# The Outlook for Asian Economies

## *Pace of recovery remains far from strong, even as downward pressures from external demand easing gradually*

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## 1. Asian Economies: Recent Developments

Most Asian economies slowing

Most economies in the Asia region have been slowing. China, the largest economy in the region, has continued to decelerate because of correcting property markets and controls over excessive investment. GDP growth slowed to +6.9% YoY in Jul-Sep from +7.0% in Apr-Jun, and recent monthly indicators suggest the same trend.

Export-dependent NIEs decelerating as ASEAN lacks overall momentum

In other Asian economies, export-dependent NIEs have been decelerating. Taiwan recorded negative growth for the first time in six years at -0.6% (Apr-Jun: +0.6%), while the growth pace in Singapore remained a low +1.9% (Apr-Jun: +2.0%). ASEAN countries remained relatively firm, but still lack momentum. Indonesia's growth stood at +4.7%, below 5% growth for the third consecutive quarter. Malaysia decelerated to +4.7% from +4.9%, mainly due to the introduction of the Goods and Services Tax (GST). Thailand's economy has posted lower growth of +2.9% (Apr-Jun: +2.8%) as weak goods exports have affected domestic demand, including private consumption and investment, but the economy has been underpinned by expanded public investment and increased services exports including a sustained recovery in tourist arrivals.

Chinese economy to grow at slower pace due to structural adjustments

Looking ahead, China's economy will continue to slow as a result of structural adjustments to surplus capital stock and ongoing credit controls. Investment will likely remain weak, primarily in heavy industries, but expanded household demand is expected to sustain the economy as services industries stay firm because of overall stable income and employment conditions and slower inflation. In addition, an economic downturn will likely be avoided because of infrastructure investment, government spending, and monetary easing. China's growth pace is projected to reach the mid-6% level growth through 2016 (Table 1).

**Sluggish external demand dampening growth**

Other Asian economies will be affected by degrees of dependence on external demand and the underlying strength of domestic demand, amidst growth slowed by weak exports. Exports are expected to pick up gradually as primarily advanced country demand recovers modestly, and the impact of lower commodity prices fades out, although the pace of recovery will be limited because of the slowing Chinese economy. As such, real GDP in export-oriented NIEs is projected to expand by around mid-+2% in 2016, compared to around +2% in 2015.

**ASEAN and Indian economies pick up modestly, driven by domestic demand**

ASEAN countries are likely to maintain +4.5 - 5.0% range growth over 2016, underpinned by solid domestic demand because of favorable income and employment conditions and economic stimulus policies, despite weaker external demand. In Indonesia, exports are likely to continue to weigh on the economy, while boosted budgetary measures and increased direct investment are expected to boost growth. Thailand's economy is expected to continue recovering at a moderate pace due to increased tourist arrivals and public investment. As for India, the economy is projected to grow within the range of +7.5 - 8.0% through FY16 due to a gradual recovery in domestic demand, as well as improved real income as a result of lower dependency on external demand and stable inflation.

**Downside risk: impact of China's slowing, US interest rate hike on financial, asset markets**

Near-team risks could further slow China's economy. A collapse of asset bubbles could lead to increased bad debt and intensify concerns about economic deceleration. This could escalate into a further fall in stock prices and currency values, eventually hurting other Asian economies. Moreover, a US Fed interest rate hike could affect financial and asset markets. This risk warrants attention as the whole region could be impacted considerably.

Table1: Asian Economic Forecasts

| | Nominal GDP(2014) | | Real GDP annual changes (in percent) | | | Consumer Prices annual changes (in percent) | | | Current account (in billions of US$) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | In trillions of US$ | Share of nominal GDP | 2014 | 2015 | 2016 | 2014 | 2015 | 2016 | 2014 | 2015 | 2016 |
| China | 10.38 | 60.9 | 7.3 | 6.8 | 6.5 | 2.0 | 1.5 | 1.9 | 220 | 300 | 253 |
| South Korea | 1.42 | 8.3 | 3.3 | 2.4 | 2.9 | 1.3 | 0.7 | 1.6 | 89 | 96 | 79 |
| Taiwan | 0.53 | 3.1 | 3.9 | 1.1 | 2.4 | 1.2 | ▲0.1 | 1.2 | 65 | 77 | 67 |
| Hong Kong | 0.29 | 1.7 | 2.5 | 2.3 | 2.0 | 4.4 | 2.9 | 2.6 | 6 | 9 | 8 |
| Singapore | 0.31 | 1.8 | 2.9 | 2.1 | 2.5 | 1.0 | ▲0.3 | 0.6 | 59 | 69 | 76 |
| NIEs | 2.54 | 14.9 | 3.3 | 2.1 | 2.6 | 1.6 | 0.7 | 1.5 | 219 | 250 | 229 |
| Indonesia | 0.89 | 5.2 | 5.0 | 4.8 | 5.0 | 6.4 | 6.5 | 4.3 | ▲27 | ▲20 | ▲18 |
| Malaysia | 0.33 | 1.9 | 6.0 | 4.8 | 4.9 | 3.1 | 2.3 | 2.4 | 14 | 11 | 11 |
| Thailand | 0.37 | 2.2 | 0.9 | 2.7 | 3.2 | 1.9 | ▲0.7 | 1.6 | 15 | 21 | 17 |
| Philippines | 0.28 | 1.7 | 6.1 | 5.8 | 6.0 | 4.1 | 1.4 | 2.5 | 11 | 9 | 8 |
| Vietnam | 0.19 | 1.1 | 6.0 | 6.4 | 6.3 | 4.1 | 0.7 | 4.1 | 9 | 9 | 5 |
| ASEAN5 | 2.06 | 12.1 | 4.7 | 4.7 | 4.9 | 4.5 | 3.3 | 3.3 | 23 | 30 | 23 |
| India* | 2.05 | 12.0 | 7.4 | 7.6 | 7.9 | 6.0 | 4.9 | 5.2 | ▲28 | ▲19 | ▲23 |
| Asia 11 | 17.04 | 100 | 6.4 | 5.9 | 5.9 | 2.7 | 2.0 | 2.4 | 434 | 560 | 482 |
| | | | Actual | Forecast | | Actual | Forecast | | | Actual | Forecast |

* Fiscal year (from April to March)
Source:Individual country statistics, BTMU



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## 2. Points to Watch in Asian Economies

### (1) CHINESE ECONOMY: SLOWING INVESTMENT CONTINUES TO WEIGH ON GROWTH EVEN AS ECONOMY SHOWS SOME SIGNS OF STABILIZATION

Private consumption remains firm overall amidst slowing growth as a result of investment restraints

China's economy has been slowing as investment has dropped off. But there have been clear signs of economic polarization; adjustments in property markets and slower investment in heavy industries with excessive production capacity weigh on growth on one hand, while firm private consumption has underpinned the economy. Major monthly indicators point to the same trend of overall solid retail sales and a continued slowdown in investment and production (Table 2).

Firm infrastructure investment growth and stabilized financing conditions also positive factors

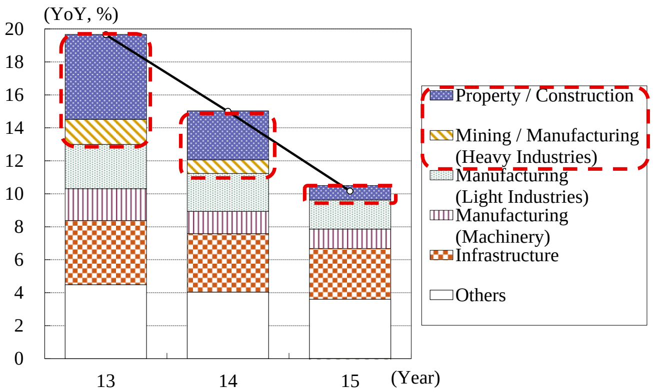
By industry, fixed investment trends have been distinguished clearly; while investment in property and heavy industries continues to slow, the transportation and storage sector and infrastructure-related activities have maintained firm growth (Figure 1). Furthermore, financial conditions stabilizing somewhat since early-2015 have been a positive. The Chinese central government has accelerated the approval process for infrastructure-related activities like railway projects and highway construction to support the economy since end-2014. However, these moves will not boost actual investment growth, since revenues from land transfer fees, the main fiscal source for local governments, have been slowing due to sluggish property markets, while financial controls and tighter anti-corruption measures have been introduced to strengthen control on local government debt. Still, central government spending has been expanding since the middle of the year, driven by investment. Supporting measures for investment growth include financing through local government bond issuances, setting up funds for using insurance capital, and utilizing the fiscal surplus.

Table 2: China's Key Economic Indicators (2015)

| | 2015 Apr | May | Jun | Jul | Aug | Sep | Oct | evaluation |
|---|---|---|---|---|---|---|---|---|
| Exports (YoY, %) | ▲ 6.6 | ▲ 3.2 | 1.9 | ▲ 8.4 | ▲ 5.5 | ▲ 3.7 | ▲ 6.9 | negative |
| Imports (YoY, %) | ▲ 16.3 | ▲ 17.8 | ▲ 6.5 | ▲ 8.2 | ▲ 13.8 | ▲ 20.4 | ▲ 18.8 | negative |
| Fixed Assets Investment (YTD, YoY, %) | 12.0 | 11.4 | 11.4 | 11.2 | 10.9 | 10.3 | 10.2 | negative |
| Retail Sales (YoY, %) | 10.0 | 10.1 | 10.6 | 10.5 | 10.8 | 10.9 | 11.0 | weak |
| Industrial Production (YoY, %) | 5.9 | 6.1 | 6.8 | 6.0 | 6.1 | 5.7 | 5.6 | negative |
| Manufacturing PMI | 50.1 | 50.2 | 50.2 | 50.0 | 49.7 | 49.8 | 49.8 | negative |
| Non-manufacturing PMI | 53.4 | 53.2 | 53.8 | 53.9 | 53.4 | 53.4 | 53.1 | weak |
| CPI (YoY, %) | 1.5 | 1.2 | 1.4 | 1.6 | 2.0 | 1.6 | 1.3 | – |
| PPI (YoY, %) | ▲ 4.6 | ▲ 4.6 | ▲ 4.8 | ▲ 5.4 | ▲ 5.9 | ▲ 5.9 | ▲ 5.9 | – |

Note: 1) Manufacturing PMI and Non-manufacturing PMI are from China National Bureau of Statistics.
2) Shadowed portion indicates lower growth rates or decline in indicators from previous months.
3) *Evaluation* is made based on the judgment as compared to the data for 6 months before.
Source: China National Bureau of Statistics, BTMU

Figure 1: Fixed Asset Investment in China




Note: 1) Figure for 2015 is based on Jan-Oct.
2) "Heavy Industries" refers to oil and chemicals, non-metallic mineral, iron and steel, non-ferrous metal and metallic products.
3) "Machinery" refers to general machinery, special machinery, electronics and automobiles.
4) "Infrastructure" refers to transportation and storage, water, environment and public facilities.
5) "Others" refers to primary sector, utilities and other third sector.
Source: National Bureau of Statistics of China, BTMU

Over reaction to China slowdown risks since summer calming

On one hand, the over-reaction to China's slowdown risks—including falling global stock prices and currency depreciation in emerging economies—since this summer has been calming recently, with stock markets and foreign exchange markets in China remaining stable. Further, the major targets in the 13th Five-Year Plan (2016-2020) approved in the Fifth Plenum appear to be achievable.

Downward pressure on economy from capital stock to persist

Going forward, slowing investment, primarily among heavy industries, is likely to continue to weigh on the economy amidst considerable room for adjustment to excessive capital stock. Adjustments are unlikely to be completed over the near term, and will likely take several years under Government control.

Stable income and employment conditions, urbanization, and narrower income gap support consumption

Private consumption is expected to pull the economy going forward, with overall stable employment and income conditions supporting the services sector. Job openings in urban areas in Apr-Jun fell on-year for the manufacturing and construction sectors, but rose in services sectors including transportation, finance, and telecommunications companies. In addition, varied consumer behavior and wide-ranging consumption resulting from a narrower urban-rural income gap will likely support consumption (Figure 2).

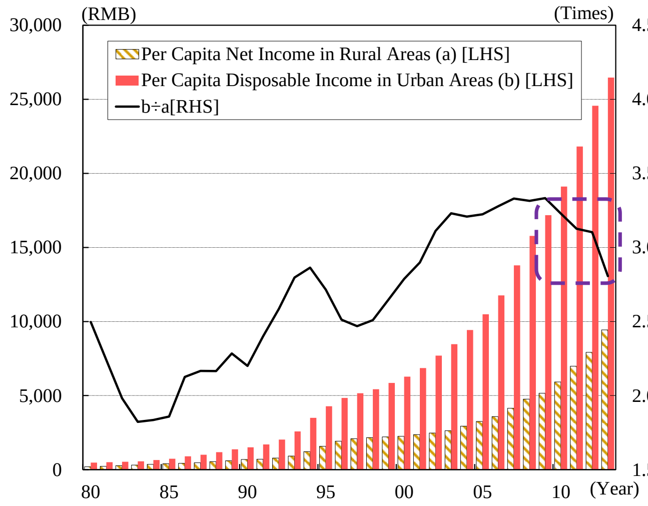
Recession to be avoided due to fiscal and financial measures

Moreover, given the ample room for monetary easing and increased public expenditures, China will likely avoid an economic recession. As described above, growing public investment and expenditures due to stabilized financing conditions for local governments are expected to support the economy over the next year.

Balancing reforms for medium- to long-term growth and ensuring short-term stable growth requires caution

Meanwhile, the latest Five-Year Plan compiled by the Central Committee, the Communist Party of China's executive authority, reiterated the policy goals of maintaining medium-to-high economic growth and doubling GDP and incomes for both urban and rural residents from 2010 levels by 2020 (Table 3). The productive-age population has peaked and further labour input-led growth and excessive investment expansion is unlikely, and utilizing private capital to improve the industrial structure and economic efficiency will be the key for boosting the country's potential growth rate. However, some degree of economic slowdown must be allowed to realize effective reforms like reducing excess production capacity for medium-to-long term growth. This may lead to economic and social destabilization through an increase in bad debts and higher unemployment rates, however. Balancing resolution of these problems with ensuring short-term economic and social stability will require a cautious approach.

Figure 2: Urban and Rural Incomes, China




Source: National Bureau of Statistics of China, BTMU

Table 3: Main Targets and Policies in the 13th Five-Year Plan

| | | | |
|---|---|---|---|
| Main target | | | ✓ Realize fairly well-off society by 2020<br>✓ Double up GDP and per capita income by 2020 from the 2010 level<br>✓ Promote highly industrialized economy<br>✓ Enhance contribution of consumption to economic growth<br>✓ Accelerate urban residency |
| Five principles of development | 1) | Innovation | – Promote Innovation-based development<br>– Promote "Internet-Plus" and "National big data strategy"<br>– Promote "Made in China 2025" |
| | 2) | Coordination | – New type of industrialization, information, urbanization and agricultural modernization<br>– Collaborative development in economic and security construction |
| | 3) | Green development | – Maintain basic national policy of resource saving and environmental protection<br>– Introduce most stringent environmental protection scheme |
| | 4) | Opening up | – Maintain openness strategy based on mutual benefits<br>– Participate actively and mark affirmative statement in public goods supply in global economy<br>– Promote construction of "Belt and Road" |
| | 5) | Sharing | – Narrow down income gap<br>– Strike a balance in raising labour remuneration and boosting labour productivity<br>– Establish sustainable social security system<br>– Allow all couples to have two children on a nation-wide, while maintaining basic national policy of planned delivery |

Source: Various sources, BTMU

## (2) OTHER ASIAN ECONOMIES: STABLE EMPLOYMENT AND INCOME CONDITIONS SUPPORT DOMESTIC DEMAND WHILE EXPORTS BOTTOM OUT

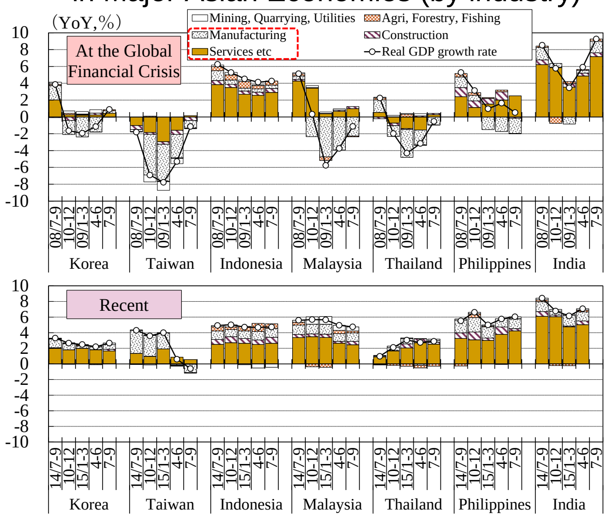
Economies supported by domestic demand due to stable income and employment conditions as exports bottom out

Following the collapse of Lehman Brothers, Asian economies were hit by sharp drops in exports to all destinations, primarily the EU and US. This effect spread and manufacturing sectors in ASEAN countries like Thailand and Malaysia slowed. Overall services sectors were also affected by slower household income and domestic demand growth (Figures 3, 4). Export volumes fell sharply, by 20% to 40%, during the global financial crisis. The current weakening in exports, on the other hand, reflects primarily price factors from cheaper commodity prices, with export volumes declining by about 10% in many nations in the region. In addition, firm manufacturing sectors, particularly oriented toward domestic demand, and overall stable employment and income conditions have underpinned economies, with the support of expanding services sectors. The drop in exports to China has been bottoming out, and the price factor will likely fade over the next year. As such, exports will likely stop falling and start to pick up in 2016.

Economic stimulus measures underpin economy

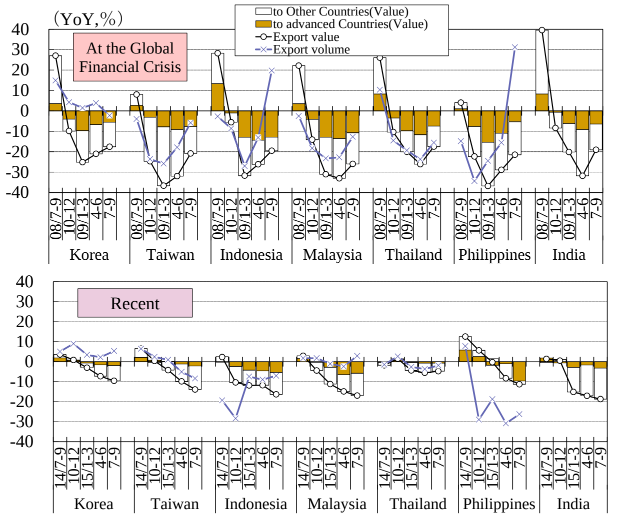
Furthermore, government economic stimulus measures are expected to support domestic demand through assistance for low-income households, increased infrastructure investment and accelerated implementation of the budget. Malaysia in particular unveiled stimulus measures to provide financing support for SMEs and households in September, and also included support for low-income families in the FY16 budget proposed in October. Thailand’s Cabinet was reshuffled in August, and the new government announced measures to stimulate domestic demand, primarily in the form of financial assistance for low-income families and SMEs. Indonesia has also put forth measures to support the economy, including first- and second-round economic policies like integrating overlapping regulations and accelerating approval processes, as well as unveiling other policies like lowering energy-related charges and introducing a sixth round of tax cuts.

Figure 3: Real GDP Growth Rates in Major Asian Economies (by industry)




Source: Respective country statistics, BTMU (Yr/Qtr)

Figure 4: Exports to Major Asian Economies




Source: Respective country statistics, BTMU (Yr/Qtr)

## (3) THAI ECONOMY: SUPPORTED BY IMPROVED EXPORTS AND ECONOMIC STIMULUS MEASURES ON TOP OF PUBLIC INVESTMENT AND TOURISM

Economy continues to recover, albeit more slowly than other ASEAN countries

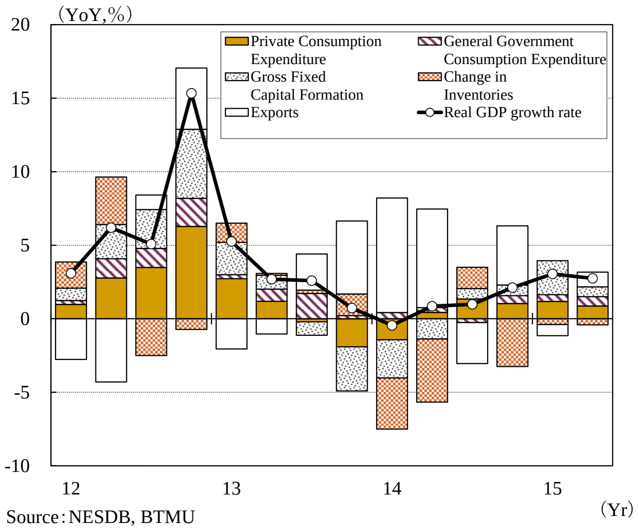
The Thai economy has been recovering, albeit at slow pace relative to other ASEAN countries. The Jul-Sep real GDP growth rate grew by +2.9% YoY. Domestic demand—private capital expenditures and consumption—was weak as a result of poor goods exports, and public investment and the tourism sector continued to support the economy (Figures 5, 6).

The slow pace of recovery reflects Thailand's heavy export dependence among ASEAN economies, with exports comprising 75% of total GDP (2014). Weak goods exports have affected domestic demand through curtailed capital investment due to lower corporate profits and dampened consumption because of stagnant wage growth and deteriorating consumer sentiment. Recent trade data shows the same tendency, with a double-digit decline in capital goods imports and decreases in consumer goods.

Public investment, tourism sector, as well as exports and stimulus measures likely to continue to support economy

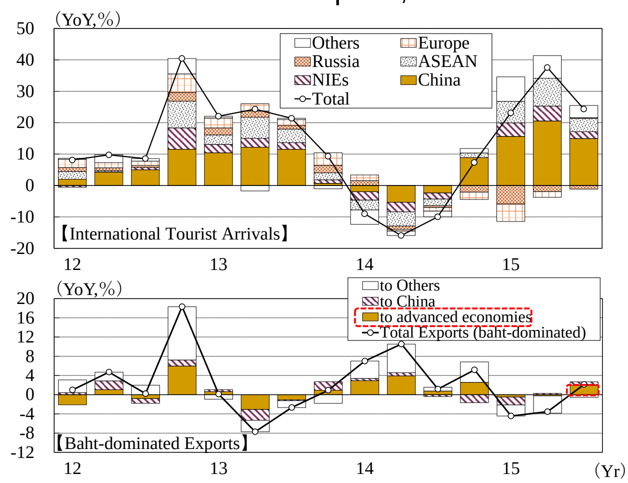
Going forward, public investment and the tourism sector will likely continue to support Thailand's economy. The number of tourist arrivals fell in September following the terrorist attack in August, but the negative impact on the sector has been limited. The hotel and restaurant sector has been registering double-digit year-on-year growth. In addition, exports, mainly to advanced economies, have been showing signs of bottoming out, partially due to the weak currency. Economic measures to stimulate domestic demand, mainly financial assistance for low-income households and the SMEs, were announced in September and will likely underpin growth. In fact, corporate and consumer sentiment has started to improve for the first time in 2015, and the production inventory trend has been showing signs of bottoming out. Going forward, domestic demand is projected to recover gradually, underpinned by economic measures and a pickup in exports, primarily to advanced economies.

Figure 5: Real GDP Growth, Thailand




Source: NESDB, BTMU

Figure 6: International Tourist Arrivals and Baht-denominated Exports, Thailand




Note: Export data is based on FOB. Exports to advanced economies exclude the NIEs.
Source: Bank of Thailand, BTMU

## (4) REGION MONETARY POLICIES: ECONOMIC CONDITIONS TO BE CONSIDERED AMIDST POSSIBLE US RATE HIKES

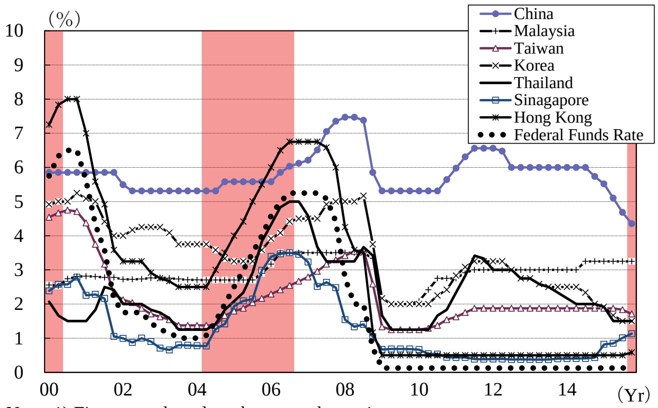
Many countries in region followed the US during previous rate hike phase in 2004

Monetary policies in the region warrant attention ahead of possible rate hikes in the US through 2016. In the previous rate hike phase beginning in 2004, many Asian countries followed US moves because of: (1) their inter-connectivity with the US economy, (2) recovering economic conditions, (3) rising inflation and (4) currency protection and the need to control import inflation due to a widening interest rate gap with the US (Figure 7).

Monetary measures will be pro-growth because of sustained low inflation and weak economy

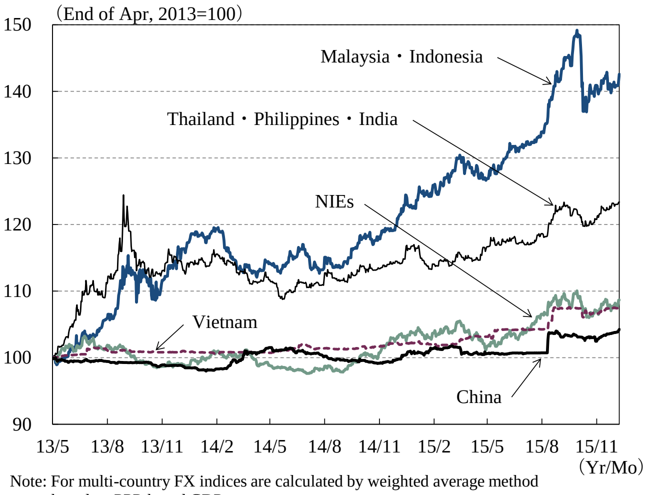
But at this juncture, monetary policies are still likely to support the region’s economies, amidst overall low inflation due to weaker commodity prices and lackluster economic conditions. Asian currencies have continued to weaken since 2H 2014. The Malaysian ringgit and Indonesia rupiah have fallen to their lowest exchange rate levels since the Asian currency crisis because of weak commodity prices, the RMB devaluation, and speculation about a US rate hike (Figure 8). However, the US rate hike appears to have been factored in to a large extent recently. Furthermore, downward pressures have eased since mid-year, as government economic stimulus measures and the Indonesian and Malaysian budget proposals have been received favorably. Indonesian monetary policy has been tightened after fuel prices were hiked in end-2014, and prices have remained elevated as the currency has fallen. However, speculation about rate cuts has grown as inflation has stabilized and the currency has bottomed out. Bank Indonesia lowered the reserve requirement ratio from 8.0% to 7.5% in November, but kept the policy interest rate unchanged. Monetary policies in other Asian economies are slowly becoming less accommodative. However, amidst stable inflation, policies will likely focus more on domestic economies, with the US monetary exit strategy taken into account. Looking ahead, severe destabilization of Asian financial markets is likely to be averted, as the pace of rate hikes will likely be moderate. Even so, there is considerable uncertainty about the US exit from the unprecedented scale of monetary easing, and caution is warranted.

Figure 7: Policy Interest Rates in Major Asian Economies




Note: 1) Figures are based on three month-moving average. Shadowed portion indicated the period of rate rise in US.
2) For Singapore, data of the 3month SIBOR is used, as the country uses foreign exchange rates as means for its monetary policy. For Malaysia, data before March 2004 is based on "money market rate", released by IMF.
Source: Individual country statistics, IMF, BTMU

Figure 8: Foreign Exchange Rates in Major Asian Economies




Note: For multi-country FX indices are calculated by weighted average method based on PPP-based GDP
Source: Bloomberg, IMF, BTMU

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