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Asia's economies expected to continue stable growth in 2012, despite deceleration

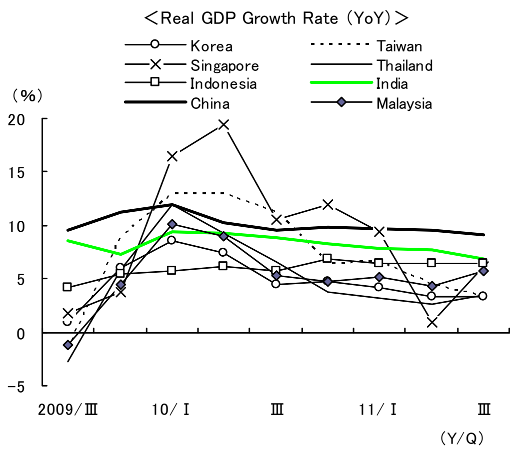
In 2012, Asia's economies will suffer the effects of economic stagnation among the developed nations, but are expected, nevertheless, to continue to post stable levels of growth, supported by expanded demand from Asian and other emerging economies. China and India are expected to post relatively high growth levels in the 8% range.

1. Asia's economies in 2011

Asia's economies have continued to post stable levels of growth, supported by expanding domestic and overseas demand. However, the effects of the global economic deceleration have resulted in a growing trend of economic deceleration of late in some sectors. Fiscal and financial instability in Europe has also cast a shadow.

■ While some economies experience only gradual slowing, some sectors are decelerating rapidly

Asia's economies recovered quickly after the slump in the wake of the Lehman Brothers' collapse, posting very high growth rates in 2010, with Singapore, Taiwan and China posting double digit growth. Although growth rates did begin to slow from mid 2010 onwards, in recoil from the high growth rates posted until then, in general they have continued to be fairly stable. The effects of Japan's March 11 Tohoku earthquake and tsunami have been limited.



Source: National Statistics

In terms of recent trends, while some countries have continued to maintain high levels of economic growth, there are others that have experienced more pronounced economic deceleration, providing evidence of considerable disparity among countries and regions.

China and Indonesia, bolstered by growing domestic and foreign demand, enjoyed comparatively high economic growth rates, 9.1% and 6.5%, respectively, in the period Q3, July to September, 2011, compared to the same period in the previous year. In Malaysia, consumption grew by a very significant 7.9%, boosting growth to 5.8% up from 4.3% in the previous period (the fading impact of the effects of the Tohoku earthquake was also a factor). The increase in consumption was also aided by increased incomes, due to higher prices for primary products, as discussed below.

India's real GDP growth rate for the period April to June was 7.7%, but there has been a more pronounced sense of deceleration of late (see below).

Elsewhere, countries like Singapore, Taiwan and Korea, which have high export dependency levels and whose main export items are IT (information technology) related products and electronic products, have experienced a slowdown in export growth, leading to a falling trend in economic growth. Taiwan's real GDP growth rate in the period July to September was 3.4%, falling below the 4.5% posted in the period April to June. This was minus 0.6% compared with the previous period, on an annually adjusted basis. Korea's GDP growth rate was 3.4%, the same as the period April to June, but the period on period growth fell from 0.9% to 0.7% (Korean Q3 growth figures from flash report).

Export trends (customs cleared basis) show that, on a quarterly basis, double digit growth has continued from Q1, January to March, 2010, till Q3, July to September, 2011, but, with the exception of Indonesia whose exports of natural resources are still strong, there has been an overall deceleration. On a monthly basis, Taiwan's export growth fell to single digit growth in August and September, and Korea's in October (flash report). The trend of deceleration is growing stronger. The source of the recent global economic deceleration is Europe. Europe has seen debt crises rekindled, and this is having a severe impact on real economies. As a result of the implementation of economic reconstruction measures in the months to come and the effects of financial institutions' credit crunch, economic downside risk has appeared. On November 10, the European Commission issued a 1.5% real GDP growth rate forecast for the 17 member Eurozone for 2011, and 0.5% for 2012. The US government also, in its mid year economic forecast of September 1, announced a 1.6% real GDP growth forecast, revised downwards from the 3.1% forecast issued in the February budget announcement.

In addition to the economic slowdown among the industrialized nations, exports, which have thus far been the economic drivers among the emerging economies, are beginning to slow. This has been because of the overlapping of policy interest rate hikes in response to accelerated inflationary pressure with the effects of the global deceleration. In response to stronger signs of economic deceleration, Brazil's central bank followed an August policy interest drop with another one in October. The Brazilian government, on November 18, 2011, revised its 2011 real GDP growth rate forecast downwards from its earlier 4.5% to 3.8%.

In terms of China's export trends, EU and US destined export growth has fallen below the overall level, and ASEAN, BRI (Brazil, Russia, India) and Latin America destined export growth is also trending slower. Along with the slowing of the pace of growth in Chinese exports, exports to China from Asian countries supplying parts and raw materials are also decelerating. Taiwanese firms have shifted many of their production bases to mainland China, so the global slump in demand has taken the form of poor growth in exports to China. Exports of liquid crystal displays have fallen below the previous year's levels since September, 2010, and exports of electronic equipment are also beginning to slow.

Along with the slowing in the growth of exports, the pace of expansion in facilities investment also appears to be losing some of its edge, but there is regional (urban) development going on, as well as wide area development that spans whole countries, and the development of transportation networks is being carried out in many countries. This kind of infrastructure investment is contributing to an increase in fixed capital formation.

China has embarked upon a full program of regional development, including development of the western interior and measures to stimulate the northeast. In India, trunk roads are being constructed and harbor facilities are being stepped up in order to develop the distribution network, and a network of roads is being constructed in order to ensure that all the harbors are properly linked to the industrial sites. Also, there is vigorous investment activity, encouraged by the growth in consumption. In addition to specialist stores selling coffee, sandwiches and clothing, there has been a rush of openings of convenience stores, drug stores and general supermarkets.

Consumption trends show that, while Malaysia and Indonesia are enjoying a strengthening of momentum, the trend among other countries overall is one of deceleration. One factor behind the expanding consumption growth in Malaysia and Indonesia is the fact that primary produce prices are rising. Currently, the top agriculture producers are Indonesia, Thailand and Malaysia, with Indonesia and Malaysia accounting for over 80% of oil palm production. Rises in the prices of primary products are linked to increased incomes for countries with those natural resources, and for their farming communities.

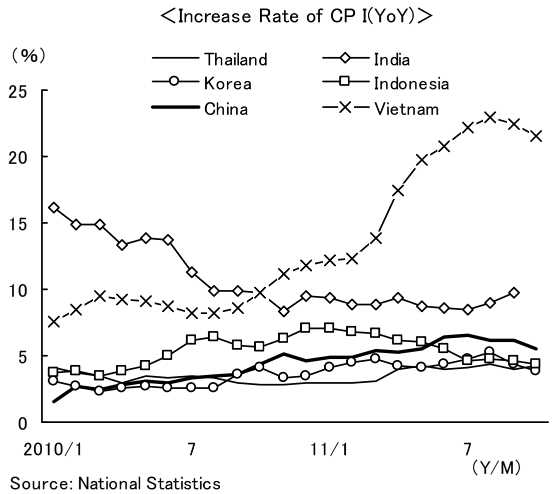
Additionally the increase of a so-called "middle tier" may be identified as one background factor supporting the expansion of consumption in Asia. In Indonesia, the per capita nominal GDP in 2010 was about $3,000. In addition, the growth of consumer loans and the lowering of interest rates in response to inflation restraints (in comparison with the severe inflation of 2008) have encouraged the expansion in consumption. In addition to the conventional urban sector, the rising prices of primary produce has led to an increase in the purchasing power of the agricultural communities, as a result of which sales of automobiles, mobile phones and the like are growing rapidly. These trends are being witnessed throughout Asia.

Additionally, one thing that is common to many countries that are experiencing a slowdown in consumption is that they are basically importers of raw materials. The rising prices of primary produce led to accelerated inflation, which in turn caused real wage growth to fall, and repeated interest rate hikes and other measures intended to curb inflation have resulted in slowing consumption.

In South Korea, the rising prices of primary produce have been accompanied by worsening income terms of trade, leading in turn to a slower real gross domestic income (GDI) growth rate. As a result of this, private sector consumption for the period July to September, 2011, could only manage 2.2% growth (see Korea). In India, due to the effects of soaring gasoline prices and rising interest rates on automobile loans, automobile sales figures, which had been posting double digit growth continuously since July, 2009, fell to lower than the previous year's growth level in July, August and October (September posted 1.0% growth), 2011.

■ Inflation rates peaking out

Due to the increased demand that accompanied economic recovery and the rising prices of primary produce, many countries began to feel the effects of increased inflationary pressure from mid 2009 onward. Because increases in the prices of food products and commuting fares, etc., have a strong impact on the lives of those in the lowest income brackets in urban areas, from 2011 many countries began to work to restrain infrastructure by freezing public utility charges, making emergency imports of foodstuffs, and implementing measures such as import tariff waivers. Also, policy interest rates were raised one after the other.



Source: National Statistics

An examination of consumer price index increase rates shows that they are generally peaking. China's peaked in July at 6.5% and then fell for three consecutive months, reaching 5.5% in October. Korea's fell from 5.3% in August to 3.9% in October. In all cases, this has been due to the contraction in the range of increase in food prices. In Vietnam the government's tardiness in beginning to implement a tight monetary policy and the impact of the lowering of the exchange rate, among other steps, had the effect of worsening inflation but, as the government's price curbing measures began to take effect, price rises peaked in August and have begun to fall.

As inflationary pressure begins to ease, there are some signs of coming changes in financial policy. With the aim of preventing economic deceleration, Indonesia lowered its policy interest rate in October and November. In China also, the possibility of financial policy fine tuning has emerged. The government of China has adopted the theme of promoting a moderate financial policy as its economic management policy for 2011, and has set the stabilization of commodity prices as a priority issue of macro-economic control. In recent months, while the brakes begin to be applied on inflation growth, the business difficulties of small and medium sized enterprises have become a problem, and the government has announced its intention to implement properly timed advance adjustments and fine tuning. China appears to be adopting a stance of switching to an economic style that will prioritize countermeasures against economic overheating.

Meanwhile, inflation is tending to accelerate in India, with the wholesale price increase rate going up from 9.0% in August to 9.7% in October. This has been due to the fact that, though foodstuff prices had begun to settle, the pace of increase in industrial product prices quickened. With the accelerated increase of wholesale prices, the policy interest rate was raised again in October, the 13th time since the financial crisis. The weakness of the rupee is also a contributory factor, and the probability is strong that inflation will stay high for the time being.

2. Asia's economies in 2012

■ Comparatively high growth rates, despite some deceleration

Looking ahead to 2012, there would appear to be a strong possibility that the effects of the global economic slowdown will lead to a blunting of export growth throughout the first half of the year. However, though export growth may lose some of its impetus, factors such as the growth of global demand for smart phones and tabloid type terminals, and the emergence of the middle tier in the new economies, are expected to result in an expansion in consumption, so that a severe deceleration in export growth can likely be avoided.

In terms of consumption, though there are concerns about the effects in some areas of employment adjustment following the slowdown in export growth, in many countries incomes are expected to rise, and real interest rates are at a low level, so consumption is expected to be able to grow at a steady pace. In addition, depending on how commodity prices and economic trends develop, there is the possibility that easier monetary policies will be introduced, and this will bolster consumption growth. In China, employment opportunities have increased following the efforts of the Hu administration to improve incomes in agricultural communities and the progress of regional development initiatives, leading to an increase in disposable income among agricultural communities in recent years. In urban communities also, wages in areas and industries that suffer from lack of manpower have risen substantially, and the raising of minimum wage levels, among other measures, has resulted in incomes increasing generally.

Among the NIEs, Korea and Taiwan are expected to post 3.5% and 4.0% growth, respectively. This is due to the fact that these economies are expected to be hit hard by the deceleration in foreign economies, leading to very pedestrian growth in exports and fixed capital formation. In Korea, with only slight growth in incomes and a general increase in non-consumption expenses (social insurance, interest payments, etc.), consumption growth is expected to be on the order of 3% or thereabouts. As for Hong Kong, with an expected slump in both domestic and foreign demand and poor growth in Chinese process trade due to economic deceleration among the developed nations, growth will likely be no more than 2.0%.

Among the ASEAN nations, Indonesia is expected to achieve 6.3% economic growth, encouraged by an increase in both domestic and foreign demand. While Malaysia is expected to feel the impact of economic deceleration among the industrialized nations, reasonably stable expansion in consumption, and investment activity related to the 10th Five Year Plan, which started in 2011, will bolster economic growth, which is expected to be 4.6%. Thailand is expected to continue to suffer the effects of flood damage through the first half of the year, but there will be reconstruction demand, and economic growth is forecast to be on the order of 3.8%. In Vietnam, as inflationary pressure begins to settle, domestic demand is expected to recover, with economic growth forecast at 6.2%, improving on 2011's performance.

In India, as consumption growth picks up the pace as a result of the progress of measures to curb inflation, and infrastructure related investments continue to be implemented, the economy is expected to grow by 8.2%. China will experience some loss of momentum in export growth, particularly as its major export partner, the EU, suffers economic slowdown, but domestic demand is expected to grow strongly in the interior as well as along the coastal regions, and an economic growth rate of 8.8% is forecast.

■ Concern over economic impact of Thai flooding and European debt woes

There are concerns over the impact on Asia's economies of the flood damage in Thailand and the debt crisis in Europe. The flooding in Thailand brought production in that country to a halt, blunted consumption appetite, caused a contraction in tourism revenue, and brought about increased fiscal burden. In addition, due to the widening of the international production division of labor network, the impact has also spread to neighboring southeast Asian nations, Japan and the US (in terms of difficulties in procuring parts and products). However, Thai automobile factories have begun to restart operations and companies are working hard to find ways of alternate production and procurement, so the expectation is that the impact may well turn out to be limited.

There is even more concern over the potential impact of the European debt crisis. The impact on Asia's economy is likely to be 1) an export slump in the wake of a deteriorating real economy, and 2) the effects (falling exchange and share prices, rising prices of import commodities, greater difficulty in procuring dollar funds, etc.) of the withdrawal of funds by US and European financial institutions as risk avoidance activities intensify.

EU destined exports are already slowing in most countries, and currencies that had been strong against the dollar have begun to fall, one after the other, since September, 2011. The biggest falls were by the Indian rupee and the Korean won. Among the factors contributing to rupee selling are believed to be the current account deficit and concerns over possible economic deceleration due to still high inflation. Additionally, won selling was likely related to the fact that Korea is described as a "small, open economy". In other words, the market has identified it as a cause for concern that, whenever there is global economic instability, 1) the Korean economy is vulnerable because of its export driven nature, and

2) because it is an open economy, capital inflow causes high levels of short term foreign debt.

The won's exchange rate against the dollar hovered in the $1 to upper 1,000 won range for a few months from April, 2011, but dropped sharply in the short term, falling to the 1,100 won range in September, and to the 1,200 won range in October. All the while, the yen was gaining strength, so the won's level against the yen reached its lowest level since the Lehman Brothers' collapse. The Korean government appears to have implemented exchange intervention (procuring dollars through the issue of foreign denominated Foreign Exchange Stabilization Fund Bonds, and then pumping these dollars into the foreign exchange market) in order to prevent a major depreciation of the won. On October 19, the Japanese government and the Bank of Japan announced that the Currency Swap Agreement with Bank of Korea would be increased from the current $13 billion to $70 billion.

In Asia, with the exception of India and Vietnam, 1) current account balances are tending to stay in the black, 2) foreign currency reserves are abundant, and 3) intra-regional financial cooperation has been progressing since the currency crisis. Thus, the outflow of funds has only a very slight possibility of causing major turmoil in the region's economies. Nevertheless, caution is required.

As the US-led TPP (Trans-Pacific Strategic Economic Partnership Agreement) progresses, there are signs within Asia also of an acceleration of intra-regional economic integration. These initiatives are likely to gather momentum throughout 2012.

(Hidehiko Mukoyama)

Economic Prospects for 2012

(year-on-year, %)

1. Economic Growth

	2009	2010	2011 (forecast)	2012 (forecast)
Korea	0.3	6.2	3.6	3.5
Taiwan	−1.8	10.7	4.3	4.0
Hong Kong	−2.7	7.0	5.0	2.0
Thailand	−2.3	7.8	1.5	3.8
Malaysia	−1.6	7.2	4.7	4.6
Indonesia	4.5	6.1	6.5	6.3
Philippines	1.1	7.6	4.2	4.5
Vietnam	5.3	6.8	5.7	6.2
India	8.0	8.5	7.6	8.2
China	9.2	10.4	9.3	8.8

2. Consumer Prices

	2009	2010	2011 (forecast)	2012 (forecast)
Korea	2.8	2.9	3.9	2.8
Taiwan	−0.9	1.0	1.5	1.1
Hong Kong	0.5	2.4	5.2	2.7
Thailand	−0.9	3.3	3.8	3.8
Malaysia	0.6	1.7	3.5	3.5
Indonesia	4.8	5.1	5.5	5.0
Philippines	3.2	3.8	4.8	4.4
Vietnam	6.7	9.2	21.0	7.0
India	12.4	10.5	8.8	8.5
China	−0.7	3.3	5.5	2.8

3. Exports

	2009	2010	2011 (forecast)	2012 (forecast)
Korea	−13.9	28.3	19.2	14.9
Taiwan	−20.3	34.8	13.0	10.4
Hong Kong	−12.2	22.5	10.0	8.0
Thailand	−14.3	28.1	17.3	9.0
Malaysia	−21.2	26.6	12.7	9.5
Indonesia	−19.4	39.7	35.0	33.0
Philippines	−21.7	34.0	0.5	5.5
Vietnam	−8.9	26.4	33.0	35.0
India	−3.5	42.0	35.0	20.0
China	−16.0	31.3	22.0	17.0

4. Imports

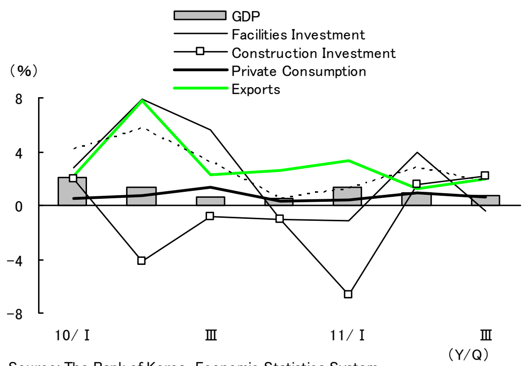
	2009	2010	2011 (forecast)	2012 (forecast)
Korea	−25.8	31.6	27.0	22.5
Taiwan	−27.4	43.8	15.1	12.9
Hong Kong	−10.6	24.7	12.0	10.0
Thailand	−25.2	36.5	20.5	16.5
Malaysia	−21.1	33.4	13.3	10.1
Indonesia	−24.1	43.5	33.0	35.0
Philippines	−24.1	27.5	16.0	7.0
Vietnam	−13.3	21.2	28.0	30.0
India	−5.0	20.4	28.0	15.0
China	−11.2	38.8	25.0	21.0

Notes: The figures in 2010, 2011 are forecasts by JRI.
Source: National statistics

Korea 3.5% growth expected in 2012

■ 3.6% growth in 2011

＜Growth Rates of Korea's GDP (QoQ)＞



Source: The Bank of Korea、Economic Statistics System

South Korea's economic growth rate has turned downwards in 2011, in recoil from the sharp economic recovery posted in 2010. The real GDP growth rate (flash report) for the third quarter, July to September was 0.7%, compared to the previous period, falling below 1.3% posted in the first quarter, January to March, and 0.9% posted in the second quarter, April to June (the year on year figure was 3.4%, the same as for the period April to June in the previous year). While exports grew 2.0%, private sector consumption growth declined to a wafer thin 0.6%, and facilities investment was minus 0.4%. Construction investment grew 2.2%, positive growth for two consecutive quarters, but was minus 4.2% year on year, and the sluggish conditions in the real estate market continue unabated.

In recent weeks, the deceleration in domestic and foreign demand appears to have gotten stronger. Exports (customs cleared basis) had been consistently posting double digit growth (compared to the same month in the previous year), but grew only 9.3% in October, falling to single digit growth for the first time in two years. In addition to poor growth in exports to the US, economic deceleration among the newly emerging economies has led to the beginning of a loss of impetus in exports to these markets. With regard to consumption performance, real retail turnover had stayed in the 5% range since August, but slowed to 2.4% growth in September, and automobile sales were minus 8.8% in October. In terms of consumption, in addition to the poor growth in real gross domestic incomes (GDI), there is expected to be an increase in non-consumption expenditure, such as social insurance payments and interest payments..

While economic deceleration continues to strengthen, the consumer price index increase rate, which had accelerated to 5.3% in August, contracted because of food and drink prices, and was 3.9% in October, falling below the previous month's level for two consecutive months. However, in addition to the price increases in transportation, housing, electricity, and gas, the won's exchange rate fall has brought about concerns over possible import commodity price rises, so attention still needs to be paid to commodity price trends. Bank of Korea has held the policy interest rate steady since June.

The won's exchange rate against the dollar was consistently in the $1 to upper 1,000 won range in the months following April, 2011, and then suffered a significant short term depreciation, falling to the 1,100 won range in mid September, and the 1,200 won range by mid October (as of November, 21: $1 to 1,136 won). During this period, the yen was consistently getting stronger, sending the won to its lowest level against the yen since the Lehman Brothers' collapse.

Part of the background to the won's rapid depreciation has been the withdrawal of funds from new emerging economies on the part of overseas investors, as their risk avoidance appetite intensifies in response to growing worries over fiscal and financial unease in Europe and global economic deceleration. In addition to this, some other reasons behind "won selling" have been the fact that 1) Korea's economic growth is export driven, making it vulnerable to the effects of global economic deceleration, and 2) it has been pointed out that Korea's short term foreign debt levels are high.

In addition to the fact that global economic deceleration will very likely cause a further blunting of export growth momentum, household budgets are going to continue to find it very tough in the foreseeable future, and the forecast is that a slowing of consumption growth is inevitable.

As described above, due to the loss of momentum in both domestic and foreign demand growth, economic growth is expected to do no better than 3.6%.

■ 3.5% growth in 2012

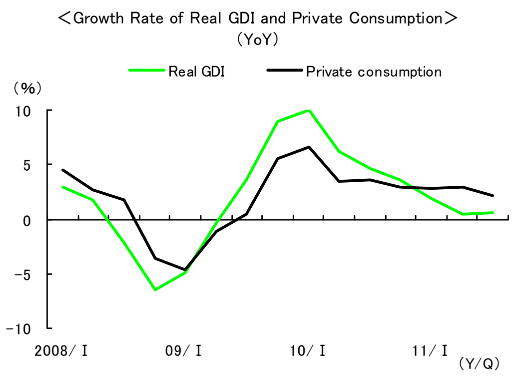
As described below, Korea is expected to achieve 3.5% economic growth in 2012, due to global economic deceleration and poor growth in domestic private sector consumption.

Regarding export growth, given the fact that economic growth among the developed economies is slowing, there is a strong possibility that export growth will be sluggish. However, though there may be some deceleration, exports will still be able to maintain positive year on year growth, so a major slump will likely be avoidable. Exports to the new emerging economies are also expected to lose some growth momentum, but the increased growth of the “middle tier” is expected to lead to an expanded demand for durable consumer goods, so a comparatively high growth level should be able to be maintained. The fact that Korean enterprises are aggressively pursuing the development of markets in the new emerging economies, and that the won is likely to continue to trade weakly against the yen for the foreseeable future, will bolster export expansion.

As regards fixed capital formation, facilities investment is expected to grow at levels comparable to 2011. While the slump in the global demand for liquid crystal displays and semiconductors, for example, is expected to hinder growth in related investments, there will likely be vigorous investment in fields such as smart phones, organic EL and lithium batteries. Construction related investment should be on the road to recovery but the delay in the recovery in the metropolitan housing market will probably mean that a full recovery will not be achieved.

The key to Korea’s economic performance in 2012 is private sector consumption. As stated above, private sector consumption has weakened due to the failure of real GDI to grow, and the increased burden of non-consumption expenses. Also, since the forecast is that real incomes can expect only wafer thin growth, household debt will likely have a negative effect on consumption.

The increase in recent years of housing loans in Korea (many of which are of short-term variable interest) has resulted in household debt levels that are high even by international standards. Moreover, as interest rates increase, the debt repayment burden is also growing. The debt repayment ratio against the average household income has been climbing since 2007 and in the period July to September, 2011, was 2.34%. This is the highest level since the Statistics Bureau began gathering statistics in 2003. Among households with a housing loan, there are some cases where the repayment of principal and interest takes up about 40% of disposable income, and rising interest rates constitute a considerable burden. The government has implemented some countermeasures in response to the growing problem of household debt. The Comprehensive Measures on Household Debt announced in late June, 2011, comprise 1) measures to keep household debt growth at a manageable pace (higher risk weights for mortgage loans, stricter loan requirement, etc.), 2) measures to enhance the soundness of household debt, 3) measures to strengthen consumer protection, and 4) measures to ensure low-income households’ access to loans.



Source: The Bank of Korea、Economic Statistics System

Further, increasing instability in the political situation cannot help but have a negative impact on consumption. In the Seoul mayoral elections held at the end of October, 2011, lawyer and civic activist Park Won Soon, who has criticized the concentration of economic power in large companies, gained victory with the support of many young people. Part of the reason for this has been the difficulty that young people are experiencing in finding jobs, with an “actual” unemployment rate of over 20%. The opposition parties have also toughened their opposition to the government, and have remained steadfastly against the ratification of a Korea – US FTA in parliament. With a general election slated for April, 2012, and a presidential election in December of the same year, the contest between the ruling and opposition parties is expected to heat up, and there are fears that the political situation will become destabilized.

In October, 2011, the Lee administration stepped away from a corporate tax reduction (lowering the maximum income tax rate from 35% to 33%, and the maximum corporate tax rate from 24% to 22%) that had been planned for 2012, in a move that appears to have taken into account public distaste for the preferential treatment shown large corporations.

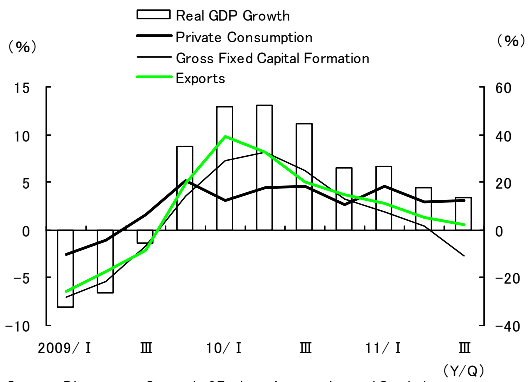
Given the fact that domestic and foreign demand growth will be restrained, Korea’s economy is expected to grow by 3.5% in 2012. **(Hidehiko Mukoyama)**

Taiwan *4.0% economic growth in 2012*

■ 4.3% growth in 2011 as external demand continues to slow

Taiwan's real GDP growth rate for the period July to September, 2011, was 3.4%, compared to the same period in the previous year, falling below the 4.5% (revised figure) posted for April to June (annual adjustment compared to previous term was minus 0.6%). Private sector consumption grew steadily at 3.1%, but export growth slipped to 2.1% and total fixed capital formation was minus 10.7% (private sector, minus 11.9%). In terms of supply side items, the wholesale and retail industries were bolstered by robust consumption and grew 4.3%, surpassing the previous period's performance. In contrast, manufacturing slowed very significantly to 3.9% growth, down from 7.5% in the previous period.

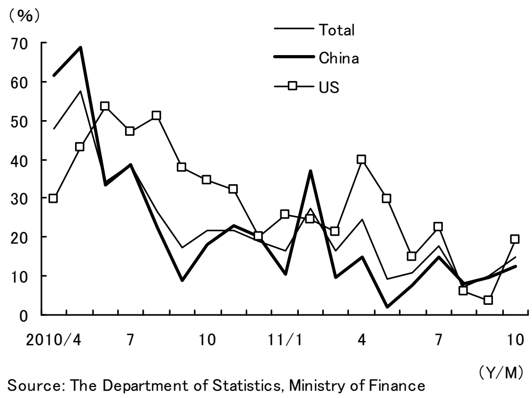
＜Taiwan's Real GDP Growth Rate(YoY)＞



Source: Directorate General of Budget, Accounting and Statistics

An examination of recent trends shows that exports (customs cleared basis) grew by double digits in October, for the first time in three months, but that the overall growth momentum is slowing. Following liquid crystal displays and electronic equipment, exports of communications equipment, which had been export drivers, have also begun to slow. In terms of export destinations, exports to China and Hong Kong, which account for 40% of total exports, are growing at a slower pace than total exports. Since many Taiwanese companies have shifted their production facilities to mainland China, the global slump in demand has made itself felt in the form of poor growth in China-bound exports.

＜Increase rate of Taiwan's Exports (YoY)＞



Source: The Department of Statistics, Ministry of Finance

As a result of the global dip in sales of flat screen TVs and personal computers, liquid crystal display manufacturers such as Chi Mei and AU Optronics continue to post operating losses, and EMS (contracted electronics products manufacturing) manufacturers such as Quanta Computers and Compal, are losing profits due to the increasing burden of rising labor costs in China. Also, semiconductor manufacturing giant TSMC saw its sales grow negatively in September and October, compared to the same period in the previous year, and is beginning to face tougher business conditions.

The unemployment rate (seasonally adjusted) has been falling after peaking in September, 2009 (6.09%), and stood at 4.3% in October, 2011, but, among export industries, there has been an increase in the number of companies (12 companies announced as of November 1, 48 companies as of November 16) that are implementing unpaid leave, following production adjustment measures.

Reacting to the economic deceleration, the Taiwanese government announced a package of emergency measures on November 7, comprising 1) support for companies seeking credit, 2) export promotion, 3) accelerated infrastructure development, and 4) measures to attract tourists.

In addition to the deceleration being experienced by the European and US economies, some of the emerging economies, such as China, India and Brazil, are also facing slower growth, making export conditions a lot tougher. This means there is a very strong probability that export momentum will be further blunted. With the employment situation improving and commodity prices stabilizing, private sector consumption has continued to grow steadily thus far, but automobile sales in October fell to single digit figures for the first time in four months. The increase in the number of exporters introducing unpaid leave, and the expected contraction in year end bonuses, are feared likely to blunt consumption growth in the months to come.

Taiwan is due to hold a general election in January, 2012, with President Ma Ying-jeou aiming for re-election. Therefore, if the economy deteriorates more than expected, there is a strong possibility that additional economic stimulus measures will be implemented.

Given the foregoing, a real GDP growth rate of 4.3% is forecast for 2011.

■ 4% growth in 2012

For 2012, the deceleration in domestic and foreign demand growth is expected to continue until the middle of the year, so the economic growth forecast is for 4.0%, slightly lower than in 2011.

First, as regards exports, the performance of exports to China is key. Supported by the implementation of domestic demand expansion measures in China and the subsequent economic recovery, Taiwan's China-bound exports had been growing at double digit rates since the autumn of 2009. However, this pace has slowed to single digit growth in many months since May, 2011. Almost half of Taiwan's exports to China are electronic products and optical equipment (including liquid crystal displays), and these are affected by the slowing of exports and consumption in China.

Though the recovery in demand for semiconductors and liquid crystal displays will be delayed in 2012 by the effects of global economic deceleration but, due to 1) the expectation that demand for smart phones and tablet type terminals will continue to expand, 2) the fact that Chinese consumption, although losing some of its forward momentum, will still continue to post a steady rate of growth, bolstered by rising incomes, and 3) the implementation of export promotion measures planned by the government, export growth throughout the whole year is expected to be roughly the same as that in 2011.

Private sector consumption faces the risk of a considerable slowdown, depending on how bad exporters' business results get, and the extent of production adjustments carried out, but since there is a strong probability that domestic demand related industries will continue to grow relatively strongly, and since it is believed that stable commodity prices and low interest rates will stay in place for the time being, consumption growth may be expected to be on the order of 3% for the whole year.

Meanwhile, total fixed capital formation is expected to grow by only the smallest of margins. Growth in total fixed capital formation is strongly linked to export performance, and the effects of export deceleration are a worry, but 1) investments related to smart phones and tablet type terminals are thought likely to grow, 2) the development of social infrastructure as part of the i-Taiwan 12 Project is progressing and, as mentioned above, 3) if the economy looks like it is deteriorating faster than expected, it is likely that additional economic stimulus measures will be introduced. Given the above, any slump in total fixed capital formation is not likely to be very great.

The Taiwanese economy in 2012 is going to be affected by the results of the planned general election in January. In addition to the challenge from opposition Democratic Progressive Party candidate Tsai Ing-wen, President Ma Ying-jeou will also be up against candidates from the ruling People First Party, and his re-election is by no means certain. In addition to economic deceleration, President Ma's statement about concluding a peace treaty with China within ten years has led to a sense of alarm among voters, with regard to unification with China.

Since its inauguration, the Ma administration has sought to vitalize the economy through stronger links with China. An economic cooperation framework agreement (ECFA) went into effect September 13, 2010, aimed at abolishing customs duties between Taiwan and China, and the work of reducing tariffs on some items began January 1, 2011. Also, in an effort to increase the number of tourists visiting Taiwan from mainland China, the upper limit on mainland tourists was increased in 2011 from 3,000 persons per day to 4,000 persons per day. In addition, from June 28, the ban on individual tourists has been lifted, with certain conditions (restricted to 500 persons per day, and residents of Beijing, Shanghai, and Amoy in Fujian province only). However, tariffs have been lowered on a restricted number of items only, and there has been poor growth in the number of Chinese tourists, so that the results have not been as good as had been expected. If Ma Ying-jeou is re-elected, it is possible that some of Taiwan's economic policies with regard to China will be reviewed.

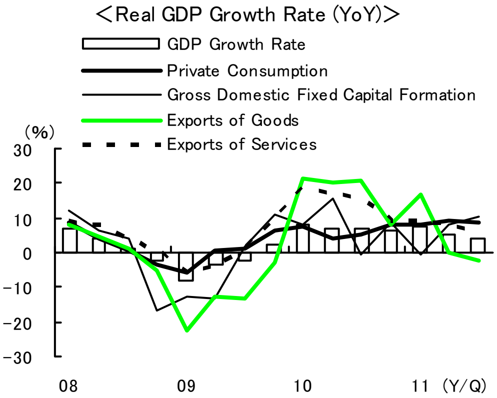
In conclusion, though there is some downside risk, Taiwan's economy will probably grow by 4.0% in 2012.

(Hidehiko Mukoyama)

Hong Kong *2.0% growth in 2012*

■ 5.0% growth in 2011

Hong Kong's real GDP growth rate was 4.3% in the July to September, 2011, time frame, compared to the same period in the previous year, down from 5.3% in April to June (up 0.1% on the previous period). Though domestic demand continues to expand, foreign demand has begun to slow.



Source: Census and Statistics Department of Hong Kong

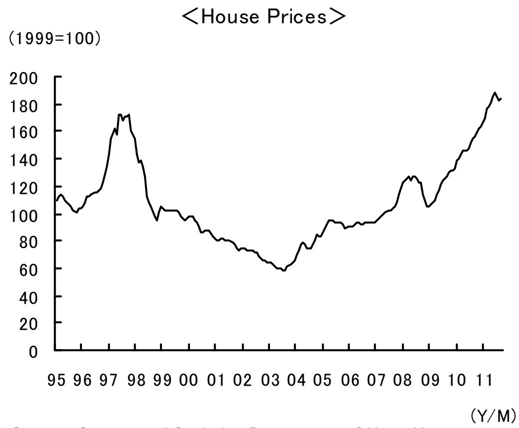
Looking at domestic demand, private consumption in July to September was 8.8%, continuing the high growth from 9.7% in April to June (up 1.1% on the previous period). The asset effect enhanced by rising housing prices, and rising wages, boosted consumption. September's housing prices rose 17.5% compared to September in the previous year, surpassing 1997's levels, which had been the highest thus far. Because of high corporate earnings and low interest rates, investment grew 10.2%, compared to the same period in the previous year, expanding significantly from 7.0% in April to June.

Exports of goods switched to negative growth, posting minus 2.2%, down from 0.3% in April to June (0.0% increase on previous period). Exports to the US decreased 5.5% and exports to China slowed to just 0.2% growth (customs cleared basis). Exports of services, affected by the loss of momentum in trade related services, slowed to single digit growth, 6.6% (up 1.1% on the previous period).

The unemployment rate was 3.2%, down 0.3 points from April to June's figures. Domestic demand related industries such as construction and retail have been able to maintain good employment conditions.

■ 2.0% economic growth in 2012

Looking forwards to 2012, it is difficult to hold out much hope for economic expansion based on foreign demand. A growing sense of unease over the future of the EU and US economies will likely mean that EU and US-bound exports will manage no more than a mild recovery. At the same time, due to poor growth in China's process trade, it is forecast that Hong Kong's process trade exports will grow only at a low level. Though China's domestic demand oriented exports will likely grow at a solid pace, process trade oriented exports account for a significantly large share, so in general terms, foreign trade will probably continue weakly.



Source: Census and Statistics Department of Hong Kong

Private consumption is expected to fluctuate along with household asset prices such as share prices and housing prices. If the outflow of capital overseas is a limited one, housing prices should be able to maintain their recent levels, and private consumption will probably be able to sustain a mild expansion due to rising wages. Though domestic demand related industries in the corporate sector will slow down slightly, low interest rates are expected to encourage investment expansion.

From the foregoing, Hong Kong's economy is expected to grow by 2.0% in 2012.

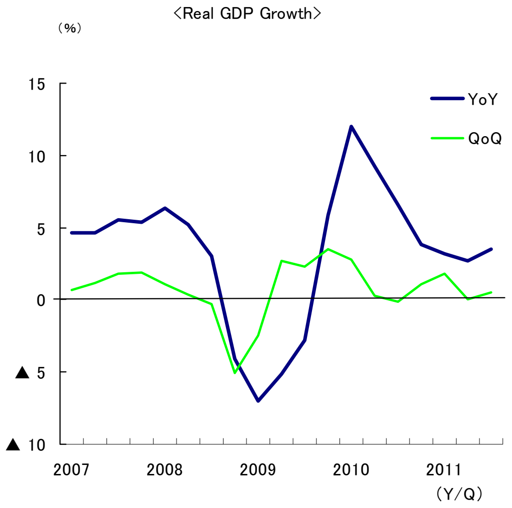
However, the recent jumps in real estate prices do pose the growing risk of a sudden drop. Housing prices in July grew negatively compared to the previous month for the first time in 14 months. If housing prices do drop, a reverse asset effect may have a negative impact on individual consumption. In that case, there is a possibility that Hong Kong's economy could slow to zero growth.

(Shinichi Seki)

Thailand 2012 economic growth 3.8%

■ Floods restrain economic growth in 2011 to 1.5%

In 2011, Thailand suffered the effects of Japan's Tohoku earthquake and tsunami in the early part of the year, and serious flood damage in the latter half of the year. As a result, the real GDP growth rate is expected to be a very low 1.5%.



Source: NESDB

The economic growth rate in the first quarter, January to March, was 3.2%, compared to the same period in the previous year, but the effects of the earthquake in Japan caused the growth rate to slow to 2.6%, similarly, in the second quarter, April to June. However, the growth rate rallied to 3.5% in the third quarter, July to September.

As of September, Thailand's economy appeared to have ridden out the worst of the impact of the earthquake and to be on the road to recovery. However, this year's rainfall turned out to be 1.4 times that of a normal year, and poor river and floodplain management resulted in unheard of flood levels that covered a swath of land stretching from the interior to Bangkok itself. Seven industrial estates were flooded and over 400 Japanese firms were affected.

On November 3, the NESDB (National Economic and Social Development Board) announced an estimate that put the flood damage at over Bt200 billion (approx. 600 billion yen), with the jobs of some 360,000 people being affected. As of mid November, the flood waters are still spreading, and the situation is still unpredictable. Economic growth in the period October to December is expected to be minus 3.2%, compared to the same period in the previous year.

Exports in the period January to September grew 25.5% compared to the same period in the previous year, reaching their highest ever level of $179.6 billion, and this in spite of the impact of the severing of the parts and components supply chain due to the Tohoku earthquake and tsunami. However, export growth in the fourth quarter, October to December, fell to minus 5.0%, due to the effects of the widespread flooding, and the figures for the whole year are expected to be no better than 17.5%, compared to the same period in the previous year, worth $249.6 billion.

Private sector consumption grew 3.3%, compared to the same period in the previous year, in the first quarter, January to March, 2.8% in the second quarter, April to June, and 2.4% in the third quarter, July to September. After the lower house elections held in July, expectations that the political situation would stabili z e led to a rise in the consumer confidence index prepared by the University of the Thai Chamber of Commerce. However, the effects of the flooding caused the index to fall in October by a very significant margin. In fact, October's automobile sales crashed to minus 68% compared to the same month in the previous year. Private sector consumption for the whole year is expected to grow no more than 2.7%, year on year. Fixed capital formation grew 9.3%, similarly, in the January to March time frame, 4.1% in April to June, and 3.3% in July to September. Growth for the whole year is estimated to be 4.6%, year on year.

■ 3.8% growth forecast for 2012, due to economic stimulus measures and recovery demand

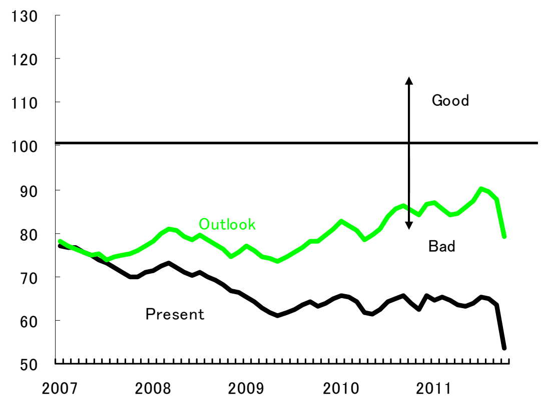
Though the first half of 2012 will still be strongly affected by the flooding, as long as subsequent recovery support is implemented according to plan, these will work together with economic stimulus measures to produce economic growth of 3.8%.

Early in November there was some good news that the water had begun to drain off in some parts of the Ayutthaya Industrial Estates, and that automobile production, which had only been slightly affected by the flooding, was restarting. In the flooded industrial sites the re-opening of factories is expected to take one to three months after the water drains away, so the forecast is that negative growth will continue throughout January to March in 2012. However, the fact that the Yingluck administration has swiftly announced and implemented countermeasures is good news for the recovery effort. In early November the New Thailand program, worth a total of Bt900 billion, was announced. Of that sum, Bt100 billion is earmarked for the recovery of the industrial sites, with the remaining Bt800 billion to be used to protect the industrial sites from flooding and for floodplain management activities. BOI (Thai Board of Investment) also has announced plans to contract production to other areas and factories, and to grant relief on import duties in order to make up the shortfall resulting from the disaster.

Japan, too, has been providing support in a number of ways. In addition to providing information and financial support to Japanese companies, restrictions have been relaxed on Thai employees being sent to work in Japan temporarily, and technical assistance on floodplain management has been provided. The flood damage will provide many Japanese companies with an opportunity to weigh the pros and cons of continuing production in Thailand, but if the Thai government is able to take action swiftly and to make clear what it proposes to do from now on, it should not be difficult to regain confidence.

From the second quarter, April to June, onwards, recovery efforts will likely pick up speed. Though export growth will continue to fall below the previous year's levels throughout the January to March time frame, the expectation is that performance will recover to the previous year's levels in the latter half of the year, and export growth for the whole of 2012 should be 9.0%, compared to the same period in the previous year. However, given that there is sure to be an increase in imports of plant and equipment to facilitate the restarting of production, and materials for the improvement of infrastructure as part of recovery and flood prevention activities, the balance of trade is expected to fall into the red for the first time in three years.

<Consumer Confidence Index>



Source: The University of Thai Chamber of Commerce (Y/M)

The economic recovery following restoration efforts will probably be bolstered by the Yingluck administration's raising of the minimum wage levels, and other initiatives, such as stimulus measures aimed at promoting automobile and housing purchases. If all of the administration's election promises are implemented, private sector consumption is expected to grow by 3.6%, year on year. Fixed capital formation is expected to grow at 8.0% through the year, compared to the previous year, due to post-flood efforts to reinforce infrastructure, and increased re-investments for the purpose of restarting factory production. The November decision to implement preferential tax measures, including the exemption of withholding tax on investments in infrastructure funds, will contribute to recovery. If recovery measures go as planned, it is expected that Japanese small and medium enterprises will resume their investment in Thailand. However, it needs to be noted that expectation of the effects of recovery demand and economic stimulus measures assumes a swift response to flood damage on the part of the Thai government.

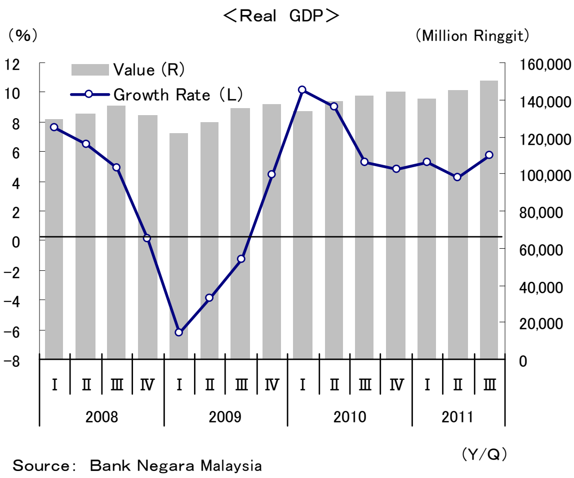
Additionally, the economic downside risk is that the implementation of economic stimulus measures may well end up encouraging inflation. The floods have not only affected manufacturing, but have had a devastating impact on agriculture. In addition to the possibility of rising food prices, there is a danger that higher wage levels will accelerate commodity price rises. Furthermore, while many businesses are expected to recommence production by mid 2012, if such initiatives are delayed, there is a possibility that the unemployment issue will worsen, and there is a danger that the raising of the minimum wage level will restrain employment growth. If inflationary pressure exacerbates the unemployment problem, the possibility is that this will combine with public dissatisfaction with the government's responses to the floods, and that political and social instability will follow.

(Keiichiro Oizumi)

Malaysia *4.6% economic growth expected in 2012*

■ 2011 economic growth 4.7%

In 2011, Malaysia's real GDP growth rate, in spite of the economic deceleration among the developed nations, was reinforced by robust domestic demand and posted 5.2% growth in the period January to March, 4.3% in the period April to June, and 5.8% in the period July to September. Even towards the end of the year, private consumption and investment have both performed solidly, leading to a 4.7% economic growth forecast for the whole year.



Source: Bank Negara Malaysia

Supported by increased levels of disposable income and an improved employment situation, private sector consumption growth has stayed strong, posting 6.7% in the period January to March, compared to the same period in the previous year, 6.4% for April to June and 7.3% for July to September. The figure for the whole year is expected to be 6.6%. In particular, the rising prices of agricultural products have contributed to increased consumption among farmers.

Additionally, fixed capital formation grew 6.5%, compared to the same period in the previous year, through January to March, and then slowed to 3.2% in the period April to June. However increased private investment in technology intensive industries, service industries and industries utilizing natural resources, in line with the Economic Transformation Program (ETP), resulted in a recovery to 6.1% for the third quarter, July to September, and the figure for the whole year is thought likely to be 4.1%. There has also been good news in that foreign direct investment, which had been on the decline in recent years, increased by 75%, compared to the same period in the previous year, in the period January to June, worth 21.2 billion ringgit.

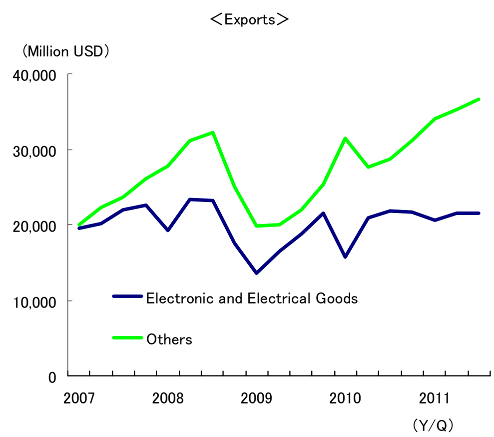
As far as the situation with exteral demand is concerned, while there were fears over the possible impact of economic stagnation in the developed countries, exports grew by 15.8% (January to September), worth $169.6 billion. Exports of electronic and electrical goods, which are a major export item for Malaysia, posted a poor 1.4% growth, compared to the same period in the previous year, but exports of palm oil grew strongly at 47.9% in the same period, as did natural rubber, at 72.4%. Exports to the US languished at 0.4% growth over the same period, and those to Europe were only 13.5%. However, exports to Japan, China and India grew strongly, coming in at 25.9%, 21.5% and 33.2%, respectively. The balance of trade was a $29.5 billion surplus, and the foreign currency reserve reached its highest ever level of $130.8 billion (worth 9.5 months of imports and 4.5 times the short term debt total). Export growth will have slowed towards the end of the year, due to the effects of the flooding in Thailand, but for the whole year the figure is expected to be 12.7%, worth $224.6 billion.

■ 4.6% growth forecast for 2012

Malaysia's export dependency is over 100% against GDP, which means that uncertainty over the future of the global economy is the country's biggest downside risk, and the business confidence index produced by the Malaysian Institute of Economic Research (MIER) stood at 113.3 points in the first quarter, January to March, 114.0 points in the second quarter, April to June, and then fell to 104.5 points in the third quarter, July to September. Meanwhile, the consumer confidence index maintained a relatively positive level over the same periods, at 108.2 points, 107.9 points and 108.7 points, respectively, and private sector consumption is expected to continue to bolster economic performance throughout 2012 as well.

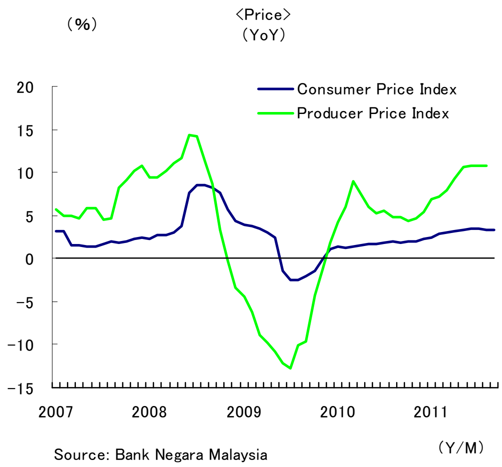
In addition to an improved employment environment, Malaysia has seen the introduction of minimum wage levels and salary increases for public officials, both of which are expected to contribute to an increase in disposable income. Therefore, private consumption is expected to grow by 6.0%, year on year. An import duty waiver on hybrid cars and electric cars, introduced in order to stimulate consumption, as well as for energy conservation purposes, has been extended till the end of 2013, and this will probably contribute to consumption growth. Further, the government has implemented the TUKAR program for the reform of small shops, aimed at improving the business efficiency of small corner shops by advising them on sales systems with modern store layouts and POS system assisted stock management. The initiative is aimed at supporting consumption growth. In actual fact, there has been an increase in foreign investment in the retail sector, in pursuit of private consumption. As of August, 2011, there were 166 foreign owned retail outlets (148 in the same period in the previous year). Fixed capital formation is expected to grow 8%, year on year, thanks to the expansion in public utilities investments, such as railway double tracking work and international airport extension work, as part of the second implementation phase of the 10th Five Year Plan. Additionally, the Special Stimulus Package (total amount: 6 billion ringgit) for investment in hospitals, schools and housing for low income earners, and donations to joint public and private project funds (20 billion ringgit) will contribute to investment growth.

Export growth is estimated to be on the order of 9.5%, worth $24.6 billion, year on year, due to the effects of economic stagnation in the developed nations. While there is still little hope that electronic and electrical goods exports will be able to grow by a significant margin, their export ratio fell from 47.8% in 2008 to 37.5% in the period January to September, 2011, and in 2012 it seems that natural resources such as crude oil, palm oil and natural rubber will be the growth drivers. The government, in addition to focusing its energies on forming concentrated areas of palm oil production, is also working to support agricultural communities by encouraging the cultivation of natural rubber, and this too will support export growth.



Source: Bank Negara Malaysia

The Najib administration is searching for ways to strengthen its international competitiveness by reinforcing its commitment to the global economy. It has already participated in TPP (Trans-Pacific Partnership) negotiations, and in 2012 is scheduled to allow 100% foreign investment in hospital services as well as 16 other service industries, such as design, accounting, legal, courier, education and communications. Furthermore, with the aim of turning Kuala Lumpur into an international finance city, investments by foreign firms which match this effort will be entitled to a corporate tax waiver for up to ten years in new preferential tax measures that are to be introduced.



Source: Bank Negara Malaysia

One economic downside risk factor is the rise in consumer commodity prices from 2011 onward. Taking the impact of the global economic deceleration into account, Bank Negara Malaysia has put off raising the policy interest rate. Meanwhile, the government is making subsidies available in order to stabilize the prices of rice, sugar, cooking oil, wheat and fuels (diesel oil, cooking gas). The plan is to continue to use subsidies to stabilize commodity prices, and the consumer price index increase rate for 2012 is expected to be around 3.5%. If commodity prices rise sharply, although there will be a risk of economic downturn just before the general election in the first half of the year, domestic and foreign demand will likely support the economy, and a growth figure of 4.6%, almost the same as that of 2011, is forecast for 2012.

(Keiichiro Oizumi)

Indonesia 2012 real GDP growth forecast 6.3％

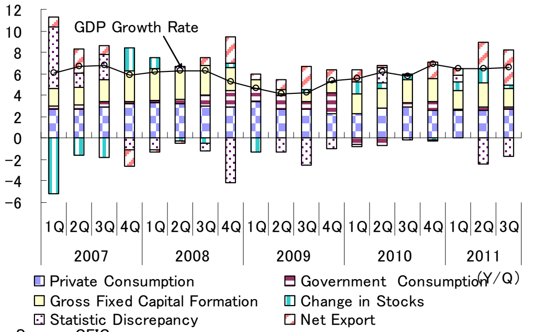
■ 6.5% economic growth in 2011

Indonesia's real GDP growth rate for the period January to September, 2011, was 6.5%, compared to the same period in the previous year. The growth rate held steady at 6.5% in each quarter. Though the growth rate for the fourth quarter, October to December, may be slightly down due to the stagnation in exports to Europe and the US, the rate for the whole year is expected to be 6.5%.

The growth rate drivers have been private consumption and investments. Private consumption has flourished, and the consumer confidence and real retail indices issued by Central Bank have maintained consistently high levels since the latter half of 2009, with no major dips. Motorbike and automobile sales in the period January to September, 2011, were 12.4% (6.19 million vehicles) and 18.6% (660,000 vehicles), respectively, compared to the same period in the previous year. Although the pace of growth has slackened off considerably in comparison with the previous year's performance, it is confidently predicted that sales figures for the whole year will top those of the previous year, in which the highest ever levels were recorded.

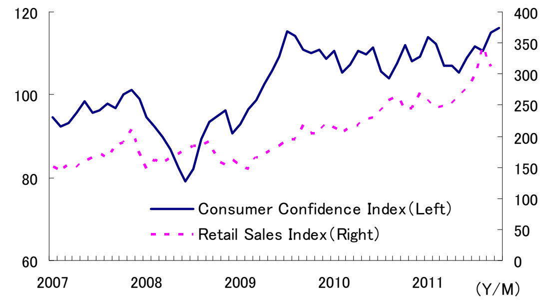
Investments have also performed strongly. According to a Central Bank business survey, although corporate business confidence dropped slightly from the latter half of 2010, it began to recover in the period April to June, 2011, and is expected to progress at a high level going forward. In terms of specific industry sectors, manufacturing is supporting the recovery in business confidence, and optimism is also growing with regard to the future of agriculture, forestry and fisheries, transportation and communications, construction, and finance and real estate. The Central Statistics Bureau's (BPS) business tendency index shows more or less the same trend. According to the Investment Coordination Agency, total investment worth (domestic and foreign investment together, realized basis) in the period January to September, 2011, grew 21.5%, compared to the same period in the previous year. In terms of domestic investments, foodstuff and plantations, and electricity, gas and water were the drivers. For foreign investments, transportation, warehousing and communications, as well as mining, were the drivers.

<GDP Growth Rate and Contribution by Demand Items>



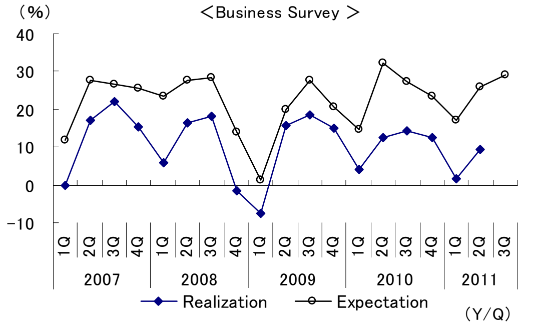
Source: CEIC

<Consumer Confidence Index and Retail Sales Index>



Note: Retail Sales Index based October 2000＝100. The net balance+100 method has been used to construct the consumer confidence index , where the index above 100 points indicates optimism.
Source: CEIC

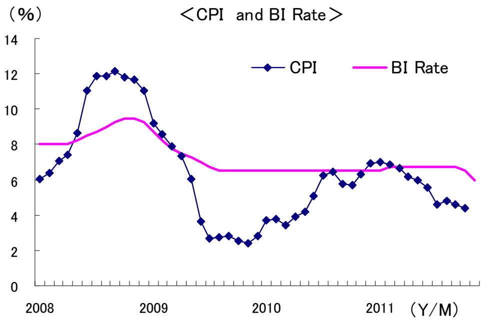
<Business Survey >



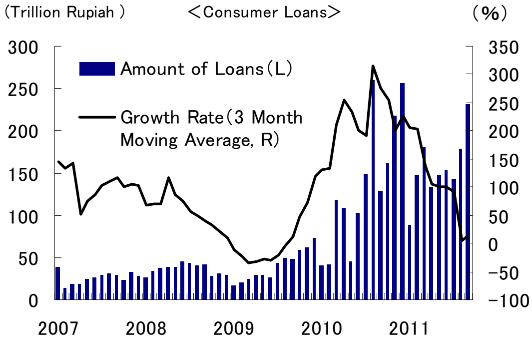
Note: The net balance+100 method has been used to construct the index, where the index above 0 points indicates optimism.
Source: Bank Indonesia, *Business Survey Quarter II-2011*

■ 6.3% economic growth forecast for 2012

Due to the effects of the eurozone debt crisis and the floods in Thailand, there is a growing sense of uncertainty about the future. The World Bank has indicated the possibility that, if the debt crisis worsens, Indonesia's economic growth rate in 2012 could fall to 4.1%. However, that is a worst case scenario. There is a good balance of individual consumption, investments and exports, and all three are expected to continue to grow steadily, so a standard scenario of 6.3% growth would appear to be appropriate. Central Bank feels that, even if exports and individual consumption do flag, investments will be able to fill the gap, and expects to see a growth rate between 6.2% and 6.7% in 2012.



Note: CPI compared to the same period in the previous year.
Source: CEIC



Source: Bank Indonesia Web

Private consumption has been supported by stable commodity prices and interest rates. The consumer price index increase rate as of January, 2011, was 7.0%, compared to the same period in the previous year. Nevertheless, it fell after that and came down to 4.4%, similarly, by October, 2011. In response, Central Bank lowered its policy interest rate (BI rate) in September from 6.75% to 6.5%, and then again to 6.0% in October. Though the consumer confidence and real retail indices have stayed high, the consumer loan growth rate has begun to decline. The fact that the policy interest rate was lowered in two consecutive months would appear to be an indication of concern over poorer consumer and corporate sentiment in the wake of economic deterioration in Europe and the US, and the subsequent economic slowing in Asia. It seems likely that the inflation rate will be kept to within the 2011 target of 5±1%, and a target of 4.5±1% has been set for 2012.

Investments also look set to grow steadily. The Investment Coordinating Agency expects that the 2011 investment target of 240 trillion rupiah is achievable, and in spite of growing fears of global economic deceleration, set an investment target of 283.5 trillion rupiah for 2012 at November 2011. The background to this is that 1) with a population of 240 million, the largest in southeast Asia, Indonesia's presence as a consumer market is growing ever stronger, 2) wage levels are rising rapidly in China and Vietnam, Indonesia's competitor countries, 3) measures to reduce or waive corporate taxes have been implemented with regard to large scale investments in industry sectors where the investment ripple effect can be expected to be large, such as basic metals, petroleum refining, basic organic chemicals, natural gas machinery, recycled energy and communications equipment, and 4) Indonesia is gaining in stature as a potential location for production in the wake of the Thai floods.

In June, 2011, President Yudhoyono announced the Master Plan, which has as its aim the inclusion of Indonesia in the world's top ten economies by 2025. In order to achieve this, Indonesia's economy will need to grow by between 8% and 9% per annum. Setting aside the question of whether the Master Plan can be achieved, ratings organizations have, one after the other, revised Indonesia's ratings upwards, indications that the economy's growth has high sustainability. According to a recent (July to September, 2011) macro-economic indicator forecast survey conducted by Central Bank, many economists are predicting an economic growth rate of between 6.6% and 7.0%, an inflation rate of between 6.1% and 7.0%, and an exchange rate of between 8,751 to 9,000 rupiah.

Issues that may cause some concern would include a fall in the prices of coal and palm oil in the wake of global economic deceleration, and blunted growth in exports and private consumption. Also, as regards investments, there are some sectors where it is unclear as to whether investments will grow in line with government expectations. The government published a list of 79 investment projects (worth \$53.4 billion) in June, in an attempt to attract private sector funding, particularly foreign investment, through PPP (public private partnership) agreements, for the development of infrastructure. However, PPP involve many different government departments and private sector firms, and there is still no clear consensus as to how much risk the Indonesian side should bear in each project. Also, there is no sign of any real progress with regard to the intangible side of the investment environment, such as a review of labor laws and measures to eradicate corruption. In order to enhance the sustainability of economic growth, concrete results are needed in these areas so that Indonesia's advantage as an investment target can be increased. **(Yuji Miura)**

Philippines *4.5% economic growth in 2012*

■ 2011 real GDP growth rate expected to be 4.2%

In 2010, the Philippines' real GDP growth rate recovered to 7.6%, up from 1.1% in the previous year. However, growth slumped again in 2011, to 4.0% in the period January to June, compared to the same period in the previous year (Q1, January to March 4.6%, Q2, April to June 3.4%). Part of the background to this development was 1) the worsening debt crisis in Europe and economic stagnation in the US, leading to a decline in the growth of mainly electronics related exports (customs cleared basis Q1 January to March 8.1% growth, Q2 April to June 1.9% growth), and 2) a recoil from the high growth level in the same period in the previous year, which was boosted by extra government spending in the run up to the general election that was held at that time.

Though there will be some recovery during the July to December time frame, the real GDP growth is forecast to be around 4.2%. Given the fact that there are fears of a global economic slowdown, there is very little prospect of a quick recovery.

Personal consumption grew 5.4%, compared to the same period in the previous year, in the period between January and June, and was a driver of the economy. Spending on food, education and hotels and restaurants all showed growth. The main contributory factor behind this development has been the improvement in the labor market. Employment has been expanding, particularly in the services and agricultural sectors, and the number of people employed has risen by about 4%, year on year. The unemployment rate is coming down, albeit slowly. In the future, employment and income growth will likely be sustained to a certain level, supporting personal consumption.

The growth rate for fixed capital formation during the January to June period was 3.2%. Durable equipment investment has supported economic recovery since the latter half of 2009, but as a result of the recoil effect and poor export growth, it slowed to 11.2% growth. Also, the delay in public utilities projects has caused construction investment to slump to minus 13.5% in the period April to June. In the weeks and months ahead, work on public utilities projects is expected to make some progress, and this and other factors will likely bring about a mild recovery in investment growth.

Exports grew 34% in 2010, but slowed to just 0.6% in the January to August, 2011 (exports and imports on customs cleared basis). Electronics related exports, which account for about 60% of the total, slumped to minus 13.7% growth in the period January to July. This was due both to the contraction in the global demand for semiconductors, and the effects of the Tohoku earthquake and tsunami in Japan. On the other hand, imports posted growth of 13.8% during January to August. In addition to increases in the price and volume of crude oil imports, imports of raw materials also increased. The trade deficit grew to $7.2 billion, around three times that of the previous year. In the future, fears of a global economic deceleration will make it very difficult to expect any rapid recovery of exports.

＜Real GDP by Expenditure Shares (YoY)＞

(%)

	2010-Q1	2010-Q2	2010-Q3	2010-Q4	2011-Q1	2011-Q2
Real GNP	11.5	9.2	6.9	5.6	3.3	1.9
Real GDP	8.4	8.9	7.3	6.1	4.6	3.4
Personal Consumption	4.0	1.9	2.4	4.9	5.3	5.4
Government Consumption	21.4	7.4	-6.5	-6.6	-17.2	4.5
Fixed Capital Formation	18.9	26.6	15.4	15.7	12.7	-5.7
Exports	18.8	24.0	23.1	16.8	2.0	-0.3
Imports	24.2	22.1	22.1	21.9	11.3	4.1

Source: National Statistical Coordination Board

The consumer price index increase rate climbed to around 4% from 2010, reflecting soaring agricultural products prices due to the effect of the rising crude oil price and typhoon damage. Further, in the months between February and September, 2011, rising international commodity prices have pushed up the rate to around 5%. In order to prevent worsening inflation, the policy interest rate was raised in March and May, by 0.25% each time. Also, the reserve requirement was raised by a total of 2%, for the first time in 6 years. Because the economy is now clearly in decline, monetary policy management will probably take both inflation and growth into account from now on, and the policy interest rate will probably stay put for the time being.

■ 4.5% real GDP growth forecast for 2012

In March of this year the Aquino government released its Medium Term Philippine Development Plan (MTPDP), covering 2011 to 2016. The basic elements underpinning the Plan include the reduction of poverty by maintaining high levels of economic growth and providing productive employment opportunities, enabling all citizens to participate in development opportunities, and the construction of an effective social safety net. The implementation of the plan assumes an annual growth rate of between 7% and 8%, and it is going to take considerable effort to achieve that.

Real GDP growth in 2012 is forecast to be around 4.5%. There are hopes that both domestic demand and foreign demand will grow at a faster pace than now, but any recovery in the global economic situation is surely going to be a gradual one, and it is difficult to imagine that the Philippines' recovery will be any different.

With regard to personal consumption, since corporate sentiment is comparatively positive at the moment, construction, financial services and other industries will very likely increase hiring, and this and the income transfer policies that the government has implemented for low income earners are expected to bolster consumption growth. Additionally, funds remitted home by overseas workers in the Middle East have failed to grow, stifled by political unrest and the global economic slowdown. However, the situation is rather better in Asia and North America, and given that more and more workers are specializing in professional jobs and finding stable demand for their labor, money remitted home by these workers may be expected to grow solidly, and this will in turn support the growth of personal consumption. Looking at the situation with regard to inflation, the effects of the tight monetary policy and economic deceleration are expected to cause inflation to come down over time. However, the Philippines often suffers from typhoons and other climatic vagaries, and if agricultural production is affected, incomes in farming communities will shrink and inflationary pressure may increase.

As far as fixed capital formation is concerned, with many businesses now increasing production and hiring, durable equipment investment should be able to maintain a certain level of growth. Other positive factors include the fact that personal consumption is solid and that capacity utilization rates are currently at high levels. Investment plans, which indicate future investment trends, are solid, and corporate loans are maintaining a high pace of growth. These factors also point to a recovery in investment growth.

Inward direct investment has been between 150 to 200 billion pesos annually since 2004, and improvements in the investment environment will be necessary to bring about a further increase in this level. In 2011, the Philippines' sovereign credit rating was raised, and it is hoped that improved confidence on the part of foreign investors will provide a significant level of support to direct investment. Also, there are plans for around 80 public private partnerships (PPP), worth a total of 740 billion pesos, to be implemented by 2016. Currently, private sector investors are reluctant to commit to infrastructure projects, given the considerable legal risks involved, but if these projects can be implemented there will be a very fast expansion of investment activity.

The diversification of the Philippines' export destinations is progressing, and exports to the US and Japan both are just over 15%, while exports to Europe are around 20% and those within Asia around 40%. Even against the backdrop of a very mild recovery in the global economy, it is expected that export growth, particularly to Asian destinations, will increase. While there are concerns that the price of crude oil may very well stay high and that the trade deficit will increase due to expanded imports, it is hoped that exports of services, such as business process outsourcing, will continue to grow at high levels, and that the current account surplus will expand.

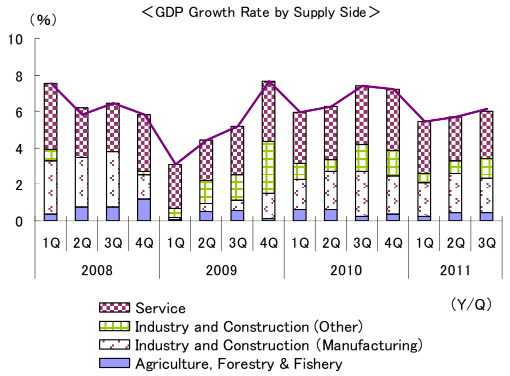
One worry is the fiscal balance trend. The fiscal deficit in the period January to August was 34.5 billion pesos, well below the 228.1 billion pesos deficit of the same period in the previous year. However, a major contributory factor here is that government spending was 8.1% lower than in the same period in the previous year. In the months ahead, it is envisaged that there will be a significant increase in spending on infrastructure development, education, poverty countermeasures and social security, and it is a bit unclear as to whether there is any real prospect of improvement in the fiscal balance situation. The government is trying to bring down the fiscal deficit to 2.0% against GDP by 2013. To achieve this goal, it will be imperative to realize high economic growth through investment expansion.

(Satoshi Shimizu)

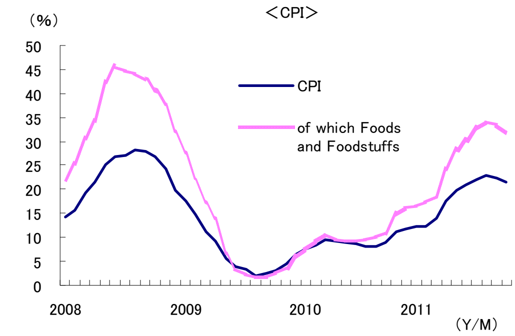
Vietnam 6.2% GDP growth forecast for 2012

■ 5.7% growth in 2011

Vietnam's real GDP in Q3, July to September, grew 6.1%, compared to the same period in the previous year, improving slightly on Q2, April to June, which posted 5.7% growth, and the growth rate for the period January to September was 5.8%, compared to the same period in the previous year. Although the growth rate is increasing slightly with each quarter, it is expected to blunt somewhat in Q4, October to December, due to the effects of sluggish exports to Europe and the US and poor domestic demand growth as a result of tight monetary policies. The Industrial Production Index (IPI), which had recovered to 6.9% growth in September, compared to the same period in the previous year, slumped again to 4.8% in October, following the drop in prices of natural resources, such as crude oil and gasoline. These developments suggest that the growth rate for the whole of 2011 may be expected to be 5.7%.



Source: CEIC



Source: CEIC

2011 saw 1) the oversupply of funds into the market as a result of economic stimulus measures adopted at the end of 2009 and 2) rising commodity prices as a result of higher gasoline and electricity charges, and the resolution of these issues was the major policy topic. As a result, individual consumption and investment were both forced into stagnation. The Vietnamese government does not release statistics about individual demand items but, since the actual retail sales performance for consumable goods and services in the period January to September grew at the unheard of low pace of only 3.9%, compared to the same period in the previous year, it may be concluded that private consumption is performing poorly. The Vietnam Automobile Manufacturers' Association (VAMA) has announced automobiles sales growth of 2%, compared to the same period in the previous year, for the period January to October, a total of 89,963 vehicles.

Investments also struggled. For the period January to September, gross capital formation grew 12.8% compared to the same period in the previous year. This is at best the nominal growth rate. Given the fact that September's consumer price index increase rate for September was 22.4%, compared to the same period in the previous year, the real growth rate will very likely turn out to have been negative. According to the Asia Development Bank (ADB), the Vietnamese government has cut fiscal spending and spending in state run enterprises by 80 trillion dong, equivalent to 3.5% of GDP.

■ 6.2% growth expected in 2012

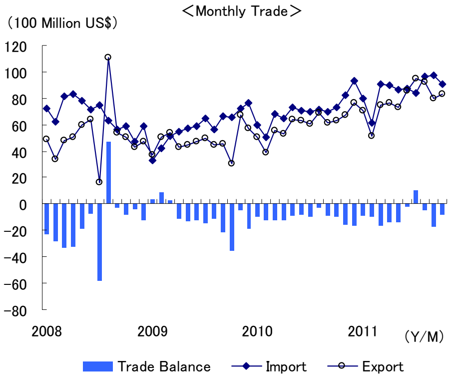
T Vietnam's economy faces a number of areas of uncertainty, such as rising commodity prices on the domestic front, and the eurozone debt crisis and Thai floods overseas. Even so, if the government and Central Bank can stabilize commodity prices, individual consumption and investments will gradually turn towards recovery, and a real GDP growth rate of 6.2% is expected in 2012. The prevailing view is that cutbacks in fiscal spending and the implementation of tighter monetary policy have resulted in commodity prices peaking, but prices of foodstuffs are still at high levels. Vietnam's economy in 2012 will be greatly swayed by whether the government can firmly maintain consistent fiscal and financial policies until commodity prices stabilize.

In February, the government adopted comprehensive policies aimed at restraining commodity prices, and Central Bank has attempted to tighten monetary policy by raising the reserve requirement ratio and re-financing interest rates (cap interest rates in open market operations). In spite of these measures, the continuing rise of commodity prices has caused worries over dong depreciation. This, in turn, has led to businesses and households transferring their capital outside of the regular financial system, to dollars and gold, so that the functionality of the government's financial policies has been damaged. Moreover, inconsistent financial policies have been a contributory factor in the deterioration of the situation. Despite the fact that commodity prices continue to rise, Central Bank has adopted a range of measures, including 1) refusing to change the prime lending rate, which is based on the commercial banks' dong-denominated lending rates and deposit interest rates, 2) providing funds, as needed, through open market operations so that small and medium sized enterprises will not face difficulties in obtaining funds, and 3) lowering the reverse repo rate in July.

Against the backdrop of these problems, the lack of progress in reforming the state run enterprises, as well as the delays in reforming the financial system, symbolized by the issues of Central Bank independence and over-banking, mean that Vietnam faces the risk of macro-economic instability in the months ahead, so that the problems cannot be resolved. However, Central Bank has stated that, while the credit balance at the end of October grew by a mere 8.6% compared to the end of the previous year, it is conducting further review with the aim of enhancing the efficiency of fiscal spending, so it may be expected that the upward pressure on commodity prices will soften somewhat for the foreseeable future.

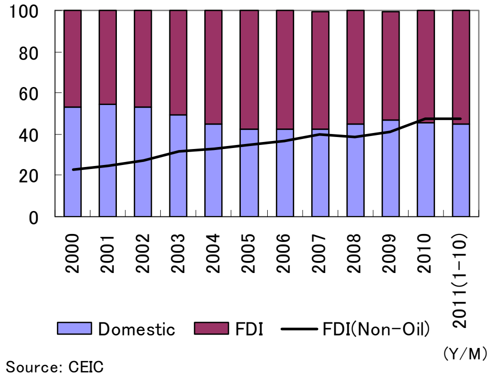
There is some good news in that the trade deficit, the prime culprit behind dong depreciation, seems to be trending towards improvement. Exports in the period January to October were up 34.9% compared to the same period in the previous year, worth $78 billion, with imports up 28.5% in the same period, worth $86.4 billion, leaving a trade deficit of $8.4 billion. The balance of trade deficit is tending to contract, due to 1) lower imports of petroleum products due to the operation of petroleum refining plants, 2) growth in exports of labor intensive products such as textiles, etc., 3) increased exports of machinery and parts and components and electrical and electronic parts by foreign firms, and 4) the rising prices of primary products such as rice, coffee, and cashew nuts. Crude oil accounted for 24.2% of exports in 2000, but this share declined to 7.8% in the period January to October, 2011. The diversification and high value added enhancement of exports through foreign direct investment is progressing steadily.

<Monthly Trade>



Source: CEIC

(%)<Export Share of Domestic and FDI Enterprises>



Source: CEIC

However, there is no shortage of concerns. First, as real estate prices have fallen, the non-performing loan ratio has risen. Urban sector housing prices are trending downwards and the view is that there is little prospect of their recovering by the latter half of 2012. Second, the raising of minimum wage levels has damaged the competitive strength of labor intensive industries. The government raised the minimum wage level in Hanoi and Ho Chi Minh City to 2 million dong (per month) in October. This latest measure has unified the minimum wage levels of both local and foreign businesses, raising the level for local business by 48.1%, and that of foreign businesses by 29.0%. While raising the minimum wage level will push up individual consumption, there is also the possibility that it will cause production facilities to be shifted to countries like Burma, where wage levels are lower. Third is the sluggish performance of PPP (Public Private Partnership) projects, which had been expected to be the trump card in infrastructure development. It has been more than a year since the selection of the pilot projects, but foreign investors to participate in the projects have still not yet been found. **(Yuji Miura)**

India Fiscal 2012 expected to post 8.2% economic growth

■ Fiscal 2011 expected to post a real GDP growth rate of 7.6%

India’s real GDP growth rate in April to June, 2011 was 7.7%, compared to the same period in the previous year, and the deceleration trend is continuing. In terms of industrial origin, agriculture did fairly well due to the recovery of the annual rainfall, but industry, which has been a driver of the economy, has decelerated over five consecutive quarters. In response to still high inflation, the Reserve Bank is continuing to raise its policy interest rate, causing corporate production and investment activity to lose vigor. Also, construction has slumped noticeably, due to the lack of progress in infrastructure development, caused mainly by political factors such as delays in approval procedures. In contrast, the services sector remains robust. With an extremely high growth in trade and double digit growth maintained in air freight, trade, hotels, transportation and communications are the drivers of economic growth.

Due to the increases in the prices of food and crude oil, the wholesale price index increase rate has been at 8% and above since the start of 2010, and has been in the 9% range from December of that year till September 2011. The policy interest rate has been raised incrementally since March 2010, and the repo rate and reverse repo rate rose from 4.75% and 3.25% to 8.5% and 7.5%, respectively.

The real GDP growth rate in fiscal 2011 is forecast to be on the order of 7.6%. Rising income levels have brought about changes in the consumption structure, leading in turn to shortages of vegetables and high-protein food, which has made it difficult for food prices to come down. Also, insufficient increases in the administered prices of petroleum related products make it also difficult for fuel prices to come down. Taking these factors together, the inflation rate is expected to remain high for the foreseeable future. The Reserve Bank sees as its priority the curbing of inflation, which is hindering growth in the mid term, and has, therefore, continued its tight monetary policy. There is now very little possibility that the policy interest rate will be increased any further, but already high interest rates will have an adverse impact on domestic demand.

Private consumption grew 8.6% in fiscal 2010, and was a driver of the economic recovery. However, the effects of inflation and high interest rates caused consumption growth to slow, and sales figures for domestic automobiles slumped to negative growth in July and August 2011. Growth is expected to be rather sluggish for the time being. There is a growing sense of concern among the public with regard to inflation, and it has become an imperative to try to clear the supply bottleneck through agricultural reform and infrastructure development. As regards fixed capital formation, there has been a significant deterioration in corporate sentiment, and there would appear to be little prospect of a rapid recovery.

In addition to the fact that domestic demand is expected to grow very slowly for the time being, there is also a possibility that foreign demand will also lose momentum. Exports have maintained very high levels of growth, but there are growing concerns over the worsening economic conditions in Europe and the US and other industrialized nations, and it will be difficult to sustain the current level of export growth. For the foreseeable future, it will probably be impossible for India to avoid economic deceleration. In 2012, the forecast is that the inflation rate will fall slightly and the economic growth rate will achieve a mild recovery.

<Real GDP by Expenditure Shares (YoY)>

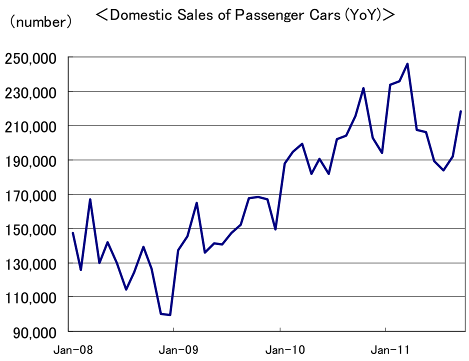
(%)

	F2008					F2009					F2010
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Q1
Real GDP	9.1	6.4	7.6	9.2	13.3	8.8	9.1	9.1	9.2	7.7	8.5
Private Consumption	7.3	6.6	8.5	7.0	7.2	8.6	9.5	8.9	8.6	8.0	6.3
Government Consumption	16.4	21.3	37.5	9.6	0.6	4.8	6.7	6.4	1.9	4.9	2.1
Gross Fixed Capital Formation	7.3	1.0	0.3	8.7	19.5	8.6	11.1	11.9	7.8	0.4	7.9
Exports	−5.5	−11.7	−14.1	−4.3	3.6	17.9	9.8	10.7	24.8	25.0	24.3
Imports	−1.8	−8.2	−16.0	1.3	18.1	9.2	15.2	11.6	0.4	10.3	23.6

Source: Center for Monitoring Indian Economy

■ Fiscal 2012 expected to post 8.2% economic growth

I India’s real GDP growth rate is expected to be around 8.2% in fiscal 2012. Although the economy may lose some momentum temporarily, India will still continue to post high levels of growth in the mid term. Even today, the services sector is growing strongly. Though there is expected to be some slowing in external demand, its upward trend is believed to be due in large part to structural factors reflecting India's outward opening. Foreign companies have been setting up businesses in India, and export competitiveness is gradually improving, leading to greater diversity of export items and destinations. In the future, exports will likely to be able to maintain a certain level of high growth.



Source：CEIC Database

Though the inflation rate will stay high for the time being, it is expected to begin to come down slowly eventually. Along with the slowdown in the global economy, it is hoped that international commodity prices will also begin to settle, that the deceleration of the domestic economy will cause a softening of demand pressure, and that the effect of tight monetary policy will begin to make itself felt. If inflation expectation cools as a result of a declining inflation rate, it is likely that there will be an end to increases in the policy interest rate, and monetary policy will likely switch to a neutral stance.

Under these circumstances, a gradual recovery in domestic demand may be expected. As regards private consumption, it will be bolstered by the fact that wages for both private sector employees and public officials are growing at double digit rates compared with the previous year. Also, in the agricultural sector, as infrastructure development and other forms of agricultural reforms progress, farmers' purchasing power is increasing. Additionally, as wage levels increase and urbanization spreads, lifestyles are continuing to change and it is expected that purchases of durable consumer goods will begin to increase again.

In terms of fixed capital formation, the end of the tight monetary policy and the lowering of raw materials costs will bring recovery in corporate earnings ratios, which will hopefully result in an improvement in corporate sentiment. This, in turn, is likely to lead to the vitalization of production and investment activities. It is hoped that a series of issues that are hampering infrastructure development and inward direct investment, such as the complicated approval procedures, the difficulties involved in land acquisition, and direct investment restrictions that remain in place for some industries, can be resolved step by step, and this will encourage investment growth. The 12th Five Year Plan (fiscal 2012 to 2016) calls for approximately $1 trillion worth of infrastructure development over the five year span, for a growth rate of 9% to be maintained. This will be the equivalent of about 10% of GDP over that period, and the advancement of large scale infrastructure development projects will support investment growth.

Around 30% of exports are accounted for by primary products (agriculture, mining) and petroleum products. These are expected to perform fairly strongly. Additionally, automobile exports will likely grow and an overall export growth of around 20%, year on year, is forecast. Around 30% of India's exports are accounted for by exports to Asia, and growth is expected in exports to Asia, particularly to China, Hong Kong and Singapore. The diversification of export items and destinations is expected to progress further.

In terms of growth risk factors, the first one is the global economic and financial situation. As India's current account deficit continues, inward direct investment has struggled to grow, leading to a growing rate of borrowings in capital inflows. Under these circumstances, if there is a sudden capital outflow, there may be a loss of liquidity and a sudden fall in the value of the rupee. The government will need to be very careful about the stable introduction of capital. The second risk factor is the growth of the fiscal deficit. In fiscal 2010, the deficit improved from 6.4% to 5.1% against GDP, but increases in petrol and fertilizer related subsidies have caused the deficit in the period April to September 2011 to expand about 2.2 times compared to the same period in the previous year. The reduction of the fiscal deficit will be vitally important in order to reduce inflationary pressure and win back international confidence. The Indian government will need to exert every effort into speeding up the selling off of government run companies' shares and the reform of the subsidy system. **(Satoshi Shimizu)**

China 8.8% economic growth forecast for 2012

■ 9.3% economic growth forecast for 2011

The pace of China's economic expansion is slowing. The real GDP growth rate for the period July to September, 2011, was 9.1%, compared to the same period in the previous year, falling from its peak in the period January to March, 2010.

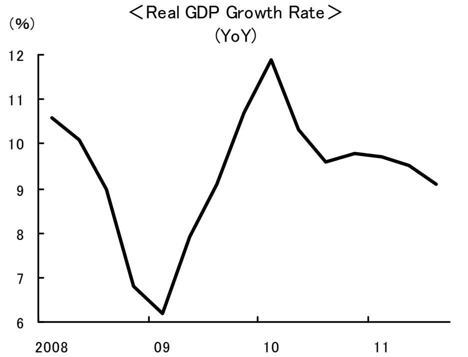
The main reason has been the decline in fixed asset investments. Investment in fixed assets (excluding agricultural households) grew strongly at 25.8% in the January to May time frame, compared to the same period in the previous year. The pace of growth began to slacken from May, and slowed to 24.9% in the January to October time frame.

In this respect, the following two points may be identified. The first is that a tight monetary policy has been followed since October 2010. The Chinese government raised interest rates a total of five times in that period, in October and December, 2010, and in February, April, and July, 2011. The reserve requirement was raised twice in November, 2010, and then once a month from December, 2010, till June, 2011.

In addition, in August, 2011, People's Bank of China expanded the scope of required reserves. Large financial institutions have been asked to prepare reserves of RMB345.6 billion with three months from September, and small and medium sized financial institutions RMB552.7 billion within six months from September. This is expected to have the same monetary tightening effect as raising the required reserve ratio two or three times.

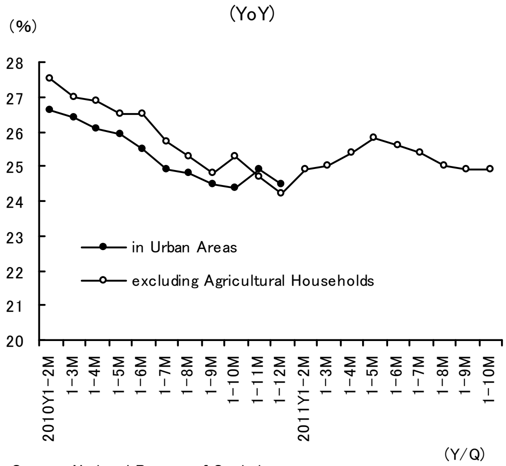
As a result of this tightening of monetary policy, investments in small and medium sized enterprises in processing manufacturing and other industries have slowed. Investments in communications equipment, computers and

＜Real GDP Growth Rate＞
(YoY)



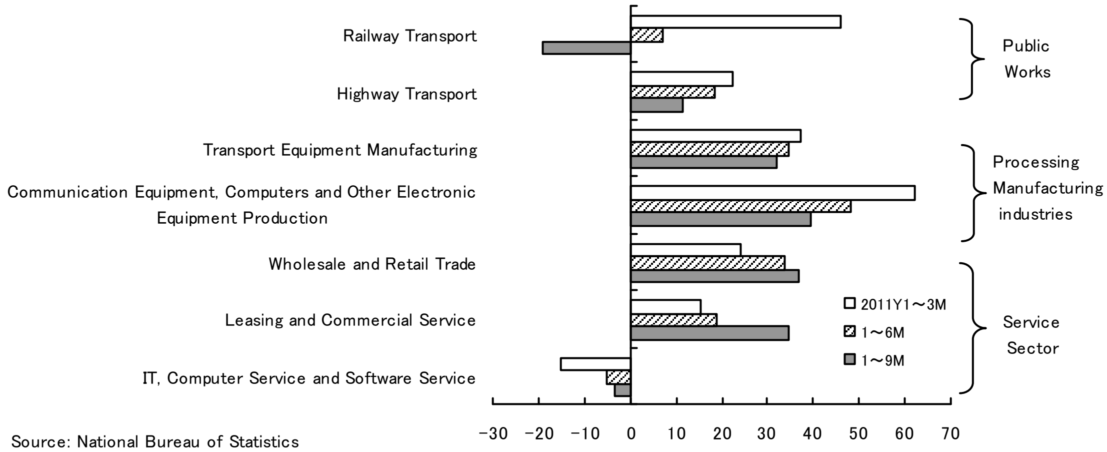
Source: National Bureau of Statistics

＜Investment in Fixed Assets＞
(YoY)



Source: National Bureau of Statistics

＜Investment in Fixed Assets＞
(excluding Agricultural Households、YoY)



Source: National Bureau of Statistics

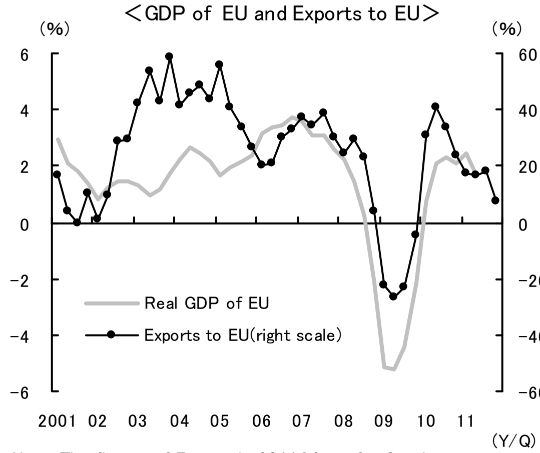
other electronic equipment manufacturing industries grew 62.0% in the period January to March, 2011, giving a strong impression of investment overheating. Rising interest rates and other factors caused the investment growth in the period January to September to contract to 39.4%, and the feeling of overheating eased somewhat. The pace of expansion in investments in the transport equipment manufacturing industry slowed similarly.

The second point is the recoil effect in public works investment. Between 2009 and 2010, infrastructure construction expanded quickly due to economic stimulus measures worth 4 trillion yuan. From 2011, the recoil effect caused motorway construction to decelerate, and railroad investment switched to negative growth, compared to the previous year.

Nevertheless, the dip in the pace of expansion in fixed asset investment is a small one, and overall growth continues to be strong. In early 2010, the growth rate of the cumulative value declined by 0.3 points every month, but this pace slowed to 0.2 points from May, 2011, onwards. Also, a 24.9% year on year growth rate posted in the period January to October is no mean achievement. In the same time frame, investments in communications equipment, computers and other electronic equipment manufacturing slowed, but were still between 30% and 40% up on the previous year.

Consumption and exports, as with fixed asset investments, have continued to post high levels of growth, in spite of experiencing a mild dip. Real retail sales grew 10.9% in the period January to February, 2011, compared to the same period in the previous year, an obvious loss of forward momentum when compared with 14.5% growth, in December, 2010, but were subsequently able to maintain a certain level of growth, and the figure for October was practically the same, at 11.7%, similarly. This has been due to continued favorable employment and income conditions. From 2011, labor shortages have continued, and in urban areas the job-to-applicants ratio is steady at 1.07. Per capita disposable income in urban areas grew 13.7% in the first three quarters, January to September, compared to the same period in the previous year. The slowing in export growth has been marginal, with export growth, principally to the new emerging economies, continuing to be high, posting 26.4% in the first quarter, January to March, 22.0% in the second quarter, April to June, and 20.5% in the third quarter, July to September.

＜GDP of EU and Exports to EU＞



Note: The figures of Exports in 2011Q4 are for October.
Source: China Customs, Eurostat

Reflecting the fact that the slowdown in domestic and foreign demand was a limited one, in 2011 industrial production has maintained a growth level of around 14% from the middle of 2010. In particular, production in communications equipment, computers and other electronic equipment manufacturing sectors grew strongly at 15.6% in October.

■ 8.8% growth forecast for 2012

Looking forwards to 2012, there are concerns that the European debt issue may worsen. Against the backdrop of slowing economic growth in the eurozone, China’s EU-bound exports are weakening. October’s EU-bound export growth slowed to 7.5% compared to the same period in the previous year. Exports to the EU account for 20% of China’s total exports. This is a significant share and its impact cannot be ignored.

Going forward, there is a strong possibility that eurozone economies will decelerate further and that growth in exports to the EU will be blunted. The forecast is that electrical equipment and industrial machinery, which make up 50% of China’s exports to the EU, will face increased downside risk, as in the days following the Lehman Brothers’ collapse. Exports of industrial machinery to the EU fell drastically to minus 20.4% in 2009, and electrical machinery minus 17.8%, compared to the same period in the previous year.

If the European debt issues worsen and eurozone economies suffer to a similar extent as in the wake of the Lehman Brothers’ collapse, China’s exports will inevitably decline.

However, examination of the past correlation between eurozone economic growth rates and exports to the EU shows that, if the eurozone economic growth decline is limited to a mere slowing and is able to maintain positive year on year growth, then EU-bound exports should be able to maintain positive year on year growth. This is where China's EU-bound exports differ from Japan. Japan's EU-bound exports will switch to negative growth, even if eurozone economic growth is zero (figure below right).

China's exports to the EU are characterised by many textiles and toys, in comparison with Japan. As of 2010, exports of textiles and toys accounted for 24% of the total. Mechanical items, such as automobiles and televisions, are optional consumption, and their income elasticity is high. On the other hand, textiles and toys have comparatively low income elasticity. In 2001, when the EU suffered an economic slowdown and Japan's exports to the EU converted to negative year on year growth, China's EU-bound exports were able to maintain positive growth.

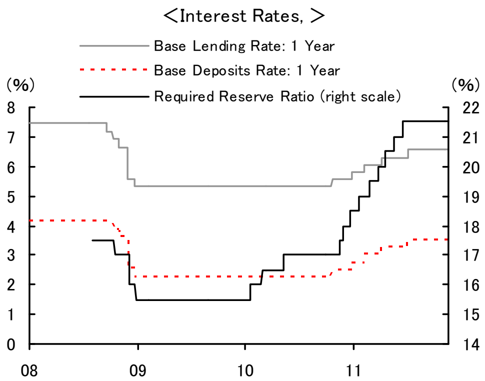
Additionally, as focus on low pricing intensifies in the eurozone, Chinese products' share of EU markets is soaring (figure upper right). This is a similar situation to the one in which deflationary Japan found itself in the late 90's. In the future, if the eurozone's economic stagnation turns out to be a protracted one, relatively cheap Chinese products will be favored strongly, which will be a factor supporting EU-bound export growth.

Meanwhile, domestic demand is expected to grow at a solid pace. Also, the forecast is that investments will maintain high levels of growth, for the following three reasons.

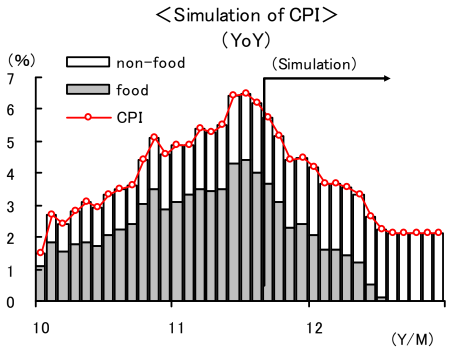
First, monetary policies changed. The required reserve ratio has been held unchanged since June, and the statutory interest rate since July. After the scope of the required reserves was expanded in late August, there have been no new tight monetary measures introduced (figure middle right).

Second, there will likely be an end to the recoil decline in public utilities investments. There is only a very slight possibility that the decline in public utilities investments will be a protracted one. There is a strong probability that there will be a mild recovery, especially in the interior.

Third, investment in the service industries is expanding. Service markets are expanding rapidly, mainly in the coastal cities, and this trend looks set to continue.



Note: RRR are figures of Large Depository Institutions.
Source: The People's Bank of China



Note: If food prices stop rising , non-food prices would rise 3.0%(YoY) after August 2011.
Source: The Japan Research Institute, Ltd., based on the data of the National Bureau of Statistics of China

Further, as inflation settles in the months ahead, it is expected that there will be more room for financial policy easing. China's consumer price index (CPI) increase rate tends to be linked to economic performance, just as in the developed nations. Recently, temporary factors such as a shortage of supply of pork and other foodstuffs, caused the CPI increase rate to stay at a high 5.5% in October, compared to the same period in the previous year. However once the supply shortage is addressed, the CPI increase rate is predicted to fall to a level matching the real GDP growth rate (figure lower right). (For details, see Asia Monthly, November, 2011, edition.)

The settling of inflation will not only be good news for investment in fixed assets through the easing of the tight monetary policy, but will also give a boost to households' real incomes. As a result, individual consumption will be boosted, which will hopefully support the Chinese economy.

From the foregoing, it may be expected that, although the driving force of external demand will be somewhat weakened in 2012, domestic demand will expand solidly and the economy will grow at a comparatively high level of 8.8%. **(Shinichi Seki)**