

ECONOMICS: ASIAN PERSPECTIVES

SUSTAINABILITY OF ASIA'S EXPORT RECOVERY REMAINS IN QUESTION

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Asia's protracted export slump may be coming to an end. But the improvement remains uneven, and structural headwinds also stand in the way of a sustained growth cycle. Moreover, uncertainty about the global trade policy dynamics may keep manufacturers wary of investment, limiting the pass-through effect of an export recovery on the broader economy.

Since the final quarter of 2016, manufacturing activity—related indicators such as the purchasing managers' index, export orders and trade flows have been consistently stronger than market expectations in both Asia and developed markets. This implies that the global trade cycle may be bottoming out after a prolonged downturn that began in mid-2015.

Nonetheless, the recent improvement has amounted to merely making back the losses from previous quarters. Considering that the drivers of the recovery remain narrow and that final demand remains tentative, we are still cautious about the sustainability of this uptick. We also expect the improvement in manufacturing to have a limited impact on the region's broader economic growth and inflation—and thus monetary policy—in 2017.

Trade Recovery Remains Uneven

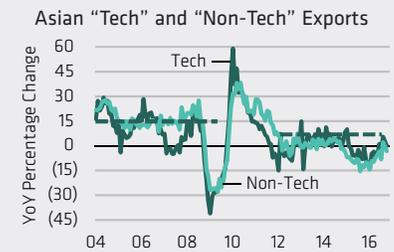
The first reason behind our cautious view is that export growth so far has been quite uneven. In recent years, recovery in Asian exports has been driven by electronics products owing to the global penetration of smartphones. Export growth in other product categories has been largely stagnant since 2012 (*Display 1*).

The recent improvement in Asian exports has also been driven by electronics. But there is something lacking—there is a clear divergence in the performance of the two key electronics exporters, Taiwan and South Korea. Sequential growth has been stronger in Taiwan, where the momentum has been more solid than in previous upcycles (*Display 2*). In South Korea, exports have yet to exhibit convincing signs of an expansionary cycle. This can be partially explained by the highly publicized recall of defective smartphones made by a South Korean maker and the subsequent windfall from substitutional demand that Taiwanese companies enjoyed.

In level terms, even Taiwan's electronics exports have only clawed their way back to where they were two years ago. South Korea's remain about 10% down from their peaks (*Display 3*). From this perspective, it's too early to say how sustainable the current electronics cycle might be. In fact, sector research specialists such as Gartner are forecasting global smartphone sales to be flat in 2017, owing to a market saturation and a dearth of innovation.

Overall, the uneven nature of the export recovery, both in terms of products and

Display 1
Export Growth Driven by Electronics



As of January 18, 2017
Source: CEIC Data and AB

Display 2
Export Performances Diverge



As of January 18, 2017
Source: CEIC Data and AB

Display 3
Levels of Electronics Exports Remain Sluggish



As of January 18, 2017
Source: CEIC Data and AB

countries, suggests that the beneficiaries of a demand recovery remain confined to very specific individual supply chains. Any spillover to region-wide growth may be more limited than in past cycles.

Final Demand Remains Sluggish

The second reason for our cautious stance is that the overall picture of global final demand remains uninspiring. When we look at import demand in volume terms, taking out the volatile commodity price factor, demand in emerging markets has been stagnant since 2013. Demand in developed markets grew between 2013 and 2015 but has since stayed flat (*Display 4*).

In emerging markets, which have been the key driver of world trade growth in the past few decades, demand is likely to be restrained by growth risks in China, owing to stretched leverage levels. In developed markets, where import demand has been closely correlated with manufacturing production (*Display 5*), there has been no sign so far of manufacturing activity picking up.

Structural Headwinds

The third reason for our skepticism is that the region's trade prospects also hinge on a wild card that is the US administration's trade policy. Asian exporters could suffer from disruptive moves such as a renegotiation of trade pacts or imposition of tariffs. Manufacturers may become hesitant about expanding capacity until there is more visibility, and this will hold back the investment cycle, limiting the pass-through to broader economic growth.

From a more structural standpoint, the rate of growth in Asian exports, even in the previous expansionary cycle, was already noticeably slower than it was prior to the 2008 global financial crisis. This could be due to fiscal constraints, balance-sheet restructuring and demographic headwinds.

Another structural element could be a change in the global supply chain. There is a trend toward consolidating production processes to a single large country, such as China, rather than spreading the chain across many countries. In the past, when unfinished products moved across borders for different production processes, there would be a sort of double-counting in

gross export values.

There is also anecdotal evidence that some manufacturers are relocating production bases back to developed markets. This is mainly due to rising wages in Asia and wider application of low-cost industrial automation. In other words, the region's competitive advantage in wages is diminishing.

These structural headwinds for Asia's trade growth are likely to stay, and a protectionist policy orientation under the new US administration may only be a catalyst that accelerates a de-globalization trend.

Export Prices Versus Volumes

The silver lining, in our view, is that there has been a recovery in export prices recently (*Display 6*). This would buoy trade growth in nominal value terms, even though its effect on volume growth would be marginal. The rebound in export prices mirrors a bottoming in the commodity market, and commodity exporters such as Indonesia and Malaysia will benefit. Even though the improvement may be just nominal, it still enhances the exporters' profit and lifts business sentiment. Even so, lingering uncertainty puts in question the propensity of companies to invest the increased earnings.

Investment Implications

All in all, while there are signs of bottoming in Asia's export cycle, the recovery is still uneven. Its sustainability, as well as its spillover to business investment and broader economic growth, remains in question.

Therefore, we expect accommodative monetary policy across Asia to stay, even though many central banks are approaching the end of their respective easing cycles.

Given the benign growth outlook, generous monetary policy despite the US Federal Reserve's tightening and recent spikes in bond yields, we believe Asia's local bond markets remain attractive. In currencies, the export cycle is unlikely to be a key performance driver. But we expect exogenous factors such as the sustainability of the US dollar's broad-based strength to be key to Asian currencies' performance, particularly given their cumulative losses over the past several months. ■

Display 4
Final Demand Has Lacked Momentum Recently



As of January 18, 2017
Source: CPB Netherlands Bureau for Economic Policy Analysis (CPB) and AB

Display 5
DM Imports Track Industrial Production



As of January 18, 2017
Source: CPB and AB

Display 6
Rebound in Export Prices Helps Industry Profits



As of January 18, 2017
Source: CPB and AB

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