Mizuho Economic Outlook & Analysis

October 25, 2021

After COVID-19 pandemic, emerging Asian economies expecting downward pressure due to fiscal reform commitments

<Summary>

◆ Major emerging countries in Asia that adopted sound fiscal policies were forced to implement large economic stimulus measures due to the COVID-19 pandemic, resulting in the deterioration of fiscal indicators in many countries.

◆ As the neglect of fiscal deterioration will lead to the downgrading of public debt and higher interest rates, the governments of major emerging countries in Asia have announced commitments to rebuilding their finances by setting medium-term goals.

◆ These countries are likely to be forced to manage their finances in an austere manner until around 2025 or later. Interest rate and exchange rate fluctuations due to deteriorating fiscal situations will also require attention.

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1. Introduction

Since experiencing the Asian currency crisis in 1997, major emerging countries in Asia have generally maintained sound fiscal management. However, from 2020 onward, in response to the COVID-19 pandemic, the fiscal situations of these countries have generally worsened as a result of being forced to implement economic stimulus measures such as cash benefits to low-income households and corporate tax reductions, as well as the expansion of healthcare systems, along with a decline in tax revenue due to the downturn of economic activity. Government bond investors and ratings agencies are taking a serious look at the fiscal situations of each such country and have already downgraded India and Malaysia **(Chart 1)**. Governments cannot afford to let their finances deteriorate further.

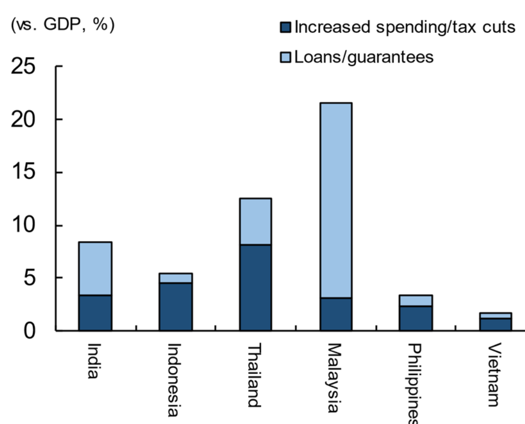
Chart 1: Ratings trends in and after April 2020

	India	Indonesia	Thailand	Malaysia	Philippines	Vietnam
Apr. 2020		S&P BBB (N)	S&P BBB+ (S) Moody's Baa1 (S)	Fitch A- (N)		
May 2020					Fitch BBB (S)	
Jun. 2020	Moody's Baa3 (N) Fitch BBB- (N)			S&P A- (N)		
Dec. 2020				Fitch BBB+ (S)		
Mar. 2021						Moody's Ba3 (P)
Apr. 2021						Fitch BB (P)
May 2021						S&P BB (P)
Jul. 2021					Fitch BBB (N)	
Oct. 2021	Moody's Baa3 (S)					

Upgraded | Downgraded
Upward outlook | Downward outlook
(P) Outlook - positive
(S) Outlook - stable
(N) Outlook - negative

Source: Made by MHRT based upon World Government Bonds

Chart 2: Size of economic stimulus packages after the occurrence of the COVID-19 pandemic



Source: Made by MHRT based upon the IMF's *Fiscal Monitor* (multiple releases) and upon data disclosed by the NNA

The goal of this report is to highlight how India, Indonesia, Thailand, Malaysia, the Philippines, and Vietnam, which are the targets of this economic outlook by Mizuho Research & Technologies, are trying to maintain fiscal discipline and then to forecast the future development of this issue.

This report focuses on three types of statistics that are discussed for public finances: those from the central government sector, those from the general government sector, and those from the public sector. This is because different countries have different statistics to focus on. In general terms, "general government" is the concept of central government plus local government, and the "public sector" is the concept of general government plus public enterprises.

Regarding the definition of "fiscal year," for India this starts in April of the current year

and ends in March of the following year (i.e., from April 2021 to March 2022 for FY2021), for Thailand this starts in October of the previous year and ends in September of the current year (i.e., October 2020 to September 2021 for FY2021), and for others this starts in January and ends in December.

2. Current fiscal policy of each country

Chart 2 shows the IMF's aggregate figures for the size of fiscal policies of each country in question, primarily of those implemented in 2020. According to the data, Thailand, the economy of which depends heavily on inbound travel and which was hit significantly by the COVID-19 pandemic, has the largest scale of fiscal policies intended to directly improve GDP (through increased spending and tax cuts) among the countries surveyed. In contrast, the size of such policy is relatively small in the Philippines and Vietnam. As for other countries, the central bank of Indonesia purchased government bonds in the primary market[1] (which, in normal times, would be considered a prohibited strategy) due to the deterioration of the country's finances.

The negative impact of the COVID-19 pandemic has been still ongoing in 2021, and countries are announcing a series of additional policy measures **(Chart 3)** to support their economies, while tax revenues are falling to record an unsatisfactory level. India, which experienced a severe economic downturn due to the spread of the Delta variant in the April–June quarter, announced new measures in June focusing on loan guarantees as it struggles with financial difficulties. The Indonesian government has extended existing policy measures, including corporate tax cuts, and Indonesia's central bank is continuing to purchase government bonds in the primary market.[2] Thailand has also added relatively large-scale measures and plans to introduce new ones by the end of 2021. Malaysia, which was hit by three waves of infections in 2021, including large and small ones, has introduced three new economic stimulus packages (which coincidently is the same number as the infection waves). The Philippines implemented a cash benefit program during the period of social activity restrictions. Vietnam, which is said to have handled the COVID-19 pandemic relatively successfully, has taken relatively small economic stimulus measures, but is now facing a new reality. Vietnam's economy deteriorated rapidly in the July–September quarter of 2021 due to the failure to contain the Delta variant. In response to the situation, the World Bank urged the Vietnamese government to implement additional policy measures such as public investment and income support.[3] There are likely to be

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[1] Purchases in 2020 were reported to be 457.3 trillion rupiah (3.0% of 2020 GDP) ("Indonesia: Bank Indonesia cuts key rate by 25bps to 3.75%," *CEEMarketWatch*, November 19, 2020).

[2] Reported 215 trillion rupiah in 2021 (1.4% of 2020 GDP) and 224 trillion rupiah in 2022 (1.5% of 2020 GDP) ("Burden sharing needs to be limited," The Jakarta Post, August 30, 2021)

[3] The World Bank (2021)

new moves by the government.

As mentioned above, the scale of the stimulus packages has expanded beyond what you can see in **Chart 2**.

Chart 3: Major economic stimulus measures announced in 2021

	India
Jun.	Waiver of visa fees for foreign-resident tourists, Rs. 1.1 trillion credit guarantee for medical/healthcare sectors, etc., raising the emergency credit line guarantee for SMEs from 3 trillion rupees to INR 4.5 trillion rupees
	Indonesia
Jun.	Corporate and personal income tax reductions extended until the end of the year, from original expiry in June
Sep.	Extension of the automobile luxury tax (excise tax) reduction/exemption until the end of 2021 (extended multiple times previously)
	Extension of the scheme to allow SMEs to apply for debt restructuring for one year until March 2023
	Thailand
Jun.	Food and necessities purchase subsidy of 150 baht per day per person for up to 31 million people; additional 200 baht in benefits per person per month for six months for low-income earners; vouchers provided for consumer spending
TBD	Additional measures planned in 2021
	Malaysia
Jan.	Payroll subsidies, subsidies for SMEs, financial support for the purchase of medical equipment and for vaccination programs (15 billion ringgits, in total)
Mar.	Payroll subsidies, discounted electricity rates for service companies heavily affected by the COVID-19 pandemic, credit lines for SMEs, etc. (20 billion ringgits, in total)
Jun.	Cash benefits to low-income households, extension of electricity rate discounts, support for vaccination costs for children, etc. (150 billion in total ringgits, of which 10 billion ringgits directly impacts the GDP)
	Philippines
Aug.	Benefit of 1,000 pesos per person (up to a maximum of 4,000 pesos per household) for citizens affected by the restrictions on social activities (13.1 billion pesos)
	Vietnam
Jun.	Expanded the scope of the existing cash benefit program to include tour guides, etc.

Source: Made by MHRT based upon various media coverage

3. Initiatives for fiscal reform

This section provides an overview of how governments are trying to proceed with their fiscal reform based on such measures as putting ceilings on fiscal deficits and government debt and the establishment of a medium-term fiscal plan.

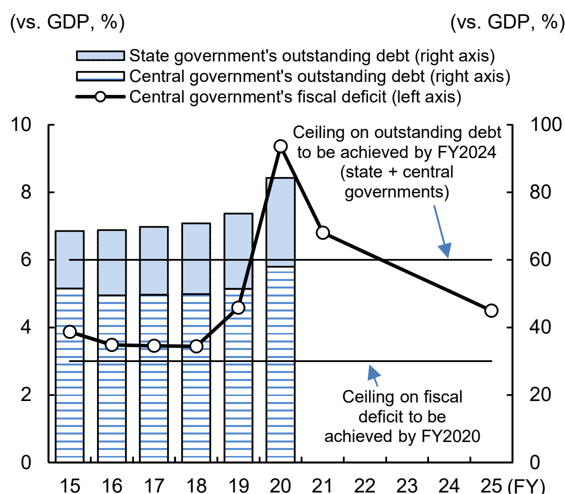
(1) India

Under the *Fiscal Responsibility and Budget Management (FRBM) Act* enforced in 2003, the central government's fiscal deficit must not exceed 3% of GDP and the general government's outstanding debt must not exceed 60% of GDP, of which the central government's outstanding debt must not exceed 40% of GDP. The deadline by which these figures should be achieved has been changed several times in the past, but under the current act, the deadline for the fiscal deficit is FY2020 and that for outstanding government debt is FY2024. However, March 2021, the last month of FY2020, has already passed, and the fiscal deficit for FY2020 was 9.4% of GDP; thus, the requirement was not satisfied at all **(Chart 4)**. Further, considering that general government's outstanding debt in FY2020 was 84.2% of GDP and that the central government's debt was 57.9% of GDP, the debt target is also expected to not be attainable. The act will surely be amended sooner or later,

and it is difficult to predict if any feasible targets will be set.

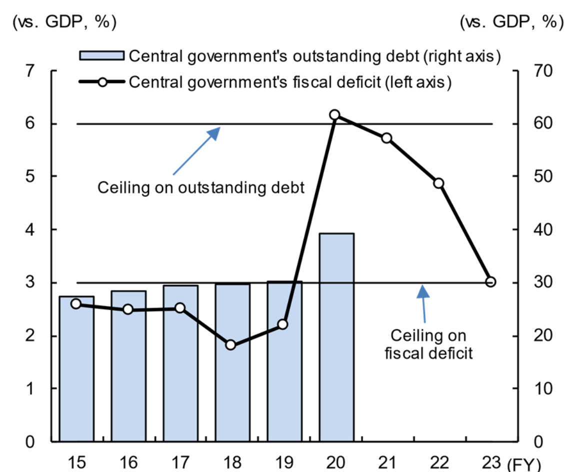
In the draft budget package for FY2021, the central government’s fiscal deficit was set at 6.8% of GDP, but Minister of State for Finance of India Nirmala Sitharaman said in an official budget announcement that the deficit target would be reduced to “less than 4.5% of GDP by fiscal year 2025.” This seems to be a reasonable target toward improving the financial soundness of India, but it might be difficult to achieve, as the government is promoting their industrialization policy with subsidies. However, the government at least should show its proactive approach to achieve the target—or the country’s government bonds could be downgraded to a level below investment grade.

Chart 4: Fiscal deficit of India’s central government and the outstanding debt of the general government of India



Note: The figure for FY2021 shows the budget. For data subsequent to that, the budget of FY2021 and the target for FY2025 are simply connected by a straight line.
Source: Made by MHRT based upon data disclosed by the Reserve Bank of India and the Ministry of Finance of India

Chart 5: Fiscal deficit and the outstanding debt of the central government of Indonesia



Note: The figures for FY2021 and FY2022 show the budget. The figure for FY2023 is the target.
Source: Made by MHRT based upon data disclosed by Statistics Indonesia (BPS)

(2) Indonesia

The *State Finance Law*, enforced in 2003, stipulates that the central government’s fiscal deficit must be 3% or less of GDP and that the central government’s outstanding debt must not be higher than 60% of GDP. As the central government’s outstanding debt in 2020 is about 40% of GDP, the latter requirement is currently expected to be satisfied.

However, due to the large scale of the stimulus packages built in response to COVID-19 pandemic, legislative measures are being taken to postpone the deadline for compliance with the fiscal deficit ceiling until 2023. Considering that the fiscal deficit for 2022 was 4.85% of GDP at the budget proposal stage **(Chart 5)**, it will take serious pain to bring it

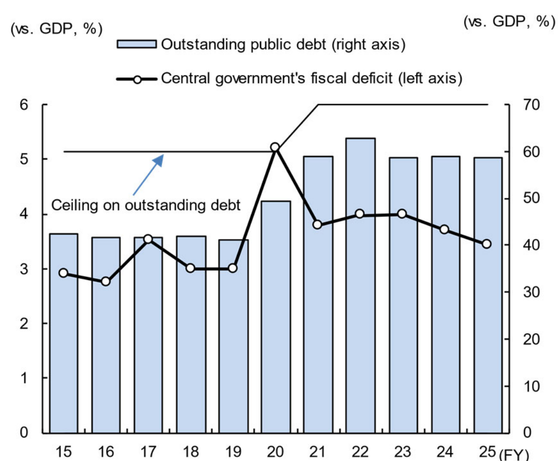
down to 3% or less in just one year. Practically, it is more likely that the target year will be postponed to around 2024–2025.

(3) Thailand

The *State Fiscal and Financial Disciplines Act* enacted in 2018 stipulates that the State Fiscal and Financial Policy Commission determines public debts-related ratios[4] and reviews them every three years. For the ratio of outstanding public debt to GDP, the ceiling was set to 60% in 2018.[5] According to the medium-term fiscal policy framework, which is usually decided by the Cabinet by around the end of each year (as a five-year plan), the target figure of 60% was supposed to be satisfied by FY2025 **(Chart 6)**.

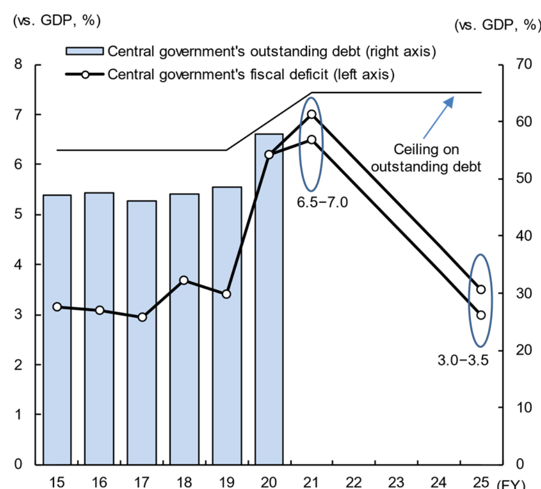
However, as the government plans to implement additional measures in the October–December quarter of 2021 (the new fiscal year starts in October), outstanding public debt in FY2022 is expected to reach 62.69% of GDP. In response to this, the ceiling on outstanding public debt has been raised to 70% of GDP. This figure is likely to be met for the time being, while the pace of fiscal deficit reduction will remain slow.

Chart 6: Fiscal deficit of Thailand's central government and the outstanding public debt of Thailand



Note: The figures for FY2021 and FY2022 show the budget. Data subsequent to that is obtained from the medium-term fiscal policy framework.
Source: Made by MHRT based upon data disclosed by the Ministry of Finance of Thailand

Chart 7: Fiscal deficit and the outstanding debt of the central government of Malaysia



Note: The figure for FY2021 shows the budget. For data subsequent to that, the budget of FY2021 and the target for FY2025 are simply connected by a straight line.
Source: Made by MHRT based upon data disclosed by Department of Statistics Malaysia

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[4] Including the ratio of outstanding public debt to GDP, the ratio of public debt repayment to revenue, the ratio of debt in foreign currency to total public debt, the ratio of foreign currency debt repayment to exports of goods and services, and other ratios that are determined as appropriate by the State Fiscal and Financial Policy Commission

[5] Thailand's public debt ceiling seems to have experienced many changes; but, at least since around 2009–2010, when the global financial crisis became serious, it has been 60%.

(4) Malaysia

Several laws have been enacted relating to the government's commitments to promote fiscal soundness, such as the *Government Funding Act* (enforced in 1983) based on which several restrictions have been established. The ceiling for central government debt (bonds issued) has been set at 55%[6] of GDP for a long time but was raised to 60% in August 2020 as a temporary measure in response to fiscal measures to address the COVID-19 pandemic **(Chart 7)**.

In 2021, the government launched a series of economic stimulus measures in response to widespread COVID-19 infections, and as a result outstanding public debt slightly exceeded 60% of GDP in March 2021. Then, the government announced additional measures in June, and the fiscal deficit forecast for 2021 has been increased to 6.5–7.0% of GDP from the initial plan of 5.4%. Due to the above situation, it is now difficult to maintain the previously set upper limit of 60%, and the new ceiling of 65% has been considered.

In September, the government also announced the Twelfth Malaysia Plan (a five-year plan for the period 2021–2025), which set a target of reducing the central government's fiscal deficit to 3.0–3.5% of GDP by 2025. The pace of deficit reduction is so rapid that the target year might actually be postponed for a year or two.

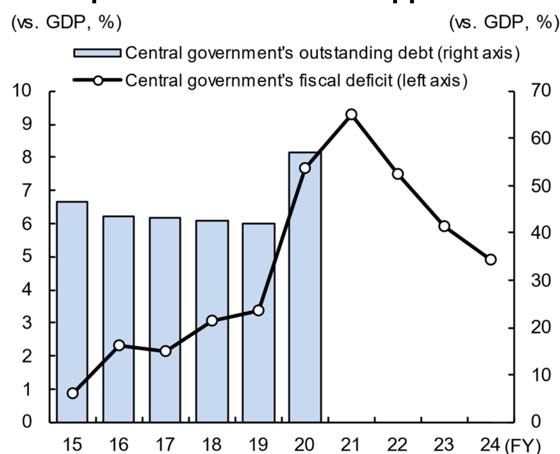
(5) The Philippines

There does not seem to be a strict ceiling on the fiscal deficit or outstanding debt in the Philippines. Still, fiscal management to date has been generally regarded as well-disciplined. However, due to prolonged restrictions on economic activities under the influence of the COVID-19 pandemic and against the backdrop of a poor healthcare system, fiscal indicators have deteriorated rapidly in response to the economic downturn **(Chart 8)**.

Looking at the draft budget and the medium-term fiscal plan, the central government seems to plan to reduce the central government's fiscal deficit (as a percentage of GDP) from FY2022 onward. However, the fiscal deficit will still be high in FY2024 compared to the pre-pandemic period. In practice, the government is expected to need several more years to reduce the fiscal deficit.

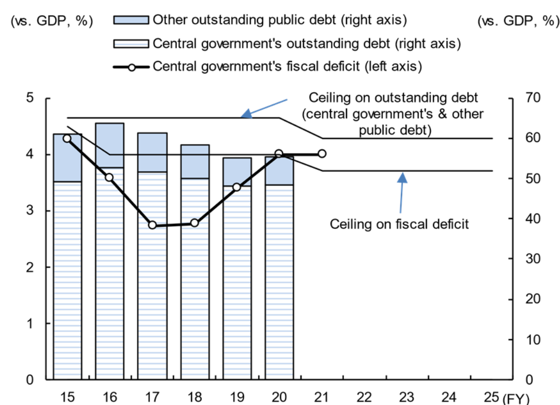
[6] The ratio was set at 40% of GDP in 2001 but was raised to 45% in 2009 when the financial crisis occurred and raised to 55% in 2010. According to the Asian Development Bank (2020), there is a rule that stipulates that the fiscal deficit should be less than 3% of GDP, but this rule is not considered by the IMF to be a fiscal rule because there is no penalty for the government's non-compliance with the rule.

Chart 8: Fiscal deficit of the Philippines' central government and the outstanding public debt of the Philippines



Note: The figure for FY2021 shows the budget. Data subsequent to that is obtained from the medium-term fiscal plan.
Source: Made by MHRT based upon data disclosed by the Department of Finance of the Philippines

Chart 9: Fiscal deficit of the Vietnam's central government and the outstanding public debt of Vietnam



Note: As mentioned in the main text, the meaning of the ceiling varies according to the period.
Source: Made by MHRT based upon data disclosed by the General Statistics Office of Vietnam

(6) Vietnam

Before the COVID-19 pandemic, the Vietnamese government had set targets for the central government's fiscal deficit and outstanding public debt through its five-year plan for social and economic development. In Vietnam, which is considered to have been relatively successful in containing COVID-19, the level of fiscal deterioration was lower than neighboring countries, and the targets set in the five-year plan for 2021–2025 were even stricter than existing targets. While the goal of the 2016–2020 five-year plan was to "reduce the central government's fiscal deficit to within 4% of GDP and the outstanding public debt to within 65% of GDP, of which the central government's outstanding debt should be 50% or less of GDP by the final year (2020)," the new five-year plan called for "an average central government fiscal deficit within 3.7% of GDP and outstanding public debt within 60% of GDP during the period, of which the central government's outstanding debt should be 50% or less of GDP" **(Chart 9)**.

However, the situation changed with widespread Delta-variant infections in the second half of 2021, and the implementation of additional economic stimulus measures seems to be on the table. While we believe that Vietnamese government will continue to make a certain level of effort to improve its fiscal soundness in aiming to upgrade the country's investment grade in the future, we do not expect it to strictly adhere to the goals formulated in the new five-year plan.

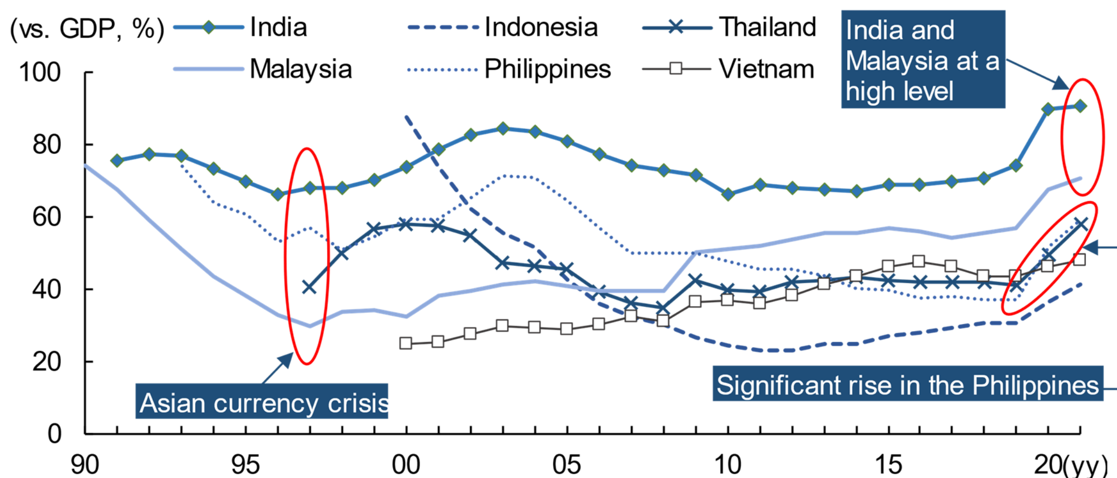
In summary, it is likely that the major emerging countries of Asia will continue their efforts to improve their fiscal soundness toward 2025 or later. India, Indonesia, Malaysia,

and the Philippines are expected to choose relatively strict measures for fiscal reform, while Thailand and Vietnam are expected to take more-moderate measures.

4. Outlook

The implementation of efforts to improve fiscal soundness as mentioned above will be a factor toward constraining economic growth to some extent. Although it is not possible to make a general comparison with the situation during the Asian currency crisis, as that involved several major issues such as the disposal of non-performing loans and structural adjustments to improve the current account balance in addition to fiscal reform, Thailand, Indonesia, Malaysia, and other countries were unable to recover the high growth rates that they achieved before the crisis. In the crisis of the COVID-19 pandemic, the major emerging countries of Asia could see a decline in growth rates, as they did before, unless these governments expand their efforts to maintain investment in infrastructure and human capital by: closely monitoring the use of the national budget, securing revenue via the sale of national government-owned assets, deregulating direct investments, achieving FTAs, and taking other effective measures.

Chart 10: General government's outstanding debt of the major emerging countries of Asia (IMF projections for 2021)



Source: Made by MHRT based upon data disclosed by the IMF

As for the question of whether there is the possibility that countries will prioritize their economies and not properly implement said efforts for fiscal reforms, and although there is the possibility that a certain level of fiscal stimulus measures will be taken to respond to unpredictable issues caused by the COVID-19 pandemic, it is unlikely that these governments will give up the public promise for fiscal reform. The reason is that, as mentioned in "Introduction," ratings agencies are closely monitoring the fiscal situation of

each country, and a downgrade could lead to a rise in interest rates. Against the backdrop of rising energy prices and an expected reduction in quantitative easing and interest rate hikes in the U.S., there is the risk of significant currency selling due to the spillover effect of deteriorating government finances.

So which countries have the highest risk of rising interest rates and falling currencies? In the previous discussion, we focused on the figures independently calculated by each country as important indicators, but here we will take a look at the general government's outstanding debt, as published by IMF the for the purpose of cross-country comparison **(Chart 10)**.

First, let's look at India. Their government debt is large, and the general government's outstanding debt has already exceeded that during the financial crisis of 1991, as well as the peak in 2004 after the Asian currency crisis and the bursting of the IT bubble. There is concern that the root cause of the non-performing loan issues of state-owned banks has not been resolved and that a certain type of fiscal burden could be incurred in connection with this in the future. The second-largest concern is Malaysia, for which debt size is second largest, after India. Although the general government's outstanding debt of Malaysia remains still lower than that in 1990,[7] the Malaysian government is a lot more unstable compared to that time,[8] and with the global trend toward decarbonization, investors do not appreciate large reserves of the country's fossil fuels as much as they once did. The third most-concerning country is the Philippines, which recorded the highest increase (among the countries surveyed) in general government's outstanding debt (as a percentage of GDP) in FY2021 compared to the pre-pandemic period of FY2019. The reason is a particularly severe economic slump **(Chart 11)**. With a presidential election coming up in May 2022, the continuity of the current administration's policies is unclear,[9] and this seems to have affected long-term interest rates, which are relatively volatile **(Chart 12)**.

As mentioned above, these three countries aim to reduce their fiscal deficits at a relatively fast pace, but efforts to improve fiscal soundness will be required until 2025 or later. It will not be easy for them to achieve the targets, but these countries should at least show their eagerness to achieve them, or they will lose the confidence of ratings agencies

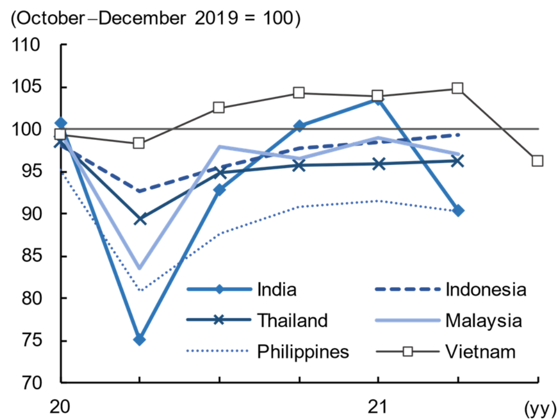
[7] Although data prior to 1990 is not available due to statistical constraints, Malaysia (a crude oil exporter) experienced economic downturns in 1985 and 1986 due to a prolonged slump in resource prices after the second oil crisis, and the negative effects of this seem to have remained. The country since then succeeded in promoting exports through concentration of manufacturing industries, and the economy returned to the high growth trend.

[8] Although not analyzed in detail here, this country has been in a state of political instability since the political upheaval in February 2020. Since Prime Minister Ismail Sabri took office in August 2021, political unrest paused, but his political base is not solid. On the other hand, in 1990, former Prime Minister Mahathir bin Mohamad had taken undisputedly strong leadership.

[9] Since re-election is prohibited by the country's constitution, President Rodrigo Duterte will be sure to resign. If Sara Duterte, the president's daughter and incumbent mayor of Davao City, runs in the election, she will have a good chance of winning due to her popularity, and current government policies are expected to be succeeded. However, she has announced that she will not join the race.

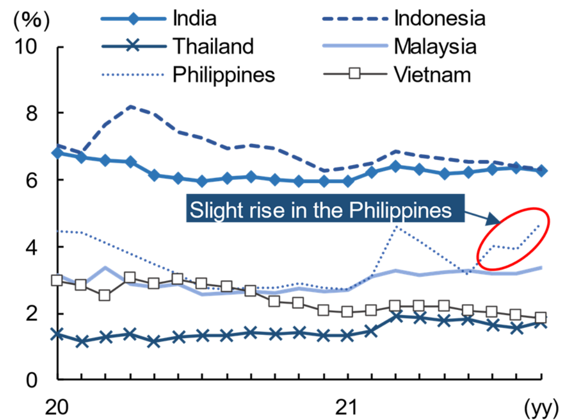
and investors. Malaysia, where political unrest continues, and the Philippines, which will soon to hold a presidential election, require special attention due to political reasons.

Chart 11: Real GDP (seasonally adjusted)



Note: Seasonal adjustment for India, Indonesia, and Vietnam was made by MHRT.
Source: Made by MHRT based upon World Government Bonds

Chart 12: Interest rates of 10-year government bonds



Note: Due to statistical constraints, data for 10-year bonds (not limited to government bonds) released by the Hanoi Stock Exchange is used only for Vietnam.
Source: Made by MHRT based upon CEIC Data

Reference

Refer to the original Japanese report by clicking the URL below for the reference material.

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