The Outlook for Asian & Australian Economies

Asian economies are likely to pick up but the pace of growth will remain slow

YASUHIRO ISHIMARU
CHIEF MANAGER
ECONOMIC RESEARCH OFFICE
T 03-3240-3204

20 DECEMBER 2016
(ORIGINAL JAPANESE VERSION RELEASED ON 1 December 2016)

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
A member of MUFG, a global financial group

1. Summary of Current Conditions and Outlook for Asian and Australian Economies

(1) CURRENT CONDITIONS

Real GDP growth of China, the largest economy in Asia, was +6.7% YoY in Jul-Sep, sustaining the same pace of growth for three quarters in a row. Major monthly economic indicators also show the economy has been stabilizing with a gradual acceleration of investment-related indicators which had declined over a long period of time.

Other Asian economies as a whole remains on a recovery trajectory amid ongoing low inflation with support from strong domestic demand, improving exports as well as emerging effects of economic stimulus measures, while recent economic indicators presented a mixed picture of growth in some countries. Looking at the real GDP growth rate of NIEs in Jul-Sep period, Taiwan's real GDP growth accelerated to +2.0% YoY and Hong Kong to +1.9% YoY, while South Korea slowed down to +2.7% YoY due to the end of tax breaks on automobile purchases at the end of June. As for ASEAN countries, the Philippine economy, a typical economy driven by domestic demand, sustained high growth of +7.1% YoY particularly buoyed by strong private consumption. In contrast, although Indonesia continues on its path of modest expansion on the back of robust private consumption, the nation's economy with high dependence on resources decelerated to +5.0% YoY impacted by ongoing sluggish growth in export, contraction in government spending due to tax revenue shortfalls, as well as capital investment reduction. The Thai economy, highly dependent on external demand, also slowed down to +3.2% YoY from the previous quarter due to the decline in government consumption but the nation's economy continues to grow thanks to the expansion of service exports as a result of increasing number of foreign tourists and a pickup in export of goods. Australia continues to be on a moderate recovery path, underpinned by solid domestic demand mainly driven by private consumption.

(2) OUTLOOK

Looking ahead, ASEAN economies and NIEs will sustain strong domestic demand led by private consumption, and an upturn in export growth will also push up the growth rates. However, Asian economies as a whole are likely to lack strength as a modest slowdown in the China's economy is expected to continue.

China will show the continued decline in growth rate in the course of the structural adjustment. Investment, a key growth driver, will continue to weigh on the growth, as the "Supply Side Reform" to reduce excess production capacity in heavy industry such as steel and coal is implemented. Nevertheless, it is anticipated that the growth rate will only decline to + lower 6% YoY throughout 2017 as the increase in infrastructure investment and the expanding demand in the household sector boosted by stable employment/income environment will support the economy (Table 1).

In other Asian economies, domestic demand especially driven by private consumption will remain firm on the back of the stable employment/income environment as well as the continuing expansionary fiscal and monetary policy to stimulate the economy. Moreover, export will gradually recover driven by the expansion of demand in advanced economies. Based on the above, real GDP growth of NIEs, with high dependency on external demand, is projected to gradually rise to +mid 2% YoY in 2017. The ASEAN economies will also maintain the growth of +upper 4% YoY in 2017. The growth rate of Thailand will gradually rise on the back of the moderate recovery in export growth as the government's stimulus package to boost domestic demand and the increasing infrastructure investment continue to spur economic growth. The Indonesian economy will be supported by stable prices and expansion of private consumption induced by a rate cut. Meanwhile, the effect of the economic stimulus measures cannot be expected for the time being due to a reduction in the government spending. We see the nation's economy continuing to grow at above 5%.

Australia is expected to see continued solid growth in private consumption with assistance from the stable employment/income environment. Furthermore, the downward pressure of mining sector on the economy will gradually become weaker following the bottoming out of resource prices. Under such environment, the country's economy is anticipated to stay on a recovery trend.

Table 1:Outlook for Asian and Australian Economies

	Nominal GDP (2015)		Real GDP growth (YoY %)			Consumer price inflation (YoY %)			Current account (USD billion)		
	USD trillion	Share %	2015 results	2016 Outlook	2017 Outlook	2015 Results	2016 Outlook	2017 Outlook	2015 Results	2016 Outlook	2017 Outlook
China	10.98	62.4	6.9	6.6	6.2	1.4	1.9	1.9	331	266	251
South Korea	1.38	7.8	2.6	2.6	2.7	0.7	1.1	1.7	106	98	94
Taiwan	0.52	3.0	0.7	1.2	1.8	▲0.3	1.2	1.3	76	78	73
Hong Kong	0.31	1.8	2.4	1.3	1.7	3.0	2.6	2.2	10	15	17
Singapore	0.29	1.7	2.0	1.5	2.1	▲0.5	▲0.6	0.6	58	54	57
NIEs	2.50	14.2	2.1	2.0	2.3	0.6	1.1	1.6	249	246	241
Indonesia	0.86	4.9	4.8	5.0	5.1	6.4	3.6	4.3	▲18	▲18	▲22
Malaysia	0.30	1.7	5.0	4.2	4.5	2.1	2.0	2.2	9	7	9
Thailand	0.40	2.2	2.8	3.1	3.2	▲0.9	0.2	1.6	32	38	31
Philippine	0.29	1.7	5.9	6.5	6.0	1.4	1.8	3.0	8	5	7
Vietnam	0.19	1.1	6.7	6.2	6.2	0.6	2.8	4.2	1	7	10
ASEAN5	2.03	11.5	4.8	4.8	4.9	3.1	2.4	3.3	32	40	34
India	2.09	11.9	7.6	7.2	7.7	4.9	5.2	5.5	▲19	▲22	▲33
Asian countries/regions	17.61	100	6.1	5.8	5.7	1.9	2.2	2.4	593	530	493
Australia	1.22	-	2.4	2.8	2.9	1.5	1.4	1.9	▲58	▲57	▲52

Note: Fiscal year in India (April-March)

Source: Compiled by BTMU Economic Research Department from country data

MUFG

As an immediate risk, the sharp falls in Asian currencies following the US presidential election could be cited. It should be noted that the abrupt depreciation of the currencies of Asian countries would fuel concerns over an increase in foreign currency debt, acceleration of inflation as well as rate hikes aimed at protecting the currency among those countries. As a result, the growth in private consumption and corporate activity that has turned upward might be dragged down. Also, attention should be paid to the trade policy to be implemented by the new US government. The US takes up about 10% to 20% share of overall exports in Asian countries. In particular, China has a large trade surplus with the US and new president-elect Trump labels China a “currency manipulator”, fueling fears of a trade conflict between China and the US in the future.

The progress in implementation of structural adjustments in China should also draw attention. Although China’s economy posed a great threat to the global economy last year due to its RMB devaluation and subsequent plunge in global stock prices, the nation’ economy has become stable since the middle of this year, without being influenced by political turmoil following Brexit and the US presidential election in Europe and the US. The government appears to keep the decline in the economy within its target range through the implementation of economic stimulus measures. However, the collapse of corporations and a decline in housing prices might cause financial institutions to have more non-performing loans (NPLs), which would have a negative impact on the economy. In that case, other Asian countries would also be influenced by a downturn of China’s economy.

2. Key points

(1) Chinese Economy

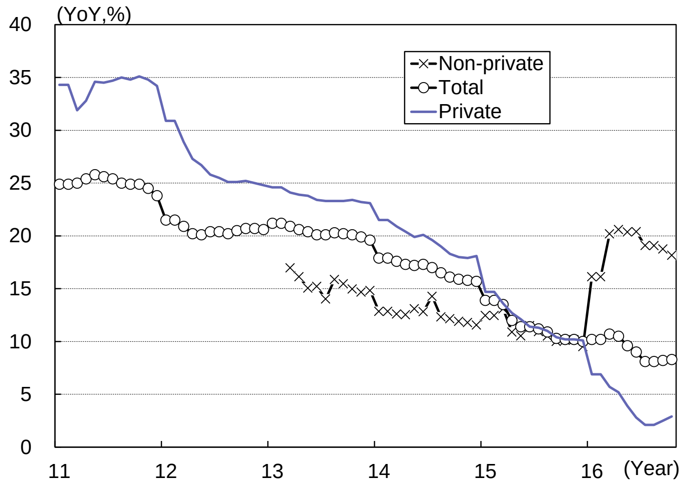
China’s economic deceleration, which was triggered by a slowdown in investment activity, has persisted, but recent economic indicators appear to show stability. The monthly economic indicators for October show that the manufacturing Purchasing Manager’s Index (PMI) (released by National Bureau of Statistics) has posted above the 50-threshold for three months in a row, which separates expansion from contraction in business activities. Fixed asset investment also accelerated slightly, while the Producer Price Index (PPI) has recovered to positive growth in September for the first time in about four and a half years, due mainly to rising resource prices (Table 2). Looking at the breakdown of the fixed asset investment by industry, the investment activities in mining and heavy industry in the face of excessive production capacity, continue to be sluggish, while the expansion of infrastructure and real estate investments underpins the economy. However, it is worth watching that a further slowdown in investment activity in the private sector in the first half of this year shows signs of bottoming out (Chart 1). The Chinese government has formulated a plan to boost private investment since July, including a program to simplify administrative work in the local governments, deregulation measures and an active utilization of public-private partnership (PPP) scheme in the infrastructure industry. These policies are considered to have contributed to the stability of private investment.

Table 1: Main Economic Indicators (China)

	2016				
	Jun	Jul	Aug	Sep	Oct
Fixed Assets Investment (YTD, YoY, %)	9.0	8.1	8.1	8.2	8.3
Retail Sales (YoY, %)	10.6	10.2	10.6	10.7	10.0
Industrial Production (YoY, %)	6.2	6.0	6.3	6.1	6.1
Manufacturing PMI	50.0	49.9	50.4	50.4	51.2
Non-manufacturing PMI	53.7	53.9	53.5	53.7	54.0
CPI (YoY, %)	1.9	1.8	1.3	1.9	2.1
PPI (YoY, %)	-2.6	-1.7	-0.8	0.1	1.2

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.
Source: China National Bureau of Statistics, BTMU

Chart 1: China's Fixed Asset Investment



Note: year-to-date figures.
Source: National Bureau of Statistics of China, BTMU

Looking ahead, there is still considerable room for reduction in surplus capital stock and debt, and slowing investment—particularly in heavy industries—is likely to continue to weigh on the economy. The pace of reduction in excess production capacity appears to have accelerated since summer on the back of the tighter management of reduction progress by the government. The iron and steel sector achieved annual reduction target (45 million ton) in October, while the coal sector reached over 80% of the annual reduction target (2.5 billion ton) at the end of September. Under the medium-term goals, however, the iron and steel sector is still required to reduce another 100 million ton and the coal sector is to cut another 2.5 billion ton. The government needs to continue strictly managing the progress of the reduction s in excess capacity. In October, the State Council released a memorandum providing guidelines aimed at lessening corporate leverage. The memorandum stated that zombie companies and those with low creditworthiness will be eliminated from debt-for-equity swap programs. In response to the announcement of those government's policies, a large state-owned steel manufacturer filed for unprecedented bankruptcy (with total debt of RMB 55.6 billion and approximately 20,000 employees) in the same month. On the other hand, state-owned enterprises with several hundred thousand employees will continue in business with support from the government. The initiative to reduce corporate leverage is highly likely to be pushed forward prudently considering the impact on employment and regional economies of China.

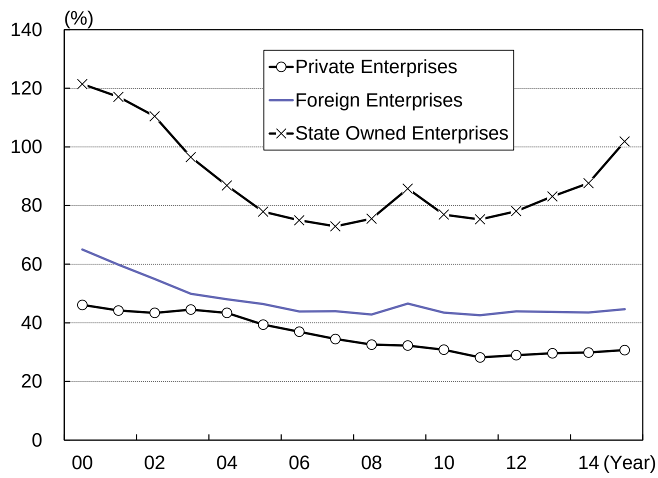
In real estate investment, the regulations on home purchases have been introduced or enhanced in first-tier cities as well as second-tier cities in part. As a result, both housing sales and prices show a sign of peak-out. The government appears to have a negative stance in shifting to a tighter monetary policy considering the corporate sector that is in the process of reducing excessive debts. However, those government's efforts to cool down the housing market through the regulations on home purchases and more stringent management of home mortgage by banks are expected to drag down the pace of investment growth.

While the downward pressure placed by curb excess investment continues to weigh on the economy, it should not be overlooked that the economic stimulus packages and a shift to a consumption-led economy support the growth. The government has implemented tax reduction measures aimed at lessening costs at companies (note 1) and an infrastructure investment plan (with a total investment amount of RMB 4.7 trillion in the next three years). Moreover, the government makes efforts to reform state-owned enterprises as well as provides intensive support for the strategic areas towards industrial advances. Although attention tends to be more focused on the stagnation in the growth of state-owned enterprises in China, it should be noted that the private companies' debt-to-sales ratio is lower than the state-owned enterprises (Chart 2) and that the increase in the economic activities of the private companies would be a future growth driver. Consumption will continue supporting the economy backed by generally stable employment/income environment especially in service sector. Expenditure allocation to focus on improving social security system and employment measures will also supplement private consumption.

As mentioned earlier, corporate bankruptcy, the increase in NPLs of financial institutions incurred by the collapse of housing bubble could be cited as a risk factor for China's economic downturn. An external risk factor will be a negative impact of extreme trade protectionism that might be promoted by the new US government. Although the exchange rate of the RMB, that is concerned by next US president –elect Trump, continues to weaken against USD at a moderate pace, the RMB has remained stronger on a real effective exchange rate basis during the past few years. In fact, the International Monetary Fund's (IMF) Article IV Consultation Report declared that the RMB is no longer undervalued, and that the RMB is broadly in line with fundamentals. Also, export goods such as textiles, apparel and electronics that top the list of goods exported to the US by China are unlikely to be produced alternately inside the US. Looking at the import of Chinese automobile tires that the US imposed an antidumping tariff on, the share of Chinese tires in the US imports decreased due to the imposition of the antidumping tariff but the absence of import from China has been compensated by the import from other countries (Chart 3). In light of this, even if the US takes a tough stance on trade with China at the beginning of the new government, it is expected that the two countries will embark on efforts to identify trade issues and foster improvement by holding bilateral consultations.

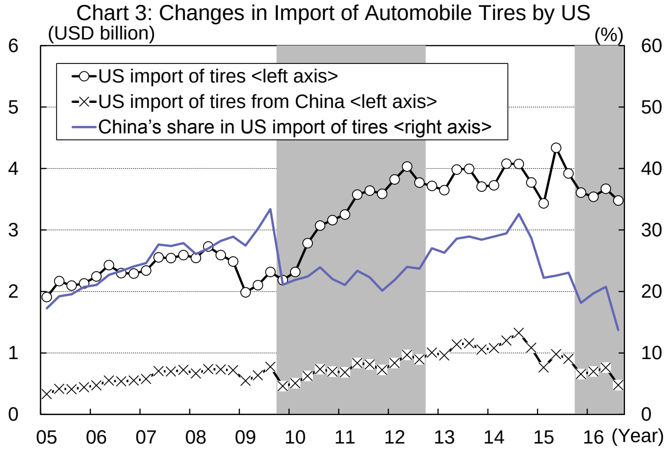
(note 1) A pilot program to convert business tax to VAT implemented in certain sectors and regions in 2012 was extended to all sectors and regions in May 2016. This is anticipated to reduce the corporate tax burden of roughly RMB 500 billion (0.7% pt of GDP).

Chart 2：Chinese Manufacturers' Debt-to-sales ratio



Source: National Bureau of Statistics of China, BTMU

Chart 3: Changes in Import of Automobile Tires by US



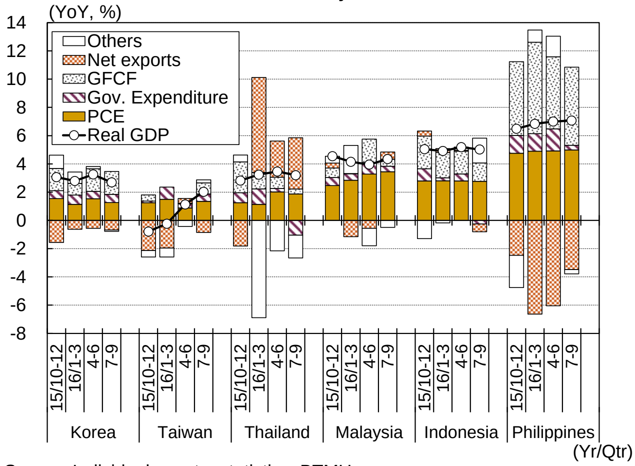
Note:The highlighted parts in gray show the period during which the US imposed an antidumping tariff on Chinese automobile tires.
Source: US Census Bureau, BTMU

(2) Other Asian Economies

Domestic demand of other Asian economies remains solid (Chart 4). In particular, private consumption remains robust backed by the improvement in real purchasing power on the back of stable employment/income environment and price stability. Furthermore, government's economic stimulus packages for the household sector, the expansion of infrastructure investment as well as central bank's accommodative monetary policies also support domestic demand. Decline in exports is bottoming out thanks to the robust growth in exports to advanced countries, particularly the US.

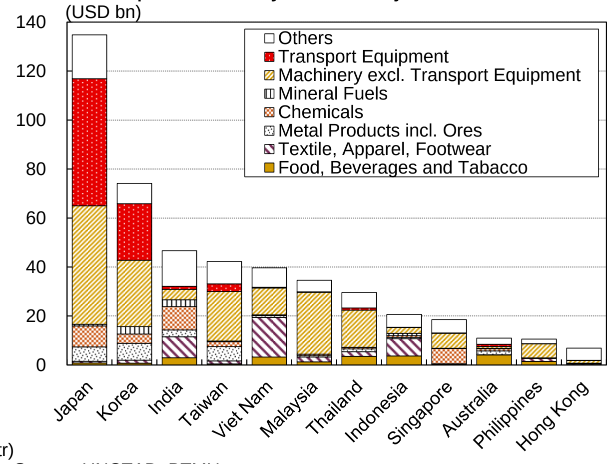
Going forward, a moderate recovery in exports is expected to gradually push up the economy amid ongoing strong domestic demand. Private consumption will continue to be supported by the stable employment/income environment and price stability. The execution of budget already proposed under the framework of fiscal measures will underpin domestic demand. Korea and Thailand with fiscal surplus still have room for expanding fiscal expenditure. Also Malaysia and Indonesia, albeit in the face of a fiscal deficit, will contribute to economic expansion by increasing investment in infrastructure businesses while maintaining fiscal discipline in the next fiscal year. Korea and Thailand decided to leave their policy interest rates at a record low, while Indonesia (6th since the beginning of the year) and India have recently implemented additional rate cuts. Current US bond yields surge on expectations of Trump's new regime, and consequently overall Asian currencies are sold. However, as long as this trend does not persist for a long period of time, the central banks of Asian countries will continue to implement a monetary policy to boost the economy based on the assumption that the FRB would increase interest rate at a moderate pace. Under such environment, a moderate rebound in exports, driven by increasing demand of developed countries, will gradually lift the Asian economies with high dependence on export such as NIEs, Thailand and Malaysia (for Korea, Taiwan and the ASEAN 4 economies, exports to developed countries account for roughly 30% of total other exports).

Chart4: Real GDP of Major Asian Economies



Source: Individual country statistics, BTMU

Chart5：Export to US by Asian Major Economies（2015）



Source: UNCTAD, BTMU

Looking at the impacts of the US presidential election on the Asian economies, attention should be paid to whether the new US government will adopt extreme trade protectionism. The Asian countries' exports to the US account for about 10% to 20% of overall exports. However, Japan and Korea mainly export to the US the transportation equipment that compete with those produced by US manufacturers, while the major export goods from ASEAN nations to the US are textiles, apparel, PCs and smartphones that are all unlikely to be produced alternatively inside the US (Chart 5). Based on this, those Asian countries look unlikely to be targeted into trade policy reform proposed by the new US government. Meanwhile, the decline in Asian currencies should be more closely watched. Following the US presidential election, the Asian currencies are sold due to the capital outflow back into the US. Currently, the plunge in the Asian currencies is abating and they are expected to gradually shift to a stable path, but if they continue to fall, there is a risk that private consumption will be pushed down through import inflation. When looking at the relation between a drop in currency values and consumption growth in the past, depreciation in currency values tends to have a relatively large impact on some Asian economies. Indonesia and India with high inflation rate and current account deficit, experienced substantial depreciation of their currencies following “Bernanke shock” of May 2013, while the Philippines, driven by domestic demand, struggling against weak currency due to the uncertainty over the political direction and the contracting current account surplus even before the US presidential election. Therefore, the future currency trends of those countries should be closely monitored.

(3) Thai Economy

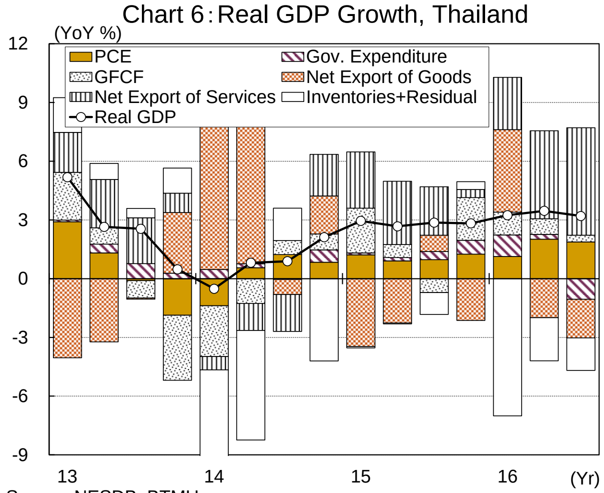
Real GDP of Thailand in Jul-Sep grew +3.2 % YoY, slowing down slightly from the previous quarter, however, the nation’s economy continues on a moderate recovery trend (Chart 6). Specifically, ongoing strong private consumption and the growth of service exports resulting from the increase in the number of foreign tourists underpinned the economy as a whole.

Looking ahead, the economic stimulus measures such as the government subsidy provided to farmers and low income earners as well as tax reduction measures, are expected to continuously lift the economy. Furthermore, the infrastructure projects for airports and railroads that have been undertaken will also continue to lift the economy. Exports of electronics products and automobiles to the US, Europe and Australia continue their upward momentum and export growth will gradually recover driven by the expanding demand of advanced countries that account for 40% of overall exports. The improved corporate earnings benefitting from the recovery of export will support the economy through the improvement of investment sentiments and income of non-agricultural workers.

With regard to the impact of the king’s passing on the economy, we believe that it would be limited as far as the political stability is ensured, in light of the influence of the past political and social events in the country on the economy (Table 3). The government expressed its commitment to following the roadmap for the enactment of a new constitution and general elections paving the way for a civilian government. On top of this, the government has requested that the local business communities try their best to minimize the impact of a year-long mourning period for the king on the economy. According to locally available information, overall corporate activities in the country seem to be normal. Based on this information, it is highly likely that a prolonged uncertain situation that the country experienced in the recent political uncertainty or the suspension of corporate production activities as seen in the severe flooding in 2011would be avoided. Currently available statistical data show that the consumer confidence index for October declined slightly from the previous month, while the business sentiment index has improved for two months in a row. This indicates that the above mentioned government’s actions seem to have supported both consumer and corporate sentiment. We anticipate that discretionary consumption including tourism revenue, which accounts for about 30% of GDP, would fall during the mourning period. However, the impact of decline in the discretionary consumption is expected to be limited. The discretionary consumption is anticipated to push down the real GDP growth rate by only 0.2% pt in 2016 and 0.1% pt in 2017 (note 2). We believe that the Thai economy is expected to remain a moderate recovery path throughout the next year.

(Note 2) Discretionary consumption growth is projected to slow down in Q4 2016 to the level of half of the growth achieved in the last year (given a 30% QoQ decline in Q3 2015 when the terrorist bombing occurred in Bangkok). However, the downward pressure on the discretionary consumption would be eased during the period from Q1 2017 through Q3 as the official mourning period comes to an end. We anticipate that the discretionary consumption will bounce back in Q4 2017 to or above the level seen before its growth decelerates in Q4 2016.

Chart 6：Real GDP Growth, Thailand



Source: NESDB, BTMU

Table 3:Thai Political and Social Events and Impact on Economy

	Passing of Princess Galyani Vadhana	Massive flooding	Military coup	Passing of King Bhumibol Adulyadej
Quality	Royal mourning	Supply chain disruption	Lengthy political and social turmoil	Royal mourning
Time	Jan 2018	Oct-Dec 2011	Nov 2013 to May 2014	Oct 2016
Affected period	【Mourning period】 15 days for government and civil servants	About 2 months	About 6 months	【Mourning period】 1 year for government and civil servants
Impact on economy	Minor	Major	Moderate	Minor (expected)
Real GDP (YoY)	+5.4% in 2007 +3.3% in Q1 2008	+0.8% in 2011 (-4.1% in Q4) +7.3% in 2012	+4.5% in 2013 +0.9% in 2014 (-0.5% in Q1)	-0.2% pt in 2016 -0.1%pt in 2017
Affected demand	Government Expenditure	Export of goods,Private consumption	Private consumption, Gross Fixed capital formation, Export of services	Government Expenditure, Private consumption, Export of services

Source: Statistical data of thailand, BTMU

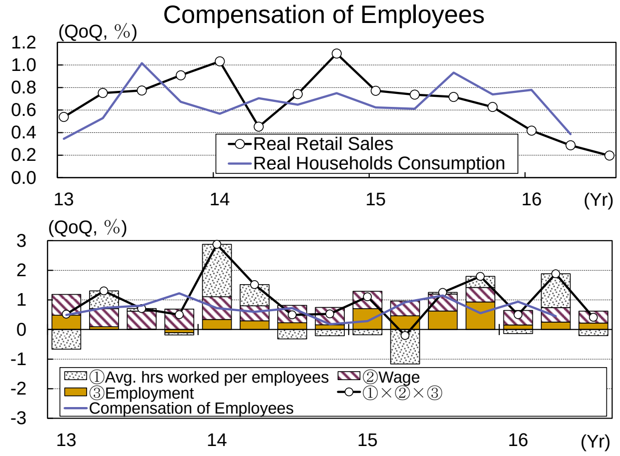
(4) Australian Economy

The Australian economy appears to maintain a moderate recovery trend particularly supported by domestic demand led by strong private consumption (GDP in Jul-Sep to be released on 7 Dec). Real retail sales continued their upward momentum in Jul-Sep on the back of the stable employment/income environment (Chart 7) and resource exports-particularly natural gas-also continue to grow.

Going forward, amid firm private consumption supported by the stable employment/income environment, the downward pressure of the mining sector on the economy will gradually weaken as a result of the bottoming out of resource prices, which will put the economy on a sustained recovery trajectory. With regard to the employment/income environment, the unemployment rate is declining and employee compensation continues to increase. Looking at the breakdown of the growth rate of the employee compensation in Jul-Sep, the growth of the number of employees and compensation was +0.2% QoQ and 0.4% QoQ, respectively, sustaining strong momentum. Private consumption is expected to remain strong with support from the increase in nominal income, the improvements of real income due to low inflation and consumer sentiment, as well as the cumulative effects of two rate cuts by the Reserve Bank of Australia (RBA) since the beginning of the year. Meanwhile, overall capital investment will decrease as the investment activity in the resource sector is expected to continue to slow down toward 2017 due to the adjustment of production capacity. However, the decline in the capital investment will tail off as corporate earnings recover following the bottoming out of recourse prices. In fact, according to the survey on a new private capital investment conducted by the Australian Bureau of Statistics, the non-resource sector investment will rise marginally in FY 2016 (ending 30 June in 2017) and the decline in resource-sector investment will diminish, whereby the overall investment activity will be close to bottoming out (Chart 8).

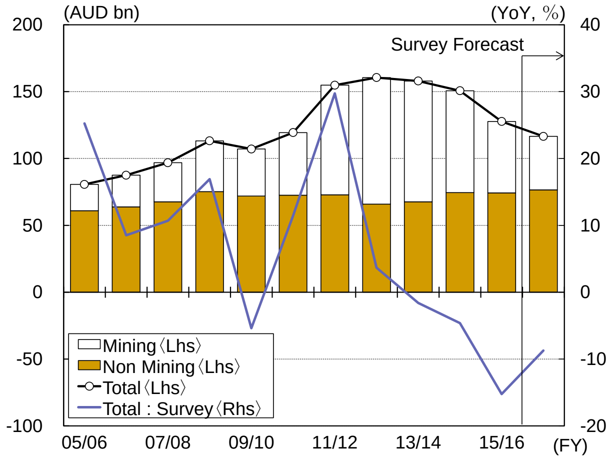
The RBA left the cash rate unchanged at the November monetary policy meeting, a decision that was widely expected by financial markets. The statement of the policy meeting did not show concerns over the higher Australian dollar that was pointed out in the August meeting. The board also noted that house prices in some markets had been rising briskly over the past few months. Regarding the direction of the monetary policy, the board offered no explicit easing bias signalling that another near-term rate cut was likely. The current inflation is in line with the RBA's forecasts and it is highly likely that the RBA will maintain the current monetary policy for the time being.

Chart7：Real Retail Sales, Households Consumption, Compensation of Employees



Source: Australian Bureau of Statistics, BTMU

Chart8: Private New Capital Expenditure



Source: Australian Bureau of Statistics, BTMU

For further details, please contact the Economic Research Office, Bank of Tokyo-Mitsubishi UFJ

Written by Aki Fukuchi <aki_fukuchi@mufg.jp>

Yuma Tsuchiya <yuuma_tsuchiya@mufg.jp>

Hayato Nakamura <hayato_nakamura@sg.mufg.jp>