The Outlook for Asian & Australian Economies

Asian economies will continue stable growth led by domestic demand amid slower export growth

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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 Apr-Jun 2017, recorded the same growth rate as the previous quarter. It has remained within a narrow range between +6.7% YoY and +6.9% YoY for the past two years as the acceleration in exports and private consumption offset the slowdown in investment including the adjustment in production capacity.

Other Asian economies as a whole remain on a moderate growth path amid ongoing low inflation, on the back of strong domestic demand led by private consumption and a recovery in investment due to export expansion. Looking at the real GDP growth rate of NIEs in Apr-Jun 2017, South Korea's real GDP growth was +2.7% YoY (versus +2.9% YoY in Jan-Mar), maintained the growth in the higher part of 2% growth, underpinned by a rebound in private consumption due to the improved consumer sentiment and an increase in corporate capital investment. Hong Kong's real GDP growth recorded +3.8% YoY (versus +4.3% YoY in Jan-Mar) and Taiwan was at +2.1% YoY (versus +2.6% YoY in Jan-Mar), both maintained stable growth. As for ASEAN countries, Malaysia, which is highly dependent on external demand, recorded +5.8% YoY (versus +5.6% YoY in Jan-Mar), the highest growth rate in two years, thanks to strong export and increasing private consumption. The Thai economy accelerated to +3.7% YoY (versus +3.3% YoY in Jan-Mar), the highest growth rate in four years, supported by increasing exports and government consumption amid strong private consumption. Domestic demand-led Indonesian economy stayed at +5.0% YoY for the second consecutive quarter led by private consumption maintained a stable growth. The Philippine economy slightly accelerated to +6.5% YoY (versus +6.4 YoY in Jan-Mar) driven by increased government consumption as well as strong private consumption. India appears to maintain higher growth mostly in private consumption due to the negative effects on economic activities of demonetization of high-value banknotes implemented in last November and the delay in the supply of new banknotes having run its course.

The Australian economy continues moderate recovery in domestic demand such as 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.

China's economy will continue to face downward pressure from the progress in structural adjustments particularly on the heavy industry and real estate sectors. Meanwhile, the economy growth of + 6% YoY range towards 2018 is to be maintained on the back of increases in exports and private consumption as well as the expansion of infrastructure investment and the expected effects of government's economic stimulus measures (see table 1).

In other Asian economies, domestic demand mainly driven by private consumption will remain firm on the back of stable employment/income environment and ongoing growth-friendly fiscal and monetary policy. The exports, which have remained firm supported by the favorable conditions such as cyclical increase in demand for semiconductors and Chinese economy showing the government-led steady growth prior to National Congress of the Communist Party set in autumn of 2017, are expected to decelerate its growth pace towards next year yet are likely to maintain its gradual increasing trend driven by solid demand in advanced countries. Based on this, we forecast real GDP of NIEs, with high dependency on external demand, to grow at + mid 2% YoY towards 2018 and ASEAN nations to maintain growth of upper level of +5% YoY. The Indian economy will continue to maintain higher growth driven by robust domestic demand, partially supported by the interest rate cut by the central bank, while the impact of the Goods and Services Tax (GST) introduced in July needs to be monitored.

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

The immediate risks could be the external environmental changes such as destabilization of financial markets due to US rate hikes and the increasing geopolitical risks. The major Asian currencies have overall remained stable backed by increasing capital inflows from overseas due to their favorable fundamentals. Note, however, that many Asian economies were faced with sharp currency depreciation amid appreciation of US interest rates/dollar after the US presidential election last November. Some Asian economies have room for interest rate cut amid decline of inflationary pressure partially due to peak out of crude oil prices while US interest rate hikes at a moderate pace continues to be expected, hence the risks of significant capital outflows and sharp currency depreciation remains. It is advisable to take note of these risks as the currency depreciation often lead to an increase in inflation, make it difficult to maintain an accommodative monetary policy, discourage strong private consumption and recovering business activities.

Table1: 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	6.1	5.8	2.2	1.9	2.2	470	366	353
China	11.22	61.7	6.7	6.8	6.4	2.0	1.5	1.7	196	132	122
India*	2.26	12.4	7.1	7.4	7.6	4.5	3.1	4.5	-15	-33	-37
NIEs	2.56	14.1	2.4	2.5	2.4	1.1	1.6	1.6	243	231	235
South Korea	1.41	7.8	2.8	2.7	2.6	1.0	1.9	1.6	99	91	90
Taiwan	0.53	2.9	1.5	2.0	2.1	1.4	1.2	1.3	72	72	73
Hong Kong	0.32	1.8	2.0	2.8	2.3	2.4	1.6	2.0	15	9	10
Singapore	0.30	1.6	2.0	2.5	2.2	-0.5	0.8	1.4	57	60	62
ASEAN5	2.14	11.8	4.9	5.1	5.1	2.4	3.3	3.6	47	35	32
Indonesia	0.93	5.1	5.0	5.1	5.2	3.5	4.2	4.6	-17	-18	-18
Malaysia	0.30	1.6	4.2	5.2	4.6	2.1	3.9	2.8	7	7	7
Thailand	0.41	2.2	3.2	3.5	3.5	0.2	0.7	1.5	48	43	39
Philippine	0.30	1.7	6.9	6.4	6.3	1.8	3.1	3.4	1	0	0
Vietnam	0.20	1.1	6.2	6.3	6.4	2.7	3.9	4.2	8	3	5
Australia	1.22	-	2.4	2.4	2.7	1.3	2.0	2.1	-33	-37	-37

Note: *Fiscal year (from April to March)

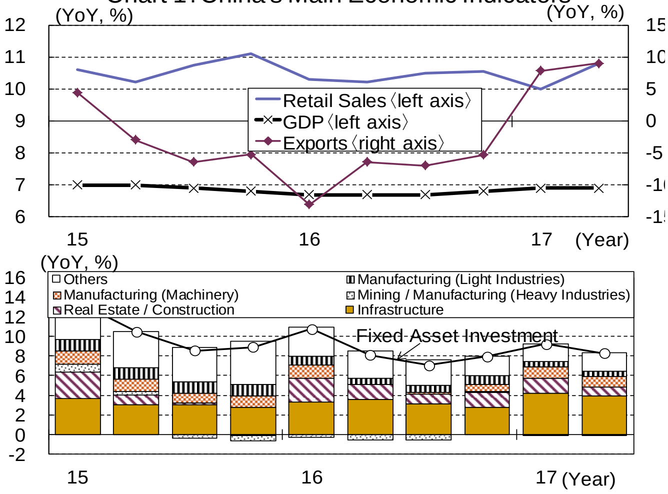
Source: Individual country statistics, BTMU Economic Research Office

2. Key points

(1) Chinese Economy

The Chinese economy continues steady growth. Real GDP growth for Apr-Jun 2017 was +6.9% YoY for the second consecutive quarter, and has remained within a narrow range between +6.7% YoY and +6.9% YoY for the past two years (see chart 1). Looking at the the details from different statistical data, a reduction of excess production capacity continues to weigh on investment in the mining and heavy industry sectors, high level of infrastructure investment has slowed down slightly and real estate investment has been affected by tightening of purchase restriction. Meanwhile, exports and private consumption have accelerated. The latest economic data in July overall slowed down from June (see Table 2). Domestic demand has been affected by heat wave nationwide as well as flooding in central and south regions, and a slowdown in the pace of export growth to Europe and US weighed on the export growth as a whole.

Chart 1 : China's Main Economic Indicators



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

Table 2: Main Economic Indicators (China)

	2017				
	Mar	Apr	May	Jun	Jul
Real GDP (YoY, %)	6.9		6.9		n.a.
Exports (YoY, %)	16.0	7.5	8.3	11.3	7.2
Imports (YoY, %)	20.0	11.7	14.5	17.2	11.0
Fixed Assets Investment (YTD, YoY, %)	9.2	8.9	8.6	8.6	8.3
Retail Sales (YoY, %)	10.9	10.7	10.7	11.0	10.4
Industrial Production (YoY, %)	7.6	6.5	6.5	7.6	6.4
Manufacturing PMI	51.8	51.2	51.2	51.7	51.4
Non-manufacturing PMI	55.1	54.0	54.5	54.9	54.5
CPI (YoY, %)	0.9	1.2	1.5	1.5	1.4
PPI (YoY, %)	7.6	6.4	5.5	5.5	5.5

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

Though the economy has been affected by natural disasters and the growth pace has decelerated slightly, the economy growth of + 6% YoY range is expected to be sustained towards 2018. While the continued downward pressure on investment due to a reduction of excess production capacity is to be expected, the positive effects like an increase in price of materials have become evident, and there are a few factors to boost economy such as a recovery in exports and an expansion of consumption. Besides, Xi Jinping administration has a reason to employ the various policy measures to achieve stable growth. It is vital for the administration to appoint the party leadership at the National Congress of the Communist Party (the most important conference taking place every five years) in the autumn of 2017 in order to build up a solid structure for his second term. Furthermore, the government will not run the risk of jeopardizing social stability by letting the economy slow down sharply after the National Congress.

We will look at the details below. The reduction of production capacity is steadily progressing in 2017, the steel sector achieved 84.8% reduction (as of end of May), while the coal sector implemented 85% reduction (as of end of July) against the annual targets, making a steady progress following the previous year. However, for inferior-quality steel bars (substandard steel products made from scrap whose production capacity is said to be around one hundred million ton), the illegal productions were found through snap inspections by the State Council, even though the National Development and Reform Commission (NDRC) has announced that it has achieved the goal of total abolition by the end of June, and Premier Li Keqiang has once again ordered a strict control over its production. While such situation will provoke skepticism to the reality of reduction in excess production, both steel and coal markets have recovered in response to rising demand due to expansion of infrastructure investment, and total profits in Jan-Jun 2017 recorded 1.9-fold YoY in steel industry and 15.1-fold YoY in coal industry respectively. Ministry of Industry and Information Technology (MIIT) said reduction in excess production is also in progress in aluminum, cement and sheet glass sectors.

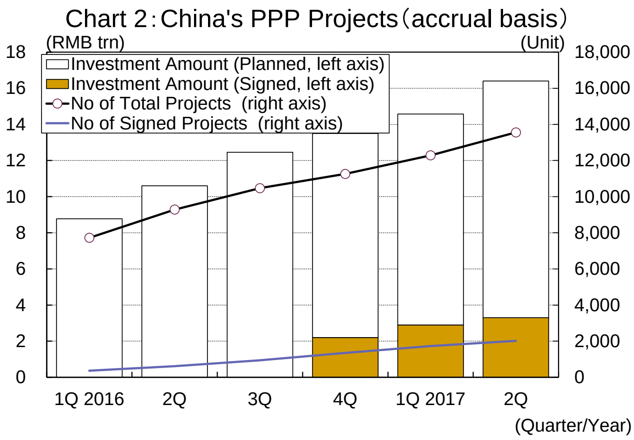
Though a reduction of excess production capacity inevitably leads to a decline in investment in the mining and heavy industry sectors, the economy has shown steady growth mainly supported by expansion of infrastructure investment which grew over +20% YoY. The main investors are state-owned enterprises through public private partnership (PPP) projects whose total number reached 13,554 and total investment amount recorded 16.4 trillion RMB as of the end of June 2017 (see chart 2), which could trigger another expansion of debts owed by local governments and state-owned enterprises, and the central government has strengthened the supervision in order to prevent the illegal funding. However, the economic growth underpinning by expanding investment in infrastructure contributes to improving the business environment of private enterprises together with tax cut and cost saving policies, and has a positive effect to indirectly encourage the acceleration of investments in both manufacturing and tertiary industries.

Real estate investment is expected to show a solid growth under the policy to offer property according to the housing inventory level. Housing inventory has dropped -26.7% compared to the peak level in early 2016. The inventory reduction has now been taken place mostly in small and medium cities. Demand has shifted to small and medium cities, as more and more local governments of major cities where the housing prices have gone up have reintroduced the regulations of housing sales since autumn 2016. Some migrant workers (those who are registered in rural farm villages yet reside in urban areas) have returned from the major cities to small and medium cities near their home villages, which is the progress of urbanization as the central government has planned.

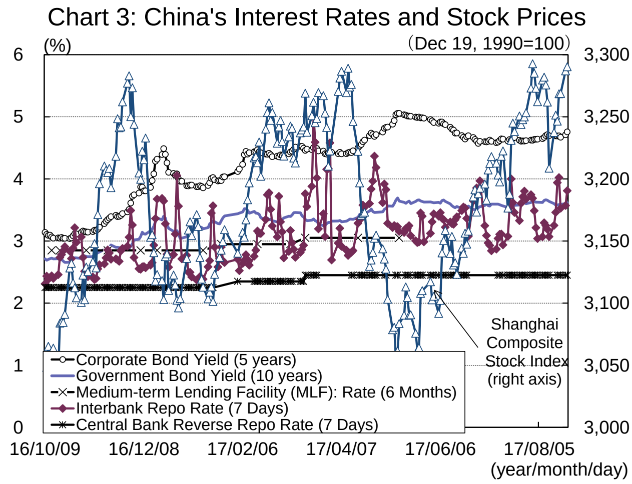
Private consumption is expected to remain firm. The negative effects of tax break reduction (from 5% to 2.5%) for small-sized vehicles since the beginning of the year have been moderated, and the growth of housing-related materials such as furniture and building materials will remain solid under assumption that the housing market will not collapse. Under stable growth, the favorable employment/income environment continues as jobs-to-applicants ratio rose to over 1.1, and income growth has slightly accelerated. Furthermore, internet sales continued to stay +40% YoY range, leading private consumption.

Exports are largely expected to increase amid global economic recovery, however uncertainties have increased. The US government was softening its stance towards trade policy expecting that China might exercise its influence to solve the issues over North Korea, but this expectation turned to a disappointment. At the first US-China Comprehensive Economic Dialogue in July, both sides failed to reach a new trade agreement. In August, directed by US President Donald Trump, the US trade representative (USTR) announced that it will initiate an investigation of China under Section 301 of the Trade Act, and China's Ministry of Commerce (MOFCOM) expressed strong dissatisfaction against this. It is widely expected that both sides will not risk worsening the relationship by imposing sanctions to each other, however the situation will not allow optimism.

It is also advisable to watch financial risks. Though the economy has maintained almost 7% growth rate, there have been persistent concerns globally towards the country's risks due to the expanding debt problem. Chinese authorities has been working on deleveraging such as guiding the rates higher or tightening regulations on shadow banking since the beginning of the year. However, because such policy is 180 degree different from the existing policy, it has caused turmoil in financial and capital markets such as a sharp rise in short-term interest rates and tumble in share prices (see chart 3). Politburo Standing Committee insisted at the meeting in July 24 that it will promote structural adjustments and prevent systemic financial risks in the second half of the year, and close attention should be paid whether the monetary authorities will manage to control the markets adequately and promptly.



Note: Numerical figures related to the invest amount of signed projects before the 3Q 2016 period are unknown.
Source: China Ministry of Finance, BTMU Economic Research Office



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

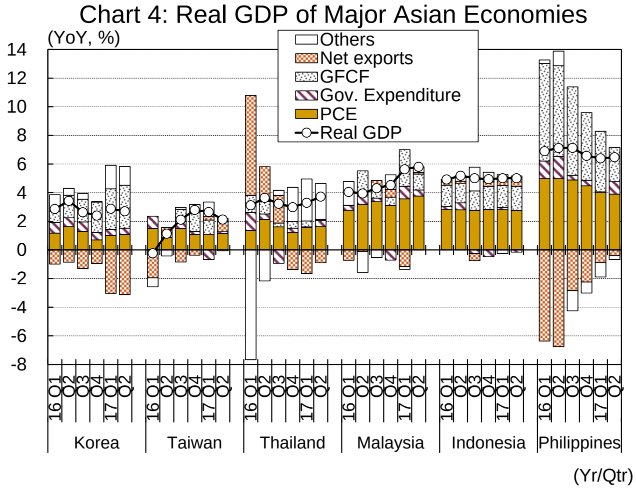
(2) Other Asian Economies

For Asian economies excluding China, domestic demand remains solid (see chart 4). In particular, private consumption remains robust on the back of stable employment/income environment, price stability and improving consumer sentiment. Exports is maintaining solid growth backed by favorable conditions like strong worldwide demand for semiconductors and Chinese economy showing the government-led steady growth prior to National Congress of the Communist Party in autumn (see chart 5).

Going forward, the trend of stable growth will continue amid ongoing solid domestic demand and expansion of exports. Private consumption will continue to steadily expand in a stable employment/income environment. Fiscal policies responding to the economic conditions and increased infrastructure investment will also continue to support domestic demand growth. In South Korea, consumer sentiment has largely improved after the parliament approved the government's 11 trillion won supplementary budget in July (the government estimates the extra spending will lift growth by +0.2 percent point), and the Moon administration pledged in the five-year (2018 – 2022) policy plan to create more jobs, raise minimum wage and enhance social welfare (total amount 178 trillion won in five years). While downward pressure on corporate sector is concerned as the administration indicated tax increase to conglomerates as one of the fiscal resources, a few factors including a recovery in private consumption are expected to boost the growth rate. The Philippines increased the ratio of infrastructure spending-to-GDP to 5.4% in the proposed budget for the current fiscal year, and announced the plan to spend 840 million peso in total to build infrastructure in the next five years. The country's investment ratio (gross fixed capital formation/nominal GDP) climbed to around 25% in 2016, roughly the same level as Thailand and Malaysia, after it has been hovering prolonged low level of around 20%. The positive effects on medium- to long-term growth, such as an increased investment due to the improvement of business environment and domestic job creation, are expected. However, close attention should be paid to the progress of tax reform, a key policy to secure the fiscal resources, as it could result in the contraction of investments. On the monetary side, while many central banks continued to keep its policy rates, Vietnam central bank cut rates in July and both Indian and Indonesian central banks cut rates in August on the back of fall in inflation rate. Furthermore, amid currency and price stability, the pace of US additional rate hike is expected to be moderate compared to the ones in the past, therefore the central banks in the region should be able to maintain its monetary policy in consideration of economic conditions.

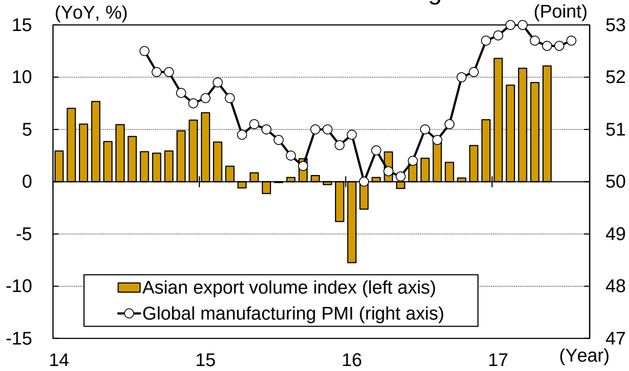
The pace of export expansion will gradually slow down into next year, while the momentum backed by increasing demand in developed nations will be maintained. Improving corporate earnings due to export expansion will lead to a recovery in private investment, reinforce an increase in household income which could increase private consumption, and contribute to boost growth rates in NIEs, Malaysia and Thailand who are highly dependent on exports.

Chart 4: Real GDP of Major Asian Economies



Source: Individual country statistics, BTMU Economic Researech Office

Chart 5: Asian export volume index and Global manufacturing PMI



Note: "Export volume" are the YoY growth rate of the volume of exports from S. Korea, Taiwan, Singapore, Malaysia, Thailand weighted average by total export value of respective country in 2016. 3-month moving average.
Source: Each country's national statistics, BTMU Economic Research Office

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