Global and APAC Economic Outlook – Navigating Growth and Inflation

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EM ASIA: FRAMING THE MACRO NARRATIVE

November 2016

EM Asia and ASEAN Economics

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See last pages for analyst certification and important disclosures
## Agenda

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EM Asia: Not a great place to start from

Framing the key moving parts –

1. Trade flows remain key to growth
   - G-3 remains key driver of trade
   - Fiscal policy stepping up in some places
2. Capital flows into EM improve on better growth differentials and easing G-3 rates
   - Capital inflows have helped stabilize currencies
   - Opening up room for policy easing
3. China lightens up, services growth feels very light
   - High debt levels pose headwinds for manufacturing
   - Services is stepping up not as trade intensive as industry
Changes in US policy – a potentially potent brew

We are operating in an uncertain policy environment in the US making it difficult to say anything substantive but given what has been said on the campaign trail, these are risks:

**Risks are rising of a reflationary/isolationist US** - Rising US fiscal stimulus would boost demand but the benefits of this stimulus - due to restrictions on trade, tax incentives for foreign income repatriation, and immigration – would accrue mainly to the US and, amid supply side bottlenecks to labor, be reflationary.

1. Implies stronger US growth, steeper and higher US term structure as growth and inflation firm but with limited trade spillover to the rest of the world.
2. EM Asia is at risk of being directly in the firing line of trade restrictions given the large trade exposures to the US and presence of US MNCs across the region.

**This scenario implies worsening US-EM Asia growth differentials** – Suggests that capital flows into EM Asia slow, with a knock on to BOP, FX and limited room to cut rates amid concerns of financial stability. This leaves fiscal policy as an option but could be constrained given the region’s general bias for fiscal conservatism.

1. In near-term (up to 1Q17), expect to see some slowing in private investment as companies wait for more policy clarity.
2. Beyond 1Q17, depending on the administration’s policies, we could see points 1-2 above play out amid tightening US financial conditions with a negative impact on EM Asia’s growth, FX and rates markets.
## Agenda

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1. EM-DM growth differentials and US$ NEER

**DM and EM real GDP**

- %oya, both scales
- Source: national sources and J.P. Morgan forecasts

**EM-DM growth and US$ NEER**

- %pt EM less DM real GDP
- %oya
- EM DM differential
- US$ NEER
- Source: national sources and JPMorgan forecasts
Growth differentials drive asset valuations

EM: growth differential & FX

%-pt diff in oya, 2qma

%oya, 2qma

EM FX vs US$

EM less US growth

Source: National sources, J.P. Morgan

EM: growth differential by region

%-pt diff in oya, 2qma

%oya, 2qma

EM Asia

LatAm

CEEMEA

Source: national sources, J.P. Morgan

J.P.Morgan
2. 2016 growth lowest since 2001; 2017 likely lower

**EM Asia: annual GDP growth**

Source: National sources and J.P. Morgan forecasts

**EM Asia: quarterly GDP growth**

Source: National sources and J.P. Morgan
In longer term, structural shifts suggest lower growth

EM Asia real GDP and IP

EM Asia IP and real exports

Source: National sources, J.P. Morgan

Source: J.P. Morgan and CPB/OECD
Weak exports is the critical factor

World merchandise trade

Index, 2005=100, real terms sa

Level

Change

EM Asia: GDP and global trade
%q/q saar 8-qtr mma, both scales

Source: CEIC and J.P. Morgan
Export slowdown the biggest driver of slower growth

EM Asia ex CN/IN: domestic demand and exports

EM Asia ex CN fixed investment and exports

EM Asia: dependence on DM growth

Source for all charts: J.P. Morgan
The unbearable lightness of DM demand

Contribution to EM Asia export growth by destination

%pt contribution to oya growth of exports ex EM Asia, US$ terms

Sources: J.P. Morgan estimates

US: equipment spending

% GDP, both scales, sa

Source: BEA

EM Asia-5¹ exports by SITC-7 breakdown

%pt contribution to average %oya growth

Source: National sources, CENSUS, Eurostat and MOF

G-3 SITC 7 imports by country

%pts contribution to average %oya headline growth

Sources: J.P. Morgan estimates
Global trend growth
% oya (average of HP and BP filtered trends)

US growth in productivity and working age population
%chg over 20qtrs, saar
% year-over-year

Source: BLS, Census Bureau
EM Asia ex CN/IN/PH industrial output

Index, 2012=100, 3mma, sa

Source: national sources and J.P. Morgan

China tech\(^1\) exports

Index, 2012=100, 3mma, sa, US$ terms

Source: GAO; 1. Defined as SITC 75, 76 and 77 products

Not much happening outside of tech…
Parts of EM Asia seeing better domestic demand

EM Asia: real GDP

%oya, both scales

EM Asia ex CN/IN: domestic demand and exports

%oya, both scales

Source: national sources and J.P. Morgan forecasts
As fiscal policy takes a step-up temporarily

**Emerging Asia: Fiscal expenditure**

\% of GDP, 1H16 less 2015 full year, central govt.

Source: national sources; KR and TH: exclude state owned enterprises

**EM Asia ex CN/IN: domestic demand**

\% chg, 1H16 from 2H15

*Th \%Chg, 1Q16/4Q15 from 3Q15/2Q15. Source: National sources

**EM Asia ex CN/IN: fixed investment**

\%pt contribut. to \% FAI chg., 1H16 from 2H15

- Non-construction
- Construction

Source: national sources
Asia motor vehicle sales – some notable trends

Asia motor vehicle sales

Thousand units, sa

%6m/6m, saar

Japan motor vehicle sales

Thousand units, sa

Source: national sources

Source: JAMA
Driven by China/India and policy

**EM Asia motor vehicle sales**

*Thousand units, sa, both scales*

Source: national sources

**China and India motor vehicle sales**

*Thousand units, sa, both scales*

Source: CAAM and SIAM
Some exhaustion in rest of EM Asia

Korea and Taiwan motor vehicle sales

Indonesia and Thailand motor vehicle sales

Source: KAMA and TTVMA

Source: AIAI and TMT
3. Markets repricing for fiscal stimulus post US elections

**10-yr UST bond yields and copper prices**

- %p.a., eop
- US$/MT
- Source: Bloomberg, J.P. Morgan

**10-yr UST bond yield and ADXY**

- %p.a., eop
- Index
- Source: Bloomberg, J.P. Morgan
Global financial conditions are tightening

Probability of Fed funds hike

- 30-Sep-16
- 7-Nov-16
- 8-Nov-16
- 9-Nov-16

% 90 80 70 60 50
Dec. 16 Feb. 17 Mar. 17 May. 17

Source: Bloomberg, J.P. Morgan

ADXY and 1-yr US treasury

% p.a.
0.8 0.6 0.4 0.2 0.0
2013 2014 2015 2016 2017

Source: Bloomberg and J.P. Morgan
Steepening US term structure suggests growth and reflation

10-yr UST and 10-yr weighted avg. Japan & Euro bond yields
% p.a., eop, both scales

Source: Bloomberg

10-yr and 1-yr UST bond yields
% p.a., eop, both scales

Source: Bloomberg

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EM Asia’s growth-lite bear steepening

10-yr UST and 10-yr EM Asia bond yields

% p.a., eop, both scales

EM Asia ex. CN/IN

US

Source: Bloomberg

EM Asia term structure

% pt., change in 2s10s spread 1H16 vs. 2015

EM Asia 10-yr govt. bond yield and UST 10-yr

Correlation coefficient, 12-mo trailing

Latest

2010-2014 Avg.

Source: National statistics authorities and J.P. Morgan
But Asia FX is expensive but could get cheaper

DM and EM REER
Index, 2010=100

EM REER
Index, 2010=100

G-3 REER
Index, 2010=100

EM Asia REER

Source: J.P. Morgan
Stronger US$ suggests flat to stable oil prices

US$ NEER and Brent

Source: J.P. Morgan

EM ASIA ECONOMIC OUTLOOK
4. China growth ‘measurement’ problem overblown

China: real imports and GDP

%oya, both scales

Source: NBS and GAC

China: real imports and manufacturing

%oya, both scales

Source: NBS and GAC
Rebalancing “lightens” China GDP

China: GDP composition

% share of total GDP, 4qma

Source: NBS

China employment by sector

% yoa

Source: MHRSS

China composition of GDP growth

% pt. contribution to headline GDP growth

Source: NBS

China output gap by sector

% deviation from HP-filtered trend

Source: NBS and J.P. Morgan
Credit comes back but with limited impact on real growth

China credit growth vs GDP

China real GDP and credit impulse

Source: NBS and PBOC
PBOC domestic purchases drive monetary expansion; NEER stabilization

**China: PBOC sources of net assets**

- **RMB tn, both scales**
  - Net foreign assets
  - Net domestic assets
  - PBOC regains control

**China: 7-day SHIBOR and NEER**

- %p.a.
  - Index, Dec 31 2014 =100
  - 7-day SHIBOR
  - CFETS NEER

*Source: PBOC*  
*Source: Bloomberg*
Slowing outflows open room for accommodation

China: capital flows
USD bn
Jan 15  Jul 15  Jan 16  Jul 16
Source: J.P. Morgan

CNY and CNH
vs. USD
Jul 15  Sep 15  Dec 15  Apr 16  Jul 16  Oct 16
Source: Bloomberg, J.P. Morgan

CNY fixing and CFETs index
vs USD
Jan 15  Apr 15  Jul 15  Oct 15  Jan 16  Apr 16  Jul 16  Oct 16  Jan 17
Source: CFET, J.P. Morgan

China: Interest rates and RRR
% pa
06 07 08 09 10 11 12 13 14 15 16
Source: CFET, J.P. Morgan

J.P.Morgan
Fiscal policy remains key in 2017

**China's fiscal trends**
- Expenditure, Revenue, and Balance ytd
- %oya ytd
- Rmb bn
- Source: MOF, J.P. Morgan

**China: fiscal balance**
- RMB bn
- Government target
- Source: CEIC, J.P. Morgan

**China: fixed asset investment**
- %oya
- Public, Private
- Source: NBS, J.P. Morgan

**China: augmented fiscal deficit**
- % of GDP, 4qma
- RMB bn, quarterly
- Source: CEIC; J.P. Morgan
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## Regional economic outlook

### Key economic statistics

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Source: National sources and J.P. Morgan forecasts
### Regional outlook: Policy rate and exchange rate forecasts

#### Official interest rates, % p.a., end-period

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#### Exchange rates, end-period

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1. The BI rate for Indonesia reflects announced recalibration effective August 19, 2016. 2. The Philippines introduced a recalibrated reverse repo rate effective June 3 at a level of 3.00%.

Source: National sources and J.P. Morgan forecasts
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<td><a href="mailto:jonathan.cavenagh@jpmorgan.com">jonathan.cavenagh@jpmorgan.com</a></td>
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<td><a href="mailto:jiwon.c.lim@jpmorgan.com">jiwon.c.lim@jpmorgan.com</a></td>
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<td><a href="mailto:haibin.zhu@jpmorgan.com">haibin.zhu@jpmorgan.com</a></td>
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J.P. Morgan Sovereign Research Ratings Distribution, as of Oct 03, 2016

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*Percentage of investment banking clients in each rating category.

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