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DEVELOPED ASIA PACIFIC: FOURTH QUARTER 2011 ECONOMIC REVIEW

Developed Asia gears for monetary actions on slowdown worries

At a Glance

- **Japan:** November exports fell 4.5% due to a strong yen and lukewarm demand from key markets such as the U.S. and the European Union as well as emerging markets.
- **Australia:** The Reserve Bank of Australia cut interest rates by 25 basis points each in October and November, bringing down lending rates to 4.5% in the wake of tepid labor markets.
- **New Zealand:** New Zealand's Prime Minister John Key was re-elected in November. Mr. Key has planned to sell a stake in state-owned companies to trim the country's debt.
- **Hong Kong:** The tourism and services industries experienced lukewarm growth in November causing unemployment to rise to 3.4% in November.

Developed Asia Pacific economies faced economic headwinds for the greater part of the fourth quarter of 2011 beginning in October. Major export-oriented economies such as Japan, Hong Kong, and Singapore witnessed slowing export growth as consumer confidence in key markets such as the U.S. and the European Union remained weak. Although China boosted exports from Developed Asia Pacific economies, overall exports to emerging economies across the world came under pressure. Furthermore, the resilience of the labor market conditions in major developed Asia Pacific economies was also tested by the slowing export and domestic markets. For instance, Hong Kong and Australia, two key developed Asia Pacific economies that were posting very low unemployment rates for the second and the third quarter of 2011 started showing strains during the fourth quarter. While Hong Kong's unemployment inched up in the face of slowing tourism and retail services industries, Australia's unemployment rose over concerns about investment growth. Although inflation in particular trended downwards along with growth, certain economies like Singapore witnessed rising inflation despite slowing growth.

Major developed Asia Pacific economies kept their monetary policy on watch as growth worries intensified during the fourth quarter of 2011. Australia, which was aggressive in raising interest rates over the past year, was also the most proactive in cutting interest rates in 2011. Starting in October, the country's central bank cut interest rates by 50 basis points in two installments. Singapore's central bank said that it will slow the appreciation of its currency to fuel growth despite higher inflation. Japan, which has near-zero interest rates, kept open its asset-buyback program to provide monetary stimulus. In Hong Kong, however, tighter borrowing conditions prevailed in the wake of an overheated property market.

Japan: Trouble with exports affect investment and labor markets

Japan's economy started showing increasing signs of strain beginning in October as exports and consumption, two important sources of growth, sputtered. First of all, the sovereign debt problems emanating from Europe are threatening all export-dependent economies across Asia, including Japan. Economists surveyed by *Bloomberg* forecasted weakening exports from Japan through the first quarter of 2012. According to the survey, Japan is not only expected to suffer from declining exports to Europe, but also to other Asian economies such as China and India over the next few quarters.

The country's exports continued to fall in the fourth quarter, with November export figures dropping 4.5% according to the Ministry of Finance. The auto industry, which is heavily dependent on overseas markets, witnessed lukewarm growth. Further, many Japanese car companies such as Toyota and Honda, which have extensive production facilities in Thailand, suffered badly when they had to shut down facilities in and around Bangkok due to heavy flooding during October. The damage caused by the flood in Thailand has created a scarcity of key parts required to manufacture cars in Japan according to a report from *Bloomberg*.

While a slowdown in Japanese exports has largely been attributed to declining demand in key destinations such as China and the European Union, a strong yen, the Japanese currency, has also been held responsible for the slump in overseas sales. Despite three interventions by the government to weaken the yen, the currency has consistently traded around the World War II high of ¥75 per U.S. dollar for the most part of the year. Many key corporations have vociferously called for government intervention against a strong yen.

The yen-induced pressure on the economy is already taking a toll on investments despite increased reconstruction spending. Japan's machinery orders fell 6.9% during November, the second straight month of decline. Falling investments and the strong yen are forcing Japanese corporations to downsize. Panasonic Corp. and TDK Corp., two electronic giants, reported in November that they are preparing to cut 17,000 and 11,000 jobs, respectively, according to a *Bloomberg* report. *The Wall Street Journal* stated that some auto companies were reportedly considering moving their manufacturing facilities outside Japan to escape the strong yen.

The problems in the export industry in turn have started trickling down into Japan's labor market. A Japanese Labor Ministry report said that the job-to-applicant ratio was stagnant during October. On another bad note, the unemployment rate in Japan during October exceeded estimates to touch 4.5% in October, up sharply from 4.1% in September.

Given such gloomy data, the Bank of Japan, the country's central bank, downgraded its assessment for the economy. The central bank, which has kept its interest rate at near-zero levels for a long time, provided furthermonetary stimulus through a bond-repurchasing program. To provide a stimulus, the Bank of Japan has allocated $260 billion for the asset-buying fund thus far.

Encouragingly though, Japan reported that department store sales and consumer spending gained momentum in November. Sales fell just 1.9% during the month according to the Japan Department Association, which had expected a much steeper drop in the wake of increasing unemployment. In December, Japan also revised its third quarter GDP growth for the three months ended September, down to 5.6% from its preliminary estimate of 6%.

Australia: Central Bank cuts interest rates as European debt concerns mount

Australia's economic performance in the fourth quarter began with a fairly resilient performance as various economic indicators such as business confidence and retail purchases climbed. Further, to arrest some of the economic doldrums arising from Europe, Australia's central bank, the Reserve Bank of Australia (RBA), cut interest rates in early November.

Thus far, Australia's economy has suffered much less this year than other developed economies such as Japan, the U.S. and the European Union. The appetite for the country's natural resources such as iron ore, coal, and natural gas, have held up quite well thanks to demand from some of

Asia's emerging economies such as India and China. That in turn has fueled investment into the Australia's mining and exploration industries, creating valuable jobs.

The Australian state of Queensland, known for its rich deposits of coal, silver and aluminum deposits added almost 17,900 workers in October alone. The number of jobs created in September too increased. Two consecutive months of rising jobs helped trim the unemployment rate in the country to 5.2% in October from 5.3% in September. A steady stream of investment into Queensland's natural gas fields is also expected to keep employment buoyant in the coming months. Big oil companies, including BG Group, ConocoPhillips, Royal Dutch Shell Plc, and PetroChina, are expected to pump in investments of nearly $50 billion into the state. A natural gas industry-funded research group has estimated that these projects will require nearly 25,000 more workers before the end of 2012. The mining industry is also fueling construction activity in the country. The total value of construction in the three months between July and September rose 12.5% to $46.7 billion. But towards the end of the fourth quarter of 2011, Australian job markets showed some signs of weakness in line with global developments as payrolls fell 6,300 during November.

To counter the initial signs of weakness in the labor market, Australia reacted with monetary easing. The country's central bank cut lending rates during November by 25 basis points to 4.5%, to prevent a slowdown in demand. This rate cut was backed up by another 25 basis point reduction in December to keep investment momentum going.

The central bank's easing has helped boost consumer confidence in the country. A consumer confidence index compiled by Melbourne Institute and Westpac Banking Corp climbed 6.3% to 103.4 in early November, the highest reading since May this year. What's more, Australia's home-loan approvals have improved significantly in recent months along with the approval for investment-related loans.

Despite the uptick in major indicators, Australia is concerned about its growth prospects due to the European debt crisis and its spill over to fast-growing Asian economies such as China and India. The central bank cut both the growth and inflation forecasts for the year ending June 30, 2012. The RBA expects Australia's growth in the period to come at around 4% down from its earlier forecast of 4.5%.

Still, the country's treasurer, Wayne Swan, said that Australia has the monetary and fiscal firepower to stimulate growth should the European debt crisis intensify. The country's Prime Minister Julia Gillard, though, said that her government will cut $6.7 billion in spending to bring the country's budget to a surplus for the fiscal year 2012-2013.

New Zealand: Re-elected Prime Minister vows to balance budget

New Zealand elected its incumbent Prime Minister, John Key for a second term in late November. The election results have been interpreted by private economists as a nod of approval for the key economic policies that the prime minister introduced in the wake of a deadly earthquake in February 2011, which brought extensive damage to New Zealand's second largest city, Christchurch.

The reconstruction spending that followed the earthquake resulted in New Zealand's fiscal deficit mounting to $13.6 billion in 2011. The re-elected prime minister has vowed to usher in fiscal consolidation by reducing the country's debt. Major ratings agencies Standard and Poors and Fitch had both downgraded New Zealand's debt ratings due to mounting debt levels in September. S&P had downgraded New Zealand's local currency debt from AAA to AA+ in September.

To tackle the debt level, Prime Minister John Key has proposed the sale of the government's stake in many companies. According to his plan, New Zealand will reduce its interest to 50% in companies such as Mighty River Power Ltd, Meridian Energy Ltd and Solid Energy from the current 100%. He also announced that the government will reduce its stake in a state-owned airline company. The government estimates that it will raise nearly $5.46 billion over the next three to five years and help balance New Zealand's budget by 2014.

In other developments, labor market conditions in New Zealand remained relatively weak despite an uptick in the agriculture and export sectors. The country's unemployment rate stood at 6.6% in October according to a government report. Measures of business and consumer confidence have trended steadily downward in the past two months according to a report cited by *Bloomberg*.

During December, New Zealand reported that its third quarter GDP for the three months ending September inched up 0.8%, beating a survey by Bloomberg that had predicted a median estimate of 0.6%. New Zealand's third quarter GDP had a significant boost from the Rugby Union World Cup that brought in thousands of tourists from many parts of the world.

Hong Kong: Stress on tourism and retail industries rise

Hong Kong's economy faced headwinds during the fourth quarter as export growth remained volatile and industrial output slowed. Although exports from the islands jumped 11.5% in October due to rising demand from China, Hong Kong had experienced slowing exports in the previous months. Hong Kong's exports fell in September, the first drop in monthly export figures in nearly two years, on weak demand from China and the European Union.

Adding to the uncertainty in the economy was Hong Kong's zealous attempts to ward off a bubble in the housing market. Prices of apartments in Hong Kong have zoomed almost 70% since 2009 on the back of low mortgage rates, an acute shortage of houses, and soaring demand from rich mainland Chinese. Over the past six months, Hong Kong's government had initiated several measures to control the bubble in property markets by raising down payments and bringing in more land to boost the supply of housing facilities. As a result of these measures, the housing market slowed considerable. Property and construction firms reported a 41% plunge in the number of transactions as of November according to *Bloomberg.*

Even the tourism and retail industries, which helped the island escape a technical recession during the third quarter have started showing increasing signs of a slowdown. Hong Kong's retail sales growth cooled for the third consecutive month in October primarily due to a slowdown in the tourism industry. Retail sales in October still grew 23% but were down from the almost 30% witnessed during the second quarter of this year.

The retail and the tourism industries had so far helped Hong Kong keep its jobless rate at 3.2%, a 13-year low for the greater part of the year. But with these two key industries slowing, unemployment in the financial center rose to 3.4% in November. Private economists surveyed by Bloomberg expect unemployment to climb to 3.8% by the end of 2012.

Hong Kong's government also fears that it will not be able to dodge the problems arising from the developed world. Overseas sales are expected to lose steam going forward due to waning momentum in other key export destinations including the European Union, the U.S. and Japan. Consequently, the government revised its 2011 GDP growth estimates downward to 5% from its previous estimates of growth between 5% and 6%. Hong Kong's GDP in 2010 expanded almost 7%.

In the wake of slowing growth, inflation is also losing steam. While inflation was flirting with high-single digits during the greater part of the year, consumer prices in November rose just 5.7%. Slowing housing market and rental costs are also contributing to a fall in inflation in the financial center.

Singapore: Growth concerns overweigh inflation worries

Like other export-dependent nations **Singapore** too showed signs of slowing economic growth during the fourth quarter of 2011. Waning demand from the European Union and the less-than-expected pace of economic growth in the U.S. have taken a toll on the island nation's industrial production lately. Singapore's seasonally-adjusted industrial production contracted almost 25.2% in November compared to a 12.8% growth in October. A host of industries including electronics and pharmaceuticals pared down production and caused industrial output to fall for the first time in nearly six months. The country's Economic Development Board also reported that manufacturing, which contributes to nearly 20% of Singapore's GDP, fell 9.6% in November.

The slowing trend observed in Singapore's economy during the fourth quarter follows a similar pattern observed during the third quarter. Industrial production growth declined 0.7% on the back of lower output from electronics industries such as chip-equipment manufacturers during the third quarter.

Despite slowing growth and falling output from key sectors, inflation has continued to climb in recent months. Inflation during November jumped to 5.7%, the fastest monthly rise in more than two years. Consumer prices had climbed 5.4% in October as well. Singapore's inflation has hovered above the 5% level over the past six months.

One reason behind Singapore's elevated inflation is the high demand for labor. Despite gains in wages, the jobless rate in Singapore has held up quite well. Employment hit a high of 78% among the resident population of the country and real median income rose by 3.1% in October. This has caused a situation in which, despite slowing economic growth, food and fuel costs along with rents have shot up.

Despite persistent inflation, Singapore seems now concerned more about growth in the wake of sovereign debt problems in the European Union, slowing growth in other Asian countries like Japan and China, and high unemployment rates in the U.S. In November, the Monetary Authority of Singapore, which uses its currency to manage price stability, said that it will slow gains to island's currency to balance growth and inflation.

Singapore, which expected its exports to grow by 6% to 7% in 2012, now anticipates exports to inch by just 1% to 2%. Similarly, government officials revised forecasts for export GDP growth to 1% to 3% from almost 5% in 2011.

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