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China's return to growth should help equities and corporate credit in North Asia

by Christiaan Tuntono | 13/08/2020

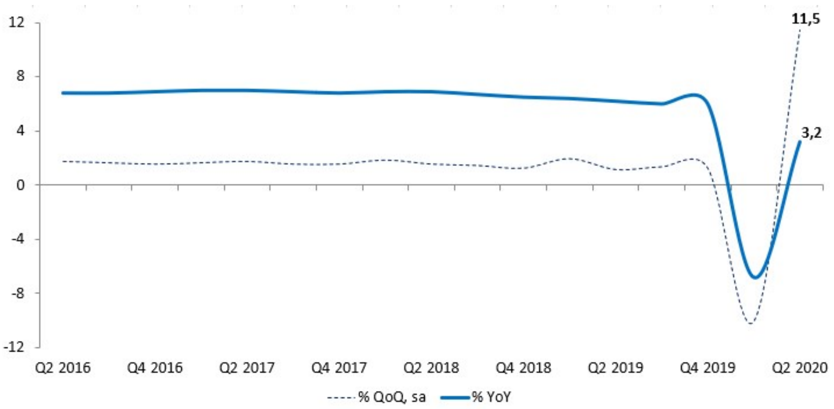
Summary

With its successful containment of Covid-19, China's ongoing recovery is likely to benefit its most closely connected neighbours.

China's GDP growth will help other Asian economies to different degrees, but virus containment is key

China's growth has rebounded sharply following the first-quarter downturn prompted by the Covid-19 pandemic (see Chart 1). We believe China's recovery will continue, though at a more moderate pace than was seen in 2Q20. The successful containment of the outbreak was the biggest factor in sustaining a functioning economy, though the government's swift and targeted stimulus measures also helped. We think the Chinese authorities will continue to keep interest rates low and implement other accommodative policy measures to support a steady economic recovery, though rates may not move much lower.
China's ongoing recovery should be good news for several other Asian economies – primarily those that are most closely linked to China and have had similar success in containing Covid-19.

Chart 1: China's growth rebounded sharply in 2Q20



Source: NBS, CEIC, AllianzGI Economics & Strategy, as at June 2020.

Hong Kong and Taiwan are likely to benefit most from mainland China's recovery

According to the Trade-in-Value-Added database compiled by the OECD (Organisation for Economic Co-operation and Development) and WTO (World Trade Organization), 9.6% of Hong Kong's GDP is generated by demand from mainland China. This means a 10% increase in mainland Chinese demand, everything else being equal, would likely lift Hong Kong's GDP by just under 1 percentage point. The sensitivity of Taiwan's GDP to mainland Chinese demand is even higher.

As Chart 2 shows, a recovery in domestic demand in mainland China would likely benefit economies like Taiwan, Hong Kong, Malaysia, Singapore and South Korea the most. This is thanks to the close trade links in goods and services that these economies have established with mainland China relative to the size of their own GDPs. For example, China imports from South Korea, Taiwan and Malaysia many technological items such as semiconductors and other intermediate components which underpin its rapid technological advances, and much of Hong Kong's revenue from tourism and trade services comes from mainland China.

Chart 2: Export exposure in value added terms (% of GDP)

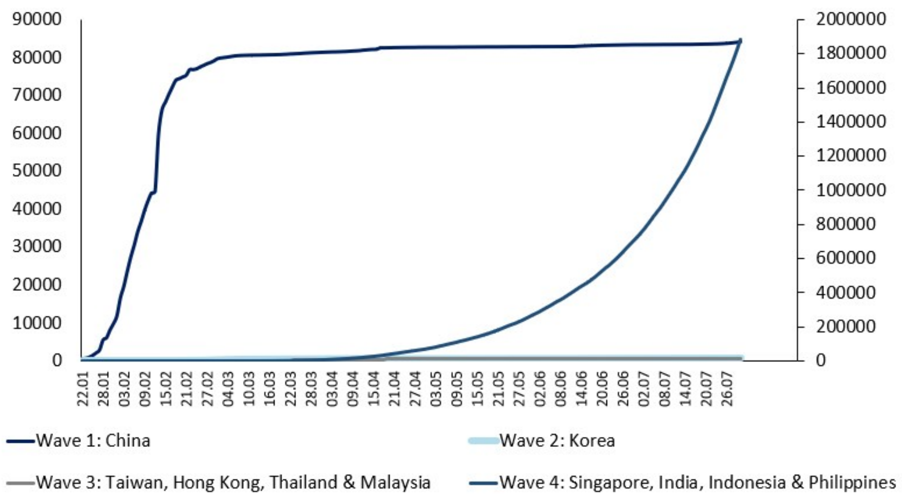
	Destination of final demand						
	China	Us	EU28	Japan	ASEAN	RoW	World
Taiwan	13,4	6,7	4,2	2,8	3,2	10,5	40,6
Hong Kong	9,6	3,0	4,3	1,3	2,6	8,3	29,2
Malaysia	9,6	6,1	4,9	4,2	6,8	16,1	47,6
Singapore	8,1	7,0	10,4	4,3	8,0	20,1	57,8
South Korea	7,7	5,6	3,3	1,8	2,2	10,0	30,6
Thailand	7,2	6,1	4,9	3,6	5,1	16,0	42,9
Vietnam	6,2	9,4	5,7	4,2	3,5	14,4	43,3
Philippines	4,1	4,7	2,6	2,4	1,9	6,2	21,8
Japan	2,9	3,2	1,7	N.A.	1,4	5,1	14,3
Indonesia	2,7	2,4	1,8	1,8	1,8	7,4	17,9
India	1,1	4,1	2,7	0,5	0,9	5,9	15,2
China	N.A	4,0	2,7	1,3	1,0	7,1	16,0

Source: OECD-WTO TiVA indicators (2018 edition), AllianzGI Economics & Strategy, as at December 2016.

India and Indonesia may see less of a benefit from China's rebound, especially since the number of Covid-19 cases is still growing in both

Domestically oriented economies such as India and Indonesia are relatively less sensitive to a recovery in Chinese domestic demand. This is because of the comparatively smaller weight of trade with mainland China-as a proportion of their own GDP. In addition, the Covid-19 pandemic isn't yet abating in India, Indonesia and the Philippines (see Chart 3). This is subduing economic activity.;

Chart 3: India, Indonesia and the Philippines are still seeing rising Covid-19 infections
Covid-19 confirmed cases to date

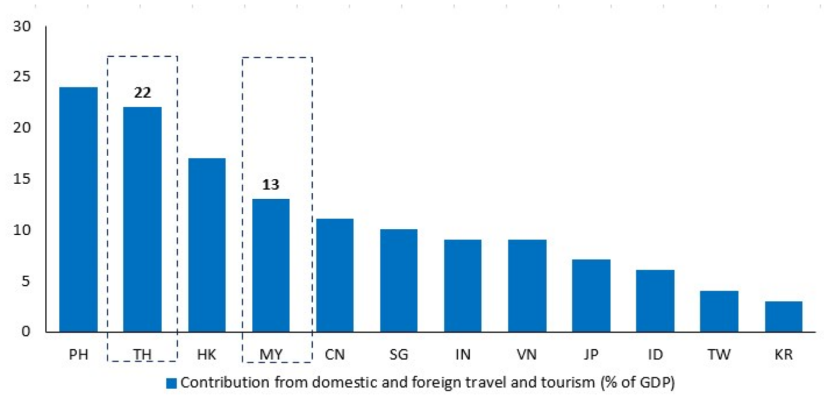


Source: Johns Hopkins University, Morgan Stanley Research, AllianzGI Economics & Strategy, as at July 2020.

Thailand and Malaysia rely on tourism, which will take time to return to usual levels

Both the Thai and Malaysian economies have so far controlled Covid-19 better than their peers, successfully flattening the new infection curves. But we do not expect a swift recovery since both Thailand and Malaysia rely greatly on tourism (see Chart 4) – a sector that is likely to continue to be hampered as a result of reduced international travel.

Chart 4: Thailand and Malaysia rely greatly on tourism revenues

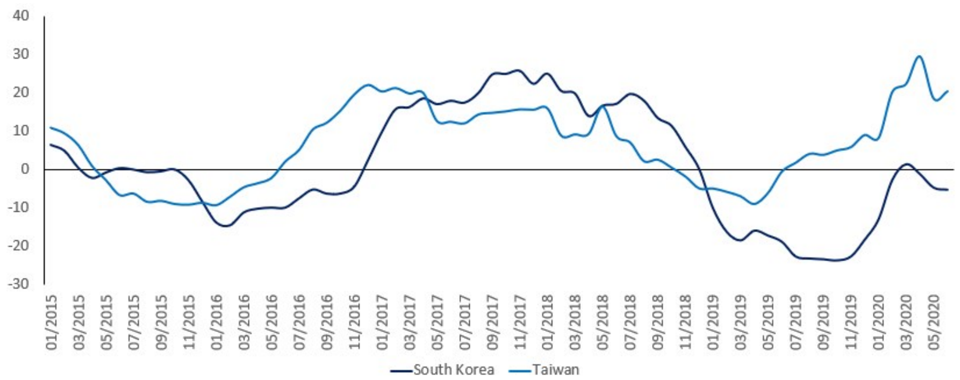


Source: CEIC, HSBC, AllianzGI Economics & Strategy, as at December 2019.

South Korea and Taiwan are in a much better position than their south Asian peers thanks to their progress so far in controlling Covid-19 and their economies' focus on technology exports

Export growth has been recovering faster than anticipated, due to the world's increased reliance on technology during the pandemic. The increase in working from home has helped drive demand for servers, laptops and other communication technology products (see Chart 5).

Chart 5: South Korea and Taiwan's exports are supported by technology products
Electronics & Electronic product exports (% yoy, 3mmav)



Source: CEIC, AllianzGI Economics & Strategy, as at June 2020.

Investment implications

In equities, consider North Asia over South and South-East Asia

We suggest staying overweight in North Asian equity markets (mainland China, Hong Kong, Taiwan and South Korea) versus the South and South-East Asian markets (India, Indonesia, Philippines, Thailand and Malaysia).

- The fact that the North Asian economies were typically more advanced in containing Covid-19 is key. Assuming there is no second-wave outbreak, these economies are likely to be at the end stage of the pandemic, moving towards economic recovery.
- We remain cautious on South and South-East Asian economies, in particularly India, Indonesia and the Philippines, as they are still fighting the spread of Covid-19. Keeping growth going may require increased fiscal stimulus, which will put pressure on central banks to deliver. Persistent growth is likely to require greater fiscal stimulus support, which in turn puts pressure on central banks to ease excessively and help finance government bond issuance.

In fixed income, consider more exposure to Asian corporate credit for better yield enhancement

With the very strong stimulus responses from the Fed and the resumption of growth in Asia, we think the risk of credit defaults in Asia should reduce considerably. This may prompt corporate credit spreads to tighten much more than sovereign and quasi-sovereign credit spreads, which we think have pretty much priced in the current circumstances.

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About the author

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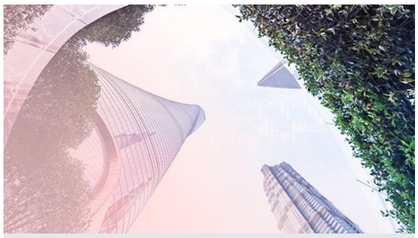

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