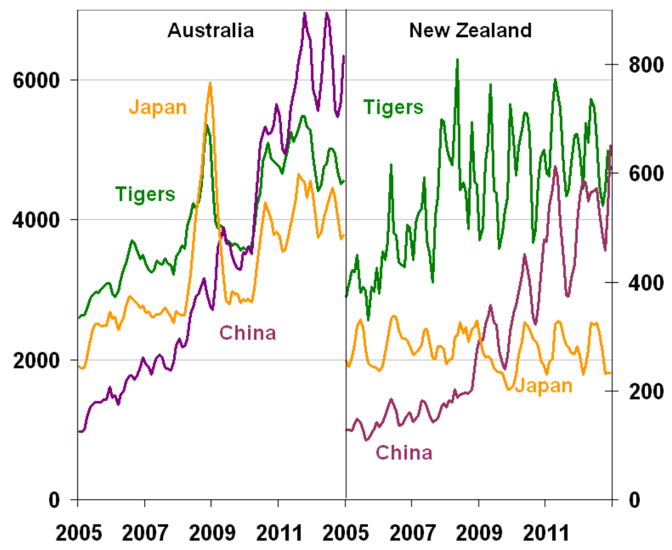
Asian Tigers Economic Update

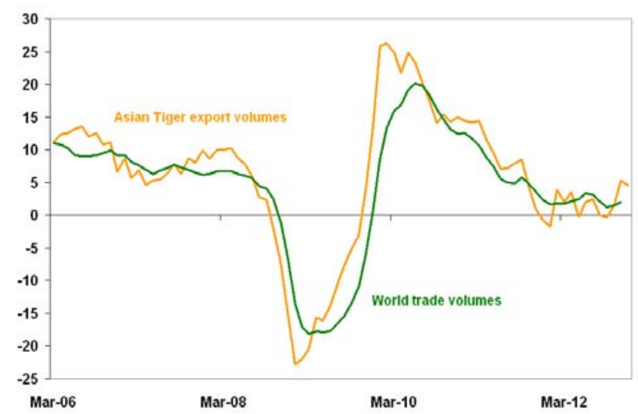
National Australia Bank

- **After having stalled through much of last year, the process of trade integration between Australasia and East Asia looked to have regained momentum at the end of 2012 – especially exports to China. Exports from both Australia and New Zealand to the "Tiger" economies (ASEAN, S Korea and Taiwan) remain below their earlier levels.**
- **This period of marking time reminds us that it is not all onwards and upwards in integrating Australasian economies into their wider region – factors like the global economic cycle and trade barriers play a role.**
- **This stagnation in our exports to the region through 2012 reflected the downturn in the global economy that hit exports from the trade-dependant economies of East Asia. This fed into slower industrial expansion which brought Tiger economic growth down to 3% yoy by the September quarter. Sluggish regional performance led to stalling imports which hit Australian and New Zealand shipment values.**
- **There are now a few straws in the wind that suggest that the worst has passed in the slowdown across the Tigers. Recent monthly indicators on trade and industrial output show modestly faster growth and a few of the surveys have turned up slightly – but it is still early days in the upturn.**
- **We expect a fairly modest upturn in growth, partly reflecting the absence of an outright recession last year in the region. Average growth across the Tigers of 3¾% and 4¼% is predicted for 2013 and 2014.**

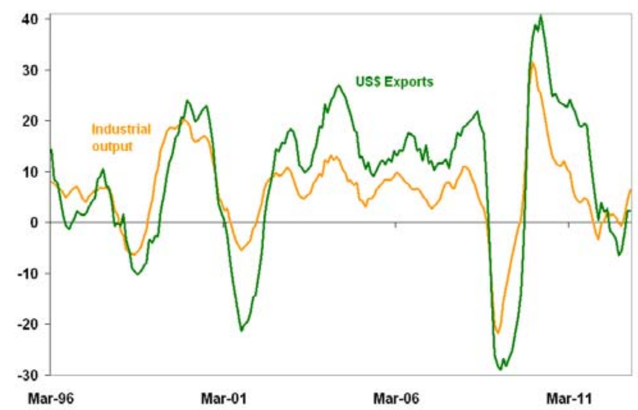
Australia/NZ Monthly exports to East Asia by region $ Mill 3MMA



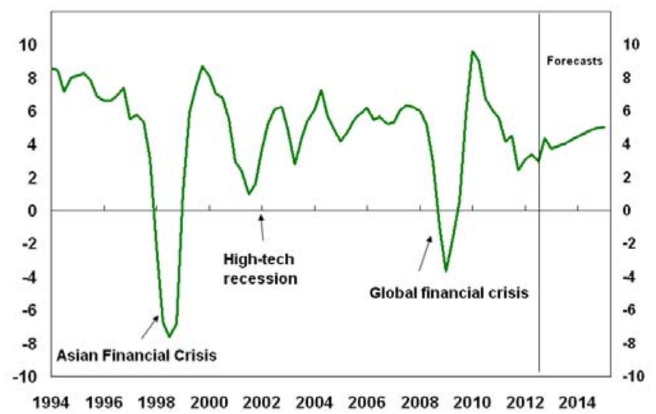
World trade and Asian Tiger export volumes (% year on year)



Asian Tiger $US exports and industrial output (% Change yoy)



Asian Tigers Regional GDP (% change year on year)



Tom Taylor Group Economics 86341883

Economic cycle passed its trough

The slowdown in global economic growth since 2010 has fed into a marked softening in economic expansion across the “Tiger” economies of East Asia (which include the ASEAN economies of SE Asia, South Korea, Taiwan and Hong Kong). Economic growth in these territories has eased from a peak of over 9% yoy in the first half of 2010 to less than 3% yoy in September quarter 2012. The slowdown has been quite broad-based across the region’s economies with only Indonesia maintaining its previous growth momentum.

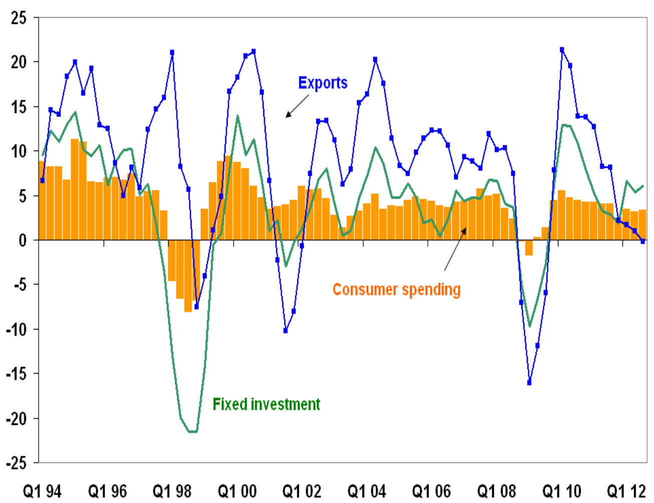
Export growth has seen the biggest slowdown among the various components of expenditure in the region, reflecting the big slowing in the growth of world trade. In previous regional downturns fixed investment has tended to slip in parallel with softer trade but this time it has been better maintained. Consumer spending has again been a stabilising force for regional activity and the latest retail figures show a modest upturn in the volume of spending. With the exception of Taiwan, the region’s economies have seen a pick-up in their pace of retail spending growth through the latter half of last year.

Investment has held up better in this cyclical slowdown than we have seen before and this reflects the strength of capital spending in Malaysia and Indonesia where a series of big infrastructure and resource projects are under way. The chart opposite shows the way in which investment spending in these SE Asian nations has picked up when exports have softened.

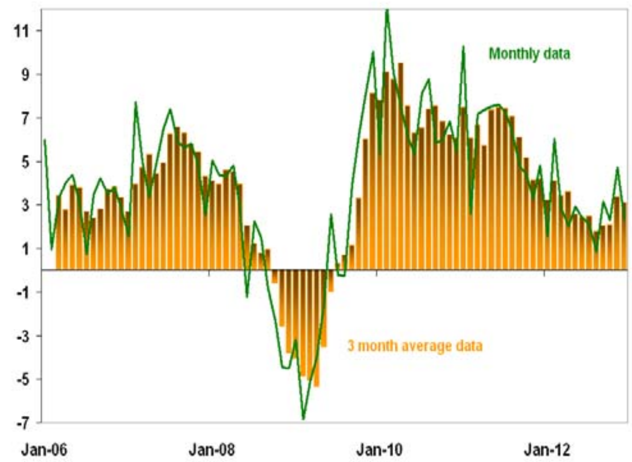
The historical correlation between exports and investment spending has been maintained in South Korea and Taiwan. In the former, investment fell by 6.6% in the final three quarters of last year while exports just about stagnated. Taiwanese exports and fixed investment fell in step through the first half of last year but picked up toward the end of the year.

Resilient consumer spending, solid investment in SE Asia and government fiscal measures ensured that the latest cyclical slowdown has been comparatively mild across the Tiger economies.

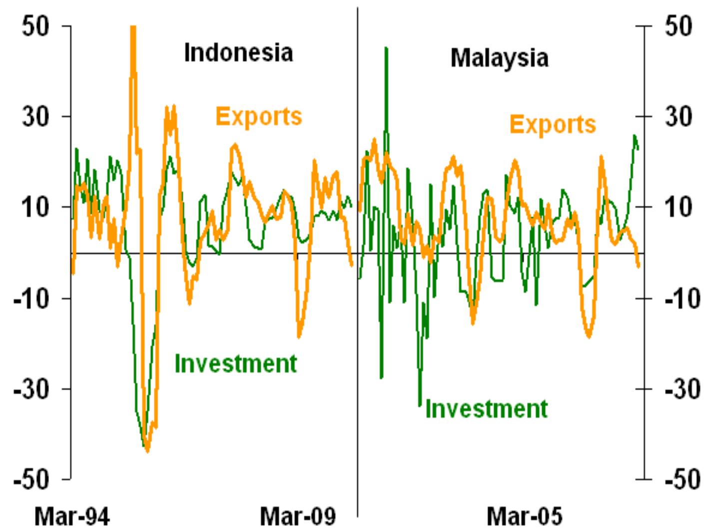
Asian Tigers Private demand volumes (% change yoy)



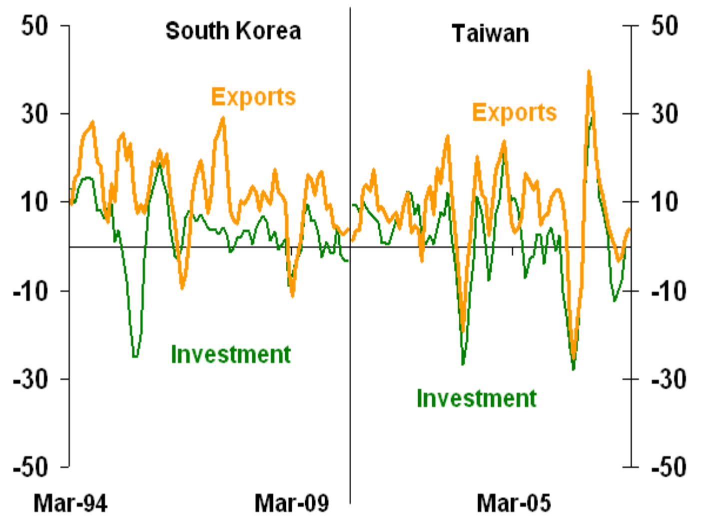
Asian Tigers Retail trade volumes (% change yoy)



SE Asian investment keeps up exports fall (% change yoy)



Exports and investment keep step elsewhere (% change yoy)



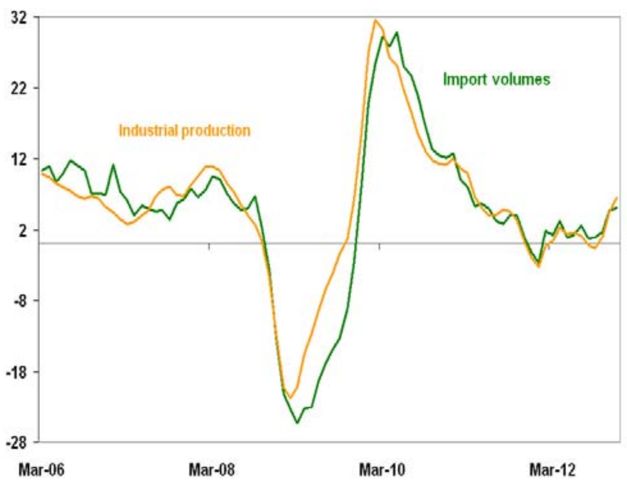
While the downturn has been much milder than those experienced in the Global Financial Crisis, the early 2000s “tech wreck” recession or the 1990s Asian Financial crisis, it was still sufficiently severe to just about stop the growth in imports into the region. Import volume growth slipped from peak rates of over 25% yoy in the middle of 2010 to virtually nothing in late 2011 and early 2012 before beginning a gradual recovery toward the end of last year. Australian and New Zealand suppliers suffered in this downturn with both showing export earnings from Tiger economy markets that were below year-earlier levels through much of 2012.

While the global economy remained weak through the closing months of 2012, there have been a few indications that the worst of the slowing is now over in at least some of the Tiger economies. Overall business survey results from places like South Korea and Taiwan – key regional economies in terms of their size – have been looking a little less depressing. Trade and industrial production growth was accelerating modestly toward the end of the year and retail trade was also turning up slightly. Taiwanese export orders rose sharply at the end of last year but the results from the South Korean survey results on export trends are conflicting and hard to make sense of.

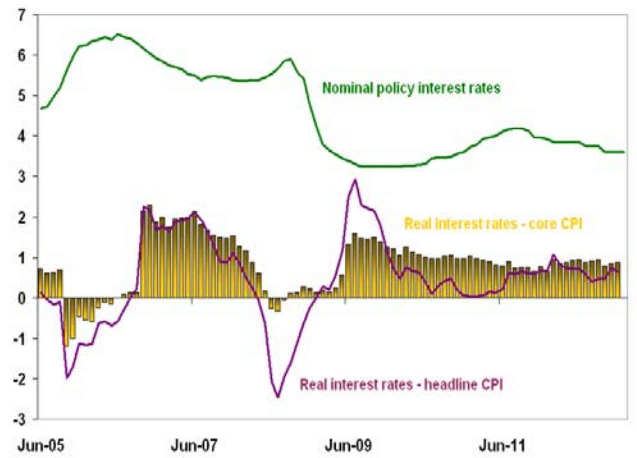
The sharp turnaround in monetary policy seen across the region through the last couple of years will also have boosted activity levels and recovery hopes. After lifting their policy rates as recessionary fears eased through 2011, regional central banks started cutting again last year – taking the region’s weighted nominal policy rate to just over 3½% by late 2012 and real rates down to around 1%. Large or widening budget deficits in Indonesia, Thailand, Taiwan and Malaysia have also propped up demand.

While growth looks set to pick-up around the region, we are only expecting a fairly modest upturn in an area that tends to outperform during cyclical upswings in the global economic cycle. This reflects the region’s fairly “soft landing” through the last global slowdown, so there was no regional recession for activity to bounce back from. Furthermore, some countries are likely to start cutting back their budget deficits as recovery prospects look more secure, ensuring that growth across the Tigers accelerates to slightly above its trend rate by late 2014.

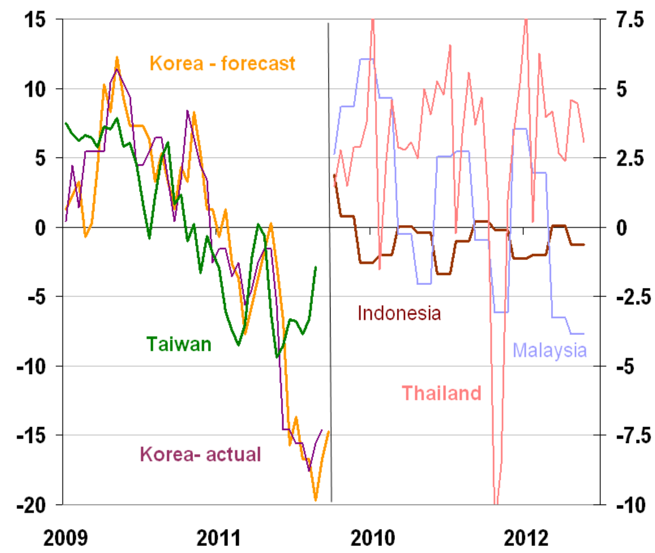
Imports and industrial output in Tiger economies(% yoy 3MMA)



Interest rates across the Tigers – nominal and real %



Business surveys – deviation from long run average



Country economic growth forecasts

Average annual growth in GDP (%)

	2011	2012	2013	2014
Hong Kong	4.9	1.2	2.6	3.6
Indonesia	6.5	6.3	6.3	5.9
Singapore	4.9	1.6	2.8	3.9
Taiwan	4.1	1.2	3.3	4.4
Thailand	0.1	4.8	4.6	5.2
Malaysia	5.1	5.2	5.1	5.6
S Korea	3.6	2.1	2.6	3.7
Philippines	3.9	5.2	4.4	4.8
Tigers	**4.2**	**3.4**	**4**	**4.7**
Memo				
World	3.9	3	3.3	3.9

A closer look - Hong Kong growth weak but signs of overheating in asset markets

Hong Kong has shared in the region-wide economic slowdown – with growth slipping to only 1½% yoy in the latter half of 2012. Nevertheless, the region has been showing all the symptoms of overheating in its asset markets. The housing market cooled briefly in late 2011 and early 2012 but since then it has risen by around 25%. Over the same period commercial property prices also rose sharply with office values up by over 20%.

Evidence of over-heating does not cover all areas of the economy. CPI inflation was trending down through 2012 with the CPI measure that excludes one-offs showing a dip in inflation from 6.7% yoy at the start of 2012 to 3.8% yoy at the end of the year. Manufacturing output prices were falling through much of last year and import prices levelled off through the latter half of 2012. Consequently, there does not seem to be a problem of generalised inflation across the economy, rather it is restricted to property markets.

This strength in asset prices reflects the amount of liquidity flowing through the Hong Kong financial system with a jump in the amount of money commercial banks hold with the HKMA (their "aggregate balance") being a classic symptom of excess liquidity. The low level of funding costs is another tell-tale sign of excess liquidity with funding rates of 30 bps which are negative in real terms. Retail lending rates are also exceptionally low and well below what the economy needs to curb asset demand. Retail lending rates (BLRs) are around 5% but over 90% of the new mortgages being granted are at rates of 2ppts or more under the 5% BLR – which implies mortgages around 2 to 3%, near zero in real terms.

Normally a central bank facing this situation would lift interest rates but Hong Kong's currency board system rules that option out and leaves the region very exposed to the impact of quantitative easing operations by the Fed and other central banks that are boosting global liquidity.

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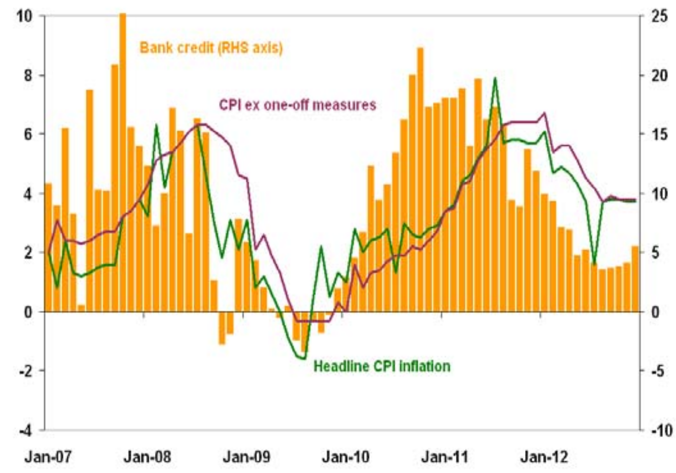
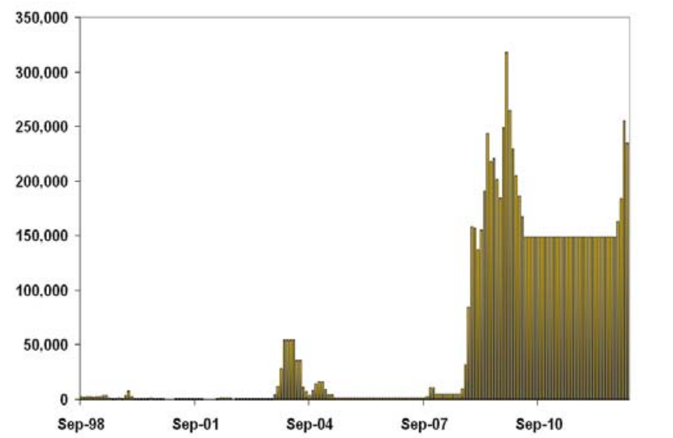
Property prices rising strongly (Index levels)

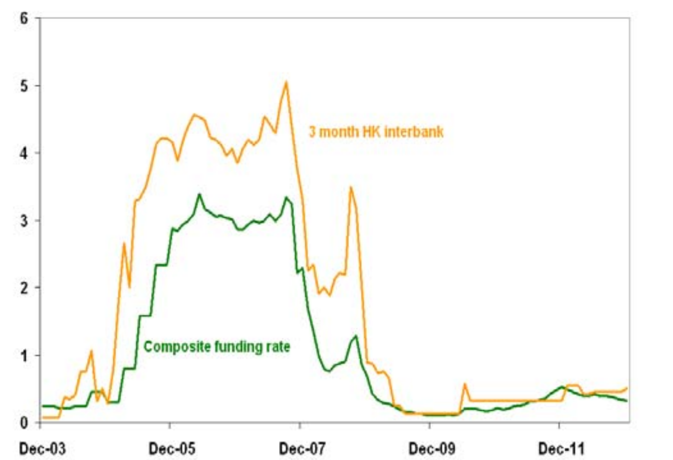
CPI inflation and credit had been rising fast too (% change yoy)



Aggregate balance – liquidity piling up in banking (HK$ Million)



Bank funding costs – system averages



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Important Notices