# The Outlook for Asian & Australian Economies

# Stable growth driven by domestic demand to continue, recovery in external demand takes time

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**1 JULY 2019**
(ORIGINAL JAPANESE VERSION RELEASED ON 4 JUNE 2019)

## 1. Overview of Asian and Australian Economies

Looking at real GDP growth rate in Jan-Mar in Asia and Australian economies, most Asian economies excluding China showed slower growth from the previous quarter while Chinese economy, the largest in the region, maintained the same growth rate as the previous quarter (see table 1). The economic growth in China recorded upper +6% YoY range in the first half, then decelerated to mid +6% YoY range in the second half of last year, and maintained the same pace since the beginning of this year. It appears that adverse effects of additional tariffs on Chinese exports to the US were offset by the effects of domestic demand-stimulus measures based on the government's change of policy from deleveraging (trimming excess debt) to economic stability. Meanwhile, other Asian economies excluding China maintained stable expansion, albeit at a slower pace, led by solid domestic demand particularly in private consumption although export growth has been sluggish partially due to a decrease in exports to China. The Australian economy seems to continue moderate growth although growth of private consumption decelerated.

Looking ahead, Asian economies as a whole will largely maintain stable expansion although the pace of growth slows down slightly as private consumption and infrastructure investment are expected to maintain firmness particularly in ASEAN countries while exports will remain sluggish for the present due to Chinese economic slowdown. However, caution will be required towards risks such as Chinese economic downturn as a result of an intensifying US-China trade friction, turmoil in the financial markets caused by investors' risk aversion, and a substantial deterioration in private sector sentiment.

Table 1: Asian Economic Forecasts

(YoY, %)

| | 2017 | | 2018 | | | | 2019 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Jul-Sep | Oct-Dec | Jan-Mar | Apr-Jun | Jul-Sep | Oct-Dec | Jan-Mar | Actual | Forecast | Forecast |
| Asia 11 | 6.2 | 6.1 | 6.3 | 6.2 | 5.8 | 5.7 | 5.4 | 6.0 | 5.6 | 5.5 |
| China | 6.7 | 6.7 | 6.8 | 6.7 | 6.5 | 6.4 | 6.4 | 6.6 | 6.2 | 6.0 |
| India* | 6.8 | 7.7 | 7.7 | 8.0 | 7.0 | 6.6 | 5.8 | 6.8 | 7.3 | 7.4 |
| NIEs | 3.9 | 3.1 | 3.3 | 3.2 | 2.2 | 2.5 | 1.5 | 2.8 | 2.0 | 2.2 |
| South Korea | 3.8 | 2.8 | 2.8 | 2.8 | 2.0 | 3.1 | 1.8 | 2.7 | 2.0 | 2.2 |
| Taiwan | 3.4 | 3.5 | 3.2 | 3.3 | 2.4 | 1.8 | 1.7 | 2.7 | 1.9 | 2.0 |
| Hong Kong | 3.6 | 3.4 | 4.6 | 3.5 | 2.9 | 1.2 | 0.5 | 3.0 | 2.2 | 2.3 |
| Singapore | 5.5 | 3.6 | 4.7 | 4.2 | 2.4 | 1.9 | 1.2 | 3.1 | 2.2 | 2.3 |
| ASEAN5 | 5.6 | 5.4 | 5.5 | 5.3 | 5.0 | 5.1 | 4.8 | 5.2 | 4.8 | 4.9 |
| Indonesia | 5.1 | 5.2 | 5.1 | 5.3 | 5.2 | 5.2 | 5.1 | 5.2 | 5.1 | 5.1 |
| Thailand | 4.5 | 3.9 | 5.0 | 4.7 | 3.2 | 3.6 | 2.8 | 4.1 | 3.1 | 3.2 |
| Malaysia | 6.1 | 5.7 | 5.3 | 4.5 | 4.4 | 4.7 | 4.5 | 4.7 | 4.4 | 4.5 |
| Philippines | 7.2 | 6.5 | 6.6 | 6.2 | 6.0 | 6.3 | 5.6 | 6.2 | 5.9 | 5.9 |
| Vietnam | 7.5 | 7.7 | 7.5 | 6.7 | 6.9 | 7.1 | 6.8 | 7.1 | 6.5 | 6.2 |
| Australia | 2.8 | 2.4 | 3.1 | 3.1 | 2.7 | 2.3 | n.a | 2.8 | 2.4 | 2.6 |

Note: *Fiscal year (from April to March)

Source: Individual country statistics, MUFG Bank Economic Research Office

## 2. Outlook of each country and region

### (1) China

The Trump administration resumed increasing tariffs on Chinese products in May, blowing away the hopes for a bilateral agreement between the US and China. The US, not only increased tariffs on USD200 billion worth of Chinese imports (from 10% to 25%, a possible grace period due to technical reasons) on 10 May, but also proposed to apply additional tariffs across Chinese imports worth around USD300 billion on 13 May. China, on the other hand, responded by raising tariffs on around USD60bn of US imports annually (implemented on 1 June).

We will assess the impact of tariffs imposed on Chinese goods by the US that were introduced from Jul-Sep last year (so-called 1st to 3rd round, total of USD250 billion) . Assuming that the additional tariffs of 25% are to be imposed on all exports to the US and the cost of the half of them is to be passed on to US consumers (the rest is to be bourne by Chinese importers in the form of price cutting), it is calculated that exports to the US will be declined by -33 percentage points (pp) annually based on price elasticity of past trend in exports to the US. Therefore, the current impact is calculated as around -8pp considering that the actual rate of additional tariffs imposed up until April remains on average at around 6%. Looking at the actual data, exports to the US has decreased in full scale since the beginning of the year when disturbing factors such as rush demand settled, recording a substantial decrease of -10.1% “YoY” in Jan-Apr. Although it is difficult to estimate how big the decrease is compared to “zero-tariff” situation, not “YoY”, when comparing to exports to EU (+7.7% YoY in Jan-Apr), which has shown a similar growth on average in the last five years to exports to the US, there is a gap of -18pp. This appears to be a significant impact for an increase of tariff rates of around 6% on average, however, the current decrease in exports to the US can be within the scope of the assumption considering the possibility that a reaction to front-loaded export since last year remains (see chart 1). Although US-China trade talks have not broken down completely, all the exports to the US will be subject to the tariffs in as early as the second half of this year and the scenario where downward pressure will be around -1pp (estimated by the Economic Research Office) based on the export decrease-to-real GDP ratio is becoming more realistic.

Take note, however, that that is not necessarily reflected in real GDP growth rate directly. The Chinese government set “maintain stable growth” as the top of the list of economic policies in the Government Work Report at the National People’s Congress (NPC) held in March, incorporating economic measures which could cover negative impacts from US-China trade conflicts, while it continues to negotiate with the US. On the fiscal front, the report incorporated the following measures: 1) reducing the tax burdens and social insurance contributions of enterprises (a decrease of RMB2 trillion, as opposed to last year’s actual result of a decrease of RMB1.3 trillion), 2) supporting infrastructure investment by increasing special local government bonds issued (an increase of RMB800 billion YoY) (see table 2). On the monetary front, the government adopted “a stable balance of debt to GDP” for the first time as one of its main targets, aiming to prevent debt from rising further. Meanwhile, the report included 3) the government’s instruction to five largest state-owned commercial banks to increase loans to small and micro businesses by over 30% YoY, aiming to ease the funding shortages faced by private enterprises and small and micro businesses. In accordance with decisions made at the NPC, various policies are being shaped and implemented promptly both on the fiscal front (reducing value-added tax rate, social insurance contributions rate and administrative expenditure) and the monetary front (cutting reserve requirement ratios for rural commercial banks).

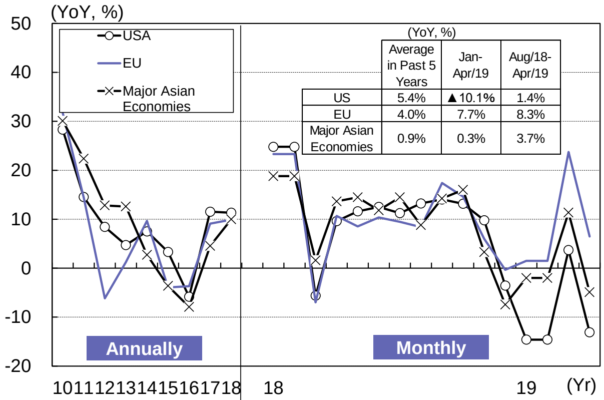
Under such measures, infrastructure investment, which supports the economic growth, is expected to remain firm. Infrastrucutre investment has got back on a year-on-year expansionary track since October last year along with a policy shift to focus more on growth, and will be supported by a substantial increase in issuing local bonds going forward. Meanwhile, manufacturing investment looks to be impacted by the effect of measures to increase loans to private enterprises. Manufacturing investment has been sluggish since the end of last year on the back of slowing exports, uncertaintines ahead, and the funding shortages faced by private enterprises due to the existing deleveraging measures. The authorieis have been expanding measures to increase loans to private enterprises and small and micro businesses from 2017 to present, however the dominant view is that the measures have little efffect so far and more effective measures are urgently needed.

Property investment, mainly driven by housing investment, is expected to remain solid. Housing investment accelerated to high level of upper +10% YoY since the beginning of this year owing to monetary easing and deregulation of home purchase, however it seems that a slowdown at some point is unavoidable as the central government is wary of overheating market and instructed the local government in 10 cities to curb the investment. The central government, however, cannot overlook slack domestic demand associated with a destabilization of housing market under the current circumstances with worsening external demand due to the trade friction with the US, and is expected to undertake more agile and flexible measures.

Private consumption is expected to be supported by the authorities' further measures to promote consumption and employment although it continued to decelerate partially due to prolonged reaction to motor vehicle sales promotion owing to tax cut until the end of 2017. At the NPC, measures to promote domestic markets were prioritized in order to lower dependency on export markets amid the trade friction with the US, and it was suggested to start inviting public opinion on measures to promote automobile and consumer electronics in April as well as implementing measures to promote employment by strengthening job training.

As the US and China retaliate against each other more intensively with imposing punitive tariffs, the damage on the Chinese economy is likely to be even greater. However, it seems that the Chinese government has room to avert the substantial economic downturn with multifaceted policies including monetary and fiscal policies. That said, it is important to keep an eye on the possibility of greater negative impact associated with the change of supply changes by companies amid an intensifying punitive measures such as the US government restricting the Chinese telecom equipment giant from using US components and services, as well as increasing "China Risks" in case of growing debts.

Chart 1: Exports by region in China




Note: "Major Asian Economies" include Japan, Hong Kong, Taiwan, S.Korea, ASEAN and India.
Source: General Administration of Customs People's Republic of China, MUFG Bank Economic Research Office

Table 2: NPC Economic Measures

| | | Rate to boost GDP |
|---|---|---|
| For enterprises / Reducing tax burdens and social insurance contributions | Reducing value-added tax rate (RMB1 trillion) | 0.4% |
| | Reducing social insurance contributions of enterprises (RMB300 billion) | |
| | Cutting administrative expenditures (RMB300 billion) | |
| Increasing local bond issuance | Supporting infrastructure investment | 0.9% |
| Financial support to private enterprises and small businesses | State-owned banks to increase loans to small and micro businesses by over 30% YoY | n.a. |
| | The National Guarantee Fund to support over RMB200 billion funding to over 100,000 small and micro businesses | |
| | Cutting RRRs for rural commercial banks, all of the excess funds of RMB280 billion to be used to provide loans to small and micro businesses | |

Source: Chinese government data, 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.

Motor vehicle sales in April dropped to -17.8% YoY in Indonesia due to conservative buying observed prior to the elections, however remained firm in Thailand (+8.7% YoY) and Malaysia (+6.2% YoY). Considering that a decline in Indonesia was due to a temporary factor related to the elections and motor vehicle penetration rates in Asia remain low level, it is likely that the pace of growth will be largely maintained going forward. Looking at income, average wage in Jan-Mar was +1.9% YoY in Thailand and +7.0% YoY in Malaysia (manufacturing sector). In Indonesia, average wage in full year of 2018 remained solid (+4.6% YoY). Income growth is also likely to be maintained amid governments' support measures for low-income earners, in addition to favorable employment environment such as low unemployment rates in Asian region. Governments in the region continue to make investments in infrastructure proactively which would contribute to a further expansion of domestic demand.

On the external demand side, exports posted negative growth year-on-year owing to the current softening in global manufacturing sector and Chinese economic slowdown (see chart 2). It appears that a softening in production activities in global manufacturing sector this time was caused 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. Looking ahead, external demand will remain sluggish as a recovery in global manufacturing sector could take some time and there have been prolonged negative factors such as an escalating US-China trade friction, although the current declining trend includes temporary factors.

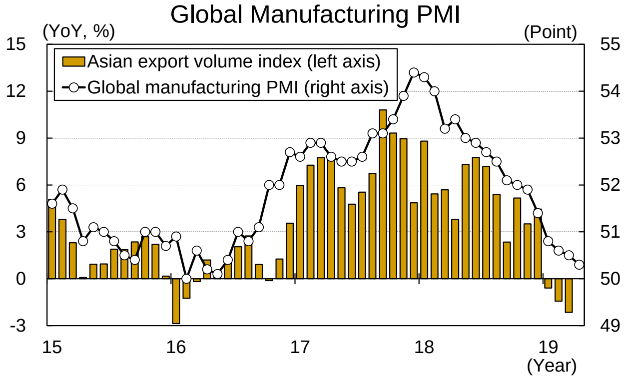
With regards to US-China trade friction, there is fear that the aftermath of a decline in Chinese exports to the US owing to an increase in the additional tariffs (as described above) will spread into further decline in Asian exports to China and then into slower growth caused by it. Looking at decline rates in value-added in Asian exports to China on Asian economies' GDP in case Chinese exports to the US declines -30%, these will be from around -0.1pp to around -0.4pp (see chart 3). These are relatively small from the standards of growth rates in Asian economies, however take note that only the impacts from export channels are taken into account in these figures. In case the conflict drangs on, there could be more significant negative impacts as a deterioration in business sentiment leads to a reduction in capital expenditure and sluggishness in global manufacturing sector worsens.

Meanwhile, looking at Asian exports to the US, growth of exports to the US accelerated in Thailand, Vietnam and Taiwan since the beginning of this year. Furthermore, some companies expressed the intent that they would move production bases from China to other Asian countries. Therefore, it is advisable to also look at positive effects such as export substitution (US importers changing suppliers from ones in China to ones in other Asian countries) in order to avoid the additional tariffs imposed by the US and moving production bases from China to other Asian countries by companies. In fact, Asian Development Bank (ADB) estimates that real GDP growth in developing Asia (excluding China) will be boosted by around +0.2% due to trade diversion effect in case the US and China impose the additional tariffs of 25% on each other's gross import value.

Although it is not easy to assess how negative impacts of a decline in exports and positive impacts of production substitution would affect, it is projected that negative impacts will become more significant in the short term and weigh on the economic growth considering a change of supply chains would take some time.

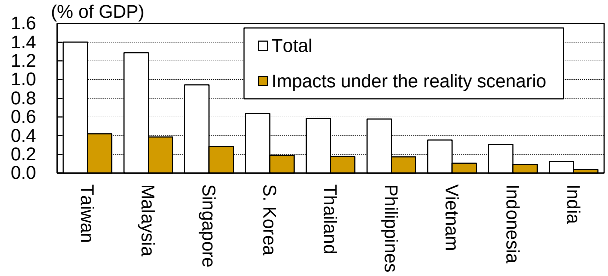
Recently, monetary authorieis in a number of countries in the region decided to lower policy rates considering that the currencies remain stable as prospect for interest rate rise in the US recedes and inflation rates also remain low. Going forward, it is likely that currencies and inflation both remain stable amid low prospects for US interest rate rise, and accommodative monetary policies continue to support private demand. In countries such as South Korea, however, currencies have weakened significantly owing to their trade structures that are heavily dependent on China amid escalating US-China trade tensions. In case such tensions escalate even further, the possibility of investors becoming more risk averse and currencies depreciating further cannot be denied.

Chart2: 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, Bloomberg, MUFG Bank Economic Research Office

Chart 3: Amount of value-added in Chinese exports to the US (Estimates, 2018)




Note: 1. Value-added by country in Chinese exports to the US in 2018 was estimated on the assumption that value-added by country in Chinese exports to the US remains constant from 2015, and its ratio to GDP was calculated accordingly.
2. “Reality Scenario” is based on the assumption that Chinese exports to the US declines by 30%.
Source: OECD, the US Commerce Department, MUFG Bank Economic Research Office

**[Thailand]**

Thai economy has managed to avoid further downturn although growing at a slower pace. Real GDP growth rate was +2.8% YoY in Jan-Mar, falling to the lowest level since Oct-Dec 2014 as external demand remained soft while domestic demand driven by private consumption maintained solid growth (see chart 4). Looking at the breakdown by expenditure, private consumption maintained high growth of +2.2% YoY on the back of an improving employment and income environment and low-interest rates. Government consumption was +0.4% YoY, also accelerating from the previous quarter. Meanwhile, exports recorded -3.8% YoY, substantially declining owing to a softening in production activities and economic slowdown in China.

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.

At the general elections held in April, both pro-Thaksin party and pro-military party fell short of a lone majority in the lower house of parliament. That said, pro-military party is expected to form a coalition with anti-Thaksin party and others to become the largest faction. There has been no political turmoil since the latest election results were announced, and this will support demand such as tourism. 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 albeit at a slower pace.

## (3) Australia

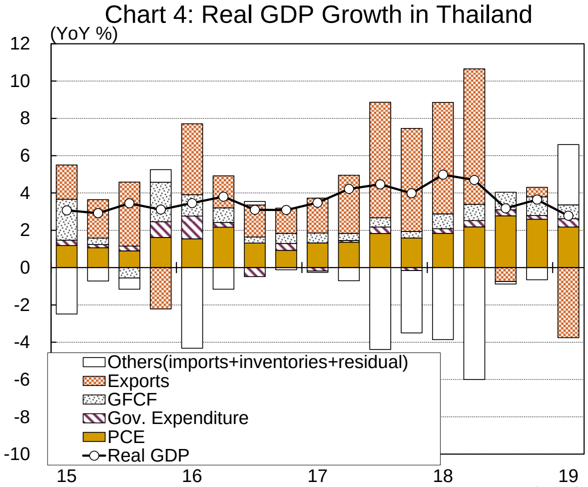
Australian economy has been slowing down since the second half of last year, and real GDP growth rate in Jan-Mar is likely to be moderate (see chart 5, translator’s note: real GDP growth rate, released on 5 June, was +1.8% YoY in Jan-Mar ) due to its country-specific factors including drought, on top of sluggish private consumption. The pace of expansion in private consumption slowed down owing to sluggish growth in household income and a drop in housing prices, dragging down growth.

Looking ahead, the economic growth rate is likely to decelerate from the last year, however is projected to remain at the moderate 2% range. Household income is a base of private consumption, but the factors of the current sluggish income growth include the temporary factors such as a decline in farmers' income due to drought, and labor market remains favorable. Considering tightening of employment environment and improvement in income due to the effect of tax cuts (described below), consumption is likely to recover gradually. It is important to keep an eye on the possibility of reverse assets effects where further deterioration in housing market will curb discretionary consumption, on the other hand, considering soaring housing prices become a social problem, if housing prices peak out at the current level of price adjustment supported by low-interest rates environment, then it is unlikely that it will become a major issue.

The current government, after winning a parliamentary election in May, pledged to deliver additional income tax cuts (total of AUD158 billion in 10 years, 8% of GDP), corporate tax cuts, and new infrastructure investment projects in the budget for the next fiscal year. Together with the accommodative monetary policy by the Reserve Bank of Australia (RBA) (the RBA decided to lower the cash rate for the first time in two years and ten months by 25bp to a historic low of 1.25% on 4 June), these measures are expected to support domestic demand both from fiscal and monetary sides. A recovery in capital investment will also continue to support the economic growth.

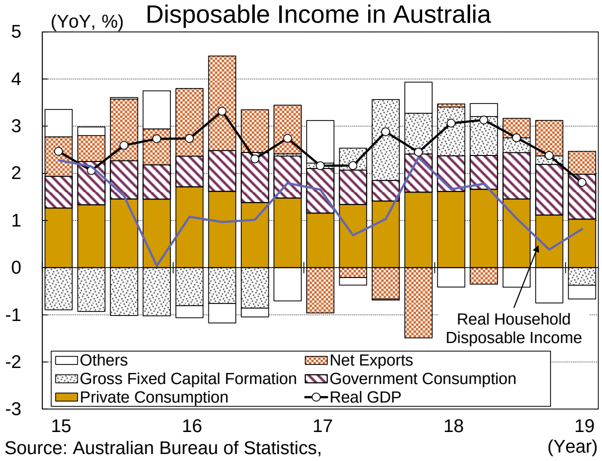
Furthermore, Australia's trade structure is mainly comprised of primary commodities and is not intricately linked with supply chains of electronic machines industry or automobile industry, hence negative impacts on its exports are not as substantial as ones on other Asian exports, which is a positive factor. Considering that global economy is expected to maintain expansionary trend albeit at a slower pace, an increasing trend in exports is likely to be maintained towards next year.

Chart 4: Real GDP Growth in Thailand




Source: NESDB, MUFG Bank Economic Research Office

Chart 5: Real GDP Growth and Real Household Disposable Income in Australia




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

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