Chapter 1.
Macroeconomic Prospects and Challenges
ASEAN+3 economies entered 2021 on an optimistic note, after relatively effective containment of the pandemic in 2020. Economic recovery was well underway, only to be disrupted by the Delta surge that took the region’s COVID-19 cases and deaths to record highs. In response, containment measures were reimposed or retightened, border reopening plans were shelved, and vaccination programs were accelerated or brought forward. The emergence of the more infectious Omicron variant poses a threat to the continued recovery of the region in 2022. However, the acceleration in vaccination coverage should help mitigate the risk to the recovery, and regional economies are likely to continue opening up gradually. AMRO staff’s baseline growth forecast for 2022 is expected to remain relatively robust at 4.7 percent, with inflation at 3.5 percent. However, risks to the outlook are mainly on the downside.

- More virulent strains of COVID-19 that are resistant to existing vaccines could emerge. A new wave of such infections could prompt a retightening of containment measures and further test the region’s healthcare capacity, derailing the prospects of economic recovery.

- An emerging key risk is the fallout of the Russia-Ukraine conflict, the immediate effects of which have been felt most notably in commodity—particularly energy—prices. A prolonged conflict will keep energy and food prices elevated and risks stoking inflation and lowering growth in the region where most economies are net energy importers. The region’s exports could also suffer as a result of lower global growth.

- As the pandemic drags on, the continuation (or recurrence) of supply chain bottlenecks that disrupted trade flows in 2021 cannot be ruled out. The likelihood of more COVID-19-related production shutdowns, raw material shortages, and port-handling delays can have cascading effects given tighter intra-regional trade linkages in recent years. Non-pandemic-related supply chain disruptions, such as shipping-lane and airspace closures during the Russia-Ukraine conflict, could disrupt freight and drive up cargo costs. Persistent supply chain disruptions could undermine the region’s export performance and raise global cost pressures.

- While financial markets are expecting a more hawkish stance by the US Fed, a sharper-than-expected monetary policy normalization in the United States could lead to a premature tightening in global financial conditions, with potential implications for interest rates, capital outflows, and financial market volatility in the region. Global bond market volatility has increased in tandem with the shift in the US inflation outlook and the attendant uncertainties. As a result, borrowing costs have trended higher, spilling over to emerging markets, including those in the region. A premature tightening in global financial conditions resulting from US Federal Reserve policy surprises can lead to volatility spikes and fuel global risk aversion. Higher risk premia can cause higher debt service and refinancing risks, and disruptive corrections to stretched assets, depressing regional growth.

- In the financial sector, the prolonged impact of the pandemic on business and household incomes means that financial risks are still elevated. If the recovery is delayed, more businesses and individuals would face greater financial distress, and this could have implications for banking sector soundness. Debt-at-risk analysis of ASEAN+3 companies suggests that default risks appear to have moderated in 2021, after rising sharply in 2020 as debt surged to record levels. Improvement in earnings amid an economic turnaround and policy measures (interest rate reductions, credit expansion, and regulatory forbearance) have helped to keep nonperforming loan ratios low, so far. AMRO staff’s top-down stress tests of individual bank balance sheets in ASEAN+3 economies suggest that the majority of banks continue to be well-buffered against large shocks to asset quality.

- Policymaking continues to be focused on alleviating the impact of the pandemic and supporting an economic recovery. The proactive and exceptionally large stimulus and support programs introduced to counter the economic fallout of the pandemic in 2020 were followed by a more targeted and calibrated approach in many of the region’s economies. Looking ahead in 2022, given the less supportive global policy settings, regional policymakers will have to undertake a crucial balancing act—avoiding a premature withdrawal of policy support in view of the still nascent economic recovery, while at the same time, facilitating the reallocation of capital and labor to new and expanding sectors, and rebuilding policy space to prepare for future risks.