Ravi Menon: Emerging Asia - short-term outlook and risks

Pointers for panel remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the 5th Milken Institute Asia Summit, Singapore, 13 September 2018.

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Global growth has shown remarkable resilience despite mounting uncertainties.

- Growth this year is likely to be as strong as last year's. And last year's growth was the strongest since the global financial crisis.
- And Emerging Asian economies have been doing well.

But the going will get tougher in the months ahead and going into 2019.

- Some slowdown in momentum is to be expected, following 12–18 months of strong growth
- What bears close watching are two headwinds emanating from the US and sweeping across the world, including Emerging Asia.

The first headwind is rising trade tensions.

The second is tightening global financial conditions.

First, growing trade disputes.

- The impact of the trade tariffs announced to-date has been limited.
- If the threats of further tariffs are carried out, trade volumes will come down and some reduction in growth is to be expected – the US by about 0.5% points and China by about the same amount.
- This will have implications down the supply chain and production networks across Emerging Asia, shaving off growth in most economies.
- 2019 will most likely not be as good a year as 2018.

But the effects will not be devastating – we are not looking at a recession.

- This is not a global trade conflict. This is centred on the US.
- The US is of course the biggest export market in the world but total US imports account for only 3% of global GDP.
- Many other countries – especially in Emerging Asia – are trading among themselves without a nexus to the US.
  - These trading linkages will grow over time as demand in these economies grows with a rising middle class, urbanisation, and investment in infrastructure.

All the same, a prolonged period of trade tensions is not good for the global economy.

- The more serious casualty is perhaps not trade but investment. Corporates may scale back investment amidst uncertainty.
- This will reduce the productive capacity for future growth, delay technological upgrading, and compromise productivity growth.

This is why the best response to unilateral trade restrictions is to push ahead with further trade liberalisation among other willing parties instead of retaliation and escalation.

- If countries do not retaliate against tariffs imposed by the US, the cost to their own

  - economies is likely to be contained.
  - And a mutually damaging trade war would be averted.

And this is what Emerging Asia is doing – liberalising trade within the region and with others.

- TPP-11 or Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)
  - This will reduce barriers across economies with a GDP of US$10 trillion, roughly 13.5% of the world economy.
  - It is expected to be ratified early next year. And five to six more countries have expressed interest in joining the CPTPP.

- ASEAN+6 or Regional Comprehensive Economic Partnership (RCEP)
  - This FTA builds on the existing five ASEAN Plus One FTAs.
  - Negotiations have been going on for some time but the pace has picked up recently as rising trade tensions have underscored the importance of enhancing economic integration to build resilience
  - When it is signed, RCEP will be the world's largest trading bloc in terms of population, covering nearly 3.5 billion people, and accounting for a third of the world's GDP.

Second headwind – tightening global financial conditions.

- As the Fed continues to raise interest rates and unwind its balance sheet, global liquidity conditions will tighten and financial market valuations will come under further pressure.
- Asset revaluations will be keenly felt in EMEs, which have benefited from large investor inflows driven in part by investors' search-for-yield in the post-GFC period.

In Emerging Asia, some economies will face higher financing costs, rising external debt burdens, short-term capital outflows, and heightened currency volatility.

- We have already seen some signs of these pressures.
- They are to be expected – as part of the normal adjustment to the normalisation of global financial conditions.

ASEAN is well placed to deal with these pressures as well as contagion effects from EMEs in other parts of the world

First, economic fundamentals in ASEAN are stronger.

- Growth is good – it is close to or above potential across the ASEAN-4 (Malaysia, Indonesia, Thailand, Philippines).
- Inflation has been subdued.
- Current accounts are in surplus or only a small deficit.
- Buffers to withstand shocks are strong – be it central banks' reserves or banks' capital adequacy.

Second, ASEAN policymakers have demonstrated that they are able and willing to adjust policies to deal with external and internal stresses.

- They have raised interest rates pre-emptively.
- They have allowed their exchange rates to depreciate in an orderly manner, intervening in the FX markets only to moderate excessive movements.

- And they have room to use fiscal policy to support growth, as debt positions are generally healthy.

Take Indonesia for example. The currency has come under some pressure but the macroeconomic fundamentals are essentially sound.

- The economy is growing at a respectable 5%.
- Inflation is under control, at about 3.5% – an achievement compared to the past.
- The fiscal deficit has come down and is now about 2% of GDP – not an alarming number.
- Total debt-to-GDP ratio is 30% – a respectable number by any international comparison.
- The current account deficit has slipped somewhat but, at 3% of GDP, is not unduly large. And it is not unusual for a developing country to run a current account deficit to finance investment for future growth.

And Indonesia's policy responses to-date have demonstrated a willingness to take tough measures to build up resilience

- The central bank has hiked interest rates.
- The government has been re-evaluating import-intensive infrastructure spending.

Markets can sometimes over-react and investors sell down EME assets in a general knee-jerk risk-off mood.

- But as investors understand better that Emerging Asian economies are on a strong footing, they are becoming more discerning.
- And contagion effects from other EMEs will then reduce over time.

More importantly, the ASEAN growth story remains intact.

ASEAN is poised for continued healthy growth over the medium term, on the back of macroeconomic stability.

- The ASEAN-5 economies – Indonesia, Malaysia, Philippines, Thailand and Singapore– are expected to grow at close to 5% per annum over the next 5 years.
- This is higher compared to Latin America (2.8%) and Eastern Europe (3.3%).

ASEAN's resilience stems from fundamental drivers that support the region's growth in a mutually reinforcing fashion

- Rising Middle Class: Rising affluence of the middle class will spur consumption, including a range of modern services – especially finance and insurance, professional services, tourism, healthcare and education.
- Urbanisation: Rural-urban migration and the expansion of cities will spur sizeable demand for infrastructure.
- Integration: ASEAN's growing integration – increasingly powered by technology and e-commerce – will allow the region to reap complementarities and synergies to sustain growth over the long term.

The ASEAN Economic Community (AEC) Blueprint 2025 lays the pathway for a highly integrated region, well connected to other parts of a dynamic Asia. More than short-term volatilities, ASEAN's prospects will depend on how well it executes closer integration and structural reforms to increase efficiency and productivity.