Global Outlook

The current global upturn is less strong than prior recoveries, and differs with them in several important ways

The Global and Regional Outlook is extracted from the Asia Pacific Executive Brief, a service of IMA ASIA.

2018 is set to be a second straight year of better global growth after the five years to 2016 delivered 3.4 per cent pa growth, lower than the two-decade average to 2011 of 3.7 per cent pa. The IMF's latest forecast puts 2017 growth at 3.6 per cent rising to 3.7 per cent in 2018. While the upturn isn't as strong as prior recoveries, when growth would hit 4.5 per cent+ for a year or two, a better balance between supply and demand has emerged, as capacity has been cut (even in China), and prices and profits have improved. The quality of the recovery has felt good for most companies, and stock markets have done very well, with the DJ Global index up 21 per centytd. In a few sectors, such as chemicals and IT components, shortages have even emerged.

> There is a big step-down in advanced-market growth, while EMs are also forecast to slow, but not by as much

This upturn also differs from prior ones in several other respects. First, there's a big step down in growth for advanced markets, with 1.8 per cent pa forecast for 2017-22 from a two-decade average to 2011 of 2.3 per cent pa. That reflects older populations and lower productivity growth. Trend growth in emerging markets (EM) also slows, but not by as much, easing to 4.9 per cent pa in 2017-22 from 5.2 per cent pa in 1992-2011. The more notable development in EM as 2017 finishes is a lift in risk, with the average EM sovereign credit rating sliding to its lowest level since early 2010. Asia's EM, however, have seen their credit ratings improve. That's important, as it points to where capital will flow in the next few years. Finally, global inflation remains muted, lowering pressure on central banks to hike interest rates.

A central question in the US outlook is the impact of a big tax cut on GDP growth that has averaged 2.1 per cent pa in the current 2010-17 expansion. If it is implemented from 2018, we think it would add about a quarter of a percentage point to our current growth forecasts of 2.3 per cent in 2018 and 2.2 per cent in 2019 due to three developments. First, the tax reform will put pressure on US firms to book more of their global profits in the US, which lifts the GDP number although there's no increase in US activity. Second, low and middle-income households will spend most of their temporary tax cut; higher income households will also spend more thanks to both a tax cut and a lift in wealth, as the 2017 stock market rally is extended by a big cut in the corporate tax rate. Finally, some manufacturers will see a tax advantage in putting production for US consumers in the

IMA Asia's forecasts (guided by IMF)

Real GDP Growth, %	2014	2015	2016	2017	2018
World – Real GDP growth, %	3.6	3.4	3.2	3.6	3.7
- US	2.6	2.9	1.5	1.9	2.3
- Euro area	1.3	2.4	1.8	2.2	1.9
- Asia/Pacific (14)	4.4	4.4	4.7	4.9	4.8
- NICs (4)	3.5	2.2	2.4	3.1	2.8
- Developing Asia (7)	6.8	6.7	6.6	6.5	6.3
- ASEAN (5)	4.4	4.5	4.6	5.3	5.2
World goods & services trade volume, % growth	3.5	2.8	2.4	4.2	4.0
Interest rates, US Fed target rate, year end, %	0.25	0.50	0.75	1.50	2.00
Inflation, CPI, US, year avg., %	1.6	0.1	1.3	2.1	2.1
Inflation, CPI, Euro area, %	0.4	0.0	0.3	1.1	1.3
Crude oil, avg of 3 spot crudes, USD	96	51	43	52	50
USD / Euro 1, year average rate	1.33	1.11	1.11	1.12	1.09
Yen / USD1, year average rate	106	121	109	112	115

The Asia/Pacific 14 = the countries on the forecast summary page. NICs are the newly industrialised countries = Korea, Taiwan, HK, Singapore. The ASEAN 6 = Indonesia, Thailand, Malaysia, Philippines, Vietnam, + Singapore. Dev Asia = ASEAN 5 + China and India. IMA Asia forecasts.

US. Our average forecast of 2 per cent pa for 2018-2022 is well below the US Treasury forecast of a lift to 3 per cent pa for the next decade.

Euro area GDP growth accelerated to 2.6 per centyoy in Q3'17, with consumer growth steady at 1.9 per centyoy and that of fixed investment lifting to 4.2 per centyoy. On the production side of GDP, growth is strongest in industry (up 3.6 per centyoy) and construction (up 3.1 per centyoy). This is a much younger recovery than that of the US, and we expect it to run through 2018 due to better domestic demand and stronger exports. Trade data captures the lift, with imports up 13.8 per centyoy in October, while exports grew 12.5 per centyoy (US$ basis). Our current GDP growth forecast of 1.9 per cent for 2018 may be upgraded in coming months.

As noted above, low inflation is one of the surprising facets of the current global recovery. But, as clients noted in our Q4 forecast debates, a lift in inflation due to product shortages or slightly stronger wage growth could be the surprise of 2018. We'll watch for this.

Apart from watching long-run inflation differentials, we also read dozens of currency reports, and we've rarely seen such a wide range in forecasts. Our short-term view is that 2-3 hikes in the US Fed cash rate in 2018 (each 25bp) should lift the US$ on its trade weighted index and on the Euro and Yen, as the ECB and BOJ continue with zero or lower rates. ■

Regional Outlook

For Asia, the year-just-gone was largely about political stability and recovering growth, though geopolitical risks remain

Asia closes 2017 with a mostly stable political risk outlook, and mostly stable sovereign risk ratings. In our accompanying Excel workbook, we track S&P's sovereign ratings at the end of every month, and 2017 saw a one notch downgrade for China in September (to a still favourable A+), with HK following in lockstep (also down one notch to AA+), while Indonesia won its long-awaited return to investment grade (BBB-) in May. With Indonesia's upgrade, 13 of the 14 countries we cover are investment grade (Vietnam is the exception), and two are AAA. Given Asia's consistent outperformance on growth, that's a simple equation for plenty of cheap money for the next few years in a world desperate for yield.

Geopolitical risk is, however, a concern, given an unpredictable North Korean regime, China's push to realign its neighbours (including niggling military action in the China Seas, cuts to tourist flows, and informal embargos on selected foreign firms in China), and a populist US president who has undermined America's traditional role in ensuring peace in Asia. Companies from Japan, South Korea, Taiwan and the US are equally exposed in this regard, and may need to prepare mitigation options for 2018.

An equally important challenge is reviving or sustaining productivity growth in Asia. China is tackling that via major reforms to its industrial and financial sectors. In 2017, that was driven by tighter regulation. While that will continue in 2018, a more interesting development will be the likely spread of digital disruption to China's many B2B markets. That could underpin a wave of productivity growth. Governments in Japan and Korea aim to lift productivity by forcing up wages, although its less clear if that will work. Singapore is tackling it by snatching up as many smart people as it can. The 7.7 per cent annual growth in its resident population holding university degrees from 2000 to 2016 is astounding. Thailand's military government also has a major industrial revitalisation plan that is promising.

Asia has been a major beneficiary of the 2017 recovery in global demand. Our forecast for 2017 GDP growth for the 14 countries covered by the Asia Brief has lifted from 4.3 per cent in January to 4.8 per cent this month. Our latest calculation for export growth for the region in 2017 is 9.7 per cent (US$ basis) with 5.7 per cent expected in 2018 after an average annual fall of 0.7 per cent for the five years to 2016. As the milder 2018 export growth forecast indicates, this isn't a repeat of the typical multi-year export rebounds of prior decades. Our export growth forecast for 2019 drops to 4.7 per cent, which is less than half the average annual 10.4 per cent rate for the two decades to 2011. Except for Vietnam, where 13

> China is pursuing major reforms, while Japan, Korea and Singapore are all looking to boost productivity

GDP (Expenditure)

Real growth, %	2014	2015	2016	2017	2018
Japan	0.3	1.1	1.0	1.7	1.6
China	7.3	6.9	6.7	6.8	6.4
Hong Kong	2.8	2.4	2.0	3.9	3.4
Taiwan	4.0	0.7	1.5	2.4	2.2
South Korea	3.3	2.8	2.8	3.0	2.8
Indonesia	5.0	4.9	5.0	5.5	5.9
Malaysia	6.0	5.0	4.2	5.9	5.0
Philippines	6.1	6.1	6.9	6.6	6.3
Singapore	3.6	1.9	2.0	3.3	2.9
Thailand	0.9	2.9	3.2	3.8	3.8
Vietnam	6.0	6.7	6.2	6.5	6.3
India (CY)	7.0	7.5	7.9	6.3	6.7
Australia	2.6	2.5	2.6	2.3	2.6
New Zealand	2.8	3.2	3.5	2.8	2.6

Inflation

CPI year average, %	2014	2015	2016	2017	2018
Japan	2.8	0.8	-0.2	0.4	0.5
China	2.0	1.4	2.0	1.6	2.5
Hong Kong (composite CPI)	4.5	3.0	2.4	1.6	2.2
Taiwan	1.2	-0.3	1.4	1.1	1.2
South Korea	1.3	0.7	1.0	2.1	2.6
Indonesia	6.4	6.4	3.5	3.8	3.8
Malaysia	3.2	2.1	2.1	4.0	3.6
Philippines	4.1	1.4	1.8	3.2	4.1
Singapore	1.0	-0.5	-0.5	0.6	1.2
Thailand	1.9	-0.9	0.2	0.7	1.4
Vietnam	4.1	0.6	2.7	3.5	3.7
India (CY CPI urban non-manual workers)	6.7	4.9	5.0	3.2	4.9
Australia	2.5	1.5	1.3	2.0	2.3
New Zealand	1.2	0.3	0.6	2.0	2.5

Exchange Rate

To USD1, year avg.	2014	2015	2016	2017	2018
Japan	106	121	109	112	115
China	6.16	6.28	6.64	6.78	6.81
Hong Kong	7.75	7.75	7.76	7.79	7.78
Taiwan	30.3	31.8	32.2	30.4	29.7
South Korea	1,053	1,131	1,160	1,132	1,116
Indonesia	11,869	13,389	13,309	13,337	13,670
Malaysia	3.27	3.90	4.14	4.30	4.02
Philippines	44.4	45.5	47.5	50.4	51.2
Singapore	1.27	1.37	1.38	1.38	1.37
Thailand	32.5	34.2	35.3	33.9	35.4
Vietnam	21,148	21,677	21,932	22,402	22,938
India (FY)	61.0	64.1	67.2	64.7	66.0
Australia	1.11	1.33	1.35	1.30	1.26
New Zealand	1.20	1.43	1.43	1.42	1.45

Sources: CEIC, central banks, and national statistics offices. Forecasts are by IMA Asia.

per cent+ export growth is expected for the next few years, the export sector can't transform Asia as it did in the last 50 years. Growth in Asia's next decade will have to come from domestic demand.

Asia's emerging market consumers have long promised to become the region's major engine of growth. That's happened in China, and more recently in the much smaller markets of the Philippines and Vietnam. Yet elsewhere the story is muted. The mass but poor consumer markets of India and Indonesia have been particularly disappointing. Fortunately, the headwinds that retarded growth in 2017 look like easing in 2018.

This month's Asia Brief notes a surge in proposed infrastructure work across SE Asia. On the plus side there's plenty of capital to fund the projects, and plenty of demand from infrastructure users. The big challenges are a chronic shortage of management capacity, mostly in the public sector, and a shortage of skilled workers. That means the apparent surge in SE Asia infrastructure work may struggle to become a reality.

In our Q3 and Q4 forecast updates, we warned of overheating in the Philippines and Vietnam, as both economies are growing at capacity, and that could trigger a jump in inflation and/or big current account deficits, both of which would undermine their currencies. 2017 closes with both countries keeping these risks under control.

Given our strong US$ forecast (see the Global page), most Asian currencies are expected to ease against the greenback in 2018. The exceptions are Taiwan, Korea, and Singapore where large current account surplus push their currencies up, and Malaysia, where the Ringgit's fall over the last few years appears to have overshot. ■

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