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Asia Economics Analyst

Ten questions for 2022

- We wish our readers a happy and healthy new year. In our first *Asia Economics Analyst* of the year, we offer our answers to ten economic and market questions for the Asia-Pacific region and individual countries in 2022. We also review our questions and answers from one year ago.
- The course of the Covid-19 pandemic will continue to play a large role in economic outcomes across the region. "Zero-Covid" strategies will remain the focus in mainland China and a few other economies, but most are shifting to a focus on "living with Covid" while limiting hospitalizations.
- Regional growth will decelerate this year, with China in particular slowing from near-8% growth in 2021, but should remain above trend in many economies. Japan is set for its fastest GDP growth in a decade on a combination of domestic fiscal support, easy financial conditions, and global reflation. The "late reopeners"—mainly South and Southeast Asian economies that had very tight domestic virus restrictions during the Delta wave—are apt to post the strongest 2022 growth.
- Inflation is likely to remain above pre-pandemic levels in many countries, but we do not expect a large further acceleration from here. Rising core (and in some cases food) inflation should be offset to some degree by a deceleration in energy inflation.
- The monetary policy tightening cycle will get underway in earnest in 2022. We expect rate hikes across the region, with the exceptions of Japan, Australia, and China.
- In China we expect macro policy to ease, with a wider "augmented fiscal deficit", modestly faster credit growth, and easier housing policy settings. Despite the divergence with monetary policy direction elsewhere, we do not expect a significant depreciation in the RMB given strong current account fundamentals and ongoing portfolio inflows.

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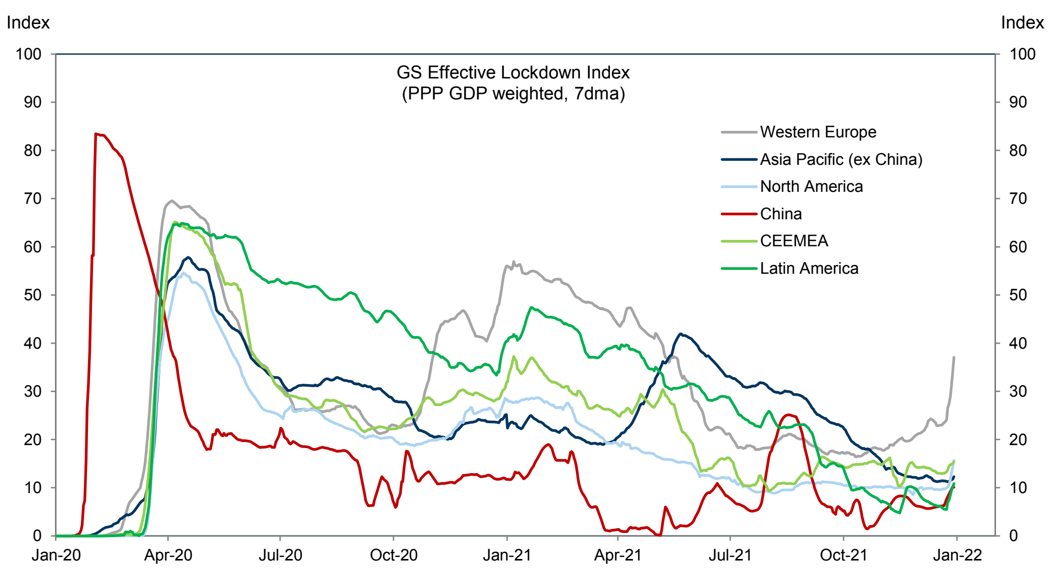
Questions for 2022

In our first *Asia Economics Analyst* of the year, we offer our answers to ten economic and market questions for the Asia-Pacific region and individual countries in 2022. These highlight some of our key macroeconomic views—for more detail on our outlooks across the region and globally, please see the 2022 outlook page on our research portal.

1. Will the Covid-19 Omicron variant prompt a wave of restrictions across the region similar to the Delta variant?

No. Although we include a small increase in virus-related restrictions in Q1 (with consequent negative impacts to growth) in many of our country forecasts, reflecting greater transmission of the coronavirus in cooler temperatures, we do not expect these increases to approach the severity of the Delta wave restrictions in mid-to-late 2021 (Exhibit 1). Protection against severe disease is much higher now, via both natural infections and the rapid progress in vaccinations across most of the region. The Omicron variant also appears to pose a modestly lower risk of hospitalization and death, controlling for other factors. That said, it is even more transmissible than the Delta variant, making it likely that countries not following strict zero-Covid policies experience an "Omicron wave" in early 2022. The question is what tradeoff each government will strike between the costs of controlling this highly infectious variant and the potential health consequences of an uncontrolled Omicron wave. Excluding mainland China, Hong Kong, Taiwan, and perhaps a few others (Japan, Korea, NZ are possibilities) we expect tightening to be fairly modest.

Exhibit 1: Asia-Pacific economies tightened virus restrictions significantly in mid/late 2021

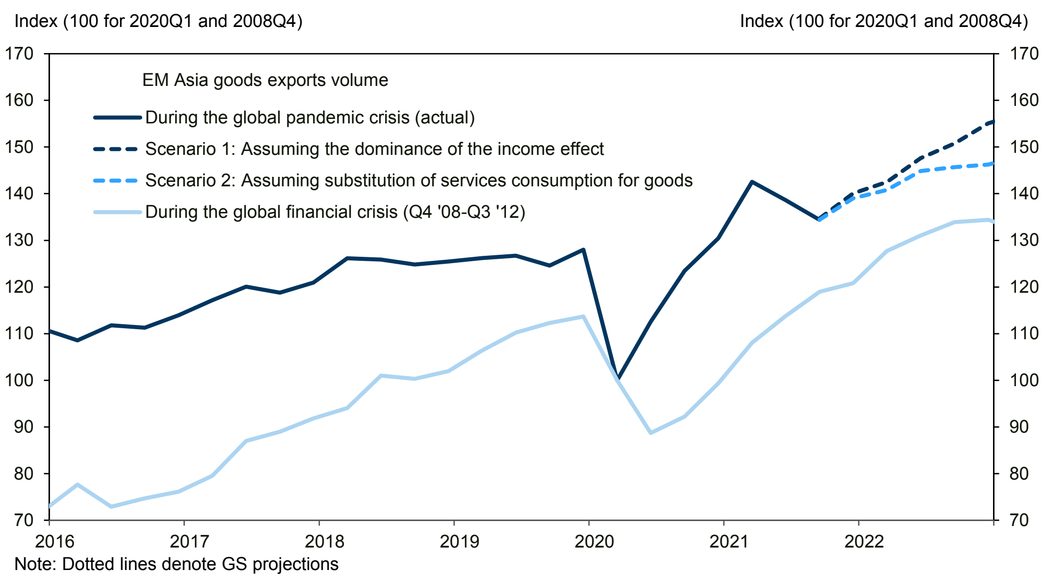


Source: Goldman Sachs Global Investment Research, University of Oxford (covidtracker.bsg.ox.ac.uk), Google LLC "Google COVID-19 Community Mobility Reports", Wind

2. Will Asia still see a positive export impulse in 2022?

Yes. Clearly, the pace of export growth is likely to fade from the very strong performance in the first year of the pandemic (Exhibit 2). As global growth decelerates and economies reopen—shifting the mix of demand back from goods towards services—the robust impulse to Asian goods exports will fade. But we expect global growth to remain above trend this year, and at least through early 2022 Covid-related restrictions will continue to play a role in boosting foreign demand for goods.

Exhibit 2: EM Asia's goods exports should rise further in 2022

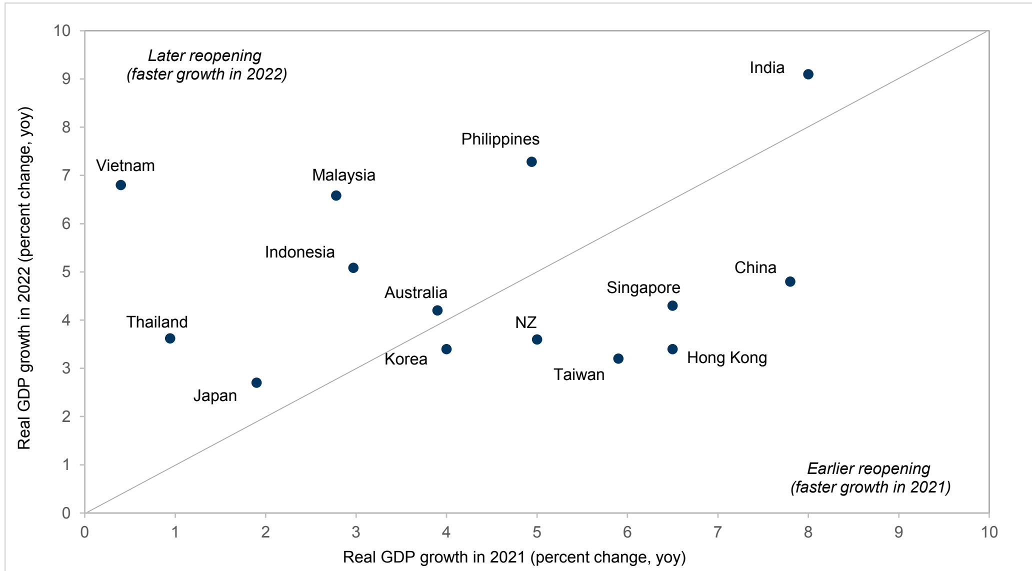


Source: Goldman Sachs Global Investment Research, Haver Analytics

3. Which economies can outperform on the growth front in 2022?

We expect the "late reopeners" in South and Southeast Asia to grow fastest in coming quarters. This reflects relatively high rates of potential growth (near or above 5% in India, Indonesia, Malaysia, Philippines, and Vietnam), relatively significant spare capacity, and still-meaningful virus restrictions (as proxied by our GS Effective Lockdown Index) in early Q4 2021. The lifting of most remaining restrictions in early to mid-2022 should contribute to strong service-sector recoveries in most of these economies. In contrast, northeast Asian economies, particularly mainland China, Hong Kong, and Taiwan, fared relatively better early in the pandemic and are already closer to potential output (Exhibit 3).

Exhibit 3: As ASEAN and India reopen, they should post stronger full-year growth in 2022

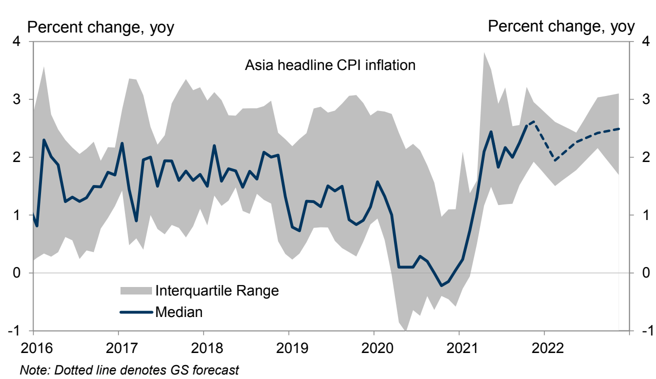


Source: Goldman Sachs Global Investment Research

4. Will inflation pressures accelerate significantly further?

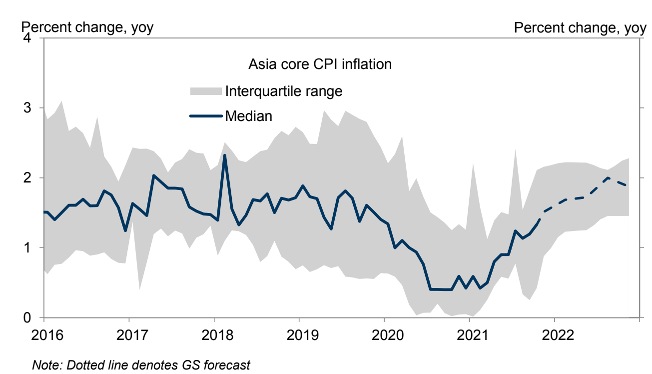
No. We expect headline CPI inflation to stay elevated in 2022 but not to rise sharply further in most economies (Exhibit 4). Core CPI inflation should continue grinding higher as economic activity improves and cost pressures are passed through (Exhibit 5). Food prices fell on average in the region in 2021, but are likely to bounce back somewhat in 2022. Conversely, the sharp inflation in producer prices (and in the energy component of CPI) is likely to ease notably this year, though price *levels* should stay high.

Exhibit 4: In most APAC economies, CPI inflation should remain somewhat elevated in 2022…



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 5: …as underlying inflation rises back to pre-Covid levels

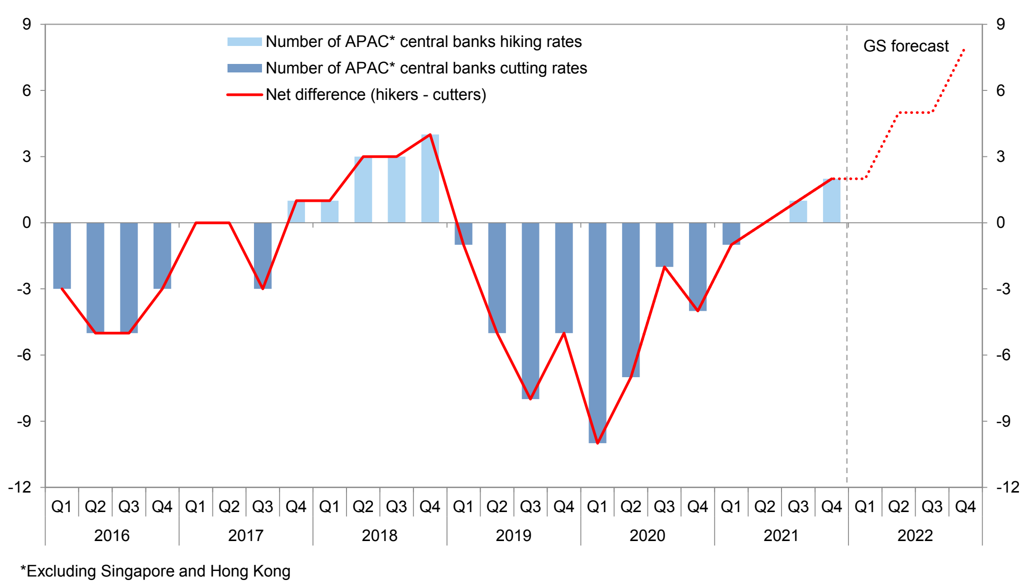


Source: Haver Analytics, Goldman Sachs Global Investment Research

5. How many regional central banks will tighten in 2022?

We expect a large majority (about two-thirds) to hike this year. Last year, the region was broadly on hold. The Bank of Korea and the RBNZ hiked twice each, and the Monetary Authority of Singapore increased the slope of appreciation of the SGD nominal effective exchange rate. We expect all three to tighten further in 2022, and to be joined by many of their peers in the region. The next group of central banks most likely to hike, in our view, are India, Malaysia, Indonesia, and Taiwan.

Exhibit 6: Regional monetary tightening cycle begins



Source: Haver Analytics, Wind, Goldman Sachs Global Investment Research

6. Can the Reserve Bank of Australia really stay on hold in 2022?

Yes. Despite a hawkish shift across many DM and small-open-economy central banks, and despite what is likely to be a wind-down of QE in coming months, we do not expect the RBA to hike rates this year given the relatively soft wage and domestic inflation dynamics. For example, trimmed-mean inflation has only just returned to the bottom of the RBA's 2-3% band after a seven-year undershoot, while core inflation measures in New Zealand, Canada, the US and the UK (to highlight several central banks that have adopted a more hawkish tone or already begun hiking) did not materially undershoot their respective targets prior to the Covid-19 pandemic and are now tracking well above target.

7. When will China remove quarantine requirements on travelers arriving from abroad?

Not before Q4, and quite possibly not in 2022.[1] Chinese policymakers appear intent on sticking with their "zero-Covid" strategy. Recent news that Sinovac offers limited protection against infection by the Omicron variant appears to have reinforced that view. The Winter Olympics will be conducted in a "bubble" and followed shortly by the annual "two sessions" policy meetings in Beijing, suggesting any significant loosening before Q2 is highly unlikely. Even then, it's clear that Covid-19 will be circulating widely outside China and with the 20th Party Congress approaching in Q4, we doubt policymakers

[1] Note we featured a similar question in our "Questions for 2021" publication, with a similarly pessimistic answer.

would eliminate quarantines before then. With transmission typically higher in the winter months, it's possible that border restrictions could be kept largely intact until spring 2023.

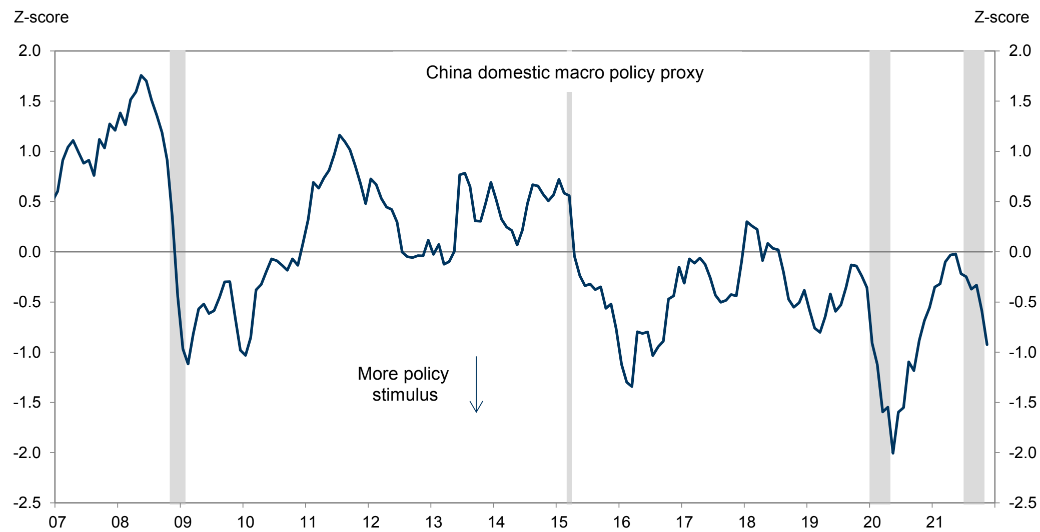
8. How much macro stimulus will China's policymakers deliver, and will this be enough to avoid a "hard landing" in the property sector?

We expect easing focused on credit and fiscal measures that cushions but does not fully absorb the downturn in housing:

- Material easing in fiscal policy. We expect our estimate of the "augmented fiscal deficit" to rise by at least 1pp on a full-year basis in 2022. This understates easing in some respects given that fiscal policy has already loosened somewhat over the past 2-3 months.
- Some acceleration in broad credit growth. Related to this, December's Central Economic Work Conference statement dispensed with the previous year's language that implied a stable macro leverage ratio.
- Modest additional monetary easing, including another RRR cut in Q1.
- Easing in housing-related regulations, particularly purchase-related restrictions at the local level and mortgage credit, some of which has already happened.

Of course, what constitutes a "hard landing" for property is subjective; some would say that's already happened. But we expect the majority of private developers to muddle through and only a moderate drag (~1pp) on overall GDP growth from this sector. (Though even a moderate drag would still represent a large swing in the contribution of housing relative to pre-pandemic growth.) Though we do not expect a collapse in property activity, we also do not expect strong reflation (e.g. high single-digit or double-digit increases in home prices).

Exhibit 7: Our China domestic macro policy proxy has eased anew, mainly driven by an easier fiscal stance



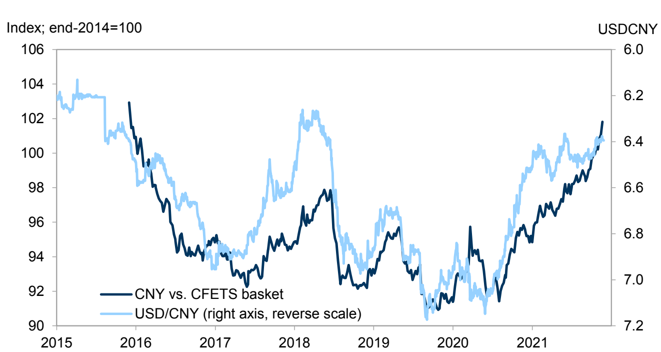
Note: Shaded areas refer to periods when the China Current Activity Indicator was below 5.5% on a three-month moving avg. basis.

Source: Goldman Sachs Global Investment Research, Wind, Haver Analytics, CEIC

9. Will the RMB depreciate significantly in 2022?

No. Chinese policymakers have recently indicated discomfort with further RMB appreciation. The PBOC raised the FX reserve requirement 2pp in December and also set a USDCNY fixing that was the weakest (relative to model expectations) in four years. Still, exchange rate fundamentals are strong. China continues to run a meaningful current account surplus, reflecting both strong goods exports and a smaller services trade deficit due to border quarantines. Net portfolio inflows should be solid in 2022, given ongoing passive flows related to index inclusions, and the possibility that equity inflows pick up on what should presumably be a better stock market performance this year than last. While China-US growth and rate differentials will be less of a tailwind, we expect small further gains (to 6.20 in 12 months' time) and think a reversal of 2021's appreciation is unlikely.

Exhibit 8: CNY strengthened against the USD and CFETS basket since mid-year 2020



*Map end 2016 index with new currency basket, starting from 2017

Source: CEIC, Wind, Goldman Sachs Global Investment Research

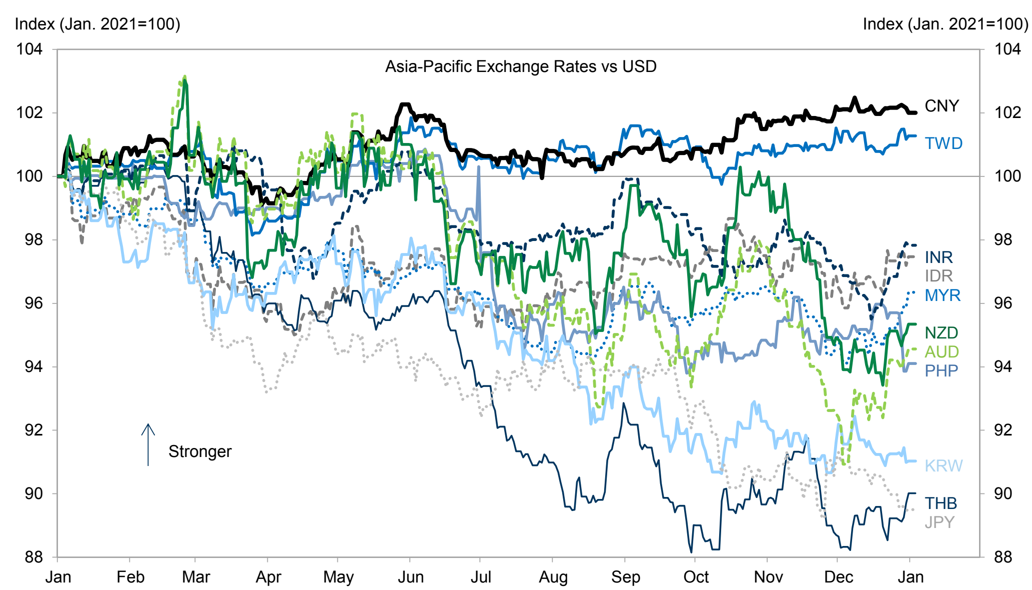
Exhibit 9: Still solid current account surplus in China

Source: Haver Analytics, SAFE

10. Will global reflation lift the Japanese economy and assets in 2022?

Yes. We expect Japan to post real GDP growth of 2.7% in 2022, which would be the fastest in a decade. This reflects both above-trend growth in the rest of the world and a relatively conducive domestic environment. New Prime Minister Fumio Kishida recently announced a mammoth 55tn yen fiscal stimulus package. While the effective stimulus will be far smaller—the headline number covers multiple years and measures such as loan guarantees—this nonetheless represents fiscal easing rather than the tightening we are seeing in most of the world. The yen was the weakest major currency in Asia in 2021 (Exhibit 10), contributing to the most stimulative Japanese financial conditions in years.

Exhibit 10: CNY strongest / JPY weakest major currency in the region in 2021



Source: Bloomberg, Goldman Sachs Global Investment Research

A brief recap of our questions and answers from 2021

In 2020 our performance was upended by the pandemic, but our confidence in a broad recovery helped us to a significantly better record in 2021.

1. Can regional growth outperform the consensus?

Our answer: Yes.

Verdict: Incorrect, based on the consensus at the time. Growth has indeed been robust in 2021, with our current estimate 6.8% for Asia ex-Japan, but this compares to a consensus of 7.5% at the outset of the year.

2. Which countries will be fastest (and slowest) to vaccinate and reach "herd immunity"?

***Our answer:* Smaller high-income economies will lead the pack.**

Verdict: Correct. South Korea, Singapore, Malaysia, Australia, and New Zealand have been among the leaders in the region (along with China and Japan). India, and the Philippines—large, lower-income economies—have lagged.

3. Will inflation test central bank tolerances on the upside?

Our answer: No.

Verdict: Correct. Most central banks stayed on hold in 2021, and with the exception of New Zealand, inflation was not the main driver for those that tightened.

4. Will the next regional monetary policy tightening cycle begin in 2021?

Our answer: No.

Verdict: Incorrect. While a broad tightening cycle has yet to begin, three countries did tighten monetary policy—South Korea, New Zealand, and Singapore—and this looks like the beginning of a broader wave.

5. Will any Asia-Pacific central banks ease further?

Our answer: Very few.

Verdict: Correct. China cut reserve requirements twice and also shaved relending rates recently, reflecting weak growth. Bank Indonesia cut rates 25bp in February.

6. Will China's macro policy tightening affect growth materially?

Our answer: **Enough to slow sequential growth in the second half of the year.**

Verdict: Correct. Sequential growth was pretty weak in the first half, in the 2-3% range, but slowed to below 1% in Q3.

7. Will China's current account continue to improve?

Our answer: No.

Verdict: Correct. China's current account surplus peaked at 2.8% of GDP (seasonally adjusted) in Q4 2020, and has ranged between 0.8%-2.4% in the first three quarters of 2021.

8. When will China remove quarantine requirements on travelers arriving from abroad?

Our answer: **Not before Q4, and quite possibly not in 2021.**

Verdict: Correct. (We have posed a similar question and answer for 2022.)

9. Will regional exporters still get a material boost from external demand?

Our answer: Yes.

Verdict: Correct. Regional export volumes grew at a double-digit rate 2021, and were particularly strong in North Asia.

10. How soon can social distancing measures be effectively eliminated across the region?

Our answer: **Not before the second half.**

Verdict: Correct. Our GS Effective Lockdown Index averaged less than 10 in China last year; ex-China it was around 30 in Q2-Q3 and fell to 14.5 in Q4, reaching its low near yearend.

11. Will China impose trade tariffs/restrictions on Australian iron ore exports?

Our answer: No.

Verdict: Correct.

12. Will India's credit cycle bottom out?

Our answer: Yes.

Verdict: Correct (barely). Credit to commercial entities hit troughs of around 5% yoy in both 2020 and 2021, though is currently growing only slightly faster (6.6% yoy).

13. Will India lose its investment grade status from one of the major rating agencies this year?

Our answer: No.

Verdict: Correct, though all three continue to rank India at the lowest investment grade notch, and Fitch has a negative outlook.

14. Will the CNY appreciate further in 2021?

Our answer: **Yes, but at a slower pace.**

Verdict: Correct. We referred to USDCNY in the discussion, which ended 2020 at 6.53 and ended at 6.36 for an appreciation of less than 3%, vs approximately 7% in 2020.

Bonus question - Will Japan hold a summer Olympics in 2021?

Our answer: Yes.

Verdict: Correct, though last year's Games featured a ban on foreign spectators.

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Reg AC

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