

Asia Pacific economic outlook



Outlook for Select Asia Pacific Economies

China

China is a country obsessed with lucky numbers, and the number eight is clearly this year's pick. It obviously refers to the 8 percent economic growth that China's authorities are shooting to achieve in 2009. At 8 percent, it is believed that enough jobs are created to accommodate new entrants into the labor force.

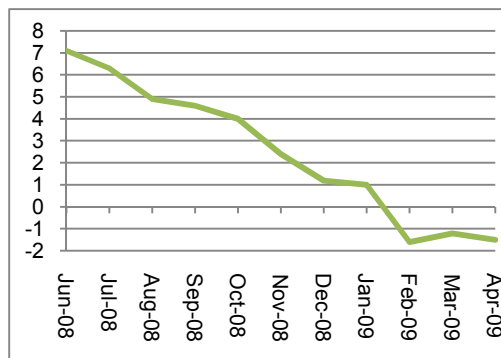
According to official pronouncements, it is a virtual certainty that the economy will grow at 8 percent this year. However, the IMF and World Bank are both projecting that the economy will only grow at 6.5 percent.

While there are certainly "green-shoots" of recovery, it is nearly impossible, even at this point of the year, to ascertain whether the economy will actually grow at 8 percent — a Bloomberg survey suggests the economy will grow at 7.5 percent. The stumbling blocks to achieving the full 8 percent the government wants are depressed external markets and still weak internal markets. Exports in April declined 22.6 percent, the sixth straight month in which they have declined. This has had a knock-on effect on the industrial sector; growth has been very sluggish and well below 2008's numbers. Internally, retail sales grew at 14.8 percent in April compared to 14.7 percent in March. While these are certainly healthy numbers, they are a notch below the average monthly growth of 21.6 percent seen in 2008. This is probably because of the rise in unemployment numbers. While the official unemployment numbers are still relatively low and flat, they do not take into account the millions of migrant workers who —as

anecdotal evidence suggests —have lost their jobs.

The "green shoots" of recovery are that investments in factories and property are going up. Urban fixed-asset investment was up 30.5 percent for the first four months of 2009 — powered by the \$586 billion stimulus package which includes direct spending, loans, and tax cuts, among others. This increased investment has meant that the PMI of manufacturers is on the up — always a good sign for the future — but it is just above 50 (53.1 in May), any level above 50 indicates an expansion. Also, new home sales in Shanghai reached a 21-month high in May.

Consumer Price Index (percent YoY)



Source: Bloomberg

Much of this boom has also been facilitated by increased lending by banks. Bank lending has also increased many-fold at the direction of the state. Loans to companies accounted for over 90 percent of the \$750 billion in loans given out in the first four months of 2009, three times what it was in 2008. This is a big concern since lending booms, especially ones of this size, usually end in bad news for the banks. Fitch Ratings, in a report said: "At the heart of these concerns is the recent steep rise in corporate exposure amid concurrent decline in enterprise profits." Lending did reduce in April, but it is very

likely to go up soon. The banking regulator has also expressed concerns about the lending boom. On May 27, the State Council announced plans to reduce the capital requirements for projects in some sectors, which directly translates to a higher leverage ratio.

The yuan is likely to remain at current levels; between January 1 and May 27, the difference was in the third decimal though there were some fluctuations in the second decimal in the intervening period. It is likely to remain at current levels especially since the State Council, on May 27, said they would take steps to keep the currency “stable”. As far as interest rates go, it has been much harder to decipher. The 1-year lending rate has been kept at 5.31 percent since last year. The central bank has been conducting monetary policy by opening the spigots of banks and not focusing on the interest rate, particularly since the interbank rate is already well below 1 percent. However, there is a good chance that it may reduce rates because of the deflation in the economy — deflation means real interest rates are rising.

The “green shoots” being seen now are just that, nothing should be read into them, since there is no data suggesting a sustainable upward trend. That said, if the economy does not hit 8 percent in 2009, it certainly will not be for lack of trying.

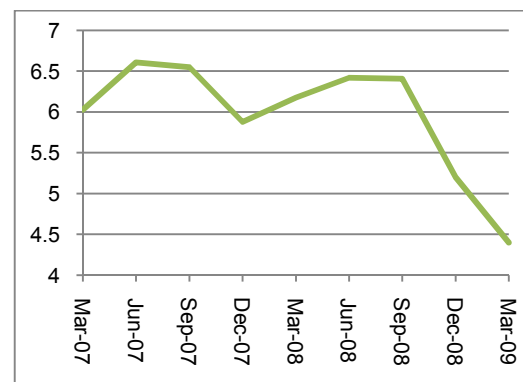
Indonesia

Growth in the Indonesian economy seems to be stellar. It grew by 4.4 percent in 1Q09, the fastest in the region. This is compared to 5.18 percent in 4Q08, but the slowdown is minimal when compared to regional economies, and understandable in light of the global slowdown. Indonesia, being less export-dependent than its neighbors, has been able to withstand the

export shock better. This is not to say that reduced exports have not affected the country. Net exports and investments were the main reasons for dragging down growth, but increased government and household spending provided sturdy counterweight. Exports fell an average of 31 percent in the first three months of 2009, and reduced oil exports (because of price falls) were responsible for only about half the fall. As a result, manufacturing growth has been very weak too.

The central bank, Bank Indonesia (BI), has forecast that growth in 2009 will be 4–5 percent. In a note accompanying the decision to cut the BI Rate by 25 basis points to 7.25 percent on May 5, there was no indication of any pessimism by the BI; rather it was chockfull of optimism. On the pessimistic side of the forecasts is the IMF — they project the economy growing 2.5 percent in 2009. It is likely that the growth rate will be in the BI’s range of expectations.

GDP Growth (percent YoY)



Source: Bloomberg

There are several reasons for this optimism. One is the boost expected from spending by political parties in the parliamentary and presidential elections. Increased spending and tax cuts included in the \$6.15 billion stimulus package will help the cause too. Another reason, and

arguably a more important one, is that consumer confidence in Indonesia is at a 4-year high, and that is a good enough reason for optimism in this domestic-demand-dependent economy. Household spending grew 5.8 percent in 1Q09 compared to 4.8 percent in 4Q08. Credit from banks has also been on the rise in the past months, perhaps signaling growth in the near to medium term.

There are some concerns however. One of them is the increasing pace at which expatriate Indonesians are returning home after losing their jobs overseas, leading to a potential fall in remittances, which could have a negative effect on domestic consumption. The other concern is the price of oil going up. As an OPEC member, Indonesia should be happy at the fact that oil prices have been on the rise. However, unlike other OPEC members, Indonesia is a net importer of oil. In August 2008, when oil prices were at their peak, net oil imports were \$7.7 billion compared to \$3.2 billion in March 2009. If oil prices rise from current levels, it has the potential to put Indonesia on the back foot.

BI has been cutting interest rates steadily; it has cut the BI Rate by 250 basis points to 7 percent between December 2008 and June 2009. Miranda Goeltom, Senior Deputy Governor of BI said that it still has room to reduce rates. It is very likely that BI will cut rates in the near term, because the inflation rate is reducing, and it needs to sustain consumer spending (the consumer confidence index is on the up partially because of the rate cuts). Indonesia also stands to benefit from bond yields reducing on account of increased optimism by investors.

The rupiah has gained a significant amount of value in the past months; it

appreciated some 17 percent between March and the end of May. Apart from the better-than-expected news on the economic front, one of the ostensible reasons for the rise has been the rising expectations that President Susilo Bambang Yudhoyono, generally believed to be a good steward of the economy, will win re-election in July. Three-month forwards indicate that the rupiah will weaken by 3–5 percent, but that is only because the 17 percent appreciation may have been a tad overdone. That said, some brokerages have upgraded their ratings of Indonesian stocks to overweight, which could mean upward pressure on the currency.

Malaysia

GDP growth in 4Q08 was quite bad; the economy just held on to positive territory, growing at 0.1 percent. In retrospect, that was great compared to the shocking 1Q09 data released on May 27. The economy shrank a massive 6.2 percent — the last time it saw negative growth was 2001. The data indicates shrinkage across the board, but it was manufacturing that really delivered the blow, shrinking by 17.6 percent in 1Q09 compared to a fall of 8.8 percent in the previous quarter. Falling manufacturing is the result of exports falling 15.2 percent in 1Q09. A monetary policy statement released on May 26 by Bank Negara Malaysia (BNM) read: “The domestic economy continues to be adversely affected by the significant contraction in external demand, resulting in steep declines in exports and industrial production. This has resulted in a marked contraction in the Malaysian economy in the first quarter of 2009. These conditions have continued into the second quarter.”

The BNM’s current forecast shows the economy shrinking 1 percent in 2009 while the Prime Minister Najib Razak said the

economy may shrink 4–5 percent in 2009, and the IMF is forecasting that it will shrink 3.5 percent. That is not good news, especially since it is very likely that the BNM's forecast is too optimistic. By the BNM's own account, conditions in the first quarter have continued into the second quarter, and therefore it is highly unlikely for the economy to shrink just 1 percent. What could potentially prevent a slide in the economy is the stimulus spending plan of 67 billion ringgit (\$19 billion). The stimulus plan is, however, split into public spending, loan guarantees, tax incentives, etc.; meaning it is not concentrated and is spread over time, and therefore may not work as quickly as planned.

Exports Growth (percent YoY)



Source: Bloomberg

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Of potential concern is Moody's putting 9 Malaysian banks on review for a possible ratings downgrade, mostly because they are undercapitalized. This contrasts with a BNM report released on May 27 which states: "The banking sector remained resilient supported by strong capitalization and stable credit quality...the banking system remained financially sound, and supported by ample liquidity, is well-positioned to continue meeting the financing needs of the economy." Only time will tell how this pans out.

The benchmark interest rate, the overnight policy rate, is currently at 2 percent, and has been at this point since February 2009. BNM Governor Zeti Akhtar Aziz expects a significant improvement in the economy in the second-half of 2009, and has gone on record saying that interest rates that are too low aren't necessarily constructive. Logically, if they wanted to reduce rates, they would have done so during their monetary policy meeting on May 26. Therefore, it is very likely that the floor has been reached vis-à-vis interest-rate reduction.

The ringgit, which lost close to 5 percent of its value between January and April, regained much of that value towards the fourth week of May, as part of a general rally of currencies in the region. However, it started losing value after the GDP data started filtering out, but 3-month forwards don't indicate much depreciation.

Vietnam

In 2008, the Vietnamese economy seemed to be impervious to the global slowdown. While neighboring economies were experiencing negative growth,

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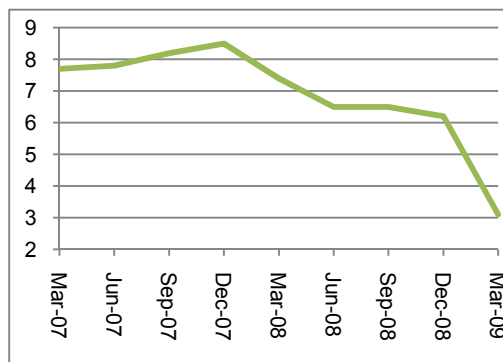
June 2009

Vietnam grew at a healthy 6.2 percent. Reality seems to have caught up with it now. The economy grew 3.1 percent in the 1Q09 compared to 6.2 percent in 4Q08, a substantial dip. The reason is not hard to fathom; the export-dependent economy saw exports falling sharply in January (-24.2 percent) returning to positive territory in March (2.4 percent) but falling again in May (-6.8 percent). This is compared to 2008's average monthly growth rate of 31 percent. It should be pointed out that exports by domestic companies have grown rather impressively since February, and most of the fall in exports has been caused by reduced crude sales (because of the drop in prices) and reduced exports by foreign companies with operations in Vietnam. This fall in exports has predictably led to a slowdown in industrial production, which averaged 5.08 percent for the first 5 months of 2009 compared to 16.3 percent in 2008. Retail sales have been holding up well though, averaging a little over 21 percent for the first 4 months of 2009.

The government initially forecast that the economy would grow 6.5 percent in 2009 — that has now been trimmed to 5 percent. The IMF's forecast has the economy growing 3.3 percent, but this projection may be too pessimistic. For one, the government has deployed a 143 trillion dong (\$8 billion) stimulus package plan, which includes income tax cuts, loan subsidies, infrastructure spending, etc. Apart from that, under a loan subsidy program, commercial lenders have lent approximately \$17 billion to businesses in 2009 (as of May 21). To complement these measures, the central bank aggressively cut its benchmark rate by 700 basis points to 7 percent between October 2008 and February 2009, and the benefits of the looser monetary policy are likely to appear in the coming months. A

cheaper exchange rate will buoy exports, and strong domestic consumption will also help.

GDP Growth (percent YoY)



Source: Bloomberg

There are some potential concerns that could lead to the IMF number becoming a reality. One is the higher-than-usual probability of the credit boom going awry. Directed lending by the state during such circumstances usually increases the chances of less-than-credit-worthy activities getting money, increasing the potential of the bottom-line of financial institutions being dented. Indeed the central bank has already warned lenders to control loans to real estate projects and stock investments. A potential issue looming is if banks are allowed to increase their lending rates. Lending rates are capped at 1.5 times the benchmark interest rate (7 percent) (not for consumer loans) and banks have been asking the central bank to remove caps on lending rates because of the squeeze this is having on their margins. Another warning sign is the fact that imports of machinery and parts have seen a substantial fall. This in itself may not mean anything, but sometimes a sharp fall in capital imports precedes a slowdown —producers become more pessimistic. A likely correlation to this is the 76 percent drop in

foreign investment between January and May 2009.

As of May 22, the dong was down 1.7 percent for the year and 10.2 percent from May 2008. The central bank has been letting the currency weaken to boost exports. It is likely that the central bank will continue to weaken the dong, albeit at a slow pace, to help boost exports. Three-month forwards indicate the dong will weaken 2.4 percent. Mixed economic news could also be contributing to the downward pressure. The central bank has kept interest rates constant since February, and weak GDP numbers in the first-quarter did not cause it to budge. It is likely that a floor has been reached, but only the second-quarter numbers will determine if the floor is permanent.

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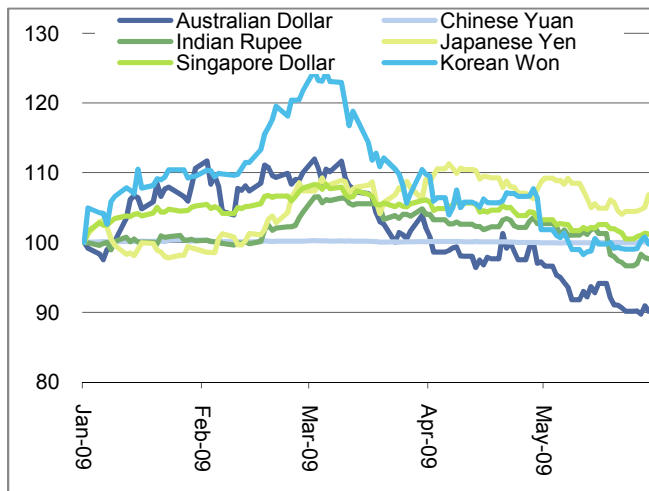
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Select Economic Indicators

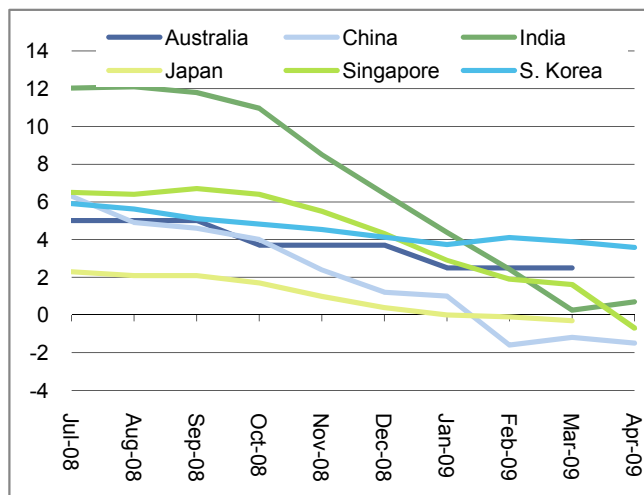
Indexed Daily Movement of Major Currencies (Jan 1, 2009 to May 28, 2009)



Source: Bloomberg

Note: Above 100 means depreciation and below 100 means appreciation. All exchange rates are against the U.S. dollar.

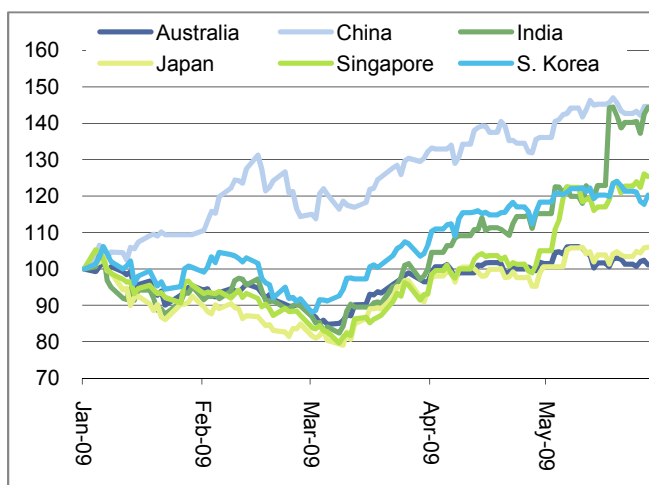
Inflation Rates



Source: Bloomberg

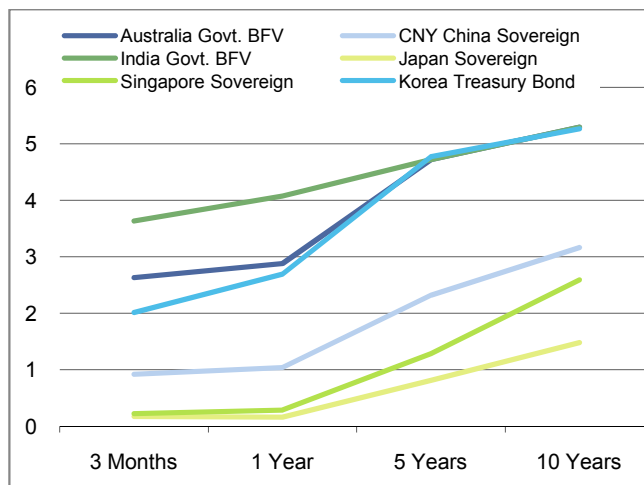
Note: Australia's inflation rate is a quarterly rate. India's is a weekly rate that is averaged.

Indexed Daily Movement of Major Stock Exchanges (Jan 1, 2009 to May 28, 2009)



Source: Bloomberg

Yield Curves*



Source: Bloomberg

* As on May 29, 2009

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