



Emerging Asia: Outlook & State of Play

Gunjan Gulati
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Business Climate Outlook 2017
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Key Themes

Region Manages to Grow Steady Amidst Global Headwinds

- **Despite global headwinds, activity in EM Asia remains anchored**
- **Domestic demand supported by public spending, offsetting weakness in manufacturing and external demand; but sustainability & strength of fiscal stimulus fading away**
- **Benign inflation and delayed Fed normalization has provided space for monetary easing**
- **But, private capex and exports have not shown signs of material strength**
- **Domestic buffers in place by way of lower inflation, higher forex reserves, improved current account balance**
- **Structural issues continue to weigh on long-term growth; economies undertaking reforms will continue to attract foreign investment, limit volatility**

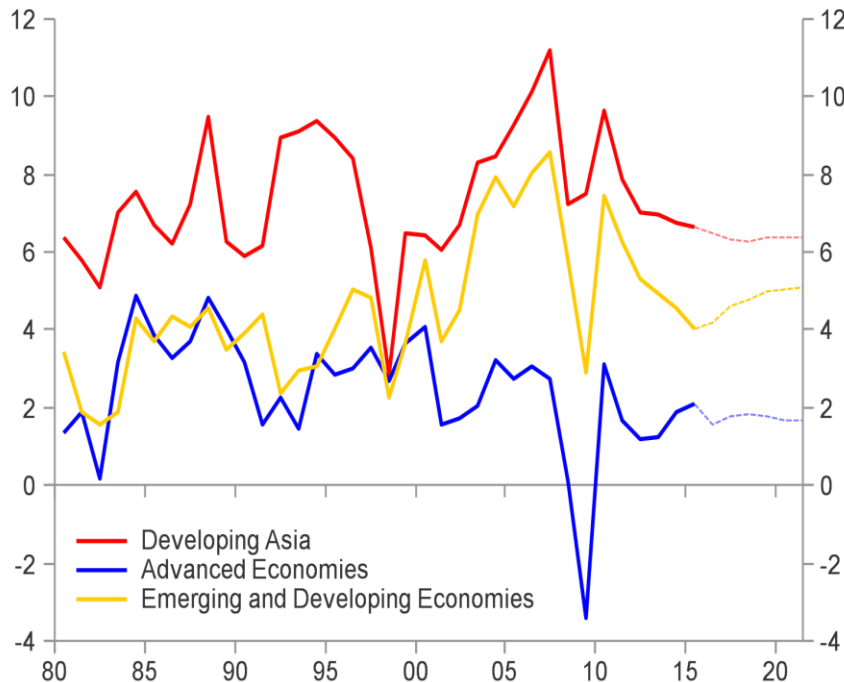
- **Risks:** Reaction to the anticipated US interest rate hikes and yield steepening, broader uncertainty about divergence of monetary policies, dealing with the 'new mediocre global growth', increased protectionism
- **Opportunities:** To undertake reform, diversify product & market mix, innovate, develop new technologies for better reach

Asian Economies Have Outperformed the Rest

But No Meaningful Upshift in Growth

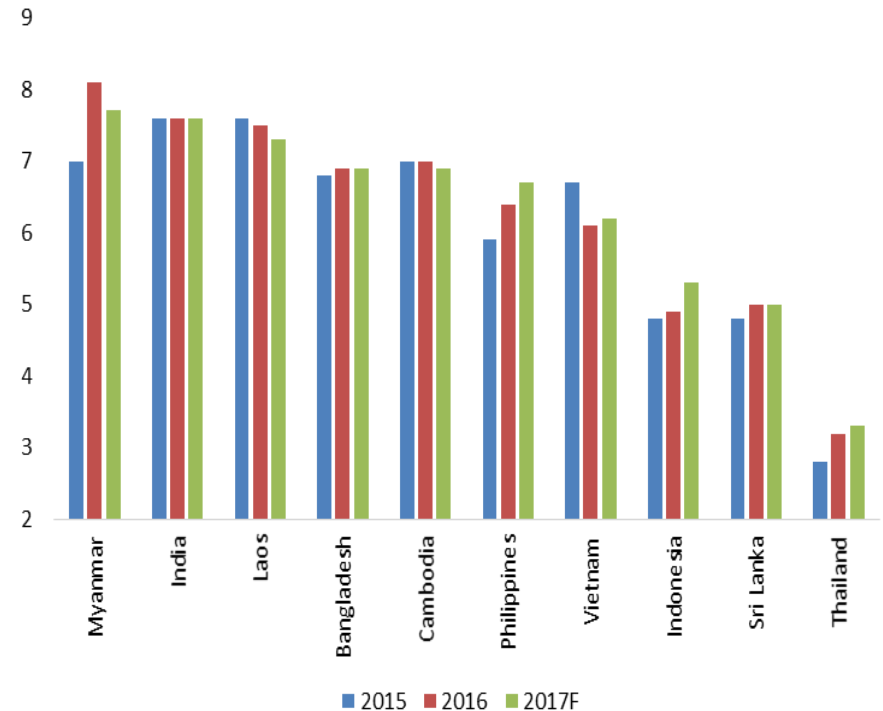
Real GDP Growth

(% YoY)



Real GDP Growth By Country

(% YOY)

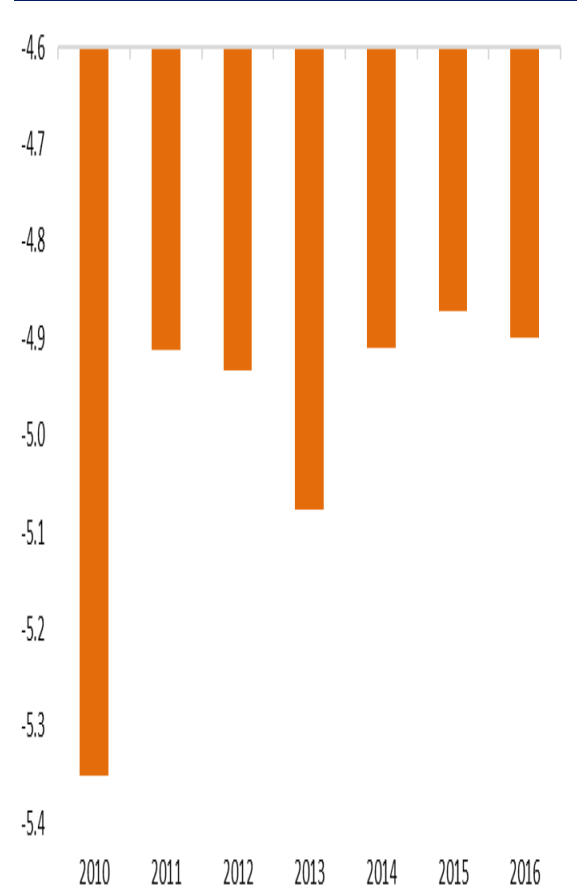


- Emerging Asia maintains the edge in growth performance over other regions
- Balance of downside risks to the region has shifted towards external than domestic; expect a gradual recovery in 2017

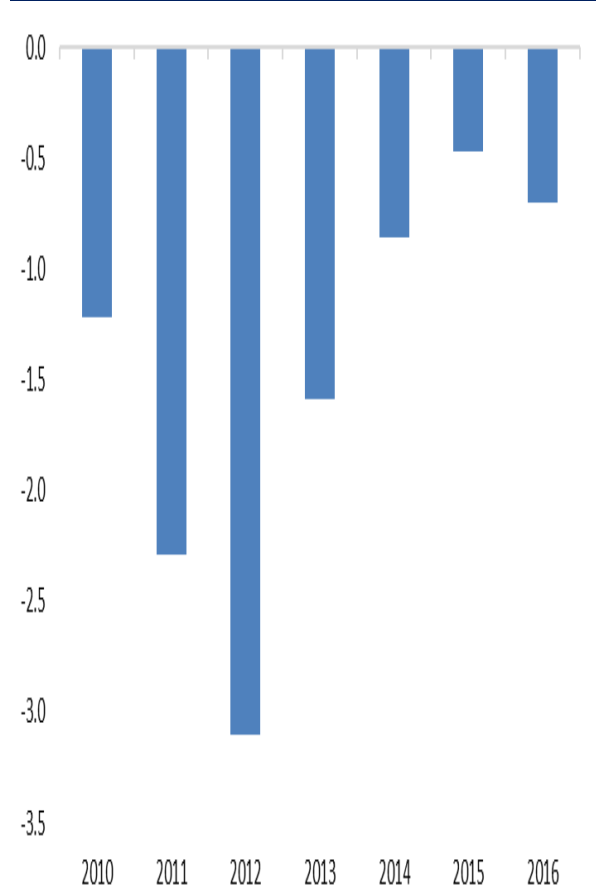
Region Undertaking Macro Adjustment, Improving Stability

Better Prepared for Headwinds

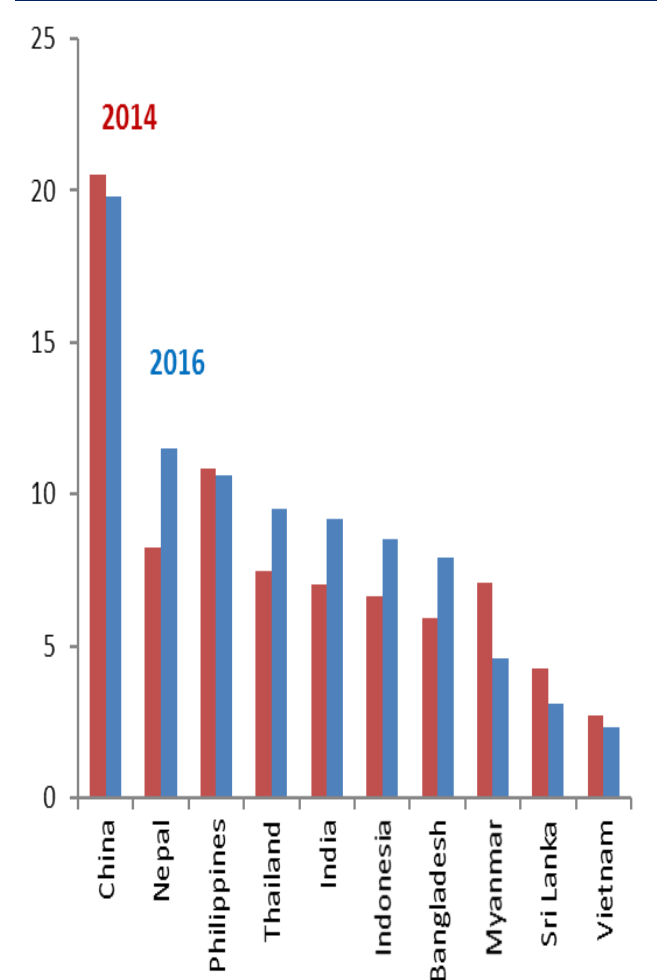
Fiscal Balance
(% of GDP)



Current A/c Balance
(% of GDP)



Forex Cover
(Months of Import)

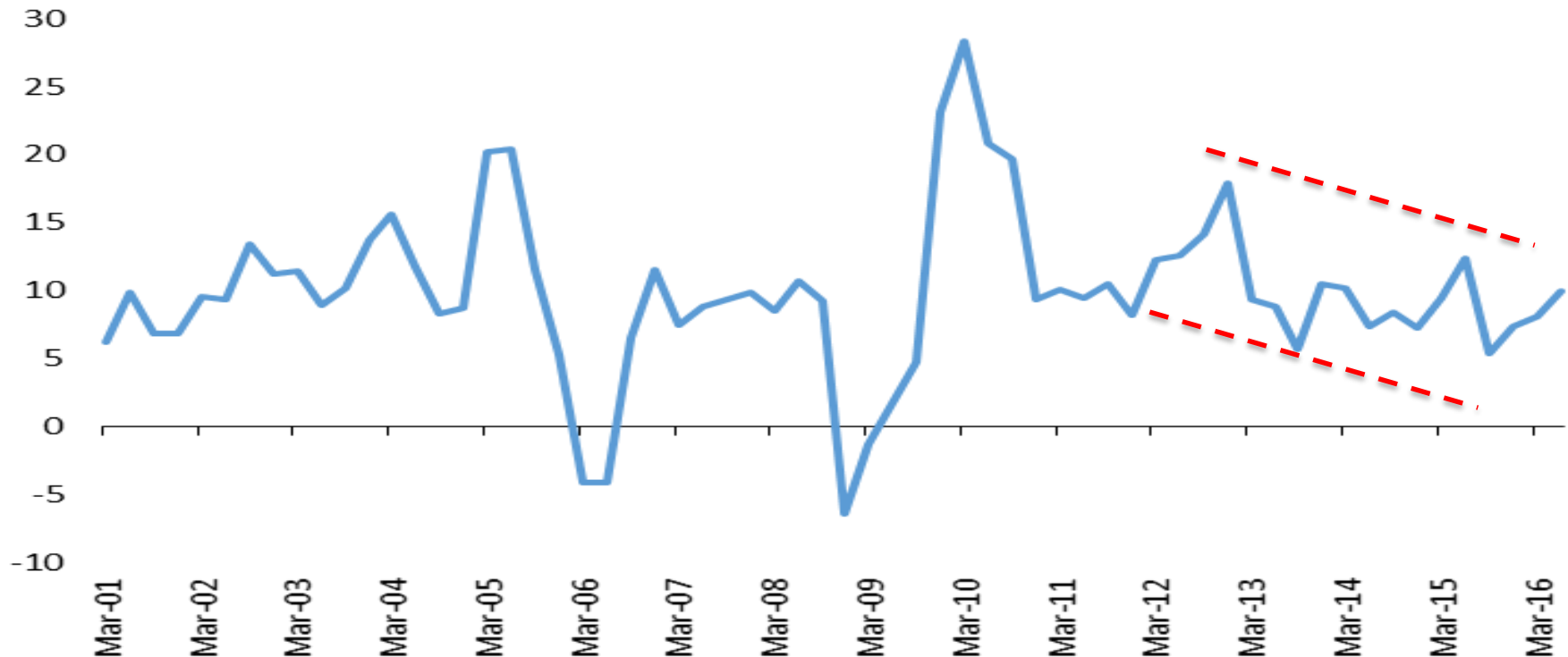


But, Domestic Demand Remains Subdued

Sustained Signs of Demand Pick-up Holding Back Capex Cycle Recovery

Retail Sales, EM Asia ex China

(% YoY)



- Consumption momentum weak, as effects of stimulus – tax credits, loan support – fades
- Risk of negative feedback loop of slow growth, lower return expectations, weak capex and declining productivity growth

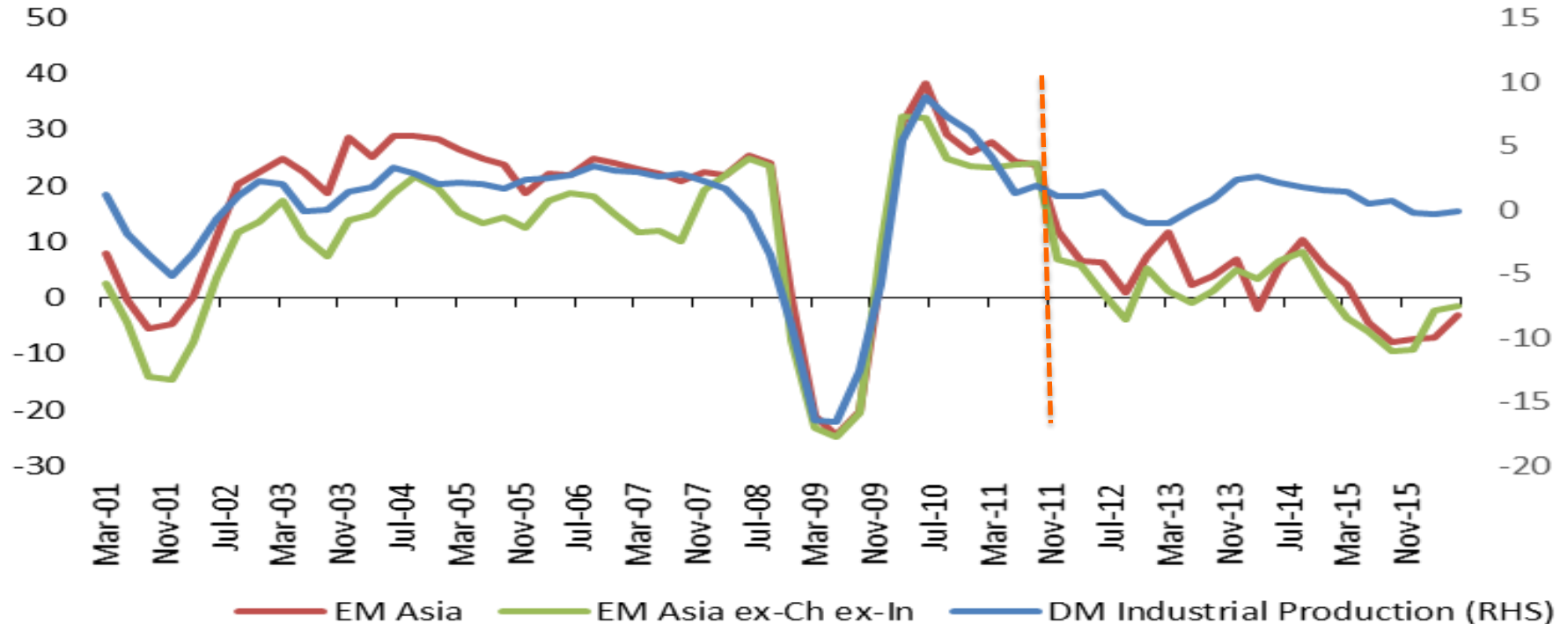
Source: Thomson Reuters - Datastream, CBCIR

Exports Showing Early Signs of Recovery

Decoupling of Asian Exports from DM Industrial Activity, Structural or Cyclical?

Asian Exports & DM Output

(% YoY, 3mma)



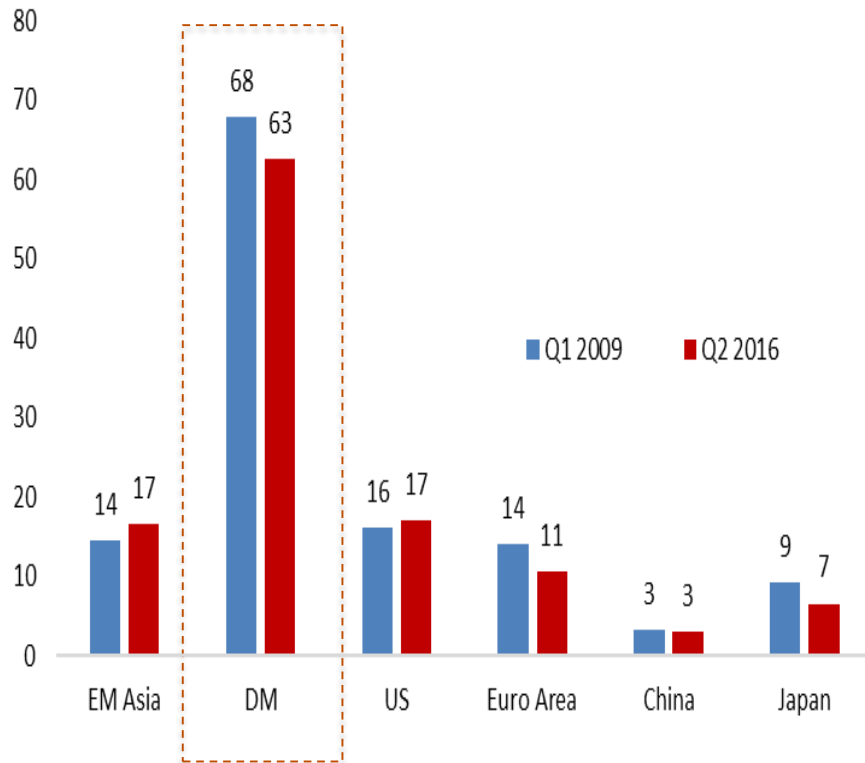
- Despite rising CA balances in most EM Asian economies, net exports remain a drag on growth. But incremental impact of export weakness on growth fading down
- Asian exports decoupling from DM industrial cycle. Structural ? Possibly due to import substitution in DMs, structural factors (evolving global chains), rising restrictions, weakening competitiveness of Asian economies

High Dependence on Developed Markets for Exports

But, Spillovers of DM Recovery Could be Limited

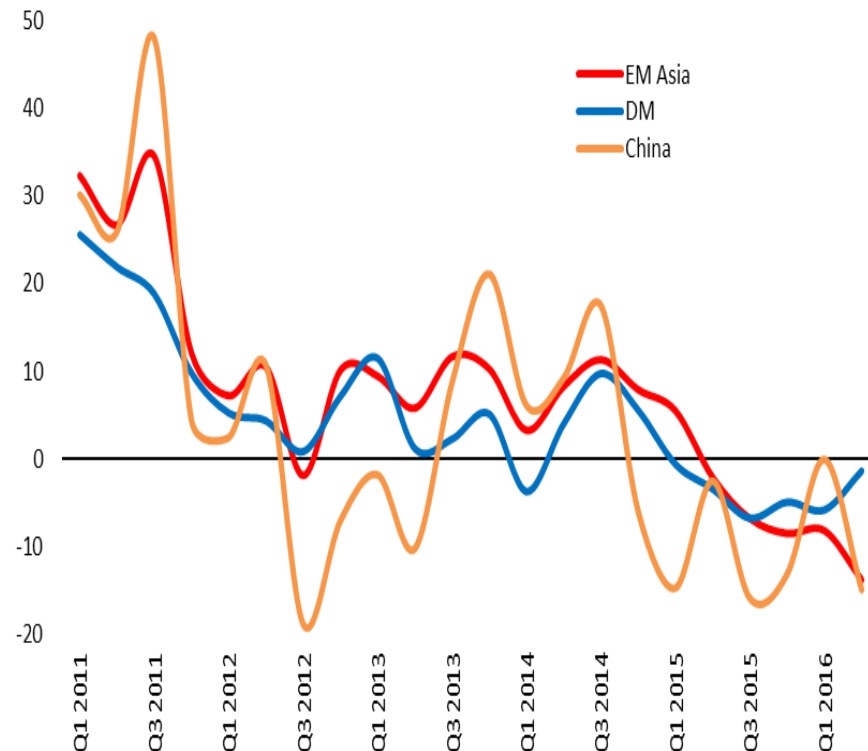
EM Asia: Share of Exports

(% of Total)



EM Asia: Destination of Exports

(Growth, % YoY)

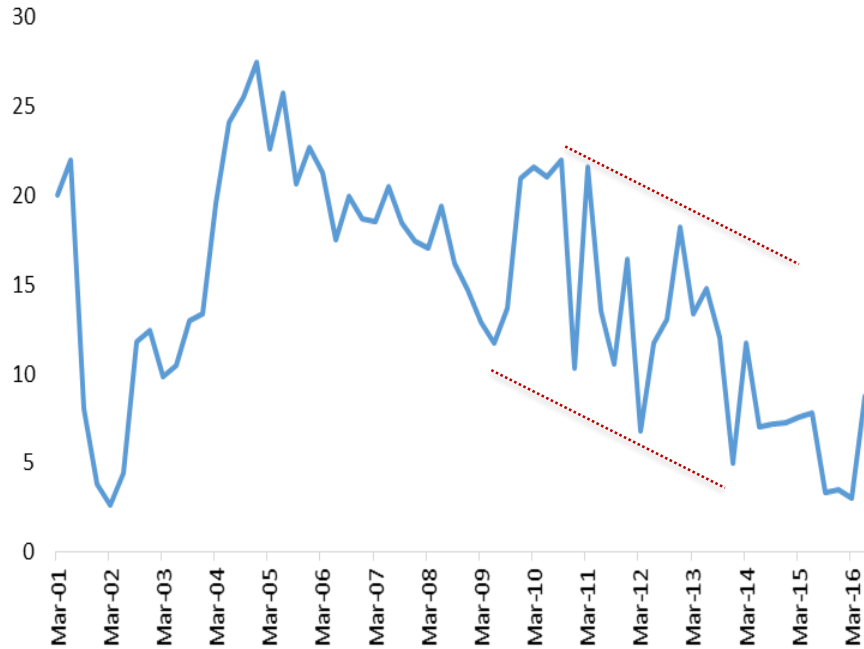


- Continued period of lower export growth could weaken investment, technology transfer/ adoption– risking lower potential growth over the medium term
- Need to diversify Asian export products & markets

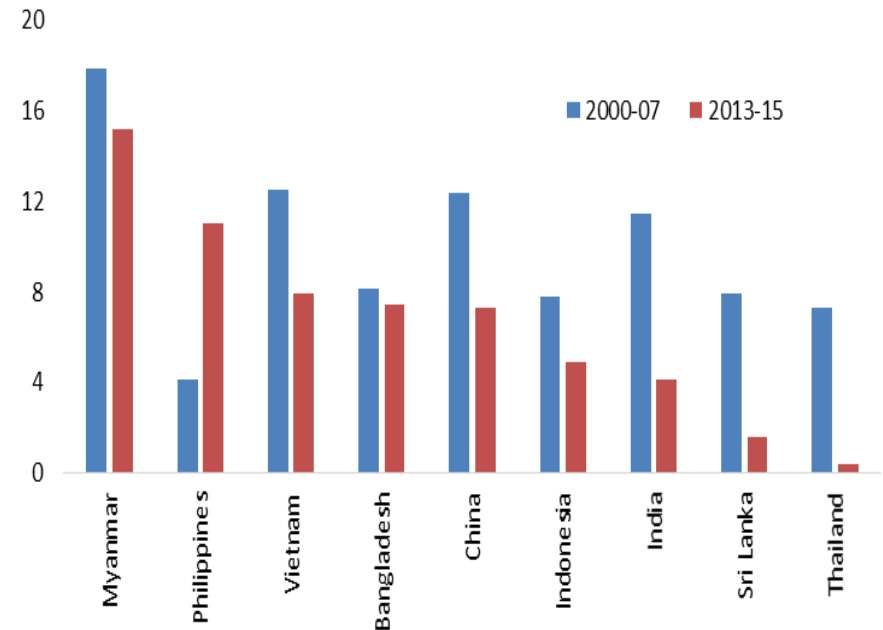
Waiting for a Capex Recovery

Investment Growth Still Below Pre-GFC levels

Fixed Capex Growth, EM Asia ex China (% YoY)



Real Fixed Capex Growth (% YoY)



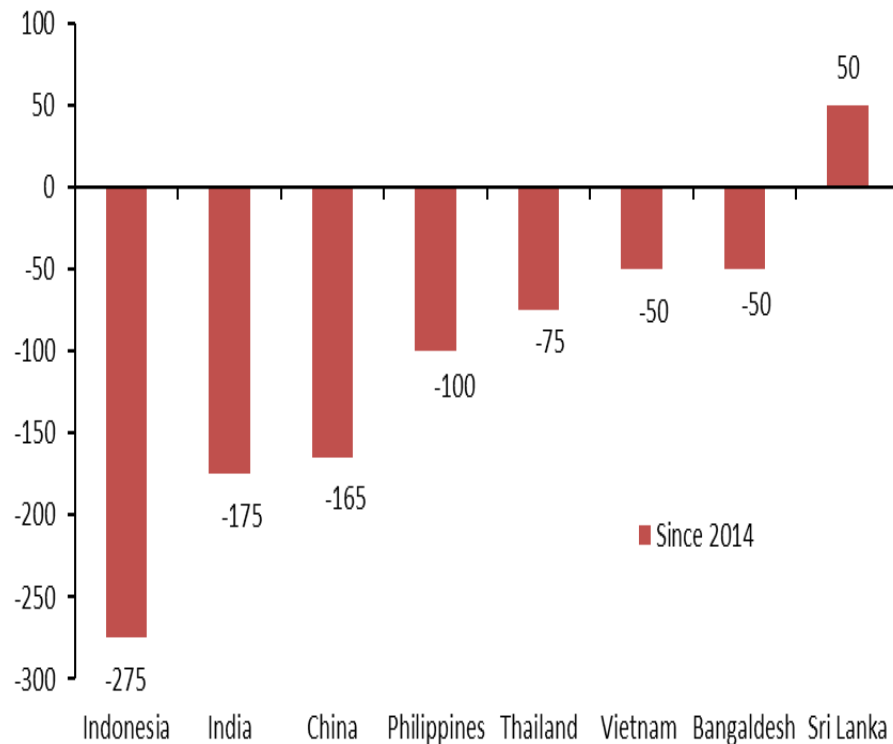
- Capex growth in most economies has remained sluggish, below the pre-GFC growth rates
- Debt accumulation, weak asset quality of the banking sector are weighing on new capex
- Downturn in both domestic demand and trade growth, lack of new sizeable markets has added to dearth of investment opportunities for the private sector. Lower expectations on future growth and returns, further weakening any incentive to invest

Policy Stimulus Strength Varying Across Region

Stimulus Limited by Financial Stability & Fiscal Sustainability Concerns

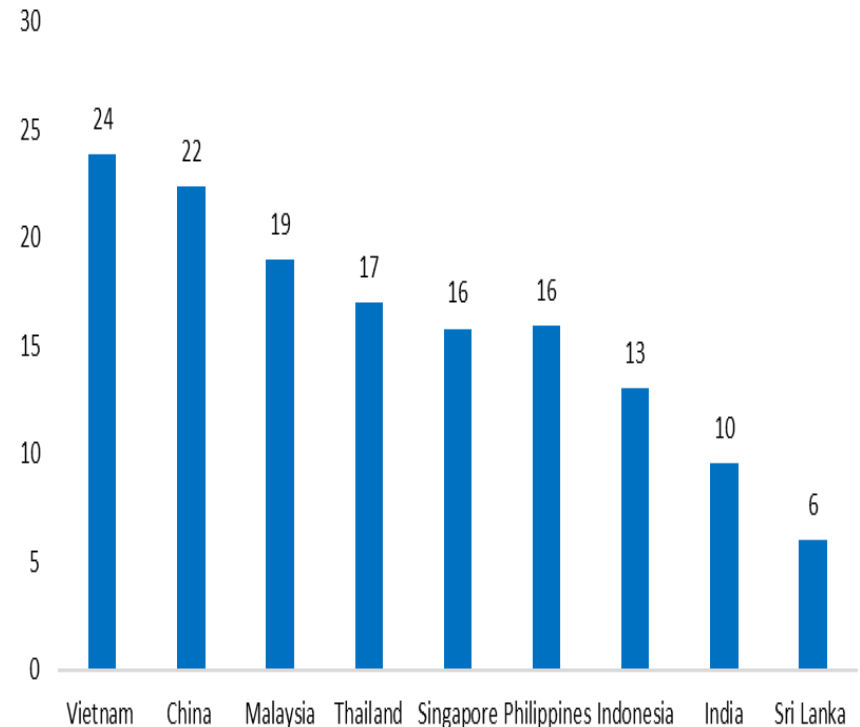
Monetary Easing

(Reduction in policy rates, in basis points)



Government Revenue to GDP

(% of GDP, 2015)



- **Policymakers responding by way of gradual monetary and fiscal easing**, balancing the financial stability risks from domestic credit growth, expected gradual Fed tightening and weak aggregate domestic and external demand
- **Better expenditure mix**, despite mild expansion in deficit will help support aggregate demand

Capital Flows Provide the Necessary Cushion

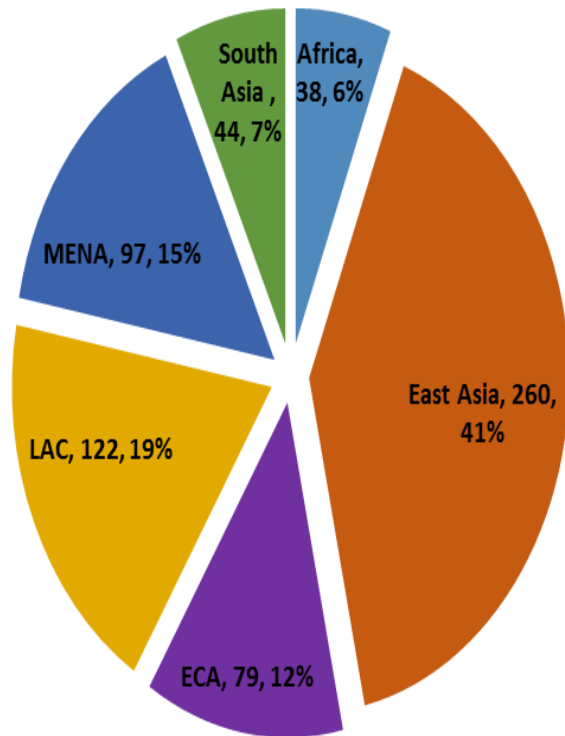


Capital Flows to Asia Remain Healthy

Inflow Momentum Targeted Towards LAC & MENA

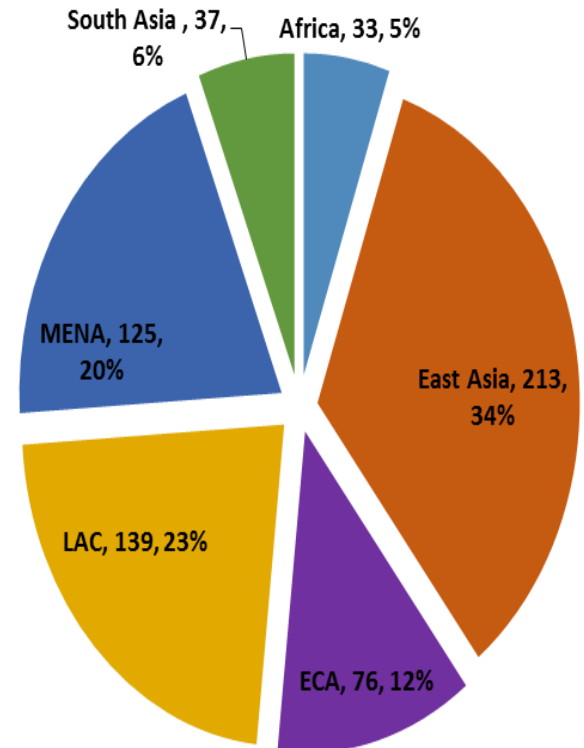
Gross Capital Flows to EMs: 2015

(US\$ bn)



Gross Capital Flows to EMs: 2016

(US\$ bn; YTD (Jan-Oct))



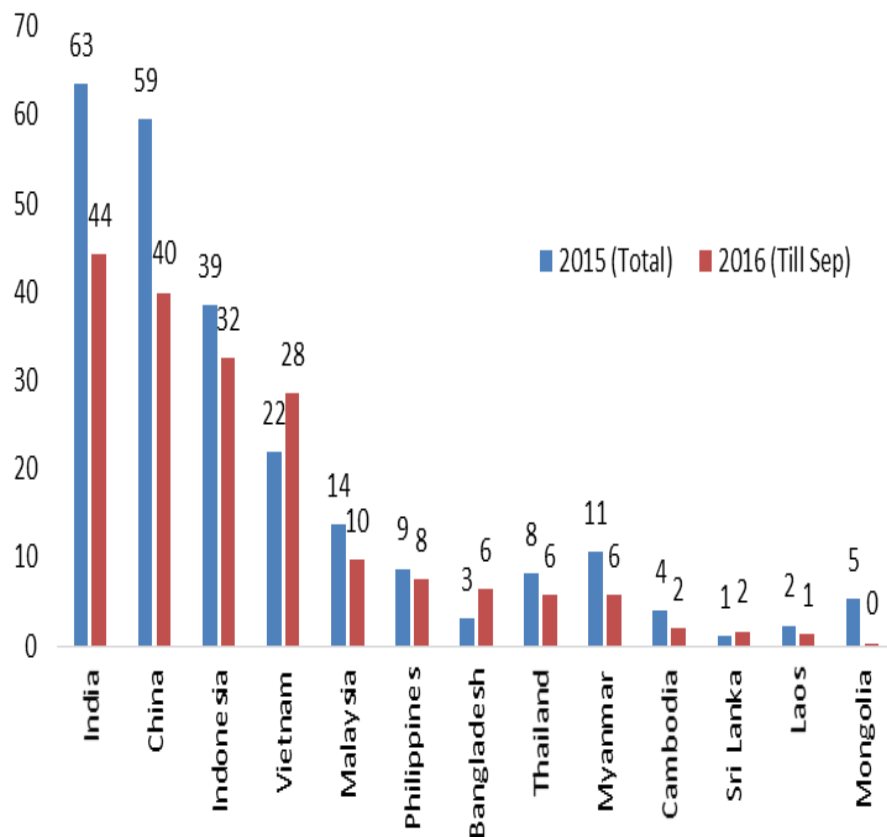
- EAP continues to attract the highest capital flows among EM regions; but YTD flows to EAP & South Asia in 2016 are lower than those in 2014 & in 2015
- MENA, followed by LAC attract the incremental increase in capital inflows

FDI Flows to EM Asia Remain Strong on Reform Expectations

India, Indonesia, Vietnam- Investors' Favorite

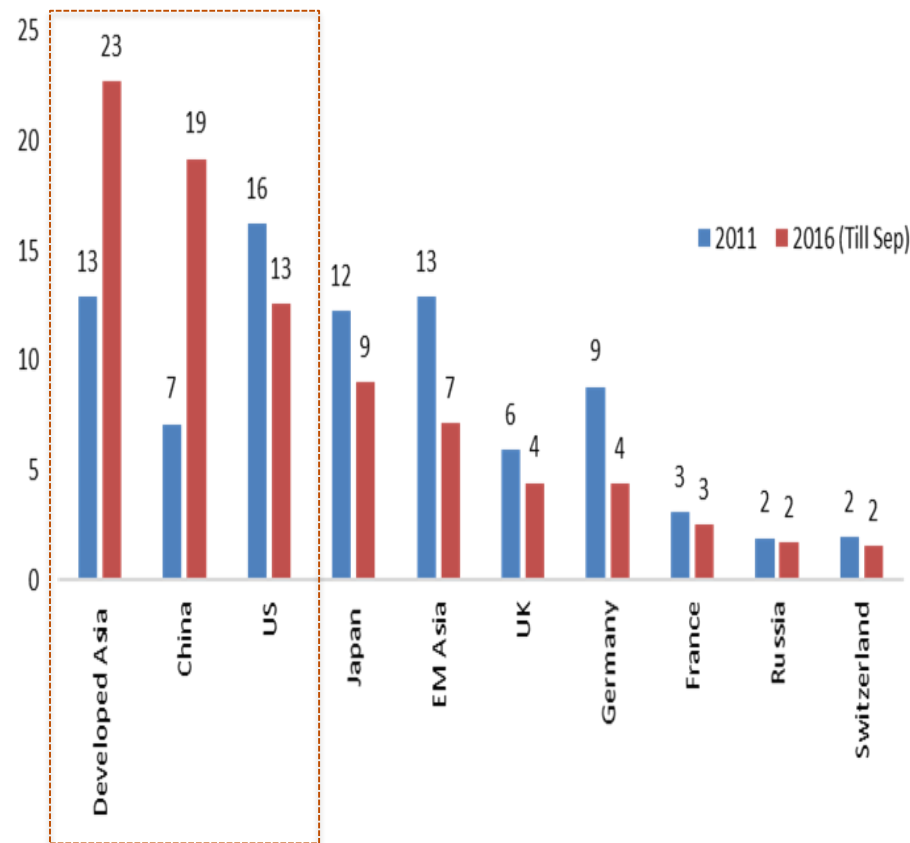
Foreign Direct Investment

(US\$ billions)



Origin of FDI to EM Asia

(US\$ billions)



- India, Indonesia, Vietnam remain investors' top pick among EM; flows driven by improving macro fundamentals, expectation of stronger growth rates and progress on reform delivery

What to Watch Out For?

Significant Global Headwinds

Fed Interest Rate Normalization & Weak Global Demand Key Risks

- **Reaction to the expected US interest rate hikes, broader uncertainty about divergence of monetary policies:**
 - Capital inflows
 - Impact on high debt corporates & households
 - Banks' balance sheets through NPLs, corporate bonds
- **China: Countries more exposed to manufacturing & investment related sectors**
- **Medium-term headwinds: “New Mediocre” in developed economies**
 - Relatively low growth for longer period, slower growth in investment and productivity, weaker growth in EM/ trading partners
 - Continued dependence on accommodative monetary policies in DM, could cause unstable asset price movements
- **Climate change & natural disasters, especially to smaller economies. Impact gets accentuated because of weak access to financial services disrupts financial intermediation**
- **Escalation in geopolitical tensions, policy uncertainty within Asia and trading partners: Policy stance of US President, regional country dynamics with China**
- **Longer-term challenges such as skill creation, jobs, rising inequality, productivity slowdown**

Source: IMF, CBCIR

What does Trump Victory Mean for Asia?

Nature of US Growth, Import Intensity, Openness of Trade Will Be Key

- **Geopolitics/ regional harmony & security**
 - Asia policy likely to be defined by the need to manage the rise of China
 - Threat of region developing their nuclear weapons, threat of withdrawal of US troops from the region – could increase tensions in the region
- **Growth spillovers**
 - Higher US growth is net positive for the region; but extent of spillover – due to restrictions on trade, tax incentives – may be limited
- **Trade Policy: Opposed to TPP, signaled protectionist policy towards China**
 - Blanket 45% tariff on electronics sector (50% of total Chinese exports to US) could hurt the Asian countries exporting intermediate goods to China
 - Over a medium term, a likely substitution in importing country will benefit Asian countries – Vietnam, Taiwan, Malaysia
- **Outsourced jobs**
 - BPO services account for a significant share in Philippines (10% of GDP) and India (7%)
- **Immigrants**
 - Significant share of Asian immigrants in US; Philippines has highest dependence on remittance inflows from US (3% of GDP)

Opportunities for Asia

Need to Reform, Draw Cushion from Higher Growth, Global Challenges

- **Asia expected to continue delivering highest growth rates in EM**, though intra-regional growth dynamics differ. Positive for Consumption /Demand led sectors
- **Close proximity to supply chains of China**, low wages, expanding workforces, rapidly growing consumer markets, rising costs in China – high potential for most of the regional economies
- **Young population & rising income levels: Demographic/urbanization opportunities across value chain** in food, health, education, retail
- **Continue with the reform efforts/ innovation: Adoption of widespread reforms towards exchange rate flexibility, fiscal & monetary discipline and relaxing capital controls** – helping in lowering EM risk profile
- **Encourage innovation, disruptive technologies, fin-tech to help expand inclusion and productivity**– expanding scope of products & services
- **Diversify to sustain growth & be more competitive: Need to identify new products, markets**
- **Work towards creating a dynamic, inter connected “one” region: A single market and production base allowing for free movement of goods, services, investment, capital and skilled labor**

Country Snapshots



India: Pace, Not the Direction of Recovery, a Concern

Improving Macroeconomic Dynamics

- **Faster growth** – Steady improvement in GDP growth to 7.1% in 1QFY17 ; Real GDP growth projected to average 7.7% in 2017-18
- **Fiscal position is gradually improving**, but limited fiscal space. Target of 3.5% of GDP achievable, as sources of slippage (spectrum revenue shortfall, pay commission, capital spending) to be balanced by higher tax revenues
- **CAD in FY17 expected to stay below 1% of GDP** driven by lower imports; exports have started to show early signs of recovery with pick-up in non-commodity exports
- **FDI inflows remained buoyant** at US\$36bn in FY17 so far; Forex reserves at US\$368 bn (~12 months of import cover)
- **Absence of revival in private capex** despite lower interest rates, increased public spending & improving capacity utilization. NPLs expected to increase to 8.5% of assets in Mar'17 from 7.6% a year earlier
- **More stable currency** due to intervention by the Central bank and better macro

Delivery of Bold, Institutional Reforms Materially Positive

- **Policymakers continue to undertake big and small steps to improve India's ease of doing business**, lower corruption and attract higher investments-- likely to raise med-long term growth potential. But, concerns around job creation (10-12 million per year)
- **Assembly elections in Jan/Feb'17 will be the next big event**; material impact on driving political sentiment prior to general elections in 2019

Government Takes Key Steps to Reduce Vulnerabilities

But External & Domestic Vulnerabilities Unable to Generate Meaningful Rebound

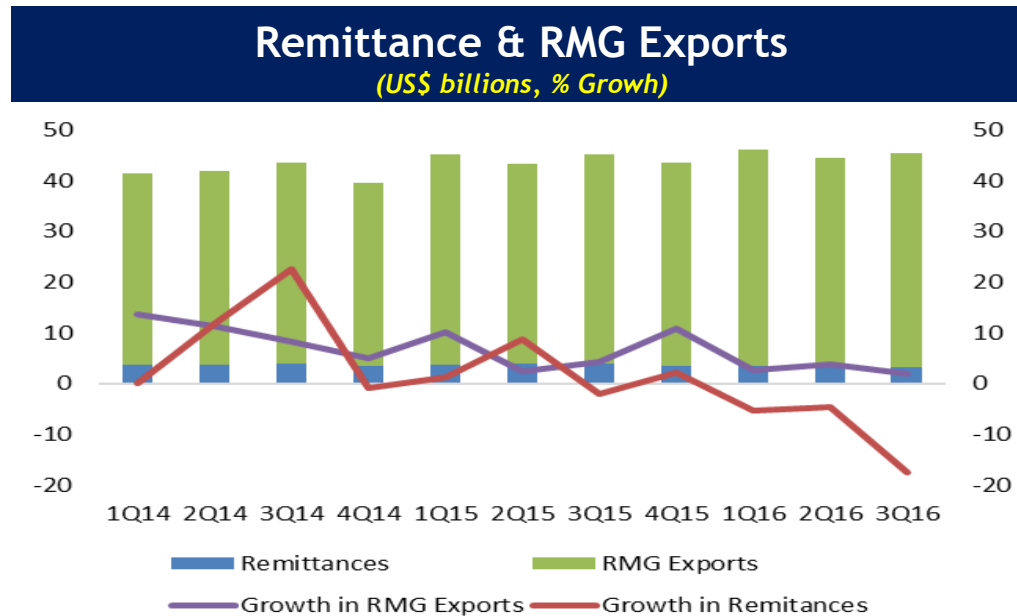


- **Material progress on the ‘big-bang’ reforms:**
 - Goods & Services tax
 - Demonetization of higher denomination currency
- **Overhauling the bureaucracy** to hasten decision-making and improve the ease of doing business
- **Clearances for stalled projects**, reviving road projects, institutional changes to undertake resource allocation (coal auctions/mining)
- **Reviving Investment:**
 - **Liberalizing FDI rules** in sectors such as railways, defense, pensions, insurance and construction
 - **Increased budget allocation for railways and road construction**
 - **Transfer to states**
- **Reduction of fuel subsidies** - deregulating gasoline and diesel prices
- **Signing an inflation targeting agreement** with the RBI; Moderate support price increase
- **Push on financial inclusion** – creating necessary infrastructure to enable transfers

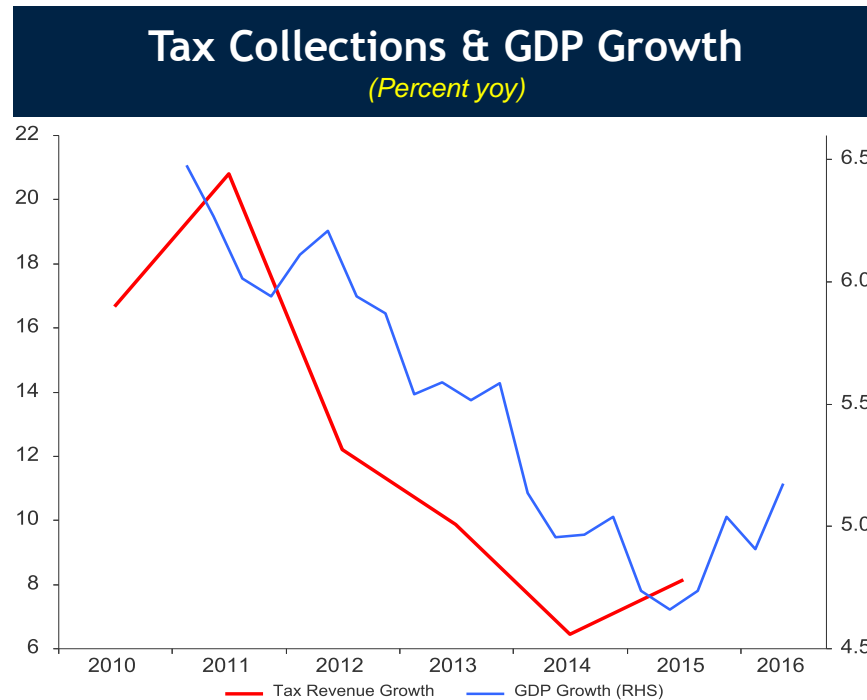
- **Reducing tax uncertainty**
- **Political opposition and strong domestic headwinds** (high corporate leverage, low capacity utilization, and high banking sector stressed assets) have dampened investment activity
- **Modest pick up** in on the ground activity
- **No clear guidance on “Make in India” campaign; inconsistent pace of labor reforms**
- **Communication within government could be more effective – corporate link is weak**

Bangladesh

Steady Growth But Challenges Remain



- **Steady improvement in GDP growth to 7.1% in FY16** from 6.5% in FY15; IMF expects growth momentum to continue, ~7% in 2017-18
- **Remittances falling** amidst lower oil prices and indigenization pressures in the Gulf; but **RMG exports (90% of total exports) and FDI inflows** maintain external account in surplus
- **Banking sector faces asset quality risks**, Gross NPL at 9.9% of total assets in 1Q16. Additional stressed loans (restructured + re-scheduled) ~7.5% of total assets. **CRAR of the banking sector at 10.6%**, marginally above the required 10%
- **Strategic location helping attract FDI inflows towards infrastructure investment**



- **Stable pace of economic activity** led by rising private consumption and higher fiscal spending
- **Cabinet reshuffle in Jul'16 has strengthened policy making;** Some progress on reforming business environment – removing foreign ownership caps, easier to set up business; but not much on labor reforms
- **Real GDP growth** expected to grow an average of 5.4% in 2017-18 from 4.9% in 2016
- **Keeping fiscal deficit below 3% of GDP is critical** for government to seek the investment grade rating from S&P

Source: *Dragon Capital, IFC Economics & Industry Research*

Myanmar

Political Transition Smooth, Progress on Reforms Slow



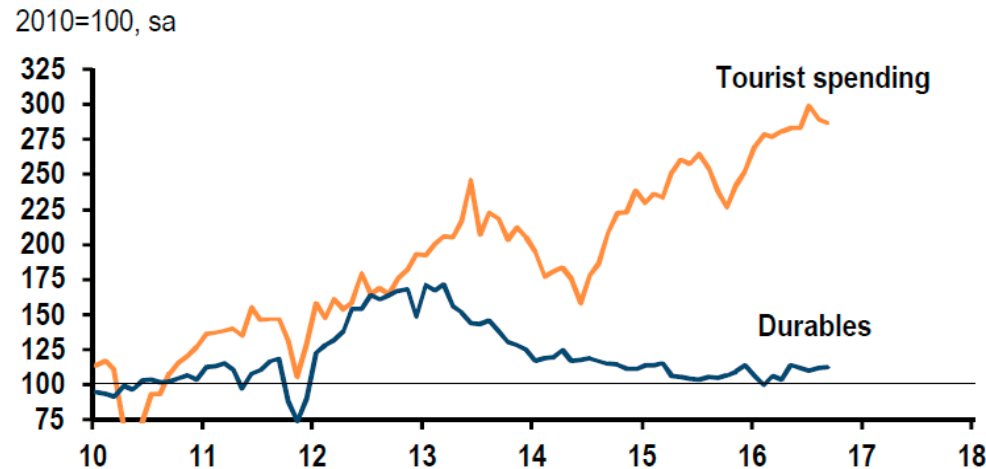
- **One of the fastest growing economies – 8% in three years to 2015. Growing concerns of overheating** driven by double digit inflation and surge in CAD (8.3%).
- **Manufacturing sector attracting greater share of investment**, 53% (US\$686m) of total investments since the new government from 14% in FY16 under the previous government
- **Reforms undertaken to encourage foreign investment** to improve FDI approval, land use regulations; But **lack of government's experience** could be a challenge .
- **Potential for social / military tension exists in many areas** regarding pending decisions about ethnic minorities peace process and the related constitutional change, military's budgets, human trafficking, forced labor
- **Challenges:** China Linkages, Undeveloped human resources, infrastructure and banking, laws yet to be implemented, perceptions of corruption

Thailand

King's Demise to Slow Economy, Stability Put to Test

Thailand Private Consumption Indicators

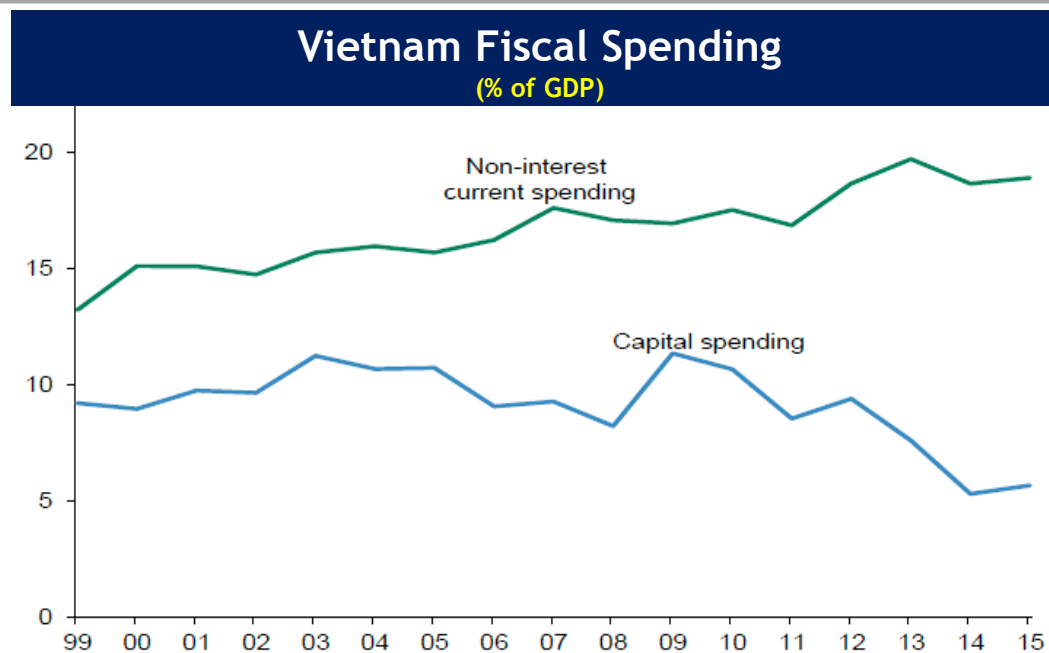
(2010=100)



- **Near-term hit to economic activity expected as the country mourns the loss of the King;** medium-term growth expected to remain weak on sluggish private investment
- **2016 real GDP growth projections by market lowered to ~2.7% from 3% earlier;** IMF expected 2017-18 growth around 3.2%
- **Government spending on infrastructure projects supporting growth,** but land acquisition and financing posing challenge. **Political uncertainty** keeping private investors at bay
- **Manufactured goods exports,** though significant (40% of GDP), likely at risk from the absence of renewed private capex, weak Chinese economy and increasing regional competition
- **High household debt (70% of GDP) and cooling property prices** worrisome

Vietnam

Steady Growth, Remains Attractive to Investors



- **GDP growth on an uptrend, growth of 6% in first three quarters of 2016**
- **Rapid growth in credit ~17.5% could be concern; Banking sector NPLs moderating but VAMC not able to address the bad debt as efficiently as expected**
- **Fiscal deterioration raising concerns:** Rapid increase in current expenditure and debt servicing costs against a lagging revenue growth; tightening space for critical spending on infrastructure investment. Public debt ~62% of GDP-- fast approaching the legal debt ceiling of 65% of GDP
- **Attractive destination for investors** driven by buoyant growth outlook, openness to trade, low cost but relatively skilled labor force, and stable political climate

Global growth momentum balance is tilting towards the 'East'

- Need to integrate with the high growth economies - scope for economic benefits and increased trade
- Share of tourist arrivals: India (17%), China (14%), G5 (25%)
- Potential benefits from energy cooperation, land and maritime connectivity, tourism

But, balance of risks tilted towards External

- Share of Exports: US (27%), UK (9.8%), EU (28.8%), India (6.1%), China (2.9%)
- Risks of increased nationalism

Follow a balanced foreign policy which would ensure cordiality with both 'halves' of the global hemisphere...?

- Need to accelerate the economic reform process to attract investment & labor, amidst increasing competition within the region
 - Regulatory, legal, labor,
 - Improving governance at various level of public administration
 - Improve information, communication, and technology systems to coordinate supply chains efficiently,
 - Lower logistics costs

Key Contacts

IFC Economics & Industry Research



Jean Pierre Lacombe

Chief Global Markets
Head of IFC Research
Tel: (202) 458-7751
JLacombe@ifc.org
www.ifc.org



Facundo Martin

Principal Economist
Tel: (202) 473-8238
FMartin1@ifc.org



Tomoko Suzuki

Senior Portfolio Officer
Tel: (202) 473-2167
TSuzuki@ifc.org



Camilo Amezcuita

Portfolio Officer
Tel: (202) 458-0785
CAmezquita@ifc.org



John Barham

Senior Strategy Officer
Tel: (202) 458-0200
JBarham@ifc.org



Gunjan Gulati

Asia Economist
Tel: (91) 22 4230 2436
GGulati@ifc.org



Monika Blaszkiewicz

Research Officer
Tel: (202) 458-7732
Mblaszkiewicz@ifc.org



Florian Moelders

Assoc. Research Officer
Tel: (202) 458-7663
FMoelders@ifc.org



Elisabeth Kim

Consultant
Tel: (202) 473-1877
EKim8@ifc.org



Keita Miyaki

Research Officer
Tel: (202) 458-8864
KMiyaki@ifc.org

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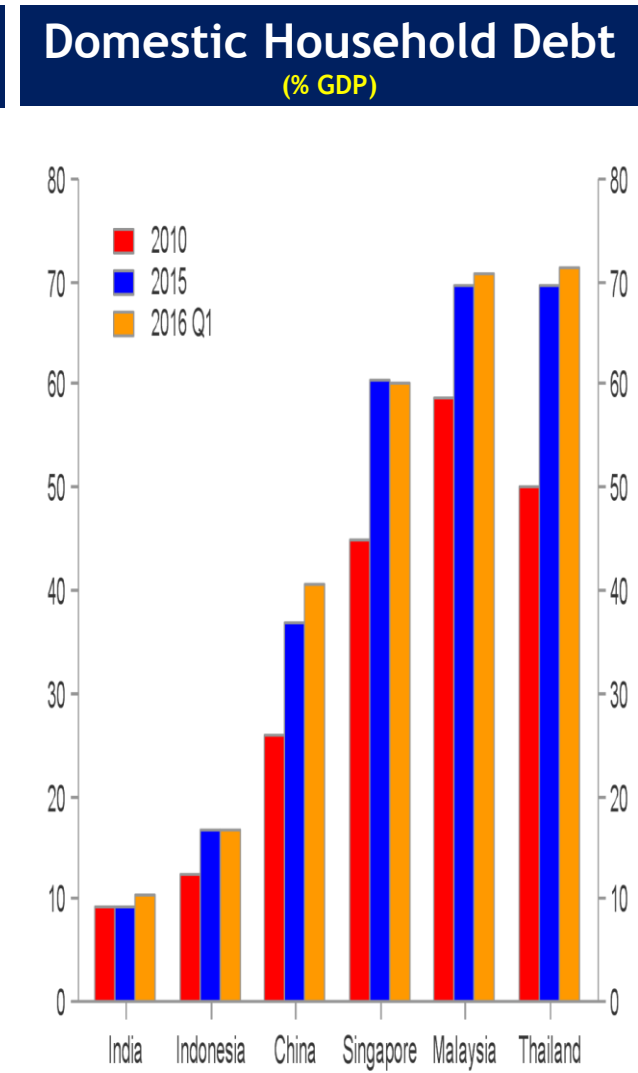
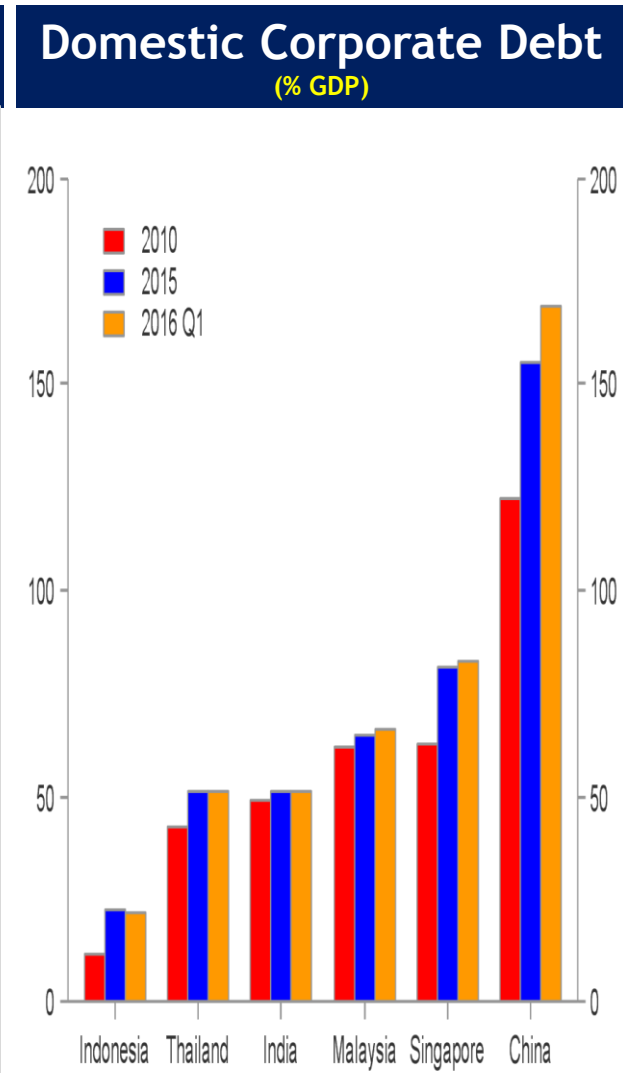
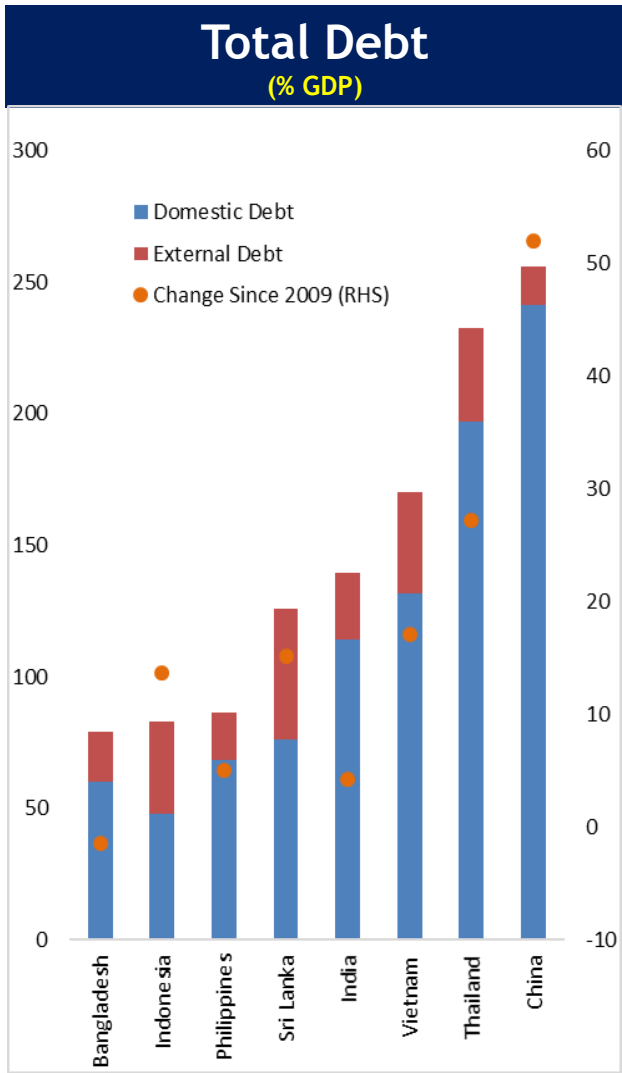
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Debt Accumulation Remains High

But With Increased Country Divergences



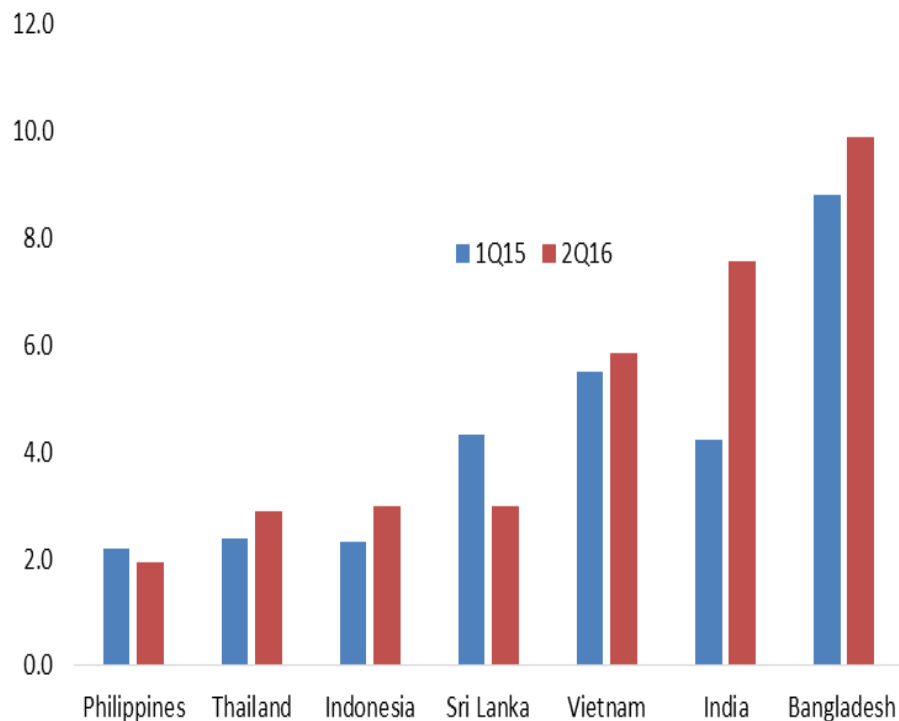
Source: Thomson Reuters - Datastream, IMF, BIS, CBCIR

Asian Banks Facing Negative Trends, Most Resilient

Higher Interest Rates Pose Risk of Asset Quality Problems

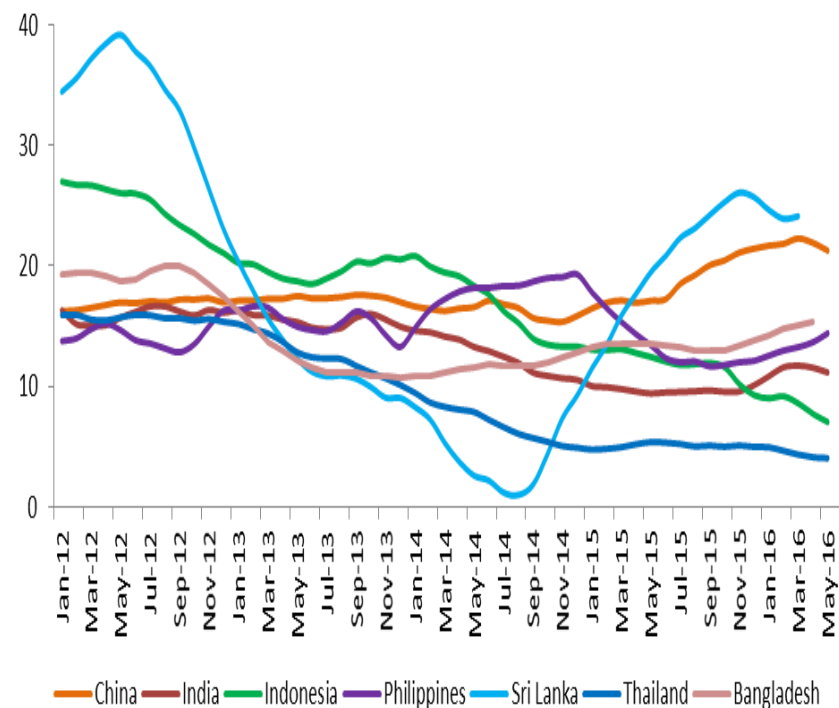
Non-performing Loans

(Percent of Total Assets)



Private Credit Growth

(3mma, Percent year-on-year)

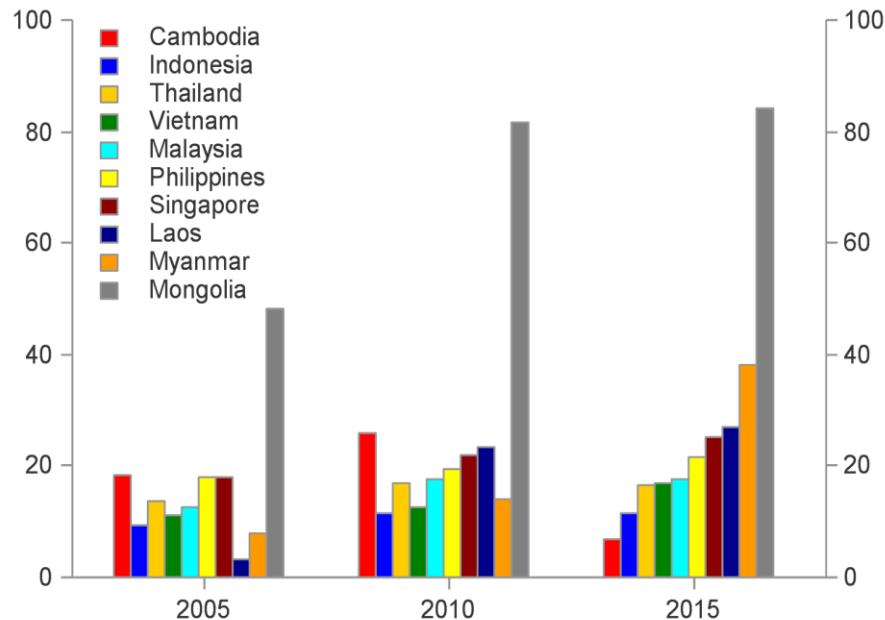


- Operating environment challenging across region, but most countries have adequate buffers to avoid systemic risks
- Rating agencies expect NPLs to increase for the next two years; Indonesia, Thailand & Malaysia on negative sector outlook

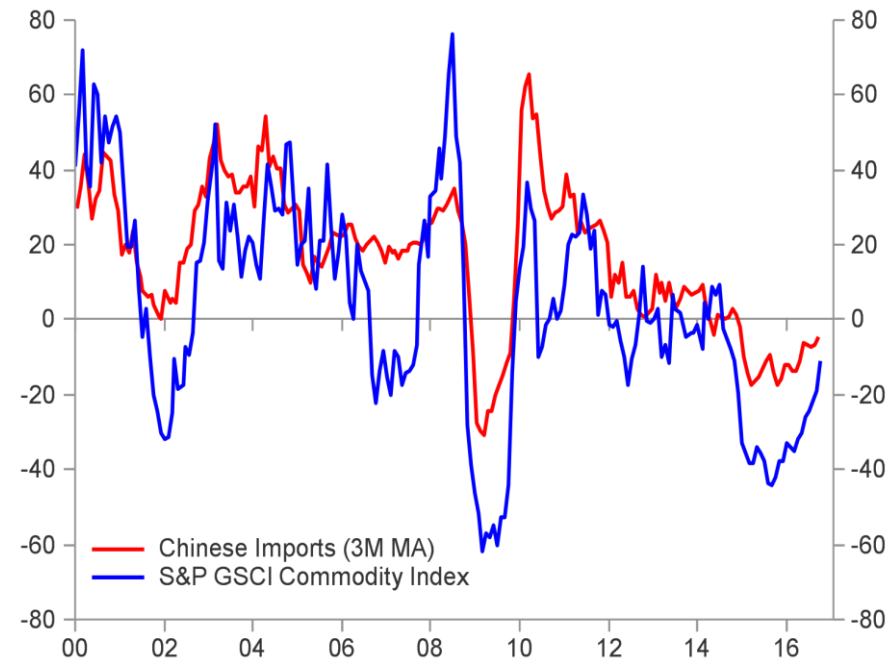
In Absence of Other Growth Drivers, China remains a ST Risk

China Rebalancing, Country Reforms to Create Opportunities

Share of China in Asia's Exports (% of Total Exports)



China's Imports and Commodity Price (% YoY)



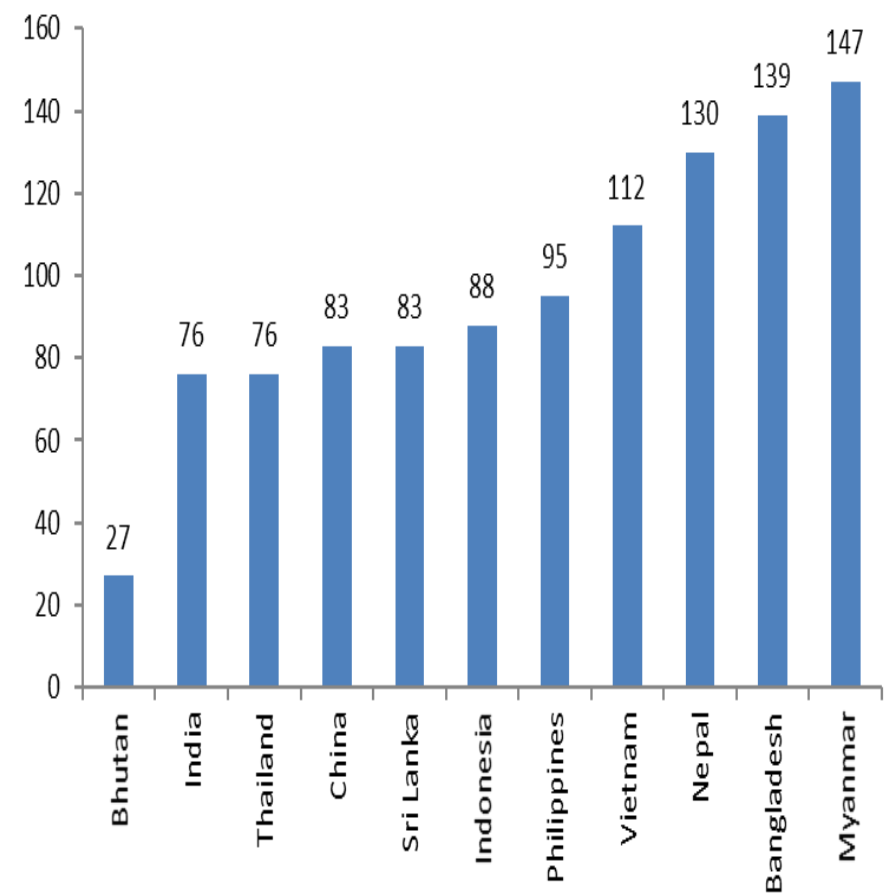
- **Weak growth in China creates risk to short-term growth in the region. Countries more exposed to manufacturing & investment related sectors are at risk**
- **Rebalancing towards consumption, any shift in US trade policy, will create opportunities for services exports (including tourism), and labor intensive, low cost production in EMs**

Source: IMF, Chinese Custom, S&P, Thomson Reuters - Datastream, CBCIR

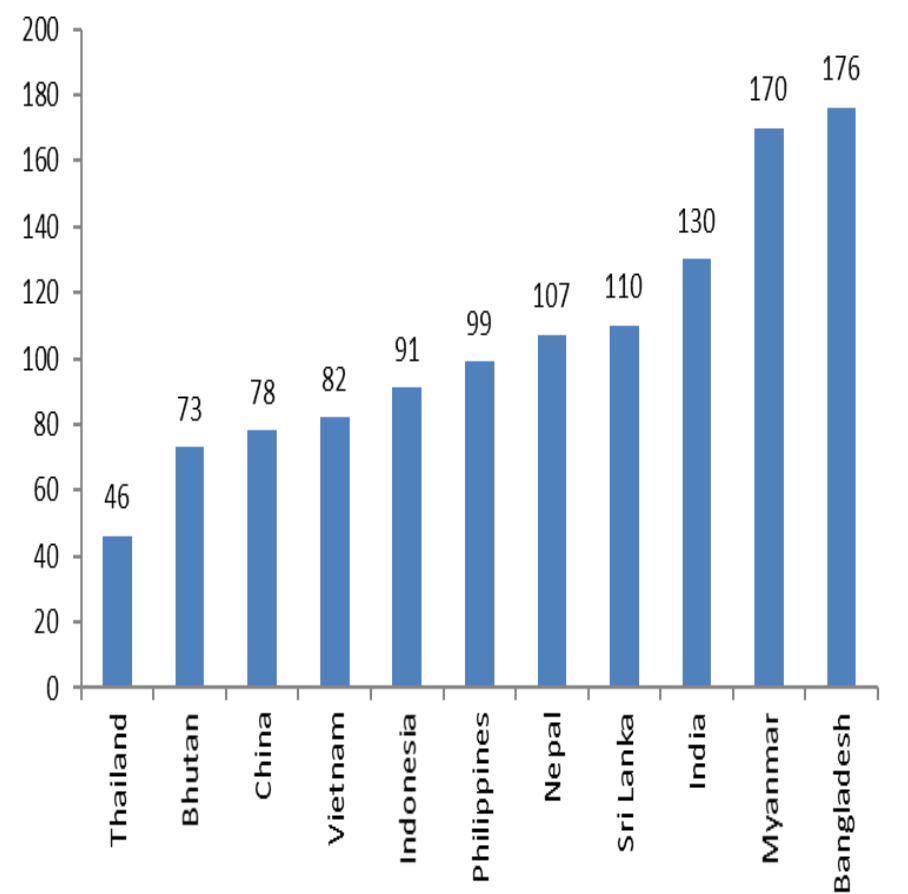
Internal Challenges

China Rebalancing, Country Reforms to Create Opportunities

Corruption Perception Index
(Rank out of 167 countries, 2015)



Ease of Doing Business Rank
(Rank out of 190 countries, 2016)



Source: IMF, Chinese Custom, S&P, Thomson Reuters - Datastream,, CBCIR

Will the Firepower Continue?

Weak USD, Rising Oil Prices, Global Hunt for Yield Spur Investor Flows

- **Fed Rate Normalization:** The ‘lower for longer’ outlook for Fed rates driven investors’ search for yield
- **EMs bought time to implement structural reforms:** e.g. India’s indirect tax reform, Indonesia’s push for fiscal reforms
- **Oil and commodity prices:** Broadly positive for EM as sluggish outlook on commodity prices has been a drag on new-investment sentiment. But a commodity super-cycle unlikely
- **New engine to drive growth...Manufacturing? Services?:** Upcoming industrial centers—in Mexico, Vietnam, India, Poland– will continue to benefit from China’s rising labor costs, but lack the physical infrastructure, skill to power an extended broad-based EM upcycle
- **Continue with the reform efforts/ innovation:** Adoption of widespread reforms towards exchange rate flexibility, fiscal & monetary discipline and relaxing capital controls – helping in lowering EM risk profile