The Outlook for Asian & Australian Economies

Stable growth to continue led by domestic demand, impact of US-China trade conflict will bear watching

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1. Overview of Asian and Australian Economies

Looking at real GDP growth in Jul-Sep in Asia and Australian economies, a deceleration from the previous quarter was observed in many economies including China, the largest in the regions (see table 1). China's deceleration was mainly due to a slowdown in investments associated with deleveraging (trimming excess debt) and a recent wait-and-see stance in investments due to uncertainty over the escalating US-China trade conflict could also have affected the economic growth. Meanwhile, other Asian economies excluding China maintained stable expansion led by solid domestic demand particularly in private consumption. The Australian economy, as monthly economic indicators show, seems to be continuing moderate growth mainly supported by private consumption.

Table 1: Asian Economic Forecasts

(YoY, %)

	2017				2018			2017	2018	2019
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Actual	Forecast	Forecast
Asia 11	6.0	6.0	6.2	6.1	6.3	6.2	5.8	6.1	6.0	5.7
China	6.9	6.9	6.8	6.8	6.8	6.7	6.5	6.9	6.6	6.2
India*	6.1	5.6	6.3	7.0	7.7	8.2	7.1	6.7	7.4	7.6
NIEs	3.0	2.9	3.9	3.1	3.3	3.2	2.2	3.2	2.8	2.6
South Korea	2.9	2.8	3.8	2.8	2.8	2.8	2.0	3.1	2.6	2.6
Taiwan	2.9	2.5	3.4	3.5	3.2	3.3	2.3	3.1	2.7	2.3
Hong Kong	4.4	3.9	3.6	3.4	4.6	3.5	2.9	3.8	3.4	2.7
Singapore	2.5	2.8	5.5	3.6	4.6	4.1	2.2	3.6	3.1	2.6
ASEAN5	5.0	5.3	5.6	5.5	5.5	5.3	5.0	5.4	5.2	5.1
Indonesia	5.0	5.0	5.1	5.2	5.1	5.3	5.2	5.1	5.2	5.1
Thailand	3.4	3.9	4.3	4.0	4.9	4.6	3.3	3.9	4.1	3.8
Malaysia	5.6	5.8	6.2	5.9	5.4	4.5	4.4	5.9	4.8	4.7
Philippines	6.5	6.6	7.2	6.5	6.6	6.2	6.1	6.7	6.2	6.1
Vietnam	5.2	6.3	7.5	7.7	7.5	6.7	6.9	6.8	6.7	6.5
Australia	1.9	1.9	2.7	2.4	3.2	3.4	n.a.	2.4	3.2	2.8

Note: *Fiscal year (from April to March)
Source: Individual country statistics, MUFG Bank Economic Research Office

Looking ahead, Asian economies as a whole will maintain stable expansion, although the pace of growth is expected to slow down slightly towards 2019, buoyed by ongoing solid domestic demand led by private consumption as well as gradual expansion of exports on the back of sustained growth of advanced economies. However, caution will be required towards risks such as possible stall in Chinese economy as a result of the intensifying US-China trade conflict, turmoil in the financial markets, and substantial deterioration in private sector sentiment. In addition, if Asian countries are forced to accelerate the pace of rate hikes due to higher-than-expected interest rate rise in the US, downward pressure on domestic demand will increase and attention will be required to such situation.

2. Outlook of each country and region

(1) China

To Xi administration, cemented its political base at the Communist Party Congress last year, this year was supposed to be the year to implement structural reforms such as deleveraging. However, trade conflict with the US has intensified to a point where both countries imposing punitive tariffs on each other's products and the Chinese government is forced to substantially change the economic policy such as prioritizing economic stimulus measures to offset the adverse impacts of the trade conflict on its economy.

A half of exports to the US are already subject to the tariffs, but no significant impacts have been indicated by individual statistics. For example, Chinese exports to the US recorded +13.2% YoY in October, the latest monthly figure. It must be noted, however, that there could have been rush demand in exports (or rush demand in imports by the US importers) as the US is planning to increase tariffs on USD200 billion worth of Chinese goods from 10% to 25% starting from the beginning of next year. It is possible for both sides to impose additional tariffs on all the import products from the other country next year. In that case, downward pressure on the Chinese real GDP growth is estimated around -1.0% points, which is a considerable negative impact, taking account of the impacts of 1) a deterioration of exports to the US, and 2) substantive decline in incomes of Chinese corporate and household sectors as a result of the US and China imposing tariffs on each other's products (see table 2). Meanwhile, the impact on the US economy is estimated around -0.3% points based on the same method of calculation. It is assumed that China will be affected more severely considering that the economy is highly export-oriented (thus China, compared to the US, has been forced to implement more extensive measures to ease the impacts of trade conflict as described later).

Nonetheless, it is not expected that the Chinese economy will substantially slow down. The Chinese authorities, since the Politburo meeting in July when they decided to change the policies to support economic growth, have been focusing on expanding the measures and more recently supporting private-sector companies. Considering that private companies are encountering more financial difficulties due to the shadow banking regulations and they are vulnerable to the US-China trade conflict as a main provider of exports (share of total exports in January-September 2018: 45.7% of private companies, 41.5% of foreign companies, and 10.5% of state-owned companies), it makes sense that the authorities have been trying to protect private companies. While continuing to regulate high-risk shadow banking, the authorities are aiming to increase bank lending to private companies through monetary easing measures for banking sector such as lowering the reserve requirement ratio (RRR) and are expected to put deleveraging, which could add downward pressure on the economy, on hold for the time being.

Furthermore, infrastructure investment has emerged again as a factor to support the economy. Infrastructure investment turned to increase year-on-year in October (see chart 1) as the central government started to promote infrastructure investment in the second half of this year such as restarting to approve the urban subway network constructions. It is assumed that the growth of infrastructure investment turning to an increase in October is not a movement for a single month but it will continue to recover going forward as the central government announced a new policy guideline on 31 October to promote investments to improve weak links in infrastructure. Looking at the breakdown of fixed asset investment, investments in mining and heavy industry, machine industry, as well as infrastructure all recently showed double-digit growth year-on-year, which is quite different from the situation up to last year. The former is due to a lull of adjustment in excess production capacity, and the latter is owing to the government's campaign to promote innovation and entrepreneurship.

Meanwhile, property investment does not seem to be a part of economic stimulus measures. Property investment has been solid until recently supported by housing investment mainly owing to the ongoing inventory reduction and rising prices in small and medium cities that have been encouraged by redevelopment projects with subsidy for relocation. However, excessive housing price rise seems to have social policy issues and the central government recently started to instruct policies that reflect the actual realities of each region to local governments, such as requesting to stop subsidy in the regions that have strong upward pressure on prices. For these, it is expected that growth of housing investment will turn to a slight slowdown from double-digit increase year-on-year until recent as housing prices stabilize.

Private consumption has shown a moderate deceleration since the beginning of 2018 with growth of retail sales declining under double-digit increase year-on-year. In addition to the demographic shift like declining productive age population, curbing on household expenditure such as securing savings for mortgage payment and home purchase weighed on private consumption and affected sluggish car sales. The government, however, has been implementing measures to promote consumption to offset the damages caused by the US-China trade conflict and included a reduction in the tax rate for low and mid-level earners and increased deductions in the individual income tax reform which was revised for the first time in seven years. It is expected that a significant deceleration will be avoided through the three-year plan (2018 - 2020) for improvement of the country's consumption structure and employment measures such as stabilization of employment by supporting enterprises and promoting professional skills training.

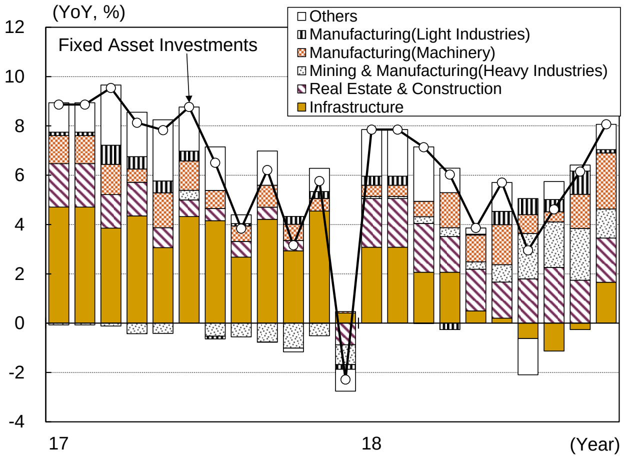
From next year onwards, the damages to exports from punitive tariffs imposed by the US will increase. Note, however, that economic stimulus measures to offset these damages have considerable room in the short term and it is possible to avert a significant growth deceleration. Rather, what becomes more important is whether the economic stimulus measures in reaction to the US-China conflict can be controlled from the medium-to-long-term perspective so as not to result in excessive debt and excessive equipment like the ones seen after the 2008 financial crisis. In addition, attention must be paid to see how serious the Xi administration, which appears to prioritize state-owned companies, is to support private companies in order to maintain the country's economic growth.

Table 2: Factor breakdown of China's 2019 real GDP growth

Real GDP growth in 2018 (YoY, %): ①	6.6
Impact on real GDP growth in 2019 (% points): ②	-0.4
Slowdown in growth trend	-0.3
The US and China imposing tariffs on each other's products	-1.0
Decline in RMB's value	＋0.3
Pause of deleveraging / Promotion of infrastructre investment	＋0.2
Tax cuts (cut in coporate and income taxes)	＋0.4
Real GDP growth in 2018 (YoY, %): ①＋②	6.2

Source: General Administration of Customs China, The US Commerce Department, MUFG Bank Economic Research Office

Chart 1: Fixed Asset Investments in China



Source: National Bureau of Statistics of China, MUFG Bank Economic Research Office

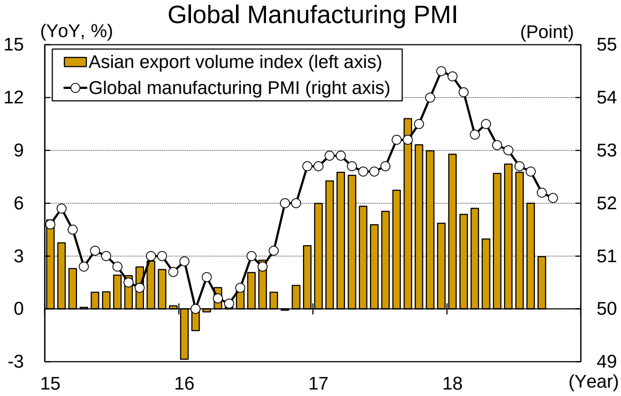
(2) Other Asian Economies

In Asian economies excluding China, stable growth will continue as domestic demand remains solid driven by private consumption amid favorable employment and income environment, ongoing growth-friendly fiscal policy and still accommodative monetary policy in real terms, also supported by export expansion. The current export slowdown reflects a softening in production activities in manufacturing industry on global basis, but still within a range of speed adjustment. Considering that the advanced economies are projected to maintain growth at a pace in line with potential rate, slowdown in manufacturing industry will settle eventually and exports will also keep an increasing trend (see chart 2).

Looking at the impact of the US imposing tariffs on Chinese imports on other Asian economies than China, a decline in exports to China of parts and materials from other Asian countries which are to be incorporated in Chinese export products to the US is anticipated in the short term. Meanwhile, in the long term, a rise in costs of Chinese products might encourage the US to switch the source of import from China to other Asian countries, and furthermore, positive impacts such as shifting investment and production from China to other Asian countries can also be expected. According to Asian Development Bank (ADB) estimate, in case the US-China trade conflict escalates and both countries impose blanket tariffs of 25% on all merchandise imports from the other country, GDP of Asian economies excluding China will be boosted by 0.22% in total as (1) disadvantage from a decline in demand associated with higher import prices of items that are subject to tariffs and a decline in production and exports to China through supply chains (direct and indirect effects) will be outweighed by (2) advantage from import substitution by third countries (trade redirection effect) (see chart 3).

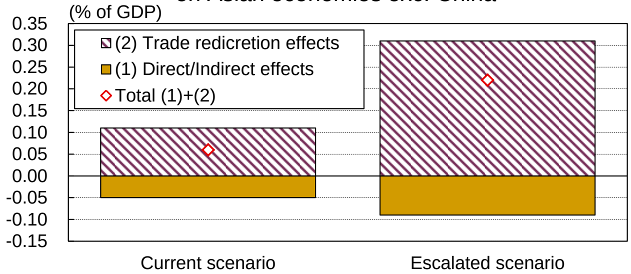
In major Asian currencies, a fall in the currencies of Indonesia, Philippines and India is significant amid growing downward pressure to the currencies of emerging countries as a result of intensifying US-China trade conflict and higher US interest rates. The governments and authorities in the regions introduced measures to curb trade deficits such as a biofuel mandate to promote the use of fuel blended with domestic palm biodiesel (Indonesia) and raising import duties on non-essential items (India), and also implemented on-and-off rate hikes. Although policy rates remain accommodative level in real terms in most countries in the regions, if those countries are forced to accelerate the pace of rate hikes in case of higher-than-expected interest rate rise in the US and the intensifying US-China trade conflict, then attention needs to be paid to the negative impacts on domestic demand.

Chart 2: Asian Export Volume Index and Global Manufacturing PMI



Note: "Export volume" is the YoY growth rate of the volume of the weighted average of exports from S. Korea, Taiwan, Thailand , Malaysia by total export value of each respective country. 3-month moving average .
Source: Individual country statistics, MUFG Bank Economic Research Office

Chart 3: Impacts of US-China trade conflict on Asian economies exc. China



Note: 1. "Current scenario" indicates all trade measures implemented as of September 2018, "Escalated scenario" is the case where both the US and China impose blanket tariffs of 25% on all merchandise imports from the other country.
2. (1) indicates the sum of direct effect (demand decline as a result of higher import prices due to tariff hikes) and indirect effect (decline of production and exports to China through supply chain).
(2) Indicates the case where the importer switches the source of import to the third countries for the half of trade volume of items that are subject to tariffs (the global share of producers of such items shall not change).
Source: Asian Development Bank, MUFG Bank Economic Research Office

[Thailand]

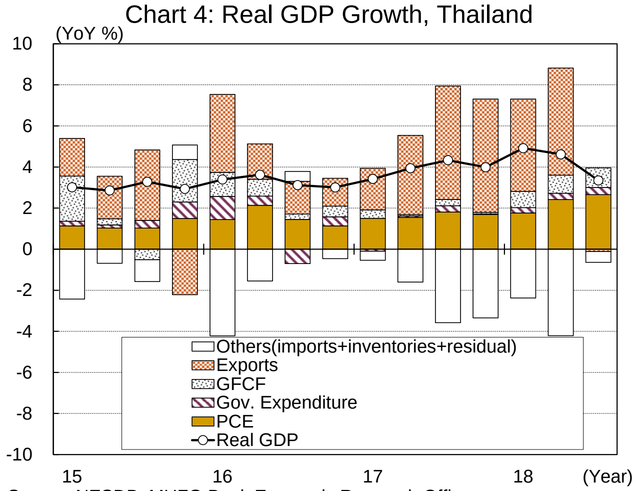
Thai economy remains solid. Real GDP growth was +3.3% YoY in Jul-Sep, decelerating to the slowest pace in around two years due to a slump in external demand, however maintained growth momentum supported by expansion of private consumption and capital investment (see chart 4). Looking at exports by items, major agricultural and fishery products such as rubber and electronic devices such as integrated circuits declined due to inventory adjustment in major export counterparts. Furthermore, exports turned to a slight decline from a substantial increase in the previous year partially due to a sluggish growth of number of tourists owing to the Phuket boat accident. However, a decline in exports can be temporary as most of these, including gold which showed reactionary decline from high level in the previous quarter, are seen as temporary factors and some recovery moves are confirmed in October customs clearance statistics. Looking ahead, the economic growth at moderate pace will continue driven by domestic demand, supported by positive effects from major infrastructure investment plans and stimulus packages as private consumption maintains firmness on the back of stable employment and income environment and improved consumer sentiment. A general election, a shift to democratic rule, is scheduled to be held in the first half of next year and major projects such as the development of Eastern Economic Corridor (EEC) are planned to be implemented based on laws even after a shift to democratic rule, therefore trend of moderate economic expansion will be maintained.

(3) Australia

Australian economy is continuing moderate expansion. Private consumption remains solid backed by improving employment and income environment and ongoing low-interest rates (see chart 5). Investments have been boosted by expansion of infrastructure investments in roads, railways and power as well as construction of office buildings and welfare facilities as the adjustment in mining sector is almost completing.

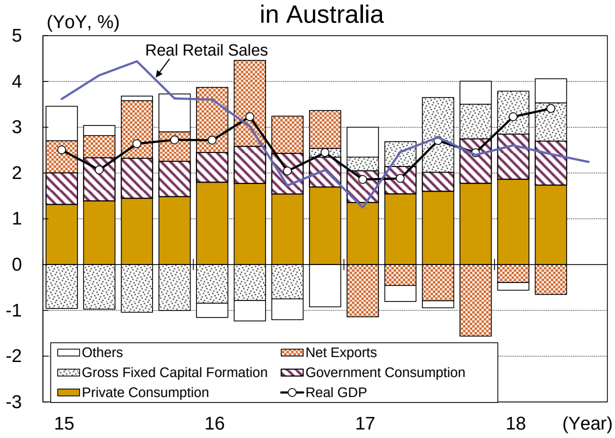
Looking ahead, the economy is expected to expand at a moderate pace. Private consumption is likely to continue expanding on the back of favorable employment and income environment and ongoing low-interest rates. Recovery in capital investments mainly in non-mining sectors backed by increasing corporate earnings and favorable business sentiment, as well as infrastructure investments in roads and railways (total AUD 75 billion in ten years) will continue to support the economy. Exports will maintain moderate expansion boosted by the operation of new liquefied natural gas (LNG) projects towards 2019 amid global economic expansion.

Chart 4: Real GDP Growth, Thailand



Source: NESDB, MUFG Bank Economic Research Office

Chart 5: Real GDP Growth and Real Retail Sales in Australia



Source: Australian Bureau of Statistics, MUFG Bank Economic Research Office

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