China shifts to multi-layered policy, Asia maintains stable growth, AU is supported by resource exports

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1. Overview of Asian and Australian Economies

Looking at real GDP growth rate in Jul-Sep in Asia and Australian economies, the Chinese economy, the largest in the region, decelerated from the previous quarter. The economy in Hong Kong, where massive protests continue, contracted for the first time in ten years while now a few economies in other Asian regions accelerated from the previous quarter (table 1). In addition to the downward pressure from deleveraging (reducing excess debt), such as curbing shadow banking, China is also starting to feel the negative impact of additional tariffs imposed by the US on its domestic and foreign demand. It appears that the Chinese government is shifting its attention to a multi-layered policy response with a combination of stimulus measures, reform and opening-up policies, indusrial policies, and fiscal and monetary policies. Meanwhile, in other Asian economies excluding China, domestic demand mainly driven by private consumption is supporting economic growth and in some economies there are signs that external demand, which had been lackluster since the second half of last year, is bottoming out. It is considered that the economies will in general continue their stable expansion. The Australian economy also seems to continue its moderate growth while private consumption is decelerating.

Looking ahead, the Chinese economy will remain under downward pressure mainly from deleveraging and the US-China trade conflict, however, the pace of slowdown will remain within the range of policy coordination, and the economic downturn is likely to be avoided. In the other Asian economies, private consumption and infrastructure investment are likely to remain solid and exports will also maintain the current recovery trend along with a recovery in the global manufacturing sector. That said, the outlook for US-China trade conflict remains uncertain and it is important to cautiously monitor if the adverse impacts on the Chinese economy become worse than expected, together with risk aversion by various economic entities (such as turmoil in financial markets and decline in demand) and the prolonged protests in Hong Kong.

Table 1: Asian Economic Forecasts

(YoY, %)

	2017	2018				2019		2018	2019	2020
	Oct-Dec	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	Actual	Forecast	Forecast
Asia 11	6.1	6.3	6.2	5.8	5.7	5.4	5.2	6.0	5.3	5.3
China	6.7	6.8	6.7	6.5	6.4	6.4	6.2	6.6	6.1	5.8
India*	7.7	7.7	8.0	7.0	6.6	5.8	5.0	6.8	6.1	7.0
NIEs	3.1	3.3	3.2	2.2	2.5	1.5	1.7	2.8	1.4	1.9
South Korea	2.8	2.8	2.8	2.0	3.1	1.7	2.0	2.7	1.9	2.2
Taiwan	3.5	3.2	3.3	2.4	1.8	1.7	2.4	2.7	2.2	2.0
Hong Kong	3.4	4.6	3.5	2.9	1.2	0.6	0.4	3.0	-1.3	0.5
Singapore	3.6	4.7	4.2	2.4	1.9	1.1	0.1	3.1	0.8	1.9
ASEAN5	5.4	5.5	5.3	5.0	5.2	4.8	4.7	5.2	4.7	4.8
Indonesia	5.2	5.1	5.3	5.2	5.2	5.1	5.1	5.2	5.0	5.1
Thailand	3.9	5.0	4.7	3.2	3.6	2.8	2.3	4.1	2.7	3.0
Malaysia	5.7	5.3	4.5	4.4	4.7	4.5	4.9	4.7	4.4	4.5
Philippines	6.5	6.6	6.2	6.0	6.3	5.6	5.5	6.2	5.8	5.9
Vietnam	7.7	7.5	6.7	6.8	7.3	6.8	6.7	7.1	6.8	6.6
Australia	2.4	3.1	3.1	2.7	2.4	1.7	1.6	2.7	1.8	2.4

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

① Current condition and outlook of the Chinese economy

The Chinese economy's decelerating trend has become evident since the second half of 2018 and its real GDP growth rate slowed to 6.0% YoY in Jul-Sep, reaching the lower limit of the 2019 target (+6.0~6.5% YoY). The most recent monthly economic data up until October also showed decelerating trend in exports/imports, fixed assets investment, production, and Purchasing Managers' Index (PMI). Looking at the influential auto sector, although it is an individual sector, motor vehicle sales remained lower than the level in the previous year. The recent year-on-year decline in motor vehicle sales became smaller as the authorities eased restrictions in some areas on the issuance of car registration plates that had been introduced in order to relieve traffic jams, and there are signs of recovery in production; however, the outlook is not rosy just yet.

Although the Chinese economy's decelerating trend is heightened, considering that the economy is in the process of a moderate decline in growth with its transition from a high-growth period to a stable-growth period and the authorities have been working on trimming excessive debt, which is the negative legacy of a large scale economic stimulus package after the financial crisis in 2008, it is considered that this deceleration falls within the scope of the Chinese government as long as it remains moderate.

It was, however, unexpected that a tightening of shadow banking regulations as part of the deleveraging measures since the end of 2017 became one of the reasons for the financial difficulties faced by private companies who have little choice but to depend on shadow banking

for financing while having the difficulties to receive financing from banks. In addition, it was also unexpected that the US-China trade conflict has escalated to this extent at this timing, putting downward pressure on the economy. Therefore, it is absolutely necessary for the government to take political action in response to such a situation with problems both at home and abroad, and it appears that the government is shifting its attention to a multi-layered policy response with a combination of opening-up policies to continue attracting foreign investment and to fend off criticism over market-distorting, industry policies to strengthen its industrial competitiveness, infrastructure investment to improve productivity and to stimulate the economy, and macroeronomic policies such as other fiscal and monetary policies.
In light of these, the Chinese economy will remain under multiple downward pressures, mainly from deleveraging and the US-China trade conflict, and will continue decelerating. That said, it is likely that the economy will avoid a substantial downturn supported by the government's stimulus measures. The economy is projected, however, to grow at +6.1% YoY in 2019 and +5.8% YoY in 2020, allowing the growth rate to fall below the symbolic +6.0% YoY level.

The US and China are reportedly continuing intense negotiations over the terms of their agreement and there is a possibility that a growing tension in Hong Kong and the US's response to the situation there could affect the US-China trade talks. If it just takes some time to reach the first-phase of "final trade agreement", the extent of damage would be limited. But in the case that the talks fail to reach an agreement at all, then the trade sanction battle between both parties would escalate further and it would not only become a strong headwind to the economy but also lead to a turmoil in global financial markets where risk appetite has improved on the back of presumed US-China trade agreement. It will be important to keep an eye on such political and economic downside risks surrounding the Chinese economy.

② Development of US-China trade conflict

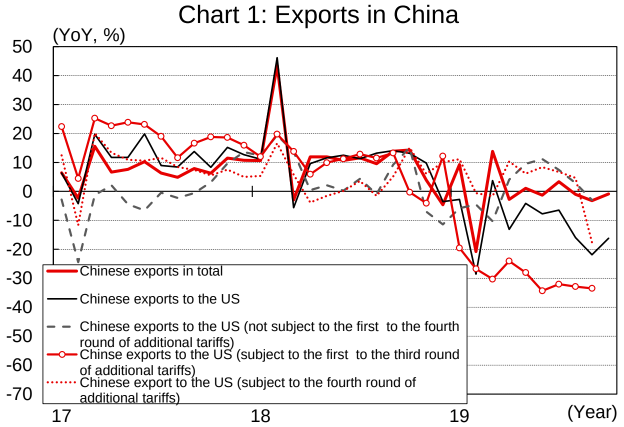
The sense of uncertainty regarding the US-China trade talks has been growing recently. Although it is difficult to reach a medium-to-long term fundamental solution as the underlying conflict appears to be over national security issues and tech hegemony between the two countries, there had been mounting expectations of a temporary conclusion to the trade talks as US President Donald Trump announced that they have "agreed to the first phase" of a trade deal (so-called "partial agreement") after high-level negotiations on 10-11 October. However, more recently, there is a growing possibility that a conflict in a separate field will make the negotiations even harder as the US Congress passed the Hong Kong Human Rights and Democracy Act almost unanimously and President Donald Trump signed it into law amid intensifying protests in Hong Kong.

Granted that both the US and China shared mutual interests and reached the first-phase trade deal, it is still difficult to expect the relationship between both parties to be fundamentally improved. Most likely they will only manage to avoid imposing additional tariffs on USD160 billions' worth of imports by the US from China that are scheduled on 15 December and are unlikely to eliminate the additional tariffs that have already been imposed in the first to fourth rounds (USD360 billions' worth). Hence, it is inevitable that punitive tariffs will continue to weigh on the Chinese economy.

Looking at the most recent Chinese exports, it can be said that the existing punitive tariffs have weighed on exports. Exports to the US recorded -16.2% YoY in October, substantially declining and weighing heavily on total exports (-0.9% YoY) (see chart 1). Looking at US import figures, which indicate the impact of additional tariffs, exports of items that were targeted in the first three rounds of punitive tariffs which were implemented from July to September last year declined by around 30% YoY recently, and exports of the items subject to the fourth round of punitive tariffs which were implemented from 1 September have also been declining rapidly since September. In light of these, it is projected that exports to the US will continue their year-on-year decline at least until the end of next year when the effects of imposing tariffs comes to an end, and this will continue to weigh on total exports.

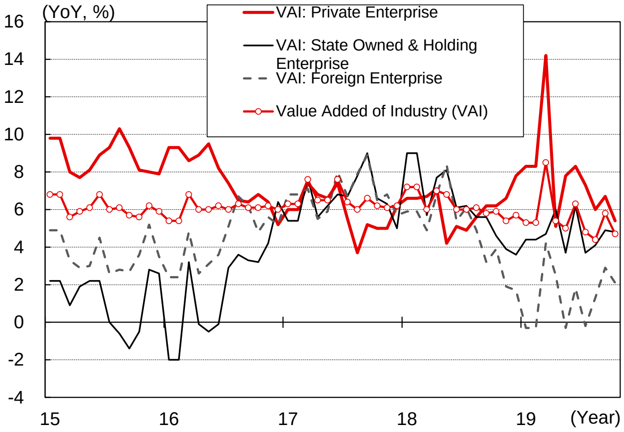
Looking at the effects of a decline in exports on production trends, a slowdown in growth of production by foreign capital enterprises became prominent since the middle of 2018. It can be said that the US-China trade conflict is bringing about not only the direct effect of softening external demand but also changes in global supply chains, which is a structural change (see chart 2).

Chart 1: Exports in China



Note: Figures in "Chinese exports to the US" are based on statistics released in the US.
Source: General Administration of Customs People's Republic of China, the US Commerce Department, MUFG Bank Economic Research Office

Chart 2: Value Added of Industry in China



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

③ Direction of domestic demand and economic and monetary policies

Looking at infrastructure investment, the quota of local special bonds (bonds that are issued to finance specific project constructions), capital to finance infrastructure investment was substantially increased for this year, and the maintenance of the system has also been carried out which allowed the use of funds from special bond issuance as part of public projects financing. However, growth of infrastructure investment has remained low so far and it is hard to say if these efforts by the central government produced their intended effect (see chart 3). In light of this, at the State Council executive meeting on 4 September, it was decided that all special local government bonds in this year's quota must be issued by the end of September and distributed to projects by the end of October, and some special local government bonds out of next year's quota will be allocated in advance. At the same meeting on 13 November, it was decided that the minimum capital adequacy ratio for some infrastructure projects including ports and coasts to be cut (from 25% to 20%). Such an expansion of policies is expected to accelerate the growth of infrastructure investment going forward.

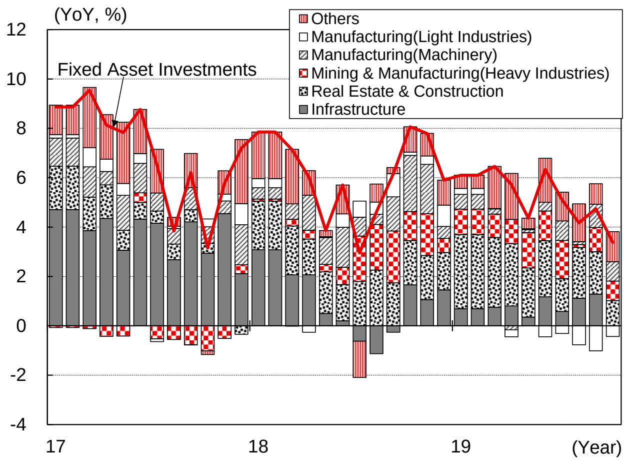
Looking at industrial investment, although investment in light industry is expected to remain in a difficult situation, investment in machinery industry is projected to remain solid next year, supported by the government's measures such as tax cuts and subsidies aiming for industrial development as well as proactive promotion of the shift to 5G.

Looking at private consumption, downward pressure on sentiment from the prolonged US-China trade conflict is likely to remain in large-scale durable goods demand such as automobiles. However, considering that no significant change in employment and income environment has been observed at this point of time and the government intends to expand measures including large-scale vocational training aimed at stabilizing employment, which is a top priority issue, the scenario where stability in employment and income supports consumption will remain unchanged. In fact, on 11 November (Singles' Day), the Chinese e-commerce giant saw +26% YoY in sales in a single day, indicating strong willingness to buy even when it came to budget minded consumer spending.

Looking at monetary policy, the authorities cut interest rates: medium-term lending facility (MLF) rate cut (3.30% to 3.25%) on 5 November, seven-day reverse repo rate cut (2.55% to 2.5%) on 18 November, loan prime rate (LPR) cut (4.20% to 4.15%) on 20 November. However, rate cuts remained modest and the substantial effects will be limited (see chart 4). Rather, it is considered that such modest policy adjustments indicate the authorities' careful attention to deleveraging.

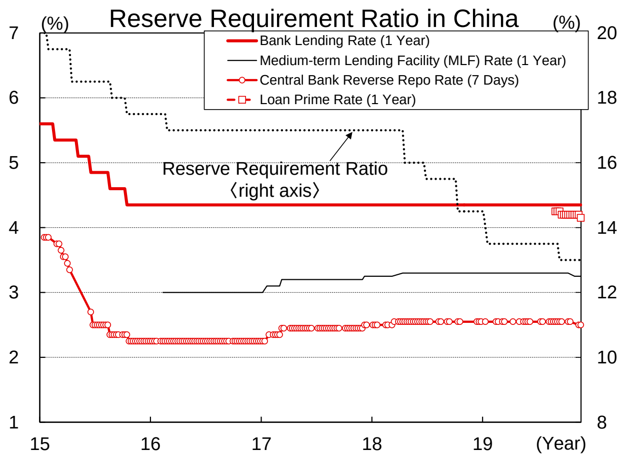
Lastly, looking into the acceleration of the reform and opening-up policies that leads to strengthening of its economic growth in the medium-to-long term in light of the prolonged trade conflict, the authorities are taking measures such as adopting regulations to improve the business environment which includes strengthening intellectual property protection and easing regulations on restricting market entry by foreign capital enterprises into the banking and insurance sectors. It is an appropriate direction to take as it is vital to improve the environment to attract foreign capital enterprises to offset negative impacts of the US-China trade conflict. However, foreign capital enterprises have experienced frustration where the regulatory laws were streamlined yet not enforced, and not being given enough access to the market. Unless this can be solved, it might be difficult to achieve evident outcomes.

Chart 3: Fixed Asset Investments in China



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

Chart 4: Interest Rates and Reserve Requirement Ratio in China



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

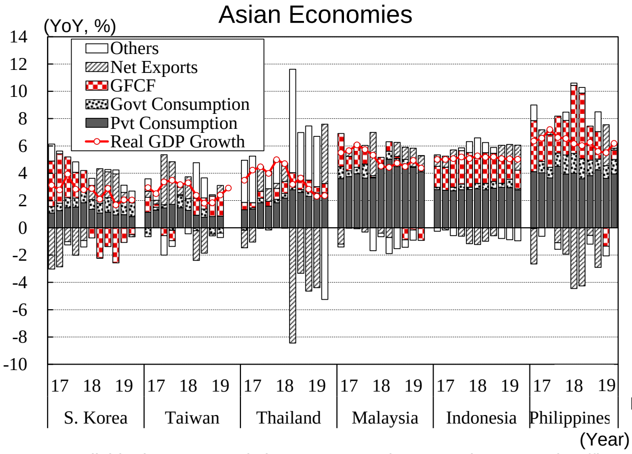
(2) Other Asian Economies

The Asian economies excluding China are likely to have hit the bottom or bottomed out. Looking at real GDP growth rate in Jul-Sep by region, ASEAN economies either maintained the same growth rate as the previous quarter or accelerated, except for Malaysia where its growth rate decelerated from the previous quarter, and recorded upper +4% YoY as a whole (see chart 5). Real GDP growth rate in NIEs economies remained mid +1% YoY range, but this is mainly due to Hong Kong economy recording negative growth of -2.9% YoY on the back of an intensifying protests over the proposed extradition law, and growth rates remained firm in

South Korea, Taiwan and Singapore. The Jul-Sep real GDP growth in India is yet to be released (translator's note: real GDP growth rate slowed to +4.5% YoY in Jul-Sep, released on 29 September, from +5.0% YoY in Apr-Jun), it likely remains slow as motor vehicle sales remained sluggish due to a rise in vehicle prices associated with environmental regulations.

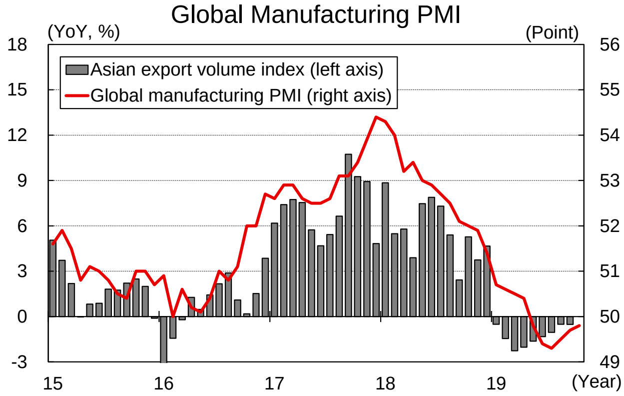
Both ASEAN and NIEs economies remained solid in general as domestic demand remained firm. Private consumption recorded growth of +4-7% YoY in ASEAN economies and +1% YoY in NIEs (except for Hong Kong where it recorded negative growth) respectively, supported by favorable employment and income environment as well as growth-friendly economic policies. Meanwhile, it must be noted that external demand, which had been lackluster, is recently showing signs of recovery. Combinined export volume in the economies which are highly reliant on external demand across Asia are showing signs of recover, along with or even leading the Global Manufacturing PMI (see chart 6).

Chart 5: Real GDP Growth Rates in Major Asian Economies



Source: Individual country statistics, MUFG Bank Economic Research Office

Chart 6: 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

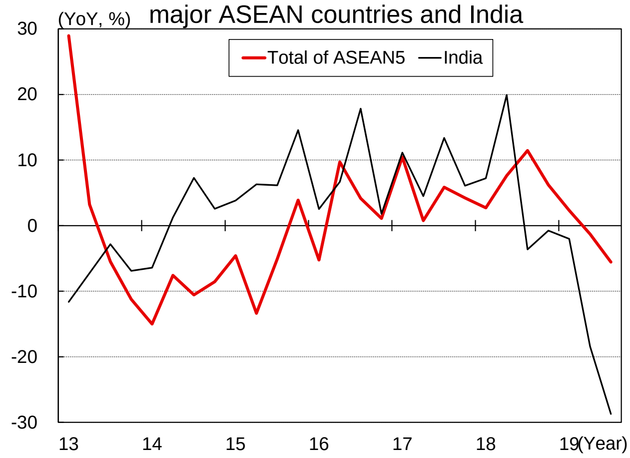
Looking ahead, the scenario where solid domestic demand driven by private consumption supports the economy as a whole will remain unchanged as the unemployment rate in each economy largely remains low and income growth remain stable and favorable employment and income environment is to be maintained. In addition, the governments in the region are likely to continue making investments in infrastructure proactively on the back of ample room for a fiscal stimulus and lower interest rates, contributing to a further expansion of domestic demand. Looking at monetary policy, it is likely that the central banks in advanced economies will maintain their accommodative policies, and peers in the Asian economies can also maintain the accommodative policies which will support private sector demand.

Reversing the course of the economic trend becomes even more stable if external demand is bottoming out as well, however it is important to keep an eye on the extent of export recovery. What is encouraging is that there are sign of prolonged inventory adjustment in semiconductor sector, in which Asian economies are also part of major players, is finally coming to an end, which is evident in global unit shipments. Whether a recovery trend continues or not will be a key and a bright prospect can be expected next year considering structural upward forces such as a further acceleration of IoT and 5G-related demand. In addition, auto sector is also expected to recover which will then support the manufacturing sector's gradual recovery and exports' recovery across Asia.

Looking at sluggishness in motor vehicle sales in India as described above, it recorded a sharp decline of -28.7% YoY in July-Sep (see chart 7). Nonetheless, it is unlikely such sharp declines will become prolonged given that the major auto makers lowered the vehicle prices and the government is encouraging public sector banks to take active lending stances. Due to high market potential (lower penetration rates) in auto sectors in India as well as across Southeast Asian region, it is expected that motor vehicle sales will largely head towards gradual recovery.

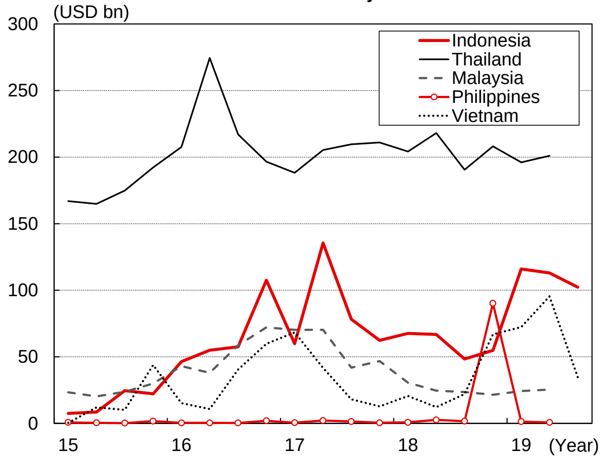
Lastly, speaking of the impacts of US-China trade conflict, a focus of world attention, on Asian economies, they remain as risks from various points of view such as a decline in exports to China due to a further slowdown in the Chinese economy and a sharp decline in local currencies owing to an escalating risk aversion by investors. It should be noted, however, that export substitution in order to avoid the additional tariffs is now bringing about positive impacts on Asian exports to the US while a decline in Chinese exports to the US due to the additional tariffs has been putting downward pressure on Asian exports to China through supply chains. It is also worth noting that US-China trade conflict is currently having impacts not only on exports but also on shifting production base. China's relative dominance as a production base has been threatened by peers in Asia owing to an increase in labor costs, and now it is possible to think that an escalating US-China dispute as a new development is driving companies' decision to shift their production bases from China to overseas. It will, of course, take some time for this trend of shifting production bases to be reflected in statistics as it usually requires construction of equipment, however signs of the trend can already be seen in some Chinese companies with fast decision-making, and in fact, looking at Chinese FDI into major ASEAN countries, FDI in Vietnam and Indonesia increased substantially since the middle of last year (see chart 8). Considering that governments in Asia are announcing a series of additional measures to attract corporates, it is likely that the Chinese companies will increase investment in other Asian countries, followed by foreign capital companies.

Chart 7: Motor Vehicle Sales in major ASEAN countries and India



Source: Individual country statistics, MUFG Bank Economic Research Office

Chart 8: Chinese FDI into major ASEAN countries



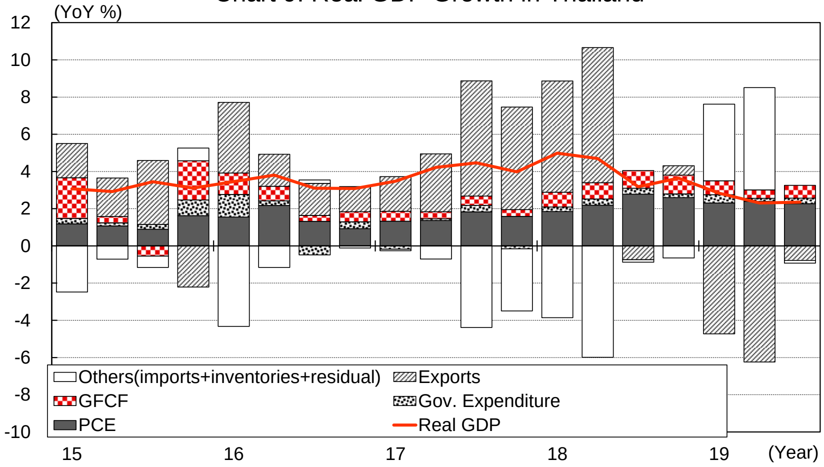
Source: Individual country statistics, MUFG Bank Economic Research Office

[Thailand]

Thai economic growth rate has been generally decelerating since the middle of last year, however real GDP growth rate slightly accelerated to +2.4% YoY in Jul-Sep from the previous quarter (+2.3% YoY) (see chart 9). Looking at the breakdown by expenditure, private consumption maintained high growth of +4.2% YoY on the back of an improvement in employment and income environment and lower interest rates while exports showed a smaller decline, recording -1.0% YoY.

Looking ahead, private consumption will remain solid on the back of stable employment and income environment, and exports are expected to head towards gradual recovery along with the Global Manufacturing PMI's bottoming out. In addition, the government's new economic stimulus measures (worth THB316 billion in total, boosting real GDP growth rate by +0.55 percentage points based on the assumption by Thai finance ministry) as well as infrastructure investment mainly in major projects such as the development of Eastern Economic Corridor (EEC) will also contribute the growth. As a result, real GDP growth rate is expected to record +2.7% YoY in 2019 and slightly accelerate to +3.0% YoY in 2020.

Chart 9: Real GDP Growth in Thailand



Source: NESDB, MUFG Bank Economic Research Office

(3) Australia

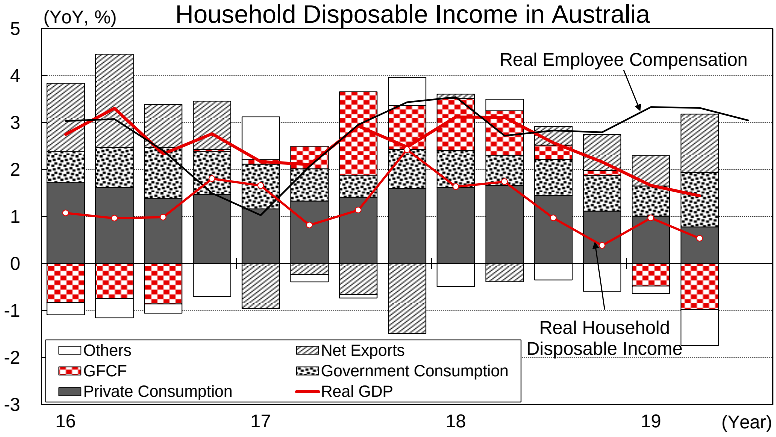
The Australian economy has been slowing down mainly due to slower growth of private consumption, and real GDP growth rate in Jul-Sep is likely to remain moderate (see chart 10, translator's note: real GDP growth rate accelerated to +1.7% YoY in Jul-Sep, released on 4 December, from upwardly revised +1.6% YoY in Apr-Jun).

Looking at private consumption, although labor market remained favorable and employee compensation maintained firmness, it has been showing sluggish growth mainly in durable goods such as automobiles and household appliances and discretionary items such as dining out, amid softer growth of household disposable income due to stronger growth in tax payments reflecting "improved compliance" (higher rate of tax collection) together with reverse asset effects associated with a deterioration in property market since last year. Meanwhile, on external demand side, Australia's exports have been recording a double-digit increase since the middle of last year, as opposed to Asian economies where sluggishness in exports has weighed on growth. In fact, export of iron ore to China, which accounts for 30% of exports, has been boosting total exports, having been supported by China's stimulus measures such as infrastructure investment.

Looking ahead, the economic growth rate will inevitably decelerate to upper +1% YoY (2018: +2.7% YoY) yet will recover to lower +2% YoY in next year. Firstly, disposable income is expected to head towards improvement owing to the effect of income tax cut by the government as tight labor supply and demand is likely to persist. Secondly, housing prices continued to rebound recently after having turned upward in some major cities in the middle of this year as uncertainties over national politics faded after the general election in May. In light of these, a restraining effect on consumption is likely to be eased gradually. Furthermore, monetary easing policies by the Reserve Bank of Australia (RBA, the RBA lowered the policy rate in October following the rate cuts in June and July, indicating it remains willing to ease policy further if needed while the policy rate is currently at all-time low), together with the government's infrastructure projects, will support domestic demand.

Looking at external demand, with the recent strong exports being supposed mainly by exports to China, there exist some risks amid concerns over rapidly increased dependence of exports on China in recent years and prospects for the Chinese economy itself. However, an increasing trend in Australia's exports will continue in the coming year at least considering that an acceleration of infrastructure investment is expected in China from policy perspective and other economies abroad are also expected to stabilize expansionary trend.

Chart 10: Real GDP Growth, Real Employee Compensation and Real Household Disposable Income in Australia



Note: "Real Employee Compensation" = Weekly Wages ÷ Consumer Price x Number of Employees
Source: Australian Bureau of Statistics, MUFG Bank Economic Research Office

(Translated by Makiko Stokes)

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