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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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Branching out

Executive Summary

We discuss three broad themes in this report.

First, headwinds are weakening regional economies: There is little doubt that the global economic recovery lost momentum in the third and fourth quarters of this year. The resurgence of COVID-19 infections in many geographies, supply side dislocations, rising energy prices and a deceleration in Chinese economic activity have all culminated in a disappointing few months. There is considerable uncertainty over the outlook as well given that the key determinants of economic growth are difficult to predict.

Nevertheless, we maintain our broadly constructive view of the global economy and its impact on the Asia Pacific region for three reasons. First, the dissipation of several of these drags on growth. Second, a faster pace of normalization of economic activity as the worst effects of the pandemic are overcome. And, third, as we argued in our previous edition, a firm recovery in global capital spending. There are of course some risks, such as the headwinds confronting the Chinese economy. Without underplaying these risks, we argue that the downsides can be contained.

Finally, as the region recovers, there is likely to be greater divergence in economic trajectories. The pandemic revealed weaknesses in some geographies pertaining to state capacity which will have a bearing on the strength and quality of their recoveries. Moreover, different geographies have varying sensitivities to the upside forces in the global economy. Finally, some have used the crisis period to undertake longer-term reforms which will also help to promote growth.

Asian giants

China's economy will settle into a period of steady growth at around 5-5.5%. The stable numbers, however, will mask considerable qualitative changes underway in the economy.

After a difficult period, India's economy will finally bounce back but the pace of recovery may be constrained by ongoing headwinds such as high inflation, a weak labor market, low credit growth, and a struggling hospitality sector.

High growth breakout nations

The patient accumulation of reforms in Vietnam and Indonesia will yield good results in both countries, which will see a noticeable acceleration in economic growth compared to pre-pandemic times.

Advanced regional economies

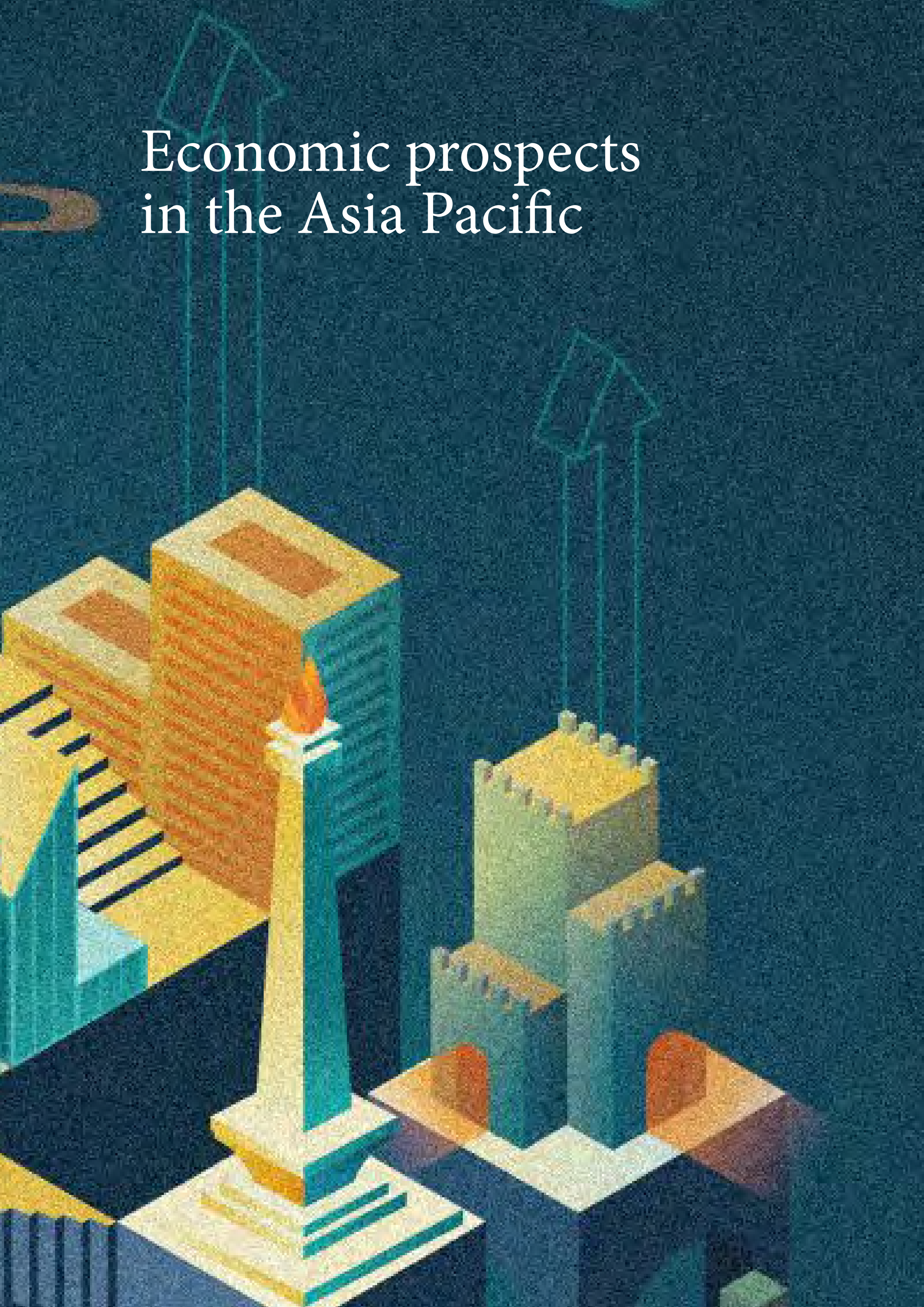
Growth will be modest in Australia, New Zealand, South Korea, Japan, Taiwan (China), Singapore as well as the Hong Kong SAR, but structural transformations will be positive.

Middle income economies

Other economies, namely Thailand and Malaysia, will continue to struggle against domestic headwinds.

Even with a decent rebound in 2022, the global economy will likely be marked by turbulence. We take a look at Australia as a case study of a mature economy that has been successful in maintaining growth throughout the multiple crises of the past two decades, and which offers valuable lessons in economic policy housekeeping for other countries to heed.

Economic prospects in the Asia Pacific



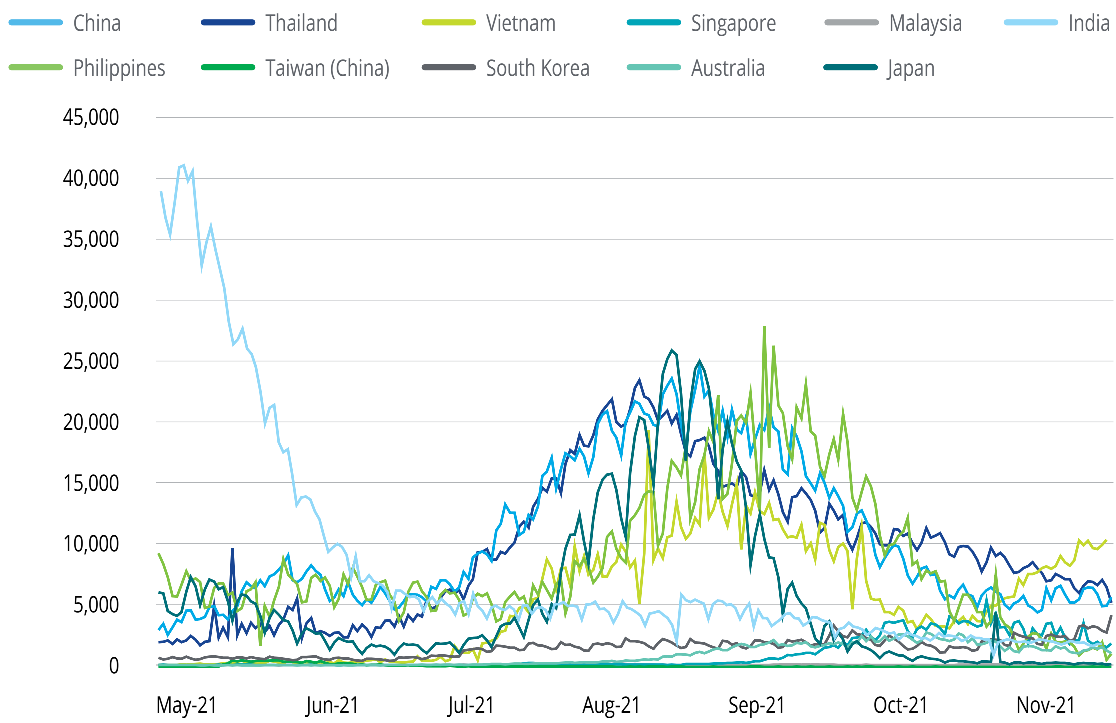
Where do regional economies stand today?

A CONFLUENCE of adverse developments has contributed to a loss of momentum in the global economic recovery over recent months. This has spread to economies in the Asia Pacific region, causing slower growth in the third quarter of the year and most likely into the fourth quarter as well.

Most notably, COVID-19 infections surged again in many geographies after the middle of this year as the more transmissible delta variant displaced other variants of the virus. In some jurisdictions, such as China, Vietnam, Australia and New Zealand, governments responded with strict lockdowns that sharply curtailed economic activity. In other countries, the response was more calibrated but still involved social distancing and other measures which caused economic disruption. Ordinary citizens became more wary of social mixing, causing them to avoid high-touch personal services or mass entertainment activities. The fact that the virus was resurgent even in geographies which were previously successful in controlling infection numbers and in areas where vaccination rates were high also damaged confidence among businesses about future prospects. All this served to undermine the economic recovery.

Figure 1:

Number of COVID-19 infection cases by economy



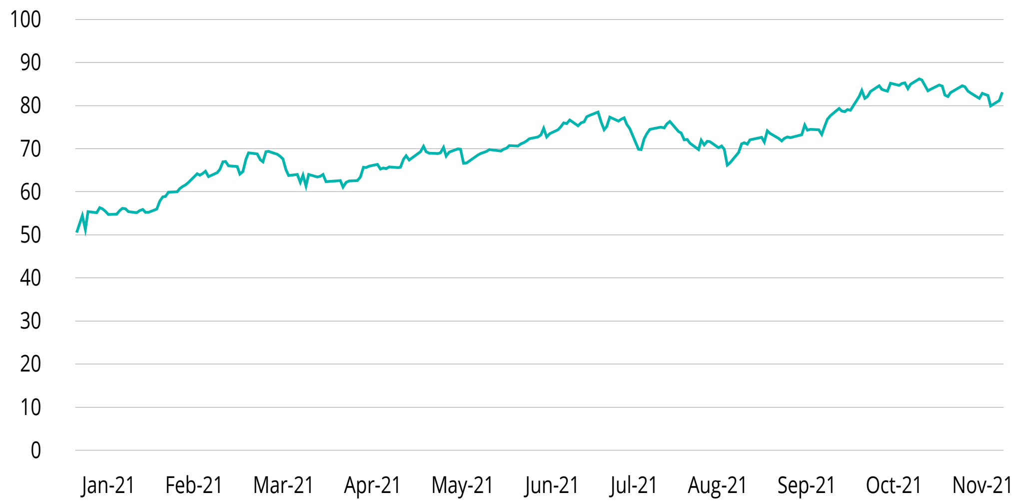
Source: CEIC

These public health measures have also caused more dislocations in supply chains than anyone previously anticipated. For example, Malaysia imposed strict limitations on mobility across districts, but its electronics industry plays an important role in the manufacturing of semiconductors, accounting for 13–14% of global chip packaging, assembling and testing capacity. Similarly, the Vietnamese authorities imposed stringent controls on movement in affected areas, which also happened to encompass key manufacturing clusters that play an important role in the information technology supply chain. Factory operations were therefore disrupted and shortages of critical components undermined global production in a range of industries dependent on semiconductors such as mobile phones and automotive.

Rising energy prices are beginning to hurt as well. Brent crude oil prices have surged above US$80 per barrel and are at seven-year highs. Not only are prices high but shortages of coal and natural gas have also led to power outages in China and elsewhere, acting as another drag on economic growth.

Figure 2:

Crude oil prices (US$ per barrel)



Source: CEIC

Fourth, there are signs of slower than expected growth in China, which serves as the largest market for exports for most Asia Pacific economies. Power outages, concerns over the fallout from the financial stresses among leading property development firms and uncertainty over the government's regulatory crackdown on big tech companies and other sectors have come together to create a perfect storm for the Chinese economy.

Figure 3:

Purchasing Managers Index for China

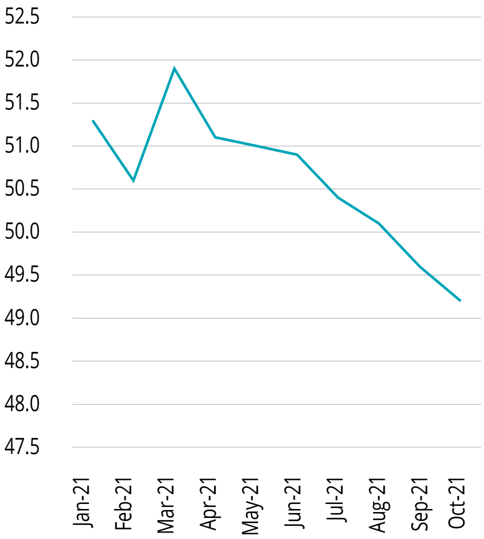
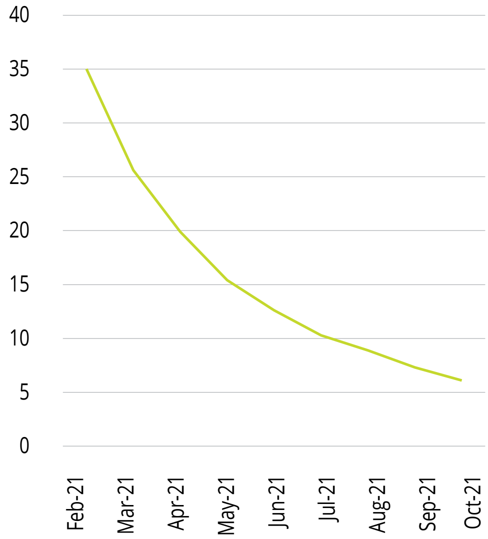


Figure 4:

Chinese fixed asset investment, cumulative year-on-year (%)



Source: National Bureau of Statistics of China

Nevertheless, not only do we believe that the global recovery is intact, we still spy a possibility for upside surprises

In its World Economic Outlook October 2021, the International Monetary Fund (IMF) noted the various impediments to an economic rebound in the second half of 2021 described above. But it has revised down its forecast for global economic growth in 2021 by just 10 basis points to 5.9%. More tellingly, it has maintained its forecast for global growth of 4.9% in 2022, in an apparent show of confidence that the headwinds of recent months will not linger long enough or substantially enough to hurt economic prospects next year.

Our view remains cautiously upbeat as well. The principal reason for this optimism is our baseline scenario for the global pandemic. There are several reasons why the headwinds to growth induced by the pandemic are likely to dissipate:

- The rollout of vaccines is improving, even in countries which were initially slow to vaccinate. As we write this, India is vaccinating its population at a rate of roughly 8 million every day. Malaysia similarly overcame teething problems and has now fully vaccinated close to 90% of its adult population, an achievement on par with most developed countries.

- Large populous countries such as India and Indonesia are experiencing precipitous declines in COVID-19 infections, owing to improved vaccination rates and resistance within the population.

- Governments generally are increasingly shifting to a public health stance that assumes the virus will be endemic. Rather than adopt a COVID-zero approach, the goalposts have shifted to how societies can live with the virus. This new approach abjures harsh economy-wide restrictions in favour of selective and calibrated responses to episodes of rising infections. Consequently, there are fewer restrictions on mobility or social mixing. In addition, governments appear keen to stimulate a recovery in travel, including cross-border travel for both business and leisure, and many governments are now prepared to risk new infections in order to reenergise their economies. Singapore has started travel bubbles with selected geographies, and where these have been shown to work well without a subsequent spike in infections, these bubbles are being extended to a wider range of geographies. Thailand has experimented with tourism "sandboxes" such as in Phuket, where travellers are allowed to enter a tourist area so long as they restrict themselves to a limited area of travel. These sandboxes are also being extended, while Indonesia is considering a similar approach for Bali. China, of course, is the major outlier here. The country's strict adherence to a zero-COVID policy is likely to persist at least until the Winter Olympic Games are over, but China's political calendar suggests that such restrictive policies could be in place for another year with the highly-anticipated 20th Party Congress likely to be held in November 2022. The economic impact will be felt mainly on the service sector, but the saving grace is that China's economy has never relied on inbound tourism. So long as residential markets in major cities hold up, consumer confidence is expected to stay firm. Such a policy, however, would deal a blow to those economies which have been enjoying a boon of Chinese tourists, notably Hong Kong and Thailand.
- Treatment regimens for the illnesses resulting from COVID-19 are also improving. Better clinical management and a wider range of medications have helped to bring down the fatality rate, while also reducing the chances that an infected patient's condition turns critical. The imminent introduction of new drugs such as Merck's antiviral drug, Molnupiravir, which can reduce the risk of hospitalization and death in at-risk patients by 50% will go further in making the disease a less terrifying one and one which people can learn to live with.

Second, we believe that there will be enough of an improvement in some of the supply chain dislocations to allow for a rebound in those production segments which have experienced abrupt slowdowns.

- Semiconductors: Many of the restrictions that hurt factory activity in Malaysia and Vietnam have been rescinded owing to an improving COVID-19 situation in Malaysia and Vietnam. In some cases, however, friction still remains. For example, migrant factory workers in some production hubs in Vietnam have returned to their home provinces after many months of isolation in the big cities, but will likely return soon. Overall though, supply chain interruptions in the niches occupied by Malaysia and Vietnam will ease. However, the general shortage of semiconductors will take more time to be fully resolved. Most of the new production capacity being constructed will only come into play at the end of 2022 or early 2023.

- Shipping and trucking: The sharp spike up in shipping rates is beginning to stabilise and reverse, and once the rush for the end of year sales period eases, rates should come down further.

Third, while monetary and fiscal stimulus in the region is mostly being wound back, policymakers will not hesitate to add stimulus should the risks to economic growth become serious. In China, for instance, we believe that the authorities will introduce calibrated measures to support the economy, including more fiscal spending such as subsidies to affected sectors.

If the headwinds to growth caused by the pandemic are reversed, and as the supply chain issues create fewer hindrances to factory activity, then the question is, how strong could the recovery be? There are two reasons for a positive take on this.

The first is that the build-up of excess savings suggests that there could be a substantial release of pent-up demand. Estimates of the magnitude of such excess savings among American households, for example, come to around US$2.5 trillion. Here, consumer psychology will be key. Our view is that there is a marked urge among consumers to return to normality as seen in how American and European consumers have taken to travel and entertainment when restrictions were lifted and concerns over infections diminished. Indeed, a recent YouGov survey found that consumers in France, Germany, Italy and Spain were prepared to spend half their excess savings relatively quickly.

In addition, as we argued in the previous issue of Voice of Asia, we see scope for a significant rebound in capital spending. In fact, there has been even more evidence to support this hypothesis since we wrote about it last time. In the semiconductor sector, for instance, individual companies have already committed to the largest and most ambitious capital spending plans ever. Taiwan Semiconductor Manufacturing Company (TSMC) has plans to spend US$100 billion over the next three years. With strong profitability and cash flows, along with growing government support, the urge to spend in this sector will only grow in 2022. In the US, the Biden administration's stimulus plans include US$52 billion to bolster the resilience and competitiveness of its semiconductor industry. Similarly in South Korea, the government is coordinating a KRW510 trillion (US$420 billion) effort through to 2030 to ensure that the country remains competitive in the sector.

Should we worry about risks in China hurting the region?

ONE REASON for the recent despondency over growth prospects in the Asia Pacific has been the signs of a slowdown in the Chinese economy. These risks are material and do serve as a caution to the rest of the region, but we also believe that there are offsetting factors that can mitigate the risks.

First, there is the Evergrande saga and its potential to hurt the economy through its knock-on impact on the financial and real estate sectors (the latter accounts for more than 20% of China's economy once all its direct and indirect effects are accounted for). Evergrande is a huge property developer with total debts estimated at CNY2 trillion and possible contingent liabilities of CNY1 trillion, so one should not downplay the risks it poses. But Evergrande's loans account for just 1.3% of total loans in China, and its local bonds account for a mere 0.1% of the national total for onshore bonds. It is also important to remember that Evergrande's situation is a known risk which policymakers have been studying for some months now. Over the years, the Chinese authorities have shown that they have the financial resources, the policy tools and the necessary control over the financial system to contain known financial risks. Moreover, China has a large current account surplus which provides another strong buffer in the system. With carefully calibrated policy support, the potential impact on real estate investment can also be managed given the strong secular demand for residential real estate, particularly in first- and second-tier cities.

Second, existing bottlenecks in production created by recent power outages may last for a few more months. However, policymakers have responded by stepping up coal production, among other measures, and the impact on production appears to be coming under control. For example, Toyota was reported to have cut planned production in its China units by 40% in September-October, but reductions in production for November were actually 15% lower than the initial plan.

Third, consumer spending and services output have been hurt by the stringent lockdowns that China tends to impose when there is even the smallest outbreak of COVID-19 infections. These restrictions have caused important ports such as Ningbo to shut down for short periods as well. However, with recent outbreaks now generally under control, these restrictions have eased. Moreover, there are some signs that the authorities are considering a more calibrated approach to the management of the pandemic, shifting away from wide-ranging restrictions to more targeted ones that minimize the economic impact.

Fourth, we expect a modest degree of additional policy support in light of the rising threats to growth. Local governments are likely to step up infrastructure spending while the central bank may cut reserve ratio requirements in order to release more liquidity into the system.

Overall then, without under-estimating the risks, we would say that the downsides in China are likely to be contained.

Economic growth will rebound but trajectories will vary across the region

TABLE 1 below shows our projections for key economic variables for the Asia Pacific. Overall, we see economies in the region regaining strength in 2022 after rebounding from the severe contractions that many endured in 2021.

Table 1

Economic Projections

Economic Projections	Year	Growth (%)	Inflation (%)	Current Account (% of GDP)	Policy rate (%)	Currency vs US$	Remarks on outlook
Australia	2020	-2.4	0.9	2.7	0.26	0.77	Robust growth underpinned by strong institutions and a flexible exchange rate
	2021	3.2	2.5	3.6	0.10	0.75	
	2022	4.5	2.1	1.3	0.20	0.727	
China	2020	2.3	2.5	1.9	2.25	6.53	Growth in line with potential
	2021	7.8	1.2	2.2	2.25	6.45	
	2022	5.5	1.8	1.5	2.25	6.55	
Hong Kong SAR	2020	-6.1	0.3	6.5	-	7.75	Resilient domestic demand
	2021	6.2	1.6	4.0	-	7.75	
	2022	4.0	1.9	3.5	-	7.75	
India	2020	-7.3	5.5	0.9	4.00	73.1	Investment upturn key to growth revival
	2021	9.5	5.3	-1.0	4.30	75.0	
	2022	7.5	5.8	-1.6	5.50	75.5	
Indonesia	2020	-2.1	1.7	-0.4	3.75	14,050	Reforms should start to pay off
	2021	4.0	2.0	-1.0	3.50	14,300	
	2022	5.5	2.5	-2.0	4.00	14,000	

Economic Projections	Year	Growth (%)	Inflation (%)	Current Account (% of GDP)	Policy rate (%)	Currency vs US$	Remarks on outlook
Japan	2020	-4.6	0	3.3	0.00	103	Solid recovery propelled by external sector and a competitive Yen
	2021	2.4	-0.2	3.5	0.00	110	
	2022	3.2	0.5	3.3	0.00	109	
Malaysia	2020	-5.6	-1.4	4.2	1.75	4.02	Vaccination to supercharge growth
	2021	4.9	1.8	4.0	1.75	4.15	
	2022	5.0	2.0	3.2	2.25	4.00	
New Zealand	2020	-2.1	1.7	-0.8	0.48	0.72	Effective control of COVID-19 and favorable prices of agricultural products
	2021	5.1	3	-3.3	0.50	0.70	
	2022	3.3	2.2	-2.5	1.60	0.68	
Philippines	2020	-9.6	3.5	3.1	2.00	48.0	Remittances and infra spending to support growth
	2021	4.8	4.4	-1.0	2.00	51.0	
	2022	6.0	3.8	-1.2	2.50	50.8	
Singapore	2020	-5.4	-0.2	17.6	-	1.33	Reopening adds to global demand
	2021	7.0	1.7	16.9	-	1.32	
	2022	3.6	1.5	17.2	-	1.27	
South Korea	2020	-0.9	0.5	4.6	0.50	1,085	Growth to moderate after peaking
	2021	4.3	2.0	4.8	1.00	1,150	
	2022	3.0	1.8	3.8	1.75	1,100	
Taiwan (China)	2020	3.1	-0.2	14.1	1.13	28.0	Tech cycle spurring capex upturn
	2021	6.2	1.7	13.9	1.13	27.3	
	2022	3.4	1.5	13.1	1.25	27.0	
Thailand	2020	-6.1	-0.8	3.5	0.50	30.0	Strong headwinds from tourism
	2021	1.0	0.7	-0.6	0.50	33.0	
	2022	3.5	1.1	1.2	0.50	32.5	
Vietnam	2020	2.8	3.2	3.7	4.00	23,080	Recovery hindered by COVID-19
	2021	3.0	2.5	2.2	4.00	23,300	
	2022	7.0	3.5	2.5	4.25	23,050	

Source: National Bureau ofSource: Centennial Asia Advisors Statistics of China

Over the medium term, based on the lessons learnt from the pandemic, we see the economic trajectories of different economies diverging according to the following factors.

First, if there is one lesson above all to be learnt from the crisis, it is that state capacity matters greatly. This state capacity is manifested in several areas:

- Quality of public healthcare management. Since the COVID-19 virus will remain endemic and continue to create public health challenges episodically, it will be important to ensure that the quantity and quality of hospital capacity, including resources for critical care and stocks of equipment and medication, are improved.

- Amount of monetary and fiscal policy space with which the country can operate. Where central banks have built credibility with financial markets and other economic agents, there will be greater scope to use monetary policy to respond aggressively to a slowdown. In the fiscal arena, governments which have maintained a record of fiscal discipline over the years, resulting in relatively low public sector debt-to-GDP ratios, will have more flexibility to use fiscal policy to support growth without fearing downgrades to ratings or any other adverse consequences in financial markets.

- Administrative capacity to respond to shocks. This includes the ability to conceive and implement programs to alleviate the damage from an exogenous shock, be it a pandemic or a financial crisis somewhere in the world economy. In some countries such as Thailand, large fiscal programs were planned but the actual disbursement of the funds was relatively slow, thereby dulling the impact of the stimulus.

Second, alignment with important trends in the global economy can also help. The following stand out in particular:

- The likely continued strength in global demand for manufactured goods if the surge in capital spending we forecast does materialize. Much of this will be in the electronics industry so geographies such as South Korea, Malaysia, Singapore and Taiwan will benefit.

- The reconfiguration of supply chains that we see unfolding over the next few years.

- The rise in commodity prices.

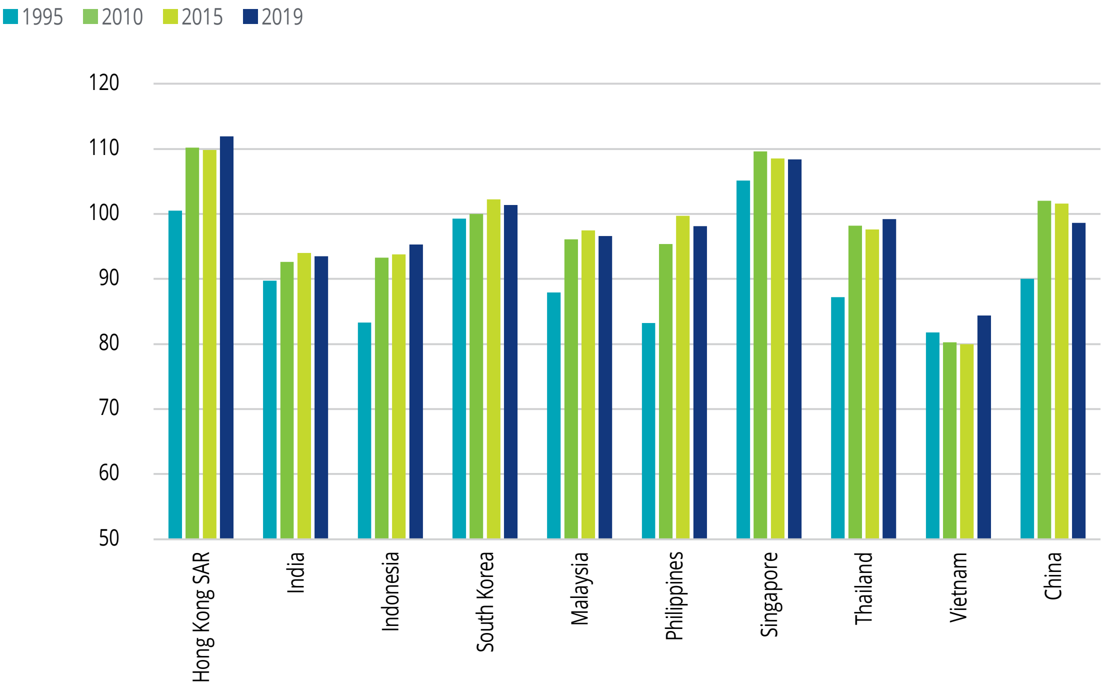
Third, the lagged effect of policy reforms in various economies. It is encouraging and noteworthy that large developing countries such as India and Indonesia persisted with substantive reforms even as the pandemic caused convulsions in their economies. We have seen a very significant set of labor market reforms in Indonesia, for example, as well as efforts to improve the labor functioning at the state level in India. Indonesia has also improved conditions for foreign investment while moving ahead with raising VAT rates, in effect raising fiscal resources to be better able to fund economic development. Since the pandemic, the Indian government has introduced several schemes to promote manufacturing, including production-linked incentive schemes to encourage domestic manufacturing facilities. The government's increased spending on infrastructure will also generate income and jobs, leading to positive externalities.

Fourth, economic partnerships and trade agreements that release positive synergies. The Regional Comprehensive Economic Partnership (RCEP) was signed last year, while the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is gaining wider traction with China's application to join.

Fifth, the degree of resilience to the potential financial turbulence that we see as a possible downside risk. Our analysis below measures the capacity of economies to rebound from external shocks. It is encouraging to see that resilience has generally improved over the years, with improved confidence in central banks by financial markets, more diversified economies, and strengthened financial balance sheets in the corporate and household sectors.

Figure 5:

Resilience Index



Source: Centennial Asia Advisors

A final differentiating factor will be domestic political issues. Political instability or fragmented political establishments that cannot generate a consensus around important political, social and economic challenges may encounter prolonged episodes of political ferment which hold those geographies back.

The region's economies can be categorised as follows:

Asian giants

China's economy will settle into a period of steady growth at around 5-5.5%. The stable numbers, however, will mask considerable qualitative changes underway in the economy, namely a structural shift away from a reliance on exports and investment to consumer spending becoming more of a driving force while excessive leverage will be reduced. Most importantly, we believe there will be an acceleration in total factor productivity growth, as the economy relies less on quantities of inputs of labor and capital and more on efficiency and knowledge.

After a difficult period, India's economy will finally bounce back but the pace of recovery may be constrained by ongoing headwinds such as high inflation, a weak labor market, low credit growth, and a struggling hospitality sector. However, these will be gradually reduced whereupon the payoff to the reforms of recent years should kick in. These include the introduction of the GST, deregulation, the production-linked incentive scheme, labor reforms, and an emphasis on digitalization to accelerate financial inclusion.

High growth breakout nations

The patient accumulation of reforms in Vietnam and Indonesia will yield good results in both countries, which will see a noticeable acceleration in economic growth compared to pre-pandemic times.

Advanced regional economies

Growth will be modest in Australia, New Zealand, South Korea, Japan, Taiwan, Singapore as well as the Hong Kong SAR, but structural transformations will be positive.

Middle income economies

Many economies will struggle against domestic headwinds. Some, such as Thailand and Malaysia, have bold economic plans to develop their economies which are well thought out. So long as current political uncertainties can be managed, they have a good chance of enjoying better growth prospects.

In the next section, we present a case study of how Australia has managed its economy. Although its economy is more mature than most others in the region, its good track record of maintaining growth through the multiple crises of the past two decades provides good lessons in economic policy housekeeping which could be valuable for all geographies.

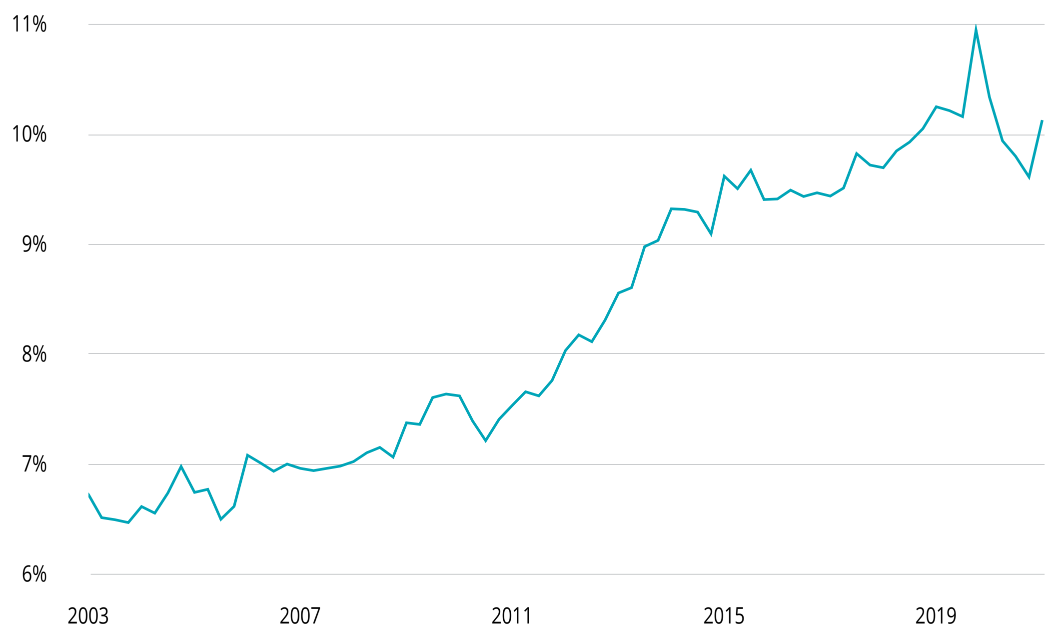
Riders on the storm: How will the Asia Pacific region perform amid elevated global volatility?

Lessons on economic housekeeping

THE WORLD is more volatile than it used to be. That's true of our economies, politics, international relations, technologies, our weather, and even the risks to our health. So how will economies in the Asia Pacific region fare in this more volatile climate? And, in particular, is a more volatile world even more dangerous for the resource-dependent nations in this region? After all, a well-diversified economy is an obvious defence against greater volatility and uncertainty, but some countries are less well diversified than others. Australia is a good case in point here.

Figure 6:

Mining as a share of the Australian economy (%)



Source: Deloitte Economics

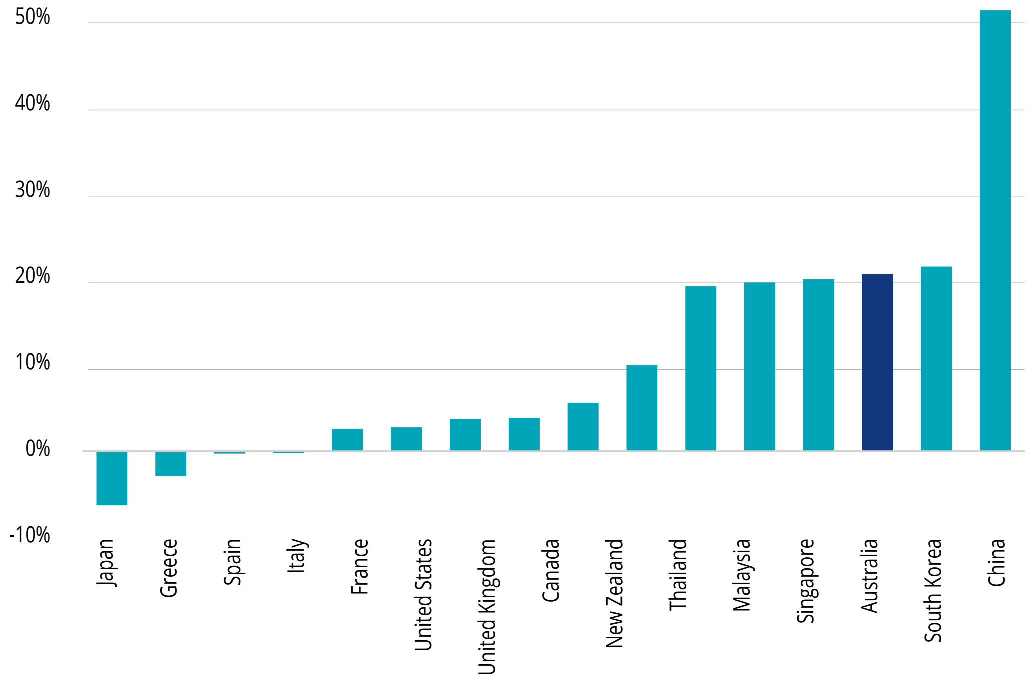
Indeed, as Figure 6 shows, mining has accounted for a rapidly rising share of the economy since the turn of the century. That says Australia's economy hasn't been diversifying its risks. It's been concentrating them. (Note that the recent swings in mining's share of the economy have been because the pandemic affected the rest of the economy much more than it affected mining.)

Does that spell trouble? The good news is that the global trend towards volatility has been increasingly entrenched for a decade and a half now, and there's no sign right now at least that Australia's resilience has been fading. Indeed, the nation has something of a global reputation for successfully rising to the challenge when the chips are down. Perhaps the most frequently quoted description of Australia harks all the way back to 1986, when The Economist wrote that, "If you look at history, Australia is one of the best managers of adversity the world has seen – and the worst manager of prosperity".

Yet the global rise of volatility implies a corresponding rise in adversity, suggesting that troubled times actually play to Australia's strengths. And the evidence since that line was first penned in The Economist more than a third of a century ago tends to back that up. After all, Australia was a relative outperformer in the financial crisis of 2008 to 2010. By 2010, as shown in Figure 7, its economy had comfortably shrugged off the pain of the financial shocks of 2008 and 2009.

Figure 7:

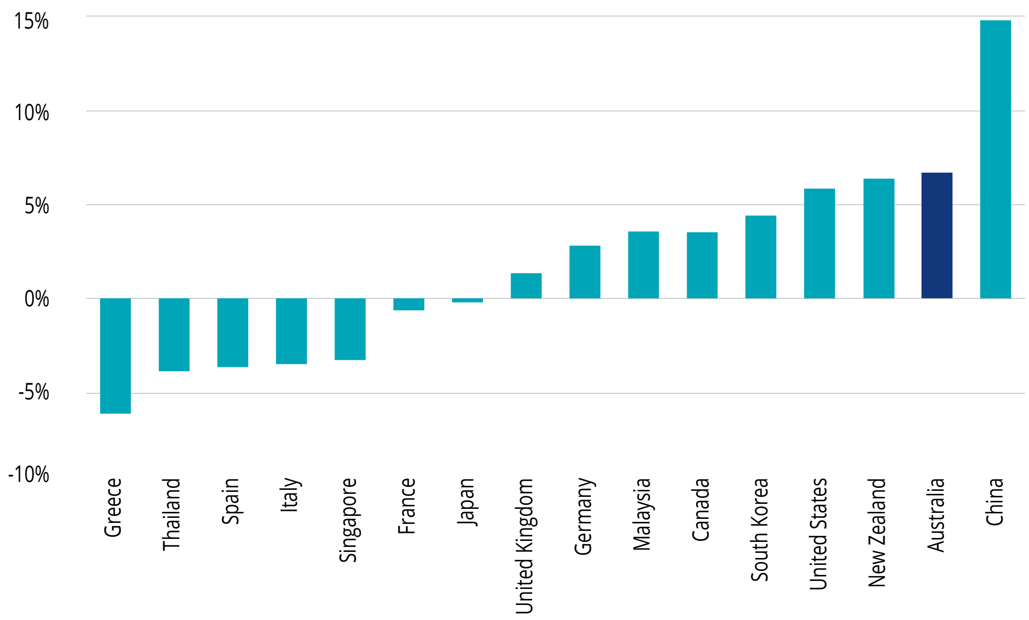
Nominal GDP by country, 2010 vs. 2007 (%)



Source: IMF

Figure 8:

Nominal GDP by country, 2021 vs. 2019 (%)



Source: IMF, Deloitte Economics

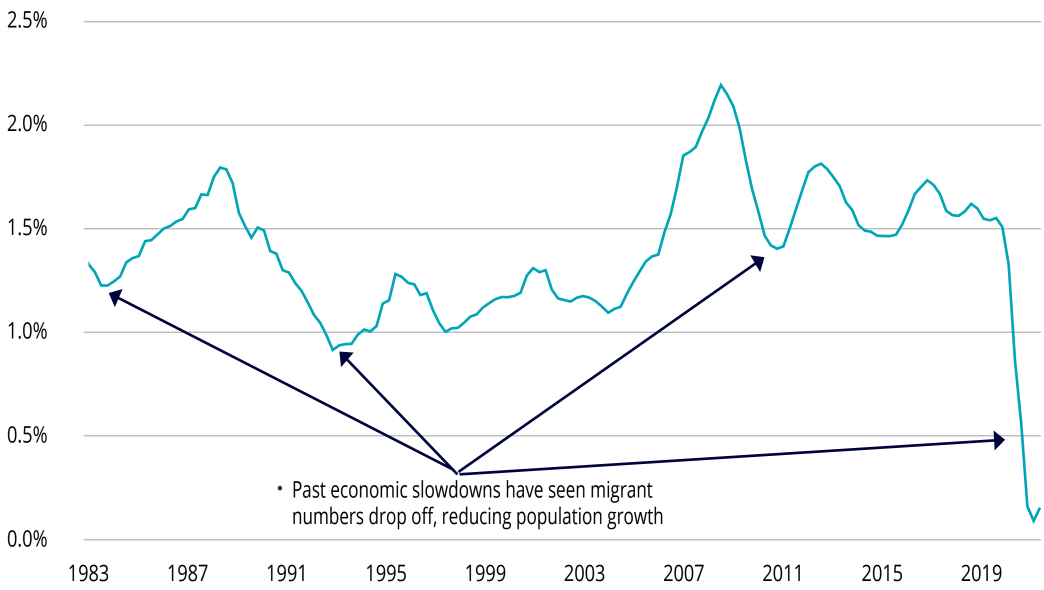
So far, Australia looks like it is once again outperforming during the current challenges wrought by the pandemic. That says that, in two very different shocks – a financial crisis and a pandemic – Australia handled itself relatively successfully. That isn't a coincidence, because although Australia's economy is more susceptible to risks than most, it also has better defenses.

First, and perhaps most obviously, the ups and downs of the Australian dollar absorb much of the pressure from shocks. The Australian dollar dropped to a low of US$0.48 in late 2008 amid the woes of the financial crash, and it similarly dropped to US$0.56 in March 2020 as the world woke up to the dangers of COVID-19. In both cases, that reduced a lot of the pain from global downturns, with the rapid improvement in currency competitiveness a big plus for many businesses. Perhaps that shouldn't be a surprise. The country is small in global economic terms, but the Australian dollar is the world's fifth most traded currency.

It also isn't just the currency that leaps to the defense of the economy in times of trouble. Australia has another ace up its sleeve: people power. Very unusually for a developed economy, Australia has seen a prolonged period of relatively rapid population growth. In a typical year, two-thirds of the increase in its population is due to net migration, which in turn also allows Australia to swiftly hunker down in times of crisis. As shown in Figure 9, population growth in Australia typically drops away when the economy is weak. For example, growth in the population eased back in the recessions of the early 1980s and early 1990s, and it did so once again in 2009 and 2010 amid the global financial crisis. The most spectacular downturn is evident right now, with Australian population growth at a standstill for the first time in over a century. That rapid change in people power helps the local labor market quickly adjust to the changing circumstances it is faced with.

Figure 9:

Australian population grow, year-on-year (%)



Source: Deloitte Economics

Lastly, Australia's well-developed and effective institutions also enable it to better weather periods of crises. For example its central bank is well regarded globally, as is the national finance ministry and the wider civil service. Its media is loud and independent, and although Australian politics is robust, the successful crisis fighting abilities of both sides of politics have been on display. Notably, the side of politics in power today were in opposition during the global financial crisis, meaning that both sides can point to their crisis management credentials. Institutional strength has always been a key asset, and chances are that it will be even more needed in the volatile times that the world faces in the months and years ahead.

It should also be noted that resilience amid turbulence isn't something that applies solely to Australia alone. A glance back at some of the charts in this article serves as a reminder that each of China, New Zealand, South Korea and Malaysia all outperformed the world in both the global financial crisis and also, at least at the time of writing, the pandemic. There will be differing contributory characteristics to the resilience widely in evidence across the nations of the Asia Pacific region, and as always, past performance is no guarantee of future success. Yet all signs to date suggest that, even in a world of enhanced volatility and risk, the Asia Pacific region looks set to remain both well-managed and well-placed.

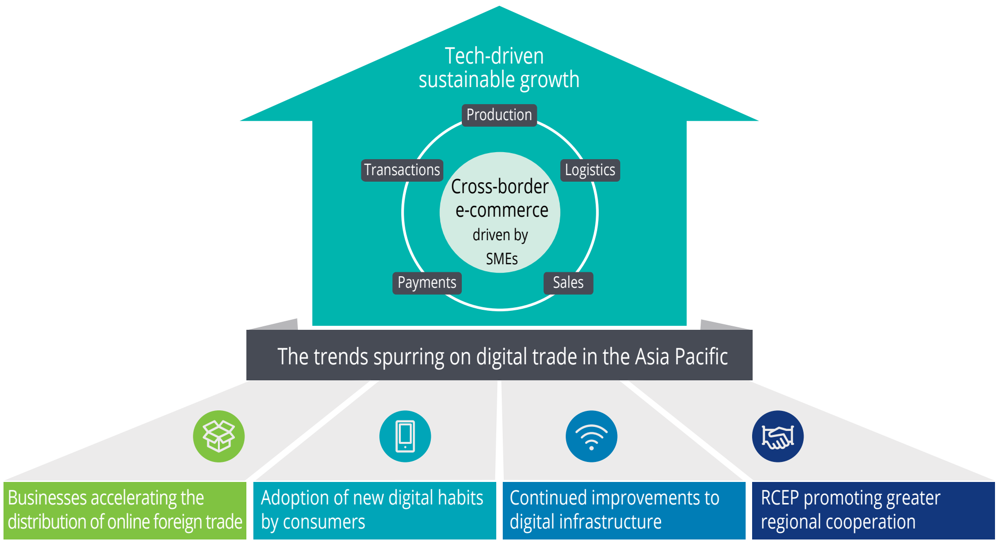
How technology is empowering digital trade in the Asia Pacific

A new digital trading ecosystem has emerged in the Asia Pacific

THE MOST ADVANCED economies in the Asia Pacific are currently thriving in a new era of digital cross-border trade. This follows on from two previous eras of global trade: the traditional era characterized by the cross-border trade of final products for production and consumption, and then a period marked by global value chains whereby deepened globalization led firms to minimize production costs and disperse production across countries, bringing about greater levels of trade in intermediate products and services. Now, a new era of digital trade has taken root in the Asia Pacific. This is being driven by the accelerated development of digital technologies such as artificial intelligence (AI), cloud and big data. These are playing an increasingly important role in both cross-border e-commerce and in the trade of digital products (e.g., audio, software) and digital services (e.g., IT services, online healthcare).

Figure 10:

Development opportunities in digital trade in the Asia Pacific



Source: Deloitte Research

With the advent of COVID-19, advancements in digital technologies and enhanced regional cooperation, the formation of digital trade networks has accelerated in the Asia Pacific region. This is being driven by four pivotal forces:

First, businesses have increasingly turned to online distribution channels in their trading activities. Under the lingering presence of COVID-19, companies globally have been forced to reckon with abandoned offline sites, cash flow challenges and sharp drops in orders, which have pushed many into bankruptcy and permanent closure. Such challenges have served as a necessary impetus for businesses to move towards online models of trade. Regional economies with already mature e-commerce business services will be able to tap into their first-mover advantage and dominate the growth of e-commerce, while businesses with both online and offline channels will increasingly shift their strategy towards e-commerce platforms. Countries with a relatively basic level of e-commerce infrastructure, by contrast, will rely more on regional e-commerce platforms to participate in cross-border digital trade at a lower cost. At the same time, businesses from these regions can apply lessons learnt from countries with more advanced e-commerce networks to promote the application of digital technology.

- **Shifting patterns of digital behavior by consumers during the pandemic are also accentuating the rapid development of regional e-commerce markets.** Improvements in IT and communications, the ubiquitous popularity of smart phones and advances in regional logistics networks before the pandemic together set the stage for the strong growth of e-commerce. Now in the era of COVID-19, the sudden acceleration of digital habits by online consumers formed during home isolation has spurred an increased reliance on e-commerce, rapid penetration of digital payments, rising use of digital entertainment, and explosive growth in the "homebound economy" during the pandemic.

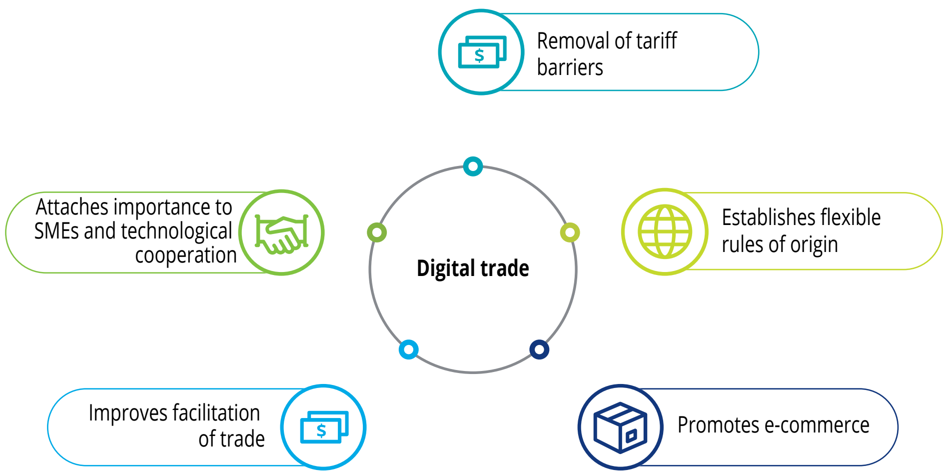
- **The Asia Pacific enjoys some of the world's most sophisticated digital infrastructure which continues to provide new growth opportunities for businesses in the region.** Policies and reforms to develop the digital economy in areas such as AI, big data and cloud, blockchain and internet penetration have ushered in new business opportunities, particularly in cross-border digital trade. Small- and medium-sized enterprises (SMEs) especially have been beneficiaries of developments to digital platforms and new tools that allow them to meet evolving consumer demands and connect directly with buyers and sellers. Improvements to digital infrastructure have also brought about lower costs to accessing information, reducing barriers to trade and utilizing idle assets to minimize production and distribution expenses. This is creating new business models and economic opportunities. In 2019, Asia accounted for 48% of global business-to-consumer revenues from digital platforms, and as businesses and governments continue to invest in digital infrastructure, this is likely to be followed by higher growth and more users. Digital platforms will also help to improve supply chain efficiency, bringing about a global network of shipping corridors that connect ports and terminals, customs, shipping lines, third party logistics and inland transport.

Similarly, digital infrastructure platforms have also transformed the nature of financial payments in cross-border trade. This has occurred through three stages of development. Phase One is dominated by basic payment channels with high service fees and relatively little choice or competition. Phase Two then saw the rise of companies providing domestic cross-border payment services, leading to lower transaction costs and payment licenses adopting industry standards. As the payments ecosystem enters Phase Three, the central element of competition moves away from just the transaction rate towards providing differentiated value-added services and one-stop cross-border trade solutions. This phase will be won by the market players that can really improve efficiency in cross-border trade, better meet the needs of cross-border sellers, and seize new areas of competitive advantage. Blockchain technology will be critical in this phase to breaking down the current restrictions of traditional cross-border payment methods.

- **Lastly, regional policies will further promote trade and technology cooperation across the Asia Pacific.** The signing of RCEP in November 2020 brought about the world's largest free trade area in terms of population, economic scale and potential for further development, and will set the direction of travel for digital trade across the region in the years to come. Once RCEP takes effect, over 90% of regional trade in goods will be tariff-free, with the goal of eliminating all tariffs within 10 years. This will no doubt significantly lower export costs and product prices, and is expected to lead to further growth in cross-border e-commerce. RCEP establishes flexible rules of origin for exporters and comprehensive rules on digital trade, while also offering specific support to SMEs to benefit from the regional FTA. The agreement's rules on customs procedures and trade facilitation are also more comprehensive in terms of facilitating and promoting the application of digital technology.

Figure 11:

Five ways in which RCEP promotes digital trade across the region



Source: Deloitte Research

- Digital trade plays a valuable role in lowering the barriers to entry in global trade, allowing SMEs to compete globally through cost reductions, selling their products in new overseas markets and carrying out cross-border procurement through regional e-commerce platforms. The support offered by e-commerce platforms means that SMEs also benefit from digital trade through a reduced risk in procurement and sales. But while SMEs are major beneficiaries of digital trade, they also contribute to its overall development. Unlike larger multinationals, the flexibility of SMEs allows them to quickly adjust to changes in short-term market demand, thereby ensuring the continued alignment of digital trade with market demand.

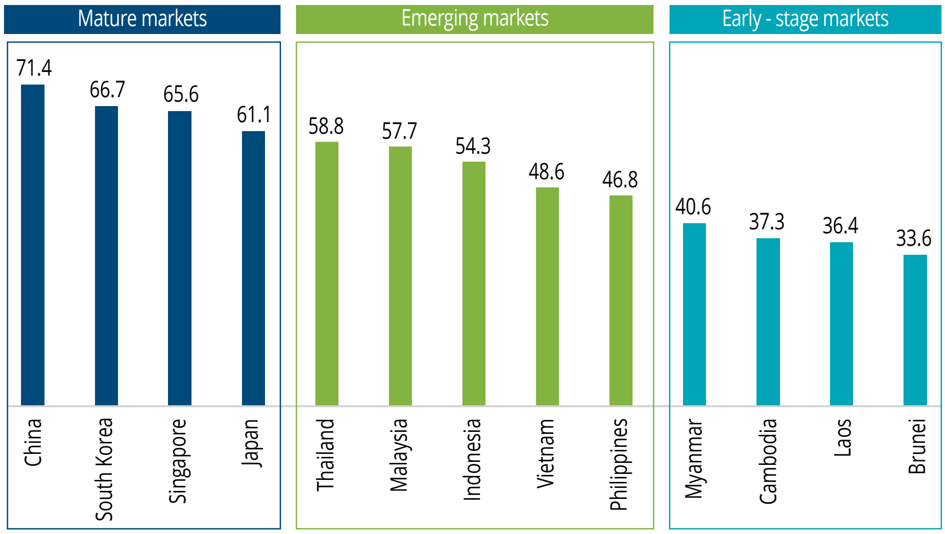
- In recent years, green and sustainable development have risen to prominence in the Asia Pacific. Regional economies such as China, Japan and South Korea have each issued carbon neutrality targets, and two-thirds of RCEP members have submitted Nationally Determined Contributions (NDCs) under the Paris Agreement. Digital technologies will play a vital role in this green transition, particularly as businesses adapt to the evolving demands and habits of more climate-conscious consumers. As income levels continue to rise in the region, stronger consumer purchasing power will translate into higher demand for green products and packaging – a trend that businesses will be quick to cater to with more environmentally-friendly products delivered through e-commerce channels. Such platforms are increasingly looking for ways in which they can save waste and encourage sustainable development, for example, through green supply chain management methods and by utilizing cloud computing, big data and AI technologies to reduce logistics costs and energy consumption.

Stages of digital trade in the Asia Pacific

ACCORDING TO a metrics system developed by Deloitte Research which measures the advancement of digital trade in the Asia Pacific, we have divided countries into three segments that characterize their respective stages of development with regards to digital trade: mature markets, developing markets and early-stage markets. This takes into account their capabilities in cross-border e-commerce and digitalization, drawing on indicators such as e-commerce penetration rate and level of consumption, network speed, internet penetration, and per capita volume of electronic payment transactions.

Figure 12:

Level of development in digital trade by country



Source: Deloitte Research

Mature markets, including China, South Korea, Singapore and Japan, are the most advanced in terms of both e-commerce and digitalization. China enjoys particular advantages in e-commerce owing to its vast scale as well as its high rate of internet penetration. By contrast, while the overall market size in Singapore is relatively small, cross-border e-commerce accounts for a high proportion of its overall e-commerce industry. In Japan and South Korea, however, this proportion is much smaller, but the overall e-commerce market in both countries is nonetheless mature with high rates of internet penetration. In the future, stronger consumer purchasing power and more developed supply chain foundations around e-commerce, combined with faster network speeds and widespread use of electronic payments, will ensure the continued growth of e-commerce as it becomes even more efficient, convenient and safer for consumers in these markets.

Despite the limited maturity of digitalization in developing markets including Thailand, Malaysia, Indonesia, Vietnam and the Philippines, e-commerce networks in these countries are actually relatively sophisticated. The e-commerce markets of Malaysia and the Philippines are expected to lead the region in terms of growth in the future, and Thailand has a high rate of cross-border e-commerce penetration. Further growth of e-commerce in these countries will indeed provide considerable potential for greater consumption from digital trade in the RCEP region. However, there is still room for improvement around internet infrastructure. This will release the untapped potential of e-commerce platforms by promoting the efficiency of information exchange, while also narrowing the gap between electronic payment applications in developing and mature markets which currently restricts the regional expansion of digital trade.

Economies such as Myanmar, Laos, Brunei and Cambodia make up the early-stage markets. In these countries, transportation and logistics remain somewhat undeveloped, and they still have a long way to go to in establishing a strong market for cross-border e-commerce. Myanmar and Laos at least though are expected to report double-digit growth in cross-border e-commerce transactions in the coming year. The level of digitalization also remains low in these markets, given the lack of established infrastructure and platforms to spur the development of the digital industry. Additionally, the level of electronic payment transactions per capita is extremely low, and an environment for online payments has not yet emerged.

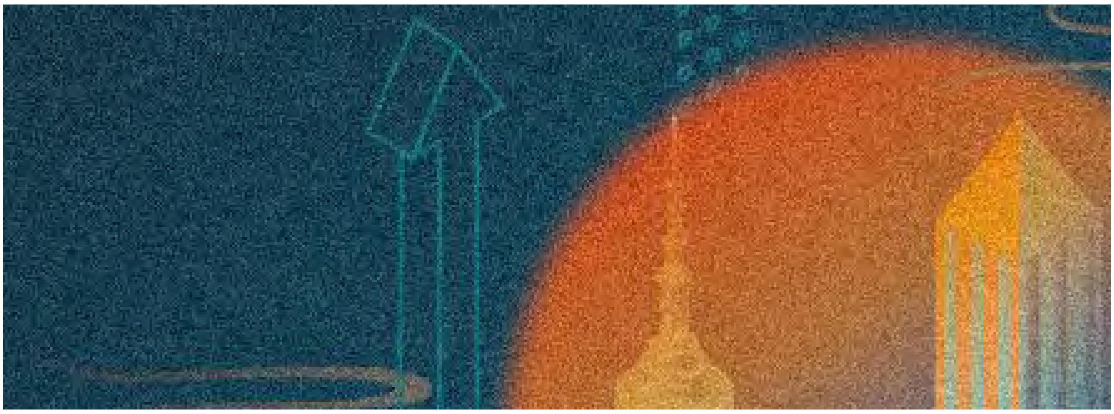
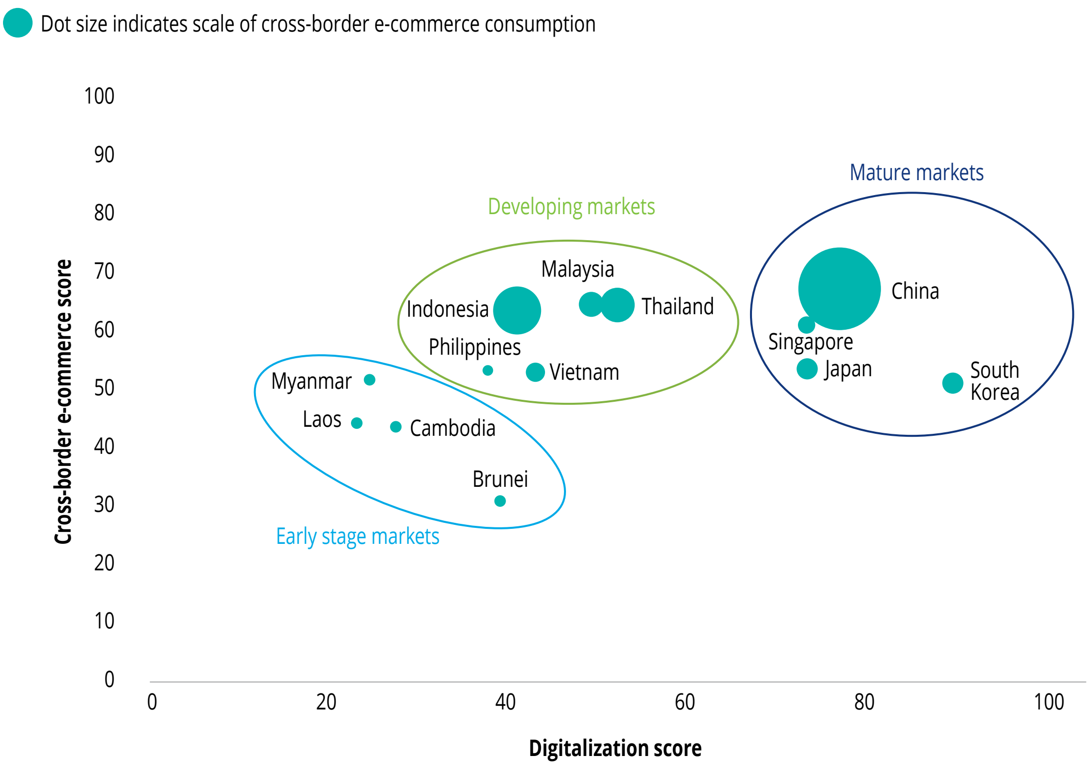


Figure 13:

Level of development in cross-border e-commerce and digitalization by market



Source: Deloitte Research

Country analysis

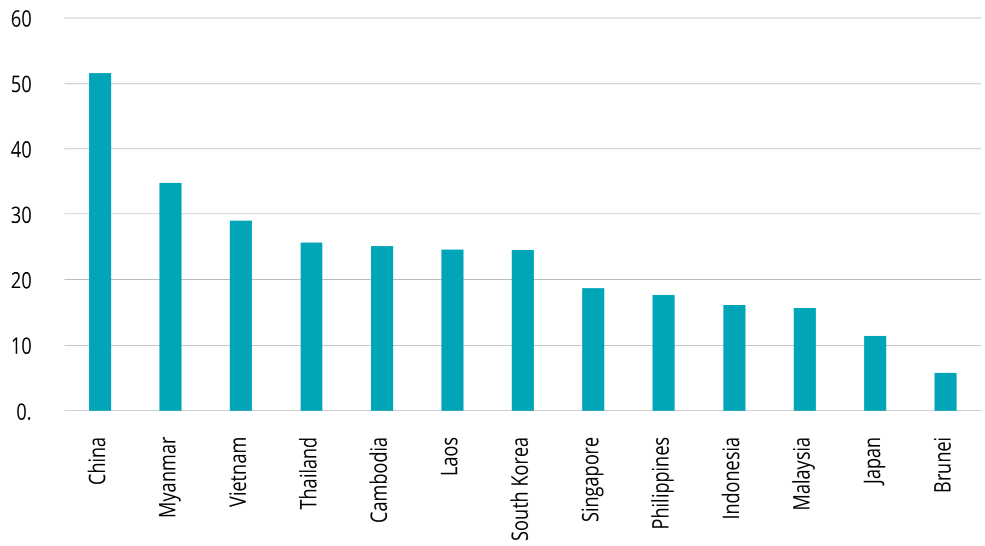
SEVERAL regional economies standout among the pack as leaders in digital trade. Below, we present a short snapshot of the most important players in Asia's digital trading landscape.

Singapore – Despite its small size, Singapore punches far above its weight as a transit point for international trade, a global aviation hub and the financial center of Southeast Asia. The city state boasts the largest foreign exchange market in the Asia Pacific, the highest per capita income in the region and is the Asia Pacific headquarters of most Fortune 500 businesses. The Singaporean government is now actively promoting digital trade and has recently issued the Digital Economy Agreement (DEA), which establishes digital trade rules and builds a framework for cooperation. The DEA will enable Singaporean companies to more seamlessly connect with overseas partners in digital trade, while also reducing their operating costs, improving their business processing efficiency and making it easier for companies to gain access to overseas markets. A significant focus of this agreement is dedicated towards AI, data protection, data innovation, networks for national electronic invoices and the digital transformation of SMEs. Furthermore, adept forward planning by the government has positioned Singapore as the regional headquarters for the world's most dynamic e-commerce platforms including the likes of Shopee, Amazon and Zalora. Singapore's e-commerce market is expected to double in size by 2025 on 2020 levels, reaching US$8 billion.

China – The digital economy has become a powerful engine of China's growth, paving the way for the rapid development of the country's e-commerce landscape. In recent years, China has passed legislation to promote the large-scale development of B2B cross-border e-commerce and effectively fill the demand gap in overseas demand. As investment into cloud platforms also increases, China's digital platform infrastructure will continue to accelerate, further strengthening the overall cross-border services environment and supporting the sustained growth of cross-border B2B trade through new digital trade platforms. China also leads the world in the development of 5G, and growth in electronic payment systems has boomed. In 2020, per capita electronic payment transaction narrowly topped US$2000, ranking second only to South Korea among RCEP countries. As a critical component of digital trade, the rapid development of electronic payment systems in China will have profound implications for the overall security and convenience of digital trade, not least in cross-border e-commerce. China's e-commerce market is currently worth US$1.5 billion, the largest among RCEP members, with B2B accounting for 73% of the overall cross-border e-commerce market. Despite the shadow of the pandemic looming over the global economy, China's B2B cross-border e-commerce imports and exports have boomed, with North America and Europe accounting for the bulk of exports.

Figure 14:

Per capita volume of electronic payment transactions (US$)



Source: Singapore Ministry of Trade and Industry; Statista; Deloitte Research

South Korea – With world-leading digital infrastructure, South Korea enjoys favorable development prospects in cross-border e-commerce. The country's advanced level of digital infrastructure development can be largely attributed to government support, and South Korea now boasts the region's highest rate of internet penetration at 96%. Starting in the mid-1990s, the authorities set to work constructing a national broadband network, while at the same time, utilizing more sophisticated digital technology to establish e-government platforms in order to better serve the public. To maintain its leading position in mobile and fixed broadband internet speeds, South Korea will invest heavily in 5G mobile communications, bringing about further development in electronic payments and cross-border e-commerce. As such, the total value of electronic payment transactions is expected to grow by 8.2% between 2021 and 2025. Cooperation and participation with other advanced countries and organizations on e-commerce has also been a particular government focus. The South Korean authorities launched the Asian Internet Market (eAMP) plan, which aims to use e-commerce infrastructure to connect overseas businesses and establish South Korea as a network hub for cross-border trade in Asia.

Japan – Strong logistics skills and advanced digital economy infrastructure have helped to propel Japan's cross-border trade, but the development of the country's electronic payments industry has not kept pace. The cost benefit of Japan's information and digital economy infrastructure is expected to be as high as US$10.1 billion in 2021, second only to China, and the construction of effective networks has helped to stimulate the competitiveness of Japan's e-commerce market. However, Japan continues to face numerous challenges, particularly in slow internet speeds by the standards of mature markets, as well as a tepid pace of development in the electronic payments industry.

This is primarily down to an aging population that prefers to pay with cash (e-wallet payment methods are estimated to account for only 7% of domestic market share). Japan's cross-border e-commerce market equally remains relatively closed, partly owing to language barriers in cross-border trade and disjointed connections with third-party platforms. Japan's advanced logistics technology does at least provide a strong safeguard for cross-border digital trade. Furthermore, as part of the government's Green Growth Strategy which aims to help the country achieve carbon neutrality by 2050, green economic development through regional trade will be promoted, particularly in clean energies such as offshore wind and hydrogen.

Malaysia – The size of Malaysia's e-commerce market has seen swift development in recent years and continues to show encouraging signs of sustained growth. This year, the e-commerce market in Malaysia will reach a value of more than US$6 million, and its compound growth rate is expected to be as high as 14.8%, the highest among all RCEP countries. However, the penetration rate of e-commerce lags behind significantly at just 44%, although improvements to internet infrastructure and the network user penetration rate are expected to bring about a further increase in the number of e-commerce users. Green development and ESG are also gaining ground in Malaysia, with the government actively promoting the use of renewable and efficient energy. Despite these efforts, carbon emissions still remain relatively high due to the economy's reliance on traditional industries, accentuating the need for Malaysia to promote the development of digital trade and the country's industrial upgrading. Environmental standards around trade also need to be further improved which remain low by regional levels.

Indonesia – With a huge population and a vast e-commerce market, the future potential of cross-border e-commerce in Indonesia is certainly favorable. At US$43 billion, the total size of the country's e-commerce market ranks fourth behind China, Japan and South Korea, and is expected to grow by 10.2% between 2021 and 2025. At the same time, the proportion of Indonesia's e-commerce consumption via cross-border channels is also high among developing markets. Cross-border e-commerce is expected to become an important part of the country's economy, benefiting significantly from the prevalence of social media domestically, with many consumers preferring to purchase goods on online platforms such as Facebook and Instagram, as well as using messaging apps such as LINE and WhatsApp to communicate directly with traders. Indonesian consumers also prefer to buy cheaper products on promotion rather than at full price, meaning that competitive pricing is essential for retaining customer loyalty. There is also a strong preference for using e-commerce platforms in local languages, which has a significant influence over shopping experience. However, the current state of logistics continues to hold back cross-border e-commerce, especially due to geographical reasons such as vast land territory and the more than 17,000 islands that compromise Indonesia.

Philippines – There is huge growth potential for e-commerce in the Philippines, but it continues to be constrained by its lagging electronic payments industry. As a country similarly made up of thousands of islands, geographical conditions have held back widespread internet penetration (currently at 67% of the total population) and internet speed. Yet the country's e-commerce market is on the cusp of rapid development, and growth is expected to be as high as 15% in the years up until 2025, despite only being used by 39% of the population currently. The use of digital payments is also on the rise, albeit growing from an extremely low base. Per capita electronic payment transactions added up to only US$139 in 2021, constrained by a low usage rate of bank accounts, a heavily cash-based society and concerns about the security of electronic payments.

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