Asia Views: 2019 Outlook—Everything in moderation

GS MACRO OUTLOOK 2019

Andrew Tilton
+852-2978-1802 | andrew.tilton@gs.com
Goldman Sachs (Asia) L.L.C.

Naohiko Baba
+81(3)6437-9960 |
naohiko.baba@gs.com
Goldman Sachs Japan Co., Ltd.

Prachi Mishra
+91(22)6616-9052 |
prachi.mishra@gs.com
Goldman Sachs India SPL

Goohoon Kwon, CFA
+852-2978-0048 |
goohoon.kwon@gs.com
Goldman Sachs (Asia) L.L.C.

MK Tang
+852-2978-6634 | mk.tang@gs.com
Goldman Sachs (Asia) L.L.C.

Andrew Boak, CFA
+61(2)9321-8576 |
andrew.boak@gs.com
Goldman Sachs Australia Pty Ltd

Nupur Gupta
+65-6654-5538 | nupur.x.gupta@gs.com
Goldman Sachs (Singapore) Pte

Tomohiro Ota
+81(3)6437-9984 |
tomohiro.ota@gs.com
Goldman Sachs Japan Co., Ltd.

Jonathan Sequeira
+852-2978-0698 |
jonathan.sequeira@gs.com
Goldman Sachs (Asia) L.L.C.

Yu Song
+86(10)6627-3111 | yu.song@ghsl.cn
Beijing Gao Hua Securities Company Limited

Danny Suwanapruti
+65-6889-1987 |
danny.suwanapruti@gs.com
Goldman Sachs (Singapore) Pte

Yuriko Tanaka
+81(3)6437-9964 |
yuriko.tanaka@gs.com
Goldman Sachs Japan Co., Ltd.

In conjunction with our global economics colleagues around the world we have just updated our 2019 forecasts. In this note we discuss the main themes of our 2019 outlook for the Asia-Pacific region. We will publish more detail on individual countries over the rest of November.

1. Growth is set to slow in the Asia-Pacific region in 2019. Over the past year, most Asian economies grew at or above the "trend" pace that we view to be sustainable in the longer term. Tighter financial conditions in recent months are likely to be a catalyst for moderately slower growth in 2019. In China, credit growth slowed due to past regulatory tightening, and fears of an escalating trade conflict with the United States also weighed on sentiment and asset markets. Our China Current Activity Indicator averaged 7.5% growth in the first half of the year, but has slowed to 5.9% based on the available October data and is likely to slide further in coming months on decelerating trade (currently, the three strongest components in our China CAI are trade-related). In countries running current account deficits—India, Indonesia, and the Philippines—monetary policy has tightened materially in 2018 on a mix of inflation dynamics and external pressures. More broadly, the impetus to regional export growth is also waning, with US and global growth now likely past its peak and trade tensions posing an additional downside risk. Our 2019 growth forecasts, shown in Exhibit 1, now imply trend or slightly below-trend growth in most economies.

Exhibit 1: Slower but still-solid Asia-Pacific growth in 2019

Real GDP Growth (year-over-year)

	2017	2018			2019		
		GS (prev)	GS (new)	*Consensus*	GS (prev)	GS (new)	*Consensus*
Asia ex-Japan	6.1	6.3	6.2	6.2	6.0	6.0	*6.0*
China	6.9	6.6	6.6	*6.6*	6.1	6.2	*6.2*
India	6.7	7.7*	7.3*	*7.4**	7.9*	7.6*	*7.5**
South Korea	3.1	2.7	2.7	*2.7*	2.7	2.5	*2.6*
Hong Kong	3.8	3.6	3.6	*3.6*	2.4	2.6	*2.7*
Taiwan	2.9	2.7	2.7	*2.7*	2.5	2.3	*2.3*
ASEAN	5.1	5.0	5.0	5.0	5.0	4.7	*4.9*
Singapore	3.6	3.4	3.5	*3.3*	2.9	2.9	*2.7*
Malaysia	5.9	4.6	4.8	*5.0*	5.2	4.6	*4.9*
Thailand	3.9	4.6	4.6	*4.4*	3.4	4.0	*3.9*
Indonesia	5.1	5.2	5.2	*5.2*	5.5	5.0	*5.1*
Philippines	6.7	6.3	6.3	*6.4*	6.5	6.0	*6.5*
Japan	1.7	0.9	0.9	*1.1*	1.0	1.0	*1.1*
Australia	2.2	3.3	3.4	*3.2*	2.8	3.1	*2.8*
New Zealand	2.8	2.8	2.8	*2.8*	3.1	3.1	*2.8*
USA	2.2	2.9	2.9	*2.9*	2.6	2.5	*2.6*
Euro area	2.5	2.1	1.9	*2.0*	1.8	1.6	*1.7*

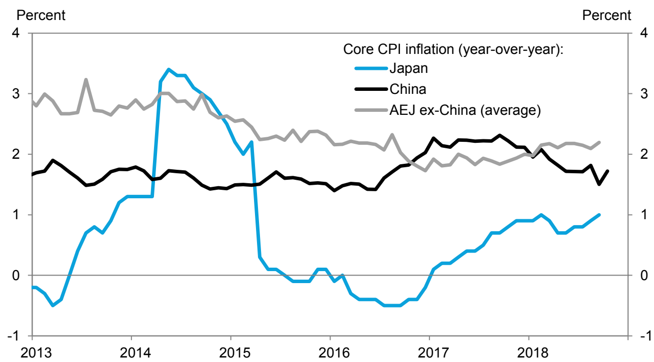
*Fiscal year basis, 2018 is India FY19 (April 2018-Mar 2019).

Source: Goldman Sachs Global Investment Research, Bloomberg

2. Inflation is likely to remain muted in most of the region (Exhibit 2). Oil prices have come off recently, and though some of the relief may be temporary, we expect additional shale oil supply to wash into global markets next year as key US pipelines are completed. (One place where fuel prices are likely to rise in 2019 is Indonesia, as subsidy cuts appear likely to be on the agenda.) Food inflation is often a source of volatility, particularly in India where it makes up nearly half of the CPI basket, but recent figures have surprised to the downside there (with past reforms to food distribution likely playing a role). As for core price pressures, in most of the region capacity constraints do not look especially tight, with the exceptions of Japan (where inflation is still well below target) and the Philippines (where the central bank has tightened significantly and policymakers are likely to liberalize rice imports soon to alleviate inflation pressures). The Philippines has been the clear standout in terms of overheating pressures this year, as we foreshadowed in our 2018 outlook, but in the year ahead we see more upside risk in India and Indonesia relative to current inflation levels.

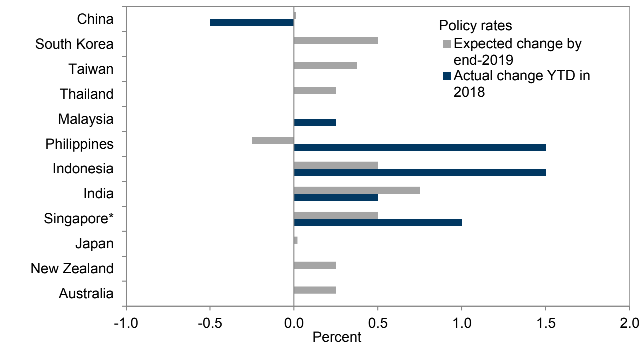
3. We expect monetary policy tightening to be shallower, but broader, in 2019. "Shallower", because most central banks won't face domestic growth or inflation pressure to hike sharply. Also, with the Fed hiking cycle closer to an end, we believe the USD is near its peak and EM Asia currency depreciation pressures should be milder and concentrated in early 2019. We therefore do not expect a repeat of the 150bp tightenings by Bank Indonesia and BSP this year, though we think India can move a bit faster (+75bp, the most of any central bank in the region, vs +50bp in 2018). "Broader", because rising US rate differentials with the region's small open economies and concerns over household leverage (in Korea and Thailand) will likely encourage policymakers to lean in the direction of slightly tighter policy. We expect Korea, Taiwan, Thailand, Australia, and New Zealand to implement their first rate hikes in years—but only gingerly. After an eventful 2018 punctuated by questions about a possible change in central bank leadership, frequent speculation about an "exit", and a move to forward guidance, the Bank of Japan is likely to stick to a highly accommodative stance in 2019. China eased early in the year; we see the possibility for a bit more dovishness in early 2019 but expect broadly stable policy rates alongside a structural decline in the reserve requirement ratio.

Exhibit 2: Inflation has been benign in most regional economies



Source: Goldman Sachs Global Investment Research

Exhibit 3: Broader but shallower rate hikes across Asia-Pacific in 2019



* Estimated change in slope of annual SGD NEER appreciation

Source: Goldman Sachs Global Investment Research

4. Fiscal policies will diverge. We forecast that Japan will tighten meaningfully, China and South Korea will ease, and India is somewhere in between. Japan's 2% consumption tax hike slated for October 2019 will drive its intra-year pattern of growth, with front-loaded demand reaching a peak in calendar Q3 followed by a falloff in Q4. China is apt to ease fiscal policy further. Although the formal on-budget deficit target will not move much—perhaps up to 3% from this year's 2.6%—we expect to see the government mobilize idle savings ("fiscal deposits") and further increase quotas for off-budget "special local government bonds" to drive infrastructure spending in 2019. In Korea, higher social spending should help drive a modest positive fiscal impulse. Though there is a possibility of a slight fiscal boost ahead of the election, India's large general government deficit—growing state deficits are offsetting improvement at the center—is likely to preclude a material fiscal impulse in 2019.

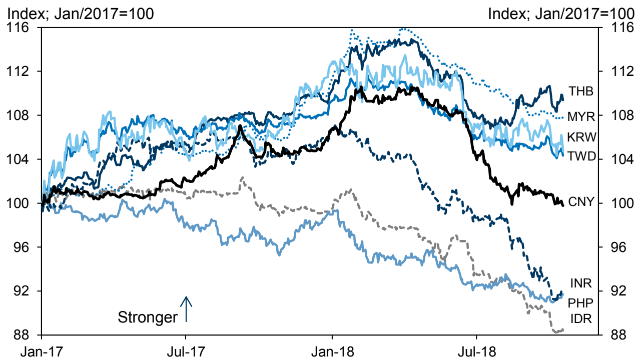
5. Trade policy remains a key source of uncertainty, especially for China. Ironically, US tariff policy seems to have boosted Chinese exports to date (as firms try to build US inventory ahead of the planned escalation of tariff rates in January), but this will clearly fade by December or January. Our analysis on the early impact of US tariffs, including surveys of our equity analysts and companies operating in China suggests that trade uncertainties have already begun to weigh on investment in China. Though our base case scenario remains further escalation in Q1, more positive comments from President Trump and increased contact between US and Chinese officials have raised hopes for the Xi-Trump meeting at the G20 in two weeks' time. We think the probability of a comprehensive "deal" and rollback of tariffs is still low (10%) in the next few months, but a more plausible positive scenario is a "pause" to allow more time for discussions (40% chance), which we think would still be an upside surprise relative to current market expectations.

6. National elections will take place in India, Indonesia, Thailand, and Australia in Q2, creating both potential policy shifts and market opportunities. In India and Indonesia, the elections mark a potential checkpoint for the reform agendas pursued by Prime Minister Narendra Modi and President Joko Widodo respectively. Both incumbents are expected to hold on to their seats but polls suggest the races could be close; state elections in India over the next few weeks will be an important barometer of sentiment. In Thailand, the military government that took power in a 2014 coup has publicly discussed and then postponed an election date several times, but now that a new constitution is in place a national poll in early 2019 looks fairly likely. A key uncertainty is whether the election result will be contested or respected by all parties. Australia appears on course for a change in government at the next federal election (likely May 2019), and new policies to boost public spending and strengthen employee bargaining power could amplify further the upswing in the macro cycle. Other notable upcoming votes in the region include next week's Taipei mayoral election, which could influence the tone of cross-Taiwan Strait relations, and the Philippines midterm election in May.

7. Regional currencies could face more near-term pressure as markets price in additional Fed hikes, but a year from now the majority should be stronger versus the USD. The US dollar was stronger than we expected in 2018, reflecting a combination of a larger fiscal boost, tougher trade policy, and more Fed hikes than markets anticipated (although the latter outcome was in line with our US team's forecast). With further US fiscal easing unlikely given divided government, investors now seemingly more pessimistic about US-China trade relations, and rates markets coming ever closer to pricing in the Fed tightening cycle we expect, our FX strategy team thinks the USD is approaching a peak. This should relieve some of the pressure that the Chinese renminbi and especially the current account deficit currencies (INR, IDR, PHP) have been under since the Fed embarked on quarterly tightening (Exhibit 4).

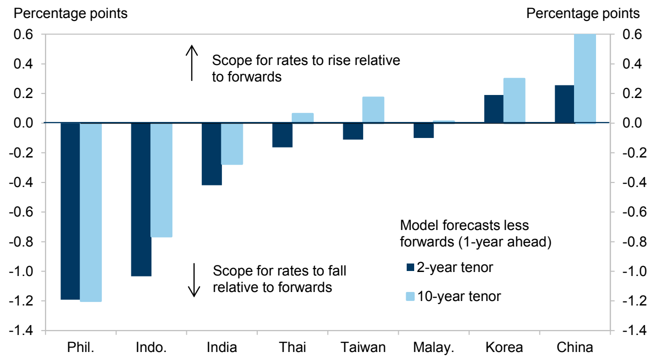
8. EM Asia high-yielders to outperform low-yielders against backdrop of slowing growth and more stable US yields. With global growth decelerating and US yields facing a smaller upward adjustment in 2019 (at least in our view), relatively high yields in the current account deficit economies of India, Indonesia, and Philippines should attract inflows, allowing rates to come down (Exhibit 5 shows results of our regional rates model) and their currencies to perform relatively better.

Exhibit 4: Current account deficit currencies have underperformed the region



Source: Goldman Sachs Global Investment Research

Exhibit 5: Interest rates in current account deficit countries have the most scope to decline



Source: Goldman Sachs Global Investment Research

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We, Andrew Tilton, Naohiko Baba, Prachi Mishra, Goohoon Kwon, CFA, MK Tang, Andrew Boak, CFA, Nupur Gupta, Tomohiro Ota, Jonathan Sequeira, Yu Song, Danny Suwanapruti and Yuriko Tanaka, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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