

ASEAN+3 Regional Economic Outlook (AREO) 2017: Risks and Opportunities

24 May 2017, Renmin University, China

Mandate

- Conduct macroeconomic and financial surveillance of global and regional economies
- Contributes to early detection of risks, policy recommendations for remedial actions and effective decision-making of the CMIM

Core Functions

Surveillance

- Conducting macroeconomic surveillance (regional, member countries, functional/sectoral) and conducting thematic studies/research

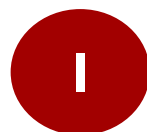
CMIM Support

- Providing support to the members to ensure that the CMIM is operationally ready

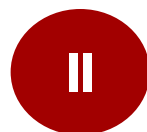
Technical Assistance (TA)

- Providing TA to the members to enhance their human and institutional capacities for macroeconomic surveillance and implementation of CMIM

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Thematic Chapter: ASEAN+3 Region 20 Years after the Asian Financial Crisis



ASEAN+3
REGIONAL
ECONOMIC
OUTLOOK 2017

ASEAN+3 Region:
20 Years after the
Asian Financial Crisis



Chapters

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ASEAN+3 Macroeconomic Prospects and Challenges

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Thematic Chapter: ASEAN+3 Region 20 Years after the Asian Financial Crisis

Chapters

I

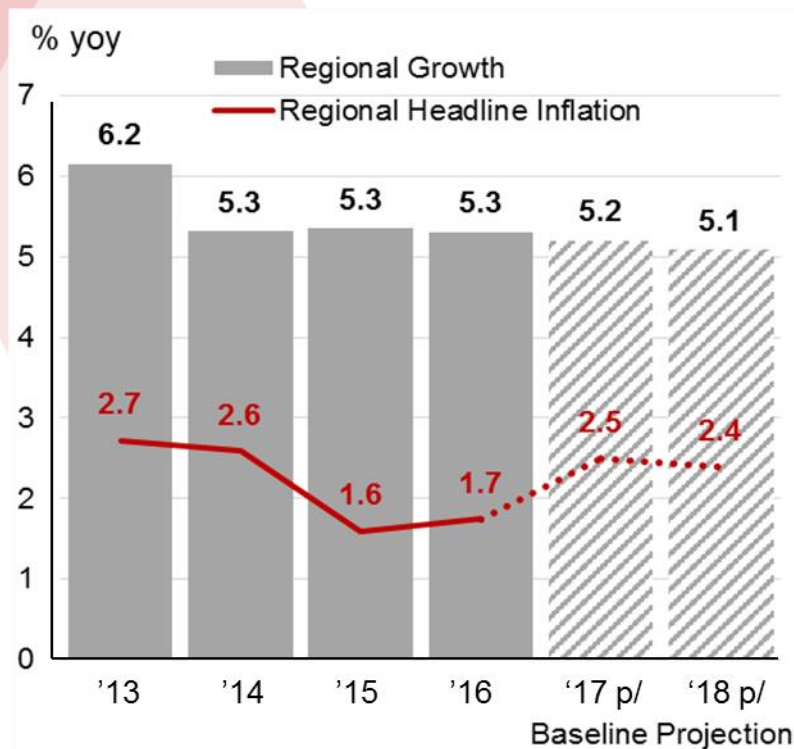
ASEAN+3 Macroeconomic Prospects and Challenges

II

Thematic Chapter: ASEAN+3 Region 20 Years after the Asian Financial Crisis

Amid the external uncertainties, regional growth will continue to be driven by domestic demand. Growth is anticipated to moderate slightly, but sustained around 5 percent in 2017-18

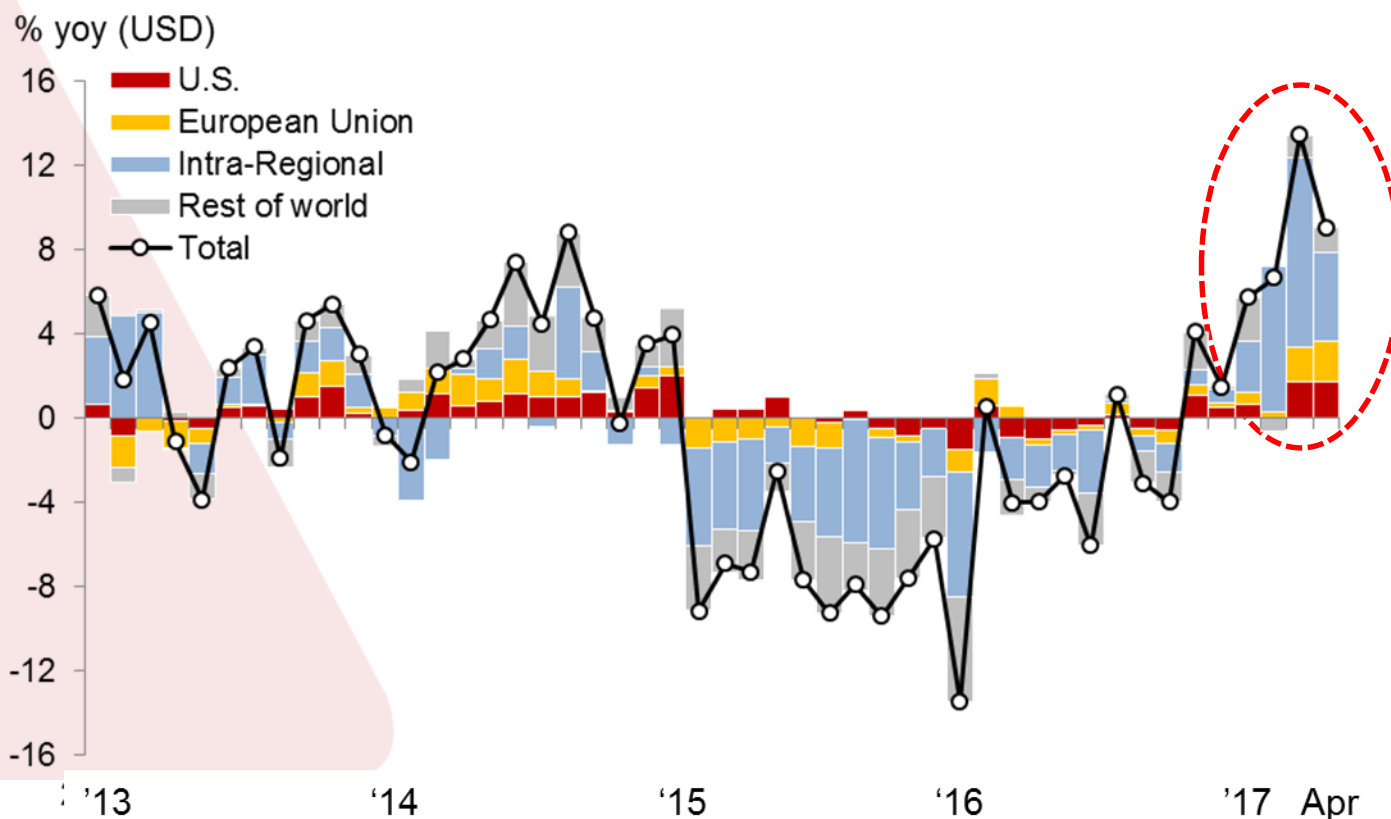
AMRO's Baseline Growth and Inflation Projections



	'16	'17 p/	'18 p/
China	6.7	6.5	6.3
Japan (FY)	1.4	1.3	1.1
Korea	2.8	2.5	2.6
ASEAN-4 & VN	5.0	5.1	5.2
BCLM	5.6	6.5	6.8
HK & SG	2.0	2.1	2.3
ASEAN+3	5.3	5.2	5.1

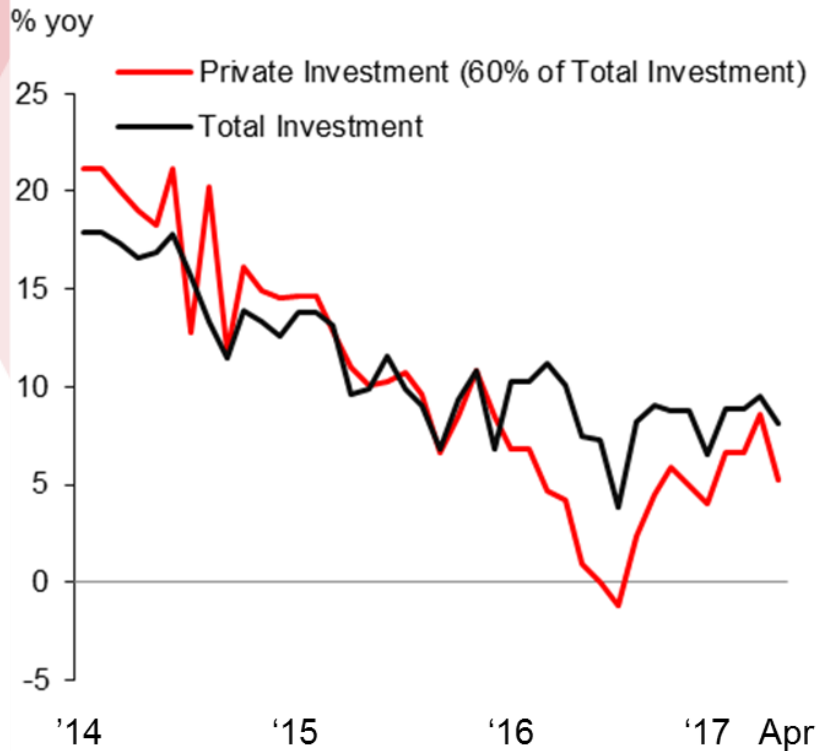
The recent recovery in global trade, if sustained, could provide some upsides to regional exports and growth

Regional Exports by Major Destinations

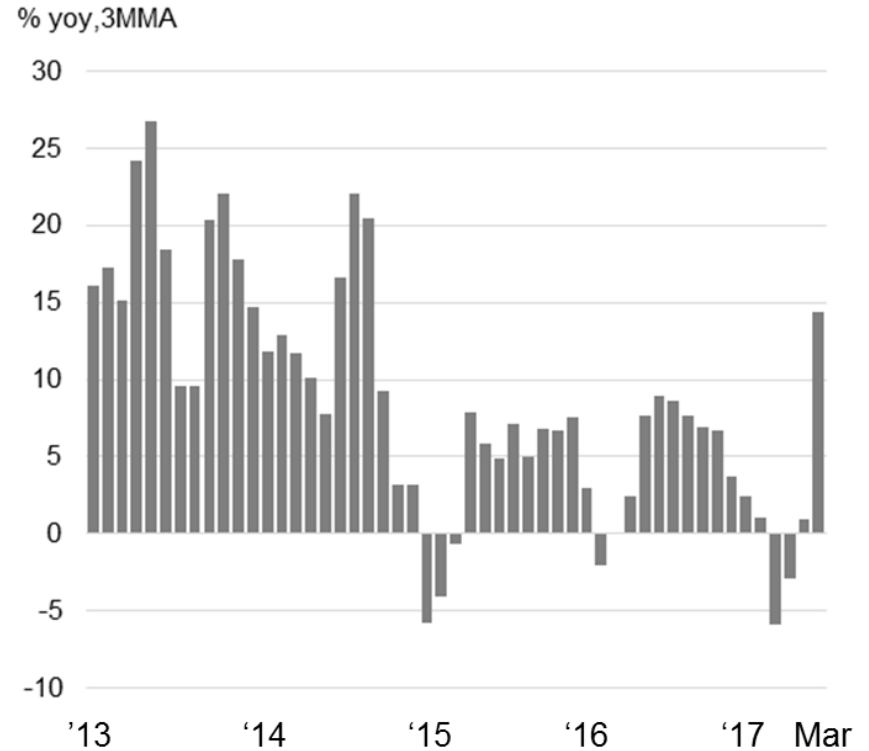


In China, the economy posted a relatively high growth in Q1 2017. Private investment is also firming, reflecting the pick-up in domestic economic activities, alongside an improvement in corporate profits

China: Private Sector Investment

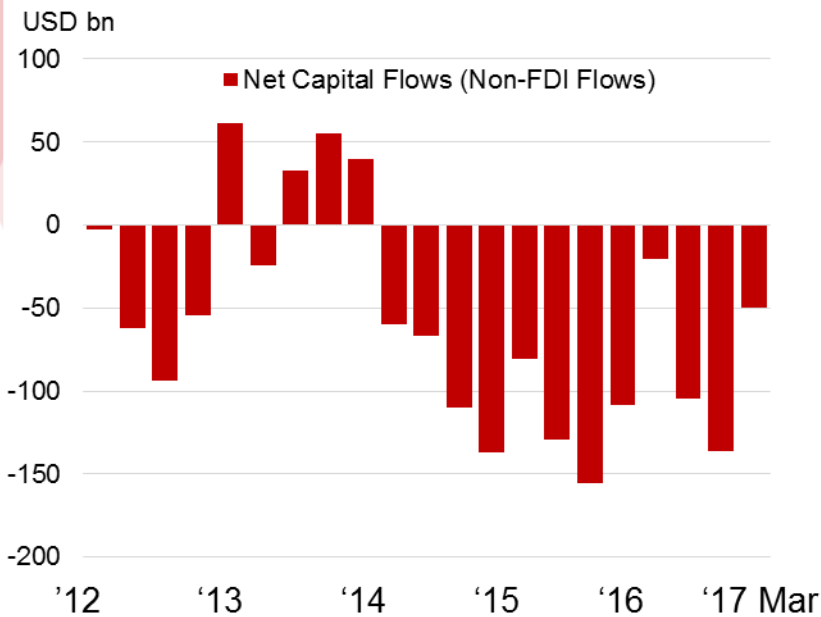


China: Private Sector Profitability

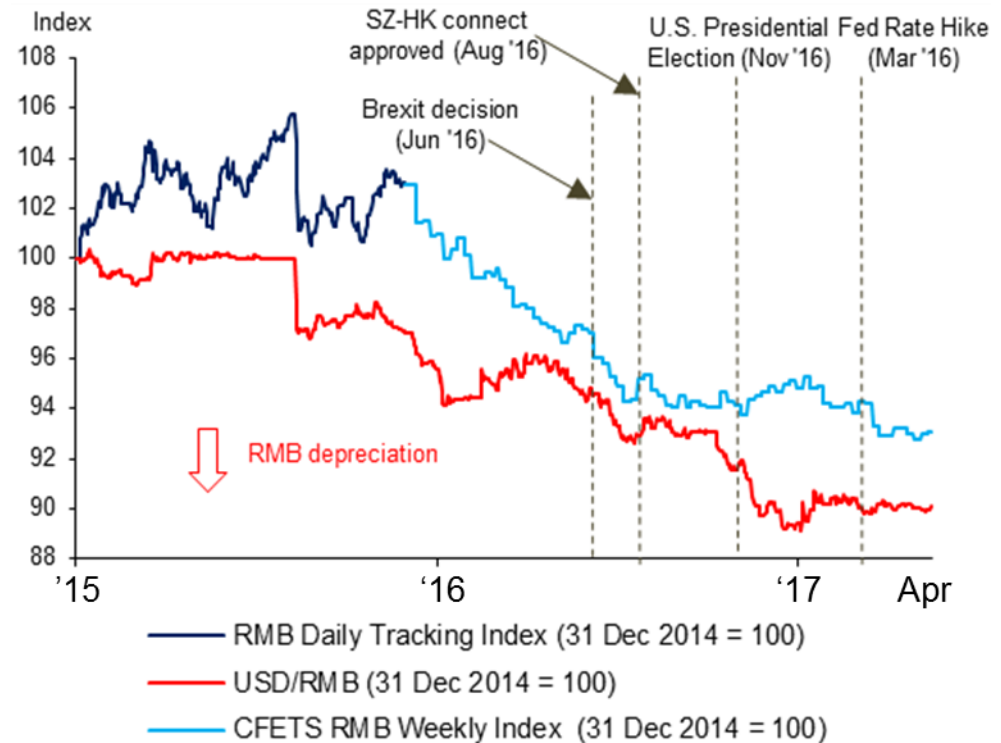


Concerns about China's capital outflows have eased recently, partly reflecting signs of growth stabilization, moderating USD as well as strengthened capital flow management which helped in containing RMB exchange rate volatility

China: Capital Flows Developments

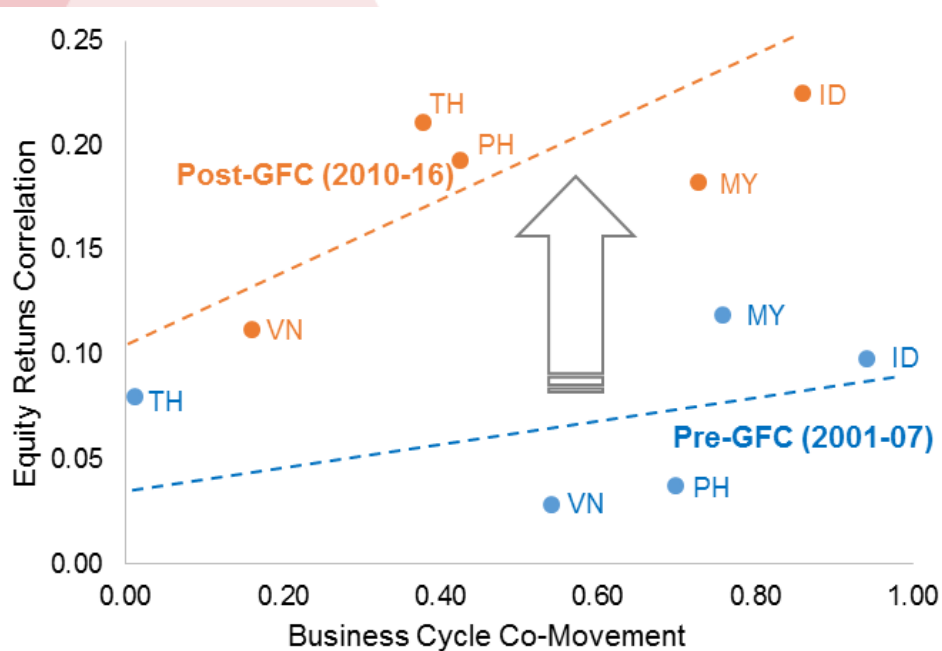


China: Exchange Rate Developments

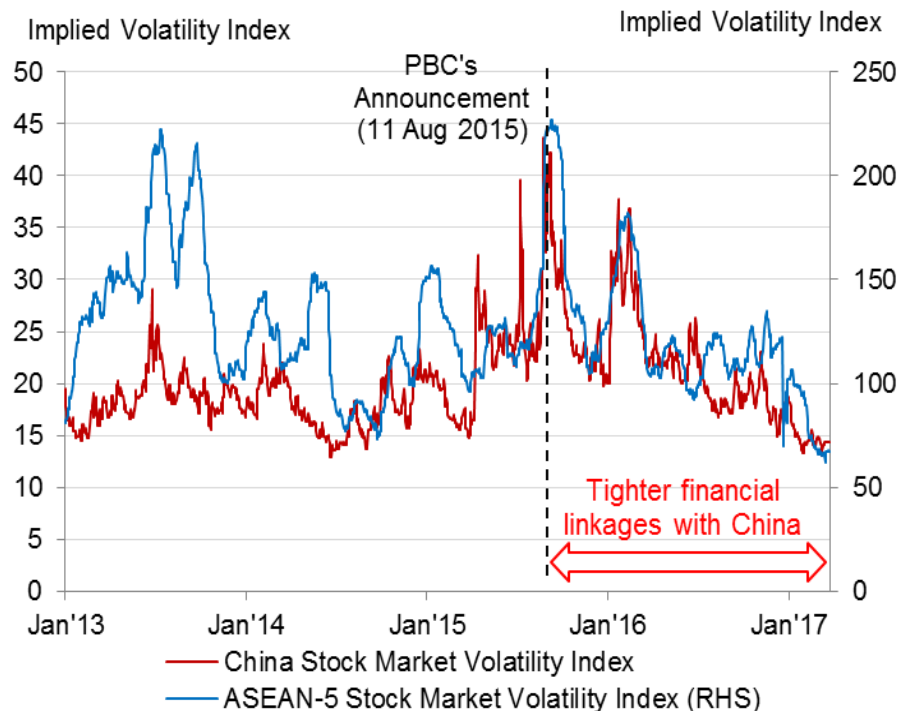


Tighter financial linkages with China post-GFC suggest that vulnerabilities to China-related shocks have increased, warranting close attentiveness to financial developments in China

Business Cycle Co-Movement & Equity Returns Correlation



Co-Movement of Stock Market Volatility (ASEAN-4 and Vietnam vs. China)



Note: On 16 May 2017, China announces a bond trading link between Hong Kong and the Mainland by year-end.

Source: National Authorities, Bloomberg, AMRO

Spillover Analysis (Shocks from 1% sustained decrease (or increase) in U.S.' & China's real & financial variables), Preliminary

1. Real Sector Shocks

1% Sustained Decline in Real GDP Growth	Mean Impact on Regional EMs (Cumulative, 36 months)
<ul style="list-style-type: none"> 1% sustained decline in U.S.' real GDP growth 	Impact on growth → -0.11 ppts
<ul style="list-style-type: none"> 1% sustained decline in China's real GDP growth 	Impact on growth → -0.75 ppts Impact on nominal export growth (in local currency) → -1.35 ppts

2. Financial Sector Shocks

	1% Sustained Increase in Expected Default Frequency (EDF)	Mean Impact on Regional EMs (Cumulative, 12 months)
Banking Sector Shocks	<ul style="list-style-type: none"> U.S.' banking sector soundness China's banking sector soundness 	→ +0.11 ppts (Impact on Regional Banks' EDF) → +0.25 ppts (Impact on Regional Banks' EDF)
Corporate Sector Shocks	<ul style="list-style-type: none"> China's corporate sector soundness 	→ +0.11 ppts (Impact on Regional Banks' EDF) → +0.12 ppts (Impact on Regional Corporates' EDF)

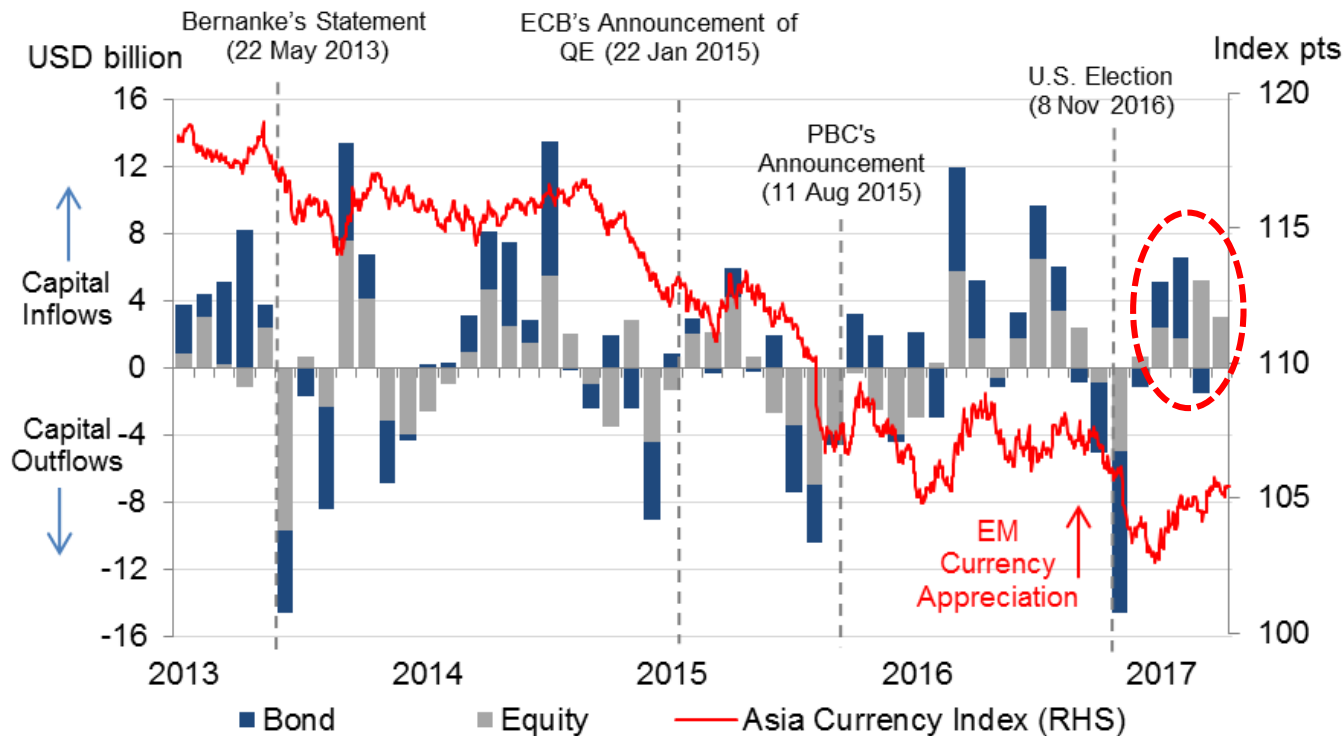
Note: Expected Default Frequency (EDF) is a measure of the probability that a firm will default over a specified period of time (typically one year). "Default" is defined as failure to make scheduled principal or interest payments. According to the Moody's EDF model, a firm defaults when the market value of its assets (the value of the ongoing business) falls below its liabilities payable (the default point). The firm level EDFs are aggregated to form EDFs at the sectoral and country level

Source: AMRO

Risks Spotlight: Capital Flows Volatility and Reversal Risks

Financial markets have been largely stable, with the resumption of capital inflows, although risks remain tilted to the downside, mainly from global policy uncertainties

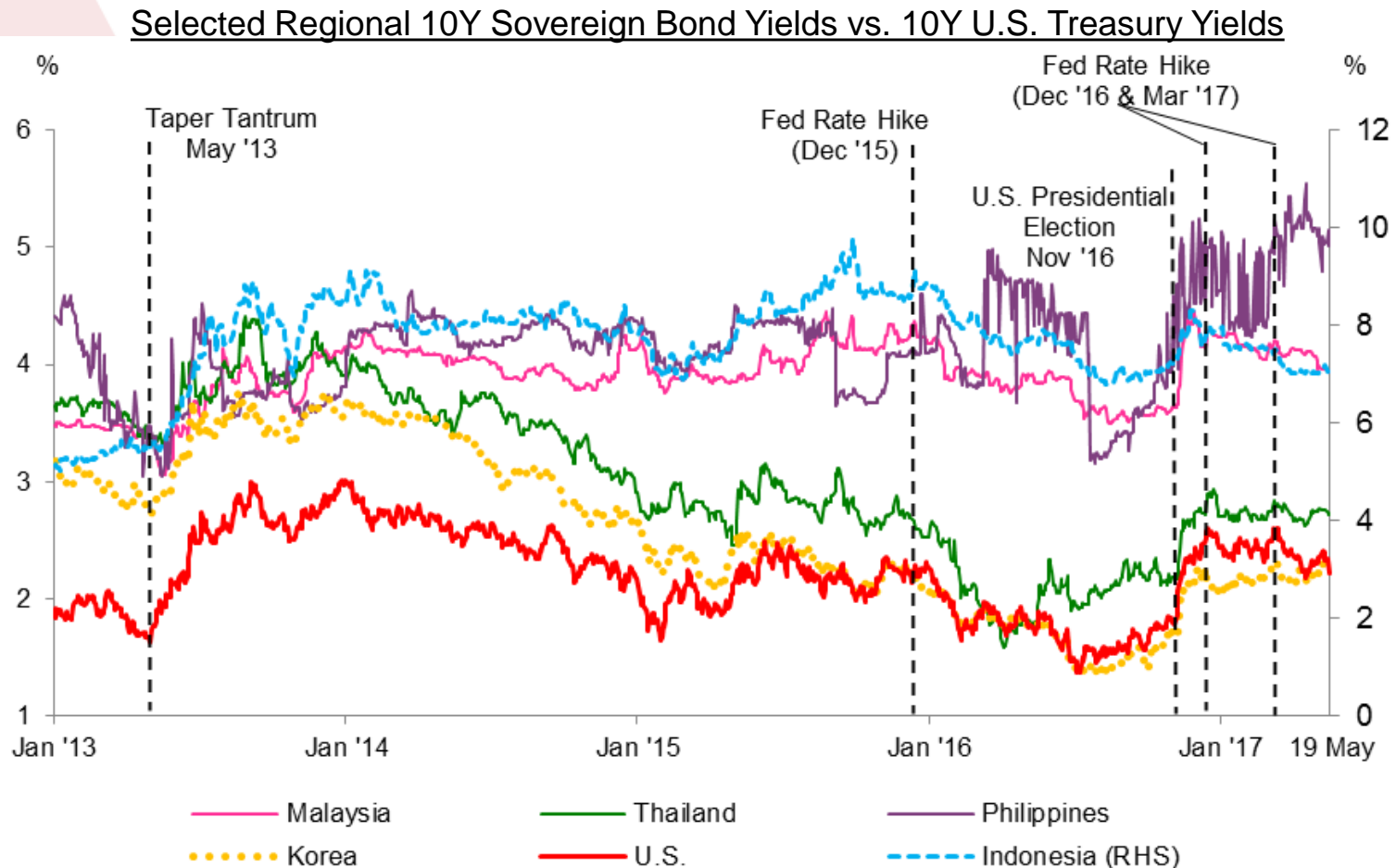
Non-Resident Net Capital Flows (ASEAN-4 and Korea)



Notes: All data are to up to end-April 2017, except for bond (up to end-Apr 2017). The Bloomberg Asia Currency Index refers to ADXY.
Source: National Authorities, Bloomberg

Risks Spotlight: Financing Risks

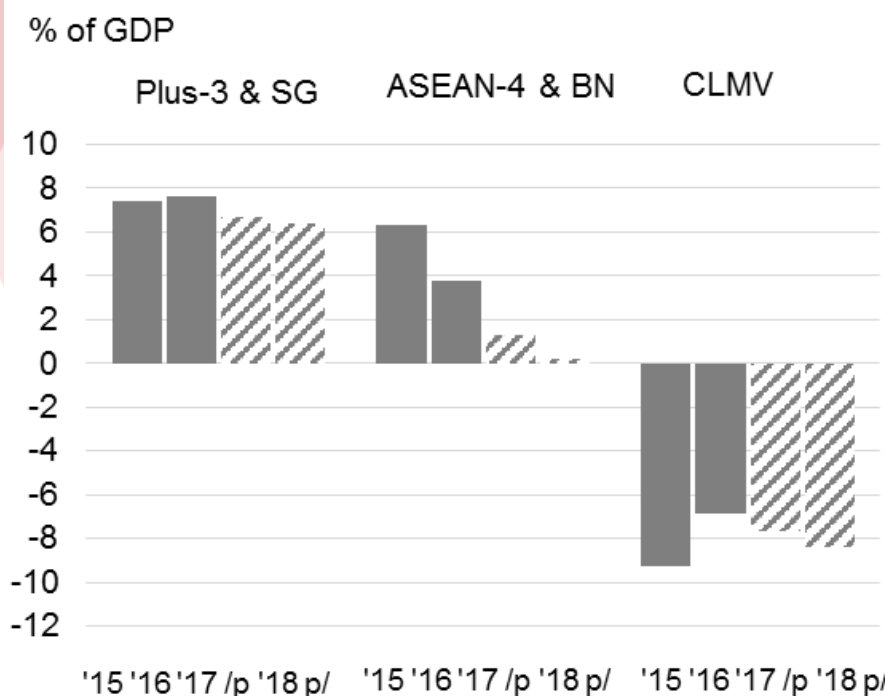
So far, talks about U.S. fiscal stimulus and concerns about foreign capital flowing back to the U.S. have not translated into sustained increase in local currency sovereign bond yields



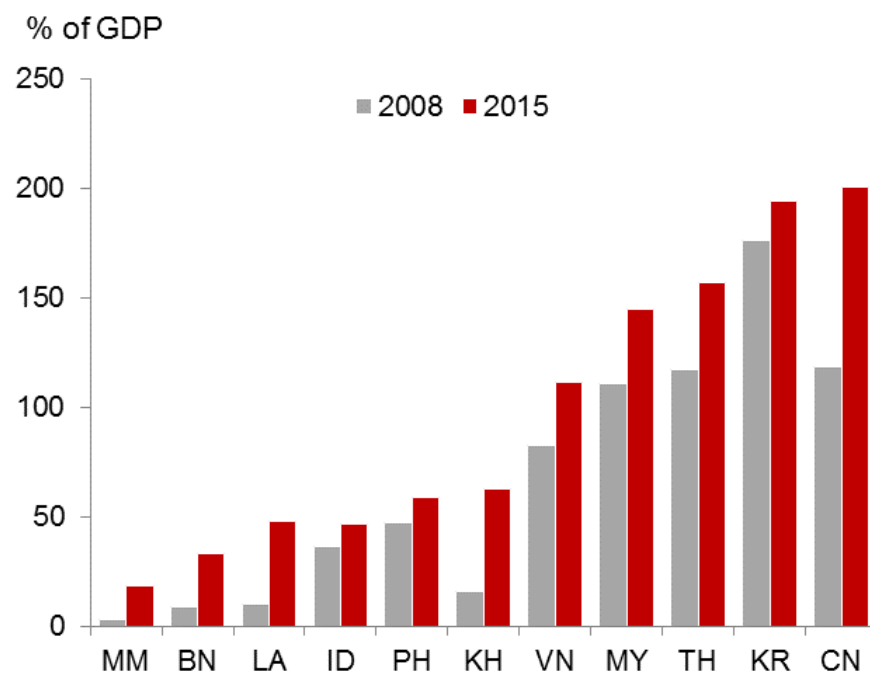
Risks Spotlight: Financing Risks & Turning of the Credit Cycle

Potential escalation of global uncertainties could amplify the financial stability risks of regional economies with large external financing needs, and where vulnerabilities have built up from sustained high private sector credit growth

Baseline Current Account Projections



Private Sector Credit-to-GDP Ratio (Selected Economies)



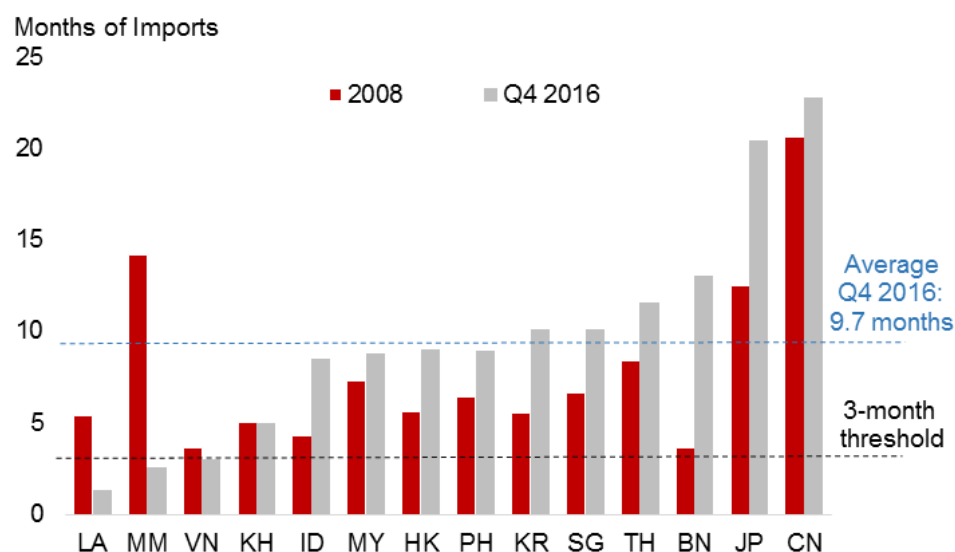
p/ Projection

Private sector credit refers to loans and advances extended by the banking system to non-financial companies and households.

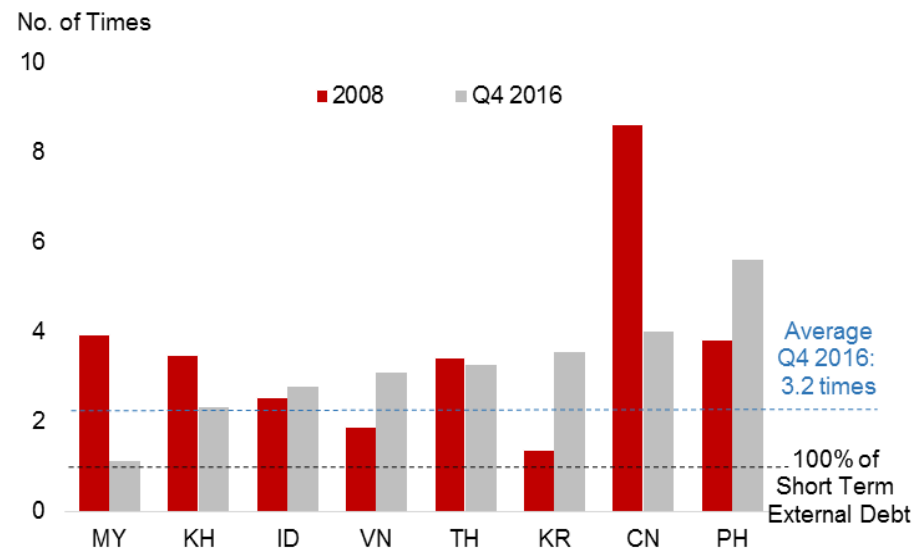
Source: National Authorities, World Bank, AMRO

The region's reserve buffers remain adequate by conventional metrics, although policy room has generally narrowed/constrained across the region

FX Reserves (in Months of Imports)



FX Reserves / Short-Term External Debt Ratio (Selected Economies)



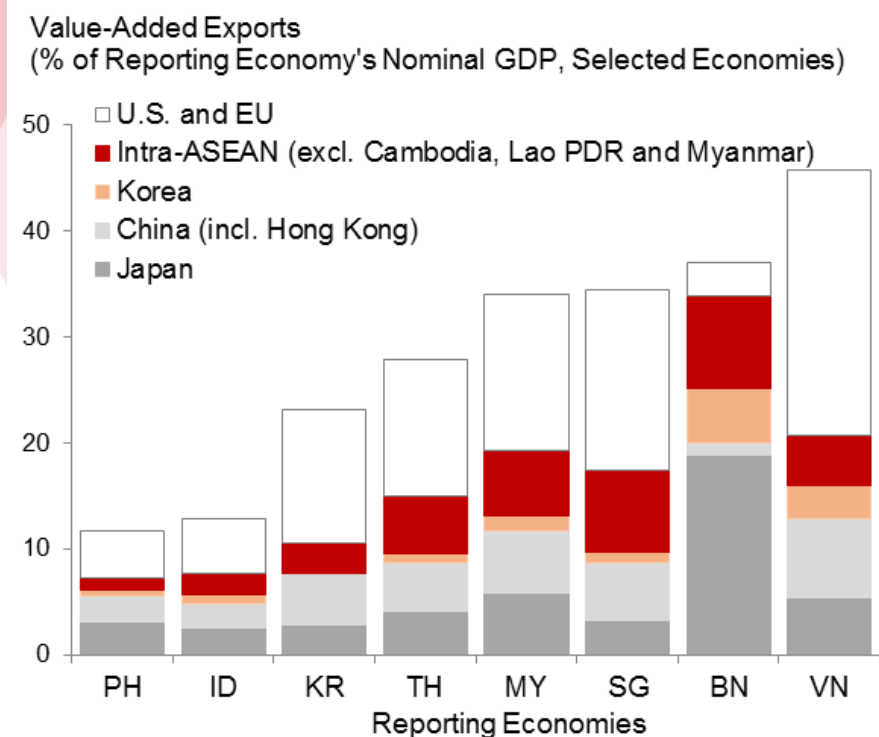
Note: Latest data refers to 2012 (for Cambodia), Q3 2016 (for China), and 2014 and 2016, respectively (for Vietnam). Some member economies have adopted the latest BPM6 (such as Malaysia), which includes local currency-denominated debt held by non-residents in their short term external debt data.

Note: Latest data refers to 2012 (for Vietnam), 2014 (for Cambodia), 2015 (for Brunei), Q3 2016 (for Myanmar). For Myanmar and Lao PDR, data reflect imports of both goods and services based on AMRO's calculations.

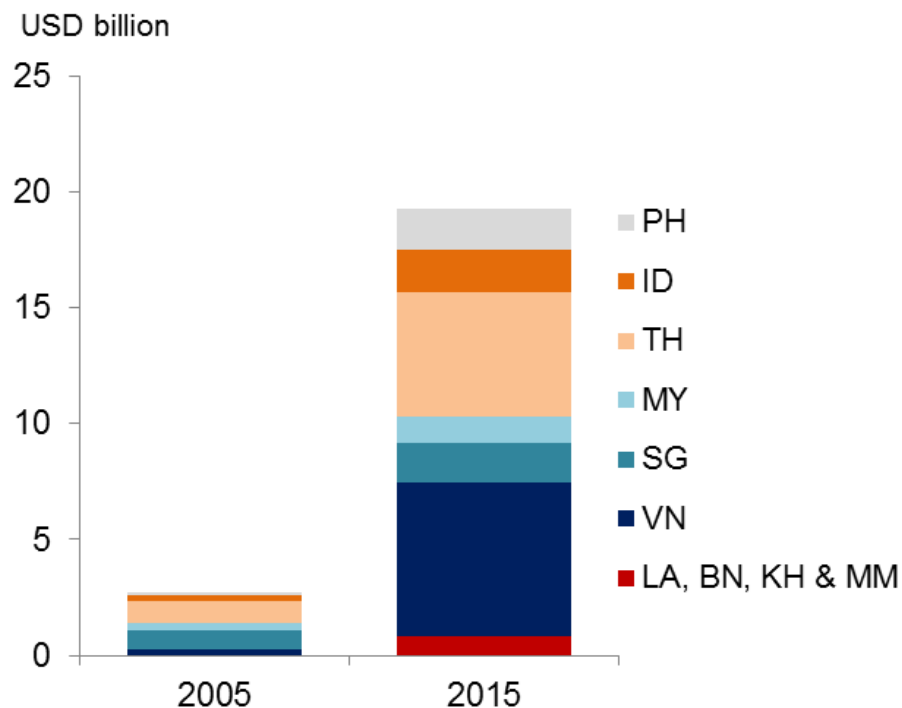
Structural Developments – Leveraging Regional Integration

On a positive note, the region has become an important source of final demand, benefiting from the growing regional integration, as well as the rising middle class in China, which can cushion the impact of potential protectionist threats

Share of Exports Destined for Final Demand in the Region
(2015 Estimates)

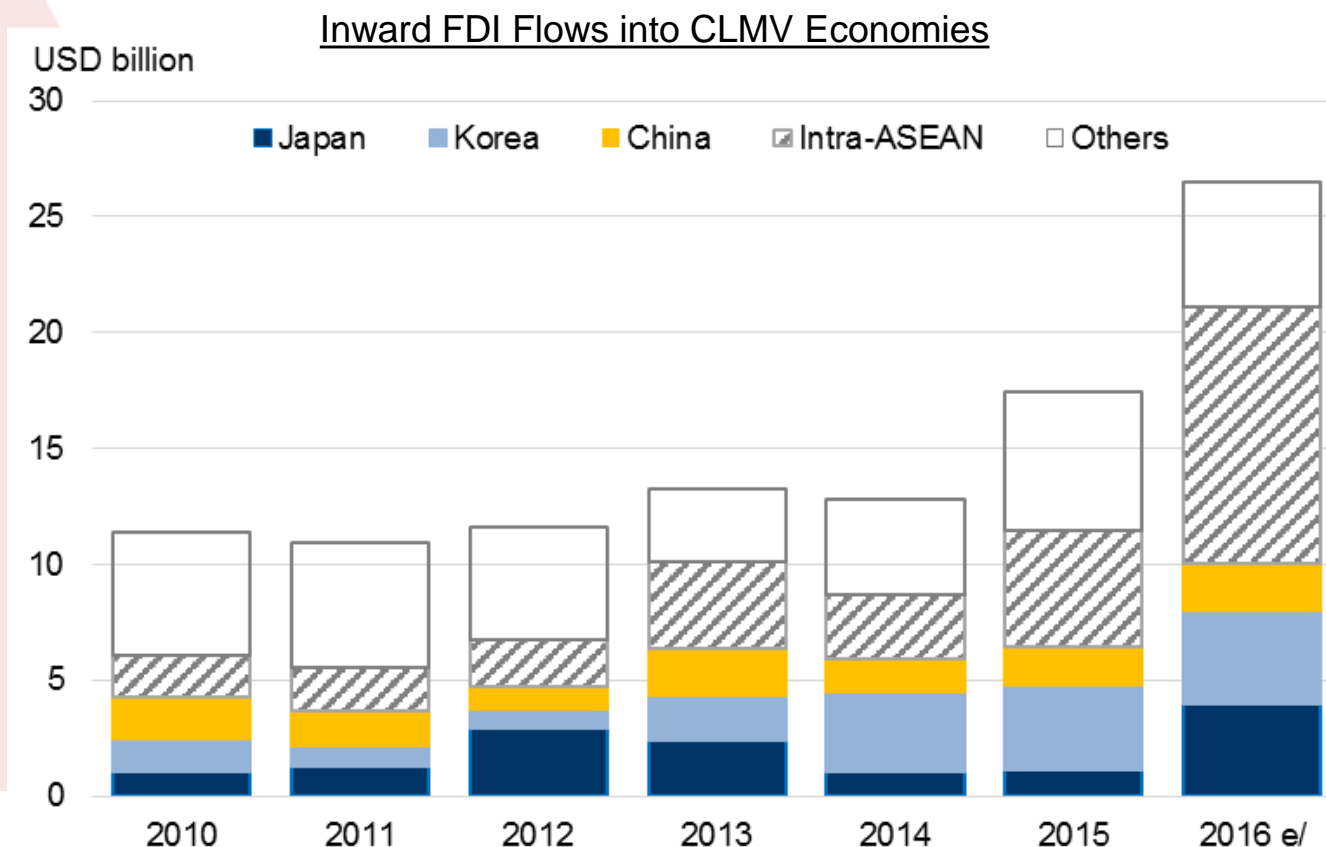


China's Imports of Consumption Goods from ASEAN



Structural Developments – Leveraging Regional Integration

Developing ASEAN economies have also benefited from the deepening of intra-regional investment, reflecting the recycling of domestic savings to productive investment in the region

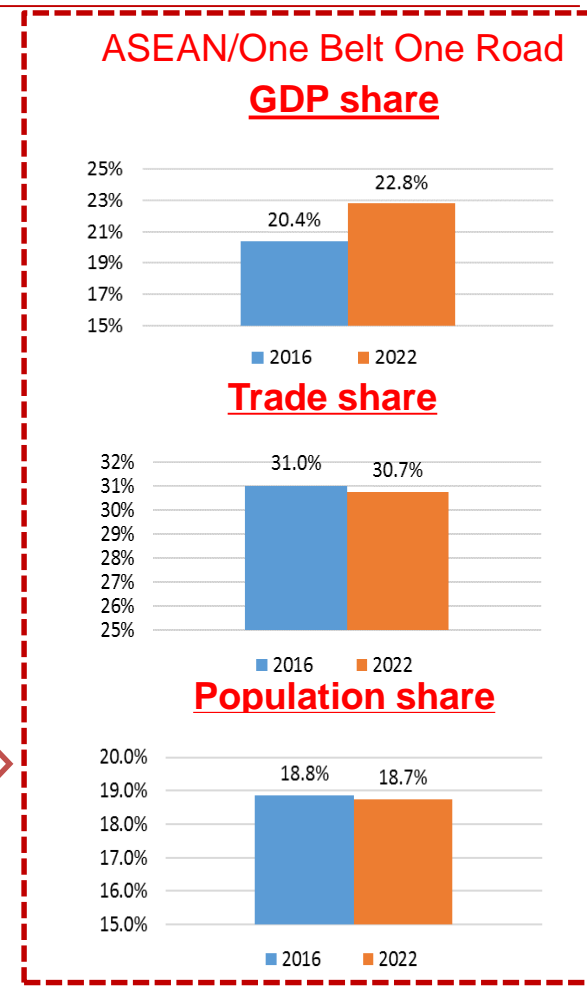


Considering the external uncertainties, it would be prudent for policymakers to prioritize financial stability

Recommended Policy Settings		Fiscal Policy	
		Consolidate	Expand
Monetary Policy	Ease	-	-
	Maintain	<p>Japan, Malaysia (continue with medium-term consolidation plans)</p> <p>Brunei (continue with fiscal consolidation and expenditure re-prioritization)</p>	<p>Hong Kong, Korea, Singapore, Thailand (ample fiscal space for expansion)</p> <p>Indonesia (fiscal expansion is subject to increased revenue sources to meet fiscal rules)</p>
	Tighten	<p>Myanmar (continue with fiscal consolidation)</p> <p>Cambodia, Lao PDR, Vietnam (continue with fiscal consolidation and focus on tightening macroprudential policy)</p>	<p>China, Philippines (expansionary fiscal policy to be maintained (China), while expansion is subject to increased revenue to meet fiscal rules (Philippines), with tightening bias for monetary policy)</p>

The Implications for One Belt and One Road

ASEAN has become one of the most important sub-regions in the **One Belt and One Road** in terms of GDP, trade and population
 ASEAN has huge demand for infrastructure investment



The Implications for One Belt and One Road

One major cooperation measure of the **One Belt and One Road** is “fend off financial risks” and AMRO has significant potential to contribute to this area



CMIM

- The largest regional financial safety network in the One Belt and One Road with USD240 billion reserve pool

AMRO, the surveillance unit of CMIM

- Macroeconomic surveillance
- Supporting the implementation of CMIM
- Technical assistance

Chapters

I

ASEAN+3 Macroeconomic Prospects and Challenges

II

Thematic Chapter: ASEAN+3 Region 20 Years after the Asian Financial Crisis

2017 marks twenty years after the Asian Financial Crisis (AFC), a landmark event in the ASEAN+3 region.

20 Years post-AFC

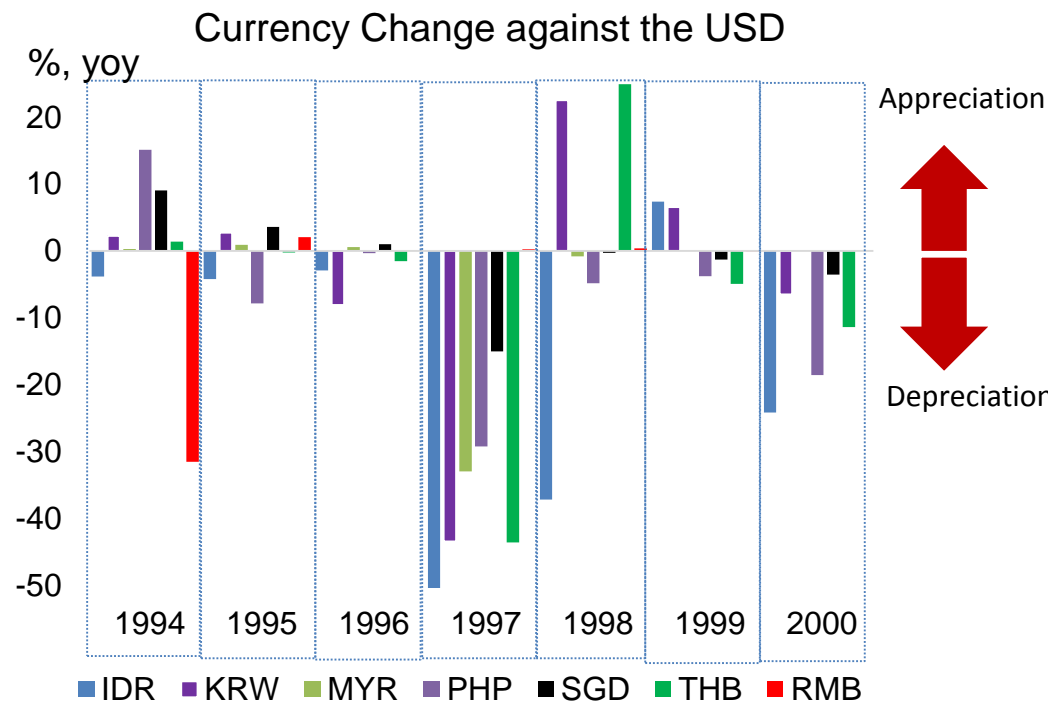
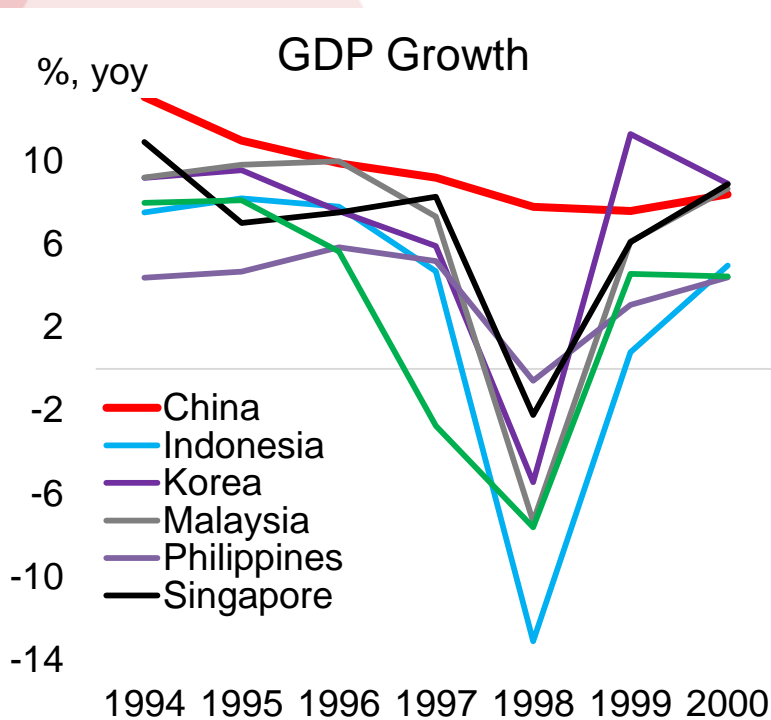
Shaped the subsequent foundations and trajectory of economic growth and regional integration

Shaped policymakers' perspectives on crisis management and resolution

- Highlighted the urgent need for regional financial cooperation
 - ➔ CMI (2000-09), CMIM (2010 onwards)
 - ➔ Establishment of AMRO as independent macroeconomic surveillance unit supporting the CMIM (2011)

1 First Decade Post-AFC: Rebuilding Foundations

- Period of economic consolidation after a sharp negative shock. For some countries, painful policy adjustments in exchange rate regimes, fiscal consolidation, corporate and financial sector reforms, and reforms in prudential regulation
- China weathered the AFC relatively well compared to other Asian emerging economies with relatively stable growth and exchange rate



2 2007 – 2016: Rebalancing and Leveraging Regional Integration

- Openness to trade, FDI and capital flows post-AFC enabled the region (esp. CLMV economies) to reap the benefits from growing regional integration and the emergence of China
- Increased intra-regional financial flows have eased the ASEAN+3 region's rebalancing from export-led to domestic-led demand.

Plus-3 and ASEAN shares of FDI inflows to CLMV

Host	Source	2013	2014	2015
Cambodia	China	22.5	32.1	31.6
	Japan	3.0	4.9	3.1
	Korea	14.0	6.2	4.2
	ASEAN-4 & SG	19.1	11.2	14.9
Lao PDR	China	35.1	67.3	61.6
	Japan	0.4	0.2	7.0
	Korea	2.5	1.4	4.2
	ASEAN-4 & SG	4.7	11.8	7.6
Myanmar	China	30.2	7.5	1.9
	Japan	1.4	4.0	3.4
	Korea	0.0	1.2	1.3
	ASEAN-4 & SG	44.6	69.8	74.5
Vietnam	China	10.7	2.3	3.2
	Japan	26.6	10.5	8.1
	Korea	19.9	35.3	29.6
	ASEAN-4 & SG	23.0	16.4	17.6

Capital Inflows Post-GFC

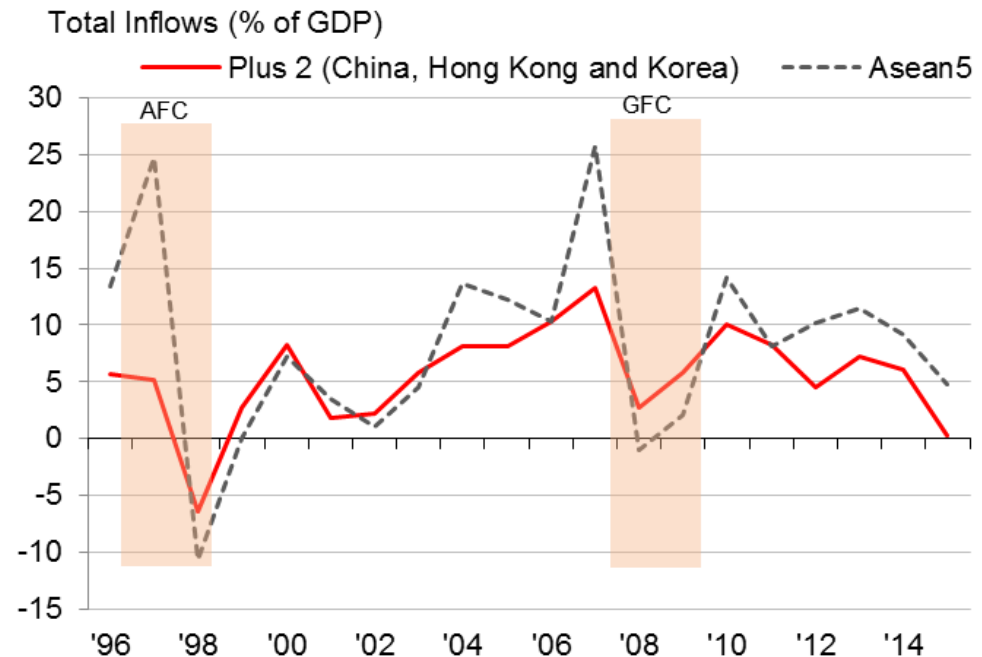
Eased rebalancing towards domestic demand, but posed risks to financial stability

- ➔ Financial vulnerabilities: credit growth, asset price inflation, leverage
- ➔ Amplifies pro-cyclicality of financial cycle and volatility, especially with lack of depth in financial markets in EMs

Policy response

- Pragmatic and robust use of policy tools, including macroprudential measures
 - ➔ Macroprudential policies
 - ➔ Capital flow management measures
 - ➔ FX interventions + greater flexibility in exchange rates

Capital Inflows (Net)
(ASEAN-4, Singapore, China and Korea)



Lessons from the AFC

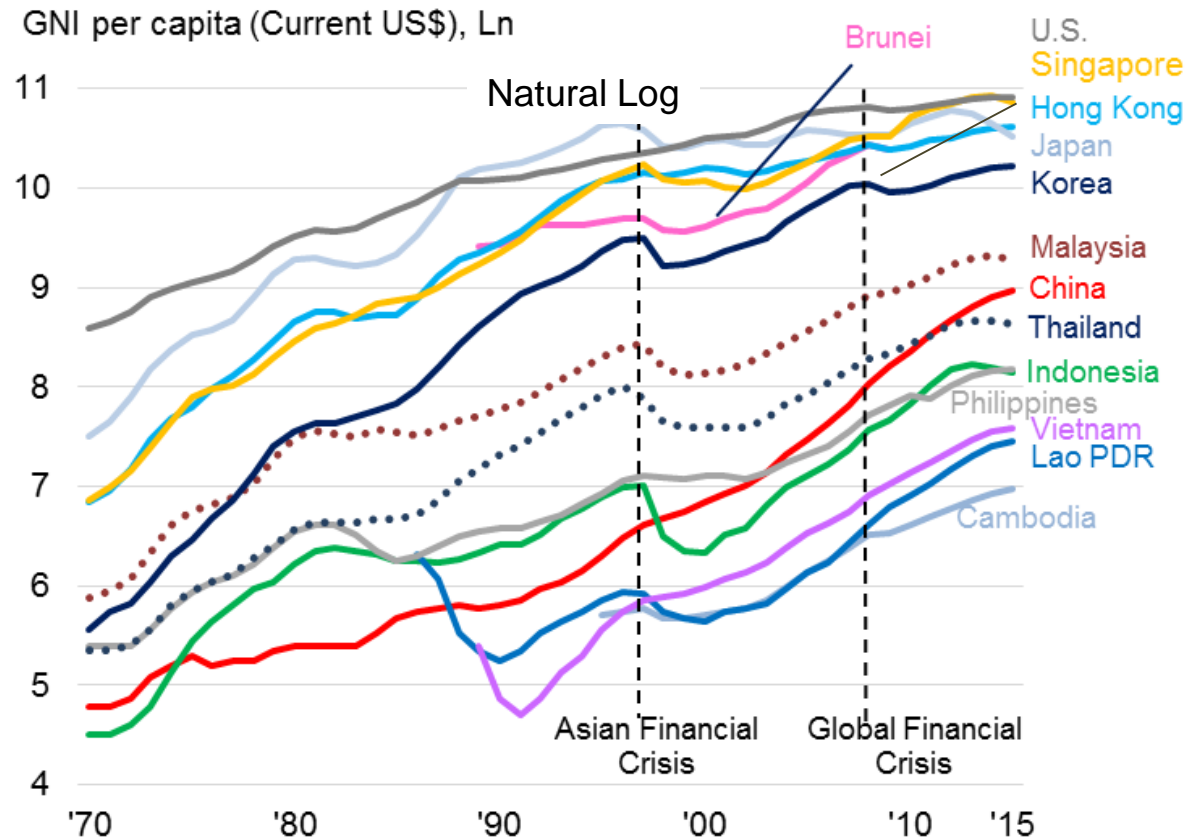
In the current uncertain global environment, the AFC continues to offer valuable lessons to policymakers

- I Focus on risks arising from financial markets and capital outflows (inter-connectedness and contagion risks)
- II Flexible and responsive policy framework, and strengthening of buffers
- III Greater financial cooperation within the region to deal with external shocks.

3 Looking Ahead: Challenges

- Short term macroeconomic & risks management
- Strengthening regional financial safety net
- Accelerating structural reforms (e.g. raising TFP to avoid growth from reaching stalling speeds)

Income Convergence and Catch-up

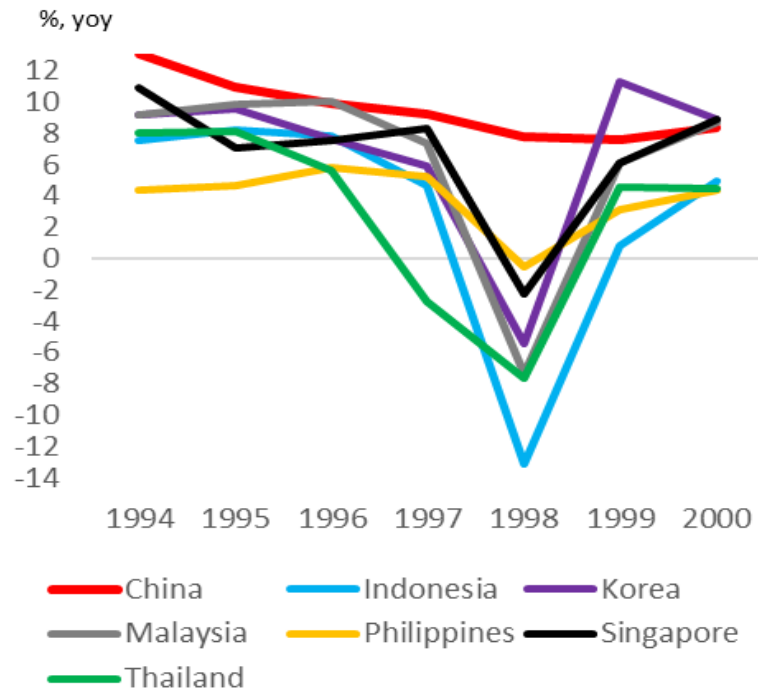


Theme: 20 Years after the Asian Financial Crisis (AFC)

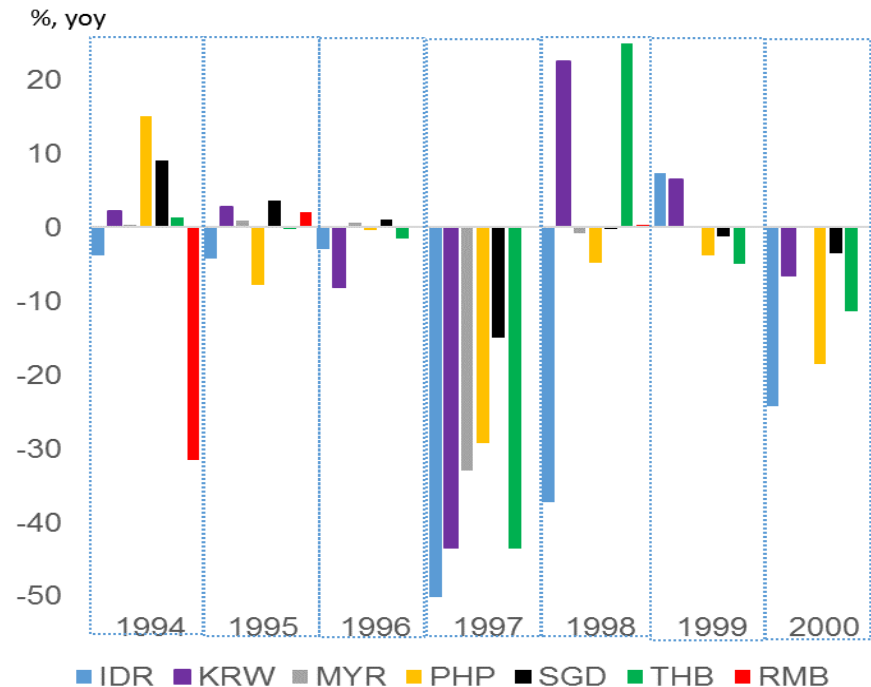
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China weathered the AFC relatively well compared to other Asian emerging economies with relatively stable growth (Figures 1). While regional exchange rates depreciated sharply after the AFC, China kept the exchange rate at 8.27 to the USD (after a sharp devaluation by 50 percent at the beginning of 1994) in order to help avoid further exchange pressures on other regional currencies.

GDP Growth



Currency Change against the USD

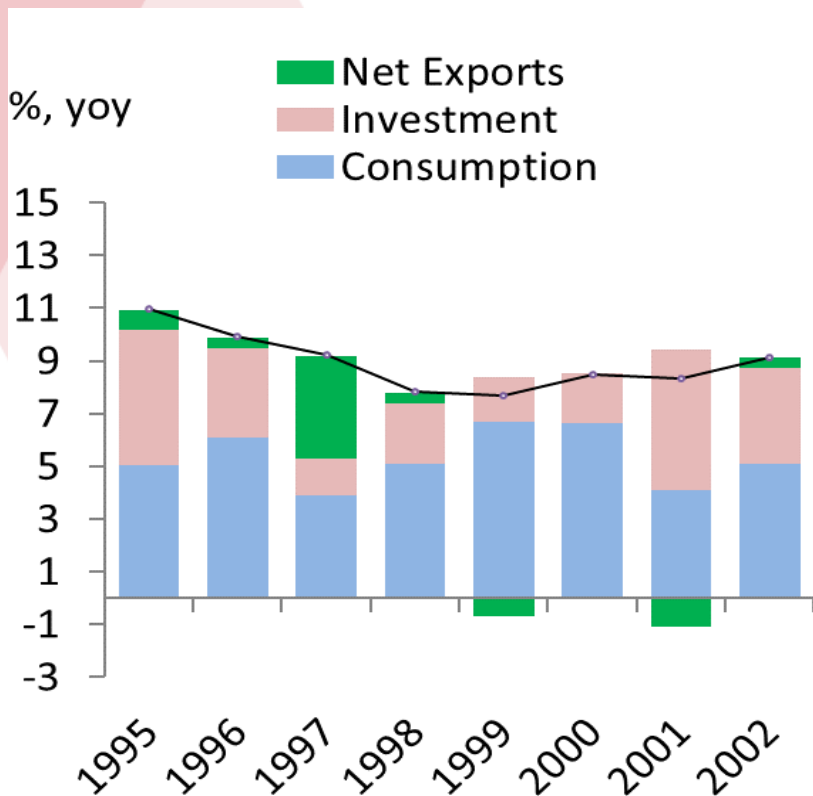


Theme: 20 Years after the Asian Financial Crisis (AFC)

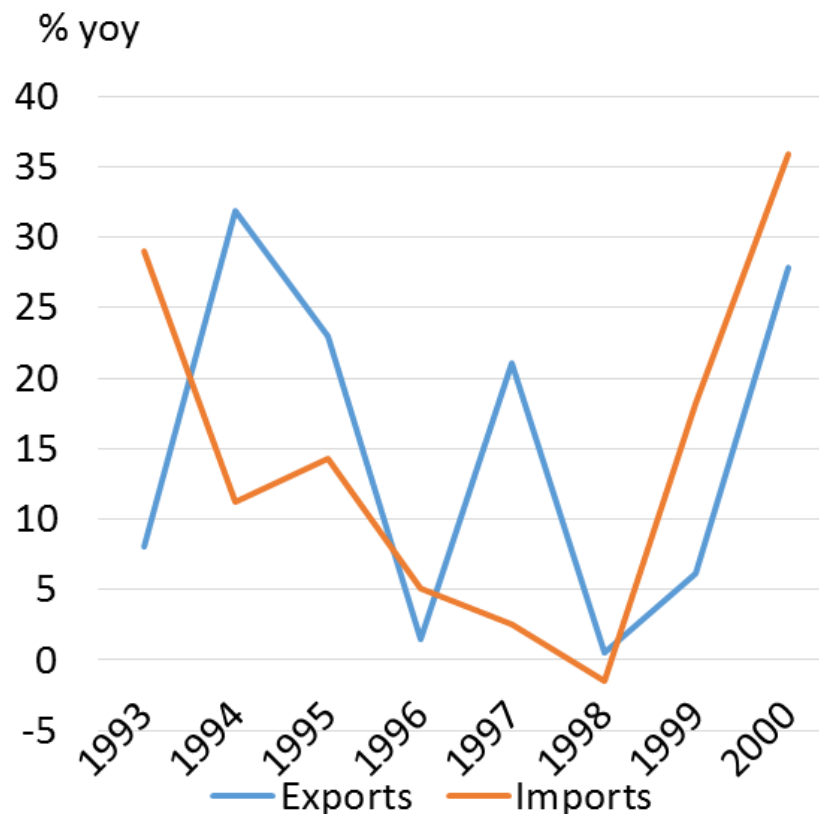
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While there was a sharp decline in net exports following the AFC, growth was supported by rising domestic investment and consumption.

China's GDP Growth Contribution



China's Trade Growth



7

China's authorities not only took comprehensive measures to maintain growth but also actively involved in regional cooperation to help maintain regional financial stability.

- **Exchange rate:** China would bear the external sector pressures as a result of the AFC and promised not to devalue the RMB further.
- **Growth support:** The Chinese government would take efforts to stimulate domestic demand and maintain economic growth. It also took measures to encourage exports and attract foreign direct investment. The government also used proactive fiscal policy.
- **Enhance domestic financial stability:** In order to effectively prevent and mitigate financial risks, the CPC Central Committee and the State Council decided to make major reforms of the financial system, including setting up four asset management companies for commercial bank NPL resolution, and promoting banking system reform.
- **International cooperation:** China actively participated in the International Monetary Fund assistance program to the inflicted Asian countries.

1. Regional growth to be sustained about 5% in 2017-18.
2. Near term outlook for the region turned somewhat brighter, although risks are tilted to the downside, from tightening global financial conditions, trade protectionism and global policy uncertainties.
3. In China, growth in the first half of the year is likely to be higher than that of the second half as strengthening industrial production supports growth while the moderating property markets will drag growth somewhat in second half of the year. For 2018, growth is expected to moderate slightly.
4. Concerns about China's capital outflows have eased recently, partly reflecting signs of growth stabilization, moderating USD as well as strengthened capital flow management which helped in containing RMB exchange rate volatility
5. AFC shaped policymakers' perspectives on crisis management and resolution – AMRO and CMIM established. Post-AFC, policy attention shifted to capital flows and contagion risks – the need for flexible policy framework.
6. Enhanced financial cooperation in ASEAN+3 will improve the resilience against shocks, allowing the region to sustain relatively strong growth.

Thank You

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