

ASIA MONTHLY

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Topics China embarks on experimental issue of municipal bonds

China's Ministry of Finance has decided on a trial basis, to issue municipal bonds by local governments in selected areas. The issue of municipal bonds will realize both benefits and problems.

China lifts ban on municipal bonds

On October 20, 2011, China's Ministry of Finance released a statement to the effect that it had selected Shanghai municipality, and the provinces of Zhejiang, Guangdong, and the city of Shenzhen (Guangdong) as the locations for the trial issue of municipal bonds. According to the communiqué, the four local governments were to begin issuing bonds from the next month, November, for the purposes of fund allocation to public welfare projects.

There will be restrictions on 1) the scale of bond issue, 2) maturity dates (bonds will be available in three and five year tranches only), 3) a prohibition on carrying the bonds over into the following year, and so on, from which it can be inferred that central government is keen to maintain control on local government debt. The announcement also specified the methods of repayment of principal and interest by the Ministry of Finance. In spite of these restrictions, the announcement is believed to be linked to a policy switch away from the current policy, which calls for the principle of local governments' formulation of balanced budgets, and the prohibition bond issue (Budget Law Article 28). The move may be interpreted as a first step towards allowing local governments to issue bonds at their own discretion.

Background to the decision and expected effects

As for the reasons behind the decision to allow the trial issue of municipal bonds, the following two points can be made. First, the "Local Government Financing Platforms" system is facing difficulties.

Under the operation of the current system, since there is no clear regulation within the text of the law covering local governments' direct loans from financial institutions, it is assumed that this is, in actuality, not accepted. Also, under China's Security Law, with the exception of the sub-lease of credit funds from foreign governments and international organizations, government organizations may not become guarantors.

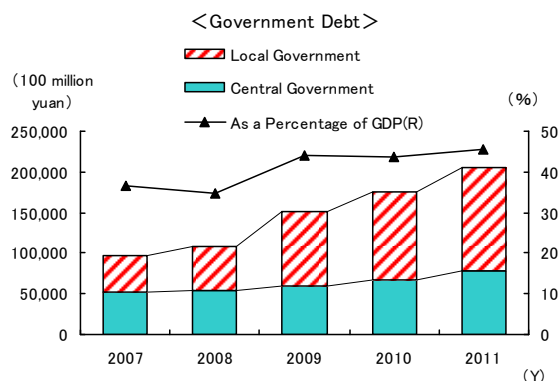
To avoid contravening these legal provisions, some local governments have established companies known as Local Government Financing Platforms, for the purpose of raising funds (some are also involved in infrastructure construction and management). These Local Government Financing Platforms raise capital by lending and issuing bonds, and also assume responsibility for repayment. Also, the local governments do not stop at initial investment upon the launch of the Local Government Financing Vehicles, but are also thought to have injected additional treasury funds and provided collateral, as needed (Jing Zhi-hong, The Study of Local Government Debt Management).

The local government debt total, including those amounts held by Local Government Financing Vehicles, increased rapidly from 5.6 trillion yuan in 2008 to 9.0 trillion yuan in 2009. At the time, economic stimulus measures worth some 4 trillion yuan had been implemented, of which central government's tab was only 1.18 trillion yuan, with at least 1.25 trillion yuan of the remainder borne by local governments in investment projects. At that time, local governments were raising funds aggressively through the Local Government Financing Vehicles, and carried out public works projects at a scale well above what had originally been

<Municipal Bonds in Selected Areas>

	Total Amount	The Date of Issue
Shanghai	7.1 billion yuan	November 15, 2011
Zhejiang	6.7 billion yuan	November 21, 2011
Guangdong	6.9 billion yuan	November 18, 2011
Shenzhen	2.2 billion yuan	November 25, 2011

Source: CHINA CENTRAL DEPOSITORY & CLEARING CO., LTD's website



Note: 2011 figures are based on the budget draft and the same pace of increase of local debt

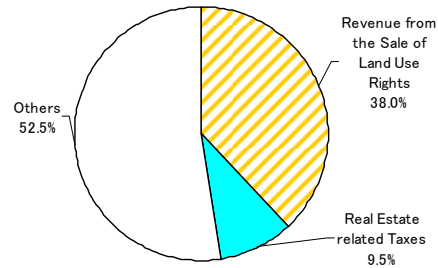
Source: Budget draft and CEIC database

envisaged.

While this series of initiatives may be said to have contributed to economic recovery and infrastructure development, it may also be said to have had a negative impact on government finances overall. In addition, as tighter monetary policy subsequent to economic recovery made it more difficult for Local Government Financing Vehicles to procure capital and to repay debt, poor transparency with regard to the details of their business has amplified nervousness over debt default. It would appear that the Local Government Financing Vehicle system may be difficult to continue, and that a new system will need to be implemented.

The second point is the breakaway from an over dependence on real estate in terms of government revenue. Local government independent income can be divided largely into the two categories of budgetary income (such as tax revenues), and government funds. Total revenue 2010 was worth 7.4219 trillion yuan, of which revenue from the sale of land use rights, which is included in government funds, totaled 2.8198 trillion, 38.0% of the total. Further, contract taxes (from real estate transactions) and other real estate related tax revenues were 702.6 billion yuan, 9.5% of the total, making tax revenue from real estate transactions about half of the value of independent revenue sources.

<Composition of the Local Government Revenue>
(2010)



Note: Real estate related taxes include 6 items such as contract tax, etc.
Source: Ministry of Finance

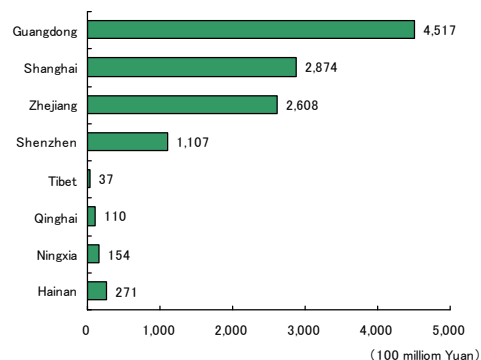
In such a situation, with an over-dependence on real estate, a sudden drop in real estate prices, or a significant contraction in the number of real estate transactions, would surely spell a serious drop in financial revenue for local governments.

Given the foregoing, the benefits that may be expected from the issue of municipal bonds are mainly 1) greater transparency in capital procurement, and 2) the securing of potentially major sources of independent income other than real estate. With regard to the former, it may be expected that, as the number of market transactions accumulates, the principles of competition will begin to take effect among local governments, leading to reductions in wasteful expenditure and gradual progress in attempts to improve fiscal discipline. As regards the latter, total transfers of financial resources from central government (2010) were 3.2341 trillion yuan, lower than the combined total of revenue from the sale of land use rights and real estate related taxes, so there are high expectations that the issue of municipal bonds will reinforce local governments' revenue bases.

■ The securing of other sources of revenue is indispensable

Nevertheless, there is only a very slight possibility that the ban on municipal bonds will be completely lifted in the short term. The areas selected this time, Shanghai, Guangdong and Zhejiang, are among the top rank of the 31 provinces, autonomous regions and direct-controlled municipalities, in terms of revenue. Shenzhen is not at province level administratively, but ranks with the top provinces in terms of revenue. As long as significant disparity exists in terms of annual revenue, the expansion of trial run candidate regions must be undertaken with the utmost caution. Hasty expansion might well lead to the excessive issue of municipal bonds and the deterioration of fiscal discipline.

<Revenue>
(2011)



Note: The figures do not include government funds and transfers from

Local governments will need to understand that the issue of municipal bonds as just another tool at their disposal, and to continue to explore other avenues, such as their own measures to increase taxation revenue, and a review of how finance is transferred from central government.

(Junya Sano)

Taiwan Export deceleration worsens, economic future is unclear

■ Europe-bound exports fall in November

Taiwan's real GDP growth rate in the period July to September, 2011, compared to the same period in the previous year, was 3.4%, down from 4.5% (revised) in the previous period (annually adjusted growth rate compared to previous period minus 0.6%). Private sector consumption grew at a steady 3.1%, while export growth slowed to 2.1% and total fixed capital formation was minus 10.7% (private sector minus 11.9%). In terms of supply side items, manufacturing's slide to 3.7% growth, down from 6.9% in the previous period, had a significant effect.

Recent figures show that export growth (customs cleared basis) slowed dramatically in November to just 1.3%, compared to the

same month in the previous year. Exports to China and Hong Kong, which account for around 40% of the total, fell to minus 2.5%, those to the US to minus 3.1%, while exports destined for Europe plunged to minus 21.9% growth. In terms of individual export items, electronic products, which account for about 40% of the total, fell to minus 1.5% growth and information and telecommunications equipment, which accounts for 7%, fell to minus 4.2%, below the previous year's level. Also, precision instruments (including liquid crystal displays), which again account for 7%, could only manage 0.6% growth. The poor growth in precision instruments exports reflects the lull in global demand for flat screen televisions and slow sales of personal computers, and though information and telecommunications equipment exports managed to sustain double digit growth until October, it should be noted that there may well be a sharp dip in November's figures.

■ Concerns over possible severe deceleration in exports and employment adjustment

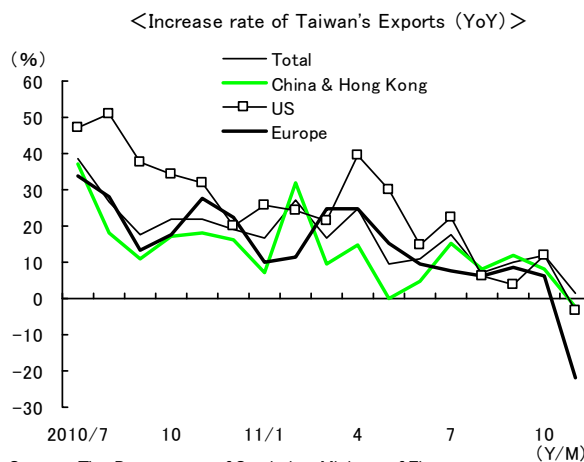
Concerns in the near future are that export growth will decelerate even further, and that full scale employment adjustment will begin. As the economic situation in Europe deteriorates, exports destined for that region will fare poorly in the interim, and there is a possibility that exports to China (whose biggest export partner is the EU) will also slow even further. Since many Taiwanese firms have relocated their production facilities to mainland China, poor global demand is making itself felt in terms of slow growth in exports to China.

The unemployment rate (seasonally adjusted) rose slightly from 4.27% in September to 4.30% in October, and among exporters there are a growing number of companies implementing an unpaid leave system (as of November 1, 12 companies, increasing to 48 by November 16, and 85 by December 1). These and other developments are indicators of a worsening employment situation. If further deceleration in export growth is accompanied by production adjustment, it will likely be impossible to avoid layoffs. Also, as year end bonuses are likely to be smaller this year, it is feared that consumption impetus will be blunted.

In response to the economic deceleration, the government announced a package of emergency economic stimulus measures on November 7, including 1) corporate liquidity support, 2) export promotion, 3) accelerated infrastructure development, and 4) measures to attract tourists. Presidential elections are slated for January 14, 2012, and President Ma Ying-jeou is seeking re-election. With Democratic Progressive Party candidate Tsai Ing-wen hot on his heels, it seems probable that there will be further economic stimulus measures. Also, since commodity prices are holding fairly steady, with the consumer price index increase rate in the 1% range, there may very well be a reduction in interest rates.

Given the foregoing, it will be necessary to keep a close watch on Taiwan's political and economic developments in the months to come.

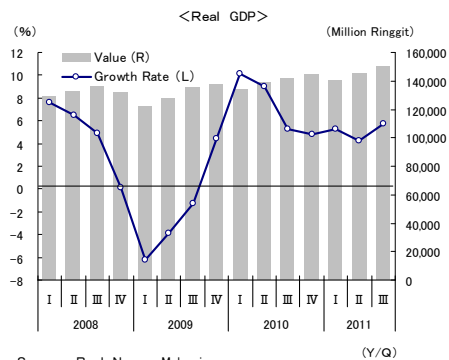
(Hidehiko Mukoyama)



Malaysia Sustaining growth and improving standards of living

■ Economy continues to expand

Malaysia's real GDP growth rate in the period July to September was a strong 5.8%, compared to the same period in the previous year, well up on 4.3% growth for April to June, in spite of concerns about the impact of slow economic growth among the developed countries, and the economy has continued to grow. In October, although exports of electrical equipment and electronic parts and components, which are major export items, were at minus 14.9% compared to the same period in the previous year, exports overall were up 17.0%, similarly, worth \$20.683 billion, due to increased exports of petrochemical products, natural rubber and palm oil. The manufacturers' production index for electronic and electrical equipment fell minus 1.2% in the same period, but the index for ferrous and non-ferrous was up 15.3%, similarly, and for petrochemical products up 8.9%, which boosted the indices overall to 6.1% growth.



Source: Bank Negara Malaysia

The government, in anticipation of further slowing in the economies of the developed countries, has prepared a budget that estimates a 45.9 billion ringgit deficit (4.7% against GDP), and is aiming to achieve economic growth of between 5% and 6% in 2012, due to expanded domestic demand, principally in public investments.

■ 2012 policies to focus on growth and stability

The overall picture of 2012's policies was made clear with the October announcement of the fiscal 2012 budget.

Prime Minister Najib presented the budget with the theme of "National Transformation Policy: Welfare for the Rakyat, Well-Being of the Nation", focusing on five main areas: 1) accelerating investment, 2) generating human capital excellence, creativity and innovation, 3) rural transformation program, 4) strengthening the civil service, and 5) easing inflation and enhancing well-being of the Rakyat.

In order to accelerate investments, some 49.2 billion ringgit will be injected into the infrastructure development of railways, roads and airports. Furthermore, up to 100% foreign capital participation will be allowed in 17 service sectors, such as hospitals, design, accounting, distribution, education, and telecommunications. In order to develop the Kuala Lumpur International Financial District Plan, eligible multinational corporations will receive tax breaks such as lower income tax rates and exemption from remittance tax. Malaysia has been participating in TPP (Trans-Pacific Partnership Agreement) talks, and 2012 is expected to be a year in which there will be much hurried preparation domestically, in the runup to the expected implementation of the agreement. For the development of human capital and the rural transformation program, as well as improving systems and developing related infrastructure, the involvement of private sector capital in both sectors will be strengthened.

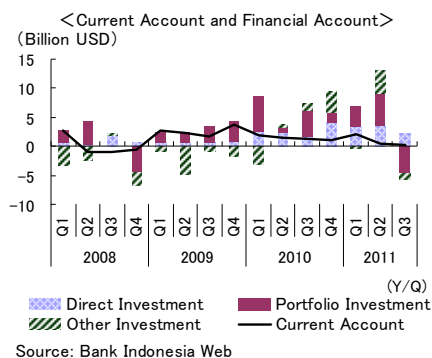
In order to improve the civil services, on the one hand, civil servants' pension payments will be increased and the compulsory retirement age raised and higher allowances will be paid to workers on special duty, but on the other hand, a New Civil Service Remuneration Scheme (SBPA), which will incorporate the principles of competition, will be implemented from January 1, 2012. In terms of inflation curbs, government subsidies will be used to stabilize the prices of staple items such as rice, sugar, cooking oil, wheat and fuel. Furthermore, in order to improve the people's standard of living and welfare provision, the living allowance paid to low income earners will be increased, and housing construction accelerated. In addition, there are plans to make considerable portions of the budget available for measures such as welfare support for taxi drivers and measures to help the homeless. The stronger emphasis on measures to support those earning low incomes is believed by some to be due in part to the fact that elections are coming up in March, 2012, but it should be noted that, with a per capita GDP of over \$8,000, Malaysia is rapidly shifting towards becoming a welfare state. However, attention must be paid to the fact that government debt is now 55% against GDP, fast approaching the 60% mark said to be a dangerous level for a developing country, and hastily implemented welfare provision expansion carries with it considerable fiscal risk.

(Keiichiro Oizumi)

Indonesia *Optimistic mood boosts private consumption*

■ Central Bank anticipating 6.5% growth for 2011

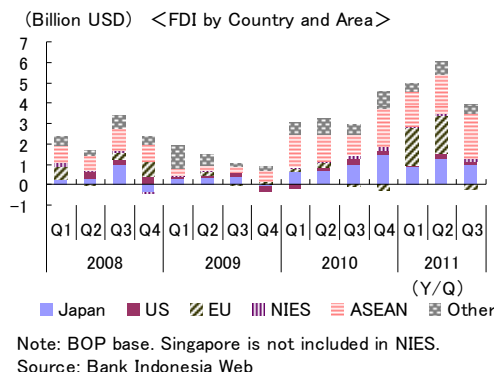
With no end in sight to the debt crisis in the eurozone, Indonesia's portfolio investment in the third quarter, July to September, changed to deficit growth for the first time since the Lehman Brothers' collapse, and both share prices and the rupiah continued to depreciate. However, share prices managed to rally over the short term and the brakes are now being applied to the rupiah's slump. Central Bank is anticipating economic growth of around 6.5% for the period October to December, and predicts an overall economic growth rate of 6.5% for 2011. A mood of optimism over the future prevails throughout the private sector, and in a forecast survey of macro-economic indices, many economists are predicting economic growth rates of 6.4% for 2011, and 6.8% for 2012.



The growth drivers will be private consumption, investment and exports. In particular, private consumption, which accounts for 60% of GDP, is strong. The consumer price index increase rate for November was up 4.2% compared to the same period in the previous year, and has been falling fairly consistently monthly from 7.0% at the beginning of the year. Meanwhile, the consumer confidence index (a score of 100 or over indicates favorable consumption sentiment) in October was 116.2, and has continued to rise slowly since the beginning of the year. August's unemployment rate was 6.56%, 0.58% points down on the same period in the previous year. Growing expectations of stable commodity prices, improved employment, and growing incomes are bolstering private consumption.

■ Investments and exports growing solidly

Meanwhile, there are signs of a slight cooling in investments. Central Bank's business survey and the Central Statistics Bureau's (BPS) business confidence index, showing the state of corporate appetite for business expansion in the period October to December, were both down in comparison with the figures for July to September. However, expansion appetite is still at a fairly high level and there is no worry that there will be an immediate drop in investments. The same thing can be said of foreign direct investment. If the international balance of payments' foreign direct investment balance is examined by country and region, it can be seen that investments from the EU, which supported investment growth in the first half of the year,



changed to negative growth in the third quarter, July to September. However, investments from ASEAN and Japan remain solid, and this and the announcement that Qatari government funds would be conducting investment for the purposes of the development of natural resources mean that a certain level of direct investment can be expected to continue for the foreseeable future.

Exports are currently performing strongly. In October, exports (flash report basis, includes tariff-free zones, so figures may differ from end of year reports) felt the effects of the falling price of crude oil, and crude oil and gas were down 26.3%, \$2.9 billion, and could only grow 4.2% compared to the same period in the previous year, at \$16.8 billion. Non petroleum and gas exports maintained a 2.2% growth momentum, at \$13.9 billion. In the period January to October, non-petroleum and gas exports increased 34.9%, compared to the same period in the previous year, at \$169 billion, with those to China \$17.1 billion (up 61.4%), to Europe \$17.1 billion (up 26.4%) and to the US \$13.2 billion (up 11.9%). Even if exports to Europe and the US should slow, it is expected that exports to China will be able to take up the slack.

(Yuji Miura)

China 2012 basic economic management was set

■ Sense of uncertainty increases and coordination to take time

The three-day Central Economic Work Conference was held from December 12 to 14. The Conference is held every year in early December in order to set the economic management policy for the following year, and to determine priority items to be tackled. According to the government website that can trace back to 1995, this year's Conference dates were the latest in the month so far. Considering the fact that Japanese Prime Minister Noda's visit to China, which had been scheduled for December 12 and 13, was postponed at the last minute at the request of the Chinese side, there is a strong possibility that it may take some time to coordinate the opinions of the leadership.

Recent economic indices show that exports for November were up 13.8%, compared to the same period in the previous year, maintaining growth in the 10% range. Exports to EU grew 5.0%, similarly, staying positive at least, but at the China Import and Export Fair, which wrapped up on November 4, contracts for export to Europe and the US were worth less than the figures posted in spring, and there is no room for an optimistic view of the future.

In terms of domestic demand, investment in fixed assets (excluding rural households) for the months January to November grew 24.5%, compared to the same period in the previous year. Thus, while the pace of growth is slowing some what, it is still at a reasonably high level. With prices settling (November's CPI grew 4.2%, compared to the same month in the previous year), total retail sales managed to make a comeback. However, there have been negative factors, such as the fact that automobile sales were lower than the previous year's figures for two consecutive months, and that the "household appliances in rural areas" plan (where measures were implemented in order to stimulate the purchase of household appliances in rural households) is coming to a gradual close.

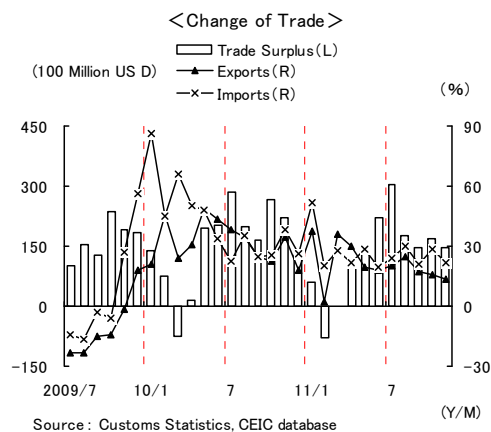
The overall result of these developments is that the economy is now in a phase where opinions may be easily divided as to whether to continue with a tight monetary policy from a mid to long term perspective, or to introduce an easier monetary policy in order to secure short term growth.

■ Keywords are steady growth and fine tuning

Given these circumstances, the Central Economic Work Conference described the economic management policy for 2012 in terms of both sustaining economic development and stabilizing commodity prices. In 2011, the stabilization of prices was set as a priority action item, and there appears to be a change in the basic stance, from restraining inflation to securing stable growth. At the same time, the new expression "consistent economic growth" was used.

In terms of fiscal and monetary policy, the Conference spoke in terms of "continuing its proactive fiscal policy, and prudent monetary policy". Although the wording is the same as that used in the previous year, there has been an increase in the number of initiatives aimed at bolstering the economy. In particular, in terms of monetary policy, reference was made to "appropriate advance adjustment and fine tuning in accordance with the economic situation", implying possible further easing of monetary policy (on December 5, the deposit reserve requirement was lowered for the first time in three years).

Whether to secure steady growth through fine tuning, or take measures to prevent a rekindling of economic overheating: in the runup to the National Congress of the Communist Party of China in the autumn, Hu Jintao's administration will need to be very careful in making the correct judgements and in the execution of policy.



<Main Points of The Central Economic Work Conference>

Decisions	Contents
Basic Economic Management of 2012	Maintaining stable and relatively fast economic development, and stabilization of prices
Fiscal & Monetary Policy	Maintaining proactive fiscal policy, and prudent monetary policy In monetary policy, appropriate advance adjustment, and fine tuning in accordance with the economic situation
Consistent Economic Growth	Continue to increase domestic demand and maintain external demand, and the conquest of internal and external instability and uncertainties

Source: Chinese Government's official site

(Junya Sano)