Monthly Update of the ASEAN+3 Regional Economic Outlook (AREO)

Special Edition

ASEAN+3 Macroeconomic Research Office (AMRO)

Singapore

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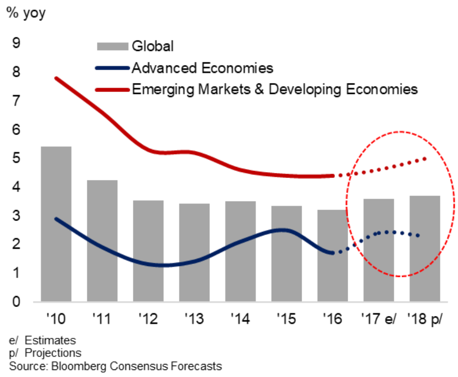
This Monthly Update of the AREO was prepared by the Regional Surveillance team and approved by Dr Khor Hoe Ee (Chief Economist).

The analysis in this report is based on information available up to 5 January 2018. For the sake of brevity, “Hong Kong, China” will be referred to as “Hong Kong” in the text and figures.

Global Settings and Spillovers to Regional Economies

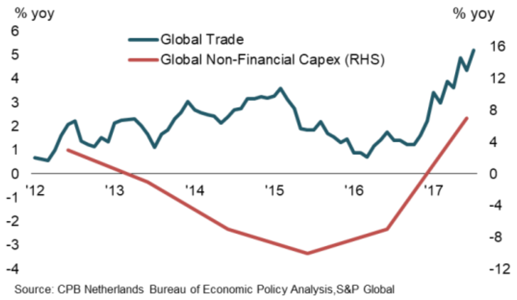
Compared to early last year, prospects for the global economy improved with broad-based growth momentum across advanced and emerging economies, while inflation pressures remained subdued (Chart 1). Major indicators such as the PMI show activity continue to pick up in major developed economies (Annex 1). Growth in the U.S. was strong though the anticipated fiscal stimulus did not yet materialize in 2017. In the Eurozone, the cyclical recovery was stronger than anticipated, supported by strengthening private sector demand.

Chart 1 First synchronized global growth after many years



Global growth was driven by an expansion in global trade, with an upcycle in sectors such as semiconductors and with capital expenditure trending up (Chart 2). Commodity prices in energy and industrial metals also recovered in 2017, benefitting export-dependent economies.

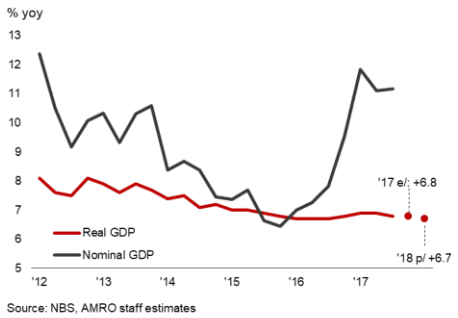
Chart 2 Cyclical upswing in global trade and capex supported global growth



The two systematically important economies in the region, China and Japan continued on a robust growth path, anchoring economic growth in the ASEAN+3 region.

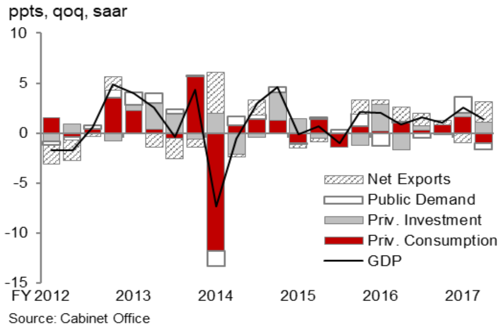
China's economic growth has been stronger than earlier anticipated (Chart 3). Growth was mainly supported by an expansion in private consumption and infrastructure investment, with an added impetus from the export sector. In addition, private investment has been picking up on the back of rising prices and improved corporate profits.

Chart 3 China continued its economic growth momentum



In Japan, economic growth continued to be robust, well above its potential growth rate (Chart 4). This reflected sustained domestic demand, supported by strong external demand. On the household side, private consumption also picked up, as household incomes

Chart 4 Japan's growth continued to be above potential



gradually increased with an improving employment outlook and a tight labor market. Inflation has been picking up, although it remained below the 2 percent target.

Global financial conditions remained favorable, though vulnerable to shocks. This improvement has supported investor risk appetite, as reflected in higher asset prices and continuing capital flows into emerging markets (Chart 5). However, risks such as a faster-than-expected tightening of global financial conditions could shift investor sentiment abruptly, with downside risks to capital inflows to emerging markets.

Regional Economic Outlook and Policy Implications

AMRO's baseline GDP growth forecast for the ASEAN+3 region is 5.5 percent in 2017, and 5.4 percent in 2018 (Chart 6). Regional economic growth remained robust, reflecting the sustained expansion in domestic demand, as well as the stronger impulse from the global trade cycle. On investment, the outlook remains positive, given the ongoing implementation of public infrastructure projects in some regional economies. Indicators such as purchasing managers' indices and new export orders suggest that growth is likely to be sustained.

Current account positions are expected to improve in 2018 with external demand picking up, and for commodity exporters, with higher global commodity prices (Chart 7). This allows the region to continue to build foreign exchange reserve buffers, which together with exchange rate flexibility, will help to buffer against the impact of possible capital flow volatility. While the region continued to receive capital inflows, inflows have started to moderate from Q3 2017 compared to earlier in the year (Chart 8).

Chart 5 Non-resident net portfolio capital inflows into global EMs have also remained positive

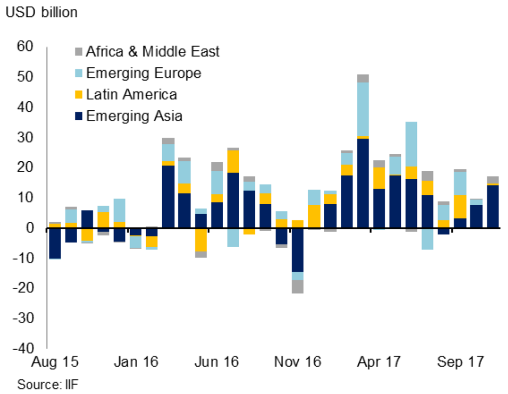


Chart 6 AMRO's baseline growth and inflation projections

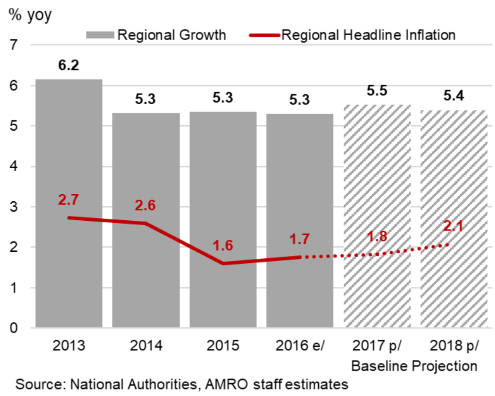


Chart 7 Regional export growth has been robust

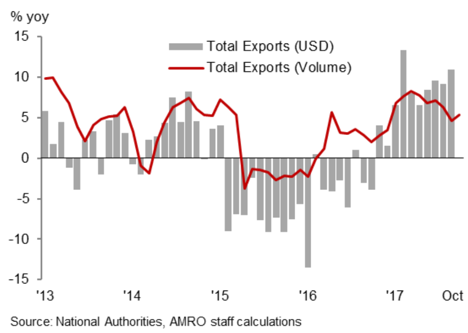
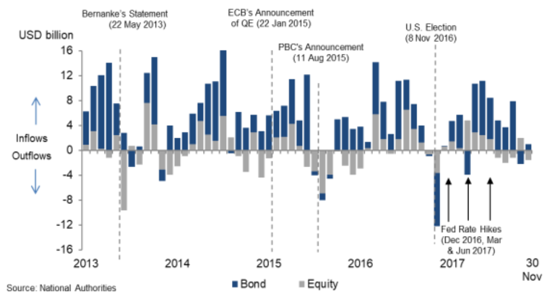


Chart 8 The region continued to see net capital inflows, driven by inflows to bond markets



The risks confronting the ASEAN+3 region are tail risks with low likelihood, but with high impact (Chart 9).

First, tighter global financial conditions, from the risk of faster-than-expected Fed rate hikes, may lead to capital outflow shocks in emerging markets. As emerging markets in ASEAN+3 have received large inflows into our bond markets relative to emerging markets elsewhere in the past two years, the impact of tightening global financial conditions on these inflows need to be monitored.

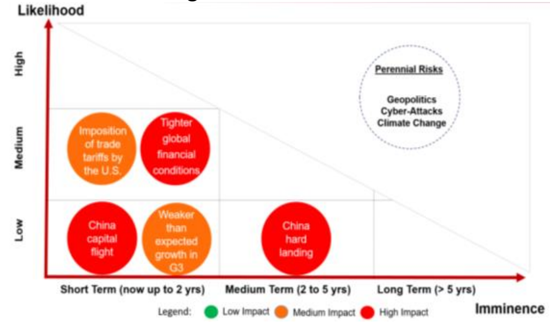
Second, protectionism from U.S. imposing tariffs on targeted exports from the region would directly impact bilateral trade and escalate global trade tensions. This risk still bears watching even though strong trade actions by the U.S. did not materialize in 2017.

Economic tail risks of low likelihood would be a hard landing or capital flight from China. This would adversely impact market confidence in the region as it would remove an engine of global economic growth and unsettle financial markets.

In addition, there are also perennial non-economic risks of geopolitical events, climate change and natural disasters, and cyber-attacks.

With these risks in mind, policymakers should continue to build policy space, particularly in monetary policy. While generally benign inflation and continued low global yields have afforded monetary policy space (Chart 10), economies would need to take into consideration financial stability and possible external vulnerabilities following tighter global financial conditions ahead.

Chart 9 The main risks facing the ASEAN+3 region are external



Source: AMRO

Chart 10 Continued low global yields have afforded monetary policy space…

Long Term Borrowing Costs (10Y), Selected Economies

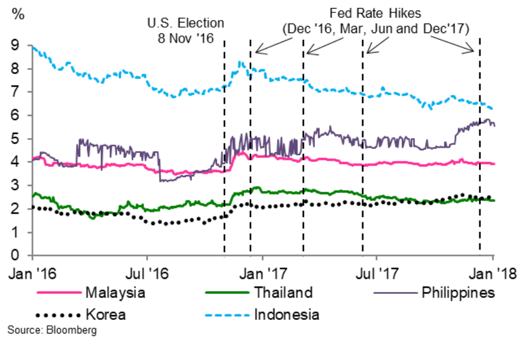
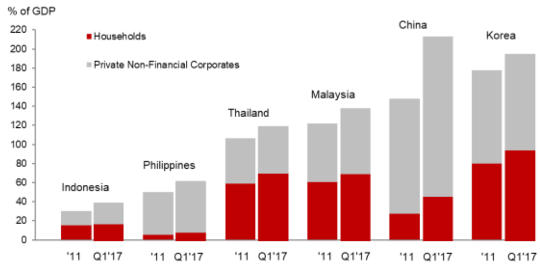


Chart 11 …and where necessary, macroprudential policy can be used

Credit to Households and Private Non-Financial Corporates from All Sectors, Selected Economies



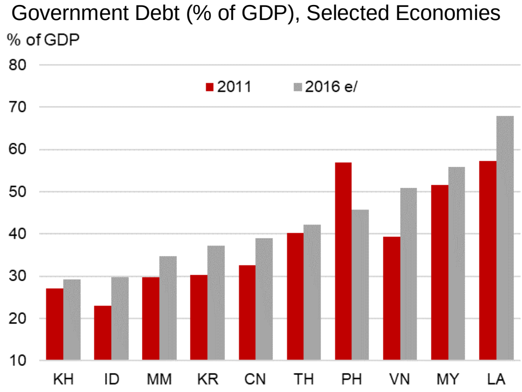
Source: Reuters

Policy will also have to be calibrated taking into account constraints from domestic and external vulnerabilities such as debt (Chart 11), and degree of reliance on external financing. Where pockets of vulnerability have built up in sectors such as the property market, tightening macroprudential policy can help safeguard financial stability, and most regional economies have already tightened macroprudential policy pro-actively.

With constraints on monetary policy due to tightening global financial conditions, fiscal policy would have to play a greater role to support growth so that the overall macroeconomic policy is not tightened too suddenly. This is subject to available fiscal space (Chart 12), and constraints posed by fiscal rules. Economies already relying on external financing for both the current account and the fiscal balance ("twin deficits") may face financing constraints when trying to maintain an expansionary fiscal policy.

In addition to demand management policies, structural reforms in building necessary physical infrastructure and human capital, and economic diversification, especially in developing ASEAN economies, would help increase the productive capacity in the long-run.

Chart 12 Fiscal policy, where there is space, would also need to play a larger role in supporting growth



Source: National Authorities

Annex 1: Global Manufacturing PMI Heatmap

Economies	2015				2016				2017												Change from Prev Month	Trend (with min and max pts)
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		
Global																					0.4	
Developed Markets																					0.5	
U.S.																					1.2	
U.K.																					-1.9	
Eurozone																					0.5	
Austria																					2.4	
France																					1.1	
Germany																					0.8	
Greece																					0.9	
Ireland																					1.0	
Italy																					-0.9	
Netherlands																					-0.2	
Spain																					-0.3	
Emerging Markets																					0.5	
Brazil																					-1.1	
India																					2.1	
Russia																					0.5	
South Africa*																					-0.4	
China																					0.7	
Hong Kong*																					0.8	
Japan																					0.4	
Korea																					-1.3	
ASEAN																					-0.9	
Indonesia																					-1.1	
Malaysia																					-2.1	
Philippines																					-0.6	
Singapore*																					-3.3	
Thailand																					0.4	
Myanmar																					-0.5	
Vietnam																					1.1	

Note: These seasonally-adjusted PMI readings are coded by colors:

- Darker shades of red in the reading denote readings further below (< 45) the diffusion level of 50; conversely, greener shades in the readings denote readings further above (> 55) the diffusion level of 50.
- The trend lines shown in the right-most column represent the PMI readings since January 2015, the red dots denote minimum and maximum points in that period.
- Global PMI is as aggregated by JP Morgan. China's PMI refers to Caixin/ Markit PMI.
- (*) denotes whole economy PMI

Source: Markit, JP Morgan

Annex 2: AMRO's Growth and Inflation Projections for ASEAN+3

% year-on-year	2015	2016	2017 e/	2018 p/
ASEAN+3				
Real GDP Growth	5.3	5.3	5.5	5.4
Inflation	1.6	1.7	1.8	2.1
Brunei Darussalam				
Real GDP Growth	-0.4	-2.5	0.6	1.6
Inflation	-0.4	-0.7	-0.1	0.2
Cambodia				
Real GDP Growth	7.0	7.0	6.9	6.8
Inflation	1.2	3.0	3.3	3.5
China				
Real GDP Growth	6.9	6.7	6.8	6.7
Inflation	1.4	2.0	1.7	2.0
Hong Kong, China				
Real GDP Growth	2.4	2.0	3.6	3.0
Inflation	3.0	2.4	1.5	2.0
Indonesia				
Real GDP Growth	4.9	5.0	5.1	5.2
Inflation	3.4	3.0	3.6	4.0
Japan				
Real GDP Growth (Fiscal Year)	1.3	1.3	1.6	1.2
Inflation (Fiscal Year)	0.2	-0.1	0.7	0.8
Korea				
Real GDP Growth	2.8	2.8	3.2	2.9
Inflation	0.7	1.0	2.0	1.9
Lao PDR				
Real GDP Growth (Fiscal Year)	7.3	7.0	6.8	7.0
Inflation	1.3	1.6	1.3	2.3
Malaysia				
Real GDP Growth	5.0	4.2	5.8	5.3
Inflation	2.1	2.1	4.0	3.0
Myanmar				
Real GDP Growth (Fiscal Year)	7.3	5.9	7.0	7.2
Inflation	10.0	6.8	4.5	5.5
The Philippines				
Real GDP Growth (Fiscal Year)	6.1	6.9	6.6	6.7
Inflation	1.4	1.8	3.2	3.4
Singapore				
Real GDP Growth	1.9	2.0	2.5	3.0
Inflation	-0.5	-0.5	0.6	1.4
Thailand				
Real GDP Growth	2.9	3.2	3.8	3.8
Inflation	-0.9	0.2	0.7	1.2
Vietnam				
Real GDP Growth	6.7	6.2	6.8	6.6
Inflation	0.6	2.7	3.5	3.4

Notes: e/ refers to estimates, p/refers to projections
GDP Growth: refers to calendar year, unless otherwise stated.
Inflation: refers to period average headline inflation; in calendar year unless otherwise indicated
Source: National authorities, AMRO staff estimates and projections