TACKLING CORONAVIRUS (COVID-19)
CONTRIBUTING TO A GLOBAL EFFORT

COVID-19 in Emerging Asia: Regional socio-economic implications and policy priorities

27 April 2020

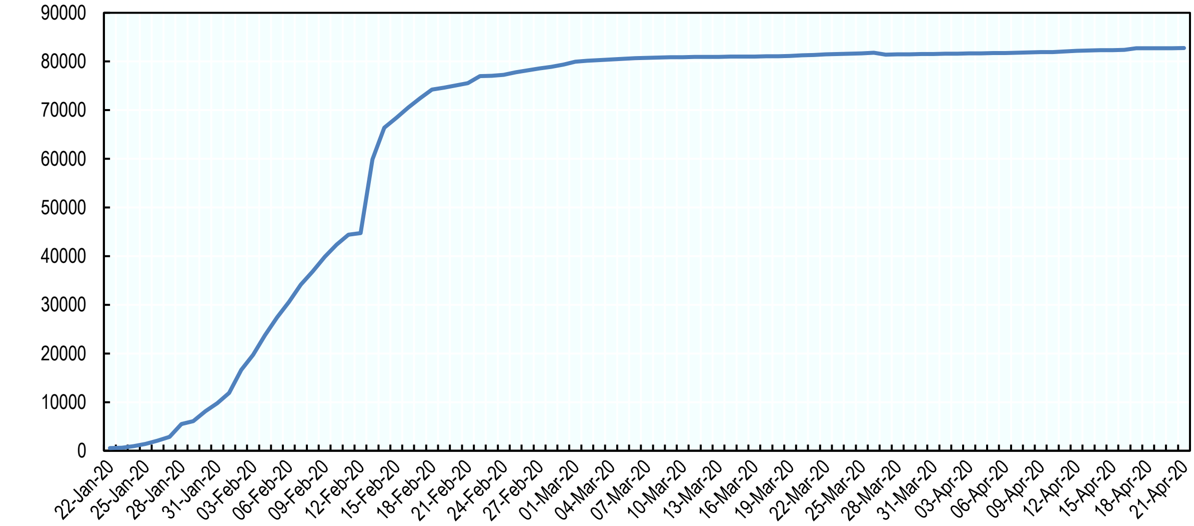
The rapid spread of Covid-19 has been affecting economic and social conditions in Emerging Asia. Economic growth, which was already weakening before the outbreak, is facing significant pressure and may weaken further. A sharp decline in regional economic growth is expected in 2020. The pandemic will likely affect financial markets and the banking sector, as well as weaken trade flows. Impacts on firms and the labour market are already apparent. Immediate healthcare responses and lockdown measures have been trying to curb spread of the virus. Timely policy responses in health and labour markets, combined with appropriate monetary and fiscal policies, will be critical. Further assessment of the economic implications of lockdown and curfew measures will be needed. Addressing medium-term challenges, including maximising the use of digitalisation and further strengthening regional co-operation, is also important.

Macroeconomic situation in Emerging Asia

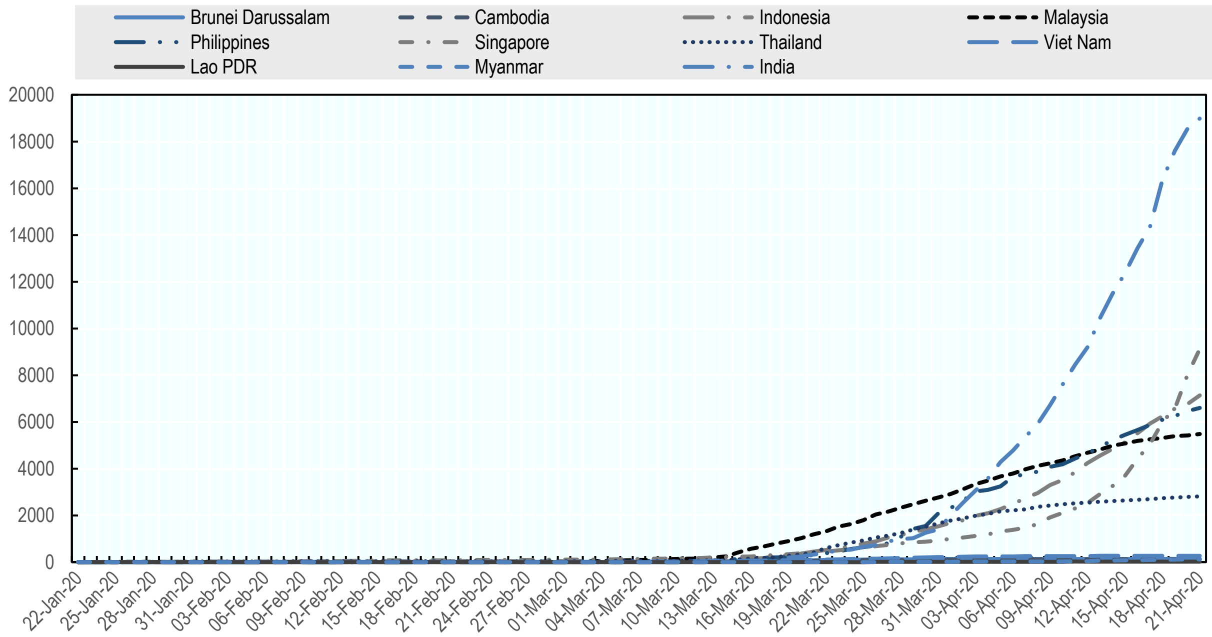
First detected in the People's Republic of China (hereafter "China"), Covid-19 spread rapidly to other countries, infecting nearly 2.5 million people worldwide and killing more than 170 000 to date (21 April). From mid-March, Southeast Asian countries started to experience an increase in the number of cases (Figure 1). As of 21 April, India confirmed nearly 19 000 cases, though the sharp increase can partly be attributed to more testing. Singapore surpassed the bar of 9 000 confirmed cases, while Indonesia has counted over 7 000 as of the same date.

Figure 1. Cumulative confirmed cases of Covid-19 for Emerging Asia

a) China



b) ASEAN and India



Source: Johns Hopkins University.

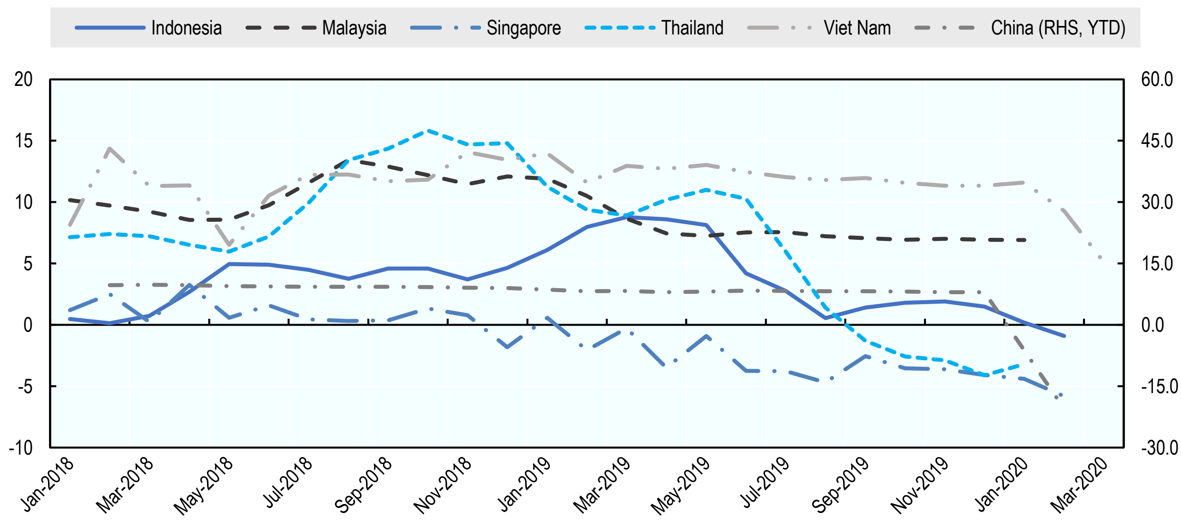
Covid-19 dims economic growth prospects

The rapid spread of Covid-19 since the end of 2019 is putting immense pressure on economic and social conditions in Emerging Asia. The region, whose growth has already been weakening due to trade tensions between the United States and China that predated the outbreak, is facing strong headwinds. A sharp decline in the region's economic activity is anticipated in 2020. The economies of several countries are likely to contract. An early estimate of Singapore's gross domestic product (GDP) in Q1 2020, for example, reveals a 2.2% decline in output year-on-year.

GDP growth in 2021 is beset by uncertainties as the pandemic still unfolds. Recovery is foreseen, but the shape of the growth path will depend on a number of global and country-level characteristics. These include the length of the tail-end of the infection curve, the ensuing impact on the stability of banks and financial markets as a whole, the speed of re-employment and the pace of private spending recovery. Risk containment measures have already stifled private spending as depicted by the marked downturn in retail sales growth beginning in February (Figure 2). Business and consumer confidence have consequently ebbed, dampening the investment outlook.

Figure 2. Retail sales in Emerging Asia

3-month moving average, year-on-year growth, percentage



Note: China data refer to year-to-date (YTD) growth as published. China does not have data in January of every year. The data series starts in February. RHS means right-hand scale.
Source: CEIC.

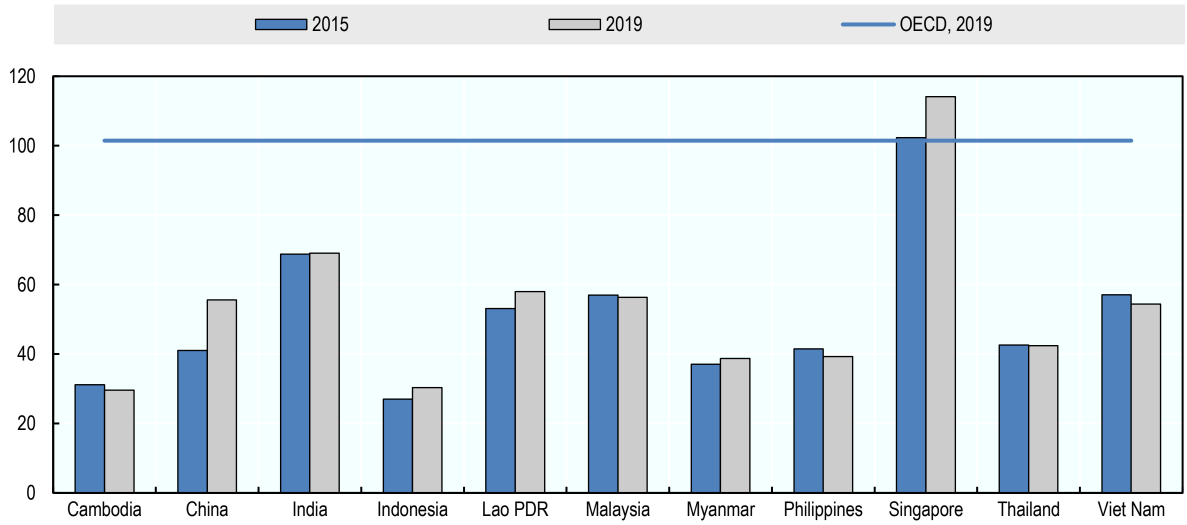
Governments roll out fiscal and monetary measures to ease the strain

Emergency fiscal measures have come in the form of re-aligned spending to Covid-19 needs, disaster funds and supplementary budgets. This spending is mainly to meet the demands of health systems and to support the basic necessities of vulnerable sectors. Multilateral institutions, foreign governments, private sector, and other philanthropic institutions have provided valuable contributions to this effort in the region.

In general, Emerging Asia has some fiscal leeway to address the needs of countries' economies under lockdown. Governments have been actively managing their debts and keeping their levels as a share of GDP under control in the last few years (Figure 3). However, it is unclear how long lockdown and curfew measures will last. This means a possible expansion of financial resources to support weakening economies. Appropriate targeting in government spending is crucial.

Figure 3. General government gross debt in Emerging Asia, 2015 and 2019

Percentage of GDP



Note: The country-level data follow the data in the *IMF Fiscal Monitor Database*. OECD average is calculated using the country-level gross debt ratios in the *IMF Fiscal Monitor Database* and the GDP data in the *IMF World Economic Outlook Database*.
Source: OECD Development Centre, *IMF Fiscal Monitor Database* and *World Economic Outlook Database*.

Emerging Asian economies have been similarly strongly inclined to increase monetary support, following the lead of advanced economies. They are adjusting reserve requirement ratios for banks. Policy rates have been cut multiple times to provide the necessary liquidity. They have been lowered by between 10 and 75 basis points (bps) since the start of the year. Meanwhile, local currency reserve requirement ratios for banks have been cut by between 25 and 200 bps. Monetary authorities have also used their open market operations tools to inject liquidity into the system, including by buying government debt securities. The moderate headline inflation in the region leaves some policy flexibility for central banks. Global oil prices have incidentally declined sharply since December 2019.

Crisis batters capital and trade flows

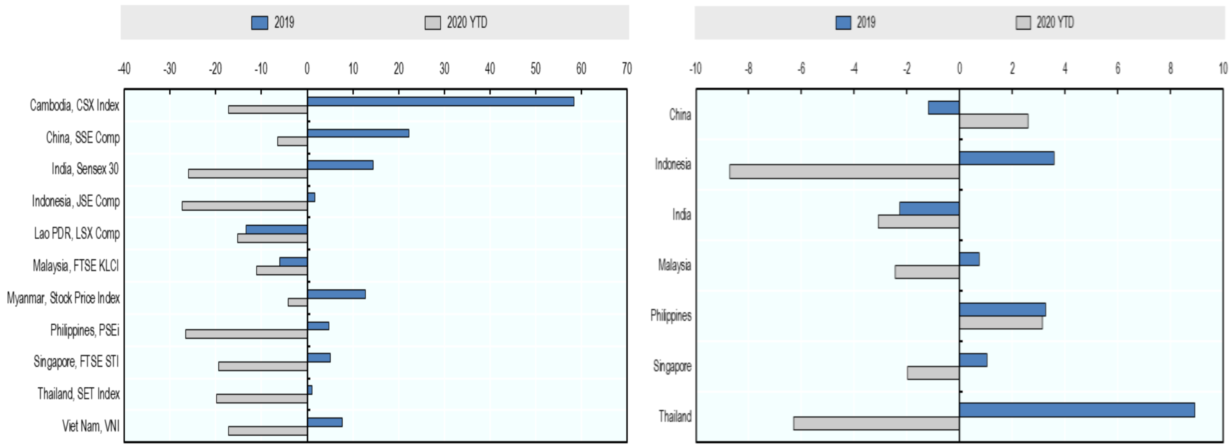
Financial markets reel from the pandemic, testing resilience of banking sectors

The health crisis has pummelled equity prices as earnings expectations decline (Figure 4). Meanwhile, bond markets have remained calm and still closely track the central banks' guidance. The region's currencies have mostly lost ground since the end of 2019. The depreciation of the Indonesian rupiah and Thai baht against the currencies of their trading partners has been marked. Meanwhile, considering the growing strain on the loan servicing capacity of the borrowers, the banks are being supervised closely.

Figure 4. Equity indices and nominal effective exchange rates in Emerging Asia, 2019-20

Year-on-year change, percentage

Equity indices **Nominal effective exchange rates**



Note: Data are as of 20 April 2020 for the equity indices and 14 April 2020 for the NEER. YTD means year-to-date. Calculation for 2019 is from end-2018 to end-2019.
Source: CEIC, Fusion Media Ltd., investing.com, and Bank for International Settlements.

The banking sectors in the region are generally well-capitalised. However, the risk of increased stress in the banking sector is rising. Small and medium-sized enterprises (SMEs), which comprise over 90% of the firms in the region, are particularly vulnerable to the downturn. Their insolvency can have systemic implications. The same can be said of the firms that are directly affected, such as those in the tourism industry. These include airlines, airport and port operators, cruise liners, hotels and other accommodation providers, private mass transport and travel agencies, among others.

Indicators suggest weakening of capital and trade flows

Data on financial account flows for the first three months of the year have yet to be released. However, if the movement in equity prices and exchange rates were any indication, the downward pressure on portfolio and other investment flows is strong. Similarly, the deterioration in business conditions and the temporary stoppage of work on large projects could have weakened the inflow of foreign direct investment.

The sizeable liquidity infusion in advanced economies could reverse the trends in financial capital flows in the coming months. Yet this brings a different policy challenge. One issue is the return of the global financial system to a state of low interest rates, high liquidity and rapid debt accumulation. Over a longer period, this could result in sharp and disruptive cross-border capital flows in emerging markets. Lessons could be drawn from changes in dynamics owing to the quantitative easing led by the United States and Europe just a few years back. It pays for the monetary authorities in the region to continue strengthening macro-prudential surveillance frameworks and toolkits.

In addition, lockdowns and curfew measures also affect migrant workers, which in turn could lead to a fall in remittances. Countries with a large number of overseas workers, such as the Philippines, India, and, to some extent Viet Nam, are particularly exposed.

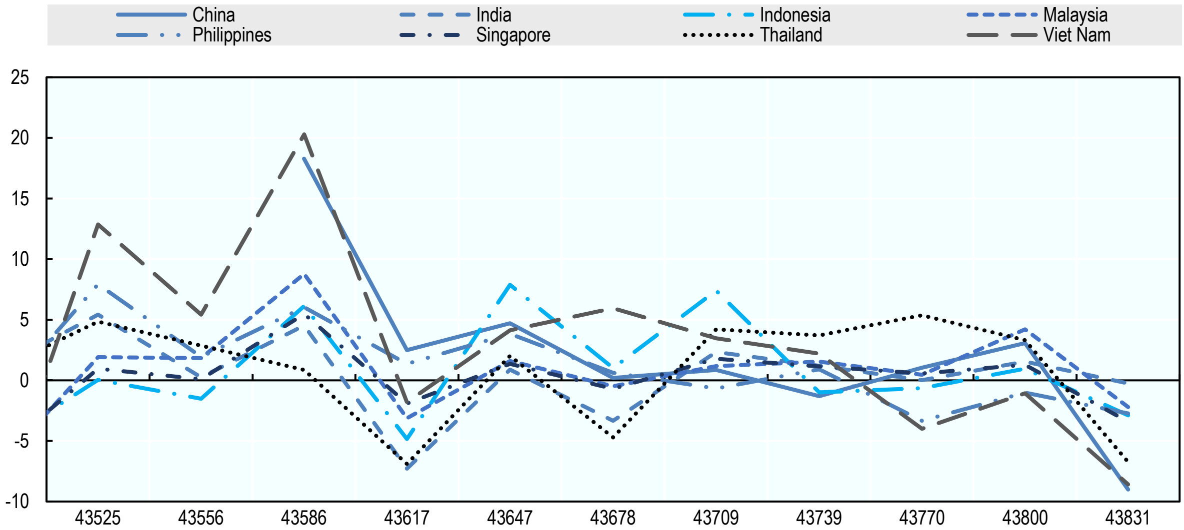
Earnings from goods trade, which had been diminished by the trade tensions in 2019, remain lacklustre despite the low base (Figure 5). A more pronounced impact of Covid-19 could presumably be seen in exports and tourism data starting March 2020 (which are not available yet for most countries). It was in

March that countries significantly tightened border controls and the global value chains began to be hampered more stringently.

From the production perspective, goods exports, particularly manufactured goods, tend to use substantial service inputs. These include logistics, finance, business facilitation and communication services. This linkage makes the service sector sensitive to external market developments akin to the industry sector. In contrast, when the trade tensions erupted in 2019, the service sector's growth generally remained stable as manufacturing growth dipped in many countries.

Figure 5. Export growth in Emerging Asia

3-month moving average, month-on-month growth, percentage



Source: CEIC.

The impact on firms and households is profound

Covid-19 is disrupting labour and the global supply chain…

Firms are confronted with less available labour as a result of increased mortality and sick leaves related to Covid-19. The lockdown and curfew measures may have an even larger effect on both manufacturing and service sectors. Evidence from Malaysia and Thailand points to a drop in capacity utilisation across a broad range of sectors. Furthermore, firms that rely on international supply chains, particularly with suppliers in China, may be confronted with disruptions from overseas deliveries of raw materials and intermediate products. The drop in the number of foreign tourists severely affects firms in the aviation, tourism and hospitality sectors. Bankruptcies are likely to spike in upcoming months, especially small businesses could be disproportionately affected by the Covid-19 shutdown. According to a survey by researchers at Tsinghua University in February 2020, 30% of 995 Chinese SMEs have seen their income decrease by more than half. In addition, more than one-third of respondents stated they only had cash flow for one month of operations.

…with dire consequences for workers' future employment and income

As firms seek to cope with the downturn by cutting costs, more workers may become unemployed. In a first phase, downward labour force adjustments will probably occur in sectors directly impacted by the lockdown and curfew measures. Restaurants, hotels and other non-essential service providers are more likely than industrial firms to lay off employees in the short term. Data from Malaysia show that more than 14 500 applications for unemployment benefits have been filed since the beginning of 2020, compared to approximately 11 000 claims in the first quarter of 2019.The labour market in Viet Nam could also face significant stress. The country's tax department had to deal with more than 3 000 business closures in Hanoi alone in less than two months.

Job market data in the first half of the year are expected to be weak. This is a key policy issue in the context of keeping social order amid strict limitations to movement. Relative to more developed economies, the unemployment support mechanism in Emerging Asia is notably passive. In response, the governments have set aside budgets for subsistence allowance of the households-in-need in quarantined areas. Some large private sector firms also agreed to continue paying wages even when the business is not operational. These mechanisms, however, are only stop-gaps.

Policy actions are urgently needed on a variety of fronts

Health actions must meet immediate needs and strengthen healthcare systems

Immediate healthcare responses following the outbreak are necessary to curb the spread of the virus. These include rapid public education; promotion of proper hygiene techniques; the importance of social distancing and quarantining when ill; identification of people who have the virus, or had it previously; and other measures to protect workers and their families from health risks. Testing for both active viral infection and antibodies are critical tools. Another important measure is easing strain on health infrastructure, and making more supplies available. Several countries have designated specific hospitals for Covid-19 patients, though in many cases they are reaching full capacity.

Shortages of necessary medical and personal protective equipment are an ongoing concern. Countries will need to strengthen their disease detection strategies and primary healthcare systems to cope with the outbreak and potential future outbreaks. Even after the current pandemic ends, investment in healthcare facilities and education remains key. Based on the most recent data available, most countries in Emerging Asia have fewer doctors per capita than the OECD average. This leaves them poorly equipped to cope with large public health emergencies. Hospital facilities are scarce, and may not have the necessary supplies and equipment to deal with large numbers of patients requiring advanced care.

Support for the most vulnerable should accompany lockdown and curfew measures

The rapid spread of Covid-19 has caused many countries to implement lockdown and curfew measures. Nationwide lockdown are imposed in Malaysia, Viet Nam and India. Countries such as Indonesia and the Philippines have applied lockdown in several provinces and regions. China has also put some areas under lockdown, including Wuhan. Cambodia and Myanmar announced closure of public places or reduction of their operating hours, although without applying total lockdown. In addition to closure of public places, Thailand imposed a national curfew, prohibiting people from leaving their house at certain hours.

Several studies identified that social distancing applied to the population as a whole would have the largest impact on curbing transmission of the disease. On the other hand, the economic costs of combatting the disease through lockdowns are large. Lockdown measures and economic activities have a trade-off. Policy makers in the region face challenges on public health, while mitigating the economic impact of the Covid-19 pandemic. Further discussion of the economic implications of lockdown measures in Emerging Asia will be important.

Implementing lockdown and curfew measures need to be accompanied by other policies that support firms and workers, particularly the most vulnerable. The outbreak is rapidly evolving and affecting various dimensions, and authorities in the region have been applying various measures. However, to be effective, the policy response must be timely, well-coordinated and well-targeted. Lockdown and curfew measures are more effective when they are combined with appropriate macroeconomic policies.

Monetary, fiscal policies must be well-timed to spur growth

Most Emerging Asian economies have room for active monetary and fiscal policies. Indeed, nearly all countries eased their monetary policy stance. Some authorities intervened multiple times within the space of one month. Reductions of policy rates occurred in China, Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam. The reserve requirements applicable to the banking sector were reduced in China, Indonesia and Malaysia. For their part, Philippine policy makers relaxed some regulatory and reporting rules applicable to banks. Other measures include loan maturity conversions (Malaysia), direct provision of credit (China), open market operations (India and Indonesia) and temporary suspensions of loan principal/interest repayments (Malaysia).

In addition to monetary policy reactions, many countries unveiled comprehensive fiscal stimulus packages to support businesses and households. The composition of the package varies by country, but many countries in Emerging Asia adopted financial subsidies, tax deferral and exemption, and increased direct spending. Overall, the composition, timing and targeting of stimulus packages will be crucial to bring about the desired growth-lifting effect.

Countries must ease economic shocks for workers and rethink the nature of work

Beyond the urgent health concerns of workers and their families, Covid-19 and the following economic shocks will impact the labour market through unemployment, wages and effects on vulnerable workers. Countries in the region have announced various measures to support jobs and income. Most countries have implemented flexible working arrangements, including teleworking and short-time work. Governments in some countries, such as those of Singapore and Cambodia, provide supports to impacted firms by co-funding their wage costs. Some countries, such as Malaysia, China and Viet Nam are suspending or reducing contribution to pension funds and/or social security. A number of countries, including Malaysia and Singapore, are providing temporary social assistance such as direct cash transfers. Supports are also provided for necessities. Indonesia, for example, provides additional funding to its basic food card programme, while Thailand and Malaysia announced water and electricity discounts. In the Philippines, the social security system has begun providing unemployment benefits for workers who lose their jobs.

Governments must embrace the digital economy

The Covid-19 outbreak has demonstrated the importance of digitalisation in countries' ability to absorb the shocks linked to crisis situations. Education, work environments, administrative services and access to healthcare have all been disrupted by policies of lockdown and curfew measures. In a state of confinement, the digitalisation of these sectors is imperative to guarantee the continuity of essential services. For instance, countries could envisage developing tools for online education. More generally, the practice of teleworking already used in some Emerging Asian countries could be supported with appropriate infrastructure and regulatory frameworks. Moreover, health experts have warned about the risks of handling contaminated coins and banknotes. In this context, the digitalisation of payment systems becomes essential. These tasks may prove particularly challenging for countries lagging behind in this area, but they must be accomplished to integrate them properly into the modern global economy.

More detailed information will be available in the forthcoming Update of the *Economic Outlook for Southeast Asia, China and India 2020*, to be released in June/July 2020.

Note: Various government sources were consulted in the preparation of this note.