



ASIAN DEVELOPMENT OUTLOOK 2022

RECOVERY CONTINUES AMID GLOBAL HEADWINDS

APRIL 2022

#ADO2022

ADB

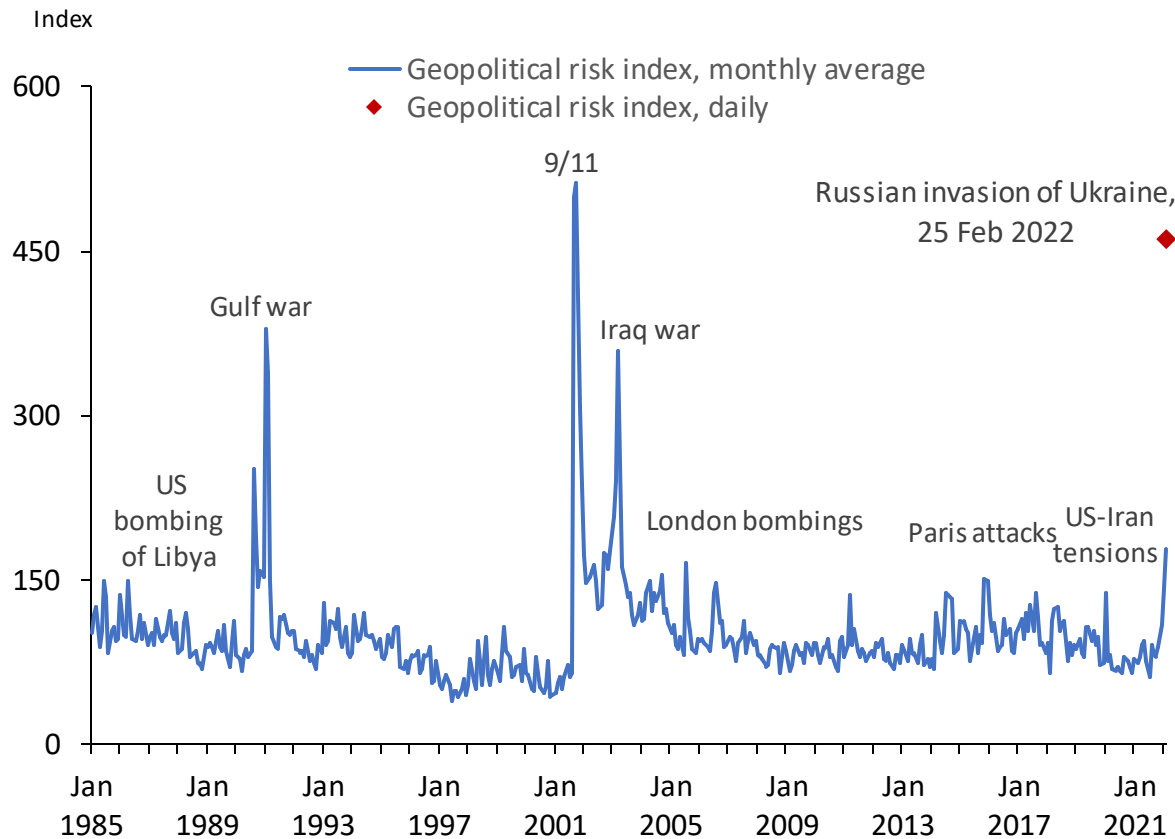
Recovery continues amid global headwinds: Key Messages

- The Russian invasion of Ukraine has heightened uncertainty and unsettled commodity markets.
- The pandemic persists, fueled by the Omicron variant. Milder health impacts and vaccination progress have allowed economies to remain more open than in previous waves.
- Developing Asia rebounded by 6.9% in 2021, buoyed by strong export growth. But the pace of recovery remained uneven across economies.
- GDP in the region will expand by 5.2% in 2022 and 5.3% in 2023, on continued recovery in domestic demand and solid exports. Inflation will rise to 3.7% in 2022 and 3.1% in 2023.
- Risks include escalation of Russia's invasion of Ukraine, financial instability triggered by the Fed's aggressive tightening, emergence of more lethal COVID-19 variants, and disruptions associated with the PRC's current outbreaks.
- The theme chapter shows how developing Asia must mobilize taxes for development, and provides policy solutions consistent with economy-specific circumstances and priorities.

Geopolitical uncertainty and commodity prices surged following the Russian invasion of Ukraine

Geopolitical tensions soared beyond the peak reached during the Iraq war.

Geopolitical risk index



After the initial spike, oil prices have declined but are expected to remain elevated.

Brent crude price, monthly average



Source: Geopolitical Risk Index (<https://www.matteoiacoviello.com/gpr.htm>) (accessed 9 March 2022)

Sources: Bloomberg, ADB estimates.

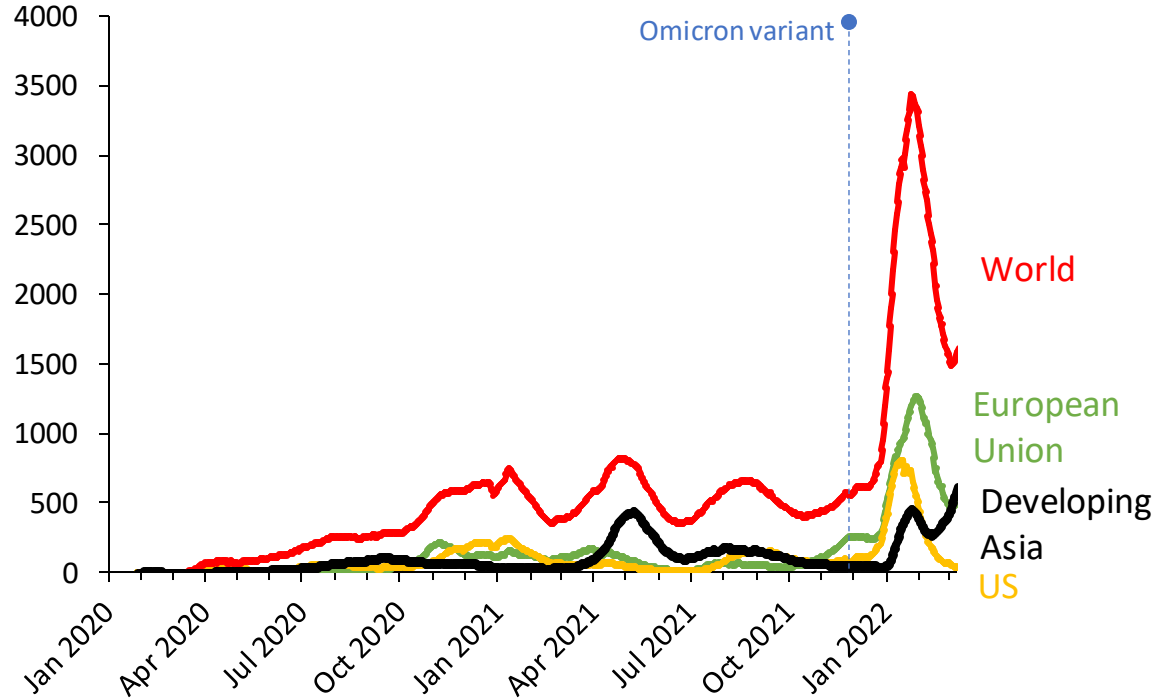
Omicron's impact on the region has been limited

Omicron outbreaks have been shorter-lived and milder than in previous waves.

Economies remained relatively open, so that economic activity softened but continued to expand in early 2022.

Daily new COVID-19 cases, 7-day moving average

New cases, 7-day moving average, thousands



Purchasing managers' index

Manufacturing PMI, seasonally adjusted

Economy	2021												2022	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
PRC	51.5	50.9	50.6	51.9	52.0	51.3	50.3	49.2	50.0	50.6	49.9	50.9	49.1	50.4
India	57.7	57.5	55.4	55.5	50.8	48.1	55.3	52.3	53.7	55.9	57.6	55.5	54.0	54.9
Indonesia	52.2	50.9	53.2	54.6	55.3	53.5	40.1	43.7	52.2	57.2	53.9	53.5	53.7	51.2
Malaysia	51.9	50.7	52.9	56.9	54.3	42.9	43.1	46.4	51.1	55.2	55.3	55.8	50.5	50.9
Philippines	52.5	52.5	52.2	49.0	49.9	50.8	50.4	46.4	50.9	51.0	51.7	51.8	50.0	52.8
Republic of Korea	53.2	55.3	55.3	54.6	53.7	53.9	53.0	51.2	52.4	50.2	50.9	51.9	52.8	53.8
Taipei, China	60.2	60.4	60.8	62.4	62.0	57.6	59.7	58.5	54.7	55.2	54.9	55.5	55.1	54.3
Thailand	49.0	47.2	48.8	50.7	47.8	49.5	48.7	48.3	48.9	50.9	50.6	49.5	51.7	52.5
Viet Nam	51.3	51.6	53.6	54.7	53.1	44.1	45.1	40.2	40.2	52.1	52.2	52.5	53.7	54.3

Services PMI, seasonally adjusted

PRC	52.0	51.5	54.3	56.3	55.1	50.3	54.9	46.7	53.4	53.8	52.1	53.1	51.4	50.2
India	52.8	55.3	54.6	54.0	46.4	41.2	45.4	56.7	55.2	58.4	58.1	55.5	51.5	51.8

PMI = Purchasing managers' index PRC = People's Republic of China, Q = quarter.

Note: For Malaysia, the series is adjusted by adding 3 points, as historical experience suggests that value above 47 are consistent with expansion.

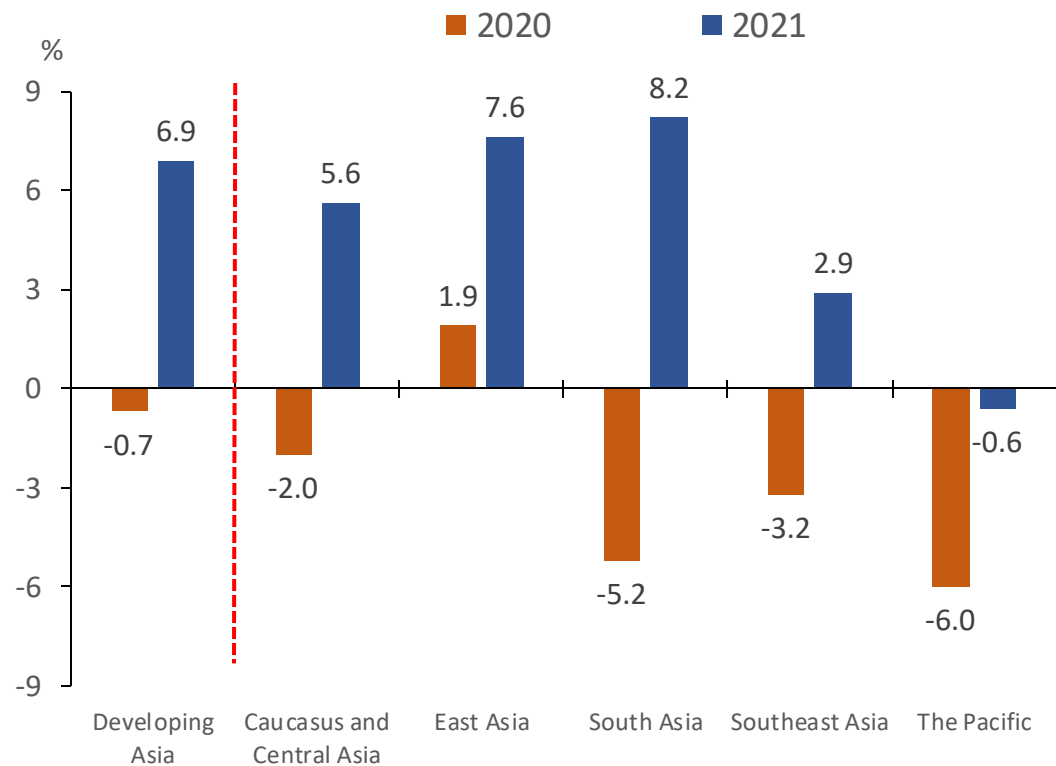
Source: CEIC Data Company (accessed 7 March 2022).

Led by exports, developing Asia saw uneven but strong recovery last year

To varying degrees, growth bounced back in most of the region last year...

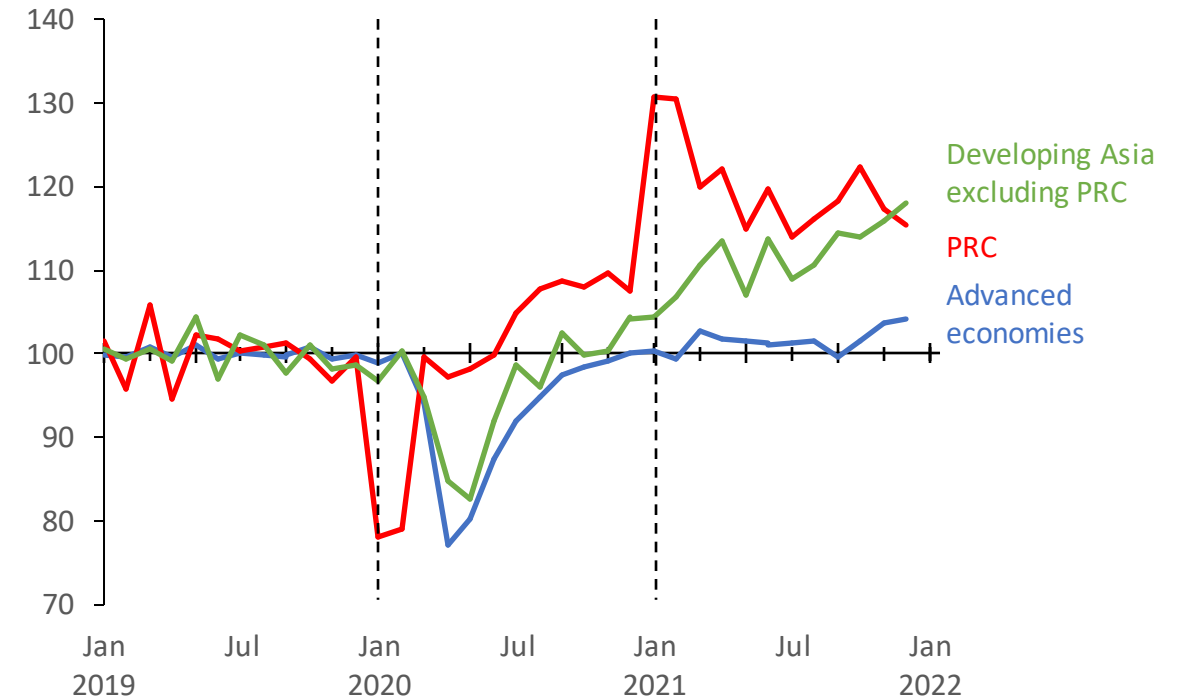
...underpinned by solid and broadening export growth, which stabilized in the PRC and kept rising in the rest of the region.

Growth by subregion in Developing Asia



Real exports

Real export volume, 2019 average = 100



Source: Asian Development Outlook database (as of 23 March 2022).

PRC = People's Republic of China.

Note: Developing Asia excluding the PRC comprises Hong Kong, China, India, Indonesia, the Republic of Korea, Malaysia, Pakistan, the Philippines, Singapore, Taipei, China, Thailand, and Viet Nam.

Source: CPB World Trade Monitor (accessed 25 February 2022).

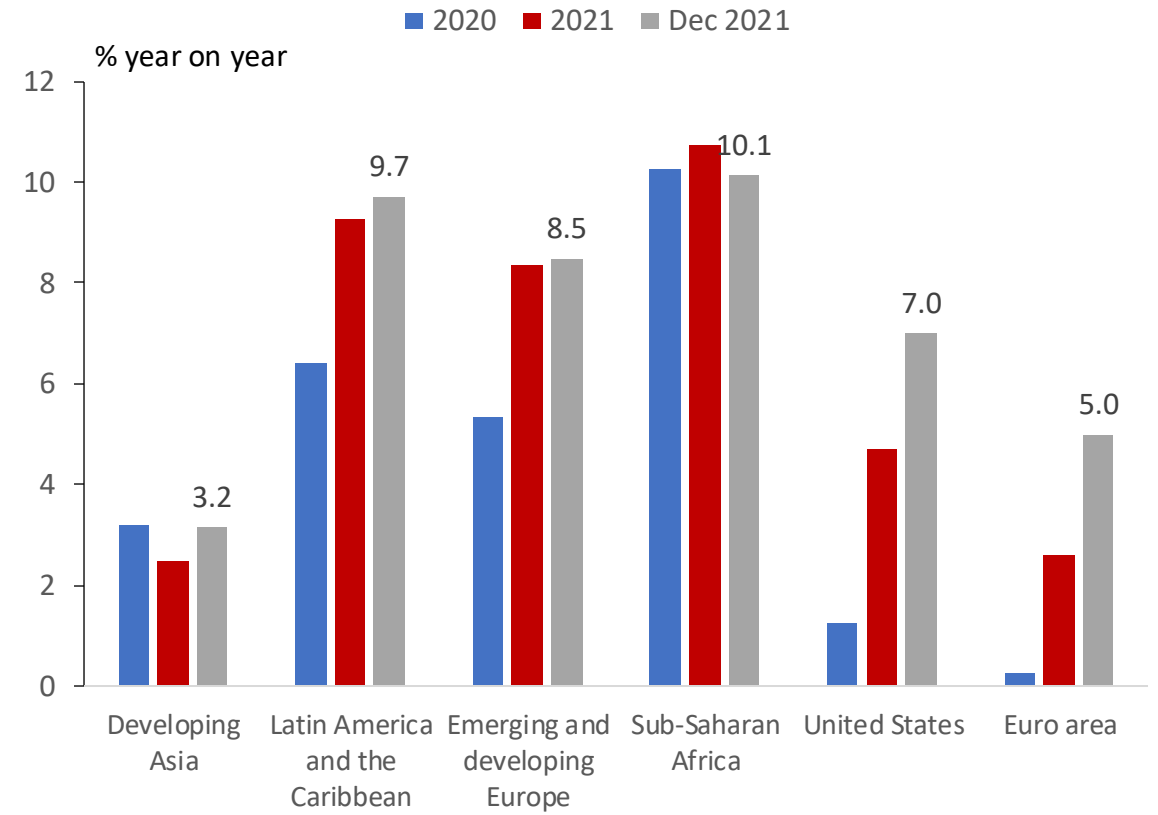
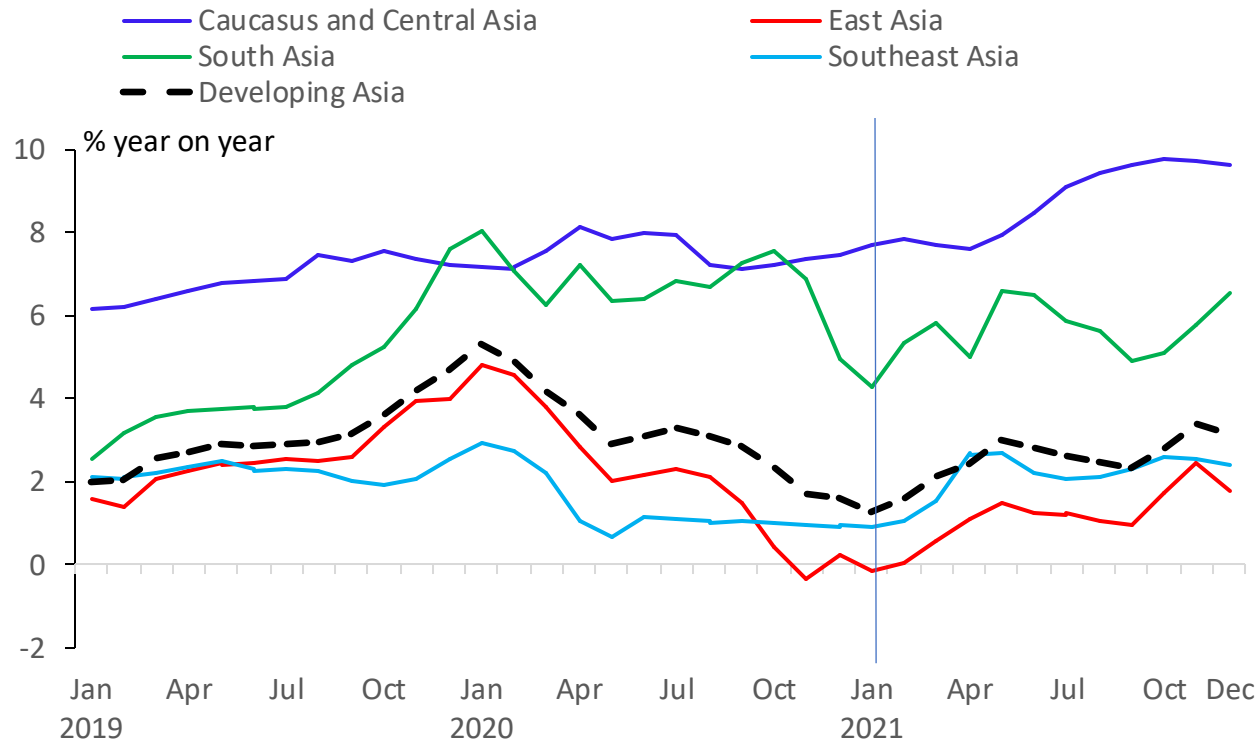
Inflation increased but remained mostly moderate outside of the Caucasus and Central Asia

Headline inflation in the region increased in late 2021...

...but stayed relatively low compared to the rest of the world, where inflation surged.

Headline inflation in Developing Asia

Headline inflation around the world



Note: The Pacific is excluded due to data unavailability.
Source: CEIC Data Company, accessed 7 March 2022.

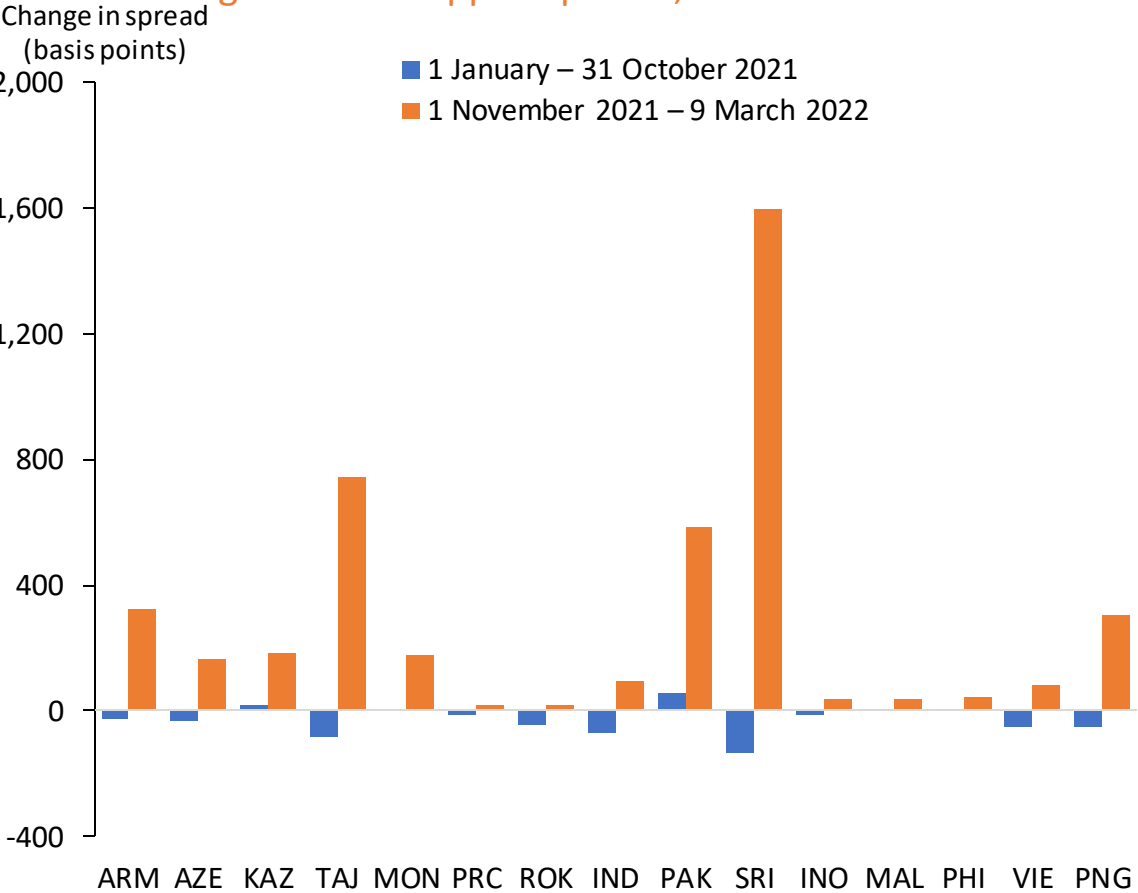
Source: CEIC Data Company, accessed 2 March 2022

Tightening global financial conditions have led to higher risk premiums and portfolio outflows

Risk premiums started to rise since November on US Fed's tapering, the Russian invasion of Ukraine, and economy-specific factors.

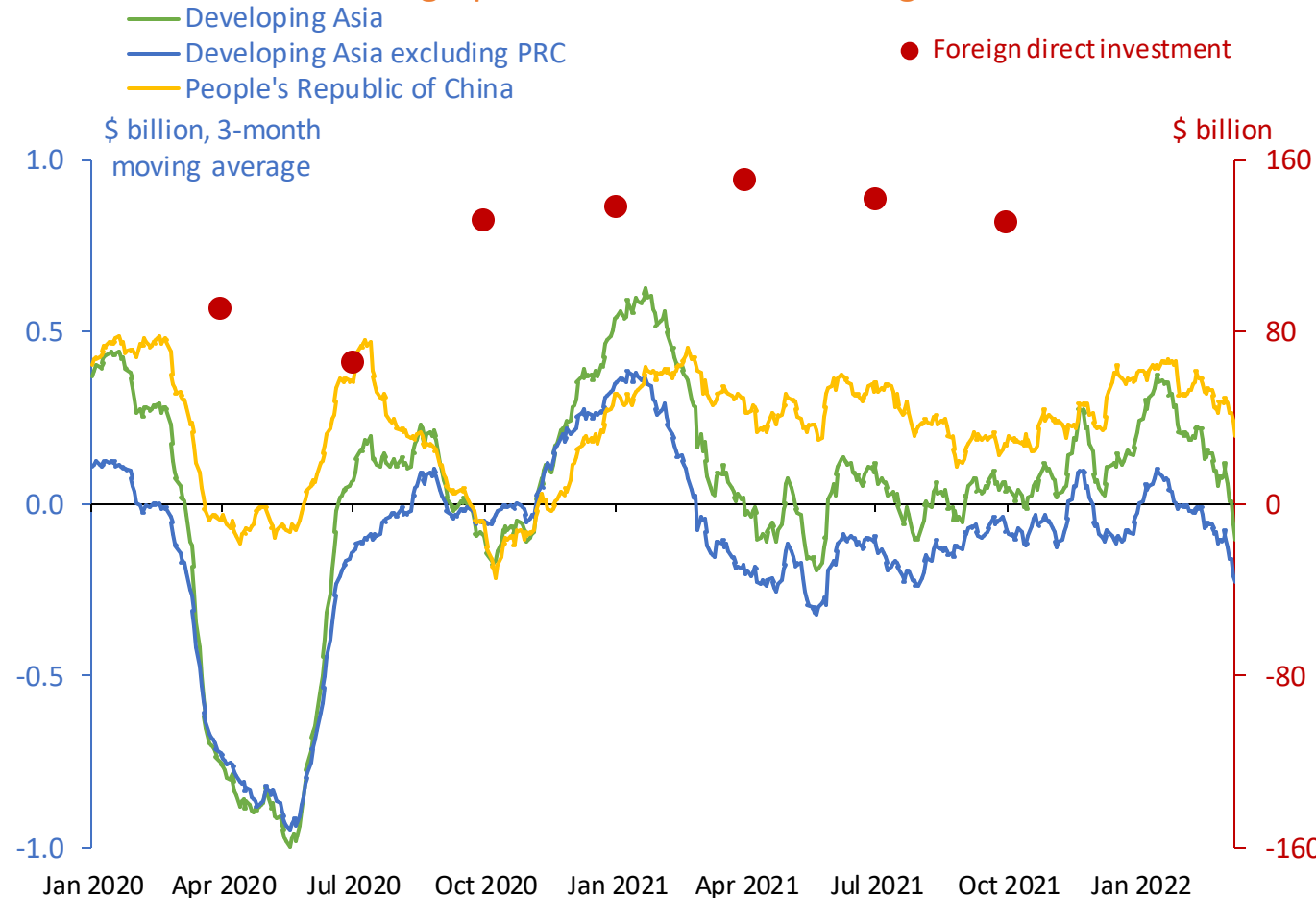
Except for the PRC, the region recorded net portfolio outflows, while foreign direct investment remained resilient.

JP Morgan EMBI stripped spreads, selected Asian economies



ARM = Armenia, AZE= Azerbaijan, IND = India, INO = Indonesia, KAZ= Kazakhstan, MAL = Malaysia, MON = Mongolia, PAK = Pakistan, PNG= Papua New Guinea, PRC = People's Republic of China, PHI = Philippines, ROK = Republic of Korea, TAJ = Tajikistan, SRI = Sri Lanka, VIE = Viet Nam.
Source: Bloomberg (10 March 2022).

Foreign portfolio flows into the region



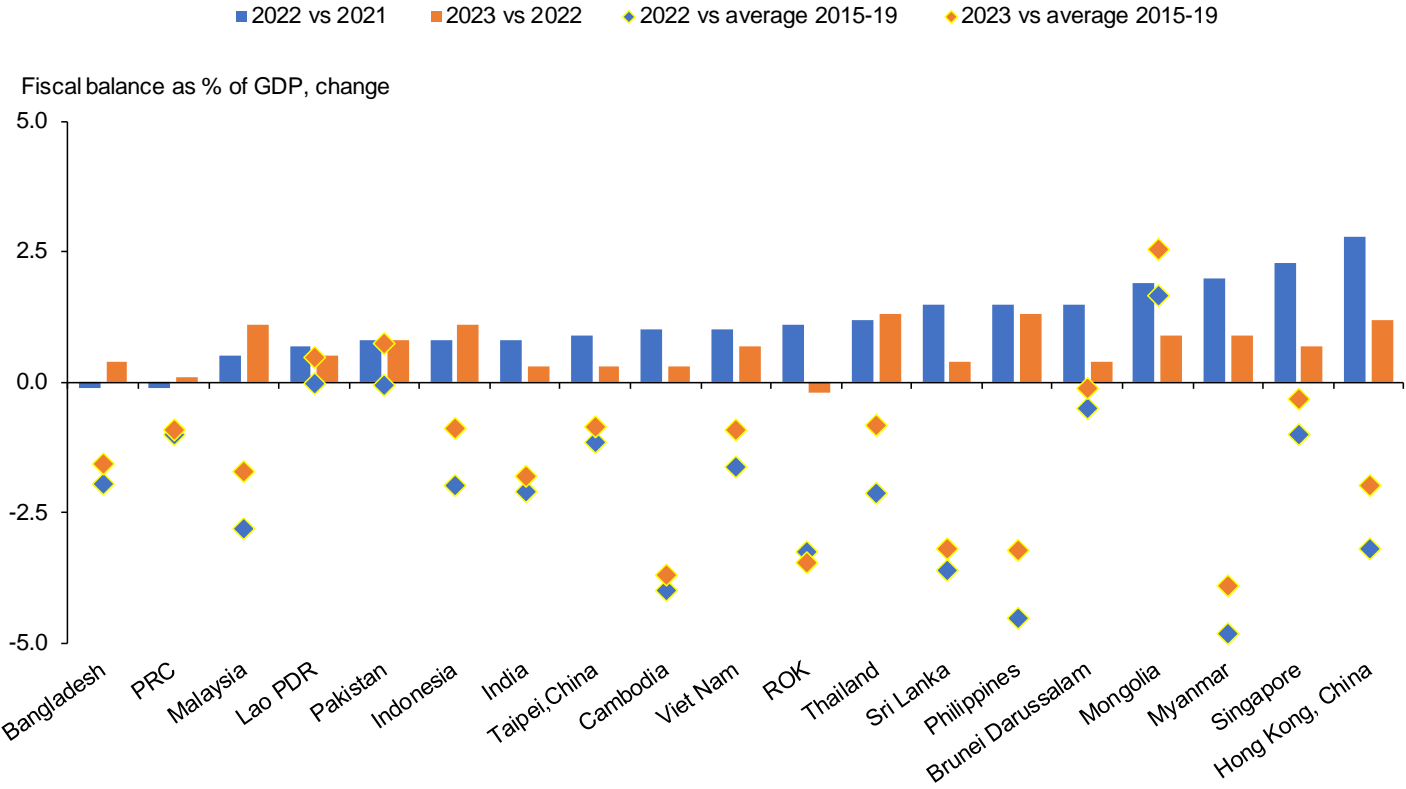
Notes: Data include India; Indonesia; Pakistan; the People's Republic of China; the Philippines; the Republic of Korea; Sri Lanka; Taipei, China; Thailand; and Viet Nam. Source: Institute of International Finance Capital flow tracker database and Haver Analytics (accessed 10 March 2022)

Policy is still supportive, but the region is on the cusp of a tightening cycle

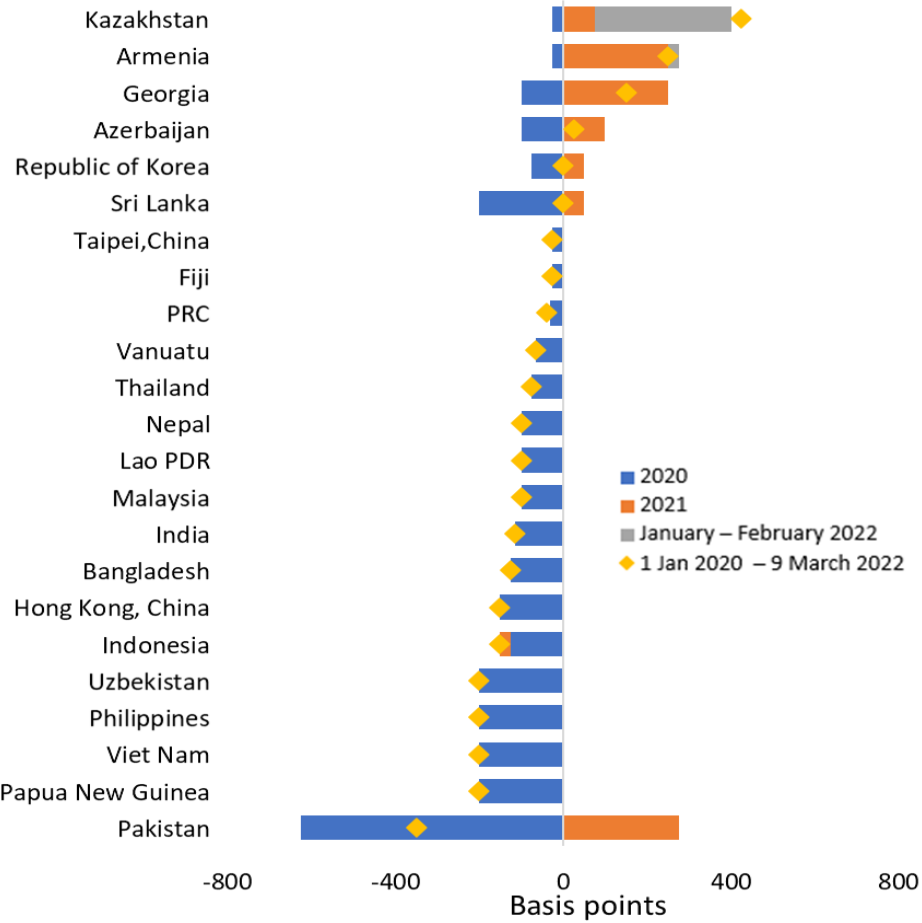
Budget balances will improve this year and next, but fiscal deficits will remain larger than prepandemic levels.

The monetary stance is still accommodative, but some central banks have already started hiking rates.

Fiscal impulse forecasts over 2022-2023, selected Asian Economies



Change in policy interest rates (selected economies)



Notes: GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, PRC=People's Republic of China, ROK = Republic of Korea. Fiscal impulse is defined as the change in the fiscal balance, expressed as percentage of GDP, from the previous year. The diamonds indicate the change in fiscal balance from the 5-year average (2015-2019). Positive changes in the fiscal balance indicate fiscal consolidation; negative changes indicate fiscal expansion.

Sources: FocusEconomics. 2022. FocusEconomics Consensus Forecast reports, February; Authors' calculations.

Source: Haver Analytics (accessed 10 March 2022).

GDP growth in developing Asia will continue to be strong, inflation will rise

GDP growth varies along with the pace of recovery across the region.

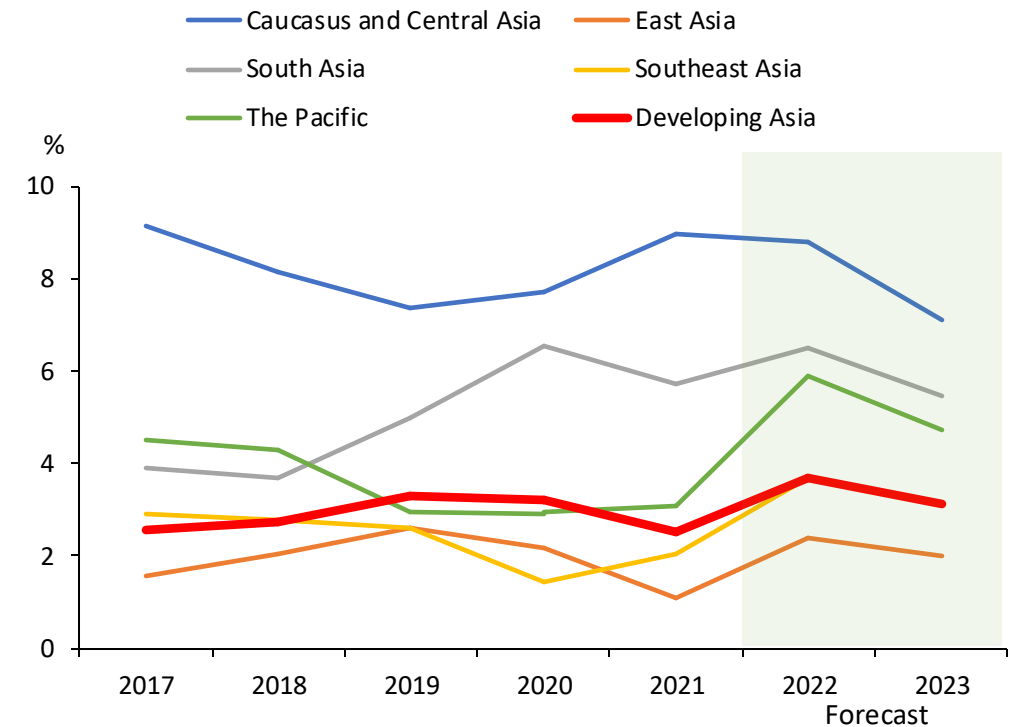
While still moderate, regional inflation will increase.

GDP growth rate (%), selected economies

	2021	2022	2023		2021	2022	2023
Developing Asia	6.9	5.2	5.3				
East Asia	7.6	4.7	4.5	South Asia	8.3	7.0	7.4
Hong Kong, China	6.4	2.0	3.7	Bangladesh	6.9	6.9	7.1
People's Republic of China	8.1	5.0	4.8	India	8.9	7.5	8.0
Republic of Korea	4.0	3.0	2.6	Pakistan	5.6	4.0	4.5
Taipei, China	6.4	3.8	3.0				
Southeast Asia	2.9	4.9	5.2	Caucasus and Central Asia	5.6	3.6	4.0
Indonesia	3.7	5.0	5.2	Azerbaijan	5.6	3.7	2.8
Malaysia	3.1	6.0	5.4	Kazakhstan	4.0	3.2	3.9
Philippines	5.6	6.0	6.3	Uzbekistan	7.4	4.0	4.5
Singapore	7.6	4.3	3.2	The Pacific	-0.6	3.9	5.4
Thailand	1.6	3.0	4.5	Fiji	-4.1	7.1	8.5
Viet Nam	2.6	6.5	6.7	Papua New Guinea	1.3	3.4	4.6

Source: Asian Development Outlook database.

Inflation forecast in developing Asia



Source: Asian Development Outlook database.

Elevated global turbulence and lingering pandemic risks

Several downside risks cloud the horizon:

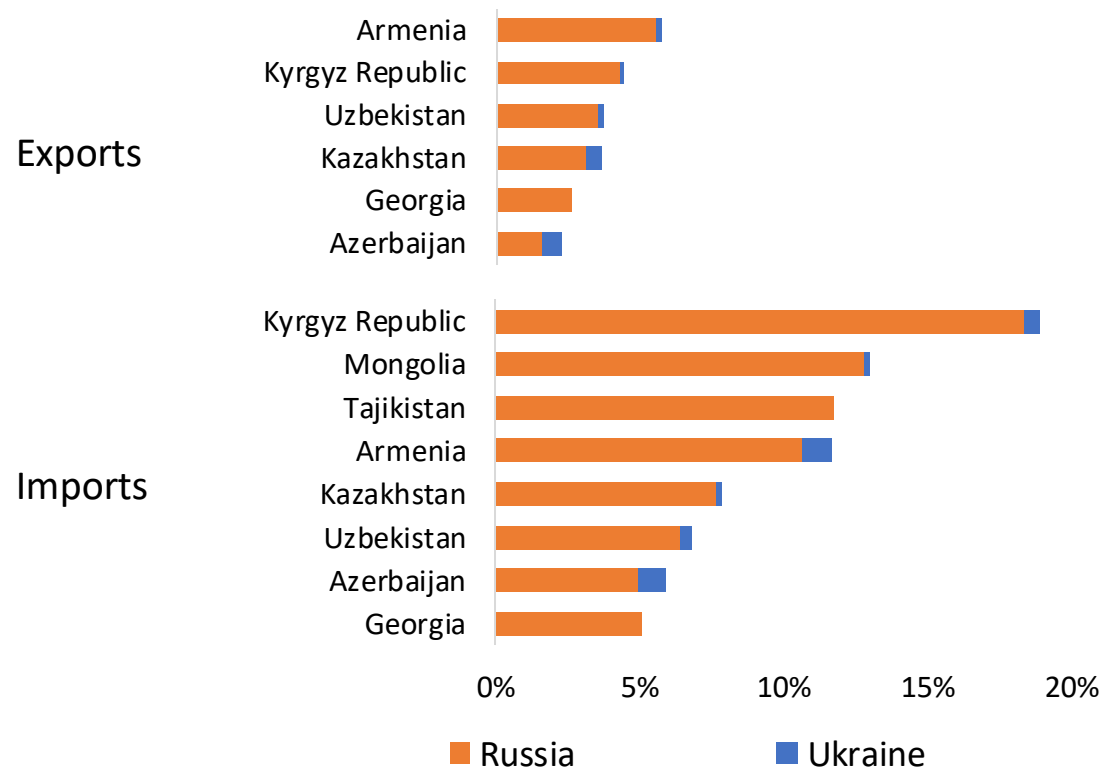
- Escalating global geopolitical tensions arising from the Russian invasion of Ukraine could spill over to the region through sharper-than-expected increases in energy and other commodity prices. (*Special Topic*)
- Aggressive tightening by the US Fed could trigger financial market volatility, capital outflows, and currency depreciations; raising financial stability risks in the region. (*Box*)
- The emergence of more deadly COVID-19 variants and the PRC's current Omicron outbreak could jeopardize regional growth and supply chains.
- Learning losses from continued school closures threaten to further exacerbate economic inequality. (*Special Topic*)

The Caucasus and Central Asia are exposed to Russia's economic downturn

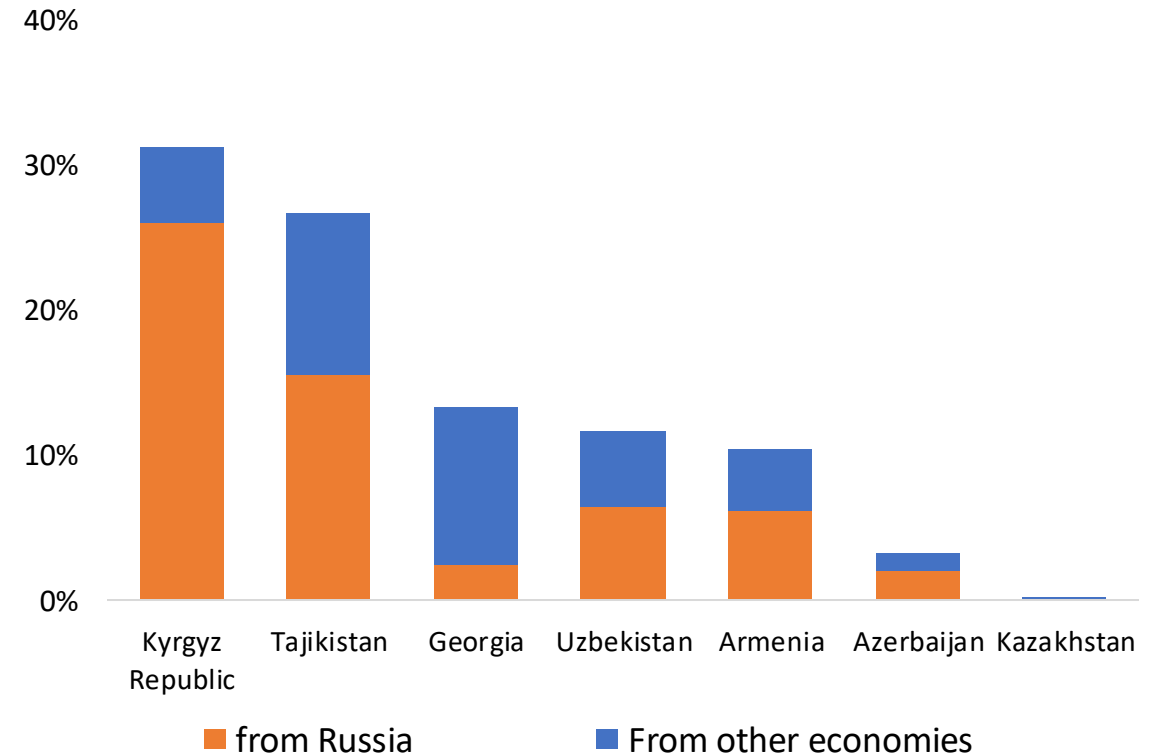
Economies in the Caucasus and Central Asia have close trade links with Russia.

Remittances from Russia exceed 15% of GDP in the Kyrgyz Republic and Tajikistan.

Trade with Russia and Ukraine (% of GDP)



Remittances (% of GDP)



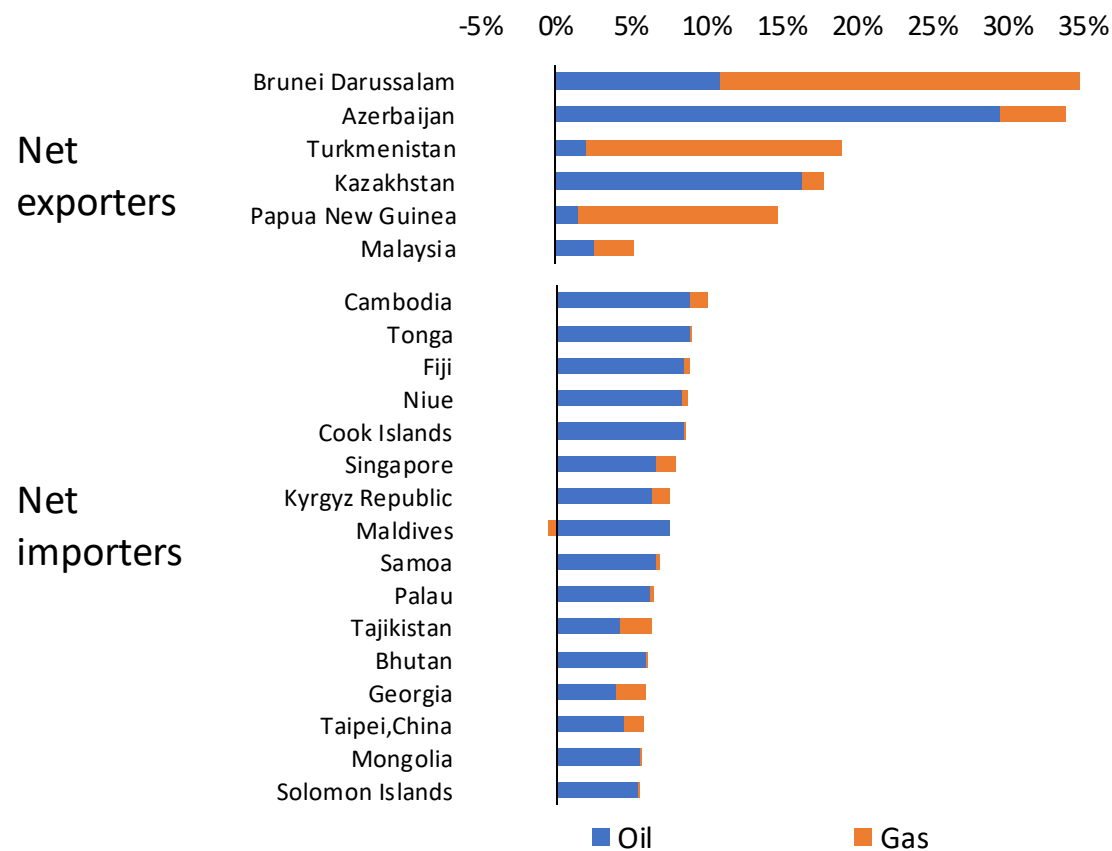
Note: Data as of 2019. Sample restricted to economies where trade with Russia and Ukraine exceeds 2% of GDP. Sources: Observatory of Economic Complexity, World Bank (both accessed 9 March 2022).

Note: Shares of remittances from Russia and Ukraine are for the first three quarters of 2021. They are applied to total incoming remittances in 2020. Source: World Bank (accessed 9 March 2022).

Energy bills will rise for oil and gas importers, while exporters will gain from higher prices

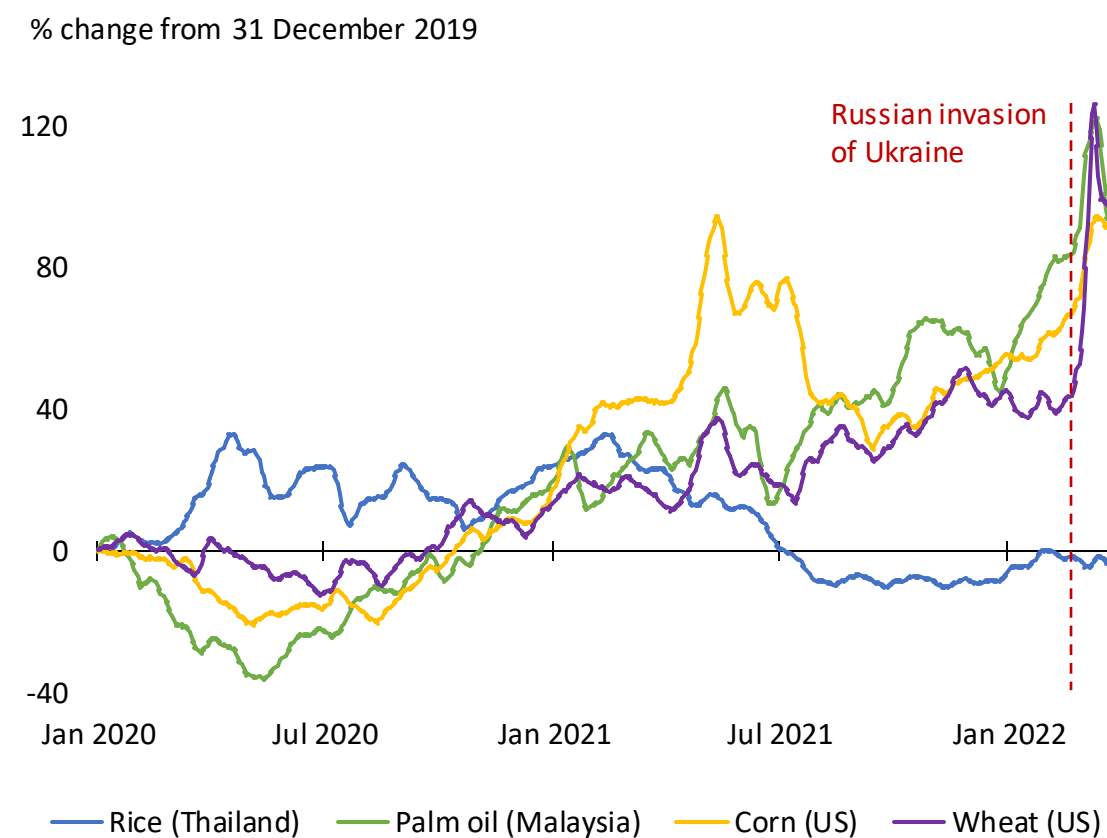
Oil and gas trade exceeds 5% of GDP for 6 regional net exporters and 16 net importers.

Net oil and gas exports and imports (% of GDP)



Grain and palm oil prices have spiked since the Russian invasion of Ukraine, but rice prices remain stable in Asia.

Prices of key agricultural products



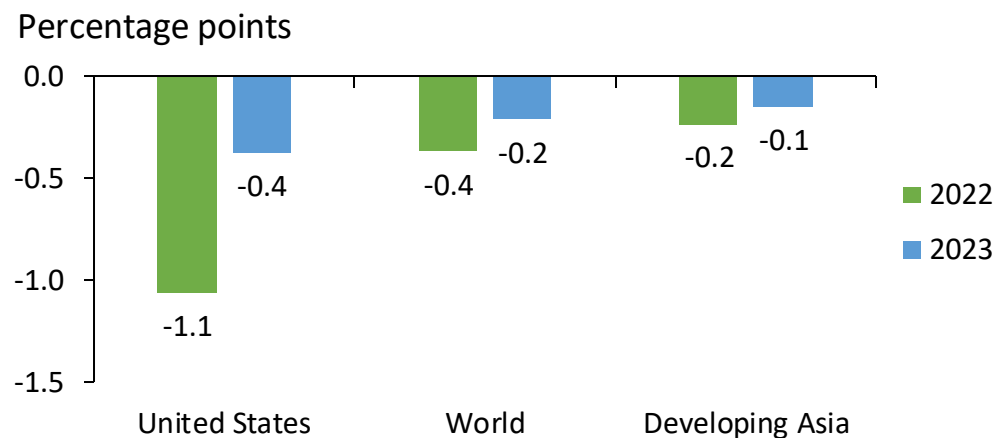
Notes: Data as of 2019. Sample restricted to economies where net oil and gas trade exceed 5% of GDP.

Sources: Observatory of Economic Complexity, World Bank (both accessed 9 March 2022).

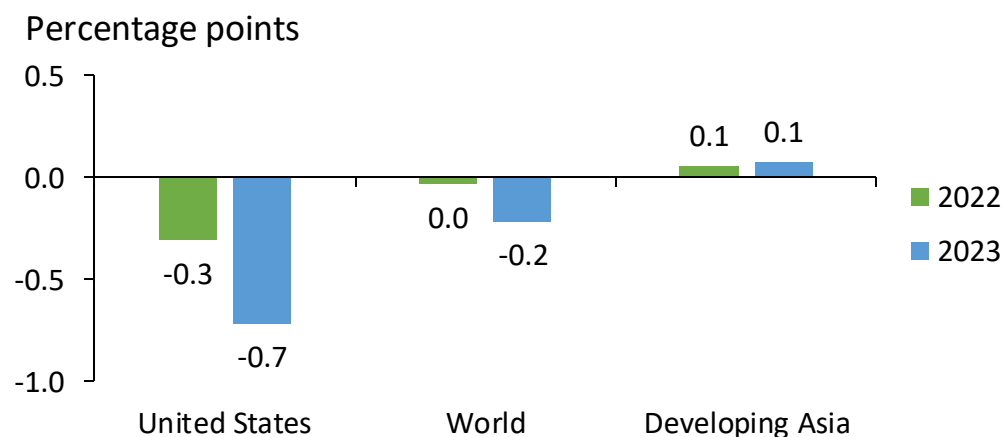
Source: CEIC Data Company (accessed 24 March 2022).

The impact of faster hikes in the US interest rate

Effect on GDP growth relative to the baseline



Effect on inflation relative to the baseline



GDP = gross domestic product.

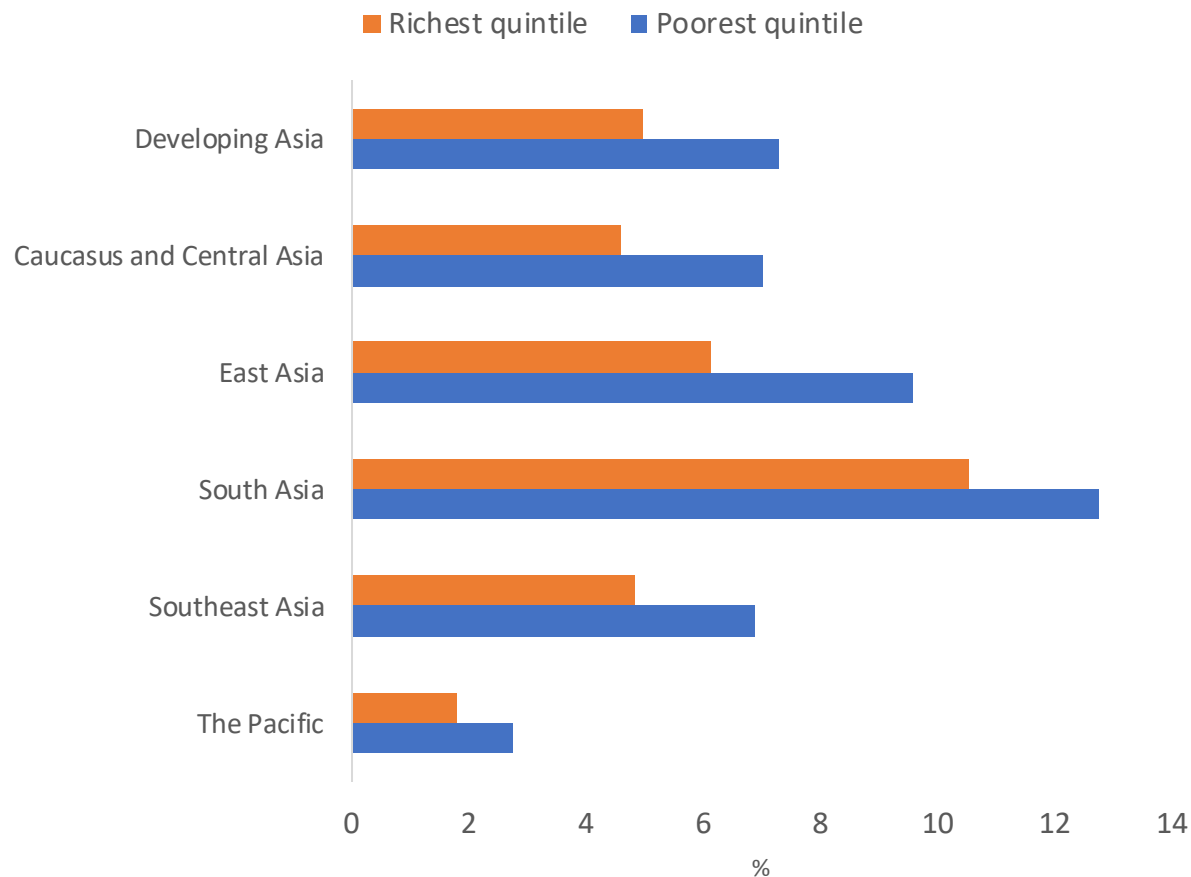
Source: ADB estimates using Global Projection Model (GPM).

- The Fed funds rate is to increase faster than the baseline:
 - 1.9% by December 2022 vs. 1.1% in baseline.
 - Up to 2.8% in 2023 vs. 2.1% in baseline.
- This may imply weaker global economic recovery and slower growth in developing Asia.
- Policy choices will become more complex in the region:
 - Inflation could accelerate, as exchange rates depreciate along with capital outflows.
 - Raising interest rates to stem capital outflows is an option but may choke domestic demand and slow the recovery.

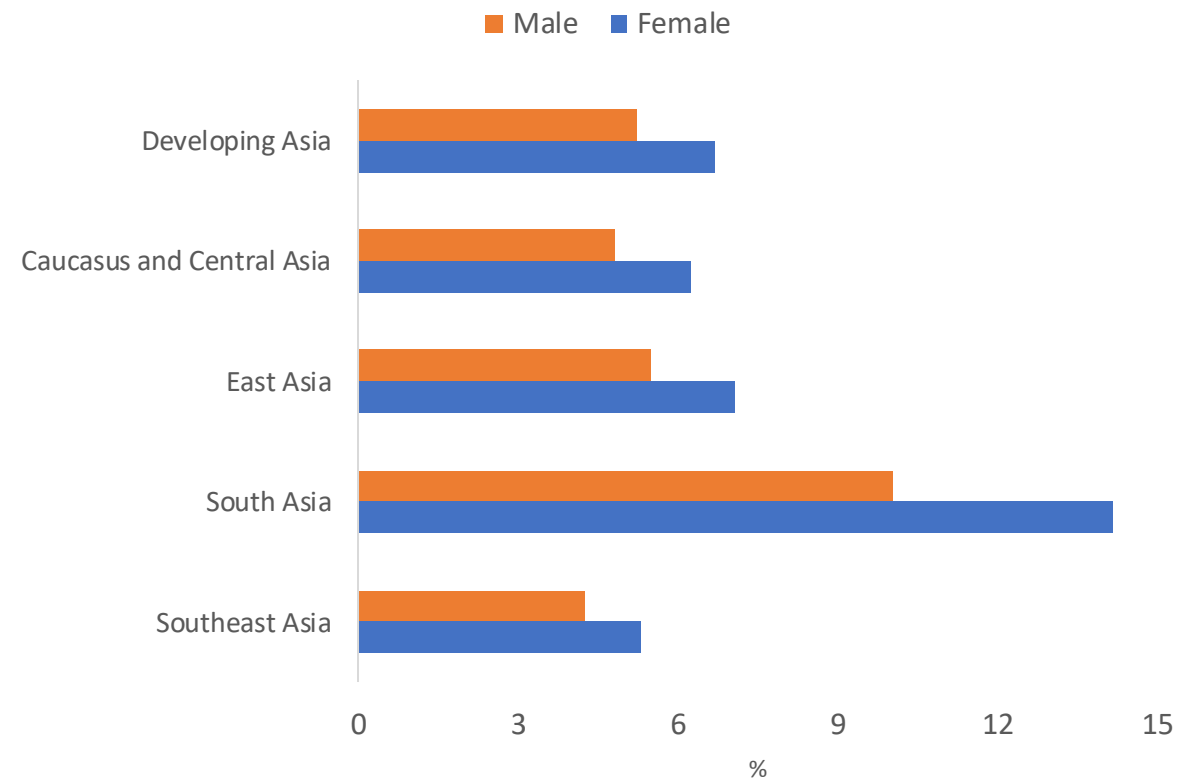
Learning losses from school closures have continued to accumulate in developing Asia, worsening inequalities

Poor students and girls are disproportionately affected by school closures.

Expected % loss in lifetime earnings, poorest vs. richest quintiles



Expected % loss in lifetime earnings, girls vs. boys



Note: Data on internet use by gender are not available for the Pacific.



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MOBILIZING TAXES FOR DEVELOPMENT

APRIL 2022

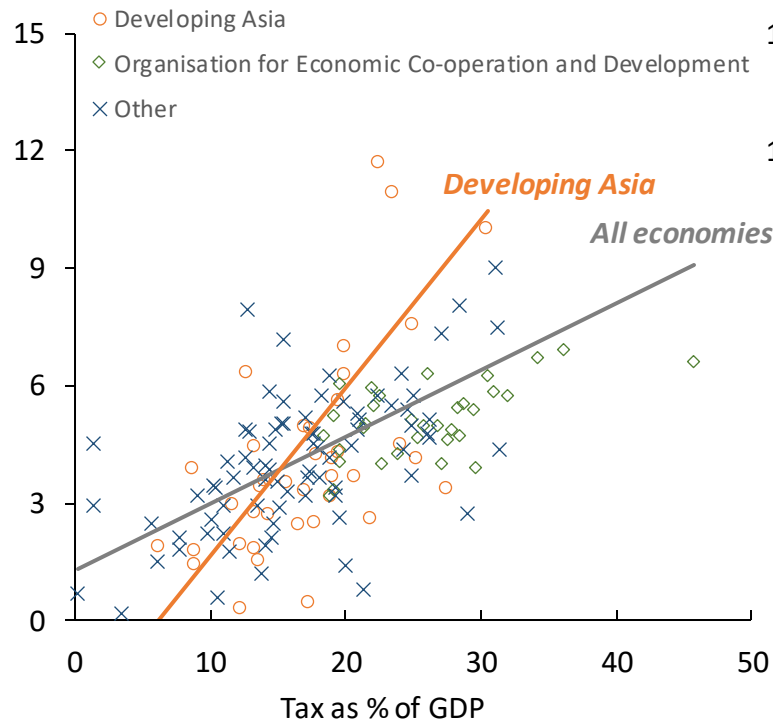
Tax mobilization is required to fund vast spending needs

- Developing Asia faces large spending needs to support inclusive and sustainable development.
- Private finance is critical but higher government spending is required.
- Improved spending efficiency can help create fiscal space but taxes need to be mobilized.

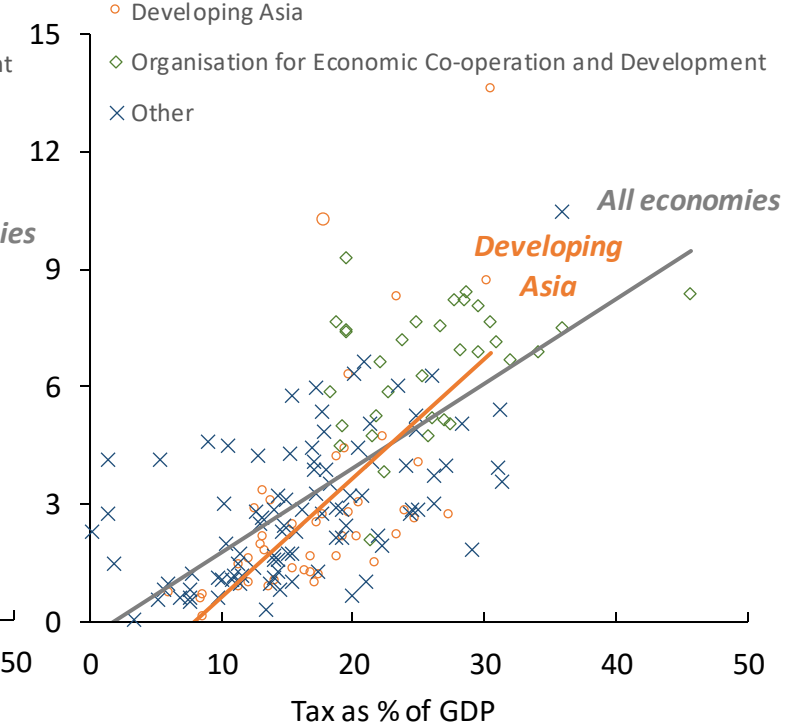
Higher tax revenue associated with greater development promoting spending.

Tax and selected expenditure, 2015–2019

Education spending as % of GDP



Health spending as % of GDP



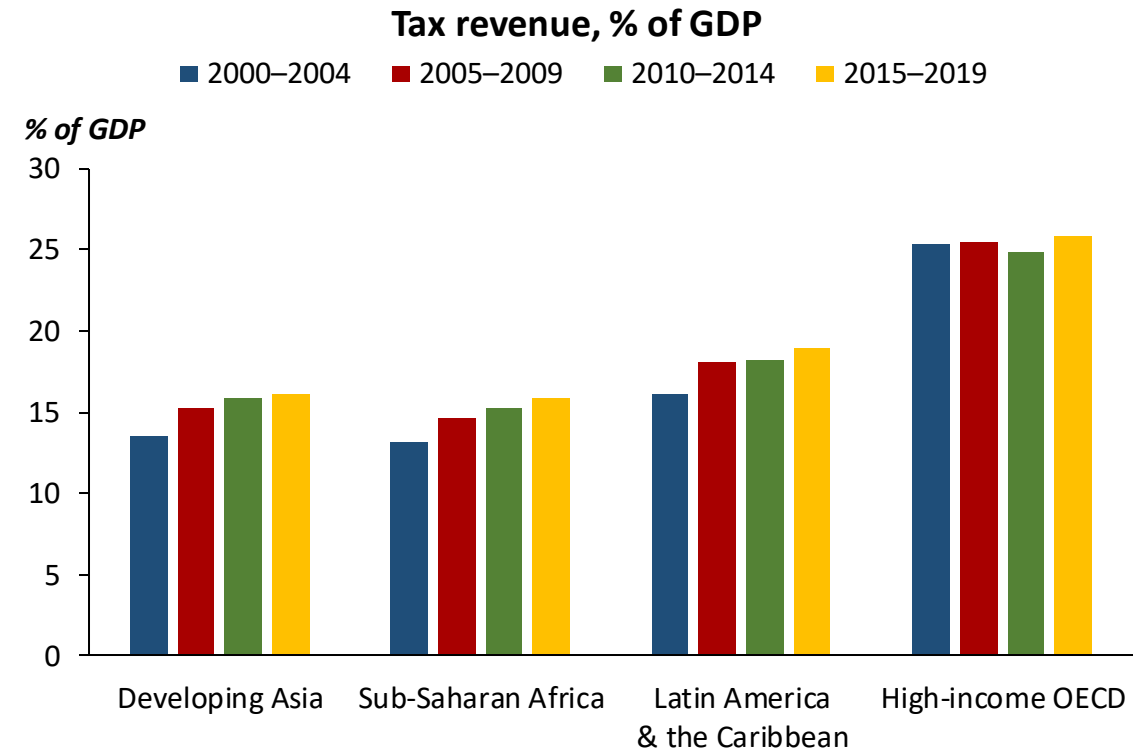
Notes: Tax revenue, education, and health expenditure (% of GDP) represent average for 2015-2019.

Sources: Organisation for Economic Co-operation and Development Revenue statistics (accessed 15 Sept 2021); International Monetary Fund Government Finance Statistics (accessed 22 Oct 2021); World Bank World Development Indicators (accessed 5 Oct 2021).

Before COVID-19 tax revenue increased but subsequently declined

- Tax revenue rose in the two decades before COVID-19 but remained comparatively low.
- Revenue declined sharply due to COVID-19.
- Tax (and spending) measures will need to be part of timely fiscal consolidation.

In developing Asia tax revenue rose before COVID-19 but remained comparatively low.



Note: 26 economies in developing Asia, 28 in sub-Saharan Africa, 27 in Latin America and the Caribbean, and 33 among high-income OECD members.

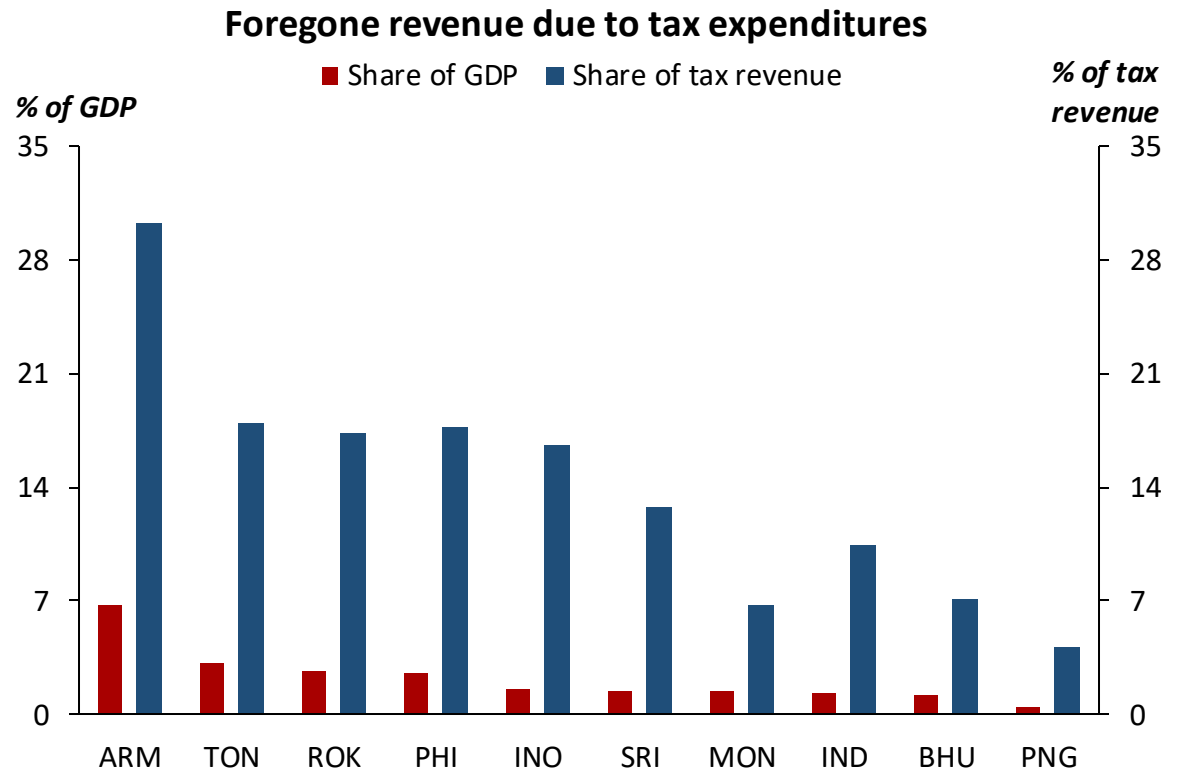
Sources: OECD. Global Revenue Statistics Database. <https://www.oecd.org>; IMF.

Government Finance Statistics online database. <https://www.imf.org> (both accessed 31 January 2022); ADB staff estimates.

Priorities vary across economies, but tax expenditures need to be optimized

- Estimates suggest potential to increase tax revenue by 3% to 4% of GDP, on average.
- Tax mobilization priorities depend on an economy's circumstances, guided by tax policy principles of efficiency, equity, and simplicity.
- Tax expenditures providing special exemptions cause substantial forgone revenue and need to be optimized.

Widely used tax expenditures forego revenue equal to about 14% of total tax revenue in developing Asia.

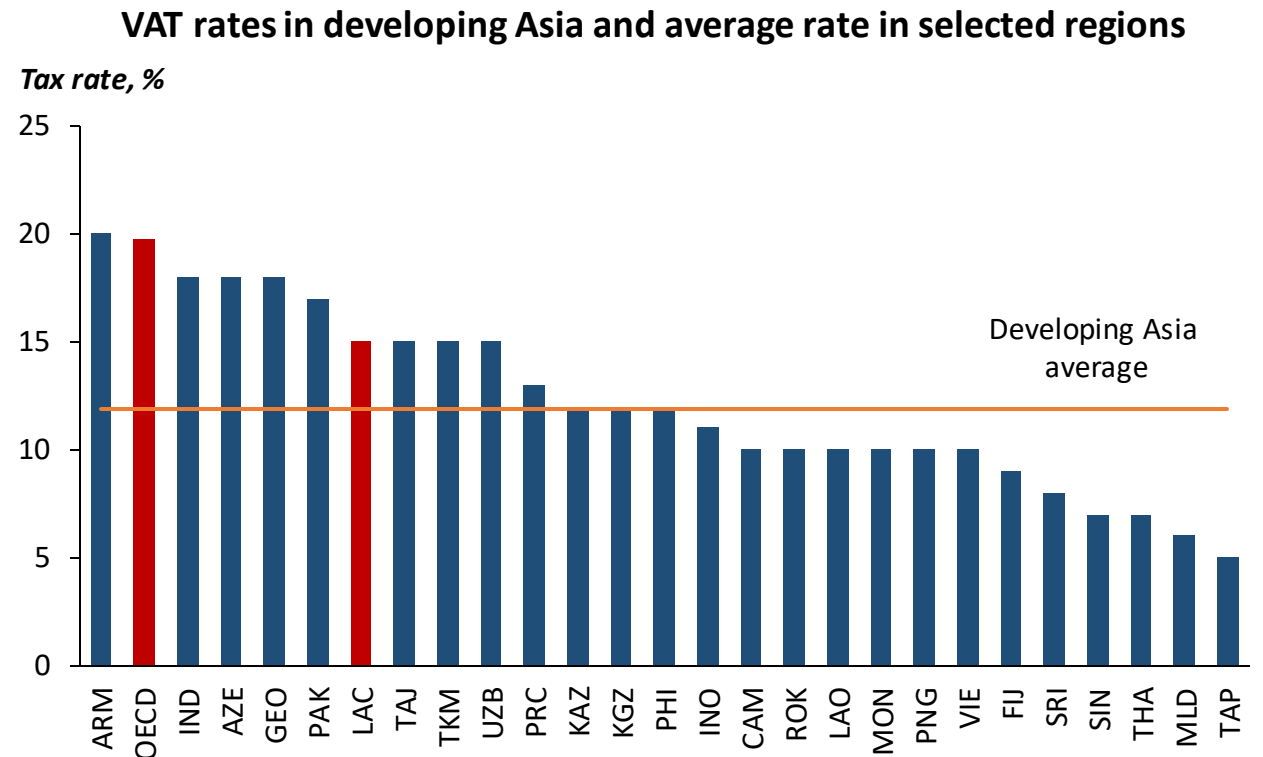


Source: Global Tax Expenditure Database. <https://gted.net> (accessed 1 Dec 2021)

Value-added tax is a revenue mainstay and must be better utilized

- Value-added tax (VAT) is a revenue mainstay in developing Asia and is a relatively efficient tax.
- VAT revenue is still lower than other regions, held back by sometimes low collection efficiency.
- VAT rates are also often low in the region, with scope to increase.

VAT rates in developing Asia are generally much lower than in other regions.

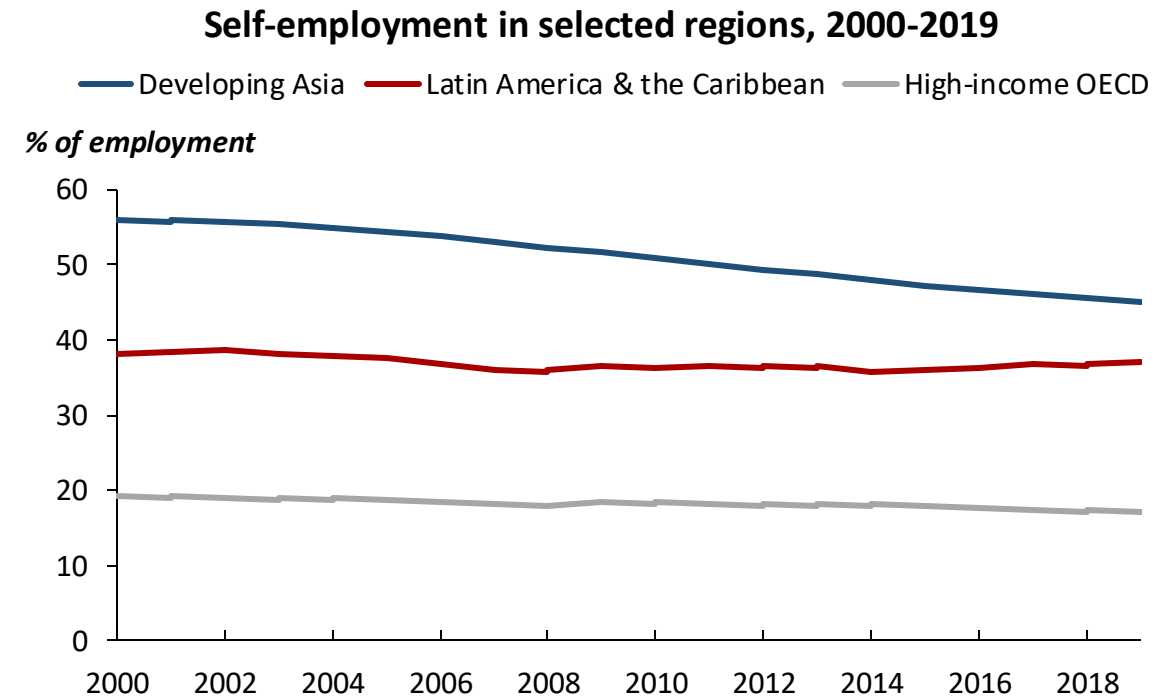


Source: PricewaterhouseCoopers. World Tax Summary. <https://taxsummaries.pwc.com/quick-charts/value-added-tax-vat-rates> (accessed 24 January 2022); Asian Development Bank estimates

Personal income and property taxes can support higher revenue and progressivity

- Increasing personal income tax revenue is challenging where collection capacity is weak, but declining self-employment creates opportunities.
- More up-to-date land valuations can support higher, more equitable property tax collection.
- Multilateral initiatives, notably the two-pillar solution, can help ease pressure on corporate income tax.

Self-employment has steadily become less prevalent in developing Asia.

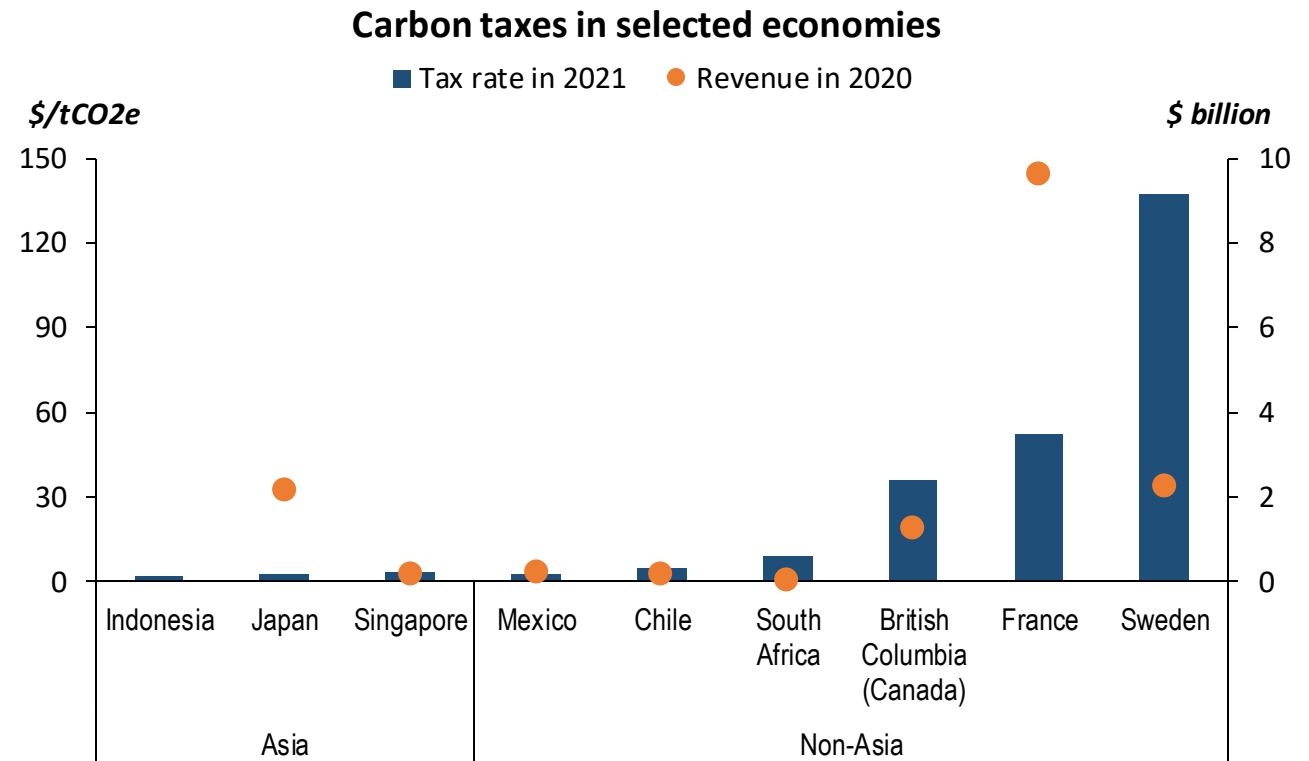


Source: World Bank World Development Indicators.
<https://databank.worldbank.org/source/world-development-indicators> (accessed 1 Dec 2021); ADB staff estimates.

Environment-related taxes are expanding in the region but remain underutilized

- Long history with environment-related tax instruments and fossil fuel taxes, but typically underutilized.
- Carbon pricing instruments are gaining popularity but carbon prices remain low, generating little revenue.
- Good design and implementation help cost-effectively support environmental goals and support revenue.

Carbon tax rates and associated revenues in Asia are comparatively low.

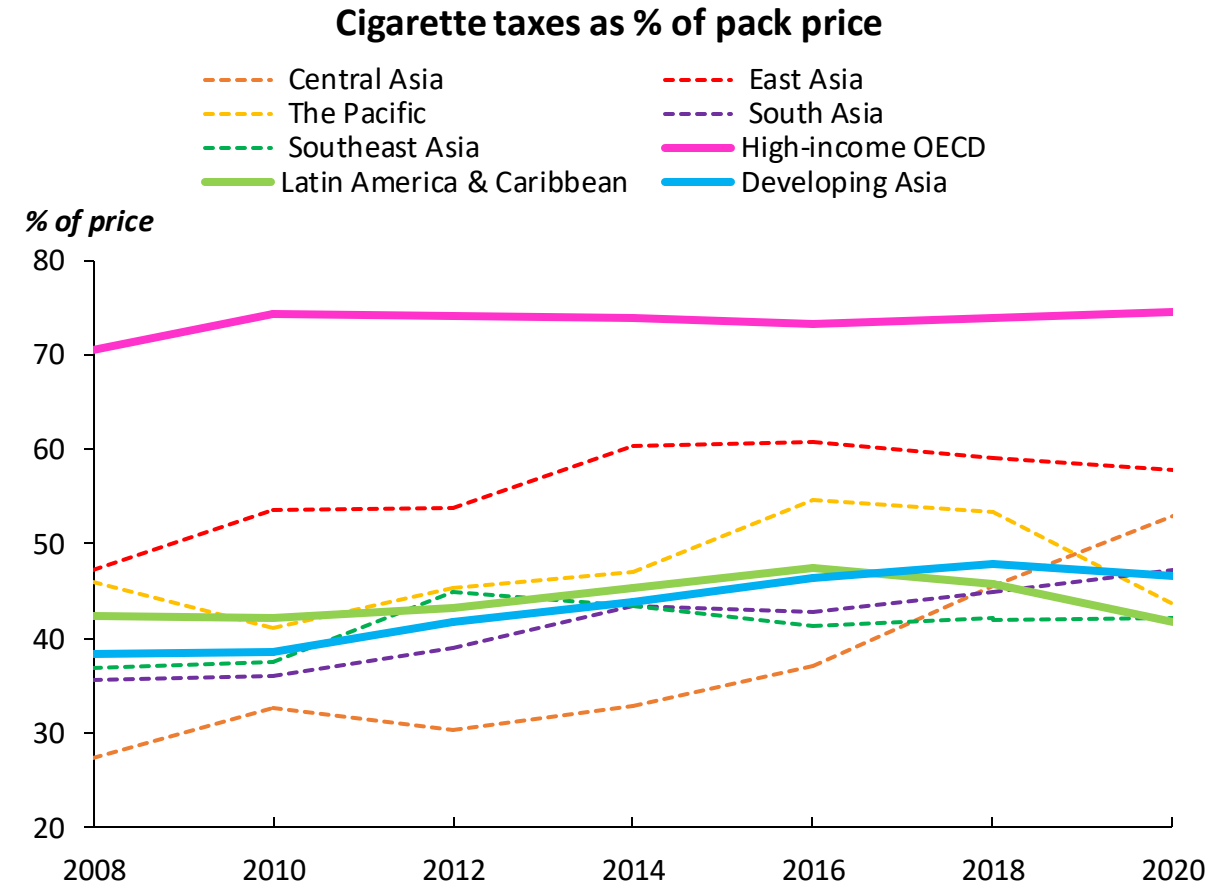


Source: Arimura et al. (2022).

Corrective health taxes can improve health and raise revenue

- Alcohol, tobacco, and unhealthy foods associated with high and rising non-communicable disease burden in region.
- Corrective health tax revenue is often below the cost of unhealthy consumption.
- Corrective health taxes can raise up to an additional 0.6% of GDP, including by increasing cigarette taxes.

Cigarette taxes in developing Asia remain significantly lower than those in advanced economies.

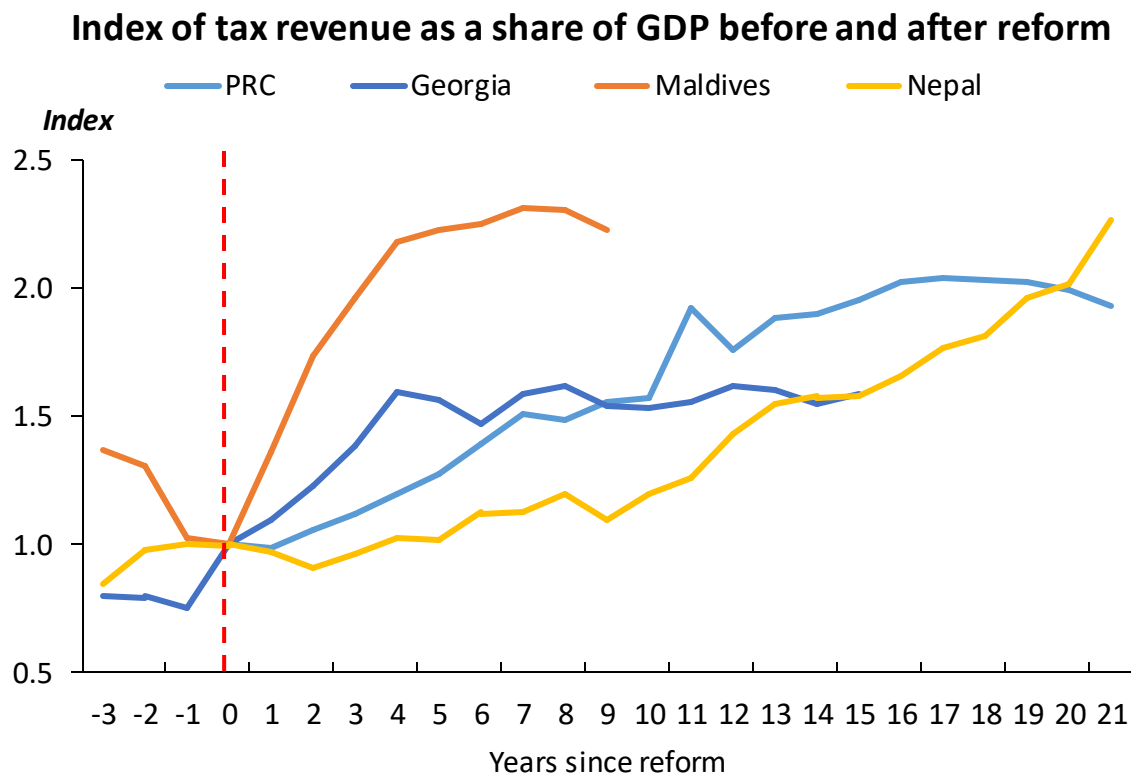


Source: World Health Organization (2021). Report of the Global Tobacco Epidemic.
<https://www.who.int/publications/i/item/9789240032095>

Reform to mobilize tax revenues is difficult but feasible

- Fundamental tax reform is hard but doable if supported by strong leadership and public buy-in.
- Cutting business registration costs would increase formality, expand the tax base and increase tax revenues.
- Stronger tax administration is essential, including by better harnessing technology.

Some developing economies have substantially increased tax revenue.



PRC = People's Republic of China

Source: International Monetary Fund Government Finance Statistics (accessed 31 January 2022); World Revenue Longitudinal Data (accessed 22 October 2021); ADB staff estimate.

Notes: Tax to GDP ratios are indexed to the year of reform for each economy. Reform years are as follows: PRC (1995), Georgia (2004), Maldives (2010), and Nepal (1997).