

China Slows, India Grows

Nov. 28, 2023

This report does not constitute a rating action.

Key Takeaways

- **Shift in regional growth pattern.** We expect Asia-Pacific's growth engine to shift from China to South and Southeast Asia. We project China's GDP growth to slow to 4.6% in 2024 (2023: 5.4%), edge up to 4.8% in 2025, and return to 4.6% in 2026. We see India reaching 7.0% in 2026 (6.4%); Vietnam, 6.8% (4.9%); Philippines, 6.4% (5.4%); and Indonesia remaining steady at 5%.
- **High rates and inflation.** With Asia-Pacific's central banks likely to keep interest rates high, the region's borrowers will see costlier debt servicing. Concurrently, a widening conflict in the Middle East could drag global supply chains and raise energy costs, fanning inflation. High input costs dilute corporate margins, while high prices weaken demand.
- **Energy and demand shock risk.** Asia-Pacific's growth is susceptible to energy shocks (widening Middle East conflict) and slower global demand (risk of U.S. hard landing). We lowered our projection for the region's growth (ex-China) in 2024 from 4.4% to 4.2%. The prospects for industries also differ, with export-centric manufacturing faring worse.

Editor's Note: S&P Global Ratings' Asia-Pacific Credit Conditions Committee took place on Nov. 21, 2023.

Despite stimulus, China's property sector remains stressed. China's recent approval of a Chinese renminbi (RMB) 1 trillion sovereign bond issue and allowance for local governments to partially frontload 2024 bond quotas, contributed to our real GDP growth forecast of 5.4% for 2023 and 4.6% for 2024. However, real estate challenges persist. Demand for new properties remains lackluster, affecting developers' cash flows and land sales (a revenue source of local and regional governments). Amid constrained liquidity, highly indebted local government financing vehicles (LGFVs) could see credit stresses intensify and hit Chinese banks' capital positions.

Costlier borrowing. We expect regional interest rates are likely to stay high, given the U.S. Federal Reserve will maintain tight monetary policy to rein in inflation to target. Meanwhile, gaps in policy rates between global and regional central banks could intensify capital outflows and domestic currency depreciation. For borrowers with impending or sizable refinancing needs, high borrowing costs and tighter credit availability from lenders are prominent risks. While onshore funding remains accessible, often cheaper than offshore, these too could turn selective.

Global obstacles. Although we anticipate the U.S. and Europe will see a soft landing in 2024, the risk of a hard landing could affect business and households' propensity to spend, slowing demand and hurting revenues. Meanwhile, a sudden shift in the Bank of Japan's monetary policy could introduce capital market volatility and reversal of the yen carry trade.

Geopolitical tensions. The risk of a widening Middle East conflict is compounding geopolitical tensions. This comes alongside ongoing U.S.-China friction and the Russia-Ukraine war. While we see the likelihood of an energy shock as remote, pricier energy and potential disruption of supply chains could reignite inflationary pressures and slow trade. The net energy-importing status of Asia-Pacific underlines its susceptibility to high energy prices. Businesses may find it harder to fully pass through costs to customers (see "[Asia Pacific Sector Roundup Q1 2024: Slowing Dragons, Roaring Tigers](#)," Nov. 7, 2023).

Longer-term risks. Climate change and rapid technological advancements are disrupting business models. To prepare for these risks, businesses are incurring higher capex investments (notably in the oil and gas, aviation, and utilities sectors for the energy transition), leading to rising debt leverage. Concurrently, increasingly extreme weather (flooding and high temperatures across Asia) could render some assets uninsurable; it could also threaten agriculture production and affect energy supply.

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Top Asia-Pacific Risks

China's economy: Deepening property sector woes, weak confidence, and high debt levels to weaken China's growth momentum

Risk level Moderate Elevated **High** Very high **Risk trend** Improving **Unchanged** Worsening

Spreading contagion from China's real estate crisis (to local governments and real estate-related sectors) is curbing the country's economic growth momentum. Risk of financiers curtailing lending amid China's very high corporate leverage could exacerbate credit stresses for borrowers.

Financing: High rates for longer to exacerbate interest burdens and worsen prospects of weaker credit issuers

Risk level Moderate Elevated **High** Very high **Risk trend** Improving **Unchanged** Worsening

Asia-Pacific could see rates stay high for longer, amid global and regional central banks' concerted efforts to contain inflation. Higher borrowing costs could strain borrowers' liquidity, while slowing economies could hit revenue growth and margins, denting borrowers' credit quality.

Global economic downturn: U.S. and Europe risk a hard landing, further depressing aggregate demand and exports

Risk level Moderate Elevated **High** Very high **Risk trend** Improving **Unchanged** Worsening

Slower household consumption and corporate investment activity could exacerbate soft demand from Western economies. For Asia-Pacific, exports and manufacturing activities face hits. Capital outflows for some economies could intensify, compounding recessionary headwinds.

High prices: Inability to fully pass-through high prices could risk increasing cost pressures faced by borrowers

Risk level Moderate Elevated **High** Very high **Risk trend** **Improving** Unchanged Worsening

While inflation has eased, rising food and fuel prices could cause core inflation to spike. While businesses had raised prices to pass through higher input costs, slowing consumption could limit the momentum. Meanwhile, soft domestic currencies add further risk of imported inflation.

Japan's monetary policy: Bank of Japan's further monetary tightening triggers short-term volatility

Risk level **Moderate** Elevated High Very high **Risk trend** Improving **Unchanged** Worsening

If investors perceive that the Bank of Japan could embark on significant monetary policy normalization, abrupt portfolio adjustments and capital market volatility may occur. This could lead to significant asset and derivative repricing, hurting economic recovery and financing conditions.

Real estate: Cash flow tests abound amid low new-sales volume and higher interest burdens

Risk level **Moderate** Elevated High Very high **Risk trend** Improving **Unchanged** Worsening

Higher mortgage rates (except China), a still-weak global commercial real estate (CRE) sector and low new sales could risk property devaluation, spilling into real-estate related segments (e.g., banks). Costlier mortgages will slow consumption and growth, while developers' narrowing cash flows intensify liquidity stresses. If CRE liquidity strains intensify, investors (such as private debt) face the likelihood of substantial write-downs.

Structural risks

Geopolitics: Intensification of geopolitical tensions could hit business confidence, worsen trade and investment conditions

Risk level Moderate **Elevated** High Very high **Risk trend** Improving Unchanged **Worsening**

Risks of deepening or widening of political tensions and conflicts, such as U.S.-China geopolitical frictions, Russia-Ukraine war, and Israel-Hamas conflict could spill over into regional trade and investment flows. In the region, the key risk is disputes with China. A further reduction in supply chain reliance on China by Western and other importers could push up costs over the next few years, adding to inflation pressures. An escalation of international disputes over the seas and lands in the south and south-east China seas would damage economic activity.

Climate change: Extreme weather and energy transition to threaten supply and costs

Risk level Moderate **Elevated** High Very high **Risk trend** Improving Unchanged **Worsening**

More extreme weather and costs of climate-change policies could worsen physical and financial effects. A rapid phase-out of fossil fuels could disrupt industries and strain credit quality. Meanwhile, disruptions in agriculture and energy supply could fan inflation and social unrest.

Technology: Accelerating technological advancement and mounting cyber-attacks to disrupt business operations

Risk level Moderate **Elevated** High Very high **Risk trend** Improving **Unchanged** Worsening

While technology advancements could enhance productivity and competitive positioning, businesses may need to incur additional ongoing and rising costs to keep up with new technologies. Critical infrastructure and issuer operations may be prone to cyber-attacks amid increasingly interconnectedness of economic activities.

Source: S&P Global Ratings.

Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high.

Risk trend reflects our current view about whether the risk level could increase or decrease over the next 12 months.

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