Economic commentary

17/08/2018

Week Ahead Asia-Pacific Economic Preview

- **Flash August PMI data released for Japan, the US and Eurozone**
- **Thailand GDP and trade data updates**
- **Taiwan trade numbers eyed for Asian export trends**
- **FOMC, RBA and ECB meeting minutes**

Flash PMI surveys will be a feature of the week, highlighting how Japan, the US and Eurozone are faring midway through the third quarter and hence giving a steer on global economic conditions. In Asia, there's a particular focus on Thailand and Taiwan, with GDP and trade data eagerly awaited.

Central bank attention rests on meeting accounts for the FOMC, Reserve Bank of Australia and ECB.

However, markets will no doubt be keenly eyeing developments in Turkey and watching for signs of contagion to other markets. Our Turkish PMI data already show signs of the economy struggling in the face of the country's currency crisis, and our special feature this week looks at which countries look most susceptible to spill-over contagion.

Flash PMIs to give global economic update

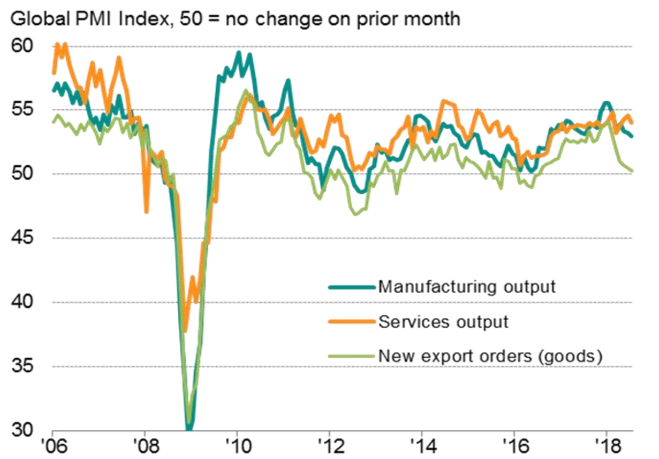
On Thursday, flash August PMI survey data for the US, Eurozone and Japan will provide important updates on the health of the some of the world's largest economies midway through the third quarter, with attention likely being focused on the export and price data as well as the headline growth indicators.

The July PMI surveys showed the pace of US growth cooling slightly but remaining consistent with the economy growing at a solid rate approaching 3%. Future business expectations dropped to a six-month low on trade worries, with export orders also down for a second successive month. More worries came from the price indices, with average prices charged for goods and services rising at the steepest rate recorded since comparable data were first available in 2009.

FOMC minutes, home sales data and durable goods orders are other notable releases in the US.

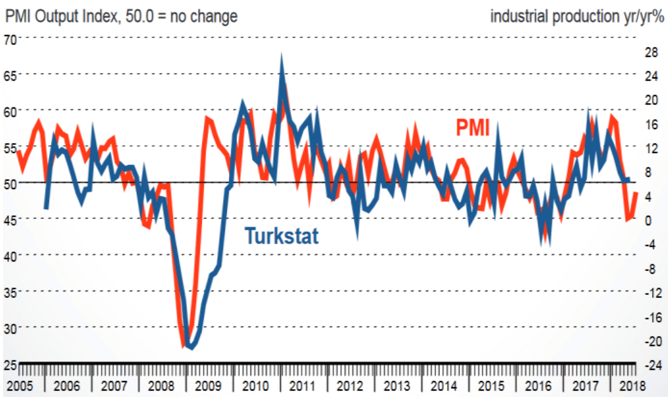
The Nikkei Japan PMI meanwhile saw manufacturing growth slow to a near one-year low in July as export sales failed to pick up following a downturn in June.

Global PMI indicators*



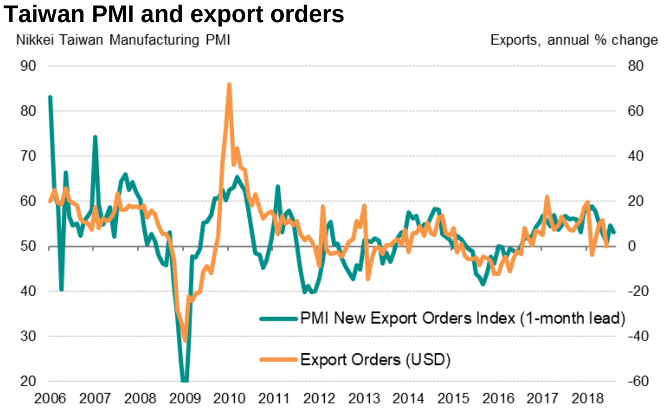
Source: IHS Markit, JPMorgan.
* PMI shown above is a GDP-weighted average of the manufacturing and services indices.

Turkey Manufacturing PMI v official data



Sources: Istanbul Chamber of Industry, IHS Markit, Datastream.

Taiwan PMI and export orders



Source: IHS Markit, Nikkei, DGBAS

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Some Japanese PMI survey participants were worried about the impact of rising trade tensions, and overall expectations among manufacturers towards future production were the lowest in four months. Another area of concern was the increasingly widespread shortage of inputs, which saw supplier delivery times lengthen to the greatest extent since the 2011 earthquakes.

July PMI data meanwhile showed one of the steepest rises in Japanese manufacturing input costs for nearly a decade, which could well feed through to higher consumer prices, data for which are also released during the week.

In Europe, the July PMI data suggested the eurozone GDP growth trend remains one of softer, but still solid, expansion. A worsening export trend was clearly having a detrimental effect on manufacturing. Export orders grew at the slowest rate for 23 months in July. Price pressures remained elevated to suggest further upward pressure on consumer prices.

Thailand's economy expected to slow

Second quarter GDP numbers are expected to show Thailand's economic growth cooling to around a 4% annual rate, down from a stronger-than-expected 4.8% in the first quarter. Analysts are anticipating higher imports to offset robust gains from exports and tourism. The Nikkei PMI surveys signaled a marginal improvement in the Thai manufacturing sector through the April-June quarter. However, a further decrease in new orders at the start of the third quarter portends softer growth in coming months.

The release of July trade data for Thailand in the same week will be keenly watched for signs of easing export performance.

Taiwan exports to provide trade insights

With escalating concerns of global trade tensions, analysts will keep an eye on Taiwan's export orders, which are widely seen as a key barometer for global trade flows, and particularly electronics across Asia. The PMI gauge for export orders, which has a close relationship with official data, suggests a pick-up in overseas sales in July following broadly stagnant growth at the end of the second quarter. However, the growth rate is likely to have remained relatively modest, and possibly below the 6.7% rate in the first half of 2018.

Taiwan's industrial production, current account, retail sales, second quarter GDP and unemployment data are also updated during the week.

Other key releases

Other key releases for the week include inflation numbers for Hong Kong, Malaysia and Singapore, with the latter also seeing updated industrial production numbers. New Zealand's retail sales and trade data are also updated.

Outside of the Asia Pacific region, UK household finance survey data for August are released by IHS Markit, which are closely watched by the Bank of England, as well as mortgage approvals for July.

Monday 20 August

Thailand GDP (Q2)

Taiwan export orders (Jul)

IHS Markit UK Household Finance Index (Jul)

Germany producer price inflation (Jul)

Euro area construction output (Jun)

Tuesday 21 August

RBA meeting minutes

Thailand trade (Jul)

Taiwan current account (Q2)

Hong Kong inflation (Jul)

Wednesday 22 August

New Zealand retail sales (Q2)

Australia construction work done (Q2)

Taiwan unemployment rate (Jul)

US existing home sales (Jul)

Thursday 23 August

IHS Markit Flash PMI surveys for US, Eurozone, Germany, France and Japan (Aug)

FOMC minutes

Singapore inflation (Jul)

Taiwan industrial production and retail sales (Jul)

France business confidence (Aug)

ECB monetary policy meeting account

Euro area consumer confidence (flash, Aug)

US new home sales (Jul) and Kansas Fed index (Aug)

Friday 24 August

New Zealand trade (Jul)

Japan inflation (Jul) and Tokyo inflation (Aug)

Malaysia inflation (Jul)

Singapore industrial production (Jul)

Taiwan GDP (final, Q2)

Germany GDP (final, Q2)

UK mortgage approvals (Jul)

US durable goods orders (Jul)

Special Focus

Will Turkey's Crisis Trigger Contagion to APAC Emerging Markets?

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

Overview

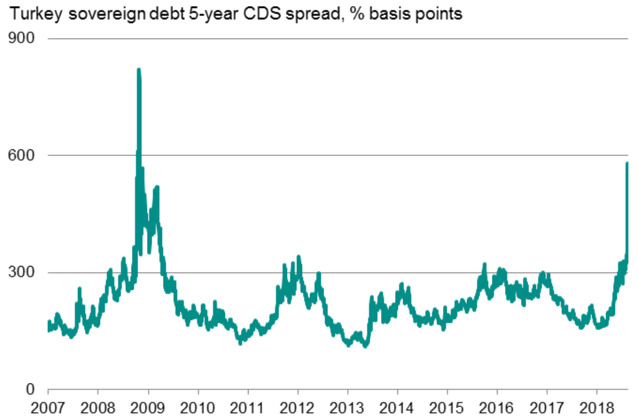
With some large emerging markets including Argentina, Venezuela and Turkey currently engulfed by economic crises, concerns have risen about the risk of contagion to other emerging markets. The escalating US-China trade war, US trade frictions with the EU and other NAFTA partners, as well as US implementation of economic sanctions on Russia and Iran, have also compounded anxieties amongst APAC governments and multinationals about the downside risks to global growth from a world trade slowdown.

East Asia continues to be haunted by the ghosts of crises past, with the contagion triggered by Thailand's economic crisis in 1997 having resulted in the protracted Asian financial crisis in 1997-98. One after another, many East Asian tiger economies were toppled by financial market contagion and capital flight. Their economies suffered recession, banking crises, corporate failures and the bursting of stock market and property market bubbles. Turkey's current economic crisis is very reminiscent of the economic crises experienced by East Asian economies such as Thailand, Indonesia and South Korea during the Asian financial crisis.

Although the trigger for the intensifying Turkish crisis has been the announcement of US sanctions and tariff measures on Turkey, the underlying causes of the economic crisis are much more deep-rooted macroeconomic imbalances, including a large current account deficit, excessive reliance on foreign portfolio capital inflows and high levels of external debt. Turkey's gross external debt is estimated to have reached USD 467 billion by March 2018, or 52.9% of GDP, according to Turkey's Ministry of Treasury and Finance.

With the Turkish lira depreciating rapidly, having fallen by around 40% versus the USD since the beginning of January until mid-August, the sharp depreciation is intensifying external debt problems while continued portfolio capital outflows put further downwards pressure on the Turkish lira. According to IHS Markit CDS spreads data, Turkey's 5-year sovereign CDS spreads have widened significantly in the first two weeks of August, reaching 580bps on 13 August. This is the first time they have approached the 600bps level since the Global Financial Crisis.

Cost of insurance against Turkey debt default

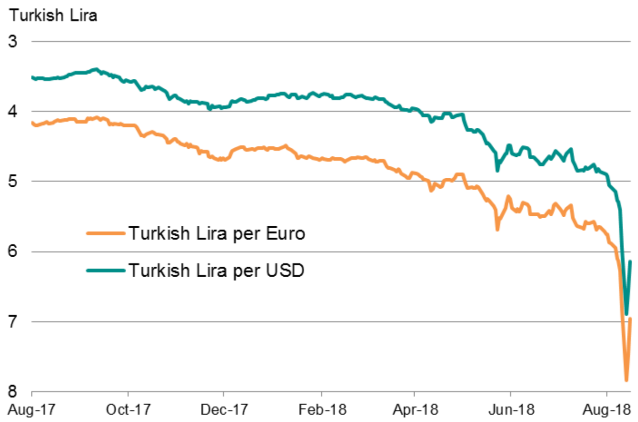


Source: IHS Markit.

Our IHS Markit Economics team covering Turkey assesses that the Turkish corporate sector has more than USD 200 billion of external debt, with many companies having a funding mismatch of borrowings in USD while their earnings are in Turkish lira, which creates an intensifying risk of rising corporate bankruptcies if firms cannot roll over their debts. (See IHS Markit Global Economics report "Initial Details of Turkish finance ministry's "plan" do little to arrest sharp lira losses", 14th August 2018).

Concerns have already mounted about contagion from Turkey's economic crisis to the European banking sector. Spanish banks have the biggest collective exposure, at around Euro 81 billion, while French banks have an estimated Euro 35 billion of exposure to Turkey, according to BIS statistics. Some European countries also have significant trade exposure to Turkey, notably Greece and Russia.

Turkey's currency crisis



Source: Datastream.

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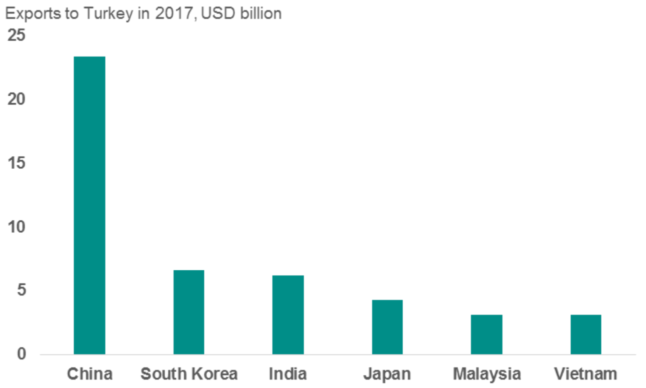
Are Emerging APAC Economies Vulnerable to Contagion?

The direct transmission links between Turkey and APAC through trade flows are significant for a number of APAC economies. Six APAC countries are among Turkey's top twenty sources of imports, led by China, which is Turkey's largest source of imports. The Turkish economic crisis and slumping lira will impact on bilateral trade, as the cost of imported goods will rise significantly in Turkish lira terms due to the sharp currency depreciation this year. For example, Malaysian bilateral trade with Turkey grew rapidly in 2017, reaching a level of Ringgit 12.1 billion for the calendar year, with Malaysian exports to Turkey having reached Ringgit 10.5 billion. However, the steep depreciation of the lira is likely to hurt Turkish orders for Malaysian products in 2018-19. In contrast, the competitiveness of Turkish imports to APAC nations will be boosted by the slumping lira.

Turkey's Key APAC trade partners



Source: IHS Markit.

However, the more significant concern for APAC nations would be if the Turkish economic crisis results in contagion to emerging markets currencies and equities, which could potentially trigger significant capital outflows from emerging markets. US Fed monetary policy tightening has already resulted in the depreciation of many emerging markets currencies against the USD since the beginning of 2018, with further US Fed tightening expected in the second half of 2018 and during 2019.

For many APAC countries, these risks to currencies and equity markets are mitigated by the significant improvements in macroeconomic resilience since the Asian crisis. During the past two decades many Asian economies that were at the centre of the Asian financial crisis, including South Korea, Thailand, Malaysia and Indonesia, have made tremendous progress in addressing the macroeconomic and financial vulnerabilities that contributed to the Asian financial crisis. Among the major achievements, there has been significant progress in the sophistication of macroeconomic management, as well as far-reaching banking sector reforms that have resulted in stronger prudential regulation of banks. Measures have included much improved capital adequacy ratios in the banking system, better risk management systems and the adoption of macro-prudential measures to manage risks related to real estate lending.

Many Asian economies have also built up their foreign-exchange reserves to improve their resilience against volatile international capital flows, and have also strengthened their financial resilience by adopting macro-prudential measures when required. The Chiang Mai Initiative, agreed in 2000 in the aftermath of the Asian financial crisis, has also created a regional mechanism for cooperation among the ASEAN countries plus China, Japan and South Korea for financial crisis prevention and resolution, initially built around a network of bilateral currency swaps.

Indonesia and the Philippines have also substantially improved their fiscal positions with very substantial reductions in government debt as a share of gross domestic product (GDP). Malaysia, Indonesia, Thailand and the Philippines have also taken steps to deepen their equity and bond markets, improving the diversity and liquidity of their capital markets.

Macroeconomic Vulnerabilities among APAC Nations

Despite the significant progress by many APAC emerging markets in improving their macroeconomic resilience, some Asian developing countries still remain vulnerable to contagion risks due to macroeconomic imbalances or political risk factors. Global investors have continued to differentiate among the various APAC economies, based on their differing vulnerabilities to political and economic risks.

In South Asia, several nations are already facing external debt problems. Sri Lanka is already a recipient of an IMF Extended Fund Facility, and faces further challenges due to high foreign debt repayments required over the medium term. The newly elected Pakistani government led by prime minister designate Imran Khan also faces an imminent external debt crisis reflecting heavy new foreign borrowing of around USD 29 billion in the past three years. This is mainly in relation to Belt & Road projects, which have pushed total external debt to an estimated USD 92 billion, creating a mounting debt burden that may eventually require another IMF bailout.

Some larger Asian emerging market economies may also be vulnerable to contagion resulting in currency depreciation and portfolio capital flight. India is one of the more vulnerable APAC emerging markets to external account shocks, as rising world oil prices have pushed up India's oil import bill, resulting in a widening current account deficit. The Indian rupee (INR) and balance of payments position is also vulnerable to foreign portfolio capital outflows, if investor sentiment about the political or economic outlook turns bearish. The INR has already hit a record low against the USD in mid-August, depreciating by around 9% in 2018 to date.

Indonesia also continues to be regarded by global investors as one of the more vulnerable large APAC emerging markets to global contagion. An important source of vulnerability for Indonesia relates to potential hot money outflows because of the high share of foreign ownership in the local equities and bond markets. Indonesia recorded net portfolio outflows in the first quarter of 2018, the first such quarterly outflow since the third quarter of 2015. Foreign ownership of rupiah-denominated government bonds remains at about 40%. In addition, non-residents hold 61% of total general government debt, amounting to about 16–19% of GDP. Corporate-sector exposure is also significant, with 45% of corporate debt in Indonesia being held by foreign investors.

Indonesia's central bank, Bank Indonesia, raised policy rates by a cumulative 100 basis points during May and June 2018, with a further 25bp rate hike on 15th August, in response to the substantial depreciation of the rupiah that the bank was unable to stabilize by intervention in foreign-exchange markets. After depleting more than USD 12 billion of foreign-exchange reserves during the first six months of 2018 in attempts to stabilize the rupiah, the Indonesian central bank has resorted to aggressive and "pre-emptive" tightening of monetary policy to help stabilize the currency.

In contrast, APAC economies with sound macroeconomic settings, strong external account positions and substantial FX reserves such as South Korea, Taiwan and Thailand have been relatively resilient, despite recent turbulence in emerging markets currencies that have been triggered by factors such as US Fed monetary policy tightening and fears of emerging markets contagion risks.

Risks to the APAC Outlook

Despite severe economic crises in a number of large emerging markets, including Argentina and Turkey, many APAC emerging markets have so far shown resilience to emerging markets contagion due to their strong macroeconomic fundamentals. Global investors have continued to differentiate between Asian economies based on vulnerabilities to macroeconomic and political risks.

However, with the US-China trade war escalating in recent weeks, a slowdown in APAC regional trade growth and negative impact effects on the East Asian manufacturing supply chain remain an important downside risk to Asian emerging markets. Macroeconomic modelling of a global protectionism scenario using the IHS Markit Global Link Model of the world economy indicate that APAC countries are among the most vulnerable in the world to an escalating US-China trade war. South Korea, Taiwan, Singapore, Malaysia, Vietnam, Thailand and the Philippines are among the most vulnerable economies to the shock waves of a such a trade war.

Furthermore, the APAC region has become increasingly vulnerable to the downside risk of a China hard landing scenario due to the rising importance of China as the largest economy in the region. While a China hard landing remains a low probability scenario, if it did in fact occur, it would likely unleash a tsunami of contagion across the APAC region through negative shocks to regional trade and investment flows and turmoil in regional financial markets.

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