



## EMERGING ASIA PACIFIC: FOURTH QUARTER 2011 ECONOMIC REVIEW

### Central banks loosen monetary strings as growth and inflation slows

Emerging Asia Pacific's economic expansion slowed considerably beginning in October 2011. In many economies, export growth along with investments grew at their slowest pace since the summer of 2009. Although the Purchasing Manager's Index (PMI) improved across key economies in November from the lows of October, the index was still under the 50 mark, which generally means a contraction in manufacturing activity. Large companies in many exported-oriented countries such as Korea either delayed or put expansions

#### At a Glance

- **China:** The Purchasing Manager's Index rose to 50.3 in December from 49 in November. House prices fell in 49 of China's 70 cities in November.
- **India:** Industrial production figures fell 5.1% in October, the first fall in 29 months, as output from factories, mines and utilities slumped.
- **South Korea:** Due to the retail and services industries, South Korea's unemployment rate fell to a three-year low of 3.1% in November even as export order growth fell.
- **Indonesia:** Export growth in November slowed to 8.25%, the first time expansion slowed to single-digits since September 2009.

on hold beginning in October. Almost all the countries in emerging Asia Pacific posted slower third quarter expansion over the year-ago period. The sluggish expansion comes in the wake of a stringent monetary policy over the past 18 months and a decline in demand from developed markets such as European Union and the U.S. But the slowdown in demand and tight monetary conditions has also resulted in lower inflation. Almost all countries in the region witnessed a letup in core inflation. Inflation over the past 12 months has hovered above the comfort zone of many central banks in the region. Countries such as Thailand and Philippines endured severe flooding during the fourth quarter of 2011. In the case of Thailand, the flooding of the industrial and manufacturing special zones in and around Bangkok forced major auto makers and electronics producers to shutter their factories.

But the sudden pullback in demand over the past three months has prompted emerging Asia Pacific central banks to announce a much less stringent monetary policy for 2012. The central banks in the region admitted that their focus has now shifted to promoting growth rather than controlling inflation. Central banks from countries ranging from India to Philippines have cut their annual growth forecast by nearly a percentage point. Meanwhile, amidst the slowdown in demand, Fitch Ratings said in December that it could cut growth estimates for the Asia Pacific region.

### **China: Headwinds abound for exports and growth**

China's growth momentum lost considerable pace during the fourth quarter of 2011 although the Middle Kingdom put up a resilient performance towards the end of the period. According to Beijing-based China Federation of Logistics and Purchasing, the country's Purchasing Manager's Index rose to 50.3 in December from 49 in November. The rise in the index comes on the back of an upswing in manufacturing and production in the run up to the New Year. The export orders index rose to 48.6 in December from 45.6 in November, a considerable improvement, although anything below the level of 50 still points to a contraction in activity.

Exports, the mainstay of China's economy, have faced some headwinds during the second half of 2011. The sovereign debt problems emanating from Europe in particular were a dampener on China's exports. During October, overseas sales in China rose 15.9%, the slowest pace of export-growth in nearly two years and the lowest export figures in nearly five months. Italy, one of the European economies facing rising yields in the wake of uncertainty over bond payments, is buying less from China. In fact, China's exports to Italy tumbled 18% in October. The slowdown in exports intensified in November again. The decline in exports resulted in China's trade surplus, the difference between imports and exports, fell to \$15.2 billion in November from \$17 billion in October.



Many traditional export fairs that serve as a harbinger of trade growth, such as the one that happens in Canton, also showed signs of strain during the year. For instance, in November the Canton export fair reported a 24% and 19% drop in orders from the U.S. and Europe, respectively.

China's monetary tightening over the past 18 months to fight inflation through five interest rate hikes and a steep rise in the bank reserve requirement ratio also contributed to the slowdown in growth. Small companies bore the brunt of this credit tightening. Many small and medium enterprises reportedly went bankrupt due to the scarcity of credit over the past six months. China's state-run news agency, Xinhua, reported in October that more than 80 small businessman from the Zhejiang province disappeared – either committing suicide or fleeing from creditors. The lack of credit had driven many businessmen to borrow from money lenders who often charged usurious rates for credit. Meanwhile, many local governments also reported a halt to a series of infrastructure projects due to the lack of credit, according to a report from *Bloomberg*. Certain marquee projects like the high-speed rail project also faced temporary suspension due to funding challenges.

The lull in economic activity in small and medium-sized industrial towns and cities spilled into China's sprawling housing markets. During November, house prices fell in 49 of China's 70 cities according to a government report. Unsurprisingly, house prices in the city of Wenzhou, in Zhejiang, home to nearly 400,000 small businesses, fell the most – 4.6% or almost ten times the average national drop in China.

The magnitude of the slowdown in the industrial provinces has caused worries in Beijing. Until recently, China was taking aim at reducing inflation, but the country is now attempting to stimulate growth. After concerns about the lack of credit for small and medium sized companies, China's central bank, the People's Bank of China, cut the reserve requirement ratio in December for nearly 20 rural credit cooperative banks in order to extend credit to smaller companies.

In a promising sign though, inflation in China too has slowed. During November, consumer prices rose just 4.2% compared to 6.1% in September. This fall in the pace of inflation was the steepest since August 2009.

### **India: Steep rise in borrowing costs weighs on growth**

[India](#)'s growth momentum has also taken a significant hit in recent months. Key figures such as industrial output and exports growth have fallen significantly over the past few months. The country's most-watched stock market index, the Sensex, fell nearly 25% for the calendar year

2011 due to a slowing economy, declining earnings growth at major companies, and dwindling portfolio investments from foreign institutional investors.

In December, the country reported that its industrial production figures fell 5.1% in October, the first drop in 29 months. Output from factories, utilities and mines tumbled in the wake of rising borrowing costs and a jump in wages and raw material prices. The country's November exports grew 3.7% to \$35.9 billion. This was the slowest pace of export growth in the past 24 months. Like China, India too had resorted to monetary tightening over the past eighteen months to rein in inflation. Over this period, India's central bank, The Reserve Bank of India, hiked interest rates 13 times and raised the benchmark lending rate by nearly 375 basis points.

Still, the rising borrowing costs have had an adverse effect in many ways. India's storied consumption growth seems to be giving in to the interest hiking spree of the central bank. Automobile sales, a widely tracked measure of consumption in India's urban areas, are under pressure. The Society of Indian Automobile Manufacturers (SIAM) reported that October sales plummeted 24% to 138,520; the worst monthly fall since December 2010. India's overall vehicle sales, which include the sales of two-wheelers and commercial trucks, also slid 1.1% in October. The SIAM now estimates 2011 automobile sales in India will grow at the slowest pace in nearly three years.

On the inflation front, however, the interest rate hiking measures have yielded some victories. Food inflation for November fell to the lowest level in more than five years. The respite in inflation comes after several months of high price rises. During October, India's inflation jumped 9.73%, the eleventh consecutive month that inflation exceeded the 9% mark. Even as other emerging countries like Indonesia and Brazil have started cutting interest rates, India's stubborn inflation has tied the hands of the country's central bank from cutting benchmark rates. Higher spending from India's central government and a weakening Indian rupee, which has made oil imports expensive, have widely been blamed for higher inflation in the country.

On the other hand, India's rising fiscal deficit is preventing the country from obtaining investment grade ratings for its debt. According to bond ratings firm Moody's, India's budget deficit is expected to rise to 5.5% for the year ending March 2012. Moody's has the highest junk grade rating on India's sovereign rupee debt.

Meanwhile, India's GDP growth during the July-September quarter grew 6.9%, the slowest pace of expansion in the past nine quarters, according to India's Central Statistics Office. Manufacturing growth inched up just 2.7% during the third quarter, while mining output shrank 2.9%. On the other hand, a positive performance from the services sector, which grew 9.3% during the quarter along with a rebound in the infrastructure and power sectors, helped India's GDP. The major boost for India's growth, however, came from consumption that grew 5.9% during the quarter.



## **South Korea: Exports in a bind as demand from developed markets fall**

**South Korea's** economy saw significant challenges as the wake of the European debt crisis affected large companies in the country. South Korea's output fell 0.4% in November over the previous month as investment spending and construction expenditure slowed. The country's central bank, The Bank of Korea, reported that the manufacturer's outlook fell to 79 in January 2012 from 83 in December 2011. The current level of the manufacturer's index reading is the lowest since July 2009 when it was 78.

Many companies in South Korea's capital goods sector have delayed capital expenditures due to the global uncertainty. This has stalled investment-led growth. Investments during the third quarter of 2011 inched up 0.7% compared to the second quarter, which recorded a 0.9% climb. South Korea's economy, dominated by large companies such as steel maker Posco, and LG, a conglomerate with interests in electronics and shipbuilding, came under pressure as corporate earnings fell substantially. Many companies including Posco, Samsung, and LG reported lower earnings during the third quarter. This again has forced South Korean companies to either downsize or put expansion plans on a hold.

The Bank of Korea, which hiked interest rates three times during the first half of the year, has held interest rates steady for the past six consecutive months as consumer prices slowed to 3.9% in October. However, the good news on the inflation front did not last long. Data released during the first week of December reported that inflation jumped to 4.2%. Consequently, the Bank of Korea, unlike central banks in other Asia Pacific nations such as Indonesia and Australia, signaled that it will not cut interest rates. The central bank's governor Kim Choong Soo, said that "rates are still accommodative".

In other developments, both consumption and consumer confidence in South Korea have largely remained high thanks to low unemployment in the country. South Korea's jobless rate fell to a three-year low of 3.1% in November as jobs in the services-based industries such as retail and wholesale remained buoyant. On the other hand, South Korea's consumer confidence sentiment index, which jumped during November, fell to 58.6 in December due to uncertainty arising from the death of Kim Jong Il, the North Korean dictator.

Meanwhile, South Korea's export-based industry, which accounts for roughly 50% of the country's economy, is facing the heat of dwindling demand from developed economies. Exports during October rose just 8%, the slowest pace in the past two years and in contrast from the double-digit growth of the past few months. The slowdown in the export industry is also taking a toll on the country's industrial output. Industrial production in South Korea slipped 0.7% in October. In December, South Korea announced that its exports will grow at just about a third of last year's pace.



## Indonesia: Back-to-back interest rate cuts to accelerate recovery

Indonesian exports have not escaped the effects of the global slowdown either. The country's export growth in November slowed to 8.25%, the first time growth fell to single-digits since September 2009. But importantly, Indonesia's economy, unlike many other Asian economies, is not particularly skewed to exports. Consequently, strong domestic consumption, higher investments, and slowing inflation are helping Indonesia's economy.

Indonesia's investment growth in particular has witnessed stellar prospects. Thanks to capital investment from countries ranging from the U.S. to Singapore, investments in Indonesia jumped 15.3% to \$7.3 billion during the quarter. As Indonesia embarked on a journey to modernize the economy through new infrastructure, investments into ports and utilities have soared. While domestic investment jumped 14.5% during the third quarter on strong spending for the plantation and food processing industries, foreign investment rose on the back of expenditures into the mining and auto industries. Japanese auto major Toyota announced investments in an auto plant in Indonesia. Meanwhile private consumption fueled by the purchase of durable items such as motorcycles and other automobiles grew 4.3%. Large Indonesian auto companies, like PT Astra International, reaped rich profits from the rising demand for motorcycle and cars.

What's more, falling inflation has helped the Indonesian central bank to loosen the monetary spigots. Thanks to generous fuel and power subsidies, inflation in the country fell to a 17-month low of 4.42% in October. Inflation further declined to 4.3% in December. This helped the country's central bank cut interest rates for the first time in two years to 6% during October. Although few economists predicted the move, the central bank justified the interest rate-cut by pointing to intensifying headwinds from global demand. However, the interest rate cuts have intensified the fall in the country's domestic currency, the Indonesian rupiah, which has declined almost 6% against the U.S. dollar over the past six months.

During the third quarter, [Indonesia](#)'s GDP grew 6.54%, the fourth consecutive quarter in which GDP expanded by more than 6.5%. Unlike other export-dependent Southeast Asian economies that have faced a slowdown due to faltering growth in developed economies, Indonesia's consumption-based economy has weathered the global slowdown fairly resiliently. All these factors helped Indonesia buck the slowdown in growth that swept other Asia Pacific economies such as Taiwan and Singapore.

On another positive note, rating agencies like Fitch and Moody's, which raised Indonesia debt to one step below the investment grade earlier in 2011, opined that the country's rating is resilient and could warrant another upgrade. Easing inflation, declining government debt, and a rise in foreign currency reserves have helped Indonesia inch closer to its first investment grade rating in nearly a decade.



## Thailand: Floods ruin cars, factories and growth

The fourth quarter of 2011 started with misfortune for Thailand. In October, [Thailand](#) witnessed its worst flooding in nearly 70 years. The flood devastated the areas surrounding Bangkok, the country's capital and its suburbs. More than 600 people were killed due to the floods and nearly 1,000 factories and industrial facilities were shuttered in central Thailand alone, as floodwaters invaded the industrial base. The floods affected 64 of Thailand's 77 provinces. Some 10,000 factories were estimated to be affected indirectly by the floods according to *Bloomberg*, and the economic value lost to the flood has been estimated at around \$20 billion.

Nearly one-fourth of the hard disks used in computers worldwide are sourced from Thailand. The flooding halted production of these integral computer parts. As well, Toyota and Honda, two of the world's top auto companies that use Thailand's industrial base to source parts, also were affected as flood waters submerged cars that were ready to be sold. The floodwater logged some of the areas for more than a month.

The closure of many factories in the region is estimated to have cost the Thailand economy over 300 billion baht (\$9.6 billion), which is almost 2% of the country's annual GDP according to the government. As the damage occurred during the fourth quarter, Thailand's central bank estimated that GDP growth will slow to 2.6% from its earlier forecast of nearly 4.1%. According to *Bloomberg*, nearly 660,000 jobs were in jeopardy. Manufacturing declined in November by almost 50% over the year-ago period and exports slumped 13%.

Thailand's tourism is also expected to be affected. The government minister responsible for the country's tourism and sports affairs said that Thailand will not be able to meet its target of 19 million tourists for the year as floods devastated tourist infrastructure.

Thailand's government announced a plan to set up a fund of 130 billion baht (\$4.2 billion) to help its flood victims. The fund will be deployed to reconstruct bridges and roads demolished by the deluge.

Still, the floods in October are not affecting the government's decision to carry on with big-ticket spending policies. The country's Prime Minister, Yingluck Shinawatra, who was sworn in last August, had based her campaign on raising minimum wages and pushing up the support price. Many industry associations representing Thailand's private companies have suggested that an increase in worker's wages would hurt their competitiveness. To help the private sector, Shinawatra has announced a series of relief measures, including tax breaks and the lifting of import tariffs on machinery.

On the monetary front, the Bank of Thailand, the country's central bank, trimmed interest rates by 25 basis points to 3.25% to reduce borrowing costs. The bank said that monetary easing will



help stimulate the country's private sector in the aftermath of the floods that wiped out industrial output by nearly 35.8% over November and December of 2011.

### **Philippines: Sputtering export engine holds back growth momentum**

The [Philippines](#)'s was buffeted by declining investment and slowing exports during the fourth quarter of 2011. During December, the Philippines statistics office reported that exports fell almost 20% to \$4.1 billion from \$4.8 billion in the third quarter, largely due to declining demand in the electronics industry. The Philippines, which accounts for almost 10% of the world's electronics manufacturing, has witnessed a drop in the production of semiconductor devices. The SEIPI, which represents the country's electronics producers, has forecasted an 18% fall in exports from the industry, dramatically different from the 5% fall it had predicted in August.

As well, investment growth in the country has also witnessed a sharp slowdown as both public and private construction spending fell. High inflation in the Philippines is one reason for a slowdown in declining construction activity. In recent months, inflation has remained persistently high despite slowing growth. Consumer price inflation for the month of October accelerated for the second consecutive month rising 5.2%. Earlier in September, inflation had risen to 4.8% on higher fuel and transportation costs. Furthermore, lower output of rice following a series of typhoons that affected crops also pushed food prices up over the past two months. During November, however, inflation advanced at a slower pace of 4.8%, but still above the central bank mandate.

Elevated inflation has tied the hands of the Philippines central bank from providing a monetary stimulus in the form of interest rate cuts. Even as other countries in the region, such as Indonesia, have resorted to interest rate cuts to boost growth, Philippines's central bank refrained from cutting interest rates at its December policy meeting for fears of stoking inflation further.

In December, the Philippines reported that GDP for the third quarter ended September grew just 3.2%, down from 7.3% during the same period a year-ago. The slowdown in the GDP growth was mainly blamed on a series of typhoons that caused widespread damage to crops and other plantations in the third quarter.

The sudden loss of pace in the economy has unnerved the Philippine government. The country's president, Benigno Aquino, approved a 72 billion-peso (\$1.7 billion) fiscal stimulus in November, designed to boost the economy through new investments into the country's roads and other infrastructure projects like bridges.



During mid-December, the Philippines also witnessed one of the worst floods in many years, claiming more than 1,500 lives and displacing nearly 400,000 people. With inflation and interest rates remaining high, the country now expects its annual GDP for 2011 will grow just 3.8% from its earlier forecast of 4.5%.

### **Malaysia: Central banks watch monetary policy as exports shine briefly**

Amidst worries over a global slowdown, Malaysia like other Southeast Asian economies has turned to its monetary policy to stimulate growth. The country's central bank, Bank Negara Malaysia, held back raising its benchmark interest rates and reserve requirement ratios for banks for the third consecutive policy meeting in November. The overnight rates for Malaysia were last raised 25 basis points in May 2011 to 3%. The central bank said that it expects the country's domestic economy will expand, but has forecasted a slump in export growth.

Despite the downbeat assessment from Malaysia's central bank, exports from the country during the initial part of the fourth quarter held up well. In December, Malaysia reported that its exports for the month of October climbed almost 16% to \$63.6 billion compared to a consensus figure of 7.3% predicted by a group of economists surveyed by *Bloomberg*. Exports mainly got a boost on the back of strong sales of energy and commodities. Sales of liquefied natural gas zoomed 82%, while crude petroleum exports and palm oil sales rose 87% and 54.3%, respectively. On the other hand, the manufacturing sector experienced a lull, with sales in the electronics industry tumbling 9%. Although the country witnessed a surge in exports, overall shipments for the fourth quarter were largely expected to remain under strain according to the country's central bank.

To counter the slump in demand, Malaysia has unveiled a series of job-creating projects to keep employment high. In early December, the country's Prime Minister Najib Razak said that his government plans to give a boost to the country's shipbuilding and repair industries. The initiative, which will be deployed through the country's Association of Marine Industries, is expected to generate nearly \$2 billion in gross national income while generating 55,000 jobs over the next five to eight years.

Meanwhile, in a major decision, Malaysia's central bank decided to allow foreign investment in the country's banking industry by removing barriers to entry for overseas players. In December, the country's central bank said that it will allow foreign banks to raise their equity stakes in Malaysian banks. It will also grant additional licenses to facilitate the expansion of the bank branch network as well as allow the short-selling of derivatives.




## Taiwan: Exports and investments slow amidst declining trade and demand

**Taiwan**'s export-dependent economy witnessed significant challenges beginning in October 2011 as overseas sales faced headwinds. Taiwan's economic zones that specialize in exports and the assembly of electronics products are now bracing for a slowdown. Many marquee companies in these zones have put off planned capital expenditures and some have even started to downsize their labor force in expectation of slowing global growth in 2012, according to a report from *Bloomberg*. For instance, Taiwan Semiconductor Manufacturing Company Limited (TSMC) announced that it will cut capital expenditure in the wake of declining profits and demand. One of the world's largest assembler and manufacturer of laptops, Quanta Computer, reported that it has offered its workers severance packages in the wake of a restructuring.

A combination of weak exports to Europe and the U.S. and a general slowdown within Asia caused Taiwan's economy to lose steam. Although one of Taiwan's key trade partners, China, helped Taiwan's exports, other countries bought less from the country. Consequently, although exports were buoyant in October, export orders climbed just 2.5% in November, the slowest pace of growth in two years.

Meanwhile, moderation in the pace of economic growth has also resulted in lower inflation. Taiwan's consumer price index rose at its slowest pace in nearly two months during November, inching up 1.01%.

Earlier, the pressure on exports reined in Taiwan's third quarter GDP. The country's economy grew 3.37% during the third quarter of 2011 over the year-ago period, the slowest pace of expansion since the beginning of 2009. The fall in exports prompted Taiwanese authorities to lower their export growth expectation for the year to 6.7% in 2012 compared to their earlier forecasts of nearly 8.5%.

Meanwhile, the planned job cuts from many of the electronics parts makers and assemblers have already resulted in higher unemployment for the country. Taiwan's seasonally adjusted jobless rate climbed to a five month-high of 4.3% in October. According to the Council of Labor Affairs, as of November 15, more than 5,000 workers from 48 Taiwanese companies were asked to leave without pay. The total number of unemployed people in Taiwan during the end of October stood at 483,000, almost 4,000 more than in September. 

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