Economic Snapshot for East & South Asia

July 18, 2018

Potential escalation of trade war between China and the U.S. threatens ESA's solid growth trajectory

The East and South Asian (ESA) economies continue to defy any threat of a sharp economic slowdown and preliminary data for Q2 suggests that the region's stellar growth trajectory was broadly steady. Benign inflation figures and large foreign reserves allowed central banks to maintain relatively accommodative monetary policies despite the ongoing monetary tightening in the United States. Moreover, subdued inflation boosted household spending in a context of tight labor markets. While the global trade cycle peaked in Q1, export growth was still robust in Q2, fueling factory work in the region. An early GDP growth estimate for the region shows that ESA countries expanded an aggregated 6.3% annually in Q2. While the print was a notch below the 6.4% increase in Q1, it was above last month's forecast of 6.2% growth for the quarter.

China was the sole country to report GDP figures for Q2 this month and data showed that growth moderated slightly, reflecting financial deleveraging and authorities' bold efforts to contain shadow banking. Household consumption supported economic growth on the back of low unemployment and sustained increases in real wages.

While GDP growth was robust in Q2, some leading data from the quarter suggests that the region will post a weaker expansion in the second half of the year. The Q2 round of manufacturing PMI readings signals that global growth is stalling. New export orders had moderated in most of the countries in the region even before the enactment of large-scale trade tariffs by the U.S. against China, suggesting that underlying global demand is softening. In this regard, export dynamics clearly worsened in June compared to the previous two months. Given that there are still no signs of a recovery in global demand, and oil prices remain high, the external sector will likely detract from growth in the coming quarters.

On the political side, what was once seen as just the possibility of a full-blown trade war between China and the United States is now becoming a reality. In early July the U.S. implemented 25% tariffs on USD 34 billion of Chinese imports, provoking an immediate retaliation from China. There is still a second round of U.S. and Chinese tariffs on USD 32 billion in bilateral trade set to come into effect in the coming weeks, and U.S. President Trump has put an additional USD 200 billion of Chinese goods under review and pledged to raise that to USD 500 billion if China continues to retaliate. Chinese authorities stated that they will use "quantitative and qualitative" measures, including higher tariffs or investment restrictions, should the country run out of U.S. imports. China imported goods worth around USD 150 billion from the U.S. in 2017, while it shipped goods valued at around USD 450 billion to the U.S., according to China Customs.

The impact of the tariffs that have been enacted is expected to be limited as it will shave just up to 0.2 percentage points off China's GDP for this year, while supply chains in the region will not be disrupted. Should the conflict escalate further and affect not just a relatively small share of trade between the two countries but also services and even ease of doing business, it would certainly weigh on business sentiment and, therefore, global growth. Against this backdrop, FocusEconomics panelists pencil in a deceleration in Q3, with growth in ESA seen slowing to 6.1%.

See the Full FocusEconomics East & South Asia Report

Q1's strong result continues to prop up 2018 GDP forecast despite trade war fears

Although ESA's economic outlook was stable this month, risks have clearly shifted to the downside and downward revisions to growth projections are expected. Rising trade protectionism globally and the gradual end of the global trade cycle will likely weigh on the region, given its deep integration within the global supply chain. Moreover, growth among key global players that have solid economic ties with the region, including the European Union and China itself, is decelerating, further reducing global demand. On the upside, growth in the United States is expected to remain robust in the coming quarters, adding some support to global demand. The faster-than-expected U.S. monetary tightening cycle is threatening to unnerve investors in the region and lead to capital flight, putting the stability of both financial markets and currencies at risk. Another important factor is that oil prices remain elevated despite some volatility and this is inflating import bills in the region, reducing the external sector's contribution to overall growth.

FocusEconomics panelists expect the ESA economy to expand 6.2% in 2018, which is unchanged from last month's estimate. Reflecting slower growth in China and mounting global economic uncertainties, regional growth for 2019 is seen slowing to 6.0%.

This month's stable outlook reflects unchanged growth prospects for regional heavyweights China, India, Korea and Taiwan. Sri Lanka also saw no change to its forecast. Solid growth in Q1 led analysts to upgrade their views on Hong Kong's and Mongolia's economies. Advance government estimates put growth in Bangladesh and Pakistan at multi-year highs in Fiscal Year 2018, which ended in June.

Bangladesh is expected to be the region's top performer this year, if preliminary estimates are confirmed, followed by India. Despite the brewing trade war with the U.S., the Chinese economy is expected to expand a solid 6.5%. The more mature economies of Korea and Taiwan will post the weakest growth rates but they will still come in at between 2.5-3.0%.

CHINA | Economic activity softens in Q2 ahead of escalating trade tariffs

Authorities' efforts to curb shadow banking and support financial deleveraging weighed on growth in Q2 amid rising trade tensions with the United States. On 6 July, the United States imposed tariffs on USD 34 billion worth of Chinese imports. China immediately retaliated with corresponding tariffs. On 11 July, President Trump's administration released a list of 10% tariffs on an additional USD 200 billion of Chinese goods likely to be enforced in two months. Chinese officials stated that the country will take unspecified measures to counter this threat, which could include non-tariff barriers, as China imports only around 150 billion from the U.S. The actual impact of ongoing trade disputes with the United States will start to be seen this month, especially in manufacturing activities and logistics.

Global and domestic headwinds are expected to impact growth in H2 and beyond. The brewing full-blown trade war between China and the United States is the main downside risk to the country's economic outlook. Domestic threats, however, including a cooling property market and financial deleveraging, are also building. FocusEconomics panelists forecast the economy will grow 6.5% in 2018, which is unchanged from last month's forecast. In 2019, the economy is seen expanding 6.3%.

See the Full FocusEconomics East & South Asia Report

INDIA | Robust growth momentum in January–March appears to have carried into April-June

The economy appears well positioned for FY 2018, which started in April, after the highest GDP growth in seven quarters was recorded in the January–March period. In June, business activity in the private sector increased for the fourth consecutive month, and at the fastest pace since October 2016. The manufacturing and service sectors both benefited from a substantial increase in output thanks to broad-based demand. Moreover, in May, industrial production expanded at a healthy pace. On 4 July, the government approved an increase in the minimum support prices paid to farmers growing summer-sown crops this year. The increase should provide farmers with a profit of 50% over the cost of crop production. This should come as welcome news to farmers, after rainfall was below-average in June, the first month of the important June–September monsoon season.

A normalization in cash conditions following the demonetization of late 2016 and the fading of disruptions from last year's launch of the Goods and Services Tax should facilitate the economic recovery in FY 2018. Nonetheless, risks of fiscal slippage in the run-up to elections next year, concerns over India's banking sector, increasing global trade tensions and higher oil prices all cloud prospects. Our panel expects GDP growth of 7.3% in FY 2018, which is unchanged from last month's estimate, and 7.5% in FY 2019.

KOREA | Leading indicators point to a moderation in growth following solid performance in Q1

The economy's performance has been solid in recent months, following robust GDP growth in the first quarter, although there appear to be warning signs. Through to June of this year, economic confidence among consumers has remained in optimistic territory, underpinned by positive outlooks regarding income, spending and living standards. However, optimism hit its lowest point in over a year in June. Moreover, in the same month, business activity in the manufacturing sector decreased for the fourth consecutive month, according to survey data. Meanwhile, local elections were held on 13 June, which boosted President Moon Jae-In's political standing. His party won 11 out of the 12 National Assembly seats in the by-elections, and 14 out of the 17 races for mayor or governor. Although Moon Jae-In will still head a minority government, this result will help his political and economic agenda progress, which includes taming conglomerate power over business and improving labor conditions.

Increased government spending, together with the possibility of reduced geopolitical tensions on the Korean peninsula, should support economic activity in 2018. However, elevated household debt, government measures to tame housing prices, rising global trade tensions, higher oil prices and signs of a slowdown in China all represent downside risks. FocusEconomics panelists forecast the economy will grow 2.9% this year, which is unchanged from last month's forecast, and 2.8% in 2019.

INFLATION | Higher energy prices boost inflation in June

Inflation in East and South Asia rose in June following the stable print in May. Regional inflation inched up from May's 2.3% to 2.4% in June, according to an estimate produced by FocusEconomics. The result mostly reflected stronger price pressures in regional behemoths China and India. Inflation also rose in Pakistan and Sri Lanka. Price pressures, however, waned in Taiwan.

The People's Bank of China decided on 24 June to reduce the reserve requirement ratio (RRR) for some banks by 50 basis points. The move was intended to free up around USD 110 billion in funding for small business in the wake of escalating trade disputes with the U.S. The RRR cut came into force on 5 July, a day before the U.S. implemented new tariffs against the country. Falling inflation, robust growth in Q1 and an uncertain global trade outlook led the Bank of Korea (BoK) to stay pat at the 12 July meeting. Taiwan's central bank also left its key policy rate unchanged at the 21 June meeting, citing similar reasons to the BoK. In an attempt to stabilize the PKR, the State Bank of Pakistan announced on 14 July a hike in its policy rate of 100 basis points, the largest increase in a decade. Moreover, the Bank allowed a greater flexibility of the rupee, prompting the currency to fall sharply on the following trading days.

Higher inflation in the region mostly reflects a rise in prices for oil and coal. Higher commodity prices, along with a general weakening of the regional currencies, will support inflationary pressures through to the end of year. Panelists polled by FocusEconomics project average inflation of 2.6% this year, which is unchanged from last month's estimate. Inflation is expected to average 2.7% in 2019.

See the Full FocusEconomics East & South Asia Report