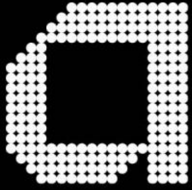

Research Institute: APAC matters

14 December 2022

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#APAC / #Monthly / #Growth

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Re-opening and rotation

China's re-opening will cause some disruptions within and outside of China, testing markets' ability to look through to endemic living. The tourism recovery will do little to offset weak global trade, while China's import-intensity will fall as it transitions.

Key takeaways

- China's sudden pivot in Covid policy is unleashing a huge wave of cases across the country, which will cause near-term disruption and necessitate restrictions to ease the strain on healthcare.
- Indicators of growth have already turned down, but will fall further over the winter months. As such, a technical recession over Q4 and Q1 is a risk.
- China's position at the very heart of global supply chains may slow, but should not stop the recovery on net. Exports have slowed markedly, new export orders were last this weak in the 2001 US recession, implying demand-supply imbalances for goods are still easing.
- China's re-opening is unlikely to give a big boost to the rest of the world: as the composition of growth shifts towards services – and policy no longer needs to prop up the economy via infrastructure – the import intensity of GDP is likely to fall, muting the typical multiplier.
- The return of tourism will not help many economies, but it should still provide a notable boost for Thailand and a modest offset for Malaysia, justifying the recent FX appreciation.
- Overall, markets' ability to look through the near-term disruption and appeal to a rapid transition to endemic living is likely to be tested.

China has de facto moved away from 'Zero Covid'

An official end to 'Zero Covid' has not been announced, but the steady stream of policy changes - such as limiting mass testing, rolling back contact tracing and ensuring lockdowns are targeted - mean that it will be almost impossible to return to a strategy which aims to eliminate outbreaks.

Case numbers are likely to rise to unprecedented levels – perhaps rising to a run rate of 5-6 million and hitting 200 million by the end of Q1 '23 - testing China's resolve to re-open alongside vaccine efficacy and the strength of the healthcare system.

Indeed, it is hard not to conclude that China is underprepared: a third of over 80s have not received 2 doses of Sinovac – which is the minimum needed to confer protection according to the study by Hong Kong Medical University – and only 40% have had a booster shot thus far. Moreover, the proportion of under 60s who have had booster shots which should give them vaccine efficacy closer to Western mRNA standards is relatively low (~55%). 3 years of 'Zero' have additionally left the population with no naturally acquired immunity, while therapeutics – such as the Covid pill – do not appear to have been stockpiled.

Indicators of growth are already turning down, consistent with rising case numbers weighing on the economy over the winter months. As such, we expect that Q4 growth will contract by a bit less than -1% q/q and Q1 GDP sequential growth may be around zero.

Our updated forecasts now incorporate a marked growth pick-up in the second half of 2023, but the risks of a disorderly exit - including the large degree of political capital spent differentiating China's approach to that of the West – suggest the government will sacrifice growth and slow the exit if the cost of a rapid transition appears too high.

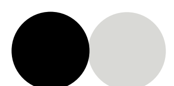
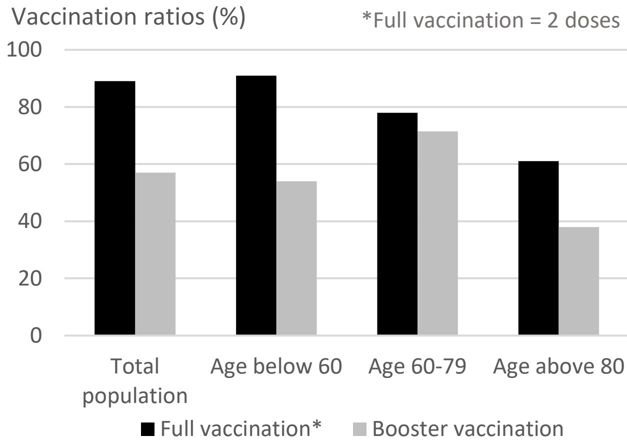


Figure 1: Case numbers will rise rapidly as restrictions are eased, testing vaccine efficacy



Source: CEIC, NHC, UBS (December 2022)

China poses only a limited threat to supply chains

China's position at the very heart of global supply chains threatens to extend disruption to goods production, keeping core goods prices high.

However, these disruptions are likely to be mild in comparison to the perfect storm which supply chains have now largely recovered from. The combined impact of the Delta wave spread across Asia, US port congestion, delays in shipping and transport networks, and elevated demand for goods in the summer of 2021 all led to severe shortages in key tech intermediate inputs such as semiconductors.

Figure 2: Shortages in key intermediate inputs have improved markedly since the "perfect storm" of 2021

Source: Haver, abrdn, December 2022

Figure 2 shows how the gap between purchases for work in progress and finished goods have now closed and remain only somewhat elevated relative to pre-pandemic norms. Broader global production bottlenecks have steadily eased over the past year – as illustrated by supplier delivery times - albeit unevenly across sectors and regions.

While China's re-opening may slow the recovery in global supply chains somewhat, continued recovery elsewhere – including an abundance of semiconductors – and a rotation of DM consumption away from goods and towards services should mean that the scale of this setback will be mild compared to the past. Helpfully for Western consumers, the bulk of Christmas goods orders are likely to have been met already.

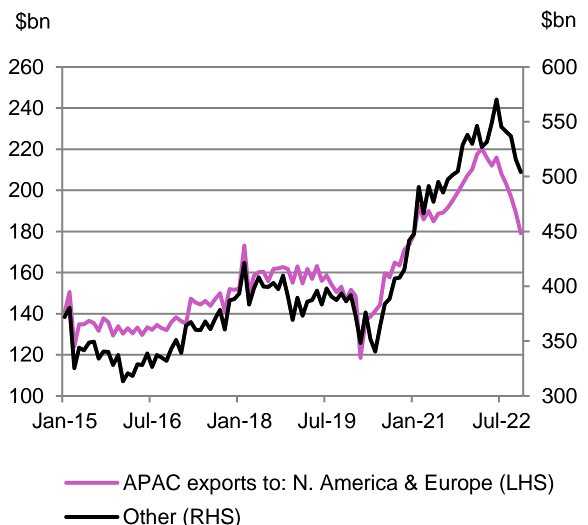
APAC exports have decisively turned down…

Declining global goods demand is certainly playing its role in helping to ease pressure on supply chains. Nowhere is this more evident than in the APAC export data.

To recap, APAC exports surged by over 60% between May 2020 and mid-2022, as locked-down consumers loaded up on tech, furniture and other goods with their savings amassed as a consequences of government support schemes and a limited ability to buy services like tourism.

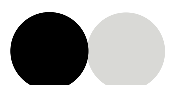
However, the latest trade data has turned increasingly ugly. We only have November trade figures for China, Korea and Taiwan (~50% of APAC's exports), but even assuming other countries' trade maintains its latest values then APAC's exports are likely to have fallen by 13% since June, with a 17% decline to exports bound for North America and Europe (see Figure 3).

Figure 3: APAC exports to the US and EU are likely now down by almost -20% since their mid-year peaks



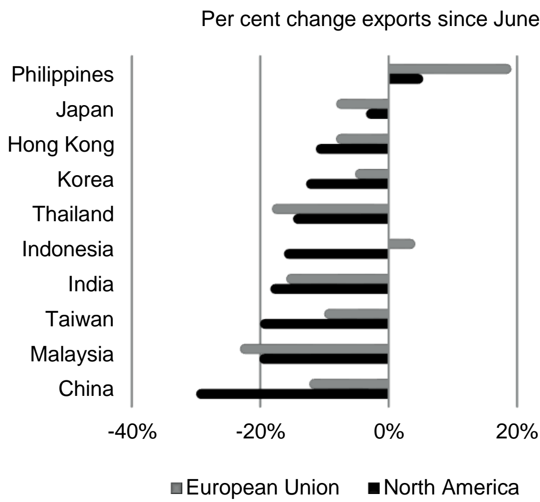
Source: Haver, abrdn, December 2022

Within APAC, China's rapid fall in exports to the US really stands out, but many countries have seen notable declines in their exports to DMs (see Figure 4). Only the Philippines has not seen a fall in exports, while Japan's modest decline – as the second largest exporter in the region – is also



notable, likely reflecting the cushioning effect from the sharp fall in the Yen.

Figure 4: Chinese exports to the US down 30%

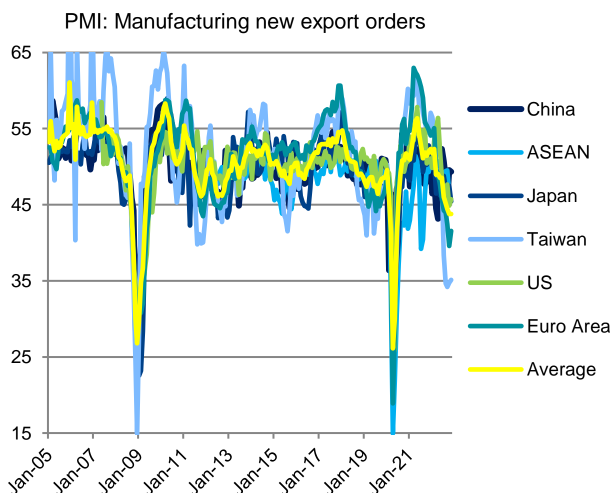


Source: Haver, abrdn, December 2022. Note: latest trade figures vary.

… and there's more weakness to come from goods

Forward looking components of the PMIs make for grim reading. New export orders are running at depressed levels in Indonesia (43.3), Malaysia (43.4), the Philippines (44.8), Japan (45.6), Korea (46.5) and Taiwan (34.8). While one has to go back to the US recession in 2001 to find a period when the global new export series is as weak as it is now (see Figure 5).

Figure 5: New export orders have not been this weak since the US recession in 2001



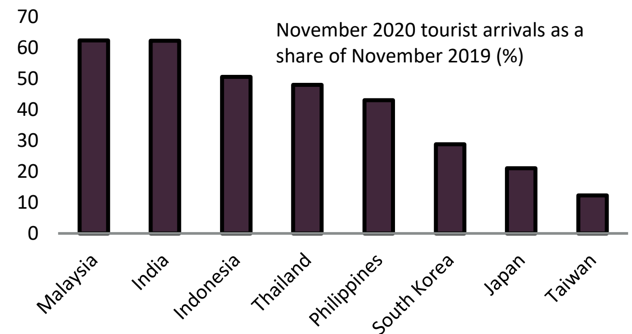
Source: Haver, abrdn, December 2022.

Moreover, with US goods volumes still around 15% above their pre-pandemic level, one cannot rule out a normalisation in the share of goods within consumption that would further amplify the downtrend in global trade. A moderation of APAC exports back down to their pre-Covid trend would be consistent with further 10-15% declines.

Could tourism come to the rescue?

A continued recovery in tourism could at least provide some offset from the rising drag from goods trade for some countries. Encouragingly, tourism recoveries have gathered pace this year, with November arrivals into Thailand and Taiwan rising more than tenfold since the start of the year, and around five-fold in Korea, Indonesia and Japan.

Figure 6: The APAC tourism recovery has gathered pace since Q2, but remains incomplete



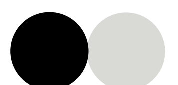
Source: Haver, abrdn, December 2022. Note: latest tourist arrivals data.

The latest arrivals data, coming alongside China's faster-than-expected shift away from 'Zero Covid' – which could further juice the tourism recovery from H2 '23 – has generated much optimism in the region's markets, with currencies like the Thai baht performing particularly well.

Under a thought experiment where non-China tourist arrivals recover to 80% of pre-pandemic levels by end-23 (from around 65% now) and Chinese tourists return to 30% (from a mere 5% now), the direct & indirect contributions of travel & tourism on Thailand's economy could boost GDP by 3.5% from current levels. Elsewhere, Malaysia is the only other economy likely to receive a noticeable (albeit modest) boost, while the Philippines and Korea will likely see rising drags as they return to their normal tourism trade deficits.

Implications for investors

- Markets are looking to the light at the end tunnel for China's re-opening. The process to get there may however test the ability to look through near-term disruption, and we are more cautious than consensus as to when China will move to endemic living.
- The combination of less import-intensive growth also reduces the benefit for the rest of APAC, which - alongside China - faces an increasingly tough external environment. The return of tourism will however provide a notable boost for Thailand and a modest offset for Malaysia, justifying the recent FX appreciation.



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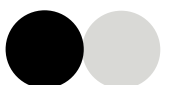

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