

Voice of Asia

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Insights

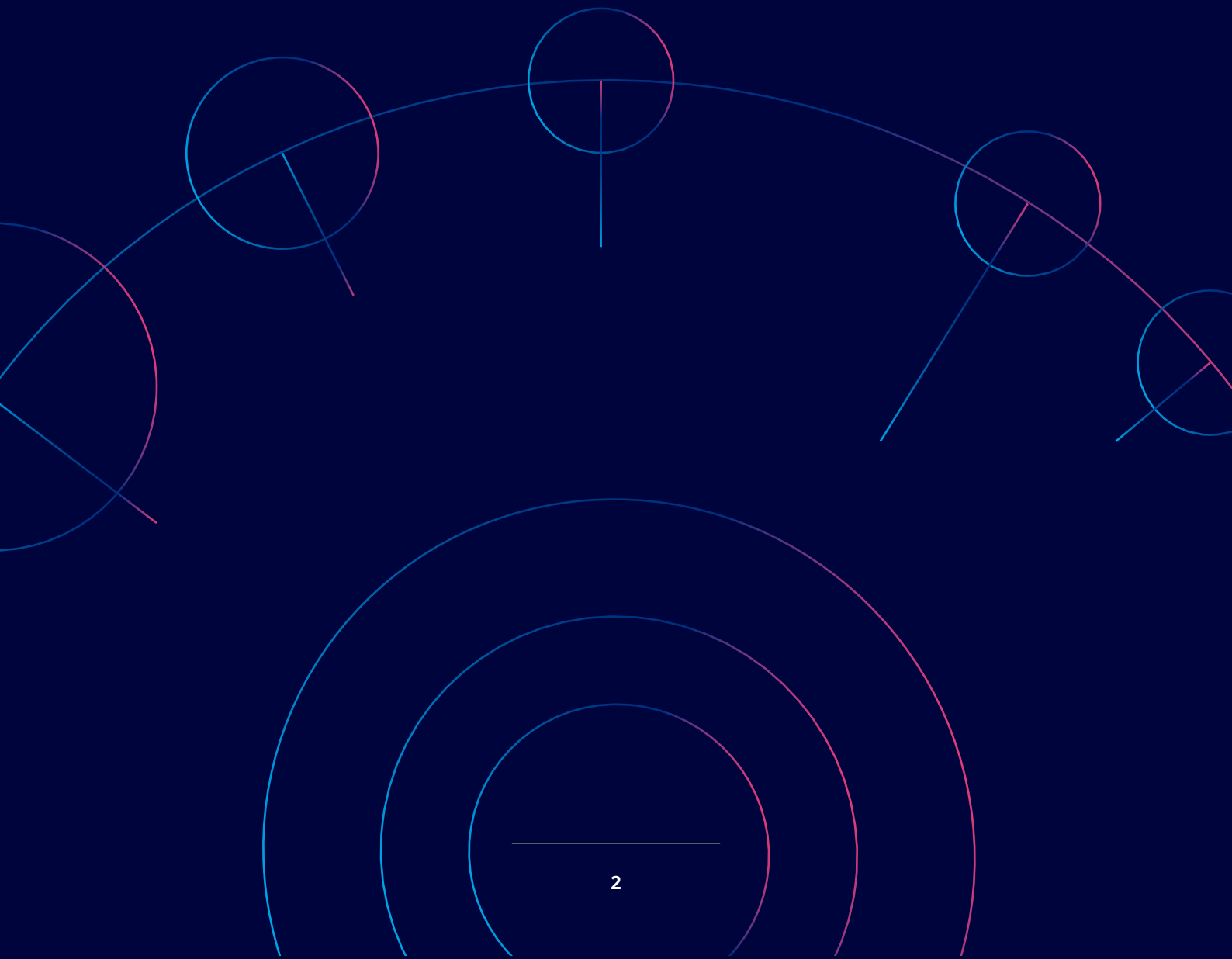


Our Voice of Asia series brings to life the challenges and opportunities facing the region today and tomorrow. Voice of Asia is the result of significant collaboration across the Deloitte Asia Pacific and Global Network.

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Five themes that will drive Asian growth in 2020



Section 1: Introduction and Summary

As we look forward to 2020, there is much pessimism in the air. This is understandable in view of the many downside risks that exist. However, while acknowledging what can go wrong, our view is that there are some strong drivers of growth that could mitigate these risks and hence produce a reasonably upbeat outcome for Asian economies next year:

1. First, some of the factors that depressed the demand for the region's exports in 2019 are on course to be reversed, at least by enough to allow a modest rebound in 2020;
2. Second, despite the heated rhetoric, as we have been consistently arguing, an interim trade deal between the US and China¹ has eventually materialized: this will help alleviate business confidence and thereby boost economic activity.
3. Third, Asian policymakers are putting in place pro-growth policies that will generate domestic sources of growth such as stepped-up infrastructure spending and more efforts to improve the business ecosystem. They have also wrapped up trade agreements which will give them more protection against aggressive trade practices of the US and other countries.

4. Fourth, production relocation out of China to Southeast Asia will pick up, adding a powerful engine of growth to the region. Such relocation has also eased the concern over RMB exchange rate adjustment.
5. Fifth, the Asian consuming classes will continue to expand, adding more demand and business opportunities.

However, we are cognisant of the downside risks. The cyclical uptick we see in 2020 hinges on these risks being contained:

1. First, would Chinese policymakers over-react with excessive stimulus which could set off yet another boom-bust cycle?
2. Second, in the US, the November 2020 presidential elections could result in erratic policies that could prove destabilising.
3. Third, global financial risks remain salient: Institutions such as the BIS have been warning of the potential downsides from quantitative easing, as corporate and other debt grows rapidly.

1. In this report, China refers to Mainland China if not otherwise specified



First, the demand for Asian exports could see a modest revival.

There are several reasons why the global economy could do better than expected:

Policy support in the large developed economies is expanding. Global monetary conditions have eased, with the Federal Reserve Bank of the US and the European Central Bank cutting rates and providing greater liquidity support. Japan is implementing an economic measures package worth JPY26 trillion, of which JPY13.2 trillion will be covered by the central and local governments while the remainder by the private sector.

Even more positive for Asia is the increasing evidence of a Chinese economic rebound, as shown in purchasing manager surveys of both the manufacturing and non-manufacturing sectors. This rebound appears sustainable, further propelled by policy measures which appear to be working:

- The flow of credit to the private sector has improved. For the banking sector as a whole, outstanding loans to small businesses rose 16.85% in Jan-Aug 19, 8.15 percentage points higher than the growth rate for all bank loans. As the most credit-constrained parts of the economy receive funding, they will step up activity and raise demand.

- The National Development and Reform Commission (NDRC) has stepped up the pace of approving projects with 21 projects worth around CNY764.3 billion given the green light in the January-October period. These include large-scale transportation projects such as a new high-speed railway network linking Chongqing and Kunming in southwest China, worth a total of CNY141.6 billion.

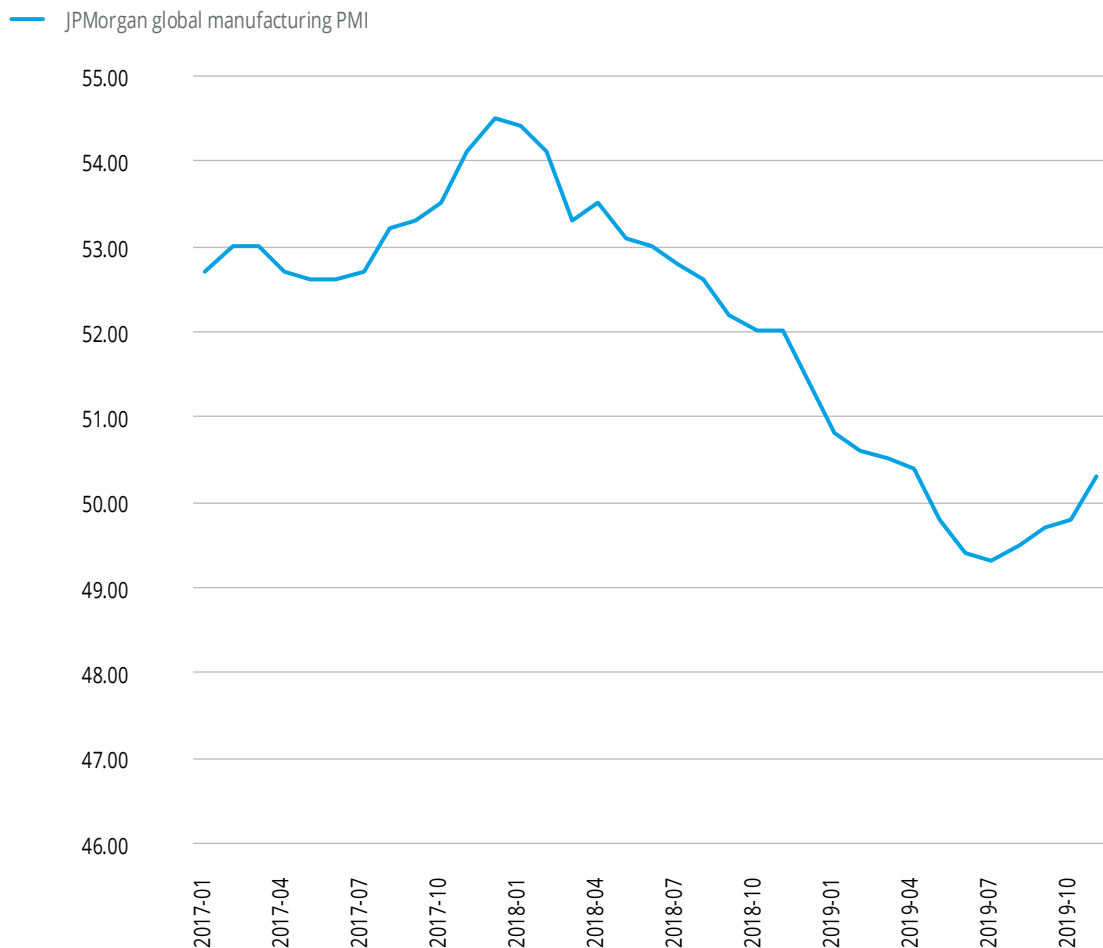
Moreover, one-off factors in the automobile and aviation sectors which contributed to the global slowdown show signs of reversing. The decline in the auto sector (which the International Monetary Fund estimates is worth 5.7% of global output) started in 2018 for a variety of reasons including the imposition of new emission standards in Europe, China and India. Some of the hit to production is likely to be reversed in 2020 – for example, in Europe, production declines were worsened by bottlenecks in meeting new emissions certifications that delayed the launch of new models. More importantly, despite falling sales of passenger vehicles in 2018 and 2019,

the trend of consumption upgrade (sales volume of luxury cars have been rising in terms of both total number and percentage of passage vehicles). The aviation sector has been hit hard by Boeing’s problems with its 737 Max airplane – problems which should be resolved by mid-2020.

And, finally, there are also signs of an uptick in the electronics cycle which is a major factor driving exports in Asia. Semiconductor billings are growing again after more than a year of decline while the inventory drawdown appears to have run its course.

FIGURE 1

A rebound in the global business activity



Source: Wind

Second, an interim US-China trade deal will help improve business confidence.

An interim – or “phase one” – trade deal was being reached on December 13. These talks have been difficult but we believe that there is a strong incentive for both sides to cut a deal which will take care of the less contentious points of dispute between the two big powers. Both sides need a deal that would stabilize business confidence and maintain growth. While such a deal will not resolve all the differences between the two, a deal will shift the focus of contention from trade which has direct and material economic impact on growth to other areas such as technology, investments and visas where the economic damage is more indirect and could be mitigated by loopholes and corporate lobbying to limit the downside.



Third, pro-growth policies in Asia will help boost domestic growth engines.

Since the middle of 2019, a clear commitment by the systemically important central banks to ease monetary policies has given more room for Southeast Asian central banks to ease monetary policy. The Federal Reserve Bank of the United States has been cutting policy rates and has indicated that it might continue cutting rates if there were any warning signs of a slowdown. The European Central Bank has also cut rates and committed to continued quantitative easing.

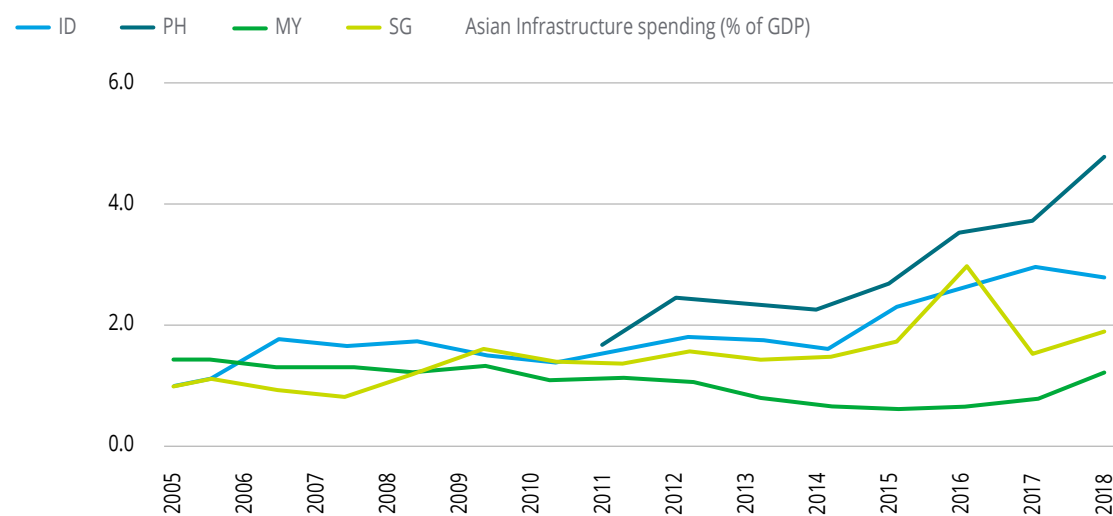
As a result, Southeast Asian central banks have cut their policy rates and eased monetary conditions through other means such as reductions in reserve requirements. Virtually every central bank has been cutting rates and some quite aggressively. For example, Bank Indonesia has been aggressive in cutting policy rates (down by 100 basis points so far) while the Philippines

central bank has reduced its policy rate by 75 basis points and reduced reserve requirements by 200 basis points. So long as inflation remains low and current account deficits well-behaved, the region’s central banks will retain the policy space to continue easing policy if they wish.

The governments of the region have also indicated that they will use fiscal policy more vigorously in 2020. In particular, infrastructure spending is likely to pick up momentum after lackluster spending in 2019 in Indonesia, Thailand and the Philippines. Governments across Southeast Asia are placing more emphasis on infrastructure as a driver of growth and this was seen in rising public spending on infrastructure as a share of GDP (Charts 1 & 2). In Indonesia, the Philippines, Malaysia and Singapore, spending on public works projects as a share of GDP is on an uptrend.

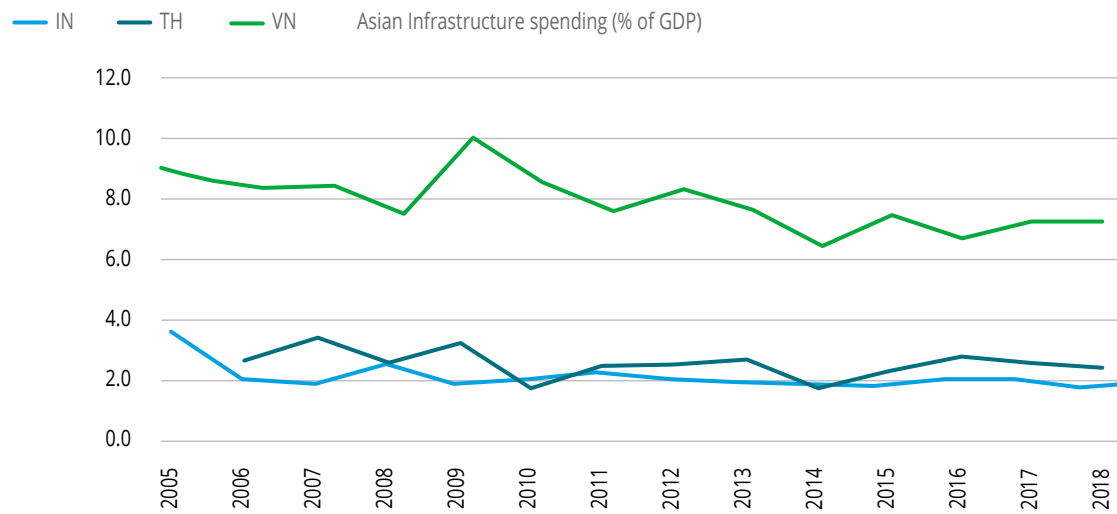
FIGURE 2

Improvements in key countries



Source: Calculated by Centennial Asia Advisors using CEIC
 Note: Data is based on allocations to infrastructure, and if that is not possible, then capital expenditures and/or the allocations toward the relevant transport ministries are taken as a proxy for infra expenditure.

FIGURE 3

...but others while lagging will pick up in 2020

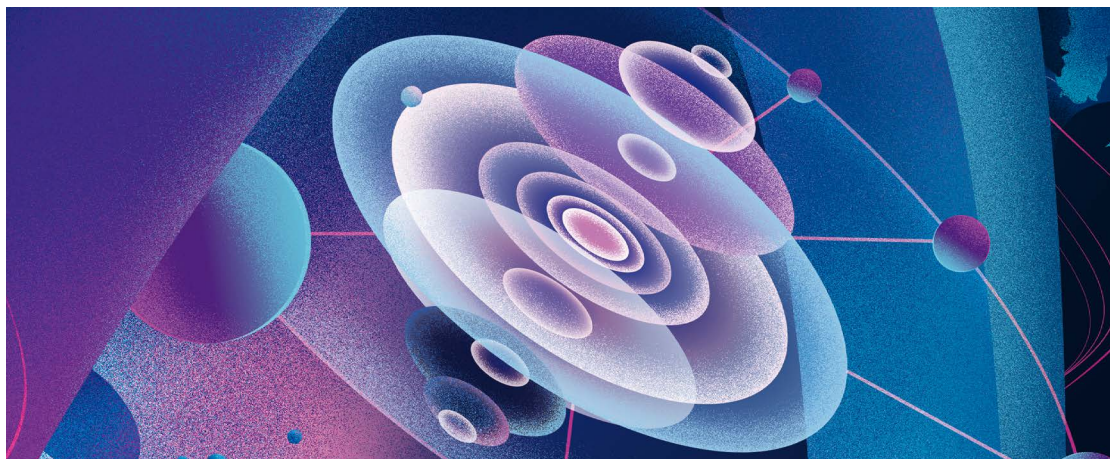
Source: Calculated by Centennial Asia Advisors using CEIC

Note: Data is based on allocations to infrastructure, and if that is not possible, then capital expenditures and/or the allocations toward the relevant transport ministries are taken as a proxy for infra expenditure.

One increasingly important thrust of Asian policy is the greater effort being made to sustain trade integration in order to build buffers against growing protectionism:

First, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) which came into force at the end of December 2018 is now being implemented. The 11 members, of whom four are ASEAN members – Brunei, Malaysia, Singapore and Vietnam – will enjoy the enhanced market access that the CPTPP provides.

Second, an agreement was reached to establish the Regional Comprehensive Economic Partnership (RCEP). RCEP is important because it harmonizes existing trade pacts in Asia. Tariffs will be cut across many areas and companies will be able to export the same product anywhere within the bloc without having to meet separate requirements and fill out separate paperwork for each country. The agreement also makes a start in liberalizing services though its provisions here are limited in scope.



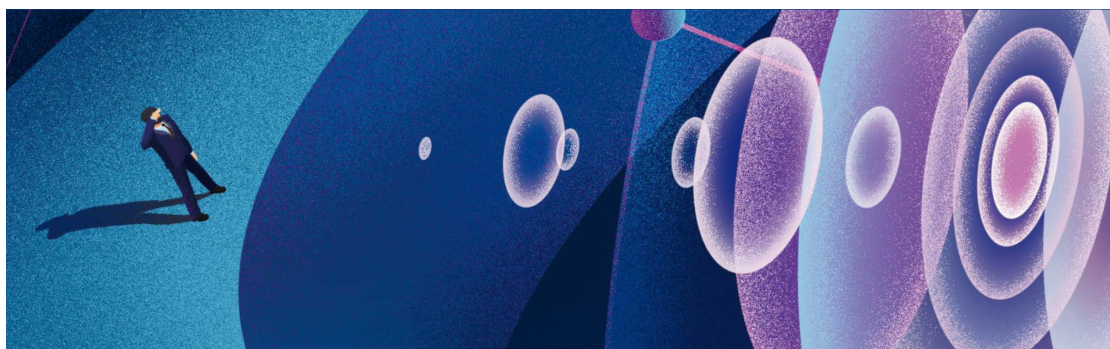
Fourth, production relocation will become a stronger driver of growth – benefiting Southeast Asia and Taiwan.

As costs in China rose and China itself moved up the value curve, a growing number of companies are moving their manufacturing out of China to lower-cost production clusters. As this factor will be an increasingly important feature of Asian economic development, we need to put it in the right context:

- First, as US-China trade relations worsen, this process is gaining traction. Indeed, both foreign investors as well as Chinese manufacturers are finding it expedient to move certain types of production elsewhere. The initial response of companies, to divert orders away from production facilities in China to factories elsewhere or “trade diversion” has now given way to relocation of production, an actual reconfiguration of supply chains. This is seen in foreign investment approvals around the region, with Vietnam and Malaysia benefitting the most. We believe more firms will decide to move in 2020 – while an interim trade deal may improve the US-China trade relationship, the deeper strategic contestation between the two

powers will not improve and may even worsen, convincing more firms that it would be prudent to make the move.

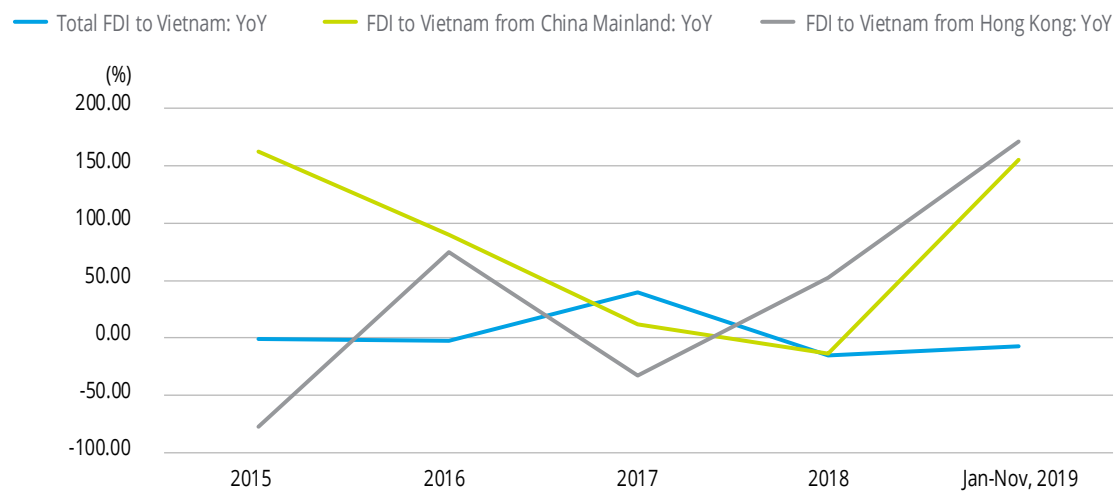
- Second, however, this relocation is a complex process. For one, China is not necessarily a big loser from this process: a recent survey by the American Chamber of Commerce in China found that few of its members who produce in China for the local market – the majority of its respondents to the survey – intend to move. However, among those who produce in China for export to the United States or other countries are now considering a move. Our view is also that where firms producing in China depend on inputs of American technology or software, they may find it necessary to shift production to another country with a better relationship with the United States. This is probably why a survey conducted by Nikkei showed that about 23.9 percent of Japanese companies with operations in China were considering a reduction in their production footprint in China.



- Moreover, relocation need not necessarily be to a low-cost production base. There is ample evidence of production being relocated back to the home countries of foreign investors. Taiwan has been a major beneficiary of such “re-shoring”. In other cases, production has also been moved back to Japan and South Korea.
- But where continued offshoring – locating production in a low-cost production base – is the chosen strategy, it is clear that Southeast Asian economies are the major beneficiaries, with Mexico gaining to some extent as well.

FIGURE 4

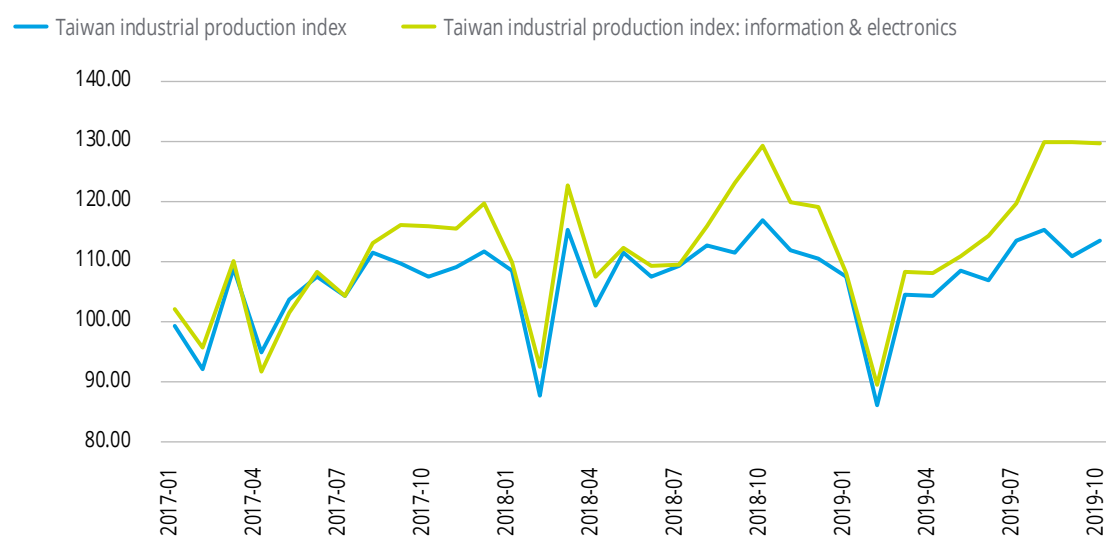
Surging FDI from Mainland China / Hong Kong SAR, China² to Vietnam



Source: Wind

FIGURE 5

Taiwan's economy reaps benefits from re-shoring



Source: Wind

2. Hong Kong will be used to indicate Hong Kong SAR, China in the following pages

Fifth, the Asian consuming classes will continue to expand, adding more demand and business opportunities.

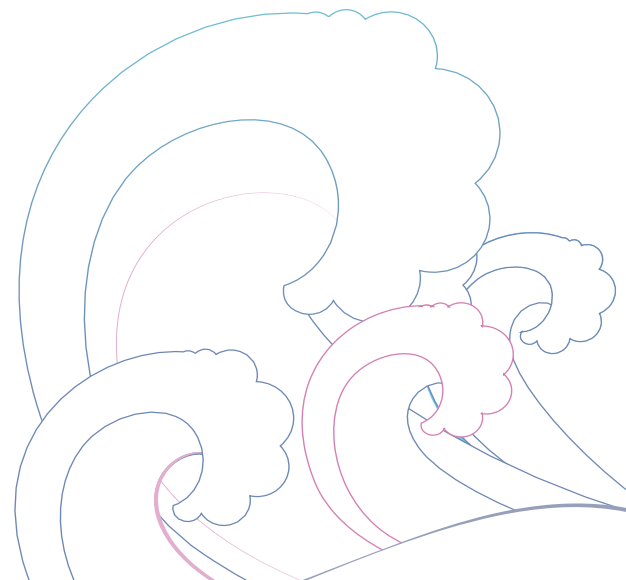
Strong labor markets, accommodative government policies and a probable increase in commodity prices will support private consumption. The outlook for consumption in Asia, going forward, remains positive.

Stability in the labor market as well as remittance inflows from overseas workers are increasing household incomes across the region. For example, crude palm oil prices have bounced back after a year of contraction, helping raise incomes of smallholders in Indonesia, Malaysia and southern Thailand.

Moreover, the sustained easing of monetary conditions through rate cuts will also help lift consumer spending.

It's also worth noting that China's consumer story remains intact, despite the concern expressed by a recent PBOC report on China's consumer leverage ratio (60.4% by the end of 2018) reaching the level similar to that of some developed countries. Besides a relatively high consumer debt in relation to income, the report also points to the debt structure: total outstanding mortgages, which

amounted to RMB25.8 trillion by the end of 2018, account for 53.9% of China's total consumer debt. The report argues that such a high level of debt is bound to constrain consumers' ability to take on fresh consumption commitments. And if housing prices start to decline, banks could well see rising non-performing loans in certain cities. However, it can be argued that it is misleading to use the debt leverage ratios of developed countries to gauge paying capacity in the Chinese market. First, growth in the developed countries is now sluggish, which is not the case in China. Second, China's chief strength lies in its strong family ties, which allow seamless wealth transfers across generations. The willingness of thrift parents to finance their children's debt should mitigate some of the concern over China's relatively high consumer leverage. In a word, the rise of Asian new consumer class, led by China and India, continue to spell huge opportunities for companies and carry the growth load for the region.



Our baseline is an upbeat one, but what are the risks?

Chinese excessive stimulus

Some observers have raised a concern that Chinese policy makers may over-reach in terms of the scale of policy stimulus, particularly the use of credit to stoke growth. Others have pointed to past excesses where infrastructure was built with no possibility of being heavily utilized for years. This is a valid concern given some excesses in the past. However, the pattern of policy responses in this cycle provide grounds for believing that the Chinese policy response this time will be more nuanced and calibrated. Policy statements regularly warn against “deluge” measures of the sort enacted in 2008 and emphasise the need to bear the risks of financial and other imbalances in mind when configuring policy responses.

Geo-political turbulence

Our bright outlook for Asia hinges on geo-political tensions being contained. The greatest threat to our baseline scenario is a breakdown in the US-China trade talks which could precipitate an escalating series of tit-for-tat trade restrictions. This would undermine business confidence around the world and in Asia, causing economic growth to slow. In addition, Middle East tension could also crystallize into broader violence which could cause oil prices to spike.

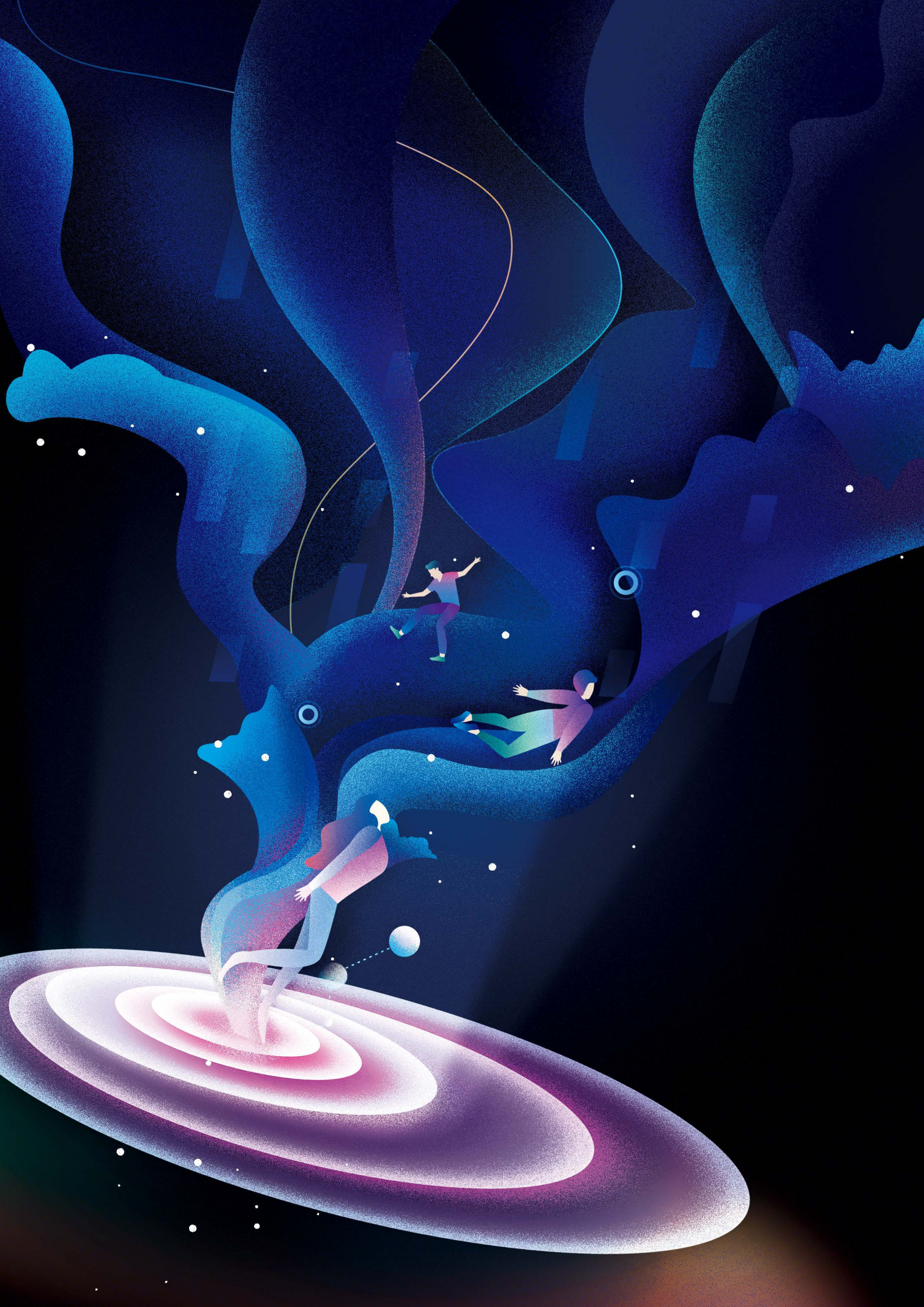
The global trade regime is already in parlous condition. The World Trade Organization’s dispute settlement mechanism has broken down, a result of American vetoes of new appointments to the appellate tribunal which has consequently ceased to function as of 10th December 2019. Asian countries which are exposed to trade will be big losers from this breakdown. Particularly in this context, a downward spiral into wider protectionism would be devastating for Asia.

Financial stresses

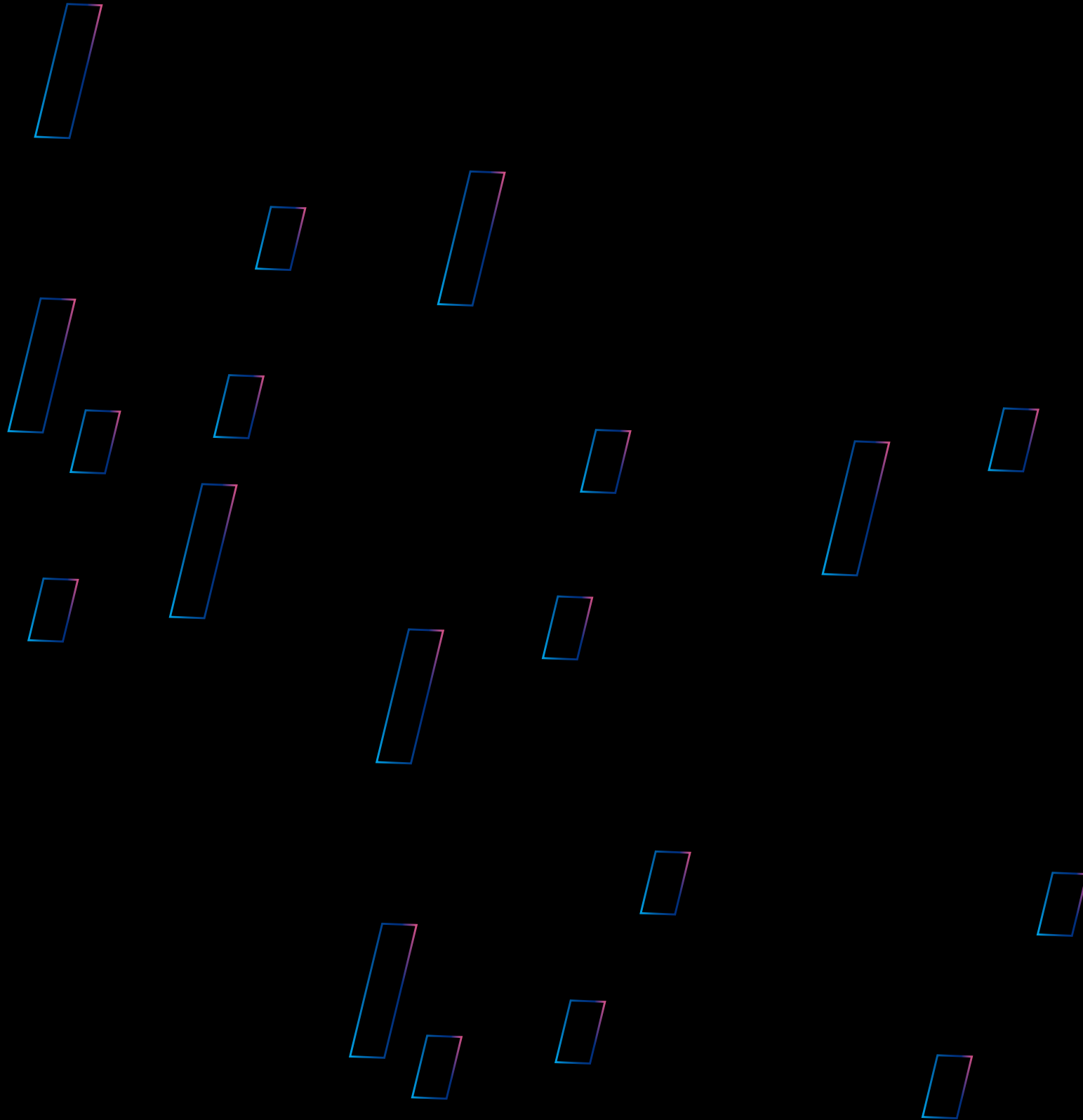
The ructions in the American repo market in the second half of 2019 reminded us of the poorly understood financial risks that are accumulating after more than 10 years of aggressive monetary easing. The Bank for International Settlements (BIS) has pointed out the role of excessively leveraged hedge funds in compounding the turbulence in the repo market. The BIS and other authorities have pointed to other risks in the financial sector such as the growth of the leveraged loan market, which has reached USD3 trillion in size.

They have also warned how credit standards have been deteriorating, as investors desperately searching for yield have supported the emergence of potentially risky financial products such as collateralised loan obligations (CLOs).





Section 2: Regional Economic Outlook



Australia: Marching to a different drum

Growth in the Australian economy has eased to decade lows. But this is a different sort of slowdown to that affecting the wider world economy.

That is because Australia's slowdown hasn't been driven by the global downturn. Weakness in the world economy usually shows up as lower prices for the key commodities that Australia sells to the world – the likes of iron ore, coal and gold. However, Australian export prices didn't fall in 2019 as the world slowed. In fact they went up:

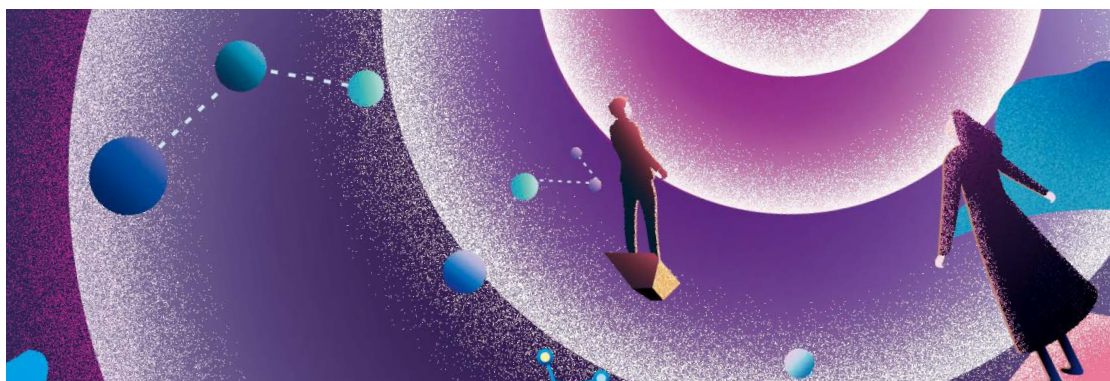
- Partly that is because China's response to its own slowdown has included policies that support construction activity.
- Partly it is because the tragic collapse of a mining dam wall and the associated loss of life cut Brazilian iron ore production.
- And partly it is because the rise in global uncertainty has boosted the gold price.

The result is that Australia is running a current account surplus for the first time in more than four decades.

Rather, Australia's slowdown is home-grown. Some of the slowdown is due to a drought that began over a year ago and has continued to get worse. But the largest driver of slowdown is linked to a fall in housing prices. Overheated housing markets saw notable price falls, especially from late 2018 to mid-2019. Those price falls spooked consumers into conservatism, and they have also led to a downturn in high-rise construction.

The good news is that the drought will eventually break, and that house prices are already rebounding sharply. Both those developments imply that there'll be better news ahead at some stage. However, the impact of the recovery in those two may show up in 2021 rather than in 2020. And although there have been both tax cuts and interest rate cuts in recent months, consumer and business confidence has moderated.

All up, that suggests Australia's 2020 will see more of the same – economic growth may pick up a little, but not by enough to make much of a dent in unemployment or to provide much additional momentum in wage gains.



China: Regaining its balance

China's prospects are affected by two factors – (a) a calibrated policy stimulus to address the cyclical deceleration of the economy; and (b) a secular deceleration in growth potential due to demographic headwinds. Our view essentially is that the cyclical deceleration is being turned around successfully but that the secular slowing of the Chinese economy will continue.

The cycle is turning: In the course of 2019, economic activity slowed. The deleveraging campaign in 2017 succeeded in purging risks from the financial system but led unintentionally tightened financial conditions for the private sector as the shadow banking channels which private enterprises depended on for credit were shuttered. The subsequent weakening in private sector investment which accounts for some 60% of total fixed asset investment precipitated the downturn which began in 3Q18.

More recently, purchasing manager surveys show confidence returning, with both the beleaguered manufacturing sector as well as services activity strengthening. The nascent recovery is built on two key developments: more credit flows to the beleaguered private sector, and a revival in infrastructure investment, as discussed above in the regional overview. In particular, infrastructure investment (accounting for over one-fifth of total fixed asset investment) is poised to rebound in 2020 as the authorities have brought forward the 2020 quota for special purpose bond issuance by local governments.

However, the secular deceleration in growth will persist: As its population ages and the labor force contracts, China's potential growth

rate is slowing. The challenges on the trade front as well as the need to adjust to the challenges in technology acquisition following restrictions placed by the United States will also contribute to a slowing. The net effect of these forces will be that the GDP growth rate for China will slow a tad to 5.8% in 2020 from 6% in 2019.

An improved growth outlook in 2020 will serve as an emollient for the cracks that are straining in the financial system, exemplified by the Baoshang incident which led to elevated borrowing costs in the interbank market for other distressed lenders. Amid slowing growth, corporate and bond default rates have risen, putting pressure on the most vulnerable parts of the banking sector – the small banks found mostly in the rural provinces that rely on more volatile funding and feature weaker balance sheets due to higher non-performing loans, tighter liquidity, thinner capital buffers, and poorer profitability.

As the government presses ahead with its objective of putting an end to systemic moral hazard in the form of implicit guarantees, we expect this pattern of episodic stresses to persist heading into 2020. However, our view is that the policymakers will be able to keep on top of things, preventing a major financial shock to the real economy.

The improved growth outlook suggests that monetary policy will be more restrained as the policymakers continue to prioritize risk control over stoking growth which they understand will come at the cost of further fuelling macro-economic imbalances.

Hong Kong: Battered but confidence on the peg remains strong

Hong Kong has been hit hard by the extended period of protests. As a result, tourism and other business activities have fallen sharply while retail sales have plummeted. All of these look set to continue as there does not seem to be an end in sight to the unrest. In addition, the US-China trade war has also corroded the trade sector, given that both economies are its top two trading partners. Hong Kong's exports of trade-related services, particularly in intermediate exports to China, and services exports to the duo have been under pressure, with ramifications for job creation and household incomes.

Going forward, the prolonged spate of protests threatens to cast a pall over Hong Kong's near-term economic outlook. Certainly, Hong Kong retains substantial advantages as a global financial and business hub as was seen in the recent massive listing of Alibaba. Hong Kong remains the pre-eminent place for international businesses to locate headquarters operations for the greater China region. Its eco-system of pools of liquidity, skilled professionals, competent regulators, facilitative policies and stable currency cannot easily be replicated. However, if the protests continue, it is possible that more and more activity and talent will peel away from the Hong Kong cluster in favor of competing global hubs in Asia such as Singapore.

Consequently, a vigorous government response will be needed. The Hong Kong government has pledged stimulus measures, starting with relief measures amounting to HKD25bn consisting of utility subsidies, waivers for property taxes for businesses, fuel subsidies among other things.

The authorities have also signalled that it will run a budget deficit for the next two years to provide a lift to the battered economy.

There are two other factors that could help mitigate the downside: First, with global interest rates likely to stay low, loose liquidity conditions are a boon for the economy, given that mortgages that are linked to the Hong Kong Interbank Offered Rate (HIBOR) account for a little more than half of new mortgages. Lower HIBOR rates, in turn, translate into lower mortgage servicing cost and higher consumption for households. Despite anecdotal evidences of capital outflows (to Singapore especially), HIBOR have not deviated from USD interest rates, suggesting that the confidence on the HKD peg remains solid.

Second, businesses will be keen to leverage off synergies through Hong Kong's integration with mainland China via the Pearl River Delta and the development of the Greater Bay Area. This growing urban agglomeration will provide Hong Kong with economies of scale and scope that none of its competitors outside China could achieve.

Overall, economic growth will remain under a cloud, in light of the instability, while the unemployment rate is poised to rise slightly as the cost of the disruptions stacks up. Inflationary pressures should ease in tandem with the labor market as economic activity softens.

The decline in services exports is likely to weigh on the current account surplus, even though part of it will be offset by dampened investments under the current economic and political climate.

India: Policies to tackle downturn in place

The Indian economy is going through a sustained slowdown as the economic activity has been losing momentum for over five quarters now. The question is whether the current economic headwinds have bottomed out or are here to stay for longer. Domestic demand has taken a breather as several factors — such as stagnating rural wages, tightening lending conditions (because of the ailing health of the financial institutions), and rising unemployment — are contributing to low demand for goods and services. Additionally, structural factors, such as changing consumer preferences among the rising number of millennials and technology innovations are transforming demand patterns and contributing to the sluggishness.

Low demand has impacted sectoral growth, resulting in a downward spiral of weakening corporate profits and exacerbating concerns over highly-leveraged corporate balance sheets, waning business sentiments, and declining investments. Leading economic indicators, such as credit growth and new orders, point to gradual growth in the current quarter as well.

As global downside risks weigh on the domestic outlook, there is a limited scope of exports contributing to growth as its share in GDP has fallen by 6 percentage points since 2013. There are concerns that India may be lacking celerity in prudent trade policies, which is needed for tapping into global opportunities and improving competitiveness and productivity. India's

decision to stay out of RCEP because of its concern regarding the impact of imports from China and other APAC regions on Indian medium and small-scale manufacturing enterprises (MSMEs) and farmers questions India's ability to compete with global players. However, past trade agreements have had a limited impact on export competitiveness and worsened trade balance. Overcoming structural bottlenecks such as inadequate domestic infrastructure, a lack of awareness among industries and exporters, especially those in the MSMEs, and a paucity of appropriate technology and standardization of products will likely help India benefit from free trade agreements.³

While RCEP negotiations are still on the table as India wants a few concerns to be addressed, the government recognizes the importance of enacting policies to address the structural issues. To jumpstart the economy, both the government and the central bank have stepped up policy support. These include liberalization of FDI norms for selected sectors; a rollback of the much-debated tax surcharge on foreign portfolio investors; incentives to support several industries; bank consolidation, the amendment of insolvency and bankruptcy code enabling the resolution of financial companies, and the blockbuster cut in the corporate tax rate. At the same time, the Reserve Bank of India (RBI) slashed policy interest rates by 110 bps over five monetary policy committee meetings in 2019 to provide the much-needed boost to growth.

3. Rumki Majumdar, "Go beyond borders to grow beyond borders", Global Economic Outlook, Q1 2016, Deloitte Insights.

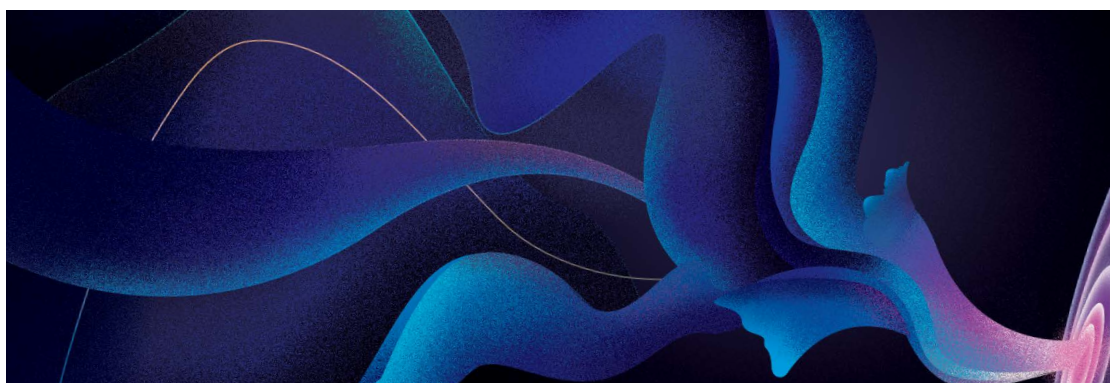
Nonetheless, uncertainty lingers as there are reservations about whether these are enough to prevent the economy from freezing. A few economic fundamentals are weighing on the economic outlook as well. The rising fiscal deficit has raised concerns over fiscal slippage in 2019, which may result in the crowding-out of private investments, hampering the transmission of monetary policy. So far, aggressive rate cuts by the RBI has failed to work its way through the economy by way of lowering lending rates as banks' willingness to lend remains low. On the other hand, rising food prices have kept inflation above the RBI's target rate of 4 percent for three consecutive months. Consequently, the RBI decided not to cut rates further in the latest MPC meeting and has raised the outlook for inflation for the second half of the financial year.

That said, several economic fundamentals in this current slowdown are better than previous slowdown cycles since liberalization. Core

inflation (inflation excluding food and oil prices) is low and is expected to remain so because of excess capacity in the economy and the economic slowdown. Current account deficit will be likely to be contained due to well behaved oil prices. Fiscal deficit is among the lowest of all slowdown cycles, which allows the government to undertake counter-cyclical policy measures.

The government has initiated actions by accelerating INR 100 lakh crore infrastructure investment under its 5-year plan and by announcing investments in 10 projects by mid December. The government is also planning to work towards rationalizing the GST rates on all essential goods.

As the government continues to take structural and counter-cyclical policy actions, the economy and the market have to remain patient as the policy changes, which are structural in nature, will impact real activity with some lag.



Indonesia: Much hinges on pro-growth reforms

Indonesia is slated to continue its pace of steady but unexciting growth, in spite of an unforgiving and increasingly risky external environment. Indonesia has been shielded from the trade war to some extent by its relatively lower exposure to trade than its neighbors. It has much going for it to sustain growth in the region of 5% for 2020. The labor force is youthful and still growing, urbanization is proceeding apace, the central banks' cuts in policy rates have eased monetary conditions and the government is likely to step up the pace of infrastructure spending. Indeed, there is ample policy space for more interest rate cuts by Bank Indonesia to further support demand.

Commodity prices have held steady, as the global economic cycle turns up. The looming implementation of the 30% biodiesel mandate (B30) from Jan 2020 has fed into expectations of heightened demand for palm oil allowing crude palm oil prices to recover, which bodes well for the 17.6 million smallholders involved. Another upshot of the B30 mandate is that it reins in the need for foreign crude oil imports, leading to import compression and improving the current account deficit.

The Indonesian economy's resilience in the face of a difficult global economy will also be supported by improvements in economic stability. Bank Indonesia has succeeded in bringing inflation down sharply over the past decade, allowing Indonesian inflation to converge closer to the average inflation rate of its trading partners. That

supports the currency as does the improvement of the current account deficit which has moved below 3% of GDP. A conservative approach to fiscal deficits and public debt has also strengthened Indonesia's fiscal position.

But Indonesia's stability and steady growth conceal wide-ranging structural impediments that have limited Indonesia's integration into global value chains. As a result, the economy has largely failed to leverage on the diversion of production out of China. Thus, the key question for Indonesia is whether reforms will be put in place to improve Indonesia's competitiveness. There are some positive signs.

First, infrastructure development, which has been a success story during President Joko Widodo's first term will continue, probably at a faster pace in his second term.

Second, the government has moved aggressively on bureaucratic reforms, an area that is within its own remit, as it announced plans to halve the number of echelons from 4 to 2 to streamline the bureaucracy. Corporate tax cuts are also on the agenda.

Third, further reforms to the labor market and the tax code will be submitted to the legislature, as the authorities are keen to correct the weaknesses in the labor code which have deterred firms from expanding. Labor market reforms could be a game changer for Indonesia.

Japan: Policy supports modest growth

The Japanese economy has held up despite it has suffered several shocks in 2019. Exports contracted on the back of the slowdown in the global economy, which itself was compounded by the trade war between the United States and China and slowdown of domestic demands in China. Business confidence suffered as a result, causing firms to cut back their production. While private consumption spending held up reasonably well at the “last minutes demand” in September before the consumption tax hike in October. The increase in the consumption tax which took effect in October could cause this segment of the economy to slow in early 2020. In addition, the Japanese economy suffered a series of natural disasters as well which also depressed economic activity in the second half of the year. The coincident economic indicator suggests that Japan economy might be in its phase of contraction. The leading economic indicator also suggests that further contraction of the economy.

Nevertheless, considering the effects of multiple shocks on the economy, GDP growth appears to have been fairly resilient, slightly accelerating to a likely 0.6% in 2019. In the first three quarters of the year, the economy was supported by domestic demand. Growth in wages and jobs, and modest growth in capital spending by firms was sufficient to offset the drag on growth and damage to industrial production caused by falling exports. Deloitte believes that Japan's economic growth is likely to hover around 0.5% for the next two years, which is still below its potential but modest rate of expansion of the economy as a result of several factors.

First, the Japanese government plans a stimulus package worth JPY26 trillion. This is meant to counter the effects of the consumption tax as well

as the anticipated slowdown of the economy once the Olympics (late July to early August) is over. Part of the package is meant to support disaster prevention efforts. There is likely to be more spending outside this package on reconstruction following the natural disasters in 2019.

Second, the interim trade deal between the United States and China as well as the recovery in global demand that we discussed in the overview should help support exports.

Third, the Olympic Games will help boost tourism which has emerged as a substantial engine of growth. Note that tourist arrivals have soared in Japan – rising from just 6.2 million in 2011 to 31 million in 2018.

The key risk to the economy centers around low consumer confidence and the resulting impact on consumer spending. The consumer confidence in Japan is at its lower end and this could suggest the slower recovery from the dip in private consumption after the tax hike. A second risk is the business sector: so far the labor market has remained tight, underpinning job security and modest wage growth. However, business investment could remain weak, resulting from the worsening of China and global economy, and there could be knock-on effects on hiring and this could dampen consumer spending. The third risk is the financial markets: the global stock and financial asset prices seem overvalued these days. Potential corrections of global elevated asset prices could cause undesirable appreciation of JPY, which in turn weighing on exports.

Malaysia: Still a lot going for the remarkably resilient economy

Despite its trade-driven nature, Malaysia held up well in spite of formidable headwinds in the external environment. Several factors continue to undergird Malaysia's economic resilience in the near-term.

Robust domestic demand, led by buoyant household spending, has underpinned this performance. A tight labor market has translated into upward pressure on wages which fuels private consumption. Malaysia's unique export diversification, and the ongoing export diversion prompted by rising trade tensions between the US and China, has provided a fillip to exports. Consequently, Malaysian exports have outperformed the region amid a slowing global and the Chinese economy. Barring a sudden escalation in trade tensions, Malaysian exports should continue to hold its ground.

Malaysia has been a winner from the production relocation out of China. Investment approvals have surged and as these translate into actual investments, economic activity will perk up. Malaysia's competitiveness has been supported by a competitive Ringgit and the clusters of manufacturing activity that have been built up over the years.

Another growth driver will be the resumption of projects which were initially suspended when the new government took power in 2018. Projects such as the East Coast Rail Link, the LRT-3 project, the MRT-2 project, TRX and Bandar Malaysia will provide a significant cumulative boost to economic activity.

Commodity prices should resume its upward march though further upsides will be limited by the prevailing global economic conditions. The institution of the B20 and B30 biodiesel mandate in Malaysia and Indonesia in January 2020 coupled with dry weather has fuelled a rally in CPO prices and has delivered higher palm oil prices to an estimated 650,000 smallholders, boosting their incomes and spending power.

Given the quiescent inflationary pressures, there is room for Bank Negara Malaysia (BNM) to ease monetary conditions further. Challenges to economic stability appear contained. For example, household debt is elevated but the financial risk posed by this debt is largely limited by burgeoning household assets, and improved debt-servicing ability among poorer households. Given strong savings in the economy, the current account surplus is likely to continue, providing the economy with further ballast.

New Zealand: Steady as she goes

Economic growth in New Zealand (NZ) has slowed over the first half of 2019 due to reduced business investment and household spending. GDP growth was 2.1% in the June 2019 quarter – below the 2.8% post-2000 average. Business confidence has fallen to the lowest level seen since 2009 and suggests that growth is likely to remain subdued over the remainder of 2019 and into the start of 2020. Global uncertainty is playing a major part in this cautious business stance, particularly for the manufacturing sector.

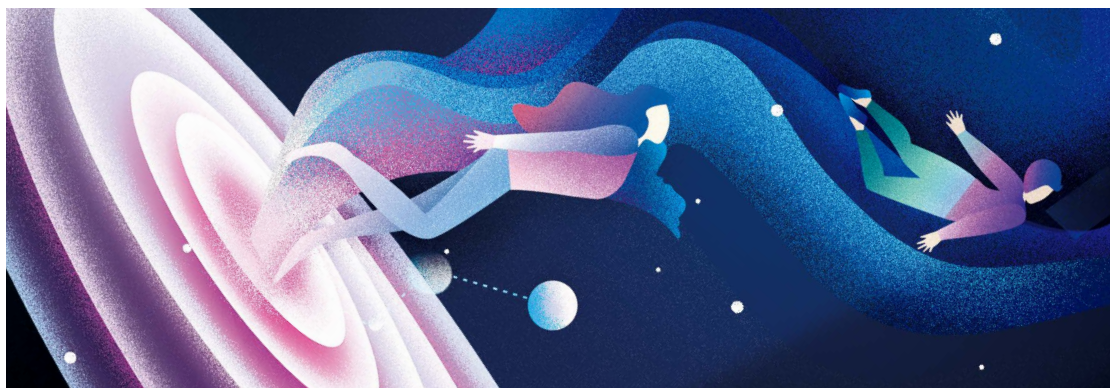
In response to weaker domestic growth, the Reserve Bank of New Zealand (RBNZ) surprised markets in August by slashing the Official Cash Rate (OCR) by 50bps to 1.00%. This type of dramatic move has historically been reserved for crisis or disaster scenarios, but new RBNZ Governor Adrian Orr has come out punching with a highly proactive stance. This aggressive cut up front has seen the RBNZ leave interest rates on hold at this new record low for the past few months. However, the risks remain skewed to the downside with the RBNZ flagging about a 40% chance of a further OCR cut in the near-to-medium term.

Headline inflation in NZ dropped to 1.5% yoy in September 2019 – below the RBNZ's 2% target.

Since the start of the year, the RBNZ has had a dual mandate focussing on both inflation and full employment – similar to the US Federal Reserve. On the positive side, the unemployment rate in NZ remains near historic lows at 4.2%.

Over the next couple of years, economic growth is expected to pick up toward trend levels (circa 2.5% yoy). There remain several supportive factors for the domestic economy – the job market is tight, population growth has moderated but is still strong, and exporters have achieved good prices and volumes. In addition, the housing market has experienced a small renaissance in recent months, supporting consumer confidence. The outlook for NZ's major trading partners has softened, but a lower NZ dollar is helping to offset some of the negative impact from weaker global demand on our export sector. A lower exchange rate is expected to continue to provide support for the export sector over the next couple of years. At the same time, commodity prices have held up at solid levels due to supply shortages.

Overall, we expect to see the economy pick up after a tough start to the year. But NZ remains vulnerable to global headwinds and interest rates are expected to remain at historic lows for an extended period.



The Philippines: Primed for a rebound

The Philippine economy bottomed out in the middle of 2019, as the impact of the earlier budgetary impasse and the pre-election ban on infrastructure expenditures dissipated. As an economy centered on domestic demand, the downside risk to growth stemming from a fractious trade environment has been limited.

Going forward, the economy will be helped by a number of factors.

A turnaround in the electronics cycle, alongside a pick-up in the Chinese economy should bolster Philippine exports.

As for services exports, remittances, which amount to 10% of GDP, remain a cornerstone of the Philippine economy and will continue to underpin private consumption while also keeping the current account balance on an even keel. The diversified nature of remittances by origin is poised to buoy the repatriation of remittances by Overseas Filipino Workers (OFWs), going forward.

Benign inflationary pressures, robust remittances, social transfers under the 4Ps to households, along with more aid to beleaguered farmers that have been on the receiving end of depressed rice prices, should lend support to household consumption in the near-term.

The Mindanao peace accord has now been implemented. Mindanao is rated by geologists as the most “mineralised” places in the world –

precious metals as well as base metals, all not exploited because of the insurgency which has now ended. Similarly, the soil is extremely fertile and most of Mindanao is not exposed to typhoons like the rest of the country. So, the potential for Mindanao to emerge as a new growth hub is real.

Similar to its peers in the region, infrastructure development, funded by a mix of foreign aid (Overseas Development Assistance), private involvement via PPP and public spending, continues to buttress the ongoing expansion.

Downside risks to growth include a potential delay to budget talks which would lead to another encore of slower growth in 2020 if Congress fails to reconcile their differences before end-2019. Progress over tax reforms has stalled as budget talks assume precedence over the former, and the resulting impact on uncertainty and investments do not bode well for the economy either.

Inflationary pressures will remain manageable in the near-term as the normalisation of prices and economic activity continue in 2020. By permitting foreign imports of rice, the rice tariffication law will keep food prices and inflation under wraps.

While the government will keep its foot on the gas by stepping up infrastructure spending, services exports, from remittances, BPO and Pogo-related revenues, will keep the external imbalances on an even keel.

Singapore: Quicker-than-expected turnaround possible

Singapore's growth came under pressure in 2019 amid the step-down in external demand, but the slowdown has been contained within the trade-related sectors. The economy is primed for a gradual recovery heading into 2020, supported by improving global growth and the nascent turnaround in the tech cycle.

Export growth has bottomed out and is reviving, albeit weakly. Industrial production was supported in recent months by stronger electronics output. Forward-looking indicators such as PMIs have also begun to improve. We note the marked improvement in business sentiment amongst the battered electronics and precision engineering firms – the two biggest drags on the economy - which may presage stronger demand in the coming quarters.

With manufacturing driving 22% of nominal value-add (VA) – more when sizable spillovers onto trade-related sectors e.g. transportation & storage, wholesale trade et cetera are accounted for – the economy could recover much earlier-than-expected, wrongfooting the current consensus which is for an extended trough in 2020.

Meanwhile, there are green shoots such as finance & insurance, essential services and the “new-economy” cluster that are benefiting from sector-specific tailwinds – these will continue to lend support to the growth outlook in 2020.

Investment commitments have been robust all-year which suggest that firms have been looking through the current soft patch and are continuing to invest for the long haul in anticipation of future demand. These will lend support to private investment in 2020.

We also expect the upcoming budget to be robustly expansionary due to the synchronisation of political and business cycles; the government will be keen to dispense generously with sops and sweeteners to keep households in a warm and fuzzy mood. Safe to say, this is accretive to the outlook for consumption demand.

Putting it all together, while the Monetary Authority of Singapore has sketched out a “tepid growth” scenario for the near-term in its latest Macroeconomic Review, we do not rule out an upside surprise in 2H20.

The outlook for the Singapore economy rests overwhelmingly on the evolution of global demand, and if one looks at the key swing factors on that front such as the health of the Chinese economy and global business confidence, a modest improvement in both which is our base case, will quickly translate into improved activity in the Singapore economy.

South Korea: A modest turnaround

The external environment was unkind to South Korea in 2019. The US-China trade dispute as well as trade disputes with Japan hurt economic growth. But, there are now reasons to be upbeat over its prospects for 2020.

A modest upturn in the fortunes of the global economy in 2020, spearheaded by a rebound in the Chinese economic momentum, as well as the bottoming out of the electronics cycle, should lend support to South Korea via the external demand for its manufactured goods. Uncertainty from salient trade tensions may still exact a toll on the economy, particularly if the partial trade deal does not materialise in the near-term. There is also a tail risk that the US slaps import tariffs on South Korea goods amid tricky cost-sharing talks over the US' military umbrella.

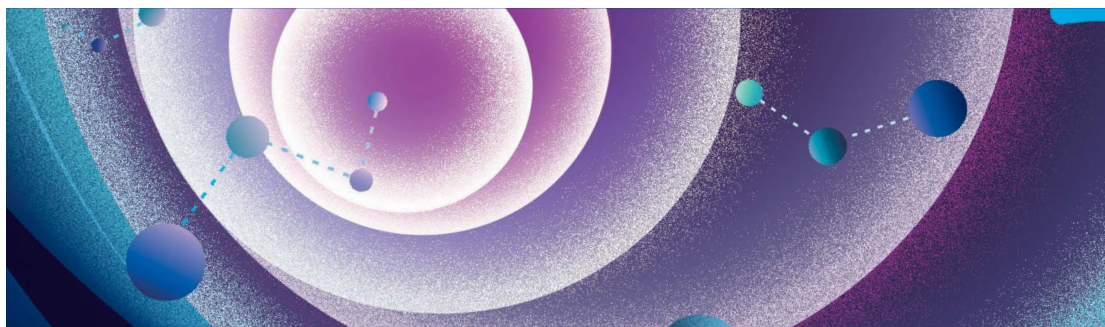
Thus, domestic policy responses will be needed to buffer the economy against such downside risks. Indeed, the policy response has been substantial. Policy levers are concerned. The government has proposed a record KRW513.5tr budget for 2020 to step up job creation and spearhead the development of new growth drivers, in an attempt to mitigate the headwinds from the external environment. The Bank of Korea has slashed rates twice in 2019, and further cuts could feature in

the foreseeable future in the event of an extended downturn, which seems unlikely at this point. Moreover, hefty hikes to the minimum wage from previous years (2018: 16.4%; 2019: 10.9%) have helped bolster income levels and undergird household spending. For 2020, the minimum wage hike has been more measured (2.9%).

More property curbs and tighter macroprudential policy to bridle the pace of property price increases could feature in 2020, weighing on the real estate and construction sector which has a higher elasticity of output with respect to labor.

Manageable food and oil prices have fed into quiescent inflationary pressures. It is also noteworthy that the minimum wage has not led to significant hikes in output charges among firms. There is a risk, however, that inflation expectations could weaken significantly and remain entrenched at low levels.

The current account surplus should narrow in the near-term on the back of a rebalancing toward domestic demand. Upbeat petrochemical and electronics exports, along with rising tourism revenues from China will be partially offset by outbound tourism.



Taiwan: Growth could outperform the region

The Taiwanese economy was unexpectedly resilient in 2019 despite being caught in the crossfire of the US-China trade war and the step-down in the global electronics cycle. We expect this to continue in 2020.

Though trade diversion has supported export growth amid weakness in external demand, the economy is being buoyed principally by an upturn in private investment, as the trade war-induced rejigging of regional supply chains have turned in Taiwan's favor, dovetailing with the government's policy of luring back high value-add manufacturing to the island which has also begun to pay dividends. We also expect 5G-related developments to spur a revival in semiconductor demand, thus delivering a fillip to the important tech sector.

Data on investment approvals show that the reshoring of high value-added manufacturing capacity, mostly in the technology and capital goods space, is fast gaining traction. The government announced that as of mid-October, 147 companies have been approved to return to Taiwan, with a total of TWD6.2tr in planned capital expenditure. What stands in Taiwan's favor is a cogent government policy that is supportive of the ongoing relocation of production. For instance, the "Action Plan for Welcoming Overseas Taiwanese Businesses to Return to Invest in Taiwan" plan was launched in 2019, plying firms with incentives should they meet certain criteria. Policymakers are also working to alleviate supply-side constraints i.e. land, labor and electricity supply, which have impeded the flow of investment into such jurisdictions as Vietnam.

In turn, the resurgence of private investment is creating lots of well-paying jobs, helping to shoring up the labor market. The aforementioned excitement over 5G-related developments has also lit a fire under the tech-heavy domestic equity market, producing a positive wealth effect on households. As a result, consumption demand has not only held up well, but is showing signs of accelerating. The overall picture which emerges of the Taiwanese economy is that growth has increased not only in quantum but in quality.

Global semiconductor billings have bottomed out and are beginning to rise, if weakly. However, a bevy of forward-looking tech cycle indicators that we keep an eye on have also turned positive, presaging a sustained turnaround in the global electronics cycle. Though longer smartphone replacement cycles are here to stay, demand is rising again, driven by 5G-related demand as well as a new round of investment in data centers. Semiconductor inventories have also been run down to levels supportive of higher prices. Higher expected demand recently spurred TSMC to announce an increase to its 2019 capex plan to USD14-15bn, up from USD11bn previously.

Putting it all together, we expect Taiwan to be a clear outperformer in East Asia, which together with the lack of serious inflationary pressure suggests that the policy stance will remain in status quo. Though political noise is likely to increase as Taiwan heads to the polls in January, the economy is likely to remain insulated and on even-keel.

Thailand: Growth upturn delayed

Growth is likely to remain tepid in the initial few months of 2020, before gradually picking up. The near-term outlook continues to be weighed down by reduced public spending and investment as a result of the delay to timely disbursement of the fiscal 2020 budget. Rising unemployment pressure within the trade and manufacturing sectors has also put a dent in consumer sentiment, though household spending has been propped up by ample policy support, such as the Taste-Shop-Spend scheme.

That said, we see growth picking up the pace in 2H20. Export growth has likely bottomed out and several important swing factors that move the needle for growth begin to turn in Thailand's favor.

First, tourist arrivals are returning to Thailand in droves after a bruising 1H19, while lead indicators such as advance accommodation bookings are on an uptrend, suggesting that this can be sustained. This is positive for the economy as the sector drives roughly 20% of GDP once spillovers to ancillary sectors are accounted for.

Second, farm incomes – so crucial to the outlook for consumption demand – will improve as the effects of one-offs dissipate. Thailand's systemically-important farm sector has been hard-hit in 2019 by a serious drought followed by equally severe flooding. However, agricultural prices and output are beginning to recover, and with it, farm incomes.

Third, the fiscal stance will turn meaningfully positive in 2Q20 once implementation of the FY2020 budget is underway circa February. That said, this is contingent on potential bottlenecks to timely implementation of infrastructure projects, stemming from such issues as land acquisition, disagreements between consortium members and the government, and historically poor coordination between government agencies.

Fourth, private investment is likely to stage a recovery after a poor showing in 2019, for two reasons. The relocation of manufacturing production out of China and into Thailand should pick up, delivering a fillip to private investment which has been moribund as a result of election-related political uncertainty and the export malaise. The government's infrastructure drive should also gain traction once budgetary funds are disbursed – this will also help to crowd-in capital spending by the private sector.

Putting it all together, growth is expected to improve in 2020 but much of that will be “backloaded”. The rather subdued level of economic activity in the interim could convince the Bank of Thailand to deliver one more rate cut in 1Q20 to juice up the economy.

Vietnam: Rousing growth for now

We expect Vietnam's outperformance vis-à-vis the rest of Southeast Asia to persist in 2020.

While the economy was buoyed initially by trade diversion, such that export growth remained resilient despite the broader malaise in external demand, Vietnam has also become far and away the biggest winner in the production relocation story, as evinced by surging foreign direct investment approval figures. This translates into a more enduring boost to growth by way of higher investment levels in the economy.

However, the surge in FDI has also put to test the supply-side fundamentals of the Southeast Asian economy, with less-than-stellar results: mounting anecdotal evidence point to diminishing manufacturing capacity and infrastructural bottlenecks. Vietnam's shortcomings include manpower constraints (in number and in skill), supply chain frictions and a yawning infrastructure gap. The congestion of roads and ports is commonly cited by firms as a pain point.

As a consequence, inflows of manufacturing FDI could slow in 2020, especially if public investment fails to keep up: capital spending by the public sector as a share of GDP has been slowing for years, and the IMF thinks that this ratio will inch lower still for the next five years.

Meanwhile, consumption indicators point to healthy domestic demand with retail sales having expanded at double-digit rates in the past 3 years on average; these figures are undergirded by the rising purchasing power of Vietnamese households given that income growth has consistently outpaced consumer price inflation.

The vigour in domestic demand is likely to be sustained in 2020 off the back of a tight jobs market, with the unemployment rate reaching a 5-year low in 2Q19; productivity growth has also kept up with wage growth as the absence of price pressures suggests.

Despite the rousing growth outlook in the near-term, impediments to growth remain.

First, spill-overs from the foreign-invested export sector onto the domestic-oriented sectors remain weak. Foreign firms have been loath to integrate local businesses into their supply chains, while local firms' ambitions to scale up have been hampered by a lack of domestic policy support (e.g. legal barriers and fewer tax incentives), and funding constraints arising from weaknesses in financial intermediation.

Second, the government's equitization drive is incomplete and slowing. The government has privatized just 35 of the 127 SOEs it set out to completely equitize from 2017 to 2020. Divestment of state capital is just as slow – it has been completed for just 88 of the 403 SOEs planned in the same period.

Appendix

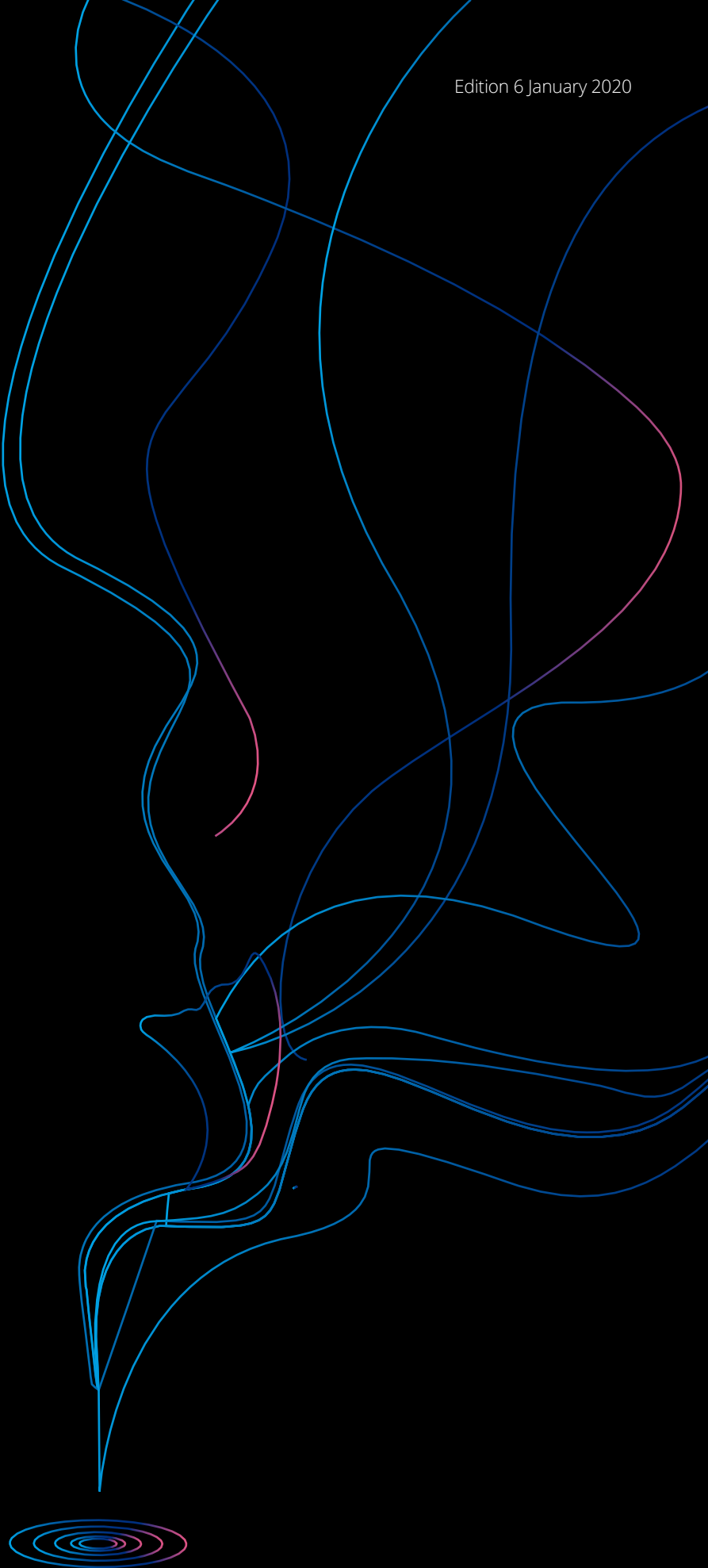


FIGURE 6

Outlook for 2020⁴

Economy	Economic Growth (%)	Inflation (%)	Current Account (% of GDP)	Currency (v USD)	Policy Rate (%)
Australia	2.1	1.6	0.0	0.69	0.50
Mainland China	5.8	2.8	0.3	7.25	2.80
Hong Kong SAR	-1.2	0.8	3.5	7.80	2.00
India⁵	5.1	4.0	-2.1	72.2	4.90
Indonesia	5.1	3.3	-3.0	13,400	4.50
Japan	0.5	0.7	3.5	105	-0.10
Malaysia	4.6	1.7	3.5	4.1	2.75
New Zealand	2.6	1.9	-2.8	0.64	1.00
The Philippines	6.3	3.0	-2.0	50.0	3.50
Singapore	1.8	1.0	17.9	1.35	-
South Korea	2.2	1.0	3.8	1,150	1.25
Taiwan	2.1	1.1	12.0	31.0	1.38
Thailand	3.3	0.9	5.5	29.5	1.00
Vietnam	6.6	3.0	2.2	23,200	6.00

4. Forecasted data by economists from Deloitte Asia Pacific member firms.

5. High frequency leading indicators point to a further slowdown in Q3 FY 2020 and a modest recovery thereafter. We expect annual growth to be lower than RBI's official forecast for both the years. Inflation pressures and policy rates may remain low.

FIGURE 7

Outlook for 2021⁶

Economy	Economic Growth (%)	Inflation (%)	Current Account (% of GDP)	Currency (v USD)	Policy Rate (%)
Australia	2.6	1.7	-1.6	0.71	0.50
Mainland China	5.6	2.6	0.0	7.5	2.80
Hong Kong SAR	1.8	2.0	3.3	7.80	2.00
India⁷	6.2	4.0	-1.6	72.5	4.75
Indonesia	5.2	3.1	-3.1	13,000	4.00
Japan	0.5	0.6	3.6	103	-0.10
Malaysia	4.6	1.5	3.7	4.0	2.75
New Zealand	2.4	1.8	-2.9	0.61	1.00
The Philippines	6.4	3.1	-2.1	51.0	3.00
Singapore	2.1	1.0	16.5	1.36	-
South Korea	2.3	1.2	3.7	1,120	1.25
Taiwan	2.2	0.7	11.5	31.1	1.38
Thailand	3.6	1.1	5.0	30.5	1.25
Vietnam	6.7	2.7	2.4	23,100	6.00

6. Forecasted data by economists from Deloitte Asia Pacific member firms.

7. High frequency leading indicators point to a further slowdown in Q3 FY 2020 and a modest recovery thereafter. We expect annual growth to be lower than RBI's official forecast for both the years. Inflation pressures and policy rates may remain low.

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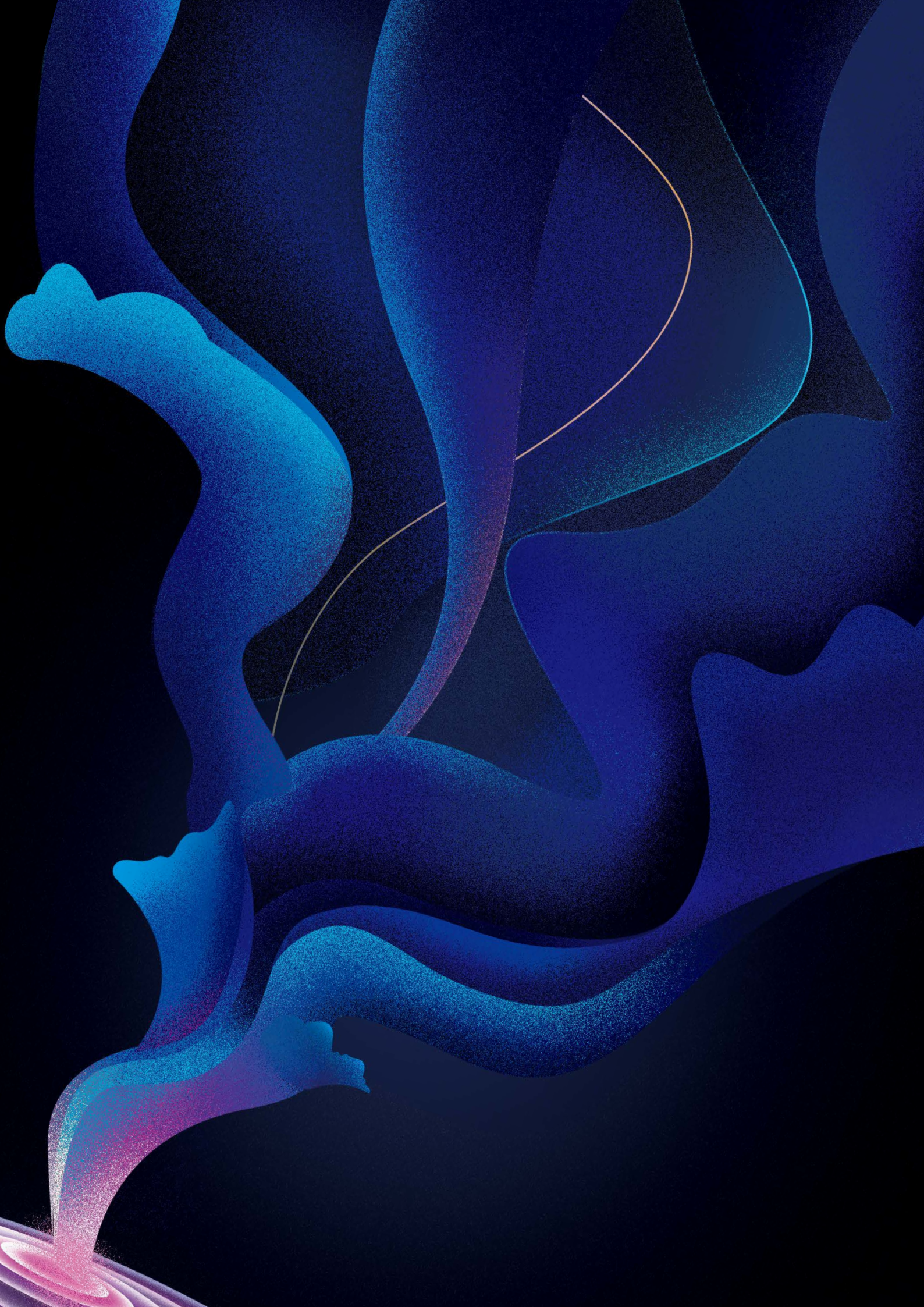
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