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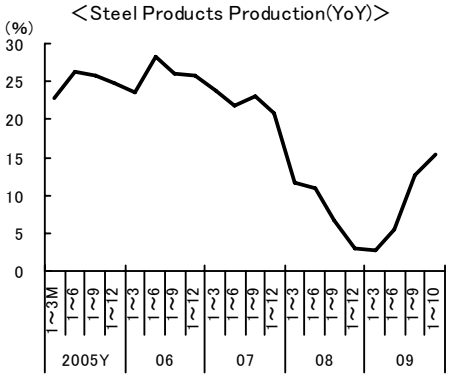
# Topics Construction investment powering China's iron and steel production

In China, production of iron and steel is recovering, mainly due to increased investment in construction. In the months to come, with strong construction investment, iron and steel production looks set to maintain high levels.

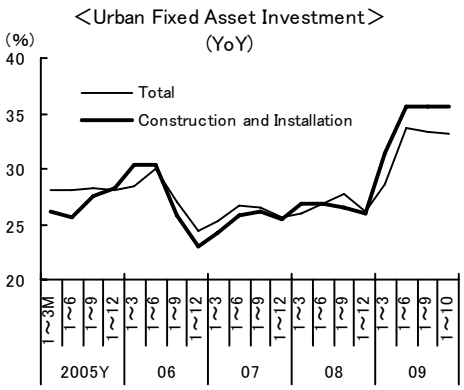
## ■ Iron and steel production recovering

China's economy is leading the world in terms of recovery. In particular, not only has automobile production increased rapidly, but the production of raw materials has recovered at the same outstanding pace as the automobile industry.

China's Steel Products Production fell to just 3.6% growth in 2008, compared to the previous year, but the slump appeared to bottom out by early 2009, switching to recovery, and in the period January to October, 2009, managed a whopping 15.4% growth, compared to the same period in the previous year.



Source: *China Monthly Economic Indicators (various months)*



Source: *China Monthly Economic Indicators (various months)*

Three main reasons may be given for the recovery in iron and steel demand. First, there has been an expansion in construction investment. Completed Investment in Fixed Assets in Urban Areas accounts for some 90% of all investment worth. Around 70% of urban fixed asset investment is accounted for by Construction and Installation, which grew by 35.7%, compared to the same period in the previous year, in the period January to October, 2009, against a backdrop of rising demand for housing and 4 trillion yuan worth of economic stimulus measures, increasing its pace of growth from 31.4%, similarly, in Q1, January to March, 2009. In China, about 50% of steel products goes to construction, so the accelerated pace of construction investment growth has an exceptionally powerful impact.

Investment in housing is at the core of construction investment. China Monthly Economic Indicators, issued by the National Bureau of Statistics of China, lists the Floor Space Completed of Buildings Constructed. Though the statistics present some problems in that 1) they do not include civil engineering works, which account for about 30% of the construction industry's production value, and 2) they are issued much later than the actual construction projects, so it is difficult to gauge current iron and steel demand, they are nevertheless useful in providing a breakdown of construction projects. According to these statistics, total completed construction area in the period January to September, 2009, was up 9.6%, compared to the same period in the previous year, and has been on the way to recovery since early 2009. In terms of types of construction, Residential Building Construction was up 11.2% in the same period, Factories and Warehouses 0.6%, similarly, Office Buildings up 13.0% and Buildings for Education up 15.6%. In terms of contribution to the total, Residential Building Construction's contribution was 6.6%, and was a clear driver of overall growth .

Second, there has been an increase in the production of durable consumer goods, along with the expansion in consumption. The proportion of steel demand accounted for by automobiles and household appliances is small, at less than 10%, but the production of many of these goods has been ramped up in short order, in response to the implementation of consumption stimulus measures. Motor Vehicle Production in the period January to October, 2009, was up 37.5%, compared to the same period in the previous year, thanks to rapid increases in sales encouraged by automobile tax reductions and the government's trade-in subsidy policy. Household Refrigerator Production also was up a huge 16.7% in the same period, boosted by the government's program of subsidizing the purchase of household appliances in rural communities.

Third, machinery related exports have rallied somewhat. China's machinery exports bottomed out in Q1, January to March, 2009, and have been recovering since then, and the demand for iron and steel used

in their production is also believed to have expanded. China's manufacturing industry depends in some respects upon imports of parts and components and raw materials, but there is still much that is procured within China.

On the other hand, exports of iron and steel continue to fare poorly. Steel exports in the period January to November, 2009, were minus 62.1%, compared to the same period in the previous year, which represents a significant decrease when compared with the minus 54.9% recorded for January to March, 2009. The scale of iron and steel exports is comparatively small, representing only 10% of production, so the impact of a decrease in export is not big. Further, around 20% of steel products demand is for machinery and equipment (excluding automobiles and household electrical appliances). Purchase of Equipment and Instruments in Urban Areas grew 26.7% in the period January to October (yoy), a slightly slower pace than the 29.9% in January to March (yoy), but still maintaining a high year on year growth of over 20%.

**■ Demand for iron and steel expected to continue fairly strongly**

China's demand for iron and steel is expected to increase, based on the following five points. First, there is the continuation of four trillion yuan worth of economic stimulus measures. Of that four trillion yuan, the government's portion is RMB1.18 trillion, with RMB104 billion earmarked for investment in October to December, 2008, RMB487.5 billion in 2009 and RMB588.5 billion in 2010. Accordingly, the four trillion yuan economic stimulus measures are expected to support an increased demand for iron and steel for use in construction in 2010.

Second, there is the migration of rural workers into the cities. The Eleventh Five Year Plan estimates that, in the years between 2006 and 2010, some 45 million people will have migrated from rural communities into the cities. This works out at around 9 million people per annum. The influx of people into the cities will surely lead to an expansion in housing demand and urban infrastructure, such as underground railways, etc. At the same time, this migration will also have a positive effect on iron and steel demand for construction, as railways and other infrastructure linking rural communities and cities is developed.

Third, there is the reform of the household registration system. With the migration of people from rural communities into the cities, the urban permanent resident population in 2008 had grown by 150 million people, compared to the figures for 2000. As a result, there are many living in the cities without city household registration. For example, the permanent resident population of Shanghai in 2007 was 18.58 million, which is 4.79 million in excess of those who actually have city household registration (13.79 million). Since 2009, 10 major cities, such as Shenzhen and Shanghai among others, have begun easing the conditions for obtaining city household registration. Due to the attendant advantages in medical treatment, education, labor insurance, employment, social security, and so forth, it is expected that there will be an increase in those applying for city household registration. As these people gain permanent resident status of the cities in which they live, they will also be likely to begin thinking about purchasing their own homes.

Fourth, the government of China will increase the housing supply to curb real estate prices. In the period Q3, July to September, 2009, real estate prices in 70 major cities grew by 1.9%, compared to the same period in the previous year, up from minus 1.1% in the period Q1, January to March, rising to a higher level than before the financial crisis and giving rise to growing fears of a real estate bubble. Increased housing supply will contribute to greater stability in real estate prices and it is likely, therefore, that the government will continue with this as a priority measure.

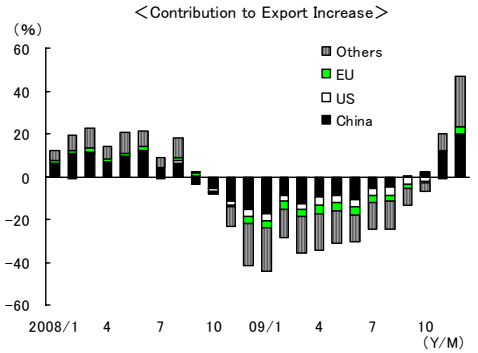
Fifth, consumption of durable consumer goods has stayed fairly strong. This is due not only to rises in wage levels, but also to the fact that the government will continue (and increase) its current consumption stimulus measures through 2010. For example, in subsidy policy, the subsidy granted for purchasing a replacement automobile has been doubled. Also, in the Appliances in Rural Households subsidy program, which is aimed at encouraging rural householders to purchase electrical household appliances, it has been decided that the upper price limit on applicable items should be raised by a significant amount. Accordingly, it is thought that iron and steel demand for the manufacture of automobiles and household appliances is likely to increase further.

From the foregoing, it may be expected that China's iron and steel production will maintain high and steady levels of growth, mainly along with increased construction investment. **(Shinichi Seki)**

# Taiwan *Economic ties with China become ever closer*

## ■ China-bound exports drive export recovery

A recovery in both domestic and external demand helped Taiwan's real GDP growth rate for July to September to improve to minus 1.3%, compared to the same period in the previous year, up from minus 6.9% in April to June. Bolstered by government consumption stimulus measures, private consumption grew by 2.2%, with total capital formation at minus 6.2% and exports at minus 8.5%, a contraction in the rate of decline in both cases. In recent weeks, the manufacturers' production index has recovered to pre-crisis levels, and there are signs of the beginnings of improvement in the employment situation, with the unemployment rate (seasonally adjusted) falling for two consecutive months from October, and the rate of decline in the growth rate in the number of those employed contracting from minus 114,000 in October to minus 41,000 in November.



Source: Department of Statistics, Ministry of Economic Affairs

Taiwan's export dependence is high, so the economy is greatly affected by export performance. Currently, exports to China are the driver of the export recovery (Taiwan's dependence on exports to China and Hong Kong was 39.0% in 2008). In the wake of China's Appliances in Rural Households project, exports to China, principally of liquid crystal displays, semiconductors, and electronic parts and components, began to recover from mid 2009. Part of this is the recoil from the previous year's slump, and December's exports to China were up 96.7%, compared to the same month in the previous year.

## ■ Further easing of restrictions on business with China

Since its inauguration in May, 2008, the administration of President Ma Ying-jeou (Ma Ying-jiu) has attempted to improve relations with China in an attempt to vitalize the economy. Firstly, they have attempted to make the 'Three Linkages' (direct trade, transportation and postal services) a reality, and have relaxed restrictions on Taiwanese firms' investment in China. 2009 saw a series measures aimed at strengthening economic relations with China: on June 30 restrictions on Chinese firms making direct investments in Taiwan were lifted, on November 16 a memorandum was signed regarding mutual investment by Chinese and Taiwanese financial institutions, and an Economic Cooperation Framework Agreement (ECFA) aiming at the abolition of customs tariffs between Taiwan and China was agreed on December 22. As described, efforts to strengthen mutual ties have been increased.

While there are some in Taiwan that view the signing of the ECFA with some trepidation, based on their fears of China's growing influence and the potential impact on Taiwanese businesses, one reason that the Ma administration is working so hard to strengthen cross-Strait relationships is that they are aware of the very real danger of Taiwan's being left behind as Asia's trade liberalization trend picks up pace. The abolition, from January, 2010, of customs duties within the ASEAN region (with the exception of certain sensitive items) and between China and ASEAN has given birth to a free trade zone comprising some 1.9 billion people. There is also a possibility that intergovernmental talks may begin with Korea in the near future. In order to ensure that Taiwanese businesses would not be forced into a competitively disadvantageous position, it was necessary for the Taiwanese government to begin dismantling customs duties with China at an early stage. Another reason is the expectation of Chinese financing. Although the unemployment rate may be said to have started to come down, as of November, 2009, it was still at a high 5.98% (seasonally adjusted). It is believed that the Taiwanese government aims to use increased exports to China and increased investments from China as an opportunity to encourage the growth of employment opportunities.

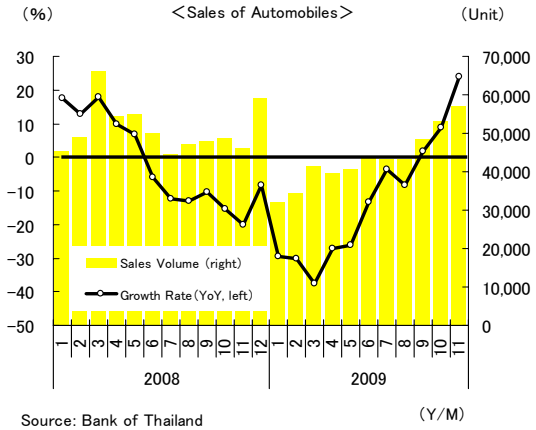
There is every possibility that Taiwan's government will further ease restrictions on business with China (including Chinese enterprises' direct investment in Taiwan) in 2010. As a result, it is expected that economic relations between China and Taiwan will become ever closer.

**(Hidehiko Mukoyama)**

# Thailand *Pace of economic recovery strengthens*

## ■ Growing anticipation of economic recovery

Thailand's exports for November, 2009, were up 17.2%, compared to the same month in the previous year, worth $13.84 billion, converting to positive growth for the first time in 13 months. In terms of export destinations, exports to Japan, the US and Europe performed poorly at minus 2.9%, plus 4.6% and plus 3.2%, respectively, in the same period, while those to China, India and ASEAN grew massively: 77.1%, 27.2% and 22.5%, respectively. 2010 will see the widespread abolition of customs tariffs within ASEAN and between ASEAN and China, and the coming into effect of the ASEAN - India FTA. As a result, exports are expected to grow by 15%, year on year.



Source: Bank of Thailand

While exports have been staging a recovery, the manufacturers' production index rose by 8.9%, compared to the same period in the previous year, in November. Electrical and electronic related industries posted a high 12.3% growth, and transportation equipment industries including automobiles posted 4.8% growth, converting to positive growth after 12 months and a slow transition to recovery. HDD production has risen to its highest ever level and double digit growth is anticipated in 2010, leading to plans for major employment expansion among related companies. Given anticipation that the government will expand preferential measures for the production of eco-cars, the automobile industry is expected to be one of the drivers of economic recovery. Further, there have been major improvements in the employment situation and the unemployment rate fell from 1.7% in May to 1.1% in October of 2009. In response to these developments, the government has decided that the unemployment countermeasures that it implemented immediately after the economic crisis should end in March of 2010.

There are also signs of recovery in domestic demand. November's automobile sales were 57,031 vehicles, 23.8% up compared to the same period in the previous year, recovering to pre-crisis levels. Private sector consumption indices were also up 4.0% in the same period. Bank of Thailand announced that credit card payments had increased in the same period by 7.1%, and that retail markets appeared to have regained some of their former vitality.

## ■ Abhisit administration targets economic recovery in order to secure political and social stabilization

The Abhisit administration recognizes economic recovery as being essential to political stability and it is expected that the government's efforts to stimulate the economy by providing living cost support to low income families and implementing large scale investments will contribute to economic recovery mid-term.

As December's consumer price index increase rate reached 3.9%, compared to the same period in the previous year, and the producer price index increase rate rose to 10.0%, similarly, the government decided to extend measures to reduce the burden of electricity, gas and transportation payments until the end of June, 2010. In addition, from January 1, all provinces raised the minimum wage level to support measures to ease the cost of living. In order to ensure the faster implementation of the Bt1.431 trillion "Strong Thailand" strategy (Thai Khem Khaeng), government bonds worth between 50 to 80 billion baht (approx. $20 billion) will be issued by March.

Though there has been no serious political unrest since April in 2009, the UDD (United Front for Democracy Against Dictatorship) is still involved in anti-government activity. In January, there was a gathering of about 5,000 people near the residence of former Prime Minister Surayud, and the group's activities look set to become energized towards April. In the weeks and months ahead, there is every possibility that anti-government activities will grow in scale as the debate continues over the freezing of former Prime Minister Thaksin's assets and a pardon for him, and as such there is little room for optimism.

**(Keiichiro Oizumi)**

# India 7.9% real GDP growth in July to September

## ■ 7.9% real GDP growth for July to September, 2009

India's real GDP growth rate for July to September, 2009, was 7.9%, compared to the same period in the previous year, up from 6.1% for April to June. This marked the highest quarterly growth rate for six quarters. In terms of individual sectors, agriculture was up 0.9%, industry 8.3% and services 9.3%. The low rainfall in the months between June and September did not have as serious an impact as feared on agricultural production. Nevertheless, the lack of rain is expected to have had the biggest impact on economic growth in the period October to December, and attention needs to be paid to that fact. In industry, the manufacturing production index growth rate rose to 9.2%. Reflecting the vitality of production activities overall, capital goods and intermediate goods grew, and consumer durables posted an outstanding recovery, with a growth rate in excess of 20%. By industry, clothing, chemicals, cement, iron and steel, and automobiles have all done particularly well. Construction has also been able to maintain a fairly robust performance.

In the services sector, government expenditure began to increase again, after having been temporarily restrained at the time of the lower house elections, causing community, social and personal services to grow by 12.7%. Additionally, trade, hotels, transportation and communications grew 8.5% against the backdrop of a rapid expansion in the mobile phone market, which is seeing the monthly net increase in the number of subscribers exceeding 10 million (the number of mobile phone contracts as of November, 2009 was 510 million, up 50.6% compared to the same month in the previous year).

## ■ Future outlook and causes for concern

India's economy may be said to be solidly on the road to recovery. Government expenditure did play a driving role in July to September, but personal consumption and fixed capital formation growth rates have turned upwards, and a full scale growth in domestic demand is expected in the future. However, for the foreseeable future, real GDP growth will likely be restricted, as 1) the agricultural sector fails to grow satisfactorily, 2) government expenditure is likely to fall far below the previous year's level, and 3) amidst the recovery in exports and imports, the trade deficit is expanding.

Along with improvements in employment and incomes, consumer sentiment is expected to continue to improve, and the personal consumption growth rate will likely increase. In particular, consumption of consumer durables is growing, and the sales of domestic passenger cars, which began to recover from early 2009, increased from 1.55 million vehicles in the previous year to 1.82 million vehicles. Also, with regard to fixed capital formation, in addition to the expansion in infrastructure provision, the growth in businesses' production activities will lead to higher capacity utilization ratios, with the expectation that there will be a gradual increase in investments in new plant and equipment. Also, the failure of external demand to grow is a cause for concern, but increased direct investment in India has brought with it an increase in exports by foreign firms, and this will likely be a supporting element.

A major worry is worsening inflation. The consumer price index increase rate for November, 2009, was 13.5% compared to the same month in the previous year, and there is a strong possibility that the Reserve Bank will raise the cash reserve ratio (CRR) and make the tightening stance clear. From the perspective of reducing the fiscal deficit, it would be difficult to envisage further increases in fiscal expenditure. Therefore, it will be important to ensure that policies do not work to hinder economic recovery. Also, careful attention needs to be paid to the risk of an asset price bubble resulting from the expansion of capital inflow from abroad.

＜Real GDP Growth Rates by Industrial Origin＞

(YoY, %)

| | FY2007 | | | | | FY2008 | | | | | FY2009 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Apr.-Jun. | Jul.-Sep. | Oct.-Dec. | Jan.-Mar. | | Apr.-Jun. | Jul.-Sep. | Oct.-Dec. | Jan.-Mar. | Apr.-Jun. | Jul.-Sep. |
| Real GDP | 9.0 | 9.2 | 9.0 | 9.3 | 8.6 | 6.7 | 7.8 | 7.7 | 5.8 | 5.8 | 6.1 | 7.9 |
| Agriculture | 4.9 | 4.3 | 3.9 | 8.1 | 2.2 | 1.6 | 3.0 | 2.7 | ▲ 0.8 | 2.7 | 2.4 | 0.9 |
| Industry | 8.1 | 9.2 | 9.1 | 8.2 | 6.2 | 3.9 | 6.0 | 6.1 | 2.3 | 1.4 | 5.0 | 8.3 |
| Mining, quarrying | 3.3 | 0.1 | 3.8 | 4.2 | 4.7 | 3.6 | 4.6 | 3.7 | 4.9 | 1.6 | 7.9 | 9.5 |
| Manufacturing | 8.2 | 10.0 | 8.2 | 8.6 | 6.3 | 2.4 | 5.5 | 5.1 | 0.9 | ▲ 1.4 | 3.4 | 9.2 |
| Elec., gas & water | 5.3 | 6.9 | 5.9 | 3.8 | 4.6 | 3.4 | 2.7 | 3.8 | 3.5 | 3.6 | 6.2 | 7.4 |
| Construction | 10.1 | 11.0 | 13.4 | 9.7 | 6.9 | 7.2 | 8.4 | 9.6 | 4.2 | 6.8 | 7.1 | 6.5 |
| Service | 10.9 | 10.8 | 10.3 | 10.3 | 11.8 | 9.7 | 10.2 | 9.8 | 10.2 | 8.6 | 7.8 | 9.3 |
| Trade, hotels, transp., comm. | 12.4 | 13.1 | 10.9 | 11.7 | 13.8 | 9.0 | 13.0 | 12.1 | 5.9 | 6.3 | 8.1 | 8.5 |
| Fin., insur., real est. | 11.7 | 12.6 | 12.4 | 11.9 | 10.3 | 7.8 | 6.9 | 6.4 | 8.3 | 9.5 | 8.1 | 7.7 |
| Comm., social, personal services | 6.8 | 4.5 | 7.1 | 5.5 | 9.5 | 13.1 | 8.2 | 9.0 | 22.5 | 12.5 | 6.8 | 12.7 |

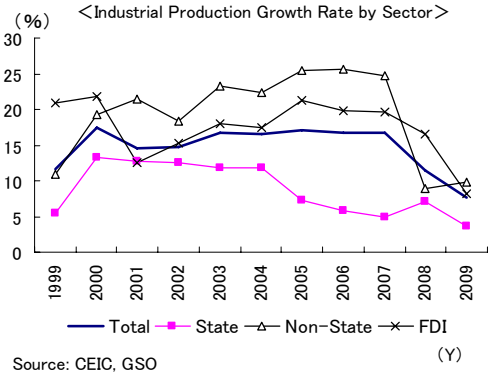
Source: Center for Monitoring Indian Economy

**(Satoshi Shimizu)**

# Vietnam *Business confidence improving, investments leading economic growth*

## ■ 5.3% GDP growth in 2009

Vietnam's real GDP growth rate was 5.3% in 2009, down from 6.2% in the previous year. In terms of supply items, agriculture, forestry and fisheries grew 1.8%, manufacturing and construction 5.5% and services 6.6%, all fairly low growth rates. However, quarterly growth rates have been exhibiting gradual but steady recovery, going from 3.1% in the first quarter, January to March, to 4.5% in April to June, 6.0% in July to September and 6.9% in October to December.



Source: CEIC, GSO

Mining and manufacturing grew 7.6% compared to the previous year. This was the first time that growth had fallen below 10% since 1998 and is evidence of the significant impact of the financial crisis. In terms of individual sectors, the state sector grew by 3.7%, the non-state sector 9.9% and the foreign sector 8.1%. The non-state and foreign sectors, which had hitherto been drivers of economic growth, have slumped considerably. In terms of production volumes of individual items, natural resources such as crude oil, coal and natural gas, as well as domestic demand related items such as beer, detergent, tires, cement, air conditioners and refrigerators, have all done fairly well, while export related items like textile products, footwear and marine produce all performed below the previous year's levels.

Total retail sales of consumer goods and services were up 11.0% on the previous year, on an actual basis, better than the previous year's 7.9%. Automobile sales began to recover from the latter half of the year, with sales for the whole year expected to reach a record 115,000 vehicles, further evidence of healthy consumption. The consumer price index increase rate (annual average) was only 6.9%, well below the previous year's 23.0%.

The nominal growth rate for gross capital formation was 15.3%, year on year, roughly the same as the previous year. Viewed sector by sector, fiscal expenditure and other state investments grew 40.5% in the same period, non-state sector investments 13.9% and foreign investments 5.8%, evidence of how fiscal expenditure has contributed to boosting investment growth. Also, new foreign direct investments were worth $16.3 billion, well below the previous year's record breaking total of $60.3 billion. Export growth was 9.7% down on the previous year at $56.6 billion, and import growth down 14.7%, worth $68.8 billion, leaving a balance of trade deficit of $12.2 billion. However, the rate of contraction of import growth was greater than that for exports, bringing the deficit total well below the previous year's $18 billion.

## ■ 80% of surveyed companies expecting expansion

T The growth target for 2010 has been set at 6.5%. While the government continues with its economic stimulus measures, it is also poised to exert every effort to achieve its growth target, accelerating infrastructure provision and the reform of state run enterprises. As regards the reform of state run enterprises, the mid term plan has been revealed, calling for 1,000 out of approximately 1,500 companies to be made into stock companies by 2015. If privatization goes ahead according to schedule, major state run enterprises in telecommunications, banking, iron and steel, and crude oil will be converted into stock companies within the year.

As anticipation of an economic recovery heightens, corporate business confidence is also improving. According to a survey released by the International Finance Corporation (IFC) last November, 83.2% of corporations surveyed responded that they expected their businesses to expand over the next three years. Investments will undoubtedly provide a support for economic growth going forward. However, it is by no means certain whether this foundation will be one that will ensure the sustainability of economic growth. The gradual heating up of investments under relaxed monetary policies may well lead to real estate or stock market bubbles. The government, as it sets about improving the investment efficiency of state investments that have been criticized for much waste, will need to develop an investment environment that that encourages investment in sectors with future potential, by implementing the relaxation of investment restrictions and by carrying out administrative reform. **(Yuji Miura)**