

Asia Economic Outlook: Bracing for a slow, grinding recovery

Le Xia

BBVA Research | Chief Economist for Asia

Contents

- 1 Key themes for Asia in 2015**
- 2 Country Focus**
 - Thailand
- 3 Risks to Asia's growth outlook**

Key themes for Asia in 2015

Oil Prices

- Falling commodity and oil prices favor commodity importers
- Lower oil prices foster benign inflation, aid external balances, lift real income of households, provide scope to enhance fiscal space and boost productive spending



External Demand

- Uneven global growth has led to an uncertain trade environment – Asian exports remain fragile
- Softness in international commodity prices taking a toll on Asian exports as price realizations erode despite export volumes going up
- Yet, net terms of trade gains and import contraction has led to narrower trade deficits



Fed Rate Increase

- Expect volatility in global financial conditions in the run up to Fed's policy rate normalization
- Global financial markets buoyed by expectations of Fed rate normalization being pushed back into late 2015, policy easing in other advanced economies, and EMEs easing interest rates
- Markets to discriminate against those with relatively weaker fundamentals and/or oil exporters



Structural Reforms

- International capital flows to favor high and sustainable growth and policy virtue
- Effective implementation of structural reforms - a key differentiating factor amongst Asian EMEs
- Asian economies try to establish manufacturing credentials amid rising labor costs in China

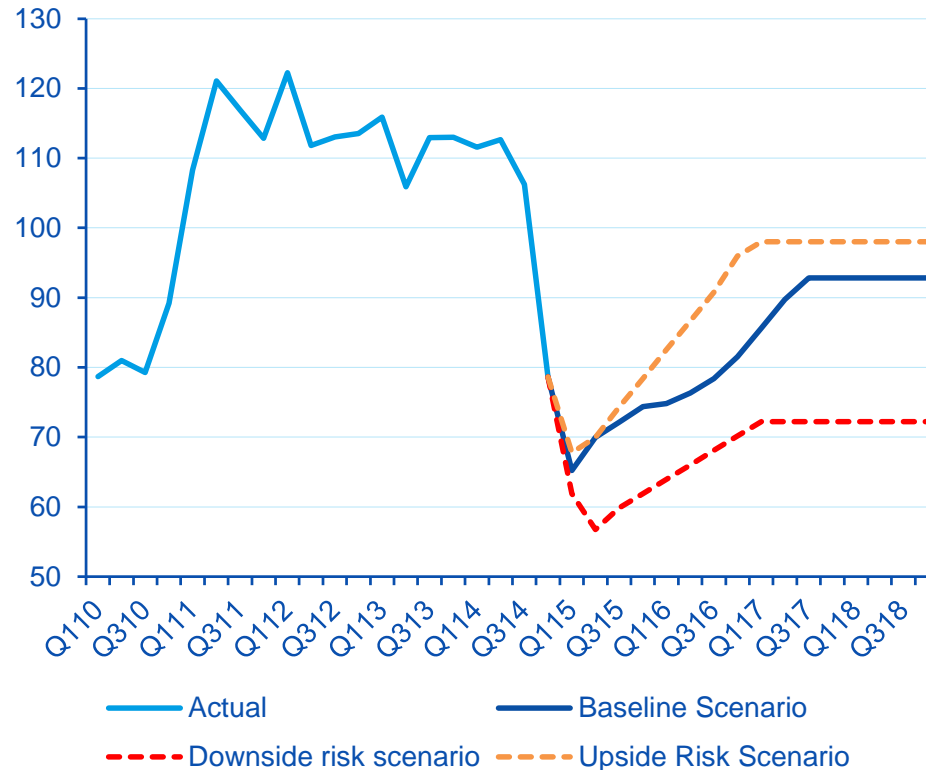


Prepare for a 'U' shaped oil recovery

- We do not expect \$40-\$50 per bbl WTI oil to last forever, but we do think it could last for another two quarters
- When higher oil prices materialize, we don't think we're going back secularly to \$80 per barrel WTI oil as downward cost pressures and the optimism surrounding US shale growth weighs on prices.

WTI Oil prices and price trajectory (USD/bbl)

Source: CEIC data, BBVA Research

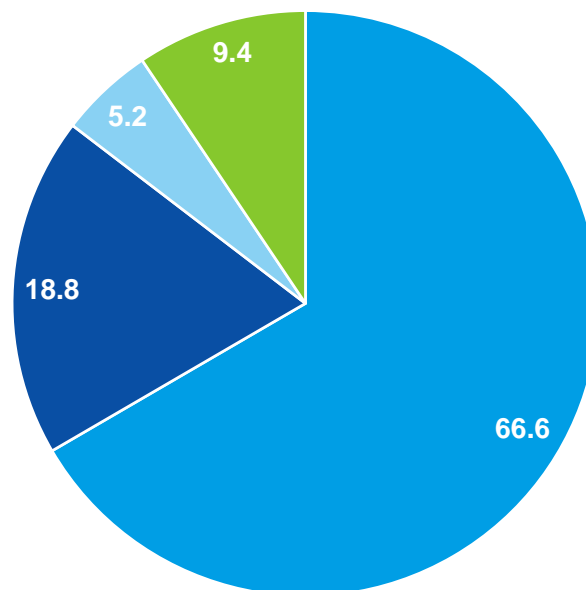


Neutral impact of oil prices on China

- China's large size helps to buffer exogenous shocks.
- Coal accounts for more than two thirds of China's energy demand, further muting any oil price impacts.
- Coal prices have fallen 40% in the last two years and this has not impacted GDP significantly.

China's Energy Mix (% share, 2012)

Source: NBS and BBVA Research



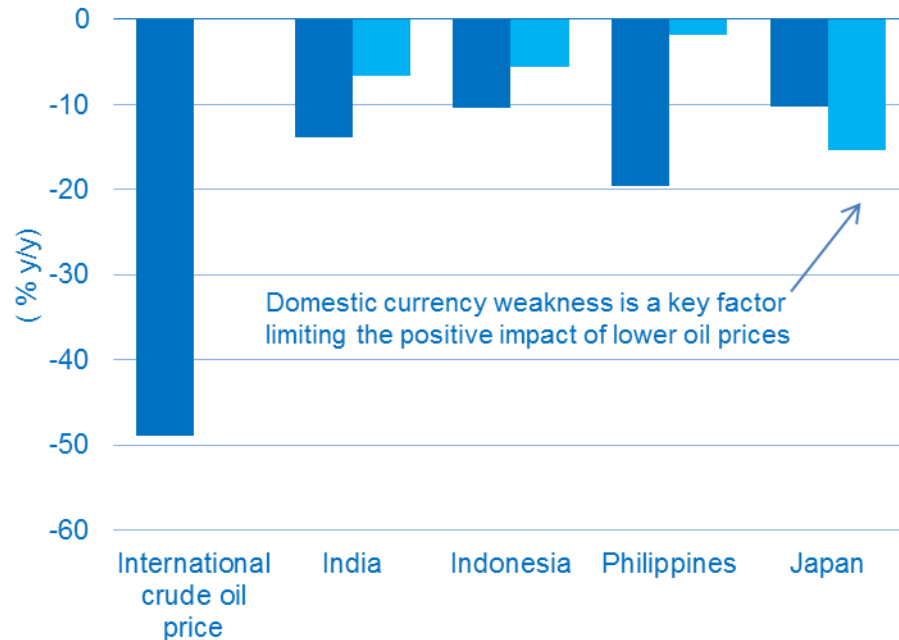
■ Coal ■ Crude Oil ■ Natural Gas ■ Hydro, Nuclear & Renewables



Low oil aids dis-inflation, eases fiscal space in Asia

Incomplete pass through of fall in crude oil prices to end consumers across most Asian economies

*All retail gasoline prices are for non-subsidized fuel at retail level; Source: CEIC, BBVA Research



■ Change in retail gasoline prices - June '14 to Dec '14

■ Change in domestic currency against US Dollar (- Depreciation/+ Appreciation)

- Falling commodity prices to foster a low inflation environment in Asia, although with a few exceptions.
- Indonesia is likely to face higher inflation in 2015 amid continued fiscal reforms aimed at reducing fuel subsidies.
- In general, lower oil prices to enhance room for Asian central banks to consider growth supportive monetary policies
- Oil prices have a positive impact on Asia's fiscal balance, enhances room for productive spending
- Trade balance sensitivities to oil prices are positive for major oil importers such as India and Indonesia in contrast to oil exporters such as Malaysia.
- Domestic currency weakness alongside hikes in excise duties on petroleum products, such as in India, have contributed to incomplete pass through of fall in crude oil prices to end consumers across most Asian economies



Intra-regional trade: Asia is a model

Intraregional exports and imports (% of total exports or imports)

Source: UNCTAD Statistical database and BBVA Research

	Exports			Imports		
	1996-2000	2001-2006	2007-2011	1996-2000	2001-2006	2007-2011
Developing Africa	9.7	9.8	10.9	13.3	13.5	12.7
Eastern Africa	12.4	14.1	13.9	8.8	9.3	7.1
Middle Africa	1.2	1	1.3	2.6	2.5	3.1
Northern Africa	3.2	2.9	3.9	2.8	3.7	3.8
Southern Africa	4.4	2.1	2.1	11.9	10.7	7.9
Western Africa	10.2	10	9	11.3	12.5	10.2
Developing America	19.1	17.6	20.6	17.6	19	21.1
Developing Asia	41.5	45.1	50.1	40.6	49.3	53
Developing Oceania	1.3	3	3.3	0.9	2.3	2.7
Europe	67.3	71.4	70	68.3	67	64.4

- Intraregional trade have progressed steadily in Asia.
- Inadequate levels of infrastructure connectivity coupled with relatively higher import substitution versus China have hindered interregional exports in Latam.
- Developing Asia to benefit from upcoming initiatives such as the AIIB and “One Road, One Belt”.

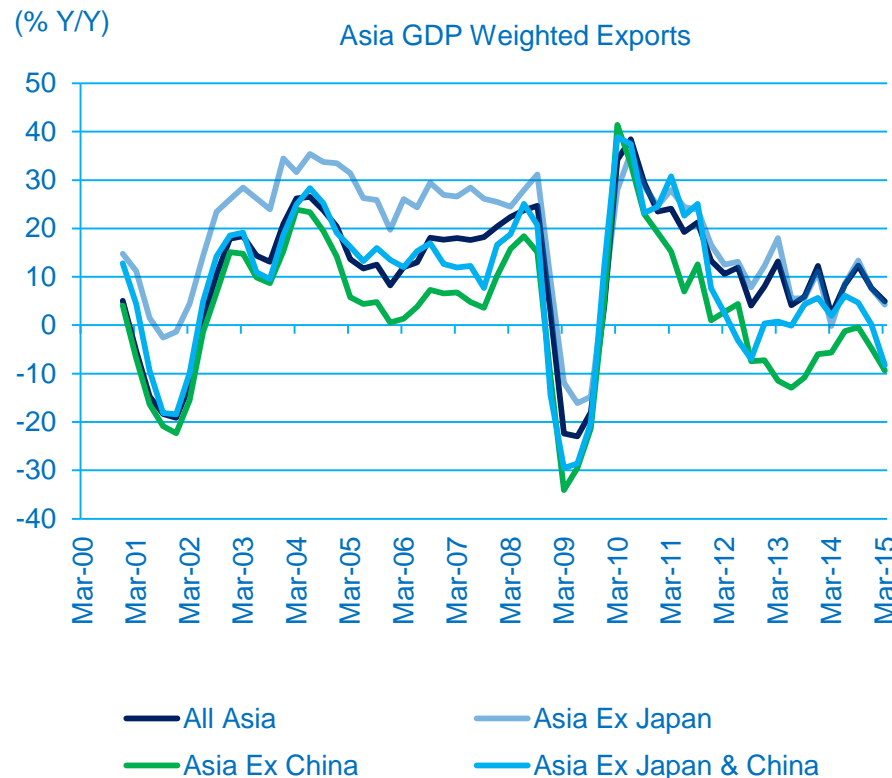


Asian exports remain fragile...

- Despite relative improvement in global growth, Asian exports continue to record negative growth
- On a nominal GDP weighted average basis, Asian exports slowed to 5.0% y/y in Q1 2015 from 8% y/y in Q4. However, exports excluding China saw a sharp contraction at -9% y/y with growth remaining in negative territory since September 2012.

Asian Exports (% Y/Y , Nominal \$ GDP Weights)

Source: CEIC data, BBVA Research

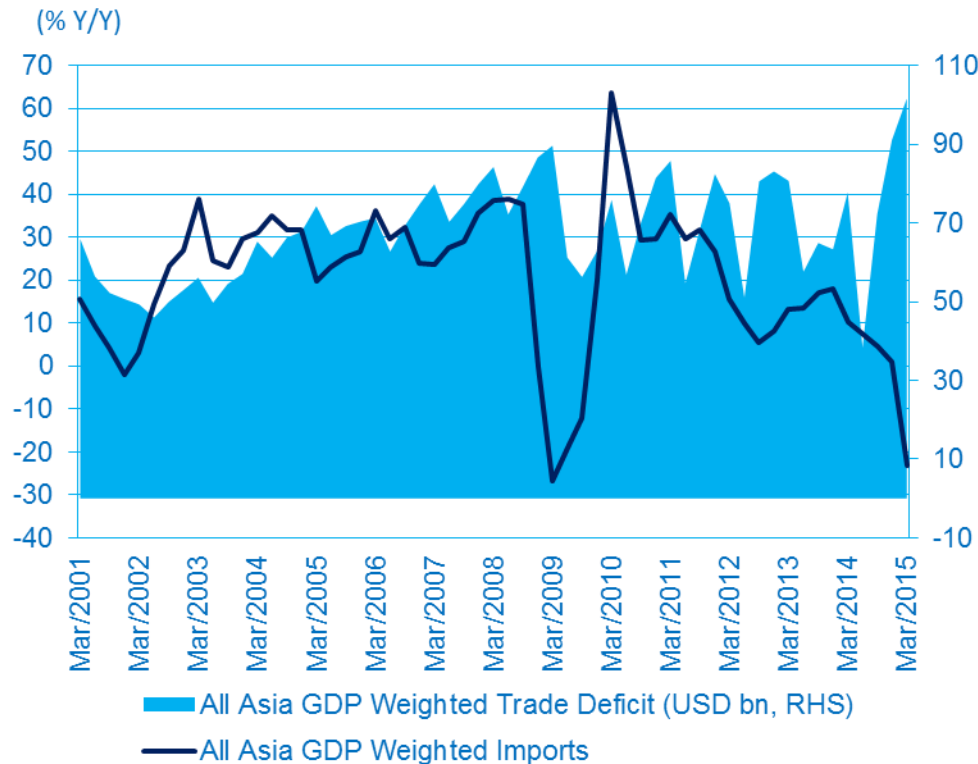


...yet, weaker imports have led to net trade gains...

- Import contraction has offset weakening exports, in turn leading to net positive trade gains for Asia.
- All Asia imports contracted 23% y/y in Q1.
- While Q1 import contraction is largely China driven, imports of Asia excluding China have seen extended weakness over the past two years.

Asian Imports and Trade Deficit (% Y/Y , USD billion)

Source: CEIC data, BBVA Research

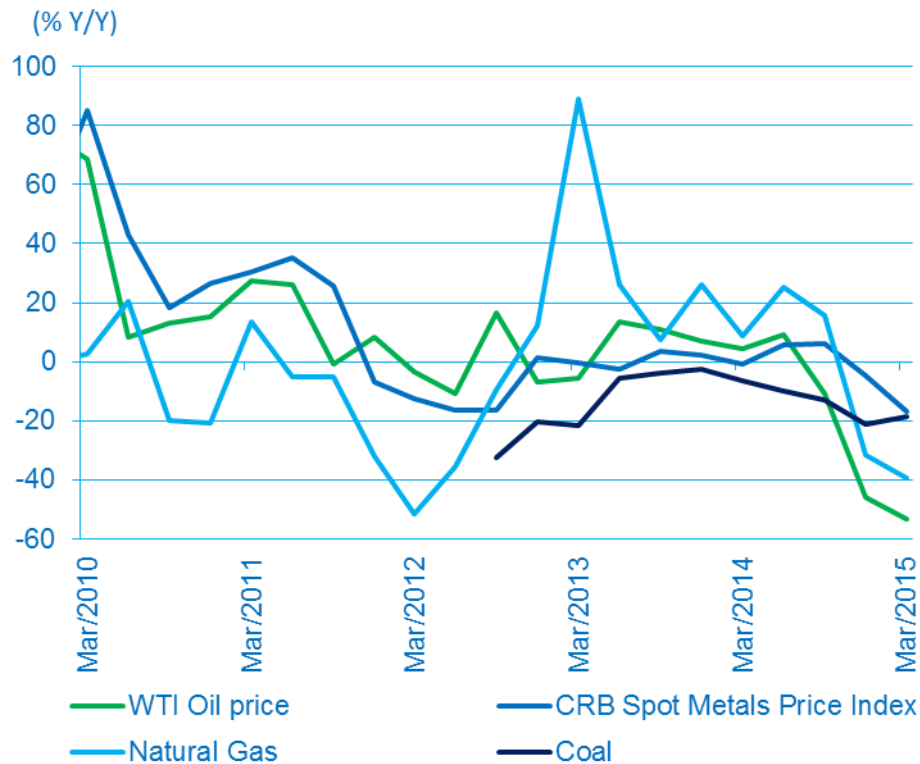


...amid impacts of commodity-currency interplay

- Despite the recent rise in oil prices, global commodity prices including oil remain subdued, This however, is offset by real trade weighted currency appreciation across Asia amid sharp depreciation of the Euro and JPY.

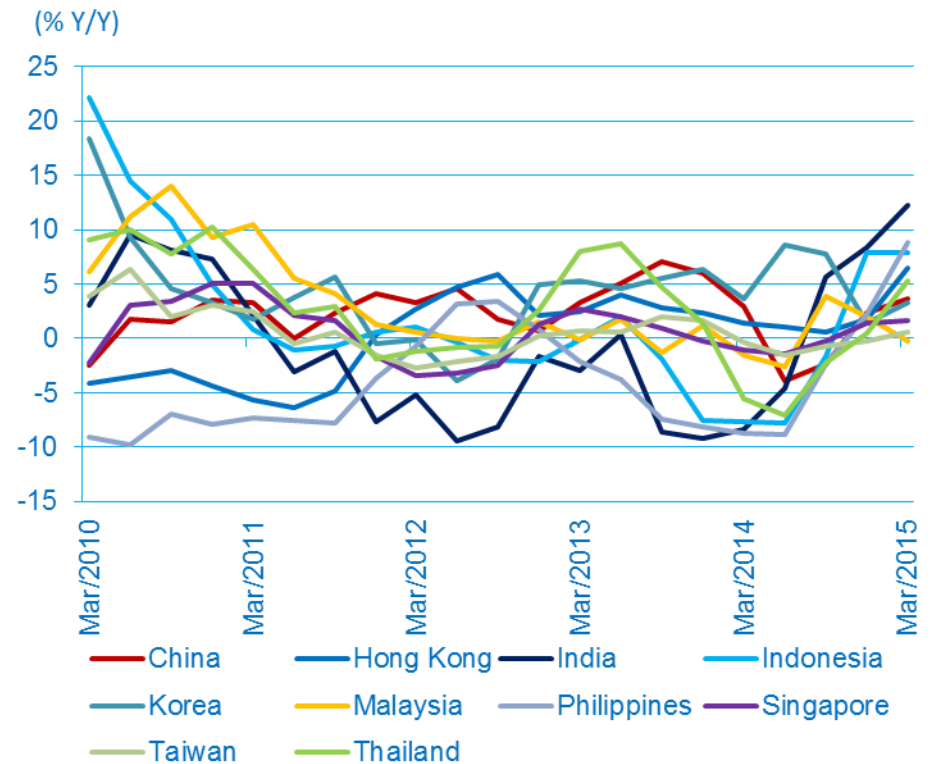
Global commodity prices have picked up recently but remain subdued in level terms (% Y/Y)

Source: CEIC data, BBVA Research



Asian currency appreciation on real trade wtd basis (% Y/Y)

Source: CEIC data, BBVA Research

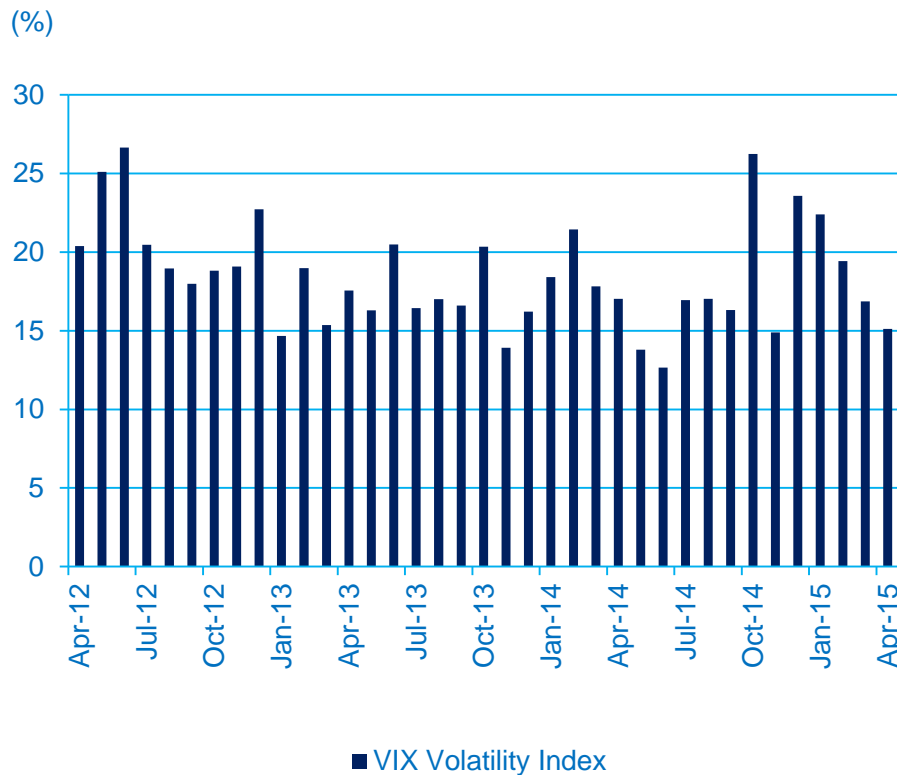


Delay in Fed's imminent 'lift-off' buoys markets...

- Scope for further growth supportive policy rate cuts across Asia amid subdued inflation pressures. However, aggressive policy easing is less likely as Central Banks prepare for volatile times in the run up to Fed's liftoff.

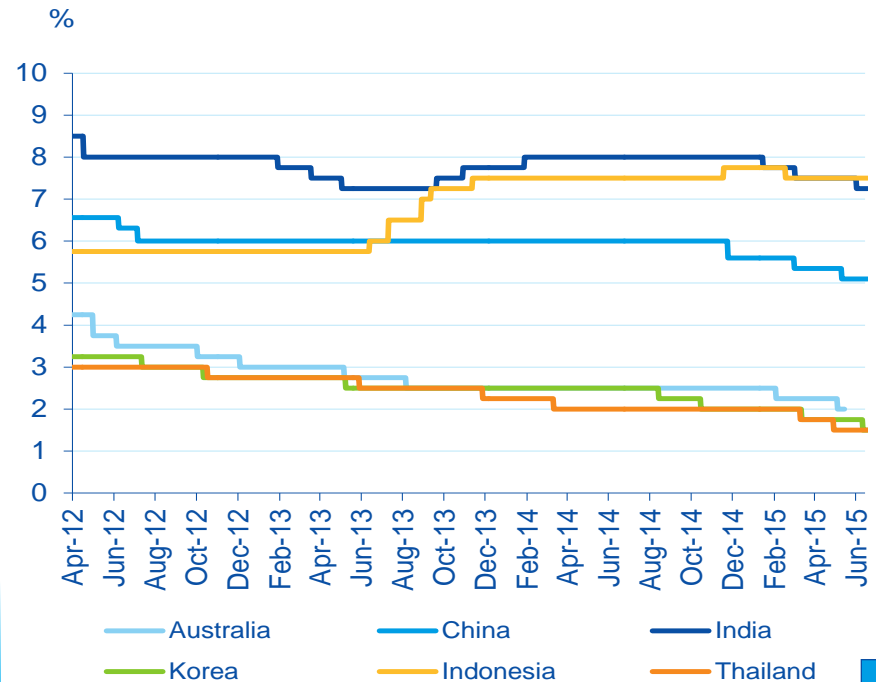
Volatility index (VIX) has trended lower in 2015

Source: Bloomberg, BBVA Research



Asian economies have used the room to ease policy rates

Source: CEIC data, BBVA Research



Asian EMEs are better prepared for Fed's lift-off

- Although knee jerk reactions to the Fed's lift-off involving short term capital outflows are inevitable, most Asian have seen improvements in external vulnerability indicators since the Fed's taper tantrum in May 2013.

External vulnerability indicators have improved for most Asian economies since the QE taper tantrum

Source: Haver Analytics data, BBVA Research

	Fiscal Sustainability		External Sustainability		Liquidity Management	
	Central Govt Debt (% of GDP)		Current Account Balance (% of GDP)		Short Term External Debt as share of FX Reserves (%)	
	May/2013	Current	May/2013	Current	May/2013	Current
India	46.8	45.0	-4.6	-0.2	34.3	26.7
Indonesia	22.7	25.8	-4.2	-2.8	61.2	55.0
Philippines	47.8	40.0	4.4	5.9	23.2	23.1
Thailand	30.9	32.0	-7.2	9.2	38.6	38.1
Malaysia	54.7	52.1	0.8	2.2	81.4	103.8

Source: Haver Analytics Data, BBVA Research



... but high debt ratios remain a weak link for Asia

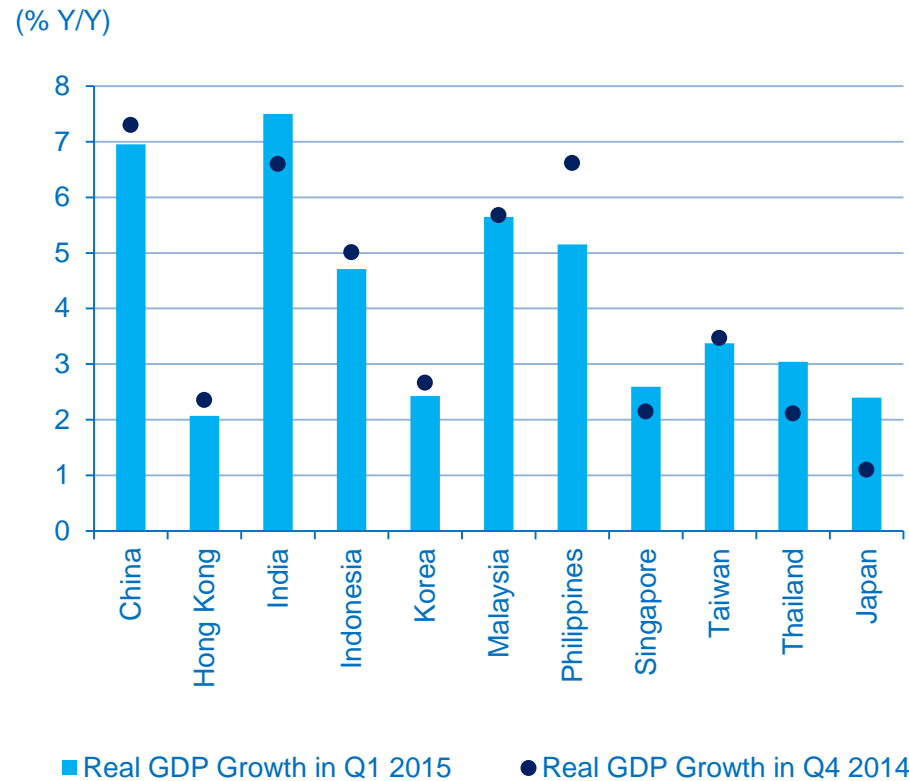
Change in Debt to GDP ratio : 2007 to 2014 across Asia					
	Current total Debt to GDP ratio* (%)	Real Economy Debt Change, 2007 - 2014 (percentage points)			
		Total	Government	Corporate	Household
China	217	83	13	52	18
India	120	0	-5	6	-1
Indonesia	88	18	-5	17	6
Korea	231	46	15	19	12
Malaysia	222	49	17	16	16
Philippines	116	4	-3	9	-2
Singapore	382	46	15	19	12
Thailand	187	43	11	6	26
Japan	400	64	63	2	-1

Source: IMF, BIS, Haver Analytics, Mckinsey Global Institute Analysis, BBVA Research

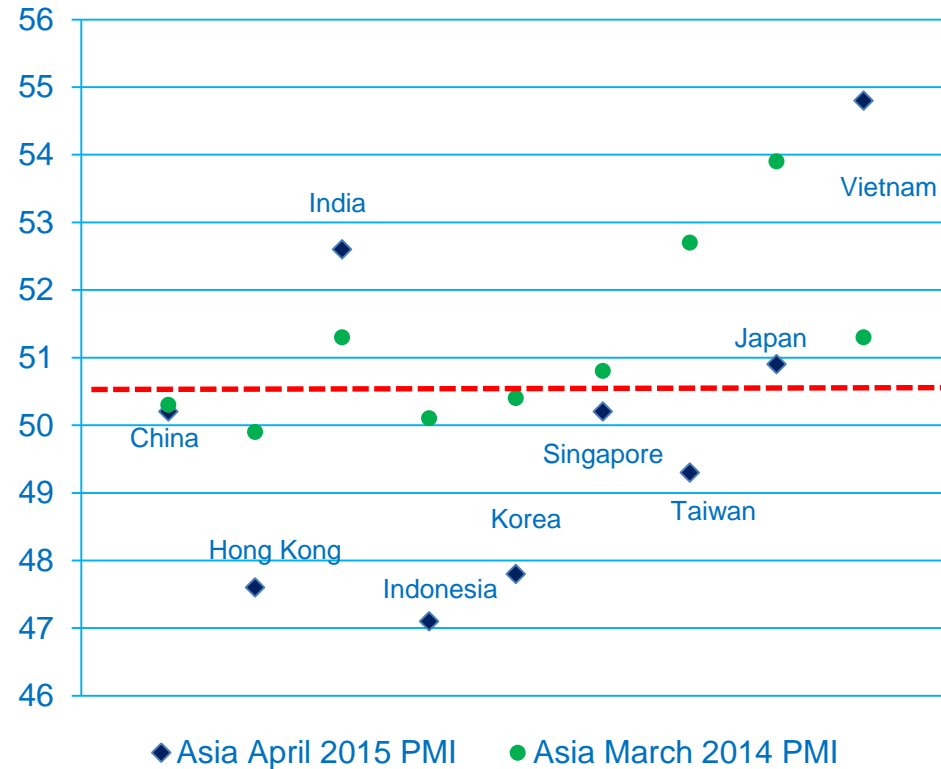
* Total debt includes government, corporate and household debt

<= Leverage **<= Deleverage**

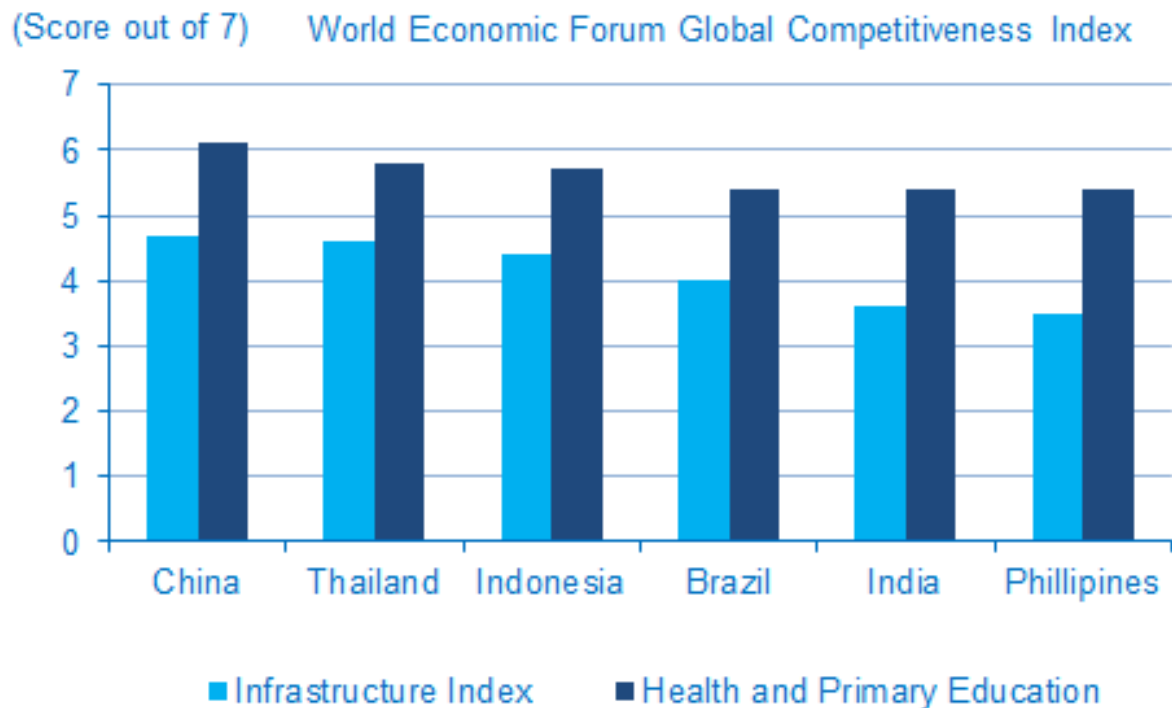
Bulk of Asia saw slower economic growth in Q1



Asian PMI's reflect significant slack in industry

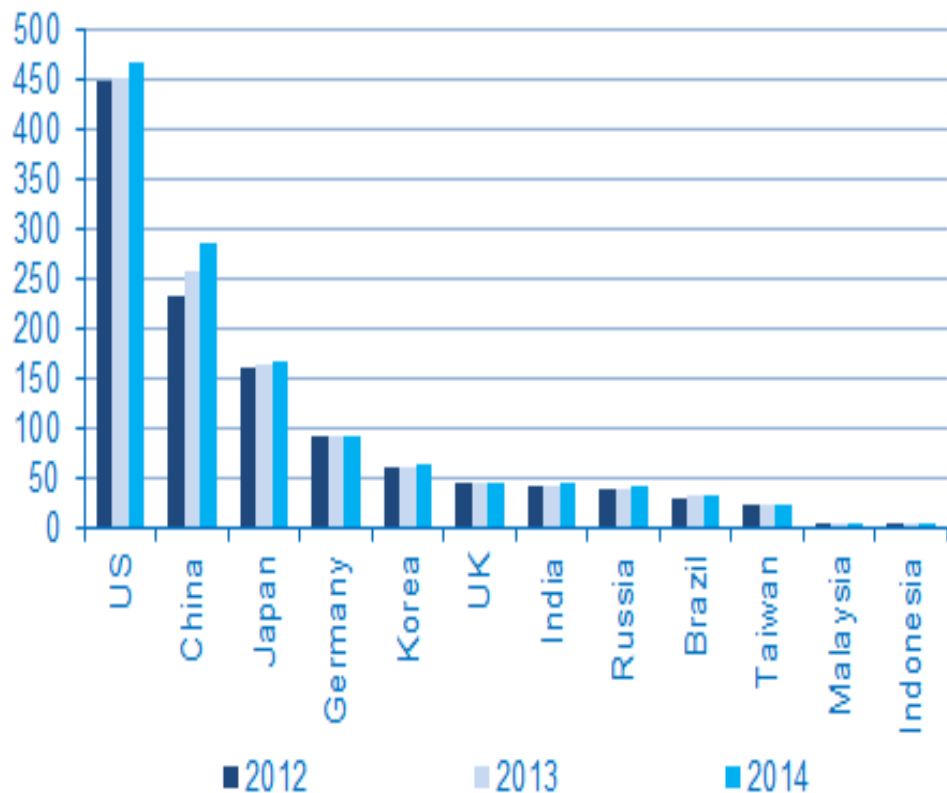


Asia should speed up reforms aimed at improving social and physical infrastructure...



... And invest more into R&D

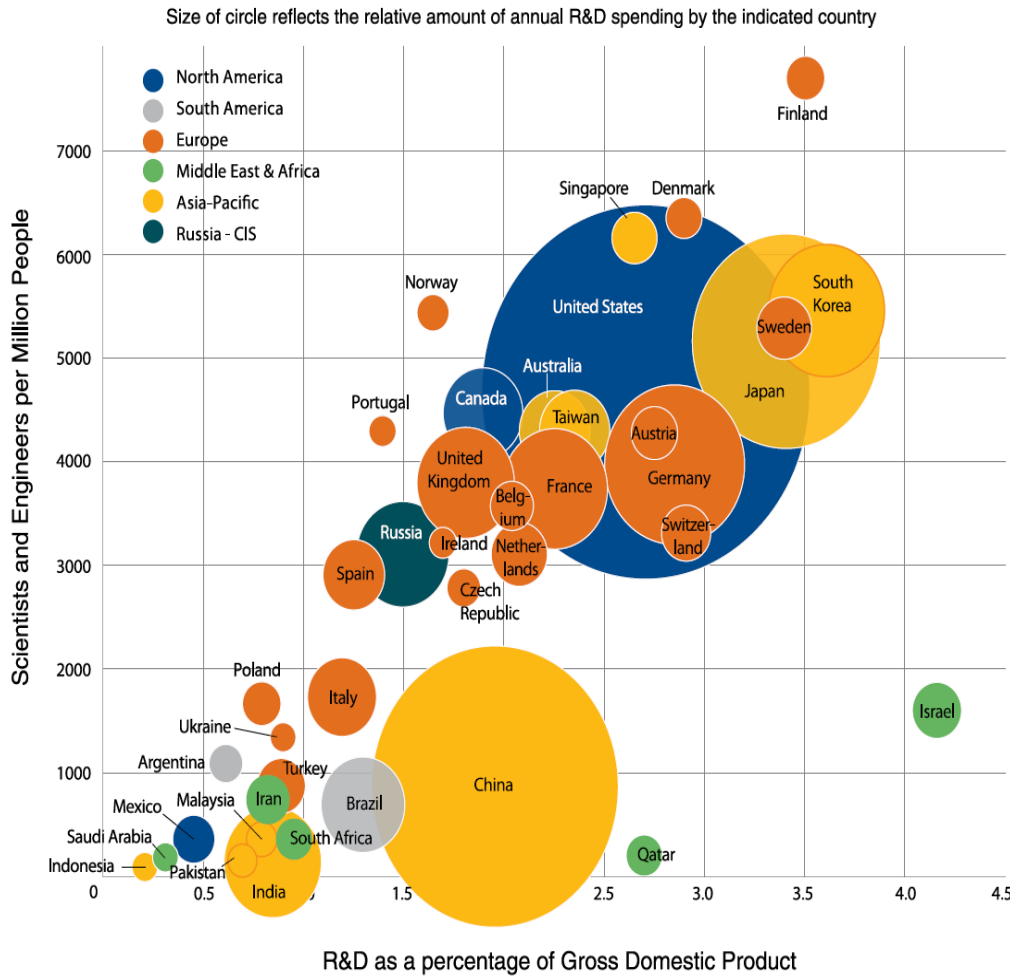
(USD Billion PPP) Gross expenditures on Research and Development



- OECD's share in global R&D spending has slipped from 90% to 70% in a decade.
- China has emerged as a major driver of global R&D despite a GDP growth slowdown.
- China's R&D spending doubled from 2008 to 2012 to USD 257 billion.
- China is investing in innovation infrastructure to move beyond its established position as a low-cost location for manufacturing
- However, China's share of expenditure on basic research to total expenditure on R&D is relatively very low at 5% (USD 9.9 bn) compared to US (17%), Japan (12%) and France (25%).



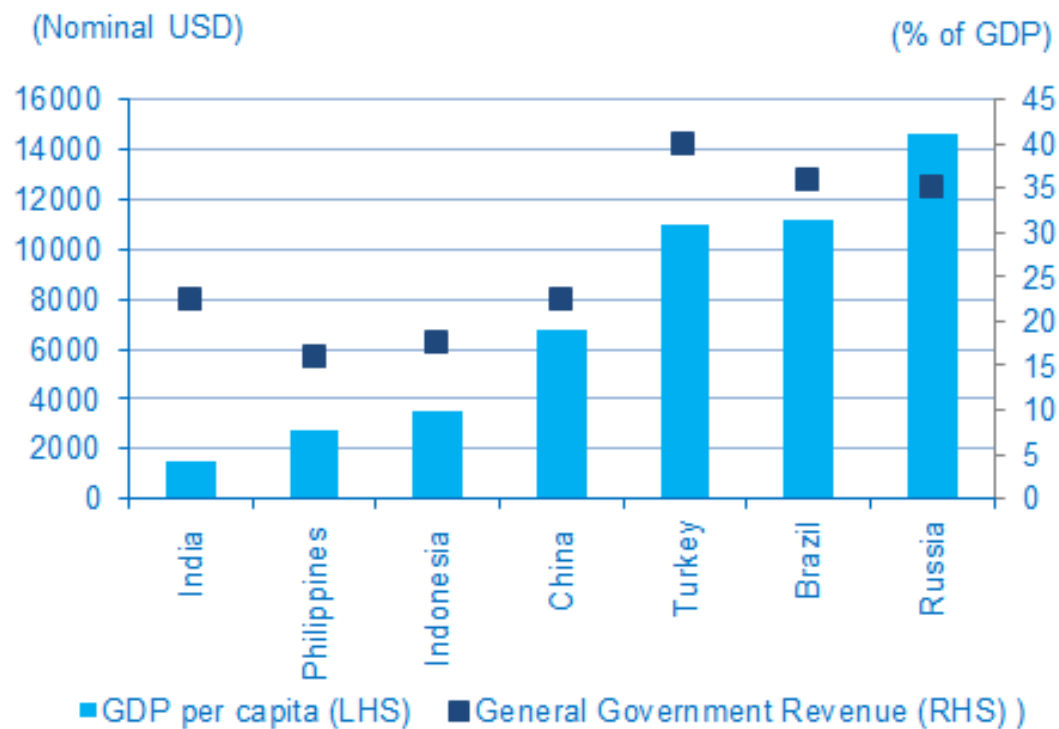
Asia needs to playing an increasingly important role in global R&D investments



- More and more western multinational companies are establishing innovation centers in Asia's.
- An area in which emerging Asia has become a clear innovation leader is price-performance innovation – the creation of products whose quality excels for their cost – something made possible by region's low labor costs and its growing pool of skilled, educated talent.
- Korea became the world's most R&D intensive country in 2012, spending 4.36% of GDP on R&D, overtaking Israel (3.93%) and versus an OECD average of 2.40%.



Lift per-capita GDP from current low levels



Source: BBVA Research, Haver Analytics Data



Asia: leading the global economy

- Emerging Asian economies to contribute 58% to global growth in next decade.
- We project that China will continue to be the largest contributor at 34% of global growth.

Contribution to global economic growth by region, 2011-2021 (%)

Source: BBVA Research and IMF WEO

Western Europe

Eastern Europe

North America

Asia (ex.Japan)

Latin America

Japan

Africa

Middle East

Australia +
New Zealand

10.5

5.8

6.0

57.9

1.8

4.1

5.0

7.8

1.0

Outlook for Asia

RMB/USD weakness continues

Source: Bloomberg and BBVA Research

	FX				
	Current Level	1Q15	2Q15	3Q15	4Q15
USD/CNY	6.13	6.22	6.27	6.23	6.17
USD/JPY	121.0	121.0	124.0	126.3	129.0
USD/HKD	7.75	7.76	7.76	7.77	7.77
AUD/USD	0.82	0.77	0.74	0.75	0.78
EUR/USD	1.06	1.06	1.02	1.00	1.01
USD/KRW	1097	1120	1120	1130	1135
USD/SGD	1.36	1.38	1.39	1.39	1.39
USD/TWD	31.3	31.9	32.0	32.2	32.3

Policy rate outlook

Source: BBVA Research and Bloomberg

	Interest Rates				
	Current Level	1Q15	2Q15	3Q15	4Q15
China	5.35	5.35	4.85	4.60	4.60
Japan	0.10	0.10	0.10	0.10	0.10
India	7.50	7.50	7.25	7.25	7.25
Korea	1.75	1.75	1.50	1.50	1.50
Australia	2.25	2.25	2.00	2.00	2.00
Indonesia	7.50	7.50	7.50	7.50	7.50
Taiwan	1.88	1.88	1.88	1.88	1.88

GDP growth outlook

Source: BBVA Research and Bloomberg

% yoy	GDP							
	2012	2013	2014	2015*	1Q15*	2Q15*	3Q15*	4Q15*
China	7.7	7.7	7.4	7.0	7.0	7.1	7.0	6.9
Japan (q/q saar)	1.5	1.5	0.0	1.3	2.3	1.0	1.1	0.3
Hong Kong	1.5	2.9	2.3	3.3	3.0	3.3	3.3	3.5
India	4.8	4.6	5.2	7.4	7.5	7.5	7.6	7.7
Australia	3.6	2.3	2.7	2.5	2.2	2.4	2.7	3.0
Korea	2.3	3.0	3.3	3.4	2.7	3.6	3.5	3.8
Singapore	2.5	3.6	3.0	3.2	2.1	3.4	3.1	3.3

* preliminary estimate

Forecasts as of 15 April 2015



Contents

- 1 Key themes for Asia in 2015
- 2 Country Focus
 - **Thailand**
- 3 Risks to Asia's growth outlook

Thailand Economic Outlook 2015

Growth

- Weak growth led by sluggish private consumption and continued contraction in exports
- Rise in public disbursement of investment spending and improvement in tourism provide respite
- BoT official growth forecast for 2015 is 3.8% y/y, well above 3.0% in Q1 2015 – Downward revision to official growth forecasts is very likely



Inflation

- Headline inflation remains negative year-to-date but expected to pick up in 2H15 as base effects of high oil prices begin to wane and likely rise in food prices
- Core inflation declining due to weakness in domestic demand
- Easing inflation provides room for monetary policy to support growth and aid financial stability



Economic Outlook

- Growth prospects remain subdued dragged by domestic fragilities and slowing Chinese demand
- Policy rate left steady at 1.5% in June meeting as BoT awaits the full effect of previous two cuts
- Another policy rate cuts cannot be discounted in 3Q15 if GDP growth fails to gain momentum

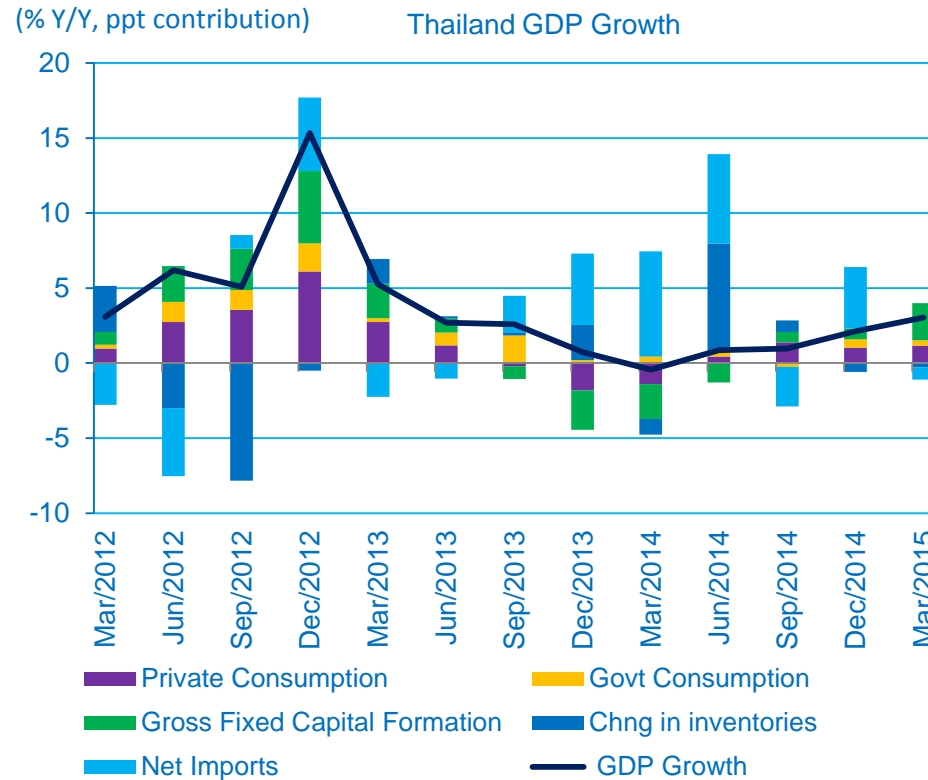


Banking sector

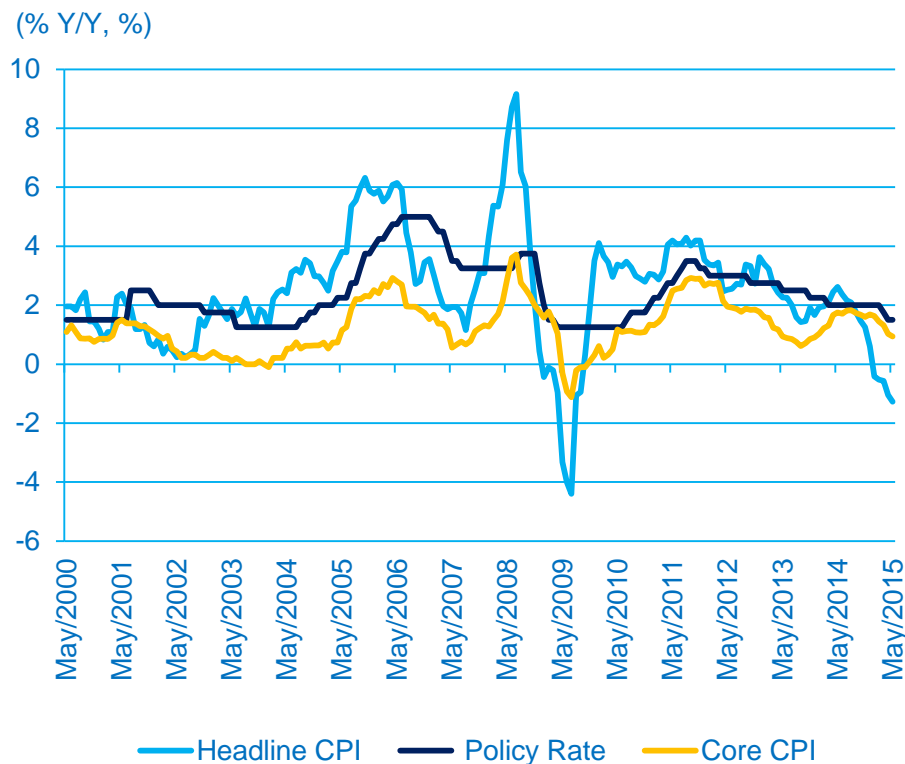
- 1Q15 banking results were generally muted undermined by a weak economic environment.
- Thailand's banking sector is currently marked by 1) asset quality stress, narrowing margins, reasonably strong fee income growth and lackluster loan growth of about 4.5% y/y.



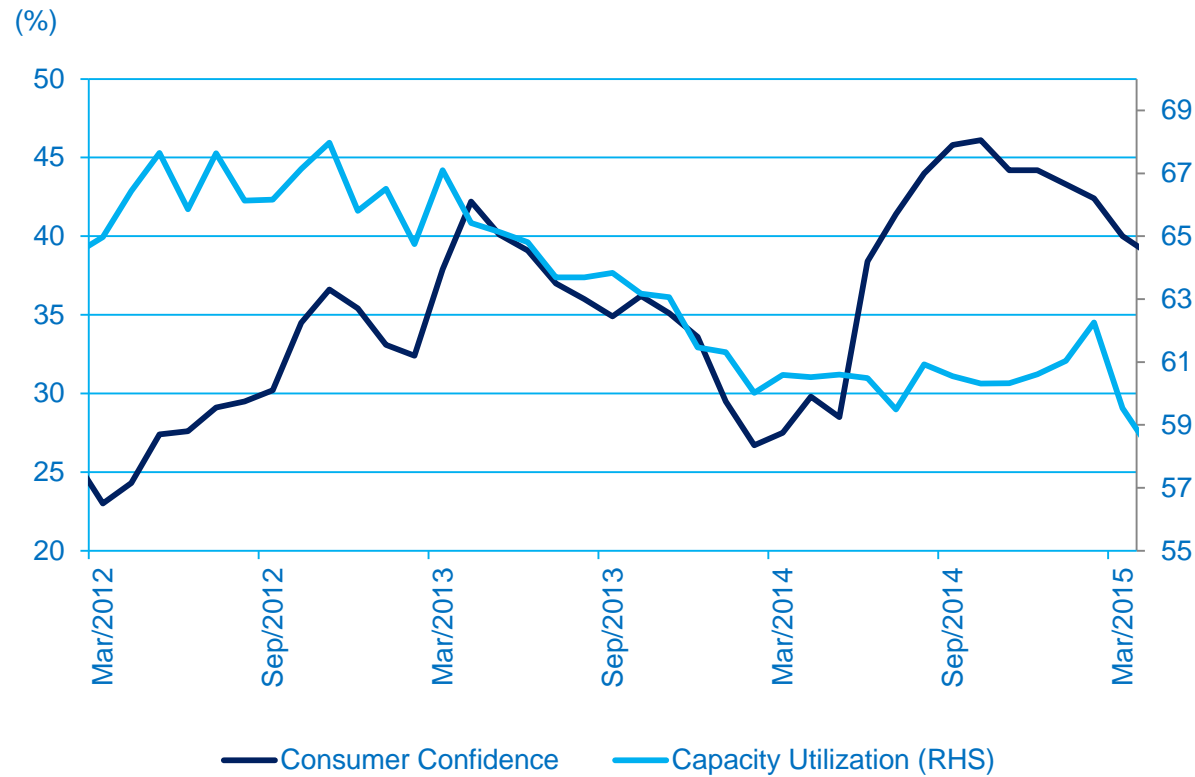
Sluggish consumption and weak external demand continue to drag on Thailand's growth



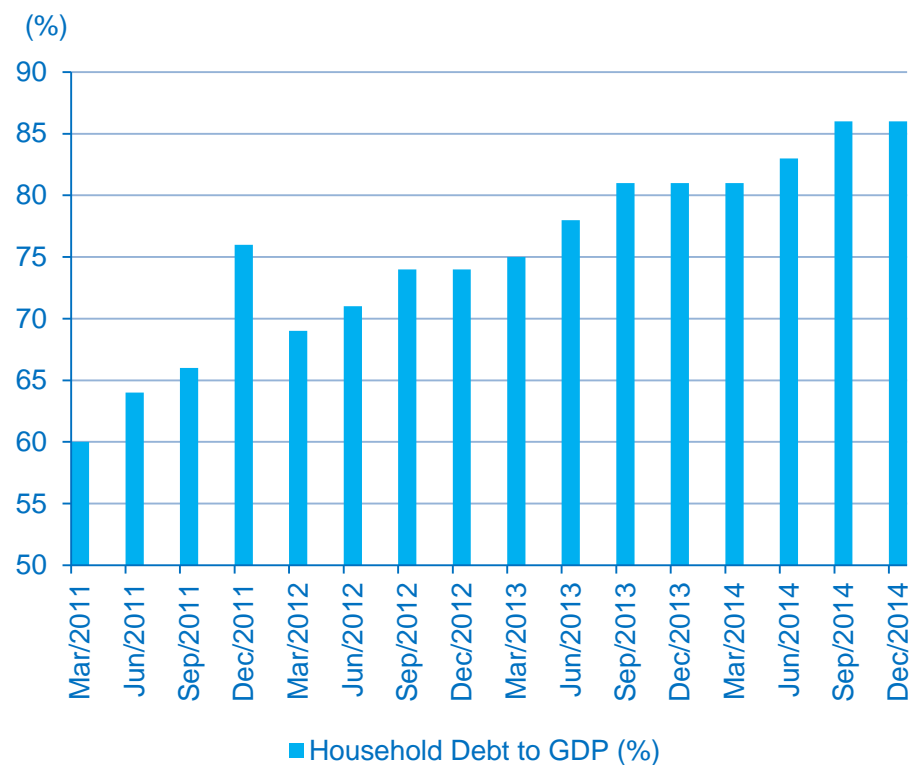
Inflation to remain subdued as core inflation is declining - leaves scope for further policy cut



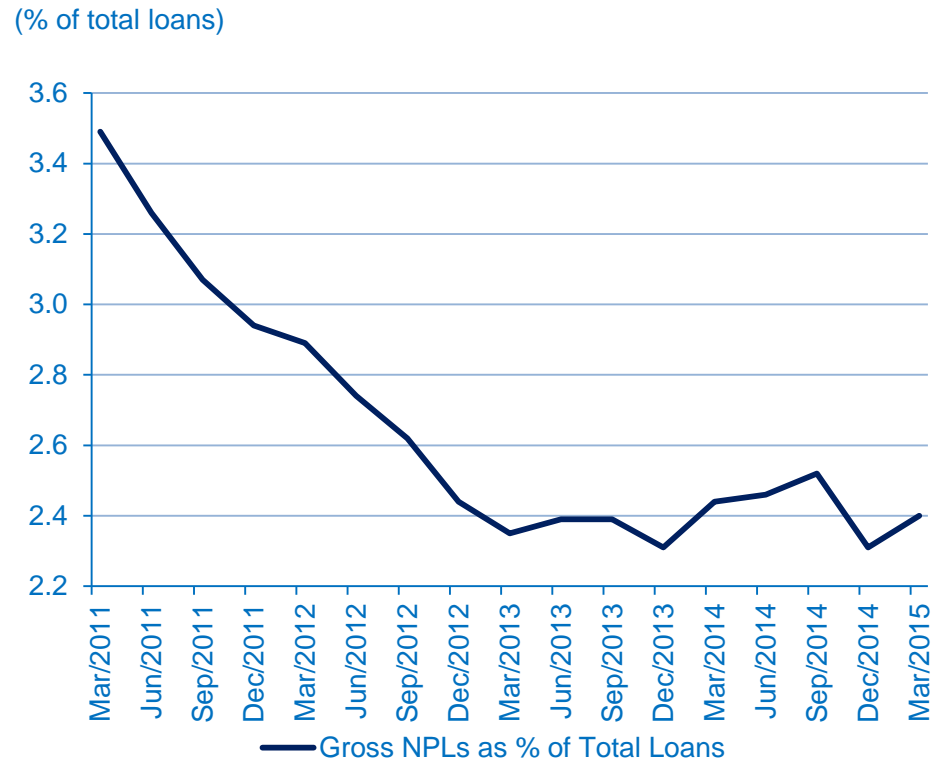
Falling capacity utilization and weak consumer confidence signals subdued growth prospects



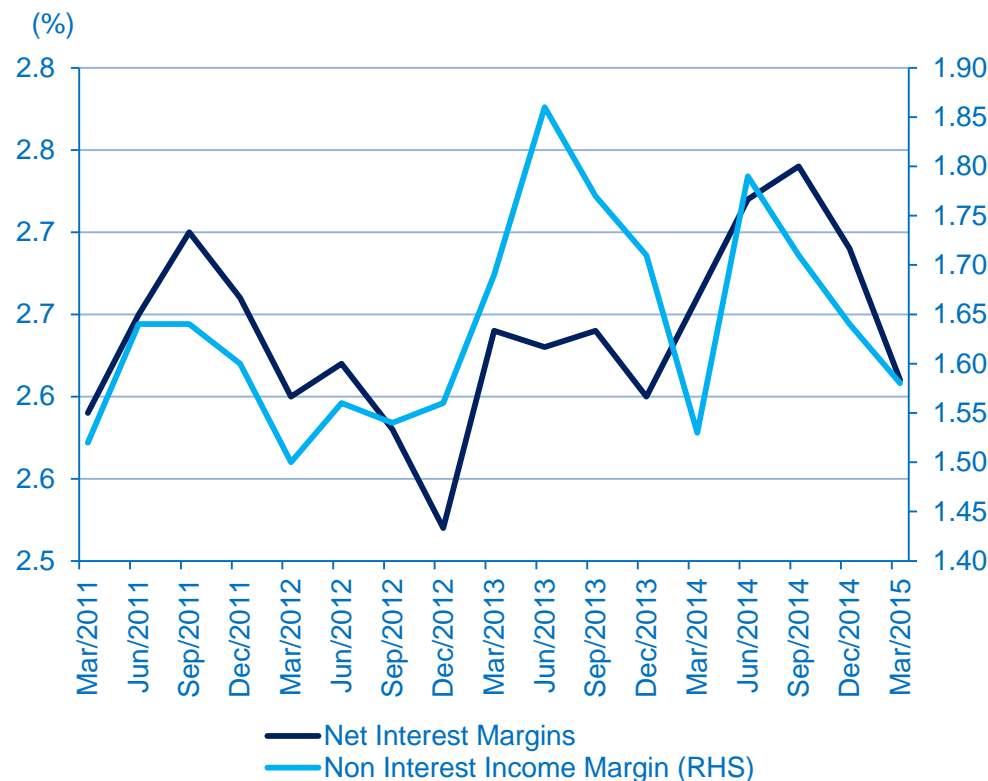
Thailand household indebtedness shows no signs of retreat - upward risk to retail NPLs



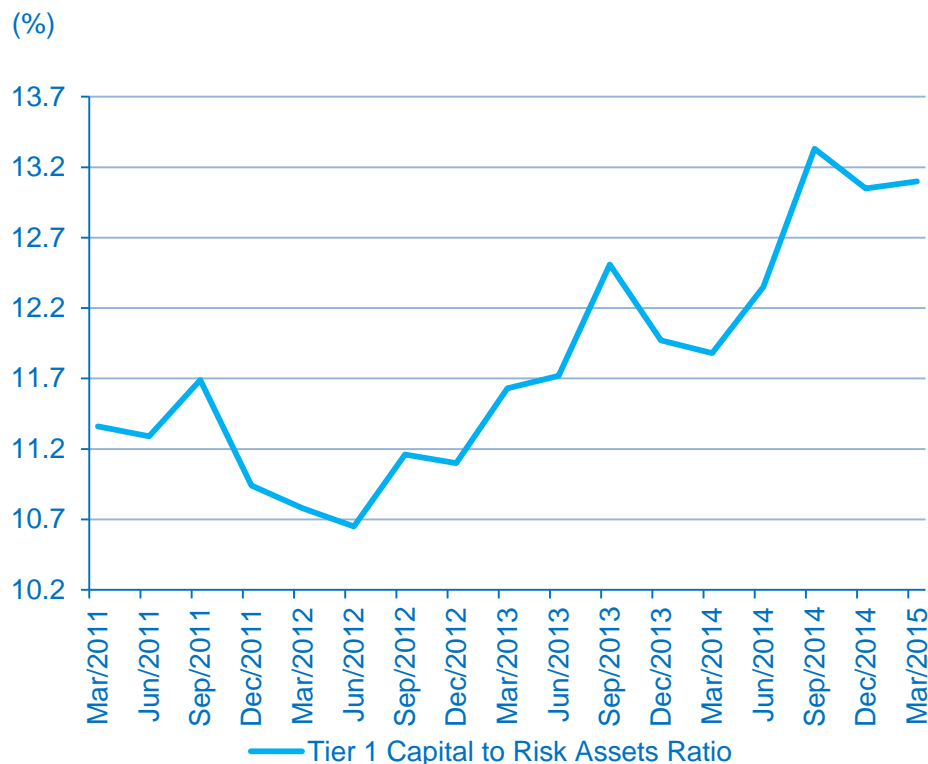
Although still at low levels, last quarter saw a rise in gross NPLs in the Thai banking sector



Profitability of banks has come under pressure amid slower loan growth & asset quality issues



In a key positive, the Thai banking system remains adequately capitalized



Contents

- 1 Key themes for Asia in 2015
- 2 Country Focus
 - Thailand
- 3 **Risks to Asia's growth outlook**

RISKS: Tilted to the downside

External risks

- Fed rate normalization
- Grexit
- Deflation in the EU
- Weakening external demand from EU and US
- Falling commodity prices
- EM spillovers (Ukraine, Iraq, Ebola, etc.)

Regional risks

- Slowdown in China
- Japanese recession
- Geopolitical risks

Implications for Asia

- Volatile capital flows and higher funding costs
- Market volatility
- Dampening effect on domestic demand and growth

Thank you! ...Questions?

xia.le@bbva.com.hk