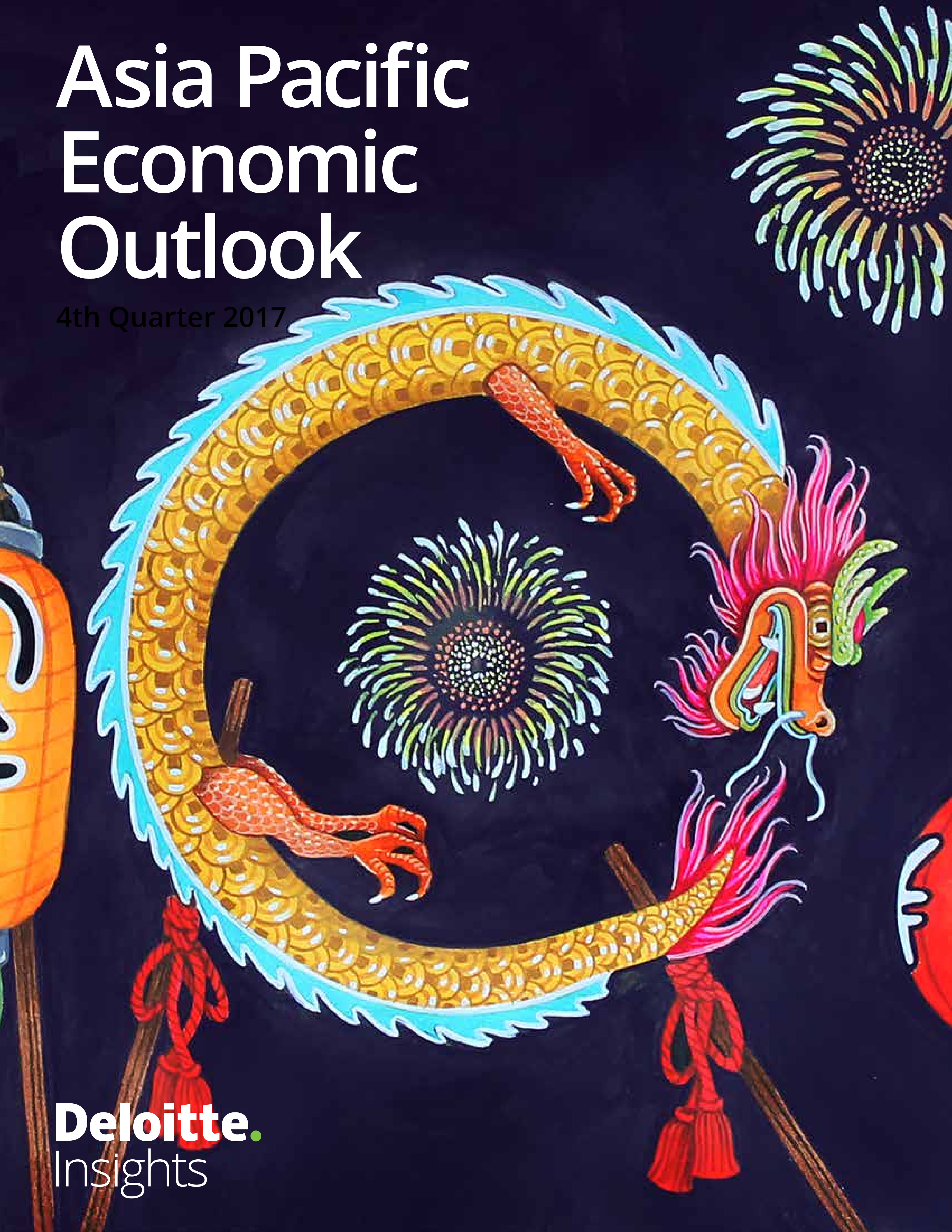
# Asia Pacific Economic Outlook

4th Quarter 2017



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The Malaysian economy registered the fastest growth in two years for two consecutive quarters, due to stronger private spending and exports. While the growth outlook for the economy has been revised up, there are considerable risks, primarily from political uncertainty and the economy's continued dependence on oil exports for its growth and revenue.

# Malaysia

## Pushing the pedal faster through turmoil

By Rumki Majumdar

### Introduction

After starting the year on a firm note with first quarter growth of 5.6 percent, Malaysia posted even stronger growth of 5.8 percent in the second quarter of 2017, beating market expectations of a slight slowdown (Reuters' poll forecast).[1] Backed by strong domestic demand, particularly due to private sector spending, exports, and broad-based expansion across all major sectors, economic growth was the fastest in two years.

Private consumption grew 7.1 percent and private investment grew 7.4 percent annually in Q2 2017. In large part, the unexpected strength was probably because of the government cash handouts and subsidies to low-income households and housing packages to the country's majority ethnic group, which cushioned the fall in total personal income due to weaker wages. On the other hand, improving global conditions and strong demand for electronics boosted exports, which grew strongly for the second consecutive quarter, at a rate of 9.6 percent.

On the supply side, the manufacturing and services sectors performed robustly, registering annual growth of 6.0 percent and 6.3 percent, respectively, in Q2. Double-digit growth in manufacturing product sales and retail trade since February 2017 and an above-20.0 percent growth in goods exports in the last two quarters boosted the manufacturing sector.

Improved asset quality and profitability of financial institutions and favorable funding conditions improved investors' sentiments, which was reflected in reduced volatility in financial market performance. Credit growth remained strong as financing to the private sector, including the housing market, continued to improve.

Headline inflation declined steadily since April, primarily due to lower domestic fuel prices, although core inflation remained relatively stable. This decline is of significance because prices had escalated threefold between December 2016 and March 2017 due to the retraction of subsidies from cooking oil, rising retail prices of fuels, and appreciation of the domestic currency. The steady decline is likely a sign that their effects on prices may now be diminishing.

Spending controls and a modest rebound in global oil prices helped the government contain the fiscal deficit this quarter. At the same time, the current account surplus improved to 3.4 percent of GDP due to a larger goods surplus and smaller services and primary income deficits. Strong economic performance, together with improving fiscal and external balances, led to an improvement in the economy's credit rating.

## Outlook revised up

Following the economy's strong performance, Malaysia's central bank revised its growth forecast for this year from 4.3 percent to above 4.8 percent. Domestic demand is projected to underpin this expansion. On the external front, exports are expected to benefit from the stronger-than-expected improvement in global growth. Headline inflation is expected to moderate further in the second half of 2017, reflecting the waning effect of the factors mentioned above. Inflation is expected to average within the forecast range of 3.0–4.0 percent.

That said, the economy still faces a number of headwinds, most importantly from political uncertainty ahead of elections. Prime Minister Najib Razak tweeted almost immediately after the GDP release and reaffirmation of a stable credit rating: "It is another recognition for the country's economic management."[2] In other words, the prime minister attributed the strong economic performance to his good governance and policy making. There is rising speculation over whether the prime minister will call for early elections to take advantage of strong economic performance and a relatively weak opposition. However, it might not be an easy election for him because of his possible connection to a scandal involving state-owned fund 1Malaysia Development Berhad (1MBD).

> The economy continues to remain heavily dependent on oil exports for its revenue and growth.

The economy continues to remain heavily dependent on oil exports for its revenue and growth. With oil prices expected to remain low for long, Malaysian growth will likely remain highly contingent on external factors such as global demand for oil and supply by US shale gas producers. Foreign direct investment has remained low and volatile in the past several quarters, which may point to low investor confidence in committing to long-term investments in the country, and may impact economic investment in the months ahead.

Private sector spending and exports have been the strongest contributors to growth in the past two quarters. However, the latest monthly data shows some tapering in imports of capital goods, signaling that private investment growth may have slowed down lately. Consumers are expected to continue to spend cautiously as real wages grow modestly and the effects of government handouts wane. Besides, unemployment has steadily increased in the past few quarters and currently hovers around post-global financial crisis highs. This will likely have an impact on consumer demand and may limit growth momentum.

Although strong, Malaysia's exports grew slower in June than in previous months. Gains in shipments of electrical goods and electronics were partly offset by a drop in exports of timber and refined petroleum products, which probably implies that export growth was not broad based. In addition, China is Malaysia's largest trading partner, and a slowdown in China might impact trade growth.

That said, the government is aiming to achieve developed nation status by 2020 through public and private investment, primarily in infrastructure. This will likely result in higher investment in the long run. Malaysia's working-age population is also expected to grow consistently over the forecast horizon, which will likely aid long-term growth.

Gains in shipments of electrical goods and electronics were partly offset by a drop in exports of timber and refined petroleum products, which probably implies that export growth was not broad based.

## ENDNOTES


1. Reuters, "Malaysia second-quarter GDP growth seen slowing on weaker private consumption: Reuters poll," August 15, 2017.
2. Reuters, "Malaysia surprises with 5.8 percent GDP growth, may add to early election talk," August 17, 2017.

Though private consumption growth has moderated, exports have kept up the momentum of GDP growth. Besides, continued government interest in the development of infrastructure translates into an increase in expenditure on public construction.

# The Philippines

## Poised for strong growth again

By Akrur Barua

## Introduction

Recent economic data from the Philippines throws no surprises. The growth momentum has continued in the first two quarters of this year, setting the stage for 6.5–7.0 percent annual GDP growth. The key drivers of growth have, however, changed a bit from last year. Private consumption growth has slowed while the contribution of exports to economic activity has gone up in the last three quarters. From a policy perspective, there appears to be no letup in the development of infrastructure—both soft and hard. Monetary policy has changed to a more cautious stance where central bank officials are keeping an eye on price pressures even as they focus on a data-driven rate path. What has also aided the central bank's position is global markets factoring in three to four rate hikes in the United States this year, thereby offering some predictability to global capital flows.[1]

## Growth was strong in Q2 2017

The economy continued to perform well in Q2, expanding by 6.5 percent year over year, slightly up from a 6.4 percent rise in Q1.[2] As in the previous quarter, exports stood out in Q2 as well, increasing by 19.7 percent. The uptick in exports since late 2016 has come at the right time for the economy as private consumption growth slows to a more moderate pace: Although growth in private consumption was healthy at 5.9 percent, it is lower than the 7.0 percent registered in 2016. The economy also received a boost from government spending in Q2. While government consumption expenditure grew by 7.1 percent, public construction—a reflection of continued focus on infrastructure investments—grew by 12.0 percent during the quarter. The only dampener during the quarter was muted growth in investments. Gross domestic fixed capital formation grew by 9.4 percent in Q2, steadily weakening over the past year. Similarly, growth in spending on durable equipment and private construction also slowed during the quarter (figure 1).

## Much to cheer about exports and remittances

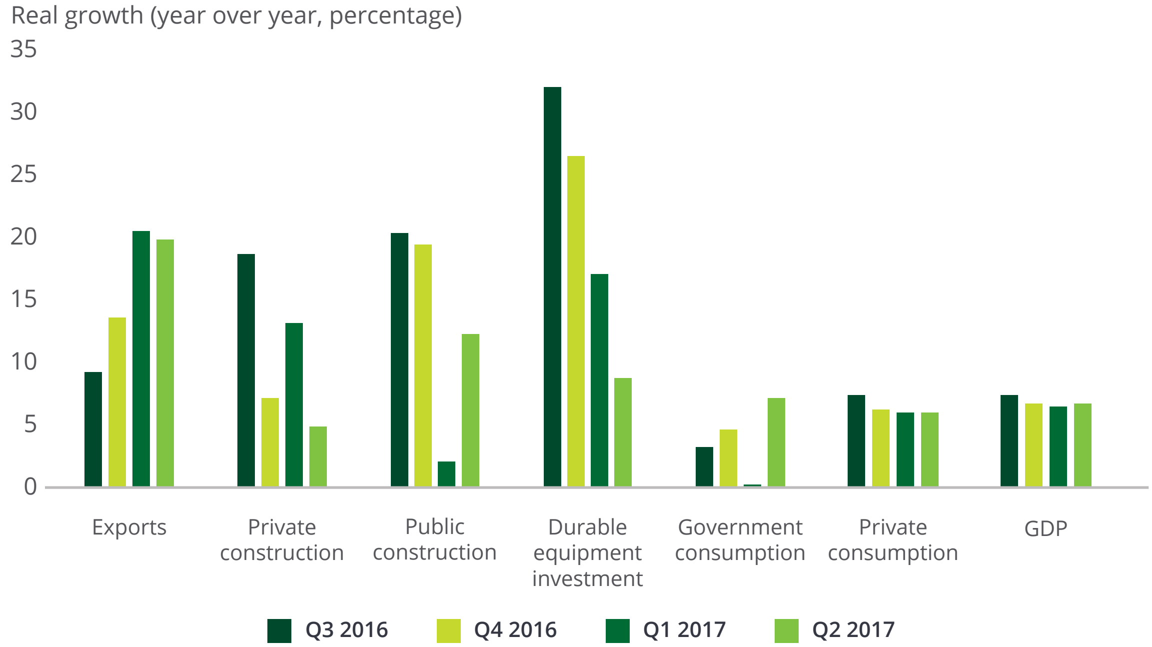
For the economy, there is much to cheer on the external front. Trade is back in the limelight with the value of merchandise exports (in USD) going up in both the first (16.3 percent year over year) and second (11.0 percent) quarters of the year. Although growth slowed in June due to a slowdown in manufacturing exports, this is likely to be a temporary hiccup. The overall outlook for trade is positive, especially given an expected uptick in external demand and higher global growth this year.[3] The pickup in trade comes along with healthy growth in remittances—a key driver of consumer spending growth in the economy. Remittances by overseas Filipino workers went up by 5.7 percent year over year in June, pushing up total remittances in the first six months of the year by 4.7 percent to USD 13.8 billion (figure 2). Like trade, remittances growth is likely to remain strong despite tensions between members of the Gulf Cooperation Council (GCC), a region that accounted for about 27.0 percent of total remittances into the Philippines in 2016.

> The overall outlook for trade is positive, especially given an expected uptick in external demand and higher global growth this year.

## The central bank turns its gaze on inflation

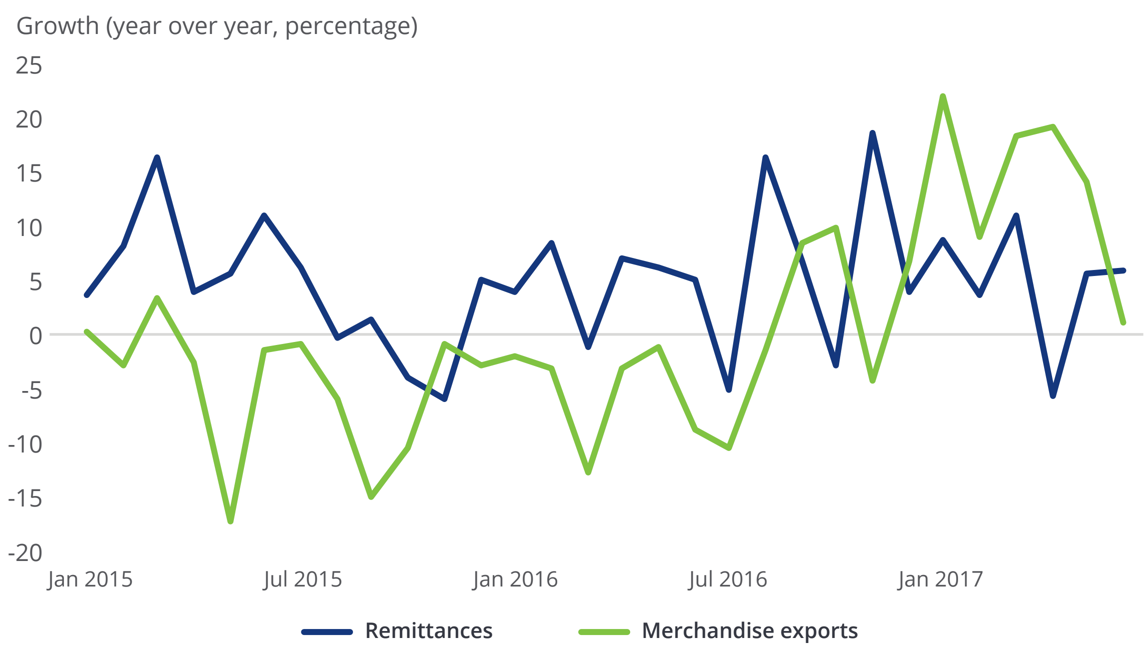
In its August 10 meeting, the Bangko Sentral ng Pilipinas (BSP) kept its key policy rate unchanged, keeping an eye on rising inflation and inflation expectations. In July, inflation moved up to 2.8 percent year over year from 2.7 percent in June; the figure has been flitting around the midpoint of the central bank's target range of 2.0–4.0 percent this year. The uptick in inflation in the last two quarters is due to multiple reasons. First, food and energy prices have been going up, albeit with a slight moderation of late (figure 3). Second, domestic demand has been growing at a fast pace over the past few years—by an average of 9.4 percent year over year in the last 10 quarters—thereby putting upward pressure on core inflation. Third, the peso has weakened against the US dollar since mid-2016 (by 6.9 percent in the 12 months to July 2017), adding to imported inflation. On a positive note, however, the worst of the peso weakening seems to be over as global markets see more clarity in the US Federal Reserve's interest rate path. Finally, with inflation staying low until mid-2016, a low base effect is also playing its part. Given these factors, it is no surprise that BSP raised its inflation forecast for 2017 and 2018 from 3.1 percent and 3.0 percent, respectively, to 3.2 percent.[4] With its focus now on inflation, BSP is not expected to move to an accommodative stance any time soon. Instead, if price pressures increase further and the peso drops sharply due to any external shock, BSP

**Figure 1. GDP growth received a boost from exports and government spending in Q2**



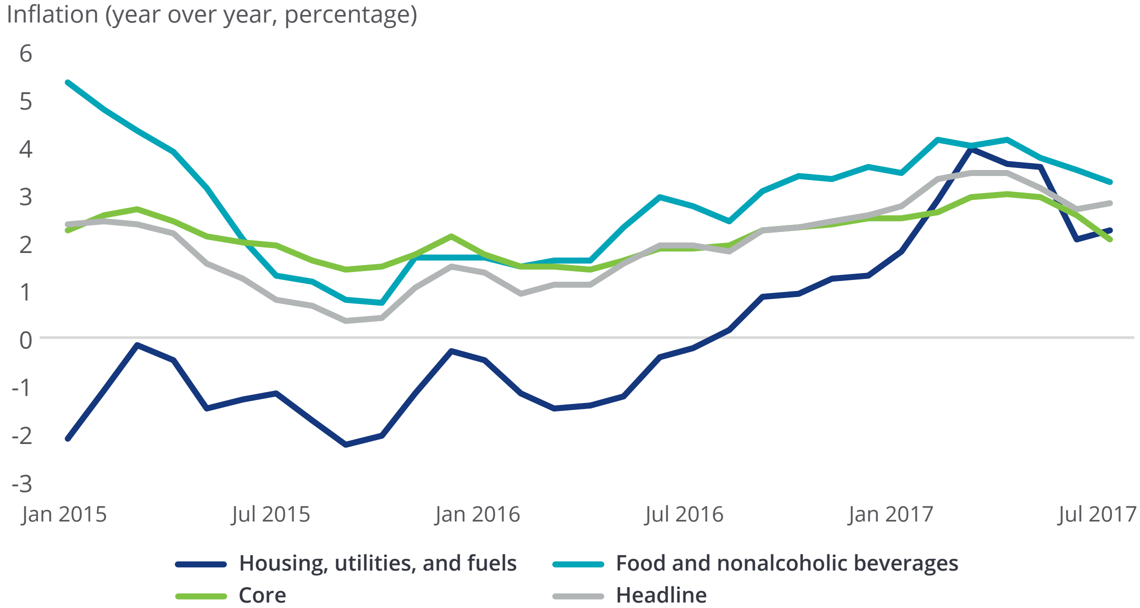

Source: Haver Analytics; Deloitte Services LP economic analysis. **Deloitte Insights | Deloitte.com/insights**

**Figure 2. Exports and remittances will continue to support the economy this year**




Source: Haver Analytics; Deloitte Services LP economic analysis. **Deloitte Insights | Deloitte.com/insights**

**Figure 3. Inflation has been heading up since 2016**




Source: Haver Analytics; Deloitte Services LP economic analysis.

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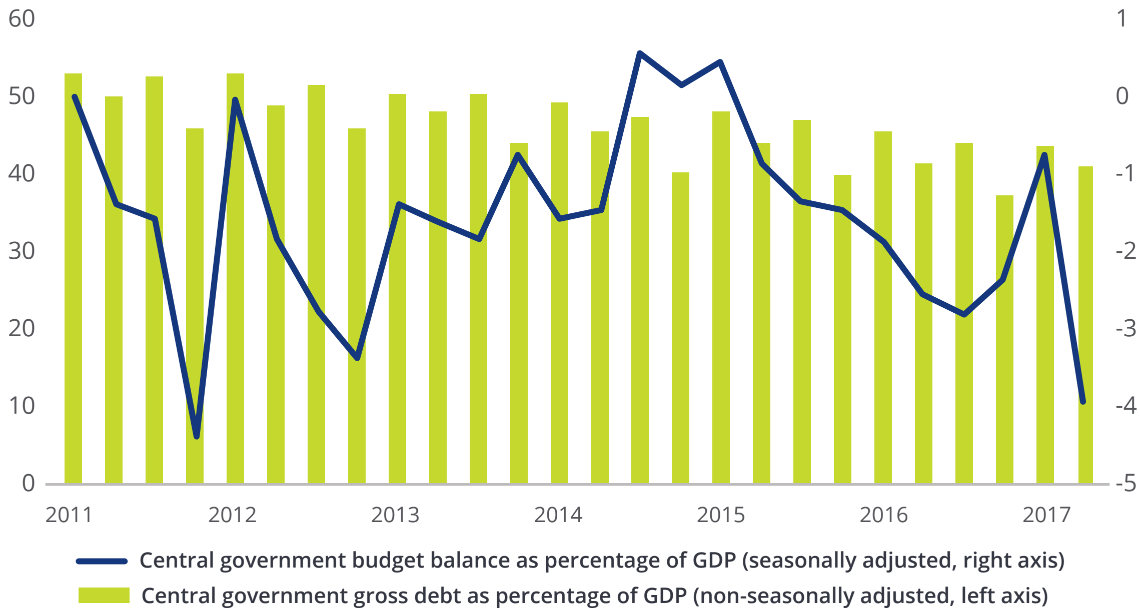
is likely to tighten policy, possibly starting with a 25-basis-point hike later this year.

## Moving toward long-term gains

Rising inflation will weigh on real income gains and thereby, consumer spending growth. The slight moderation in private consumption growth in the last two quarters is likely a result of higher price pressures. Policy makers would be wary of this and BSP in particular would continue to focus on inflation over the next year. Despite these inflation concerns, consumers appear upbeat—about their current situation, the next three months, and the year ahead—given continued economic momentum.[5] This augurs well for domestic demand, which will also benefit from government spending. However, the continued focus on infrastructure spending combined with a slight slowing of revenue growth in Q2 will have some impact on the budget deficit. Government finances will also likely be dented by USD 2 billion a year due to a new law, which allows free tuition in state universities and colleges.[6] But, with low levels of debt and deficit as a percentage of GDP (figure 4), any increased burden due to higher spending on education and infrastructure will not be a major cause for worry, especially given the long-term benefits of such spending on investments and productivity growth.

**Figure 4. Government finances are healthy despite a rise in the deficit**




*Note: Series is seasonally adjusted by Haver Analytics.*
Source: Department of Statistics via Haver Analytics; Deloitte Services LP economic analysis.
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4. Siegfrid Alegado, Ditas B Lopez, and Norman P Aquino, “Espenilla holds Philippine rate, raises CPI outlook in debut,” *Bloomberg*, August 10, 2017.
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Export performance in July was fueled by strong increases in exports to the United States and the European Union, though growth in exports to China decelerated. However, a potential trade war between China and the United States could result in Taiwan being caught in the cross fire, affecting exports.

# Taiwan

## Export growth bodes well for GDP expansion

By Ira Kalish

### The current situation

Taiwan's economy is on a moderate growth path, fueled largely by exports but also by consumer spending. Specifically, the economy grew 2.1 percent in the second quarter versus a year earlier. This included 5.0 percent growth in exports, 2.0 percent growth in consumer spending, and almost no growth in business investment. Moreover, exports grew 12.5 percent in July versus a year earlier, boding well for further expansion of GDP in the third quarter. The favorable export performance in July was fueled by strong increases in exports to the United States and the European Union. Growth in exports to China, however, decelerated. Future export performance will depend, in part, on global demand for the next generation of smartphones and other electronic devices, which in turn, will influence investment in Taiwan's massive technology sector. While investment has lately been dormant, a rebound in tech sales could have a positive impact on investment growth in the coming year. As for domestic demand, consumer spending has grown modestly, but retail sales have lately declined. This has been attributed to a slowdown in inbound tourism from China, possibly a reflection of the fact that Taiwan elected a government last year that has more tense relations with the mainland than the previous government.

One of the key issues Taiwan's economy faces is that real, or inflation-adjusted, earnings have been stagnant for the past decade. Meanwhile, South Korea's real earnings have increased about 30.0 percent in the past decade. What does this mean? There are both positive and negative consequences. On the positive side, steady wages mean improved competitiveness for the country's exporters, especially given that productivity has expanded in the past several years, thereby reducing unit labor costs (the labor cost of producing an additional unit of output). Indeed, Taiwan's export prowess in the important technology industry has been strong, especially at a time when South Korea has faced competitive challenges. On the other hand, stagnant real earnings mean that Taiwanese households have not seen significant increases in their purchasing power. This has held back domestic demand. However, real earnings have lately started to rebound modestly, likely owing to tightness in the job market. If this continues, it will help to boost growth of consumer spending. Yet, as long as productivity gains remain robust, wage increases will not necessarily hurt global competitiveness.

## Risks for Taiwan

There are a number of issues that pose risks to Taiwan's economic health. First and foremost is the possibility of a slowdown in the Chinese economy. China takes in roughly a third of Taiwan's exports. Lately, China's central bank has tightened monetary policy, creating the potential for a slowdown in economic growth. However, any slowdown might be concentrated in China's massive property sector. Yet, much of what Taiwan exports to China are components that are used to assemble final products for export. It is not clear if a slowdown in China will have a negative impact on this side of the economy. One thing that might hurt China's exports, however, would be a trade war with the United States. This represents a significant risk to Taiwan. The US government is currently undergoing two processes that could result in the imposition of punitive tariffs on Chinese goods. First, the US administration is investigating whether steel imports are harming national security. A positive determination could result in new tariffs. Second, the US government is investigating the extent to which Chinese practices regarding intellectual property are harming US companies. A positive determination could result in punitive tariffs. Either action would likely invite retaliation by the Chinese government, thereby setting off a potentially damaging trade war. Taiwan would be caught in the cross fire.

A longer-term risk to Taiwan stems from its demographics. The working-age population is set to decline by an annual average of 0.5 percent between now and 2020. It will then decline by an annual average of 1.0 percent from 2020 to 2025. However, due to rising participation in the labor force, the overall size of the labor force is expected to grow 0.4 percent each year between now and 2020, and then decline each year by 0.5 percent until 2025. Still, these numbers represent a considerable slowdown in the growth of the labor force compared to recent years. Absent an acceleration in productivity growth, this implies a slowdown in economic growth. On the other hand, a shortage of labor that leads to much

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higher labor costs could compel businesses to invest more in labor-saving technology, thereby boosting productivity growth.

## Favorable conditions

Despite risks, Taiwan is well positioned for the future. The unemployment rate is 3.8 percent, while the consumer price inflation rate is only 0.8 percent. Thus the central bank can be relatively relaxed about policy, leaving the currency stable. The country has a large external surplus and a high level of foreign currency reserves (about USD 444 billion). Thus it is effectively insulated from the negative consequences of a sharp drop in foreign currency earnings should there be a global economic crisis. Modest levels of government debt mean that the government can use aggressive fiscal policy, should the need arise.

The country has a large external surplus and a high level of foreign currency reserves (about USD 444 billion).

Vietnam stands strong as far as short-term growth prospects are concerned. However, to sustain long-term growth and reach its goal of becoming an upper-middle-income nation by 2035, the country needs to tackle fiscal consolidation, access to funds for development projects, protectionist trade policies from abroad, and aging demographics.

# Vietnam

## Fast and steady

By Lester Gunnion

### Introduction

Vietnam is one of the fastest-growing nations in the fastest-growing region of the global economy. After a slight loss of momentum in 2016 due to severe drought and weak oil prices, economic growth in Vietnam is likely to edge up in 2017 due to multiple supporting factors. Domestic demand and capital formation remain healthy, and foreign investment continues to flow into the economy to support export growth as external demand strengthens. While these factors are likely to spur fast and steady short-term growth, there are challenges to medium- and long-term growth that Vietnam needs to address.

### Strong growth in the first half of 2017

Real GDP growth accelerated in Vietnam in Q2 2017. Output produced during the quarter increased by 6.2 percent relative to a year ago, accelerating from 5.1 percent in the previous quarter. All three major sectors of the economy experienced quicker growth in Q2 compared to the previous quarter. The services sector grew 7.1 percent relative to a year ago. Within the services sector, the boarding and lodging subsector experienced particularly quick growth due to an increased number of international visitors, primarily from China. The industry and construction sector also grew 7.1 percent from a year ago. Robust growth in manufacturing more than compensated for the slowdown in the mining sector due to weak oil prices and suspended offshore drilling in the South China Sea.

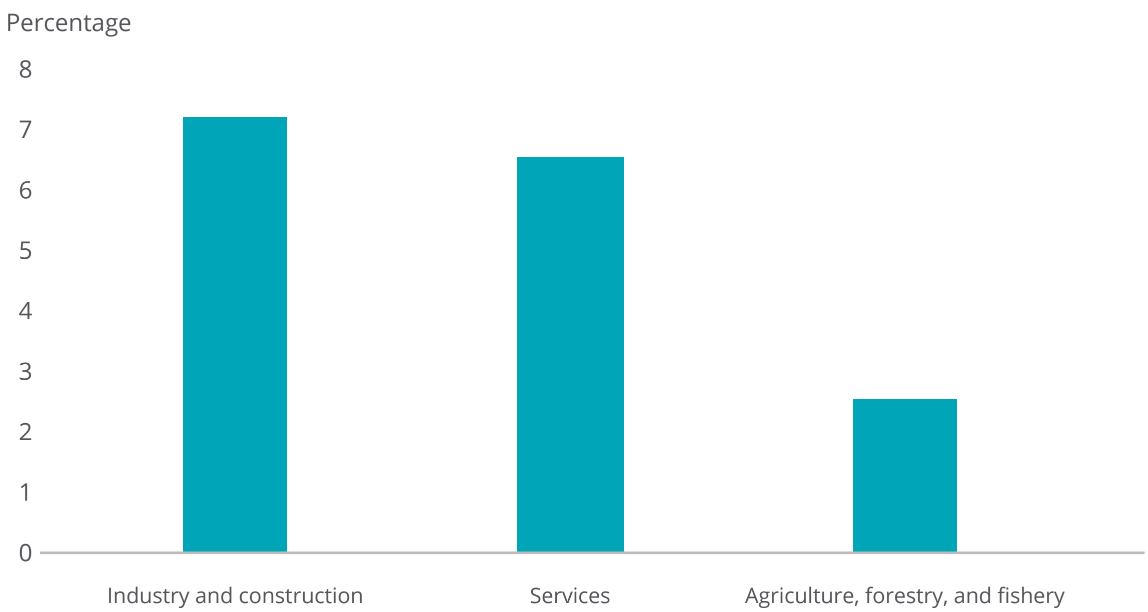
The manufacturing sector continues to gain from an inflow of foreign investment. Growth in construction was also robust during the quarter reflecting strong residential investment that has been boosted by the liberalization of the housing market since 2015, and the country's continued drive to develop physical infrastructure. Agriculture, forestry, and fishery grew 2.9 percent albeit from a low base in the previous year when Vietnam experienced the worst drought in a century. Over the last five years, industry and construction and services have recorded quick growth, while the agriculture, forestry, and fishery sector, which accounts for roughly 40.0 percent of Vietnam's employed workforce, has grown relatively slowly (see figure 1).[1]

The manufacturing sector continues to gain from an inflow of foreign investment.

## What is fueling Vietnam's continued growth?

At present, Vietnam finds itself in a sweet spot for economic growth. About 70.0 percent of the population is of working age, unemployment is low, domestic demand is robust, and fixed capital formation is growing rapidly. Most importantly, an ever-increasing inflow of foreign direct investment (FDI) continues to support healthy export growth. In the first half of 2017, export of goods and services increased 18.0 percent relative to a year ago. Imports, however, outgrew exports in the first half

**Figure 1. Average annual growth rate over the last five years by sector**




Source: General Statistics Office of Vietnam via Haver Analytics.

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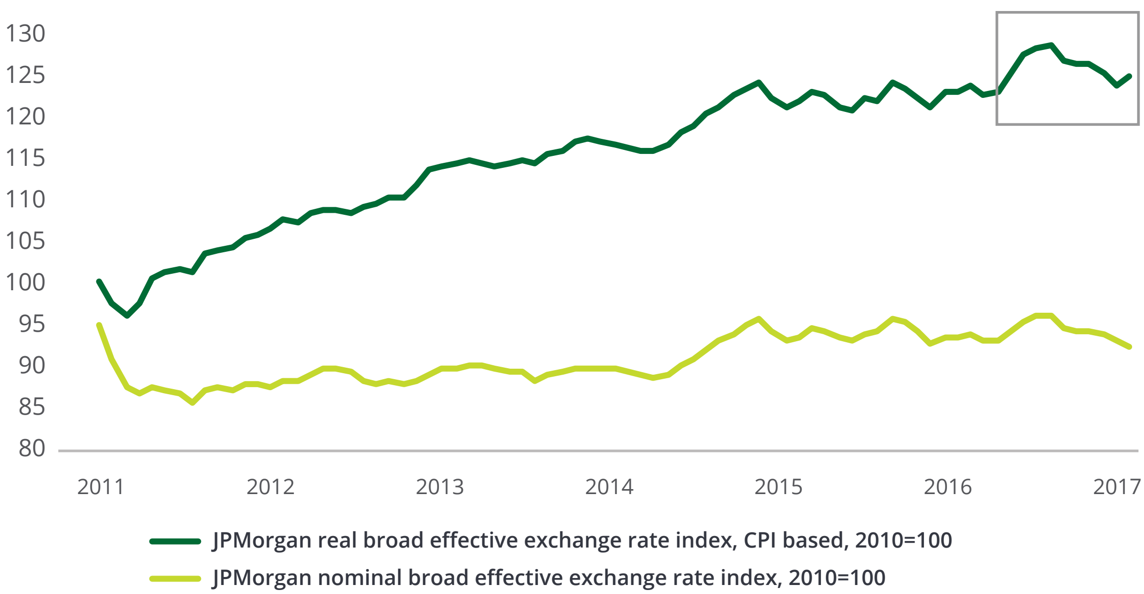
of the year, increasing 22.3 percent, resulting in an overall trade deficit.[2] The domestic-owned sector recorded a trade deficit, while the foreign-owned sector posted a trade surplus—a pattern that underlines the importance of export-oriented FDI inflows in funding imports for domestic consumption.

However, strong inflows of FDI and an overall trade surplus in four of the last six years (driven by the trade surplus of the foreign-owned sector of the economy) contributed to an upward trend in the exchange rate of the Vietnamese dong from 2011 until the end of 2016. During this period, the trade-weighted nominal exchange rate remained comparatively flat, while the trade-weighted real exchange rate trended upward. Vietnam's higher inflation rate compared to its primary trading partners (the United States, the European Union, China, and South Korea) during these years meant that at the relatively flat trade-weighted nominal exchange rate, domestic output in Vietnam was more expensive than the same basket of output in its trading partners. This explains the upward trend in the trade-weighted real exchange rate. While an upward trend makes imports for domestic consumption cheaper, it also hurts the competitiveness of Vietnam's exporters. However, a spurt in the growth of imports in the first half of 2017 contributed to a lower trade-weighted nominal exchange rate for the dong despite the continued inflow of export-oriented FDI. A lower nominal exchange rate, in turn, contributes to a lower real exchange rate. Additionally, a steady drop in the inflation rate in Vietnam since the start of 2017 has contributed to the drop in the trade-weighted real exchange rate (see figure 2).

This reversal in the trade-weighted real exchange rate is likely to support further export growth in the short term especially as external demand recovers. Export growth in the second half of 2017 will continue to be dominated by the foreign-owned sector of the economy. In 2016, FDI inflows reached a record high and accounted for 72.0 percent of the country's total goods exports.[3] In the first six months of 2017, FDI was up 6.5 percent from the same period a year ago.[4] An increase in the number of new licensed projects and registered capital during the first half of the year is likely to contribute to further expansion of the foreign-owned sector, which in turn, is likely to boost overall exports in the near term.

**Figure 2. Lower inflation and strong import growth in 2017 have led to a weakening of the trade-weighted real exchange rate**




Source: JP Morgan; Haver Analytics.

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One key determinant of Vietnam's overall export performance is Samsung's Vietnam-based manufacturing plants. The South Korean conglomerate accounts for 20.0 percent of all Vietnam's exports.[5] Furthermore, 40.0 percent of all Samsung's smartphone devices are made in Vietnam.[6] The success of the newly launched Samsung Galaxy S8 smartphone is likely to be beneficial to Vietnam's export numbers.

## Challenges to future growth

While critical FDI inflow is likely to continue in the short term, other factors might serve as a drag on growth. The need for fiscal consolidation is one such factor. Fiscal debt has grown roughly three times faster than real GDP over the last five years. In fact, Vietnam hit its self-imposed ceiling on public debt, set at 65.0 percent of GDP, at the end of 2016.

In response, the administration has committed to a comprehensive fiscal consolidation plan. While this may be a prudent measure to sustain medium- to long-term growth, it is also likely to slow growth in the short term. Lower government spending is likely to affect large infrastructure projects. For example, delayed payments for Ho Chi Minh City's metro railway project, due to a shortfall in funding, have led to delays in construction.[7] The Vietnamese administration is now looking toward private financiers to close the gap in funding. However, such funding gaps, particularly for large infrastructure projects, could potentially draw FDI flows that might have otherwise headed to other sectors such as manufacturing. Furthermore, factors such as lack of transparency in large state-owned enterprises—which account for a majority of bad loans in Vietnam—might serve as obstacles to private funding. Additionally, by virtue of its status as a middle-income nation, Vietnam no longer has access to cheap credit from institutions such as the World Bank and the Asian Development Bank.

And while the private sector continues to be buoyed by strong domestic demand, there are potential risks. Credit has expanded aggressively, growing at the rate of 19.8 percent in Q1.[8] Though rapid credit growth is likely to support GDP growth in the short term, it could put Vietnam's banking sector at risk in the medium to long term.

For now, the financial system appears stable. At the end of Q1, the ratio of nonperforming loans to total outstanding loans in the banking sector was relatively low at 2.6 percent.[9] However, this does not account for bad loans sold by credit institutions to the Vietnam Asset Management Company (VAMC) since it was set up in 2013. If the VAMC's share of bad loans is taken into account, the ratio rises to 5.8 percent.[10] Furthermore, if rescheduled bad debts are taken into account, the ratio of bad loans rises to 10.1 percent.[11] Recent banking sector reforms allow the VAMC and credit institutions to sell assets pledged as collateral to bad loans at market price, even at a discounted rate, in order to avoid litigation and speed up the process of cleaning the banking sector of toxic loans. However, a renewed surge in bad debt due to aggressive credit lending could slow growth.

On the trade front, the failure of the Trans-Pacific Partnership (TPP) and the threat of protectionism might have dented hopes of quicker economic growth in the medium to long term. However, in the short term, exports to major destinations such as the United States and the European Union are likely to continue. Vietnam's dependence on China as a source of vital imports is also likely to continue.

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Finally, while Vietnam does enjoy a demographic advantage in the short term, its population is also aging fast. At present, the median age in Vietnam is 26 years, but birth rates are falling and life expectancy is rising. According to the World Bank, the number of people in Vietnam above the age of 65 years will triple by 2040.[12] Moreover, Vietnam's rapid aging is likely to happen at lower per capita income levels compared to countries that currently have old populations.[13] Boosting productivity will therefore be essential to sustain quick growth in the medium to long term.

## The short-term outlook remains bright

The short-term outlook for Vietnam's economy remains bright. Inflation has slowed through the first half of 2017 and monetary policy rates were revised down in July. This is likely to keep domestic demand robust. A gradual strengthening of the global economy, particularly Vietnam's export markets, is likely to keep external demand healthy. Vietnam's quick growth and future prospects will likely keep foreign investment flowing in over the short term. The International Monetary Fund forecasts GDP growth of 6.3 percent in 2017, slightly higher than in the previous year.[14] Reform, policy, and global developments will determine whether Vietnam grows fast enough to reach its target of being an upper-middle-income nation by 2035.

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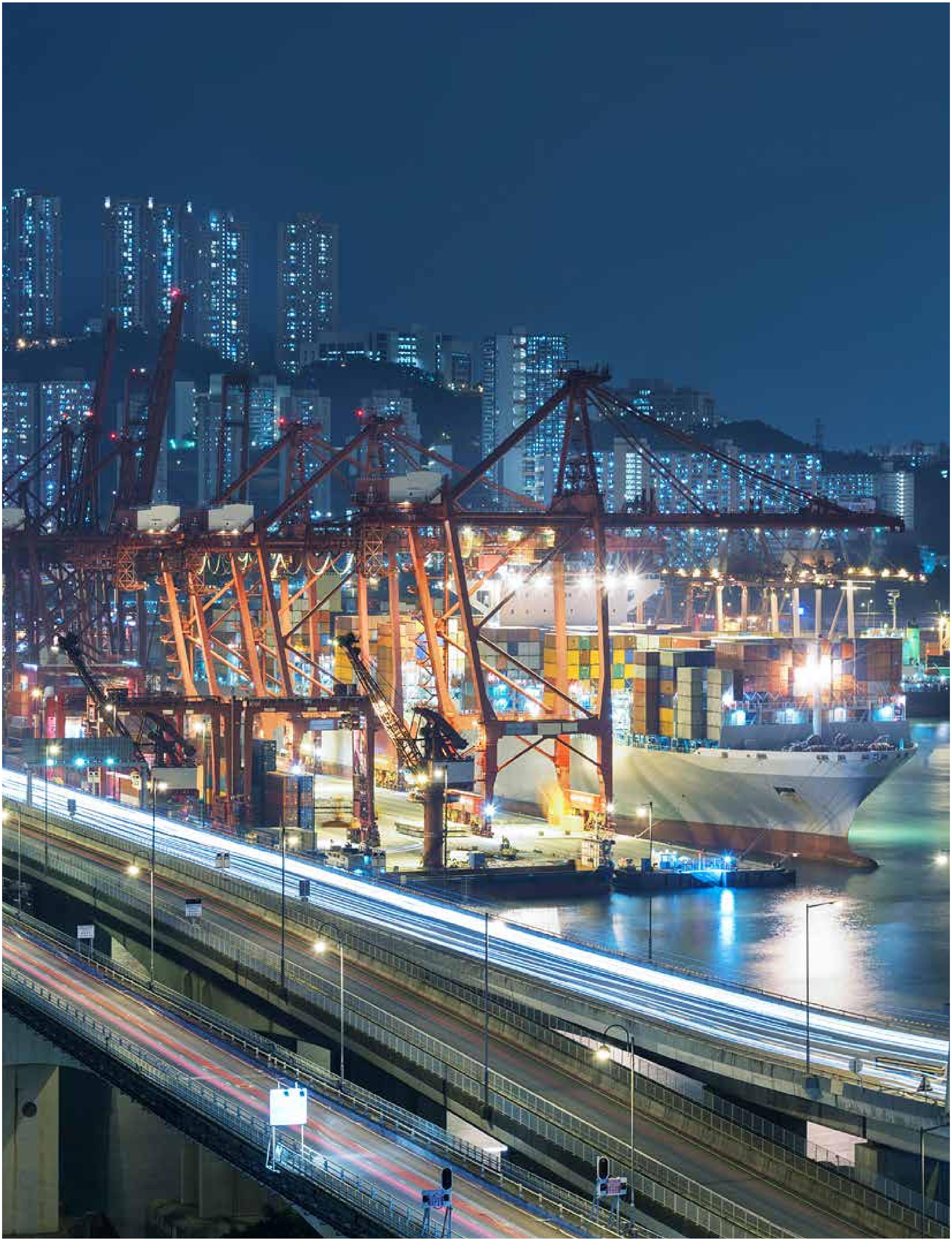

Even though slowing global demand after the Great Recession affected Asia in recent years, improving trade figures in the region are now a ray of hope for globalization. But is the current recovery in Asian exports likely to continue?

# Asian exports

## Time to bet on a strong show

By Akrur Barua

## Introduction

Amid all the rhetoric about protectionism, improving trade figures in Asia are a ray of hope for globalization. An export powerhouse for a long time now, Asia has, however, felt the heat in recent years, as global demand slowed after the Great Recession, in turn bringing down the pace of international trade expansion. Thankfully, the tide appears to be turning of late. In China, for example, net exports contributed 0.3 percentage points to real GDP growth in both Q1 and Q2; the positive contribution in Q1 was the first since Q2 2015.[1] In India, where exports had faced strong headwinds due to slower growth in key markets such as Europe, real exports grew 10.3 percent year over year in Q1 2017, the fastest pace

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of growth since Q2 2014. Similar trends of export recovery can also be seen in other key Asian economies (figure 1). Growing export volumes, combined with an uptick in commodity prices (commodities are a key export item for countries such as Indonesia and Malaysia), have pushed up export values for these countries (figure 2), which, in turn, has aided their external balances. That augurs well for currencies in the region facing potential downside pressure from rising interest rate differentials with the United States.

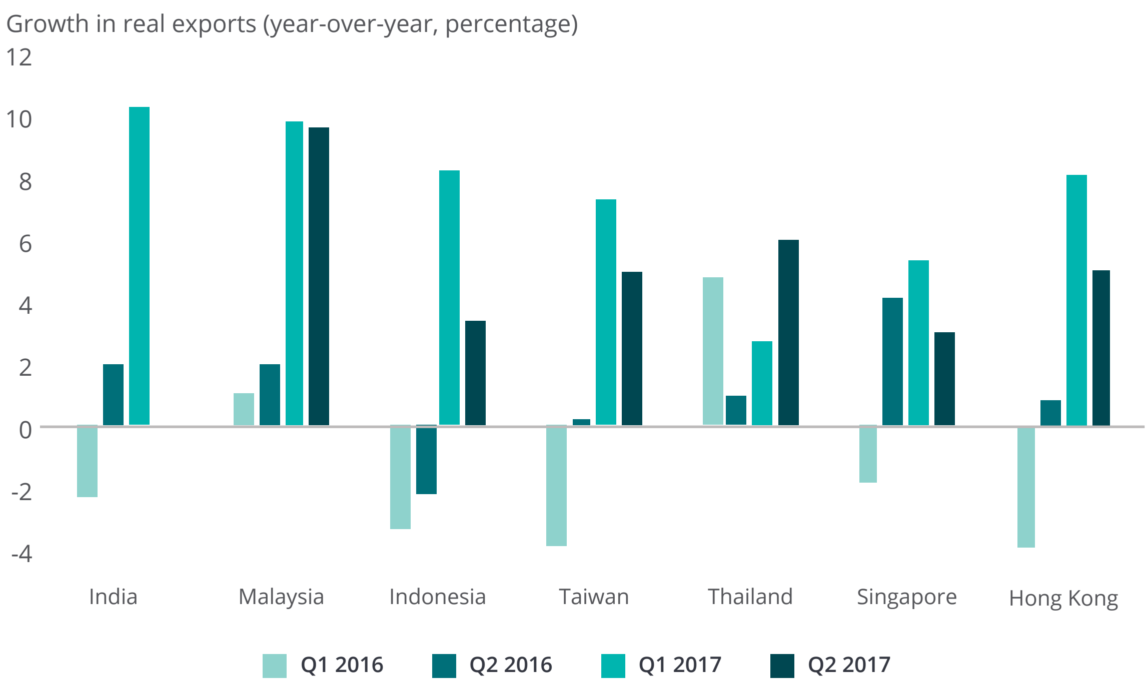
So, is the current recovery in Asian exports likely to continue? It seems probable, given that key fundamentals such as global demand and regional trade are likely to remain positive.

## The clouds looming over global demand appear to be clearing

Global growth fundamentals for 2017 appear much better than they were a year before. According to the International Monetary Fund (IMF), world GDP is set to grow 3.5 percent in 2017 and 3.6 percent in 2018, up from a 3.1 percent rise last year, with growth in both advanced and emerging economies set to rise (figure 3).[2] Troubled economies in the Eurozone appear to be getting back on track. Growth in Ireland (5.2 percent in 2016) and Spain (3.2 percent in 2016) has surged, while in Greece, inflation is edging up, rekindling hopes of a break from deflation.[3] The story for emerging economies, especially those in Asia, is even brighter. While China's strong GDP growth in Q1 and Q2 2017 (6.9 percent) helped dispel fears of a slowdown, India, with growth of 7.0 percent in Q4 2016 and 6.1 percent in Q1 2017, appears to have shrugged off any major dent in growth due to demonetization.

Global growth fundamentals for 2017 appear much better than they were a year before.

**Figure 1. Real exports are on the way up for key Asian exporters this year**




Source: Haver Analytics; Deloitte Services LP economic analysis.

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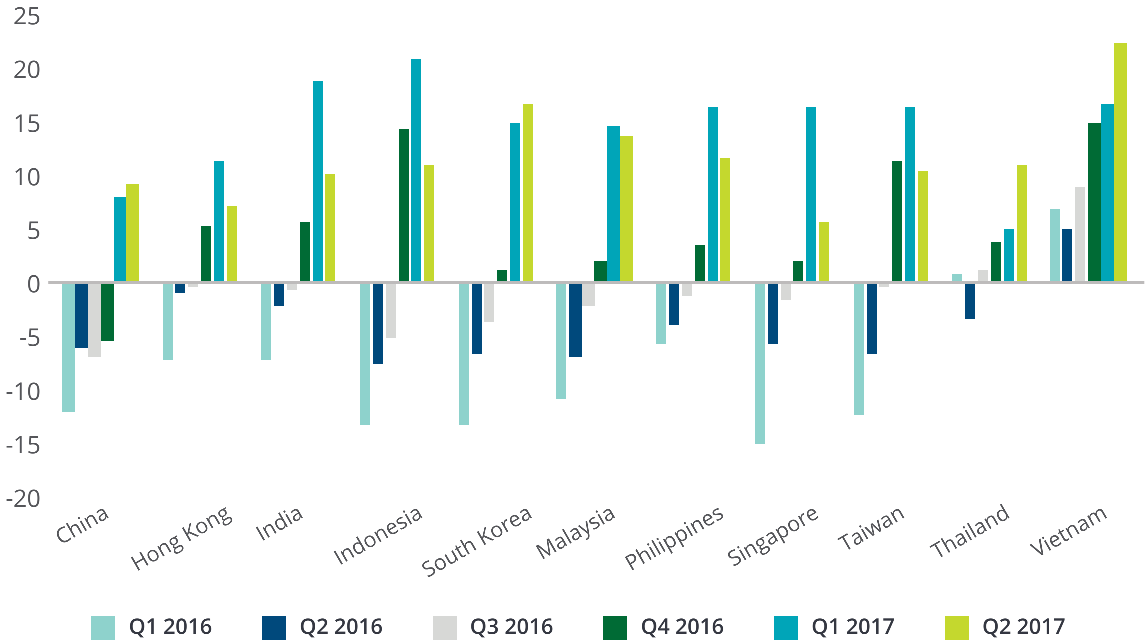
**Figure 2. Growth in value of merchandise exports will benefit countries' external balances**

Growth in seasonally adjusted value of merchandise exports priced in USD (year over year, percentage)




Source: Haver Analytics; Deloitte Services LP economic analysis.

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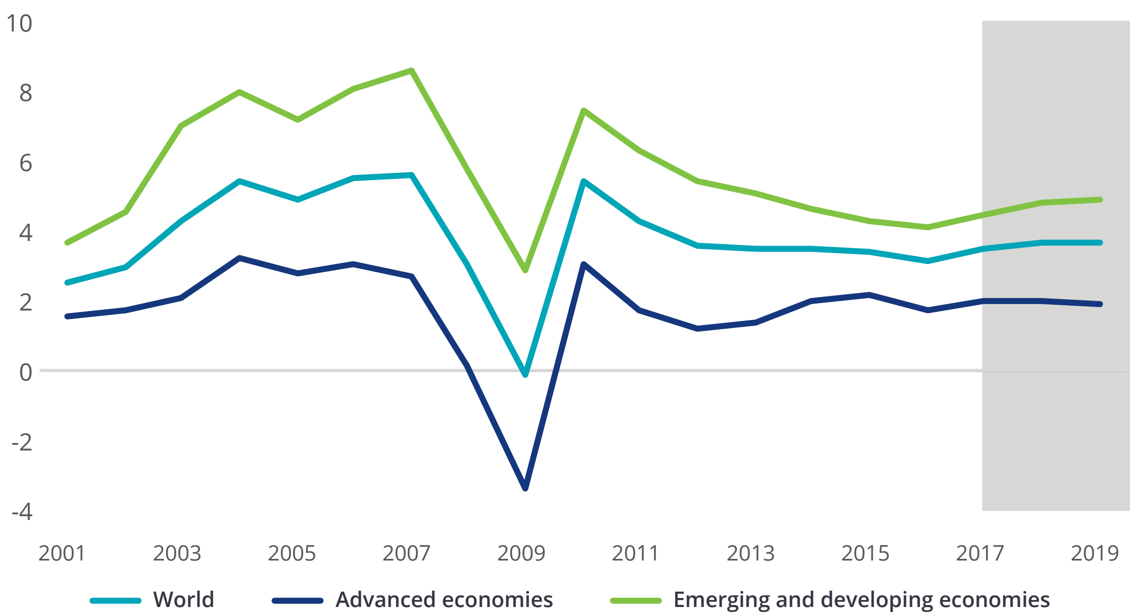
**Figure 3. GDP growth has picked up across both advanced and emerging economies**

Annual real GDP growth (percentage)




*Note: The categorization of advanced economies, and emerging and developing economies is by the International Monetary Fund in its World Economic Outlook.*

Source: International Monetary Fund; Deloitte Services LP economic analysis.

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## Strong demand within Asia is the key

Asian growth has continued unabated over the years, driven in recent years by emerging economies such as China and India.[4] Consequently, within Asia, the flow of goods and services has gone up sharply. For example, back in 1980, North America and Europe had the biggest share in exports from emerging and developing countries in Asia, while exports within the region itself were just 6.6 percent of the total (figure 4).[5] By 2016, the region had the highest share in its own exports, highlighting a strong rise in demand from within the region. This is not surprising given favorable demographics and increasing prosperity, leading to a sharp rise in the middle class in the region.[6] Also, Asian companies have rapidly moved up the value chain from being mere assemblers of semifinished products. Be it automobiles or smartphones, countries such as China and India have caught up with peers such as South Korea and Japan[7]—and they are increasingly exporting to one another.

## Asian commodity exporters are benefitting from elevated prices

Global commodity prices have been on a rebound since 2016. For example, since the beginning of 2016 (until August 21, 2017), the price of Brent crude has gone up 38.3 percent, while rubber and coal prices are up 49.8 percent and 78.8 percent, respectively (figure 5). Asian commodity exporters such as Indonesia and Malaysia have benefitted from this resurgence in commodity prices. For example, the value of exports (in Malaysian ringgits) of inedible crude materials from Malaysia went up 40.7 percent year over year in Q1 2017 and 35.9 percent in Q2. Similarly, exports of mineral fuels and related products grew 41.1 percent in Q1, the fastest pace of expansion since Q2 2010, and the momentum has continued into Q2 as well. Palm oil exports, in particular, have been a key beneficiary of rising prices.

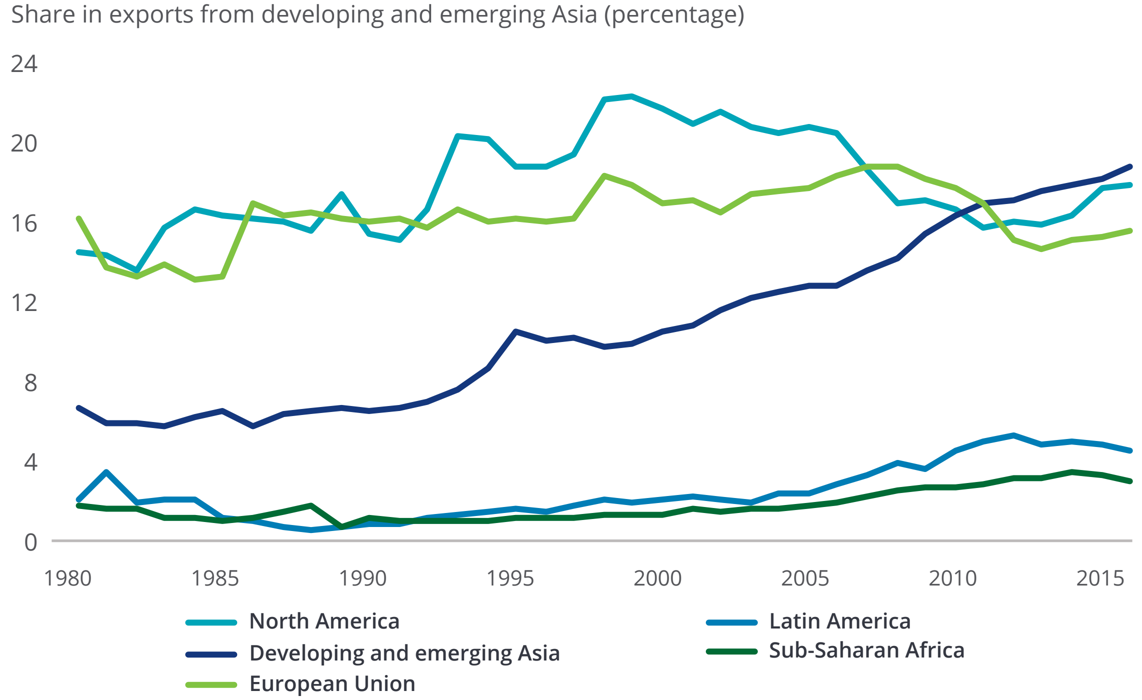
> Asian commodity exporters such as Indonesia and Malaysia have benefitted from this resurgence in commodity prices.

The trend is similar in Indonesia, where the value of mining and related exports (in US dollars) went up 37.2 percent in Q2 2017, the highest rise since Q3 2010. The rise in commodity prices is also translating into higher prices for refined products and, hence, exports of those products. Singapore, in particular, has benefitted, with the country's export value of petroleum products rising 30.1 percent in Q4 2016, and then by 70.4 percent in Q1 2017; the growth momentum continued into the second quarter of this year as well. This trend of healthy commodity exports is likely to continue, given increasing global demand and elevated prices; although commodity prices have flattened of late, they remain high compared with 2015 and early 2016.

## Currency stability and monetary policy predictability will aid Asian exports

Supporting trade fundamentals in Asia is a return to stability of key currencies in the region. Currencies were a worry last year, as speculation increased about possible moves by the US Federal Reserve (Fed). However, the Fed's interest rate path has become clearer.[8] This has eased the pressure on key Asian currencies. For example, the Malaysian ringgit, the Indian rupee, and the Indonesian rupiah have stabilized this year (figure 6). Currencies are also likely to benefit from improving economic fundamentals across the globe. Within the Eurozone, rising inflation is a positive development, especially

**Figure 4. Asian economies are increasingly trading with one another**




Source: Haver Analytics; Deloitte Services LP economic analysis.

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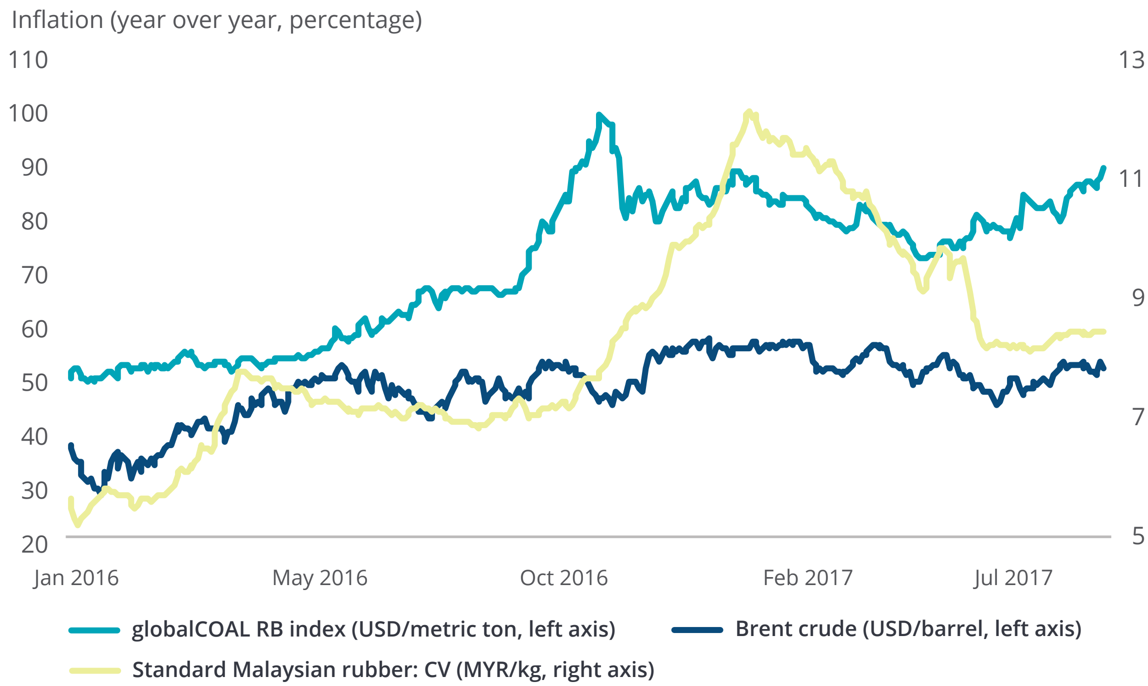
**Figure 5. Key commodity prices have gone up, benefitting Asian commodity exporters**




*Note: The rubber price we have quoted here is Standard Malaysian Rubber with the CV type made from latex. We have used this as an indicator to highlight trends for rubber prices in general.*
Source: Haver Analytics; Deloitte Services LP economic analysis.

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in debt-laden economies.[9] In Greece, for example, where inflation went up above 1.0 percent this year—for the first time since August 2012—rising consumer prices, if sustained, will push up nominal GDP, thereby reducing the debt burden as a share of nominal GDP. The European Central Bank will be in no mood to stem this momentum. The same holds true for the Bank of Japan in its long-running fight against deflation.

## Winds are blowing in favor of trade

Since the global downturn of 2008–09, Asian exporters have increasingly turned to domestic consumers for growth as international trade suffered. Asian households, in turn, delivered, with increasing affluence in emerging economies aiding spending.[10]

Times, however, are changing. Households in many parts of Asia have seen debt levels soar,[11] with real estate cycles exacerbating the situation.[12] This, in turn, has impacted banks' asset quality in economies such as Thailand, while corporate bad debt is on the rise in countries such as India and China. These factors have hit credit growth despite monetary easing over the past year. Now, with inflation edging up, monetary policy is likely to play a smaller role in driving economic growth. In such a scenario, the current revival in exports is welcome, and key trade fundamentals indicate that exports are likely to remain strong in the near term. While naysayers may point to the risk of rising protectionist overtones, rhetoric might remain far from reality. Good economics often makes for better politics, and both within Asia and across the globe, trade is likely to win in the medium to long term.[13]

**Figure 6. Asian currencies have stabilized of late**

Returns against the USD with respect to January 4, 2016 (percentage)


Source: Haver Analytics; Deloitte Services LP economic analysis.

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# ENDNOTES


1. All statistics are sourced from Haver Analytics in August 2017 unless otherwise stated.
2. International Monetary Fund, World Economic Outlook database, sourced via Haver Analytics on May 22, 2017.
3. Haver Analytics; Akrur Barua, “Global inflation: Not yet a worry for most policymakers,” *Global Economic Outlook, Q2 2017*, Deloitte University Press, May 12, 2017.
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5. International Monetary Fund, Direction of Trade statistics, sourced via Haver Analytics, May 22, 2017.
6. Akrur Barua, “Asia’s retail spending boom: Shoppers go on a frenzy and why not?,” *Asia Pacific Economic Outlook, Q2 2017*, Deloitte University Press, March 28, 2017.
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8. Daniel Bachman and Rumki Majumdar, *US Economic Forecast, 1st Quarter 2017*, Deloitte University Press, March 13, 2017; Barua, “Global inflation: Not yet a worry for most policymakers.”
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10. Barua, “Asia’s retail spending boom.”
11. Akrur Barua, “Prudent no more: Household debt piles up in Asia,” *Asia Pacific Economic Outlook, Q3 2015,* Deloitte University Press, July 1, 2015.
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13. “Trade to trump protectionists and boost global growth,” *Voice of Asia,* January 2017, Deloitte University Press, January 13, 2017.

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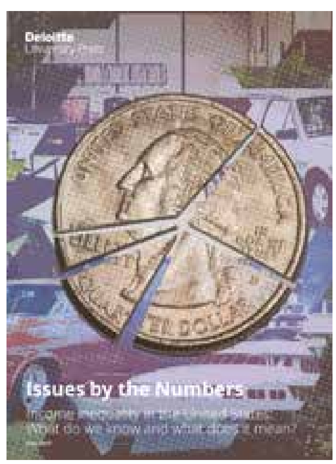


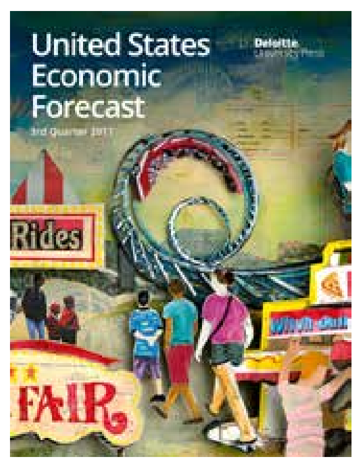

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