



# Asia: 2019 Key Themes & CLMV Outlook

Challenges Abound In 2019

January 2019

# Disclaimer

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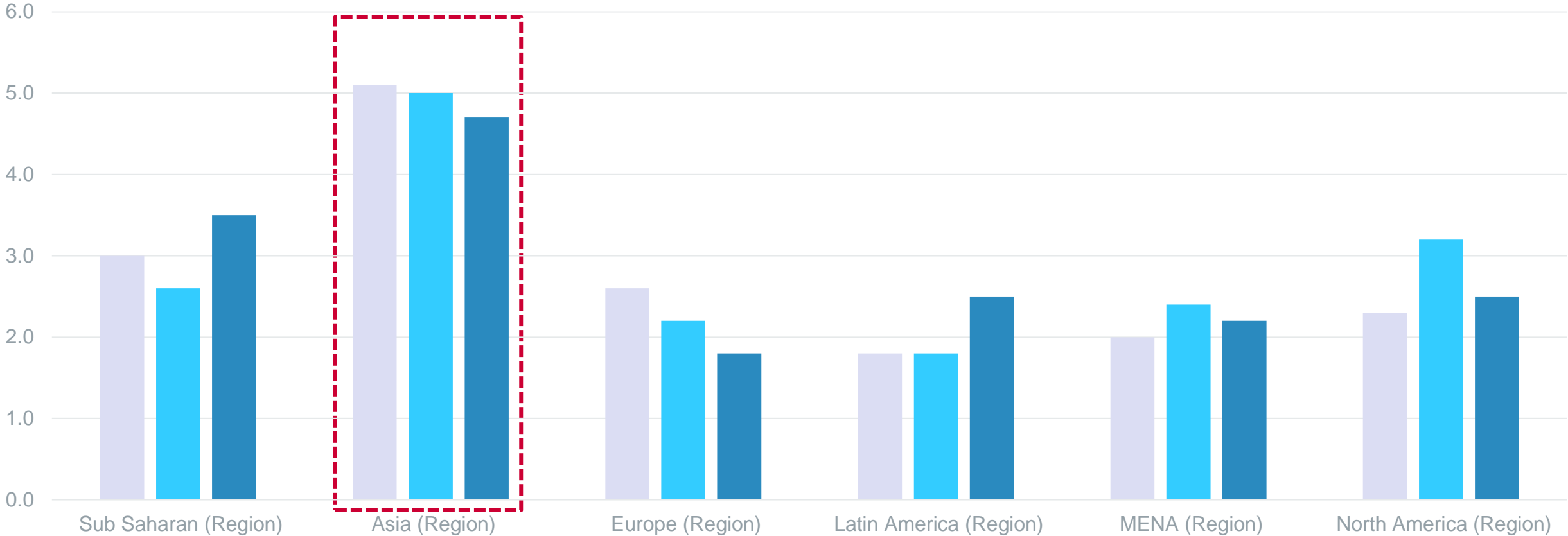
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# Asia To Lead Global Real GDP Growth... Again

## Real GDP Growth By Region

%

■ 2017 ■ 2018 ■ 2019

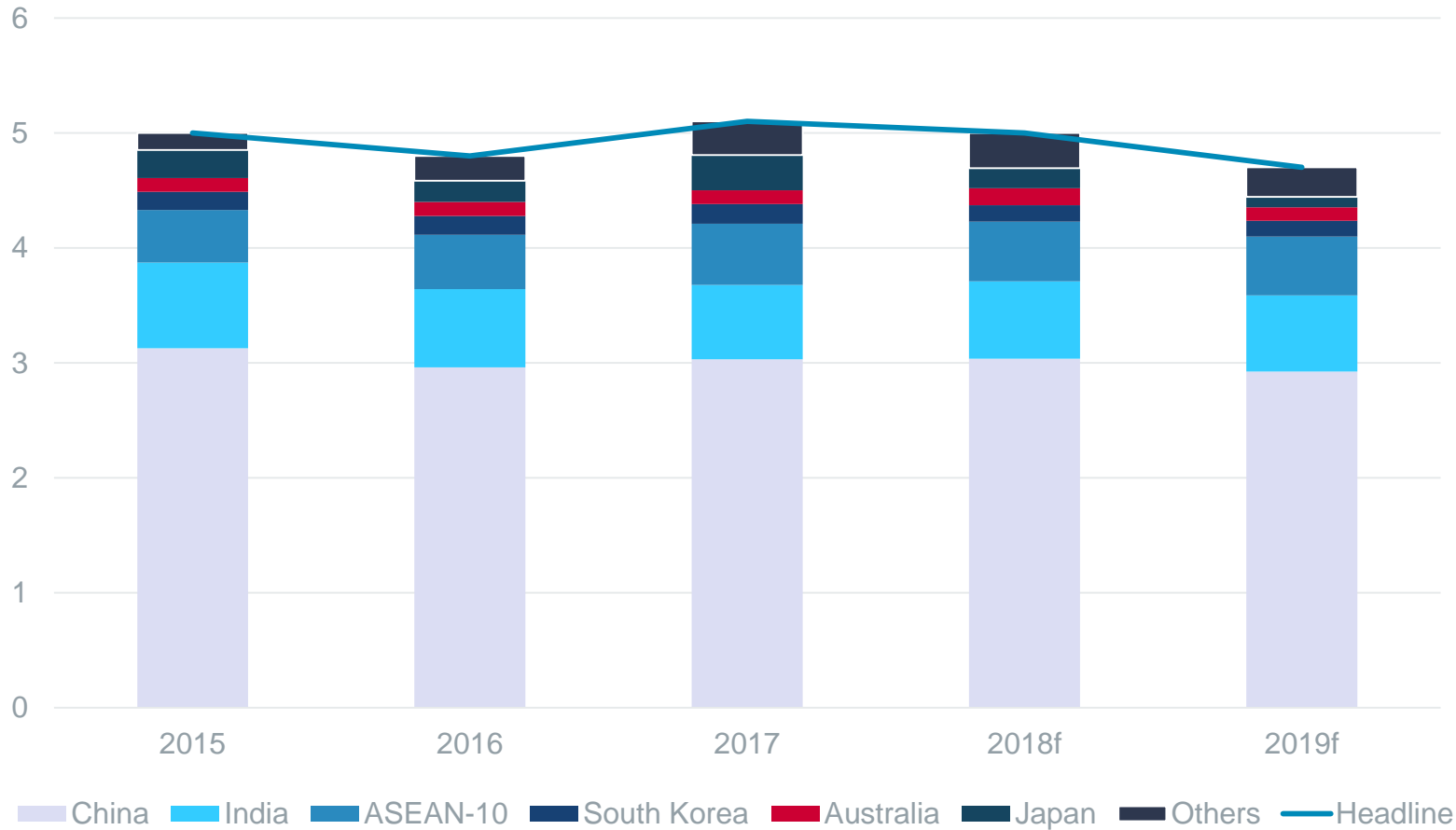


Source: Fitch Solutions

# 1. Slowdown Amid Trade Tensions, Vietnam May Benefit

## China At The Heart Of Asian-Wide Slowdown

Real GDP Growth, % & Percentage Point Contribution



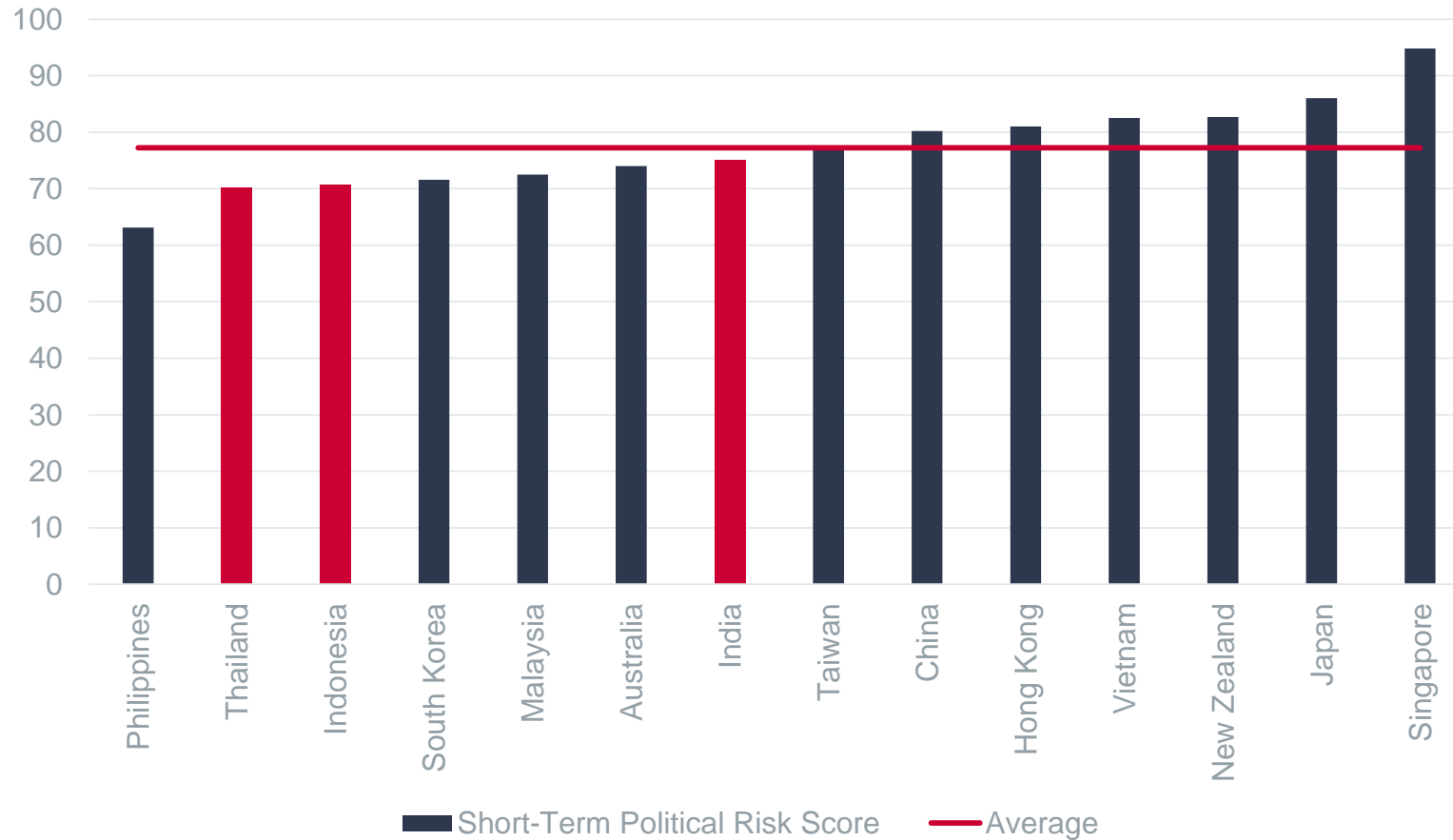
f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

- Asia Pacific's real GDP growth will likely slow once again to 4.7% in 2019, from 5.0% in 2018 and 5.1% in 2017.
- China will be at the forefront of the slowdown, given the strong likelihood of re-escalation in trade tensions between the US and China following the 90-day truce. Given the integrated supply chain in the region and reliance on China, growth will likely weaken across the board. Hong Kong, South Korea, Taiwan and Singapore are most at risk.
- That said, Vietnam is likely to benefit from the trade conflict as it will accelerate the process of companies relocating to the lower-cost country.

## 2. Continuity Following Indian, Indonesian, Thai Elections

### Below Average Scores For India, Indonesia, Thailand

Short-Term Political Risk Score (out of 100)



Source: Fitch Solutions

- 2019 will see high-profile elections in key emerging Asia economies, with general elections in India and Thailand, and the presidential elections in Indonesia.
- Incumbents are favoured in all three countries, but opposition will likely put up a fight. This will continue to result in a general populist shift in policy direction to shore up support among voters.
- Economic reforms is expected to stall in the near-term but we expect all three governments to remain broadly committed to improving the business environment over the medium term.

# 3. Continued Pockets Of Currency Vulnerability

## Twin Deficit Economies Remain At Risk In 2019

### Vulnerability Metrics

Countries	Current Account, % Of GDP	Fiscal Metric	Short-Term External Debt, % Of Reserves	Short-Term Political Risk Score (STPR)	Foreign Holdings Of General Government Debt Securities, % Of Total	Total
Australia	1	1	1	1	1	5
Indonesia	1	1	0	1	1	4
India	1	1	0	1	0	3
Philippines	1	1	0	1	0	3
Malaysia	0	1	0	1	1	3
New Zealand	1	0	1	0	1	3
China	1	1	0	0	0	2
Japan	0	1	1	0	0	2
Thailand	0	1	0	1	0	2
Taiwan	0	1	0	1	0	2
Vietnam	0	1	0	0	0	1
Hong Kong	0	0	1	0	0	1
South Korea	0	0	0	1	0	1
Singapore	0	1	0	0	0	1

Source: National sources, IMF, Fitch Solutions. Note: 5 illustrates the most vulnerable. Current Account: 1 is assigned for deficit economies, Fiscal: 1 is assigned for economies with a budget deficit or above-average government debt, Short-term external debt and foreign holdings of government debt: 1 is assigned for above-average economies, STPR: 1 is assigned for below average selected economies.

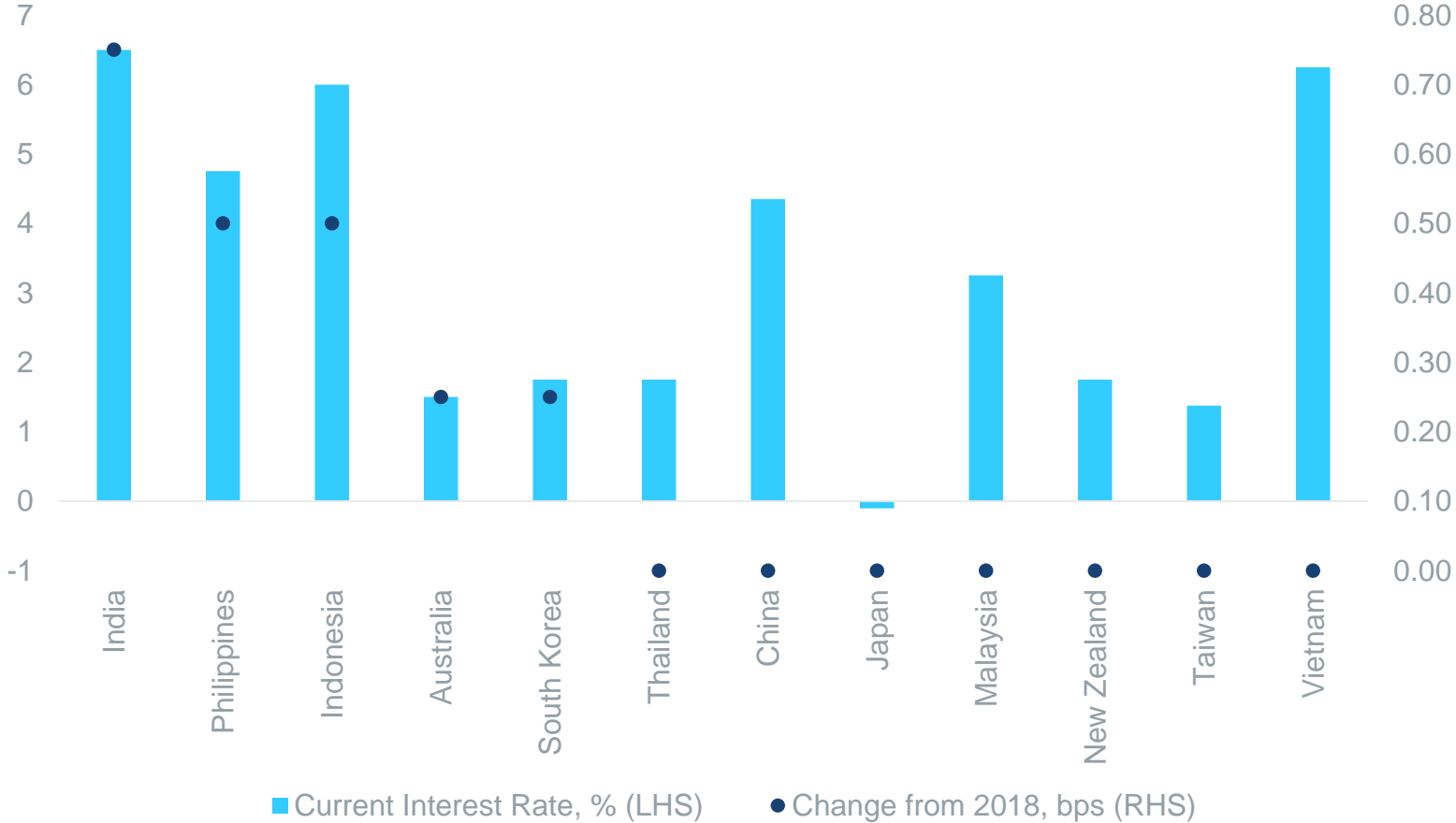
- We see pockets of currency vulnerability in a number of key major Asian economies in 2019 as monetary tightening led by the US Fed continues.
- Australia, Indonesia, India, the Philippines, Malaysia and New Zealand are the most vulnerable to currency sell-offs amid rising aversion to risk.
- Australia, Indonesia, India and the Philippines all run twin deficits, and have below average Short-Term Political Risk scores, which heighten the prospects of volatility extending from 2018 into 2019.



# 4. Obstacles To Hiking Path Amid Stability-Growth Trade-Off

## Growing Challenges For Asian Monetary Authorities

Selected Central Bank Policy Interest Rates, %



- Out of the 12 major Asian central banks that we closely monitor, we are forecasting five to raise interest rates and the rest to remain on hold in 2019 owing to factors such as rising inflation, vulnerability to hot money flows, and to ensure macroeconomic stability
- However, amid downside growth pressures from weaker external demand, policymakers are likely to face dilemma.
- Risks to our interest rate forecasts are therefore weighted to the downside. This could result in more downside volatility in the event risk sentiment deteriorates.

Source: Bloomberg, Fitch Solutions

# 5. China Expands Diplomatic Reach, But Faces Pushback

## China Will Likely Have To Manage Pushback Against BRI

Asian Countries Likely To Be Involved In BRI

Low Financial Risk	Vulnerable To Over-Indebtedness To China	More Vulnerable To Over-Indebtedness To China
Brunei	Cambodia	Pakistan
China	Afghanistan	The Maldives
Indonesia	Bhutan	Laos
Malaysia	Sri Lanka	Mongolia
Myanmar		Tajikistan
Philippines		Kyrgyzstan
Singapore		
South Korea		
Thailand		
Timor-Leste		
Vietnam		

- We believe that China will step up its diplomatic efforts in Asia as it continues to push its ambitious Belt and Road Initiative.
- That said, the negative coverage in the media alleging Chinese debt traps in poorer countries such as Sri Lanka will complicate Chinese diplomatic efforts.
- China’s growing economic and geopolitical importance globally, and especially within Asia, will make it difficult for Asian countries to distance themselves from China.

Source: Center For Global Development, Fitch Solutions

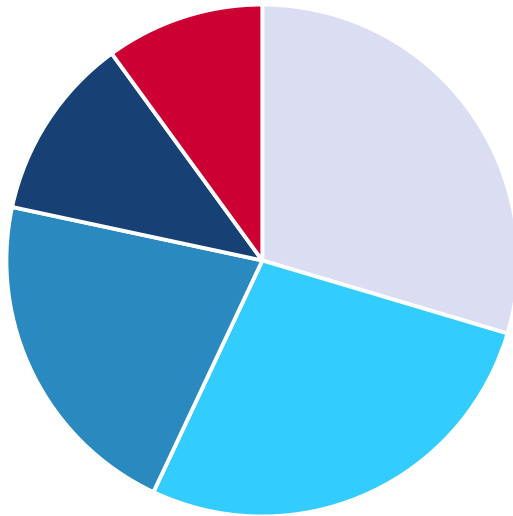


# Vietnam: Growth To Slow; Still Regional Outperformer

## Slowdown In Major Economies To Hurt Exports

Exports By Country, % Of Total

■ US ■ EU-28 ■ China ■ Japan ■ South Korea

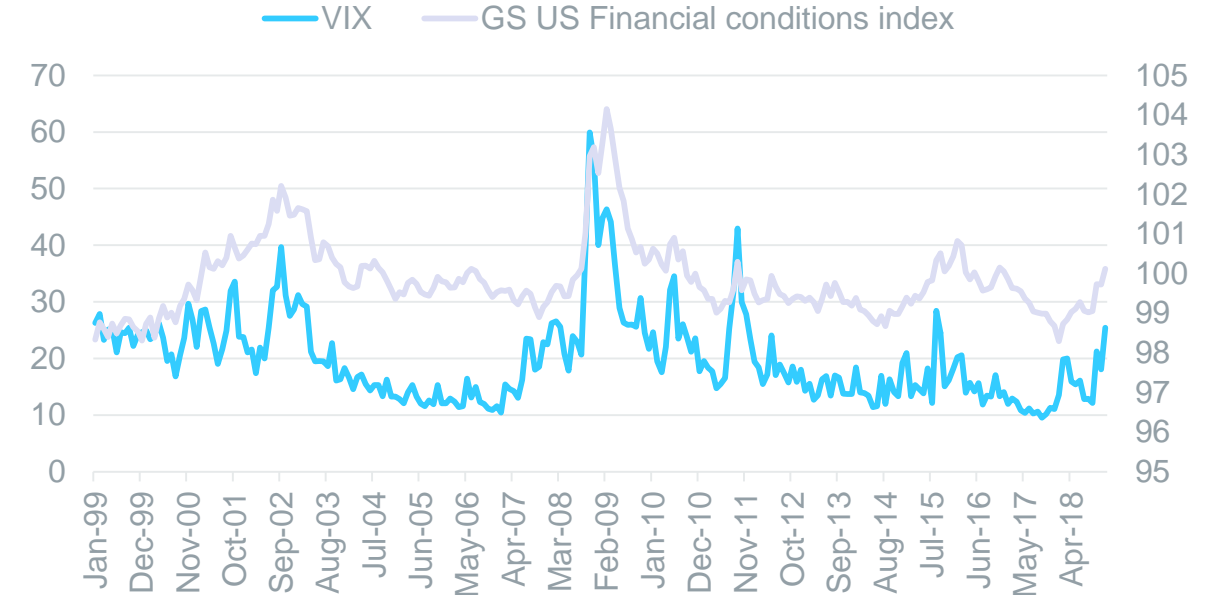


- We forecast real GDP growth to decline to 6.5% in 2019, in line with the wider trend of slowing global growth.
- Monetary policy tightening across the globe is likely to weigh on risk appetite and Vietnam's reliance on FDI suggest that growth momentum will wane.

Source: Directorate-General for Trade, Bloomberg, Fitch Solutions

## Tighter Financial Conditions Leading To More Volatility

Volatility Index (LHS) & GS Financial Conditions Index

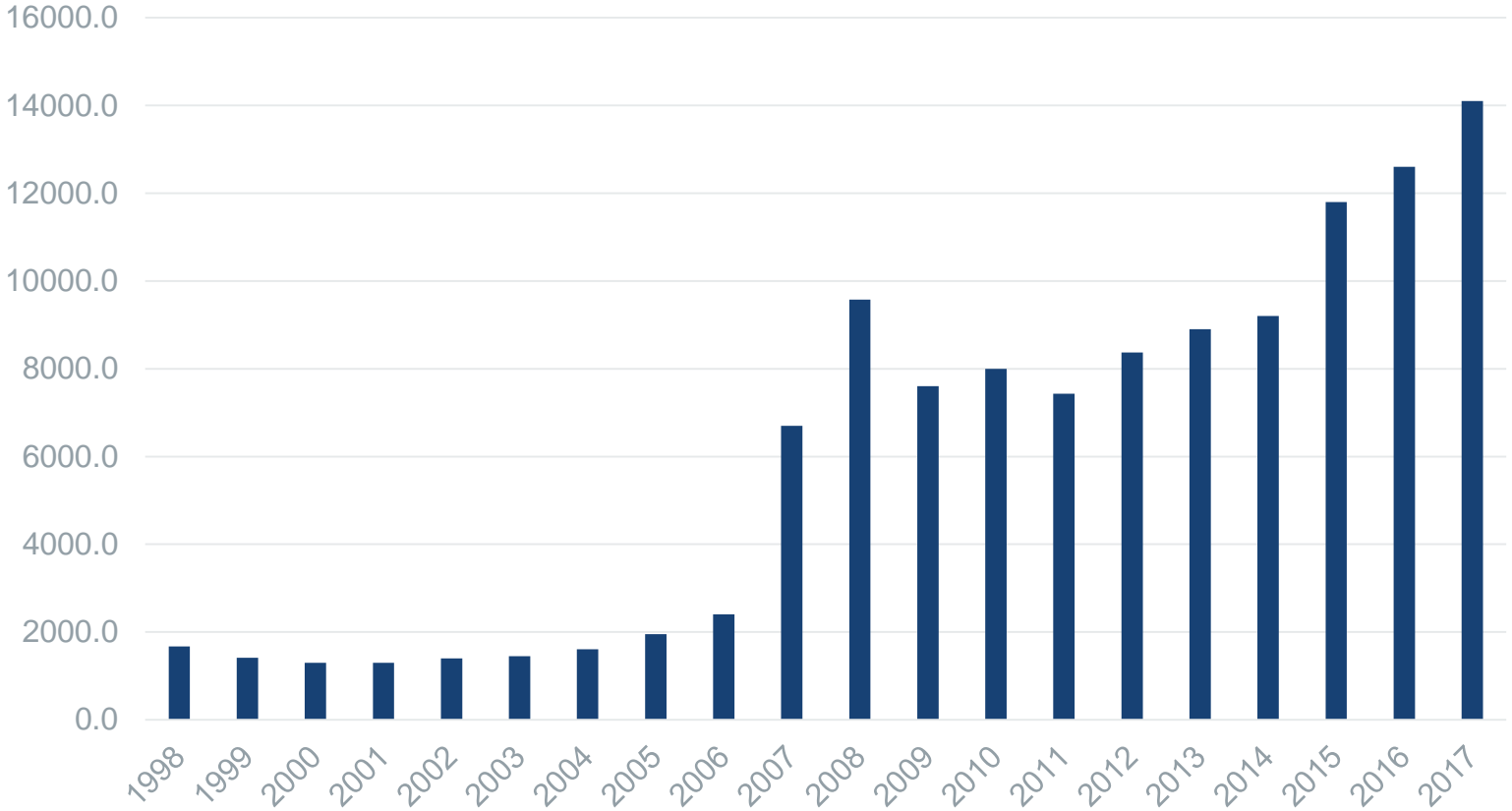


- The manufacturing sector will remain an outperformer, benefitting from growing degree of economic liberalisation and divestment from China.
- Key attractiveness include a cheap and large labour force, proximity to shipping routes and China, and political stability.

# Vietnam: Diplomatic Efforts At Full-Throttle

## FDI Uptrend To Be Supported By Open-Door Policy

Net Foreign Direct Investment Inflows, USDmn



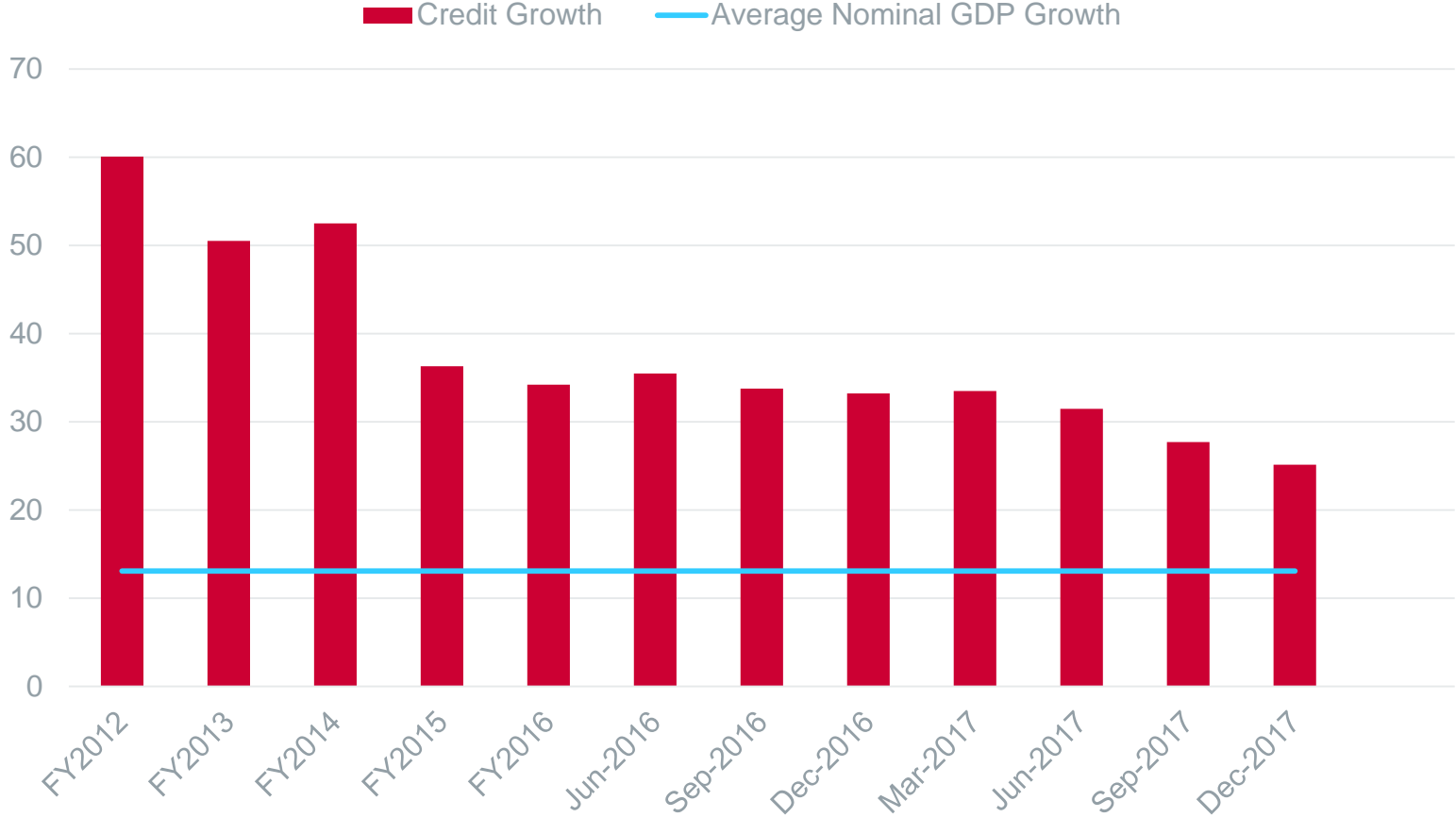
Source: Bloomberg, Fitch Solutions

- The government has been actively pursuing an open-door trade policy over the past decade, and in 2018, seems to stepping up diplomatic efforts both within the region and beyond.
- Vietnam is already signatory to 10 FTAs and there are six more in the pipeline.
- While such moves have partly been motivated by security concerns, it will also help its ambition to become a global manufacturing hub.
- The leadership hopes to reduce its economic reliance on China, and this is partly driven by rising anti-Chinese sentiment at home.

# Myanmar: Three Downside Risks To Positive Growth Outlook

## Credit Growth Slowing But Still Unsustainably High

Private Sector Credit & Nominal GDP Growth, %



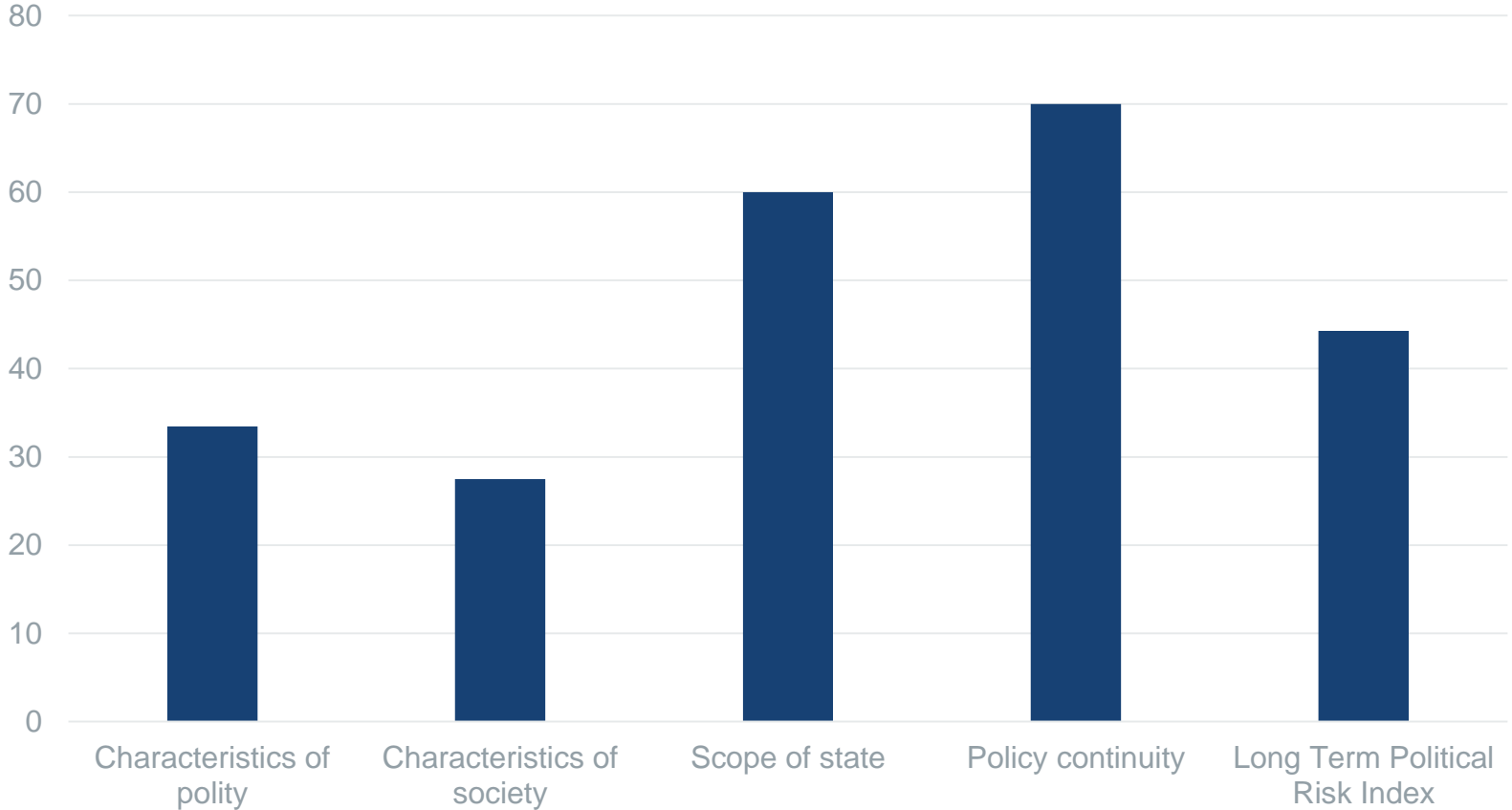
Source: CBM, Fitch Solutions

- Myanmar’s economic growth recovery is likely to continue over the coming quarters, with real GDP expanding by 6.3% in FY2018/19. This will be mainly driven by the construction and manufacturing sector.
- Preferential trade access to the EU is now in jeopardy after the UN released a 440-page report in September 2018 detailing human rights violations; Renewed fighting in Rakhine adds to concerns.
- Financial stability is at increasingly at risk as loan growth continues to outstrip nominal GDP growth by a large margin. Risks of monetary and fiscal slippage remains high.

# Myanmar: Ruling NLD Losing Political Momentum

## Characteristics Of Polity And Society Are Key Drags

Long-Term Political Risk Index Score, Out Of 100



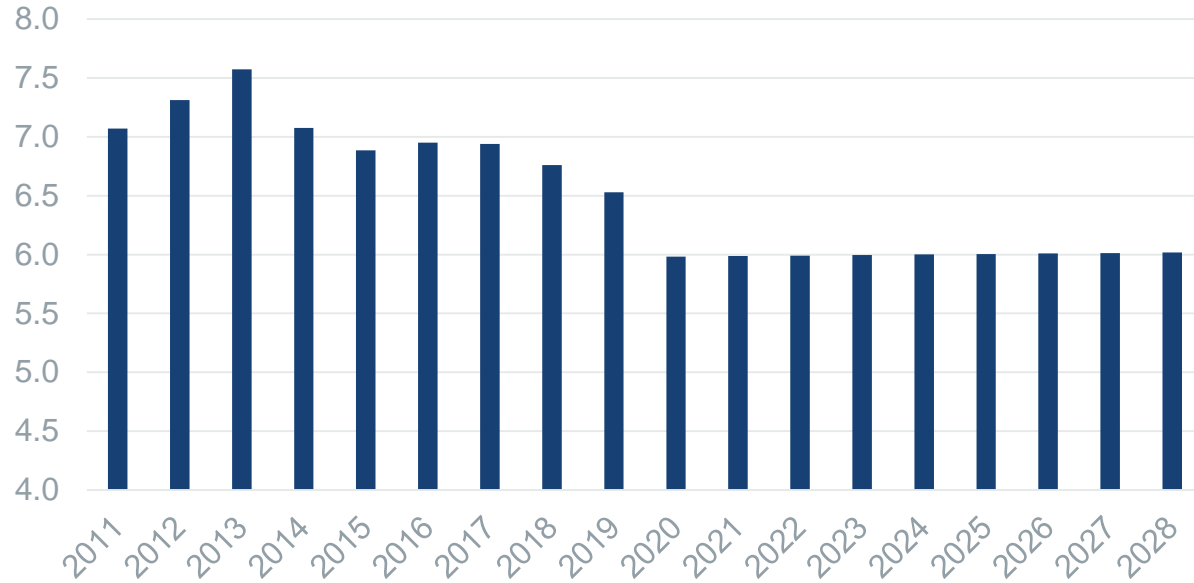
Source: Fitch Solutions

- Myanmar’s ruling party, the NLD, won only seven out of 13 seats that were up for contest in the November 3 2018 by-elections, and we see this as indicative of the party’s declining popularity.
- The party held a comfortable majority of 60% in the upper house and 58% in the lower house, but if this trend continues, it could lose its simple majority in parliament at the upcoming 2020 general elections.
- The ruling NLD will likely struggle to reverse its slumping political momentum given the complexity of the country’s ethnic conflicts and the dominance of the Tatmadaw.

# Cambodia: Economic Rebalancing Imminent

## Growth Momentum To Wane Without Diversification

Real GDP Growth, %

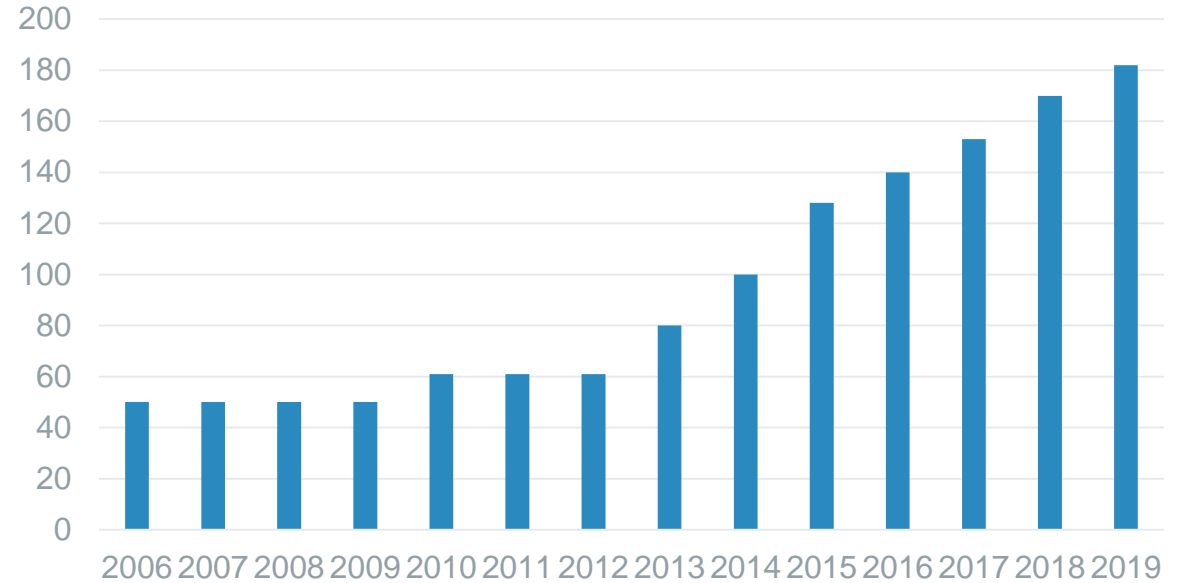


- Cambodia's real GDP growth will likely slow to 6.5% in 2019, from an estimated 6.8% in 2018, as the garment industry is likely to take a hit from rising wages and trade uncertainty.
- There is a rising risk that the EU would withdraw Cambodia's preferential trade access as Hun Sen remains defiant.

Source: Ministry of Labour, Fitch Solutions

## Pace Of Increase Has Accelerated Sharply Since 2014

Minimum Wages, USD

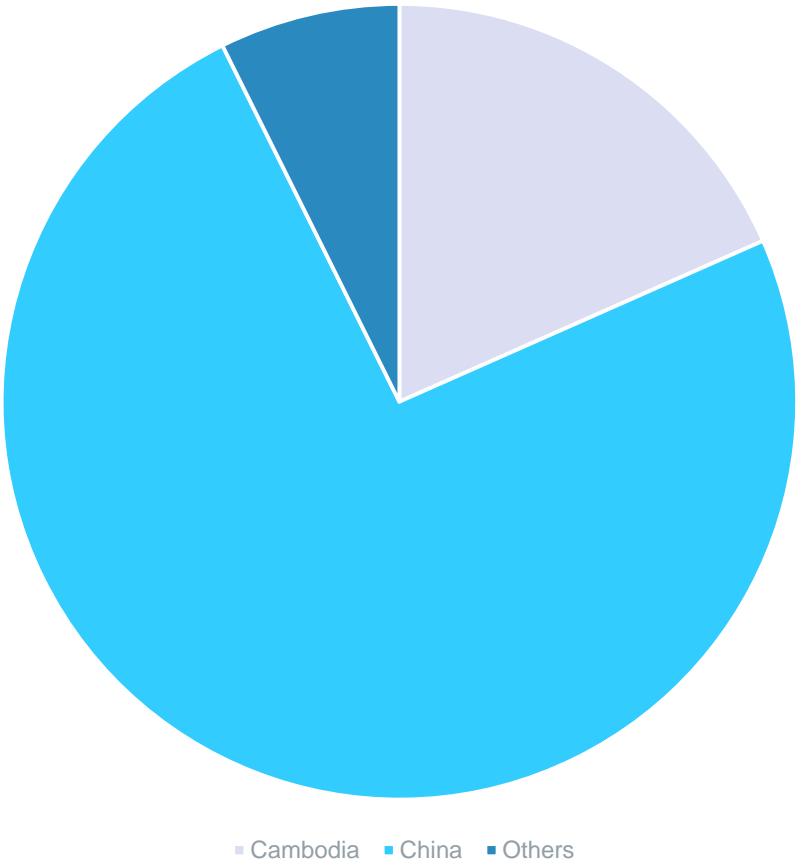


- A withdrawal would strongly impact the garment sector that is already facing growing competition and force the economy to accelerate the process of seeking new engines of growth
- Lack of economic diversification will continue to weigh on long-term growth potential.

# Cambodia: Political Concessions Likely To Fall Short

## China Accounts For The Lion's Share

Approved Investment By Countries In Q218, USDmn



Source: NBC, Fitch Solutions

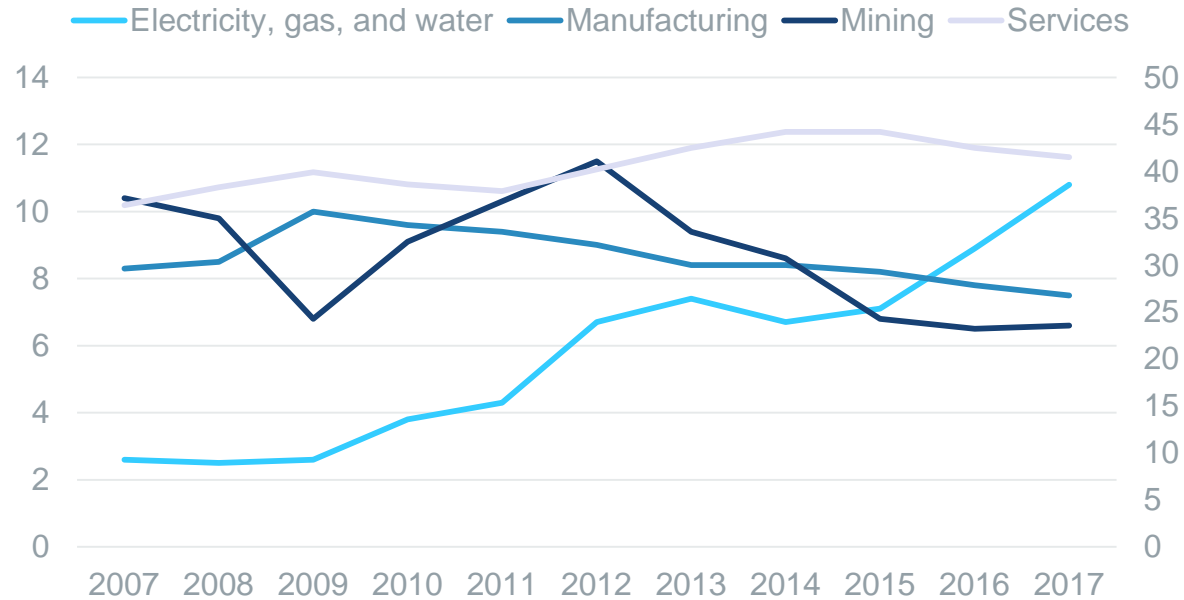
- Hun Sen's move to ease pressure on labor union leaders is part of his administration's effort to placate the EU, after the bloc proceeded with a six month review in October that could strip the country of its preferential trade access.
- However, we expect Cambodia's efforts to fall short of the EU's demands, as the strongman leader appears unlikely to reinstate the opposition CNRP or free their leaders.
- Hun Sen is by no means backed into a corner economically or politically as Cambodia continues to receive strong economic support from Japan and China.



# Laos: Growth Likely To Be Stuck In 6% Range

## Manufacturing And Services Sectors In Backseat

GDP By Sector Breakdown, Services (RHS), % Of Total

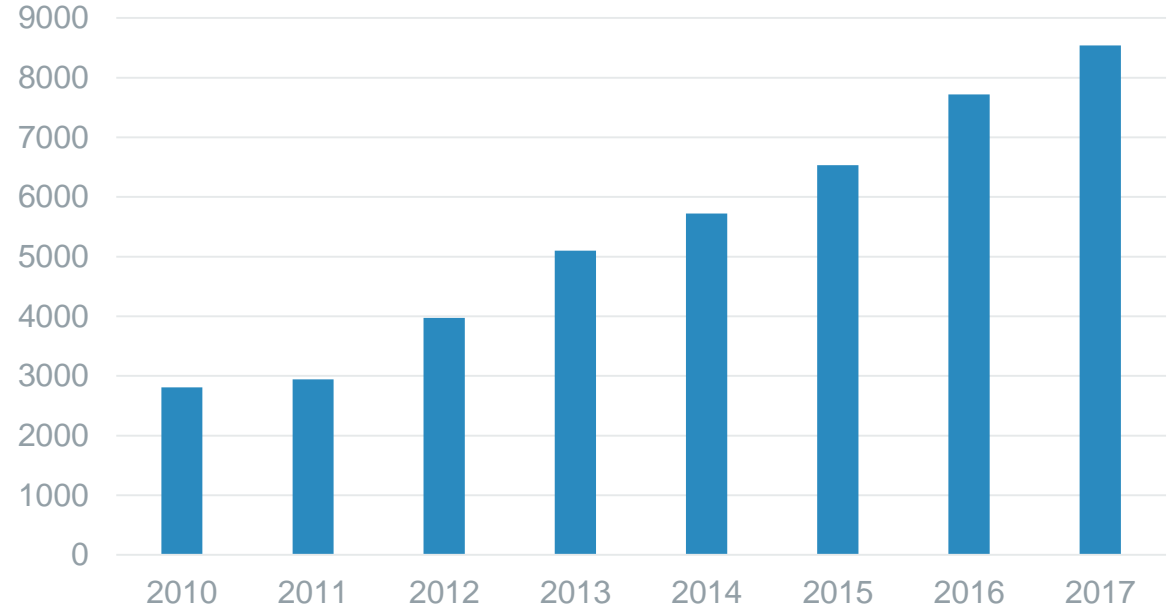


- Laos' real GDP growth is expected to slow to 6.6% per annum over the coming decade, versus an average of 7.6% in the last ten years.
- Progress on economic diversification has stalled, which is critical if the country wishes to sustain its rapid growth pace.

Source: Bank Of Lao, Fitch Solutions

## External Debt Has Risen More Than 3X Since 2010

Government External Debt, USDmn



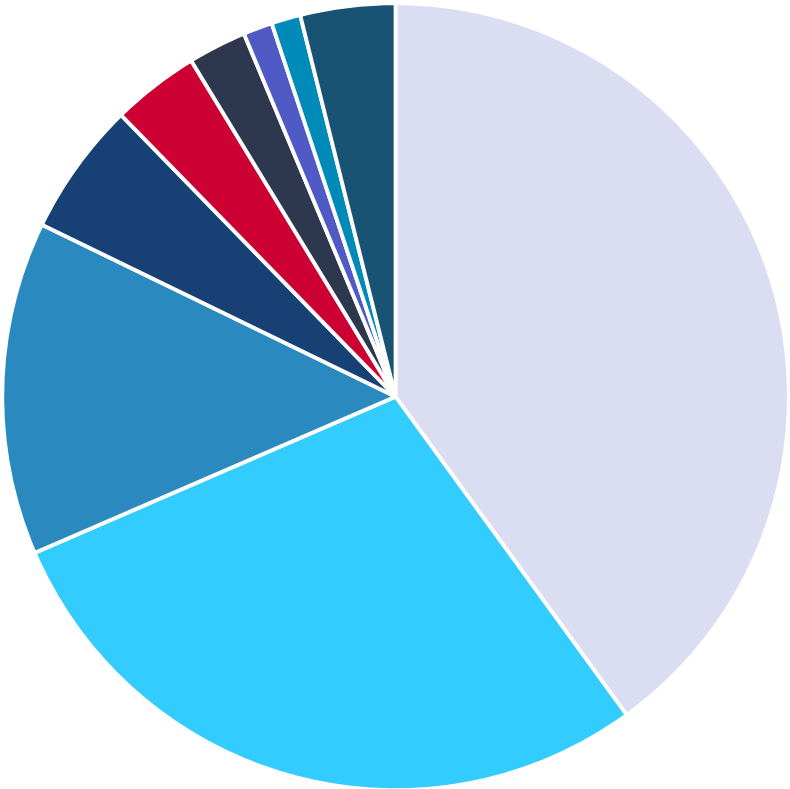
- The country's external debt load has been increasing rapidly; these funds are being used for sub-optimal investments, which would weigh on future growth potential.
- The deteriorating business environment and worsening corruption add to the country's growth challenge.

# Laos: Political Reforms To Remain Slow Despite Pressure

## US And EU Account For Less Than 10% Of Exports

Exports By Country Breakdown, % Of Total

■ Thailand ■ China ■ Vietnam ■ EU-28 ■ India ■ Japan ■ Switzerland ■ US ■ Others



Source: Directorate-General for Trade, Fitch Solutions

- Rising levels of corruption within the government, and widening income disparity will continue to put downside pressure on social stability, as well as challenge the party's legitimacy; this would prompt a tighter grip on power.
- Laos is set to face increased scrutiny over the coming quarters by the pro-democratic Western community after a review by the UNHRC highlighted the country's dismal human rights record.
- However, we believe that this will have limited impact on political liberalisation and legal reforms in the country given that Laos remain dependent on its immediate neighbours for economic and political support.