

Global boom: Asia's giants re-emerge

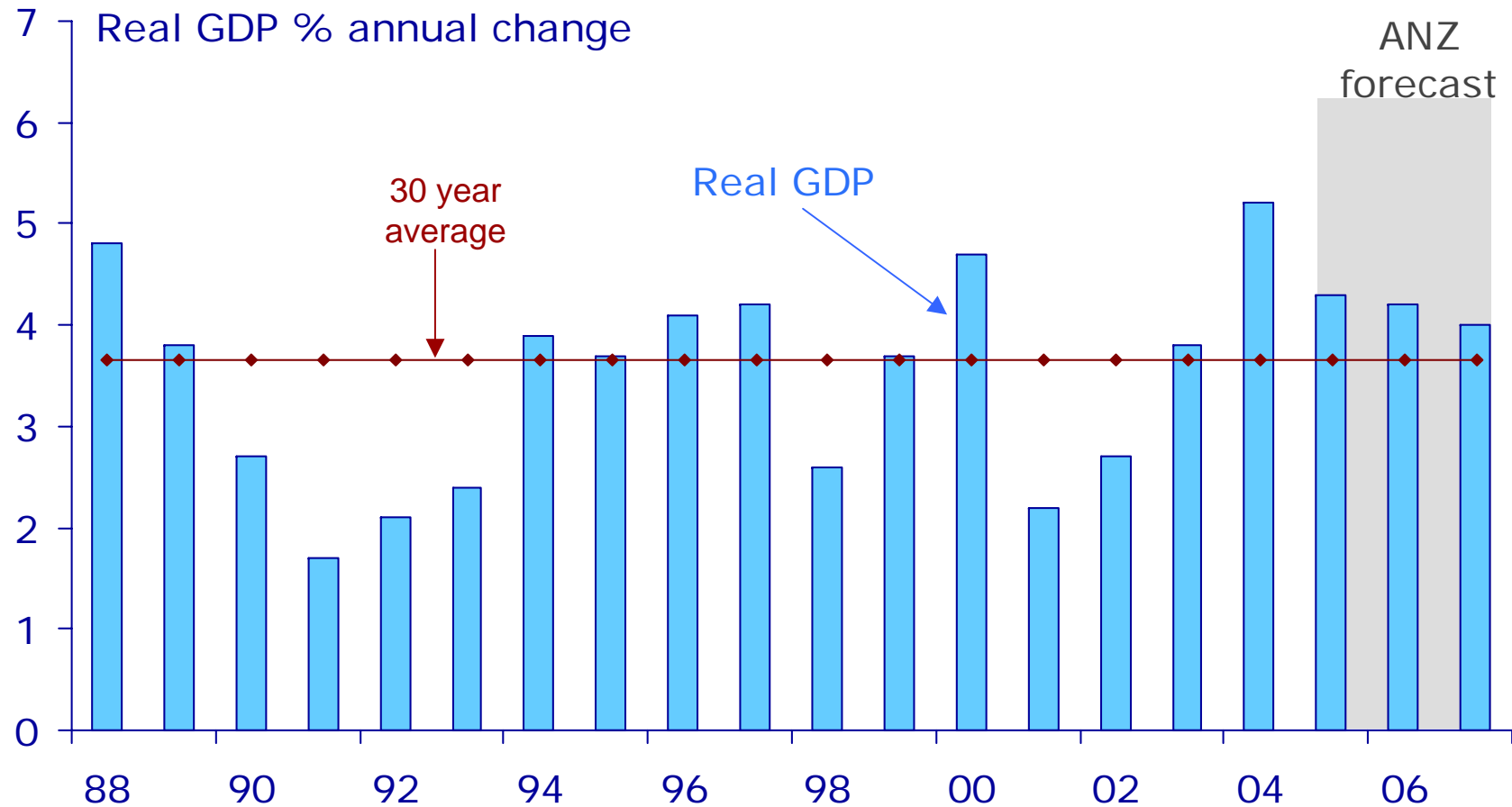
Amy Auster
Head of International Economics
ANZ Bank

August 2005

Economics@ANZ

Global growth will be above trend for 5 consecutive years

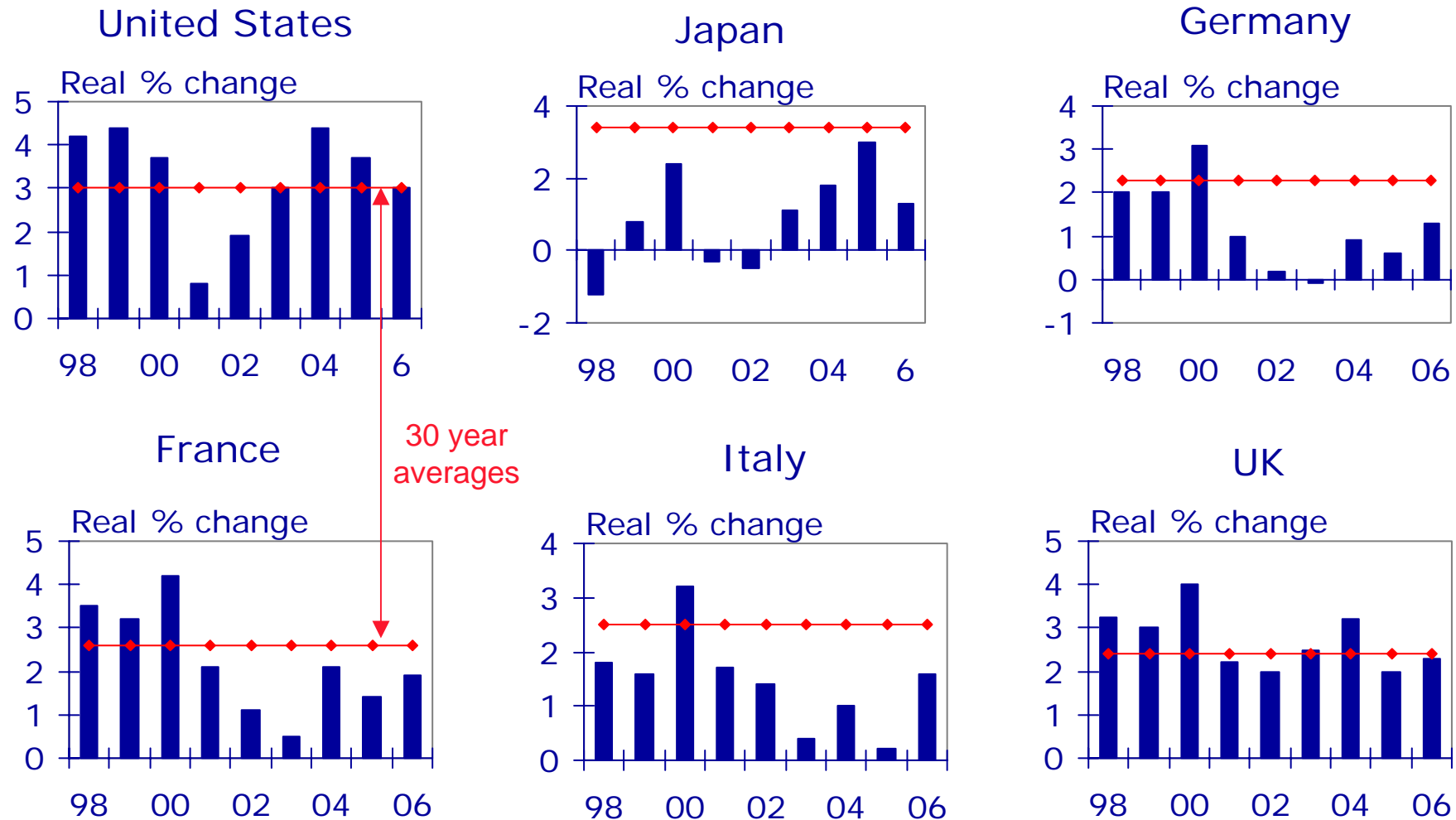
World economic growth



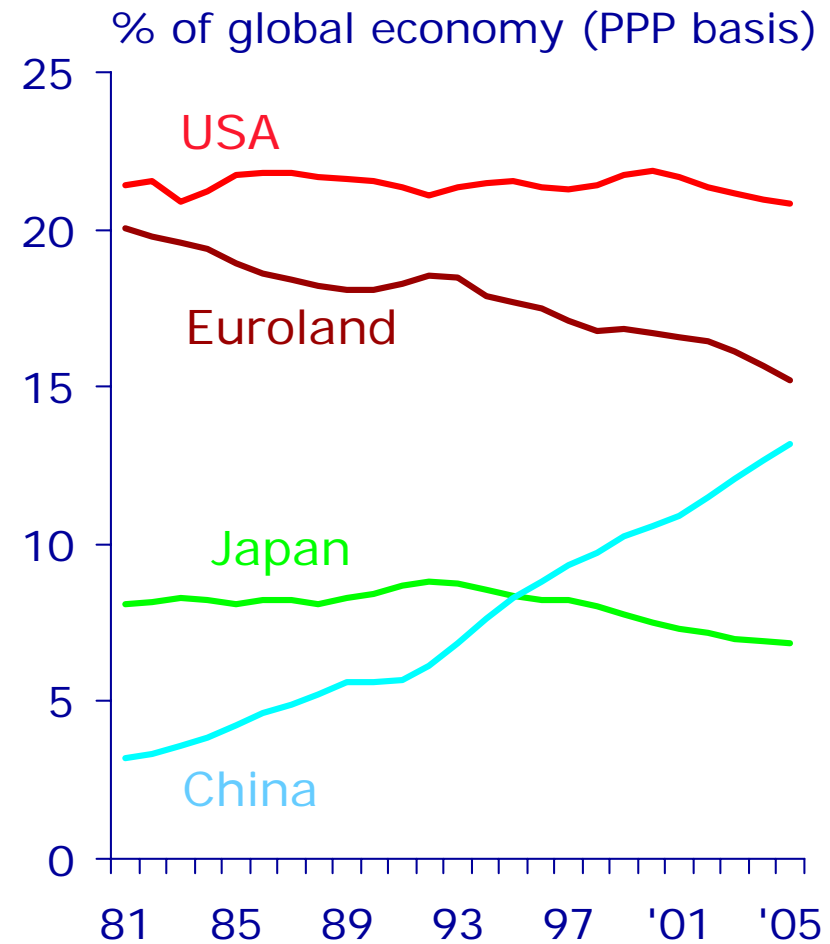
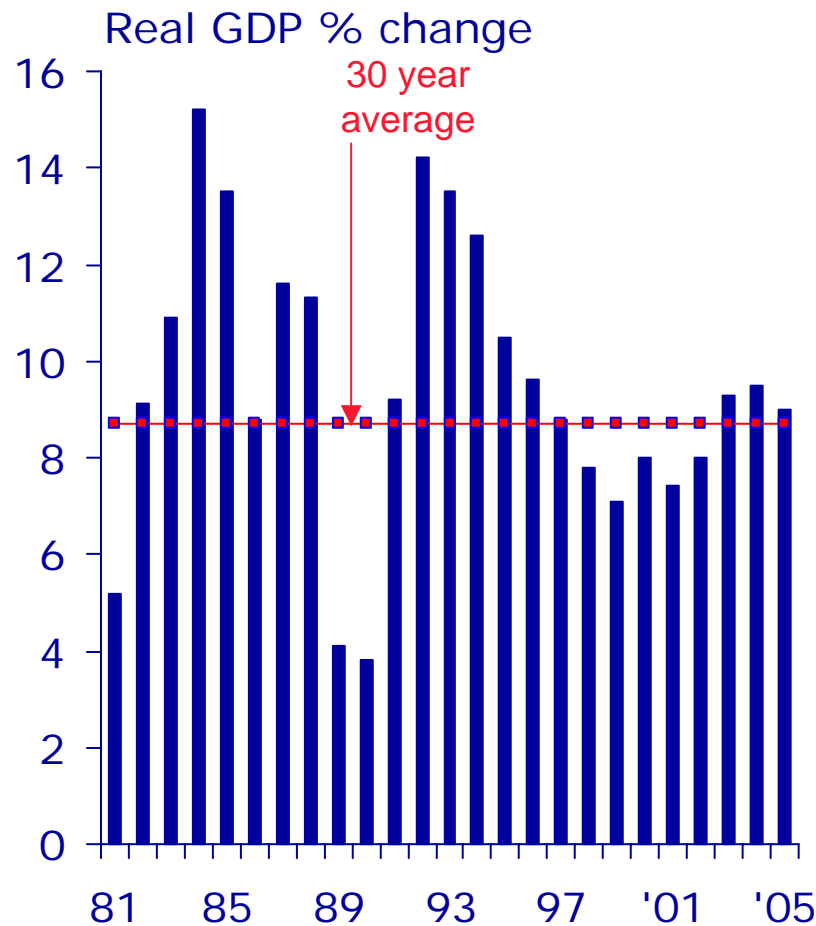
Note: GDP based on 50 countries aggregated using 'purchasing power parity' weights.

Sources: National agencies, Datastream, OECD and Economics@ANZ.

Surprising, because G7 countries ex-US have been growing only at or below historic trend

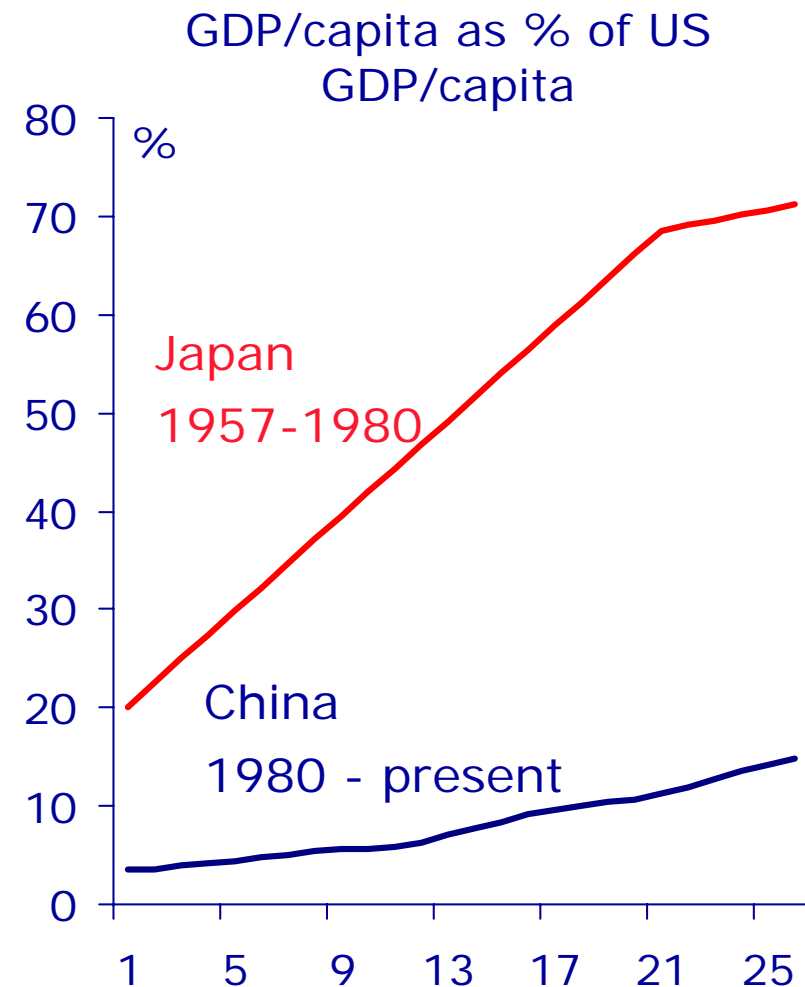
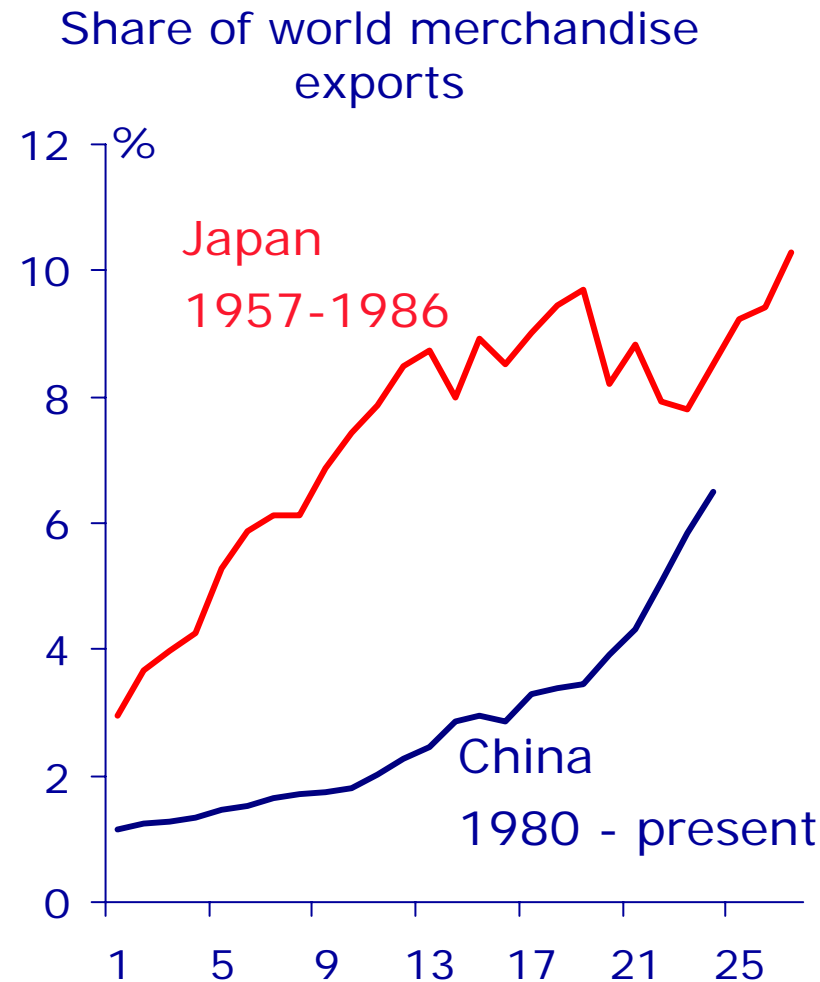


It is the China-US partnership that is making the difference



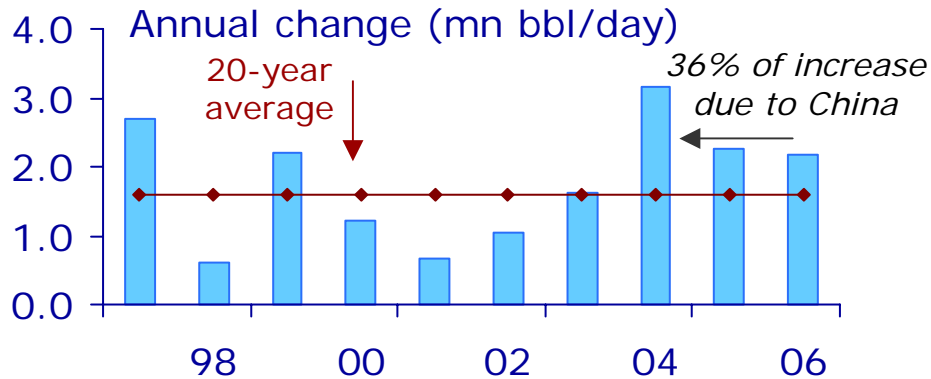
China is now the 2nd largest economy in the world on PPP basis

Despite rapid expansion, still considerable room for growth

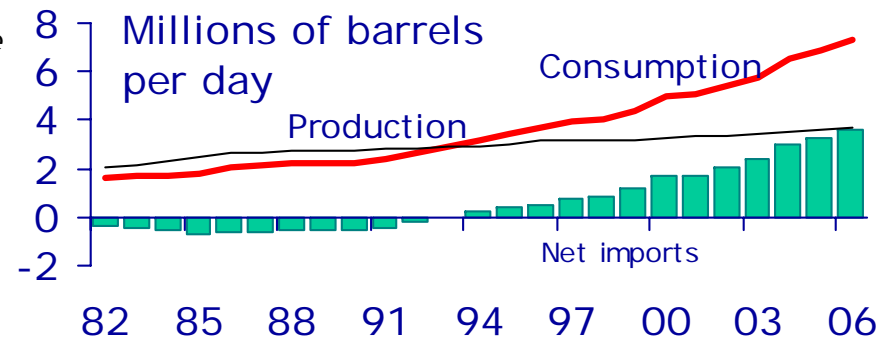


The rise in China's demand for energy is commensurate with its growth rate

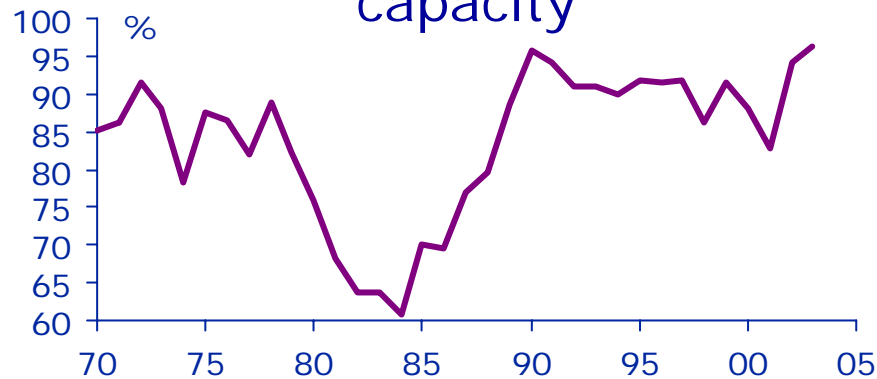
Global oil demand



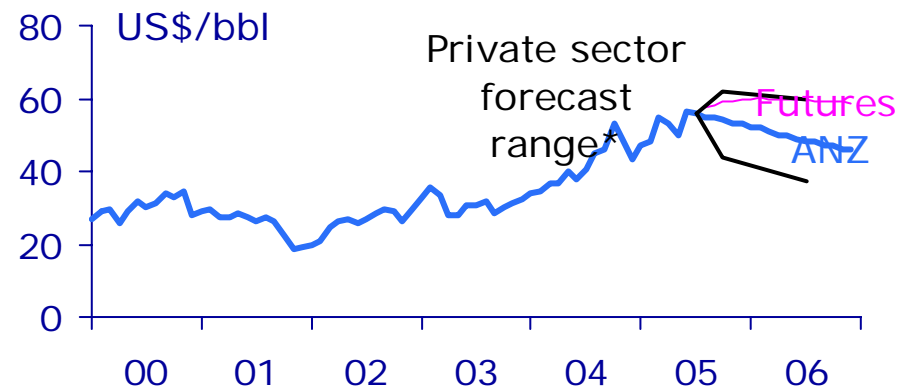
OPEC excess capacity



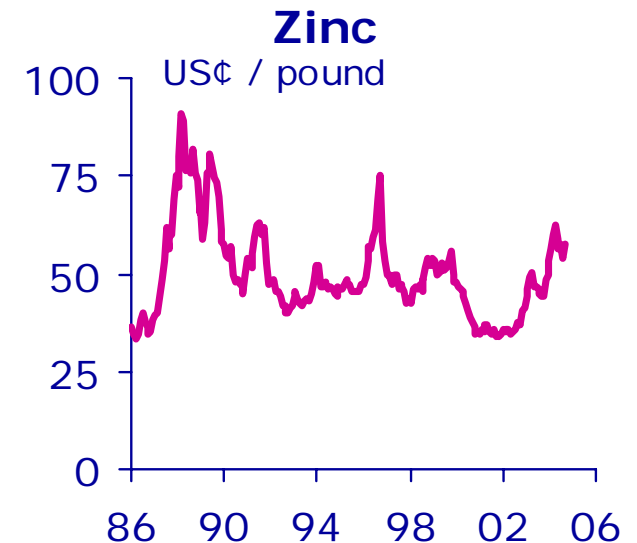
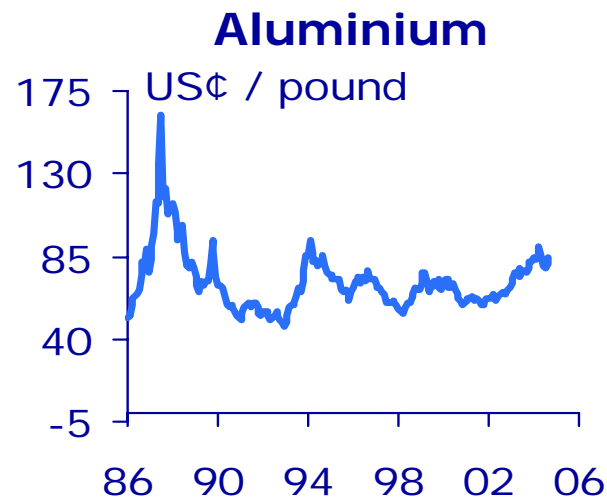
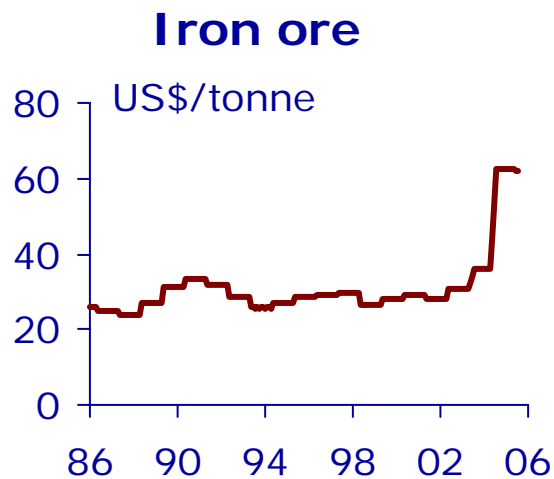
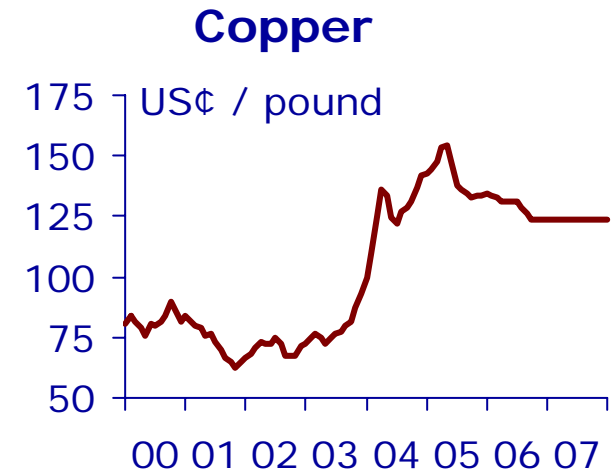
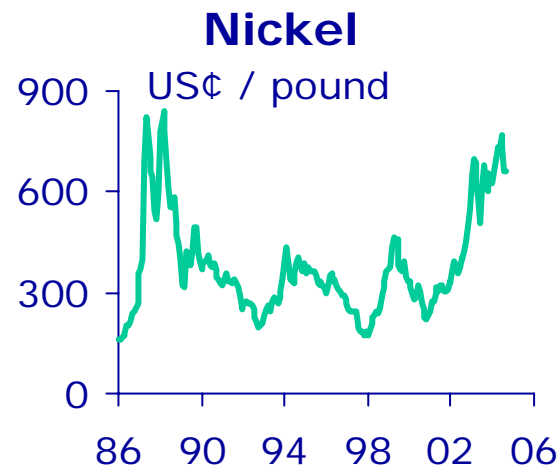
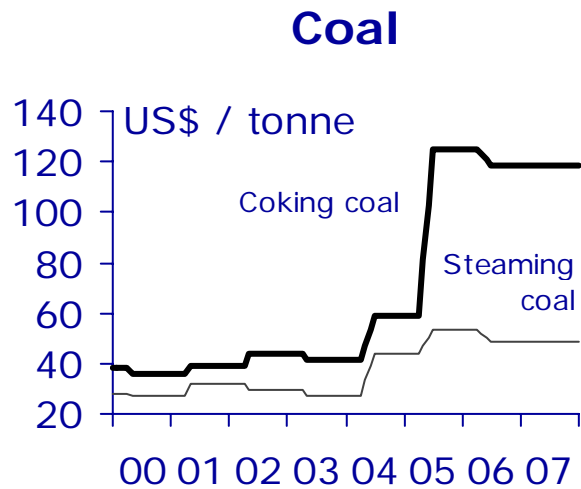
OPEC production as % of capacity



WTI oil prices



Impact on other commodities will depend upon whether China imports or exports them



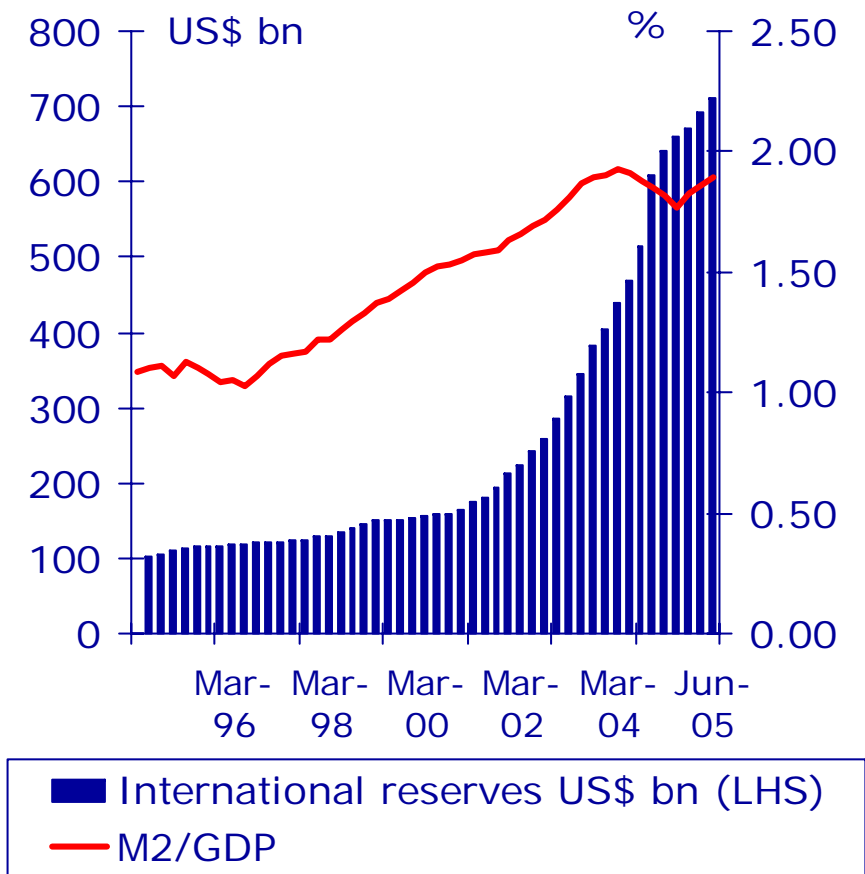
The world economy in 10 years' time

	GDP in 2005		GDP growth, 2006-2015 (f)	GDP in 2015	
	US\$bn	Rank		US\$bn	Rank
United States	12,332	1	3.2	16,950	2
China	8,092	2	8.0	17,550	1
Japan	4,009	3	1.5	4,650	4
India	3,603	4	6.0	7,015	3
Germany	2,499	5	1.5	2,897	5
United Kingdom	1,826	6	2.1	2,250	=7
France	1,812	7	2.1	2,239	9
Italy	1,695	8	1.6	1,978	10
Russia	1,586	9	5.0	2,585	6
Brazil	1,553	10	3.8	2,252	=7
Canada	1,112	11	2.7	1,448	14
Korea	1,099	12	4.5	1,702	11
Indonesia	864	15	6.0	1,543	=12
Australia	639	16	3.4	900	21

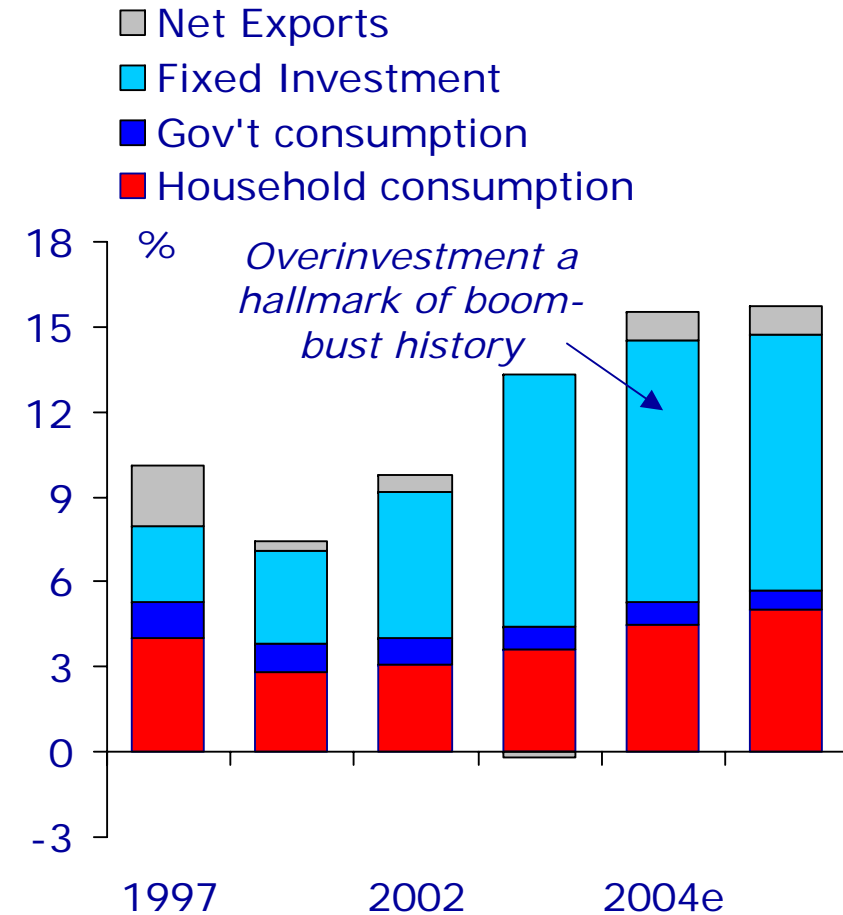
Note: GDP figures are converted to US\$ at purchasing power parities (PPPs), not market exchange rates. Forecasts are 'consensus forecasts'; the fact that they are presented here does not imply that they are endorsed by Economics@ANZ. *Sources:* IMF, *World Economic Outlook*

Caveat: steady state is not a certain bet

Excessive capital inflows...

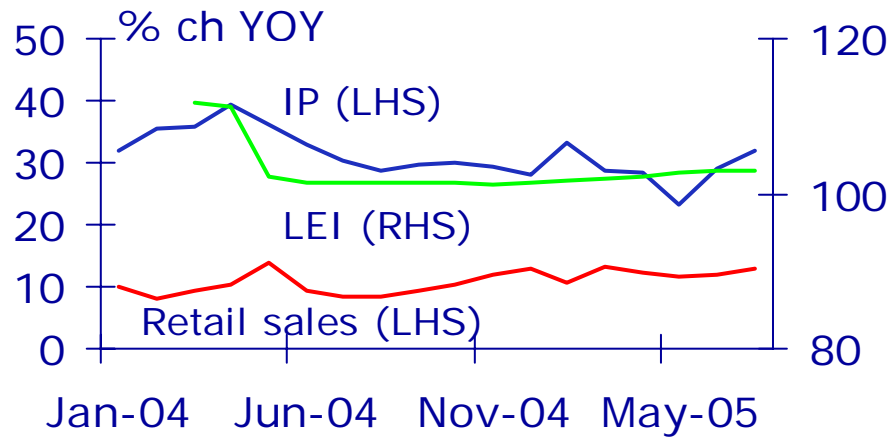


Excessive investment?

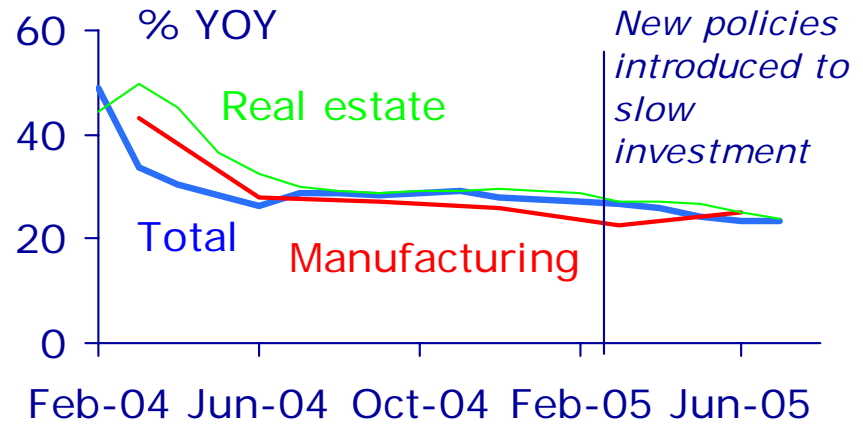


Sector bubbles are still real concern

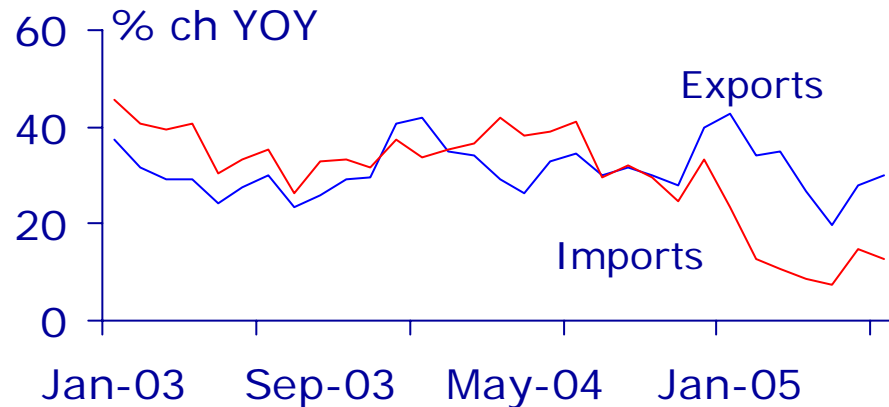
Leading indicators



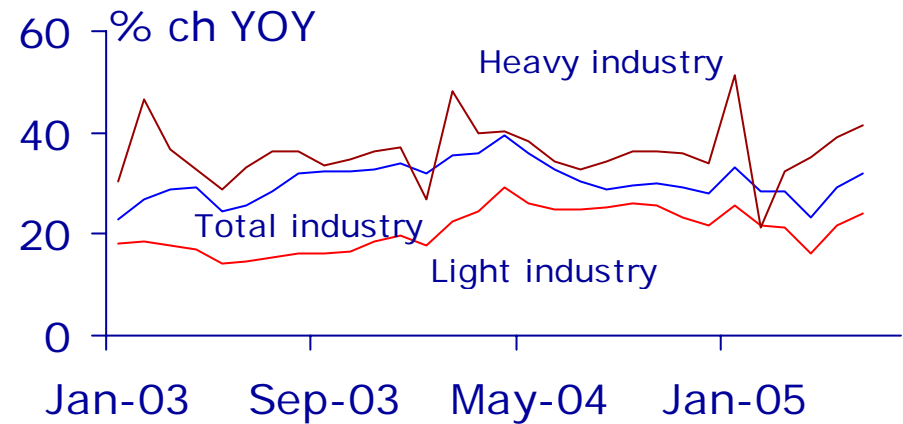
Investment



Exports and imports

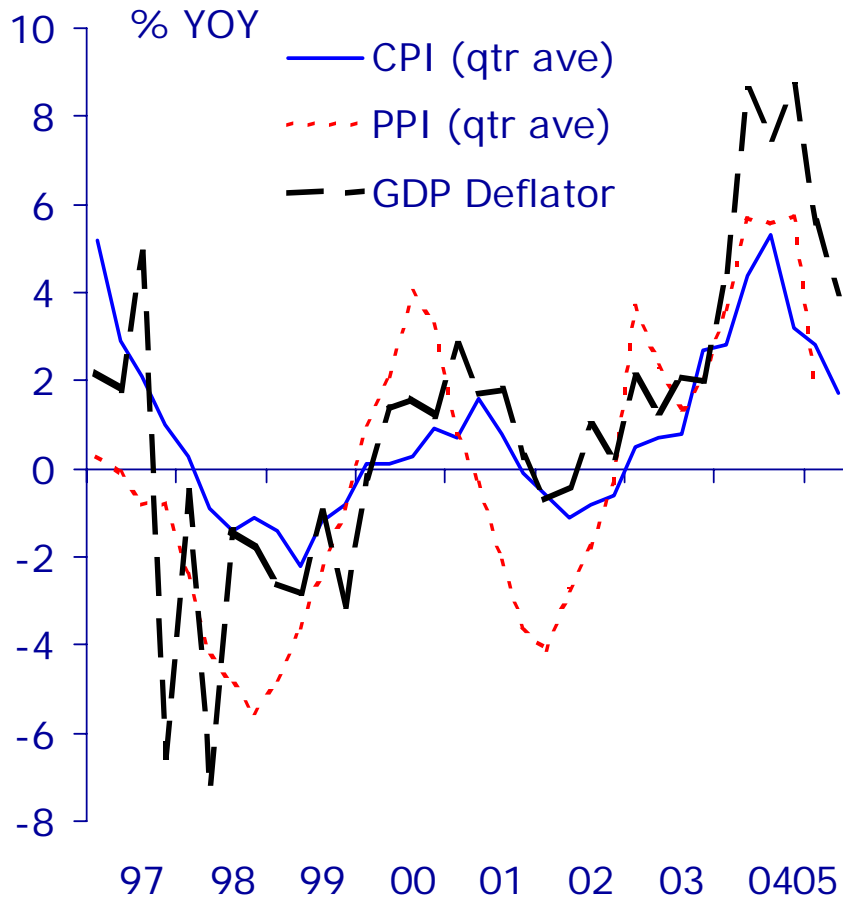


Industrial output by value added

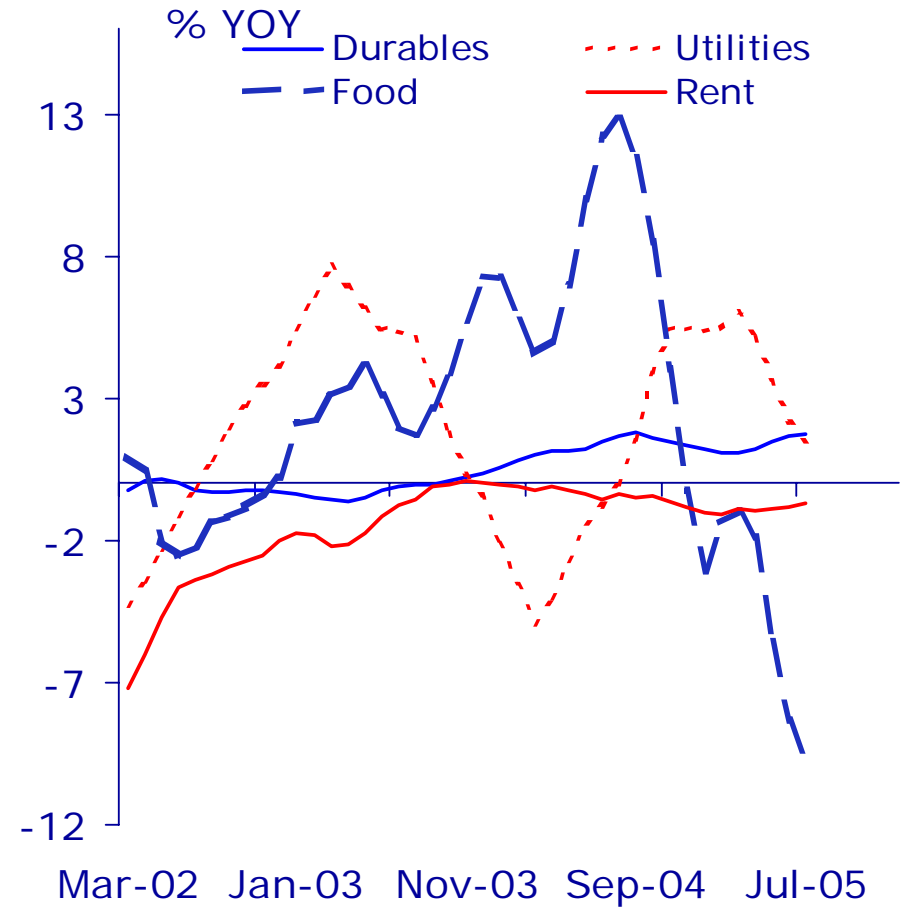


Authorities will be worried about deflation

Broad inflation measures



Components of CPI



Sources: Datastream, Economics@ANZ.

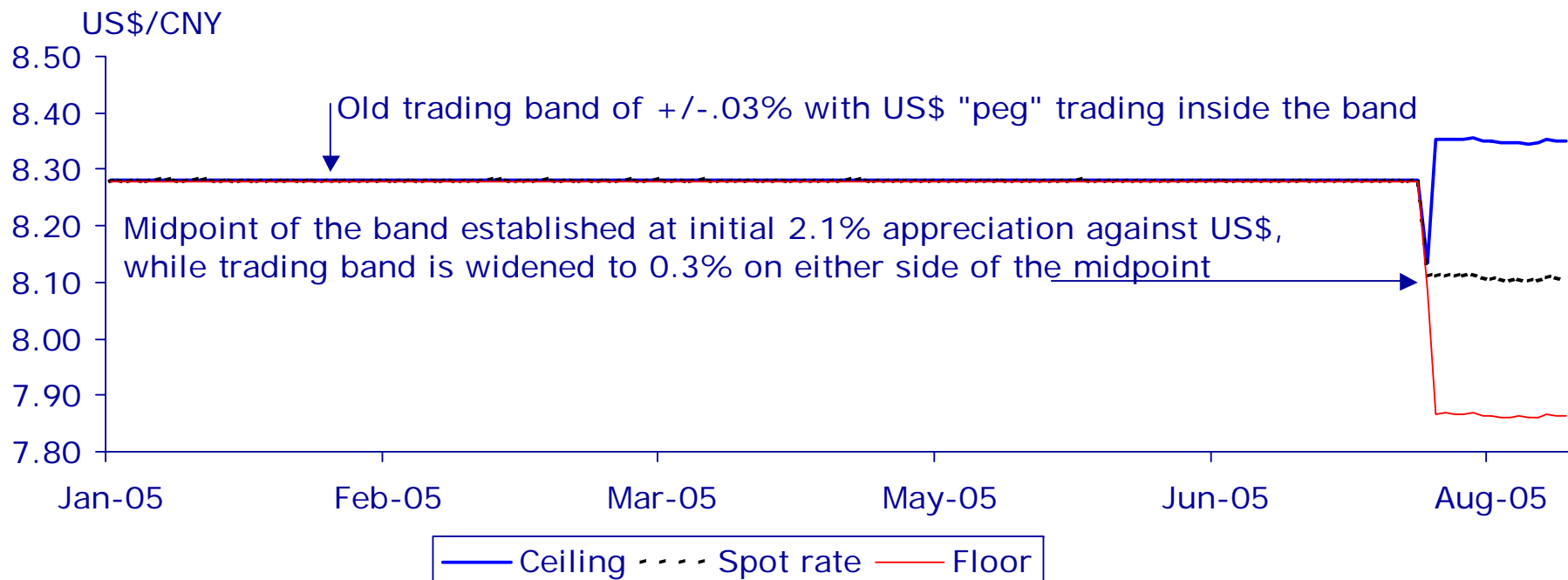
21 July announcement focused on capital flows, with FX regime shift only a part of the picture

- Greater liberalisation of capital account – in one direction
 - Raised allowable foreign currency holdings as percentage of firm profits
 - Allowed travellers to take more foreign currency overseas
 - Loosen restrictions on outbound foreign direct investment
- Encourage greater holdings of foreign currency
 - Raised one-year rates on onshore foreign currency deposits - twice
 - May raise reserve requirement, or reduce interest paid on reserves held at PBOC
- Showed expectations of greater currency volatility
 - Expanded FX forwards market and introduced swap market

Article in People's Daily stated that US\$300 bn of reserves would be sufficient for 6 months of import cover and 100% of short term foreign currency debt cover

International reserves US\$711 bn as of end June – will pace of accumulation slow to below US\$16.8 bn per month seen in H1?

The new FX regime



- Other currencies in the basket were named as: USD, EUR, JPY, KRW, AUD, SGD, MYR, GBP, CAD, THB, RUB
- PBOC has intervened to keep US dollar within the band. Market has not yet really tested other currency crosses, but if PBOC intervenes then implications for volatility in the FX market are extremely important – PBOC could “anchor” global currencies as it is “anchoring” bond yields

Currency regimes in Asia

•Singapore

- Trade weighted basket – weights not disclosed
- Quoted against USD but fluctuates against USD, yen and euro
- Main monetary policy instrument – policy statements refer to expectations of the width of the band and SGD's position in the band

•Malaysia

- Details yet to be announced
- On a trade weighted basis, US\$ likely more than 60% share of invoiced currency for exports given commodities

•Hong Kong

- “Two-way” convertibility is a soft peg against the US dollar
- No other currencies considered

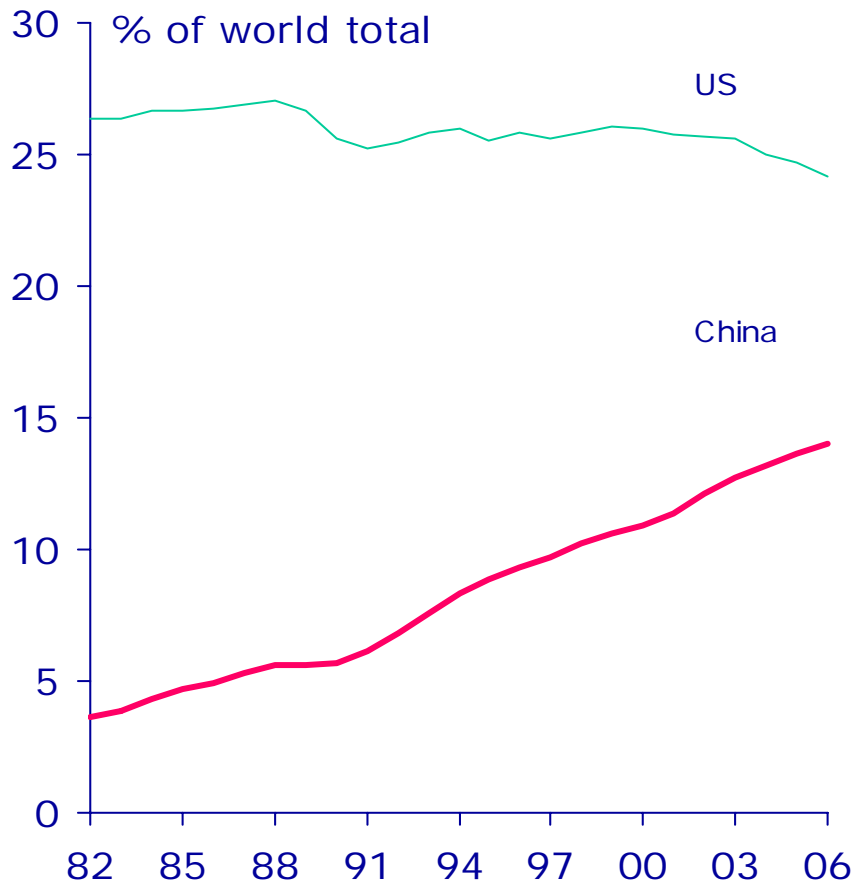
Country	Currencies in trade invoicing in selected countries - % of total currency share in exports		
	US\$	Euro	Yen
USA	95		
Japan	52.4		36.1
Korea	84.9		7.1
Australia	67.9	1.4	1.0
UK	40 non EU 29 in EU	5.0 non EU 15 in EU	

Some scenarios for China's landing

<i>End of year 2006</i>	Scenario 1 Base Case	Scenario 2 Rapid revaluation	Scenario 3 No further reval
USD/CNY	7.78	6.89	8.11
GDP growth (%)	8.2	7.5	6.8
Asia ex-Japan real GDP growth (%)	7.0	6.2	5.7
Japan real GDP growth (%)	1.7	1.4	1.0
Global GDP growth (%)	4.2	4.0	3.8

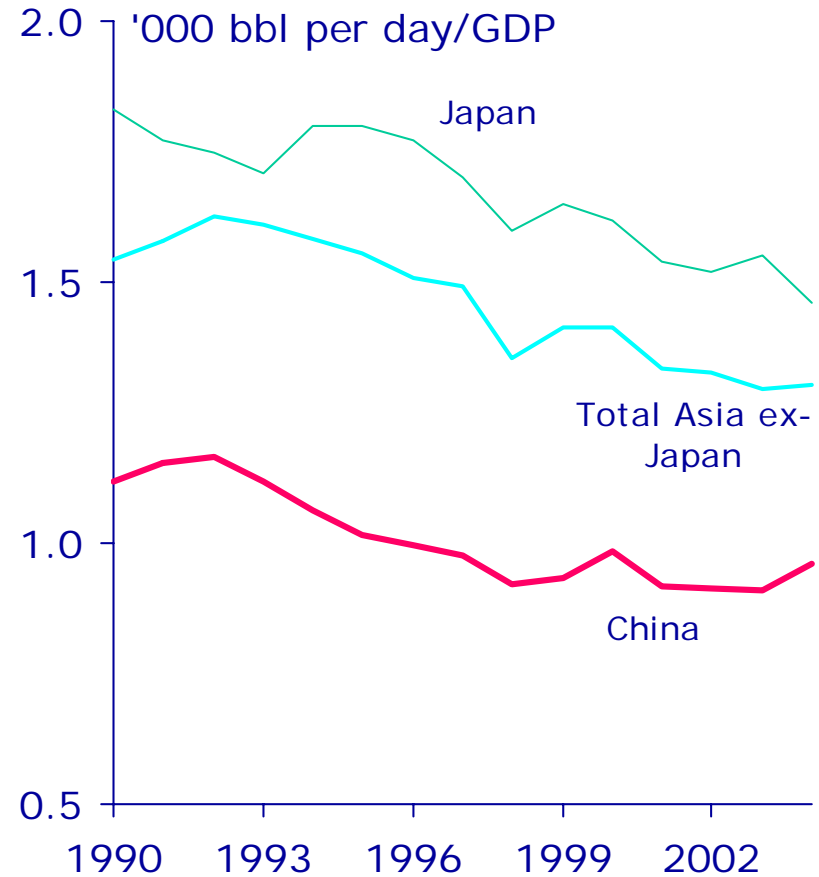
China effect #1: continued high oil prices

Share of world oil use



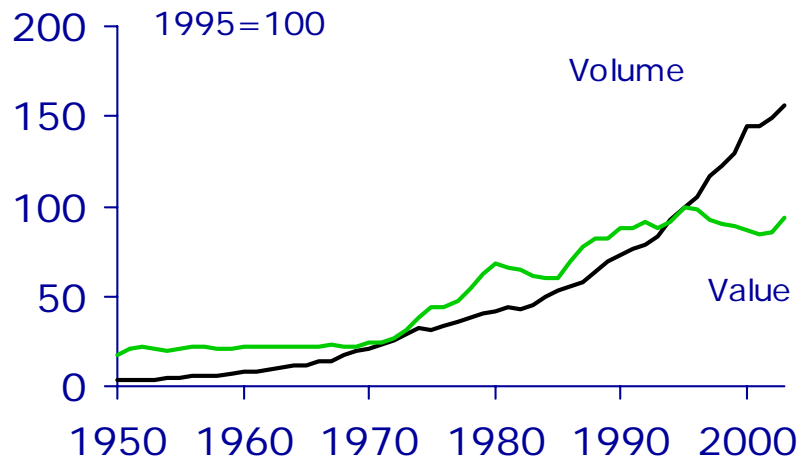
In US\$ converted at purchasing power parities

Oil intensity

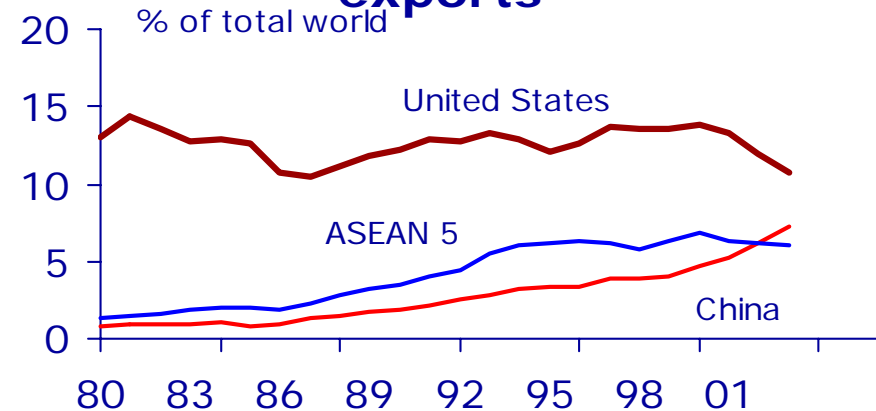


China effect #2: Falling prices for manufactures, and anything produced in China

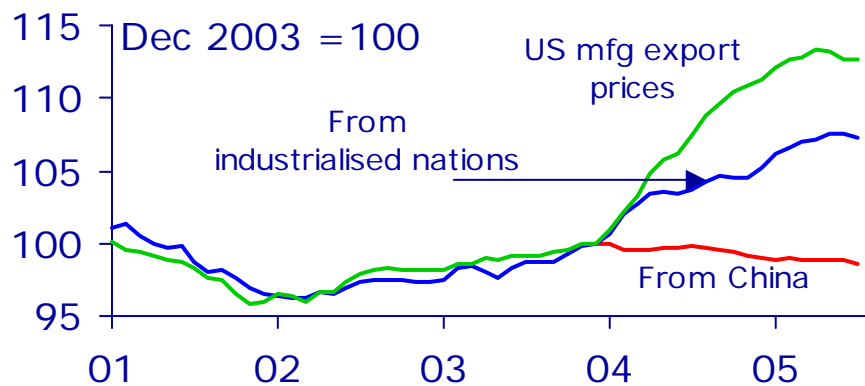
World merchandise exports



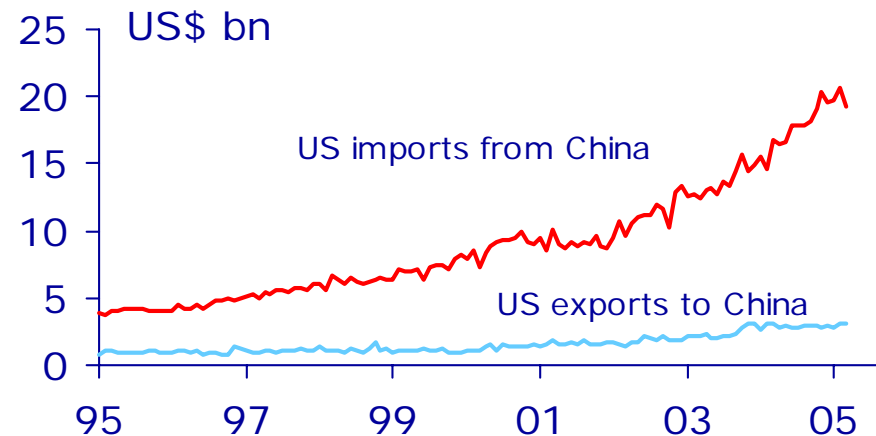
Share of world manufactures exports



Price of US manufactures imports

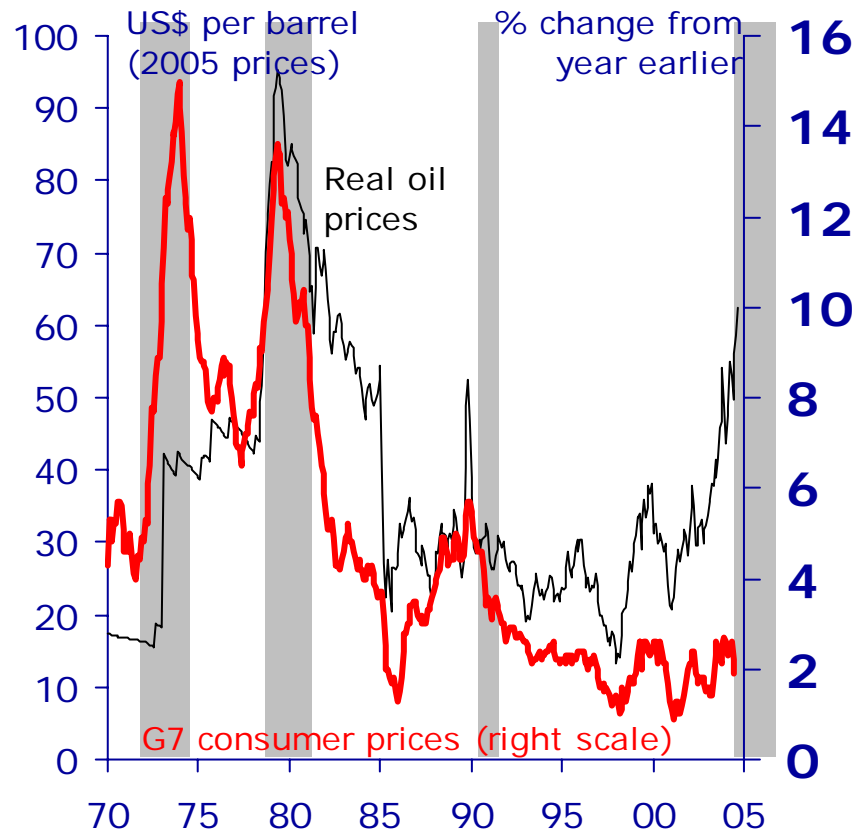


Value of US trade with China

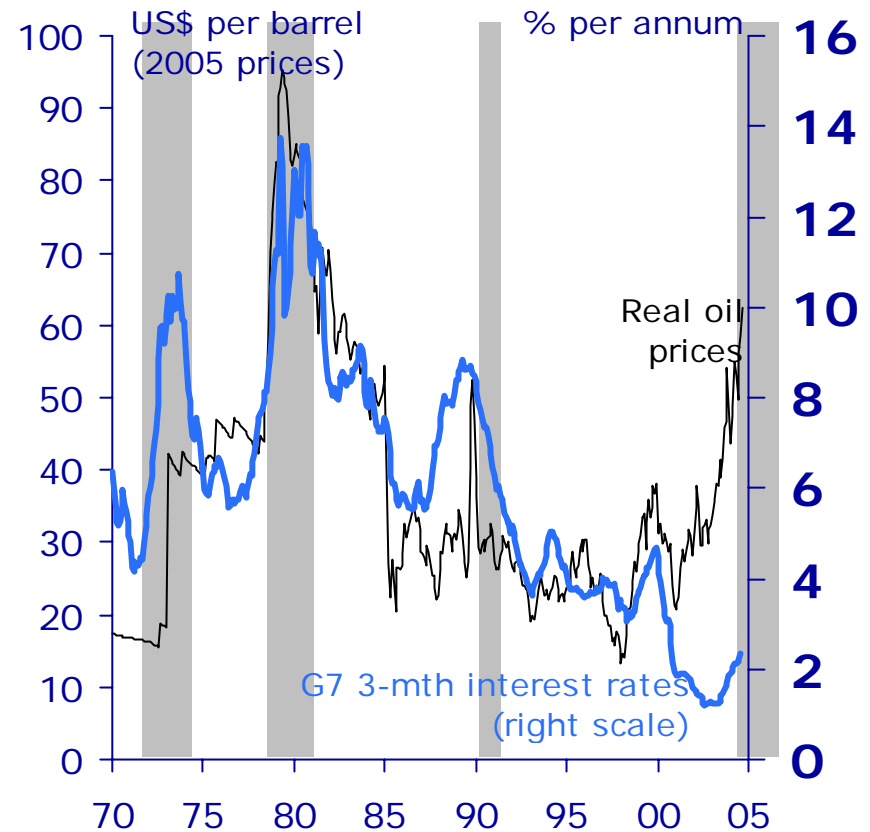


Effect #2 has offset effect #1, so high oil prices have not pushed up inflation

Oil prices and inflation



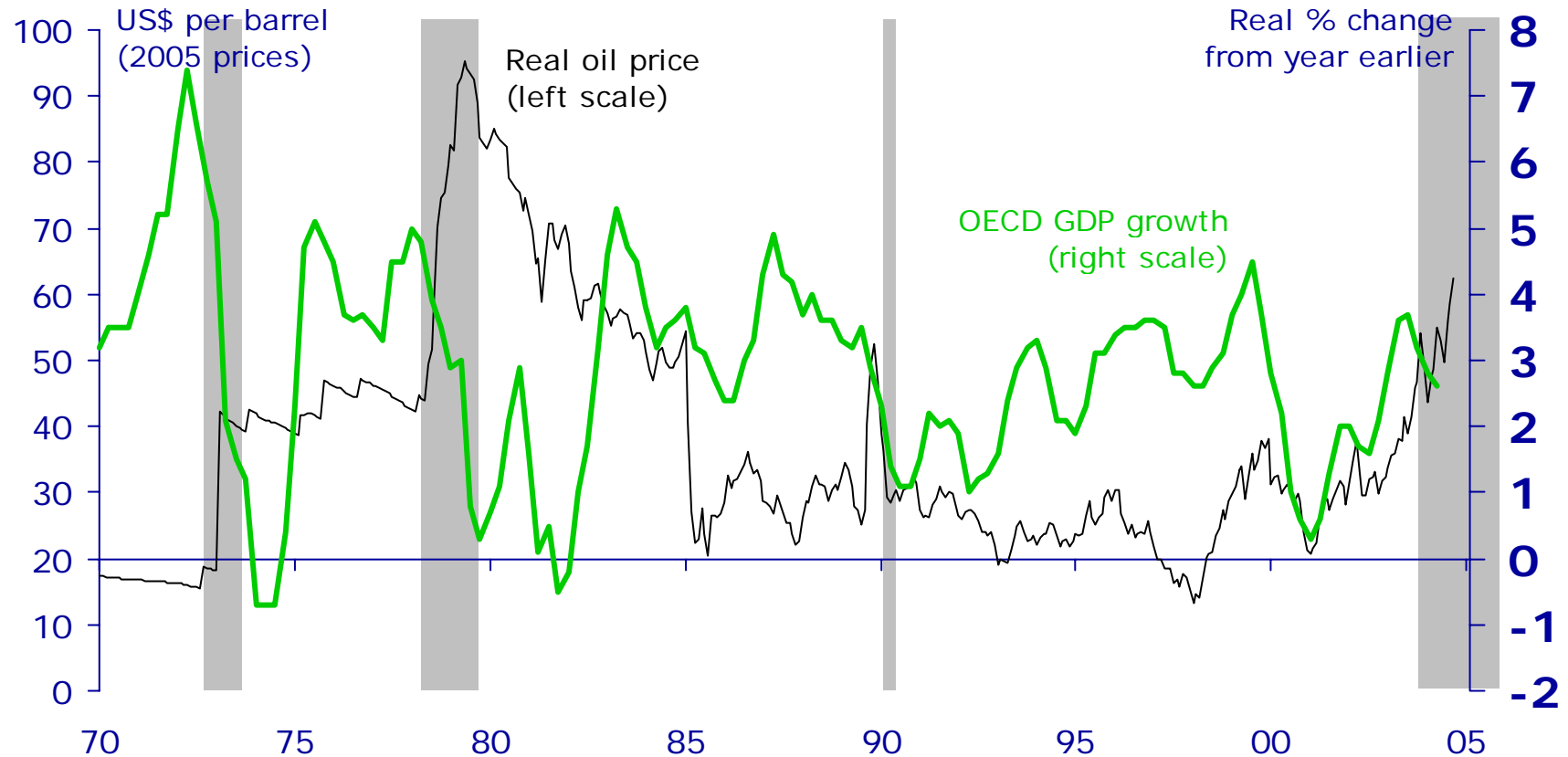
Oil prices and interest rates



Note: Shaded areas denote "oil price shocks"
Sources: Datastream; OECD; Economics@ANZ.

And global growth has felt only a slight impact

Oil prices and economic growth

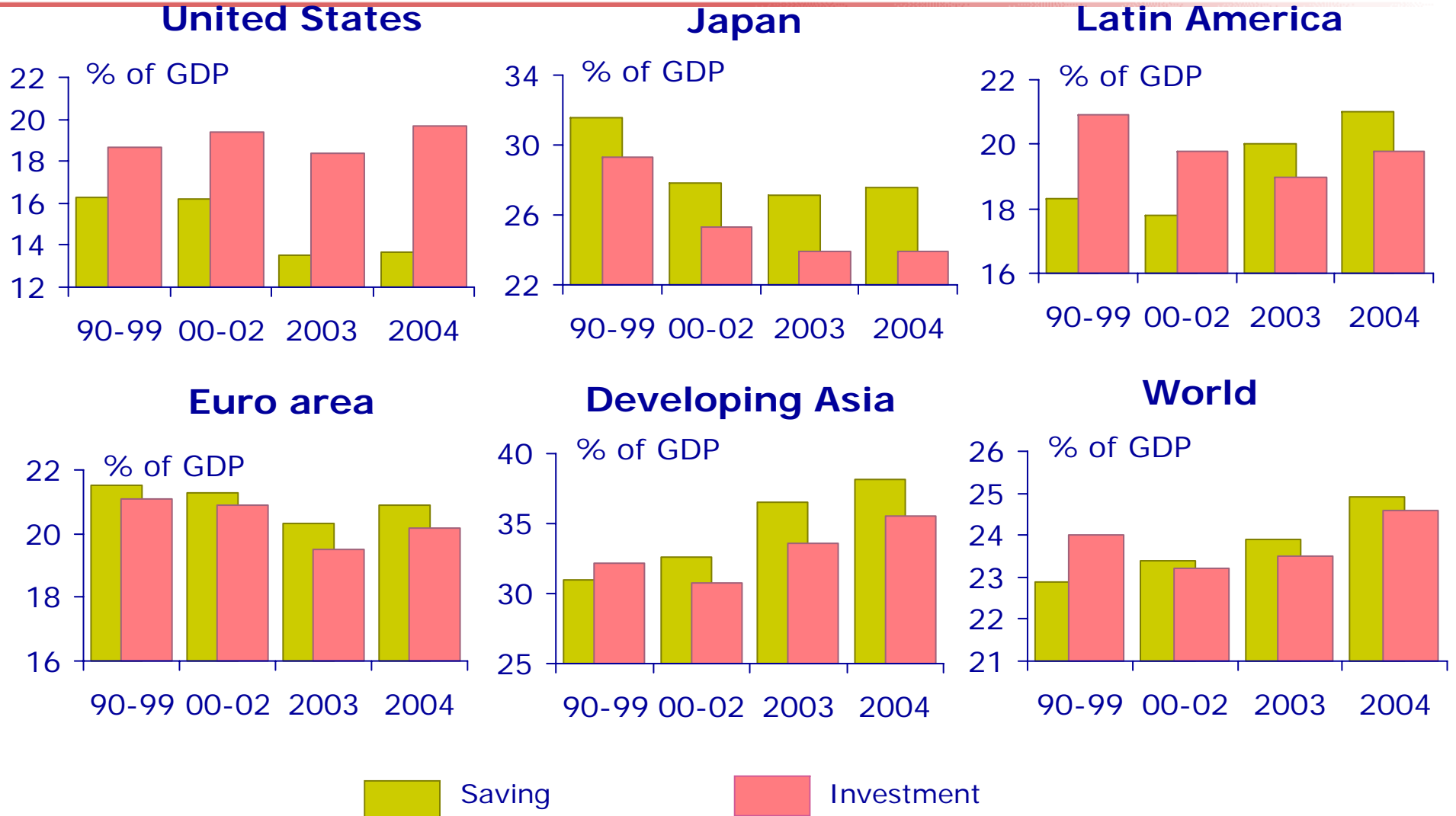


Note: Shaded areas denote oil price 'shocks'.
Source: Thomson Financial Datastream; OECD.

In Asia, it is the same story

<i>Simulation at US\$40/bbl average price WTI Q22004-Q42005</i>	<i>2004 Average WTI US\$41/bbl</i>	<i>2005 Simulated result</i>	<i>2005 ANZ Forecast (avg: US\$50/bbl)</i>
<i>GDP GROWTH</i>			
China	9.5	8.7	9.0
Indonesia	5.1	5.2	5.2
Japan	2.6	2.1	2.0
Korea	4.6	4.0	3.8
Thailand	6.1	3.9	4.2
Asia ex-Japan	8.1	7.3	7.3
<i>INFLATION</i>			
China	3.9	5.2	1.6
Indonesia	6.1	7.4	7.6
Japan	0.0	0.7	0.0
Korea	3.5	4.3	3.7
Thailand	2.8	4.3	3.5
Asia ex-Japan	3.2	4.3	2.8

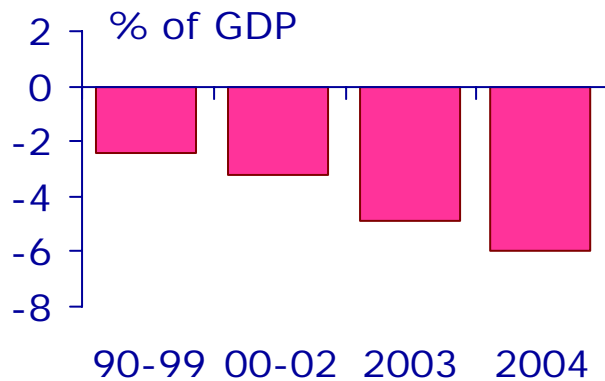
Effect #3: a global savings glut directed at US



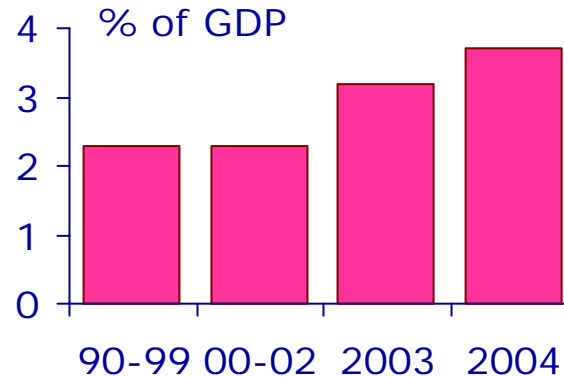
The rise in the US current account deficit has been matched (driven?) by Asia's savings

Net lending as a % of GDP

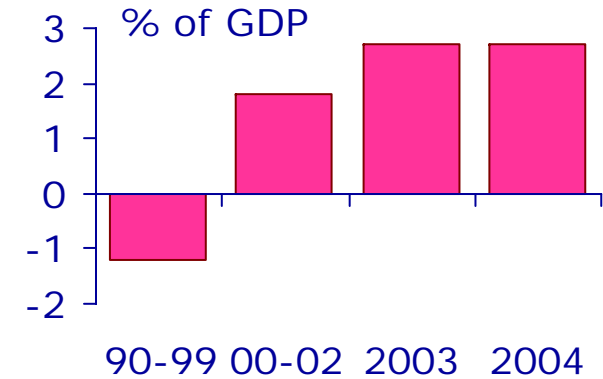
United States



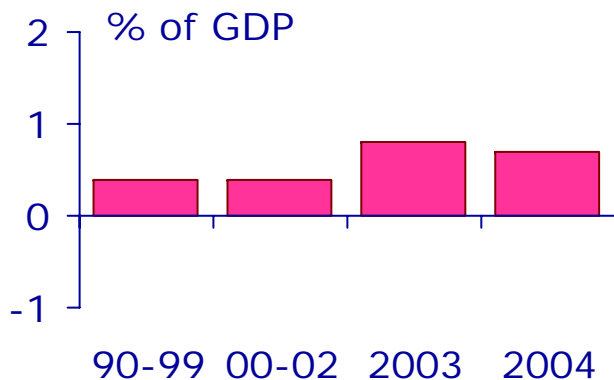
Japan



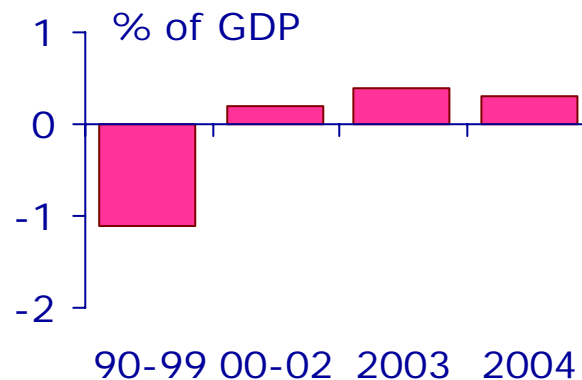
Developing Asia



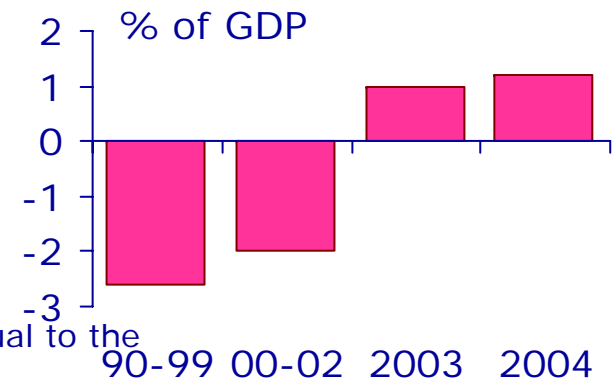
Euro area



Latin America



World



'Net lending' is gross saving minus gross investment. It is conceptually equal to the current account balance.

Low inflation expectations and global savings are interfering with Fed efforts to cool economy

10-year bond yield forecasts

	Jun-05 (A)	Sep-05 (F)	Dec-05 (F)	Jun-06 (F)	Dec-06 (F)
United States					
Old	3.99	4.85	5.30	5.40	5.50
New	3.99	4.25	4.50	4.50	4.25
Australia					
Old	5.11	5.70	6.10	5.80	6.10
New	5.11	5.35	5.50	5.30	5.05
New Zealand					
Old	5.75	6.30	6.60	6.70	6.70
New	5.75	5.60	6.10	6.20	5.90

Effect #4: Rising interest in India as alternative source of production

POSTIIVES

- Lower cost of labor
- Competitive cost of land, particularly in relation to China's growth corridor
- Predominance of English among workers of all skill levels
- Little "binary" risk of massive economic adjustment as in China
- Prudential regulation of banking sector in place
- Robust private sector in diversified economy
- Socioeconomic risk may be lower given higher percentage of middle income households
- Politics have become increasingly stable with less frequent changes of government
- Functional multi-party democracy
- Legal and tax systems are mature; English common law prevails

NEGATIVES

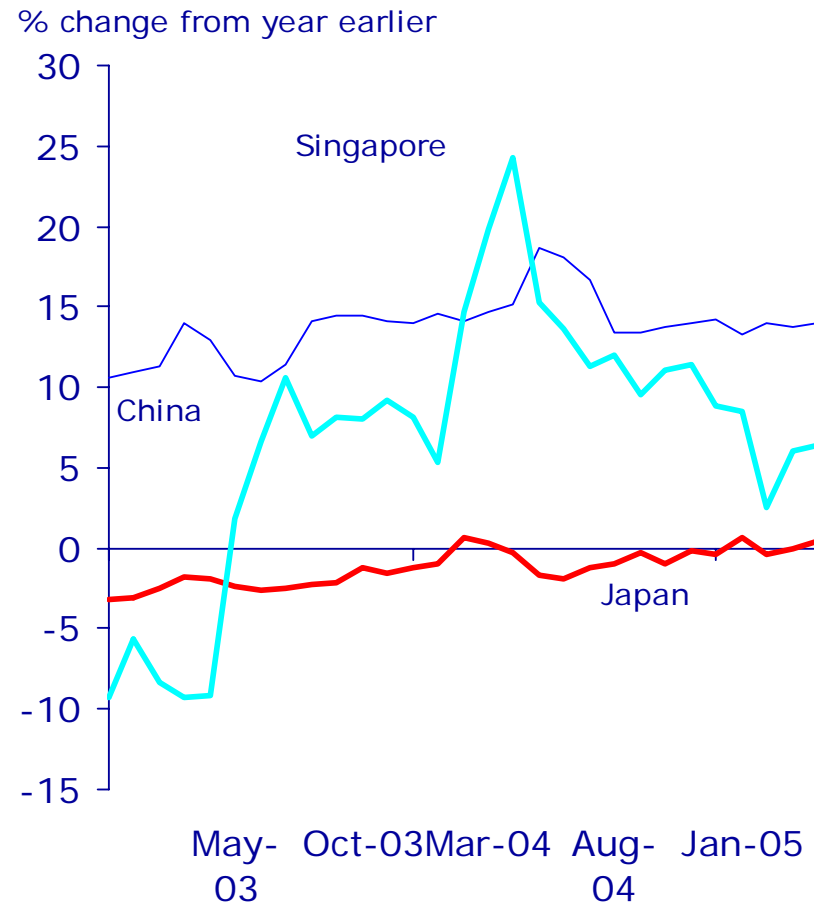
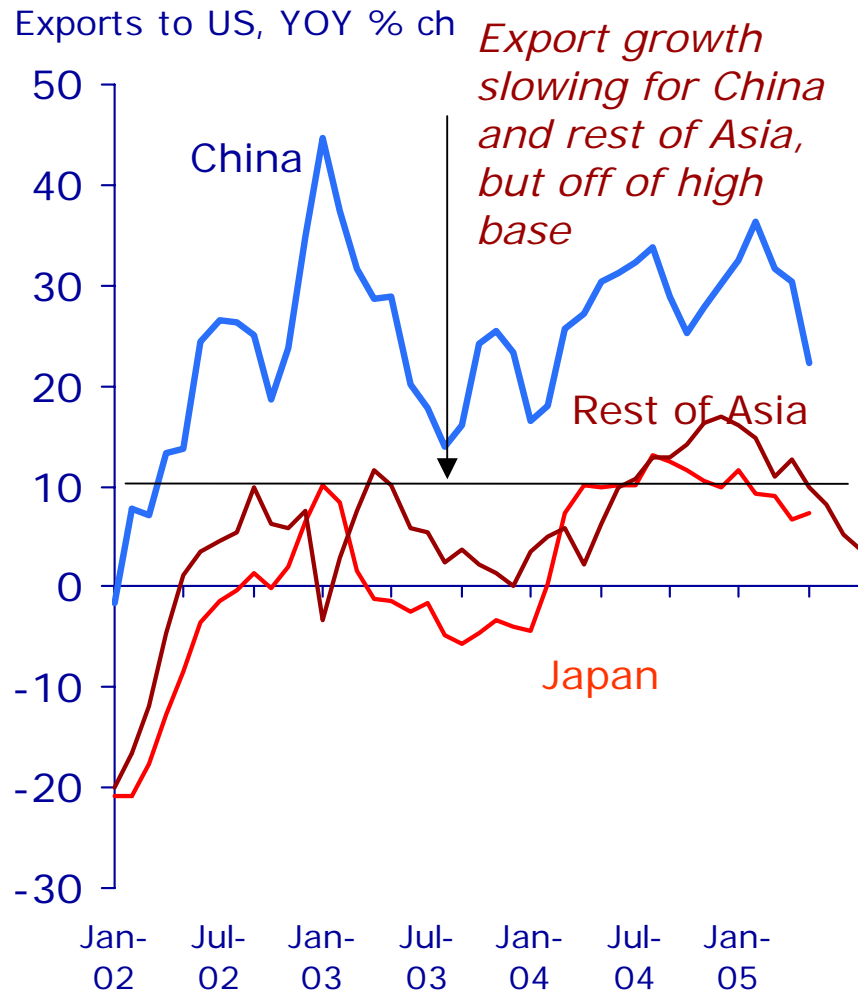
- Higher cost of capital
- Fragmented government, esp between state/central government
- Greater bureaucracy / more expensive to start and close a business
- Less developed infrastructure, particular in relation to China growth areas
- Persistent high fiscal deficit and sovereign funding needs
- Lower productivity growth
- Lower savings and investment ratios
- Lower adult literacy
- Lower health standards across entire population
- Significantly greater income disparity across population
- Security situation

Some competitiveness measures

	China	India	Indonesia
Office rent US\$/sq meter	N/a	422	138
Compensation – hourly manufacturing (US\$)	0.75	0.60	0.33
Compensation – gross annual income, personal assistant, services (US\$)	7,800	1,800	4,300
Energy intensity – commercial energy consumed for each US\$ of GDP in Kj	27,435	30,478	22,127
Secondary school - % of age group in full time education	N/a	60.9	56.9

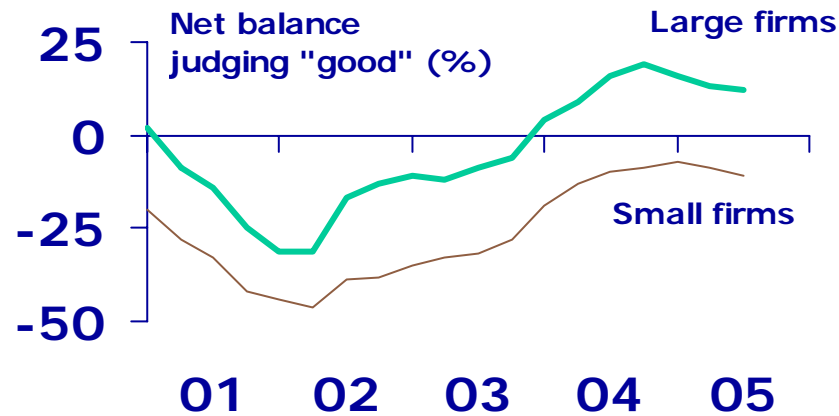
Japan doing well out of strong US and China demand, but domestic economy is improving

US Imports by Country

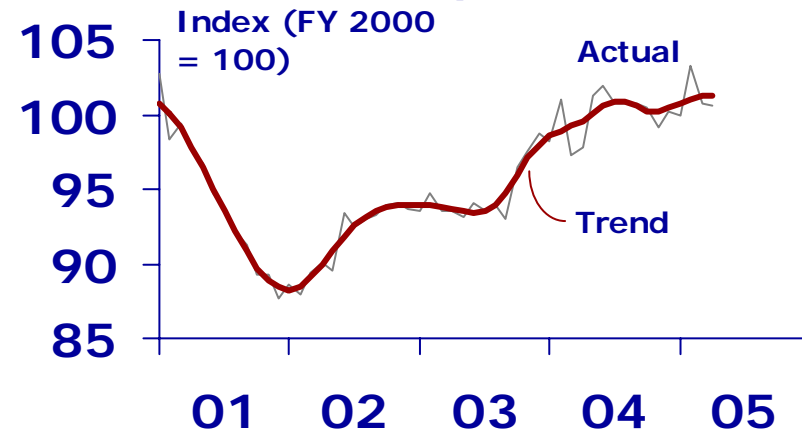


Bank of Japan has started looking at timing to reduce target reserves

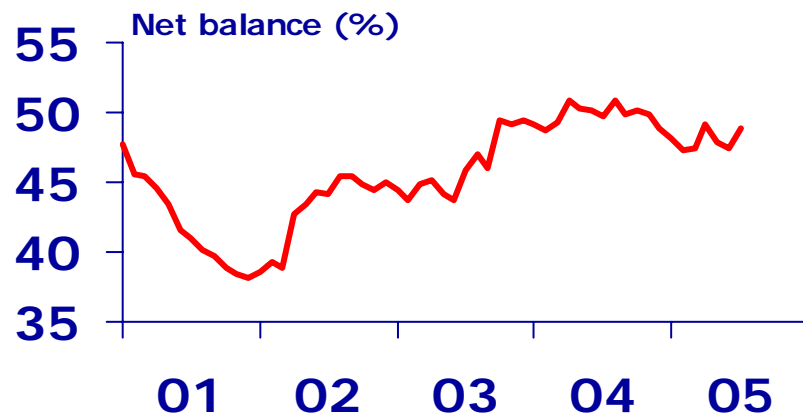
Tankan business conditions



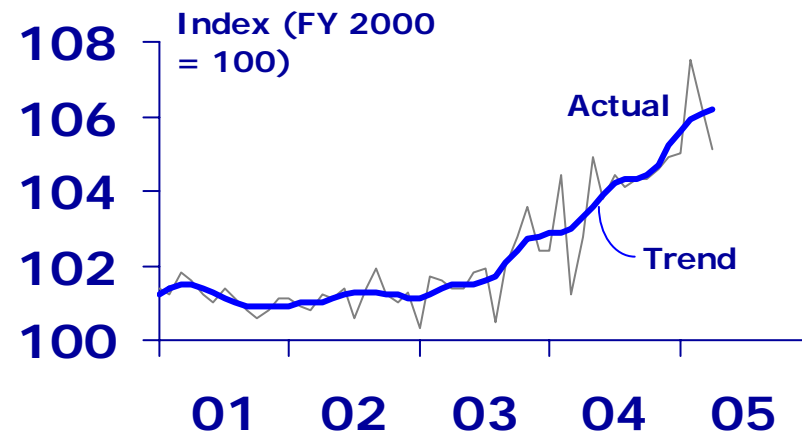
Industrial production



Shokochukin (SME) index



Tertiary sector activity



Sources: Bank of Japan; Shokochukin Bank; METI; Economics@ANZ.

Decent LDP victory is best case scenario

Yomiuri poll results 17-19 August	53.2% support for Koizumi cabinet
Yomiuri poll results 8-9 August	47.7% support for Koizumi cabinet
Projected LDP seats after 11 Sept elections	221-222 (average projected by political analysts)
Current number LDP seats	212
Projected Komeito seats	27-31
Projected coalition seats	248-253 out of 480
Current coalition seats	246
Koizumi self-declared minimum	241

Regional growth forecasts

	2005	2006	2007
Oil prices (US\$ per barrel)	52.1	43.0	40.0
World GDP growth (%)	4.0	4.2	4.1
China	9.0	8.2	7.8
Japan	2.0	1.8	1.3
Korea	3.8	4.6	4.2
Taiwan	3.8	4.5	4.2
Indonesia	6.0	5.8	5.7
Thailand	4.2	5.1	5.4
Hong Kong	4.5	3.2	3.3
Malaysia	4.4	4.7	6.2
Singapore	3.8	5.3	4.7
Philippines	3.8	3.0	4.1
Vietnam	7.5	7.0	7.0
Non-Japan East Asia*	7.3	7.0	6.7
Non-Japan East Asia excl. China*	4.5	4.9	4.9

*weighted GDP at PPP exchange rates

ANZ's Asia currency forecasts

	Dec 2004	Sept 2005	Dec 2005	Dec 2006
US\$ - ¥	102.6	115	116	118
US\$ - Yuan	8.28	8.08	8.03	7.78
US\$ - Won	1 035	1 042	1 050	1 065
US\$ - NT\$	31.69	32.3	32.50	33.0
US\$ - Rph	9 290	10 300	9 825	9 500
US\$ - Bt	38.91	42.26	43.00	40.00
US\$ - HK\$	7.80	7.78	7.79	7.80
US\$ - M\$	3.80	3.73	3.73	3.68
US\$ - S\$	1.64	1.67	1.68	1.70
US\$ - PP	56.05	56.3	56.8	57.0
US\$ - Dong	15 768	15 973	16 100	16 400

Cross rates with A\$ forecasts

	Dec 2004	Sept 2005	Dec 2005	Dec 2006
A\$ - ¥	79.9	83.5	76.5	76.7
A\$ - Euro	0.57	0.62	0.57	0.59
A\$ - Yuan	6.45	5.87	5.30	5.06
A\$ - Won	806	757	693	692
A\$ - NT\$	24.68	23.5	21.5	21.5
A\$ - Rph	7 236	7 213	6 485	6 175
A\$ - Bt	30.31	30.7	28.4	26.0
A\$ - M\$	2.96	2.70	2.50	2.40
A\$ - S\$	1.27	1.21	1.11	1.11
A\$ - PP	43.66	41.0	37.5	37.1
A\$ - Dong	12 282	11 609	10 626	10 660

Thank you