

# Week Ahead Asia-Pacific Economic Preview

- Release of IHS Markit flash PMI surveys
- Bank Indonesia decides on monetary policy, as do ECB and Turkey
- US and South Korea Q3 GDP
- Inflation data for Singapore, Malaysia and Hong Kong
- Special focus on South Korea's aging population and its economic impact

The coming week sees the release of the flash October PMI surveys, which will provide important steers on economic growth and inflation trends in major economies at the start of the fourth quarter, as well as third quarter GDP numbers for the US. The ECB and Turkey are meanwhile meeting to set monetary policy, but in Asia eyes are focused on Bank Indonesia amid recent reports of capital controls.

Other data highlights for Asia include South Korean GDP, export orders, industrial output and retail sales data for Taiwan, as well as inflation figures for Singapore, Malaysia and Hong Kong.

Our special focus this week looks at the economic impact of ageing demographics in South Korea.

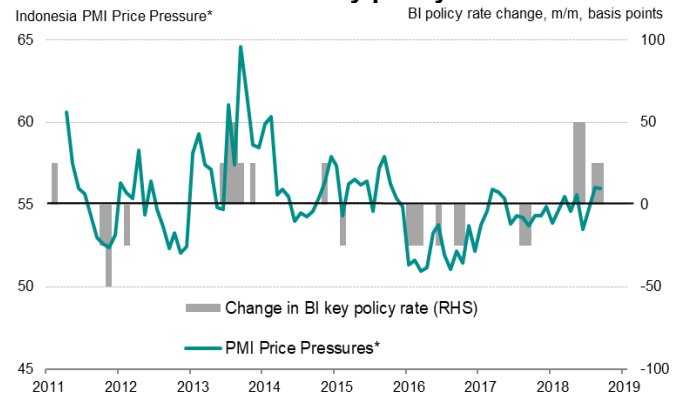
## Flash PMI surveys and US GDP

With global financial markets on edge over the pace of US interest rate hikes and the impact of trade wars, flash PMI data for the US, Eurozone and Japan will be scoured for signals of economic performance at the start of the final quarter of 2018. Prior [US PMI data](#) showed the pace of expansion slowing to an eight-month low, dampened in part by extreme weather but also by intensifying capacity constraints. Prices growth hit the highest in the survey's history as tariffs exacerbated rising underlying inflationary pressures.

The flash PMI numbers will be followed by the advance estimate of US third quarter GDP, which is widely expected to show solid growth, albeit slightly less than the 4.2% annualised rate of increase seen in the second quarter.

Adverse weather and trade jitters had also subdued the [Nikkei PMI for Japan](#), keeping exports close to stagnation, so October's flash manufacturing reading will hopefully provide greater clarity into underlying growth trends.

## Indonesia PMI and monetary policy



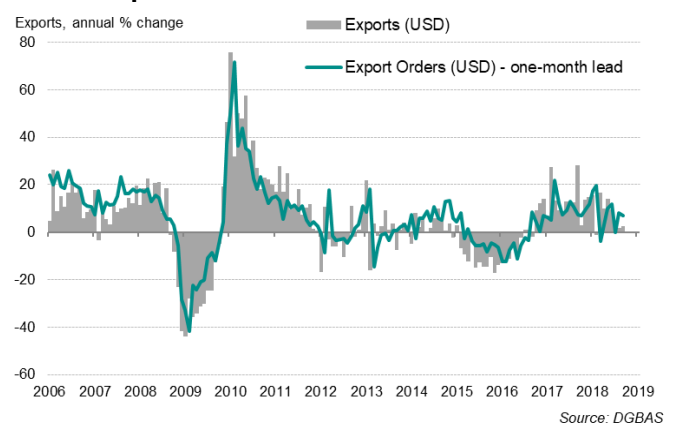
\* a blended index of input prices and suppliers' delivery times. Sources: IHS Markit, Nikkei, Bank Indonesia

## Korea PMI and economic growth



Sources: IHS Markit, Nikkei, BOK

## Taiwan export orders



Source: DGBAS

Continued...

The publication of eurozone flash PMI data will meanwhile provide timely insights into price and growth trends within the single currency area on the day prior to the European Central Bank's monetary policy meeting. The [Eurozone PMI](#) showed the pace of growth near a two-year low in September, with price pressures also moderating. The weaker PMI numbers mean a rate rise looks unlikely within the coming year, as per current ECB guidance, and could be pushed further out if downside risks materialise.

### Indonesia interest rate decision

With [recent comments](#) about capital controls being part of monetary policymaking tools from several ASEAN central bankers, there will be great interest in Indonesia when policymakers meet. The rupiah remains under considerable downward pressure, having fallen nearly 12% against the US dollar so far this year. In response, Bank Indonesia hiked its policy rate in five out of the last six meetings, while also announcing plans to develop the onshore markets for non-deliverable forwards, as well as encouraging FX swaps as part of efforts to stabilise the rupiah. Since then the [September PMI survey](#) signalled greater inflation pressures in Indonesia, with the input price index at a three-year high, driven mostly by a weaker exchange rate. Analysts will therefore be keen to monitor any post-decision comments on capital controls. Even if Bank Indonesia keeps interest rates steady in the upcoming policy meeting, the central bank's stance remains hawkish, with future policy decisions hinging on the pace of US rate tightening cycle, global trade conditions and financial market movements.

### South Korea GDP

Next week sees the release of advance estimates of third quarter GDP in South Korea. The [Nikkei PMI surveys](#) signals another decline in the third quarter PMI average reading as a whole. Although September PMI data indicated the first improvement in the health of the manufacturing sector since February, a further contraction in export orders suggest softening external demand would weigh on future business activity.

### Taiwan export orders

In Taiwan, the release of September export orders, a barometer for regional trade performance, will be keenly watched. Growth of Taiwanese goods shipments had slowed in recent months, likely reflecting the deterioration in worldwide trade conditions and a maturing global electronics cycle. The ongoing shortage in electronic components, as

indicated in recent PMI surveys, has also dented business activity in the electronics sector.

Other data highlights in Taiwan include industrial production and retail sales.

### Monday 22 October

Thailand trade (Sep)  
Taiwan export orders (Sep)  
UK household finance index (Sep)  
US Chicago Fed national activity index (Sep)

### Tuesday 23 October

Singapore inflation (Sep)  
Germany PPI (Sep)  
Turkey consumer confidence  
Indonesia monetary policy decision  
Taiwan retail sales and industrial production (Sep)  
Hong Kong inflation (Sep)  
Euro area consumer confidence (flash, Oct)

### Wednesday 24 October

IHS Markit flash PMI surveys for US, Eurozone, Germany, France and Japan (Oct)  
Malaysia inflation (Sep)  
US new home sales (Sep)

### Thursday 25 October

New Zealand trade (Sep)  
South Korea GDP (adv, Q3)  
Spain unemployment rate (Q3)  
Germany IFO surveys (Oct)  
Hong Kong trade (Sep)  
Turkey monetary policy decision  
ECB policy meeting  
US durable goods orders and pending home sales (Sep)  
US goods trade and wholesale inventories (adv, Sep)

### Friday 26 October

South Korea consumer confidence (Oct)  
Taiwan consumer confidence (Sep)  
Singapore jobless rate (Q3) and industrial production (Sep)  
Germany consumer confidence (Nov)  
France consumer confidence (Oct)  
Russia interest rate decision  
US GDP (adv, Q3)  
US Michigan surveys (final, Oct)

By Bernard Aw, Principal Economist, IHS Markit

# Special Focus

## Northeast Asia's Ageing Demographics: The Economic Impact on South Korea

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

*The economic impact of ageing demographics in Northeast Asia will be assessed in a three-part series of articles that will be featured in the APAC Preview. This first article considers the economic and social challenges facing South Korea as its old age dependency ratio rises over the next three decades.*

### Overview

Northeast Asia is facing significant challenges due to the impact of population ageing. The advanced economies of Japan and South Korea face particularly substantial economic and social effects as their populations age over the next three decades, and China also is confronting the long-term impact of ageing demographics, albeit with the impact over the next three decades not projected to be as severe as for Japan and South Korea.

Demographic ageing will be an important factor contributing to a significant moderation in the potential GDP growth rates of Northeast Asian economies. Japan's population of working age has already fallen by around 10 million over the past two decades, with its total population having begun to contract since 2010. This has already had a substantial impact on economic growth, with estimates of potential GDP growth already at less than 1% per year, according to recent Bank of Japan estimates. South Korean potential GDP growth has also fallen significantly since the 1990s.

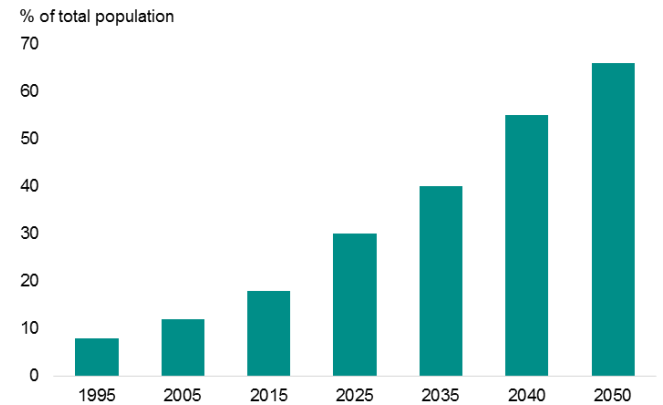
Furthermore, the rising old age dependency ratios in Japan and South Korea imply that significant increases in social security and public health care costs will occur over the next three decades, resulting in a rising fiscal burden for health care, pensions and other social security outlays at a time when GDP growth is slowing.

### South Korea's ageing population structure

South Korea's population is projected to still show a small increase over the next decade, rising from 50 million in 2015 to 52.7 million by 2030, before declining to 50 million again by 2050 according to the UN World Population Prospects 2017 Variant. While South Korea does not yet face such a severe population decline as Japan over the next three decades, a key economic

challenge for South Korea is that the old age dependency ratio, measured as the share of persons aged over 65 as a share of the total population is projected to increase from 18% in 2015 to 66% by 2050.

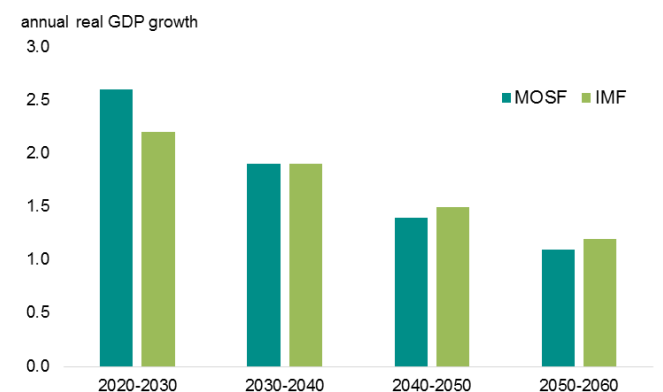
### South Korea's Rising Old Age Dependency Ratio



Source: UN World Population Prospects

Due to the rapidly ageing population, South Korea is facing significant economic challenges. The rising old age dependency ratio will be a substantial factor contributing to South Korea's moderating potential growth rates over the next decade and beyond. South Korea's potential GDP growth rate has already slowed sharply, down from around 8% in 1990 to approximately 3% by 2017, due to factors such as the impact of weaker productivity growth and the declining contribution to growth from labour inputs.

### South Korea's Potential GDP Growth Will Slow



Source: MOSF; IMF projections.

Over the next two decades, South Korea's manufacturing sector will face similar challenges to Japan's economy, which experienced two 'lost decades' of weak growth since 1990 due to a range of factors, including the bursting of the economic bubble and the impact of ageing demographics and rising

labour costs. The South Korean Ministry of Strategy and Finance (MOSF) has estimated that South Korea's potential GDP growth rate will average around 2.6% per year over the 2020-2030 decade, moderating further to 1.9% per year in the 2030-2040 decade.

### The changing competitive landscape for South Korean manufacturing

The combined impact of rising labour costs and severe demographic ageing will make it increasingly difficult for South Korea's manufacturing sector to compete against fast growing, low-cost manufacturing hubs such as Vietnam and India. South Korea's manufacturing sector is therefore likely to face continued 'hollowing out' as its large South Korean manufacturing MNCs shift production of products such as cars, electrical and electronics goods to low-cost hubs elsewhere in fast growing emerging Asian markets.

As South Korea's population is stabilising and economic growth slows, the pace of expansion of the domestic consumer market is also moderating, making the fast-growing consumer markets of other Asian emerging markets such as India, Vietnam and Indonesia increasingly attractive for South Korean multinationals as new manufacturing hubs.

In addition to facing competition from lower cost manufacturing hubs for low end manufactures, South Korea is also facing increasing competition for higher value-added manufacturing products, notably from China. China has embarked on the "Made in China 2025" strategy, which aims to build China's competitiveness in higher value-added industries such as industrial automation and robotics, electric vehicles, advanced electronics and aerospace.

Due to China's high dependency on imported semiconductors from South Korea, Taiwan and the US, China is also trying to build substantial new capacity to manufacture semiconductors, which could pose a long-term threat to South Korea's semiconductor industry. In the communications equipment sector, Chinese firms such as Huawei are also becoming global leaders, creating new sources of international competition for South Korea's communications equipment sector. Consequently, South Korean manufacturing faces considerable competitive threats from other Asian manufacturing hubs over the decade ahead.

### Outlook for policy reforms

As ageing demographics result in a significant slowdown in South Korea's potential GDP growth rate, the South Korean government will need to implement substantial economic policy reforms to help boost productivity growth and mitigate the impact of ageing demographics, such as increasing labour force participation rates. Japan has been attempting to undertake similar economic reforms under Prime Minister Abe's 'Third Arrow' economic reforms.

As in Japan, South Korea has historically had a very homogenous society, with relatively limited immigration of foreign workers. Significant reforms to immigration policy still look unlikely to be used as a policy lever to address demographic ageing, in contrast to the way that nations such as Singapore, Germany and Australia have implemented various forms of immigration policies to mitigate the impact of demographic change and cope with shortages of skilled labour. With the immigration policy lever politically difficult to implement, this will put more pressure on South Korean policymakers to make alternative substantial economic reforms in order to try to address the economic impact of demographic ageing.

One such key alternative strategy needed by South Korea to address these competitive challenges will be to diversify the growth engines of the economy away from manufacturing towards services such as tourism, education, financial services and health care. A second key strategy will also be to maintain South Korea's global leadership in R&D, through joint collaborative initiatives between government, industry and universities to drive technological leadership in key manufacturing industries such as electronics, aerospace and medical equipment. A further important strategy will be to boost the ecosystem for technology start-ups, which can generate significant skilled jobs growth in technology sectors such as smart cities technology, cyber security and robotics.

One potential upside risk scenario for South Korea that may help to mitigate the impact of demographic ageing would be a durable peace agreement with North Korea, albeit this scenario is still subject to considerable uncertainty. While peace on the Korean peninsula would be a big positive for the South Korean economy over the medium term, it is too early to determine the timing of such an impact, since it is crucial for the US and North Korea to reach an agreement on denuclearization of the Korean Peninsula before any

economic roadmap for closer co-operation on the Korean Peninsula can occur.

However, if the US and North Korea can reach a durable peace deal, it could have a positive impact for the South Korean economy over the medium to long term, allowing the development of an economic roadmap for improving bilateral trade and investment relations with North Korea. This could provide opportunities for South Korean firms to resume production in North Korea, such as restarting operations at the Kaesong Industrial Complex, if and when UN economic sanctions on North Korea are eventually lifted. This would also allow South Korean firms to tap the low wage North Korean workforce, as well as creating some market development opportunities for South Korean firms in the North Korean economy.

### For further information:

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