The Outlook for Asian & Australian Economies

Stable growth driven by domestic demand continues although Chinese economic slowdown weighs on

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1. Overview of Asian and Australian Economies

Looking at real GDP growth in Oct-Dec 2018 in Asia and Australian economies, many economies particularly in ASEAN countries showed faster growth from the previous quarter while growth of Chinese economy, the largest in the region, decelerated from the previous quarter (see table 1). Chinese economy recorded a deceleration for the third consecutive quarter, mainly due to 1) downward pressure on investments from deleveraging (trimming excess debt) and 2) weakened external demand as the impact of additional tariffs on exports to the US became evident. Meanwhile, other Asian economies excluding China maintained stable expansion led by solid domestic demand particularly in private consumption although export growth has been decelerating partially due to a decrease in exports to China. 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	Actual	Forecast
Asia 11	6.0	6.0	6.2	6.2	6.3	6.2	5.8	6.1	6.0	5.7
China	6.8	6.8	6.7	6.7	6.8	6.7	6.5	6.8	6.6	6.2
India*	6.1	6.0	6.8	7.7	7.7	8.0	7.0	7.1	7.3	7.5
NIEs	3.0	2.9	3.9	3.1	3.3	3.2	2.2	3.2	2.8	2.4
South Korea	2.9	2.8	3.8	2.8	2.8	2.8	2.0	3.1	2.7	2.5
Taiwan	2.9	2.5	3.4	3.5	3.2	3.3	2.4	3.1	2.7	2.1
Hong Kong	4.4	3.9	3.6	3.4	4.6	3.5	2.9	3.8	3.0	2.4
Singapore	2.5	2.8	5.5	3.6	4.7	4.2	2.4	3.6	3.2	2.5
ASEAN5	5.0	5.3	5.6	5.5	5.5	5.3	5.0	5.4	5.2	5.0
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	3.2	3.9	4.1	3.8
Malaysia	5.6	5.8	6.2	5.9	5.4	4.5	4.4	5.9	4.7	4.5
Philippines	6.5	6.6	7.2	6.5	6.6	6.2	6.0	6.7	6.2	6.1
Vietnam	5.2	6.3	7.5	7.7	7.5	6.7	6.9	6.8	7.1	6.5
Australia	2.2	2.1	2.8	2.4	3.1	3.1	2.7	2.4	2.8	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 slows down slightly as private consumption and infrastructure investment will maintain firmness particularly in ASEAN countries while Chinese economic slowdown continues to weigh on the growth and moderate expansion of exports is also expected as advanced economies will maintain an expansionary trend albeit at a slower pace. However, caution will be required towards risks such as Chinese economic downturn as a result of the intensifying US-China trade friction, turmoil in the financial markets, and a substantial deterioration in private sector sentiment.

2. Outlook of each country and region

(1) China

Xi administration in recent years has undertaken serious action to reduce excess debts, negative legacy of large-scale economic measures after the 2008 financial crisis, and tolerated a gradual decline in growth rate associated with slowdown in investments. The growth in infrastructure investment slowed down towards the middle of 2018 amid tightening of regulations on shadow banking (see chart 1), and it appears that bloated local government debts, which support infrastructure investment, were contained. On the other hand, this tightening of regulations on shadow banking brought an adverse effect where private enterprises face funding shortfall. Furthermore, an escalating US-China trade friction with total USD250 billion (annualized) of additional tariffs on exports to the US imposed in Jul-Sep 2018 evoked further dificulties to private enterprises who are primary drivers of exports.

That said, it was around the end of last year when a slowdown in exports became more evident. It was after December when exports to the US started to show a decline year-on-year (see chart 2), and it appears that adverse effects surfaced late due to front-loaded export. Although the deadline of US-China trade talks on 1 March was postponed amid the progress of the negotiation, it is reported that the barriers are still high to reach an agreement. In any case, it is unlikely that punitive tariffs will be removed and, together with a decline in reaction to front-loaded export, a deterioration in exports particularly the one to the US is inevitable in the future.

Xi administration would not tolerate a substantial slowdown in growth rate in order to 1) ensure social stability and 2) achieve the long term goal of doubling real GDP by 2020 from 2010. For this, the administration has already switched its stance to focus more on economig growth since the middle of 2018, revealed a policy to promote business activities of private enterprises at the Politburo in October, and both the central government and local covernments have been working on expanding such policies. On the monetary side, the reserve requirement ratio (RRR) was cut in order to boost credit for private enterprises and a new monetary tool with lower interest rate than the normal medium-term lending facility (MLF) was introduced in December. On the fiscal side, reduction in corporate income tax, value-added tax and various regional taxes were decieded (2019-2021, CNY200 billion per year) for small and medium-sized enterprises. Furthermore, the State Council instructed an early payment of the outstanding amount that the government and state-owned enterprises owe to small and private enterprises. Local governments have also decided to establish relief funds for private enterprises and distribute support funds towards direct finance such as stock offering.

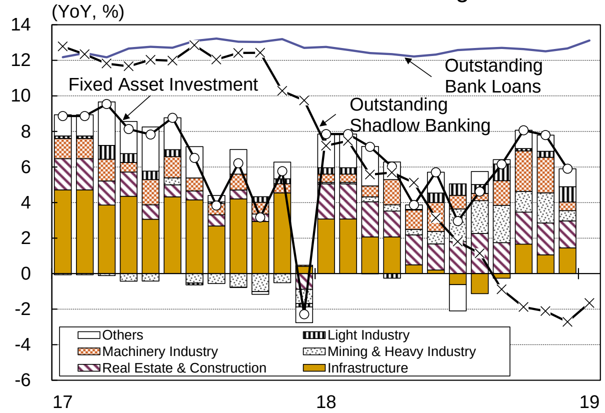
Promoting infrastructure investment is also an existing policy, and the central government has been focusing on reinforcement of subway and railway constructions and vulnerable areas since the second half of last year. It has been promoting issuance of local government bonds as a source of funds and as a result infrastructure investment turned to an increase on a year-on-year basis since October last year in spite of reduction in outstanding balance of shadow banking. Meanwhile, manufacturing investment where private enterprises play a key role has been sluggish since the end of last year and it indicates financial dificulties that private enterprises are facing in addition to increasing uncertainties going forward. It is important to keep an eye on the government's measures to change the stance of state-owned banks who have been preferentially lending to state-owned enterprises in anticipation of an implicit government guarantee and how effective these measures can be, considering that the monetary authorities have tried to implement such measure many times in the past.

Meanwhile, a further acceleration of property investment supported by full-scale deregulation for stimulation is hard to be expected as an increasing trend mainly driven by residential properties was already seen last year. The central government announced stabilization of land and residential property prices and promoting development of healthy property market as this year's target, focusing on controlling home purchase for investment purposes and meeting actual demand from middle-and-low income earners. It also instructed reduction in subsidy for relocation in small and medium cities where housing prices have been rising in order to control the price increase while it tolerated the spread of deregulation in the regions with sluggish market. As the government implements policies tailored to each region's circumstance, property investment is expected to remain solid although it is likely to slightly decelerate.

Private consumption will avoid a substantial slowdown supported by solid income and employment environment as a base and the current measures to promote consumption although the various mid-to-long and short term factors putting downward pressure remains such as a low birthrate and an aging population, an increasing burden of paying back mortgages, reactionary decline to an increase in motor vehicle sales due to tax cut. As measures to promote private consumption, prop up measures such as subsidies for purchasing energy saving and eco vehicles and consumer electronics, in addition to cuts in individual income taxes, are expected to be introduced. The implementation plan to promote consumption issued by the central government and 10 other ministries in January rather focused on instructing local governments to take measures and included few concrete proposals, but the Ministry of Commerce said it would announce concrete proposals in April.

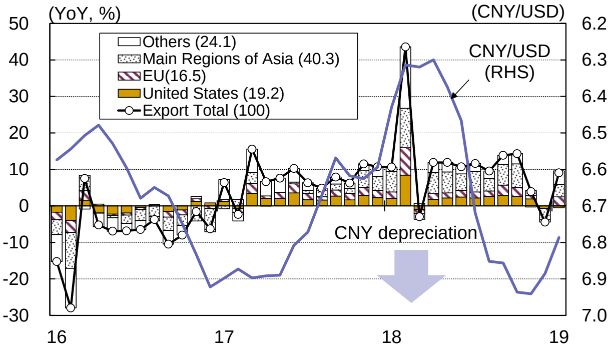
There is a great uncertainty over the development of US-China trade friction and its impact on the Chinese economy is hard to measure, but it can be said that the Chinese government has room to avert the economic downturn with multifaceted policies including monetary and fiscal policies even in the situation where the adverse effects intensify. That said, it is important to keep an eye on concrete content of the measures and its effectiveness as well as the possibility of raising concerns about the China Risks in case of renewed growing debts.

Chart 1: Fixed Asset Investment, Outstanding Balance of Bank Loans and Shadow Banking in China



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

Chart 2: Exports by Destinations in China



Note: 1. ( ) next to countries/regions represents percentage of total (as of 2017).
2. "Main Regions of Asia" include Japan, Hong Kong, Taiwan, South Korea, ASEAN and India.

Source: General Administration of Customs People's Republic of China, MUFG Bank Economic Research Office

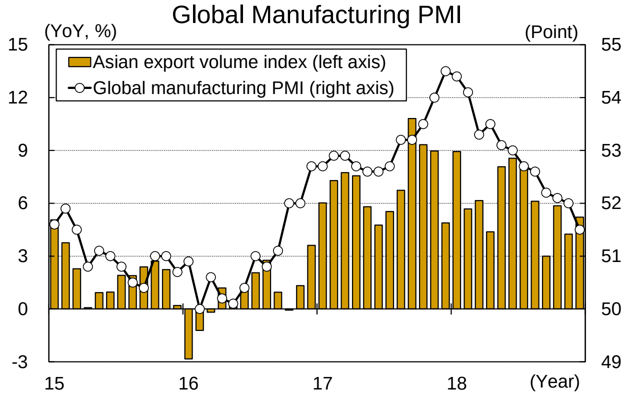
(2) Other Asian Economies

In Asian economies excluding China, domestic demand is expected to remain solid driven by private consumption amid favorable employment and income environment and ongoing growth-friendly fiscal policy and accommodative monetary policy. Looking at external demand, it has not declined in volume terms as sharp as the worsened business confidence in global manufacturing industry indicates although the current export slowdown is a cause for concern (see chart 3). A softening in production activities in global manufacturing industry is the third one since the 2008 financial crisis and it appears that it was caused this time by cyclical factors such as semiconductor cycle, a fall in automobile production in China and Europe (the former is a decline reacting to sales increase due to tax cut and the latter is due to tightening of emission regulations), and the impact of US-China trade friction. Although it is difficult to predicut how US-China trade friction will turn out, other factors are either cyclical or temporary and there is not enough indication at this stage to assume that the current softening in manufacturing industry will become much more serious compared to the last two in the past. The economies of the advanced countries as a whole are likely to maitain the pace of expansion in line with potential growth rate albeit at a slower pace, and the softening in manufacturing industry will come to an end eventually and exports in Asian economies will continue to increase albeit at a more modest pace.

To Asian economies excluding China, economic trend in China, which is geographically and economically close, is one of focal issues. Recently China exports to the US have declined owing to US-China trade friction, and Asia exports to China have also declined accordingly. It is undeniable that China's economic change is one of the factors that are adding downward pressure on Asian economies' growth rate. That said, according to the estimate of direct impact of a decrease in exports to China on Asian economies' GDP in case China's real GDP growth decelerates by 1 percentage point (pp), the impact will be -0.4pp and -0.3pp respectively, which are not so significant, to GDP of Singapore and Vietnam both with a large percentage of exports to China relative to their GDP (see table 2). Looking at Malaysia and Thailand whose exports to China account for less than 10% of GDP, the impact will be not more than -0.2pp. In fact, it is expected that a decline in China's real GDP growth will be less than 1pp (China's real GDP growth was +6.6% YoY in 2018 and it is expected to record +6.2% YoY in 2019), and its impact on Asian economies' GDP will be limited even further. In general, although Asian economies will be adversely affected by China's economic slowdown to some extent, it is unlikely that each economy will experience downturn as it is supported by solid private consumption and infrastructure investment, unless Chinese economy is going to lose pace.

The currencies of emerging countries in general turned to an appreciating trend as the prospect of rate hikes in the US recedes. Major ASEAN countries have kept policy rates on hold since the beginning of this year and India cut its benchmark interest rate by 25 bps (from 6.50% to 6.25%) in February. Inflation rates have remained low in general due to currency stabilization, and it is less likely now that the authorities are forced to take monetary tightening in order to defend exchange rates or keep inflation in check. Thus, continuation of accommodative monetary policy is likely and this will also underpin private demand.

Chart 3: 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

Table 2: The impact of China's economic slowdown on each economy through declining export to China (Estimate)

	Amount of export to China (USD bn)	Nominal GDP (USD bn)	% of export to China in each economy's GDP (%)	Impact on each economy's GDP (pp)
Singapore	52	310	16.7	- 0.4
Vietnam	31	224	14.0	- 0.3
Taiwan	71	579	12.3	- 0.3
Malaysia	29	314	9.3	- 0.2
South Korea	142	1,538	9.2	- 0.2
Thailand	29	450	6.5	- 0.2
Philippines	8	314	2.6	- 0.1
Indonesia	23	1,016	2.3	- 0.1

Note: 1. "Impact on each economy's GDP" is calculated based on the assumption that China's GDP growth rate will deteriorate 1.0pp and China's value for import elasticity is 2.5. Value for import elasticity is calculated based on the data in 2005-2017.
2. "Amount of export to China" and "Nominal GDP" are 2017 actual results.
Source: UNCTAD, MUFG Bank Economic Research Office

[Thailand]

Thai economy remains solid. Real GDP growth was +3.7% YoY in Oct-Dec 2018, accelerating from the previous quarter (+3.2% YoY) as growth of external demand accelerated while domestic demand maintained solid growth (see chart 4). Looking at real GDP by expenditures, private consumption maintained high growth on the back of an improvement in employment and income environment and low-interest rates and gross fixed capital formation also accelerated from the previous quarter. Exports, mainly in services sector, turned into positive growth as the number of visitor arrivals recovered as the effect of the Phuket boat accident faded.

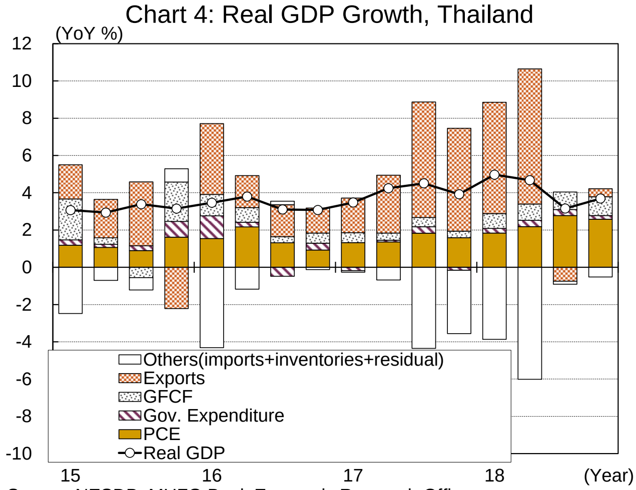
Looking ahead, the economic growth at moderate pace driven by domestic demand is expected to continue as private consumption will remain solid on the back of stable employment and income environment and an improving consumer sentiment. A general election aiming to shift to democratic rule is scheduled to be held in March and its result and how smoothly it will be held is attracting attentions. 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 and positive effects from infrastructure investment and economic stimulus measures will also continue, therefore trend of moderate economic expansion will be maintained.

(3) Australia

Australian economy is continuing moderate expansion (see chart 5). Private consumption remained solid backed by an improving employment and income environment and ongoing low-interest rates, and investments remained firm buoyed by expansion of infrastructure investments in roads, railways and power as the adjustment in mining sector is nearly completing.

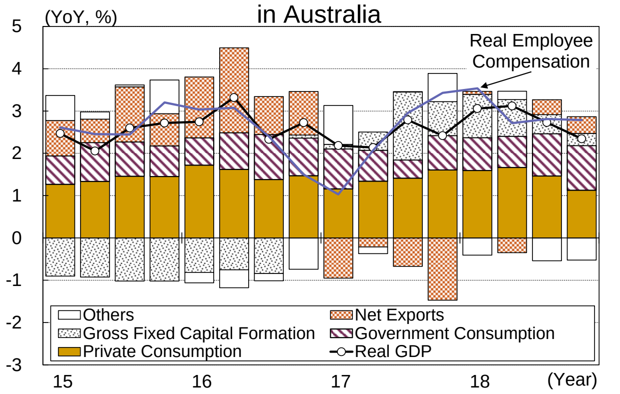
Looking ahead, the economy is expected to continue expanding at a moderate pace. Private consumption is likely to remain solid based on an improving employment and income environment. A recovery in capital investments mainly in non-mining sectors will continue backed by increasing corporate earnings and favorable business sentiment, and expanding infrastructure investments pushed by the government will continue to support the economy. Furthermore, the Reserve Bank of Australia (RBA) lowered forecast for inflation rate owing to stable wage growth rate and falling fuel prices and indicated a shift from the existing tightening bias in terms of future monetary policy, thus it is likely that ongoing low-interest rates will support domestic demand. Looking at external demand, exports will maintain an increasing trend as global economy is expected to maintain an expansionary trend albeit at a slower pace and a full-scale operation of new liquefied natural gas (LNG) projects starts this year.

Chart 4: Real GDP Growth, Thailand



Source: NESDB, MUFG Bank Economic Research Office

Real GDP Growth and Real Employee Compensation in Australia



Note: "Real Employee Compensation" = Weekly Wages ÷ Consumer Price x Number of Employees

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

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