



Asia Pacific: Economic Review August 2010

There were fresh worries for Japan when recent data showed that the country's economy grew at an annualized pace of just 0.4% in the second quarter, lower than expected by most analysts. This propelled China to the remarkable status of becoming the world's second largest economy.

Elsewhere, most countries in the region reported encouraging data led by a strong export sector. Inflationary pressures remained stable, although India perhaps, had the most reason to worry. Pakistan's already ravaged economy was further battered by monsoonal floods, which have caused immense destruction to life and property.

At a Glance

- **Japan:** Japan's hopes for a quick economic recovery were dented when the country's gross domestic product rose a mere 0.4% in the second quarter over a year earlier.
- **China:** Offsetting the news of the recent spate of landslides and devastating floods, China has now overtaken Japan as the world's second largest economy.
- **India:** The Index of Industrial Production rose just 7.1% year-on-year in June with moderation witnessed in some sectors.
- **South Korea:** With consumer prices in South Korea remaining steady at 2.6% in July over a year earlier, the South Korean central bank continued to freeze its benchmark interest rate at 2.25%.
- **Australia:** In its quarterly statement on monetary policy, the Reserve Bank of Australia or RBA has maintained its forecast for the Australian economy, saying it expects the resource-rich economy to grow 3.25% this year.

Japan: Second quarter growth slows

Japan's hopes for a quick economic recovery were dented when the country's gross domestic product rose a mere 0.4% in the second quarter over a year earlier. In contrast, the Japanese economy had registered 5% expansion in the previous quarter, which added to the disappointment. The result puts additional pressure on Naoto Kan's government to retain and expand stimulus measures, an effort hampered by the country's large public debt.

Previous government stimulus measures, which included cash handouts at one stage, helped fuel anemic domestic consumption in Japan, and the country had managed to wriggle itself out of one its longest recessions with the help of a robust export sector led by strong demand from developing countries in Asia. However, the National Strategy Minister Satoshi Arai expected the Japanese economy to improve further, despite indications that domestic consumption may be slowing with reduced demand for government-backed energy-efficient cars and electronics.

The lower-than-expected GDP figures have also meant that China has overtaken Japan as the world's second largest economy after the developing Asian nation reported second quarter GDP at \$1.3 trillion. There was further bad news for the Japanese economy when the export sector as well showed an indication of slowing down. Overseas shipments rose 27.7% year-on-year to \$67 billion, the slowest pace in almost six months in June. This was slower than a 32.1% rise in May, with demand from Asia still supporting much of the growth. The Finance Ministry has raised its economic forecast for Japan, but the economic outlook for the country remains uncertain, especially with global growth showing signs of slowing down as well. The Bank of Japan, as widely expected, kept its overnight call rate unchanged at 0.1%, stating that the Japanese economy continues to show signs of a moderate recovery. There have been concerns that a rising yen may further dent the export sector, but the bank refrained from commenting on any other policy actions in its monthly monetary policy meeting.

China: Floods cause widespread devastation

Although China overtook Japan as the world's second largest economy, August remained a bitter month for the country. A recent spate of landslides and devastating floods left at least 1,239 dead in Gansu Province, Sichuan Province and other regions in the country's less developed South West. More than 600 are still reported missing, and China observed a day of mourning for the dead on August 15 with flags flying at half-mast and public entertainment suspended.

The floods may also have triggered a spike in inflation, with consumer prices rising 3.3% year-on-year in July and food prices contributing to much of the rise. **Earlier, China's trade surplus widened to an 18-month high of \$28.7 billion led by a slowdown in the import sector.** While exports rose 38.1% to \$145 billion, imports climbed 22.7% to \$116.8 billion in July over a year earlier. This contrasts sharply with a 43.9% year-on-year jump in exports in June and a 34.1% increase in imports for the same period over a year earlier. Import growth is expected to slow further over the rest of the year as the economy cools down from its previous highs.

Trade friction between the U.S. and China is only bound to rise if exports continue their growth, amidst slowing import growth. China has pledged to remove a two-year peg of the yuan to the dollar, but the yuan has barely appreciated since, and may cause potential political conflicts between China and its major trading partners in the future.

In other data, China's manufacturing output grew at the slowest pace in 17 months, indicating that the government's efforts to cool down the economy are starting to filter down. The Purchasing Managers' Index fell to 51.2 in July from 52.1 in June. And a separately managed Index, the HSBC China Manufacturing Purchasing Managers' Index, actually showed a contraction, with manufacturing activity falling to 49.4 in July from 50.4 in June. The People's Bank of China has so far maintained that it would continue its flexible monetary policy, and has expressed confidence that there was no substantial risk of a massive slowdown in the Chinese economy, or the threat of a double-dip recession.



India: Industrial output slumps

India celebrated its Independence Day with Prime Minister Manmohan Singh expressing confidence in the Indian economy, and commenting that inflation, currently a matter of concern to policy makers, would eventually subside. The Prime Minister's confidence should come as some relief to India-watchers, who must have met July's industrial output data with some disappointment. The Index of Industrial Production rose just 7.1% year-on-year in June with moderation witnessed in some sectors. In June 2009, the IIP stood at 8.3%. The capital goods sector crept down to single-digit growth for the first time after five consecutive months of double-digit expansion.

Adding to this, the export sector also underperformed for the first time in five months. **Exports grew 13.2% in July over a year earlier, raising questions if the country may be able to meet its export target of \$200 billion for the fiscal year to March 2011.** Imports also surged 34.3% to \$29.17 billion, resulting in a trade deficit of \$12.93 billion. The Commerce Ministry has already warned that the export sector may 'take a hit' as economic recovery weakens in key developed markets. India's key exports goods like leather, electronic goods, garments, tea and other commodities suffered during the month with slackening demand from Europe and the U.S.

The central bank of India has struggled to contain rising consumer prices, despite several rate hikes in the recent past. Inflation in July crept up to the double-digit mark in July, surging to 11.40%, led mainly by a rise in fuel prices. The central bank expects the Indian economy to grow at 8.4% this financial year, in line with most international projections that also forecast the Asian giant to grow at 8% to 9% this year.

South Korea: Central bank keeps interest rate unchanged

With consumer prices in South Korea remaining steady at 2.6% in July over a year earlier, the South Korean central bank continued to freeze its benchmark interest rate at 2.25%. The South Korean economy has rallied impressively over the past year, but downside risks to growth are still present. However, in its latest policy statement, the central bank indicated that its focus has clearly shifted to curtailing price pressures rather than on growth. Although inflation has remained benign, with an increase in power tariffs this month and rising costs of fuel, consumer prices are expected to climb above the central bank's comfort target of 2% to 4%.

The central bank expects growth momentum to accelerate for the rest of the year, anticipating that the country will grow at 5.9% in 2010. "The domestic economy is expected to continue on

an upward track, even in the presence of external risk," the bank said, in a statement accompanying the policy.

South Korea's economy grew 1.5% in the second quarter over a year earlier. But with the government-led stimulus initiatives fading, unemployment or the jobless rate rose to a three-month high of 3.7% in July from June. Those figures though are within the government's comfort range as the Finance Ministry expects the country to add around 300,000 jobs this year. Also, for the sixth consecutive month, South Korea posted a trade surplus of \$5.51 billion. Exports grew 28.3% in July over a year earlier to \$40.95 billion, while imports surged 28% to \$35.4 billion.

Australia and New Zealand: RBA maintains benchmark interest rate; Slowdown in services sector in New Zealand

In its quarterly statement on monetary policy, the Reserve Bank of Australia or RBA has maintained its forecast for the Australian economy. The bank said that it expects the resource-rich economy to grow 3.25% in the year, but warned that volatility persists in world markets and the recovery may possibly be delayed due to the economic downturn in developed markets.

Australia's growth has been driven by Asian powerhouses, India and China, which have been major consumers of the country's iron ore and other natural resources. The RBA acknowledged that Asian growth and demand for energy and resources over the next few years would largely steer Australia's growth. Other factors that may hamper Australia's momentum include a fall in the steel-making and the construction sector. The RBA has been bullish in raising interest rates, but has kept its rates on hold at 4.5% in its latest policy meeting. Indications of a less than stable recovery have been rife in the Australian economy with retail sales rising just 0.2% in June over the previous year. Also, building approvals dropped 3.3% in June, the fifth such fall in six months, indications that the RBA's rate hiking moves may be starting to bite the average Australian customer. And, consumer unwillingness to buy was also reflected in consumer prices rising just 0.6% in the quarter to June, with headline inflation increasing to 3.1% for the year to June.

New Zealand has had a tougher time of it than Australia, and its fragile economic recovery suffered a jolt when its services industry increased at the slowest pace since October last year. The Performance of Services Index, tracked by the Bank of New Zealand and Business New Zealand fell to 50.5 in July from 55.1 in June. Any reading above 50 indicates expansion while below 50 indicates a contraction. The prospect of a slowdown doesn't seem to have affected the New Zealand central bank, which last month raised the official cash rate to 3%, but

indicated that further rate hikes might proceed at a slower pace. However, mixed data continues to come in, making it difficult to forecast if the New Zealand economy is indeed slowing. For instance, retail sales surprised analysts by rising 1.3% in the second quarter from the first quarter, the largest increase in terms of volume in three years. But, on the other hand, the second quarter unemployment rate spurted to 6.8% in the second quarter over a year earlier, indicating there are certain weaknesses in the economy still. Also, the Home Price Index, published by the Real Estate Institute of New Zealand, showed that house prices fell 1.2% in July compared to the previous month. Housing sales also slumped 27% for the same period over a year earlier.

Indonesia and Philippines: Indonesian economy grows 6.2% in Q2; Overseas remittances rise in Philippines

Much like India's Prime Minister, Indonesia's President Susilo Bambang Yudhoyono has set high standards for the nation's economy, expecting it to grow 7.7% annually, creating 10.7 million jobs by the time he ends his second term in 2014. The President's confidence would have stemmed from the fact that Indonesia's GDP rose 2.8% in the April-June quarter, compared to the previous quarter. On an annualized basis, the economy expanded 6.2% for the same quarter. This was faster than the 5.7% year-on-year growth recorded in the first quarter of this year. Given that most other economic indicators for this country appear robust, Indonesia can very well expect GDP growth in excess of 6% for the whole year.

It is clear that the government's focus is on growth. In July, the central bank kept its benchmark interest rate unchanged at 6.5% despite a rise in inflation. Consumer prices in July rose 6.22% over a year earlier, led mainly by a spike in food prices. This level is only just higher than the central bank's comfort zone of 4% to 6% for 2010 and 2011. Unlike most other economies in Asia, Indonesia's growth has been led by strong domestic consumption. Household consumption increased 5% in the second quarter over a year earlier, and even the export sector has not been lagging. Exports surged 44.83% in the first half of 2010 to \$72.52 billion, in line to meet the government's targets of 15% growth in overseas shipments in 2010. Although Indonesia's economic rise has never been in question, the country's progress has often been thwarted by red tape, corruption and a chronically underdeveloped infrastructure. But with Yudhoyono at the helm, Indonesia has also achieved a certain degree of political stability, enough so that rating agency Moody raised the country's sovereign rating outlook to positive.

Meanwhile, in the Philippines, overseas remittances, a key contributor to the country's GDP, continued to rise. For June, overseas remittances increased 8.3% to \$1.6 billion with cumulative remittances up 6.9% in the first half of 2010 over the previous year. Also, a surge in demand for the Philippines' electronics products contributed to a 33.4% rise in exports in June over a year earlier. The Philippines has enjoyed strong economic growth this year. The economy

surged 7.3% in the first quarter of 2010, and with other positive indicators, the central bank has stated that it may keep its benchmark interest rate steady at 4% when it meets next on August 26. Consumer prices have been held in check with July inflation rising just 3.9% year-on-year. In a bid to stimulate the economy, Bangko Sentral ng Pilipinas has refrained from raising interest rates for almost a year now.

Thailand: Exports surge 46.3%

Thailand's fragile political scenario is stable for now, and that is slowly reviving interest in the country's tourism sector, which has been battered by repeated unrest over the past two years. However, a strong showing by the export sector should help. Thailand's overseas shipments grew 46.3% to \$18.04 billion, prompting the Commerce Ministry to revise upwards its export target for the full year to 19% from 14% earlier. For the first half of 2010, exports totaled \$93.07 billion, up 36.6% year-on-year. Imports also rose 51.7% to \$86.69 billion resulting in a trade surplus of \$6.38 billion. The sharp rebound in exports has been met with surprise by even the Finance Minister Korn Chatikavanij, who told *Bloomberg News* that he was 'surprised by the rebound in exports and also the level in private investment and consumption.' He expects the economy to now grow at 7% this year, and achieve 8% if the current trend continues.

The central bank of Thailand is also slowly shifting its focus from growth to curtailing inflation when it raised borrowing costs last month for the first time in almost two years. Increasing the benchmark interest rate by a quarter of a percentage point to 1.5%, the central bank is expected to raise interest rates again marginally when it meets again later in August. However, the bank has indicated that its rate hiking measures may not be immediately aggressive, especially considering that it expects economic growth to 'soften' a bit, although growth momentum remains strong. Inflation is slowly raising its ugly head in Thailand, with consumer prices rising for the 10th consecutive month in July. Inflation accelerated to 3.4% in July over a year earlier, following a similar 3.3% gain in June.

Hong Kong: Jobless rate drops

Hong Kong's seasonally adjusted jobless rate dropped in the May to July period, falling to 4.3%. The number of employed rose by 8,100 to 3.5 million during the same period. This is the lowest that the rate has dipped in the past 19 months, which prompted the Finance Ministry to predict that the jobless rate would fall even further in the next few months.

Hong Kong's economy has recovered surprisingly well from the recession of last year when it contracted 2.9%. The economy grew 6.5% year-on-year in the second quarter, following an 8% rise in the first quarter. That has moved the government to raise the full-year GDP forecast to 5% to 6% from a previous projection of 4% to 5%. Adding to the general sense of optimism surrounding Hong Kong, retail sales in the city increased 15.3% in June from a year earlier, provisionally valued at \$24.3 billion. For the first half of this year, retail sales have surged by 17.9% in value compared to the same period a year earlier.

Malaysia and Singapore: Export growth slows in Malaysia; Scorching GDP expansion for Singapore

Like its neighboring counterparts, Malaysia's export sector has been enjoying a healthy revival from the slump of the global economic recession. **Overseas exports grew 17.9% in June over a year earlier, rather subdued when compared to Thailand or Indonesia's robust growth, but still in line with analyst expectations.** Imports also soared 30.1% during the same period over a year earlier. However, the pace of growth is the slowest since November, but that can be largely attributed to the gradual tapering off of base effects than any real slowdown in growth. In other data, industrial output in Malaysia increased by just 9.4% in June over a year earlier, much slower than the double-digit rise of 12.3% that was reported in May. This marks the slowest pace of growth in four months.

Meanwhile, just as the Philippines saw increased demand for its electronic products, Singaporean exports saw the opposite, with slumping demand for both its electronic and non-electronic products in July. **The city state's non-oil exports grew just 18% in July year-on-year compared to 28.5% growth in June.** Singapore has reason to worry, with the Trade Minister Lim Hng Kiang stating that recent fiscal austerity measures introduced in the European Union might affect Singapore. The EU accounts for around 12% of Singapore's exports and weakening EU demand might further dent its export sector. For now though, the Singapore economy is booming. Most recently released data shows that the economy power-surged its way to an astonishing 18.8% growth year-on-year in the second quarter of 2010. With such phenomenal growth, the government now expects the Singapore economy to rise by as much as 13% to 15% this year, leaving behind bigger economies such as China and India.

Pakistan: Floods cause widespread devastation

Pakistan's chronically embattled economy received its biggest jolt yet when devastating floods triggered by the monsoon, wreaked havoc in the country, causing more than 1,000 deaths. The

United Nations estimates that more than 20 million have lost their homes in Pakistan, with around 8% of the population displaced. Fears abound that with relief aid slow in coming, epidemics like cholera may spread, which will cause further distress to a country that is struggling to rebuild itself from the ravages of insurgency and political instability. The World Bank has already offered a \$900 million loan to help the country deal with the unprecedented calamity.

Already, the Finance Ministry has stated that Pakistan may miss this year's GDP target of 4.5% and the government's already depleted coffers may be further strained by the crisis. Initial estimates state that the fiscal deficit may rise to as much as 8% of the GDP. The floods have destroyed crops worth around \$1 billion including much of the country's main exports like rice, cotton and sugarcane. Nature's fury may also add to Pakistan's inflationary woes. Consumer prices eased a bit in July, rising 12.34% year-on-year compared to 12.69% in June, but the worst may be yet to come.

Taiwan: Parliament passes new pact with China

Taiwan continues to work on improving its China relations, with the Taiwanese government passing the Economic Cooperation Framework Agreement. President Ma Ying-jeou has stated that the pact is necessary to prevent Taiwan's economic marginalization. Though heavily criticized by the Opposition, Ma's relative strength in the 110-seat Parliament ensured that the deal went through. A key feature of the pact is that it slashes tariffs on a wide range of Chinese and Taiwanese products, and could significantly boost bilateral trade. Relations between China and Taiwan have improved under Ma's leadership, with direct flights between the two countries as well as new cargo routes established since 2008.

Improving relations with Asia's fastest growing economy has also helped spur Taiwan's export industry. Led by strong demand from China and the rest of Asia, Taiwanese exports rose 38.5%, the ninth consecutive month of increase while imports also surged 42.7%, resulting in a trade surplus of \$2.16 billion. 🌐

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