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.

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

Geopolitical risk index

Brent crude price, monthly average


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.

New cases, 7-day moving average, thousands

Purchasing managers’ index

Manufacturing PMI, seasonally adjusted

Services PMI, seasonally adjusted

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...

Growth by subregion in Developing Asia

Real exports

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

Source: Asian Development Outlook database (as of 21 March 2022).

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.

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

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

...but has 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 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. JP Morgan EMBI stripped spreads, selected Asian economies.

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

Source: Bloomberg (10 March 2022).

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.*

Fiscal impulse forecasts over 2022-2023, selected Asian Economies

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

Change in policy interest rates (selected economies)

Notes: GDP = gross domestic product, Lao = 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.

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

<table>
<thead>
<tr>
<th>Region</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
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</thead>
<tbody>
<tr>
<td>Developing Asia</td>
<td>6.9</td>
<td>5.2</td>
<td>5.3</td>
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<tr>
<td>East Asia</td>
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<td>4.7</td>
<td>4.5</td>
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<tr>
<td>Hong Kong, China</td>
<td>6.4</td>
<td>2.0</td>
<td>3.7</td>
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<tr>
<td>People's Republic of China</td>
<td>8.1</td>
<td>5.0</td>
<td>4.8</td>
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<tr>
<td>Republic of Korea</td>
<td>4.0</td>
<td>3.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Taipei, China</td>
<td>6.4</td>
<td>3.8</td>
<td>3.0</td>
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<tr>
<td>Southeast Asia</td>
<td>2.9</td>
<td>4.9</td>
<td>5.2</td>
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<tr>
<td>Indonesia</td>
<td>3.7</td>
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<td>3.1</td>
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<tr>
<td>Philippines</td>
<td>5.6</td>
<td>6.0</td>
<td>6.3</td>
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<tr>
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<td>7.6</td>
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<tr>
<td>Thailand</td>
<td>1.6</td>
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<tr>
<td>Viet Nam</td>
<td>2.6</td>
<td>6.5</td>
<td>6.7</td>
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South Asia
- Bangladesh: 8.3, 7.0, 7.4
- India: 6.9, 6.9, 7.1
- Pakistan: 5.6, 4.0, 4.5

Caucasus and Central Asia
- Azerbaijan: 5.6, 3.6, 4.0
- Kazakhstan: 4.0, 3.2, 3.9
- Uzbekistan: 7.4, 4.0, 4.5

The Pacific
- Fiji: -0.6, 3.9, 5.4
- 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.**

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade with Russia and Ukraine (% of GDP)</th>
<th>Remittances (% of GDP)</th>
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<tbody>
<tr>
<td>Armenia</td>
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<td>Kyrgyz Republic</td>
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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).

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

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.

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

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).

The impact of faster hikes in the US policy rate

- 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.

**Effect on GDP growth relative to the baseline**

- United States: -1.1% in 2022, -0.4% in 2023
- World: -0.2% in 2022, -0.4% in 2023
- Developing Asia: -0.1% in 2022, -0.2% in 2023

**Effect on inflation relative to the baseline**

- United States: -0.3% in 2022, -0.7% in 2023
- World: -0.2% in 2022, -0.7% in 2023
- Developing Asia: -0.1% in 2022, 0.1% in 2023

GDP = gross domestic product.
Source: ADB estimates using Global Projection Model (GPM).
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
Developing Asia faces an urgent need to better mobilize tax revenues

- Developing Asia faces large spending needs to support inclusive and sustainable development.
- Tax revenue rose in the two decades before COVID-19 but remained comparatively low.
- Furthermore, revenue declined sharply due to COVID-19.

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.
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.

- Global experience shows it is possible to substantially increase tax revenues.

- There is no one-size-fits-all path to successful reform.

- But strengthening value-added tax (VAT) and optimizing tax incentives holds promise across the region.

Some developing economies have substantially increased tax revenue.

Index of tax revenue as a share of GDP before and after reform

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).
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