

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

ASEAN+3 Macroeconomic Research Office (AMRO)

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This Monthly Update of the AREO was prepared by Anthony Tan, Vanne Khut and Edmond Choo (Regional Surveillance team), reviewed by Li Lian Ong (Group Head) and approved by Hoe Ee Khor (Chief Economist).

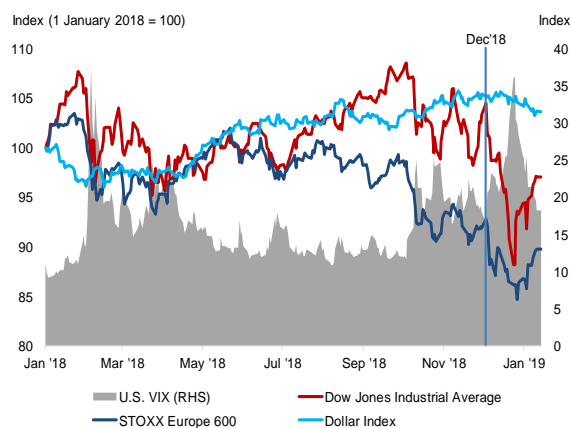
Unless otherwise indicated, the analysis in this report is based on information available up to 4 January 2019. For the sake of brevity, “Hong Kong, China” will be referred to as “Hong Kong” in the text and figures.

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Global Economic Developments

Global markets started 2019 in the same way it ended 2018—in significant turbulence (Figure 1). In December, the VIX spiked to levels seen earlier in the year (when President Trump sparked concerns about a global trade war), following the President's criticism of the U.S. Fed for raising interest rates, and the Treasury Secretary's subsequent "unusual" attempts to reassure markets. In January, dramatic price swings accompanied the release of markedly weaker U.S. and China manufacturing PMIs, the continuing U.S. government shut-down, and the Fed Chairman's dovish remarks on monetary policy, which also contributed to a softer dollar index.

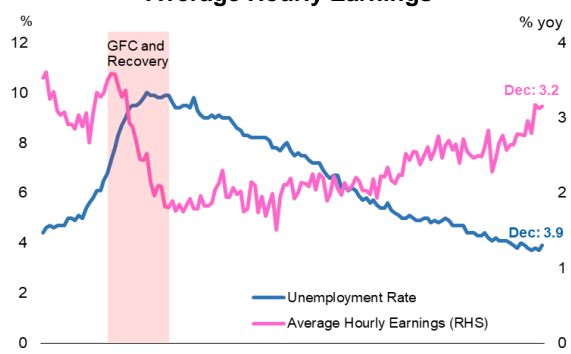
Figure 1. U.S. and EU Stock Markets, and Dollar Index



Source: Haver Analytics.

The data show that the U.S. economy continued to expand at above trend in Q3 2018, supporting job creation and bolstering wage increases (Figure 2). Real GDP growth increased by an annual rate of 3.4 percent, after hitting a record high of 4.2 percent in Q2 2018. Meanwhile, headline inflation has softened since October 2018, reflecting the sharp decline in gasoline prices, although underlying inflationary pressures remain firm.

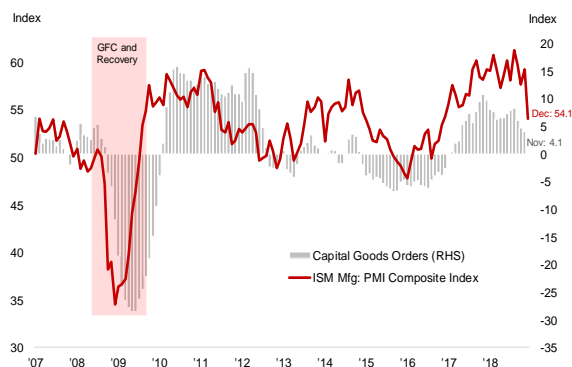
Figure 2. United States: Unemployment Rate and Average Hourly Earnings



Note: Payrolls growth totaled 2.6 million in 2018, the highest since 2015 and well above the 2.2 million registered in 2017.
Source: Bureau of Economic Analysis.

Looking ahead, the U.S. ISM manufacturing PMI survey points to continuing strength in business activity in 2019, albeit at much lower levels. After relatively steady growth, U.S. manufacturing activity slowed in December 2018 (Figure 3). Forward momentum is likely to be more moderate, with the growth outlook for 2019 capped by diminishing fiscal impulse and expectations of lower business investment spending.

Figure 3. United States: ISM Manufacturing PMI and Capital Spending



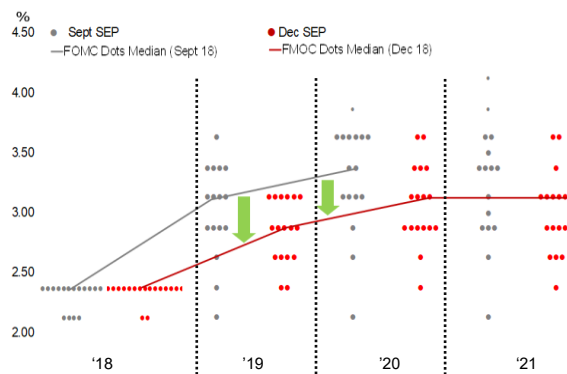
Sources: Institute for Supply Management; Haver Analytics.

Although the U.S. Fed tightened monetary policy, it is expecting weaker growth in 2019 (Figure 4). On 19 December 2018, the central bank raised the Fed funds rate by 25 basis points to the 2.25–2.50 percent range, and signaled two rate hikes in 2019 (as compared to three in the September 2018 Summary of Economic Projections), while keeping the pace of balance sheet reductions unchanged. It concurrently downgraded the 2019 growth outlook from 2.5 percent to 2.3 percent. The Fed Fund Futures rate suggests that markets are not expecting another rate hike in Q1 2019.

In the Eurozone, economic activity continues to moderate, with signs of a broad-based slowdown. While the setback to growth, particularly in Q3 2018, was attributable to sector-specific developments (e.g. new emission standards which impacted auto production), manufacturing activity has remained largely flat since October 2018. The manufacturing PMI index decreased to 51.4 in December 2018 (from 51.8 in the previous month), the weakest in over 4 years, suggesting downside risks to the growth outlook. The Sentix coincident indicator of economic activity also suggests growing pessimism (Figure 5).

In the United Kingdom, domestic demand remains subdued, with the near term outlook weighed down by considerable uncertainties over Brexit. Surprisingly solid activity in Q3 2018 was supported by transitory factors, such as England's strong showing in the World Cup and a sunny summer pushing up retail sales. However, Brexit concerns continue to cast a shadow over business investment, which has declined over three consecutive quarters (Figure 6).

Figure 4. FOMC Dot Plot Comparisons (September and December 2018)



Source: U.S. Federal Reserve.

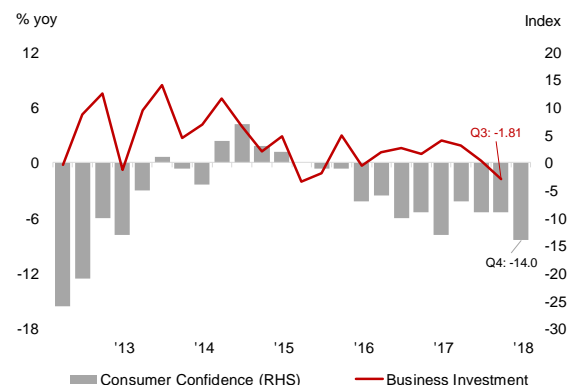
Figure 5. Eurozone: Growth and Sentix Economic Index



Notes: Real GDP growth as of Q3 2018, Sentix Economic Index as of December 2018. The Eurozone economic sentiment refers to the Sentix Economic Index on current situation. A reading above zero indicates optimism; below zero indicates pessimism.

Sources: EuroStat; Haver Analytics.

Figure 6. United Kingdom: Consumer Confidence and Business Investment



Sources: U.K. Office for National Statistics; GfK NOP (U.K.).

In commodity markets, global oil prices rebounded in early January after steep declines in the previous two months. Prices plunged to USD 53.8 per barrel in late December, compared to around USD 80 per barrel in September. The agreement by OPEC and other major oil producers in December to cut oil production by 1.2 million barrels per day, coupled with growing optimism about the latest U.S. and China trade talks, has helped to stabilize crude oil prices (Figure 7). Meanwhile, agricultural commodity prices, notably palm oil and soybean, remained sluggish.

Regional Economic Developments

AMRO staff has revised the ASEAN+3 regional growth for 2018 downwards, and see greater uncertainty in the outlook for 2019. With weaker Q3 2018 growth in some regional economies, staff now estimates that the region grew at 5.3 percent in 2018 (down by 0.1 percentage point from October 2018) and is maintaining a growth forecast of 5.1 percent for 2019, taking into account the potential short-term impact from the already-implemented trade protectionism measures (Figure 8). Separately, recovering global oil prices pose some upside risks to headline inflation.

Japan's growth moderated in 2018 and will likely slow further this year. Economic activity was affected by Typhoon Jebi in Q3 2018 while uncertainties over the outlook for global trade discouraged business investment spending, which contracted by an annualized 10.6 percent (Figure 9). The outlook for 2019 is for softer growth, with the planned consumption tax hike in October 2019 representing a downside risk to consumer and business confidence.

Figure 7. Global Commodities Prices

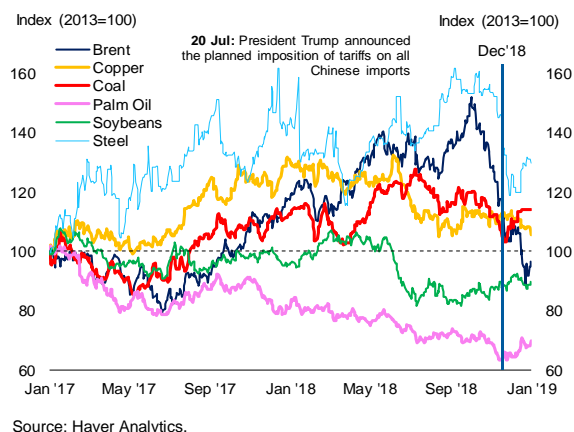
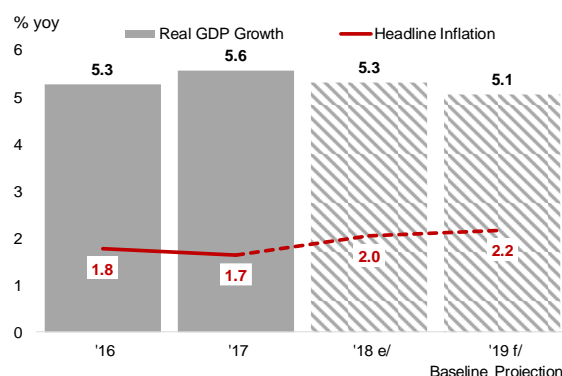
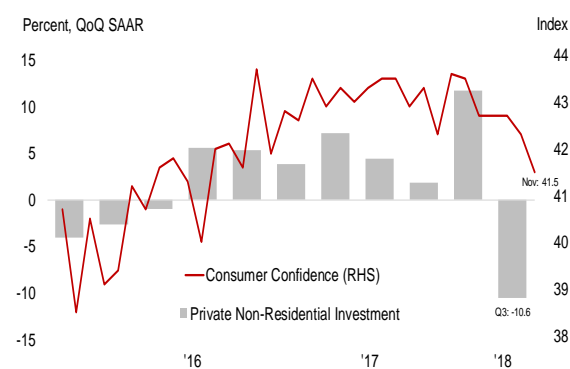


Figure 8. ASEAN+3: Growth and Inflation



Source: National Authorities; AMRO staff estimates.

Figure 9. Japan: Consumer Confidence and Private Non-Residential Investment



In China, weaker domestic and external demand for goods going into Q4 2018 have raised concerns over the outlook for economic activity in 2019:

- In November, retail sales grew at its weakest pace since 2003, attributable in part to a double-digit decline in auto sales (Figure 10). Other domestic demand indicators such as industrial output and private fixed asset investment were also relatively weak. Market surveys subsequently revealed that factory activity contracted in December for the first time in over two years, on the back of weak demand both at home and abroad.
- Correspondingly, export growth slowed significantly (to 5 percent yoy) in November, after some frontloading of exports to the United States in September, ahead of the previous 1 January 2019 tariff deadline. The outlook is weighed down by declining new export orders, which contracted for the seventh consecutive month in December (Figure 11).

In contrast, the services sector represents a "bright spot," with market surveys indicating continuing expansion in December.

Consistent with weaker factory output, the region's exports decelerated sharply in November 2018 (Figure 12). Exports slowed for Korea, Singapore, and contracted for Indonesia and Thailand. The export "cliff effect" was mainly driven by China's exports, which fell sharply. The near term outlook is for much weaker exports, judging from the pace with which export volume has declined, and to some extent, softer export prices. This could weigh further on the region's business confidence and export-related capital investment.

Figure 10. China: Retail Sales and Private Investment

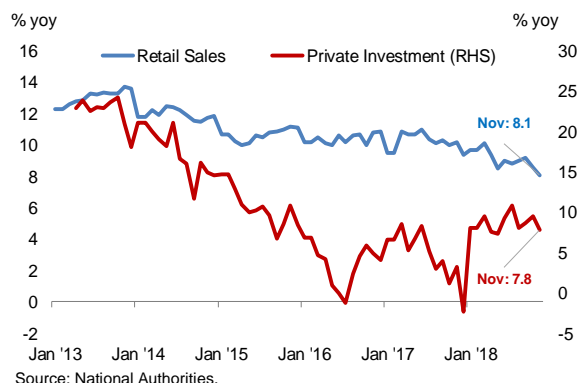


Figure 11. China: Exports and New Export Orders

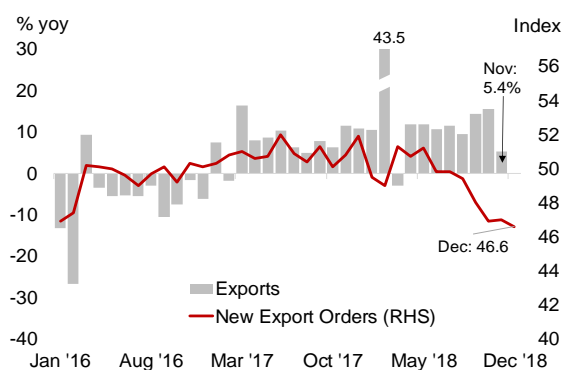
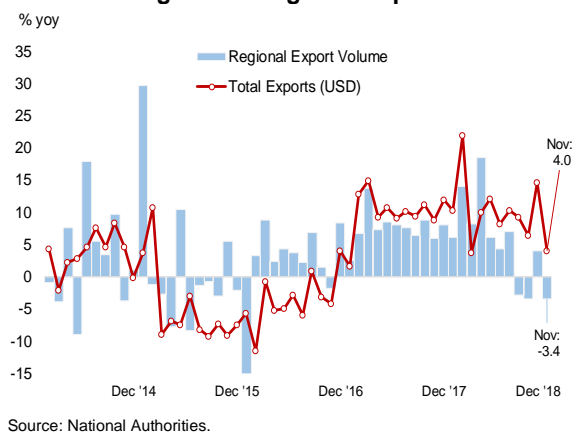


Figure 12. Regional Exports



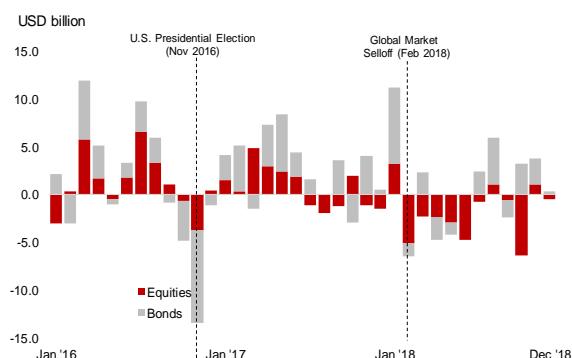
In tandem with global markets, equities in the region exhibited volatility at the end of the year and in January. Although regional emerging markets (ASEAN-4, Korea and China) shed an average 1 percent in the second half of December 2018, China's benchmark Shanghai Composite lost almost four percent (Figure 13). However, some markets rebounded in January (China, Indonesia, Philippines and Thailand) while the others were down.

Figure 13. Regional Emerging Market Equities



Source: Haver Analytics.

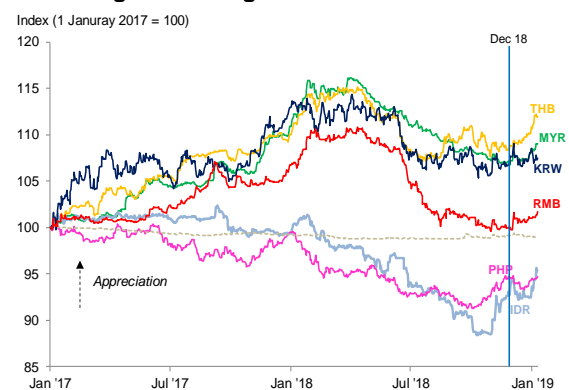
Figure 14. Capital Flows into Regional Equity and Bond Markets



Source: National Authorities.

Regional emerging markets (excluding China) posted net capital outflows in December. Equity markets lost USD 0.4 billion in non-resident flows, which were offset by bond inflows of USD 0.3 billion, largely driven by investment in Korea (Figure 14).

Figure 15. Regional EM Currencies



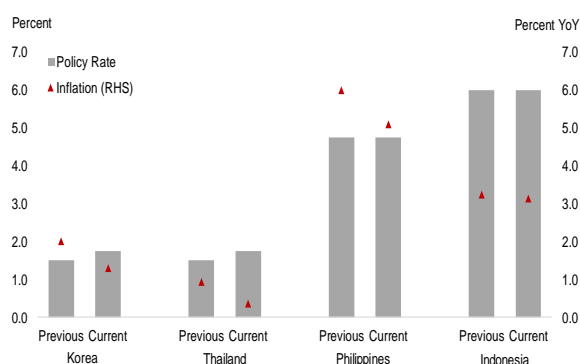
Source: Haver Analytics.

In other financial markets, most currencies strengthened while sovereign yields were largely stable. Emerging market currencies appreciated against the USD towards end-December 2018/early January 2019 (Figure 15), largely attributable to a weaker USD (Figure 1).

Amid moderate growth performance with inflation starting to ease, some economies in the region have kept their interest rates on hold during their most recent policy meetings:

- The Philippines maintained the policy rate at 4.75 percent, following four rate rises since May, as the Peso has strengthened slightly while inflation has started to moderate.
- Indonesia maintained its 7-day Reverse Repo rate at 6.0 percent to support the Rupiah.
- In Korea and Thailand, the recent increases in their key rates are aimed at addressing concerns over high household debt levels and to mitigate the risk of financial instability.
- Elsewhere, the People's Bank of China announced that it would cut the reserve requirement ratio by a total of 100 basis points (or USD 218 billion) in January, in an effort to partially offset local government repayments under the Medium-Term Lending Facility, to ease pressure on banks, as well as to stimulate the gradually slowing economy.

Figure 16. Selected ASEAN+3 Economies: Policy Interest Rates and Inflation,



Source: National Authorities.

Annex 1: GDP Growth and Forecast for Selected ASEAN+3 Economies

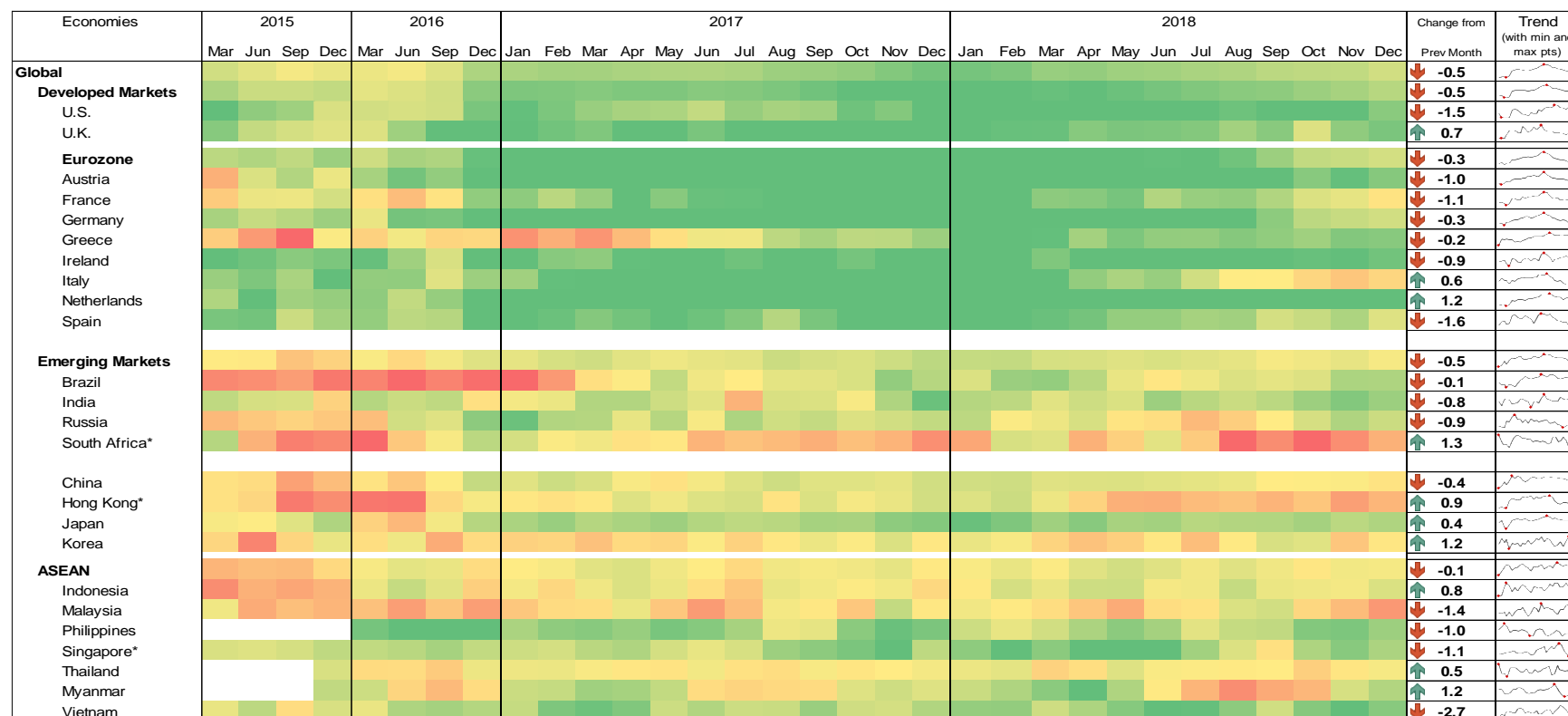
% year-on-year	2016	2017	2018					2019 f/
			Q1'18	Q2'18	Q3'18	Q4'18	2018	
ASEAN+3								
Real GDP Growth	5.3	5.6	NA	NA	NA	NA	5.3	5.1
Inflation	1.8	1.7	NA	NA	NA	NA	2.0	2.2
Brunei Darussalam								
Real GDP Growth	-2.5	1.3	2.6	-2.8	0.0	-	0.5	2.1
Inflation	-0.7	-0.2	0.2	0.2	0.2	0.1	0.2	0.4
Cambodia								
Real GDP Growth	7.0	7.0	NA	NA	NA	NA	7.2	7.1
Inflation	3.0	2.9	2.2	2.7	2.6	2.8	2.6	2.9
China								
Real GDP Growth	6.7	6.9	6.8	6.7	6.5	-	6.6	6.2
Inflation	2.0	1.6	2.2	1.8	2.3	2.2	2.1	2.2
Hong Kong, China								
Real GDP Growth	2.2	3.8	4.6	3.5	2.9	-	3.3	2.7
Inflation	2.4	1.5	2.4	2.1	2.5	-	2.4	2.5
Indonesia								
Real GDP Growth	5.0	5.1	5.1	5.3	5.2	-	5.2	5.1
Inflation	3.0	3.6	3.3	3.3	3.1	3.2	3.2	3.5
Japan								
Real GDP Growth (Fiscal Year)	1.2	1.6	1.2	1.4	0.0	-	0.8	0.7
Inflation (Fiscal Year)	-0.1	0.7	1.3	0.6	1.1	-	0.9	1.0
Korea								
Real GDP Growth	2.9	3.1	2.8	2.8	2.0		2.8	2.6
Inflation	1.0	1.9	1.1	1.5	1.5	1.8	1.5	1.9
Lao PDR								
Real GDP Growth (Fiscal Year)	7.0	6.9	NA	NA	NA	NA	6.5	6.7
Inflation	1.6	0.8	1.5	2.0	2.7	-	2.5	2.5
Malaysia								
Real GDP Growth	4.2	5.9	5.4	4.5	4.4	-	4.9	4.7
Inflation	2.1	3.8	1.8	1.3	0.5	-	1.2	2.3
Myanmar								
Real GDP Growth (Fiscal Year)	5.9	6.8	NA	NA	NA	NA	7.3	7.3
Inflation	6.8	4.0	5.3	6.1	8.1	-	5.0	5.0
The Philippines								
Real GDP Growth (Fiscal Year)	6.9	6.7	6.6	6.2	6.1	-	6.4	6.3
Inflation	1.3	2.9	3.9	4.8	6.2	5.9	5.2	3.0
Singapore								
Real GDP Growth	2.4	3.6	4.5	4.1	2.3	2.2	3.2	2.5
Inflation	-0.5	0.6	0.2	0.3	0.7	-	0.6	1.3
Thailand								
Real GDP Growth	3.3	3.9	4.9	4.6	3.3	-	4.2	4.0
Inflation	0.2	0.7	0.6	1.3	1.5	0.8	1.1	1.4
Vietnam								
Real GDP Growth	6.2	6.8	7.5	6.7	6.8	7.3	7.1	6.8
Inflation	2.7	3.5	2.8	3.8	4.1	3.4	3.5	3.8

Notes: f/ refers to forecasts.

GDP Growth: refers to calendar year, unless otherwise stated. Where full year inflation data are not available yet, the figures refer to AMRO staff estimates. Inflation: refers to period average headline inflation; in calendar year unless otherwise indicated.

Sources: National authorities; AMRO staff estimates and projections.

Annex 2: Global Manufacturing PMI Heatmap



Notes: 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 3: Major Policy Developments (01 November 2018 – 11 January 2019)

China	<p>[19 December 2018] People's Bank of China introduced a new kind of lending facility to encourage loans to small and private businesses. PBOC is now open to applications from qualified banks for the use of a new tool called targeted medium-term lending facility (TMLF) to get stable long-term funds to support their businesses. Banks that lend heavily to the real economy and meet macro prudent requirements can apply for the TMLF.</p> <p>[22 December 2018] The meeting was participated in by the Chinese leaders. In 2019, China will continue to implement proactive fiscal policy as well as prudent monetary policy, make pre-emptive adjustments and fine-tune policies at proper time, and ensure stable aggregate demand. Other policy priorities include: more tax cuts, fewer zombie companies, high-quality manufacturing sector, stronger domestic market, rural vitalization, capital market reform, further opening-up, more exports and imports and healthy property market.</p> <p>[25 December 2018] China will adjust duties on 706 import items from aircraft engines to pianos and baby's diapers from next year. To actively expand imports, reduce institutional costs and advance supply-side structural reforms, China will implement a tentative import tax rate on these goods and commodities, from Jan 1, 2019.</p> <p>[03 January 2019] People's Bank of China decided Wednesday to ease evaluation rules for qualifying financial institutions to enjoy lower reserve requirement ratios (RRR) in a move to encourage inclusive financing. Financial institutions can deposit less in the central bank as reserve money if they lend a certain share of their loans to small and micro firms.</p>
Hong Kong	<p>[20 December 2018] The Hong Kong Monetary Authority (HKMA) raised its interest rate by 25 basis points, from 2.50 percent to 2.75 percent, after the Fed lifted short-term interest rates another quarter point to 2.25 - 2.5 percent on Wednesday.</p>
Japan	<p>[20 December 2018] The Policy Board of the Bank of Japan decided to maintain the policy rates and the guidelines for asset purchases unchanged.</p>
Korea	<p>[30 November 2018] The Monetary Policy Board of the Bank of Korea raised the base rate by 25 basis points, from 1.50 percent to 1.75 percent.</p> <p>[8 December 2018] The Budget Proposal for the Fiscal Year 2019 was approved by the parliament. The 2019 budget is amounted KRW926.5 billion or approximately USD0.83 billion.</p> <p>[17 December 2018] Ministry of Economy and Finance announced the 2019 Economic Policies. The main objectives of the policies are to boost the economy, to continue ongoing industrial restructuring, to pursue the government's more inclusive growth goal and to address mid-to-long-term structural challenges in the Korean economy.</p>
Indonesia	<p>[1 November 2018] The domestic Non-Delivery Forward (DNDF) market was launched.</p>

	<p>[15 November 2018] Bank Indonesia (BI) raised its 7-day reverse repo rate by 25 basis points to 6.00 percent, while also raising the Deposit Facility (DF) and Lending Facility (LF) rates by 25 bps to 5.25 percent and 6.75 percent respectively.</p> <p>[16 December 2018] Indonesian Minister of Trade and ministers and other representatives from the EFTA States signed a Comprehensive Economic Partnership Agreement (CEPA), which is expected to strengthen the economic ties and promote trade and investment between the two sides.</p> <p>[20 December 2018] The BI Board of Governors held the BI 7-Day Reverse Repo Rate at 6.00 percent, while also maintaining the Deposit Facility (DF) and Lending Facility (LF) rates at 5.25 percent and 6.75 percent, respectively.</p>
Lao PDR	<p>[7 December 2018] During the Lao National Assembly session the Amended Law on Commercial Banks was approved. The amended law seeks to enhance the effectiveness, transparency and financial stability of the banking sector in Lao PDR. In particular, it increases the minimum registered capital of domestic commercial bank from three hundred billion Kip to five hundred billion Kip; and the minimum investment capital of foreign commercial bank branch from one hundred billion Kip to three hundred billion Kip.</p> <p>[21 December 2018] During the Lao National Assembly session, the government sought to impose stricter fiscal discipline, first through the issuance of Budget Expenditure Norm No. 4000/MOF which sets ceilings for various administrative and maintenance expenses to cap current expenditure, and second through stricter scrutiny of public investment projects to emphasize on the quality of public investments and enhance the effectiveness of capital expenditure under budget 2019.</p> <p>[25 December 2018] Ministry of Finance of Lao PDR issued government bonds amounting to 1,000 Billion Kip to finance budget deficit. The government bonds will be listed at the Lao Securities Exchange in two phases (30 percent to be listed in December 2018 and the remaining in Q1-Q2 2019). The bonds are in four tenors, namely, one year, three year, five year and seven year bonds.</p>
Philippines	<p>[14 Nov 2018] The Congress passed the rice tariffication bill. With the passage of this bill into law, the Philippines will replace its rice importation from a quota-based system with a tariff-based system. For ASEAN countries, the rice import tariff will be 35 percent, and for non-ASEAN countries the tariff rate will be 50 percent. In order to protect the domestic industry, a Rice Competition Enhancement Fund will be set up.</p> <p>[13 December 2018] The Bangko Sentral ng Pilipinas left its policy interest rate on hold at 4.75 percent for the first time in six meetings. The interest rates on the overnight lending and deposit facilities were likewise held steady.</p>
Thailand	<p>[14 Nov 2018] The BOT Monetary Policy Committee decided to maintain the policy rate of 1.5 percent.</p> <p>[19 Dec 2018] The BOT Monetary Policy Committee decided to raise the policy rate by 25 bps to 1.75 percent.</p>

Source: National Authorities.