Economic outlook for Asia

Presentation to
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Commercial Bank Economists

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ANZ

www.anz.com/go/economics
Japan’s longest period of sustained growth since the ‘bubble’ era is continuing

Japanese real GDP growth

Note: Shaded periods denote recessions.
Source: Economic & Social Research Institute, Cabinet Office.
Household and business spending are firmly established as the mainstays of growth

Source: Economic & Social Research Institute
Japan’s corporate sector has worked off the ‘four excesses’ created by the 1980s ‘bubble’ ...
... and is now in its strongest financial position since the mid-1980s

Corporate profit share of GDP

Rate of return on assets

Debt-equity ratio

Bankruptcies

Sources: Bank of Japan; Tokyo Shoko Research Company.
The improving financial position of the business sector has allowed it to resume hiring ...

Sources: Home Ministry.
... which has in turn led to an improvement in household confidence and spending

Sources: ESRI; Construction Ministry; OECD.
Japan’s trade surplus is shrinking, despite rising export volumes, as its terms of trade deteriorate.

Export volumes

% change from year earlier

Import volumes

% change from year earlier

Trade price indices

% change from year earlier

Trade surplus

¥ trillion (annual rate)

Sources: Ministry of Finance; Bank of Japan.
The banking system has largely dealt with its bad loan problem and is now lending again.

**Banks’ NPL ratio**

- % (as at 31 March)

**Bank lending**

- % change from year earlier

**Banks’ capital adequacy ratio**

- % (as at 31 March)

**Tankan bank lending judgement**

- Net balance (%) reporting banks' lending stance 'easier'

*Sources: IMF; Financial Supervisory Agency; Bank of Japan.*
Most price indicators now suggest that deflation has ended

Sources: Bank of Japan; OECD; Economic & Social Research Institute.
Japanese asset price deflation has also clearly ended

Share prices

Dec 1989 = 100
(monthly average)

Land prices

Sep qtr 1990 = 100

Topix index
(relative to 'bubble' peak)

6 major cities
(relative to 'bubble' peak)

Sources: Thomson Financial Datastream; National Land Agency.
The Bank of Japan is poised to lift interest rates within the next few months.

The BoJ has implemented its ‘quantitative easing’ policy by maintaining the banking systems’ current accounts with it at levels well in excess of those required for the normal functioning of the banking system – as much as ¥32 trillion in recent years. Since announcing the end of ‘quantitative easing in March, the BoJ has been running down these balances towards the level at which it can again exert leverage over the level of short-term interest rates.

Sources: Bank of Japan; Datastream.
Japan faces a considerable task in cleaning up its public finances.

**Government financial balance**

- **% of GDP**
- **Actual**
- **Structural**

**Government debt**

- **% of GDP**
- **Gross**
- **Net**

*Source: OECD Economic Outlook, May 2007.*
Falling population, participation and productivity growth are key challenges for Japan

**Population growth**

% change from year earlier

**Labour force participation**

% of civilian population aged 15+

**Labour productivity growth**

% pa (3-year moving average)

**Productivity as a pc of US level**

% 

Sources: ESRI; Home Ministry; University of Groningen and The Conference Board, GGDC Total Economy Database 2005.
A surprisingly large proportion of Japan’s work force is employed in low-productivity industries

Productivity in 11 sectors of the Japanese economy relative to the US

China’s growth has accelerated in the first half of 2006 despite official plans to slow it down.

**Real GDP**

- % ch. from year earlier

**Industrial production**

- % ch. from year earlier

**Retail sales**

- % ch. from year earlier

**Fixed asset investment**

- Cumulative % ch. from year earlier

*Source: China National Statistics Bureau*
Despite accelerating economic growth, inflation has remained on a downward trend.

**Producer prices**

**Consumer prices**

Source: China National Statistics Bureau
Export growth has slowed, but the trade surplus is still widening

Source: China National Statistics Bureau
The People’s Bank of China has again tightened monetary policy to dampen credit growth.

**Interest rates**

- **% change from year earlier**
- **1 yr base lending rate**

**Money supply growth**

- **% change from year earlier**
  - **M1**
  - **M2**
  - **PBoC target**

**Bank lending**

- **% change from year earlier**

**Construction loans**

- **% change from year earlier**
  - **Construction**
  - **Other**

*Source: People’s Bank of China.*
The liquidity created by China’s FX policies may eventually lead to another asset price ‘bubble’ ...

* NDF = ‘non-deliverable forward’ rate.
Sources: People’s Bank of China; Thomson Financial Datastream.
... as similar currency policies did in Japan in the late 1980s

**¥ vs US$**

![Graph showing ¥ vs US$ from 1985 to 1990](image)

**FX reserves**

![Graph showing FX reserves from 1985 to 1990](image)

**Money supply (M2+CDs)**

![Graph showing % change from year earlier from 1985 to 1990](image)

**Land and share prices**

![Graph showing land and share prices from 1985 to 1990](image)

*Sources: Bank of Japan; National Land Agency; Thomson Financial Datastream.*
Economic growth in the smaller East Asian economies is accelerating again

Leading indicators of the business cycle in smaller East Asian economies

* expressed as a six-month smoothed annualized rate of change. IP data is a three-month moving average. Sources: national statistical agencies and central banks; NTC; Datastream; Economics@ANZ.
On-going strong Chinese growth and recovery in Japan is boosting these countries’ exports

Exports and imports

Merchandise trade balance

Sources: national statistical agencies and central banks; Datastream; Economics@ANZ.
Inflation is rising – particularly in those countries which have reduced fuel subsidies

**Consumer prices**

Sources: national statistical agencies and central banks; Datastream; Economics@ANZ.
Consumer spending has slowed in those countries which have cut fuel subsidies

Source: National statistical agencies and central banks.
Further monetary policy tightening likely in most countries this year ahead of easing in 2007

Source: Datastream; Economics@ANZ.
More recently many Asian central banks have allowed their currencies to appreciate

**Korean won**

![](chart.png)

**Thai baht**

![](chart.png)

**Malaysian ringgit**

![](chart.png)

**Singapore dollar**

![](chart.png)

**Indonesian rupiah**

![](chart.png)

**Philippine peso**

![](chart.png)

*Source: Datastream*
Key issues for South-East Asia

- **Political stability**
  - Democratic institutions have passed important tests in Thailand, Indonesia and Philippines in recent years but confidence in them remains fragile

- **Security risks**
  - Islamist terrorist organizations remain active in Indonesia, southern Thailand and southern Philippines

- **Macro-economic stability**
  - Yet to be credibly established in Indonesia (despite progress under SBY administration) or Philippines

- **Accelerating the pace of regional integration**
  - Goal of ASEAN free trade area remains frustrated by economic nationalist / protectionist instincts

- **Competition from China and India**
  - SE Asia struggles to attract foreign investment in competition with China and India
  - Export-oriented sectors facing increasing competition across a growing range of industries from China
  - More advanced economies (eg Singapore and Malaysia) don’t find it easy to reconcile need to encourage greater ‘creativity’ with traditionally authoritarian political structures
Most Asian central banks now have more than adequate levels of FX reserves (I)

Asian central bank reserves as a multiple of imports

Sources: National central banks and statistical agencies; Datastream; Economics@ANZ.
Most Asian central banks now have more than adequate levels of FX reserves (II)

Asian central bank reserves as a multiple of short-term foreign debt

Sources: Economist Intelligence Unit; Datastream; Economics@ANZ.
Asian central banks (other than the PBoC) have scaled back their FX intervention since 2004.

### Asian central bank FX reserves

<table>
<thead>
<tr>
<th>Country</th>
<th>Increase in 2006 to date</th>
<th>Increase in 2005</th>
<th>Increase in 2004</th>
<th>Increase in 2003</th>
<th>Level as at Dec 2002</th>
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<tbody>
<tr>
<td>Japan</td>
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<tr>
<td>China</td>
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<tr>
<td>Taiwan</td>
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<tr>
<td>Korea</td>
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<tr>
<td>India</td>
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<tr>
<td>HK</td>
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<tr>
<td>Singapore</td>
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<td>Malaysia</td>
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<tr>
<td>Other</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

### Foreign central bank purchases of US Treasury bonds

- **Source:** Thomson Financial Datastream; US Treasury; Economics@ANZ.
India’s economy is growing strongly but above-average inflation is eroding competitiveness

**Real GDP**

% ch. from year earlier

% from 00 01 02 03 04 05 06

**Inflation**

% ch. from year earlier

% from 00 01 02 03 04 05 06

**Industrial production**

% ch. from year earlier

% from 00 01 02 03 04 05 06

**Merchandise trade balance**

US$bn (12-mth moving total)

Source: Reserve Bank of India; Datastream; OECD.
Summary of the Asian economic outlook (1)

<table>
<thead>
<tr>
<th>Real GDP growth</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<tr>
<td>Japan</td>
<td>2.3</td>
<td>2.6</td>
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<tr>
<td>China</td>
<td>10.1</td>
<td>9.9</td>
<td>9¾</td>
<td>9</td>
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<td>Korea</td>
<td>4.7</td>
<td>4.0</td>
<td>5</td>
<td>3¼</td>
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<td>Taiwan</td>
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<td>Hong Kong</td>
<td>8.6</td>
<td>7.3</td>
<td>4¾</td>
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<td>Indonesia</td>
<td>5.1</td>
<td>5.6</td>
<td>4¾</td>
<td>6½</td>
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<tr>
<td>Thailand</td>
<td>6.1</td>
<td>4.6</td>
<td>4½</td>
<td>4¼</td>
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<tr>
<td>Malaysia</td>
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<td>5.3</td>
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<td>Singapore</td>
<td>8.7</td>
<td>6.3</td>
<td>7</td>
<td>5</td>
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<tr>
<td>Philippines</td>
<td>6.0</td>
<td>5.1</td>
<td>4½</td>
<td>4¼</td>
</tr>
<tr>
<td>Vietnam</td>
<td>7.7</td>
<td>8.4</td>
<td>7¾</td>
<td>7½</td>
</tr>
<tr>
<td>India (a)</td>
<td>7.5</td>
<td>8.5</td>
<td>7½</td>
<td>7¼</td>
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(a) Fiscal years beginning 1 April
### Summary of the Asian economic outlook (2)

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<tr>
<th>Inflation</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<td>-0.2</td>
<td>¼</td>
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<tr>
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<td>3.9</td>
<td>1.8</td>
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<td>3</td>
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<tr>
<td>Korea</td>
<td>3.6</td>
<td>2.8</td>
<td>3</td>
<td>3¾</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1.6</td>
<td>2.3</td>
<td>3</td>
<td>2½</td>
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<tr>
<td>Hong Kong</td>
<td>0.0</td>
<td>0.8</td>
<td>1¾</td>
<td>1½</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6.1</td>
<td>10.4</td>
<td>12¾</td>
<td>7¾</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.8</td>
<td>4.5</td>
<td>4¾</td>
<td>3</td>
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<td>Malaysia</td>
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<tr>
<td>Singapore</td>
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<td>0.5</td>
<td>1½</td>
<td>1</td>
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<tr>
<td>Philippines</td>
<td>5.9</td>
<td>7.7</td>
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<td>6</td>
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</tr>
<tr>
<td>India (a)</td>
<td>3.8</td>
<td>4.1</td>
<td>4½</td>
<td>3½</td>
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(a) Fiscal year beginning 1 April
## Summary of the Asian economic outlook (3)

<table>
<thead>
<tr>
<th>Current account (% of GDP)</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<tbody>
<tr>
<td>Japan</td>
<td>3.8</td>
<td>3.9</td>
<td>4</td>
<td>3½</td>
</tr>
<tr>
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<td>4.0</td>
<td>6.7</td>
<td>4½</td>
<td>4</td>
</tr>
<tr>
<td>Korea</td>
<td>4.1</td>
<td>2.4</td>
<td>1¾</td>
<td>1¼</td>
</tr>
<tr>
<td>Taiwan</td>
<td>5.8</td>
<td>3.4</td>
<td>3</td>
<td>2½</td>
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<tr>
<td>Hong Kong</td>
<td>9.5</td>
<td>9.3</td>
<td>5½</td>
<td>2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.2</td>
<td>0.5</td>
<td>1¼</td>
<td>1½</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.1</td>
<td>-1.4</td>
<td>-1</td>
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<tr>
<td>Malaysia</td>
<td>12.5</td>
<td>11.7</td>
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<td>Singapore</td>
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<tr>
<td>Vietnam</td>
<td>-2.1</td>
<td>-2.7</td>
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<td>-4</td>
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<tr>
<td>India (a)</td>
<td>-0.1</td>
<td>-2.1</td>
<td>-2½</td>
<td>-2½</td>
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(a) Fiscal year beginning 1 April
## Asian interest rate outlook

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<tbody>
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<td>0.00</td>
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<td>China 1 yr base rate</td>
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<td>Hong Kong discount rate</td>
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<td>Indonesia BI rate</td>
<td>12.75</td>
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<td>Thailand 14-d repo rate</td>
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* Actual
## Asian currency outlook

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<td>Won</td>
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* Actual