



Asia (ex Japan): Triple troubles

At first glance, Asia's ongoing economic slowdown could be explained away in cyclical terms that could bottom next year. After all, the hangover from the global financial crisis of 2008-09 persists and global economic recovery is uneven. With appropriate policy support, the recovery could gain strength, and it appears that 2016 may well be the year of strong fiscal spending in many parts of the world. The recent commodity bust may turn out to be temporary, with only short-lived impact on investment. G2 economies could continue to get stronger and re-emerge as a source of vigorous exports demand for Asia. China's cyclical measures to deal with overcapacity and financial system stress could pave the way for healthier growth.

Even if some of these favorable developments were to transpire, Asia may find the economic environment in 2016 and 2017 to be about the same as the last couple of years. There may be further slowing of China, but India and Indonesia could see growth accelerate, Malaysia and the Philippines could maintain trend growth, and the rest of Asia could see less disappointment.

Indeed, our forecast for the next two years assumes such a path. We see China settling at sub-7% growth in an orderly manner, while by 2017 India's growth should head past 7.5% and Indonesia should go back to 5%. 2-3% growth may be the norm for many other Asian economies, but given the challenging nature of the cycle, that ought to be an acceptable outturn. The key assumption in these forecasts is that financial sector risks are managed and economic spillovers from a slowing China are contained.

But there are some major fault lines in this somewhat innocuous narrative. Deeper examination of the region's economic dynamic however reveals a series of headwinds that transcend the cycle. In this piece, we go over three key headwinds – aging, stagnant trade, and rising debt – that could get in the way of growth and prosperity in the coming years. There are enough savings and safeguards in place in the region to mitigate risks of an outright crisis owing to these headwinds; a more likely scenario however is a gradual erosion of potential GDP growth rate, worsening of public finances, and a general decline in sentiment about the region's prospects.

Aging

Considerable attention has been paid in recent years to China's rapid aging. Indeed, recent news on the relaxation of the long-standing one-child policy reflects the seriousness with which the Chinese authorities are considering the aging problem. Beyond China, a number of Asian Tiger economies are undergoing an aging process that will last decades. Aging is problematic for a variety of reasons. As the number of elderly rises, the labor force shrinks, reducing not just the availability of workers but also the output, incomes, and taxes generated by those workers. As a result, potential GDP growth declines, the fiscal position worsens (as transfers to dependents rise and tax collection from the shrinking pool of workers declines), and overall economic vitality dissipates. The decline in potential GDP growth along with a rise in the share of dependents also has adverse implications for savings, debt sustainability, and financial markets.

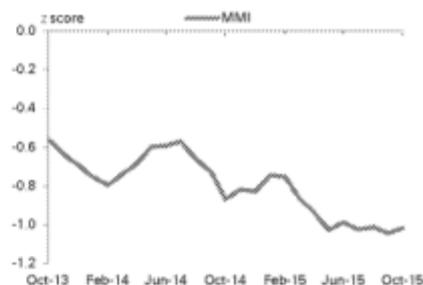
Can't public policy arrest this problem? While we welcome China's latest initiative, we find that aging is very difficult to reverse. Singapore is a case in point. Faced with declining fertility and the prospect of rapid aging, the authorities have introduced wide-ranging measures to encourage families to have more children. These measures include longer leave for parents, tax incentives, and a more generous social safety net. But so far, the track record

Figure 1: Deutsche Bank forecasts:
Emerging Asia

% yoy, unless stated:	2014	2015F	2016F	2017F
Real GDP growth	6.4	6.1	6.1	6.3
Private consumption	6.7	6.5	6.7	6.9
Investment	5.2	5.7	6.3	6.7
Government consumption	16.9	17.6	18.7	5.7
Exports	4.3	-1.5	4.2	5.9
Imports	1.7	-6.1	5.3	7.5
CPI	3.4	2.4	2.9	2.9
CA balance, % of GDP	2.4	2.6	2.1	1.8
Asia ex. China and India				
Real GDP growth	4.1	3.6	3.8	4.2
CPI	3.4	2.2	2.9	3.3

Source: National authorities, Deutsche Bank Research

Figure 2: Regional growth momentum continues to be weak



Note: Regional z-score is GDP-weighted, derived as a composite of country-by-country scores of monthly indicators of domestic demand (e.g. retail sales, imports, credit growth, and industrial production). Data is from 1995 to present.
 Source: CEIC, Deutsche Bank Research