

# Economics, interest rates and currencies pack

Prepared for  
**Asian ALCO**

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Melbourne  
August 2005

***Economics@ANZ***

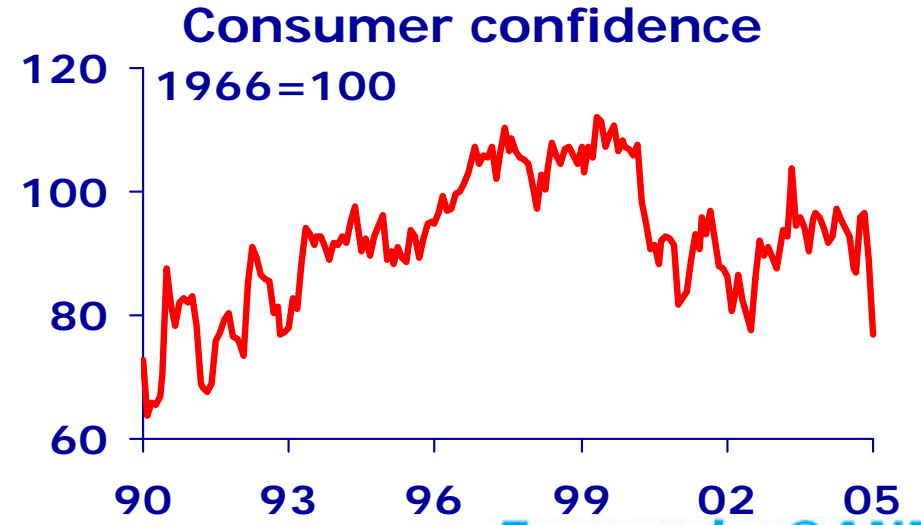
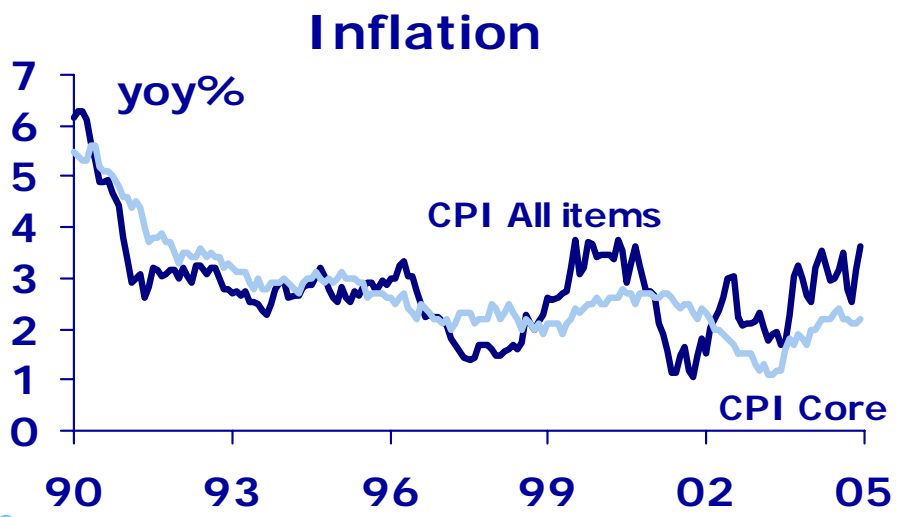
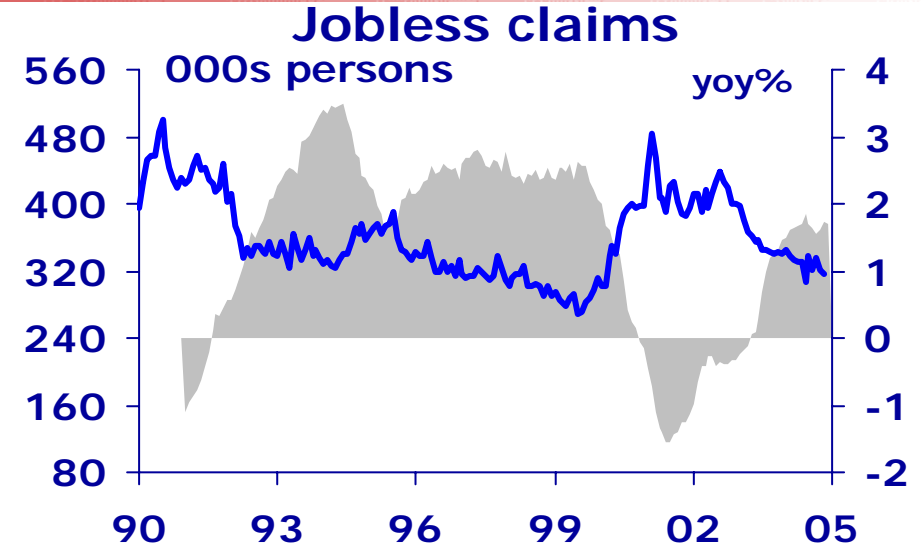
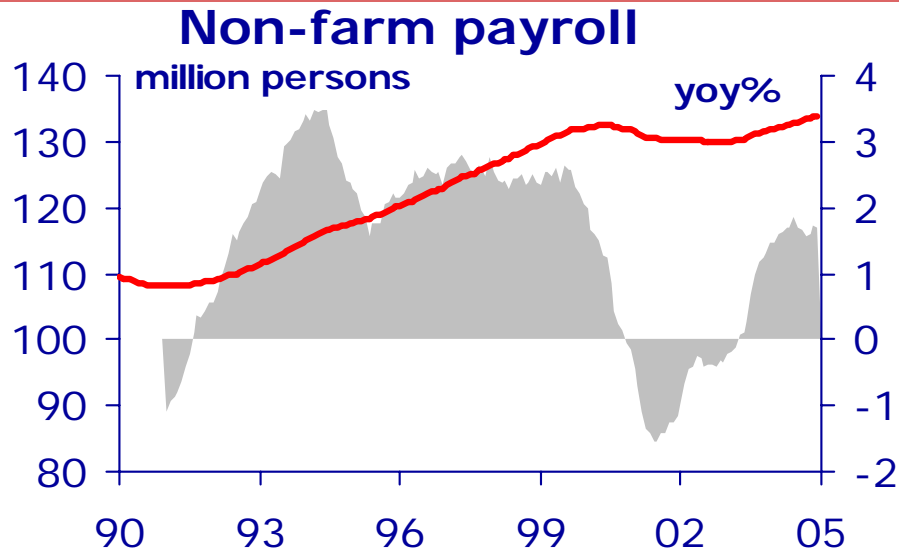
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# Katrina has changed our world view

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- **Katrina represents a supply shock to US energy demand**
  - Oil forecasts have changed
    - End 2005 US\$55/bbl → US\$70/bbl
    - End 2006 US\$45/bbl → US\$60/bbl
    - End 2007 US\$55/bbl
  - Gasoline prices above US\$2.00/gallon affect American consumers
- **US growth forecast revised downward to reflect expectations of softening household consumption**
  - Private consumption forecast to ease from 3.4% growth this year to 2.5% next year
- **Reconstruction will somewhat offset falling consumption for headline US GDP, but not for Asian exporters**
  - Bulk of Asian exports excluding IT related to US private consumption
- **Persistently higher oil prices will further pressure Asian economies**
  - Little evidence yet, but reduction in fuel subsidies will soon come through to dampen demand and increase inflation expectations
  - When will China start to pass through rising cost basis?
- **Theme for 2006 will be return of inflation to Asia, along with higher interest rates**

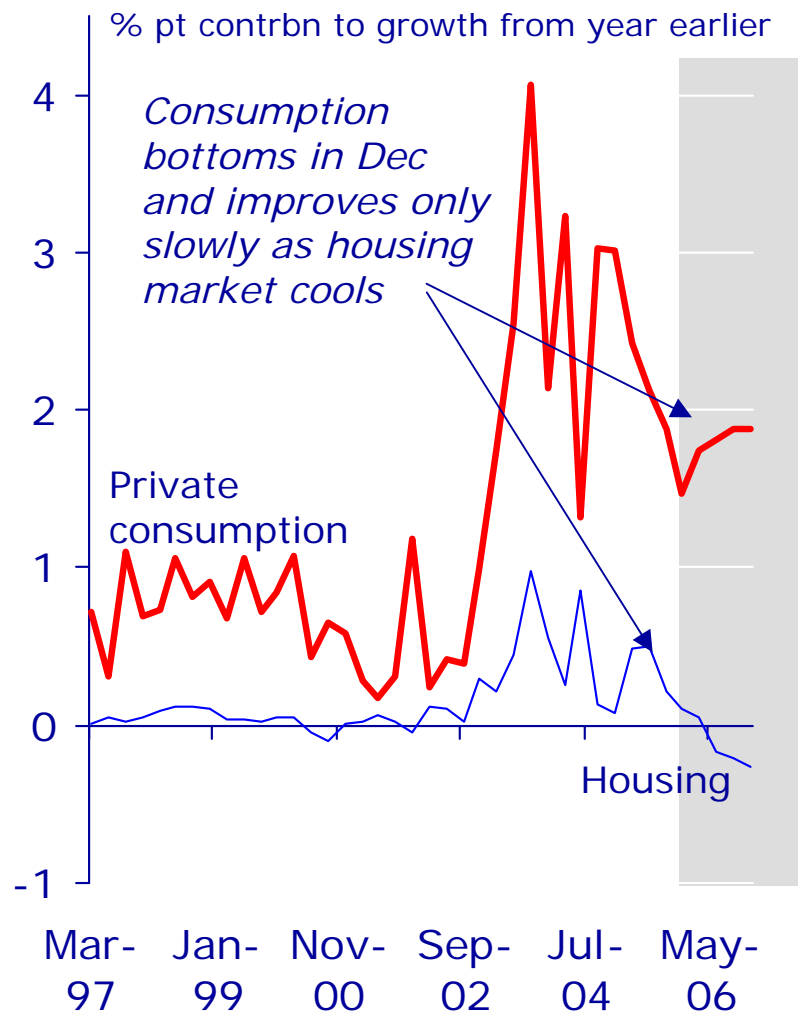
# Katrina negative for jobs, confidence, inflation



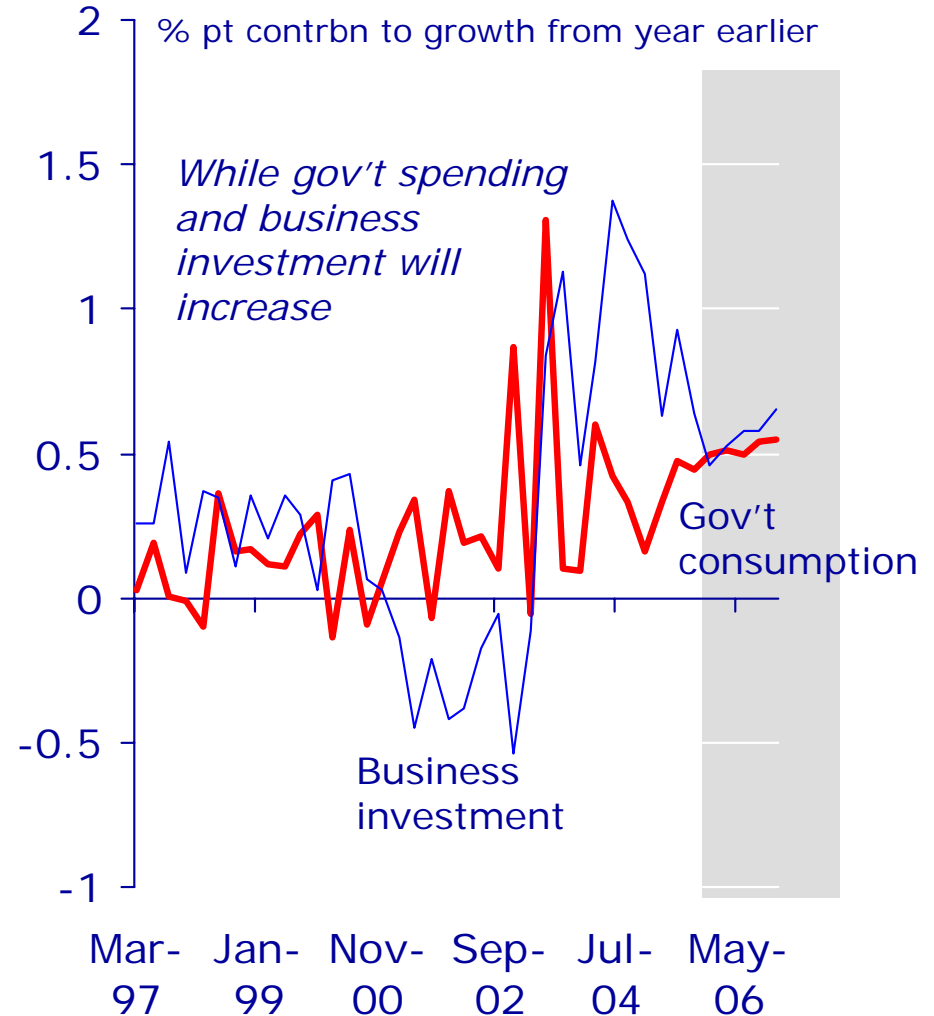
Source: Datastream

# Composition of demand shifts as growth slows

## Household contribution



## Non-household contribution



Source: Datastream

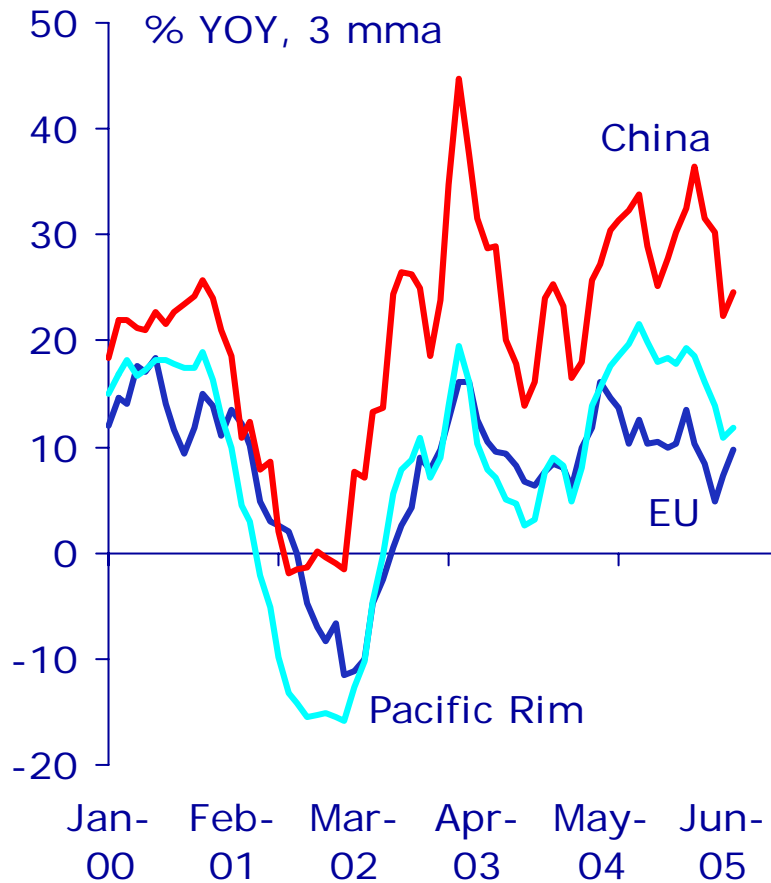
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## Summary of economic outlook for US

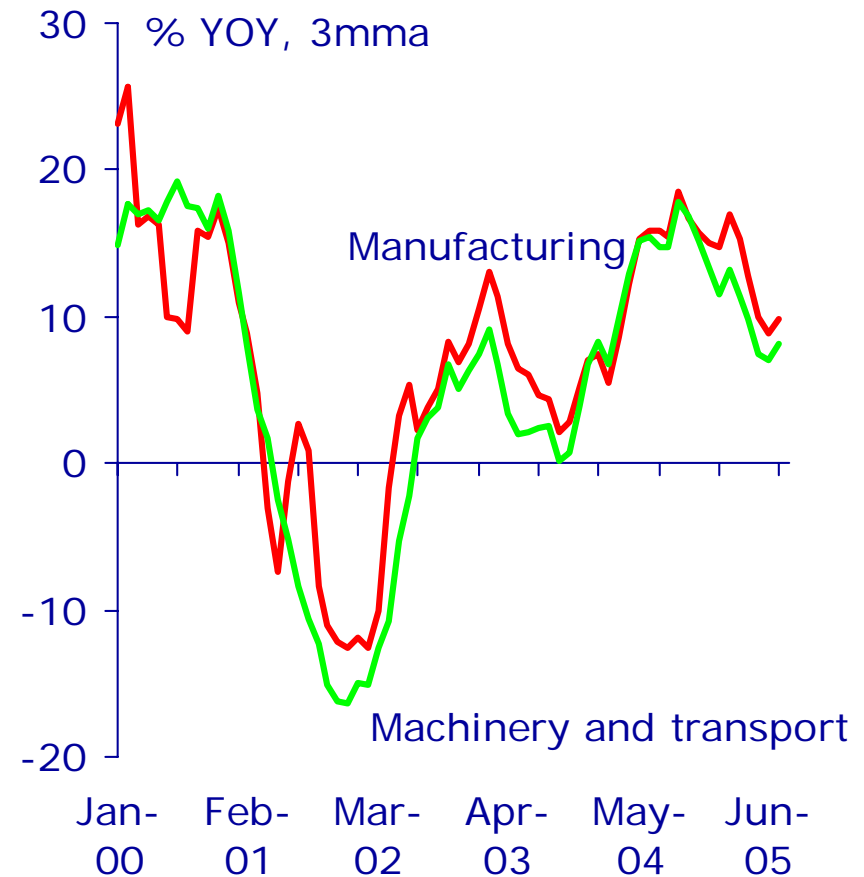
	2004	2005	2006	2007
Real GDP growth (%)	4.2	3.5	3.0	3.0
Private consumption	3.9	3.4	2.5	2.8
Business investment	9.4	8.2	5.1	5.5
Government consump.	2.2	2.0	2.7	2.5
Employment growth (%)	1.1	1.6	1.2	1.2
Unemployment rate (%) <sup>(a)</sup>	5.5	5.4	6.0	6.8
Core CPI inflation (%)	1.8	2.3	2.2	1.8
Current account (% GDP)	-5.7	-6.6	-6.7	-6.4
Fed funds rate (% pa)	2.25	4.25	4.50	4.25
10-year bond yield (%)	4.22	4.50	4.25	N/a
A\$ - US\$	0.78	0.76	0.68	0.76
US\$ - ¥	102	107.5	117	110

# Decline in US demand will affect Asian exports

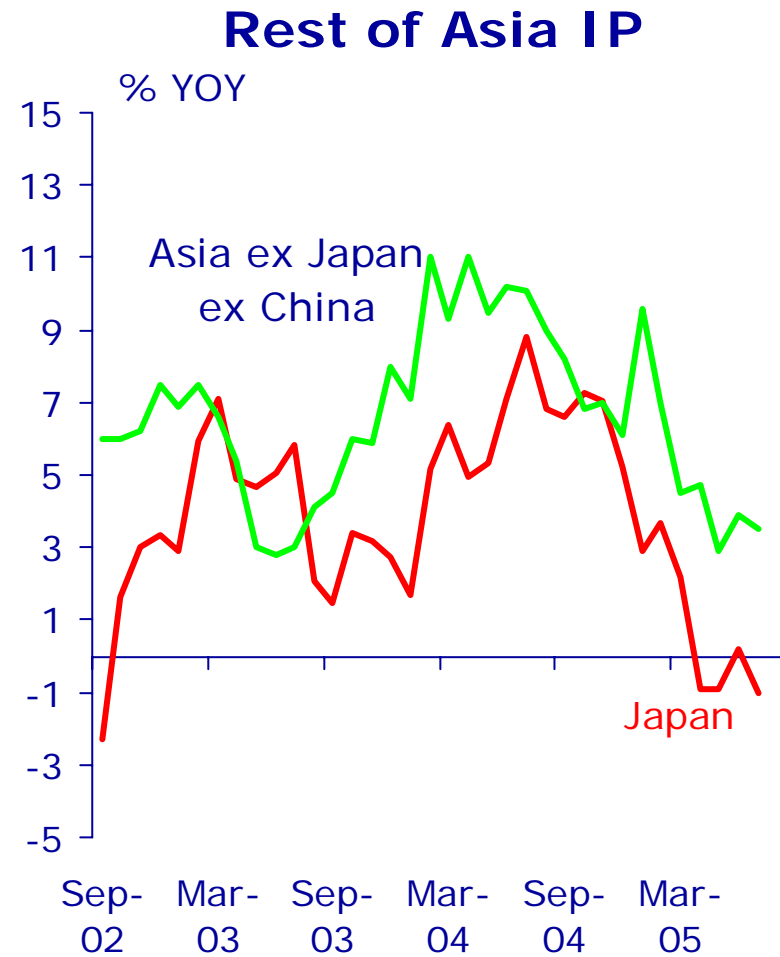
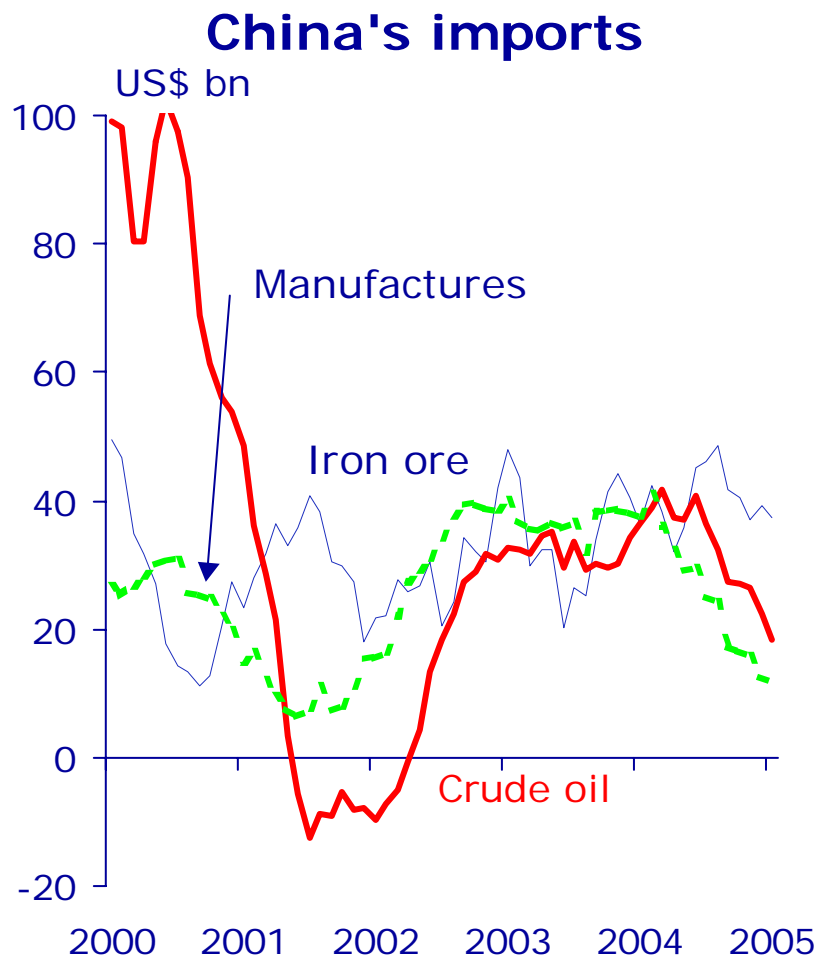
## US imports by origin



## US imports by good

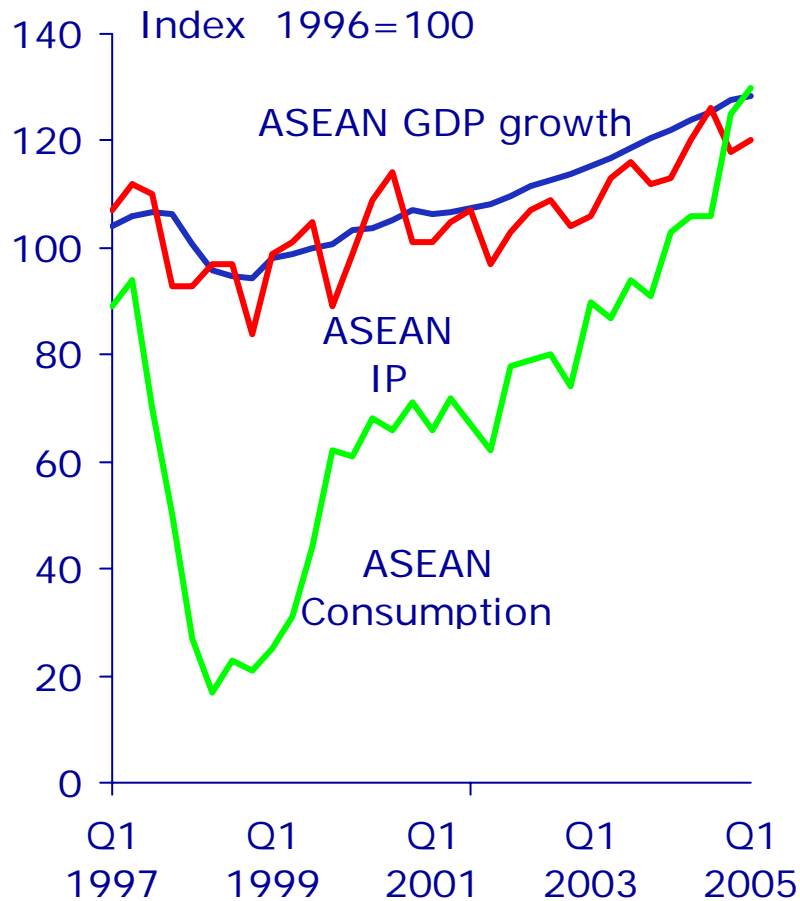


# Demand from China is also softening as more intermediate goods produced at home

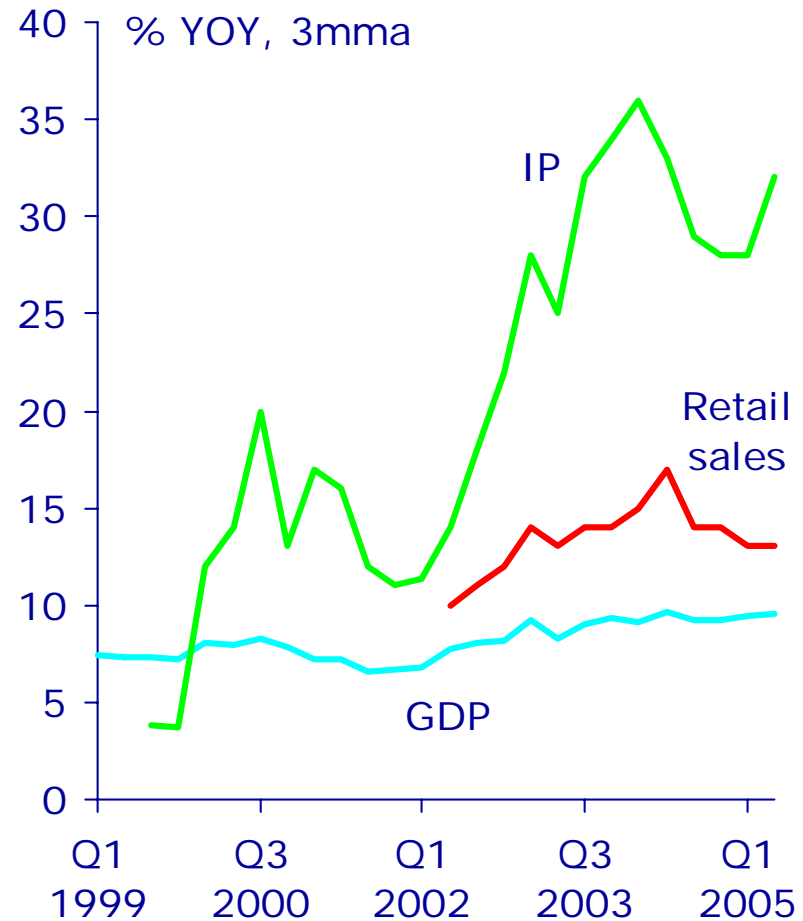


# Consumption still not the main growth driver across most of Asia

## ASEAN growth mix



## China growth mix

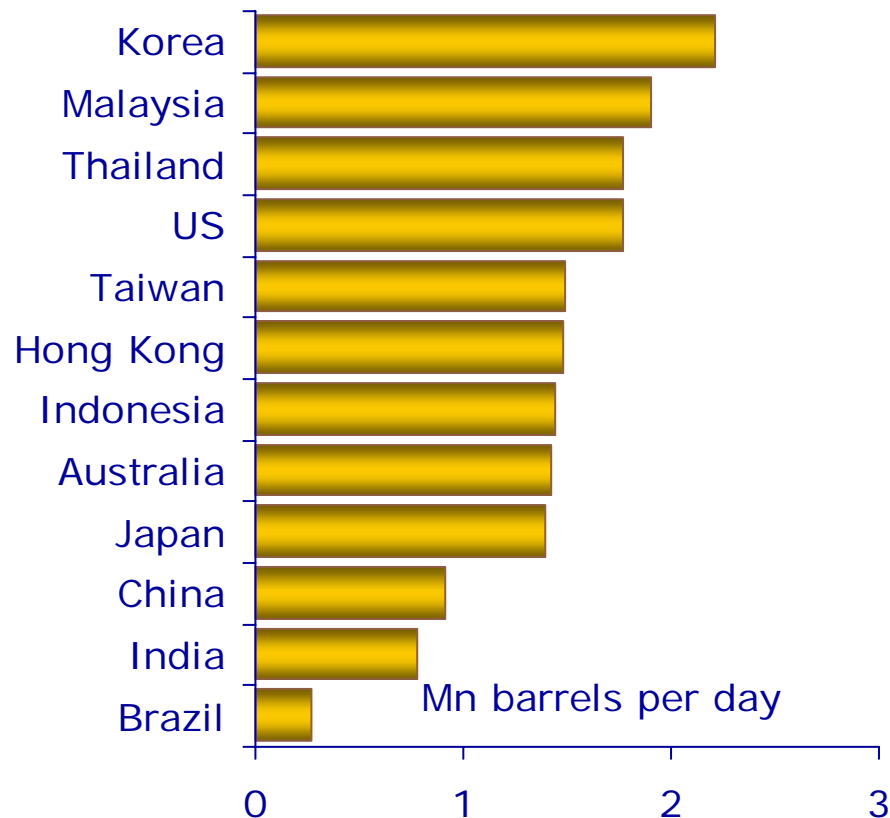


Regional indices of GDP, IP & retail sales (or motor vehicle sales), weighted on PPP GDP basis

Sources: Datastream

# Oil prices will hurt producers and consumers in Asia - eventually

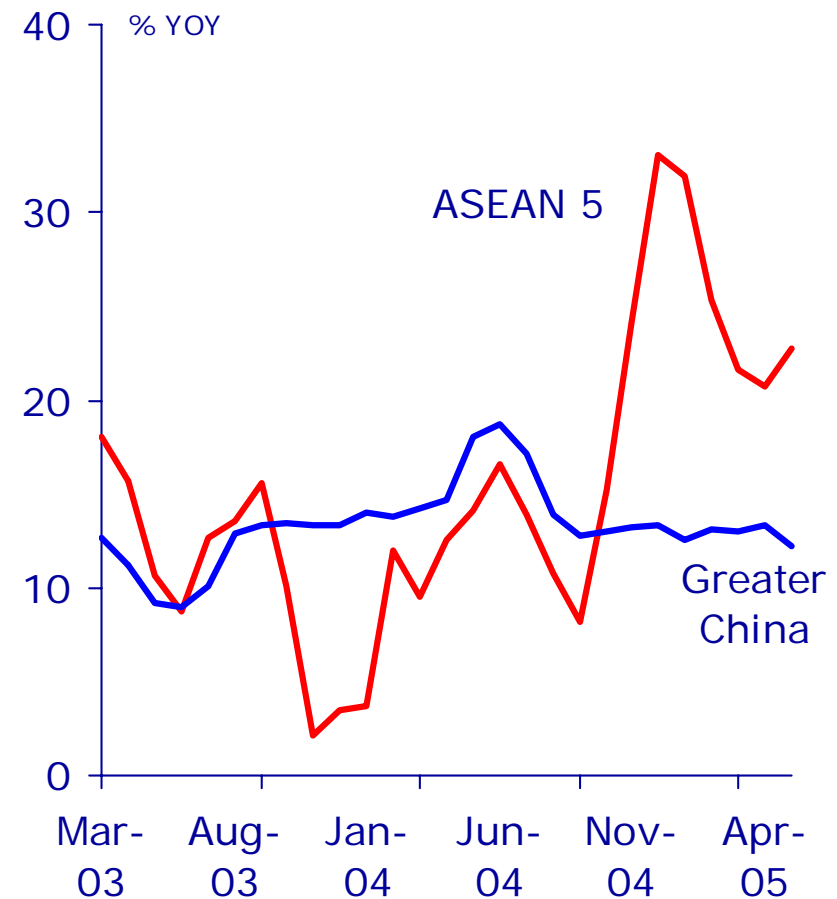
**Oil consumption per US\$1mn of GDP\*, 2004**



\* At purchasing power parities

Sources: US Bureau of Economic Analysis; BP Statistical Review of World Energy 2005; IMF World Economic Outlook database; Economics@ANZ.

**Consumption in Asia**



Regional index of retail sales (or motor vehicle sales if retail not available), weighted on PPP GDP basis

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# Reduction of fuel subsidies exacerbates high oil prices by increasing “shock” of price rises

## •China

- Price caps imposed on state-owned energy companies for retail market
- Refiners’ losses estimated at US\$0.5 bn in first half of 2005 – reports of shortages

## •Indonesia

- Rp112 tr in subsidy
- Larger as a share of GDP and fiscal expenditure than other SE Asian countries

## •Malaysia

- Government eliminated of price supports – but then imposed price caps
- Diesel prices raised twice this year but subsidies and tax exemptions still cost

## •Philippines

- No fiscal measures
- Public transport fares raised once, electricity tariffs raised twice

## •Thailand

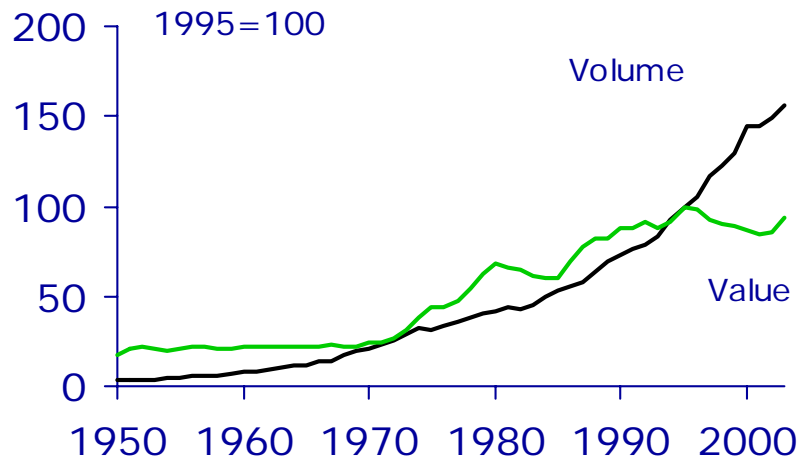
- Diesel prices allowed to “float” July 2005 but some subsidies still in place

	US\$ bn	% GDP*	Inflation
<b>Indonesia</b>	<b>12.5</b>	<b>4.7</b>	<b>8.3</b>
<b>Malaysia</b>	<b>3.8</b>	<b>2.9</b>	<b>2.8</b>
<b>Philippines</b>	<b>0</b>	<b>0</b>	<b>7.5</b>
<b>Thailand</b>	<b>2.2</b>	<b>1.3</b>	<b>3.5</b>

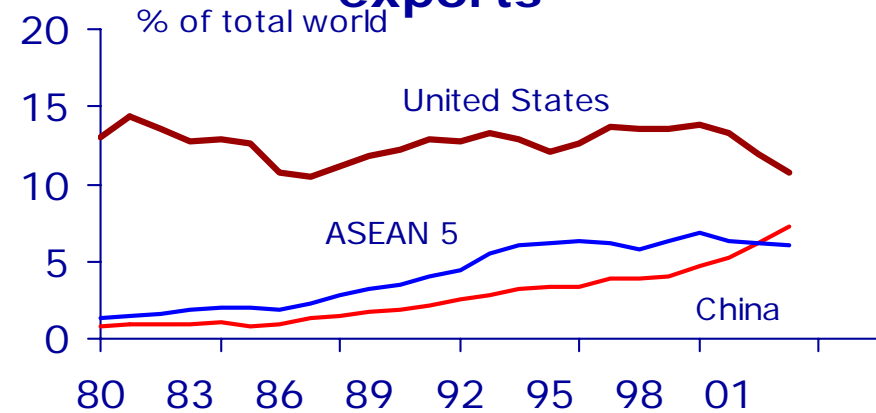
\*At market exchange rates

# So far, China's producers have been helping to absorb the costs of higher energy prices

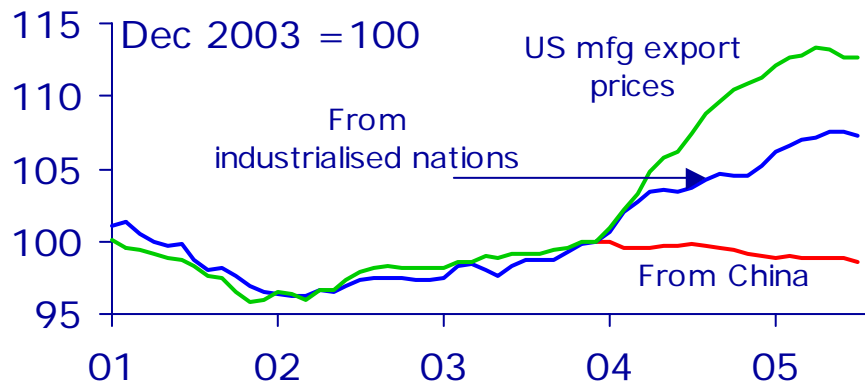
## World merchandise exports



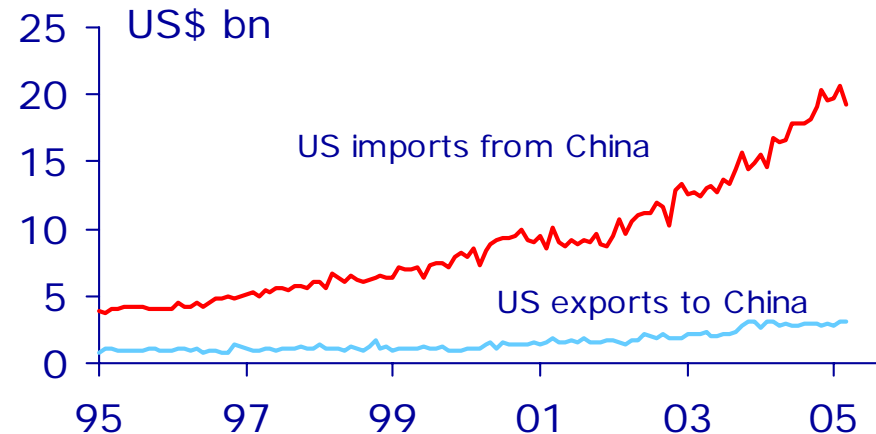
## Share of world manufactures exports



## Price of US manufactures imports

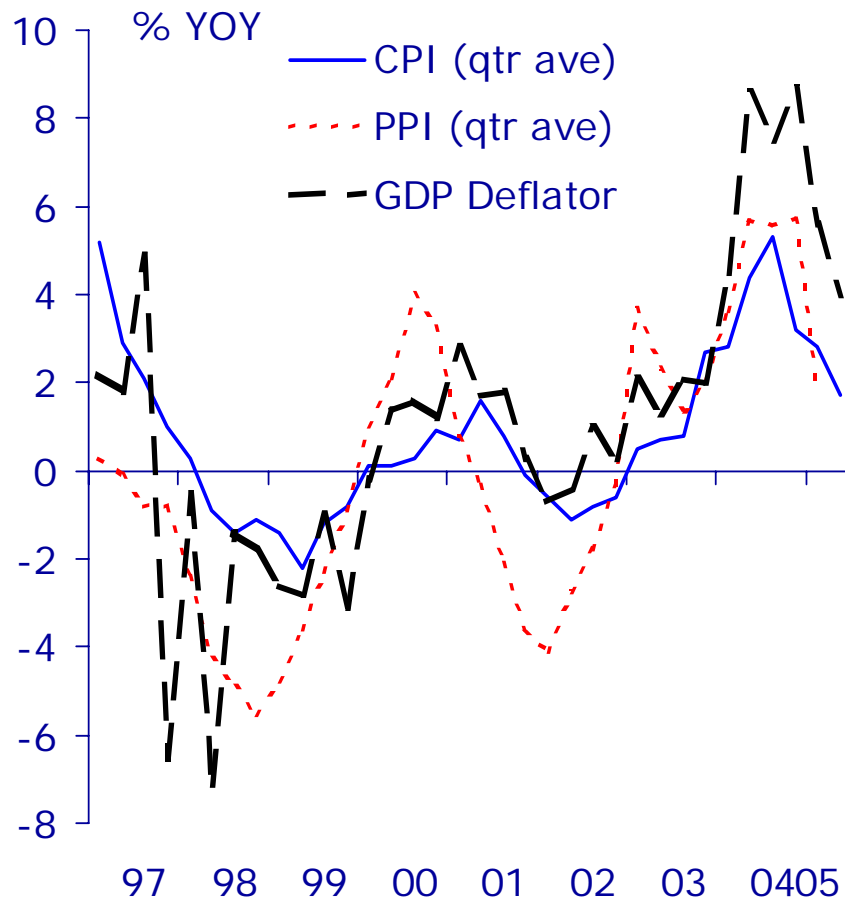


## Value of US trade with China

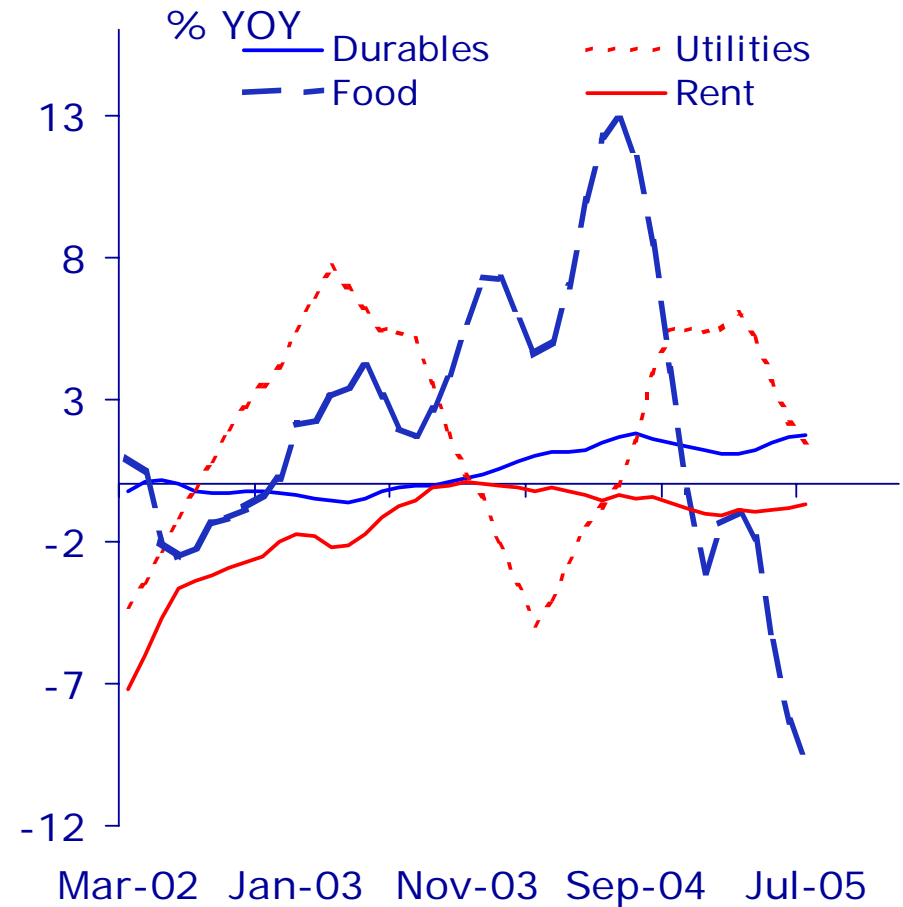


# Plenty of room to raise prices in China, but authorities worried about income inequality

## Broad inflation measures



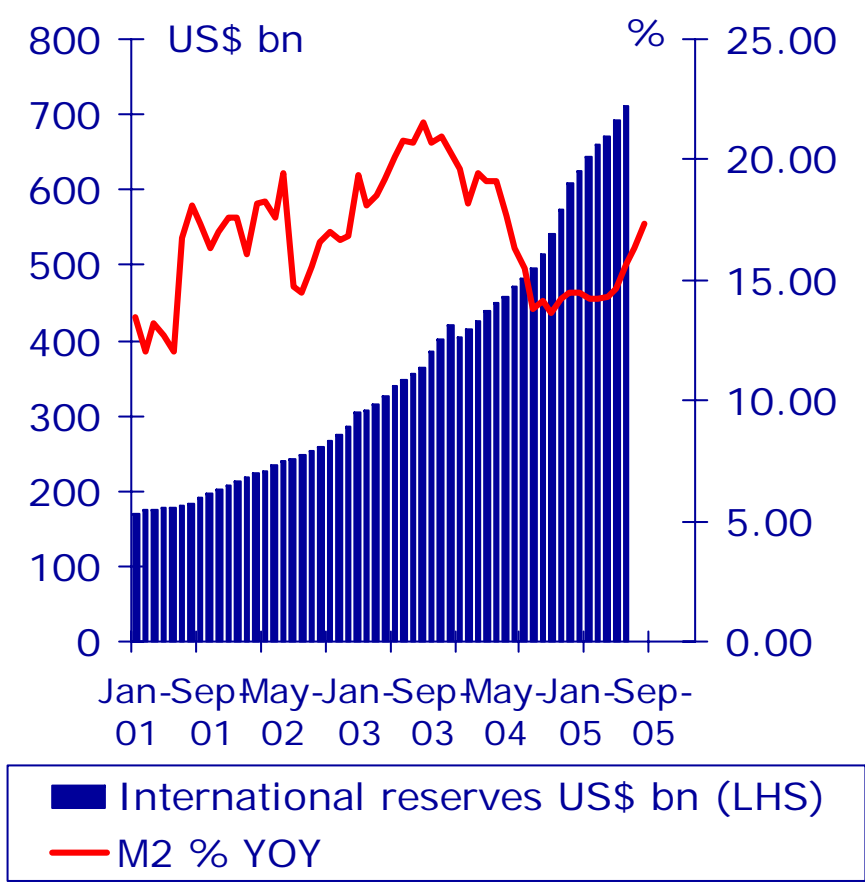
## Components of CPI



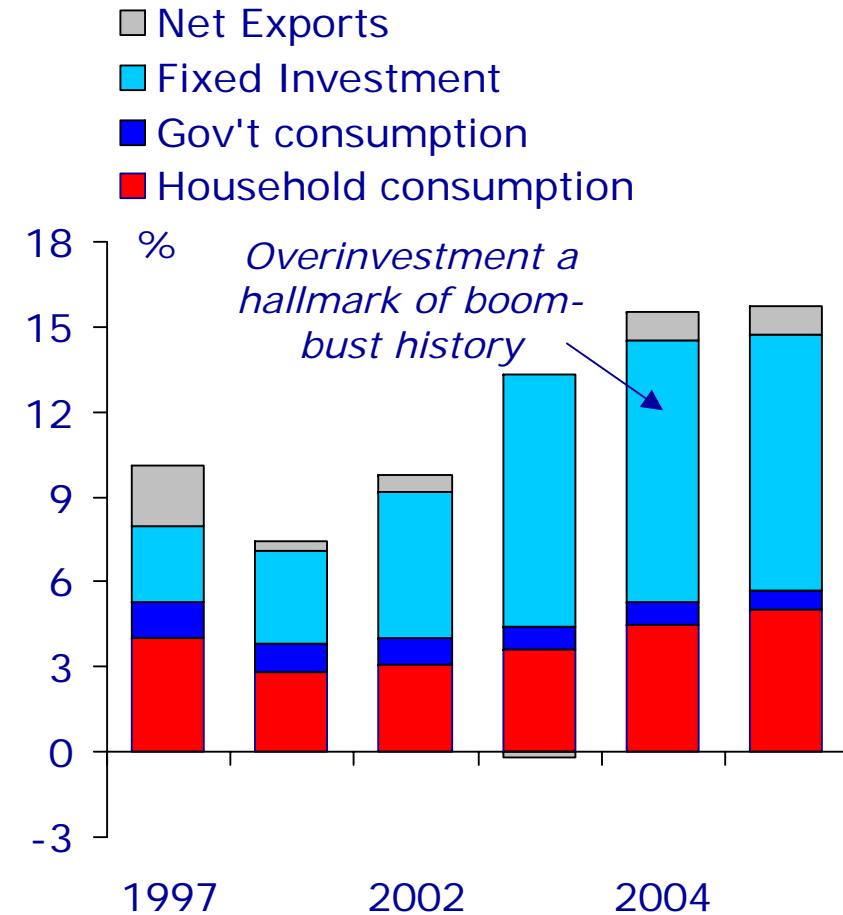
Sources: Datastream, Economics@ANZ.

# Warning: where are China's reserves data? (and note sudden upturn in monetary base)

## Excessive capital inflows...

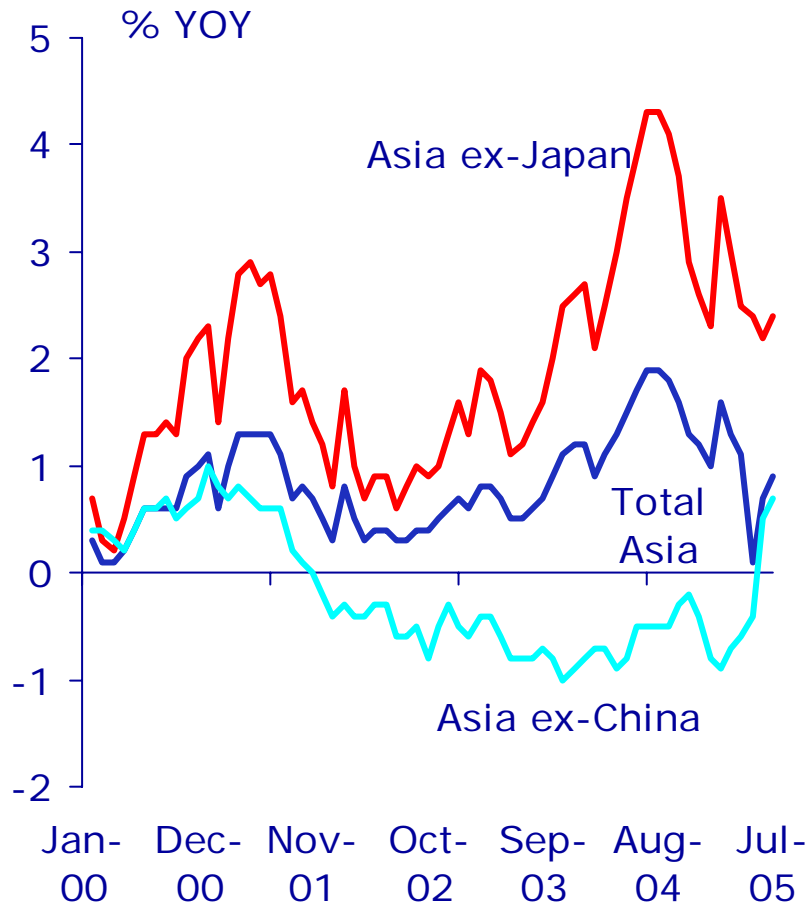


## Excessive investment?



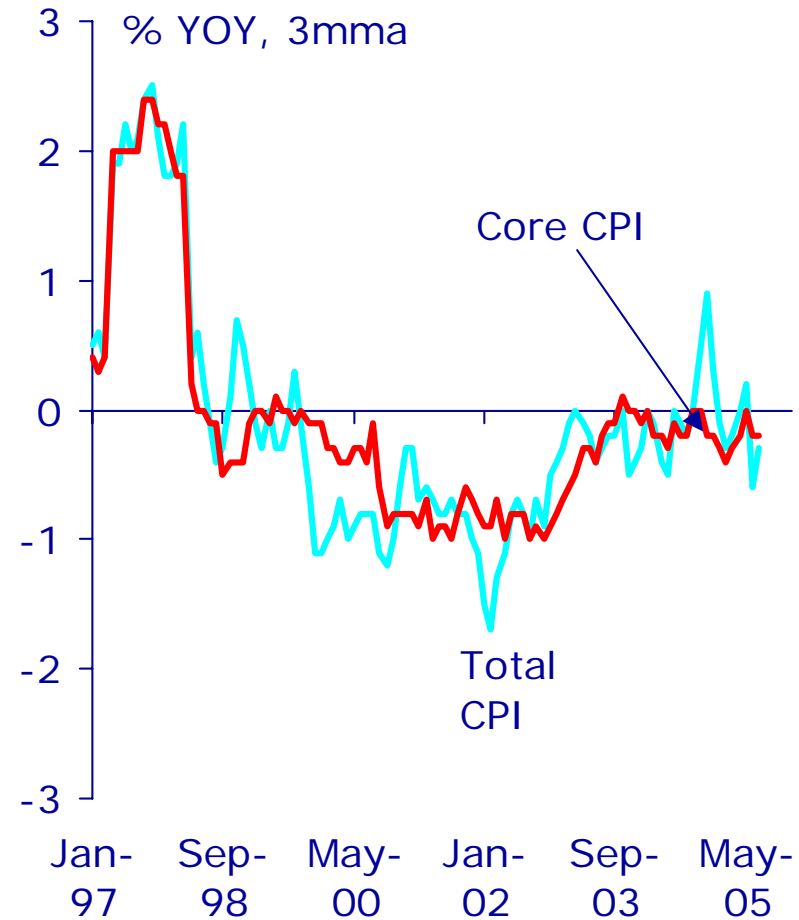
# Outside China, inflation is rising and Japan will soon emerge from deflation

## Inflation in Asia



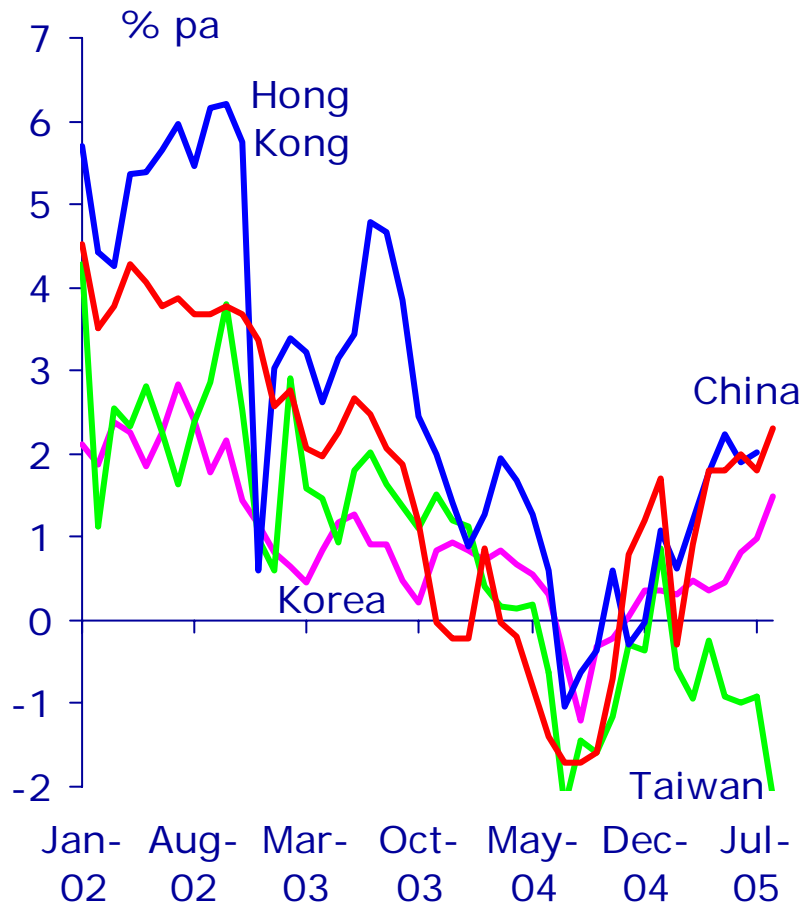
CPI % YOY weighted on PPP GDP basis

## Japan's reflation

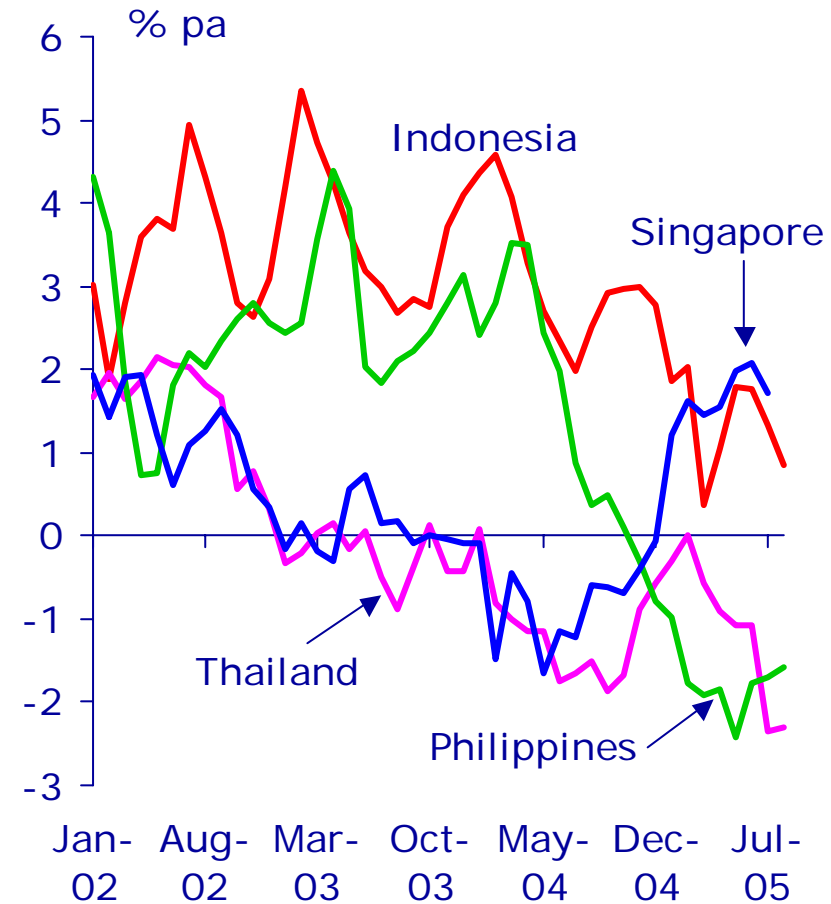


# Real interest rates have fallen and turned negative in several countries

## Real interest rates – N Asia

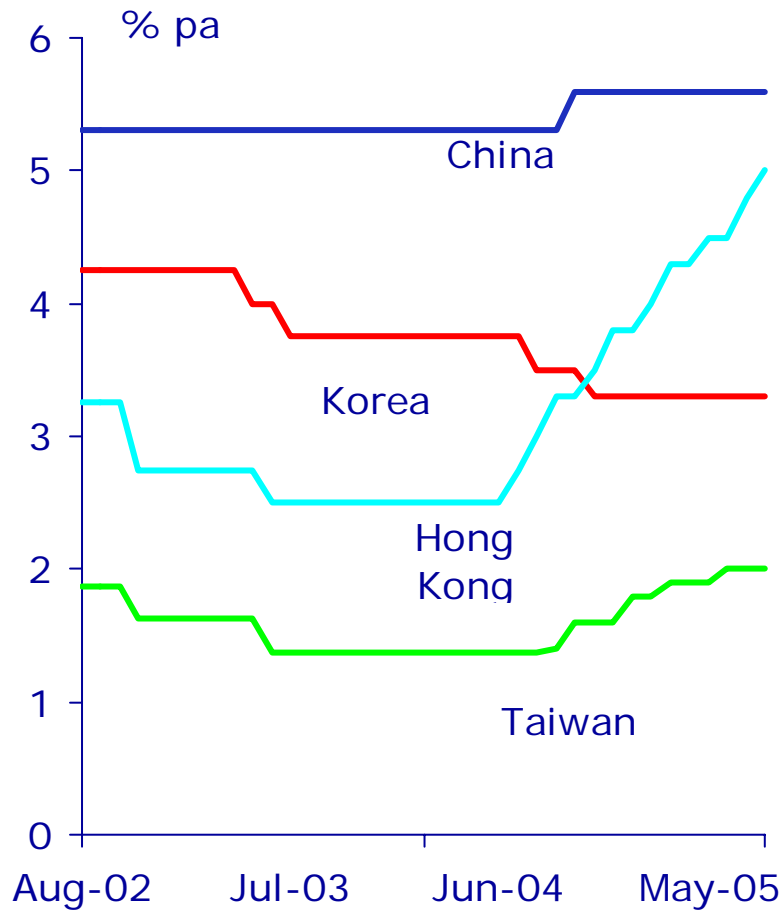


## Real interest rates – SE Asia

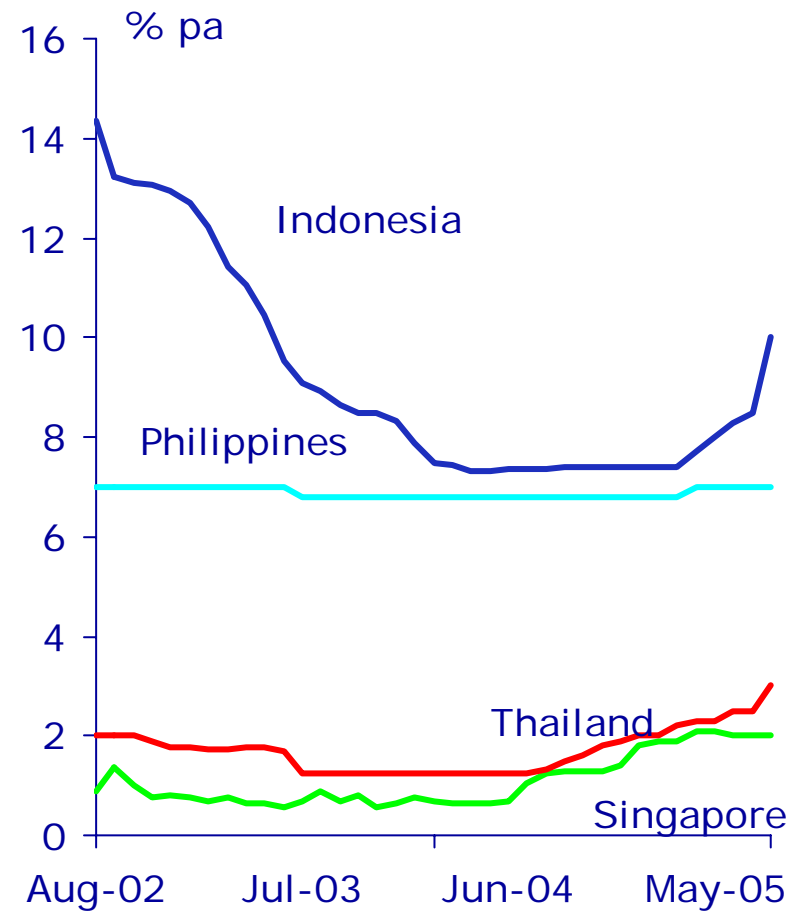


# Policy interest rates have started to rise, and will continue on this path

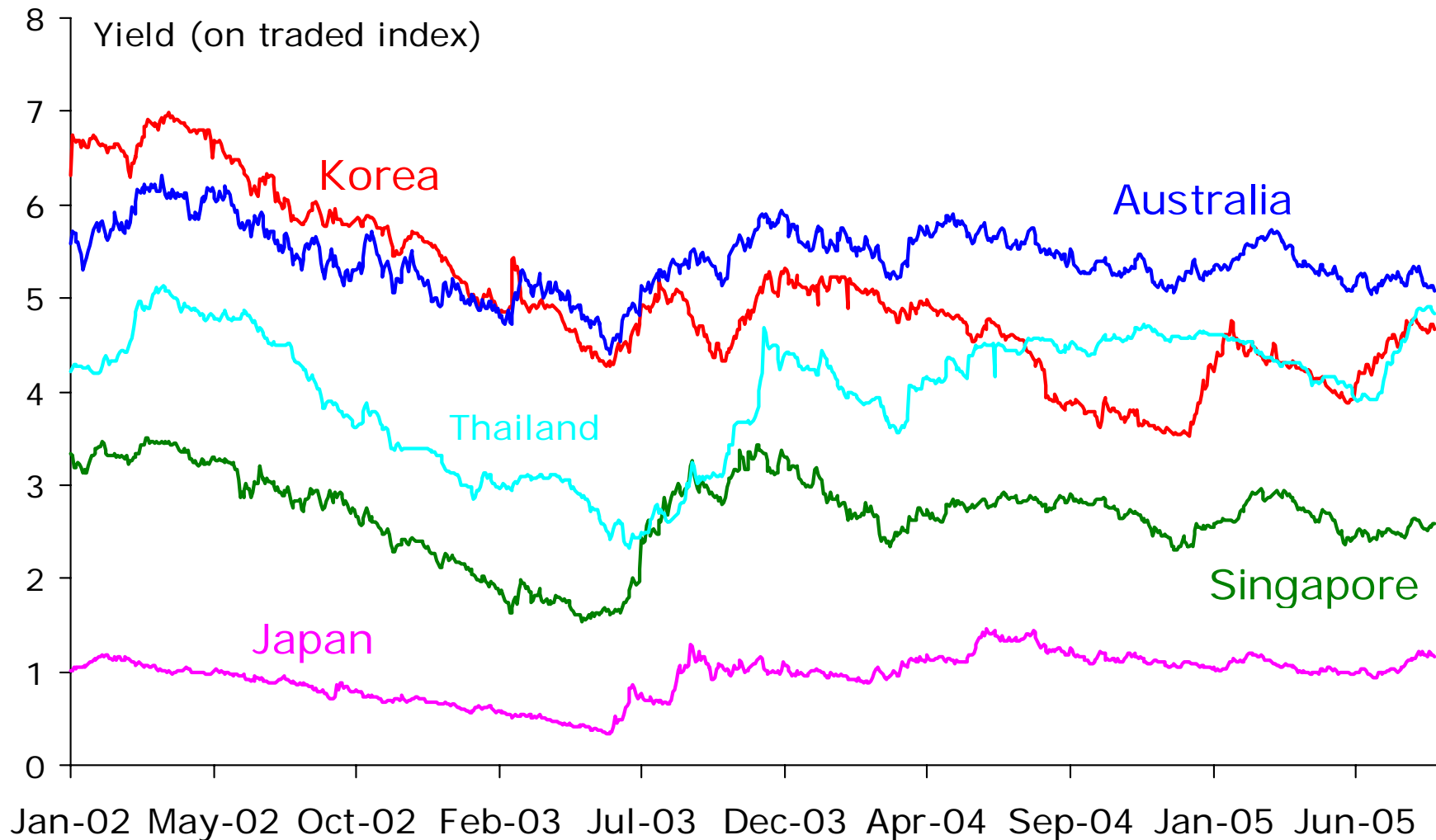
## Nominal rates – N Asia



## Nominal rate – SE Asia



# Yields in Korea and Thailand highlight sensitivities to rising inflation expectations

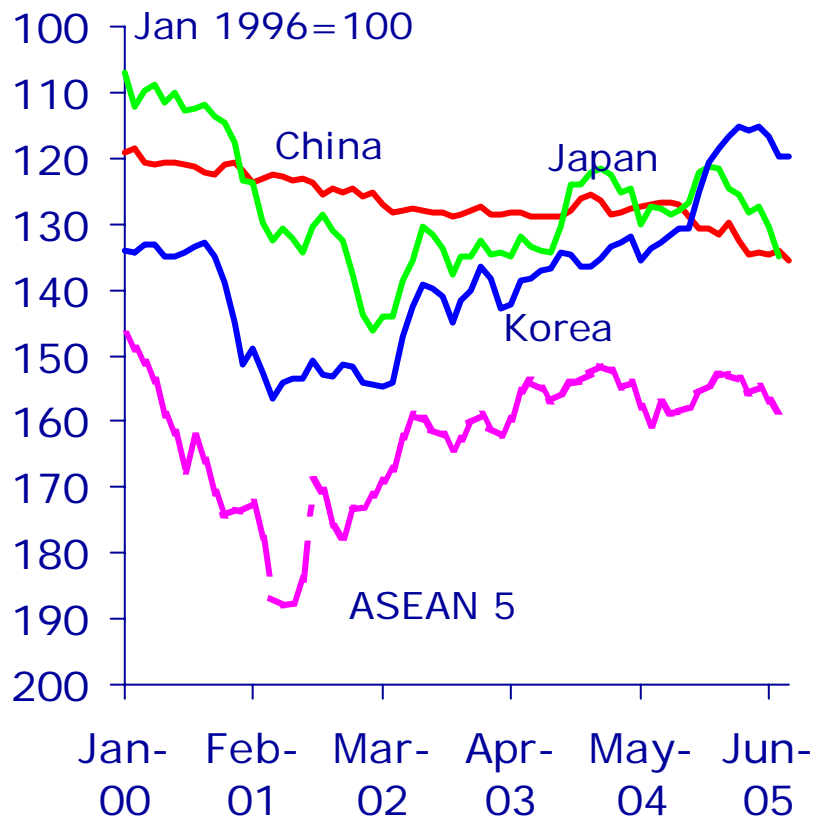


## Result: lower growth, higher inflation

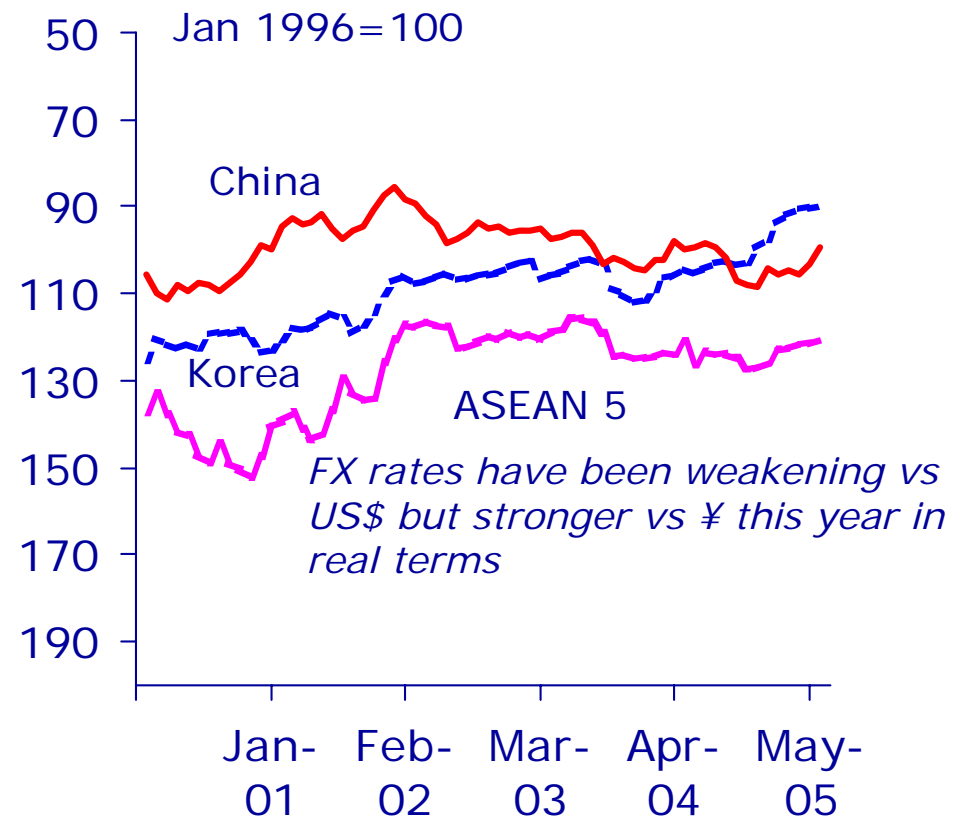
	2005 <i>old</i>	2005 <i>new</i>	2006 <i>old</i>	2006 <i>new</i>
<b><i>GDP GROWTH</i></b>				
China	9.0	9.0	8.2	8.0
Indonesia	5.5	5.4	6.1	5.6
Japan	1.7	2.1	1.5	1.5
Korea	3.8	3.7	4.6	3.5
Thailand	3.7	3.6	4.9	3.8
<b>Asia ex-Japan</b>	7.3	7.3	7.0	6.6
<b><i>INFLATION</i></b>				
China	1.6	1.4	2.2	2.6
Indonesia	7.6	8.5	6.5	7.6
Japan	0.0	0.0	0.4	0.4
Korea	3.7	3.3	3.2	4.4
Thailand	3.5	4.3	2.7	4.8
<b>Asia ex-Japan</b>	2.5	2.9	3.0	3.7

# Ability of central banks to use strong currencies to dampen inflation will be more limited

## Real exchange rates – USD (inverted)



## Real exchange rates – JPY (inverted)



On both charts a downward movement indicates an appreciation of the 'home' currency (USD or JPY) against the 'foreign' currency. Any implied percentage shift is measured as a proportion of the home currency.

Source: Datastream, Economics@ANZ

# World economy forecasts

	% change in real GDP from previous year			
	2004	2005	2006	2007
United States	4.2	3½	3	3
Japan	2.6	2.1	1½	1.3
Euro area	1.7	1.2	1½	1.7
United Kingdom	3.2	1.8	1.7	2½
Canada	5.5	3.0	2.9	2.7
Developed economies	3.1	2.4	2.2	2.3
East Asia	8.1	7.3	6.6	6.3
South Asia	6.7	7.0	6½	6.3
Latin America	5.8	4.0	3.6	3.4
Eastern Europe & Russia	6.3	5.1	4.8	4.5
Emerging economies	7.3	6.4	5.8	5.6
World	5.0	4.2	3.8	3.8

20 \* Weighted by GDP in US\$ at purchasing power parity exchange rates. Sources: national agencies; IMF; Economics@ANZ.

## G7 currency and rate forecasts

	Aug 2005*	Dec 2005	Jun 2006	Dec 2006
US Fed funds rate	3.5	4.25	4.50	4.50
Bank of Japan call rate	0.00	0.00	0.00	0.25
European Central Bank refi rate	2.00	2.00	2.00	2.00
Bank of England refi rate	4.5	4.50	4.50	4.50
US 10-year bond yield	4.01	4.50	4.50	4.25
US\$ - ¥	111.7	108	115	117
€ - US\$	1.21	1.29	1.23	1.20
£ - US\$	1.78	1.89	1.8	1.72
€ - ¥	135.1	139	141	140
US\$ - SwFr	1.27	1.18	1.23	1.27

# Asia currency forecasts

	Aug 2005*	Dec 2005	Jun 2006	Dec 2006
US\$ - ¥	111.7	108	115	117
US\$ - Yuan	8.10	8.03	7.91	7.78
US\$ - Won	1 039	1 010	1 040	1 030
US\$ - NT\$	32.7	32.4	32.5	32.5
US\$ - Rupiah	10 250	9 825	9 663	9 500
US\$ - Baht	41.4	40.0	42.8	42.0
US\$ - HK\$	7.77	7.80	7.80	7.80
US\$ - Ringgit	3.77	3.73	3.71	3.68
US\$ - S\$	1.69	1.66	1.67	1.68
US\$ - Peso	56.3	56.5	57.0	57.3
US\$ - Dong	15 877	16 100	16 250	16 400
US\$ - Rupee	44.1	44.0	43.0	42.0

# Cross rates with A\$ forecasts

	Aug 2004*	Sept 2005	Dec 2005	Dec 2006
A\$ - ¥	83.4	85.0	81.7	79.6
A\$ - Euro	0.62	0.64	0.59	0.57
A\$ - Yuan	6.05	6.30	6.10	5.29
A\$ - Won	776	800	768	700
A\$ - NT\$	24.46	25.43	24.62	22.10
A\$ - Rph	7655	8190	7467	6460
A\$ - Bt	30.89	31.91	30.40	28.56
A\$ - M\$	2.82	2.91	2.83	2.50
A\$ - S\$	1.26	1.30	1.26	1.14
A\$ - PP	42.05	43.88	42.94	38.93
A\$ - Dong	11 857	12 459	12 236	11 152