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Post-COVID-19 Asia will grow strongly in 2021 but structural problems continue to pile up

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2020 was a terrible year for Asia but for some countries less than for others. Countries recovered divergently with some managing to grow positively notwithstanding the pandemic, namely mainland China, Taiwan, and Vietnam. The rest of Asia had a hard time, facing problems such as current-account deficit, tourism reliance, and limited fiscal and monetary space. This article discusses the unevenness of COVID-19 and the divergent recovery of Asian economies in the post-COVID-19 era.

Keywords: COVID-19, Asian economies, fiscal and monetary policy, US–China relations

JEL codes: E52, E62, F50

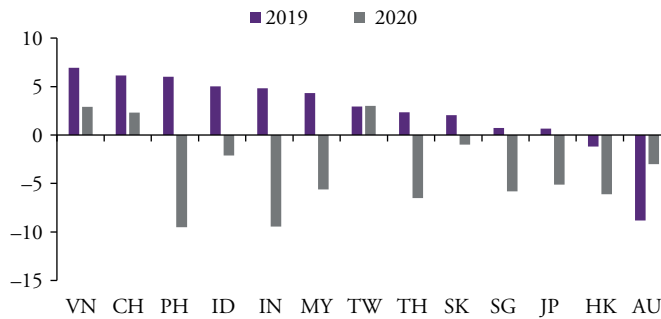
1 ASIA IS EMERGING STRONGER OUT OF COVID-19 THAN THE REST OF THE WORLD BUT WITH WIDE DIVERGENCE

2020 was a terrible year for Asia but for some countries less than for others. A number of countries managed to grow positively notwithstanding the pandemic, with mainland China as the most obvious example, but not the only one. Taiwan grew above potential and Vietnam grew positively. The rest of Asia really had a hard time, especially the Philippines as well as India and Thailand, due to the much wider spread of the pandemic and the limited fiscal and monetary space. Small open economies, such as Singapore and Hong Kong, also suffered immensely due to their reliance on visitors (Figures 1 and 2).

To understand the unevenness of COVID-19 across Asia, we have to start with the virus and the structure of the Asian economies. Beginning in mainland China, the spread of the pandemic was taken control of by the local government with suppression measures in 2020Q1. In developed Asia, early detection of COVID-19 helped the economies, namely Taiwan, South Korea, Hong Kong, and Singapore, which had relatively good domestic mobility. Meanwhile, developing economies, namely Vietnam, Thailand, India, Indonesia, Malaysia, and the Philippines, had rather strong lockdown measures that impacted their mobility¹ (Table 1) and thereby domestic demand. Figure 3 shows the difference in mobility¹ between countries, which was crushed in 2020Q1 and improved in 2020Q3. The November–December 2020 spike in cases has forced the governments to deploy another round of strict lockdown measures, especially in the Philippines, Malaysia, and Indonesia. These economies with current-account deficits don't have much space for more containments; difficulties in securing enough vaccine worsens the situation even

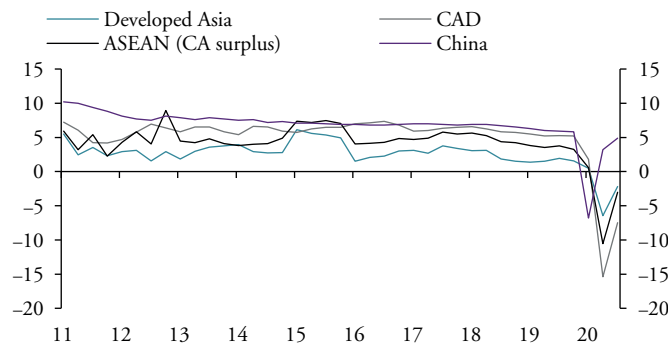
1. Google mobility is derived by Google from activities detected by Google Maps. The data originated shows changes of visits to residencies, schools, pharmacies, workplaces, and so on. In this article we use the average result of each item. Mobility is compared to the baseline as of 15 February 2020.

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Source: Natixis, Bloomberg.

Figure 1 GDP growth, by country (percent, YoY)



Notes: CAD = current-account deficit countries of Indonesia, India, and the Philippines; ASEAN (CA surplus) = Vietnam, Thailand, Malaysia, and Singapore; developed Asia includes South Korea, Taiwan, Hong Kong, and Japan.

Source: Natixis, CEIC.

Figure 2 GDP growth, by region (percent, YoY)

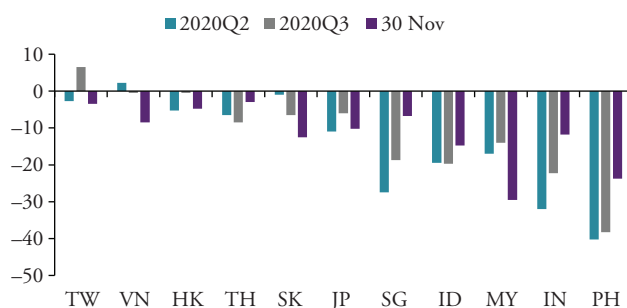
further. Details of the lengths of the lockdowns are given in Table 1. The impact of such suppression measures of course is seen best in retail sales across Asia where the trough coincided with the peak of lockdowns and recovery coincided with normalization of domestic movement. But lockdowns are just one aspect of growth performance and do not fully explain the divergence in Asia. To understand the magnitude of the impact of COVID-19, we must differentiate economies by their structural differences.

A number of lessons can be learned from this very different economic impact of the pandemic across Asian economies. The first is that a strong domestic demand does help. This is clearly the case in China. Second, sectoral specialization is also important. For example, the South Korean and Taiwanese economies were supported by their internet technology component (ITC)-oriented export structure, as opposed to economies dependent on the export of services, whether that is tourism like Hong Kong, Singapore, or Thailand (Figure 4), or remittances like the Philippines (Figure 5). Third, countries with current-account deficits do not have as much room to support the economy without risking an increase in the external cost of funding. This is the case in India, Indonesia, and the Philippines.

Table 1 Key lockdown measures

Economy	Measures
AU	No lockdown but limited public gatherings in New South Wales from mid Mar to mid May. On 19 Nov South Australia implemented a lockdown for six days.
CN	Wuhan lockdown from 23 Jan to 8 Apr. Large-scale mobility restrictions at the national level and gradual reopening from mid Feb. Partial movement restrictions in some parts.
HK	No lockdown but limited public gatherings.
JP	Nationwide state of emergency from 7 Apr to 25 May.
SK	No lockdown but limited public gatherings.
TW	No lockdown but limited public gatherings. New measures on containment from 1 Dec to 28 Feb 2021.
ID	Partial lockdown in cities or regions from 16 Mar. No national lockdown but 'Large-Scale Social Restrictions' for some regions and cities from May with gradual easing from mid Jun. Large-scale social restrictions reimposed on Jakarta from 14 Sep.
IN	National lockdown from 24 Mar to 17 May. Gradual partial reopening from 1 Jun. Transitional Large-Scale Social Restrictions from 14 Sep extended until 6 Dec. As of Nov, still 13 "Containment Zones" in partial lockdown until 30 Nov.
MY	Movement Control Order from 16 Mar to 12 May and gradual reopening in Jun. New partial lockdown from 9 Nov to 6 Dec.
PH	Partial lockdown from mid Mar with gradual reopening from Jun. Stricter lockdown reimposed in Metro Manila and nearby provinces from 4 Aug.
SG	Circuit breaker from 7 Apr to 1 Jun.
TH	National lockdown from 21 Mar to 30 Apr with gradual reopening in May.
VN	Partial lockdown in some regions over time.

Source: Natixis, Bloomberg, government websites.

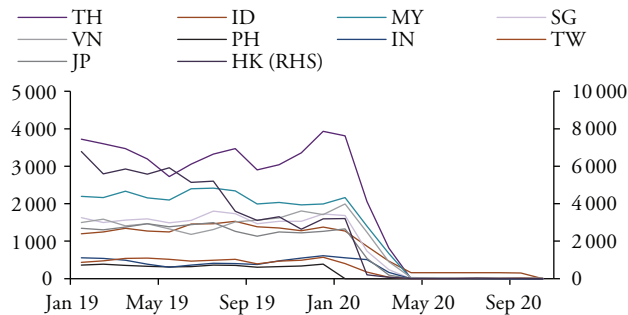


Note: From baseline on 15 February.

Source: Natixis, Google.

Figure 3 Decline in Google mobility (percent)

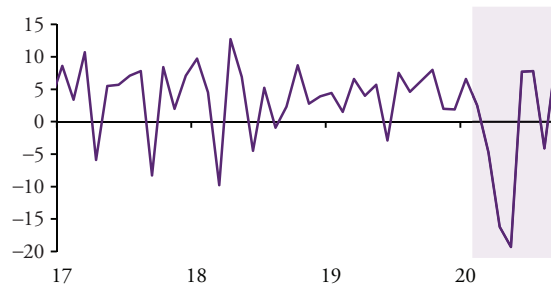
Countries with current-account deficits (CADs) do not have as much room to support their economies without risking an increase in the external cost of funding. This is the case in India, Indonesia, and the Philippines, which also have the lowest share of merchandise exports as a percentage of GDP. The worst month for CAD countries was clearly March



Note: Data as of March 2021.

Source: Natixis, CEIC.

Figure 4 Visitor arrivals (thousands)



Note: Data for 2020 are up to September.

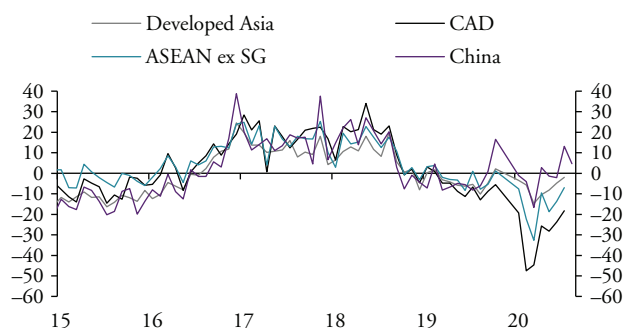
Source: Natixis, Bloomberg.

Figure 5 COVID-19 decreased remittances to the Philippines (percent, YoY)

2020, given the sudden risk-averse appetite by international investors and the sharp increase in the cost of funding following the sudden dollar strength. The situation improved thereafter as the US Federal Reserve (Fed) injected enormous liquidity through rate cuts and liquidity swaps line arrangements, which helped to ease strains in global funding markets. All in all and beyond the dependence on external sources of funding, CAD economies have suffered from the sharpest contraction of imports (Figure 6) and with the poorest economic performance overall.

One economy which has managed to have low counts of the virus and decent domestic mobility while still suffering rather significantly is Thailand. Its high dependency on tourism has made it vulnerable to global pandemic control even if the domestic containment was moderate in terms of lost mobility (Figure 4). Political challenges at home also limited the government's ability to confront issues of COVID-19 as well as resorting to extending the Emergency Decree longer than necessary. Hong Kong, too, followed the same fate as its efforts in containing the virus without full domestic lockdown could not overcome the regional and global decline of mobility, especially from mainland China, a place it depends upon enormously for visitors and their related expenditure in the city (Nguyen 2020a).

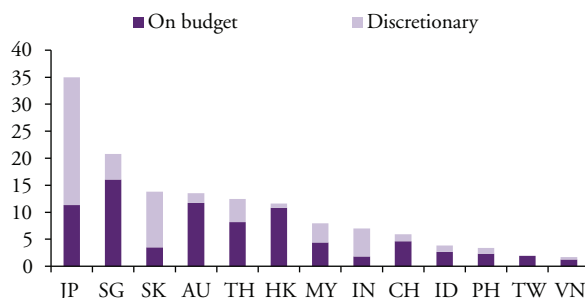
Finally, the fiscal and monetary policy reaction to the pandemic depends not only on the authorities' willingness to mitigate COVID-19's economic impact, but also the policy space



Notes: CAD refers to current-account deficit economies; developed Asia refers to Singapore, South Korea, Taiwan, and Hong Kong.

Source: Natixis, Bloomberg.

Figure 6 Asia imports (percent, YoY)



Sources: Natixis, Bloomberg, IMF.

Figure 7 Fiscal support package as a share of GDP (percent)

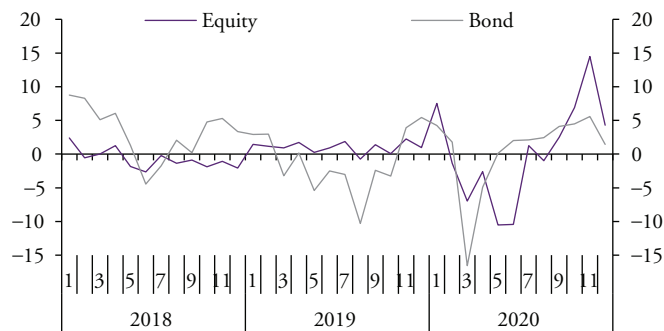
they may have to do so. In fact, the economies most affected – the Philippines, India, and Indonesia – are also the ones with the least fiscal support (Figure 7). Part of the reason for that is the tendency to be fiscally prudent given weak revenue generation and an unwillingness to raise the debt burden significantly since the deficit already widens through revenue decline as well as the capital outflow, leaving less space for large expenditure increase. In contrast, economies that have sizeable domestic support in savings and/or more room for deficits, such as Japan and Singapore, could have broader fiscal and monetary policy space.

Beyond fiscal support, monetary policy easing has been rather aggressive in Asia (Table 2, p. 246) through not just policy rate cuts but also moving into quantitative easing (QE). In fact, Australia followed Japan in introducing yield-curve control as quantitative targets for purchases of assets, while South Korea is moving into QE. As for emerging economies, India, Indonesia, and the Philippines all introduced QE, to varying degrees. While the Bank of Thailand did not introduce QE, it did create funds to purchase corporate bonds to shore up financial markets.

Beyond the Asian economies' domestic QE programs, the Fed's aggressive international liquidity creation after the sudden US\$ appreciation related to the anti-risk event in March 2020 (in which global capital flew from emerging countries to the US) gave

some room for maneuver for Asian central banks. The injection of cross-border dollar liquidity through swap and repo lines as well as a massive fiscal stimulus carried out by the US administration eased the US\$ strains for bonds and equities, but led to a weakening of the US\$, though created easier financial conditions globally.

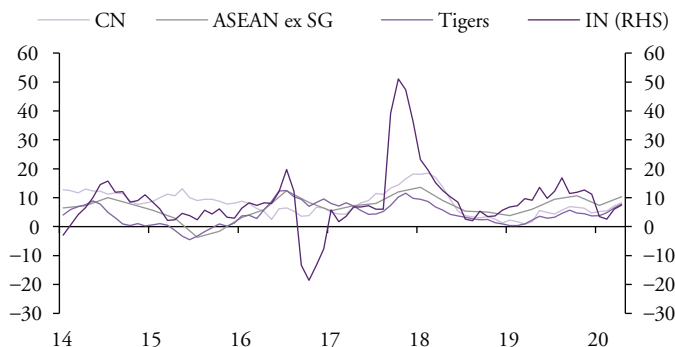
For emerging Asian countries, funding costs declined across Asia as risk appetites returned with central banks' massive liquidity injections. Nevertheless, real monetary conditions remained tight across Asia as growth (and thereby inflation) weakened much more than the easing of rates. The only place with accelerating inflation was India with higher food prices due to supply-chain issues caused by domestic mobility constraints even as output remained weak. Figure 8 shows the rebound of fund flows into Asia bonds and equities. M2 growth has also picked up across the region thanks to fiscal stimulus as well as monetary support (Figure 9). That said, the pace of the recovery has differed across Asia. The economic impact has varied; more specifically, the monetary conditions have been very different. Real interest rate and real effective exchange rate are much impacted



Notes: Data as of 4 December 2020.

Source: Natixis, EPFR.

Figure 8 EM Asia capital flows (US\$ billions)



Source: Natixis, CEIC.

Figure 9 Asian countries: M2 growth (percent, YoY)

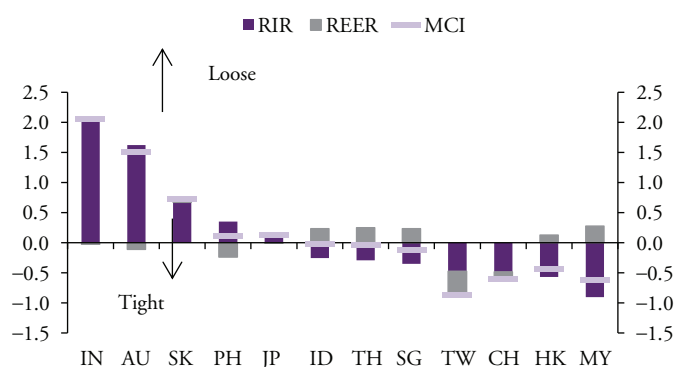
Table 2 *Monetary support*

Economy	Benchmark rate cut (bps)	Reserve ratio cut (bps)	Unconventional monetary support	Targeted support
AU	65	–	Target three-year government bond yield at 0.10% via purchases of government bonds in the secondary market	RBA announced A\$100 billion secondary market purchases. Broadened OMO collaterals. Swap line with the Fed up to US\$60 billion. A\$200 billion to support SMEs.
CH	30	200 ^a	–	Liquidity injections via OMOs. Expansion of relending and rediscount facilities by RMB1.8 billion to MSMEs. Policy banks' credit line raised to RMB350 billion for private corporates and SMEs.
HK	–	100 ^b	–	Lowered capital requirements for banks. Temporary US\$10 billion liquidity facility. Cheaper interest rate for SMEs.
JP	–	–	No upper limit on BoJ purchases of JGBs, CD and corporate bond 20 trillion, special and new funds 90 trillion	Increase in BoJ's purchases of ETFs and J-REITs. Temporary increase of targeted purchases of CP and corporate bonds. ¥90 trillion to support SMEs.
SK	75	–	6 trillion purchases of government bonds and 5 trillion announced by 2020	Temporary unlimited OMOs. Expand the list of eligible OMO participants and collaterals. Augment funds for SMEs by 0.9% of GDP. Financial stabilization plan for 5.3% of GDP fiscal that is mostly lending and security purchases. Additional 1.3% of GDP to purchase corporate bonds and CP and further support to SMEs. Fed swap line for US\$60 billion.
TW ID	25 125	– 100	– Purchases of government bonds via primary market	Aviation, shipping, guarantee for loans. OJK introduced a new share buyback policy (allowing listed companies to repurchase their shares without a prior shareholders' meeting) and introduced limits on stock price declines. Fed repo line.

IN	115	100	LTROs and TLTROs, OMOs, resulting in cumulative liquidity injections of 5.9% of GDP	Government guarantees on loans. Lowered capital requirements. Emergency Credit Line Guarantee Scheme (ECLGS) for MSMEs until March 2021 relaxing the eligibility criteria.
MY	125 ^c	100	–	Temporary easing of regulatory and supervisory compliance on banks. Suspended short-selling and announced regulatory relief for publicly listed firms; created facility to help with state gov short-term funding; introduced measures to help SMEs.
PH	200	200	300 billion purchases of government securities through repos and fresh provisional advance amounting to PHP540 billion approved in Oct	A temporary relaxation of requirements on compliance reporting; easier access to the BSP's rediscounting facility; a temporary relaxation of provisioning requirement.
SG	Cut slope of currency band to zero	–	–	US\$60 billion swap line with the US. Lowered capital requirement. SGD125mn package to sustain financial services and FinTech capabilities. Extended support to individuals and SMEs that need more time to resume loan repayments.
TH	75	–	BOT purchase THB100 billion of gov bonds	THB500 billion loans to financial institutions and cover six months of interests. Created a Corporate Bond Stabilization Fund of THB400 billion.
VN	300	–	–	Credit package worth 3.8% of GDP.

Notes: a. Targeted cut for qualified banks. b. Cut counter-cyclical capital buffer. c. Include the rate cut of 25 bps on 22 January 2020.

Source: Natixis, Bloomberg, IMF, government websites.



Source: Natixis.

Figure 10 MCI composition and MCI change

by inflation levels and some countries, namely Malaysia, are facing tighter constraints. The monetary condition index also reveals the same pattern across countries where credit and liquidity conditions differ (Figure 10).

2 SLOWLY, ROADBLOCKS TO GROWTH ARE BEING CLEARED: STARTING WITH BETTER DOMESTIC MOBILITY, AND THEN GLOBAL

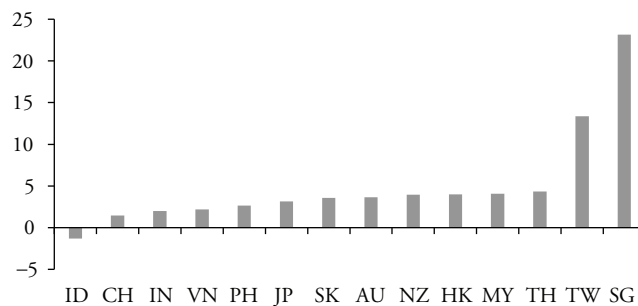
Even before the availability of vaccines, Asian economies, especially CAD ones, started to alter their reaction function to the virus from 2020Q3. Though the economies were partially simulated via fiscal and monetary easing in payment slips and rate cuts, they still struggled to tame the virus as normalization of mobility led to higher case counts. However, instead of more lockdowns, suppression measures were much lighter, partly due to a prudent fiscal stance as the deficit had already widened significantly that limited the ability to offset through public support (Nguyen 2020b). As such, domestic activity was able to normalize, albeit gradually. We can see this not just through Google Mobility data but also the high-frequency indicators such as the Purchasing Managers Index, which show a gradual improvement in business sentiment and activity. And this is especially helpful for CAD economies, as their growth model is primarily domestic-dependent. Of course, nowhere is as normalized domestically as mainland China, Taiwan, and Vietnam. If we look at real investment growth in Asia, we can see a much better performance for the surplus economies than for those with current-account deficits. The reason is that the latter are domestic-demand-driven while domestic demand collapsed. The rebound in 2021 should, thus, be quite natural.

As regards external imbalances, the sharp decline of imports has allowed economies such as India and the Philippines to turn into surplus and for Indonesia to have a narrower deficit. In addition to the current account absorbing shocks through imports, the sharp turnaround of remittances as well as increasing foreign capital inflows helps ease financial conditions rather materially in these CAD economies. Their adjustment in financial conditions, for reasons discussed above, will also pave the way for a recovery in 2021 as deficit imbalances get attuned. Thus, even before the vaccines arrive, emerging Asian economies, especially the worst-performing ones, have already started to stage a recovery on improved financial conditions, led by a softening US\$, low interest rates, and a better current account. After a large injection

by central banks in developing countries since the end of February 2020 (Figures 11 and 12), as well as massive fiscal injections, financial conditions eased significantly in developed markets and started to filter through to emerging markets (Figure 8). The large share of negative- to low-yielding rates, as well as increasingly high valuations of developed markets' equities, gave a push for investors to go up the risk curve. That risk appetite has found its way to Asia, which is especially key for CAD economies that need foreign funding, as they were most affected by the anti-risk outflow at the end of 2020Q1 and early 2020Q2.

All in all, the return to calmer times, with a clear pro-risk sentiment, has pushed the dollar lower against virtually all currencies (Figure 13). This constitutes another positive element to capital inflows into emerging Asia. Finally, the conclusion of the US election with Biden winning the presidency but with a likely divided Congress should mean more policy continuity with low rates, and a massive fiscal stimulus and, most likely, the existing tax regime left intact. That should also provide another catalyst for pro-risk investment activities into Asia, which should help the laggard Asian economies the most, as they have a much more favorable base upon which to recover.

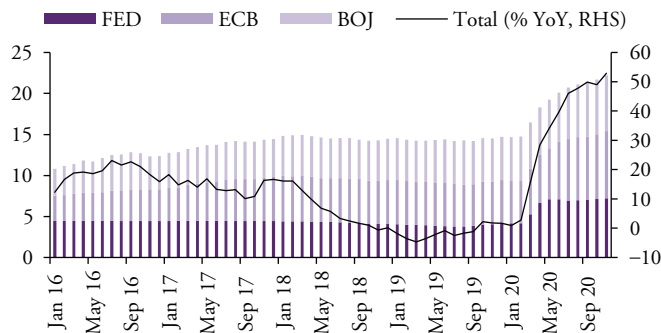
Beyond the normalization of domestic demand, especially for CAD economies, the regional and global recovery will also help with export growth. In 2020, COVID-19 has



Notes: Average of Q1, Q2, and Q3 if available.

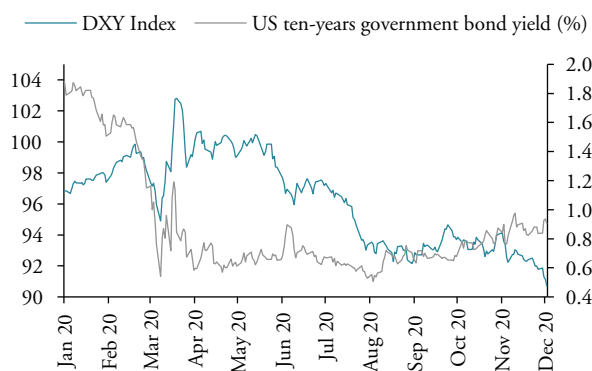
Source: Natixis, CEIC, Bloomberg.

Figure 11 Current account as of GDP (2020, percent)



Source: Natixis, Bloomberg.

Figure 12 Total assets on balance sheet (US\$ trillions)



Source: Natixis, Bloomberg.

Figure 13 US ten-year government bond yield and DXY

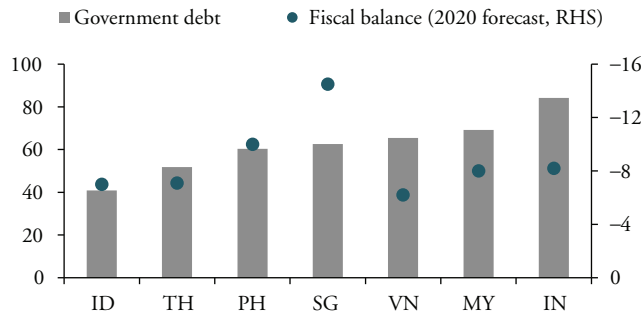
benefited the digital, health, and home economy where Asian tech, electronics, and medical goods outperformed economy sectors such as oil, gas, and industrial products such as cars, as well as consumer goods such as textiles and footwear. Only mainland China, North Asia (Taiwan, South Korea, Japan), and Vietnam, as well as selected sectors in economies such as Malaysia and Singapore, did well overall for exports as they had the composition necessary to benefit from the trends. Commodity-driven economies such as Indonesia have done rather poorly for exports in 2020. But an expected improvement in growth in the US, the EU, China, and key Asian economies should spur export growth in 2021, which should be supported by the rotation out of the tech-driven cycle. All in all, we expect the US to grow by 4.1 percent, the EU by 5.7 percent, and China by 7.8 percent in 2021.

One of the big questions for markets within that favorable scenario is how fast international mobility of people can recover. Our expectation is that international travel should start to normalize in the second half of 2021 as vaccines are being deployed. That means that meaningful recovery of sectors related to tourism such as retail and hospitality for most exposed economies will take place more earnestly in the second half of 2021. The corollary of this is that economies which are highly dependent on visitors will not see a full recovery in 2021.

As Asia is expected to stage a recovery in 2021 (Figure 15), we expect both fiscal and monetary policy to take a back seat. Wider fiscal deficits in 2020 (Figure 14) and higher leverage levels in public and non-public sectors will dampen the appetite for higher spending, especially as the private sector is expected to recover in 2021. On the monetary side, while monetary conditions remain tight for many Asian economies, especially Malaysia, the space to cut interest rates will narrow in 2021 as growth stages a recovery, propelling the consumption and investment cycle, pushing inflation higher.

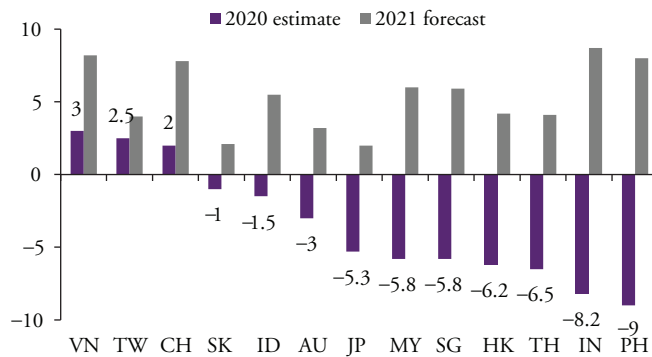
The strengthening of Asian currencies since April 2020 are a cause of concern for some Asian economies, especially exporters such as South Korea, but with rates close to the zero bound, the policy choice for interest-rate cuts to weaken currencies remains limited and will have to be driven by communication and interventions rather than rate cuts. For CAD economies, especially Indonesia, a rise of IDR versus US\$ is more welcomed as it alleviates the foreign-currency debt burden as well as making imports less expensive.

Overall, we expect growth to rebound in Asia, with CAD economies catching up with East Asian economies on normalization thanks to improvement of domestic mobility and



Sources: Natixis, IMF, BIS.

Figure 14 Fiscal condition for 2020 (percentage of GDP)



Source: Natixis.

Figure 15 Natixis GDP forecast for APAC economies (percent, YoY)

the exit out of lockdown policy, better liquidity from both domestic rate cuts, and pro-risk flows from foreign investors. The delivering of the vaccine in the second half of 2021 will add another boost, giving a reprieve to long-suffering economies such as Thailand's as well as highly exposed tourist economies such as the Association of Southeast Asian Nations (ASEAN) and Hong Kong. The improvement of external demand, too, led by the recovery in the US, the EU, and China, should bolster exports in the region, with a rotation out of digital and into other economic sectors. Improvement of activities should allow central banks to hold their interest rates unchanged. Wider fiscal deficits and higher debt in 2020, as well as better private-sector demand, will limit the appetite for more fiscal support. That said, the recovery in 2021 is not without risks, which we will cover in the next section.

3 RECOVERY TO COME WITH SOME BURDENS AND ADDITIONAL RISKS

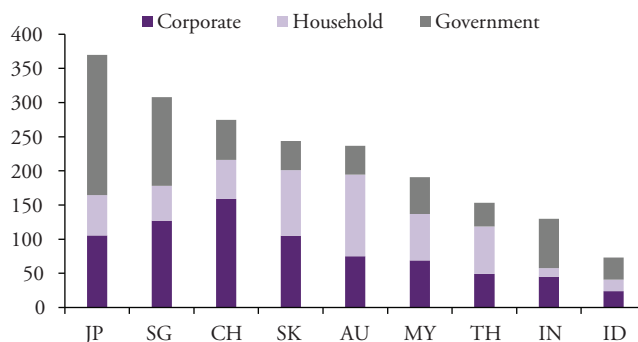
The optimism of the regional recovery does come without the handover of the pandemic as seen by the successful containment of COVID-19 spread in mainland China, South Korea, and Taiwan, as well as the growth rebound, especially in exports. Issues lie

ahead and the most obvious one is debt burden, notwithstanding the more structural one: aging. One silver lining, though, is the recent announcement to move ahead with more regional trade integration, through the Regional Comprehensive Economic Partnership. All these issues, whether it is our rather rosy baseline scenario or the longer-term implications, come with important risks. This section develops the longer-term issues (debt, aging, and trade integration) with the most important risks.

3.1 Debt burden and weaker income growth may limit the investment recovery and consumption

Most Asian economies have swiftly offset suppression measures with direct and discretionary stimuli but revenue has continued to weaken, whether at the company, household, or government level. In the same vein, debt has continued to pile up, albeit to a lesser extent than in developed markets. Correspondingly, on the private-sector side, companies have shed headcount and reduced investment as revenue and profitability has stalled. That has helped with the adjustment process by lowering costs, but still leaves the stock of debt elevated. On the household side, given limited income support by governments, Asian households have taken on more debt, with falling income growth. South Korea stands out, given its already very high household debt, which increased by 7 percent YoY in 2020Q3 to 88 percent of GDP. Figure 16 shows the debt stock in 2020 for selected Asian economies. The increasingly high debt levels imply that monetary support will remain necessary to keep interest payments sustainable. On the household side, higher debt levels in places with an already high debt load, such as Australia, South Korea, and Thailand, mean that the propensity to consume in the future is also dampened by high interest expense payments – a key risk to our recovery prospects.

For lowly indebted economies such as Indonesia, India, and the Philippines (CAD economies), the worry is less about the debt stock, especially household debt, than about income sources. To cope with weaker earnings, households and corporates reduced consumption and investment significantly, and more than the rest of Asia. That said, given the already relatively low living standards and GDP per capita, this coping mechanism is unsustainable and these economies need to raise income sources to grow



Note: Data as of 2020Q1.

Source: Natixis, BIS.

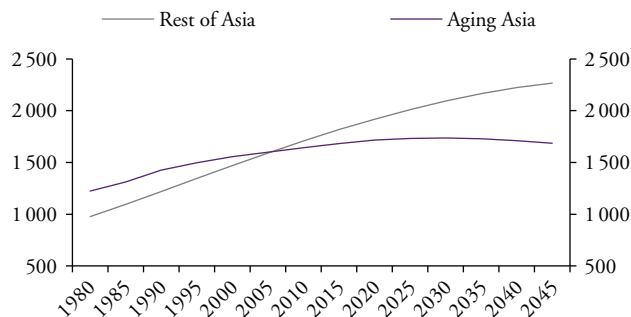
Figure 16 Debt to GDP (percent)

consumption and investment. While portfolio flows, and to a lesser extent FDI, are returning and will increase next year, household income sources are too dependent on remittances and need to diversify to more sectors such as exports, and especially manufacturing goods. The investment and labor reforms passed by Indonesia (Nguyen 2020c) are a step in the right direction to address this income weakness. The Philippines too is working on investment reforms to be more competitive. While positive, the key risk is that these reforms are too slow to attract enough income and funding in 2021 and thus limit the ability of these economies still dependent on foreign capital to recover in 2021. This is particularly important in 2021 as domestic demand is expected to rebound and with potentially widening current-account deficits through the increase in imports.

3.2 COVID-19 burden: accelerating aging trends and declining fertility in Asian economies, pushing down growth potential

Another key burden to our outlook is of course aggressive aging in many Asian economies. Dampening growth momentum puts pressure on already weak pension systems that are further eroded during the pandemic as countries dip into public savings to offset reduced income. COVID-19 has not helped as fertility rates fell further for countries such as mainland China and South Korea, exacerbating existing trends. Working-age population in Hong Kong, Japan, mainland China, Singapore, South Korea, Taiwan, and Thailand peaked in 2015 and will gradually decline at an accelerating rate in the coming decades (Figures 17 and 18). By 2050, the elderly population in these countries is expected to increase to 27 percent, from 7 percent in 1995. Our report explores the consequences of this important trend at the macro and sectoral level (Herrero/Nguyen 2020).

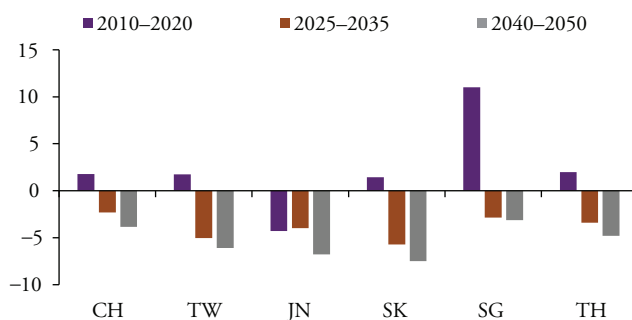
Reduced labor supply creates a drag on growth, but this can be mitigated by higher labor participation, capital investment, and policies that address productivity. That said, it is a gravity-defying act. With fewer workers and an increased elderly population requiring more household savings to sustain spending in retirement, greater pressure on public finances is expected. As such, the more prepared an economy can be while still youthful, the more likely it is to age gracefully. With lower potential output, assuming all else is



Note: Aging Asia includes mainland China, Hong Kong, Japan, Singapore, South Korea, Taiwan, and Thailand.

Source: UN Population Statistics, Natixis.

Figure 17 Diverging demographic trends within Asia (mn)



Source: UN Population Statistics, Natixis.

Figure 18 Working-age population growth rates shrinking for aging Asian economies (percent)

equal, the goal to rapidly grow GDP per capita or the standard of living is more difficult. Some Asian economies, such as mainland China and Thailand, will still be in the ‘middle income trap’ when they rapidly age. Our analysis of external savings, GDP per capita, and pension systems shows that most Asian economies are not adequately prepared for aging, with Thailand being the worst-positioned, while Singapore, Taiwan, and South Korea are more prepared.

Japan shows that even when aging with a high income per capita, productivity tends to slow. As demand for healthcare increased, larger employment in the sector with lower productivity has reduced overall productivity. Furthermore, policies tend to favor the elderly over the young, with larger expenditures in healthcare and pensions than in childcare and education, which has been a political roadblock to improving fertility. Rapidly aging populations have also offset efforts to lift the potential growth rate through increasing labor participation. Therefore, without structural reforms in the labor market and regulation, the Japanese economy could lose vibrancy as the population ages.

Mainland China too will age rather rapidly in the coming decades: by 2050, one out of four Chinese will be elderly, versus one out of ten in 2020. The reduction in the supply of available workers, other things being given, will push up wage costs and drag down corporate earning abilities and thereby economic growth as the economy has fewer productive adults. In mainland China’s case, the deceleration of total factor productivity is more substantial than its decrease of output, which means that even as inputs, labor, and capital were growing, productivity was already weakening (Tombe/Zhu 2019). Moving forward, population aging will further weigh on mainland China’s potential labor input and thus weaken its existing competitiveness in the longer term, taking Japan as an example. The economic transformation toward more capital and skilled-labor-intensive activities will help buffer such a shock but this needs more efficient organization of the factors to enhance labor productivity. Another important consequence is the increased fiscal pressure. The immediate impact of the latter is likely to be limited, but over the longer term the issue could become more concerning if the economy continues to decelerate.

There is a silver lining to an aging Asia. Japan is the pioneer in defying the gravity of aging on growth with clear shifts towards healthcare on the demand side and robotics on

the supply side. With a graying population, sales of pharmaceutical and medical equipment have grown, but the government has controlled the expense through price control. Japan has also become one of the biggest producers and users of industrial robots. Fewer workers mean e-commerce will be essential to reduce costs and increase productivity. Although a shrinking population may be challenging for finance, automobiles, and lifestyle, as such industries rely on massive consumption or transaction from customers, evolving consumer patterns will bring opportunities. The costs of healthcare have stimulated the demand for pensions and investment services, meaning asset management is more relevant than ever. Car sales will also be supported by the popularity of mini-cars and the preference of ongoing driving by the elderly. In terms of lifestyle, traveling is the top choice among all hobbies for the retirees. However, insurance, communication, and education could face pressure with the need to transform their business models and increase the reliance on overseas markets.

While Japan has shown a clear path of an aging society, its example is not the only destiny as Taiwan shows that capital-intensive sector specialization and industrial policies can mitigate the impact of aging on growth. The reasons behind the sprouting tech sector are the heavy R&D expenditure and supportive government policies. As such, Taiwan has managed to keep its growth of total factor productivity afloat against the aging population. From a global perspective, ongoing input for robotics will be one of the key game-changers in industrial production and services.

3.3 A silver lining to structural issues, increasing regional trade integration through RCEP

After two years of trade war and a pandemic leading to decoupling but also deglobalization forces, Asian countries have managed to turn that tide through a new regional trade integration tool, namely RCEP. This is very good news for regional trade flows, while it pushes the burden for outsiders to the region which may miss out on Asia's dynamism. This is, of course, the US as well as Europe. Among RCEP members, it is interesting to note that the biggest winner might not necessarily be China. China is no doubt bound to benefit, but other members within RCEP may benefit even more. China will face fewer barriers to exports into the rest of Asia (including e-commerce). But the ASEAN, on the one hand, and South Korea and Japan, on the other, will find it easier to build their value chain where production is based in the ASEAN with North Asian investment. In fact, the ASEAN has been receiving an increasing amount of manufacturing foreign direct investment (FDI) from North Asia which is already bigger than their FDI into China. Such a sharp increase in investment into the ASEAN is not only a response to higher labor costs in China but also to diversifying away from an excessively China-centric value chain. Thanks to this, Japan and South Korea's trade integration within the ASEAN has also been increasing, especially when focusing on intermediate goods. Against this backdrop, the ASEAN will likely grow its own manufacturing capacity, thanks to North Asia's FDI. However, a good chunk of the final demand might still be in China. Nevertheless, it is important to note that the RCEP negotiations have been dragging on for eight years and that the final agreement has been watered down in terms of key liberalization measures. Not only was the geographical coverage bigger when the negotiations started, but the scope in terms of liberalization was also larger. Furthermore, when RCEP started as response to the Trans-Pacific Partnership (TPP), the US-China strategic competition was just starting, while it is now pooling RCEP members in different directions today. The best example is recent trade frictions between China and Australia, but

there could be many others. In the same vein, increasingly pervasive US sanctions against China targets will not help in making RCEP a success.

Against the backdrop of rather negative structural trends, except for regional integration, we have to be mindful of a number of key risks:

Risk #1: Vaccine setback The first and most obvious is a setback in the current narrative that the pandemic should come to an end by the end of 2021, thanks to a flurry of vaccines. The low – but still important – probability of a setback would constitute a huge shock for Asian economies as the fast recovery that we are expecting for 2021 would probably not materialize. This is more the case for economies which have run out of fiscal and monetary space.

Risk #2: Inflation from pent-up demand and insufficient supply, especially in CAD economies Overall, with growth staging a comeback and companies resuming investment after a massive drop in 2020, the risk of inflation looms if consumption and the investment cycle upturn outstrip supply. Such a risk, let alone the strong cyclical recovery expected in 2021, implies that Asian central banks' easing cycle has probably come to an end. In 2021, Asian central banks will not only pause but also consider the possibility of exiting from QE.

Risk #3: Although we do not expect a reset of US–China tensions, it could be worse Before COVID-19, the key risk to the global economy was the US–China tensions and rising deglobalization threatening regional stability and growth. The election of Joseph Biden, who is seen as less hawkish than President Trump, is unlikely to change the strategic competition between the US and China. Already, Biden has said that he will not be repealing the Phase 1 tariffs and other tariffs until comprehensive review. His rhetoric is also seen as rather hawkish in recent days on China. And in the final days of his term, Trump passed a series of executive actions that further put a wedge between China and the US that will require the Biden administration to reverse.

In other words, while the Biden administration may cap the deterioration of US–China relations, it is very unlikely that it will reverse to the Obama years. So far, China has done well in recovering in 2020 thanks to its containment of the virus, which has helped with growth recovery. Our studies of Chinese corporates also show that they are outperforming peers due to better domestic mobility and also export sectors that have done well during COVID-19 (Herrero/Ng 2020).

That said, US–China tensions still constitute an important risk for China in 2021, and the region as a whole. This is particularly the case as different stakeholders in the US call for additional actions to contain mainland China, whether Congress or even NATO in its new position paper. Beyond the US, China-related tensions are growing, especially in Australia. Beyond the straining of economic relationships, more disruptive risks could come in the security realm, such as Taiwan and the South China Sea.

Risk #4: Geopolitics pushing supply-chain reshuffling and deglobalization US–China tensions as well as regional geopolitical challenges mean that the decoupling and diversification of supply chains in Asia might continue and it is unlikely that the recent announcement of such a large regional trade deal as RCEP will change that trend (Herrero/Tan 2020). The reason is that the diversification away from the excessive dependence on China has become a key objective of companies in the global value chain. This political consideration may also be important in some cases.

4 CONCLUSION

The COVID-19 pandemic has hit Asian economies hard, which had already experienced difficulties in 2019 due to the trade war, China's decelerating growth, and other idiosyncratic issues, especially in India. As for the pandemic, the shock has been very different across geographical areas. Beyond the extent of lockdowns and the size of the policy response, whether fiscal or monetary, the underlying characteristics of Asian economies also explain differences in growth trends. Countries with current-account deficits have suffered as risk-averse episodes, especially last March, have complicated their necessary external funding, constraining their fiscal support. On the positive front, mainland China, Taiwan, and Vietnam have managed to recover from the COVID-19 shock faster not only because of a better sanitary response to the pandemic but also for structural reasons, related to their sectoral specialization. In fact, an important lesson to draw from the winners and losers of this pandemic is how important an early containment might be but also the sectoral specialization and the fundamentals, especially how costly it might be to depend on foreign funding.

Regarding policy response, the region has shown much more courage compared with previous crises, even in emerging Asia. This is more the case on the monetary front than on the fiscal front – with the clear exception of Japan and Singapore. The introduction of full-fledged quantitative easing in some other geographical areas, such as Australia and even in some emerging countries such as Indonesia, India, and the Philippines, are welcome. Looking forward, most countries in the region would do well to improve on the efficiency of fiscal policy for counter-cyclical purposes. The good news is that aggressive easing in developed markets has driven rates and the US\$ lower, helping with risk appetite.

Among major Asian economies, mainland China has clearly been the first in and the first out with a rather robust recovery. We expect the recovery to continue to be supported by the roll-out of new vaccines. Against such a background and supported by base effects and the impact of the 2020 fiscal policy stimuli, growth in 2021 will be much faster even if cyclical. The rotation away from COVID-19 sectors into the real economy will help old sectors, especially transportation, energy, and retail sales, as well as countries most dependent on them. The challenges of COVID-19 have also facilitated progress of a number of reforms in India, Indonesia, and the Philippines, to which investors will pay even more attention as the clouds of the COVID-19 pandemic continue to be lifted. Japan, by contrast, will have a harder time in terms of lifting the economy beyond a statistical rebound, notwithstanding a much bigger fiscal and monetary stimulus. The minimal structural reform during the Abenomics years will continue to push down potential growth.

Overall, with growth staging a comeback and companies resuming investment after a massive drop in 2020, our outlook remains positive but not without acknowledging the hangover of the pandemic. In fact, faster debt accumulation is an important negative consequence of COVID-19 and the policy response, not only in Asia but globally. The second negative consequence is an acceleration of demographic problems due to the fall in the fertility rate across the globe. In Asia, this hits aging economies much more brutally than those with a still-positive demographic dividend. On the positive side, there is a silver lining to COVID-19, namely a potential boost to regional trade integration thanks to RCEP.

However, a number of important risks remain to our positive scenario for 2021. The first and most obvious one relates to vaccine-related delays, which could come from production or distribution bottlenecks, as well as new mutations of the COVID-19 virus and renewed lockdowns. At the other end of the spectrum, an inflationary shock could appear

due to supply constraints on the back of pent-up demand from a smooth vaccine roll-out and widespread optimism. Supply constraints would obviously hit economies with current-account deficits more severely, as such economies rely more on imports of goods. The third one comes from growing tensions between the US and mainland China, especially as they move further from economics to security issues. Taiwan and the South China Sea are clearly the most important flashpoints. Finally, such a complicated geopolitical outlook, coupled with the lessons learned from COVID-19 regarding supply disruptions, could push the reshuffling of value chains further, with important consequences for Asia. The risk of decoupling, or even deglobalization if more generalized, could actually extend beyond trade towards technology or even finance, with obvious negative consequences for growth in Asia and globally.

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