Report on the Asia-Pacific Economies

USAL UNIVERSIDAD DEL SALVADOR

Research Institute **Nº11**

September , 2022

Russian attack on Ukraine: winners and losers

- From January through July 2022 trade in the region grew 16.6% y-o-y.
- Imports grew faster than exports, with significant differences among countries.
- China' trade surplus rose USD 145 billion, Japan's deficit increased USD 70 billion and India's deficit grew by USD 55 billion
- Energy exports from Russia to China reached record levels, while India is importing oil from Russia at a considerable discount.

Effects on trade of the invasion of Ukraine

Russia's invasion to Ukraine led to a series of sanctions that have shaken the fragile *status quo,* and these were followed by an increase in food and energy prices. At the same time, under the incipient price inflation in the United States and Europe, this shock led to the highest price level hikes in this century. Winners and losers turned up according to the features of each country's productive system, its foreign trade, and its relationships with Russia. The new scenario is riskier for all developing countries, as long as the increase in interest rates to fight inflation encourage global investors to buy sovereign bonds from industrialized countries.

In the first seven months of 2022, the region's foreign trade rose 16.6% y-o-y. In the six largest economies of ASEAN the growth is even larger (25%). Furthermore, the increase from the same months in 2019 was 40%. Such performance was explained by price hikes, rather than by physical volumes. WTO forecasted just a 3% increase in traded volumes for this year.

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Exports increased faster than imports in the 2019/2022 period, enlarging the trade surplus of the region. Exports grew 42.8%, and imports 37.1%. ASEAN countries showed even higher increase rates. Nevertheless, imports increased more than exports, with important variations between countries.

One of the winners was China. Exports in the first seven months of this year USD 215 billion more than in the same period of 2021 and imports "just" USD 70 billion, so its monthly trade balance surpassed US$ 100 billion, the highest record in its history. Indonesia also improved its trade balance thanks to an export increase of USD 44 billion vs. an import hike of USD 31 billion. One of the losers was India: imports increased by USD 100 billion, and exports of USD 45 billion. Another one was Japan: imports increased by ¥ 18 trillion, but exports grew just ¥ 7,5 trillion, so that its trade deficit increased by USD 70 billion.

Table 1. Foreign Trade Index, January-July (base 2019=100)

	EXPORTS				IMPORTS			
	2019	**2020**	**2021**	**2022**	**2019**	**2020**	**2021**	**2022**
Philippines	100	80.4	102.0	109.7	100	70.6	95.2	123.2
Indonesia	100	94.3	127.9	174.5	100	83.3	108.7	140.8
Malaysia	100	94.3	118.8	151.8	100	93.3	113.4	150.3
Singapore	100	92.5	111.0	137.1	100	92.2	106.3	138.6
Thailand	100	99.2	107.4	119.6	100	86.7	109.5	131.3
Vietnam	100	100.1	127.7	148.8	100	96.6	131.1	150.0
ASEAN6	**100**	**93.8**	**118**	**147.2**	**100**	**85.8**	**109.5**	**138.7**
China	100	93.6	129.5	147.8	100	93.6	128.0	135.1
Korea	100	89.2	133.5	151.9	100	90.6	108.2	122.2
India	100	75.3	110.9	138.0	100	68.4	103.3	143.9
Japan	100	84.0	105.2	121.8	100	86.8	99.8	139.1
Taiwan	100	100.5	126.7	156.5	100	98.3	125.4	159.1
CKJI	**100**	**89.6**	**122.7**	**142.0**	**100**	**89.4**	**118.2**	**136.6**
TOTAL AP e I	**100**	**90.2**	**122.4**	**142.8**	**100**	**89.2**	**117.5**	**137.1**

Source: Research institute, based on nations' official statistics.

The increase in exports and imports varied across countries in line with their different trade patterns. Those who import more energy and food are negatively affected, while those who export them are positively influenced. Japan imports around 90% of its energy consumption and 63% of food domestic demand. Coupled to a strong devaluation of the yen (which went from 110 per dollar in the last day of August 2021 to 138 in the same day of 2022), domestic prices have skyrocketed in the last months, raising both production costs and the cost of living. Even though inflation is below the USA and EU levels, July CPI increase by 2.6% y-o-y remains well above the Bank of Japan´s target of 2%. According to analysts surveyed by Reuters, 80% of them forecasted that salary hikes will be lower than price hikes, hurting private consumption. The increase in energy price is forcing the government to reconsider its energy policy. According to the prime minister Kishida's announcements, nuclear reactors halted after Fukushima's accident in 2011 would be reinitiated, the life span of existing reactors would be extended and the development of safer, last generation, nuclear reactors.

India is a major oil importer of oil, gas and coal. The main source of energy is coal, and the biggest coal exporter to India is Indonesia, the world's third largest producer and lead exporter. India's energy balance is very negative, and its dependence on foreign hydrocarbons might hurt its economy. In the

second quarter of 2022, India imported 47.5 billion dollars of crude petroleum, 50% more than in 2021. Taking advantage of the sanctions imposed on Russia (whose oil and gas companies are looking for new customers), India has increased its imports from Russian suppliers, at a large discount. Hence, Russia has become the second oil exporter to India, surpassing Saudi Arabia.

This opportunity in the oil sector cannot be found for gas. Only 10% of Russian gas exports is carried by ships, which previously requires the transformation into liquefied natural gas (LNG). Most of its exports depend on pipeline systems, which take time to be built. China increased year on year almost 50% its imports from Russia in the first seven months of 2022, mainly crude oil and LNG, and it has become the first destination for Russia's petroleum. In the beginning of August, Gazprom announced that its exports of natural gas to China through the pipeline "Power of Siberia" increased 60% y-o-y. Feasibility studies are being carried out to build a new pipeline from Russia to China though Mongolia, whose prime minister recently said that the works would start in 2024, entering in full operation by 2030.

The new scenario benefits to Malaysia that enjoyed a 40% annual increase in exports in the first seven months of the year and also to Brunei: 90% of its exports were hydrocarbons.

The general increase in the price of energy and industrial goods are stressing Asian global value chains, jointly with persistent in the supply of certain components. Hence, the industrial sector faces challenging times, with moderate uncertainty on the near future. The Purchasing Managers Index, which indicates if the activity is expanding or contracting, shows that in several sectors there is a fall in new purchasing orders in the region. Industrial activity fell in Korea for the first time in two years, while in Japan it decreased 1.8% annually. Nevertheless, the decline does not happen in all the countries: China, Vietnam, Philippines and Malaysia exhibited a positive increase (y-o-y) in the industrial production, but on a downward trend. Indonesia and Thailand showed a strong expansion in July.

The increase in the price of commodities affects inflation rates, that exceed the projections made at the beginning of the year. China's inflation rate in July was 4.2%, when the annual inflation was expected to be 2.1% at the beginning of 2022. Korea (6.3% and 4%), Japan (2.6% and 1%), Thailand (7.6% and 3.5%) and Philippines (6.4% and 4.3%) also show the same trend. In all these countries, July inflation (y-o-y) was higher than April record.

The new global scenario after Ukraine's invasion strongly affects Asia Pacific and India's economies. The increase in the price of energy had non-negligible impact on trade balance and energy policies, leading to a jump in inflation rates, and increasing the pressures on value chains. Nevertheless, the impact is uneven across countries. This new scenario generates tensions and readjustments, and some nations will emerge as winners and other as losers.

Points of interest and general perspectives for the region

- Laos is going through a deep economic crisis, with an inflation rate that reached 23.6% and an external debt of 14.5 billion USD (76% of its GDP). China is the main creditor, as it provided funds for the Laotian infrastructure, and it could take possession of that infrastructure in the case the credit is not paid (a scheme known as China's debt trap).

- Scarcity of semiconductors and the lack of some auto-parts due to the closing of factories in Shanghai led Honda to cut its car production in Japan 10% in July, 30% in August and up to 40% in September. China's semiconductor production declined 16% year on year in July.
- India's foreign minister, S. Jaishankar, defended QUAD, saying that the scheme benefits the whole Indo-Pacific region. This group of four countries (India, Japan, Australia and the United States) was created in 2017 under the initiative of former Japanese Prime Minister Shinzo Abe to collaborate in defense matters. China and Russia have criticized this cooperation, and Jaishankar replied that it is a “unilateralist opposition to collective and cooperative endeavors”.
- The new Korean president, Yoon Suk-yeol Yoon Suk-yeol, presented a 2023 budget proposal with steep cuts in governments expenses for the first time in 13 years. The cuts aim at providing more sustainability to the country's public finances, in a context of growing inflation. Infrastructure expenses will decrease 10%, while some public projects will be transferred to the private sector, and some top level public servants' salaries will be cut.