AMRO

ASEAN +3 MACROECONOMIC RESEARCH OFFICE

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

29 May 2017, Singapore

Introduction: About AMRO

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


ASEAN+3
REGIONAL
ECONOMIC
OUTLOOK 2017
ASEAN+3 Region:
20 Years after the
Asian Financial Crisis
AMRO

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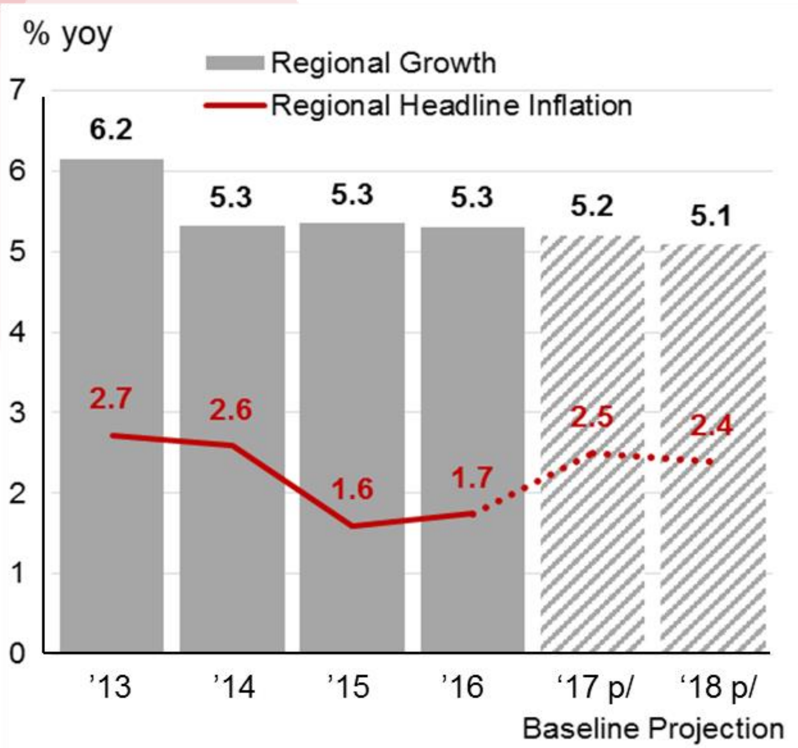
Regional Growth Outlook

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

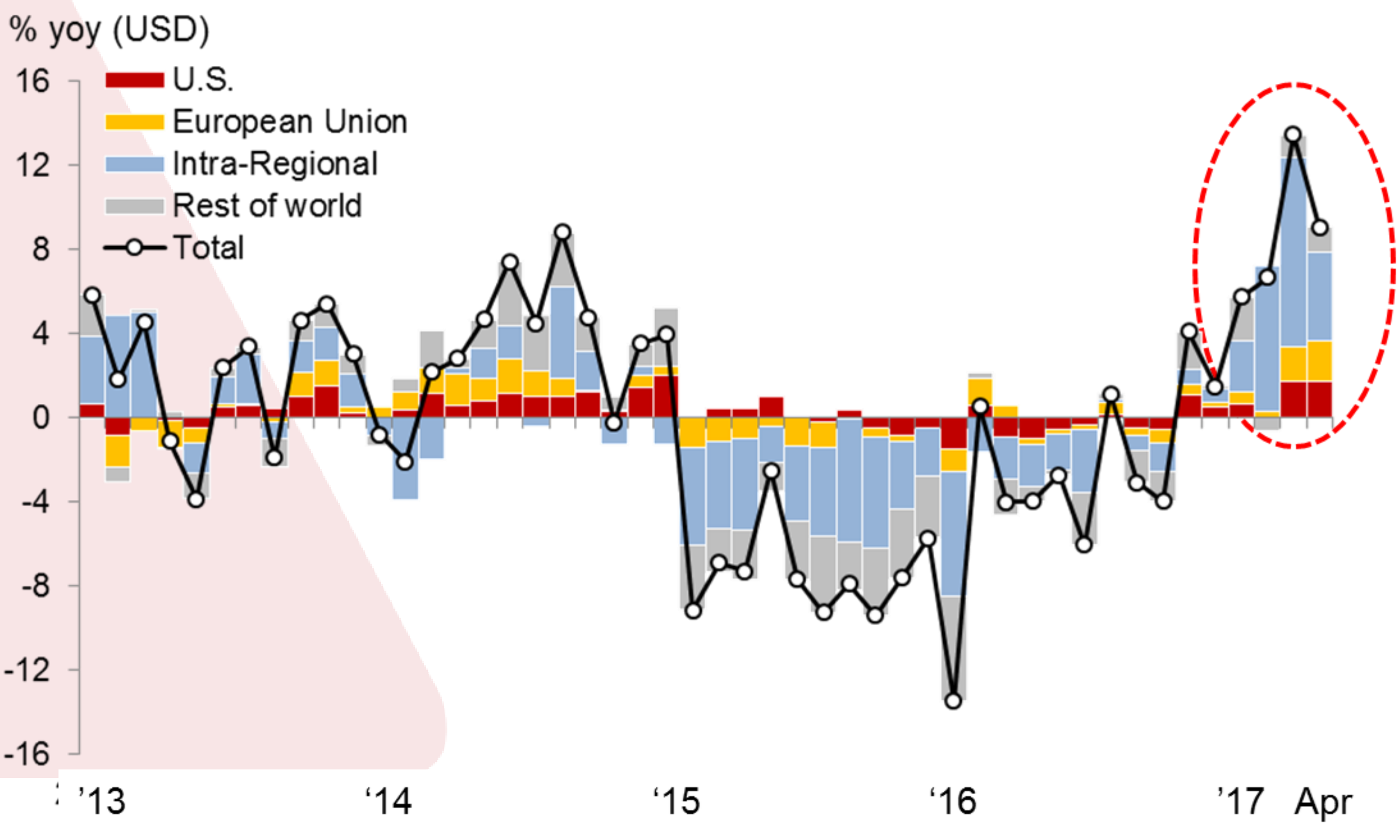


	'16	'17 p/	'18 p/
China	6.7	6.5	6.3
Japan (FY)	1.4	1.3	1.1
Korea	2.8	2.5	2.6
ASEAN-4 & VN	5.0	5.1	5.2
BCLM	5.6	6.5	6.8
HK & SG	2.0	2.1	2.3
ASEAN+3	**5.3**	**5.2**	**5.1**

p/ Projections
Source: National authorities, AMRO

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

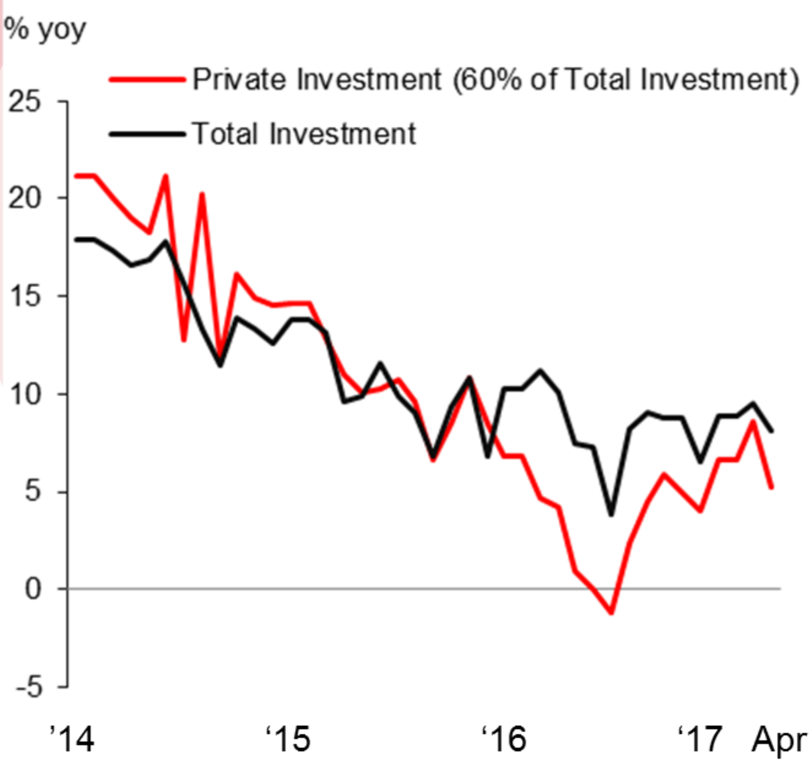
Regional Exports by Major Destinations



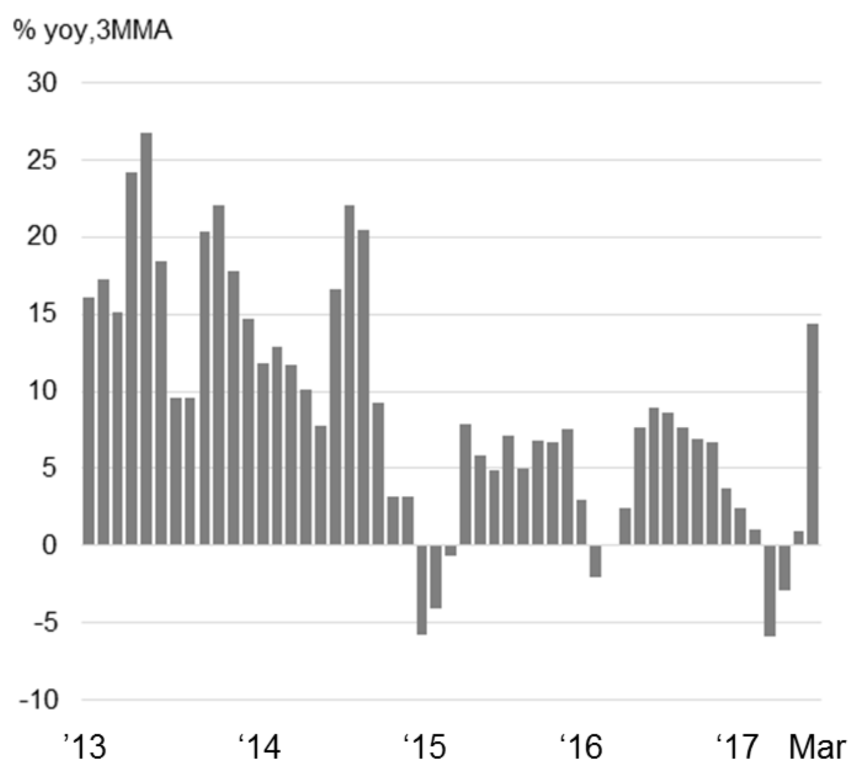
Note: ASEAN excludes BCLM economies
Source: National Authorities

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



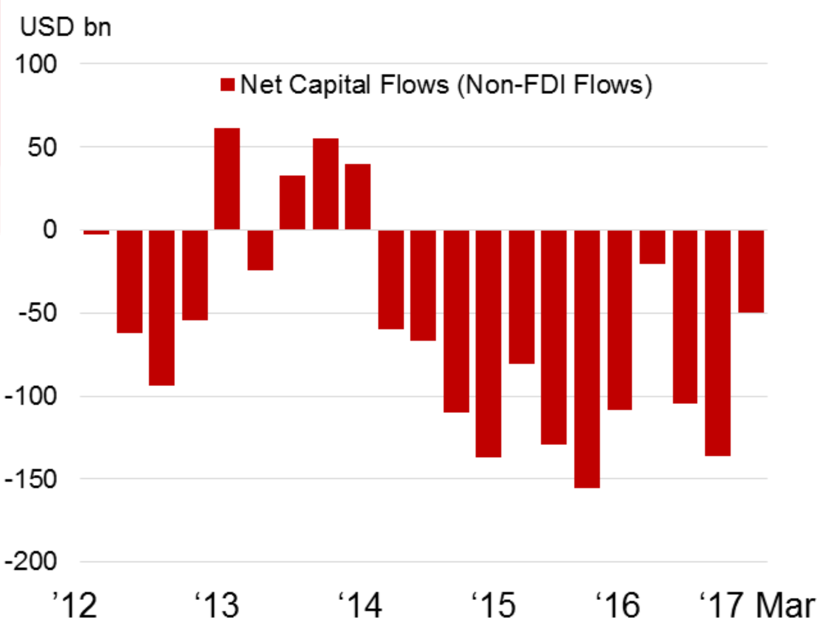
China: Private Sector Profitability



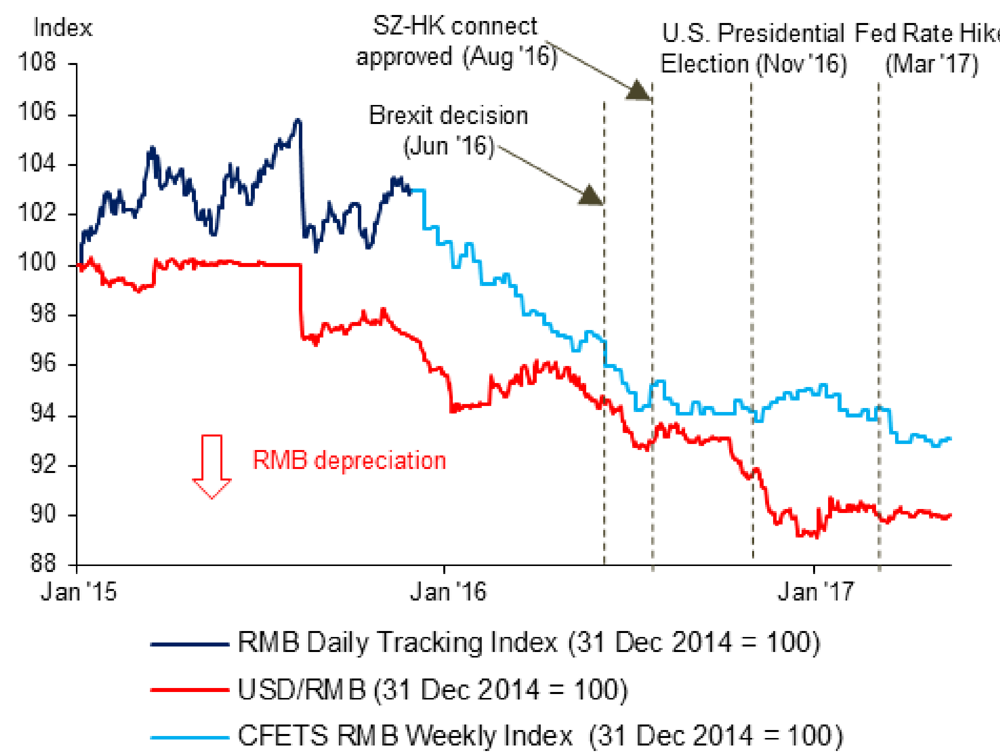
Source: NBS, AMRO

Concerns about China's capital outflows have eased recently, partly reflecting the strengthened capital flows management which helped in containing RMB exchange rate volatility

China: Capital Flows Developments



China: Exchange Rate Developments

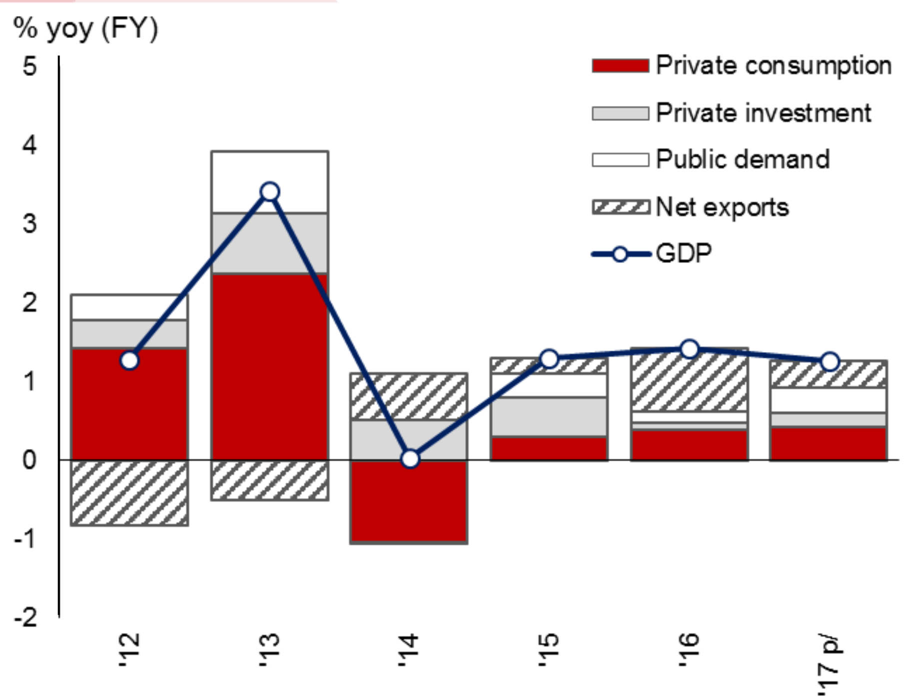


Source: PBC, SAFE, AMRO

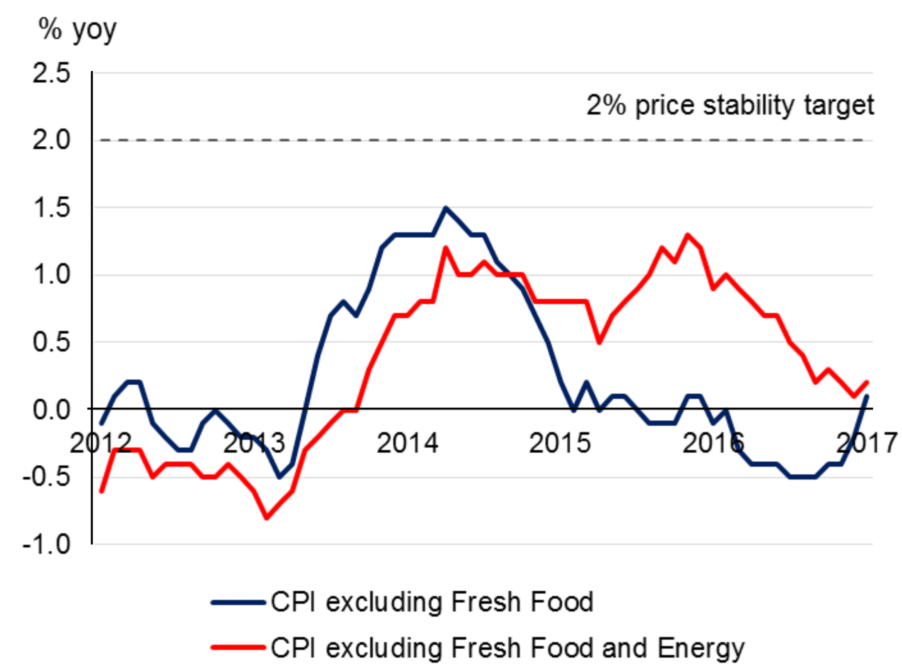
Japan Outlook

In Japan, growth is expected to remain strong in 2017, higher than the potential growth rate, while achieving the price stability target of 2.0 percent remains challenging

Japan: Real GDP Growth



Japan: Inflation and Price Stability Target



p/ Projections
Source: Cabinet Office, JMOF, BOJ, AMRO

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

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1. Real Sector Shocks

1% Sustained Decline in Real GDP Growth	Mean Impact on Regional EMs (Cumulative, 36 months)
• 1% sustained decline in U.S.' real GDP growth	Impact on growth ➔ -0.11 ppts
• 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

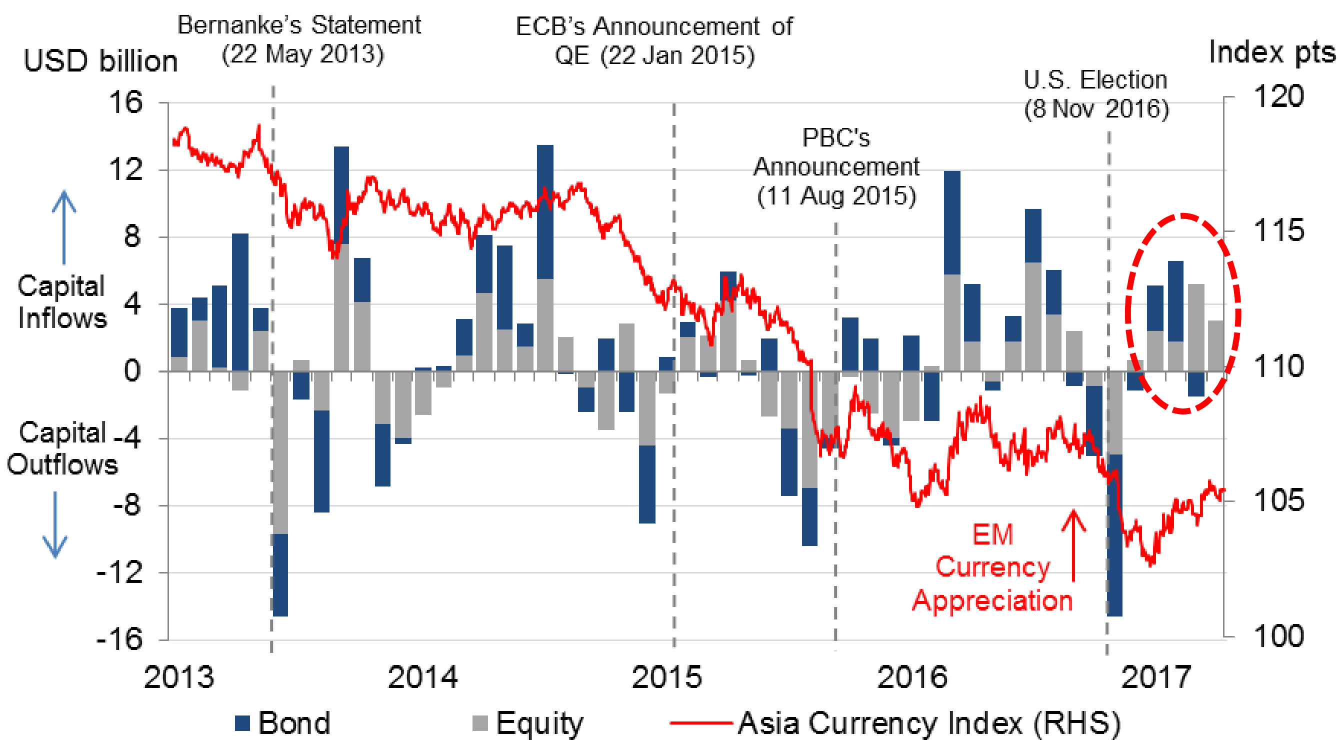
	1% Sustained Increase in Expected Default Frequency (EDF)	Mean Impact on Regional EMs (Cumulative, 12 months)
Banking Sector Shocks	• U.S.' banking sector soundness • China's banking sector soundness	➔ +0.11 ppts (Impact on Regional Banks' EDF) ➔ +0.25 ppts (Impact on Regional Banks' EDF)
Corporate Sector Shocks	• 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)

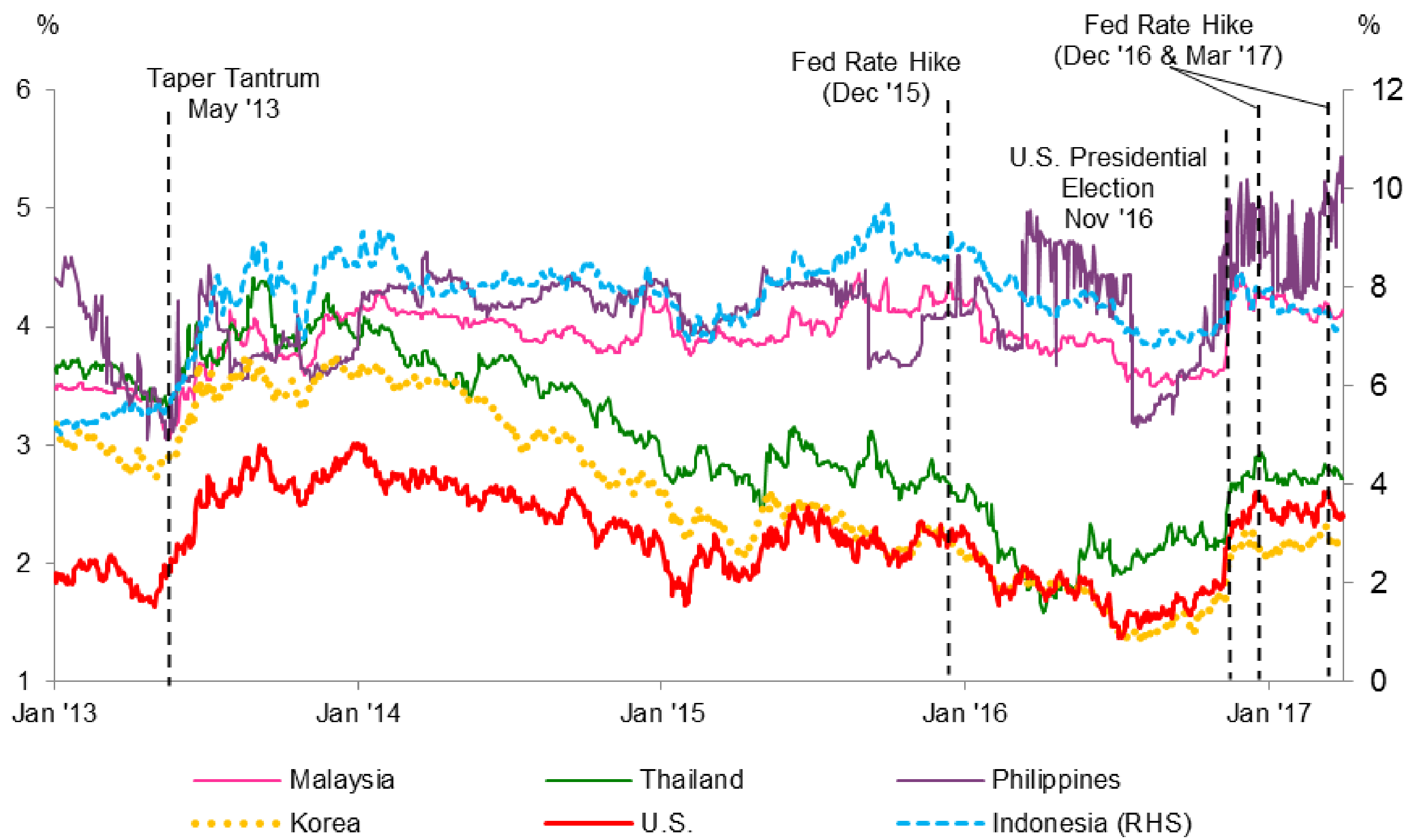


Notes: All data are to up to end-April 2017, except for bond (up to end-Apr 2017). The Bloomberg Asia Currency Index refers to ADXY.
Source: National Authorities, Bloomberg

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

Selected Regional 10Y Sovereign Bond Yields vs. 10Y U.S. Treasury Yields

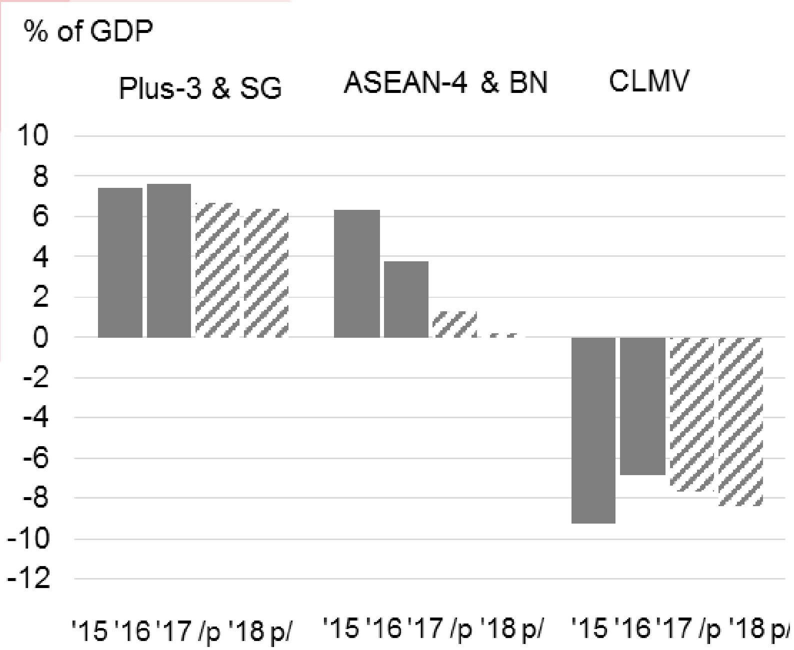


Source: Reuters

Risks Spotlight: Financing Risks

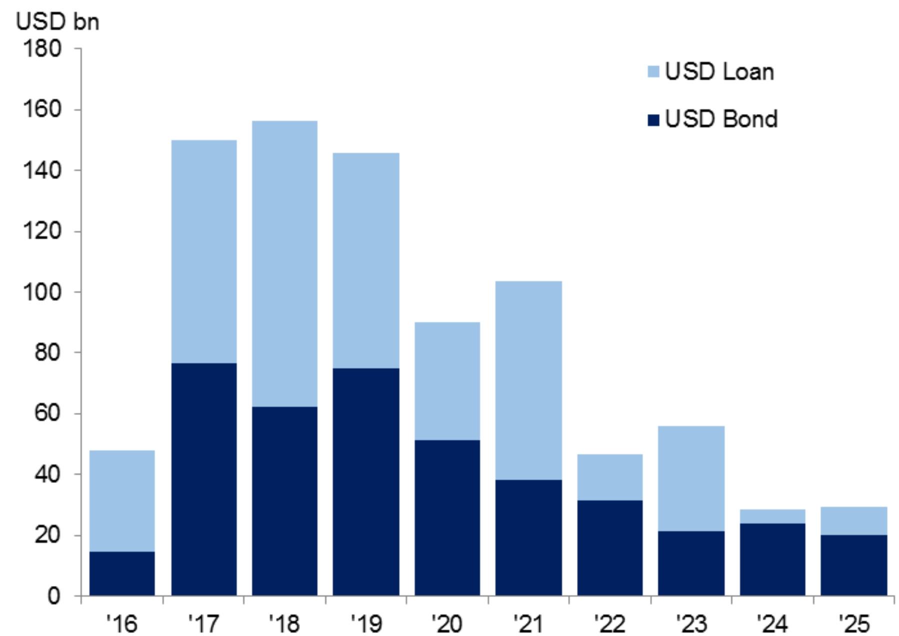
Potential escalation of global uncertainties could amplify the financial stability risks of regional economies (sovereigns and non-financial corporates (NFCs) with large external financing needs, given the rising cost of borrowing ahead

Baseline Current Account Projections



p/ Projection

Maturity Profile of Regional NFC Debt



Note: The data includes non-financial corporations and financial corporations. Regional Asia EM in the sample includes China, Hong Kong, China; Indonesia, Malaysia, Singapore, Korea, and Thailand.

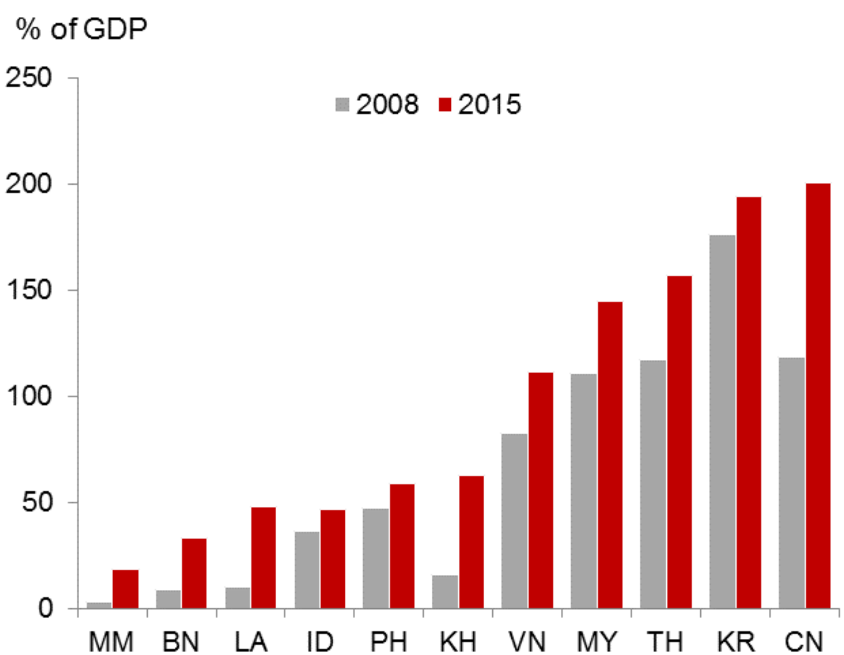
Source: National Authorities, World Bank, IIF, AMRO

Risks Spotlight: Turning of the Credit Cycle

Rising cost of borrowing could pose vulnerabilities to some regional economies where private sector credit to GDP ratio has increased significantly since 2008

U.S.: Average Daily Fed Funds Effective Rate (Implicit for December 2017)

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

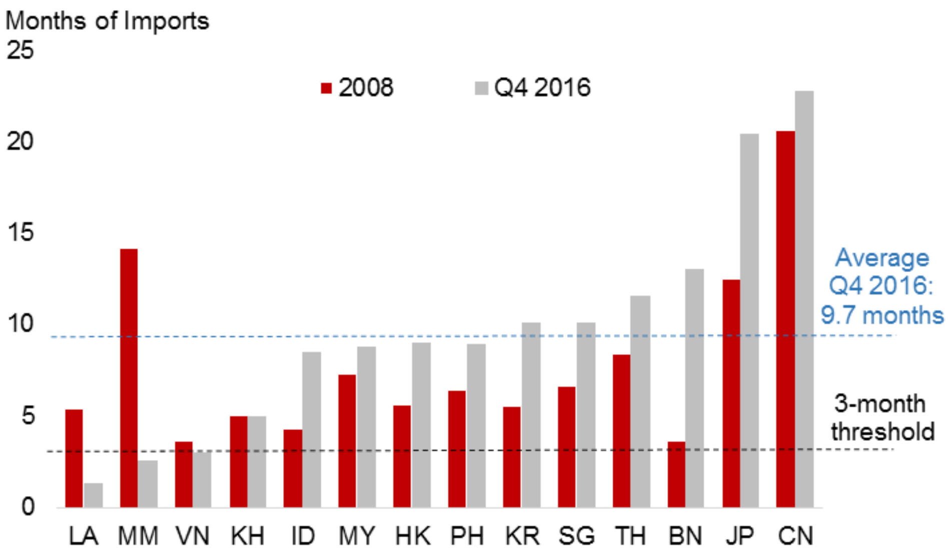


Note: Private sector credit refers to loans and advances extended by the banking system to non-financial companies and households.
Source: National Authorities, World Bank, Bloomberg

Buffers

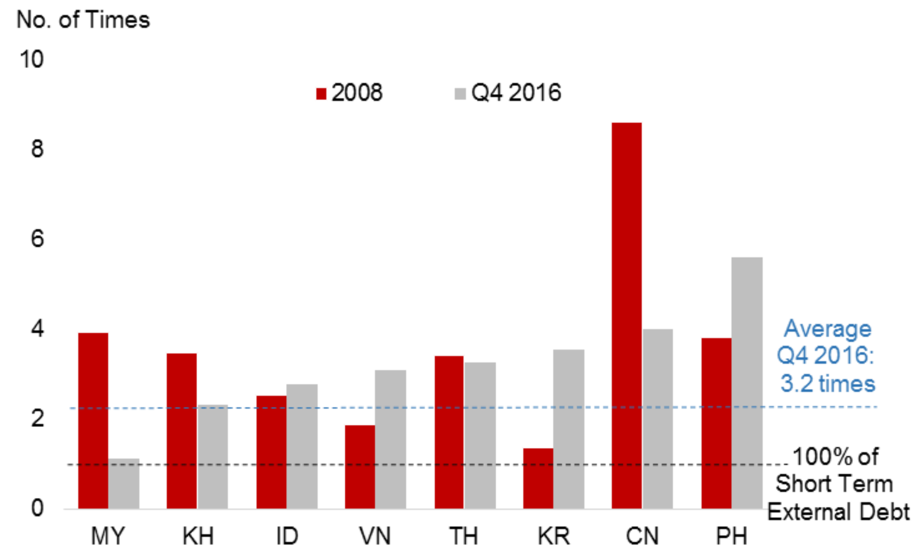
The region's reserve buffers remain adequate by conventional metrics, although policy room has generally narrowed/constrained across the region

FX Reserves (in Months of Imports)



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.

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



Note: Latest data refers to 2012 (for Cambodia), Q3 2016 (for Chna), 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.

Source: National Authorities, AMRO ERPD Matrix

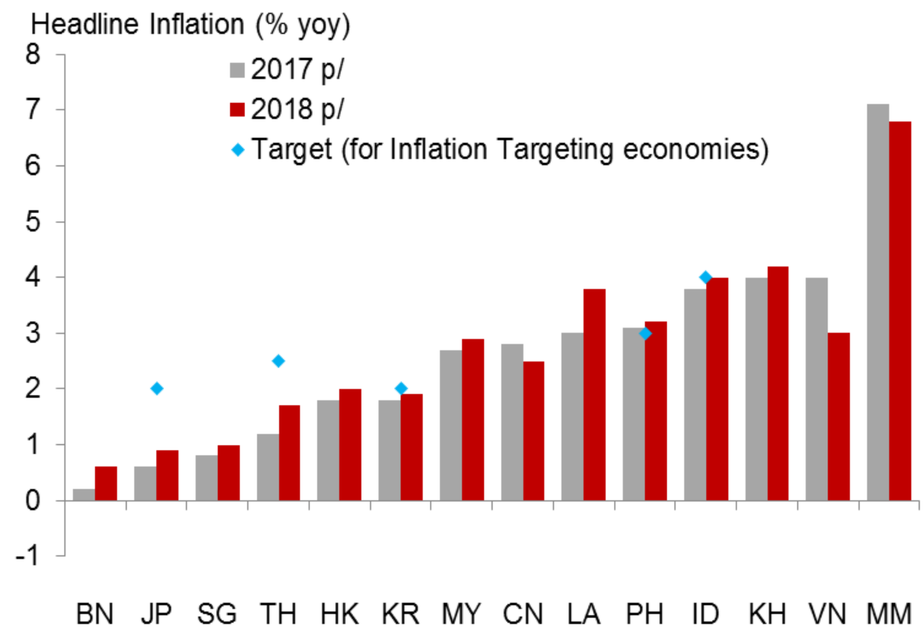
Suggested Policy Consideration

Some policymakers will face a sharper trade-off between growth and financial stability objectives, at a time when policy space has narrowed/constrained

Monetary Policy / Macroprudential Policy

- Tightening global monetary conditions in 2017 and rising inflation will constrain regional economies' use of monetary policy to support growth.
- Constraints most apparent where financial vulnerabilities have built up.
- Targeted macroprudential policy measures can help to safeguard financial stability.

Headline Inflation

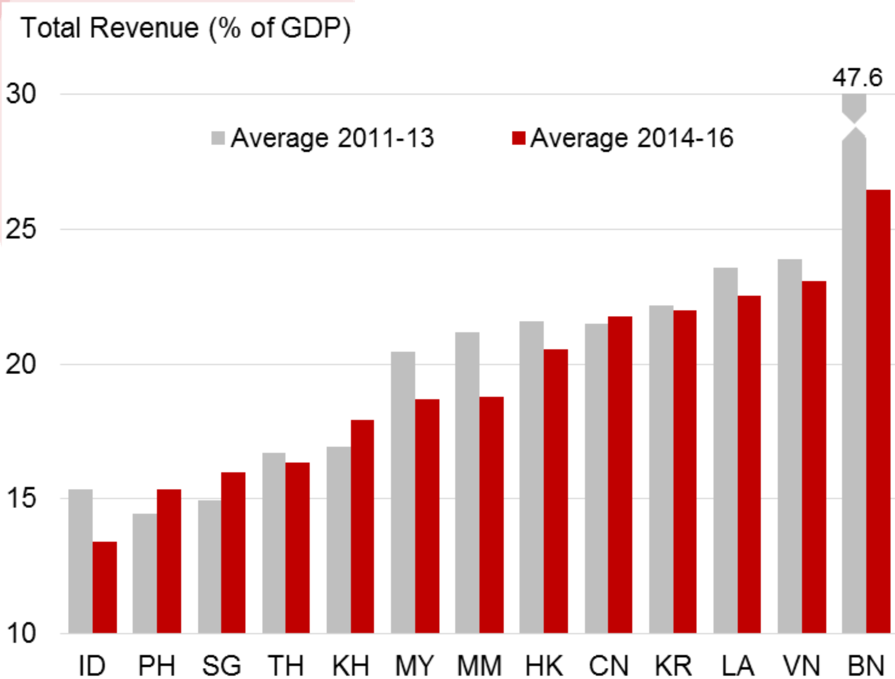


p/ Projection
Source: National Authorities, AMRO

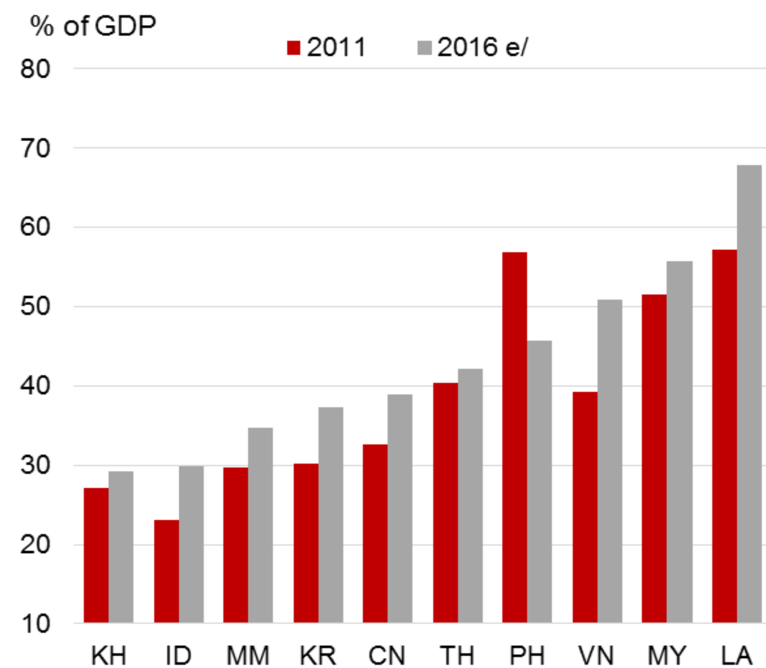
Fiscal Policy

- Fiscal conditions are expected to remain generally tight due to revenue shortfalls in some economies, with debt-to-GDP ratio edging higher. In economies with weaker fiscal position, reprioritizing and rebalancing existing expenditure programs should be the first steps pursued.

Central Government Fiscal Revenue Performance



Government Debt-to-GDP Ratio (Selected Economies)

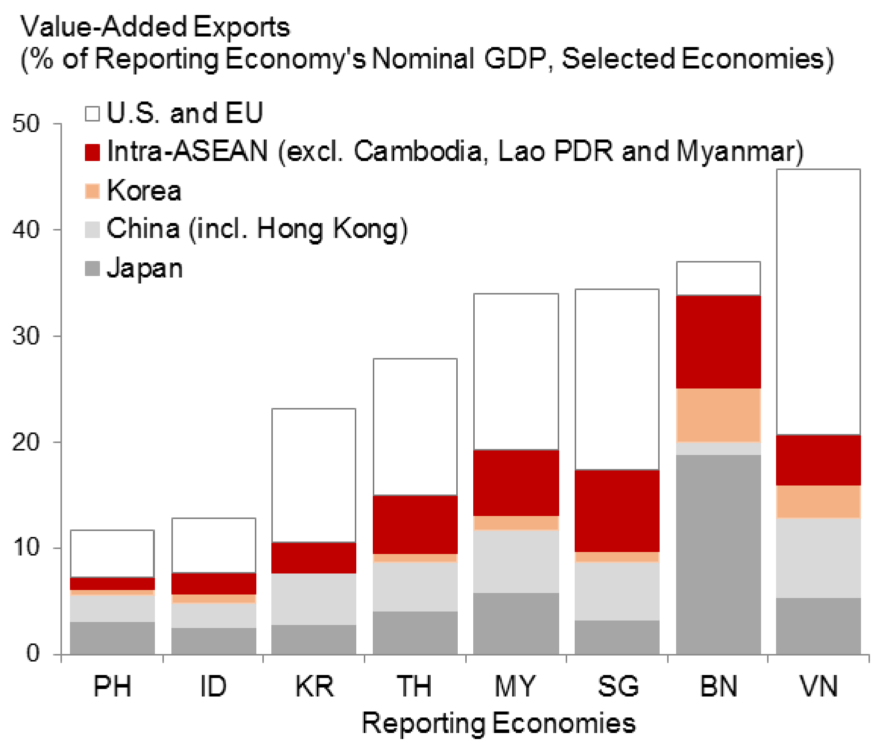


Source: National Authorities, AMRO

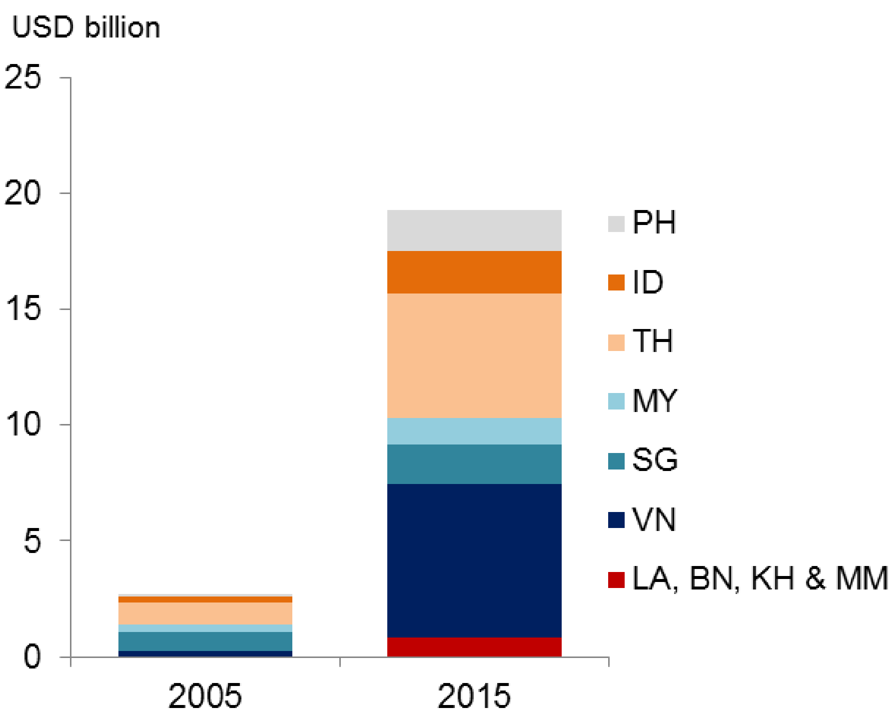
Structural Developments – Leveraging Regional Integration

On structural developments, the region has become an important source of final demand, benefiting from the growing regional integration, and 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)



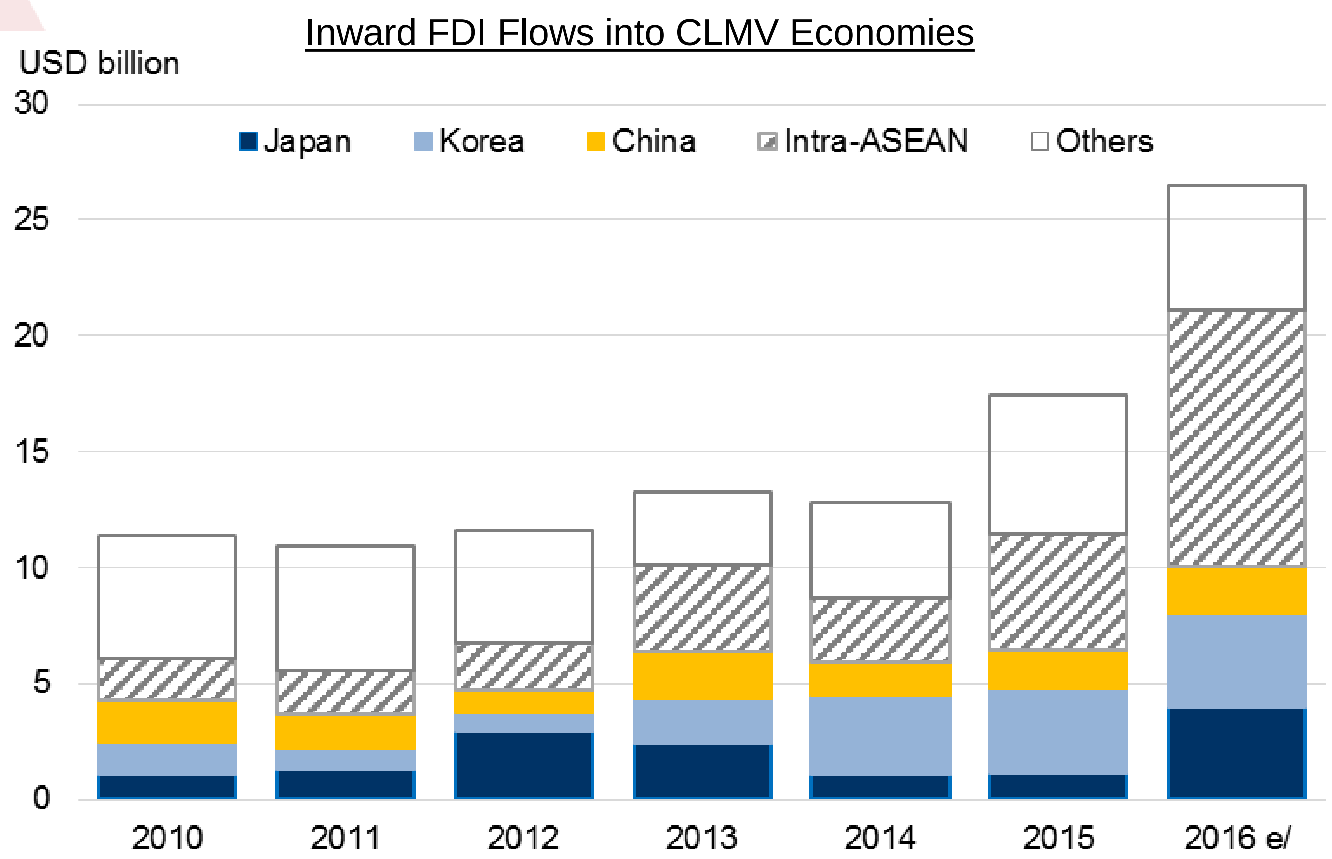
China's Imports of Consumption Goods from ASEAN



Source: COMTRADE, OECD, AMRO

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



e/ Estimates
Source: ASEANStats, AMRO

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Chapters

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

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

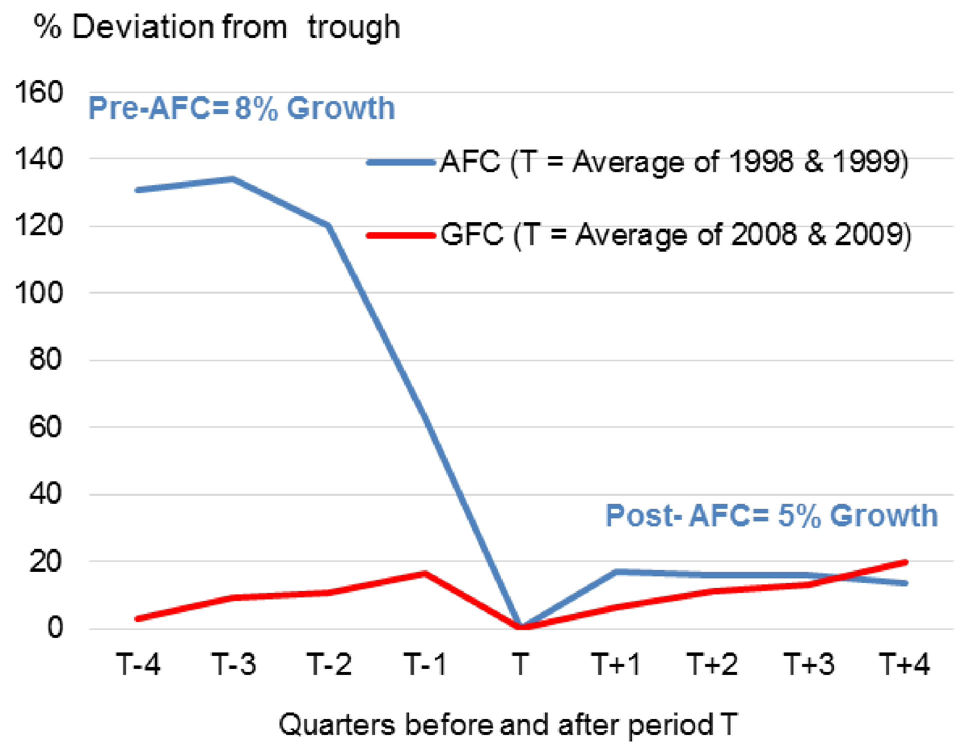
- Highlighted the urgent need for regional financial cooperation
  - ➔ CMI (2000-09), CMIM (2010 onwards)
  - ➔ Establishment of AMRO as independent macroeconomic surveillance unit supporting the CMIM (2011)

Source: AMRO

1 First Decade Post-AFC: Rebuilding Foundations

- Period of economic consolidation after a sharp negative shock
- Painful policy adjustments in exchange rate regimes, corporate and financial sector reforms, fiscal consolidation, and reforms in prudential regulation
- Policy adjustments enabled the affected economies to rebuild the foundations for economic growth, with exports leading the recovery

Real GDP: ASEAN-4 and Korea



Source: National Authorities, AMRO

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

Source: ASEANstats

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

Capital Inflows Post-GFC

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

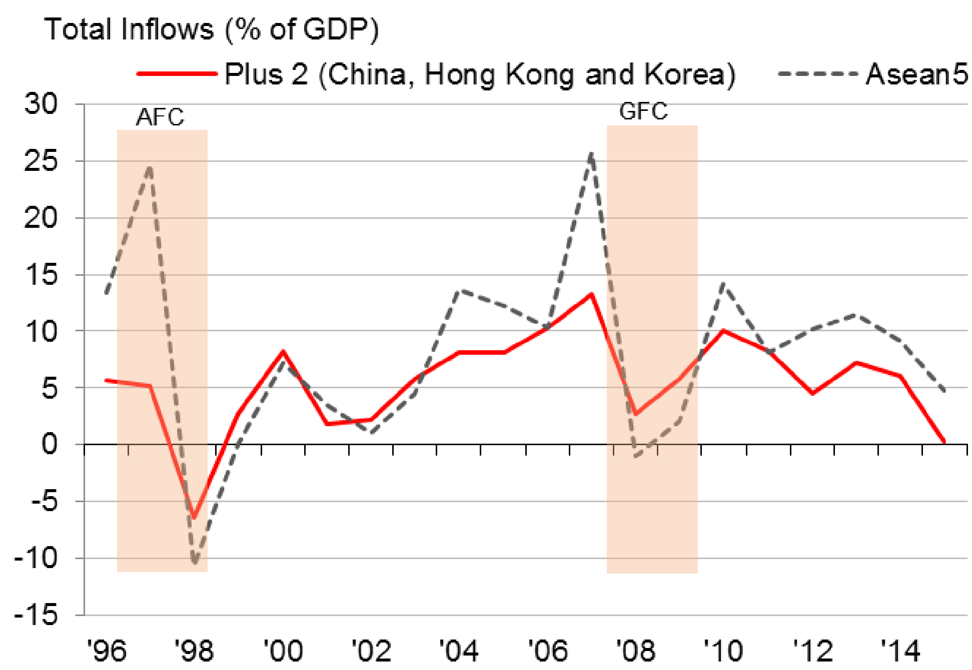
➔ Financial vulnerabilities: credit growth, asset price inflation, leverage

➔ 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)



Source: AMRO, IMF

Lessons from the AFC

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

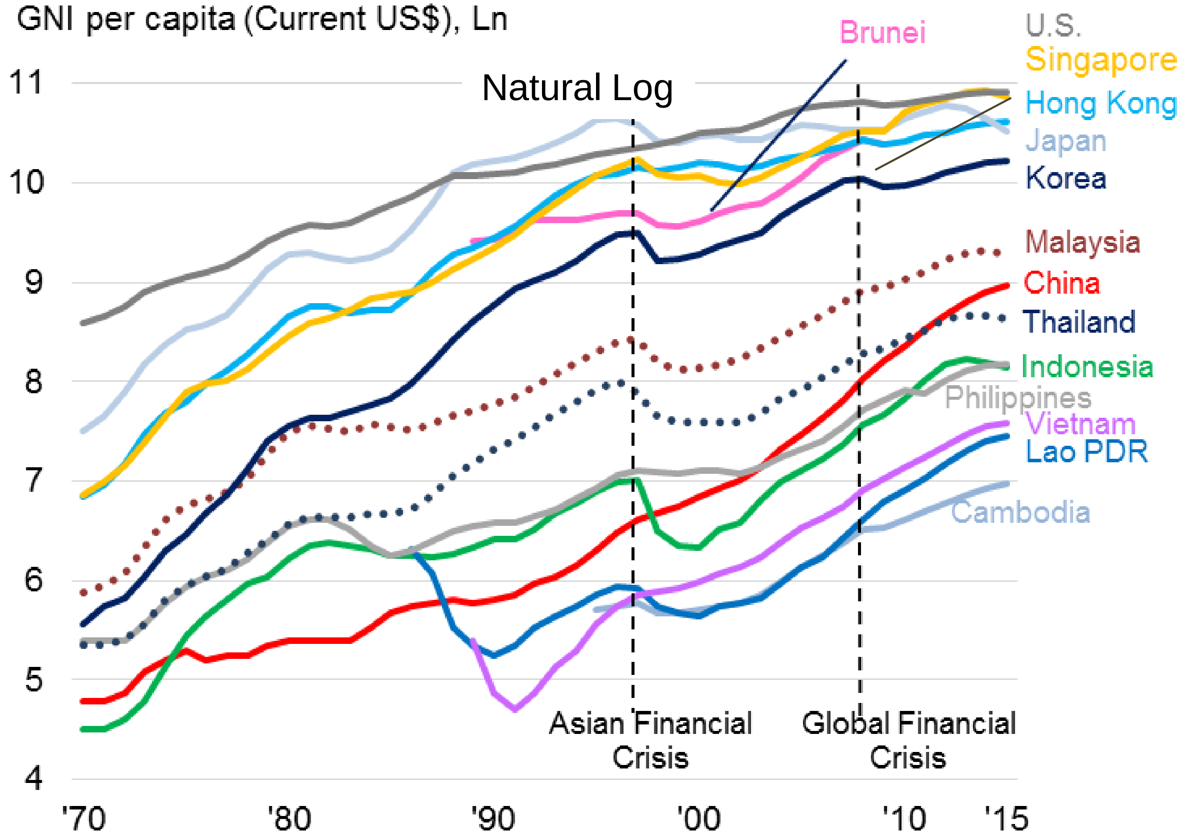
- I Focus on risks arising from financial markets and capital outflows (inter-connectedness and contagion risks)
- II Flexible and responsive policy framework, and strengthening of buffers
- III Greater financial cooperation within the region to deal with external shocks.

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

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

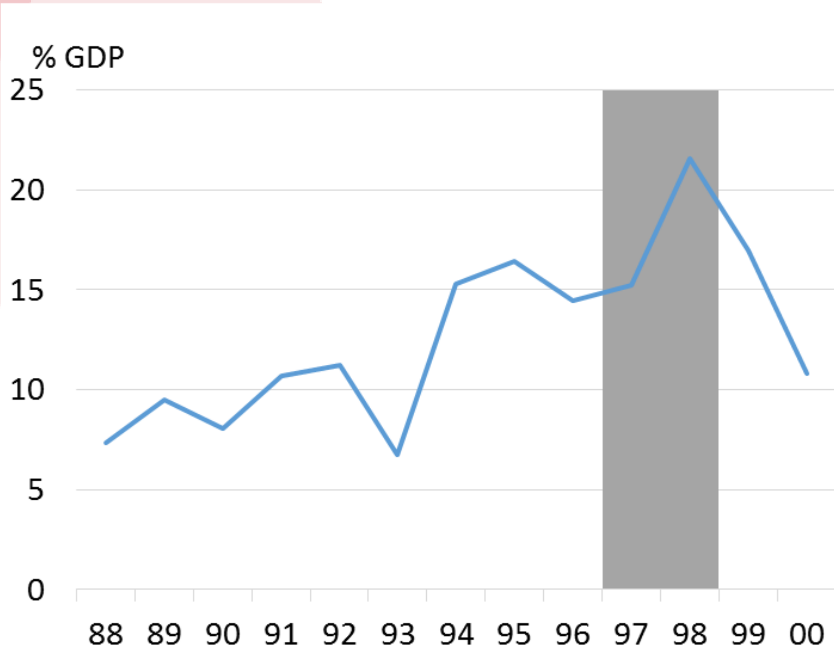


Note: Data for Myanmar are not available
Source: World Bank

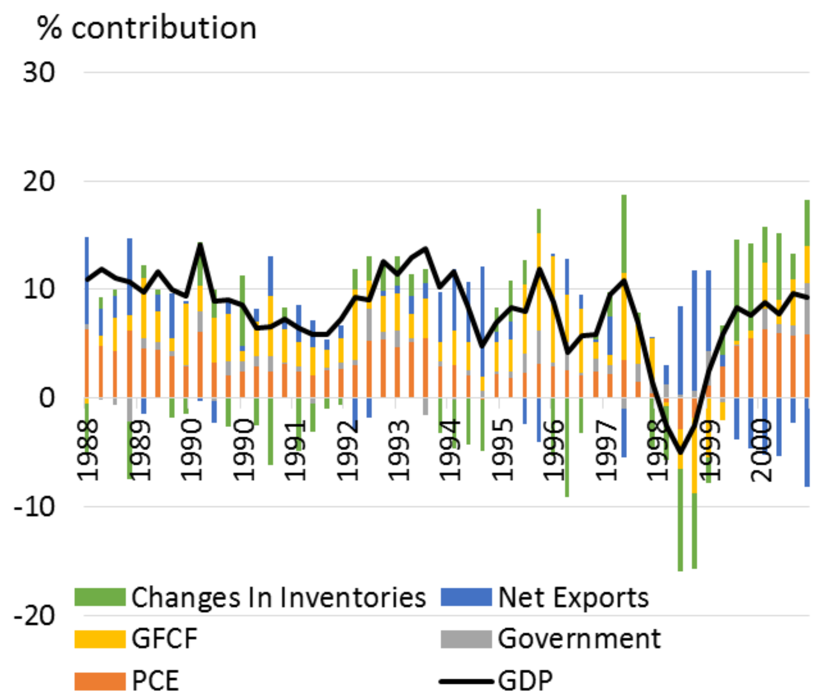
Singapore's Experience

- Singapore weathered the AFC relatively well. The economic fundamentals were sound with large current account and fiscal account surplus.
- However, Singapore did not escape the fallout from the regional crisis, and GDP declined during AFC.

Current account



GDP by expenditure

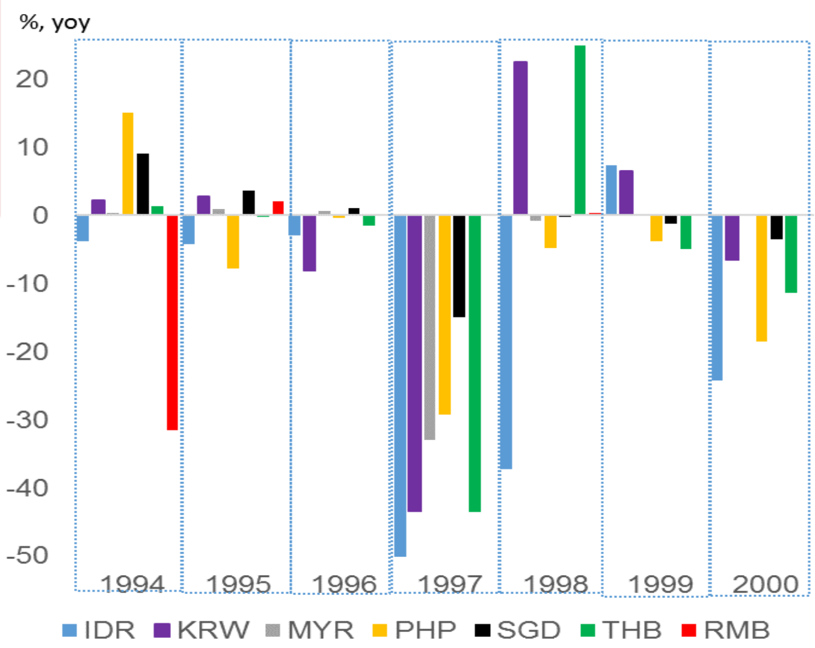


Source: CEIC

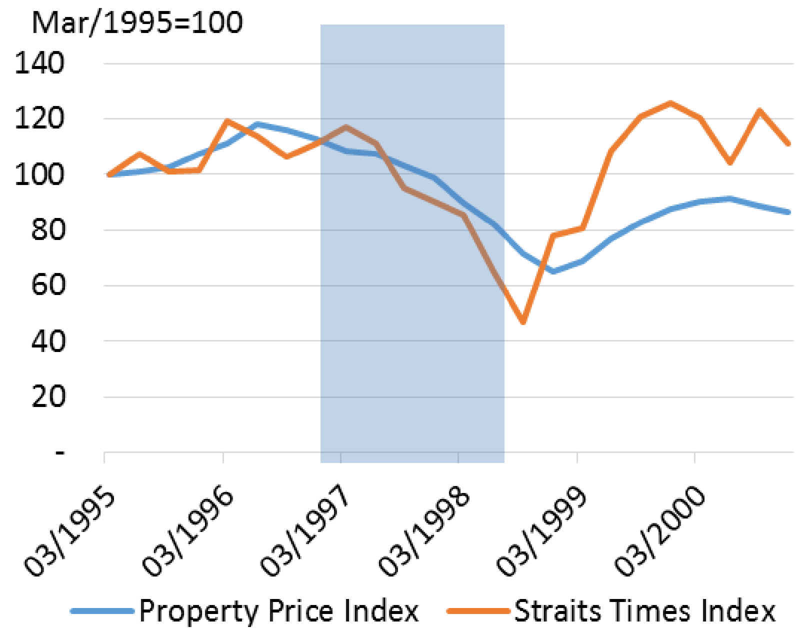
Singapore's Experience

- SGD fell against the USD but rose against regional currencies. SGD's appreciation against the regional currency posed a challenge in cost competiveness.
- Asset price fell, hurting corporate, households and the financial institutions.

Exchange rate (against USD)



Asset price fell



Source: CEIC

Singapore's Experience

- Singapore's policy response to the crisis is not to reject globalization and liberalizations, but to undertake further reforms and restructuring to ensure international competitiveness.

  - **Managed exchange rate system:** Following the outbreak of the crisis, the MAS took steps to ease its monetary policy somewhat to cushion the rapidly decelerating Singapore economy.
  - **Fiscal and cost-cutting measures:** Singapore adopted a more expansionary fiscal policy in FY 1998, including a number of off-budget packages of cost cutting and stimulus measures, such as substantial wage cuts, CPF cuts, cuts in land and rental costs and in government user charges. There was also more public investment expenditures and tax rebates. It is pragmatic and kept Singapore competitive and kept jobs.
  - **Stick to openness and long term economic restructuring:** Singapore's fundamental approach towards economic development remained unchanged, with continuing reliance on market forces, allowing free capital flows and foreign investments. At the same time, it continued to promote education and training, encouraging new investments and liberalization of the financial sector in the long term.

Recap: Key Messages

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 is expected to moderate in 2017-18, projected at 6.5% and 6.3%, respectively. Private investment activities have notably picked up recently, alongside improvement in corporate profits.
4. Some policymakers will face a sharper trade-off between growth and financial stability objectives, at a time when policy space has narrowed/constrained.
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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