



ASIAN DEVELOPMENT OUTLOOK

APRIL 2023

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Notes:

In this publication, “\$” refers to US dollars.

ADB recognizes “Hong Kong” as Hong Kong, China; “China” as the People’s Republic of China; “Korea” and “South Korea” as the Republic of Korea; and “Vietnam” as Viet Nam.

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FOREWORD

Many economies in developing Asia have shown strong resilience during the coronavirus disease (COVID-19) pandemic. This has enhanced the growth prospects for Asia and the Pacific as the pandemic recedes.

Asian Development Outlook April 2023 forecasts robust growth of 4.8% for developing Asia in 2023 and 2024. Several developments inform this outlook. Tourism in some economies in the region is now closing in on, or steadily approaching, pre-pandemic levels. Remittances and inflows of money transfers remain buoyant. The exit of the People's Republic of China from its zero-COVID strategy in December 2022 will further boost regional tourism and provide a lift to trade.

However, obstacles could impede progress toward strong and lasting growth. An escalation of the Russian invasion of Ukraine could result in a renewed surge in commodity prices, stoke global inflation, and induce monetary tightening. Risks from higher debt and interest rates, which are becoming evident in some banks in the US and Europe, could threaten financial stability in Asia and the Pacific. In the medium term, the possibility of global fracturing, along with challenges brought about by climate change, could undermine the growth prospects for developing Asia. To stave off these challenges, the region must closely integrate its economies, working together to build financial resilience and stimulate growth.

I am pleased that this edition of *Asian Development Outlook* will provide relevant insights to policy makers and other stakeholders as they chart the next stage in the region's development journey.



MASATSUGU ASAKAWA

President

Asian Development Bank

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ERCD economists, led by Abdul Abiad, director of the Macroeconomics Research Division, coordinated the production of this report, assisted by Edith Laviña and Priscille Villanueva. Shiela Camingue-Romance, Cindy Castillejos-Petalcorin, David Keith De Padua, Nedelyn Magtibay-Ramos, Homer Pagkalinawan, Pilipinas Quising, Dennis Sorino, Mai Lin Villaruel, and Priscille Villanueva provided technical and research support. Emmanuel Alano, Gilliane Gorostiza, Jesson Pagaduan, Rene Cris Rivera, and Michael Timbang did additional research. Economic editorial advisors Robert Boumphrey, Eric Clifton, Joshua Greene, Richard Niebuhr, and Reza Vaez-Zadeh made substantial contributions to the chapters of Part 2.

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DEFINITIONS AND ASSUMPTIONS

The economies discussed in *Asian Development Outlook 2022* are classified by major analytic or geographic group. For the purposes of this report, the following apply:

- **Association of Southeast Asian Nations (ASEAN)** comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. The ASEAN-5 are Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam.
- **Developing Asia** comprises the 46 members of the Asian Development Bank listed below by geographic group.
- **Caucasus and Central Asia** comprises Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
- **East Asia** comprises Hong Kong, China; Mongolia; the People's Republic of China; the Republic of Korea; and Taipei, China.
- **South Asia** comprises Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
- **Southeast Asia** comprises Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Timor-Leste, and Viet Nam.
- **The Pacific** comprises the Cook Islands, the Federated States of Micronesia, Fiji, Kiribati, the Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

Unless otherwise specified, the symbol "\$" and the word "dollar" refer to US dollars.

A number of assumptions have been made for the projections in *Asian Development Outlook 2022*: The policies of national authorities are maintained. Real effective exchange rates remain constant at their average from 13 January to 9 March 2022. The average price of oil is \$107/barrel in 2021 and \$93/barrel in 2022. The 6-month London interbank offered rate for US dollar deposits averages 0.5% in 2022 and 1.3% in 2023, the European Central Bank refinancing rate averages 0.0% in 2022 and 0.5% in 2023, and the Bank of Japan's overnight call rate averages 0% in both years.

The forecasts and analysis in this *ADO* are based on information available to 9 March 2022.

ABBREVIATIONS

ADB	Asian Development Bank
ADO	<i>Asian Development Outlook</i>
bps	basis points
COVID-19	Coronavirus Disease 2019
CPI	consumer price index
DARe	Business Eco-system and Darussalam Enterprise
DISCOM	electric power distribution company
ECB	European Central Bank
EU	European Union
FDI	foreign direct investment
FSM	Federated States of Micronesia
FY	fiscal year
GDP	gross domestic product
GHG	greenhouse gas
GST	goods and services tax
HCP	honorary citizenship program
HTHH	Hunga Tonga–Hunga Ha’apai volcano in Tonga
IMF	International Monetary Fund
Lao PDR	Lao People’s Democratic Republic
LNG	liquefied natural gas
LT-LEDS	long-term low greenhouse gas emission development strategy
M2	broad money that includes cash and highly liquid accounts
M2b	broad money that adds to M2 some foreign currency deposits in commercial banks
M3	broad money that adds time accounts to M2
NDC	nationally determined contribution
NPL	nonperforming loan
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PMI	purchasing managers’ index
PNG	Papua New Guinea
PRC	People’s Republic of China
Q	quarter
ROK	Republic of Korea
RPC	Regional Processing Centre in Nauru
saar	seasonally adjusted annualized rate
SOE	state-owned enterprise
STEM	science, technology, engineering, and mathematics
tCO ₂ e	ton of carbon dioxide equivalent
TEA	total early-stage entrepreneurial activity
TFP	total factor productivity
TVET	technical and vocational education and training
US, USA	United States
VAT	value-added tax

ADO APRIL 2023

HIGHLIGHTS

Developing Asia's economies are reopening with impressive dynamism. Private consumption, investment, and services—including, hearteningly, tourism—are reviving now that the pandemic has largely passed. Growth is gathering pace after showing resilience last year amid weakened demand from advanced economies, lockdowns in the People's Republic of China (PRC), monetary policy tightening, and the Russian invasion of Ukraine.

The PRC's reopening after last year's lockdowns is brightening the outlook for both the region and the global economy. Regional growth is expected at 4.8% this year and next, with South Asia expected to grow faster than other regions. Growth in East Asia and Southeast Asia is benefiting from increased domestic demand, and growth in the Pacific from returning tourists. Headline inflation is gradually coming down to pre-pandemic levels—we forecast the rate for developing Asia at 4.2% this year and 3.3% in 2024. Policy makers should nevertheless closely monitor price pressures, which remain broad-based and elevated in several economies in the region.

An array of immediate and emerging challenges could still hold back the region's recovery. The recent banking turmoil in Europe and the United States is an indication that financial stability risks have heightened. Policy makers should stay vigilant in the post-pandemic environment of higher interest rates and debt. Governments must continue supporting multilateralism, and lean against the risks of global fracturing. And Asia must continue its strong regional cooperation to weather these uncertain environments.



Albert F. Park
Chief Economist
Asian Development Bank

Brighter Prospects Amid Ongoing Challenges

Reopening in the People's Republic of China Lifts the Regional Outlook

- **Developing Asia's economic prospects are markedly improving on the rapid reopening in the People's Republic of China (PRC).** Population mobility in the PRC has normalized following the end of the zero-COVID strategy, and activity in services is rebounding the fastest. The reopening of the PRC will boost regional growth through demand for goods and services, as well as supply chain linkages.
- **Developing Asia remained resilient in 2022.** For most of last year, growth in much of the region held up on improved consumption and investment as COVID-19 receded in many economies. This helped offset the impacts of elevated food and energy prices caused by the Russian invasion of Ukraine, the tightening global financial conditions, and the PRC's economic slowdown last year.
- **Some improvement in production is now discernible.** Weaker global demand dampened production and industrial output declined in the second half of 2022, and lockdowns in the PRC held back export orders in many regional economies. But indicators of business conditions in early 2023 signal improving demand for manufactured goods and services in several economies in the region.
- **Tourists are returning; money transfers and remittances remain buoyant.** Many economies in the region have gradually opened to tourists—and visitor arrivals in some tourism-dependent ones are steadily returning to pre-pandemic levels. The outlook for tourism has improved further on the PRC's reopening. Remittances to the region remain robust, with economies in the Caucasus and Central Asia receiving large inflows of money transfers.
- **Financial conditions improved in late 2022, but have stalled recently.** Conditions tightened over most of last year, but eased in the fourth quarter on positive market sentiment due to slower US inflation and less hawkish tightening by the Federal Reserve in November. Risk premiums declined for most regional economies and equity markets picked up. Foreign portfolio outflows reversed course and many regional currencies have strengthened against the US dollar since the last quarter of 2022. But the easing of financial conditions stalled in February and March, as inflation proved more persistent and as turmoil affected banking sectors in the US and Europe.
- **Headline inflation is decelerating, but core inflation remains elevated.** Spiking commodity prices contributed to the rise in inflation in 2022 following the Russian invasion of Ukraine. The depreciation of many local currencies, prompted by monetary tightening by the Fed, pushed import prices up further. As global energy and food prices declined with the easing of supply disruptions, headline inflation reversed its upward trend, but core inflation remains high in some economies and requires close monitoring.
- **Monetary policy tightening is slowing and fiscal positions improving.** The frequency and magnitude of rate hikes by central banks in the region is declining. Fiscal balances are improving in many economies where growth has picked up, and budget plans in many economies envision further growth this year.

- **The PRC's recovery and healthy domestic demand in India will be the region's main growth supports this year and next.** Growth in developing Asia is forecast at 4.8% this year and in 2024, up from 4.2% last year. The PRC's reopening is brightening East Asia's outlook with positive trade, tourism, and other spillovers to the rest of developing Asia. Growth in the PRC is forecast to rebound to 5.0% this year from 3.0% in 2022; growth in 2024 is projected at 4.5%. South Asia will grow strongly, but the outlook varies substantially within the subregion. India is forecast to grow by 6.4% this year and 6.7% next year on healthy domestic demand, but Pakistan and Sri Lanka face a challenging outlook. Growth in the Caucasus and Central Asia, the Pacific, and Southeast Asia will be lifted by their reopening and recovery in tourism-related sectors.
- **Inflation is expected to moderate this year and next, gradually moving closer to pre-pandemic levels.** Headline inflation is forecast to decelerate to 4.2% this year and 3.3% in 2024 from 4.4% last year. While higher interest rates and still-elevated commodity prices are expected to shape the region's inflation outlook, headline inflation should remain the same this year in East Asia and decline in other subregions.
- **The PRC's reopening poses an upside risk, but many challenges remain.** A smoother and more rapid reopening may lead to stronger regional growth than is currently forecast. But there are several downside risks. Higher debt and interest rates have magnified financial stability risks, as evidenced by recent banking sector problems in the US and Europe. An escalation in the Russian invasion of Ukraine could cause renewed surges in commodity prices, stoking global inflation and inducing further monetary tightening. And global fracturing and climate change are persistent challenges.

The Causes and Consequences of Higher-than-Expected Growth in the Caucasus and Central Asia

- **The Caucasus and Central Asia grew more strongly than expected in 2022.** This report's *Special Topic* finds this was in part due to Russians boosting consumption and business activity as they migrated to the subregion, fueling a significant rise in money transfers to the economies there. Exports to the Russian Federation also grew sharply last year, with reexports accounting for 49% of the rise, mostly driven by many companies ceasing to export directly to Russia—even if their products were not on the sanctions list of the European Union. These windfall gains may be temporary if reexports and the inflow of Russian migrants wane. Russia's increasing isolation and the risk of a long-term decline suggests that countries in the subregion should diversify their economic linkages.

GDP Growth Rate and Inflation, % Per Year								
	GDP Growth				Inflation			
	2021	2022	2023	2024	2021	2022	2023	2024
Developing Asia	7.2	4.2	4.8	4.8	2.6	4.4	4.2	3.3
Developing Asia excluding the PRC	6.1	5.4	4.6	5.1	4.2	6.7	6.2	4.5
Caucasus and Central Asia	5.8	5.1	4.4	4.6	9.0	12.9	10.3	7.5
Armenia	5.7	12.6	6.5	5.5	7.2	8.6	7.0	6.2
Azerbaijan	5.6	4.6	3.5	3.8	6.7	13.9	7.0	6.5
Georgia	10.5	10.2	4.5	5.0	9.6	11.9	6.0	4.0
Kazakhstan	4.3	3.2	3.7	4.1	8.0	15.0	11.8	6.4
Kyrgyz Republic	6.2	7.0	4.5	4.0	11.9	13.9	12.0	8.6
Tajikistan	9.2	8.0	5.5	6.5	8.0	4.2	7.0	6.5
Turkmenistan	5.0	6.2	6.5	6.0	12.5	10.0	10.0	10.0
Uzbekistan	7.4	5.7	5.0	5.0	10.7	11.4	11.0	10.0
East Asia	7.9	2.8	4.6	4.2	1.1	2.3	2.3	2.0
Hong Kong, China	6.4	-3.5	3.6	3.7	1.6	1.9	2.3	2.1
Mongolia	1.6	4.8	5.4	6.1	7.3	15.2	10.9	8.7
People's Republic of China	8.4	3.0	5.0	4.5	0.9	2.0	2.2	2.0
Republic of Korea	4.1	2.6	1.5	2.2	2.5	5.1	3.2	2.0
Taipei, China	6.5	2.5	2.0	2.6	2.0	2.9	2.0	2.0
South Asia	8.4	6.4	5.5	6.1	5.8	8.2	8.1	5.8
Afghanistan	-20.7	...	...	...	5.2	13.8	...	...
Bangladesh	6.9	7.1	5.3	6.5	5.6	6.2	8.7	6.6
Bhutan	4.1	4.7	4.6	4.2	7.3	5.6	5.5	5.1
India	9.1	6.8	6.4	6.7	5.5	6.7	5.0	4.5
Maldives	41.7	12.3	7.1	6.9	0.5	2.3	4.5	2.0
Nepal	4.2	5.8	4.1	5.0	3.6	6.3	7.4	6.2
Pakistan	5.7	6.0	0.6	2.0	8.9	12.2	27.5	15.0
Sri Lanka	3.5	-7.8	-3.0	1.3	6.0	46.4	24.6	5.5
Southeast Asia	3.5	5.6	4.7	5.0	2.0	5.0	4.4	3.3
Brunei Darussalam	-1.6	-0.5	2.5	2.8	1.7	3.7	2.0	1.6
Cambodia	3.0	5.2	5.5	6.0	2.9	5.3	3.0	4.0
Indonesia	3.7	5.3	4.8	5.0	1.6	4.2	4.2	3.0
Lao People's Democratic Republic	2.3	2.5	4.0	4.0	3.8	23.0	16.0	5.0
Malaysia	3.1	8.7	4.7	4.9	2.5	3.4	3.1	2.8
Myanmar	-5.9	2.0	2.8	3.2	3.6	16.0	10.5	8.2
Philippines	5.7	7.6	6.0	6.2	3.9	5.8	6.2	4.0
Singapore	8.9	3.6	2.0	3.0	2.3	6.1	5.0	2.0
Thailand	1.5	2.6	3.3	3.7	1.2	6.1	2.9	2.3
Timor-Leste	2.9	3.2	3.1	3.0	3.8	7.0	5.5	2.8
Viet Nam	2.6	8.0	6.5	6.8	1.8	3.2	4.5	4.2
The Pacific	-1.4	5.2	3.3	2.8	3.1	5.7	5.0	4.4
Cook Islands	-29.1	10.5	11.2	9.1	1.8	4.2	7.7	2.3
Federated States of Micronesia	-1.3	2.0	4.1	0.5	1.8	5.0	3.6	0.4
Fiji	-5.1	15.9	6.3	3.0	0.2	4.3	4.2	3.5
Kiribati	1.5	1.8	2.3	2.8	1.0	5.0	3.7	3.0
Marshall Islands	1.1	-0.9	1.5	2.0	2.2	3.3	3.7	3.5
Nauru	1.5	1.2	1.8	2.2	1.2	2.3	2.5	1.9
Niue	...	...	...	...	...	...	...	...
Palau	-17.1	-1.0	3.8	6.5	0.5	10.2	5.0	5.5
Papua New Guinea	0.1	3.2	2.4	2.6	4.5	6.0	5.0	5.0
Samoa	-7.1	-6.0	4.8	2.5	-3.0	8.8	10.2	2.0
Solomon Islands	-0.5	-4.2	3.0	2.5	-0.2	5.5	4.5	3.7
Tonga	-2.7	-2.2	2.5	3.2	1.4	8.5	9.4	1.5
Tuvalu	1.8	1.5	2.5	2.0	6.7	7.6	3.3	2.8
Vanuatu	1.0	2.0	1.0	4.2	2.3	4.8	4.0	3.0

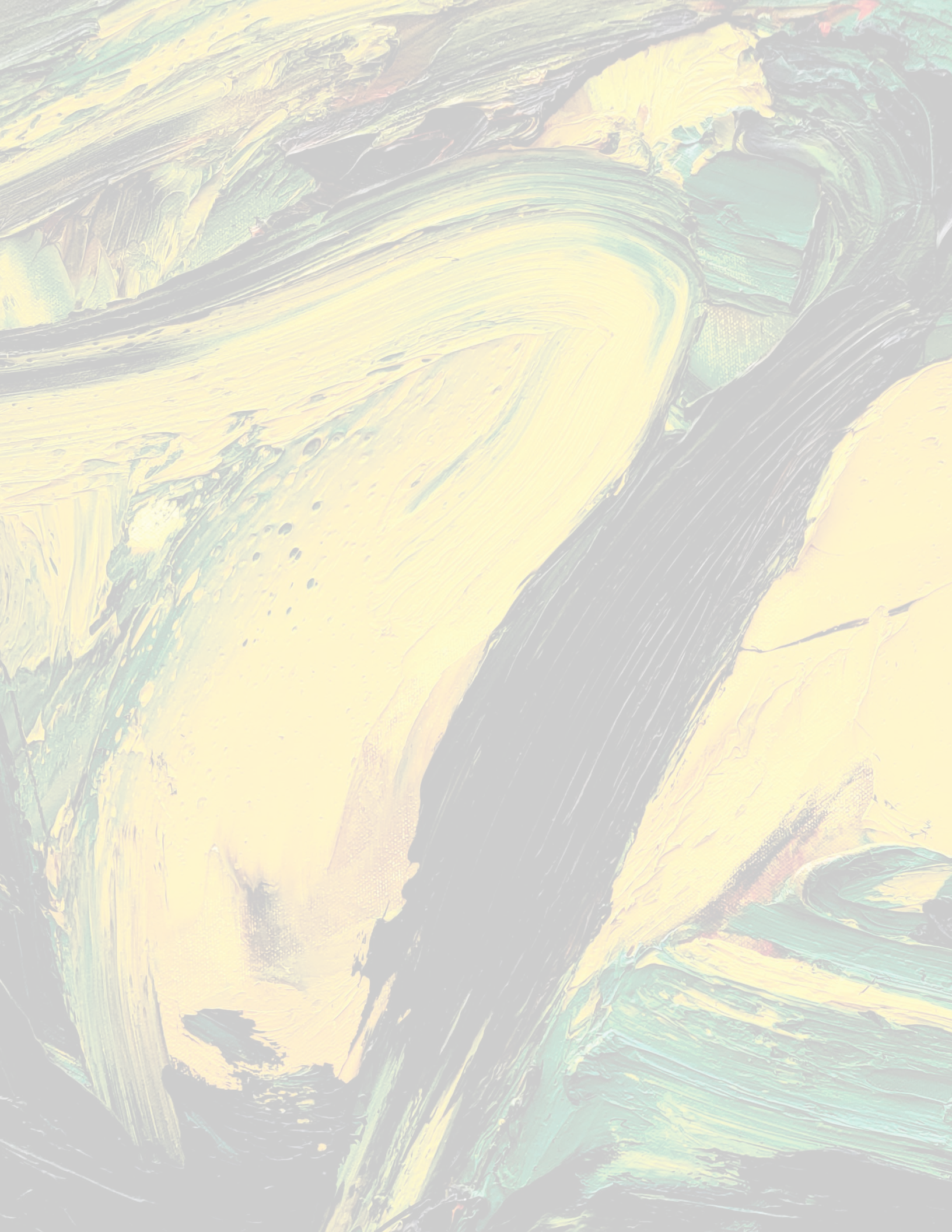
... = not available, GDP = gross domestic product, PRC = People's Republic of China.

Note: The current uncertain situation permits no estimates or forecasts for Afghanistan in 2022–2024. ADB placed on hold its assistance in Afghanistan effective 15 August 2021. [ADB Statement on Afghanistan](#).



1

**BRIGHTER PROSPECTS
AMID ONGOING
CHALLENGES**



BRIGHTER PROSPECTS AMID ONGOING CHALLENGES

Growth in developing Asia remained resilient amid multiple challenges. Economic activity in 2022 was underpinned by the continued reopening of many economies, strengthening domestic consumption and investment. This helped to offset the slowdown in demand from advanced economies induced by tighter monetary policy, the demand shift from goods to services, and a downturn in electronics and semiconductor production. Exports and industrial production dipped because of the global slowdown and lockdowns in the People's Republic of China (PRC), but recent high-frequency data point to improvements in the prospects for manufacturing. Remittances to the region remain robust and the recovery in tourism is gaining momentum.

The PRC exiting its zero-COVID strategy in December has brightened the regional and global outlook.

Growth in developing Asia is expected to accelerate to 4.8% this year and next from 4.2% in 2022. The region's headline inflation rate is forecast at 4.2% this year, easing to 3.3% in 2024 as it inches back to pre-pandemic levels on dissipating supply-side pressures.

The PRC's reopening has lifted the region's outlook, but multiple challenges remain. A faster-than-expected reopening in the PRC could lead to a stronger pick-up in growth there, boosting external demand for economies in the rest of the region. On the downside, the tightening of global financial conditions has heightened financial stability risks, as evidenced by emerging banking sector vulnerabilities in the United States and Europe. Uncertainty over the Russian invasion of Ukraine persists; an escalation could rekindle inflation pressures and sharpen food security challenges.

This section was written by Abdul Abiad, Shiela Camingue-Romance, David Keith De Padua, Jules Hugot, Yothin Jinjark (lead), Yuho Myoda, Homer Pagkalinawan, Pilipinas Quising, Irfan Qureshi (colead), Priscille Villanueva, and Mai Lin Villaruel of the Economic Research and Regional Cooperation Department (ERCD), Asian Development Bank (ADB), Manila, Cindy Castillejos-Petalcorin of the South Asia Department, ADB, and Jesson Pagaduan, ERCD consultant.

Developing Asia's Growth Moderated amid Dampening Global Demand

Slower growth in 2022 and output losses widening from pre-pandemic trends were driven primarily by the PRC's zero-COVID strategy. This lowered East Asia's growth to 2.8% last year from 7.9% in 2021 (Figure 1.1.1, panel A). The gap between gross domestic product (GDP) and the pre-pandemic trend also widened in East Asia, to -3.2% from -1.0%, and it widened slightly in South Asia due largely to Sri Lanka's economy contracting by 7.8% (panel B). Growth strengthened in the Pacific and Southeast Asia last year as economies in these subregions reopened further and narrowed output losses. Growth moderated in the Caucasus and Central Asia after strong rebounds in 2021.

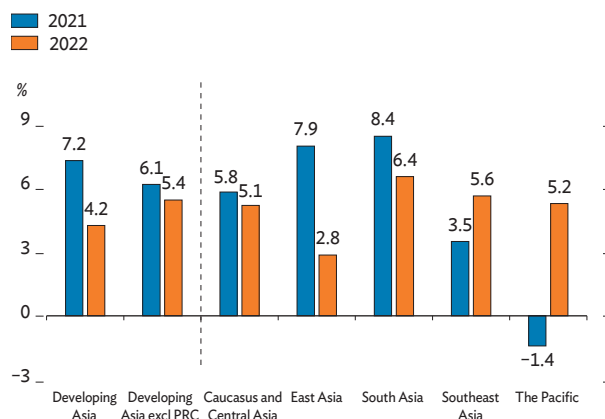
Robust domestic demand supported growth in the second half of 2022 in four larger Southeast Asian economies, but net exports weakened growth in the region's key technology exporters.

Growth in Southeast Asia was boosted by economies reopening, and stronger private consumption and investment quickened growth in Indonesia, Malaysia, and Thailand. But declining net exports slowed growth in the key technology exporting economies—the Republic of Korea; Singapore; and Taipei, China (Figure 1.1.2, panel A). Although private consumption recovered in these economies, this was not strong enough to offset the impact of weaker net exports.

Figure 1.1.1 Economic Performance by Subregion in Developing Asia

A. GDP Growth

The region's growth rate declined in 2022, mainly due to slower growth in East Asia.



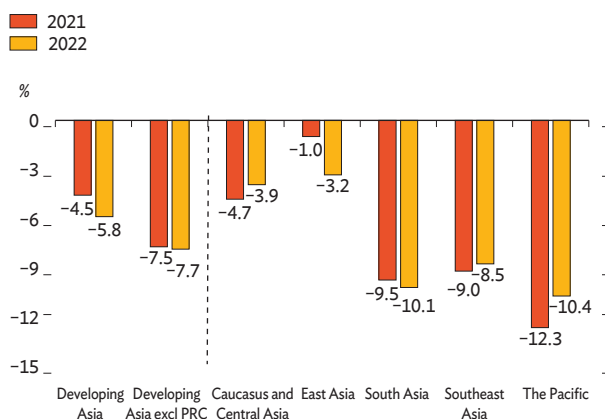
GDP = gross domestic product, PRC = People's Republic of China.

Note: Output losses are the difference between actual GDP and the pre-pandemic trend.

Sources: International Monetary Fund. World Economic Outlook Databases; *Asian Development Outlook* database; Asian Development Bank estimates.

B. Output Losses

Output losses widened in East Asia and South Asia, but narrowed in other subregions.



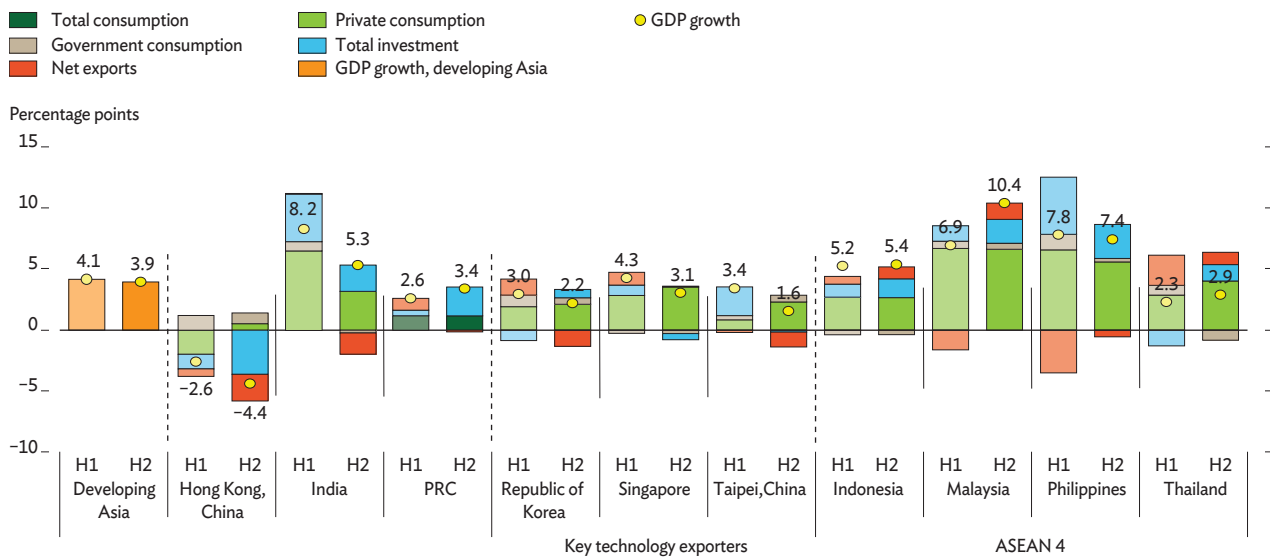
The shift in demand from goods to services continued in recently reopened economies (Figure 1.1.2, panel B). Growth in services strengthened in four of the larger Southeast Asian economies in the second half of last year, supported by reopening, the further lifting of border restrictions,

and the resumption of in-bound tourism. But the contribution of services moderated somewhat in the Republic of Korea and Taipei, China and was almost unchanged in Singapore as higher output in tourism-related services in these economies was offset by a slowdown in finance and insurance services.

Figure 1.1.2 Growth Components in Developing Asia

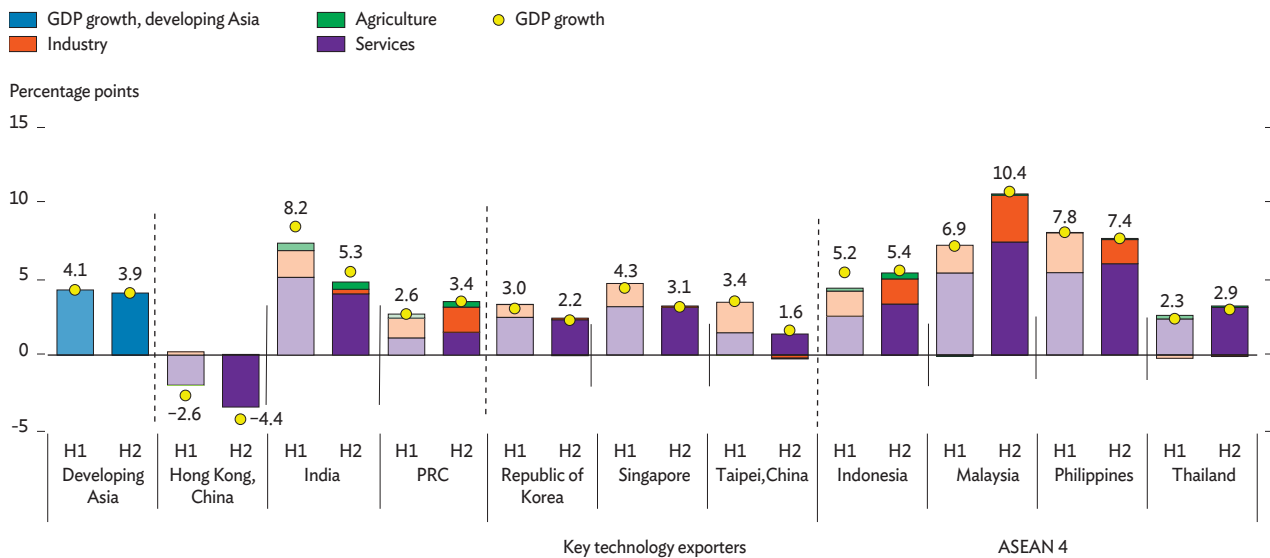
A. Demand-side Contributions to GDP Growth, 2022

Falling exports slowed growth in H2 2022 in key technology exporters, while stronger private consumption and investment boosted growth in ASEAN 4 economies ...



B. Supply-side Contributions to GDP Growth, 2022

... in line with the strong expansion in services as more economies in the subregion reopened.



ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product, H = half, PRC = People's Republic of China.

Notes: Panel A excludes statistical discrepancies; Panel B excludes taxes and subsidies on imports. Developing Asia weighted using GDP (purchasing price parity).

Sources: CEIC Data Company; Haver Analytics.

Production in the region’s key manufacturing economies slowed in the fourth quarter of 2022, but business prospects have started to improve in many economies.

Industrial production in the key technology exporters and in Thailand contracted in the last few months of 2022 after robust expansion in the third quarter. Industrial production grew at a slower pace in Malaysia and Viet Nam as external demand softened (Figure 1.1.3). Declining external demand was also reflected in the purchasing managers’ index (PMI) for the key manufacturing economies. The manufacturing PMI for the region’s key technology exporters, as well as Malaysia and Viet Nam, fell significantly below 50—the index threshold indicating improvement (Table 1.1.1). New export orders, the external component of the manufacturing PMI, sharply deteriorated in these economies ahead of a more generalized decline in overall manufacturing (Table 1.1.2). However, the manufacturing PMI returned to above 50 in February in most economies, and rose markedly in those where PMIs remained below 50, indicating that business sentiment in the region is improving again.

The region’s key technology exporters are facing a downturn in the semiconductor cycle.

Global sales of semiconductors and semiconductor-related goods exports from the Republic of Korea; Singapore; and Taipei, China started to decline in late 2022 (Figure 1.1.4). Semiconductor exports from the Republic of Korea show the sharpest decline, which is in line with the

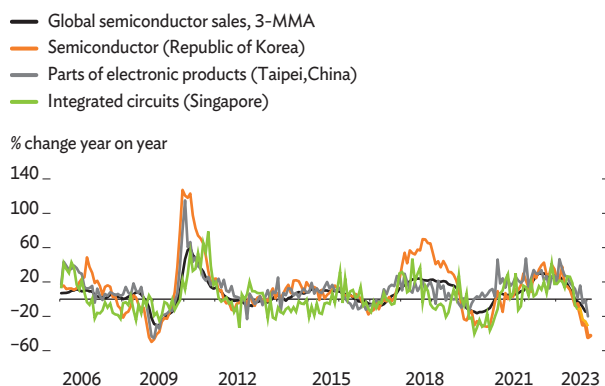
weakening in business sentiment there. Its exports were also volatile in previous peaks and troughs because its semiconductor sector relies heavily on memory chips, which are thought to be more cyclical than other semiconductor products.

The global slowdown in the second half of 2022 lowered commodity prices, helping reduce headline inflation in the region.

The overall rise in inflation was much less than in the US and the euro area (Figure 1.1.5). But important variations in headline inflation emerged. In the Caucasus and Central Asia,

Figure 1.1.4 Semiconductor Sales and Exports in Developing Asia’s Main Technology Exporters

The sector faces a cyclical downturn in demand.

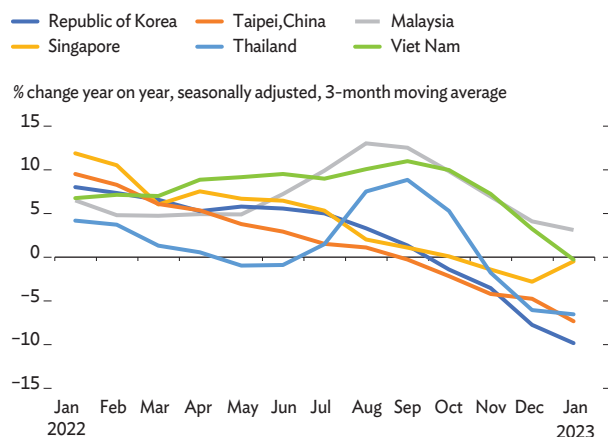


3-MMA = 3-month moving average.

Source: CEIC Data Company.

Figure 1.1.3 Industrial Production in Selected Developing Asian Economies

Industrial production declined in Q4 2022 in manufacturing exporters.

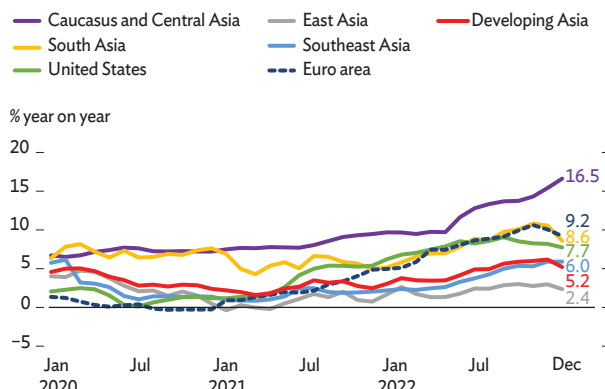


Q = quarter.

Source: CEIC Data Company.

Figure 1.1.5 Inflation in Developing Asia, United States, and Euro Area

Inflation slowed in most developing Asian economies in Q4 2022 after accelerating in the previous three quarters.



Q = quarter.

Sources: CEIC Data Company; Haver Analytics.

Table 1.1.1 Manufacturing Purchasing Managers' Index in Selected Developing Asian Economies*Business prospects improved in early 2023 in most economies.*

Economy	2022												2023	
	Q1			Q2			Q3			Q4			Q1	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
India	54.0	54.9	54.0	54.7	54.6	53.9	56.4	56.2	55.1	55.3	55.7	57.8	55.4	55.3
Thailand	51.7	52.5	51.8	51.9	51.9	50.7	52.4	53.7	55.7	51.6	51.1	52.5	54.5	54.8
Philippines	50.0	52.8	53.2	54.3	54.1	53.8	50.8	51.2	52.9	52.6	52.7	53.1	53.5	52.7
PRC	49.1	50.4	48.1	46.0	48.1	51.7	50.4	49.5	48.1	49.2	49.4	49.0	49.2	51.6
Indonesia	53.7	51.2	51.3	51.9	50.8	50.2	51.3	51.7	53.7	51.8	50.3	50.9	51.3	51.2
Viet Nam	53.7	54.3	51.7	51.7	54.7	54.0	51.2	52.7	52.5	50.6	47.4	46.4	47.4	51.2
Singapore	50.6	50.2	50.1	50.3	50.4	50.3	50.1	50.0	49.9	49.7	49.8	49.7	49.8	50.0
Taipei,China	55.1	54.3	54.1	51.7	50.0	49.8	44.6	42.7	42.2	41.5	41.6	44.6	44.3	49.0
Republic of Korea	52.8	53.8	51.2	52.1	51.8	51.3	49.8	47.6	47.3	48.2	49.0	48.2	48.5	48.5
Malaysia	50.5	50.9	49.6	51.6	50.1	50.4	50.6	50.3	49.1	48.7	47.9	47.8	46.5	48.4

PRC = People's Republic of China, Q = quarter.

Notes: The manufacturing purchasing managers' index is seasonally adjusted except for Singapore. Pink to red indicates deterioration (<50) and white to green indicates improvement (>50).

Source: CEIC Data Company.

Table 1.1.2 New Export Orders Purchasing Managers' Index*The slowdown in external demand is bottoming out.*

	2022												2023	
	Q1			Q2			Q3			Q4				
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
Viet Nam	56.2	55.7	53	52.3	53.7	53.9	52.9	52.8	51.9	50.6	46.3	47.6	50.3	53.7
Taipei,China	56.5	55.1	49	48.7	49.6	47.9	38.4	34.7	34.2	34.8	35.1	39.2	38.3	49.5
Thailand	48.2	48.2	48.1	50.0	48.9	50.4	50.2	49.5	50.5	49.7	48.5	49.4	48.9	49.2
Republic of Korea	50.4	53.2	45.8	46.2	47.2	48	46.9	44.7	45.1	46.5	48.3	39.9	44.1	47.8
Malaysia	49.2	50.6	48.8	50.3	50.7	50.1	48.7	47.7	47.2	45.4	46.4	47.3	45.3	46.8

Q = quarter.

Note: Pink to red indicates deterioration (<50) and white to green indicates improvement (>50).

Source: CEIC Data Company.

the Russian invasion of Ukraine accelerated inflation by pushing up manufacturing costs through supply chain disruptions and raising prices of food products, including wheat. The invasion also increased demand for local goods and services through inflows of Russians and their money into several economies in the Caucasus and Central Asia. For other subregions, headline inflation slowed as import price pressures from previously rising commodity prices and currency depreciations seem to have dissipated in the second half of 2022.

Core inflation remains elevated due to reopening-related improvements in consumption. Pressure on headline inflation became broad-based with core inflation far higher than the pre-pandemic average for most economies in the region with available data (Table 1.1.3). In the Caucasus and Central Asia, especially Kazakhstan and the Kyrgyz Republic, core inflation reached double digits in December 2022. In South Asia, core inflation in Pakistan was at 14.7% and 57.5% in Sri Lanka for the same month.

Table 1.1.3 Core Inflation in Developing Asia, % year on year*Core inflation remains elevated for most economies in the region.*

	2021	2022	Dec 2022	2015–2019 average
Caucasus and Central Asia				
Armenia	5.3	7.4	8.1	1.3
Georgia	6.4	6.3	6.9	3.7
Kazakhstan	7.6	15.0	21.2	8.3
Kyrgyz Republic	11.3	15.4	17.5	2.8
East Asia				
Mongolia	5.4	15.8	...	5.3
People's Republic of China	0.8	0.9	0.7	1.8
Taipei, China	1.3	2.6	2.7	0.9
Republic of Korea	1.8	4.1	4.8	1.5
South Asia				
India	5.9	6.1	6.1	4.8
Pakistan	6.7	11.6	14.7	5.8
Sri Lanka	5.5	43.4	57.5	4.7
Southeast Asia				
Indonesia	1.4	2.8	3.4	3.5
Malaysia	0.7	3.0	4.1	1.7
Philippines	3.0	3.9	6.9	2.5
Singapore	0.9	4.1	5.1	1.1
Thailand	0.2	2.5	3.2	0.7
Viet Nam	0.8	2.6	5.0	1.8

... = not available.

Notes: Numbers highlighted in pink indicate values higher than the 2015–2019 average. 2022 up to June for Mongolia.

Source: CEIC Data Company.

Slowing Global Demand Held Back the Region's Exports

Exports from developing Asia weakened in the second half of 2022. A revival in the first half was offset by weaker exports in the second half as demand for electronics slowed and commodity prices declined (Figure 1.1.6, panel A). The decline was particularly steep for the region's key technology exporters as semiconductor exports slumped. In real terms, export growth in developing Asia excluding the PRC fell to 6.7% in 2022 from 15.5% last year. In the PRC, real exports contracted by 0.6% on softening global demand and stringent COVID-19 restrictions from 19.6% growth in 2021.

Slowing exports of electronics drove the decline in exports from the region in the second half of 2022. Exports had already slowed in the first half before contracting sharply in the second on waning global demand following 2021's large increase in demand (Figure 1.1.7). Exports of machinery, however, grew as investment—often delayed during the pandemic—picked up in the first half. Rising global demand for

vehicles also supported exports last year. Commodity exports moved in tandem with the sharp swings in global prices—rising in the first half and declining in the second.

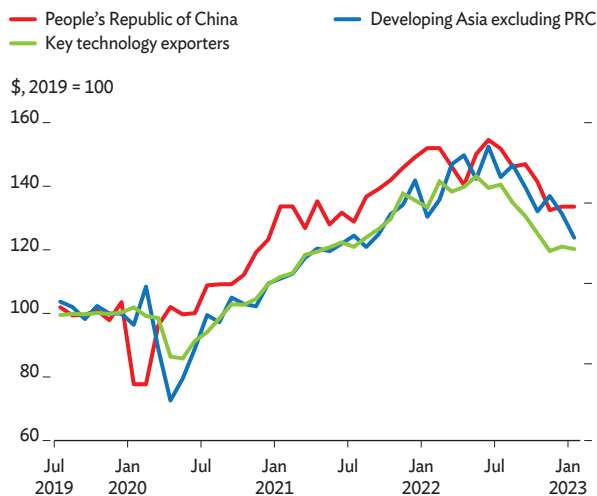
Weakening demand for electronics dampened East Asia's exports in 2022. Electronic exports slowed as global demand softened, particularly in the second half of the year (Figure 1.1.8, panel A). This decline was particularly steep in the Republic of Korea and Taipei,China, where exports are concentrated on semiconductor chips. Exports of machinery and vehicles were resilient, cushioning the overall decline.

Southeast Asia's exports were resilient due to healthy exports of commodities, electronics, and machinery. Rising exports of crude and refined oil, and of palm oil in Indonesia and Malaysia, helped lift the subregion's exports last year (Figure 1.1.8, panel B). In Thailand, rising exports of electronics and vehicles mitigated declines in other sectors. In Malaysia, exports of electronics remained buoyant as they are concentrated in lower-end semiconductors and consumer electronics, for which demand held up better than for the higher-end semiconductors exported by the Republic of Korea and Taipei,China.

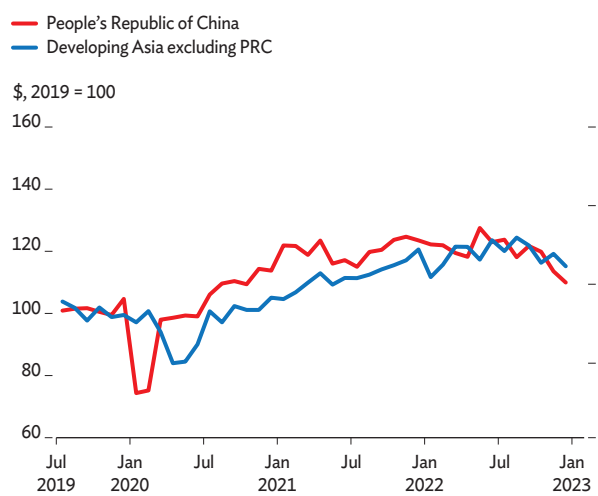
Figure 1.1.6 Nominal and Real Merchandise Exports in Developing Asia

Exports slowed in H2 2022 on weakening demand for electronics and commodities.

A. Nominal Exports



B. Real Exports



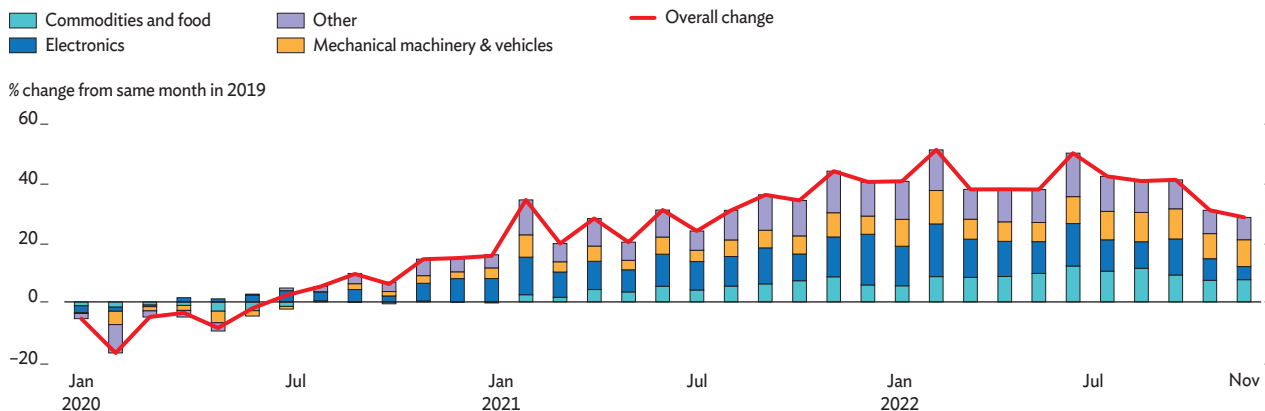
H= half, PRC = People's Republic of China.

Notes: Developing Asia excluding PRC comprises Hong Kong, China; India; Indonesia; Republic of Korea; Malaysia; Pakistan; Philippines; Singapore; Taipei,China; Thailand; Viet Nam. The key technology exporters are the Republic of Korea; Singapore; Taipei,China. Data are seasonally adjusted. The PRC's exports for January and February are averaged to avoid reflecting the timing of the Chinese New Year.

Sources: CEIC Data Company; CPB Netherlands Bureau for Economic Policy Analysis. [CPB World Trade Monitor](#).

Figure 1.1.7 Sector Contributions to Nominal Export Growth in Developing Asia

Exports of commodities, machinery, and vehicles increased in 2022, but electronics fell.



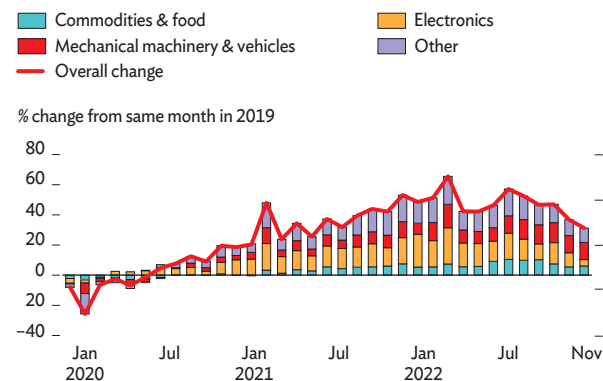
Note: The sample comprises 10 economies accounting for 78% of developing Asia’s exports in 2019: Armenia; Georgia; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the People’s Republic of China; Taipei,China; Thailand; Uzbekistan.

Sources: International Trade Centre. [Trade Map](#); [Observatory of Economic Complexity](#); [United Nations Comtrade Database](#).

Figure 1.1.8 Sector Contributions to Nominal Export Growth in Developing Asia

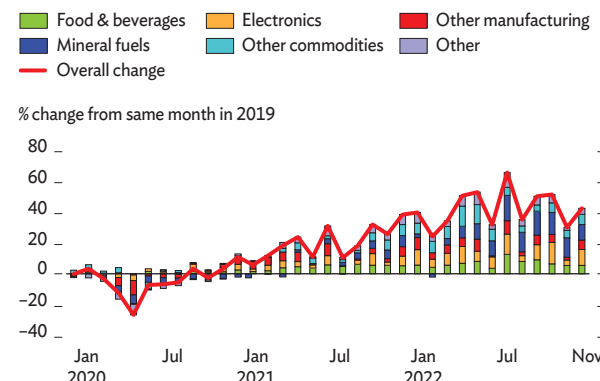
A. East Asia

Falling demand for electronics caused exports to slump in H2 2022.



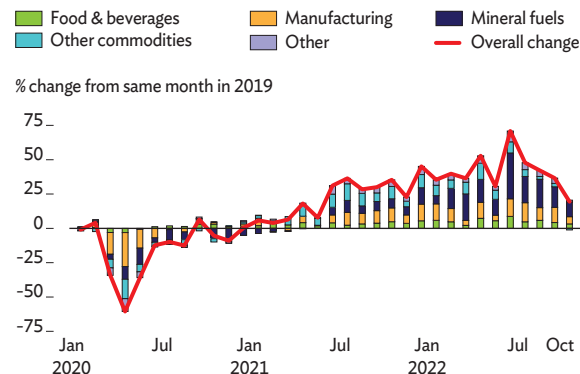
B. Southeast Asia

Exports were resilient due to diversification from commodities to manufactured goods.



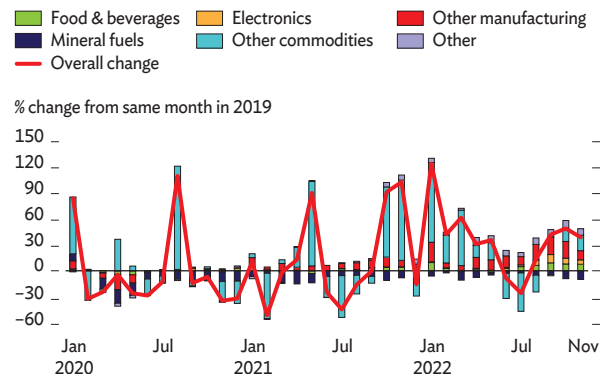
C. South Asia

Commodity exports rose in H1 2022 and declined in H2 on commodity price fluctuations.



D. Caucasus and Central Asia

Exports became more diversified to cater to demand from the Russian Federation.



H = half.

Note: In the figure, East Asia comprises Hong Kong, China; the People’s Republic of China; the Republic of Korea; Taipei,China. South Asia comprises India. Southeast Asia comprises Indonesia, Malaysia, Thailand. Caucasus and Central Asia comprises Armenia, Georgia, Uzbekistan.

Sources: International Trade Centre. [Trade Map](#); [Observatory of Economic Complexity](#); [United Nations Comtrade Database](#).

Commodity price variations drove South Asia’s exports. India’s exports rose in the first half of 2022, lifted mainly by rising prices for refined oil products (Figure 1.1.8, panel C). Exports fell in the second half on softening global prices and weaker exports of base metals and other commodities. Rice exports were lower, depressed by a ban on exports of broken rice and a 20% export tax on several varieties of rice imposed in September.

Rising demand from the Russian Federation diversified exports of the Caucasus and Central Asia. Economies in the subregion last year started reexporting commodities and precious metals goods that became more difficult to buy in Russia following the Russian invasion of Ukraine—and reexports of electronics and vehicles, among other goods, also rose sharply (Figure 1.1.8, panel D). Russian buyers also bought more food products from the Caucasus and Central Asia, as these became more difficult to source (*Special Topic* on the economic impact of the Russian invasion of Ukraine on the Caucasus and Central Asia). Exports of other commodities—an export category that primarily consists of precious metals and jewelry—fluctuated sharply over 2022.

Tourism Rebounds Further and Remittances Remain Steady

The rebound in tourism is well underway. The industry’s further recovery in 2022 benefited from eased travel restrictions, rising vaccination rates, and pent-up demand for travel (Figure 1.1.9). Although data for 20 economies in developing Asia show visitor arrivals last year averaged just 26% of 2019’s level, arrivals in the fourth quarter rose to 45% of that level. And some tourism-dependent economies, including Fiji, Georgia, and Maldives, are receiving more tourists than before the pandemic.

The recovery in tourism is particularly strong in the Caucasus and Central Asia, the Pacific, and South Asia. In the Caucasus and Central Asia, tourists from Russia supported the recovery, with economies in the subregion also benefiting from the spending of Russian migrants.

Tourism from Russia was spurred by difficulties encountered visiting Europe after the Russian invasion of Ukraine. In the Pacific and South Asia, the recovery in tourism accelerated on entry restrictions due to the pandemic being mostly lifted in 2021. In South Asia, the gap from the loss of tourists from the PRC, and from Russia and Ukraine, was filled by tourists from Europe, India, and the US. In the Pacific, tourism continues to bounce back after borders reopened in late 2021. The recovery is particularly strong in Fiji, as well as Cook Islands and Samoa, due to visitors from Australia, New Zealand, and the US. In Fiji and Solomon Islands, tourists stayed longer and spent more than they did in 2019.

Tourism started to recover in East Asia and Southeast Asia in 2022, but arrivals are still below pre-pandemic levels. Reopened borders and eased travel restrictions are lifting tourism in Southeast Asia. Before the pandemic, the subregion attracted large numbers of tourists from East Asia, where outbound travel restrictions were only relaxed this year. In East Asia excluding the PRC, the recovery started only in mid-2022, when entry restrictions were gradually eased. The absence of tourists from the PRC for most of the year affected tourism to other economies in the subregion. But the reopening of the PRC’s borders in December triggered a sharp rebound of arrivals in these economies, which is expected to further revive tourism in the region (Box 1.1.1).

Remittances declined slightly in South Asia, remained steady in Southeast Asia, and soared in the Pacific. In Bangladesh and Pakistan, remittances declined by about 5% last year on slowdowns in host economies for migrant workers and greater use of informal channels driven by the gap between official and unofficial exchange rates widening (Figure 1.1.10, panel A). In Sri Lanka, official remittances declined by 31%, as the gap between official and parallel exchange rates widened from 2021. These remittances, however, picked up slightly during the year as the gap between the two rates narrowed. In the Philippines, remittances remained steady. In the Pacific, remittances rose by 17% in Samoa and by 23% in Fiji on resuming seasonal labor migration to Australia and New Zealand after travel restrictions were eased (Figure 1.1.10, panel B). This is a positive development only in part as labor migration is generating domestic labor shortages in several Pacific island economies, particularly for skilled workers.

Box 1.1.1 The Return of Tourists from the People’s Republic of China: Implications for Developing Asia

Developing Asia will benefit from an influx of tourists from the People’s Republic of China (PRC) after restrictions on overseas travel were lifted in December 2022. In 2019, the region attracted 56% of the PRC’s total 155 million tourists (box figure). The return of these tourists will be highly welcome as tourism revenues are important for many economies in developing Asia. Most tourist destinations in the region have reopened, and tourism in East Asia and Southeast Asia should recover fastest this year given their proximity to the PRC.

The return of tourists from the PRC will support growth in host economies. An estimated 110 million outbound travelers are expected to leave the PRC this year—about two thirds of the level in 2019 (China Outbound Tourism Research Institute 2023). Their spending will lift employment and support many sectors of the economy and not just tourism because of multiplier effects. The return could spur tourism-related investments, further supporting growth in host economies. And it could also help alleviate poverty where it has risen because of the pandemic, as a 1% increase in tourist arrivals has been associated with a 0.12% reduction in the number of poor people in host economies (Asia Pacific Economic Cooperation 2016).

Early indicators show a marked increase in travel bookings. Outbound flights and overseas hotel bookings rose by more than 400% during Chinese New Year compared to last year (Trip.com 2023).

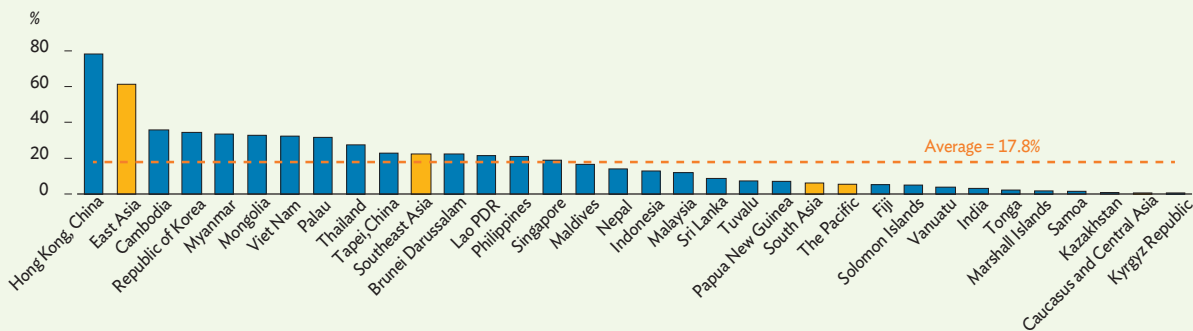
This rebound was particularly strong in Bali—where bookings increased by 2,900%—and Singapore, up 800%. From 1 January to 5 March, international passenger flights from the PRC rose by 173% year on year, although they were still just 13% of 2019’s level. And for the week of 5 March, the increase reached 311%, suggesting the rebound is rapidly picking up (VariFlight 2023).

Travel restrictions still in place in other destinations could divert PRC tourists to developing Asia. As of 1 March, 10 countries continued to impose various forms of restrictions on travelers from the PRC, including Australia, Germany, the United Kingdom, and the United States (UNWTO 2023). These 10 countries accounted for 5.3% of outbound PRC tourists in 2019. If all these tourists were to travel to developing Asia, this would increase visitor arrivals to the region by some 8 million this year.

References:
 Asia-Pacific Economic Cooperation. 2016. [Tourist Arrivals and Inclusive Growth](#).
 China Outbound Tourism Research Institute. 2023. [COTRI Analytics](#).
 Trip.com. 2023. [Ctrip Lunar New Year Data Shows Outbound Bookings up 640% as Mainland Chinese Travellers Venture Overseas for the Holiday](#). 31 January.
 United Nations World Tourism Organization. 2023. [UNWTO Tourism Data Dashboard](#).
 VariFlight. 2023. [CAPSE: March 2023 Travel Intention Index Analysis](#).

Share of Tourists from the People’s Republic of China in Arrivals to Developing Asian Economies, 2019

The PRC accounted for 17.8% of arrivals on average across economies in the region in pre-pandemic 2019.

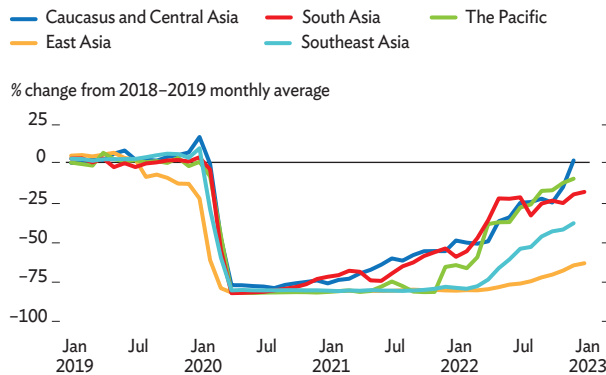


Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.
 Sources: CEIC Data Company; official sources; UN World Tourism Organization.

Money transfers from Russia surged in the Caucasus and Central Asia. Transfers to Armenia, Georgia, Kazakhstan, the Kyrgyz Republic, and Uzbekistan roughly doubled last year due to steady remittances, large inflows of Russian migrants, transfers of savings from Russian households, and money transfers to pay for imports into Russia rerouted through the Caucasus and Central Asia (Figure 1.1.1 0, panel C). From March to December, money transfers rose by 162% in Armenia, by 147% in Uzbekistan, and by 97% in Georgia.

Figure 1.1.9 International Tourist Arrivals in Developing Asia by Subregion

Tourism is recovering in all subregions as the pandemic passes.

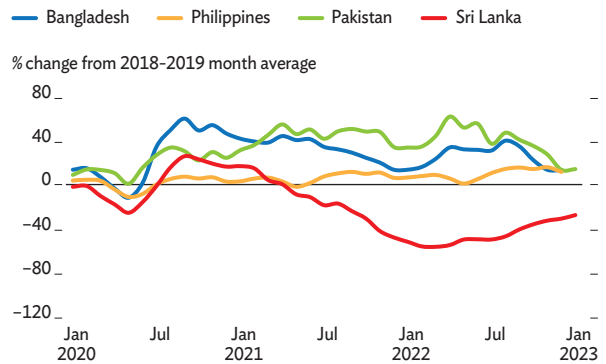


Note: In the figure, Caucasus and Central Asia comprises Armenia and Georgia; East Asia comprises Hong Kong, China, the Republic of Korea, and Taipei, China; the Pacific comprises Cook Islands, Fiji, Palau, Samoa, Tonga, and Vanuatu; South Asia comprises Bhutan, India, Maldives, Nepal, and Sri Lanka; Southeast Asia comprises Cambodia, Indonesia, the Lao People’s Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Viet Nam. Adjustments made to the Caucasus and Central Asia because complete data are not available for all economies. Sources: CEIC Data Company; official sources.

Figure 1.1.10 Remittances and Money Transfers in Developing Asia

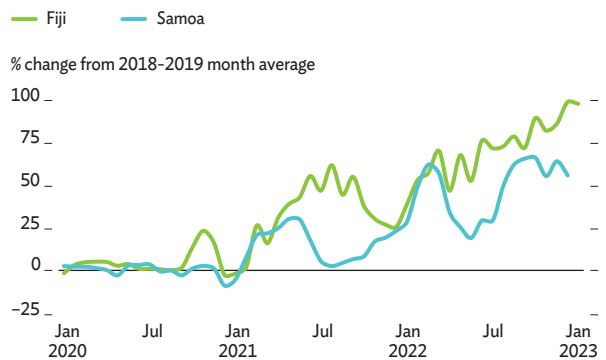
A. South Asia and Southeast Asia

Remittances moderated, but remained mostly above pre-pandemic levels.



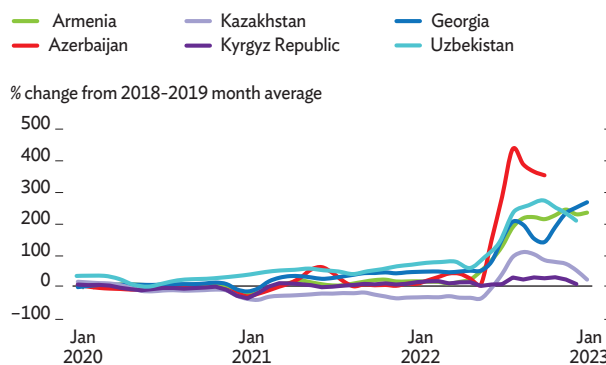
B. The Pacific

Money transfers to the Pacific picked up as labor migration to Australia and New Zealand resumed.



C. Caucasus and Central Asia

Money transfers to the Caucasus and Central Asia surged last year.



Note: 3-month moving average. Sources: CEIC Data Company; official sources.

Financial Conditions Improved in Late 2022

Global financial conditions tightened through most of 2022, but eased in the fourth quarter on optimistic market sentiment. This was supported by expectations of a less hawkish tightening by the Federal Reserve in November. Equity markets then rose after declining in the first 10 months of last year, risk premiums narrowed, regional currencies strengthened, and foreign portfolio outflows reversed direction. However, the easing of financial conditions lost momentum in February on uncertainty over the pace of the Fed's monetary tightening due to continuing inflation pressure and in March on the turmoil in the US banking sector.

Equity markets in developing Asia gained in late 2022 on the moderating pace of monetary policy tightening in the US and after the PRC's border reopening. This followed a market value-weighted loss of 17.1% from 1 January to 30 September on aggressive monetary tightening by the Fed, the economic fallout from the Russian invasion of Ukraine, and COVID-19 lockdowns and restrictions in the PRC. But the less aggressive Fed tightening in November lifted market sentiment in the fourth quarter, as seen in the decline of the Chicago Board Options Exchange's volatility index (Figure 1.1.11). The improved sentiment led to a market value-weighted return of 7.9% from 1 October 2022 to 17 March 2023 in the major developing Asian economies. Equity markets in East Asia led, on the PRC exiting its zero-COVID policy and the more positive outlook for the country's economy, followed by the Caucasus and Central Asia, South Asia, and Southeast Asia. Equity markets in the region slipped in February on expectations of higher US interest rates as disinflation slowed and in March on the US banking turmoil (Box 1.1.2).

Foreign portfolio investment turned into net inflows late last year. A slowdown in monetary tightening in the US following steady disinflation since June improved market sentiment and boosted net portfolio inflows to the region in the fourth quarter of 2022 to \$21.3 billion; these inflows peaked in December. Net portfolio inflows to the region further increased

Figure 1.1.11 Equity Markets in Developing Asia

Markets revived in November 2022 on the moderating pace of US monetary tightening.



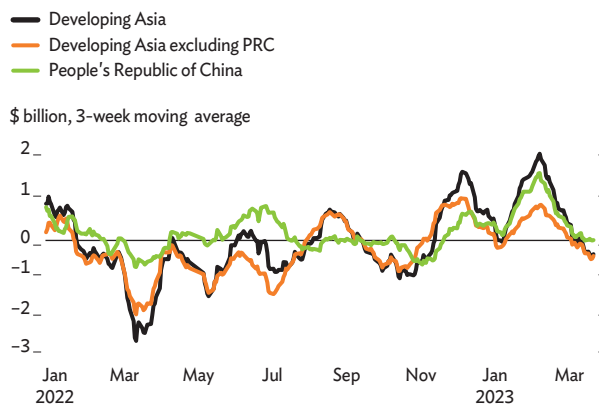
CBOE = Chicago Board Options Exchange, FOMC = Federal Open Market Committee, SVB = Silicon Valley Bank, US = United States.

Source: Bloomberg.

on the PRC's reopening, with total portfolio inflows of \$34.1 billion from 1 January to 17 March 2023. The PRC gained \$24.3 billion and the rest of developing Asia \$9.8 billion. But net portfolio investment inflows to the region slowed in February in response to renewed hawkish statements by the Fed and the European Central Bank (Figure 1.1.12).

Figure 1.1.12 Net Portfolio Flows in Developing Asia

Foreign investment into the region picked up at the end of 2022 and continued in early 2023 on the PRC's reopening.



PRC = People's Republic of China.

Source: Institute of International Finance.

Box 1.1.2 Banking Turmoil in the United States and Europe and Its Implications for Developing Asia

Two medium-sized banks failed in the United States. Silicon Valley Bank (SVB), a commercial bank specializing in technology start-ups, was placed under the receivership of the Federal Deposit Insurance Corporation on 10 March 2023. SVB, facing rising liquidity pressures from depositors, was forced to sell its holdings of fixed-income securities, including mortgage-backed securities and US Treasuries. As SVB depositors pulled their money, US regulators intervened. Then on 12 March, Signature Bank, specializing in cryptocurrency clients, failed because of a bank run.

The collapse of two banks in just 3 days panicked markets. The failures heightened investor concerns over the fragility of the banking sector in the US and Europe. Deteriorating market sentiment increased selling pressure in the equity market on other US banks that, like the two failed banks, had large numbers of deposits not covered by insurance protection. Bank stocks with low profitability also came under pressure. First Republic Bank, a mid-sized US bank, saw its share price fall sharply and it was forced to suspend trading, prompting major banks to move deposits in a coordinated effort to address fears of a growing outflow of deposits. In Europe, Credit Suisse, Switzerland's second-biggest bank, suffered a massive price fall because of its performance in recent years, causing the Swiss authorities to provide a backstop for the bank, and the country's biggest bank, UBS, buying Credit Suisse in a rescue deal. The Swiss National Bank provided extensive liquidity and other support.

In the US, policy support eased pressure on the banking sector. To maintain confidence in the banking system and calm depositors' fears, US and other financial regulators announced policy support measures. Both insured and uninsured deposits in the two collapsed banks were safeguarded to prevent a potential systemic risk. The Federal Reserve launched a new facility, the Bank Term Funding Program, through which it provides short-term liquidity of up to 1 year in exchange for eligible collateral, such as US Treasuries, agency debt, and mortgage-backed securities. The Fed and other five major central banks announced actions to enhance liquidity via standing US dollar swap line arrangements.

The banking turmoil had at the time of writing a limited impact on the banking sector in developing Asia. Compared to the US and Europe, downward pressure on banking stocks has been limited in Asia. From 1 to 17 March, the S&P Pan Asia Broad Market Index Banks declined by 4.2% compared to 21.0% in the US and 15.4% in Europe (box figure 1, panel A) and has remained relatively stable (panel B). This reflects investor confidence that spillovers to Asian banks will be limited. As Fitch Ratings noted on March 16 that "direct exposures to Silicon Valley Bank and Signature Bank among Fitch Ratings' portfolio of rated banks in APAC [Asia-Pacific] appear limited."^a It also reflects the view that most banking sectors in the region are relatively healthy. Asian banks, across different sizes, have on average higher capital buffers than their US bank counterparts (box table).

The full impact of the banking turmoil has yet to be seen. Market jitters following the collapse of the two US banks, if prolonged, are likely to result in somewhat tighter credit conditions that will weigh on economic activity, employment, and inflation. But exactly how the turmoil will play out is uncertain. In its monetary policy announcement on 21 March, the Fed emphasized the soundness and resilience of the US banking system, and the latest Banking Industry Country Risk Assessments by S&P Global classifies the US and European banking systems as low risk.

More widespread bank turmoil in the US and Europe could have a substantial impact on regional forecasts. Periods of banking turmoil often result in the widespread tightening of bank lending standards, as banks move to improve their balance sheets and liquidity positions. But tighter lending conditions depress economic activity and have negative spillovers to trading partners. A modified version of the Global Projection Model is used to simulate the impact of tighter bank lending standards in the US and Europe at a magnitude of about half the scale observed during the 2008–2009 global financial crisis. Under the simulation, this shock peaks in the second quarter of 2023 and eases back only gradually into 2024 as banks consolidate.

^a Fitch Ratings. 2023. *APAC Banks Resilient to Risks Highlighted by US Bank Failures*. 16 March.

Box 1.1.2 Continued

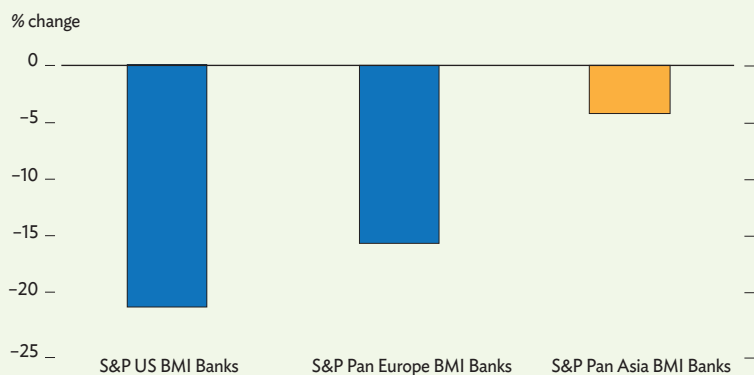
This squeezes credit conditions and economic activity in the US and Europe, and spills over to the rest of the world. Under this scenario, the US economy contracts in 2024 and growth is estimated to be substantially weaker in Europe and Japan. Growth rates in the People’s Republic of China will fall below the baseline forecasts by 0.4% points in 2023 and 0.6% points in 2024 (box figure 2, panel A).

The average reduction in gross domestic product growth forecasts in other developing Asian economies will be relatively less, reflecting heterogeneity within the group as some economies—particularly India—are less dependent on external demand than others. Inflation in advanced economies and developing Asia will also fall due to lower demand (box figure 2, panel B).

1 S&P Broad Market Indexes for Banking Stocks in the United States, Europe, and Asia

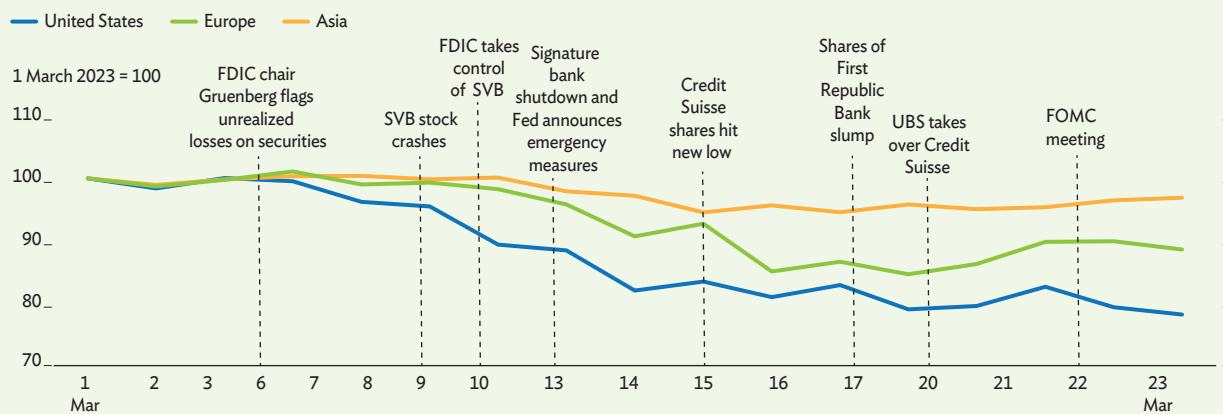
A. BMI Banks Changes 1 to 17 March

Compared to the US and Europe, downward pressure on banking stocks in Asia was limited in the period.



B. Banking Turmoil Highlights March 2023

Index has remained relatively stable in Asia since the sector’s roiling in the US and Europe.



BMI = Broad Market Index, FDIC = Federal Deposit Insurance Corporation, FOMC = Federal Open Market Committee, SVB = Silicon Valley Bank, US = United States.

Notes: S&P’s BMIs for banks are comprehensive benchmarks of bank stocks in the United States, Europe, and Asia and the Pacific, and are subindexes of the S&P Global BMI for Banks. The S&P Pan Asia BMI comprises Australia; Hong Kong, China; India; Indonesia; Japan; Malaysia; New Zealand; Pakistan; the People’s Republic of China, the Philippines, the Republic of Korea, Singapore; Thailand; Taipei, China.

Source: S&P Global.

Box 1.1.2 Continued

Common Capital Ratio and Loan-to-Deposit Ratio by Region

Small and medium-to-small banks in developing Asia have a healthy capital buffer and similar level of the loan-to-deposit ratio.

Banking Indicators	Large Banks	Medium-to-Large	Medium-to-Small	Small Banks
Tier 1 Common Capital Ratio				
United States	14.6	12.4	11.8	11.5
Europe	19.6	18.1	15.5	14.8
Asia and the Pacific	16.8	16.3	15.4	13.6
Loan-to-Deposit Ratio				
United States	74.9	85.1	86.3	62.7
Europe	98.4	127.1	105.0	95.3
Asia and the Pacific	78.6	80.0	81.3	81.6

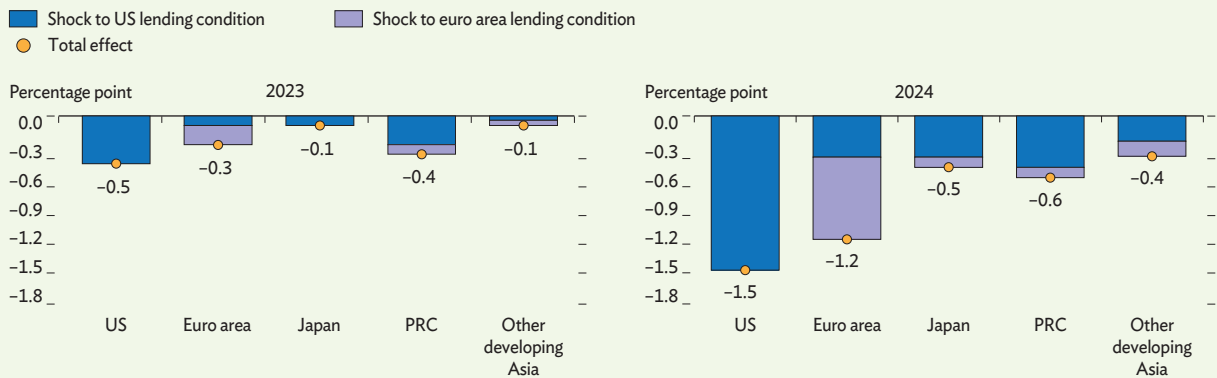
Note: Banks are categorized according to the size of their market capitalization and divided into quartiles. Numbers are weighted average based on market capitalization. Large banks are the top 25%, medium-to-large banks are in the 25%–50% group, medium-to-small banks in the 50%–75% group, and small banks in the bottom 75%–100%.

Source: Authors' calculation based on S&P Global.

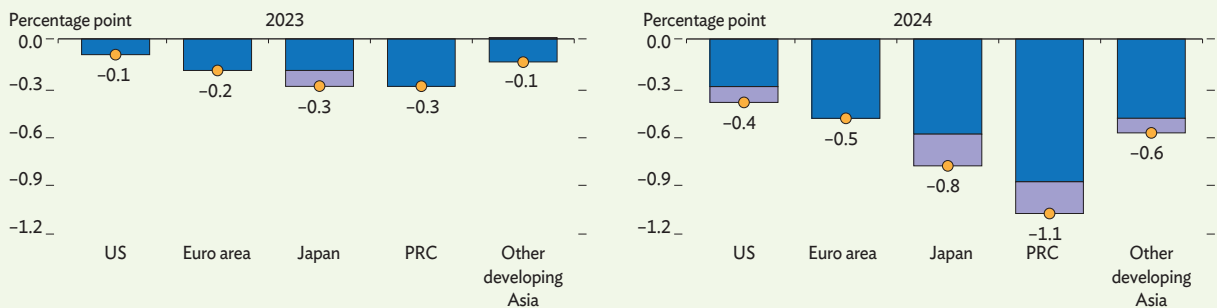
2 Simulated Impact of Credit Tightening in the United States and Euro Area on Growth and Inflation in Developing Asia Relative to the Baseline

Tighter lending conditions in the US and the euro area will weaken global demand, resulting in sharply reduced forecasts for growth and inflation elsewhere in the region.

A. GDP



B. Inflation



GDP = gross domestic product, PRC = People's Republic of China, US = United States.

Note: Other developing Asian economies are Hong Kong, China; India; Indonesia; Malaysia; the Philippines; the Republic of Korea; Singapore; Thailand; and Taipei, China.

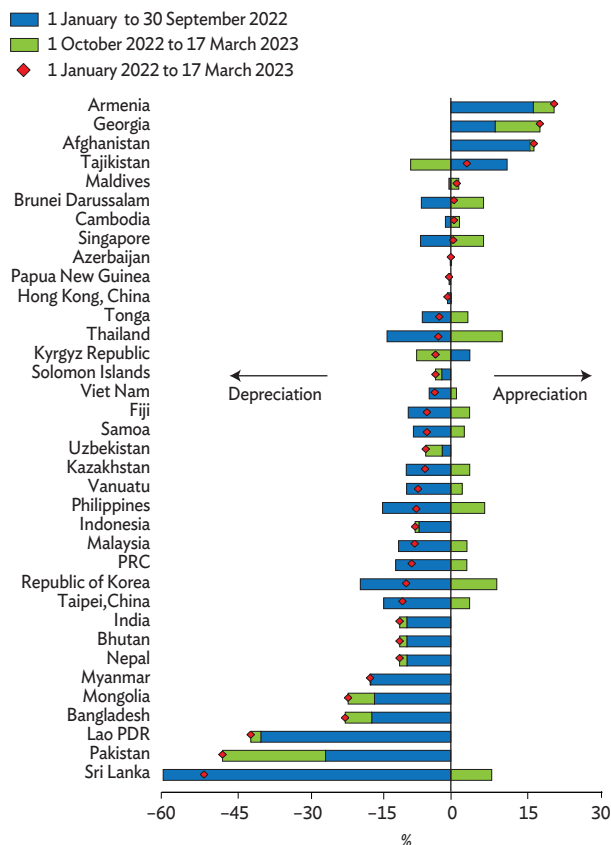
Source: Asian Development Bank estimates using the Global Projection Model.

This box was written by Abdul Abiad, Yothin Jinjarak, Yuhu Myoda, Irfan Qureshi, Arief Ramayandi, Dennis Sorino, and Mai Lin Villaruel of the Economic Research and Regional Cooperation Department, Asian Development Bank, Manila.

More than half of the 36 currencies in developing Asia strengthened against the US dollar since the fourth quarter of 2022. From 1 October 2022 to 17 March this year, currencies in the region appreciated by 2.7% on a GDP-weighted average basis. Currency gains were large in the Republic of Korea, on higher portfolio investment inflows, and Thailand, on returning tourists. Sri Lanka’s rupee, 2022’s worst performing currency, has appreciated since the fourth quarter on improved inflows. Several economies in the region, however, had exchange rate depreciations, including Bangladesh, the Lao People’s Democratic Republic, and Pakistan (Figure 1.1.13).

Figure 1.1.13 Exchange Rate Movements in Developing Asia

22 out of 36 currencies have strengthened against the US dollar since October 2022.



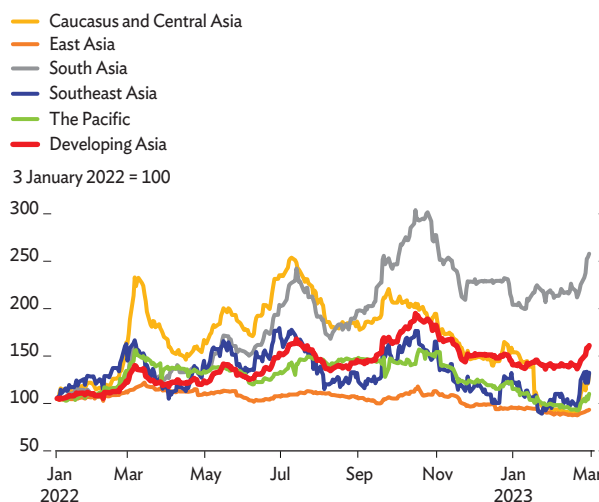
Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

Source: Bloomberg.

Risk premiums retreated in November on improved sentiment, but they are still more elevated than were in January 2022. Risk premiums in most developing Asian markets, as measured by the J. P. Morgan Emerging Markets Bond Index Global stripped spreads, widened in 2022 amid accelerating monetary tightening in advanced economies and slower global growth prospects. That trend, however, shifted in the fourth quarter on improved market sentiment supported by the Fed’s milder monetary tightening stance. Weighted average risk premiums in the region narrowed by 17 basis points (bps) from 1 October 2022 to 17 March 2023, but they were still higher than in January last year (Figure 1.1.14). Bond spreads narrowed, led by the Caucasus and Central Asia, where spreads declined by 170 bps as economies there performed much better than expected following the Russian invasion of Ukraine. Spreads declined in Southeast Asia by 31 bps in the same period and were flat in East Asia. Bond spreads widened in South Asia by 15 bps as sentiments worsened in Pakistan on protracted negotiations with the International Monetary Fund (IMF).

Figure 1.1.14 J. P. Morgan Emerging Market Bond Index Stripped Spreads in Developing Asia Subregions

Average risk premiums widened in the first 3 quarters of 2022 and narrowed from November on improved sentiment, but were still higher than in January 2022.



Source: Bloomberg.

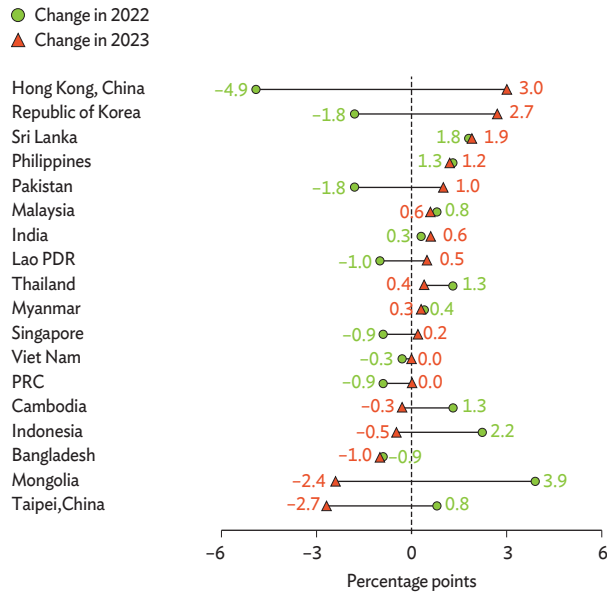
Fiscal Positions Will Improve and the Pace of Monetary Tightening Ease

Most economies in developing Asia will see better fiscal positions in 2023 after last year's divergence.

The uneven pace of recovery across the region resulted in fiscal balances worsening in about half of the region's economies in 2022 (Figure 1.1.15). In the PRC and Hong Kong, China, fiscal policy was used to counteract weak economic activity from COVID-19 lockdowns. In Pakistan, higher debt repayments and relief spending due to widespread flooding worsened the fiscal position. Fiscal balances improved in Malaysia, Indonesia, the Philippines, and Thailand as growth accelerated on robust consumer spending.

Figure 1.1.15 Changes in Fiscal Balances in Selected Economies in Developing Asia

Fiscal balances diverged in 2022, but are expected to improve for most economies in 2023.



Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Notes: Fiscal balance is the difference between a government's revenues (taxes and proceeds from asset sales) and its expenditures, expressed as a percentage of gross domestic product. Fiscal balance for the Republic of Korea includes social security contributions. Cambodia data and forecasts for the PRC and Thailand are from FocusEconomics.

Sources: *Asian Development Outlook* database; FocusEconomics. 2023. Economic Consensus Forecast Reports. March; official sources; Asian Development Bank calculations.

The continued normalization in economic activity throughout the region should improve fiscal balances in 2023. Even so, budget balances are expected to be below the 5-year pre-pandemic average in most economies due to lower tax receipts because of incomplete recoveries and increased spending associated with continued support to cushion the impact of higher energy and food prices.

The monetary tightening cycle in the region is expected to slow on easing inflationary pressures and softer growth.

Real policy interest rates—defined as policy rates adjusted for forecast headline inflation—are positive for more than half of the region's economies, and the change in real policy rates has also been positive for more than half of them, signaling tightened monetary conditions (Figure 1.1.16, panel A). However, the policy rate hikes were less than the large increases in expected inflation for several economies, notably the Lao People's Democratic Republic, Pakistan, and Sri Lanka, where real policy interest rates remain large and negative (Figure 1.1.16, panel B). In 2022, rising inflation caused central banks in the region to hike rates 72 times by an average of 86 basis points (Figure 1.1.17). The pace of tightening eased in January and February on 13 decisions to keep interest rates unchanged—and increases have become modest: seven averaging 39 basis points in the same period.

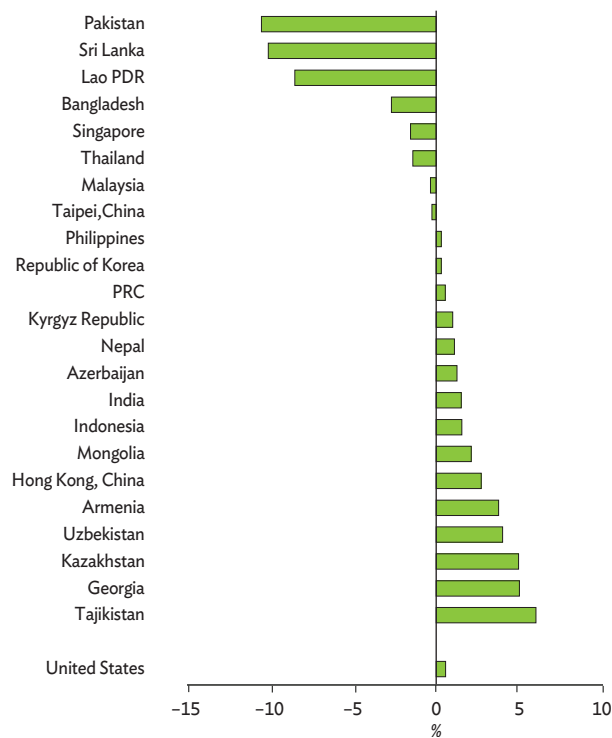
The monetary policy environment is a balancing act of withdrawing pandemic measures, calibrating inflation mitigation policies, and supporting growth amid tighter monetary conditions.

With most of developing Asia's economies ending COVID-19 restrictions, measures to soften the pandemic's impact should be smaller this year. But inflation remains high and warrants targeted fiscal measures, such as cash transfers to support those hardest hit by elevated prices. Because of this, the pace of deficit reductions should depend on the progress of disinflation and monetary stances, which are economy specific. The higher interest rate environment could also challenge fiscal sustainability, underscoring the need for the coordinated implementation of fiscal and monetary policy.

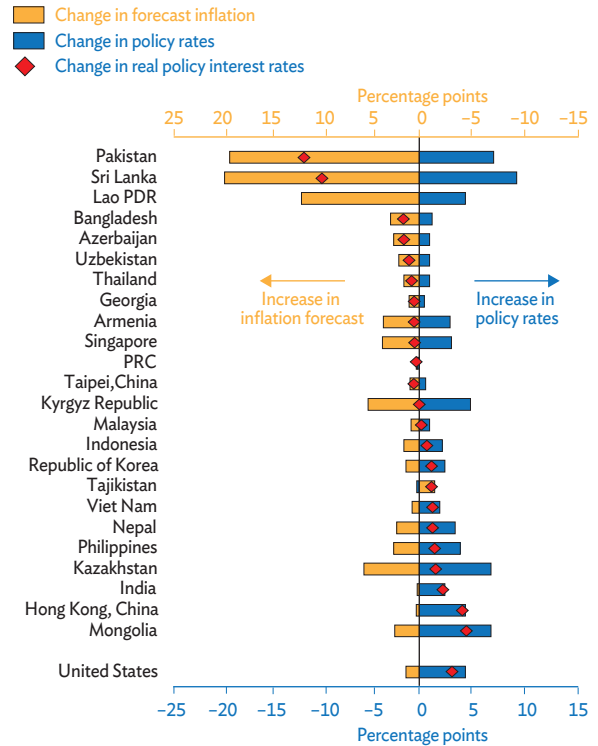
Figure 1.1.16 Real Policy Interest Rates in Selected Economies in Developing Asia

Real policy interest rates increased and are mostly positive now, because of tighter monetary conditions.

A. Real Policy Interest Rates, March 2023



B. Change in Real Policy Interest Rates, January 2022–March 2023



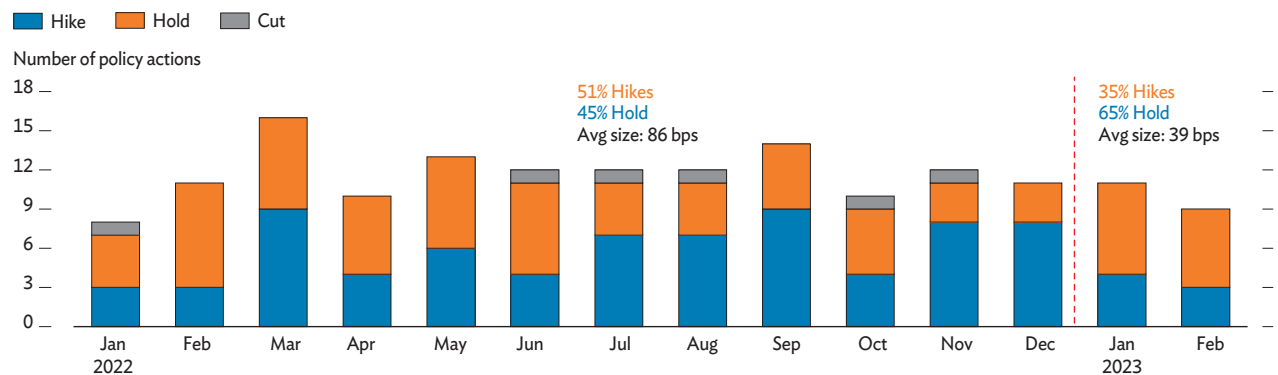
Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

Notes: Real policy interest rates are constructed as the difference between policy rates and forecast headline inflation. Change in real interest rates refers to the difference between January 2022 and March 2023.

Sources: Asian Development Outlook database; CEIC Data Company.

Figure 1.1.17 Policy Rate Decisions in Developing Asia

Central banks chose to hold rates in two-thirds of policy decisions in January and February 2023, and have hiked rates only by an average of less than half a percent.



bps = basis points.

Notes: This figure represents policy rate decisions in the following developing Asian economies: Armenia; Azerbaijan; Georgia; Hong Kong, China; India; Indonesia; Kazakhstan; the Kyrgyz Republic; Malaysia; Mongolia; Pakistan; the Philippines; the People’s Republic of China; the Republic of Korea; Sri Lanka; Tajikistan; Taipei, China; Thailand; Uzbekistan.

Source: Trading Economics.

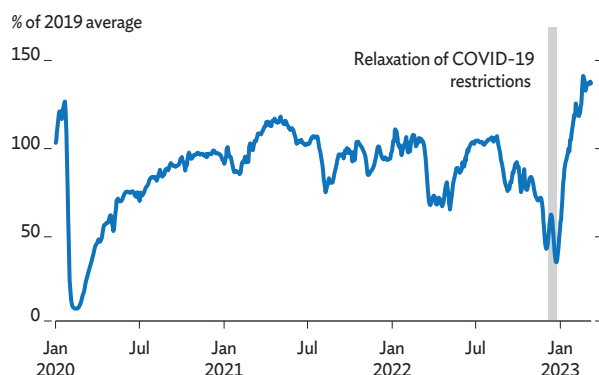
Regional Outlook Buoyed by the People’s Republic of China Reopening

The PRC’s reopening will shape developing Asia’s outlook this year.

Growth in the PRC is forecast to rebound to 5.0% this year and to 4.5% in 2024 from 3.0% in 2022. Since the reopening, mobility—for instance, subway ridership—has bounced back (Figure 1.1.18). Other mobility measures, such as Baidu’s intercity mobility index around the Chinese New Year and movie ticket sales, provide further evidence of a normalization in consumption in the PRC. The rebound is particularly strong for services sectors, including hospitality, leisure, and transport (Figure 1.1.19). Pent-up demand is expected to support consumption this year. But the increase in household savings over 2020–2022 to 33% on average from 30% before the pandemic is less than half the increase in the US over 2020–2021. Consumers in the PRC are also expected to draw down excess savings at a lower rate than in advanced economies last year, because of fragilities in the real estate market and the lingering effects of lockdowns on households.

Figure 1.1.18 Subway Ridership in 23 Cities in the People’s Republic of China

Mobility is back to pre-pandemic levels.



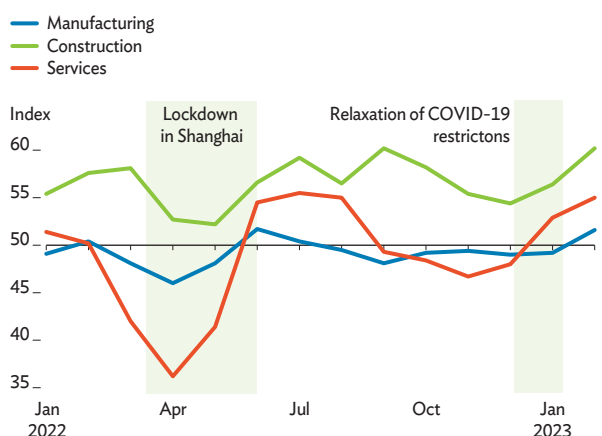
COVID-19 = Coronavirus Disease 2019.

Note: 7-day average.

Source: Capital Economics.

Figure 1.1.19 Purchasing Managers’ Index Subindices in the People’s Republic of China

Activity is rebounding, particularly in services.



COVID-19 = Coronavirus Disease 2019.

Source: CEIC Data Company.

The PRC’s reopening will also lift regional growth through trade, regional value-chains, and tourism linkages.

This will support growth in regional exporters of commodities, manufactured intermediates, and final goods. Regional tourism will also benefit, notably in Cambodia, Maldives, Palau, and Thailand, where the PRC was the main source of tourists up to 2019 (Box 1.1.1).

Despite the positive impact of the PRC’s reopening, rising interest rates will continue to weigh on global demand.

Having raised interest rates sharply in 2022, central banks in advanced economies are expected to proceed with additional hikes before policy rates stabilize in the second half of this year (Figure 1.1.20). Monetary tightening is already slowing economic activity in advanced economies and lagged effects are expected to continue affecting the global economy this year and the next. Although the major advanced economies are expected to avoid recessions, growth is expected to slow

to 0.5% in the euro area, 0.8% in Japan, and 0.9% in the US (Annex, Table A1.1). Developing Asia's exposure to this slowdown will be primarily through lower demand from advanced economies. This will be compounded by consumption in advanced economies further shifting back from manufactured goods to services, which are less import intensive. Growth will pick up slightly in advanced economies next year, but it will remain weak given tight financial conditions as inflation is expected to remain slightly above central bank targets, at 2.5% in the euro area and 2.4% in the US.

Energy prices will moderate but remain elevated.

Hydrocarbon prices are expected to be lower than last year's average Brent oil price of \$100 per barrel. But the PRC's reopening will put upward pressures on prices. This is expected to push oil prices up to \$88 per barrel on average in 2023—up from \$83 in February (Figure 1.1.21, panel A). Oil prices are expected to rise further to \$90 per barrel next year as global demand picks up and sanctions on Russia remain in place—even if a ceasefire is reached in Ukraine.

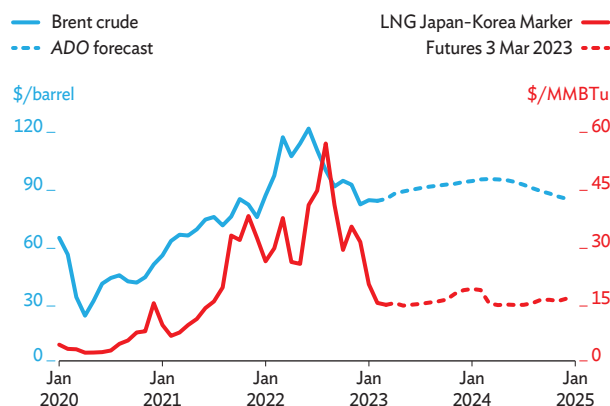
Food prices will remain high as demand from the PRC picks up.

Despite a sharp decline in the second half of last year, food prices will remain elevated in 2023 due to demand from the PRC and remaining supply chain disruptions affecting the shipping of grain from the Black Sea (Figure 1.1.21, panel B).

Figure 1.1.21 Commodity Price Forecasts

Commodity prices will remain high in 2023, but below 2022's levels.

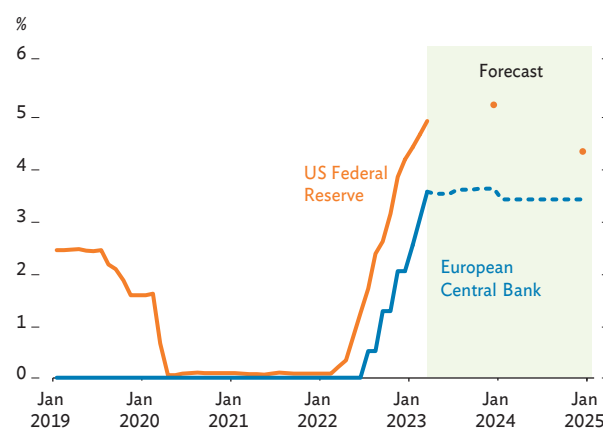
A. Energy



Rice prices were stable for most of last year, but have risen since November because of lower production due to unfavorable weather, a reduction in planted area, and appreciating Asian currencies. On the demand side, price pressures arose from precautionary stockpiling in India and rising purchases from the Middle East to substitute rice for wheat. Rice prices came down slightly in February and are expected to moderate further as supply pressures abate with the arrival of new crops on global markets in April and May and importers switching to cheaper grades of rice.

Figure 1.1.20 Policy Rates in the Euro Area and United States

Monetary tightening will continue, but at a slower pace.

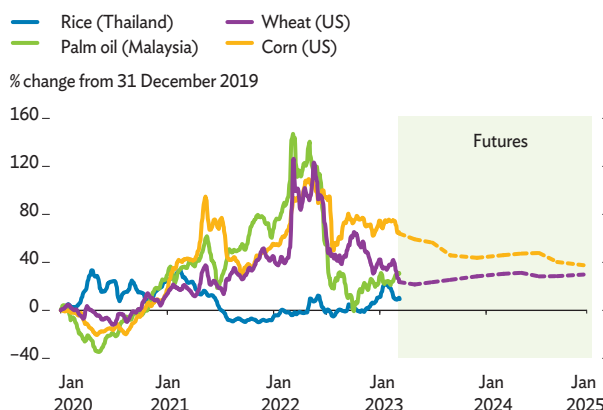


US = United States.

Note: Forecasts are from the European Central Bank's survey of professional respondents and the Federal Reserve's Summary of Economic Projections.

Sources: European Central Bank; Federal Reserve.

B. Food



ADO = Asian Development Outlook, LNG = liquefied natural gas, MMBTu = metric million British thermal unit, US = United States.

Note: Panel B shows 7-day moving averages.

Sources: Bloomberg; CEIC Data Company; Investing.com; World Bank. Commodity Markets, Pink Sheet data.

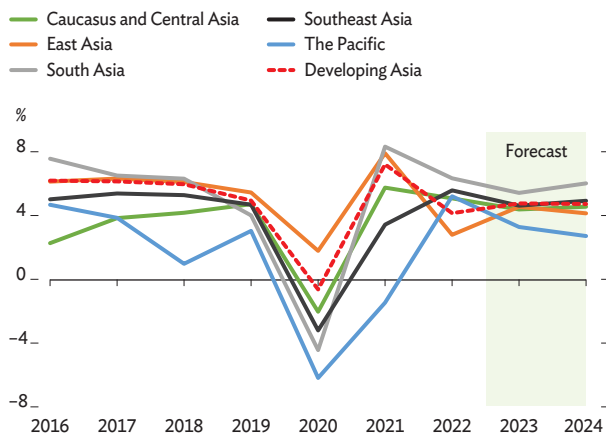
Domestic Demand Will Drive Growth in the Region

South Asia will grow strongly, but the outlook varies substantially within the subregion.

Growth in South Asia will exceed the regional average this year and in 2024 (Figure 1.1.22). This will result in the subregion’s growth path converging toward East Asia’s next year, despite East Asia’s exceptional resilience in 2020 and 2021 (Figure 1.1.23). South Asia’s performance will be driven by India, where growth is forecast at 6.4% this year and 6.7% in 2024 (Table 1.1.4). India’s contribution to developing Asia’s growth is projected to have risen from 22% on average over 2015–2019 to 25% this year and 27% in 2024 (Figure 1.1.24). This rapid growth reflects healthy domestic consumption, which will be further boosted by the tax cuts and exemptions in February’s Union Budget. Because of the more limited role of exports in the economy, India will be less affected by the slowdown in advanced economies. In Bangladesh, growth will decelerate from last year due to weaker demand from advanced economies, monetary tightening, and persistently high commodity prices. The rebound in tourism will continue supporting growth in Maldives and Nepal, as will increased production of hydroelectricity in Bhutan and Nepal.

Figure 1.1.22 GDP Growth in Developing Asia by Subregion

Growth in the region is forecast to normalize after 2022’s sharp rebound.

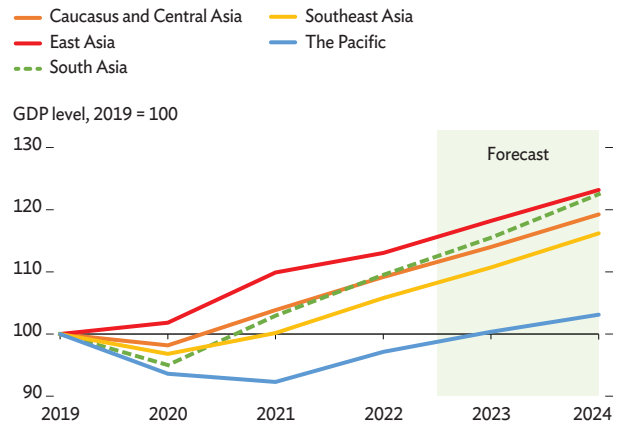


GDP = gross domestic product.

Source: Asian Development Outlook database.

Figure 1.1.23 GDP Growth Paths in Developing Asia by Subregion

South Asia’s recovery path is forecast to converge toward East Asia’s in 2024.



GDP = gross domestic product.

Source: Asian Development Outlook database.

Pakistan and Sri Lanka face a challenging outlook.

Growth in Pakistan is expected to slow to 0.6% this year, down from 2022’s 6.0%, on fiscal consolidation and monetary tightening. Growth is projected at 2.0% in 2024. Sri Lanka’s economy—grappling with a debt and balance of payments crisis—is expected to shrink by 3.0% this year after a 7.8% contraction in 2022. Sri Lanka’s growth prospects are expected to improve next year on the IMF’s \$2.9 billion financing and associated reforms approved on 20 March. This should help the country restore debt sustainability and macroeconomic stability. A modest rebound of 1.3% growth is forecast for 2024.

Growth of key technology exporters will slow as external demand wanes.

Growth in Singapore is forecast to slow to 2.0% this year from 3.6% in 2022 and to 2.0% from 2.5% in Taipei, China. The slowdowns will be largely driven by declining exports of electronics, and this will be even sharper in the Republic of Korea, where growth is forecast to be just 1.5% this year—down from 2.6% last year. In the Republic of Korea, exports of memory chips and consumer electronics have been hit hard by plunging global demand. The growth slowdown in the region’s key tech exporting economies will, however, be mitigated by a demand boost from the PRC’s reopening, which is already reflected in the Asia PMI and export orders bouncing back to slightly positive territory in February (Box 1.1.3).

Table 1.1.4 GDP Growth in Developing Asia, %

The PRC is expected to grow only slightly faster than the region, but India will substantially outperform regional growth.

	2021	2022	2023	2024
Developing Asia	7.2	4.2	4.8	4.8
Developing Asia excluding the PRC	6.1	5.4	4.6	5.1
Caucasus and Central Asia	5.8	5.1	4.4	4.6
Armenia	5.7	12.6	6.5	5.5
Azerbaijan	5.6	4.6	3.5	3.8
Georgia	10.5	10.2	4.5	5.0
Kazakhstan	4.3	3.2	3.7	4.1
Kyrgyz Republic	6.2	7.0	4.5	4.0
Tajikistan	9.2	8.0	5.5	6.5
Turkmenistan	5.0	6.2	6.5	6.0
Uzbekistan	7.4	5.7	5.0	5.0
East Asia	7.9	2.8	4.6	4.2
Hong Kong, China	6.4	-3.5	3.6	3.7
Mongolia	1.6	4.8	5.4	6.1
People's Republic of China	8.4	3.0	5.0	4.5
Republic of Korea	4.1	2.6	1.5	2.2
Taipei, China	6.5	2.5	2.0	2.6
South Asia	8.4	6.4	5.5	6.1
Afghanistan	-20.7	...	...	...
Bangladesh	6.9	7.1	5.3	6.5
Bhutan	4.1	4.7	4.6	4.2
India	9.1	6.8	6.4	6.7
Maldives	41.7	12.3	7.1	6.9
Nepal	4.2	5.8	4.1	5.0
Pakistan	5.7	6.0	0.6	2.0
Sri Lanka	3.5	-7.8	-3.0	1.3
Southeast Asia	3.5	5.6	4.7	5.0
Brunei Darussalam	-1.6	-0.5	2.5	2.8
Cambodia	3.0	5.2	5.5	6.0
Indonesia	3.7	5.3	4.8	5.0
Lao People's Democratic Republic	2.3	2.5	4.0	4.0
Malaysia	3.1	8.7	4.7	4.9
Myanmar	-5.9	2.0	2.8	3.2
Philippines	5.7	7.6	6.0	6.2
Singapore	8.9	3.6	2.0	3.0
Thailand	1.5	2.6	3.3	3.7
Timor-Leste	2.9	3.2	3.1	3.0
Viet Nam	2.6	8.0	6.5	6.8
The Pacific	-1.4	5.2	3.3	2.8
Cook Islands	-29.1	10.5	11.2	9.1
Federated States of Micronesia	-1.3	2.0	4.1	0.5
Fiji	-5.1	15.9	6.3	3.0
Kiribati	1.5	1.8	2.3	2.8
Marshall Islands	1.1	-0.9	1.5	2.0
Nauru	1.5	1.2	1.8	2.2
Niue	...	...	...	...
Palau	-17.1	-1.0	3.8	6.5
Papua New Guinea	0.1	3.2	2.4	2.6
Samoa	-7.1	-6.0	4.8	2.5
Solomon Islands	-0.5	-4.2	3.0	2.5
Tonga	-2.7	-2.2	2.5	3.2
Tuvalu	1.8	1.5	2.5	2.0
Vanuatu	1.0	2.0	1.0	4.2

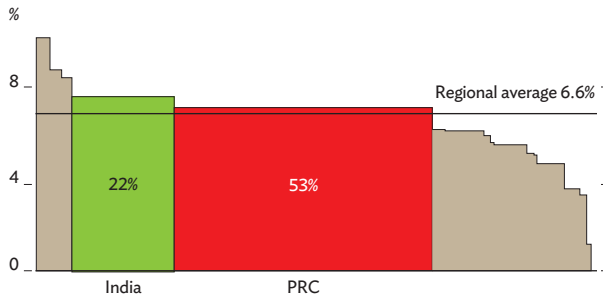
... = not available, GDP = gross domestic product, PRC = People's Republic of China.

Source: Asian Development Outlook database.

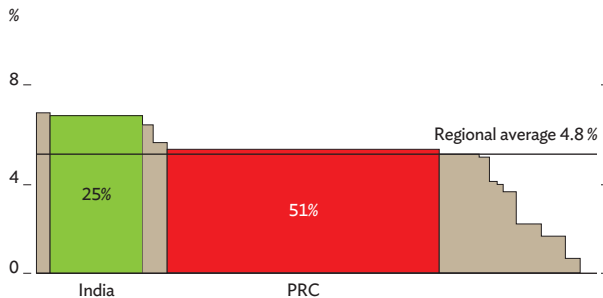
Figure 1.1.24 Contributions of India and the People's Republic of China to GDP Growth in Developing Asia

The PRC still accounts for about half of the region's growth, but its contribution will decline.

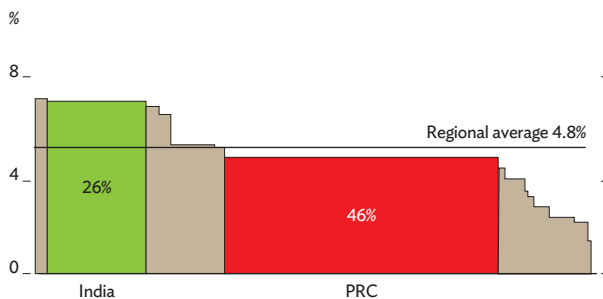
A. 2015-2019



B. 2023



C. 2024



GDP = gross domestic product, PRC = People's Republic of China.

Notes: Each box represents a developing Asian economy; wider boxes denote larger GDP in the baseline year. Sri Lanka is omitted in panel B as it is the only economy where growth is forecast to be negative.

Source: Asian Development Outlook database.

Growth in the Caucasus and Central Asia will slow after last year's strong expansion.

The subregion is forecast to grow by 4.4% in 2023, down from 5.1% last year. The unexpected windfall from the fallout of the Russian invasion of Ukraine will mostly wane this year. Growth is expected to decline sharply in the three economies that benefited the most from inflows of Russians and their capital. Growth is forecast to decline to 6.5% in Armenia this year from 12.6% last year,

to 4.5% in Georgia from 10.2%, and to 4.5% in the Kyrgyz Republic from 7.0%. In Kazakhstan—the subregion's largest economy—growth is expected to pick up to 3.7% from 3.2% last year as some issues that disrupted oil exports through pipelines crossing Russia last year are resolved.

Growth in Southeast Asia is normalizing after a sharp rebound last year.

The subregion is expected to grow by 4.7% in 2023, down from 5.6% last year. This continuing recovery is largely because of the subregion's economic reopening. Countries where tourism accounts for a large share of GDP will benefit from the return of tourists from the PRC, notably Cambodia, the Philippines, and Thailand. The tailwinds from the PRC's reopening will be partly offset by tight monetary conditions. Policy rates were raised to 6.0% in Viet Nam and 6.5% each in the Lao People's Democratic Republic and the Philippines last year. Weak exports will also drag growth, as demand from advanced economies continues to shift away from goods, particularly electronics, and back to services. Viet Nam will buck the trend, with exports expected to strengthen on sustained foreign investment in manufacturing. Its economy is forecast to grow the fastest in the subregion, at 6.5% this year and 6.8% in 2024.

Growth in the Pacific will slow, dragged by Papua New Guinea and Fiji, its two biggest economies.

The subregion's growth is forecast to decline to 3.3% this year from 5.2% in 2022. Growth in Papua New Guinea—which accounts for over two-thirds of the subregional economy—is projected to slide to 2.4% from 3.2% on lower global prices for its main exports: natural gas, oil, copper, nickel, and palm oil. Growth in Fiji is forecast sharply decelerating to 6.3% this year from 15.9% last year, when a remarkable recovery in tourism powered growth. Excluding these two economies, the subregion's growth is forecast at 3.4% in 2023—the first year of growth since 2020—after a 1.6% contraction in 2022. The rebound will be mostly driven by the return of tourists and the resumption of infrastructure projects that were on hold during the pandemic.

Regional Inflation Will Decline and Remain Low Compared to the Rest of the World

Inflation in developing Asia is forecast declining to 4.2% this year, mainly on benign inflation in the PRC.

Regional inflation will remain lower than in advanced economies (projected at 4.4%), and much lower than in non-Asian emerging markets (14.9%) (Figure 1.1.25). This will be driven by inflation remaining muted in the PRC this year and in 2024. Excluding the PRC, regional inflation is forecast at 6.2% this year and 4.4% next year—higher than in advanced economies, but still much lower than in emerging markets outside the region (Table 1.1.5). The decline will be supported by global disinflationary forces that include monetary tightening and easing supply chain and shipping bottlenecks. Receding commodity prices following their spikes last year will also limit inflation in 2023, particularly for economies importing Russian crude oil at discounted prices (Box 1.1.4).

Inflation is expected to remain modest in the PRC, at just 2.2% this year. Excess savings accumulated over 2020–2022 will only lightly feed into inflation this year in the PRC as the level is less than half what it was in the US last year, and because households are expected to draw down these savings at a slower pace. Price

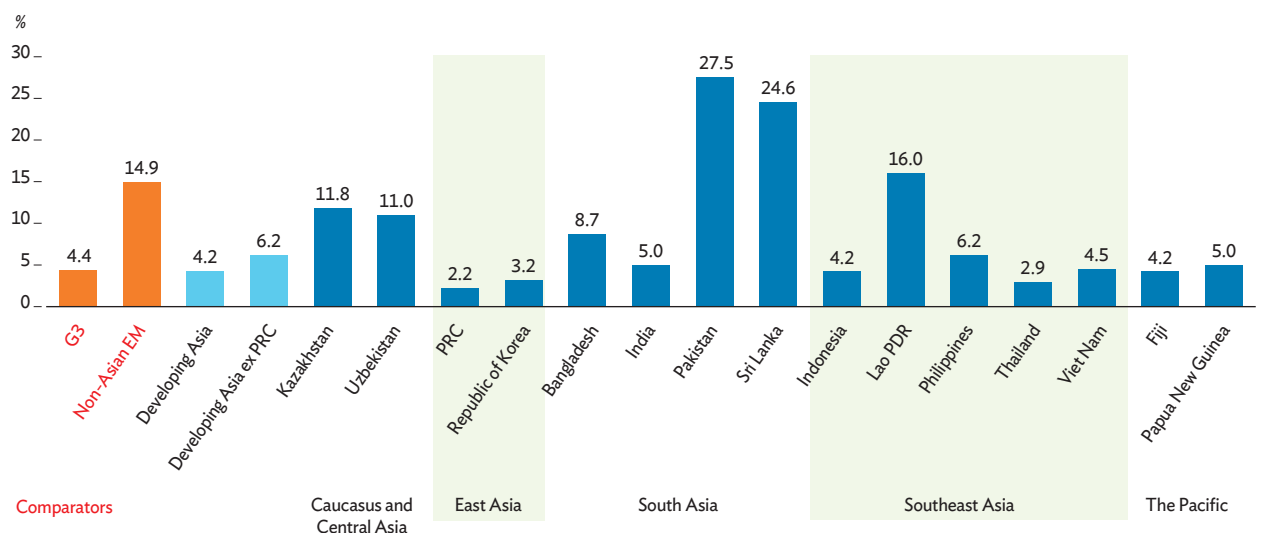
increases will also be curtailed by a global environment in which drivers of inflation have receded compared to last year, in particular the Russian invasion of Ukraine.

In South Asia, inflation is expected to still remain high, driven by Pakistan and Sri Lanka. South Asia's inflation rate is expected to decline to only 8.1% this year from 8.2% in 2022 (Figure 1.1.26). India will account for most of the decrease; headline inflation there is expected to slow to 5.0% this year and 4.5% in 2024. Inflation in Sri Lanka is forecast at 24.6%—a decline nevertheless from 46.4% last year as fiscal and monetary tightening weighs on domestic demand. Sri Lanka's inflation is expected to fall sharply to 5.5% in 2024 as further tightening helps reanchor inflation expectations. Inflation is expected to accelerate in Pakistan to 27.5% this year and 15.0% next year, up from 12.2% in 2022.

Inflation in the Caucasus and Central Asia will decelerate but remain high. Moderating global energy and food prices will help decelerate headline inflation to a forecast 10.3% this year and 7.5% in 2024 from 12.9% last year. These disinflationary forces will be partly offset by rising prices of imported goods as local currencies depreciate against the US dollar in the wake of the ruble's depreciation following the EU's import ban on oil and the \$60 cap imposed on Russia's global exports of oil.

Figure 1.1.25 Inflation Forecasts for 2023 for Selected Economies in Developing Asia

Inflation will remain high in the Caucasus and Central Asia, the Lao PDR, Pakistan, and Sri Lanka.

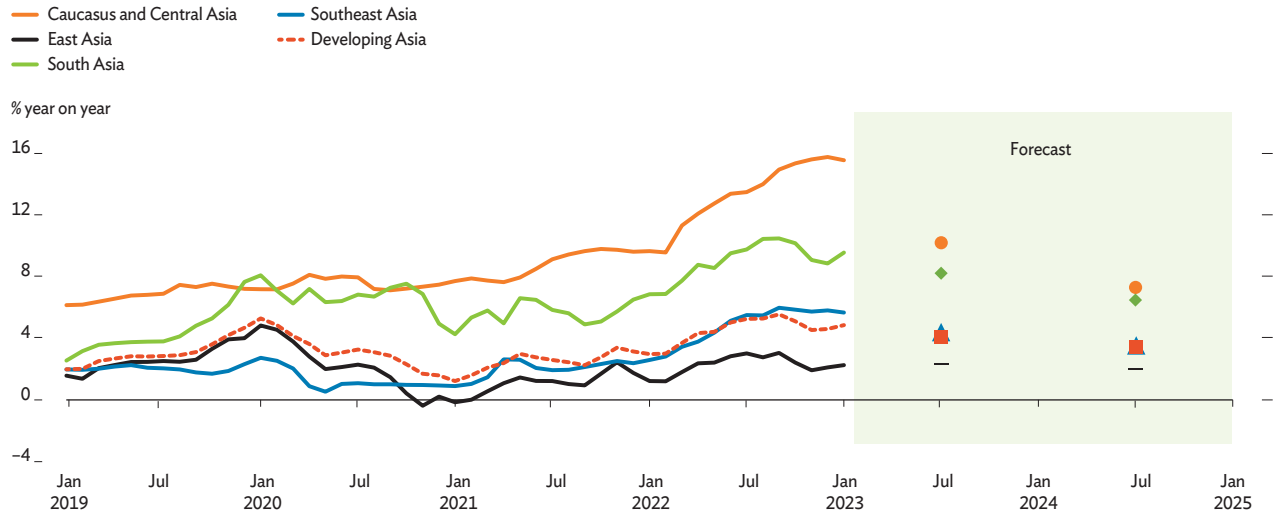


EM = emerging markets; G3 = euro area, Japan, United States; Lao PDR = Lao People's Democratic Republic; PRC = People's Republic of China.

Sources: Asian Development Outlook database; International Monetary Fund. World Economic Outlook Database.

Figure 1.1.26 Headline Inflation in Developing Asia by Subregion

Inflation will moderate in 2023 and fall back to pre-pandemic levels in 2024.



Source: Asian Development Outlook database.

Box 1.1.3 Semiconductor Market: Prospects and Implications for Developing Asia's Key Technology Exporters

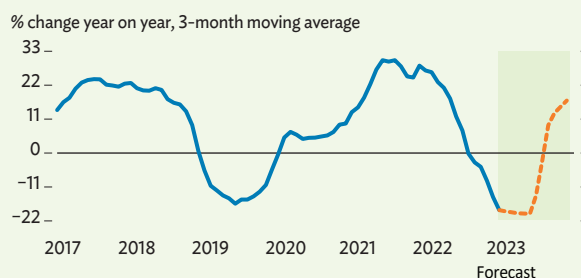
The semiconductor market is in a prolonged downturn. The growth of global semiconductor sales peaked in mid-2021 and sales started contracting in August 2022 (box figure). The downturn is being driven by slowing demand for consumer electronics, which spiked during the pandemic. The market was also hit by the lockdowns in the People's Republic of China, which stalled semiconductor production.

The decline in the semiconductor market should bottom out in mid-2023. World Semiconductor Trade Statistics forecast semiconductor sales declining by 4.1% in 2023, led by the memory segment. But the market should recover later this year and into 2024—a pattern consistent with more recent cycles that suggest the bottoming-out will happen 22–25 months after the previous peak (box table). The implications of this for economies in developing Asia may vary, reflecting differences in product segments and economies' positions in the cycles. The slump in electronics exports has primarily been in high-end semiconductors, and has affected developing Asia's key technology exporters: the Republic of Korea; Singapore; and Taipei, China. Economies in the region that focus more on lower-end semiconductors, including Malaysia, the Philippines, Thailand, and Viet Nam, have seen less of a decline in their electronics exports—and a mini-rebound synchronized with the PRC's reopening.

Semiconductor demand will be supported by several global trends. The remarkable growth in chip-intensive electric vehicles—sales doubled to 6.6 million in 2021 from the previous year—is expected to continue in the coming years, helped by sustained policy support, the rollout of supporting infrastructure, and shifting consumer demand (IEA 2022). Other important drivers of semiconductor demand include next-generation wireless communication, the growth of cloud computing, and the expansion of the Internet of Things.^a For cloud computing, the increasing needs for cleantech, agritech, fintech, and healthtech should further expand its customer base. The end-user cloud computing segment is expected to grow by 20.7% to \$591.8 billion in 2023 (Gartner 2022). The development of autonomous vehicles, the Internet of Things, and advanced applications that require high-speed, low-latency connectivity should boost demand for wireless communication, which is expected to grow 30.7% from 2023 to 2030 (Grand View Research 2023).

Semiconductor Sales Trends and Forecasts

After peaking in mid-2021, sales are forecast bottoming out in mid-2023.



Sources: World Semiconductor Trade Statistics. *Historical Billings Report*; Asian Development Bank estimates.

Semiconductor Peak-Trough Sales Cycles

Recent semiconductor downturns lasted 22–25 months.

Peak	Trough	Length of Cycle (months)
Jun 2004	Jun 2005	12
Jun 2008	Feb 2009	8
Mar 2010	Jan 2012	22
Feb 2014	May 2016	25
Jul 2017	Jun 2019	23

Sources: World Semiconductor Trade Statistics. *Historical Billings Report*; Asian Development Bank estimates.

Given these expected trends, developing Asia's key technology exporters should see growing and long-term demand for their exports in the next rise in the semiconductor cycle.

^a Taken from a survey of 151 senior executives from global semiconductor companies conducted in the fourth quarter of 2022 by KPMG and the Global Semiconductor Alliance. KPMG. 2023. *Global Semiconductor Industry Outlook 2023*.

References:

- Gartner. 2022. *Gartner Forecasts Worldwide Public Cloud End-User Spending to Reach Nearly \$600 Billion in 2023*. Press release. 31 October.
- Grand View Research. 2023. *5G Core Market Size, Share & Trends Analysis Report by Component, by Deployment, by Network Function, by Architecture, by End-user, by Region, and Segment Forecasts, 2023–2030*.
- IEA (International Energy Agency). 2022. *Global EV Outlook 2022*.

This box was written by Abdul Abiad, Yothin Jinjarak, Yuho Myoda, Pilipinas Quising and Irfan Qureshi of the Economic Research and Regional Cooperation Department, Asian Development Bank, Manila.

Box 1.1.4 Cheap Russian Oil May Lower Energy Inflation and Support Growth in Some Economies in Developing Asia

Asia receives most of the Russian Federation's exports of crude oil after sanctions were imposed from late 2022 over the Russian invasion of Ukraine. The European Union (EU) and G7 countries imposed a \$60 price cap on Russian crude oil exports on 3 December 2022, and this was extended on 5 February to refined oil, with price caps for each product. The EU also banned seaborne imports of crude oil from Russia on 5 December. Even before these sanctions, Russia's crude exports to the EU declined by 16% in 2022. In the same period, Russia's crude exports rose by 22%, with Asia filling the gap. Crude exports to India, the People's Republic of China (PRC), and Türkiye increased in total by 216% (box figure 1). As of February, 33% of Russia's crude exports went to India and 22% to the PRC.

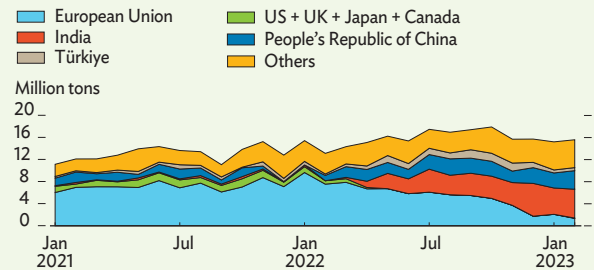
Cheaper Russian oil will help moderate energy prices in some economies. From the Russian invasion of Ukraine in February 2022 to early December, Urals crude oil—the benchmark price index for Russian oil—was trading at an average 21% discount to Brent crude oil (box figure 2). This discount has further risen to 32% since the imposition of the price cap.^a Assuming the discounted prices are passed on to consumers, this will ease energy inflation in the economies in developing Asia that still import Russian oil.

Refiners in developing Asia are making windfall revenue from processing Russian crude oil bought at discounted prices. Rerouting exports of Russian refined oil products to Asia has been more difficult than for crude because most Asian markets have their own refining sectors, which will seek protection from competition. This is boosting margins for refiners that have substituted cheaper Russian crude for oil from other suppliers. For regional exporters of refined oil products, such as India and Singapore, this is also supporting net exports.

Some evidence suggests that some economies in the region are still buying Russian oil at prices above the \$60 cap. Using Russian customs data for the last weeks of December, Babina et al. (2023) find that Russian oil was sold at \$74/barrel on average, above Urals crude, which was at \$52. For Russian oil shipped from Pacific ports—which is critical for exports to East Asia—the average price was even higher, at \$82. This suggests that a large share of Russian oil shipped to Asia does not comply with the \$60 price cap.

1 Monthly Deliveries of Russian Crude Oil by Region

Exports of Russian oil to India and the People's Republic of China mostly offset falling exports to countries imposing sanctions.

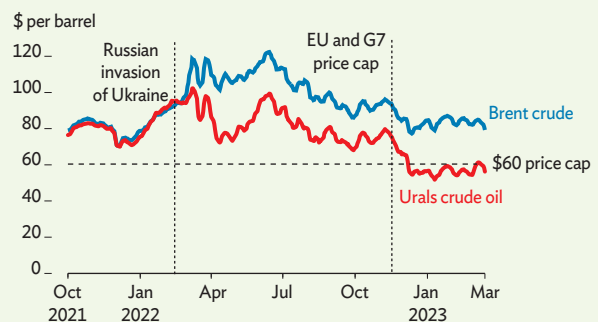


UK = United Kingdom, US = United States.

Source: Bruegel. [Russian Crude Oil Tracker](#). 13 March 2023.

2 Brent Crude and Urals Benchmark Oil Prices

Russian oil has been trading at a 32% discount since the EU and G7 price cap was imposed on 5 December 2022.



EU = European Union, G7 = Group of Seven.

Sources: CEIC Data Company; [Investing.com](#).

One explanation is that Sovcomflot—Russia's largest, state-owned shipping company—now handles about half of Russian oil shipments. Another is that the shadow fleet of oil tankers bought by Russian operators has made it even more difficult to enforce the price cap.

^a The EU and G7 price cap on exports of Russian oil only affects third countries outside these two blocs. The price cap makes it illegal for EU or G7 service providers to insure, carry, or finance exports of Russian oil to any destination if it was purchased at a price exceeding \$60 per barrel.

Reference:

T. Babina et al. 2023. [Assessing the Impact of International Sanctions on Russian Oil Exports](#). CEPR Working Paper DP17957. Center for Economic and Policy Research.

This box was written by Jules Hugot of the Economic Research and Regional Cooperation Department, Asian Development Bank, Manila.

Table 1.1.5 Inflation in Developing Asia, %*Inflation is expected to gradually moderate this year and the next.*

	2021	2022	2023	2024
Developing Asia	2.6	4.4	4.2	3.3
Developing Asia excluding the PRC	4.2	6.7	6.2	4.4
Caucasus and Central Asia	9.0	12.9	10.3	7.5
Armenia	7.2	8.6	7.0	6.2
Azerbaijan	6.7	13.9	7.0	6.5
Georgia	9.6	11.9	6.0	4.0
Kazakhstan	8.0	15.0	11.8	6.4
Kyrgyz Republic	11.9	13.9	12.0	8.6
Tajikistan	8.0	4.2	7.0	6.5
Turkmenistan	12.5	10.0	10.0	10.0
Uzbekistan	10.7	11.4	11.0	10.0
East Asia	1.1	2.3	2.3	2.0
Hong Kong, China	1.6	1.9	2.3	2.1
Mongolia	7.3	15.2	10.9	8.7
People's Republic of China	0.9	2.0	2.2	2.0
Republic of Korea	2.5	5.1	3.2	2.0
Taipei, China	2.0	2.9	2.0	2.0
South Asia	5.8	8.2	8.1	5.8
Afghanistan	5.2	13.8	...	...
Bangladesh	5.6	6.2	8.7	6.6
Bhutan	7.3	5.6	5.5	5.1
India	5.5	6.7	5.0	4.5
Maldives	0.5	2.3	4.5	2.0
Nepal	3.6	6.3	7.4	6.2
Pakistan	8.9	12.2	27.5	15.0
Sri Lanka	6.0	46.4	24.6	5.5
Southeast Asia	2.0	5.0	4.4	3.3
Brunei Darussalam	1.7	3.7	2.0	1.6
Cambodia	2.9	5.3	3.0	4.0
Indonesia	1.6	4.2	4.2	3.0
Lao People's Democratic Republic	3.8	23.0	16.0	5.0
Malaysia	2.5	3.4	3.1	2.8
Myanmar	3.6	16.0	10.5	8.2
Philippines	3.9	5.8	6.2	4.0
Singapore	2.3	6.1	5.0	2.0
Thailand	1.2	6.1	2.9	2.3
Timor-Leste	3.8	7.0	5.5	2.8
Viet Nam	1.8	3.2	4.5	4.2
The Pacific	3.1	5.7	5.0	4.4
Cook Islands	1.8	4.2	7.7	2.3
Federated States of Micronesia	1.8	5.0	3.6	0.4
Fiji	0.2	4.3	4.2	3.5
Kiribati	1.0	5.0	3.7	3.0
Marshall Islands	2.2	3.3	3.7	3.5
Nauru	1.2	2.3	2.5	1.9
Niue	...	...	...	...
Palau	0.5	10.2	5.0	5.5
Papua New Guinea	4.5	6.0	5.0	5.0
Samoa	-3.0	8.8	10.2	2.0
Solomon Islands	-0.2	5.5	4.5	3.7
Tonga	1.4	8.5	9.4	1.5
Tuvalu	6.7	7.6	3.3	2.8
Vanuatu	2.3	4.8	4.0	3.0

... = not available, PRC = People's Republic of China.

Source: Asian Development Outlook database.

The People's Republic of China Reopening is an Upside Risk, but Many Challenges Remain

Upside risks are emerging, but near-term challenges remain. The PRC's reopening brightened developing Asia's outlook, but the global economy continues to face multiple challenges. Financial conditions remain tight because of monetary tightening in advanced economies, uncertainty is rising over the banking sector turmoil in the US and Europe, and concerns over the Russian invasion of Ukraine persist.

A stronger-than-expected recovery in the PRC could bring positive spillovers to the region. With the PRC's continued reopening, a disorderly exit from COVID-19 restrictions is becoming less likely. A stronger-than-expected opening in the PRC will have positive spillovers through tourism (Box 1.1.1) and trade links (Box 1.1.5). But this could also trigger inflationary pressures through higher global commodity prices that would require close monitoring.

Slower-than-expected disinflation in advanced economies could prompt more persistent monetary policy tightening. If the momentum in economic activity and inflation continues, the Fed and central banks in other advanced economies might be forced to maintain higher interest rates for longer than assumed in the baseline, hurting global prospects. Tighter financing conditions could also trigger the risk of excessive capital outflows and weaken currencies in the region. Vulnerable economies and those with large external obligations will be especially challenged.

Tight global financial conditions have heightened financial stability risks. Monetary tightening to date, plus any more in the pipeline, could trigger stresses, as evidenced by the banking turmoil in the US and Europe (Box 1.1.2).

Tighter financial conditions will be a challenge to financial stability in economies with weaker economic fundamentals, high credit risks, and weaker institutional frameworks. The possibility of large-scale financial turmoil in the advanced economies seems low at this point, but if it were to happen, the impact on the economic outlook will be substantial.

The Russian invasion of Ukraine continues to be a risk to the global economy. An escalation could renew surges in commodity prices, stoking global inflation and broader food security challenges. This could weigh on the growth outlook through inflation and increased uncertainty in Europe, and even more so if this pushes central banks to maintain tight financial conditions for longer.

The main medium-term challenges of geopolitical tensions and climate change require coordinated policy actions to tackle them. Geopolitical tensions, including between the US and PRC, could fracture international trade and supply chain links, potentially erasing the efficiency gains from globalization. Climate change has increased the frequency and severity of extreme weather events in developing Asia. Economies in the region must ready themselves for the transition to net zero emissions, and this will have wide-ranging impacts on consumption, investment, and public finances. The upcoming Asian Development Outlook Thematic Report analyzes how developing Asia will be affected by the global transition to net zero.

Box 1.1.5 Impact of Stronger-than-Expected Growth in the People’s Republic of China on Developing Asia

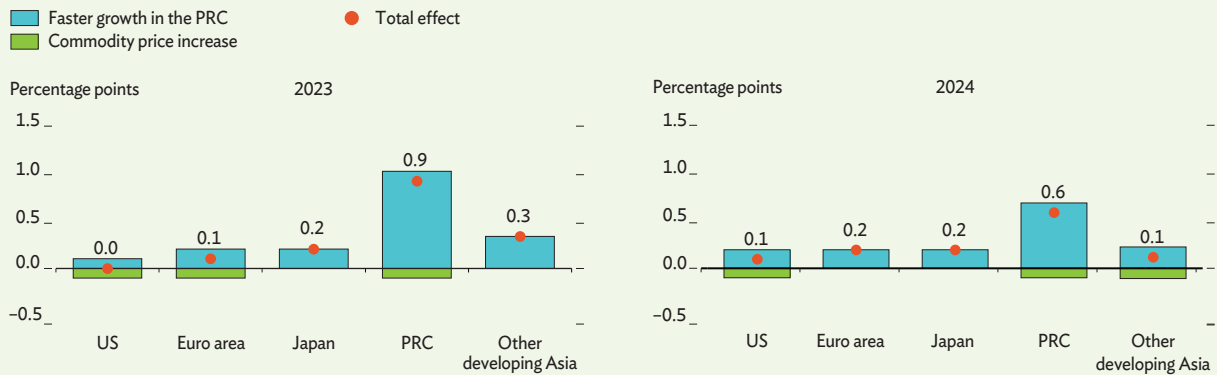
A faster rebound in the People’s Republic of China (PRC) has implications for the global and regional outlook. The lifting of COVID-19 restrictions is expected to boost consumption and demand in the PRC, possibly by more than assumed in the baseline. Because of the size of the economy—accounting for half of developing Asia’s gross domestic product (GDP) and a fifth of global GDP—faster-than-expected growth will not only increase regional growth but also raise global commodity prices, which will increase inflationary pressures.

This box quantifies the impact of faster-than-expected growth in the PRC. To show how GDP growth and inflation elsewhere may be affected, a modified version of the Global Projection Model—a multiregional general equilibrium model that features Asian economies, including the PRC and other developing economies in the region—is used.^a The model simulates a scenario of stronger-than-expected economic growth in the PRC.

Effect of Faster Growth in the People’s Republic of China on Regional GDP Growth and Inflation Relative to the Baseline

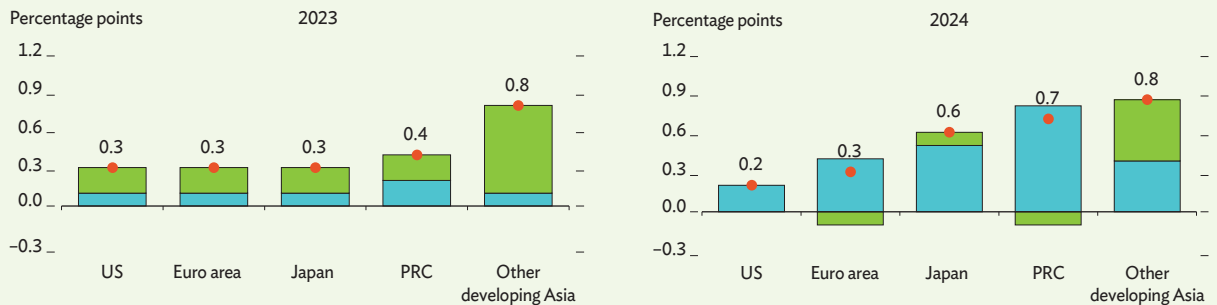
A. GDP

Faster growth in the PRC will boost global demand and raise growth forecasts elsewhere.



B. Inflation

Increases in global commodity prices due to stronger demand will raise inflationary pressures.



GDP = gross domestic product, PRC = People’s Republic of China, US = United States.

Note: Other developing Asia economies are Hong Kong, China; India; Indonesia; Malaysia; the Philippines; the Republic of Korea; Singapore; Taipei,China; Thailand.

Source: Asian Development Bank estimates using the Global Projection Model.

Box 1.1.5 Continued**Faster growth in the PRC will boost global activity, raising growth in the region and elsewhere.**

In this scenario, the PRC's GDP accelerates at a faster 6.0% in 2023—around the pre-pandemic level—before slowing to 5.2% in 2024. This is, respectively, 1.0 and 0.7 percentage points (ppts) higher than the forecast (box figure, panel A). Faster growth in the PRC will boost global demand and has positive spillovers on other economies. The United States, under this scenario, will grow faster, by 0.1 ppt in 2023 and 0.2 ppts in 2024, as will the euro area and Japan, by 0.2 ppts each year over the outlook period. An increase in demand for exports will drive faster average growth rates in other Asian economies, by 0.3 ppts in 2023 and 0.1 ppt in 2024. The effect on other economies in the region varies. Those with strong trade links with the PRC, such as the Republic of Korea, Taipei, China, and most Southeast Asian economies, will benefit the most from the additional boost in demand from the PRC, while those that trade less with the PRC will see smaller effects on their GDP growth.

Stronger global demand induced by faster growth in the PRC will raise global commodity prices and increase inflationary pressures.

Global commodity prices are expected to rise to levels seen in 2022.

The average Brent crude price is forecast rising from the baseline assumption of \$88/barrel in 2023 to \$95 and from \$90 in 2024 to about \$98. US inflation is projected reaching 4.3% in 2023 as higher demand and prices of commodities add 0.3 ppts to the rate (box figure, panel B). Higher prices are also projected in 2024. The rise in demand and elevated global commodity prices are also expected to trigger inflation in other advanced economies and Asia, although to different degrees. On average, inflation in other developing Asian economies will be about 0.8 ppts higher than the baseline over the outlook period. Inflation in some economies will be more affected by higher global commodity prices, which would trigger more aggressive monetary policy tightening that would partially offset the positive growth spillovers from the PRC's faster growth.

^a Other developing Asian economies for the purposes of this box comprise Hong Kong, China; India; Indonesia; Malaysia; the Philippines; the Republic of Korea; Singapore; Thailand; Taipei, China. For more information on the basic model, see [Global Projection Model Network](#) and Blagrove et al. 2013. [Adding China to the Global Projection Model](#). Working Paper 13/256. International Monetary Fund.

This box was written by Arief Ramayandi and Dennis Sorino of the Economic Research and Regional Cooperation Department, Asian Development Bank, Manila

The Economic Impact of the Russian Invasion of Ukraine on the Caucasus and Central Asia: Short-Term Benefits and Long-Term Challenges

Growth was remarkably strong in the Caucasus and Central Asia in 2022.

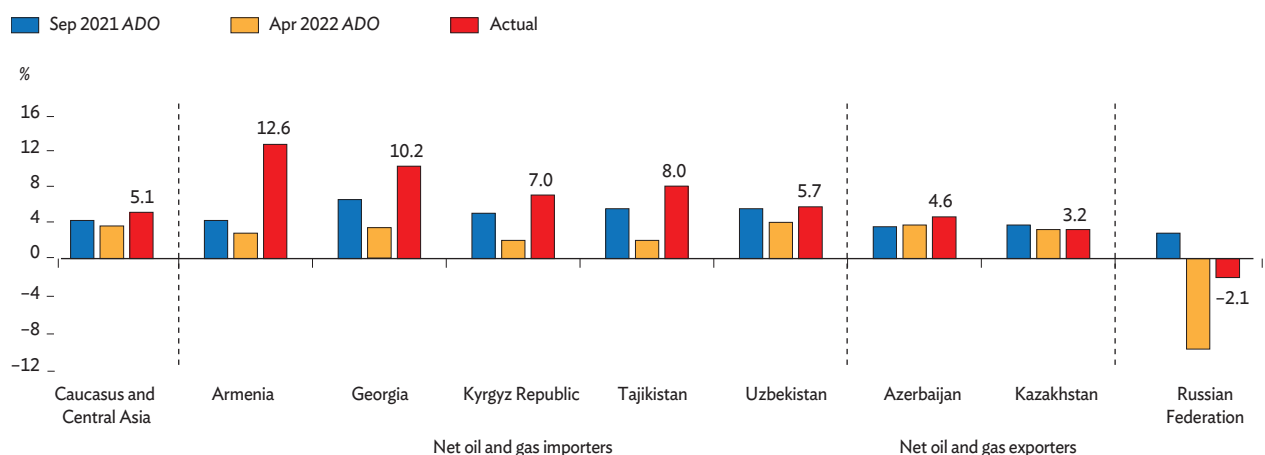
Gross domestic product (GDP) grew by 5.1% in the region, much higher than the 3.6% growth forecast in April—shortly after the Russian invasion of Ukraine—and even higher than the 4.2% growth projected in September 2021 before the invasion.¹ Within the region, growth was highest for oil and gas importing economies, reaching 12.6% in Armenia and 10.2% in Georgia (Figure 1.2.1). This *Special Topic* examines the reasons for this unexpected performance, including Russian migration to the region and rising exports to the Russian Federation. It also highlights the challenges this new situation will bring in the longer term.

Russian Migrants Boost Consumption and Business Activity

Several hundred thousand Russians migrated to the Caucasus and Central Asia in two waves last year. The first was in the months immediately following the Russian invasion of Ukraine, and the second after the partial mobilization in Russia in September. Both waves boosted domestic consumption, particularly in sectors catering to these migrants, such as accommodation and restaurants. This impact was felt the most where the number of migrants was large relative to host countries' populations.

Figure 1.2.1 GDP Growth Forecasts and Actual Growth in the Caucasus and Central Asia

The unexpected boost to growth was stronger for energy importers.



ADO = Asian Development Outlook, GDP = gross domestic product.

Sources: ADO database; Consensus Economics; Federal Statistics Service of the Russian Federation.

This section was written by Jules Hugot of the Economic Research and Regional Cooperation Department and Roman Mogilevskii of the Central and West Asia Regional Department, ADB, Manila.

¹ In this *Special Topic*, “the region” refers to the Caucasus and Central Asia.

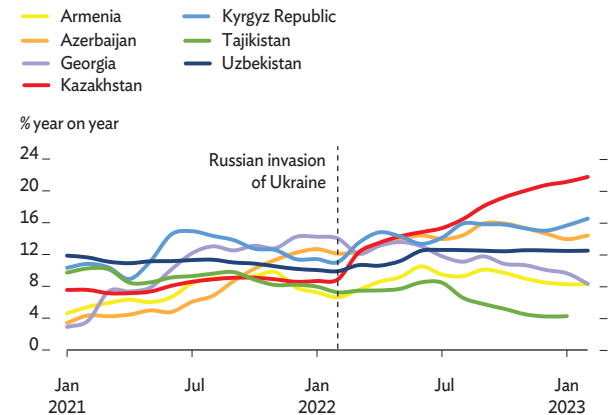
In Armenia, services consumption rose by 15% as 1.1 million Russians transited through the country and about 65,000—representing 2.5% of the population—settled there, largely Armenian ethnics. In Georgia, spending on accommodation was up 124% in the second half of the year from the same period in 2019 as visitor arrivals increased by 8% from Russia, although they were still down 35% from other countries.

Sanctions caused businesses in Russia to relocate to the Caucasus and Central Asia. This enabled companies to shield their import-export businesses from sanctions and made it easier to receive payments in foreign currency. In Kazakhstan, this was reflected in foreign direct investment rising 18% in the first 9 months of 2022. In Uzbekistan, new company registrations with Russian capital doubled in January and February 2023 from the same period last year. Many international firms also relocated staff from Russia to the region, including US technology multinational Nvidia, which opened a research center in Yerevan, and US industrial conglomerate Honeywell, which transferred its regional office and opened a plant in Almaty.

The impact of the Russian invasion of Ukraine on inflation in the region has been ambiguous. The inflow of Russian migrants has an inflationary impact as it boosts demand, but does not increase supply to the same extent. Sanctions disrupted supply chains, and this was particularly pronounced in Kazakhstan, which relies heavily on imports from Russia. Kazakhstan's headline inflation rate rose to 15.0% last year and it was still rising in February 2023, at 21.3% year on year (Figure 1.2.2). Sugar prices in Kazakhstan soared by 82% in spring-summer 2022 because of an export ban imposed by Russia. But the inflow of Russian capital led to currency appreciations in some economies, which mitigated inflation by making imported goods less expensive.

Figure 1.2.2 Monthly Headline Inflation in the Caucasus and Central Asia

Inflation mostly rose in 2022, particularly in Kazakhstan, where it reached 21.3% in February 2023.



Source: CEIC Data Company.

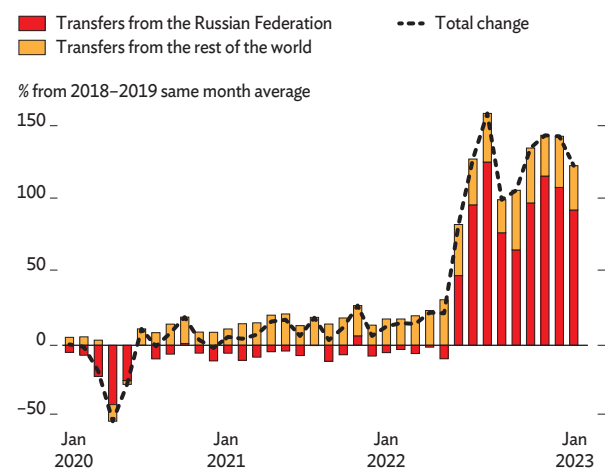
Russian Migrants Fueling a Sharp Rise in Money Transfers

Money transfers rose by 94% in five economies in the region for which data are available.

This represents an increase from the equivalent of 5.2% of GDP in 2021 to 10.1% last year, with transfers from Russia rising by 156% and accounting for 87% of the overall growth in money transfers (Figure 1.2.3, panel A). Armenia saw the sharpest increase, with transfers rising to 37.4% of GDP from 15.2% in 2021 (panel B). These transfers not only supported the consumption of Russian migrants in host countries but were also used to transfer their wealth from Russia—either as a precaution or to be able to make payments abroad through international credit cards, bank transfers, or online solutions, such as PayPal and Wise. These private transfers were further buoyed by business-related transfers to support small-scale exports and reexports to Russia, and to process payments to foreign suppliers.

Figure 1.2.3 Money Transfers to the Caucasus and Central Asia

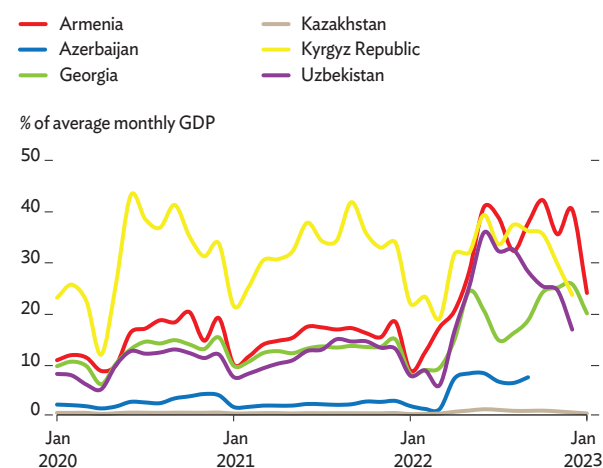
Money transfers rose by 94% in 2022.

A. Transfers to the Region

GDP = gross domestic product.

Notes: In panel A, the sample includes Armenia, Georgia, Kazakhstan, and the Kyrgyz Republic. In panel B, GDP was assumed to be distributed equally across months.

Source: National central banks.

B. Transfers as a Share of GDP

Some currencies in the region appreciated on rising money transfers from the currency exchanges of Russian migrants. The Armenian dram is at its highest rate in 10 years, up 24% against the US dollar in mid-March 2023 from its pre-invasion rate (Figure 1.2.4). The Georgian lari was up 17% in the same period. But in some regional economies where the inflow of Russian migrants was less significant, local currencies were down about 5%, including in Kazakhstan, the Kyrgyz Republic, and Uzbekistan.

The Russian invasion of Ukraine had mixed effects on labor migration to Russia in 2022.

The economic contraction in Russia constrained labor demand, but emigration and mobilization in the army increased demand in certain locations and occupations. As a result, inflows of permanent migrants from the Caucasus and Central Asia to Russia—who might be subject to mobilization if they acquire citizenship—fell for all economies in the region except Tajikistan. This reversed the trend of rising outmigration to Russia and the acquisition of Russian passports in previous years. In contrast, registrations as job seekers in Russia increased by 11% last year for citizens from the Kyrgyz Republic, 29% from Uzbekistan, and 45% from Tajikistan, suggesting that temporary labor migration to Russia remained

steady. Registrations of Armenian job seekers, however, decreased by 15%.² This divergence in trends for permanent and temporary labor migration for most economies in the region suggests a shrinking time horizon for migrants, who are still open to short-term job opportunities but are increasingly wary of permanently relocating to Russia.

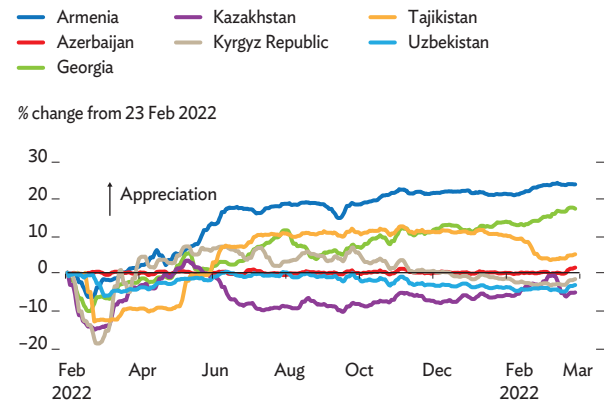
Available data suggest remittances from Russia remained mostly steady.

Before the Russian invasion of Ukraine, remittances from migrant workers were estimated to be equivalent to about 10% of GDP in Armenia and Uzbekistan, and 30% in the Kyrgyz Republic and Tajikistan. Assessing remittances, however, is challenging because data rely on transfers via money transfer services and banks, which mix genuine remittances with other flows, such as the repatriation of export revenue. Last year, inferring remittances became even more difficult as transfers by Russian migrants further blurred the picture. Still, the steep increase in money transfers from Russia suggests that remittances were at least steady, if not rising. The picture is slightly different in the Kyrgyz Republic as net transfers there fell by 14% last year, hinting at a decline in remittances. The situation for remittances therefore reflects heterogeneity across countries for labor migration.

² Ministry of Internal Affairs, Russian Federation. 2023. [Statistical Information on Migrations](#) (in Russian).

Figure 1.2.4 Exchange Rates of Economies in the Caucasus and Central Asia against the US Dollar

The Armenian dram and Georgian lari appreciated sharply in 2022.



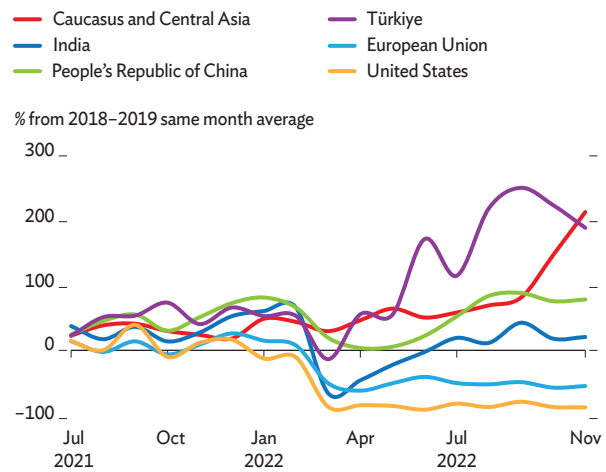
US = United States.

Note: 7-day moving averages.

Source: CEIC Data Company.

Figure 1.2.5 Exports to the Russian Federation

Exports up by 95% in March–November 2022 from the same period in 2018–2019.



Source: International Monetary Fund. [Direction of Trade Statistics database](#).

Departure of International Companies from Russia Boosted Caucasus and Central Asia's Exports

Merchandise trade in the Caucasus and Central Asia grew sharply in 2022. The region's total exports rose by 43% from 2021, and imports by 27% due partly to the spike in oil and gas prices because of the Russian invasion of Ukraine and sanctions against Russia.³ Azerbaijan's energy exports grew by 113% and Kazakhstan's by 49%. The region's energy imports rose by 33%, mostly from Russia. The region's exports to Russia rose by 63% over March–November last year from the same period in 2021 (Figure 1.2.5). This is a sharper increase than Russia's imports from the People's Republic of China (PRC) (9%), but about the same as from Türkiye (61%). Annual exports to Russia rose for all countries in the region, albeit at a varying pace—a modest 6% in Azerbaijan and 7% in Georgia to record highs of 195% in Armenia and 151% in the Kyrgyz Republic (Figure 1.2.6, panel A).

Export creation accounted for 59% of last year's rise in exports to Russia. Product data were used to disentangle the drivers of changes in exports to Russia, including export creation, export destruction, and reexports. Export creation comprises the exports of products that were already exported in 2021, but increased significantly last year.⁴ This was largest in Kazakhstan (minerals, including uranium, and machinery and equipment), Uzbekistan (textiles, fruit, copper pipes, and electrical appliances), and Armenia (diamonds, base metals, and fish) (Figure 1.2.6, panel B). These exports notably substituted Russia's imports from economies that imposed sanctions. Export destruction comprises products that were exported in 2021, but for which shipments declined in 2022. This was most noticeable in Kazakhstan, where exports of iron ore to the Magnitogorsk metallurgical plant in Russia stopped as the plant was hit by sanctions.

Reexports accounted for 49% of the rise in exports to Russia. Reexports comprise products for which imports—from any origin—and exports to Russia both rose significantly.⁵ These exports were primarily aimed

³ Turkmenistan is omitted as data not available.

⁴ For export creation, export destruction, and reexports, "significantly" means that for a product defined by its 4-digit Harmonized System code, exports to Russia rose—or declined, in the case of export destruction—in 2022 by more than 20% of the 2021 value of exports to the world. Trade flows are classified as export creation or destruction if their exports exceeded \$5 million in 2021. Only export flows exceeding \$5 million to Russia in 2022 are included in reexports.

at replacing imports from sanctioning economies, whether for products under sanction or not. The reexported products included smartphones and cars from Armenia; printers, parts of electrical engines, and tractors from Kazakhstan; automatic locks and packaging equipment from the Kyrgyz Republic; and printers and some types of plastics from Uzbekistan. For these products, these economies saw increased imports mostly from the European Union (EU) and the PRC.

Rising exports were not primarily driven by efforts to circumvent sanctions on Russia.

Exports from the region to Russia of goods falling under the EU export ban rose faster than other exports in 2022.⁶ But even with these large increases, they contributed less than 3 percentage points in export rises in Georgia and Uzbekistan (Figure 1.2.7). In Armenia, these exports contributed from 2 to 33 percentage points in the overall 79% rise in exports, depending on the

uncertain share of the country's exports to Russia that falls under the EU's definition of luxury goods. Thus, the key driver of reexports was not the evasion of sanctions, but the decision of many companies to stop exporting to Russia even though their products were not sanctioned. However, nothing prevents these companies from exporting to the Caucasus and Central Asia where regional traders used the opportunity to resell such products to Russia.

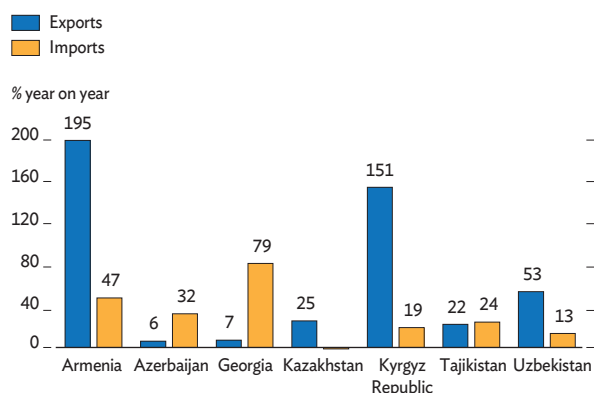
Russian migrants boosted the region's trade in services, including air travel, accommodation and catering, and banking.

Kazakhstan's exports of services to Russia increased by 75% in the first 9 months of 2022 year on year. In the Kyrgyz Republic, the issuance of Visa cards rose by 48%, mostly on Russians seeking to travel abroad. In Georgia, Russians opened nearly 110,000 bank accounts in 2022. And in Armenia, Ameriabank—the country's largest bank—posted the biggest profit in its history, up 128% from 2021.

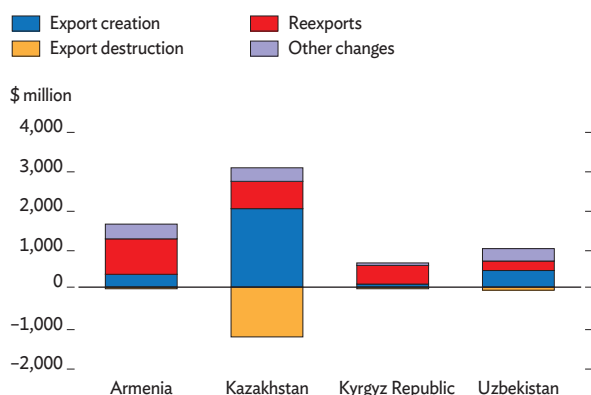
Figure 1.2.6 Caucasus and Central Asia Trade with the Russian Federation, 2022

Exports to Russia rose the most in Armenia and the Kyrgyz Republic, driven by reexports.

A. Growth in Trade with Russia



B. Decomposition of Export Growth to Russia



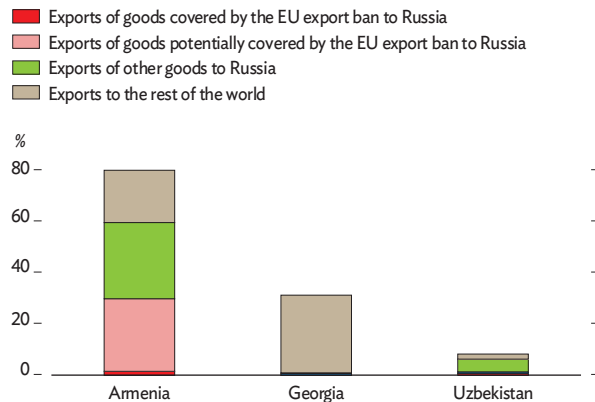
Source: Authors' calculations using data from [United Nations Comtrade database](#), national statistics, customs agencies, and central banks.

⁵ The overall change in exports to Russia was accounted for by export creation—59 percentage points (pp)—export destruction (–30 pp), reexports (49 pp), and other changes (22 pp).

⁶ M. Chupilkin, B. Javorcik, and A. Plekhanov. 2023. *The Eurasian Roundabout: Trade Flows into Russia through the Caucasus and Central Asia*. EBRD Working Paper No. 276. European Bank for Reconstruction and Development.

Figure 1.2.7 Export Growth across Destinations and Types of Goods in Armenia, Georgia, and Uzbekistan, 2022

Rising exports to the Russian Federation were mostly driven by goods not covered by the EU export ban.



EU = European Union.

Note: Annex XVIII of the [EU Council Regulation No. 833/2014](#) lists goods covered by the EU export ban only when their unit values exceed certain thresholds, making them luxury goods. The unit prices, however, cannot be determined from the data and thus the precise share of these goods effectively falling under the export ban is provided here as a range—only the red bars if 0% fall under the Annex XVIII ban and the sum of the red and red-green bars if 100% falls under the ban.

Source: Authors' calculations using data from [United Nations Comtrade database](#).

Windfall Gains May Be Temporary and Challenges Are Emerging

The inflow of skilled labor from Russia might be temporary. Russian information technology professionals and other skilled workers flooded the Caucasus and Central Asia in spring and fall 2022. Some of them will settle permanently in the region, especially those originating from there, but many have and will move closer to major global markets for the services they can provide. In the long term, this will limit the benefits of their participation in the region's labor markets.

The windfall reexport margins will likely be short-lived. The reexports of goods included in the export-ban list of economies imposing sanctions on Russia expose some economies in the region to secondary sanctions. Even if secondary sanctions are not implemented, the region does not have a geographical or logistical advantage in being a hub for supplying Russia because there are shorter routes from the EU and a

long common border between Russia and the PRC. In the short term, traders in the region will benefit from preestablished business networks in Russia, but in the longer term, shorter and cheaper transit routes might be found, depriving the Caucasus and Central Asia of some of these windfall gains.

Russia's ability to supply machinery and equipment to the Caucasus and Central Asia is at risk.

In pre-pandemic 2019, the region sourced 16% of its imports of machinery and equipment—including agriculture machinery, railway wagons, and pumps—from Russia. This share declined to 11% in 2022, a drop that suggests Russia's technological isolation from developed economies is undermining its role in supplying technologies to the region. This will require shifting to new suppliers, which will involve the region breaking its good connection with Russian suppliers—and may involve not only higher shipping costs but also information frictions caused notably by language barriers. This strengthens the case for improving connectivity along the Middle Corridor, which links East Asia and Europe via the Caucasus and Central Asia.

Russia's increasing isolation and the risk of its lasting economic decline warrants the region diversifying its economic ties.

The supply chain disruptions reported last year showed the dependence of many economies in the region on transit through Russia. Diversifying trade routes and developing regional supply chains would mitigate these risks. Achieving this will require more intensive and efficient regional cooperation. Similarly, the heavy labor migration in Russia poses risks that can be mitigated by policies to diversify the destinations of migrant workers, particularly in the Kyrgyz Republic and Tajikistan. And Russia's isolation will hamper its ability to be a regional hub for knowledge, access to technologies, and modern business practices. The International Monetary Fund forecasts that Russia's real GDP will not recover to its 2021 level before 2028. Russia's economy will also face longer-term headwinds from global decarbonization and the country's demographic decline—the population is projected to fall below that of the Caucasus and Central Asia by 2061. Continuing to catch up with productivity in more advanced economies will thus require the region forging closer links with other regional hubs, both east and west.

Tighter Liquidity Slows Global Growth

Growth in the major advanced economies of the United States, the euro area, and Japan is expected to decelerate in 2023 and 2024. Last year's aggressive monetary policy tightening in the US and euro area will continue weighing on consumer and capital spending in the early part of this year. Weaker external demand and the normalization of COVID-related emergency spending will drag Japan's growth this year and next. Brent crude prices over the outlook period are expected to remain higher than pre-pandemic levels due to the People's Republic of China (PRC) reopening and constrained oil supply. In aggregate, growth in the major advanced economies is expected to slow to 0.7% in 2023 from 2.5% in 2022 and pick up to 1.3% in 2024 (Table A.1).

Table A1.1 Baseline Assumptions on the International Economy

	2021	2022	2023	2024
GDP growth, %				
Major industrial economies ^a	5.2	2.5	0.7	1.3
United States	5.9	2.1	0.9	1.3
Euro area	5.3	3.5	0.5	1.4
Japan	2.2	1.3	0.8	0.8
Inflation, %				
Major industrial economies ^a	3.3	7.5	4.4	2.4
United States	4.7	8.0	4.0	2.4
Euro area	2.6	8.4	5.7	2.5
Japan	-0.2	2.3	2.0	1.9
Brent crude spot prices, average, \$ per barrel	70.44	100.00	88.00	90.00
Interest rates				
United States federal funds rate, average, %	0.1	1.7	4.8	4.7
European Central Bank refinancing rate, average, %	0.0	0.7	3.8	3.3
Bank of Japan overnight call rate, average, %	0.0	0.0	0.0	0.0
\$ Libor, ^b %	0.1	2.1	4.8	4.7

ADO = Asian Development Outlook, GDP = gross domestic product.

^a Average growth rates are weighted by GDP purchasing power parity.

^b Average London interbank offered rate quotations on 1-month loans.

Sources: Bloomberg; CEIC Data Company; Haver Analytics; International Monetary Fund. World Economic Outlook; Asian Development Bank estimates.

This annex was written by Jules Hugot, Matteo Lanzafame, Nedelyn Magtibay-Ramos, Yuho Myoda, Pilipinas Quising, Arief Ramayandi, and Dennis Sorino of the Economic Research and Regional Cooperation Department (ERCD), ADB, Manila, and Michael Timbang and Jesson Pagaduan, ERCD consultants.

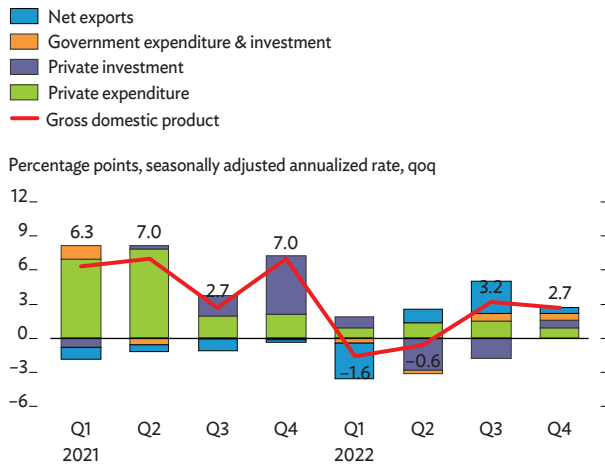
Recent Developments in the Major Advanced Economies

United States

The economy grew in 2022 as the technical recession in the first half was outweighed by economic expansions in the second half. Gross domestic product (GDP) grew by 3.2% and 2.7% quarter on quarter in seasonally adjusted annualized terms in the third quarter (Q) and Q4 (Figure A.1), bringing growth to 2.1% for the year. Although private consumption contributed 1.9 percentage points to annual growth and investment 0.7 points, government spending and net exports weighed on growth.

Figure A.1 Demand-side Contributions to Growth, United States

Trade surpluses helped GDP to resume growth in 2022.



Q = quarter, qoq = quarter on quarter.

Sources: Department of Commerce. Bureau of Economic Analysis; Haver Analytics.

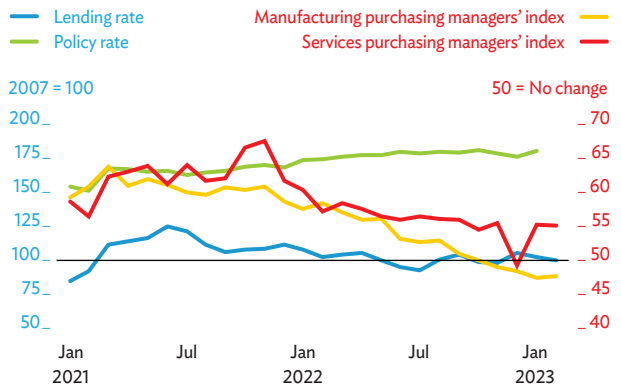
All demand-side components contributed to the 2.7% growth in Q4 despite successive interest rate hikes. Spending on services supported consumption, particularly on housing and health care. Sharply higher mortgage rates put off potential home buyers and drove rents up. Higher interest rates led to a sharp drop in residential investment, but this was offset by rising inventories due to restocking. Overall government spending increased as the federal government raised nondefense outlays and states and local governments

raised employee compensation. Trade continued making a positive contribution to growth as imports contracted faster than exports due to weaker global demand.

The economy shows resilience despite slowing growth. The Federal Reserve’s aggressive tightening and weakening global demand have slowed the momentum for growth. The outlook for investment is mixed as the manufacturing purchasing managers’ index (PMI) has been below 50—the threshold indicating expansion—since November 2022, but the expansion in services resumed after the downward blip in December. The manufacturing PMI continued to indicate contractions in January and February, implying a further weakening of activity in the sector in Q1 2023, which is consistent with the falling industrial production index since November (Figure A.2). The consumer confidence index weakened in January and February, partly due to the Fed’s tightening, but consumer demand seemed to stay strong following the continued increase in earnings. The services PMI also suggested the sector’s consecutive expansions in January and February mainly on stronger new orders that generate business activity and employment in the sector.

Figure A.2 Business Activity, United States

Business activity is slowing despite some signs of resilience.



Note: A purchasing manager’s index reading <50 signals deterioration, >50 improvement.

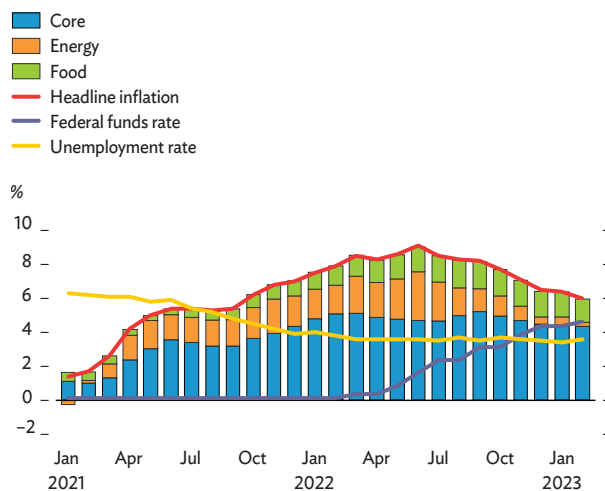
Source: Haver Analytics.

Inflation has started to decline, but it is still stubbornly high. The Fed has raised interest rates aggressively since March last year to tackle inflation, bringing the policy rate to a range of 4.75%–5.00% by the end of March this year. Headline inflation has

declined since July 2022, but the rate was still at an elevated 6.0% in February (Figure A.3). Although all components of inflation have started to decelerate, the declines have been only gradual and mostly due to slower increases in energy prices. Core inflation remains elevated as high demand for housing rentals pushed up rents and the relaxation of COVID-19 travel restrictions increased the costs of transport services. The labor market remains tight, with 311,000 jobs added and the unemployment rate at 3.6% in February, way below the natural rate of unemployment at 4.4%. Elevated core inflation and the tight labor market may cause the Fed to consider another round of aggressive interest rate hikes.

Figure A.3 Inflation, Federal Funds Rate, and Unemployment Rate, United States

Prices and employment remained stubbornly high despite interest rate hikes.



Source: CEIC Data Company.

Growth will slow substantially over the outlook period. GDP is forecast to grow by 0.9% in 2023 as economic activity slows in the first half in response to last year's rapid tightening in monetary policy, before accelerating in the second half. Growth next year will strengthen gradually to a forecast 1.3%. The Fed's pledge to return inflation to its 2% target suggests more interest rate hikes in the first half of 2023 and no cuts over the rest of the year. The Fed's "dot plot"—a survey of the projections of Fed officials for the outlook for interest rates—suggests the policy rate will be just above 5% by the end of 2023. Inflation will decline gradually, and is forecast at 4.0% this year and 2.4% in 2024.

Risks to the forecast are balanced. Growth forecasts may be revised upward if inflation can be brought down without generating a deep recession, but downward revisions are also possible if inflation stays stubbornly high. Although less likely, the statutory debt limit issue poses a negative risk to the forecast. On 19 January, the Department of the Treasury started to pursue extraordinary measures to prevent the US from defaulting on its obligations. Although it is unlikely that cash and the extraordinary measures will be exhausted before early June, when the debt ceiling limit will likely be hit, the government failing to meet its obligations could damage the economy and global financial stability.

Euro area

Growth fell to a still respectable 3.5% in 2022 from a record 5.3% high in 2021.

Despite the Russian invasion of Ukraine, growth in the euro area was underpinned by residual reopening effects as COVID-19 passes and the disbursement of European Union (EU) Recovery and Resilience Facility funds. However, as the energy crisis took its toll, GDP contracted by a seasonally adjusted annualized rate (saar) of 0.1% in Q4, dragged by falling domestic demand (Figure A.4). Private consumption expenditure declined by 3.4% saar and fixed investment dropped by 3.6%, as elevated inflation and rising interest rates dampened retail sales and industrial output. All major economies were affected by the quarter's weak performance, albeit to varying degrees. Germany (-1.7%) and Italy (-0.5%) posted negative saar growth, while growth in France slowed to 0.3%. Spain's Q4 growth, at 0.9%, was unchanged from the previous quarter.

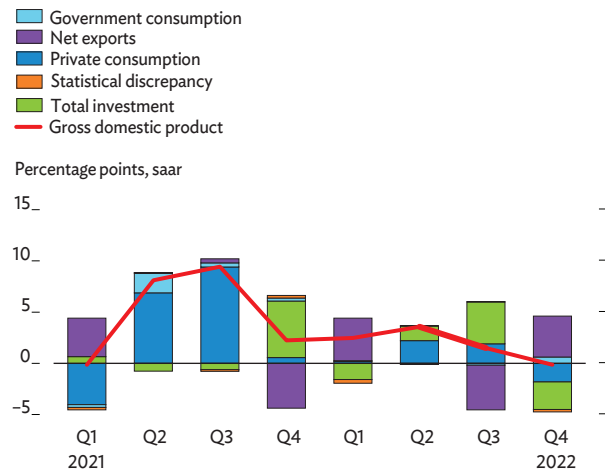
Leading indicators suggest marginal but continued improvement in the euro area in 2023.

Economic sentiment increased for the fourth consecutive month in January to 99.9, only slightly below its long-term average of 100 (Figure A.5). Industry, services, consumer, and retail confidence improved, but construction confidence fell on lower employment expectations in the sector. The seasonally-adjusted composite PMI rose from 49.3 in December to 50.3 in January and to 52.0 in February. Sentiment improved in manufacturing and services on mending supply chains offsetting softer demand, easing input price pressures, and robust employment intentions.

The manufacturing output index was still contractionary in January, although it increased to a 7-month high of 49.0 in that month. The services PMI also rose for the first time in 7 months to 50.8 in January and to 52.7 in February, driven by growth in technology, industry, health care, and pharmaceuticals.

Figure A.4 Demand-side Contributions to Growth, Euro Area

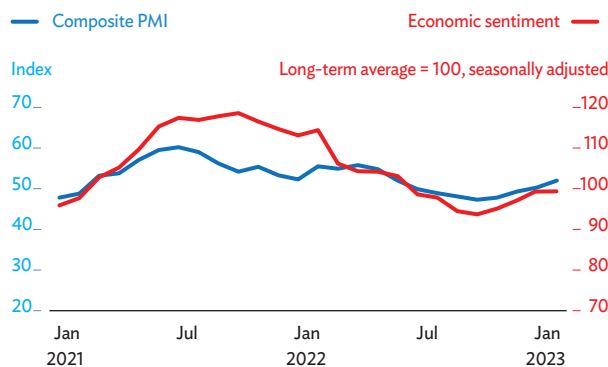
Growth declined in Q4 2022 on falling domestic demand.



Q = quarter, saar = seasonally adjusted annualized rate.
Source: Haver Analytics.

Figure A.5 Economic Sentiment and Purchasing Managers' Indexes, Euro Area

Leading indicators showed a mild improvement in January 2023.



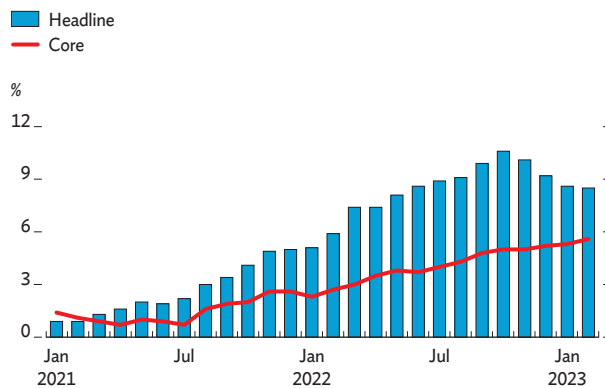
Sources: CEIC Data Company; Haver Analytics.

Growth in the euro area is forecast at 0.5% this year and 1.4% in 2024. Economic activity is expected to remain weak in early 2023, but gradually improve in the second half and into 2024. High inflation and tight liquidity will continue weighing on consumer and capital spending this year, when the tailwinds from reopening will fade. Household consumption expenditure will soften alongside declining real disposable income, both depressed by elevated inflation and softer growth in labor and nonlabor incomes. Investment will weaken this year, dented by monetary policy tightening and lower business confidence. Fiscal policy will remain supportive, but the focus will gradually shift toward consolidation as higher bond yields increasingly weigh on government budgets. Easing inflationary pressures, resilient labor markets, and improving external conditions are expected to underpin strengthening domestic and external demand from Q3. The remaining supply bottlenecks should be mostly resolved by mid-2023, and energy supply constraints will continue easing—except for 2024’s winter months. GDP growth will accelerate in 2024, as energy markets normalize and the tightening cycle of the European Central Bank (ECB) ends.

The headline inflation rate is forecast declining to 5.7% in 2023 and falling sharply to 2.5% next year. Soaring energy prices stoked inflation in the euro area, lifting consumer price inflation to 8.4% in 2022. As energy inflation cooled, headline inflation eased to 8.6% in January and to 8.5% in February—down from an all-time high of 10.6% in October. Core inflation, however, rose from 5.2% in December to 5.3% in January and to 5.6% in February, indicating that underlying price pressures remain significant (Figure A.6). In response, the ECB raised its key interest rates by 50 basis points in December, another 50 points in January, and by the same amount again in March, bringing the rate on its main refinancing operations to 3.5%. The ECB will also reduce its asset purchase program from March. Monetary tightening and energy-price base effects are expected to result in gradual disinflation over the outlook period, but persistent wage pressures and high core inflation will keep headline inflation above the ECB’s 2% target.

Figure A.6 Headline and Core Inflation, Euro Area

Inflation has increased steadily on surging energy prices.



Sources: CEIC Data Company; Haver Analytics.

Risks to the outlook are balanced and mainly associated with the Russian invasion of Ukraine and inflation dynamics. Negative developments in the Russian Federation and Ukraine could spawn renewed surges in oil and gas prices, as well as supply disruptions. This could lead to more aggressive monetary tightening by the ECB, as could stubbornly high core inflation. On the upside, an earlier-than-expected ceasefire in Ukraine could bring down energy prices and allow the ECB to pivot toward policy rate cuts sooner than currently anticipated.

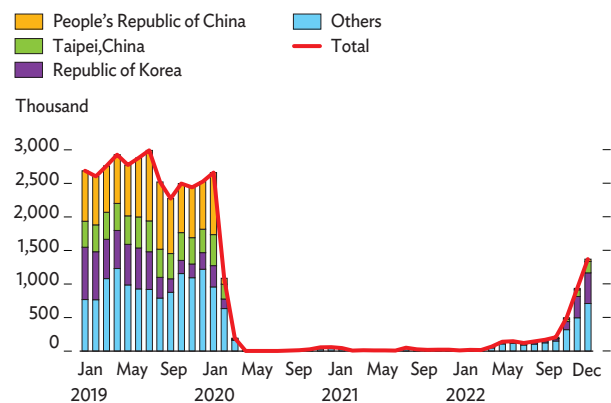
Japan

The economy rebounded by 0.6% quarter on quarter saar in Q4 2022 on recovering private consumption and improving net services exports. Despite a surge in COVID-19 infections in November and December, the number of people needing inpatient care remained manageable. Private consumption, especially services, continued rising in Q4. Weak private investment and inventory change weighed on growth, reflecting weaker orders for manufactured goods, including semiconductor manufacturing equipment. But the normalization of arrival processes for foreign visitors in October triggered a rapid recovery in tourist arrivals in Q4 (Figure A.7). This recovery, magnified by increased per-person consumption due in part to the cheaper yen, significantly improved the services trade balance.

Inflation in the core consumer price index (CPI) that excludes fresh food accelerated in 2022, averaging 3.7% year on year in Q4. The rise in international commodity prices and the yen's concurrent depreciation in the first half of 2022 increased inflation pressures through higher import prices. However, the pass-through of higher import prices will likely peak soon. Brent crude oil prices declined by more than 30% from June to the end of 2022, and the yen appreciated by almost 20% against the US dollar from its low during October–January. Because of this, the yen-based import price index started to decline in November (Figure A.8).

Figure A.7 International Tourist Arrivals, Japan

Big rebound in foreign tourists in Q4 2022 on normalizing arrival procedures.

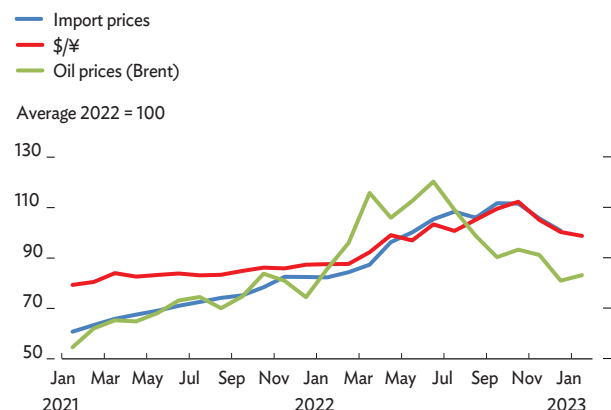


Q = quarter.

Source: Japan National Tourism Organization.

Figure A.8 Import Prices, Exchange Rate, and Oil Prices, Japan

Declining oil prices and a rising yen have brought down import prices since November 2022.



Source: CEIC Data Company.

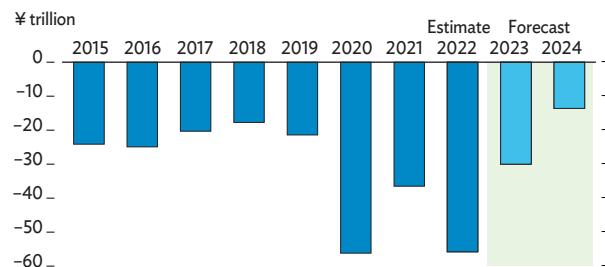
The economy is expected to grow by 0.8% this year and next. Growth will slow in mid-2023, reflecting weaker global demand, but rebound in 2024, and the GDP gap will close by the end of outlook period. Government consumption will decline considerably in 2023 as COVID-related emergency spending eases. Private consumption growth is not expected to be strong enough to fully compensate for weaker external and public demand because nominal wage growth will fail to keep pace with inflation. Growth in 2024 will be driven by improving external demand.

Core CPI is forecast at 2.0% this year and 1.9% in 2024. Monthly core consumer prices reached 4.0% in December 2022, but inflation will decelerate from February due to government subsidies on electricity and city gas bills. Core inflation will slow from the first half of 2023 as the pass-through from higher import prices fades. The index is expected to fall to about 1.5% by the end of 2023, although the termination of subsidies on electricity, gas, and gasoline will cause a transitory rebound in year-on-year inflation and may change the annual inflation rate significantly.

Fiscal consolidation is expected over the outlook period; accommodative monetary policy will remain largely unchanged. According to the government, the primary budget deficit increased by about ¥35 trillion from fiscal year 2019 (FY2019, ended 31 March 2020) to FY2020 due to COVID-19 emergency spending packages and was at the same level in FY2022 (Figure A.9). In FY2023, the primary balance deficit is expected to decline substantially as most of these emergency expenditures normalize.

Figure A.9 Fiscal Balance of Central and Local Government, Japan

Fiscal deficits are planned to be reduced in 2023 and 2024.



Note: Years are fiscal years ending on 31 March of the next year.
Source: Cabinet Office estimates.

But because a sustained increase in prices accompanied by rising wages is still not likely to be achieved, it is assumed that the Bank of Japan will maintain its accommodative monetary policy.

Risks to growth are mostly balanced, but the inflation risk is skewed upward. If, as the Bank of Japan argues, the adaptive expectation formation mechanism—an economic model in which past events play an important role in predicting the future—is more apparent for the economy, recent import price-driven inflation may raise price expectations, allowing the central bank to achieve sustained price increases sooner than expected in the outlook period. New geopolitical tensions and a rapid recovery in the PRC could cause import price-led inflation again by raising global commodity prices.

Recent Developments and Outlook in Nearby Economies

Russian Federation

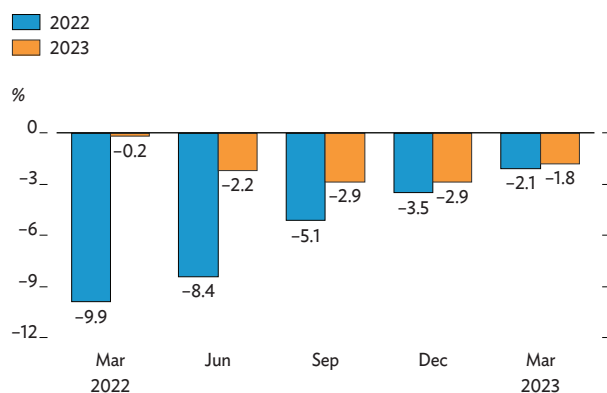
The economy performed much better than expected in 2022 according to official government statistics. In March last year, Consensus Forecasts had GDP contracting by close to 10% in 2022 while the estimate from February this year by the Federal Statistics Service suggests the economy contracted by just 2.1% last year (Figure A.10). The mobilization of 300,000 new troops in September hurt consumer confidence and economic activity, but the impact on growth reported by authorities was milder than expected. In Q4, manufacturing, agriculture, and consumer services output increased sharply, although import bans and the price cap on Russian oil imposed by the EU and G7 countries hurt the external sector in December. Lending also picked up in December, and procurement for military supplies continued to support manufacturing.

Inflation has stabilized. The Central Bank of Russia reported that inflation moderated to 11.8% year on year in January from 11.9% in December. The central bank kept its policy rate unchanged at 7.5% at its February meeting—the third consecutive hold in its monetary policy stance. Despite weak fiscal prospects,

the large National Wealth Fund—totaling about 12% of GDP before the Russian invasion of Ukraine—should allow the budget to stay afloat this year, enabling the government to continue stimulating domestic demand, particularly in military-related industries. The ruble has depreciated since December last year following the oil embargo and price cap, which erased all 2022's appreciation. The weaker ruble will add to inflation pressures because it will make imported goods more expensive.

Figure A.10 Consensus Economics GDP Forecasts, Russian Federation

The economy withstood international sanctions better than expected.



GDP = gross domestic product.

Note: The figure reported as the 2022 forecast as of March 2023 (-2.1%) is the estimate for 2022 GDP from the Federal Statistics Service.

Source: Consensus Economics.

The outlook will depend on Russia's ability to divert its oil exports from the EU to Asia. In volume terms, the country's crude oil exports fell by 12% in December as shipments plunged after the EU import ban and the G7's price cap at \$60 per barrel came into force on 5 December. Oil and gas revenues fell nearly 50% annually in January. Oil exports will be further hindered by the extension of the embargo to refined oil products and the corresponding price cap that came into force on 6 February. Further declines are expected after Russia announced that it will cut its oil output by 0.5 million barrels per day. With the EU still accounting for 24% of Russian oil exports as of November, the effect of international sanctions may be mitigated by redirecting exports to Asia, especially to India and the PRC. Persisting sanctions, heightened political and economic isolation, and declining global energy prices further cloud the outlook. As of 13 March, Consensus

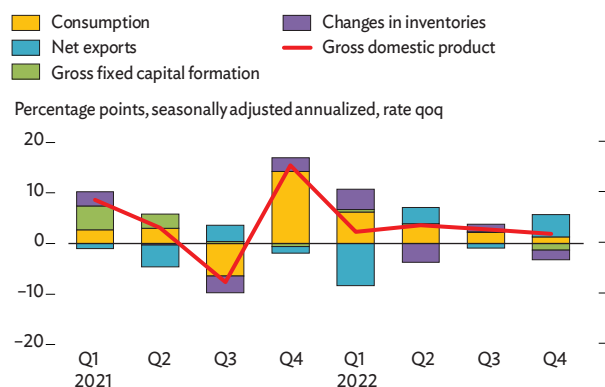
forecasts had GDP contracting by 1.6% in 2023 and expanding by 1.3% in 2024. Key risks include further international sanctions and internal political instability.

Australia

Strong economic growth in 2022 was supported by robust consumption, which remained resilient despite high inflation. GDP growth moderated to a still healthy 1.9% saar in Q4 from 2.8% in Q3 (Figure A.11). Household spending remained high amid declining unemployment, at a 44-year low of 3.7% in 2022, and improving wage growth. Seasonally adjusted retail sales grew by 11.4% in 2022, more than double 2021's 5.5%. Inflation in December was 7.8%, the highest in 32 years and well above the Reserve Bank of Australia's 2%–3% target. Global concerns, strong domestic demand, rising wage growth, and higher production costs are stoking high inflation.

Figure A.11 Demand-side Contributions to Growth, Australia

Strong growth in 2022 stabilized at a rate higher than in pre-pandemic 2019.



Q = quarter, qoq = quarter on quarter.

Source: CEIC Data Company.

Rising interest rates, price pressures, and the diminishing boost of the economy reopening will constrain growth in the short term. The Reserve Bank Board raised its policy rate to 3.35% in February in response to high inflation, and interest rates are expected to increase further in the coming months. The recovery in services spending due to eased COVID-19 restrictions is waning and tighter financial conditions will limit spending.

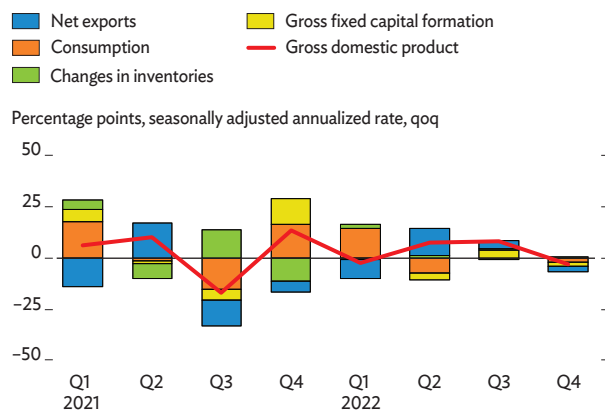
Positive trade developments may support the external sector. On 29 December 2022, a trade agreement with India came into effect; this is expected to substantially increase bilateral trade over the next 5 years. The government is trying to improve trade relations with the PRC, and a ban on Australian coal imports has been lifted. The PRC's reopening is a major upside risk. Consensus Forecasts, as of 20 March 2023, had GDP growing by 1.6% in 2023 and 1.7% in 2024.

New Zealand

After expanding in Q2 and Q3 2022, the economy contracted in Q4 by 3.0% saar in Q4. The contraction was on reduced exports and investment, with exports of goods and services down 8.6% in the quarter (Figure A.12). Monetary policy tightening weighed on fixed investment, which declined 7.5%. Tourist arrivals surged 590% in 2022 on the lifting of COVID-19 travel restrictions, but visitor arrivals were still only 37% of the level in 2019. Unemployment averaged 3.3% last year, the lowest since 1986. Retail sales rose by 5.4% in Q4. Inflation, averaging 7.2% in 2022, is at a 32-year high and well above the Reserve Bank of New Zealand's target of 1%–3%. Rising commodity and fuel prices due to the Russian invasion of Ukraine added to the inflationary pressures that resulted from the pandemic. Increasing wages because of labor shortages are also contributing to high inflation.

Figure A.12 Demand-side Contributions to Growth, New Zealand

The economy contracted in Q4, dragged by weaker exports and investment.



Q = quarter, qoq = quarter on quarter.

Source: CEIC Data Company.

High inflation, labor shortages, and bleaker prospects for global demand will weigh on growth this year. In response to high inflation, the Monetary Policy Committee increased the official cash rate to 4.75% from 4.25% in February 2023. More increases are expected in the coming months to bring inflation back to its target range and meet employment goals. Inflation, however, is expected to stay high over the outlook period. Weaker external demand will reduce exports, and the uncertain global prospects will likely decrease investment. But household expenditure is expected to remain high, and growth in tourism will support economic activity. The PRC's reopening poses an upside risk to the outlook. Consensus Forecasts, as of 20 March 2023, had GDP growing by 0.9% in 2023 and 1.1% in 2024.

Oil prices

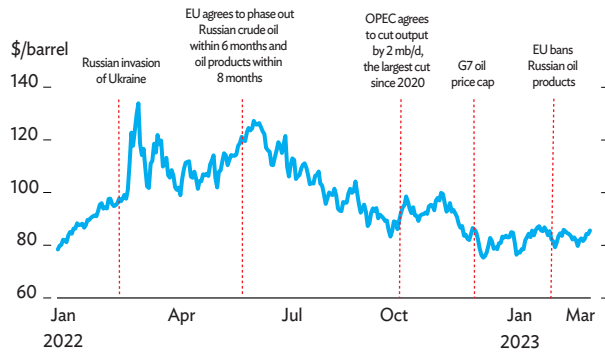
Brent crude ended 2022 at \$84/barrel, roughly where it began the year, but the average price of \$100/barrel was well above previous years. During the year, however, prices reached highs not seen since mid-2014, hitting \$127/barrel in June (Figure A.14). Concerns over tighter crude oil supplies propelled prices because the Russian invasion of Ukraine threatened to remove about 2 million barrels from an already tight market and the increased demand for oil as the world emerged from COVID-19 restrictions. As these concerns subsided and prospects for the global economy weakened, prices started to ease toward the end of 2022. Brent crude's annual average price of \$100/barrel last year was 42% higher than in 2021 and the highest since 2013.

Supply and demand worries caused the recent fluctuations in oil prices. Brent crude prices started 2023 weak, buffeted by worries over macroeconomic headwinds, cuts by Organization of the Petroleum Exporting Countries (OPEC) Plus members, EU embargoes against Russia becoming less of a concern, and a warmer-than-expected northern hemisphere winter. Brent crude oil prices fell to as low as \$76/barrel in the first week of January, but started trending up after the PRC announced its reopening, reaching \$87/barrel on 23 January.

Since then, oil prices have moved sideways on uncertainty over the timing and strength of the PRC's demand recovery and the trajectory of US interest rates. At the time of writing, Brent crude prices were hovering around \$84/barrel.

Figure A.14 Brent Crude Oil Prices

Brent crude oil prices fluctuated on demand and supply concerns.



EU = European Union, G7 = Group of Seven, mb/d = million barrels/day, OPEC = Organization of the Petroleum Exporting Countries.

Source: Bloomberg.

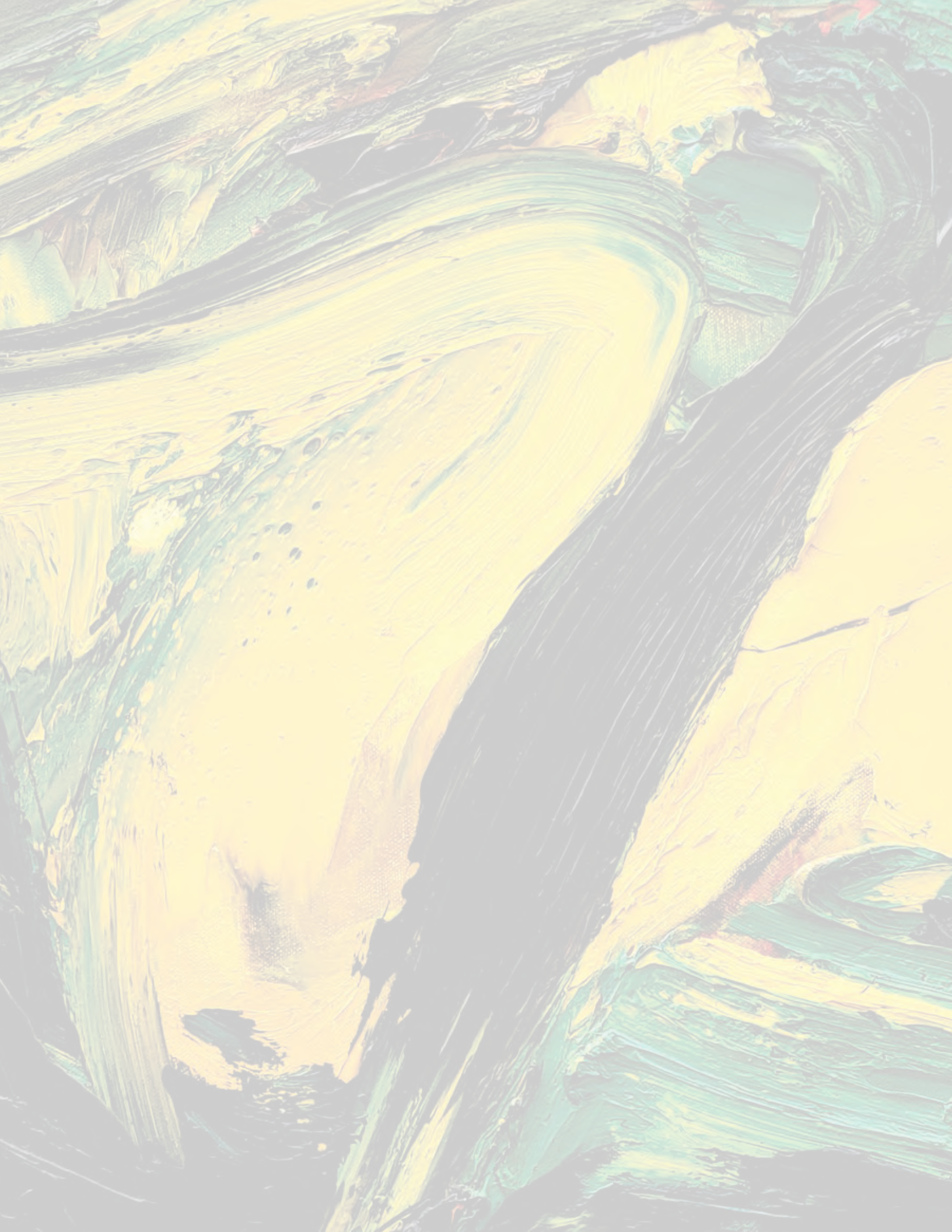
Brent crude prices are expected to rise slightly this year, averaging \$88/barrel. The spot price is expected to average \$85/barrel in the first half, rising to an average \$91/barrel in the second half as the PRC's economy gathers speed and economic conditions in major advanced economies improve. Additional upward price pressures will come from constrained supply due to recent production cuts by OPEC Plus and an expected decline in Russian oil exports because of EU sanctions. The EU's ban in February on imports of Russian petroleum products may turn out to be more disruptive than the December ban on crude oil imports. This is because Russia may find it more difficult to find new export destinations due to the limited availability of clean tankers.

Brent crude prices are expected to average \$90/barrel in 2024. As the boost from PRC demand fades and the transition to low-carbon energy continues, oil demand is expected to grow more slowly in 2024 and the growth in the supply of oil will remain constrained. OPEC Plus output has long fallen short of output targets, while firms in the US shale industry have prioritized debt reduction and dividend distribution over increased output in recent years. According to the International Energy Agency's *World Energy Investment 2022* report, upstream oil and gas investments are still 20% lower than in 2019. The trend toward renewable energy and the resulting policy uncertainty, the financial difficulties of oil and gas companies, and a general reluctance to make large capital commitments that may take many years to repay are limiting the price responsiveness of investments. Several factors will affect the forecasts for crude prices, including the rate of global economic growth, additional oil reserve releases or purchases, changes in OPEC Plus production, and the impact of the G7 price cap and EU sanctions on Russian oil exports.



2

**ECONOMIC TRENDS
AND PROSPECTS
IN DEVELOPING ASIA**





CAUCASUS AND CENTRAL ASIA

Armenia

Azerbaijan

Georgia

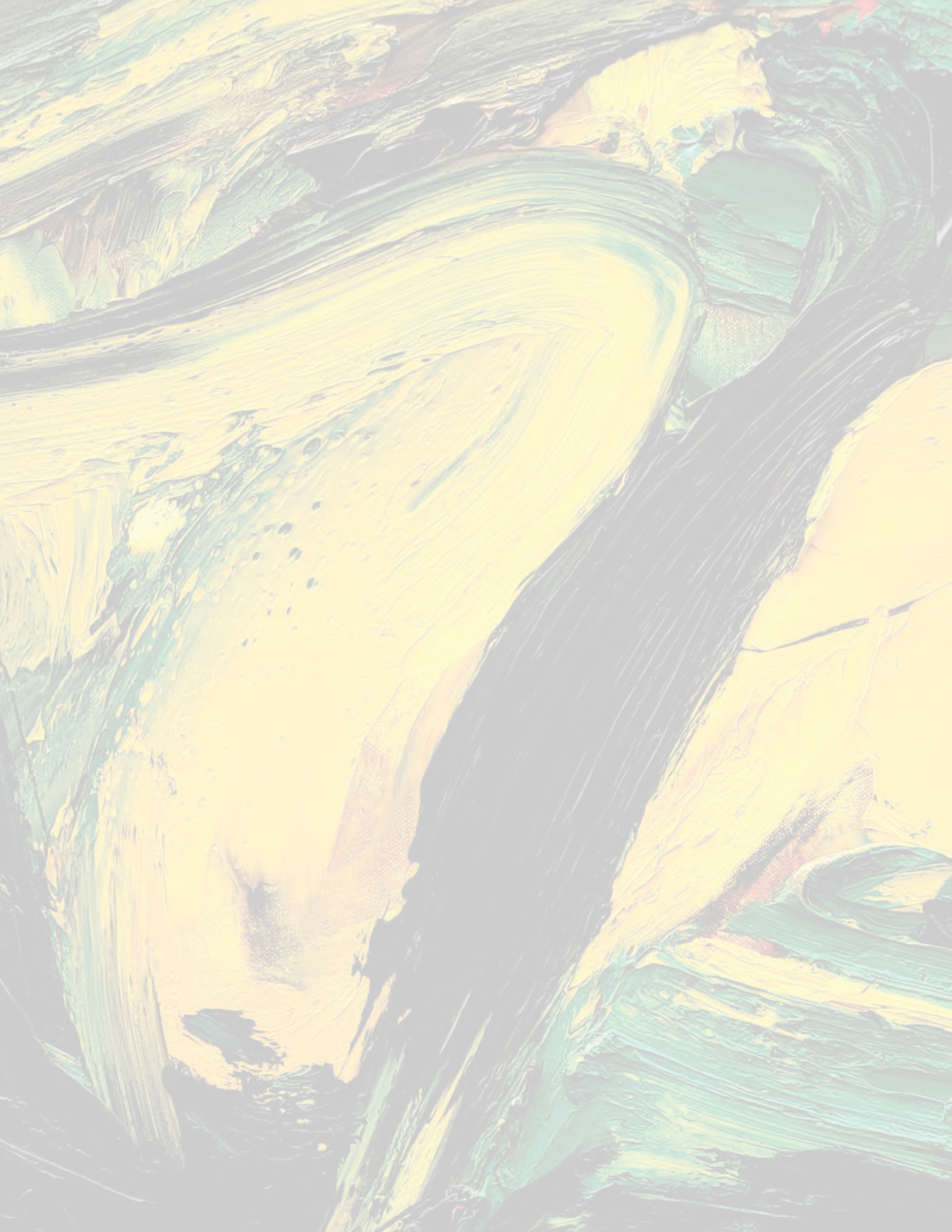
Kazakhstan

Kyrgyz Republic

Tajikistan

Turkmenistan

Uzbekistan



ARMENIA

Despite headwinds, the economy grew strongly in 2022 on rapid expansion in consumption and services reflecting an influx of people and capital from the Russian Federation. Fiscal and current account deficits narrowed, but inflation accelerated. Growth is expected to moderate in 2023 and 2024 as stimulus from inflows of capital, people, and firms from the Russian Federation wanes. Inflation is expected to moderate, and the current account deficit to widen slightly. Strengthening education is critical for inclusive and sustainable growth.

Economic Performance

Economic growth more than doubled from 5.7% in 2021 to 12.6% in 2022, the highest rate since 2008.

Rapid growth came from buoyant demand and soaring investment that reflected a large influx of people and capital from Russia.

On the supply side, a pickup in consumption

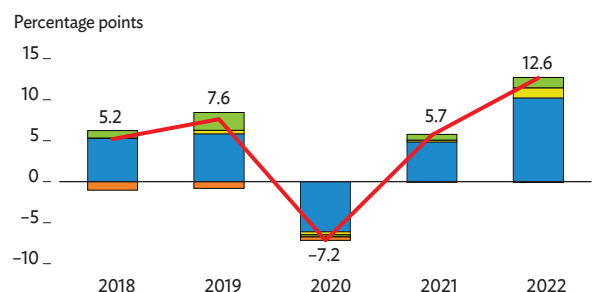
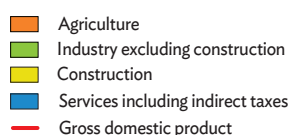
boosted services. Expansion in services jumped from 6.9% in 2021 to 17.7%, contributing 10.2 percentage points to growth in 2022 with increases in all subsectors except health (Figure 2.1.1). Transportation, information and communication, and financial services continued strong double-digit growth for a second consecutive year at an annual rate of 45%–47%, reflecting a further spike in domestic and external demand. Industry excluding construction grew by 6.4%, up from 3.5% in 2021, with growth in manufacturing and utilities offsetting a 3.4% decline in mining and quarrying. Construction expanded by about sixfold to 18.8% in line with a rise in public and private investment. However, agriculture contracted further by 0.7% in 2022, a similar drop as in 2021, from lower livestock production.

On the demand side, growth was led by

consumption. Growth in private consumption more than doubled from 3.4% in 2021 to 8.2%, mainly reflecting a surge in money transfers including

Figure 2.1.1 Supply-Side Contributions to Growth

Growth accelerated sharply in 2022, driven by consumption-led services.



Source: Statistical Committee of Armenia.

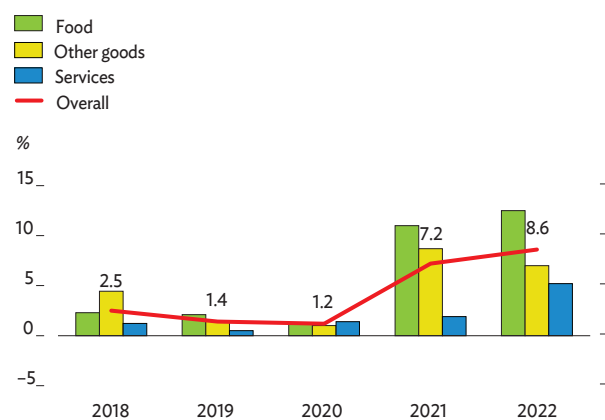
remittances. Growth in public consumption slowed from 8.4% in 2021 to 6.5% in line with fiscal consolidation. Expansion in gross fixed capital formation increased from 6.3% in 2021 to 9.5% in 2022 on higher government allocations to infrastructure projects and increased private investment. The deficit in net exports of goods and services narrowed sharply as exports grew faster than imports.

Inflation accelerated on strong demand and high food prices.

Average annual inflation accelerated from 7.2% in 2021 to 8.6% in 2022 as domestic demand strengthened and global commodity prices rose (Figure 2.1.2). Prices rose by 12.5% for food, 7.0% for other goods, and 5.2% for services. Inflation was 8.3% year on year in December 2022, well above the upper limit of the Central Bank of Armenia's target range of 2.5%–5.5%. To restrain inflation, the central bank continued tightening monetary policy for a second consecutive year in 2022 by raising its policy rate a cumulative 300 basis points in six steps to reach 10.75% by year-end.

Figure 2.1.2 Annual Inflation

Inflation accelerated further in 2022, following on high inflation in 2021.



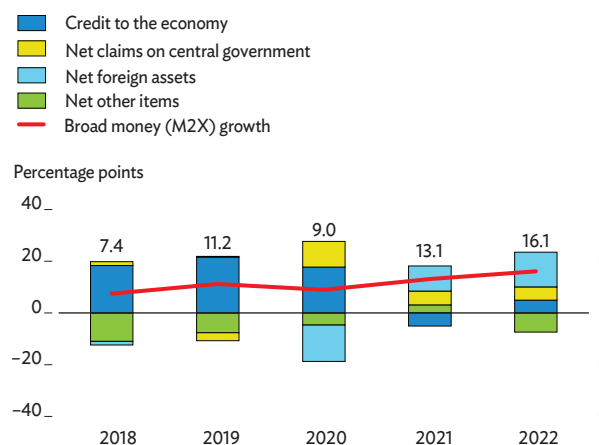
Source: Statistical Committee of Armenia.

The financial system remains healthy.

Broad money growth accelerated from 13.1% in 2021 to 16.1% in 2022, fueled by higher economic activity and by strong money transfers and capital inflows (Figure 2.1.3). Net foreign assets turned positive for the first time since 2011, reflecting an 8.4% rise in the central bank's net foreign assets and a 29.5% reduction in the negative balance of net foreign assets in depository institutions. Credit to the economy grew by 4.5%, driven mainly by 32.5% higher mortgage lending, following an already strong 34.7% rise in 2021, about 80% of which were mortgages denominated in Armenian dram. Higher transfers and average deposit rates helped increase local currency deposits by 15.9% in 2022 and foreign currency deposits by 21.0%. Bank profitability improved on higher foreign exchange gains, lower provisioning, and other noninterest income. Nonperforming loans rose slightly in 2022 but remained low at 2.6% of all loans.

Figure 2.1.3 Contributions to Broad Money Growth

A significant rise in net foreign assets increased broad money supply in 2022.



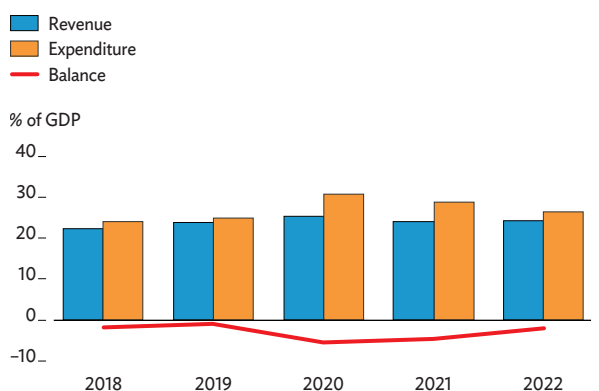
Source: Central Bank of Armenia.

Gradual fiscal consolidation is under way.

Despite higher capital outlays to support long-term growth, fiscal policy tightened as the budget deficit narrowed from the equivalent of 4.6% of GDP in 2021 to 2.1% in 2022 (Figure 2.1.4). Robust growth, high commodity prices, and improved tax administration raised government revenue from 24.1% of GDP in 2021 to 24.3% in 2022. Budget expenditure grew by 11.9% but declined as a percentage of GDP from 28.7% in 2021 to 26.4%. Capital outlays grew by about 76% to equal 4.5% of GDP, in line with the government's plan to spur public investment in infrastructure, but

Figure 2.1.4 Fiscal Indicators

The fiscal deficit fell by more than half in 2022, reflecting improved revenue performance.



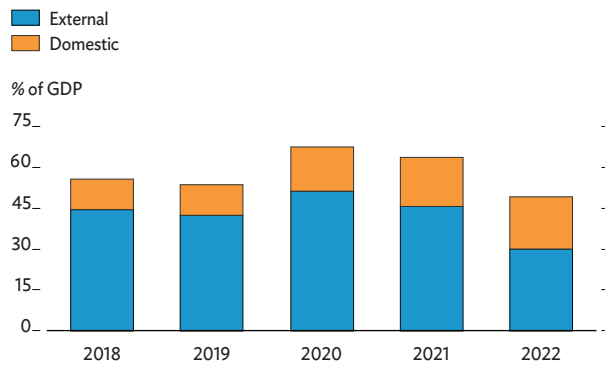
GDP = gross domestic product.

Sources: Ministry of Finance; Statistical Committee of Armenia.

current spending increased by only 4.2%. Reflecting high growth and currency appreciation, public debt declined sharply from 63.4% of GDP in 2021 to 49.3%, well below the official 60% ceiling despite rising in nominal terms (Figure 2.1.5). External public debt declined by 3.0% to \$6.5 billion, equal to 29.9% of GDP, while domestic public debt climbed by 62.5% to \$4.2 billion. The share of domestic debt in all debt increased by 11.4 percentage points to 39.4%, in line with the government’s strategy to shift its borrowing to domestic sources.

Figure 2.1.5 Public Debt

Public debt declined sharply in 2022 on higher economic growth and appreciation of the Armenian dram.

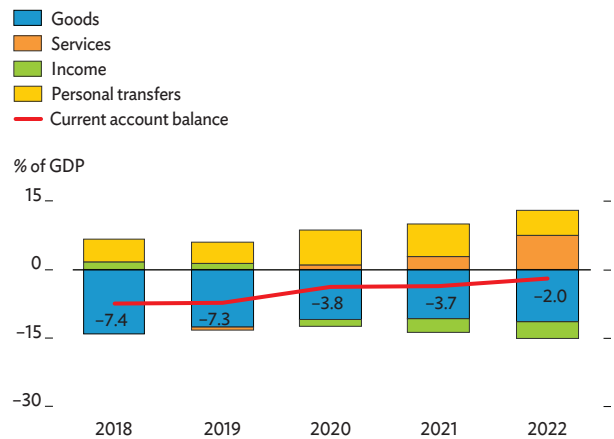


GDP = gross domestic product.
Sources: Ministry of Finance; Statistical Committee of Armenia.

Armenia’s external position improved, reflecting a marked surplus in services and higher money transfers, mainly from Russia. The current account deficit narrowed from the equivalent of 3.7% of GDP in 2021 to an estimated 2.0% (Figure 2.1.6). The merchandise trade deficit widened from 10.9% of GDP to an estimated 11.5% with the rise of what appears to be transit trade through Armenia, spurring double-digit growth in both exports and imports. The surplus in services grew roughly fourfold in 2022, reflecting gains in finance and in travel and tourism services. The income deficit widened slightly on a larger deficit in investment income and employee compensation from abroad. However, net money transfer inflows by individuals through banks tripled to \$2.6 billion. The current account deficit in 2022 was financed by modest public sector borrowing but mainly by foreign direct investment, which rose from the equivalent of 2.5% of GDP a year earlier to an estimated 4.0%. Growth in gross international reserves rose from 23.5%

Figure 2.1.6 Current Account Components

The current account deficit narrowed as surpluses in services and personal transfers increased sharply.



GDP = gross domestic product.
Source: Central Bank of Armenia; Statistical Committee of Armenia.

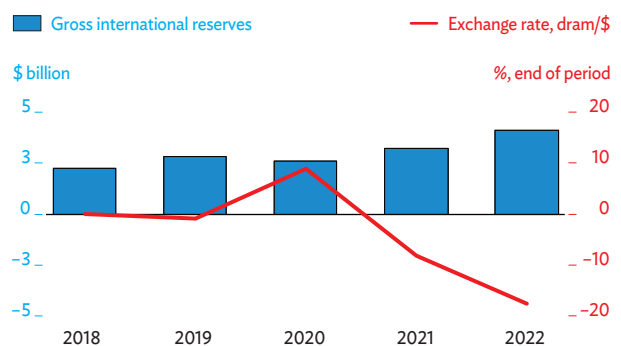
in 2021 to 27.2% to reach an all-time high of \$4.1 billion at the end of 2022, providing cover for 4.6 months of imports of goods and services (Figure 2.1.7). The dram appreciated in 2022 by 20.9% in nominal effective terms and by 27.6% in real effective terms.

Economic Prospects

Growth will slow to 6.5% in 2023 and 5.5% in 2024, reflecting base effects from last year’s exceptional performance (Figure 2.1.8 and Table 2.1.1). Both domestic and external demand will support growth. However, external demand should grow more slowly

Figure 2.1.7 Reserves and Average Exchange Rates

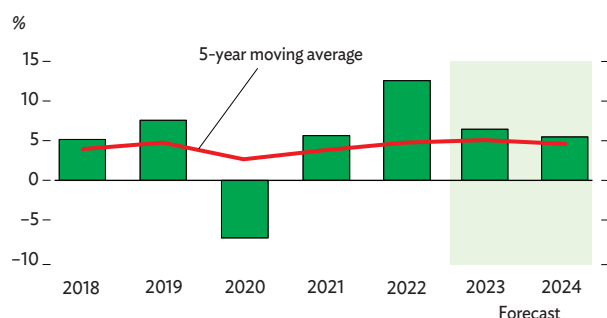
Reserves are at a historic high.



Source: Central Bank of Armenia.

Figure 2.1.8 Gross Domestic Product Growth

Growth is expected to moderate over the next 2 years.



GDP = gross domestic product.

Sources: [Statistical Committee of Armenia](#); Asian Development Bank estimates.

Table 2.1.1 Selected Economic Indicators, %

Growth and inflation are projected to slow during 2023 and 2024.

	2021	2022	2023	2024
GDP growth	5.7	12.6	6.5	5.5
Inflation	7.2	8.6	7.0	6.2

GDP = gross domestic product.

Source: Asian Development Bank estimates.

considering adverse economic prospects in Russia and an expected slowdown in other trade partner countries. Uncertainties stemming from the Russian invasion of Ukraine may include a continued influx of people, firms, and capital, spurring domestic demand.

On the supply side, services will remain the key driver of growth.

Services are projected to grow by a further 9.4% in 2023 before moderating to 5.4% in 2024, reflecting gains in finance, recreation, retail trade, and transport and communications. Industry excluding construction is projected to grow by 3.5% in 2023 and 5.5% in 2024 as manufacturing expands further, benefiting from higher output of processed foods, textiles, and other nonmetal products. Growth in construction is projected at 17.6% in 2023 and 12.9% in 2024, primarily on increased government capital expenditure in 2023 and 2024 and as planned substantial public investments on the north–south regional road take place. Agriculture is projected to rebound by 1.1% in 2023 and 2.2% in 2024, assuming favorable weather and higher spending on government programs that offer subsidies for smart livestock

buildings and intensive gardening. A pilot program of land consolidation, to be implemented in 2023–2025, will likely support long-term growth in agriculture.

On the demand side, consumption and investment will again contribute to growth, though to a lesser extent.

Growth in private consumption is projected to moderate to 6.9% in 2023 and 5.1% in 2024 as money transfers including remittances fall off their record high in 2022. Public consumption is projected to grow by 4.1% in 2023 and 4.7% in 2024 on public salary increases in January 2023, larger pensions from July 2023, and higher social spending. Growth in investment is projected at 7.4% in 2023 and 7.1% in 2024, reflecting a roughly 40% rise in capital outlays from the state budget in 2023.

Inflation will gradually moderate. With lower growth, a smaller budget deficit, monetary tightening, and a smaller rise in international commodity prices, average inflation is projected to slow to 7.0% in 2023 and further to 6.2% in 2024. The projection assumes normal weather and no steep currency depreciation. By the end of the year, inflation is forecast to be almost within the 5.5% upper limit of the central bank's inflation target. Monetary policy is expected to remain tight throughout most of 2023 to curb inflation, easing gradually toward the end of 2023 and in 2024 as both domestic and external demand moderate.

The pace of fiscal consolidation will ease to accommodate targeted support to the economy.

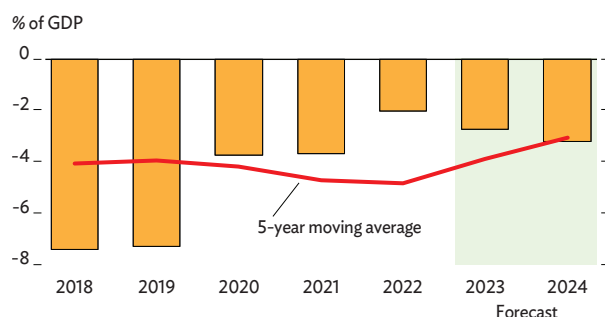
The 2023 budget projects a deficit equal to 3.1% of GDP and revenue increasing to 24.7% of GDP as growth moderates, and tax administration is further improved. The government's goal is to increase capital spending gradually to support and sustain long-term growth while further reducing the ratio of public debt to GDP. In July 2022, a legal requirement was introduced that no transactions equivalent to more than \$750 be paid in cash, which is expected to raise tax revenue. Expenditure is forecast to reach the equivalent of 27.8% of GDP with plans to raise salaries, pensions, allocations for social expenditure, and capital outlays, which are projected to reach 5.7% of GDP in 2023. Barring sharp depreciation of the dram, public debt is expected to remain around 50% of GDP at the end of 2023.

A widening current account deficit is projected to equal 2.7% of GDP in 2023 and 3.2% in 2024.

The surplus in services and money transfers including remittances is expected to moderate after exceptional performances in 2022 (Figure 2.1.9). The merchandise trade deficit is forecast to widen further to 12.6% of GDP in 2023 and 14.2% in 2024. Despite continuing transit trade, growth in merchandise exports is projected to moderate to 14.5% in 2023, with higher exports of processed food, agricultural products, nonferrous metals, machinery, and equipment. And, despite new infrastructure projects, growth in imports is expected to moderate to 16.5% in 2023 in line with slower growth in private consumption.

Figure 2.1.9 Current Account Balance

The current account deficit is projected to widen slightly over the next 2 years.



GDP = gross domestic product.

Sources: Central Bank of Armenia; Statistical Committee of Armenia; Asian Development Bank estimates.

Policy Challenge—Strengthening Education for Inclusive and Sustainable Growth

Armenia has made real achievements in education, but challenges remain. Despite significant reform in recent decades, numerous issues remain regarding the accessibility, quality, and efficiency of education. Low educational attainment leaves students with skills that are inadequate and do not match labor demand. The Human Capital Index of the World Bank scored Armenia at 0.58 in 2020, significantly below the

0.69 average for Europe and Central Asia. The score indicates opportunities for students stagnating, and that children born in Armenia today will only be 58% as productive as they could have been had they received a full set of health and education services. While gross enrolment ratios for lower secondary education are unchanged over the past decade, those for primary and upper secondary school have declined, education reform is thus essential to boost productivity and promote sustainable and inclusive long-term growth.

Armenia needs education standards that meet the requirements of post-secondary institutions and the labor market. Further improvement and full implementation of the national qualification framework will ensure that achievements are comparable with the comprehensive framework of European qualifications. Also important are increasing access to e-learning, especially in rural areas, through distance learning services, open resource online applications, and online courses at all levels of education. Recognizing the importance of providing high-quality and continuing education while ensuring continuity in formal schooling, the government tapped experience gained under the COVID-19 pandemic and introduced in 2022 a comprehensive distance education platform as an alternative to offline education under certain conditions. It is essential to expand existing innovative and creative multidisciplinary centers for education outside of conventional school buildings.

Armenia annually invests 2.2% of GDP on average in education, below the 4.1% average in upper-middle-income countries. Because financial resources for education are limited, they require an evidence-based system to efficiently manage education that includes the key indicators needed for proper program budgeting. For efficiency, the government has initiated a process of separating administrative and economic management functions in schools from course content management, and of centralizing administrative and economic management. Meanwhile, investment in school infrastructure and physical conditions for learning is also important to improved accessibility and quality. This requires increased capital outlays to build earthquake-resistant schools across the country.

AZERBAIJAN

Growth slowed in 2022 because of lower oil production even as high oil prices sharply widened the current account surplus. Annual inflation doubled on rising prices for food and other imported goods. Growth is projected to decelerate further in 2023 with slower expansion in services and construction before rising in 2024. Tight monetary policy and an expected decline in global commodity prices should reduce inflation in both years. Strengthening knowledge management is vital to improving policy making.

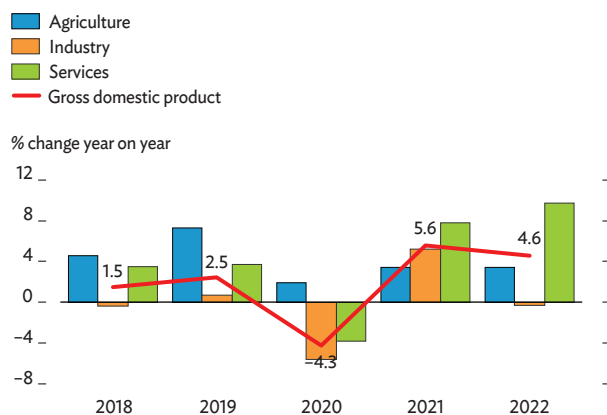
Economic Performance

Growth slowed from 5.6% in 2021 to 4.6% in 2022 as oil output dropped (Figure 2.2.1). The slowdown occurred despite strong 9.1% growth outside of the large hydrocarbon industry. Mining declined by 2.6% as oil output fell by 5.6% because major oil rigs were shut down for maintenance, more than offsetting a rise in gas production. The broader industry sector reversed 5.2% expansion in 2021 to contract by 0.3% as the

decline in mining from lower oil production outweighed substantial gains in manufacturing and construction. Manufacturing expanded by 9.1% with higher production of construction materials, pharmaceuticals, furniture, and machinery. Construction grew by 13.4% on higher public and private investment. Growth in services, which provide nearly 40% of GDP, rose from 7.8% in 2021 to 9.7%, driven by a 3.2% gain in wholesale and retail trade, 23.2% expansion in transport including freight handling and warehousing, and 58.2% growth in accommodation and public catering. Expansion in agriculture stabilized with 3.4% growth in livestock and 3.3% growth in crop production, both buoyed by a continuing agriculture credit support program and subsidies for inputs.

Figure 2.2.1 GDP Growth

Growth slowed in 2022 as oil production declined.



GDP = gross domestic product.

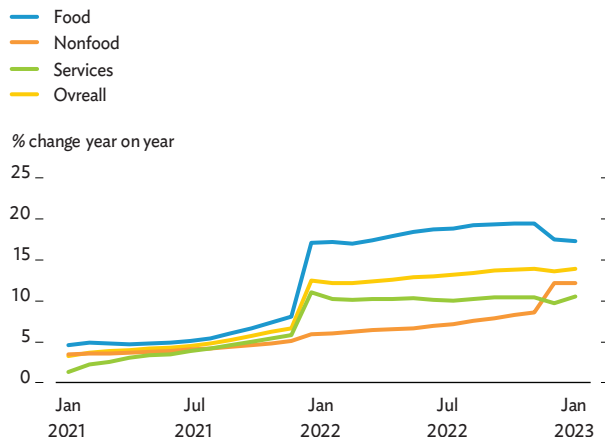
Source: State Statistics Committee of the Republic of Azerbaijan.

On the demand side, economic activity benefited from easing pandemic restrictions. Growth in private consumption accelerated from 3.7% in 2021 to 4.4% in 2022 as the non-petroleum economy rebounded. Public investment expanded by 8.3% as investment in regained territories picked up, while private investment contracted by 0.1%. After considering changes in inventories, total investment rose by 5.5%, reversing an 8.2% decline in 2021. However, the drop in oil export volume reduced net exports.

Both external and domestic factors contributed to a sharp rise in prices. Average annual inflation doubled from 6.7% in 2021 to 13.9% in 2022 on stronger domestic demand, rising food prices attributable to disruption caused by the Russian invasion of Ukraine, and higher prices for other imported goods (Figure 2.2.2). A rise in utility tariffs early in 2022 added to inflation, as did the government’s adjustment of minimum salaries in response to inflation. Prices rose by 19.5% for food, 8.6% for other goods, and 10.4% for services. To curb inflation, the central bank increased its policy rate from 7.50% to 8.25% in three steps from January and December 2022, and then raised it a further 25 basis points in January 2023 as inflation remained high (Figure 2.2.3). The continued de facto peg of the Azerbaijan manat to the US dollar held down pressure from imported inflation.

Figure 2.2.2 Inflation

Inflation spiked in 2022 as food prices jumped.

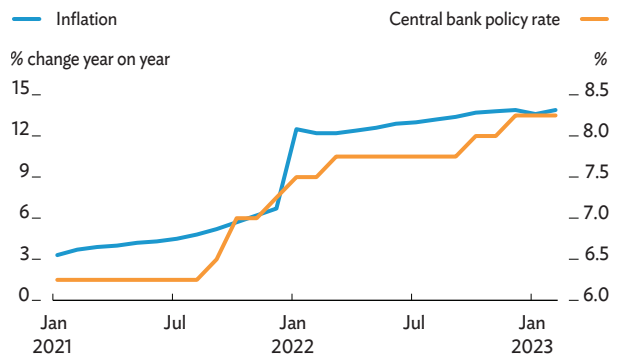


Source: State Statistics Committee of the Republic of Azerbaijan.

Despite higher oil prices, the budget remained in deficit. The budget deficit narrowed slightly from the equivalent of 1.1% of GDP in 2021 to 1.0% as both revenue and expenditure declined as a percentage of GDP (Figure 2.2.4). The non-hydrocarbon primary deficit reached 13.3% of non-hydrocarbon GDP. Transfers from the State Oil Fund of Azerbaijan, the sovereign wealth fund, decreased by 30.2%, amounting only to 25.0% of total revenue as the government managed to raise tax collections. With the cut in wealth fund transfers, total revenue fell from 28.4% of GDP in 2021 to 22.9% despite rising by 16.1% in absolute

Figure 2.2.3 Inflation and Policy Rate

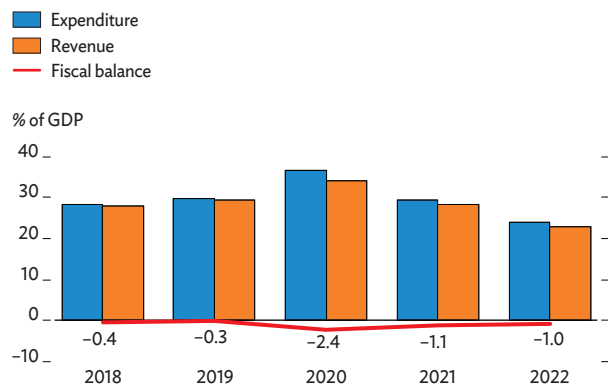
Monetary policy tightened as inflation picked up.



Sources: State Statistics Committee of the Republic of Azerbaijan; Central Bank of the Republic of Azerbaijan.

Figure 2.2.4 Fiscal Indicators

The fiscal deficit narrowed in 2022 as both revenue and expenditure declined in percent of GDP.



GDP = gross domestic product.

Source: The Ministry of Finance of the Republic of Azerbaijan.

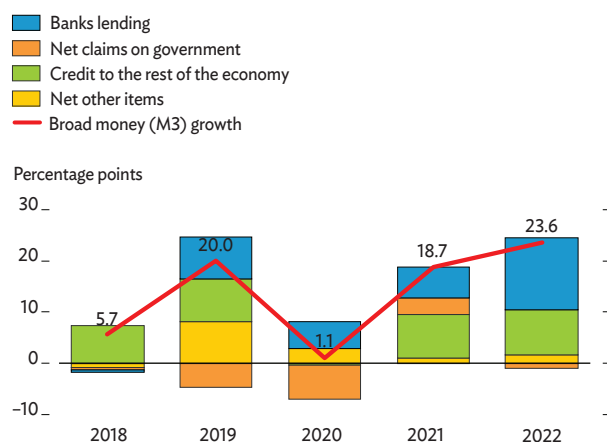
terms. Expenditure fell from 29.5% of GDP in 2021 to an estimated 24.0%. Public and publicly guaranteed debt, both external and domestic, declined from 16.2% of GDP in 2021 to 11.8% as the government continued its conservative borrowing policy. An update to the government’s debt-management strategy set ceilings for total public debt at 20% of GDP in 2025 and 15% in 2030.

Banks remained resilient. They increased lending by 31.5% in 2022, reflecting growth in private consumption, while deposits grew by 28.0%. Loans to households rose by 11.1%. Net bank profits rose by 70.1% in 2022, supported by high interest margins.

The share of impaired loans in total lending declined considerably from 4.2% in 2021 to 0.3% in 2022. Deposit dollarization fell slightly from 49.4% at the end of 2021 to 48.4% a year later, while loan dollarization declined from 25.8% to 19.7%. Broad money expansion rose from 18.7% in 2021 to 23.6% (Figure 2.2.5).

Figure 2.2.5 Money Supply

Broad money growth accelerated on higher lending.

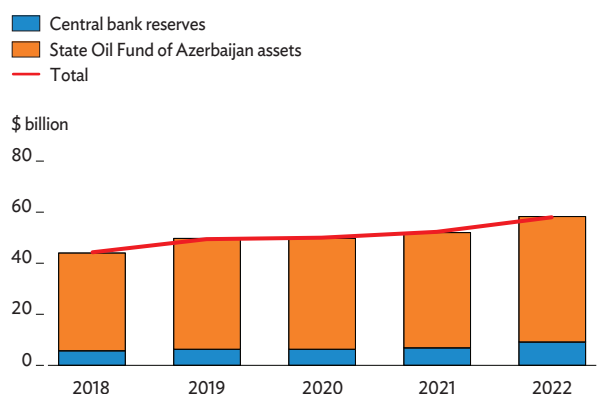


Source: Central Bank of the Republic of Azerbaijan.

High hydrocarbon prices significantly widened the current account surplus. The current account surplus expanded from the equivalent of 15.2% of GDP in 2021 to an estimated 25.7% in 2022 as export earnings skyrocketed by 81.9% on higher hydrocarbon prices. The trade surplus more than doubled from \$11.2 billion a year earlier to an estimated \$24.2 billion on higher oil and gas export earnings, increased transportation services, and higher income inflow, with hydrocarbons accounting for 90% of exports. Higher domestic demand boosted merchandise imports by 23.7%. Secondary income rose sharply from \$0.7 billion in the first 9 months of 2021 to \$2.3 billion in the same period of 2022 because of higher remittances and money transfers from Russian migrants. Net foreign direct investment in the first 9 months of 2022 rose by 24% to \$4.6 billion, with nearly 70% of investment going into oil. The central bank's foreign exchange reserves rose by 27.1% to \$9.0 billion, providing cover for 9.5 months of imports. Together with the assets of the State Oil Fund, Azerbaijan's strategic reserves reached \$58.0 billion at the end of 2022, equal to 73.7% of GDP (Figure 2.2.6).

Figure 2.2.6 International Reserves

International reserves increased as oil prices remained high.



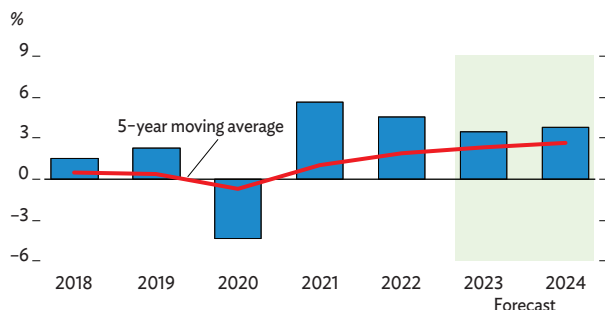
Sources: Central Bank of the Republic of Azerbaijan; State Oil Fund of the Republic of Azerbaijan.

Economic Prospects

Growth is projected to moderate in 2023 and accelerate slightly in 2024 (Figure 2.2.7). Its slowing to 3.5% in 2023 will reflect less expansion in the non-hydrocarbon economy, and it will likely recover to 3.8% in 2024 along with oil production following the rehabilitation of oil field infrastructure in 2022. Meanwhile, gas production will expand further. A surge in mining output will help industry expand by 0.5% in 2023 and 1.0% in 2024. The plan to rebuild regained territories, as outlined by the government in its socioeconomic strategy for 2022–2026, will support public and private investment. Growth in construction will nevertheless slow slightly from 13.4% in 2022 to 12.0% in 2023 and, as the main public infrastructure projects are completed, to 11.0% in 2024. Agriculture is projected to grow by 3.8% in 2023 and 4.0% in 2024 with continued subsidies for fuel and fertilizer, a specialized agriculture leasing facility providing long-term financing at low rates, and other concessional lending to farmers. Growth in services is projected to slow to 7.0% in 2023 before recovering to 7.5% in 2024 with support from retail trade and transportation. KazmunayGaz of Kazakhstan and the State Oil Company of Azerbaijan are close to agreeing on transporting oil from Kazakhstan, which would boost transport services if agreement is reached.

Figure 2.2.7 Gross Domestic Product Forecast

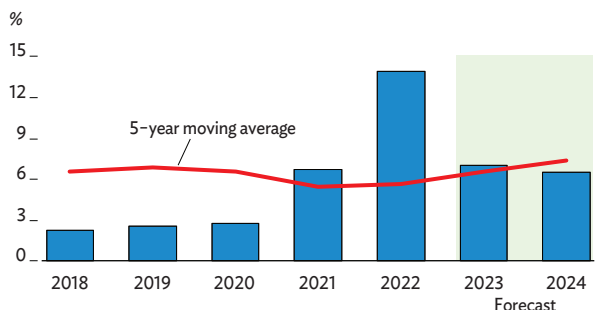
Growth is projected to slow in 2023 before rising in 2024.



Source: Asian Development Bank estimates.

Figure 2.2.8 Inflation Forecast

Inflation is projected to slow in 2023 and 2024.



Source: Asian Development Bank estimates.

Table 2.2.1 Selected Economic Indicators, %

Growth is projected to slow in 2023 before rising in 2024, with inflation declining in both years.

	2021	2022	2023	2024
GDP growth	5.6	4.6	3.5	3.8
Inflation	6.7	13.9	7.0	6.5

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Net exports will be the main demand-side driver of growth.

Private consumption is forecast to contract in real terms because of tightened monetary policy, while higher civil service wages will boost public consumption. The rise in construction, reflecting higher public and private investment, will be insufficient to boost total domestic demand. Net exports will rise in 2023 on higher hydrocarbon exports and lower imports before moderating in 2024 on cuts to hydrocarbon output and higher imports to meet improving domestic demand.

Inflation will ease. It is projected to diminish to 7.0% in 2023 and 6.5% in 2024, reflecting tight monetary policy, some decline in global commodity prices, and reduced bank lending (Figure 2.2.8). However, a rise in minimum wages and pensions in late 2022 could boost inflation. The central bank is expected to maintain its policy rate until at least mid-2023 while it observes price movements and consumer sentiment. The policy rate will be adjusted once inflation settles within the target band of 2%–6%. The exchange rate is forecast to remain stable as hard currency inflow rises.

Fiscal policy will become more expansionary.

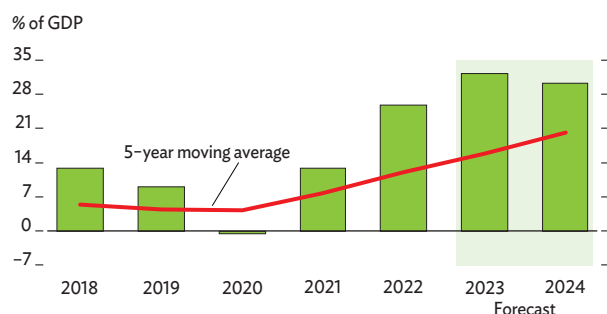
The state budget deficit is expected to double to the equivalent of 2.1% of GDP in 2023 and 2.2% in 2024. Hydrocarbon revenue will remain a key funding source. The non-hydrocarbon deficit will equal 7.0% of GDP in 2023 and widen further to 11.1%, with transfers from the sovereign wealth fund projected to increase in 2024. Total revenue is expected to decline to 22.2% of GDP in 2023 and further to 21.2% in 2024, while expenditure is forecast to equal 24.1% of GDP in 2023 and 23.2% in 2024, even as both revenue and spending rise in nominal terms. Public debt is forecast to remain moderate under the government’s revised debt management strategy to keep public debt below 20% of GDP after 2025.

The current account surplus is projected to widen to the equivalent of 32.2% of GDP in 2023 and then narrow slightly to 30.2% in 2024 (Figure 2.2.9).

With higher oil production and gas exports, the export total will rise by 0.2% in 2023 despite lower average oil prices. Exports will decline by 2.9% in 2024 with a forecast small decline in oil production. The overall trade surplus is expected to widen by 6.4% in 2023 and then narrow by 5.6% in 2024. Imports are seen diminishing in 2023 because of lower domestic demand but then rising in 2024 as growth accelerates and demand revives. Higher inflows from transport and tourism services will narrow the deficit in services by 5.8% in 2023 and 16.7% in 2024. However, rebuilding costs in the regained territories may widen the deficit. The income deficit may widen further in 2023 and 2024 because of rising income repatriation by foreign investors and interest payments on foreign securities and loans.

Figure 2.2.9 Current Account Forecast

The current account surplus will widen in 2023 before narrowing in 2024.



Source: Asian Development Bank estimates.

Policy Challenge—Strengthening Knowledge Management for Better Economic Policies

Azerbaijan continues to rely on revenue from hydrocarbon exports and is thus vulnerable to external shocks. Since 2016, the government has spent significant resources to accelerate diversification and boost the non-hydrocarbon economy. However, reform has been slow to take effect because of frequent policy changes, reversals of institutional decisions, and staff turnover. Underlying these problems is the difficulty of sharing knowledge within the government.

Knowledge is not disseminated across agencies, but is usually the preserve of individual employees.

Moreover, inadequate coordination across government silos constrains knowledge sharing. A lack of proper infrastructure to collect, store, and use knowledge limits its dissemination. Moreover, a lack of regulations to protect knowledge and the absence of a dedicated government agency to act as the knowledge custodian further undermine knowledge sharing in the government.

Azerbaijan has significantly improved public service delivery by adopting digital technology and a one-stop shop. The system encompasses the E-government Development Center, which

mobilizes all intergovernmental activities under a single platform used mainly for public services. The national socioeconomic strategy for 2022–2026 highlights the importance of achieving a knowledge society for further economic development. The government has started developing a digital strategy that will improve information technology infrastructure toward building a resilient knowledge- and evidence-based economy.

In addition, the government needs to adopt a program on knowledge management. A regulatory framework is needed to enable a smooth process for sharing knowledge and enhancing learning in and across government institutions. An efficient institutional setup with a dedicated government agency to serve as a knowledge custodian could optimize the use of knowledge products in the country. It is critical to institutionalize underlying knowledge management systems for agencies to benefit fully from knowledge enhancement. A supportive regulatory framework will promote intergovernmental collaboration to share knowledge. In addition, effective use of digital technologies that are fit for purpose can ensure easy and timely access to knowledge resources.

A key consideration in designing a knowledge management system is to ensure adequate resource allocation. The necessary resources include funding, staffing, technology, management commitment, and an organizational culture that motivates staff to tackle change management. Because knowledge derives from both education and practice, the capacity-building component of a knowledge management system is critical to ensure that all workers create and use knowledge products.

There is strong demand for knowledge and support technical assistance projects implemented by international organizations. As an upper middle-income country, Azerbaijan could co-finance such technical assistance programs it implements with international institutions.

GEORGIA

The economy posted double-digit growth in 2022, reflecting strong exports and an influx of Russian citizens. Growth should moderate in 2023 and 2024. Demand-side factors raised inflation despite tight monetary policy and a smaller fiscal deficit. Slowing domestic demand and tighter macroeconomic policies should trim inflation. Strong foreign inflows substantially narrowed the current account deficit, which will likely widen again in 2023 and 2024. It is critical to address climate change to minimize losses from disasters and promote green growth.

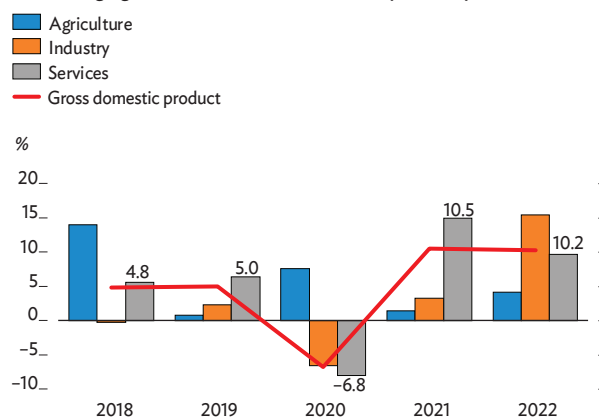
Economic Performance

In 2022, the economy performed strongly, as expected adverse spillover from the Russian invasion of Ukraine failed to materialize. Growth was estimated at 10.2% in 2022, little changed from 10.5% in 2021, driven mostly by industry (Figure 2.3.1). Industry growth accelerated from 3.2% in 2021 to 15.4%, led by gains in mining at 21.2%, construction 6.2%, and utilities 48.9%. Despite sharp recovery in tourism and strong expansion in information and communication at 36.8% and transport at 27.2%, growth in services slowed from 15.0% in 2021 to 9.6% as growth moderated to 22.5% in accommodation and food services, 5.4% in financial and insurance services, and 18.7% in arts, entertainment, and recreation. Health and social work shrank by 3.3%. Favorable weather and increased demand for food boosted expansion in agriculture from 1.4% in 2021 to 4.2%.

Both domestic and external demand lifted growth. Private consumption grew by 9.7%, little changed from 9.5% in 2021, largely on spending by an influx of Russian migrants. Meanwhile, private investment reversed a decline in 2021 to grow by 5.9%. After flatlining in 2021, net exports of goods and services expanded by 10.8% on higher exports of both merchandise and services related to travel and transport.

Figure 2.3.1 Supply-Side Growth

Double-digit growth continued in 2022, led by industry and services.

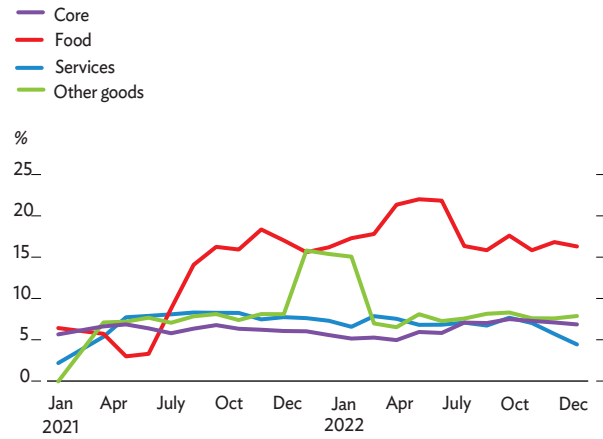


Source: National Statistics Office of Georgia.

Inflation remained elevated, reflecting strong domestic demand. Inflation accelerated from 9.6% in 2021 to 11.9% on a sharp rise in consumption, mainly by Russian migrants, and higher wages. Inflation rose from 10.9% in 2021 to 17.9% for food, from 7.1% to 8.9% for other goods, and from 6.9% to 6.8% for services (Figure 2.3.2). However, core inflation moderated in the second half of 2022 as fuel and transportation costs abated. The Georgian lari appreciated in 2022 by 27.1% in nominal terms and 18.8% in real effective terms, easing inflation (Figure 2.3.3).

Figure 2.3.2 Monthly Inflation

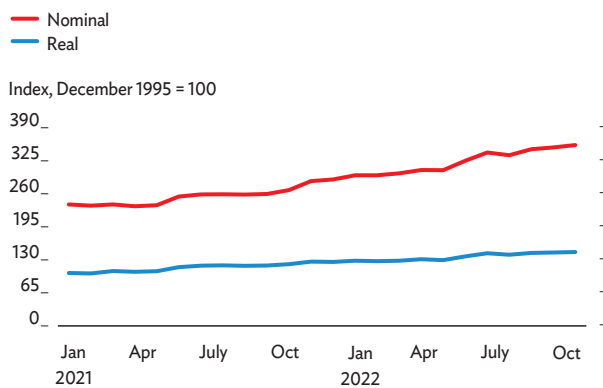
Rising food prices sustained inflation in 2022.



Source: National Statistics Office of Georgia.

Figure 2.3.3 Nominal and Real Exchange Rates

The Georgian lari appreciated on sizeable foreign inflows.



Source: National Bank of Georgia.

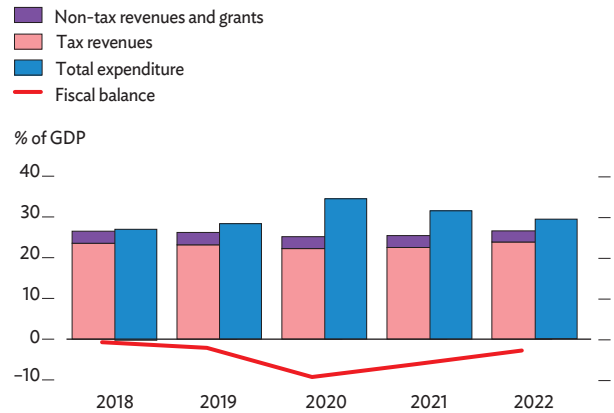
Revenue overperformance sharply narrowed the budget deficit from the equivalent of 6.1% of GDP in 2021 to 2.8% in 2022 (Figure 2.3.4).

Revenue increased by 27.0%, rising from 25.4% of GDP in 2021 to 26.6%. Fiscal consolidation helped cut current expenditure from 25.6% of GDP in 2021 to 23.0% despite a 10% rise in the public wage bill. Total expenditure declined from 31.5% of GDP in 2021 to 29.4%, with capital spending sustained at about 7% of GDP. Public debt declined from 49.7% of GDP in 2021 to 39.6%.

The National Bank of Georgia, the central bank, has maintained its policy rate at 11% since March 2022 to control inflation. Broad money grew by 11.6%, little changed from 11.3% in 2021. Credit

Figure 2.3.4 Fiscal Indicators

The fiscal deficit continued to shrink in 2022.



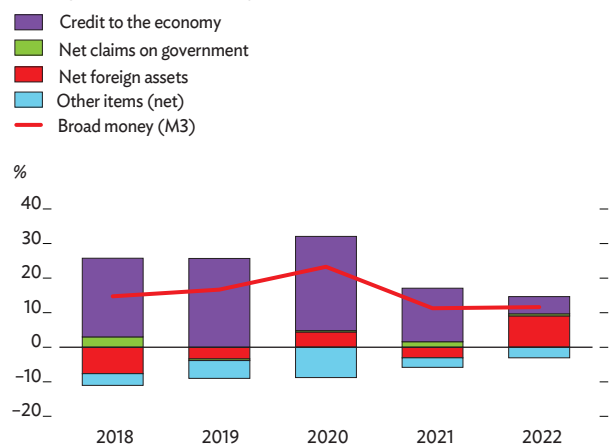
GDP = gross domestic product.

Sources: International Monetary Fund; Ministry of Finance of Georgia.

continued to expand but more slowly, driven mostly by local currency lending as foreign currency loans became more expensive, and as the central bank implemented new macroprudential measures to curb unhedged borrowing (Figure 2.3.5). Bank deposits, mainly by nonresidents, increased by 11.8%. Nonperforming loans remained under 2% of all loans despite a rise in restructured loans in the hospitality industry. The financial position of banks remained sound, with high liquidity and substantial profitability thanks to strong returns on assets at 3.8% and equity at 30.2%.

Figure 2.3.5 Growth in Broad Money

Credit growth slowed with tight monetary policy.



Source: National Bank of Georgia.

The balance of payments strengthened on buoyant tourism revenue, a surge in financial inflows, and higher transit trade.

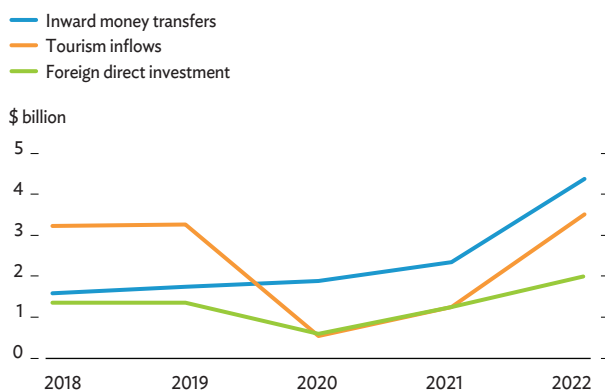
The current account deficit narrowed sharply from the equivalent of 10.4% of GDP in 2021 to 3.2% despite the merchandise trade deficit widening because of higher imports of petroleum products, automobiles, and intermediate inputs such as metals. Growth in merchandise exports accelerated from 27.4% in 2021 to 32.3% on increased vehicle reexports and exports of fertilizer and of copper ore and concentrates. Higher commodity prices in the first half of 2022 and strong domestic demand boosted import growth from 24.2% in 2021 to 31.6%. Tourism inflows exceeded the pre-pandemic 2019 peak by 7.6%, while inward money transfers surged by 86.1% to a record 17.7% of GDP, mainly as multiple waves of Russian settlers brought capital into Georgia. Money transfers from the US and European Union also increased (Figure 2.3.6). These favorable conditions enabled the central bank to rebuild gross international reserves to a record high of \$4.9 billion, cover for 4 months of imports of goods and services. External public debt declined from the equivalent of 39.9% of GDP at the end of 2021 to 29.8% a year later. Foreign direct investment almost doubled to \$2.0 billion in 2022, mainly reflecting reinvested earnings.

Economic Prospects

Growth is forecast to slow considerably. In 2023, growth will decelerate to 4.5% as migrant and financial inflows are expected to subside, and as slower growth or recession in trade partners inhibits export growth

Figure 2.3.6 Foreign Inflows

Foreign inflows accelerated, led by growth in money transfers.

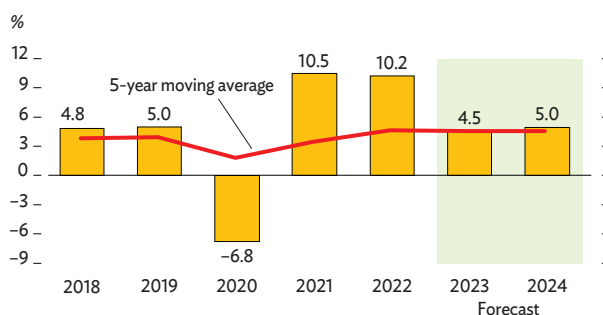


Sources: National Bank of Georgia; National Statistics Office of Georgia.

and cuts money transfers (Figure 2.3.7 and Table 2.3.1). Growth should reaccelerate to 5.0% in 2024 with continued gains in services. On the supply side, industry is forecast to expand by 3.9% in 2023 and 4.9% in 2024, with continued increases in construction. Services are projected to grow by 5.2% in 2023 and 5.7% in 2024 from continued expansion in service exports and tourism. Agriculture is expected to grow in both 2023 and 2024, reflecting government investment in modern farm technologies.

Figure 2.3.7 GDP Growth

Growth will slow in 2023 and recover slightly in 2024.



Sources: National Statistics Office of Georgia; Asian Development Bank estimates.

Table 2.3.1 Selected Economic Indicators, %

Growth is projected to slow in 2023 and recover slightly in 2024, with inflation declining in both years.

	2021	2022	2023	2024
GDP growth	10.5	10.2	4.5	5.0
Inflation	9.6	11.9	6.0	4.0

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Domestic demand will grow more slowly, assuming no more waves of Russian migrants.

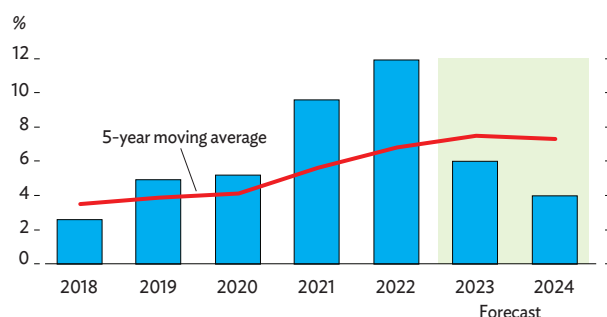
On the demand side, growth in private consumption is expected to moderate to 4.9% in 2023 because of tight monetary policy and reduced consumer purchasing power as inflation remains elevated, then reaccelerate somewhat to 5.6% in 2024. Investment is projected to expand by 5.5% in 2023 and 3.5% in 2024 as business confidence continues to improve. A widening trade deficit is expected to drive net exports down by 8.1% in 2023 and 8.0% in 2024.

Inflation is projected to slow to single digits in 2023 and 2024.

Tight monetary policy, weaker domestic demand, and improved supply chains are expected to cut inflation to 6.0% in 2023 and further to 4.0% in 2024, approaching the central bank's 3.0% target (Figure 2.3.8). An assumed lack of further waves of migrants should trim inflation. Broad money is projected to grow by 11.5% in 2023 and 11.1% in 2024, reflecting expected increases in credit growth to 13.3% in 2023 and 12.4% in 2024 with higher private sector investment.

Figure 2.3.8 Inflation

Inflation will halve in 2023 and decline further in 2024.



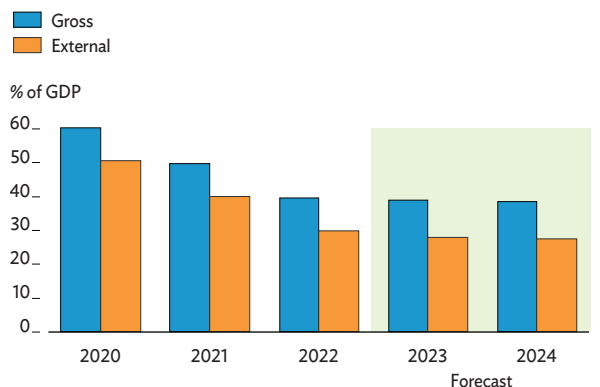
Sources: National Statistics Office of Georgia; Asian Development Bank estimates.

The budget deficit is projected to decline to the equivalent of 2.7% of GDP in 2023 and 2.5% in 2024.

This will reflect strengthened revenue administration, sound debt management, and fiscal consolidation to ensure compliance with a rule that limits Georgia's fiscal deficit to 3% of GDP. Revenue is forecast to equal 26.0% of GDP in 2023 and 25.8% in 2024. Expenditure is projected at 28.7% of GDP in 2023 and 28.3% in 2024 as current expenditure is kept in check and capital expenditure is maintained, with infrastructure spending targeted at about 7% of GDP to support growth. Public debt is projected to decline to 39.0% of GDP in 2023 and 38.5% in 2024, barring an unlikely major depreciation of the local currency (Figure 2.3.9). Structural reform could support fiscal sustainability by incorporating climate resilience issues into the public investment management framework and quantifying fiscal risks that stem from natural hazards.

Figure 2.3.9 Public Debt

Public debt will continue to decline as a percentage of GDP.



GDP = gross domestic product.

Sources: International Monetary Fund; Ministry of Finance of Georgia.

The current account deficit is forecast to widen to equal 5.0% of GDP in 2023 and 6.0% in 2024 as the trade deficit deepens.

Export growth is expected to decelerate to 10.7% in 2023 as slower expansion in the euro area and recession in Russia could affect external demand and supply chains, then edge up to 11.2% in 2024. Import growth is also expected to diminish to 11.6% in 2023 and 6.2% in 2024 in line with slowing domestic economic expansion. Services should rise by 18.8% in 2023 before moderating to 11.2% in 2024 as tourism and transportation services revive and subsequently slow. Money transfers are forecast to fall to \$2.5 billion in each year as external inflows from migrants moderate, possibly creating exchange rate pressures. Gross reserves are projected at \$4.6 billion in 2023 and \$4.7 billion in 2024. Public external debt is projected to fall to the equivalent of 28.0% of GDP at the end of 2023 and 27.5% a year later, and total external debt to 73.1% and then 68.4%.

Risks skew to the downside. A prolonged Russian invasion of Ukraine would hinder global recovery and stoke inflation, possibly shrinking external demand and new investment, driving down production, and stemming inflows from tourism. On the other hand, a strong upturn among key trading partners, increased transit trade, and further inward migration from Russia could boost growth but also inflation.

Policy Challenge—Addressing Climate Change to Mitigate Disasters and Promote Green Growth

Georgia is highly susceptible to floods, droughts, forest fires, landslides, and mudslides under climate change. Worsening floods have destroyed property and crops and damaged infrastructure. Droughts and forest fires in eastern Georgia have degraded soils and fertility, undermining harvests and food security. Less snowfall in the mountains has hindered winter tourism and the hospitality industry, which provide nearly 20% of GDP. In addition, mudslides and landslides have required the government to fund the rehabilitation of affected infrastructure.

Georgia joined the Paris Agreement in 2015 and committed to achieving carbon neutrality by 2050. Georgia has allocated more than \$1 billion to meet its climate targets in a national climate strategy for a just transition to low-emission, climate resilient development. The country strives to increase the share of renewable hydro, wind, and solar energy to 87% of electricity production by 2030. Under its revised nationally determined contributions, Georgia committed to reducing greenhouse gas emissions by at least 15% below business as usual by 2030, including reductions of 15% in transportation and in electricity generation and transmission, and 5% in agriculture and industry.

The government has developed sector initiatives. Programs address carbon emissions from the energy sector, which contributes about 60% of Georgia's carbon footprint; agriculture with 20%; manufacturing and transport 11%; and waste management 9%. Georgia currently uses only an estimated quarter of its rich hydropower resources, and the country aims to generate 100% of its electricity consumption from renewable sources by 2050 by expanding renewable energy generation capacity. The government has taken measures to ensure responsible energy consumption by supporting climate resilient housing projects, with the ultimate goal of housing stock in full compliance with new building code standards requiring 100% thermal

insulation. Georgia takes advantage of technological know-how such as remote sensing to map agricultural land and prevent crop failure by matching climate-resilient crop varieties with local climatic conditions, as well as climate smart irrigation and agriculture, using modern, innovative technologies. It aims to limit growth in carbon-intensive industries and bolster energy-efficient transport such as electric vehicles with a wide network of charging stations. Georgia has made efforts to reduce emissions through recycling and improved waste management, strengthen forest management in support of a clean ecosystem and green tourism, and streamline practices for natural resource extraction and sustainable rural development.

To preserve biodiversity for sustainable eco- and agri-tourism, Georgia should further strengthen its environmental policies. Disaster and climate risks could be mainstreamed by including in the government's framework for managing public investment quantified fiscal risks stemming from climate change and natural hazards and by targeting expenditure for greenfield and brownfield investment. Benefits would accrue from cost-benefit analyses of new tax incentives that promote green growth and introduce climate-smart technologies in agriculture, and from identifying suitable policy options to shift toward greener transport alternatives, such as redirecting freight from road to rail transport.

Georgia can explore other ways to accelerate its transition to green growth without jeopardizing its development goals or growth prospects. These include accelerating trade digitalization, as a significant portion of global greenhouse gas emissions stem from trade and supply chains linked to company operations. Georgia can further benefit from decarbonization by trading emissions through global market mechanisms to support appropriate incentives for energy use and increase revenue for low-emitting firms. Georgia will thus be able to join an emerging cohort of climate-conscious countries that promote a green economy based on clean energy. The government should also do more to engage the private sector in its climate-friendly policies and provide climate financing incentives with shared risk, to ensure greener and more sustainable private sector development.

KAZAKHSTAN

Growth slowed in 2022 mainly because of temporarily interrupted oil production and delivery. Inflation accelerated on currency depreciation, supply chain disruption, and fiscal stimulus, while high global energy prices turned a persistent current account deficit into a surplus. Growth will accelerate in 2023 and 2024, driven by recovering industry, services, and domestic demand. Inflation will subside with tight monetary policy and price controls, assuming a stable exchange rate. As regional disparities widen, addressing them requires place-sensitive policies and improved fiscal decentralization and redistribution.

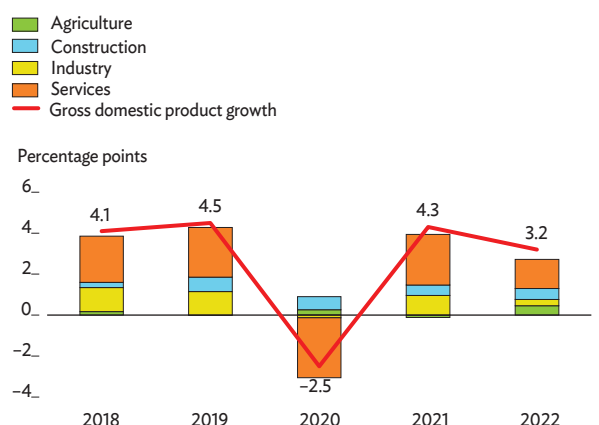
Economic Performance

Disruption to oil production slowed economic activity in 2022, despite high petroleum prices and robust growth in agriculture and construction.

Growth decelerated from 4.3% in 2021 to 3.2% as the economy coped with supply chain disruption, exchange rate volatility, and higher interest rates from tight monetary policy (Figure 2.4.1). On the supply side, mining reversed 1.9% growth in 2021 to decline by 1.0% as production fell for iron ore by 20.6% because of disrupted exports to a sanctioned enterprise in Russia, for oil by 1.9% because of interrupted flows through the Caspian Pipeline Consortium and breakdowns in the Kashagan oil field, and for gas by 1.0%. Growth in industry slowed from 3.6% in 2021 to 1.0% as manufacturing expansion decelerated from 4.7% in 2021 to 3.4% despite support from investment and import substitution measures. Expansion in services also slowed, from 4.4% to 2.6%, despite gains of 8.0% in communications, 5.0% in trade, and 3.9% in transport and warehousing. Growth in construction accelerated from 8.3% in 2021 to 9.4% as subsidized state mortgage programs and pension funds boosted finance for housing. Agriculture reversed drought-induced 2.2% contraction in 2021 to expand by 9.1% as crops rebounded by 15.0% and livestock edged up by 0.9%.

Figure 2.4.1 Supply-Side Contributions to Growth

Growth slowed in 2022 with smaller increases in industry and services.



Source: Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan.

Rising exports offset declining consumption.

Data on the demand side, available for only the first 9 months of 2022, show consumption reversing 4.1% growth during the same period in 2021 to decline by 1.5%. Private consumption fell by 1.0% as rising inflation cut real incomes. Growth in investment roused from

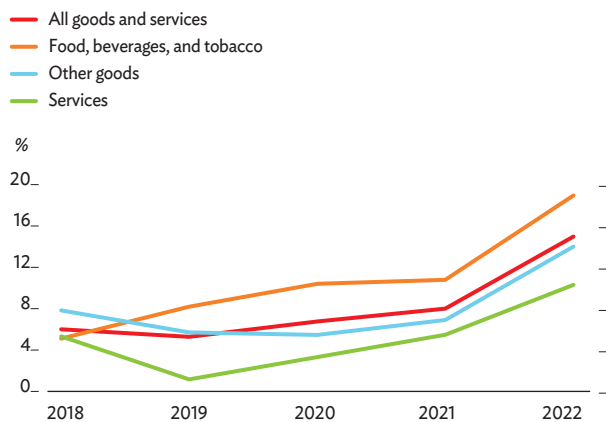
zero in 2021 to 1.0% on a 3.0% expansion in gross fixed capital formation. The key growth driver was an 18.0% rise in exports of goods and services that outpaced an 11.2% increase in imports.

Inflation accelerated sharply to double digits.

Average annual inflation accelerated from 8.0% in 2021 to 15.0% in 2022, reflecting supply chain disruption, shortages, currency depreciation, and rising transportation costs (Figure 2.4.2). Food price inflation rose from 10.8% in 2021 to 19.0%, with prices soaring by 62.8% for sugar, 31.5% for wheat, and double digits for many other staple foods. Inflation for other goods doubled from 6.9% in 2021 to 14.0% on rising inflationary expectations and depreciation of the tenge, by 8.1% against the US dollar and by 20.2% against the Russian ruble. In addition, an influx of migrants from Russia pushed up rents by 30.1% and nearly doubled the rate of price increases for services from 5.5% to 10.3%.

Figure 2.4.2 Average Inflation

Inflation accelerated in 2022, with increases in all major categories.



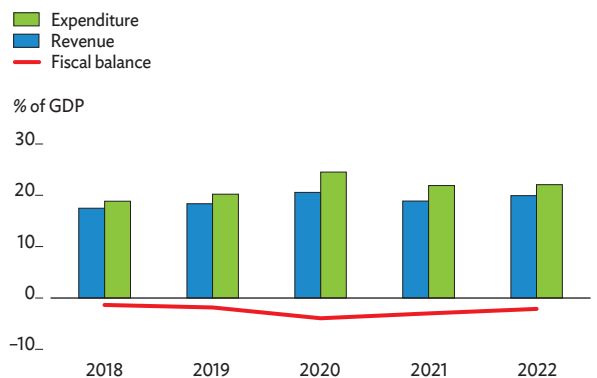
Source: Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan.

Expansionary fiscal policy accommodated economic support measures.

Expenditure edged up from the equivalent of 21.9% of GDP in 2021 to 22.1% in 2022 as state defense expenditure climbed by 49.4% from a relatively low base and outlays for education rose by 22.8% and for social spending by 11.6% (Figure 2.4.3). In April 2022, the government raised state expenditure by the equivalent of 2.8% of GDP, financed by transfers from the National Fund of the Republic of Kazakhstan, the sovereign wealth fund. The transfers

Figure 2.4.3 Fiscal Indicators

The fiscal deficit narrowed in 2022 as revenue rose more than expenditure.



GDP = gross domestic product.

Source: Bureau of National Statistics of the Agency for Strategic Planning and Reforms of the Republic of Kazakhstan.

marginally exceeded those in 2021 and constituted 22.6% of budget revenue. Total budget revenue increased from 18.9% of GDP in 2021 to 19.9% in 2022 as tax revenue jumped by an unexpectedly robust 38.4%, partly reflecting 58.5% higher oil export duty. The state budget deficit shrank from the equivalent of 3.0% of GDP in 2021 to 2.1%. Not counting large oil industry revenue, the deficit subsided from 9.6% of GDP to 8.2%.

Public debt remained low.

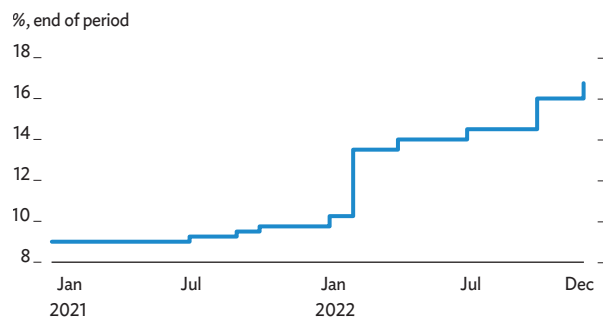
Government and government-guaranteed debt declined from 27.6% of GDP at the end of 2021 to 26.2% a year later. An estimated 63% of the debt was internal, denominated in local currency, and 87% of it had long-term maturity. Government debt service payments as a share of tax revenue declined from 9.1% in 2021 to 8.7% in 2022.

Monetary policy tightened in response to inflation.

In February, the National Bank of Kazakhstan, the central bank, sharply raised its key policy rate by 325 basis points to 13.5% following the Russian invasion of Ukraine (Figure 2.4.4). As inflation accelerated, the central bank raised the rate a further 50 basis points in both April and July, 150 basis points in October, and 75 basis points in December, reaching 16.75% by the end of the year. Growth in broad money (M3) slowed from 20.8% in 2021 to 13.9%, with bank lending rising by 20.1% and deposits by 18.9% (Figure 2.4.5). Mortgage lending expanded by 42.6% as the government extended a subsidized

Figure 2.4.4 Policy Interest Rate

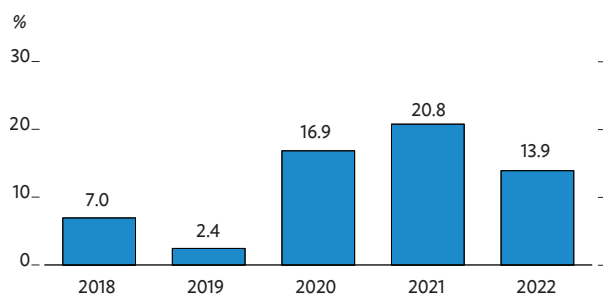
The policy interest rate was raised sharply in 2022 to restrain inflation.



Source: Haver Analytics.

Figure 2.4.5 Broad Money Growth

Broad money growth slowed noticeably in 2022.



Note: Broad money growth is the percentage change from December to December.

Source: National Bank of the Republic of Kazakhstan.

lending program. Total consumer lending grew by 25.1%. Lending to firms rebounded by 17.4% in 2022 after years of contraction, with loans to small and medium-sized enterprises rising by 16.3%. The share of nonperforming loans increased marginally from a historic low of 3.3% at the end of 2021 to 3.4% a year later. The central bank sold 6.4% more of its own short-term securities than in 2021, and government-issued domestic securities rose by 24.0% to finance the budget deficit. The share of foreign currency deposits declined from 37.2% of all deposits at the end of 2021 to 36.7%, and foreign currency loans decreased from 10.3% in 2021 of all loans to 8.1% in 2022.

High oil prices drove export earnings to a decade high that lifted the current account into surplus.

Preliminary estimates show a current account surplus equal to 2.8% of GDP in 2022, reversing a 4.0% deficit in 2021. The merchandise trade surplus almost

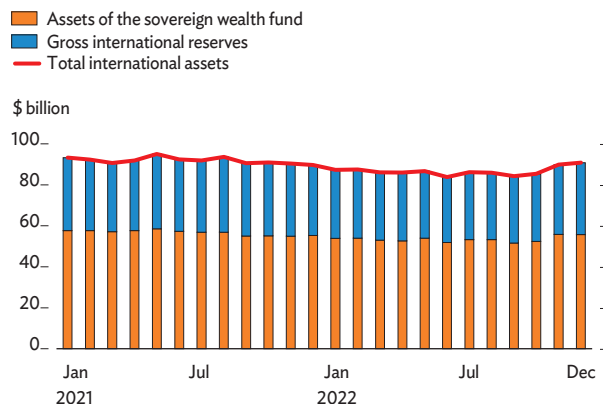
doubled for a second year in a row, benefiting from higher oil and gas prices. Merchandise exports rose by 40.7% to their highest amount in a decade, while merchandise imports grew by 19.6%. The deficit in services fell by a quarter as export growth, reflecting increased transit and personal travel, outpaced 18.0% increase in service imports. Profit repatriation rose modestly by 12.8%, widening the deficit in primary income, while higher outward money transfers pushed the secondary income account into deficit. Net inflow of foreign direct investment quadrupled, while portfolio investment outflow was the highest in a decade.

Strong external earnings boosted foreign exchange reserves.

Despite the central bank selling \$1.4 billion in reserves to support the currency, gross international reserves increased by 2.0% to \$35.1 billion at the end of 2022, providing cover for 7.2 months of imports. However, the share of reserves held in gold dropped from 68.5% at the end of 2021 to 58.4% a year later. Sovereign wealth fund assets fluctuated significantly and grew marginally, by 0.7%, to \$55.7 billion as windfall petroleum profits exceeded budget transfers and market value declines for fund assets (Figure 2.4.6). The sovereign wealth fund sold \$4.3 billion in foreign exchange on the market to finance budget transfers, and state-owned enterprises sold an additional \$5.1 billion. By the third quarter of 2022, external debt, 58.2% of it private intercompany debt, had declined sharply to equal an estimated 74.7% of GDP, reflecting debt repayment by foreign subsidiaries.

Figure 2.4.6 Foreign Currency Reserves and Sovereign Wealth Fund Assets

Gross international reserves and sovereign wealth fund assets fluctuated but finally grew in 2022.



Source: National Bank of the Republic of Kazakhstan.

Economic Prospects

Recovering oil production will accelerate

expansion. Growth is projected to increase to 3.7% in 2023 and 4.1% in 2024 as mining rebounds on higher oil production at the Kashagan and Tengiz oil fields (Table 2.4.1 and Figure 2.4.7). Projected price increases for the main export commodities will stimulate investment and support business sentiment. Spillover from sanctions on Russia poses the greatest risk to the outlook.

Table 2.4.1 Selected Economic Indicators, %

Growth will accelerate, and inflation slow, in 2023 and 2024.

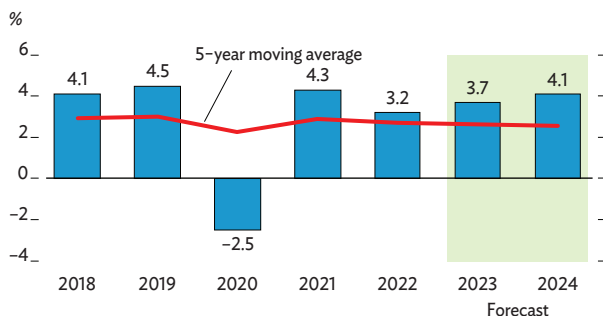
	2021	2022	2023	2024
GDP growth	4.3	3.2	3.7	4.1
Inflation	8.0	15.0	11.8	6.4

GDP = gross domestic product.

Sources: Bureau of National Statistics; National Bank of Kazakhstan; Asian Development Bank estimates.

Figure 2.4.7 GDP Growth

Growth is expected to recover in 2023 and 2024.



GDP = gross domestic product.

Source: Asian Development Outlook database.

Services and industry will become the main growth engines.

On the supply side, growth in services is forecast to accelerate from 3.4% in 2023 to 3.9% in 2024, supported by transport, trade, and hospitality and benefiting from greater trade facilitation between Europe and Asia. Growth in industry is forecast to jump to 4.7% in 2023 on strong external demand for commodities, with mining rising by 5.2%

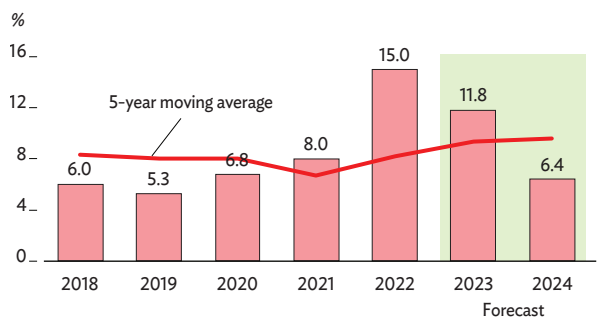
in that year, then slow to 4.3% in 2024, with mining increasing by 4.1%. Firms relocating from Russia and continued government support programs will expand manufacturing by 4.0% each year. Growth in construction will moderate to 5.5% in 2023 and 4.2% in 2024 as large infrastructure projects reach completion. Growth in agriculture will average only 3.5% in 2023 and 2024, reflecting a high base and limited investment inflow.

Consumer spending will support expansion. On the demand side, growth in consumption is projected to rebound to 1.6% in 2023 and 2.2% in 2024 as reduced inflation boosts real incomes and state social support allocations increase. Investment will increase by 3.2% and then 3.7% as companies relocate production facilities from Russia and state infrastructure development programs continue. Net exports are forecast to increase gradually in both years as rising commodity export volume outpaces import growth.

Inflation should gradually subside. Inflation is projected to slow to 11.8% in 2023 and 6.4% in 2024, reflecting tight monetary policy and presuming a stable currency (Figure 2.4.8). Price controls and export restrictions on food staples are projected to slow food price increases to 14.0% in 2023 and 8.6% in 2024. The government extended its ceiling price for gasoline, and market regulation will hold inflation for other goods to 10.0% in 2023 and 5.0% in 2024. Inflation in services is projected to accelerate to 10.6% in 2023 before subsiding to 4.8% in 2024, with the government allowing utility price increases in exchange

Figure 2.4.8 Inflation

Inflation is projected to slow in 2023 and 2024.



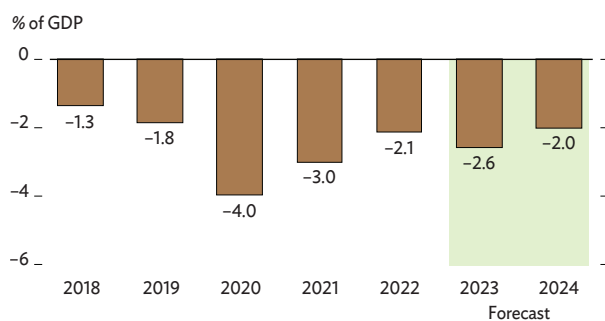
Source: Asian Development Outlook database.

for investment. Focused on bringing inflation down toward the target range of 4%–5%, the central bank will maintain an elevated policy rate in 2023 to manage inflationary expectations until inflation subsides in 2024. Broad money growth is projected to slow to 8.4% in 2023 and 6.4% in 2024 as the central bank drains excess liquidity from the market by issuing securities. The central bank will intervene to contain exchange rate volatility following any exogenous currency shock.

The fiscal deficit will expand as sovereign wealth fund transfers decline. Despite rising tax revenue, total revenue is projected to slide to the equivalent of 18.7% of GDP in 2023 as transfers from the sovereign wealth fund are curtailed, and then increase marginally to 18.9% in 2024 (Figure 2.4.9). Expenditure is forecast to drop to 21.3% of GDP in 2023 and 20.9% in 2024 as economic support programs are phased out. With lower sovereign wealth fund transfers, the budget deficit is projected to widen to 2.6% of GDP in 2023 before narrowing to 2.0% in 2024, with the non-oil deficit narrowing to 7.2% of GDP in 2023 and 6.8% in 2024.

Figure 2.4.9 Fiscal Balance

The fiscal deficit will widen in 2023 before narrowing in 2024.



GDP = gross domestic product.

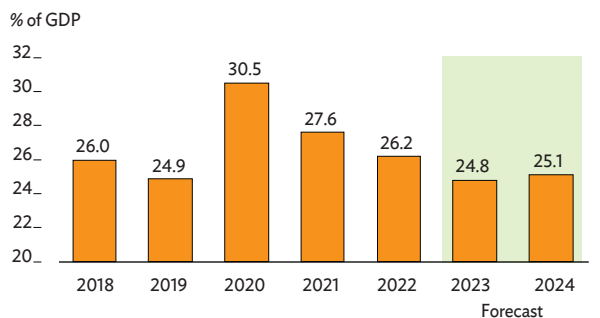
Source: Asian Development Outlook database.

Public debt is forecast to remain stable.

Government and government-guaranteed debt is projected to decline as a share of GDP to 24.8% by the end of 2023, rising marginally to 25.1% a year later (Figure 2.4.10). New fiscal rules, including limits on sovereign wealth fund transfers and expenditure

Figure 2.4.10 Public Debt

Public debt is projected to stay near the equivalent of 25% of GDP in 2023 and 2024.



GDP = gross domestic product.

Source: Asian Development Outlook database.

growth, should support long-term debt sustainability. External debt is expected to decline to about 74% of GDP at the end of 2023 and 72% a year later as state-owned enterprises repay foreign debt and foreign-owned subsidiaries repay intercompany debt.

The current account surplus is expected to narrow over the forecast period.

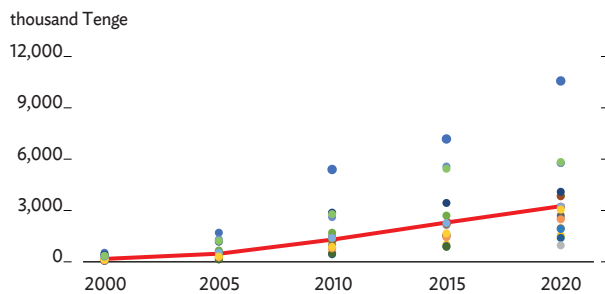
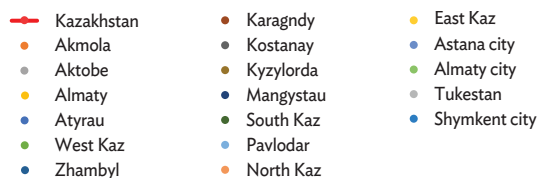
Increasing oil production and relatively high commodity prices will support a modest 0.8% expansion of export earnings in 2023, while imports are projected to grow by 10.3%. The service deficit will gradually narrow as revenue from transit services increase. As commodity investors continue to enjoy and repatriate windfall profits, the primary income deficit will continue. However, outward transfers are expected to decline in 2023, closing the secondary income deficit. Gross international reserves are projected to increase to \$37.2 billion in 2023, providing cover for 7 months of imports, and reach \$40.5 billion in 2024, assuming little intervention in the foreign exchange market. Sovereign wealth fund assets are forecast to expand to \$58 billion in 2023 and exceed \$60 billion in 2024 as budget transfers fall below inflows and earnings.

Policy Challenge—Address Worsening Regional Disparity

Widening regional disparity spurred protests in January 2022. Over the past two decades, Kazakhstan’s economy has performed well, with GDP increasing tenfold, but wealth has become concentrated regionally (Figure 2.4.11). An ADB consultant’s report in 2021 found economic polarization widening among Kazakhstan’s regions, with some stuck in a development trap. The Regional Competitiveness and Cohesion Index, which examines growth, employment, and productivity, revealed considerable regional gaps in opportunity and competitiveness. Large urban areas and resource-rich regions enjoyed exceptionally high wealth, while agrarian and more populous southern regions lagged far behind and struggled to benefit from growth.

Figure 2.4.11 Gross Regional Product per Capita

Gross product per capita varies significantly across regions.



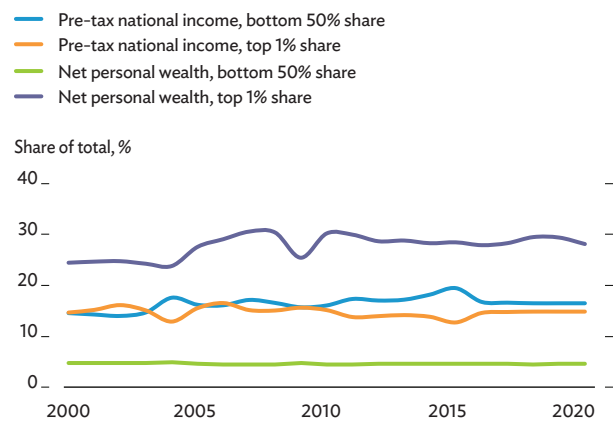
Note: Gross regional product per capita in current prices. Kazakhstan country values are calculated as the arithmetic average of regional values. Source: Kazakhstan Statistical Department.

Standard indexes that show relative income equality do not reflect the high share of informal employment and disparity across regions. The main traditional inequality measure, the Gini index, ranks Kazakhstan as a relatively equal country. However, the index does not capture the shadow economy and hides underreporting among high earners. The World Inequality Database estimates that the top 1% of

Kazakh adults received 15.0% of all income in 2021 and owned 29.2% of all wealth, while the bottom half of the population earned 16.4% of all income and owned only 4.6% of wealth (Figure 2.4.12). Stark inequality also shows in variation in the quality of social services and infrastructure across regions and in people’s access to them. A 2021 report on the education systems nationally estimated a 50% gap between the regions performing best and worst in education effectiveness.

Figure 2.4.12 Income and Wealth Inequality in Kazakhstan

Kazakhstan’s top 1% had 6 times the wealth of the bottom 50% from 2010 to 2020.



Source: World Inequality Database.

Government increasingly devotes more attention to regional development issues. The government has implemented since 2019 its Auy-el Besigi program to improve the quality of life in rural areas by modernizing infrastructure in settlements determined by the government to have potential. In 2022, the government approved the main guidelines for regional development by adopting its Plan for Territorial Development until 2025. More recently the President promulgated a law delegating greater autonomy and decision-making authority to selected metropolitan areas. These programs could better address regional development issues if design and implementation stages include more active public engagement.

Unlocking the potential of all regions and ensuring inclusive growth requires more nuanced and supportive national policies. The government needs to provide guidelines that are flexible enough

to adapt programs to local needs and strengthened implementation capacity in regional government. Suitably flexible regional development programs would be able to adapt to differing regional needs and challenges and promote place-sensitive policies that reflect differences in regional development. This approach would require better coordination between the central and regional governments. Because place-sensitive policies delegate decision-making and empower local authorities, their success depends on adequate regional capacity and institutional development. Corruption and lack of transparency can easily thwart well-intended policies. Introducing local performance audits conducted by independent third parties would instill accountability and improve value for money.

Fiscal decentralization and redistribution policies require development and fine tuning. Since 2018, seven types of tax and nontax revenue have been transferred to subnational governments. However, taxes account for a small share of subnational budgets, as nearly 60% of their revenue comes as transfers from the central government budget. The fiscal redistribution system needs improvement to take into account residents' quality of life and to motivate regional and local authorities to raise living standards. Regularly scheduled surveys that assess perceptions of well-being can be valuable for monitoring and guiding resource allocation to address the most pressing regional and local issues.

KYRGYZ REPUBLIC

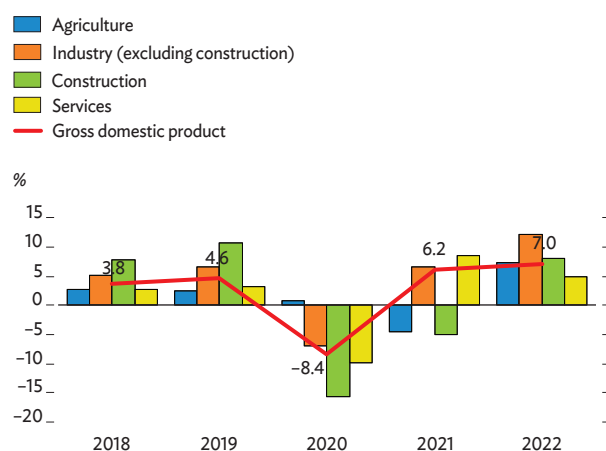
Growth accelerated in 2022, reflecting a rebound in gold production, strong domestic demand, and milder-than-expected impact on the economy from the Russian invasion of Ukraine. Inflation also accelerated, and both fiscal and current account deficits widened. Growth and inflation are expected to moderate over the forecast period, with diminishing external inflow of funds and less favorable conditions in trade partners. Pension reform is needed for more sustainable and inclusive growth.

Economic Performance

The economy performed better than expected, with growth accelerating. Despite global and regional shocks, growth rose from 6.2% in 2021 to an estimated 7.0% in 2022 (Figure 2.5.1). On the supply side, industry excluding construction expanded by 12.2%, almost double the rate in 2021, driven by a rebound in gold production. Growth in services slowed from a strong 8.4% in 2021 to 4.8% with smaller but still notable gains in trade, at 7.7%, and transport at 10.1%.

Figure 2.5.1 Supply-Side Growth

Growth accelerated in 2022, led by a rebound in gold production.



Source: National Statistics Committee of the Kyrgyz Republic.

Expansion remained high at 23.8% in hotels and restaurants, which benefited from capital inflow and foreign arrivals, mostly from Russia. After contracting by 4.9% in 2021, construction expanded by 8.0% in line with increased investment, both foreign and domestic. Agriculture reversed drought-induced decline by 4.6% in 2021 with growth by 7.3%, which reflected a strong 40.5% increase in grain production.

Private consumption and investment were the main demand-side drivers of growth. Growth in domestic demand surged from 3.8% in the first 3 quarters of 2021 to 33.2% in the same period of 2022. On the demand side, higher household savings slowed growth in private consumption from 11.1% in 2021 to a still-strong 9.0% in 2022, supported mainly by increases in real wages and inward money transfers. Public consumption grew by 0.8% in the first 3 quarters of the year, up slightly from 0.3% in the same period of 2021, with the data not yet fully reflecting significant increases to public wages and pensions and border-related spending introduced in the last quarter of 2022. Growth in gross capital formation jumped by more than threefold, supported by strong expansion in both gross fixed capital formation and changes in inventories. The deficit in net exports widened by 3.4 times as imports spiked and exports declined.

Inflation remained elevated, reflecting high commodity prices and strong domestic demand.

Average annual inflation rose from 11.9% in 2021 to a decade high of 13.9% in 2022, mainly on higher global prices for food and energy, wage growth, and a surge in demand from an influx of relocating Russians (Figure 2.5.2). By category, inflation slowed from 18.0% in 2021 to 16.2% for food but accelerated from 9.0% to 17.3% for alcoholic beverages and tobacco, from 7.3% to 11.1% for other goods, and from 4.4% to 9.8% for services. Inflation reached 14.7% year on year in December 2022, well above the 5%–7% target range set by the National Bank of the Kyrgyz Republic, the central bank. In the first quarter of 2022, the central bank tightened monetary policy in response to increasingly broad inflation and inflationary expectations and a nearly 24% plunge by the Kyrgyz som, in tandem with the Russian ruble, against the US dollar. During this period it raised the policy rate three times by a cumulative 600 basis points to 14.0%. The policy rate then remained unchanged until 29 November, when it was lowered by 100 basis points to 13.0%, despite demand pressures, to support growth and in the light of slowing inflation and a full recovery in the exchange rate (Figure 2.5.3).

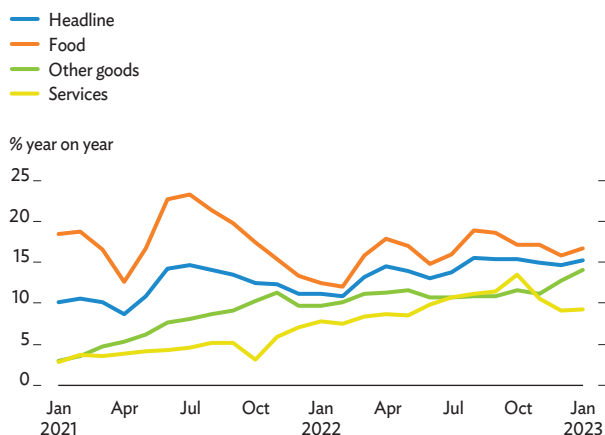
Fiscal policy became more expansionary as the general government deficit widened from 0.2% of GDP in 2021 to 1.1% in 2022 (Figure 2.5.4).

Intensified tax administration efforts and cyclical revenue recovery substantially improved revenue collection in 2022 from the equivalent of 29.0% of GDP in 2021 to 32.7%. However, expenditure expanded even more, reflecting increases in public wages, pensions, public investment, and spending in the Batken region after tensions there at the border. Outlays rose from 29.3% of GDP in 2021 to 33.8%, with large sums directed to countercyclical measures. With public debt equaling 52% of GDP at the end of 2022, public debt service payments reached 10.8% of all expenditure (Figure 2.5.5).

The current account deficit ballooned from 8.7% of GDP in 2021 to 48.6% in the first 3 quarters of 2022 (Figure 2.5.6). Net money transfers from abroad including remittances remained positive in 2022 but declined by 21.2% (Figure 2.5.7). The decline likely reflected larger outflow from capital flight as Russian rubles were converted into US dollars and sent abroad.

Figure 2.5.2 Monthly Inflation

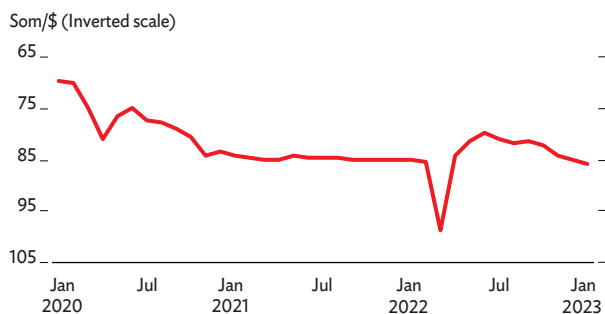
Inflation accelerated further, reflecting high commodity prices and strong domestic demand.



Source: National Statistics Committee of the Kyrgyz Republic.

Figure 2.5.3 Exchange Rate

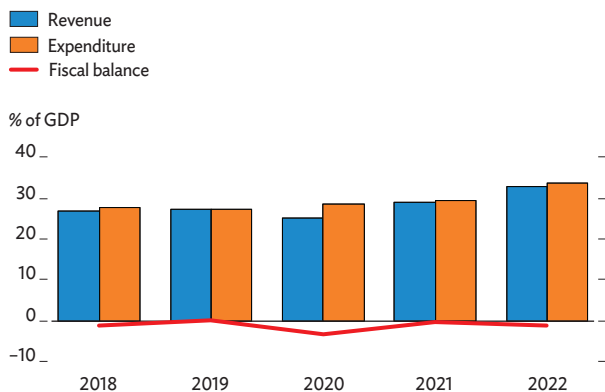
The Kyrgyz som fully recovered against the US dollar after sharp depreciation in February 2022.



Source: National Bank of the Kyrgyz Republic.

Figure 2.5.4 Fiscal Indicators

The fiscal deficit widened in 2022 as expenditure outpaced improved revenue performance.

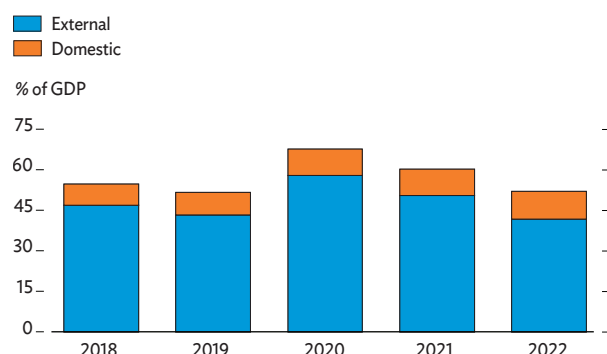


GDP = gross domestic product.

Source: National Statistics Committee of the Kyrgyz Republic.

Figure 2.5.5 Public Debt

Public debt fell as a share of gross domestic product in 2022.

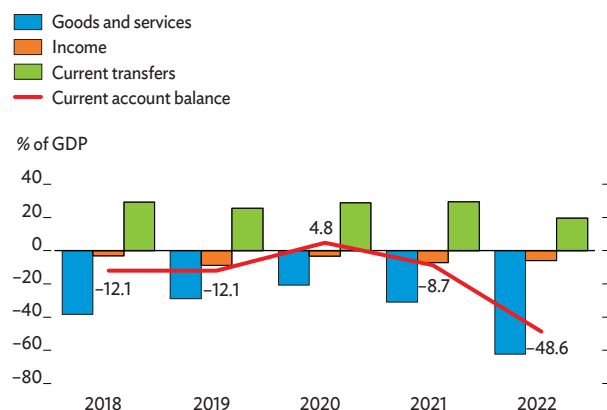


GDP = gross domestic product.

Sources: Ministry of Finance of the Kyrgyz Republic; National Bank of the Kyrgyz Republic.

Figure 2.5.6 Current Account Components

The current account deficit ballooned as imports increased sharply while exports declined.



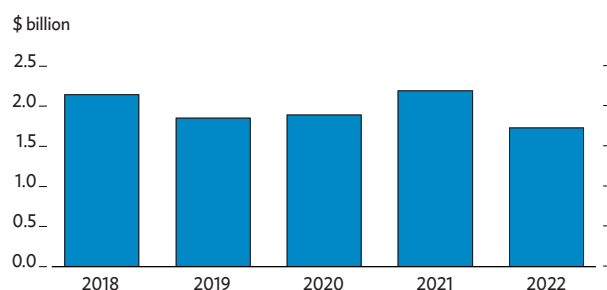
GDP = gross domestic product.

Note: 2022 data are for the first 9 months and presented as a percentage of annualized GDP.

Source: National Bank of the Kyrgyz Republic.

Figure 2.5.7 Net Money Transfers

Net money transfers declined in 2022 with significantly increased outflow.



Source: National Bank of the Kyrgyz Republic.

Imports increased by 72.6%, reflecting higher oil prices and domestic demand. Exports declined by 20.5% as gold exports were suspended and reexports to other countries in the Eurasian Economic Union were likely not fully documented. During this period the central bank purchased domestically produced gold. Gross foreign exchange reserves declined, reducing cover for imports of goods and services from 5.3 months in 2021 to 3.6 months. Central bank foreign exchange interventions in 2022 entailed net sales of \$229.1 million. However, external debt, including government-guaranteed and private debt, is estimated to have fallen from the equivalent of 89.9% of GDP at the end of 2021 to 74.3% at the end of September 2022.

Banks stayed financially healthy despite some weakening in asset quality, and the interest rate spread remained relatively high.

In 2022, bank lending continued to grow as credit in local currency rose by 19.0%, including consumer lending by 50.4% and mortgage lending by 24.6%. The share of loans in foreign currency fell by 4.4 percentage points to 23.6%, but the share of foreign currency deposits increased to 48.3%. The spread between lending and deposit rates widened in a tightening monetary environment as hikes to lending rates in local currency outpaced higher deposit rates. Deposits grew by 39.5%, though little went into time deposits. Bank profitability improved as return on assets rose from 1.2% in 2021 to 5.9% in 2022, reflecting higher non-interest income. Banks remained liquid and well-capitalized with a capital adequacy ratio of 25.6% and a liquidity ratio of 82.8% at the end of 2022. However, nonperforming loans increased from 11.1% of all loans in 2021 to 12.8% in 2022.

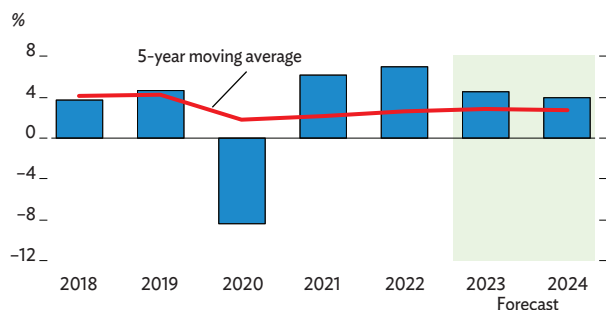
Economic Prospects

Growth is projected to slow to 4.5% in 2023 and further to 4.0% in 2024 as uncertainty increases

(Figure 2.5.8 and Table 2.5.1). Geopolitical developments may spill over to weigh on growth and inflation through remittances, exchange rate fluctuation, and trade and financial links. Significant downside risks such as contraction in the Russian economy could reduce growth further or add to inflation. Gold production from the Kumtor mine is also highly uncertain. On the other hand, capital and migrant inflows from Russia could improve the growth outlook, as in 2022.

Figure 2.5.8 GDP Growth

Growth is expected to moderate over the forecast period.



GDP = gross domestic product.

Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Table 2.5.1 Selected Economic Indicators, %

Growth and inflation are both expected to decelerate in 2023 and 2024.

	2021	2022	2023	2024
GDP growth	6.2	7.0	4.5	4.0
Inflation	11.9	13.9	12.0	8.6

GDP = gross domestic product.

Source: Asian Development Bank estimates.

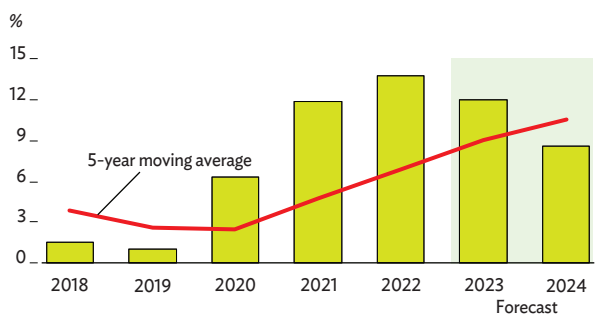
Growth will decelerate as expansion in gold production and domestic demand slows. On the supply side, growth in industry is expected to slow, reflecting a gradual decline in gold production as the Kumtor gold mine approaches its capacity limit. Expansion in electricity generation is projected to slow because of low water levels. Following strong growth last year, agriculture will decelerate to 3.0% increase in 2023 and 2.5% in 2024, with expansion coming mainly in livestock as crop production slows. However, growth in services is forecast to remain largely unchanged, supported by growth in trade averaging 7.6% annually and continuing demand from the influx of Russians last year. On the demand side, private consumption and investment will grow more slowly as remittances and other money transfers decelerate. However, net exports will rise as gold exports are expected to resume, while growth in imports will slow with fewer reexports.

Inflation is expected to moderate somewhat but remain high (Figure 2.5.9).

While elevated core inflation suggests continuing strong underlying price pressures, along with announced increases to electricity tariffs and other administered prices and likely further currency depreciation, average inflation is expected to decelerate to 12.0% in 2023, reflecting likely moderation in prices for imported food and energy. Inflation is forecast to decline further to 8.6% in 2024, as demand diminishes. The central bank is expected to intervene to smooth excess exchange rate volatility.

Figure 2.5.9 Annual Inflation

Inflation is projected to decelerate but remain high.



Sources: National Statistics Committee of the Kyrgyz Republic; Asian Development Bank estimates.

Expansionary fiscal policy is unlikely to reverse over the next 2 years. The fiscal deficit is projected to widen to an average of 2.5% of GDP in both years. Continuing improvement to tax and customs administration is expected to boost revenue. However, expenditure is expected to climb even more to cover wage and pension increases enacted in 2022 and as public debt service payments rise. Increased expenditure will likely keep the deficit elevated despite a planned reduction in domestically financed investment spending. With little foreign financing available, this could require further costly domestic borrowing.

The current account deficit is projected to narrow in 2023 and 2024 as gold exports resume and global energy and food prices moderate. Exports of other goods should continue to increase, supported by transit trade. Imports are expected to grow more slowly, with slower growth in domestic demand offsetting a rise in imports from continued regional and transit trade.

Converting nonmonetary gold on the central bank's balance sheet into foreign exchange and monetary gold would support and diversify international reserves, though gross reserves are projected to decline further. Likely depreciation of the Kyrgyz som, mirroring an expected weakening of the Russian ruble against the US dollar during the forecast period, could affect the ratio of external debt to GDP in 2023 and 2024.

Policy Challenge—Strengthening Pension Reform to Support Sustainable and Inclusive Growth

The current pension system is costly and complex.

Despite improvements after decades of reform, some challenges remain: (i) dependence on the state budget to ensure financial sustainability, as government transfers cover more than 40% of pension fund expenditure; (ii) a high contribution rate of 27.25%, combined with relatively low benefits; and (iii) unregistered employment and evasion, which may reflect high contribution rates and poor coverage. System performance indicators could be further improved by, for example, increasing the wage replacement rate (30% in 2021) and by decreasing the system dependency ratio. The pension system has become structurally complex, with multiple components and special arrangements for workers in particular industries. In addition, the Kyrgyz Republic spends about 9% of GDP on its pension system despite having a relatively young population. These challenges may create further disincentives to comply with participation requirements and have a negative impact on economic growth at large. The problem is especially acute for about a million migrant workers abroad, as well as for farmers and other self-employed individuals. Failing to address these issues could worsen the country's poverty rate.

Encouragingly, the government has developed several initiatives to address these problems.

In line with the Kyrgyz pension strategy, the government drafted in 2022 amendments to the law on state pensions. They aim for better balance by, for example, adjusting the number of years required for contributions and the retirement age for certain categories of people. The authorities have proposed amendments regarding contribution rates for some sectors and other changes. The strategy strives to strengthen the system's defined contributions component as well, recognizing that the country's financial system consists largely of banks and that the capital market remains shallow and underdeveloped. These measures may mitigate some weaknesses of the system. However, further reform is necessary to address continuing challenges under the current system, particularly because delaying reform will mean higher adjustment costs in the future.

The Kyrgyz Republic may need more systemic and thorough pension reform to support growth.

Measures would promote sustainability by building a more simple and transparent pension system that would be easier to administer. Reform to encourage greater participation and compliance would reduce costs to the private sector and the financial burden on the state budget, freeing up government funds to invest in people and infrastructure for more sustainable growth. The authorities' exceptional efforts provide almost full coverage to the elderly, contributing greatly to poverty alleviation in the country. However, the government should do more to address the issue of pension adequacy. This could reduce or even eliminate poverty among the elderly while making the system more efficient and mobilizing public support for reform. At the same time, the government should recognize that improving pensions can increase investment, generate national wealth, and promote more inclusive growth.

TAJIKISTAN

Growth slowed in 2022 but less than expected thanks to a rebound in remittances. Inflation fell in response to tight monetary policy, currency appreciation, and the release of strategic food reserves. The current account remained in surplus despite a wider trade deficit. Growth will slow in 2023 and recover in 2024, with inflation accelerating and then moderating. A digital economy is key to providing adequate public services and support to firms.

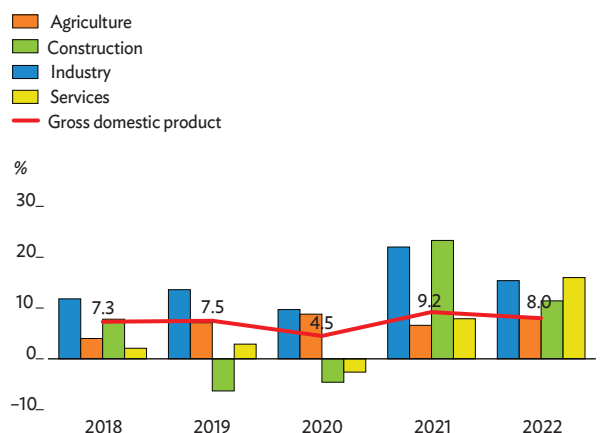
Economic Performance

Growth decelerated somewhat from 9.2% in 2021 to 8.0% because of adverse spillover, though limited, from the Russian invasion of Ukraine. The impact proved less severe than expected, as Russian ruble appreciation and a 51.8% rise in migrant workers to Russia in 2022 sustained financial inflow including remittances. A government plan to mitigate risks to the economy helped sustain activity.

The slowdown reflected smaller gains in industry, agriculture, and construction, and it came despite a rebound in services. Growth in industry moderated from 22.0% in 2021 to 15.4% in 2022 because of supply-chain disruption (Figure 2.6.1). Growth in manufacturing was 16.4%, little changed from 16.3% in 2021, and expansion in electricity generation rose from 15.2% in 2021 to 17.5% on the launch of new production facilities. Mining reversed extraordinary 150% growth in 2021 to contract by 2.3%. Despite rising fertilizer prices and worse weather, expansion in agriculture decelerated only marginally, from 8.8% in 2021 to 8.0% in 2022, with gains in fruit and vegetable production and strong growth in livestock and fishing. Construction growth declined by more than half from 23.3% in 2021 to 11.4% in 2022 with the completion of investments for celebrating the 30th anniversary of Tajikistan's independence. Growth in services doubled from 7.9% in 2021 to 16.0% in 2022 on strong financial inflow, a 15% rise in household disposable income, and a boost in lending that expanded retail trade by 11.2%.

Figure 2.6.1 GDP Growth by Sector

Growth remained robust but declined slightly in 2022.



Source: Tajikistan State Statistical Agency.

On the demand side, domestic demand supported growth. Investment rose by 11.4%, mainly for electricity generation and distribution, transport and communication, and education, while a rebound in remittances boosted consumption. The deficit in net exports expanded by 46.9% as the reopening of borders boosted imports by 22.8%, while exports—mainly gold, minerals, and textiles—decreased by 0.4%.

Despite higher global prices, reported annual average inflation fell by almost half from 8.0% in 2021 to 4.2%. This brought inflation to the lower

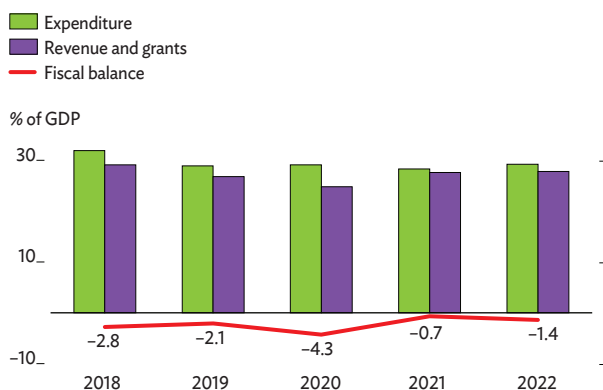
end of the 4%–8% target range of the National Bank of Tajikistan, the central bank. Seasonal factors and shocks from the Russian invasion of Ukraine boosted prices by 5.2% for food, 3.9% for other goods, and 2.0% for services—but all increases were less than in 2021. The Tajik somoni appreciated by 9.7%, mirroring recovery in the Russian ruble and offsetting earlier price hikes from surging international prices for food and fuel and a 13.3% rise in credit. Monetary tightening helped restrain inflation, while sustained agricultural production and the strategic release of food reserves contained prices for domestically produced food.

The fiscal deficit doubled from the equivalent of 0.7% of GDP in 2021 to an estimated 1.4% in 2022 (Figure 2.6.2). The increase reflected higher spending on social protection and border security, as well as further investment in the Rogun hydropower project. The state budget was revised in November 2022 to reflect better tax collection and calls for higher social spending. Revenue rose marginally from the equivalent of 27.6% of GDP in 2021 to an estimated 27.8% as improved tax administration, electronic filing, the elimination of some tax exemptions, and more accurate valuation of imports compensated for reduced rates for value-added and income tax introduced at the beginning of 2022. Despite some spending cuts, expenditure increased from 28.3% of GDP in 2021 to 29.2%, reflecting defense spending and compensation for higher food prices. Public and publicly guaranteed external debt fell from 37.8% of GDP in 2021 to 28.5% a year later with rising GDP and an appreciating currency, while total public debt fell from 42.8% of GDP to 34.2% (Figure 2.6.3). In January 2022, the joint World Bank and International Monetary Fund Debt Sustainability Analysis concluded that Tajikistan’s debt was sustainable but with a high risk of debt distress.

The monetary stance remains relatively tight despite cuts in the policy rate since November 2022. Following pressure on the somoni from earlier ruble depreciation and a drop in remittances, the central bank devalued the somoni by 15.0% against the US dollar on 9 March, erasing a significant gap between official and market exchange rates. The somoni subsequently appreciated by 21.5% to the end of December, mirroring ruble strengthening. To restrain liquidity and mitigate inflation, the central bank increased sales of Treasury bills and central bank securities and, in August 2022, raised the policy interest rate from 13.25% to 13.50%.

Figure 2.6.2 Fiscal Indicators

The fiscal deficit widened in 2022 as tax revenue dropped marginally and expenditure increased as a percentage of GDP.

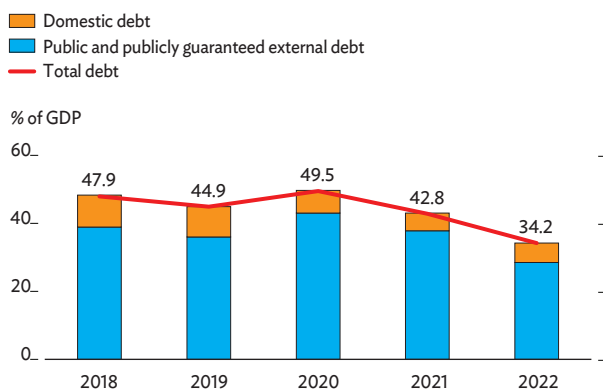


GDP = gross domestic product.

Sources: Ministry of Finance; Asian Development Bank estimates

Figure 2.6.3 Public Debt

Public debt declined as a share of GDP thanks to economic growth and appreciating local currency.



GDP = gross domestic product.

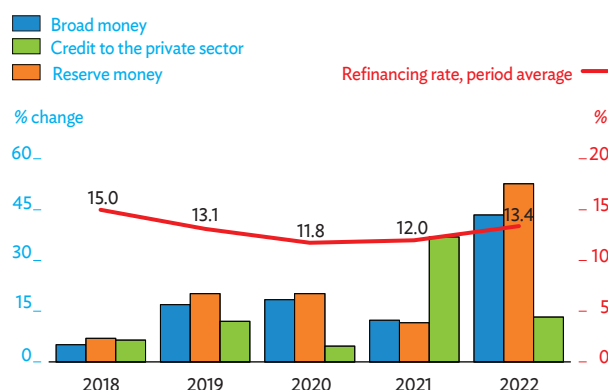
Source: Ministry of Finance

It also maintained reserve requirements at 9.0% on US dollar accounts and 3.0% on somoni accounts. However, with inflation subdued in August and September, the central bank reduced its policy rate to 13.0% in November 2022 and to 11.0% in February 2023. Broad money growth accelerated from 12.3% in 2021 to 43.4% in 2022, and private sector credit rose by 13.3%, despite central bank sales of deposit certificates to sterilize excess liquidity from strong financial inflow and its own purchases of domestically produced gold (Figure 2.6.4).

The soundness of the banking system continued to improve. Improved bank supervision reduced the share of nonperforming loans from 13.7% in 2021 to

Figure 2.6.4 Monetary Indicators

Broad money growth rose in line with strong financial inflow.



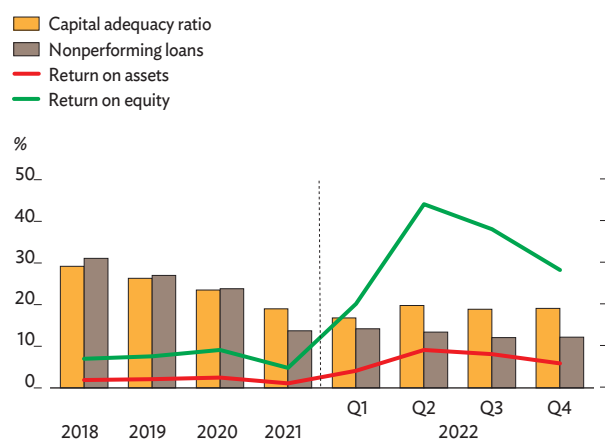
Source: National Bank of Tajikistan.

12.2% in 2022. Return on bank assets rose from 1.1% in 2021 to 5.9%, and on bank equity from 4.8% to 28.3% (Figure 2.6.5).

The current account surplus narrowed by more than half from the equivalent of 8.4% of GDP in 2021 to an estimated 3.3%. The trade deficit widened as strong domestic demand and recovery in trade links raised imports by 22.8%, while exports dropped by 0.4%. However, after an initial plunge, remittances rebounded sharply, offsetting much of the larger trade deficit. Gross international reserves reached \$3.4 billion at the end of September 2022, providing cover for 8.3 months of imports (Figure 2.6.6).

Figure 2.6.5 Banking System Soundness Indicators

Returns on assets and equity rose in 2022.

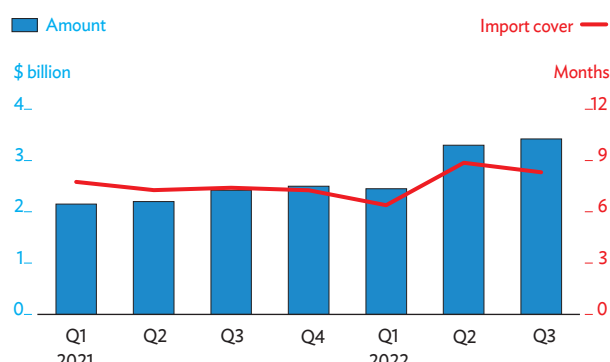


Q = quarter.

Source: National Bank of Tajikistan.

Figure 2.6.6 Gross International Reserves

Reserves rose in the second and third quarters of 2022 as remittances rebounded in the second half of the year.



Q = quarter.

Source: National Bank of Tajikistan.

Economic Prospects

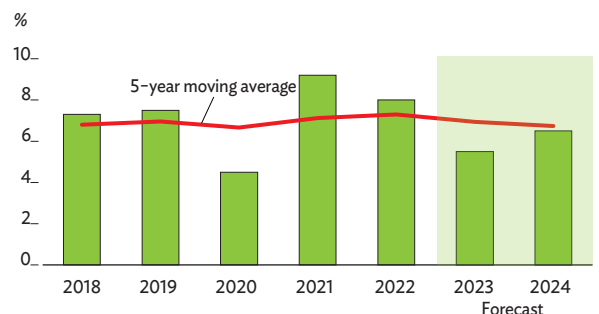
Growth is forecast to decelerate to 5.5% in 2023 as demand ebbs following last year's strong inflow (Figure 2.6.7 and Table 2.6.1). Uncertainty remains high, as does the risk of lingering negative spillover from weak economic activity in Russia.

Moreover, any escalation of the Russian invasion of Ukraine or new waves of military mobilization in Russia could force migrant workers to return home, reducing remittances and investment and disrupting trade. However, gains in industry, particularly in mining, and an easier tax regime should support economic activity, with growth forecast to reach 6.5% in 2024.

On the supply side, industry, agriculture, and services will grow but at a lesser rate. Industry is forecast to expand by 10% in 2023 and 2024, with

Figure 2.6.7 GDP Growth

Slower growth is projected in 2023, with a small recovery in 2024.



Sources: Tajikistan State Statistical Agency; Asian Development Bank estimates.

Table 2.6.1 Selected Economic Indicators, %

Growth will slow in 2023 before accelerating in 2024, but inflation will accelerate in 2023 and then slow.

	2021	2022	2023	2024
GDP growth	9.2	8.0	5.5	6.5
Inflation	8.0	4.2	7.0	6.5

GDP = gross domestic product.
Sources: TAJSTAT; National Bank of Tajikistan; Asian Development Bank estimates.

continued efforts to boost electricity generation, manufacturing, and mining, especially of gold. Agriculture should rise modestly by 5% each year on efforts to expand cultivated area and improve efficiency. Services are projected to grow by 15% in 2023 and a further 10% in 2024, driven by a rise in disposable income from higher public salaries, the implementation of the Rogun project, rising public investment, and increased business activity.

On the demand side, public investment will remain the main growth driver, though rising at a slower pace.

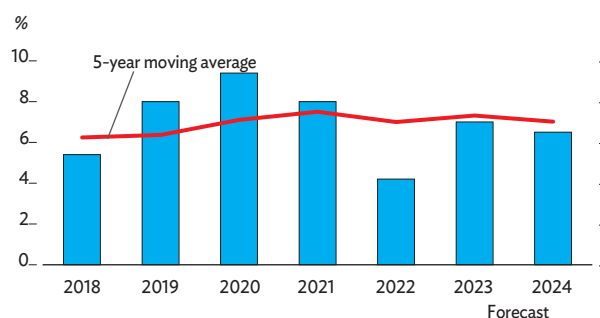
Despite lower business tax rates, continued weakness in the business climate will limit private investment. Private consumption will grow moderately. The deficit in net exports should widen in 2023 as rising domestic income boosts imports, though imports for the Rogun project are expected to moderate.

Inflation will likely accelerate, reaching 7.0% in 2023. This will reflect possible currency depreciation in tandem with a weakening Russian ruble, further increases in consumer lending, announced salary hikes for some civil servants from March to July, and a rise in pensions in July. An increase in electricity tariffs expected in November 2023 will add to inflation (Figure 2.6.8). Inflation is projected to slow slightly to 6.5% in 2024 as global food prices moderate. However, it could accelerate if currency depreciation continues or fiscal needs for budget financing from domestic sources exceed expectations.

Fiscal policy will remain expansionary, with the budget deficit widening to equal 2.5% of GDP in 2023 and 2024. Outlays for the Rogun project will be financed using only domestic budget resources and concessional borrowing. Achieving the deficit target will require expenditure restraint and administrative

Figure 2.6.8 Inflation

Inflation is forecast to remain within the central bank's target range of 4%–8% in both 2022 and 2023.



Sources: Tajikistan State Statistical Agency; Asian Development Bank estimates.

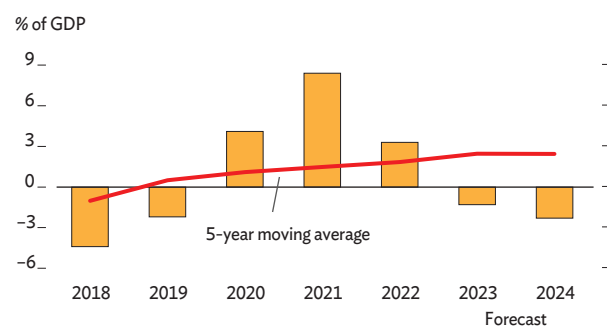
reform as cuts in revenue under the 2022 tax code limit revenue to 28.5% of GDP in 2023 and 26.5% in 2024. Expenditure is forecast to reach 31.0% of GDP in 2023 before declining to 29.0% in 2024. However, it could be higher with any clearing of arrears at state-owned enterprises, faster currency depreciation, or increased social spending for returning migrants. With economic growth, external debt—all of it public—may drop to the equivalent of 33.5% of GDP by the end of 2023, though it could be higher with currency depreciation.

The central bank will try to contain inflation and currency depreciation. Liquidity may be constrained after accommodating budget financing needs. Lending to private firms may increase further following the recent decline in nonperforming loans. Given pressure from depreciation of the ruble and some other trade partners' currencies, the central bank may intervene to support the local currency.

The current account is forecast to revert to deficits. Weak remittances and higher imports of consumer goods and inputs for infrastructure projects will turn the current account into a deficit equal to 1.3% of GDP in 2023 and 2.3% in 2024 (Figure 2.6.9). Exports are projected to rise by 15% in 2023 and a further 10% in 2024 with higher electricity exports, including to Afghanistan and Uzbekistan. Imports are expected to rise by 15% in 2023 as disposable income from domestic sources increases, and by a further 30% in 2024 as remittances recover. Remittances are projected to moderate in US dollar terms in 2023 as a weak Russian economy reduces employment opportunities for migrant workers, causing many to

Figure 2.6.9 Current Account Balance

The current account is projected to fall into deficit in 2023 and 2024.



GDP = gross domestic product.

Sources: National Bank of Tajikistan; Asian Development Bank estimates.

return home, and as ruble depreciation diminishes the US dollar value of most remittances received. Remittances may grow by 15% in 2024 if the international situation permits revived demand for migrant workers. Despite central bank purchases of domestically produced gold, foreign reserves may fall below \$3.0 billion to pay for currency intervention to support the somoni.

Policy Challenge—Moving Towards a Digital Economy

This year's policy challenge focuses on Tajikistan government's efforts to expedite economic development by applying digital technologies and creating an enabling environment for the development of the digital economy. Tajikistan's National Development Strategy to 2030 lists among its strategic goals accelerated industrialization and expansion of productive employment. Achieving these goals requires a transition to a digital economy, as do the objectives of enhancing the delivery of public services and fostering innovation. Recent growth has come largely from expanded industry and construction, mainly through mining and public investment. A more digitized economy could support growth while reducing economic and social inequality.

Insufficient and costly digital connectivity is a barrier to digital development. Tajikistan lags other countries in the region in mobile broadband subscriptions, with only 44% of households subscribing in 2021, versus 53% in the

Kyrgyz Republic, 65% in Kazakhstan, and 77% in Russia. Only one third of the population uses mobile internet. Moreover, the cost of a mobile broadband subscription with at least 1.5 gigabytes of data is the highest in the region, averaging 7.5% of monthly gross national income per capita, and as much as 15.3% of income for poor households. Broadband download speed for mobile users is very low, ranking Tajikistan 134th among 138 countries in the latest Speedtest Global Index.

The government has been promoting digitalization.

A concept note on Tajikistan's digital economy was endorsed in 2019, and a midterm program for developing it in 2021–2025 was approved in 2021. Measures on e-governance, e-document flow, e-signature, and e-commerce have been adopted. The President of Tajikistan established an agency for innovation and digital technology to strengthen digital governance. The tax committee has introduced 20 new modules in the tax administration information system, expanding the number of e-services to 67. The central bank has authorized remote identity confirmation for individuals using e-money and other digital financial products. Financial technology development has increased in recent years.

However, more is needed to promote digitalization in Tajikistan. Steps could include creating public service centers or halls across the country where the front offices of ministries and agencies would be integrated into a single unit to offer public services to firms and citizens efficiently and transparently. Some 70 of the current 3,000 public services should be digitalized by the end of 2025. Successful digitalization will require registering the unique identification cards carried by all residents.

Investing in improved connectivity, hardware, and software can facilitate the transition to a digital economy and reduce inequity. Disadvantaged groups will benefit from access to digital connectivity, hardware, and software. Funds can be allocated to facilitate access for girls through gender-sensitive digital literacy campaigns and by improving internet access for low-income households. In addition, targeted subsidies could make internet subscription plans more affordable. Finally, programming and coding courses for youth in remote areas could enhance their job prospects at home, thereby reducing labor migration to other countries.

TURKMENISTAN

Gains in hydrocarbon production and exports spurred economic recovery in 2022. Inflation remained in double digits, and the current account registered a large surplus. Growth will increase slightly in 2023 and moderate in 2024. Inflation will remain elevated because of foreign exchange imbalances and large credits directed to state-owned enterprises. With the evolving agenda on climate change, Turkmenistan needs to foster energy efficiency, develop renewable energy sources, and advance technological innovation to shrink its carbon footprint and ensure sustainable growth.

Economic Performance

Economic growth continues to come from both within and outside of the large hydrocarbon sector.

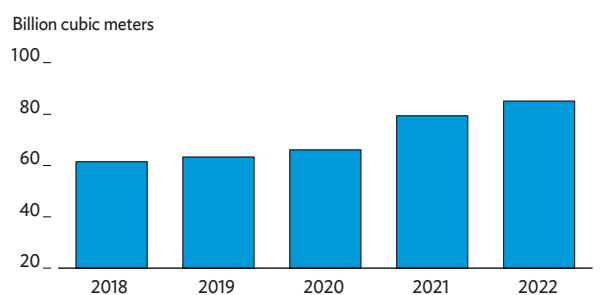
According to the government, growth reached 6.2% in 2022, reflecting higher hydrocarbon exports and rising domestic demand following the end of a protracted lockdown that occurred in 2020 and 2021. Expansion was spurred by the opening of borders, a gradual resumption of international flights, greater domestic mobility, increased trade, and revitalized services in 2022. Higher volumes of hydrocarbons, mainly natural gas, exported at higher prices added considerably to growth. Exports expanded mainly to satisfy demand from the People's Republic of China (PRC) and, to a lesser extent, from Azerbaijan and Iran.

On the supply side, industry was reported to have expanded by 6.3%, particularly in hydrocarbons.

After 20% growth in 2021, gas production expanded further by an estimated 7.2% (Figure 2.7.1). Also contributing to industry expansion were higher output of crude oil, oil products, chemicals, and electricity, as well as gains in construction and manufacturing, food processing, construction materials and textiles, and other products, including those produced under import-substitution programs. Agriculture grew by 5.7% as targets for cotton and wheat production were achieved, and from expansion in horticulture production for domestic and foreign markets. Services expanded by 7.0% with the relaxation of restrictions on

Figure 2.7.1 Natural Gas Production

Natural gas production rose in 2022.



Source: BP Statistical Review of World Energy 2021; Asian Development Bank estimates.

external and domestic transportation and enhanced activity, notably in trade and catering.

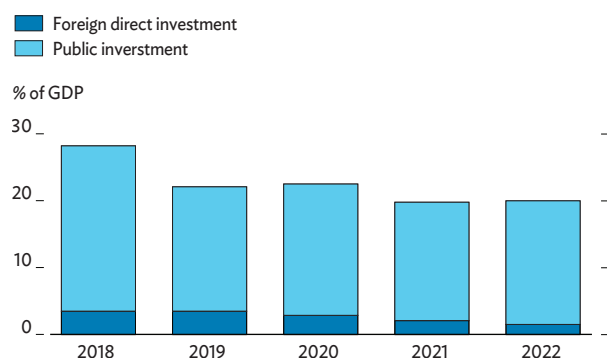
On the demand side, public investment and net exports were the main drivers of growth.

Gross investment in various production facilities and social infrastructure under the President's program for socioeconomic development in 2022–2028 increased notably to reach an estimated 20% of GDP in 2022 (Figure 2.7.2). The government reported commissioning during the year 76 production units and social facilities: new health centers, educational establishments, cultural centers, and, one of the largest

projects in the provinces, the construction of Arkadag, a new administrative city. A program to provide affordable housing put into operation 1.5 million square meters of residential buildings in 2022. In addition, rural development programs invested in interregional highways, high-voltage electric transmission lines, and municipal infrastructure throughout the country. Net exports increased on reported 43.6% growth in exports. However, elevated prices and shrinking real incomes constrained private consumption.

Figure 2.7.2 Gross Investment

Gross investment reached the equivalent of 20% of GDP in 2022.



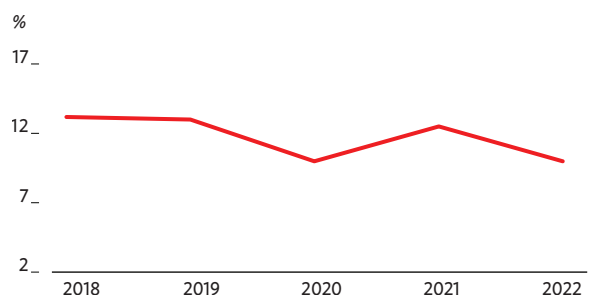
GDP = gross domestic product.

Sources: Asian Development Bank estimates.

Inflation remained in double digits despite some easing. Preliminary estimates show average annual inflation declining from 12.5% in 2021 to 10.0% in 2022 because of price controls, tighter credit policy, and base effects (Figure 2.7.3). The Central Bank of Turkmenistan maintained its fixed exchange rate regime, which limits foreign currency sales and international money transfers. Demand for foreign exchange on the parallel market maintained a large gap between the official and parallel exchange rates. According to the United Nations' Common Country Analysis Update 2022, consumer prices have adjusted to the parallel exchange rate, degrading the purchasing power of incomes earned in national currency. Most bank lending involved soft loans to state-owned enterprises in the government's priority sectors, with some credit provided to private firms engaged in import substitution.

Figure 2.7.3 Inflation

Inflation slowed to 10.0% in 2022.

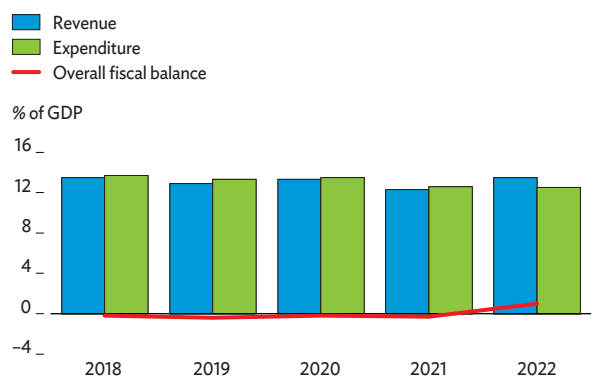


Sources: International Monetary Fund. 2022. *Regional Economic Outlook, Middle East and Central Asia*. October; Asian Development Bank estimates.

The state budget reversed a deficit equal to 0.3% of GDP in 2021 with a 1.0% surplus (Figure 2.7.4). This does not include substantial extrabudgetary spending that continued to finance most investment. According to the latest report by Fitch Ratings in February 2023, off-budget transfers and the role of off-budget entities and funds complicate any assessment of the government's fiscal position, particularly in regard to capital spending. However, Fitch did not see evidence of rising public debt, which is estimated to have declined from the equivalent of 11.1% of GDP at the end of 2021 to 6.1% a year later.

Figure 2.7.4 Government Fiscal Balance

The government reported a fiscal surplus equal to 1.0% of GDP in 2022.



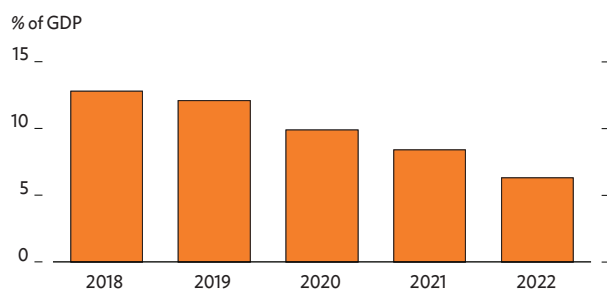
GDP = gross domestic product.

Source: International Monetary Fund. 2022. *Regional Economic Outlook, Middle East and Central Asia*. October.

The current account remained in surplus. The surplus equaled 6.0% of GDP in 2022, reflecting higher energy prices and export volumes as imports were restrained by controls. Export revenue is estimated to have risen by 43.6%, mainly on exports of gas to the PRC but also with additional exports to Iran and Azerbaijan under gas swap agreements. With extensive repayment of external loans, external debt declined from an estimated 8.4% of GDP at the end of 2021 to 6.3% a year later (Figure 2.7.5).

Figure 2.7.5 External Debt

External debt fell to the equivalent of 6.3% of GDP at the end of 2022.



GDP = gross domestic product.

Source: International Monetary Fund. 2022. Regional Economic Outlook, Middle East and Central Asia. October.

Economic Prospects

The President's socioeconomic development program for 2022–2028 will guide activity in 2023 and 2024. The program contains plans to diversify the economy through private sector development. It aims to develop innovative industries and digitalize the economy, foster job creation, improve social conditions, narrow disparities between urban and rural areas, and transition to greener and more sustainable growth. Additional measures are expected to meet infrastructure and social concerns, with more efforts to attract foreign direct investment. Turkmenistan's 2023 investment program calls for outlays of \$10.7 billion, near 20% of GDP, with 55.6% of this sum allocated to constructing industrial units and the rest for other infrastructure: residential buildings, health centers, kindergartens, highways, telecommunications, and social facilities.

The government projects growth rising to 6.5% in 2023, then decelerating in 2024 off a high base (Table 2.7.1). This forecast assumes higher capital spending and continued strong demand for hydrocarbon exports. Oil and gas production and exports will continue to sustain growth during this period, with expectations of continued high prices and higher export volumes. Meanwhile, activity outside of the large hydrocarbon economy will continue to depend on government support for state-owned enterprises and private firms engaged in import substitution and on export promotion programs.

Table 2.7.1 Selected Economic Indicators, %

Growth is forecast to accelerate modestly in 2023 and then slow in 2024, with inflation unchanged.

	2021	2022	2023	2024
GDP growth	5.0	6.2	6.5	6.0
Inflation	12.5	10.0	10.0	10.0

GDP = gross domestic product.

Source: Asian Development Bank estimates.

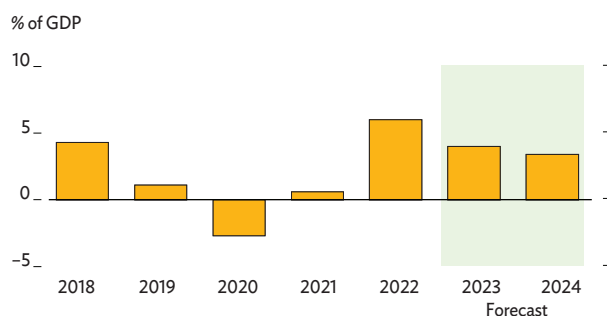
Projected higher revenue from hydrocarbon exports will keep the state budget near balance this year and next. However, most government investment projects are expected to continue being financed off budget.

Inflation is projected to remain elevated at about 10.0% in both years. The outlook assumes no change in foreign exchange policy or banks' practice of lending mainly to state-owned enterprises.

Higher gas shipments are projected to maintain export growth in the coming years. Anticipated increases in imports will supply industrial inputs to export-oriented industries and consumer goods to the domestic market. Anticipated relaxation of import constraints is projected to narrow the current account surplus to the equivalent of 4.0% of GDP in 2023 and 3.4% in 2024 (Figure 2.7.6). External debt is projected to be minimal with scheduled debt amortization and government aversion to new borrowing.

Figure 2.7.6 Current Account Balance

The current account surplus soared to 6.0% of GDP in 2022 but is projected to decline gradually in 2023 and 2024.



GDP = gross domestic product.

Sources: International Monetary Fund. 2022. *Regional Economic Outlook, Middle East and Central Asia*. October; Fitch Ratings. 2023. *Turkmenistan-Rating Action Report*. February; Asian Development Bank estimates.

Fitch has upgraded its outlook for Turkmenistan to positive B+ from its earlier stable rating.

This reflects the strengthening of fiscal and external balance sheets from higher prices for hydrocarbon exports and the country's willingness to service and repay debts. Among the factors that could garner a further rating upgrade are improvements in governance standards and the business environment, a more consistent economic policy that reduces macroeconomic distortion, and greater data transparency.

Policy Challenge—Transitioning to a Sustainable, Low-Carbon Energy Environment

Attaining global carbon neutrality by 2050 demands urgent climate action to cut carbon dioxide emissions.

The devastating effects of climate change felt most keenly in the Central Asia are spreading desertification, water scarcity, heat waves, and droughts.

The evolving climate change agenda has implications for hydrocarbon-rich Turkmenistan.

Turkmenistan is among the most energy-intensive economies in the subregion because of its large oil and gas industry. Continuing heavy reliance on fossil fuels under a scenario of business as usual could become unsustainable in the long run without the adoption of

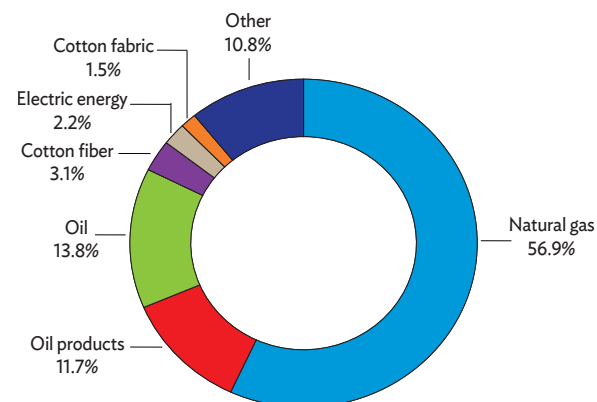
environmentally sustainable practices. While presenting considerable investment opportunity, the hydrocarbon sector is expected to be subject to more stringent environmental controls on its operations as a condition for receiving financing.

Continued heavy reliance on fossil fuels poses considerable challenges to the country.

Hydrocarbon reserves are estimated to exceed 50 trillion cubic meters of natural gas and 20 billion tons of oil. According to British Petroleum, Turkmenistan has the world's fourth-largest natural gas reserves, as well as substantial oil reserves. Hydrocarbons are 90% of all exports and the main source of budget revenue (Figure 2.7.7). Gas alone comprises more than half of exports and is essentially the only fossil fuel used in Turkmenistan to generate electricity. Installed renewable energy is minimal despite considerable potential for solar and wind energy.

Figure 2.7.7 Structure of Exports, 2021

Hydrocarbons comprised about 90% of exports in 2021.



Source: 2022 Statistical Yearbook of Turkmenistan.

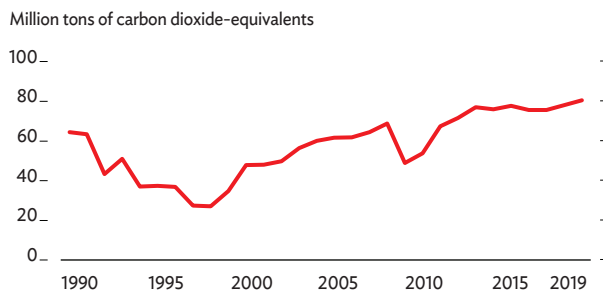
The government plans to expand hydrocarbon production and exports in the short and medium term.

The government's national development programs to 2030 call for increasing oil and gas production and exports. Expanded gas exports through current pipelines to the PRC, Russia, and Iran and through planned pipelines—the Turkmenistan–Afghanistan–Pakistan–India pipeline and the Trans-Caspian pipeline—could contribute to regional energy security and decarbonize the region by replacing coal with gas.

According to the Central Asia Regional Economic Cooperation Energy Outlook 2030, Turkmenistan ranked 103rd out of 172 countries in the global ranking of carbon intensity of energy. Moreover, the country's oil and gas methane emissions are rising and need to be addressed (Figure 2.7.8). The United Nations' Common Country Analysis Update 2022 for Turkmenistan said 75% of these methane emissions could be eliminated by modernizing infrastructure, and more than half of this reduction would come at no net cost.

Figure 2.7.8 Methane Emissions

Methane emissions from oil and gas operations are increasing.



Source: Our World in Data based on Climate Analysis Indicators Tool (CAIT).

The government recognizes the importance of the global climate agenda. It committed to tackling climate change through its National Program on Climate Change in 2012. In 2016, Turkmenistan ratified the Paris Agreement to restrain global temperature rise. In line with this, it adopted policies under the State Program for Energy Saving for 2018–2024, Program for the Development of Energy Diplomacy of Turkmenistan for 2021–2025, and National Strategy for the Development of Renewable Energy in Turkmenistan until 2030. The government demonstrated its further alignment with global

efforts to reduce greenhouse gas (GHG) emissions by submitting its updated nationally determined contribution in 2022. The update established the ambitious goal of reducing GHG emissions by 2030 to 20% below 2010 emissions. Various means of reducing GHG emissions have been identified for application in several sectors of the economy, notably energy, industry, transport, housing, and municipal infrastructure.

As the energy sector produces 85% of GHG emissions, the government has prioritized reducing fossil fuel emissions.

The first measure under consideration is to improve energy efficiency in the production, consumption, and transportation of hydrocarbons, including the prevention of methane leaks. Second, Turkmenistan has vast potential for developing renewable energy such as solar and wind power, so investments to diversify sources could bring gains. Third, in fostering technological advances, the country plans to explore the development of green hydrogen by learning and adopting modern practices used in developed countries. Further it intends to introduce various technologies for carbon capture, use, and storage to reduce harmful emissions into the atmosphere.

Implementing these measures requires further policy reform and institutional strengthening.

These steps would improve the current regulatory and legislative framework, develop financial and tax mechanisms to promote GHG reduction, stimulate investment in research and development, and encourage private sector investment. Achieving technological advances would require access to global finance and technology to facilitate the adoption of global best practices. With an improved business and investment climate, Turkmenistan would be able to make itself more appealing to foreign investors.

UZBEKISTAN

Growth remained strong but slowed across all sectors in 2022. Inflation accelerated, while surging remittances and money transfers slashed the current account deficit. Cooling demand is projected to trim growth in 2023 and stabilize in 2024, especially in services and private consumption. Protracted monetary tightening is expected to reduce inflation, despite an anticipated rise in utility tariffs. A growing population and diversifying economy need education reform and improved training, particularly in science, technology, engineering, and mathematics.

Economic Performance

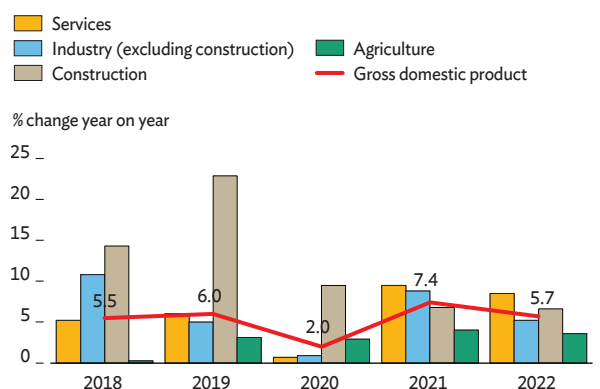
Growth decelerated following robust recovery from the pandemic in 2021 but remained strong.

The State Statistics Agency reported growth slowing from 7.4% in 2021 to 5.7% in 2022. On the supply side, expansion in industry diminished from 8.8% in 2021 to a still strong 5.2%, driven by gains of 5.3% in manufacturing and 2.1% in mining and quarrying. Growth in oil production slowed from 2.9% in 2021 to 1.8% in 2022. Natural gas output contracted by 4.0%, reversing a 8.2% increase in 2021 and causing energy shortages in winter. The downturn reflected decreased natural gas reserves and operational difficulties in gas fields. Growth in services edged down from 9.5% to 8.5% as trade, accommodation, and food services slowed from 13.6% in 2021 to 9.3% and transportation, storage, and information and communication slowed from 17.8% in 2021 to 14.7%. Expansion in road transport services fell steeply from 15.5% in 2021 to 6.5% as lower demand cooled business activity and production. Growth in agriculture moderated slightly from 4.0% in 2021 to 3.6%, reflecting deceleration in crop production, in particular cotton and wheat. Growth in construction, mostly in buildings and structures, stabilized at 6.6% in 2022, following 6.8% growth in 2021 (Figure 2.8.1).

Elevated inflation and slower government investment weighed on domestic demand. On the demand side, growth in consumption decreased from 9.6% in 2021 to an estimated 8.5%. Higher prices

Figure 2.8.1 GDP Growth by Sector

Growth decelerated in 2022 with slowdown across all sectors.



Source: [Statistics Agency](#).

trimmed real income growth, slowing the expansion in private consumption from 11.6% to an estimated 10.7%, despite a reported jump in money transfers, including remittances, by 233.8%, up from 14.3% in 2021, and a 12.0% rise in public wages, pensions, and social assistance. Fiscal consolidation cut growth in public consumption from 3.1% to an estimated 1.2%. Growth in investment fell from 2.9% to 0.9%, with decreases in public investment in urban infrastructure and private investment in manufacturing. The deficit in net exports of goods and services widened by 38.9%, or slightly less than 40.8% expansion in 2021.

External and domestic shocks reversed a declining trend for inflation. Inflation accelerated from 10.7% in 2021 to 11.4% in 2022, reflecting higher global prices for food and energy and wheat price liberalization. Food inflation rose from 14.4% in 2021 to 15.3% on price increases for cereals, meat, vegetables, dairy products, edible oil, and sugar. Inflation for other goods accelerated from 8.3% to 10.0%, while that for services diminished from 8.2% to 7.0%. An influx of Russian citizens into Uzbekistan raised housing rental prices by 24.6% in 2022, up from 8.9% a year earlier.

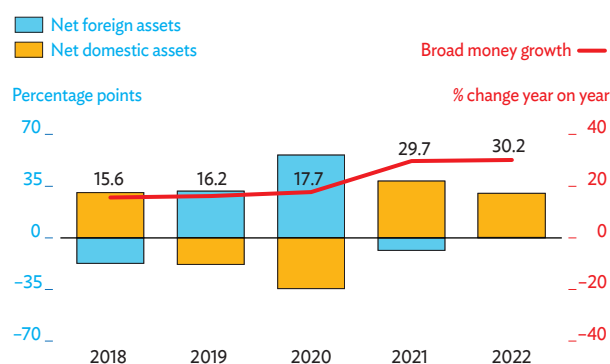
Fiscal consolidation continued but accommodated increasing social spending. The fiscal deficit narrowed from the equivalent of 6.1% of GDP in 2021 to 4.0% as growth in revenue outpaced expenditure. According to a State Tax Committee report, revenue rose from 26.1% of GDP in 2021 to 29.7%, reflecting improvement in tax collection and a broadening of the tax base. Collections of value-added tax (VAT) jumped by 15.8% on an increase in the number of taxpayers, particularly in retail, transport, and information technology services. Taxes paid by state-owned enterprises—the largest taxpayers—were stable, buoyed by high prices for gold, copper, and petrochemicals. Outlays rose from the equivalent of 32.1% of GDP to 33.9% with increased expenditure on social protection, education, and health care. Most of the deficit was financed externally, raising public debt by 5.3%.

Monetary policy remained focused on reducing inflation. In response to high inflation, the central bank kept monetary policy tight with a policy rate of 15.0% throughout 2022. Credit to the economy grew by 19.5%, up from 17.8% a year earlier, on rising demand from industry and agriculture and higher mortgage lending. The share of nonperforming loans shrank from 5.2% of all loans in 2021 to 3.6% in 2022. Growth in broad money edged up from 29.7% in 2021 to 30.2% as expansion in the money supply in local currency accelerated from 28.9% in 2021 to 39.0% while growth in foreign currency deposits plunged from 31.5% to 10.8% (Figure 2.8.2). The Uzbek sum depreciated slightly, by 4.2% against the US dollar in 2022, the decline limited by a doubling of money transfers including remittances.

Soaring cross-border transfers from Russia shrank the current account deficit. The gap narrowed from the equivalent of 7.0% of GDP in 2021 to 0.6%

Figure 2.8.2 Contributions to Money Supply Growth

Broad money expanded in 2022, driven by growth in the money supply in local currency.



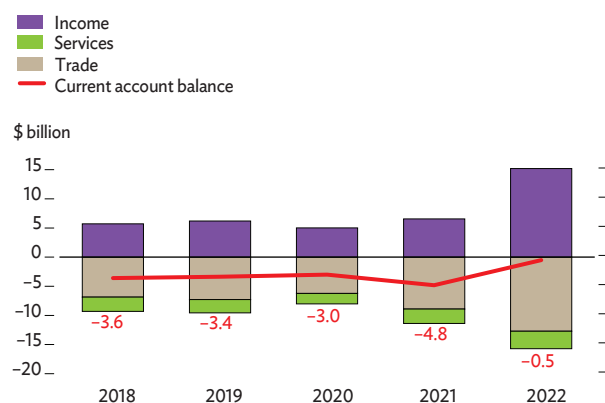
Sources: The Central Bank of the Republic of Uzbekistan. *Statistical Bulletin: January-December 2022*; Asian Development Bank estimates.

in 2022, as money transfers to Uzbekistan jumped by \$8.6 billion. The rise came partly from repatriated revenue from agricultural exports, and partly from migrant workers in Russia shifting their transfers home from informal to formal bank channels as Russia introduced restrictions on taking US dollar cash out of the country (Figure 2.8.3). The combined deficit in goods and services amounted to \$15.7 billion. Exports of goods and services grew by 17.7%, up from 12.9% in 2021, as strong external demand from Russia and higher prices boosted exports of petrochemicals, steel, food, machinery and equipment, and apparel. Tourism services soared from 65.0% growth in 2021 to 281.5% with an influx of short- and long-term visitors from Russia. Imports of goods and services grew by 26.0%, up from 23.1% a year earlier, with higher imports of machinery and equipment, hydrocarbons, petrochemicals, food, and travel and transport services. Net foreign direct investment edged up from the equivalent of 3.0% of GDP in 2021 to an estimated 3.5% in 2022.

Debt management was prudent, and international reserves remained sound. Public external debt moderated from the equivalent of 33.9% of GDP in 2021 to 31.2% despite most of the budget deficit being financed by external borrowing. Gross foreign reserves rose slightly, from \$35.1 billion at the end of 2021 to \$35.8 billion a year later, providing cover for 14 months of imports. A 10.1% rise in gold reserves offset an 11.0% decline in foreign currency reserves (Figure 2.8.4).

Figure 2.8.3 Current Account Components

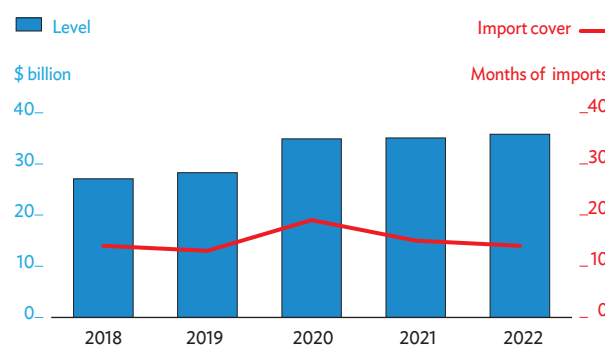
The current account deficit in 2022 narrowed as reported remittances increased.



Sources: The Central Bank of Uzbekistan. 2023. *Preliminary Data of Current Account Balance for 2022*; Asian Development Bank estimates.

Figure 2.8.4 Gross International Reserves

Gross foreign reserves edged up in 2022 as gold reserves increased.



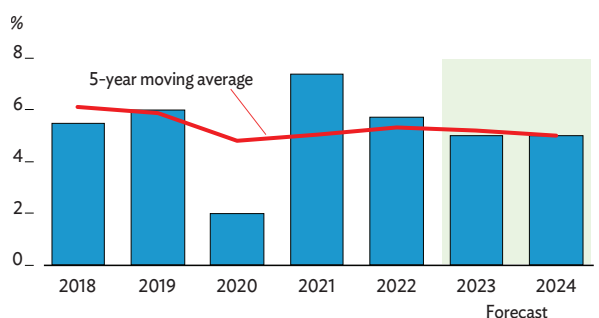
Sources: *Statistics Agency of Uzbekistan*; Asian Development Bank estimates.

Economic Prospects

Growth is forecast to slow to 5.0% in 2023 as expansion in private consumption and services decelerates, and stabilize in 2024 (Figure 2.8.5 and Table 2.8.1). Risks to growth remain from continued sanctions on Russia and their repercussions on external demand for Uzbekistan's exports. Further mobilization of military reservists in Russia would create an additional influx of migrants and visitors. However, likely economic contraction in Russia could reduce demand for Uzbek migrant workers and, thus, inward remittances.

Figure 2.8.5 GDP Growth

Growth is forecast to slow in 2023–2024 as expansion in private consumption and services slows.



Sources: *Statistics Agency of Uzbekistan*; Asian Development Bank estimates.

Table 2.8.1 Selected Economic Indicators, %

Growth will slow and inflation decelerate in 2023 and 2024.

	2021	2022	2023	2024
GDP growth	7.4	5.7	5.0	5.0
Inflation	10.7	11.4	11.0	10.0

GDP = gross domestic product.

Sources: *State Statistics Agency*; *Central Bank of Uzbekistan*; Asian Development Bank estimates.

Growth will remain subdued in services and construction and stabilize in industry and agriculture. On the supply side, growth in services is projected to edge down to 5.5% in both 2023 and 2024 as demand cools for food and accommodation, storage, and transportation services. Growth in construction is also forecast to slip, to 6.0% in 2023 and 2024, with slower expansion in housing, local infrastructure, and upgrades to manufacturing plants. Growth in industry, by contrast, is expected to rise to 5.5% in both years with modest recovery in textiles, food, and mining and quarrying in response to growing demand for hydrocarbons and high external demand, mainly from Russia, for apparel and processed food. Growth in agriculture is projected to remain at 3.5% in both years, reflecting continued gains in farm productivity from wheat price liberalization in 2022 and assuming sufficient water to irrigate cotton and wheat.

Growth in private consumption and investment will moderate. On the demand side, growth in private consumption is expected to decelerate to 8.0% in 2023 and 2024 as demand cools further and an anticipated

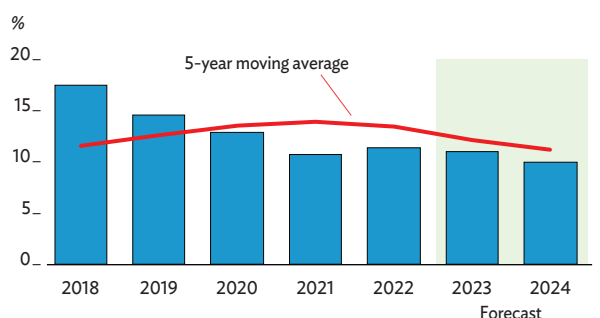
rise in domestic energy prices restrains real household income growth, despite government plans to raise public wages and pensions and implement, from the start of 2023, a cut in VAT from 15% to 12%. Public consumption is projected to grow by 2% in both years on higher spending to operate and maintain public institutions such as hospitals and schools. With anticipated higher public investment in urban infrastructure, education, and health care, total investment is forecast to grow by 3% in both years. The deficit in net exports is expected to widen as migrant flows from Russia abate, weakening demand for tourism and transport services, and with higher imports of consumer products and of capital and intermediate goods for industry.

Inflationary pressure will persist, coming in part from continuing structural reform and increasing social spending. Inflation has continued to rise, reaching 12.1% year on year in January 2023 from 9.7% a year earlier. However, average annual inflation is anticipated to decelerate to 11.0% in 2023 and 10.0% in 2024 as monetary policy remains tight (Figure 2.8.6). The central bank kept its policy rate at 15.0% at its January 2023 meeting and is expected to continue a tight monetary policy to curb inflation in 2024. In addition, to help contain food inflation, the government extended import duty exemptions for essential foods such as edible oils, poultry, wheat flour, and rice to the end of 2023. The government is expected to raise prices for natural gas and electricity in 2023 and again in 2024 to revive delayed structural reform in energy that started in 2019, while increasing social assistance to cushion the cost to low-income households. Broad money is projected to increase by 25.0% in both 2023 and 2024.

Narrowing the budget deficit may be rendered difficult by structural reform and increased social spending. The fiscal deficit is forecast to remain equal to 4.0% of GDP in 2023 and moderate to 3.5% in 2024 (Figure 2.8.7). Revenue is expected to decline to 28.0% of GDP in 2023 and 2024 with the cut in the VAT rate and despite steady tax revenue from state-owned enterprises in mining and quarrying. The government plans to maintain high outlays for social protection, education, health care, and capital projects. However, the authorities are cutting public sector staff by 30% in 2023 and 2024 with reductions

Figure 2.8.6 Inflation

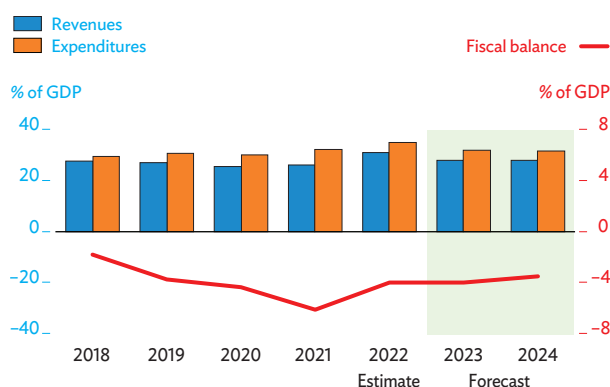
Inflation will decline in 2023-24 with anticipated monetary tightening and extended import duty exemptions on food.



Source: Statistics Agency of Uzbekistan; Asian Development Bank estimates.

Figure 2.8.7 Fiscal Components

The fiscal deficit will remain unchanged in 2023 and narrow in 2024 as government spending is reduced.



GDP = gross domestic product.

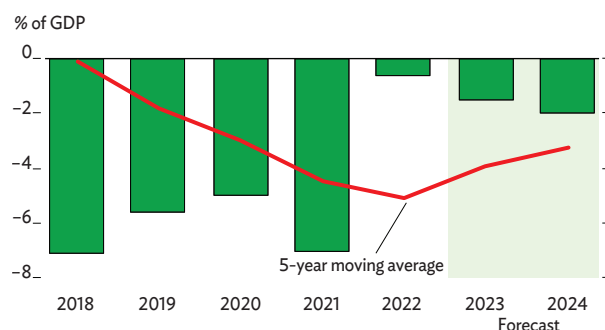
Sources: International Monetary Fund; Asian Development Bank estimates.

in ministries and agencies to curb government spending. Expenditure is forecast to moderate to the equivalent of 32.0% of GDP in 2023 and 31.5% in 2024.

Higher imports and lower income inflows will widen the current account deficit. The current account deficit is expected to widen to equal 1.5% of GDP in 2023 and 2.0% 2024 as imports rise and remittance inflows and money transfers from Russia decline (Figure 2.8.8). Exports of goods and services are projected to grow, but more slowly than imports, as demand rises for imported transport services, capital and intermediate goods, and consumer products.

Figure 2.8.8 Current Account Balance

The current account deficit will widen in 2023–2024 with rising imports.



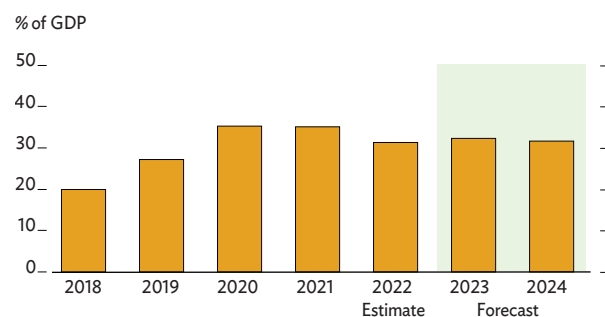
GDP = gross domestic product.

Sources: International Monetary Fund; Asian Development Bank estimates.

Gross foreign reserves are projected to increase to \$37 billion in 2023 and 2024 with a rise in gold reserves. This will provide cover for 12 months of imports in 2023 and 11 months in 2024. The authorities set a \$4.5 billion ceiling on external borrowing in 2023 to keep public debt below 60% of GDP in 2023 and 2024. External public debt of about \$24 billion is currently below 32% of GDP and is expected to stay at about 32% to the end of 2024 (Figure 2.8.9). Foreign direct investment is forecast to grow by 10% in 2023 and 2024 with capital investment in mining, quarrying, and petrochemicals.

Figure 2.8.9 External Debt

Public external debt will remain stable as a share of GDP in 2023–24.



GDP = gross domestic product.

Sources: Statistics Agency of Uzbekistan; Asian Development Bank estimates.

Policy Challenge—Reforming Education

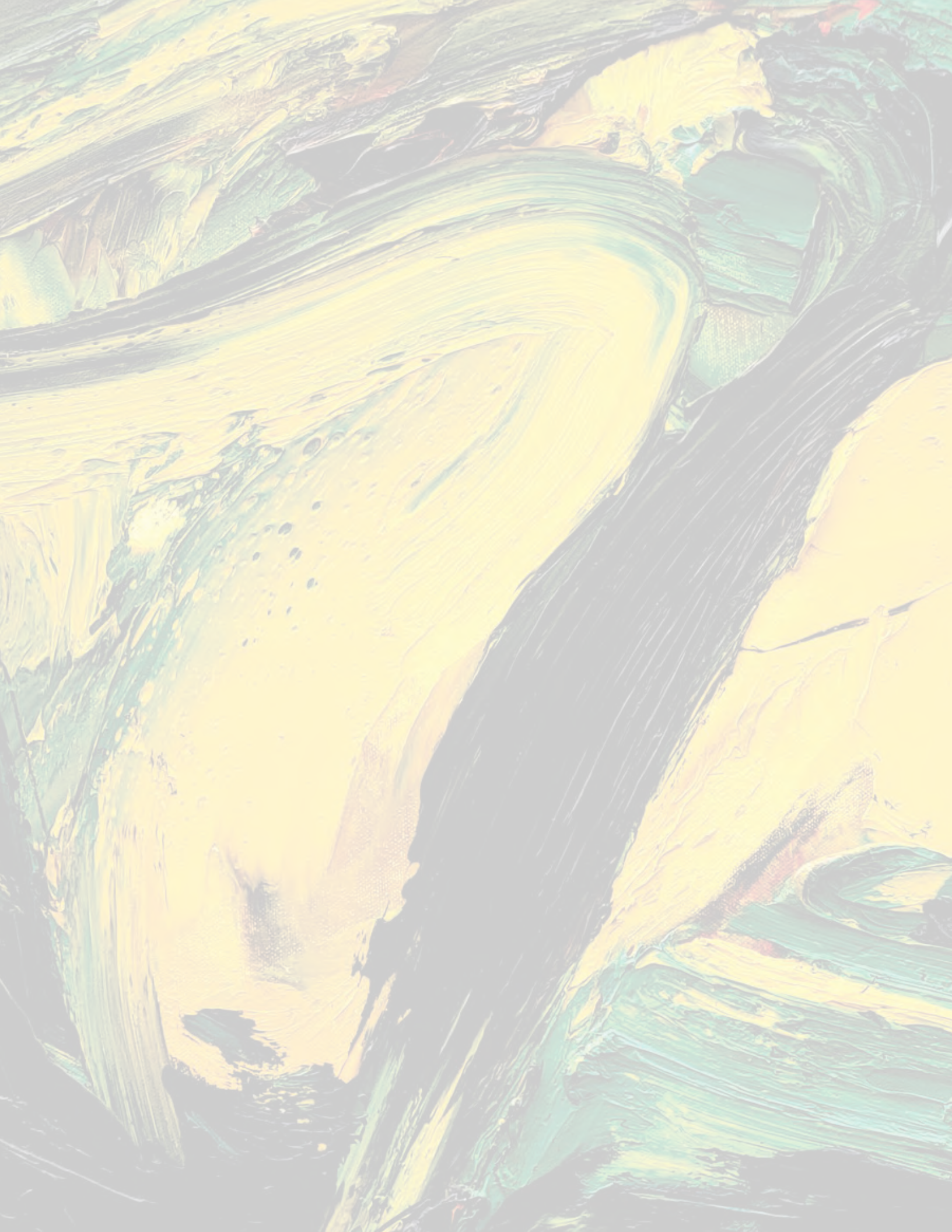
With population growth at 2% a year, Uzbekistan needs more secondary schools and higher-quality education. Secondary education including vocational schools absorbed an estimated 72.3% of public spending on education in 2022. In the 2021/2022 academic year, 6.3 million students attended 10,289 secondary schools, and nearly 500,000 graduated annually. Government plans to increase enrollment by an additional 1.2 million students require either the construction of an estimated 1,961 schools or shorter school days to allow more double shifts.

The quality of secondary education is a concern.

Uzbekistan has not yet conducted the Program for International Student Assessment to obtain a comparative measure of the quality of its secondary school education. However, it is clear that the academic program needs improvement if measured by school graduates' admission to higher education. About 1.8 million students apply annually for admission to bachelor's degree programs at 154 higher education institutions, but only 12.2% of applicants are admitted. In 2022, half of all applicants could not obtain the minimum required score on higher education admission tests, suggesting a failure to coordinate secondary school education with requirements for higher education. In part, this reflects education policy fragmented between the Ministry of Preschools and School Education and the Ministry of Higher Education, Science, and Innovation. Secondary school students often take paid courses at private education centers to prepare for admission tests to higher education institutions. Inability to afford such courses reduces the chances of young people from low-income households gaining access to higher education. In addition, annual tuition for undergraduate study in public higher education institutions in Uzbekistan averages \$717, which is one-third of GDP per capita, making it unaffordable for low-income families. The government aims to increase the share of students enrolled in higher education from 21% in 2021 to 50% by 2026, mainly by improving the quality of pre-university education and creating a more enabling environment for private universities.

As the economy diversifies, it will need more labor with science, technology, engineering, and mathematics (STEM) skills. Structural transformation has raised the share of industry in GDP from 19.5% in 2016 to 26.7% in 2022. The government intends to expand exports by accelerating manufacturing growth. Consistent with national targets for Sustainable Development Goal 9—on industry, innovation, and infrastructure—Uzbekistan plans to promote inclusive and sustainable industrialization through 2030, which is expected to expand further the share of manufacturing in total employment from 12.1% in 2021. To meet industry demand for skilled labor, especially in research and development, accelerated improvement of STEM education is necessary. In 2022, ADB highlighted several recommendations to improve education in STEM and Education Technology in Bangladesh,

Cambodia, the Kyrgyz Republic, and Uzbekistan: A Synthesis Report. The government is advised to (i) boost students' interest in science and mathematics, (ii) ensure that STEM teachers attend regular in-service courses as part of their professional development and apply the latest developments in STEM education, (iii) improve preservice and in-service teacher education in STEM subjects to enhance pedagogical practices that improve student learning outcomes, (iv) further develop research expertise in academic staff at teacher education institutes, (v) establish science centers to popularize STEM, (vi) form nongovernment scientific societies to further boost activity in STEM education, (vii) promote integrated STEM education initiatives through low-cost initiatives, and (viii) significantly increase internet bandwidth in schools.





EAST ASIA

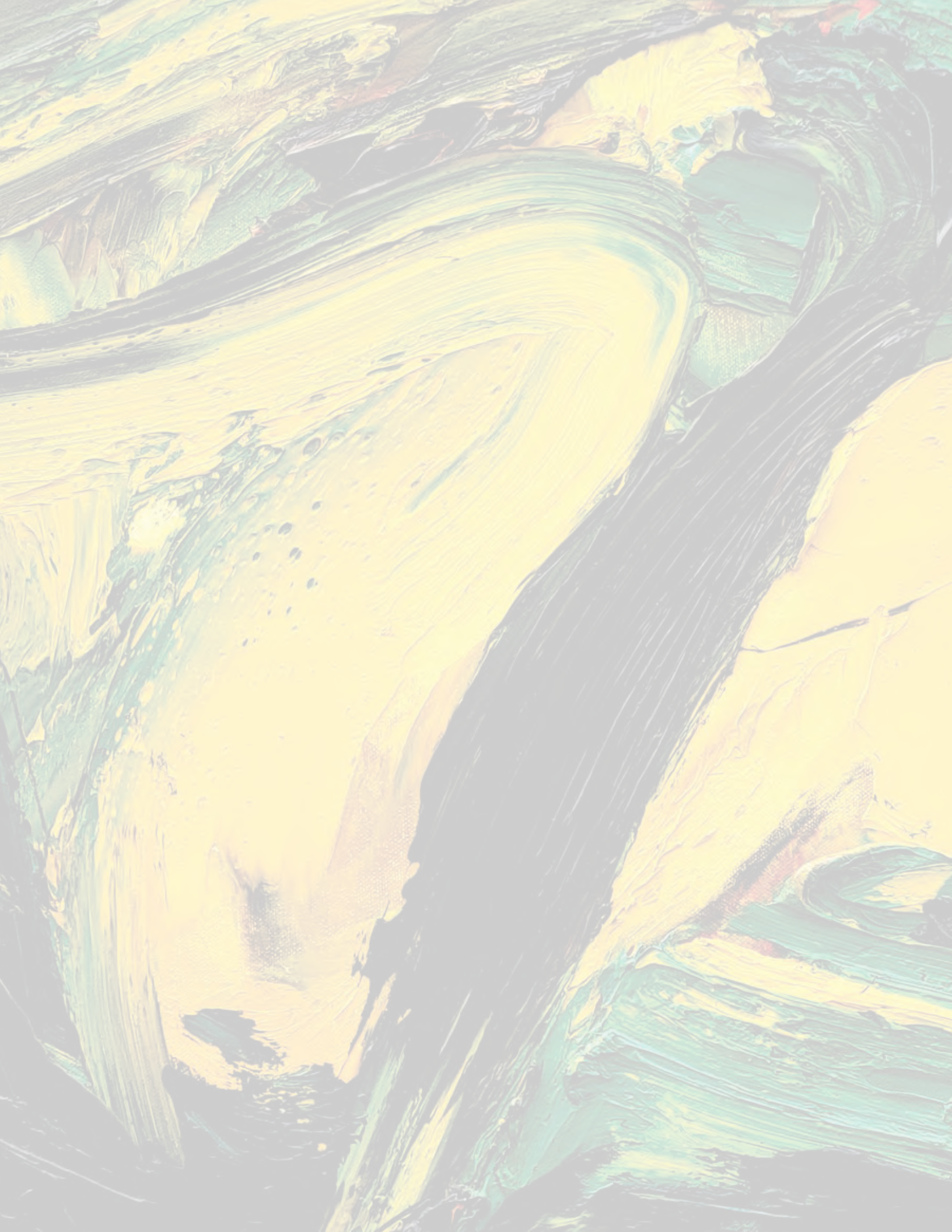
Hong Kong, China 

Mongolia 

People's Republic of China 

Republic of Korea 

Taipei, China 



HONG KONG, CHINA

The economy contracted in 2022 for a third time in 4 years, dragged down by falling demand at home and abroad. Inflation edged up on moderate food and energy price rises. Growth is expected to rebound this year, as domestic demand and services recover, and improve in 2024 on more favorable global and domestic conditions. Inflation will likely remain low to the forecast horizon. Tax reform is needed in the medium term to move toward fiscal balance without damaging competitiveness.

Economic Performance

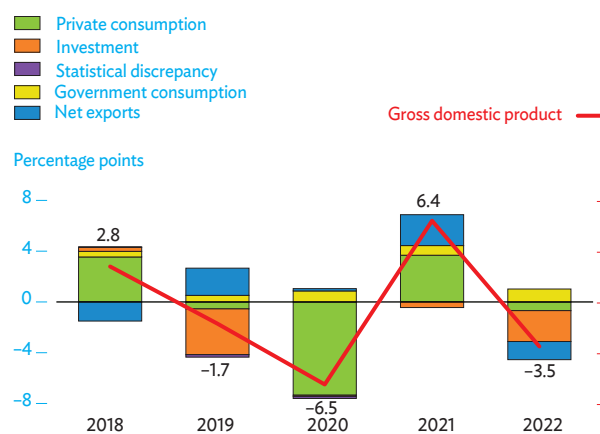
The economy shrank by 3.5% last year. The economic fallout of the fifth wave of the COVID-19 pandemic included 2.6% contraction in the first half of the year. Strict pandemic containment measures took a huge toll on consumption, business sentiment, and contact-intensive activities. Even as the pandemic situation improved, tightened financial conditions and a sharp deterioration in the external environment pushed GDP into a deeper 4.4% decrease in the second half.

Domestic demand deteriorated in 2022, weighed down by pandemic restrictions and tightening monetary policy. Private consumption expenditure declined by 1.0% in real terms, subtracting 0.7 percentage points from growth (Figure 2.9.1). Retail sales volume decreased by 3.4% on average and the value of restaurant receipts by 6.3%, dragged down by pandemic disruption to retail trade early in the year (Figure 2.9.2). Financial conditions tightened with sharp interest rate hikes that battered investment and business sentiment. Gross fixed capital formation reversed an 8.3% jump in 2021 to fall by 8.5%, subtracting 1.5 percentage points from growth. Expenditure on machinery, equipment, and intellectual property products dropped by 16.1% amid a subdued business outlook and higher borrowing costs. The cost of property ownership transfer fell by 41.4% as the value of property transactions plunged by

a monthly average of 39.6% year on year and volume by 38.0%. At the same time, expenditure on buildings and construction rose by 4.3% as increased public sector spending more than offset lower private sector spending. Meanwhile, government consumption expenditure rose markedly by 8.1%, reflecting the government's expansionary fiscal policies and efforts to support the economy, and contributing 1.0 point to growth.

Figure 2.9.1 Demand-Side Contributions to Growth

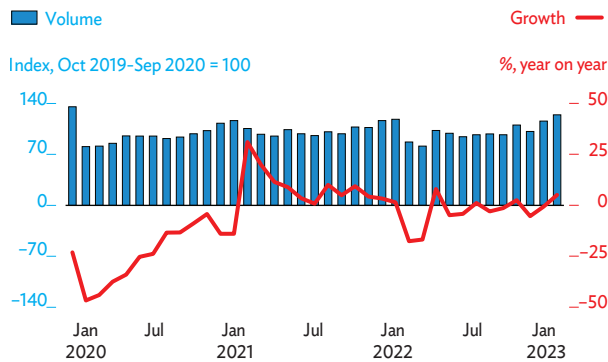
Growth declined last year on falling domestic and external demand.



Source: Census and Statistics Department.

Figure 2.9.2 Retail Sales

Retail sales dropped in 2022 on pandemic disruption.



Source: Census and Statistics Department.

External demand slumped as growth in advanced economies and the People’s Republic of China (PRC) softened.

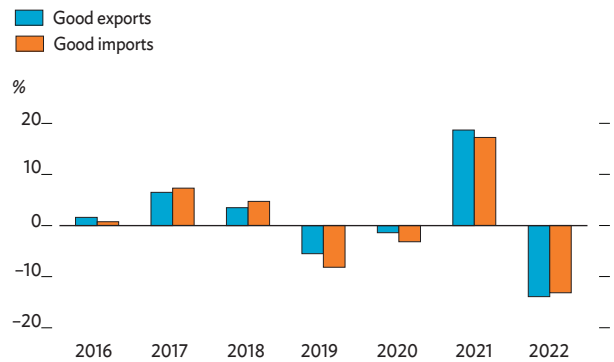
Exports of goods plummeted last year by 13.9% in real terms in an increasingly challenging global environment (Figure 2.9.3). Exports to the PRC declined even more, by 20.6%, stymied by cross-border truck movement disrupted primarily by strict pandemic containment measures. Exports to the US, the European Union, and other major Asian markets also declined. Service exports decreased by 0.9% as exports of financial, business, and other services contracted in line with weakened cross-border commerce and trade. Tourist arrivals increased by a factor of nearly six to 605,000 last year but remained far below the pre-pandemic annual average of 59 million in 2015–2019 (Figure 2.9.4). Meanwhile, softened domestic demand drove imports of goods down by 13.2% and of services by 1.0%. In sum, net exports subtracted 1.4 percentage points from growth.

Mirroring demand-side developments, output in most sectors declined in 2022.

The combined impact of pandemic restrictions, slower global growth, and worsened financial conditions battered nearly all economic activities. Services reversed 5.9% growth year on year in 2021 to contract by 3.0%. Import and export, wholesale, and retail trade slumped by 12.1%, and accommodation and food services by 10.9%. Expansion in manufacturing output ground to a halt, slowing from 5.5% in 2021 to 0.2% a year later. Construction bucked the trend, expanding by 4.9% in real terms.

Figure 2.9.3 Export and Import Growth

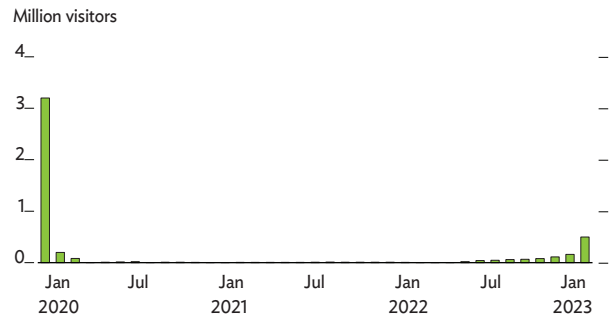
Exports deteriorated amid challenging external environment.



Source: Census and Statistics Department.

Figure 2.9.4 Tourism Indicators

Tourist arrivals increased in late 2022 but remained below pre-pandemic levels



Source: CEIC Data Company.

Headline consumer price inflation edged up from 1.6% in 2021 to 1.9% last year.

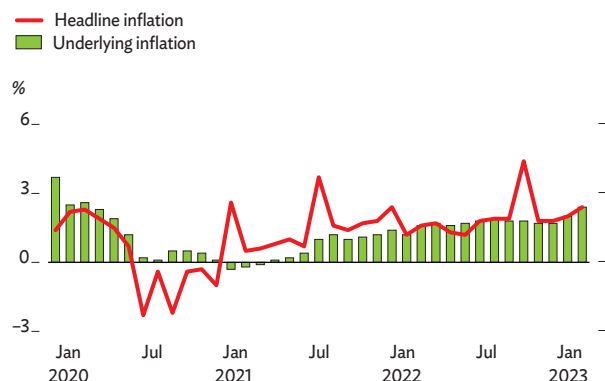
Pass-through from soaring global oil and gas prices was not substantial because of the low, 2.8% weight of energy (electricity, gas, and water) in the consumption basket. Additionally, low food inflation in the PRC was reflected in only moderate price increases for food imports as recession subdued domestic demand. Netting out the effects of all government one-off relief measures, the underlying inflation rate rose from an average of 0.6% in 2021 to 1.7% in 2022 (Figure 2.9.5). Meanwhile, the residential property price index retreated by 15.0% year on year in December and the property rental index by 4.1%.

The current account surplus equaled 10.7% of GDP in 2022.

A decline by 1.1 percentage points from 2021 reflected a larger trade deficit mostly offset by a higher service surplus. The overall balance of payments

Figure 2.9.5 Monthly Inflation

Inflation edged up on moderate increases in food and energy prices.



Source: CEIC Data Company.

deficit meanwhile ballooned from 0.3% of GDP in 2021 to 13.0% in the same period last year, driven by huge outflows from capital and financial accounts. Gross official reserves fell from \$496.9 billion in December 2021 to \$424.0 billion at the end of 2022. Net external financial assets amounted to 4.9 times GDP at the end of 2022, providing a strong cushion against external shocks.

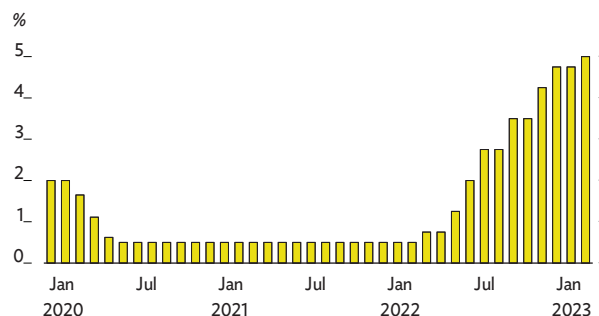
The budget deficit in fiscal year 2022 (FY2022, ended 31 March 2023) **is estimated to equal 4.9% of GDP.** This more than doubled the 1.9% originally planned. Expenditure was 0.3% higher than the original estimate, reflecting increased pandemic-related spending and massive countercyclical measures. Meanwhile, revenue was 15.7% lower than expected. Revenue from land premium and stamp duties declined significantly, owing to sluggish property and stock markets and fewer transactions.

Reflecting developments in the US, monetary policy tightened substantially in 2022. Following successive interest rate hikes by the US Federal Reserve, the Hong Kong Monetary Authority raised its base rate seven times last year to sustain the local dollar peg to the US dollar. The base rate increased from 0.50% in January to 4.75% in December, keeping the interest rate spread with the US Federal Funds rate constant at 50 basis points and the local dollar within the Linked Exchange Rate System tolerance band of HK\$7.75–HK\$7.85 to the US dollar (Figure 2.9.6).

Averaging 0.1% year on year, monthly growth in domestic credit flatlined, while broad money supply (M3) increased by only 1.6% in the year (Figure 2.9.7). Reflecting sharp monetary policy tightening by major central banks and slackening global growth, the local stock market suffered a marked correction last year. The Hang Seng Index plunged by 42.1% year on year to October 2022—to 14,687, the lowest since April 2019—as economic contraction depressed investor sentiment. It recovered strongly to 19,781 at year-end in December, and further to 21,842 in January 2023, on improved expectations following the PRC’s exit from its zero-COVID strategy (Figure 2.9.8).

Figure 2.9.6 Policy Rate

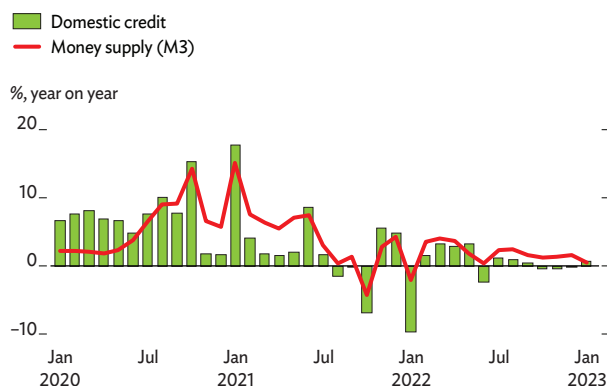
The base rate increased seven times in 2022 to keep the local dollar peg to the US dollar.



Source: CEIC Data Company.

Figure 2.9.7 Domestic Credit and Money Supply Growth

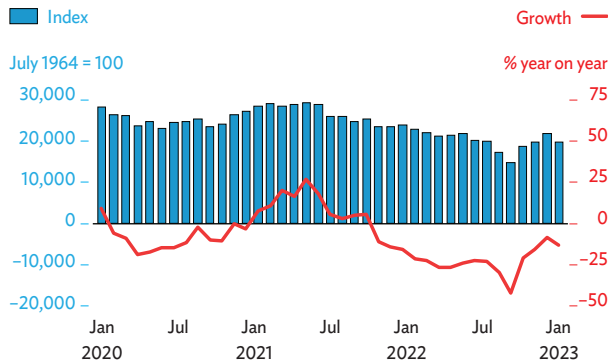
Growth in domestic credit slowed on tightened financial conditions.



Sources: CEIC Data Company and Hong Kong Monetary Authority.

Figure 2.9.8 Hang Seng Index

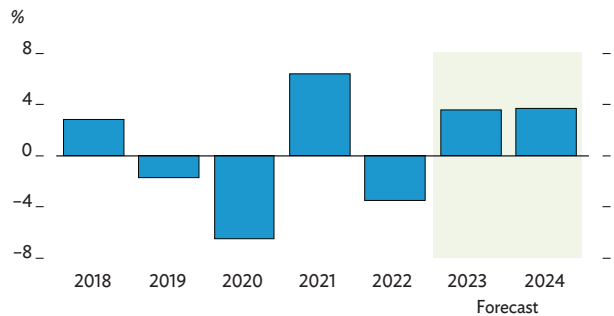
The local stock market suffered a marked correction amid tighter monetary policy.



Sources: CEIC Data Company.

Figure 2.9.9 GDP Growth

Growth will recover this year and next, buttressed by domestic demand and services.



Source: Asian Development Outlook database.

Economic Prospects

GDP growth is forecast to bounce back to 3.6% in 2023, buoyed by revived domestic demand and services (Table 2.9.1). Reopening and the boost from a growth rebound in the PRC should support economic activity this year despite a weak global environment and lingering uncertainty about pandemic developments. GDP is projected to expand further by 3.7% in 2024 as more favorable global and domestic conditions underpin the economy’s convergence with pre-2019 output (Figure 2.9.9).

Domestic demand is poised to recover, supported by a resilient labor market and improving business sentiment. The forecast assumes reopening fully accomplished in the first quarter of 2023, thus fostering robust resumption in economic activity this year. Private consumption will be the main driver of growth. Household incomes will benefit from rising employment and another round of consumption

Table 2.9.1 Selected Economic Indicators, %

Growth will pick up this year and next, while inflation will remain moderate.

	2021	2022	2023	2024
GDP growth	6.4	-3.5	3.6	3.7
Inflation	1.6	1.9	2.3	2.1

GDP = gross domestic product.

Source: Census and Statistics Department; Asian Development Bank estimates.

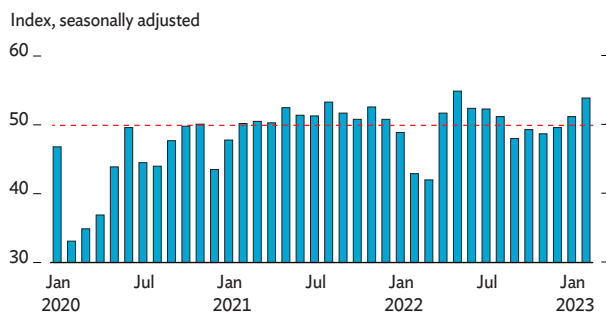
vouchers provided to eligible residents, while further relaxation of travel restrictions and containment measures will boost demand for consumer services. The labor market proved to be resilient as the seasonally adjusted unemployment rate improved to 3.3% in December 2022–February 2023, its best since November 2019. Fixed investment is seen to recover gradually on an improving business outlook. Official surveys indicated that, despite tightened financial conditions, one in five businesses in Hong Kong, China expected improved economic prospects in the first quarter of 2023. While a deteriorating external environment will continue to be a major drag on commodity exports in the first half of 2023, thereafter the anticipated acceleration of economic activity in the PRC and other major trade partners should provide some lift to the economy. Service exports are also projected to rebound alongside the pickup in growth. Tourist arrivals increased ninefold from December 2022 to February 2023 and are expected to gradually approach pre-pandemic levels this year and next. Imports of goods will rise as domestic demand continues to recover. Normalizing external and domestic conditions will sustain continued growth in domestic demand in 2024.

On the supply side, leading indicators show activity already expanding at the beginning of 2023.

Easing pandemic restrictions buoyed the composite purchasing managers’ index, a leading indicator of businesses’ expectation of growth, from 49.6 in December 2022 to 51.2 in January (Figure 2.9.10). This reading was the first since August 2022 above the threshold at 50 separating expansion from contraction.

Figure 2.9.10 Purchasing Managers' Index

PMI edged up in January 2023 on easing pandemic restrictions.



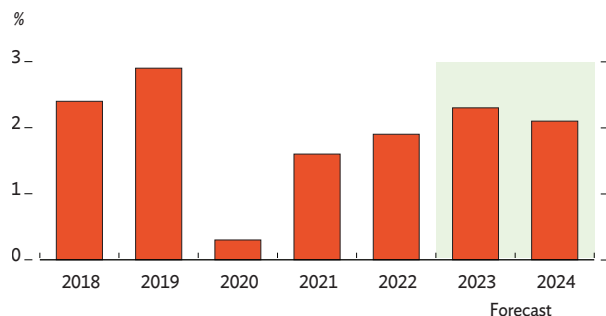
Source: CEIC Data Company.

Services, which provide 94% of GDP, will be the main engine of growth, with expansion in trade, financial, and professional services leading the recovery.

Headline inflation is forecast to average 2.3% in 2023 and 2.1% in 2024 (Figure 2.9.11). Price pressures will remain mild as the economy continues to operate below capacity and spillover from external price pressures remains largely contained. The rise in prices is expected to be gradual and broad based, with most consumer price index components picking up in tandem with the projected growth path.

Figure 2.9.11 Inflation

Inflation will remain low this year and next on muted price pressures.



Source: Asian Development Outlook database.

The FY2023 fiscal deficit is projected narrowing to equal 1.8% of GDP. Recurrent expenditure will increase by only 3.3%, mainly to support health care, social welfare, and education services. On the other hand, nonrecurrent expenditure will fall significantly by 53.0%, reducing total government expenditure by 6.0%

to the equivalent of 25.0% of GDP. Meanwhile, earnings and profits tax are forecast to increase by 6.4%, revenue from land premium by 20.0%, and revenue from stamp duty by 27.0%. In the medium term, the government plans to contain expenditure gradually from 25.0% of GDP in FY2023 to 22.0% in FY2027 and to raise revenue from 21.0% of GDP to over 23.0%. This is projected to raise fiscal reserves to the equivalent of 25.6% of GDP by the end of FY2027, or coverage for 14 months of government expenditure.

Risks to the outlook hinge on how global headwinds evolve, lingering pandemic uncertainty, and reopening in the PRC. Unexpectedly aggressive monetary tightening by the US Fed—and, by extension, the local monetary authority—would worsen the outlook, particularly through higher mortgage rates and their depressive effect on the housing market. Persistent residual pandemic restrictions and continued weakening in global growth also pose risks, as they could dent business and consumer confidence. On the upside, recovery in the PRC that outpaces expectations would boost the projected pickup in external demand and foster faster growth in Hong Kong, China.

Policy Challenge—Tax Reform to Address Medium-Term Challenges

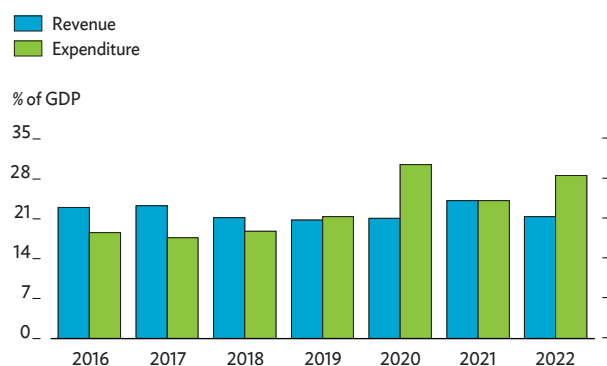
A simple and transparent low-tax system has been a key driver of economic success. According to accounting firm PricewaterhouseCoopers and the World Bank, Hong Kong, China had in 2020 the second most friendly tax system in the world, behind only Bahrain. A resident’s income from employment in Hong Kong, China is taxed at progressive rates from 2% to 17%, and income earned abroad is not subject to taxation. The corporate tax rate is either 8.25% or 16.5%, depending on how much income was earned in Hong Kong, China. No taxes are charged on capital gains, interest, or dividends, and there is no net-worth, public benefit, or sales tax.

While a low-tax environment has boosted competitiveness, it leaves fiscal revenue highly dependent on the business cycle. Indeed, fiscal revenue can be volatile and fall substantially in downturns. Economic downturns slashed tax revenue by 8.4% in FY2019 and 2.5% in FY2020 compared

with average tax revenue in FY2017 and FY2018. In contrast, a growth rebound in FY2021 boosted tax revenue by 10.7% (Figure 2.9.12). Partly because of uncertainty inherent in such revenue variability, the government follows a prudent fiscal approach. That is, public expenditure is allowed to increase only in line with fiscal revenue, aiming to maintain a balanced budget and substantial fiscal buffers. This strategy paid dividends during the pandemic as ample fiscal space allowed the government to provide significant support to the economy. However, two structural factors are likely to put pressure on public spending in the medium term.

Figure 2.9.12 Government Revenue and Expenditure

Government revenue increased in 2021 on robust economic growth.



Sources: Financial Services and the Treasury Bureau; The 2023-24 Budget Speech.

First, population aging will affect Hong Kong, China significantly in the coming years. Government demographic projections indicate that the share of the working-age population aged 15–64 will drop from 69% in 2022 to 64% in 2030 and further to 59% in 2050. Meanwhile, the share of people aged 70 and older will increase from 13% in 2022 to 19% in 2030 and further to 27% in 2050. With an older population, spending on pensions, health care, and other social services will have to increase.

Second, public expenditure to safeguard against adverse climate change and extreme weather is bound to increase. As a coastal city, Hong Kong, China is vulnerable to climate change in various ways. Extreme precipitation has become more frequent. Average annual temperatures increased by 0.28°C per decade during 1993–2022, while the average number of days with a maximum temperature reaching at least 33°C rose from 10 in 1981–2010 to 37 in the past 10 years. Relative to the average in 1995–2014, the annual mean sea level in 2100 is projected to rise by 0.37–0.82 meters under a scenario with intermediate greenhouse gas emissions and by 0.57–1.08 meters under very high emissions. While a green transition will provide opportunities to raise taxes, their potential benefit to the fiscal balance remains more uncertain so far than is the increased spending needed to mitigate and adapt to climate change.

A tax system structurally adjusted to increase revenue is needed to finance higher spending, sustain fiscal balance, and safeguard competitiveness. This challenge was recognized in the FY2022 budget, which highlighted broadening the tax base as the main pillar of tax reform. In this respect, the proposed introduction of a progressive rating system for domestic properties, whereby higher-valued properties pay higher rates, is a step in the right direction and would structurally increase tax revenue. The introduction of the global minimum effective tax rate on large multinational enterprise groups as advocated by the Organisation for Economic Co-operation and Development (OECD) and the implementation of the domestic minimum top-up tax should also have positive effects. As suggested by the International Monetary Fund, other alternatives include introducing a value-added tax, increasing personal income tax rates for the top brackets, and taxing capital gains and dividends. Hong Kong, China will need to strike the right balance when changing its tax system. Designing and implementing comprehensive tax reform will be key to ensuring fairness, fiscal sustainability, and competitiveness.

MONGOLIA

Economic growth rebounded in 2022 despite exogenous shocks. Inflation accelerated further to its highest since 2008, and the current account deficit continued to widen. Growth will accelerate in 2023 and 2024 as exports recover and impacts from exogenous shocks wane. Inflation will moderate on reduced risk of trade disruption, and the current account deficit will narrow in both years as exports increase. Mongolia needs investment climate reform to ensure sustainable growth.

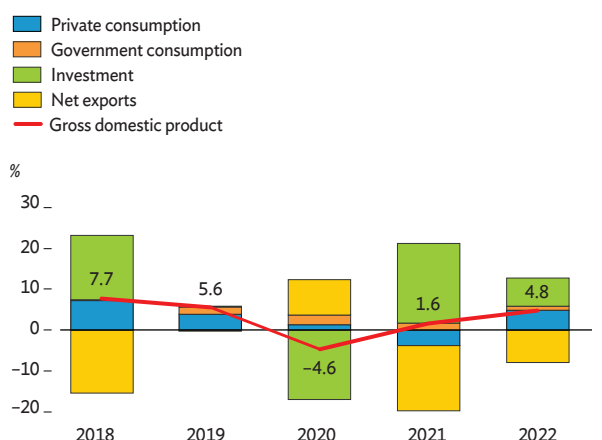
Economic Performance

Driven by domestic demand, the economy recovered in 2022. Despite considerable stress and uncertainty arising from exogenous shocks, most notably restrictions on the border with the People's Republic of China (PRC) and effects stemming from the Russian invasion of Ukraine, GDP expanded by 4.8% in 2022, following deep economic contraction by 4.6% in 2020 and sluggish growth by 1.6% in 2021. Domestic demand recovered following full reopening of the domestic economy in February 2022 with the lifting of all pandemic-related restrictions, as well as from continued fiscal and monetary stimulus. Cash transfers promoted household consumption, which contributed 4.8 percentage points to growth. Investment grew by 15.5% and contributed 6.9 points to growth, supported by monetary stimulus through long-term repo operations, private outlays, and 25.1% growth in budgetary capital spending. Government consumption increased by 5.4% but contributed a mere 1.1 points. Net exports dragged growth down by 8.0 points as the current account deficit increased by 25.8%, primarily on 30.0% higher imports of goods and services, outpacing export growth at 22.2% (Figure 2.10.1).

The service sector expanded for a second consecutive year with growth in 2022 at 6.4%, surpassing its pre-pandemic value and contributing 3.4 percentage points to growth.

Figure 2.10.1 Demand-Side Contributions to Growth

Investment and household consumption were major drivers of growth.

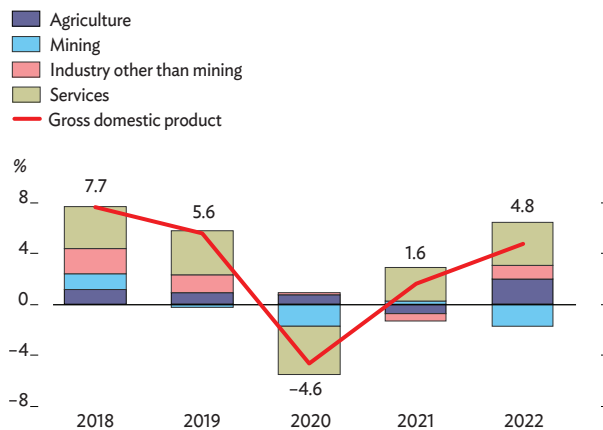


Sources: National Statistics Office of Mongolia, Statistical Information Services; Asian Development Bank estimates.

Agriculture and industry other than mining rebounded from severe contraction in 2021 to grow by 13.0% and 7.1%, respectively, together contributing 3.1 points. However, constrained by COVID-19, mining contracted by 11.1% in 2022, dragging growth down by 1.7 points (Figure 2.10.2).

Figure 2.10.2 Supply-Side Contributions to Growth

Economic recovery in 2022 was supported by agriculture, services, and industry other than mining.



Note: Industry other than mining includes construction, manufacturing, and electricity production.

Sources: National Statistics Office of Mongolia, Statistical Information Services; Asian Development Bank estimates.

Inflation hit a 14-year high despite monetary tightening.

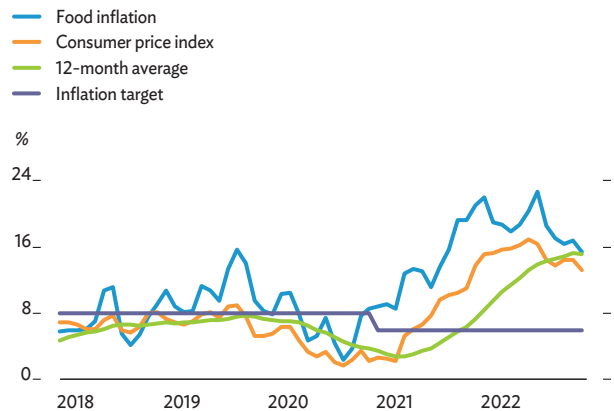
Average consumer price inflation more than doubled from 7.3% in 2021 to 15.2% in 2022, with prices 13.2% higher in December 2022 than a year earlier. Significant drivers of inflation were high food and fuel prices. Average food price inflation soared from 13.8% in 2021 to 18.6% in 2022. Factors affecting prices included supply shocks associated with trade disruption caused by COVID-19 and the Russian invasion of Ukraine, currency depreciation, imported inflation, and, more recently, demand-pull inflation following a return to growth in private and public consumption (Figure 2.10.3).

The fiscal balance improved in 2022 with higher revenue mobilization.

Expenditure growth by 16.5% was outpaced by budget revenue lifted by 30.4% with increased receipts from value-added tax, social insurance, income tax, and royalties and other receipts from the mineral industry, which benefitted from high commodity prices. The ratio of tax revenue to GDP increased significantly from 22.7% in 2020 to 29.4% in 2022, the highest since 2007. The primary fiscal balance recorded a surplus equal to 2.3% of GDP, and the overall surplus 0.8%. The structural fiscal deficit narrowed by 66.3% to equal 1.9% of GDP, less than half of the cap stipulated by parliament (Figure 2.10.4).

Figure 2.10.3 Inflation

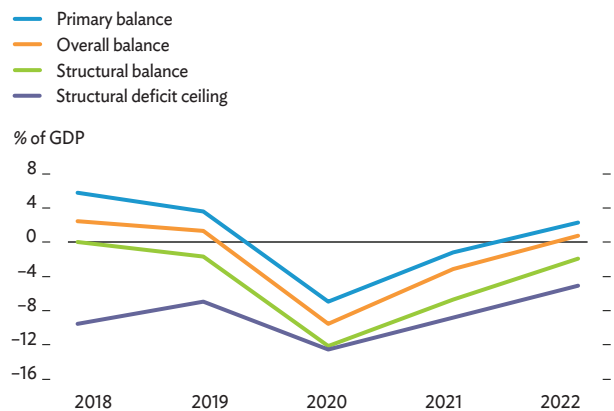
Consumer price inflation hit a 14-year high in 2022.



Sources: National Statistics Office of Mongolia. Statistical Information Services; Parliament Resolutions on Monetary Policy Guidelines, 2015–2022; Asian Development Bank estimates.

Figure 2.10.4 Government Budget

The primary and overall fiscal balances recorded surpluses.



GDP = gross domestic product.

Notes: The primary balance is the gap between revenue and expenditure, adjusted by interest expenditure. The structural balance is the gap between expenditure and the revenue, adjusted by savings in the Fiscal Stabilization Fund, and Future Heritage Fund, the ceiling for which is set by the Fiscal Stability Law but subject to parliamentary amendment.

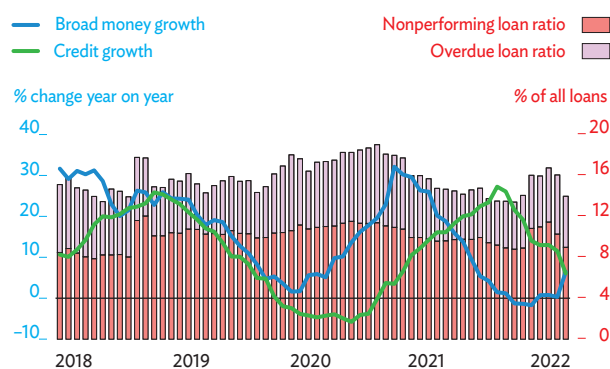
Sources: National Statistics Office of Mongolia, Statistical Information Services; Parliament resolutions on government budget, 2015–2022; Asian Development Bank estimates.

Public debt including central bank external liabilities decreased by 6.0 percentage points to equal 73.3% of GDP, 3.8 points lower than the ratio before the pandemic. In that time, central bank external liabilities fell by 16.6% and nominal GDP rose by 21.4%.

Monetary policy was tightened in 2022 in response to persistently high inflation and pressure on the balance of payments. The Bank of Mongolia, the central bank, increased the policy rate from 6.0% in December 2021 to 13.0% in December 2022 and tapered its liquidity support and its sectoral lending intended to ensure energy, foreign reserve, and food security. Bank credit growth slowed by 14 percentage points to 6.0% in 2022, but broad money supply increased by 6.5%. The value of nonperforming loans decreased by 2.6% but remained 11% above their 2019 value. Their ratio to all loans declined marginally to 9.0% (Figure 2.10.5).

Figure 2.10.5 Money and Credit

Credit growth moderated in line with monetary tightening throughout 2022.



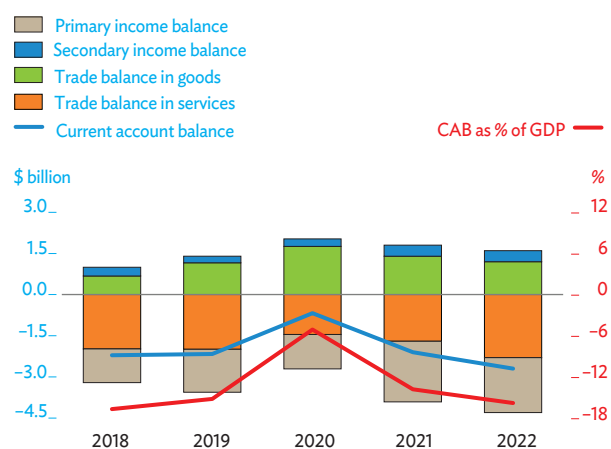
Sources: Bank of Mongolia. *Monthly Statistical Bulletin and Banking Sector Consolidated Balance Sheet*; Asian Development Bank estimates.

Exogenous shocks intensified pressure on the balance of payments. The current account deficit expanded by 25.8% to equal 15.8% of GDP as imports of goods increased by 27.6%, outpacing 20.4% growth in exports and thus lowering the merchandise trade surplus to the equivalent of 6.9% of GDP. The service deficit expanded by 34.9%, but the deficit in income balance improved by 13.5%, mainly on lower expatriation of investment income (Figure 2.10.6). The financial account surplus remained flat in 2022, and the overall balance of payments recorded a deficit of \$727 million. Foreign exchange reserves decreased by 22.1% to \$3.4 billion, or cover for 3.4 months of imports of goods and services, 2.3 months less than in 2021 (Figure 2.10.7).

Despite high inflation, the Mongolian togrog had depreciated in real effective terms year on year by 5.6% as of December 2022 because of 12.0% depreciation in nominal effective terms. Despite the central bank repeatedly intervening in the foreign exchange market to smooth exchange rate volatility, the togrog depreciated by 20.9% against the US dollar in 2022 (Figure 2.10.8).

Figure 2.10.6 Current Account Balance

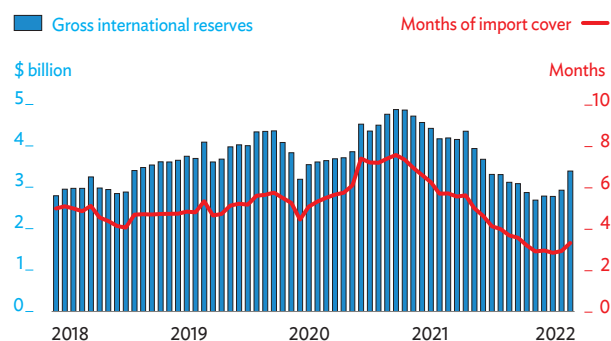
Balance of payment pressures persisted as the current account deficit continued to widen.



CAB = current account balance, GDP = gross domestic product.
Sources: Bank of Mongolia. Balance of payments statistics; Asian Development Bank estimates.

Figure 2.10.7 Gross International Reserves

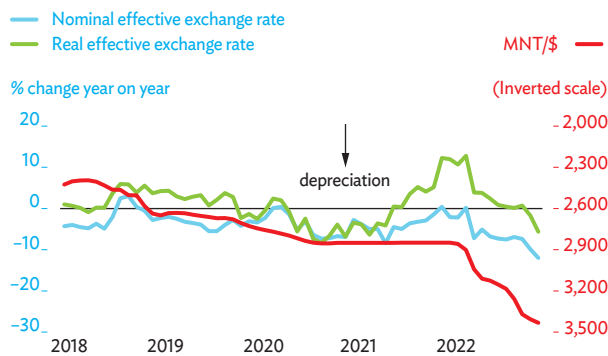
Foreign exchange reserves bottomed out in August 2022, but they have since stabilized and then rebounded.



Sources: Bank of Mongolia. *External sector statistics*; Asian Development Bank estimates.

Figure 2.10.8 Exchange Rates

The togrog depreciated in 2022 in both nominal and real effective terms.



Sources: Bank of Mongolia. Monthly Statistical Bulletin; Asian Development Bank estimates.

Economic Prospects

The economy is transitioning to post-pandemic expansion. The PRC's recent economic reopening, robust demand for mineral commodities, and a comparatively stable outlook for coking coal and base metal prices are easing economic uncertainty, boosting economic confidence, and changing previous gloomy growth expectations despite tightened financing conditions globally and domestically. The reopening of the PRC economy will revive the Mongolian economy, notably through export and tourism recovery and lessened risk of trade disruption. Moreover, international reserves started to rise from August 2022, and the government has successfully refinanced maturing sovereign bonds and maintained access to international capital markets.

Growth is forecast to rise to 5.4% in 2023 and 6.1% in 2023, assuming no new exogenous shocks. Economic expansion will be driven by the completion of the Oyu Tolgoi underground mine development project in 2023, recovery in mining, and positive spillover to transport and other pursuits. Consumer spending will be dampened by tightened monetary policy and a resumption of home mortgage repayments since the beginning of this year. The contribution of private consumption to growth will be lower this year before increasing next year, assuming monetary tightening gives way to gradual easing as inflation recedes, and that growth in consumer credit accelerates in 2024.

The contribution of investment to growth will also be tamped down this year as bank credit to businesses will grow only moderately as bank lending becomes more cautious in the runup to expected initial public offerings of the remaining three systemically important banks by the end of June 2023. Fiscal policy will remain expansionary. The 2023 budget has capital expenditure growing by 24.5%, despite no new capital projects financed or implemented in 2023, and all expenditure growing by 14.3%. The government plans to increase spending in 2024 on the assumption of strong revenue. Net exports will contribute to growth this year and next as import growth is outpaced in both years by exports expanding on increased exports of coal, copper concentrate, iron ore, and crude oil, and on the expansion of copper production from the Oyu Tolgoi mine. Exports should be facilitated by a more efficient transport and logistics system, including new railways built for transporting coal from mines to border crossing points, automated customs clearing, and coal sales based on a competitive bidding process.

Inflation will moderate in both years, and the current account deficit is expected to narrow. Average inflation will moderate to 10.9% in 2023 and 8.7% in 2024 as supply shocks and trade disruption risk wane (Table 2.10.1). However, it will still exceed the central bank target of 6%, mainly on pass-through of togrog depreciation and revived domestic demand. More aggressive fiscal consolidation will support the external balance and reduce how much tight monetary policy crowds out the private sector. The current account deficit is projected to diminish in both years mainly as merchandise exports increase and the service deficit narrows with lesser trade disruption, consequently lower risk premiums for shippers, and lower transportation service charges.

Table 2.10.1 Selected Economic Indicators, %

Growth will rise and inflation will moderate.

	2021	2022	2023	2024
GDP growth	1.6	4.8	5.4	6.1
Inflation	7.3	15.2	10.9	8.7

GDP = gross domestic product.

Sources: National Statistics Office of Mongolia. Statistical Information Services; Asian Development Bank estimates.

There are downside risks to the outlook. They include a worsening situation regarding the Russian invasion of Ukraine, new COVID-19 variants or waves, a significant commodity price correction, domestic political risks, and the adverse implications of offtake barter agreements, whereby development projects such as railway construction, for example, are financed and implemented by local contractors and foreign coal importers, who the major state-owned coal exporter repays through future coal contracts and proceeds. These contracts are insufficiently transparent and can reduce proceeds from coal exports.

Policy Challenge—Designing and Implementing Investment Climate Reform

Growth depends heavily on foreign direct investment (FDI), but this is likely to fall in 2024.

Mining and the broader extractive industry has been a key driver of economic growth, but its business cycle is highly volatile because it depends on FDI and PRC demand for minerals. Indeed, 72.8% of FDI stock was in mining and other extractive industries in 2010–2022. FDI peaked at the equivalent of 43.1% of GDP in 2011, slumped in 2013–2016, and historically has been key to financing a persistent deficit in the current account. Absorbing 50%–90% of net FDI annually since 2010, Oyu Tolgoi, one of the world's largest copper mines, will complete its underground mine project in 2023. Investment outside of mining with more potential to create jobs is insignificant, posing a major challenge to export and economic diversification.

Several major constraints degrade Mongolia's investment climate. They include (i) macroeconomic risks in a volatile business environment in which GDP growth fluctuated from 17.3% expansion in 2011 to 4.6% contraction in 2020, as well as a deteriorating ranking for ease of doing business since 2017; (ii) policy procyclicality and instability; (iii) a lack of good governance, with a regulatory quality index historical showing negative values except in 2018 and 2019; (iv) underinvestment in infrastructure and logistics; (v) skill mismatch in the labor market; (vi) poor investment promotion and protection; (vii) an uneven playing field for businesses caused by public intervention in markets; and (viii) climate risks.

Mongolia needs to design and implement comprehensive investment climate reform.

This is essential to sustain economic growth over the medium term and create an enabling environment for development led by the private sector. The government has initiated some measures to improve the investment climate. It has formed an agency to encourage foreign investment and trade and established a working group to improve the legal environment. These measures should be strengthened by a more comprehensive, practical, and targeted action plan that includes the following pillars: (i) fully operationalizing the newly established trade and investment agency to set specific targets for attracting, promoting, retaining, and protecting FDI; (ii) revising the Investment Law to improve the legal and regulatory environment and to ensure investment protection; (iii) improving Mongolia's indicators for governance, government effectiveness, the business environment, and logistics performance; (iv) developing a credible commitment to combating corruption at all levels and ensuring that all public institutions maintain high standards of governance; (v) proactively investing in infrastructure, health, education, and the environment; and (vi) promoting industries with export potential and mobilizing green finance. Working groups should be established to thrash out the details under each of these reform headings and action plans for their implementation.

PEOPLE'S REPUBLIC OF CHINA

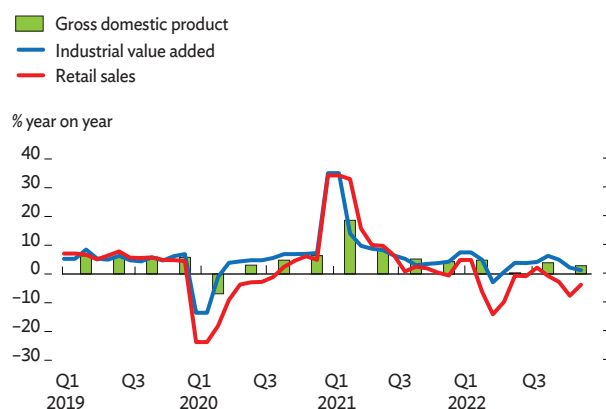
Economic growth is forecast to pick up in 2023 as household demand recovers following the lifting of COVID-19 restrictions, then moderate in 2024. Consumer price inflation is expected to stay subdued in 2023 and 2024 because pass-through from higher producer prices has become less likely. Boosting long-term potential growth is a policy challenge, calling for structural reform to allocate capital and credit more efficiently, address demographics, strengthen human capital, and raise productivity.

Economic Performance

Growth slowed to 3.0% in 2022 after strong economic recovery in 2021. Affected by COVID-19 lockdowns, GDP growth in the People's Republic of China (PRC) dipped twice in 2022: from 4.8% in the first quarter (Q1) to 0.4% in Q2, and from 3.9% in Q3 to 2.9% in Q4 (Figure 2.11.1).

Figure 2.11.1 Real Economic Growth

After strong recovery in 2021, economic growth slowed notably in 2022.



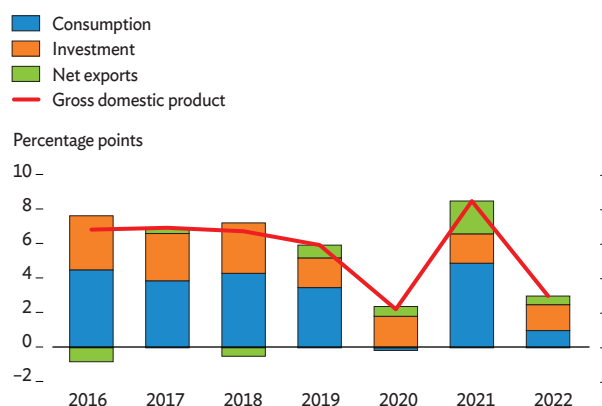
Q = quarter.

Sources: CEIC Data Company; Asian Development Bank estimates.

On the demand side, investment was the key driver of growth in 2022. Investment contributed 1.5 percentage points to the growth, 0.2 points lower than a year earlier (Figure 2.11.2).

Figure 2.11.2 Demand-Side Contributions to Growth

Investment was the key driver of growth in 2022, while the contribution of net exports moderated.

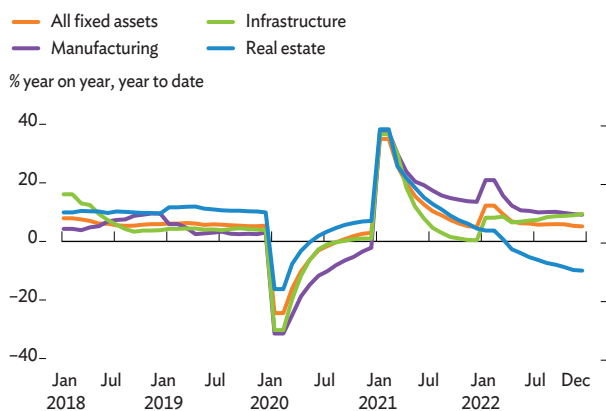


Source: CEIC Data Company.

Nominal fixed asset investment grew by 5.1%, up from 4.9% in 2021 (Figure 2.11.3). Contraction in real estate investment was offset by solid growth in manufacturing and infrastructure investment. Infrastructure investment surged on strong government support and expanded by 9.4% in 2022, up from only 0.4% in 2021. While manufacturing investment increased by 9.1%, a downturn in the property market brought contraction by 10.0% in real estate investment (see discussion in *Asian Development Outlook 2022 Update*).

Figure 2.11.3 Growth in Fixed Asset Investment

Infrastructure investment surged in 2022 while real estate investment contracted.



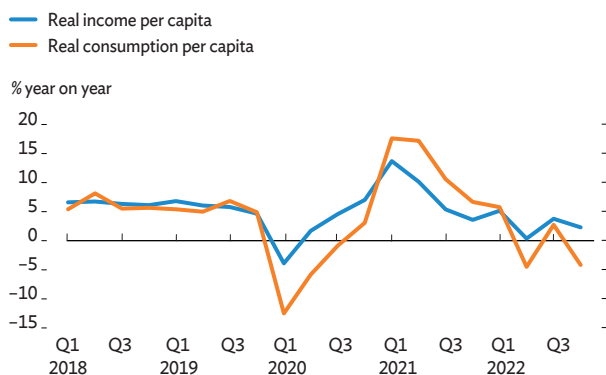
Source: CEIC Data Company.

Contributions to growth from consumption and net exports eased.

COVID-19 lockdowns slashed the contribution of consumption to growth from 4.9 percentage points in 2021 to 1.0 point a year later, in line with weaker real household consumption and retail sales. While real growth in household income moderated from 8.1% in 2021 to 2.9% in 2022, household consumption plunged from 12.6% expansion in real terms in 2021 to 0.2% contraction in 2022 (Figure 2.11.4). Retail sales are estimated to have fallen in real terms by more than 10 percentage points for contraction by 2.8% in 2022. Meanwhile, net exports' contribution to growth eased from 1.9 percentage points in 2021 to 0.5 points in 2022, reflecting lower trade growth.

Figure 2.11.4 Growth in Income and Consumption Expenditure per Capita

Income grew slowly while consumption plunged in 2022.



Q= quarter.

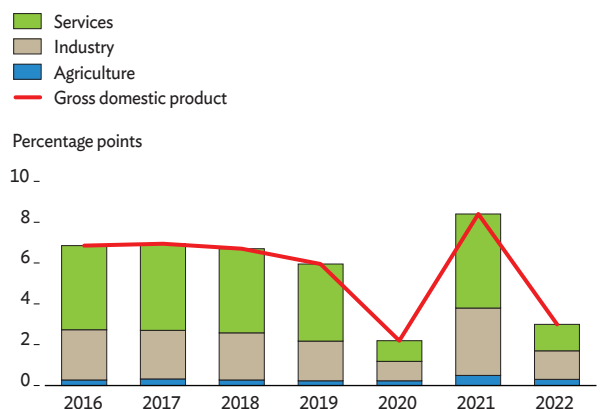
Sources: CEIC Data Company; Asian Development Bank estimates.

On the supply side, the secondary sector became the main contributor to growth.

It increased by 3.8% in real terms in 2022, contributing 1.4 points to GDP growth (Figure 2.11.5). Growth in industry slowed from 10.4% in 2021 to 3.4% in 2022 as export growth slowed, while construction expanded by 5.5%, driven up from 1.1% a year earlier by high infrastructure investment.

Figure 2.11.5 Supply-Side Contributions to Growth

Reflecting renewed COVID-19 lockdowns, supply-side contributions to growth in 2022 resembled those in 2020.



Source: CEIC Data Company.

Services were hit hard by the pandemic.

Growth in services decelerated from 8.5% in 2021 to 2.3% in 2022, contributing 1.3 percentage points to growth. Service growth was dragged down mainly by a 5.1% decline in real estate services and declines in accommodation and catering by 2.3% and in transportation by 0.8%, reflecting COVID-19 restrictions. Information technology, up by 9.1%, and financial services, up by 5.6%, were the main growth drivers. Agriculture growth moderated from an exceptionally high 7.1% in 2021 to 4.1% in 2022, contributing 0.3 percentage points to growth, which was 0.2 points lower than a year earlier.

The labor market weakened in 2022, particularly for youth.

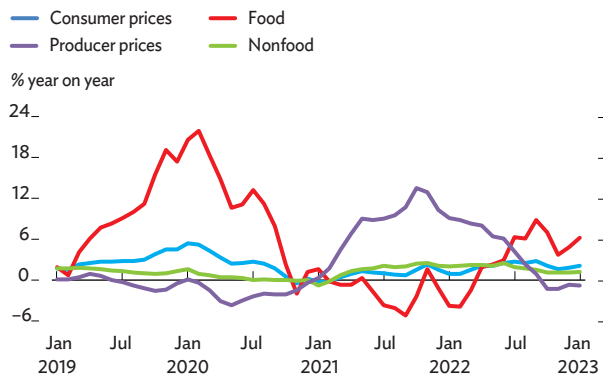
The labor market faced several headwinds in 2022: Frequent but unpredictable lockdowns and resulting economic downturns prompted firms to delay hiring. Tighter regulation of technology, education, and property enterprises also weighed on the labor market. While the surveyed urban unemployment rate retreated from its peak of 6.1% in April 2022 to 5.5% in December, the unemployment rate for youths aged 16–24 reached a record high of 19.9% in July 2022, decreasing to 16.7% in December. The number of rural labor migrants

working in urban areas remained virtually unchanged at 172 million at the end of 2022, still more than 2 million fewer than at the end of 2019, before the pandemic.

Consumer price inflation and producer price inflation showed diverging trends. Consumer price inflation averaged 2.0% in 2022, up from 0.9% in 2021, as food prices increased by 2.9%, driven mainly by higher prices for fresh fruit (Figure 2.11.6). In contrast, producer price inflation averaged 4.2% in 2022 while on a declining trend, even reaching negative territory in Q4. Prices for newly constructed homes in the top 70 cities declined by 1.0% on average in 2022, with prices in tier-3 cities declining the most and those in top-tier cities remaining resilient (Figure 2.11.7).

Figure 2.11.6 Monthly Inflation

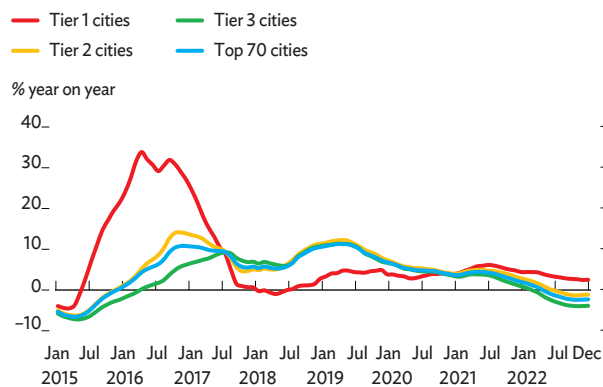
Consumer price inflation edged up, while producer price inflation came down.



Source: CEIC Data Company.

Figure 2.11.7 Prices for Newly Constructed Homes

Housing prices were on a declining trend in 2022, with prices in tier-3 cities declining the most.



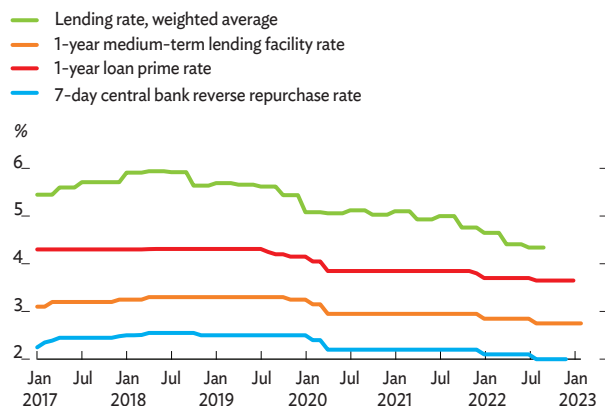
Note: Tier-1 cities are Beijing, Guangzhou, Shanghai, and Shenzhen; tier 2 has 31 provincial capitals and larger municipalities; and tier 3 has 35 other cities.

Sources: CEIC Data Company; Asian Development Bank estimates.

Monetary policy gradually eased as key policy rates were trimmed. The People’s Bank of China, the central bank, cut the 1-year medium-term lending facility rate twice by 10 basis points each time to 2.75% in August 2022 (Figure 2.11.8). As a result, the 1-year loan prime rate moderated from 3.80% at the end of 2021 to 3.65% a year later. To support the stressed real estate sector, the 5-year loan prime rate used for mortgage pricing was reduced twice in 2022 by a total of 30 basis points to 4.30%. In addition, the required reserve ratio for commercial banks was cut twice to free up more funds for lending.

Figure 2.11.8 Banking Lending and Policy Rates

Monetary policy gradually eased as key policy rates were trimmed.

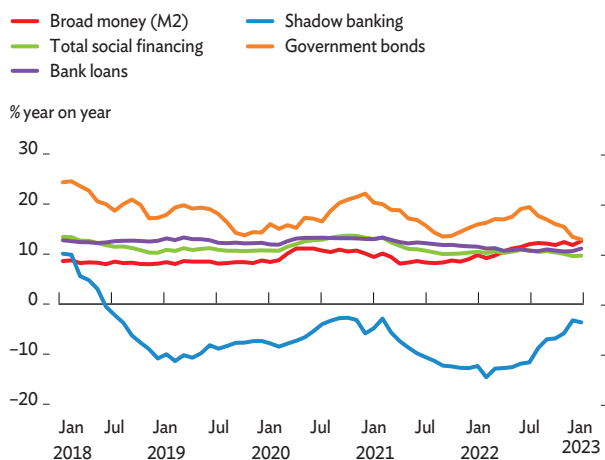


Source: CEIC Data Company.

Despite moderate monetary policy loosening, credit expansion softened. With the property market downturn, repeated lockdowns, and a surge in new COVID-19 infections toward the end of the year, growth in total social financing, a broad credit aggregate, slowed. The amount outstanding grew by 9.6% at the end of 2022, down from 10.3% a year earlier (Figure 2.11.9). Shadow bank finance outstanding declined by 3.2%, while bank loans outstanding increased by 10.6% and government bonds outstanding rose by 13.4% as the government stepped up infrastructure investment to support economic growth. Broad money (M2) increased by 11.8% in 2022, up from 9.0% a year earlier.

Figure 2.11.9 Growth in Credit Outstanding, Government Bonds Outstanding, and Broad Money

Despite some monetary policy easing, growth in bank loans eased in 2022.



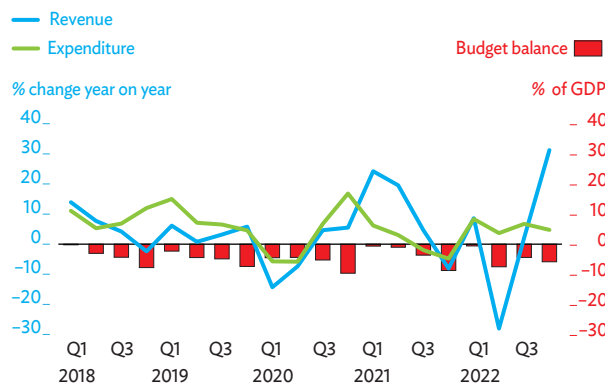
Note: Shadow banking comprises entrust loans, trust loans, and banks' acceptance bills.

Sources: CEIC Data Company; Asian Development Bank calculations.

Fiscal policy support for the economy increased in 2022. The annual budget deficit widened from the equivalent of 3.8% of GDP in 2021 to 4.7% in 2022 (Figure 2.11.10).

Figure 2.11.10 General Government Fiscal Revenue and Expenditure

Fiscal revenue growth fluctuated in 2022, while expenditure growth was comparatively steady.



GDP = gross domestic product, Q = quarter.

Note: Public finance budget only.

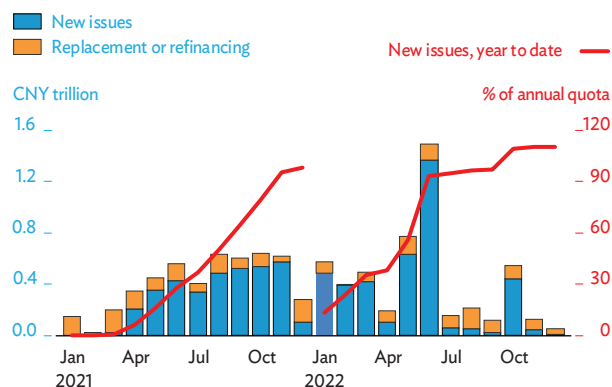
Sources: CEIC Data Company; Asian Development Bank calculations.

Constrained by COVID-19 lockdowns and value-added tax credit refunds, which drove down tax revenue by 3.5%, general government fiscal revenue increased by only 0.6%, with nontax revenue higher by 24.4%. Meanwhile, fiscal expenditure grew by 6.1%

as the government increased spending on health, which expanded by 17.8%, and on social security and employment, which grew by 8.1%. New local government special bonds issued amounted to CNY4.04 trillion by the end of 2022, exceeding the annual quota as the central government approved in August CNY500 billion in additional new local government special bonds (Figure 2.11.11).

Figure 2.11.11 Local Government Special Bond Issues

New special bond issues soared to finance infrastructure investment in 2022.

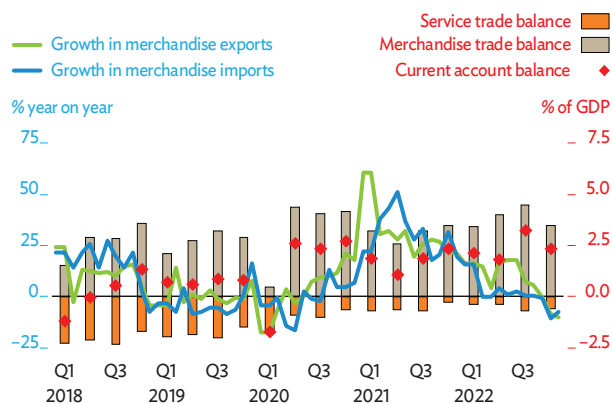


Sources: CEIC Data Company; Asian Development Bank calculations.

The current account improved notably in 2022. The current account surplus increased from the equivalent of 1.8% of GDP in 2021 to 2.3% in 2022 as the merchandise trade surplus expanded while the service deficit narrowed (Figure 2.11.12).

Figure 2.11.12 Current Account Balance and Merchandise Trade

Trade growth slowed notably as global demand weakened in 2022.



GDP = gross domestic product, Q = quarter.

Note: January and February data are combined to exclude the Lunar New Year effect.

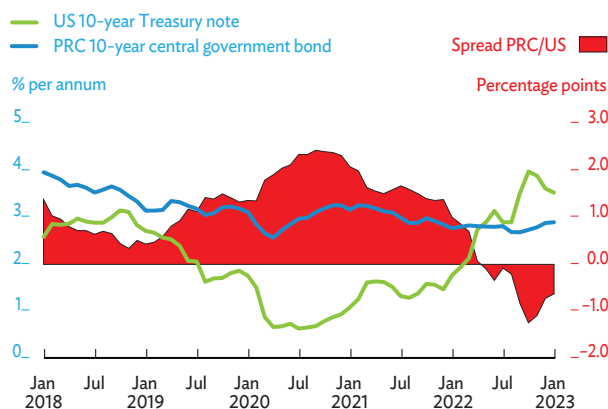
Sources: CEIC Data Company; Asian Development Bank calculations.

Merchandise exports rose by 4.6% in US dollar terms after expanding by 28.1% in 2021, while import growth fell from 32.7% to 1.0%, reflecting weak domestic demand due to the pandemic and weakening export demand. Geographically, export growth to the PRC's major trade partners moderated in line with their growth slowdown and softening consumer demand. Following double-digit gains in 2021, export growth to the European Union moderated in 2022 to 8.3%, Japan to 4.3%, and the US to 0.9%, while exports to Southeast Asia grew by a solid 18.1%.

Net portfolio investment reversed direction, and net foreign direct investment (FDI) decreased in 2022. Under tightening US monetary policy, the 10-year US Treasury note yield rose sharply in 2022 (Figure 2.11.13), triggering non-FDI capital outflow from the PRC. In the first 3 quarters of 2022, net portfolio investment outflow reached \$260.6 billion, reversing net inflow worth \$14.4 billion during the same period of the previous year. In addition, the PRC attracted less net FDI in 2022 than in 2021 (Figure 2.11.14). Net FDI fell by a percentage point from the equivalent of 1.2% of GDP in 2021 to 0.2% a year later. Reserve assets decreased by \$120.4 billion to stand at \$3.31 trillion at the end of 2022.

Figure 2.11.13 Government Bond Yields

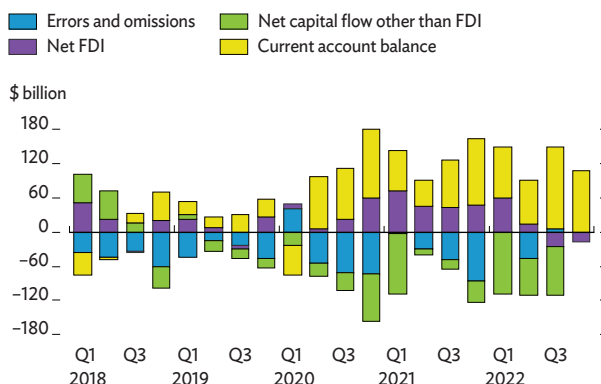
The tightening of US monetary policy saw the yield spread reverse in May 2022.



PRC = People's Republic of China, US = United States.
 Note: Yields are monthly averages.
 Sources: CEIC Data Company; Asian Development Bank calculations.

Figure 2.11.14 Balance of Payments

The current account surplus increased significantly, but net capital outflow was high in 2022.



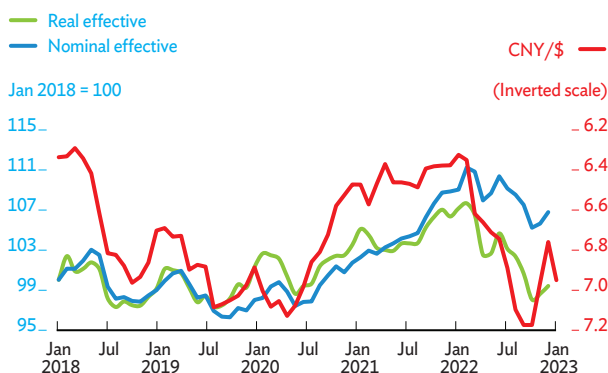
FDI = foreign direct investment, Q = quarter.
 Note: Only current account balance and net FDI data available for Q4 2022.
 Sources: CEIC Data Company; Asian Development Bank calculations

The renminbi depreciated against the US dollar in most of 2022 before recovering toward year-end.

The renminbi depreciated by 9.2% against the US dollar over the course of 2022 (Figure 2.11.15). Besides the economic slowdown, renminbi depreciation reflected mainly US dollar strengthening as the US tightened monetary policy. The renminbi recovered against the US dollar toward the end of the year, after the government ended COVID-19 restrictions. In nominal effective terms, against a trade-weighted basket of currencies, the renminbi depreciated by 2.9% in 2022. In real effective terms, taking into account inflation, it depreciated by 7.9% in the same period.

Figure 2.11.15 Renminbi Exchange Rates

The renminbi depreciated against the US dollar in most of 2022 before recovering toward the end of the year.



Sources: CEIC Data Company; Asian Development Bank calculations.

Economic Prospects

Growth is forecast to recover in 2023. Consumer demand is expected to pick up after the lifting of COVID-19 restrictions in December 2022. At the same time, possible new spikes in COVID-19 infections after the end of pandemic restrictions could still undermine household demand. Consequently, ongoing fiscal spending, most notably infrastructure investment, will continue to be needed in the short run to catalyze economic recovery, particularly against the backdrop of a cooling global economy, which will suppress demand for PRC exports. Factoring in continued policy support, GDP is forecast to grow by 5.0% in 2023 on cyclical recovery in household demand before easing to 4.5% in 2024 as consumption fades (Table 2.11.1).

Domestic demand is expected to recover. Given the reluctance of households to spend over the past 3 years owing to pandemic-related uncertainty, it may take time for consumer demand to revive fully. Further, some households, especially those less well-off, may have drawn down their savings during the pandemic, which may draw out recovery in household consumption. At the same time, household deposits surged in 2022, increasing the potential for a revival in household consumption as consumer confidence recovers alongside higher economic growth. The government has already started loosening housing market policies to support economic recovery, but further relaxation may be needed to turn around the property market. This, together with continued growth in infrastructure investment, would support economic growth in the short run. At the same time, external demand may ease in 2023 as growth in advanced economies cools.

On the supply side, services are expected to pick up as consumer demand recovers. Accommodation and catering, transportation, and tourism will benefit from the lifting of pandemic restrictions. Given the likely weakening of external demand in 2023, manufacturing should expect to face headwinds from moderating exports, but construction will benefit from the recent loosening of housing market restrictions, and from further loosening likely to come. Improvement in the housing market will not only help retail sales by boosting demand for housewares, furniture, and home appliances but also boost consumer confidence, dragging up services in its slipstream. Agriculture, meanwhile, is expected to grow steadily.

Table 2.11.1 Selected Economic Indicators, %

Economic growth is expected to recover in 2023, while inflation should stay moderate.

	2021	2022	2023	2024
GDP growth	8.4	3.0	5.0	4.5
Inflation	0.9	2.0	2.2	2.0

GDP = gross domestic product.

Sources: CEIC Data Company; Asian Development Bank estimates.

The labor market should benefit from the lifting of pandemic restrictions. In addition, the tight regulation of technology, education, and property sectors that weighed on the labor market in 2022 will likely be finetuned, which should help the labor market. However, labor absorption remains a challenge as a record high of 11.6 million new college and university graduates are expected to enter the job market in 2023.

Consumer price inflation is expected to stay moderate. Pass-through from producer to consumer prices has become much less likely since producer prices started to ease in Q4 2022. Service prices look set to pick up, driven by higher household demand. Nonfood inflation may edge up as household consumption recovers in 2023, but from a low base. In sum, inflation pressure should stay low overall. Inflation is forecast at 2.2% in 2023 before easing to 2.0% in 2024 in line with lower economic growth.

Monetary policy is expected to ease marginally in 2023 to support economic recovery. The recent strengthening of the renminbi provides some room for policy easing. At the same time, though, any further tightening of monetary policy in advanced economies in 2023 would limit space for substantial cuts to key policy rates. Company profits have suffered during the past 3 years from pandemic restrictions, and many micro and small service businesses were hit hard. It will be crucial that banks support smaller businesses that stand to profit from a recovery in household consumption.

Slow credit growth may weigh on recovery. To generate momentum for economic recovery, bank lending will need to pick up. Further cuts to the reserve requirement ratio are likely as banks may otherwise struggle to provide sufficient credit to the economy. Credit demand from manufacturing will likely ease

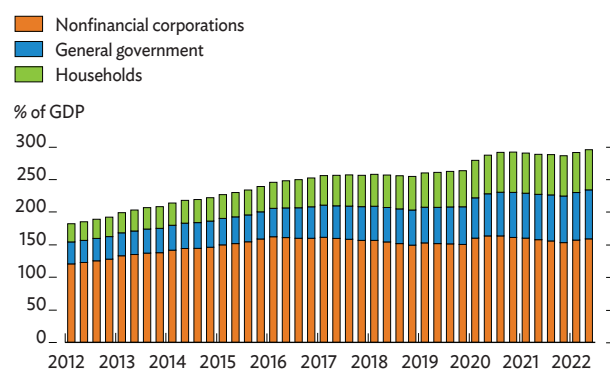
alongside weakening external trade, but credit demand from property should increase in light of loosening credit restrictions on developers. However, if credit flows to real estate pick up too much, this could come at a cost to other sectors and reemerge as a challenge for policy makers.

Fiscal policy is expected to remain supportive to growth in 2023. While the government set the 2023 GDP growth target at around 5%, it budgeted a 5.6% expenditure increase in the general public budget this year, slightly below 6.1% actual growth in spending in 2022. Fiscal revenue is planned to increase by 6.7% in 2023, up from 0.6% actual growth in 2022, which, however, was distorted by value-added tax credit refunds. Meanwhile, the annual quota for new local government special bond issues was set at CNY3.8 trillion, slightly below actual issuance of CNY4.0 trillion in 2022. While these budget figures would indicate marginal withdrawal of fiscal support, they do not provide a comprehensive picture of government spending. To support the economy, the government has ways of mobilizing additional off-budget spending, such as increasing policy banks' credit, and using central bank lending facilities and local government financing vehicles—all of which can be used as needed.

Fiscal policy should aim for fiscal consolidation once economic recovery has taken hold. Continuing weakness in the labor market and a cooling global economy justify ongoing fiscal support for now. At the same time, general government debt has increased in recent years, calling for deleveraging efforts once economic recovery has taken hold (Figure 2.11.16).

Figure 2.11.16 Debt Structure

Debt in the PRC has increased following the onset of the COVID-19 pandemic in 2020.



GDP = gross domestic product.

Source: Bank for International Settlements.

An additional challenge is to achieve sustainable local government financing, given that the local fiscal space has shrunk over the years as local government debt has increased.

External trade is expected to moderate, and capital flows may be more balanced in 2023. As demand from advanced economies softens, exports will likely decline, though from a high base. Weaker exports of consumer and investment goods should restrain merchandise imports, while trade in services should pick up as outbound travel from the PRC resumes. The current account surplus is expected to decline to slightly below the equivalent of 2% of GDP in 2023 and gradually ease further in 2024. On the capital account, higher GDP growth may attract capital inflow, reducing sizable net portfolio outflow in 2022 (Figure 2.11.14).

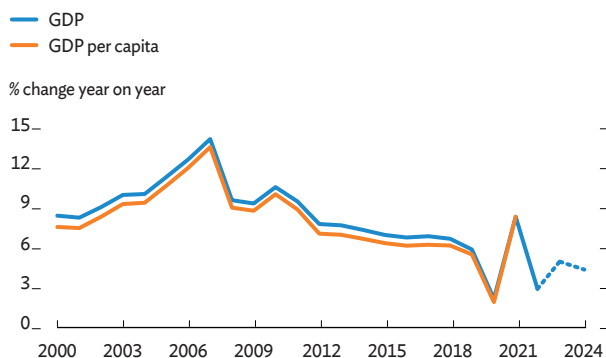
Risks to the outlook remain. They include the unpredictability of the COVID-19 virus as new variants could undermine recovery in domestic consumption. Another risk is that the recovery in consumption or in the housing market turns out slower than expected because of changed households' expectations about future economic growth and confidence in housing in lower-tier cities as a store of value. On the other hand, a recovery in consumer confidence that exceeds expectations could lift GDP growth above the forecast. An external risk is the global economy cooling faster or deeper than expected.

Policy Challenge—Declining Potential Growth

Even before the pandemic, economic growth was trending down (Figure 2.11.17). Critical questions are to which level of GDP growth the PRC will return and what the country's long-term growth prospects are given its rapidly aging society, the continued dependence of growth on investment, and a changed international environment. Long-term potential GDP growth can be estimated by fitting a production function. To obtain an estimate of future potential growth, the trends of all input factors—labor, human capital, financial capital, and total factor productivity (TFP)—are estimated separately and then combined into an estimate (Figures 2.11.18 and 2.11.19).

Figure 2.11.17 Real GDP Growth, 2000–2024

GDP growth has been on a declining trend for more than a decade.



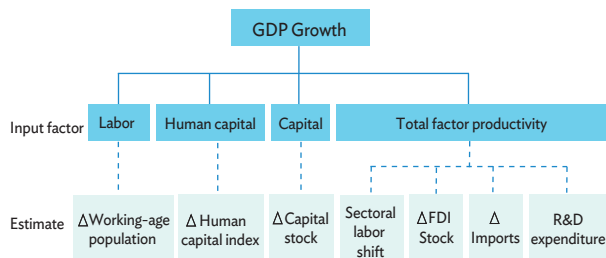
GDP = gross domestic product.

Note: Values for 2023 and 2024 are forecasts.

Sources: CEIC Data Company and ADO 2023 forecast.

Figure 2.11.18 Input Factors of the Production Function

Estimating long-term potential growth requires estimating the trend in many variables.



FDI = foreign direct investment, GDP = gross domestic product, R&D = research and development.

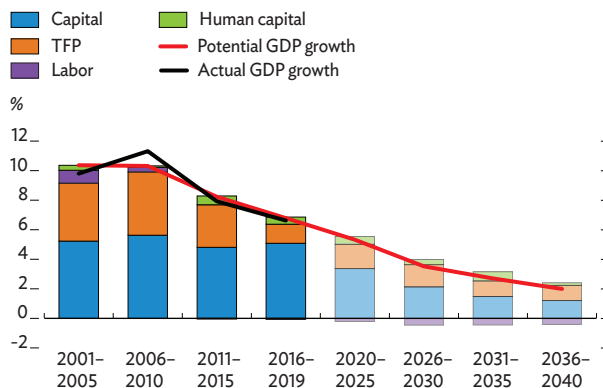
Note: Δ symbol means change in.

Source: Peschel, D. and W. Liu. 2022. The Long-Term Growth Prospects of the People's Republic of China. ADB East Asia Working Paper Series, No. 54. Manila: Asian Development Bank.

Potential GDP growth will likely decline. Potential GDP growth is estimated to be 5.3% on average in 2020–2025 and then to moderate to 3.5% in 2026–2030, 2.7% in 2031–2035, and 2.0% in 2036–2040. Capital and TFP are major contributors to potential growth in the long run. The contribution of capital is forecast to decline gradually from 3.4 percentage points on average in 2020–2025 to 1.2 points in 2036–2040. The contribution of TFP to growth is estimated to be smaller in the next 2 decades because of a decline in the contribution from the sectoral labor shift—i.e., people migrating from low-productivity

Figure 2.11.19 Decomposition of Contributions to Potential GDP Growth, 2001–2040

Despite remaining the main driver of growth, capital will contribute less to growth in the future.



GDP = gross domestic product, TFP = total factor productivity.

Source: Peschel, D. and W. Liu. 2022. The Long-Term Growth Prospects of the People's Republic of China. ADB East Asia Working Paper Series, No. 54. Manila: Asian Development Bank.

agriculture to higher-productivity industry and services—and lower returns to research and development (R&D). The shrinking of the working-age population will increasingly weigh on growth, but increases in human capital will moderately contribute to growth.

Structural reform is needed to increase potential growth. Reform is necessary in particular with respect to the country's capital and credit allocation, as are policy measures to address the shrinking labor force. Additional measures should be taken to increase TFP growth and the quality of education.

Changes to the allocation of capital and credit, including state-owned enterprise (SOE) reform are key to raising potential growth. Industrial SOEs tend to be less efficient than their private peers while profiting from superior access to credit. SOE reform should aim to clarify SOE scope and function, level the playing field for the private sector, separate social functions from SOEs, and improve SOE management. Moreover, credit allocation needs to be shifted in favor of the private sector, particularly micro and small businesses. To this end, banks need to strengthen their ability to assess credit risk, leading to higher operational efficiency.

Growth should be driven increasingly by domestic consumption. With a declining share of industry and a rising share of services in the economy, growth should be driven less by investment and more by domestic consumption. This would also be less capital-intensive. Developing the domestic service sector would require boosting household demand. To this end, basic public services and social security must be strengthened to reduce households' need for precautionary savings.

Demographics will increasingly weigh on economic growth in the coming 2 decades. The working-age population started to shrink about a decade ago. Policy action can mitigate how demographic aging affects the labor force. Measures include raising the retirement age, improving health care, raising female workforce participation rates, and increasing labor mobility. Shifting policy priorities to support families with children could spur the birth rate and thus improve demographics in the long run.

More and better education can raise human capital. The disparity in years of schooling between rural and urban areas in the PRC is significant, calling

for efforts to increase years of schooling in rural areas. Moreover, better education would lift potential growth by raising workforce productivity. The quality and effectiveness of education can be improved by expanding early childhood development, enhancing the quality of tertiary education, strengthening technical and vocational education and training, and increasing on-the-job training.

Finally, measures are needed to boost TFP growth, which has declined over time. TFP growth benefits from sectoral labor shift, growth in imports and the stock of FDI, and higher R&D expenditure. The sectoral labor shift should be facilitated by relaxing residence permit restrictions and providing to labor migrants easier access to basic social services. Also, to make the country more attractive to FDI, restrictions on FDI and joint venture requirements should be loosened. In addition, advancing trade and investment agreements could engender openness and domestic reform. Finally, improving the country's R&D effectiveness requires more efficient R&D fund use and a higher share of basic research.

REPUBLIC OF KOREA

Growth moderated in 2022 as exports and investment struggled in a challenging external environment. Growth is expected to slow further in 2023 before picking up in 2024 as the global outlook improves. In 2022, inflation reached its highest in 2 decades, but it is expected to slow in line with falling rents and weaker domestic demand. The Republic of Korea (ROK) needs to address issues that arise with an aging population.

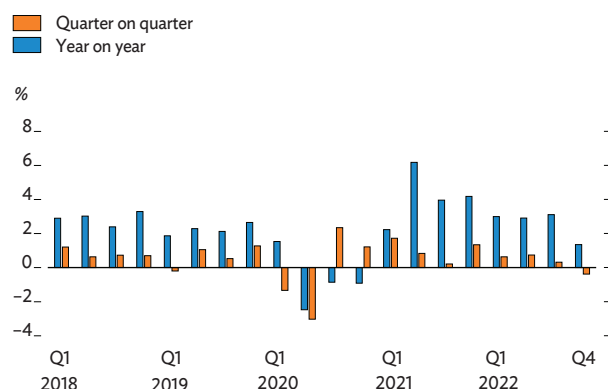
Economic Performance

GDP growth moderated from 4.1% in 2021 to 2.6% in 2022, reflecting a deteriorating global economy (Figure 2.12.1). After averaging 3.0% year on year in the first 3 quarters, growth slowed to 1.4% in the last quarter. GDP shrank by 0.41% quarter on quarter in the last quarter of 2022, more than anticipated and marking the first quarterly decline since the second quarter of 2020.

On the demand side, growth was boosted by consumption. Private consumption growth increased from 3.7% in 2021 to 4.3% in 2022 and contributed 2.0 percentage points to growth (Figure 2.12.2).

Figure 2.12.1 Quarterly GDP Growth

Growth slowed during the year.

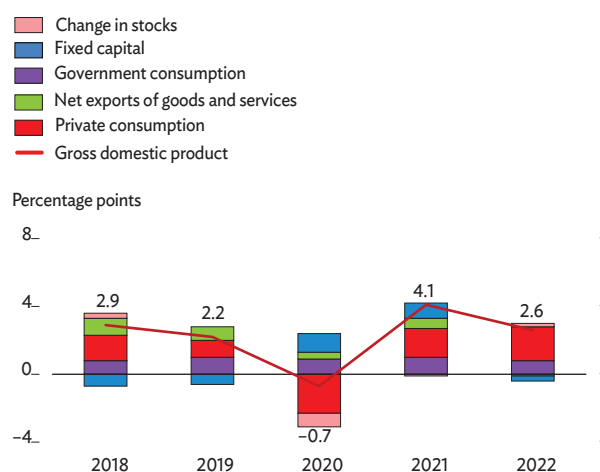


Source: CEIC Data Company.

Retail sales volume increased on better labor market conditions as the unemployment rate fell from 3.7% in 2021 to 2.9% in 2022. Additionally, the government pursued several initiatives to support consumption, including fuel subsidies and discount consumption coupons for agriculture, fishery, and livestock products. Nevertheless, government consumption contributed only 0.7 percentage points to growth, despite the implementation of pandemic fiscal stimulus.

Figure 2.12.2 Demand-Side Contributions to Growth

Private consumption continued its strong contribution to growth in 2022.



Source: CEIC Data Company.

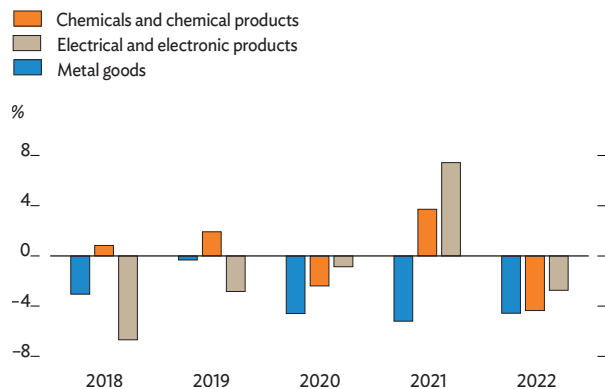
Fixed investment contracted by 0.8%, subtracting 0.3 percentage points from growth as government outlays declined by 6.2% owing to pandemic priorities.

Investment in facilities reversed 9.0% growth in 2021 to contract by 0.5%, while construction investment growth remained in negative territory for a second year in a row. The 2021 housing price boom began to fade in 2022, and by the end of the year home prices were 4.7% lower than they had been at the end of 2021.

Growth in exports of goods and services slowed from 10.8% in 2021 to 3.2% in 2022. This was mainly a decline in the volume of major commodity exports—especially electrical and electronic products, chemicals and chemical products, and metal goods—as demand for ROK exports faltered (Figure 2.12.3). Imports of goods and services grew more rapidly than exports, at 3.7%, such that net exports subtracted 0.1 percentage points from growth.

Figure 2.12.3 Growth in Volume of Major Commodity Exports

Exports of major commodities faltered.

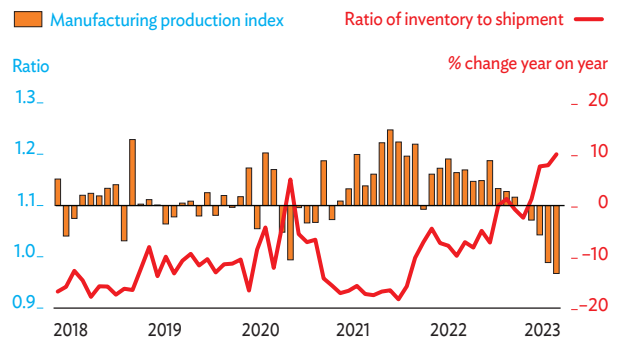


Source: CEIC Data Company.

On the supply side, services were the main contributor to growth, contributing 2.4 percentage points. Benefiting from the economy’s continued reopening, wholesale and retail trade, lodging, and food services more than doubled their growth rate in 2021 to 6.8%, contributing 0.6 percentage points. After rebounding in 2021 to 6.9% expansion, manufacturing output growth slowed to 1.4% in 2022. The production of major exports such as semiconductors and petrochemicals fell on worsening global demand overall, creating a surge in inventories (Figure 2.12.4). Construction grew by 0.3% after declining for 4 years in a row.

Figure 2.12.4 Manufacturing Indicators

Inventories rose as production fell on weakened external demand.

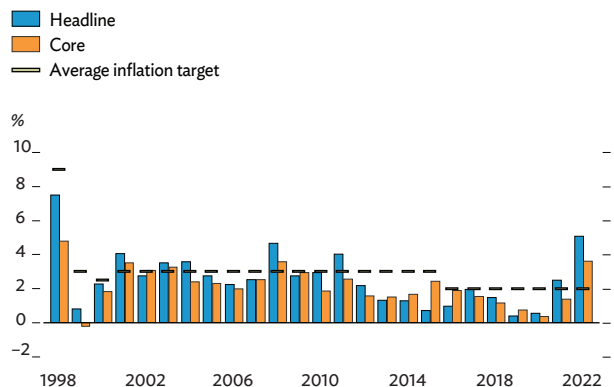


Source: CEIC Data Company.

Inflation rose to 5.1%, the highest since 1998 (Figure 2.12.5). Higher input costs and demand propelled the price increase. Import prices rose by 26%, partly reflecting ROK won depreciation. The main contributors to inflation were transportation, food, restaurants and hotels, housing and utilities, and personal care. Core inflation, which excludes food and energy, rose to 3.6%, the fastest pace since 2008. In response to the inflationary pressures, the Bank of Korea, the central bank, hiked its policy interest rate seven times during the year, raising it by a total of 225 basis points to reach 3.25% in November. As a result, bank lending interest rates have risen over the past 2 years.

Figure 2.12.5 Inflation

Inflation remained above the 2% target.



Source: CEIC Data Company.

Lending to businesses and households expanded more slowly than in 2021. Corporate bond issuance fell by 9.8% in 2022, the first decline in 7 years, as benchmark rates rose and some loan defaults and payment delays rippled through the market. Similarly, by the end of 2022, outstanding credit to households had decreased by 0.2% from 2021. As a result, domestic liquidity growth decreased from 12.9% in 2021 to 5.1% in 2022.

The current account surplus stood at \$29.3 billion, well below \$85.2 billion recorded in 2021 (Figure 2.12.6). This was largely a result of the narrowing of the merchandise trade surplus by 80.1% as imports rose more rapidly than exports because of high energy prices, and the widening of the net services deficit. Growth in merchandise exports was subdued at 6.3%, only a quarter of the rate in 2021 as the slowdown in the People’s Republic of China (PRC) and negative growth rates in Russia and Hong Kong, China undercut growth of exports to Asia and Europe. Exports to the PRC, which takes more than a fifth of ROK exports, contracted by 4.4% as exports fell for electrical and electronic products, machinery and precision instruments, and crude materials and fuels. Net foreign direct investment and net portfolio investment weakened, pushing the overall balance of payments deficit to the equivalent of 1.7% of GDP. Official foreign exchange reserves fell by 8.6% from a year earlier to \$423 billion in December 2022 but still provided cover for 7.5 months of merchandise imports. The won strengthened against the US dollar toward the end of the year, cumulatively depreciating by 6.5% in 2022 despite plunging by 17.4% in October.

Fiscal policy remained supportive of growth in 2022. Two supplementary budgets passed in February and May 2022 provided an additional W20 trillion to support small businesses and vulnerable populations, improve disease control efforts, stabilize prices, and protect people’s livelihoods. Tax revenue grew by W53 trillion, from W344 trillion in 2021 to W397 trillion, thanks to improved corporate earnings. Consequently, government revenue excluding social security contributions rose by an estimated 7.2% from 2021 while expenditure increased by an estimated 13.3%. The fiscal deficit thus widened from the equivalent of 5.2% of GDP in 2021 to 7.0% in 2022.

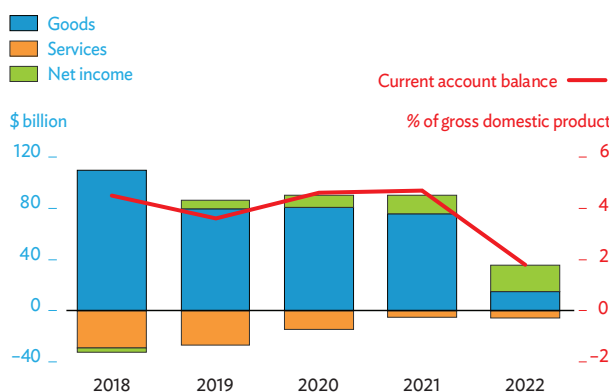
Economic Prospects

Growth is forecast to slow to 1.5% in 2023 and rise gradually to 2.2% in 2024 (Table 2.12.1). It will be supported mainly by consumption with limited contribution from investment or exports. Consumption will, however, grow only moderately in 2023. Real household incomes will remain constrained, as real wage growth has lagged GDP growth since the middle of the 2000s. This trend is likely to continue, though slowing inflation will alleviate some of the pressure. With household debt reaching 105% of GDP and mostly borrowed with floating interest rates, the increase in the central bank policy rate by 25 basis points in January 2023 will raise household debt service expenditure. These factors and lower rental income and capital gains caused by falling property values will dampen household spending. Public consumption will be constrained by the government’s efforts to cut the fiscal deficit this year. Expenditure under the approved 2023 budget of W638.7 trillion, equal to 27.3% of GDP, is 6% lower than last year’s budget and is allocated mainly to public health, welfare, and employment programs, which receive 35.4%, followed by education with 15.1%, and national defense with 8.9%. To provide immediate relief to an economy suffering slow growth in exports and employment, the government aims to spend at least 60% of the 2023 budget in the first half.

Exports are projected to rise slightly in 2023 and strengthen gradually in 2024. Following sharp declines in exports, manufacturing, and services since the beginning of the fourth quarter of 2022, exports to such prime markets as the PRC, the European Union, the US, and Japan, will likely grow only modestly in

Figure 2.12.6 Current Account Balance

The current account surplus narrowed in line with a decline in the merchandise trade surplus.



Source: CEIC Data Company.

Table 2.12.1 Selected Economic Indicators, %

Growth will slow in 2023 before picking up in 2024 while inflation gradually decelerates.

	2021	2022	2023	2024
GDP growth	4.1	2.6	1.5	2.2
Inflation	2.5	5.1	3.2	2.0

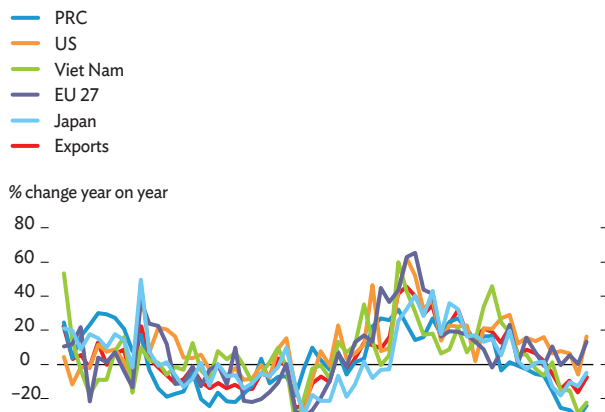
GDP = gross domestic product.

Source: Asian Development Bank estimates.

2023, given the forecast global economic slowdown. Exports were still contracting in February by 7.5% year on year, but that was improved on the previous month's 16.6% decline as exports to major destinations strengthened, indicating possible recovery in the months ahead (Figure 2.12.7). PRC demand for consumer goods and industrial parts is expected to increase this year following its exit from its zero-COVID policy, but the positive effect on the ROK economy may not be felt until the second half of the year.

Figure 2.12.7 Merchandise Exports

Goods exports may have bottomed out.



EU = European Union, PRC = People's Republic of China, US = United States of America.

Source: CEIC Data Company.

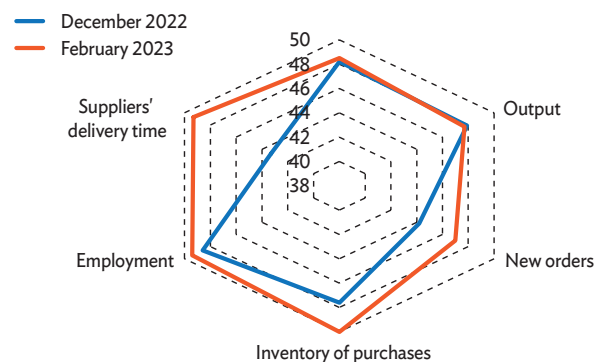
Investment growth will be subdued. Corporate investment surveys indicate that major firms in the ROK plan only modest investments in 2023 because of high economic uncertainty. The drop in exports will be reflected in production and investment as manufacturers draw down inventories. Business

confidence indicators reveal unusually strong pessimism, which bodes ill for equipment investment in the first half of the year. The March business sentiment index, based on a Federation of Korean Industries survey, was 93.5, still below the 100-point threshold but up by 10.4 points from February. The composite purchasing managers' index continued to signal contraction, its reading of 48.5 in February unchanged from the previous month but up from 48.2 in December 2022 as most subindexes improved (Figure 2.12.8). Machinery orders, a good indicator of equipment investment, rose by 4.6% year on year in January after dropping by 25.2% in December 2022. Construction investment, which contracted in both 2021 and 2022, is expected to rise only marginally. A buildup of unsold houses and a decline in housing starts indicates that the housing market is heading into a downturn that will drag on construction (Figure 2.12.9). While the government will continue to ease lending requirements and real estate regulations, high interest rates will make it more difficult for consumers to reenter the housing market. Further, the recent fall in housing prices may dampen the outlook for profitability and crimp residential construction.

Inflation will trend downward. Consumer prices increased by 4.8% year on year in February, decelerating from 5.2% in January (Figure 2.12.10). Core inflation remained at 4.0% in February, indicating that underlying pressures remain high. The inflation rate has been well

Figure 2.12.8 Purchasing Managers' Index

The index shows some improvement but remains below the 50-point threshold.

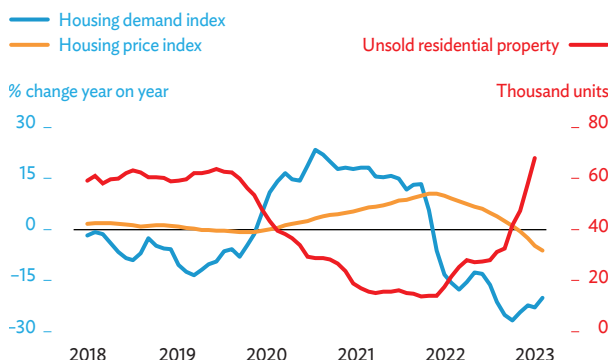


Note: A purchasing managers' index reading <50 signals deterioration, >50 improvement.

Source: CEIC Data Company.

Figure 2.12.9 Housing Indicators

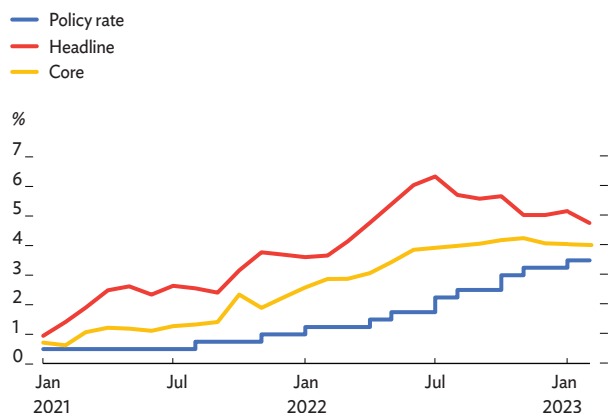
Construction will be hampered by the housing downturn.



Source: CEIC Data Company.

Figure 2.12.10 Inflation and the Policy Rate

Tightened monetary stance should support disinflation.



Source: CEIC Data Company.

above the 2% target since the fourth quarter of 2021, and bringing it down will require sustained monetary tightening. However, the weakening economic condition is expected this year. The Bank of Korea raised policy rates by another 25 basis points in January 2023, bringing it to 3.5%, before pausing in February. The biggest utility company in the nation increased electricity prices by 9.5% on 1 January. Additionally, the government reduced its tax break on gasoline that same day from 37% to 25%. These measures mean inflation is likely to remain elevated in the early months of 2023, but feed-through effects from monetary tightening in 2022 and declining rents and weaker domestic demand should dampen inflation to an average of 3.2% in 2023 and 2.0% in 2024.

Risks to the outlook tilt somewhat to the downside.

Unexpectedly strong global economic growth and rapid decline in commodity prices are upside risks to the outlook. However, worsened supply chain disruption brought on by a resurgent pandemic, a prolonged Russian invasion of Ukraine, or any sign of delay in PRC economic recovery would be detrimental to growth. The major domestic risks to the outlook are rising public and private debt, which could raise debt service costs, reduce consumption more than anticipated, and generate financial instability.

Policy Challenge— Responding to an Ageing Population

The population is getting older, with implications for growth potential.

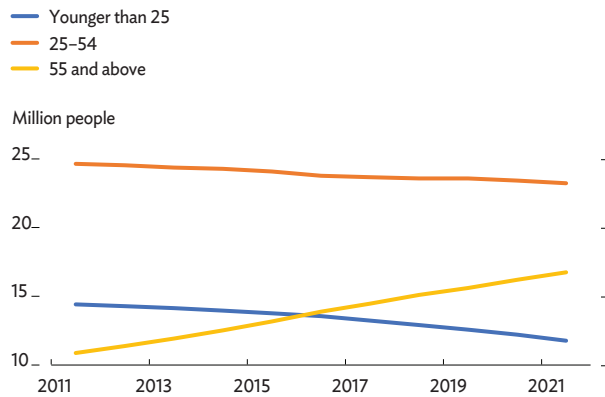
There were 14.4 million people in the ROK under the age of 25 in 2011 but only 11.8 million in 2021 (Figure 2.12.11). Also, the portion of the population aged 25–54 has decreased by 1.4 million, but the number of those aged 55 and over has increased from 11.0 million in 2011 to 16.7 million in 2021. Demographic projections show the ROK among the world’s fastest aging economies, with a high percentage of elderly comparable to Japan and the PRC. According to estimates by Statistics Korea, 17.5% of the population was over the age of 65 in 2022. This will rise to 40.1% by the 2050. By then, the old-age dependency ratio, or the population aged 65 or more over the population aged 15–64, is expected to be 79% (Figure 2.12.12). With a fertility rate of 0.84 children per woman, the lowest in the world, and rising longevity thanks to its national health-care system and improving quality of life, a fast-aging population will deprive the country of human capital and stall long-term growth potential. The labor force will grow more slowly as the population ages, and within 20–30 years it may even start to decline. Insufficient labor will undermine productive capacity and competitiveness.

Fiscal sustainability could face a significant structural challenge as the elderly population grows rapidly.

A declining population of tax-paying workers can reduce government revenue even as government spending on programs for the elderly, particularly health care, places a persistent burden on public finances. The growing debt burden could be inflationary and challenge public financial management,

Figure 2.12.11 Inflation and the Policy Rate

The Republic of Korea's population is aging quickly.



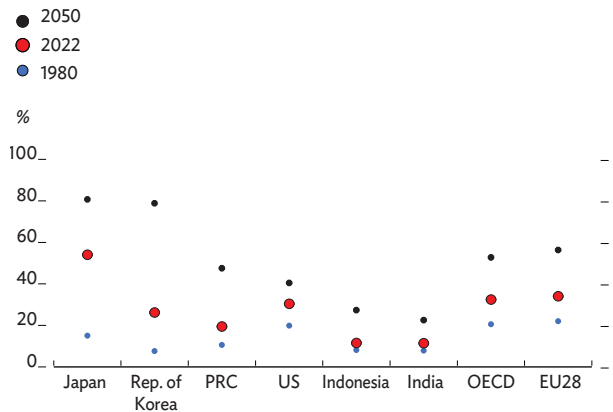
Source: CEIC Data Company.

including tax collection and budget allocation to other important development priorities, such as technological improvement and productivity growth, and climate change mitigation and adaptation. Policy actions to mitigate a labor shortage include encouraging automation, offering incentives to attract qualified migrant workers, and initiatives to keep the elderly on the job.

Ongoing efforts to increase employment among the elderly show promise. The Senior Employment and Social Activity Support Program helps elderly job seekers maintain their physical and emotional well-being and their social and economic viability. The program, which is run by the Korea Labor Force Development Institute for the Aged, aims to provide reliable sources of income for the elderly while helping

Figure 2.12.12 Inflation and the Policy Rate

The dependency ratio is expected to rise further in the Republic of Korea.



EU = European Union, OECD = Organisation for Economic Co-operation and Development, PRC = People's Republic of China, ROK = Republic of Korea, USA = United States of America.

Note: The old-age dependency ratio is the number of individuals aged at least 65 per 100 people of working age, or 20-64.

Source: OECD. 2023. [Old-Age Dependency Ratio \(indicator\)](#).

them to save money on their medical expenses. Additional policies and coordination of the public and private sectors are needed to enhance the prospects of older workers in the labor market through upskilling, work incentives, and enhancing job quality with decent incomes and work environments. In Singapore, for example, the government has a national program called SkillsFuture that gives every Singaporean aged 25 and older a \$500 opening credit that can be used to take skills courses. In Japan, the government invests in aged-care industries to meet the needs of an aging population while lowering the cost of care.

TAIPEI, CHINA

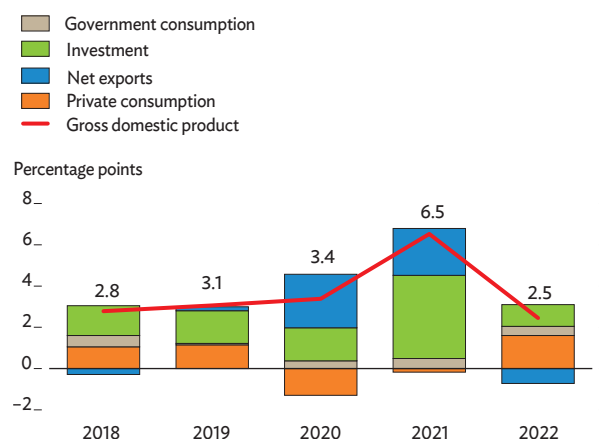
With global demand weakening, growth slowed in 2022 with sharp deceleration in exports and investment. Consumption rebounded as COVID-19 restrictions gradually eased. Inflation rose to its highest since 2008 as food and petroleum prices increased. Growth is expected to moderate further in 2023 as global demand remains weak but to rebound in 2024 as global growth recovers. Inflation will slow as energy prices stabilize and economic activity moderates. Policy action is needed to stimulate entrepreneurial activity as a new driver of growth.

Economic Performance

Growth slowed to 2.5% in 2022 as weaker global demand weighed on exports and investment, though consumption rebounded. The external sector weakened substantially, and net exports cut 0.7 percentage points from growth (Figure 2.13.1). Export growth braked from 17.3% in 2021 to 2.4% as imports grew by 4.5% on elevated prices for imported oil and higher imports of machinery and electronics. As a result, the current account surplus narrowed from the equivalent of 14.8% of GDP in 2021 to 13.3%. Investment was strong in the first half of the year but tapered off in second half as firms postponed capacity expansion, tamping down investment growth from 17.3% in 2021 to 4.1% in 2022. Investment was nevertheless the second largest driver, contributing 1.1 percentage points to growth. Consumption bolstered growth, as COVID-19 restrictions were lifted and the government incentivized travel and spending through a stimulus package to boost the tourism industry. Private consumption rebounded by 3.6% and was the main driver of growth, contributing 1.6 percentage points, while government consumption grew by 3.4% and contributed 0.4 points. On the supply side, agriculture contracted by 1.9%, shaving growth by 0.03 points; industry, driven by manufacturing, added 0.8 points; and services contributed 1.4 points as relaxed COVID-19 restrictions reinvigorated the sector.

Figure 2.13.1 Demand-Side Contributions to Growth

Domestic demand drove growth in 2022.



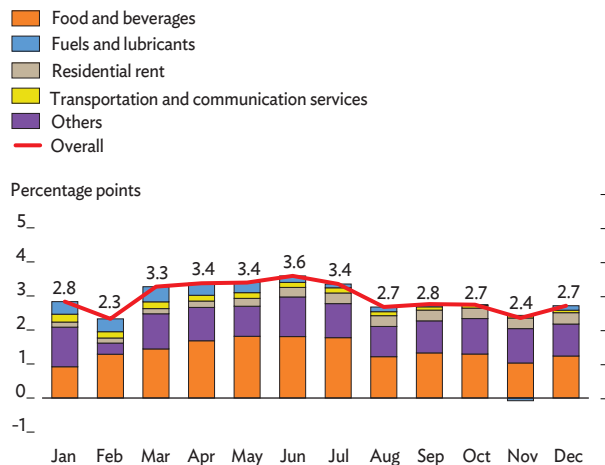
Source: CEIC Data Company.

Inflation averaged 2.9% in 2022, its highest in over a decade as commodity prices surged. It accelerated and peaked at 3.6% in June 2022, before moderating somewhat in the second half of the year. Inflation came largely from higher food prices as the Russian invasion of Ukraine drove prices for agricultural and industrial raw materials higher, while government measures to stabilize prices, including price controls

on energy products such as liquefied petroleum gas, mitigated the impact of higher global oil prices (Figure 2.13.2). Residential rent was also a major contributor to inflation as landlords passed on higher maintenance costs to tenants.

Figure 2.13.2 Inflation, 2022

Inflation was driven largely by food prices.



Source: Haver Analytics.

The central bank tightened monetary policy, but fiscal policy remained supportive of growth.

The central bank hiked its policy rate four times in 2022 for a total increase of 62.5 basis points to 1.75%. Broad money growth slowed from 7.4% year on year in December 2021 to 6.7% a year later, and credit growth also slowed that month, from 8.4% to 6.4%. On the fiscal side, the government continued to provide COVID-19 policy support with relief and stimulus loans offered to smaller enterprises and upskilling programs and subsidies to workers affected by the pandemic. Government revenue equaled 11.9% of GDP in 2022, and expenditure 11.8%, broadly unchanged from the previous year. Unexpected revenue from strong growth translated into a fiscal surplus equal to 0.1% of GDP. Public debt remained manageable at 24.1% of GDP at the end of 2022.

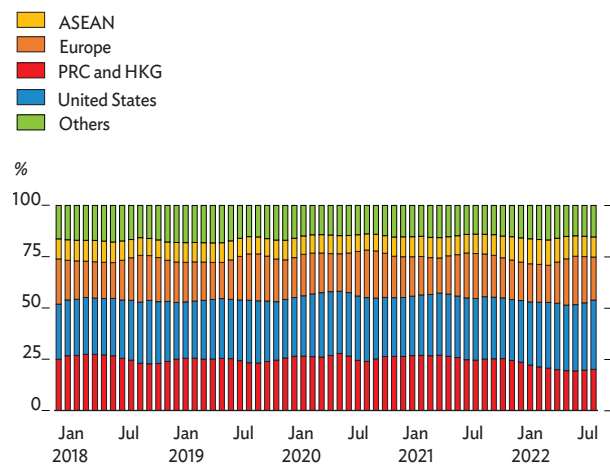
Economic Prospects

Growth will slow further this year as the global economy weakens. Global growth prospects in 2023 are dimmed largely by recent rapid monetary

tightening synchronized in the advanced economies and much of developing Asia. Expected weakness in global demand does not bode well for the export-driven economy of Taipei, China. Export orders to the People’s Republic of China (PRC) and Hong Kong, China, which receive roughly 40% of all exports, declined steadily last year as COVID-19 outbreaks and zero-COVID restrictions hampered economic activity in those economies (Figure 2.13.3). While this was partly offset by continued orders from the US, the export order total eventually declined from September to December. Export orders typically lead actual exports by 2–3 months, suggesting that export growth would remain weak at least through the first quarter of this year. Investment will slow in line with exports, though this decline should be softened by continued reshoring of overseas companies, investment in offshore wind energy, and airline fleet expansion to keep up with resurgent cross-border tourism. On balance, growth is forecast to slow to 2.0 in 2023, supported primarily by resilient private consumption as COVID-19 restrictions are relaxed further (Table 2.13.1). Exports and imports are expected to slow at roughly the same rate, with weak external demand dragging down exports and slower investment and stabilizing commodity prices dampening imports. The current account surplus is thus expected to remain stable at about 13% of GDP.

Figure 2.13.3 Export Orders

Export orders declined, especially to the PRC and Hong Kong, China.



ASEAN = Association of Southeast Asian Nations, HKG = Hong Kong, China, PRC = People’s Republic of China.

Source: CEIC Data Company.

Table 2.13.1 Selected Economic Indicators, %*Growth will moderate and then rebound, and inflation will slow.*

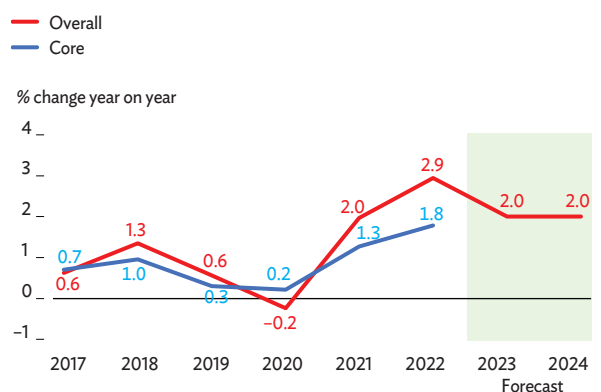
	2021	2022	2023	2024
GDP growth	6.5	2.5	2.0	2.6
Inflation	2.0	2.9	2.0	2.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

The economy will rebound in 2024 as external demand recovers. Consumer confidence fell to 59.1 in December of last year, its lowest since 2009, but climbed to 62.5 in February, signaling a more upbeat consumer outlook for the next 6 months. Moreover, domestic tourism is picking up and a steady increase in international tourist arrivals will support private spending. Investment will grow, albeit not as strongly as last year. With monetary tightening by central banks expected to slow this year, global growth is set to recover in 2024, fueling higher growth for exports, the resumption of investment, and higher growth in 2024 at 2.6%.

Price pressures will wane over the forecast period with stabilizing commodity prices and tighter monetary policy. Inflation is expected to stabilize at 2.0% in 2023 and 2024 (Figure 2.13.4). Rent, transport services, and dining out, which drove inflation higher in 2022, will likely continue to see higher prices at least into this year, even as global commodity prices stabilize. However, with the surge in prices largely concentrated in food and energy, steadying global commodity prices will be key to slowing inflation. The central bank has signaled that it is closely monitoring inflation and stands ready to raise rates if inflation persists.

Risks to the outlook arise mainly from external factors. Continued monetary tightening and slower global growth pose downside risks to the growth outlook. Conversely, if the tightening cycle of key advanced economies ends sooner than expected, 2023 growth may be higher than forecast. However, the key risk is the pace of reopening in the PRC. A speedy reopening and consequent pickup in economic activity would boost exports and reinvigorate growth in Taipei, China. A quick return of tourists from the PRC, who were about 20% of all overseas tourist arrivals in 2019, would boost growth. On the other hand, a slower

Figure 2.13.4 Headline and Core Inflation*Inflation rose in 2022 but will slow as commodity prices stabilize.*

Source: CEIC Data Company.

or stalled reopening of the PRC could further weaken exports, dragging down 2023 growth and potentially delaying the expected rebound in 2024. Developments in the PRC can also have implications for inflation. Faster economic activity in the PRC may stoke global energy prices and push inflation in Taipei, China higher, prompting policy action that may stymie growth.

Policy Challenge—Encouraging Entrepreneurial Activity as a Driver of Growth

High-tech export specialization is a solid foundation for entrepreneurial development. Taipei, China is a key export hub for semiconductors and other high-tech products. In 2020, it had a 63% share of the world market for semiconductors, with sales worth \$85.1 billion. Its specialization in the export of tech products has established a strong information technology supply chain, which has become the basis for a large concentration of world-class tech firms. As COVID-19 sent the world into lockdown, remote work created a boom in demand for electronic devices and accessories. Now, with pandemic-driven exceptional demand for electronics waning and growth in external demand slowing at least in the near term, Taipei, China needs to find new drivers of growth. To this end, it should take advantage of the dynamism of its high-tech export sector to encourage entrepreneurial development.

Entrepreneurial activity is lower than in other leading startup hubs. According to the Global Entrepreneurship Monitor 2022/2023, total early-stage entrepreneurial activity (TEA), or the percentage of people aged 18–64 who are starting or running a new business, is relatively low in Taipei,China despite a conducive environment for startups. TEA fell from 8.4% in 2020 to 5% in 2022, indicating that only 1 in about 20 adults is starting or running a new business (Figure 2.13.5). This contrasts with other leading startup hubs such as the United Arab Emirates with a TEA of 25%, the United States at 18%, and the Republic of Korea at 12%.

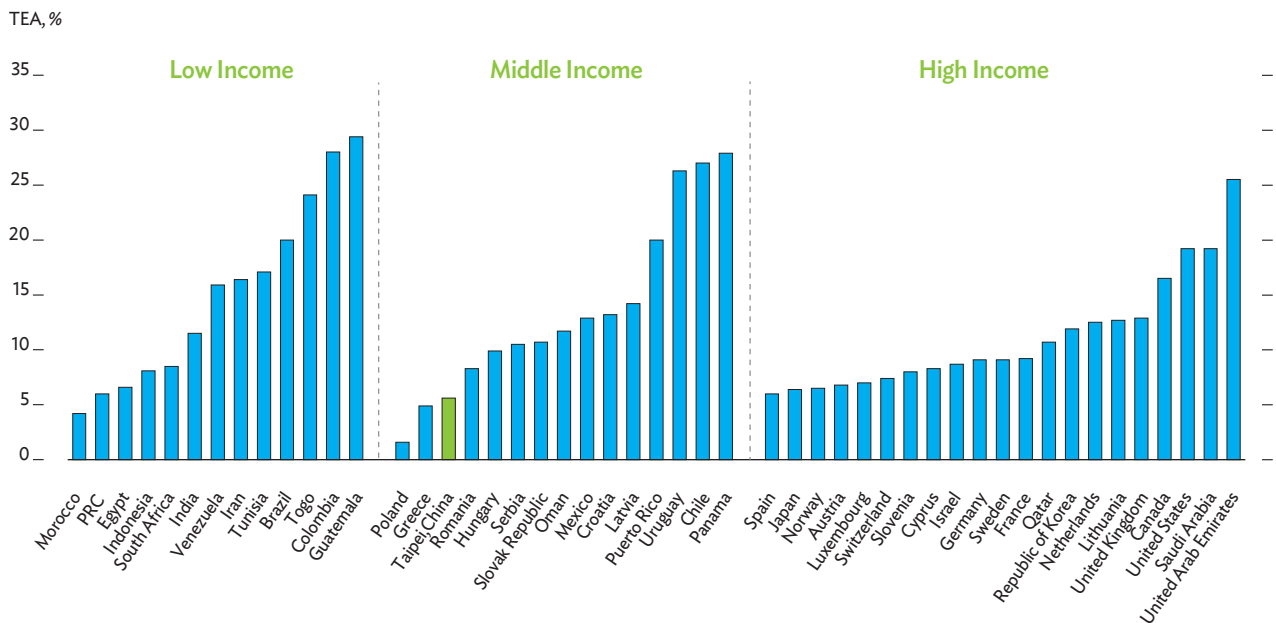
Barriers to entry and an underdeveloped entrepreneurial culture constrain potential for entrepreneurial growth. Regulations and antitrust legislation are factors cited by the Global Entrepreneurship Monitor survey as hindering ease of entry. Respondents indicated that the pandemic decreased household incomes and made starting a business more difficult. Further, people show considerable reluctance to engage in entrepreneurial activity, keeping “entrepreneurial intentions” relatively low. Only 15% of adults in Taipei,China expect to start

a business in the next 3 years, while 45% of adults in the United Arab Emirates and 23% in the Republic of Korea said they would do so. Taipei,China also ranks relatively poorly in terms of entrepreneurial behavior and attitudes as, among those surveyed, no more than 40% of respondents thought themselves capable of being an entrepreneur. As reported in Asian Development Outlook 2022, people throughout developing Asia generally have a poor opinion of entrepreneurs in terms of status and career choice, and legal frameworks in the region need to be adapted to the fast-moving environment of digital entrepreneurship.

Current government policies help to nurture entrepreneurial activity in the tech sector, but additional steps are needed. The government is creating an environment that nurtures innovation, including through several startup incubators, incentives for foreign participation, and programs that provide access to credit for startups and small and medium-sized enterprises. Apart from these initiatives, enhancing entrepreneurial education is key. Entrepreneurial education was scored as insufficient (Figure 2.13.6), a key factor that may be driving the decline in TEA and adults’ reluctance to start

Figure 2.13.5 Total Early-Stage Entrepreneurial Activity

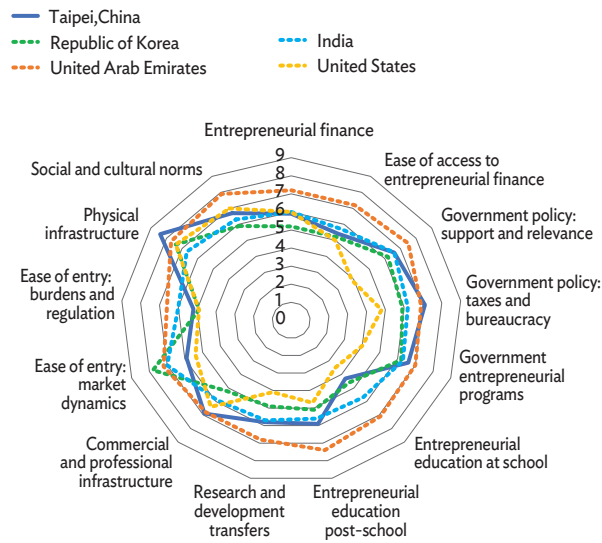
Entrepreneurial activity remains relatively low despite a conducive environment.



PRC = People’s Republic of China, TEA = total early-stage entrepreneurial activity.
Source: Global Entrepreneurship Monitor 2022/2023.

Figure 2.13.6 Entrepreneurial Framework Conditions

Taipei, China has relatively low scores for ease of entry and entrepreneurial education.



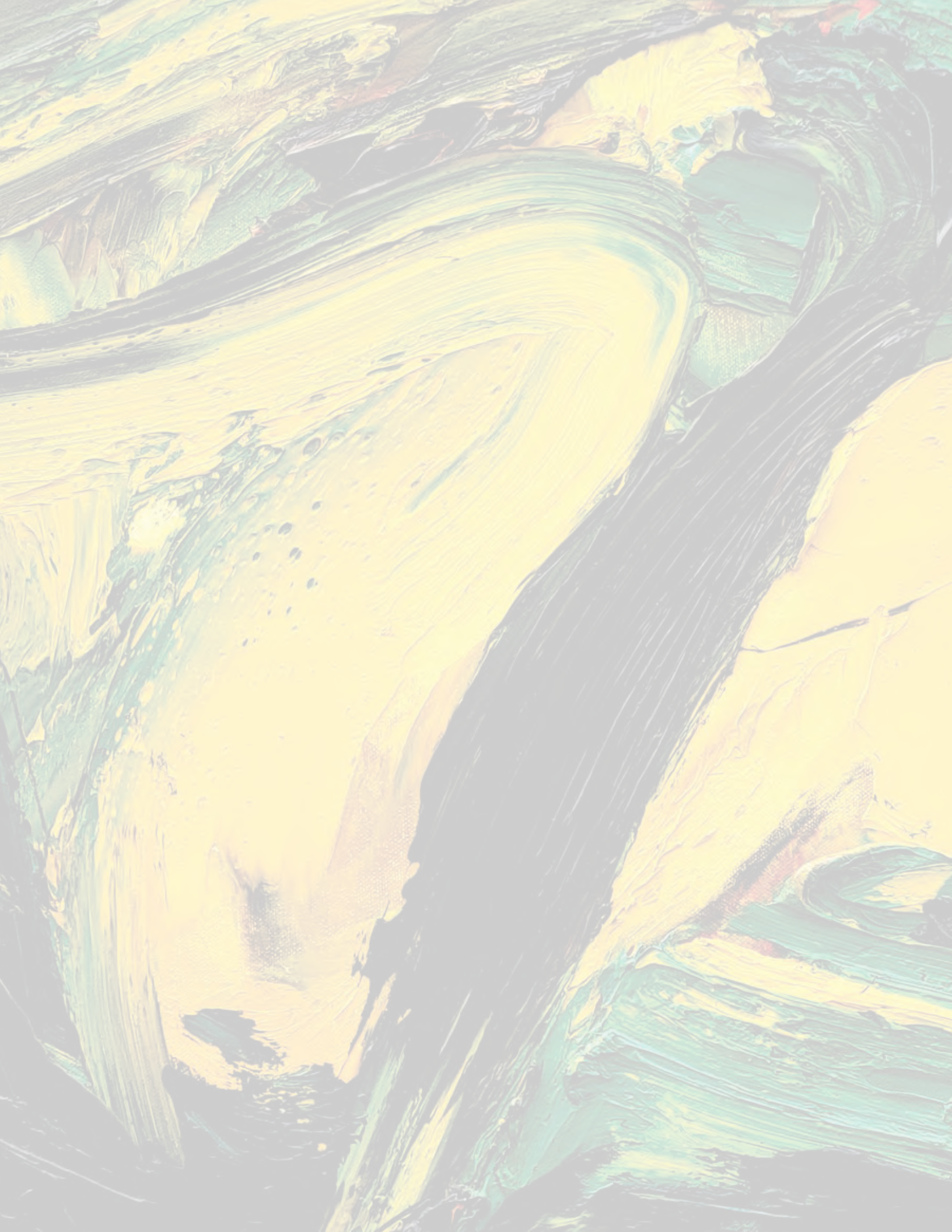
Note: A score <5 is “insufficient.”

Source: Global Entrepreneurship Monitor 2022/2023.

a business. There needs to be more entrepreneur-focused courses to build confidence and launch a new wave of young entrepreneurs that can maximize the rich startup environment the government is cultivating. The government’s Small and Medium Enterprise Administration and its Ministry of Labor

already have several programs for talent cultivation and skill training. Scaling up these efforts and enhancing partnership with universities that liaise with the various incubators and accelerators would help establish a clearer path for young entrepreneurs. Strengthening entrepreneurial education—not just at the graduate level, but also for younger students through exposure to business courses—can help instill confidence and an entrepreneurial spirit in the young.

There is a need to increase awareness and streamline access to the startup ecosystem. More than 60% of adults surveyed in Taipei, China said it is difficult to start a business. This is despite the economy ranking 15th in 190 economies in the World Bank’s Doing Business 2020, suggesting a disconnect between public perception and the actual process of setting up a business. Building the ecosystem has been a concerted effort across many ministries and institutions. A downside of this arrangement is that useful information for entrepreneurs can be overwhelming or scattered across different websites and resources. Streamlining access to these resources can simplify processes and encourage potential entrepreneurs. Overall, the combination of tech expertise and supportive government policies present a unique opportunity for the emergence of a class of entrepreneurs that can capitalize on knowledge and capabilities generated in the export of high-tech products and use it to diversify the economy’s sources of growth.



An abstract painting with thick, expressive brushstrokes in shades of yellow, green, and black. The composition is dynamic, with a large, bright yellow area on the left and a dark, swirling green and black area on the right. The overall effect is one of intense energy and movement.

SOUTH ASIA

Afghanistan

Bangladesh

Bhutan

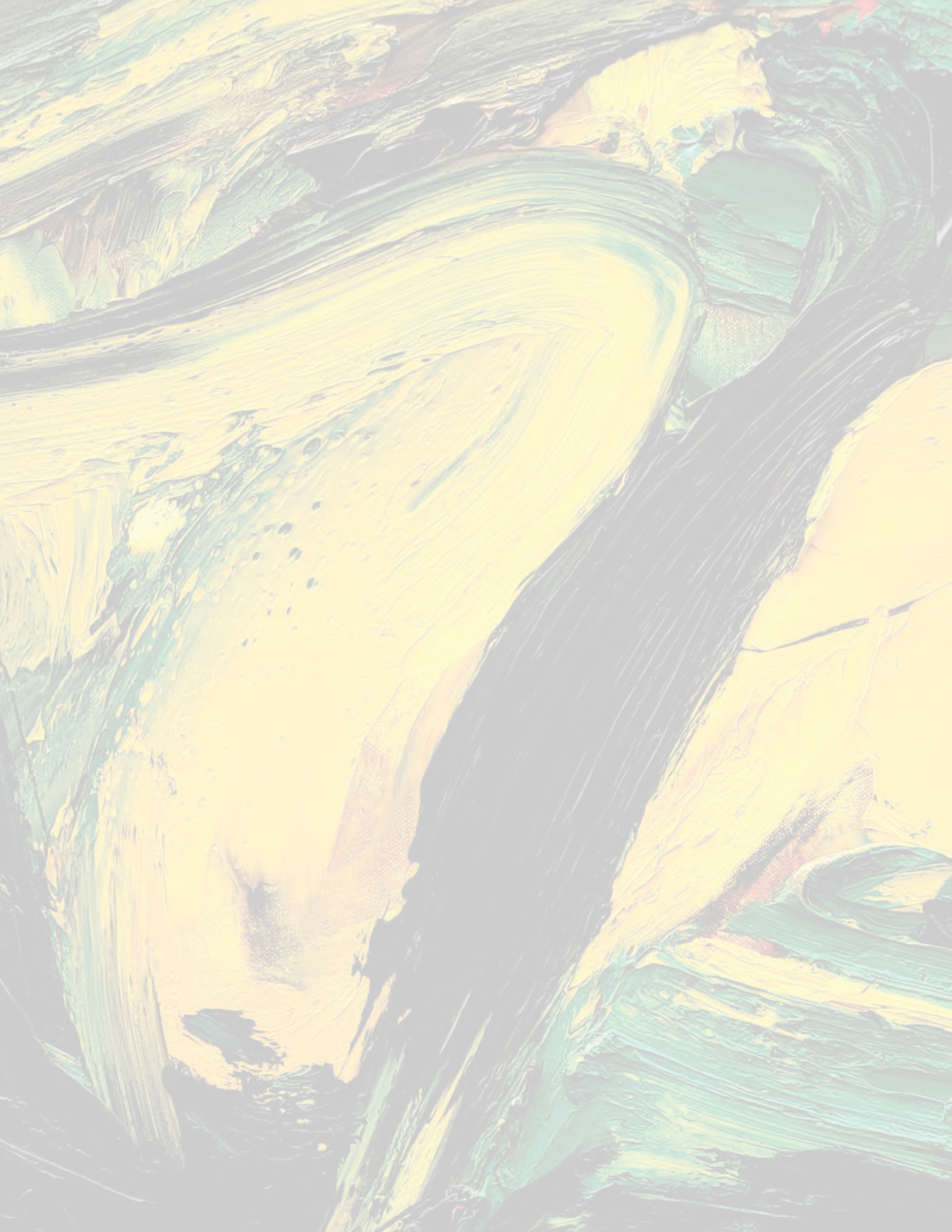
India

Maldives

Nepal

Pakistan

Sri Lanka



AFGHANISTAN

After some growth in the first half of 2022—aided by humanitarian assistance, better security, and reduced corruption—a harsh winter, a de facto government ban on higher education for girls, and restrictions on women working for nongovernment organizations seriously undermined economic activity and the delivery of humanitarian aid. These developments and continuing repercussions from the 2021 political transition may bring further economic contraction in the near term. Addressing food insecurity is a major policy challenge.

Economic Performance

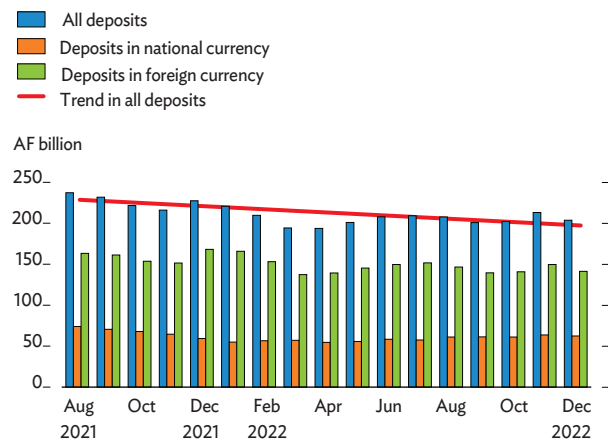
The economy remains in deep recession, buffeted by economic consequences from the August 2021 change in government. Key consequences are political isolation from the international community, the suspension of international development assistance, the freezing of Afghanistan’s international reserves held abroad, a plethora of international sanctions, brain drain, and severe disruption to the formal financial sector and international remittances. Services, the largest sector of the economy, contracted markedly, especially logistics, housing, banking, insurance, and hotels and restaurants, which had largely catered to foreigners. Mining has increased, offsetting a sharp decline in construction and manufacturing to leave the share of industry in the economy unchanged. With the country facing drought, there is a distinct shift toward subsistence agriculture. Precipitation below average from December 2021 to April 2022 diminished the formation of snowpacks during the winter months and consequently the availability of water for irrigation during spring and summer, affecting livestock health and the livelihoods of subsistence farmers.

Banks face a deep liquidity crisis owing to pervasive uncertainty, capital flight, and loss of technical staff. They also face challenges from the continuing effects of sanctions and from international banking restrictions to counter money laundering and the financing of terrorism. From August 2021 to December 2022, domestic

deposits in local currency dropped by 15.7% and in foreign currency by 13.4% (Figure 2.14.1). Domestic currency loans fell by 38.5% and foreign currency loans by 18.6% (Figure 2.14.2). Microfinance, which depends largely on grants from development partners, has shrunk by more than half since August 2021 to AF4.4 billion, undermining the viability of micro-enterprises and people’s livelihoods. According to the United Nations Development Programme, the number of microfinance institutions declined from 10 to 6.

Figure 2.14.1 Bank Deposits

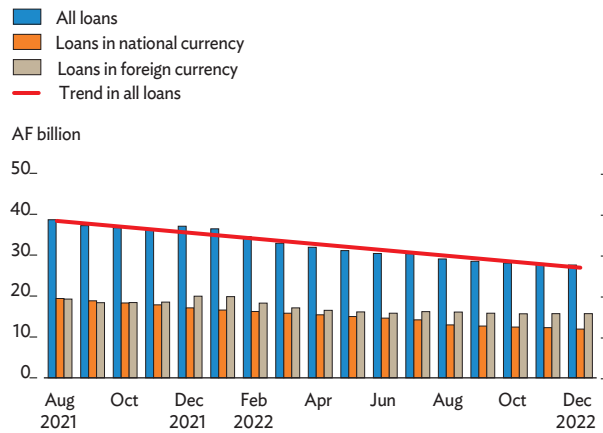
Deposits have dropped, reflecting a lack of confidence in banks.



Source: Official statistics from international sources.

Figure 2.14.2 Loans

Credit in domestic and foreign currency plunged in response to economic woes and liquidity pressures.



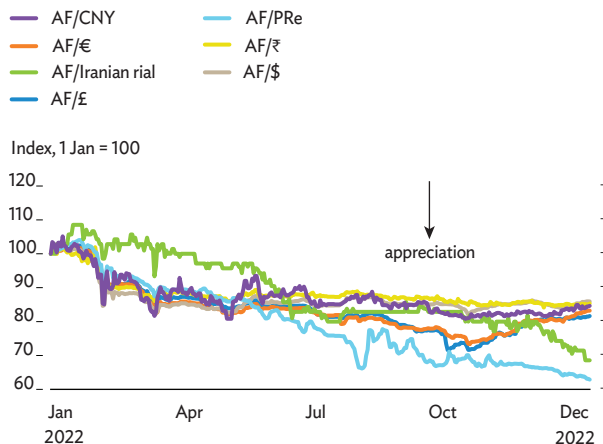
Source: Official statistics from international sources.

Recession has created a widespread humanitarian crisis and rapid fall in living standards as GDP per capita plunged to \$368.80 in 2021.

However, humanitarian assistance in 2022, including direct cash payments of \$2.0 billion, eased some of the crisis by supporting the delivery of essential services, injecting market liquidity, and reducing exchange rate volatility in the absence of regular US dollar auctions by the central bank (Figure 2.14.3). Transparency International found lower perception of corruption in 2022, and there were

Figure 2.14.3 Afghani Exchange Rates

The afghani appreciated against many currencies during 2022.



Source: Official statistics from international sources.

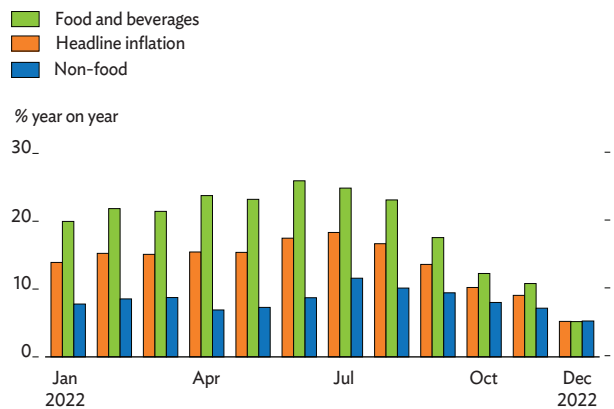
fewer security incidents. These developments slightly improved business profits and employment in the first half of 2022 over the last quarter of 2021, but indicators started to worsen again in November 2022 with the onset of winter. Economic activity declined further with the slowing of international aid following a ban on girls' higher education and restrictions on women working in nongovernment organizations in December 2022.

Headline inflation, as measured by the consumer price index, jumped from an annual average of 5.2% in 2021 to 13.8% in 2022.

Inflation year on year peaked at 18.3% in July 2022 (Figure 2.14.4). Food inflation averaged 19.1% in 2022, up from 5.7% in 2021. Higher global food and energy prices, supply shocks emanating from disrupted domestic and international supply chains, and drought were the major causes of inflation. However, in the third quarter of 2022, global food and energy prices began to decline and supply-side bottlenecks eased, reducing food and other prices. Inflation slowed to 5.2% year on year in December 2022, with food prices up by 5.2% and other prices by 5.3%.

Figure 2.14.4 Inflation

Inflation rose through mid-2022 before declining toward the end of the year as global commodity prices and supply bottlenecks began to ease.



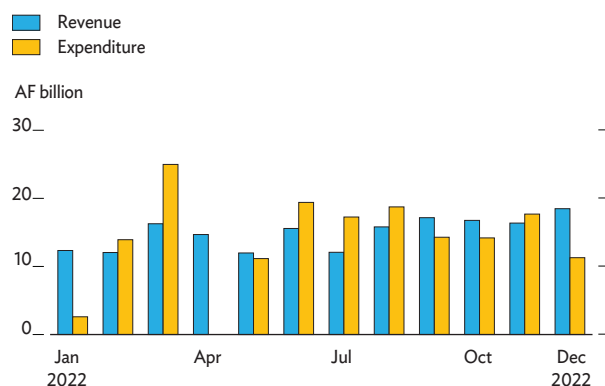
Source: Official statistics from international sources.

Despite the economic slowdown, domestic revenue collection in 2022 was little changed from \$2 billion in 2020.

Customs and other border revenue were the primary sources (Figure 2.14.5). Royalties and fees from mining increased significantly. However, the suspension of on-budget development assistance has slashed development spending by 80% since 2020.

Figure 2.14.5 Revenue and Expenditure, 2022

Revenue collections remained strong, with customs and border revenue the primary sources.

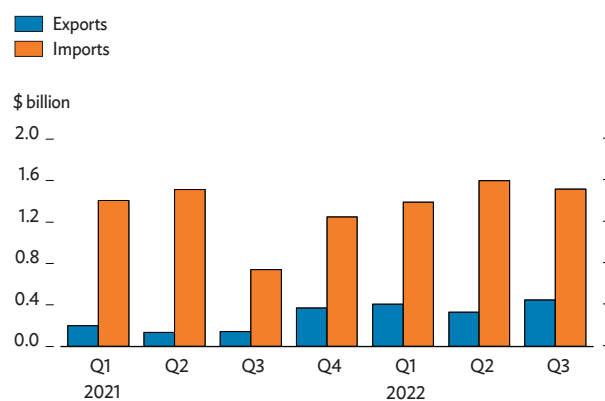


Source: Official statistics from international sources.

Merchandise exports increased in 2022 (Figure 2.14.6). Afghanistan exported \$1.2 billion in goods in the first 3 quarters of 2022, up from \$0.9 billion in 2021. Vegetables, minerals, and textiles constituted more than 90% of exports. India, Pakistan, and the People's Republic of China remained the top export destinations. Meanwhile, imports in the first 3 quarters of 2022 were \$4.5 billion, almost \$800 million higher than in the first 9 months of 2021. They came mainly from Iran, Pakistan, and the People's Republic of China.

Figure 2.14.6 Merchandise Trade

Merchandise exports increased with higher mineral exports.



Q = quarter.

Source: Official statistics from international sources.

Economic Prospects

Two main scenarios exist for economic prospects.

The baseline scenario assumes a continuation of the current security and political environment. In this scenario, brain drain continues, and aid provided in US dollars is assumed to decline significantly, though assistance in kind is unchanged from 2022. (ADB placed its regular assistance to Afghanistan on hold, effective from 15 August 2021, but in 2022 supported a special arrangement with the United Nations to address basic human needs.) An alternative scenario assumes that the government shows a strong commitment to basic human rights, specifically by removing restrictions on girls' education and female employment, with more positive consequences for the economy.

Under the baseline scenario, GDP contracts further in the newly introduced fiscal year 2023

(FY2023, ending 20 March 2024). Population growth drives down income per capita more sharply. A lack of liquidity in the formal banking sector and concerns over money laundering and the financing of terrorism would constrain business transactions and international payments. Lower aid in US dollars, which is inflow of secondary income in the balance of payments, would likely trigger 10%–15% afghani depreciation. This could reverse the recent decline in prices for essential foodstuffs, exacerbating food insecurity because Afghanistan is a net food importer. The drop in imports, economic contraction, and currency depreciation could lower customs revenue, underfunding the budget. Obtaining raw materials for manufacturing would become harder, and energy imports would be hindered. In the absence of technical level engagement with the international community, the capacity of public institutions is likely to weaken further. In addition, low investment in infrastructure and other public goods would worsen the current shortfall in provision of infrastructure and public services. Incomes would likely decline, unemployment increase, and poverty worsen. These developments would exacerbate already dismal social and political conditions, spurring more internal displacement and civil conflict. Moreover, Afghanistan would fall further behind in reaching its Sustainable Development Goals.

In the alternate scenario, the government shows a strong commitment to basic human rights and removes the restrictions on girls’ education and female employment. International support would then go beyond basic humanitarian assistance, allowing education and health care to strengthen. The political and investment climate would improve, and financial sector constraints would ease. The value of the afghani would remain broadly stable, taming inflation and improving food security and real household income. Productivity and the human capital index would be higher than in the baseline scenario because higher female labor force participation would add to factor accumulation. Domestic revenue collection would increase, facilitating expenditure on government services. These changes, along with improvements in trade and mining revenues, could raise GDP modestly in FY2023.

Policy Challenge—Addressing Food Insecurity

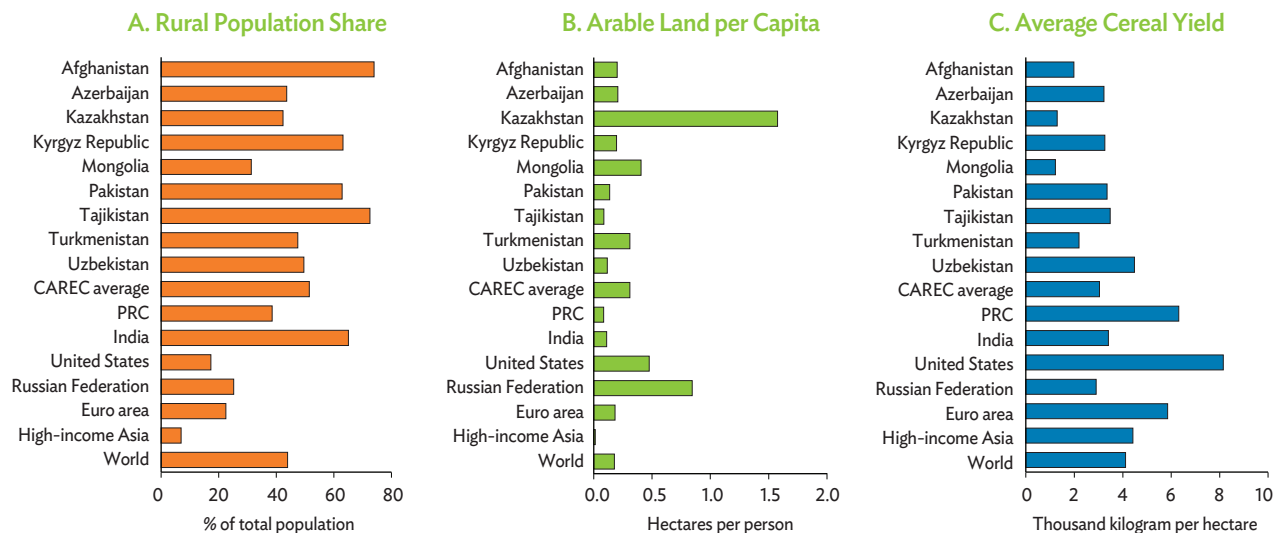
The political crisis has further exacerbated food insecurity in many regions of Afghanistan. After decades of adversity and institutional uncertainty,

Afghanistan entered a period of acute humanitarian crisis after regime change in August 2021, with food insecurity reaching crisis levels in many parts of the country. According to the United Nations Office for the Coordination of International Affairs, after the 2022 harvest, an estimated 20 million people, or more than half of the population, experienced food insecurity classified as crisis (Phase 3) or emergency (Phase 4) under the Integrated Food Security Phase Classification system. The international community currently provides food to 38% of the population. During the winter, smallholder farmers have been particularly hurt by drought. High food and energy prices and disrupted international supply chains have aggravated an already dire situation.

With a large share of the population in rural areas, Afghanistan has agricultural potential (Figure 2.14.7). Arable land per capita is three times that of the People’s Republic of China and seven times that of Japan and the Republic of Korea, three of Asia’s leading food export destinations. However, current agricultural productivity is critically low, with average cereal yield only about 2 tons per hectare, or a third of that in the People’s Republic of China. Smallholder farmers face three critical challenges: (i) disintegrated market access and supply chain disruption, (ii)

Figure 2.14.7 Rural Population, Arable Land, and Average Cereal Yield Compared

Afghanistan has a high rural population share and significant arable land per capita.



CAREC = Central Asia Regional Economic Cooperation Program, PRC = People’s Republic of China.
Source: Official statistics from international sources.

information asymmetry, and (iii) low productivity. Addressing these challenges with the help of the international community could significantly improve agricultural productivity.

Sustained and inclusive economic growth, education, and infrastructure investment can significantly enhance food security and agricultural development.

Inclusive economic growth is essential for improving food security. This requires the government to pursue policies that address the devastating collapse of external assistance and disruption to the labor market, trade, and private enterprise. Education and vocational training can provide globally competitive skills to most of the working population. In addition to restoring female labor force participation, policies to accelerate skill

development are essential to improve productivity in agriculture. Further, investment in irrigation and other infrastructure, including roads and information technology, could dramatically improve market access, producer bargaining power, and supply chain efficiency.

Trade and foreign direct investment are imperative to modernize and expand agriculture.

Afghanistan has always been a trade crossroads. Its engagement with the global economy presents a significant opportunity to leverage external demand and import technology to enable growth. International partnerships for inbound investment can accelerate growth, modernize agriculture, and enhance food security. Moreover, foreign direct investment can facilitate market access for exports and technology transfer.

BANGLADESH

GDP growth continued to recover in fiscal 2022, buoyed by strong external demand. Inflation edged up and the current account deficit widened. Growth will slow markedly this year in line with worsening global economic conditions following the Russian invasion of Ukraine but will likely edge up next year on recovering growth in trade partners. Inflation will increase sharply this year but moderate next year. Education reform is critical to improve productivity, diversify industry, and sustain high growth.

Economic Performance

GDP growth edged up to 7.1% in fiscal year 2022

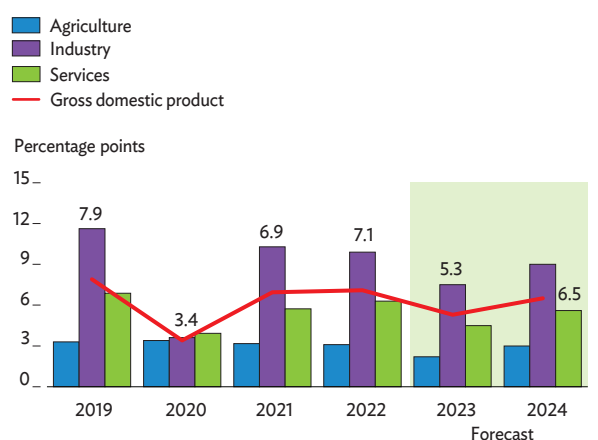
(FY2022, ended 30 June 2022). This was marginally higher than 6.9% in the previous year and driven by services (Figure 2.15.1). Growth in services accelerated from 5.7% in FY2021 to 6.3% in FY2022 with strong contributions from wholesale and retail trade, transport, real estate, education, finance, and accommodation. In contrast, growth in industry decelerated from 10.3% to 9.9% with lower manufacturing output from micro, small, and medium-sized enterprises and contraction in mining and quarrying. Agriculture was marginally down as sector growth slowed from 3.2% to 3.1%.

On the demand side, increased external demand contributed to growth. Exports and imports alike grew strongly as major overseas markets reopened with the waning of the pandemic. Private consumption growth eased slightly under higher inflation. Growth in public consumption also slowed as the government reduced its dependence on high-cost borrowing through national savings certificates. Public investment rose, however, on the expedited implementation of large infrastructure projects, which notably saw the opening of the Padma Bridge. Private investment also increased, as reflected in higher imports of industrial raw materials and capital goods and in solid growth in private sector credit.

Inflation edged up from 5.6% in FY2021 to average 6.2% in FY2022. This mainly reflected higher global commodity prices, especially for energy, caused by

Figure 2.15.1 GDP Growth by Sector

The economy recovered before slowing in FY2023.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

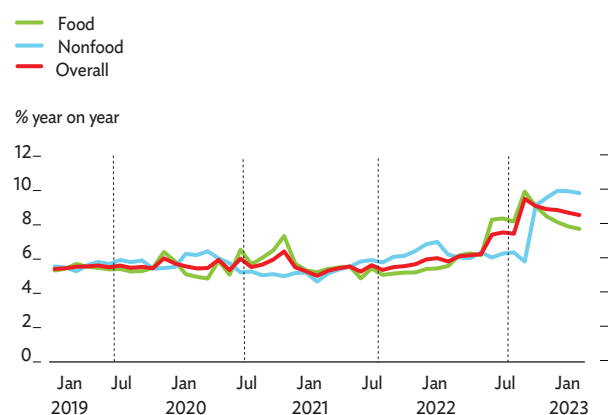
Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

supply disruption following the Russian invasion of Ukraine (Figure 2.15.2). Local currency depreciation against the US dollar also fueled inflation. Monthly nonfood inflation accelerated in the first half and food inflation in the second. High import costs induced the government to raise energy prices.

Broad money growth slowed from 13.6% in FY2021 to 9.4% in FY2022. This came as net foreign assets fell significantly below a monetary program target of

Figure 2.15.2 Monthly Inflation

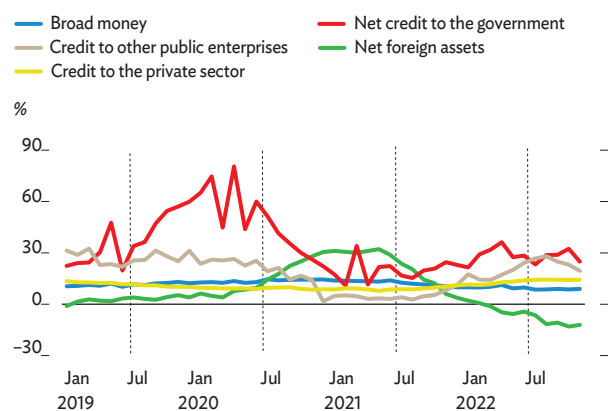
Inflation accelerated in 2022.

Source: Bangladesh Bank. 2022. [Monthly Economic Trends](#). February.

15.0% (Figure 2.15.3). Growth in private sector credit accelerated from 8.4% in FY2021 to 13.7%, close to the targeted growth of 14.8%. Growth was spurred in part by a cap on interest rates imposed by the central bank. Growth in net credit to the public sector rose significantly from 19.3% in FY2021 to 27.7% as foreign credit inflow increased but still fell short of the 32.5% target. Interest rates remained controlled under accommodative monetary policy set by Bangladesh Bank, the central bank, which nevertheless raised the repo rate twice—by 25 basis points in May 2022 and by 50 points in June 2022 to reach 5.5%—to contain mounting inflationary pressure.

Figure 2.15.3 Monetary Indicators

Credit to the private sector accelerated in 2022.

Source: Bangladesh Bank. 2022. [Major Economic Indicators: Monthly Update](#). December.

Fiscal policy remained expansionary to support economic recovery and mitigate the effects of the pandemic on the poor and vulnerable. Taxes collected by the National Board of Revenue—more than 87.0% of total revenue—grew by 11.5% in FY2022, mainly on increased value-added tax and supplementary duty collection. Despite this, growth in tax collection underperformed because of subdued customs duty and income tax collection. Government expenditure substantially increased from 9.5% growth in the preceding year to 13.3% on higher recurrent spending on subsidies, transfer payments, and pay and allowances, and as growth in development spending more than doubled from 5.6% to 12.6%. Total revenue equaled 8.5% of GDP, and spending 13.1%, which widened the fiscal deficit from 3.7% of GDP to 4.6%.

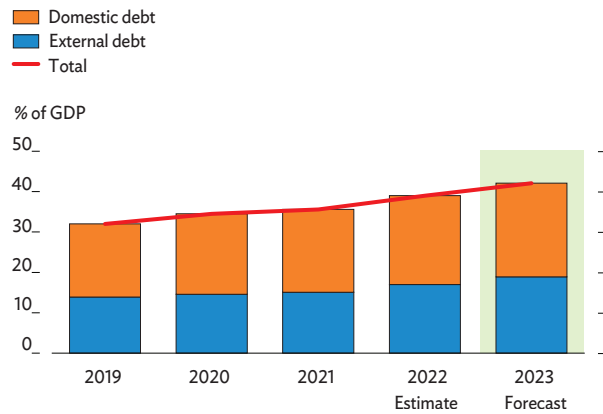
Bangladesh remains at a low risk of external and overall debt distress. The ratio of government debt to GDP increased from 35.6% in FY2021 to 39.0% in FY2022 (Figure 2.15.4). The government continues to rely largely on concessional external borrowing, especially to finance infrastructure projects, which raised external debt from 15.1% of GDP to 17.0%. Domestic debt increased from 20.5% of GDP to 22.0%, but with less reliance on the issuance of higher cost national savings certificates.

Export growth more than doubled from 12.4% in FY2021 to 33.4%, to reach \$49.2 billion. The large increase reflected pent-up demand from major export destinations. Garment exports grew by 35.5%, bolstered by competitive prices, strong demand for knitwear and woven garments, and the diversion of export orders from other major exporters. Exports of leather and leather products also registered impressive gains, as did engineering products.

Import growth increased from 19.7% in FY2021 to 35.9%, to reach \$82.5 billion. About a third of the rise came from higher imports of intermediates for the garment industry to meet sharply increased demand for exports, and from higher prices for them. Imports of pharmaceuticals, fertilizer, and intermediate goods for construction rose by a robust 63.5%, contributing about 40% of the import increase. Imports of capital goods rose by 26.3%, signifying strong business confidence. A substantial rise in edible oil and wheat imports reflected higher international prices caused by global supply chain disruption and protective measures imposed by some key exporters of edible oil and wheat.

Figure 2.15.4 Government Debt

Growth in debt accelerated in 2022.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: International Monetary Fund.

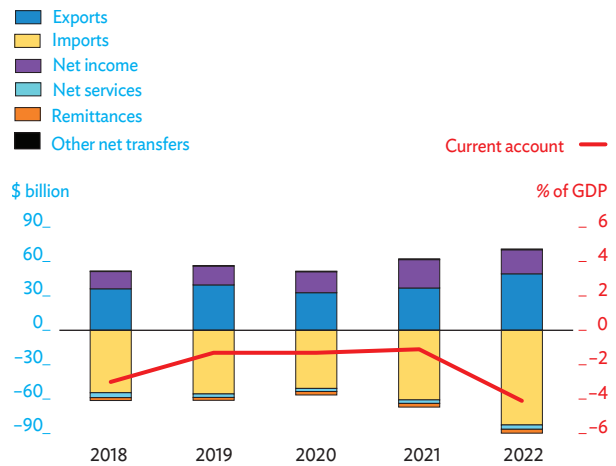
A deficit in the balance of payments sharply drew down official foreign exchange reserves in FY2022.

The trade deficit widened to \$33.2 billion, equal to 7.2% of GDP, as a \$21.8 billion increase in imports far surpassed a \$12.3 billion rise in exports. Remittances contracted by 15.1% from \$24.8 billion in FY2021 to \$21.0 billion, reflecting remitters' greater use of unofficial channels to avoid receiving a much lower official exchange rate. The higher trade deficit, lower remittances, and deficits in services and primary income widened the current account deficit to \$18.7 billion, or 4.1% of GDP (Figure 2.15.5). The combined capital and financial account surplus, adjusted for errors and omissions, decreased to \$13.3 billion, reflecting a large decline in the use of net trade credit. As the current account deficit significantly exceeded net financial inflow, gross foreign exchange reserves decreased by 9.8% to \$41.8 billion, or cover for around 5 months of imports of goods and services (Figure 2.15.6).

The Bangladesh taka depreciated by 9.2% against the US dollar in FY2022 as demand for imports surged (Figure 2.15.7). The central bank sold \$7.6 billion to commercial banks to curb excessive volatility. However, inflation differentials meant the taka appreciated by 0.5% in real effective terms in the year to June 2022.

Figure 2.15.5 Current Account Components

The current account deficit widened sharply in FY2022 on higher imports.



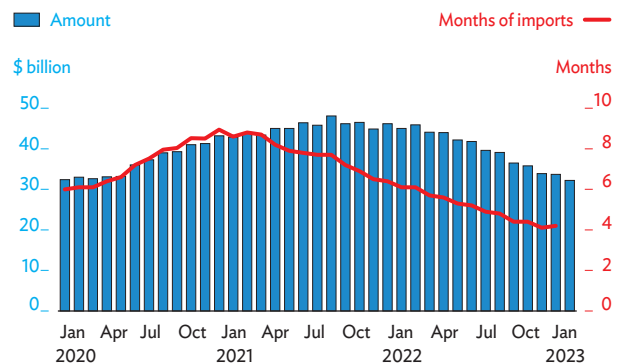
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: Bangladesh Bank.

Figure 2.15.6 Gross Foreign Exchange Reserves

Central bank reserves trended lower.



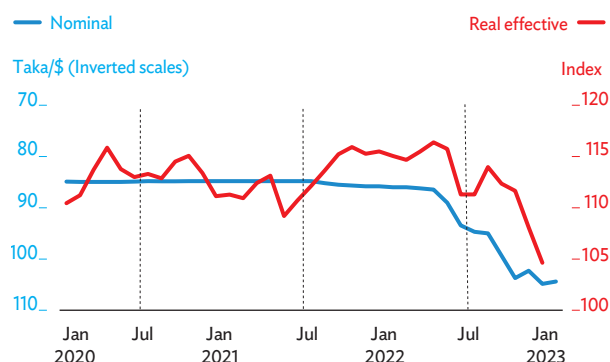
Source: Bangladesh Bank.

Economic Prospects

GDP growth is projected to slow to 5.3% in FY2023 and then edge back up to 6.5% in FY2024 (Table 2.15.1 and Figure 2.15.8). The marked downturn reflects global economic disruption caused by the Russian invasion of Ukraine. Private consumption growth is expected to slow further because of economic uncertainty caused by high inflation and growth in public consumption continues to slow with

Figure 2.15.7 Exchange Rates

Taka has markedly depreciated against the US dollar in 2022.



Source: Bangladesh Bank. 2023. *Monthly Economic Trends*. February.

Table 2.15.1 Selected Economic Indicators, %

Growth slows in line with expected weaker global outlook.

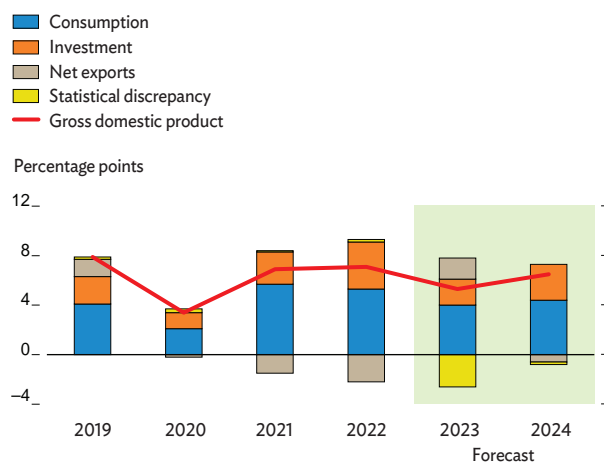
	2021	2022	2023	2024
GDP growth	6.9	7.1	5.3	6.5
Inflation	5.6	6.2	8.7	6.6

GDP = gross domestic product.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

Figure 2.15.8 Demand-Side Contributions to Growth

Subdued consumption pulls down growth in 2023.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; ADB estimates.

government’s austerity measures to curb inflation. Public investment will be affected by austerity measures that prioritize implementation of large investment projects due to lower revenue and declining foreign exchange reserves. Private investment is expected to be lower because of energy shortages and higher production costs. Net exports will add to growth as imports decline under restrictions and importers struggle to open letters of credit.

Bangladesh is taking proactive steps to respond to climate change and a dim global economic outlook.

As a precautionary measure, it has embarked on IMF programs under the Resilience and Sustainability Facility, Extended Fund Facility, and Extended Credit Facility. The programs foster economic resilience and sustainable growth by providing resources and technical assistance to address immediate challenges such as current account imbalances and reserve losses; and longer-term structural issues in the economy including vulnerability to climate change.

On the supply side, setbacks mainly in industrial and services will slow GDP growth in FY2023.

Growth in industry is projected to decelerate to 7.5% because of energy shortages and high inflation. Growth in services is similarly expected to decelerate to 4.5% as incomes and demand weaken, with knock-on effects hitting agriculture and industry. Floods, cyclones, and droughts are expected to slow growth in agriculture to 2.2%.

GDP growth is expected to edge up to 6.5% in FY2024.

This reflects stronger demand for ready-made garments in the US and Europe as growth recovers and domestic energy costs ease. The contribution from private consumption is expected to be buoyed by higher remittances as more workers go abroad for jobs. Private investment is expected to rise as consumer and investor confidence improves. Higher implementation of development projects, including fast-track projects in the run-up to general elections, is expected to contribute to growth. On the supply side, agriculture growth is forecast to rise to 3.0% if normal weather prevails. Growth in industry is expected to accelerate to 9.0% with higher earnings from apparel and other exports in line with gradual improvement in global demand and continued government policy support. Growth in services is expected higher at 5.6% following trends in agriculture and industry.

Inflation is projected to accelerate to average 8.7% in FY2023 and then moderate in FY2024. Escalating inflation in FY2023 will derive from substantial upward adjustments to domestic electricity and fuel prices, rising domestic food prices, and pass-through from steep currency depreciation, with headline inflation having already increased from 7.5% in July 2022 to 8.6% in January 2023. Inflation is projected to moderate to 6.6% in FY2024 as global prices for oil and other commodities ease. Moreover, the authorities have taken steps to keep domestic food prices stable by boosting agricultural production.

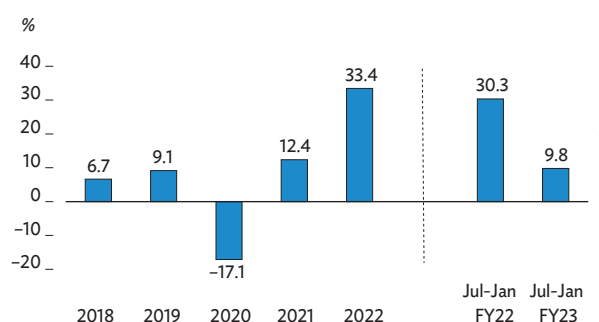
Monetary policy continues to be tilted toward tightening. The central bank increased its policy repo rate to 6% from January 2023 to restrain inflation, exchange rate pressures, and reserve outflow. At the same time, policies aim to support economic growth by ensuring adequate funding for productive pursuits that generate employment. To make policy more responsive, institutional changes aim to establish a market-based, flexible, and unified exchange rate regime by the end of FY2023. In the meantime, it has significantly increased margins on opening letters of credit to discourage imports of luxury goods.

Slow global growth forecasted for 2023 will hit exports. Export growth year on year decelerated significantly in the first 7 months of FY2023 from 30.3% a year earlier to 9.8% (Figure 2.15.9). Since most export growth in FY2022 occurred in the first half on a surge in global garment demand, slower export growth to date in FY2023 reflects a marked weakening of income and demand in major export destinations. On balance, export growth is projected to slow to 6.8% in FY2023, then recover somewhat in FY2024 to 8.2% as demand strengthens.

Imports are volatile in this trade-dependent economy. Imports contracted by 2.2% in the first half of FY2023, following a 54.5% expansion in the same period of FY2022. The decline largely reflected decreased imports of intermediates for the garment industry but also the downturn in economic growth, restrictions imposed to discourage nonessential imports, and a sharply depreciated currency. On balance, imports are forecast to contract by 5.0% in FY2023 but rebound to 5.5% expansion in FY2024 on improved export demand and domestic growth.

Figure 2.15.9 Exports Growth

Merchandise exports have slowed in FY2023 on lower demand in advanced economies.



Note: Years are fiscal years ending on 30 June of that year.

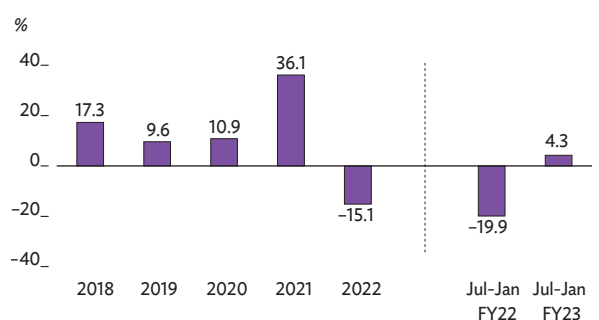
Sources: Bangladesh Bank; and Export Promotion Bureau, Bangladesh.

Remittances are a major source of foreign exchange earnings. Remittances increased by 4.3% in the first 7 months of FY2023, following a 19.9% contraction in the same period of FY2022 (Figure 2.15.10). The revival was driven by a sharply depreciated currency, a 2.5% cash incentive offered by the government to users of formal channels, and easier remittance transfer through newly allowed mobile financial services. Remittances are forecast to increase by 4.0% to \$21.9 billion in FY2023, and then by 7.4% to \$23.5 billion in FY2024 under a fully market-oriented exchange rate.

The current account deficit is projected to moderate. With a reduced trade deficit and rising remittances, the current account deficit is expected

Figure 2.15.10 Growth in Remittances

Currency depreciation boosts remittances recovery in FY2023.



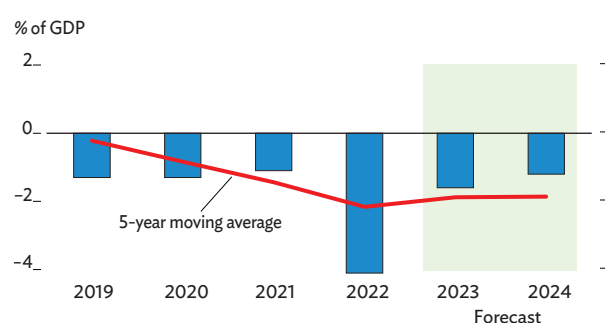
Note: Years are fiscal years ending on 30 June of that year.

Source: Bangladesh Bank.

to narrow to the equivalent of 1.6% of GDP in FY2023 (Figure 2.15.11). It is expected to narrow further to 1.2% in FY2024 with stronger growth in remittances and exports. Underpinning these projections are taka depreciation by 17.6% against the US dollar in the year to the end of January 2023 and the move to a flexible, market-based, and unified exchange rate regime by the end of FY2023.

Figure 2.15.11 Current Account Balance

The current account deficit is forecast to narrow on improvement in the trade deficit and remittances.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bank, 2022. *Annual Report 2021-2022*; ADB estimates.

Government's fiscal targets in the FY2023 budget may not be fully achieved. The FY2023 budget targets 11.3% growth in revenue to the equivalent of 9.7% of GDP, a 14.2% rise in public spending to 15.2% of GDP, and thus a 5.5% deficit. However, the National Board of Revenue reported revenue collected in the first half of FY2023 reaching only 33.6% of the target for the whole year. In light of this, revenue collection is expected to equal 8.8% of GDP. However, austerity measures will likely limit spending to 14.4% of GDP. With higher relative shortfall in revenue, fiscal deficit is expected to increase to 5.6% of GDP in FY2023, from 4.6% in FY2022. Continued revenue shortfalls underline the need for expediting tax reforms, as increasing the ratio of revenue to GDP will be critical to supporting much-needed spending on social and infrastructure development, and climate change priorities.

The outlook is subject to downside risks. A greater economic slowdown in major export destinations is a key risk. Another risk is heightened global political

tensions that disrupt prices and supply chains for oil and other commodities. Any delay in reform to tax policy or administration could risk higher public debt. Extreme weather is a perennial risk.

Policy Challenge—Preparing Better Education for the Next Generation

As Bangladesh graduates from least-developed-country status in 2026, it needs to reset its growth strategy. The country will lose the advantages of

low-cost labor and preferential market access, perhaps making its traditional labor-intensive manufacturing industries less competitive. In addition, the ongoing Fourth Industrial Revolution may challenge the government's objective of generating 30 million jobs by 2030, as labor intensive industries are likely to be disrupted by robotics, automation, and machine learning. Bangladesh therefore needs structural transformation toward products and services with higher value addition to match its aspiration to become an upper-middle-income country by 2031. Government strategies need to emphasize job creation by promoting modern services and export-oriented manufactures and thus capitalizing on advances in digital technology and a skilled, technology-ready workforce. This requires investment in human capital by improving education quality and deepening skill development, which is recognized as critical to the country's development aspirations. To facilitate skill development, the National Skills Development Authority has been set up and authorized to set policy, strategy, and an action plan. Further, the government's Skills for Employment Investment Program aims to enhance the productivity and employability of young workers with industry-relevant skills across priority sectors.

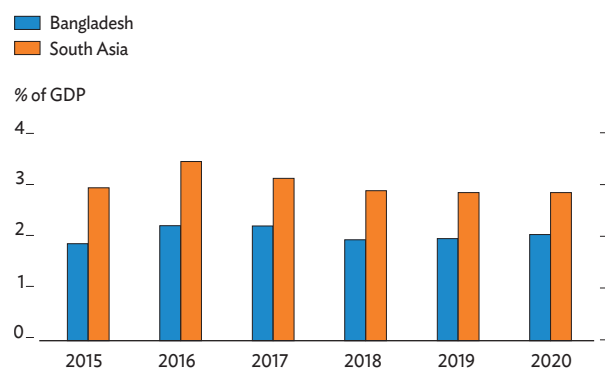
Despite recent education achievements in Bangladesh, challenges remain in access, equity, and quality. The link between education and

employment is weak. Bangladesh scored 0.46 on the World Bank's Human Capital Index in 2020, below the South Asian average of 0.48. Bangladesh spends less on education than the South Asian average (Figure 2.15.12). Skill shortages are evident, and industry lacks diversification. The country has a large

and young population, but workers are inadequately skilled. The working-age population aged 15–59 is expected to reach 119 million by 2026, but only 1.7% have received formal skill training. The skill ranking of Bangladesh in the Global Competitiveness Report in 2019 was a low 117 among 140 economies. Mismatch between skill supply and demand widened as the youth unemployment rate almost doubled from 6.4% in 2010 to 12.2% in 2019. Moreover, skill shortage and mismatch have driven socioeconomic inequality and relative expansion in the informal economy.

Figure 2.15.12 Government Expenditure on Education

Public investment in education remains inadequate compared with South Asia average.



Note: Years are fiscal years ending on 30 June of that year.

Source: World Bank. World Development Indicators database.

Public expenditure on technical and vocational education and training (TVET) is lower than in most other developing countries. Moreover, the quality and relevance of TVET courses fall short as only about 40% for TVET graduates find skilled jobs. Qualified teachers in modern and emerging technologies are in short supply. Bangladesh has about 50,000 teachers in government and nongovernment TVET institutions, but most of them lack an advanced degree in technical education or industry work experience.

Lack of access to high-quality higher education remains a challenge. Tertiary education suffers a mismatch between the education offered and the education demanded by industry. An acute shortage of skilled middle managers usually leaves these positions to be filled by professionals from neighboring countries. Laboratories for engineering and technology education are often insufficient, outdated, and therefore unable to take up new technology. Students are granted little laboratory time for hands-on experience and practice, and laboratories are often poorly equipped and maintained. Programs are often similarly outdated, their teaching methods teacher-centric and theory-focused, and assessment largely by examination.

Skill development needs to match economic aspirations. A key imperative is to improve the quality of TVET by improving the quality of TVET institutes. Public expenditure on TVET needs to be substantially increased to underwrite such efforts. The courses offered need to be more relevant to job market needs, with collaboration between industry and academia playing a critical role in reform. Modernizing the curriculum so that courses meet world standards and are taught in facilities and laboratories with latest equipment is urgently needed to improve the quality of education.

Major reform will be required to address challenges in higher education. Improved education quality and relevance must be ensured by selecting university teachers for their strong academic credentials and by raising tertiary enrolment rates in science, technology, engineering, and mathematics. Capacity for research and innovation needs to be strengthened with adequate public funding, productive relationships between academia and industry, and digitized university education. Better university governance will be required. Public university funding needs to be expanded with more from both the government and private donors and by adopting the innovative financing methods used in upper-middle-income and high-income countries and by instituting a low-cost student loan program.

BHUTAN

Growth accelerated in 2022. Inflation eased, but the current account deficit widened sharply, drawing down official reserves. The outlook is for moderate slowing of growth as impetus from recovery in production and the commissioning of new hydropower projects is offset by low investment during the transition to the 13th Five Year Plan covering the period 2024–2028. Current account deficits are expected to remain elevated, placing further pressure on foreign exchange reserves. Bhutan needs a more vibrant private sector to achieve its development goals.

Economic Performance

Provisional estimates show growth increasing from 4.1% in 2021 to 4.7% in 2022 (Figure 2.16.1).

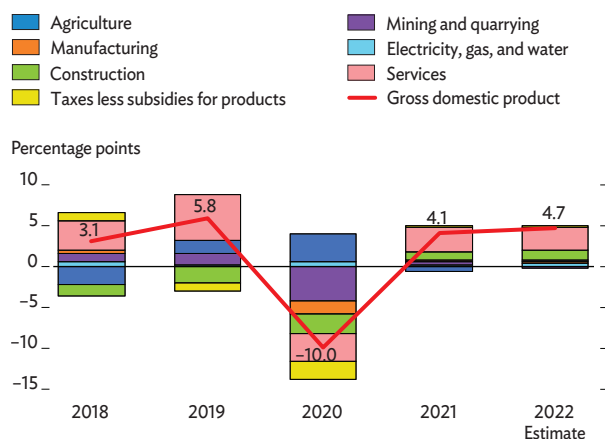
All sectors are estimated to have grown in 2022 on strong domestic demand supported by government’s monetary relief measures and the easing of COVID-19 restrictions. Services were the largest contributor, with growth estimated at 5.6% and underpinned by strong expansion in accommodation and food services and in transport, storage, and communication. Industry output is estimated to have increased by 4.4% on a 10.0% expansion in construction as capital spending surged and restrictions limiting expatriate labor imports were relaxed. New policies requiring value addition to minerals before export caused minerals, mining, and quarrying to contract by 1.5%. Agriculture grew by 2.2%.

On the demand side, growth was driven by continued revival in gross fixed capital formation and consumption expenditure (Figure 2.16.2).

Growth in gross fixed investment is estimated to have increased to 15.0% on double-digit growth on both the public and the private side, and with a marked buildup in inventory. Private consumption expenditure expanded by 4.8% and public by 5.3%. Net exports became a larger drag on growth with sharp expansion in imports.

Figure 2.16.1 Supply-Side Contributions to Growth

All sectors registered moderate growth in 2022.

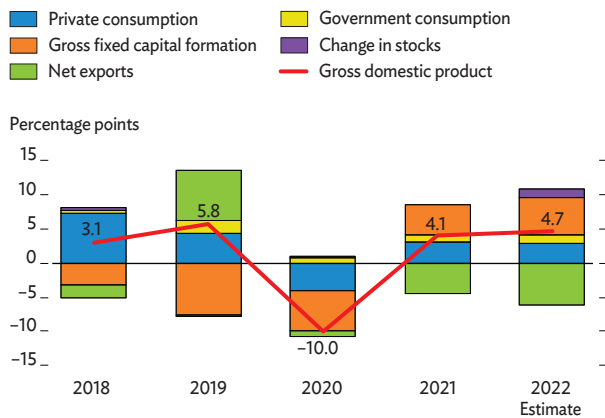


Sources: National Statistics Bureau ; Haver Analytics; Asian Development Bank estimates.

Inflation moderated from 7.3% in 2021 to 5.6% in 2022 (Figure 2.16.3). Inflation slowed in 2022 in tandem with food price inflation, which fell from 12.8% in 2021 to 5.0%. Nonfood inflation averaged 9.0%, driven mainly by transport costs that increased by nearly 13.0% with a large rise in global oil prices following the Russian invasion of Ukraine. One-third of overall inflation came from this category.

Figure 2.16.2 Demand-Side Contributions to Growth

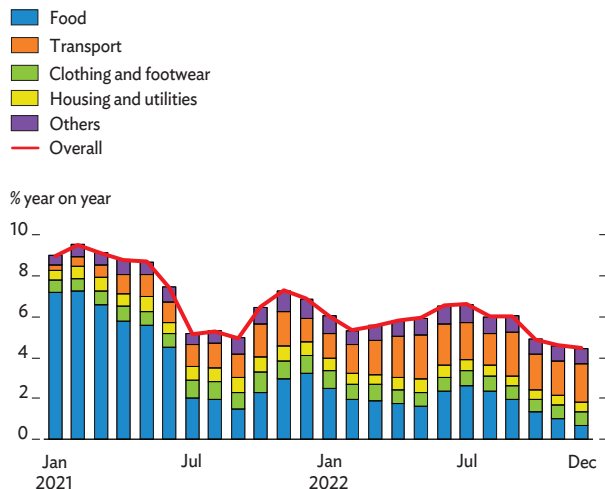
Demand-side drivers highlight continued reliance on public spending.



Sources: National Statistics Bureau ; Haver Analytics; Asian Development Bank estimates.

Figure 2.16.3 Inflation

Inflation moderated in 2022 as food price inflation slowed.



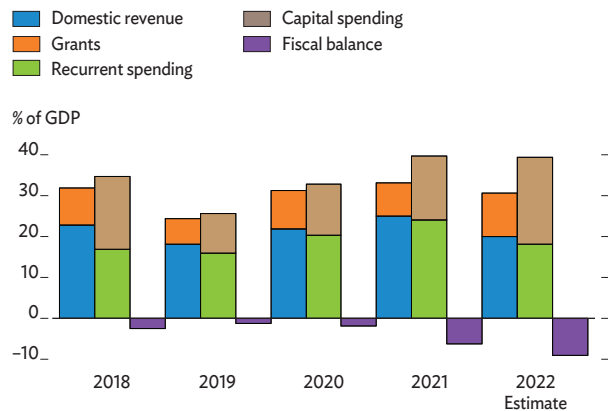
Sources: National Statistics Bureau ; Haver Analytics.

The budget deficit widened in fiscal year 2022 (FY2022, ended 30 June 2022) from 6.2% a year earlier to 8.8%.

There were marked changes in the composition of both expenditure and revenue (Figure 2.16.4). Government spending was marginally lower, down from 39.5% of GDP in FY2021 to 39.3% in FY2022 despite a 25.8% increase in capital expenditure to 21.4% of GDP. However, the increase in capital expenditure was offset by a decline in current expenditure, which fell from 24.2% of GDP to 18.0% mainly with the scaling back of economic relief

Figure 2.16.4 Fiscal Indicators

As revenue fell, a widening fiscal deficit helped to sustain growth.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Ministry of Finance; Asian Development Bank estimates.

measures provided during the height of COVID-19 lockdowns. Despite a modest increase in growth, domestic revenue declined sharply from 24.9% of GDP in FY2021 to 20.1%. Even with an increase in grants to 10.4% of GDP, revenue and grants together amounted to only 30.5% of GDP, or 2.7 percentage points less than in FY2021. With a slight decline in expenditure, the increase in the deficit was held to 2.5 percentage points, equal to 8.8% of GDP.

Monetary policy remained accommodative to revive the economy.

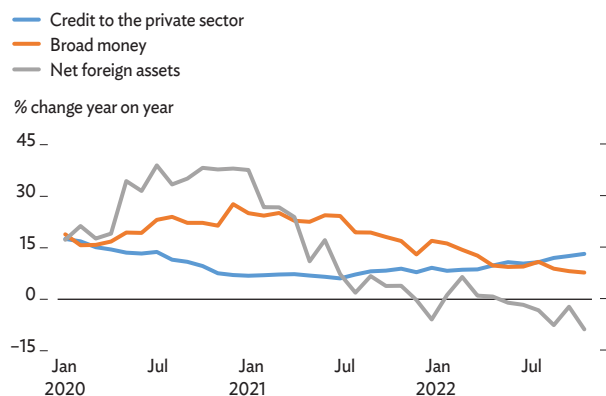
Monetary policy continued to promote economic growth and ensure adequate and uninterrupted flow of credit. Domestic credit grew in 2022 by an estimated 18.7%, with a 13.2% increase to the private sector and a near doubling of net credit to the government. Money supply is estimated to have grown by only 7.7%, however, as net foreign assets fell steeply along with official reserves as a result of marked deterioration in the balance of payments (Figure 2.16.5).

The current account deficit widened considerably from the equivalent of 21.9% of GDP in 2021 to an estimated 34.3% (Figure 2.16.6).

The trade deficit grew as imports increased by 35.2% from a year earlier, largely because of price rises for fuel and steel and a dramatic rise in the imports of information technology equipment, while exports increased by only 2.4%. The current account deficit was financed

Figure 2.16.5 Monetary Indicators

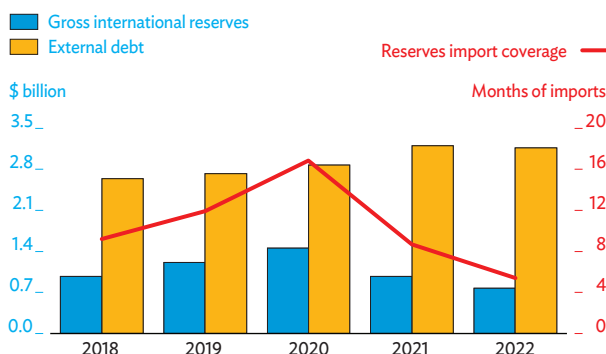
Accommodative monetary policy contributed to economic growth.



Source: Royal Monetary Authority.

Figure 2.16.7 External Debt and Gross International Reserves

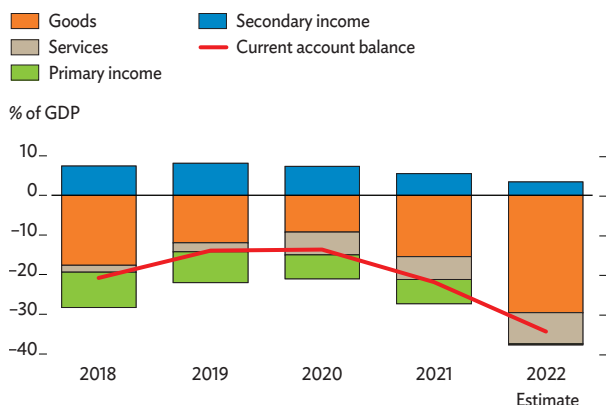
An import surge diminished gross international reserves.



Source: Royal Monetary Authority.

Figure 2.16.6 Components of the Current Account

The current account deficit widened on strong growth in imports.



GDP = gross domestic product.

Sources: Royal Monetary Authority; Asian Development Bank estimates.

by a large net financial account inflow, if errors and omissions are included, and by drawing down gross foreign exchange reserves by \$215.0 million.

Despite falling by 20% in 2022, gross international reserves at \$755.0 million provided cover for 4.7 months of merchandise and service imports (Figure 2.16.7). Public external debt fell from the equivalent of 117.7% of GDP in 2021 to 115.8% in 2022 largely because of GDP growth. Though the ratio of debt to GDP ratio is high, 69.2% of public external debt is hydropower debt owed to India, which the IMF points out is self-liquidating, given Bhutan’s power purchase agreements with India. Hence, Bhutan’s risk of debt distress is moderate.

Economic Prospects

Growth will slow slightly in 2023 and 2024 (Table 2.16.1). A return to normal hydropower production after 2 years of decline will underpin growth in 2023, while expected production from two newly commissioned hydropower plants will help sustain growth in 2024. At conservatively projected capacity for that year, these plants are expected to raise GDP by 3 percentage points. As India is Bhutan’s main trade partner, its robust economic growth prospects in 2023 and 2024 will boost exports and growth. However, growth prospects are tempered this year and next by a marked decline in investment caused by emerging domestic macroeconomic issues, national elections in December 2023, and a transition to a new government five year plan. On balance, growth is projected to slow from 4.7% in 2022 to 4.6% in 2023 and 4.2% in 2024.

Table 2.16.1 Selected Economic Indicators, %

Growth and inflation are expected to moderate in 2023 and 2024.

	2021	2022	2023	2024
GDP growth	4.1	4.7	4.6	4.2
Inflation	7.3	5.6	5.5	5.1

GDP = gross domestic product.

Sources: Ministry of Finance; National Statistical Bureau; Asian Development Bank estimates.

Greater hydropower generation in 2023 and 2024 will sustain growth. Bhutan opened up its economy to tourism on 23 September 2022. While the recovery in tourist arrivals has been slow due to the increase in the sustainable development fee, total tourist arrivals in 2023 will be considerably higher than in 2022 and boost foreign reserves and services. While tourism is expected to remain well below its 2019 level, accommodation and food services will grow by 4.3%. Wholesale and retail trade, however, is forecast to contract as import restrictions are sustained to reduce pressure on foreign exchange reserves. Growth in agriculture is forecast at 3.2% in 2023 and 2.6% in 2024 as the government continues to invest in agricultural infrastructure, value chain creation, and contingency measures to address the rising issue of human–wildlife conflict. Industry growth at 5.0% will be strengthened by increased electricity output in 2023, reaching the 2020 level on expected better hydrological flow and less maintenance downtime—two factors that held back generation in 2021 and 2022. However, mining and quarrying will be hampered by changes in export policy. Moreover, growth in the large construction industry will slow as work winds down and nears completion on the 1,020 megawatt Puna-2 hydropower plant and the smaller Nikachhu plant. In 2024, growth in electricity output from the commissioning of these two plants will underpin 5.4% expansion in industry growth. Services are expected to continue to grow in 2024, but with accommodation and food services remaining below their 2019 level as tourist arrivals continue to lag, in part because the sustainable development fee charged to international tourists has risen steeply.

On the demand side, aggregate consumption expenditure will drive growth. It is forecast to expand by 25.4% in 2023 and 12.3% in 2024, mainly on strong private consumption, as is consistent with the experience of past government election cycles. Public consumption is expected to grow by 5.6% in 2023 and 5.0% in 2024. Fixed investment is projected to contract by 8.1% in 2023 and 1.6% in 2024, with the FY2024 capital allocation shrinking by almost 20%—the largest decrease in the Twelfth Five-Year Plan, 2018–2023. Transition to a new government

and 5-year plan will slow growth in fixed investment as arrangements are made for newly selected projects and financing. On balance, the budget deficit is projected to widen marginally in FY2023 as grants and other revenue shrink and then narrow in FY2024 as expenditure declines.

A widening fiscal deficit and declining foreign exchange reserves will remain key concerns for the government. If reserves continue to decline at the 2022 rate, they will likely breach the constitutionally mandated requirement that they be sufficient to cover 12 months of essential imports. As a small and import-dependent economy, Bhutan could face challenging tradeoffs if this problem persists. In the near term, higher hydropower output will likely sustain Bhutan's exports and finances. Moreover, the expected cessation of large information technology imports by mid-2023 is expected to keep the reserve position from deteriorating at such a rapid clip. At the same time, it is important that Bhutan continue to implement its medium-term strategy for debt management and the latest International Monetary Fund Article IV recommendations to reduce its debt: gradual fiscal consolidation, revenue mobilization, normalization of an accommodative monetary policy introduced in response to COVID-19, and addressing risks to banks, especially from a possible rise in nonperforming loans when pandemic relief measures expire.

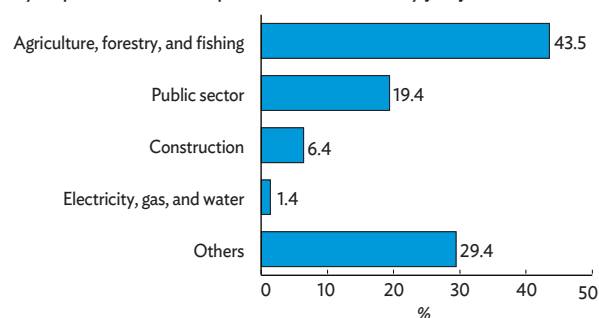
Headline inflation is projected to remain elevated at 5.5% in 2023, driven mainly by moderating but still relatively high global prices for petroleum, food, and other commodities caused by the Russian invasion of Ukraine. Given the government's food security drive, domestic food prices are expected to remain low, offsetting some imported inflation. Moderation of inflation in India, to 5.0% in 2023 and 4.5% in 2024, will help contain inflation in Bhutan as imports from India constitute about half of the consumer price index. The rule of thumb is that a 1.0 percentage point change in India induces a 0.5 point change in Bhutan. With improvements to the global supply chain and the geopolitical situation, and with moderation of inflation in India, average inflation in Bhutan is forecast at 5.1% in 2024.

Policy Challenge—Strengthening the Private Sector as a Partner in Economic Development

Private sector development in Bhutan has stalled despite it being envisioned as an engine of growth. Aside from hydropower, the economy is largely stagnant. This is an obstacle to equitable growth because hydropower and related sectors use little labor. While the public sector and agriculture collectively provide about 63% of employment and a quarter of GDP, construction, electricity, water, and gas provide another quarter of GDP with only 8% of employment (Figure 2.16.8). Meanwhile, the GDP share of manufacturing has slowly fallen since 2009 while its employment share held steady, indicating a lack of productivity growth. The absence of a dynamic private sector constrains the creation of productive employment for Bhutanese, which is reflected in rising youth unemployment over the past 3 years to a high rate of 29% in 2022.

Figure 2.16.8 Employment by Sector, 2022

Hydropower and related pursuits create relatively few jobs.



Note: The public sector includes public administration, defense, compulsory social security, education, health care, and social work.
Source: National Statistical Bureau. 2022. *Labour Force Survey Report*.

The private sector is constrained by a regulatory burden and factor market constraints. Bhutan's business environment is held back by burdensome business compliance processes, a shortage of skilled workers, low digitization, crowding out by state-owned enterprises, and poor access to finance. In an economic

census in 2018, businesses cited customs procedures, business licensing, workforce skills, timely clearances, tax administration, and access to finance as factors affecting operations. Without a conducive business environment, private firms struggle to grow and exploit economies of scale.

The government is undertaking reform to improve the business and investment climate. Administrative approval processes are being simplified and digitized through the Government to Citizen initiative. Public services are progressively being integrated and placed online. Ongoing civil service reform has at its core, improved coordination between public agencies and easy access to public services.

The private sector needs to grow to achieve the government's ambitious target of a \$10 billion economy by 2034. This will require additional reforms. It is imperative to create an environment of policy certainty, promote the private sector through public-private partnerships, privatize loss-making state-owned enterprises, and support skill development, product innovation, and process innovation. Foreign direct investment will be essential, given the large and growing gap between savings and investment. As competition for such inflows is highly competitive, a favorable policy framework is required to induce entry, smoothen the operations of foreign companies, and improve access to credit. An environment of trust and policy certainty needs to be established.

The urgency of private sector development is greater than ever given ongoing mass emigration. Thousands of Bhutanese have emigrated for economic reasons in the past year. Unless the private sector is empowered to create jobs that match the aspirations of Bhutanese youth, the exodus of human capital will continue, hampering the country's long-term development efforts.

INDIA

Spurred by private consumption and investment, the economy grew strongly in fiscal 2022, albeit more slowly than a year earlier. Rising food and fuel prices pushed inflation up beyond the central bank's target. Growth will moderate slightly this year and rise next year, buoyed again by private consumption and investment as the global economy improves. Inflation will be on a downward trend as global price pressures moderate. Improving states' financial management is necessary to increase needed public investment.

Economic Performance

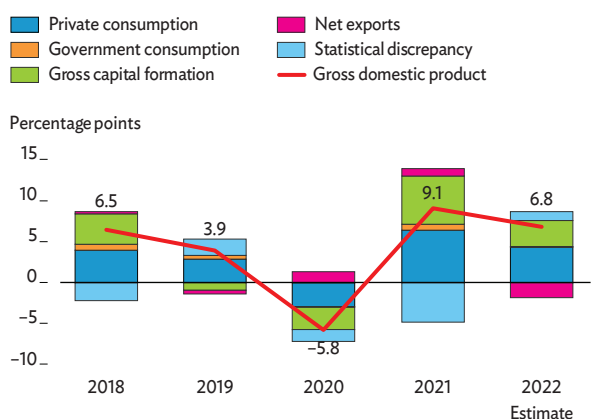
The economy is estimated to have grown by 6.8% in fiscal year 2022 (FY2022, ending 31 March 2023).

Despite global headwinds, expansion benefited from strong growth in private consumption by an estimated 7.3%, and in investment, up by an estimated 11.2% (Figure 2.17.1). On the supply side, GDP growth was supported by agriculture, up by 3.3%, and services, up by 8.8%. Trade, hotels, transport, and communication grew robustly by an estimated 14.0%. Manufacturing growth moderated yet remained positive at 0.6%, reflecting a slowdown in global growth and high input costs (Figure 2.17.2).

Headline inflation exceeded the inflation target range of 2%–6%, averaging 6.8% in the first 10 months of FY2022. At its highest, it reached 7.8% in April 2022 (Figure 2.17.3). Global prices for oilseed, fertilizer, and fuel were elevated by the Russian invasion of Ukraine, an Indonesian ban on palm oil exports, a shortfall in global production of edible oil, and such domestic factors as disappointing wheat production and an unseasonably hot March spiking vegetable prices. These factors pushed food inflation to an average of 6.9% in the first 10 months of FY2022, while fuel inflation remained in double digits, averaging 10.6%. Inflation in both rural and urban areas was high in January 2023.

Figure 2.17.1 Demand-Side Contributions to Growth

Net exports subtracted from growth in 2022, reflecting global headwinds.



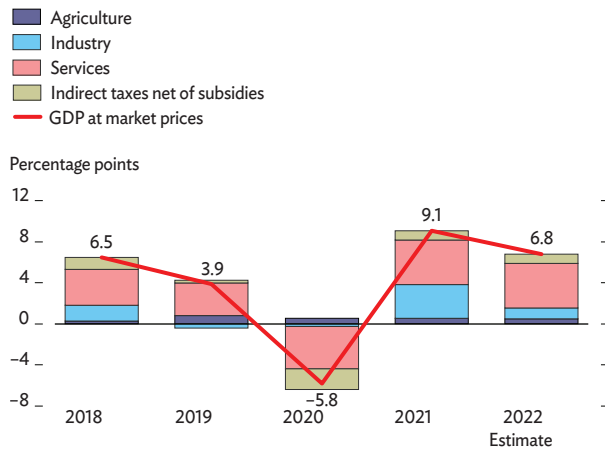
Note: Years are fiscal years ending on 31 March of the next year.

Sources: Ministry of Statistics and Programme Implementation; CEIC Data Company.

The government and the Reserve Bank of India, the central bank, undertook several measures to control inflation and its impact. The government banned exports of wheat and broken rice in 2022 to tamp down domestic price fluctuation and ensure food security. The ban on exports of broken rice was lifted in November 2022 but the ban on wheat remains.

Figure 2.17.2 Supply-Side Contributions to Growth

Services continue to be the key driver of growth in the Indian economy.



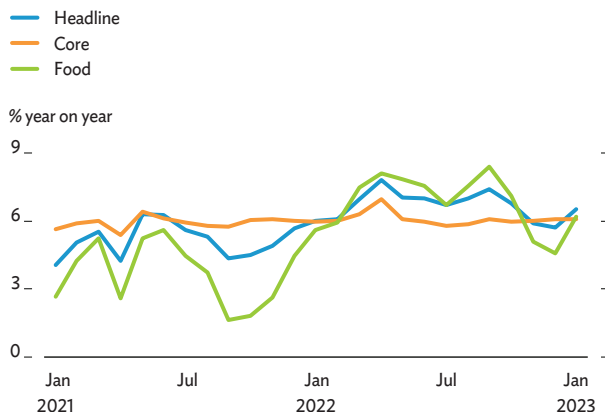
GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year. Indirect taxes are imposed on production and sales, such as goods and services tax.

Sources: Ministry of Statistics and Programme Implementation; CEIC Data Company.

Figure 2.17.3 Consumer Price Inflation

Consumer inflation remained above 6.0% for most of FY2022.



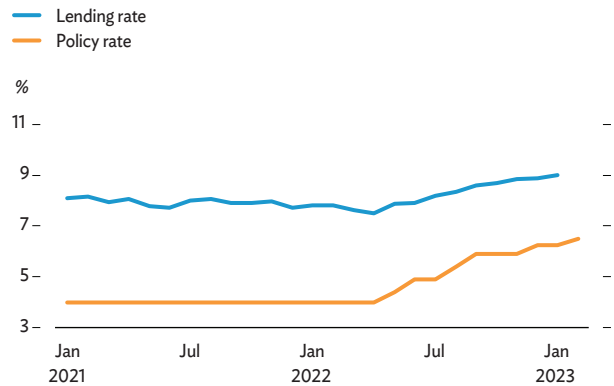
FY = fiscal year.

Source: CEIC Data Company.

Further, the government increased fertilizer subsidies by about half to ₹2.25 trillion, the highest ever from the central government. The central bank has tightened monetary policy in a series of hikes since April 2022, raising its policy rate by 250 basis points to 6.50% in February 2023, higher than the pre-pandemic rate of 5.15%. As a result, the lending rate for fresh rupee loans increased by 137 basis points from April 2022 to reach 9.00% in January 2023 (Figure 2.17.4).

Figure 2.17.4 Policy Rate and Average Lending Rate

Higher monetary policy rates to control inflation pushed up lending costs.



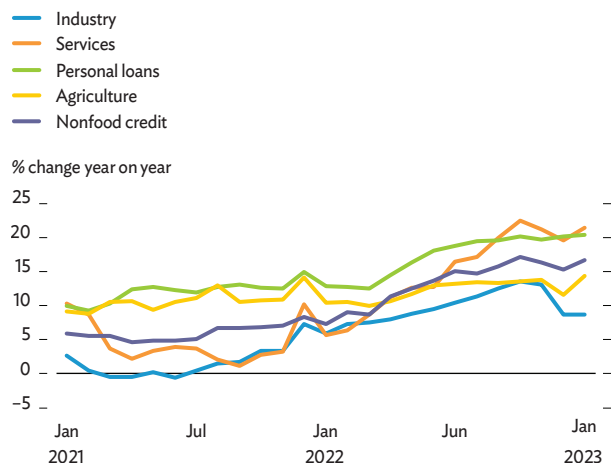
Source: CEIC Data Company.

Bank credit growth nevertheless picked up in FY2022.

Excluding public sector loans for buying crops from farmers, growth in bank credit almost doubled from 8.7% year on year in March 2022 to 16.7% in January 2023, exceeding expected nominal GDP growth at 15.2%. Bank credit for agriculture and allied activities grew by 14.4% and for services by 21.5%, but for industry by only 8.7% (Figure 2.17.5). Personal loans grew by 20.4%, pushing up growth in consumption. However, continued double-digit contraction of export credit reflected weakening exports.

Figure 2.17.5 Outstanding Bank Credit

Bank credit grew, especially for services and agriculture.



Note: Nonfood credit excludes public loans for buying crops from farmers.

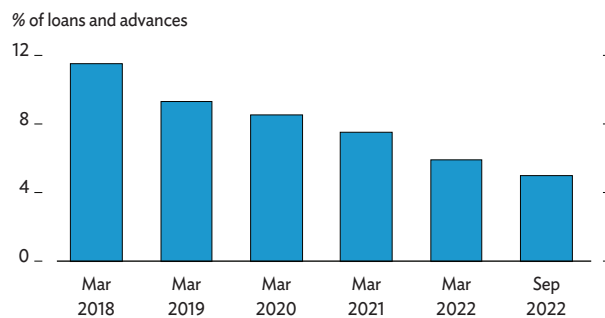
Source: Centre for Monitoring Indian Economy Outlook Database.

Nonperforming loans (NPLs) declined to a 7-year low of 5.0% of all loans and advances at the end of September 2022 (Figure 2.17.6).

The decline is attributed to earlier regulatory reform undertaken by the government: enacting and implementing the Insolvency and Bankruptcy Code in 2016 and reforming public sector banks starting in 2018. A publicly owned asset-reconstruction company set up in 2021 aims to reduce NPLs on banks' balance sheets by acquiring stressed assets from banks and speeding their resolution. High nominal GDP growth helped reduce corporate debt stress by accelerating growth in corporate revenue and thus making it easier for them to service debt. Stress tests conducted by the central bank indicate that NPLs may decline to 4.9% by September 2023.

Figure 2.17.6 Gross Nonperforming Loans

A fall in nonperforming loans indicates diminishing stress on banks.

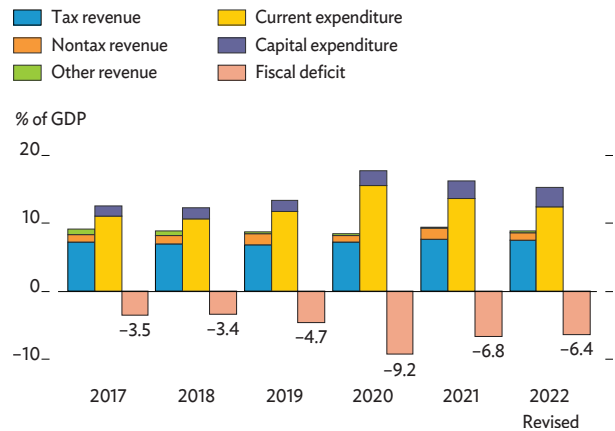


Source: Reserve Bank of India.

The central government fiscal deficit shrank from the equivalent of 6.8% of GDP in FY2021 to an estimated 6.4% (Figure 2.17.7). Central government expenditure increased in FY2022, with both current and investment outlays higher. Fertilizer subsidies were raised, and a free food distribution program was extended to protect the poor and vulnerable. Interest payments grew by 16.8% and capital expenditure by 22.8%. Expenditure cuts in areas other than energy, transport, and rural development left the government's fiscal position better than what was budgeted. Gross tax revenue is expected to greatly surpass the budget target of 2% with growth at 12.3%, which is still lower than nominal GDP growth. Tax buoyancy declined in FY2022 to 0.8, indicating a need to improve revenue mobilization. While nontax revenue fell in FY2022 by

Figure 2.17.7 Central Government Revenue and Expenditure

Reduction in current expenditure as share of GDP narrowed the deficit.



GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

Source: Haver Analytics.

an estimated 28.3%, the government counted on asset monetization and receipts from disinvestment to balloon by 309.9% to meet its fiscal deficit target. Failure to meet disinvestment targets can widen the fiscal deficit.

Unemployment fell to 4.1% in 2021/2022, further below the pre-pandemic rate (Figure 2.17.8).

The unemployment rate improved despite an increase in the average labor force participation rate from 53.5% in 2019/2020 to 55.2% in 2021/2022, indicating improved job creation. Labor force survey data indicate that labor market conditions improved further during FY2022. Urban unemployment fell further in December 2022 and rural real wages resumed growth in November after declines in earlier months. However, the share of organized labor in employment has not increased, which could impede growth in worker productivity across the Indian economy.

The current account deficit is expected to equal 2.9% of GDP in FY2022, its widest since FY2012 (Figure 2.17.9).

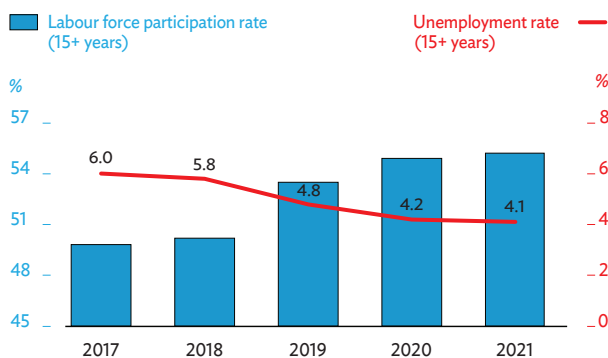
The main reasons are rising oil prices and a slowdown in global demand. Growth in goods exports moderated to 7.5% in the first 10 months of FY2022, slowing consistently since Q2 FY2022. The decline spanned commodities and most manufactures, reflecting slowing global demand and, later in the year, moderation in commodity

prices. Exports of electronics, on the other hand, grew sharply in FY2022, reflecting the impact of India’s production incentive scheme and other policy measures undertaken to induce investment into electronics. Imports of goods grew by 21.9% in the first 10 months, but growth moderated from September 2022 in line with moderation in commodity prices. As import growth outpaced that of exports, the goods trade deficit widened by 54% in first 10 months of

FY2022 over the corresponding period in FY2021. The trade surplus in services, by contrast, grew by 27.7% in the first 9 months of FY2022 despite global economic uncertainty, reflecting India’s continued competitiveness in services. This was helped by growth in information technology and professional services but also by reopening, which improved inbound travel and transport receipts. Remittances also grew strongly, by 28.5%, on a depreciating rupee.

Figure 2.17.8 Labor Force Participation and Unemployment

The unemployment rate fell even as participation in the labor market improved.



Note: Years are survey year starting in July of that year and ending in June of the following year. Estimates are for workers’ usual status of employment during the year.

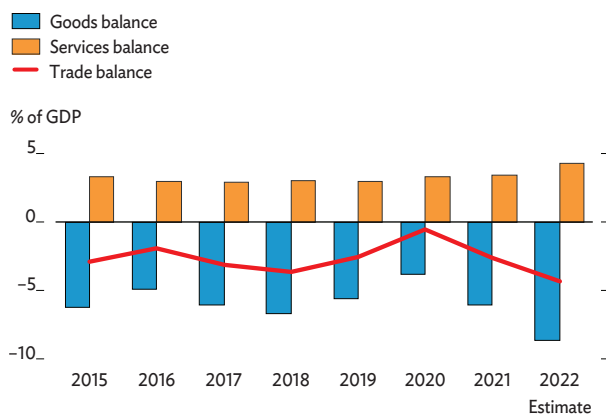
Source: Periodic Labour Force Survey Report. Ministry of Statistics and Programme Implementation.

Despite weaker capital inflow, foreign exchange reserves remain comfortable.

Foreign direct investment inflow declined from \$43.17 billion in the first 9 months of FY2021 to \$36.7 billion a year later as financial conditions tightened. Foreign portfolio investment outflow in FY2022 reflected higher policy interest rates in the US and rising global tensions. The stock market had, as of 2 March 2023, yielded slightly negative returns since the beginning of the fiscal year despite being a strong performer among emerging markets since 2021 (Figure 2.17.10). The Indian rupee had depreciated by 7.4% year on year at the end of January 2023, reaching a record low of ₹83.2 per dollar in October 2022 (Figure 2.17.11). To keep the rupee from depreciating further, the central bank sold \$30.5 billion in international reserves. As of end of January 2023, foreign exchange reserves worth \$575.3 billion provided cover for an estimated 9.2 months of imports (Figure 2.17.12).

Figure 2.17.9 Goods and Services Trade Balance

Despite a higher surplus in services, a widening goods deficit widened the trade deficit.



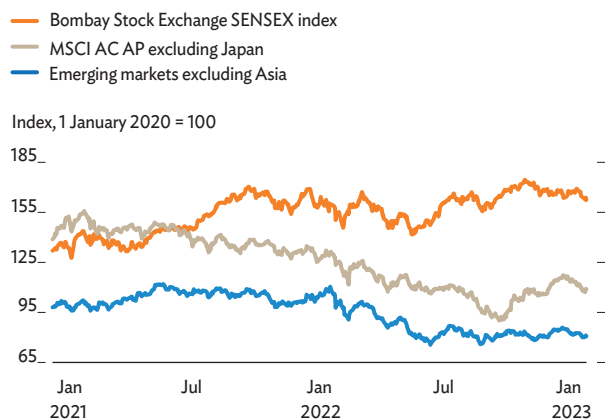
GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

Source: CEIC Data Company.

Figure 2.17.10 Stock Prices

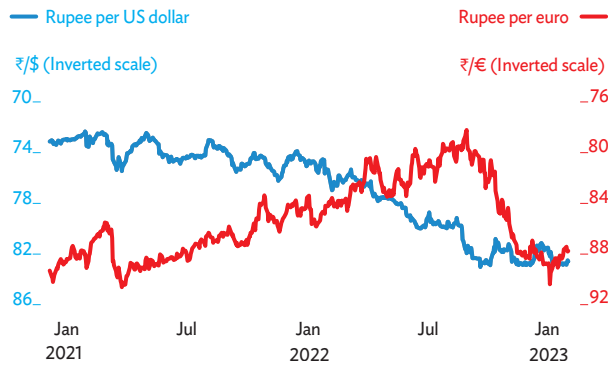
Stock prices have fallen with an outflow of global capital.



Source: Bloomberg.

Figure 2.17.11 Exchange Rate

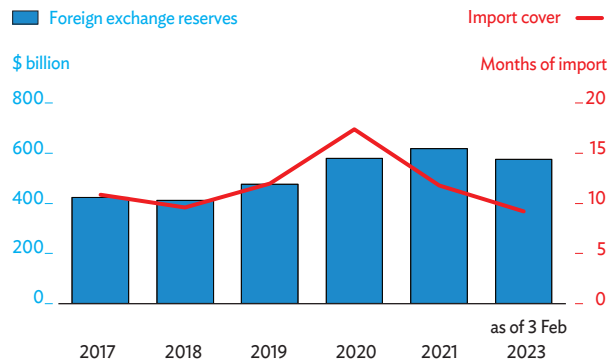
The Indian rupee depreciated against the US dollar and euro as India's trade deficit expanded and capital inflow weakened.



US = United States.
Source: Bloomberg.

Figure 2.17.12 International Reserves

Reserves declined in 2022 but still provided comfortable cover for imports.



Note: Years are fiscal years ending on 31 March of the next year. For FY2022, data are up to January 2023.
Source: CEIC Data Company; Reserve Bank of India.

Economic Prospects

GDP growth is forecast to slow to 6.4% in FY2023

(Table 2.17.1). The causes are an expected global economic slowdown, tight monetary conditions, and persistently elevated oil prices. The growth rate in India is stronger than in many peer economies, reflecting relatively robust domestic consumption and lesser dependence on global demand. Growth is expected to strengthen to 6.7% in FY2024 as private investment improves and growth accelerates in industry.

Table 2.17.1 Selected Economic Indicators, %

Growth will moderate in FY2023 but pick up again in FY2024.

	2021	2022	2023	2024
GDP growth	9.1	6.8	6.4	6.7
Inflation	5.5	6.7	5.0	4.5

GDP = gross domestic product, FY = fiscal year
Note: Years are fiscal years ending on 31 March of the next year.
Source: Ministry of Statistics and Programme Implementation, Government of India; Reserve Bank of India; Asian Development Bank estimates.

Private consumption will be the main driver of growth.

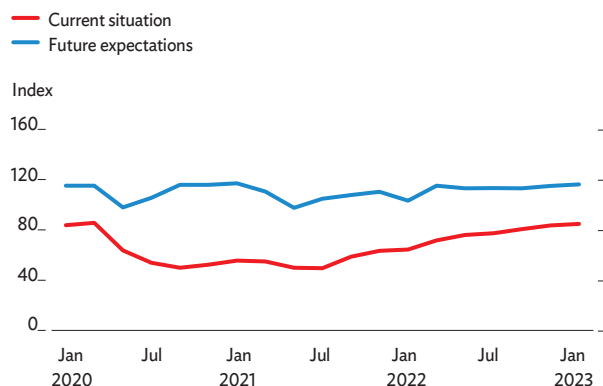
India's large domestic consumption base will mitigate the impact of a global growth slowdown. A robust labor market and rising consumer confidence are indicators of relatively strong growth in consumption in FY2023 and FY2024 (Figure 2.17.13). Further, a higher tax rebate and a raised income threshold for tax exemption, announced in the most recent budget, may increase disposable income for the middle class, also boosting private consumption. However, public consumption is likely to grow only slowly, as central government expenditure shifts toward investment. Private investment growth is likely to be lower in FY2023 given tightened monetary policy, high lending rates, global uncertainty, and moderating optimism on business conditions (Figure 2.17.14). However, FY2024 should bring fast growth in investment because of strong macroeconomic fundamentals; lower nonperforming loans in banks than in recent years, which supports banks' ability to lend; and significant corporate deleveraging, which has improved corporations' ability to borrow. Several government policies aiming to improve transport infrastructure, logistics, and the business ecosystem will induce greater private investment. However, the contribution of net exports to growth will be small as growth in both exports and imports of goods moderates in tandem with a slowing global economy, even as India's service exports remain relatively robust.

The projection for agriculture is robust growth in line with past trends.

The area sown with winter crops in January 2023 was 3% higher than a year earlier. In another encouraging sign, the government increased its target for subsidized agriculture credit by 11% to ₹20 trillion. The sector will be further supported in

Figure 2.17.13 Consumer Confidence Index

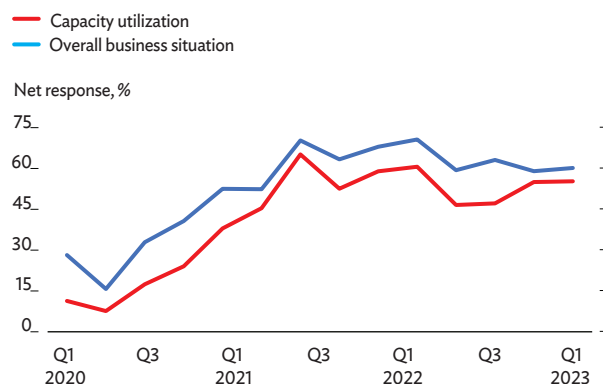
Consumer confidence improved despite higher consumer prices.



Source: Reserve Bank of India.

Figure 2.17.14 Outlook for Overall Business Situation and Capacity Utilization

Moderating business optimism can affect private investment in the short term.



Q = quarter.

Note: The figure shows the number of survey responses expressing optimism over the number expressing pessimism.

Source: CEIC Data Company.

the medium term by various policies announced in the recent budget to boost agricultural productivity: setting up digital public infrastructure that provides information services for crop planning and support for start-ups and growth in the agri-tech industry.

Manufacturing growth will be sluggish in FY2023 but pick up in FY2024.

It will be tamped down by weak global demand but is expected to benefit as input price inflation moderates while relatively high prices persist for outputs. Production incentives introduced in April 2021 to boost manufacturing productivity and

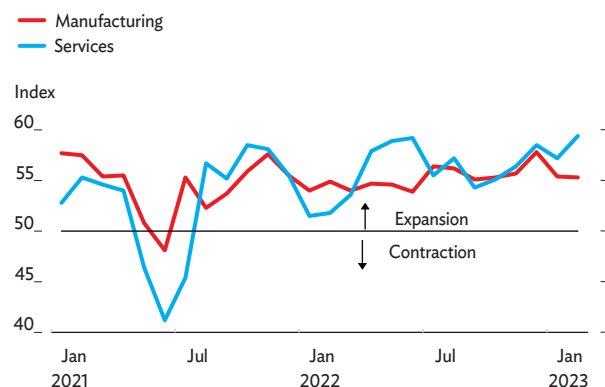
export competitiveness have attracted investment amounting to \$5.6 billion. Electronics was one of the first industries covered by these schemes and is likely to see increased production and exports this fiscal year. However, other beneficiary industries may not see significant impact on output as early as FY2023. Manufacturing growth will likely be tepid in FY2023, given the global growth slowdown, but it is seen picking up in FY2024 as expected improvement in global economic conditions lifts private investment.

Services will grow strongly this fiscal year and next as COVID-19 impacts fade away.

The business outlook for services remains positive, as the purchasing managers' index for services remains in the expansion phase (Figure 2.17.15). Growth in services will be helped by recovery in tourism and other contact services as COVID-19 impacts dissipate and the share of services in domestic consumption continues to increase. Further, relatively resilient service exports despite the global slowdown will continue to boost growth in the sector. The value of transactions through the Unified Payments Interface, the public digital retail payment system, grew by 68% in FY2022 to February, further driving service growth. India's introduction of a central bank digital currency is likely to accelerate the adoption of digital payment. Nevertheless, the contribution of services to GDP growth will be lower than in FY2022 as the high base effect from normalization after COVID-19 dissipates.

Figure 2.17.15 Purchasing Managers' Indexes for Manufacturing and Services

Leading indicators for both manufacturing and services foretell strong expansion.



Source: Bloomberg.

Consumer inflation is forecast to moderate to 5.0% in FY2023, assuming moderation in oil and food prices. This will bring the rate back within the monetary policy target of 2%–6%. Inflation in FY2024 is expected to slow further to 4.5% as inflationary expectations are tamped down and global inflationary pressures subside. Monetary policy in FY2023 is expected to become progressively less accommodative as core inflation, which excludes fuel and food prices, persists because of high inflation expectations and high input costs. Policy will become more accommodative in FY2024 in tandem with expected actions by the US Federal Reserve.

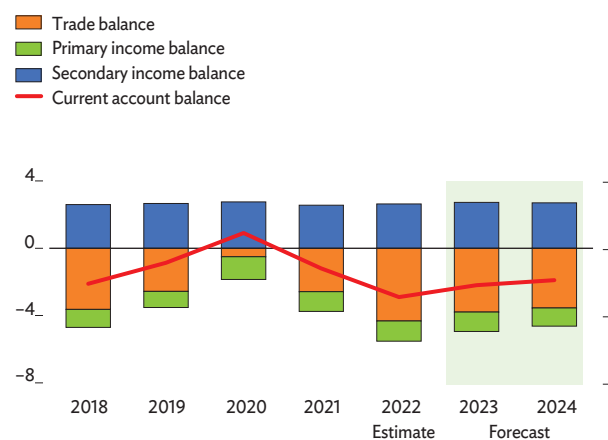
Fiscal policy will remain supportive of growth even as fiscal consolidation continues. The budget targets narrowing the central government’s fiscal deficit to the equivalent of 6.4% of GDP in FY2022 and 5.9% in FY2023. The central government has reiterated that it is committed to bringing its fiscal deficit below 4.5% by FY2025. The projected deficit for general government, combining central and state governments, under the current fiscal consolidation plan is 7.5% of GDP by 2025, down from 10.4% in 2021. India’s public debt is on a sustainable path. After general government debt increased from 75% of GDP in 2019 to 89% in 2020 as the authorities responded to the pandemic, it declined to 84% in FY2022 and is expected to continue to decline gradually over the medium term. As it undertakes fiscal consolidation, the central government will still increase capital spending to support growth. This is important because capital spending is especially effective in India at spurring overall demand. Increased capital spending by the states is also important to garner more growth from public capital expenditure. However, the ability of states to contribute may be stymied unless their financial vulnerabilities are addressed (see below).

The current account deficit will likely moderate to the equivalent of 2.2% of GDP in FY2023 and 1.9% in FY2024 (Figure 2.17.16). It will narrow with moderation in global oil prices below \$100 per barrel. Growth in goods exports is forecast to moderate as well in FY2023 as global demand slows and then improve in 2024 as production incentive schemes improve performance in electronics and some other areas of manufacturing. Growth in exports of services, while also likely slower than in FY2022, is expected

to outpace goods exports, given India’s competitive advantage in information technology services. Growth in imports of goods and services is expected to slow as commodity prices moderate, narrowing the trade deficit. With rising global uncertainty and interest rates, foreign direct investment and portfolio inflow are likely to remain weak in FY2023 before picking up slightly in FY2024 (Figure 2.17.17). Nevertheless, India’s overall balance of payments will remain strong to the forecast horizon.

Figure 2.17.16 Current Account Balance

An improving trade balance will narrow the current account deficit in FY2023 and FY2024.



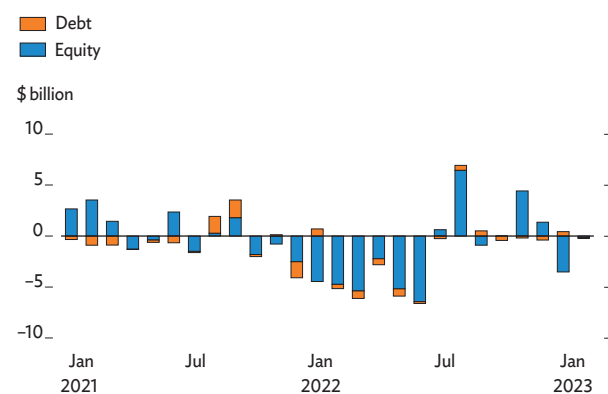
FY= fiscal year.

Note: Years are fiscal years ending on 31 March of the next year.

Sources: CEIC Data Company; Asian Development Bank estimates.

Figure 2.17.17 Net Foreign Portfolio Investment Flows

Foreign portfolio inflow will continue to be weak as global economic uncertainty persists.



Source: Security and Exchange Board of India.

Risks to the growth outlook arise from both global and domestic factors. If global conditions do not deteriorate as much as anticipated, higher global demand will likely spur growth in India. However, any worsening of geopolitical tensions is likely to exert further downward pressure on global demand and increase uncertainty, tamping down India's growth rate and pushing up inflation. Domestically, weather shocks to agricultural production, including abnormal rainfall or higher temperatures, could spur food inflation, thereby putting further pressure on the central bank to raise interest rates.

Policy Challenge—States' Quality of Expenditure and Off-Budget Borrowing

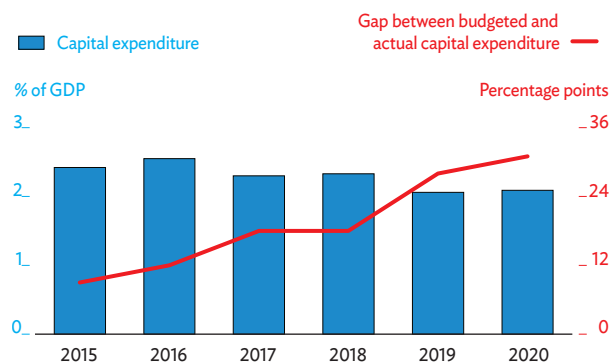
India needs higher public investment in infrastructure, urban development, health, and education, but individual state investment has been weak. States are an essential part of India's fiscal architecture and responsible for a majority of general government expenditure. The central government has raised expenditure on infrastructure and health care, but states have not followed suit. Capital expenditure by states fell from 2.6% of GDP in FY2016 to 2.1% of GDP in FY2020. At the same time, a significant gap exists between budgeted and actual capital expenditure, with 9% of budgeted capital expenditure unspent in FY2015, rising to 28% in FY2019 and 31% in FY2020 (Figure 2.17.18). Excluding union territories, the widest capital expenditure gaps exist in Andhra Pradesh, Bihar, Punjab, and West Bengal.

Lower capital expenditure occurs as revenue falls short of the budgeted amounts and other spending is prioritized. Even before the pandemic, state revenue had fallen from the equivalent of 13.6% of GDP in FY2017 to 13.3% in FY2019, with own tax revenue falling by 0.5 percentage points. State finances have been affected as well by high expenditure on such nondiscretionary items as interest payments, salaries, and pensions, and by priorities accorded to subsidizing electricity, water supply, and various other services.

Rising off-budget vulnerabilities and other contingent liabilities frustrate efforts to improve states' capital expenditure. In most states, fiscal

Figure 2.17.18 State Capital Expenditure, Budgeted and Actual

States capital expenditure has fallen as a share of GDP in recent years.



GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

Source: Reserve Bank of India. 2023. State Finances: A Study of Budgets of 2022-23.

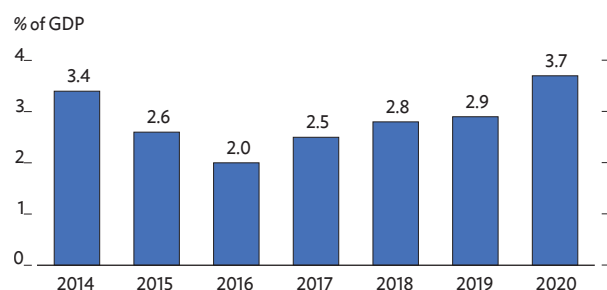
responsibility and budgetary management legislation aims to keep the fiscal deficit below the equivalent of 3% of GDP. In the pre-pandemic period of 2014–2019, the average state fiscal deficit equaled 2.7% of GDP. However, states also borrow off budget and therefore beyond the reach of the legislative framework. Off-budget liabilities occur when public sector entities borrow on behalf of the state governments with the expectation of debt being serviced through the state budgets. States may face other contingent liabilities when public sector entities borrow more than they can service on the strength of a sovereign guarantee, explicit or implicit, which may require state intervention. Off-budget and other contingent liability amounts covered by explicit guarantees issued by states fell in FY2015 and FY2016 but increased from the equivalent of 2.0% of GDP in FY2016 to 3.7% in FY2020 (Figure 2.17.19).

Electricity supply accounts for most contingent liabilities and typifies the fiscal risks to states.

Because of consistent financial losses suffered by several state electric power distribution companies (DISCOMs) and their accumulated debt, state governments took over DISCOM liabilities under a central government scheme launched in 2015. This lowered contingent liabilities in FY2015 and FY2016 but added to state government debt and interest payments. Meanwhile, DISCOM losses have continued, piling up outstanding debt. This will likely affect states'

Figure 2.17.19 Outstanding Guarantees of State Governments

Outstanding guarantees issued by state governments increased.



GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

Source: Reserve Bank of India. 2023, State Finances: A Study of Budgets of 2022-23.

fiscal positions, especially as newly proposed reform by the central government entails state budgets absorbing the financial losses. Whether remaining as contingent liabilities or brought on budget, the guarantees provided by state governments inhibit their ability to undertake needed public investment.

Addressing this problem requires comprehensive reform. Efforts to improve states' resource mobilization are required to enhance resource availability. This could be achieved by enhancing either tax revenue through better tax design and administration where controlled by the states, such as the property taxes, or nontax revenue such as user fees for services provided by states. States need to improve budget transparency by including all off-budget borrowing and planned spending into their budgets. They should also reform electricity supply to improve the financial management of DISCOMs, reduce leakage, and enhance their financial viability. This would include revising electricity tariffs, installing robust metering systems to prevent revenue leakage, strengthening distribution systems, institutional and governance reform, and introducing private sector competition where feasible. Further, states should prioritize productivity-enhancing investment in physical and human capital over popular subsidies and income transfer schemes.

MALDIVES

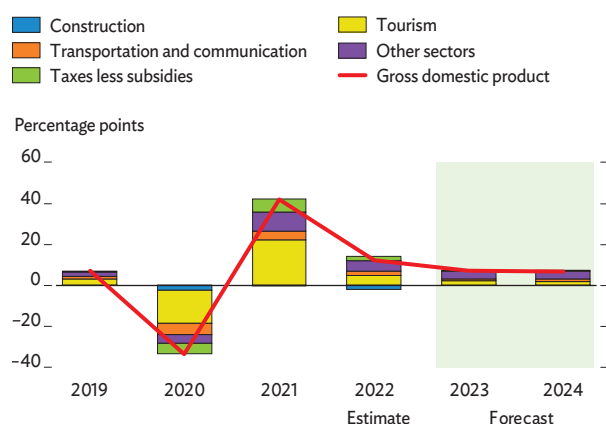
With continued strong recovery in tourism, double-digit growth in 2022 was exceptional in a year that saw an economic downdraft snag most countries. Inflation was kept low by subsidies, but the current account deficit increased sharply on large increases to global prices for oil and other commodities. Robust tourism and public investment are expected to underpin growth to the forecast horizon. A legacy of substantial budget deficits and high debt pose a threat to sustainability.

Economic Performance

Growth moderated to an estimated 12.3% in 2022 following an extraordinary 41.7% rebound in 2021 on revived tourism (Figure 2.18.1). While tourism was the main driver, growth also came from expansion in other industries, mainly transportation and communication, and wholesale and retail trade.

Figure 2.18.1 Supply-Side Contributions to Growth

Tourism was, along with transportation and communication, the main driver of growth.



Source: Maldives Monetary Authority. 2023. [Monthly Statistics](#). February.

Tourist arrivals climbed by 26.7%, from 1.3 million in 2021 to 1.7 million in 2022. Despite a remarkable rebound, arrivals were still 1.6% lower than in pre-pandemic 2019. Tourist arrivals from Russia, which

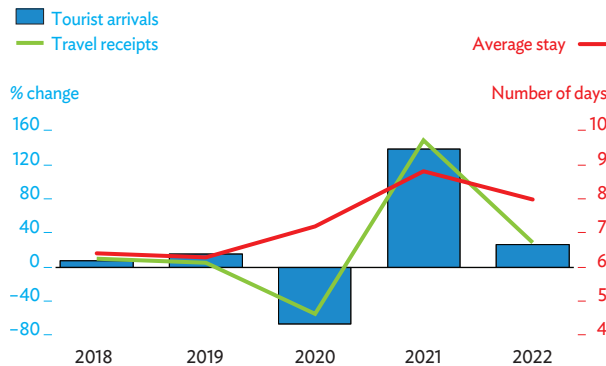
was Maldives' second-largest source country in 2021, declined during the 3 months following the Russian invasion of Ukraine but largely recovered in the second half of 2022 to post a relatively benign 9.2% drop from 2021. Maldives managed to attract tourists from both its traditional markets and new ones, which compensated for this loss. With a 61.0% share of all arrivals, Europe was the largest regional source market as arrivals rose by 32.4% in 2022, accounting for 70.8% of growth in arrivals. Arrivals from Asia improved by 17.7% for a 23.7% share of arrivals, with India alone, the biggest source country in the region, comprising 14.4% of all arrivals. The share of arrivals from the People's Republic of China (PRC) was negligible given its stringent zero-COVID policy. Meanwhile, tourist inflows from all other regions increased by 20.4% to attain a 15.3% share in all arrivals, mostly from the United States.

Tourism receipts were broadly in line with growth in arrivals. Bed-night stays, a proxy for tourism earnings, totaled 12.3 million in 2022, up by 21.7% from the year earlier. Preliminary estimates indicate that travel receipts rose by 28.2% from 2021 (Figure 2.18.2).

Average inflation edged up, but remained low at 2.3% in 2022. Inflation was contained despite high global prices for petroleum and other commodities thanks to government subsidies on food staples, fuel, and electricity, as well as other administrative price controls (Figure 2.18.3).

Figure 2.18.2 Tourism Indicators

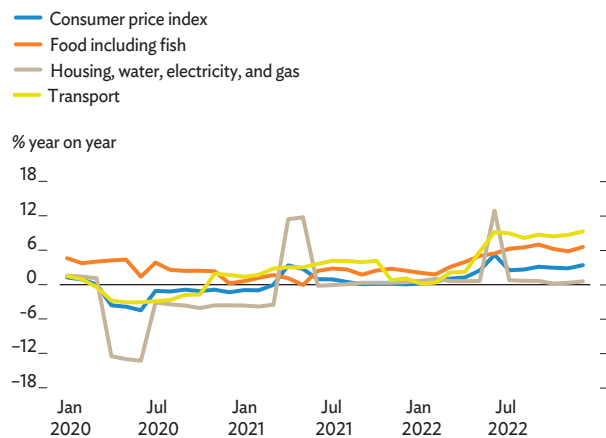
Tourism growth moderated in 2022 but remained strong.



Source: Maldives Monetary Authority. 2023. *Monthly Statistics*. February.

Figure 2.18.3 Inflation

Inflation edged up in 2022.



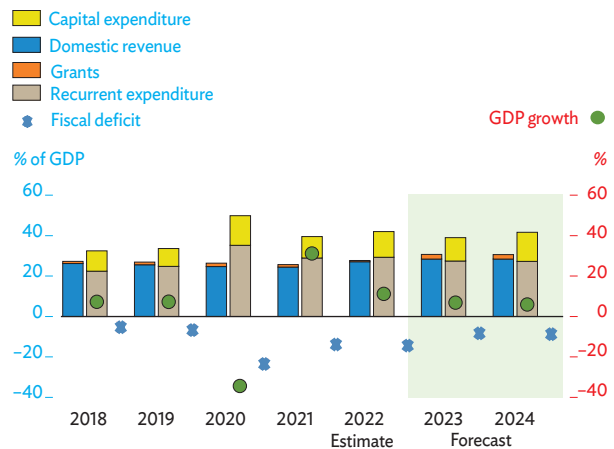
Source: Maldives Monetary Authority. 2023. *Monthly Statistics*. February.

Continued rebound in tourism improved government revenue, but expenditure growth widened the budget deficit to 14.3% of GDP in 2022.

Revenue increased by 23.5% to equal 27.7% of GDP on significant increases from taxes on goods and services, the business profit tax, and import duties. Government expenditure grew by 21.7% to 42.0% of GDP, reflecting a 37.1% rise in capital expenditure and a 16.1% increase in recurrent spending, mainly for salaries and wages, financing and interest costs, health insurance, and subsidies including fuel (Figure 2.18.4). More than 80.0% of the budget deficit was funded domestically by government securities and the extension of a Parliament-approved overdraft

Figure 2.18.4 Fiscal Indicators

Fiscal deficit is projected to stay below the equivalent of 9.0% of GDP in 2023 and 2024.



GDP = gross domestic product.

Note: Figures for 2023 and 2024 are government's forecasts based on approved Budget for 2023.

Source: Maldives Monetary Authority. 2023. *Monthly Statistics*. February.

facility from the Maldives Monetary Authority. External funding was secured from financial institutions and bilateral partners.

Public debt including state-guaranteed debt in 2022 increased by 12.0% to Rf105.7 billion, equal to 111.0% of GDP

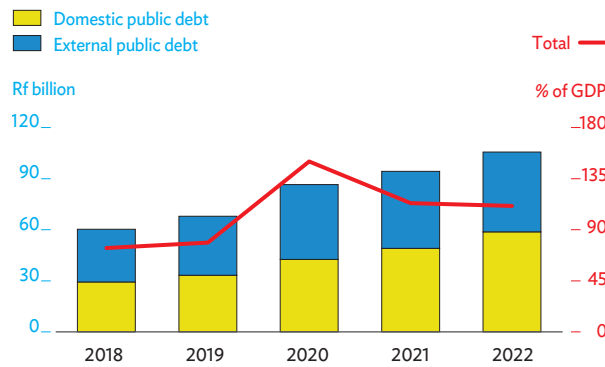
(Figure 2.18.5). External debt rose by 3.5% to Rf46.9 billion, or 49.2% of GDP, mainly on external borrowing to cover the budget deficit and augment foreign exchange reserves. Domestic debt expanded by 19.9% to Rf58.8 billion, or 61.8% of GDP. In its latest assessment in September 2022, the International Monetary Fund continued to rate Maldives at high risk of external debt distress and high overall risk of debt distress. Moody's Investors Service kept Maldives' sovereign rating at *Caa1 stable* in 2022. In October 2022, Fitch Ratings revised its Maldives' outlook from *stable* to *negative* as global financial conditions tightened and foreign exchange buffers declined sharply.

The current account deficit deepened from \$0.4 billion in 2021, equal to 7.9% of GDP, to \$1.1 billion in 2022, or 18.0%.

This deterioration mainly reflected an increased import bill, in part from higher energy and food prices. Payments for imports increased by 34.8% during the year, but service exports grew by only 13.9%. The current account deficit was financed largely by net financial account inflows (Figure 2.18.6).

Figure 2.18.5 Public Debt including Guarantees

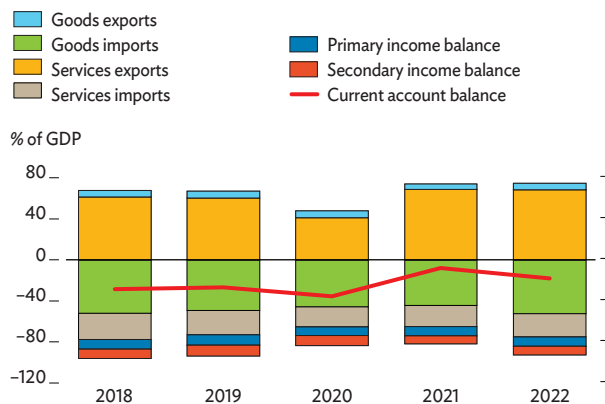
Public and publicly guaranteed debt rose in 2022 by 12.0% but marginally declined as a percentage of GDP from 113.6% in 2021 to 111.0%.



GDP = gross domestic product.
Source: Maldives Monetary Authority. 2023. [Monthly Statistics](#). February.

Figure 2.18.6 Balance of Payments

The ratio of the current account deficit to GDP worsened in 2022 owing to wider trade gap caused by higher prices for imported oil and food.



GDP = gross domestic product.
Source: Maldives Monetary Authority. 2023. [Monthly Statistics](#). February.

Reserve buffers remain stressed. Gross international reserves rose by 2.7% to \$827.7 million in 2022, providing only 2.1 months of cover for imports of goods and services. Reserves dropped below \$500 million in October, but a \$100 million Treasury bond investment by India through the State Bank of India-Malé in November built up the reserves by year-end, as did the use of a \$200 million currency swap facility from the Reserve Bank of India in December (Figure 2.18.7).

Figure 2.18.7 Gross International Reserves

A \$200 million currency swap facility with the Reserve Bank of India in December helped improve the stock of foreign reserves by the end of 2022.



Source: Maldives Monetary Authority. 2023. [Monthly Statistics](#). February.

Economic Prospects

Robust tourism and construction are expected to underpin growth in 2023 and 2024.

High tourist arrivals will be sustained by the release of pent-up travel demand and the lifting of travel restrictions in most countries, including Maldives' main tourist markets. The resumption of flights between the PRC and Maldives from 18 January 2023 is projected to provide a big boost to tourist inflows. Prior to the pandemic, the PRC was the largest single source country of tourists to Maldives, sending almost 300,000 guests in 2019, or 16.7% of all arrivals that year. The government expects that, with the return of tourists from the PRC, total arrivals for the year will be 10.0% higher than its original target of 1.8 million. From 1 January to 7 March 2023, the PRC ranked eighth and provided 2.9% of 393,839 arrivals. The opening of a new runway at Velana International Airport in October 2022 also bodes well for growth in the tourism industry, as it increases efficiency and volume in flight operations with reduced landing and parking time and higher flight capacity.

After slowing in 2022, construction will pick up, driven by the government's big-ticket infrastructure investments. Those scheduled for this year and the next include the Greater Malé Connectivity Project (Thilamalé Bridge), domestic

and international airports, and housing projects. Infrastructure investment by the private sector, particularly in tourism and housing, are also expected to strengthen construction.

Fisheries and tourism-allied services will likewise support growth. Prospects for fisheries are favorable as the government further ramps up investment to develop the capacity of a state-owned fishing company, Maldives Industrial Fisheries Company Limited, with additional cold storage and freezing facilities and fish processing plants. The government is also gearing up to expand fish exports to markets in the Middle East and other markets, where demand is high for yellowfin and skipjack tuna, and is working to get duty-free access for its fish exports to the European Union and the United Kingdom. Growth in tourism-allied services such as transportation and communication and wholesale and retail trade, and in private consumption, is expected to accelerate on positive spillover from continued recovery in tourism.

The fiscal position is expected to improve in 2023 on higher revenue growth and planned cost-cutting. The 2023 budget sees revenue increasing by 15.0%, mainly because of higher rates for the goods and services tax (GST) that became effective from 1 January 2023. As of 2 March 2023, revenue had already climbed by 41.3% from the year-earlier period, primarily on a 52.7% rise in GST collections. While the government also plans austerity measures to cut recurrent spending, elections in 2023 may push up administrative and operational costs.

On balance, GDP will likely rise by 7.1% in 2023 and 6.9% in 2024 (Table 3.18.1). Risks to the outlook include more marked global interest rate hikes to tame inflation, which could constrain planned fiscal borrowing; global political tensions that may produce shocks that lift global commodity prices substantially higher than expected; and possibly slower growth in Europe, Maldives dominant tourist market, dampening arrivals below expectations. The realization of any of these risks could substantially heighten fiscal and debt vulnerabilities, given Maldives' elevated ratio of public debt to GDP and thin international reserves.

Inflation will jump to 4.5% in 2023 with the implementation of the GST rate hike, then moderate in 2024. General GST rate increasing from

Table 2.18.1 Selected Economic Indicators, %

Economic growth will moderate in the next 2 years, and inflation will jump in 2023 before easing again in 2024.

	2021	2022	2023	2024
GDP growth	41.7	12.3	7.1	6.9
Inflation	0.5	2.3	4.5	2.0

GDP = gross domestic product.

Note: 2022 data are government estimates.

Sources: Maldives Monetary Authority, 2023. [Monthly Statistics, February](#); Asian Development Bank estimates.

6.0% to 8.0% and tourism GST rate from 12.0% to 16.0% will push inflation up in 2023. Election-related spending during the year will also increase price pressure. Inflation will then ease to 2.0% in 2024 considering high base effects in 2023 and continued subsidies.

While continued strong tourism will improve the current account, the deficit will remain elevated.

The ratio of the current account deficit to GDP will drop to 13.5% in 2023 with the enhancement of taxes on goods and services for tourism, boosting travel receipts. Meanwhile, increased earnings from fish exports are expected as volumes rise and world prices strengthen. Forecast moderation in global prices for commodities will help narrow the merchandise trade gap. The current account deficit, however, will edge up to the equivalent of 14.0% of GDP in 2024, on projections that global fuel prices will rise slightly.

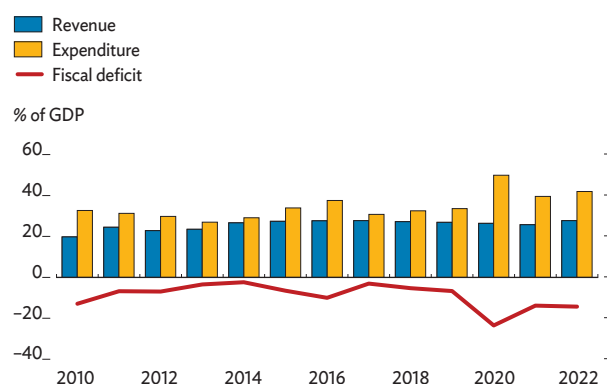
Policy Challenge—Fiscal and Debt Sustainability in Maldives

The country has run persistent budget deficits and faces large and growing public debt. Revenue improved significantly after the government adopted an ambitious tax reform agenda in 2011 that rationalized the tax system and diversified revenue sources. Prior to this, revenue collection was done by multiple government agencies, and revenue sources were more limited. Revenue growth has, however, been continuously outpaced by expenditure growth, generating chronic budget deficits. Further, from 2014, the ratio of revenue to GDP has remained stagnant at about 26.0% while government spending as a proportion

of GDP—despite dropping in some years—has been consistently large, averaging 32.0% from 2011 to 2019 and reaching almost 50.0% in 2020, during the COVID-19 pandemic (Figure 2.18.8). To fill large financing gaps, particularly in 2020, the government has resorted to borrowing, including through a \$500 million Islamic bond. This has held public debt above 100% of GDP since 2020.

Figure 2.18.8 Revenue, Expenditure, and Fiscal Deficit

The ratio of expenditure to GDP averaged 9 percentage points higher than the ratio of revenue to GDP from 2010 to 2022.



GDP = gross domestic product.

Source: Maldives Monetary Authority.

A precarious fiscal position has prompted the government to implement reform to tackle fiscal imbalances and high debt. A departure tax and an airport development fee were introduced in January 2022, and GST hikes in January 2023 are expected to generate an additional Rf3.0 billion in revenue, equal to about 3.0% of GDP. The government also plans a subsidy-rationalization program to cut government expenditure.

Ensuring Maldives' pathway to debt sustainability in the medium and long term requires, however, additional substantial fiscal consolidation.

This includes strengthening domestic resource mobilization and debt management and enhancing expenditure efficiency.

A tax base that has relied mostly on tourism should be expanded. As recommended in the ADB-supported tax administration diagnostic assessment tool and Maldives' medium-term revenue strategy, the government should consider including digital services and offshore travel agents under the tax net, imposing GST on imports at customs, and formalizing and raising excise taxes. In addition, personal income tax needs to be revised to become more progressive by increasing marginal rates. It should also lower the zero-rate threshold, as annual income not exceeding Rf720,000 is currently untaxable despite being much higher than the median wage of Rf115,200.

The government should streamline large expenditures that have become burdensome. Public sector wages eat up as much as 30.0% of the budget and must be controlled, while massive investment programs that have rapidly piled up public debt since 2015 should be systematically programmed and prioritized. Subsidies for food, fuel, and electricity, which currently cover the entire population, need to be rationalized to reduce leakage and better target low-income beneficiaries. Further, several state-funded pension schemes under institution-specific laws and regulations, which are outside of the pension act, should be harmonized to remove duplication and to streamline costs. Pension spending absorbs 4.0%–5.0% of the national budget on average, or about 2.0%–3.0% of GDP, despite only 5.0% of the population being aged 65 and above. This expenditure is comparable with other countries that have much higher elderly populations, such as the Republic of Korea with 17.0%.

Debt management should be strengthened. This includes undertaking cost-risk analysis of borrowing decisions and restructuring existing high-cost debt to reduce fiscal risk. Lastly, a new bill needs to be enacted to consolidate debt operation and management and to provide a holistic legal framework for managing debt, because at present multiple laws cover these transactions separately and inefficiently.

NEPAL

Growth accelerated in fiscal 2022 on continued fiscal and monetary stimulus. Inflation increased as prices for oil and other commodities rose, and the current account deficit substantially widened as imports surged. Growth will decelerate this year under tight monetary policy, the unwinding of pandemic stimulus, and persistent global headwinds, then pick up again in fiscal 2024. Inflation will rise again on elevated import prices, but the current account deficit will narrow with a reduced trade deficit and buoyant remittance inflow.

Economic Performance

The economy grew strongly, underpinned by the authorities' expansionary macroeconomic policies.

Preliminary official estimates show GDP expanding by 5.8% in fiscal year 2022 (FY2022, ended mid-July 2022) after rising by 4.2% in FY2021 (Figure 2.19.1). Higher growth was supported by increased generation of hydroelectricity, improved manufacturing output, expanded construction, and a gradual revival of tourism.

Supply conditions were buoyant except in agriculture.

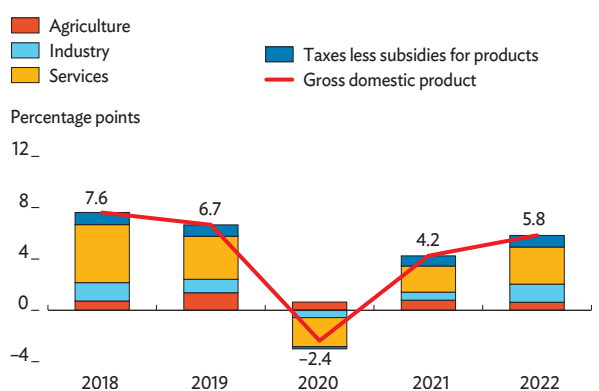
Growth in agriculture slipped from 2.8% in FY2021 to 2.3% in FY2022 after excessive rain and consequent flooding in mid-October damaged crops just as they were ready to harvest. Industry growth more than doubled to 10.2% on strong domestic demand and a surge in exports. Gains in construction, electricity, and manufacturing were notable. Growth in services accelerated from 4.2% in FY2021 to 5.9% as wholesale and retail trade, transport, and financial services picked up significantly with the lifting of COVID-19 mobility restrictions. Tourism and related activities gathered pace, but income from them was far below pre-pandemic levels.

On the demand side, a 10.5% increase in gross capital formation underpinned accelerated growth.

Private investment advanced by 8.8%, raising its share to 27.1% of GDP. There was a double-digit inventory growth, but public investment declined by 6.0% due to

Figure 2.19.1 Supply-side Contributions to GDP Growth

Growth surged on favorable macroeconomic policies in 2022.



Note: Years are fiscal years ending in mid-July of that year.

Sources: Central Bureau of Statistics, 2022. National Accounts of Nepal 2021/22; Asian Development Bank estimates.

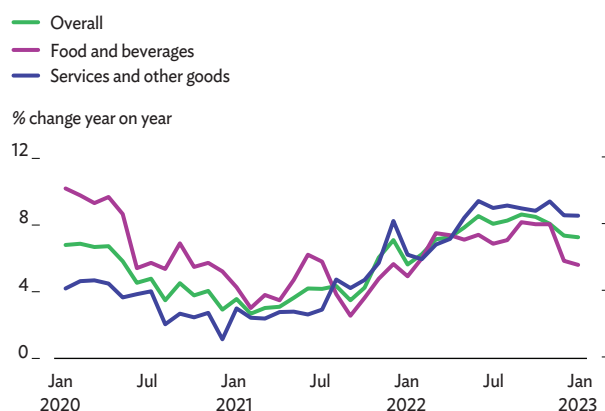
delays in implementation of budgeted initiatives. Growth in private consumption rose from 4.3% in FY2021 to 5.4%. Imports grew rapidly, particularly in the first half of FY2022, as economic activity intensified with the lifting of COVID-19 restrictions. This generated a large trade deficit, however, that dragged down growth.

Inflation increased largely owing to high global prices following the Russian invasion of Ukraine.

Average annual inflation increased from 3.6% in FY2021 to 6.3%

Figure 2.19.2 Monthly Inflation

Inflation is likely to remain elevated as global headwinds persist.



Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

in FY2022 as food and fuel prices rose (Figure 2.19.2). Other factors driving up inflation were dampened domestic agriculture production and recovery in domestic demand. Food inflation accelerated from 5.8% to 6.9%, while nonfood inflation rose from 2.9% to 9.0%. About 6% depreciation of Nepali rupee vis-à-vis US dollar in FY2022 also raised market prices of goods.

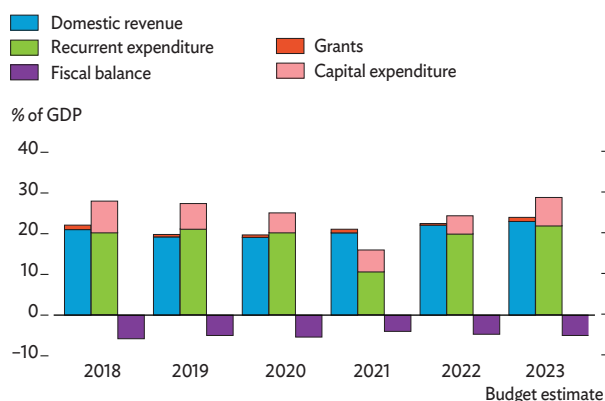
The budget deficit widened on higher recurrent expenditure. It deepened from the equivalent of 4.0% of GDP in FY2021 to 4.7% in FY2022 (Figure 2.19.3). Expenditure increased by 18.3% to equal 26.2% of GDP in FY2022 despite sluggish growth in capital expenditure. A 27.9% increase in recurrent expenditure—mainly for vaccine procurement, strengthening the health-care system, and economic relief measures—raised overall expenditure. Revenue (including grants), at 21.5% of GDP, increased by 17.7% in FY2022 on buoyant income tax and excise duty receipts.

Since FY2019, government debt has mounted rapidly with higher domestic and foreign borrowing.

Debt increased from the equivalent of 27.0% of GDP in FY2019 to 36.7% in FY2020 and 40.6% in FY2021 as the government borrowed to finance COVID-19 expenditure and to support the economy (Figure 2.19.4). With economic activity gaining fuller traction in FY2022, growth in debt moderated but still rose to equal 41.7% of GDP, with domestic debt at 20.4% of GDP and external debt, most of it concessional, at 21.3%. Despite the rise, Nepal's risk of debt distress is low in light of low ratios of external debt to GDP and of external debt servicing to exports.

Figure 2.19.3 Fiscal Indicators

The fiscal deficit widened on increased recurrent expenditure.



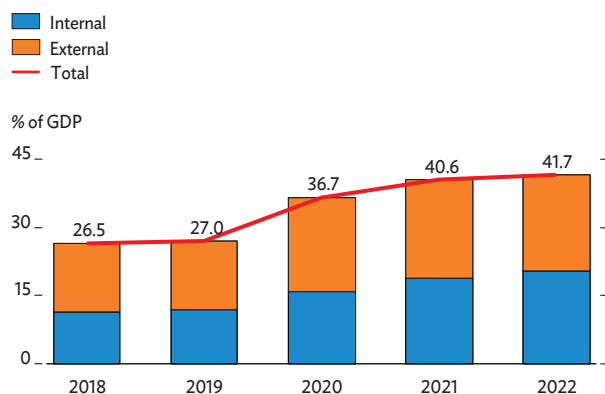
GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Source: Ministry of Finance. Budget Speech 2023.

Figure 2.19.4 Public Debt

Growth in public debt moderated as external borrowing declined with the waning of COVID-19 influence.



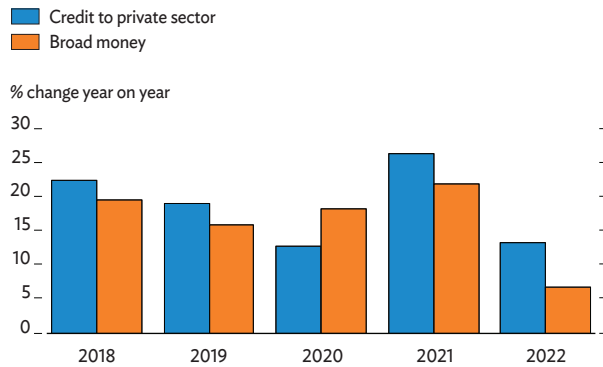
Note: Years are fiscal years ending in mid-July of that year.

Source: Central Bureau of Statistics; Financial Comptroller General Office; Public Debt Management Office.

Monetary policy remained accommodative in the first half of FY2022. A surge in credit in FY2021 and the first half of FY2022 spurred rapid growth in imports and consequent loss of foreign exchange reserves. To restrain growth in private sector credit, Nepal Rastra Bank, the central bank, intervened through its midyear monetary policy review to hike the policy rate by 250 basis points to 5.5% in February 2022. The cost of using the refinancing facility was similarly raised by 200 basis points to 7.0%. Private sector credit growth consequently moderated from a peak of 32% year on year in September 2021 to 13.3%

Figure 2.19.5 Credit to the Private Sector and Broad Money Growth

Growth in credit to the private sector moderated after a hike in interest rates.



Note: Years are fiscal years ending in mid-July of that year.

Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

in mid-July 2022 (Figure 2.19.5). Broad money growth moderated from 21.8% in FY2021 to 6.8% in FY2022 as net foreign assets declined.

The current account deficit widened along with the trade deficit (Figure 2.19.6). Measures to restrict credit and hike interest rates moderated import growth from 26.5% in FY2021 to 21.9% in FY2022. Exports increased but had a minimal impact on the trade deficit as they were worth only about 10% of imports. Workers' remittances increased by 2.2% but fell far short of countering the deepening trade deficit. The current account deficit widened in FY2022 by 82.2% to \$5.2 billion, equal to 12.9% of GDP. Financial inflow was insufficient to offset the deteriorating current account, requiring a drawdown of foreign exchange reserves. Reserves fell from \$11.8 billion in mid-July 2021, or cover for 10.2 months of imports of goods and services, to \$9.5 billion a year later, or cover for only 6.9 months, but a substantial part of the reduction took place in the first half of FY2022 (Figure 2.19.7).

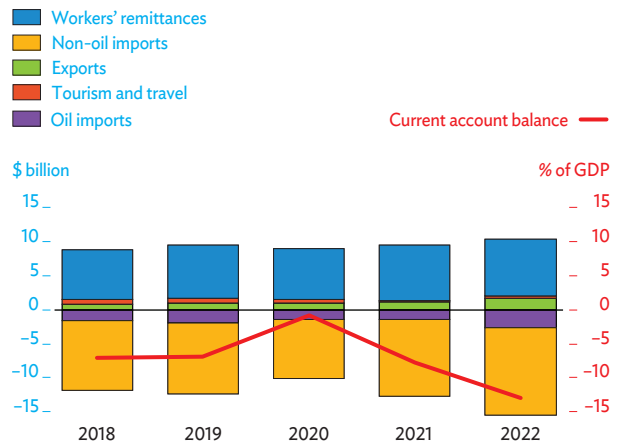
Economic Prospects

Growth is expected to decelerate to 4.1% in FY2023 and then pick up to 5.0% in FY2024 (Table 2.19.1).

The downturn in FY2023 reflects tighter monetary policy, slackened domestic demand, the unwinding of COVID-19 stimulus, and persistent global headwinds. GDP growth was officially estimated at 0.8% in the first quarter of FY2023, significantly down from 3.0% a year

Figure 2.19.6 Current Account Indicators

The current account deficit widened along with a large trade deficit.



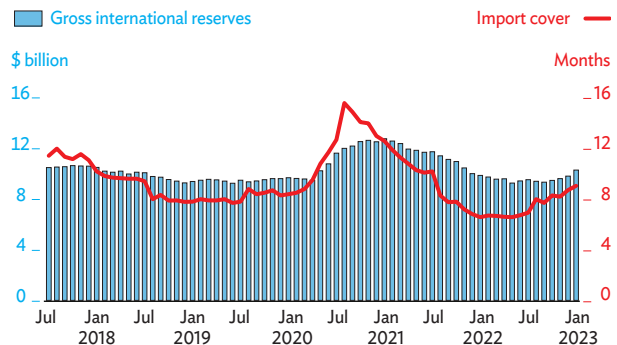
GDP= gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

Figure 2.19.7 Gross International Reserves and Foreign Exchange Adequacy

After declining, foreign exchange reserves have improved due to tighter monetary policy.



Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

earlier. Key areas of the economy have contracted, notably construction and manufacturing. Monetary policy in FY2023 continues to aim to curb high credit growth to contain domestic demand, escalating prices, and rising imports. The central bank hiked the bank rate by 150 basis points to 8.5% and the policy rate by the same amount to 7.0%, effective in August 2022. This exerted further upward pressure on market interest rates. The aim is to restrict private sector credit growth to 12.6% in FY2023. GDP growth is expected to pick up to 5.0% in FY2024, however, with the dissipation of inflation, increased infrastructure spending, and further

Table 2.19.1 Selected Economic Indicators, %

Growth decelerates on tighter monetary policy, but picks up with the dissipation of inflation.

	2021	2022	2023	2024
GDP growth	4.2	5.8	4.1	5.0
Inflation	3.6	6.3	7.4	6.2

GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Sources: Asian Development Bank estimates.

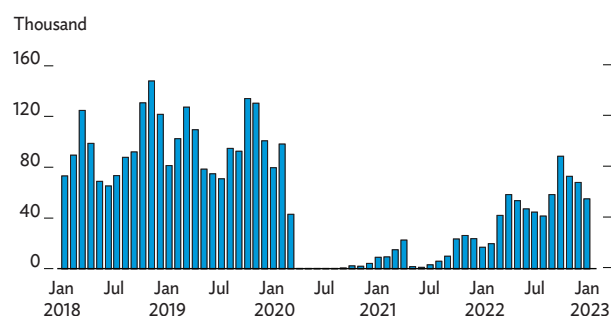
recovery in tourism and related services. The successful conclusion of the International Monetary Fund's Extended Credit Facility review on 28 February 2023 showed Nepal's economy on a sustainable path, with fiscal risks mitigated, external risks largely contained, and sustainable debt management ensured.

Growth in all production sectors is forecast to moderate in FY2023. Agriculture growth will likely ease from 2.3% in FY2022 to 2.0% in FY2023. Preliminary estimates show that rice output increased by about 7.0% thanks to a normal monsoon, but winter rainfall has been scanty, likely affecting winter crop yield and overall agriculture output. Despite a boost to industry expected with 700 megawatts of hydroelectricity added to the national grid, sector growth will likely decelerate by half from 10.2% to 5.1% as manufacturing and construction are hit by higher interest rates, import restrictions, a slowdown in domestic consumption, and dampened external demand. Growth in services will moderate from 5.9% to 4.4% after credit controls and a hike in interest rates slow real estate, wholesale, and retail trade. While tourism growth has been strong, international tourist arrivals are still only half of their pre-pandemic numbers (Figure 2.19.8).

Growth in private consumption expenditure will slow, and public investment may grow marginally in FY2023. After rising by 5.4% in FY2022, growth in private consumption expenditure will decelerate to 3.7% in FY2023, dampened by higher prices and credit controls. Public sector consumption is anticipated to expand by 3.6% in FY2023, largely on election spending by provinces and the federal government. Growth in private investment expenditure will slow from 8.8% in FY2022 to 4.0%, tamped down by import restrictions (lifted in mid-December 2022), higher policy rates, and a cash margin requirement for imports (lifted on 19

Figure 2.19.8 Monthly Tourist Arrivals

Tourism has picked up but has yet to reach pre-pandemic levels.



Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

January 2023). Public investment, having contracted by 6.0% in FY2022, is expected to expand only marginally by 1.3% in FY2023.

Fiscal policy in FY2023 continues to prioritize agriculture, infrastructure, and social protection.

While the original FY2023 budget was expansionary, the government downsized budget expenditure by about 14.0% during its midyear review, largely to cover revenue shortfalls in the first half of FY2023. The revised estimate sets recurrent expenditure equal to 12.5% of GDP and capital expenditure at 5.8%. The budget deficit is expected to narrow from 4.7% of GDP in FY2022 to 3.6%.

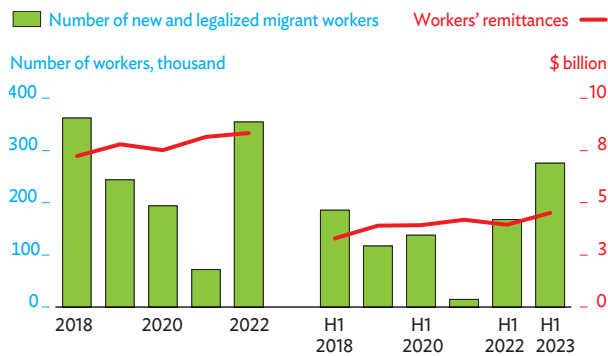
Inflation is forecast to edge up in FY2023 before moderating in FY2024. Average inflation accelerated to 8.0% in the first 6 months of FY2023. Food inflation edged up to 5.6% and nonfood inflation climbed to 8.6% as prices rose for housing, utilities, and transportation. Inflation is expected to moderate to an average of 7.4% in FY2023 as tighter monetary and fiscal policies take further hold in the second half of the fiscal year. Inflation is expected to decelerate to 6.2% in FY2024, assuming a normal harvest, subdued oil prices, and a decline in Indian inflation.

The current account deficit is projected to narrow in FY2023 and further in FY2024. Moderation in the deficit reflects both an easing trade deficit and buoyant remittance inflows. Having deepened by 44.2% in the first 6 months of FY2022, the merchandise trade deficit narrowed by 27.2% a year later, largely because of tight monetary policy and import restrictions. Workers' remittances, meanwhile, reversed 5.7% contraction to expand by 13.9% thanks to increased migration for employment overseas (Figure 2.19.9). The current

account deficit narrowed sharply by 92.1% to \$233.3 million and, coupled with broadly stable financial inflow, increased reserves by \$765.3 million in the first 6 months of FY2023, bringing them to \$10.3 billion providing import cover for 9.1 months. Considering developments so far, this fiscal year, the current account deficit is expected to narrow substantially from the equivalent of 12.9% of GDP in FY2022 to 4.0%. It will likely moderate slightly in FY2024 to 3.9% of GDP, even as growth increases to 5.0%, as global commodity prices normalize, and fuel imports are partially replaced by domestic hydroelectricity.

Figure 2.19.9 Migrant Workers and Remittances

Remittances have been resilient as migration for employment overseas increased.



Note: Years are fiscal years ending in mid-July of that year.

Source: Nepal Rastra Bank. 2023. Recent Macroeconomic Situation.

The main downside risk to the outlook is a global downturn hitting Nepal's tourism and remittance receipts.

A drastic tightening of global financial conditions to tame rising inflation would require tighter domestic monetary policy, which would erode investment and domestic consumption, dragging down growth. Intensified geopolitical turmoil and any natural hazards such as landslides or floods would further dampen growth prospects.

Policy Challenge—Effectively Implementing Relief Programs

Fearing food insecurity, the government announced a food relief program for vulnerable groups and those who lost livelihoods in the pandemic. When the pandemic struck Nepal, food security and food systems

were already stressed by powerful earthquakes in 2015 and trade supply disruption in 2016. Local governments distributed food to poor and vulnerable households from 24 March to 21 July 2020. The Ministry of Federal Affairs and General Administration facilitated and coordinated the food relief. While the program was considered successful, it faced several challenges: beneficiary identification, food procurement, monitoring, auditing, transparency, and food expenditure accountability.

Despite formulation of a systematic approach to provide food relief to the poor and vulnerable, it was not effectively carried out.

Beneficiary selection in some local levels was flawed, and there was no mechanism by which a third party would monitor food distribution. Local governments conducted no serious public audits of food relief expenditure. Data from a crisis management information system were found useful for monitoring the crisis and food relief program, but local governments failed to establish an enabling environment for information management through dedicated information technology sections. Further, system data were not fully integrated for policy formulation, planning, or monitoring.

The authorities could better plan and execute future relief programs by heeding the following policy recommendations.

Maintain a good database of poor and vulnerable households and update it periodically to better target relief. Intersectoral coordination among stakeholders is instrumental for efficiently delivering relief programs, harmonizing relief implementation procedures, and avoiding duplication. Local governments' institutional, technical, and managerial capacity should be strengthened to enable them to respond better to crises, provided that they have adequate resources and can generate additional resources from civil society. To avoid any fiduciary risks, a committee that selects beneficiaries should be as inclusive as possible. It should use digital modes of communication and strong procurement capacity and quality control mechanisms. To address grievances, a judicial committee should be formed by mobilizing trained staff and recruiting experts on gender-based violence. Finally, disaster management sections should be established in all local levels and be fully equipped with requisite human and technical resources.

PAKISTAN

Growth remained strong in fiscal 2022, and a larger fiscal deficit pushed up inflation despite tighter monetary policy. A substantial rise in imports widened the current account deficit, and international currency reserves plunged. Growth is projected to slow substantially in fiscal 2023, reflecting the impact of floods and a foreign exchange crisis, with currency depreciation and supply disruption doubling inflation. Fiscal and current account deficits should narrow nevertheless. Pakistan urgently needs to adapt to climate change.

Economic Performance

Accommodative policies last year supported strong growth. Growth edged up to 6.0% in fiscal year 2022 (FY2022, ended 30 June 2022) from 5.7% in FY2021, driven by rapidly rising domestic demand (Figure 2.20.1). Demand rose thanks to major fiscal stimulus that featured fuel and electricity subsidies higher than originally budgeted, tax exemptions, a tax amnesty for real estate, increased public wages and pensions, and a late response from the State Bank of Pakistan, the central bank, to overheating. Growth in

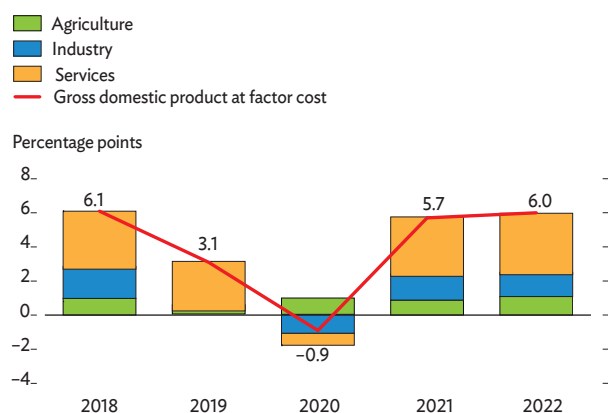
private consumption accelerated from 9.3% in FY2021 to 10.0%. However, private investment reversed 2.5% growth in FY2021 with 0.5% contraction, slowing growth in total investment and reflecting declining business confidence as political tensions and economic vulnerabilities intensified in the second half of FY2022.

On the supply side, growth reflected gains across sectors. Expansion in agriculture rose from 3.5% in FY2021 to 4.4% in FY2022 as crop production accelerated from 6.0% growth in FY2021 to 6.6% thanks to better weather, improved availability of seed and other inputs, increased credit, and attractive prices. Growth in livestock production rose from 2.4% in FY2021 to 3.3%. Industrial output remained strong, rising by 7.2% in FY2022 because of higher domestic and external demand, with growth in large-scale manufacturing up from 11.2% in FY2021 to 11.7%. Strong consumer demand lifted growth in services slightly, from 6.0% in FY2021 to 6.2%, as wholesale and retail trade expanded by 10.0% and strong economic activity boosted transportation and storage by 5.4%.

Headline inflation accelerated from 8.9% in FY2021 to 12.2%, reflecting currency depreciation, high global prices, and strong demand (Figure 2.20.2). Food prices rose by 13.4% in urban areas and 13.0% in rural as prices rose for agricultural inputs and imported food, and as the local currency depreciated. Energy

Figure 2.20.1 Supply-Side Contributions to Growth

Growth edged up in 2022 with expansion in agriculture and industry.

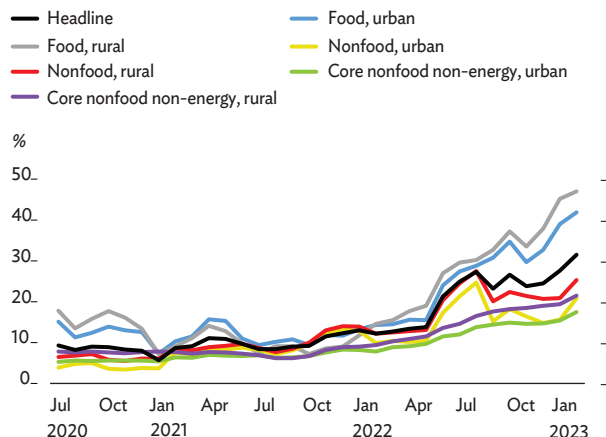


Notes Years are fiscal years ending on 30 June of that year.

Source: Pakistan Bureau of Statistics, [National Accounts Tables Base 2015-16](#).

Figure 2.20.2 Monthly Inflation

Inflation accelerated in 2022 on higher energy and food prices.



Source: Pakistan Bureau of Statistics, [Monthly Review on Price Indices, February 2023](#).

prices rose even faster, by 25.5% in urban areas and 24.7% in rural, reflecting higher global fuel prices, delayed implementation of FY2020 and FY2021 quarterly tariff adjustments for electricity, and the abandonment in May 2022 of a 4-month freeze on fuel prices, which more than doubled domestic petroleum prices. Core inflation, excluding food and energy, accelerated from 6.0% in FY2021 to 8.1% in urban areas and from 7.6% to 9.0% in rural, largely reflecting currency depreciation and rising domestic demand.

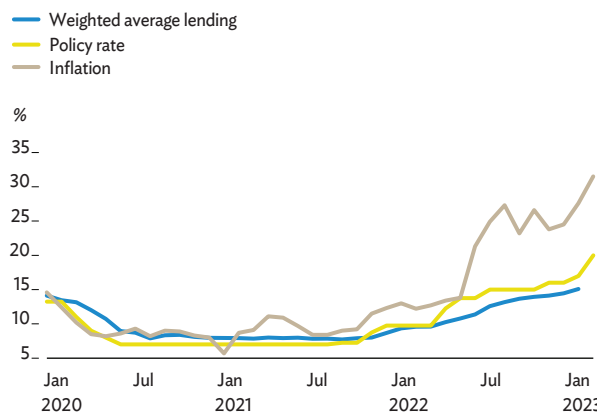
The central bank moved slowly to contain inflation.

It increased the policy rate by a cumulative 800 basis points from September 2021 to reach 15% by the end of FY2022 (Figure 2.20.3). However, with inflation above the policy rate, the real rate remained negative throughout FY2022. Growth in private sector credit almost doubled from 11.8% in FY2021 to 22.7% in FY2022, propelled by strong economic growth, negative real interest rates, and concessionary central bank finance schemes.

Loose fiscal policy contributed to rising macroeconomic imbalances. The consolidated fiscal deficit of the federal and provincial governments widened from the equivalent of 6.1% of GDP in FY2021 to 7.9% (Figure 2.20.4). Revenue dropped in FY2022 by 0.4 percentage points to 12.0% of GDP as a large decline in nontax revenue outweighed strong tax collection. Tax revenue rose from 9.5% of GDP

Figure 2.20.3 Interest Rates and Inflation

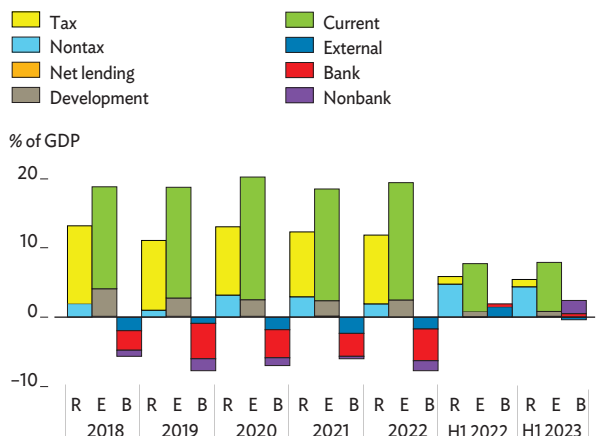
Inflation remained above the policy rate set by the central bank.



Source: State Bank of Pakistan. Economic Data.

Figure 2.20.4 Government Budget Indicators

The fiscal deficit widened in 2022 with a rise in government spending.



B = budget financing, E = expenditure, GDP = gross domestic product, R = revenue.

Note: Years are fiscal years ending on 30 June of that year.

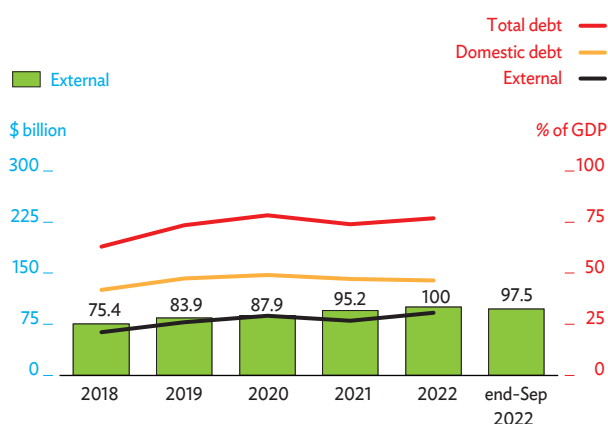
Source: Ministry of Finance, Pakistan Summary of Consolidated Federal & Provincial Fiscal Operations, July-December 2022-23.

in FY2021 to 10.1%, mainly from higher collection of direct taxes and sales tax on goods, reflecting strong domestic economic activity, higher prices, and increased imports. Nontax revenue slipped from 2.9% of GDP in FY2021 to 1.9%, reflecting smaller transfers of central bank profits and the government’s suspension of the petroleum development levy to alleviate inflation, plunging receipts from the levy to their lowest since 2015. Expenditure rose from

18.5% of GDP in FY2021 to 19.9%, driven mainly by a substantial rise in current spending caused by fuel and electricity subsidies, higher interest payments as domestic interest rates rose, and currency depreciation. The primary deficit almost tripled from 1.2% of GDP in FY2021 to 3.1% in FY2022, with 59% of budget financing from banks, 18.6% from nonbank sources, and 22.4% from foreign borrowing (Figure 2.20.5).

Figure 2.20.5 Government Domestic and External Debt

Government debt rose in 2022 as external debt increased.



GDP = gross domestic product.

Notes: Years are fiscal years ending on 30 June of that year. External debt includes government and other external liabilities and public corporations.

Source: State Bank of Pakistan, [Economic Data](#).

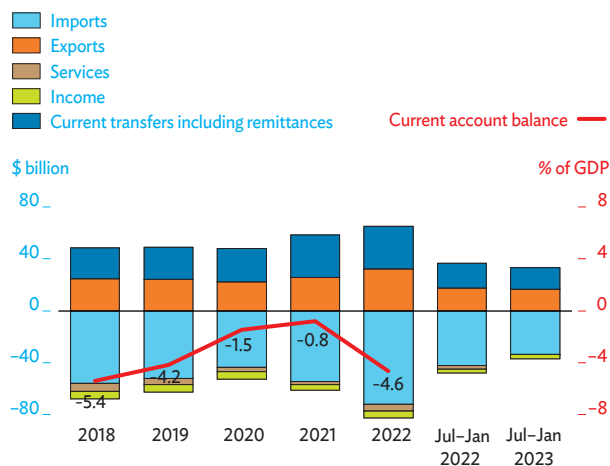
The current account deficit soared from \$2.8 billion in FY2021 to \$17.3 billion, driven by a larger trade deficit.

As a percentage of GDP, it widened sharply from 0.8% to 4.6% (Figure 2.20.6). The merchandise trade deficit expanded from 8.2% of GDP in FY2021 to 10.5% as 32.8% growth in imports exceeded 26.6% expansion for exports, reflecting strong recovery in domestic demand and higher prices, especially global energy and food prices (Figure 2.20.7). The service deficit more than doubled to equal 1.4% of GDP, reflecting higher financial service payments, freight charges for imports, and the normalization of travel post-pandemic. While official remittances remained strong at 8.4% of GDP, remittance growth year on year slowed from 27.0% in FY2021 to 7.1% in FY2022 (Figure 2.20.8). Net central bank foreign exchange reserves plunged from \$17.3 billion at the end of FY2021 to \$9.8 billion a year later, cover for only to 1.4

months of imports, after debt repayment and frequent central bank intervention to mitigate exchange rate pressures. The Pakistan rupee depreciated by 23.6% in FY2022 against the US dollar, reflecting worsening external conditions and a persistently high import bill, among other factors (Figure 2.20.9).

Figure 2.20.6 Current Account Components

The current account deficit widened, driven by a larger trade deficit.



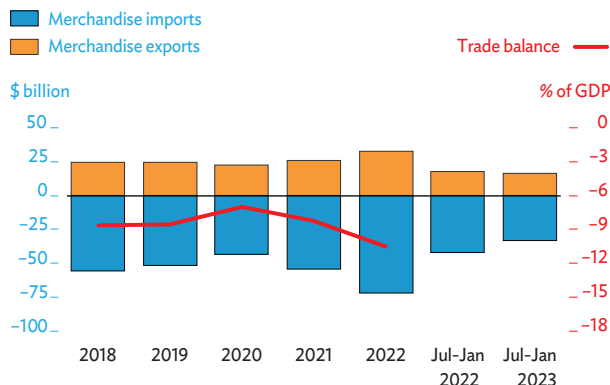
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per Balance of payments and international investment position manual, sixth edition (BPM6). January 2023.

Figure 2.20.7 Trade Balance

The merchandise trade deficit widened as imports grew faster than exports.



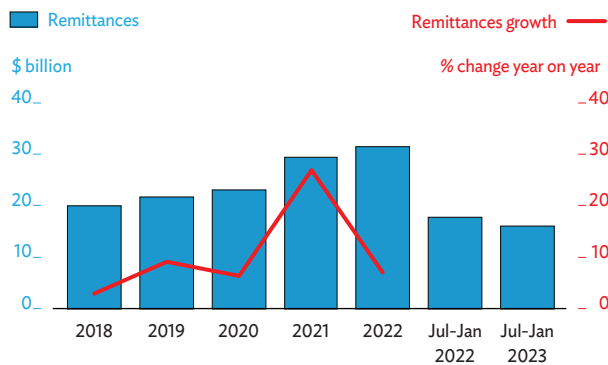
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per Balance of payments and international investment position manual, sixth edition (BPM6). January 2023.

Figure 2.20.8 Remittances

Remittance growth slowed in 2022 and continued to decline in the first half of 2023.

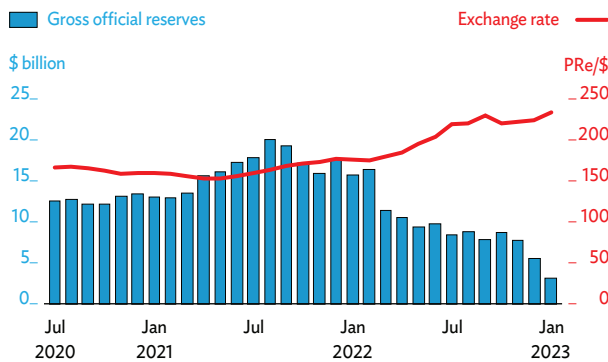


Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Worker's Remittances.

Figure 2.20.9 Gross Official Reserves and Exchange Rate

Reserves declined as the Pakistan rupee depreciated sharply in 2022.



Source: State Bank of Pakistan. Economic Data.

Economic Prospects

The International Monetary Fund (IMF) recently concluded talks with Pakistan on the pending ninth review of its extended fund facility. The arrangement would release \$1.18 billion to Pakistan. An IMF mission to Pakistan in February 2023 discussed policies to restore domestic and external sustainability, including strengthening Pakistan's fiscal position durably while supporting the vulnerable and those affected by floods; restoring the viability of the electric power sector and reversing the continued accumulation of circular debt from subsidies and unpaid bills; and restoring the proper functioning of the foreign exchange market

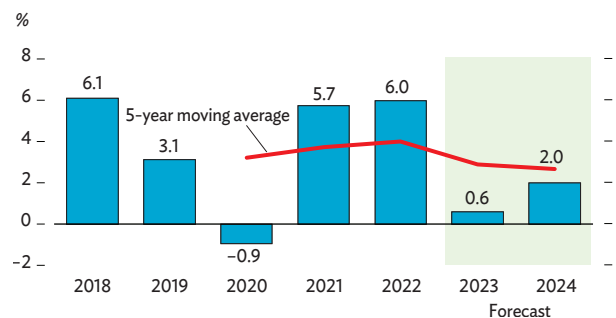
so that a realistic exchange rate can attract sufficient foreign exchange. Virtual discussions continue toward finalizing details on these policies. Their timely and decisive implementation are critical for Pakistan to regain macroeconomic stability, as is securing financial support from other development partners. At the end of February 2023, items pending included a higher petroleum development levy, electricity tariff increases, and the withdrawal of electricity subsidies to export industries and agriculture. The government must also identify financing sources to fill the external financing gap.

Growth is projected to slow substantially, with significant risks to the outlook.

Growth is projected to decelerate to 0.6% in FY2023 (Figure 2.20.10). Weighing on economic activity are the difficult political situation, economic losses and devastation from flooding, the ongoing foreign exchange crisis, tighter macroeconomic policies, and the challenging external environment. High inflation will affect purchasing power and thus restrain domestic demand. Increased government spending to support relief, recovery, and rehabilitation in the aftermath of the floods is expected to compensate for some of the damage and disruption to economic activity during the first half of the fiscal year. Growth is forecast to improve to 2.0% in FY2024, assuming sustained macroeconomic policies, reform implementation, recovery from supply shocks caused by flooding, and improving external conditions. A return to political stability with the formation of a new government after scheduled general elections would improve business sentiment.

Figure 2.20.10 GDP Growth

Growth is expected to slow in 2023 before recovering somewhat in 2024.



GDP = gross domestic product.

Notes: Years are fiscal years ending on 30 June of that year.

Sources: Pakistan Bureau of Statistics, National Accounts Tables Base 2015-16, Table 5, Accessed 21 February 2023; Asian Development Bank estimates.

Table 2.20.1 Selected Economic Indicators, %

Growth is projected to plunge and inflation accelerate in FY2023, with both indicators improving somewhat in FY2024.

	2021	2022	2023	2024
GDP growth	5.7	6.0	0.6	2.0
Inflation	8.9	12.2	27.5	15.0

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: Pakistan Bureau of Statistics, National Accounts Tables Base 2015-16, Table 5: Gross Domestic Product of Pakistan (at constant basic prices of 2015-16); State Bank of Pakistan, Economic Data, Inflation Snapshot (2015-16 = 100); Asian Development Bank estimates.

Agriculture will likely contract in FY2023 for the first time in 2 decades. This follows massive losses to cotton, wheat, and rice crops caused by flooding, as well as loss of livestock. Some 4,410 million acres of agriculture land was affected, affecting 40% of the cotton crop. Improved input availability from incentives announced in the Kissan Package 2022 for farmers may boost agricultural productivity and enhance crop production in the winter season, partly offsetting losses to summer crops.

A flood-induced supply shock severely affects industry and services. The production of textiles, which are normally 25% of industrial output and about 60% of export goods, is expected to plunge because prices for imported cotton to replace domestic supply are driven up by the foreign exchange crisis. The decline in food and livestock production will reduce slaughtering and food processing. Industry faces additional pressures as higher inflation and an expected tightening of fiscal and monetary policies curb domestic demand. Moreover, liquidity shortages caused by depleted foreign currency reserves are disrupting supply chains and making it harder to import essential raw materials, intermediate goods, and machinery for industry. Consequently, many factories have either closed temporarily or operate below capacity. Output from large manufacturers fell by 3.6% from July to November 2022, with output dropping in 19 of 25 categories. In November, output from large manufacturers plunged by 5.5% year on year. Industry is thus expected to contract in FY2023 but, as demand and supply shocks dissipate, expand in FY2024. Growth in services is projected to slow

as contraction in agriculture and industry drag down wholesale and transportation services, which are half of the sector. Further weakening of economic activity overall is expected from continued supply disruption caused by the loss to flooding of critical transportation infrastructure.

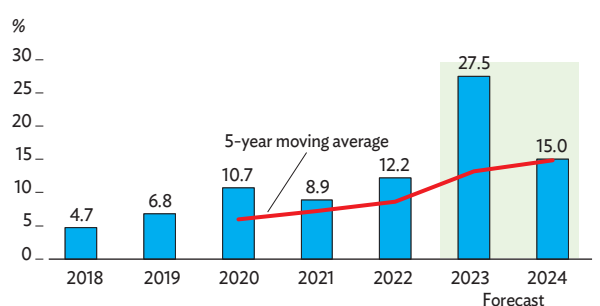
Average inflation is projected to more than double from 12.2% in FY2022 to 27.5% (Figure 2.20.11).

Headline consumer inflation jumped to 25.4% in the first 7 months of the fiscal year on higher domestic energy prices, a weaker currency, flood-related supply disruption, and restraint on imports caused by a serious crisis in the balance of payments. Core inflation in rural areas escalated to 17.7% year on year in the first 7 months of FY2023 from 9.0% a year earlier, while urban core inflation averaged 14.3% in this period, up from 8.1%. Headline inflation is expected to decrease to 15.0% in FY2024 as global energy prices decline and flood-induced supply constraints are resolved, as well as from a high base effect. The central bank tightened monetary policy further in response to rising inflation and external imbalances, raising the policy rate by another 200 basis points in the first half of FY2023 to 17.0% in January 2023, which was still below the inflation rate. On 2 March 2023, the central bank increased its policy rate by a further 300 basis points to 20.0% to tackle inflation.

The fiscal deficit is projected to narrow slightly to the equivalent of 6.9% of GDP in FY2023. If the IMF program remains on track, it will likely continue to shrink over the medium term as revenue mobilization

Figure 2.20.11 Inflation

Inflation is expected to surge in 2023 as energy and commodity prices spike, then slow in 2024.



Notes: Years are fiscal years ending on 30 June of that year.

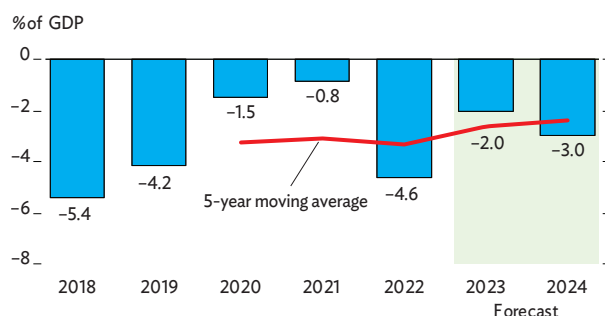
Source: State Bank of Pakistan, [Monthly Inflation Snapshot](#); Asian Development Bank estimates.

measures gain momentum, including general sales tax harmonization and personal income tax reform. The fiscal deficit stood at 2.0% of GDP during July–December 2022, remaining stable from the same period of 2021, while the primary surplus rose from 0.1% of GDP to 1.1%. Domestic tax collection declined slightly by 0.4% in the first half of the current fiscal year.

The current account deficit is projected to narrow to 2.0% in FY2023 (Figure 2.20.12). In the first half of FY2023, the current account deficit fell from \$9.1 billion a year earlier to \$3.7 billion, mainly from a 26% drop in the merchandise trade deficit. In the period, merchandise exports declined by 6.8% because of flood damage to the rice and cotton crops and industry shutdowns. Merchandise imports plunged by 18.2% as import restraints were imposed to slow the drain on international reserves. Workers' remittances have also declined in FY2023, with average monthly remittances in the first half falling from \$2.6 billion a year earlier to \$2.3 billion.

Figure 2.20.12 Current Account Balance

The current account deficit will narrow in 2023 and slightly widen in 2024.



GDP = gross domestic product.

Notes: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. [Economic Data](#); Asian Development Bank estimates.

Risks to the outlook and program implementation are high, tilting to the downside because of challenges both domestic and external.

Macroeconomic conditions have deteriorated seriously in the current fiscal year, and Pakistan is at dire risk because international reserves have reached critical lows. The economic outlook appears weak, with substantial risks from slower global growth or any further increases in world energy and food prices

caused by the ongoing Russian invasion of Ukraine. Bilateral and multilateral sources of affordable external financing would be hampered by higher international interest rates, weaker market sentiment, or tighter global financing conditions. The stalled IMF program must be resumed to buttress falling reserves and ease the balance of payments crisis, in part by catalyzing financing from other sources.

Policy Challenge—Adapting to Climate Change

Climate change poses a grave challenge to economic, social, and environmental development in Pakistan. For the past 20 years, the Global Climate Risk Index has consistently ranked Pakistan among the 10 most vulnerable countries, with thousands of fatalities caused by climate-induced extreme weather, as well as colossal losses to agriculture, infrastructure, and the economy. In 2022, Pakistan endured devastating drought and flooding that decimated assets, lives, and livelihoods on a massive scale. A post-disaster needs assessment following the 2022 floods estimated damage exceeding \$14.9 billion, in addition to the total economic losses of \$15.2 billion, requiring \$16.5 billion for recovery and rehabilitation. As the likelihood of such devastating shocks continues to rise, so do their impacts on Pakistani people and their livelihoods, and on ecosystems and the economy, worsening poverty and food insecurity and risking conflict over water and other resources.

Improving consistency and continuity in climate policies, budgets, and programs, will help implementing Pakistan's climate agenda.

Further, a clear gap exists between policy direction and implementation mechanisms. Pakistan's Ministry of Climate Change is responsible for climate change policy-making at the national level. With improved capacity and sufficient resources, it can better influence outcomes. In recent years, however, the government has taken a more proactive stance toward climate change. In 2021, it revised its National Climate Change Policy (NCCP) to link climate action and economic growth by integrating climate concerns with other national policies. The updated NCCP incorporates measures for disaster preparedness, capacity building, institutional strengthening,

technology transfer, and international cooperation. In line with the NCCP, several new sectoral policies supporting decarbonization have been adopted. The Alternative and Renewable Energy Policy, 2019 aims to create a framework for sustainable growth in Pakistan's alternative and renewable energy industry. The Strategic Plan for Energy Efficiency and Conservation, 2020–2023 supports energy efficiency and conservation, and the National Electric Vehicle Policy, 2020–2025 promotes a stronger transport supply chain and the use of electric vehicles. These innovations signal new momentum toward addressing climate challenges.

Urgent and collective action climate action must align with global climate measures. Such measures are needed to steer Pakistan toward climate-compatible development. The country needs to transform its system of managing agriculture, food,

and water to become more inclusive, sustainable, climate-smart, and resilient. It also needs to support the development of clean, green, and livable cities and accelerate the transition to sustainable energy and low-emission transportation.

Climate change actions should be introduced into sectoral policies through planning and development departments. Climate considerations should be incorporated into project and program development when preparing annual development plans and the budgetary framework. Decentralization can promote provincial and local ownership of climate policies. In recent years, several provincial governments have developed policies, strategies, and action plans to address climate change. These developments show that provincial commitment can help overcome institutional constraints and propel the implementation of environmental action.

SRI LANKA

With the country in deep crisis, the economy contracted sharply in 2022 and is projected to contract again in 2023. Slow recovery is forecast for 2024, assuming timely progress on debt relief and much-needed reform. Inflation surged in 2022 in response to shortages but is expected to moderate somewhat in 2023 and more so in 2024 with fiscal and monetary tightening. Sri Lanka must address longstanding structural issues to resolve its economic crisis.

Economic Performance

Macroeconomic vulnerabilities that predate the pandemic were aggravated by policy missteps and exogenous shocks, leading to sovereign debt and balance-of-payment crises. The results in 2022 were steep economic contraction and soaring inflation. Persistent fiscal and current account deficits generated large and ultimately unsustainable public debt. Gross financing needs increased sharply and foreign currency debt-service requirements exceeded foreign exchange reserves. Fiscal imbalances worsened given significant tax cuts in late 2019 following a change in government. Rollback of the automatic fuel price adjustment mechanism and suspension of reform measures to strengthen public finances exacerbated the vulnerabilities. A de facto exchange rate peg was maintained from April 2021 to early March 2022 which discouraged remittances as a wide gap opened between the official and the parallel market rate, putting further pressure on foreign exchange reserves. Economic activity was undermined by fallout from a temporary ban on the import of chemical fertilizer in 2021, dwindling reserves, and foreign currency constraints that caused shortages of essentials and triggered an acute energy crisis that featured prolonged power cuts and fuel shortages. Fallout from the COVID-19 pandemic and the Russian invasion of Ukraine tipped Sri Lanka into a balance-of-payments crisis and, in 2022, forced default on its official bilateral and commercial external debt.

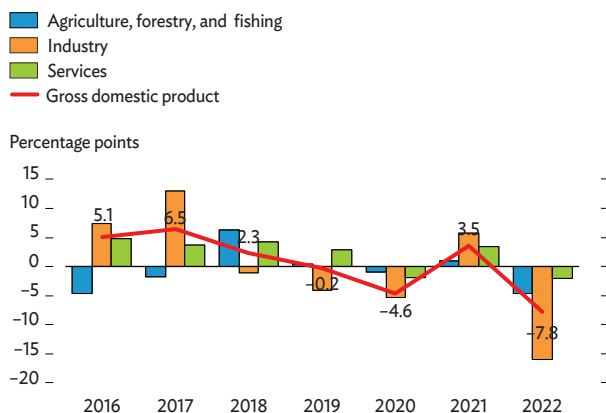
The economy contracted in 2022 by 7.8%, more than it had contracted in 2020. The \$3.65/day (at 2017 PPP) poverty rate is estimated to have doubled over 2021 and 2022, with stark implications for food insecurity. Worsening hardship sparked widespread protests, triggering political instability and multiple changes of administration in 2022. Adding to vulnerability and uncertainty about the economic outlook were delays in implementing measures to stabilize the situation and start addressing the root causes of the crisis.

Agriculture contracted by 4.6% in 2022. The chemical fertilizer ban, which was in effect from May to November 2021, cut average rice yield by 33.8% for the Maha 2021/2022 season, which is the country's major cropping season. Even after the fertilizer ban was rescinded, its lingering effects and foreign currency scarcity constrained fertilizer imports, hampering the cultivation of the next crop and reducing rice production in 2022 by 34.1%. Other key agricultural products such as tea, a major foreign exchange earner, and fruit and vegetables also suffered sharp declines (Figure 2.21.1).

Industry, the sector worst affected, contracted by 16.0%. Foreign exchange scarcity, import restrictions, and the difficulty of opening letters of credit curtailed supplies of imported raw materials, intermediate goods, and equipment.

Figure 2.21.1 Gross Domestic Product Growth by Sector

Sri Lanka recorded its sharpest contraction on record in 2022 as it faced multiple headwinds.



Source: Department of Census and Statistics of Sri Lanka.

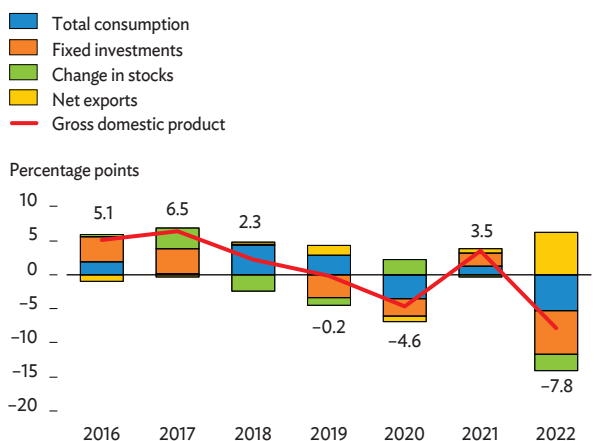
Added shocks were prolonged power cuts, transport bottlenecks, contractionary fiscal policy, and higher policy rates. Against this backdrop, construction contracted by 20.9% and manufacturing by 12.6%.

Services, the largest contributor to GDP, contracted by 2.0% in 2022. A pick-up in tourism in the fourth quarter (Q4) of 2022 buoyed services to some extent with contributions from accommodation and transport services. However, an 18.3% contraction in financial services and insurance offset growth in accommodation, public administration and compulsory social security, and transport amid heightened economic uncertainty and limited demand.

Both consumption and investment fell substantially as domestic demand weakened. Private consumption fell by 9.0% as consumer confidence weakened and inflation held spending in check. Gross capital formation led overall contraction in 2022 with a 24.9% decline amid poor business sentiment and rising interest rates. Government spending saw a slight uptick with increased outlay on social protection. Contribution of net exports to GDP was positive in 2022 because of import restrictions, foreign exchange scarcity, and recovery of global demand in the first half of 2022 (Figure 2.21.2).

Figure 2.21.2 Demand-Side Contributions to Growth

Demand contracted significantly amid tight economic conditions.



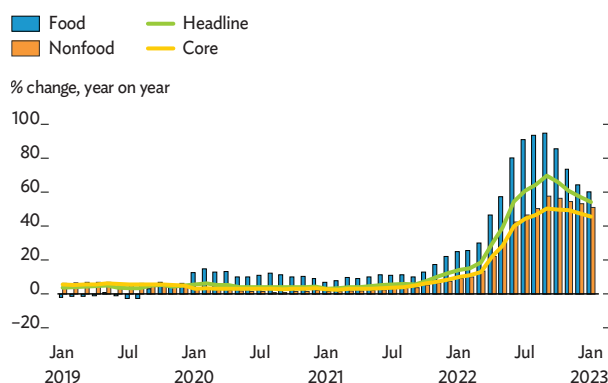
Source: Department of Census and Statistics of Sri Lanka.

Inflation intensified in 2022. Headline inflation soared from an average of 5.9% in 2021 to 46.4% because of shortages of essential goods such as food, fuel, and cooking gas; higher prices for energy in all forms; import restrictions; sharp currency depreciation; and substantial liquidity injections by the Central Bank of Sri Lanka. As inflation surged from 14.2% year on year in January 2022 to a peak of 69.8% in September 2022, food inflation peaked that month at 94.9%. With fiscal tightening, an easing of supply chain disruptions, weak demand, and a high base effect in Q4 2021, inflation gradually eased to 57.2% year on year by the end of 2022. Food inflation averaged 64.0% in the whole year and, despite slowing in Q4 2022, nonfood inflation remained elevated at 37.2%. Core inflation averaged 34.3% year on year, softening from its peak of 50.2% in September (Figure 2.21.3).

Policy rates were raised in 2022 to tackle inflationary pressures. The central bank raised policy rates by 150 basis points in Q1 2022, by an unprecedented 700 basis points in April, and by a total of 1,050 basis points from January 2022 to March 2023. To allow quicker transmission of higher policy rates, it revoked maximum interest rate caps previously imposed on banks. As a result, the average weighted prime lending rate ballooned from 7.9% in January 2022 to a peak of 29.7% in November 2022, dampening private sector credit growth from 13.1% in 2021 to 6.2% in 2022, which reduced demand and eased pressure on the exchange rate (Figure 2.21.4).

Figure 2.21.3 Inflation

Headline inflation surged, mainly as food prices soared.

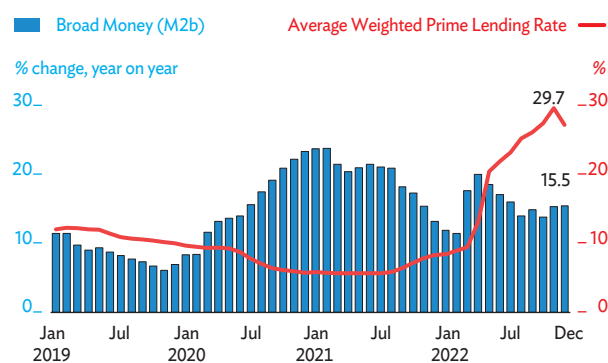


Note: Inflation reported is based on the Colombo Consumer Price Index (2013 = 100).

Source: Department of Census and Statistics of Sri Lanka.

Figure 2.21.4 Broad Money Growth versus Market Lending Rate

Following a historic rate hike, the average weighted prime lending rate neared 30% in 2022.



Note: M2b includes currency held with the public; demand, time and savings deposits of the public; and a part of foreign currency deposits held with the commercial banks.

Source: Central Bank of Sri Lanka.

To enhance bank liquidity, the central bank restricted discretionary payments, permitted capital conservation buffers to be drawn down, and extended to the end of 2023 the deadline to meet an enhanced minimum capital requirement.

The government continued to rely on monetary financing to finance the fiscal deficit in 2022 as revenue collection remained weak.

Low economic activity was one cause of revenue weakness, and another was the tax cuts in 2019.

Intensifying internal and external imbalances prompted sovereign credit rating downgrades, constraining the government's access to international markets. Net credit from the central bank to the government more than doubled in 2022, raising central bank holdings of government securities by 24.1% year on year at the end of December 2022. Central bank credit accounted for 95% of the increase in banking system claims on the government, which grew by 46%, and for 61% of growth in broad money (M2b) supply, which rose from 13.2% in 2021 to 15.5%.

Prolonged macroeconomic stress undermined financial intermediation.

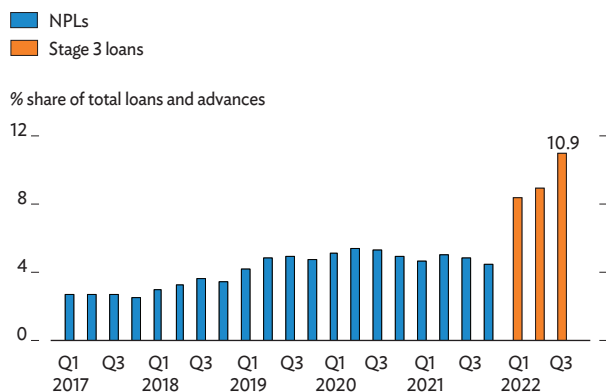
Since the second half of 2021, domestic banks have faced foreign currency liquidity constraints because the central bank was unable to provide necessary foreign currency liquidity owing to its low reserves, and their access to foreign credit and swap lines was undermined by the country's weakening macroeconomic outlook and external sector vulnerability. Further, domestic currency liquidity pressure started mounting in Q3 2022 as historically high yields of close to 30% in the government bill market sparked an outflow from bank deposits into securities, forcing banks to curtail credit extension. Also heightening risk to financial sector stability were its exposure to sovereign debt, risk concentration from exposure to large borrowers, high interest rates, and lack of access to international markets. Banks have raised their capital buffers in line with regulatory requirements under Basel III, with the core equity tier 1 ratio at 13.2% and the capital adequacy ratio at 16.5% in Q4 2021. However, following local currency depreciation and significant economic headwinds, loans classified as credit-impaired increased from 8.4% of all loans in Q1 2022 to 10.9% in Q3 (Figure 2.21.5).

The fiscal deficit narrowed to an estimated 10.2% of GDP in 2022 as the primary deficit fell to 3.7%.

Government recurrent expenditure declined from the equivalent of 15.6% of GDP in 2021 to 14.6% in 2022 as current spending did not increase in line with inflation. Capital expenditure fell from 4.4% of GDP in 2021 to 3.9% in 2022 amid spending restraints as the government was faced with resource constraints. Overall, total expenditure declined from 20.0% of GDP in 2021 to 18.5% in 2022 (Figure 2.21.6). Revenue to GDP ratio remained flat at 8.3% of GDP in 2022 as improvement in revenue collection following various revenue measures introduced in 2022 was offset

Figure 2.21.5 Impaired Loan Ratio

Stress in the financial increased in 2022.



NPL = nonperforming loan.

Note: The central bank discontinued in 2022 its calculation of NPLs and introduced instead stage 3 loan classification, which gives banks more discretion to provide against high-risk assets even before default.

Source: Central Bank of Sri Lanka. [Financial sector statistics](#).

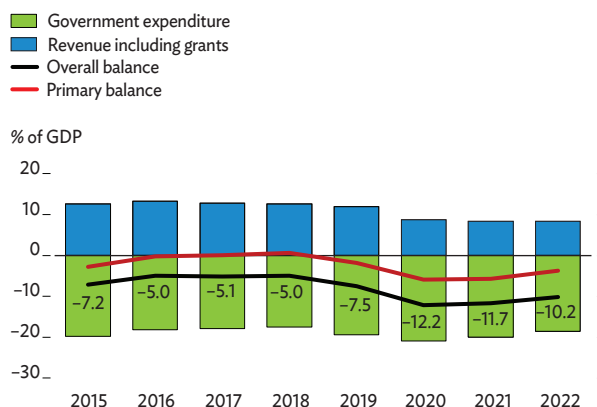
by declines due to the severe economic contraction and reductions in imports. Public and publicly guaranteed debt increased from the equivalent of 114.9% of GDP at the end of 2021 to 125.7% a year later.

Weaker imports and higher exports, remittances, and tourism earnings narrowed the current account deficit.

It fell from the equivalent of 3.8% of GDP in 2021 to 2.2% in 2022 (Figure 2.21.7). Merchandise imports declined by 11.4% as demand contracted, the local currency depreciated, and import controls kicked in—and despite fuel bill increases following the Russian invasion of Ukraine. The import bill declined largely in line with sharply shrinking volumes (Figures 2.21.8). Merchandise exports expanded by 4.9% in 2022, led by 7.9% growth in industrial exports. Agricultural exports contracted by 5.9% because of the fertilizer ban in 2021. The merchandise trade deficit contracted by 36.3% in 2022 to its lowest in 12 years. Following some improvement in early 2022, tourism was disrupted by domestic and external headwinds for a fourth consecutive year. Arrivals increased during the traditional peak season but remained far below their pre-pandemic norms (Figure 2.21.9). Remittance inflows were 31.0% less than in 2021 and 44.8% less than the average in the pre-pandemic

Figure 2.21.6 Central Government Finance

Primary balance for 2022 at -3.7% of GDP outperformed the targeted -4.0%.



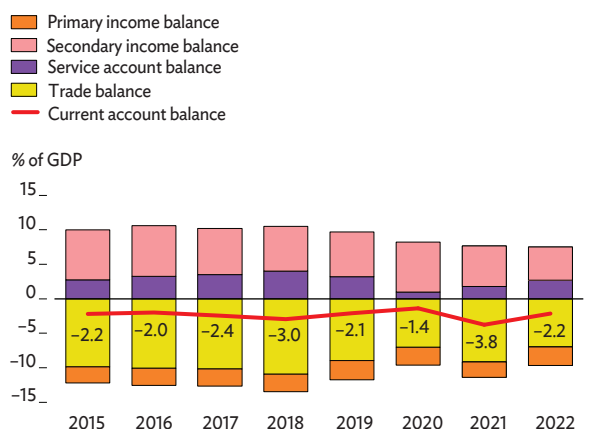
GDP = gross domestic product.

Notes: Figures exclude revenue and expenditure transfers to provincial councils. Data on government expenditure in 2019 and 2020, and fiscal data in 2022 are from the IMF.

Sources: Department of Census and Statistics of Sri Lanka; International Monetary Fund; Ministry of Finance.

Figure 2.21.7 Current Account Balance

A narrowing merchandise trade deficit and higher remittances supported the current account.



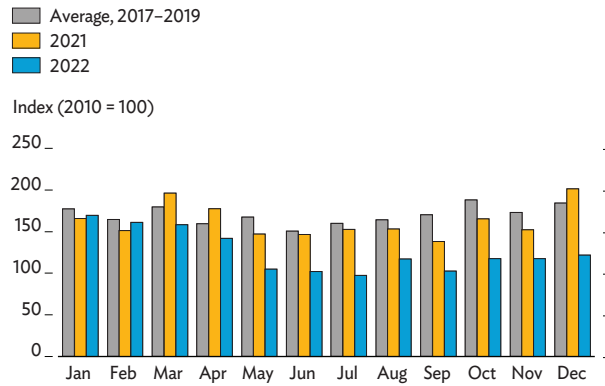
GDP = gross domestic product.

Sources: Central Bank of Sri Lanka; Department of Census and Statistics of Sri Lanka; Asian Development Bank estimates for 2022.

years 2018–2019, mainly reflecting sharp divergence between official and parallel market exchange rates, particularly at the beginning of the year. Remittances rose somewhat in the second half as the exchange rate gap narrowed (Figure 2.21.10).

Figure 2.21.8 Import Volume

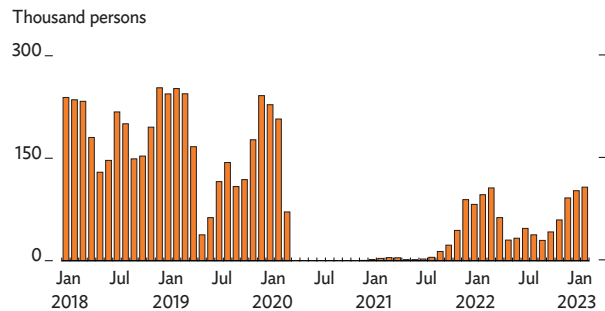
Sharp decline in import volume led to a decline in import bill despite higher unit value.



Source: Central Bank of Sri Lanka.

Figure 2.21.9 Tourist Arrivals

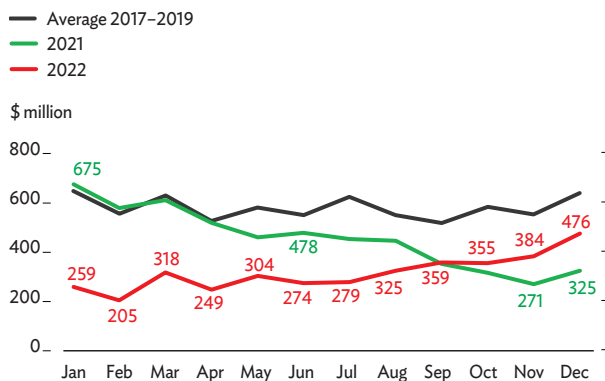
Tourist arrivals improved in the fourth quarter of 2022 but remained well below arrivals before the pandemic.



Source: Central Bank of Sri Lanka.

Figure 2.21.10 Monthly Remittance Inflow

Remittances inflow increased gradually during 2022, but remained below the 2017-2019 average.



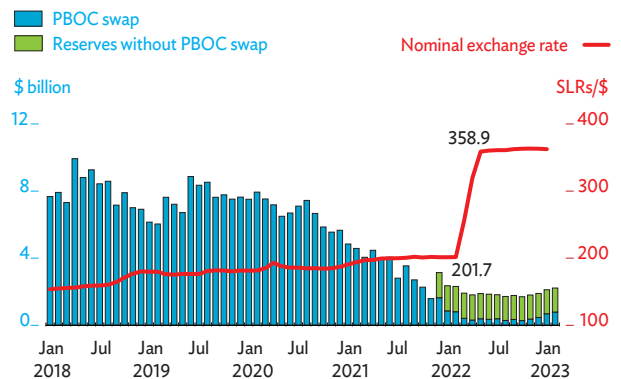
Source: Central Bank of Sri Lanka.

The balance of payments remained under pressure in 2022.

With external financing risks materializing following downgrading of the country’s sovereign credit rating and official reserves falling sharply to \$1.92 billion in March 2022, of which only \$420 million was usable, the government suspended debt service on its external debt excluding multilateral loans, trade credits, and currency swaps and initiated negotiations with the International Monetary Fund (IMF) for a new program. Heightened domestic economic uncertainty and monetary tightening in the advanced economies weakened capital inflow throughout the year. Reserves remained under \$1.9 billion since April 2022 of which \$1.4 billion was the swap agreement with the People’s Bank of China (PBOC), which could not be used due to certain restrictions. The country did not have sufficient usable reserves even for one month of imports (Figure 2.21.11). Some net inflow was recorded into the government securities market following a staff-level agreement with the IMF in September, and as the government’s fiscal consolidation efforts became clearer, but foreign holdings of government securities remained significantly lower than the SLRs104 billion held in 2019.

Figure 2.21.11 Gross Official Reserves and Nominal Exchange Rate

Usable reserves fell precariously low.



PBOC = People’s Bank of China.

Source: Central Bank of Sri Lanka.

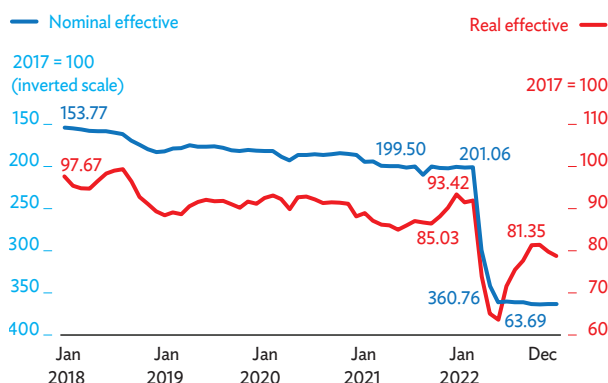
Higher inflation partly offset competitiveness gains from currency depreciation.

As pressure on the currency intensified and reserves were all but depleted, the central bank abandoned in March 2022 its de facto exchange rate peg to the US dollar, which had

been in place since April 2021, and introduced greater flexibility in exchange rate determination, eventually moving to a free float in March 2023. The Sri Lankan rupee depreciated by 44.8% against the US dollar in 2022. The rupee had been appreciating in real effective terms before March 2022, but it depreciated in real effective terms by 44.4% from February 2022 to May 2022. Sharp depreciation helped restore some competitiveness, but soaring inflation eroded the gains as the rupee appreciated in real effective terms in the second half of the year (Figure 2.21.12).

Figure 2.21.12 Exchange rates

Inflationary surge offset the real effective exchange rate depreciation eroding competitiveness.



Source: Central Bank of Sri Lanka.

Economic Prospects

Historic back-to-back contraction in 2023 is likely to be followed by only tepid recovery in 2024 (Table 2.21.1).

Sri Lanka’s efforts to stabilize its economy and return to recovery hinge on progress toward finalizing debt relief and its steadfast implementation of a 4-year, \$3.0 billion extended fund facility agreed with the IMF in March 2023. The agreement will help unlock external financing and thereby improve confidence. Assuming these conditions are met, the economy is forecast to contract by only 3.0% in 2023 and then grow by 1.3% in 2024 as the country’s debt overhang wanes.

Consumption and investment will continue to be weak in 2023 due to tight fiscal policy, high interest rates, and uncertain economic conditions. As the country implements a wide ranging reform program

Table 2.21.1 Selected Economic Indicators, %

GDP will contract this year and grow modestly in 2024 as inflation falls sharply.

	2021	2022	2023	2024
GDP growth	3.5	-7.8	-3.0	1.3
Inflation	6.0	46.4	24.6	5.5

GDP = gross domestic product.

Sources: Department of Census and Statistics of Sri Lanka; Asian Development Bank estimates.

which includes tax increases, lower disposable income will constrain household demand. Limited fiscal space and higher corporate tax rates will constrain public and private investment. Improved remittances will, however, provide some cushion to household spending. Contribution of net exports to GDP growth will remain positive as import growth remains muted and export growth is driven by recovery in tourism. With higher corporate tax rates, continuing import controls, and limited fiscal space for public investment, industry is expected to contract for a second consecutive year. Services will see gradual recovery as consumer confidence and tourism improve. With the removal of restrictions on chemical fertilizer imports and the renewed availability of foreign exchange with which to import fertilizers, conditions in agriculture are likely to improve. Industry sector is likely to remain subdued amid weak demand, domestically and globally. Services will see gradual recovery as tourism is expected to continue improving and progress on reforms over the course of the year builds confidence.

Inflation is forecast to ease in 2023 and return to single digits in 2024. Inflation is projected to average 24.6% in 2023 as fiscal tightening and double-digit interest rates weigh on domestic demand, supply-side disruption eases, and moderating external pressures alleviate food shortages. Factoring in a high base effect, inflation is expected to be sharply lower in 2024.

The fiscal deficit is expected to decline to the equivalent of 7.9% of GDP in 2023. An improved fiscal balance depends on an expected increase in revenue from the equivalent of 8.8% of GDP in 2022 to 11.2% in 2023 following revenue measures introduced in 2022 and 2023. The primary deficit is expected to fall to 0.7% of GDP in 2023, and

the government is forecasting a primary surplus of 0.8% in 2024. The budget for 2023 prioritizes social protection spending while postponing less urgent public investment. The government continued to face cash constraints in early 2023 as delays were encountered in the disbursement of social welfare payments and public sector salaries and pensions, following which further expenditure cuts were announced.

The current account balance is forecast to improve as tourism and remittances continue to recover.

Export growth is likely to remain weak in 2023 as global growth slows, high inflation erodes Sri Lankan competitiveness, and skilled workers emigrate, leaving labor shortages. Imports are expected to increase, however, as foreign currency liquidity improves and import restrictions are relaxed. But imports will remain below pre-pandemic averages because of fiscal tightening and high interest rates. The expected widening of the merchandise trade deficit will be offset by rising tourism and remittance inflows. Approval of the IMF program may improve investor sentiment, encourage capital inflow, and will help unlock financing from other international financial institutions, which will bolster reserves. However, access to external capital markets remains closed while the country seeks to finalize a debt treatment plan with its official bilateral and commercial creditors.

Sri Lanka's economy faces several headwinds.

The outlook is clouded by uncertainty concerning progress on debt restructuring, the timely implementation of measures under the IMF program, political developments as the country enters the electoral cycle that will likely test the authorities' will to carry out reform, and unpredictable weather patterns. Risks to the outlook could also emanate from the financial sector which has a significant sovereign exposure and faces deteriorating credit quality. Other downside risks are a global slowdown that exceeds expectations, which would hit foreign exchange earnings; political instability, which could hit tourism or delay reform; and a possible resurgence of the pandemic.

Policy Challenge—Addressing the Economic Crisis

Persistent structural impediments and weak economic management over the years left the economy vulnerable and the country entered the pandemic with limited buffers.

Sri Lanka is considered a classic “twin deficit” economy, with persistent fiscal deficits as budgetary expenditure consistently exceeded revenue, which has declined relative to GDP since the 1990s, and persistent current account deficits as national savings were consistently less than national investment. Sri Lanka's public debt accumulated over time, and debt service costs increased, diverting revenue to debt service. To keep the cost of servicing external debt manageable, an exchange rate system was maintained that led to an overvalued rupee and made the economy less competitive. Regarding domestic finance, the need to finance the fiscal deficit constrained monetary policy choices and limited space for adjusting the exchange rate. This caused macroeconomic volatility and frequent balance of payment crises, impelling recourse to the IMF.

Sri Lanka's vulnerability was aggravated by policy missteps and multiple shocks.

Shocks included disasters in 2016 and 2017, a constitutional crisis in 2018, the Easter Sunday terror attacks in 2019, COVID-19 in 2020 and 2021, and the Russian invasion of Ukraine in 2022. Owing to past policy shortcomings, such as a tax cut in late 2019, the country did not have adequate buffers to respond to these shocks, and in many instances it adopted ultimately counterproductive policies in the face of growing vulnerability: the ban on imports of chemical fertilizers, moving to a de facto exchange rate peg, and defending the peg despite declining reserves in April 2021. The weaknesses evident before the pandemic were exacerbated by multiple shocks as growth slowed sharply. New national account data show that growth was negative in 4 of the 8 quarters in 2018 and 2019. Internal and external imbalances continued to build up in early 2022, ultimately leading to the country's most severe economic crisis since independence.

Enhancing domestic resource mobilization will be critical to addressing macroeconomic vulnerability and imbalances.

Measures already taken include increasing value-added tax rates, lowering the tax-free threshold, expanding the tax base, increasing income tax rates for the top income brackets, narrowing tax brackets, and removing discretionary tax concessions and exemptions. Measures that will strengthen tax administration and mitigate tax evasion and avoidance include simplifying procedures, digitalization, strict enforcement, and capacity building in administration and new analytical tools. Reducing reliance on indirect taxes would improve progressivity in the tax regime.

Improving state-owned enterprise performance would lighten the fiscal burden.

Nearly 20 of the 52 key state-owned enterprises (SOEs) in Sri Lanka lost money on average in 2018–2022. SOE borrowing has grown to constitute a significant part of Sri Lanka's public debt, with government-guaranteed SOE debt equaling 5.7% of GDP at the end of 2022. SOEs also owe debt to one another, creating a maze of so-called circular debt. Key reform priorities include applying cost-reflective pricing and improving financial discipline; strengthening governance mechanisms to improve accountability and transparency; introducing key performance indicators; strengthening performance management systems and processes; separating government roles as policy maker, regulator, and operator; creating a conducive environment for private sector participation; and public-private partnership.

Strengthening public financial management and fiscal rules would improve fiscal discipline and monetary policy.

Sri Lanka enacted the Fiscal Management (Responsibility) Act in 2003, but it has been frequently relaxed. Essential to instilling fiscal discipline are strengthened budgetary institutions, establishing hard-and-fast fiscal rules and ensuring credible commitment to them, and improved transparency and consistency. These actions would curtail the fiscal deterioration that in the past has coincided with political cycles. Along with a proposed law to strengthen central bank independence, strengthening public financial management would make monetary policy more effective.

Safeguarding bank soundness and financial sector stability are essential for growth.

Government and SOE domestic borrowing has left banks with

significant sovereign exposure, which is a potential source of sector vulnerability as government finances come under strain. To enhance bank soundness and prevent fragility in the banking system, its supervisory and regulatory framework should be strengthened to ensure adequate capitalization, contain excessive risk-taking by banks, and address nonperforming loans. In the near term, a crisis-preparedness framework needs to be established, including for the resolution and liquidation of financial institutions, deposit insurance, and contingency planning. Capital market development should continue to be a policy priority over the medium and long term to mobilize long-term financing for infrastructure development and risk capital for entrepreneurs. Establishing a credit guarantee institution for small and medium-sized enterprises would encourage entrepreneurs and private sector participation.

Policies are needed to make the private sector more competitive and enable it to engage more effectively in external trade.

Sri Lanka has become less open to trade since 1990, and its participation in global value chains is meager. Since the 1970s, Sri Lanka's export basket has seen minimal change, with garment exports still earning over 45% of export income in 2022. Sri Lanka's lack of openness is indicated also by a low ratio of foreign direct investment to GDP, which averaged 1.2% in 2012–2028 and nearly halved to 0.7% in 2019–2021. Attracting capital inflow that does not create debt is imperative to building external sector resilience. Several measures are needed to address these shortcomings. First, investment policy to attract foreign direct investment will need to be accompanied by policies that facilitate trade. These policies include removing protectionist measures and the anti-export bias in trade policy by harmonizing tariffs, reducing para-tariffs, and simplifying trade rules. Second, the regulatory environment that impedes private investment and contributes to growth in the informal sector should be reformed. Owing to impediments to business activity, Sri Lanka's global competitiveness index ranking slipped from 62 among 142 economies in 2011 to 84 among 141 economies in 2019. Constraints that need to be alleviated relate to land access, as over 80% of land is owned by the government; a restrictive licensing and permit regime; rigid labor market regulation; delays in contract enforcement; frequent and inconsistent changes in tax and investment regimes; and weak trade facilitation.

Social protection is urgent and requires strengthened procedures and transparency.

As low-income households continue to bear the brunt of the economic crisis, expenditure on social protection needs to be prioritized. The current social assistance scheme should be strengthened to improve transparency, eliminate inclusion and exclusion errors to ensure that cash transfers are received by the most vulnerable, and raise the level of support, which is low at present. The government has operationalized the Welfare Benefits Board and has already acted to establish a new social registry to improve targeting and transparency in government social assistance programs.

Corruption and poor governance have undermined economic growth and stability.

In 2022, Sri Lanka ranked 101 among 180 countries on Transparency International's corruption perceptions index, sliding from 91 in 2017. Strengthening anticorruption legislation, building strong institutions, increasing transparency, and improving governance and accountability mechanisms will be essential to addressing the country's economic vulnerability and limited fiscal space. Sri Lanka also needs to continue strengthening its efforts to suppress money laundering and terror financing.



SOUTHEAST ASIA

Brunei Darussalam

Cambodia

Indonesia

Lao PDR

Malaysia

Myanmar

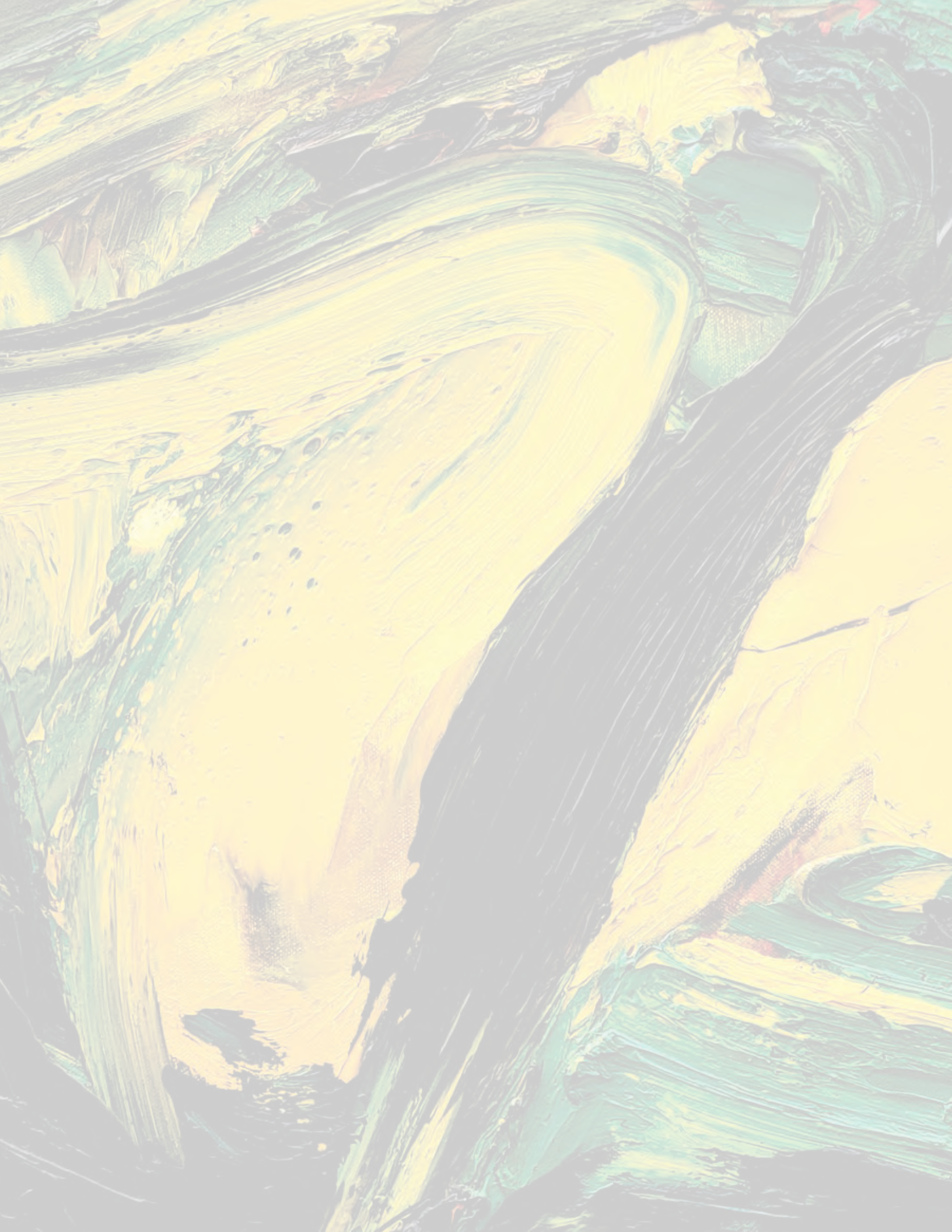
Philippines

Singapore

Thailand

Timor-Leste

Viet Nam



BRUNEI DARUSSALAM

Growth resumed in late 2022 with the reopening of borders and easing of travel restrictions. Inflation surged because of supply chain disruption. Growth is forecast to rise in the medium term with higher production of petroleum and chemical products. Inflation should ease as global supply conditions normalize. A significant challenge is diversifying the economy to ensure more balanced sources of future growth.

Economic Performance

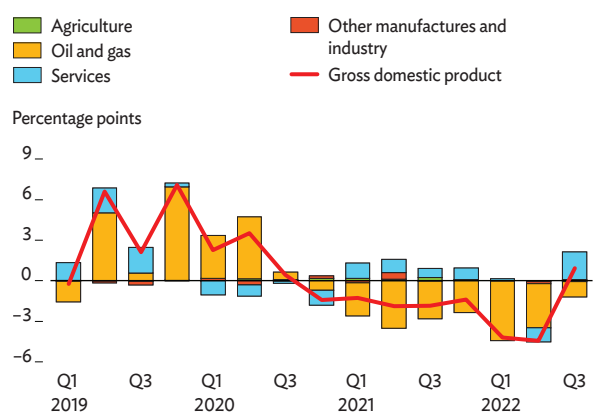
After contracting in the first 2 quarters of 2022, GDP growth resumed in the third quarter (Q3) on robust expansion in services. After 7 consecutive quarters of contraction, the economy grew marginally by 0.9% in Q3 (Figure 2.22.1). The service sector was the main contributor to growth, adding 2.1 percentage points, as borders reopened and travel restrictions were lifted, reviving activity in air transport, hotels, and restaurants. Industries other than oil, gas, or methanol contributed 0.1 percentage points with expansion by 1.5% coming mainly from manufacturing. However, the oil and gas industry contracted by 2.0%, deducting 1.1 points as maintenance and COVID-19 restrictions heavily disrupted the production of crude oil and natural gas. Expanding fisheries mitigated contraction in agriculture.

On the demand side, trade boosted growth in Q3.

All demand factors contributed to growth, with net exports the most significant contributor, adding 8.3 percentage points (Figure 2.22.2). The easing of travel restrictions boosted consumption in Q3, which had been maintained by subsidies, financial support, and other measures enacted by the government to ease the impact of COVID-19. Investment recovered slightly, but accommodating a sizeable statistical discrepancy on the demand side required that 11.7 percentage points be subtracted from GDP growth. With demand recovering after borders reopened, annual contraction of GDP improved somewhat from 1.6% in 2021 to an estimated 0.5% in 2022.

Figure 2.22.1 Supply-Side Contributions to Growth

Marginal expansion in the third quarter came from solid growth in services.



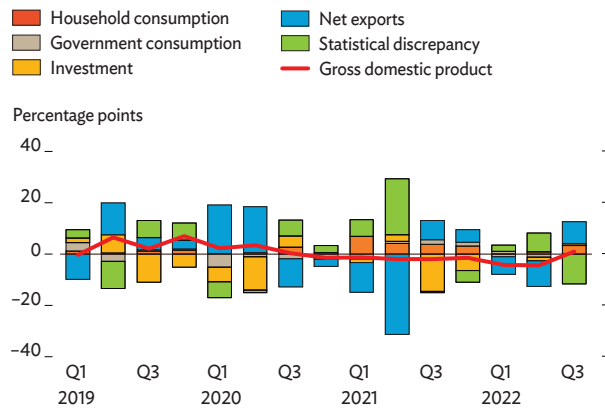
Q = quarter.

Source: CEIC Data Company.

Inflation in 2022 was the highest in 27 years. The inflation rate was 3.7% as several items had higher price rises throughout the year, caused by supply chain disruption that meant higher costs for imports and transport (Figure 2.22.3). Food and nonalcoholic beverages, transport, and miscellaneous goods and services were the biggest drivers of domestic inflation. However, unlike the double-digit increases seen in many other parts of the world, inflation remained manageable. Monetary policy tightening in Singapore dampen inflation, as Brunei Darussalam maintains parity between its dollar and the Singapore dollar. This softened the effect of higher import prices.

Figure 2.22.2 Demand-Side Contributions to Growth

All demand components contributed positively to growth in the third quarter.

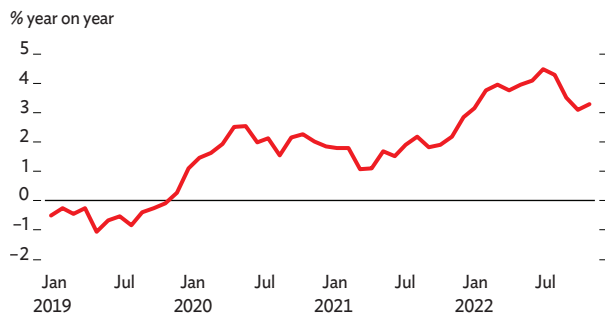


Q = quarter.

Source: CEIC Data Company.

Figure 2.22.3 Inflation

Inflation surged in 2022 because of supply chain disruption.



Source: CEIC Data Company.

Government measures partly eased labor shortages during the COVID-19 pandemic. As travel restrictions reduced the supply of foreign workers, the government enacted some measures to help businesses alleviate this constraint. The foreign worker license application process was expedited to allow the Job Centre Brunei to issue clearance letters. Further, the government introduced programs to upgrade the quality of local workers to thereby reduce reliance on imported labor in the future. The reopening of the economy and increased infrastructure development shifted the top hiring businesses in 2022. The three most active recruiters of local and nonlocal workers were wholesale and retail trade, motor vehicle and motorcycle repair services, accommodations and food services, and construction.

The trade balance remained in surplus in 2022.

The surplus came mainly from a Q3 surge in the goods account, the largest component in the current account, reflecting strong exports. In the year to November, the trade surplus grew by 46.9% as 40.5% expansion in exports outweighed 37.6% growth in imports. Export growth came mainly from mineral fuels and chemicals following the introduction of fertilizer production earlier in the year. Mineral fuels led imports, brought in to provide feedstock for the downstream petrochemical sector.

Economic Prospects

The growth outlook is for improvement across sectors. Supported by higher production of petroleum and chemical products, GDP growth is forecast to return after an absence of 2 years, reaching 2.5% in 2023 and rising to 2.8% 2024 (Table 2.22.1). Higher production targets and exploration for new oil wells will spur revival in upstream oil and gas activities. Ramped-up fertilizer production will drive improved growth downstream in the oil and gas industry, aiming to achieve optimal production capacity for export purposes and to increase methanol production. Industry outside of oil and gas will also contribute to economic expansion. Growth in construction is expected with ongoing projects under the National Development Plan. Primary industry will gain from the assumed achievement of higher production targets across agriculture, fisheries, and livestock rearing. Full reopening of air, land, and sea borders will further boost growth in the transport and logistics industry.

Table 2.22.1 Selected Economic Indicators, %

Growth and inflation will moderate.

	2021	2022	2023	2024
GDP growth	-1.6	-0.5	2.5	2.8
Inflation	1.7	3.7	2.0	1.6

GDP = gross domestic product.

Sources: CEIC Data Company; Asian Development Bank estimates.

Consumption growth will be supported by further recovery in tourism. Growth prospects suggest sustained consumption to the forecast horizon. In addition, efforts to invigorate domestic tourism, enhance product offerings, and promote sustainability will further strengthen domestic consumption. Border reopening will benefit hotels and restaurants as tourist arrivals increase, though higher outbound tourism may undermine domestic retail performance. Hotel reservations and flight frequencies have increased since the reopening.

Growth in exports is likely to accelerate. An expected increase in crude oil and natural gas production supports prospects for export growth. In addition, the maturing of operational processes at Brunei Fertilizer Industries, a government-owned company, is expected to stabilize production growth for export. Meanwhile, crude oil imports—the main driver of imports in recent years, mainly to provide feedstock for the downstream petrochemical industry—are expected to slow as refinery production at Hengyi Industries is interrupted by scheduled maintenance. Consequently, net exports are expected to continue contributing to growth.

Investment is expected to increase. Government investment in multiple basic infrastructure projects, the Lugu Phase 2 Housing Project, and several road infrastructure projects will continue under the National Development Plan. Foreign direct investment in food production, transport services, and eco-tourism have potential to boost investment. Investment in food production promises to offset the country's food trade deficit in the future.

Inflation is expected to ease to 2.0% in 2023 and 1.6% in 2024. As borders reopen globally and likely ease supply chain disruption, inflation is forecast to slow. However, stronger domestic demand and persistently elevated prices in global commodity markets will continue to exert upward pressure on domestic prices.

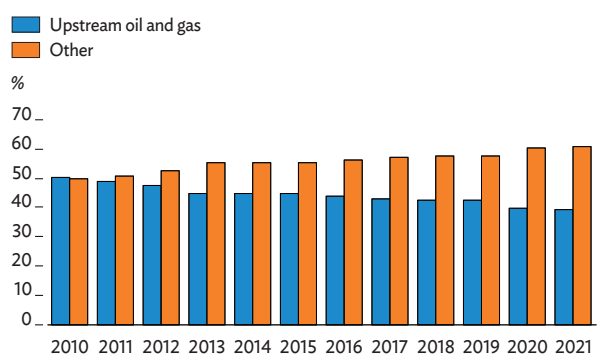
While the overall outlook is improving, downside risks predominate. If the global economy weakens more than expected or geopolitical tensions worsen, these developments could disrupt markets in major trading partners, hurting growth and stoking inflation.

Policy Challenge—Furthering Economic Diversification

Economic diversification would reduce risks from the volatile oil and gas market and foster cleaner production. The oil and gas industry remains the most critical in the economy. But the share of activity outside of oil and gas extraction increased steadily from 49.7% in 2010 to 60.7% in 2021 (Figure 2.22.4). Expanding the role of the downstream oil and gas industry and other non-extractive industries will strengthen the economy's resilience when global oil and gas markets are disrupted, and it will move the economy forward in terms of promoting cleaner and better production processes.

Figure 2.22.4 Share in GDP

The share of GDP generated outside of oil and gas extraction has increased.



GDP = gross domestic product.

Source: CEIC Data Company.

The government emphasizes development in five priority sectors. Brunei Darussalam has started strengthening the 5 priority sectors, downstream oil and gas industries, food, services, tourism, and information and communication technology, which are expected to increase future revenue outside of the upstream oil and gas industry. To do so, the provision of industrial sites by the Division of Industry and Business Eco-system and Darussalam Enterprise (DARE) is key to the future development of clusters. DARE's engagement in public-private partnership under projects such as Brunei Food Industry Development and the Brunei Innovation Lab will have to be enhanced to give local businesses access to opportunities and services that can foster higher-quality economic activity and growth.

Ensuring an adequate supply of competitive input factors is a challenge. Preventing labor shortages is key to ensuring continuity when diversifying the economy. Increasing expenditure on education, particularly geared for employment outside of oil, will serve the economy well. Available programs for upskilling and reskilling workers can be enhanced with additional training and the adoption of new technology, in particular digital technology. Businesses are engaged in training programs and research and development facilitated by DARE to build their capacity and gain more knowledge about business development and growth. As the economy relies heavily on imports of input materials, ensuring the provision of these materials at a competitive price is crucial, particularly for small-scale producers. To this end, the government has initiated efforts to procure input factors in bulk to achieve economies of scale and guarantee adequate provision at competitive prices.

Increasing foreign direct investment will expand the economy aside from petroleum and boost export capability. The Brunei Economic Development Board, government agencies, and local players in the logistics industry are looking at ways to support growth in exports. Projects in 2022 included a new scheduled container shipping line servicing Muara in Brunei Darussalam, Kota Kinabalu and Bintulu in Malaysia, and Singapore fortnightly, with anchorage facilities in Brunei Bay. Also launched in 2022 was the Integrated Marine Maintenance Yard and Decommissioning Yard project. The project is expected to provide maintenance, repair, and overhaul services for vessels in the region, as well as asset decommissioning, material recovery, and disposal services for companies within Brunei Darussalam and in the region. Integrating the development board and DARE promises to provide a seamless and effective platform for identifying potential spinoff activities using foreign direct investment. Local companies will be supported to develop their capabilities and have the opportunity to participate in the supply chains of incoming FDI projects.

CAMBODIA

Strong export growth and tourism recovery accelerated growth in 2022 and shrank the current account deficit. Inflation peaked in mid-2022 on surging prices for imported goods but decelerated in the second half of the year. Growth is projected to accelerate this year and next, supported by continued tourism recovery, but inflation will moderate. Cambodia needs to scale up green investment in strategic priority areas to unlock its long-term growth potential.

Economic Performance

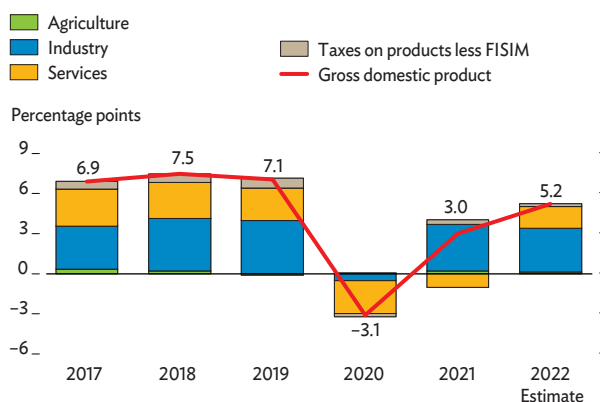
Growth accelerated on solid export and tourism recovery. The economy grew by an estimated 5.2% in 2022, led by rising external demand for Cambodian goods and tourism services. Industrial output grew by an estimated 8.3% in 2022 (Figure 2.23.1). Exports of garments, footwear, and travel goods increased by 39.8% year on year in the first half of 2022, and exports of other manufactured goods grew by 38.0%. Exports slowed, however, in the second half as growth weakened in the advanced economies. Construction recovered more slowly than expected as demand from foreign buyers declined, dragging down investment in the construction business.

After contracting in 2020 and 2021, services finally recovered. Sector growth rebounded to an estimated 4.6% in 2022 on tourism recovery that beat expectations and revived demand for food and accommodation, and on growth in local trade, transport, and communications. With improved confidence in travel and the removal of mobility restrictions, international visitor arrivals rebounded from 0.2 million in 2021 to 2.3 million (Figure 2.23.2). Recovery in real estate, meanwhile, was softer than expected as construction lagged, as did sales of high-end properties, which go primarily to foreign buyers.

Surging prices for agricultural inputs slowed sector growth. Growth in agriculture decelerated from 1.2% in 2021 to an estimated 0.7% in 2022 because higher

Figure 2.23.1 Supply-Side Contributions to Growth

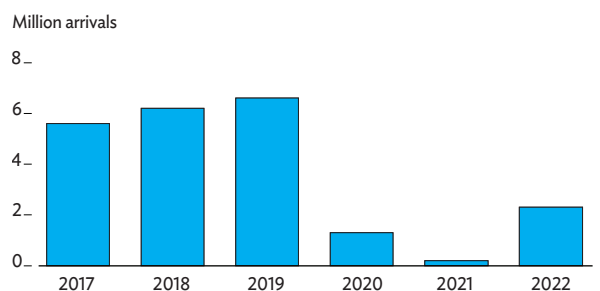
Growth accelerated in 2022, led by industry and recovery in services.



Sources: Ministry of Economy and Finance; National Institute of Statistics; Asian Development Bank estimates.

Figure 2.23.2 Tourist Arrivals

Tourist arrivals rebounded quickly on improved confidence in travel.



Source: Ministry of Tourism.

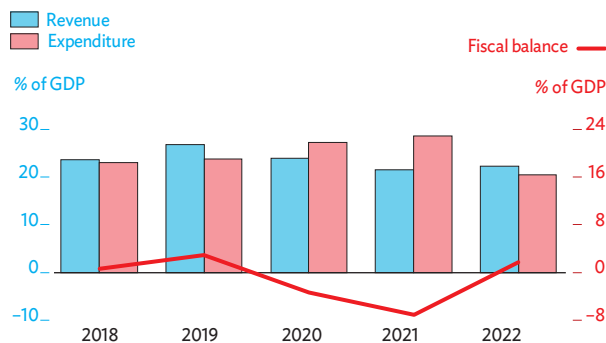
prices for fuel and other agricultural inputs constrained growth in crop and livestock production. Agricultural exports grew by a marginal 1.2%.

Inflation accelerated in 2022 on sharply rising international prices for fuel and other commodities. Consumer price inflation jumped in February 2022 and peaked in June at 7.9% year on year as global oil prices surged following the Russian invasion of Ukraine. Inflation then decelerated in the second half, averaging 5.3% for the year. The exchange rate remained stable, averaging KR4,102 per US dollar. Money supply (M2) growth moderated from 17.2% in 2021 to 8.2% in 2022, and growth in credit to the private sector from 24.9% to 18.6%.

Unexpectedly high tax revenue collection and slow spending turned the government budget into a surplus. The government continued to support COVID-19 prevention and treatment, the livelihoods of poor and vulnerable households, and the implementation of its economic recovery plan. The general government budget, which combines central and local government budgets, projected a deficit equal to 5.5% of GDP in 2022, but high revenue and low expenditure generated instead an estimated surplus of 1.7% (Figure 2.23.3). Tax collection above expectations increased revenue to an estimated 22.2% of GDP, against 20.2% budgeted, while spending initially estimated at 20.5% of GDP underperformed planned expenditure of 25.7%. The estimate for the 2022 outcome will be revised as new data become available.

Figure 2.23.3 Fiscal Indicators

Tax collection higher than planned and expenditure lower than budgeted returned the fiscal balance to surplus.



GDP = gross domestic product.

Source: Ministry of Economy and Finance.

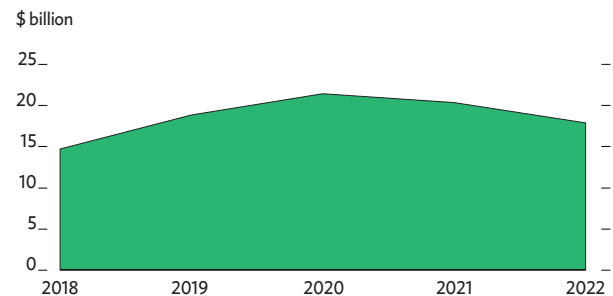
The government issued \$17.5 billion in sovereign bonds in 2022 to diversify its financing sources. Public external debt rose in nominal terms but shrank as a percentage of GDP, from \$9.5 billion in 2021, equal to 35.2% of GDP, to \$10.0 billion in 2022, equal to 33.3%.

The current account deficit narrowed significantly from 40.4% of GDP in 2021 to 25.3% in 2022.

Merchandise exports expanded by 18.7%, led by garments, footwear, and travel goods and by other manufactures. Merchandise imports grew by 4.2% from a high base in 2021. Import growth was led by fuel, construction materials and equipment, and consumer goods. Tourism recovery reduced the service trade deficit. Gold imports declined by 24.6% but remained large. Foreign direct investment inflow marginally increased by 2.7% to \$3,579 million. International reserves fell to \$17.8 billion, or cover for 6.1 months of imports, on tightening global financial conditions and US dollar appreciation (Figure 2.23.4).

Figure 2.23.4 International Reserves

International reserves continued to fall in 2022 as global financial conditions tightened.



Source: National Bank of Cambodia.

Economic Prospects

Economic recovery is forecast to continue despite weakened external demand.

The economy is expected to grow by 5.5% in 2023 and 6.0% in 2024 on more robust tourism recovery (Table 2.23.1 and Figure 2.23.5). Growth in garments, footwear, and travel goods is projected to decelerate as demand weakens in the US and Europe. Yet industry continues to benefit from new trade agreements and policy reform that includes a new investment law to create a one-stop service organization for investors. Industrial output growth is expected to decelerate to 5.8% in

Table 2.23.1 Selected Economic Indicators, %

Growth accelerated in 2022 and is forecast to gather further strength in 2023 and 2024.

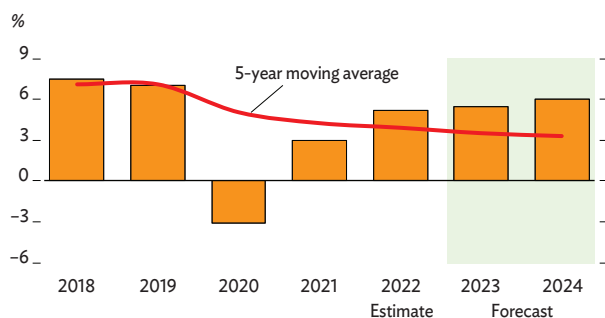
	2021	2022	2023	2024
GDP growth	3.0	5.2	5.5	6.0
Inflation	2.9	5.3	3.0	4.0

GDP = gross domestic product.

Sources: Ministry of Economy and Finance; National Bank of Cambodia; National Institute of Statistics; Asian Development Bank estimates.

Figure 2.23.5 GDP growth

Growth will continue above the 5-year moving average in 2023 and 2024.



GDP = gross domestic product.

Source: Asian Development Outlook database.

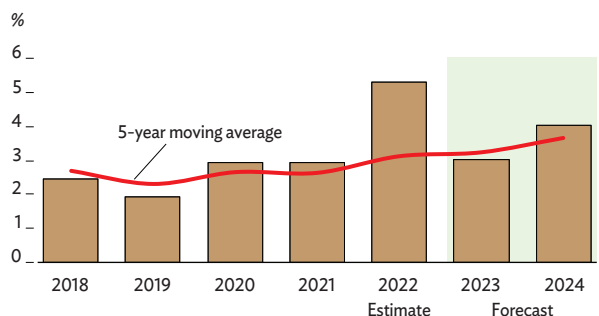
2023 before reaccelerating to 7.8% in 2024. Growth in construction—a key driver of growth before the pandemic—is expected to remain slow. Agriculture is forecast to grow by 1.1% this year and 1.2% in 2024, boosted by crop production for export.

Service growth will continue to be driven by ongoing tourism recovery. Growth in services is forecast to accelerate to 7.3% in 2023 before easing to 6.8% in 2024. It will be led by even stronger tourism growth expected following the loosening of COVID-19 restrictions in the People’s Republic of China (PRC), Cambodia’s largest tourist market. Other expected boosts to services are Cambodia’s hosting of the 32nd Southeast Asian Games in May 2023 and the 12th ASEAN Para Games the following month, and its national election the month after that.

In tandem with global energy prices, inflation is projected to moderate this year to an average of 3.0%. It is seen rising in 2024 to 4.0% (Figure 2.23.6). Inflation stood at 3.0% year on year at the end of January 2023, affecting mainly prices for food, transportation, and housing materials. Monetary policy will continue to target price stability with the implicit goal of promoting greater use of the local currency and maintaining a stable exchange rate against the US dollar. Dollarization, as measured by the ratio of foreign currency deposits to the money supply (M2), remained high at 83.0% at the end of 2022.

Figure 2.23.6 Inflation

Inflation will moderate in 2023 in line with lower energy prices, then edge up in 2024.



Source: Asian Development Outlook database.

The government is expected to pursue an expansionary fiscal policy to support growth. It will sustain its socioeconomic intervention packages to support recovery following the pandemic. Programs aim to prevent COVID-19 outbreaks and provide treatment but also offer skill training, cash for work, and cash transfers. Important spending priorities are the two regional sports events and the national elections. The fiscal budget for general government operations plans a deficit of \$1.6 billion, equal to 5.0% of GDP in 2023, with revenue budgeted at 21.6% of GDP and expenditure at 26.6%. The planned deficit will be financed by \$0.2 billion from government savings, \$0.2 billion from sovereign bond issues, and \$1.2 billion in borrowing from overseas. Cambodia remains at a low risk of debt distress, with public external debt projected to rise to a manageable 34.7% of GDP in 2023 and 34.5% in 2024. The planned \$200

million in sovereign bonds for issuance in 2023 will provide the government with an alternative financing source and more instruments for managing monetary policy, while offering more investment options to institutional investors.

The current account deficit is expected to shrink further as tourism continues to recover and merchandise exports grow. This assumes that imbalance caused by the gold trade continues to wane. Growth in merchandise exports is projected to slow to 7.0% in 2023, recovering to 9.5% in 2024. Tourism recovery, supported by the reopening of the PRC, is expected to turn the service trade deficit into a surplus. Merchandise imports are expected to fall by 1.5% in 2023 before growing by 6.5% in 2024. The current account deficit will be financed by the continued inflow of foreign direct investment and aid, which are expected to build up gross international reserves beyond \$21.1 billion by the end of 2024, or cover for about 7.0 months of imports.

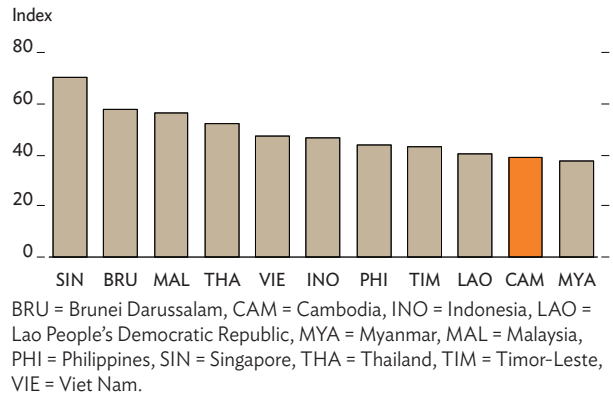
Risks to the outlook tilt to the downside. They include weaker growth in the US and Europe, high private debt, disappointing tourist arrivals from the PRC and foreign direct investment, soaring energy prices, and extreme weather.

Policy Challenge—Scaling Up Green Investments to Unlock Growth Potential

Cambodia is rendered highly vulnerable to climate change by geography, weak governance, and high dependence on climate-sensitive pursuits. It is also one of the countries least ready to improve its climate resilience, ranking 149th among 182 countries in the 2022 Notre Dame-Global Adaptation Index (Figure 2.23.7). With extensive floodplains, Cambodia is highly exposed to floods, scoring 9.5 out of 10 in the 2023 global risk index for humanitarian crises and disasters (Figure 2.23.8). Climate change is expected to increase the frequency and intensity of flooding and drought, raise average temperatures and sea levels, and worsen saline intrusion.

Figure 2.23.7 Vulnerability to Climate Change in Southeast Asia

Cambodia is among the countries in Southeast Asia most vulnerable to climate change.

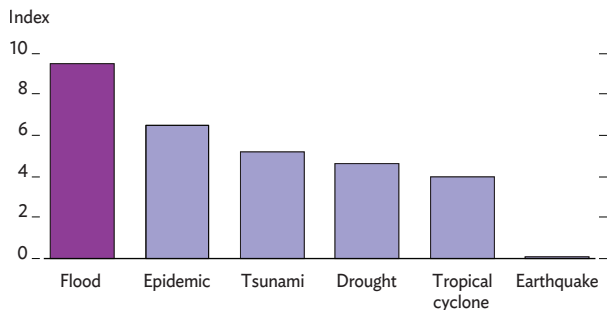


Note: The Notre Dame-Global Adaptation Country Index rates climate resilience on a scale of 0–100, with 100 indicating most resilient.

Source: Notre Dame-Global Adaptation Index 2020.

Figure 2.23.8 Cambodia's Exposure to Natural Hazards

Flooding poses the highest risk to Cambodia.



Note: The INFORM Risk Index rates the disaster risk profiles of 191 countries on a scale of 1–10, with 10 indicating highest risk.

Source: INFORM Risk Index. 2023.

Climate change can significantly hamper

Cambodia's potential long-term growth. Cambodia aspires to become an upper-middle-income country by 2030 and a high-income country by 2050. Climate change could, however, hold down Cambodia's GDP by about 10% by 2050, mainly from labor productivity lost to extreme weather events and rising temperatures. Worsened flood and drought frequency and severity is expected to hit agriculture, and rising sea levels and saline intrusion to impair Cambodia's freshwater fisheries and degrade agricultural land. Tourism is also vulnerable to climate change, which can damage key infrastructure and tourism demand.

Cambodia must consider climate change while pursuing its economic growth mandate. While Cambodia is a low emitter of greenhouse gases, its emissions are rising because of deforestation, expanded rice cultivation, and rising energy demand from industry. Shrinking its carbon footprint would present Cambodia with new growth opportunities, given rising global demand for environmentally sustainable products and services. Transitioning to a net zero economy would also create higher-quality jobs and give Cambodia better access to global investors increasingly interested in green investment.

Scaling up green investment in priority sectors would help Cambodia unlock its long-term growth potential. The government is committed to pursuing

green growth through its National Strategic Plan on Green Growth, 2013–2030 and its Long-Term Strategy for Carbon Neutrality by 2050. Cambodia has potential to scale up investment in renewable energy and energy efficiency using its abundant solar energy resources. Additionally, given the importance of agriculture to Cambodian food security and its potential for commercialization, investment in climate-smart agriculture and natural capital management should be prioritized. Finally, investment in climate-resilient infrastructure will be critical to promoting growth and ensuring long-term sustainability.

INDONESIA

Growth rose in 2022. Exports boomed, supporting growth and generating windfall fiscal revenues. Higher commodity prices raised inflation—not as much as expected but enough to dampen consumption and investment and spur monetary tightening. External debt inflows decreased, foreign reserves fell, and the rupiah weakened. For 2023, slower global growth will contain exports and growth. For the medium term, repairing the impact of the recession will be challenging.

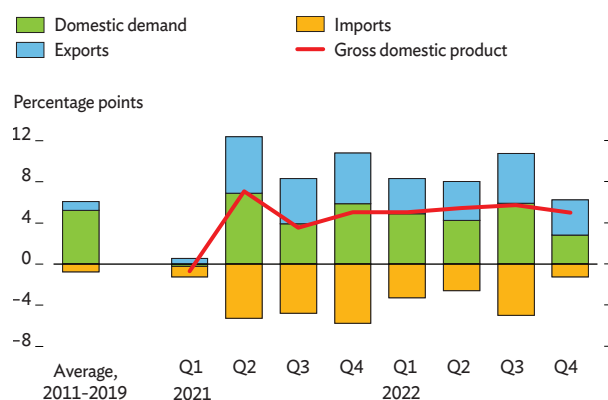
Economic Performance

Commodity exports boomed in 2022, making up for modest domestic demand. In national account terms, exports of goods grew by 14.4%. Exports of coal, palm oil, nickel, and copper were especially robust. As restrictions were reduced, tourism picked up, albeit from a very low base, and services exports grew by 56.1%. In contrast, domestic demand grew by 3.8%, below its pre-pandemic trend of 5.2%. Total imports grew by 14.8% (Figure 2.24.1).

Increased mobility spurred consumption, but rising inflation and uncertainty derailed “revenge spending.” Pent-up demand (especially for services) drove private consumption growth to about 5.5% during the second quarter (Q2) and Q3. But rising prices of basic goods such as fuels, cooking oil, and noodles cut purchasing power, eventually trimmed consumption growth to 4.5% in Q4, and kept it to 4.9% for the full year, lower than the pre-pandemic trend (Figures 2.24.2 and 2.24.3). Meanwhile, government consumption fell each quarter and by 4.5% for the full year.

Figure 2.24.1 Demand-Side Contributions to Growth

Exports rivaled domestic demand as the driver of growth.



Q = quarter

Notes: The statistical discrepancy is distributed proportionately to the components of GDP. Domestic demand is the sum of private consumption, government consumption, and gross capital formation.

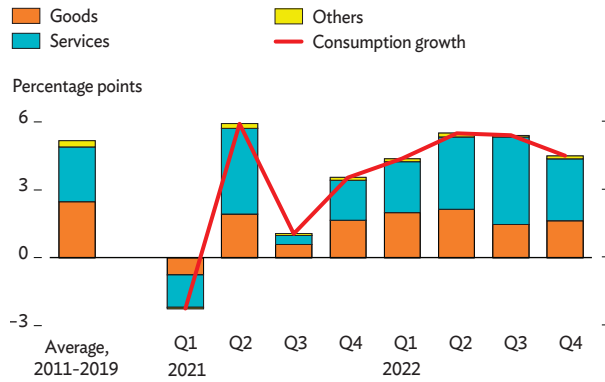
Source: [Statistics Indonesia](#).

Businesses held back fixed investment, unsure about the duration of the export boom. Gross capital formation (fixed investment and inventories) grew by 4.0% (Figure 2.24.4). Despite favorable conditions (the export boom and recovering activity, ample liquidity, and investment-friendly policy reforms), producers adopted a “wait-and-see” attitude. The government, pursuing fiscal consolidation, kept capital expenditures unchanged from 2021 in nominal terms, a cut in real terms. Construction, 74% of total fixed investment, stagnated. Other indicators of business activity dipped in Q4 (Figure 2.24.5).

Inflation jumped in September after fuel price increases. Headline inflation had been rising through August but stayed below 5% (Figure 2.24.6). On 3 September, to contain swelling subsidies for fuel and electricity, the government raised key fuel prices by

Figure 2.24.2 Contributions of Consumption Components to Growth

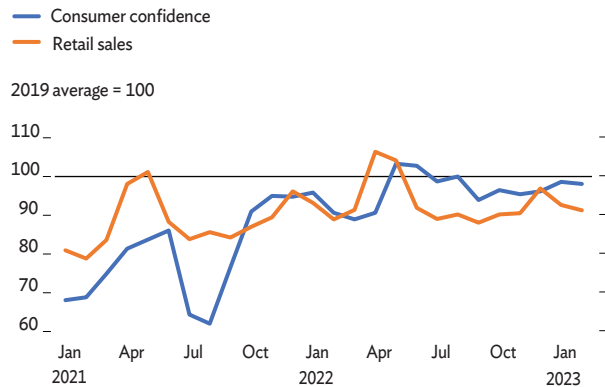
As restrictions eased, spending started strong, especially on services ...



Q = quarter.
Source: Statistics Indonesia.

Figure 2.24.3 Consumer Spending Indicators

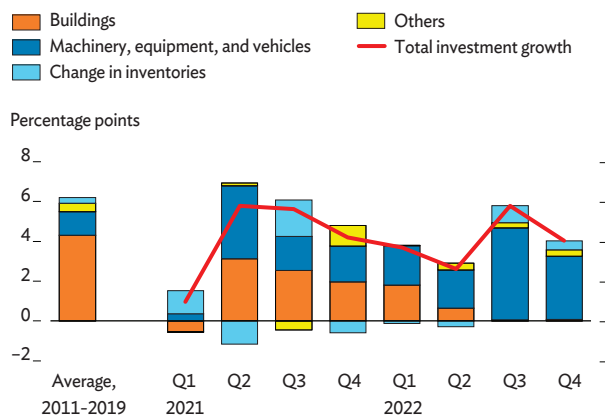
... but eventually there was no “revenge spending.”



Sources: Bank Indonesia; CEIC Data Company.

Figure 2.24.4 Contributions of Investment Components to Growth

“Wait and see” held down investment, especially in construction.



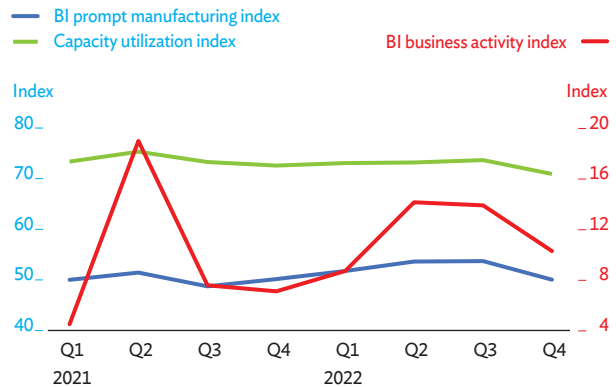
Q = quarter.
Source: Statistics Indonesia.

30%. Inflation rose to almost 6% in September, way above the 4.0% inflation ceiling of Bank Indonesia, the central bank.

Subsequently, inflation did not rise as much as expected. Some forecasters expected inflation to be above 6% in December and to average 4.7% for all of 2022. In the event, inflation averaged 4.2% in 2022, and the consensus forecast for 2023 fell to 4.1%. The persistent output gap helped contain inflation. Although the economy is now 3% larger than in 2019, it is about 7% below its full potential. Inflation expectations from surveys were broadly steady, likely

Figure 2.24.5 Business Activity Indicators

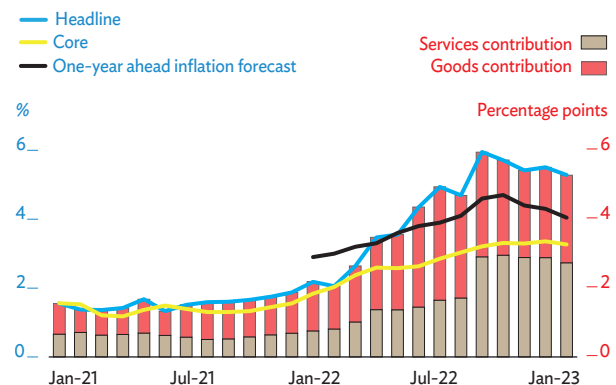
Business surveys bear out the Q4 slowdown.



BI = Bank Indonesia, Q = quarter.
Notes: For BI Prompt manufacturing index, a value greater than 50 indicates expansion.
Source: Bank Indonesia.

Figure 2.24.6 Inflation

Inflation jumped after the fuel price hike but then eased faster than expected.



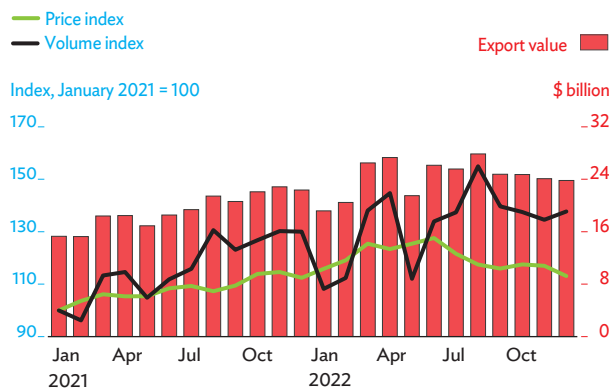
Q = quarter.
Source: Statistics Indonesia.

reflecting public acceptance of the low inflation regime set since 2015. It also helped that regional governments subsidized basic items, such as bus fares, and that infrastructure has improved since 2015, helping contain domestic logistics costs.

Indonesia achieved record trade and current account surpluses. The trade surplus in 2022 was \$63 billion, compared to \$44 billion in 2021, the previous record. Export and import growth both slowed in the second half, mainly due to a base year effect but also because of weaker prices for coal and palm oil exports. In US dollar terms, exports grew by 26% for the full year; imports, by 21% (Figures 2.24.7 and 2.24.8). Imports of intermediate goods were especially robust. After subtracting the usual deficits in services and incomes, the current account surplus was \$13.2 billion (1% of GDP) in 2022, compared to 0.3% in 2021. Pre-pandemic current account balances averaged -2.5% of GDP.

Figure 2.24.7 Merchandise Exports

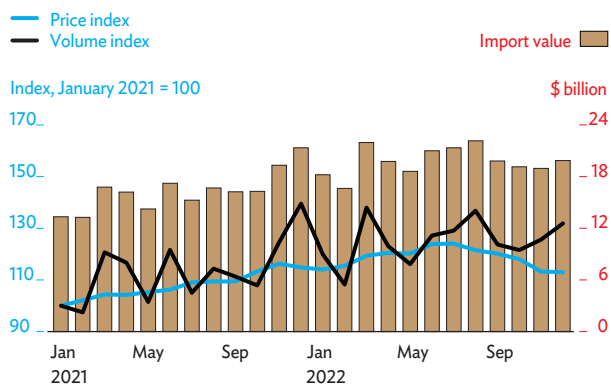
Strong demand kept export prices and volumes high all year.



Source: Statistics Indonesia.

Figure 2.24.8 Merchandise Imports

Like exports, imports remained robust, despite high import prices.



Source: Statistics Indonesia.

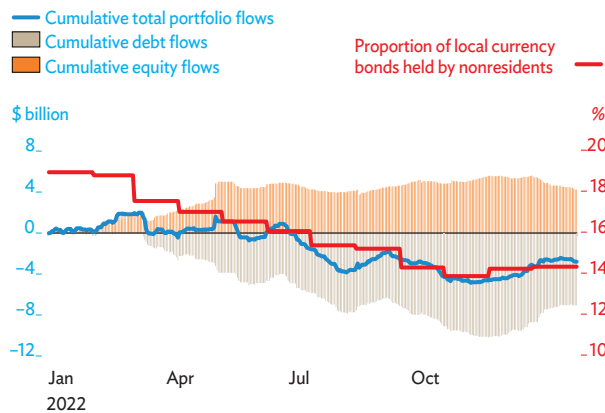
However, shrinking portfolio debt turned the financial account into a deficit, pushing down reserves and the rupiah. Portfolio debt financing suffered net outflows through August on rising yields in advanced economies (Figure 2.24.9). Debt inflows recovered in November on central bank policy rate increases, growing expectations of US Federal Reserve moderation, and a general rebalancing toward emerging market and developing economy assets by bond investors. Positive net flows have continued in 2023 so far, and equity capital and foreign direct investment have remained healthy. International reserves troughed at \$130.2 billion in October and rose to \$137 billion in December (Figure 2.24.10). In January, reserves rose to \$139 billion, after a heavily oversubscribed global bond issue of \$3 billion and further to \$140 billion in February, about 6 months of imports and debt service and more than twice the amount of external debt due in 1 year. To boost domestic dollar availability, the central bank now offers a special term deposit facility for exporters' dollar proceeds. The rupiah bottomed out at Rp15,743 = \$1 in November (9% lower than at end-2021) and was Rp15,235 = \$1 at the end of February (Figure 2.24.11). The external debt was \$397 billion at the end of 2022, equivalent to 30% of GDP, from 35% in 2021. Sovereign credit ratings are stable. Nonresident investors now hold about 14% of Indonesian bonds, down from 30% in 2020.

The fiscal deficit was much smaller than targeted.

The revised budget in June targeted a deficit of Rp840 billion, or 4.50% of GDP. The actual deficit was Rp464 billion, or 2.37% of GDP in 2022, 1 year ahead of the scheduled return to the 3% deficit ceiling (Figure 2.24.12). The waning of COVID-19 and the economic recovery allowed lower spending on health and economic stimulus. However, higher fuel and food prices swelled subsidies for gasoline and electricity and cash transfers to vulnerable households. Total spending turned out 13% larger than budgeted. Revenues, however, were 42% larger than expected due to the export windfall, the recovery of economic activity, and new tax measures (including an increase in the value-added tax rate to 11% in April). Based on International Monetary Fund estimates, the deficit overperformance produced a contractionary fiscal impulse of about 1.8% of GDP, contributing to the tepid domestic demand. The public debt was Rp7,734 trillion (39% of GDP) in December, from Rp6,984 trillion (41% of GDP) in 2021.

Figure 2.24.9 Portfolio Flows

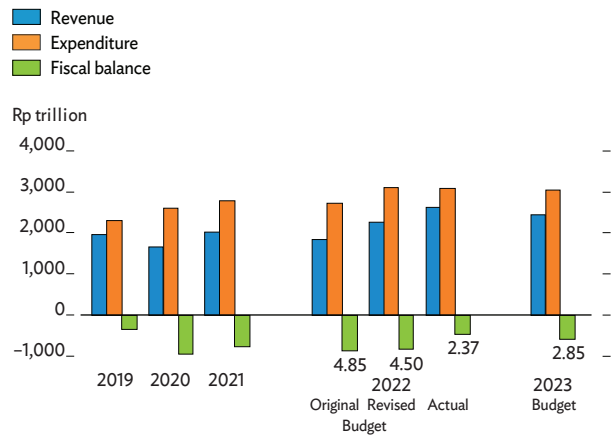
Large debt outflows eased starting November ...



Sources: Institute of International Finance; Haver Analytics.

Figure 2.24.12 Fiscal Indicators

Windfall revenues from commodity exports led to a smaller-than-expected fiscal deficit.

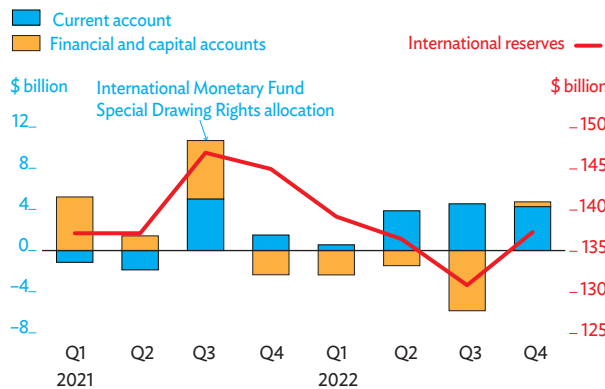


Note: Numbers in below the green bars are fiscal balances as percentage of gross domestic product.

Source: Ministry of Finance.

Figure 2.24.10 Balance of Payments

... but not soon enough and reserves fell for much of 2022 ...

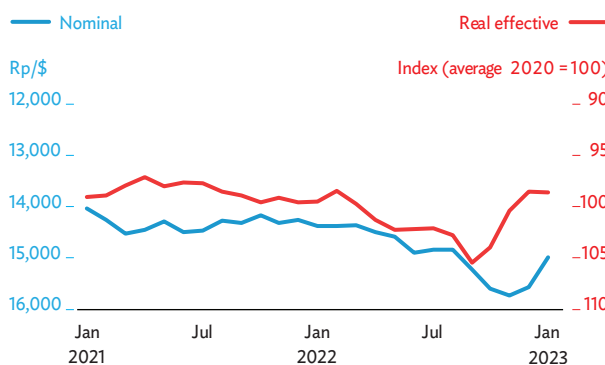


Notes: Net errors and omissions are included in the financial and capital accounts.

Source: Bank Indonesia.

Figure 2.24.11 Exchange Rate

... as did the rupiah, in both nominal and real terms.



Sources: Haver Analytics; Bank for International Settlements.

Monetary policy tightening sped up in late 2022 but ended in early 2023.

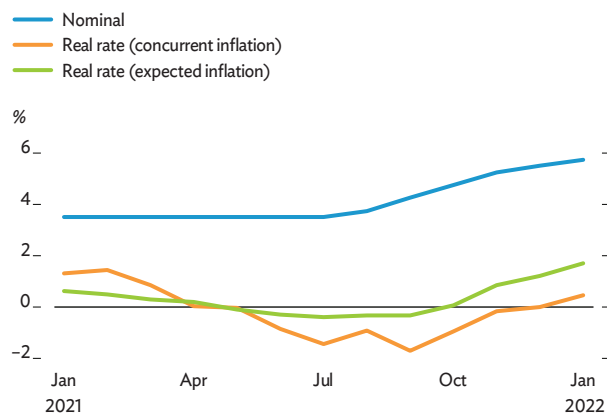
The central bank, after initially raising the reserve requirement to 9.50% and the policy rate to 3.75% in August, brought the policy rate to 5.75% by December and has kept it at that level. The real policy rate is now significantly positive, but the central bank has tried to keep the longer-term rates about the same (Figure 2.24.13). Because inflation is easing, the central bank kept the policy rate unchanged in February and will likely not raise it further. As agreed with the Ministry of Finance, the central bank’s direct purchases of government bonds (“burden sharing”) ended in December (Figure 2.24.14). These purchases totaled Rp831 trillion in 2020–2021 and Rp144 trillion in 2022.

Lending volumes and quality continued to improve.

Lending to businesses grew by 11.6%; to households, by 9.1% (Figure 2.24.15). During previous export booms, lending increased by about 20%. The nonperforming loan ratio was 2.4% and the capital adequacy ratio 25%, both comfortably meeting regulatory requirements. Restructured loans peaked at Rp800 trillion in Q2 2020 and were Rp469 trillion in Q4 2022. Given improving conditions, the financial regulator ended banks’ breathing room, which had allowed them not to classify as nonperforming the loans restructured during the pandemic. The remaining exceptions through March 2024 are loans to textile and footwear manufacturers, hotels and restaurants, and micro, small, and medium-sized enterprises.

Figure 2.24.13 Bank Indonesia Policy Rate

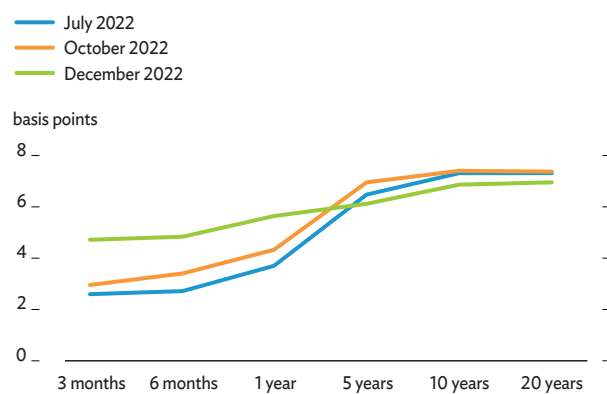
The central bank in August–December restored a positive real policy rate ...



Sources: Bank Indonesia; Haver Analytics.

Figure 2.24.14 Bond Yields by Maturity Dates

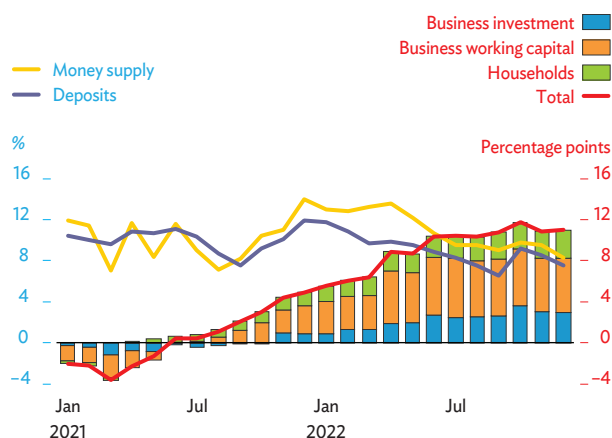
... while “twisting” the yield curve.



Source: Haver Analytics.

Figure 2.24.15 Monetary and Financial Indicators

Deposit growth slowed on rising spending; lending growth was steady.



Source: Haver Analytics.

Structural reforms continued in investment and finance.

In 2022, the Constitutional Court, citing procedural shortcomings, halted the implementation of the Omnibus Job Creation Law, which aims to encourage trade and investment and improve business operations. In January 2023, the president issued a revised version of the law and submitted it to the legislature for an expedited vote, citing urgency. Also in January, the legislature approved the Omnibus Financial Law. The law beefs up consumer rights, recognizes crypto trading and places it under regulatory supervision, establishes a framework for carbon trading and for a “bullion bank,” and gives the deposit insurance company’s head a vote in the Financial Stability Committee. It charges the central bank with promoting sustainable growth, in addition to its mandate of price stability, and allows future direct purchases of government bonds by the central bank should the President declare an economic emergency.

Trade restrictions were stepped up to promote “downstream industrialization” and regulate domestic supplies of basic goods.

The government banned exports of raw nickel in 2020, spurring domestic processing of nickel into ferronickel, pig iron, and matte. The government aims to use processed nickel to promote the production of batteries for electric vehicles. Despite a ruling against the nickel export ban at the World Trade Organization, the government will ban exports of bauxite and copper starting in June 2023 and is considering a similar ban for tin. It now also requires palm oil exporters to allocate 20% of their export volume to the domestic market at a set price and diesel producers to raise the palm oil content of their products. It is piloting the Commodity Balance mechanism, an integrated national database envisaged to eventually govern import permits and export licenses for thousands of goods.

Social indicators continued to improve, but most have not fully recovered.

The poverty rate fell to 9.6% of the population in September 2022 from 9.7% in September 2021. The unemployment rate fell to 5.9% from 6.5% in the same period. The poverty and unemployment rates in 2019 were 9.2% and 5.2%, respectively. The stunting rate for children under 5 fell to 21.6% in 2022, the fifth successive annual decline.

Economic Prospects

Growth in 2023 is forecast at 4.8% and is expected to settle at about 5.0% in 2024, below the pre-pandemic trend of 5.3% (Table 2.24.1). This projection assumes persistent economic scarring from the pandemic and no additional major structural reforms (Figure 2.24.16). The budget deficit is expected to remain below the statutory ceiling of 3% of GDP. Inflation is forecast to ease further to 3% by 2024, comfortably within the central bank’s target of 2%–4%. Export and import growth will be about 6%, with tourism recovering to its pre-pandemic level. The current account is projected to be in surplus during 2023 and 2024. Over time, measures like the European Union’s anti-deforestation rules and carbon border adjustment mechanism could crimp Indonesia’s export prospects.

Table 2.24.1 Selected Economic Indicators, %

Growth is projected to settle slightly below its pre-pandemic trend.

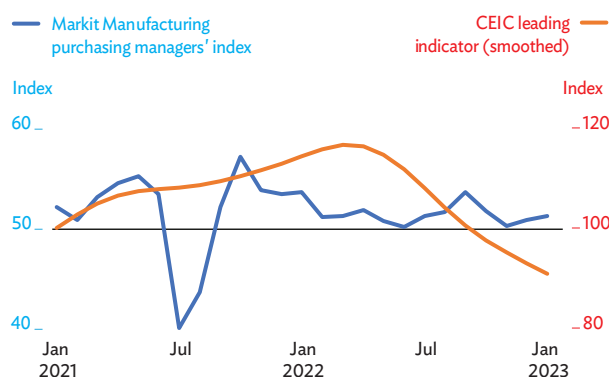
	2021	2022	2023	2024
GDP growth	3.7	5.3	4.8	5.0
Inflation	1.6	4.2	4.2	3.0

GDP = gross domestic product.

Sources: Statistics Indonesia; Asian Development Bank estimates.

Figure 2.24.16 Leading Indicators

Leading indicators point to slower growth in 2023.



Note: Purchasing managers’ index values above 50 indicate expansion, while observations above 100 for the CEIC leading indicator can be interpreted as periods above the long-term trend.

Source: CEIC Data Company; Haver Analytics.

Consumption is projected to pick up, but not that much. Consumption should be healthy on mobility restrictions disappearing, inflation moderating, monetary tightening ceasing, and fiscal policy somewhat easing. Pre-election campaign spending in Q4 in the run-up to the February–June general elections will also stimulate consumption. But the “revenge spending” that faded in 2022 is not likely to happen in 2023 because of a smaller trickle-down from export earnings and increased uncertainty. Private consumption should therefore grow by about 5% in 2023.

“Wait and see” by businesses will continue to restrain investment. Investment in machinery and buildings is projected to grow by about 5% in 2023, and changes in stocks to contribute about zero to growth. This projection is based on the fading of the export boom and investors’ behavior during previous pre-election years. But the full implementation of the Omnibus Job Creation Law should provide a floor to investment.

Monetary and fiscal policies in 2023 are programmed to be slightly supportive of growth. The central bank is unlikely to tighten more as inflation is abating. The programmed fiscal deficit of 2.85% of GDP, larger than in 2022, would impart a small positive fiscal impulse. But because the government’s projections tend to be cautious, revenue could turn out significantly larger than projected in the budget, and the deficit smaller. Government consumption is forecast to grow by 4.5%. The government may frontload spending in Q1 to help spur private demand. The government will also reform screening under the cash transfer mechanism to reduce the likelihood of needy households not getting aid.

Slower global growth is projected to sharply cut export growth, holding back incomes, jobs, and confidence. Export growth is projected to drop to 8% in national income account terms in 2023. There is some upside risk to exports and growth if recovery in the People’s Republic of China turns out stronger. Still, the downside external threats are substantial, including the Russian invasion of Ukraine worsening, inflation and monetary tightening in advanced economies persisting, financial market volatility increasing, and asset prices sliding. And the baseline scenario assumes no shocks like an outbreak of war or a deadly new COVID-19 variant.

Inflation is projected to moderate to 4.2% on average in 2023. Global commodity prices are projected to ease further, reducing supply-side pressures on domestic prices. The policy rate increases in 2022 will have a lagged effect in 2023.

Lower commodity prices and lower export volume growth will cut the current account surplus to about 0.2% of GDP by 2024. Slower global growth and restrictions on exports of goods like coconut oil are near-term reasons to expect export growth to slow. Earnings from tourism will increase as arrivals return to pre-pandemic levels but only partly offset the sharp fall in exports of goods. Imports in US dollar terms will increase by less than 10% as weaker import prices will offset continuing growth in demand.

The financial account is projected to be modestly positive, enabling a small increase in reserves. The healthy financial inflows in 2023 so far point to a recovery of foreign portfolio investors' appetite for Indonesian debt instruments. Net inflows of portfolio equity finance and foreign direct investment should be about the same as in 2022, at \$4 billion and \$15 billion, respectively, producing a reserve buildup of about \$5 billion.

For 2023, the risks are on the downside; for 2024, they are about evenly balanced. For 2023, the risks arise mainly from potential external shocks. For 2024, the benefits of normalization and the fruition of reforms enacted in 2021 and 2022 could be offset by the setbacks to workers' earnings potential and businesses' investment capacity.

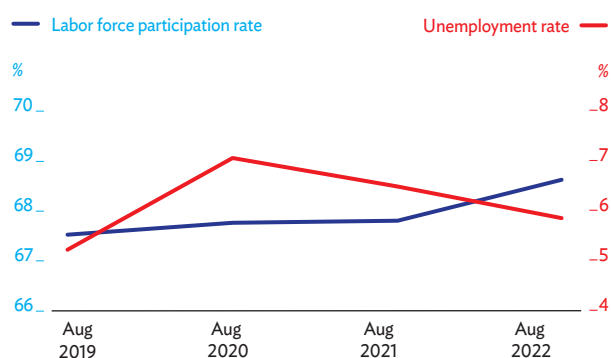
Policy Challenge—Repairing the Impact of the Recession

Most key labor indicators have not returned to their pre-pandemic levels. For the near term, continuing weakness in jobs and incomes (and their pass-through to confidence) could impede a full demand recovery. The working-age population's scarring could reduce potential growth in the medium to long term. This long-term concern is in addition to the learning losses experienced by children, which could affect their lifetime incomes.

Labor force participation has recovered, but unemployment is stubbornly high. In contrast to some advanced economies, Indonesia's labor force participation rate in 2022, at about 69%, was higher than its pre-pandemic level. But job creation has not kept pace. Hence, while the number of unemployed in August 2022 was 8.4 million, an improvement compared to 9.8 million in August 2020, it was much higher compared to around 7 million during 2016–2019. The unemployment rate in August was 5.9%, compared to 5.0% during 2016–2019 (Figure 2.24.17).

Figure 2.24.17 Labor Market Indicators

The labor market has not fully recovered.



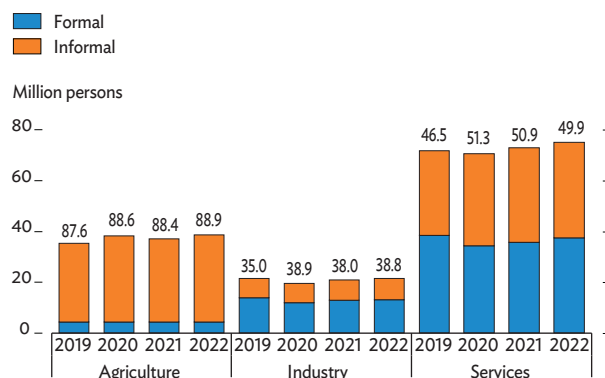
Source: Statistics Indonesia. 2019 to 2022. National Labor Force Survey Reports.

Informality has increased. Informality averaged 56% pre-pandemic and is now about 60%. This is concerning because informal workers tend to have low productivity, income, and social protection (Figure 2.24.18).

Gender gaps narrowed during the pandemic, but perhaps not in a good way. Pre-pandemic, females had a lower unemployment rate than males but also a lower employment rate, labor force participation rate, real wages, and higher informality. During the pandemic, females' relative positions improved. For instance, the female unemployment rate rose, but not as fast as for males. A study concludes that Indonesian women became more likely to be employed not because labor demand shifted toward females but because households suffering from income losses were compelled to send their female members to take up any jobs.

Figure 2.24.18 Formal and Informal Employment by Sector

Informality has increased in all of the main sectors.



Note: Numbers above the bars refer to the share of informal sector to total employment in the sector.

Source: Statistics Indonesia. 2019 to 2022. *National Labor Force Survey* reports.

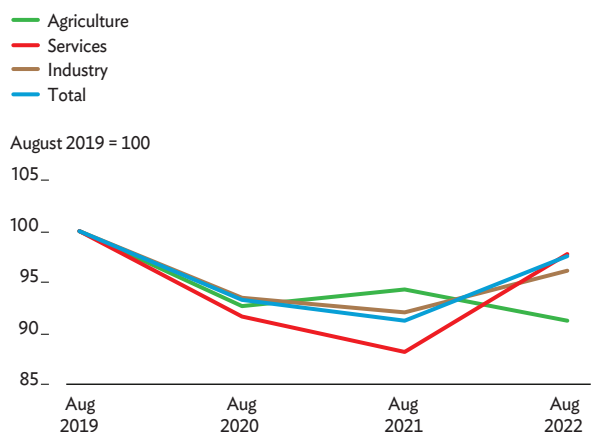
Real wages have not recovered. The average real wage in 2022 was about 2.5% below its 2019 level, but this comparison conceals an important recent change. In Q3 2022, the real wage rose by 7.2% compared to Q3 2021, perhaps indicating that workers' bargaining power has improved somewhat as the economy recovered (Figure 2.24.19).

Young workers have suffered significantly. The proportion of youth not in employment, education, or training rose from 21.8% in 2019 to 24.3% in 2020 and was 23.2% in 2022. Studies have found that the negative consequences for youths entering working age during downturns can be large and long-lasting.

The Pre-Employment Card Program, launched in 2020, is one measure already in place to mitigate labor market scarring. To date, it has helped 16.4 million displaced workers reintegrate into

Figure 2.24.19 Monthly Real Wages

Real wages are still below pre-pandemic levels.



Source: Asian Development Bank calculations using Statistics Indonesia. 2019 to 2022. *National Labor Force Survey* reports.

the workforce. The program imparts technical and vocational skills through digital learning, training to start businesses, and scholarships.

Several additional measures could help. These include promoting local labor market exchanges, investing in job information, and piloting a fund that provides workers with training credits.

Sustaining the recovery is critical in returning key labor indicators to their pre-pandemic levels.

Macroeconomic policy should stand ready to prop up demand should the global slowdown turn out worse than currently projected. For the long term, ongoing structural reforms can increase potential growth and soak up labor, raise skills and productivity, and increase incomes.

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Gradual economic recovery continued in 2022, benefiting from border reopening and improved mobility. Recovery in services will likely continue to drive growth this year and next. Currency depreciation in 2022 will keep inflation high in 2023, particularly for food and fuel, dampening household purchasing power. Rising wages in neighboring countries are incentivizing workers to migrate out of the Lao People's Democratic Republic (Lao PDR), which poses challenges for economic recovery.

Economic Performance

The economy grew by 2.5% in 2022 with support from border reopening.

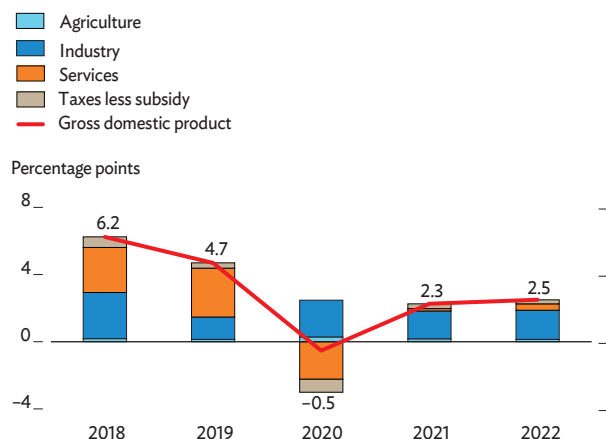
As mobility improved across Southeast Asia, regional tourism stimulated spending on domestic services in hospitality, trade, and transport. International tourist arrivals climbed from zero in 2021 to 1.3 million in 2022, and domestic tourist numbers increased by 76% to 1.4 million. However, high inflation, fuel shortages in June, and rising input costs caused by insufficient foreign exchange for fuel imports dampened domestic consumption and activity in construction, manufacturing, and agriculture (Figure 2.25.1).

Industry was supported by rising electricity generation for export and construction on important investment projects.

Sufficient rainfall allowed many hydropower plants to optimize their production capacity. Electricity generation in 2022 increased by 13% to 50,975 million kilowatts, most of which was exported to neighboring countries (Figure 2.25.2). Major ongoing construction projects include the rehabilitation of National Road No. 13, Bokeo International Airport, and a fifth bridge across the Mekong River. Higher inputs cost, including for fuel and labor, delayed progress on some projects.

Figure 2.25.1 Supply-Side Contributions to Growth

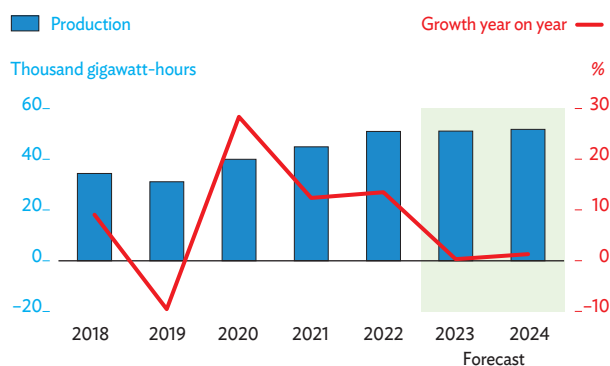
Services gradually recovered from the pandemic.



Sources: Lao Statistics Bureau; Asian Development Bank estimates.

Figure 2.25.2 Electricity Generation

Electricity generation has increased, most of it for export.



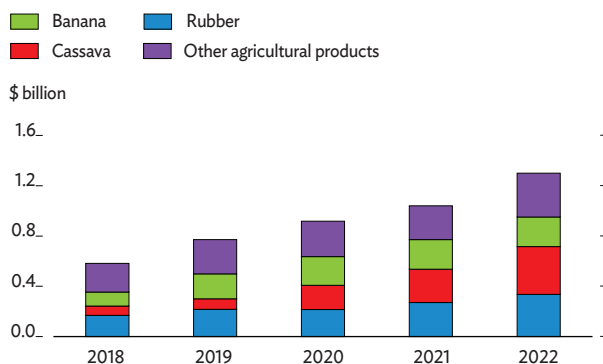
Source: Ministry of Energy and Mines.

Agriculture was hampered by fuel shortages and the rising cost of inputs.

Favorable weather and demand for agricultural exports partly offset rising prices for fuel, fertilizer, and animal feed that held down production for and sales in local markets. Agricultural exports rose from \$871 million in 2021 to \$1.3 billion in 2022. Cassava output increased by 31% to 4.8 million tons, sugarcane by 32%, and coffee by 6.0%, while rice production increased moderately by 3.3% to 3.8 million tons (Figure 2.25.3). However, high inflation, particularly for food, rendered one in seven households food insecure, and over half meeting essential needs by sacrificing health or education spending, for example, or drawing down savings.

Figure 2.25.3 Agriculture Exports by Major Component

Favorable weather benefited agriculture exports.

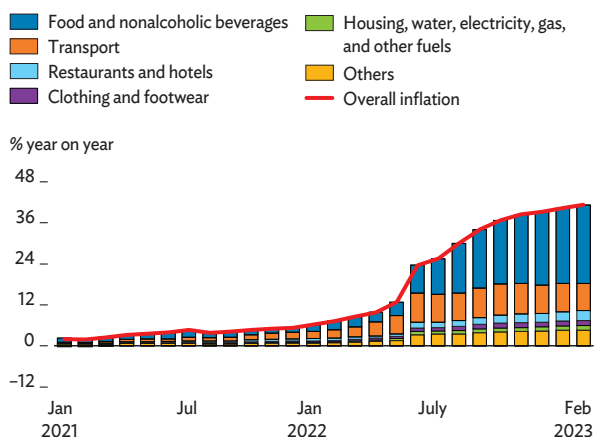


Source: Ministry of Industry and Commerce.

High inflation dragged on recovery. Average inflation jumped from 3.8% in 2021 to 23.0% in 2022 (Figure 2.25.4). Rising oil prices and a weak Lao kip pushed the inflation rate to 39.6% in December 2022, a record high since the Asian Financial Crisis of 1997–1998. Average retail petroleum prices increased by 82.2% in 2022, while the kip depreciated against the US dollar by 53.6% on the official market (Figure 2.25.5). The shortage of foreign currency to pay for fuel imports in June 2022 caused the kip to depreciate, with price differentials on imports passed through to farmers and consumers. Rising input cost, particularly for fertilizer, fuel, and animal feed, drove up prices for staples such as rice and meat, which together are weighted at 46% of the consumer price index. To tackle inflation and stabilize the exchange rate, the Bank of the Lao PDR, the central bank, raised its policy rate from 3.1% to 6.5% and, to boost liquidity in commercial banks, suspended

Figure 2.25.4 Monthly Inflation

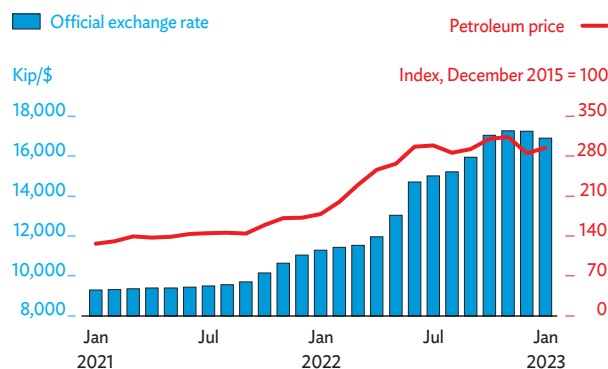
Inflation accelerated in 2022, particularly for food and fuel.



Source: Lao Statistics Bureau.

Figure 2.25.5 Exchange Rate and Petroleum Price

Rising oil prices and a weak Lao kip contributed to rising inflation.



Sources: Lao Statistics Bureau; Bank of the Lao PDR.

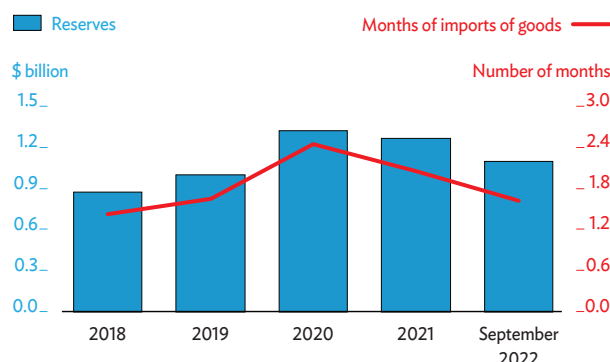
the business licenses of exchange bureaus operating in the parallel market. It also provided foreign exchange through commercial banks for imports of critical goods.

The current account deficit narrowed to the equivalent of 4.7% of GDP as growth in exports outpaced imports.

Trade recorded a surplus of \$405 million in 2022, most of it from exports of electricity and agricultural commodities. Electricity exports rose by 9% to \$2.3 billion, while agricultural exports reached \$1.3 billion. Import growth was subdued by high global oil prices, the weaker kip, and meager foreign exchange reserves. Gross official reserves were \$1.1 billion at the end of September 2022, or cover for only 1.6 months of goods imports, down from 2.0 months just 3 months earlier in June (Figure 2.25.6).

Figure 2.25.6 Reserves and Imports

Foreign currency reserves cover for imports has dropped.

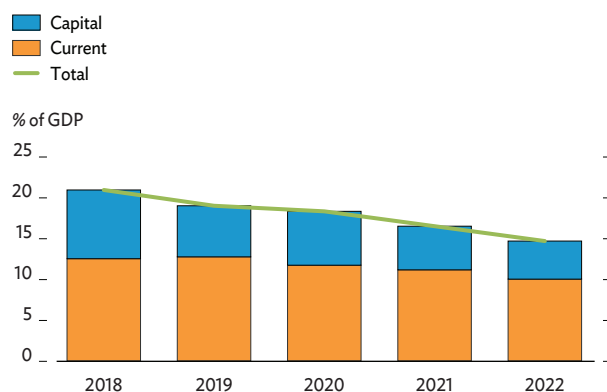


Sources: Bank of the Lao PDR; Asian Development Bank estimates.

The fiscal deficit widened from the equivalent of 1.3% of GDP in 2021 to 1.6% in 2022. The government's balance sheet was hit by exchange rate effects that drove up interest payments and tax relief granted to contain retail fuel prices. Expenditure reached KN33.2 trillion, or 95.8% of planned expenditure as the government continued fiscal consolidation by holding back spending on capital investment (Figure 2.25.7). Expenditure arrears to the private sector continued to be a problem, signaling an urgent need for progress to resolve public finance issues pertaining to procurement and the management of contracts and cash flow. Tax revenue collection reached KN24.4 trillion, or 95.5% of the target, despite massive tax exemptions for fuel imports and a reduction to the value-added tax to mitigate the rising cost of living. These two measures cost the government budget an amount equal to 0.9% of GDP.

Figure 2.25.7 Government Expenditure

Current expenditure rose relative to the total as the government reined in capital spending.



GDP = gross domestic product.

Sources: Ministry of Finance; Asian Development Bank estimates.

Public and publicly guaranteed debt surpassed 100% of GDP in 2022, driven by kip depreciation. Sharp kip depreciation in 2022 saw the ratio of public debt to GDP rise (Figure 2.25.8). However, the stock of external and domestic public debt remained stable—external at \$12.4 billion, equal to 94% of GDP, and domestic at KN29.4 trillion, or 16.0%—much of it incurred at low interest rates. Nonetheless, public debt will continue to be elevated for a protracted period, with market confidence vulnerable to exchange rate fluctuation. External public debt servicing requirements will average \$1.2 billion annually over the next 5 years, half of which is owed to the People's Republic of China (PRC). However, from 2020 to 2022, reported debt service payments to the PRC have been less than the amounts scheduled.

Figure 2.25.8 Public Debt

Kip devaluation in 2022 saw the ratio of public debt to GDP rise.



GDP = gross domestic product.

Sources: Ministry of Finance; Asian Development Bank estimates.

Economic Prospects

Real GDP growth is forecast to expand moderately by 4.0% this year and next (Table 2.25.1). The

reopening of the PRC border and increased operation of the Lao–PRC railway will support recovery. New and ongoing investment from private sector infrastructure projects, including industrial parks and renewable energy, will support industrial performance. However, inflation will remain high along with interest rates, depressing consumption and domestic investment. Limited fiscal space will continue to drag on recovery.

Tourism and logistics will boost recovery in services.

With upgrades to major connectivity infrastructure complete and borders now reopened, international

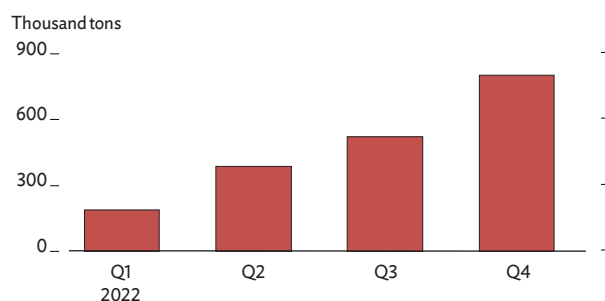
Table 2.25.1 Selected Economic Indicators, %*Growth is forecast to pick up while inflation remains elevated.*

	2021	2022	2023	2024
GDP growth	2.3	2.5	4.0	4.0
Inflation	3.8	23.0	16.0	5.0

GDP = gross domestic product.

Sources: Lao Statistics Bureau; Asian Development Bank estimates.

tourist arrivals are projected to double from 1.3 million in 2022 to 2.6 million in 2023. Transit freight is expected to continue its steady expansion, with 1.3 million passengers and 1.9 million tons of cargo transported through the Lao PDR–PRC rail link in 2022 (Figure 2.25.9). Tourism will enjoy additional support with the Lao PDR as the 2024 chair of the Association of Southeast Asian Nations (ASEAN).

Figure 2.25.9 Cargo Transported through the Lao PDR–PRC Rail*Freight traffic has grown steadily.*

Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China, Q = quarter.

Sources: Laos–China Railway Company; Asian Development Bank estimates.

Investment in renewable energy will drive moderate growth in industry.

Four new hydropower plants with combined capacity of 400 megawatts will be commissioned in 2023. Construction of the 600-megawatt Monsoon Wind Power Project is expected to commence in 2023 and be completed by 2025. With a financing package of \$692.55 million, the project will install 133 wind turbines in Sekong and Attapeu provinces in the southern region of the country, making it the largest wind farm in Southeast Asia and the first-ever cross border wind power project in Asia. New and ongoing infrastructure development projects include dry ports and industrial park development along the Lao–PRC rail link.

Agriculture expansion is to be gradual this year and next.

The government has introduced low interest loans for farmers and processing factories for agricultural produce to promote commercialization for export. Agricultural commodities including cassava, banana, sweet corn, and livestock have been granted higher PRC import quotas under a bilateral trade agreement. The challenge now is to raise production to realize trade potential.

Inflation pressure will remain high in 2023.

Average consumer inflation is projected to decline from 23.0% in 2022 to 16.0% in 2023 and further to 5.0% in 2024. Prices are expected to climb in 2023 as businesses pass on costs from imported goods and wage increases. Adjustments are also planned for electricity tariffs. Measures to support foreign exchange stabilization and monetary tightening will tamp down consumer demand and domestic-focused enterprises. As such, the balance sheets of households and businesses are expected to remain weak.

The current account deficit is expected to stabilize in 2023.

The weaker kip will subdue imports of consumer products and slow spending on imported vehicles and household electronic goods. Import demand will be offset by continued strong export performance in electricity, minerals, and agricultural products. In 2024, the current account deficit is expected to widen on imports of capital goods for infrastructure projects.

Fiscal consolidation will continue.

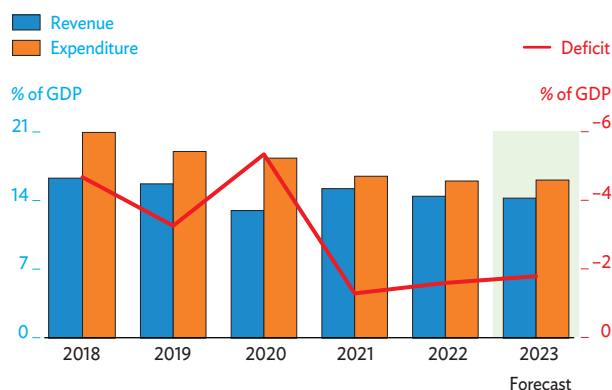
The government is targeting a fiscal deficit equal to 1.8% of GDP in 2023, to be achieved through restraint on capital spending (Figure 2.25.10). It also plans this year to revise the law on investment promotion to improve policy coordination concerning tax exemptions, and it is considering restoring the value-added tax, from 7% since 2021 back to 10%. In 2024, the government plans to upgrade the regulatory environment for public–private partnership by tabling a new law in the National Assembly.

Low foreign exchange reserves and high public debt are key risks to the outlook.

The public debt stock remains high, as are official debt service payments coming due, with little official information forthcoming on debt relief from bilateral creditors. The speed of progress on domestic reform, including reform to improve the business environment and strengthen the financial sector, remain critical issues. The primary external risks

Figure 2.25.10 Fiscal Indicators

The government seeks to contain the fiscal deficit this year.



GDP = gross domestic product.

Sources: Ministry of Finance; Asian Development Bank estimates.

to the outlook are disappointing recovery in the advanced economies and the PRC, and commodity and food prices climbing higher than expected.

Policy Challenge—Managing the Emigration of Workers

Incentives to migrate for higher wages erode potential benefits to the Lao PDR from its young population. With almost two-thirds of its population currently of working age, the Lao PDR should be reaping the benefits of a demographic dividend—an acceleration of economic growth enabled by favorable demographics. A young workforce means that more people have potential to be productive and contribute to growth. However, comparatively low wages at home mean that many workers opt to work in neighboring countries in the Greater Mekong Subregion (GMS), where they can earn more. This creates challenges, including a shortage of skilled labor for local industry and loss of productive human capital—a brain drain—that, if sustained, could dampen the country's prospects for economic growth and industrial diversification.

Recent macroeconomic instability has eroded purchasing power. High inflation and kip devaluation in 2022 have curtailed purchasing power and imposed real income losses on workers in the Lao PDR, coincidentally lowering wages at home when compared

with neighboring countries. In addition, scarring effects on the labor market from the pandemic have raised rates of unemployment and labor underutilization. As a result, workers are incentivized to explore options further afield in the GMS. With proximity and language similarity, Thailand is the most popular destination.

To compensate for rising living costs, policy makers increased the statutory minimum wage. In response to concerns about the increasing cost of living, the Lao PDR authorities raised the monthly minimum wage to \$77. To further bolster purchasing power, they temporarily reduced the value-added tax and suspended the excise tax on fuel. Finally, the availability of foreign exchange for critical imports was increased to stabilize the exchange rate.

In parallel, Thailand increased the minimum wage across its provinces. The Thai authorities adjusted the minimum wage upward in 2022, putting the lowest monthly income at \$235. While living costs are higher in Thailand, these costs are offset by salaries three times higher than are offered within the Lao PDR. Another consideration for workers considering the move is the low cost of migration. The authorities of the two countries agreed that migrant workers from the Lao PDR must pay \$226 for a 2-year visa and work permit, but the fee includes a medical examination and health insurance.

The Lao PDR must improve competitiveness, community, and connectivity to converge incomes and living standards. High rates of out-migration hamper the Lao PDR's ability to benefit from its demographic dividend. It may also deepen inequality between GMS countries. Addressing the challenge will require innovative solutions, including a comprehensive program that addresses macroeconomic vulnerabilities and challenges in the labor market. It is important for the government to support local industrial development through regulatory reform that improves the business environment. Greater engagement among the government, employers, schools, and other training providers is needed to ensure that the education and skilling system is geared toward making local industry more competitive. Also important is to continue to promote convergence in living standards in the GMS, particularly through fostering knowledge spillover to promote local industry development throughout the subregion.

MALAYSIA

Growth exceeded expectations in 2022, buoyed by strong domestic consumption and a rebound in services as borders reopened and economic activity normalized. Inflation remained broadly muted, dampened by government subsidies and price controls. A less accommodative monetary stance was adopted in response to higher global interest rates. Growth is expected to moderate, and inflation to decelerate, in 2023 and 2024, mainly tracking changes in the global environment. Malaysia should promote gender-inclusive policies to boost women’s participation in the labor market.

Economic Performance

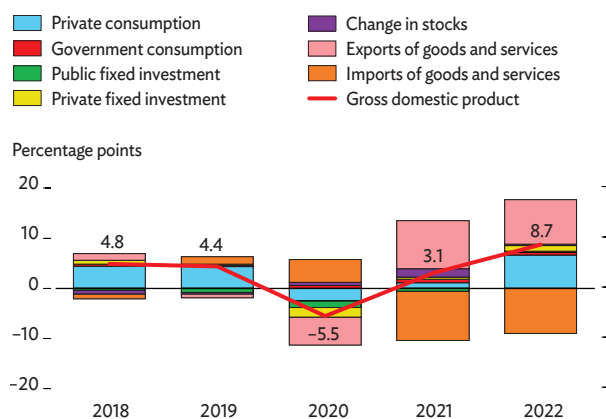
Growth outperformed expectations. Malaysia maintained a performance that was better than expected, growing by 7.0% year on year in the fourth quarter (Q4) to round off 2022 with growth at 8.7%, significantly higher than 3.1% in 2021 (Figure 2.26.1). Robust growth was driven mainly by strong domestic consumption as markets normalized and labor market conditions improved.

All demand components contributed to strong growth, with private consumption at the forefront.

Private consumption accelerated from 1.9% growth in 2021 to double-digit growth at 11.3% in 2022, sustained by higher employment and incomes. The unemployment rate improved from 4.3% at the end of 2021 to 3.6% a year later. Other spurs to spending were several policy measures, notably an increase in the monthly minimum wage from RM1,200 to RM1,500, and Bantuan Keluarga Malaysia, a financial package for low-income households (Figure 2.26.2). Growth in public consumption moderated from 5.3% the previous year to 3.9%. Public consumption was supported by COVID-19 expenditure such as vaccine procurement at the start of the year and, later, increased spending on supplies and services.

Figure 2.26.1 Demand-Side Contributions to Growth

Domestic consumption boosted growth, supported by the reopening of borders.



Sources: Bank Negara Malaysia. 2023. *Monthly Highlights and Statistics*; Haver Analytics.

Public investment recovered after contracting by 11.3% in 2021 to grow by 5.3% in 2022. The main drivers of growth were increased capital spending by the general government and public corporations in oil, gas, and telecommunications. Private investment expanded by 7.2% in 2022 from 2.6% growth last year. Services and manufacturing alike saw increases in capital spending. Firms expanded capacity in response to continued improvement in demand, which fueled

Figure 2.26.2 Labor Market Indicators

Labor market conditions improved with the revival of economic operations and social activities.



Q = quarter.

Source: Haver Analytics.

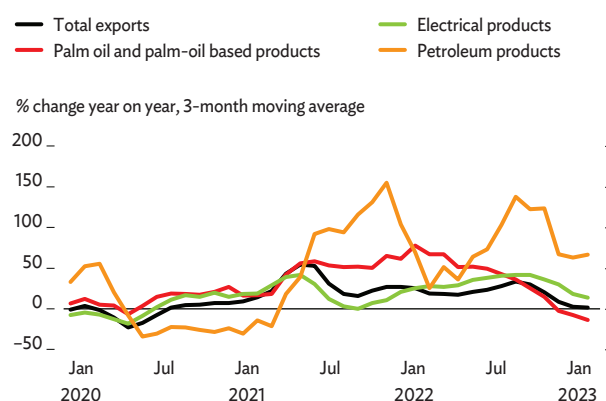
robust investment in machinery and equipment. A shift toward automation and digitalization saw manufacturers invest in information and communication technology.

Trade performance started to weaken in 2022, reflecting softer external demand. Growth in exports of goods and services slowed from 23.9% in Q3 2022 to 9.6% in Q4 as global demand weakened. Despite slowing export growth in recent months, growth in the whole year was, at 12.8%, not much lower than 15.4% in 2021. Exports of electrical and electronic products and of petroleum products had increased before Q4 2022 in line with higher commodity prices, especially for petroleum, which pushed up export value. Growth in all three key export commodities then slowed by the end of 2022 (Figure 2.26.3). Meanwhile, import growth slowed from the previous year's 17.7% to 14.2%, the increase fueled by demand for imported goods buoyed by accelerated growth in private consumption. Capital imports soared on investment activity and firms building inventory. Imports outpaced exports, narrowing the trade surplus to the equivalent of 5.4% of GDP.

A resurgence of other economic activity sparked robust growth in services. Services performed strongly as growth surged from a mere 1.9% in 2021 to 10.9% (Figure 2.26.4). With the reopening of the economy and the normalization of activity, consumers returned to drive robust growth in retail and leisure businesses. Business improved as well in air passenger traffic, tourist arrivals, and property transactions.

Figure 2.26.3 Exports of Key Commodities

Growth of exports slowed in line with weakening global demand.



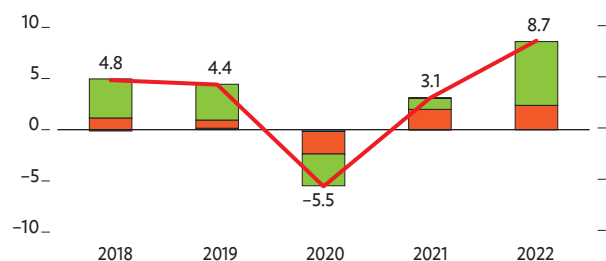
Source: Haver Analytics.

Figure 2.26.4 Supply-Side Contributions to Growth

Services expanded substantially as consumer and leisure activities gained momentum.



Percentage points



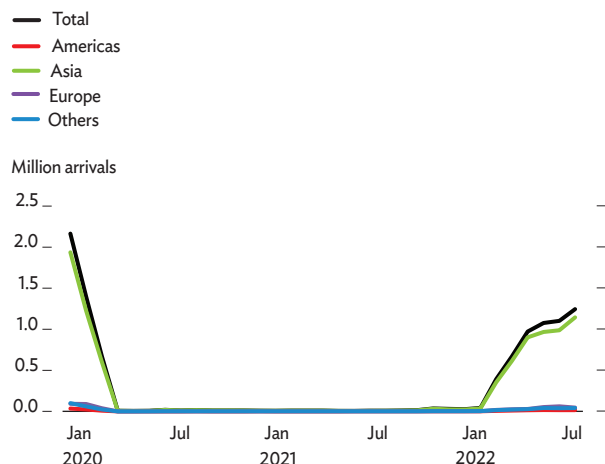
Sources: Bank Negara Malaysia. 2023. *Monthly Highlights and Statistics*; Haver Analytics.

Tourist arrivals soared from fewer than 80,000 in January–September 2021 to 5.6 million a year later (Figure 2.26.5). Areas leading growth in services were accommodation at 125.1% growth, motor vehicle sales at 40.0%, transport and storage 30.8%, and real estate 28.5%.

Manufacturing remained resilient but showed signs of slowing down. From 13.2% year on year in Q3 2022, growth in manufacturing decelerated to 3.9% in Q4 with slower semiconductor sales globally. In the whole year, manufacturing growth slowed from 9.5% in 2021 to 8.1%, with little difference between

Figure 2.26.5 Tourist Arrivals

Tourist arrivals started to pick up as borders reopened in April 2022.

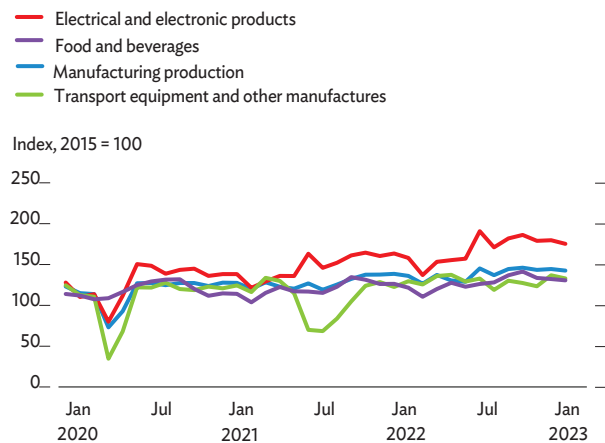


Source: Haver Analytics.

export-oriented and domestic industry. Despite the slowdown in Q4 2022, resilient demand for electrical and electronic goods increased the segment’s industrial production index from 147.7 in 2021 to 168.8 in 2022. Meanwhile, higher consumer spending accelerated growth in consumer goods, as reflected by a rise in the industrial production index of transport equipment and other manufactures from 110.1 in 2021 to 130.0 in 2022 (Figure 2.26.6).

Figure 2.26.6 Manufacturing Production Index

Manufacturing continued to expand but at a more moderate pace.



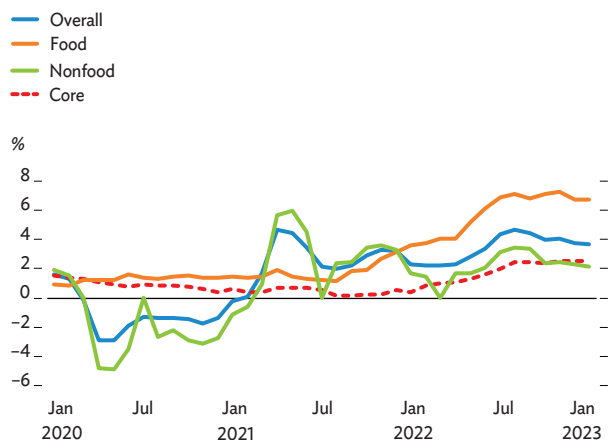
Source: Haver Analytics.

Robust demand, supply disruption, and cost-push factors sustained high inflation.

Inflation remained elevated in Q3 2022, reaching 4.7% year on year in August 2022. This reflected a base effect from the expiration of electricity bill discounts under the People’s Protection and Economic Recovery Package implemented from July to September 2021. Inflation eased to 3.8% in December, but 2022 still posted a higher average rate of 3.4%, up from 2.5% in 2021. The rise in inflation was driven mainly by price increases for food at 5.8%, transportation 4.7%, and restaurants and hotels 5.0% (Figure 2.26.7). Factors that drove inflation in 2022 were continued demand improvement despite a high-cost environment from supply disruption and commodity price increases caused by geopolitical tensions, lockdowns in the People’s Republic of China (PRC), and adverse weather in key food-exporting countries, as well as a weakening local currency against the US dollar. The government contained inflation and its impact on households through price controls and subsidies, with the subsidy bill for the year reaching approximately RM80 billion, the highest ever recorded.

Figure 2.26.7 Monthly Inflation

Inflationary pressures drove up food prices in particular.



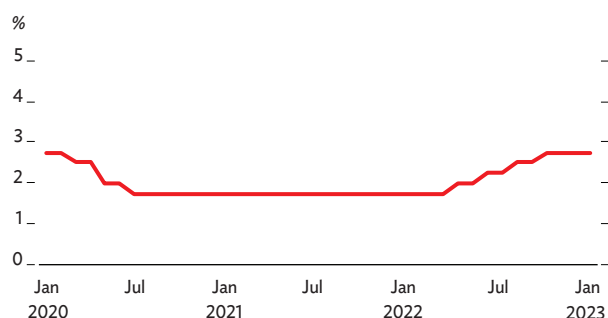
Source: Haver Analytics.

The steep increase in inflation prompted less accommodative monetary policy.

Bank Negara Malaysia, the central bank, raised its overnight policy rate by 100 basis points, from 1.75% at the end of 2021 to 2.75% a year later (Figure 2.26.8). The central bank believed that, despite the increase in the policy rate, its monetary stance remained supportive of recovery and growth.

Figure 2.26.8 Policy Rate

Elevated cost pressures prompted a less accommodative monetary stance.



Source: Haver Analytics.

Fiscal and external positions remained stable with moderate debt and depreciation of the local currency. With a higher surplus in the goods account and a reduced deficit in services with increased travel and transport receipts from a pick up of tourist arrivals, the current account surplus expanded further in Q4 2022. However, in the whole year, the current account surplus declined from the equivalent of 3.8% of GDP in 2021 to 2.6% in 2022. Growth in government revenue rose from 3.9% in 2021 to 25.9% as, similarly, operating expenditure rose from 3.1% to 26.4%. Net development expenditure, on the other hand, posted slower growth, falling from 26.3% the previous year to 10.9%. The fiscal deficit widened slightly from RM98.7 billion in 2021 to RM99.6 billion. The weakening of the Malaysian ringgit against the US dollar and increased intragroup interbank borrowings edged external debt higher to RM1,169.4 billion, equal to 67.0% of GDP, at the end of Q3 2022. By the end of December 2022, external debt had eased to RM1,144.0 billion, or 64.0% of GDP. Higher global interest rates caused the ringgit to depreciate against the US dollar by an average of 6.2% in 2022. International reserves stood at \$114.6 billion in December 2022, enough to cover 5.2 months of imports of goods and services.

Economic Prospects

Economic performance in 2023 will depend on the external environment. Factors include spillover from the reopening of the PRC, government policy support, and developments in the electronics industry. The global economic slowdown, persistent inflation, and continuing rate hikes by the US Federal Reserve diminish prospects for the year. On the upside, impacts from such downside risks can be countered by stronger growth in the reopened PRC, recovery in tourism, and continued government support to boost domestic consumption and tame inflation. In 2023, GDP is expected to grow at a moderate pace of 4.7% before accelerating to 4.9% in 2024 (Table 2.26.1 and Figure 2.26.9).

Resilient consumer spending will support domestic consumption. Private consumption is anticipated to remain the primary driver of growth, increasing by an average of 5.6% in 2023 and 2024. Consumer sentiment has brightened on improved expectations for income and employment. However, consumers remain

Table 2.26.1 Selected Economic Indicators, %

Moderate growth is expected in 2023 and 2024, along with relatively stable inflation.

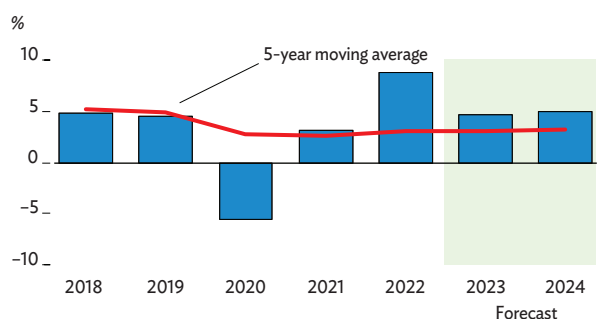
	2021	2022	2023	2024
GDP growth	3.1	8.7	4.7	4.9
Inflation	2.5	3.4	3.1	2.8

GDP = gross domestic product.

Sources: Department of Statistics Malaysia; Asian Development Bank estimates.

Figure 2.26.9 GDP Growth

The economy is projected to grow moderately in 2023 and 2024.



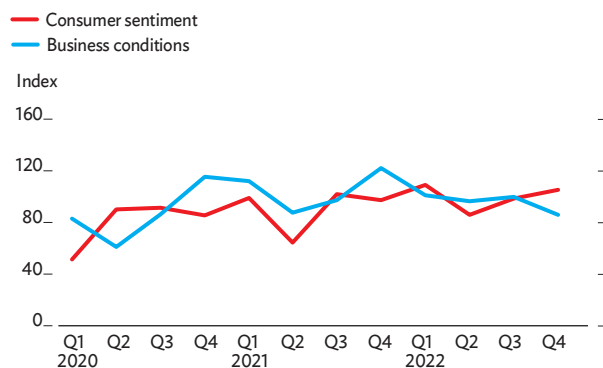
Source: Asian Development Outlook database.

cautious about the possibility of a future downturn and further price developments that would likely affect the cost of living (Figure 2.26.10).

The perception of business conditions could dim with the growth slowdown. Meanwhile, business prospects are worsening, with firms seeing reduced orders, both domestic and external. The business sentiment index remained below the 100 threshold, declining from 99.8 in Q3 2022 to 85.9 in Q4 (Figure 2.26.10).

Figure 2.26.10 Consumer and Business Sentiment

Consumer expectations continued to be optimistic, while business prospects became gloomy.



Q = quarter.
Source: Haver Analytics.

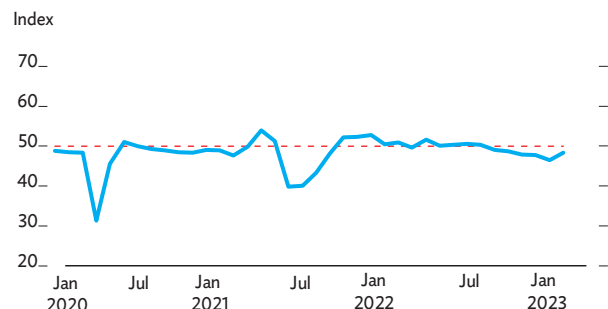
Investment could still expand, however, with sustained digitalization and government reform to improve the business environment. The outlook for investment is projected to be positive as a technology-driven surge in approved foreign direct investment is expected to continue under automation and digitalization initiatives and the rollout of 5G infrastructure. The government aims to encourage investment in high technology and restructure investment incentives in key industries such as electrical and electronic goods and aerospace. Further, the government strives to reform the public sector to inspire confidence in it and improve governance, which can enhance the investment environment.

Services will continue to drive growth, with manufacturing hampered by weak external demand and a grim global outlook for tech. On the supply side, services will take the lead as tourist

arrivals increase and economic activity returns to pre-pandemic conditions, further enlivening leisure and consumer services. Manufacturing, on the other hand, faces challenges as exports will likely to be crimped by reduced global demand and changes in the environment for semiconductors. The manufacturing purchasing managers' index declined further from 47.8 in December 2022 to 46.5 in January 2023 as demand and production slowed in line with economic weaknesses both at home and abroad (Figure 2.26.11). Semiconductor sales are challenged by a change in industry dynamics, with the US, Europe, Japan, and the Republic of Korea pursuing policies to boost local production and thereby strengthen their national supply chain security in response to supply disruption and geopolitical tensions between the US and the PRC.

Figure 2.26.11 Manufacturing Purchasing Managers' Index

The manufacturing index has been contractionary for the past 6 months.



Note: A purchasing managers' index reading <50 signals deterioration, >50 improvement.
Source: Haver Analytics.

The global slowdown may bring slightly lower inflation, but prices could surprise on the upside if commodity prices soar again. The inflation rate will likely decelerate with the weakening of domestic and global demand amid continuing efforts by the government to contain a rising cost of living and strengthen the ringgit, and by recovery in the global supply chain. Any increase in inflation would depend on changes to domestic policies on subsidies and price controls and developments in global commodity prices. Inflation is projected to be lower, at 3.1% in 2023 and 2.8% in 2024.

The government plans to continue to support growth and domestic consumption and strengthen fiscal sustainability.

It is taking an expansionary stance to support economic growth. The 2023 budget is RM386.1 billion, larger by 16.3% over last year, and includes an increase in development expenditure from RM71.6 billion to RM97.0 billion to fund programs to eradicate poverty and improve public infrastructure and rural facilities. Measures to reduce the cost of living are maintained by the government with an allocation of RM64 billion provided through subsidies, assistance, incentives, and price controls on essential goods. The national debt is forecasted to reach about RM1.2 trillion and thus exceed 60% of GDP. With the high debt burden, fiscal sustainability is at the forefront of government objectives to manage debt by tamping down on new loans and target fiscal deficit reduction from the equivalent of 5.6% of GDP last year to 5.0%.

Monetary policy could still tighten in 2023 but not as much as in 2022.

In adjusting monetary policy, the central bank aims to balance managing inflation and supporting economic growth. Any change in monetary policy has been put on pause. However, there is a possibility of an increase by 25 basis points in the year, but it depends on global commodity price movements and on domestic policy measures such as fuel subsidies and price controls.

Risks tilt to the downside. Manufacturing exports are likely to contract with the slowdown in global demand. The downward outlook in the tech cycle means higher risks for the electrical and electronics industry, and worsening geopolitical tensions could disrupt supply and further raise trade costs. On the other hand, the outlook could improve with higher tourist arrivals from the PRC and higher revenue from elevated prices for oil and other commodities.

Policy Challenge—Promoting Inclusive Gender Policies

Dealing with gender equality is a major challenge for Malaysia.

Gender disparities have narrowed in recent years, but Malaysian women could still contribute more to the economy. Disparities in the labor market and housework restrict the occupational choices of Malaysian women and lower their expected wages. Malaysia has made considerable progress in advancing women's education and health, but gender disparities in the labor market remain challenging. Women comprise 48.4% of Malaysia's working-age population, but only 55.5% of them participated in the labor market in 2021, their share in the labor force only 39%. While female labor force participation has improved somewhat from 46.8% in 2010, it remains lower than in Malaysia's neighbors in Southeast Asia and in countries of similar income status. Women dominate among those outside the labor force at 69%, and most cited housework as an important reason for not seeking work. Moreover, gender segregation in occupations discourages women in the more high-skilled ones; they are often employed instead in semiskilled occupations in services and as clerical workers.

Women's mean monthly earnings are significantly lower than men's in all major occupations.

Female managers earn only 77.4% of what male managers earn. In services, sales, and clerical work, where most women are employed, their salaries are only 81.3%–81.5% of what men in the same occupation receive. The smallest earnings difference is in crafts and related work, at 4.3%, and in low-skilled occupations, at 6.4%. Increasing female participation in the labor market, particularly in highly productive jobs, can help Malaysia fulfill its development potential. Malaysia is expected to become an aging society by 2030. With its declining total fertility rate, the working-age share of the population is likely to shrink in the coming years. Policy makers should address persistent barriers that prevent women in Malaysia from joining the workforce and identify the most effective instruments to encourage women to take part.

MYANMAR

The economy continued to be weighed down in fiscal 2022 by instability and volatility. These factors will likely persist in the near term, along with high inflation and real growth languishing below potential. The economic downturn has stretched household incomes and hampered access to food, such that malnutrition is becoming more prevalent nationwide. The cumulative impact of this situation has taken a heavy toll on the poor, posing major challenges to social protection programs.

Economic Performance

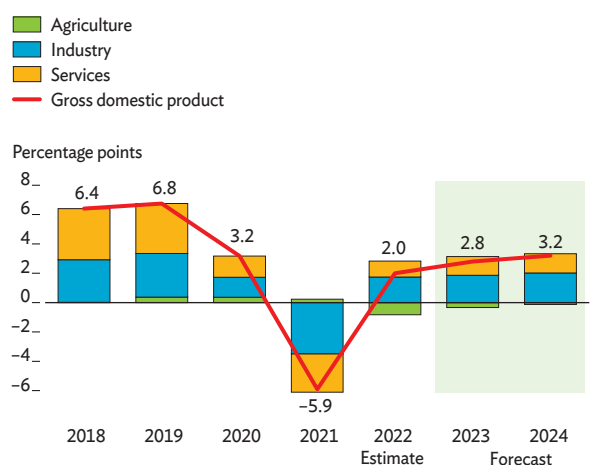
Multiple persistent challenges and risks constrained GDP growth to an estimated 2.0% in fiscal year 2022 (FY2022, ended 30 September 2022). Growth in agriculture contracted further from 1.0% to 3.5% amid soaring input and energy prices, declining access to finance and capital, supply disruption, and persistent armed conflict in rural areas. Industry grew by 5.0%, supported by modest expansion in manufacturing, construction, and light industry (Figure 2.27.1). Services grew by 2.6% as business resumed in transport, finance, health, and travel and tourism. While international tourist arrival increased compared to FY2021, this was well below the pre-pandemic level.

Inflation reached 16.0% in FY2022 (Figure 2.27.2). The causes were steep depreciation of the Myanmar kyat, high international commodity prices, and supply distortions throughout FY2022. Average food prices accelerated by 14.0% in FY2022, while other inflation increased to average 17.5%. The kyat depreciated against the US dollar by more than half in the course of FY2022 and finished the year with an official exchange rate at half of the market rate.

Trade gradually recovered in FY2022. Merchandise exports grew by 8.6% in US dollar terms, driven by robust demand for livestock, forestry, and manufactured goods, exported mainly to Asian

Figure 2.27.1 Supply-Side Contributions to Growth

Industry and services rebounded, but agriculture remained weak.



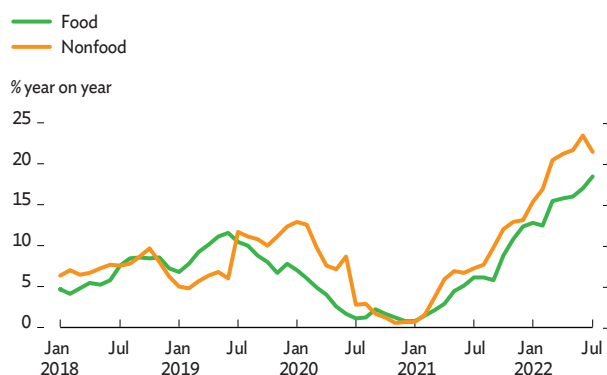
Note: Years are fiscal years ending on 30 September of that year.

Sources: Central Bank of Myanmar. 2021. [Quarterly Statistics Bulletin, Volume III](#); Asian Development Bank estimates.

countries. Buoyed by strong growth in imports of intermediate goods and raw materials for the garment industry, merchandise imports increased by 12.2% in US dollar terms, widening the FY2022 current account deficit (Figure 2.27.3). Foreign direct investment was halved, from \$3.8 billion in FY2021 to \$1.9 billion in FY2022, by political worries, a weaker business environment, and macroeconomic instability. Investment, mainly from Asia, went to electric power generation, services, and manufacturing.

Figure 2.27.2 Inflation

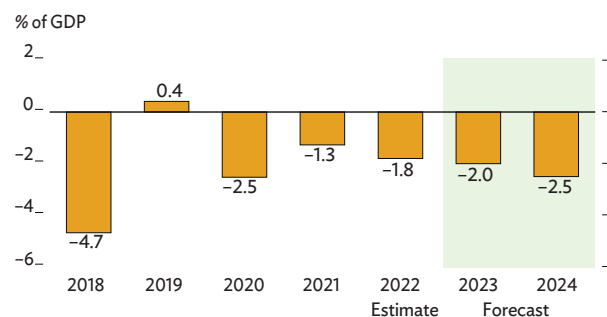
Inflation has surged due to currency depreciation and high commodity prices.



Source: Central Statistical Organization.

Figure 2.27.3 Current Account Balance

The current account deficit is gradually widening.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 September of that year.

Sources: Central Bank of Myanmar. 2021. *Balance of Payment Statistics*; Asian Development Bank estimates.

Modestly improved revenue collection narrowed the budget deficit. The gap is estimated to have narrowed from the equivalent of 8.1% of GDP in FY2021 to 7.7% (Figure 2.27.4). The ratio of revenue to GDP improved from an estimated 13.9% in FY2021 to 14.4% in FY2022 mainly as revenue collection rose along with economic activity. Tax revenue soared by 59.7% at the end of the third quarter of FY2022, reversing a significant decline a year earlier.

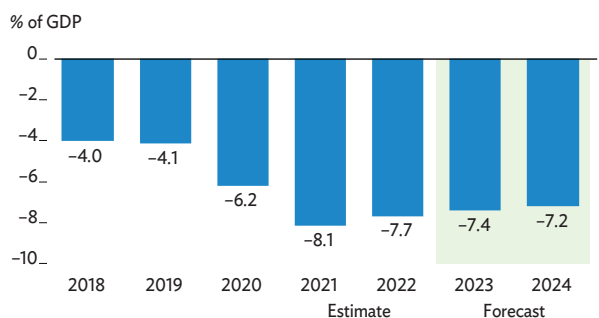
Economic Prospects

Growth is forecast to remain below the steady expansion at 6%–7% recorded before the pandemic.

In light of continued instability, real GDP growth is

Figure 2.27.4 Fiscal Balance

The deficit will remain high despite some improvement in revenue collection.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 September of that year.

Sources: Central Bank of Myanmar. 2021. *Quarterly Statistics Bulletin, Volume III*; Asian Development Bank estimates.

projected to rise moderately to 2.8% in FY2023 and 3.2% in FY2024 (Table 2.27.1). While agricultural exports improved in the first quarter of FY2023, and lower prices for fertilizer and other inputs should ease production constraints, worsening armed conflict in rural areas is expected to continue to restrain agricultural output. Agriculture is expected to contract by 1.5% in FY2023, which would be less contraction than in FY2022. The reopening of borders, particularly with the People's Republic of China, will encourage input flows and boost agricultural output in the near term.

Table 2.27.1 Selected Economic Indicators, %

Economic growth is expected to recover in 2023, while inflation should stay moderate.

	2021	2022	2023	2024
GDP growth	-5.9	2.0	2.8	3.2
Inflation	3.6	16.0	10.5	8.2

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 September of that year.

Sources: Central Bank of Myanmar. 2021. *Quarterly Statistics Bulletin, Volume III*; Asian Development Bank estimates.

Industry is expected to pick up only modestly. With an unfavorable business environment, power shortages, weak global demand, and supply constraints, growth in industry is forecast at 5.2% in FY2023 and 5.5% in FY2024. Increased capital imports in the first quarter of FY2023 reflected the resumption of public and private investment in larger projects, construction, and

other industries. Services are expected to grow by 3.0% with improvement in banking, travel and tourism, and telecommunications.

Inflation is forecast lower but trade and current account deficits wider. With slower depreciation of the kyat and lower energy prices, inflation is projected to ease to 10.5% in FY2023 before dropping to 8.2% in FY2024. The trade and current account deficits are expected to widen in the next 2 years as export earnings weaken and imports strengthen on more robust demand for capital goods. A \$562.1 million merchandise trade deficit reached in the first quarter of FY2023 reversed a \$204.9 million surplus a year earlier as capital imports surged by 69.9%. In the whole fiscal year, imports are expected to expand by 10.5% as exports likely increase by 5.5%. Sustained growth in remittances from migrant workers will cushion the trade deficit.

The fiscal deficit is forecast to narrow slightly from the equivalent of 7.4% of GDP in FY2023 to 7.2% in FY2024. Spending is expected to increase on higher capital expenditure and defense spending and to service public debt, which grew to more than 62% of GDP at the end of FY2022. However, current expenditure is expected to remain low, as is spending on social sectors, budgeted to decline by 26.6% while a rebound in trade and economic activities will boost revenues.

Protracted political tensions pose significant domestic downside risks to the outlook. The major external threats to the outlook are an unexpectedly slow recovery in major trading partners and new sanctions imposed by other countries in early 2023.

Policy Challenge—Enhancing Social Protection

External and internal shocks have buffeted the country since 2020. The results are worsened poverty incidence, food insecurity, and malnutrition in children. These shocks are reversing economic gains and improvements in well-being achieved before the pandemic, with disproportionate impact on the poor and vulnerable, particularly women and children.

Slow growth disrupted employment and incomes. Employment declined by 6.4% in 2020, 14.7% in 2021,

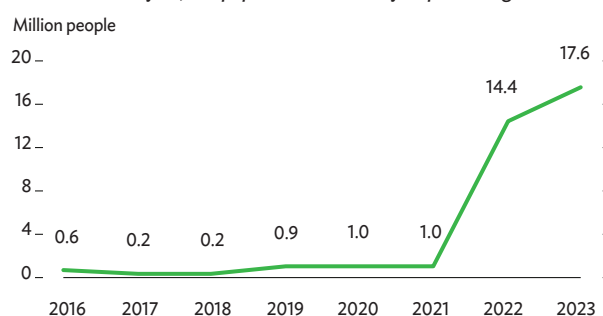
and 11.5% in 2022, as the poverty rate almost doubled from 24.8% in 2017 to 46.3% in 2022, approaching the 2005 level. As more people fall into poverty, they are unable to secure adequate nutrition. Given the country's inadequate social protection system, income losses have significantly reduced access to food, particularly among the poor. The prevalence of undernourishment increased by 0.6% to 3.1% in 2021, raising the number of undernourished people by 300,000 above the 2019 estimate to 1.7 million. The incidence of wasting and stunting among children under 5 has also increased, risking generational effects that leave children with lower cognitive ability, educational attainment, and income as adults.

Vulnerability to natural hazards amplifies risks to people's safety and well-being. In 2023, an estimated 17.6 million people—or one person in three, including 11.9 million women and children—will need humanitarian assistance (Figure 2.27.5). A projected 28% of the population will be food insecure in 2023, up from 25% in 2021. Further, an estimated 1.4 million people will be newly displaced in 2023, doubling the number of internally displaced people to 2.7 million by the end of the year.

Effective and sustainable social programs protect populations from shocks. Risk reduction can come from health and nutrition services, social assistance, child protection, policies to promote economic opportunity, education and training, climate resilience, and good governance—if adequate financing for such programs can be secured.

Figure 2.27.5 People in Need of Humanitarian Assistance

With armed conflict, the population in need of help has surged.



Source: United Nations Office for the Coordination of Humanitarian Affairs Myanmar.

PHILIPPINES

Robust investment and consumption drove high GDP growth in 2022. Growth is projected to moderate but will still be strong at 6.0% this year and 6.2% next. A recent buildup of inflationary pressure will moderate next year as tighter monetary policy takes effect. The current account will continue to post deficits partly because of brisk imports of investment goods. Strengthening food security is vital to ensuring inclusive growth.

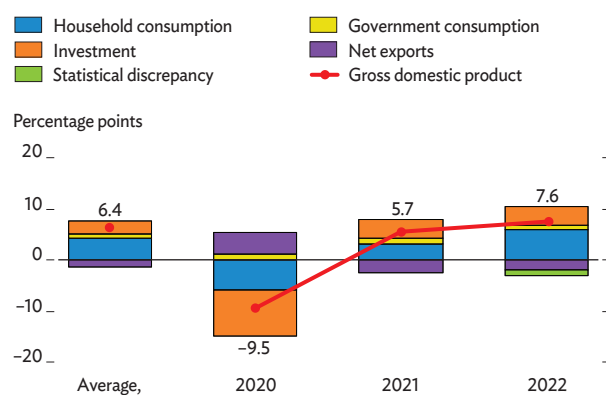
Economic Performance

Robust private consumption and investment lifted GDP growth from 5.7% in 2021 to 7.6% in 2022.

Growth in household consumption rose from 4.2% in 2021 to 8.3%, making it the largest demand-side contribution to GDP growth (Figure 2.28.1). Consumption became more broad-based across goods and services with a sharp rebound in spending on recreation, transport, restaurants, and hotels. Higher employment and remittances from overseas Filipinos supported household consumption. Growth in public consumption moderated to 5.0% as fiscal stimulus to address the pandemic wound down.

Figure 2.28.1 Demand-Side Contributions to Growth

Robust household consumption largely propelled growth, followed by investment.



Sources: Philippine Statistics Authority; CEIC Data Company.

The labor market showed continued improvement.

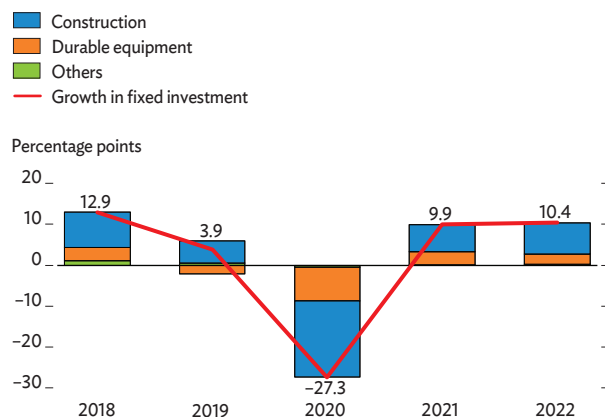
Unemployment rates dropped below their pre-pandemic average despite higher labor force participation. The unemployment rate declined to 4.3% in December 2022, improving on the pre-pandemic rate of 5.1% in 2019. Unemployment declined despite a significant increase in the labor force participation rate from 61.3% before the pandemic to 66.4%. Remittances from overseas workers rose by 3.6% to \$36.1 billion.

Fixed investment remained buoyant. Growth in fixed investment rose from 9.9% in 2021 to 10.4% with construction as the lead contributor (Figure 2.28.2). Public investment in construction rose by 11.9% with large public infrastructure projects under way. Higher private investment was driven by purchases of machinery and equipment and a 13.2% rise in private construction that reversed 0.5% contraction in 2021.

The deficit in net exports widened. Imports of goods and services rose by 13.1% in real terms, outpacing 10.7% export growth. Weak external demand slashed merchandise export growth from 11.6% in 2021 to 4.9%. Exports of electronic products, about 60% of all exports, softened. Growth in service exports rose sharply from 2.5% in 2021 to 20.2%. Tourism bounced back with the further lifting of travel restrictions, and growth remained strong for business process outsourcing and information services. A rapid rise in merchandise imports was spurred by higher demand for capital and consumer goods.

Figure 2.28.2 Contributions to Fixed Investment Growth

Construction, both public and private, drove investment.



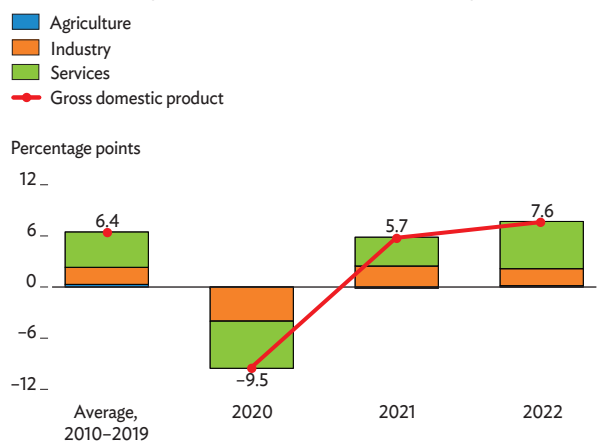
Sources: Philippine Statistics Authority; CEIC Data Company.

Services contributed the most to growth on the supply side, buoyed by increased mobility and the release of pent-up demand. Growth in services accelerated from 5.4% in 2021 to 9.2% and contributed nearly three-fourths of GDP growth (Figure 2.28.3). With a full return to classrooms and a rebound in tourism, all areas of services expanded, but key drivers were retail trade, accommodation and food services, transportation, and professional and business services. Industry continued to expand, by 6.7% in 2022, contributing one-fourth of GDP growth, mainly from manufacturing and construction. Manufacturing alone contributed 12.6% of the increase in GDP despite slowing from 8.8% growth in 2021 to 5.0% as external demand slackened. Food processing, which constitutes about half of manufacturing, posted robust gains from revived domestic demand. Gains were recorded in the manufacture of chemicals, machinery, and transport equipment, partly offset by a growth slowdown in electronic products, the country's main export product category. A tepid performance in agriculture continued throughout the year as output was hit by typhoons, rising input costs, and low productivity.

Rising food and energy prices accelerated inflation throughout the year. Inflation rose from an average of 3.9% in 2021 to 5.8% in 2022, quickening to 7.9% in the fourth quarter. Price pressures stemmed from elevated global commodity prices and tight domestic food supply caused in part by bad weather. Higher energy prices spilled over into utility and transportation costs. Rising core inflation suggests underlying price

Figure 2.28.3 Supply-Side Contributions to Growth

Further reopening and increased mobility spurred stronger services.



Sources: Philippine Statistics Authority; CEIC Data Company.

pressures. Core inflation averaged 3.9% during the year but climbed to 6.9% in December. High inflation prompted a sharp tightening of monetary policy. Policy rates were raised by 350 basis points in 2022, bringing the benchmark rate to 5.5% in December. The higher policy rate reined in growth in broad money (M3) from 8.5% year on year in January 2022 to 5.5% a year later.

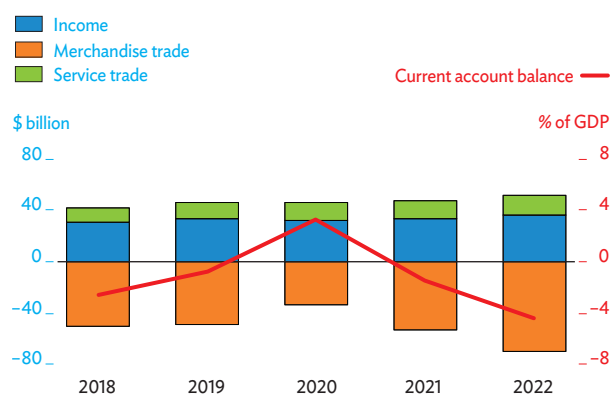
The fiscal deficit narrowed as revenue grew by 18.0%, outpacing 10.4% growth in expenditure.

The fiscal deficit shrank from the equivalent of 8.6% of GDP in 2021 to 7.3% in 2022. Revenue rose on robust domestic activity and government measures to strengthen digitalization and tax administration. Tax collection, comprising 91% of all revenue, improved from 14.1% of GDP in 2021 to 14.6%. As the government continued to unwind fiscal support offered during the pandemic, growth in current expenditure eased. Infrastructure spending remained strong.

The current account deficit widened as a larger merchandise trade deficit more than offset growth in service exports and remittances. The current account deficit almost tripled from the equivalent of 1.5% of GDP in 2021 to 4.4% in 2022 (Figure 2.28.4). The merchandise trade deficit widened from 13.4% of GDP a year earlier to 17.2% on strong imports to meet higher demand for consumer and capital goods. Rising remittances and service exports partly cushioned the merchandise trade deficit. The surplus in services expanded on gains in business processing outsourcing, finance, and tourism. The overall balance of payments

Figure 2.28.4 Current Account Components

The current account deficit widened, reflecting high imports.



GDP = gross domestic product.

Source: CEIC Data Company.

reversed a surplus equal to 0.3% of GDP in 2021 with a 1.8% deficit in 2022.

The Philippine peso depreciated by 9.2% in the year to the end of 2022. Official reserves of \$96.1 billion at the end of 2022 provided cover for 7.2 months of imports and services and income payments. The ratio of external debt to GDP rose from 27.0% at the end of 2021 to 27.5% a year later.

Economic Prospects

Growth is expected to remain strong, albeit slowed by global headwinds, high inflation, and tighter monetary policy. GDP growth is forecast at 6.0% in 2023, picking up to 6.2% in 2024 as the external environment improves (Table 2.28.1). Private consumption and investment will continue to expand, though easing from last year's brisk pace. Household

Table 2.28.1 Selected Economic Indicators, %

Growth is projected to remain strong, underpinned by domestic demand.

	2021	2022	2023	2024
GDP growth	5.7	7.6	6.0	6.2
Inflation	3.9	5.8	6.2	4.0

GDP = gross domestic product.

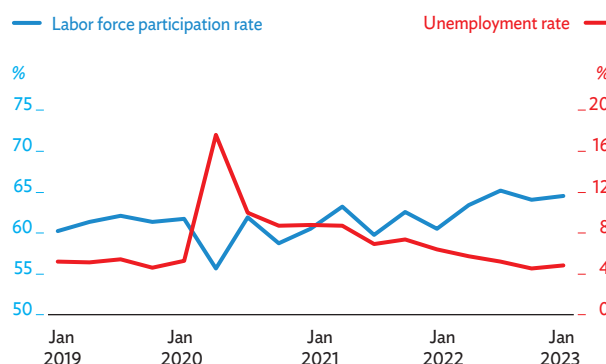
Sources: CEIC Data Company; Asian Development Bank estimates.

spending will be buoyed by rising employment and steady remittances from Philippine workers overseas. A reduction in income tax rates in 2023 for most workers should provide a further boost to growth.

The unemployment rate improved from 6.4% in January 2022 to 4.8% a year later, lower than before the pandemic (Figure 2.28.5). An additional 4.1 million jobs were generated over the year, the majority in services, in particular wholesale and retail trade, transport, and accommodation and food services. Employment in agriculture and manufacturing also rose but to a lesser extent. Job recovery was accompanied by an increase in informal jobs, with largely self-employed and unpaid workers comprising about a third of employment.

Figure 2.28.5 Labor Force Participation and Unemployment Rates

The unemployment rate was below pre-pandemic levels despite higher labor force participation.



Sources: Philippine Statistics Authority; CEIC Data Company.

Indicators of future economic activity are mixed.

A fourth quarter 2022 central bank survey showed consumer and business sentiment turning less optimistic, weighed down by concerns over high inflation and interest rates (Figure 2.28.6). Growth in imports of industrial machinery and credit to businesses has eased. Growth in bank lending to businesses softened to 9.2% in January 2023, the slowest in a year (Figure 2.28.7). Lending remained strong, however, to wholesale and retail trade with growth at 10.4%, to manufacturing at 10.3%, and to information and communication at 21.4%.

Figure 2.28.6 Business and Consumer Expectations for the Next 12 Months

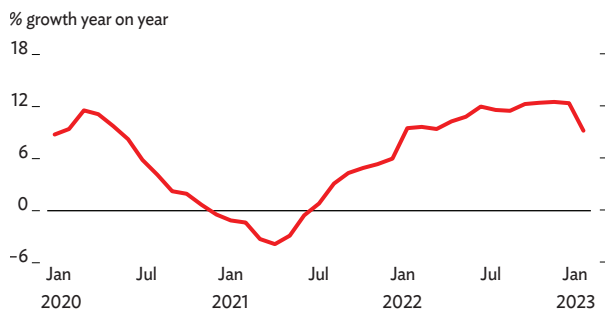
Sentiment has turned less optimistic because of high inflation and interest rates.



Sources: Bangko Sentral ng Pilipinas; CEIC Data Company.

Figure 2.28.7 Bank Lending to Businesses

Lending continued to expand, though at a lesser pace.



Sources: Bangko Sentral ng Pilipinas; CEIC Data Company.

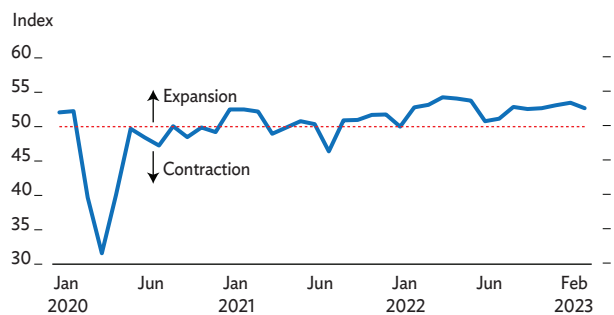
Growth in services, which provide about 60% of GDP, is expected to remain robust. Private consumption will underpin retail trade, while growing international tourist arrivals will benefit a range of services, most notably hotels and restaurants, transport, and communication. The government expects domestic tourism to recover to 2019 levels this year, and for international tourism to follow by 2024. The government is targeting at least 4.8 million international visitors this year, almost double 2022 arrivals, which will still be well below 8.3 million arrivals in pre-pandemic 2019. Prior to the pandemic, the tourism share of GDP was 12.9% in 2019, and it provided 13.6% of employment.

Prospects for construction and manufacturing remain favorable, underpinned by domestic demand.

The purchasing managers' index continued to indicate expansion with a reading of 52.7 in February 2023, though slightly down from 53.5 in January (Figure 2.28.8). Output and new orders expanded further. Growth in the manufacturing production index accelerated to 10.6% year on year in January, driven mainly by food products, transport equipment, and electrical equipment, while the average manufacturing capacity utilization rate rose to 72.6%, the highest since the onset of the pandemic. Private construction expanded in response to demand for office space, housing, and retail space.

Figure 2.28.8 Manufacturing Purchasing Managers' Index

The index continued to indicate expansion, though slightly lower in February 2023.



Note: A purchasing managers' index reading <50 signals deterioration, >50 improvement.

Sources: Bangko Sentral ng Pilipinas; CEIC Data Company.

Government expenditure is budgeted 4.9% higher in 2023 than in 2022 to cover social programs, infrastructure, and disaster risk management. Social programs include national health insurance, nutrition and education programs, conditional cash transfers to poor families, and livelihood assistance. Infrastructure spending, which equaled 5.8% of GDP in 2021, is planned at 5.0%–6.0% of GDP this year and for the medium term. The government approved in March 2023 a list of 194 high-impact priority projects amounting to about \$165 billion to further strengthen its infrastructure program. Most of the projects aim to improve physical connectivity with railways, bridges, and airports, or to strengthen water management through irrigation, water supply, and flood control. Climate change mitigation and adaptation are prioritized as well as projects on digital connectivity, health, electric power and energy, and agriculture.

Reform supports private investment. Reform is being undertaken to strengthen public–private partnership. The government has simplified and revised guidelines for joint venture projects to improve the competitive processes by which partners are selected, ensure that projects are technically and financially sound, and facilitate fast and efficient project implementation. The guidelines align with recently revised implementing rules and regulations governing build–operate–transfer projects and the bill on public–private partnership currently pending in Congress, which aims to develop well-structured projects aligned with the country’s development priorities. Philippine ratification of the Regional Comprehensive Economic Partnership in February 2023 should attract foreign direct investment, as should reform to open more sectors to foreign participation. In 2022, restrictions on foreign participation in key sectors were eased through amendments to the Foreign Investment Act and the Public Service Act, allowing full foreign ownership in telecommunications, airlines, shipping, railways, expressways, and tollways. The Retail Trade Liberalization Act was amended to ease capitalization requirements for foreign investors in retail trade. The Corporate Recovery and Tax Incentives for Enterprises Law, approved in April 2021, included tax rate reductions from 30% to 25% for corporations and to 20% for micro, small, and medium-sized enterprises.

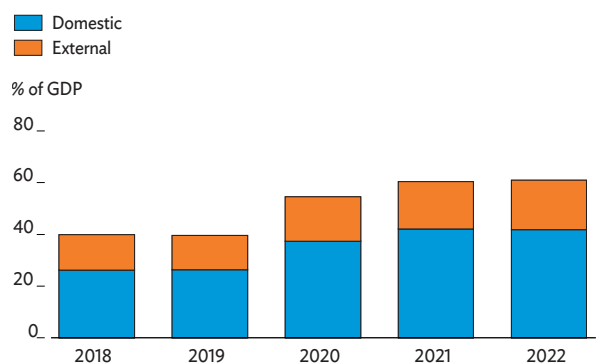
The Philippine Development Plan, 2023–2028 lays out the government’s socioeconomic agenda and strategies. Launched in December 2022, the plan aims to guide the economy back to a high growth trajectory, reinvigorate the creation of high-quality jobs, and accelerate poverty reduction. It prioritizes further investment in infrastructure and human capital development, climate change mitigation and adaptation, and targeted social assistance.

Fiscal consolidation under the plan aims to narrow the deficit from 6.1% of GDP in 2023 to 3.0% by 2028. Programs are being undertaken to make spending and revenue mobilization more efficient. Bills pending in Congress seek to right-size government bureaucracy for enhanced public service delivery by streamlining, restructuring government operations, and digitalizing systems. Additional public financial management reform is being institutionalized to ensure the timely implementation of programs. On the revenue side, measures have been taken to broaden the

base for value-added tax and increase excise taxes on petroleum products, cigarettes, and alcohol. Further, the government is considering, among other measures, a value-added tax on digital goods and services and an excise tax on single-use plastics. It is ramping up digitalization programs to improve tax administration. In line with a narrowing fiscal deficit, the ratio of debt to GDP is programmed to start declining in 2024. National government debt grew from the equivalent of 60.4% of GDP at the end of 2021 to 60.9% a year later (Figure 2.28.9). Debt composition remains favorable, with a high two-thirds of debt denominated in Philippine pesos, most of it medium or long term. The country’s investment grade sovereign credit ratings were affirmed in 2022.

Figure 2.28.9 National Government Debt

Debt is predominantly domestic.



GDP = gross domestic product.

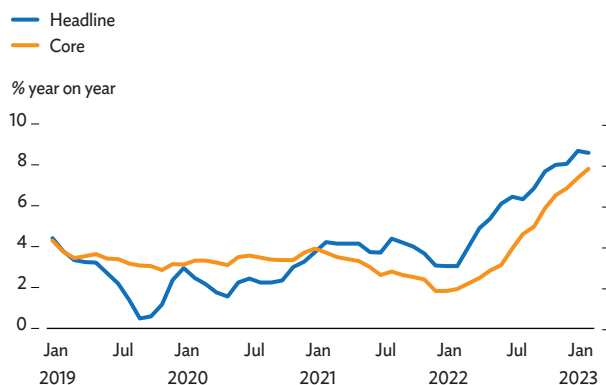
Sources: Bureau of the Treasury; CEIC Data Company.

As inflationary pressure mounted, interest rates were raised repeatedly. Headline and core inflation measures alike intensified in early 2023, indicating broad price pressures (Figure 2.28.10). Headline inflation accelerated from 8.1% year on year in December to 8.7% in January but then eased slightly to 8.6% in February. Food was the biggest contributor, owing to local supply constraints affecting some items and high global commodity prices. Transport inflation slowed but remains elevated at 9.0% in February. Core inflation rose from 6.9% in December to 7.4% in January and 7.8% in February.

Inflation is expected to average 6.2% in 2023 before easing to 4.0% in 2024. Inflation is projected to decelerate in the second half of 2023 and through 2024 as monetary tightening takes hold and global

Figure 2.28.10 Inflation

Inflationary pressures are broadening.



Source: CEIC Data Company.

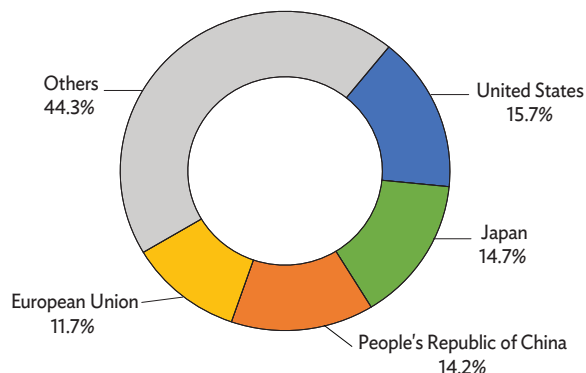
commodity prices moderate. The benchmark policy rate was further raised by a cumulative 75 basis points in February and March to 6.25%.

The current account deficit will narrow, partly reflecting strengthened service exports.

Merchandise export growth is expected to be moderate in 2023 because prospects for major external markets are uneven. As growth firms up in the People’s Republic of China, which receives 14.2% of Philippine exports, it is countered by growth moderation in other export markets in the European Union, Japan, and the US, which together comprise about 40% of the Philippines’ export market (Figure 2.28.11). Domestic demand will continue to drive imports of both consumer and

Figure 2.28.11 Exports to Major Markets, 2018–2022 Average

Major advanced economies account for a significant share of exports.



Sources: Philippine Statistics Authority; CEIC Data Company.

capital goods, but the merchandise trade deficit should be cushioned by strength in service exports, notably from business process outsourcing and the rebound in tourism, and by higher remittances from overseas workers. In 2024, improved economic prospects for the advanced economies bode well for exports and a narrowing of the current account deficit.

Downside external risks weigh on the outlook.

Particularly notable are a sharper slowdown in major advanced economies, heightened geopolitical tensions, and global commodity prices above expectations.

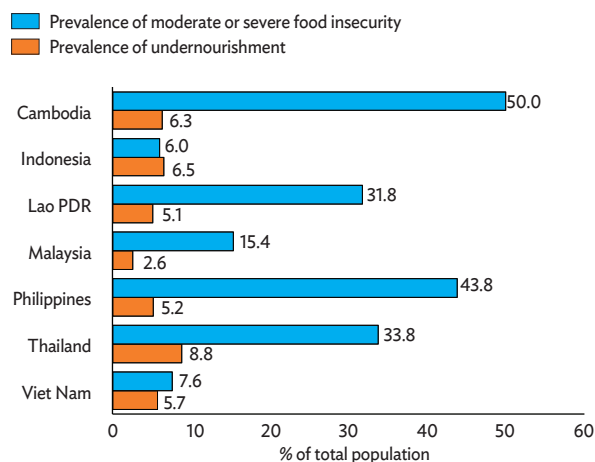
Policy Challenge—Fostering Food Security

The Philippines has enjoyed rapid economic growth in recent years.

Despite impressive gains in economic growth and poverty reduction, the incidence of hunger remains high, especially among the bottom two income deciles, and malnutrition persists. Data from the Food and Agriculture Organization of the United Nations show the prevalence of moderate or severe food insecurity in the Philippines averaging 43.8% of the total population from 2019 to 2021 (Figure 2.28.12).

Figure 2.28.12 Prevalence of Food Insecurity and Undernourishment, 2019–2021

High prevalence of food insecurity is exacerbated by elevated food inflation.



Lao PDR = Lao People’s Democratic Republic.

Note: Data on food insecurity and undernourishment are 3-year averages from 2019 to 2021. Malaysia data on undernourishment are available only from 2018 to 2020.

Source: FAOSTAT. Food and Agriculture Organization of the United Nations.

Most other countries in Southeast Asia fare better by this measure. In the same period, the prevalence of undernourishment was 5.2%.

High rates of stunting and malnutrition in children compromise future human capital and productivity. The 2021 Expanded National Nutrition Survey showed undernutrition rates were very high, with stunting at 26.7% among children under 5 years of age. Among school-age children (5 to 10 years old), the stunting rate is 19.7% and much higher for the poorest quintile at 32.7%. Chronic malnutrition and stunting are strongly linked to disease and premature death. They adversely affect crucial stages of development, causing cognitive and behavioral deficits, learning disability, and ultimately a suboptimal and uncompetitive labor force.

Sharply higher food inflation compounds the food security challenge. Supply-side shocks drove food inflation to 11.1% year on year in February 2023. While rice prices rose only moderately, significant price increases were recorded for sugar, vegetables, flour, and bread. Domestic production has been affected by typhoons and high prices for farm inputs such as fertilizer, feed, and fuel caused by supply disruption in the wake of the Russian invasion of Ukraine. The government has responded with short-term measures that provide social support to vulnerable groups and temporarily ease import restrictions on some agricultural products.

Ensuring food security and adequate nutrition requires a multipronged approach that considers both supply and demand. Key factors on the supply side include local food production and agricultural productivity, and trade, as well as the coverage and quality of health and nutrition services. Demand-side factors include household incomes and entitlements and incentives for improving health and nutritional outcomes.

The Philippine Development Plan prioritizes enhanced agricultural productivity and environmental sustainability. Growth in agriculture has underperformed for the past 2 decades. It grew by an average of 3.5% annually from 2000 to 2010, then by 1.5% from 2011 to 2022. While the agriculture share to GDP has declined from over 15% in the early 2000s to an average of 9% in the past 5 years, one-fifth

of employment remains in agriculture. Yet Philippine agricultural labor productivity lags regional peers.

The impact of climate change is acute in the Philippines, where many livelihoods depend on natural resources. The increased frequency of extreme weather disturbances has diminished productive capacity in agriculture and fisheries, undermining food and nutrition security. While weather plays a role in erratic growth in agriculture and periodic food price instability, policy shortcomings also weigh on sector development: trade restrictions on some agricultural products, inadequate extension services to farmers, poor water management, and underinvestment in rural infrastructure.

The Rice Tariffication Law of 2019 liberalized the rice trade and was thus a major step toward improved farm productivity and incomes. The law replaces quantitative restrictions on rice imports with tariffs. It has contained domestic rice price rises, such that they have contributed to inflation only minimally since 2019. The law supports programs to enhance productivity through the Rice Competitiveness Enhancement Fund, which is financed by tariffs on rice imports. Such reform could set an example for fostering a more open trade regime for other agricultural products, which would smooth supply variability and price volatility through diversified sources of supply.

An archipelagic country needs good infrastructure to ensure access to food, reduce postharvest losses, and increase agricultural incomes. Smallholder farmers rely on multiple layers of intermediaries to consolidate and transport their products to market. Small and unregulated markets need to be integrated into larger markets and distribution centers with infrastructure that improves agro-logistics, safety, and quality control. Also important is innovation that engages private sector providers of extension services to facilitate a transition to higher-value crops, digital technologies, and online marketing.

Food security and nutrition can be strengthened by social protection responses. After poverty incidence declined from 23.5% of the population in 2015 to 16.7% in 2018, it rose again to 18.1% in 2021 because of the pandemic. Social protection programs play a central role in alleviating poverty and hunger.

Social protection can intervene at various levels to ensure access to food, including through entitlements. Also instrumental is social assistance with strong links to income, food, nutrition, and health programs. An array of ongoing programs can be expanded or built on. Some of the most common interventions provide direct support through conditional cash transfers but also address some of the causes of food insecurity by, for example, requiring household members to attend classes on the importance of breastfeeding and nutritious diets. Food vouchers can be used to buy only food, usually in selected shops where its quality is controlled. School feeding programs can simultaneously strengthen health, nutrition, and education outcomes.

Institutional reform is key to effective supply and demand interventions. The existence of multiple agencies can challenge coordination. Policies need to ensure that supply and demand factors work in tandem, markets remain efficient, and access constraints are addressed. Strengthening coordination with local governments is vital as they lead the implementation of several programs that address food and nutrition security.

SINGAPORE

GDP growth slowed in 2022 as expansion in all sectors moderated and contributions from net exports and investment fell sharply. Inflation accelerated as food and energy prices rose. Growth should moderate further this year on softer external demand but improve in 2024. Inflation will be on a downward trend to the forecast horizon, contained by the lagged effect of monetary tightening. A comprehensive fiscal policy package should be designed to support a planned move toward low carbon transition while safeguarding competitiveness.

Economic Performance

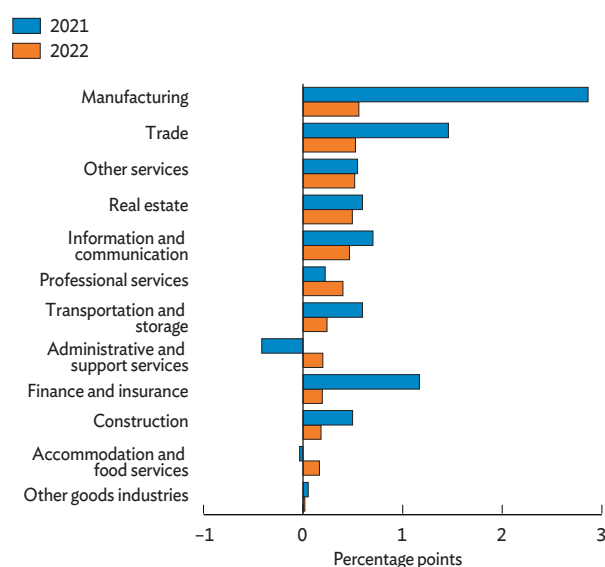
Growth decelerated as external demand softened.

GDP expansion moderated from 8.9% in 2021 to 3.6% in 2022. Growth was supported mostly by services but weighed down by weaker external demand and cyclical factors in manufacturing. Services grew by 4.8%, contributing 3.2 percentage points to growth and reflecting support from residents and tourists alike. Trade and finance slowed under sluggish external demand and weakened global financial conditions. Manufacturing growth decelerated, as the electronics segment weakened, to 2.5%, contributing 0.5 points to growth. Growth in construction decelerated to 6.7%, contributing only 0.2 points as both public and private construction declined (Figure 2.29.1).

Buoyed by private consumption, domestic demand grew by 5.2% in 2022 and contributed 3.5 percentage points to GDP growth. Supported by higher wages and higher cash assistance to cope with price increases, private consumption expanded by 9.7%, adding 3.2 percentage points to growth. By contrast, government consumption expenditure contracted, subtracting 0.3 points. Investment grew by only 0.6%, contributing 0.2 points as public construction contracted with lower investment in machinery and equipment. Meanwhile, exports of goods and services contracted in real terms by 1.3%, while imports of goods and services fell by 1.9%, such that positive change in net exports contributed 0.5 points to growth (Figure 2.29.2).

Figure 2.29.1 Supply-Side Contributions to Growth

Weak manufacturing and external demand weighed on growth in 2022.

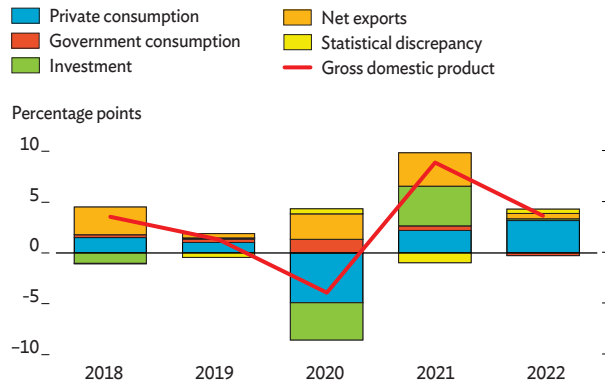


Source: Ministry of Trade and Industry. [Economic Survey Singapore 2022](#).

Inflation rose on higher energy and food prices from 2.3% in 2021 to 6.1% in 2022. Prices for all components of the consumer price index increased except for communication, as prices for telecommunication equipment declined. The top three contributors accounted for 63% of the index: transportation contributing 2.8 points as car and

Figure 2.29.2 Demand-Side Contributions to Growth

Economic reopening supported private consumption in 2022.

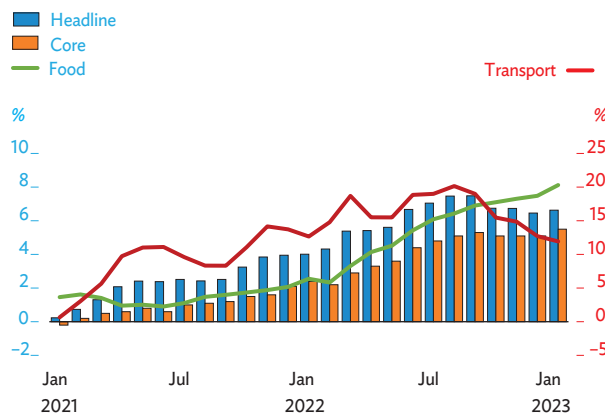


Source: Ministry of Trade and Industry. *Economic Survey Singapore 2022*.

gasoline prices rose, higher food prices contributing 1.1 points, and accommodation contributing 0.9 points because of higher rents. The central bank’s core inflation index, which excludes private transportation and accommodation, rose from 0.9% in 2021 to 4.1% because of higher prices for food and services (Figure 2.29.3).

Figure 2.29.3 Inflation

Transportation and food prices drove headline inflation.

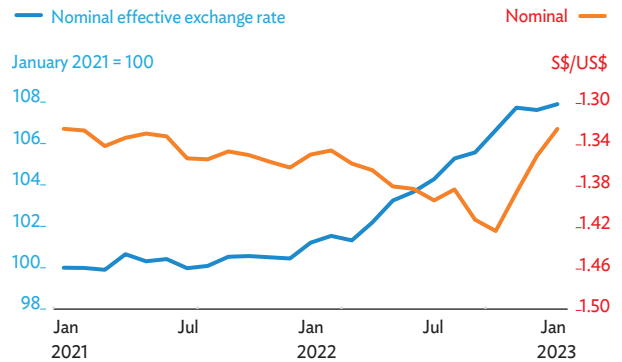


Source: CEIC Data Company.

The central bank tightened monetary policy to curb inflationary pressure. It raised the Singapore dollar nominal effective exchange rate policy band in January, April, July, and October of 2022. The local currency appreciated last year by 6.3% in nominal effective terms but depreciated by 0.1% against the US dollar (Figure 2.29.4).

Figure 2.29.4 Exchange Rates

With the US dollar strong, the Singapore dollar weakened against it until October.



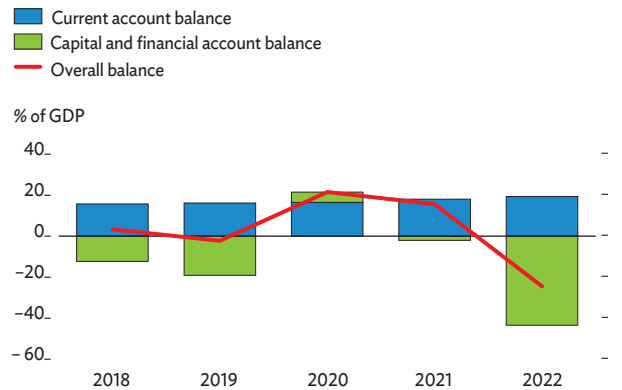
Source: CEIC Data Company.

The current account surplus expanded to equal 19.3% of GDP as the surplus in services widened.

Driven by higher net receipts from transport and financial services, the service surplus rose from 5.6% of GDP in 2021 to 7.0% in 2022, outweighing a slight narrowing of the trade surplus from 29.7% of GDP in 2021 to 29.2%. This was largely driven by higher oil prices, which pushed up merchandise imports by 13.9% in US dollar terms, more than the 12.6% increase in exports. However, the balance of payments recorded an overall deficit equal to 24.5% of GDP as the capital and financial accounts registered net outflow of \$202.6 billion, equal to 43.4% of GDP (Figure 2.29.5).

Figure 2.29.5 Balance of Payments

Large net capital outflow in 2022 pushed the balance of payments into deficit.



Source: CEIC Data Company.

Fiscal policy remained accommodative. The budget for fiscal year 2022 (FY2022, ended 31 March 2023) recorded a deficit equal to 0.7% of GDP, a reversal from a surplus of 0.2% in FY2021. Total revenue including the contribution of net investment returns narrowed from 18.1% of GDP in FY2021 to 17.4% with lower collection of corporate income taxes. Government expenditure including special transfers rose to 18.0% of GDP, a bit higher than originally planned, owing to higher spending on social services and economic development projects.

Economic Prospects

Growth will moderate to 2.0% in 2023, as manufacturing slows and external demand weakens, before improving to 3.0% in 2024. The main driver of growth will be services, especially travel-related ones as recovery in international air travel and inbound tourism is expected to accelerate following the reopening of the People's Republic of China's (PRC). However, sluggish external-oriented and finance sectors will still weigh on growth, given a slowdown in the global economy and tightening financial conditions. Manufacturing will remain weak in 2023. Business sentiment in manufacturing remains negative, as companies continue to face waning demand for manufactured goods as supply-chain challenges persist (Figure 2.29.6). Reflecting these sentiments, the purchasing managers' index contracted for 5 consecutive months to 49.8 in January 2023, then edged up to 50.0 in February. The electronics index fell to 49.3 in February following 7 months of contraction.

Waning external demand, tightening financial conditions, and higher taxes will moderate consumption, investment, and net exports. Consumer spending will be tempered somewhat by an increase in the goods and services tax (GST) and lower consumer confidence. Investment growth will be bolstered by a strong pipeline of government projects and private investment commitments that, at S\$22.5 billion, will almost double those registered in 2021, though higher borrowing costs may dampen the effect on growth. Net exports of goods and services will contract because of the global economic slowdown, though a positive economic outlook in the PRC will ease the contraction modestly.

Table 2.30.1 Selected Economic Indicators, %

Growth will slow this year and reaccelerate next year, but inflation will be on a downward trend.

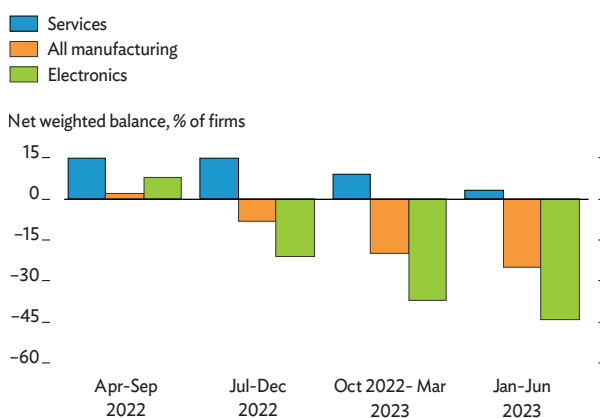
	2021	2022	2023	2024
GDP growth	8.9	3.6	2.0	3.0
Inflation	2.3	6.1	5.0	2.0

GDP = gross domestic product.

Sources: Ministry of Trade and Industry. Economic Survey Singapore 2022; Asian Development Bank estimates.

Figure 2.29.6 Business Sentiment

Business sentiment weakened in the first half of the year, especially in manufacturing.



Note: The net weighted balance is the difference between the weighted percentage of up responses and the weighted percentage of down responses.

Source: CEIC Data Company.

Inflation will moderate slightly in 2023 to 5.0% and ease further to 2.0% in 2024. While price increases have moderated, businesses still face higher costs for utilities and raw materials amid resilient demand, which will pass through to consumer prices in 2023. Singapore's imported inflation is expected to remain high in 2023, while domestic factors—such as the implementation of higher GST rates and wage increases in a tightened labor market, which rose by 4.3% in 2022—will play an increasingly important role in 2023 inflation. Inflation edged up from 6.5% year on year in December 2022 to 6.6% in January. However, price pressures are expected to moderate in the second half of 2023 thanks to lagged effects from monetary policy tightening, and ease further in 2024 as the impact of higher taxes wanes and the labor market stabilizes.

The ratio of the current account surplus to GDP will remain stable at 18.0% in 2023 and 2024.

Merchandise exports contracted by 7.9% in January 2023 as electronics and other non-oil exports declined, while imports fell by 9.6% as non-oil imports contracted. Similar developments are expected for the rest of the year as muted domestic demand likely means more slowing for import growth than for exports. The trade balance is therefore expected to remain in surplus. Net service receipts will likely rise on higher demand for maintenance in transport services, particularly aviation, and for financial services. Capital outflow will be lower than last year as investment sentiment improves in line with a moderating pace of monetary tightening in advanced countries.

Fiscal policy will stay accommodative in FY2023.

A budget deficit equal to 0.5% of GDP is planned for FY2023. Expenditure is expected to equal 17.6% of GDP as the government emphasizes economic resilience through support to local business and strengthened social safety nets. Revenue will be 17.1% of GDP because of increases in GST and receipts from fees and charges.

Risks to the outlook remain tilted to the downside amid heightened uncertainty and global headwinds. The main risks include weaker-than-expected economic performance in major trade partners, unexpectedly persistent inflation, and unexpectedly fast monetary policy tightening in advanced economies.

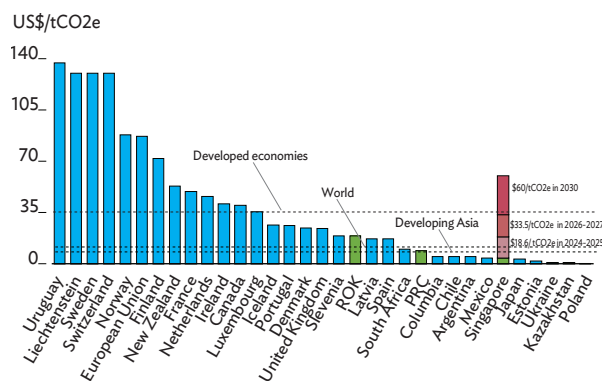
Policy Challenge—Transitioning to a Net-Zero Carbon Emissions Economy

Singapore’s decarbonization process has accelerated with rising carbon taxes, imposing social and economic consequences. Singapore instituted a carbon tax in 2019 at S\$5 per ton of carbon dioxide equivalent (tCO₂e). To achieve the goal of net-zero emissions by mid-century, the government scheduled gradual increase in the carbon tax to S\$50–S\$80/tCO₂e in 2030 (Figure 2.29.7). In the next few years, Singapore’s carbon price may be higher than in many other economies in developing Asia, if not

the highest. This significant increase in carbon prices, while facilitating Singapore’s shift to a low carbon growth path, will have various economic and social consequences in the short and medium term. These challenges are complicated as the world still recovering from the pandemic and facing global headwinds.

Figure 2.29.7 Carbon Prices by Country, 2022

Singapore’s carbon price will rise to catch up with that in major advanced economies.



PRC = People’s Republic of China, ROK = Republic of Korea, tCO₂e = ton of carbon dioxide equivalent.

Notes: Lines are averages carbon prices aggregated using 2019 greenhouse gas emission as weights.

Source: World Bank Carbon Pricing Dashboard.

Economic and social impacts from accelerated decarbonization will be large for high-emitting sectors and vulnerable groups. High-emitting sectors still play significant roles in Singapore’s economy. Industry, which provides 25.0% of jobs and 27.1% of GDP, was the largest source of greenhouse gas emissions in 2019, accounting for 45.1%. The use of fossil fuels in oil refineries and petrochemical companies is the main cause of these emissions. Singapore has over 100 chemical firms and was the eighth largest exporter of chemicals in 2019, and it is among the world’s top three petroleum refining centers. A high carbon price will saddle these high-emitting sectors with higher costs, which could undermine competitiveness and narrow profit margins. Higher carbon prices will incur job losses in carbon-intensive activities and reveal a skill mismatch for emerging low carbon jobs. Meanwhile, a higher carbon price could push up the cost of goods and basic services like electricity, transportation, and food, inflicting

disproportionally large pain on vulnerable groups, thereby challenging inclusiveness. The government estimates that a carbon tax of S\$25/tCO₂e will boost utility bills by about S\$4 per month for 31.5% of households in Singapore.

A comprehensive policy package is needed to support a timely and smooth shift toward low-carbon growth and sustain competitiveness.

Besides carbon pricing, green growth policies must support the creation of new green industries to unlock new growth opportunities during the transition. Economic incentives such as tax credits, labeling and other standards, and subsidies could boost innovation and scale up green technologies such as renewable energy and electric vehicles. For example, a rebate on newly registered electric cars and taxis from 2021 to 2023 has encouraged the adoption of electric vehicles. Singapore's Mandatory Energy Labelling

Scheme provides information on energy efficiency that encourages people to buy more energy-efficient appliances. Besides incentives that foster investment in green innovation and technology and behavioral change, compensating policies are needed to ensure fairness. Singapore has provided rebates to compensate for the pass-through of carbon tax to lower-income households.

Singapore may expand the use of carbon revenue to address social and growth challenges. Like the Republic of Korea and the PRC, Singapore uses a large part of its carbon revenue to support investment in and adoption of green technologies, as well as to help decarbonize high-emitting businesses. As carbon revenue increases, it can also be used to help affected workers find new jobs through reskilling, training, and information-sharing programs, as well as strengthen social protection and support growth.

THAILAND

The Thai economy continued to expand in 2022 due to robust private consumption and tourism recovery. Tourism and private consumption are expected to be the main growth drivers in 2023–2024. However, a global economic slowdown may derail the Thai economy from its recovery path as risks are tilted to the downside. Transitioning to a net-zero carbon emissions economy is a policy challenge, but the economy is highly vulnerable to global climate change.

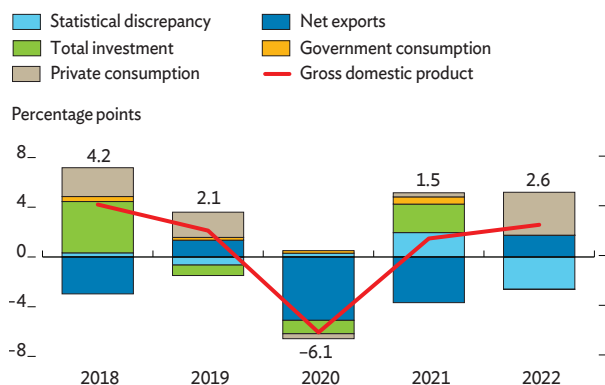
Economic Performance

In 2022, the Thai economy continued to recover gradually from the pandemic as the government lifted domestic mobility restrictions and reopened to international travel. GDP growth was 2.6%,

up from 1.5% in the previous year (Figure 2.30.1). Externally, the export of goods and services grew strongly by 6.8%. Merchandise exports value in US dollar terms expanded by 1.3%, mainly manufacturing products. Major manufacturing exports such as integrated circuits, air conditioners, electrical appliances, and machinery increased, partly due to COVID-19 restrictions relief in several countries.

Figure 2.30.1 Demand-Side Contributions to Growth

The economy was primarily driven by private consumption and export of services.



Source: Office of the National Economic and Social Development Council.

However, exports of petroleum products fell, and palm oil shipments declined because Indonesia, the world's largest palm oil producer and exporter, removed the palm oil export levy.

Regarding agricultural products, rice exports expanded particularly to Iraq, which had not imported rice from Thailand for several years.

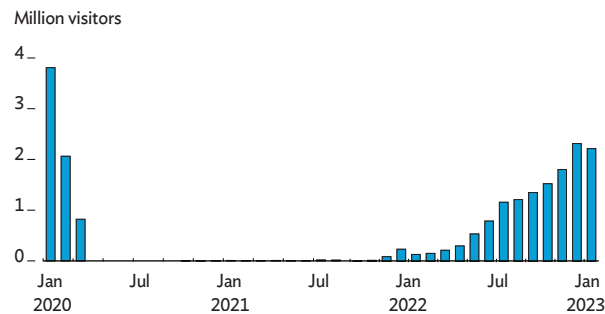
In addition, the export of chilled and frozen fresh chicken, as well as prepared chicken, recorded double-digit growth because of a chicken supply shortage in Malaysia. Agro-industry product exports expanded, particularly sugar, as India, the world's second-largest sugar exporter, implemented sugar export restrictions to control domestic prices. The value of merchandise exports started to slow down in the last quarter of 2022 due to a slowdown in trading partners' demand.

The export of services grew by 65.7% thanks to the significant return of international tourists after Thailand opened its borders to vaccinated travelers and dropped the pre-departure test requirement in July 2022.

The number of international tourists in 2022 was 11.2 million, increasing from 427,869 tourists in 2021 (Figure 2.30.2). Private consumption benefited from the robust tourism recovery as workers in tourism-related sectors were able to return to work. The government also extended a co-payment scheme and tourism stimulus packages to revitalize the economy.

Figure 2.30.2 Monthly International Tourists

Tourism strongly recovered after the country reopened.



Source: CEIC Data Company.

However, higher costs of living caused by the rise of energy and food prices dampened private consumption somewhat. Therefore, private consumption expanded by 6.3%, compared to 0.6% in 2021.

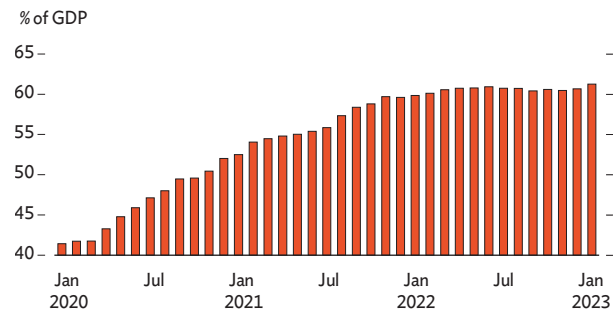
Private investment expanded by 5.1% in line with improving economic activities, particularly in service sectors. However, construction slowed because major construction projects were completed in 2021 and there were no new construction projects.

Public consumption declined by 0.04% year on year because of the budget cut in fiscal year 2022 (FY2022, ended 30 September 2022). In FY2022, annual budget expenditure was set at B3.1 trillion, with a 5.7% decrease compared to FY2021. The budget cut was attributable to decreased purchases of materials and supplies of health care services. Public investment also declined by 4.9% year on year due to a lower disbursement for roads, bridges, and office building construction. The government ran a fiscal deficit of 3.6% of GDP, down from 4.9% in FY2021. Public debt at the end of FY2022 stood at 60.4% of GDP, below the ceiling of 70% of GDP (Figure 2.30.3).

External stability remained sound. Imports expanded by 4.1% in line with the continued expansion of merchandise exports and increases in import prices. In the third quarter of 2022, external debt to GDP stood at 37%. Gross international reserves were enough to cover 2.2 times of short-term external debt and 7.1 months of imports. However, the current account as a percentage of GDP recorded a deficit of 3.4% in 2022. This was because of a significant rise in energy import prices and high profit and dividend transfers abroad in the first half of 2022.

Figure 2.30.3 Public Debt

Fiscal stability remained sound.



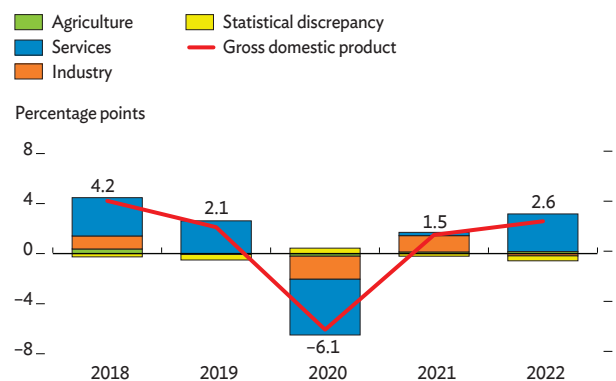
GDP = gross domestic product.

Source: Public Debt Management Office.

By sector, agriculture expanded by a paltry 2.5% due to lower yields of major crops, such as cassava, and fruits, especially durian and pineapple, partly caused by floods and unfavorable weather in the third quarter of 2022. Industry increased by 2.6% in line with a continued rise in merchandise exports and a rebound in private consumption. The services sector grew by 4.3%, mainly driven by accommodations and food service activities, transportation and storage, as well as wholesale and retail trade, supported by a pickup in international tourist arrivals (Figure 2.30.4).

Figure 2.30.4 Supply-Side Contributions to Growth

Services led economic growth on robust tourism recovery.



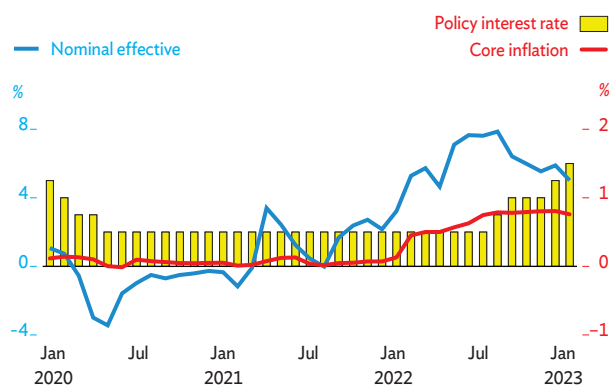
Source: Office of the National Economic and Social Development Council.

Notwithstanding higher inflation, monetary policy gradually normalized as the ultra-low policy interest rate in response to the pandemic became less needed. Headline inflation in 2022 rose by 6.1% from a year earlier due mainly to rising energy prices

(Figure 2.30.5). The Bank of Thailand, the central bank, raised the policy interest rate by 0.25 percentage points in August, September, and November 2022 from 0.5% to 1.25%. The baht depreciated by 9.6% and was highly volatile in the last quarter of 2022 because of aggressive monetary policy tightening in advanced economies.

Figure 2.30.5 Inflation and Policy Interest Rate

Inflation increased significantly last year, and the policy rate was hiked at year-end.



Source: CEIC Data Company.

Economic Prospects

The Thai economy is forecast to expand moderately even as the global economy slows. Real growth should be led by tourism and private consumption. Overall, real GDP growth is projected to expand by 3.3% in 2023 and 3.7% in 2024, while inflation should ease (Table 2.30.1 and Figure 2.30.6).

On the external front, exports of goods and services in 2023 and 2024 are expected to grow moderately by 6.6% and 6.3%, respectively. A global economic slowdown in 2023 and local currency appreciation would cause a slowdown in merchandise exports. However, in 2024, merchandise exports should bounce back in line with the improving global economic outlook. As for service exports, international tourism receipts are forecast to pick up mainly due to the return of tourists from the People's Republic of China. The number of international tourists is projected to be 28 million in 2023 and 35 million in 2024, approaching the pre-pandemic level of 40 million.

Table 2.30.1 Selected Economic Indicators, %

Moderate growth is expected in 2023 and 2024.

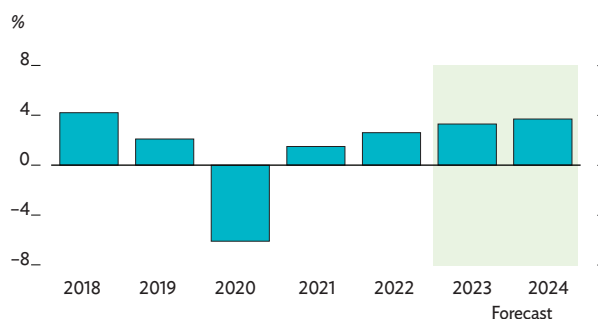
	2021	2022	2023	2024
GDP growth	1.5	2.6	3.3	3.7
Inflation	1.2	6.1	2.9	2.3

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Figure 2.30.6 GDP Growth

The economy is expected to continue to expand, driven by tourism and private consumption.



GDP = gross domestic product.

Source: Asian Development Outlook database.

Private consumption should gain traction led by improvement in employment, especially in the service sectors. Another factor that drives private consumption is increases in minimum daily wages across the country by an average of 5%. New daily minimum wages in Thailand announced in October 2022 range from the lowest at \$8.59 per day to the highest at \$9.27. Wages purchasing power fell because of rising inflation in 2022, and these increases should help workers relieve the high cost of living situation and stimulate private consumption in 2023 and 2024. It is thus projected to expand by 3.0% in 2023 and 3.6% in 2024.

Although merchandise exports are forecast to slow, private investment will continue to grow this year and next. Private investment is forecast to grow by 2.5% in 2023 and 3.5% in 2024, reflecting the high number of applications for investment promotion in 2021 and 2022. In 2023, most investment would be in services sectors to serve rising demand. In 2024, investment in manufacturing sectors should rise with support from the government. Thailand's Board of Investment launched new incentives for foreign investors in late 2022, targeting the high-tech, innovative, and

green sectors. They come into force in 2023, running until 2027. Special incentives will be given for foreign direct investments in sustainable new industries, including electric vehicle battery swapping stations, manufacturing hydrogen vehicles, novel and organic food production, and hydrogen production. A 10–13 year corporate income tax exemption is offered for upstream industries investment, such as biotech, nanotech, and advanced materials. In addition, the Board of Investment also launched a relocation program covering headquarters as well as research and manufacturing facilities. This program grants an additional corporate income tax exemption for 5 years to companies relocating all their activities to Thailand. This could attract more foreign direct investment inflows to the country.

Public consumption is expected to contract by 1.3% this year and return to positive growth of 0.9% next year. The government plans to keep its budget deficit to no more than 3% of GDP, narrowing from the pandemic period. Public investment for 2023 and 2024 is projected to expand by 2.3% and 5.4%, respectively. The expansion in FY2023 is according to the FY2023 investment budget framework, amounting to B695 billion, which increases from B613 billion in FY2022. In addition, the continued progress of the state-owned enterprises' investment in major infrastructure investment projects, particularly railway, expressway and electricity transmission development projects could boost public investment this year and next.

Imports of goods and services are forecast to rise by 2.6% in 2023 and 4.1% in 2024, in line with growing exports, private consumption, and investment.

The import of services is expected to rise continually following increasing numbers of outbound travelers. Meanwhile, import prices are expected to decrease in line with the assumption of declining energy prices.

By sector, the agriculture sector is projected to grow by 3.0% this year and 3.3% next year. Favorable weather and sufficient water levels should contribute to the expansion of agricultural production in the crop year 2023/2024. Industry growth is expected at 2.9% this year and 3.2% next year, supported primarily by improving private consumption. The services sector is expected to expand by 9.4% and 9.7% this year and next, thanks to the strong recovery in tourism-related sectors.

Headline inflation is expected to decline from 2022.

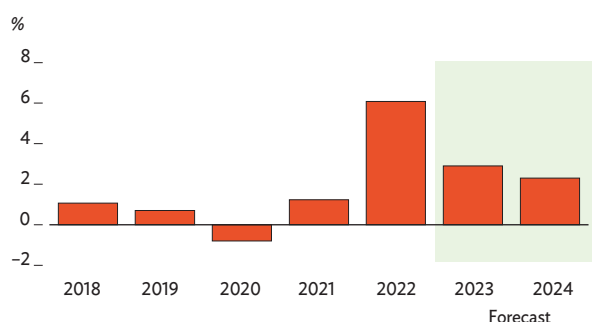
In 2023, it is projected to decline by 2.9%. Supply-side inflationary pressures would gradually decline, consistent with lowering global energy and commodity prices. However, core inflation is projected to remain high in the first half of 2023 before slowly decreasing in the rest of the forecast period. Tourism recovery could increase demand-side inflationary pressures and the prices of tourism-related goods and services, including food prices. For 2024, headline inflation should slow to 2.3% as supply-side pressures ease (Figure 2.30.7). The current account relative to GDP is expected to post a surplus of 2.8% and 3.4% this year and next, mainly driven by high international tourism receipts (Figure 2.30.8).

Risks to the outlook are tilted to the downside.

Externally, geopolitical tensions could result in supply disruptions and continued high production costs. Furthermore, if the global economic slowdown is more

Figure 2.30.7 Inflation

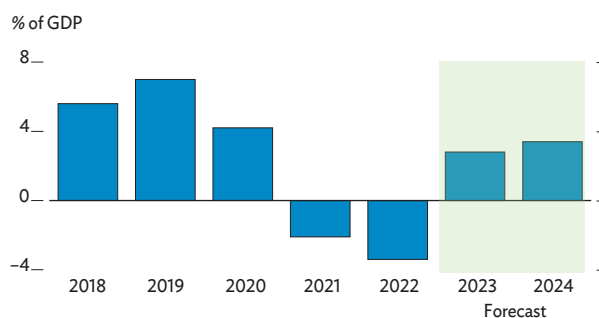
Oil prices are projected to decline, easing inflation pressures.



Source: Asian Development Outlook database.

Figure 2.30.8 Current Account Balance

The balance will return to the surplus in 2023 and 2024.



GDP = gross domestic product.

Source: Asian Development Outlook database.

severe and longer than expected, Thailand's recovery would be affected by weaker goods exports and tourism demand. At the same time, the economy is highly dependent on tourism, and the resulting foreign exchange inflows could lead to baht appreciation hampering merchandise exports and domestic manufacturing. The forthcoming general election in Thailand this year is a key risk domestically as it could cause budget delays.

Policy Challenge—Transitioning to a Net-Zero Carbon Emissions Economy

Thailand is highly vulnerable to the impact of climate change. It experienced more severe and intensified weather impacts nationwide during 2000–2019. Floods and droughts regularly occur nowadays. In 2021, Thailand was ranked ninth by Germanwatch's Global Climate Risk Index to be the country most affected by extreme weather events, with a significant risk that the poorest and marginalized groups will experience disproportionately more substantial loss and damage.

The country has committed to reducing annual greenhouse gas (GHG) emissions by 30% from the projected business-as-usual level by 2030, according to the nationally determined contribution (NDC).

At the 26th UN Climate Change Conference of the Parties (COP 26) in 2021, Thailand committed to reaching carbon neutrality by 2050 and net-zero GHG emissions by 2065. Later in November 2022, the country revised its pathway containing these targets in the long-term low greenhouse gas emission development strategy (LT-LEDS). The second updated NDC was also announced to increase the GHG emissions reduction target to 40% by 2030. Furthermore, the Climate Change Act, Thailand's first climate legislation is formulated to provide regulatory measures and incentive mechanisms to help promote a climate-friendly investment. According to LT-LEDS, the Climate Change Act will establish an Environmental Fund, the first domestic climate financing mechanism, with resource allocation to support climate mitigation and adaptation projects and research activities. Sustainable finance initiatives were also introduced by the Ministry of Finance, the Bank of Thailand, the Securities Exchange Commission, the Office of Insurance

Commission, and Thailand's Stock Exchange to help channel financial flows to the real economy's transition towards sustainability.

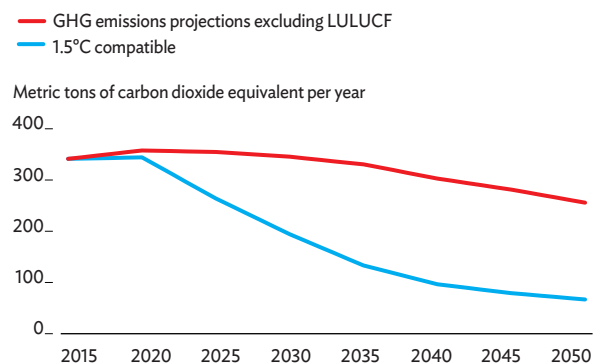
Although Thailand's commitment to climate policies has grown in recent years with ambitious mitigation targets, much remains to be implemented. The Climate Action Tracker rates Thailand's overall rating as "critically insufficient," meaning that Thailand's current climate policies and commitments reflect minimal action and are inconsistent with the Paris Agreement. Under the current policies, carbon emissions in Thailand will continue to rise more than 4°C, which is not consistent with the criteria of the 1.5°C temperature limit, stated by the Intergovernmental Panel on Climate Change (Figure 2.30.9).

To achieve these ambitious targets, all sectors will be required to reduce GHG emissions significantly, especially the energy sector, which accounts for the largest volume of carbon emissions among all sectors.

The challenge going forward has to do with investment in GHG emissions reduction technology that could affect the short-term performance of businesses because the cost of technology is high. Some companies are facing a lack of capital from investors. Another challenge is collaboration among government, companies, and consumers to realize the net-zero goal collectively. In Thailand, there is hardly any discussion among the general public about the need to reduce GHG emissions. The government should work more closely with the general public to raise awareness of the environmental imperative to combat rising global temperatures.

Figure 2.30.9 Thailand's Overall Climate Performance

Under current climate policies, it will be difficult to achieve climate commitments.



GHG = greenhouse gas, LULUCF = land use, land-use change, and forestry.

Source: Climate Action Tracker.

TIMOR-LESTE

The economy recovered in 2022 on increased government expenditure and a rebound in private consumption. It will likely sustain similar growth rates in 2023 and 2024 with public spending continuing as the main growth driver in the medium term. Inflation nearly doubled in 2022 but is forecast to ease this year and next. A major challenge is to ensure cost-effective, high-quality investment in human capital accumulation to allow the rising generation to put Timor-Leste on a sustainable, resilient growth path.

Economic Performance

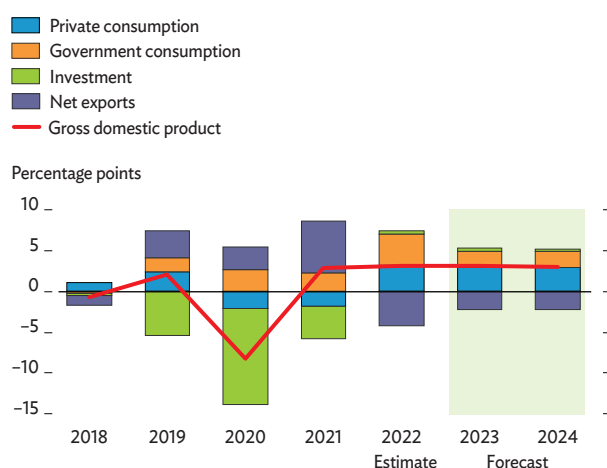
The economy grew by an estimated 3.2% in 2022.

A presidential election in the first quarter of 2022 instilled confidence that the economy would return to normal. Government spending on transfers and other safety net programs stimulated private consumption and investment (Figure 2.31.1). Private consumption reversed 2.7% decline in 2021 to grow by an estimated 5.0% as consumer confidence and household income steadily recovered from the pandemic and flooding in

April 2021. Government consumption was supported by the country’s largest-ever budget, a supplement in May 2022 taking it to \$2.4 billion (Figure 2.31.2). Transfers increased by an amount equal to almost a third of 2021 transfers spending. A high budget ceiling notwithstanding, execution continued to lag. A \$1 billion allocation for the Veterans’ Fund went unspent in 2022. Capital development spending was also low, reaching only 29% of its budget allocation and recording real annual growth at a paltry 1.0% (Figure 2.31.3).

Figure 2.31.1 Demand-Side Contributions to Growth

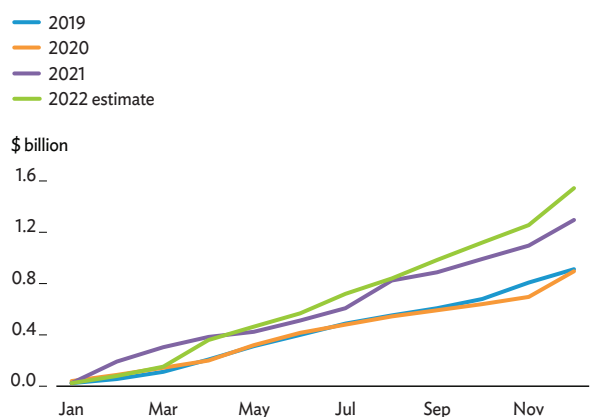
Growth was maintained despite falling net exports.



Sources: General Directorate of Statistics; Asian Development Bank estimates.

Figure 2.31.2 Cumulative Recurrent Expenditure

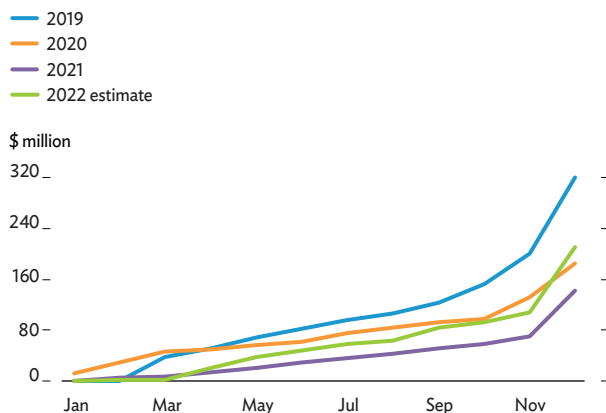
Current expenditure accelerated last year.



Sources: Ministry of Finance; Asian Development Bank estimates.

Figure 2.31.3 Cumulative Capital Expenditure

Capital expenditure slowed.

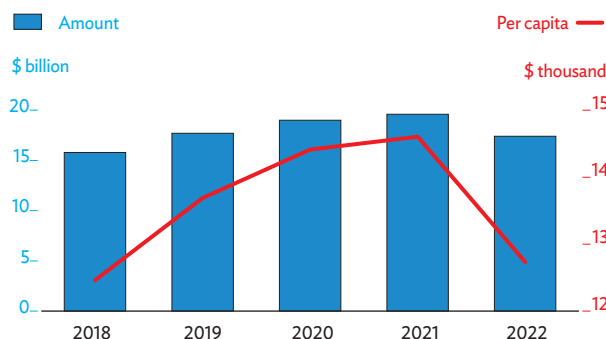


Sources: Ministry of Finance; Asian Development Bank estimates.

Domestic revenue aside from oil increased by an estimated 10.8% in 2022 but remained low, equal to just 10% of GDP. Leaving aside the large offshore petroleum industry, tax collection grew by an estimated 12.5% on stronger economic growth and increases in excise, sales, and withholding taxes. Despite growth in domestic revenue, government spending, financed mainly through the Petroleum Fund, generated a fiscal deficit equal to 49.1% of GDP. The Petroleum Fund suffered its largest-ever net investment loss as a \$1.9 billion decline in 2022 reversed \$1.1 billion in net investment income in 2021. Losses incurred by the Petroleum Fund, attributable to global financial market fluctuations, reduced the fund balance from \$19.6 billion at the end of December 2021 to an estimated \$17.4 billion a year later (Figure 2.31.4).

Figure 2.31.4 Petroleum Fund Balance

Global market turmoil contributed to a decline in the fund.



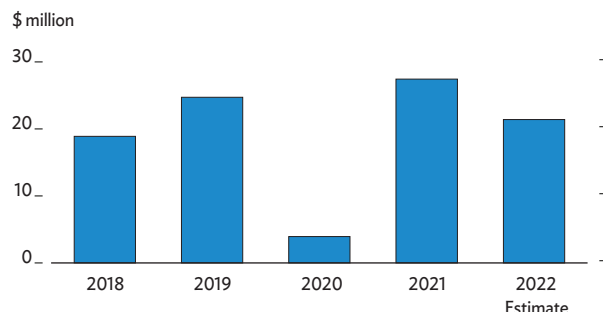
Sources: Ministry of Finance; Banco Central de Timor-Leste; Asian Development Bank estimates.

Growth in exports of goods and services normalized down to 6.1% in 2022 after a rebound in 2021. Coffee production stabilized, but the value of coffee exports softened as the world price for Arabica varieties suffered a 22% decline (Figure 2.31.5). Imports, on the other hand, increased by 9.2% on higher government spending on transfers, particularly through the Cesta Basica food subsidy program and the Bolsa de Mae-Jersaun Foun support scheme for pregnant women and children. This generated a current account deficit equal to 22% of GDP (Figure 2.31.6).

Consumer price inflation spiked sharply from 3.8% in 2021 to 7.0% in 2022. Domestic prices for food and fuel rose on surges in global energy, food, and fertilizer

Figure 2.31.5 Coffee Exports

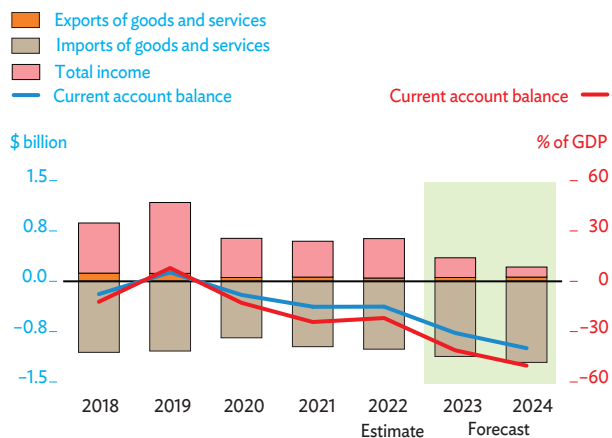
World coffee prices declined, dragging down exports.



Sources: General Directorate of Statistics; Asian Development Bank estimates.

Figure 2.31.6 Current Account

The current account balance is forecast to fall deeper into deficit.



GDP = gross domestic product.

Sources: Banco Central de Timor-Leste; Asian Development Bank estimates.

prices following the Russian invasion of Ukraine and on increased tax rates for alcoholic beverages and tobacco. Inflation had a disproportionate impact on poorer households.

Economic Prospects

The economy is forecast to grow by 3.1% in 2023 and 3.0% in 2024. Parliament approved a budget ceiling for the 2023 budget at \$2.2 billion, an 8.3% reduction from 2022, with over a third budgeted for transfers. Budget execution rates are expected to be higher thanks to an improved economic and health context, supporting private consumption. However, real GDP growth is expected to be constrained by a dim global growth outlook (Table 2.31.1).

Table 2.31.1 Selected Economic Indicators, %

Growth and inflation are forecast to slow.

	2021	2022	2023	2024
GDP growth	2.9	3.2	3.1	3.0
Inflation	3.8	7.0	5.5	2.8

GDP = gross domestic product.

Sources: General Directorate of Statistics; Asian Development Bank estimates.

Growth driven by government spending will depend on the Petroleum Fund. The government will need to be prudent when spending Petroleum Fund assets. With production from the Bayu-Undan offshore field likely to end in 2023, Timor-Leste needs to strengthen its fiscal sustainability.

Investment in roads, bridges, and other infrastructure is expected to continue. Noteworthy projects include an extension of the Presidente Nicolau Lobato International Airport and a plan to develop the Dili Port to increase its domestic cargo and passenger capacity. Other government priorities are to boost agricultural productivity, enhance medical facilities, ensure affordable housing, and develop tourism.

Inflation is forecast slowing to 5.5% in 2023 and 2.8% in 2024. Prospects for medium-term economic recovery keep inflation from decelerating further. A risk to the inflation forecast is the vulnerability of Timor-Leste to

climate change, in that extreme weather and disasters could drive up food prices.

The current account is projected to fall into a significant deficit starting in 2023. Trade in goods will record a substantial deficit with a decline in oil revenue and growth in imports as consumption increases. Coffee exports are expected to grow steadily, barring a slowdown in the US or the European Union.

Risks to the outlook tilt to the downside. Timor-Leste depends heavily on exports of petroleum products and food imports, making it highly exposed to global economic developments and worsening geopolitical tensions. Climate-related disasters pose a risk to growth as well as to inflation forecasts.

Policy Challenge—Investing in Skills for the Next Generation

Human capital development is essential to Timor-Leste's economic transformation toward sustainable, resilient development. A vital aspect of human capital development is the improvement of skills and productivity. As economies accumulate more physical and human capital, the focus shifts to pursuits with more potential for positive productivity spillover, such as higher education and advanced infrastructure. Historic trends in Timor-Leste's total factor productivity have been more erratic than in other Southeast Asian countries, with the results generally lower than for its peers. Few jobs are available in either the public or private sector, and the labor market is further weakened by low productivity and a mismatch between skill supply and demand. Strengthening the environment for skill development and the labor market would enable Timor-Leste to capitalize on its young population and realize a demographic dividend.

Timor-Leste has one of the youngest populations in the world, with a median age of 20.8. With 37% of the population younger than 15 years old, the country's currently high dependency ratio—69.3% in 2021—is projected to fall but then rise again by 2050 as the population ages. Meanwhile, unemployment among young workers aged 15–24 is 32.9%, significantly higher than the national average of 5.3%. The private sector should play a bigger role in creating jobs, but

its development is hindered by several impediments, notably poor access to finance and the skill mismatch in the labor market. To achieve higher human capital development, the government plans investments to fill gaps in infrastructure and ensure a healthy, adequately educated, and productive young population.

Several indicators of education participation have improved. Timor-Leste moved closer to achieving 100% primary school enrollment as the attendance rate rose from 65% in 2001 to an estimated 92% in 2019 across genders. Net enrollment in secondary education increased from 28.8% in 2015 to 42.8% in 2019, albeit below the 60% target in the National Education Strategic Plan.

The government has identified investment in education as a key pillar of the country's post-pandemic recovery. An important component of this plan is to strengthen and expand technical and vocational education and training (TVET) to make the workforce more employable and productive. So far, TVET has had little impact on the job market because of its informal nature, the low number of training

programs and centers in operation, and enrolment in secondary TVET languishing below target. The government recognizes that, alongside higher-quality of primary and secondary education, enhanced TVET programs would build human capital and create jobs.

In 2022, the government conducted a review of its TVET Plan, 2011–2030. The plan is intended to complement the current Education Sector Plan, 2020–2024 and the National Strategic Education Plan, 2011–2030. Reform of the TVET framework will include piloting education clusters by strategically selecting schools to upgrade and link them with relevant industries; realigning the curriculum by introducing more comprehensive core elective subjects to provide students with broader skill sets upon graduation; building a unified certification system; diversifying post-TVET opportunities and strengthening the link between vocational training and the labor market; training school personnel by undertaking a needs-assessment to identify specific areas of capacity development required for instructors; and employing technologies that will innovate tools and techniques for learning and teaching.

VIET NAM

Economic recovery was impressive in 2022, supported by exports, robust foreign direct investment, and rebounding domestic consumption. The pandemic nevertheless exposed structural issues that are among the main downside risks to the economy. Growth is forecast to moderate in the coming 2 years, and inflation is expected to edge up. A particular challenge is managing problems that have built up in the financial sector, including a proliferation in nonperforming loans.

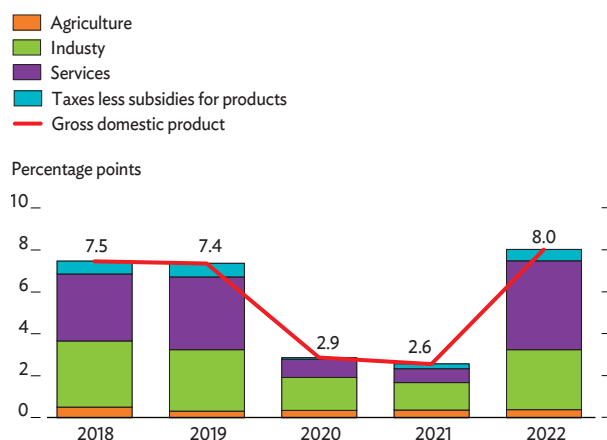
Economic Performance

The removal of COVID-19 restrictions and the achievement of nationwide vaccine coverage boosted growth, particularly in services. In 2022, real GDP increased by 8.0%, the fastest pace in the past 25 years. Normalized mobility spurred domestic tourism, lifting service sector growth from 1.6% a year earlier to 10% and contributing 4.2 percentage points to growth (Figure 2.32.1).

Other sectors grew robustly as well. Industry and construction growth accelerated from 3.6% in 2021 to 7.8%, boosted by 8.1% expansion in manufacturing and a rebound by mining from 7.8% contraction in 2021 to 5.2% growth. Construction similarly rebounded, from 0.3% contraction a year earlier to 8.2% growth, as mobility restrictions were lifted. Agriculture sustained strong growth at 3.4%.

Figure 2.32.1 Supply-Side Contributions to Growth

All sectors performed strongly in 2022, particularly services.



Source: General Statistics Office.

On the demand side, consumption and investment grew faster. Domestic demand was buoyed by recovery in private consumption growth, which jumped from 2.0% in 2021 to 7.8%. Retail sales of consumer goods and services in 2022 soared by 19.8% over the previous year. Gross investment growth picked up from 4.0% a year earlier to 5.8%, driven by a 13.5% increase in foreign direct investment (FDI) disbursement estimated at \$22.4 billion. This was the highest FDI disbursement ever in Viet Nam, testifying to foreign investors' confidence in economic recovery. Newly registered FDI, on the other hand, dropped by 11%, an effect of geopolitical tensions and tightened global financial conditions.

Inflation rose in 2022, notwithstanding factors limiting the uptick.

Self-sufficiency in food supply and effective price controls on essential commodities kept inflation in check at 3.2% in 2022, albeit up from 1.8% in 2021 (Figure 2.32.2). Core inflation inched up to 2.6%.

The increase in inflation was further checked by monetary policy.

Viet Nam raised key interest rates twice by a total of 200 basis points in the second half of 2022, widening the exchange rate trading band for the Viet Nam dong against the US dollar from $\pm 3\%$ to $\pm 5\%$, with effect from 17 October 2022, and expanding credit growth from 13.6% in 2021 to an estimated 14.2%. A flexible monetary policy in Viet Nam that combines policy interest rate changes, foreign exchange intervention, and control of credit growth cushioned impacts from external shocks, including a sharp US dollar appreciation and global price inflation. Money supply growth moderated from 10.7% in 2021 to an estimated 6.2% (Figure 2.32.3).

Domestic financial markets came under pressure.

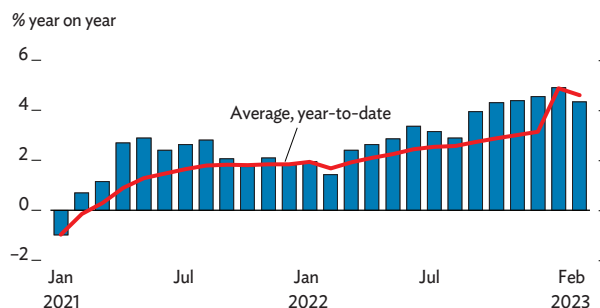
Irregularities in corporate bond and equity markets prompted further regulatory tightening of the capital markets, which created a liquidity crunch in the third quarter that eroded investors' confidence. Average interbank interest rates were 3.5–5.0 percentage points higher in the first 2 months of 2023 than a year earlier (Figure 2.32.4).

Resilient neighboring economies bolstered Viet Nam's exports and partly compensated for lower exports to the advanced economies.

Economies in the Association of Southeast Asian Nations (ASEAN) were in aggregate the fourth largest export market for Viet Nam's products in 2022. Higher global demand and a depreciating dong spurred merchandise export growth to 10.5%. Exports of mobile phones, computers, and electronics, accounting for 30% of all exports, rose by 5%, and exports of machinery by 20%. The US remained Viet Nam's biggest export market with turnover of \$109.4 billion, a 13% increase over the previous year and accounting for 29.4% of exports by value. Higher high-tech exports stimulated imports of parts and components for computers, phones, and other electronics, expanding merchandise imports by 8.3%. However, an appreciating US dollar and the zero-COVID closure of the People's Republic of China (PRC), Viet Nam's main import market, hindered imports.

Figure 2.32.2 Monthly Inflation

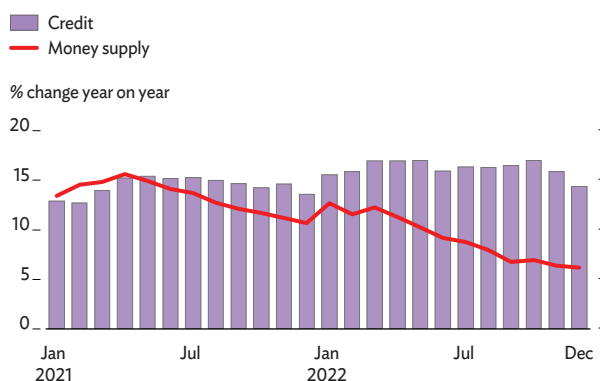
Inflation has accelerated since early 2021.



Sources: General Statistics Office; Haver Analytics.

Figure 2.32.3 Credit and Money Supply Growth

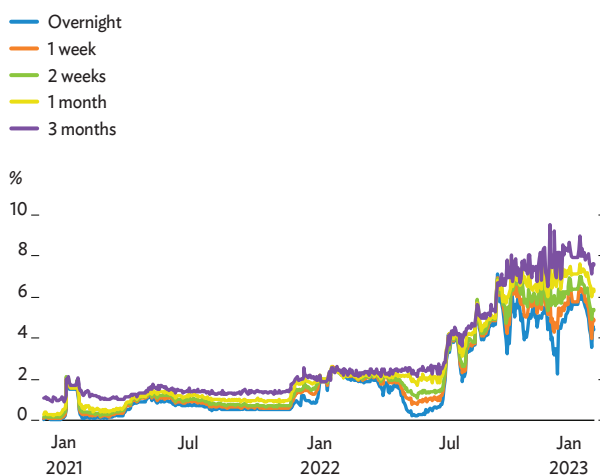
Money supply growth slowed last year, but credit growth was maintained.



Sources: State Bank of Viet Nam; Asian Development Bank estimates.

Figure 2.32.4 Interbank Interest Rates

Average interbank interest rates rose for all tenors.

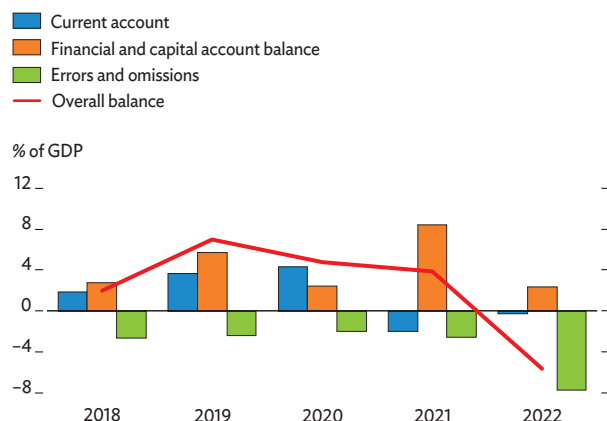


Source: CEIC Data Company.

The current account deficit narrowed from the equivalent of 2.0% of GDP in 2021 to an estimated 0.3%, but the overall balance of payments still worsened. The merchandise trade surplus was an estimated 6.4% of GDP, and this partly offset a sharp decline in net receipts from services and lower remittances as global economic conditions deteriorated. Reduced inflows shrank the surplus in the financial and capital account from 8.4% of GDP in 2021 to 2.4%. A drop this big in the financial and capital account surplus overwhelmed the narrower current account deficit to flip the overall balance of payments from a surplus equal to 3.9% of GDP in 2021 into a deficit estimated at 5.6% in 2022 (Figure 2.32.5). At the end of December 2022, foreign reserves were estimated to cover 2.8 months of imports, down from 3.9 months a year earlier.

Figure 2.32.5 Balance of Payments Indicators

The overall balance of payments fell into deficit last year.



GDP = gross domestic product.

Sources: State Bank of Viet Nam; Asian Development Bank estimates.

The fiscal deficit widened slightly. Increased fiscal receipts from trade expansion and improved domestic revenue collection lifted government revenue by 18.2% in 2022. Higher oil prices helped to increase oil revenue by 93.2%. Expenditure increased by 19.1%, with capital expenditure up by 35.4%. However, public investment disbursement still lagged behind the annual plan. The budget deficit widened from the equivalent of 4.1% of GDP in 2021 to an estimated 4.4% last year.

Economic Prospects

Growth will be constrained in 2023 by the global slowdown, continued monetary tightening, and spillover from the Russian invasion of Ukraine.

However, the reopening of the PRC will counter these headwinds, and the economy is forecast to grow by 6.5% in 2023 and 6.8% in 2024 (Table 2.32.1 and Figure 2.32.6).

Table 2.32.1 Selected Economic Indicators, %

Growth will moderate, and inflation will rise.

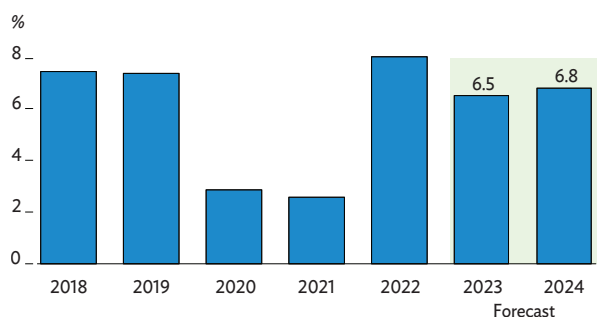
	2021	2022	2023	2024
GDP growth	2.6	8.0	6.5	6.8
Inflation	1.8	3.2	4.5	4.2

GDP = gross domestic product.

Sources: General Statistics Office; Asian Development Bank estimates.

Figure 2.32.6 GDP Growth

The economy has recovered strongly from the pandemic.



GDP = gross domestic product.

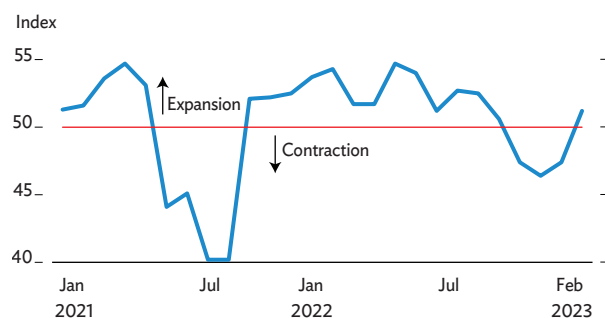
Sources: State Bank of Viet Nam; Asian Development Bank estimates.

Declining global demand has hit manufacturing.

The global economic slowdown deepened in the fourth quarter of 2022 and will likely continue in 2023. Falling global demand drove the industrial production index down by 6.3% in the first 2 months of 2023 relative to the same period in 2022. The manufacturing purchasing managers' index sank below 50 for 4 consecutive months as export-driven manufacturing contracted while consumption-led manufacturing was unable to take up the slack, then the index revived from 46.4 in January 2023 to 51.2 in February 2023 (Figure 2.32.7). Industry growth is forecast to slow to 7.5%

Figure 2.32.7 Purchasing Managers' Index

This leading indicator signaled a slowdown in late 2022 but recovered early this year.



Note: A purchasing managers' index <50 signals deterioration, >50 improvement.

Source: IHS Markit.

in 2023, contributing 2.7 percentage points to GDP growth. Construction could pick up, however, if major infrastructure projects can be implemented in 2023 as planned.

Services are expected to expand by 8.0% in 2023 on revived tourism and associated services. The PRC initially left Viet Nam off the list of the countries that could receive its outbound tourists. On 12 March 2023, though, a revised list added Viet Nam, allowing group tours from the PRC to Viet Nam to resume on 15 March. As the PRC is Viet Nam's largest tourist market, the country will benefit considerably from this development.

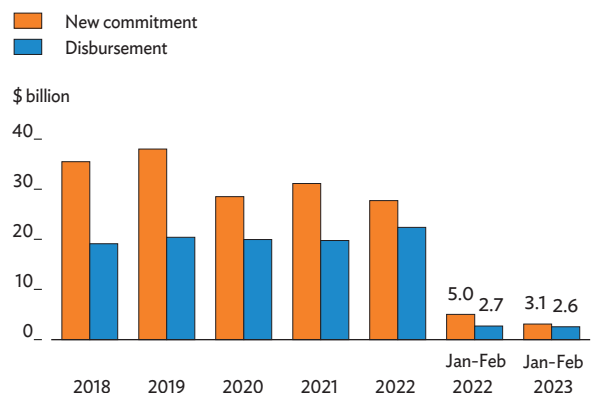
The PRC's reopening will also benefit agriculture.

The PRC could generate significant demand for Viet Nam agricultural exports, as the country receives 45% of Viet Nam's exports of fruit and vegetables. Agriculture is therefore expected to expand by 3.2% in 2023.

Public investment will be the key driver for economic recovery and growth in 2023. A considerable amount of public investment is scheduled to be disbursed in 2023. The government is committed to disbursing \$30.0 billion in the year, of which 90% had been allocated to disbursing ministries and provinces as of January 2023. Foreign investment, however, will still be hampered by the global economic slowdown. Newly registered and disbursed FDI fell by 38% and then 4.9% year on year in the first 2 months of 2023 (Figure 2.32.8). The fiscal deficit in 2023 could exceed

Figure 2.32.8 Foreign Direct Investment

Slowing global growth forced down foreign direct investment in the first 2 months of 2023.



Sources: General Statistics Office; Haver Analytics.

the deficit target, which is 4.4% of GDP. In the future, Viet Nam should continue reform to make its finances more sustainable, significantly reducing dependence on unsustainable revenue sources such as land and oil.

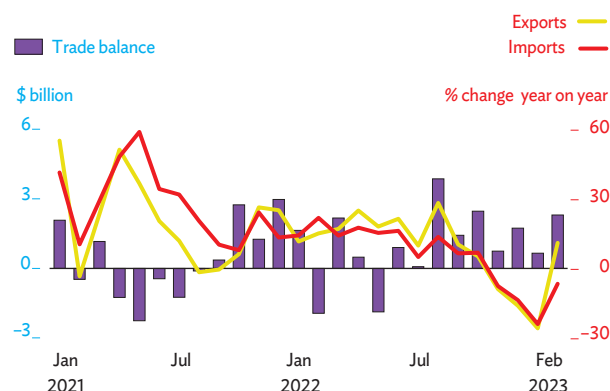
On the demand side, domestic consumption will continue to rebound in 2023. Revived tourism, new public investment and stimulus programs initiated in January 2022, and a salary increase effective in July 2023 are expected to keep domestic consumption on the rise, though higher inflation may hamper its recovery. Retail revenue in the first 2 months of 2023 was, however, 24.9% higher than in the same period of pre-pandemic 2019, albeit partly reflecting the Lunar New Year holiday.

Weakening global demand will continue to dampen trade in 2023. Exports in the first 2 months of 2023 decreased by 10.4% year on year, while imports dropped by 16.0% (Figure 2.32.9). Both imports and exports are forecast to shrink by 7.0% this year and next. Slowing trade could create a current account deficit that equals 1.0% of GDP this year before moving back into surplus in 2024.

Surprise policy rate cuts make Viet Nam the first economy in Southeast Asia to ease monetary policy. The State Bank of Vietnam, the central bank, acted because stressed capital markets had caused a credit crunch for real estate and hit investor confidence. Meanwhile, slightly lower inflation and recent banking turmoil in the US were seen to motivate the Federal Reserve there to temper its hawkish

Figure 2.32.9 Trade Growth

Trade declined strikingly last year and has continued to slow this year.



Sources: General Statistics Office; Haver Analytics.

monetary tightening, potentially easing cost-push inflation abroad. At the same time, pressure was mounting for action to maintain economic growth in Viet Nam as the global economy stalled. These factors prompted the government to instruct the central bank on 7 March to act to support liquidity and economic recovery. The central bank cut the discount rate from 4.5% to 3.5%, the overnight rate for interbank electronic payments and clearing through the central bank from 7.0% to 6.0%, and the interest rate cap on short-term dong loans to priority sectors from 5.5% to 5.0%—all cuts effective on 15 March. The central bank kept the refinancing rate unchanged at 6.0%.

External risks to the forecast skew to the downside.

The principal external downside risks are a deeper global economic slowdown, continued monetary tightening in major trade partners, and escalation in the Russian invasion of Ukraine.

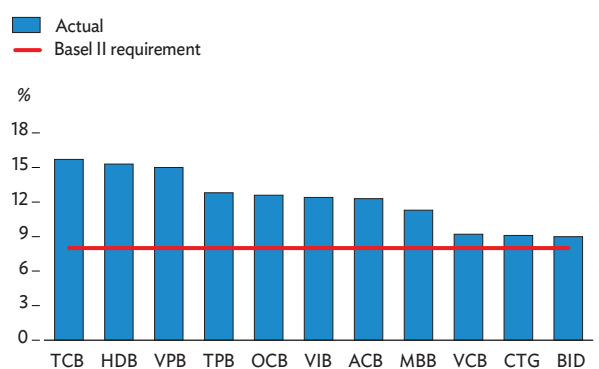
Policy Challenge—Managing Financial and Capital Market Stress

Financial markets were turbulent last year, raising risk. Financial fraud hit the corporate bond market in 2022, causing bond issuance in the fourth quarter to plunge by 98.8% from a year earlier. Bond repayment due in 2023 is estimated at \$10 billion, of which 42.8% will be from real estate and 30.8% from banks. As banks are resilient, market turbulence has not yet

caused serious systemic risks. The capital adequacy ratio against risk-weighted assets is still above 8%, as Basel II requires (Figure 2.32.10). Banks' financial statements were still positive in the fourth quarter of 2022. Yet risks are becoming evident. Bank credit to real estate in 2022 grew by 24%, its highest growth rate in the past 5 years. Gross nonperforming loans reached 4.5% in 2022 from 3.8% in 2021 and may continue to increase. Further risk of contagion may come from banks' exposure to real estate and construction and a high ratio of property in the collateral held by banks. Many banks' ratio of loans to deposits breached the 85% threshold.

Figure 2.32.10 Capital Adequacy Ratio of Selected Banks, Third Quarter of 2022

The capital adequacy ratio is still above 8%, as required by Basel II.



ACB = Asia Commercial Joint Stock Bank, BID = Joint Stock Commercial Bank for Investment and Development of Viet Nam, CTG = Vietnam Joint Stock Commercial Bank for Industry and Trade, HDB = Ho Chi Minh City Development Joint Stock Commercial Bank, MBB = Military Commercial Joint Stock Bank, OCB = Orient Commercial Joint Stock Bank, TCB = Viet Nam Technological and Commercial Joint Stock Bank, TPB = Tien Phong Commercial Joint Stock Bank, VCB = Joint Stock Commercial Bank for Foreign Trade of Vietnam, VIB = Viet Nam International Bank, VPB = Vietnam Prosperity Joint Stock Commercial Bank.

Source: Fiingroup.

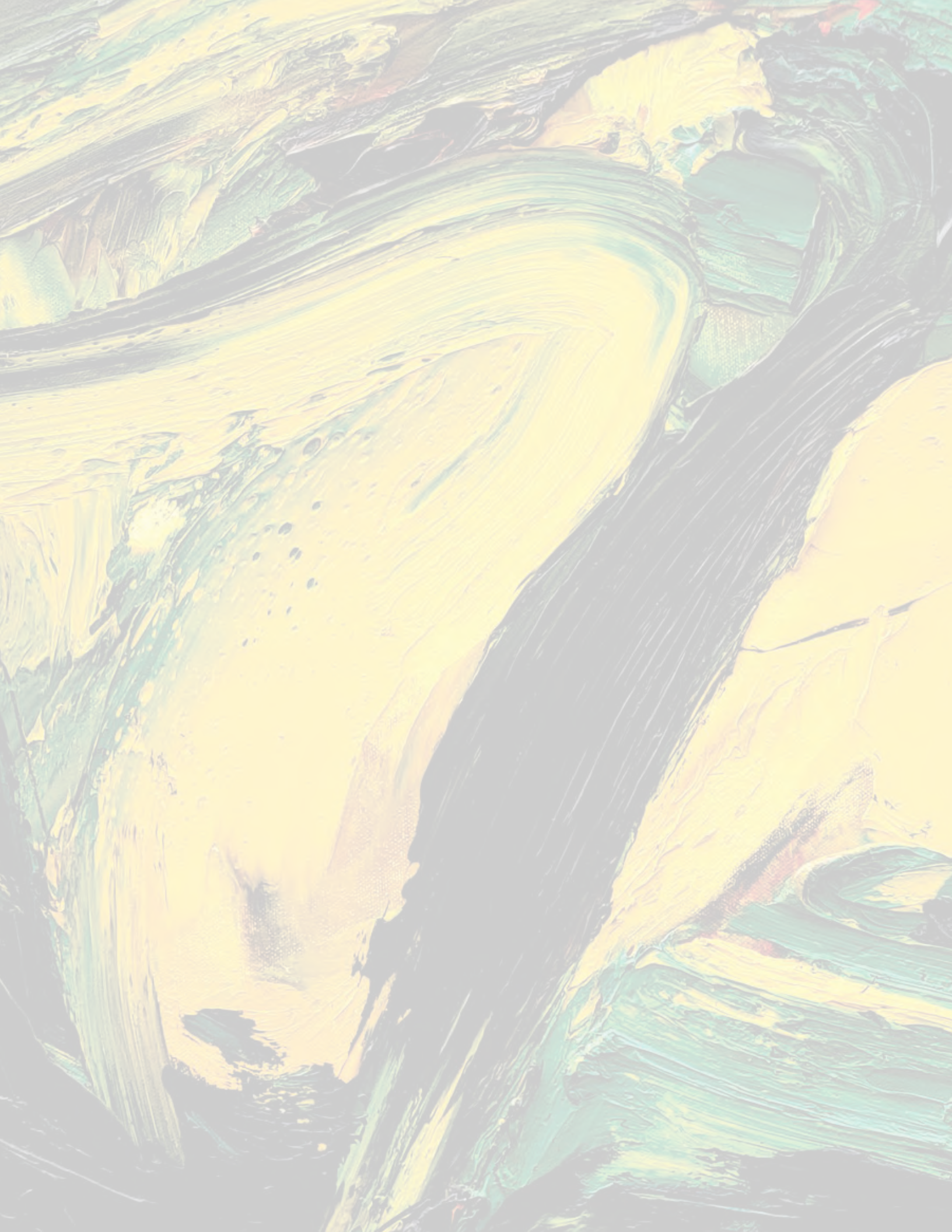
The government responded quickly to worsening market conditions. Decree 65 was passed swiftly in the third quarter of 2022 to strengthen governance in the corporate bond market. However, it did not improve market sentiment, and investors abruptly paused their corporate bond purchases because of doubts about bond repayment. The government then deferred for 1 year compliance with regulatory requirements for corporate bond issuance, including the mandatory credit rating for private bond placement. The government issued another decree on 5 March

2023 to allow bond interest and principal to be paid not just in cash but also using physical and other assets. This raised doubts about enforcement as many of the troubled physical assets have no legal status for valuation. Further, the central bank included time deposits of the State Treasury into banks' deposits to improve the ratio of loans to deposits and expand bank credit space. On 17 February 2023, the State Bank of Viet Nam proposed a credit program worth \$5 billion for social housing to be implemented by four state-owned commercial banks.

Monetary and fiscal measures should continue to be coordinated to support the economy.

The issuance of Decree 65 was timely, and its implementation should be resumed as delays may worsen future bad debts. The implementation of a social housing program should balance the need for

prudent lending to avoid future nonperforming loans with the need to speed up disbursement. A more accommodative monetary stance notwithstanding, Viet Nam should continue to prioritize price stability because escalating geopolitical tensions and accelerating disbursement of public investment may still stoke inflation in 2023. Average inflation in the first 2 months of 2023 rose from 1.7% a year earlier to 4.6%. Inflation is therefore forecast to increase slightly to 4.5% in 2023. Finally, it is critical to accelerate the disbursement of \$30 billion in public investment. Along with the continued implementation of the stimulus program endorsed in January 2022, this spending will generate substantial multiplier effects, creating strong motivation for the whole economy. In the long term, financial reform should continue, to reduce dependence on bank finance and enhance transparency in bond markets.





THE PACIFIC

Fiji

Papua New Guinea

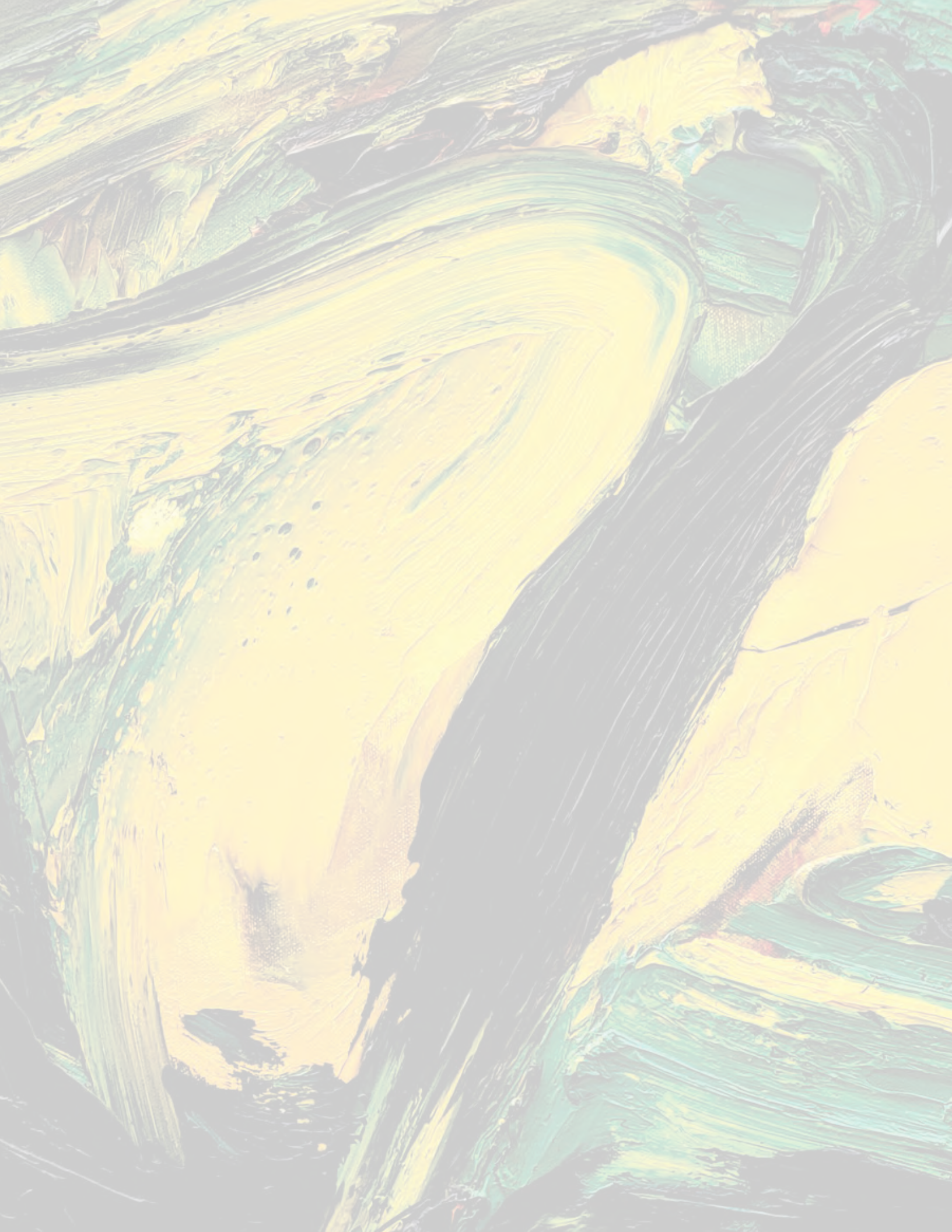
Solomon Islands

Vanuatu

Central Pacific economies

North Pacific economies

South Pacific economies



FIJI

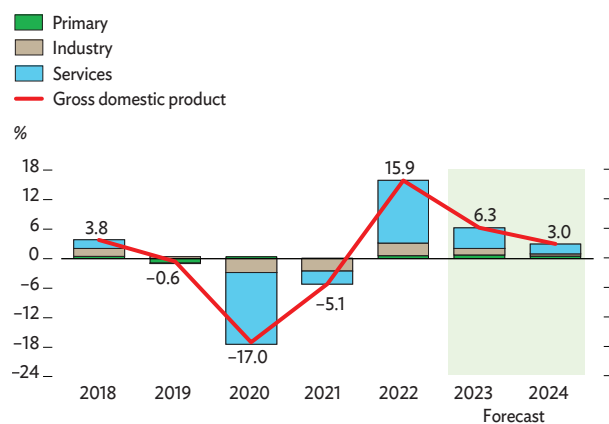
Tourism led strong recovery in 2022. While arrivals were only 71% of pre-pandemic levels, visitors stayed longer and spent more. Positive effects spilled over into transport and wholesale and retail trade. Credit from commercial banks increased as confidence strengthened. Remittances reached record levels. Revenue increased, but higher debt stock will likely constrain fiscal space. Inflation accelerated in tandem with commodity price trends and domestic demand. Economic expansion is projected to moderate from 2023 as brain drain drags on growth.

Economic Performance

Tourism rebound supported economic recovery in 2022. The reopening of international borders at the end of 2021 revived tourism and contributed to 15.9% GDP growth in 2022. Services contributed 12.8 percentage points to growth as tourism rebounded, lifting complementary services such as wholesale and retail trade and transportation (Figure 2.33.1). Higher sugar and cement production underpinned growth in industry, and growth was noted as well in niche agriculture.

Figure 2.33.1 GDP Growth

Tourism recovery drove economic growth.



GDP = gross domestic product.

Sources: Fiji Bureau of Statistics; Asian Development Bank estimates.

Visitor arrivals recovered and guests spent more.

Visitor arrivals from Australia in 2022 reached 94% of their numbers in 2019, with December recording Fiji's highest monthly arrivals ever. Meanwhile, arrivals from New Zealand and North America were more than two-thirds of their 2019 number (Figure 2.33.2). Surveys found visitors spending more daily and staying longer than in 2019. On average, Australian visitors spent 20% more from April to August 2022 than in the same period in 2019, while spending by American visitors was 18% higher. More than 80% of visitors to Fiji were there for leisure or holiday, with visiting friends and relatives at 10% and business travel at 2%.

Consumption increased with support from higher incomes.

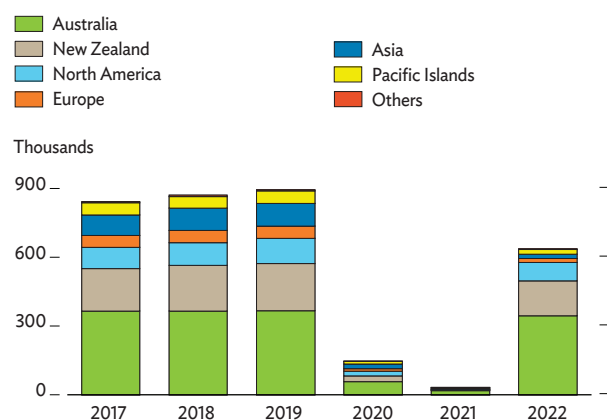
Inward remittances surpassed F\$1 billion for the first time as they increased by 23% in 2022. This has translated to higher consumption, with value-added tax collection rising by 84% and vehicle sales by 24%. Personal income tax increased by 17%, and new consumer loans were 32% higher. Increases in cement sales and investment lending suggest higher investment in 2022.

The fiscal deficit widened in 2022 on higher spending.

The shortfall reached the equivalent of 12.2% of GDP in fiscal year 2022 (FY2022, ended 31 July 2022). Expenditure increased by 7%, mostly to

Figure 2.33.2 Visitor Arrivals

Arrivals recorded a strong rebound but remained below pre-pandemic levels.



Source: Fiji Bureau of Statistics.

fund pandemic relief measures, but revenue remained largely unchanged from a year earlier. This translated into higher national debt, which rose to an equivalent of 91.1% of GDP (Figure 2.33.3). Personnel costs remained stable as the government tightened control over civil service wages, froze recruitment, and implemented other cost-cutting measures.

The government managed to reduce the cost of its external debt. It did so in part by accessing concessional financing with longer repayment periods from multilateral and bilateral partners. Apart from 2021, when Fiji had to pay back the whole principal on a maturing global bond, external debt repayment has been below 4% of government revenue and domestic debt repayment below 20% of government revenue (Figure 2.33.4).

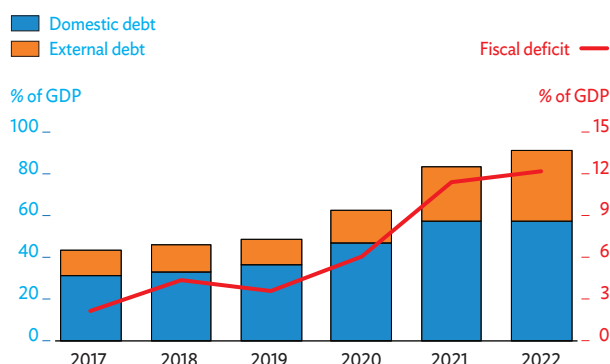
The financial sector has made strides toward recovery from the impact of COVID-19. Commercial bank liquidity increased in line with high foreign currency reserves, keeping the lending rate on a downward trend. Private sector credit grew for the first time since 2019, by 7%.

Inflation surged in 2022, reflecting the impact of the Russian invasion of Ukraine on global prices.

The consumer price index jumped by 4.3% in 2022 compared with 0.2% in 2021. High oil prices raised transport prices by 17.8% and supply constraints raised food prices by 6.1% (Figure 2.33.5).

Figure 2.33.3 Fiscal Deficit and Public Debt

Countercyclical measures drove up the fiscal deficit.



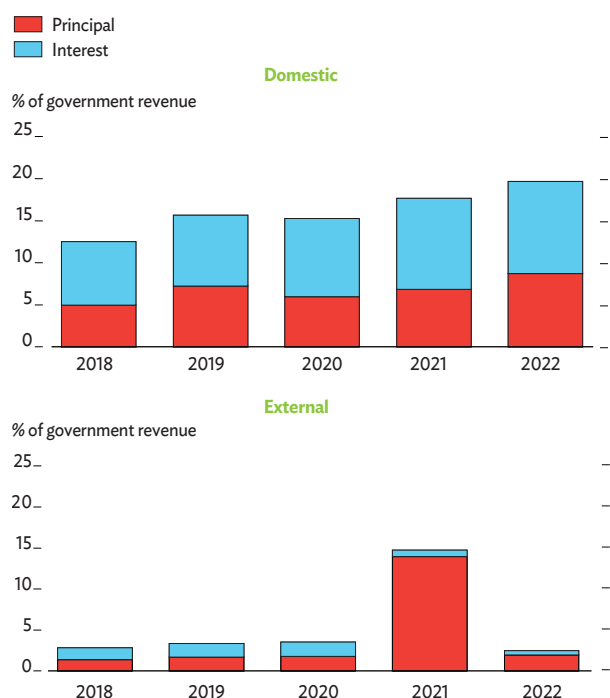
GDP = gross domestic product.

Note: Years are fiscal years ending 31 July of that year.

Sources: Fiji Ministry of Finance; Reserve Bank of Fiji.

Figure 2.33.4 Debt Repayments

Longer repayment periods helped the government reduce its external debt cost.



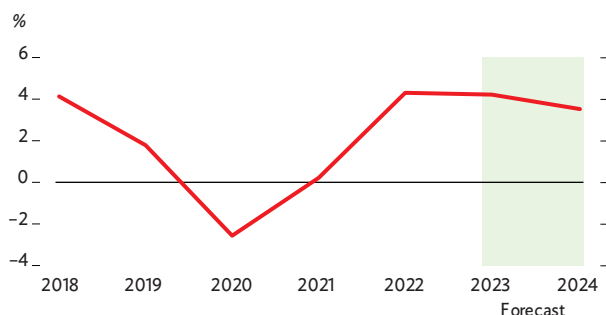
Note: Years are fiscal years ending 31 July of that year.

Sources: Fiji Ministry of Finance; Reserve Bank of Fiji.

The current account deficit widened despite recovery in tourism. While remittances and tourism earnings increased, high demand for imports and elevated commodity prices for most of the year offset these gains, increasing the current account deficit to the equivalent of 12.5% of GDP.

Figure 2.33.5 Inflation

High fuel prices pushed up inflation overall.



Sources: Fiji Bureau of Statistics; Asian Development Bank estimates.

Economic Prospects

GDP growth is projected to moderate to 6.3% in 2023 and 3.0% in 2024 (Table 2.33.1). The economy is expected to return to pre-pandemic activity by 2024, with tourism as the main driver of growth. Primary sector exports such as timber and niche agricultural produce are also expected to grow as foreign demand improves, and business process outsourcing is likely to expand further in line with growing demand. However, the sustainability of the economic rebound may be tested by increased emigration of skilled workers.

Table 2.33.1 Selected Economic Indicators, %

Growth is expected to moderate as the economy stabilizes following a post-pandemic rebound.

	2021	2022	2023	2024
GDP growth	-5.1	15.9	6.3	3.0
Inflation	0.2	4.3	4.2	3.5

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Fiji will face intense competition from other tourist destinations as travel normalizes. While Fiji relies heavily on Australian arrivals, this dependence is one-sided, as the destination normally welcomes only about 3% of Australian outbound travelers. It will have to compete with other destinations such as Bali (Indonesia) and Thailand. Fiji aims to increase arrivals from North America, with the national airline aiming to expand direct flight connections beyond Los Angeles and San Francisco, as well as continue to fly the

Vancouver route it launched in November 2022. Direct flights from Tokyo’s Narita airport are scheduled to resume in April 2023. For the new routes, the national airline is expected to add two A350s this year to its current fleet. Before the pandemic, North Americans and Europeans normally stayed longer and spent more than visitors from other markets.

Inflation is projected to subside to 4.2% in 2023 and 3.5% in 2024, in line with easing global commodity prices. While prices for selected items such as onions are currently elevated in Fiji, price movements are projected to remain restrained, reflecting movements in international prices and falling inflation in major economies.

Favorable terms of trade are likely to narrow the current account deficit to 12.2% of GDP in 2023 and 11.8% in 2024. A lower trade deficit as commodity prices decline and tourism earnings rise is expected to reduce the current account deficit even as remittances moderate.

Fiji’s fiscal position is expected to improve over the forecast horizon. The government projects a lower fiscal deficit, equal to 7.4% of GDP in FY2023 and 4.5% in FY2024. Revenue will likely remain below pre-pandemic levels for some time with the continuation of structural tax reduction instituted in response to COVID-19. While the government restrains additional expenditure, tighter fiscal space is likely to bring the ratio of debt to GDP down to about 83% by FY2024.

Policy Challenge—Reducing Brain Drain to Sustain Recovery

As Fiji recovers from the pandemic, steadily increasing emigration of skilled labor poses a challenge. As of mid-2019, more than 222,000 Fiji-born people, equal to a quarter of the population of Fiji, resided abroad, 95% of them in Australia, Canada, New Zealand, or the US. In 2022, more citizens of Fiji departed for emigration and employment in Australia and the US than in any year since 2016. While emigration boosted remittances, which play a critical role in stabilizing Fiji’s external position and providing a safety net to Fijians, consequent brain drain exacerbates skill gaps and is an emerging concern.

Fiji's access to labor mobility schemes in Australia and New Zealand has increased the emigration of skilled labor.

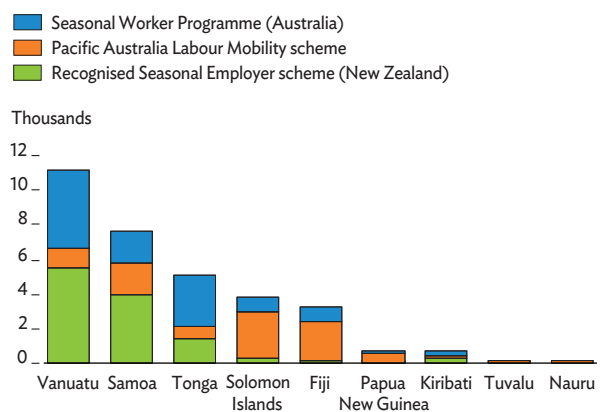
Of 34,400 Pacific workers employed in a labor scheme in either Australia or New Zealand in mid-2022, about 3,300 were from Fiji (Figure 2.33.6). Recent migrants from many Pacific developing member countries have tended to be more skilled than in the past. The pace of emigration from Fiji has left many businesses understaffed, especially as many emigrants leave on short notice after having secured work visas. Emigration has affected in particular restaurants with an exodus of chefs and serving staff, health-care providers with the resignation of 800 nurses last year, and tourism businesses, which lost 16,000 workers to emigration last year. The ramping up of overseas recruitment has coincided with Fiji's reopening and recovery, when it can least afford to be short of labor.

In the short term, training can strengthen labor market mobility and resilience.

Continuous training of workers should be integral to business strategy to ensure continuity of operations. Training and apprenticeship programs can match skills with ever-changing labor market needs, thereby improving the chances of labor market reintegration and responding to immediate labor shortage concerns. Over the long term, responsibility to train workers can extend beyond businesses and may involve the governments of both source and recipient countries. Governments should consider how to collaborate to train labor migrants and their replacements in the source countries. Education and training policies and systems must align with labor market demand in growth sectors and occupations.

Figure 2.33.6 Workers from Pacific Developing Member Countries in Australia or New Zealand, mid-2022

Most of the skilled laborers who migrated out of Fiji are employed in Australia.



Source: Howes, S., R. Curtain, and E. Sharman. 2022. *Labour Mobility in the Pacific: Transformational and/or Negligible?* *Devpolicy Blog*.

The government response over the longer term should complement and sustain gains from short-term solutions. Longer-term solutions include responsive skilling programs and enabling policies that reduce the likelihood of labor shortages and migration issues recurring. Emigration must be addressed to sustain Fiji's economic recovery. The targeted labor market strategies discussed above must be complemented by closer coordination and collaboration among stakeholders to ensure a seamless and effective response.

PAPUA NEW GUINEA

Growth rebounded in 2022 on normalizing economic activity, higher resource output, and commodity price spikes triggered by the Russian invasion of Ukraine. Recovery is forecast to continue at a moderate pace in 2023 and 2024, supported by expansion of the non-resource sector. Petroleum and gas output will likely contract, narrowing the current account surplus. Inflation is forecast to subside in line with global trends. Operationalizing the sovereign wealth fund would strengthen resource revenue management and macroeconomic stability.

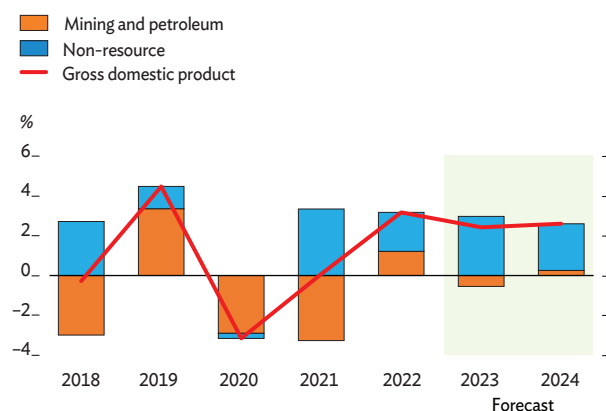
Economic Performance

GDP grew by an estimated 3.2% in 2022

(Figure 2.34.1). Economic activity in Papua New Guinea (PNG) normalized across sectors following the impact of COVID-19. There were no additional surges of COVID-19 cases or national lockdowns in 2022, even though by the end of the year only about 3% of the population was fully vaccinated. This is the lowest vaccination rate in developing Asia. As of 28 February 2023, 46,809 cases of COVID-19 and 670 deaths had been reported, though the actual numbers were probably substantially higher.

Figure 2.34.1 Gross Domestic Product Growth

Growth recovered in 2022 on normalizing economic activity.



Source: Asian Development Bank estimates using data from Papua New Guinea National Statistical Office.

The resource sector expanded by an estimated 4.6% in 2022.

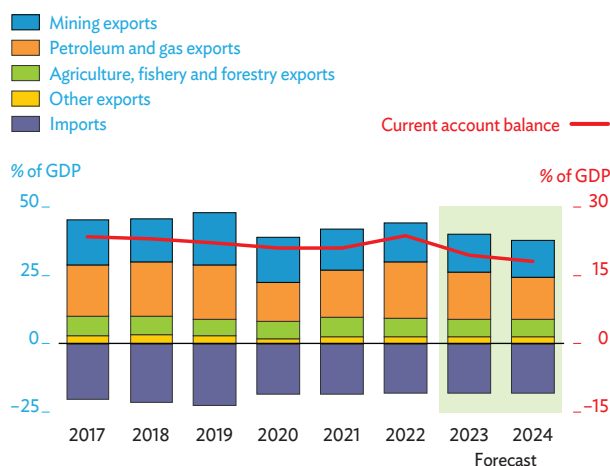
This was driven by higher output in mining and liquefied natural gas (LNG) production, as well as commodity price spikes following the Russian invasion of Ukraine. Gold production increased in the Lihir and Ok Tedi mines, while the PNG LNG project produced above its nameplate capacity, or nominal registered output, of 8.3 million tons per year. The PNG economy benefited from higher foreign exchange (forex) inflows and an easing of forex restrictions that have persisted to varying degrees since 2015 to prop up an overvalued PNG kina. Spending related to the 2022 general election also provided stimulus. However, growth was hindered by the ongoing closure of the Porgera gold mine since April 2020. Unresolved negotiations between operator Barrick Niugini Limited and the government, in part over a tax dispute, have delayed its reopening. In the rest of the economy, global supply chain disruption delayed deliveries, lifted production costs, and deferred investment.

The current account surplus widened from the equivalent of 21.0% of GDP in 2021 to an estimated 23.7% in 2022

(Figure 2.34.2). This was a result of the rebound in mining and LNG output, as well as a surge in crude oil and LNG prices. Imports were still suppressed by forex restrictions and global supply chain disruption. But much of the current account surplus was offset by financial outflows associated with initial PNG LNG investments.

Figure 2.34.2 Current Account Balance

The current account surplus is expected to narrow as liquefied natural gas exports decline.



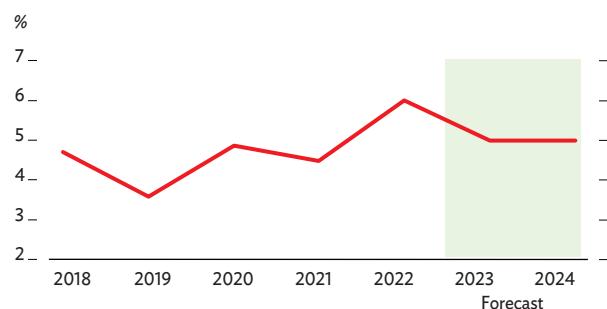
GDP = gross domestic product.

Sources: Bank of Papua New Guinea; Asian Development Bank estimates.

Inflation accelerated from 4.5% in 2021 to an estimated 6.0% in 2022 (Figure 2.34.3). Prices for food and nonalcoholic beverages rose by an estimated 7.2% in 2022, transportation by 12.5%, and household appliances by 10.6%. To cushion households against inflation, the government introduced tax exemptions for retail fuel and increased the tax-free threshold on salaries from K12,500 to K17,500.

Figure 2.34.3 Inflation

Inflationary pressures are forecast to ease, but inflationary risks remain.



Sources: Papua New Guinea National Statistical Office; Papua New Guinea Department of Treasury; and Asian Development Bank estimates.

A supplementary budget passed in September 2022 estimated the fiscal deficit at the equivalent of 5.6% of GDP. This was broadly in line with the original budget, maintaining a decline from 6.8% of GDP in 2021. The increase in both operational and capital expenditure was partially offset by a resource revenue windfall. Public debt rose to equal 50.2% of GDP.

Economic Prospects

Growth is forecast at 2.4% in 2023 and 2.6% in 2024 with a mixed outlook across sectors (Table 2.34.1). Growth will be supported primarily by ongoing recovery outside of the resource sector. It will be led by agriculture, forestry, and fishing, projected to expand by 3.0% this year, information and communication by 8.0%, and trade by 4.5%. Accommodation and food services, transportation, and real estate are among the other businesses likely to benefit from increased international travel, supply chain recovery, and fiscal stimulus through investment spending.

Table 2.34.1 Selected Economic Indicators, %

Recovery will continue at a moderate pace as inflation subsides in 2023 and 2024.

	2021	2022	2023	2024
GDP growth	0.1	3.2	2.4	2.6
Inflation	4.5	6.0	5.0	5.0

GDP = gross domestic product.

Source: Asian Development Bank estimates.

The resource sector, typically the PNG growth engine, is expected to contract by 2.0% this year.

The reason is a 6.0% drop in output of petroleum and gas as the PNG LNG project operator envisages production below nameplate capacity. This is somewhat offset by a 7.0% increase in mining as the Ok Tedi mine accesses higher-grade ore. The Porgera gold mine is removed from the baseline forecast because there is no clear indication of startup operations materializing. In 2024, resource sector growth will be lackluster as PNG LNG production is expected to remain below its nameplate capacity.

Forex restrictions are likely to continue, weighing down the economy. The forex situation has been tightening in early 2023, with increases in average processing time for forex orders and a backlog on commercial banks' order books. The forex situation has also affected fuel supplies. In January, all domestic flights were suspended for 2 days because of a fuel shortage. In February, fuel rationing by Puma Energy closed many service stations and generated long queues outside others.

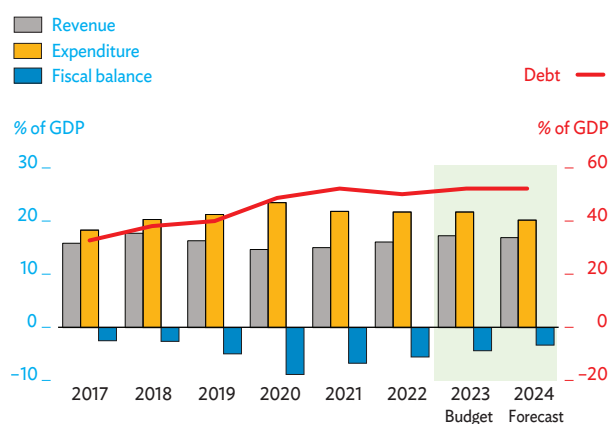
Inflation is forecast to moderate to 5.0% in both 2023 and 2024. The main reasons for inflation to ease are lower commodity prices, the gradual resolution of global supply chain issues, and generally decelerating world inflation, particularly in the US. A potential upside risk to the inflation outlook is currency depreciation, considered in light of persistent kina overvaluation. Another is any escalation of the Russian invasion of Ukraine.

The current account surplus is projected to narrow to the equivalent of 19.5% of GDP in 2023 and 18.0% in 2024. Even as LNG exports decline, supply chain recovery and the pick-up in activity aside from resources are likely to spur higher demand for imports. It remains to be seen whether the Bank of Papua New Guinea, the central bank, will release the reserves necessary to pay for additional imports.

The 2023 national budget forecasts fiscal deficits equal to 4.4% of GDP in 2023 and 3.3% in 2024 (Figure 2.34.4). Revenue including grants is projected to increase by K2.2 billion, or 1.9% of GDP, on higher goods and services tax, dividend payments, and the imposition of a 45% corporate income tax on commercial banks. On the expenditure side, the capital budget allocation is expected to increase by 0.7% of GDP and the operation budget allocation by 0.2%. The payroll bill is projected at 28% of total expenditure. Successful fiscal consolidation hinges on the government's ability to strengthen its revenue collection strategy and control spending. Executing the budget will continue to depend on support from multilateral and bilateral development partners. The Department of Treasury forecasts public debt rising to 52.3% of GDP in 2023 before stabilizing at 52.2% in 2024.

Figure 2.34.4 Fiscal Balance

Public debt is projected to stabilize in 2024 as fiscal deficits decline.



GDP = gross domestic product.

Source: Papua New Guinea Department of Treasury.

Risks to the growth outlook are considerable but tilt to the upside. Early reopening of the Porgera gold mine would add up to 2 percentage points to growth, but even in the most optimistic scenario this is unlikely before the end of 2023, given that negotiations continue and start-up operations would take time to be completed. Another upside risk is Papua LNG, a multibillion-dollar LNG project, going ahead. The final investment decision is planned for the end of 2023 or early 2024, possibly followed by 4 years of construction and the first gas production thereafter. A downside risk would be an unexpected tightening of forex restrictions stifling recovery, especially if fuel rationing recurs and drags on.

Policy Challenge—Operationalizing the Sovereign Wealth Fund

Sovereign wealth funds (SWFs) are important vehicles for managing volatile revenue from exhaustible resources. PNG legislated its SWF through the Organic Law on the Sovereign Wealth Fund, 2015. The law gives SWF objectives as (i) macroeconomic stabilization, (ii) inter-generational equity, and (iii) asset management through the establishment of a stabilization fund and a savings fund. However, these funds have never been operationalized, possibly because commodity prices and resource revenue were low in the years after the law was passed (Figure 2.34.5).

Last year’s revenue windfall of K4.2 billion, or K2.7 billion more than budgeted, highlighted the need to operationalize the SWF. Despite arrears, and perhaps because of high spending pressure on the newly elected government, the 2022 supplementary budget allocated this windfall to additional expenditure. According to the Organic Law, 50% of mining and petroleum tax revenue and 75% of dividends returned to the government must be deposited into the stabilization fund. Withdrawals are governed by a legislated formula that aims to smooth expenditure countercyclically. K2.1 billion should thus have been deposited into the stabilization fund last year and only about K800 million withdrawn, for net accumulation of K1.3 billion.

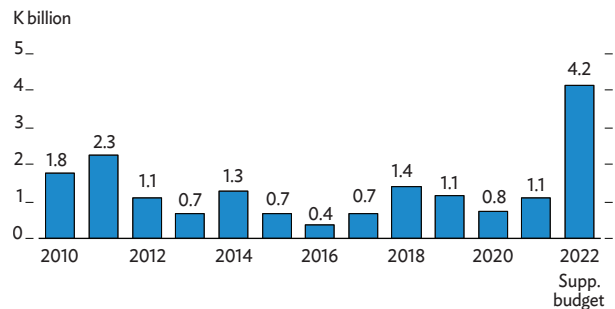
Now is an opportune time to operationalize the SWF before the next resource revenue bonanza.

Tax revenue from the resource sector is anticipated to rise in the coming years from the PNG LNG project when tax exemptions expire in 2026, early royalties and production levies from Papua LNG when production commences as envisaged in 2027, and Porgera’s reopening when it materializes.

An SWF that is up and running would help manage the next boom–bust cycle and bring better macroeconomic outcomes. During a boom period, SWF deposits restrain inflation, fiscal spending sprees, and excessive appreciation of the kina in real terms. This promotes activity in tradeable goods outside of the resource sector. When the boom dissipates and revenue declines, withdrawals from the stabilization fund support recurrent spending on health and education and avoid any need for sharp kina depreciation, thereby protecting real incomes. Heightened macroeconomic stability means more growth for PNG over the long term.

Figure 2.34.5 Mining and Petroleum Revenue

The resource revenue windfall in 2022 was significant.



Source: Papua New Guinea Department of Treasury.

Should PNG establish a savings fund in addition to a stabilization fund?

While a savings fund addresses intergenerational equity, directly investing in the capital-poor domestic economy would bring higher returns than would accumulating foreign assets. Future generations would benefit from higher incomes in a more developed economy. The challenges are low absorptive capacity in the domestic economy and the accrual of resource revenue not necessarily coinciding with when domestic investment would be most productive. A “parking fund” could help navigate these challenges. While the organic law in its current form does not foresee the establishment of a parking fund, an amendment to that effect would be prudent.

SOLOMON ISLANDS

Restrictions to contain COVID-19 brought the worst economic contraction in over 2 decades. Lower log output and higher international commodity prices pushed the current account deficit higher. Economic recovery in 2023 will be buoyed mainly by public investment and consumer spending tied to hosting the Pacific Games. While inflation is expected to ease slightly in 2023, the current account deficit is projected to rise further as imports accelerate. Finance and tax reform are laying the foundation for broad-based growth.

Economic Performance

GDP contracted by 4.2% in 2022, the worst result since 2001. Restrictions to contain COVID-19 and the lingering impacts of civil unrest in November 2021 spelled economic contraction for a third consecutive year (Table 2.35.1). After community transmission of COVID-19 was detected in January 2022, restrictions on travel and transportation were quickly implemented. Counter measures impeded the reconstruction and gradual relocation of strife-affected businesses and, as the disease nevertheless spread quickly throughout the archipelago, affected almost all production and consumption. Most restriction were lifted in May, and international borders reopened in July.

COVID-19 restrictions exacerbated a decline in logging output. Logging output contracted by 22% in 2022, the fourth consecutive year of decline (Figure 2.35.1). Exports of logs and timber fell by 20%, driving down export duties from logging by 33%. Yet logging remained a linchpin of the economy, contributing 11% of GDP in 2021. Its performance thus affected manufacturing, transport, and trade.

Table 2.35.1 Selected Economic Indicators, %

After years of contraction, hosting of Pacific Games pushes growth in 2023, but keeps inflation elevated.

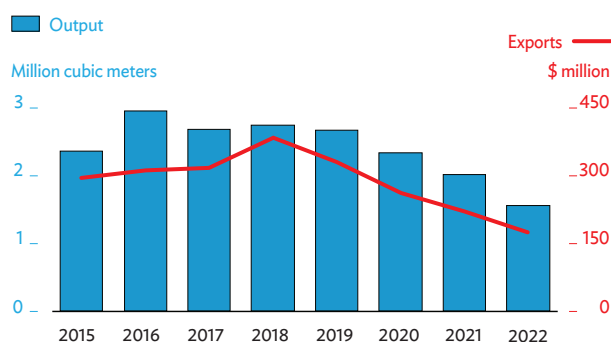
	2021	2022	2023	2024
GDP growth	-0.5	-4.2	3.0	2.5
Inflation	-0.2	5.5	4.5	3.7

GDP = gross domestic product.

Source: Asian Development Bank estimates.

Figure 2.35.1 Log Output and Exports

Log output started declining even before the COVID-19 pandemic.

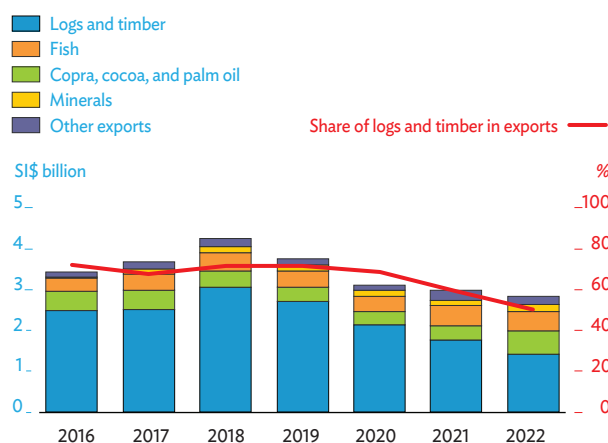


Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.

Fishing, a potential engine of growth, also suffered setbacks. The fish catch fell by 6.8% in 2022, but higher global prices kept fish exports almost unchanged (Figure 2.35.2). Similarly, production of other crops declined—copra by 23.9%, coconut oil 26.4%, palm oil 6.8%, palm kernel oil 5.0%, and cocoa 44.4%—but higher prices boosted exports of copra and coconut oil by 22.1% and of palm oil and kernels by 39.3%.

Figure 2.35.2 Exports

Rising exports of copra, palm oil, and minerals were insufficient to offset a massive decline in logging.



Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.

Despite the reopening of Gold Ridge mine, industry growth remained subdued. Gold Ridge, the country's sole gold mine, reopened in November, helping to more than double mining exports in 2022. However, construction remained weak with stalled infrastructure projects resuming only slowly in the second half of 2022 and imports of machinery and transport equipment fell by 20.0% for the whole year.

Late budget approval and COVID-19 restrictions narrowed the fiscal deficit. Delay in passing the budget to April and movement restrictions slowed fund disbursement, especially for capital projects. Expenditure contracted by 10.0%, with spending on goods and services down by 13.6% and capital spending lower by 18.3%. Meanwhile, revenue from income taxes fell by 2.3% and from goods and services taxes by 4.2%, further constraining revenue already crippled by the plunging duties from log exports. Revenue from international trade other than logs was virtually

unchanged as higher fuel prices—and thus duty collections—offset a reduction in the fuel duty in June and its elimination in September. Even with revenue falling by 7.0%, the fiscal deficit narrowed from the equivalent of 5.5% of GDP in 2021 to 3.7% in 2022.

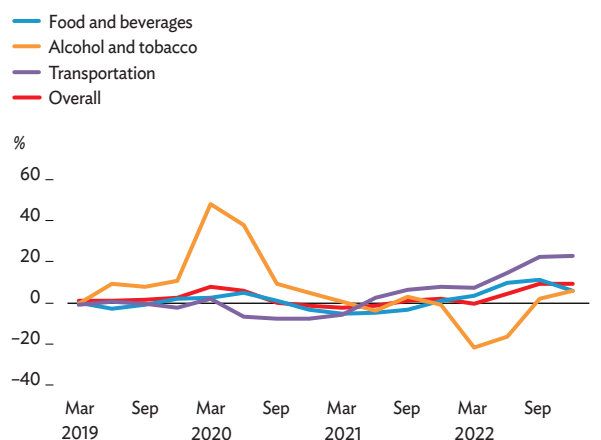
Inflation returned at 5.5% in 2022, reversing 0.2% deflation in 2021. Prices for food rose by 7.7%, transportation 15.6%, and home utilities 7.2%, while those for alcoholic beverages, tobacco, and the price-volatile betel nut fell by 9.0% (Figure 2.35.3). Transportation and home utility inflation would have been higher if not for the fuel duty rate relief. Despite higher inflation, the Central Bank of Solomon Islands has kept its accommodative monetary policy unchanged since March 2020. As the current account deficit widened from the equivalent of 4.8% of GDP in 2021 to 12.4% in 2022, international reserves declined by 5% but remained sufficient to cover 13.7 months of imports, according to the central bank.

Economic Prospects

Hosting of the Pacific Games is likely to spur growth of 3.0% in 2023. Construction, wholesale and retail trade, transportation, food services, and public services are expected to be the major growth drivers (Figure 2.35.4). Held for 2 weeks from 17 November, the games are expected to bring more than 5,000

Figure 2.35.3 Inflation

Higher food and transportation costs drove inflation higher in 2022.

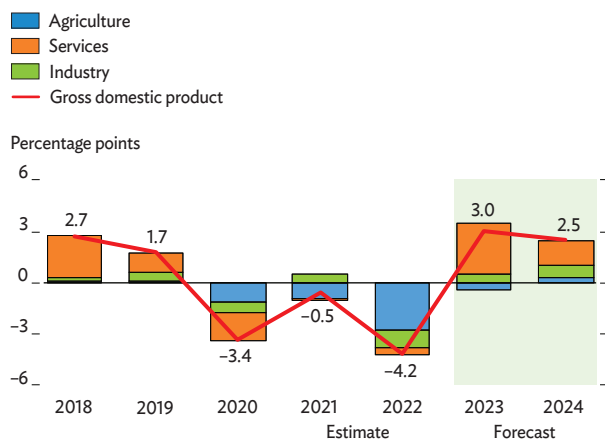


Note: Alcohol and tobacco includes betel nut.

Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.

Figure 2.35.4 Supply-Side Contributions to Growth

Expansion in services and industry related to the 2023 Pacific Games is expected to boost growth this year.



Sources: Solomon Islands National Statistics Office; Asian Development Bank estimates.

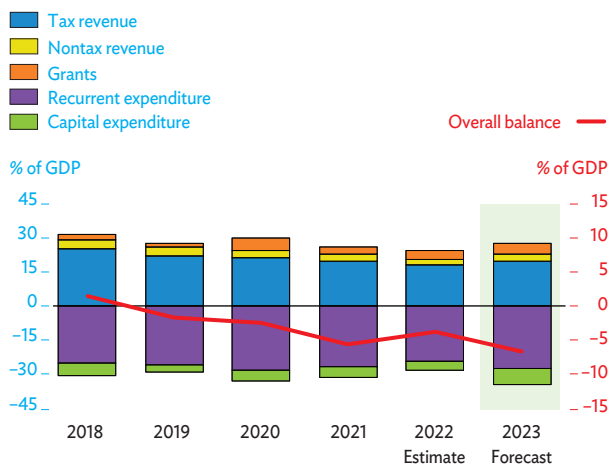
athletes and staff from 24 nations. Honiara is getting a major facelift with renovations to the airport, roads, and other public infrastructure. Growth is expected to remain relatively robust at 2.5% in 2024 on higher government spending and investment associated with national elections scheduled in April 2024.

The fiscal deficit is projected to widen in 2023 on higher spending for the Pacific Games. Recurrent expenditure is forecast to rise by 19.8% and capital expenditure by 70.1% while revenue, including grants, is expected to rise by only 16.5%. The fiscal deficit is therefore expected to widen to the equivalent of 6.7% of GDP (Figure 2.35.5). Borrowing from development partners will cover about 80% of the deficit, and domestic bond issuance the rest. The deficit is expected to persist in 2024 with logging duties continuing to fall while spending remains elevated with scheduled elections.

Inflation is expected to decelerate in 2023 and 2024 as global price rises ease. In line with global trends, inflation in 2023 is expected to fall to 4.5% but remain elevated with demand associated with the Pacific Games and the expected restoration of import duties on fuel. Inflation is forecast to fall further to 3.7% in 2024. While food and fuel prices follow global price movements, their impact on inflation overall is constrained by price controls in Honiara.

Figure 2.35.5 Fiscal Balance

The budget deficit will widen with higher spending on the Pacific Games despite higher tax revenue.



GDP = gross domestic product.

Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.

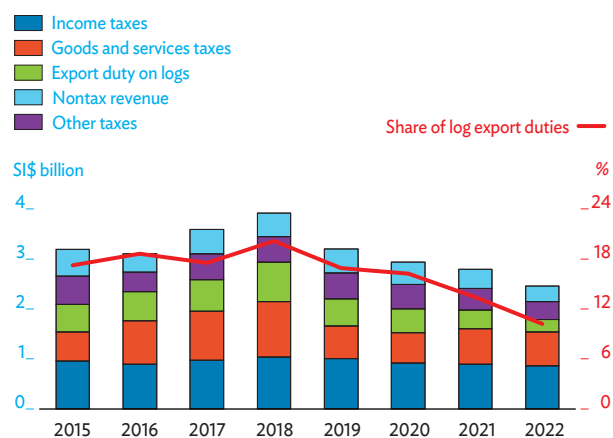
The current account deficit will likely expand with significantly higher imports for the games. Aside from the games, resumed construction on projects financed by development partners is expected to accelerate imports of machinery and construction materials. The decline in logging exports will likely be partly offset by higher mineral exports with gold production in full swing. Despite the increase in imports, the risk of depleted foreign reserves is small because most projects are financed by loans and grants. Higher tourism receipts and remittances from seasonal workers in Australia and New Zealand are also expected to boost the supply of foreign currency.

Policy Challenge—Promoting Reform of Tax and Payment Systems

A continued decline in logging output aligns with the National Forest Policy 2020. While logging output fell below 2.0 million cubic meters in 2022, it still greatly exceeded the sustainable harvest rate of 250,000 cubic meters. As logging output has fallen, the share of export duties in domestic revenue has shrunk from 20% in 2018 to 10% in 2022 (Figure 2.35.6). As the economy shifts to more sustainable logging output, new engines of growth and domestic revenue mobilization will be needed.

Figure 2.35.6 Domestic Revenue

As logging output has declined, the share of log export duties in revenue shrank.



Sources: Solomon Islands Ministry of Finance and Treasury; Asian Development Bank estimates.

The government is embarking on reform to enhance economic efficiency and sustainability.

Instead of opting for revenue quick fixes, the government is laying the foundation for broad-based economic development through several reform measures:

- National Payment Systems Act.** Passed in July 2022, the act provides financial infrastructure toward an electronic fund-settlement process that allows financial institutions and businesses to transfer money safely, efficiently, and quickly. Undertaken in consultation with the central bank, the act is expected to enhance access to affordable digital payment services and thus financial inclusion while reducing reliance on cash. These benefits are expected to promote private sector development.
- Tax Administration Act.** Passed in August 2022, the act creates a unified tax code that strengthens revenue administration and collection. It is expected to enhance revenue by promoting a fair and efficient tax environment. The revision is in phase one of a comprehensive tax reform program launched in 2017.
- Value-added and other tax reforms.** Over the next year, phase two of the tax reform program will revise the income tax and introduce value-added tax to replace taxes on goods and services. Reform is expected to broaden the tax base, minimize inefficiency and tax leakage, and enable broad-based economic growth and development.

VANUATU

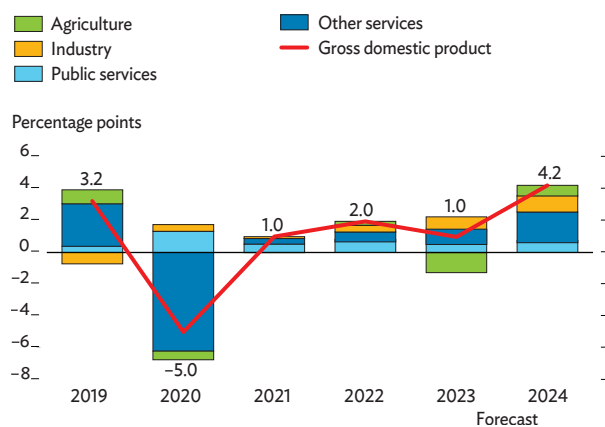
Economic recovery continued in 2022 with border reopening in the second half. Inflation accelerated, and higher global commodity prices drove the current account balance into deficit. Growth is expected to slow in 2023 because of cyclone and earthquake damage to crops and infrastructure, which is seen to keep inflation elevated and the current account in deficit. Facing labor shortages, the new government needs to balance competing demand for skilled workers in tourism at home and for seasonal worker schemes abroad.

Economic Performance

Gradual economic recovery continued in 2022 as growth doubled from 1.0% in 2021 to 2.0%. Despite domestic transmission of COVID-19 early in the year, international borders reopened in July. Growth was restored in much of the economy but particularly in such tourism-related areas as trade, real estate, and restaurants and accommodation (Figure 2.36.1). Public services rose as spending increased on COVID-19 response and support. Stalled infrastructure projects resumed, boosting construction.

Figure 2.36.1 Supply-Side Contributions to Growth

Damage to agriculture and infrastructure is expected to lead to slower growth in 2023.

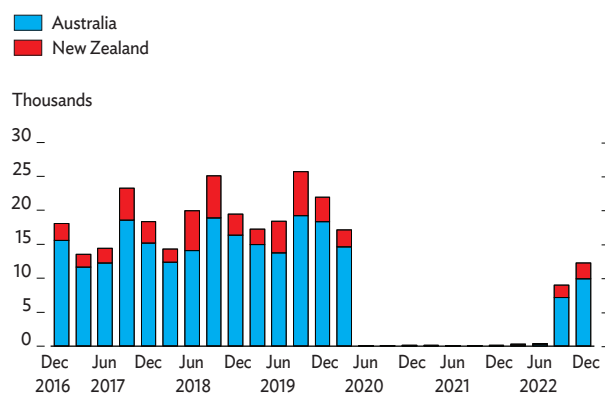


Sources: Vanuatu National Statistics Office; Asian Development Bank estimates.

International borders reopened, but to considerably fewer tourists than before the pandemic. Visitor arrivals in July 2022 were only 30% of the average in July 2017–2019, and visitors in the second half of 2022 from Australia and New Zealand, the two biggest markets, were about 48% of that baseline (Figure 2.36.2). Cruise ships resumed operations in November, but data on arrivals aboard them are not available.

Figure 2.36.2 Arrivals by Air from Australia and New Zealand

The inflow of tourists in 2022 from the two biggest source markets is below pre-pandemic levels.



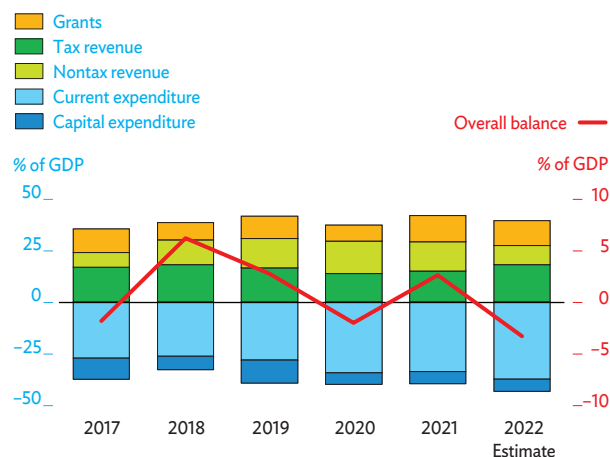
Sources: Australian Bureau of Statistics; Statistics New Zealand.

The fiscal deficit returned with higher spending on COVID-19 response and lower nontax revenue.

A fiscal surplus equal to 2.7% of GDP in 2021 turned into a 3.3% deficit in 2022 (Figure 2.36.3). Import duties and value-added tax collections rose, reflecting increased consumer demand and higher prices. However, nontax revenue—mainly from honorary citizenship programs (HCPs)—fell by more than a fifth, while grants also declined. Revenue from HCPs has provided about 30% of all revenue in recent years. Along with other problems, HCP revenue continued to decline with the suspension in March 2022 of a European Union visa waiver program. Current expenditure rose, driven by higher spending on goods and services and employee compensation in response to domestic COVID-19 transmission in the first half of 2022. Capital spending also increased as projects stalled due to COVID-19 restrictions resumed.

Figure 2.36.3 Fiscal Balance

Higher spending and lower nontax revenue fueled a budget deficit in 2022.



GDP = gross domestic product.

Sources: Vanuatu Department of Finance and Treasury; Asian Development Bank estimates.

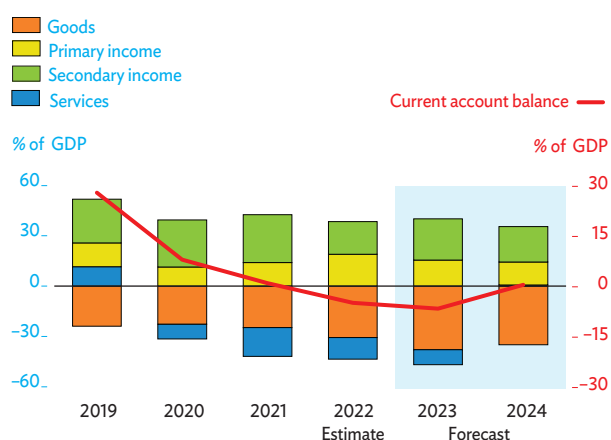
Inflation doubled from 2.3% in 2021 to 4.8% in 2022 on higher global prices. Price increases for food, transportation, housing and utilities, education, and alcoholic drinks and tobacco were the main drivers of inflation. With higher global fuel prices, bus fares soared by 33% in November. Despite inflation exceeding its 1%–4% target, the Reserve Bank of Vanuatu, the central bank, kept its key policy rate at 2.25%, unchanged since March 2020.

The current account fell into deficit with higher global commodity prices.

Increases in remittances, exports of goods, and tourism receipts were insufficient to offset the rise in imports. Higher global prices pushed fuel import bill up by 150%, while imports of manufactured goods and of machine and transport equipment also rose substantially. Lower HCP revenue helped push the current account from a surplus equal to 0.8% of GDP into a 5% deficit (Figure 2.36.4). Gross international reserves were little changed from 2021, still enough to cover 21 months of imports.

Figure 2.36.4 Current Account Balance

Higher tourism receipts were outpaced by higher imports in 2022.



GDP = gross domestic product.

Sources: Reserve Bank of Vanuatu; Asian Development Bank estimates.

Economic Prospects

Economic growth is forecast to slow to 1.0% in 2023 following multiple disasters.

Vanuatu was battered in March 2023 by two category 4 cyclones and by earthquakes that massively damaged agriculture and infrastructure. The damage may be as bad as from Cyclone Pam in 2015, for which estimates ranged as high as 60% of GDP. Economic recovery will partly depend on revival in tourism, but frequent disasters have made that more risky, as the country's focus frequently shifts to reconstruction. These developments compound the challenges faced by a new government elected in November 2022. That said, continued remittance inflows and the gradual return of tourists in the second half of the year will likely sustain consumer spending. Growth is forecast to accelerate to 4.2% in 2024 (Table 2.36.1), driven by agriculture, trade and tourism services, and reconstruction.

Table 2.36.1 Selected Economic Indicators, %

Growth inched up after the border reopened in 2022, but inflation also rose on higher global prices.

	2021	2022	2023	2024
GDP growth	1.0	2.0	1.0	4.2
Inflation	2.3	4.8	4.0	3.0

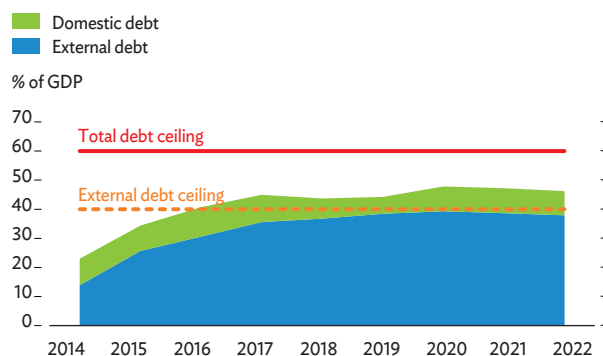
GDP = gross domestic product.

Source: Asian Development Bank estimates.

Reconstruction and recovery costs are expected to tighten fiscal space further. The latest disasters are expected to lower tax collections and increase expenditure for recovery and reconstruction, widening the fiscal deficit. The 2023 budget, delayed by the early dissolution of Parliament in August 2022, was passed in March and included additional allocations and borrowing for disaster relief and recovery. Infrastructure rehabilitation and upgrading after Cyclone Pam in 2015 pushed external debt from the equivalent of 14% of GDP in 2014 to 39% in 2020, almost breaching the 40% ceiling (Figure 2.36.5). In January 2023, the International Monetary Fund reconfirmed that Vanuatu’s debt remained sustainable but with limited space to absorb further shocks like disasters.

Figure 2.36.5 Public Debt

Reconstruction after Cyclone Pam in 2015 pushed external debt close to the threshold of 40% of GDP.



GDP = gross domestic product.

Sources: Vanuatu Department of Finance and Treasury; Asian Development Bank estimates.

The need to rebuild damaged facilities and infrastructure will delay recovery in tourism.

Climate-proofed and upgraded after Cyclone Pam damaged it in 2015, Port Vila airport was able to resume operations almost immediately after the cyclones passed. However, damage to other tourism facilities comes on top of problems affecting Air Vanuatu, which suffered cancellations and delays for lack of crew and aircraft after borders reopened in 2022. With aircraft and crew outsourced from the national airlines of Fiji, Nauru, and Solomon Islands, benefits from the return of tourists are not fully realized. In December 2022, the new government replaced airline management and started considering several options including privatization.

Supply constraints are expected to keep inflation elevated at 4.0% in 2023 and 3.0% in 2024.

Cyclone devastation of agriculture and damage to infrastructure will crimp supply chains, offsetting lower international prices for food and fuel. Rising demand from tourists in 2024 may sustain inflation slightly higher than the long-term average. The current account deficit is expected to expand to the equivalent of 6.7% of GDP in 2023. Higher imports of food and materials for relief and reconstruction are expected to counter increased receipts from tourism, remittances, and grants.

Policy Challenge—Shortage of Skilled Labor

Increase in remittances lent resilience to the economy during the pandemic.

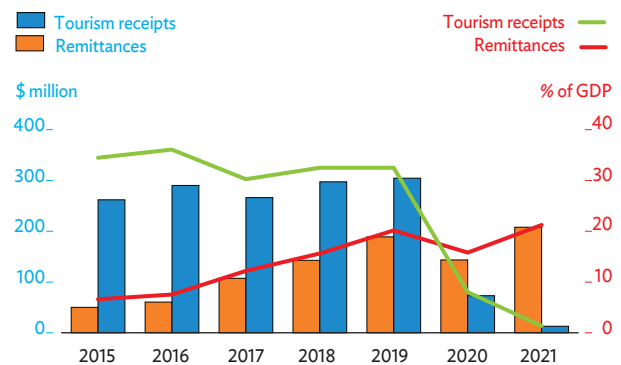
Official remittance inflow increased from \$50 million in 2015 to \$208 million in 2021, or 21.2% of GDP (Figure 2.36.6). These figures do not include cash carried in or money sent through other informal channels. Remittances are sent mainly by Vanuatu nationals employed in seasonal worker schemes in Australia and New Zealand. Since these schemes started, Vanuatu has been the largest sending country, providing 32% of Pacific seasonal workers in 2022. The schemes employed about 14% of Vanuatu’s working-age men and 2% of women. Further, the 11,118 seasonal workers in mid-2022 outnumbered government employees—a rare feat in the Pacific, where the public sector usually dominates.

Demand for seasonal workers is likely to increase with changes introduced by Australia and New Zealand in 2022. When the pandemic forced tourism businesses in Vanuatu to close, many of their staff applied for seasonal worker openings. As tourism businesses reopen, they struggle to find workers with the required skills, hampering tourism industry revival.

Balancing these two growth drivers is expected to be difficult. By halting the issuance of new passports to prospective seasonal workers until July 2023, the government effectively capped the supply of new workers at 6,000, the number provided with passports from November 2022 to January 2023. This aligns with a government review of labor mobility programs to refocus on national needs. Yet frequent disasters in Vanuatu highlight the importance of remittances as a safety net supported by external sources. A longer-term challenge is how to increase labor participation, especially by women. In 2020, only 51% of working age men and 42% of women were in the labor force. Also needed are training and better education to raise the number of skilled workers.

Figure 2.36.6 Remittance Inflow and Tourism Receipts

While tourism receipts dried up with COVID-19, remittances remained strong.



GDP = gross domestic product.

Sources: International Monetary Fund; Haver Analytics; Asian Development Bank estimates.

CENTRAL PACIFIC ECONOMIES

Three years into the pandemic, Central Pacific economies have started on the road to recovery. Growth is gradually accelerating in Kiribati but moderated last year in Nauru and Tuvalu. A surge in global commodity prices since the Russian invasion of Ukraine translated into higher inflation across the Central Pacific. While all three economies are expected to grow with mostly moderate inflation over the forecast horizon, the external environment will significantly influence both indicators.

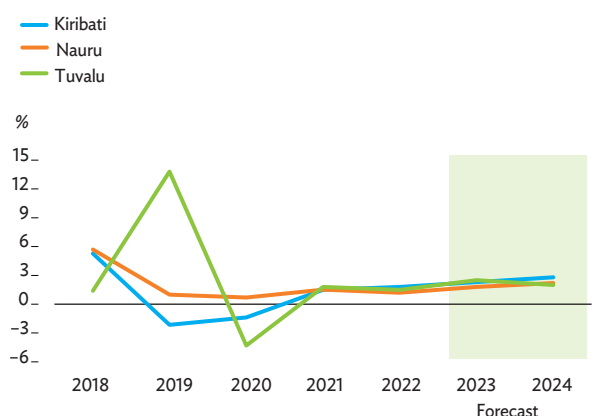
Kiribati

Economic growth was sustained in 2022 by the resumption of infrastructure projects and higher social protection spending. Despite a severe drought, the economy grew by 1.8% in 2022 (Figure 2.37.1). This reflected in part higher government spending on its copra subsidy, unemployment benefits, and other social protection schemes. In addition, Kiribati's reopening of its international borders in August 2022 permitted the resumption of infrastructure projects.

Growth is forecast to accelerate in 2023 and 2024 as recovery gains traction. The roll out of energy, water, and transport projects in 2023 and sustained social protection spending are expected to accelerate growth to 2.3% in 2023 and 2.8% in 2024 (Table 2.37.1). With help from development partners, the government has programmed 2023 outlays for infrastructure projects and social protection equal to 39.6% of 2022 GDP. The easing of travel restrictions for international visitors and the free movement of goods are likewise expected to support growth prospects in Kiribati. The main downside risks to the forecast are any future outbreak of COVID-19 becoming unmanageable and ever-present natural hazards such as drought and tropical cyclones, which could jeopardize infrastructure projects dependent on imported equipment and materials.

Figure 2.37.1 GDP Growth

The resumption of infrastructure projects supported growth in 2022, and border reopening will likely sustain growth to the forecast horizon.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Sources: Kiribati, Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

Kiribati's fiscal position improved in 2022 and is expected to return to surplus. The fiscal deficit narrowed to the equivalent of 3.3% of GDP in 2022 from 12.8% in 2021. After 2 consecutive years of decline under the pandemic, fishing license revenue bounced back in 2022 by 18.1% (Figure 2.37.2).

Table 2.37.1 Selected Economic Indicators, %

Despite mixed growth outcomes in 2022, growth is expected to accelerate in 2023 across the Central Pacific.

	2021	2022	2023	2024
Kiribati				
GDP growth	1.5	1.8	2.3	2.8
Inflation	1.0	5.0	3.7	3.0
Nauru				
GDP growth	1.5	1.2	1.8	2.2
Inflation	1.2	2.3	2.5	1.9
Tuvalu				
GDP growth	1.8	1.5	2.5	2.0
Inflation	6.7	7.6	3.3	2.8

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Source: Asian Development Bank estimates.

Relaxed movement restrictions allowed the deployment of more I-Kiribati observers on fishing vessels, which significantly increased fishing activity. Recovery in fishing license revenue was the sole driver of revenue collection as lower collection of value-added and excise taxes shrank tax revenue by 17.7%. Meanwhile, expenditure jumped by 17.1% as high spending on social protection continued and more capital projects resumed. The fiscal balance is forecast to return to surplus in 2023 and 2024 with further increase in fishing license revenue, recovery in tax collection, and continued budget support from development partners.

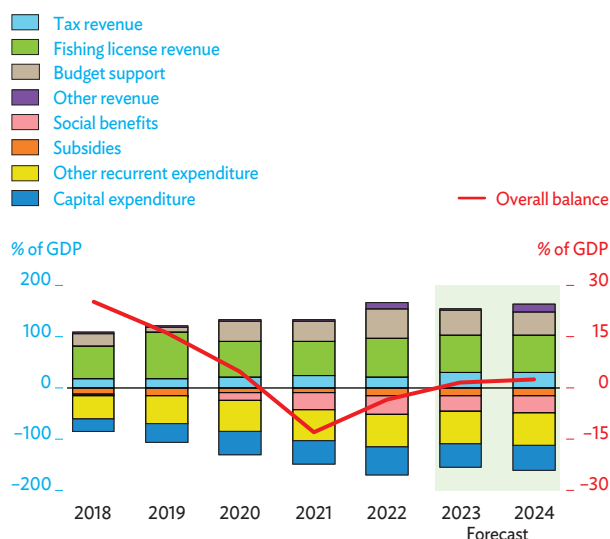
Inflation accelerated in 2022 and will likely remain elevated in the next 2 years.

Inflation accelerated to 5.0% in 2022 as global prices for Kiribati imports rose (Figure 2.37.3). While movement restrictions and supply disruption under the pandemic mostly disappeared, the Russian invasion of Ukraine became an important factor in the movement of global prices for commodities, particularly food, fuel, and raw materials. However, direct impact on Kiribati was moderated by fuel and other energy subsidies from the government. Inflation is expected to decelerate to 3.7% in 2023 and 3.0% in 2024—still elevated as events overseas drive price movements.

Stronger external revenue translated into a higher current account surplus in 2022. The Kiribati current account surplus increased on recovery in

Figure 2.37.2 Kiribati Fiscal Components

Kiribati's fiscal position improved as fishing license revenue recovered.

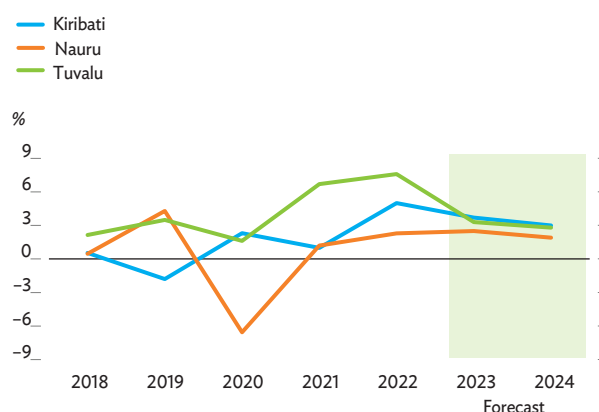


GDP = gross domestic product.

Source: Asian Development Bank estimates using Kiribati budget documents.

Figure 2.37.3 Inflation

Higher global prices for fuel, food, and other commodities accelerated inflation in 2022.



Note: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Sources: Kiribati, Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

fishing license revenue and steady remittance flow. These developments offset higher deficits on goods and services. Sustained remittances are expected to continue supporting a surplus despite a resumption of infrastructure projects, which are dependent on imported materials and equipment.

Nauru

Economic growth slowed as the future of the Regional Processing Centre (RPC) remained unclear.

The slowdown to 1.2% in fiscal year 2022 (FY2022, ended 30 June 2022) mainly reflected reduced activity in the RPC. The FY2022 budget, passed in June 2021, assumed that RPC operations would transition into enduring capability after December 2021. In September 2021, the governments of Nauru and Australia signed a new agreement on the transition which keeps the RPC open. The FY2023 budget assumed that enduring capability would begin in January 2023, but that discussion on the details of its implementation would continue. Lower income tax collection indicates that the number of expatriates working in the RPC declined in FY2022.

Growth is expected to edge up to 1.8% in FY2023 and 2.2% in FY2024 on infrastructure projects jointly funded with development partners.

These projects include Nauru Port, which is expected to spur growth in other areas such as retail trade, transportation, and fishing. A solar energy project including a power plant is scheduled for completion by July 2023 and will add 6 megawatts to the grid. Other notable projects include community housing and the rehabilitation of previously mined areas.

Domestic transmission of COVID-19 was detected in mid-June 2022, sparking lockdowns.

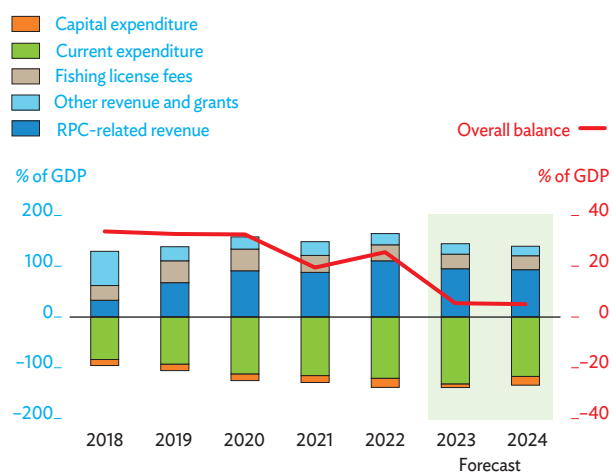
With almost all eligible adults and children vaccinated with at least two doses, the government was able to lift most movement restrictions after 3 months. However, more than 4,600 cases in a population of 10,834 in August 2022 gave Nauru one of the highest case loads per capita in the Pacific. To cushion the impact of the lockdown, the government increased its ex gratia payments to public workers, pensioners, and people with disabilities. The allocation for overseas medical referral has already been raised three times in FY2023.

The fiscal surplus increased in FY2022, but its future remains unclear.

Government revenue depends largely on the RPC, fishing license fees, and grants. In line with the transition to enduring capability, visa fees and taxes declined, while hosting fees for the RPC rose by more than 150%. This raised revenue attributable to the RPC by 63.2% and widened the fiscal surplus from the equivalent of 19.5% of GDP in FY2021 to 25.5% in

Figure 2.37.4 Nauru Fiscal Components

Higher revenue from the Regional Processing Centre drove up the fiscal surplus in FY2022.



FY = fiscal year, GDP = gross domestic product, RPC = Regional Processing Centre.

Note: Years are fiscal years ending on 30 June of that year.

Source: Asian Development Bank estimates using Nauru budget documents.

FY2022 (Figure 2.37.4). The budget for FY2023 targeted an 8.6% surplus, but with higher expenditure reflected in three supplementary budgets to December 2022, the surplus is now expected to be only 5.4%. Fiscal surpluses have been deposited in the Nauru Trust Fund and a fiscal cash buffer, which stood at A\$175.4 million in June 2022, more than quadruple the minimum requirement that it cover 2 months of spending.

Inflation accelerated in FY2022 and is expected to rise further in FY2023 before easing in FY2024.

Inflation accelerated to 2.3% in FY2022 along with global prices for food and fuel and is forecast to reach 2.5% in FY2023 before easing to 1.9% in FY2024. Price increases would be much higher if the government had not reduced import duties on fuel in June 2022 and extended electricity subsidies. Further, the government subsidizes the state-owned airline and shipping line, which allows them to charge less when bringing supplies into the country.

Higher imports and lower grants pushed the current account to a deficit equal to 2.5% of GDP in FY2022.

Exports of services are expected to increase in the next few years following Air Nauru's successful bid under the Pacific Flights Programme of the Government of Australia for the Brisbane–Nauru–Tarawa–Majuro–Pohnpei link.

Despite the election of a new president in September 2022, the main economic policies are expected to remain unchanged. Only 2 of 19 members of parliament were not reelected, both of them in the opposition. The President was elected unopposed by his fellow members of the parliament, and the previous president was elected deputy speaker. Though the campaign lasted less than a month, election spending spurred economic activity.

Tuvalu

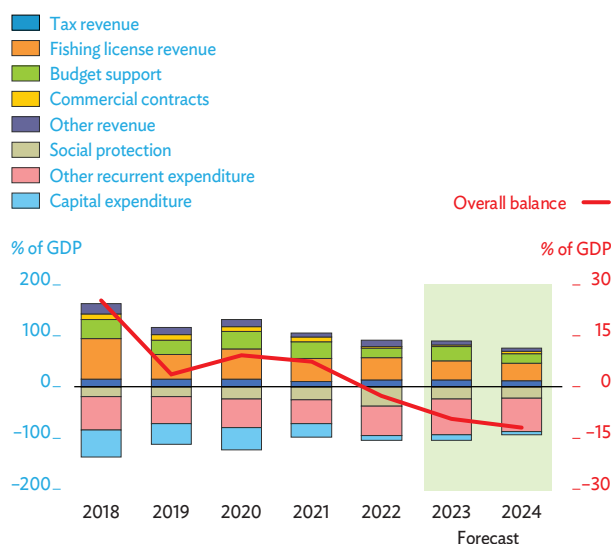
Growth moderated in 2022 under external and domestic shocks. After recovering in 2021, the economy grew by 1.5% in 2022. Stringent COVID-19 measures that were relaxed only at the end of the year restrained economic activity. Other lingering effects of the pandemic, such as supply chain disruption and delayed shipments of construction materials, further dragged on recovery. Tuvalu's borders remained closed to international visitors until the end of November 2022. Despite these efforts, the country faced an outbreak of COVID-19 in the second half of the year. Separately, the government declared a state of public emergency in November 2022 because of extreme drought across the country. While some infrastructure projects resumed, most government spending was directed toward social protection to mitigate impacts from the COVID-19 outbreak and drought.

Faster growth is expected to the forecast horizon, driven by more infrastructure projects and the reopening of borders. Several infrastructure projects funded by development partners, including harbors, health facilities, and submarine cables, are scheduled for rollout in 2023. Other projects to develop outer islands and to improve domestic air services are in progress. With Tuvalu reopening its borders to international visitors, the resumption of business travel and the implementation of infrastructure projects are expected to boost growth to 2.5% in 2023. However, the Russian invasion of Ukraine is likely to drag on growth as resulting inflation creates additional spending pressures and delays expenditure on other items, which will likely slow growth to 2.0% in 2024.

A fiscal deficit, the first since 2012, equivalent to 2.5% of GDP in 2022, is expected to persist through 2024 (Figure 2.37.5). Recurrent revenue recovered in 2022 as tax collections rose by 33.8% and fishing license revenue edged up by 3.0%. However, spending on social protection increased by 55.7%. The deficit is forecast to balloon in 2023 and 2024 as the government ramps up infrastructure spending and revenue weakens.

Figure 2.37.5 Tuvalu Fiscal Components

The government increased spending on social protection to mitigate impacts from COVID-19 and drought.



GDP = gross domestic product.

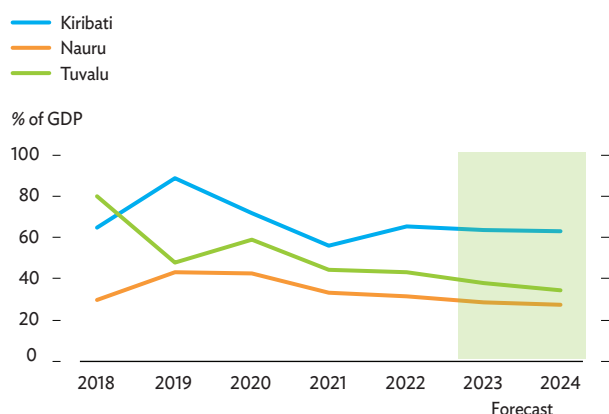
Source: Asian Development Bank estimates using Tuvalu budget documents.

Inflation accelerated in 2022 but will likely slow in 2023 and 2024. After surging in 2021 with the implementation of sin taxes, inflation rose further to 7.6% in 2022. The Russian invasion of Ukraine drove up the cost of imported fuel and, consequently, electricity prices. Food prices have likewise soared because of supply constraints. Inflation is expected to moderate to 3.3% in 2023 and 2.8% in 2024 as global supply chains recover, but events overseas will continue to have a significant impact on price movements.

Higher import prices widened the current account deficit in 2022. The import-dependent economy posted a current account deficit equivalent to 4.1% of GDP as the Russian invasion of Ukraine pushed up global prices for fuel and agricultural commodities. Lower revenue from fishing licenses (Figure 2.37.6) and reduced assistance flows from development partners in 2022 also played a role in expanding the deficit. However, lower fuel prices will likely contribute to narrower deficits in 2023 and 2024.

Figure 2.37.6 Fishing License Revenue

Fishing license revenue rebounded in Kiribati but was declining in Nauru and Tuvalu.



GDP = gross domestic product.

Notes: Years are fiscal years ending on 30 June of that year in Nauru and coinciding with the calendar year in Kiribati and Tuvalu.

Sources: Kiribati, Nauru, and Tuvalu budget documents; International Monetary Fund Article IV reports; Asian Development Bank estimates.

Policy Challenge—Strengthening Water Security

The economies of the Central Pacific are highly vulnerable to climate change and shortages of potable water. Kiribati and Tuvalu experienced extreme drought in 2022, compelling governments to activate disaster response. Nauru’s small land area makes collecting enough freshwater for its population a perennial challenge. All three countries extend just a few meters above sea level, making them susceptible to surges stirred up by tropical cyclones that may flood islands for days and contaminate drinking water. Prolonged drought can deplete water supplies, causing serious shortages and health issues.

Despite some gains, improving water security in the Central Pacific remains a work in progress.

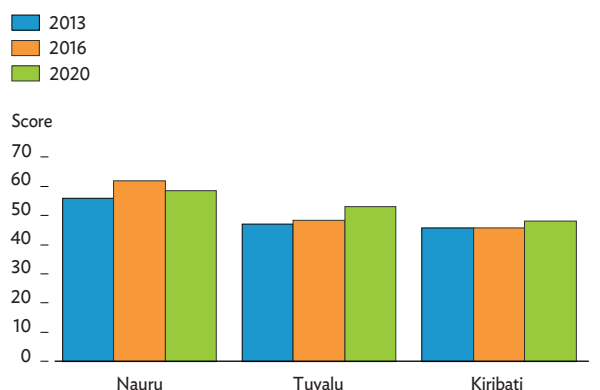
In 2020, ADB released the fourth edition of the *Asian Water Development Outlook*, which assessed the water security situation of its members in Asia and the Pacific. Among the three Central Pacific economies, Nauru posted the highest score at 58.6 points out of 100, followed by Tuvalu at 53.0 points and Kiribati at 48.2 (Figure 2.37.7). Nauru’s 2020 water security score was a downgrade from its 2016 score because of weaker water disaster resilience. Kiribati and Tuvalu both improved their scores in 2020, Kiribati benefiting from a huge gain in environmental water security and Tuvalu from better scores for rural household water security and environmental water security. Room exists for more improvement. In the 2020 assessment, Nauru is barely above the Pacific average score of 55.9 points, and Kiribati and Tuvalu both underperform it (Figure 2.37.8).

A number of water projects are planned or being implemented.

One of the biggest water infrastructure projects in Kiribati is the South Tarawa Water Supply Project. The \$61.8 million project, supported by multilateral development partners, aims to improve access to safe and climate-resilient water supplies. The project has been hampered by the pandemic, and inflation and supply disruptions continue to pose

Figure 2.37.7 National Water Security Scores in the Central Pacific

Despite progress, improving water security in the Central Pacific remains a challenge.

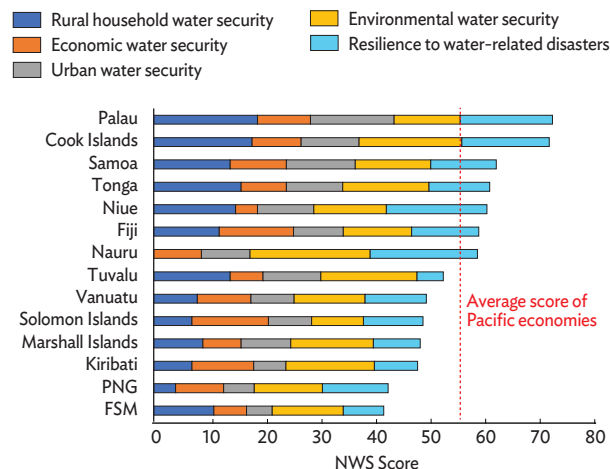


Note: Perfect score is 100.

Source: ADB. 2020. *Asian Water Development Outlook 2020: Advancing Water Security across Asia and the Pacific*. Manila.

Figure 2.37.8 Water Security in Pacific Developing Member Countries, 2020

Water security in the Central Pacific barely matches the average among Pacific developing member countries



FSM = Federated States of Micronesia, NWS = national water security, PNG = Papua New Guinea.

Note: Perfect score is 100. Nauru has no score for rural household water security because it is 100% urban; the NWS index is determined by multiplying the sum of key dimensions by a factor of 5/4.

Source: ADB. 2020. *Asian Water Development Outlook 2020: Advancing Water Security across Asia and the Pacific*. Manila.

implementation challenges. The Government of Nauru prioritized in its FY2023 budget the Nauru Sustainable Urban Development Project. With grant financing from development partners, the project is designed to improve essential water supply, sanitation, and solid waste management services and to expand capacity for urban planning. This complements a government-

funded pipeline project to minimize contamination of Nauru's brackish water. In Tuvalu, a government project addresses water security challenges in communities. Working with development partners, the government has rolled out a project to improve the supply, storage, and distribution of potable water to communities and schools on the capital, Funafuti. The upcoming Funafuti Water and Sanitation Project builds on this to increase access to safe water, improve sanitation, and lower the incidence of waterborne disease.

Improving water security in the Central Pacific requires a multipronged approach.

The usual sources of financing for water investments are taxes, revenue from water tariffs, and transfers from development partners. In the Central Pacific, as elsewhere in the subregion, small populations and inadequate fiscal resources and technical expertise mean heavy dependence on support from development partners. Heightened vulnerability to climate change and fiscal constraints highlight the importance of external financing. Projects need adaptation plans based on evidence using updated data. Detailed project implementation arrangements are especially important because delays in project implementation can leave communities with insufficient potable water. Yet capacity constraints mean these countries struggle to implement projects efficiently and effectively. Improving water security in the Central Pacific thus requires steady financing, strong project management, enhanced public financial management, and other support mechanisms provided by good governance.

NORTH PACIFIC ECONOMIES

Pandemic impacts began to dissipate in the Federated States of Micronesia and the Marshall Islands, but contraction continued in Palau. Recovery is expected with border reopening and incipient revival in Palau's key tourism markets. Inflation will be driven by high international commodity prices, but effects will differ in each economy. The anticipated renewal of compacts with the US brightens economic and fiscal prospects but requires strengthened implementation capacity and public financial management.

Federated States of Micronesia

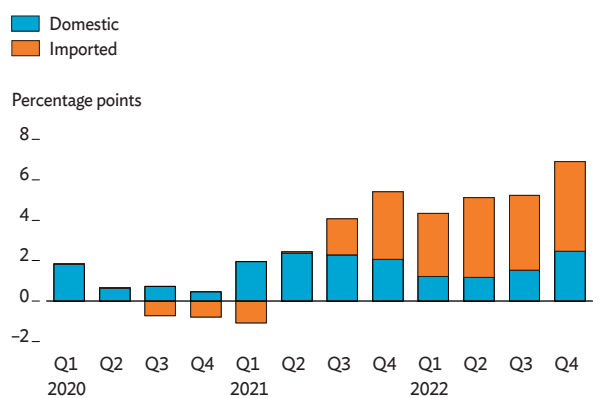
The economy has started to recover from the COVID-19 pandemic. GDP grew by an estimated 2.0% in fiscal year 2022 (FY2022, ended 30 September 2022 in all three North Pacific economies) following contraction by 1.3% in FY2021. The gradual easing of public health measures and reopening of international borders underpinned a rebound in transportation, hotels and restaurants, construction, and agriculture. Further support came from government economic stimulus and social protection packages.

Inflation accelerated on higher import prices and stronger economic activity. Consumer prices rose by 5.0% in FY2022, the fastest in nearly a decade, on a spike in international commodity prices after the Russian invasion of Ukraine and with economic normalization following the relaxation of mobility restrictions. Imports led the rise in prices (Figure 2.38.1).

The fiscal surplus continued to shrink. The national government's fiscal surplus is estimated to have declined from the equivalent of 5.8% of GDP in FY2021 to 4.4% in FY2022 as grants from development partners normalized. Grant funding and fishing license fees nevertheless supported the government's fiscal position, allowing external debt to shrink to 11.3% of GDP at the end of FY2022.

Figure 2.38.1 Inflation Contributions in the Federated States of Micronesia

Higher import prices have fueled inflation.



Q = quarter.

Source: Federated States of Micronesia Statistics Office.

Sustained recovery is expected to bring the economy back to its pre-pandemic level. FY2023 will be the first full year since pandemic measures were rolled back and borders reopened, facilitating the implementation of government projects and general economic activity. Growth in construction, transportation, hotels and restaurants, and retail trade is seen to restore the economy to its pre-pandemic level this year before growth slows to the long-term average in FY2024 (Table 2.38.1). Elevated consumer

Table 2.38.1 Selected Economic Indicators, %

All three North Pacific economies are seen to return to economic growth in the near term.

	2021	2022	2023	2024
Federated States of Micronesia				
GDP growth	-1.3	2.0	4.1	0.5
Inflation	1.8	5.0	3.6	0.4
Marshall Islands				
GDP growth	1.1	-0.9	1.5	2.0
Inflation	2.2	3.3	3.7	3.5
Palau				
GDP growth	-17.1	-1.0	3.8	6.5
Inflation	0.5	10.2	5.0	5.5

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 September of that year.

Source: Asian Development Bank estimates.

prices, particularly for transportation and retail trade, pose a risk to the outlook in the near term. Inflation averaged 6.9% year on year in the first quarter (Q1) of FY2023, during which transportation and utility prices climbed by 18.8%.

Inflation is likely to stay elevated in the near term but progressively decline.

Consumer inflation is projected to slow to 3.6% in FY2023 and further to 0.4% in FY2024 in line with international commodity prices, particularly energy and food. The outlook remains uncertain, however, and will depend on the inflationary impacts of the Russian invasion of Ukraine and growth in the major economies.

Fiscal surpluses are seen to increase on improved economic prospects.

The winding down of pandemic assistance to households, higher economic activity, and the renewal of the Compact of Free Association with the US are expected to bolster public finances over the next 2 years. The government signed a memorandum of understanding (MOU) with the US for increased financial assistance under the renewed compact, but the capacity of the national and state governments to harness this for service delivery and investment is a persistent issue.

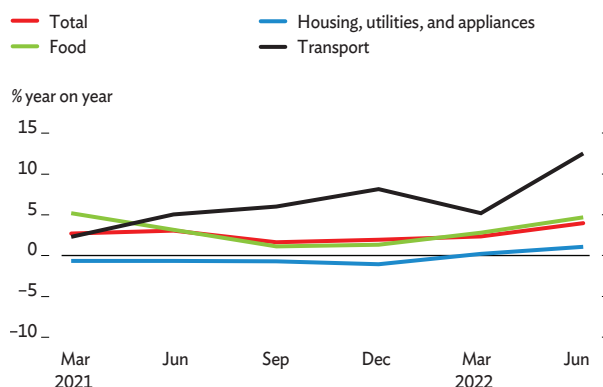
Marshall Islands

The impact of the pandemic was less severe than initially predicted. The Marshall Islands economy contracted by 0.9% in FY2022, reversing growth of 1.1% in FY2021. Border restrictions shrank onshore fishery support services, including a tuna loining plant, and other private sector activities such as construction and hospitality services. Offsetting this decline was expansion in domestic retail trade, reflecting pandemic mitigation supported by development partners, and other fishery activities, including commercial fishing.

Inflation was lower than elsewhere in the subregion, but price pressures increased. Inflation was 3.3% in FY2022, driven by transportation and food, but lower than in other North Pacific economies (Figure 2.38.2). Housing and utility prices recorded smaller increases, but at the end of FY2022 the Marshalls Energy Company reported that higher international fuel prices had doubled its fuel costs and that it would need subsidies or higher tariffs to offset sizable losses.

Figure 2.38.2 Inflation in the Marshall Islands

Food and transportation costs exerted most of the upward pressure on inflation.



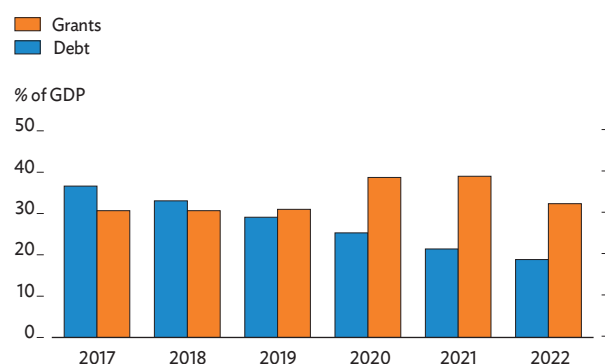
Source: Graduate School USA Economic Monitoring Analysis Program.

Grants declined, causing a fiscal deficit.

The government incurred a fiscal deficit equal to 2.6% of GDP in FY2022 as a 15% drop in grants and reduced fishing license revenue caused resources to decline faster than expenditure. However, grant funding—elevated in previous years as development partners supported pandemic response—continued to limit the need to borrow. Public debt declined to the equivalent of 18.9% of GDP at the end of FY2022 (Figure 2.38.3).

Figure 2.38.3 Marshall Islands Debt

Public debt continued to decline as grant funding limited the need to borrow.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 September of that year.

Source: Graduate School USA Economic Monitoring Analysis Program.

Recovery is expected as borders reopen. Growth is forecast at 1.5% in FY2023 and 2.0% in FY2024 as business begins to return to pre-pandemic levels. Nauru Airlines' expansion of connections between Australia and five Pacific economies including the Marshall Islands could facilitate visitor arrivals.

Inflation will accelerate on both domestic and international price movements. Inflation is projected to reach 3.7% in FY2023 because of revived business activity and increased power tariffs in the major urban centers of Majuro and Ebeye. Higher international fuel prices and continued expansion in demand will likely keep inflation elevated at 3.5% in FY2024.

Continued fiscal deficits are anticipated despite prospects for an extended relationship with the US. The government is likely to incur a fiscal deficit equal to 2.9% of GDP in both FY2023 and FY2024. With the end of grant inflow in response to COVID-19, and with higher prices, spending growth is expected to outpace revenue expansion, as was observed before the pandemic. However, continued grant funding will help drive down external debt to the equivalent of 15.8% of GDP in FY2023 and 12.9% in FY2024.

In January 2023, the Marshall Islands signed an MOU with the US to guide ongoing negotiations on the Compact of Free Association. Final agreement is expected ahead of the expiration of the existing compact on 30 September 2023. The proposed compact, subject

to approval by the US Congress, would increase financial assistance and contribute to the Compact Trust Fund in support of public services, infrastructure, and climate adaptation.

Palau

The economy contracted for a seventh consecutive year. Palau's economy contracted by a further 1.0% in FY2022 for a cumulative decline of 26.8% during the COVID-19 pandemic. Including a tourism-induced decline before the pandemic, the economy has now lost about a third of annual output since FY2015. The onset of COVID-19 in January 2022 dampened economic activity, particularly in Q2 FY2022. After supporting the economy during the height of the pandemic, construction fell by about 20% as projects were completed. Although visitor arrivals nearly tripled to 9,247 in FY2022, they remained well below pre-pandemic levels of about 90,000.

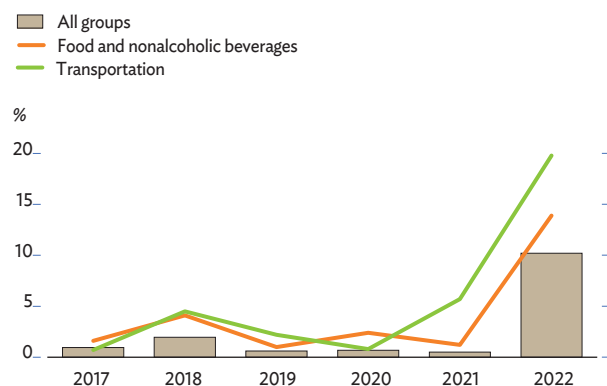
Limited flight connections constrained recovery in tourism. Arrivals from the US and Canada in FY2022 were 70% of their pre-pandemic levels and more than 60% of all arrivals. Tourism from other smaller markets, mainly the Philippines, reached 27% of pre-pandemic levels. By contrast, arrivals from Palau's top four sources of tourists—Japan, the People's Republic of China, the Republic of Korea, and Taipei, China—were 0.1%–7.0% of the pre-COVID numbers. These trends reflect the incomplete restoration of direct flight connections, currently available only from Guam and Manila.

Inflation reached a historic high on elevated international commodity prices. Palau relies heavily on imported commodities, and fuel price shocks following the Russian invasion of Ukraine pushed inflation to 10.2% in FY2022 (Figure 2.38.4), with transportation peaking at 23.6% and food costs at 14.8% in Q3 FY2022 before easing slightly.

The fiscal deficit lingered with weak revenue. Tax revenue remained low, equal to 16.8% of GDP in FY2022 and down from an average of 20.4% in FY2015–FY2019. However, expenditure fell as COVID-19 assistance declined and capital projects wound down. Consequently, the fiscal deficit narrowed

Figure 2.38.4 Inflation in Palau

Consumer price inflation accelerated to double digits as transportation and imported food prices spiked.



Note: Years are fiscal years ending on 30 September of that year.

Source: Palau Bureau of Budget and Planning.

from the equivalent of 17.2% of GDP in FY2021 to 9.0% in FY2022. A significant risk nonetheless comes from increased subsidies to state-owned enterprises to compensate for rising fuel prices. After 3 successive years of fiscal deficits, public debt increased to equal 90.3% of GDP at the end of FY2022, almost tripling levels prior to COVID-19.

Continued tourism recovery underpins an outlook for a return to growth.

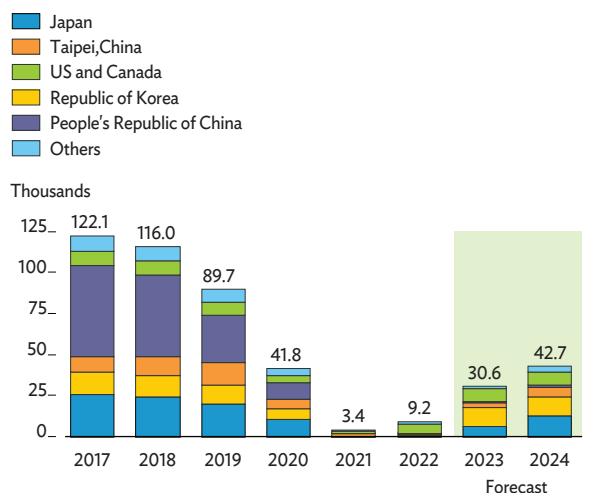
Latest assessments point to continuing recovery in tourism from the US and renewed arrivals from the Republic of Korea, which rebounded strongly late last year in neighboring tourist destinations including Guam and Saipan. However, recovery in arrivals from other main source markets, particularly Japan, may take longer. Visitor arrivals are projected to reach about 31,000 in FY2023 and 43,000 in FY2024 (Figure 2.38.5), pushing growth to 3.8% in FY2023 and 6.5% in FY2024. An upside risk to this outlook would be unexpectedly rapid revival in tourism demand and reestablished direct flights from major markets in East Asia.

Inflation will likely ease but remain elevated.

Following lower food and transportation price inflation since Q4 FY2022, and with expectations of lower international oil prices, inflation is seen to ease to 5.0% in FY2023. In line with a projected slight uptick in oil prices, it is expected to accelerate again to 5.5% in FY2024.

Figure 2.38.5 Visitor Arrivals in Palau, by Source

Tourism is expected to recover gradually with higher arrivals from the Republic of Korea and the US.



Note: Years are fiscal years ending on 30 September of that year.

Source: Palau Bureau of Budget and Planning, Palau Bureau of Immigration, and Palau Visitors Authority.

Fiscal accounts are likely to remain in deficit.

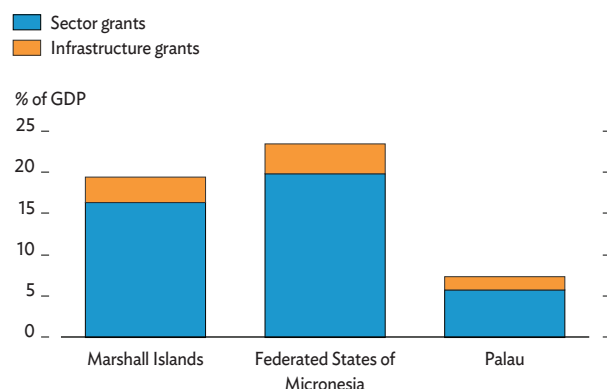
Anticipated gradual economic recovery should mean recovery in tax collection. However, comprehensive tax reform may entail temporary adjustment costs that could constrain revenue in FY2023. As spending normalizes while pandemic-related grants fade, the gradual recovery in revenues is seen to translate into fiscal deficits remaining at the equivalent of about 10% of GDP in FY2023 and FY2024. While recent developments suggest expanded financial assistance from the US, the projected near-term fiscal gap will likely necessitate further borrowing.

Policy Challenge—Managing Available Fiscal Resources

Renewal of annual financial assistance from the US can boost longer-term prospects. Each of the three North Pacific economies has a Compact of Free Association with the US that provides substantial financial assistance and an open migration policy, while allowing the US access to geopolitically important airspace and waters (Figure 2.38.6). In January 2023, Palau and the US signed an MOU outlining a broad

Figure 2.38.6 Average Ratio of Compact Grants, FY2010–FY2019

US Compact assistance is significant across all North Pacific economies.



GDP = gross domestic product.

Notes: Fiscal year ends 30 September for all 3 economies. For the Federated States of Micronesia, the chart covers FY2009–FY2018 (the latest available data).

Source: ADB estimates based on data from Graduate School USA Economic Monitoring Analysis Program.

framework for continuing their partnership. The MOU more than doubles assistance in the coming 20 years over the previous 2 decades. The Marshall Islands likewise signed an MOU that provides for considerable US assistance. On 11 February, the Government of the Federated States of Micronesia (FSM) announced an MOU providing for continued economic assistance, increased sector grants, and funding infusion into the FSM's Compact Trust Fund. The government had earlier reported consensus on increasing annual sector grant assistance to \$140 million, or \$2.8 billion over 20 years, and a \$500-million contribution to the trust fund spread over 2 years.

Harnessing additional resources requires strengthening absorptive capacity.

To translate expanded fiscal resources into improved development outcomes, the parties to the agreements must build on lessons from previous experience. Chief among them is the need to build more efficient systems and expand absorptive capacity, particularly for using compact infrastructure grants. The Marshall Islands and Palau

have lower ratios of capital expenditure to GDP than their Pacific peers. While capital spending is higher in the FSM, significant room remains for increases, as its unspent infrastructure grants were estimated at \$246 million in FY2021, equal to 61% of GDP. Steps should be supported and sustained to address understaffing and lack of specific technical skills in project management offices, ensure compliance with US building codes and standards, and continuously update development planning and programming practices.

Reforms are critical to improve absorptive capacity and the development effectiveness of economic assistance to the North Pacific.

In 2020, the Marshall Islands finalized its National Strategic Plan, 2020–2030, which includes an infrastructure pillar. Similarly, Palau developed its National Infrastructure Investment Plan, 2021–2030, and is updating its national development plan for 2023–2028. The FSM Infrastructure Development Plan, FY2016–FY2025, is due to be updated soon to ensure that it can likewise continue to provide strategic guidance toward efficiently implementing project pipelines. Over the longer term, needs include sustained capacity building and supplementary support for project management offices from development partners, along with more flexible and differentiated approaches to project implementation tailored to the contexts of small island developing states.

Prudent public financial management remains key to resilience.

Another important lesson is the importance of building fiscal buffers to cushion the impact of economic downturns. The COVID-19 pandemic highlights the need to invest in resilience, as do extreme weather events and other disasters. The proposed renewed compacts will support this through contributions to North Pacific trust funds and expanded assistance that will free up other fiscal resources for establishing and building reserves. These may be for funding general government operations or for more specific purposes, such as post-disaster emergency response.

SOUTH PACIFIC ECONOMIES

The Cook Islands, Niue, Samoa, and Tonga have struggled to recover from 3 years of economic disruption. In all four countries, GDP in fiscal year 2022 (FY2022, ended 30 June 2022) languished lower than in FY2019, tourism recovery was uneven, and labor supply issues came to the fore. Public expenditure will provide some stimulus, but fiscal positions will be mixed in the medium term. Remittances to Samoa and Tonga may help households grapple with rising inflation.

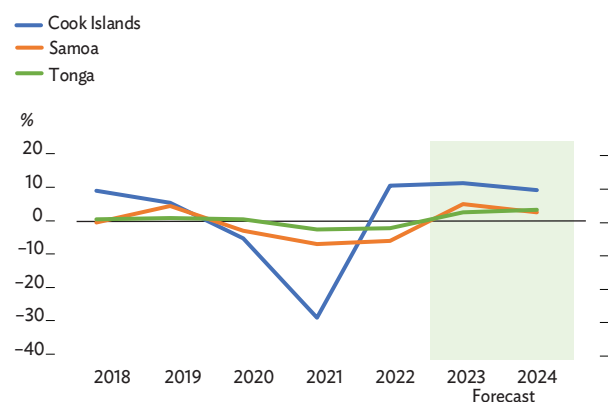
Cook Islands

The economy rebounded in FY2022 by 10.5% following sharp contraction in FY2021 (Figure 2.39.1). Growth was driven by recovery in tourism arrivals following the reopening of borders in January 2022. Arrivals were 66.0% of FY2019 levels, with 88.7% of travelers from New Zealand, the primary tourist market.

Growth is forecast at 11.2% in FY2023 and 9.1% in FY2024 (Table 2.39.1). Support to growth will come from steady recovery in tourism arrivals, led again by New Zealand, and from infrastructure projects, notably upgrades for health facilities and the Rarotonga airport. Natural hazards and acute labor shortages are downside risks to recovery, though the active recruitment of foreign workers should mitigate labor shortages.

Figure 2.39.1 Economic Growth

Economic recovery commenced once borders reopened.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

Table 2.39.1 Selected Economic Indicators, %

Recoveries have commenced, but inflation is near record highs.

	2021	2022	2023	2024
Cook Islands				
GDP growth	-29.1	10.5	11.2	9.1
Inflation	1.8	4.2	7.7	2.3
Samoa				
GDP growth	-7.1	-6.0	4.8	2.5
Inflation	-3.0	8.8	10.2	2.0
Tonga				
GDP growth	-2.7	-2.2	2.5	3.2
Inflation	1.4	8.5	9.4	1.5

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

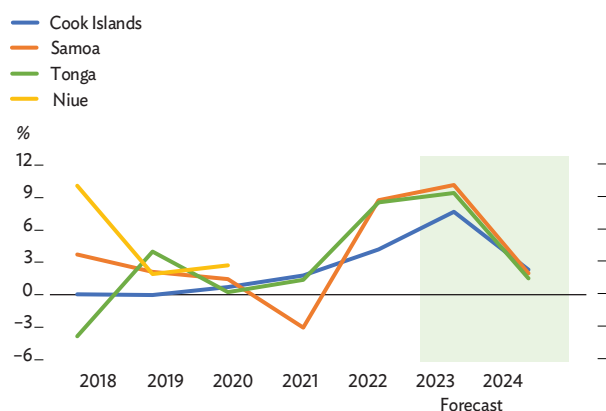
Source: Asian Development Bank estimates.

Inflation increased in FY2022 and is expected to rise further before falling back to trend in FY2024.

The Russian invasion of Ukraine disrupted supplies by escalating global fuel prices and transportation costs. Inflation increased from 1.8% in FY2021 to 4.2% in FY2022, with prices up 9.3% for transportation and 6.8% for food (Figure 2.39.2). It is expected to climb further in FY2023 before falling in FY2024 to 2.3% as imported fuel and food prices normalize.

Figure 2.39.2 Inflation

Inflation remains at or near record highs across the South Pacific.



Note: Years are fiscal years ending on 30 June of that year.

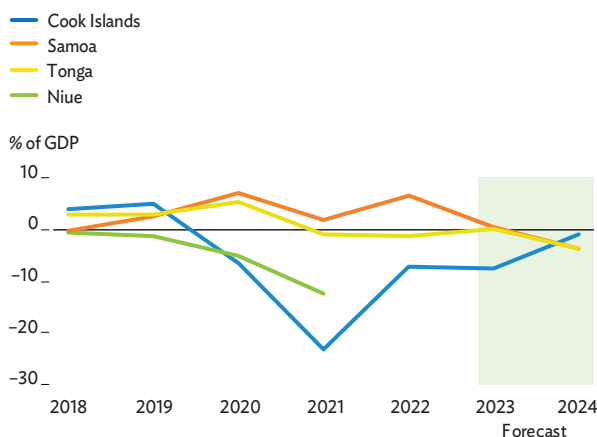
Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

The fiscal deficit is expected to narrow over the medium term as public debt remains stable.

The government reduced its fiscal deficit to the equivalent of 7.0% of GDP in FY2022 on 23.0% growth in tax revenue and 14.2% lower expenditure with underspending on capital projects. The deficit is projected to be slightly higher in FY2023 at 7.4%, despite further growth in tax revenue (Figure 2.39.3). After supporting economic stimulus measures and public spending during the pandemic, public debt equaled 43.9% of GDP in FY2022 but is expected to ease back below 35.0% by FY2024.

Figure 2.39.3 Fiscal Balance

Falls in tax revenue were offset by grants in Samoa and Tonga, alongside low mobilization of public investment for all economies.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

Samoa

The economy shrank for a third year in FY2022, by 6.0%.

Closed borders and community transmission of COVID-19 affected tourism receipts, which were 24.2% of GDP in FY2019, and constrained mobilization for many public sector capital projects. GDP in FY2022 was 15.4% lower than in FY2019.

GDP may rebound in FY2023 from a low base, but medium-term prospects are mixed.

The mobilization of public investment projects from a low base and the initial return of visitor arrivals will likely support GDP growth of 4.8% in FY2023. However, difficulties in rebuilding tourism services and fierce international competition may limit the ability to sustain visitor growth currently supported by visiting friends and relatives, back after lengthy separations. These factors are forecast to limit growth to 2.5% in FY2024.

Inflation persists well above trend. Inflation is forecast to increase from 8.8% in FY2022 to 10.2% in FY2023. Monthly inflation from July 2022 to January 2023 averaged 12.2% year on year, with prices of imported goods up by an average of 16.0% in the same period. The major increases were for food, transportation, communications, and restaurants.

Inflation is expected to moderate heading into FY2024 as softer international commodity prices begin to feed through to local prices.

Remittances and the return of tourism receipts in FY2023 are expected to narrow the current account deficit. Remittance growth remained strong, increasing by 22.2% in the 12 months to December 2022 on continued expansion of regional labor programs and sustained engagement by Samoan diaspora. As tourism receipts recover in the short term, the current account deficit is forecast to narrow sharply from the equivalent of 12.4% of GDP in FY2022 to 1.3% in FY2023. Official foreign currency reserves are sound, as of December 2022 covering 9.6 months of goods imports, well above the 4.0 months targeted by the Central Bank of Samoa.

Expansionary fiscal policy and lower revenue will likely push the fiscal balance into deficit. The government achieved a fiscal surplus equal to 6.4% of GDP in FY2022 on improved tax compliance, grant inflows, and deferred implementation of planned public investment. With borders open, some capital works delayed in FY2022 will be able to commence, though the major construction phases for some larger projects will likely occur in FY2024. As expenditure bottlenecks loosen, a narrower fiscal surplus equal to 0.8% of GDP is projected in FY2023 which may turn into a fiscal deficit equal to 3.5% in FY2024. Public external debt is forecast to decrease from the equivalent of 47.5% of GDP in FY2022 to 37.4% in FY2024.

Tonga

Disasters and COVID-19 further shrank GDP in FY2022. The economy contracted by 2.2% in FY2022 following the eruption of the Hunga Tonga–Hunga Ha’apai (HTHH) volcano and consequent tsunami in January 2022, which occurred alongside the first community transmission of COVID-19. The eruption caused extensive damage to property, infrastructure, and agriculture, with the World Bank estimating total economic losses equal to 36.4% of GDP. The undersea fiberoptic cable to Tonga was severed for nearly a month immediately following the tsunami, disrupting telecommunications and remittance inflows. Remittances nevertheless grew by 1.0% in FY2022 from their previous record set in FY2021.

Easing mobility restrictions and revived public investment will likely expand GDP by 2.5% in FY2023. Tourist accommodation capacity lost to the HTHH eruption will limit the ability of tourism to contribute to stronger economic recovery, but continued public investment is projected to support GDP growth at 3.2% in FY2024.

Inflation is forecast to accelerate further from 8.5% in FY2022 to 9.4% in FY2023. Prices increased by 9.7% in the 12 months to January 2023, and will likely remain elevated. Inflation in FY2023 is expected to be driven by import prices, local supply constraints, and domestic food price increases. Inflation is projected to drop sharply to 1.5% in FY2024 as local agriculture continues to recover from the eruption and easing international commodity prices feed through to the local economy.

Despite these shocks, the fiscal deficit equaled a modest 1.2% of GDP in FY2022. Tax collection was boosted as several large vendors automated their payment of value-added tax, grants from development partners increased, and public capital spending fell. While financing needs for reconstruction remain large, significant increases in grants from development partners will likely generate a fiscal surplus equal to 0.3% of GDP in FY2023. With remaining financing gaps funded from cash reserves, external debt is expected to fall from 38.5% of GDP in FY2022 to 31.7% in FY2023.

The current account deficit is likely to widen dramatically, which may reduce official reserves in the medium term. Remittances have begun to decline from record levels, falling by 2.7% in November 2022 as compared with a year earlier, likely affected by rising living costs and economic slowdowns in source countries. Returning friends and relatives may have converted some remittance receipts into informal cash transfers or tourism receipts. Continued moderation in remittances and substantial need for imported goods and materials for reconstruction are expected to enlarge the current account deficit from the equivalent of 5.7% of GDP in FY2022 to 9.0% in FY2023 and 11.2% in FY2024. This rapid widening will likely reduce official foreign currency reserves from 13.5 months of import coverage as of December 2022 to about 6 months in FY2024.

Niue

The economy likely contracted for a third consecutive year in FY2022 as tourism remained below pre-pandemic levels. High fuel prices and freight costs and tightening supply constraints weighed on limited fiscal space. Though borders reopened, travel was frequently interrupted by new COVID-19 cases, which may have affected consumer confidence.

The fiscal deficit in FY2022 equaled 13.3% of FY2019 GDP as higher recurrent expenditure outweighed moderate gains in recurrent revenue. Official grants declined by 19% from FY2021. The government projects a higher deficit equal to 21.4% of GDP in FY2023 as both capital and recurrent spending increase significantly.

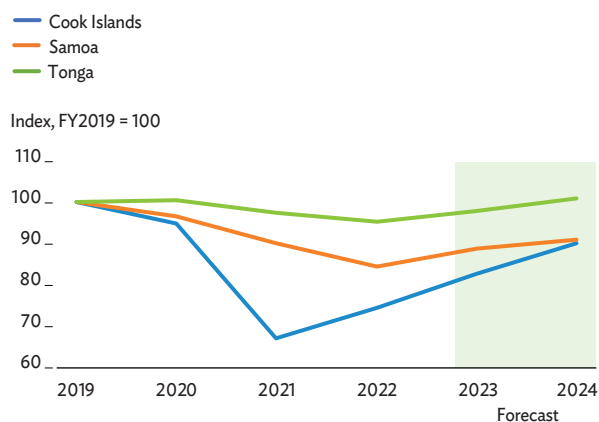
The impact of recent import price movements is unknown for lack of inflation data. The latest inflation data available are from 2020. Inflation in Niue normally mirrors price movements in New Zealand, where prices rose by 7.2% in the 12 months to December 2022. Domestic price controls partly mute the transmission of foreign price trends, though, making it a challenge to infer domestic price movements. In November 2022, for example, the Niue authorities held fuel prices constant despite increased import prices.

Policy Challenge—Navigating a Long Path to Recovery

Despite mitigated health impacts from the pandemic, output in South Pacific economies remains below pre-pandemic levels (Figure 2.39.4). Economic recovery in the South Pacific remains fragile, at risk from further shocks, and easily reversible. Tourism and related businesses have lost financial and human capital, which may delay their recovery. Slower growth may degrade recovery in other retail and commercial services and in governments' fiscal positions. As the eruption in Tonga has illustrated, the South Pacific is highly exposed to natural hazards, and post-disaster emergency response and reconstruction costs need to be factored into long-term development financing estimates. Fiscal positions are much weaker than when the COVID-19 crisis began 3 years ago, with

Figure 2.39.4 Change in Gross Domestic Product

Economies in the South Pacific are still considerably smaller than before the pandemic.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

elevated debt in the Cook Islands, cash constraints in Niue, and weaker medium-term recovery prospects in Samoa and Tonga.

Labor availability is becoming a key policy issue across the region and may hinder any return to pre-crisis trends. The ongoing shortage of local labor in the Cook Islands has likely increased dependency on attracting labor from abroad. Proactive immigration measures adopted during the COVID-19 crisis may need to be expanded to ensure adequate labor supply to support continued growth. In Samoa and Tonga, the reopening of borders and resumption of international travel are essential to salvaging tourism and resuming public infrastructure programs, but they have also opened up regional labor opportunities that have drawn away workers. In pursuit of higher incomes, an estimated 18.2% of male Tongan workers and 14.1% of male Samoan workers participated in at least one regional labor program in New Zealand or Australia in 2022. This is a rising trend. In response, Samoa briefly paused the mobilization of workers in early 2023 but soon resumed its engagement in the programs.

Repeated disasters have likely set back Tongan tourism for decades. A collaborative study by the Government of Tonga, the ADB Private Sector Development Initiative, and the World Bank highlighted the dramatic impacts of Cyclone Harold in 2020

and the HTHH eruption in 2022 on accommodation capacity. Cyclone Harold affected 18% of providers, damaging 28% of rooms. HTHH affected 27% of providers and damaged 32% of rooms, completely destroying or severely damaging 23 properties, half of which had already been damaged by Cyclone Harold. Three properties were destroyed for a second time after rebuilding from the first disaster. In addition to the 20 or so businesses that cannot rebuild without financial assistance, many businesses continue to operate below capacity for lack of funds to invest. Even if travelers return to Tonga in the medium term, the supply of accommodation may take many years to recover.

Tourism in Samoa faces significant uncertainty in the medium term. The ability of the industry to recover to pre-crisis levels in the medium term may be stymied by nonperforming loans to some large accommodators from before COVID-19, extended closure until August 2022, and the loss of labor. While visitor numbers in the second quarter of FY2023 were about two-thirds of those pre-pandemic, much of this was a rebound in visiting friends and relatives. Visitors identified as holidaymakers were off their previous highs by half. Uneven recovery and ongoing uncertainty suggest some consolidation in visitor accommodation in the medium term.

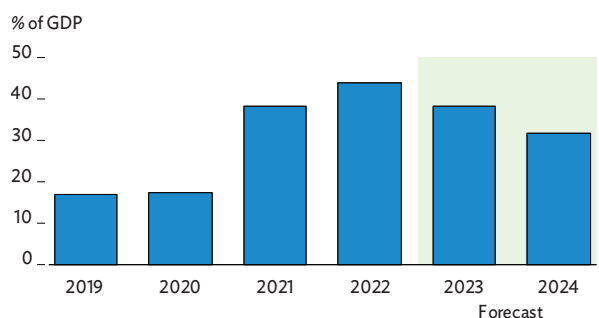
Despite these challenges, Tonga and Samoa avoided large fiscal deficits during the crises.

Both countries also avoided taking on significant new debt, thereby preserving the downward trend in their ratios of debt to GDP despite economic and revenue disruption. Remittances and official grants boosted foreign currency reserves to all-time records. Together, these buffers will mitigate future shocks in both countries, strengthened by contingent disaster grant financing instruments provided by ADB and the World Bank. While economic recovery may face headwinds, ongoing reform to strengthen tax compliance and administration will help both countries meet growing fiscal needs.

While tourism is on its way to recovery, elevated debt in the Cook Islands may inhibit public investment in the short term. From a low 16.7% of GDP in FY2019, public debt reached a peak of 49.3% in FY2022 (Figure 2.39.5). Along with cash reserves equal to 25.8% of GDP in FY2019, the increase in credit helped the government avoid cash solvency crises

Figure 2.39.5 Public Debt in the Cook Islands

Previously low debt in the Cook Islands dramatically increased during the pandemic.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance and Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; Asian Development Bank estimates.

in 2020, 2021, and 2022. The retention of tourism businesses facilitated a rapid return of visitor arrivals, which will support economic and fiscal recovery. However, large public investments in key infrastructure will likely need to be postponed. While gross debt is still below the government ceiling of 65%, debt servicing is set to increase from a low of about 6% of revenue in FY2021 to 16% by FY2030. Without access to concessional resources, this will crimp new debt financing of public infrastructure until FY2026, when an anticipated return to fiscal surpluses should support higher expenditure.

The Pacific needs to balance post-pandemic recovery carefully. Governments need to balance ongoing needs for private and public investment against their desire to restore fiscal health. Continued grant financing from development partners and improved domestic revenue collection across all countries will help, but financing needs for public investment and the challenges facing the private sector are more acute now than these nations have experienced in recent years.



3

STATISTICAL APPENDIX

STATISTICAL NOTES AND TABLES

The statistical appendix presents in 18 tables selected economic indicators for the 46 developing member economies of the Asian Development Bank (ADB). The economies are grouped into five subregions: the Caucasus and Central Asia, East Asia, South Asia, Southeast Asia, and the Pacific. Most of the tables contain historical data from 2018 to 2022; some have forecasts for 2023 and 2024.

The data were standardized to the degree possible to allow comparability over time and across economies, but differences in statistical methodology, definitions, coverage, and practices make full comparability impossible. The national income accounts section is based on the United Nations System of National Accounts, while the data on the balance of payments use International Monetary Fund (IMF) accounting standards. Historical data were obtained from official sources, statistical publications, and databases, as well as the documents of ADB, the IMF, and the World Bank. For some economies, data for 2022 were estimated from the latest available information. Projections for 2023 and 2024 are generally ADB estimates based on available quarterly or monthly data, though some projections are from governments.

Most economies report by calendar year. The following record their government finance data by fiscal year: Bhutan; Brunei Darussalam; Fiji; Hong Kong, China; Singapore; Tajikistan; Thailand; and Uzbekistan. Reporting all variables by fiscal year are South Asian countries (except for Bhutan, Maldives, and Sri Lanka), the Cook Islands, the Federated States of Micronesia, the Marshall Islands, Myanmar, Nauru, Niue, Palau, Samoa, and Tonga.

Regional and subregional averages or totals are provided for seven tables: A1, A2, A6, A11, A12, A13, and A14. For tables A1, A2, A6, A11, A12, and A14, averages were weighted by purchasing power parity gross domestic product (GDP) in current international dollars. Purchasing power parity GDP data for 2018–2021 were obtained from the IMF World Economic Outlook Database, October 2022 edition.

Weights for 2021 were carried over to 2024. For Table A13, regional and subregional totals were computed using a consistent sum, which means that if economy data were missing for a given year, the sum excluded that economy.

Tables A1, A2, A3, A4, and A5 show data on output growth, production, and demand. Changes were made to the national income accounts series for some economies to accommodate a change in source, methodology, and/or base year. Constant factor cost measures differ from market price measures in that they exclude taxes on production and include subsidies. Basic price valuation is the factor cost plus some taxes on production, such as property and payroll taxes, and less some subsidies, such as for labor but not for products. The series for Afghanistan, India, Myanmar, and Pakistan reflect fiscal year data, rather than calendar year data, and those for Timor-Leste reflect GDP excluding the offshore petroleum industry. Some historical data for Turkmenistan are not presented for lack of uniformity. A fluid situation permits no estimates or forecasts for Afghanistan in 2022–2024.

Table A1: Growth Rate of GDP, % per year.

The table shows annual growth rates of GDP valued at constant market prices, factor costs, or basic prices. GDP at market prices is the aggregate value added by all resident producers at producers' prices including taxes less subsidies on imports plus all nondeductible value-added or similar taxes. Most economies use constant market price valuation. Pakistan uses constant factor costs, and Fiji basic prices.

Table A2: Growth Rate of GDP per Capita, % per year. The table provides the growth rates of real GDP per capita, which is defined as GDP at constant prices divided by population. Also shown are data on gross national income per capita in US dollar terms (Atlas method) for 2021 sourced from the World Bank's World Development Indicators online.

Table A3: Growth Rate of Value Added in Agriculture, % per year. The table shows the growth rates of value added in agriculture at constant prices and agriculture's share of GDP in 2021 at current prices. The agriculture sector comprises plant crops, livestock, poultry, fisheries, and forestry.

Table A4: Growth Rate of Value Added in Industry, % per year. The table provides the growth rates of value added in industry at constant prices and industry's share of GDP in 2021 at current prices. This sector comprises manufacturing, mining and quarrying, and, generally, construction and utilities.

Table A5: Growth Rate of Value Added in Services, % per year. The table gives the growth rates of value added in services at constant prices and services' share of GDP in 2021 at current prices. Services generally include trade, banking, finance, real estate, and similar businesses, as well as public administration. For Malaysia, electricity, gas, water supply, and waste management are included under services.

Table A6: Inflation, % per year. Data on inflation rates are period averages. Inflation rates are based on consumer price indexes. The consumer price indexes of the following economies are for a given city only: Cambodia is for Phnom Penh, the Marshall Islands for Majuro, and Sri Lanka for Colombo. For Indonesia, a series break starts in 2019 because of a change in base year from 2012 to 2018. A fluid situation permits no forecasts for Afghanistan in 2023–2024.

Table A7: Change in Money Supply, % per year. This table tracks annual percentage change in broad money supply at the end of the period, M2 for most economies. M2 is defined as the sum of currency in circulation plus demand deposits (M1) plus quasi-money, which consists of time and savings deposits including foreign currency deposits. For the Kyrgyz Republic broad money is M2X, or M2 plus deposits of residents in foreign currency. For Cook Islands; Georgia; Hong Kong, China; India; Kazakhstan; and Solomon Islands, broad money is M3, which adds longer-term time deposits. For Sri Lanka broad money is M2b, or M2 plus bond funds.

Tables A8, A9, and A10: Government Finance.

These tables give central government revenue, expenditure, and fiscal balance expressed as percentages of GDP in nominal terms. Where full-year data are not yet available, GDP shares are estimated using available monthly or quarterly data. For Cambodia, Georgia, India, Kazakhstan, the Kyrgyz Republic, Mongolia, the People's Republic of China, and Tajikistan, transactions are those reported by the general government. A fluid situation permits no estimates for Afghanistan in 2021–2022.

Table A8: Central Government Revenue, % of GDP.

Central government revenue comprises all nonrepayable receipts, both current and capital, plus grants. These amounts are computed as a percentage of GDP at current prices. For the Republic of Korea, revenue excludes social security contributions. For Kazakhstan, revenue includes transfers from the national fund. Grants are excluded for Malaysia and Thailand. Revenue from disinvestment is included for India. Only current revenue is included for Bangladesh.

Table A9: Central Government Expenditure, % of GDP.

Central government expenditure comprises all nonrepayable payments to meet both current and capital expenses, plus net lending. These amounts are computed as shares of GDP at current prices. For Thailand, expenditure refers to budgetary expenditure excluding externally financed expenditure and borrowing. For Tajikistan, expenditure includes externally financed public investment programs. One-off expenditures are excluded for Pakistan.

Table A10: Fiscal Balance of the Central Government, % of GDP.

Fiscal balance is the difference between central government revenue and expenditure. The difference is computed as a share of GDP at current prices. Data variation may arise from statistical discrepancy when, for example, balancing items for general governments (central plus selected subnational governments), and from differences between coverage used in individual revenue and expenditure calculations and fiscal balance calculations. For Fiji, the fiscal balance excludes loan repayment. For Georgia, the fiscal balance is calculated according to the IMF *Government Finance Statistics Manual 2021* format, as is the Cambodia general government fiscal balance using the 2014 manual. For Solomon Islands, fiscal balance does not include balance of payment grants.

For Thailand, the fiscal balance is the cash balance of combined budgetary and nonbudgetary balances. For Turkmenistan, the fiscal balance does not include off-budget accounts. For Singapore, fiscal balance includes special transfers (top-ups to endowment and trust funds) and contributions from net investment returns. For the Republic of Korea, it excludes funds related to social security.

Tables A11, A12, A13, and A14: Balance of Payments. These tables show the annual flows of selected international economic transactions of economies as recorded in their balance of payments. A fluid situation permits no estimates or forecasts for Afghanistan in 2021–2024.

Tables A11 and A12: Growth Rates of Merchandise Exports and Imports, % per year. These tables show the annual growth rates of exports and imports of goods. Data are in million US dollars, primarily obtained from the balance-of-payments accounts of each economy. Export data are reported free on board. Import data are reported free onboard except for the following economies, which value them based on cost insurance and freight: Afghanistan; Hong Kong, China; Georgia; India; the Lao People’s Democratic Republic; Maldives; Myanmar; Singapore; and Thailand.

Table A13: Trade Balance, \$ million. The trade balance is the difference between merchandise exports and imports. Figures in this table are based on the export and import amounts used to generate tables A11 and A12.

Table A14: Current Account Balance, % of GDP. The current account balance is the sum of the balance of trade in merchandise, net trade in services and factor income, and net transfers. The values reported are divided by GDP at current prices in US dollars. Some historical data for Turkmenistan are not presented for lack of uniformity.

Table A15: Exchange Rates to the US Dollar, annual average. Annual average exchange rates are quoted as the local currency per US dollar.

Table A16: Gross International Reserves, \$ million. Gross international reserves are defined as the US dollar value at the end of a given period of holdings in foreign exchange, gold, special drawing rights, and IMF reserve position. For Taipei, China, this heading refers to foreign exchange reserves only. In some economies, the rubric is foreign assets plus the reserves of national monetary authorities (the net foreign reserves of, for example, the State Bank of Pakistan) plus national funds for earnings from oil or other natural resources. A fluid situation permits no estimates for Afghanistan in 2021–2022.

Table A17: External Debt Outstanding, \$ million. For most economies, external debt outstanding includes short-, medium-, and long-term debt, public and private, as well as IMF credit. For Armenia, Cambodia, and Maldives, only public external debt is reported. Intercompany lending is excluded for Georgia. Data for 2022 are as of the end of September for Sri Lanka, Singapore, and Thailand. A fluid situation permits no estimates for Afghanistan in 2021–2022.

Table A18: Debt Service Ratio, % of exports of goods and services. This table generally presents the total debt service payments of each economy, which comprise principal repayment (excluding short-term debt) and interest payments on outstanding external debt, given as a percentage of exports of goods and services. For Armenia and Cambodia, debt service refers to external public debt only. For the Philippines, income and exports of goods and services are used as the denominator. For Bangladesh, the ratio presents debt service payments on medium- and long-term loans as a percentage of exports of goods, nonfactor services, and overseas workers’ remittances.

Table A1 Growth Rate of GDP, % per year

	2018	2019	2020	2021	2022	2023	2024
Developing Asia	6.0	5.0	-0.6	7.2	4.2	4.8	4.8
Developing Asia excluding the PRC	5.4	4.0	-3.2	6.1	5.4	4.6	5.1
Caucasus and Central Asia	4.2	4.8	-2.0	5.8	5.1	4.4	4.6
Armenia	5.2	7.6	-7.2	5.7	12.6	6.5	5.5
Azerbaijan	1.5	2.5	-4.3	5.6	4.6	3.5	3.8
Georgia	4.8	5.0	-6.8	10.5	10.2	4.5	5.0
Kazakhstan	4.1	4.5	-2.5	4.3	3.2	3.7	4.1
Kyrgyz Republic	3.8	4.6	-8.4	6.2	7.0	4.5	4.0
Tajikistan	7.3	7.5	4.5	9.2	8.0	5.5	6.5
Turkmenistan	...	...	...	5.0	6.2	6.5	6.0
Uzbekistan	5.5	6.0	2.0	7.4	5.7	5.0	5.0
East Asia	6.1	5.5	1.8	7.9	2.8	4.6	4.2
Hong Kong, China	2.8	-1.7	-6.5	6.4	-3.5	3.6	3.7
Mongolia	7.7	5.6	-4.6	1.6	4.8	5.4	6.1
People's Republic of China	6.7	6.1	2.1	8.4	3.0	5.0	4.5
Republic of Korea	2.9	2.2	-0.7	4.1	2.6	1.5	2.2
Taipei, China	2.8	3.1	3.4	6.5	2.5	2.0	2.6
South Asia	6.4	4.0	-4.4	8.4	6.4	5.5	6.1
Afghanistan	1.2	3.9	-2.4	-20.7	...	...	...
Bangladesh	7.3	7.9	3.4	6.9	7.1	5.3	6.5
Bhutan	3.1	5.8	-10.0	4.1	4.7	4.6	4.2
India	6.5	3.9	-5.8	9.1	6.8	6.4	6.7
Maldives	8.1	7.1	-33.5	41.7	12.3	7.1	6.9
Nepal	7.6	6.7	-2.4	4.2	5.8	4.1	5.0
Pakistan	6.1	3.1	-0.9	5.7	6.0	0.6	2.0
Sri Lanka	2.3	-0.2	-4.6	3.5	-7.8	-3.0	1.3
Southeast Asia	5.3	4.7	-3.2	3.5	5.6	4.7	5.0
Brunei Darussalam	0.1	3.9	1.1	-1.6	-0.5	2.5	2.8
Cambodia	7.5	7.1	-3.1	3.0	5.2	5.5	6.0
Indonesia	5.2	5.0	-2.1	3.7	5.3	4.8	5.0
Lao People's Democratic Republic	6.2	4.7	-0.5	2.3	2.5	4.0	4.0
Malaysia	4.8	4.4	-5.5	3.1	8.7	4.7	4.9
Myanmar	6.4	6.8	3.2	-5.9	2.0	2.8	3.2
Philippines	6.3	6.1	-9.5	5.7	7.6	6.0	6.2
Singapore	3.6	1.3	-3.9	8.9	3.6	2.0	3.0
Thailand	4.2	2.1	-6.1	1.5	2.6	3.3	3.7
Timor-Leste	-0.7	2.1	-8.3	2.9	3.2	3.1	3.0
Viet Nam	7.5	7.4	2.9	2.6	8.0	6.5	6.8
The Pacific	1.0	3.1	-6.1	-1.4	5.2	3.3	2.8
Cook Islands	8.9	5.3	-5.2	-29.1	10.5	11.2	9.1
Federated States of Micronesia	0.1	2.7	-3.6	-1.3	2.0	4.1	0.5
Fiji	3.8	-0.6	-17.0	-5.1	15.9	6.3	3.0
Kiribati	5.3	-2.1	-1.4	1.5	1.8	2.3	2.8
Marshall Islands	4.2	10.8	-1.8	1.1	-0.9	1.5	2.0
Nauru	5.7	1.0	0.7	1.5	1.2	1.8	2.2
Niue	6.5	4.9	...	...	...	...	...
Palau	-0.1	-1.9	-9.7	-17.1	-1.0	3.8	6.5
Papua New Guinea	-0.3	4.5	-3.2	0.1	3.2	2.4	2.6
Samoa	-0.6	4.5	-3.1	-7.1	-6.0	4.8	2.5
Solomon Islands	2.7	1.7	-3.4	-0.5	-4.2	3.0	2.5
Tonga	0.3	0.7	0.4	-2.7	-2.2	2.5	3.2
Tuvalu	1.4	13.8	-4.3	1.8	1.5	2.5	2.0
Vanuatu	2.9	3.2	-5.0	1.0	2.0	1.0	4.2

... = not available, GDP = gross domestic product.

Table A2 Growth Rate of Per Capita GDP, % per year

	2018	2019	2020	2021	2022	2023	2024	Per capita GNI, \$, 2021
Developing Asia	5.2	4.3	-1.1	6.8	3.8	4.3	4.4	
Caucasus and Central Asia	2.9	3.4	-3.2	4.4	3.8	3.0	3.2	
Armenia	5.7	7.9	-7.0	5.6	12.1	7.0	5.5	4,850
Azerbaijan	0.6	1.6	-5.1	4.6	3.9	2.5	2.8	4,900
Georgia	4.8	5.2	-6.6	10.1	11.4	4.5	5.0	4,700
Kazakhstan	2.8	3.2	-3.9	3.0	1.9	2.4	2.8	8,880
Kyrgyz Republic	1.8	2.4	-10.3	4.4	5.3	0.8	1.9	1,180
Tajikistan	5.1	3.1	4.5	7.1	5.9	4.5	4.5	1,150
Turkmenistan	...	...	...	3.5	4.8	5.1	4.7	...
Uzbekistan	3.7	4.0	0.1	5.3	3.5	3.0	3.0	1,960
East Asia	5.7	5.1	1.6	7.9	2.9	4.6	4.2	
Hong Kong, China	2.0	-2.4	-6.2	7.4	-2.6	-1.1	3.2	54,460
Mongolia	5.7	3.7	-6.2	0.0	3.3	3.3	4.0	3,730
People's Republic of China	6.2	5.7	1.9	8.3	3.0	5.1	4.5	11,880
Republic of Korea	2.5	1.9	-0.8	4.3	2.8	1.6	2.3	35,110
Taipei, China	2.7	3.0	3.6	7.4	3.0	1.9	2.0	...
South Asia	5.2	2.8	-5.5	7.1	5.3	4.4	5.0	
Afghanistan	0.4	0.9	-5.7	...	...	...	...	390
Bangladesh	6.1	6.6	2.3	5.8	5.9	4.1	5.4	2,570
Bhutan	3.2	4.7	-10.9	3.1	3.7	3.8	3.0	3,040
India	5.4	2.8	-6.8	7.9	5.6	5.2	5.5	2,150
Maldives	3.9	2.8	-37.9	37.4	8.0	2.8	2.6	9,600
Nepal	6.2	5.2	-3.6	2.9	4.6	2.9	3.7	1,220
Pakistan	4.0	1.1	-2.9	3.7	5.4	0.1	1.4	1,470
Sri Lanka	1.2	-0.8	-5.1	2.4	-7.9	-3.3	0.4	4,030
Southeast Asia	4.3	3.7	-4.0	3.1	4.6	3.7	4.5	
Brunei Darussalam	-2.3	0.6	3.2	-1.3	-1.3	1.7	2.0	30,320
Cambodia	6.0	5.6	-4.4	1.7	3.6	4.1	4.6	1,580
Indonesia	4.1	3.9	-3.3	2.9	4.3	3.8	5.0	4,180
Lao People's Democratic Republic	4.6	3.1	-1.9	0.7	0.9	3.2	2.2	2,500
Malaysia	3.7	4.0	-5.3	2.7	8.4	4.2	4.5	10,710
Myanmar	5.5	5.8	2.2	-6.5	1.3	2.1	2.5	1,170
Philippines	4.7	4.6	-10.8	4.3	6.3	4.8	6.2	3,550
Singapore	3.1	0.2	-3.6	13.5	0.2	0.9	1.2	64,010
Thailand	3.8	1.8	-6.3	1.0	2.1	2.8	3.2	7,090
Timor-Leste	-2.6	0.1	-10.0	1.0	1.4	1.3	1.2	1,140
Viet Nam	6.3	5.4	1.7	1.6	7.0	5.2	5.5	3,590
The Pacific	-1.2	0.8	-8.3	-3.7	2.8	1.0	0.4	
Cook Islands	9.5	5.8	-4.7	-28.7	11.1	11.8	9.7	...
Federated States of Micronesia	-1.0	2.5	-3.8	-1.5	1.8	3.9	0.3	3,980
Fiji	3.2	-1.1	-17.5	-5.7	15.3	5.7	2.4	4,500
Kiribati	4.0	-3.3	-4.6	-0.2	0.1	0.6	1.1	2,750
Marshall Islands	7.8	13.7	-1.5	5.2	-1.3	1.1	1.6	6,780
Nauru	4.0	-0.6	-0.5	0.3	0.4	1.0	1.4	16,920
Niue	6.5	...	...	...	...	...	...	...
Palau	2.0	-1.6	-9.4	-16.8	-0.7	4.2	6.9	12,790
Papua New Guinea	-3.3	1.3	-6.1	-2.9	0.1	-0.7	-0.5	2,460
Samoa	-1.4	3.6	-3.9	-7.8	-6.8	4.0	1.7	3,810
Solomon Islands	0.0	-1.1	-5.9	-3.2	-6.7	0.3	-0.2	2,320
Tonga	0.4	0.8	0.5	-2.6	-2.1	2.6	3.3	4,930
Tuvalu	1.8	14.2	-14.0	0.9	0.6	1.6	1.1	7,200
Vanuatu	0.8	1.0	-6.2	-1.2	-0.2	-1.1	2.0	3,240

... = not available, GDP = gross domestic product, GNI = gross national income.

Table A3 Growth Rate of Value Added in Agriculture, % per year

	2018	2019	2020	2021	2022	Sector share, 2021, %
Caucasus and Central Asia						
Armenia	-6.9	-5.8	-3.7	-0.6	-0.7	12.5
Azerbaijan	4.6	7.3	1.9	3.3	...	6.4
Georgia	14.0	0.8	7.6	1.4	4.2	7.4
Kazakhstan	3.8	-0.1	5.9	-2.2	9.1	5.3
Kyrgyz Republic	2.6	2.5	0.9	-4.6	7.3	15.9
Tajikistan	4.0	7.1	8.8	6.6	8.0	...
Turkmenistan	...	...	...	...	...	...
Uzbekistan	0.3	3.1	2.9	4.0	3.6	26.5
East Asia						
Hong Kong, China	-1.8	-0.8	3.8	-2.5	-5.4	0.1
Mongolia	6.5	5.2	5.8	-5.5	12.0	14.7
People's Republic of China	3.5	3.1	3.1	7.1	4.1	6.9
Republic of Korea	0.2	3.9	-5.8	3.8	-1.3	2.0
Taipei, China	4.5	-0.9	-1.5	-4.3	-1.9	1.4
South Asia						
Afghanistan	-4.4	17.5	5.9	...	...	...
Bangladesh	3.5	3.3	3.4	3.2	3.1	12.1
Bhutan	4.2	1.3	4.6	2.1	2.2	19.7
India	2.1	5.5	3.3	3.5	3.3	15.6
Maldives	4.8	-7.5	7.1	-0.6	5.6	6.0
Nepal	2.6	5.2	2.4	2.8	2.3	24.9
Pakistan	3.9	0.9	3.9	3.5	4.4	24.2
Sri Lanka	6.3	0.5	-0.9	0.9	-4.6	9.4
Southeast Asia						
Brunei Darussalam	-1.6	-1.4	14.4	16.9	-0.9	1.2
Cambodia	1.1	-0.5	0.6	1.2	0.7	24.3
Indonesia	3.9	3.6	1.8	1.9	2.3	13.8
Lao People's Democratic Republic	1.3	1.0	2.1	1.2	1.0	17.4
Malaysia	0.1	1.9	-2.4	-0.2	0.1	9.7
Myanmar	0.1	1.6	1.6	1.0	-3.5	22.7
Philippines	1.1	1.2	-0.2	-0.3	0.5	10.1
Singapore	3.3	6.7	-4.3	11.4	-7.7	0.0
Thailand	6.1	-1.0	-3.3	2.3	2.5	8.7
Timor-Leste	2.9	2.5	0.6	5.5	3.2	19.4
Viet Nam	4.1	2.7	3.0	3.3	3.4	13.8
The Pacific						
Cook Islands	0.0	-2.1	-8.6	-4.0	5.6	3.0
Federated States of Micronesia	0.1	2.1	-2.0	-1.2	-0.6	27.7
Fiji	3.7	4.5	3.3	0.5	3.1	12.6
Kiribati	-2.6	2.5	-1.8	...	...	...
Marshall Islands	10.0	63.0	-2.5	8.8	0.5	25.1
Nauru	...	...	...	...	...	...
Niue	1.7	...	...	...	...	...
Palau	-5.2	-4.2	...	...	...	...
Papua New Guinea	4.6	2.3	1.9	1.8	2.7	20.4
Samoa	-7.8	-6.1	-1.4	0.9	-9.4	10.9
Solomon Islands	0.4	0.1	-3.8	-3.3	-9.6	34.3
Tonga	0.4	3.6	3.2	0.1	...	19.9
Tuvalu	1.6	13.9	...	...	...	...
Vanuatu	0.9	6.2	-2.7	0.0	1.0	24.7

... = not available.

Table A4 Growth Rate of Value Added in Industry, % per year

	2018	2019	2020	2021	2022	Sector share, 2021, %
Caucasus and Central Asia						
Armenia	3.7	10.5	-2.5	3.4	9.4	29.3
Azerbaijan	-0.7	1.0	-5.7	2.8	...	52.9
Georgia	-0.3	2.3	-6.6	3.2	15.4	24.5
Kazakhstan	4.4	5.5	1.5	4.4	2.4	37.4
Kyrgyz Republic	5.9	8.0	-9.9	2.7	10.9	29.6
Tajikistan	11.8	13.6	9.7	22.0	15.4	...
Turkmenistan	...	...	...	...	...	...
Uzbekistan	10.8	5.0	0.9	8.8	5.2	33.9
East Asia						
Hong Kong, China	2.4	-6.5	-11.4	1.2	2.5	6.3
Mongolia	8.5	3.1	-4.4	-2.2	-2.8	40.9
People's Republic of China	5.8	4.9	2.5	8.7	3.8	45.3
Republic of Korea	2.0	0.8	-0.7	5.3	1.2	35.6
Taipei, China	2.6	1.4	7.1	13.4	2.1	38.8
South Asia						
Afghanistan	11.1	4.8	-4.6	...	...	...
Bangladesh	10.2	11.6	3.6	10.3	9.9	34.6
Bhutan	-5.0	2.0	-12.8	2.0	4.4	35.1
India	5.3	-1.4	-3.3	11.6	3.6	31.4
Maldives	15.5	2.1	-24.8	4.5	-17.6	10.2
Nepal	10.4	7.4	-4.0	4.5	10.2	13.7
Pakistan	9.2	0.2	-5.7	7.8	7.2	20.1
Sri Lanka	-1.1	-4.1	-5.3	5.7	-16.0	31.7
Southeast Asia						
Brunei Darussalam	-0.4	4.2	2.9	-4.2	-0.9	61.7
Cambodia	11.6	11.3	-1.4	9.4	8.3	39.2
Indonesia	4.3	3.8	-2.8	3.4	4.1	41.5
Lao People's Democratic Republic	7.8	3.7	6.2	4.4	4.5	37.3
Malaysia	3.2	2.3	-6.4	5.9	6.9	35.5
Myanmar	8.3	8.4	3.8	-9.6	5.0	37.1
Philippines	7.3	5.5	-13.1	8.5	6.7	28.9
Singapore	5.5	-1.1	-0.2	13.5	2.9	28.1
Thailand	2.9	0.0	-5.4	3.7	-0.6	35.0
Timor-Leste	5.3	4.8	-22.9	-11.2	3.2	12.1
Viet Nam	9.0	8.2	4.4	3.6	7.8	41.1
The Pacific						
Cook Islands	11.7	25.6	-31.6	-17.9	9.3	11.1
Federated States of Micronesia	-7.3	-6.9	-0.3	1.4	11.8	5.3
Fiji	5.5	-0.9	-10.6	-8.3	8.3	20.9
Kiribati	-13.9	-9.4	-2.8	...	...	...
Marshall Islands	8.2	14.6	-4.7	-3.7	-1.9	10.2
Nauru	...	...	...	...	...	...
Niue	90.4	...	...	...	...	...
Palau	2.3	5.9	...	...	...	...
Papua New Guinea	-7.5	7.5	-7.5	-8.1	4.0	34.3
Samoa	-12.1	10.3	-9.6	-9.6	-0.2	12.3
Solomon Islands	1.3	3.5	-3.8	3.4	-6.8	18.5
Tonga	-14.4	4.6	-3.5	1.2	...	19.4
Tuvalu	2.2	-5.6	...	...	...	...
Vanuatu	4.9	-8.3	4.0	-6.7	3.3	11.1

... = not available.

Table A5 Growth Rate of Value Added in Services, % per year

	2018	2019	2020	2021	2022	Sector share, 2021, %
Caucasus and Central Asia						
Armenia	9.2	9.8	-8.7	6.9	17.7	58.2
Azerbaijan	3.8	3.8	-3.9	7.8	...	40.7
Georgia	5.6	6.4	-8.1	15.0	9.6	68.1
Kazakhstan	3.9	4.4	-5.3	4.4	2.6	57.2
Kyrgyz Republic	2.8	3.2	-9.8	8.4	4.8	54.5
Tajikistan	2.1	2.9	-2.6	7.9	16.0	...
Turkmenistan	...	...	...	...	...	...
Uzbekistan	5.7	6.7	1.1	9.5	8.5	39.6
East Asia						
Hong Kong, China	3.1	-0.6	-6.7	5.9	-3.0	93.6
Mongolia	5.1	6.4	-6.5	3.9	5.5	44.4
People's Republic of China	8.0	7.2	1.9	8.5	2.3	47.8
Republic of Korea	3.8	3.4	-0.8	3.8	4.2	62.5
Taipei, China	3.0	3.6	1.2	2.5	2.1	59.8
South Asia						
Afghanistan	1.9	-1.4	-5.9	...	...	...
Bangladesh	6.6	6.9	3.9	5.7	6.3	53.3
Bhutan	8.9	13.2	-6.9	6.3	5.6	45.2
India	7.2	6.3	-7.8	8.8	9.4	53.0
Maldives	7.3	8.8	-34.3	46.8	15.1	83.8
Nepal	9.3	6.8	-4.5	4.2	5.9	61.4
Pakistan	6.0	5.0	-1.2	6.0	6.2	55.7
Sri Lanka	4.3	2.9	-1.9	3.5	-2.0	58.9
Southeast Asia						
Brunei Darussalam	0.8	3.4	-2.1	2.5	0.2	37.0
Cambodia	6.8	6.2	-6.3	-2.7	4.6	36.4
Indonesia	5.8	6.4	-1.5	3.5	6.5	44.6
Lao People's Democratic Republic	6.8	7.4	-5.5	0.4	1.0	45.3
Malaysia	6.9	6.2	-5.4	1.9	10.9	54.9
Myanmar	8.7	8.3	3.4	-6.3	2.6	40.2
Philippines	6.7	7.2	-9.1	5.4	9.2	61.0
Singapore	3.4	2.1	-4.2	7.1	4.5	72.1
Thailand	4.8	3.9	-7.0	0.3	4.6	56.3
Timor-Leste	-2.1	1.2	-7.2	6.2	3.2	68.5
Viet Nam	7.5	8.1	2.0	1.6	10.0	45.2
The Pacific						
Cook Islands	7.0	4.3	0.1	-26.8	0.6	85.9
Federated States of Micronesia	0.8	3.0	-4.3	-1.5	0.6	67.0
Fiji	1.7	0.0	-16.8	-2.9	12.9	66.5
Kiribati	2.0	3.1	-0.5	...	...	...
Marshall Islands	3.1	0.0	-0.3	-0.4	-0.7	64.7
Nauru	...	...	...	...	...	...
Niue	4.7	...	...	...	...	...
Palau	9.3	0.6	...	...	...	...
Papua New Guinea	5.0	2.5	-0.2	5.5	4.0	45.3
Samoa	2.7	4.5	-1.2	-6.8	-5.5	76.9
Solomon Islands	4.8	2.0	-3.0	-0.1	-0.7	47.1
Tonga	3.3	0.8	-0.3	-7.6	...	60.6
Tuvalu	-8.5	77.0	...	...	...	...
Vanuatu	0.8	6.1	-6.7	-7.6	1.7	64.2

... = not available.

Table A6 Inflation, % per year

	2018	2019	2020	2021	2022	2023	2024
Developing Asia	2.7	3.2	3.3	2.6	4.4	4.2	3.3
Developing Asia excluding the PRC	3.3	3.5	4.1	4.2	6.7	6.2	4.4
Caucasus and Central Asia	8.2	7.4	7.7	9.0	12.9	10.3	7.5
Armenia	2.5	1.4	1.2	7.2	8.6	7.0	6.2
Azerbaijan	2.4	2.7	2.8	6.7	13.9	7.0	6.5
Georgia	2.6	4.9	5.2	9.6	11.9	6.0	4.0
Kazakhstan	6.0	5.3	6.8	8.0	15.0	11.8	6.4
Kyrgyz Republic	1.5	1.1	6.3	11.9	13.9	12.0	8.6
Tajikistan	5.4	8.0	9.4	8.0	4.2	7.0	6.5
Turkmenistan	13.2	13.0	10.0	12.5	10.0	10.0	10.0
Uzbekistan	17.5	14.6	12.9	10.7	11.4	11.0	10.0
East Asia	2.0	2.6	2.2	1.1	2.3	2.3	2.0
Hong Kong, China	2.4	2.9	0.3	1.6	1.9	2.3	2.1
Mongolia	6.8	7.3	3.7	7.3	15.2	10.9	8.7
People's Republic of China	2.1	2.9	2.5	0.9	2.0	2.2	2.0
Republic of Korea	1.5	0.4	0.5	2.5	5.1	3.2	2.0
Taipei, China	1.4	0.6	-0.2	2.0	2.9	2.0	2.0
South Asia	3.7	5.0	6.5	5.8	8.2	8.1	5.8
Afghanistan	0.6	2.3	5.6	5.2	13.8	...	...
Bangladesh	5.8	5.5	5.7	5.6	6.2	8.7	6.6
Bhutan	2.6	2.8	5.6	7.3	5.6	5.5	5.1
India	3.4	4.8	6.2	5.5	6.7	5.0	4.5
Maldives	-0.1	0.2	-1.4	0.5	2.3	4.5	2.0
Nepal	4.2	4.6	6.2	3.6	6.3	7.4	6.2
Pakistan	4.7	6.8	10.7	8.9	12.2	27.5	15.0
Sri Lanka	4.3	4.3	4.6	6.0	46.4	24.6	5.5
Southeast Asia	2.8	2.2	2.2	2.0	5.0	4.4	3.3
Brunei Darussalam	1.0	-0.4	1.9	1.7	3.7	2.0	1.6
Cambodia	2.5	1.9	2.9	2.9	5.3	3.0	4.0
Indonesia	3.3	2.8	3.8	1.6	4.2	4.2	3.0
Lao People's Democratic Republic	2.0	3.3	5.1	3.8	23.0	16.0	5.0
Malaysia	1.0	0.7	-1.1	2.5	3.4	3.1	2.8
Myanmar	5.9	8.6	5.7	3.6	16.0	10.5	8.2
Philippines	5.2	2.4	2.4	3.9	5.8	6.2	4.0
Singapore	0.4	0.6	-0.2	2.3	6.1	5.0	2.0
Thailand	1.1	0.7	-0.8	1.2	6.1	2.9	2.3
Timor-Leste	2.4	1.0	0.5	3.8	7.0	5.5	2.8
Viet Nam	3.5	2.8	3.2	1.8	3.2	4.5	4.2
The Pacific	4.3	3.0	3.0	3.1	5.7	5.0	4.4
Cook Islands	0.1	0.0	0.7	1.8	4.2	7.7	2.3
Federated States of Micronesia	1.1	2.2	1.0	1.8	5.0	3.6	0.4
Fiji	4.1	1.8	-2.6	0.2	4.3	4.2	3.5
Kiribati	0.6	-1.8	2.3	1.0	5.0	3.7	3.0
Marshall Islands	0.8	-0.1	-0.7	2.2	3.3	3.7	3.5
Nauru	0.5	4.3	-6.6	1.2	2.3	2.5	1.9
Niue	9.6	2.4	2.3	...	...	...	...
Palau	2.0	0.6	0.7	0.5	10.2	5.0	5.5
Papua New Guinea	4.7	3.6	4.9	4.5	6.0	5.0	5.0
Samoa	3.7	2.2	1.5	-3.0	8.8	10.2	2.0
Solomon Islands	3.5	1.6	3.0	-0.2	5.5	4.5	3.7
Tonga	-3.9	4.0	0.2	1.4	8.5	9.4	1.5
Tuvalu	2.2	3.5	1.6	6.7	7.6	3.3	2.8
Vanuatu	2.3	2.8	5.3	2.3	4.8	4.0	3.0

... = not available, PRC = People's Republic of China.

Table A7 Change in Money Supply, % per year

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	7.4	11.2	9.0	13.1	16.1
Azerbaijan	5.7	20.0	1.1	18.7	23.6
Georgia	14.7	16.7	23.3	11.3	11.6
Kazakhstan	7.0	2.4	16.9	20.8	13.9
Kyrgyz Republic	5.5	12.8	23.9	19.1	30.6
Tajikistan	5.1	17.0	18.4	12.3	43.4
Turkmenistan	8.4	12.9	11.8	18.1	19.9
Uzbekistan	15.6	16.2	17.7	29.7	30.2
East Asia					
Hong Kong, China	4.3	2.7	5.8	4.3	1.6
Mongolia	22.8	7.0	16.3	15.0	6.5
People's Republic of China	8.1	8.7	10.1	9.0	11.8
Republic of Korea	6.7	7.9	9.8	12.9	4.0
Taipei, China	2.7	4.5	9.4	7.3	6.7
South Asia					
Afghanistan	2.6	5.7	12.1	...	...
Bangladesh	9.2	9.9	12.6	13.6	9.4
Bhutan	6.5	13.1	27.7	13.1	...
India	10.5	8.9	12.2	6.7	8.8
Maldives	3.4	9.5	14.2	26.2	6.0
Nepal	19.4	15.8	18.1	21.8	6.8
Pakistan	9.7	11.3	17.5	16.2	13.6
Sri Lanka	13.0	7.0	23.4	13.2	15.5
Southeast Asia					
Brunei Darussalam	2.8	4.3	-0.4	2.7	1.3
Cambodia	26.6	18.2	15.3	16.4	8.2
Indonesia	6.3	6.5	12.5	14.0	8.4
Lao People's Democratic Republic	8.4	18.9	16.3	24.0	39.0
Malaysia	9.1	3.5	4.0	6.4	4.3
Myanmar	18.6	15.4	15.0	11.4	14.0
Philippines	9.5	11.5	9.6	7.9	6.7
Singapore	3.2	5.5	12.7	7.2	8.7
Thailand	4.7	3.6	10.2	4.8	3.9
Timor-Leste	3.1	-7.1	10.2	28.7	5.1
Viet Nam	12.4	14.8	14.5	10.7	6.2
The Pacific					
Cook Islands	14.8	7.3	14.8	-6.6	...
Federated States of Micronesia	...	...	...	...	...
Fiji	3.1	2.5	0.9	11.9	4.0
Kiribati	...	...	...	...	...
Marshall Islands	...	...	...	...	...
Nauru	...	...	...	...	...
Niue	...	...	...	...	...
Palau	...	...	...	...	...
Papua New Guinea	-4.0	4.7	7.0	11.7	...
Samoa	16.5	9.9	-0.9	8.1	2.2
Solomon Islands	6.8	-3.1	6.6	1.9	0.1
Tonga	10.6	1.8	1.1	19.3	-1.5
Tuvalu	...	...	...	...	...
Vanuatu	13.1	7.0	-0.7	8.9	6.7

... = not available.

Table A8 Central Government Revenues, % of GDP

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	22.3	23.9	25.2	24.1	24.3
Azerbaijan	28.0	29.5	34.1	28.5	22.9
Georgia	26.5	26.2	25.2	25.4	26.6
Kazakhstan	17.5	18.3	20.6	18.9	19.9
Kyrgyz Republic	26.6	27.0	25.3	29.0	32.7
Tajikistan	29.1	26.8	24.8	27.6	27.8
Turkmenistan	13.5	12.9	13.3	12.3	13.5
Uzbekistan	27.7	27.7	26.6	27.7	30.4
East Asia					
Hong Kong, China	21.2	20.8	21.1	24.2	21.4
Mongolia	30.9	31.5	27.8	32.9	35.2
People's Republic of China	19.9	19.3	18.0	17.6	16.8
Republic of Korea	19.7	19.4	19.2	22.2	22.9
Taipei, China	11.0	11.0	10.9	11.0	11.9
South Asia					
Afghanistan	30.6	26.9	25.7	...	...
Bangladesh	8.2	8.5	8.4	9.3	8.5
Bhutan	31.9	24.3	31.1	33.2	30.5
India	8.8	8.7	8.5	9.4	8.9
Maldives	27.2	26.9	26.4	25.7	27.7
Nepal	22.2	22.4	22.2	23.7	22.4
Pakistan	13.3	11.2	13.2	12.4	12.0
Sri Lanka	12.6	11.9	8.8	8.3	8.8
Southeast Asia					
Brunei Darussalam	32.7	26.4	12.6	24.3	18.4
Cambodia	23.7	26.8	23.9	21.6	22.2
Indonesia	13.1	12.4	10.7	11.8	11.8
Lao People's Democratic Republic	16.2	15.7	12.9	15.2	14.4
Malaysia	16.1	17.5	15.9	15.1	16.3
Myanmar	19.2	18.2	20.5	14.3	14.7
Philippines	15.6	16.1	15.9	15.5	16.1
Singapore	17.7	17.8	17.8	18.1	17.4
Thailand	15.5	17.0	17.1	16.5	16.7
Timor-Leste	57.3	52.2	58.3	55.7	52.9
Viet Nam	20.4	20.2	18.7	18.0	17.0
The Pacific					
Cook Islands	45.9	42.3	44.8	42.5	40.8
Federated States of Micronesia	80.0	75.4	70.2	65.1	52.6
Fiji	28.5	27.1	25.4	23.4	21.9
Kiribati	108.4	122.1	133.5	135.0	166.9
Marshall Islands	63.2	63.9	70.2	67.2	58.6
Nauru	129.3	138.3	157.9	148.6	164.3
Niue	69.3	79.9	58.9	73.2	75.3
Palau	44.5	44.5	47.4	51.6	45.9
Papua New Guinea	17.7	16.3	14.7	15.0	16.1
Samoa	35.4	36.9	43.5	44.7	46.0
Solomon Islands	31.7	27.4	30.1	25.8	24.5
Tonga	42.6	41.7	44.2	48.3	46.0
Tuvalu	163.0	116.9	131.7	105.5	104.5
Vanuatu	38.8	41.8	37.7	42.2	39.9

... = not available, GDP = gross domestic product.

Table A9 Central Government Expenditures, % of GDP

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	24.0	24.9	30.6	28.7	26.4
Azerbaijan	28.4	29.8	36.5	29.5	23.9
Georgia	27.2	28.3	34.5	31.5	29.4
Kazakhstan	18.8	20.2	24.5	21.9	22.1
Kyrgyz Republic	27.7	27.1	28.6	29.3	33.8
Tajikistan	31.9	28.9	29.1	28.3	29.2
Turkmenistan	13.7	13.3	13.5	12.6	12.5
Uzbekistan	29.5	31.4	31.0	33.4	34.4
East Asia					
Hong Kong, China	18.8	21.4	30.5	24.2	28.6
Mongolia	28.3	30.2	37.3	36.0	34.4
People's Republic of China	24.0	24.2	24.2	21.4	21.5
Republic of Korea	21.4	23.7	26.7	27.4	29.9
Taipei, China	10.9	10.9	12.3	11.6	11.8
South Asia					
Afghanistan	28.9	28.0	27.9	...	...
Bangladesh	12.2	13.3	13.3	13.0	13.1
Bhutan	34.5	25.5	33.1	39.3	39.3
India	12.2	13.4	17.7	16.2	15.3
Maldives	32.5	33.6	49.9	39.5	42.0
Nepal	28.0	27.3	27.6	27.7	27.0
Pakistan	19.1	19.1	20.3	18.5	19.9
Sri Lanka	17.5	19.4	21.0	20.0	18.6
Southeast Asia					
Brunei Darussalam	32.5	31.9	32.6	29.5	33.0
Cambodia	23.0	23.8	27.3	28.6	20.5
Indonesia	14.9	14.6	16.8	16.4	14.8
Lao People's Democratic Republic	20.9	19.0	18.3	16.5	14.7
Malaysia	19.8	20.9	19.4	19.1	17.0
Myanmar	23.2	22.3	26.8	22.4	22.4
Philippines	18.7	19.5	23.5	24.1	23.4
Singapore	17.1	17.6	28.5	17.8	18.0
Thailand	17.5	20.9	28.8	33.8	33.4
Timor-Leste	82.6	82.1	83.6	102.4	102.0
Viet Nam	20.5	19.8	22.2	20.2	21.4
The Pacific					
Cook Islands	41.8	37.3	51.1	65.6	47.9
Federated States of Micronesia	55.7	56.3	61.2	59.3	48.2
Fiji	32.8	30.6	31.3	34.8	34.1
Kiribati	83.0	105.9	128.7	147.8	170.1
Marshall Islands	60.6	65.7	67.8	66.4	61.2
Nauru	95.6	105.6	125.4	129.1	138.7
Niue	69.7	81.1	52.5	80.5	88.6
Palau	38.2	44.1	58.3	68.8	54.9
Papua New Guinea	20.3	21.3	23.5	21.8	21.7
Samoa	35.6	33.8	35.6	42.6	39.6
Solomon Islands	30.2	29.0	32.6	31.4	28.2
Tonga	39.7	38.5	38.8	49.3	47.2
Tuvalu	137.5	113.2	122.5	98.0	107.0
Vanuatu	32.5	39.0	39.7	39.5	43.2

... = not available, GDP = gross domestic product.

Table A10 Fiscal Balance of Central Government, % of GDP

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	-1.8	-1.0	-5.4	-4.6	-2.1
Azerbaijan	-0.4	-0.3	-2.4	-1.1	-1.0
Georgia	-0.7	-2.1	-9.3	-6.1	-2.8
Kazakhstan	-1.3	-1.8	-4.0	-3.0	-2.1
Kyrgyz Republic	-1.1	-0.1	-3.3	-0.2	-1.1
Tajikistan	-2.8	-2.1	-4.3	-0.7	-1.4
Turkmenistan	-0.2	-0.4	-0.2	-0.3	1.0
Uzbekistan	-1.8	-3.8	-4.4	-5.7	-4.0
East Asia					
Hong Kong, China	2.4	-0.6	-9.4	0.0	-4.9
Mongolia	2.5	1.3	-9.5	-3.1	0.8
People's Republic of China	-4.1	-4.9	-6.2	-3.8	-4.7
Republic of Korea	-1.8	-4.2	-7.5	-5.2	-7.0
Taipei, China	0.1	0.1	-1.4	-0.7	0.1
South Asia					
Afghanistan	1.6	-1.1	-2.2	...	...
Bangladesh	-4.0	-4.7	-4.9	-3.7	-4.6
Bhutan	-2.6	-1.2	-1.9	-6.2	-8.8
India	-3.4	-4.7	-9.2	-6.8	-6.4
Maldives	-5.3	-6.7	-23.5	-13.8	-14.3
Nepal	-5.8	-5.0	-5.4	-4.0	-4.6
Pakistan	-5.8	-7.9	-7.1	-6.1	-7.9
Sri Lanka	-5.0	-7.5	-12.2	-11.7	-9.8
Southeast Asia					
Brunei Darussalam	0.2	-5.6	-20.0	-5.2	-14.6
Cambodia	0.7	3.0	-3.4	-7.1	1.7
Indonesia	-1.8	-2.2	-6.1	-4.6	-3.0
Lao People's Democratic Republic	-4.7	-3.3	-5.3	-1.3	-0.3
Malaysia	-3.7	-3.4	-3.5	-4.0	-0.7
Myanmar	-4.0	-4.1	-6.2	-8.1	-7.7
Philippines	-3.1	-3.4	-7.6	-8.6	-7.3
Singapore	0.7	0.2	-10.7	0.2	-0.7
Thailand	-2.4	-3.9	-11.7	-17.3	-16.7
Timor-Leste	-25.3	-30.0	-25.3	-46.8	-49.1
Viet Nam	-0.1	0.3	-3.5	-2.2	-4.4
The Pacific					
Cook Islands	4.1	4.9	-6.3	-23.1	-7.0
Federated States of Micronesia	24.3	19.1	9.0	5.8	4.4
Fiji	-4.4	-3.6	-5.9	-11.4	-12.2
Kiribati	25.4	16.2	4.8	-12.8	-3.3
Marshall Islands	2.6	-1.8	2.4	0.7	-2.6
Nauru	33.7	32.7	32.5	19.5	25.5
Niue	-0.5	-1.2	6.4	-7.3	-13.3
Palau	6.3	0.4	-10.9	-17.2	-9.0
Papua New Guinea	-2.6	-5.0	-8.9	-6.8	-5.6
Samoa	-0.2	3.1	7.9	2.1	6.4
Solomon Islands	1.5	-1.5	-2.4	-5.5	-3.7
Tonga	2.9	3.2	5.3	-1.0	-1.2
Tuvalu	25.5	3.7	9.2	7.6	-2.5
Vanuatu	6.3	2.8	-2.0	2.7	-3.3

... = not available, GDP = gross domestic product.

Table A11 Growth Rate of Merchandise Exports, % per year

	2018	2019	2020	2021	2022
Developing Asia	9.0	-2.4	-0.7	30.5	8.2
Caucasus and Central Asia	24.6	5.6	-16.3	30.2	31.3
Armenia	14.1	23.3	-19.1	20.5	33.5
Azerbaijan	37.2	-4.5	-36.6	72.3	41.6
Georgia	22.4	12.2	-12.4	27.4	32.3
Kazakhstan	26.5	-2.8	-18.7	27.5	40.7
Kyrgyz Republic	5.6	6.6	-1.3	37.9	...
Tajikistan	-10.4	9.3	19.8	52.8	-0.4
Turkmenistan	49.6	8.1	...	...	...
Uzbekistan	12.0	22.1	-7.7	10.2	12.4
East Asia	8.5	-2.3	4.0	28.0	4.5
Hong Kong, China	5.1	-4.4	-0.3	24.5	-8.7
Mongolia	12.4	9.6	-2.7	16.4	20.4
People's Republic of China	9.1	-1.3	5.2	28.1	4.6
Republic of Korea	7.9	-11.1	-7.0	25.4	6.3
Taipei, China	0.8	-4.3	3.6	32.4	2.7
South Asia	9.2	-3.2	-8.6	38.1	10.1
Afghanistan	11.6	-1.3	-10.1	...	...
Bangladesh	6.7	9.1	-17.1	12.4	33.4
Bhutan	5.9	13.1	-5.4	20.0	2.4
India	9.1	-5.0	-7.5	44.8	4.9
Maldives	6.6	6.3	-28.6	10.8	34.8
Nepal	15.8	12.5	-7.6	31.0	43.5
Pakistan	12.6	-2.1	-7.1	13.8	26.6
Sri Lanka	4.7	0.4	-15.9	24.4	4.9
Southeast Asia	7.9	-2.5	-3.2	28.2	15.6
Brunei Darussalam	18.2	11.4	-9.4	68.3	7.8
Cambodia	15.5	15.6	23.6	5.4	18.7
Indonesia	7.0	-6.8	-3.0	42.5	25.6
Lao People's Democratic Republic	18.6	2.9	8.0	24.8	7.9
Malaysia	10.4	-4.1	-5.9	27.0	13.8
Myanmar	7.4	-6.8	-4.1	-2.6	5.3
Philippines	0.3	2.9	-9.8	12.5	5.9
Singapore	10.4	-4.1	-5.0	22.5	12.6
Thailand	7.5	-3.3	-6.5	19.2	5.5
Timor-Leste	48.6	5.5	-33.0	91.1	-22.0
Viet Nam	13.9	8.4	7.0	18.9	10.5
The Pacific	4.2	6.8	-17.3	13.9	19.3
Cook Islands	91.6	-56.3	110.6	-12.3	-40.5
Federated States of Micronesia	-14.7	72.7	-25.1	2.5	4.3
Fiji	1.9	2.2	-20.3	8.5	15.0
Kiribati	-44.9	46.9	1.3	10.4	-11.6
Marshall Islands	3.9	-0.3	11.7	51.8	...
Nauru	-14.8	17.0	-61.5	125.0	8.4
Niue	-2.2	...	...	...	...
Palau	6.2	-13.5	-54.5	42.6	16.1
Papua New Guinea	5.4	8.8	-18.6	17.3	18.5
Samoa	-4.6	38.0	-9.5	-23.1	-8.6
Solomon Islands	14.5	-14.0	-17.7	-2.1	-6.8
Tonga	-31.2	9.9	14.3	-9.8	279.7
Tuvalu	-51.6	152.5	-78.1	14.2	47.3
Vanuatu	4.4	-26.1	-1.2	17.4	37.2

... = not available.

Table A12 Growth Rate of Merchandise Imports, % per year

	2018	2019	2020	2021	2022
Developing Asia	14.8	-3.6	-6.4	35.7	10.1
Caucasus and Central Asia	16.2	12.1	-9.9	14.5	18.3
Armenia	18.3	13.3	-19.3	16.6	38.5
Azerbaijan	21.2	3.5	-11.1	3.4	-8.5
Georgia	15.1	1.8	-13.5	24.2	31.6
Kazakhstan	12.9	17.5	-7.5	9.2	19.6
Kyrgyz Republic	17.9	-5.7	-26.0	50.4	...
Tajikistan	13.5	6.3	-5.9	33.6	22.8
Turkmenistan	-47.8	1.6	...	...	...
Uzbekistan	47.5	16.1	-10.1	21.0	24.1
East Asia	15.9	-2.7	-0.6	32.6	2.6
Hong Kong, China	6.6	-7.0	-2.1	22.7	-7.4
Mongolia	35.4	2.4	-13.1	29.2	27.6
People's Republic of China	17.1	-2.1	0.3	32.7	1.0
Republic of Korea	10.6	-7.6	-8.3	31.2	17.7
Taipei, China	6.6	-1.9	-2.2	36.8	8.6
South Asia	12.1	-6.7	-15.9	48.0	22.6
Afghanistan	-1.4	-7.0	-4.6	...	...
Bangladesh	25.2	1.8	-8.6	19.7	35.9
Bhutan	0.2	-4.6	-12.7	35.4	35.0
India	10.3	-7.6	-16.6	55.3	20.9
Maldives	24.2	-0.4	-37.9	40.0	35.3
Nepal	27.9	5.2	-18.9	26.5	21.9
Pakistan	16.0	-6.8	-15.9	24.4	32.8
Sri Lanka	6.0	-10.3	-19.5	28.5	-11.4
Southeast Asia	15.4	-4.5	-12.2	31.2	17.1
Brunei Darussalam	33.7	21.8	3.5	60.8	9.0
Cambodia	21.3	18.3	-5.3	45.9	4.2
Indonesia	20.6	-8.8	-18.1	39.9	21.6
Lao People's Democratic Republic	6.1	-0.9	-9.3	11.9	10.1
Malaysia	11.4	-5.7	-8.5	27.2	18.1
Myanmar	2.9	-13.8	5.9	-22.8	8.5
Philippines	11.9	-0.2	-20.2	30.5	18.5
Singapore	12.7	-3.4	-8.9	24.0	13.9
Thailand	13.7	-5.6	-13.6	27.7	15.3
Timor-Leste	-2.9	-3.4	-11.0	7.7	3.9
Viet Nam	12.2	7.0	3.7	26.7	8.3
The Pacific	13.0	4.7	-18.1	6.2	24.0
Cook Islands	15.2	-4.7	-5.3	-12.4	19.7
Federated States of Micronesia	0.1	-0.6	-1.5	18.5	38.8
Fiji	11.4	-13.6	-27.5	15.8	74.1
Kiribati	-11.6	5.9	0.6	1.2	6.2
Marshall Islands	10.4	56.8	-35.4	9.7	...
Nauru	33.3	0.7	4.8	24.0	3.8
Niue	11.3	...	...	...	...
Palau	-1.0	3.0	-1.7	-18.3	35.2
Papua New Guinea	14.7	12.1	-16.5	3.1	9.3
Samoa	6.7	6.2	-9.5	0.9	7.9
Solomon Islands	14.7	-6.2	-18.6	15.8	17.5
Tonga	5.2	2.2	-5.5	2.2	55.6
Tuvalu	-8.3	95.1	4.4	-1.9	-3.4
Vanuatu	-4.2	-10.5	-6.5	16.8	24.8

... = not available.

Table A13 Trade Balance, \$ million

	2018	2019	2020	2021	2022
Developing Asia	402,405	426,154	699,349	679,084	605,227
Caucasus and Central Asia	21,259	13,238	-3,657	9,391	30,507
Armenia	-1,763	-1,722	-1,382	-1,505	-2,248
Azerbaijan	9,841	8,533	2,512	11,274	21,178
Georgia	-5,982	-5,721	-4,709	-5,858	-7,923
Kazakhstan	24,839	17,044	9,249	18,756	35,125
Kyrgyz Republic	-3,034	-2,626	-1,440	-2,420	...
Tajikistan	-2,104	-2,165	-1,671	-1,953	-2,914
Turkmenistan	6,328	7,186	...	...	...
Uzbekistan	-6,867	-7,291	-6,216	-8,904	-12,711
East Asia	525,488	516,072	663,408	730,962	765,040
Hong Kong, China	-32,282	-15,382	-5,328	3,174	-5,775
Mongolia	676	1,158	1,756	1,370	1,165
People's Republic of China	380,074	392,993	511,103	562,724	685,600
Republic of Korea	110,087	79,812	80,605	75,731	15,061
Taipei, China	66,934	57,491	75,273	87,963	68,989
South Asia	-259,178	-228,327	-163,081	-264,018	-392,913
Afghanistan	-5,721	-5,294	-5,101	...	...
Bangladesh	-18,178	-15,835	-17,858	-23,778	-33,249
Bhutan	-431	-304	-216	-392	-783
India	-180,283	-157,506	-102,152	-189,459	-297,394
Maldives	-2,425	-2,392	-1,451	-2,107	-2,851
Nepal	-10,895	-11,386	-9,186	-11,510	-13,759
Pakistan	-30,903	-27,612	-21,109	-28,634	-39,598
Sri Lanka	-10,343	-7,997	-6,008	-8,139	-5,185
Southeast Asia	110,505	120,105	198,616	197,435	196,932
Brunei Darussalam	2,365	2,211	1,359	2,679	2,781
Cambodia	-5,844	-7,255	-2,544	-11,205	-8,826
Indonesia	-228	3,508	28,301	43,806	62,682
Lao People's Democratic Republic	-1,635	-1,408	-264	524	405
Malaysia	28,405	30,112	32,708	41,168	38,465
Myanmar	-4,362	-2,978	-4,204	-1,216	-1,632
Philippines	-50,972	-49,312	-33,775	-52,806	-69,393
Singapore	104,437	97,848	106,435	125,745	136,535
Thailand	22,388	26,725	40,402	32,354	10,814
Timor-Leste	-589	-566	-510	-586	-617
Viet Nam	16,540	21,221	30,708	16,971	25,717
The Pacific	4,331	5,066	4,063	5,314	5,568
Cook Islands	-114	-121	-102	-90	-119
Federated States of Micronesia	-129	-93	-111	-141	-175
Fiji	-1,293	-958	-621	-779	-1,881
Kiribati	-92	-94	-95	-95	-103
Marshall Islands	-63	-135	-57	-33	...
Nauru	-55	-53	-68	-77	-79
Niue	-13	...	...	...	...
Palau	-136	-143	-148	-117	-160
Papua New Guinea	6,973	7,465	5,998	7,503	9,204
Samoa	-293	-299	-271	-284	-313
Solomon Islands	6	-36	-26	-97	-204
Tonga	-202	-206	-191	-198	-271
Tuvalu	-18	-36	-38	-37	-36
Vanuatu	-240	-224	-207	-242	-295

... = not available.

Table A14 Current Account Balance, % of GDP

	2018	2019	2020	2021	2022
Developing Asia	0.1	0.8	2.0	1.3	1.1
Caucasus and Central Asia	-1.2	-3.2	-3.9	-1.9	4.4
Armenia	-7.4	-7.3	-3.8	-3.7	-2.0
Azerbaijan	12.8	9.1	-0.5	15.2	22.5
Georgia	-6.8	-5.5	-12.4	-10.4	-3.2
Kazakhstan	-0.5	-4.6	-4.4	-4.0	2.8
Kyrgyz Republic	-12.1	-12.1	4.8	-8.7	...
Tajikistan	-4.4	-2.2	4.1	8.4	3.3
Turkmenistan	...	...	...	0.6	6.0
Uzbekistan	-7.1	-5.6	-5.0	-7.0	-0.6
East Asia	1.1	1.5	2.6	2.8	2.9
Hong Kong, China	3.7	5.9	7.0	11.8	10.7
Mongolia	-16.7	-15.2	-5.1	-13.8	-15.8
People's Republic of China	0.2	0.7	1.7	1.8	2.3
Republic of Korea	4.5	3.6	4.6	4.7	1.8
Taipei, China	11.6	10.9	14.3	15.1	13.3
South Asia	-2.5	-1.3	0.4	-1.3	-3.3
Afghanistan	12.2	11.7	11.2	...	...
Bangladesh	-3.0	-1.3	-1.3	-1.1	-4.1
Bhutan	-20.9	-13.9	-13.7	-21.9	-34.3
India	-2.1	-0.9	0.9	-1.2	-2.9
Maldives	-28.4	-26.6	-35.6	-7.9	-18.0
Nepal	-7.2	-6.9	-0.9	-7.8	-12.8
Pakistan	-5.4	-4.2	-1.5	-0.8	-4.6
Sri Lanka	-3.0	-2.1	-1.4	-3.8	-2.2
Southeast Asia	0.7	1.7	2.7	0.7	0.7
Brunei Darussalam	6.9	6.6	4.3	11.2	9.0
Cambodia	-11.8	-10.8	-3.4	-40.4	-25.3
Indonesia	-2.9	-2.7	-0.4	0.3	1.0
Lao People's Democratic Republic	-13.1	-12.2	-6.6	-5.0	-4.7
Malaysia	2.2	3.5	4.2	3.8	2.6
Myanmar	-4.7	0.4	-2.5	-1.3	-1.8
Philippines	-2.6	-0.8	3.2	-1.5	-4.4
Singapore	15.7	16.2	16.5	18.0	19.3
Thailand	5.6	7.0	4.2	-2.1	-3.4
Timor-Leste	-12.2	7.9	-12.8	-24.2	-21.9
Viet Nam	1.9	3.6	4.3	-2.0	-0.3
The Pacific	13.4	13.7	11.4	11.3	12.6
Cook Islands	39.3	33.2	10.8	-11.8	-7.0
Federated States of Micronesia	20.4	31.3	12.2	-3.6	-13.9
Fiji	-7.2	-4.9	-12.8	-12.0	-12.5
Kiribati	37.7	49.3	20.2	33.2	38.1
Marshall Islands	0.7	-27.8	19.4	25.1	...
Nauru	8.1	4.9	2.7	4.1	-2.5
Niue	15.7	...	...	...	...
Palau	-15.6	-31.1	-48.2	-55.9	-67.9
Papua New Guinea	22.9	22.1	20.9	21.0	23.7
Samoa	0.9	3.1	0.0	-17.7	-13.6
Solomon Islands	-3.0	-9.5	-1.6	-4.8	-12.4
Tonga	-6.3	-4.0	-7.5	-3.9	-5.7
Tuvalu	54.1	-16.9	4.0	-1.9	-4.1
Vanuatu	8.8	27.8	7.9	0.8	-5.0

... = not available, GDP = gross domestic product.

Table A15 Exchange Rates to the United States Dollar, annual average

	Currency	Symbol	2018	2019	2020	2021	2022
Caucasus and Central Asia							
Armenia	Dram	AMD	482.99	480.45	489.01	503.77	435.67
Azerbaijan	Azerbaijan new manat	AZN	1.70	1.70	1.70	1.70	1.70
Georgia	Lari	GEL	2.53	2.82	3.11	3.22	2.92
Kazakhstan	Tenge	T	344.71	382.75	412.95	425.91	460.17
Kyrgyz Republic	Som	Som	68.84	69.79	77.35	84.64	84.12
Tajikistan	Somoni	TJS	9.15	9.53	10.32	11.31	10.75
Turkmenistan	Turkmen manat	TMM	3.50	3.50	3.50	3.50	3.50
Uzbekistan	Sum	SUM	8,069.00	8,837.00	10,065.00	10,623.00	11,050.15
East Asia							
Hong Kong, China	Hong Kong dollar	HK\$	7.84	7.84	7.76	7.80	7.80
Mongolia	Togrog	MNT	2,472.60	2,663.70	2,813.20	2,849.25	3,141.40
People's Republic of China	Yuan	CNY	6.62	6.90	6.90	6.45	6.73
Republic of Korea	Won	W	1,100.16	1,165.36	1,180.27	1,143.96	1,291.88
Taipei, China	NT dollar	NT\$	30.13	30.90	29.45	27.93	29.80
South Asia							
Afghanistan	Afghani	AF	72.08	78.40	76.80	83.55	90.00
Bangladesh	Taka	Tk	82.10	84.03	84.78	84.81	86.30
Bhutan	Ngultrum	Nu	68.40	70.42	74.11	73.94	78.60
India	Indian rupee/s	Re/Rs	69.92	70.90	74.22	74.50	79.03
Maldives	Rufiyaa	Rf	15.41	15.38	15.41	15.39	15.40
Nepal	Nepalese rupee/s	NRe/NRs	104.69	112.90	116.75	117.86	121.21
Pakistan	Pakistan rupee/s	PRe/PRs	109.80	136.10	158.00	160.02	177.45
Sri Lanka	Sri Lanka rupee/s	SLRe/SLRs	162.48	178.78	185.52	198.88	324.55
Southeast Asia							
Brunei Darussalam	Brunei dollar	B\$	1.35	1.36	1.38	1.34	1.38
Cambodia	Riel	KR	4,065.00	4,070.00	4,078.00	4,095.00	4,090.00
Indonesia	Rupiah	Rp	14,237.83	14,147.75	14,581.92	14,310.00	14,849.92
Lao People's Dem. Rep.	Kip	KN	8,401.38	8,679.85	9,049.00	9,737.25	14,035.00
Malaysia	Ringgit	RM	4.04	4.14	4.20	4.14	4.40
Myanmar	Kyat	MK	1,381.92	1,525.82	1,429.05	1,490.40	1,822.09
Philippines	Peso	P	52.66	51.80	49.62	49.26	54.48
Singapore	Singapore dollar	S\$	1.35	1.36	1.38	1.34	1.38
Thailand	Baht	B	32.31	31.05	31.29	31.98	35.06
Timor-Leste	US dollar	US\$	1.00	1.00	1.00	1.00	1.00
Viet Nam	Dong	D	22,602.90	23,050.47	23,208.82	23,159.72	23,271.48
The Pacific							
Cook Islands	New Zealand dollar	NZ\$	1.40	1.49	1.57	1.44	1.47
Federated States of Micronesia	US dollar	US\$	1.00	1.00	1.00	1.00	1.00
Fiji	Fiji dollar	F\$	2.09	2.16	2.17	2.07	2.07
Kiribati	Australian dollar	A\$	1.34	1.44	1.45	1.33	1.44
Marshall Islands	US dollar	US\$	1.00	1.00	1.00	1.00	1.00
Nauru	Australian dollar	A\$	1.34	1.44	1.45	1.34	1.38
Niue	New Zealand dollar	NZ\$	1.40	1.49	1.57	1.44	1.47
Palau	US dollar	US\$	1.00	1.00	1.00	1.00	1.00
Papua New Guinea	Kina	K	3.30	3.39	3.46	3.51	3.52
Samoa	Tala	ST	2.57	2.62	2.70	2.57	2.61
Solomon Islands	Sol. Islands dollar	SI\$	7.95	8.17	8.21	8.03	8.16
Tonga	Pa'anga	T\$	2.19	2.27	2.31	2.28	2.27
Tuvalu	Australian dollar	A\$	1.34	1.44	1.45	1.33	1.44
Vanuatu	Vatu	Vt	110.17	114.73	115.38	109.45	116.98

... = not available.

Table A16 Gross International Reserve, \$ million

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	2,259	2,850	2,616	3,230	4,109
Azerbaijan	5,628	6,258	6,369	7,074	8,996
Georgia	3,300	3,500	3,900	4,200	4,900
Kazakhstan	30,927	28,958	35,638	34,378	35,076
Kyrgyz Republic	2,155	2,424	2,808	2,978	2,798
Tajikistan	1,211	1,385	2,238	2,498	3,322
Turkmenistan	...	...	...	...	...
Uzbekistan	27,081	29,172	34,904	35,139	35,768
East Asia					
Hong Kong, China	424,670	441,350	491,775	496,867	424,029
Mongolia	3,549	4,349	4,534	4,366	3,400
People's Republic of China	3,167,992	3,222,933	3,356,529	3,426,908	...
Republic of Korea	403,694	408,816	443,098	463,118	423,164
Taipei, China	461,784	478,126	529,911	548,408	554,932
South Asia					
Afghanistan	8,273	8,573	9,763	...	...
Bangladesh	32,916	32,717	36,037	46,391	41,827
Bhutan	974	1,214	1,454	970	773
India	412,871	477,807	576,984	607,309	583,315
Maldives	712	754	985	806	828
Nepal	10,084	9,500	11,646	11,753	9,535
Pakistan	9,765	7,285	12,132	17,299	9,815
Sri Lanka	6,919	7,642	5,664	3,139	1,898
Southeast Asia					
Brunei Darussalam	3,407	4,273	3,997	4,982	5,863
Cambodia	14,629	18,763	21,334	20,265	17,805
Indonesia	120,654	129,183	135,897	144,905	137,233
Lao People's Democratic Republic	873	997	1,319	1,263	1,100
Malaysia	103,978	102,376	102,861	117,503	114,355
Myanmar	5,462	5,668	6,772	7,800	...
Philippines	79,193	87,840	110,117	108,794	96,149
Singapore	287,673	279,450	362,305	417,904	289,484
Thailand	206,318	217,632	247,579	256,812	213,442
Timor-Leste	16,467	18,337	19,647	19,816	...
Viet Nam	55,263	78,517	95,149	109,439	86,694
The Pacific					
Cook Islands	...	...	...	...	...
Federated States of Micronesia	...	...	...	...	...
Fiji	964	1,027	1,011	1,546	1,701
Kiribati	84	102	173	139	116
Marshall Islands	...	...	...	...	...
Nauru	...	...	...	...	...
Niue	...	...	...	...	...
Palau	...	...	...	...	...
Papua New Guinea	2,215	2,313	2,686	2,878	2,422
Samoa	155	187	220	282	278
Solomon Islands	627	576	647	700	665
Tonga	214	213	235	314	388
Tuvalu	86	89	91	91	99
Vanuatu	434	510	572	678	638

... = not available.

Table A17 External Debt Outstanding, \$ million

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	5,536	5,785	6,059	6,648	6,451
Azerbaijan	8,927	9,091	8,822	8,136	8,629
Georgia	14,634	15,324	17,043	18,358	18,731
Kazakhstan	160,331	159,544	164,517	164,737	...
Kyrgyz Republic	6,828	7,008	7,367	7,667	7,574
Tajikistan	2,925	2,922	3,247	3,015	3,228
Turkmenistan	...	...	...	...	...
Uzbekistan	18,750	26,331	36,295	43,400	49,000
East Asia					
Hong Kong, China	1,696,008	1,667,263	1,789,612	1,873,329	1,814,937
Mongolia	28,715	30,702	32,362	33,806	33,586
People's Republic of China	1,982,800	2,070,810	2,400,807	2,746,600	...
Republic of Korea	441,153	470,736	550,628	632,394	664,503
Taipei, China	191,161	184,659	189,873	213,592	202,146
South Asia					
Afghanistan	1,212	1,147	1,482	...	...
Bangladesh	33,512	38,475	44,095	50,880	55,602
Bhutan	2,642	2,728	2,873	3,203	3,163
India	543,189	558,500	563,500	593,100	620,737
Maldives	1,333	1,432	1,617	2,068	...
Nepal	4,781	5,366	6,745	7,828	8,026
Pakistan	95,237	106,349	113,014	122,294	130,196
Sri Lanka	52,412	54,811	49,041	50,724	47,676
Southeast Asia					
Brunei Darussalam	...	...	...	...	...
Cambodia	7,022	7,597	8,810	9,503	9,971
Indonesia	375,430	403,563	416,935	396,844	396,844
Lao People's Democratic Republic	15,533	16,572	17,431	17,188	...
Malaysia	223,035	231,506	238,844	259,114	259,242
Myanmar	10,100	11,100	12,900	13,000	13,900
Philippines	78,960	83,618	98,488	106,428	107,910
Singapore	1,541,608	1,560,539	1,643,352	1,779,612	1,823,506
Thailand	163,103	171,885	190,713	196,274	187,878
Timor-Leste	146	192	218	281	332
Viet Nam	106,855	117,338	125,065	136,213	...
The Pacific					
Cook Islands	61	62	55	115	148
Federated States of Micronesia	76	71	65	59	52
Fiji	698	674	788	1,170	1,625
Kiribati	39	37	35	39	34
Marshall Islands	73	68	61	56	50
Nauru	82	88	88	4	18
Niue	...	...	...	...	...
Palau	92	93	150	175	209
Papua New Guinea	3,026	4,228	5,185	6,531	7,571
Samoa	426	399	372	389	363
Solomon Islands	94	94	126	145	141
Tonga	198	197	181	196	196
Tuvalu	3	5	4	4	4
Vanuatu	337	360	357	378	365

... = not available.

Table A18 Debt Service Ratio, % of exports of goods and services

	2018	2019	2020	2021	2022
Caucasus and Central Asia					
Armenia	6.2	6.1	10.6	7.9	5.0
Azerbaijan	6.3	4.5	8.1	5.7	...
Georgia	19.2	19.3	27.8	24.2	23.1
Kazakhstan	75.2	56.1	64.8	48.3	...
Kyrgyz Republic	32.8	36.6	44.4	26.7	...
Tajikistan	16.8	13.9	15.9	15.4	...
Turkmenistan	...	...	...	...	...
Uzbekistan	15.6	15.7	23.3	17.1	18.1
East Asia					
Hong Kong, China	...	...	...	...	...
Mongolia	50.1	40.8	44.5	40.6	22.2
People's Republic of China	5.5	6.7	6.5	5.9	...
Republic of Korea	8.8	...	...	...	...
Taipei, China	2.3	4.8	2.3	2.1	2.1
South Asia					
Afghanistan	...	...	...	...	...
Bangladesh	3.5	3.4	4.4	4.3	3.4
Bhutan	23.4	34.9	29.5	38.1	10.8
India	6.4	6.5	8.2	5.2	5.7
Maldives	2.9	2.7	4.9	7.1	...
Nepal	8.3	8.2	10.9	4.6	3.4
Pakistan	24.5	38.3	52.1	42.5	46.4
Sri Lanka	28.9	29.7	35.2	30.0	...
Southeast Asia					
Brunei Darussalam	...	...	...	...	...
Cambodia	1.4	1.5	1.8	1.9	1.8
Indonesia	25.1	26.9	27.7	22.1	16.5
Lao People's Democratic Republic	13.0	11.5	10.3	8.6	...
Malaysia	11.3	12.8	14.5	10.9	11.9
Myanmar	5.2	4.2	5.4	5.3	6.6
Philippines	6.6	6.7	6.7	7.3	5.9
Singapore	...	...	...	...	...
Thailand	6.2	6.7	7.5	6.1	...
Timor-Leste	2.6	6.1	16.7	25.5	50.8
Viet Nam	7.0	5.8	5.6	5.9	...
The Pacific					
Cook Islands	5.6	4.5	6.6	9.2	...
Federated States of Micronesia	5.2	4.6	6.3	5.7	5.0
Fiji	1.7	1.9	4.3	19.7	1.6
Kiribati	4.2	4.5	5.8	7.6	8.1
Marshall Islands	8.2	8.9	7.8	5.6	...
Nauru	2.3	0.9	0.9	0.7	3.6
Niue	...	...	...	...	...
Palau	5.9	7.9	16.1	39.4	18.9
Papua New Guinea	0.8	1.2	1.4	0.8	1.0
Samoa	9.5	8.4	11.3	25.6	26.7
Solomon Islands	0.7	1.1	1.5	1.6	1.4
Tonga	6.0	8.2	13.0	18.7	19.1
Tuvalu	12.4	...	...	...	...
Vanuatu	9.8	9.5	28.9	51.1	27.9

... = not available.

Asian Development Outlook April 2023

Developing Asia's prospects are brightening on the rapid reopening in the People's Republic of China and continued resilience in many economies as the pandemic passes. Domestic demand, services, and tourism are reviving at a dynamic pace, supporting growth. But risks could undermine the region's recovery. Rising interest rates are increasing the risk of debt vulnerability and financial instability, and global fracturing, climate change, and geopolitical tensions are continuing threats. To confront these challenges, policy makers across developing Asia must remain vigilant and strengthen policies to ensure financial stability and actively support multilateralism to deepen regional cooperation among economies.

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