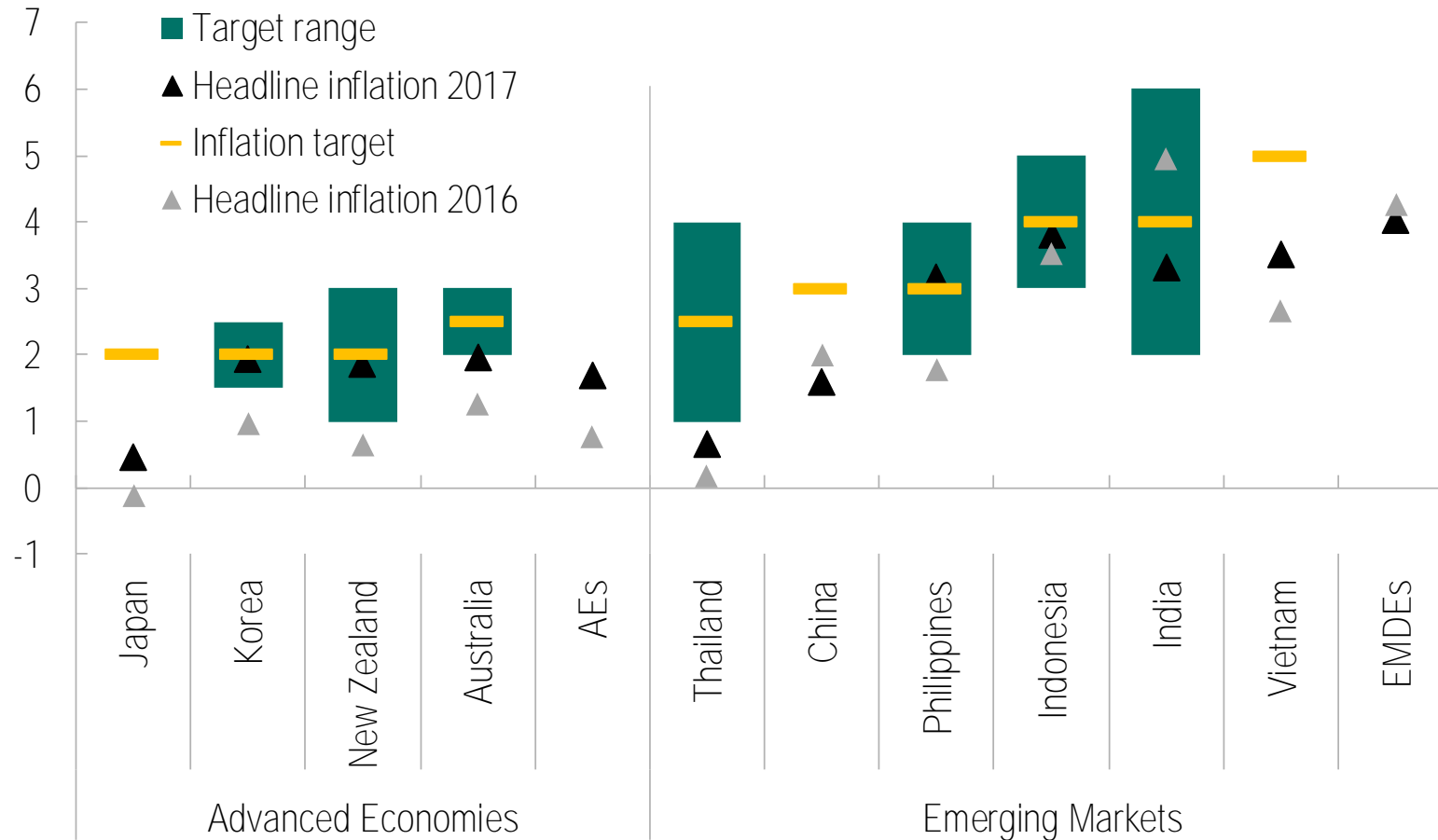
	World	 Asia	 China	 Japan	 India	 Korea	Australia and New Zealand	ASEAN	APD Small States
2017	3.8	5.7	6.9	1.7	6.7	3.1	2.4	5.3	3.0
2018	3.9	5.6	6.6	1.2	7.4	3.0	3.0	5.3	3.7
Revision from Oct. 2017	0.2	0.1	0.1	0.6	0.0	0.1	0.1	0.1	-0.7
2019	3.9	5.6	6.4	0.9	7.8	2.9	3.1	5.3	3.9
Revision from Oct. 2017	0.2	0.1	0.1	0.1	0.0	0.0	0.2	0.1	-0.8

Source: IMF staff.

Note: Figures for India are on a fiscal year basis.

...and inflation has been rising but subdued.

2017 Inflation Target versus Headline Inflation
(Percent)



Sources: Haver Analytics; and IMF staff calculations.

Note: Australia and New Zealand are based on quarterly data as of 2017:Q3.

Uncertainties

A moment of considerable uncertainty

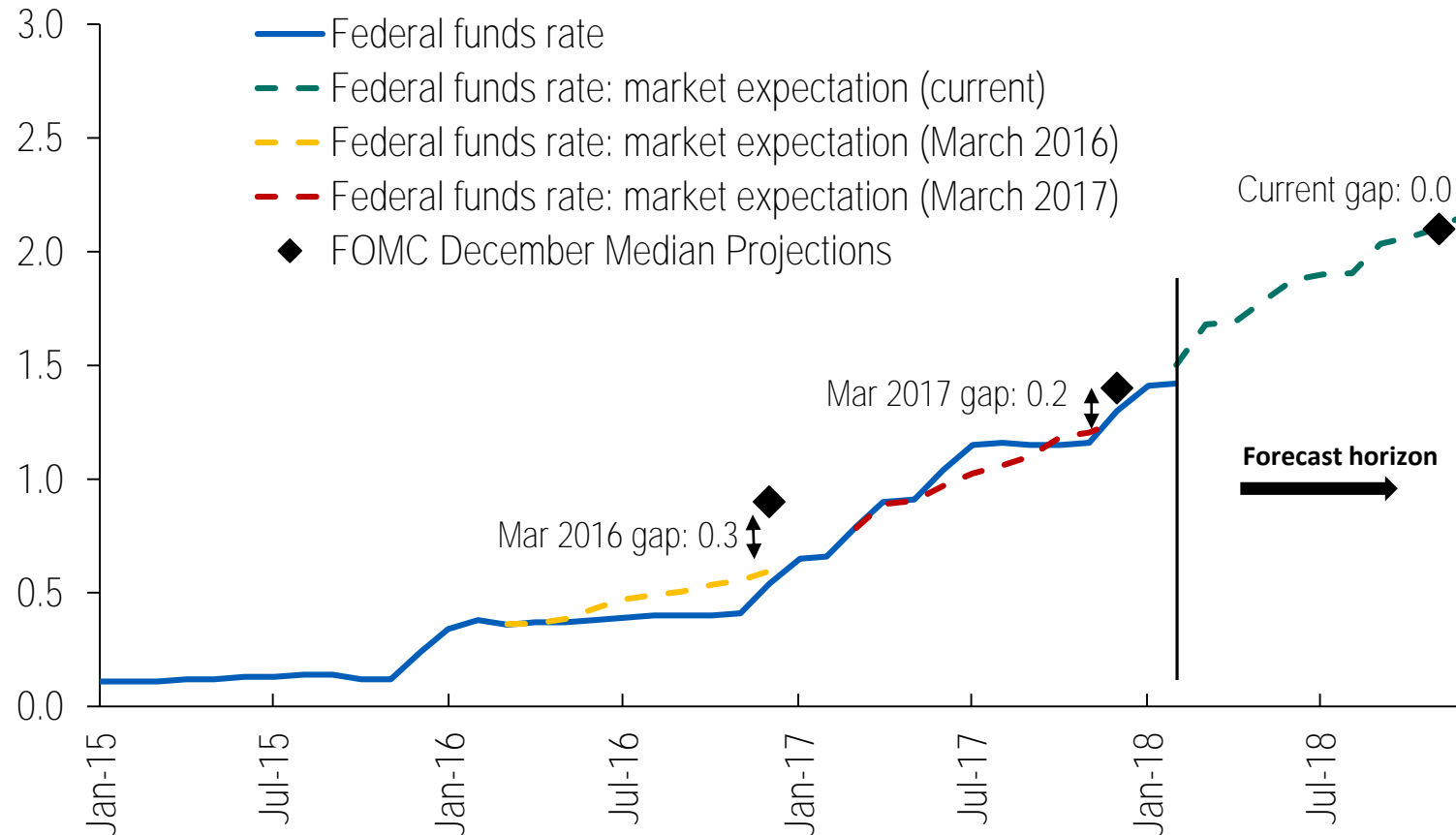
1. Monetary policy normalization
2. Prospects for trade
3. Spillovers from US tax reform
4. Other risks



Monetary Policies

The market is catching up to the dot plot, suggesting less risk of surprises...

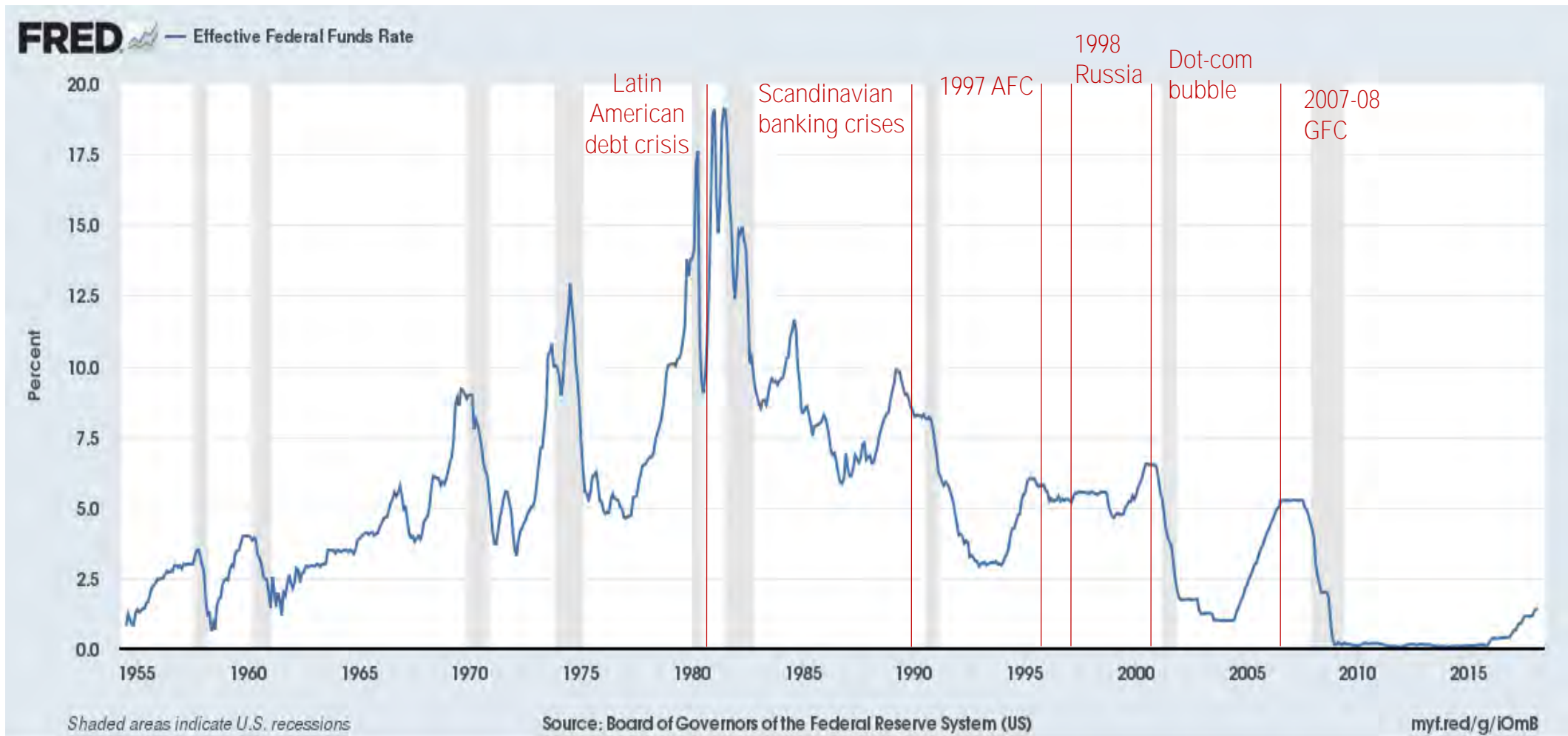
United States: Interest Rates



Source: Bloomberg L.P.

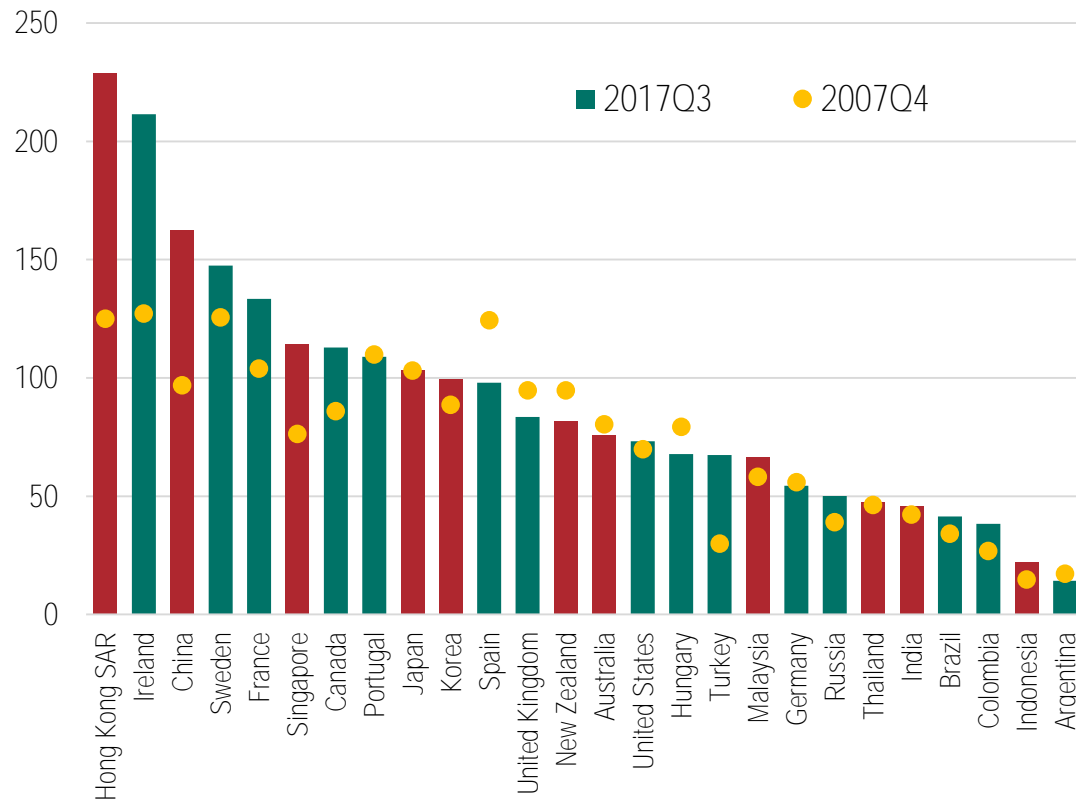
Note: FOMC = Federal Open Market Committee.

...but historically, market turmoil has often followed monetary normalization...



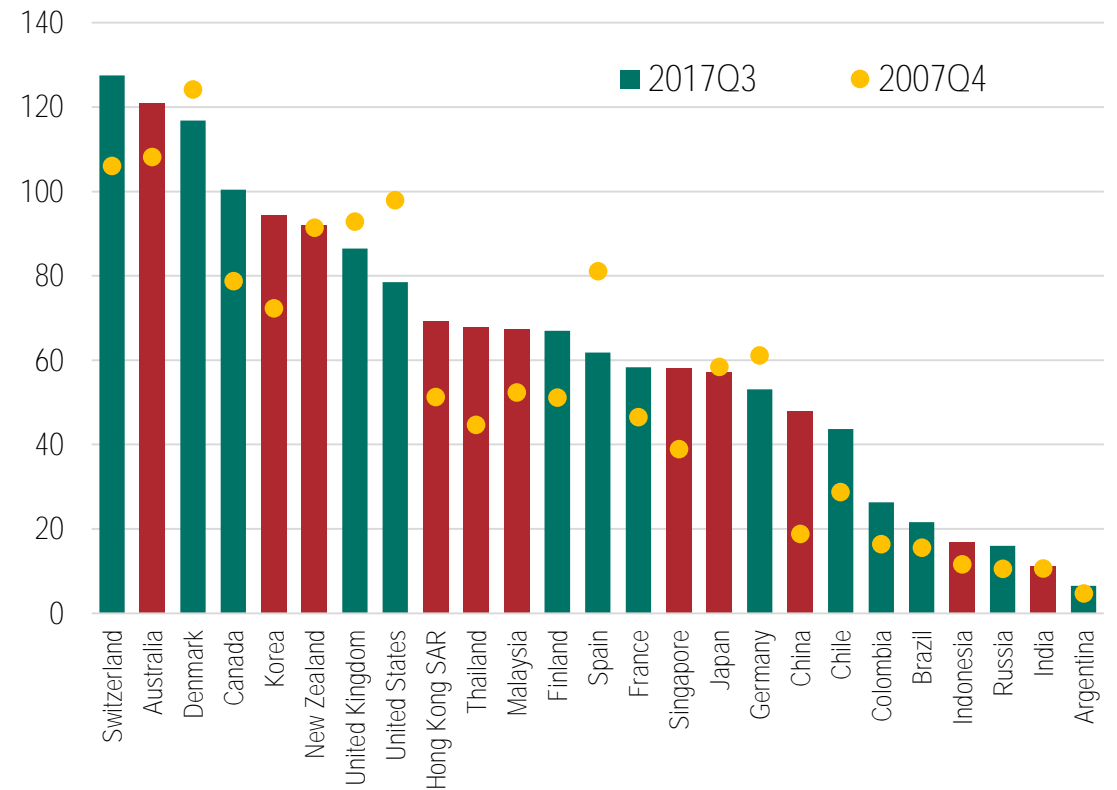
...and Asia could be materially affected given its high household and corporate leverage...

Non-Financial Corporate Debt
(Percent of GDP)



Source: Bank of International Settlements.

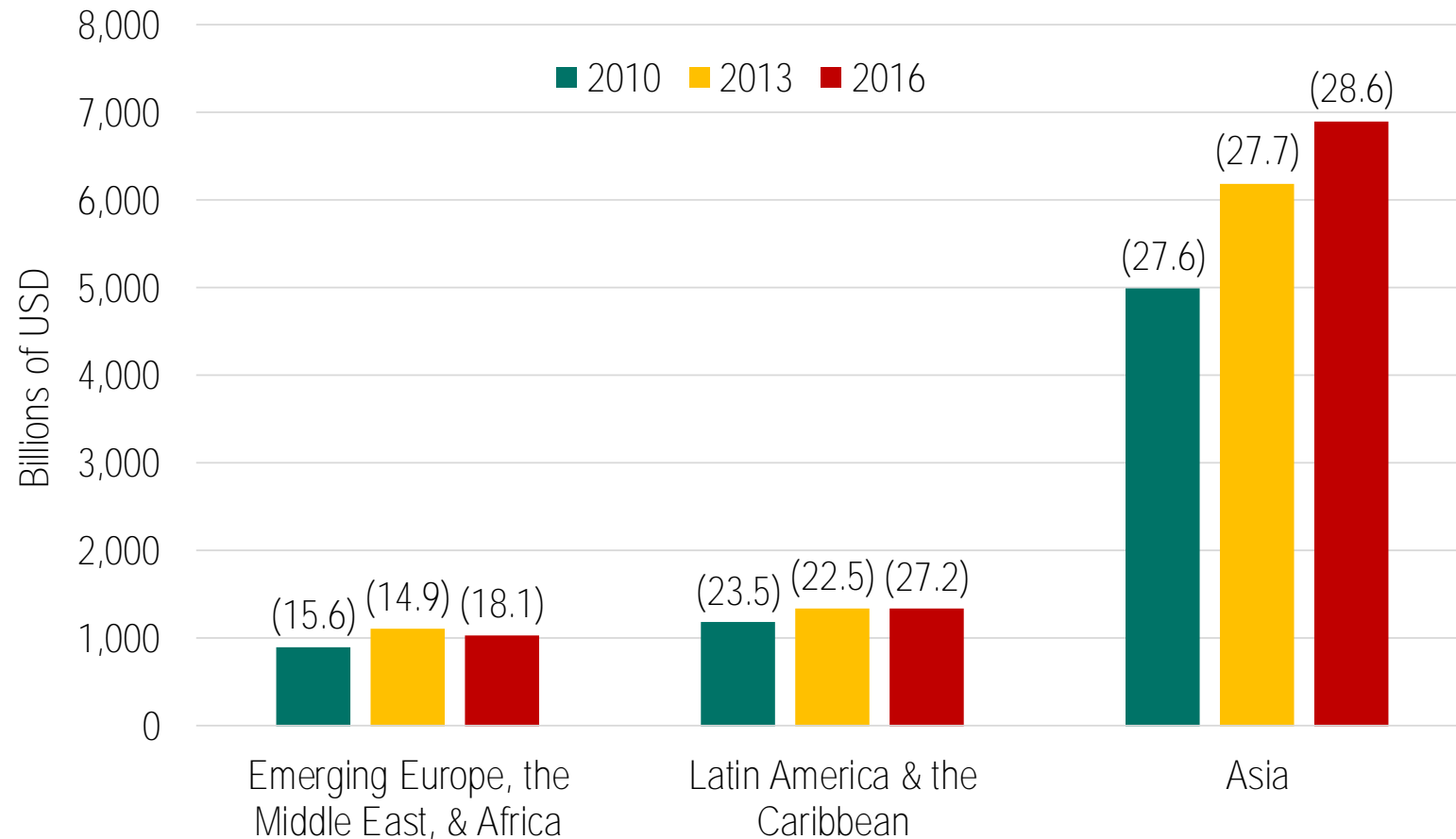
Household Debt
(Percent of GDP)



Source: Bank of International Settlements.

...as well as the large capital flows it has attracted.

Total Portfolio Investment Liabilities
(Percent of GDP in parentheses)



Sources: IMF *IFS* database, and staff calculations.

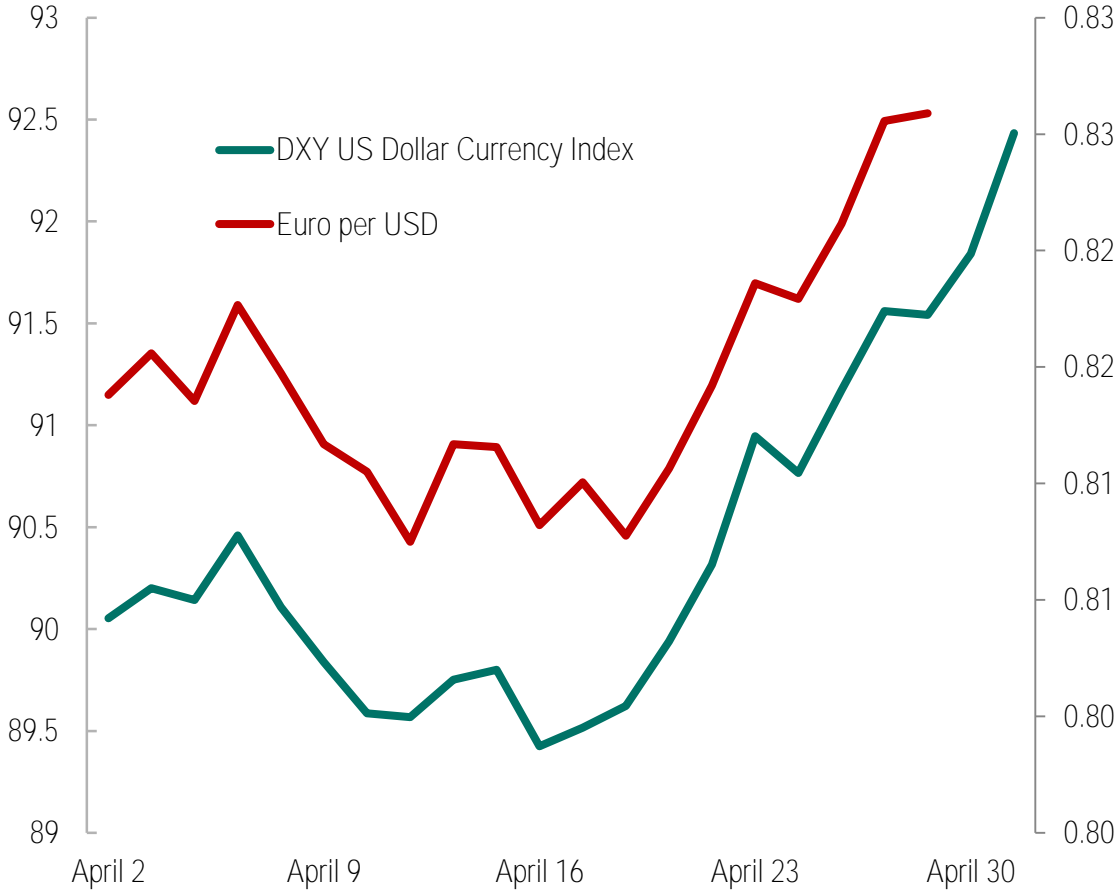
Recent yield and dollar movements underscore the uncertainty.

US 10-Year Bond Yield
(Percent)



Source: Thomson Reuters Datastream.

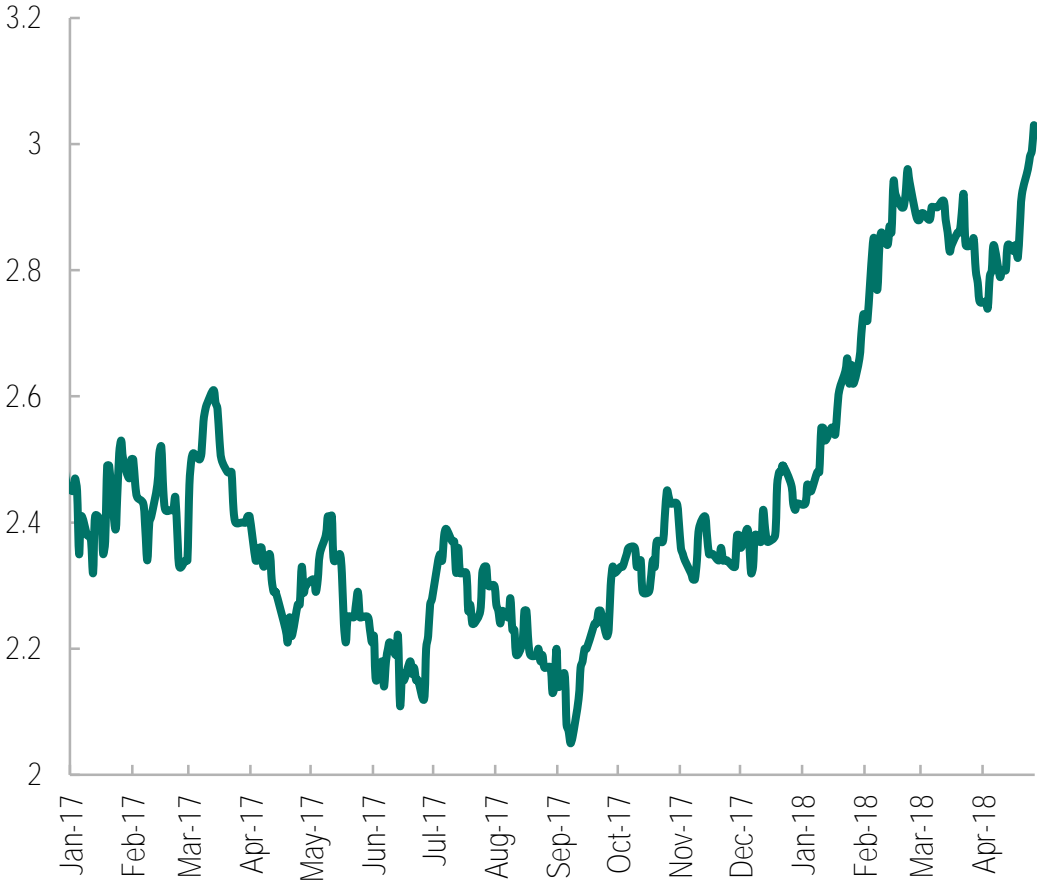
US dollar and Euro Exchange Rate



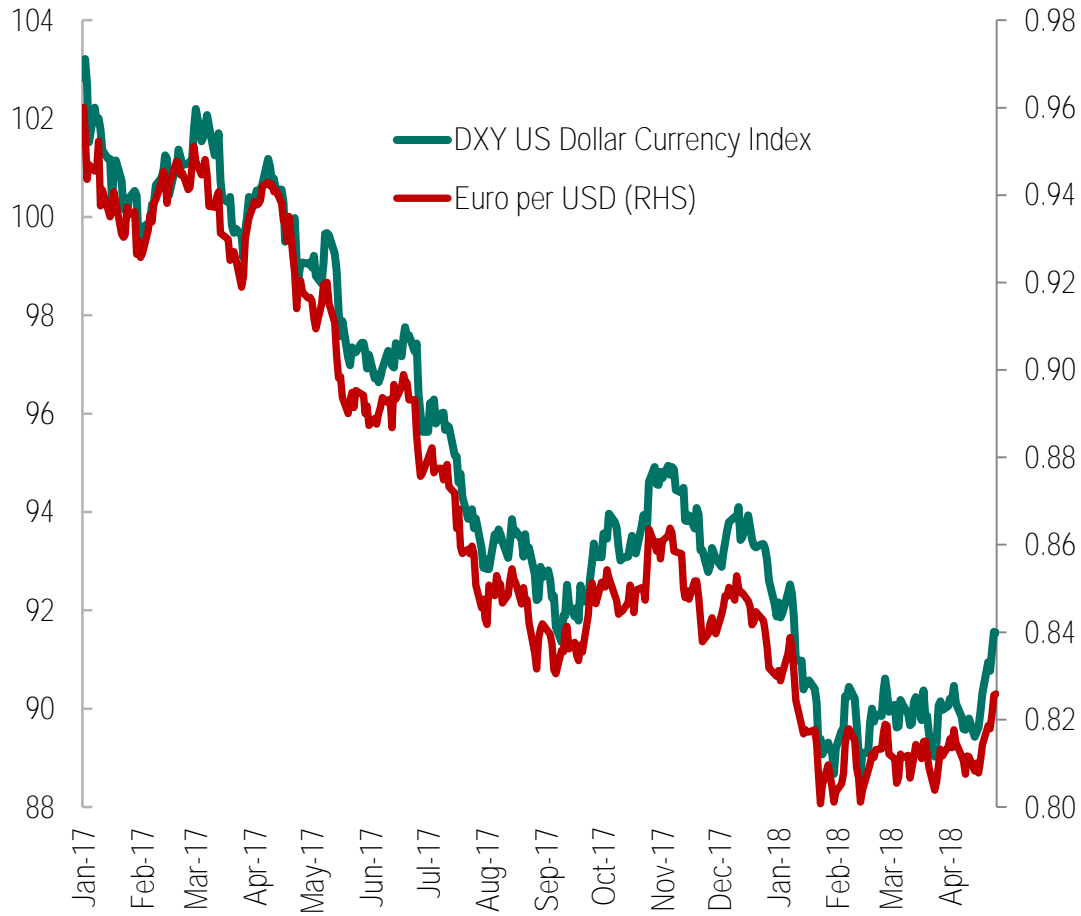
Source: Thomson Reuters Datastream, and Haver Analytics..

Recent yield and dollar movements underscore the uncertainty.

US 10-Year Bond Yield (Percent)



US dollar and Euro Exchange Rate



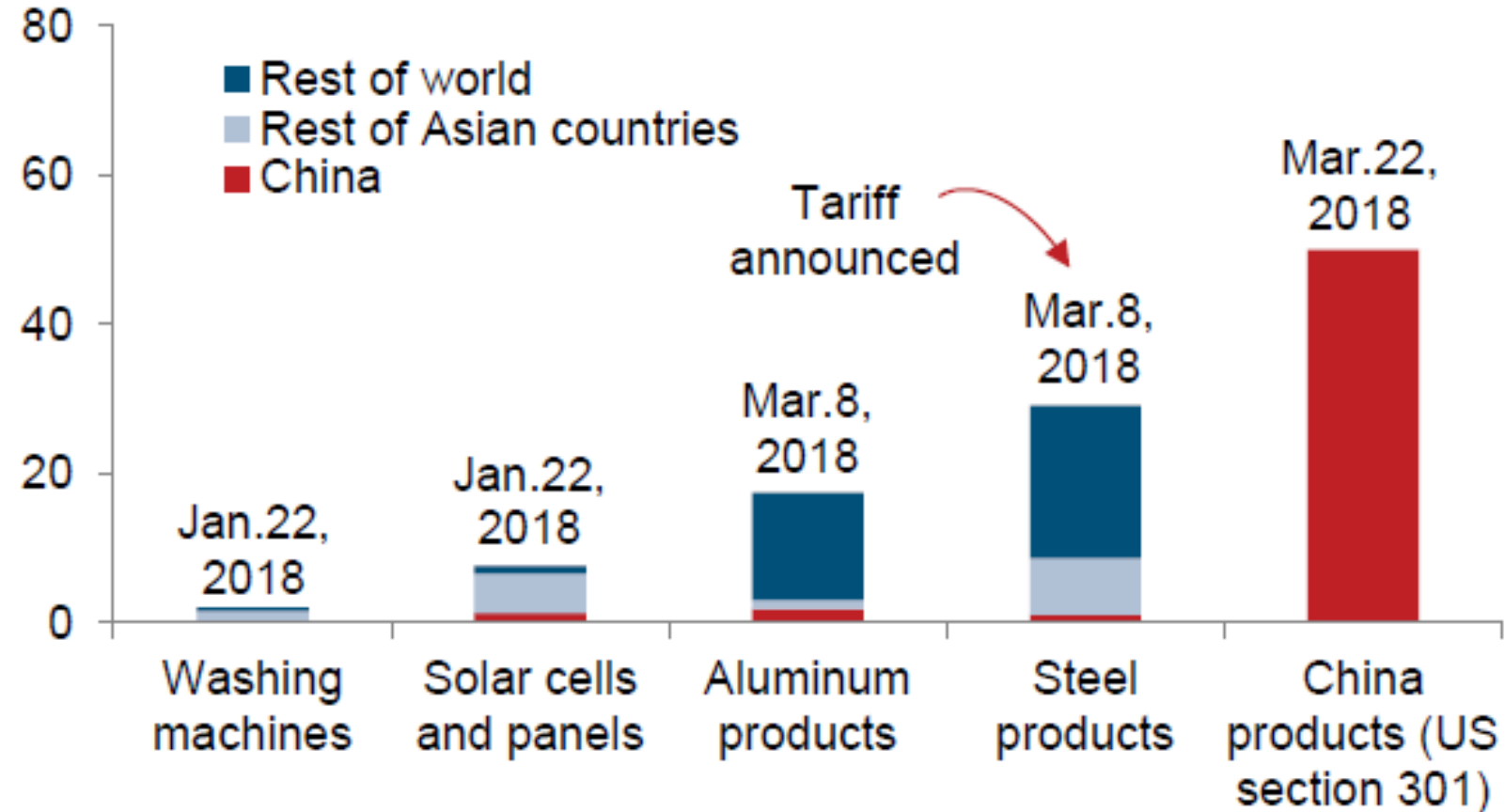
Source: Haver Analytics.

Source: Thomson Reuters Datastream, and Haver Analytics..

Trade

The US has made several recent tariff announcements.

2017 US imports of goods targeted by recent tariffs* , \$bn

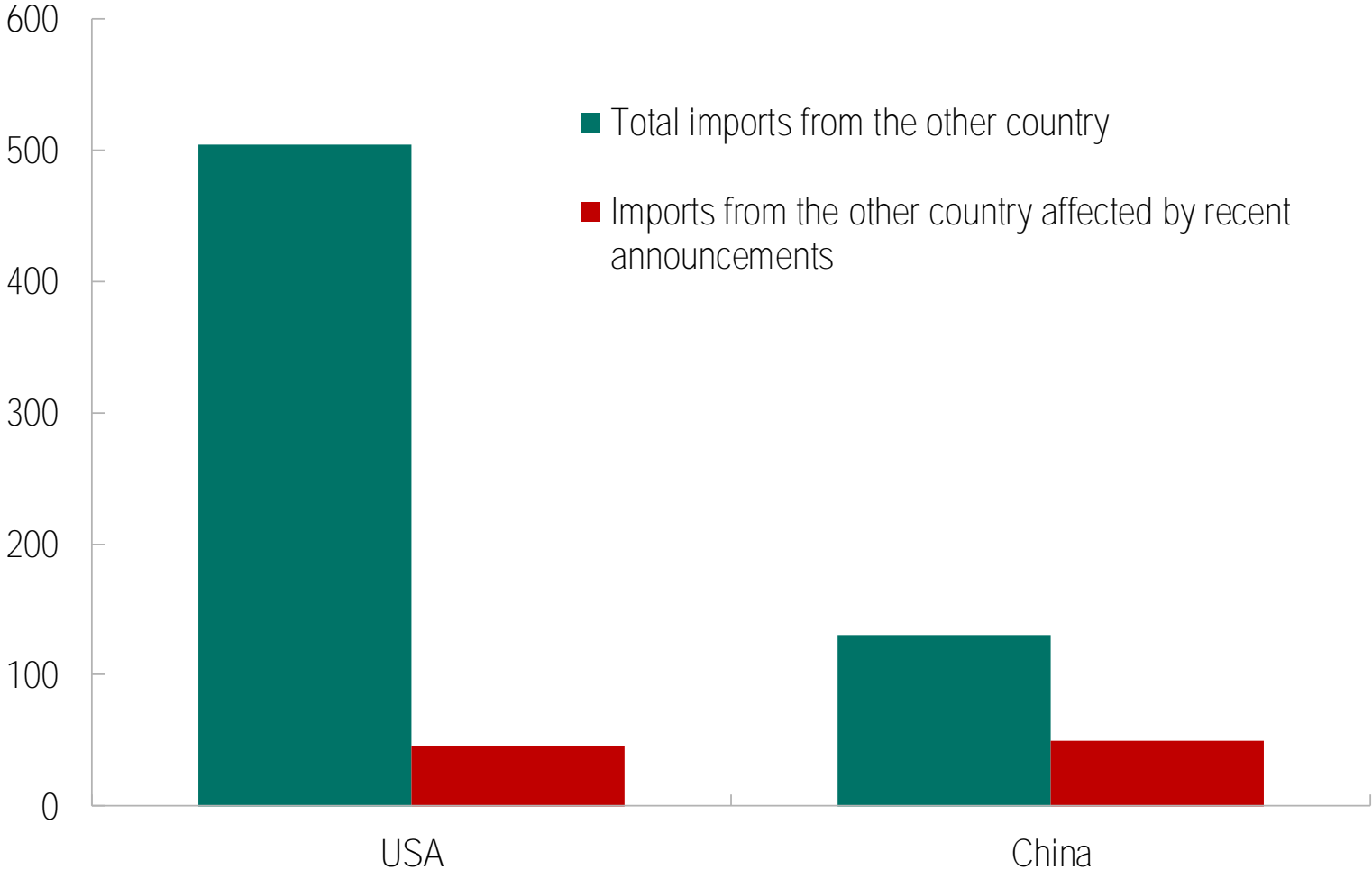


*Figures do not account for recent steel/aluminum exemptions.

Source: Dept. of Commerce, Haver, Goldman Sachs Global Investment Research.

China, in turn, has announced new tariffs...

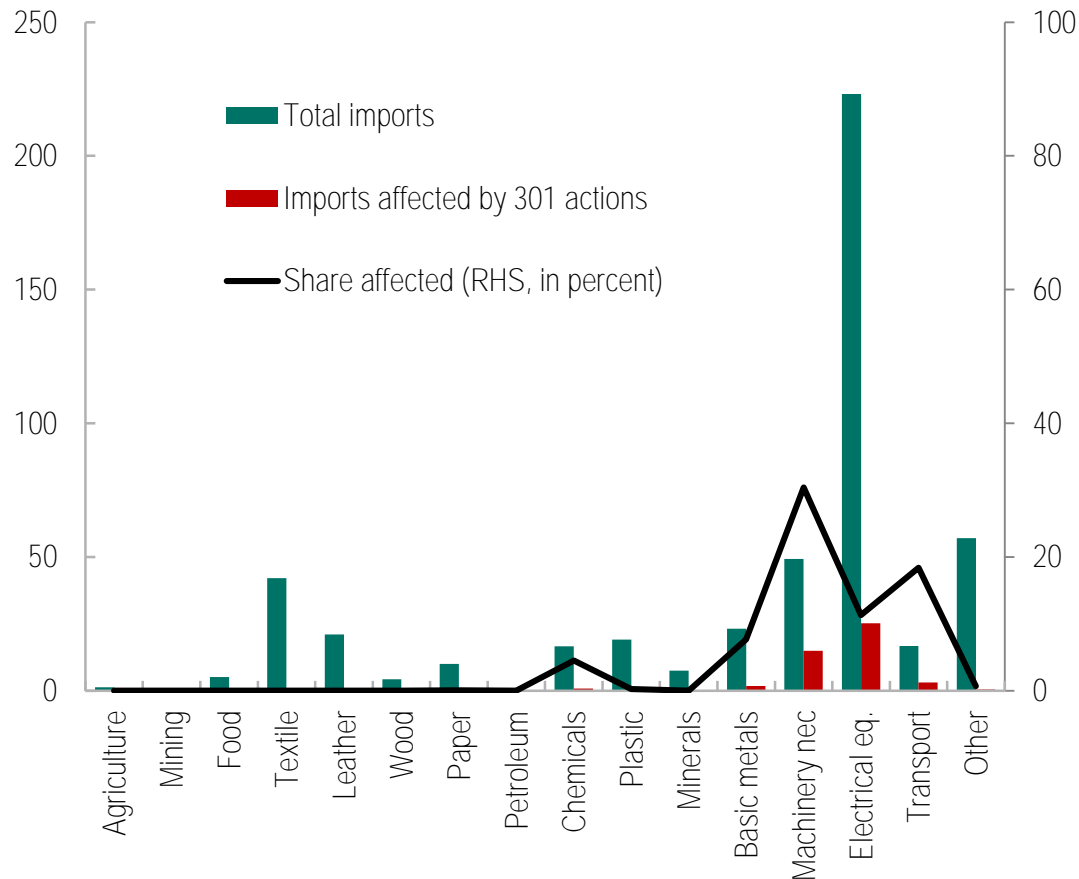
(Billions of US dollars)



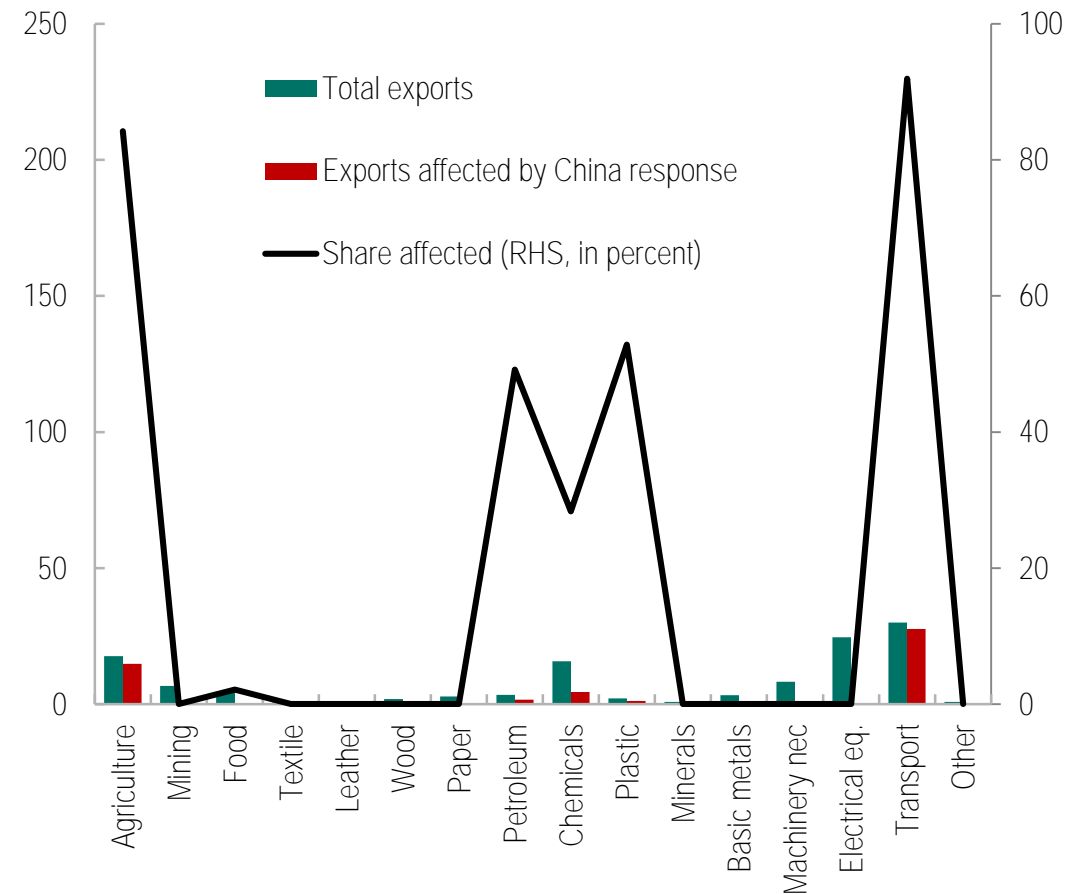
Source: PIIIE.

...which are concentrated in a few sectors.

US Imports from China
(Billions of US dollars)



US Exports to China
(Billions of US dollars)

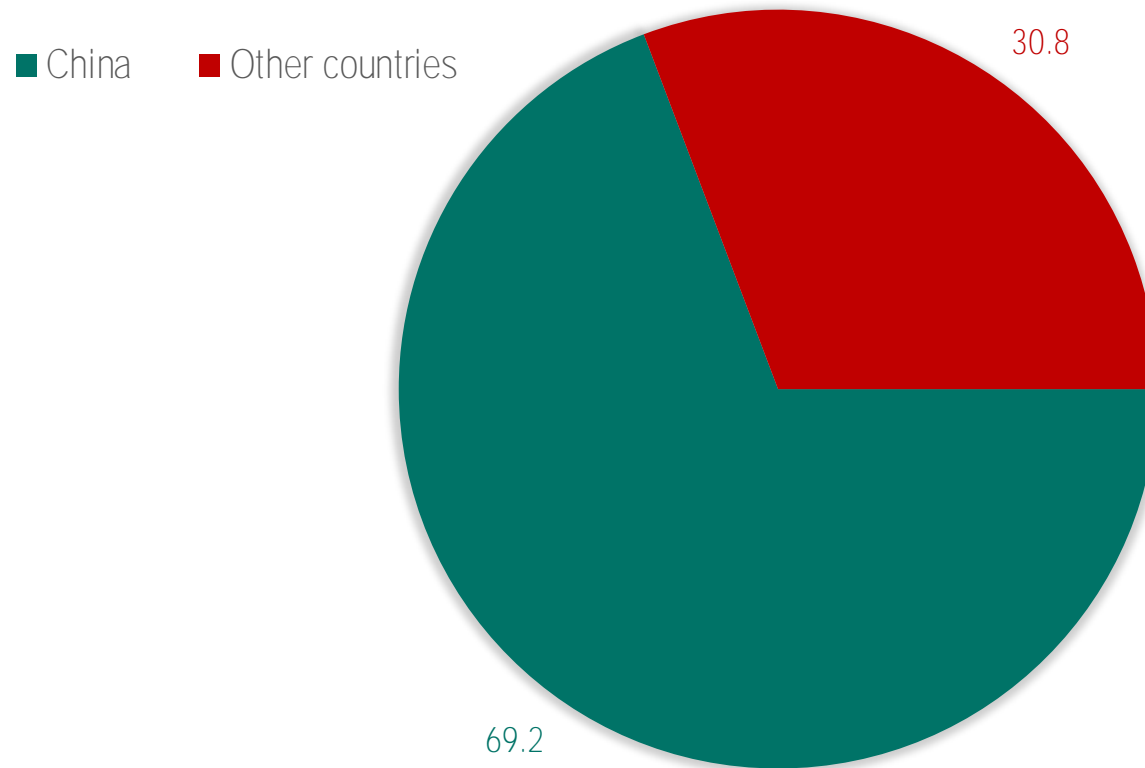


Sources: PIIE, Staff estimates.

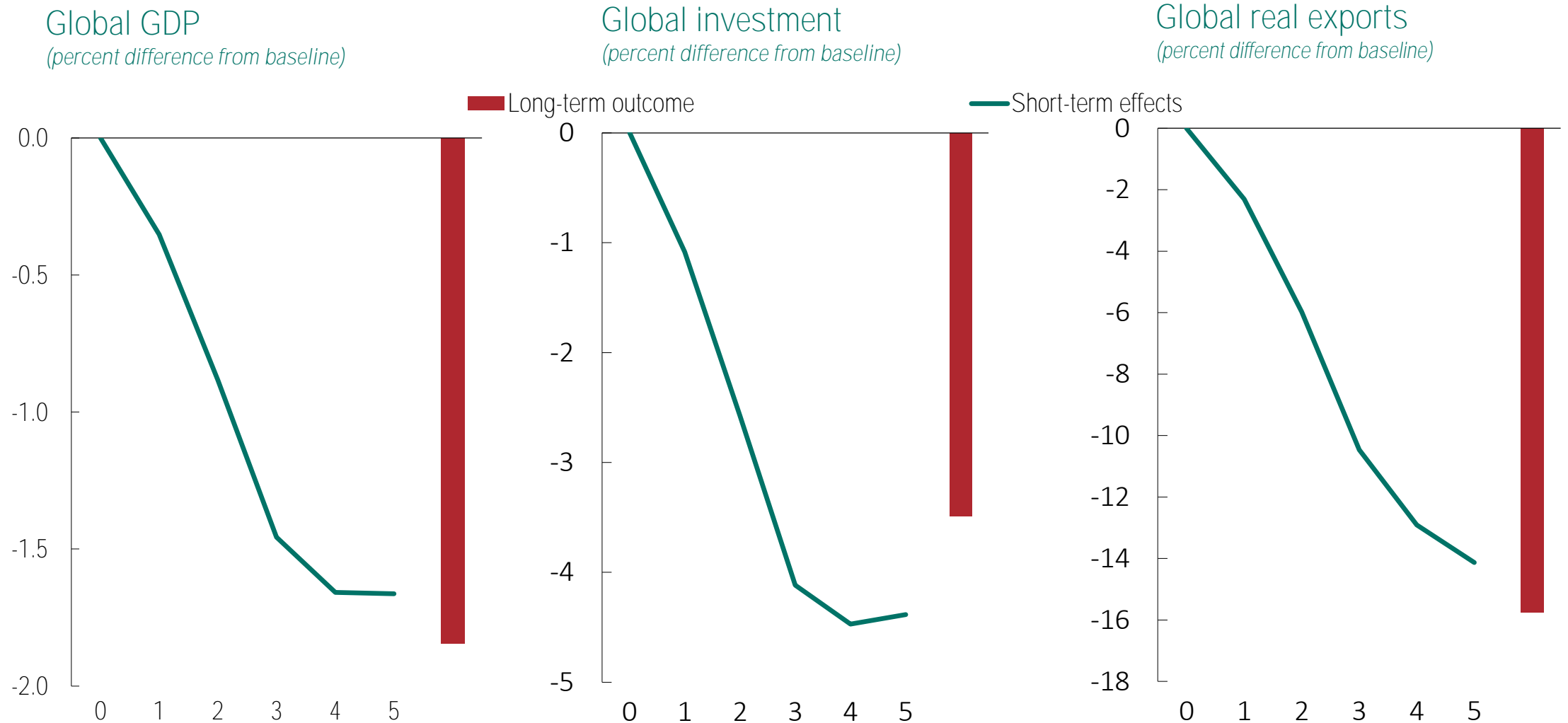
Sources: PIIE, Staff estimates.

Other countries are also exposed given their supply chain linkages to China.

Value Added by Origins in China's Exports to the US
(Percent, in 2011)



A move toward protectionism would be damaging.

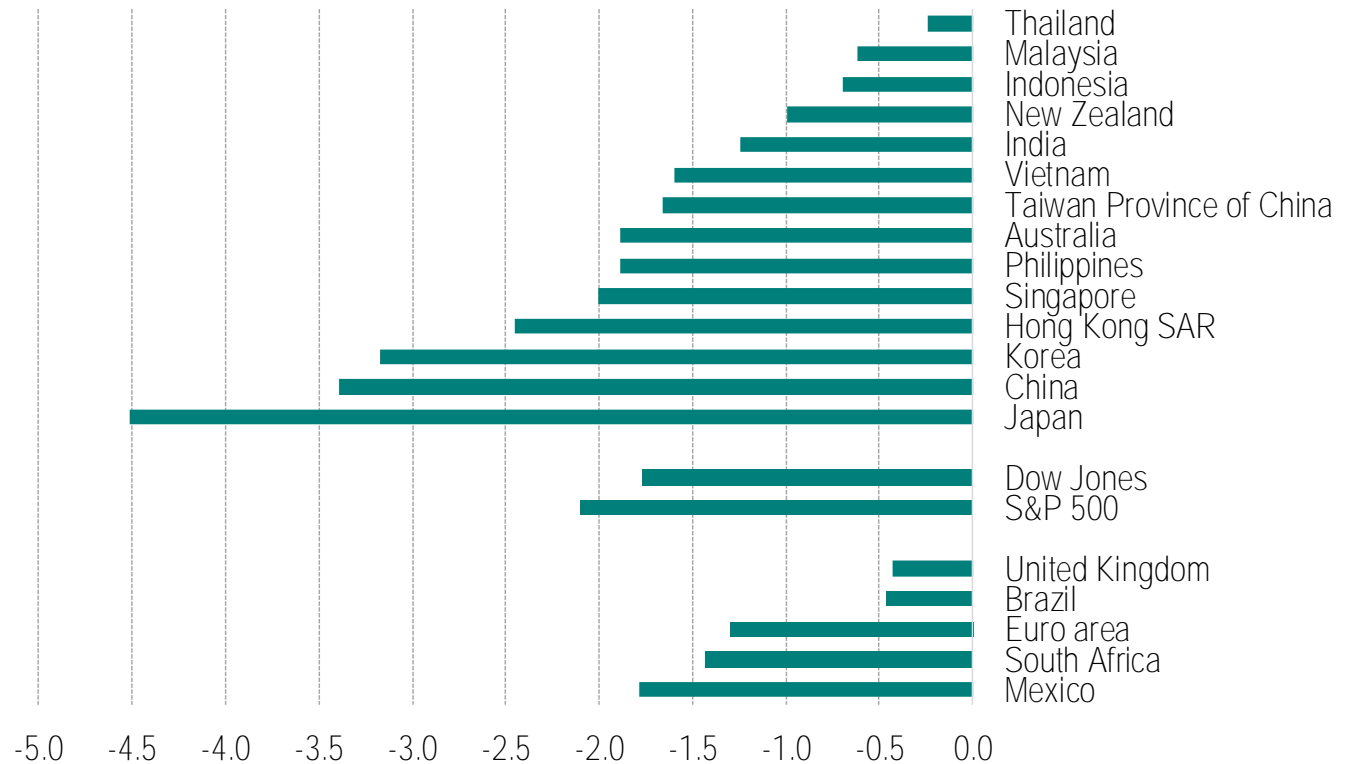


Sources: IMF, World Economic Outlook; and IMF staff calculations.

Effects through non-trade channels could be even more damaging.

- Financial markets
- Business and consumer confidence
- FDI and domestic investment
- Other channels

Stock Market Index March 23, 2018
(Percent change; in local currency)



Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations.

Taxes

The *Tax Cuts and Jobs Act* could affect Asia in many different ways.

Key elements of the corporate tax reform:

1. Rate cut from 35 to 21 (or even 13) percent
2. Expensing for 5 years (investment fully deductible for income tax purposes)
3. Shift from Worldwide to Territorial taxation

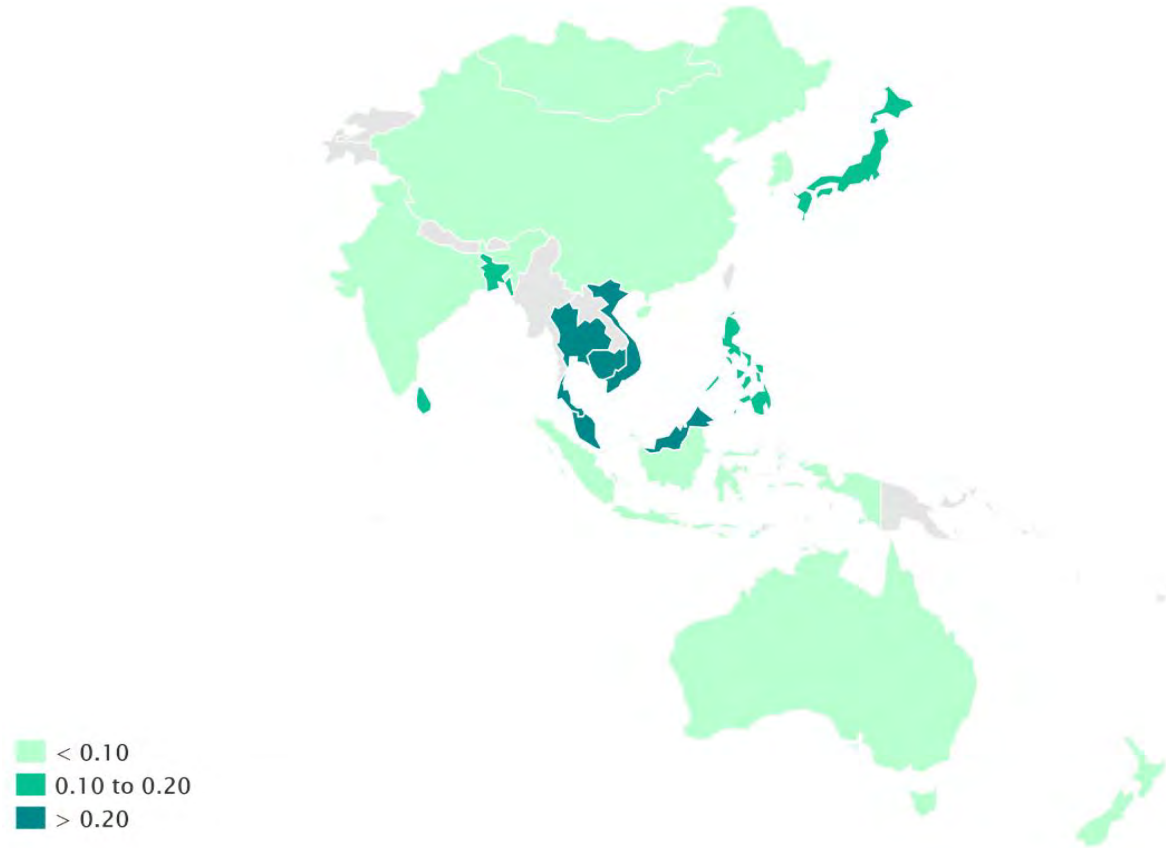
Many possible spillover channels:

1. Higher US investment / growth → positive spillovers to Asia
2. Tax competition → loss of US investment in Asia? fiscal loss?
3. Deemed repatriation → capital flows out of Asia?

The direct spillovers from higher US growth are positive but likely to be modest.

Impact on Real GDP Growth

(Deviation from scenario without U.S. Tax Reform; Cumulative 2018-2020)



■ < 0.10
■ 0.10 to 0.20
■ > 0.20

Source: IMF staff calculations

Impact on Real GDP Growth (2018-2020)

Asia

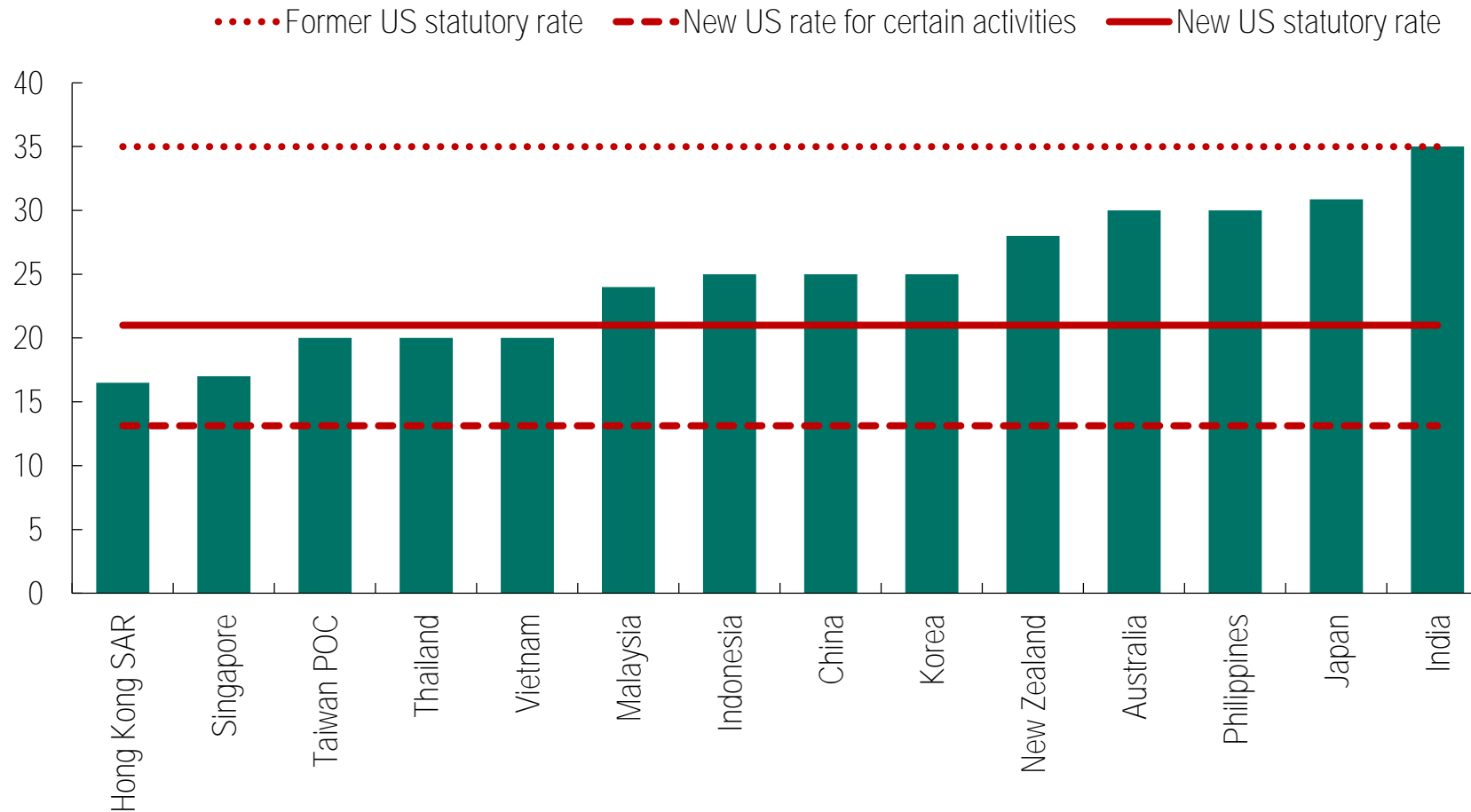
Cambodia	0.5
Vietnam	0.4
Pacific Islands	0.2
Thailand	0.2
Singapore	0.2
Hong Kong SAR	0.2
Malaysia	0.2
Sri Lanka	0.2
Philippines	0.2
Bangladesh	0.1
Korea	0.1
New Zealand	0.1
Mongolia	0.0
Japan	0.2
Indonesia	0.1
China	0.1
India	0.1
Australia	0.0

Other Countries & Regional Aggregates

Canada	0.5
Mexico	0.4
Asia (average)	0.2
Latin America	0.3
Euro Area	0.2
Other Advanced Economies	0.2
Other Countries	0.1

But how will Asia be affected by the international tax competition that may arise?

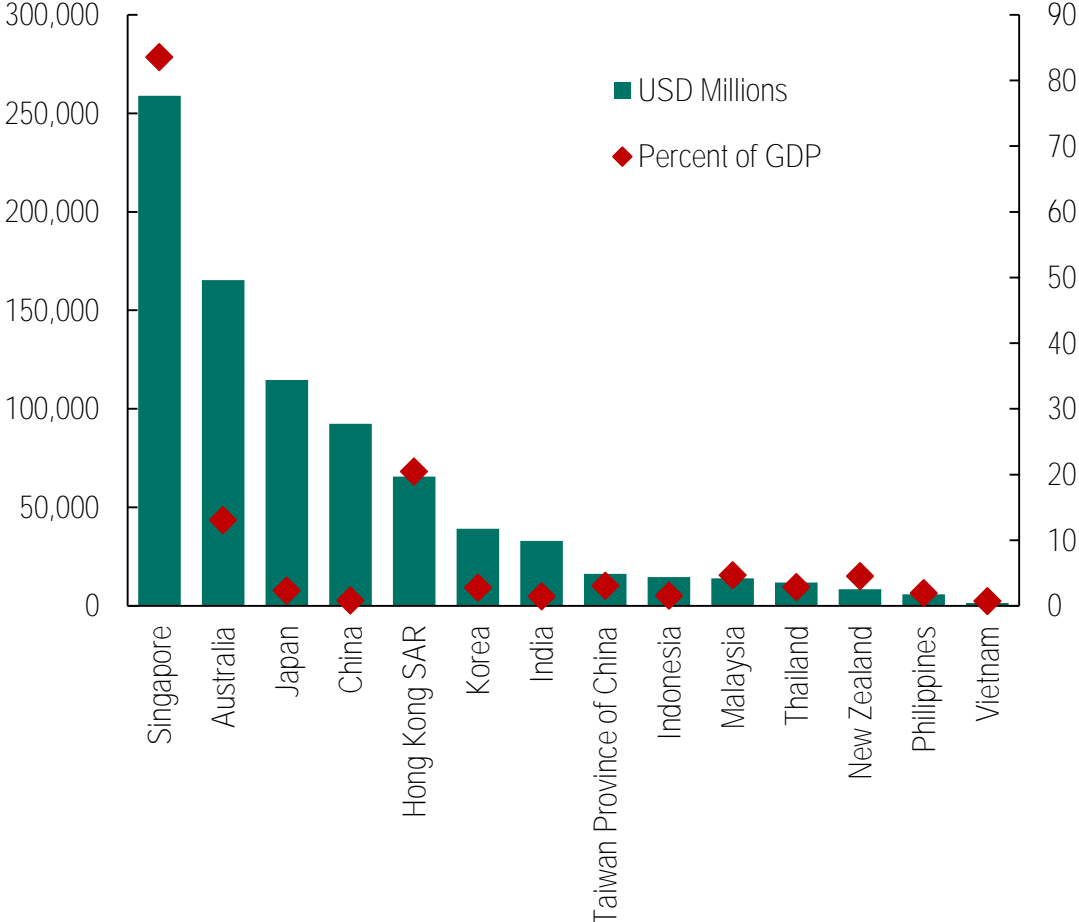
Selected Economies: Corporate Income Tax Rates
(Percent)



Source: IMF Fiscal Affairs Department, Tax Policy Rates.

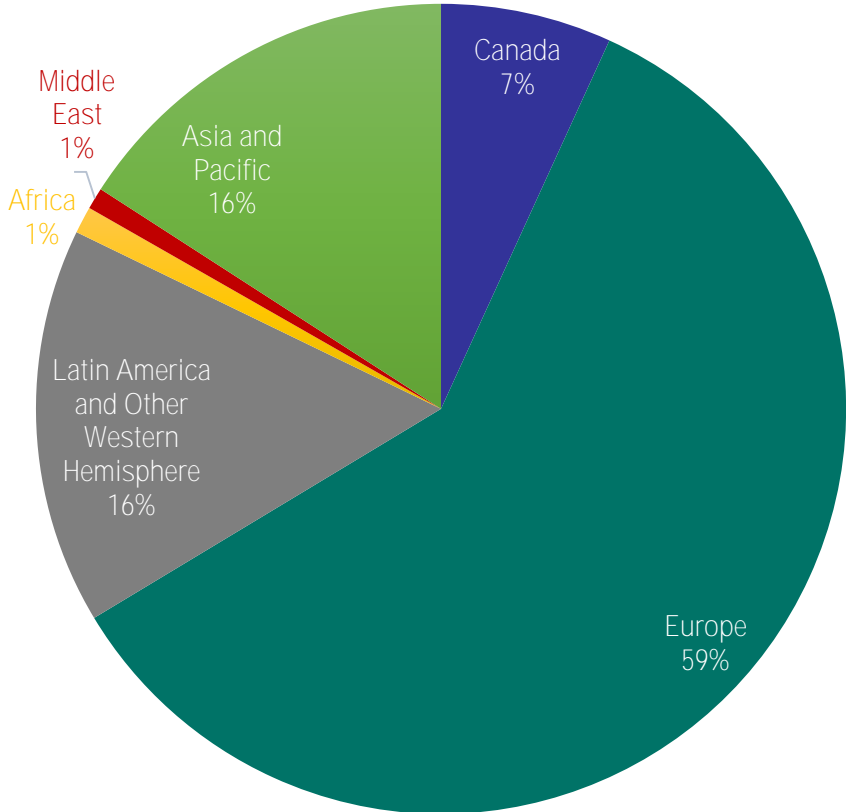
Asian countries receive substantial FDI from the US...

U.S. Direct Investment Position Abroad
(USD Millions & Percent of GDP, 2016)



Note: On a historical cost basis; Source: Bureau of Economic Analysis

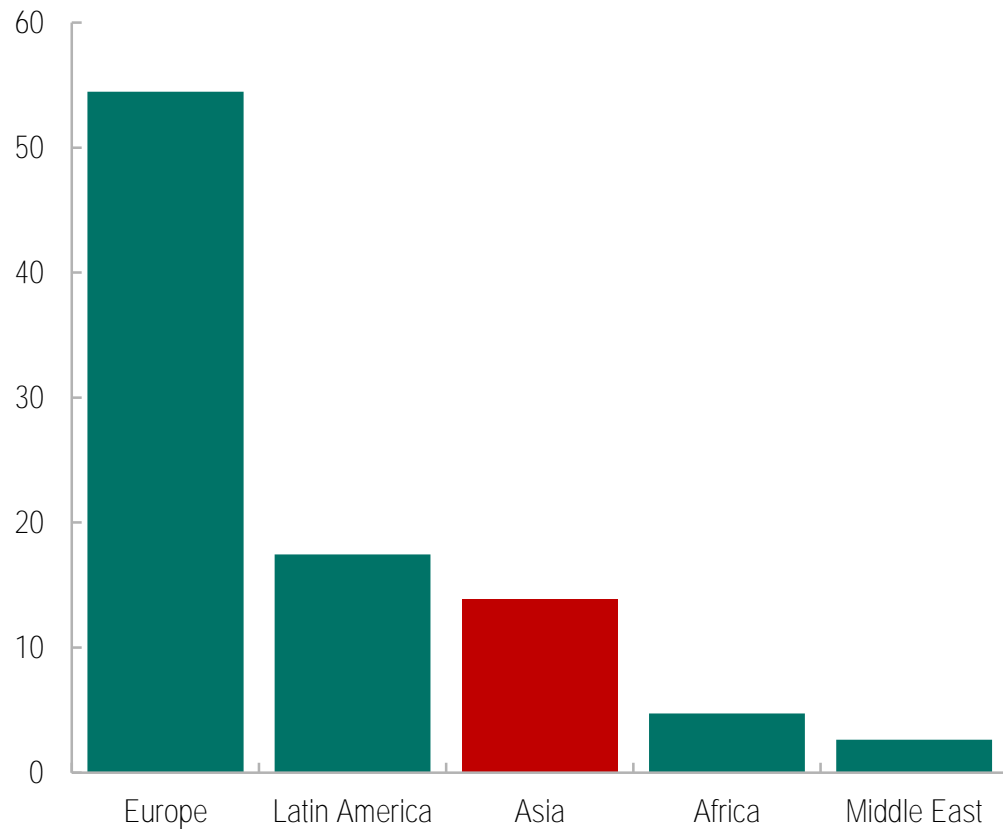
U.S. Direct Investment Position Abroad
(Millions of dollars, 2016)



Note: On a historical cost basis; Source: Bureau of Economic Analysis

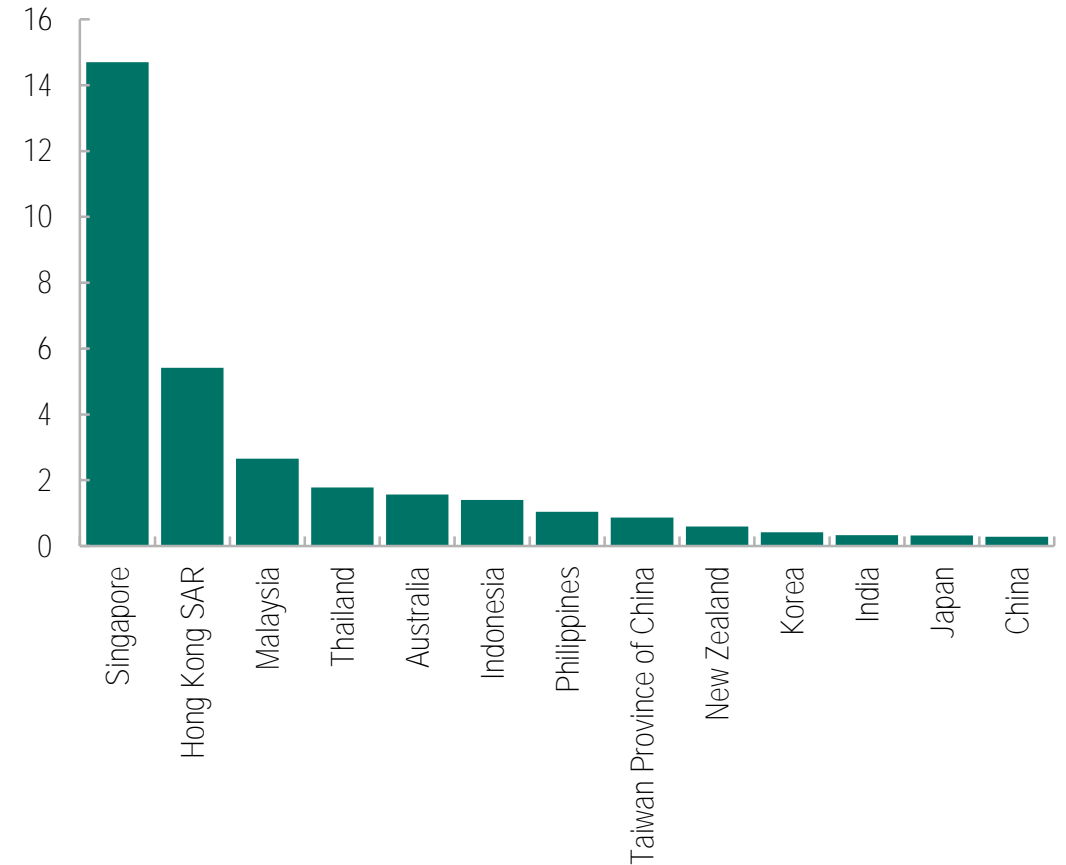
US corporations earn substantial profits in some Asian countries.

Foreign Pre-Tax Income Reported by US MNEs
(Percent of total foreign pre-tax income; 2010–13)



Sources: US Bureau of Economic Analysis; and IMF staff calculations.

Foreign Pre-Tax Income Reported by US MNEs
(Percent of domestic GDP; 2010–13)

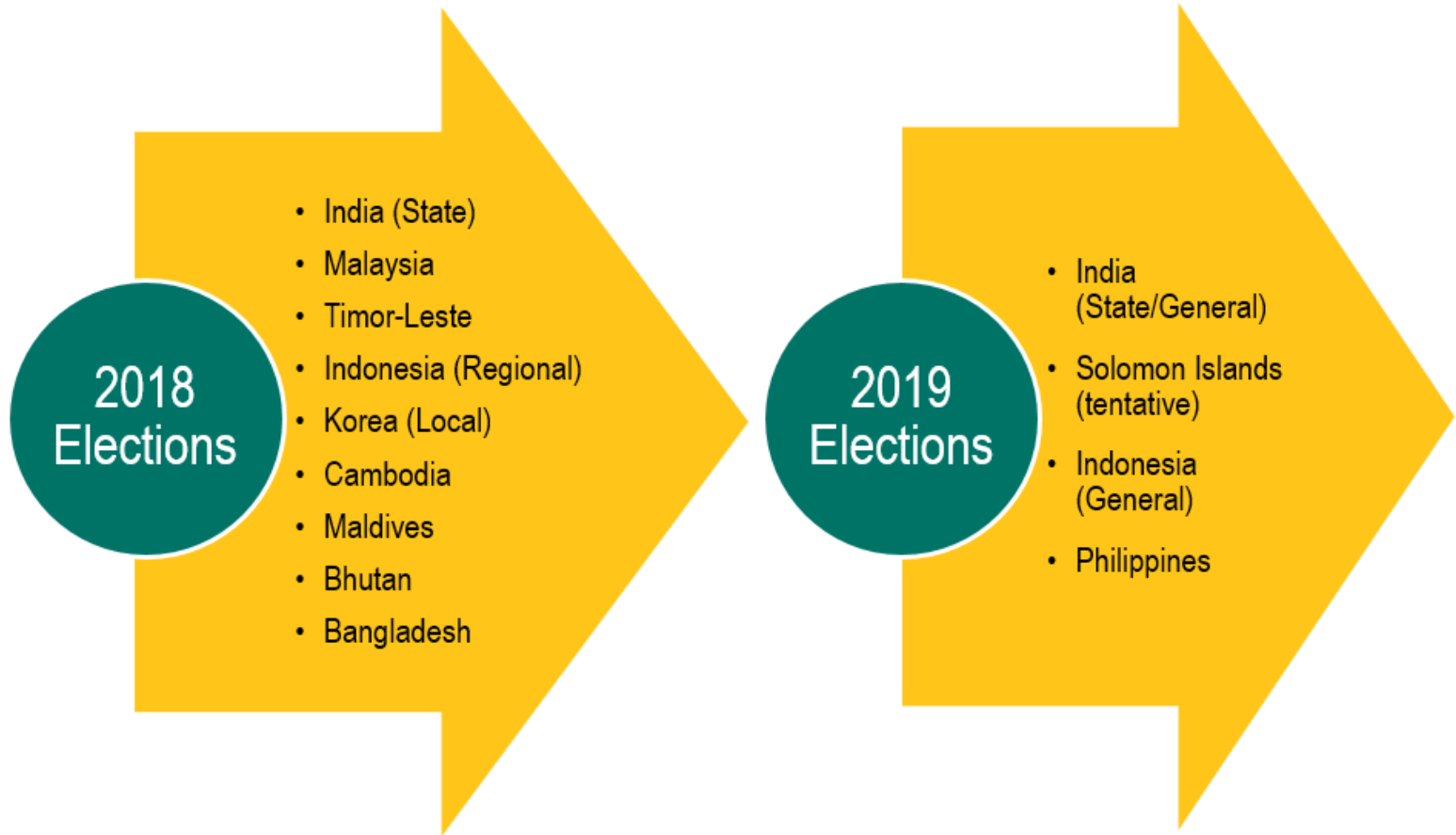


Sources: US Bureau of Economic Analysis; IMF *World Economic Outlook*; and staff calculations.

Other Uncertainties

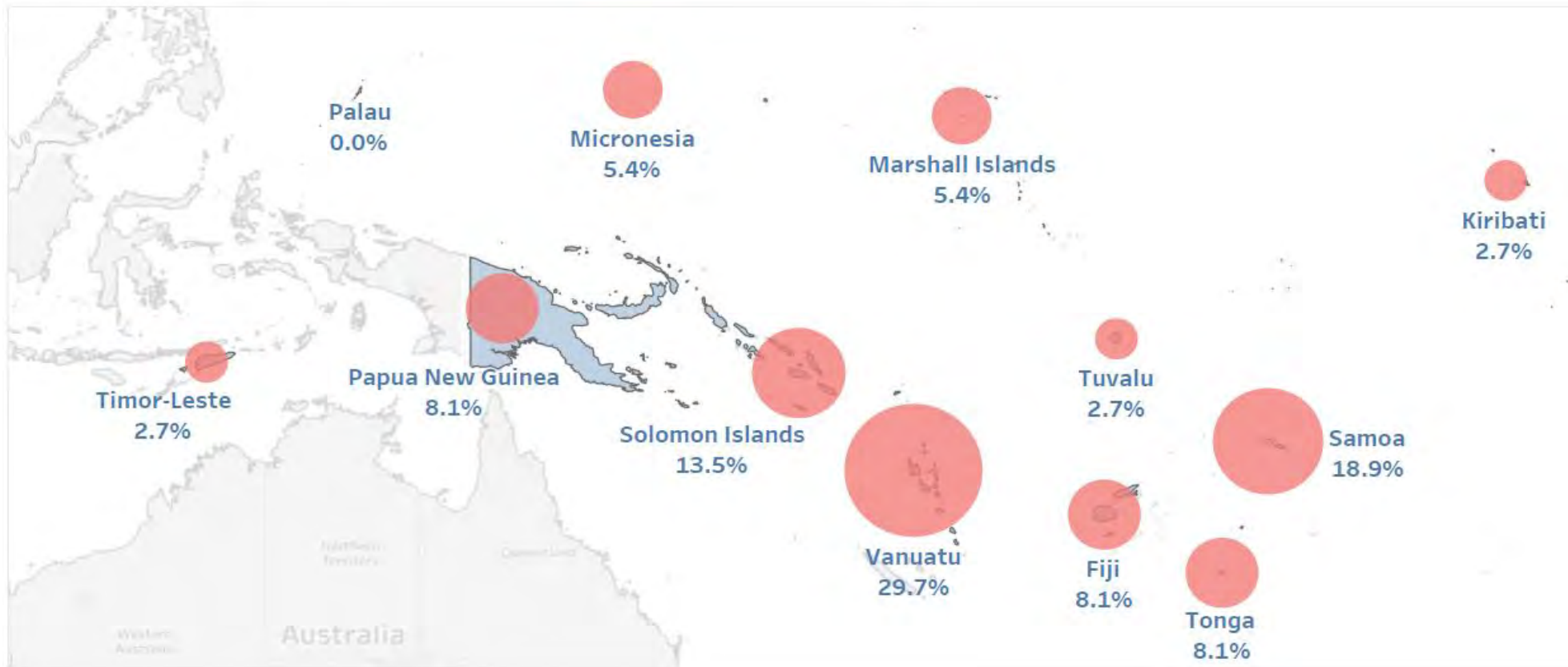
Asia also faces geopolitical risks...

1. North Korea tensions
2. Many elections coming up in 2018-19



...and many economies—particularly the PICs—are highly vulnerable to natural disasters.

Probability of a severe natural disaster during a given year



Note: The size of circle denotes the probability that each country is hit by a severe (above 75th percentile) natural disaster.

Policies

Polycymaking—a premium on prudence

1. Fiscal policy should generally focus more on building buffers
2. Monetary policy should be vigilant
3. Macroprudential tools are part of the toolkit
4. Structural policies: fix the roof



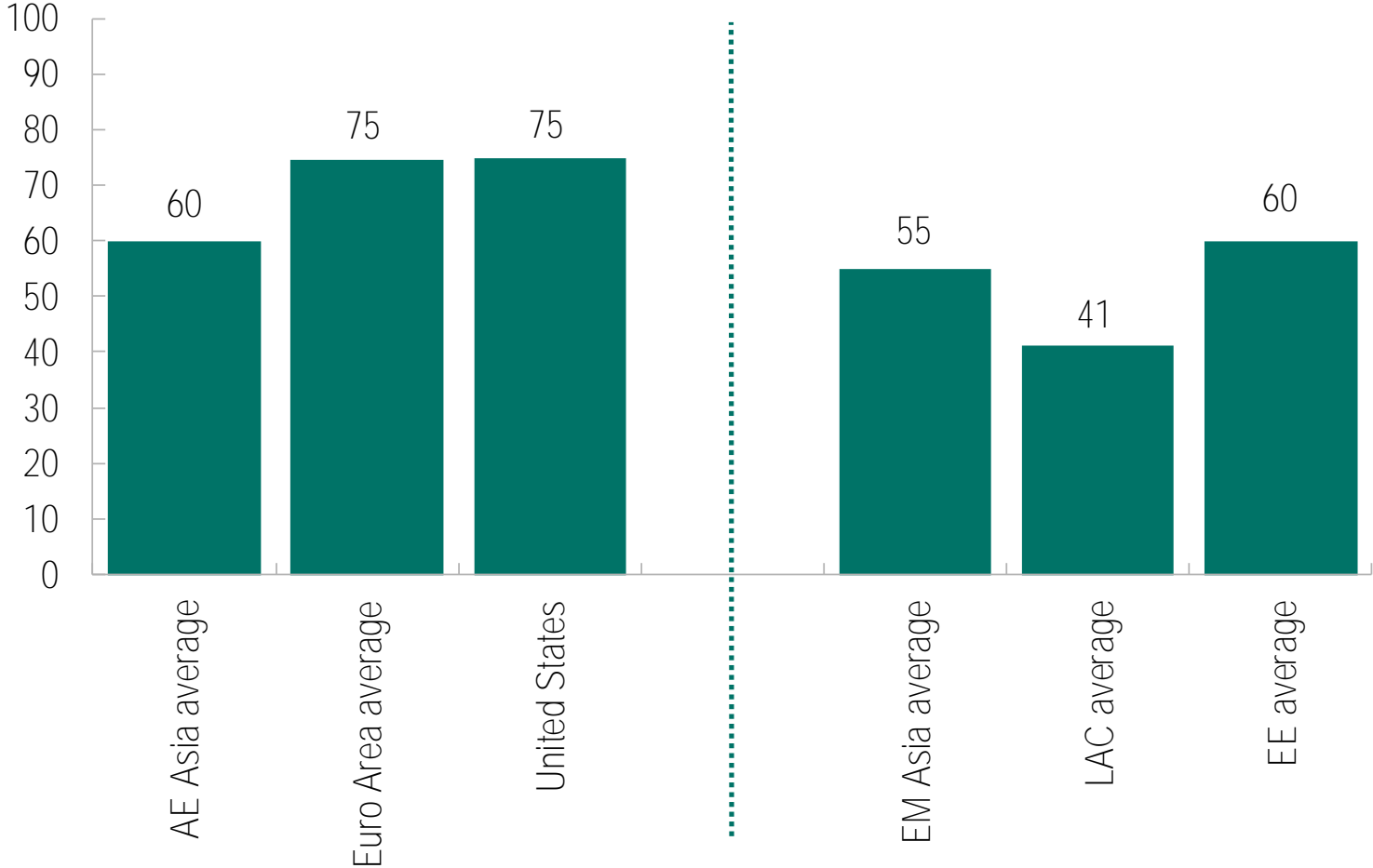
"Never, ever, think outside the box."

Monetary policymakers must be vigilant and decisive.

1. Global factors have kept inflation low → this could reverse
2. Inflation has become more backward looking → once it rises, it may persist
3. The Phillips Curve has flattened → reducing inflation may imply large output costs

Global factors have kept inflation subdued, but could reverse.

Inflation Explained by Global Factors
(Percent)



Source: IMF staff estimates.

The inflation process has also become more backward-looking.

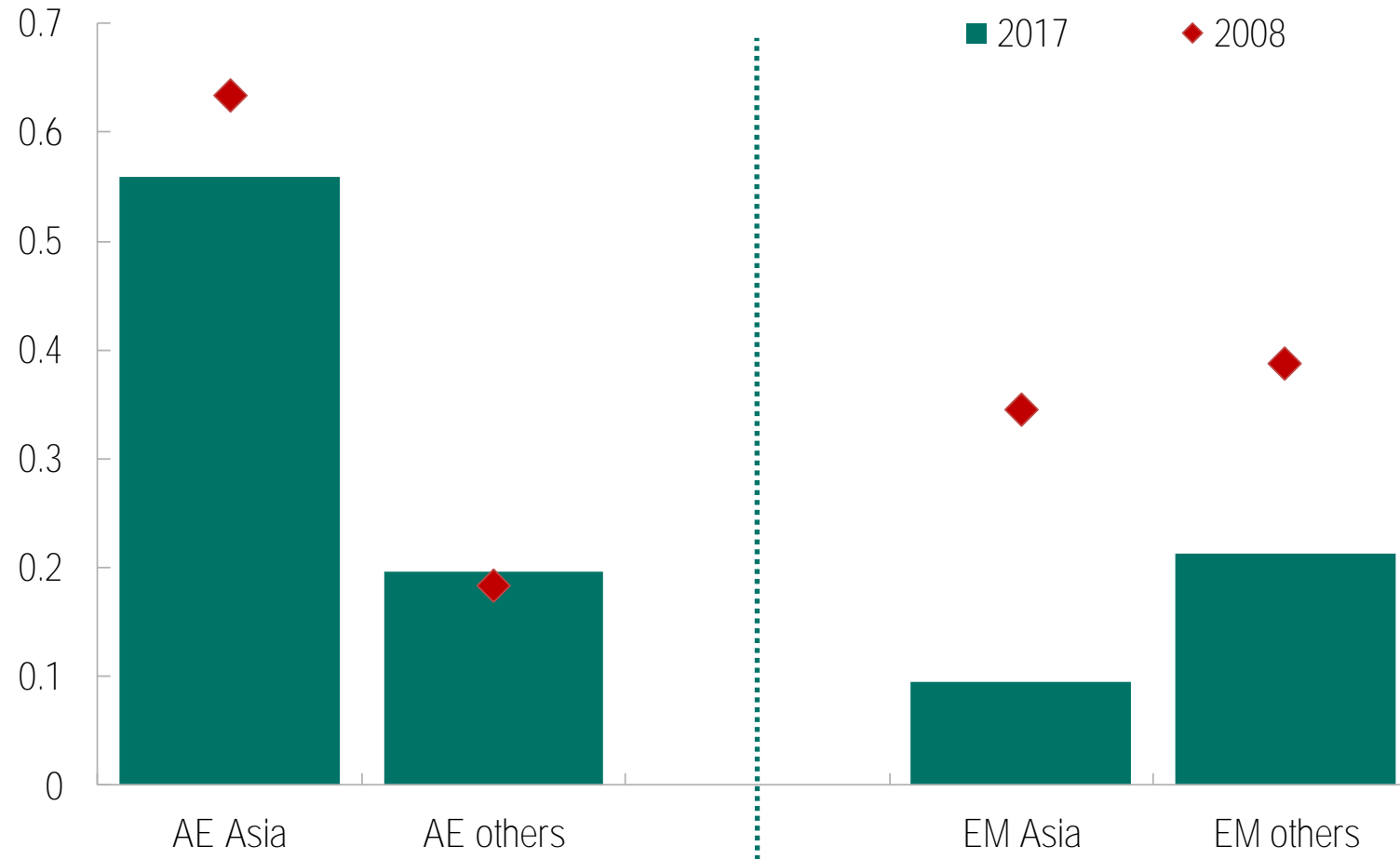
Inflation Expectations Coefficient
(Percent)



Source: IMF staff estimates.

The Phillips Curve has flattened.

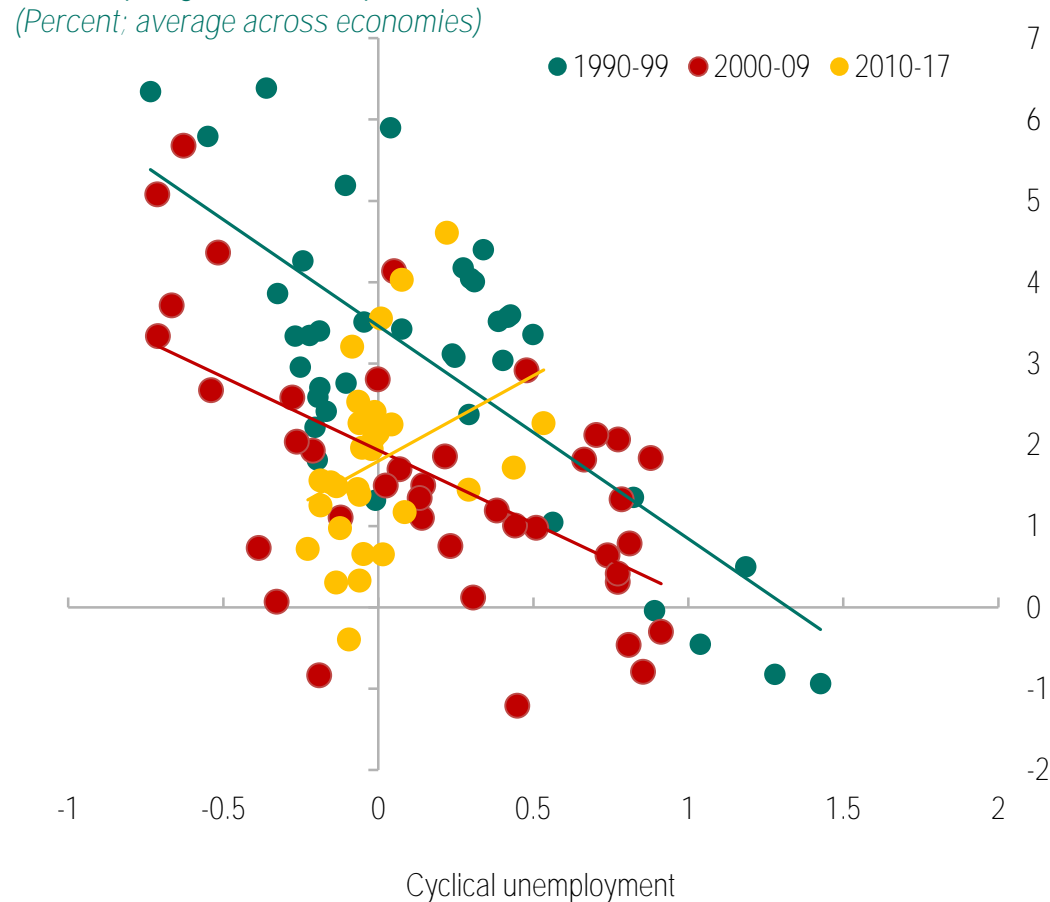
Unemployment Gap Coefficient
(Percent)



Source: IMF staff estimates.

The Phillips Curve has flattened.

Advanced Asia: Headline Inflation and Cyclical Unemployment Gap
(Percent; average across economies)



Emerging Asia: Headline Inflation and Cyclical Unemployment Gap
(Percent; average across economies)

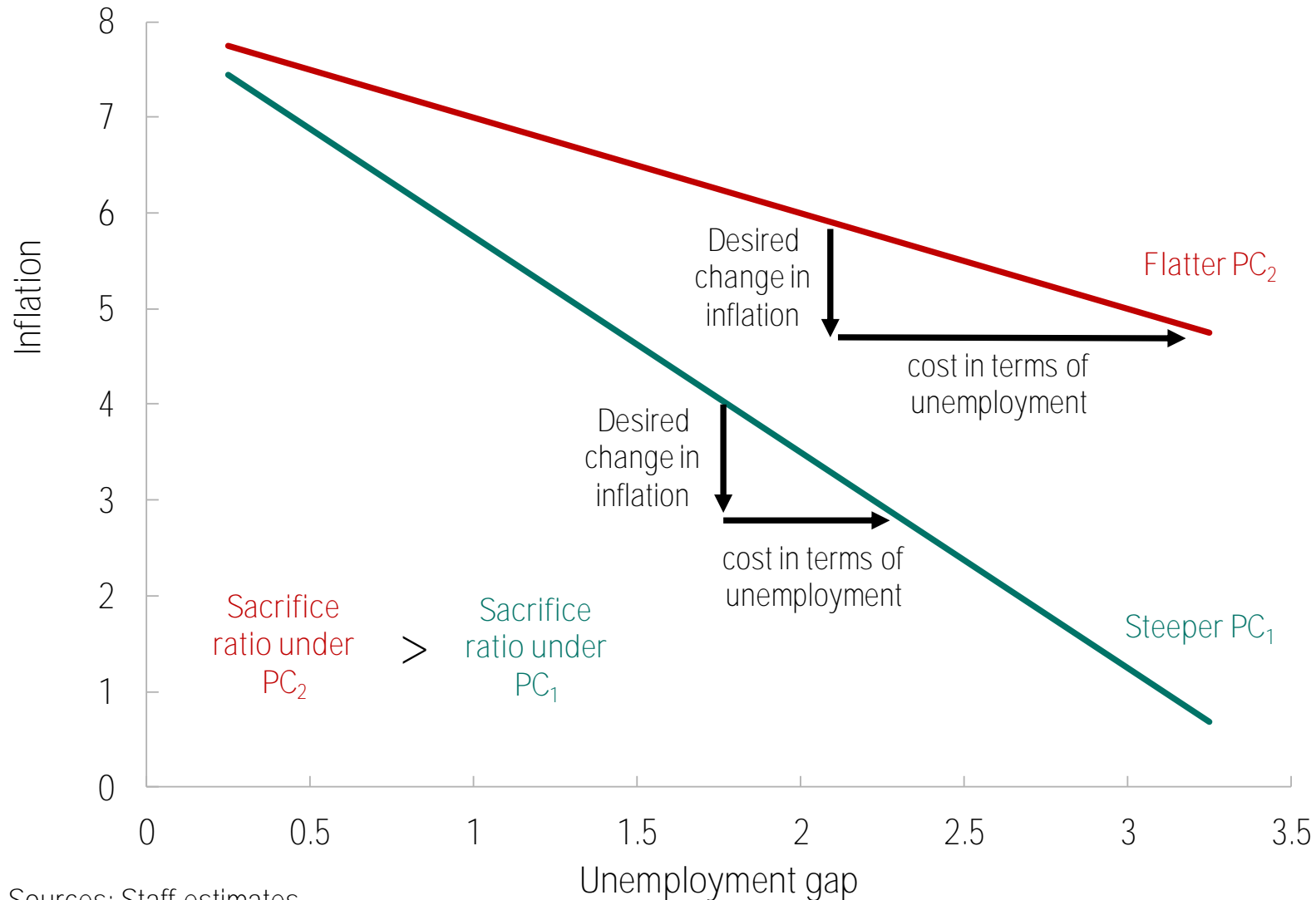


Source: IMF staff calculations.

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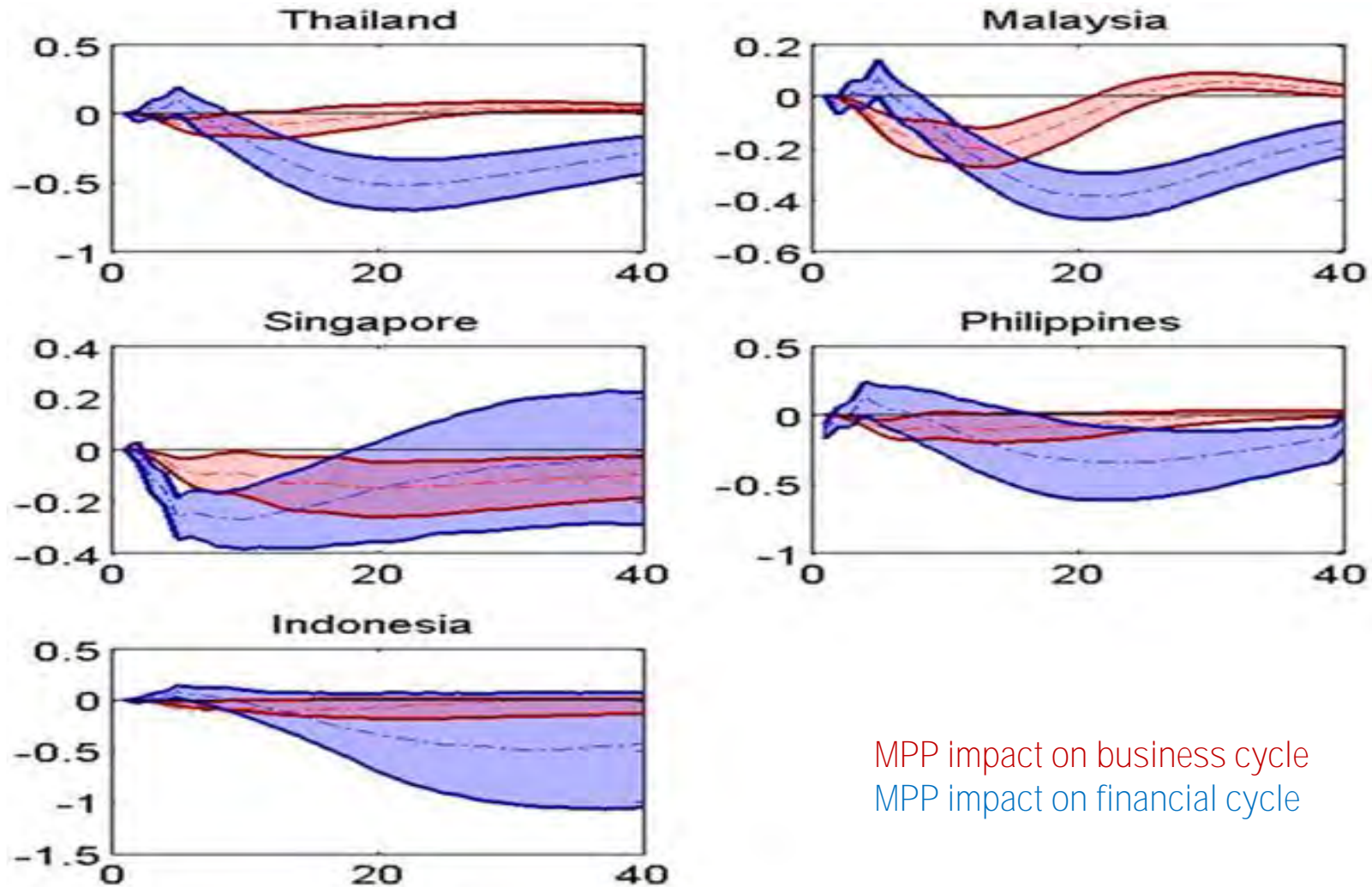
A flatter Phillips curve means a larger sacrifice ratio.

Slope of Phillips Curve and Disinflation



Sources: Staff estimates

Macroprudential policies appear to be effective in controlling credit without dampening output.



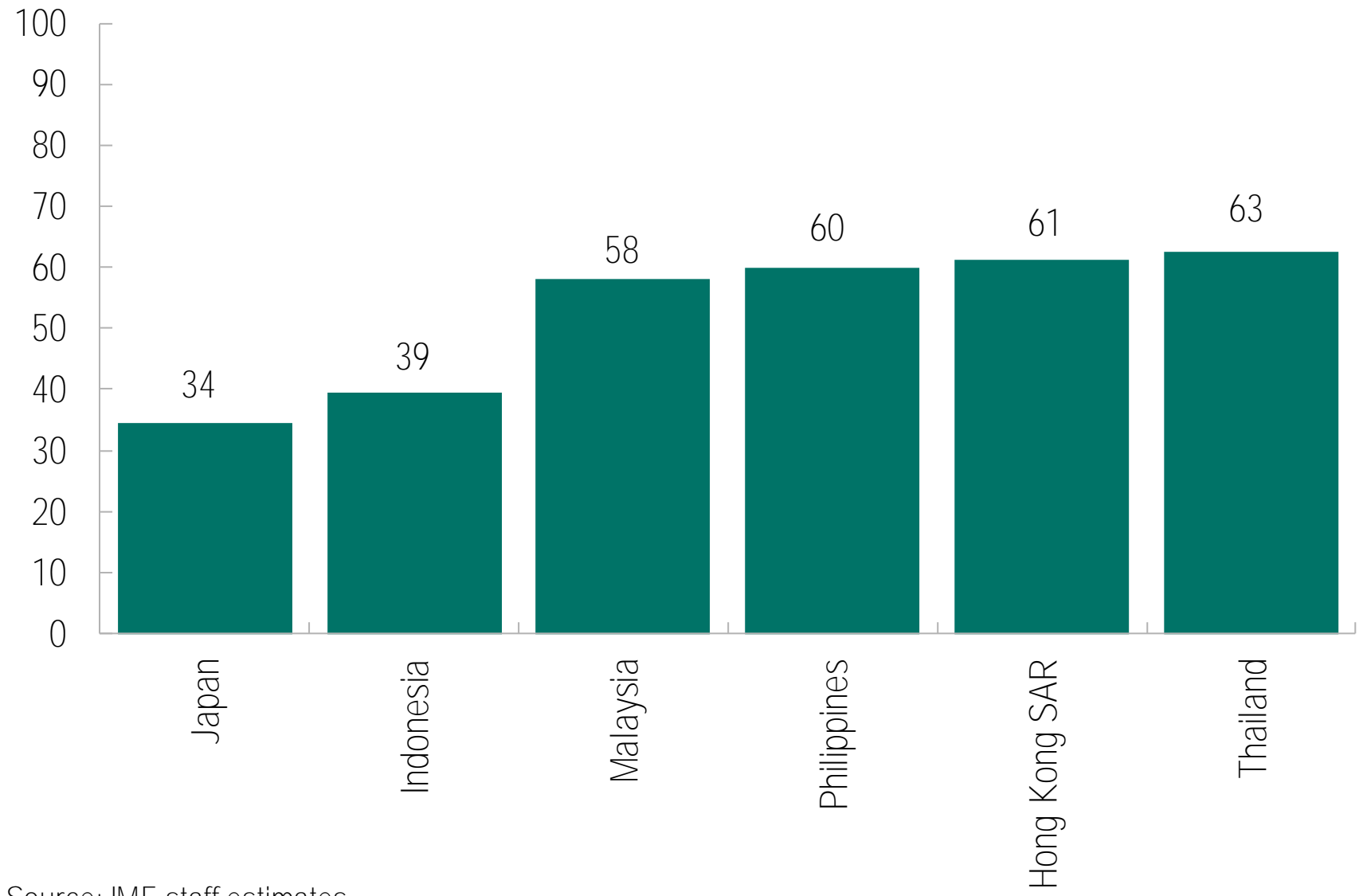
MPP impact on business cycle
MPP impact on financial cycle

Thank you!

Additional Slides

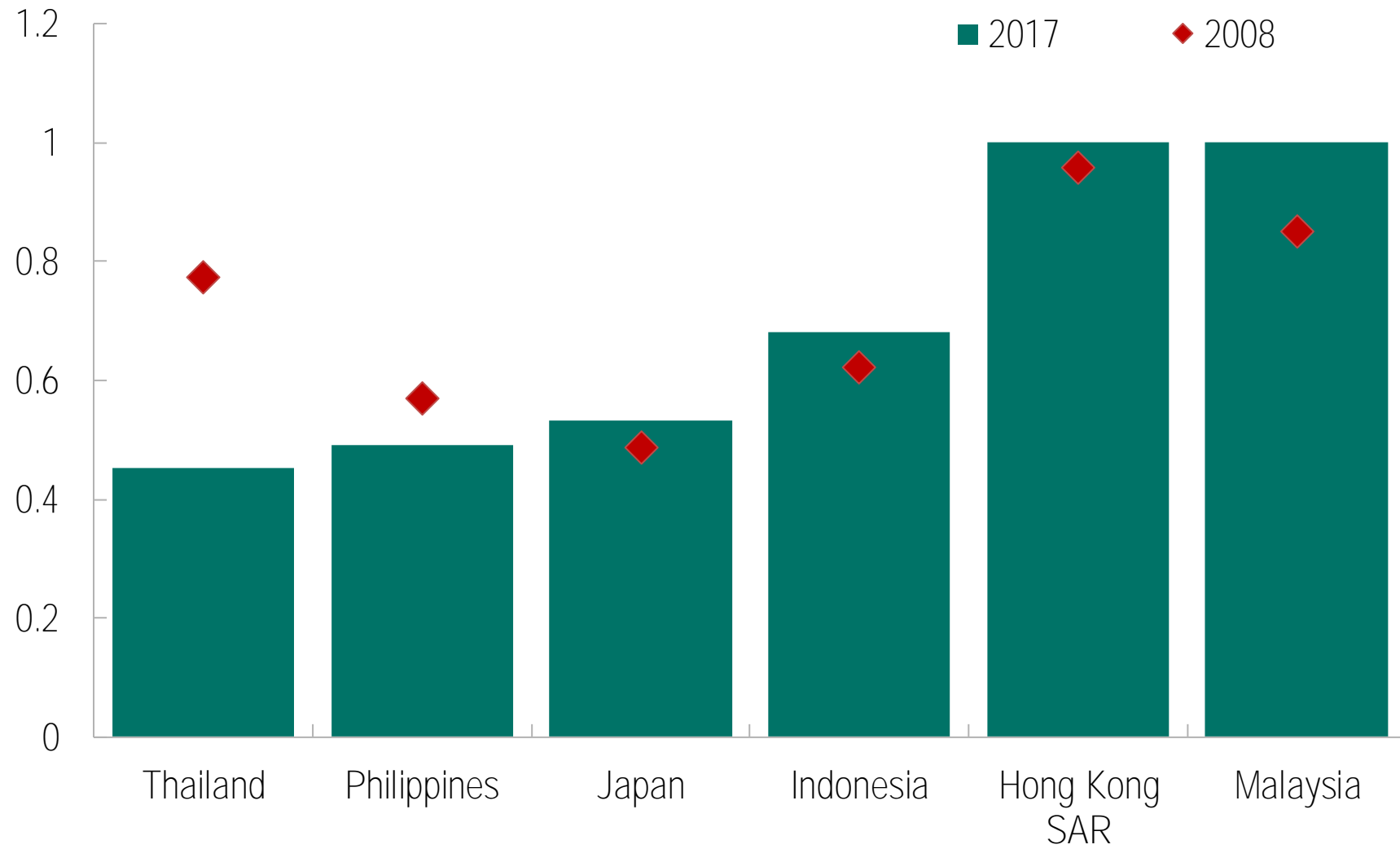
Inflation Explained by Global Factors

(Percent)



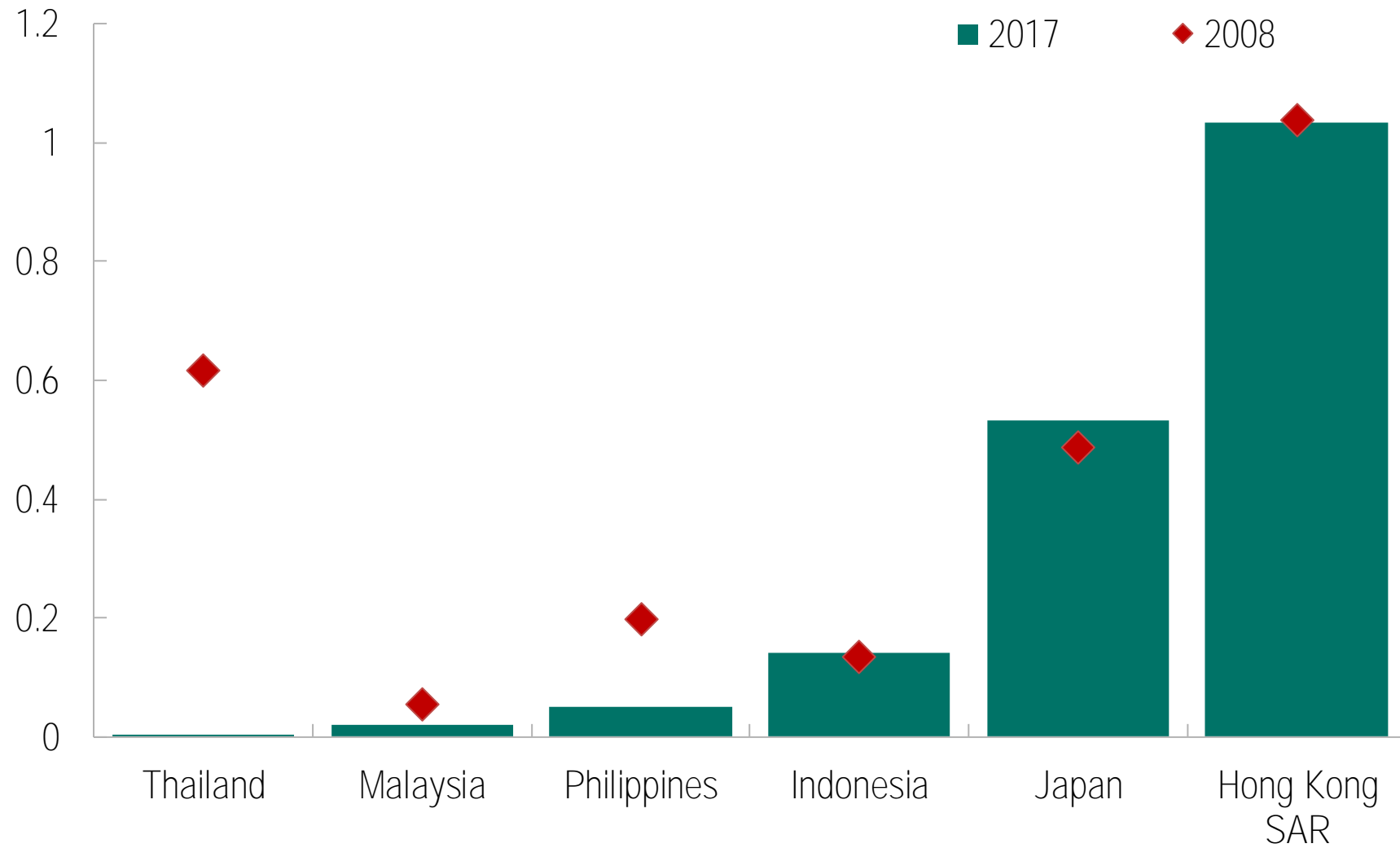
Source: IMF staff estimates.

Inflation Expectations Coefficient (Percent)



Source: IMF staff estimates.

Unemployment Gap Coefficient (Percent)



Source: IMF staff estimates.