The Outlook for Asian & Australian Economies

Asian economies will continue stable growth led by solid domestic demand and export expansion

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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 +6.9% YoY in Jan-Mar 2017, showing the second consecutive quarter of slight acceleration. China's both manufacturing and non-manufacturing Purchasing Manager's Index (PMI) has continued to stay above 50 and exports have steadily increased, suggesting that the economy maintains solid growth.

Other Asian economies as a whole remain on a moderate growth trajectory amid ongoing low inflation, supported by strong domestic demand and a recovery in investment due to export expansion. Looking at the real GDP growth rate of NIEs in Jan-Mar 2017, South Korea's real GDP growth rose to +2.7% YoY (versus +2.4% YoY in Oct-Dec 2016) underpinned by a rebound in private consumption due to consumer sentiment having improved following the end of the political turmoil around the former president, as well as by an increase in corporate capital investment thanks to an export recovery. Hong Kong's real GDP growth also accelerated to +4.3% YoY (versus +3.2% YoY in Oct-Dec) and Taiwan maintained stable growth at +2.6% YoY (versus +2.8% YoY in the same period). As for ASEAN countries, Malaysia, which is highly dependent on external demand, showed higher growth rate of +5.6% YoY (versus +4.5% YoY in Oct-Dec 2016) for the first time in two years, thanks to strong private consumption and increasing capital investment due to export expansion. The Thai economy accelerated to +3.3% YoY (versus +3.0% YoY in Oct-Dec) as private consumption and exports recovered amid public investment continuing to underpin the economy. The Philippine economy, a typical economy driven by domestic demand, continued to report strong growth of +6.4 YoY led by private consumption, albeit slowing down from +6.6% YoY growth in Oct-Dec. The deceleration of growth from the previous quarter seems to result from the diminishing effects of economic stimulus measures that were implemented ahead to the election in May 2016 and rising food prices. India appears to maintain higher growth particularly in private consumption due to a halt in the negative effects on economic activities of demonetization of high-value banknotes implemented by the government last November and the delay in the supply of new banknotes.

The Australian economy continues moderate recovery as private investment picked up amid continued strong growth in private consumption.

(2) OUTLOOK

Looking ahead, Asian economies as a whole will continue stable growth towards 2018 buoyed by ongoing strong domestic demand led by private consumption as well as the expected recovery in private investment due to export expansion, although high growth cannot be expected as in the past.

China's economy will continue to face downward pressure particularly on the heavy industry and real estate sectors due to the progress in structural adjustments. However, we see the economy maintaining growth of + 6% YoY towards 2018 supported by increases in exports and private investment in the IT and service sectors, a stable consumption expansion as well as the expected effects of government's economic stimulus measures (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 continuation of fiscal and monetary policy that correspond to the economic conditions. Besides, exports are expected to gradually expand driven by increasing demand from advanced economies. Based on this, we forecast real GDP of NIEs, with high dependency on external demand, to grow at + lower 2% YoY towards 2018 and ASEAN nations to maintain growth of around +5% YoY.

In South Korea, real GDP growth will be boosted by an increase in private investment due to export growth and an uptick in private consumption resulting from the improvement in consumer sentiment after the start of the new government. Moon Jae-in, former leader of the Democratic Party, won the presidential election in May, promising to create jobs particularly in the public sector, which is expected to have a positive impact on the economy. As the president's Democratic Party is a minority in parliament, a reasonable proposal should be made for economic policy and its scale in the course of forming a ruling coalition with other political parties including opposition parties. In Thailand, government's economic stimulus measures and large infrastructure investment continue to underpin economic growth. Additionally, an export increase and vigorous private consumption are expected to push up growth, albeit slightly. The Indonesian economy will continue to grow at +5% YoY, buoyed by an expansion of private consumption amid stable prices and ongoing loose monetary policy. However, the effects of economic stimulus measures cannot be expected for the time being due to a slash in government spending to keep the budget in balance. The Indian economy will continue to maintain higher growth driven by robust domestic demand. On the other hand, there is a near-term risk of a possible disruption to the economy during the process to implement the Goods and Services Tax (GST) which is scheduled for July. Therefore, close attention should be paid to such risk factor.

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

Table 1:Outlook for Asian and Australian Economies

	Nominal GDP (2016)		Real GDP growth (YoY %)			Consumer price inflation (YoY %)			Current account (USD billion)		
	USD trillion	Share %	2016 Results	2017 Outlook	2018 Outlook	2016 Results	2017 Outlook	2018 Outlook	2016 Results	2017 Outlook	2018 Outlook
Asian countries/regions	18.17	100.0	5.9	5.9	5.7	2.2	2.5	2.5	463	414	387
China	11.22	61.7	6.7	6.6	6.2	2.0	2.0	1.8	196	165	157
India*	2.26	12.4	6.8	7.4	7.6	4.5	5.0	5.7	-15	-31	-37
NIEs	2.56	14.1	2.3	2.3	2.4	1.1	1.5	1.6	243	233	232
South Korea	1.41	7.8	2.7	2.5	2.7	1.0	1.8	1.7	99	94	92
Taiwan	0.53	2.9	1.5	1.9	2.0	1.4	1.2	1.3	72	71	71
Hong Kong	0.32	1.8	2.0	2.3	2.2	2.4	1.6	2.0	15	10	10
Singapore	0.30	1.6	2.0	2.2	2.1	-0.5	0.6	1.5	57	58	60
ASEAN5	2.14	11.8	4.9	4.9	5.0	2.4	3.5	3.7	39	47	35
Indonesia	0.93	5.1	5.0	5.1	5.2	3.5	4.4	4.8	-16	-13	-15
Malaysia	0.30	1.6	4.2	4.6	4.4	2.1	3.7	2.8	6	8	9
Thailand	0.41	2.2	3.2	3.3	3.4	0.2	1.3	1.8	47	50	40
Philippine	0.30	1.7	6.9	6.3	6.1	1.8	3.3	3.6	1	1	-2
Vietnam	0.20	1.1	6.2	6.2	6.4	2.7	4.1	4.3	2	2	2
Australia	1.22	-	2.4	2.5	2.7	1.3	1.9	2.1	-33	-38	-34

Note: *Fiscal year (from April to March)

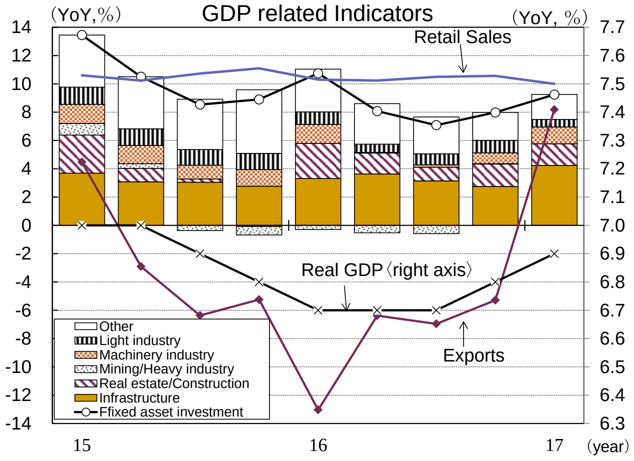
Source: Individual country statistics, BTMU Economic Research Office

2. Key points

(1) Chinese Economy

The Chinese economy continues steady growth. Real GDP growth rate has remained within a narrow range between +6.7% YoY and +6.9% YoY for the past close to two years, while real GDP growth for Jan-Mar 2017 was +6.9% YoY, showing the second consecutive quarter of slight acceleration (see chart 1). Looking at the drivers of real GDP growth from different statistical data, a reduction of excess production capacity, which is identified as the most important issue of supply-side reform, a core economic policy of the Xi Jinping administration, continues to weigh on investment in the mining and heavy industry sectors. However, the downturn in the economy as a result of the progress in reducing excess production has been offset by increases in infrastructure investment and exports. The latest economic data in April overall slowed down from March that saw favorable growth. Despite this, those economic indicators maintain a level of growth equivalent to that seen before February (see Table 2). In particular, it is good news that exports show signs of increasing trends. The decline in price competitiveness seems to have been halted by a recovery in overseas economies as well as the correction in the yuan appreciation in 2016 on a real effective exchange rate basis.

Chart 1: Changes in China's Fixed Asset Investment and GDP related Indicators



Source: National Bureau of Statistics of the People's Republic of China, BTMU Economic Research Office

Table 1: Main Economic Indicators (China)

	2016		2017			
	Nov	Dec	Jan	Feb	Mar	Apr
Exports (YoY, %)	-1.5	-6.2	3.8		16.4	8.0
Imports (YoY, %)	5.5	3.1	26.3		20.4	11.9
Fixed Assets Investment (YTD, YoY, %)	8.3	8.1	8.9		9.2	8.9
Retail Sales (YoY, %)	10.8	10.9	9.5		10.9	10.7
Industrial Production (YoY, %)	6.2	6.0	6.3		7.6	6.5
Manufacturing PMI	51.7	51.4	51.3	51.6	51.8	51.2
Non-manufacturing PMI	54.7	54.5	54.6	54.2	55.1	54.0
CPI (YoY, %)	2.3	2.1	2.5	0.8	0.9	1.2
PPI (YoY, %)	3.3	5.5	6.9	7.8	7.6	6.4

Note: 1) Manufacturing PMI and Non-manufacturing PMI are from China National Bureau of Statistics.
2) Shadow ed portion indicates low er grow th 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 take into account the government's stance of continuing efforts to advance supply-side structural reform that focuses on reducing excess production. Although it is unavoidable that the economy will slow down amid the progress in supply-side reform, the pace of an economic slowdown will be moderate by policy management as the government announced a stance emphasizing sustainable employment. It is vital for China to maintain steady growth, especially until the autumn of 2017 when the National Congress of the Communist Party will be held (the most important conference taking place every five years).

Looking at the progress in reducing excess production in 2016, the steel and coal sectors reduced 65 million ton and 290 million ton, respectively, achieving the reduction targets of 45 million ton (for the steel sector) and 250 million ton (for the coal sector). In 2017, the steel sector achieved a 63.4% reduction against the annual target of 50 million ton as of May, while the coal sector implemented a 46% reduction against the target of 150 million ton.

The reduction in excess production in those sectors will put downward pressure on investment growth, whereas the positive aspects of production cuts should also be worth watching. More specifically, there is growing expectation of a tighter supply and demand balance for steels and coals as a result of growing demand for those resources spurred by increased infrastructure investment. This helps to push up prices of irons and coals, leading to an improvement in the profit margins of those sectors. The total profit of the entire industrial sector improved significantly in Jan-Apr 2017 with an increase of 24.4% YoY. This demonstrates that the increase in profits in those sectors results from the following factors: i) increased infrastructure investment, which also underpins the economy, ii) improved supply and demand balance in the sectors as a result of excess production cuts and iii) reduced corporate costs by implementing measures including tax cuts. Looking at profit by private and public sector, state-owned companies have mainly benefited from the above-mentioned factors, reporting a significant increase in profits by 58.7% YoY. Private companies have also returned to a double-digit increase in profits by 14.3% YoY, leading to a recovery in private investment which is positive for the economy (see chart 2). This helps to reduce excessive dependence on infrastructure investment.

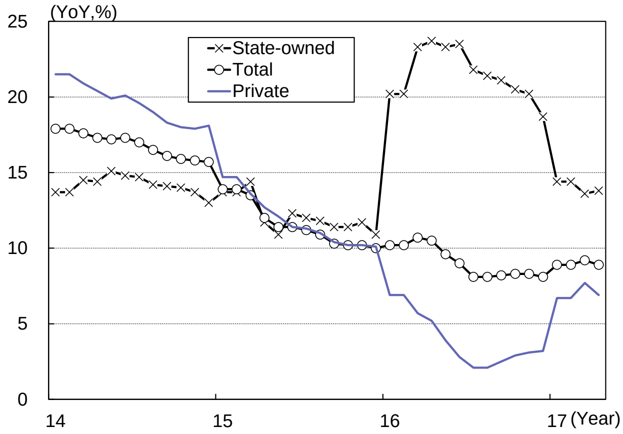
The government cut cost burdens on companies by 200 billion yuan in Jan-Mar 2017 by exempting government administrative fees and reducing their payment of social security contributions. Additionally, the State Council announced in April the measures to cut taxes on companies by 380 billion yuan by lowering the value added tax rate and introducing a preferential tax system for small and medium-sized companies. In May, another announcement was made to implement additional measures to further cut corporate cost burden by 120 billion yuan by lowering some fees in logistics fees and electric power charges. Environmental improvement over companies should help to maintain not only the growth in investment but also the stable employment/income environment. Although it is unavoidable that consumption growth will be hampered by a reduction in a tax cut on small-engine automobiles (from 5% to 2.5%), that started in the beginning of the year, growth in consumption is unlikely to slow down too much.

A decline in real estate investment is likely to be mild. Tighter regulations on property purchases have been introduced across the country since last autumn due to soaring housing prices. Meanwhile, with the intention of making adjustments in supply and demand to avoid a significant cooling of the housing market, the central government announced in April a policy to offer property according to the following housing inventory classification: Inventory of over 36 months: property not offered, inventory of 18-36 months: reduction of property offered, inventory of 6-12 months: increase of property offered, inventory of less than 6 months: prompt increase of property offered. Due to the surge in housing sales so far, the housing inventory level in major cities is low and according to data from a real estate company, many regions fall under the above category of “increase of property offered”. On the other hand, the housing inventory in small and medium cities still remains high and this will be a long-term issue to be addressed.

China is expected to see a slight increase in exports amid a global economic recovery. The US and China announced at a summit meeting in April the “100 day plan” on trade to reduce the US trade deficit with China. As the first result of the action plan, the both countries reached a comprehensive trade deal in May which covers 10 areas including China lifting its ban on imports of beef from the US. As a result, the US hardline trade policy towards China is avoided for the time being. Furthermore, according to its recent China-US trade report, the Chinese government indicated a policy to increase the imports of energy, agricultural products and aircraft from the US. However, it is not easy for China to significantly narrow the trade surplus with the US and it cannot be denied that uncertainty will remain over a trade policy towards the US heading into 2018.

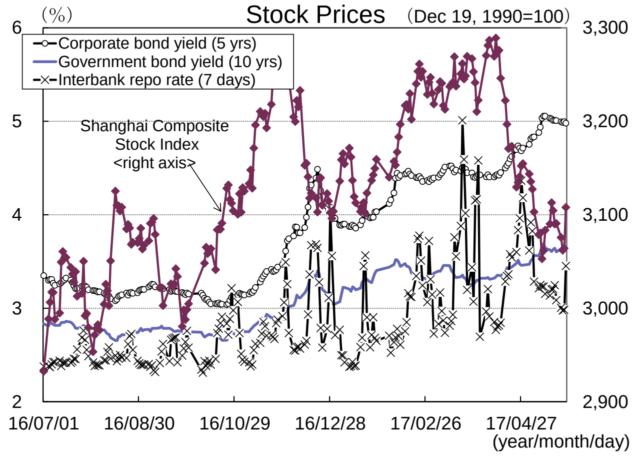
Amid increasing stability in the real economy, the Chinese authorities focus is shifting to financial risk avoidance. The People’s Bank of China has started to raise the operation interest rates since the start of 2017. Besides, the China Banking Regulatory Commission (CBRC) has announced a series of measures to strengthen risk control in an effort to rein in shadow banking activity, after Guo Shuqing was appointed as the head of CBRC in February. Under such circumstances, both long-and short-term market interest rates have trended upwards and the corporate bond market saw a sharp increase in the postponement or cancellation of bond issuance. Stock prices have also plummeted (see chart 3). Financial risk avoidance appears to become the highest priority issue in the economic policy as President Xi Jinping highlighted it at a Politburo Standing Committee meeting on April 25. However, it is not easy to stabilize the financial and capital markets while pushing forward with deleveraging and therefore, close attention should be paid to unexpected risk in the markets.

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



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

Chart 3: Changes in China's Interest Rates and Stock Prices



Source:People's Bank of China, BTMU Economic Research Office

(2) Other Asian Economies

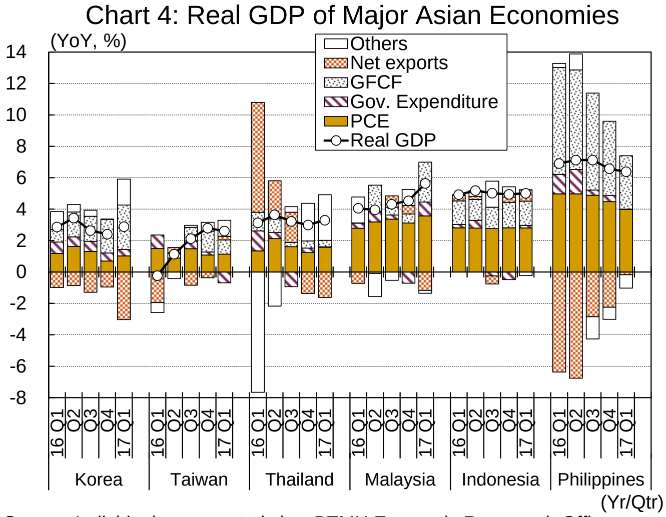
Domestic demand of Asian economies apart from China remains solid (see chart 4). In particular, private consumption remains robust on the back of a favorable employment/income environment, stable prices as well as improving consumer sentiment. Furthermore, a recovery of private investment due to an expansion of exports also contributes to growth.

Going forward, a moderate increase in exports is expected to continue to push up the economy amid ongoing strong domestic demand. Private consumption will continue to steadily expand in a continuously stable employment/income environment. Fiscal policies responding to the economic conditions and increased infrastructure investment will also continue to support domestic demand growth. The Philippines with fiscal surplus has increased the ratio of infrastructure spending-to-GDP to 5.4% in the proposed budget for the current fiscal year. The Thai government approved a supplementary budget for the current fiscal year (worth 190 billion baht, the budget as a percentage of GDP is 1.3%) with a focus on regional development measures including benefit payments to low-income farmers and exemption of debts owed by farmers. In addition, the government announced a five year plan for infrastructure investment and industrial promotion. Indonesia, Malaysia and India in the face of fiscal deficits, strive to support the growth in 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, some central banks in the region are shifting to a neutral stance due to improving growth prospects, the rise in inflation and interest rate hikes in the US. Meanwhile, as inflationary pressure is still weak thanks to a stable foreign exchange market and the US is anticipated to increase interest rates at a moderate pace at a moderate pace than in the past, the central banks will continue to implement a monetary policy by considering the economic conditions. An expansion of exports, particularly of electrical & electronics and petrochemical products, should continue for the time being amid the production of more sophisticated electronics products such as smartphones, growing demand for semiconductors for IoT technologies, as well as improved demand for natural resources on the back of global economic recovery (see chart 5). Improving corporate earnings due to increasing exports will lead to a recovery in private investment and an increase in household income which boosts private consumption. As a result, Asian economies with high dependence on export, especially NIEs, Thailand and Malaysia will pick up.

The US dollar appreciated further against emerging market currencies after the US presidential election last November and many Asian economies were faced with currency depreciation. However, since the start of the year, major Asian currencies have overall remained stable. Increasing capital inflows from overseas into Asian economies due to their favorable fundamentals contribute to stabilizing their currencies. Particularly, in India where the ruling party won the local assembly elections, expectations of progress in the economic reforms help to push up the rupee. A major rating agency upgraded Indonesia’s sovereign ratings from “BB+” to investment grade “BBB-” following their assessment of reduced risks to the country’s fiscal position. This leads to the stability of Rupiah’s exchange rate.

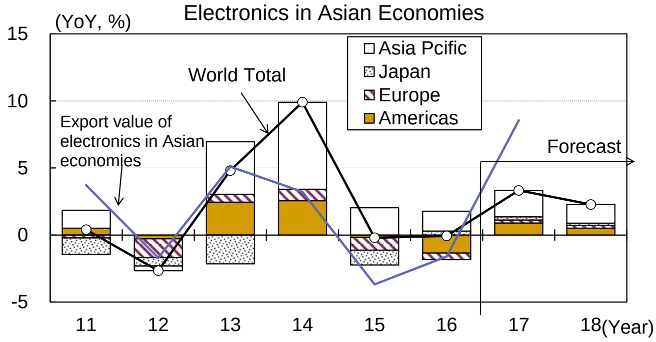
Uncertainty in the financial markets still remains concerning the policies of Trump’s administration and geopolitical risk involving North Korea. However, Asian economies are highly likely to avoid the tail risk of a currency crisis because of overall improvement in their fundamentals and risk tolerance, a shift to a floating exchange rate system in many economies in the region as well as the expansion of currency swap agreements as a safety net.

Chart 4: Real GDP of Major Asian Economies



Source: Individual country statistics, BTMU Economic Researech Office

Chart 5: Sales of Semiconductors by Region and Exports of Electronics in Asian Economies



Note:1) Sales of semiconductors for 2017 is based on the forecast from WSTS.
2) "Exports of electronics in Asian economies" are a weighted average of YoY growth in the export value of electronics in Korea, Taiwan, Singapore, Malaysia, the Philippine and Thailand, and total export value of electronics in those economies in 2016. Exports for 2017 is the actual value of the Jan-Mar 2017 quarter.

Source: World Semiconductor Trade Statistics (WSTS), statistics from individual countries/regions and BTMU Economic Research Office

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