

# Asia Economic Outlook: Cautious optimism

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## **2 Country Focus**

- China
- Japan
- India
- Indonesia

## **3 Risks to Asia's growth outlook**

# Asia: leading the global economy

- Emerging Asian economies to contribute 58% to global growth in next decade.
- We project that China will continue to be the largest contributor at 34% of global growth.

## Contribution to global economic growth by region, 2011-2021 (%)

Source: BBVA Research and IMF WEO

Western Europe

Eastern Europe

North America

**10.5**

**5.8**

**6.0**

**57.9**

Asia (ex.Japan)

**1.8**

Japan

Latin America

**4.1**

**5.0**

Middle East

Africa

**7.8**

**1.0**

Australia +  
New Zealand

# Outlook for Asia

## RMB/USD weakness continues

Source: Bloomberg and BBVA Research

	FX				
	Current Level	1Q15	2Q15	3Q15	4Q15
USD/CNY	6.13	6.22	6.27	6.23	6.17
USD/JPY	121.0	121.0	124.0	126.3	129.0
USD/HKD	7.75	7.76	7.76	7.77	7.77
AUD/USD	0.82	0.77	0.74	0.75	0.78
EUR/USD	1.06	1.06	1.02	1.00	1.01
USD/KRW	1097	1120	1120	1130	1135
USD/SGD	1.36	1.38	1.39	1.39	1.39
USD/TWD	31.3	31.9	32.0	32.2	32.3

## Policy rate outlook

Source: BBVA Research and Bloomberg

	Interest Rates				
	Current Level	1Q15	2Q15	3Q15	4Q15
China	5.35	5.35	4.85	4.60	4.60
Japan	0.10	0.10	0.10	0.10	0.10
India	7.50	7.50	7.25	7.25	7.25
Korea	1.75	1.75	1.75	1.75	1.80
Australia	2.25	2.25	2.00	2.00	2.00
Indonesia	7.50	7.50	7.50	7.50	7.50
Taiwan	1.88	1.88	1.88	1.88	1.88

## GDP growth outlook

Source: BBVA Research and Bloomberg

% yoy	GDP							
	2012	2013	2014	2015*	1Q15*	2Q15*	3Q15*	4Q15*
China	7.7	7.7	7.4	7.0	7.0	7.1	7.0	6.9
Japan (q/q saar)	1.5	1.5	0.0	1.3	2.3	1.0	1.1	0.3
Hong Kong	1.5	2.9	2.3	3.3	3.0	3.3	3.3	3.5
India	4.8	4.6	5.2	7.4	7.5	7.5	7.6	7.7
Australia	3.6	2.3	2.7	2.5	2.2	2.4	2.7	3.0
Korea	2.3	3.0	3.3	3.4	2.7	3.6	3.5	3.8
Singapore	2.5	3.6	3.0	3.2	2.1	3.4	3.1	3.3

\* preliminary estimate

Forecasts as of 15 April 2015

# Key themes for Asia in 2015

## Oil Prices

- Falling commodity and oil prices favor commodity importers
- Lower oil prices foster benign inflation, aid external balances, lift real income of households, provide scope to enhance fiscal space and boost productive spending

## External Demand

- Uneven global growth has led to an uncertain trade environment – Asian exports remain fragile
- Softness in international commodity prices taking a toll on Asian exports as price realizations erode despite export volumes going up
- Yet, net terms of trade gains and import contraction has led to narrower trade deficits

## Fed Rate Increase

- Expect volatility in global financial conditions in the run up to Fed's policy rate normalization
- Global financial markets buoyed by expectations of Fed rate normalization being pushed back into late 2015, policy easing in other advanced economies, and EMEs easing interest rates
- Markets to discriminate against those with relatively weaker fundamentals and/or oil exporters

## Structural Reforms

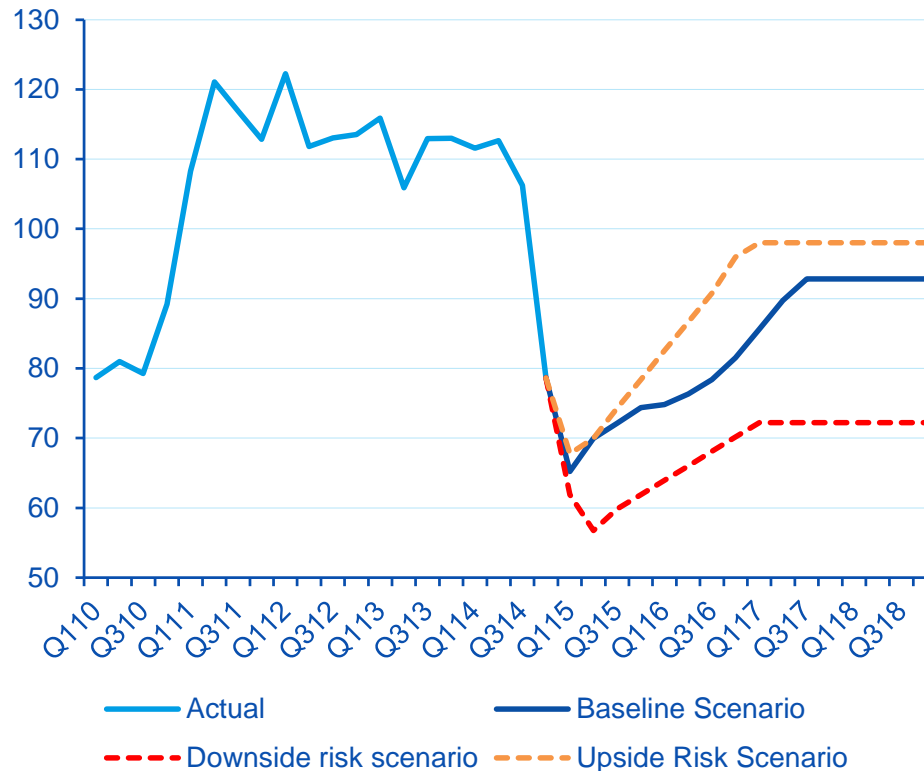
- International capital flows to favor high and sustainable growth and policy virtue
- Effective implementation of structural reforms - a key differentiating factor amongst Asian EMEs
- Asian economies try to establish manufacturing credentials amid rising labor costs in China

# Oil price impact: a 'U' shaped price recovery

- We do not expect \$40-\$50 per bbl WTI oil to last forever, but we do think it could last for another two quarters
- When higher oil prices materialize, we don't think we're going back secularly to \$80 per barrel WTI oil as downward cost pressures and the optimism surrounding US shale growth weighs on prices.

**WTI Oil prices and price trajectory (USD/bbl)**

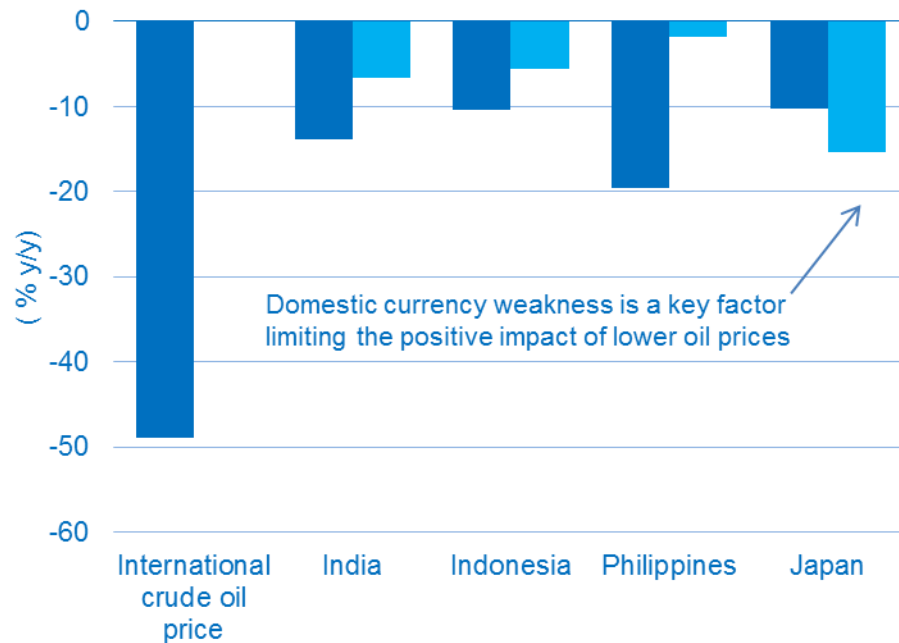
Source: CEIC data, BBVA Research



# Oil price impact: low oil price aids dis-inflation and eases fiscal space in Asia

## Incomplete pass through of fall in crude oil prices to end consumers across most Asian economies

\*All retail gasoline prices are for non-subsidized fuel at retail level; Source: CEIC, BBVA Research



■ Change in retail gasoline prices - June '14 to Dec '14

■ Change in domestic currency against US Dollar (- Depreciation/+ Appreciation)

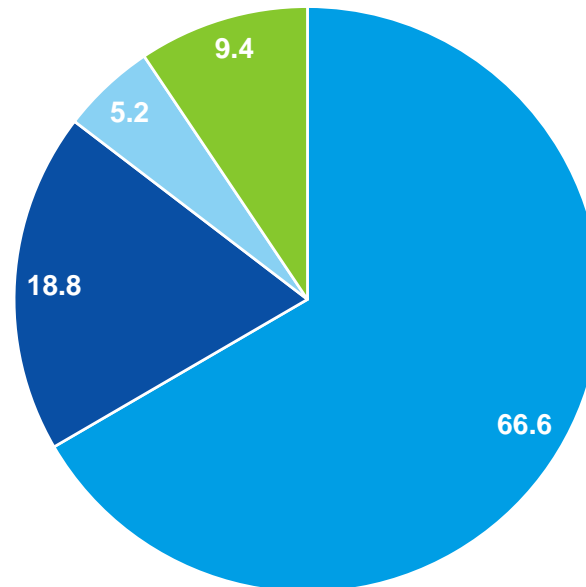
- Falling commodity prices to foster a low inflation environment in Asia, although with a few exceptions.
- Indonesia is likely to face higher inflation in 2015 amid continued fiscal reforms aimed at reducing fuel subsidies.
- In general, lower oil prices to enhance room for Asian central banks to consider growth supportive monetary policies
- Oil prices have a positive impact on Asia's fiscal balance, enhances room for productive spending
- Trade balance sensitivities to oil prices are positive for major oil importers such as India and Indonesia in contrast to oil exporters such as Malaysia.
- Domestic currency weakness alongside hikes in excise duties on petroleum products, such as in India, have contributed to incomplete pass through of fall in crude oil prices to end consumers across most Asian economies

# Oil Price Impact: neutral on China

- China's large size helps to buffer exogenous shocks.
- Coal accounts for more than two thirds of China's energy demand, further muting any oil price impacts.
- Coal prices have fallen 40% in the last two years and this has not impacted GDP significantly.

## China's Energy Mix (% share, 2012)

Source: NBS and BBVA Research



■ Coal ■ Crude Oil ■ Natural Gas ■ Hydro, Nuclear & Renewables

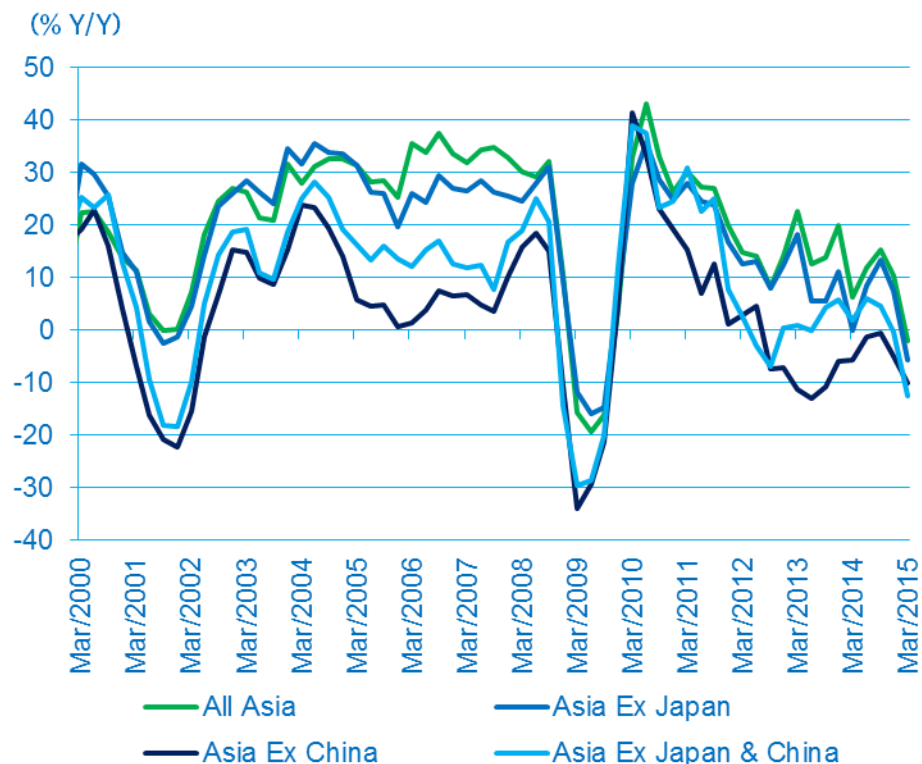


# External demand: Asian exports remain fragile...

- Despite relative improvement in global growth, Asian exports continue to record negative growth
- Asian exports contracted 12% y/y in Q1, the sharpest since September 2009, on a nominal GDP weighted average basis.

## Asian Exports ( % Y/Y , Nominal \$ GDP Weights)

Source: CEIC data, BBVA Research

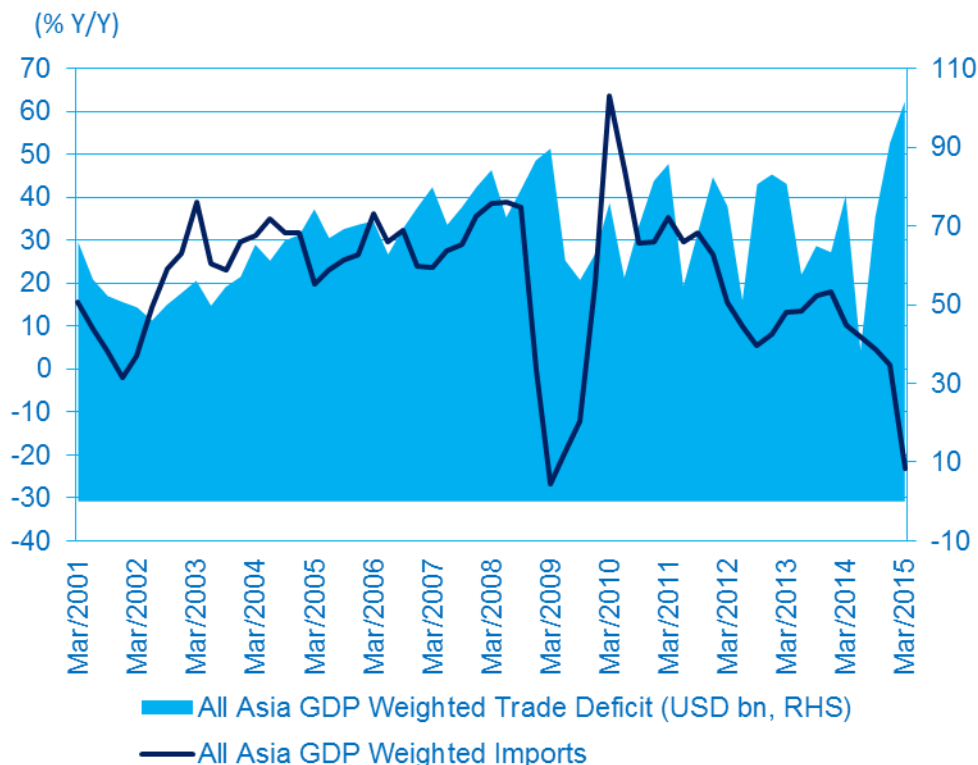


# External demand: weaker imports have led to net trade gains...

- Import contraction has offset weakening exports, in turn leading to net positive trade gains for Asia.
- All Asia imports contracted 23% y/y in Q1.
- While Q1 import contraction is largely China driven, imports of Asia excluding China have seen extended weakness over the past two years.

## Asian Imports and Trade Deficit ( % Y/Y , USD billion)

Source: CEIC data, BBVA Research

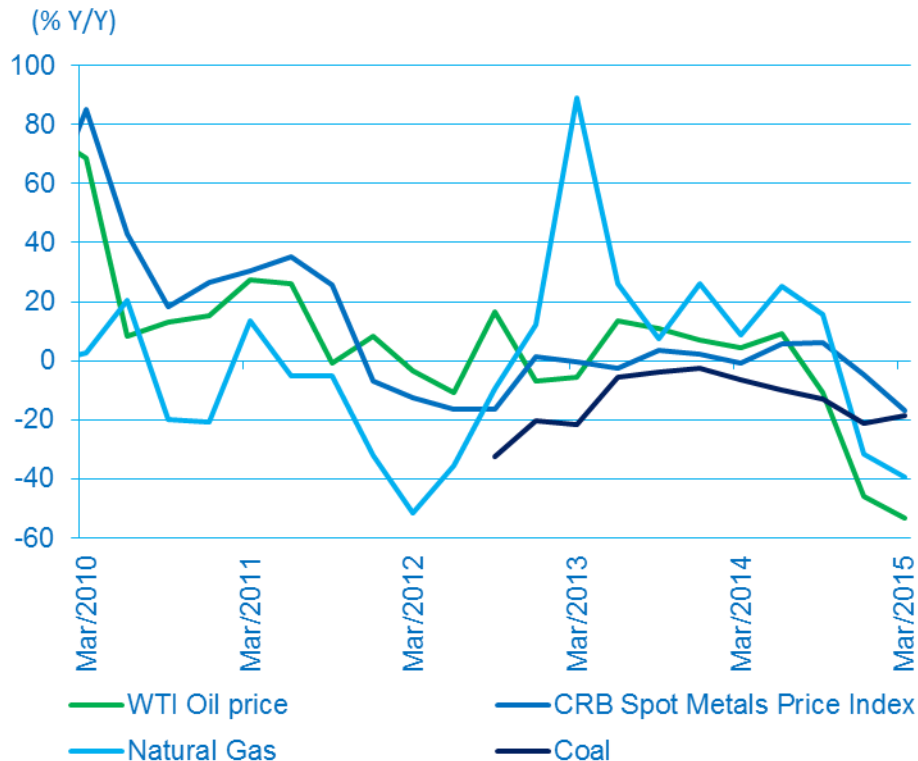


# External Demand: impacts of commodity-currency interplay

- The slump in commodity prices has been partly offset by relative currency appreciation of most Asian economies amid sharp depreciation of the Euro and JPY.

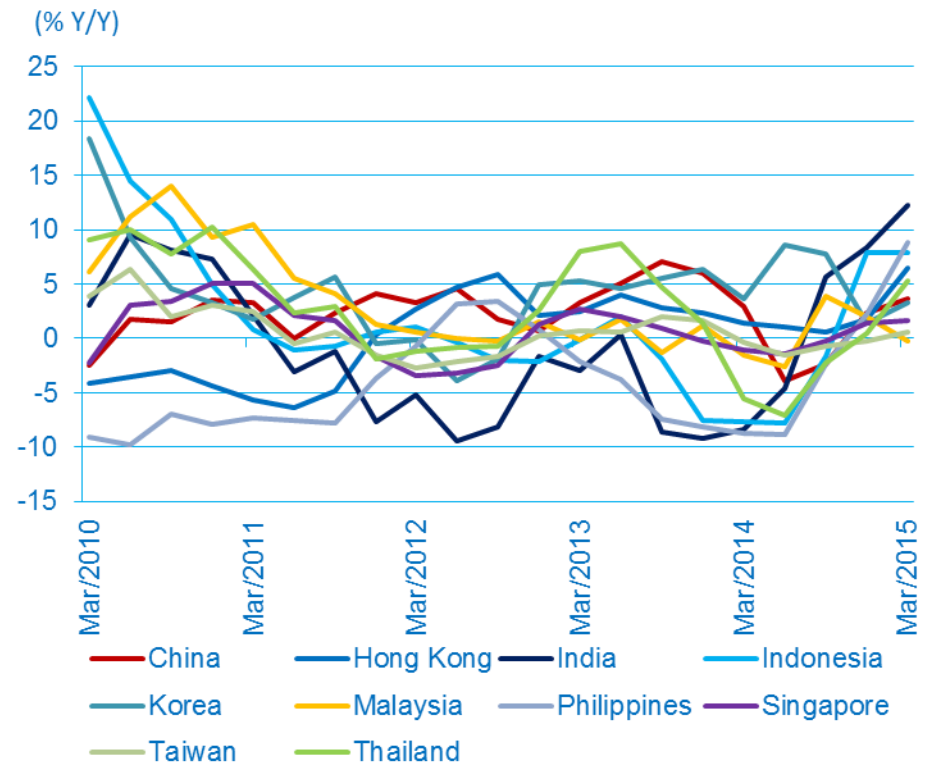
## Slump in global commodity Prices (%Y/Y)

Source: CEIC data, BBVA Research



## Asian currency appreciation on real trade weighted basis (%Y/Y)

Source: CEIC data, BBVA Research

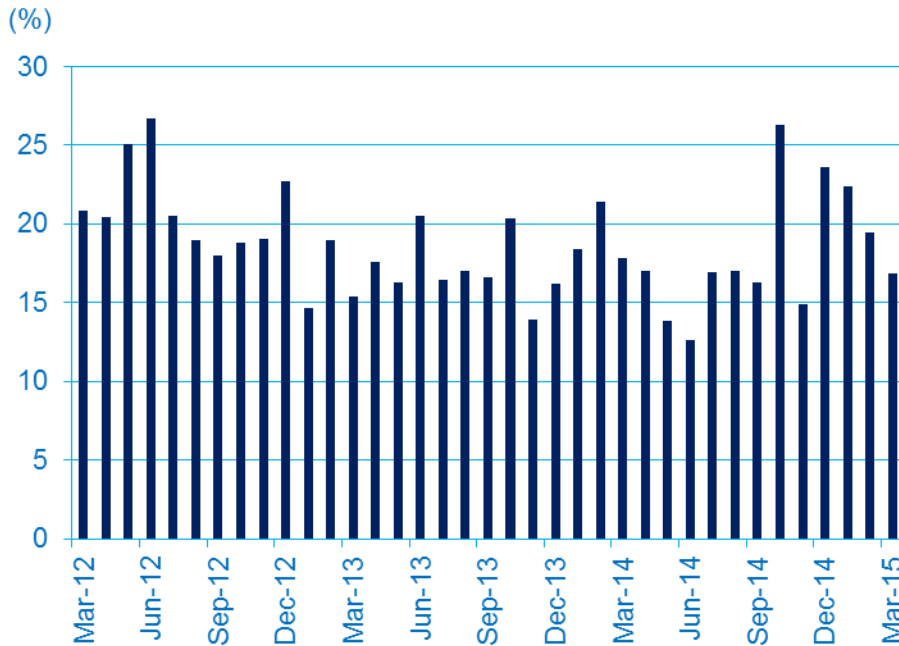


# Fed's policy normalization: delay in Fed's imminent 'lift-off' buoys markets...

- Scope for further growth supportive policy rate cuts across Asia amid subdued inflation pressures. However, aggressive policy easing is less likely as Central Banks prepare for volatile times in the run up to Fed's liftoff.

## Volatility index (VIX) has trended lower in 2015

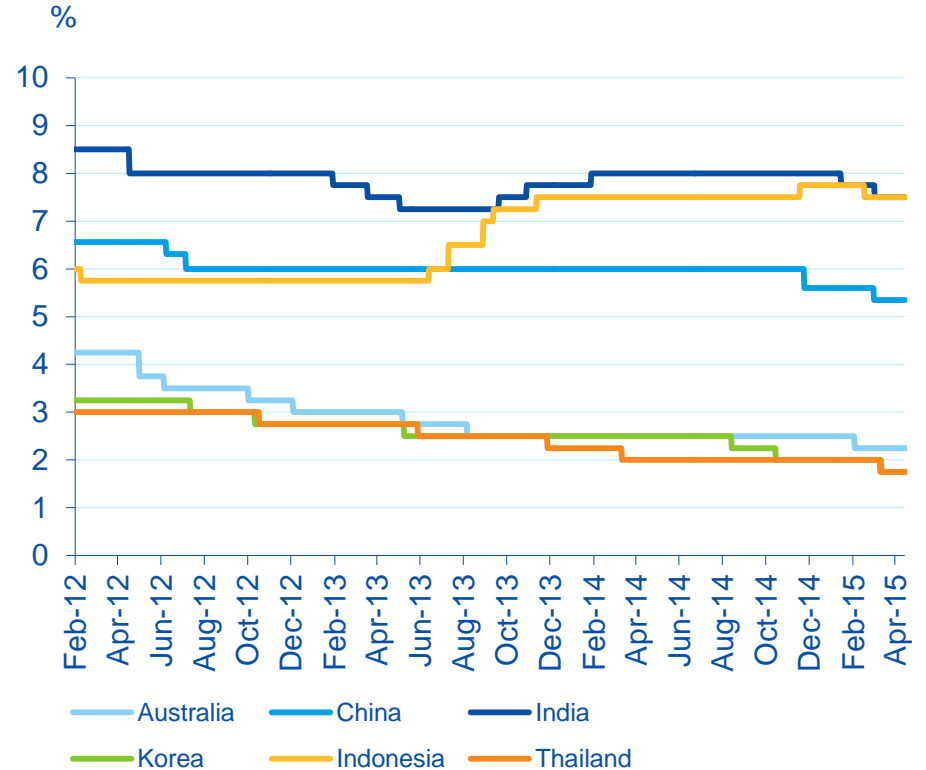
Source: CEIC data, BBVA Research



■ VIX

## Asian economies have used the room to ease policy rates

Source: CEIC data, BBVA Research



# Fed's policy normalization: Asian EMEs are better prepared for Fed's lift-off

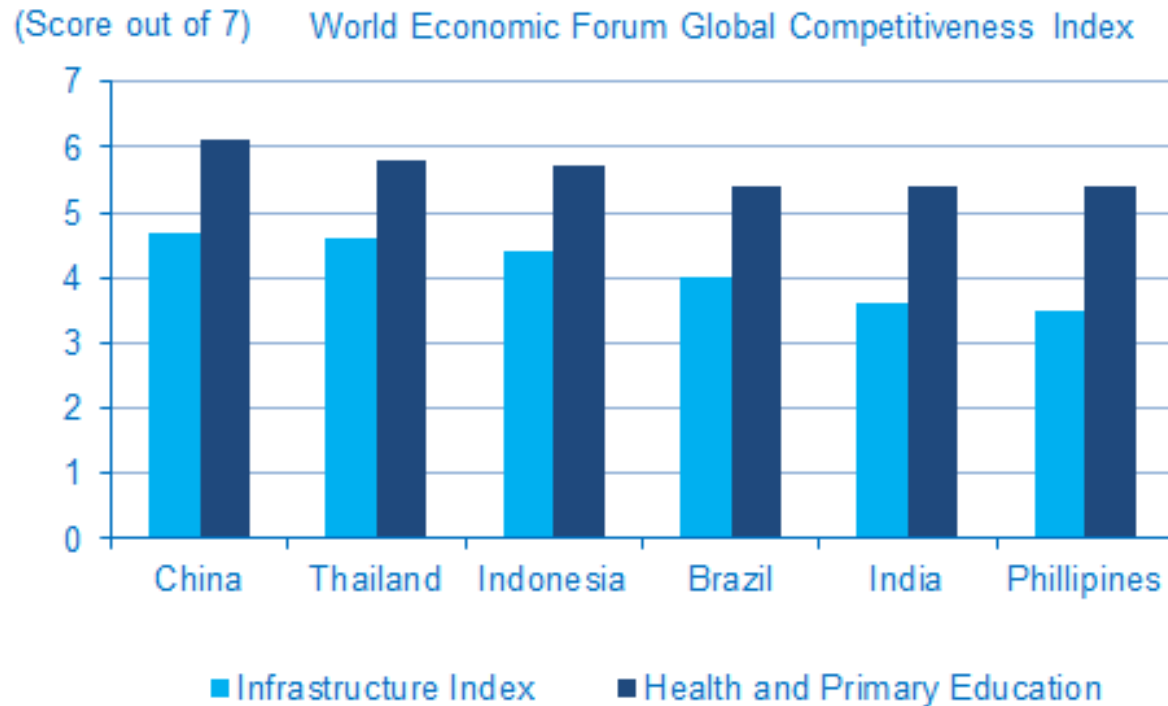
- Although knee jerk reactions to the Fed's lift-off involving short term capital outflows are inevitable, most Asian have seen improvements in external vulnerability indicators since the Fed's taper tantrum in May 2013.

## External vulnerability indicators have improved for most Asian economies since the QE taper tantrum

Source: Haver Analytics data, BBVA Research

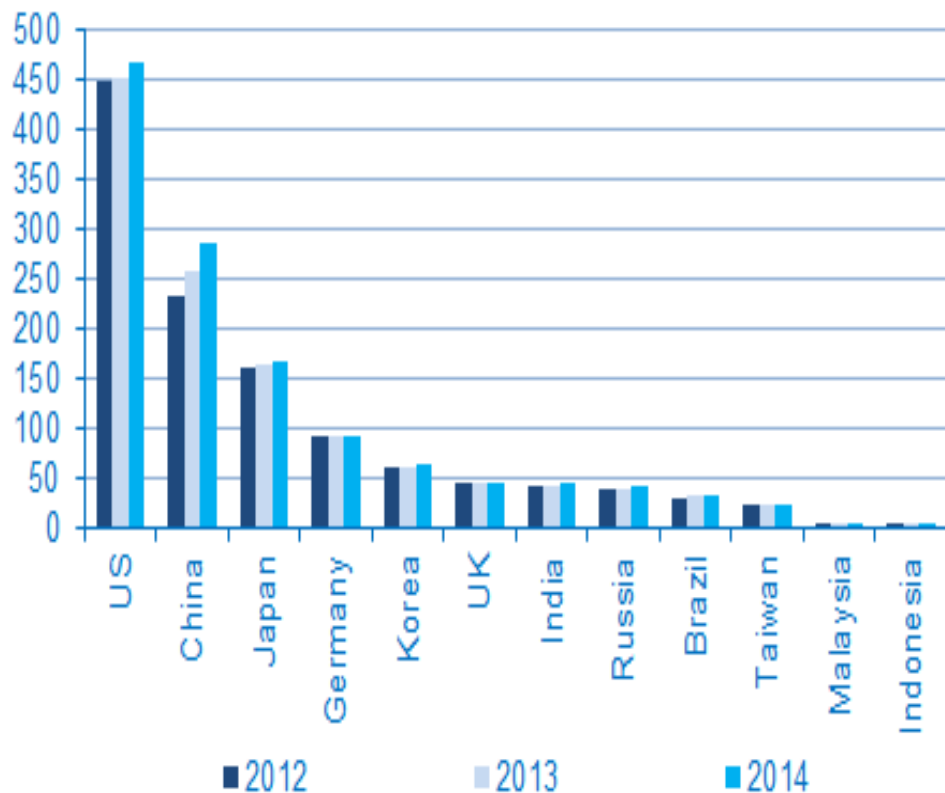
	Fiscal Sustainability		External Sustainability		Liquidity Management	
	Central Govt Debt (% of GDP)		Current Account Balance (% of GDP)		Short Term External Debt as share of FX Reserves (%)	
	May/2013	Current	May/2013	Current	May/2013	Current
<b>India</b>	46.8	45.0	-4.6	-1.6	34.3	26.7
<b>Indonesia</b>	22.7	25.8	-4.2	-2.8	61.2	55.0
<b>Philippines</b>	47.8	40.0	4.4	5.9	23.2	23.1
<b>Thailand</b>	30.9	32.0	-7.2	9.2	38.6	38.1
<b>Malaysia</b>	54.7	52.1	0.8	2.2	81.4	103.8

# Structural Reforms: aimed at improving social and physical infrastructure...



# Structural reforms: invest more into R&D

(USD Billion PPP) Gross expenditures on Research and Development



- OECD's share in global R&D spending has slipped from 90% to 70% in a decade.
- China has emerged as a major driver of global R&D despite a GDP growth slowdown.
- China's R&D spending doubled from 2008 to 2012 to USD 257 billion.
- China is investing in innovation infrastructure to move beyond its established position as a low-cost location for manufacturing
- However, China's share of expenditure on basic research to total expenditure on R&D is relatively very low at 5% (USD 9.9 bn) compared to US (17%), Japan (12%) and France (25%).

Source: BBVA Research, R&D magazine, IMF, CIA Fact Book, OECD

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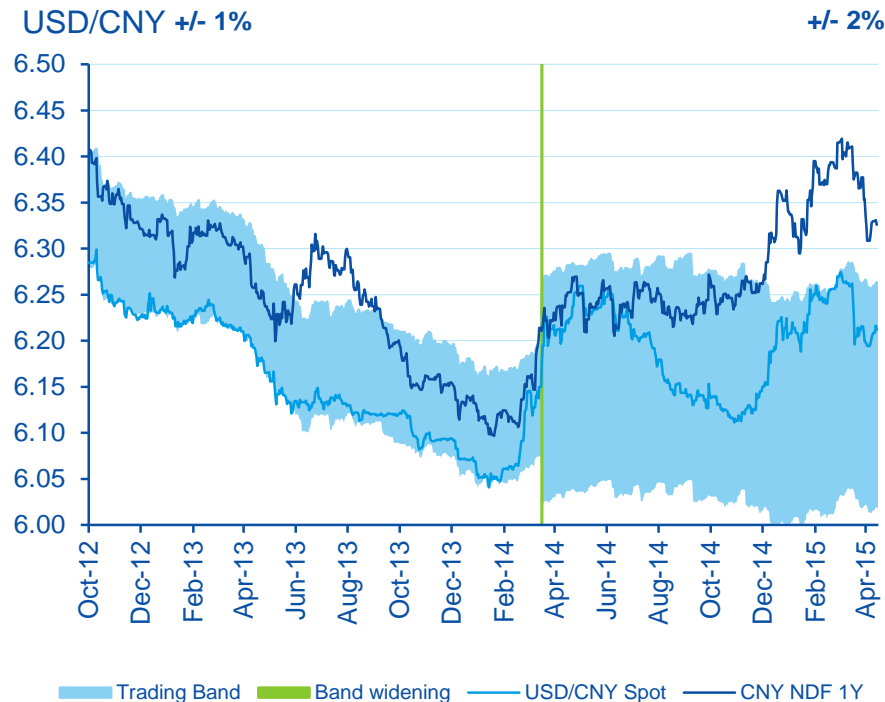


# China: RMB stabilized but weakening bias intact

- The RMB exchange rate has recovered slightly which is probably due to the authorities' stealthy intervention. However, the NDF market still prices in a significant depreciation in a year ahead;
- The discussions about including the RMB in the SDR basket and the prospective AIIB denominating currencies has provided some psychological support for the CNY
- Strengthening trend is expected to stabilize towards the end of the year (6.20-6.25 USD/CNY by year's end) which could further hamper Chinese exports.

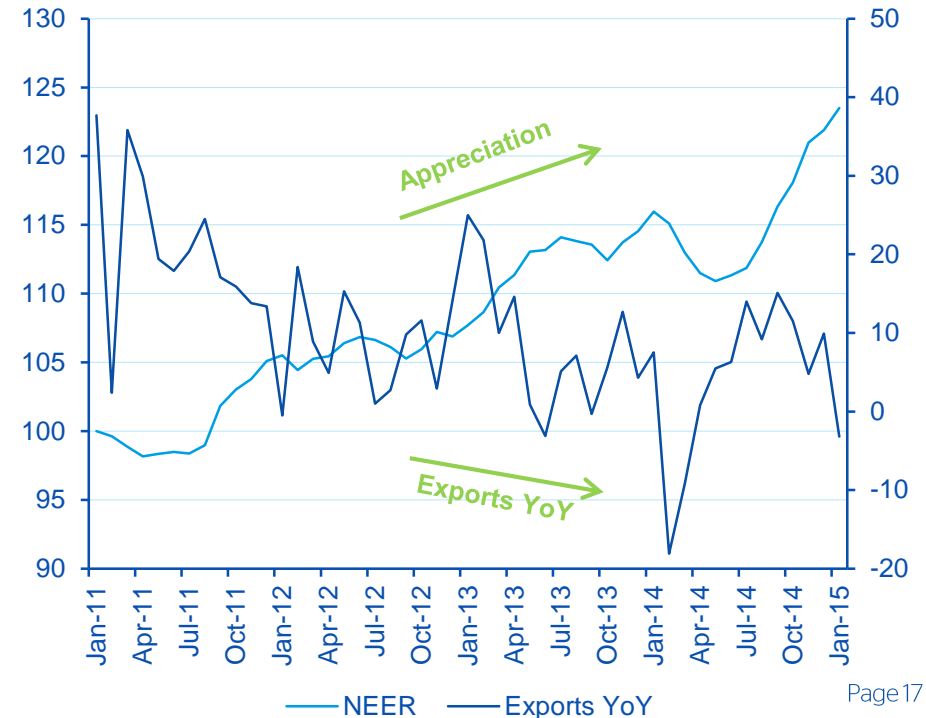
## The RMB recovers slightly...

Source: Bloomberg and BBVA Research



## .... In line with steady appreciation since 2012

Source: BIS and BBVA Research

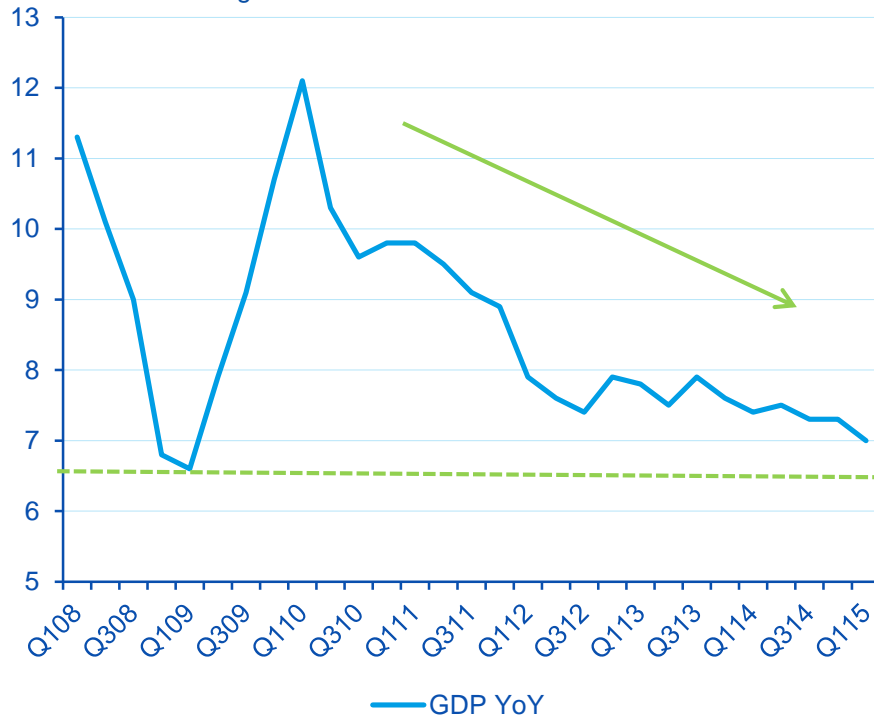


# China: Sluggish growth amid tighter liquidity

- China's Q115 GDP came in at 7.0% y/y, in line with consensus. The latest indicator confirms the downward trend of China's economy. IP (5.6% y/y) and FAI (13.5% y/y) also came in lower than expected signaling mounting downside risks.;
- M2 increased by 11.6% y/y in March compared to the same period a year ago, down from February's 12.5%;
- Shadow banking activities contracted significantly in March due to the authorities' clampdown and the fiscal consolidation of local governments.

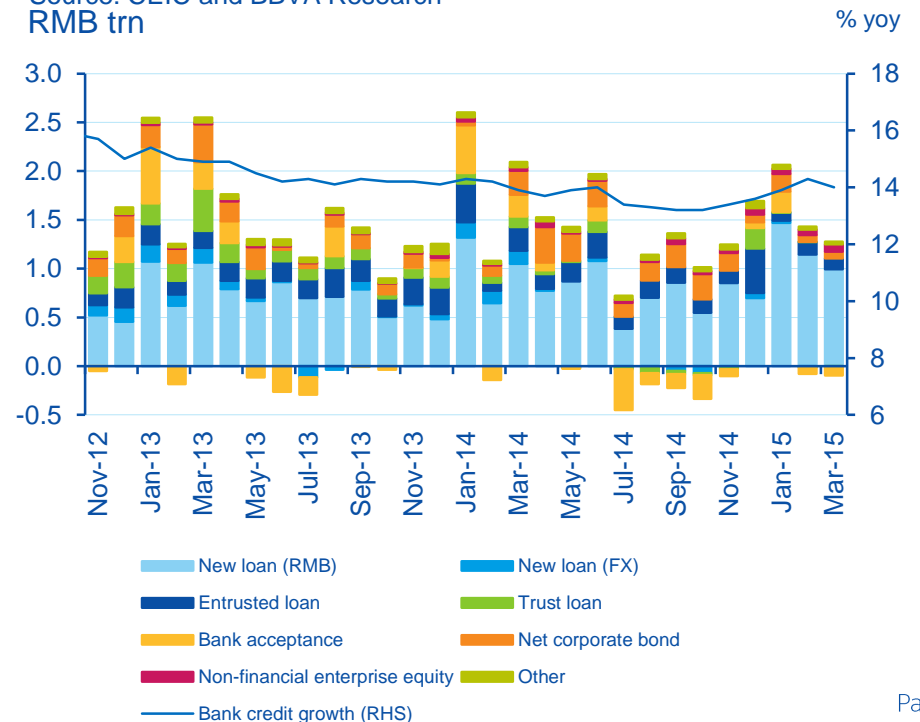
## China's 1Q15 GDP reached lowest level since 2Q09

Source: Bloomberg and BBVA Research



## Bank credit growth fails to impress on a y/y basis

Source: CEIC and BBVA Research  
RMB trn

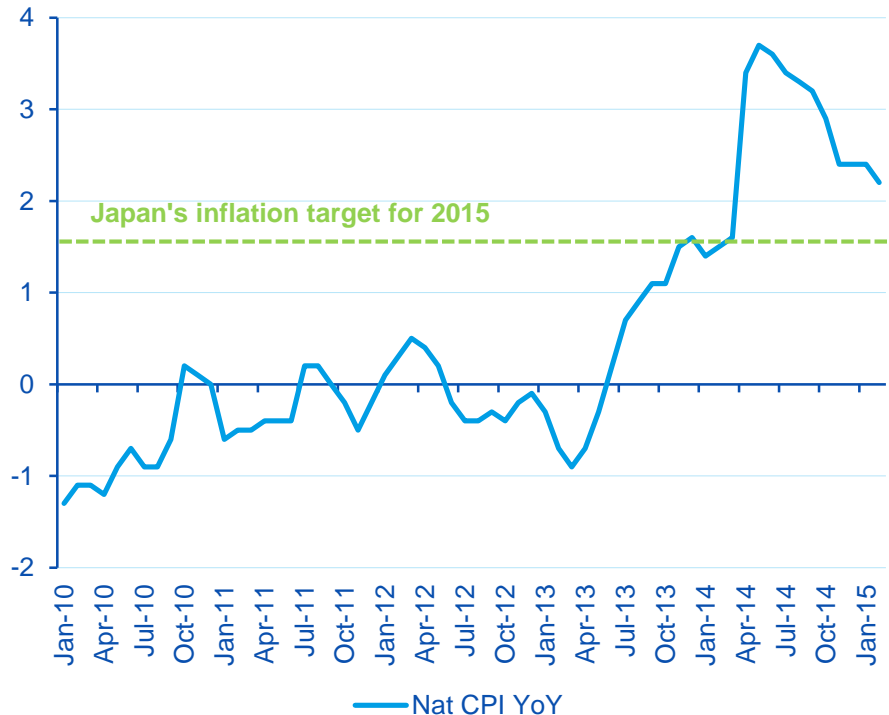


# Japan: Favourable factors in the short-term and more assertive QQE

- Japan managed to stumble out of recession in 4Q14, growing by 1.5% q/q on an annualized SA basis;
- With several favorable short-term factors, Japan is expected to perform well this year although a number of long-lasting problems need to be addressed by structural reforms;
- However, lower than expected CPI outturns mean that Japan may fall short of its 2% inflation target, signaling more assertive easing measures ahead.

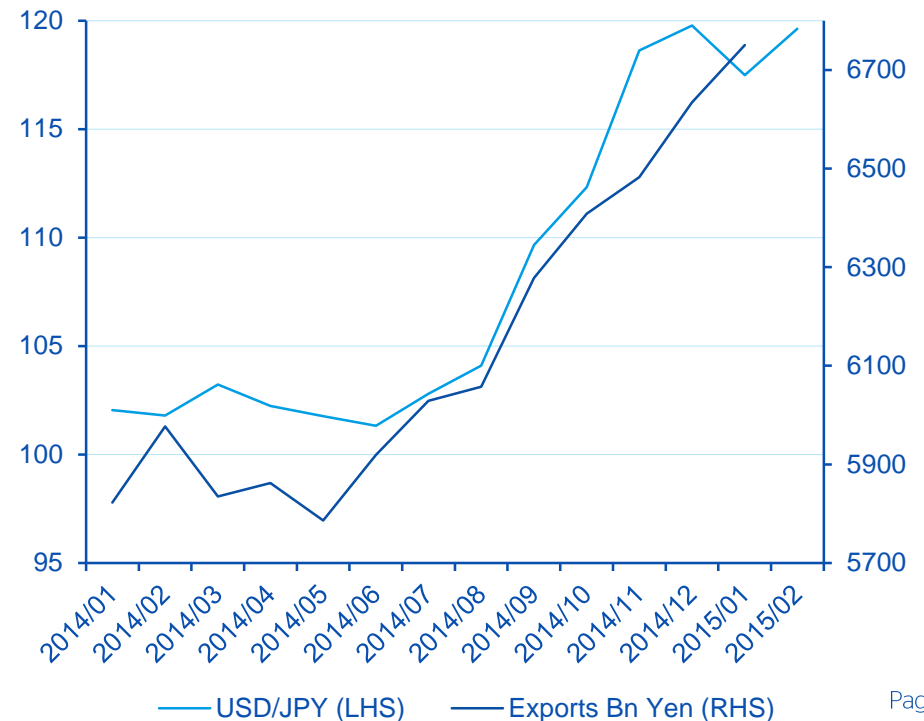
## Japan to struggle to meet its inflation target

Source: Bloomberg and BBVA Research



## Depreciation vs. the USD has boosted exports

Source: Bloomberg and BBVA Research

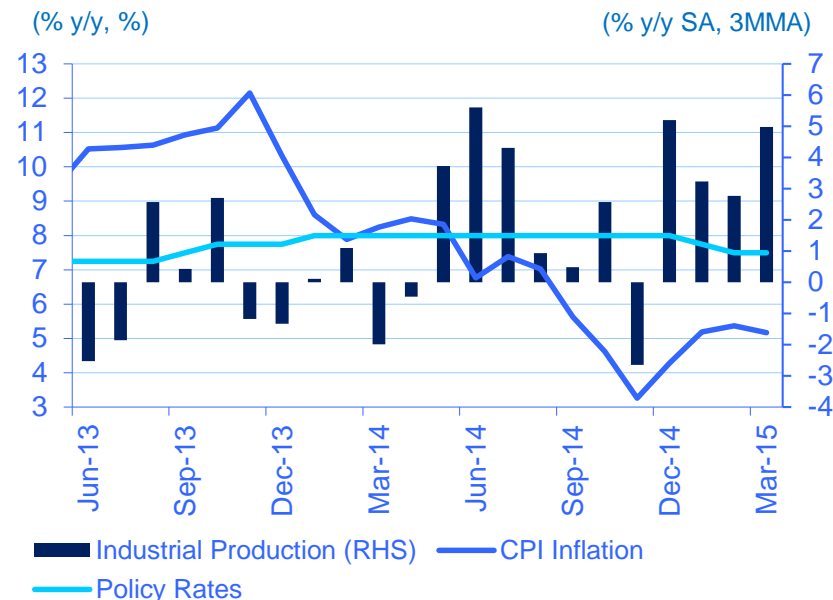


# India: A rating outlook upgrade by Moody's echoes optimism in Modi-Rajan's reform efforts

- Early this month, Moody's upgraded India's sovereign ratings outlook to positive from stable and hinted at possible rating upgrade from Baa3 over the next year citing increased traction on policy reforms and improved fundamentals.
- March CPI inflation outturn echoed ongoing disinflationary momentum across the economy and provides comfort to RBI given its present accommodative policy stance. We foresee scope for a further 25 bps rate cut by RBI in 2015.
- However, room for more aggressive policy easing in 2015 is limited amid imminent Fed rate normalization
- India's record high FX reserves and narrow current account deficit hold it in good stead against the imminent Fed interest rate lift-off although a short term knee jerk reaction to local financial markets cannot be discounted.

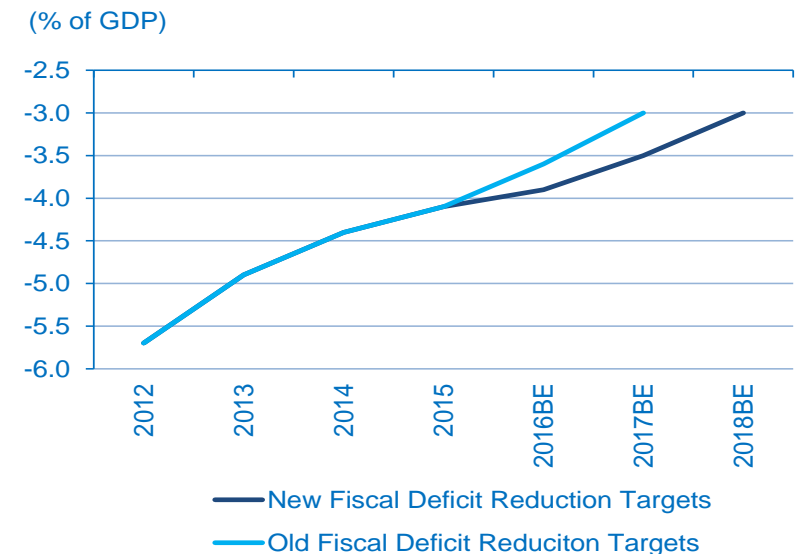
## Indian economy is in a sweet spot amid easing inflation and gradually improving growth...

Source: BBVA Research, Gol



## ... but, Government's fiscal consolidation efforts will be a key for incremental RBI policy easing

Source: BBVA Research, Gol



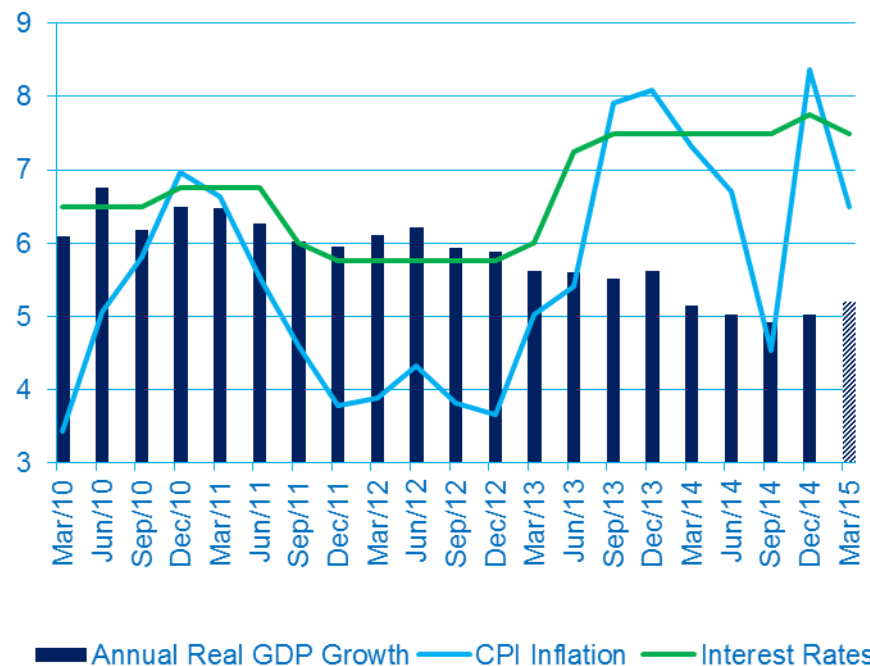
# Indonesia: A long and grinding recovery ahead

- Indonesia's challenges originate from external developments. Unwinding of the global commodity super cycle and China slowdown has led to adverse terms of trade, which used to help fund domestic demand previously.
- Need to develop alternative growth engines to boost productivity and competitiveness of non-commodity sector.
- Reform momentum under President Joko Widodo has been gradual so far and challenged by Indonesia's complex policy making process that centres around consensus building.

## A long drawn economic recovery for Indonesia

Source: CEIC data, BBVA Research

(% Y/Y,



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# RISKS: Tilted to the downside

## External risks

- Deflation in the EU
- Grexit
- Weakening external demand from EU and US
- Falling commodity prices
- EM spillovers (Ukraine, Iraq, Ebola, etc.)

## Regional risks

- Deflationary risks in China
- Slowdown in China
- Japanese recession
- Political tensions in Hong Kong

## Implications for Asia

- Volatile capital flows and higher funding costs
- Market volatility
- Dampening effect on domestic demand and growth

# Thank you!

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