

Economic Analysis

Asia is bracing for a slow, grinding recovery

Sumedh Deorukhkar / Le Xia

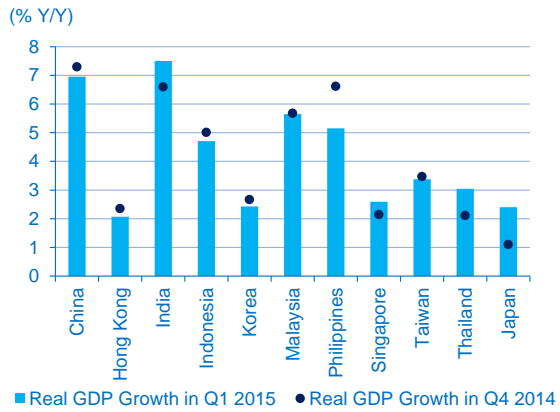
GDP growth slowed across most Asian economies in Q1 2015 as a pullback in government spending, subdued domestic demand and negative exports growth offset a gradually improving investment outlook (See Figures 1 to 4). The sluggish economic activities have prompted the authorities to loosen monetary policy through May, with more easing measures in the pipeline. On the other hand, the elevated debt levels in some Asian countries have made them increasingly vulnerable to an abrupt change of the US monetary policy and accompanying capital flights. The challenging backdrop warrants Asian authorities to 1) expedite structural reforms, 2) introduce micro as well macro prudential measures to mitigate liquidity risks emanating from high leverage, and 3) step up efforts to correct twin deficit concerns on the fiscal and current account.

Growth deceleration is prevalent in the region with only a few exceptions: The downtrend was led by China, which grew 7.0% y/y in Q1 from 7.3% in the previous quarter, its slowest pace since Q1 2009 ([See our China Economic Outlook](#)), in turn raising expectations of more aggressive policy easing through certain QE-like measures. Prima facie, India beat China's pace of growth, as it clocked 7.5% y/y during the period. However, India's headline GDP outturn masked significant weakness under the hood. Excluding volatile net indirect tax receipts, India's Q1 GDP growth slowed to 6.1% y/y from 6.8% in 4Q14. Furthermore, most high frequency domestic activity indicators such as credit growth, IP, freight traffic and vehicle sales; remain subdued while Q1 corporate earnings have disappointed. Elsewhere, GDP growth decelerated significantly in Indonesia (4.7% in 1Q15 vs. 5.0% in 4Q14) ([See our Indonesia GDP flash](#)) and Philippines (5.2% vs. 6.6%), and to a lesser extent in Korea (2.4% vs. 2.7%), Malaysia (5.6% vs. 5.7%), Hong Kong (2.1% vs. 2.4%) and Taiwan (3.4% vs. 3.5%). The brighter spots in the region include Japan (2.4% vs. 1.1%), Thailand (3.0% vs. 2.1%) and Singapore (2.6% vs. 2.1%), although the pick-up in Japan was largely led by inventory adjustments.

The spectrum for further rate cuts across Asia has narrowed but sharper growth deceleration could prod Central banks to act: Apart from potential changes in Fed's monetary policy, domestic macro and financial stability and exchange rate movements will continue to play a vital role in future rate decisions across Asia. For India, Indonesia, Philippines Thailand, and Korea, the risk-reward is in favor of their central banks staying on hold throughout 2015, although we do expect a final 25 bps rate cut by the RBI later this week followed by a long pause. Uncertainty over monsoon rains and its impact on inflation would play a key role in RBI's policy decisions looking ahead while Bank Indonesia needs to strike a delicate balance between supporting growth and stemming macro-stability and exchange rate risks. Meanwhile we expect significant policy easing through fiscal, monetary and unconventional channels by China over the coming months.

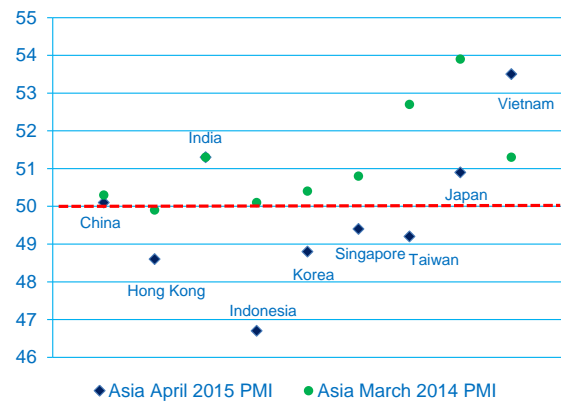
Asia's debt pileup undermines the regions resilience against global liquidity shocks: Divergent monetary policy cycles across the Atlantic, given the imminent US monetary policy normalization, Europe's open ended QE and China's probable QE-like measures, alongside lingering geopolitical conflicts have left capital markets vulnerable to bouts of illiquidity, in turn exacerbating financial stability risks for emerging Asia. High debt levels in the region are a weak link for external vulnerability despite overall improvement in financial stability indicators for Asian economies (See Figures 5 and 6) since the Fed's QE taper tantrum in May 2013. Although still at moderate levels compared to Japan, China's debt accumulation has been the most rapid across Asia since 2007, up 83 percentage points to 217% of GDP. Asia's debt binge is heterogeneous across countries, meaning that it has played out differently – China, Indonesia and Korea has seen a pick-up in corporate debt, Malaysia and Japan have seen higher government debt while Thailand has seen larger household debt.

Figure 1
Bulk of Asia faced slower economic growth in Q1



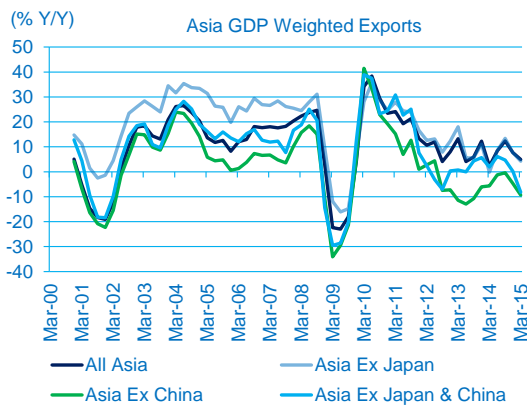
Source: BBVA Research, CEIC

Figure 2
PMI's reflect significant slack in industrial sector



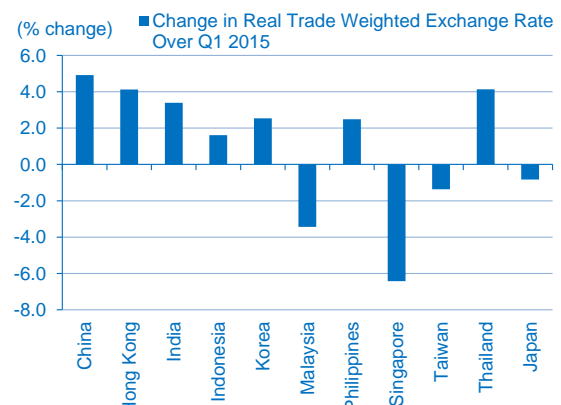
Source: BBVA Research, CEIC

Figure 3
Export growth has seen protracted weakness...



Source: BBVA Research, CEIC

Figure 4
... dragged by real appreciation in exchange rates



Source: BBVA Research, CEIC

Figure 5
Asia's massive debt pileup...

	Change in Debt to GDP ratio : 2007 to 2014 across Asia				
	Current total Debt to GDP ratio* (%)	Real Economy Debt Change, 2007 - 2014 (percentage points)			
		Total	Government	Corporate	Household
China	217	83	13	52	18
India	120	0	-5	6	-1
Indonesia	88	18	-5	17	6
Korea	231	46	15	19	12
Malaysia	222	49	17	16	16
Philippines	116	4	-3	9	-2
Singapore	382	46	15	19	12
Thailand	187	43	11	6	26
Japan	400	64	63	2	-1

Source: IMF, BIS, Haver Analytics, Mckinsey Global Institute Analysis, BBVA Research
* Total debt includes government, corporate and household debt
<= Leverage <= Deleverage

Source: BBVA Research, CEIC

Figure 6
... undermines an otherwise improving financial stability environment across the region

	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
India	46.8	45.0	-4.6	-1.6	34.3	26.7
Indonesia	22.7	25.8	-4.2	-2.8	61.2	55.0
Philippines	47.8	40.0	4.4	5.9	23.2	23.1
Thailand	30.9	32.0	-7.2	9.2	38.6	38.1
Malaysia	54.7	52.1	0.8	2.2	81.4	103.8

Source: BBVA Research, CEIC

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