# Northern Trust

## Asia Economic Outlook

# A Shaky Recovery

JUNE 2023

***Editor's Note: Welcome to the premier issue of Northern Trust's quarterly Asia Economic Outlook. We hope these views will be helpful to clients interested in details on regional performance.***

2022 was a tough year for Asian economies, hit by soaring energy prices and the strong dollar. Higher energy prices pushed up inflation and added to the need for central bank tightening. Prospects for this year are not much improved, with varied economic performances expected across the continent.

Higher interest rates will keep domestic demand in check. Disinflation will continue, reflecting normalized supply chains and the impact of tighter monetary policy. Reduced interest rate differentials with the United States will help regional currencies hold their values a bit better.

China's reopening will generate some positive spillovers, but export growth will wane with western economies set to slow sharply. Growing fragmentation amid rising geopolitical tension will weigh on the performance of highly open Asian economies.

Encouragingly, lessons from the 1997 Asian and 2008 global financial crisis are helping insulate the region from the banking stress experienced in the United States.

Following are our views on how major Asian markets are poised to perform this year and next.

**Japan**

- Trends in Japan are following a similar path to those in the rest of the developed world, but on a more subtle scale: higher inflation, better wage gains for workers, and recovering growth. Pent-up demand and more reliable supply chains supported the economy at the start of the year. That said, growth momentum is set to weaken, led by a sluggish external backdrop and fading domestic demand.
- Inflation has been hovering well above 2% target since March 2022, fueling speculation that the Bank of Japan (BoJ) will be forced to reverse course under the new leadership. With inflation unlikely to sustain above 2% for reasons listed here, only modest policy changes are in the offing. The BoJ will likely tweak its yield curve control program by shortening its target maturity.

**China**

- The Chinese economy grew at a dismal rate of 3% year over year in 2022, below the global average for the first time in over four decades. With the economy no longer weighed down by COVID restrictions, the reopening has spurred a recovery in consumption. The property market is starting to stabilize. However, the optimism has tempered with the rebound falling short of broader expectations. A combination of weak employment, housing market uncertainty, weakened household balance sheets and softer export demand will hold the economy back. Our views on China are summarized here.
- A stalling post-pandemic recovery has forced the People's Bank of China (PBoC) to resume monetary policy easing. The PBoC cut the reserve requirement ratio for almost all banks by 25 basis points amid spikes in domestic borrowing costs in March, followed by a 10 basis points reduction in the short- and medium-term lending rates. The moves indicate the central bank's willingness to support recovery amid downside surprises to activity. Fiscal policy too will remain pro-growth with a focus on maintaining support for embattled developers and the property sector.

**Singapore**

- After recording a second year of economic recovery from COVID, the Singapore economy entered 2023 on weaker footing. Gross domestic product contracted in the first quarter. Singaporeans have been pulling back, reflected in a sharp contraction in retail sales at the start of the year. Industrial production fell for a seventh month in a row in April. China's reopening is expected to provide only a modest positive uplift to Singapore's goods and tourism sectors. Higher inflation in rents and other operating costs are undermining Singapore's attractiveness to foreign businesses. Trade data revealed another steep fall with more pain likely in store for the continent's most trade-dependent economy.
- Amid increased financial stability concerns, moderating inflation dynamics and a less supportive growth environment, the Monetary Authority of Singapore (MAS) paused its tightening cycle. Given the inflation and growth outlook, we don't expect any further tightening by the MAS.

**Hong Kong**

- After suffering a 3.5% contraction last year, Hong Kong's economy is showing signs of recovery. Removal of COVID-related restrictions has led to visible improvements in activity and cross-border travel this year. The retail sector will benefit from a raft of measures such as cash handouts to residents, lower taxes and energy subsidies, along with inbound tourism. However, like most of its regional peers, the global financial hub also faces strong headwinds from the slowdown in the major advanced economies and tighter financial conditions.

- The Hong Kong Monetary Authority (HKMA), which follows the U.S. Federal Reserve in raising rates, hiked the Base Rate by 25 basis points to 5.50% at the May meeting. With the rising odds of the Fed hiking in July, we expect the HKMA to stick to its pre-set formula, implying a peak Base Rate of 5.75%. Hong Kong dollar (HKD) peg has come under renewed pressure. But despite recent pressure, the HKD's peg to the U.S. dollar is here to stay, backed by strong foreign reserves.

**Australia**

- Growth in Australian economic activity slowed in the March quarter and is forecast to remain subdued through this year. Retail sales volumes during the first quarter of 2023 fell for a second straight quarter, a sign that rising interest rates and the high cost of living are working to curb consumer spending. Conditions in the housing market are starting to stabilize, but the past declines in household wealth will continue to weigh on growth. Labor markets remain tight, but the unemployment rate is expected to rise because of subdued economic growth.
- After an initial pause in April, the Reserve Bank of Australia returned to tightening with hikes in May and June. Although inflation has peaked, the RBA board is still uncomfortable with its brisk pace given recent trends in wages and house prices. As a result, we expect one more hike of 25 basis points at the next meeting to a terminal rate of 4.35%.

## Asia Economic Forecast – June 2023

| | 2021 | 2022 | 2023F | 2024F |
|---|---|---|---|---|
| **Japan** | | | | |
| Real GDP (Q4-Q4 % change) | 0.9 | 0.4 | 1.2 | 1.2 |
| Unemployment Rate EOP (%) | 2.7 | 2.5 | 2.5 | 2.4 |
| Inflation (CPI, Q4-Q4, %) | 0.5 | 3.8 | 1.8 | 1.4 |
| Policy Rate, EOP (%) | -0.10 | -0.10 | -0.10 | -0.10 |
| **China** | | | | |
| Real GDP (Q4-Q4 % change) | 4.2 | 2.9 | 5.3 | 4.3 |
| Unemployment Rate EOP (%)* | 5.1 | 5.5 | 5.3 | 5.1 |
| Inflation (CPI, Q4-Q4, %) | 1.8 | 1.8 | 2.2 | 2.1 |
| 1-Year MLF Rate**, EOP (%) | 2.95 | 2.75 | 2.65 | 2.65 |
| **Hong Kong** | | | | |
| Real GDP (Q4-Q4 % change) | 4.6 | -4.2 | 6.3 | 3.2 |
| Unemployment Rate EOP (%) | 4.0 | 3.5 | 3.5 | 3.6 |
| Inflation (CPI, Q4-Q4, %) | 2.0 | 1.8 | 2.5 | 2.4 |
| Policy Rate, EOP (%) | 0.50 | 4.10 | 5.75 | 3.75 |
| **Singapore** | | | | |
| Real GDP (Q4-Q4 % change) | 6.7 | 2.1 | 2.0 | 2.2 |
| Inflation (CPI, Q4-Q4, %) | 3.7 | 6.6 | 2.8 | 2.2 |
| **Australia** | | | | |
| Real GDP (Q4-Q4 % change) | 4.6 | 2.7 | 1.5 | 2.0 |
| Unemployment Rate EOP (%) | 4.7 | 3.5 | 3.9 | 4.0 |
| Inflation (CPI, Q4-Q4, %) | 3.5 | 7.8 | 4.0 | 2.5 |
| Policy Rate, EOP (%) | 0.10 | 3.10 | 4.35 | 3.35 |
| **Exchange rates (EOP)** | **Jun-2023F** | **Sep-2023F** | **Dec-2023F** | **Mar-2024F** |
| USD/JPY | 131.0 | 130.0 | 129.0 | 129.0 |
| USD/CNY | 6.85 | 6.80 | 6.75 | 6.75 |
| USD/HKD | 7.85 | 7.83 | 7.82 | 7.81 |
| USD/SGD | 1.33 | 1.32 | 1.31 | 1.30 |
| AUD/USD | 0.68 | 0.69 | 0.71 | 0.72 |

**Surveyed*

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