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ASIA MACRO

Asia: Long road to reopening amidst stark regional divergences

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KEY TAKEAWAYS

- Asian markets remain under lockdown, despite the rest of the world seeming to have resumed economic reopening.
- Lower vaccination rates can be explained by two main factors: vaccine availability and governance. Asian DMs will likely reopen sooner, while EMs may still take longer to reach appropriate levels of immunisation.
- For this reason, we expect that growth in 2021 will be led by DMs with export-oriented production structures. Asian EMs with consumption-oriented economies will continue to experience headwinds to growth for longer.
- As a result, EMs will continue to experience outflows, leading to sustained depreciatory pressures throughout the remainder of 2021. Meanwhile, DMs will benefit from economic reopening, likely supporting risk assets in Asia.
- Singapore emerges as a clear bright spot. It was amongst the first in the world to achieve 80% vaccination rates, thanks to an efficient inoculation program and even owns a stake in Germany's BioNTech.

Asia sticks to 'zero-tolerance' policy for longer

Travel restrictions have remained in place in Asia, as markets in Europe and North America have gradually moved towards reopening over the summer. This took place even against the backdrop of rising COVID-19 cases. The justification behind this decision goes as follows: A larger proportion of the population is now vaccinated, which should reduce the burden on national healthcare services despite rising cases. As the debate shifts from pandemic to endemic, better access to vaccines should enable governments to pivot away from counting daily cases to focus on reopening their economies while learning to live with the virus. But the same thinking has not yet permeated policy circles in Asia Pacific. Japan banned international spectators from attending the Summer Olympics. New Zealand locked up the entire country over a single COVID-19 case in Auckland on August 17. The outbreak has since extended to around 700 cases, prompting Prime Minister Ardern to extend its Level 4 lockdown until September 14. Under Level 4 rules, New Zealanders can only leave their homes for exercise, supermarket shopping, essential medical care and getting a COVID test. Quarantine-free travel between Australia and New Zealand has been suspended. Australia has recorded over 1,000 daily cases on average in August, as the situation in New South Wales (NSW) continued to deteriorate. Meanwhile, the Hong Kong government extended its quarantine requirement to 21 days for international travellers, the longest in the world, following two imported cases on August 16 – the seven-day daily average in Hong Kong is zero. In contrast, Switzerland experienced around 2,500 daily cases during the same period while the United States (US), which has a much larger population, had over 160,000. Why are Asian governments so adamant on pursuing zero-tolerance?

Firstly, over 60% of the world's population inhabits under 30% of earth's total land mass according to figures by the United Nations (UN). This implies a higher population density than the rest of the world, making Asia especially

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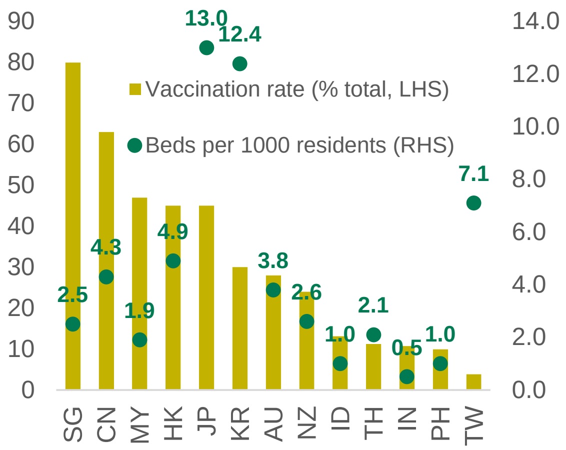
vulnerable to pandemic spread. The region had 150 inhabitants per kilometre squared (km^2) in 2019 according to the UN, but this number can easily be higher. For example, India's population density was 464 per km^2, more than three times higher than the average for Asia. In contrast, the US's population density was 36 per km^2, while other large emerging markets such as Brazil also had lower densities of 25 per km^2. As uncertainties about the epidemiological development of COVID-19 remain, a large series of outbreaks in Asia could have catastrophic consequences for the entire world.

Except Singapore, where 80% of the population has already been immunised, the rest of Asia is lagging in terms of vaccination rates (**Chart 1**). This boils down to two main factors: vaccine availability and quality of governance. Access to vaccines has been a major drag for many Emerging Markets (EMs) in the region and around the world. Large domestic-oriented economies such as India, Indonesia, the Philippines, or Thailand do not have access to sufficient doses. Thus, it will still take many months before adequate immunisation levels are achieved. This leaves their economies vulnerable to potential future outbreaks. In the case of the region's Developed Markets (DMS), poor governance is mostly to blame. In some cases, insularity led to false perceptions of "safety", as many economies have export-oriented production structures or can afford to close borders without incurring outsized economic losses. These governments did not place orders for vaccines early, having to overcompensate ex-post. Moreover, resolute border control measures early in the crisis spared many Asian DMs from experiencing more serious outbreaks. This has translated into complacency, as the sense of "urgency" is lower relative to other parts of the world.

There's also a point to be made about the quality of healthcare systems. The region's DM's have a higher count of hospital beds per capita (**Chart 1**). This means that markets such as Japan and South Korea may be in a better position to cope with higher cases of COVID-19, whereas their EM counterparts need to adopt a more cautious approach. This was one of the main factors that enabled the Tokyo Summer Olympics to go ahead. The question remains open for Beijing's Winter Olympics, which are scheduled to take place on February 2022. We expect that China will remain closed until higher vaccination rates are achieved, most likely beyond February 2022. There is a growing body of evidence suggesting that traditional technologies such as China's Sinovac, Sinopharm and India's Covaxin vaccines, offer lower immunity against variant strains of COVID-19, requiring three doses to reach similar levels of protection. Given that these vaccines were used extensively in other EMs in Asia, it may take that much longer for these countries to be able to reopen safely.

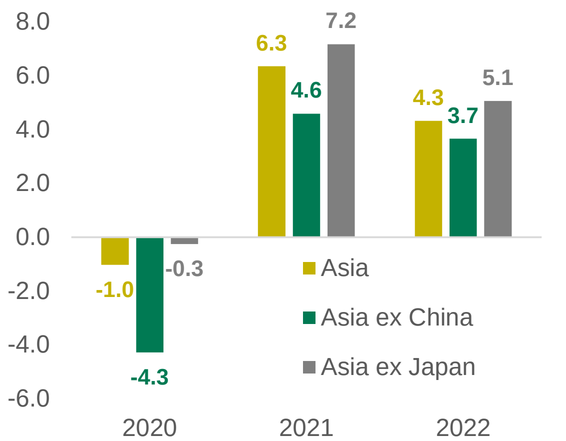
Against this backdrop, Singapore emerges as a clear bright spot. Singapore, which was amongst the first in the world to place orders for the vaccine, managed its inoculation program extremely efficiently and even owns a stake in Germany's BioNTech via a USD 250 million investment by Temasek. With almost 80% of the population now fully vaccinated, Singapore has announced quarantine-free travel with selected regions and is gearing towards economic reopening. Together with a pickup in domestic consumption, we expect that this will deliver substantial upside risks to GDP growth in the remainder of 2021 and into H1-22. Singapore's reopening in the coming months should also serve as a model for other Asian markets. Provided things go well, Asian markets, in particular DMs, could gradually embrace a similar approach as vaccination rates progress throughout 2022.

Chart 1: Vaccination rates & hospital beds



Sources: Our World in Data, JHU, UBP

Chart 2: Asia growth forecasts (GDP weighted average)

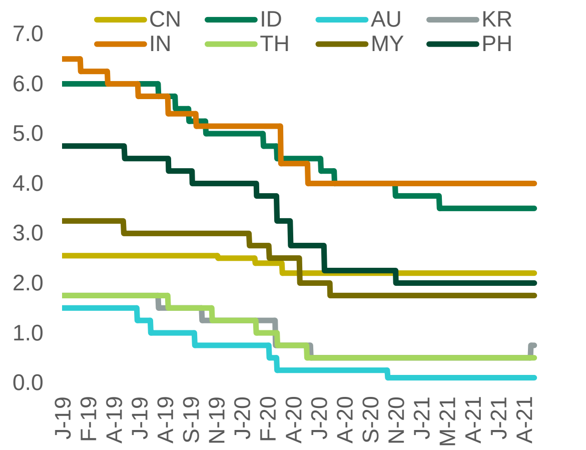


Sources: Bloomberg, UBP

Divergences between DMs and EMs become more stark

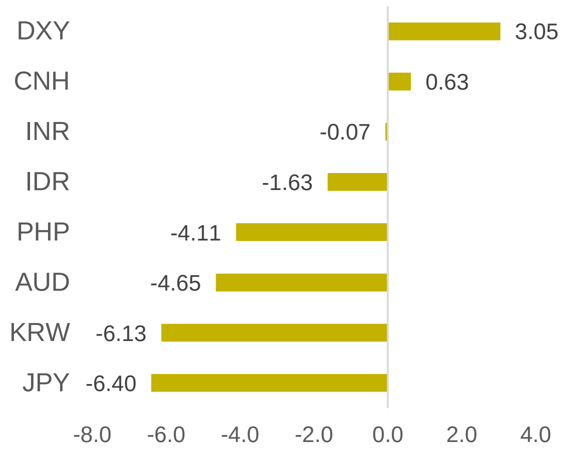
We expect to continue to observe marked differences in the region in terms of growth, performance, and policy support. Growth in H2-21 will be led by DMs with export-oriented production structures. These economies are benefitting from access to vaccines, still loose domestic conditions and sustained external demand. Asian EMs with consumption-oriented economies have been adversely impacted by a spike in COVID-19, led by India, Indonesia, Thailand and Philippines. These economies will continue to experience headwinds, as vaccination rates remain low, delaying the reopening. We have therefore revised our growth projections for Asia down to 6.3% in 2021 vs prior 6.5% (**Chart 2**). Much of this can be traced back to downward revision to our forecast for China, now 8.2% vs prior 8.6%. However, we have also revised downwards our growth forecasts for Indonesia, Malaysia, the Philippines and Thailand. Inversely, we have revised upwards our growth forecasts for Hong Kong, Singapore, South Korea and Taiwan. However, the overall balance remains less positive.

Chart 3: BOK rate hike marks start of tightening cycle



Sources: National sources, Bloomberg, UBP

Chart 4: Depreciation against the USD (YTD %)



Sources: Bloomberg, UBP

In addition, we are observing stronger divergences in terms of monetary policies. Central banks in South Korea, Australia and New Zealand are leading the tightening cycle, whereas the rest of the region will remain in a dovish pause. For example, Bank of Korea (BOK) hiked rates to 0.75% in August (**Chart 3**), shrugging off the impact of rising delta cases and choosing to address financial risks instead. The BOK is concerned that too much liquidity will exacerbate housing prices, encouraging household debt, which at 105% of GDP is amongst the highest in Asia. The Reserve Bank of Australia (RBA) announced in July 2021 that it would start tapering before the end of 2021. This is because the Australian economy was running hot before the latest outbreak in NSW, as evidenced by Q2-21 GDP numbers (9.1% y/y). The RBA is currently debating whether to delay the decision, owing to rising COVID-19 cases, but no reversal is expected. Likewise, the Reserve Bank of New Zealand has also stated that it intends to start removing policy accommodation before the end of 2021 and is expected to deliver this on schedule.

On the other end of the spectrum, central banks in Asian EMs will continue to provide policy accommodation as headwinds to growth persist amid lower vaccination rates. However, their ability to deliver additional support will remain constrained by tapering plans by the US Federal Reserve (Fed), as well as higher imported inflation. On August 2, Bank Indonesia's (BI) Governor Perry Warjiyo stated that the BI's next move would be a rate hike, but that "rates would remain low for longer" on account of tighter lockdown measures since July. An interest rate hike is therefore not likely in 2022. Meanwhile, the Reserve Bank of India's Governor Shaktikanta Das stated that the bank is "in no hurry to reverse course on record low interest rates" despite mounting worries around inflation. A dovish pause is counter-cyclical in nature and will inevitably result in fewer tailwinds to growth in 2021 and 2022.

Implications for investors

As a result of weaker growth, low vaccination rates and diverging monetary policies, we expect that Asian EMs will continue to experience portfolio outflows, resulting in sustained depreciatory pressures throughout the remainder of 2021 (**Chart 4**). The good news is that most Asian markets are well positioned to withstand these pressures. Current account surpluses widened in most cases, excluding India and Indonesia, where small deficits persist. Moreover, foreign holdings of domestic assets are low in most markets, excluding Indonesia and Thailand. A reversal in conditions will take place once more progress is made on the vaccine front or in case the Fed pushes rate hikes further into the future. Meanwhile, Asian DMs will benefit from economic reopening, likely supporting risk assets in the region. Singapore has emerged as a clear winner, but we expect sustained upside in Japan, South Korea and Hong Kong in H2-21.

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