ASIA MONTHLY

December 2017

株式会社日本総合研究所

http://www.jri.co.jp/english/periodical/asia/

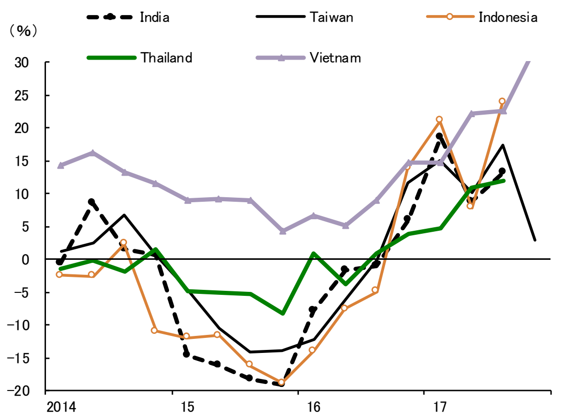
Asia's economy expected to continue to grow steadily in 2018

In addition to the sustained recovery in foreign demand, Asia's economy in 2018 is expected to enjoy steady growth in domestic demand. While the overall growth rate may dip slightly due to China's economic deceleration and other factors, the expectation is that the economy will not stall and that, overall, continued steady growth can be expected.

1. Economy picking up

In 2017, Asia's economy maintained its tone of recovery from the latter half of the previous year. Although there are signs of slowing here and there, Malaysia's real GDP growth rate in the April to June quarter (compared to the same period in the previous year) posted high growth for the first time in nine quarters, and Thailand's for the first time in 17 quarters, in addition to which, many countries and regions, including these two, posted a quarter on quarter acceleration in growth in the July to September quarter. This may be explained by the following three factors.

＜Export(Customs Clearing, YoY)＞



Source: Government Statistics, CEIC
Note: Newest Data is the July to September quarter. Taiwan and Vietnam are October.

First, there is the increase in export growth. As the personal consumption driven US economy began to recover, and resource-rich economies began to pull out of the worst of their depression, Asian exports managed to escape the declining trend that had started at the end of 2014, and converted to expansion from around the end of 2016. Further, thanks to the recovery in global demand for electronic parts and components, driven by demand for smartphones, etc., export growth began to pick up momentum, particularly in Korea and Taiwan and other countries related to these products.

Second, domestic demand is picking up. For example, among the ASEAN countries, instead of just short term economic measures, large scale infrastructure development plans have been announced, aimed at expanding inward direct investment, and these are moving towards implementation, albeit gradually. The recent expansion of investments in countries like Indonesia is thought to be a result of the implementation of these public works projects.

Inflation rates have stabilized at lower levels, and this is contributing to the recovery in domestic demand. Prices of primary products such as crude oil and agricultural produce have generally exhibited signs of settling since the start of 2017. With inflation rates trending low globally, the pace of consumer price rises in the countries and regions of Asia has slowed generally. This stabilization of consumer prices has had the effect of substantially improving purchasing power and supporting private sector consumption. Also, since the pace of US monetary policy normalization has remained modest, the capital outflow to

＜Real GDP Growth Rate and Forecast in Asia＞

(Year, %)

	2014 (Actual)	2015 (Actual)	2016 (Actual)	2017 (Forecast)	2018 (Forecast)	2019 (Forecast)
Asia	6.5	6.3	6.3	6.1	6.1	6.0
China	7.3	6.9	6.7	6.8	6.4	6.3
Asia(exclude China)	5.5	5.6	5.8	5.4	5.7	5.7
NIEs	3.5	2.1	2.3	2.9	2.4	2.4
ASEAN	4.6	4.9	4.9	5.3	5.3	5.4
India	7.5	8.0	7.1	6.8	7.3	7.4

Source: IMF *World Economic Outlook* (October, 2017)
Note1: GDP figures are calculated by Purchasing Power Parity of the year 2016. After 2017, the forecast calculating by JRI are based on the calendar year.
Note2: NIEs is composed of Korea, Taiwan, and Hong Kong. ASEAN is composed of Indonesia, Malaysia, Philippines, Thailand, and Vietnam.
Note3: India data on this chart are Fiscal Year (from Apr to Mar).

foreign markets that was raised as a potential risk factor in the previous Outlook (December, 2016) turned out to be short-lived and modest. Currency depreciation bottomed out in the wake of the November, 2016 US presidential elections, meaning that interest rate hikes for the purpose of currency defense and inflation prevention were not carried out, and authorities generally have maintained a monetary easing stance. Indonesia, Vietnam and India implemented interest rate cuts in order to firm up their economic recovery.

Third, China's economy is recovering. In addition to the emergence of the effects of the government's economic stimulus measures, centering on infrastructure investment, the private sector has bottomed out and the economy continues to grow at a pace that will exceed the government's target (around 6.5%) for 2017. The sheer scale of China's economy is a prominent factor (China accounted for 53% of Asia's economy on a purchasing power parity basis in 2016), and its recovery will greatly contribute to Asia's economy overall.

However, despite the continuing recovery, Asia's economic growth rate in 2017 is expected to be 6.1%, compared to the previous year, on a par with 2016's level. In the midst of a generally favorable economic environment, India's economic growth rate fell significantly below the previous year's level, due largely to temporary and special causes such as the turmoil caused by the demonetization of large denomination banknotes, and purchasing restraint in the run up to the introduction of GST, and this has been a major factor in exerting downward pressure on Asia's overall economic growth rate.

2. Four factors supporting strong economic growth in 2018

Looking ahead to Asia's economy in 2018, while economic growth rates in some countries and regions may fall below 2017's levels due to a recoil as the effects of government measures begin to wane, the expectation is that this will not cause the economy to stall. Viewed overall, it is expected that the economy will be supported by 1) sustained recovery in foreign demand, 2) continued robust domestic demand, 3) stabilization in the international money flow, and 4) stable growth in the Chinese economy. These four factors are examined separately in more detail below.

(1) Sustained recovery in foreign demand

First of all, foreign demand is expected to continue to expand throughout 2018 also, against the backdrop of a gentle recovery trend in the global economy. However, there will be some recoil from the recent strong recovery in exports and it may be difficult to expect a major increase in export growth.

In terms of individual countries, exports to the US are expected to grow solidly against the backdrop of the trend of self-sustaining recovery in the US economy. As the US is one of Asia's most important export destinations, continued steady growth in the US economy will make a positive contribution to Asia's economy.

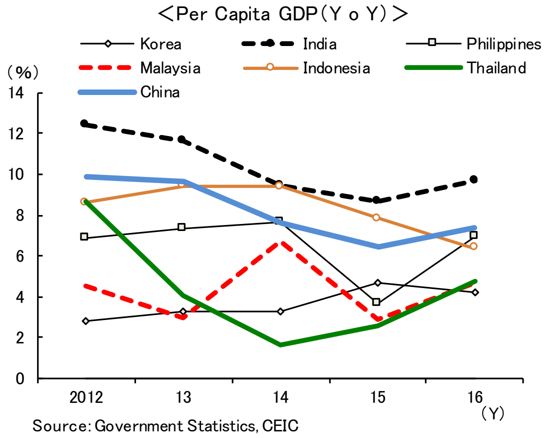
In terms of individual export items, attention is being paid to IT related demand trends. The number of subscriptions to mobile phones and smartphones worldwide is forecast to continue to grow at a modest pace from 2018 onwards (Ministry of Internal Affairs and Communications "White Paper 2017 Information and Communications in Japan" figure, lower right). In addition, there are trends becoming more and more obvious, such as the enhanced provision of data centers, automatic driving and the increased utilization of telecommunications equipment in distribution and other sectors, which will contribute to the sustained growth of IT related demand in the mid to long term.

However, with regard to smartphone demand, the same rapid growth that has been seen until now may be difficult to expect in the future, as penetration rates increase and replacement purchase cycles grow longer. There are already some signs of subscribers tending to hold back on replacing their current models in anticipation of the later launch of more advanced smartphones. In the light of these developments, while the expansion of IT related demand is expected to be sustained through 2018, there is every possibility that the pace will be modest at best. While the export and production of IT related products and parts and components in Asia is thought likely to maintain its growth impetus, it will be unlikely to demonstrate the same vigor as in 2017.

(2) Continued robust domestic demand

With regard to domestic demand, consumption and investment in each country and region are expected to continue to expand strongly.

In consumption, continued rising income levels will be the driver of expansion. Per capita GDP in Asian countries continues to grow at high levels, and macro-economic wage levels are improving steadily. Also, while commodity prices are expected to rise slightly due to economic improvements, factors such as the stability in resource prices and global residual product oversupply mean that prices are likely to be maintained in a stable condition. The composition in which increased incomes and low inflation rates lead to further increases in real purchasing power, resulting in turn in a robust expansion in consumption, is expected to continue in many countries and regions in 2018 also.

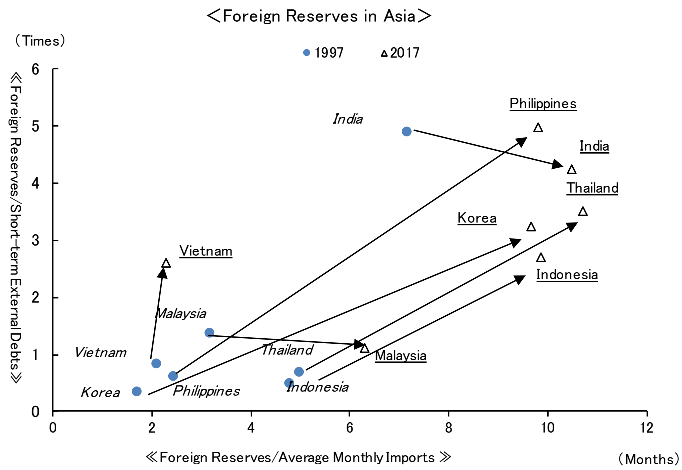


Source: Government Statistics, CEIC
Note: India data are Fiscal Year (from Apr to Mar).

Given the current situation in which infrastructure development is failing to keep up with demand, there are expectations that infrastructure investment will expand strongly. For example, in Indonesia and the Philippines, work based on the aforementioned development plans is gradually going ahead and it is envisioned that this will contribute to the boosting of growth. In India too, in October of 2017, comprehensive economic stimulus measures that included road construction were announced, and these will likely be a factor in boosting investment expansion and further economic growth from 2018 onward.

(3) Stabilization in the international money flow

The international money flow, which is often regarded as a weak point of the countries and regions of Asia, is not expected to exert a negative influence on Asia's economy, for the time being. The normalization of European and US monetary policies, feared to be the biggest destabilizing factor, is expected to proceed at a modest pace, thanks to continued low inflation rates and the cautious stances of central banks, so that turmoil in the money flow is highly unlikely.



Source: CEIC (Original Sources are World Bank, Government Statistics)
Note: Year 2017 is newest end of month. However, short-term external debt of Vietnam is the end of 2016.

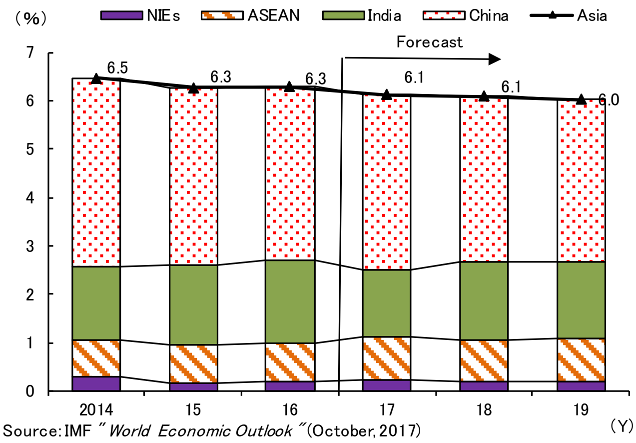
Also, having learned the lessons of the Asian currency crisis, Asian economies have strengthened their measures against capital outflow, increasing their foreign exchange reserves, for example, and the risk of another currency crisis has decreased. As referred to above, the currency depreciation that had continued since the US presidential elections in 2016 turned out to be a temporary phenomenon, and exchange rates have been performing steadily recently (November, 2017). These developments, providing as they do a tailwind for growth in trade and consumption and an expansion in direct inward investment, may be said to be leading to solid growth in Asia's economies.

(4) Stable growth in the Chinese economy

Whether the Chinese economy can maintain stable growth is one of the most important points when looking ahead to Asia's economy in 2018 and beyond. In anticipation of the conclusion, the expectation is that, while the Chinese economy cannot avoid some deceleration, it is not likely to stall completely. In order to get to grips with structural adjustment centering on measures to suppress the overheating of the housing market and to clear overcapacity and excess debt, the Chinese government is shifting its policy stance towards tightening (see “China” for details). Under these circumstances, for the time being it is unlikely that the effects of a series of tightening measures will be identified, leading to the implementation of additional measures. If there are signs that the economy is going to suffer a greater downswing than had been expected, it is thought likely that the government will implement measures such as fiscal stimulus in order to avoid economic stalling. In this way, under the control of the government, the outlook is that the Chinese economy will experience a gentle deceleration, while avoiding a complete stall. With this scenario of a soft landing towards stable growth, there is expected to be no negative impact on other Asian economies.

Taking the foregoing points together, Asia’s economy in 2018 may be expected to grow at around the same pace as in the previous year. First, China’s economic growth is expected to decelerate slightly, at 6.4%. In other countries and regions, the outlook is that economic growth will not falter, thanks to the sustained recovery in foreign demand and continued solid growth in domestic demand, and that growth will continue strongly overall. India’s economy is expected to accelerate to growth in the 7% range, as political downside factors begin to wane. As a result of these developments, Asia’s economy overall is expected to grow at 6.1%, on a par with the previous year’s performance. In 2019 also, the basic recovery composition will not change. Though China’s economy will decelerate at a gentle pace, other Asian countries will be able to maintain solid economic growth, so that overall growth is forecast to be on the order of 6.0%.

<GDP Growth Rate in Asia by Country and Region>



Source: IMF "*World Economic Outlook*" (October, 2017)
Note: Growth rates are calculated by Purchasing Power Parity of the year 2016.
The figures after 2017 are forecasts by JRI.

3. Downside risk

Against the main scenario of continued robust growth overall in both domestic and foreign demand, there are the following three downside risks.

The first is the stalling of the Chinese economy. The Party Congress in the autumn of 2017 saw a further intensification of the concentration of political power in General Secretary Xi Jinping. While it is hoped that this will be a motive force for the promotion of reform, the flip side is that the weakening of the administration’s internal check functions, etc., gives rise to the risk of economic policy failure.

The second is trade friction with the US and Asia. The Trump administration has started negotiations to review the US – Korea FTA, and is also working to correct trade imbalances with Asian economies other than China. The US has trade deficits across the board with the economies of Asia, so it is possible that countries other than China or Korea will bear the brunt of negotiations and corrective actions. If that happens, these countries will not be able to avoid the negative impact of such developments, such as a slump in their exports to the US. In particular, Vietnam, whose exports to the US account for a large proportion of the total, would likely suffer a serious impact across its entire economy.

The third is the lull in the global demand for electronic parts and components. Should smartphone demand peak and IT related demand convert to a decline globally, the negative impacts on Korea and Taiwan, which are highly reliant on parts and components exports, will become quite significant.

For many Asian countries, these downside risks are exogenous factors, and they do not have many options in terms of risk reduction measures. These countries and regions face the common challenge of creating a domestic demand base that is capable of withstanding external shocks, through policy measures that contribute to the strengthening of their industrial competitive strength and the sustainable expansion of consumption, etc.

(Junya Sano)

NIEs Strong growth continues overall

■ Gently paced recovery is the keynote

The NIEs's (excluding Singapore) real GDP growth rate in 2017 is expected to have been 2.9%, compared to the previous year, picking up speed from 2016 (2.3%).

In 2017, each country is expected to have achieved high growth levels of between the upper 2% to upper 3% ranges, with robust exports leading the recovery. In particular, following the expansion in IT related demand for semiconductors, exports of electronic parts and components are expected to recover significantly from their slump. In addition, in response to the increase in exports, it is expected that employmen t and incomes situations will improve and that consumer sentiment will stay positive, the result of which will be a continued, gentle expansion in domestic demand also.

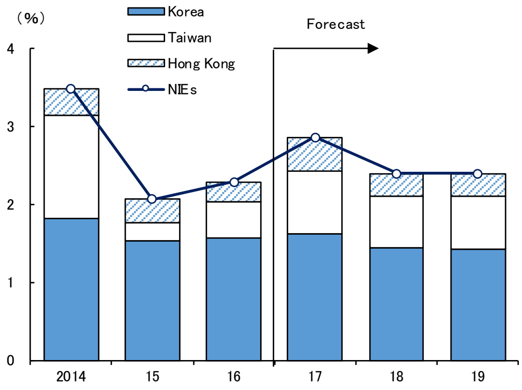
However, for countries and regions that have a high degree of economic dependence on China, maintaining a diplomatic relationship with China is a challenge, and uncertainty over the future remains. In Korea there are concerns that countermeasures implemented by China in retaliation for the deployment of THAAD could result in a prolonged stagnation in exports of services and automobiles. In Taiwan, while there has been no significant worsening in relations since the inauguration of the Tsai Ing-wen administration, neither has there been any progress towards improvement, and the ruling Democratic Progressive Party's approval rating is declining. China's influence in Hong Kong is strengthening, with some pro-democracy councillors being stripped of their qualifications because of violations of their oaths of allegiance, and the possibility of slipping into political unrest remains.

＜Real GDP Growth Rate and Forecast of NIEs＞

	2014 (Actual)	2015 (Actual)	2016 (Actual)	2017 (Forecast)	2018 (Forecast)	2019 (Forecast)
NIEs	3.5	2.1	2.3	2.9	2.4	2.4
Korea	3.3	2.8	2.8	2.9	2.6	2.6
Taiwan	4.0	0.7	1.5	2.5	2.0	2.1
Hong Kong	2.8	2.4	2.0	3.6	2.4	2.4

Source: IMF, Government Statistics

＜Real GDP Growth Rate of NIEs (Y o Y Contribution)＞



Source: IMF, Bank of Korea, Directorate-General of Budget, Accounting and Statistics, Executive Yuan, Census and Statistics Department

In addition to these challenges on the diplomatic front, as first the US and then European monetary policies gradually drift towards the correction of monetary easing, the global trend towards the normalization of monetary policy is beginning to have an influence on policy in the NIEs, with Korea exploring rate hikes and Hong Kong's dollar pegged rates rising in linkage with those in the US, for example.

From 2018 and beyond, as the global economy posts a gently paced recovery, mainly in Europe and the US, the improvement export growth is expected to provide the backdrop to a continued trend of recovery. However, in addition to the loss of momentum in semiconductor export growth, which is the economic growth driver in Korea and Taiwan, tougher restrictions on housing investment and higher policy interest rates are expected to blunt the pace of recovery, so that the NIEs overall are forecast to grow by 2.4% in 2018, and 2.4% in 2019, decelerating from 2017. Further, geopolitical risks, such as the North Korean situation, remain, and attention will need to be paid to the impact on trade and financial markets.

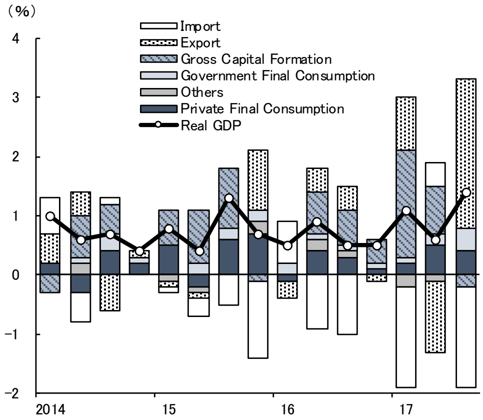
1. Korea 2.9% economic growth in 2017, 2.6% in 2018

■ 2.9% growth in 2017

Korea's real GDP growth rate in the July to September quarter of 2017 was 1.4% compared to the same period in the previous quarter, accelerating from the April to June quarter (0.6%).

Examination of the breakdown shows that export growth accelerated significantly against the backdrop of increased demand for semiconductors and other electronic parts and components, and a recovery in service exports, which had been in a slump. In addition, private sector consumption grew solidly at 0.4%, and government expenditure grew 0.4%, due to the growth in expenditure in support of employment, in line with the supplementary budget established in July. On the other hand, the pace of recovery seems to have run out of steam recently, with a deceleration in equipment investment, which had maintained vigorous growth since 2016, in addition to the slowing of the pace of growth in construction investment, which had been a driver of economic growth in recent years.

＜GDP Growth Rate and Contributions by Expenditures＞



Source: Bank of Korea, Economic Statistics System

In the October to December period, in addition to strong semiconductor demand following the introduction of new smartphone products, as the global economy continues to recover, it is thought likely that exports overall will continue to perform strongly. Also, as regards domestic demand, the improvements in the employment situation as the result of the implementation of the supplementary budget, and the accompanying strong consumer sentiment, are expected to lead to continued growth in private sector consumption. Given these circumstances, the projected growth for 2017 is 2.9%, exceeding the previous year's performance.

■ Economic growth expected to slow to 2.6% in 2018, and stay at 2.6% in 2019

In 2018, Korea's economy is expected to decelerate somewhat, with a lull in export momentum, which has been the driver of economic growth, and an expected slowing in housing investments in response to tougher household debt controls by the government in the face of expanding household debt.

Private consumption is expected to continue to increase strongly, against the backdrop of improvements in the employment and incomes situation, and rising asset prices. The hiring of more civil servants and the raising minimum wage levels, which were among the election promises of the Moon Jae-in administration, are expected to have the effect of improving incomes. In 2018, the minimum wage level will go up by 16.4%, compared to the previous year, a very significant increase compared to the 7 to 8% increase of that year. In addition, the asset effect of rising share prices is also expected to contribute to an expansion in private sector consumption. However, there is a possibility that 1) additional interest payments due to increased household debt, and 2) various increased dues for the expansion of social security, etc., will become a burden. In addition, with regard to monetary policy, as interest rates are expected to go up in the future, the forecast is that the pace of recovery in private sector consumption will be modest at best.

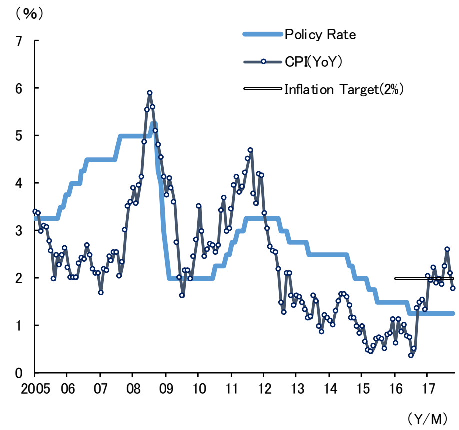
Export growth is expected to continue to recover across a wide range of items as economic recovery continues among the industrialized nations, particularly the US, and the deceleration of China's economy stays at a modest pace. However, semiconductors and other electronic parts and components will not be able to avoid a blunting of momentum in recoil from the strong growth that they enjoyed in the previous year, and it will be difficult to expect growth at the same levels as 2017. It is thought likely that, as the number of cloud services and the like increases, demand for memory capacity for data centers will continue to grow strongly, but as the penetration rate of smartphones has peaked, expansion in 2018 is expected to be modest at best. While the demand for semiconductors in new fields, such as IoT, automatic driving and AI, is becoming more pronounced, it will likely take some time before this contributes to an expansion in export growth. Meanwhile, there is expected to be an improvement in services exports, which have been in a slump. In retaliation for Korea's deployment of THAAD, China has suspended the sales of group tour packages to Korea, and the number of Chinese visitors to Korea continues to fall significantly. However, in October of 2017, the leaders of the two countries reached agreements aimed at improving relations, and in November the Korean government launched a tourism promotion plan targeting inbound tourists from China and Southeast Asia, and there is a strong probability that the situation may begin to recover in the future.

With regard to gross fixed capital formation, while construction investment continues to struggle to grow, equipment investment is expected to continue to grow solidly. While monetary easing policies were encouraging lending rates to come down significantly, construction investment, particularly in housing, continued to grow strongly, but at the same time there was a drastic surge in household debt. Concerned about the situation, from 2016 the Korean government brought out a series of measures, including tougher screening standards for housing loans. As a result, the number of housing construction permits declined by more than 10% in 2017, new construction floor space is also decreasing, and the effects of monetary tightening are gradually beginning to make themselves felt. In October of 2017, a new set of measures aimed at curbing household debt was announced. In addition to this, future interest rate increases are expected, making it difficult to anticipate an increase in construction investment. On the other hand, the introduction of state of the art equipment by semiconductor manufacturers continues to drive growth in plant and equipment investment, and the rally in prices of raw materials is expected to lead to a modest paced recovery in plant and equipment investment in materials related industries. However, with the shift of automobile production to overseas plants and prolonged restructuring in the shipbuilding industry, there are industry sectors where the pace of recovery will possibly be very slow.

In addition, the monetary policy stance has been one of relaxatio n thus far, and the policy interest rate has remained at the historically low level of 1.25%. While the economy continues to recover currently, given that Central Bank governor Lee Ju-yeol has spoken of a review of the policy interest rate and the consumer price rise rate is closing in on Central Bank's target inflation rate of around 2%, it is expected that, sooner or later, Central Bank will embark upon monetary tightening.

Based on the foregoing, the forecast is that the economic growth rate in 2018 will slow from the previous year to 2.6%, and will remain at 2.6% in 2019, bolstered by the employment policies of the Moon Jae-in administration and sustained growth in exports as the global economy recovers.

＜Policy Rate and Consumer Price Index＞



Source: The Bank of Korea, Statistics Korea

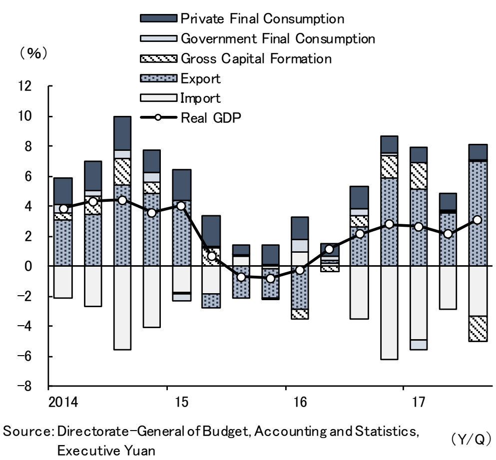
2. Taiwan　2.5% growth in 2017, slowing to 2.0% in 2018

■ Growth accelerating with exports in the driving role

Taiwan's real GDP growth rate for the July to September quarter of 2016 (compared to the same period in the previous year, hereafter the same) was 2.1%, a significant improvement on the previous period (0.7%).

Part of the background to this may be said to be, in addition to a large increase in exports of flagship products such as semiconductors, an expansion in public works investments. Also, private sector consumption, which had tended to decelerate from the latter half of 2015 onwards, continued to grow steadily at 2.4%, and gross capital formation, which had been growing negatively for six consecutive quarters, moved to positive growth, and these developments pushed up the growth rate.

＜GDP Growth Rate and Contributions by Expenditures＞



Source: Directorate-General of Budget, Accounting and Statistics, Executive Yuan

In the October to December quarter also, the introduction of new smartphone products, which had been put back, is expected to lead to a surge in the growth of semiconductor related exports, and this will continue to drive economic growth. In addition to this, as the prices of raw materials begin to rally, the outlook is for continued recovery across a broad range of industries. Also, the employment situation is expected to continue to improve, reflecting strong corporate performance figures. Although gross capital formation continues to be in a slump, the main reason behind this is believed to be a concentrated investment lull on the part of semiconductor manufacturers, and the risk of a significant downswing in the corporate sector is slight. Given the foregoing, the forecast is for 2.5% growth in the whole year 2017.

■ **2.0% growth in 2018**

In 2018, economic growth is expected to slow down as export growth peaks, but against a backdrop of solid private sector consumption and infrastructure investment plans leading to a recovery in gross fixed asset formation, growth of 2.0% is expected.

With regard to exports, although the growth trend is thought likely to continue as a result of the improvement in the global economy, given the fact that there is expected to be a decline, in recoil principally from the massive growth enjoyed by semiconductors, in 2017, and with the emergence of Chinese competitors and the advance of the shift of production to overseas plants, the expectation is that the pace of growth will be fairly pedestrian, compared with that of 2017. The penetration rates of smartphones, which have been supporting the recent demand for semiconductors, are rising in both the developed and emerging economies, and replacement purchase cycles are becoming longer in some countries due to the spread of high end products. Also, in Taiwan, where semiconductor production is mainly by foundries, demand from China is likely to dwindle gradually as the Chinese government hammers out policies aimed at increasing China's self-sufficiency in semiconductors.

With regard to gross capital formation, while private sector plant and equipment investment may lack vigor due to the blunting of export growth, there is expected to be an increase in public works investment due to large scale infrastructure investment plans, and gross capital formation is expected to grow solidly overall. In terms of plant and equipment investment, it is thought likely that there will continue to be strong investment in semiconductor manufacturing equipment and labor saving equipment, such as manufacturing line automation devices, etc. However, in anticipation of a slowdown in the momentum of export growth, it is expected that investment in research and development, etc., will continue to be lackluster. On the other hand, there are hopes that the "Forward-looking Infrastructure Program", a large scale infrastructure investment plan announced in March, 2017, will help to bolster the economy. The Program entails an investment of some NT$882.3 billion over an eight year period from 2017 on railroad upgrades and improvements to digital industry facilities. A special budget for the Program was passed in August.

Despite the slowing pace of improvements in the employment and incomes situations, which reflect the blunting of export growth momentum, private sector consumption is expected to remain firm, due to the asset affect and price stability resulting from share price appreciation and other factors.

In 2019, as the global economy continues a moderate recovery, especially among the industrialized nations, Taiwan's exports will likely stay firm, and economic growth of 2.1% is forecast.

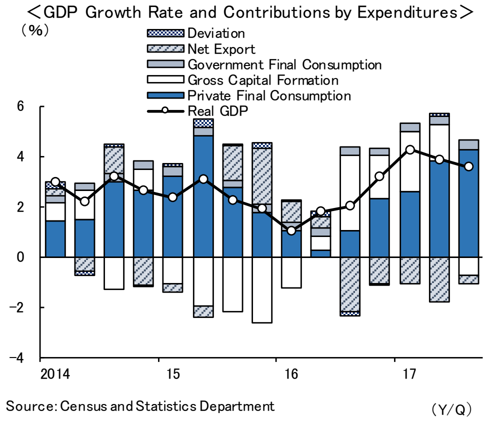
3. Hong Kong 3.6% economic growth in 2017, 2.4% in 2018

■ **3. 6% growth in 2017**

Hong Kong's real GDP growth rate in the July to September quarter of 2017 was 3.6% (compared to the same period in the previous year), decelerating slightly from the April to June quarter (3.9%), but continuing strongly nevertheless.

In spite of the fact that gross capital formation changed to negative growth as a result of deceleration in private sector plant and equipment investment, export growth increased strongly due to the global economic recovery, and private sector consumption bolstered economic growth, reflecting the improved employment situation in the region. 2017 looks set to post 3.6% growth, the highest level since 2013.

＜GDP Growth Rate and Contributions by Expenditures＞



Source: Census and Statistics Department

■ **Deceleration in 2018, growth in 2% range**

It is expected that 2018 will see a deceleration in recoil from the high growth posted in 2017.

In terms of private sector consumption, due to the lull in the rise in real estate prices, the asset effect that boosted consumption in 2017 is expected to weaken. As the Hong Kong dollar is pegged to the US dollar, Hong Kong's policy interest rate will go up in tandem with future US interest rate hikes, so increased bank lending rates will mean that stronger downward pressure on real estate prices cannot be avoided. However, given that the pace of US interest rate hikes will be mild, and that Hong Kong's employment and incomes situations are good, any deceleration in private sector consumption will likely be a limited one.

As for exports, given the fact that China's economic deceleration will be a mild one, and that the global economy continues to recover, solid growth is expected to continue. In addition, services exports, which had been a factor exerting downward pressure, are expected to turn to a positive contribution. Chinese visitors to Hong Kong account for 70% of the total of overseas visitors, and this number is recovering and expected to continue to do so.

Based on the foregoing, the forecast is for 2.4% economic growth in 2018, staying at 2.4% in 2019 thanks to support from domestic demand.

(Kentaro Matsuda)

ASEAN Strong economic growth in 2018 also

■ ASEAN economic growth accelerates in 2017

The real GDP growth rate for ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) in 2017 is expected to turn out to have accelerated to 5.3%, compared to the previous year, the highest growth rate in five years. Although the Philippines suffered deceleration in recoil to the economic boosting that followed the general elections and presidential elections in 2016, the other countries are expected to enjoy strong growth rates as a result of progress made with infrastructure development projects and robust export growth, etc.

＜Growth Rate Prospects of ASEAN5＞

(%)

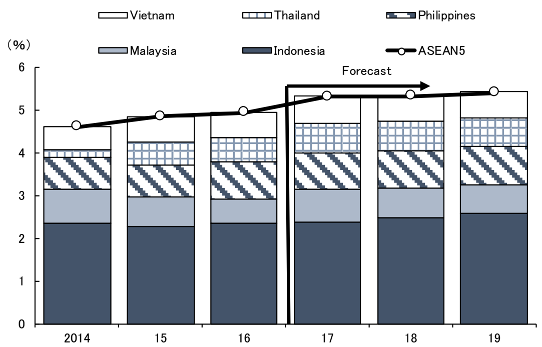
		2014 (Actual)	2015 (Actual)	2016 (Actual)	2017 (Forecast)	2018 (Forecast)	2019 (Forecast)
ASEAN5		4.6	4.9	4.9	5.3	5.3	5.4
	Indonesia	5.0	4.9	5.0	5.1	5.3	5.5
	Malaysia	6.0	5.0	4.2	5.8	5.2	4.9
	Philippines	6.1	6.1	6.9	6.6	6.8	6.9
	Thailand	0.9	2.9	3.2	4.0	3.9	3.9
	Vietnam	6.0	6.7	6.2	6.7	6.3	6.4

Note : "ASEAN5" is the weighted average value.
Source : Government Statistics, IMF

■ Economy expected to continue to recover

For 2018 and beyond, the forecast is that the economies of ASEAN5 will continue to perform solidly. In terms of domestic demand, while inflation rates continue to stay low, private consumption will continue to grow strongly, and as infrastructure related projects get fully underway, the growth momentum of gross capital formation is expected to strengthen. In addition, general elections are slated for 2018 in Malaysia and Thailand, and 2019 in Indonesia, and there is a strong probability that the resulting swell in consumpion and expansion in government expenditure will contribute to a boost in economic growth rates. Meanwhile, although the gradual recovery in the global economy will provide some support to growth in foreign demand, there are signs that there will be a recoil to the strong increase enjoyed in the previous year, so it is anticipated that growth momentum will be blunted in 2018. In addition, the ASEAN countries are dependent on imports for a high proportion of intermediate goods and capital goods so, as the upgrading and development of infrastructure gets underway, the resulting increase in imports is thought likely to exert downward pressure on their growth rates.

＜Real GDP Growth Rate of Contribution by Countries of ASEAN5＞



Source : Governemnt Statistics, IMF

Given these factors, although the economies will expand at a steady pace in 2018 and beyond, it is not thought likely that they will post any substantial acceleration in growth. The forecast for the ASEAN 5 growth rate is 5.3% for 2018, and 5.4% for 2019.

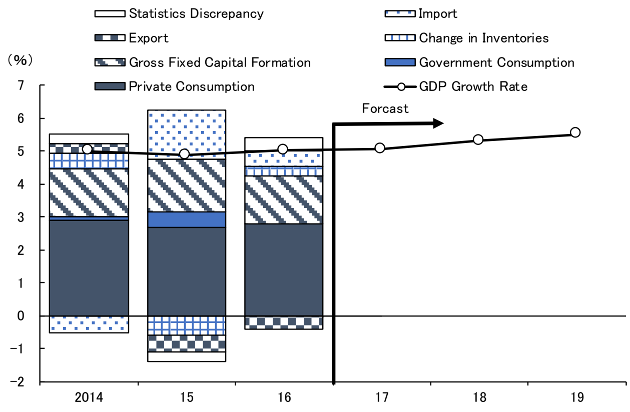
Meanwhile, given the expansion of infrastructure related expenditure in ASEAN5, there are concerns about the possible deterioration of fiscal discipline in these countries. In developing countries, infrastructure development contributes to future economic growth by virtue of expanded direct inward investment and improved economic efficiency, etc., so it is not necessarily a bad thing to have a temporary fiscal deficit. However, looking back on the past, there have been many examples in emerging economies where, even though funds have been made available for infrastructure development, problems such as land expropriation and corruption have hindered the progress of actual construction and development, and have derailed infrastructure development plans. Also, as the US and Europe move ahead gradually with the normalization of their financial policies, it is all the easier now for capital to flow out of emerging economies. This means that, if infrastructure development plans end in failure and concerns over deteriorating fiscal discipline become stronger, this may trigger the withdrawal of capital from ASEAN5 and lead to sudden and drastic currency depreciation and stalled economic growth. The countries of ASEAN5 will not only need to expand their budgets, but will also need to implement measures to reform systems and eradicate corruption, in order to proceed with the development of systems that allow them to implement policies swiftly and steadily, and enhance their administrative and operational abilities in order to complete their infrastructure projects as planned.

1. Indonesia Growth to accelerate to 5.3% in 2018

■ Growth accelerates to 5.1% in 2017

Indonesia's real GDP growth rate for 2017 is expected to be 5.1%, compared to the previous year, which is slightly shy of the government's target (5.2%, similarly), as expressed in the fiscal 2017 supplementary budget, but still a slight gain on 2016 (5.0%). Though measures to suppress government expenditure in the first half of the year proved a hindrance to economic performance, export growth momentum expanded as the global economy improved, and the acceleration of infrastructure development in the latter half of the year played a driving role.

＜Real GDP Growth Rate and Contribution by Expenditures＞



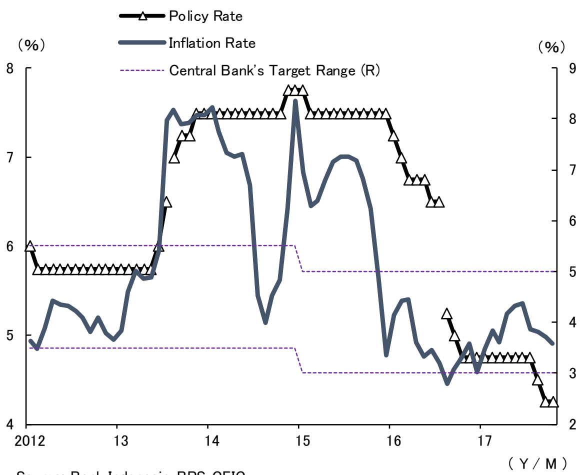
Source: BPS

■ Recovery tone to continue through 2018, 2019

From 2018 onwards, the recovery pace of Indonesia's economy is expected to intensify.

Looking at 2018 in more detail, the expectation is that the pace of increase in raw materials prices will remain moderate, and that private consumption will continue strongly, encouraged by the tailwind of low inflation. Furthermore, expanded government spending in anticipation of the general elections and presidential elections due to be held in 2019, and the acceleration of infrastructure upgrading and development work, will likely give something of a boost to government expenditure and gross fixed capital formation. In fact, in the fiscal 2018 budget, the total expenditure is increased by 6.7% compared to the initial budget for fiscal 2017, the first time in two years that a budget has exceeded the initial budget of the previous fiscal year. In addition to this, the infrastructure related budget was also increased by 5.9% compared to fiscal 2017. In addition, with the spread of the effects of the interest rate cuts implemented in August and September of 2017, private investment is expected to swell.

＜Policy Rate and Inflation Rate＞



Source: Bank Indonesia, BPS, CEIC
Note: On Aug. 2016 Bank Indonesia changed the policy rate from BI rate to 7 days reverse repo rate.

On the other hand, although foreign demand will receive some support from the gradual expansion of the global economy, the recoil reaction from the previous year's sudden recovery will likely cause growth to contract. Nevertheless, since the driving force of domestic demand is expected to exceed this, the economic growth rate for 2018 looks likely to accelerate 5.3%, compared to the previous year.

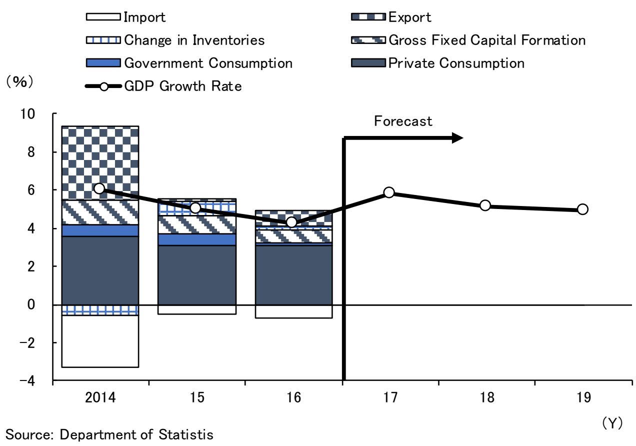
The focus of attention going forward will be on to what extent the Joko administration, facing the end of its term of office in mid 2019, can produce results from reform. Since its inauguration in October of 2014, the Joko administration has aggressively tackled the structural reform of Indonesia's economy, through the elimination of fuel subsidies and the intermittent application of economic stimulus packages, etc. However, the economic growth rate thus far is still far removed from the 7% target originally set by the administration, and it must be said that reforms so far have not yet borne much fruit. A major cause of this has been that there are many obstacles in the implementation of reform, so that even if system reform is implemented, there are still many problems with on-site operation. With one and a half years left to go, all eyes will be on whether the administration can put systems in place for the thorough implementation of the reforms it has presented until now, and make them effective.

2. Malaysia 2018 growth rate to slow to 5.2%

■ Growth rate rallies strongly to 5.8% in 2017

Malaysia's real GDP growth rate in 2017 is expected to be 5.8%, compared to the previous year, the first improvement in three years. Foreign demand powered economic growth. In terms of exports, against the backdrop of a global economic recovery and expanded IT demand, main export items such as palm oil and semiconductors have continued to perform strongly. Meanwhile in terms of domestic demand, the low inflation rate, an increased minimum wage and increases in benefit payments to low wage earners have led to a strong expansion in private consumption. Also, increasingly active private sector investment following the significant increases in export growth have led to a big expansion in gross fixed capital formation.

＜Real GDP Growth Rate and Contribution by Expenditures＞



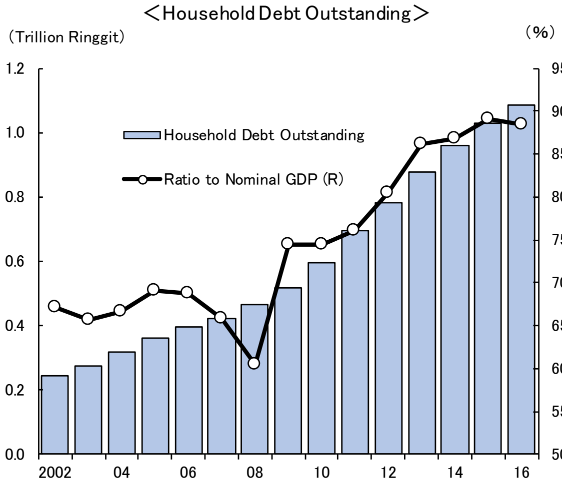
Source: Department of Statistis

■ Growth rate to decline from 2018 onward

The declining trend in Malaysia's economy is expected to intensify once more in 2018 and 2019.

In the first half of 2018, the growth rate is thought likely to continue at a high level. Though exports may contract due to a recoil from the rapid increase in the previous year and a pause in the expansion of IT demand, as the vitalization of election related expenditure accompanying the general elections scheduled for springtime boosts domestic demand, the forecast is that the economy overall will continue to perform solidly.

＜Household Debt Outstanding＞



Source: Bank Negara Malaysia

In the latter half of the year, in addition to deceleration in foreign demand, domestic demand will also be weak and the sense of economic deceleration is expected to intensify. As regards private consumption, while the continued low inflation rate is one supporting factor, together with government consumption, the lull in election related expenditure will be one factor exerting downward pressure, in addition to which high levels of household debt will be a hindrance to growth. Given these factors, the economic growth rate for 2018 is forecast to be 5.2%, compared to the previous year.

In 2019, while foreign demand will be able to escape from its recoil decline phase, domestic demand will feel the full effects of recoil decline from election related demand, so the economic growth rate is expected to be 4.9%, year on year, falling below the 5% mark for the first time in three years.

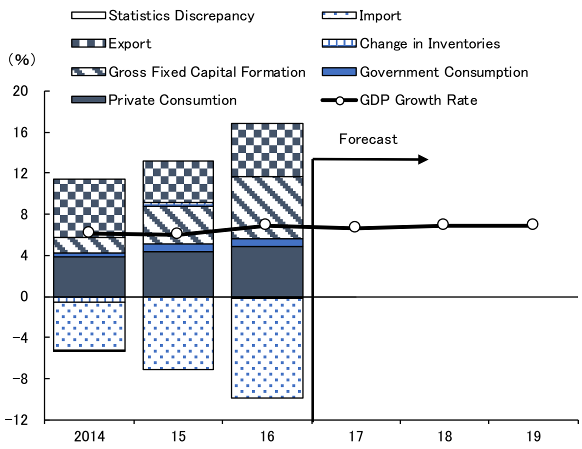
On the political front, as mentioned above, Malaysia is due to hold its first House of Representatives election in the spring of 2018. The massive economic acceleration enjoyed in 2017 is expected to provide a tailwind to Prime Minister Najib's "United Malays National Organization (UMNO)" and other parties in the ruling coalition. However, the cloud of a corruption scandal still lingers over Prime Minister Najib's head, and the situation is still unpredictable. UMNO has been in power since the founding of Malaysia, and Malaysia has been able to grow by attracting foreign capital through maintaining a stable political base. There are concerns that, should the ruling coalition lose a large number of seats in the election, it could have an adverse impact on the economy, such as the suspension of foreign capital investment, etc., and to that extent attention will be on the election results as one factor influencing the mid-term economic outlook.

3. Philippines　Economic growth to rally to 6.8% in 2018

■ Growth slows slightly to 6.6% in 2017

In 2017, though increased export growth in response to a recovery in the global economy did contribute an upward boost, the Philippine economy is expected to have slowed for the first time in four years, due to a recoil from increased expenditure related to the general elections and presidential elections in the previous year, and the effects of delay in the implementation of infrastructure development projects in the first half of the year. Nevertheless, the real GDP growth rate is expected to turn out to have been 6.6%, year on year, maintaining a high level of growth and achieving the government's growth target (6.5 to 7.5%).

＜Real GDP Growth Rate and Contribution by Expenditures＞



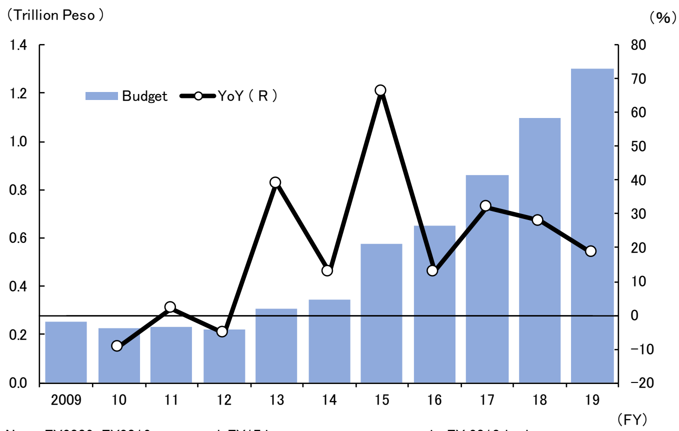
Source: PSA

■ Economy expected to pick up again in 2018 and 2019

The Philippine economy is expected to pick up again from 2018 onward.

The driver of growth will be the government's infrastructure development projects. In April, 2017, the Duterte administration announced plans to carry out infrastructure investment to the tune of 8.4 trillion pesos in the period 2017 to 2022. It is expected that there will be investment of 1.1 trillion pesos in 2018, an increase of 27.9% on the previous year, and 1.3 billion pesos in 2019, an increase of 18.5%, similarly. With the implementation of these investment plans, gross fixed capital formation can be expected to provide support for economic growth. Also, consumption will likely continue strongly, bolstered by low inflation rates and solid homeward remittances by Filipinos working abroad.

＜Public Sector Infrastructure Budget＞



Note: FY2009-FY2016 are actual. FY17 is government prospects in FY 2018 budget.
FY 2018 is budget. FY 2019 is from government materials.
Source: DBM, PSA, "Build-Build-Build"Homepage

However, the fact that the Philippines lags behind other ASEAN countries in terms of the development of its manufacturing industries, this means it is highly reliant on imports of iron and steel and capital goods, so that active infrastructure development tends to result in a big expansion in imports. For this reason, it looks as if net exports will continue to grow negatively through 2018 and 2019, and part of the economic booster effect will be lost.

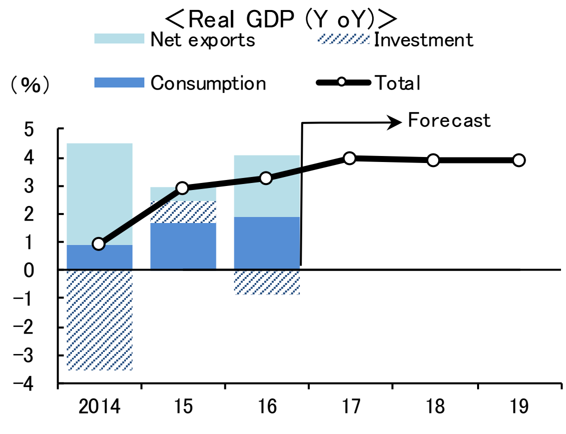
In consideration of the foregoing, the forecast for the economic growth rates in 2018 and 2019 is 6.8% and 6.9%, respectively, a modest improvement trend, but still shy of the government's target (7.0% to 8.0%).

There is growing anticipation that the large scale infrastructure investment plans proposed by the Duterte administration will not only boost the economy in the short term, but will also pump-prime an increase in direct inward investment, thus linking to the mid to long development of the Philippine economy. On the other hand, however, there are many who voice concern over the deterioration of the fiscal situation as a result of increased government expenditure. In fact, in the past, the fragile structure of the Philippine economy, with its permanent fiscal deficit and current account deficit, caused a debt crisis, and the failure to secure foreign capital meant that the Philippine economy was long ridiculed as the "sick man of Asia". In order to dispel concerns about the fiscal situation, the government is preparing a package of five taxation system reforms that will include an expansion of the taxable scope of value added tax, and much attention will be paid to the timing of the upcoming legislation and its effect on the economy and the fiscal situation.

4. Thailand　Growth rate expected to remain flat

■ Strong growth expected in 2017 for the first time in five years

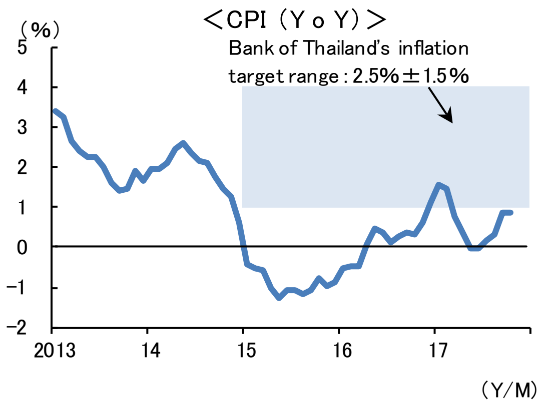
Thailand's real GDP growth rate for 2017 is expected to be 4.0%, year on year, accelerating from the previous year (3.2%, similarly), reflecting robust consumption due to the rise in real purchasing power as a result of low inflation, and increased export growth due to improvements in the global economy. The real GDP rate for the July to September quarter was 4.3%, compared to the same period in the previous year, due mainly to factors such as the rally in gross fixed capital formation and the acceleration in export growth momentum, and the highest growth posted since the January to March quarter of 2013. Although flood damage due to heavy rain in the October to December quarter was one factor that exerted downward pressure on economic growth, it is expected that the growth rate will continue to be strong due to a rebound from the previous year's blunted growth following the mood of self restraint in the wake of the passing of King Bhumibol Adulyadej, as well as the decline in the number of Chinese tourists following the crackdown on "zero dollar tours".



Source: NESDB

■ Economic growth to stay flat in 2018

In 2018, while a favorable employment environment and infrastructure development will help to bolster the economy, in addition to the burden on consumption caused by high levels of household debt, a sense of uncertainty with regard to the sustainability of the global economic recovery, and with regard to political stability after the transition to civilian political rule, will likely cause investment growth to stagnate, and the expectation is that the economic growth rate will decelerate slightly to 3.9%, compared to the previous year. With regard to monetary policy, against the backdrop of the normalization of a low inflation rate that is below the lower limit of the price targets, and the baht's continued strength against the dollar, there are growing calls for the policy interest rate to be lowered. However, from the perspective of a cautious stance with regard to any further increases in household debt and the adverse effects of capital outflow, Central Bank will very likely be indisposed towards additional interest rate cuts. Further, should there be a further increase in upward pressure on the baht due to strong direct inward investment and securities investments following the continued current account surplus and economic recovery, it is thought likely that policy measures such as efforts to promote outward investment and exchange intervention, etc., will be intensified, so the forecast is that economic stalling as a result of excessive baht appreciation will be able to be avoided.



Source: Ministry of Commerce, Bank of Thailand

On the political front, a general election is scheduled for around November of 2018. In the new electoral system, in the Upper House, during the five year transition period, the majority of members will be selected by a committee appointed by the current junta, with some seats allocated to top members of the military and security establishment, so that the military will retain a strong influence. In the Lower House, meanwhile, as the result of a change in the electoral system which makes it easier for the emergence of large political parties to be suppressed, and the Phak Pheu Thai party's loss of influence following former Prime Minster Yingluck's flight out of the country, it is expected to be difficult for pro-Thaksin factions, which wielded considerable influence in past elections, to gain many more seats. In contrast, the current administration has been asking the people in early November about the pros and cons of the junta's forming of a new political party, and its support of specific political parties, and appears to be intent on maintaining some kind of influence in the Lower House. While a continued military influence would secure political stability, there is the possibility that policies would not fully reflect the will of the people.

5. Vietnam Economic growth to slow to 6.3% in 2018

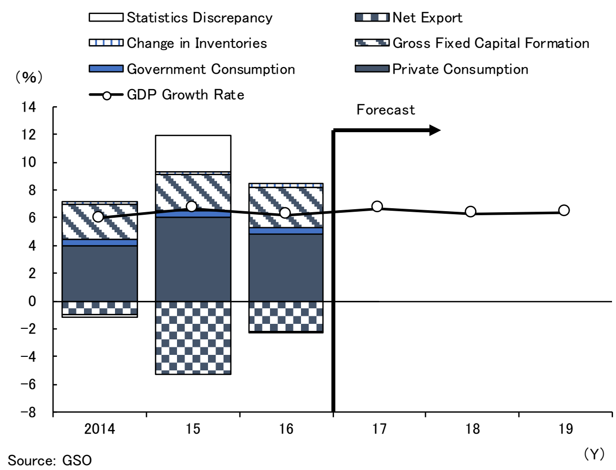
■ 6.7% economic growth in 2017

Vietnam's real GDP growth rate in 2017 is thought likely to come in at 6.7%, compared to the previous year, reflecting the major growth in exports as a result of burgeoning IT related demand, and the progress of infrastructure development projects, and thus meeting the government's target (6.7%, similarly).

■ High growth levels expected to be maintained in 2018 and beyond

In 2018 and beyond, it is expected that Vietnam's growth rate will be in the low 6% range, maintaining a high growth rate in comparison with other Asian emerging economies.

＜Real GDP Growth Rete and Contribution by Expenditures＞



Source: GSO

A detailed examination of 2018 shows that domestic demand will probably continue to perform strongly. The expectation is that private consumption will continue to grow strongly, due to factors such as, persistently low inflation rates due to the mild pace of increase in the prices of raw materials, and expectations of a rally in automobile sales, which had been suffering from buyers' purchase postponements in 2017 in anticipation of the abolition of tariffs within ASEAN. In addition, it is believed that gross capital formation will continue to perform solidly due to factors such as 1) the progress of infrastructure development, 2) the spread of the effects of the interest rate cuts implemented in July of 2017, and 3) the fact that TPP11 has reached broad agreement, and the entry of foreign capital as a result of the FTA with the EU, which is scheduled to come into effect from mid 2018.

In contrast, foreign demand is expected to be weak. While exports will likely enjoy the benefits of the tailwind from economic recovery in Vietnam's major export destinations, the US, EU, Japan and other industrialized nations, there is also expected to be a contraction in growth in recoil to the rapid expansion in 2017. Also, since Vietnam relies on imports for many of its capital goods and intermediate goods, expansion in domestic demand tends to lead to an increase in imports also. In particular, from 2018 onward, tariff barriers within the ASEAN region will be completely abolished, leaving Vietnamese products, which lack competitive strength, prone to being replaced by products from other ASEAN countries, and making increased imports more likely. This means that, as the import growth rate exceeds that of exports, the net export contribution rate will expand negatively. As a result, the economic growth rate for 2018 is expected to decelerate to 6.3%, compared to the previous year.

In 2019, in addition to continued strong domestic demand on the back of vigorous infrastructure demand, exports will continue to perform solidly and the economic growth rate is expected to be 6.4%, compared to the previous year, a slight acceleration from 2018.

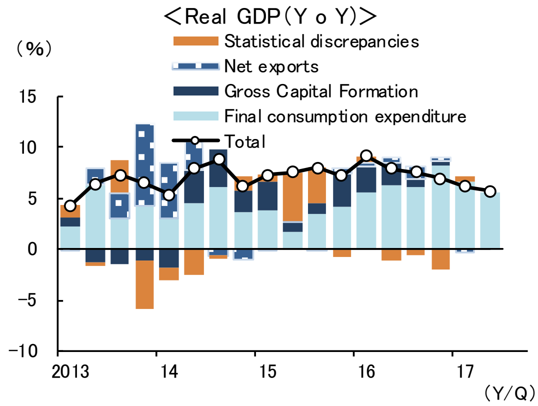
While the economy overall appears to be performing strongly, economic structural reform, on the other hand, has become an imperative. The ASEAN member countries, in principle, were supposed to have reduced intra-regional import tariffs to zero by the time of the launch of the ASEAN Economic Community (AEC) at the end of 2015, but the ASEAN late starters, Cambodia, Laos, Myanmar and Vietnam, as an exception, were to be allowed to delay the deadline for the elimination of tariffs to 2018, for certain products such as automobiles and the like. The elimination of import tariffs will mean that consumers will be able to purchase goods more cheaply, but on the other hand, domestic industries will be exposed to competition. In Vietnam, there are many state owned enterprises in the market, and many point out that this hinders the development of efficiency in the economy. In order to maintain high growth levels in the mid term, it will be essential to fundamentally improve corporate competitive strength.

Thailand:（Shotaro Kumagai）
Excluding Thailand：(Yuta Tsukada)

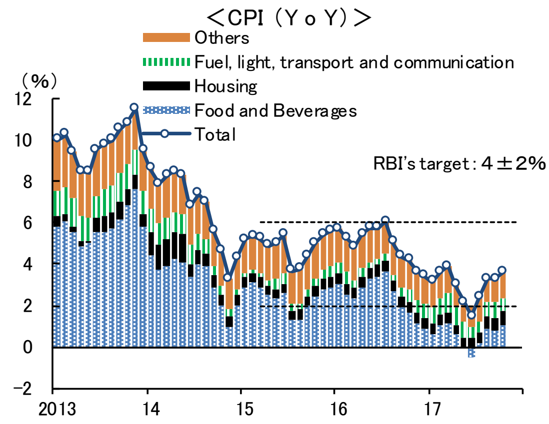
India Robust growth sustained

■ 6.8% growth in 2017

India's economy continued to decelerate through the first half of 2017, against the backdrop of the economic and social turmoil caused by the cash shortages that followed the sudden decision in November of 2016 to abolish high denomination paper currency, and the inventory adjustments that were made necessary by the introduction of GST (Goods and Services Tax) from July of 2017. The real GDP growth rate in the April to June quarter of 2017 was 5.7%, compared to the same period in the previous year, the lowest growth rate since the January to March quarter of 2014, against the backdrop of a deceleration in private sector consumption following the reluctance to purchase automobiles and other items before the introduction of GST. From July onward, though there have been media reports of some companies continuing to expe rience confusion related to the introduction of GST, monthly economic indices, such as the industrial production index, exports, automobiles sales figures, etc., are steady, and it has been judged that the economy is changing to recovery. Against this backdrop, SENSEX, a representative stock price index, posted a new historical high at the end of October, due to improved consumer sentiment following the global trend of higher stock prices and advances in domestic economic reform.



Source: Ministry of Statistics and Program Implementation



Source: Central Statistics Office

One reason that the Indian economy is performing strongly in spite of the confusion caused by the demonetization of high denomination bills and the introduction of GST may be said to be the improvement in households' real purchasing power, due to the settling of imported energy prices and lower food inflation due to good weather. Consumer prices have stayed close to the lower limits of Central Bank's target (4±2%, year on year), and in June rose 1.5%, falling below the target range. Subsequently, although the consumer price growth rate did rise from July, after the introduction of GST, it has nevertheless continued to be stable. In response to a slower growth rate in the April to June quarter, and a stable inflation rate, at a monetary policy meeting in early August, Central Bank voted to lower the policy interest rate (repo rate) to 6.0%, the lowest rate since October of 2010. Consumption also provided some support on the interest front.

In terms of the economic outlook for the near future, it is expected that the real GDP growth rate for the July to September quarter will have recovered to the 6% range, compared to the same period in the previous year, due to the end of inventory adjustments. Further from the October to December quarter onwards also, as the impact of last year's demonetization of high denomination bill wears off and the effects kick in of a range of economic measures implemented by the government in late October, including road construction and support measures for small and medium sized enterprises and farming households, etc., the growth rate is expected to strengthen to the 7% range. As a result, the economic growth rate for fiscal 2017 (April of 2017 to March of 2018) is expected to be 6.8%. With regard to prices, though economic recovery will have the effect of increasing inflationary pressure, the forecast is that the fact that the GST basic tax rate on over 200 items has been lowered from mid-November will mean that the pace of price rises will be modest. From the perspective of a gradual rise in the inflation rate and the risk of capital outflow following the normalization of monetary policy in Europe and the US, Central

Bank is expected to keep the policy interest rate unchanged for the time being.

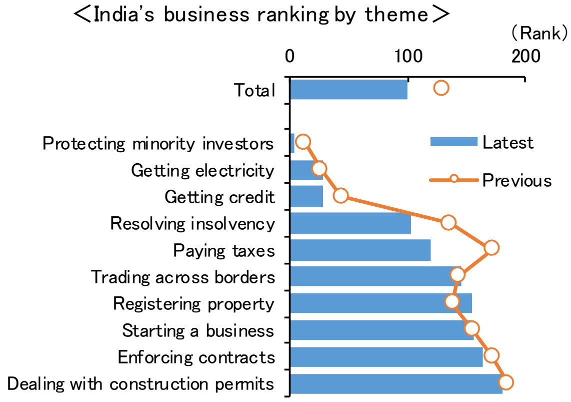
■ Growth rate to rally to 7.3% in 2018

Looking ahead to India's economic performance in 2018, as the downward economic pressure resulting from the introduction of GST comes to an end, the forecast is that the growth rate will recover to the 7% range. However, given the continuation of restrictive fiscal policy aimed at shrinking the fiscal deficit, and the expectation that the policy interest rate will remain unchanged for the time being, the outlook is that the growth rate will recover at a modest pace.

With regard to consumption, which accounts for about 60% of GDP, it is important to remember that about 50% of India's workers are engaged in agriculture, forestry and fishery industries, whose incomes are vulnerable to the vagaries of the weather in the monsoon season (June to September). However, the structural factor of the spread of durable consumable goods accompanying the increased population and that per capita incomes will support economic growth, a positive consumer sentiment reflecting hopes for the Modi administration's economic reforms is expected to lead to a basically solid growth in consumption.

Investment growth also is expected to gradually regain its strength as progress is made in infrastructure development and system reforms aimed at improving the business environment. Further, in light of developments such as the upgrading of the Bankruptcy Law, the introduction of GST and the introduction of online systems such as procedures for obtaining construction permits and setting up businesses, in its latest business environment survey announced at the end of October, World Bank raised India's business ranking from 130th position last year to 100th this year. Though many in the corporate sector and others experienced various burdens when GST was first introduced, it is expected that it will eventually have the effect of boosting the economy by virtue of reducing the cost of taxation, improving productivity and suppressing inflation through the construction of optimal supply chains across state boundaries, and increased direct inward investment, etc.

＜India's business ranking by theme＞



Source: World Bank

Meanwhile, with regard to exports, given the lingering uncertainty with regard to the sustainability of the current strong economic conditions worldwide, and the continuing stagnation of international prices of petroleum products, etc., which are major export items, and the fact that India's capital exports account for a much lower proportion of GDP than in other Asian emerging economies, the economic booster effect will likely be a limited one. However, advances are being made in the Modi administration's "Make In India" initiative to stimulate domestic manufacturing industries, and if there are stronger movements to use India as a production base due to the improvements in the business environment, then it is expected that the ability of exports to drive economic growth will grow stronger in the future.

Finally, in terms of political trends, following parliamentary elections in the states of Gujarat and Himachal Pradesh in December of 2017, parliamentary elections are slated for mid-2018 in a further eight states. With the primary focus on the three states of Karnataka, Madhya Pradesh and Rajasthan, which occupy many seats in the upper and lower houses, there will be much attention on the election results, seen as a preliminary battle for the lower house elections in 2019. Also, as upper house councilors are selected by the state legislature, in terms of forecasting the period when the parliamentary twist between the upper and lower houses will be resolved, the local elections attract much attention. Since the upper house re-elects one third of its councilors every two years, it was expected that it would take considerable time to resolve the twist. However, due to the effect of some opposition parties switching their allegiance to the government, there is a growing possibility that the BJP-led (Indian People's Party) ruling coalition may occupy a majority of seats in the upper house in 2018. If the twist between the upper and lower houses can be resolved and the pace of economic reform accelerated, this will be a factor in reinforcing mid-term economic growth strength.

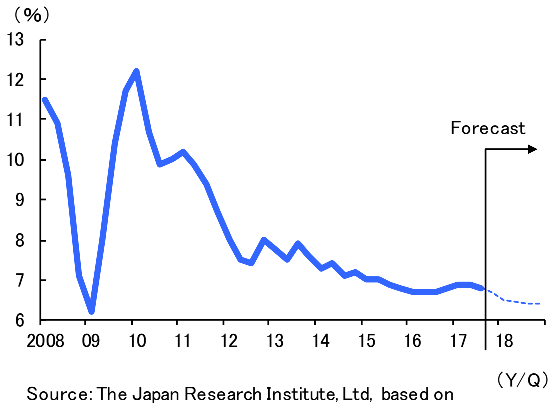
(Shotaro Kumagai)

China Economic growth to slow to 6.4% in 2018

■ Economy slows from mid-2017

In the first half of 2017, China's real GDP growth ratio accelerated to 6.9% compared to the same period in the previous year, but in the July to September quarter it slipped to 6.8%, similarly, for the first time in seven quarters. Among this October's statistics, there are many showing deceleration, and a sense of economic slowdown has strengthened once again.

＜Gross Domestic Product(YoY)＞

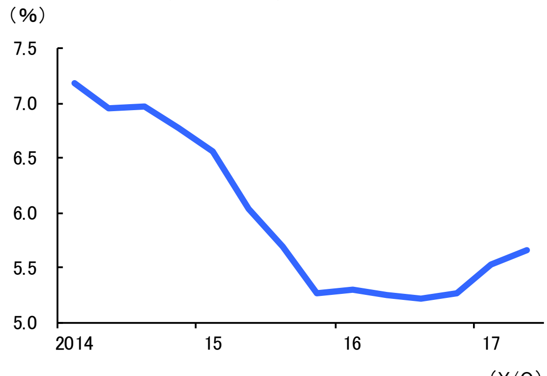


Source: The Japan Research Institute, Ltd, based on National Bureau of Statistics

The Chinese government's changed policy stance may be considered one reason for the economic slowdown. Up until 2016, the government had implemented positive fiscal expenditure and easy monetary policy, in order to prevent the economy from stalling. However, the government switched its stance towards tighter monetary and fiscal policy from the end of 2016 and, after a slight time lag, it appears that the effects are beginning to be felt.

On the monetary front, in addition to inducing short term market interest rates, financial supervision was strengthened. People's Bank of China raised the reverse repo interest rate for open market operations in two successive months from February of 2017, so the short term market interest rate rose through April.

＜Average Lending Interest Rates＞

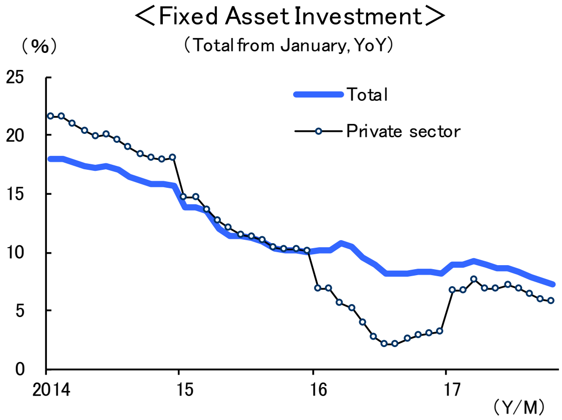


Source: People's Bank of China

As a result of these developments, the financial institutions' average lending interest rates went up, as did the cost of private sector companies' capital procurement. As a result of this, private sector companies' fixed asset investments grew 5.8% in the January to October period, compared to the same period in the previous year, once again entering a phase of deceleration. Also, housing sales floor space, which had been growing rapidly till around spring time, decelerated to 8.6% growth, compared to the same period in the previous year, in October.

On the financial front, since the Central Economic Work Conference in December of 2016, the government has been suppressing approval of public investment projects. As a result of this, the brakes were suddenly applied to the new construction investment planned total, which has increased 20.9% in 2016, year on year, causing it to decelerate to 3.8% growth in the January to October period of 2017, compared to the same period in the previous year.

＜Fixed Asset Investment＞
(Total from January, YoY)



Source: National Bureau of Statistics of China

The fixed asset investments of state owned enterprises in the same period grew 10.9%, similarly, slowing from almost 20% growth.

In addition to these developments, in response to worsening air pollution and other issues, the government has tightened environmental restrictions, and there are already signs of reduced production in heavy industries. This too has been a factor in the deceleration of the economy.

One reason behind the government's change in policy stance may be said to be the worsening of the distortion caused by the stance of prioritizing the economy.

First, the sense of overheating in the housing market could no longer be ignored. In response to monetary easing, housing demand swelled greatly and, as a result, housing prices soared, not only in Beijing, Shanghai and other coastal cities, but also in rural cities in the interior.

In addition, the problem of over-capacity in the manufacturing industry re-emerged. For example, in crude steel manufacturing, which had struggled with the problem of over-capacity for some time, the trend towards increased production began to intensify once more. Although the government has not abandoned its stance on reducing production capacity, it seems that improved market conditions have stirred corporate appetite for increased production.

Further, as a result of large scale monetary easing, the issues of corporate debt and non-performing loans became more serious, and concerns began with regard to systemic risk. For these reasons, the government appears to have set deleveraging (curbing credit and debt) as a priority challenge.

■ Economy to decline gently from start of 2018

Looking to the future, the Chinese economy is expected to continue its trend of deceleration from now on, due to the following reasons.

The first is the decrease in automobile demand. The vehicle acquisition tax on small cars with an engine capacity of 1,600 cc or less is normally 10%, but when this was lowered to 5% between October of 2015 and the end of 2016, automobile sales rose dramatically. The authorities raised the tax back up to 7.5% from the start of 2017, and automobile sales growth subsequently slowed. In 2018, the tax incentive period will come to a complete stop and there is a very strong probability that automobile sales will convert to a decline.

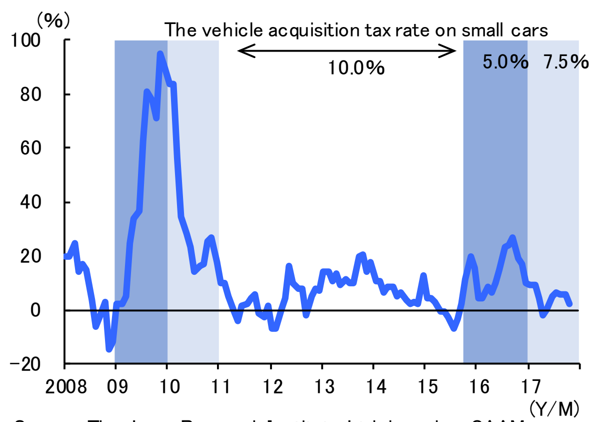
The second is the balance sheet adjustments of private sector companies. There is a strong probability that private sector companies will hold back from plant and equipment investment in order to allocate their cash flow to the repayment of debt, in order to eliminate excess liabilities. In China, corporate debt has reached 166% as a percentage of nominal GDP, higher than Japan’s levels during the years of the bubble economy. The average lending rate on loans to companies at the end of June in 2017 was 5.67%. A rough calculation puts annual interest payments at 9.4% of GDP. As interest payment burdens and balance sheet adjustment pressures grow, corporate debt reduction might well be seen as a natural move.

The third is tighter environmental control. As the Xi Jinping administration enters its second term it has set environmental conservation as one of its priority policies. Therefore, there is little likelihood that the government will soften its demands for environmental control and reduced production.

Nevertheless, the risk of the economy stalling is judged to be slight. Firstly, although the government will continue with tightening its monetary policy stance, it is not likely to strengthen these policies to an extent that would cause the economy to cool. The economic control policies that have been implemented till now have had a reasonable effect, so it would seem likely that the government will wait and judge the effects of the current policy line for the time being.

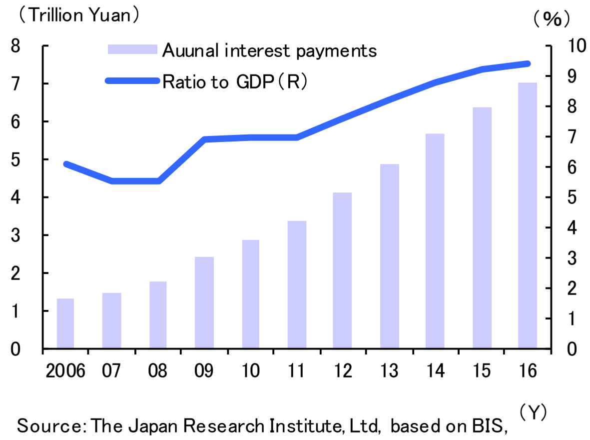
In actual fact, on the monetary front, there have not been any new interest rate hikes recently. Also, there are signs of a rally in the pace of growth of loans to real estate companies. Given the weakness of

<Automobile Sales(YoY)>



Source: The Japan Research Institute, Ltd, based on CAAM

<Simulation of Annual Interest Payments>



Source: The Japan Research Institute, Ltd, based on BIS, National Bureau of Statistics, People’s Bank of China housing demand, the government is believed to have relaxed lending restrictions somewhat, in order to alleviate the difficulty that real estate developers have been facing in raising funds.

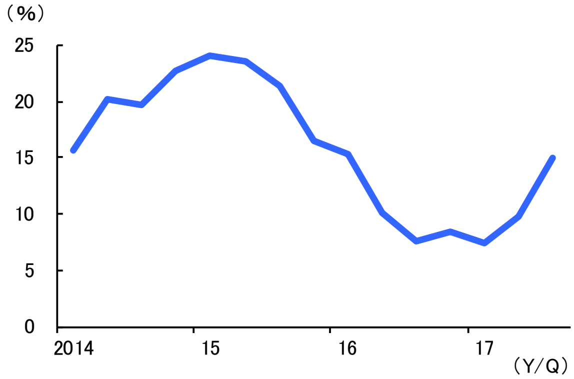
On the financial front as well, the government is controlling the new construction total floor area so that it does not fall below the previous year's level. The outlook is that infrastructure investment will continue at a certain pace, and will support economic growth. If economic downside risk were to intensify in the future, it is likely that the government would respond with flexible fiscal stimulus to avoid downside risk, as it did in 2016.

In terms of the real economy also, solid economic growth is expected. Following improved corporate business showings, the per capita disposable income in the cities in the July to September quarter grew 7.1%, compared to the same period in the previous year, rallying from the beginning of 2017. For the time being, against the backdrop of a healthy incomes environment, the outlook is that personal consumption will provide support for economic growth.

As described above, while there are factors that will exert downward pressure on China's economy in 2018, government control and the strength of the consumption market will support growth, and it is thought likely that the economy will be able to avoid stalling and achieve a soft landing.

As a result of these developments, the real economic growth rate for 2018 is expected to be 6.4%, year on year, a slight deceleration from the 6.8% expected for 2017. This may be interpreted as a return to the deceleration trend that had been continuing since 2012, after the temporary economic upswing enjoyed until the first half of 2017.

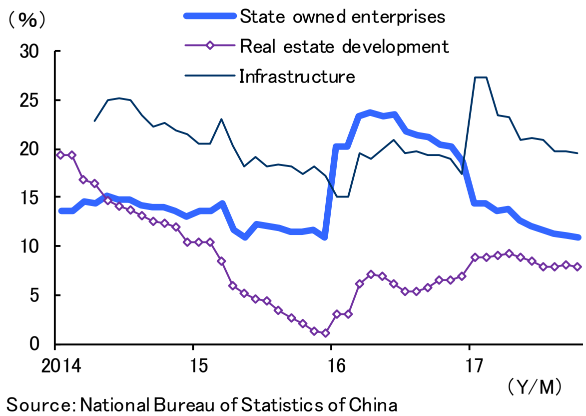
<Loans to Real Estate Companies (YoY)>



Source: People's Bank of China

<Fixed Asset Investment>

(Total from January, YoY)

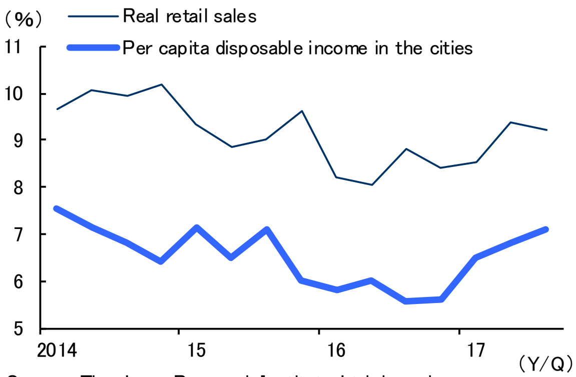


Source: National Bureau of Statistics of China

■ The need to pay attention to developments in the normalization of monetary policy in the industrialized nations

Further, there is a possibility, albeit a slight one, that the normalization of monetary policy in the industrialized nations may result in significant downward pressure on the Chinse economy. For instance, there is a danger that if US interest rate hikes proceed at a faster pace than had been envisioned, China's domestic interest rates may also rise drastically. That scenario would bring with it the risk that private sector fixed asset investment would plummet, as it did in 2014 to 2015. Additionally, if sudden interest rate hikes were to lead to a significant slump in real estate and other asset prices, the possibility of a spiral credit crunch could not be ruled out. Since the scale of China's debt is extremely large, careful attention needs to be paid to this kind of risk scenario.

<Income and Retail Sales (YoY)>



Source: The Japan Research Institute, Ltd, based on National Bureau of Statistics

(Shinichi Seki)