EM Asia mid-year outlook

Rocky start, bumpy recovery

Policies and reforms key to the outlook

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Renee Chen

Senior Investment Strategist

Key takeaways:

- EM Asia saw a sharp slowdown in Q1 amid the pandemic shock. Further weakness in Q2 is likely as containment measures were in full force, except China where Q1 likely marked a trough and Q2 should record a notable qoq expansion
- Following China (first in, first out), other parts of EM Asia have also started to reopen with easing restrictions. Several high frequency indicators have either stabilised at low, well-below normal, levels or become less bad lately
- Industrialised Asia leads the return to normalcy, helped by their stronger healthcare system capacity and policy space
- Policy responses to the COVID-19 shock have been significant with better fiscal and monetary policy coordination. While a material deterioration fiscal balances is expected this year, most EM Asia has policy space to do more given the relatively sounder starting points for public debt and current account balance vs. other EMs
- The recovery path will likely largely hinge on the (health) institutional response and the ramifications on domestic demand (as supply is slowly restored); global macro backdrop; and domestic policy actions and reforms
- The emergence from the lockdown will be gradual and the recovery will be bumpy, amid external risks as well as corporate solvency, labour market and financial stability concerns

HSBC Global Asset Management

Signs of domestic activity normalisation amidst easing restrictions

The COVID-19 pandemic has hit Asian economies hard through both supply disruptions and demand destruction. The shock has been most devastating for offline, discretionary services, especially travel-related activities. GDP in the first quarter (Q1) of 2020 slowed sharply year-on-year (yoy) and contracted on a seasonally adjusted sequential basis across the region, except India. India's March-quarter GDP reflected the impact of just one-week lockdown and was primarily boosted by higher government spending. Growth was less stronger than suggested by high-frequency activity indicators, which may be attributed to data collection issues amidst the lockdown; a downward revision later is likely.

We expect further weakness in the second quarter (Q2) for most EM Asian economies as containment measures were in full force this quarter, halting activity in major parts of the economy. The exception is China where Q1 likely marked a trough and Q2 is likely to record a notable quarter-on-quarter (qoq) expansion. Recent indicators showed a strong rebound in industrial activity and a construction/investment recovery led by real estate and infrastructure. Tech and health sectors have held up relatively well, while auto sales volume yoy growth turned positive in April amid policy support, pent-up demand, and consumer preference for private over public transport. That said, the recovery remains uneven with manufacturing capex and selective consumer (services) sectors lagging, though more recently, some services, including property sales, restaurant orders, domestic flights and hotel occupancy have also shown improvement.

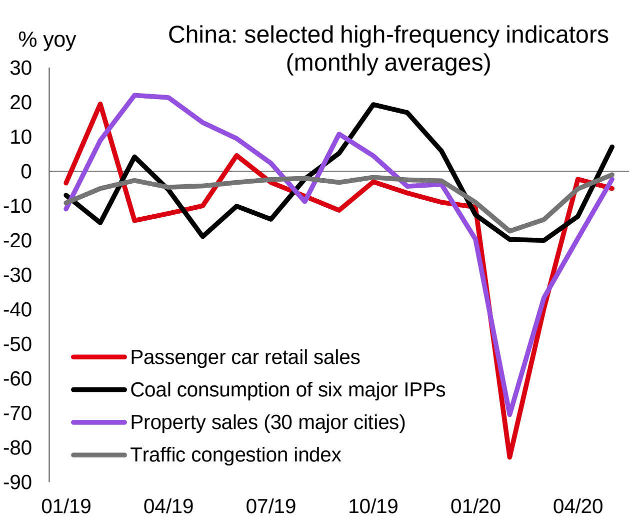
Following China (first in, first out), other parts of EM Asia have also started to reopen by easing restrictions as COVID-19 infection rates have moved past the peak in most economies. Several high frequency indicators have either stabilised at low levels or become less negative lately, such as weekly power demand, highway traffic, public transit, air cargo volume, scheduled flights and domestic tourism. Manufacturing PMI stayed in contraction territory for Asia ex. China in May, but rebounded modestly from April's record-low levels especially in economies where stringent lockdowns are being eased. Supply (production) recovered faster than demand (new orders). Suppliers' delivery time improved and suggested easing supply chain bottlenecks, but the level is far from normal.

Different near-term macro paths: industrialised EM Asia leading the return to normalcy

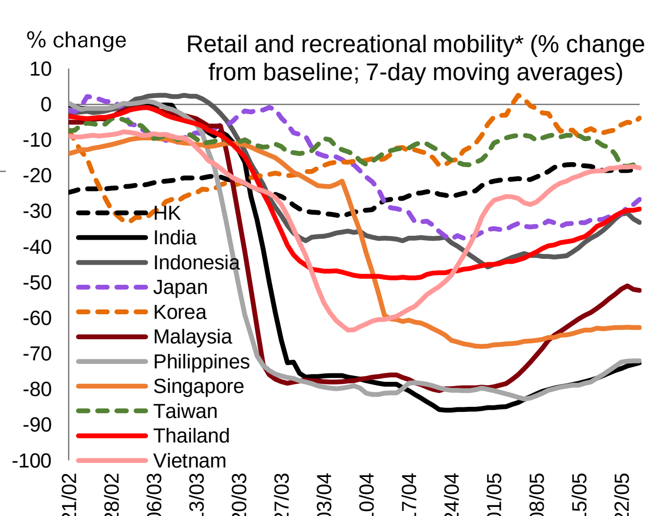
The relaxation of containment measures has progressed at different speeds across much of EM Asia. The exit strategy is likely to be gradual and calibrated, balancing health risks against economic costs in the absence of vaccines. That said, not all healthcare systems were equally equipped to handle the pandemic and policy space to mitigate the economic fallout also varies between economies. Thus, the COVID-19 has also marked different near-term macro paths. North Asian economies, including Korea, Taiwan and Hong Kong, and Vietnam, fought the pandemic early and already transitioned into softer social distancing measures in late April/ early May, after having managed to curtail the virus spread. Together with China, they have led the region's activity normalisation, and the subsequent economic cost from the COVID-19 shock could be lower. Their mobility indicators in terms of visits to retail and recreational locations fell less than the rest of EM Asia. The industrialised Asian economies appear better prepared for exit given their relatively stronger testing and contact-tracing capacity of the healthcare systems.

Meanwhile, parts of ASEAN and India have also started to reopen the economy recently and ramped up policy support, allowing a gradual return to normalcy. Malaysia and Thailand announced relaxations of lockdown measures two-four weeks after the epidemic curve flattened on a sustainable basis; their mobility indicators have clearly picked up. Mobility indicators stayed at relatively depressed levels as of late May in Singapore, Indonesia, India and Philippines where the COVID-19 situation and/or containment measures have eased to a lesser extent. India has been reopening parts of the economy since late April, and continuing its calibrated and staggered opening. Indonesia and Philippines also re-opened the economy amid still-rising new daily COVID-19 cases, running the risk of a worsening and prolonged outbreak and underscoring a more difficult policy trade-off between health and economic risks. Many of these South and Southeast Asian countries have weaker healthcare resources and infrastructure.

China leads post-lockdown recovery



Mobility picks up as economies reopen in Asia



Note: * Baseline was the median value during the 5-week period (3 January-6 February 2020, defined by Google); Source: WIND, Google Mobility Report, HSBC Global Asset Management, as of June 2020.

Significant policy response to mitigate the pandemic shock; policy space remains

Policy responses to the COVID-19 shock have been significant across most parts of EM Asia. Policy packages are mainly focused on virus containment (e.g. increased health spending), alleviating the damage to the most affected sectors, providing cash flow support for companies (especially SMEs, the largest source of employment), preserving employment, and supporting low income households and the rural economy. Substantial fiscal support and weak growth/tax revenue collections are likely to cause a material deterioration in EM Asia's fiscal balances this year, though the region generally has policy space, as the starting points for public debt/fiscal deficit (ex. India) are favourable relative to many non-Asian EM economies. The current account surplus in most parts of EM Asia also means there is domestic savings surplus to fund wider fiscal deficits. That said, fiscal space varies. Singapore, Hong Kong, Taiwan and Korea have most fiscal space, followed by Thailand, Philippines and China. India and Malaysia face more fiscal constraints. Indonesia has a relatively low debt-to-GDP ratio, but its low revenue mobilisation, current account deficit and a relatively high share of foreign funding are challenges.

Central banks' credit/financial support has also been increased, through soft loans, government loan guarantees, regulatory relaxations (e.g. loan moratoriums), state capital injections, and financial market stabilization efforts. Monetary policy has been eased with a focus on lowering the cost of capital and improving transmission. Where the fiscal space is constrained and transmission faces challenges (e.g. India and Indonesia), central banks have engaged in unconventional policies leaning on their own balance sheets. Central banks are playing a larger role in supporting the government borrowing programmes/deficit financing, including some form of bond purchases.

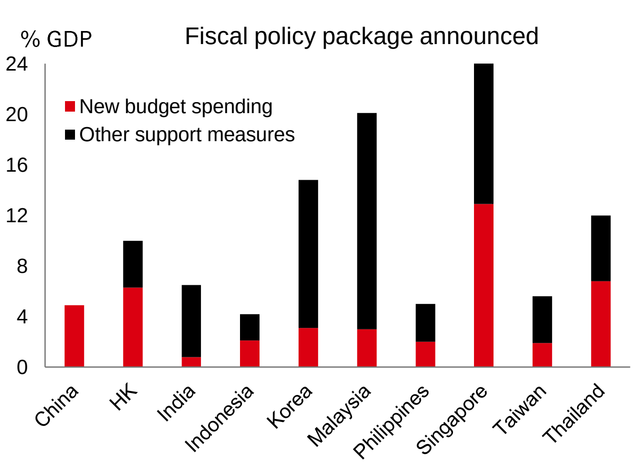
Post-lockdown recovery faces challenges; policy actions/reforms key to the outlook

The recovery path will likely largely hinge on the (health) institutional response to handle the COVID-19 and the ramifications on domestic demand (as supply is slowly restored); the economy's exposure to external shocks; and policy actions and effectiveness. The emergence from the lockdown will be gradual and the subsequent recovery will be bumpy, given challenges of second wave infections and new normal of social distancing. Global demand slowdown, geopolitical/US-China tensions and the structural trend of slowing globalisation are among the key external risks. The trade-oriented economies or these where tourism revenues account for a relatively large share of GDP (international borders likely will be the last to be opened) are more vulnerable, such as Hong Kong, Singapore, Malaysia, Thailand, Taiwan and Korea. This is despite the relative resilience of demand for certain products, e.g. pharmaceuticals and technology. Tech exports have been supported by increased digitalisation demand given more remote working, online education/ learning, and e-commerce, as well as demand alongside 5G and automation. That said, the strength and sustainability of such demand is uncertain beyond the near term.

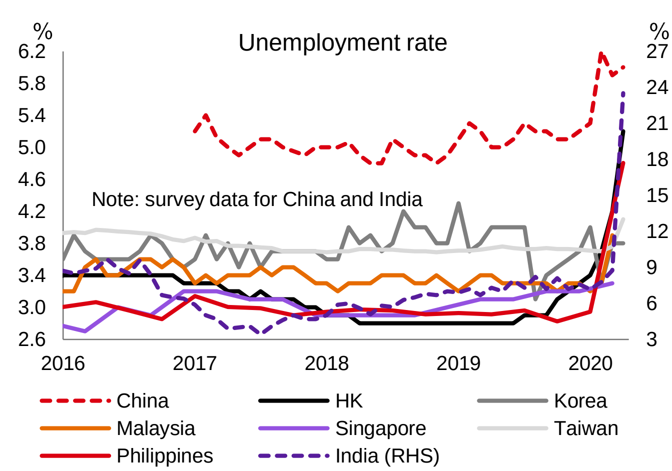
We also see risks from knock-on effects of the COVID-19 shock on corporate insolvency/ default risks; the labour market and household income; banking sector fundamentals; and fiscal and debt sustainability concerns. Strong policy support could help cushion the downside and prevent longer-term damage to the economy by limiting large-scale corporate bankruptcies and preventing a permanent rise in unemployment, but solvency challenges remain with weaker business balance sheets. Labour market pressure has risen, though headline unemployment rates tend to understate the underlying weakness, such as a rise in the underemployment rate (e.g. workers on unpaid leaves), reductions in hours worked and wages, and a decline in the labour force participation rate. In lower-income countries, a larger proportion of the workers are employed in the informal sector. While temporary government support may have preserved jobs, hiring could stay subdued well into the recovery. Some services/ consumer sectors could face a delayed and slow recovery, amid job and income losses and as some degree of restrictions and behavioural caution (due to the public fear factor) will likely persist, until a vaccine is available.

Overall, we think continued policy support is needed to facilitate and sustain the recovery, particularly to boost demand. Fiscal and structural reforms (e.g. focused on infrastructure, human capital, the labour market and healthcare) are crucial to raising the medium-term growth potential/productivity and improving debt sustainability.

Increased policy support; ready to step up



Signs of labour market weakness



Source: CEIC, Bloomberg, government/budget announcements, HSBC Global Asset Management, as of June 2020.

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