Key Messages

1. The short-term outlook for Asia is strong, in line with expectations.

2. But the outlook is subject to considerable uncertainty.

3. In such a moment, policymaking should be conservative and aimed at building buffers and increasing resilience.
Outlook
Asia remains the world’s fastest growing region...

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

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>Asia</th>
<th>China</th>
<th>Japan</th>
<th>India</th>
<th>Korea</th>
<th>Australia and New Zealand</th>
<th>ASEAN</th>
<th>APD Small States</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>3.8</td>
<td>5.7</td>
<td>6.9</td>
<td>1.7</td>
<td>6.7</td>
<td>3.1</td>
<td>2.4</td>
<td>5.3</td>
<td>3.0</td>
</tr>
<tr>
<td>2018</td>
<td>3.9</td>
<td>5.6</td>
<td>6.6</td>
<td>1.2</td>
<td>7.4</td>
<td>3.0</td>
<td>3.0</td>
<td>5.3</td>
<td>3.7</td>
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<tr>
<td>Revision from Oct. 2017</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.6</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>-0.7</td>
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<tr>
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<td>0.0</td>
<td>0.2</td>
<td>0.1</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

Source: IMF staff.
Note: Figures for India are on a fiscal year basis.
...and inflation has been rising but subdued.

2017 Inflation Target versus Headline Inflation (Percent)

- Target range
- Headline inflation 2017
- Inflation target
- Headline inflation 2016

Sources: Haver Analytics; and IMF staff calculations.
Note: Australia and New Zealand are based on quarterly data as of 2017:Q3.
Uncertainties
A moment of considerable uncertainty

1. Monetary policy normalization
2. Prospects for trade
3. Spillovers from US tax reform
4. Other risks
Monetary Policies
The market is catching up to the dot plot, suggesting less risk of surprises…

United States: Interest Rates

- Federal funds rate
- Federal funds rate: market expectation (current)
- Federal funds rate: market expectation (March 2016)
- Federal funds rate: market expectation (March 2017)
- FOMC December Median Projections

Source: Bloomberg L.P.
Note: FOMC = Federal Open Market Committee.
…but historically, market turmoil has often followed monetary normalization…
...and Asia could be materially affected given its high household and corporate leverage...

Source: Bank of International Settlements.
...as well as the large capital flows it has attracted.

Total Portfolio Investment Liabilities
(Percent of GDP in parentheses)

<table>
<thead>
<tr>
<th>Region</th>
<th>2010</th>
<th>2013</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging Europe, the Middle East, &amp; Africa</td>
<td>(15.6)</td>
<td>(14.9)</td>
<td>(18.1)</td>
</tr>
<tr>
<td>Latin America &amp; the Caribbean</td>
<td>(23.5)</td>
<td>(22.5)</td>
<td>(27.2)</td>
</tr>
<tr>
<td>Asia</td>
<td>(27.6)</td>
<td>(27.7)</td>
<td>(28.6)</td>
</tr>
</tbody>
</table>

Sources: IMF IFS database, and staff calculations.
Recent yield and dollar movements underscore the uncertainty.

**US 10-Year Bond Yield**

- **US dollar and Euro Exchange Rate**

Source: Thomson Reuters Datastream..
Recent yield and dollar movements underscore the uncertainty.

**US 10-Year Bond Yield**

- **Source:** Haver Analytics.

**US dollar and Euro Exchange Rate**

- **Source:** Thomson Reuters Datastream, and Haver Analytics.
Trade
The US has made several recent tariff announcements.

*Figures do not account for recent steel/aluminum exemptions. Source: Dept. of Commerce, Haver, Goldman Sachs Global Investment Research.
China, in turn, has announced new tariffs…

Source: PIIE.
...which are concentrated in a few sectors.

**US Imports from China**  
(Billions of US dollars)

- **Total imports**
- **Imports affected by 301 actions**
- **Share affected (RHS, in percent)**

**US Exports to China**  
(Billions of US dollars)

- **Total exports**
- **Exports affected by China response**
- **Share affected (RHS, in percent)**

Sources: PIIE, Staff estimates.
Other countries are also exposed given their supply chain linkages to China.

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

Sources: WIOD, and IMF staff calculations.
A move toward protectionism would be damaging.

Sources: IMF, World Economic Outlook; and IMF staff calculations.
Effects through non-trade channels could be even more damaging.

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

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

Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations.
Taxes
The *Tax Cuts and Jobs Act* could affect Asia in many different ways.

Key elements of the corporate tax reform:

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

Many possible spillover channels:

1. Higher US investment / growth $\rightarrow$ positive spillovers to Asia
2. Tax competition $\rightarrow$ loss of US investment in Asia? fiscal loss?
3. Deemed repatriation $\rightarrow$ capital flows out of Asia?
The direct spillovers from higher US growth are positive but likely to be modest.

Impact on Real GDP Growth
(Deviation from scenario without U.S. Tax Reform; Cumulative 2018-2020)

<table>
<thead>
<tr>
<th>Asia</th>
<th>Impact on Real GDP Growth (2018-2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>0.5</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0.4</td>
</tr>
<tr>
<td>Pacific Islands</td>
<td>0.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.2</td>
</tr>
<tr>
<td>Hong Kong SAR</td>
<td>0.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.2</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>0.2</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.2</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>0.1</td>
</tr>
<tr>
<td>Korea</td>
<td>0.1</td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.1</td>
</tr>
<tr>
<td>Mongolia</td>
<td>0.0</td>
</tr>
<tr>
<td>Japan</td>
<td>0.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.1</td>
</tr>
<tr>
<td>China</td>
<td>0.1</td>
</tr>
<tr>
<td>India</td>
<td>0.1</td>
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<tr>
<td>Australia</td>
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</tr>
</tbody>
</table>

Other Countries & Regional Aggregates

<table>
<thead>
<tr>
<th>Other Countries &amp; Regional Aggregates</th>
<th>Impact on Real GDP Growth (2018-2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>0.5</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.4</td>
</tr>
<tr>
<td>Asia (average)</td>
<td>0.2</td>
</tr>
<tr>
<td>Latin America</td>
<td>0.3</td>
</tr>
<tr>
<td>Euro Area</td>
<td>0.2</td>
</tr>
<tr>
<td>Other Advanced Economies</td>
<td>0.2</td>
</tr>
<tr>
<td>Other Countries</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: IMF staff calculations
But how will Asia be affected by the international tax competition that may arise?

Selected Economies: Corporate Income Tax Rates
(Percent)

Source: IMF Fiscal Affairs Department, Tax Policy Rates.
Asian countries receive substantial FDI from the US...

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

- **Europe**: 59%
- **Asia and Pacific**: 16%
- **Latin America and Other Western Hemisphere**: 16%
- **Middle East**: 1%
- **Africa**: 1%
- **Canada**: 7%
- **Asia and Pacific**: 16%
- **Latin America and Other Western Hemisphere**: 16%

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

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Note: On a historical cost basis; Source: Bureau of Economic Analysis
US corporations earn substantial profits in some Asian countries.

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

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

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

Sources: US Bureau of Economic Analysis; IMF World Economic Outlook; and staff calculations.
Other Uncertainties
Asia also faces geopolitical risks…

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

**2018 Elections**
- India (State)
- Malaysia
- Timor-Leste
- Indonesia (Regional)
- Korea (Local)
- Cambodia
- Maldives
- Bhutan
- Bangladesh

**2019 Elections**
- India (State/General)
- Solomon Islands (tentative)
- Indonesia (General)
- Philippines
...and many economies—particularly the PICs—are highly vulnerable to natural disasters.

Probability of a severe natural disaster during a given year

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

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

1. Global factors have kept inflation low → this could reverse

2. Inflation has become more backward looking → once it rises, it may persist

3. The Phillips Curve has flattened → reducing inflation may imply large output costs
Global factors have kept inflation subdued, but could reverse.

Source: IMF staff estimates.
The inflation process has also become more backward-looking.
The Phillips Curve has flattened.

Unemployment Gap Coefficient
(Percent)

Source: IMF staff estimates.
The Phillips Curve has flattened.

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

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

Source: IMF staff calculations.
A flatter Phillips curve means a larger sacrifice ratio.

Sources: Staff estimates
Macroprudential policies appear to be effective in controlling credit without dampening output.
Thank you!
Additional Slides
Inflation Explained by Global Factors

(Percent)

Source: IMF staff estimates.
Source: IMF staff estimates.
Unemployment Gap Coefficient (Percent)

Source: IMF staff estimates.