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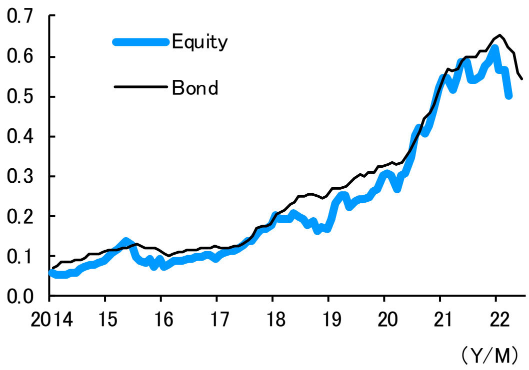
Topics Limited room for further easing in China due to capital outflow

Concerns about capital outflows from China are making it difficult for the People's Bank of China (PBOC) to accelerate monetary easing. The capital outflows reflect the U.S. interest rate hikes, as well as the zero-COVID policy and wariness about the possibility of secondary sanctions being imposed over the country's dealings with Russia.

■ Inward portfolio investment to China is facing headwinds

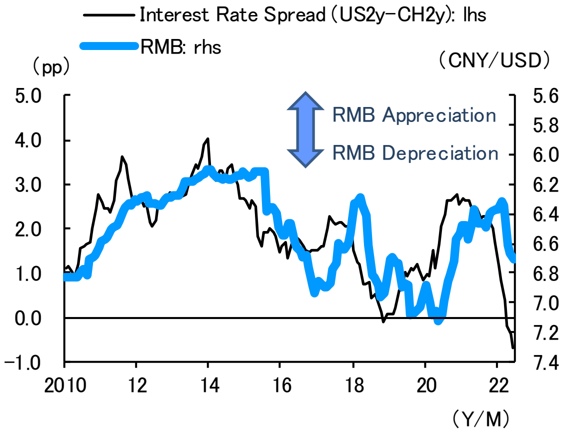
In recent years, global investors have been active in mainland China securities markets, expanding their investments in Chinese stocks and bonds. However, since the end of last year, foreign investors have been selling Chinese assets, raising concerns that capital outflows will accelerate. According to the International Institute of Finance (IIF), net outflows from the Chinese securities market totaled USD 37.4 billion (USD 6.6 billion in stocks and USD 30.7 billion in bonds) in March of this year. These figures were the largest since 2015, when data began being released. According to the PBOC, the pace of increase in foreign investor holdings of mainland China securities had been rising since around 2018. However, from the end of 2021 to the beginning of 2022, both stock and bond holdings started to decline. Bloomberg News reported on July 15 that Chinese regulators had been asked to exercise greater caution when it comes to reviewing new overseas spending and investment plans.

＜Mainland China RMB Securities Held by Oversea Imvestors＞



Source: JRI, based on PBOC and CEIC

＜RMB and Interest Rate Spread between US and China＞



Source: JRI, based on CEIC

Global investors are becoming increasingly pessimistic about portfolio investment in China, and this is likely due to the following three factors:

The first is the inversion of U.S. and Chinese government-bond yields. There is a huge gulf in monetary policy between the U.S., where inflation is rising rapidly, and China, where the economic outlook is becoming more and more uncertain alongside low inflation. The two-year U.S. Treasury yield topped the yield on equivalent Chinese government bonds for the first time in 3.5 years in April of this year, hastening the flow of funds from China to the U.S. In fact, the Renminbi appears to be depreciating (against the dollar) in lockstep with the U.S.-China interest rate differential.

The second is the negative impact of the zero-COVID policy on the Chinese economy. In China, the economy stalled from late March due to sweeping activity restrictions. The Chinese authorities' efforts to quash even the super infectious Omicron strain ground economic activity to a halt. With the Chinese government refusing to waver in sticking with its zero-COVID policy, there is a risk that strict activity restrictions will be imposed again there in the near future, so the economic turmoil could be repeated. Investors are also well aware of the flagging performance of Chinese companies, and this seems to have accelerated their sell-off of Chinese equities.

And the third is caution regarding the potential for secondary sanctions to be imposed in connection with China's trade with Russia. Western countries may impose secondary sanctions on foreign individuals and companies that do business with Russia to prevent the opening of "backdoors" for evading sanctions against

Russia. China's opposition to economic sanctions puts it at high risk of being targeted by such sanctions, so investors now need to pay attention to relationships between Chinese and Russia companies. Indeed, it was reported (July 12, Wall Street Journal) that foreign investors are selling bonds issued by two of China's policy banks, namely the China Development Bank and the Export-Import Bank of China, because they have extended loans in connection with Russian energy development projects.

In addition, as part of their sanctions, Western countries have shut Russian banks out of the Society for Worldwide Interbank Financial Telecommunications (SWIFT) international payment system, a move that has largely stopped Russian entities doing financial transactions with the outside world. If China were to be subject to similar sanctions, investors holding financial assets in mainland China would find it difficult to conduct external financial transactions. Although the likelihood of such a situation occurring is low at this time, a growing number of investors now view the expansion of investment in mainland China as a risk.

■ Concerns about capital outflows have reduced room for monetary easing

As capital outflows from China accelerate, there is less leeway for pursuing monetary easing measures such as interest rate cuts and money supply expansion, as these measures could exacerbate such outflows. In the first half of 2022, the reserve ratio and the loan prime rate (LPR), which is the key policy rate, were reduced. After that, it was hoped that the economy would be supported by monetary easing, but the situation has changed rapidly over the past few months. The interest rate cut implemented in May was limited to stimulating housing demand (the five-year LPR is the base rate for mortgage rates). The PBOC Governor Yi (June 27, Bloomberg News) and the head of the PBOC's monetary policy department Zou (July 13, Bloomberg News) have indicated that it is unlikely that the PBOC will cut rates in the future, on the grounds that real interest rates are already quite low and that there is plenty of liquidity in the domestic interbank market.

Although the Chinese economy has been picking up recently, it has been severely damaged by the zero-COVID policy. Policy support is needed to quicken the pace of recovery. However, on July 19, Premier Li Keqiang commented that "We will not introduce supersize stimulus measures, issue excessive money supply, or sacrifice future interests to go after an excessively high growth speed," suggesting that China will not necessarily stick to its 2022 economic growth rate target of "around +5.5%." To sum up, it is highly likely that the Chinese authorities will not deliver further rate cuts as an economic stimulus measure at least until the end of this year in order to avoid a situation where capital outflows have a negative impact on medium- to long-term economic development.

＜Monetary Policy Action from the People's Bank of China＞

Date		Policy Rates/Tools		Changes
2021	15-Jul	Reserve requirement ratio		-50bps
	15-Dec	Reserve requirement ratio		-50bps
	20-Dec	Loan prime rate	1-year	-5bps
2022	17-Jan	Medium-term lending facility rate		-10bps
		Seven-day reverse repurchase rate		-10bps
	20-Jan	Loan prime rate	1-year	-10bps
			5-year	-5bps
	15-Apr	Reserve requirement ratio		-25bps
			Small banks	-50bps
	15-May	Minimum mortgage rate for first-home buyers		-20bps
	20-May	Loan prime rate	5-year	-15bps

Source: JRI, based on Bloomberg News

(Minoru Nogimori)

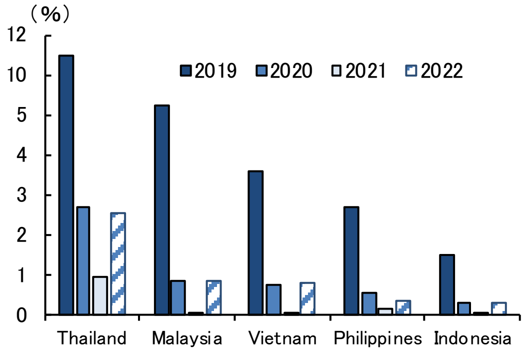
Topics ASEAN is aiming for a recovery in tourism

The ASEAN countries have been easing entry restrictions, and tourists, who had been stopped from coming due to the COVID pandemic, are beginning to return. ASEAN's tourism sector is expected to continue to recover through mid-2023, supporting the ASEAN economies.

■ ASEAN's tourism sector was dealt a heavy blow by the COVID pandemic

The spread of COVID-19 had a major impact on the global tourism sector, and took an especially serious toll on the ASEAN zone. In fact, according to the World Travel & Tourism Council (WTTC), the tourism sector's contribution to GDP in 2020 was down 52.7% year on year in ASEAN, a greater deterioration than the global average (-49.1%) as well of that of North America (-42.2%), and Europe (-50.0%). In 2019, ASEAN's tourism sector accounted for 11.8% of its GDP, higher than the global average of 10.4%. The percentages are particularly high in the Philippines (22.5%), Thailand (20.3%), and Malaysia (11.7%). The sector also employs a larger proportion of all jobs in ASEAN (the Philippines: 22.7%, Thailand: 21.8%, Malaysia: 15.1%) than the global average (10.6%), so it is of great importance on employment in ASEAN.

＜ASEAN5 International Tourism Receipts (Relative to GDP)＞



Sources: Prepared by JRI based on data from the UNWTO and IMF
Note: Figures for 2022 are JRI estimates based on each country's target for the number of tourists.

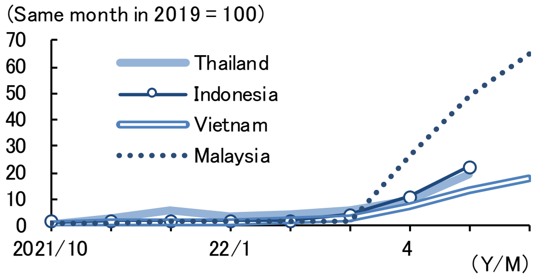
ASEAN's tourism sector is characterized by its heavy dependence on inbound demand. Spending by foreign tourists as a percentage of tourism expenditures (2019) is 46.6% in the ASEAN5 (Indonesia, Thailand, the Philippines, Malaysia, and Vietnam), considerably higher than the global average of 28.3%. According to the United Nations World Tourism Organization (UNWTO), international tourism receipts in the ASEAN5 were 80% lower than 2019 levels in 2020, and in 2021 they were 95% lower. These huge drops were due to COVID-related restrictions, and led directly to economic downturns.

■ Countries are relaxing entry restrictions to accommodate foreign tourists

The tourism sector is thus very important to ASEAN, and governments are aiming for a rapid recovery in the number of international arrivals that will return them to 2020 levels during 2022. Countries are already taking steps to ease entry restrictions, and the number of people coming into the ASEAN nations is on the rise. Malaysia, which is experiencing the fastest recovery, has seen a large increase in travelers from Singapore. In Malaysia, 40% of all arrivals in 2019 were from Singapore, but since April this figure has been 60%. This is the result of priority being given to easing entry restrictions for incomers from neighboring countries.

In Malaysia, entry restrictions were also eased for other countries besides Singapore in April. Fully vaccinated visitors are exempt from post-entry quarantine, and they no longer need to submit proof of a negative test result and undergo another test when they arrive. In Thailand, the system of exempting the fully vaccinated from post-entry quarantine has been reintroduced, and arriving visitors are also no longer required to present proof

＜No. of Arrivals in Major ASEAN Countries＞



Source: Prepared by JRI based on statistics from each country
Note 1: Figures for Indonesia are for arrivals at the 25 biggest ports of entry.
Note 2: Figures for Malaysia are JRI estimates based on an announcement made in June by the Malaysian Minister of Tourism, Arts and Culture.

＜Testing/Quarantine Procedures for Arrivals＞

		Thailand		Malaysia		Vietnam	
		Vaccinated	Unvaccinated	Vaccinated	Unvaccinated	Vaccinated	Unvaccinated
Before Entry	Proof of Vaccination	Necessary	Unnecessary	Necessary	Unnecessary	No provisions	
	Proof of Negative Test	Unnecessary	Necessary	Unnecessary	Necessary	Unnecessary	
Upon Entry	COVID Test	Unnecessary	Unnecessary	Unnecessary	Necessary	Unnecessary	
After Entry	Quarantine	Unnecessary	Unnecessary	Unnecessary	Necessary	Unnecessary	

		Philippines		Indonesia	
		Vaccinated	Unvaccinated	Vaccinated	Unvaccinated
Before Entry	Proof of Vaccination	Necessary	Cannot Enter	Necessary	Cannot Enter
	Proof of Negative Test	Necessary		Unnecessary	
Upon Entry	COVID Test	Unnecessary		Unnecessary	
After Entry	Quarantine	Unnecessary		Unnecessary	

Source: Prepared by JRI based on announcements from each country and various media reports
Note 1: When a foreigner aged 18 or over arrives for the purpose of tourism. As of July 15.
Note 2: In the Philippines, those who have received a booster shot need not present proof of a negative test result.
Note 3: In Indonesia, those arriving with symptoms or a temperature of 37.5 degrees or higher are tested for COVID.

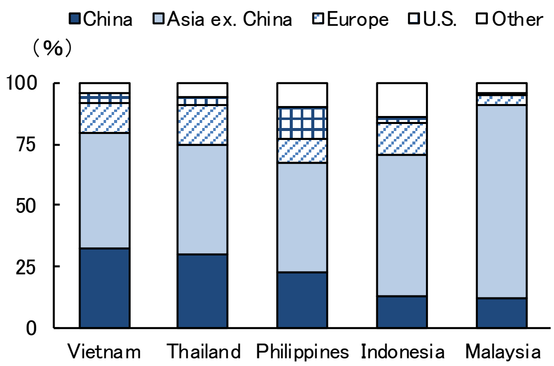
of a negative test. Vietnam resumed accepting foreign visitors in March and exempted them from testing upon entry and post-entry quarantine if they produced proof of a negative test. Later, presentation of proof of a negative test and the obligation to make a declaration regarding one's health condition were also scrapped. In Indonesia, post-entry quarantine has been waived for those who are fully vaccinated, and the presentation of proof of a negative test has been eliminated. The Philippines has also reopened to tourists, with visitors from all countries exempt from post-entry quarantine as long as they are fully vaccinated.

As of July 15, those who are fully vaccinated are not required to be tested or quarantined upon entry when entering the ASEAN5. Furthermore, Thailand, Malaysia, and Vietnam have been especially enthusiastic about accepting foreign tourists, even allowing those who are not fully vaccinated to enter their countries.

■ Tourism is expected to contribute to the economy through mid-2023

Estimates indicate that the number of arrivals will return to pre-pandemic levels in the fall of 2022 in Malaysia, early 2023 in Indonesia, and

＜Breakdown of Arrivals (by Country /Territory, 2019)＞



Source: Prepared by JRI based on statistics from each country mid-2023 in Thailand and Vietnam. Basically, the continued recovery of the tourism sector is expected to support the ASEAN economy going forward.

However, the number of arrivals from China, which is sticking with its zero-COVID policy and has strict border control measures in place, is expected to remain low. In Vietnam, Thailand, and Indonesia, arrivals from China in May remained 98% lower than prior to the COVID pandemic (May 2019). Vietnam and Thailand are especially affected, as arrivals from China accounted for about 30% of their total visitors before the pandemic. It needs to be noted that if China's strict border control measures stay in place for a long time, the speed of recovery of the tourism sector may be slower in these two countries than in other ASEAN nations.

(Mitsuhiro Matsumoto)