ICAEW Economic Insight Report Q2 2024: Mainland China and Southeast Asia

Mainland China Q2 2024 Summary

Still a likely growth slowdown in the following quarters

- Q1 figures were stronger than expected, largely driven by manufacturing outperformance.
- However, this is unlikely to be sustained due to domestic demand continuing to remain weak.
- Deflationary risks, including entrenched downward price expectations driving up real rates, could further weigh on corporate and household sentiment.

China's Q1 GDP growth print was a solid 5.3% y/y. However, both March and April monthly data suggest slowing momentum. In March, retail sales and industrial production declined on a sequential basis, while retail sales in April were sequentially flat. Additionally, the persistence of disinflationary pressures onshore meant that nominal GDP growth was estimated to be just 4.2% y/y. Due to the roughly 5% depreciation of the yuan against the dollar over the past year, GDP in nominal dollar terms actually contracted on a y/y basis.

The strong Q1 data appears to be driven by manufacturing growth, which grew by about 6.7% y/y in Q1. However, the manufacturing boom alongside declining capacity utilisation rates suggests that there was likely a sizeable inventory build-up in Q1. This implies that at some point inventory building will have to slow, and it's likely that some measure of destocking will take place rather than production continuing at the same pace. This will likely weigh on GDP growth in the subsequent quarters.

On the consumer side, the momentum in household consumption looks to be fading, following a temporary festivities-related boost in January and February, with consumer goods and catering sales normalising sharply in March. Furthermore, April sales data came in at 2.3% y/y, lower than our 3.0% y/y forecast. However, we see signs that retail spending is starting to decouple from the continued weakness in property transactions, amid a broader social acceptance of a multiyear housing correction.

The external environment is likely to offset some of the domestic oversupply pressures as China continues to exhibit strong tradeable goods competitiveness. We expect China's real goods exports to sustain healthy 6.3% growth for 2024. Domestic policy support is likely to step in to offset any renewed external weakness, including that arising from rising tariff risk.

Cyclically, growth should decelerate in Q2, while deflationary risks remain on the horizon, weighing on private sector sentiment. The unwinding of inventory in the coming quarters, the normalisation of retail sales post-festivities, the softness and unpredictability of external demand, and still-careful stimulus suggests that the Q1 performance is not likely to be sustained.

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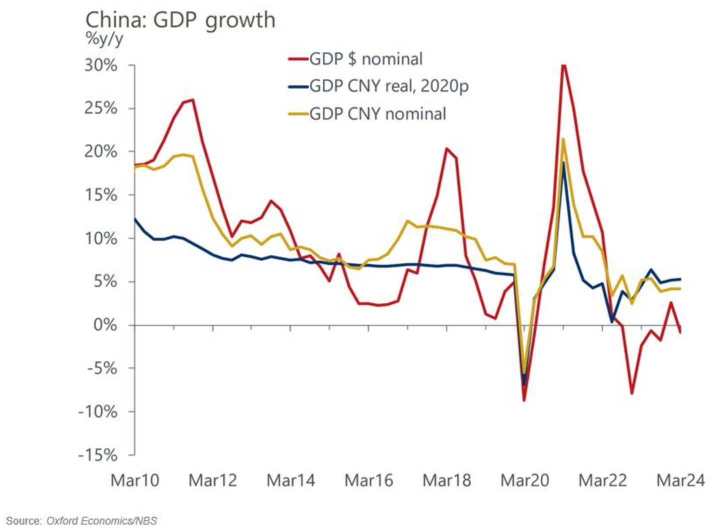

Southeast Asia (SEA) Q2 2024 Summary

- SEA: Electronics exports support Q1 growth, but the outlook is still cautious
- Malaysia: Buoyant domestic demand is starting to cool
- Singapore: Trade-weighted economy will likely remain subdued
- Indonesia: Weak currency poses a challenge to Bank Indonesia
- Vietnam: Below-trend, but still solid growth for 2024

SEA: Electronics exports support Q1 growth, but the outlook is still cautious

- The external sector has been supported by the recovery in electronics and tourism.
- Private consumption has been more resilient than expected but is likely to remain subdued.
- Cuts to policy rates have been delayed to H2 2024 due to weak currencies against the US dollar.

For Southeast Asian economies, Q1 2024 was mixed. While exports were buoyed by electronics and domestic consumption has been more resilient than expected, the outlook for growth is still cautious.

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GDP Growth							
	% q/q (seasonally-adjusted)			% y/y			2024 forecast
	Q4'23		Q1'24	Q4'23		Q1'24	
Malaysia	-1.0	⬆	1.4	2.9	⬆	4.2	3.1
Singapore	1.2	⬇	0.1	2.2	⬆	2.7	2.0
Vietnam	1.7	⬇	0.1	6.7	⬇	5.7	5.6
Indonesia	1.3	⬆	1.4	5.0	⬆	5.1	4.8
China	1.1	⬆	1.9	5.2	⬆	5.3	4.7

External demand still rather subdued, but electronics cycle provides some relief for goods exports

Electronics-focussed exporters in Southeast Asia have managed to gain a better foothold in Q1 2024, in large part due to the bottoming out of the electronics sector. The recovery in the global sales of semiconductors – an estimated 15.3% y/y in Q1 2024 – has been beneficial for economies that produce both semiconductors and their related components. Vietnam's export growth for the first quarter outperformed, growing at an estimated 16.8% y/y. Singapore's non-oil domestic exports also finally turned slightly positive for the first time in six quarters. We expect Malaysia's exports to benefit from this uplift only later in H2 2024 due to its electronics exports being further down in the value chain.

World: Worldwide sales of semiconductors, 3MMA

Source: Oxford Economics/Haver Analytics. Q1 2024 is shaded in blue.

That said, the overall external outlook is still subdued given the expected slowdown in global growth. The boost from electronics has significantly benefitted producers in Taiwan and South Korea, but the impact on Southeast Asia, while positive, is softer. In US dollar terms, although exports improved from Q4 2023, they still contracted in Q1 2024 compared to a year ago in

Indonesia, Malaysia, and the Philippines. It's likely that tight monetary policy around the world is having an adverse impact on external demand for the region's exports. Considering the 2024 forecast for global growth of 2.6% is still lower than the years preceding the pandemic, this means any recovery for the region's goods exports is likely to be modest.

Meanwhile, tourism numbers have improved notably since November 2023, partly due to the various visa-free travel schemes with China. Intraregional tourism outside of China has increased as well. However, it's likely that the recent rapid recovery in tourist arrivals will become more gradual. In addition, Southeast Asia still faces supply-side constraints, such as flight capacity and limited hotel rooms.

Domestic consumption was more resilient than expected, but is unlikely to be a key driver

Domestic consumption in Q1 was somewhat resilient. While some economies like Singapore showed a modest improvement in retail sales growth, it was still relatively weak in Malaysia and Vietnam compared to pre-pandemic levels.

There are two reasons why consumption is likely to be challenged in the next quarter, and what strength we are currently seeing is unlikely to last. First, the impact of tight monetary policy in local economies will feed through and keep private consumption constrained, as debt servicing and new borrowing costs remain high. As interest rates remain higher for longer, it's likely that the effects of this will weigh on the region for longer than anticipated.

Second, it's likely that consumers and businesses are continuing to consolidate, repairing the damage to their balance sheets from the pandemic. Consolidation to re-build savings is likely to continue in the short-term, given that household savings were affected.

Governments have also been consolidating to offset the fiscal payouts during the pandemic crisis. Taxes have been raised this year in both Singapore and Thailand. A rise in the VAT is slated in Indonesia in 2025 as well. Fiscal outlays are also being constrained. Malaysia is currently looking at adjusting the RON95 subsidies that were scheduled in H2 2024, replacing the blanket policy with a more targeted one.

Weak currencies in Asia limit policy choices

Despite the outlook suffering under several headwinds, central banks are unlikely to provide support through monetary policy easing.

Certainly, inflation is moderating, but Asian currencies remain weak against the US dollar and are expected to continue to come under pressure. The US Fed is keeping interest rates higher for longer, and the result is sustained dollar strength. Hence, the central banks in the region will likely be unable to cut rates quickly, as that would likely worsen pressures on local currencies. Bank Indonesia was even forced to hike rates in Q1 2024 due to the weak currency. Later, after the US Fed cuts, which we expect to happen in Q3 2024, currency pressures should start abating, and easing across the region should follow.

Overall, the growth outlook is subdued

Oxford Economics expect Southeast Asia's economy to grow by 4.0% in 2024 and 2025. For context, the region grew by an average of 5% a year in the five years before the pandemic.

Malaysia: Buoyant domestic demand is starting to cool

- GDP growth grew drastically from the previous quarter but is unlikely to be sustained.
- Exports are set to improve relative to domestic demand in H2.
- The Malaysian ringgit continues to weaken against the US dollar.

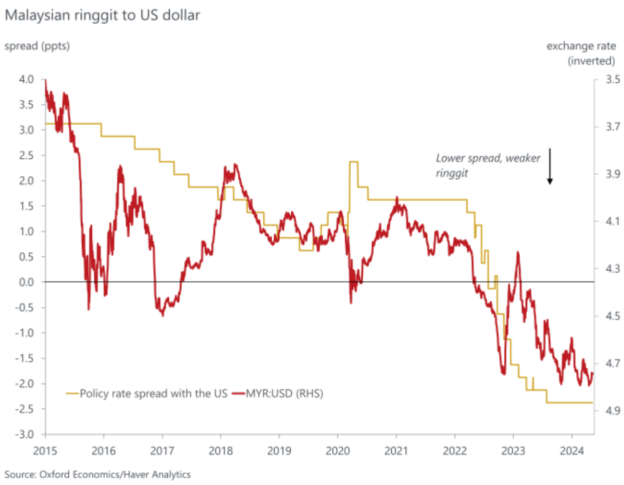
Malaysia's GDP expanded from a downwardly revised 2.9% y/y in Q4 2023 to 4.2% in Q1 2024. In seasonally adjusted terms, the economy grew 1.4% q/q in Q1, more than reversing the 1.0% contraction in Q4. However, it's likely that these growth rates will be difficult to sustain. The strong 9.7% q/q sa growth in exports services was likely due to the return of Chinese tourists during the Chinese New Year holiday in February. This was probably thanks to the bilateral visa free arrangement that came into effect in December 2023. The latest available data in December 2023 shows that there was a rise in tourist arrivals, largely led by a 40% m/m and 35% m/m surge in visitors from Singapore and China respectively. However, we doubt the strength will continue as the initial boost fades.

Indeed, the strong 4.4% m/m sa in retail sales volumes in February, following four consecutive months of declines, appears to have faded in March, with retail sales growing only 0.7%. While the labour market looks healthy and unemployment remains low compared to its history, there are some initial signs of softness with new jobs growth stuttering and wage growth cooling. A further softening probably lies ahead, keeping consumers spendthrift.

The other elements of domestic demand are unlikely to grow much either. Government consumption is set to be flat or even decline, with the recent 2024 budget planning for a nominal reduction in spending. Fuel subsidies are also being cut to lower the budget deficit and improve the public debt-to-GDP ratio. Investment, particularly among industry, will likely be constrained by the uncertain external environment.

For the external sector, exports are set to grow modestly in 2024 with some improvements in global demand. The bottoming out of the electronics cycle will likely feed through to Malaysian exports only in H2 2024 due to its position in global supply chains. Still, our global growth forecast of 2.6% for 2024 is subdued by historical standards, and external demand is unlikely to offer a significantly stronger boost. Already, goods exports in February and March declined in seasonally adjusted terms.

The currency remains a major challenge. The Malaysian ringgit had reached a new 26-year low in Q1 2024. This is likely due to the large discount of the Bank Negara Malaysia's (BNM) policy rate relative to the US Federal Funds rate. Currency weakness remains an impediment to BNM easing policy to support the economy despite inflation not being much of a concern – it's stayed under 2% for the past six months and is unlikely to move much higher over the year. Until the US Federal Reserve starts to cut rates, as we expect it to do in Q3, pressure on the ringgit will prevent any policy rate changes.



Singapore: Trade-weighted economy will likely remain subdued

- GDP growth was sequentially stagnant in Q1. Manufacturing and construction shrank.
- Exports strength is set to fade. But electronic exports are projected to continue to trend up.
- Domestic demand is likely to moderate this year after a strong entertainment-led start in Q1.

Singapore's GDP grew 2.7% y/y in Q1 while seasonally adjusted Q1 GDP grew slightly by 0.1% q/q, mainly due to the slump in manufacturing and construction, both of which contracted in seasonally adjusted q/q terms of -2.9% and -1.7%, respectively. In contrast, the services sector grew by 1.2% q/q sa, aided by the tourism-sensitive accommodation and food services sector. Singapore's economic momentum is likely to improve, but will probably remain slightly below trend this year.

The strong momentum in the external sector is likely to fade. Tourism supported services exports in Q1, as seasonally adjusted arrivals were 94% of their 2019 level, up from 74% in Q4. We expect part of the spike in business-service exports to be reversed, as Q1 was supported by concertgoers flocking to Singapore. Goods export volumes held up well, but it was largely due to stronger re-exports. Domestic exports, which are more important for GDP, are still on a downtrend despite the uptick in April. This is reflected in the contraction in the manufacturing sector in Q1.

Real exports in Singapore dollar terms rose sharply by 3.7% m/m sa in April, mainly fuelled by the 7.6% m/m sa jump in non-oil domestic export (NODX) following an 8.5% contraction in March. The growth in NODX was due to the roughly equally sharp rise in both electronics and non-electronics. Electronic exports are likely to remain on an uptrend due to rising demand as the global electronics cycle continues to bottom out, and as businesses are starting to invest heavily in chips again to ride the AI wave. We estimate that electronics NODX volumes jumped 11.9% m/m sa in April.

That said, domestic demand is unlikely to rise materially in Q2 as the labour market keeps softening, and high interest rates constrain business investment. Furthermore, as Singapore's business investment tends to shadow exports closely, it will be restrained in the face of uncertain external demand.

Spending probably ticked up but is unlikely to be maintained. Private consumption was stronger than we expected in Q4, rising by 1.6% q/q. Seasonally adjusted retail sales volumes suggest this might have persisted in Q1, as much of the strength was concentrated in February. This is propelled by several one-off factors such as the visa-free travel for citizens from China started in February, which coincided with Chinese New Year holiday. Moreover, March retail sales volumes resumed their contractionary trend, suggesting that the uptick is unlikely to be sustained.

Indonesia: Weak currency poses a challenge to Bank Indonesia

- Private consumption will continue to be a key pillar for economic growth this year, largely weathering the impact of monetary tightening.

- The external sector will be a drag, given soft global growth. Already, trade figures are moving sideways. Lower external demand will also mean less need for business investment.
- Concerns over the rupiah are tying the hands of Bank Indonesia. BI will likely only be able to cut after the US Fed does, and we expect only one 25bps cut this year in Q4.

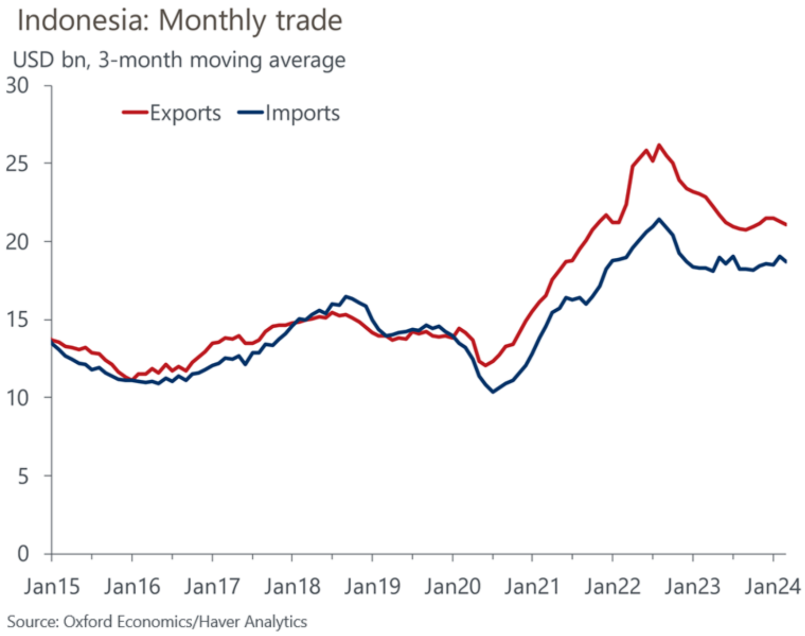
Indonesia's economy grew by 5.1% y/y in Q1, slightly quicker than the 5% in Q4. Continued resilience was led by domestic consumption in both the private and public segments, with the latter likely bolstered by election-related spending.

Private consumption will likely drive the economy this year, given the likely limited monetary transmission and contained rise in real interest rates. However, we think the strength in government consumption will prove temporary, while soft investment and exports momentum will likely linger given the softness in global economic backdrop.

Although our latest global growth forecast of 2.6% points to a soft landing, it will still be weak by historical standards. Some of Indonesia's regional peers are set to benefit from the boom in the AI chip cycle, but Indonesia is missing out on the opportunity given its underdeveloped electronics sector. China, Indonesia's biggest export destination, is grappling with sluggishness in the real estate sector, and its subpar economic performance this year will be a drag on Indonesia's external-facing sectors.

CPI inflation has consistently been within the central bank's target range since early 2023, settling at 3% in April. Core inflation is even more subdued, at 1.8% as of April, pointing to the absence of demand-pull inflationary pressures. Although there are some upside risks emanating from supply-side disruptions, we think headline inflation will remain comfortably within the target range this year.

Against the backdrop of strong economic data, a hawkish US Fed, and geopolitical tensions, the strong US dollar is weighing on the rupiah. A weak currency is limiting BI's policy options, and the central bank recently hiked its policy rate to guard against further depreciation of the currency. We expect BI will stay on hold until Q4, when it will cut the policy rate by 25bps, after the US Fed commences its own rate cutting cycle in September.



Vietnam: Below-trend, but still solid growth for 2024

- Vietnam has continued its export outperformance, driven by electronics and agriculture.
- Poor sentiment, capital deployment, and consumption are likely to remain drags.
- Momentum is likely to gradually improve in H2 2024.

Vietnam's real GDP grew 5.6% y/y in Q1 2024, slowing from the strong 6.7% y/y in Q4 2023. The moderation was broad-based across all sectors. Exports continued to show robust performance for the first four months of the year, growing by an estimated 15.3% y/y. While this was driven mostly by increased shipments of electronics, agriculture exports have also picked up as of late due to elevated coffee and rice prices, as well as being China's biggest importer of durian early this year. Monthly tourism arrivals have also started to surpass the levels in 2019. Vietnam is also benefitting from the structural supply chain reshuffling from China, which is likely to support foreign direct investments into the country.

Despite higher levels of optimism, the headline forecast for GDP of 5.6% y/y is still below the long-run trend of 7%, as well as the official 6.0-6.5% y/y GDP growth target. Higher-for-longer interest rates in key export partners are likely to weigh on import demand from Vietnam. Our latest global GDP growth forecast is 2.6%, which is still subdued by historical standards.

On the domestic front, the deployment of capital has been historically weak. Year-to-date credit growth, or the amount of loans from commercial banks, was only at 1.3% y/y in March after two months of negative figures. This is the slowest credit growth has been in the last 10 years. The crackdown on financial fraud is also likely prompting banks to be more careful, on top of lingering challenges in the real estate sector. We expect only a gradual improvement in the real estate and financial sectors over the rest of the year.

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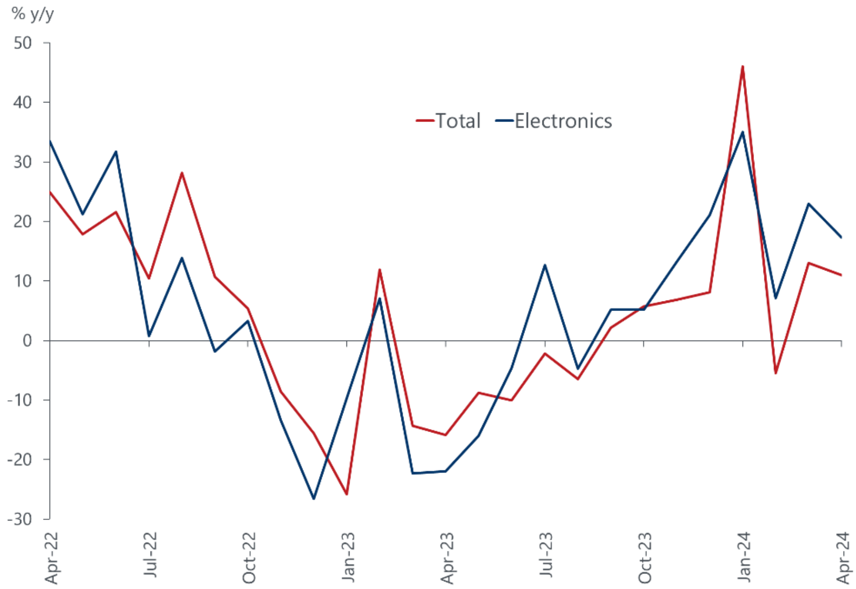
For consumers, income growth has accelerated for the third consecutive quarter, at 7.8% y/y in Q1 2024. The unemployment rate also remains low at 2.24%. However, consumption, while positive, appears to be growing at a pace that is slower than pre-pandemic levels. Retail sales in Q1 2024 were 2.9%, whereas 2019 saw double-digit figures every quarter. It's likely that in the short-term income is being redirected to savings.

The State Bank of Vietnam (SBV) is likely to keep its policy rate accommodative at 3.0% to support both corporates and consumers. It is not likely inflation will be a major concern for 2024; inflation in April was 4.4%, within the 4-4.5% target range for the year. We expect the SBV to keep rates on hold for 2024.

Vietnam: Export values (in US$ terms)



Source: Oxford Economics/Haver Analytics