IHS Markit

Economic commentary

31/08/2018

Week Ahead Asia-Pacific Economic Preview

- **Worldwide release of IHS Markit PMI surveys**
- **Australia and Malaysia monetary policy meetings**
- **Inflation updates for Indonesia, Philippines, Thailand and Taiwan**
- **US non-farm payrolls and wage growth**
- **Special focus on China's 'Belt and Road'**

The coming week sees the worldwide release of IHS Markit's August PMI surveys, providing clues as to economic performance and price trends in the third quarter. Analysts will also keenly monitor inflation updates for several Asian countries, as well as monetary policy decisions from Australia and Malaysia. Other highlights include US jobs and earnings data as well as second quarter growth updates for the Eurozone.

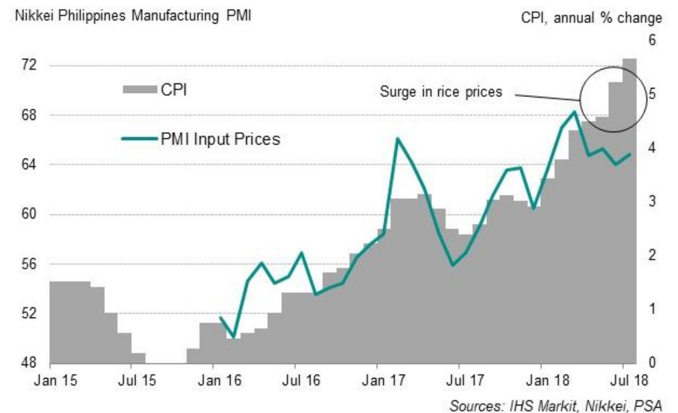
With rising trade tensions, our special focus this week delves into the issues that China is facing in Asia Pacific relating to its Belt and Road Initiative.

Asian inflation trends

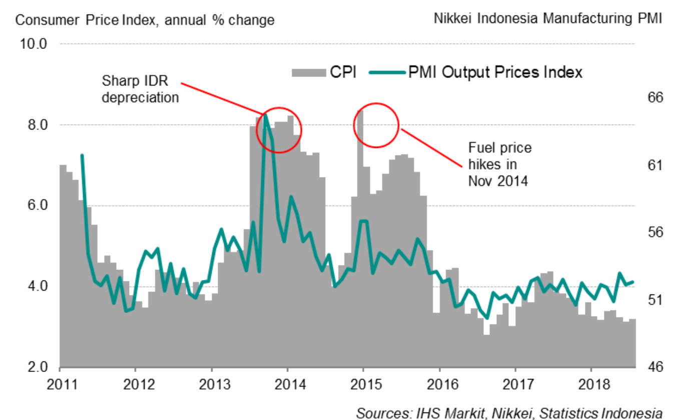
Inflation data for several Asian economies will provide insights into price trends across the region. In Indonesia, a weaker rupiah has, so far, not translated into higher consumer price inflation. Market expectations point to an annual CPI rate of 3.2% in August, which will fall comfortably within the central bank's target range of 2.5–4.5%. However, the Nikkei Indonesia Manufacturing PMI has been signalling strong cost pressures in recent months, hinting at higher inflation in coming months as increased costs look likely to filter through to consumer prices. As such, updated PMI figures for August will be keenly monitored.

In contrast, a weaker peso and the new excise tax have been the main inflationary drivers in the Philippines so far this year, which has seen consumer price inflation exceed the upper bound of the central bank's 2–4% target range in each month since March. The central bank expects August to see CPI rise higher than July's 5.7% annual rate, which will build expectations for more rate hikes. The central bank has raised interest rates three times in the last four months to rein in inflationary expectations. The August PMI update will also provide clues on price trends ahead of the official data.

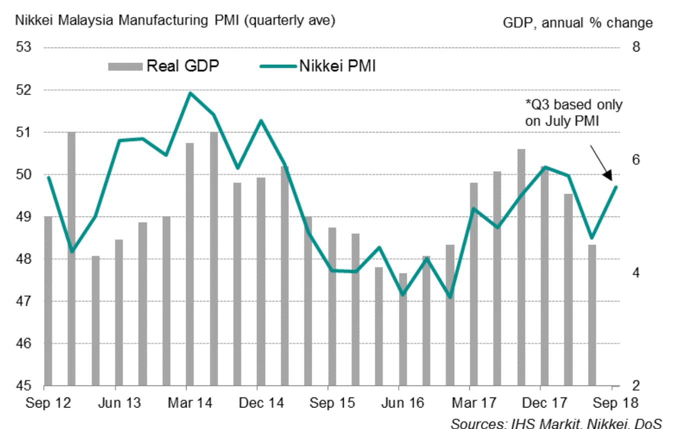
Philippines PMI prices and consumer inflation



Indonesia PMI prices and consumer inflation



Malaysia PMI hints at Q3 upturn after weak Q2



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Australia policy meeting

The Reserve Bank of Australia meets early in the week to set monetary policy during a period of political leadership transition.

The RBA has continued to see little change in inflation and wage growth, and with recent CBA PMI surveys indicating a slowing growth momentum in the Australian economy, policymakers look likely to hold rates for now.

Second quarter GDP numbers are also forecast to show the Australian economy losing momentum to reach a 2.9% annual rate, down from 3.1% in the opening three months of 2018. The August update to the CBA PMI surveys will provide clues to economic performance in the third quarter.

Malaysia monetary policy

Despite second quarter GDP slowing noticeably from the opening quarter of 2018, Bank Negara Malaysia is expected to keep policy rates steady at the next meeting.

With escalating trade tensions and weak fiscal finances posing potential downside risks to growth, alongside the new government's announcement to suspend three large infrastructure projects connected to China's Belt and Road Initiative (See Special Focus for an in-depth report), the central bank will prefer to err on the side of caution and keep monetary policy accommodative for the moment. Updated Nikkei Malaysia Manufacturing PMI data will also offer a view to economic performance midway through the third quarter, having signalled the second quarter slowdown well in advance.

US employment report

With the strength of the dollar a growing concern for many emerging markets, the US employment report will no doubt help steer policy guidance and hence the Greenback. Judging by survey evidence, such as the August flash PMI surveys, another healthy non-farm payroll gain of 180k is to be expected. However, more crucial to policymakers will be wage growth. While the July report showed the economy adding jobs at a healthy clip of 157,000, analysts generally saw the need for restraint from the Fed as pay inflation held at 2.7%.

Monday 3 September

Worldwide IHS Markit Manufacturing PMI surveys (Aug)
Japan capital spending (Q2)
Australia retail sales (Jul)
Indonesia and Thailand inflation (Aug)
Spain consumer confidence (Aug)
Singapore SIPMM Manufacturing PMI (Aug)
Brazil trade balance (Aug)

Tuesday 4 September

South Korea GDP (final, Q2) and inflation (Aug)
RBA interest rate decision
Spain unemployment change (Aug)
UK IHS Markit/CIPS Construction PMI (Aug)
Euro area PPI (Jul)
South Africa GDP (Q2)
Brazil industrial production (Jul)
US ISM manufacturing (Aug) and construction spending (Jul)
US total vehicle sales (Aug)

Wednesday 5 September

Worldwide IHS Markit Services PMI and Whole Economy PMI surveys (Aug)
Philippines inflation (Aug) and unemployment rate (Q3)
Australia GDP (Q2)
Malaysia monetary policy decision and trade data (Jul)
Taiwan inflation and wholesale prices (Aug)
Euro area retail sales (Jul)
US trade (Jul)
Canada monetary policy decision and trade (Jul)

Thursday 6 September

Australia trade (Jul)
Thailand consumer confidence (Aug)
Germany IHS Markit Construction PMI (Aug) and factory orders (Jul)
Brazil inflation (Aug)
US ADP employment and ISM non-manufacturing (Aug)
US factory orders (Jul)

Friday 7 September

Japan household spending (Jul)
Australia home loans (Jul)
Taiwan trade (Aug)
Germany trade, industrial production and current account (Jul)
France industrial production and trade balance (Jul)
UK Halifax House Price Index (Aug) and consumer inflation expectations (Q3)
Italy retail sales (Jul)
Euro area GDP (3rd est, Q2)
Canada unemployment rate (Aug)
US nonfarm payrolls, earnings and unemployment rate (Aug)

Special Focus

China's Belt & Road Initiative Hits Turbulence in APAC

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

Overview

China's Belt and Road Initiative (BRI), which has an estimated 65 partner nations worldwide, has been embraced by many developing nations since it was originally launched in 2013. With over USD 1 trillion of infrastructure financing planned over the next decade, the BRI could contribute significantly to improving infrastructure and accelerating economic development in many developing countries. However, the ambitious vision to boost infrastructure connectivity across Asia, the Middle East, Europe and Africa has hit some turbulence, notably in Asia.

This was highlighted during the visit of Malaysian Prime Minister Mahathir bin Mohamad to China in mid-August, with the Malaysian government's plans to suspend or scrap several BRI infrastructure megaprojects in Malaysia having been a key focus for the bilateral talks in Beijing. At present, BRI projects with a combined project value of Ringgit 92 billion have been suspended by the Malaysian government.

Incoming Pakistani Prime Minister Imran Khan has also indicated that Pakistan's BRI projects may need to be reviewed, with China having already committed around USD 62 billion in funding for BRI projects in Pakistan under the China-Pakistan Economic Corridor (CPEC) initiative. Pakistan is currently facing an imminent external debt crisis, which has become a key priority for the new PTI-led coalition government.

Malaysia's Infrastructure Megaprojects

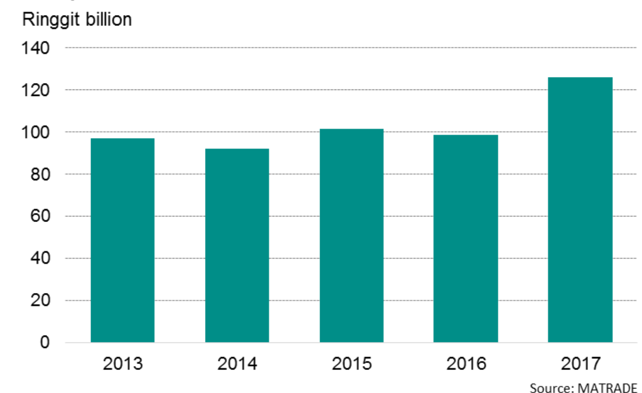
The incoming new Malaysian Pakatan Harapan (PH) government, led by Prime Minister Dr. Mahathir bin Mohamad, that took office in May 2018 has moved swiftly on its election campaign promise to review large infrastructure projects. A key concern for the new government is the high level of government debt that would be incurred as a result of these infrastructure megaprojects.

The new administration has estimated that Malaysian government debt has reached Ringgit 1.087 trillion, making controlling further escalation in government debt a key priority. The new Malaysian Finance Minister Lim Guan Eng stated on 24th May that the government's estimate of Malaysian government debt included official federal government debt of Ringgit 687 billion, or 50.8% of GDP. An additional estimated Ringgit 199 billion of contingent liabilities, relating to government guarantees for state-owned enterprises is equivalent to an extra 14.6 per cent of GDP. Further government payments for public-private partnerships amount to an estimated Ringgit 201 billion, or 14.9% of GDP.

In order to prevent a sharp escalation of government debt, a number of infrastructure megaprojects are under review. One BRI megaproject that will be either cancelled or deferred is the East Coast Rail Link (ECRL) megaproject. The ECRL project is a bilateral project agreed between Malaysia and China under the BRI, with the latest estimated total cost being around Ringgit 81 billion. The ECRL project construction is 85 per cent financed by the Export-Import Bank of China with a loan at a 3.25 per cent interest rate.

In addition, the Trans-Sabah Gas Pipeline project and the Multi-Product Pipeline project, both being built by China Petroleum Pipeline Bureau, have also been suspended. The two pipeline projects have a combined project value of Ringgit 11.1 billion. A suspension order for all contracts related to the two pipeline projects as well as the ECRL project was issued on 3rd July by the Malaysian Ministry of Finance.

Malaysian Exports to China



The China-Pakistan Economic Corridor

The newly elected PTI-led coalition government in Pakistan faces an imminent external debt crisis due to the rapid rise of foreign debt levels over the past three years. Some of the increase in foreign debt relates to new loans for BRI projects, with around 20 CPEC projects with a total project cost of USD 19 billion having either been completed or currently under construction. Total external debt reached USD 89 billion at the end of 2017, according to the State Bank of Pakistan, and rose further to USD 92 billion by March 2018.

Pakistan's external debt has increased by USD 13 billion compared to a year ago, and is around 50% higher than in June 2013. The current account deficit has widened to 5.7% of GDP in the fiscal year ended June 2018 and the government faces a large financing gap in relation to its near-term external debt repayment schedule. Official foreign exchange reserves have depleted to USD 10.5 billion in late July, which was sufficient for only 2 months' import cover, even after China provided an emergency USD 2 billion loan in July to boost Pakistan's reserves.

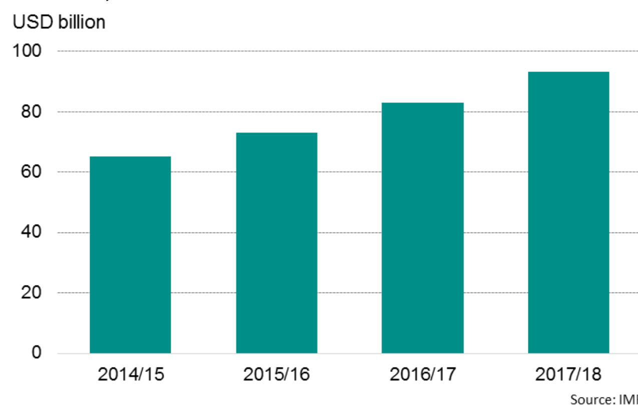
Pakistan is facing an imminent external payments crisis unless it can raise additional financing of around USD 13 billion in the next few months either through bilateral assistance from China or an IMF bailout. This comes only two years since the completion of a previous USD 6.4 billion

IMF facility in September 2016, the twelfth IMF bailout since the 1980s.

However, if there is another IMF bailout soon, the IMF will likely seek transparency about the terms and conditions of the BRI projects, which have so far remained confidential. If Pakistan does obtain an IMF bailout package, its fiscal policies and debt sustainability will be key areas of IMF review.

With Pakistan already facing an external payments crisis, the ability of the nation to take on additional foreign loans to finance more CPEC projects has become a key concern for the incoming PTI coalition government.

Pakistan, Total External Debt



Sri Lanka's Hambantota Port Project

The Hambantota Port project in Sri Lanka was funded by China as one of its BRI projects, with a loan of USD 1.3 billion provided to the Sri Lankan government. However, the port was commercially unsuccessful, with accumulating losses during its first six years of operation. The Sri Lankan government eventually negotiated an agreement in 2017 whereby China Merchants Port Holdings Company purchased an 85% stake in the port of USD 1.12 billion, giving it a 99-year lease for the port. The Sri Lanka Ports Authority retains a 15% stake in the port joint venture.

Outlook

A number of APAC developing countries that have taken loans for BRI projects have run into various financial difficulties in relation to their BRI loans. This has highlighted the need for greater project evaluation and value-for-money studies for individual BRI projects, as well as the fiscal and debt sustainability implications of overall BRI programs in developing nations. Since many of the BRI partner nations are low-income developing countries, some with a recent history of external debt problems, their vulnerability to external account difficulties is often high.

International financial institutions such as the IMF and World Bank have highlighted the importance for nations to assess the debt sustainability implications of BRI loans, as well as the need to adopt more open tender processes to ensure that the projects are built on the most efficient, value-for-money basis.

One joint initiative launched by the IMF together with China to address these concerns is the creation of the China-IMF Capacity Development Center in April 2018, which will help to improve capacity building for developing countries in relation to macroeconomic stability and debt sustainability.

Greater transparency in the tendering process for BRI project contracts and more international competition may also help to improve the project outcomes.

However, with many BRI projects having already been completed or currently underway, some additional low-income developing countries could still face difficulties with their debt repayments for BRI projects.

Given that the ambition of the BRI is to create greater infrastructure connectivity across much of Asia, Africa, the Middle East and Europe, greater internationalization of BRI projects will help to strengthen their commercial viability. This will require more open and transparent project tendering processes and more jointly funded projects involving international financing from a range of sources, including multilateral financing institutions.

The BRI experience of countries such as Pakistan, Malaysia and Sri Lanka provide a salutary lesson about the pitfalls of BRI project debt for other developing countries. Their experiences highlight the need for BRI partner nations to properly assess the economic costs and benefits of BRI projects, as well as the fiscal and debt sustainability implications.

For further information:

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