Chapter 1.
Macroeconomic Prospects and Challenges
Highlights

• ASEAN+3 economies demonstrated their resilience to the health and economic impact of the COVID-19 pandemic, with a V-shaped rebound in the latter part of 2020. AMRO staff’s baseline forecast is for the regional economy to expand by 6.7 percent in 2021, following a slight contraction in 2020. The risks to a sustained recovery are now focused largely on those arising from the longer-lasting consequences of the pandemic—the inevitable “scarring” of segments of the economy, and their ultimate implications on financial stability and sovereign debt. Meanwhile, the future of US–China trade relations continues to simmer in the background.

• The pandemic has been defined by its uneven impact on industries and businesses, with attendant implications for the workforce and individual economies in general. Public health measures disrupted, in particular, close contact services and severely limited consumption. Even with the pickup in economic activity, some output losses are expected to persist. Unsurprisingly, investor sentiment was dampened by the uncertain outlook, but promising signs of improvement are emerging. With the electronics sector expected to continue its recovery, following the downturn in 2019, capital expenditure is likely to follow. Meanwhile, investment diversion from China to ASEAN represents an upside risk factor for the latter, post-pandemic.

• Rapid digitalization as a result of the pandemic has fundamentally transformed economies by permanently changing the way companies do business, individuals work, and consumers consume. Some segments of the economy will rebound quickly with the turnaround in manufacturing, from innovation in technology, or benefit from pent-up savings and robust domestic demand, while others will remain under pressure and must adapt, move on, or reinvent themselves to survive. Employment prospects will also depend on the recovery of the services sector, which accounts for a large share of all jobs, including in the more vulnerable informal and smaller business segments.

• Trade in the highly export-oriented ASEAN+3 region was adversely affected by the pandemic, just as it had started to recover from the US–China trade conflict, and the outlook is expected to remain complicated. While export contraction troughed in mid-2020, improvements have been uneven across the region and sectors—some have benefitted from pandemic-driven demand, while the more traditional export sectors and goods have continued to lag. Trade in services, a cushion to goods trade in 2019, has been devastated as the pandemic has shut down the travel and tourism industry and other close contact services, and the deployment of vaccines will play a key role in their revival.

• The financial sector has undergone an interesting bifurcation. Markets have posted positive returns—indeed, equity markets have soared—as unprecedented policy stimuli and, more recently, the development of highly efficacious vaccines, have motivated a sharp rally in asset prices. In contrast, concerns are rising as to what corporate and household—and hence bank—balance sheets could reveal about economic scarring when the stimulus policy measures are eventually removed. AMRO staff’s top-down stress tests of individual bank balance sheets in ASEAN+3 economies suggest that the majority of banks are well-buffered against large shocks to asset quality.

• Policymaking in the year ahead should be aimed at repairing the damage from the pandemic and allowing them to properly recover to minimize scarring, while safeguarding against new crises. Pandemic policy responses have been unprecedented by any measure, in the form of monetary easing, liquidity injections, massive fiscal stimuli, and regulatory forbearance, to offset the liquidity squeeze and income losses. Consequently, policy space has narrowed, albeit still comfortable for some. Policymakers are, appropriately, thinking about the eventual transition from the myriad of crisis response policies but the decision as to when and how to exit smoothly without triggering any cliff effect to growth and financial stability is a challenging one, and should be effected in a holistic, coordinated manner. Realistically, rebuilding policy space will be feasible only in the medium-term.