

Reforms for Recovery

EAP Economic Update, October 2022

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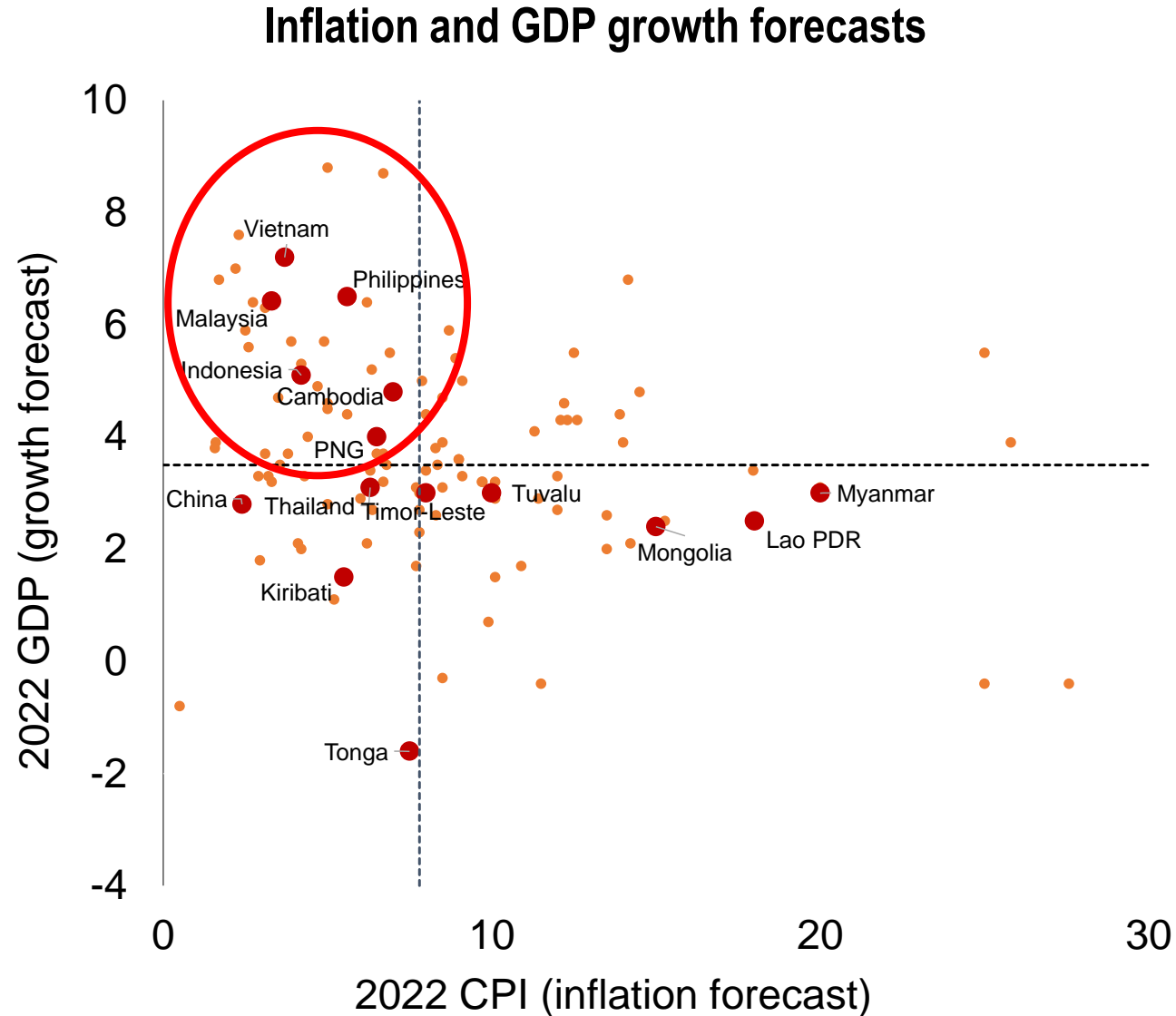
Three key points

1. Malaysia and the EAP region are growing faster with lower inflation than other regions of the world; but within the region, a role reversal
2. Looking ahead, three impediments to growth: deceleration, debt and distortions
3. More efficient social protection, and better policies for food, fuel, and finance, could soften the pain today and boost growth tomorrow

Recent developments

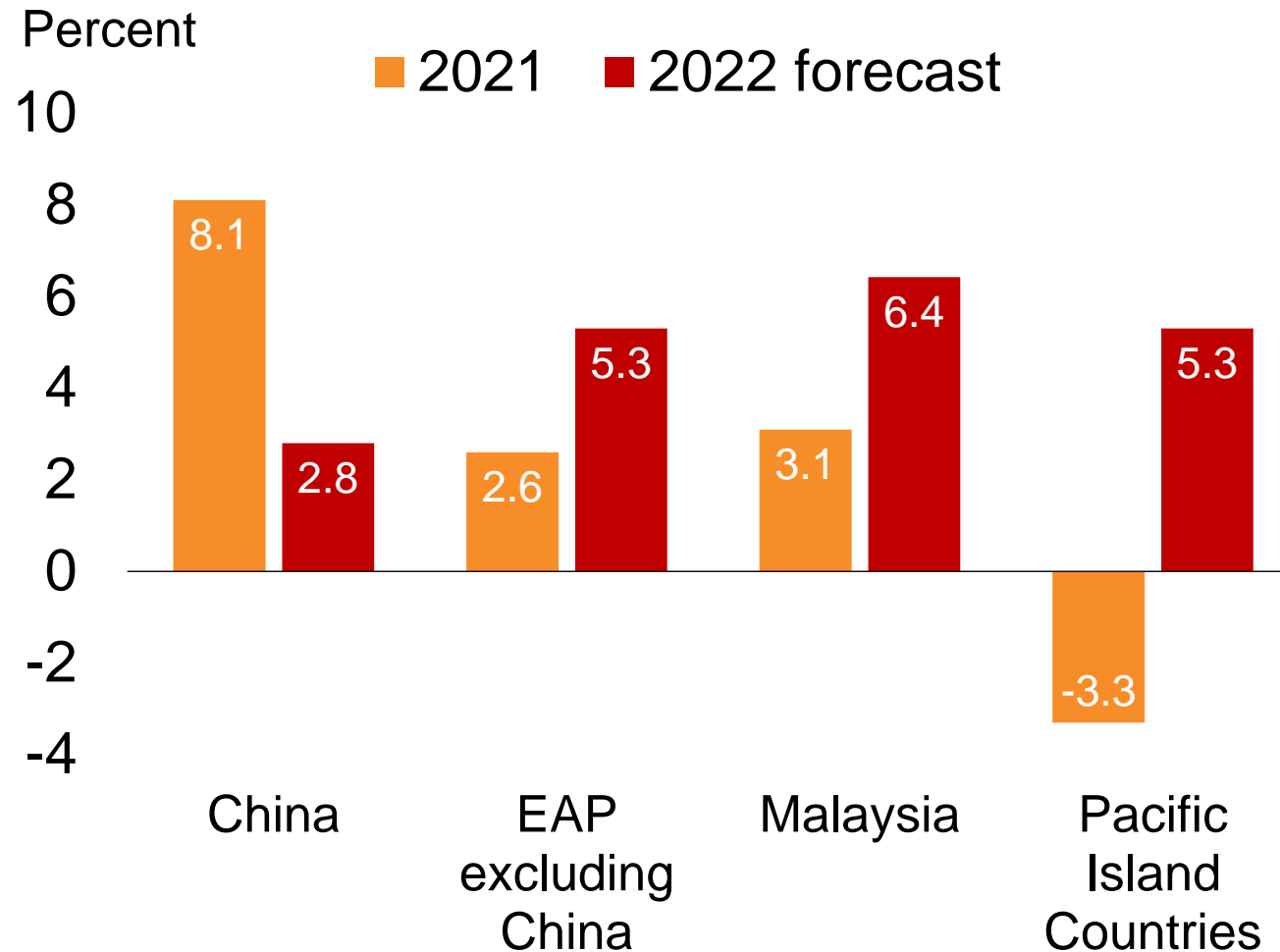
Growth; Inflation; Disease

Growth in major EAP countries is projected to be higher and inflation lower than in the rest of the world



Source: World Bank; Fitch's (as of July 2022)

Role reversal: China slows down, rest of the region accelerates

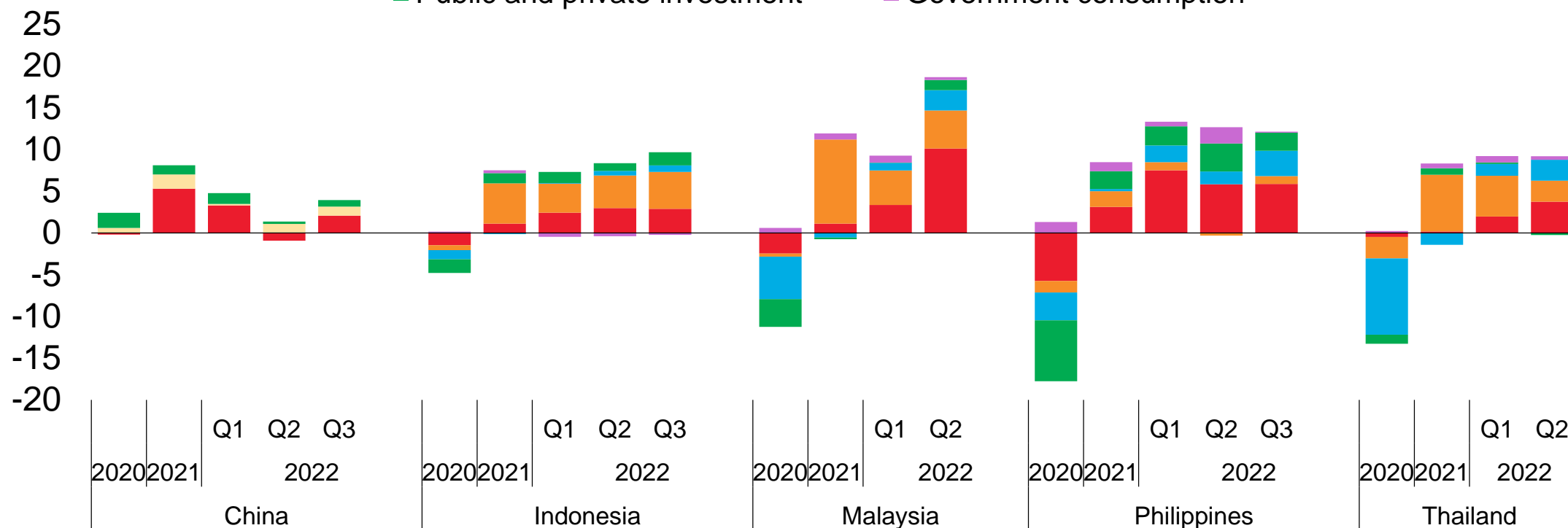


Rebounding from the pandemic, private consumption and exports are driving growth in EAP outside China

Contribution to GDP growth, selected components

Percentage point

- Private consumption
- Services exports
- Public and private investment
- Goods exports
- Net export (for China)
- Government consumption

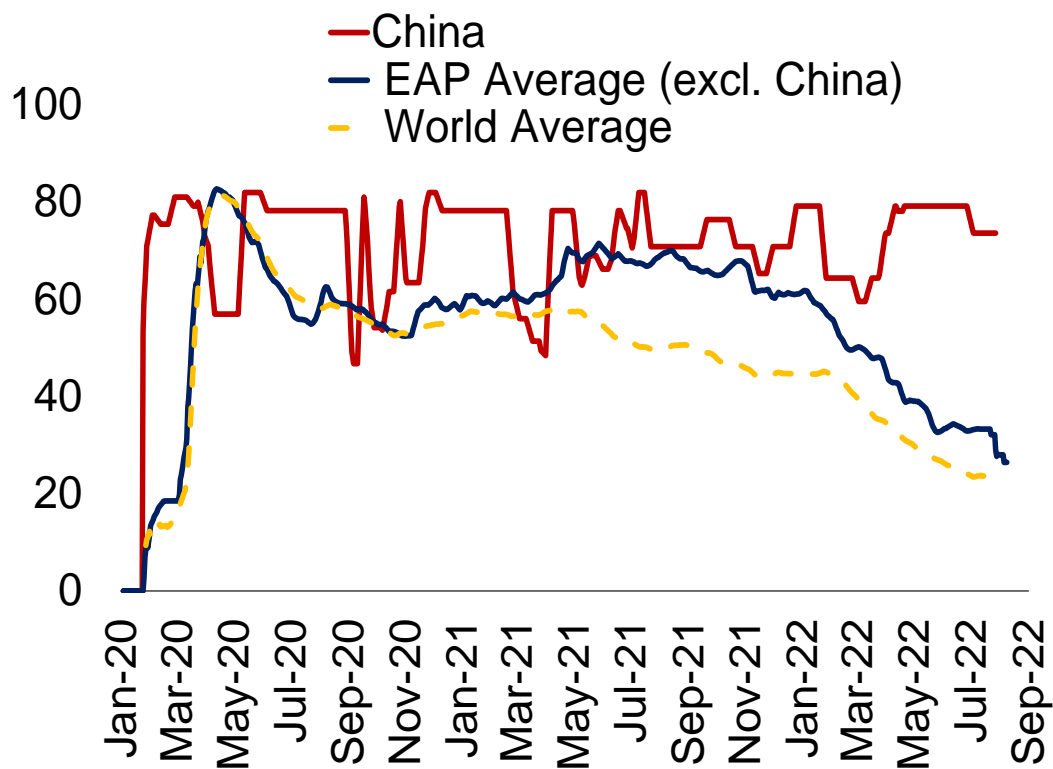


Source: Haver Analytics

Note: China's private consumption includes government consumption

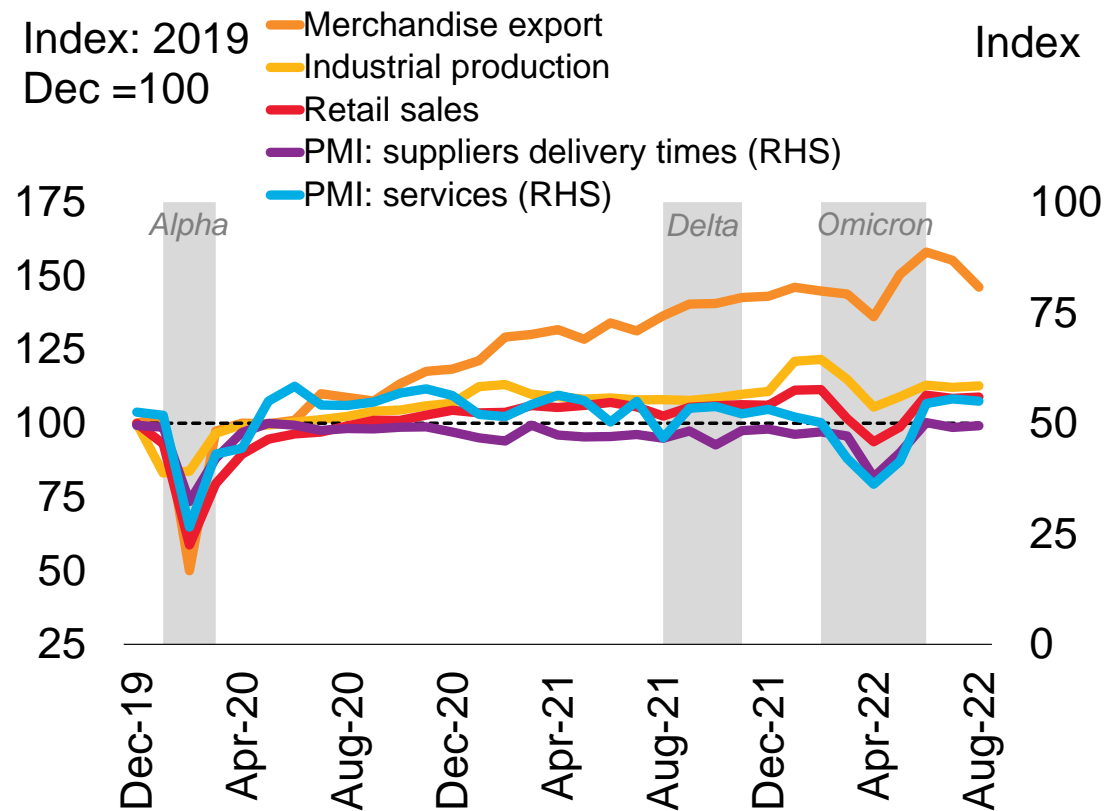
Recurrent outbreaks amidst China's zero-COVID policies are disrupting economic activity

Stringency of mobility restrictions in China and rest of EAP



Source: Haver Analytics

COVID-19 infection waves and economic activity in China



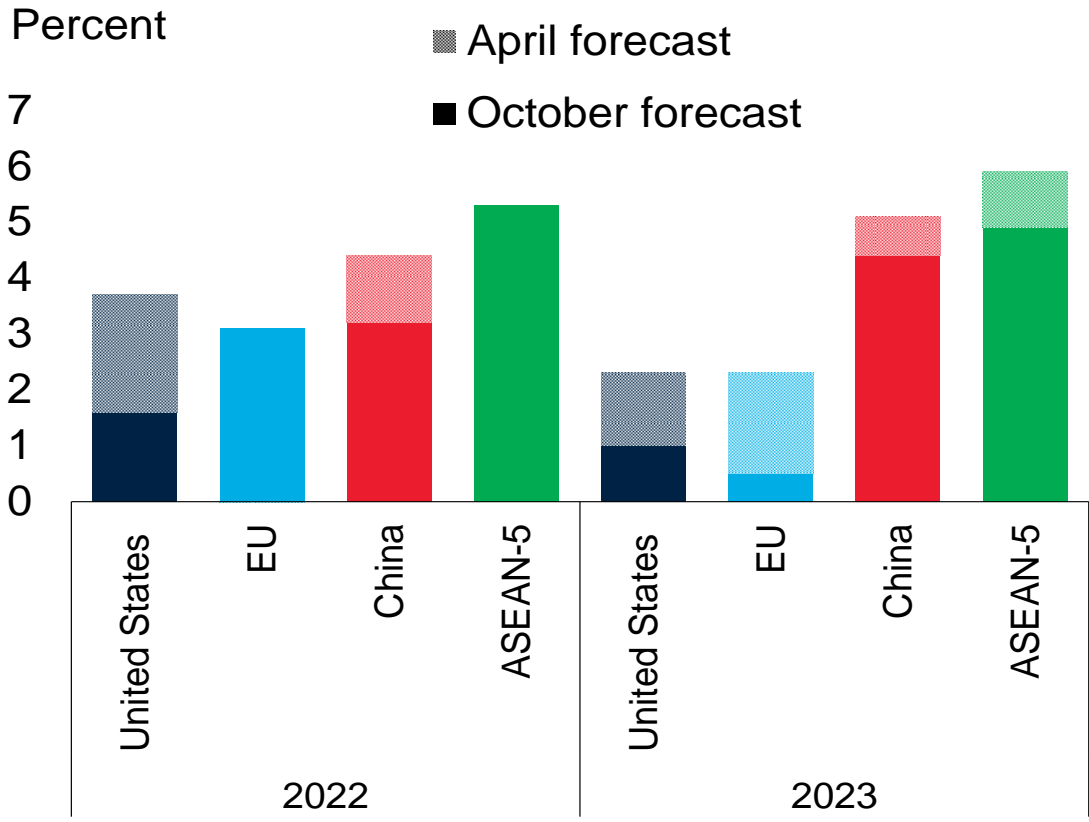
Source: Haver Analytics, Johns Hopkins University Center for Systems Science and Engineering's COVID-19 Data.

Three risks to growth

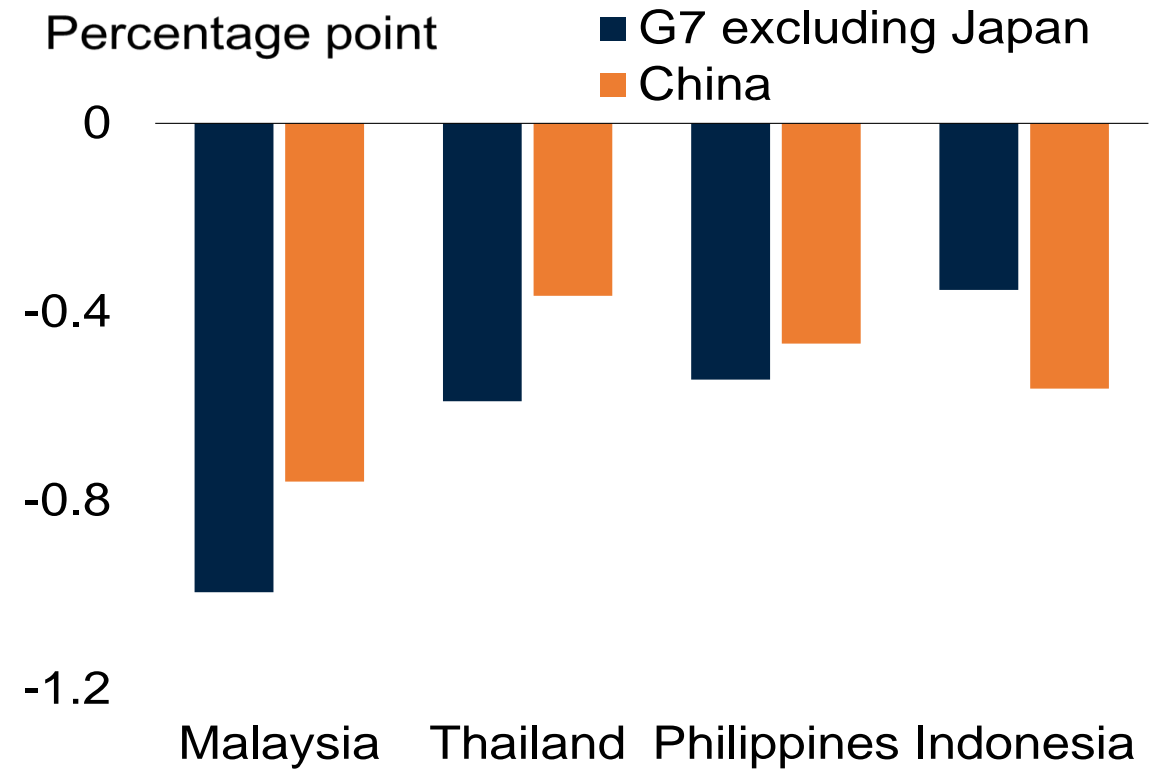
Deceleration; Debt; Distortions

Slowing global growth will negatively affect growth in the region

Revisions in GDP growth forecast



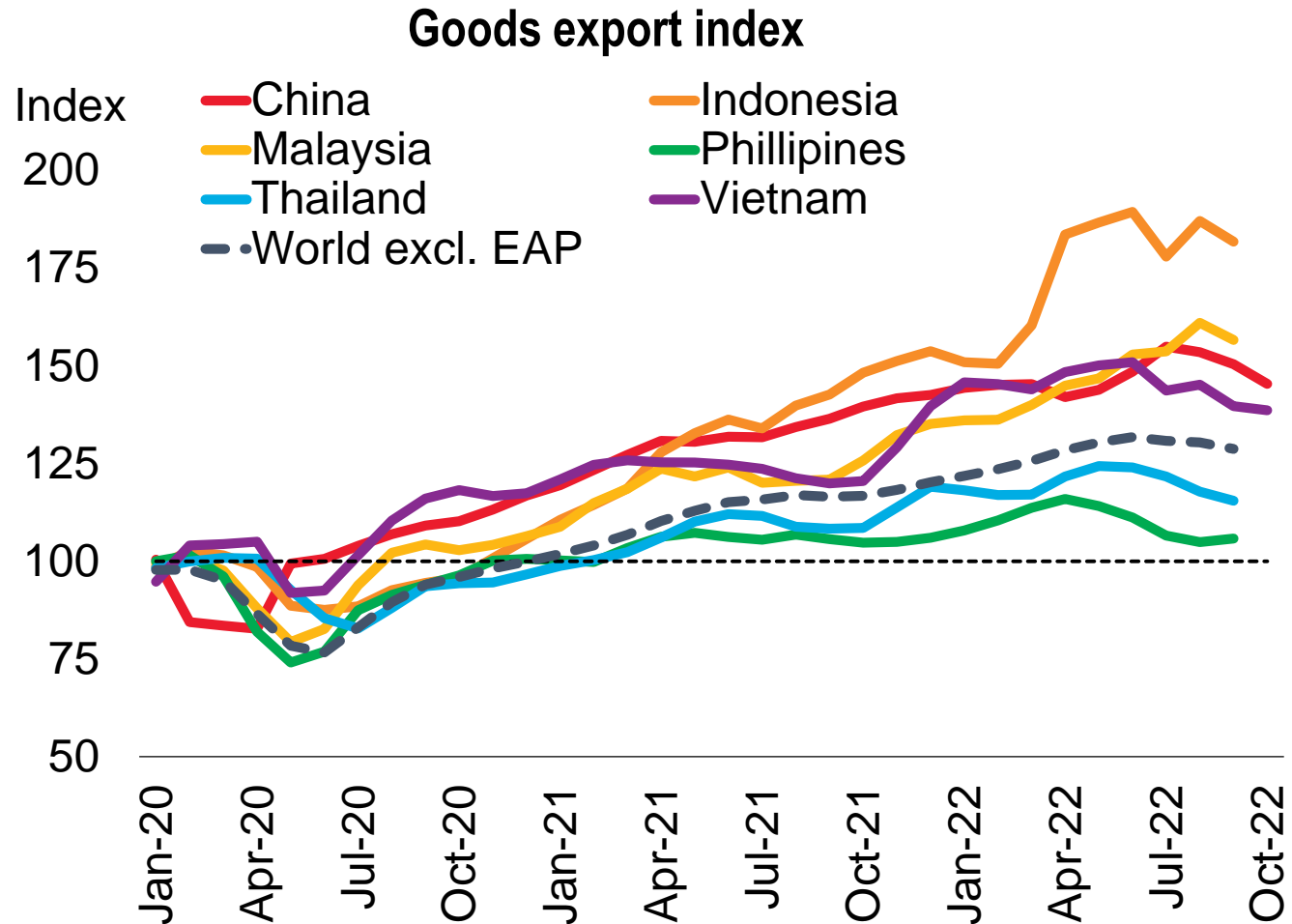
Impact of a 1 p.p. decline in the G7 (excl. Japan) and Chinese GDP growth rate



Source: IMF

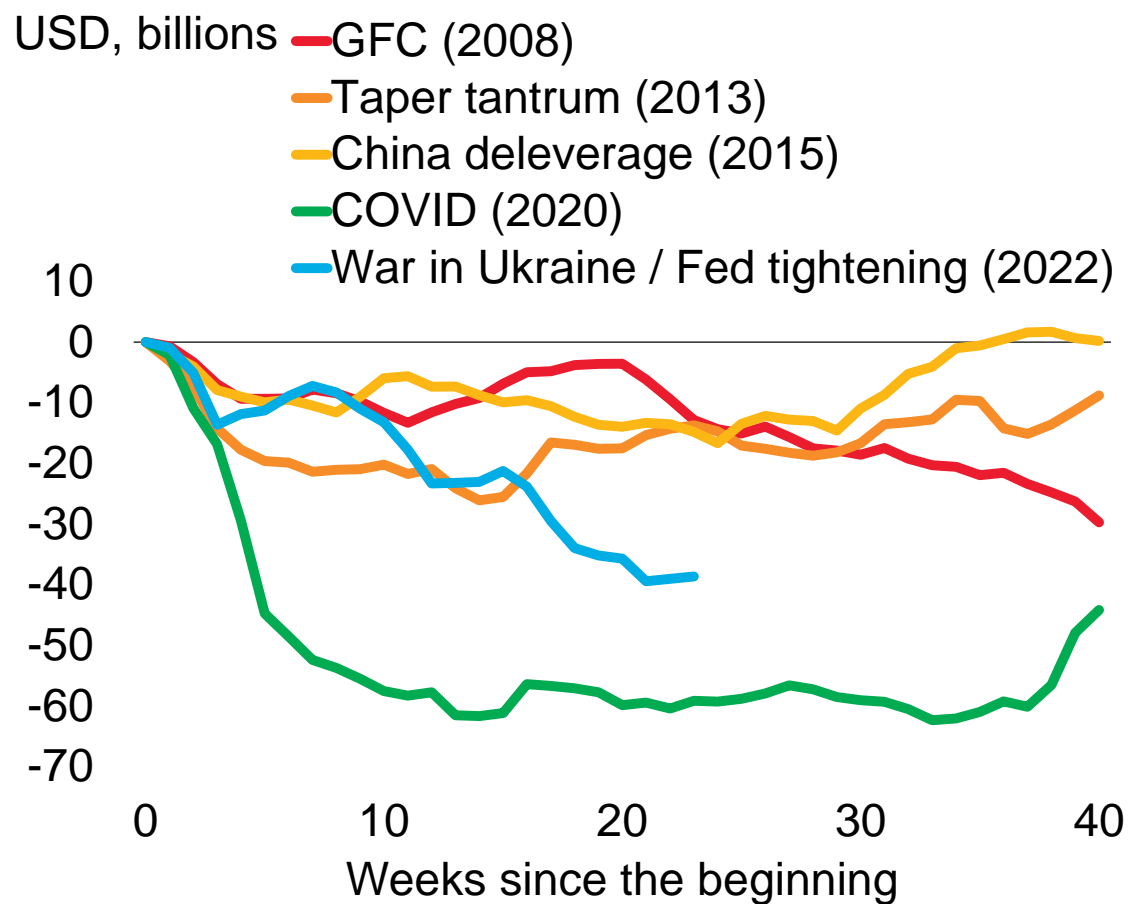
Source: IMF, WEO; World Bank staff estimates
Cumulative impact on growth after one year.

Already signs of declining goods exports



Increasing interest rates abroad are leading to capital outflows and currency depreciation in EAP countries

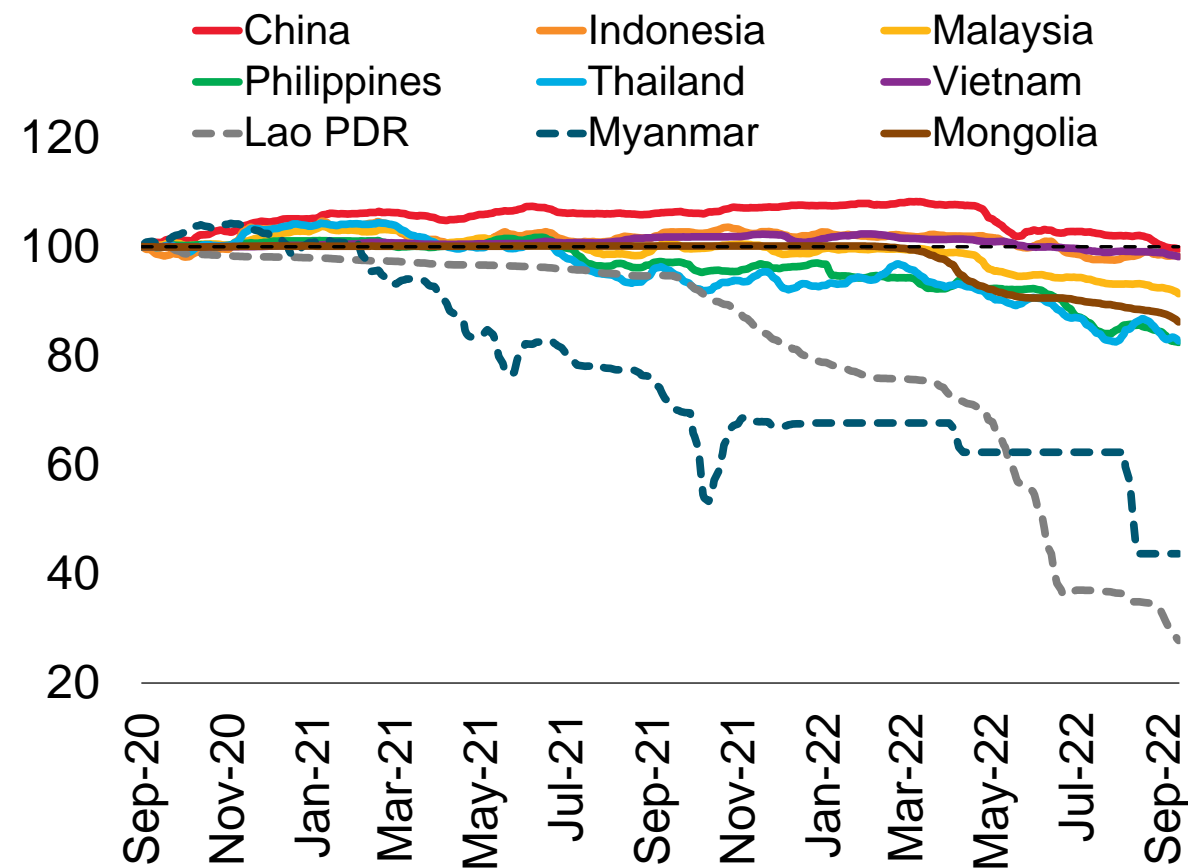
Emerging markets equity and debt flows (cumulative)



Source: Institute of International Finance.
Sample of selected EM countries.

Exchange rates (local currency to US dollar)

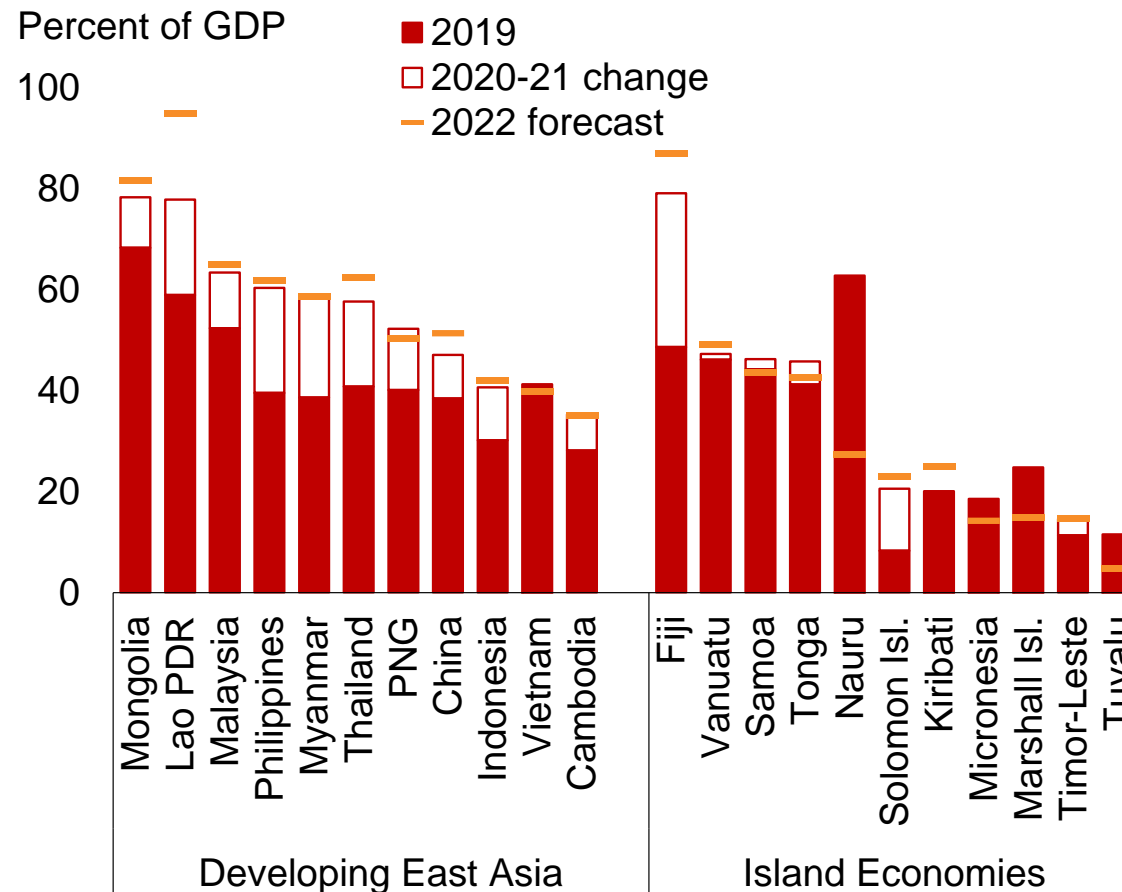
Index, Sep 2020=100



Source: Haver Analytics

The burden of debt is increasing

General government debt

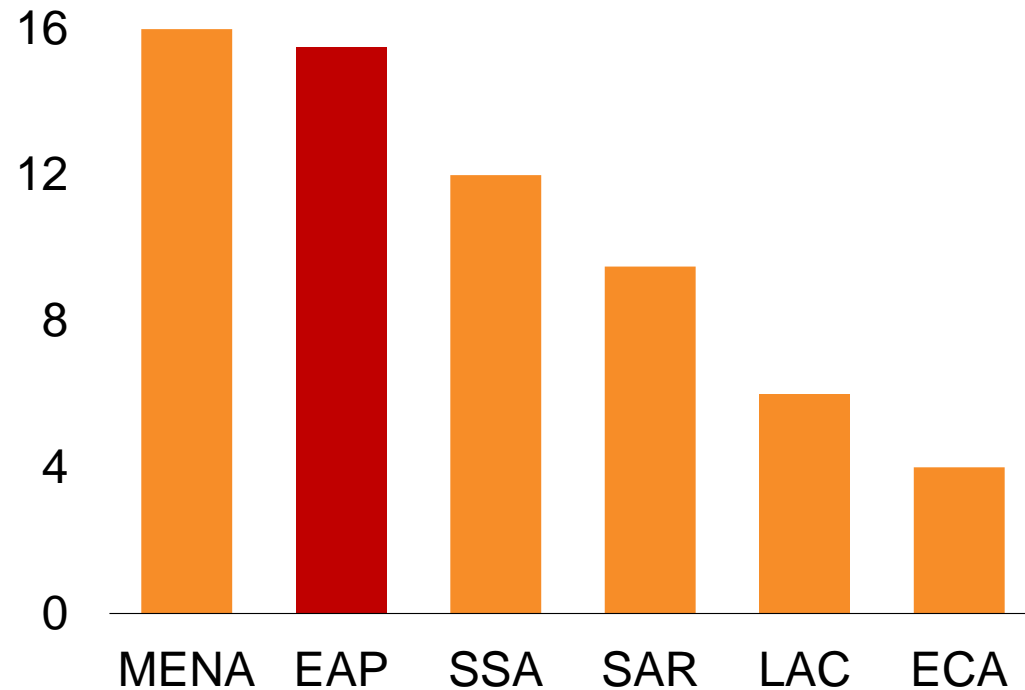


Source: International Monetary Fund, Haver Analytics, World Bank staff estimates

EAP countries use price controls to suppress inflation

Price controls

Number of products with price control

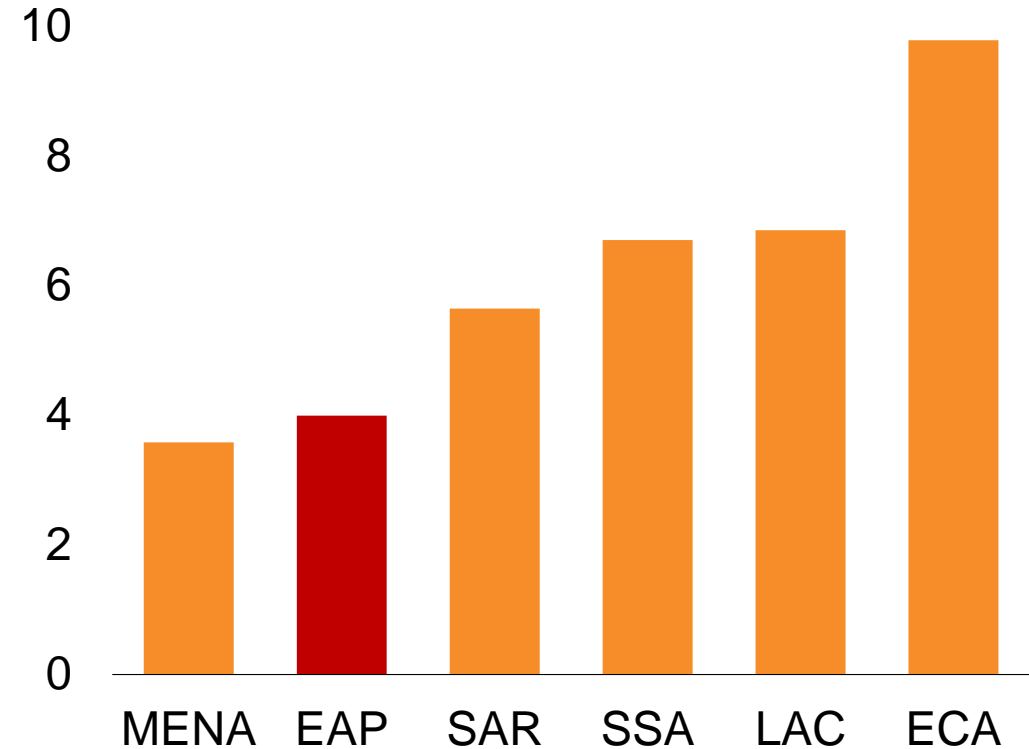


Source: Trade Policy Reviews.

Note: Latest available number of import products with price controls reported. Weighted average.

Median inflation (yoy, seasonally adjusted)

Percent



Source: World Bank's Global Economic Monitoring

Note: 2022 year to date as of July 2022. Weighted average

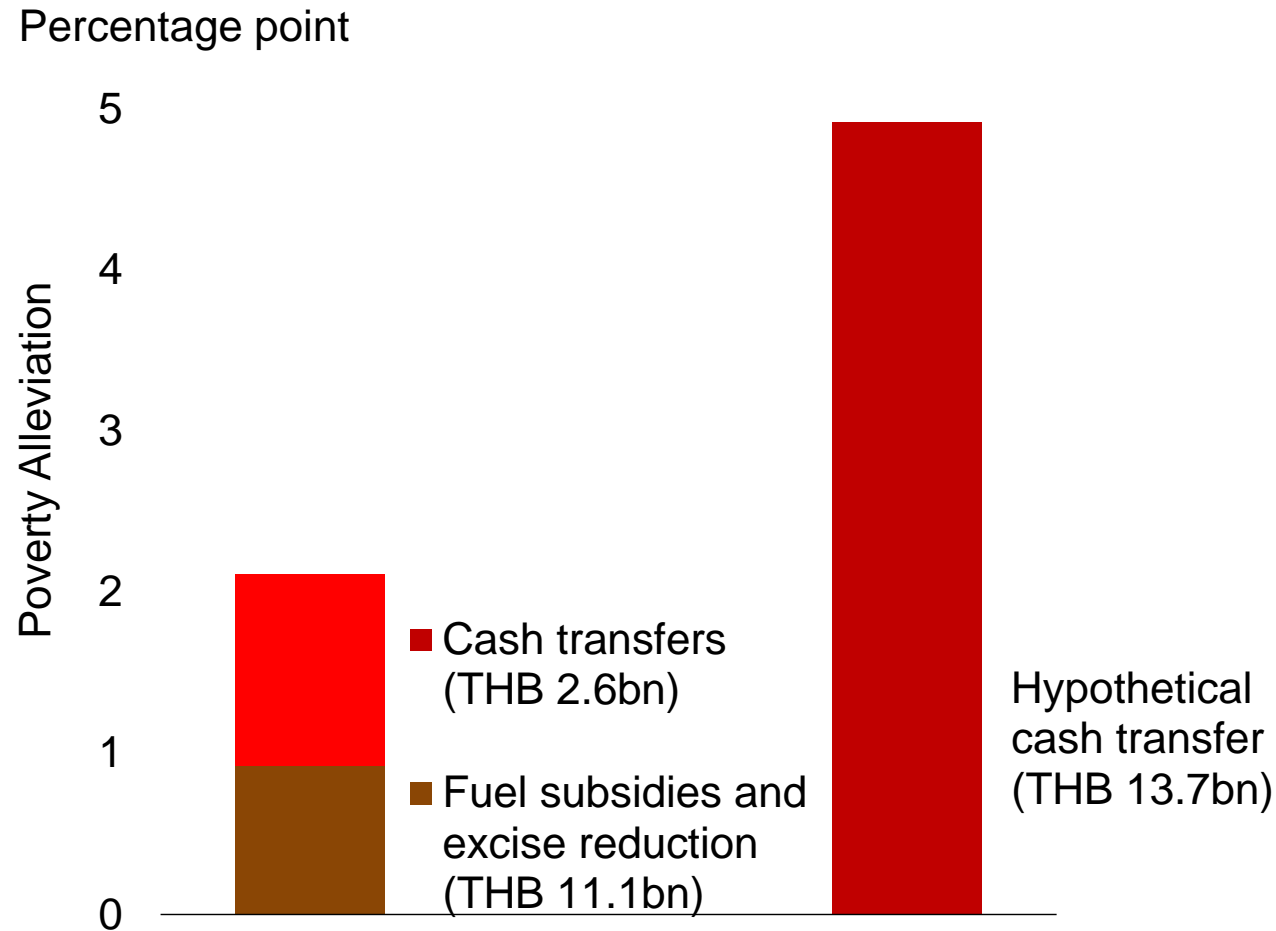
Policy distortions new and old

Food; Fuel; Finance

Consumer subsidies

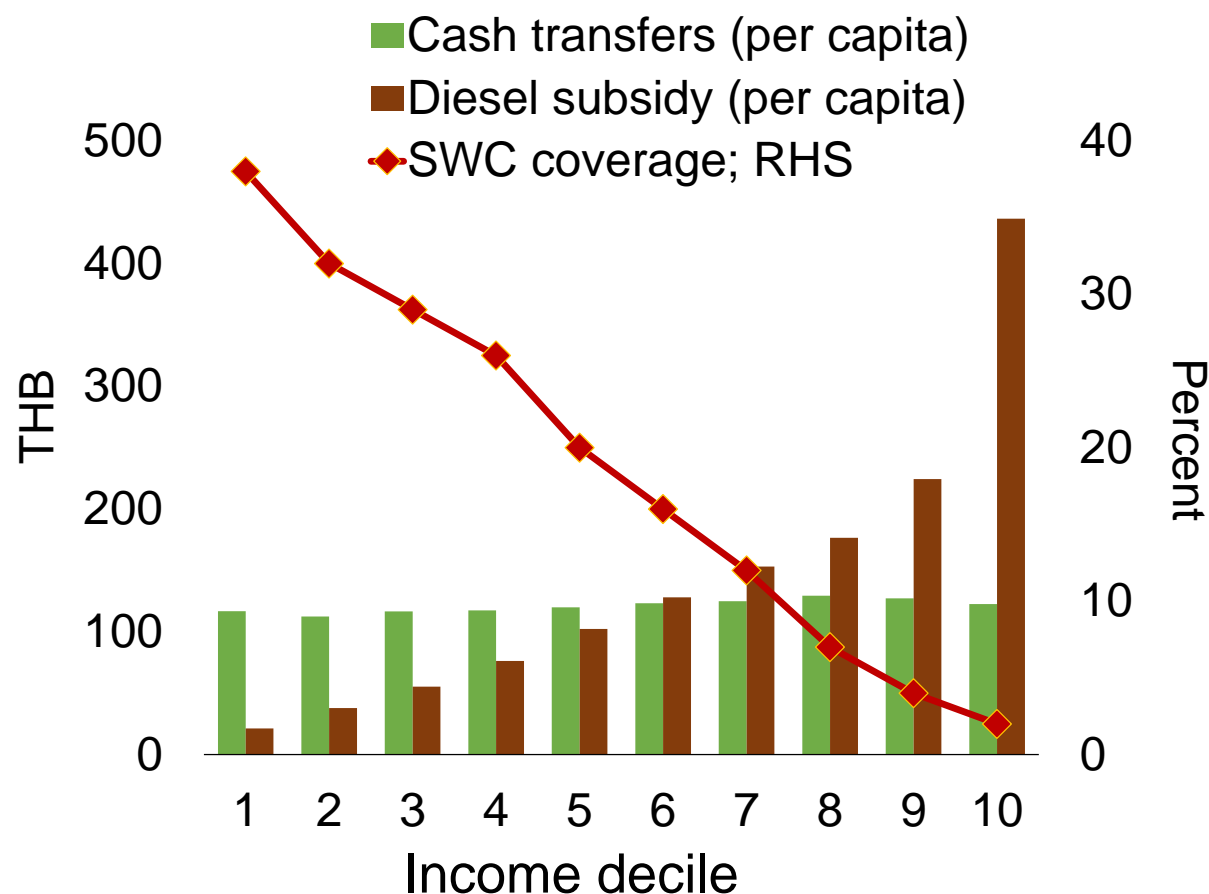
Subsidized prices provide support not just to the poor but also the rich;
transfers target the poor

Poverty reduction by different policies in Thailand (simulations)



Income transfers are preferable to price regulation because they do not distort choices, can be targeted to those most in need, and therefore cost less.

Why do governments still choose fuel subsidies?



Social welfare: A deficient infrastructure for targeting can exclude eligible households

Political economy: Targeted transfers do not benefit those above the poverty line

Industrial policy: Stable prices can shield firms from rising costs of production

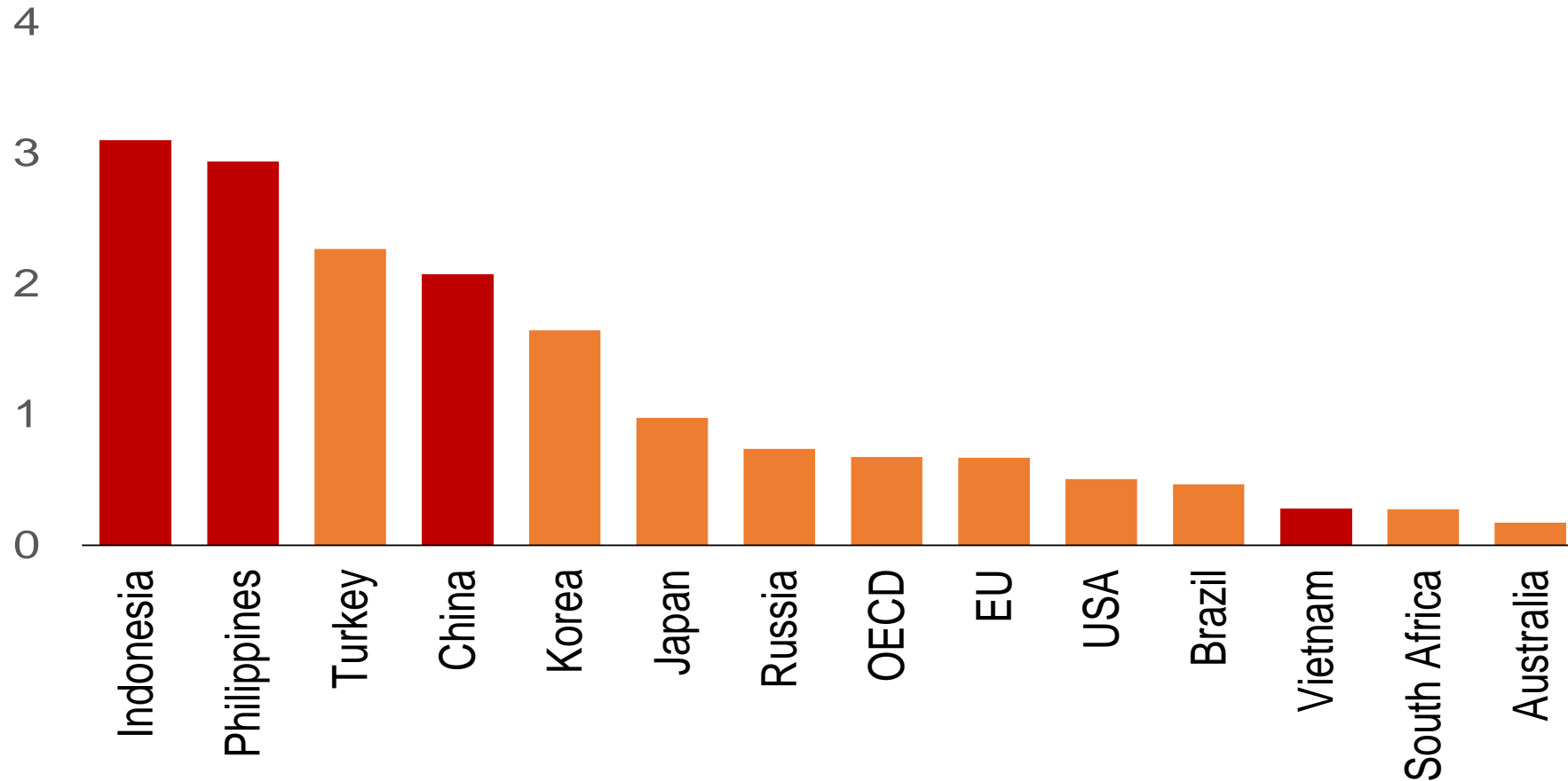
Macro policy: In the absence of a credible monetary authority, or well-anchored inflation expectations, preventing price increases can keep inflation in check.

EAP countries provide relatively high support to agriculture

Total Support Estimate for Agriculture, as a % of GDP

Selected EAP countries and other economies (2010-2020 average)

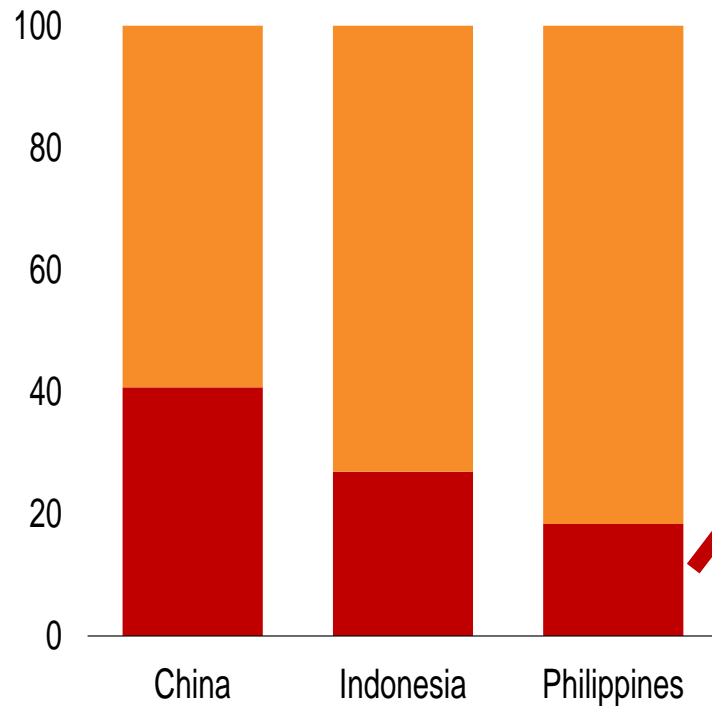
Percent of GDP



Food But support goes mostly to rice, not nutritious foods and to input- and irrigation-intensive production

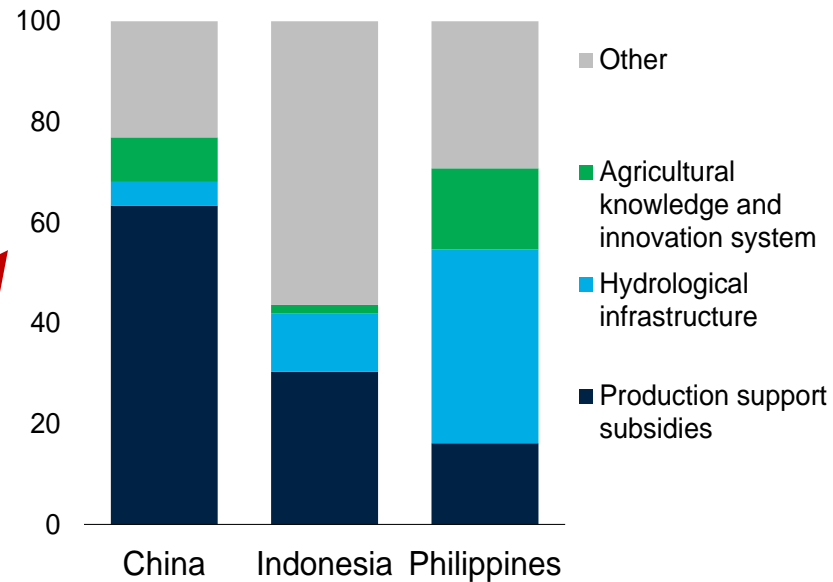
Transfers and market price support

Percent ■ Transfers ■ Market price support



Components of transfers to agriculture

Percent



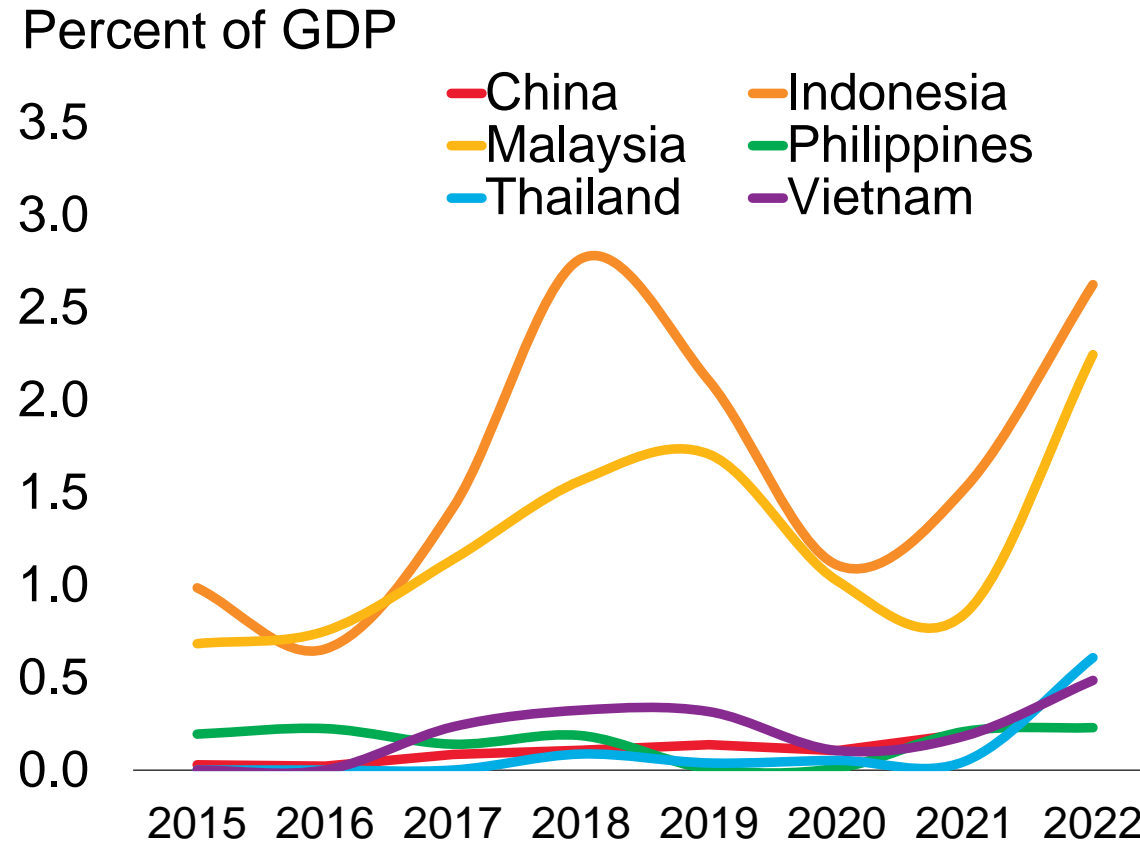
Shift focus from rice-centric food security to nutrition security.

Reduce subsidies and trade barriers that favor the production of rice to encourage diversified production of more nutritious foods.

Shift support from input subsidies to encourage higher productivity and greater sustainability.

Fuel Energy subsidies have increased but go to fossil fuels, not the cleanest sources

Fossil fuel subsidies in EAP countries (% of GDP)

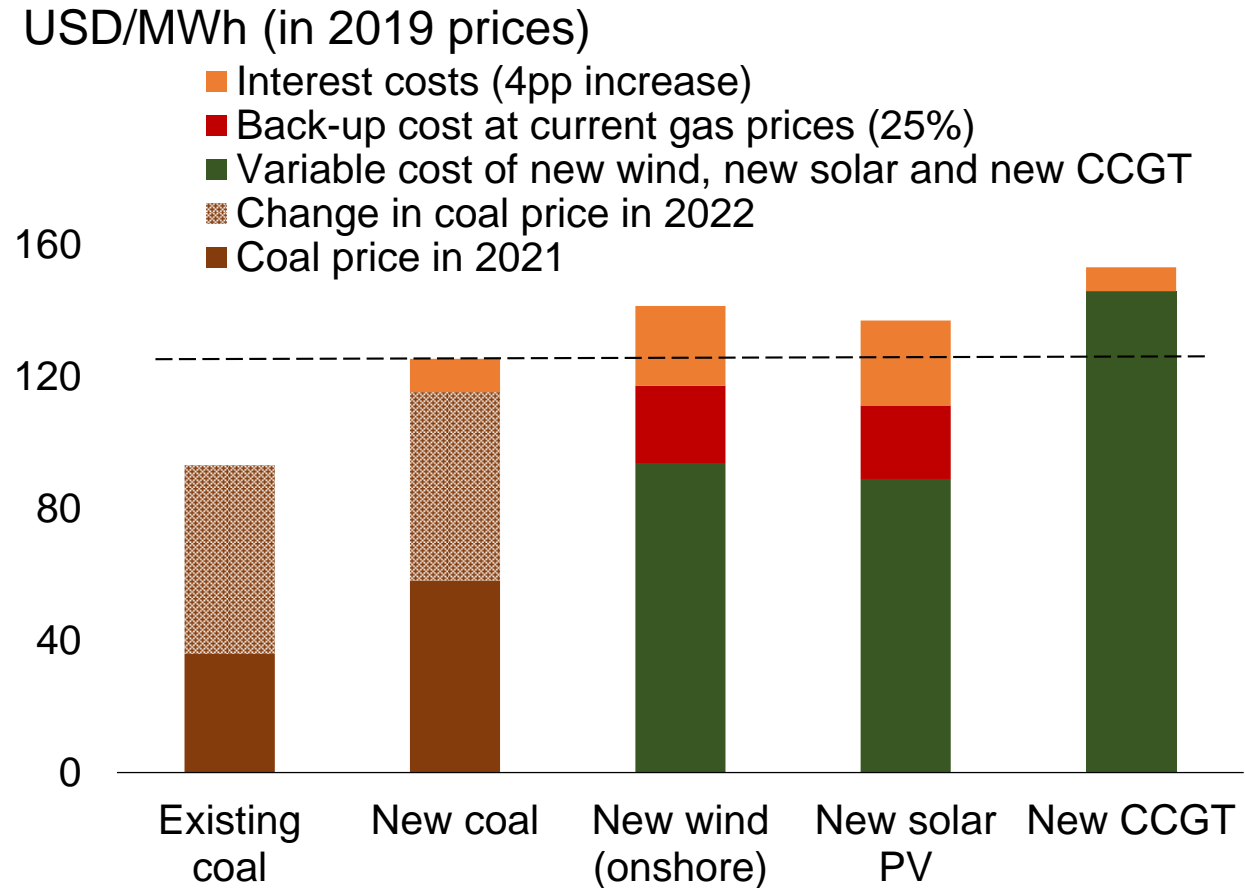


Source: Haver Analytics. Institute of International Finance. IEA.

Note: Chart combines 2015-2021 IEA data with World Bank's estimates for 2022.

Fuel Existing coal is the cheapest source of energy, even at current prices, but favorable finance could make renewables cheaper than new coal

Simulated impact of fuel price and interest rate increases on the levelized cost of energy



Reducing fuel subsidies and encouraging investment in renewables could reduce exposure to volatility in prices of fossil fuels and help meet emission reduction commitments

Source: IRENA and World Bank staff estimates

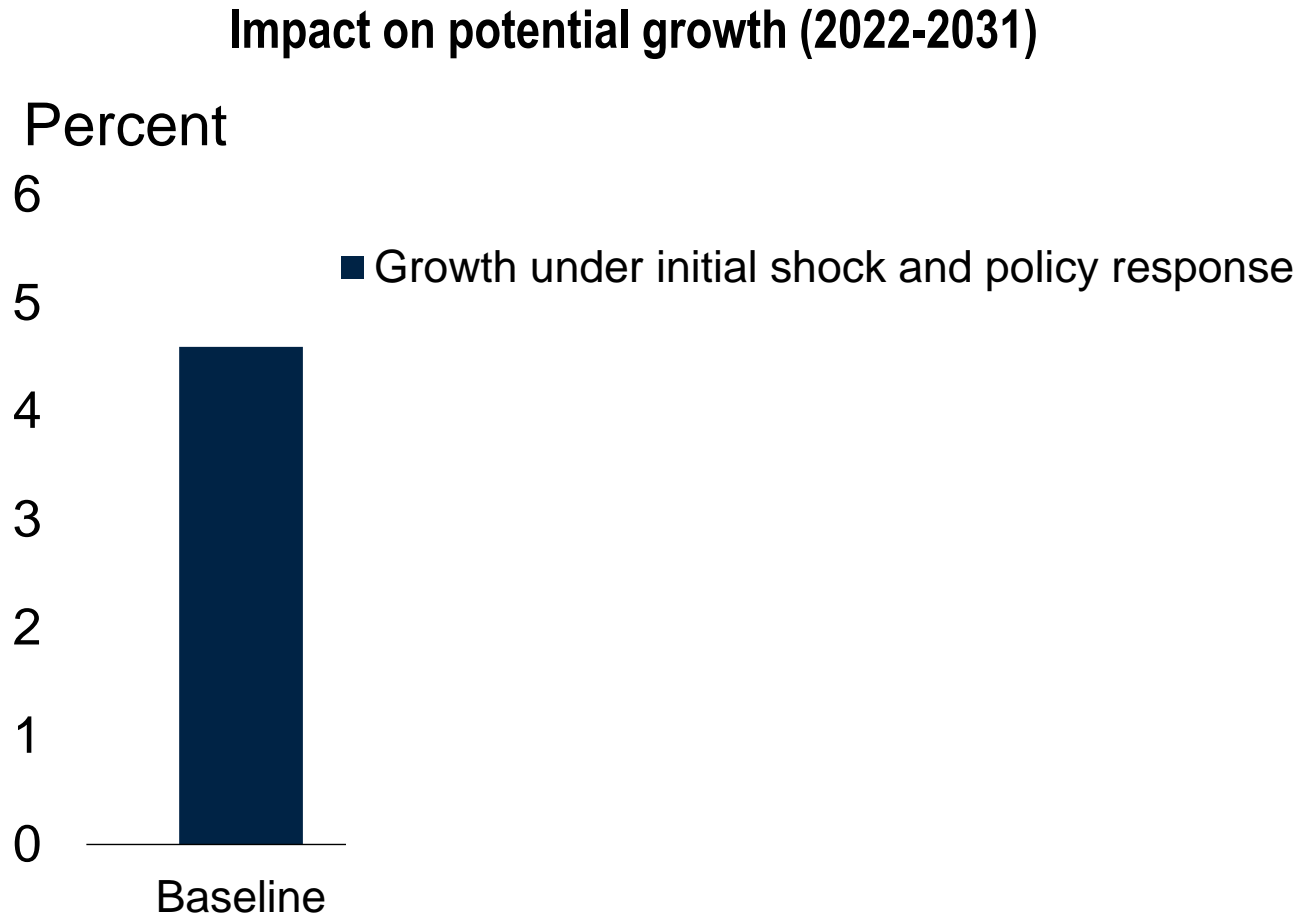
Note: The figures show 'levelized' cost calculations of the average unit price of generation using each technology.

Financial sector is well capitalized and NPLs seem low but risks remain to financial health

	Capital Adequacy		Asset Quality	
	Regulatory Capital to Risk-Weighted Assets (%)		NPLs to Total Gross Loans (%)	
	2022	change	2022	change
Cambodia	23	1	2	1
China	15	0	2	0
Indonesia	23	2	3	0
Lao PDR	20	8	2	-1
Malaysia	18	0	2	0
Mongolia				
Myanmar	13	13		
Philippines	16	1	4	2
Thailand	19	0	3	0
Vietnam	11	-1	2	0

Identifying problems that lurk behind pandemic era measures like regulatory forbearance would help prevent the emergence of zombie firms and the misallocation of credit.

Inefficient interventions could magnify the growth costs; more efficient ones and deeper reforms could offset the negative impacts



Thank you!
