Asia outlook

Recovery 2021: transitioning to a post-COVID new normal

December 2020

Renee Chen

Senior Investment Strategist

Key takeaways:

- After a wild ride in 2020, we expect economic activities across Asia to continue the transition to a post-Covid new normal in 2021
- The recovery, led by mainland China / North Asia in 2020 should further broaden to the rest of the region in 2021, with a larger scope of catchup growth for India and ASEAN to narrow the growth divergence
- The prospect of wider availability of effective vaccines raises hopes of a faster return to normalcy, but distribution and deployment face logistical challenges. We do not expect a full normalisation of mobility or cross-border travel in 2021
- Despite the vaccine optimism, Covid-19 will likely still leave some lasting economic scars. A greater concern is the pandemic's impact on the region's medium-term growth potential
- Macro policies will likely stay accommodative to sustain the recovery and lessen the economic scarring. But incremental policy impulse will fade and policy support will become more targeted and data dependent as economic recovery gains traction, and amidst reduced policy space and debt/financial stability concerns
- We expect a greater focus on structural reforms to boost longer-term growth potential (which also helps mitigate debt sustainability risks). Asia' growth outlook will depend on effective healthcare and macro policies and reform implementation

HSBC
Global Asset
Management

From growth divergence to growth convergence; India and ASEAN catching up

The Covid-19 pandemic has delivered severe shocks to Asian economies via the economic impact of the health crisis and containment measures as well as the spillover from the global recession. After a wild ride in 2020, we expect 2021 to be a year during which activities – particularly in the laggard economies and sectors – transition to a post-Covid new normal. Recent data shows an ongoing recovery across Asia, albeit still uneven, from a trough in Q2, driven by gradual relaxation of mobility restrictions, significant policy stimulus in 2020, and resilient external trade – thanks to Asia's relative success in managing the first wave of infections and earlier production normalisation, a product mix benefiting from 'stay-at-home' (tech) and medical demand, and robust shipments to mainland China and the US.

Mainland China / North Asia showed relative growth outperformance in 2020. In 2021, the recovery should further broaden to the rest of the region, with a larger scope of catchup growth for India and ASEAN to narrow the growth divergence. We see near-term risks due to a resurgence of infections globally and locally, but we do not expect a significant derailing or reversal of the recovery. Factors that would help mitigate some of the negative impact include a higher level of healthcare policy and institutional preparedness, a more targeted and less stringent containment approach, and increased adaptability of consumers and companies to the new normal. The availability of an effective vaccine, even as it starts with small numbers of doses relative to the population size, should help buoy household and business confidence and should be a positive for a rebound in activity.

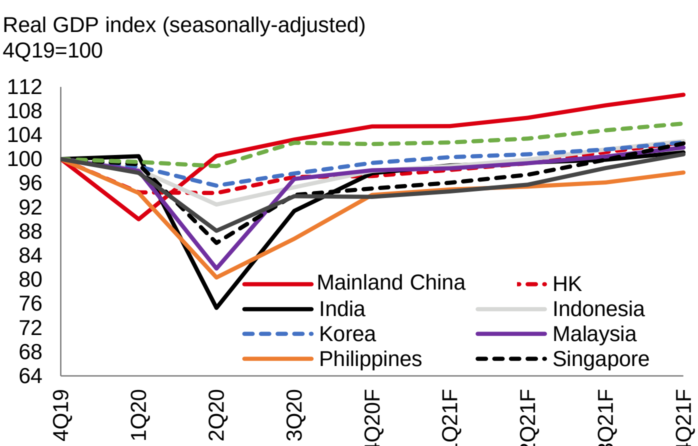
Vaccine availability lifts hopes of a faster return to normalcy; deployment faces challenges

The vaccine rollout could disproportionately benefit economies with large exposure to international travel/ tourism-related services (e.g. ASEAN and Hong Kong), as well as economies which have trailed in Covid-19 containment (e.g. India and select ASEAN economies). That said, while we see the potential for mass vaccination to begin in H2 2021 / before the end of 2021 for most parts of Asia, rolling out the logistics and supply chain for the distribution will be challenging. These challenges could be expected despite mainland China's late stage trials for several vaccines and its intention to give priority to ASEAN; some Asian economies will also ramp up manufacturing capacities and partner with drug-makers to produce and distribute vaccines in the region – India is one of the largest vaccine manufacturers globally. Effective vaccine deployment is key. We see mass vaccination occurring only gradually and we do not expect a full normalisation of mobility or cross-border travel flows in 2021. Even assuming a phased reopening of borders, the rush to travel may not occur until the pandemic eases more significantly. International travel-related and in-person / consumer-facing services may only improve gradually through 2021. Overall, the growth outlook would depend on effective healthcare and macroeconomic policies.

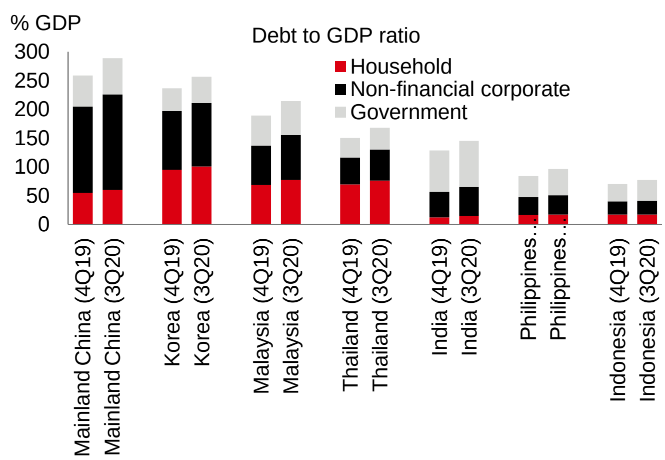
Asia's relatively better pandemic control does not prevent some lasting economic scars

The prospect of wide availability of an effective vaccine has reduced the threat of the virus and brightened the cyclical growth outlook, but the pandemic will likely leave a lasting legacy of economic imbalance and slack. The pace of recovery could be restrained by some lasting economic scars and a number of factors including a slow labor market recovery with the risk of some permanent job losses, the hit to household incomes and private-sector balance sheets, credit default and bank asset quality risks, and debt sustainability concerns. Mainland China is likely to be the only major economy to record positive growth in 2020, while we expect the nation's growth to accelerate to ~8% in 2021. We see a likely return to pre-Covid-19 "levels" of output/GDP (taken as the prevailing level in Q4 2019) for most Asian economies in H2 2021, although the Philippines (due to more prolonged lockdown) and Thailand (due to the heavy exposure to tourism) could lag. However, returning to the pre-pandemic "trend growth path" will take longer and a greater concern involves the possible decline in the region's medium-term growth potential as Covid-19 weighs on investment, productivity and labor force participation.

Growth convergence expected for 2021



Debt sustainability/financial stability concerns



Source: CEIC, Bloomberg, HSBC Global Asset Management, as of December 2020.

Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Global Asset Management Limited accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purposes only.

Macro policies will likely stay accommodative to sustain the recovery and lessen the economic scarring. Benign inflation and the lack of major external imbalances in Asia, coupled with the Fed's average inflation targeting framework, would allow Asian central banks to keep policy rates low for longer. A negative output gap caps demand-pull inflationary pressures. Core inflation outside of India (where core inflation is sticky – a near-term policy constraint) is expected to see a slow pick-up. Headline inflation outside of mainland China and India should rise in 2021 (but remain benign), off of 2020's low base and given a gradual recovery in services consumption and higher global oil prices; in mainland China and India, headline inflation is likely to moderate as food inflation is expected to soften due to easing supply-side factors and logistics disruption. Meanwhile, the Covid-19 induced improvement in the current account balance, via a combination of sharp import falls and relative export resilience, is set to reverse in 2021 as imports are expected to rebound, but such normalisation will likely be a gradual process.

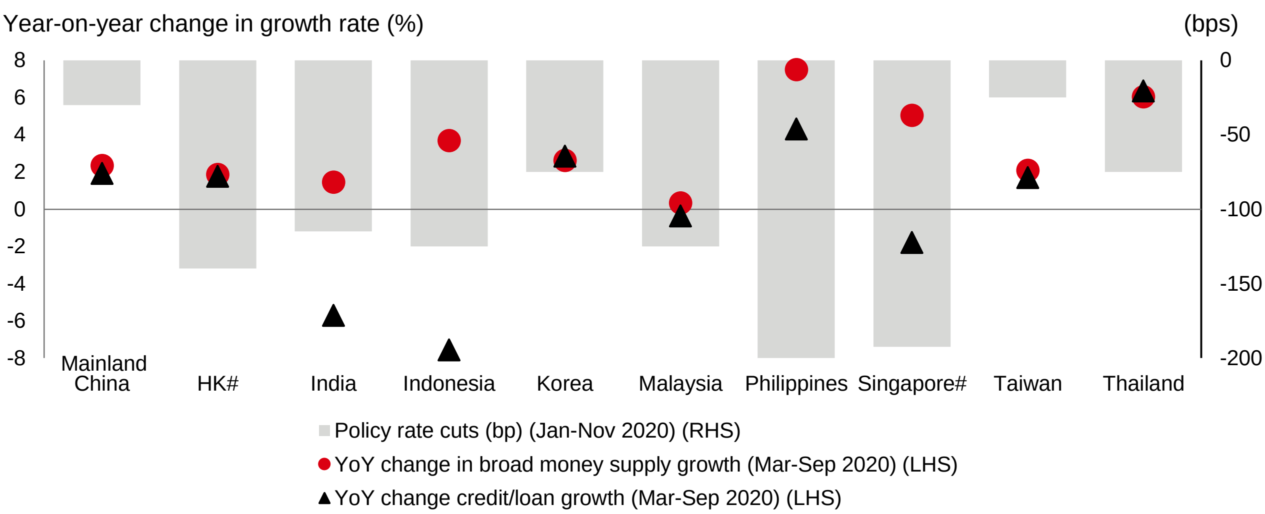
More targeted policy support with incremental impulse to fade; an abrupt shift unlikely

We expect largely stable monetary policy in most parts of Asia in 2021, although several economies that suffered significant economic damage from the pandemic and that face greater fiscal constraints and/or have relatively high real interest rates may ease modestly further (e.g. Indonesia). We see more limited room for policy maneuver, following 2020's aggressive easing via policy rate cuts, liquidity infusion, and unconventional measures such as bond purchases. The recovery is expected to gather pace, and many central banks consider multiple objectives implied/embedded in broader mandates beyond inflation-targeting, which could include growth and employment as well as asset/ housing prices amid financial stability concerns (e.g. in mainland China and Korea). Mainland China's central bank is already normalising interest rates and credit growth will likely decelerate into 2021. That said, we expect targeted easing measures and liquidity support to continue, particularly as default risks warrant close watch as policies deferring small and medium-sized enterprises' loan repayments are due to expire next March. Despite the relatively hawkish policy tone in mainland China and the potential for talks to emerge about policy normalisation in select economies in H2 2021, an abrupt exit of policy support is unlikely.

We expect fiscal-monetary policy coordination to continue, including efforts to mitigate solvency risks and the risks to the financial system (once government forbearance or other short-term debt relief measures expire). Central banks may support government financing in the form of maintaining a benign interest rate environment and/or bond purchases, especially in Indonesia and the Philippines, albeit in a more measured and conditional form (e.g. serving as a standby buyer at government debt auctions). Nonetheless, the use of QE-like programmes or debt monetisation is likely to be more constrained in emerging markets due to concerns over medium-term macro stability on inflation, capital flows and FX.

The significant fiscal expansion in 2020 with widespread policy response to the pandemic caused a sharp deterioration in the fiscal balance and a marked increase in public debt ratios. Debt sustainability is expected to come to the fore despite largely manageable public debt ratios and track records of fiscal prudence for most major Asian economies. There is likely to be a shift to fiscal consolidation in 2021, though fiscal deficits are only expected to narrow slightly (partly due to a rise in nominal GDP) and stay large by historical standards. With the recovery gaining traction, this may also reduce government incentive to ramp up additional stimulus, though some relief measures, such as aids for most pandemic-vulnerable sectors and wage subsidy programmes, may get extended in a more targeted form and some effects of previously announced measures will likely continue to support the economy. Overall, we expect less expansionary but still supportive fiscal policy stance in 2021.

Strong monetary easing reduces policy space



3-month interbank rates used for HK and Singapore

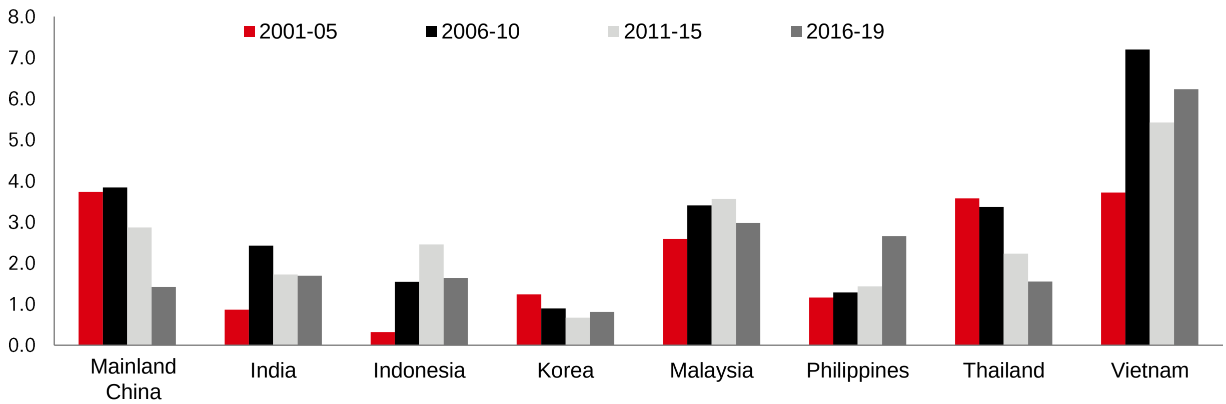
Source: CEIC, Bloomberg, HSBC Global Asset Management, as of December 2020.
Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Global Asset Management Limited accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purposes only.

Focus on structural reforms and digitalisation/innovation to boost productivity

With the worst of the pandemic behind us, there is greater policy focus on structural reforms to boost longer-term growth potential (which also helps mitigate fiscal/debt risks). In mainland China, the 14th Five-Year Plan focuses on promoting indigenous technology and innovation capacity, expanding domestic (consumer) demand, and pursuing higher quality and more balanced and sustainable growth. The "dual circulation" development strategy focuses on strengthening self-sufficiency and competitiveness while deepening opening up. Many economies in the region also continue to press ahead with structural reforms and deregulation to improve ease of doing business and to shore up economic resilience in the face of slowing globalisation and geopolitical uncertainties; these reforms are aimed at creating employment, attracting foreign direct investment (FDI), capitalising from supply-chain realignments (e.g. the "China+1" strategy and/or regionalisation) and raising the long-term productivity/potential growth. The recent signing of the Regional Comprehensive Economic Partnership (RCEP) should facilitate regional economic integration and provide a modest boost to GDP over the longer term. A set of common rules of origin with harmonised rates and standards should provide a greater incentive for companies in RCEP economies to build their supply chains and production hubs in the bloc. Meanwhile, the pandemic has accelerated the digital transformation and will boost Asia's internet economy over the medium term, while many economies have also made green and sustainable development among the priorities of their political and policy agendas. Overall, effective reform implementation is key to the region's medium-term, post-pandemic growth outlook.

Reform push to attract FDI

Net FDI inflows as % of GDP



Source: CEIC, Bloomberg, HSBC Global Asset Management, as of December 2020.

Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Global Asset Management Limited accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purposes only.

Important information

For Professional Clients and intermediaries within countries and territories set out below; and for Institutional Investors and Financial Advisors in Canada and the US. This document should not be distributed to or relied upon by Retail clients/investors.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in Emerging Markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries and territories with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries and territories in which they trade. Mutual fund investments are subject to market risks, read all scheme related documents carefully.

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of HSBC Global Asset Management Global Investment Strategy Unit at the time of preparation, and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Global Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity. Foreign and emerging markets. Investments in foreign markets involve risks such as currency rate fluctuations, potential differences in accounting and taxation policies, as well as possible political, economic, and market risks. These risks are heightened for investments in emerging markets which are also subject to greater illiquidity and volatility than developed foreign markets. This commentary is for information purposes only. It is a marketing communication and does not constitute investment advice or a recommendation to any reader of this content to buy or sell investments nor should it be regarded as investment research. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified. HSBC Global Asset Management is a group of companies in many countries and territories throughout the world that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings Plc (HSBC Group). HSBC Global Asset Management is the brand name for the asset management business of HSBC Group. The above communication is distributed by the following entities: In Argentina by HSBC Administradora de Inversiones S.A.S.G.F.C.I., Sociedad Gerente de Fondos Comunes de Inversión, registered with the Comisión Nacional de Valores (CNV) under N° [1]; in Australia, this document is issued by HSBC Global Asset Management (Australia), the sales and distribution arm of HSBC global funds for Australian investors and a division of HSBC Bank Australia Limited ABN 48 006 434 162, AFSL 232595; for HSBC Global Asset Management (Hong Kong) Limited ARBN 132 834 149 ("HSBC"). This document is not available for distribution to retail clients (as defined under the Corporations Act). HSBC Global Asset Management (Hong Kong) Limited is exempt from the requirement to hold an Australian financial services license under the Corporations Act in respect of the financial services it provides. HSBC Global Asset Management (Hong Kong) Limited is regulated by the Securities and Futures Commission of Hong Kong under the Hong Kong laws, which differ from Australian laws; in Bermuda by HSBC Global Asset Management (Bermuda) Limited, of 37 Front Street, Hamilton, Bermuda which is licensed to conduct investment business by the Bermuda Monetary Authority; in Canada by HSBC Global Asset Management (Canada) Limited which provides its services as a dealer in all provinces of Canada except Prince Edward Island and also provides services in Northwest Territories. HSBC Global Asset Management (Canada) Limited provides its services as an advisor in all provinces of Canada except Prince Edward Island; In Chile, operations by HSBC's headquarters or other offices of this bank located abroad are not subject to Chilean inspections or regulations and are not covered by warranty of the Chilean state. Further information may be obtained about the state guarantee to deposits at your bank or on www.sbif.cl; in Colombia, HSBC Bank USA NA has an authorized representative by the Superintendencia Financiera de Colombia (SFC) whereby its activities conform to the General Legal Financial System. SFC has not reviewed the information provided to the investor. This document is for the exclusive use of institutional investors in Colombia and is not for public distribution; in Finland, Norway, Denmark and Sweden by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026) and through the Stockholm branch of HSBC Global Asset Management (France), regulated by the Swedish Financial Supervisory Authority (Finansinspektionen); in France, Belgium, Netherlands, Luxembourg, Portugal and Greece by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026); in Germany by HSBC Global Asset Management (Deutschland) GmbH which is regulated by BaFin; in Hong Kong by HSBC Global Asset Management (Hong Kong) Limited, which is regulated by the Securities and Futures Commission; this document has not been reviewed by the Securities and Futures Commission; in India by HSBC Asset Management (India) Pvt Ltd. which is regulated by the Securities and Exchange Board of India; in Ireland, the materials are distributed by HSBC France, Dublin Branch. HSBC France, Dublin Branch is registered in Ireland by HSBC France, which is directly supervised by the European Central Bank (ECB), under the Single Supervisory Mechanism (SSM), and regulated by the French Prudential Supervisory and Resolution Authority (Autorité de contrôle prudentiel et de résolution – ACPR)) and the French Markets Authority (The Autorité des marchés financiers (AMF)). HSBC France, Dublin Branch is regulated by the Central Bank of Ireland for conduct of business rules; in Israel, HSBC Bank plc (Israel Branch) is regulated by the Bank Of Israel. This document is only directed in Israel to qualified investors (under the Investment advice, Investment marketing and Investment portfolio management law-1995) of the Israeli Branch of HBEU for their own use only and is not intended for distribution; in Italy and Spain by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026) and through the Italian and Spanish branches of HSBC Global Asset Management (France), regulated respectively by Banca d'Italia and Commissione Nazionale per le Società e la Borsa (Consob) in Italy, and the Comisión Nacional del Mercado de Valores (CNMV) in Spain; in Mexico by HSBC Global Asset Management (Mexico), SA de CV, Sociedad Operadora de Fondos de Inversión, Grupo Financiero HSBC which is regulated by Comisión Nacional Bancaria y de Valores; in the United Arab Emirates, Qatar, Bahrain and Kuwait by HSBC Bank Middle East Limited which are regulated by relevant local Central Banks for the purpose of this promotion and lead regulated by the Dubai Financial Services Authority; in Oman by HSBC Bank Oman S.A.O.G regulated by Central Bank of Oman and Capital Market Authority of Oman; in Peru, HSBC Bank USA NA has an authorized representative by the Superintendencia de Banca y Seguros in Perú whereby its activities conform to the General Legal Financial System – Law No. 26702. Funds have not been registered before the Superintendencia del Mercado de Valores (SMV) and are being placed by means of a private offer. SMV has not reviewed the information provided to the investor. This document is for the exclusive use of institutional investors in Perú and is not for public distribution; in Singapore by HSBC Global Asset Management (Singapore) Limited, which is regulated by the Monetary Authority of Singapore; in Switzerland by HSBC Global Asset Management (Switzerland) AG whose activities are regulated in Switzerland and which activities are, where applicable, duly authorised by the Swiss Financial Market Supervisory Authority. Intended exclusively towards qualified investors in the meaning of Art. 10 para 3, 3bis and 3ter of the Federal Collective Investment Schemes Act (CISA); in Taiwan by HSBC Global Asset Management (Taiwan) Limited which is regulated by the Financial Supervisory Commission R.O.C. (Taiwan); in the UK by HSBC Global Asset Management (UK) Limited, which is authorised and regulated by the Financial Conduct Authority; and in the US by HSBC Global Asset Management (USA) Inc. which is an investment advisor registered with the US Securities and Exchange Commission.

INVESTMENT PRODUCTS:

- Are not a deposit or other obligation of the bank or any of its affiliates;
- Not FDIC insured or insured by any federal government agency of the United States;
- Not guaranteed by the bank or any of its affiliates; and
- Are subject to investment risk, including possible loss of principal invested.