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[2022-23 Economic Outlook: Asia]

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The Asian economy is performing well, but facing financial risks

— COVID-19 and the Ukraine crisis could make it more vulnerable —

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Summary

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- Overall, the Asian economy has recovered since the early fall of 2021. We expect the Asian economy to continue to grow in the second half of this year as 1) easing of activity restrictions, 2) improvement of the Chinese economy, and 3) increase in external demand will support it. We expect the Asian economy to grow at a stable rate of + 4.7% in 2022, lower than the 7.2% growth recorded in 2021, but on par with the stable growth of +5.0% in 2019.

- However, we have to pay attention to the possibility of financial instability becoming a downside risk to the Asian economy. An acceleration of US monetary policy normalization is increasing risks ~~for~~ to capital inflow in emerging economies. The problems of 1) deteriorating current account balances, 2) accelerating inflation, and 3) cumulatively increasing government debt caused by the COVID-19 pandemic and Ukraine crisis could make Asian economies more vulnerable to external shocks.

- By country, the Chinese economy is picking up due to the easing of activity restrictions and economic stimulus. Although we expect it to continue to pick up, we see the severe economic downturn in the April-June quarter dragging down the full-year real growth rate for 2022 to just +4.4%.

- We expect India's GDP to grow by +6.5% in FY 2022 as the economy continues to expand due to further easing of restrictions on activities. However, the pace of economic expansion is likely to be moderate given the mounting downward pressure on the economy from inflation and US monetary tightening.

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1. (1) Stable growth trend in Asia

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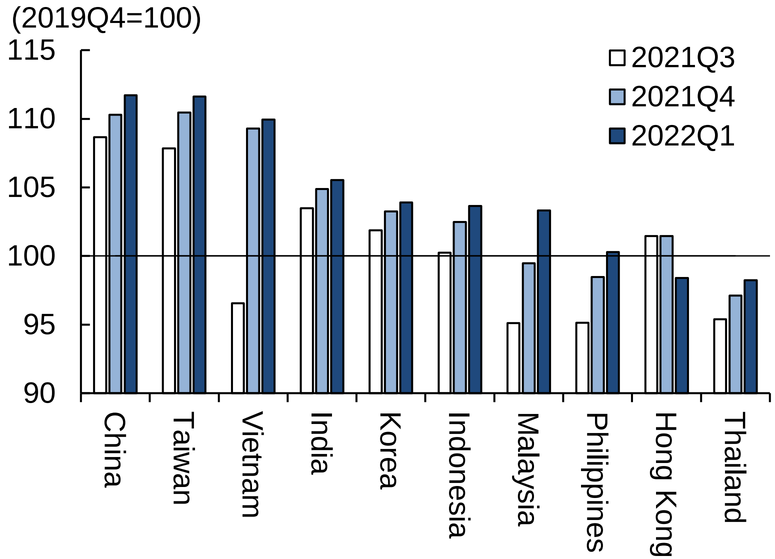
- Overall, the Asia economy had recovered since the early fall of 2021, but moving into 2022, the pace of the recoveries among the economies has varied due to different actions by the governments on COVID-19.
- We expect the Asian economy to grow at a stable rate of + 4.7% in 2022 as 1) easing of activity restrictions, 2) improvement of the Chinese economy, and 3) increase in external demand will support it.

＜Real GDP, seasonally adjusted＞



Source: JRI, based on Google

＜Growth Forecasts for Asian Economies (as of June 30, 2022)＞

(%)

	2020	2021	2022 (Forecast)	2023 (Forecast)
Asia	- 0.6	7.2	4.7	5.0
Northeast Asia	1.9	7.7	4.1	4.8
China	2.2	8.1	4.4	5.2
Korea	- 0.7	4.1	2.2	2.0
Taiwan	3.4	6.6	2.7	2.1
Hong Kong	- 6.5	6.3	0.3	3.4
ASEAN 5	- 3.6	3.4	5.1	4.6
Indonesia	- 2.1	3.7	4.9	4.8
Thailand	- 6.2	1.5	2.1	2.4
Philippines	- 9.5	5.7	6.5	5.3
Malaysia	- 5.5	3.1	5.8	5.1
Vietnam	2.9	2.6	7.8	6.0
India (FY)	- 6.6	8.7	6.5	5.8

Source: JRI

1. (2) Most economies are further relaxing restrictions on activities

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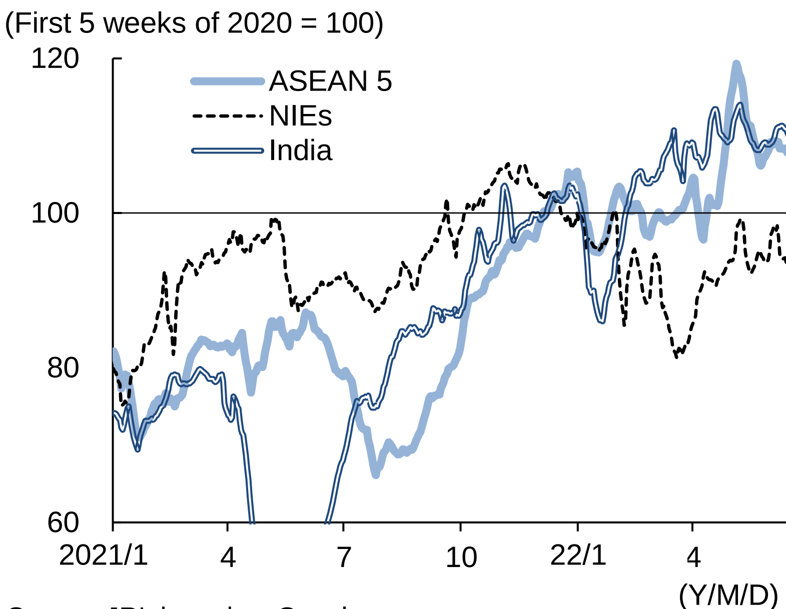
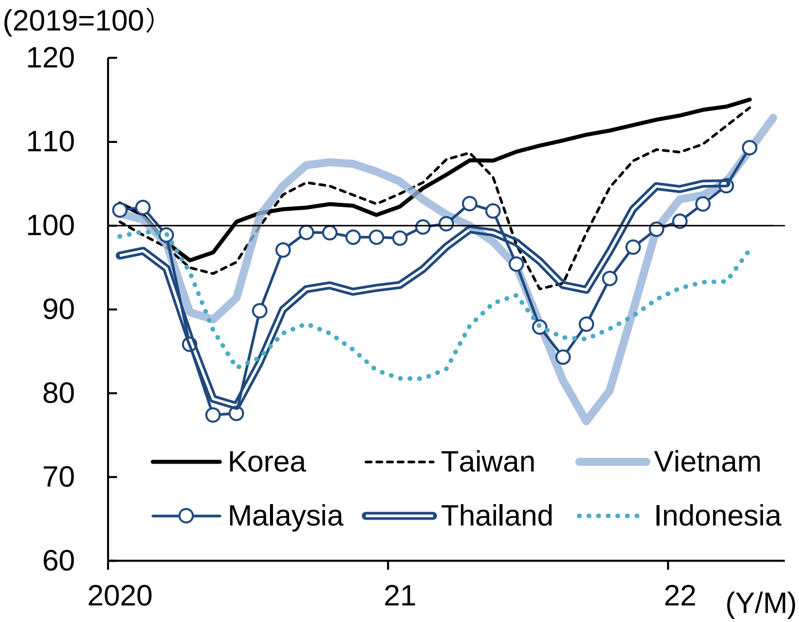
- Asian countries/regions except China and Hong Kong have changed tack and adopted a policy of living with COVID-19. Crowds in shopping malls have exceeded pre-COVID-19 levels.
- Retail sales have recovered in these economies. With the easing of restrictions expected to continue, demand will likely further recover, driven by the retail and service sectors.

＜Mobility Data (Retail & recreation)＞



Source: JRI, based on Google
Note: Calculated by JRI, based on a weighted average of the population of each country/region. 5-day backward moving averages.

＜Retail Sales＞



Source: JRI, based on the statistics of each country
Note: Seasonally adjusted. 3-month backward moving averages.

1. (3) Booming domestic demand in ASEAN

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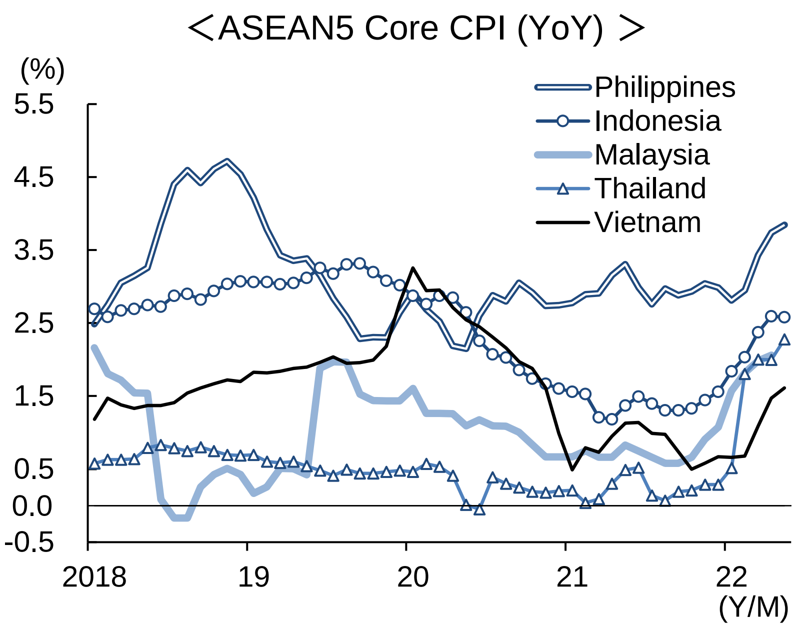
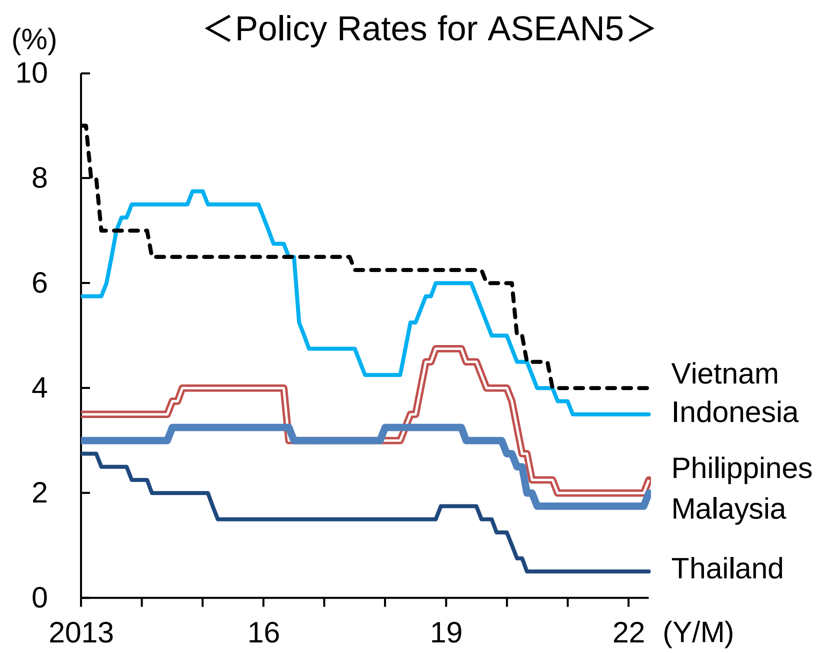
- Food and energy prices are soaring, and core inflation is also on the rise in ASEAN countries due to the strong recovery in domestic demand.
- Central banks in ASEAN could accelerate rate hikes as downward pressure on their currencies due to U.S. interest rate hikes, as well as the resulting upward pressure on prices. Indeed, some ASEAN countries have already started rate hikes, and others could follow it.



Source: JRI, based on CEIC

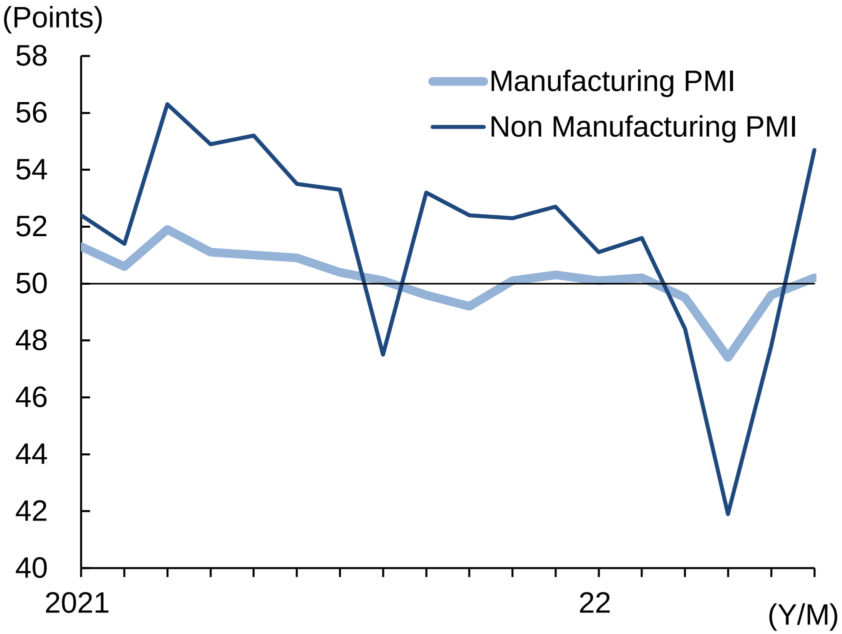


Source: JRI, based on Bloomberg L.P
Note: Data for Vietnam are Refinancing rate.

1. (4) The Chinese economy is picking up

- In China, although the zero-COVID strategy is still in place, activity restrictions have been eased as the number of infected people has declined since May, and consumption and industrial production are rebounding.
- n addition, the government has indicated that it plans to increase fiscal spending/monetary easing. The Chinese economy is thus predicted to pick up, mainly led by public-sector demand.

＜China Purchasing Managers Index＞



Source: JRI, based on National Bureau of Statistics of China

＜China's Economic Policies＞

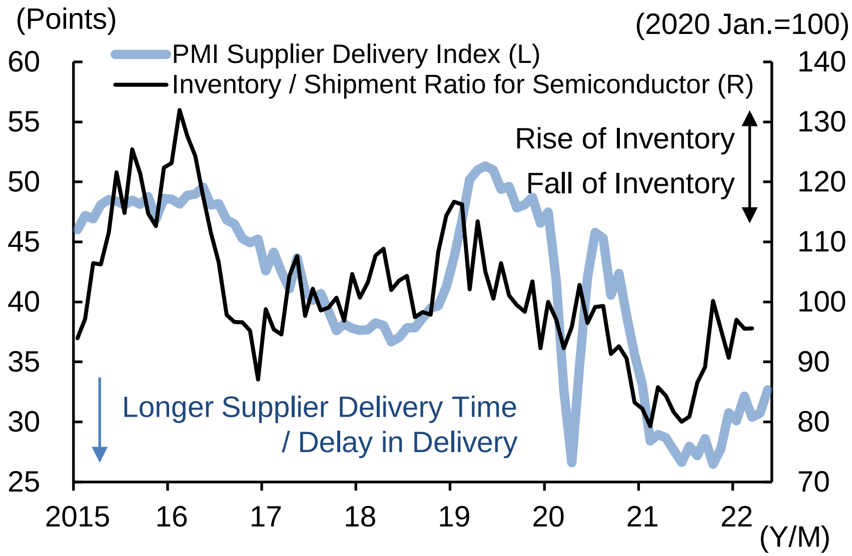
	Main Initiatives
Fiscal Policy	Reinforcement of infrastructure development (Expansion of coverage, accelerated execution of public works projects) Early implementation of Tax reduction and refunds
Financial Policy	Implement various policies
Industrial Policy	Gradual easing of crackdown on Internet platform companies

Source: JRI, based on 中国共产党新闻网 and various reports

1. (5) External demand will remain solid

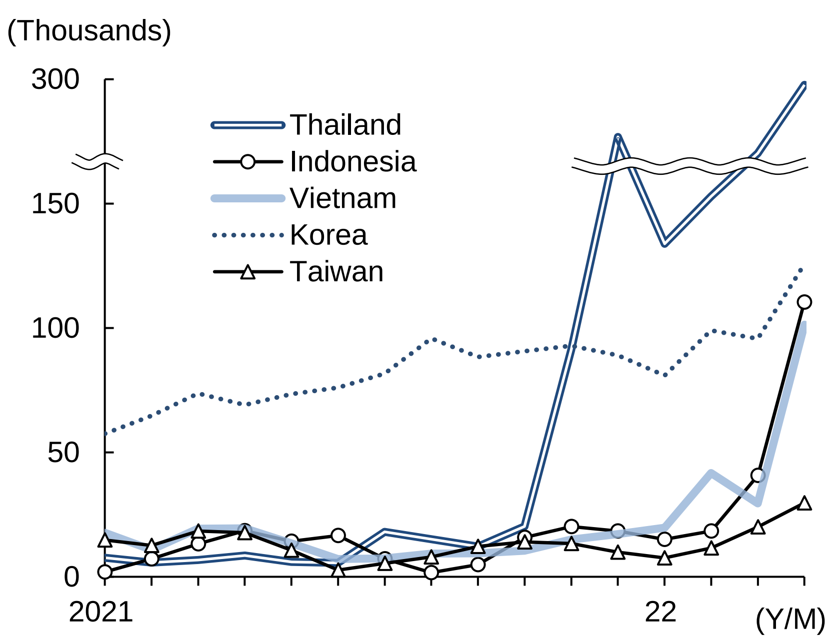
- Goods exports/imports should stay on an upward path as global demand for semiconductors will remain robust. Inventories in semiconductors are still at low levels, suggesting chip makers will increase production to resolve the semiconductor shortage.
- Asian economies other than China are moving to ease entry restrictions for visitors from overseas. The relaxation of entry restrictions could help boost total foreign demand going forward.

＜PMI Supplier Delivery Index (Global Electronics) and Inventory / Shipment Ratio for Semiconductor＞



Source: JRI, based on S&P Global and CEIC
Note: Semiconductor inventory / shipment ratio is the weighted average of exports by Japan, the United States, Korea and Taiwan in 2020.

＜Number of foreign arrivals＞

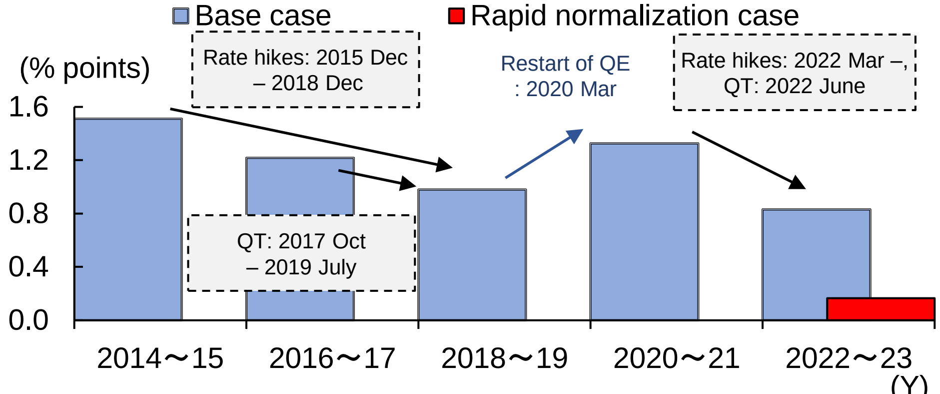


Source: JRI, based on CEIC

2. (1) Higher risks to capital inflow in emerging economies

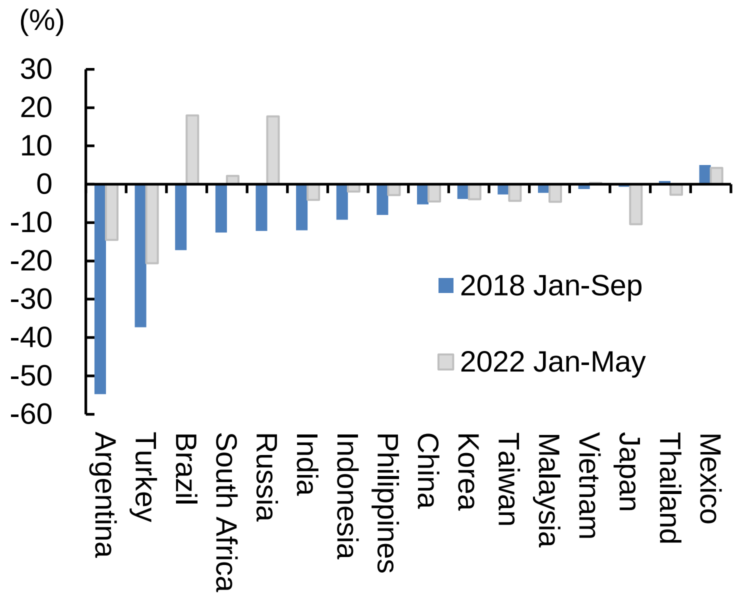
- An acceleration of US monetary policy normalization is increasing risks to capital inflow in emerging economies. We estimate it could depress capital inflow (% of GDP) by 0.5 percentage point in 2022-23.
- Rate hikes in tandem with QT in 2018 caused market turmoil with many emerging countries' currencies falling. The risk of a similar situation occurring again is mounting.

＜Impacts of the US Monetary Policy on the Capital Flow (Net inflow) in Emerging Economies (% of GDP)＞



Source: JRI estimates
Note: Estimated impacts derive from the monetary policy factors in the model that is estimated based on the panel data of 9 major emerging countries (India, Indonesia, Malaysia, Philippines, Thailand, Brazil, Mexico, South Africa, Turkey). The model includes capital flows (% of GDP) of emerging countries as an explained variable and US monetary policy factors (interest rate differences and assets of the FRB), growth factors (growth rate gap), risk factors (VIX, etc.) as explanatory variables.
[Base case] We use the outlook for the Fed's asset balance and FF rates based on the statement and median forecasts by the FOMC committee (as of June 2022).
[Rapid Normalization case] We use the assumption that the US policy interest rate and the Fed's asset balance will return to the level of 2006 by the end of 2023

＜Foreign Exchange Rates in Major Countries＞



Source: JRI, based on CEIC

2. (2) Vulnerability to external shock in Asia

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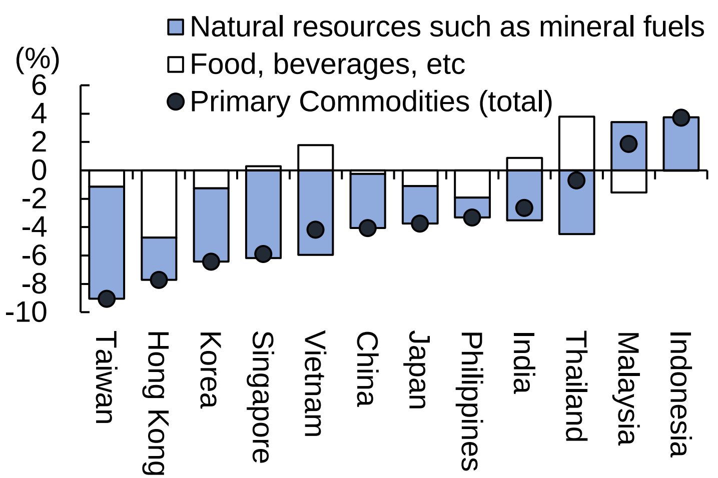
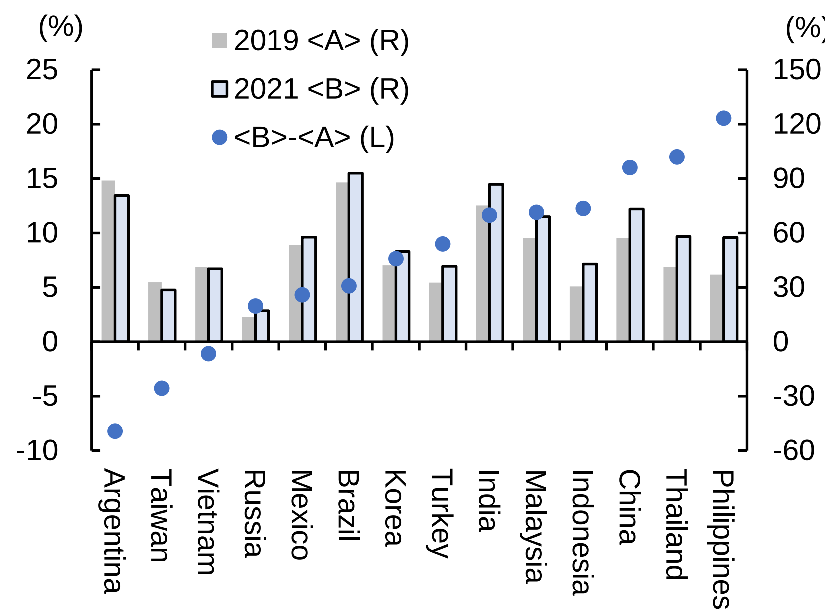
- Asia's economic fundamentals related to external vulnerability could deteriorate further due to the COVID-19 pandemic and Ukraine crisis.
- In Asia, higher commodity prices have caused the problems of 1) deteriorating current account balances, 2) accelerating inflation, and further spending by the governments to help the weakening economy under the pandemic and the relief measures for higher prices have resulted in 3) cumulatively increasing government debt.

＜Trade Balance of Primary Commodities (% of GDP, 2020)＞



Source: JRI, based on WITS(World Integrated Trade Solution)
Note: Primary commodities consist of section 0 (Food and live animals), 1(Beverages and tobacco), 2(Crude materials, inedible, except fuels), 3(Mineral fuels, lubricants and related materials), 4(Animal and vegetable oils, fats and waxes), 68(Non-ferrous metals) in the Standard International Trade Classification (SITC).

＜General Government Debt＞



Source: JRI, based on IMF

3. (1) De-coupling from China may have begun

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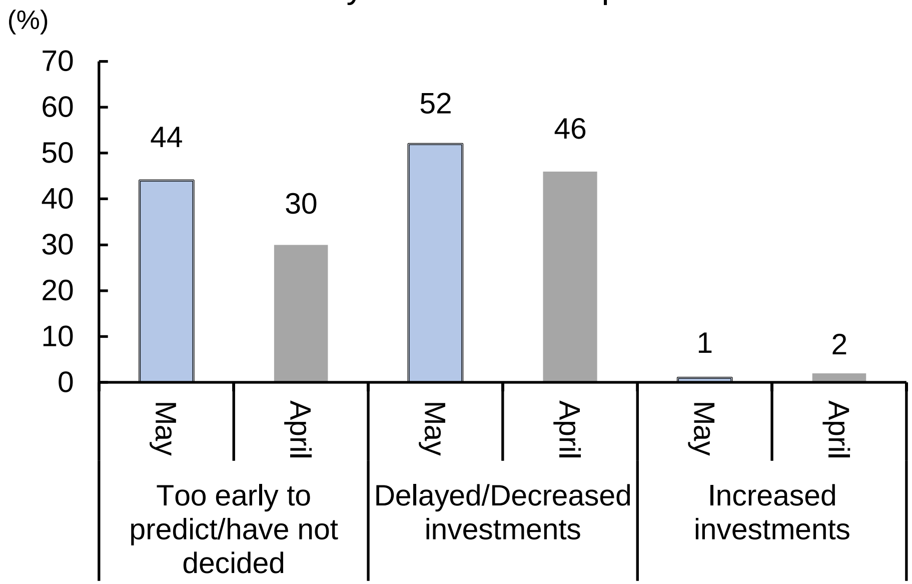
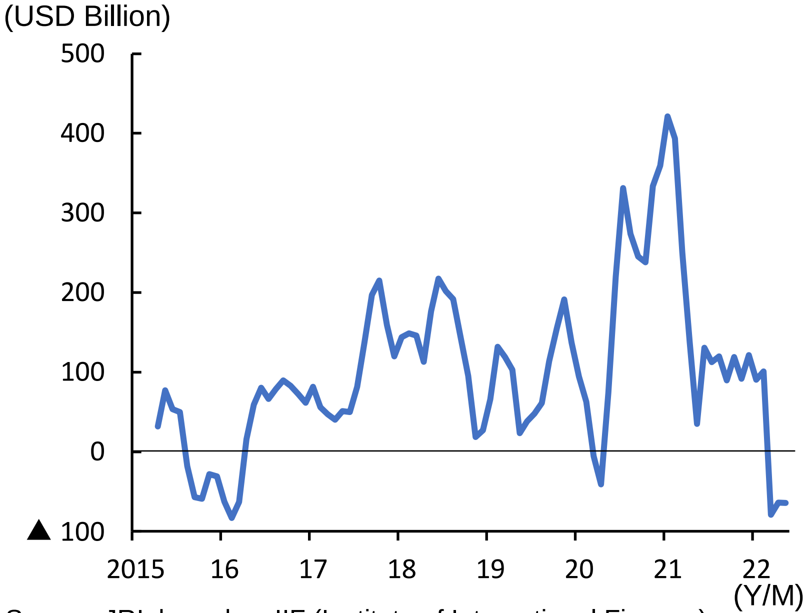
- For foreign companies, the risks of doing business in China are higher than ever, as there is a risk that strict activity restrictions will be imposed again there in the near future with China still sticking with its zero-COVID strategy. The “secondary sanctions” related to Russia may adversely affect companies in China.
- Investment in China mainland from overseas has declined, which could suggest there is a move of de-coupling from China in the financial market.

＜AmCham China Flash Survey:
What impact has the recent COVID-19 outbreak in China had on your investment plans? ＞



Source: JRI, based on AmCham China

＜Capital Flow in China
(Net inflow of Portfolio investment)＞



Source: JRI, based on IIF (Institute of International Finance)
Note: 3-month backward moving averages.

3. (2) “Friend-shoring” by the U.S. is accelerating

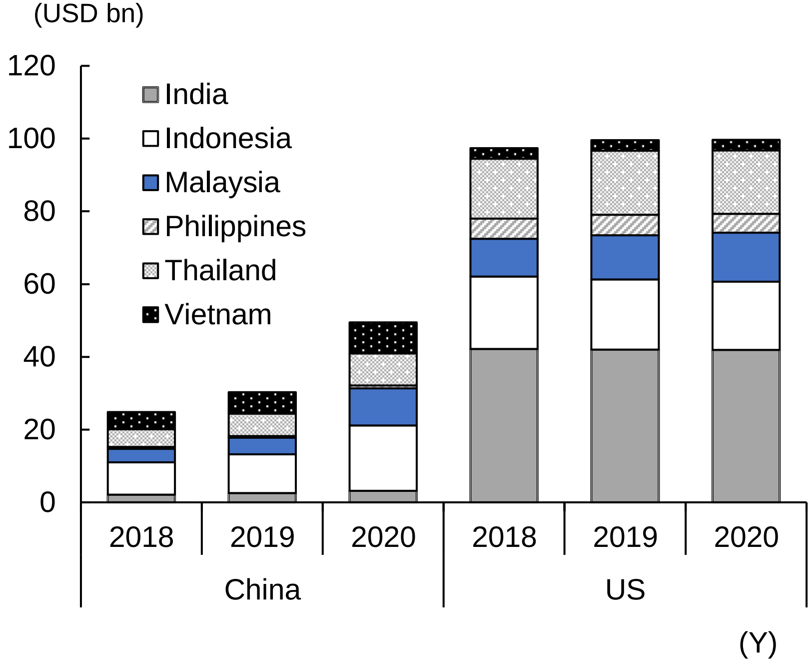
- The U.S. is now promoting “friend-shoring” which involves developing supply chains in friendly countries, and announced the launch of the Indo-Pacific Economic Framework for Prosperity (IPEF) .
- However, no concrete measures, such as subsidies for the relocation of companies and infrastructure development, etc., have been announced for IPEF. It is currently unknown whether the IPEF will actually function to form a strong coalition against China.

＜Four Pillars of the IPEF＞

14 countries agreed to join the IPEF negotiations, which include the U.S., Australia, Brunei, Fiji, India, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, Korea, Thailand, and Vietnam. (as of June 2022)	
Trade	Building high-standard, inclusive, free, and fair trade commitments
	Cooperation in the digital economy
Supply Chains	Improving transparency, diversity, security, and sustainability in our supply chains
	Ensuring access to key raw and processed materials, semiconductors, critical minerals, and clean energy technology
Clean Energy, Decarbonization, and Infrastructure	Accelerating the development and deployment of clean energy technologies
	Deepening cooperation on technologies, on mobilizing finance, including concessional finance, and on seeking ways to improve competitiveness and enhance connectivity by supporting the development of sustainable and durable infrastructure and by providing technical assistance.
Tax and Anti-Corruption	Enacting and enforcing effective and robust tax, anti-money laundering, and anti-bribery regimes

Source: Ministry of Foreign Affairs of Japan

<FDI to Asia from China and US>



Source: JRI based on IMF(CDIS)

This is a English version of "【アジア経済見通し】アジア景気は良好も、金融面にリスク～新型コロナとウクライナ危機によって高まる脆弱性～" in JRI Research Report (https://www.jri.co.jp/MediaLibrary/file/report/researchreport/pdf/13532.pdf)

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