The Outlook for Asian & Australian Economies

Asian economies will continue stable growth supported by solid domestic demand and export recovery

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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 +6.8% YoY in Oct-Dec 2016, slightly accelerating from the previous quarter. After 2017 began, China's both manufacturing and non-manufacturing Purchasing Manager's Index (PMI) has continued to stay above 50, suggesting that the economy maintains steady growth.

Other Asian economies as a whole remain on a recovery moderate growth trajectory amid ongoing low inflation, supported by strong domestic demand, improving exports as well as emerging effects of economic stimulus measures. Meanwhile, recent economic indicators presented a mixed picture of growth in some Asian economies. Looking at the real GDP growth rate of NIEs in Oct-Dec 2016, Taiwan's real GDP growth accelerated to +2.9% YoY (versus +2.1% YoY in Jul-Sep) and Hong Kong to +3.1% YoY (versus +2.0% in the same period), while South Korea slowed down to +2.3% YoY (versus +2.6% YoY in the same period) due to a drop in private consumption stemming from the subdued consumption of expensive items as a result of the new anti-graft law passed last September, and to a worsening of consumer sentiment caused by political instability. As for ASEAN countries, the Philippine economy, a typical economy driven by domestic demand, reported growth of +6.6% YoY, slowing down from +7.0% YoY in the previous quarter due to the diminishing effects of economic stimulus measures observed in the middle of last year and rising food prices. Nevertheless, the economy sustains high growth particularly buoyed by strong private consumption. Thai economy, with its high dependency on external demand, maintained stable growth at +3.0% YoY underpinned by a recovery in export of goods and increased public investment, although faced with downward pressure from subdued private consumption after the king's passing last October and the sluggish growth of service exports impacted by the decreasing number of foreign tourists. The Malaysian economy accelerated to grow by +4.5% YoY thanks to solid private consumption and a recovery in exports, amid downward pressure exerted by retrenchment of government spending toward restoring fiscal soundness. On the other hand, India saw a decline in business confidence and a slowdown in discretionary consumption of expensive durable goods towards the end of last year, due to demonetization of high-value banknotes implemented by the government in November. This signals that the economy could not avoid a short-term slowdown in the pace of growth.

Australia's real GDP growth rate was -0.5% QoQ in Jul-Sep 2016, the first negative growth in five and a half years, but this negative growth is largely due to a temporary factor and private consumption remains relatively robust.

(2) OUTLOOK

Looking ahead, Asian economies as a whole will lack strength as a modest slowdown in the China's economy is expected to continue. However, as ASEAN economies and NIEs are assumed to continue stable growth spurred by ongoing strong domestic demand led by private consumption, and a recovery in exports is also expected to help push up growth, Asian economies will maintain steady growth.

China will show the continued decline in growth rate in the course of the structural adjustment. It would be unavoidable that investment, a key growth driver, would continue to slow down particularly in heavy industries amid the progress in the structural adjustment. At the Central Economic Work Conference held last December, Chinese leaders made their decision to continue efforts to push forward supply-side structural reforms throughout 2017, a core economic policy of the government, aiming to cut overcapacity particularly in the steel and coal sectors, as well as to eliminate zombie companies that continue in business with support from the government or bank financing. Meanwhile, the government has taken more proactive attitude towards public spending, which suggests that increasing infrastructure investment will support the economy, contributing to stabilizing an employment/income environment and consumption. We see the economy maintaining growth of + mid 6% YoY in 2017 (see table 1).

In other Asian economies, domestic demand especially driven by private consumption will remain firm on the back of stable employment/income environment as well as the continuing fiscal expansion and monetary policy that correspond to the economic conditions. Besides, export will gradually recover driven by expanding demand in advanced economies. Based on this, real GDP of NIEs, with high dependency on external demand, will grow at + lower 2% YoY in 2017 and ASEAN nations will maintain growth of +upper 4% YoY. In Thailand, government's economic stimulus measures and large infrastructure investment continue to underpin economic growth and a moderate recovery in exports is also expected to push up growth, albeit slightly. The Indonesian economy will continue to grow at +5% YoY, mainly driven by stable prices and expansion of private consumption thanks to ongoing accommodative monetary policy. However, the effects of fiscal stimulus measures cannot be expected for the time being due to a slash in government spending. In India, the sales of automobiles and motorcycles which was on the decline, has picked up since the beginning of the year, suggesting that the economy has already escaped the worst of the downturn triggered by demonetization of high-value banknotes. The economy is expected to gradually revert to a growth path in the upcoming fiscal year, that would see an easing in a shortage of new banknotes in circulation, mainly driven by domestic demand, buoyed by a pent-up demand for discretionary consumption after the decline caused by the demonetization and by a recovery in corporate investment.

The Australian economy is expected to stay on a recovery trend amid ongoing solid growth in private consumption, as the downward pressure of mining sector on the economy is anticipated to gradually become weaker after resource prices bottomed out.

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 Results	2017 Outlook	2015 Results	2016 Results	2017 Outlook	2015 Results	2016 Results	2017 Outlook
Asian countries/regions	17.69	100.0	6.1	5.9	5.8	2	2	3	585	471	440
China	11.06	62.5	6.9	6.7	6.4	1	2	2	331	210	201
India*	2.09	11.8	7.9	6.8	7.6	5	5	5	-22	-20	-30
NIEs	2.50	14.2	2.1	2.3	2.2	1	1	2	245	241	247
South Korea	1.38	7.8	2.6	2.7	2.4	1	1	2	106	99	103
Taiwan	0.52	3.0	0.7	1.5	1.8	0	1	1	75	71	74
Hong Kong	0.31	1.8	2.4	1.9	1.9	3	2	2	10	15	13
Singapore	0.29	1.7	1.9	2.0	2.1	-1	-1	1	54	56	58
ASEAN5	2.03	11.5	4.8	4.9	4.9	3	2	3	32	39	21
Indonesia	0.86	4.9	4.9	5.0	5.1	6	4	4	-18	-16	-22
Malaysia	0.30	1.7	5.0	4.2	4.4	2	2	2	9	6	8
Thailand	0.40	2.2	2.9	3.2	3.3	-1	0	2	32	46	31
Philippine	0.29	1.7	5.9	6.8	6.1	1	2	3	7	1	4
Vietnam	0.19	1.1	6.7	6.2	6.2	1	3	4	1	2	2
Australia	1.22	-	2.4	2.4	2.7	2	1	2	-57	-33	-48

Note: *Fiscal year (from April to March)

Source: Individual country statistics, BTMU Economic Research Office

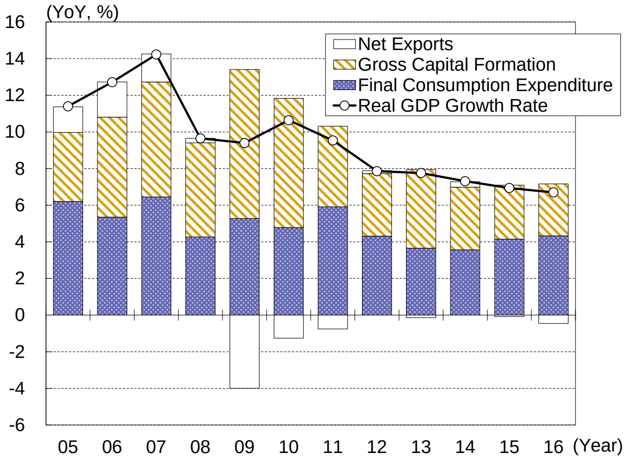
2. Key points

(1) Chinese Economy

The Chinese economy maintains steady growth, although official economic figures confirmed the economy had entered into an L-shaped growth trajectory. The government pursued its efforts to cut excess production capacity throughout 2016, which is identified as the most important issue of supply-side structural reform, a core economic policy of the Xi Jinping administration. As a result, the progress in the supply-side reform weighed on the economy. However, the downturn in the economy was offset by an increase in infrastructure investment and the stability of employment/income environment was ensured, which led to a slight acceleration in growth of consumption. As a consequence, 2016's full-year real GDP growth was +6.7% YoY, with only a modest decrease from the 2015' figure of +6.9% YoY (see chart1). After 2017 began, China's both manufacturing and non-manufacturing Purchasing Manager's Index (PMI) has continued to stay above 50 and export data also showed much better-than-expected growth of +7.9% YoY (see table 2).

As described above, China's real economy continues stable growth according to the government's growth scenario. On the other hand, it is true that the economy continues to slow down and it faces structural issues such as excessive investment and debt, which has caused yuan's depreciation and capital outflows. In fact, those factors are globally considered as China risks. Given this situation, the government has rolled out policies to stabilize the yuan and prevent capital outflows since the end of last year. Thanks to these government's measures, the pace of capital outflow has slowed down and the yuan has appreciated by about 1% against US dollar since last year end.

Chart 1: China's Real GDP Growth Rate



Source: China National Bureau of Statistics, BTMU Economic Research Office

Table 2: Main Economic Indicators (China)

	2016				2017
	Sep	Oct	Nov	Dec	Jan
Exports (YoY, %)	-10.4	-7.9	-1.5	-6.1	7.9
Imports (YoY, %)	-1.6	-1.6	5.5	3.1	16.7
Fixed Assets Investment (YTD, YoY, %)	8.2	8.3	8.3	8.1	n.a.
Retail Sales (YoY, %)	10.7	10.0	10.8	10.9	n.a.
Industrial Production (YoY, %)	6.1	6.1	6.2	6.0	n.a.
Manufacturing PMI	50.4	51.2	51.7	51.4	51.3
Non-manufacturing PMI	53.7	54.0	54.7	54.5	54.6
CPI (YoY, %)	1.9	2.1	2.3	2.1	2.5
PPI (YoY, %)	0.1	1.2	3.3	5.5	6.9

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.
Source: China National Bureau of Statistics, BTMU Economic Research Office

To predict economic outlook, it is necessary to understand the Chinese government's policies. At the Central Economic Work Conference (an annual meeting held in China which reviews its economic performance current year and sets the national agenda for its economy for the following year) held last December, Chinese leaders made their decision to continue efforts to advance supply-side structural reforms throughout 2017, a core economic policy of the government, aiming to cut overcapacity particularly in the steel and coal sectors, as well as to eliminate zombie companies that continue in business with support from the government or bank financing. Amid the progress in supply-side reform, it would be unavoidable that investment would continue to slow down particularly in heavy industries. Reduction in excess production capacity was implemented in the steel and coal sectors as a model case in 2016, which achieved a reduction exceeding annual reduction targets (45 million ton for the steel sector, 250 million ton for the coal sector). However, those sectors are still required to further reduce excess capacity towards 2020 (another 50 to 100 million ton for the steel, another 550 million ton for the coal). Further, it is said that other sectors such as cement or glass will also be targeted for a reduction in excess facilities.

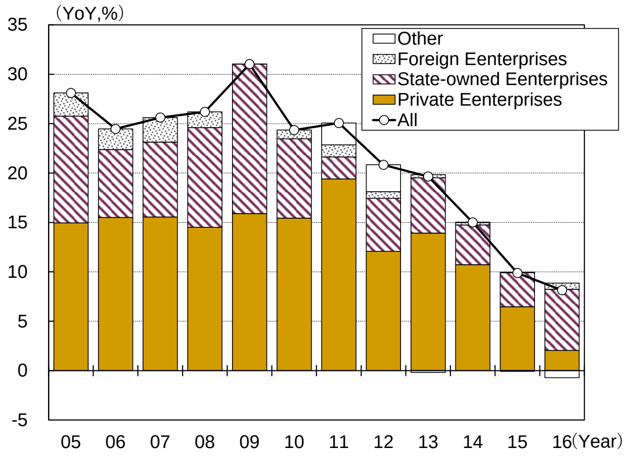
The government's policies also provide a headwind to property investment. As an easing of regulations on home purchases in 2015 triggered soaring property prices in major cities, the government has moved to introduce tighter regulations on property purchases across the country since last autumn, causing a sharp decrease in the momentum for housing sales. At the Central Economic Work Conference, Chinese policymakers highlighted curbing a property bubble by warning about the trends in property purchase for speculation and growth in property investment is expected to slow down.

As discussed above, the government's policies would put a damper on investment growth in the mining and manufacturing, and property sectors, while a proactive fiscal policy has been proposed at the conference, suggesting that the government will continue to support the economy through increasing infrastructure investment. If expansion of infrastructure investment is ensured, it would contribute to stabilizing employment/income environment and consumption. Consumption is assumed to remain firm, aided by long-lasting, supportive factors such as promoting urbanization or boosting consumption in rural areas through electronic commerce (EC). However, a reduction in cuts to the small automobile tax (from 5% to 2.5%) and tougher regulations on house purchases might place downward pressure on consumption growth.

It is vital for China to sustain stable growth in 2017 mainly driven by infrastructure investment, which is an important year for the government due to the holding of the National Congress of the Communist Party in autumn every five years. Under such circumstances, the government appears likely to achieve sustainable growth goal. However, medium- to long-term concerns still remain. As with the case of the measures to expand large-scale investment after the collapse of Lehman Brothers, major participants in infrastructure investment are state-owned enterprises and those who engage in PPP (public-private partnership) projects are also state-owned enterprises. On the other hand, investment by private enterprises who have driven the Chinese economy especially in the new economy and service sector lacks momentum (see chart 2). Furthermore, as for a reduction in excessive corporate debt which is also a government's goal in addition to a reduction in excess capacity, the ratio of corporate debt-to-GDP is increasing further, creating a concern that sufficient funds are not invested in real investment to help increase the productivity of the Chinese economy as opposed to the fund's inflows into the financial and property markets.

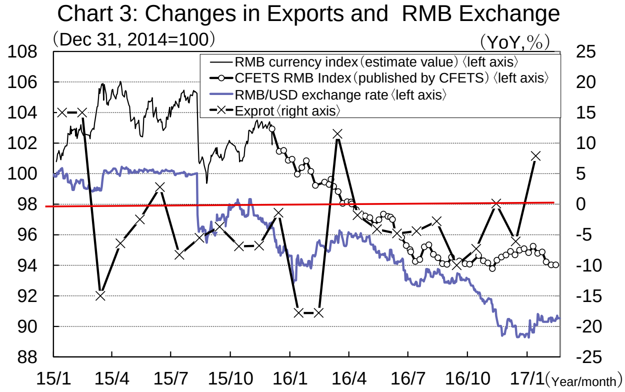
In addition to the above-mentioned factors, there is another uncertain factor arising from the policies under the new US government. The RMB has depreciated by about 10% from its peak in the middle of 2015 against the US dollar as well as a basket of currencies. Considering this, it is not surprising that exports, which were on the decline for the past two years, have bottomed out (see chart 3). However, there is a risk that Trump's administration would have a negative impact on China's exports to the US by setting up high trade barriers, as demonstrated by his pledge during the election campaign to designate China as a currency manipulator or impose a 45% tariff on imports from China. Meanwhile, attention should also be paid to the possibility that the US government would make difficult requests to China for opening up its markets.

Chart 2: China's Fixed Asset Investment by Type of Enterprise



Source:National Bureau of Statistics of China, BTMU Economic Research Office

Chart 3: Changes in Exports and RMB Exchange

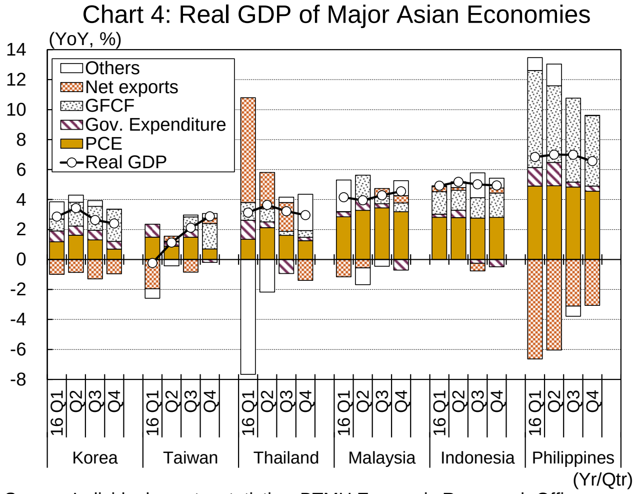


Note:1)The RMB currency index (estimate value) is calculated by using the prevailing exchange rates of the RMB against currencies included in the CFETS RMB Index .
2) The export data for the months of January and February is calculated based on a total export volume in those two months to correct for statistical distortions arising from Chinese New Year.
Source: China Foreign Exchange Trade System (CFETS), General Administration of Customs of the People's Republic of China, BTMU Economic Research Office

(2) Other Asian Economies

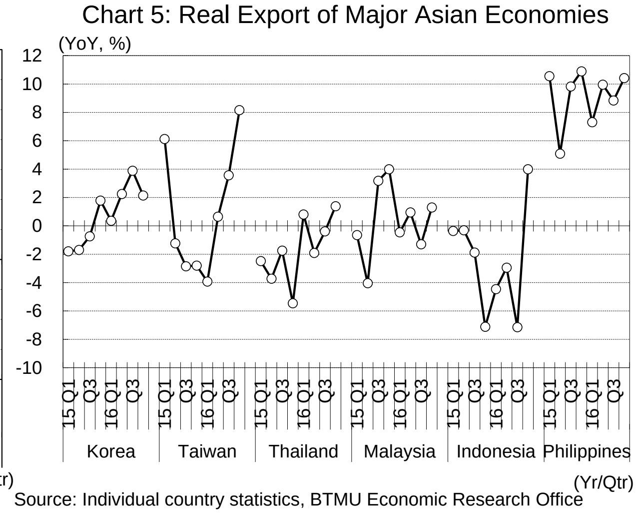
Domestic demand of Asian economies apart from China remains solid (see chart 4). In particular, private consumption remains robust on the back of a favorable employment/income environment and stable prices. Furthermore, government's economic stimulus packages, expansion of infrastructure investment as well as central bank's accommodative monetary policies underpin domestic demand. A recovery in exports also contributes to boosting economic growth (see chart 5). Looking at the export recovery by country or region, the recovery in exports to not only developed countries such as the US and Europe, but also to the same Asian economies such as China becomes more visible. When looking by export item, growth in exports of electrical & electronics and petrochemical products is particularly pronounced on the back of growing demand of semiconductors from high-end electronics products such as smartphones, and IoT technologies, as well as of improving commodity markets.

Chart 4: Real GDP of Major Asian Economies



Source: Individual country statistics, BTMU Economic Researech Office

Chart 5: Real Export of Major Asian Economies



Source: Individual country statistics, BTMU Economic Research Office

Going forward, a moderate recovery in exports is expected to continue to gradually push up the economy amid ongoing strong domestic demand. Private consumption will continue to be solid in a stable employment/income environment. Besides, fiscal policies responding to the economic conditions will also continue to support domestic demand. The Philippines with fiscal surplus has increased the ratio of infrastructure spending-to-GDP to 5.4% in the proposed budget for FY2017. Indonesia, Malaysia and India in the face of fiscal deficits, strive to support domestic demand by allocating more budget to low income earners and infrastructure investment, although it is difficult to anticipate their fiscal policies to significantly boost the economy. On the monetary side, central banks in the region have suspended additional rate reduction due to economic stability, improving growth prospects and the rise in inflation rate. Meanwhile, as inflationary pressure is expected to be generally small and the US is anticipated to increase interest rates at a moderate pace than in the past, the central banks will continue to implement a monetary policy by considering the economic conditions. Under such environment, improving corporate earnings thanks to increasing exports will lead to a recovery in private investment and an increase in household income, which will be followed by expansion of private consumption. As a result, Asian economies with high dependence on export, especially NIEs, Thailand and Malaysia will gradually pick up.

High uncertainty still remains concerning the policies of Trump's administration. If the administration adopts a protectionist trade policy, it would negatively impact the Asian economies. In fact, many Asian economies have been faced with currency depreciation since the US presidential election and it is concerned that the US protectionist policy could have an adverse impact on the real economy in the region. However, a strengthened US dollar against emerging market (EM) currencies following the US presidential election, is mainly due to capital inflows back to the US on expectations of fiscal expansion by the new US administration boosting the economy and increasing interest rates in the US. The recent depreciation of EM currencies against the dollar is essentially different from the currency crisis in the past where the EM currencies experienced a sharp selloff due to the deep structural problems faced by emerging countries. On the other hand, a certain level of decrease in currency value provides several benefits to the economy, such as an increase in export competitiveness or more amount of money received by tourists or overseas workers when they convert the currency of a country where they reside or work, to those EM currencies. Asian economies are highly likely to avoid the tail risk of a currency crisis because of overall improvement in their fundamentals and risk tolerance, a shift to a floating exchange rate system in many of the region's economies as well as expansion of currency swap agreements as a safety net. However, the slow progress in improving currency value is observed among some Asian countries especially with a shortfall in the proposed level of foreign exchange reserves by the IMF, a current-account deficit or fiscal deficit, or its relatively high dependency on the US economy in the aspect of trade and employment. Therefore, trends in currency value in those countries should be closely watched.

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