

Emerging Asia Watch

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Crawling out of the abyss

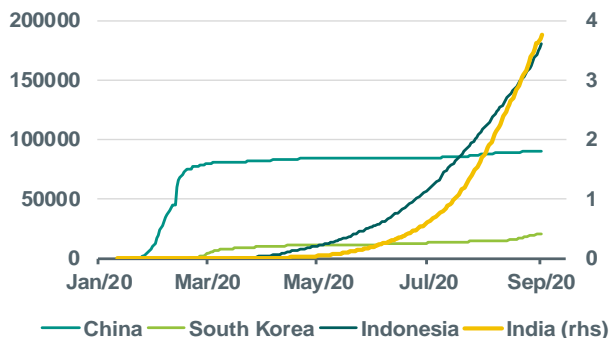
- ▶ PMIs, foreign trade and capital flow data indicate that recovery from covid-19 collapse has started
- ▶ Post covid-19 shock, we expect regional GDP to contract by $\pm 1\%$ in 2020 and grow by 7.5% in 2021
- ▶ North Asia is doing better than South Asia in terms of containing the virus and the economic damage
- ▶ China, Taiwan and Vietnam are the only three countries with positive annual growth this year
- ▶ Decline of (core) inflation has created room for post covid-19 easing wave
- ▶ Pandemic fiscal support and falling revenues visible in deterioration fiscal indicators

A regional contraction in 1H 2020 on covid-19, with North East Asia performing better than South Asia

The covid-19 shock had a huge impact on growth in emerging Asia in the first half of this year. Following the imposition of lockdowns and other safety restrictions, EM Asian countries had to deal with domestic covid-19 related supply and demand shocks, the drying up of tourist revenues and/or all kinds of supply chain distortions. The export oriented region also felt the impact of the collapse in global growth and trade. For commodity exporters, such as Indonesia or Malaysia, the drop in commodity prices formed an additional drag. As a result, we have cut our regional growth forecasts in the course of this year sharply. That is particularly true for India that was faced with a lengthy but ineffective lockdown, with a stunning 23% yoy GDP contraction in Q2. But we also have cut our forecasts sharply for tourist destinations Thailand and Philippines, oil exporters Malaysia and Indonesia and trade hubs Singapore and Hong Kong. Meanwhile, the impact on growth is less dramatic (but still significant) in North East Asia (China, South Korea, Taiwan) and Vietnam, as the authorities concerned had more success in getting the pandemic under control – notwithstanding the occurrence of second waves in China and South Korea. China, Taiwan and Vietnam are the only three countries for which we expect positive annual growth this year.

Covid-19 under control? - North versus South

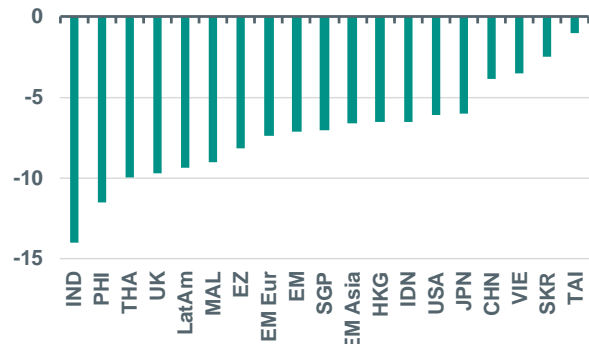
Confirmed covid-19 cases (India in millions, right hand scale)



Source: Bloomberg

Growth forecasts sharply down due to covid-19 shock

2020 growth forecasts ABN AMRO GE, Jan-20 versus now (ppts)



Source: ABN AMRO Group Economics, EIU

We expect ±1% contraction of regional GDP this year, followed by almost 7.5% growth in 2021

After EM Asia grew by around 6% in 2018 and 5% in 2019, following the covid-19 shock we expect a contraction of regional real GDP this year, by a bit more than 1%. We expect growth to re-accelerate in 2021, to an above trend pace of 7-7.5%. Next year's re-acceleration is mainly driven by base effects, as the covid-19 driven collapse in the first half of this year will gradually fade out of the figures by then. All this implies that despite the collapse in regional growth in the first half of this year, emerging Asia will remain a relative 'outperformer' versus other regions. That partly stems from its generally prudent policies and the availability of 'buffers' that create room for fiscal and monetary easing in challenging times. That said, we expect emerging Asia to have lost a bit more than 5% of GDP compared to our pre-corona base case by end 2021.

Emerging Asia: Economic growth (forecasts)							
% yoy	Q4-19	Q1-20	Q2-20	2018	2019	2020f	2021f
China	6.0	-6.8	3.2	6.6	6.1	2.0	8.0
Hong Kong	-3.0	-9.1	-9.0	2.8	-1.2	-6.0	4.0
India [^]	4.1	3.1	-23.9	6.1	4.2	-7.5	9.0
Indonesia	5.0	3.0	-5.3	5.2	5.0	-1.5	6.0
Malaysia	3.6	0.7	-17.1	4.8	4.3	-4.5	6.0
Singapore	1.0	-0.3	-13.2	3.4	0.7	-5.5	5.0
South Korea	2.3	1.4	-2.7	2.9	2.0	-0.5	3.5
Taiwan	3.3	2.2	-0.6	2.7	2.7	1.0	3.0
Thailand	1.5	-2.0	-12.2	4.1	2.5	-7.0	4.5
Regional average	5.0	-2.9	-5.3	5.9	5.0	-1.2	7.3

Source: ABN AMRO Group Economics, Bloomberg, EIU.

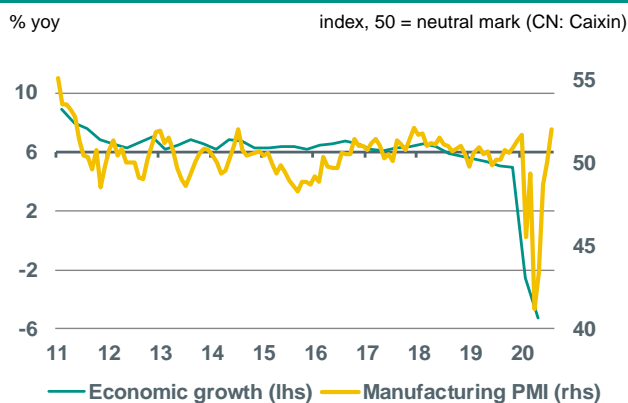
* Forecasts 2020-21 rounded except for China

[^] India: fiscal years

PMIs indicate that recovery from covid-19 collapse has started

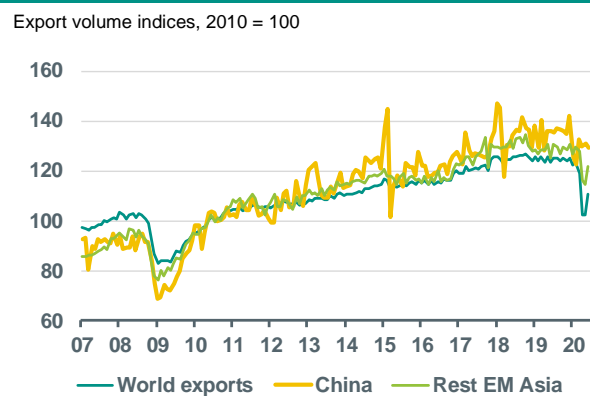
On a more positive note, for most countries the trough in activity has taken place in Q2-20 (for China Q1-20), with a recovery in economic activity visible thereafter. This is also shown by high frequency data such as manufacturing PMIs. After falling sharply in April/May (and before in February due to China), our GDP weighted regional manufacturing PMI has improved clearly since April and rose back above the neutral 50 mark in August. That said, while the general trend in Asian PMIs is up, there is still quite some divergence between countries. Whereas in August the manufacturing PMIs have returned to 50 or higher in China, India, Indonesia, Taiwan, and Singapore, they were below 50 in South Korea, Malaysia, Hong Kong and Vietnam (suggesting that material headwinds remain).

EM Asian growth collapses, PMIs point to turnaround



Source: ABN AMRO GE, Bloomberg, Thomson Reuters Datastream

Trade collapsed in April, rebound visible in June



Source: CPB

Foreign trade starts recovering from the covid-19 shock

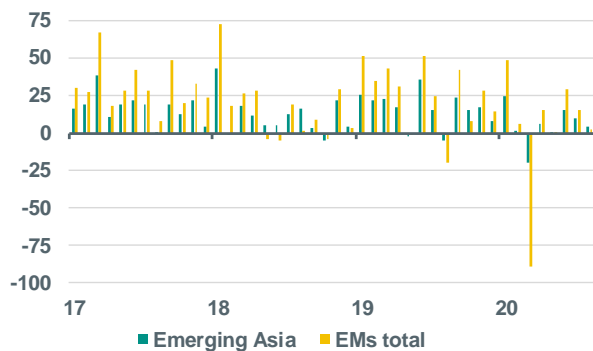
Just as the eurozone, emerging Asia is a very exported oriented region, and is therefore highly exposed to the global business cycle. The covid-19 shock to global trade therefore also has a clear impact on emerging Asian exports, while vice versa the shock to domestic demand also had a clear impact on regional imports. That said, the collapse in EM Asian exports was not as bad as the global average and so far less deep and more short-lived as during the global financial crisis. This 'outperformance' is likely in part due to the fact that the region is relatively well positioned in technologic supply chains, with the tech sector being one of the 'winners' from the covid-19 shock. China did even better than the regional and the world average, with export volumes being supported by medical (and tech) goods (see for more background [here](#)). The improvement in foreign trade momentum is also visible in Asian export PMIs, which have started a comeback from the sharp decline earlier this year. The PMI export subindices for China (Caixin) and Taiwan rose to above the neutral 50 mark again in August, for the first time since the covid-19 shock.

After record outflows in Q1, portfolio inflows have cautiously returned

The covid-19 crisis hit emerging Asia through the capital flow channel as well. Given the unexpected nature of this crisis, market agents had to adjust their portfolios at an extremely high speed. That resulted in capital outflows from EMs in March that were larger than the amounts seen during any single month of the global financial crisis in 2008-09. That said, during the global financial crisis the outflow episode lasted for four months, while in the covid-19 crisis portfolio flows already started to cautiously return one month later helped by the sharp easing of monetary policy in the US. Emerging Asia has been hit as well in March, with the IMF estimating total portfolio outflows (through debt and equity instruments) at USD 19.5 bn. Also in EM Asia, portfolio flows started to return cautiously since April, with particularly June and July showing decent inflows. All in all, although there was a clear impact from the covid-19 shock, the region did relatively well in this respect.

Portfolio flows have returned after covid-19 shock

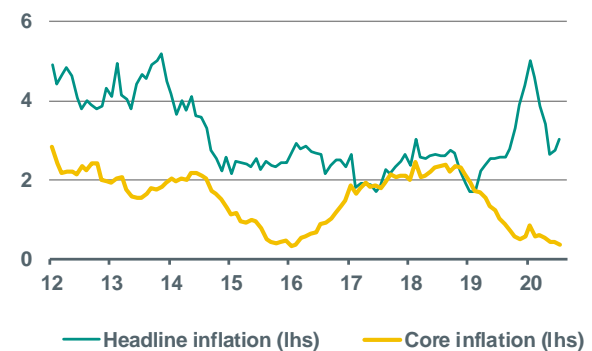
Portfolio inflows, USD bn



Source: Institute of International Finance

Core inflation down to lowest level since early 2016

% yoy



Source: Thomson Reuters Datastream

Core inflation further down, creating additional room for a post-covid-19 easing wave

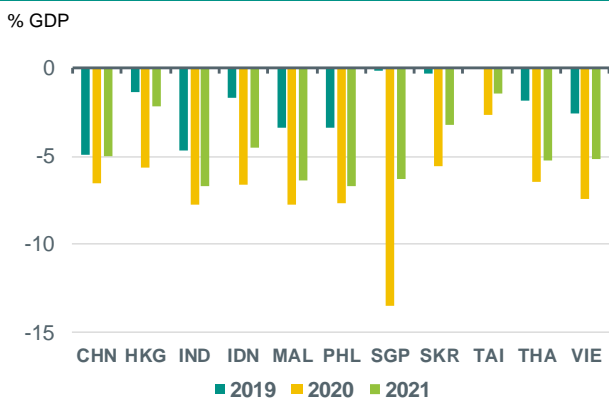
Despite a gradual slowdown of regional growth last year, our regional, GDP-weighted headline inflation index rose sharply (to 5% yoy end 2019), mainly driven by food price inflation in China and India. This year, with the pandemic creating economic havoc and commodity prices falling, headline inflation has eased sharply, falling back to around 3% in recent months. Meanwhile, core inflation (excluding volatile components such as food and oil) already started to come down last year and that trend has continued this year, with regional core inflation at a 4.5 year low (0.4% yoy) in July. All this has shaped additional room for Asian central banks to step up monetary easing, in an attempt to stem the fall-out from covid-19. In China, the one-year lone prime rate (the new policy rate) was cut by 30 bps in the course of this year (to 3,85%), while some other policy rates were cut as well. We expect the PBoC's piecemeal and targeted monetary easing to continue, although after some pause. In other Asian countries, policy rates were cut as well following the covid-19 shock. The sharpest

cuts were visible in the Philippines (175 bp, to 2.25%), followed by Hong Kong – with the HKMA following the US Fed – and Vietnam (150 bp, to 0.5% and 4.5%, respectively), Malaysia (125 bp, to 1.75%), India (115 bp, to 4%), Indonesia (100 bp, to 4%), South Korea and Thailand (75 bp, to 0.5%) and Taiwan (a modest 25 bp, to 1.125%). Meanwhile, Singapore eased its currency policy. Many central banks also introduced or broadened the use of other instruments, to help governments supporting pandemic fiscal spending programmes and/or to safeguard overall bank liquidity. With the worst of the pandemic shock now likely behind us, we think that most other EM Asian central banks will generally keep their monetary powder dry for a while now, although we generally still see some room for further easing measures should circumstances ask for that.

Pandemic fiscal stimulus leads to deterioration of public finance indicators

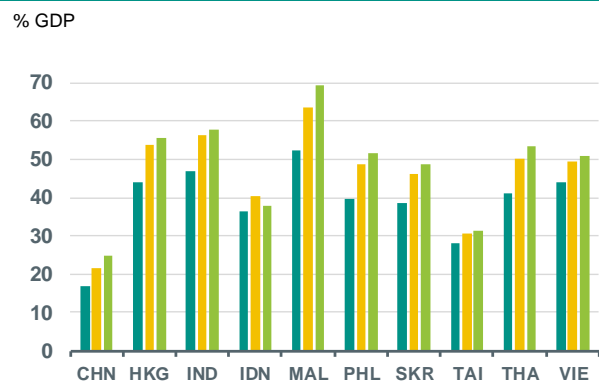
Next to monetary easing, Asian governments in general introduced special pandemic fiscal support to mitigate the fall-out from the covid-19 shock. This pandemic support, in combination with falling fiscal revenues, has gone hand in hand with a clear deterioration of fiscal indicators for all countries concerned. Leaving aside the more 'developed' Asian countries, budget deficits are estimated to rise to elevated levels in India, Malaysia and Philippines (around 8% of GDP), followed by Vietnam (7.5%) and China (central government deficit, not the augmented one), Indonesia and Thailand (around 6.5%). As a result, public debt ratios are expected to rise significantly in most countries in 2020-21, but in general remain at manageable levels (with only Malaysia expected to surpass the 60% of GDP level this year). That helps explaining why Asian governments have quite some room for manoeuvre on this front. Nevertheless, the deterioration in fiscal indicators has resulted in rating actions: India was downgraded by Moody's in June, while India, Indonesia and Malaysia were put on Negative outlook by one or two of the leading rating agencies.

Pandemic support leads to higher budget deficits ...



Source: EIU, ABN AMRO Group Economics

... and rising public debt ratios



Source: EIU

To conclude

In our base case we assume EM Asian economies – led by China – to recover from the covid-19 shock in the second half of this year, with an acceleration of regional growth to above trend levels in 2021 helped by base effects. While we expect US-China relations to remain tense in the run-up to the US presidential elections, we do not expect a revival of the tariff war. In our view, the main risk factors that could derail our base case are:

- Renewed (uncontrolled) outbreaks of covid-19
- Material further escalation of US-China trade, tech, and wider tensions (although some countries – like Taiwan and Vietnam seem to profit from the shifting of supply chains)
- Other geopolitical risks (Taiwan/Hong Kong, South Chinese Sea, North Korea).
- Growth disappointment in China (given strong trade and other linkages between China and rest of Asia)

GDP growth (%)	2018	2019e	2020e	2021e	Inflation (%)	2018	2019e	2020e	2021e
Emerging Asia	5.9	5.0	-1.2	7.3	Emerging Asia	2.6	2.9	3.0	2.9
Emerging Europe	3.3	2.0	-5.0	3.8	Emerging Europe	6.3	6.6	5.1	4.8
Latin America	1.1	-0.2	-8.0	4.0	Latin America**	7.3	9.2	7.3	7.9
Emerging markets total	4.5	3.5	-3.0	5.9	Emerging markets total	4.2	4.7	4.3	4.1
Eurozone	1.9	1.3	-7.4	3.6	Eurozone	1.8	1.2	0.4	1.0
US	2.9	2.2	-4.8	3.4	US	2.4	1.8	1.2	2.0
Budget balance (%GDP)	2018	2019e	2020e	2021e	Current account (%GDP)	2018	2019e	2020e	2021e
Emerging Asia	-3.3	-4.1	-7.0	-5.5	Emerging Asia	0.2	1.1	1.6	1.0
Emerging Europe	0.4	-0.4	-6.0	-3.5	Emerging Europe	1.5	1.4	#NUM!	#NUM!
Latin America	-4.6	-4.1	-10.5	-5.5	Latin America	-2.6	-1.9	-1.0	-1.5
Eurozone	-0.5	-0.6	-10.1	-8.1	Eurozone	3.7	3.3	3.4	3.6
US	-4.2	-4.5	-14.6	-10.3	US	-2.4	-2.5	-2.6	-2.5

Source: EIU, ABN AMRO Group Economics

**Inflation Latin America and World without Venezuela

* figures Emerging Markets regions are rounded

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