ASIA MONTHLY

September 2013

株式会社日本総合研究所

http://www.jri.co.jp/english/periodical/asia/

Topics Japan – ASEAN bilateral financial cooperation progressing

Asian regional financial cooperation is progressing steadily. Efforts to strengthen the Japan – ASEAN bilateral financial cooperation that had been announced in May are expected to bring further progress and to bring significant benefits to Japan.

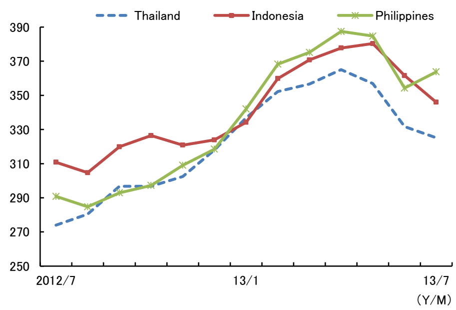
■ Asian Bond Markets Initiative (ABMI) moving ahead

With hints that US quantitative easing could be scaled back which were given in May, and with the Chinese economy showing signs of deceleration, the flow of capital out of Asia began to expand. Share prices dropped and exchange rates depreciated markedly. As with the Asian financial crisis of 1997 and the Lehman shock of 2008, there has been a repeated and vigorous flow of capital in and out of Asia, and the managing of this capital flow is now an extremely important issue. Meanwhile, with the advance of globalization, capital flow expansion and fluctuation rates continue to rise, and it is becoming more difficult to respond to these developments.

Against this backdrop, regional financial cooperation with a crisis management aspect is growing more and more important. Under the Asian Bond Markets Initiative (ABMI) being conducted by the ASEAN+3 finance ministers and central bank governors' meetings, the former "New Roadmap" was reviewed and a "New Roadmap +" was adopted in May 2012, listing nine priority items. These items were selected after much debate, with the understanding that, more than ever before, concrete results were required. The relevant task forces drew up their work plans in order to ensure the realization of these results.

The nine items include the start-up of the CGIF (Credit Guarantee and Investment Facility) and the reinforcement of the activities of ABMF (ASEAN+3 Bond Markets Forum). The role of CGIF, established in November, 2010, is to support the issue of local currency denominated bonds by investment grade companies within the Asian region (so graded by local rating agencies) by guaranteeing 100% principal and interest payments. The envisaged targets for support would include 1) cross-border bond issues, 2) bonds that are of investment grade, but which are difficult to be issued alone because they are for companies that have a comparatively low rating, and 3) bonds whose maturity can be extended by guarantees. The main issuers are assumed to be of the ASEAN5 countries (Indonesia, Malaysia, the Philippines, Singapore, Thailand). At some point in the future, the guarantees may include cases that the issuers from other ASEAN countries (BCLMV) issue bonds in Japan, China, and Korea, as well as their own markets.

＜Stock Price Index（Jan.2009＝100）＞



Source：from each country

In April of this year, as the first project, Thai baht bonds (three year period, value roughly $100 million) issued by a Hong Kong trading company, Noble Group, were guaranteed. As the capital of CGIF is just $700 million, it is very likely that recapitalization will be considered in the future.

Meanwhile, ABMF is a public – private collaborative forum that was established in 2010. With the aim of adopting regional common bond issuance programs for professional investors (AMBIF: ASEAN+3 Multi-currency Bond Issuance Framework) and of improving and integrating the settlement systems of countries in the region, meetings are held roughly once every three months in various places of the region and the debate is on-going. In July, the 13th meeting was held in Tokyo. The number of participants has expanded to around 100 persons, making it a unique discussion forum for the promotion of regional financial integration.

Further, in the joint statement released by the ASEAN+3 meeting of finance ministers and central bank governors in May, 2013, the establishment of an initiative on "Fostering Infrastructure Financing Bonds Development" was approved, and efforts are continuing towards the expansion of financing means for infrastructure development.

■ Strengthening bilateral financial cooperation between Japan and ASEAN countries

Japan plays a central role within ABMI, and in May, announced that it would be strengthening bilateral financial cooperation with individual ASEAN 5 countries. This development follows a certain degree of success having been achieved through multilateral cooperation, including CMIM (Chiang Mai Initiative Multilateralisation) and ABMI, and seeks to add bilateral policy dialogue and cooperation to this in order, for example, 1) to promote further financial cooperation, 2) to enable a more finely tuned response to the different needs of countries at different stages of economic development, and to contribute to the promotion of intra-regional demand, and 3) to provide support for active Japanese companies doing business in Asia from the perspective of local currency procurement.

In the months ahead, the joint working groups established between Japan and these various countries will work to grapple with a range of issues. Individual issues will differ country by country, but may be summarized in general as follows. 1) The re-engagement and enhancement of bilateral currency swap agreements: promoting the re-engagement of agreements that have already ended with Malaysia, Singapore and Thailand. 2) Expanding the use of local currencies by Japanese firms doing business in those countries (see below for details). 3) Supporting the development of local currency denominated bond markets: reinforce activities for the realization of AMBIF in different countries. 4) Promoting the use of Islamic finance: work to expand the use of Islamic finance in Malaysia by Japanese firms and banks. 5) Infrastructure development support that takes ASEAN connectivity into account: support for PPP project preparation and advice on capital procurement frameworks, etc. 6) Technical support for the development of financial markets in ASEAN countries: joint support for the capacity development of authorities in the BCLMV countries, sharing of knowledge related to small and medium sized enterprises credit, and reinforcing technical cooperation in financial markets overall. Further, Japan is trying to promote cooperation with the BCLMV countries with respect to items 5) and 6) in particular.

Item 2) is particularly concerned with bilateral cooperation, and examples of concrete proposals include local currency supply through cross-border collateral schemes backed by Japanese government bonds (principally for response to emergencies. Examples would be coordination between BoJ and BoT at the time of flooding in Oct. 2011); establishment of foreign exchange markets for the direct exchange between Japanese yen and one of the ASEAN currencies (we already have this kind of market for yen and Chinese RMB); the Japan Bank for International Cooperation (JBIC) two step loan scheme for the supply of capital to Japanese firms, etc.; representation and intermediation by Japanese banks in transactions between local banks and Japanese firms; and JBIC guarantee grants for long term currency swap transactions. If these can be achieved, it is possible that the results will include the reinforcement of local banks, and the greater empowerment of Asian currencies overall through the expansion of local currency denominated business transactions. In the working groups with each country, the Japanese side is represented by delegates from the Ministry of Finance, the Financial Services Agency, BoJ, Japan International Cooperation Agency (JICA) and JBIC. It is expected that inter-agency collaboration will lead to effective cooperation.

■ Significance and challenges of stronger regional financial cooperation

The strengthening of bilateral financial cooperation is expected to have benefits for both sides. In order for Japanese banks to widen their scope of activity in Asia, it will be necessary for these countries to relax some of their restrictions, and in order for Japanese institutional investors to be able to expand their investments in Asian bonds, it will be essential for the liquidity of secondary markets to be improved, for some capital transaction restrictions to be relaxed, for settlement systems to be fully developed, for withholding taxes to be abolished, and for a range of obstacles to be removed or relaxed. However, these will likely be difficult to achieve in the short term and, as a premise, long term support for the improvement of standards in Asia's financial systems will be required.

In addition, in order to attract Asian economic entities to Japan, the Tokyo Pro-Bond market has started to be utilized, and the Japan Exchange Group is working on the development of strategies for its businesses with Asia. In these initiatives, it will be very important to give full consideration to the benefits to the other side. To that end, it will be vital to have a deeper understanding of the movements going on within Asia's financial and capital markets and economic entities. Further, support of the fostering of institutional investors in the region will surely lead to greater investment in Japan.

＜Institutional Investors vs. GDP (Year 2011)＞

(%)

	Pension funds assets	Insurance premiums	Mutual funds assets
China	1.8	3.0	5.6
Hong Kong	20.6	11.6	415.1
Indonesia	1.7	1.8	2.3
Korea	29.2	10.8	21.1
Malaysia	57.1	5.2	30.4
Philippines	10.8	1.3	1.1
Singapore	66.5	8.0	423.6
Thailand	5.2	4.5	19.8
Japan	25.1	11.0	12.7

Source：from each country, Swiss Re, Investment Company Institute

(Satoshi Shimizu)

Korea Growth accelerated, but outlook warrants caution

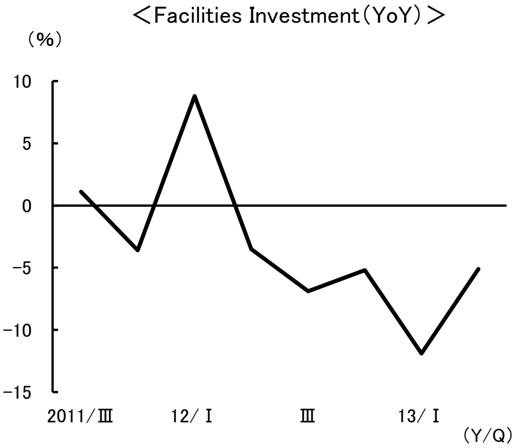
■ Q2 growth up 1.1% on previous quarter

South Korea's real GDP growth rate for the April to June quarter (compared to the previous quarter) was 1.1%, up from 0.8% in the January to March quarter (on a year on year basis also, 2.3% growth, up from 1.5% in Q1). This marks the first 1% range growth rate in nine consecutive quarters.

Export growth decelerated from 3.0% in Q1 to 1.5%, and fixed capital formation from 3.8% to 1.9%, similarly, but private sector consumption accelerated from minus 0.4% in Q1 (largely due to the weakening of the tax reduction effect) to 0.6%, and government spending was up from 1.2% to 2.4%. With regard to fixed capital formation, construction investment, which had been doing poorly until last year, followed 4.1% growth in Q1 with 3.3% growth, continuing the recovery trend, while facilities investment changed to negative growth again, coming in at minus 0.7%.

Overall, the accelerated economic growth in the April to June quarter may be said to have been largely due to the government's economic stimulus measures (supplementary budgets, front-loaded budget implementation, real estate measures, etc.). In terms of recent developments, export growth (customs cleared basis, flash report) was minus 1.0% in June (compared to the same period in the previous year) but recovered to 2.6% in July, and automobile sales in July exceeded the previous year's level for the first time in three months, both indicators of a gradual economic recovery.

<Facilities Investment (YoY)>



Source: The Bank of Korea, Economic Statistics System

■ Cautious future outlook

The economic growth forecast for 2013 was revised upwards in June by the S. Korean government to 2.7%, up from a 2.4% forecast in March, and by Bank of Korea to 2.8% in July, up from 2.6% in April, signs that the sense of crisis over economic deterioration has weakened somewhat, but the following points need to be borne in mind in the near future.

One is the trend in facilities investment. Year on year growth in facilities investment has been negative for five consecutive quarters. In addition to the deceleration in domestic and overseas demand, the impact of government policy needs to be considered also. In the retail sector, from 2012, there has been a widening of movements towards business restrictions on large companies. Because of the significant influence of the chaebol, there may be a need for some restrictions on their entry into the business areas of small and medium sized enterprises. However, it cannot be denied that some restrictions have been intensified under the broad banners of "co-existence of large and small and medium sized enterprises", and "economic democratization", and that this has caused some contraction in corporate investment.

Another point is the trend in the housing market. In September, 2012, as economic countermeasures, 1) for first time housing purchases, the real estate acquisition tax on acquisition prices up to 900 million won was reduced from the current rate of 2% to 1%, 2) the real estate acquisition tax on acquisition prices of 900 million won or over, or for purchases of multiple residences, was lowered from the current 4% to 2%, and 3) a five year capital gains tax exemption on purchases within the year of unsold residential properties, etc., was implemented. These measures were originally scheduled to finish at the end of the year, but were extended until June, 2013. This resulted in an increase in the number of business transactions, but the sharp drop in that number in July indicates the effect of the end of the stimulus measures (under the Park Geun-hye administration, a new policy of "housing market administration" has been implemented, and acquisition tax exemptions have been introduced, with some conditions).

On August 5, President Park replaced a number of her cabinet secretaries and her presidential chief of staff, in an effort to promote more effectiveness in parliamentary business and internal affairs. Attention will need to be paid to the administration's policy management under the current challenging economic conditions.

(Hidehiko Mukoyama)

Hong Kong Consumption expansion supporting economy

■ Exports and imports slump, but retail sales are solid

Though poor trade performance is blunting the pace of recovery, Hong Kong's economy is fairly solid, supported principally by expanding consumption.

Exports in May were minus 1.0% compared to the same period in the previous year, and in June minus 0.2% (with the same results for both US$ denominated and HK$ denominated figures), falling below the previous year's figures for two consecutive months. June exports (HK$ denominated) to major countries and regions returned to year on year positive growth for the EU from December, 2012, while exports to China, which accounted for 54.1% of the total export worth (in 2012), fell below the previous year's level for the first time in 12 months, excluding the months of January and February, during which there are significant fluctuations caused by the lunar new year holiday. There are concerns that Hong Kong's export stagnation may be a prolonged one as a result of the deceleration of the Chinese economy.

Imports also, in concert with the sluggish performance of re-exports, have continued to trend downwards since April. Trade services accounts for 20.7% of Hong Kong's industry specific GDP (2011), making it a major industry. Given the industrial structure, the poor performance of trade transactions must surely cause domestic demand to slump.

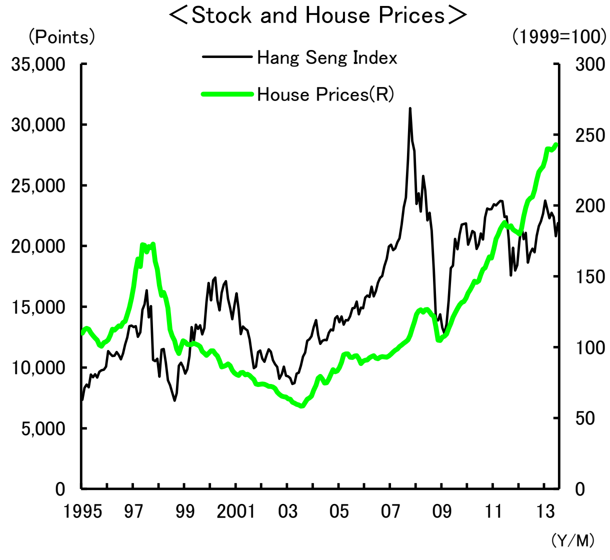
Under these conditions, it is consumption that is supporting the economy. Retail turnover has continued to increase at the rate of between 10 to 20% on an actual basis, compared to the same period in the previous year, due to factors such as 1) the increased number of visitors to Hong Kong, 2) good employment conditions (the unemployment rate is low and stable at 3.3%, after seasonal adjustments, for April to June), and 3) rises in the minimum wage level and in wages generally.

■ Resolution of real estate problems key to economic and approval rate recovery

Looking at economic trends going forward, it is believed that, in its second year, the most important task for the Hong Kong government, led by Chief Executive CY Leung, will be the appropriate resolution of real estate problems.

Though the government has implemented measures to curb the soaring real estate market, the housing price index (1999 = 100) was above the previous month's level for two consecutive months, in May and June, and market overheating has yet to be reined in. The continuation of countermeasures is believed essential to resolving the problem. On the other hand, there are increasing calls for restrictive measures to be stopped, particularly from real estate brokers who are suffering from the reduced number of transactions. The challenge for the Hong Kong government will be to continue with measures to control real estate transactions, while at the same time trying to minimize the demerits.

＜Stock and House Prices＞



Source: Hong Kong Government, CEIC

From late July onwards, there have been demonstrations protesting against the planned North East New Territories development, as well as growing criticism of the fact that family members of two officials in the Development Bureau were found to have land interests in the region. As a result, the approval rate of Chief Executive CY Leung and his administration has fallen to its lowest level since his inauguration (according to a periodic opinion poll conducted by the Chinese University of Hong Kong).

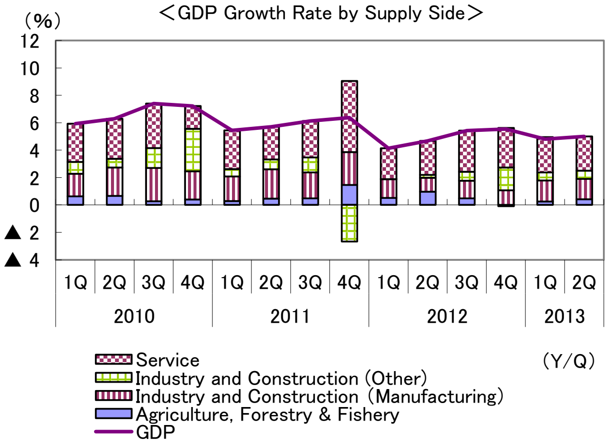
If Chief Executive Leung is to recover his approval rate and the economy, he will need to address the two challenges of calming the real estate market and dealing with the vested interests of two high ranking officials.

(Junya Sano)

Vietnam *Little progress in disposal of non-performing loans*

■ Q2 GDP growth rate 5.0%

Vietnam's real GDP growth rate in the April to June quarter was 5.0%, compared to the same period in the previous year, slightly up on 4.8% posted for the January to March quarter. In terms of supply item contribution, agriculture, forestry and fisheries was 0.4% points, construction related manufacturing 1.5% points, non-manufacturing 0.6% points, and services 2.5% points. Of course, growth for the period January to June was only 4.9%, similarly, making the government's target for 2013 (5.5%) difficult to achieve.



Source: CEIC

The statistics for demand items have not been released, but it is believed that both domestic and foreign demand have performed poorly. The real growth rate for the retail value in the January to June period for consumer goods and services, which is an indicator of private consumption, was only 4.9%, compared to the same period in the previous year. Investments also struggled, with social capital investment in the January to June period up 5.9% on a nominal basis. Considering the consumer price index rate of increase for June (6.7% compared to the same period in the previous year), actual investment growth might very well turn out to have been negative.

External demand is also performing poorly. Exports in the January to July period were bolstered by mobile telephones and grew 15.6%, $73.6 billion, compared to the same period in the previous year. However, the dependence on imports of parts and components means that an increase in export growth also triggers an increase in import growth, and does not contribute much to improving the balance of trade. Increases in imports of machinery and parts and components boosted import growth to 18.4%, $74.4 billion, outstripping that of exports, so that the $730 million balance of trade surplus of the same period in the previous year turned into an $870 million deficit.

■ No shortage of economic management problems ahead

The government faces the challenges described below, and will be forced into some tough economic management over the latter half of the year. The first problem is that there are no signs of any recovery in investments. The banks do not appear to be making much headway in the disposal of non-performing loans, so there does not seem to be any room for movement. Against this backdrop, there are growing calls for fiscal stimuli in order to prevent any further economic deterioration, and in July the government revealed plans for 40 trillion dong of special financing for real estate development projects, with the nominal aim of bolstering the real estate market, which continues to struggle. However, as real estate prices continue to tumble, there are criticisms to the effect that this financing will end up being no more than a bail-out for the real estate developers, and there are doubts as to whether it will really go ahead.

The second problem is that of rising commodity prices. The consumer price index rate of increase for July was 7.3%, compared to the same period in the previous year, well above the target (6%) level set for 2013. The principal cause of this was the rise in prices of transportation and foodstuffs, brought about by increases in the prices of diesel oil and gasoline. If commodity prices continue to rise, tighter monetary policy will be unavoidable, which in turn cannot help but induce a slump in investments and private consumption.

The third challenge is the burgeoning fiscal deficit. Revenues in the January to June timeframe could only reach the 39.8% level of the initial budget, and the fiscal deficit reached 5.59% against GDP. This is well above World Bank's estimate for 2014 (4.0% against GDP), made in July. The government, in addition to expenditure restraints, such as putting off non-urgent business trips, etc., is also considering the issue of government bonds in order to procure financing for much-needed projects.

(Yuji Miura)

China Advancing reform while keeping an eye on the economy

■ Economic management policy for the latter half of the year fixed

The Politburo of the Communist Party of China convened on July 30 and determined its economic management policy for the rest of the year. Particular attention is paid to the following two points.

First, the continuation and deepening of a range of reforms was reaffirmed. Currently, from the perspective of vitalizing the private sector, the Chinese government is moving towards abolishing government approvals and licenses, and transferring these to local government. The Politburo evaluated a review of the government approvals and licenses, and transferring which was exercised during the first half of the year, and announced that, continuing over the latter half of the year, it would work to abolish the government approvals and licenses, and transfer them to local government. The statement also incorporated policies for the deepening of the reforms of fiscal, taxation, and financial systems as priority issues to be tackled over the latter half of the year.

<Economic Management Policy for the Latter Half of the Year>

Priority Areas	Main Points
Correspondence of Economic Trends	・Pre-tuning and fine-tuning in response to changing circumstances
Policy Measures	・Continuing its proactive fiscal policy, and prudent monetary policy
	・Support to Small and Medium Sized Enterprises, and stabilizing foreign trade
Continuing Reform	・Deepening of the reforms of financial systems, fiscal, taxation
	・Abolishing government approvals and licenses, and transferring these to local government

Source: News of the Communist Party of China's Website

Second, although certain measures have been implemented in light of the trend of economic deceleration, no clear mention was made of plans to implement any large scale economic stimulus measures. The fact that the Politburo has emphasized "pre-tuning and fine-tuning in response to changing circumstances" may be taken as a sign of this stance.

Further, in line with the decisions taken to work to reduce the burden of small and medium sized enterprises, and to stabilize foreign trade, there have been 1) a temporary suspension of the business tax and value added tax on businesses with a monthly turnover of under 20,000 yuan, and 2) measures to simplify customs procedures and to lower related fees. However, reports from the meeting contained no suggestions of any significant fiscal stimulus such as the expansion of public works, or of positive moves towards financial easing, such as lowering interest rates, and stopped at affirming the policy of "continue to implement the proactive fiscal policy and prudent monetary policy".

From these statements, it might be conjectured that the government's stance will be one of advancing reform while keeping a careful eye on the economy.

■ Attention focused on future decisions of Xi administration

According to recent economic indices, fixed asset investment in the January to July period (excluding rural households) was up 20.1%, compared to the same period in the previous year, maintaining the same growth rate as the January to June timeframe. Nominal retail sales turnover for July also was up 13.2%, compared to the same period in the previous year, maintaining roughly the same pace of growth as in June (up 13.3%, similarly). Also, in terms of trade, exports recovered to positive year on year growth for the first time in two months, and imports the same for the first time in three months. The need to come up with short order large scale economic stimuli may be said to have receded somewhat in comparison the situation at the end of June.

For the Xi Jinping administration, the economic slowdown has not been stopped, but as long as the annual economic growth target (approx. 7.5%) is not missed by too much, the probability is that the policies described above will be continued. However, as a trade-off for the advancement of painful reforms such as administrative and financial reform, and the reform of state owned enterprises, it may be envisaged that the government will accede to the requests from local government and central government agencies for a significant increase in investment projects. While the acceleration of various reforms is a topic that is expected to be raised during the plenary session of the Central Committee of the Chinese Communist Party scheduled for this autumn, all eyes will be on the judgement of the Xi administration.

(Junya Sano)