The Outlook for Asian & Australian Economies

Stable growth led by domestic demand, caution needed on intensifying US-China trade tensions

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1. Overview of Asian and Australian Economies

Real GDP growth of China, the largest economy in Asia, was +6.7% YoY in Apr-Jun, slightly decelerating from the previous quarter mainly due to slow down in growth of domestic demand associated with deleveraging (trimming excess debt). Nonetheless, it is maintaining robust growth which exceeds the government's target (+6.5% YoY) (see table 1). In other Asian economies excluding China, solid domestic demand driven by private consumption and ongoing increasing trend in exports have enabled stable economic expansion. Real GDP growth in Apr-Jun decelerated from the previous quarter in most Asian economies. However looking at the breakdown by countries, the growth accelerated in South Korea, Taiwan and Indonesia. And even those whose economy showed deceleration still manage to maintain high growth level (see table 1). The Australian economy, as monthly economic indicators show, seems to be continuing gradual growth mainly supported by private consumption.

Table 1: Real GDP Growth Rates, Major Asian Economies

(YoY, %)

	2017				2018	
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun
China	6.9	6.9	6.8	6.8	6.8	6.7
India	6.1	5.6	6.3	7.0	7.7	n.a.
South Korea	2.9	2.8	3.8	2.8	2.8	2.9
Taiwan	2.6	2.3	3.2	3.4	3.1	3.3
Hong Kong	4.4	3.9	3.6	3.4	4.6	3.5
Singapore	2.5	2.8	5.5	3.6	4.5	3.9
NIEs	3.0	2.8	3.8	3.1	3.3	3.2
Indonesia	5.0	5.0	5.1	5.2	5.1	5.3
Malaysia	5.6	5.8	6.2	5.9	5.4	4.5
Thailand	3.4	3.9	4.3	4.0	4.9	4.6
Philippines	6.5	6.6	7.2	6.5	6.6	6.0
Vietnam	5.2	6.3	7.5	7.7	7.5	6.8
ASEAN5	5.0	5.3	5.6	5.5	5.5	5.3
Asia 11 economies	6.0	6.0	6.2	6.1	6.3	n.a.
Australia	1.8	2.0	2.8	2.4	3.1	n.a.

Note: Shadowed portion indicates lower growth rates from previous quarters.
Source: Individual country statistics, MUFG Bank Economic Research Office

Looking ahead, albeit the potential spread of negative repercussions associated with intensifying US-China trade tensions bears watching, Asian economies as a whole will maintain stable expansion, although the pace of growth is expected to slow down slightly towards 2019, buoyed by ongoing solid domestic demand led by private consumption as well as gradual expansion of exports.

2. Outlook of each country and region

(1) China

To Xi administration, cemented its political base at the Communist Party Congress last year, this year was supposed to be a good opportunity to implement structural reforms such as deleveraging. However, intensifying trade tensions with the US is becoming an obstacle at the moment. According to US President Donald Trump's statements, all exports to the US from China (2017: USD 429.8 billion) are subject to additional tariffs, of which USD 53 billion in Chinese goods have been levied (March: USD 3 billion worth of steel and aluminum, July: USD 34 billion of goods including electrical and electronic equipment and machinery, August: USD 16 billion of goods including semiconductors and plastics) and additional USD 200 billion of Chinese products have been listed to be levied in as early as September. Chinese exports have been showing strong double-digit growth year on year since the beginning of this year (see chart 1). However, undeniable possibility that this was due to a rush before the US imposes tariffs needs to be taken into account, and export to the US will inevitably be affected by an expansion of product categories that are subject to tariffs.

The Communist Party's Politburo said that "there are obvious changes in the external environment" in a statement from the meeting on 31 July, pledged to take measures to prop up the economy. They called for "prudent" monetary policy, changing its stance from "prudent and neutral" used for the last two years and was approved by National People's Congress (NPC) in March, shifting towards a more accommodative policy. Indeed, reserve requirement ratios (RRRs) were lowered on two occasions since April and market interest rates declined even though the authority set conditions for the use of the extra funds which had been released as a result of lowering the RRR. With this in mind, the shift towards a more accommodative policy can be considered as the confirmation of the current situation. Party leaders at the meeting also pledged to continue implementing a "proactive fiscal policy". Although the deficit target was lowered by 0.4% point of Nominal GDP at NPC, the government now intends to boost the economy with a "proactive fiscal policy" literally.

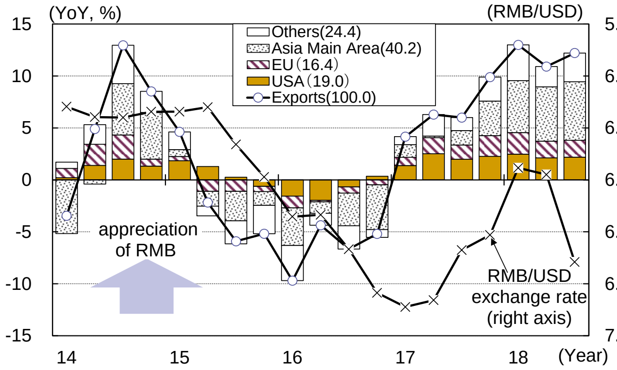
Taking such change in the government's policy into account, slowdown in investments will come to an end eventually and investment growth is expected to accelerate gradually towards next year buoyed by the policy effect. Infrastructure investment, especially, has been curved recently mainly due to the concern over excessive debt at local governments (see chart 2) but the movements to reaccelerate have been observed as well. For example, National Development and Reform Commission (NDRC) decided to increase 10% of railway investment this year and resumed approving construction of subways in urban areas. The Finance Ministry told local governments to speed up issuance of special bonds used to fund infrastructure projects within a few months. That being said, the Politburo intends to continue the deleveraging campaign, trying to avoid inefficient investments like the ones made during the global financial crisis, by promoting effective infrastructure investment in vulnerable areas.

Meanwhile, real estate investment is expected to slow down. The Politburo pledged to "resolutely curb housing price rises", expressing a strong sense of caution towards housing bubble, and local governments are strengthening the regulations. Looking at the growth of housing prices, it has peaked out in major cities owing to strict regulations and is expected to decline in small and medium cities as well due to cut in housing relocation subsidy for redevelopment of residential areas. While redevelopment itself is likely to remain resilient because it is backed as the economic stimulus measures, housing investment will not be able to maintain high level since the beginning of this year (+14.2% YoY in Jan-Jul, cumulative YTD).

Private consumption has been gradually decelerating as the pace of increase in retail sales failed to record double figures year on year recently. While housing prices rose and remained high amid increasing household debts, it appears that the move to secure savings for mortgage repayment or home purchase has been weighing on consumption in China as well. That being said, it seems that there will be no major changes in consumption environment going forward as there have been no significant changes in favorable employment and income environment and innovations by "New Retail", the integration of online and physical stores, continue at micro-level. Retail sales will maintain stable expansion with high single-digit growth year on year. Furthermore, depending on how seriously export to the US could get worse, sales promotion measures towards new energy vehicles and IT equipment or tax cut might be introduced and these could boost consumption.

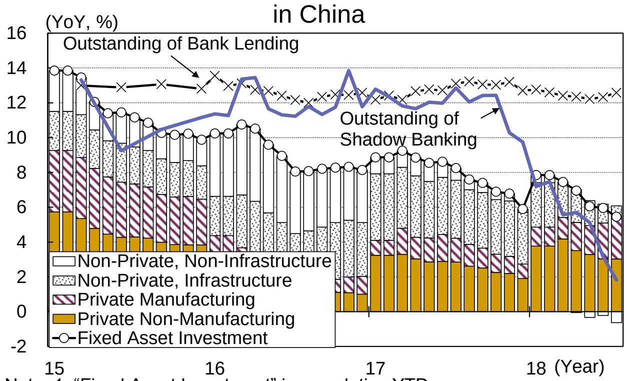
While US-China tit-for-tat tariffs could be prolonged, downside pressure associated with a decrease in export to the US, which accounts for approximately 20% of total exports, cannot be neglected. An escalation of pervasive sense of caution against China in Europe and the US will also bear watching. However, such direct adverse effect on external demand could be offset with domestic demand expansion with fiscal and monetary policies as described. As a result it should not be impossible to achieve the growth targeted by the government. In fact,20% decrease in exports had been offset with domestic demand stimulation right after the global financial crisis in 2009.Rather, meticulous and careful policy development would be required not to 1) expand already-excessive production capacity and debt and 2) boost

Chart 1: Exports by destinations in China (in USD)



Note: 1. ( ) next to countries/regions represents percentage of total (as of 2017).
2. "Asia Main Area" includes Japan, Hong Kong, Taiwan, South Korea, ASEAN and India.
3. Quarterly basis except for the latest (July) figure.
Source: China's General Administration of Customs, IMF, MUFG Bank Economic Research Office

Chart 2: Fixed Asset Investment and Outstanding Debt in China



Note: 1. "Fixed Asset Investment" is cumulative YTD.
2. "Outstanding of Shadow Banking" is a total of "entrusted loans", "trust loans", "bankers' acceptances" and "corporate bonds".
Source: National Bureau of Statistics of China, MUFG Bank Economic Research Office

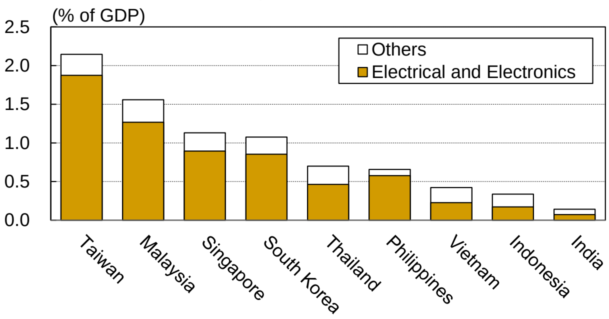
medium-to-long-term risks by putting excessive focus on short-term economic stimulus measures.

(2) Other Asian Economies

In Asian economies excluding China, stable growth will continue as domestic demand remains solid driven by private consumption amid favorable employment and income environment, ongoing growth-friendly fiscal policy and accommodative monetary policy, also supported by export expansion. Looking at exports, although the spreading adverse effect of intensifying US-China trade tensions needs to be watched as a risk factor, advanced economies are expected to continue expanding at the pace close to the potential growth rate and thus exports will maintain increasing trend albeit at a slower pace towards 2019.

As for the effects of US tariffs on Chinese goods on Asian economies excluding China, it is likely that exports of parts and materials, which are incorporated into the Chinese export to the US, from other Asian economies to China will decline in the short term. Looking at the value-added from Asia in Chinese export to the US, ones from Taiwan, Malaysia, Singapore and South Korea are equivalent to 1-2 % of Nominal GDP which are relatively high in Asia, and the adverse effect could be substantial (see chart 3). Meanwhile, it is possible that the US will switch the source of import from China to other Asian economies as a result of cost increase in Chinese products, and there could be positive effects such as investment and production shift from China to other Asian economies in the long-term. Whether this would be advantage or disadvantage will depend on countries and sectors.

Chart 3: Estimation of value-added by country in China's export to the US (2017)



Note: Value-added by country in China's export to the US in 2017 was estimated on the assumption that value-added by country in China's export to the US remains constant from 2011, and its ratio to GDP was calculated accordingly.
Source: OECD, The US Commerce Department, MUFG Bank Economic Research Office

Table 2: External Balance and Currency Performance of Major Emerging Economies

	Current Account (% of GDP)		External Debt (% of GDP)		Foreign Reserve to shot-term debt (times)		Change in exchange rates (from 18 April to 10 Sep, %)
	1997	2017	1997	2017	1997	2017	
China	3.8	1.3	13.7	14.0	4.5	3.1	▲ 8.5
Indonesia	▲ 2.3	▲ 1.7	60.6	34.7	0.5	2.6	▲ 7.3
Malaysia	▲ 5.3	3.0	46.7	65.3	1.4	1.2	▲ 6.2
Thailand	▲ 2.9	10.6	72.1	32.7	0.7	3.1	▲ 5.0
Philippines	▲ 4.8	▲ 0.8	47.3	23.3	0.6	5.1	▲ 3.3
Vietnam	▲ 5.7	2.9	81.0	42.4	0.8	2.6	▲ 2.3
India	▲ 0.7	▲ 1.5	25.1	20.4	4.9	4.0	▲ 9.4
Argentina	▲ 3.9	▲ 4.8	39.6	36.5	0.7	0.9	▲ 46.1
Brazil	▲ 3.5	▲ 0.5	22.6	15.4	1.5	7.2	▲ 17.3
Turkey	▲ 1.0	▲ 5.6	33.3	53.2	1.0	0.7	▲ 38.0
【cf.】USD Nominal Effective Exchange Rate Index(%)							5.4

Note: 1) Shadowed portion indicates an improvement from 1997.
2) Figures for Vietnam's External Debt is as of the end of 2016.
Source: IMF, World Bank, MUFG Bank Economic Research Office

Some point out that there has been a growing risk over massive capital outflow from and currency depreciation in emerging countries as a result of intensifying US-China trade tensions and concern over Turkey's financial turmoil as well as US interest rate hike and appreciation in the dollars. Depreciation in Asian currencies, on the other hand, has been limited so far (see table 2) compared to Turkey and Argentina who are facing vulnerability of external balances such as current account deficit and total reserves and uncertainty of policy management. In some countries like Indonesia and Philippines, the central banks have been raising interest rates actively in order to stabilize currency value or curve inflation. However, policy rates of both countries remain historically accommodative level. In Indonesia, Bank Indonesia relaxed regulation on loan-to-value ratio (LTV) on housing loans and the government reintroduced fuel subsidies, which were abolished in 2015, eyeing on the presidential election scheduled in April 2019. Rising interest rates, together with such fiscal management focusing on low-income earners, will not become a major obstacle to economic expansion.

[Thailand]

Thai economy remains solid. Real GDP growth was + 4.6% YoY in Apr-Jun, decelerating from the previous quarter yet maintaining high level (see chart 4). Acceleration of private consumption, together with expansion of capital investment and infrastructure investment, boosted the growth.

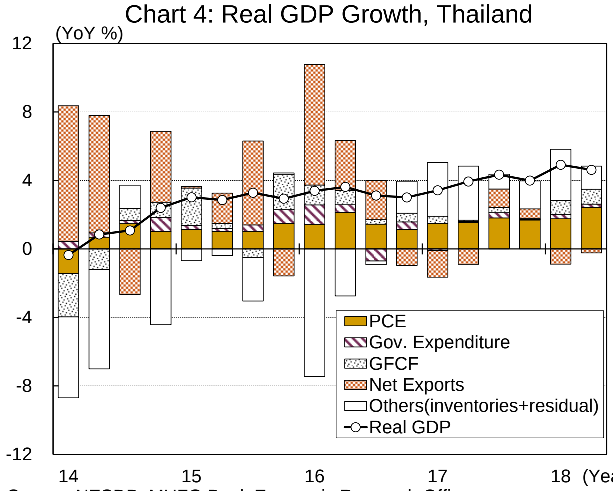
Looking ahead, an improvement of corporate earnings as a result of export expansion will boost capital investment and make a positive contribution to private consumption through an increase in household income, and the economy will continue to grow at a moderate pace. On the policy front, it is expected to implement the infrastructure investment project (of total THB 1 trillion) on expansion of international airports, construction of high-speed railways between major airports and port maintenance. Furthermore, an expansion of subsidies to low-income earners via "welfare smartcards" (implemented from October last year) as well as low-interest loan and debt relief aimed at farmers (implemented from August) will help boosting household consumption. A general election, a shift to democratic rule, is scheduled to be held early next year. Major projects such as the development of Eastern Economic Corridor (EEC) in the three Eastern provinces are planned to be implemented based on laws even after a shift to democratic rule, therefore trend of gradual economic expansion will be maintained.

(3) Australia

Australian economy is continuing gradual expansion (see chart 5). Private consumption remains solid backed by improving employment and income environment and ongoing low-interest rates. Investments have been boosted by expansion of infrastructure investment as well as construction of hotels and care welfare facilities while the adjustment in mining sector is almost completing.

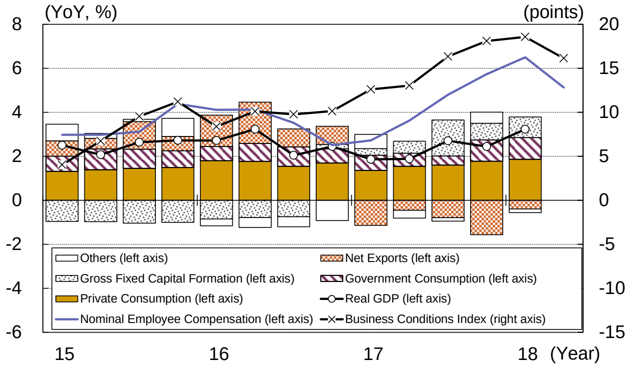
Looking ahead, the economy is expected to expand at a gradual pace. Private consumption is likely to continue gradual recovery on the back of ongoing low-interest rates and income tax reduction (AUD 13.4 billion in four years). Amid global economic expansion, the operation of new liquefied natural gas (LNG) projects and growing demand for non-ferrous metals such as copper, aluminum and lithium associated with expansion of electric vehicles (EV) and renewable energy markets will support exports. Recovery in capital investment mainly in non-mining sector backed by increasing corporate earnings and favorable business sentiment, as well as infrastructure projects to invest in building roads and railways (AUD 75 billion in ten years) will continue to support the economy. On the political front, Scott Morrison has been elected as new leader of the ruling Liberal Party in the party-room ballot on 24 August after political turmoil, and sworn in as the prime minister of Australia on the same day, eyeing on the general election which is due by May 2019. Mr Morrison was known to be a close aid to the former prime minister, Malcolm Turnbull, and was planning fiscal policy as the treasurer in the former administration. Although no major changes are expected in terms of economic policy, close attention needs to be paid if Mr Morrison will manage to bring the party back together and boost low approving ratings, ahead of the general election.

Chart 4: Real GDP Growth, Thailand



Source: NESDB, MUFG Bank Economic Research Office

Chart 5: Real GDP Growth, Employee Compensation and Business Conditions in Australia



Note: "Nominal Employee Compensation" is multiplication of number of employees by wage per week.

Source: Australian Bureau of Statistics, National Australia Bank, MUFG Bank Economic Research Office

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