# East Asian emerging market economies – June 2014

National Australia Bank

## *Key Points:*

- *Moderate sub-trend growth continues across the emerging market economies of East Asia (S Korea, Thailand, Taiwan, Malaysia, Indonesia, Singapore, HK and Philippines). Lack-lustre growth in world trade has dampened activity in this export-oriented region but domestic demand has held up better than in previous export slowdowns.*
- *Regional GDP expansion has settled at just below 4% yoy since mid-2013 and we expect growth to trend upwards to around 4½% by the latter half of 2016. Malaysia, the Philippines and Indonesia should grow the fastest.*
- *There are big differences between the region's economies, reflecting the diversity of political, financial and economic structures across the region. Political instability has hit the Thai economy and growth forecasts have been revised down. Indonesia remains one of the fastest growing regional economies but its reliance on foreign capital inflows shows its continued vulnerability to shifting risk appetites in global financial markets.*
- *Economic policy varies across the region. Above target inflation, a weak currency and external deficits led to interest rate rises in Indonesia. The Malaysian central bank has signalled that its next interest rate move is probably upwards. Below target inflation in S Korea underpins ongoing low interest rates and Taiwan's low inflation puts its central bank in a similar position. The Thai economy is weak and inflation is forecast to remain within its target band but interest rates are already low and the Bank of Thailand sees little room for more cuts. Singapore's central bank continues its monetary tightening via currency appreciation.*
- *Below trend economic growth in the Asian emerging market economies has led to only modest expansion in regional import demand and that, along with the downward trend in bulk resource commodity prices, has led to a stagnation in Australian goods exports to the region.*

**Figure 1: Moderate economic growth set to continue**

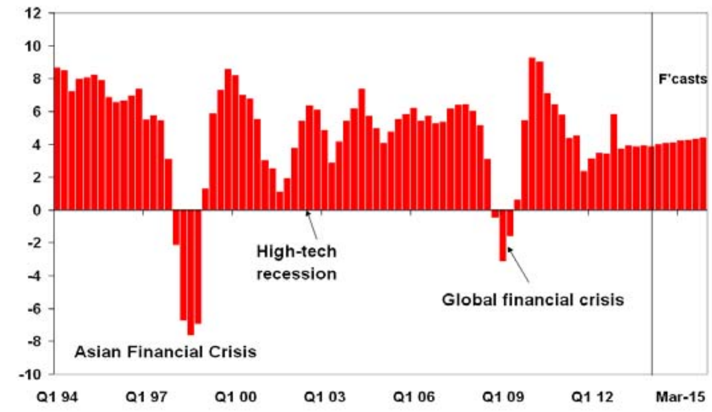



**Table 1 : Economic growth – 2013 actual and forecasts**

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Hong Kong | 2.9 | 3.2 | 3.6 |
| Indonesia | 5.8 | 5.2 | 5.6 |
| Singapore | 3.8 | 4.7 | 4.5 |
| Taiwan | 2.1 | 3.1 | 3.4 |
| Thailand | 2.9 | 1.2 | 3.4 |
| Malaysia | 4.7 | 5.7 | 5.2 |
| S Korea | 3.0. | 3.8 | 3.8 |
| Philippines | 7.2 | 6.1 | 5.8 |
| Average | 3.9 | 4.0 | 4.3 |

# Regional aggregate trends in economic activity

- With the exception of Indonesia, the Asian emerging market economies are very open export driven economies. In the past domestic demand has tended to follow export cycles as trade-generated downturns in business investment and household income hit local spending.
- Predictably, the big slowdown in the growth of world trade since 2010 has hit regional export expansion. Growth in regional export volumes has picked up slightly since mid-2013 but it remains well below its long run trend. Malaysia and Korea have had the best export performance, Indonesia, Thailand and Singapore the worst outcomes.
- Modest export growth has been reflected in equally disappointing outcomes for regional industrial output and import volume growth has been sluggish too – as the region's export-oriented manufacturing relies heavily on imported raw materials and intermediate goods.
- Domestic demand has slowed but by less than in previous downturns. Public sector projects have supported investment spending and consumer spending growth has been maintained at around 3½% yoy. Trend retail trade growth has slowed to around 2% yoy with a big fall in Hong Kong distorting the latest data.

**Figure 2: Regional averages % year on year**

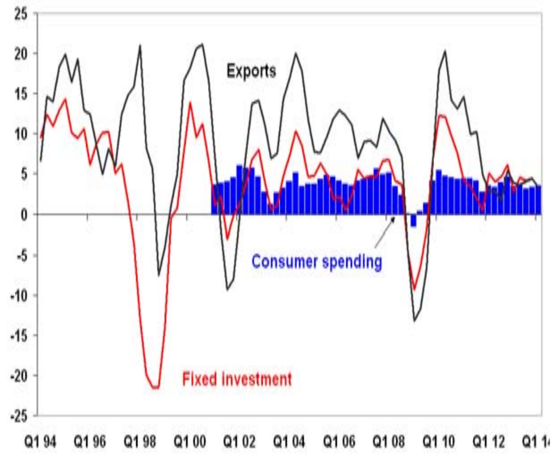



**Figure 3: World trade and regional exports %**


**Figure 4: Regional imports and output %**

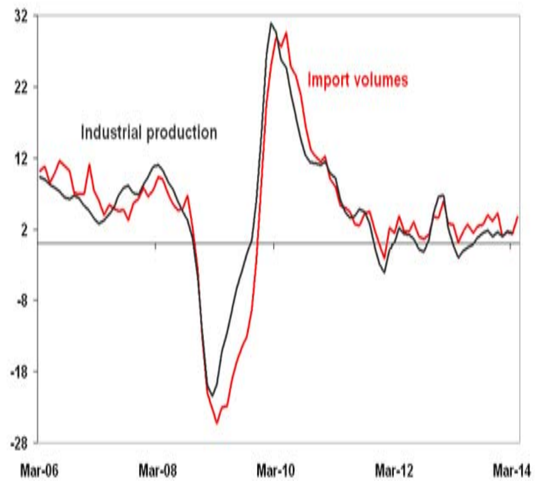
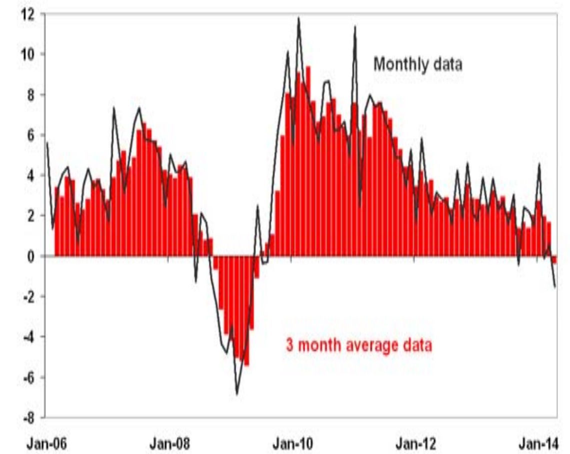



**Figure 5: Regional retail trade volumes %**



# Regional trends in property markets

- Conditions in the region's housing and commercial property markets have been a key concern of its central banks and governments since the 1990s Asian Financial crisis showed how property market booms and busts could destabilise their economies.
- Given this background, the surge in regional residential property prices through the last few years has resulted in policy measures to cool the market in several economies. The impact of these measures is now becoming increasingly apparent.
- Hong Kong residential prices have levelled off and the value of transactions has dropped as moves to cool the previous boom (through higher housing down-payments, sales taxes and stamp duties) plus higher property supply changed the market. With HK interest rates likely to track US rates higher and low housing affordability, bearish analysts warn of a market correction while bulls see a buying opportunity.
- Indonesia introduced new rules to cool over-heated property markets last year with higher LTV ratios on extra house purchases and tougher controls on bank lending. Surveys show falling property sales and slower credit growth this year and flat to falling price to rent ratios.
- Taiwan house prices have risen strongly as wealthy locals invest in rental assets. The authorities took some small steps in 2011 to cool the market (a luxury tax) but they have not had much impact yet on conditions.

**Figure 6: Residential prices Mar 10=100**

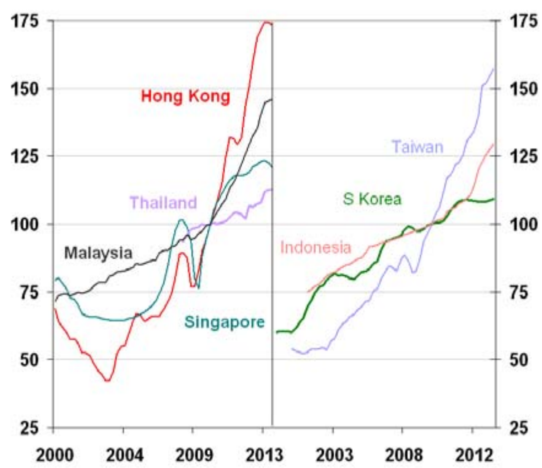



**Figure 7: Commercial property Mar 10=100**

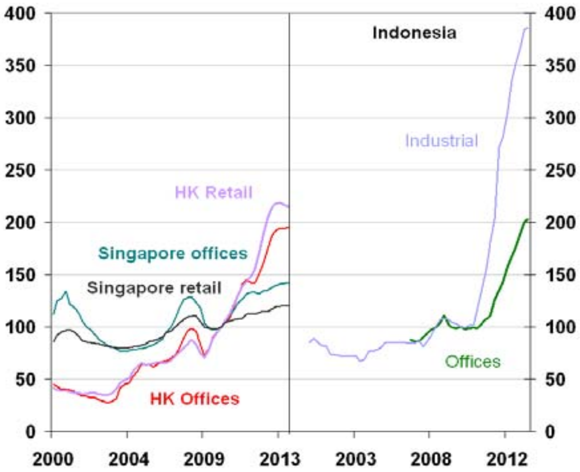



**Figure 8: Hong Kong property sales $M**

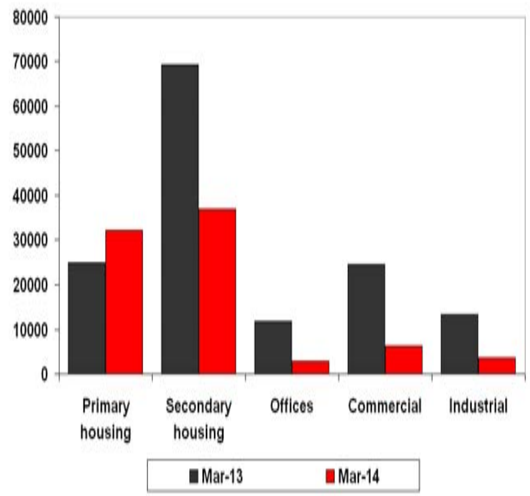
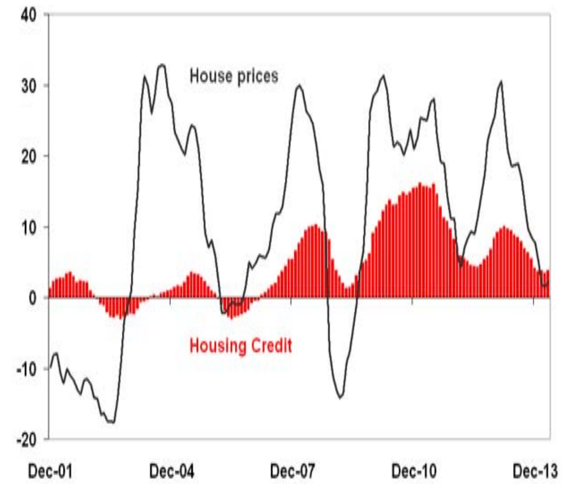



**Figure 9: Hong Kong housing %**



# Regional trends in inflation

- Consumer price inflation is generally well under control across the region with Indonesia standing out as the only big economy where the rate of price growth is above target. The rate of inflation has recently started trending higher in several economies where it had been low.
- The absence of inflationary pressure coming from import prices has helped maintain low inflation across much of the region. This reflects a combination of falling global commodity prices, modest global inflation and some regional currency appreciation (eg Won, Sing $)
- Import prices have been trending down in Singapore, Taiwan and South Korea and they have been quite flat in Malaysia. Thai import prices rose as the Baht depreciated but they are only back to mid-2012 levels. Indonesia is the exception with the weaker Rupiah contributing to a 16% rise in the wholesale price of imported goods since mid-2013.
- The persistence of excess capacity has also borne down on inflation as generally modest regional growth rates coincide with still sizeable increases in productive potential in some countries (eg Thailand, South Korea). In Malaysia, both core and headline CPI inflation have been rising quite sharply and its central bank believes that the economy is now operating at around its long-term potential rate with little excess capacity left to be absorbed.

**Figure 10: Headline CPI Inflation % yoy**

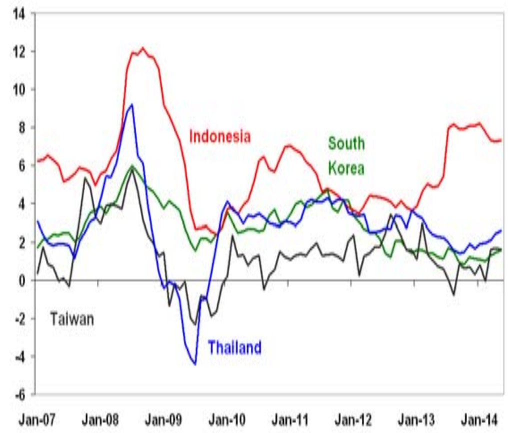



**Figure 11: Core CPI Inflation % yoy**


**Figure 12: Core and headline CPI %**

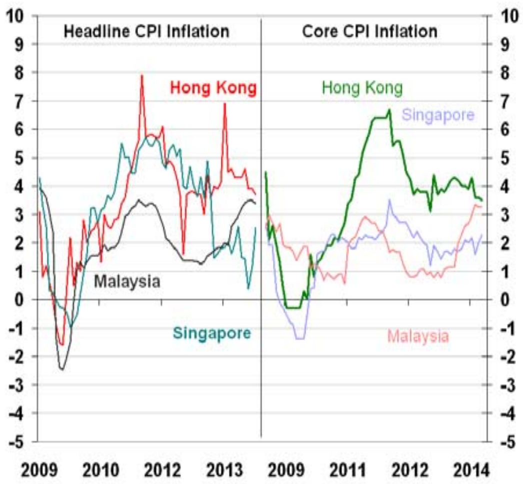
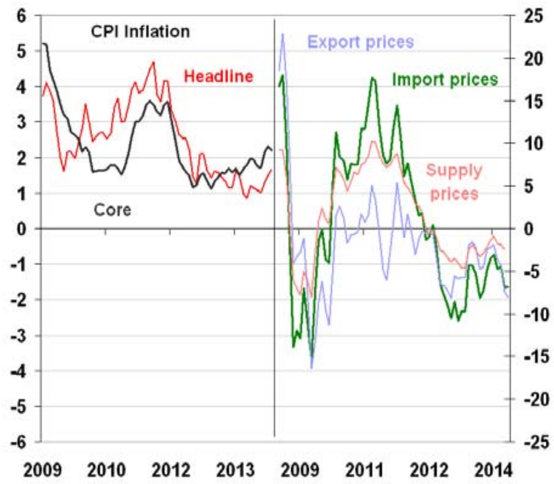



**Figure 13: S Korean inflation %**



# External accounts

- Although most East Asian emerging market economies record sizeable current account surpluses – which means they do not need to import foreign capital to fund shortfalls between their domestic savings and investment spending – they are all still tied into the global financial market with its volatility in interest rates and sudden reversals in flows of funds.
- The 1990s Asian Financial crisis, the 2008/9 Global Financial crisis and the pulling back from the region by EU banks a few years ago all illustrate the vulnerability of emerging market economies to financial market instability. The fluctuation in the amount of capital moving into the region is shown in the top 2 charts opposite with even highly rated centres like Hong Kong and Singapore being hit alongside financially weaker economies like Thailand or Indonesia.
- Recently capital has been moving back into the region and the IIF forecasts do not envisage a sudden pull-back, even though the likely upward trend in US interest rates would be expected to see more investor focus there.
- Indonesia is probably the most vulnerable economy to capital outflow – it runs a sizeable current account deficit and has a history of being hit in episodes of global risk aversion. Moreover, foreign investors own a third of Rupiah government bonds and lots of equities. However Malaysia and Thailand share this vulnerability as foreign investors also own 30% and 17% of their stock of local currency Government bonds.

**Figure 14: Private net capital inflow $US M**

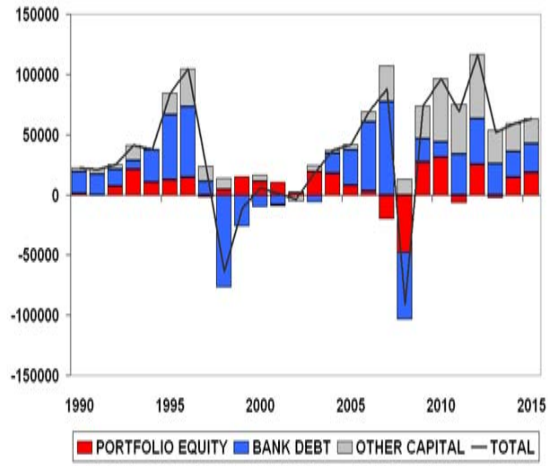



**Figure 15: Bank lending change yoy $US M**

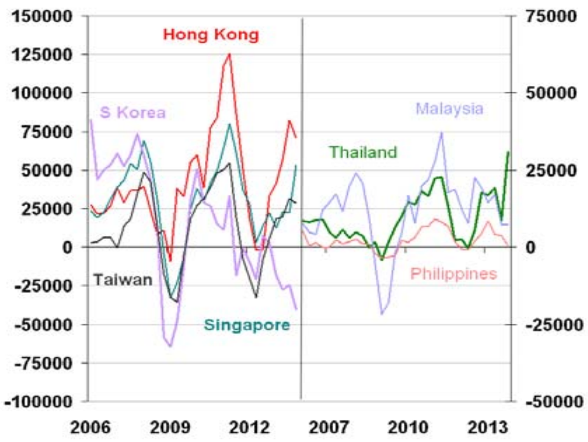
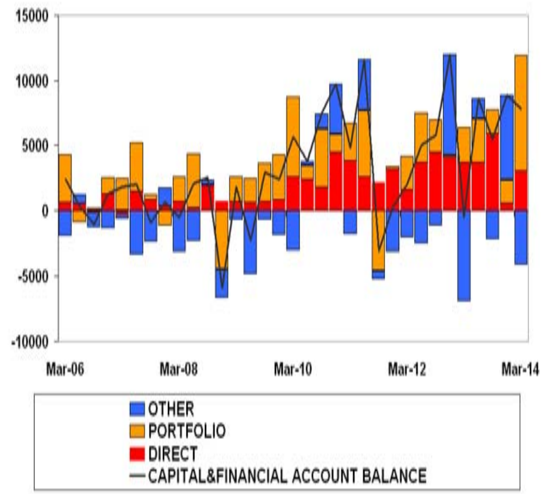



**Table 2: Current account balance/GDP %**

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Hong Kong | 3.1 | 3.3 | 3.9 |
| Indonesia | -3.3 | -3.0 | -2.7 |
| Singapore | 18.4 | 17.7 | 17.1 |
| Taiwan | 11.7 | 11.7 | 10.9 |
| Thailand | -0.7 | 0.2 | 0.3 |
| Malaysia | 3.8 | 4.0 | 4.0 |
| S Korea | 5.8. | 4.4 | 3.5 |

**Figure 16: Indonesian external accounts US$**



# Monetary and exchange rate conditions

- Given the focus of regional central bank policy on maintaining price stability, the general absence of much upward pressure on inflation and the sub-trend pace of regional economic growth, it is hardly surprising that policy interest rates are generally low and stable. Real interest rates are near zero across the region.
- Some regional economies have set clear inflation target ranges for their central banks and the latter use interest rates to hit the target.  Inflation remains within or even below its target range in South Korea and Thailand – so there is no need to start lifting rates in either. Core inflation in Thailand is 1.8% and the target range is ½ to 3%.  South Korean CPI inflation was 1.7% yoy in May, below the 2½ to 3½% target range.
- Malaysia is different – it has no numerical inflation target and problems are mounting. Increases in administered prices have contributed to the rise in Malaysian inflation but after Bank Negara's May warning that the prolonged period of  low interest rates is leading to financial imbalances, there is concern the central bank might start tightening policy from July.
- Singapore and Hong Kong use their exchange rates to achieve price stability.  Hong Kong has its long-standing currency peg to the US$ while Singapore uses movements against a trade-weighted basket to bear upon inflation. Facing rising domestic cost pressures, the MAS plans to continue appreciation of the Singapore dollar.

**Figure 17:  Central Bank Policy rates**

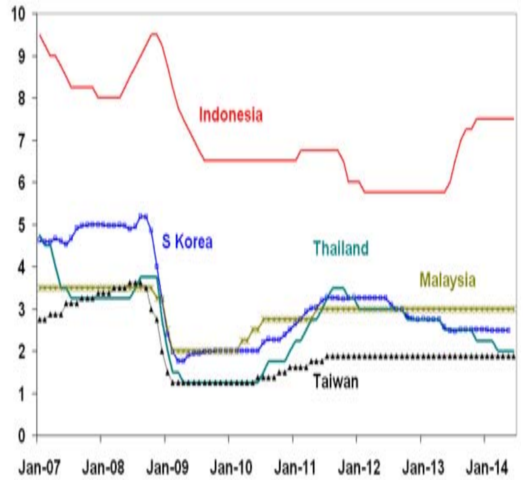



**Figure 18:  Regional real interest rates & growth**

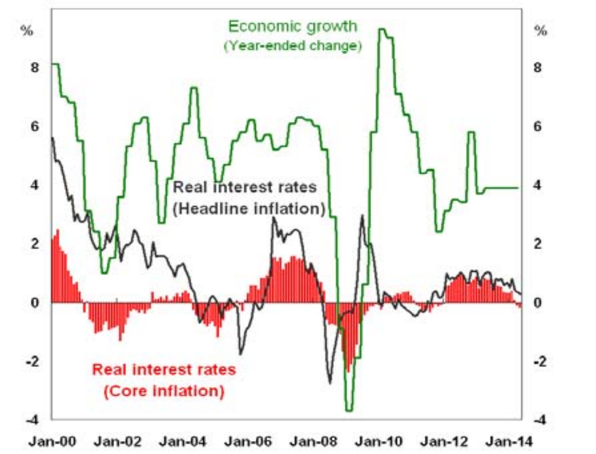



**Figure 19:  Rupiah per US$**

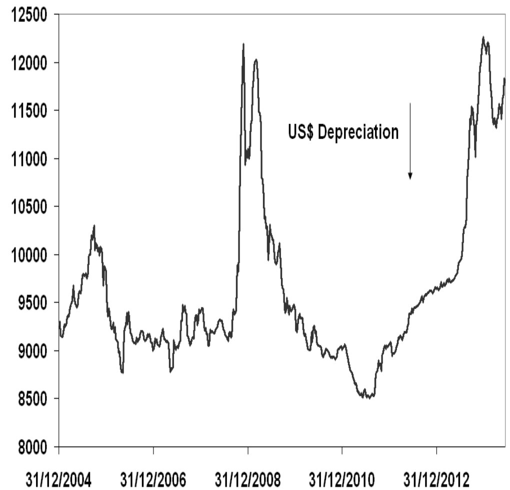
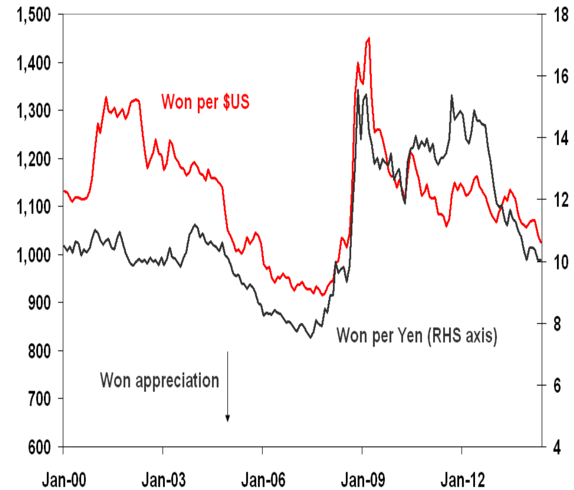



**Figure 20:  S Korean Won per $US**



# Indonesia

- Indonesia has been one of the strongest performers in the region when it comes to economic growth but this has partly been at the price of above-target inflation and the increased vulnerability to global financial market instability associated with running a current account deficit. Fortunately, the Indonesian authorities are well aware of these risks and they are trying to manage them.
- Indonesian economic growth has been primarily driven by domestic demand with consumer spending and fixed investment generally accounting for most of the increase in GDP. Recent monthly data shows solid growth in retail sales and buoyant consumer confidence.
- A combination of Rupiah depreciation boosting import prices with a big increase in household fuel prices (as subsidy payments were cut) triggered a jump in headline CPI inflation from under 4% in early 2013 to around 7½% yoy in early 2014. Core inflation has been more stable, remaining around 4½ to 5% yoy. CPI inflation has exceeded Bank Indonesia's 3½ to 5½% target band for 2014, causing a series of interest rate rises through the latter half of last year.
- The current account also moved into a sustained deficit for the first time in many years – but it has narrowed recently – and short-term portfolio capital has been coming back into the country after leaving it in 2012 when there was a move toward greater risk aversion in global financial markets.

**Figure 21: Economic growth ppts yoy**

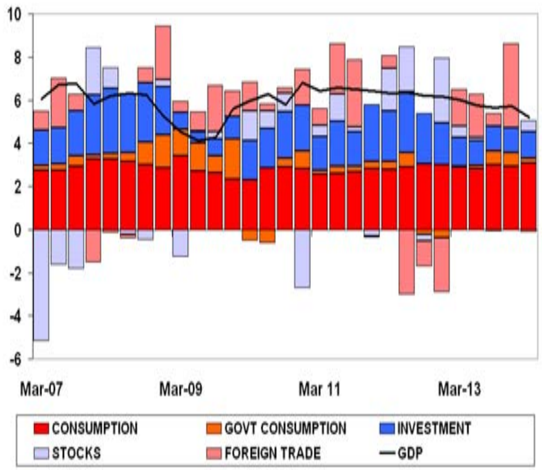



**Figure 22: Inflation % year on year**

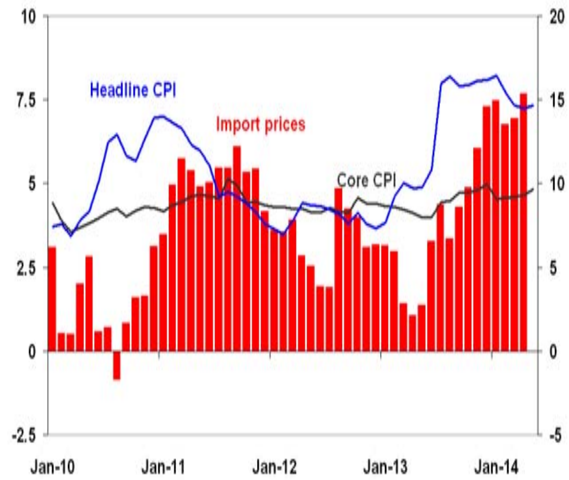



**Figure 23: Current account balance**

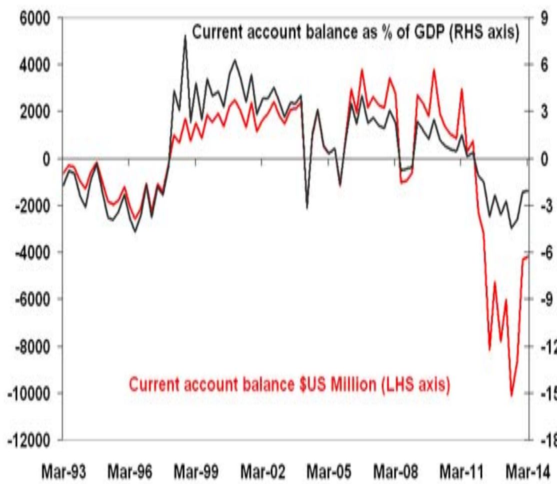
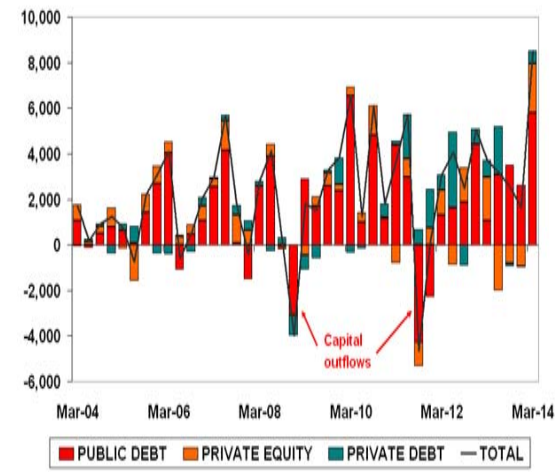



**Figure 24: Portfolio capital US$M Quarterly**



# South Korea

- South Korean growth has been running at an annual rate of around 4% and this growth is now quite broadly-based with substantial contributions from household consumption, fixed investment and foreign trade.  The monthly economic data shows growth picking up through late 2013 and early 2014 in industrial output as well as export and import volumes. Capacity utilisation in manufacturing is running at very high levels as is business investment in equipment. Against this, retail sales are flat and consumer sentiment is weak.
- Despite these positive figures, business sentiment remains surprisingly soft in South Korea.  The detailed results of the Bank of Korea and Federation of Korean Industry surveys are not pointing to any acceleration in the pace of growth and our forecast is for South Korean economic growth to remain just under 4% through 2014 and 2015.
- South Korean heavy industry is an important customer for Australian resource exporters.  Monthly steel production has climbed back in recent months to the 6 million tonne peak seen in 2012.  However, growth in output has exceeded growth in shipments and steel inventories are accumulating.  As a result, the sector’s stock to sales ratio has been rising quite rapidly and it rose to well above its historic average through the first four months of 2014.

**Figure 25:  Economic growth ppts yoy**

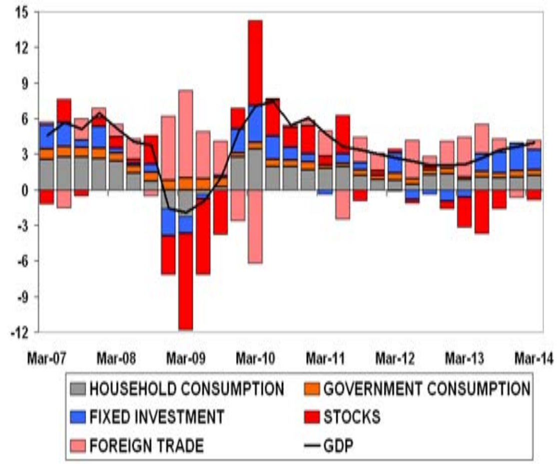



**Figure 26:  Business survey activity readings**

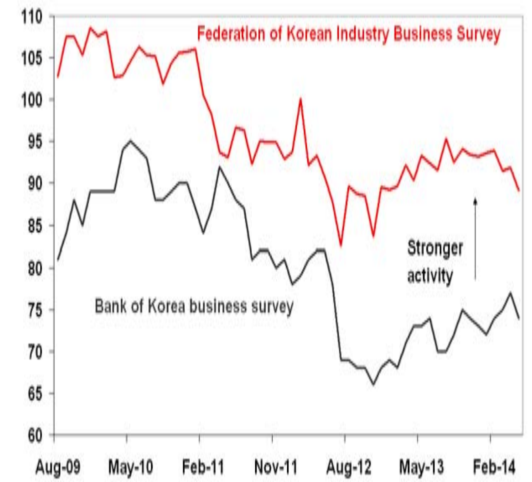



**Figure 27:  Trade and output volumes % yoy**

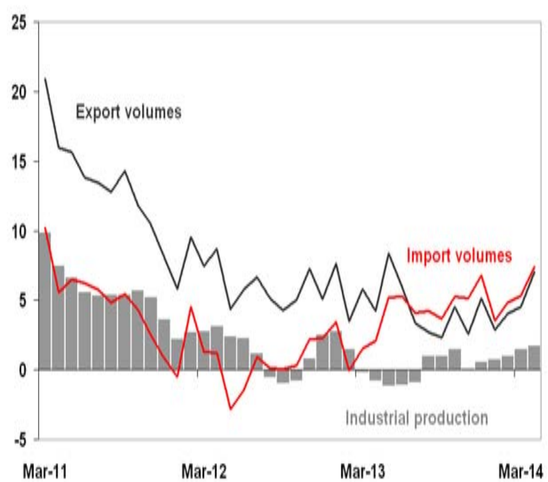
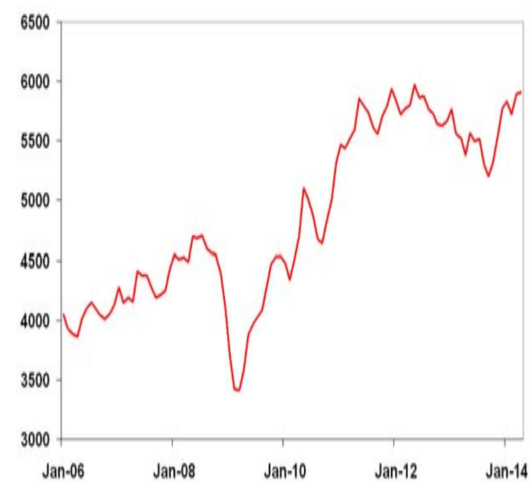



**Figure 28:  S Korean monthly steel output kts**



# Australian exports to emerging market East Asia

- The emerging market economies of East Asia accounted for over one fifth of Australian merchandise exports in the opening months of 2014. That share has been trending down through the last 15 years as China's has increased.
- The evolution of the $A value of Australian exports to the Asian emerging market economies has tended to parallel the disappointing record of shipment values to Japan rather than the growth seen in Chinese purchases. Exports to the Asian emerging markets were worth $56 billion in the year ended April 2014, well above the $53 billion recorded in the year ended June 2013 but below the $60+ billion recorded through much of 2011 and 2012. Recent monthly data shows a pick up in export earnings but they remain 10% below their 2011 peak values.
- Australian exports to these economies are dominated by commodities with the $A10 billion in sales of coal and iron ore to South Korea and the $A4½ billion sales to Taiwan accounting for a third of 2012/13's $A47 billion total goods exports to the region. This product concentration explains the time profile of export receipts from the region – it mirrors Australian bulk commodity prices.
- The near doubling in exports to Singapore between early 2013 and 2014 is the stand-out feature in exports to individual markets. Petroleum products and gold accounted for $A3½ billion of 2012/13's $A6½ billion in total exports to Singapore.

**Figure 29: Goods exports 3mths to April 14**

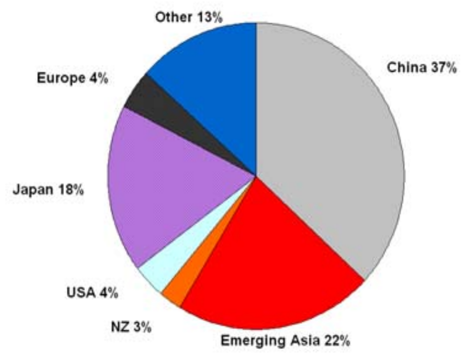



**Figure 30: Monthly exports $A Million**

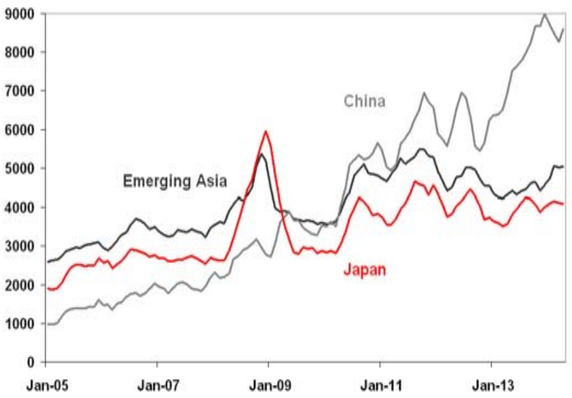



**Figure 31: % change exports Jan-April 13/14**

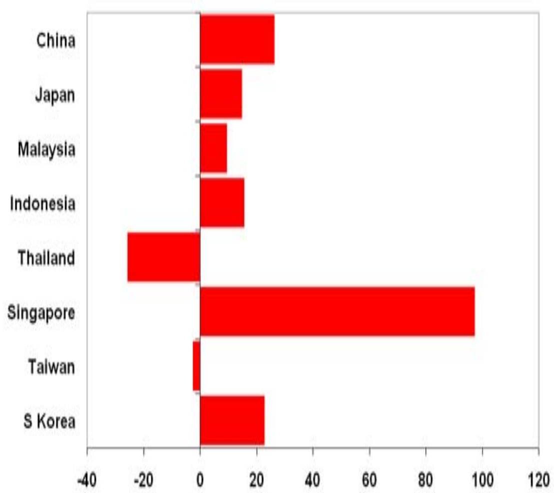
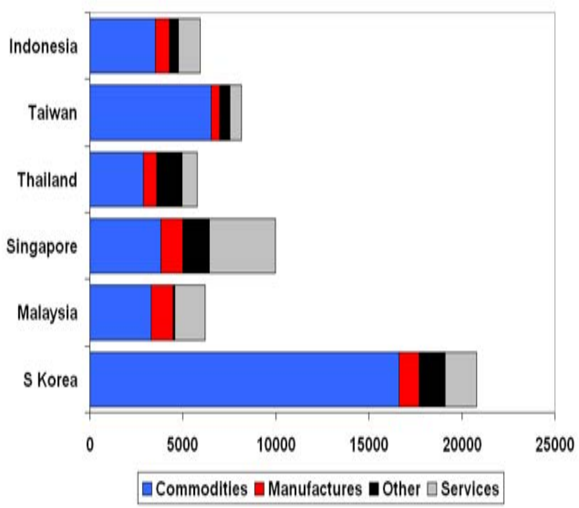



**Figure 32: Export composition 2012/12 $A**

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