

[2020-22 Economic Outlook : Asia]

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The Uneven Economic Recovery in Asia — Supply chain restructuring could be the key to a full-fledged recovery in ASEAN/India —

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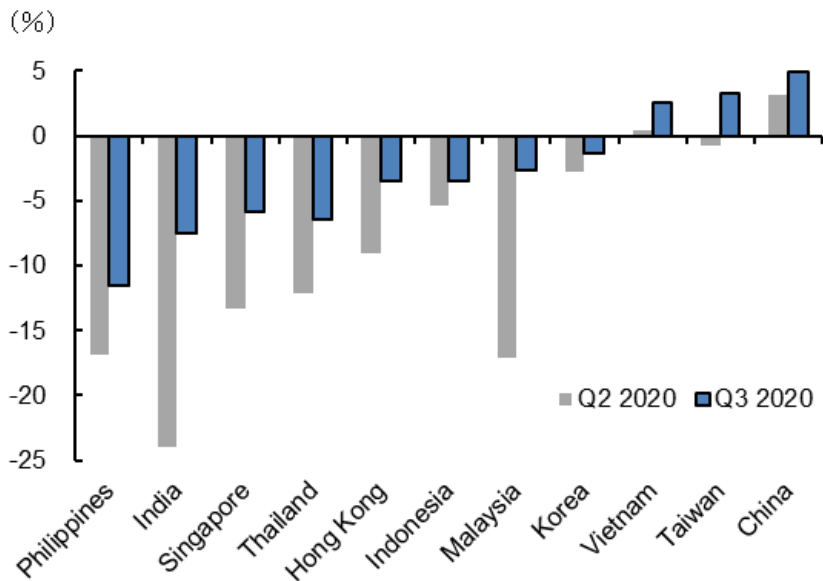
- ◆ The Asia economies bottomed out following their sharp deterioration in Q2 2020 due to the easing and lifting of restrictions on activities, and entered into a rebound phase with support from special demand amid the Covid-19 pandemic. However, the pace of recovery has been uneven, and ASEAN, except for Vietnam and India, continue to face a difficult situation. In 2020, we expect real GDP for the whole Asian economy to contract by 1.4%, mainly due to the sluggish ASEAN economies, except for Vietnam and India. All countries are expected to have relatively high growth rates in 2021; however, this will simply reflect the reaction to the downturn experienced in 2020. Although the GDP of China, Taiwan, and Vietnam already exceeded levels seen prior to the outbreak of COVID-19 as of the Q3 2020 period, recovery for other countries will likely take a long time. Specifically, GDP is not expected to return to pre-coronavirus levels until around mid-2021 for Korea, Malaysia and Indonesia, and around 2022 for India, the Philippines and Thailand.
- ◆ Although the economy has bottomed out, it is difficult to see any signs of a strong recovery in ASEAN, except for Vietnam and India. Under such circumstances, the shift of production bases by companies through supply chain restructuring is expected to boost the economy. However, moves to reorganize supply chains are facing headwinds such as 1) the recovery of China's production, 2) the postponement of FDI, and 3) the destabilization of social conditions amid the COVID-19 pandemic. Therefore, it will be important for ASEAN, except for Vietnam and India, to actively promote policies to increase their attractiveness to entice businesses and promote free trade agreements. Moreover, there will be no big change in the hawkish stance of the U.S. on China even after the inauguration of the new administration in early 2021. Also, the Japanese government earmarked 23.5 billion yen to support a shift of production bases to ASEAN nations and India, and South Korea also plans to strengthen its relations with ASEAN nations and India under its "New South Policy." Whether or not the destinations for the transfer of production bases from China will expand beyond Vietnam will be a focal point of discussion when looking at the Asian economy in 2021 and thereafter.
- ◆ **China:** China's economy has recovered ahead of Japan, the U.S. and Europe due to 1) the government's direction to resume activities starting from an early stage, 2) aggressive stimulus measures, and 3) recovery of external demand. Economic recovery will likely continue as the economic engine gradually shifts from investment to consumption. China's new "dual circulation" economic development model suggests that the government will continue to provide generous support in the high-tech sector. Given the lower growth level in the previous year, it is estimated that the Chinese economy will grow by 8.2% year-on-year in 2021 due to a slight reactionary increase. Although the annual growth rate will fluctuate significantly, China will likely maintain a quarterly growth rate at around the potential growth rate (~5%) due in part to policy guidance through economic stimulus measures.
- ◆ **India:** Although the economy bottomed out as economic activity gradually resumed, the pace of recovery remained slow due to continued restrictions on economic activity in areas designated as "containment zones" and independent lockdowns by state governments. Concern about stagflation remains. The growth rate is expected to increase by double digits, up 11.0% on a year-on-year basis, due to a rebound from the previous year, but several downside risks could linger. India's ability to return to a high-growth path hinges on whether it can take the coronavirus pandemic as an opportunity for fundamental reform and implement reforms that have thus far been stagnant, such as facilitating expropriation of land in order to promote direct investment in the manufacturing sector, easing restrictions on dismissal, and improving the management efficiency of state banks.

1. Asia Economy

(1) The uneven economic recovery

- Q3 y-o-y growth rates were positive for China, Taiwan, and Vietnam, with the GDP of these countries already exceeding the level prior to the COVID-19 outbreak.
- We expect real 2020 GDP for the Asian economy to contract by 1.4%. Although relatively high growth rates are expected in 2021, this will simply reflect the reaction to the downturn experienced in 2020.
- ASEAN, except for Vietnam and India, will continue to lag behind, with GDP not expected to return to pre-coronavirus levels before 2021.

Year-on-year GDP Growth in Asia



Source: JRI, based on CEIC

Growth Forecasts for Asian Economies

	2019	2020 (F)	2021 (F)	2022 (F)
Asia	5.2	-1.4	7.4	4.8
Northeast	5.5	1.5	7.5	4.7
China	6.1	1.8	8.2	5.1
Korea	2.0	-1.0	3.0	2.1
Taiwan	2.7	2.0	3.9	2.1
Hong Kong	-1.2	-6.0	2.7	2.2
Southeast/South	4.9	-6.1	7.2	4.9
ASEAN	4.8	-3.3	5.7	5.0
Thailand	2.4	-6.3	3.4	2.9
Malaysia	4.3	-5.2	6.4	4.5
Indonesia	5.0	-1.4	5.4	5.2
Philippines	6.0	-9.4	8.1	6.1
Vietnam	7.0	2.7	7.2	6.6
India (Fiscal year)	4.2	-10.6	11.0	5.5

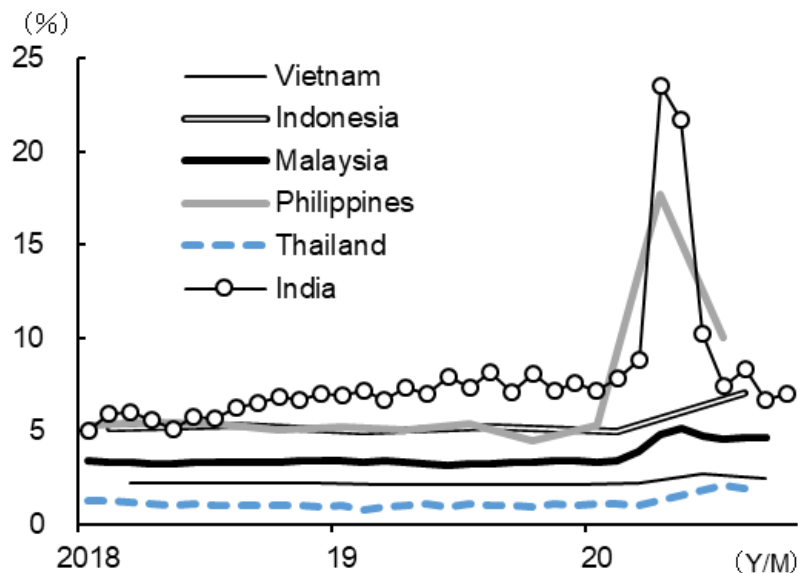
Source: JRI

1. Asia Economy

(2) The slump in ASEAN and India

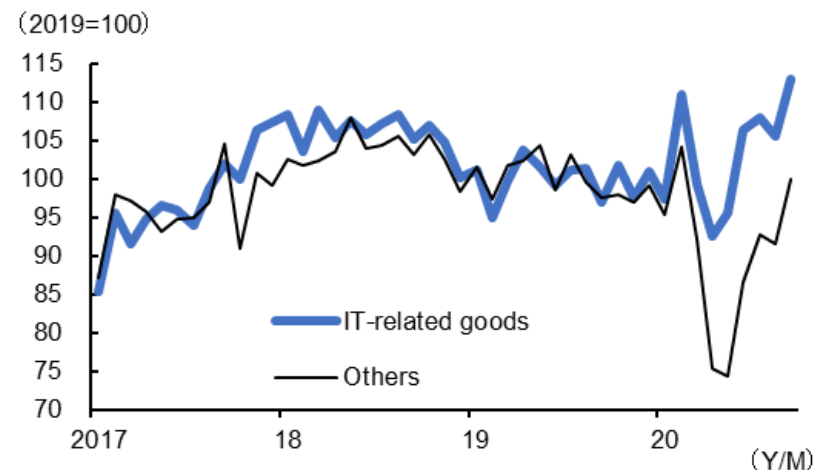
- The aftereffects of restrictions such as higher unemployment rates have placed downward pressure on activities in ASEAN, except for Vietnam and India.
- It is difficult for ASEAN, except for Vietnam and India, to benefit from IT demand, as the export of IT-related goods relative to GDP is smaller than that for Taiwan and Vietnam.
- The destabilization of social conditions in Thailand and Indonesia could weigh indirectly on the economy

Unemployment Rates in ASEAN/India



Source: JRI, based on CEIC, CMIE

Exports of Asia ex China (USD, SA)



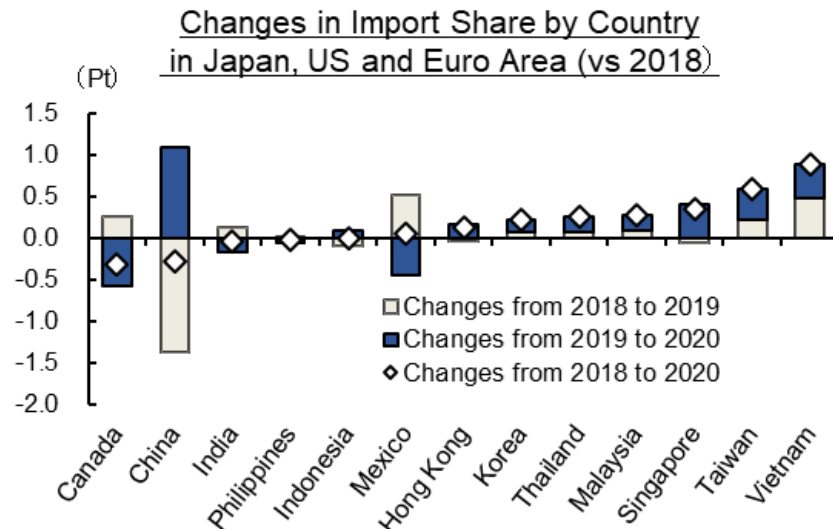
Source: JRI, based on CEIC

Note: IT-related goods are comprised of export goods categories including semiconductors, electrical/electronic equipment in Taiwan, Korea, Hong Kong, Thailand, Malaysia, Indonesia, Philippines, Vietnam, Singapore, and India.

1. Asia Economy

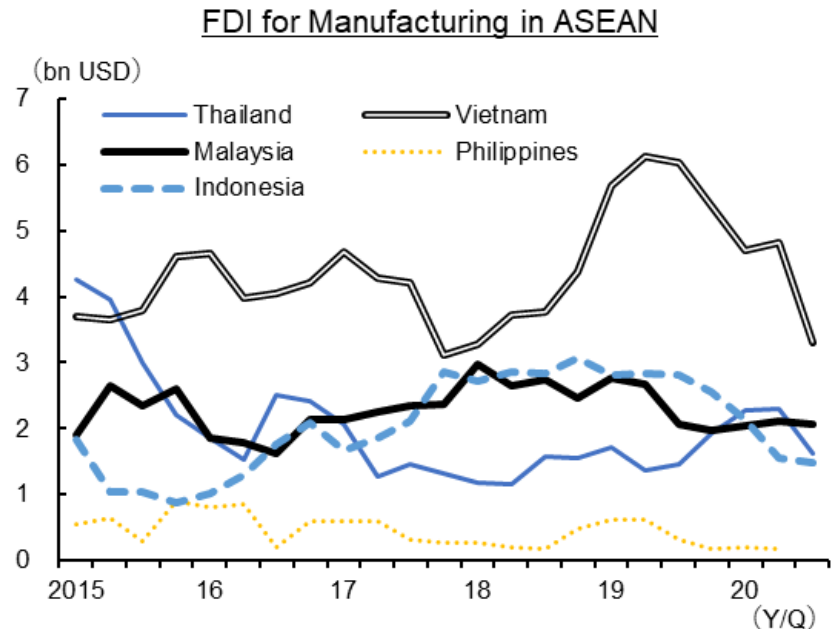
(3) Supply chain restructuring

- The shift of production bases by companies was expected to boost exports in ASEAN and India. Indeed, exports from Vietnam have rapidly expanded.
- However, China's share of exports to the U.S., Europe, and Japan has been rapidly recovering, supported by special demand in the medical and IT sectors amid the COVID-19 pandemic.
- Also, the postponement of FDI and recent social disorder have negatively affected progress in supply chain restructuring.



Source: JRI, based on CEIC

Note: The data show changes in share of aggregate imports from Japan, the US and Euro Area. Share in 2020 is calculated from average imports from January to July.



Source: JRI, based on CEIC

Note: 3 quarters moving average.

1. Asia Economy

(4) Production shift to Asia ex China

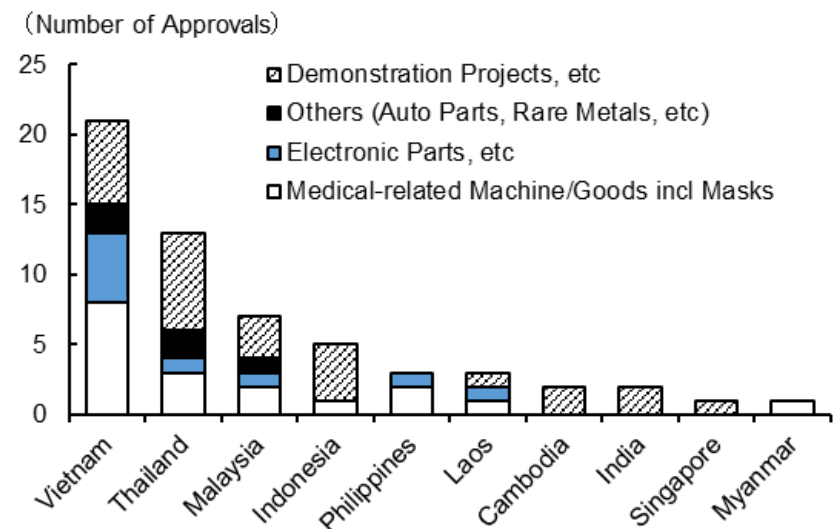
- It will be important for ASEAN, except for Vietnam and India, to actively promote policies to increase their attractiveness to entice businesses and promote free trade agreements.
- In October 2020, the Omnibus Law on Job Creation, which aims to attract investment, was passed in Indonesia. The agreement was reached on the RCEP in November.
- Whether or not the destinations for the transfer of production bases from China will expand beyond Vietnam will be a focal point of discussion when looking at the Asian economy in 2021 and thereafter.

Major Economies' Policy for Supply Chain Restructuring

Japan	2020- Overseas Supply Chain Diversification Support Program
Taiwan	2016- New Southbound Policy
Korea	2017- New Southern Policy
U.S.	No specific policy, but no big change in hawkish stance on China.

Source: JRI, based on various media reports

Support for Manufacturing Supply Chain Diversification by the Japanese Government



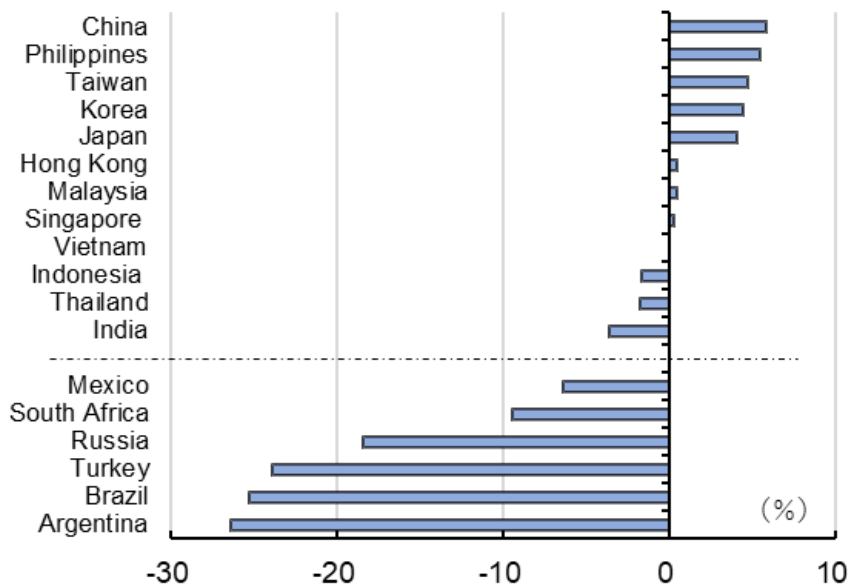
Source: JRI, based on JETRO

1. Asia Economy

(5) Fiscal and monetary policy

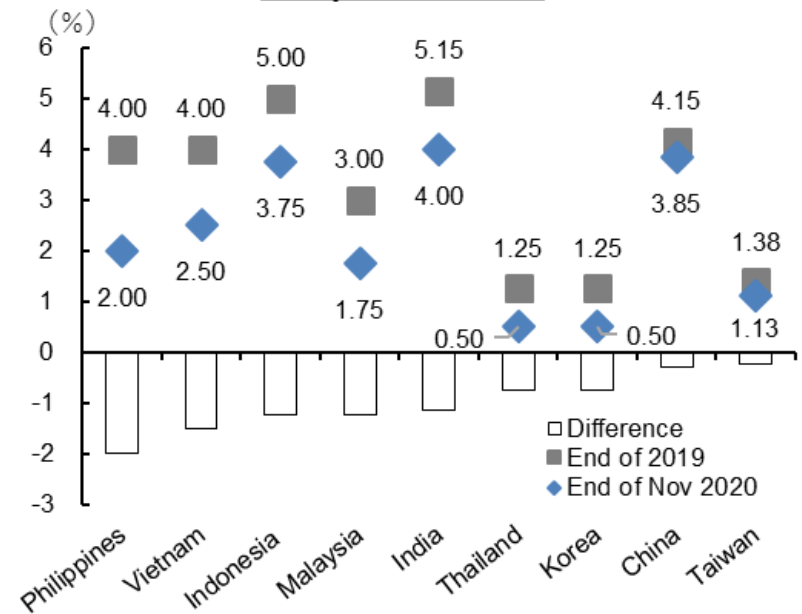
- Currently, there are differences in policy stance between Northeast Asia and ASEAN nations and India in accordance with their economic disparities.
- Relatively stable foreign exchange markets and low inflation have allowed room for policy easing in ASEAN, except for Vietnam and India.
- After 2022, downward pressure on these currencies and the risk of capital outflow may increase, as the U.S. will become more aware of the need to normalize its monetary policy by tapering its asset purchases.

YTD Changes in FX (Against USD, 2020)



Source: JRI, based on CEIC
Note: As of the end of Nov 2020.

Policy Rates in Asia

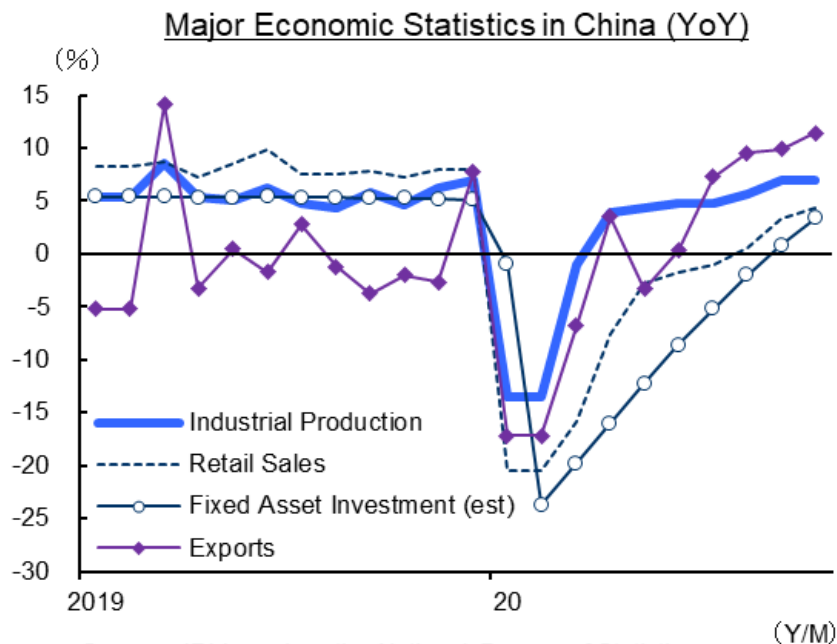


Source: JRI, based on CEIC

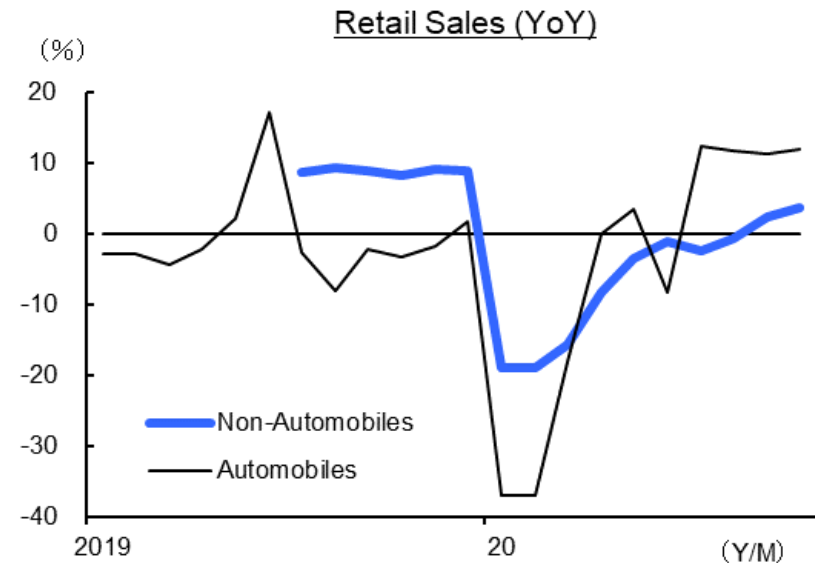
2. China

(1) Recovery ahead of others

- The government directed the resumption of economic activities in February after thoroughly monitoring the infection status of the Chinese people.
- Fiscal stimulus and monetary easing boosted automobile sales, infrastructure investment and investment in 5G and new energy. Exports also recovered.



Source: JRI based on the National Bureau of Statistics of China and General Administration of Customs, China

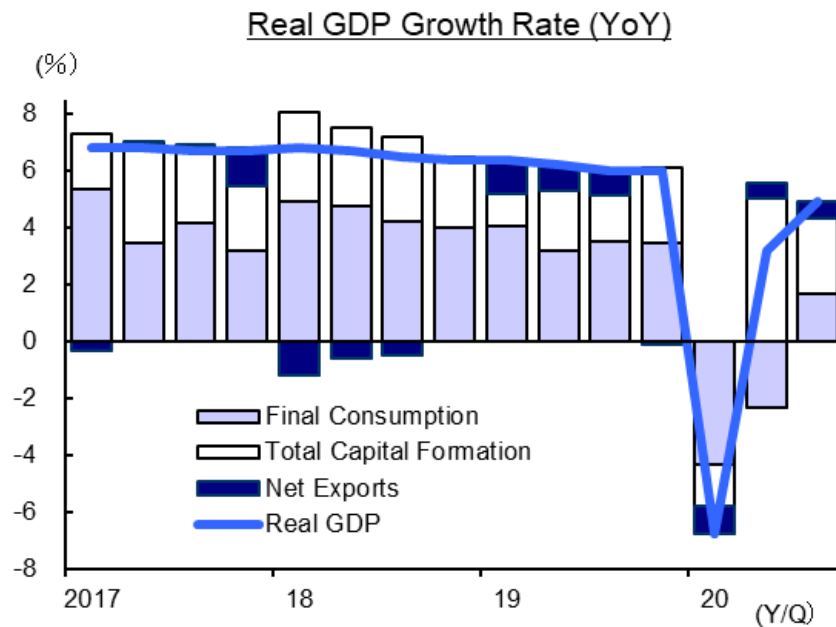


Source: "Total Retail Sales of Consumer Goods" by the National Bureau of Statistics of China
Note: Figures for January and February are the respective totals for January and February.

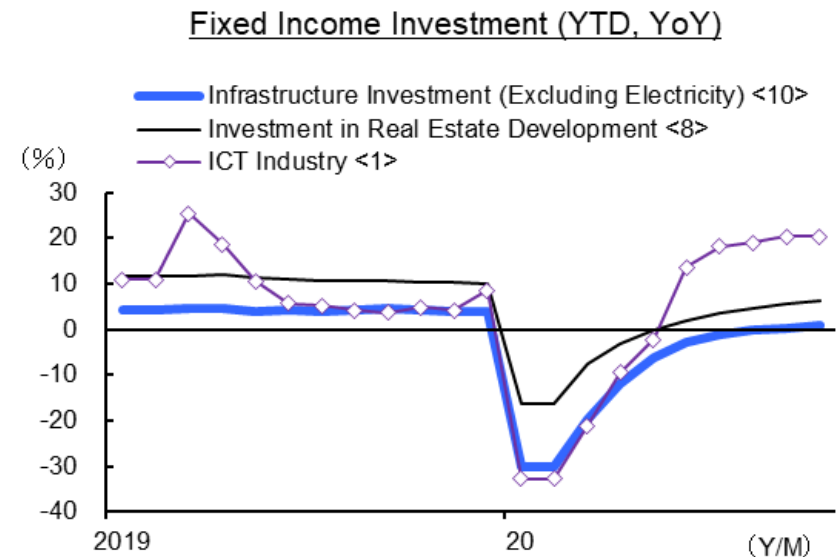
2. China

(2) Normalization will likely continue

- As progress is made in the development of vaccines, the negative impact of COVID-19 is anticipated to ease going forward and the contribution of final consumption to GDP will likely increase further.
- Investment in 5G and new energy supported by the government will likely continue to boost the Chinese economy.



Source: CEIC, "System of National Accounts" by the National Bureau of Statistics of China

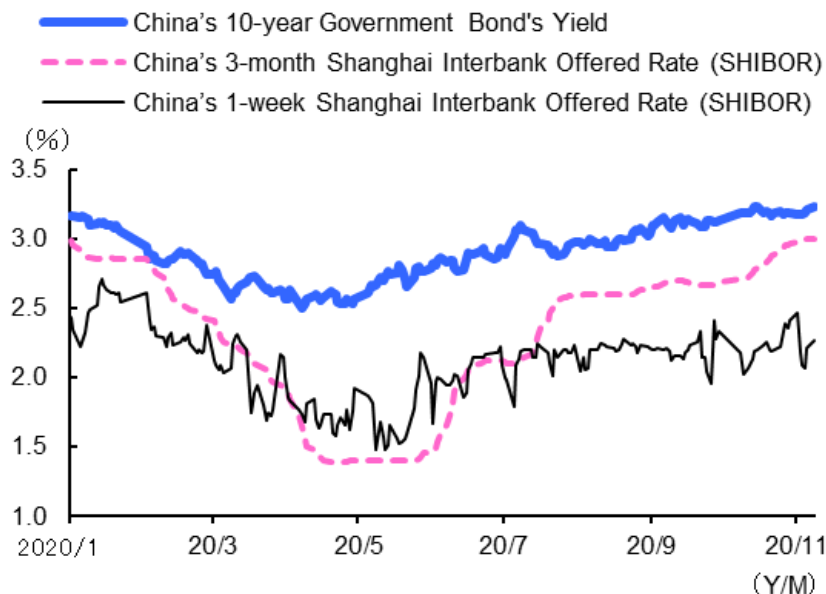


Source: "National Fixed Asset Investment" and "National Real Estate Development Investment and Sales Report" by the National Bureau of Statistics Note: Figures in parentheses < > indicate the share of GDP.

(3) The growth rate will likely remain at 5%

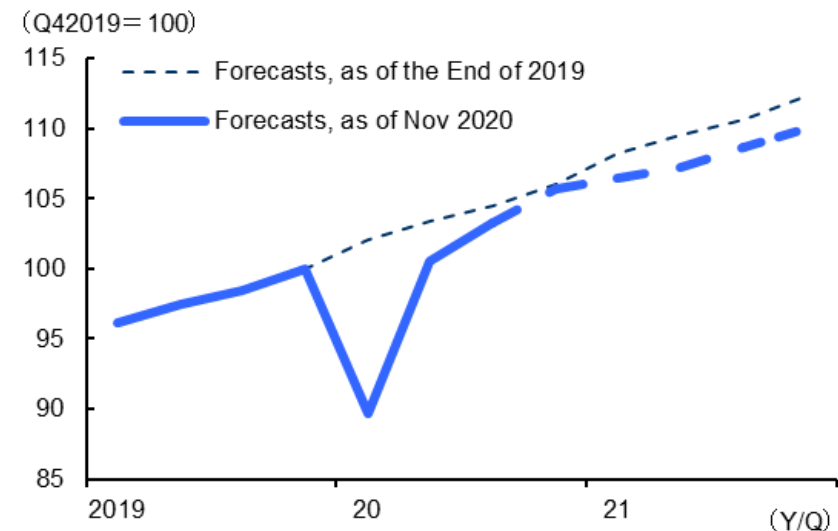
- The Chinese authorities have become the first in the world to tighten monetary policy. Also, there is growing concern about high-profile bond defaults involving state-owned enterprises.
- China's economy will likely maintain its quarterly growth rate at around the potential rate (~5%) under government guidance, which should result in +1.8% in 2020 and +8.2% in 2020.

Interest Rates of Major Markets



Source: National Interbank Funding Center

Forecasts for China Real GDP (SA)

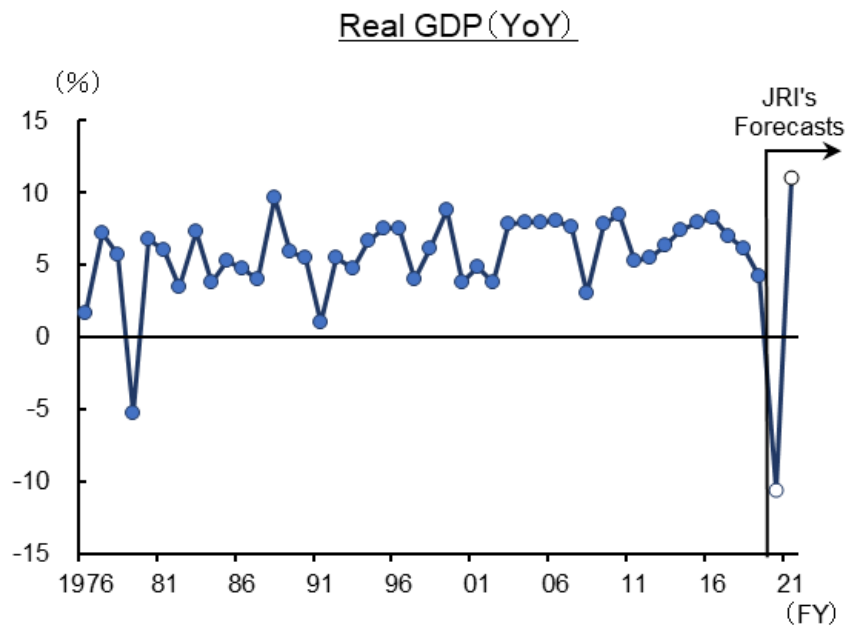


Source: JRI based on the National Bureau of Statistics of China
Note: Dotted lines show forecasts.

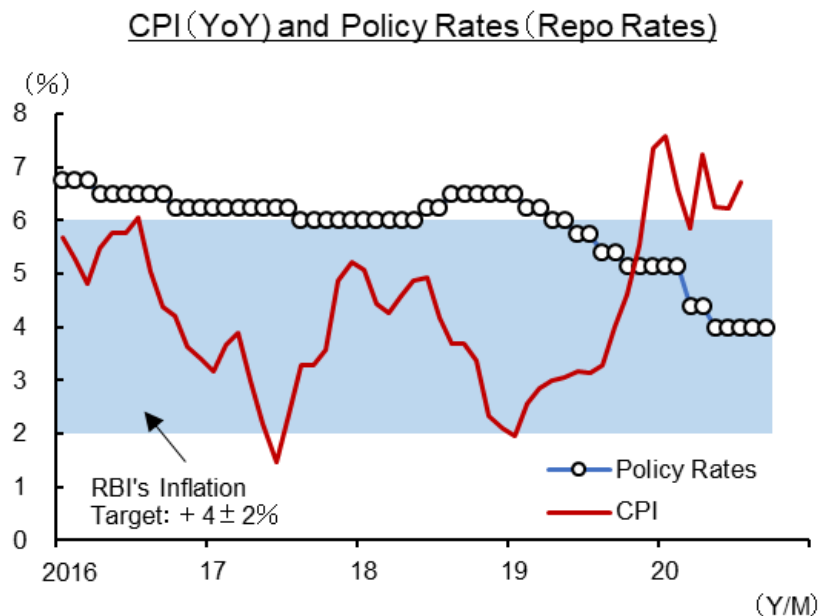
3. India

(1) The worst slump in FY2020

- Although the economy bottomed out as economic activity gradually resumed, the pace of recovery remained slow.
- Caught between an economic downturn and higher inflation, difficult maneuvering by the Reserve Bank of India has been required.



Source: Ministry of Statistics and Programme Implementation



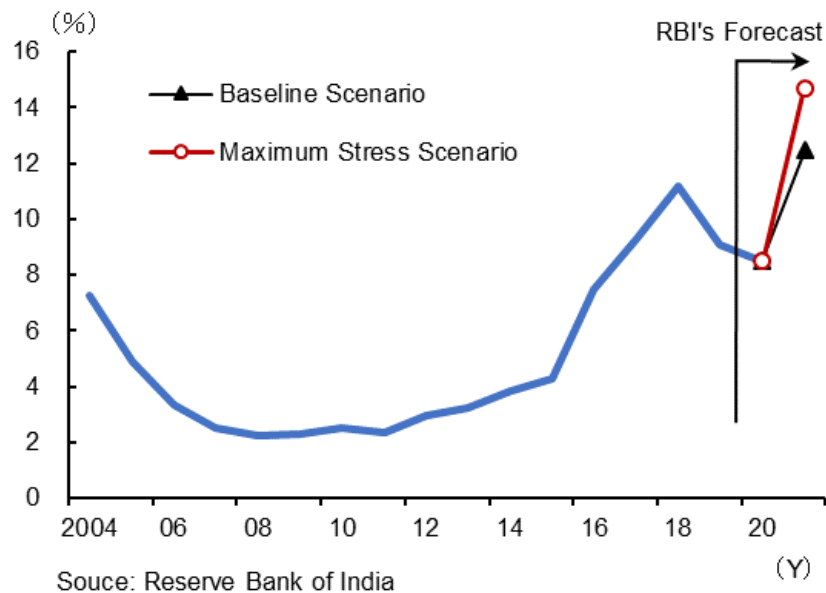
Source: Reserve Bank of India

3. India

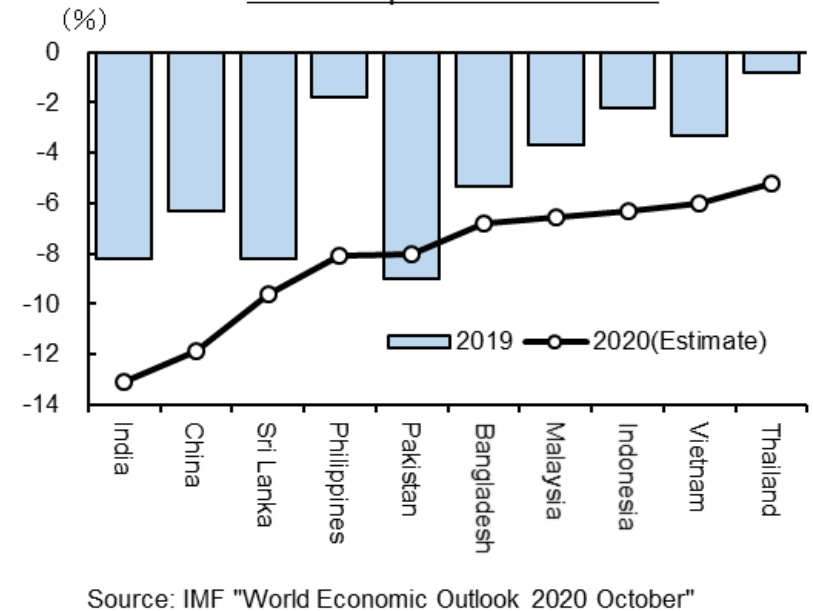
(2) Downside risk remains high

- The Indian economy is expected to continue on a recovery trend even after the beginning of fiscal 2021, mainly due to the gradual easing of restrictions on economic activities and global economic recovery.
- However, downside risk is expected to remain high amid financial and fiscal constraint.

Commercial Banks' Gross Non-Performing Asset Ratios



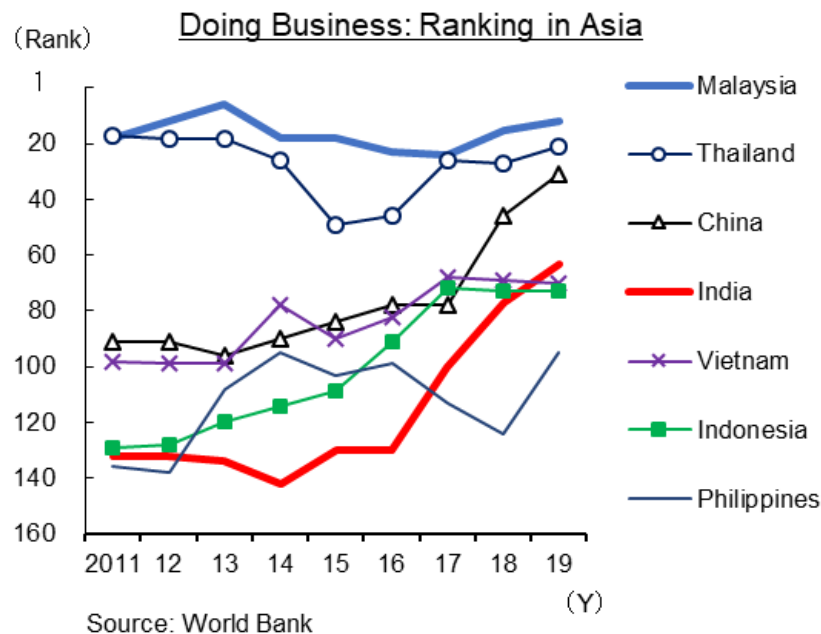
Fiscal Surplus/Deficit to GDP



3. India

(3) Structural reform is the key

- Although the business environment in India improved significantly under the Modi administration, several reforms have not yet progressed.
- Further structural reform is needed for a high-growth path amid higher risk in financial and fiscal conditions.



Major Structural Reforms Needed in India

Facilitating expropriation of land in order to promote direct investment in the manufacturing sector

Easing restrictions on dismissal

Improving the management efficiency of state banks

Source: JRI

This is a English version of “【アジア経済見通し】アジア景気は回復も、ペースにばらつき～ASEAN・インド経済復活のカギとなる供給網再編～” in JRI Research Report (The original version is available at <https://www.jri.co.jp/MediaLibrary/file/report/researchreport/pdf/12249.pdf>)

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