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Asia Views: 2023 Outlook: Inflation Peaks and Growth Troughs

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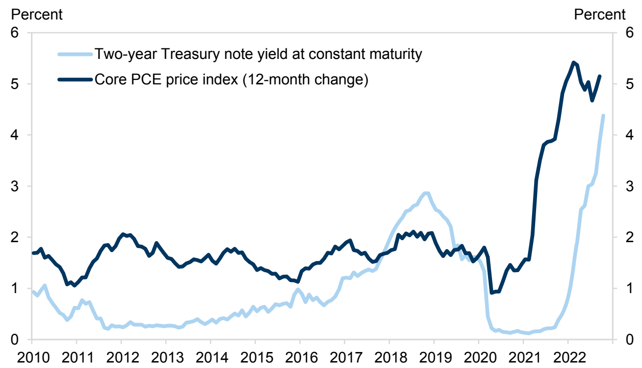
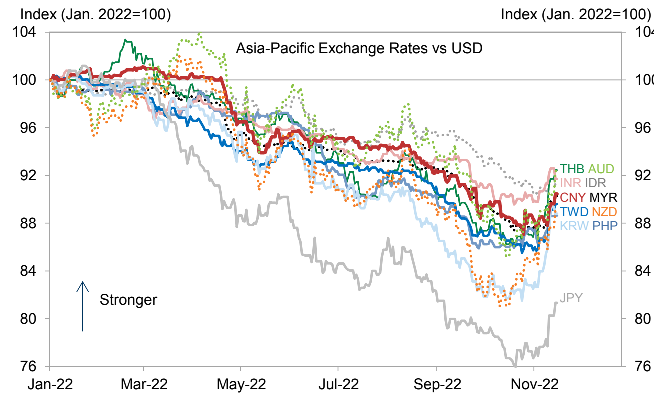
1. The year 2022 has been a tumultuous one in Asian (and global) financial markets. A surge in inflation drove an abrupt repricing of global rates – with the US 2y Treasury yield up roughly 400bp over the past year (Exhibit 1). Most of the Asia-Pacific region reopened from Covid, but China doubled down on containing the virus—suppressing economic activity. Russia's invasion of Ukraine pushed global commodity prices higher. Xi Jinping consolidated power at China's 20th Party Congress, and US-China tensions escalated. Most of these events proved challenging for regional asset prices, with bonds, equities, and regional currencies all taking a beating (Exhibit 2). Despite the headwinds, and a material slowdown in global growth, much of the region (ex-China/HK) still posted above-trend growth, with particularly strong activity in India and Southeast Asia.

Exhibit 1: A surge in inflation and interest rates



Source: Haver Analytics

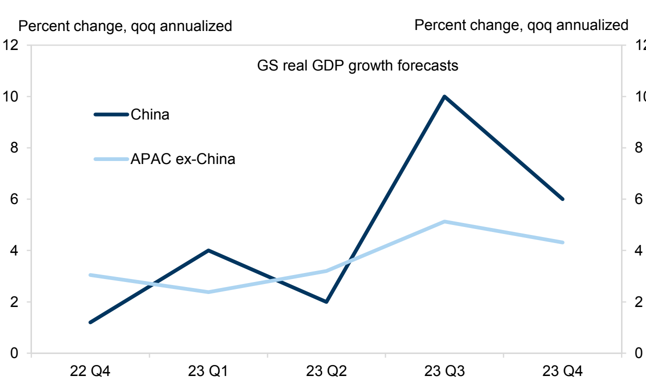
Exhibit 2: Regional currencies weakened sharply through October



Source: Bloomberg, Goldman Sachs Global Investment Research

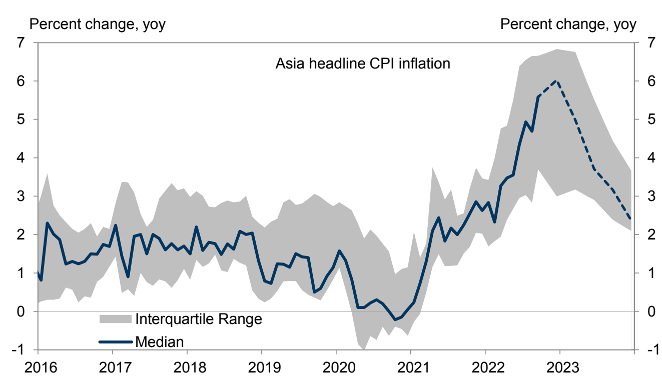
2. Looking ahead to 2023, economic growth is likely to start the year on the weak side across most of the Asia-Pacific – as a fading reopening boost, slowing global manufacturing cycle, and past monetary tightening weigh on activity. As these headwinds fade and China's reopening gets underway, we expect growth to reaccelerate. While most of our GDP forecasts are a little below consensus for 2023 as a whole, we are more positive on second-half growth, particularly in China (Exhibit 3). In contrast, inflation is likely to come off the boil as commodity price gains slow or reverse, regional currencies stabilize, and soft growth tempers domestic price pressures (Exhibit 4). These conditions should allow Asia-Pacific central banks to stop hiking in Q1 or Q2 and, in a few cases, begin contemplating cuts late in the year. (See tables at the end of this report for our updated growth, inflation, and policy views.) This improving growth/inflation tradeoff sets up potentially better outcomes for regional asset markets in 2023.

Exhibit 3: Growth weak now, better in late 2023



Source: Goldman Sachs Global Investment Research

Exhibit 4: Regional inflation close to a peak



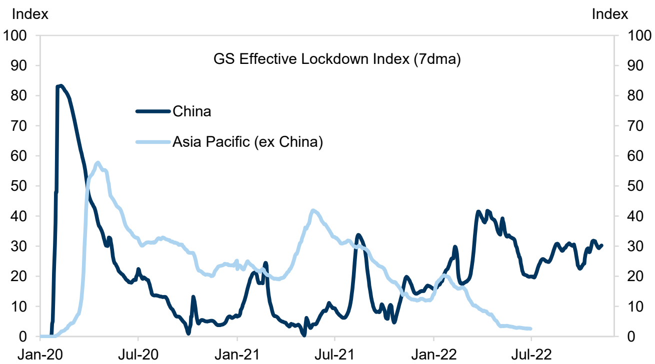
Note: Dotted line denotes GS forecast

Source: Haver Analytics, Goldman Sachs Global Investment Research

3. China's economy faces a trifecta of growth challenges as 2023 approaches. First, the combination of a zero-Covid stance and more infectious Omicron variants of the coronavirus has led to significant restrictions, with our Effective Lockdown Index around 30 (versus an average of less than 10 in 2021 – see Exhibit 5) but daily reported cases nonetheless rising towards record levels. Second, the property sector slump continues, as regulatory controls on credit front-loaded an inevitable demographic downturn,

creating uncertainty around the viability of private developers and pushing down sales and construction (Exhibit 6). Third, China's pandemic-era export boom is clearly fading. Though the country reported a trade surplus of >$100bn in July, the largest in world history, exports are now down slightly year-over-year and are likely to be sluggish going forward. Collectively, these forces have pushed down official GDP growth to what looks likely to be 3% for 2022 as a whole, and contributed to material slack in the labor market, with youth (16-24yo) unemployment at 17.9%, nearly double its pre-Covid level.

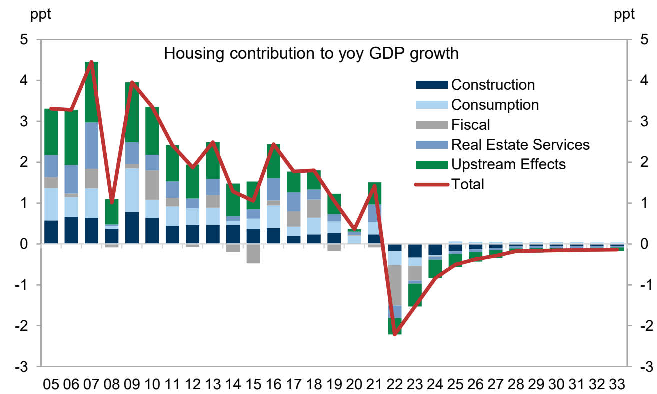
Exhibit 5: China's Covid restrictions remain elevated



Last accessed: July 3, 2022

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

Exhibit 6: Property drag on China's economy to fade in 2023 and beyond



Source: Haver Analytics, Goldman Sachs Global Investment Research

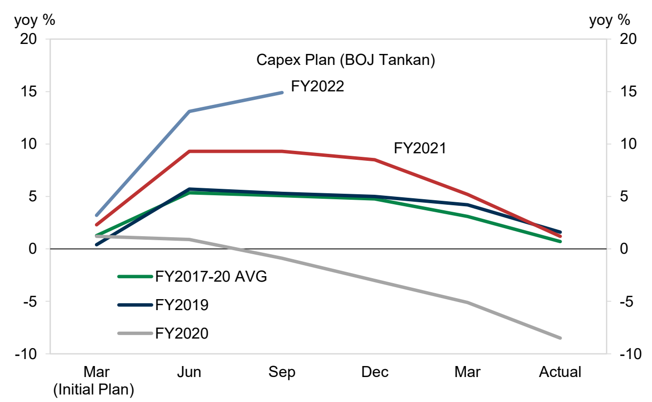
4. In response, China's policymakers are beginning to "pivot". October's 20th Communist Party Congress had left many observers concerned that growth would take a backseat to other policy objectives (more on this below). But even if leaders' priorities have shifted, a very weak economy—as suggested by the latest October macro data—ultimately could be destabilizing and put other goals at risk. Policymakers have already rolled out Covid policy adjustments—not dramatic changes, but an encouraging signal that more significant reopening steps could be in store in 2023. We expect China to begin easing zero-Covid policies in earnest shortly after March's Two Sessions, though reopening will likely take several quarters, pausing during significant resurgence of the virus. Similarly, policymakers' new support measures related to the property sector don't resolve default risks, but should ease short-term funding pressures, buying time to consider further steps at December's Central Economic Work Conference and the Two Sessions. Broad macro policy is likely to remain supportive into early 2023, though will be dialed back somewhat once growth improves. We think reopening, a shallower pace of decline in property activity, and a recovery in the global goods cycle could collectively push China's GDP growth from well below trend in H1 (3% annualized) to well above trend in H2 (8%).

5. China-US tensions escalated this year. Despite China's apparent adherence to US sanctions on Russia, the "no limits" Russia-China partnership and increased imports of Russian commodities rankled US officials. From China's perspective, US House Speaker Nancy Pelosi's visit to Taiwan in August crossed a key "red line". Just prior to the 20th Party Congress, the US imposed export controls on advanced semiconductor chips and the equipment and software necessary to manufacture them, a potential blow to

China's stated goal of technological development that could impose a material drag on growth. President Xi's consolidation of power at the 20th Party Congress, emphasis on "security", and increased focus on Taiwan fanned US concerns. Increasingly, Chinese and US policymakers have appeared to be trapped in a classic "prisoner's dilemma", where a lack of trust leads to outcomes that are ultimately far from optimal for both sides. Against that low bar, this week's meeting between presidents Xi and Biden at the G20 summit in Bali exceeded expectations, with both leaders indicating a desire to avoid conflict and resume working-level diplomatic exchanges

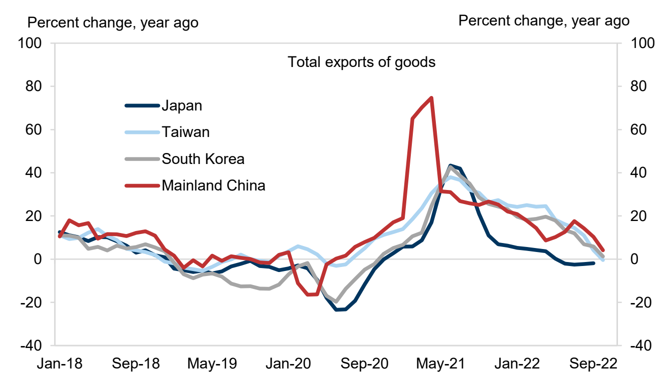
6. Japan's reopening boost should fade over the next few quarters, but we expect labor market tightness to motivate faster capex growth (Exhibit 7), keeping overall GDP growth at 1.3% in 2023, a half-point above trend. Inflation should stabilize somewhat in 2023, as JPY depreciation eases, food price pressures fade, and government subsidies help to cap energy prices; wage growth has been picking up but is likely to remain well shy of the 3% pace the Bank of Japan thinks consistent with its CPI inflation target. The BOJ is set for a major leadership change in 2023: Governor Kuroda's second term ends in April and those of the two deputy governors expire in March. Nonetheless, we do not expect a change in policy rates in 2023, given the risks of tightening amid slowing global growth and the Kishida administration's revealed preference for fiscal policy as a tool to cushion inflation pressures on households. However, adjustments to the BOJ's forward guidance and/or the yield curve control band are certainly possible.

Exhibit 7: Capex to power Japanese growth in 2023



Source: BoJ, data compiled by Goldman Sachs Global Investment Research

Exhibit 8: Deceleration in Asia goods trade

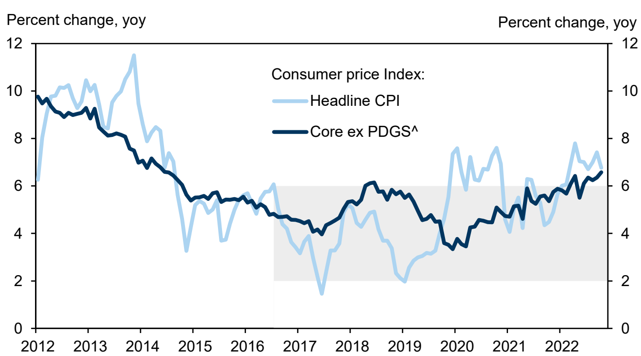


Source: Haver Analytics

7. The ebbing global goods cycle has been evident in northeast Asia in recent months, with South Korean and Taiwanese exports slowing sharply alongside those from mainland China (Exhibit 8). Culprits include a post-Covid global shift back from goods to services demand, weakness in the "tech cycle" as tighter financial conditions start to weigh on investment, and nascent inventory corrections in some sectors. We expect goods production and trade to remain soft into early 2023, keeping GDP growth in these economies below potential. CPI inflation in Korea and Taiwan has slowed in recent months (though in Korea it remains quite high at 5.7% yoy), and should decelerate further. In Korea, a surprise default on an asset-backed security guaranteed by a local government has led to elevated financial stress in recent weeks, but we do not expect systemic issues as the Bank of Korea and other regulators have acted quickly to provide liquidity.

8. India is entering a window of strategic opportunity for reform and rapid development. Domestically, conditions have normalized after the damaging Covid pandemic. Demographic tailwinds will continue through the coming decade. Efforts to implement tax reforms (GST) and digital platforms (Aadhaar) under the current and previous governments are beginning to pay dividends. The political setup is conducive to further economic reforms as India's ruling BJP/NDA government has comfortable majorities, with the next general election 18 months away. Internationally, global firms are looking to diversify sources of supply ("China +1"), and India presents a potentially attractive consumer market over the long term, a favorable backdrop for PM Modi's "Make in India" initiative. Given its strategic importance, India has stayed on good terms with both the West and Russia, allowing it to continue trading with the latter. In short, if India can continue economic reform, it has a golden opportunity to attract foreign investment and boost potential growth beyond the 6% we estimate currently. Policymakers are also likely to ease barriers to foreign portfolio inflows, in our view, with an effort to achieve inclusion in global bond indexes in coming years. Key risks include ongoing current account deficits, above-target inflation (Exhibit 9), and still-negative real policy rates, all of which point to further RBI hikes in the near term (Exhibit 10).

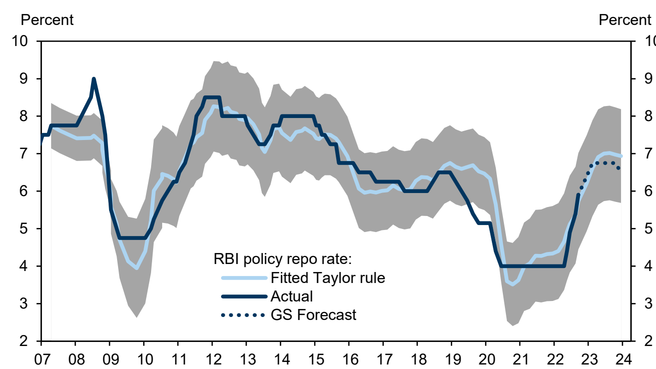
Exhibit 9: Underlying inflation still grinding higher in India



^Core ex PDGS inflation is headline inflation excluding food, fuel, petrol, diesel, gold and silver inflation. *Shaded area denotes the official inflation target of 4%+/-2%

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

Exhibit 10: Our RBI "Taylor rule" suggests hiking cycle not yet finished



Shaded area denotes +/- 1 standard deviation bands

Source: Goldman Sachs Global Investment Research, Haver Analytics, Bloomberg, RBI

9. ASEAN economies could enjoy a privileged geopolitical position in coming years for similar reasons, as US-China rivalry drives both countries to invest and deepen ties in the region. Indonesia, Vietnam, and the Philippines all have young, relatively fast-growing populations of ~100m+ and should see potential growth of 4.5-6.5% in coming years. Thailand and Malaysia could post decent (~4%) growth next year on normalizing global tourism and travel, though each country faces some political uncertainty (including a general election in Malaysia in coming days). We forecast above-consensus CPI inflation and policy rates across all ASEAN economies in 2023. External balances are also in focus, with the Philippines' large current account deficit (2022E: 6.6% of GDP) to narrow only slightly in coming years given ongoing infra investment; alongside dwindling reserves this will keep pressure on BSP to stabilize the peso with rate hikes. Thailand's current account should move back near balance next year on a tourism rebound, while Indonesia's could return to deficit by 2024 on relatively strong growth and some erosion in the terms of trade.

10. In Australia and New Zealand, accelerating and broadening price pressures have kept pressure on central bankers to tighten, which in turn is likely to contribute to slower growth over the coming year (we forecast 1.9% real GDP growth in 2023 and 1.7% in 2024). The RBA's trimmed-mean CPI accelerated to 6.1% yoy in Q3, and ~70% of the inflation basket is now rising faster than 3% yoy (the upper bound of the RBA's inflation target band). The RBA downshifted to 25bp at its October meeting, which we think increases the risk of a longer tightening cycle (through May 2023) and higher terminal rate (4.1%). The story is qualitatively similar in New Zealand, but we expect the RBNZ to hike 75bp in its upcoming meeting before slowing and ultimately peaking at 5% in mid-2023. Both the RBA and RBNZ are apt to find space to ease modestly in 2024.

11. Risks are plentiful, but arguably more two-sided after this year's adjustments in the global economy and markets. Outside the region, the path of US inflation remains a critical uncertainty given this underlies the Fed tightening that has weighed so heavily on regional currencies and markets. On the growth outlook we are principally focused on the possibility that energy shocks and/or overtightening materially worsen prospects for key Asian export markets, especially the US and Europe. Any sign of a lasting ceasefire in Ukraine would of course be welcome. Within the region, the timing and extent of China's reopening is probably the biggest uncertainty.

12. Across markets, 2023 could mark a rotation away from "late reopeners" (South and Southeast Asian economies that outperformed this year) as policy tightens in those countries.

Exhibit 11: At or below-trend growth in most Asian economies in 2023

Real GDP Growth (year-over-year)

	2021	2022		2023		Potential Growth (2023)
		GS	*Consensus*	GS	*Consensus*	
Asia ex-Japan	7.3	3.7	*3.9*	4.4	*4.6*	
China	8.1	3.0	*3.3*	4.5	*4.8*	4.2
India	8.3	6.9	*7.1*	5.9	*5.8*	6.0
South Korea	4.1	2.4	*2.6*	1.4	*1.8*	2.5
Hong Kong	6.3	-3.2	*-1.2*	2.5	*3.0*	2.8
Taiwan	6.6	2.8	*3.2*	1.9	*2.3*	2.5
ASEAN	3.9	5.7	*5.4*	4.3	*4.7*	
Singapore	7.6	3.7	*3.7*	1.5	*2.6*	2.2
Malaysia	3.1	9.2	*7.2*	4.0	*4.3*	4.3
Thailand	1.5	3.4	*3.3*	4.0	*3.9*	2.6
Indonesia	3.7	5.2	*5.3*	4.4	*4.9*	4.8
Philippines	5.7	7.2	*6.8*	5.8	*5.7*	6.1
Vietnam	2.6	7.0	*7.3*	5.8	*6.5*	6.5
Japan	1.7	1.5	*1.6*	1.3	*1.4*	0.8
Australia	4.9	4.0	*4.0*	1.9	*2.0*	2.1
New Zealand	5.6	2.4	*2.2*	1.8	*1.6*	2.4
USA	5.9	1.9	*1.8*	1.0	*0.4*	1.8
Euro area	5.3	3.3	*3.1*	-0.1	*-0.1*	0.9

Note: All forecasts are calculated on calendar year basis. India consensus is from IMF.
Potential growth is median of GS estimates for 2023-2025 for USA and Euro area.

Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 12: Inflation remains on the high side in 2023 (ex-China)

Consumer Prices (year-over-year)

	2021	2022		2023		Inflation Target/ Range
		GS	*Consensus*	GS	*Consensus*	
Asia ex-Japan	2.3	4.4	*4.4*	3.9	*3.3*	
China	0.8	2.0	*2.2*	2.2	*2.4*	3.0^
India	5.1	6.8	*6.7*	6.1	*5.3*	2.0-6.0
South Korea	2.5	5.2	*5.2*	3.2	*3.2*	2.0
Hong Kong	1.6	2.0	*2.0*	2.4	*2.3*	-
Taiwan	2.0	3.0	*3.0*	1.6	*1.8*	0.0-2.0
ASEAN	2.2	4.9	*4.8*	4.6	*3.5*	
Singapore	2.3	6.4	*6.0*	5.8	*3.7*	1.0-2.0
Malaysia	2.5	3.5	*3.3*	4.2	*2.6*	-
Thailand	1.2	6.2	*6.2*	3.2	*2.5*	1.0-3.0
Indonesia	1.6	4.5	*4.4*	5.1	*4.4*	2.0-4.0
Philippines	3.9	5.7	*5.4*	5.1	*4.2*	2.0-4.0
Vietnam	1.8	3.2	*3.5*	4.3	*3.7*	4.0
Japan	-0.2	2.4	*2.3*	2.5	*1.6*	2.0
Australia	2.9	6.6	*6.4*	5.0	*4.7*	2.0-3.0
New Zealand	3.9	7.0	*6.9*	4.1	*4.1*	1.0-3.0
USA	4.7	8.0	*8.1*	3.8	*4.1*	2.0
Euro area	2.6	8.7	*8.5*	8.1	*5.8*	2.0

^We see the "target" as the upper band of the desirable range.

Note: All forecasts are calculated on calendar year basis. Bloomberg FY forecasts used for India consensus when quarterly figure not available

Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 13: APAC policy rates to peak in early 2023

Policy Interest Rates (percent)

	Current	2022				2023			
	15-Nov	1Q	2Q	3Q	4QF	1QF	2QF	3QF	4QF
Asia ex-Japan									
China	2.00	2.10	2.10	2.00	2.00	2.00	2.00	2.00	2.00
India	5.90	4.00	4.90	5.90	6.40	6.75	6.75	6.75	6.50
South Korea	3.00	1.25	1.75	2.50	3.25	3.50	3.75	3.75	3.50
Hong Kong	-	-	-	-	-	-	-	-	-
Taiwan	1.63	1.38	1.50	1.63	1.75	1.88	2.00	2.00	2.00
ASEAN									
Singapore	-	-	-	-	-	-	-	-	-
Malaysia	2.75	1.75	2.00	2.50	2.75	3.25	3.50	3.50	3.50
Thailand	1.00	0.50	0.50	1.00	1.25	1.75	2.00	2.50	2.50
Indonesia	4.75	3.50	3.50	4.25	5.50	6.25	6.25	6.25	6.25
Philippines^	4.25	2.00	2.50	4.25	5.50	6.00	6.00	6.00	6.00
Vietnam	6.00	4.00	4.00	5.00	7.00	7.00	7.00	7.00	7.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Australia	2.85	0.10	0.85	2.35	3.10	3.60	4.10	4.10	4.10
New Zealand	3.50	1.00	2.00	3.00	4.25	4.75	5.00	5.00	5.00
USA	3.88	0.38	1.63	3.13	4.38	4.88	5.13	5.13	5.13
Euro area	1.50	-0.50	-0.50	0.75	2.00	2.75	3.00	3.00	3.00

Policy interest rates: China: 7-day OMO rate, India: repo rate; Korea: 7-day repo; Malaysia: overnight policy rate;
Thailand: 1-day repo, Philippines: repo rate, Indonesia: 7-day reverse repo rate, Taiwan: rediscount rate; Vietnam: re-financing rate;
USA: Fed funds effective rate; Euro Area: Deposit facility rate; Japan: Short-term policy rate.
^Starting from 2016 Q2, we forecast the overnight reverse repurchase facility (RRP) rate after BSP shifted to the IRC system.
We interpret this change as a purely operational change, not as a change in policy stance

Source: Haver Analytics, Goldman Sachs Global Investment Research

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Reg AC

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