Coface
Asia Pacific Macro Intelligence

ASIA PACIFIC REGION   www.coface.com

OCTOBER 2022 ISSUE

› Increasing global uncertainty, with rising recession risks in US and Eurozone
› APAC recovery shifts from external to domestic demand
› Inflationary pressures no signs of abating
› Rapid interest rate rises disruptive to businesses

The global outlook is increasingly uncertain. Recession risks in major advanced economies are growing. Recent Bloomberg polls place the probability of recession in the US and Eurozone over the next 12 months at 60% and 80% respectively. The emergence of a 'hard-landing' shock in advanced economies will have spill-over effects for Asia, posing risks to the current Asian recovery.

With growth in global trade volume softening, September saw a loss of momentum in Asia manufacturing output. The source of growth has turned from external to domestic demand, reflected in economic expansion shifting from manufacturing to services. Most of the Asian sectors indicating growth in the third quarter were in services. This shift contributed to weaker goods export growth and a build-up of inventory levels. In China, consumption remains a weak link amid the zero-Covid stance, with its growth outlook darkening. We downgraded China's 2022 GDP forecast to 3.2%. There are still some bright spots, however. Economies with borders reopened and mobility curbs lifted recently, such as Southeast Asia, should see growth supported by a recovery in services and tourism activity.

We have fallen into a world of higher inflation and higher interest rates. Consequently, the APAC region faces formidable headwinds in the coming quarters, with the global electronics slowdown, and new US export controls on advanced semiconductors and chip-making tools posing an additional risk of disruption to global electronics supply chains, which will have consequences for economies such as Taiwan, South Korea and Japan.

COFACE ASIA PACIFIC ECONOMIC RESEARCH

Bernard AW
Economist for Asia Pacific
Singapore

Eve BARRE
ASEAN Economist
Singapore

Click here for more economic, country and sector risk research publications.

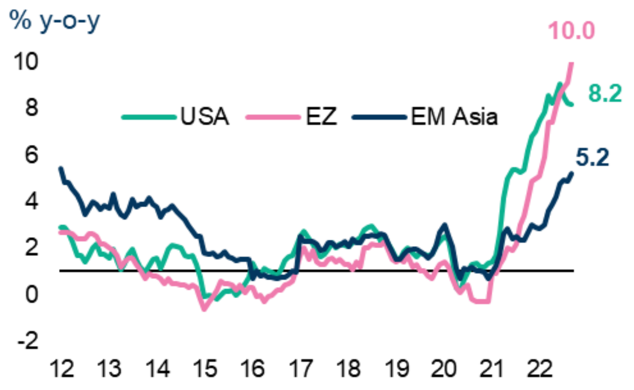
Asia Pacific Macro Intelligence (APMI) *is a monthly report providing Coface economists' views on the latest macroeconomic trends across the Asia Pacific region, with a focus on economic indicators that are relevant to business operations, including commodity prices, financial conditions, and supply chain developments. This report is aimed at business decision makers involved in risk management, finance, and corporate strategy.*

www.coface.com

coface FOR TRADE

CONTENT

Asian inflation rising fast



Source: Refinitiv Datastream, Coface

Asia inflation show no signs of easing yet

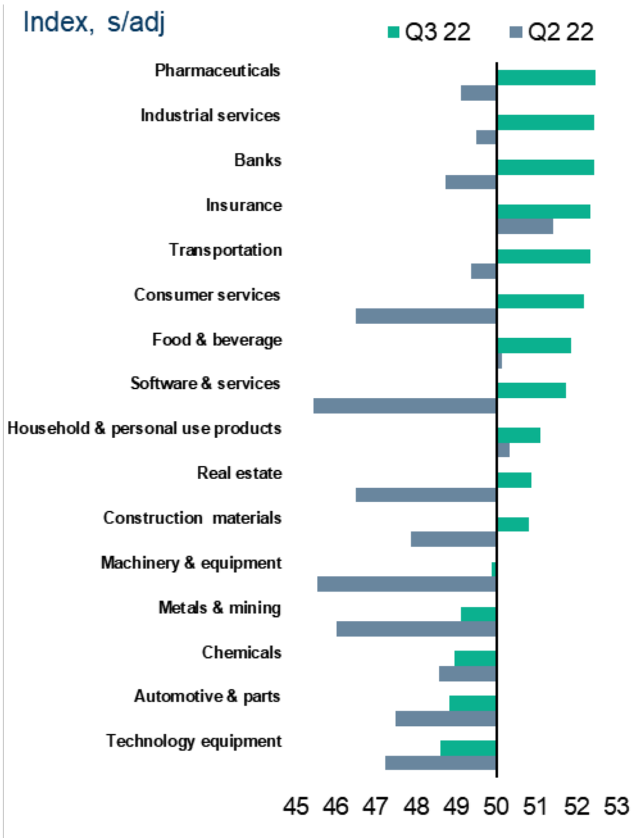
Emerging Asia inflation accelerated in September, surpassing an annual rate of 5% according to Coface's calculations, the fastest since 2011. This suggested that the inflation peak could be delayed by a few months, which will have implications for businesses since continuously passing on higher costs to customers is not sustainable. Meanwhile, higher material costs have filtered through to a wider range of goods and services, with core inflation rate gaining momentum. Persistently high inflation would raise consumers' inflation expectations, which will act as a constraint on private expenditure, particularly on non-essential purchases.

An inability to tame persistently high inflation will keep the US Federal Reserve stepping hard on the 'tightening' pedal which, in turn, continues to pressure Asian central banks to raise interest rates, and becoming more selective with credit.

Key headwinds in coming months

The key headwinds that would affect the Asia Pacific economy over the next 12 months are (1) persistently high cost inflation, resulting in a sustained margin squeeze for corporates, and constraint on consumption; (2) higher interest rates and tighter financial conditions; (3) worsening China's slowdown; (4) global recession.

Asia sector PMI led mostly by services in Q3



Source: S&P Global, Coface

Bernard AW
Economist for Asia Pacific
Coface

Material costs and business profitability

Slower rise in material prices in September brings scant relief

Global commodity prices rose at a slower pace in September amid an easing in energy cost growth, but this hardly provided relief to businesses, particularly energy-intensive ones. Despite a further softening of industrial material prices, such as metals, hardwood, rubber and cotton, input costs remained elevated (36% higher than 2021 average). This continued to keep pressure on Asian manufacturers' margins as softening demand and rising inventories have weakened companies' pricing power.

Slower rise in energy costs

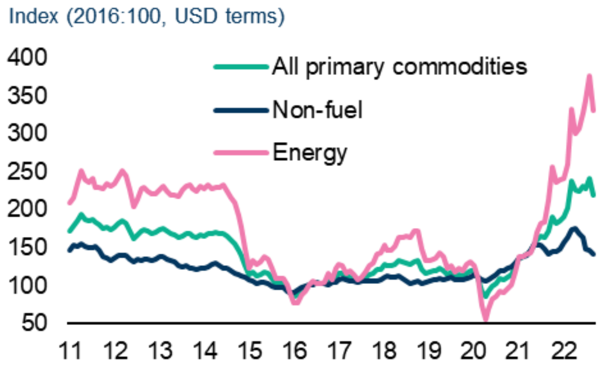
The rise in global commodity prices lost some momentum as energy costs, especially natural gas, rose at a slower rate, according to IMF data. The Natural Gas Price Index increased by an annual rate of 110% in September, down from 266% in August, but still a significant rise. The European benchmark for natural gas, the Dutch TTF, fell from a monthly average of $70/mbtu to $55 in September, but is over three times higher than the 2021 average of $16 amid tight supply and geopolitical uncertainty. LNG Northeast Asia prices likewise remained elevated at $45/mbtu (2021 average: $19). The decision by China to halt LNG resales to buyers in Europe and Asia could restart an upward push on LNG prices. Coal prices continued to rise at triple-digit rates (+115%).

Meanwhile, industrial input prices continued to fall in September, down for a fifth straight month, weighed down by a further decline in metals prices, and a slower rise in agricultural raw material costs (e.g. timber, cotton, rubber, wool). Food price growth continued to slow, with September seeing the weakest rise (+4.1%) since 2020.

Asian firms see rising margin pressure

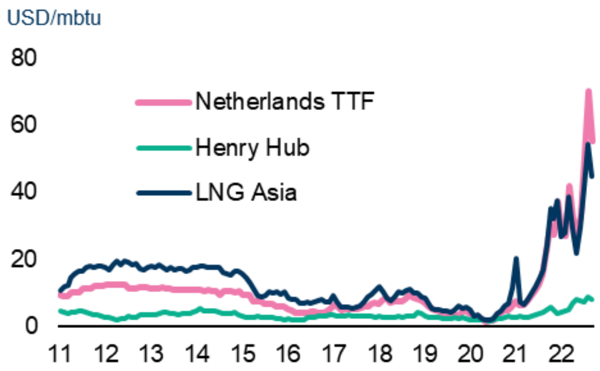
The pressure on American manufacturers' margins continued to ease in at the end of the third quarter, reflected by September PMI data. By contrast, European and Asian goods producers reported a deepening of margin pressures, with the difference between PMI output prices and input prices widening in September after several months of narrowing. Elevated energy costs, especially natural gas prices, have limited the extent to which margin pressures can be alleviated amid a weakening global demand. Companies that rely on natural gas as a key input will continue to face a heavy cost burden in raw material, while those that depend on petroleum may not see significant relief from spot crude prices with OPEC+ deciding to cut output to support prices in response to expectations of lower demand.

Energy price surge push commodity costs up



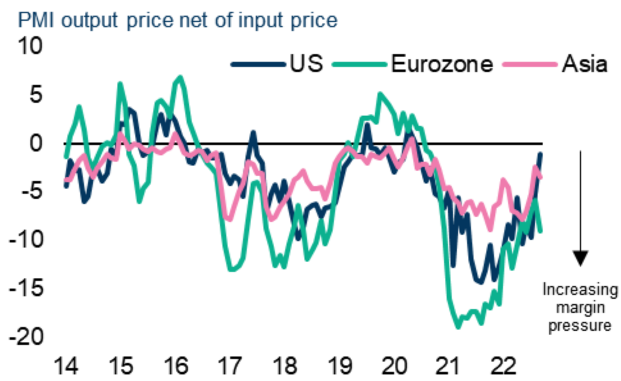
Source: IMF

Europe, Asia gas prices eased in Sep but still high



Source: IMF

Margin pressures rise for Asia manufacturers



Source: S&P, Coface

Monetary policy and financial conditions

Tightening financial conditions pose funding risks amid rising cost pressures

The global shift to rate increases contributed to a tightening of financial conditions across the world, including in APAC. The number of regional central banks tightening their policy has grown over recent months, with Vietnam being the latest joiner. Rising interest rates and tightening financial conditions would raise funding risk.

Asia rate tightening gains momentum

Monetary tightening is accelerating in Asia-Pacific amid an increasingly broad-based inflation. With the US Federal Reserve expected to raise its interest rate to around 4.5% by end of the year, concerns over capital outflows and local currency depreciation were at the top of Asian central banks' mind. An aggressive Fed pressured Asian central banks to take larger-size hikes, with Vietnam putting in a 100bps hike (first increase since 2020), while Indonesia delivered two 50bp-hikes in September and October after a 25bps rise in August. Except Sri Lanka and Pakistan, Hong Kong has raised its policy rate the most this year, with a cumulative 300 basis points, followed by Australia and New Zealand.

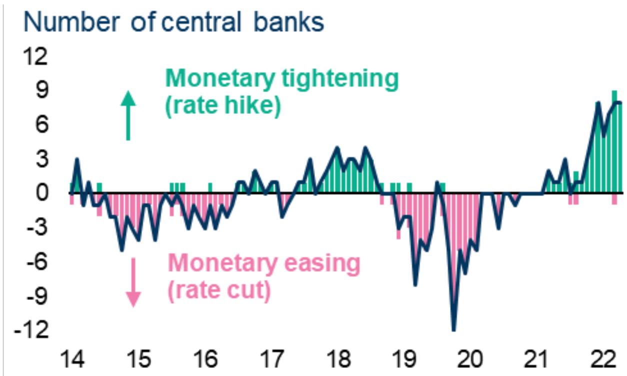
Tighter financial conditions

Asia's financial conditions tightened further in September, according to our calculations based on Goldman Sachs Financial Conditions Index (FCI) data. Figures for the first half of October suggest a continuation of the trend. An increasing tightening stance from the Fed and Asian central banks had affected bond yields, corporate yields, trade-weighted exchange rates and the stock markets, factors that affect financial conditions. Tightening financial conditions were broad-based across the region. Despite massive pressure on the yen, Japan continued to be the outlier, though any emerging signs of stronger wage growth could prompt a policy shift.

Widespread currency depreciation

The relentless rise of the US dollar against a broad range of currencies placed many Asian currencies under immense depreciation pressure. The Japanese yen (JPY) was the worst hit, touching 150 and down well over 20% against the USD so far this year. The key drivers of JPY weakness were interest rate differentials (Japan vs US), Japan's trade deficit, and speculative positions in financial markets reflecting risk sentiment. The renminbi has also weakened past 7 against the dollar since mid-September.

Rising number of APAC central banks tighten policy

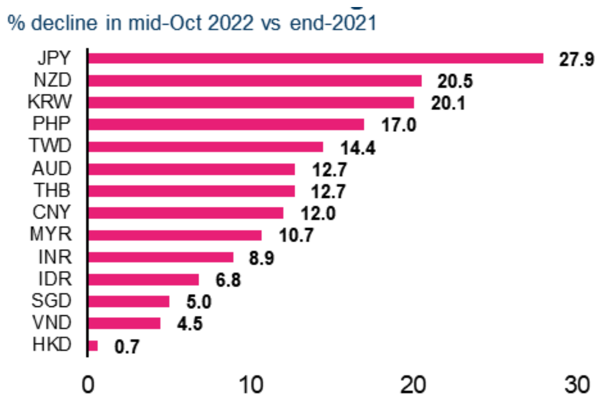


*APAC sample consists of 15 economies (AUS, NZL, CHN, HKL, TWN, JPN, KOR, IDN, THA, MYS, PHL IND, BGD, LKA, PAK)
Source: Refinitiv Datastream, Coface

Asia financial conditions tightening

Asia FCI is an equally-weighted index of eight GS Asian FCI
Source: Bloomberg, Goldman Sachs FCI series

Broad depreciation in APAC currencies against USD



Source: WM/Refinitiv, Coface

Supply chain developments

Supply pressures ease on lower demand; container freight rates fall further

Growing signs of weakening global trade demand, rising inventories, and high inflation constraining consumption provided relief to worldwide supply conditions. While this brought about a further decrease in container shipping rates, dry bulk shipping costs rebounded as demand for grains and coal rose, partially driven by geopolitical tensions and some countries imposing export restrictions on agricultural products.

Global supply pressure eases further

Global supply chain conditions eased for a fifth straight month in September, according to the Global Supply Chain Pressure index (GSCPI), compiled by the New York Fed. The GSCPI fell to a near two-year low as global goods demand continued to weaken through the third quarter, with global manufacturing new orders PMI dropping to the lowest since mid-2020. Rising inventories amid signs of softening demand led companies to be more cautious about building more stocks.

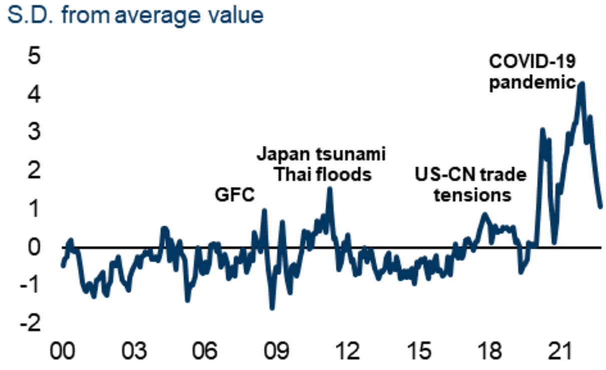
PMI data also indicated a further easing in supply disruptions in the US, Eurozone, and ASEAN. However, East Asian economies, especially Japan automakers, continued to report supply issues impacting their production volumes. Honda and Toyota both announced production cuts for October due to ongoing supply chain and logistical problems.

Falling freight rates, but dry bulk costs up

Ocean freight rates continued their decline in mid-October, with China–US East Coast/West Coast prices decreasing 70% and 84% respectively from the same week a year ago. The decline reflects weakening demand for sea-freight, linked to excess inventories among importers (retailers, wholesalers, etc), and many retailers already brought forward their peak season orders to avoid delays.

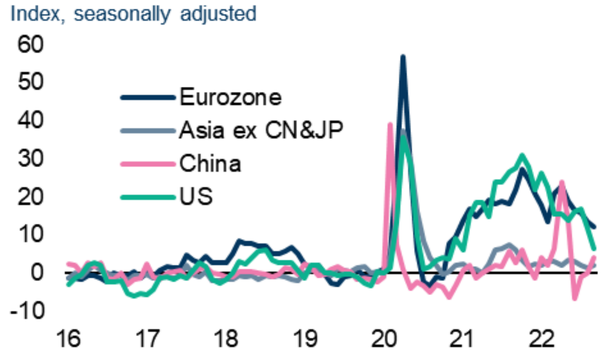
The Baltic Index (BDI), a leading indicator of economic activity by measuring changes in the shipping costs of dry bulk commodities such as coal, grain and steel, continued its rise through the first half of October due to rising grain exports from the Americans and EU imports of coal from the US, Australia and Indonesia. However, the BDI remained 18% lower than at the start of the year. Meanwhile, the Harpex Index, which looks at ship chartering price development, continued its decline.

Supply chains pressure eases further



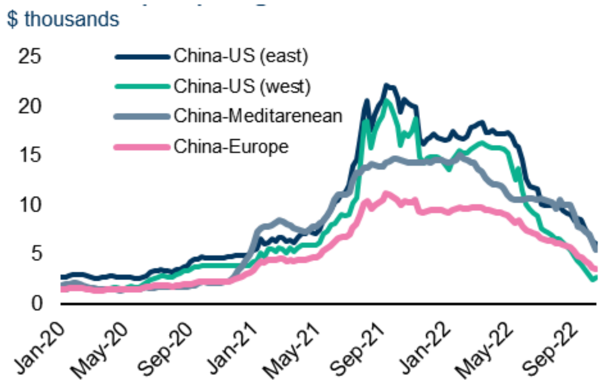
Source: New York Fed, Coface

Supply disruptions eased further in US, Eurozone



* Difference between PMI delivery simes and output indices
Source: S&P Global, Coface

Shipping rates continued to decline



Source: Freightos, Coface

Coface Q3 2022 Barometer*

A cold chill on the global economy

By Coface Economic Research team

Executive summary

As autumn sets in across the northern hemisphere, the skies are darkening over the global economy. Beyond the repercussions of the war in Ukraine, which we highlighted in our last barometer, the global monetary tightening and the multiple constraints on Chinese growth paint a gloomy outlook, to say the least. In the short-term, the economy seems to be settling into a regime of "stagflation", where almost no growth and rapidly rising prices coexist. The possibility of a global recession, meanwhile, is becoming clearer. The general downward revisions to our GDP growth forecasts this quarter reflect this.

Our assessment changes are also consistent with this logic and with the numerous downgrades made last quarter. Coface has downgraded eight countries (Italy, Denmark, Switzerland, Cyprus, Luxembourg, Malta, Egypt and Chile), after 19 in the second quarter. The 49 sector risk assessment downgrades highlight the clear deterioration of conditions in sectors sensitive to the economic cycle (construction, metals and wood).

Over Europe, more than anywhere else, the clouds are particularly threatening. Following the complete shutdown of the Nord Stream gas pipeline at the beginning of September, the energy crisis triggered by the Russian invasion of Ukraine is intensifying. The Old Continent is therefore preparing for "imposed" sobriety, as the European Union has finally agreed on a plan to reduce gas consumption, while some industries have announced that they would reduce their production to cope with soaring energy costs. As the region prepares to wrap itself in its winter clothes, it seems inevitable that it will have to ration its energy consumption, especially of natural gas and electricity. Germany, the continent's leading industrial power, will be at the forefront of this crisis.

Concomitantly, inflationary pressures, exacerbated by the war, show little sign of abating. The major central banks, led by the U.S. Federal Reserve (Fed), remain resolutely aggressive to contain inflation. Breaking the low interest rate environment that prevailed following the global financial crisis (2008-2009), particularly in the advanced economies, most of them (United States, Canada, Europe, United Kingdom, Australia, etc.) have already returned to key interest rate levels unseen in the last decade. Far from being deterred by the growing signs of a slowdown in activity, they are even intensifying their efforts to curb inflation. In the dock - sometimes wrongly - for letting the inflation genie out of the lamp, central banks are now at risk of dragging the global economy into a major slowdown or even a recession. This is particularly acute in the case of the Fed, whose aggressiveness is leading to increased monetary tightening in other countries - especially emerging countries - in order to stem the depreciation of their currencies against the USD (a reverse "currency war"). Such a tightening of global monetary and financial conditions, should it continue at the current pace, would obviously threaten global growth and financial stability.

In addition to this already gloomy picture, the Chinese economy is experiencing difficulties: the real estate crisis is still simmering and the "zero-COVID" policy continues to penalise domestic activity, with repercussions on supply chains in Asia, Europe, the Americas and Africa. While there is much speculation that this policy will be relaxed after the Chinese Communist Party Congress on 16 October, the health situation (low immunity) and the coming winter do not call for an immediate easing.

While the sources of risk and uncertainty are legion, new political disturbances could add to their ranks. First, the new geopolitical landscape opened up by Russia's actions could reawaken risks in other global hotspots. Furthermore, price pressures, particularly on necessities, continue to fuel frustrations, building on those generated by the economic and health crisis triggered almost three years ago by the pandemic. As it does every year in the third quarter, Coface shares the results of the update of its index of social and political fragility in this study. Although the index has declined from last year's record level, it still suggests a high risk environment. While the focus naturally shifts to the risks of unrest in emerging countries, the advanced economies are not expected to be spared from this upsurge in social tensions.

Please click here to download the full report.

** **Coface Country and Sector Risks Barometer** is a quarterly publication covering our latest risk assessments for 162 economies, as well as 13 sectors for 28 countries across 6 regions.*

KEY DIARY EVENTS – 2022

October

3	Asia manufacturing PMI (Sep)
4	RBA monetary policy meeting
11	IMF World Economic Outlook, October 2022
12	South Korea monetary policy meeting
14	Singapore monetary policy meeting
16	The 20th National Congress of the Communist Party of China
19-20	Indonesia policy meeting
19-21	APEC Finance Ministers' Meeting, Bangkok
20	China LPR (Oct)
24	Australia and Japan flash PMI (Oct) China GDP (Q3)
27	ECB monetary policy meeting
27-28	BOJ monetary policy meeting
31	China NBS PMI (Oct)

November

1	RBA monetary policy meeting Asia manufacturing PMI (Oct)
1-2	US FOMC Meetings
3	Malaysia monetary policy meeting
4	Indonesia GDP (Q3)
8	US Mid-terms elections
10-13	ASEAN Summit, Phnom Penh
11	Malaysia GDP (Q3)
14-19	APEC Economic Leaders' Week, Bangkok
15	Japan GDP (Q3, advance)
15-16	G20 Summit, Bali
16-17	Indonesia monetary policy meeting
21	China LPR (Nov)
23	Australia flash PMI (Nov)
24	Japan flash PMI (Nov) South Korea monetary policy meeting
26	Taiwan local elections, constitutional referendum on lowering voting age
30	China NBS PMI (Nov) India GDP (Sep quarter)

December

1	Asia manufacturing PMI (Nov)
6	RBA monetary policy meeting
7	Australia GDP (Q3)
8	Japan GDP (Q3)
13-14	US FOMC meeting
15	ECB monetary policy meeting
16	Australia and Japan flash PMI (Dec)
19-20	BOJ monetary policy meeting
20	China LPR (Dec)
21-22	Indonesia monetary policy meeting
31	China NBS PMI (Dec)

Recent Coface economic publications:

20 Oct	Metals - Lithium at the crossroads of great industrial opportunities and tight supply
12 Oct	A cold chill on the global economy (Q3 barometer)
10 Oct	Egypt – Squeezing imports to reduce pressure on external accounts & FX reserves
5 Oct	Brazil – Polarised presidential elections
27 Sep	Italy – far-right victory will put strains on Europe
21 Sep	Kyrgyzstan and Tajikistan – a never-ending conflict
13 Sep	Germany Corporate Payment Survey 2022
5 Sep	UK – new PM Truss will face a huge economic challenge
19 Aug	Turkey – Central bank cuts policy rate unexpectedly, despite soaring inflation
29 Jul	US – Negative GDP fuel recession debate
26 Jul	Metals – Downward shift in global prices announces gloomy economic outlook
25 Jul	ASEAN 6 – Growing pressures to tighten monetary policy
22 Jul	ECB – A rate hike, a new instrument and farewell to forward guidance
21 Jul	Italy – Draghi's resignation is yet another headache for the ECB and EU
13 Jul	EUR/USD parity for first time in 20 years

www.coface.com

coface

FOR TRADE