

# ASIAN DEVELOPMENT OUTLOOK

JULY 2023

## HIGHLIGHTS

- Exports from developing Asia weakened in the first quarter of 2023 as global demand slowed. However, consumption and investment are forecast to boost aggregate regional growth to 4.8% in 2023, as earlier forecast, with the projection for 2024 revised down only marginally to 4.7%.
- Given balancing developments, growth forecasts for East Asia are maintained at 4.6% in 2023 and at 4.2% in 2024, for South Asia at 5.5% in 2023 and 6.1% in 2024, and for the Pacific at 3.3% in 2023 and 2.8% in 2024.
- Southeast Asia's growth prospects are downgraded slightly from 4.7% to 4.6% in 2023 and from 5.0% to 4.9% in 2024, reflecting weaker global demand for manufactured exports.
- Growth forecasts for the Caucasus and Central Asia are adjusted down from 4.4% to 4.3% in 2023 and from 4.6% to 4.4% in 2024 after oil production in Azerbaijan fell more than expected.
- Headline inflation eased toward pre-pandemic averages as fuel and food prices waned.
- With lower inflation in developing Asia and more moderate monetary tightening in the United States, most central banks in the region have kept policy rates steady this year, with signs emerging of a shift toward easier money.
- Interest rates in the United States and other advanced economies are likely to shape the regional growth outlook, with upside and downside risks in balance.

## ROBUST GROWTH WITH MODERATING INFLATION

### Recent Developments

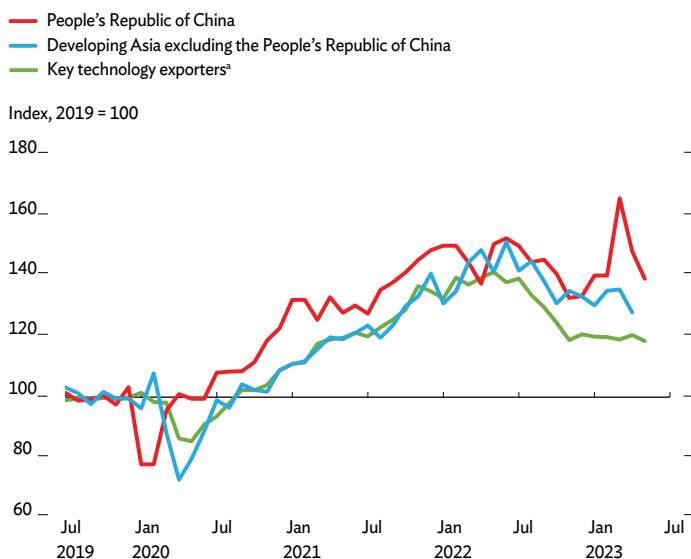
**Economic activity in major advanced economies remained weak as monetary tightening took hold.** Although gross domestic product (GDP) growth in the United States (US) slowed from 2022, it surprised on the upside at 1.3% in the first quarter (Q1) of 2023 (box). While the labor market remained tight, inflation declined to 3.0% in June. The euro area contracted for a second consecutive quarter and thus entered a technical recession, with leading economic activity indicators suggesting continued weakness. In Japan, revived inbound tourism and services boosted growth to 2.7%. Strong services were the main driver of recovery in the People's Republic of China (PRC), where GDP growth rebounded to 4.5% but consumer price pressures remained benign. Oil prices declined from their peak in April as global activity weakened from last year.

**Exports and industrial activity in developing Asia continue to decelerate as global demand slows** (Figure 1). Year on year in the year to date, exports from key technology exporters declined sharply, while weaker demand also held down exports from the rest of the region. Manufacturing purchasing managers' indexes (PMIs) across major regional economies show divergence but also general weakness in export-oriented economies (Table 1). PMIs remain below 50 in the Republic of Korea (ROK), Singapore, and Taipei, China, indicating contraction month on month, especially in exporters of semiconductors, electronics, and other high technology products, but readings indicate high growth in India, the Philippines, and Thailand buoyed by strong domestic demand. In the PRC, exports of motor vehicles, lithium batteries, and solar cells improved in the first half of this year, but exports of furniture, textiles,

The Asian Development Bank Regional Economic Outlook Task Force led the preparation of a revised outlook for this *Asian Development Outlook*. The task force is chaired by the Economic Research and Development Impact Department and includes representatives of the Central and West Asia Department, East Asia Department, Pacific Department, South Asia Department, and Southeast Asia Department.

**Figure 1 Exports from Developing Asia**

After a spike as suppliers filled order backlogs following COVID-19 and supply chain disruption, exports from the People's Republic of China weakened again.



COVID-19 = coronavirus disease.

\* the Republic of Korea, Singapore; and Taipei,China.

Sources: CEIC Data Company; CPB World Trade Monitor.

**Table 1 Seasonally Adjusted Manufacturing Purchasing Managers' Indexes**

These leading indicators continued to diverge in the region as manufacturing remained weak in key technology exporters.

Economy	2023					
	Q1			Q2		
	Jan	Feb	Mar	Apr	May	Jun
India	55.4	55.3	56.4	57.2	58.7	57.8
Thailand	54.5	54.8	53.1	60.4	58.2	53.2
Indonesia	51.3	51.2	51.9	52.7	50.3	52.5
Philippines	53.5	52.7	52.5	51.4	52.2	50.9
People's Republic of China	49.2	51.6	50.0	49.5	50.9	50.5
Singapore	49.8	50.0	49.9	49.7	49.5	49.7
Republic of Korea	48.5	48.5	47.6	48.1	48.4	47.8
Malaysia	46.5	48.4	48.8	48.8	47.8	47.7
Viet Nam	47.4	51.2	47.7	46.7	45.3	46.2
Taipei,China	44.3	49.0	48.6	47.1	44.3	44.8

Note: Pink to red indicates worsening (<50) and white to green indicates improvement (>50). The series for Singapore is not seasonally adjusted. Key technology exporters include the Republic of Korea; Singapore; and Taipei,China. Source: CEIC Data Company.

and electronics and components faltered. Tourism continues to recover, with arrivals reaching pre-pandemic levels in many economies.

**Headline inflation eased toward pre-pandemic averages as supply-side pressures waned and monetary tightening took hold.** It has trended down in all subregions this year along with fuel and food prices. Core inflation is more mixed. It remained elevated in many East and Southeast Asian economies because of higher input prices and as revived leisure activities pushed up prices for services, but it started to trend down in the Caucasus and Central Asia, partly reflecting base effects there.

**Most central banks have kept policy rates steady this year, but signs have emerged of a shift toward easing.** Three-quarters of monetary policy decisions made since April in developing Asia have left policy rates unchanged. Central banks in Armenia, Georgia, the PRC, and Sri Lanka have actually cut policy rates.

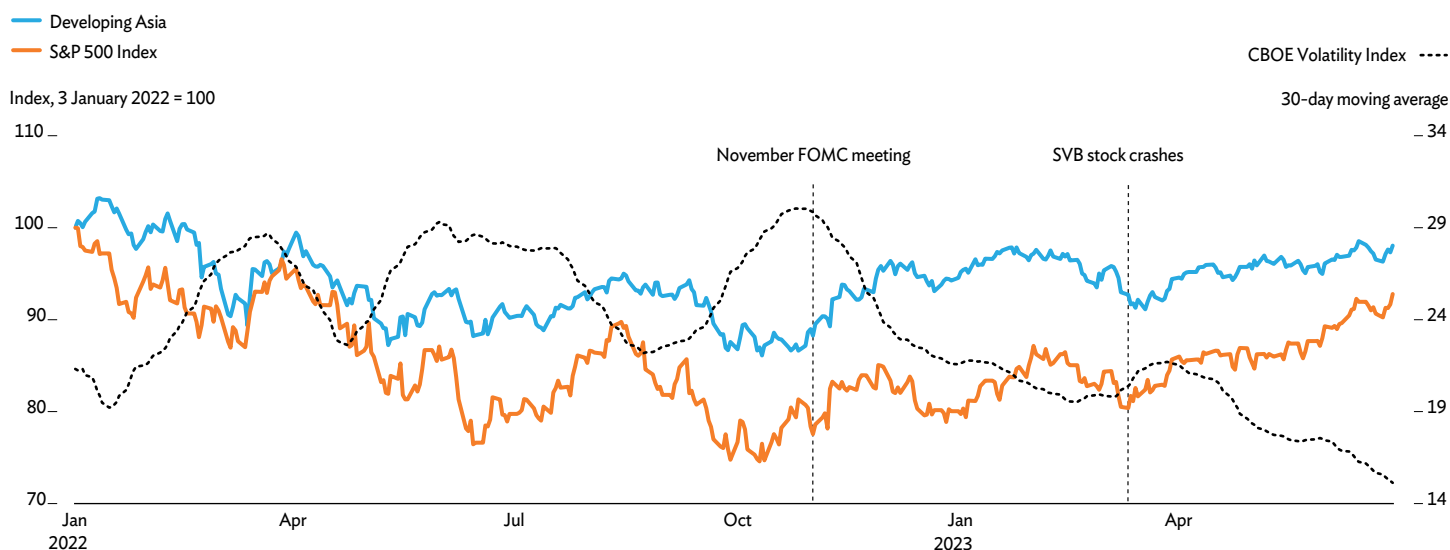
**With inflation easing in the region and the US Federal Reserve moderating its monetary tightening, financial conditions have improved since March.** After temporarily rising in March, the volatility index of the Chicago Board Options Exchange has since steadily declined, tracking market normalization and reduced uncertainty, especially for banks. As market sentiment improved, value-weighted return on equities increased by 6.4% from 18 March to 30 June (Figure 2). In the same period, the weighted average regional risk premium narrowed marginally, as measured by J. P. Morgan Emerging Markets Bond Index Global stripped spreads.

**Despite an upgrade for US growth this year, the global outlook for next year is dimmed by lagged effects from interest rate hikes.** The 2023 growth forecast for the US is revised up from Asian Development Outlook, April 2023 (ADO April 2023) following expansion in Q1 that surprised on the upside. However, US growth is now projected to slow in 2024. The forecast for growth acceleration next year in the euro area is similarly downgraded because of interest rate hikes. Japan's growth forecasts for 2023 and 2024 are revised down in line with weakening export demand and capital investment.

**As domestic demand remains robust, the regional growth forecast is maintained at 4.8% for 2023 and revised down only marginally to 4.7% for 2024** (Table 2). Aggregate GDP growth in the region's 10 largest economies accelerated from 2.1% year on year in the second half of 2022 to 3.7% in Q1 2023, driven by a strong recovery in services after the PRC lifted coronavirus disease (COVID-19) restrictions. Subregional growth forecasts for this year and next are little changed, but with a notable downward revision for the Caucasus and Central Asia in

**Figure 2 Equity Market Performance**

Equity markets recovered from losses inflicted in March by poor investor sentiment during banking turmoil in the United States and Europe.



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

Source: Bloomberg.

**Table 2 GDP Growth Rate and Inflation, %**

	GDP Growth					Inflation				
	2022	2023		2024		2022	2023		2024	
		April	July	April	July		April	July	April	July
<b>Developing Asia</b>	<b>4.3</b>	<b>4.8</b>	<b>4.8</b>	<b>4.8</b>	<b>4.7</b>	<b>4.4</b>	<b>4.2</b>	<b>3.6</b>	<b>3.3</b>	<b>3.4</b>
<b>Developing Asia excluding the PRC</b>	<b>5.5</b>	<b>4.6</b>	<b>4.5</b>	<b>5.1</b>	<b>5.0</b>	<b>6.7</b>	<b>6.2</b>	<b>6.2</b>	<b>4.4</b>	<b>4.8</b>
<b>Caucasus and Central Asia</b>	<b>5.1</b>	<b>4.4</b>	<b>4.3</b>	<b>4.6</b>	<b>4.4</b>	<b>12.9</b>	<b>10.3</b>	<b>10.6</b>	<b>7.5</b>	<b>7.8</b>
Kazakhstan	3.3	3.7	3.9	4.1	4.1	15.0	11.8	12.4	6.4	7.2
<b>East Asia</b>	<b>2.8</b>	<b>4.6</b>	<b>4.6</b>	<b>4.2</b>	<b>4.2</b>	<b>2.3</b>	<b>2.3</b>	<b>1.3</b>	<b>2.0</b>	<b>2.1</b>
Hong Kong, China	-3.5	3.6	4.7	3.7	3.3	1.9	2.3	2.5	2.1	2.1
People's Republic of China	3.0	5.0	5.0	4.5	4.5	2.0	2.2	1.0	2.0	2.0
Republic of Korea	2.6	1.5	1.3	2.2	2.2	5.1	3.2	3.5	2.0	2.5
Taipei, China	2.4	2.0	1.5	2.6	2.7	2.9	2.0	2.0	2.0	2.0
<b>South Asia</b>	<b>6.7</b>	<b>5.5</b>	<b>5.5</b>	<b>6.1</b>	<b>6.1</b>	<b>8.2</b>	<b>8.1</b>	<b>8.1</b>	<b>5.8</b>	<b>6.4</b>
India	7.2	6.4	6.4	6.7	6.7	6.7	5.0	4.9	4.5	4.5
<b>Southeast Asia</b>	<b>5.6</b>	<b>4.7</b>	<b>4.6</b>	<b>5.0</b>	<b>4.9</b>	<b>5.1</b>	<b>4.4</b>	<b>4.3</b>	<b>3.3</b>	<b>3.2</b>
Indonesia	5.3	4.8	4.8	5.0	5.0	4.2	4.2	3.8	3.0	3.0
Malaysia	8.7	4.7	4.7	4.9	4.9	3.4	3.1	3.1	2.8	2.8
Philippines	7.6	6.0	6.0	6.2	6.2	5.8	6.2	6.2	4.0	4.0
Singapore	3.6	2.0	1.5	3.0	3.0	6.1	5.0	5.0	2.0	2.0
Thailand	2.6	3.3	3.5	3.7	3.7	6.1	2.9	2.9	2.3	2.3
Viet Nam	8.0	6.5	5.8	6.8	6.2	3.2	4.5	4.0	4.2	4.0
<b>The Pacific</b>	<b>5.3</b>	<b>3.3</b>	<b>3.3</b>	<b>2.8</b>	<b>2.8</b>	<b>5.2</b>	<b>5.0</b>	<b>5.0</b>	<b>4.4</b>	<b>4.4</b>

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

Note: **Developing Asia** refers to the 46 developing members of the Asian Development Bank. **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.

Sources: Asian Development Bank. 2023. *Asian Development Outlook April 2023*; Asian Development Bank estimates.

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2024. The forecast for regional inflation in 2023 is downgraded to 3.6% as the PRC drives a downward revision for East Asia, as does Indonesia for Southeast Asia.

### **With interest rates in the US and other advanced economies likely to shape regional growth, upside and downside risks to the outlook are in balance.**

If inflation is tamed more quickly than currently expected in the advanced economies, the authorities there will likely adopt a more dovish monetary policy, which would support growth in the region. On the other hand, the regional outlook could be dented by an array of immediate and emerging challenges. Financial stability risks remain elevated, and fragility in banks and other financial institutions requires continued monitoring, particularly in economies with high obligations denominated in foreign currency and domestic debt in such highly leveraged sectors as households, construction, and property development. Some regional economies with high credit risk, poor institutional frameworks, or weak macroeconomic fundamentals are especially exposed to interest rate risks. Uncertainty persists over the Russian invasion of Ukraine, and any escalation there could renew energy and food security challenges and rekindle inflation. Finally, changing weather patterns, including a return of El Niño disruption this year, may have macroeconomic consequences.

## Growth and Inflation Outlook by Subregion

### *East Asia*

**The growth forecast for East Asia as a whole is unchanged at 4.6% in 2023, slowing to 4.2% in 2024.** GDP growth projections for the PRC are sustained as recent developments offset one another and stay consistent, on balance, with *ADO April 2023* forecasts. Downward revisions to 2023 projections for the ROK and Taipei, China to accommodate weak global demand are offset by an upward revision for Hong Kong, China following surprisingly strong growth there in Q1.

### **PRC growth forecasts for 2023 and 2024 are maintained.**

Economic activity bounced back in Q1 2023 with services—especially contact services such as hospitality, catering, and transportation—particularly strong. Despite weakness in key indicators including retail sales and fixed asset investment, growth in Q2 is expected to pick up further on a base effect. Growth in manufacturing investment is expected to moderate in line with cooling exports, while that of infrastructure investment is likely to remain stable. Monetary and fiscal policies will

continue to support economic recovery, particularly to boost domestic demand. In June, the central bank cut three key policy rates to boost the economy. With a strong rebound in Q1 and moderating growth in Q2, growth remains largely consistent with projections made in *ADO April 2023*. The growth forecast for 2023 is thus kept at 5.0%, and for 2024 at 4.5%.

**Forecasts for Taipei, China are adjusted down for 2023 and slightly up for 2024.** The economy shrank by 2.9% year on year in Q1 2023 as exports plunged by 10.8% with a continued slump in demand for electronics. Meanwhile, imports fell by just 4.0%, such that net exports pulled down growth by 5.4 percentage points. Investment fell by 3.2% as low capacity utilization and higher interest rates weighed on firms' appetite for investment. On the positive side, private consumption grew by 6.5% as relaxed COVID-19 restrictions continued to boost the economy. With Q1 weaker than expected and global demand still faltering, the forecast for 2023 is revised down substantially to 1.5%. The projection for 2024 is revised up marginally to 2.7%, the rebound reflecting recovery in global demand.

**Growth this year in the ROK is projected to be slower than previously predicted.** The economy slowed from 1.3% year on year in Q4 2022 to 0.8% in Q1 2023. Inertia in information technology and minimal positive spillover from economic recovery in the PRC caused exports to shrink by 3.0% year on year in Q1. In the first 5 months of 2023, exports to the PRC shrank, dragging all exports down by 13.6% year on year and semiconductor exports down by 39.4%. Private consumption and investment are expected to remain weakened in 2023 by high interest rates and a sluggish housing market, but then improve in 2024.

**Hong Kong, China has its growth forecast raised for 2023 and lowered for 2024.** Marked upward revision of the forecast for this year from 3.6% to 4.7% reflects an unexpectedly strong rebound in Q1. Inbound tourism is now expected to recover quickly as pandemic-related disruption to transportation and handling capacity gradually fades. Continued improvement in economic conditions and prospects, including recovery in the PRC, should further boost consumption and domestic demand despite drag from tight financial conditions. On the downside, slower growth in advanced economies will continue to weigh on external demand. While normalizing external and domestic conditions will underpin continued recovery in 2024, the growth forecast is revised down to 3.3% primarily to accommodate base effects.

**Inflation forecasts for East Asia are sharply down to 1.3% in 2023 and slightly higher at 2.1% in 2024.** Average consumer price inflation in the PRC was muted in the first half of this year at 0.7%. Reflecting softer global commodity prices and weaker-than-anticipated domestic demand, inflation is now forecast

to slow to 1.0% in 2023, but the forecast for 2024 remains unchanged at 2.0%. In Taipei, China, inflation slowed as expected to 2.0% in May and is projected to ease further as growth weakens and food price inflation slows. Forecasts of 2.0% inflation in both years are thus maintained. In the ROK, inflation fell from 3.7% year on year in April to 3.3% in May with lower prices for transportation, food, and energy, but forecasts are now raised as inflation remains strong and shows no sign of abating. In Hong Kong, China, inflation is seen gradually picking up in the rest of this year. External price pressures are expected to moderate somewhat, but inflation is forecast to increase this year, in tandem with economic recovery, more than projected in *ADO April 2023*.

## South Asia

**South Asia is on course to achieve ADO April 2023 growth forecasts.** Downward revisions for Nepal and Pakistan in 2023 reflect mainly tighter monetary and fiscal policies and are offset by an upward revision for Bangladesh as net exports performed better than expected. Growth projections elsewhere in South Asia are largely maintained.

**The Indian economy, supported by upbeat domestic demand, is set to meet earlier projections.** In fiscal year 2023 (FY2023, ending 31 March 2024), consumption demand in India is expected to recover with improvement in both rural and urban demand as reflected in such indicators as consumer confidence, urban unemployment, and motorbike sales. Investment growth will remain robust, underpinned by strong bank credit growth and demand for housing, and supported by fewer interest rate hikes by the central bank. However, the global economic slowdown has suppressed merchandise trade, which will be a drag on growth. On the supply side, growth will be buoyed by manufacturing as input prices cool. The service PMI has remained above 60, indicating resilient growth in the sector. Assuming normal rainfall and other weather factors, and no further geopolitical shocks, India is expected to grow by 6.4% in FY2023 and 6.7% in FY2024, as projected in *ADO April 2023*.

**Sri Lanka's GDP growth projections for 2023 and 2024 are maintained at 3.0% contraction followed by 1.3% growth.** The economy contracted by 11.5% year on year in Q1 2023, with both services and manufacturing sharply down. Agriculture grew by 0.8% as fertilizer availability improved. A positive development is that Sri Lanka has met some key benchmarks under an International Monetary Fund (IMF) program using its Extended Fund Facility, notably implementing a payment scheme for social safety net welfare benefits and reaching its primary balance target for Q1 2023 despite revenue collection

below expectations. Economic growth in the second half of 2023 will likely be supported by improved foreign exchange liquidity, looser monetary policy, and parliamentary agreement in early July on how to optimize domestic debt. The Sri Lankan rupee appreciated against the US dollar in the first half of 2023 as remittances and tourism brought in more dollars, import demand weakened, dollar liquidity improved, government securities recorded net inflow, and the exchange rate guidance peg was lifted.

**Growth in Bangladesh is estimated higher than forecast for fiscal 2023.** The higher estimate of 6.0% for FY2023 (ended 30 June 2023) reflects strong net exports as imports fell more sharply than expected and export growth slowed less than expected. On the supply side, manufacturing firms of all sizes leveraged supportive government policies to contribute to growth. Crop losses to floods, cyclones, and droughts were partly offset by subsidies, incentives, and other measures. The service sector was buoyed by higher warehouse and support activities and health and social services. On the demand side, growth in public consumption outpaced expectations, as did public investment. The *ADO April 2023* forecast for growth in FY2024 is unchanged at 6.5%.

**GDP projections for Nepal and Pakistan are adjusted down for FY2023 and maintained for FY2024.** Growth in Pakistan in FY2023 (ended 30 June 2023) was weighed down by tighter monetary and fiscal policies to safeguard macroeconomic stability, pervasive inflation, and significant damage from flooding. In Nepal, significant growth moderation in FY2023 (ended mid-July 2023) reflected unexpectedly sharp effects from a number of factors, notably tighter monetary policy driving up interest rates, high fuel prices, and import restrictions imposed to manage declining foreign exchange reserves. Forecasts for FY2024 in both economies are maintained on the assumption that external and domestic conditions improve. The *ADO April 2023* projection for Pakistan in FY2024 assumes that the government will continue reform as recommended by the IMF under a new policy-support program approved on 12 July.

**Growth projections for Maldives are sustained, and little changed for Bhutan.** Recent news suggests a weaker year than expected for industry in Bhutan. With credit to finance construction suspended, the sector is now expected to contract by 4.0%, not grow by 1.0% as projected in *ADO April 2023*. In Maldives, buoyant tourism and construction are expected to continue to drive growth.

**The 2023 inflation forecast for South Asia is kept at 8.1%, and the 2024 projection revised up markedly to 6.4%.** The inflation projection for India in FY2023 is reduced slightly from

5.0% in ADO April 2023 to 4.9% and maintained at 4.5% in FY2024. As food and oil prices moderated, inflation eased below the 6.0% upper bound of the monetary policy target. Expected softening of Brent crude prices in 2023 should lower headline inflation, but core inflation, which excludes food and fuel, is expected to be stubbornly high. The Bhutan inflation projection for 2023 is revised down after fuel prices dropped more than expected. Similarly, the inflation forecast for Sri Lanka is revised down on account of declining prices for food, transportation, and utilities, as well as base changes for the consumer price index. In contrast, 2023 inflation projections for Bangladesh and Nepal are revised up, and actual inflation in Pakistan in FY2023 was higher than projected, leaving the subregional forecast unchanged. Continued demand-side pressures in Pakistan play an outsized role in the upward revision to the subregional inflation forecast for 2024.

### Southeast Asia

#### **Southeast Asian growth is now projected somewhat lower.**

GDP growth forecasts are downgraded marginally, from 4.7% to 4.6% in 2023 and from 5.0% to 4.9% in 2024. Weaker global demand for manufactured exports has slowed growth even as domestic demand remained intact. Private consumption continued to be the primary driver of economic growth in the first half of 2023, buoyed by improved labor market conditions and income across Southeast Asia. Revenge travel continues to lift tourist arrivals and related activities. In addition, PRC recovery, while still subdued, supports demand for agricultural exports from the subregion.

#### **The growth forecast for Indonesia in 2023 is kept at 4.8%.**

GDP grew by 5.0% year on year in Q1 2023, little changed from Q4 2022 but lower than the pre-pandemic quarterly average of 5.3%. Despite normalization, domestic demand grew only modestly, as is expected in the full year. Consumption has shown no signs of revenge spending, and investment growth is held down by businesses' wait-and-see attitude. Export growth slowed on base-year effects and lower demand from trade partners, which is expected to persist.

**Private consumption underpinned economic growth in Malaysia.** Notable trends are improved labor market conditions, investment, and construction. Still, Q1 2023 GDP growth was, at 5.6% year on year, much lower than 7.1% in the previous quarter. Private investment rose by 4.7% in Q1 2023 as firms continued to increase their capacity and construction revived. Public investment also grew, by 5.7% in Q1 2023, as government corporations lifted capital expenditure. With quarterly GDP growth expected to ease further in the coming quarters, ADO April 2023 forecasts for 2023 and 2024 will likely be met.

#### **GDP growth projections for the Philippines are maintained.**

Robust investment and private consumption drove growth by 6.4% year on year in Q1 2023, supported by rising employment, expanding production and retail sales, and brisk private and public construction. Net exports weighed on GDP. Merchandise export declined, partly offset by expansion in service exports. Tourism bounced back, and growth remained strong for business process outsourcing and information services. GDP forecasts are maintained at 6.0% in 2023 and 6.2% in 2024.

**Thailand experienced in the first half of 2023 surprisingly strong private consumption and service exports.** The GDP growth forecast is therefore revised up from 3.3% to 3.5% for 2023 but maintained at 3.7% for next year. Private spending has risen on improved crop yields and higher income, in particular from tourism and related businesses. While household debt remains high, financial institutions continue to ease the debt repayment burden for retail borrowers to sustain economic recovery. The forecast for international tourist arrivals is revised up from 28 million to 30 million in 2023 and from 35 million to 36 million in 2024.

**Singapore's growth forecast for 2023 is revised down from 2.0% to 1.5%.** In May, the manufacturing PMI dropped to 49.5 and the electronics PMI to 49.1, signaling contraction. Lingering uncertainty about financial risks and monetary tightening in the US still suppresses financial services, and the trade-related cluster is expected to contract further. Growth in private consumption is expected to slow as higher consumer prices restrain spending and higher borrowing costs further dampen investment growth. The 2024 GDP growth forecast is maintained at 3.0%, supported by public spending, a strong pipeline of government housing projects, and private investment commitments.

**The Viet Nam growth forecast is revised down from 6.5% to 5.8% in 2023 and from 6.8% to 6.2% in 2024.** Growth slowed from 6.5% year on year in the first half of 2022 to 3.7% a year later as external demand weakened and growth in manufacturing output braked to only 0.4%—the lowest half-year figure in a dozen years. The manufacturing PMI has languished below 50 since March 2023 as weaker trade growth closed many businesses, notably in export-driven manufacturing. Industrial production was hit as well by recent power outages in the north and trouble in the real estate sector. A credit crunch in response to corporate bond market and bank exposure to elevated property risk squeezed construction. Meanwhile, though, recovery in domestic travel boosted consumption, with retail sales up by 11% year on year in the first half of 2023.

**The inflation forecast for Southeast Asia is revised down for both years.** Downgrades from 4.4% to 4.3% in 2023 and

from 3.3% to 3.2% in 2024 reflect easing global commodity prices and tighter monetary policy. In Indonesia, inflation is projected to average 3.8% in 2023, lower than 4.2% projected in the *ADO April 2023* after headline inflation came down steadily from its peak a whisker short of 6.0% in September 2022. In Viet Nam, the inflation forecast is trimmed to 4.0% in 2023 and 2024 on declining global energy prices and stable food supply. Inflation forecasts for 2023 and 2024 are maintained for Malaysia, the Philippines, Singapore, and Thailand.

### *Caucasus and Central Asia*

**The GDP growth forecast for the subregion is downgraded by 0.1 percentage points in 2023 and by 0.2 points in 2024.**

Both changes reflect downgrades for Azerbaijan and Turkmenistan. In Azerbaijan, oil and gas production declined more than expected in the first 5 months of 2023, while global oil prices sank. Production is expected to slow further to the forecast horizon. While growth forecasts are upgraded slightly for Georgia, Kazakhstan, and Tajikistan in 2023 following stronger performance in the first 5 months of the year, this is insufficient to offset the downgrades to Azerbaijan and Turkmenistan projections. Growth forecasts are unchanged for Armenia, the Kyrgyz Republic, and Uzbekistan.

**The 2023 growth forecast for Kazakhstan, the subregion's largest economy, is revised up to 3.9%.** The upgrade accommodates higher growth in Q1 2023 and expanded domestic demand after budget revision in March added 10% to fiscal stimulus. GDP growth accelerated to 5.0% year on year in Q1 2023, with manufacturing increasing by 5.4% and services by 5.3%, reflecting sustained domestic demand. Private consumption will likely continue to accelerate as inflation slows and households enjoy higher real incomes. Sustained social spending and longstanding expansionary fiscal policy will support public consumption. Large infrastructure projects included in 2023 fiscal stimulus will boost investment. Export growth will be buoyed by a gradual increase in oil output, which at 1.6 million barrels per day in April 2023 approached Kazakhstan's quota under arrangements with other petroleum exporters. Improved demand from Kazakhstan's trade partners will further support exports. The growth forecast for 2024 is unchanged at 4.1%.

**Inflation in the subregion is forecast to remain elevated at 10.6% in 2023 and 7.8% in 2024.** Both projections are higher than in *ADO April 2023* mainly because of high inflation in Kazakhstan and especially Azerbaijan, where inflation held up at 11.5% in the first 5 months of 2023 despite tightening monetary policy. In Kazakhstan, external inflationary pressures eased, but tamping down inflation will be hampered by recently announced augmentation to expansionary fiscal policy in both 2023 and 2024. By contrast, inflation decelerated significantly in Georgia, from 13.1% year on year in the first 5 months of 2022 to 5.4% a year later, and in Armenia from 7.7% to 5.2%. Central banks in both countries have thus lowered their policy rates for the first time since 2020. Inflation forecasts in this report are thus revised down for both countries in both years, as they are for Turkmenistan as well.

### *The Pacific*

**The Pacific is still projected to grow by 3.3% in 2023 and 2.8% in 2024.**

Expectations for expansion remain broadly in line with *ADO April 2023*. Growth prospects vary across the subregion. Among tourism-dependent economies, Palau is projected to accelerate growth steadily on continued tourism recovery, Vanuatu is seen to bounce back from multiple disasters that occurred in March 2023, strong visitor arrivals are expected to help keep growth elevated in the Cook Islands, and expansion is seen to moderate in Fiji as economic activity reverts to pre-pandemic trends. As resource exports play a diminished role in Papua New Guinea, other output is expected to drive growth, while in Solomon Islands one-off events such as the Pacific Games and national elections promise to support recovery. Economic activity will revive in the small island economies to varying degrees in line with capacity constraints, particularly for implementing projects and accommodating tourists.

**Inflation is still forecast to moderate to 5.0% in 2023 and 4.4% in 2024 in the Pacific subregion as a whole.** Considering individual economies, 2023 projections are revised up for Samoa on unexpectedly high prices for food and transportation and for Palau, where a value-added tax change has pushed up food and fuel prices, and electricity and wastewater tariffs have been raised. The 2024 projection for Palau is adjusted down to accommodate a consequent base effect.

### Box Global Assumptions

**As growth slows this year, forecasts for major advanced economies are revised marginally up for 2023 and significantly down for 2024 (box table).** Following a decent first quarter (Q1) in the US, interest rate hikes and weaker consumer confidence have stalled the economy and undermined investment, and will continue to do so. The euro area having entered a technical recession, weakness there is expected to persist longer than forecast in Asian Development Outlook, April 2023 (*ADO April 2023*), while the global economic slowdown further restrains exports and investment in Japan. Aggregate growth is now expected at 0.8% in 2023 and 0.9% in 2024.

#### Baseline Assumptions on the International Economy

	2022		2023		2024	
	Actual	April	July	April	July	
<b>GDP growth, %</b>						
<b>Major advanced economies</b>	<b>2.5</b>	<b>0.7</b>	<b>0.8</b>	<b>1.3</b>	<b>0.9</b>	
United States	2.1	0.9	1.1	1.3	0.8	
Euro area	3.5	0.5	0.5	1.4	1.0	
Japan	1.0	0.8	0.6	0.8	0.7	
<b>Prices and inflation</b>						
Average Brent crude spot prices, \$/barrel	100	88	80	90	84	
CPI inflation, major advanced economies' average, %	7.5	4.4	4.5	2.4	2.3	

CPI = consumer price index, GDP = gross domestic product.

Note: Average rates are weighed by GDP purchasing power parity.

Sources: Bloomberg; CEIC Data Company; Haver Analytics; IMF *World Economic Outlook*; Asian Development Bank estimates.

**The US economy continued to expand in Q1.** While halved from 2.6% growth in Q4 2022, GDP growth by 1.3% in Q1 was stronger than forecast in *ADO April 2023*. Deceleration reflected 11.5% contraction in investment driven mostly by inventory, which was compensated by rebounds in private consumption and government spending. Strong imports completely offset export growth, muting net exports.

**Interest rate hikes began to slow the economy.** Investment is likely to weaken further, as suggested by continued contraction in the manufacturing purchasing managers' index

(PMI). Retail sales have remained relatively steady since the beginning of the year, but some signs of weaker consumer confidence materialized in Q2, which is likely to slow consumption growth.

**A strong labor market and persistent inflation suggest continued monetary tightening.** Nonfarm payrolls rose by a robust 339,000 jobs in May, much better than expected, and the unemployment rate stayed low at 3.7% despite rising slightly along with the labor participation rate. Declining energy prices brought the consumer price index down to 3.0% in June, though core inflation remains stubbornly high at 4.8%. The US Federal Reserve paused its interest rate hikes at its June meeting but is expected to raise rates one or two more times in the coming months.

**The growth forecast is revised up to 1.1% for 2023 and down to 0.8% for 2024.** The upward revision for 2023 reflects unexpectedly strong growth in Q1, moderated by slower growth expected in the rest of the year. Slower growth is expected to extend to 2024. Inflation forecasts are unchanged as the Fed is expected to continue its focus on bringing inflation down to its target rate of 2.0%.

**The euro area entered a technical recession in Q1 2023.** Following contraction by a seasonally adjusted annualized rate of 0.5% in Q4 2022, the bloc contracted again by 0.4% in the following quarter. High inflation and interest rates continued to restrain domestic demand enough for private consumption and investment to subtract from growth, as did falling government consumption. Net exports mitigated the decline as imports contracted more than exports.

**Leading economic indicators suggest continued weakness in Q2.** The economic sentiment indicator stayed below its long-term average of 100, sinking from 99.0 in April to 96.5 in May with lower confidence in industry, services, and retail trade. The composite PMI fell from 52.8 in May to 50.3 in June, signaling that expansion, indicated by a value above 50, has all but stalled. Index subcomponents reveal widening divergence among sectors. The service PMI remained expansionary at 52.4 as the manufacturing PMI plunged to a 37-month low of 43.6, weighed down by souring export demand.

**The growth forecast for the euro area is unchanged at 0.5% for 2023 but trimmed to 1.0% for 2024.** Growth is expected to remain weak this year as high inflation and tight liquidity dent consumer and capital spending, and as softening external demand drags down exports. Owing to the persistence of these headwinds, activity in 2024 is seen improving more slowly than projected in *ADO April 2023*.

*continued on next page*



**Box Continued**

The inflation forecast is maintained at 5.7% this year and 2.5% next year. Headline inflation eased by 0.9 percentage points to 6.1% in May, but core inflation fell by only 0.3 percentage points and remains elevated at 5.3%. As such, the European Central Bank followed up a 25-basis-point interest rate hike in May with another by the same amount in June, lifting the main refinancing operations rate to 4.0%.

**Japan surged in Q1 2023.** Growth at a seasonally adjusted annualized rate to 2.7% was fueled by revivals in inbound tourism and domestic services. The number of international tourist arrivals from most regions except the People's Republic of China (PRC) and Taipei, China regained pre-pandemic levels in April. Increased private inventories also boosted growth in the quarter with an annualized contribution of 1.6 percentage points.

**For the whole year, growth is projected at 0.6% in 2023 and 0.7% in 2024.** Expected expansion in airline operations with the resumption of tourism from the PRC will likely further increase foreign tourist arrivals in the coming quarters. The removal of special treatment for COVID-19 in May should buoy consumer confidence in older households and contribute to sustained recovery in services. However, the global economic slowdown will likely restrain Japan's goods exports and capital investment throughout the year.

**Consumer inflation is forecast at 2.5% in 2023 and 1.5% in 2024.** While policy interventions kept energy inflation muted, pass-through will nevertheless be broadly felt this year. Lagged inflation in services accounts for a higher forecast than in *ADO April 2023*. With inflation now seen likely to hover at around 2% this year and next, the Bank of Japan may reassess monetary policy after its July meeting.

**Oil prices resumed their year-long decline.** As of 30 June, Brent crude stood at \$75.68/barrel—down by 14.4% from a recent peak in April and by 40.5% from a peak in June 2022—as concerns about global economic health and, consequently, demand for oil dampened market sentiment.

Despite expected market tightening under such factors as higher seasonal demand for gasoline, broadly stronger demand in Asia, and production cuts in the bloc led by the Organization of the Petroleum Exporting Countries (OPEC+), prices were constrained by subdued industrial activity, high interest rates, and unexpectedly high oil exports from the Russian Federation.

**OPEC+ moves to support oil prices.** OPEC+ agreed on 4 June to extend oil production cuts through 2024, with combined oil production restricted to 40.463 million barrels per day (mbd) and some quota reallocation among members. Saudi Arabia announced a further voluntary, open-ended cut of 1 mbd beginning in July. The market reacted positively at first, but elation quickly faded, allowing Brent crude to slide by 6 June below \$76/barrel, where it hovered for the remainder of the month.

**Brent crude forecasts are revised down to \$80/barrel for 2023 and \$84/barrel for 2024.** While crude oil prices are expected to climb in the remainder of this year, steep price drops in April and May will depress the average price. Growing demand in the PRC and tight supply in the second half of the year will be countered by the Russian Federation's oil export resilience and concerns about US demand. Crude oil prices are expected to recover more slowly in 2024. The International Energy Agency expects global oil demand to rise by 0.86 mbd in 2024. This is less than in 2023 because a rebound in the wake of COVID-19 has largely run its course and economic activity will be dampened by monetary tightening this year. However, supply growth is similarly expected to slow, from 1.4 mbd in 2023 to 1.0 mbd in 2024 as US shale growth slows and OPEC+ curbs bite.

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### Asian Development Outlook July 2023

*Asian Development Outlook* is the main economic forecasting product from ADB. It is published each April with an update published in September and brief reports published in July and December.

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[www.adb.org](http://www.adb.org)  
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ISBN 978-92-9270-248-9 (print); 978-92-9270-249-6 (electronic)  
Publication Stock No. FLS230267-3  
DOI: <http://dx.doi.org/10.22617/FLS230267-3>

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