ASIA MONTHLY

January 2016

株式会社日本総合研究所

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

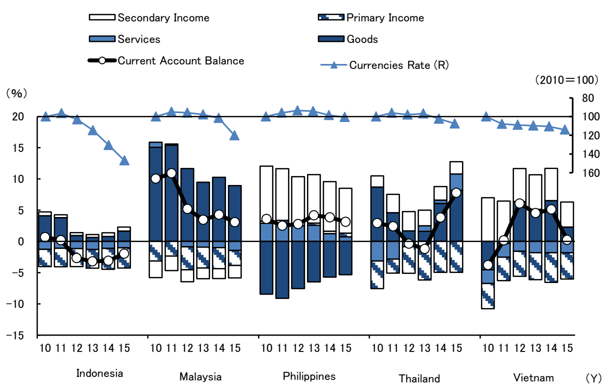
Topics Services surplus expansion expected in ASEAN

In recent years in ASEAN 5, in response to currency depreciation, the conversion of the current account balance to a surplus and the expansion of the surplus have become urgent tasks. One answer that is attracting attention is the growing of the credit of the services account through the attraction of Chinese tourists, etc.

■ Current account balance needs to be converted to surplus and expanded urgently

Since the May, 2013, Bernanke shock, when the US FRB hinted at a scaling back of quantitative easing, the currencies of many of the newly emerging economies have been depreciating sharply. Although there are typically many influencing factors behind currency depreciation, the trend has been observed that those countries with current account deficits or shrinking surpluses tend to have more serious currency depreciation. Within ASEAN5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam) it has been seen that in Indonesia, which has continued to post a current account deficit since 2012, the rupiah has lost more than 40% of its value against the dollar (rate of change between the average for 2012 and the average for January to November, 2015), and Malaysia, where the balance of trade surplus has contracted due to the falling prices of natural resources, has seen the ringgit fall by 25%. In Vietnam, where the degree of openness to capital markets is low, the dong has managed to keep its depreciation to within a small range, but is nevertheless under severe depreciatory pressure, having been devalued three times since the start of 2015, and the fluctuation range having had to be expanded twice. Many of the newly emerging economies are thought likely to be vulnerable to the continued depreciation of their currencies, due to the capital outflow that is expected to accompany US interest rate hikes, and it has become an urgent task for them to convert their current account balances to the black, and to expand the breadth of the surplus.

＜Currencies Rate against the US Dollar and Current Account Balance (percent of nominal GDP) in ASEAN＞

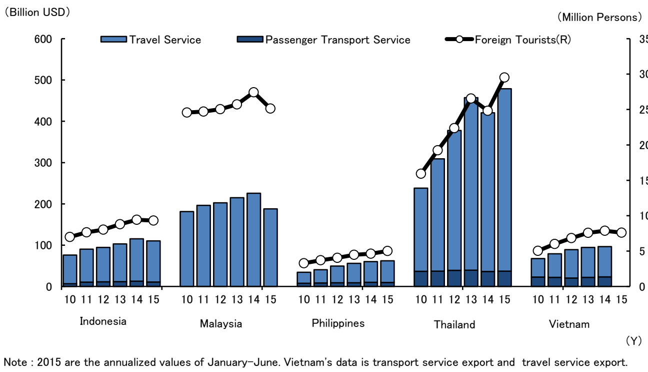


Note : Current Account Balance of 2015 are the annualized values of January-June. Nominal GDP of 2014 and 15 in Vietnam, 2015 in other countries are estimated by IMF. Currencies Rates of 2015 are the average values of January-November.
Source : IMF Bloomberg L.P.

■ Growing importance of services account balance

However, the situation facing ASEAN5 is tough. With the exception of the Philippines, for countries where the balance of trade accounts for over half of the current account surplus, sluggish export growth as a result of the deceleration of the Chinese economy and the falling prices of natural resources and primary products, and increased imports of intermediate goods and capital goods along with infrastructure development, have meant that there can be little prospect of further increase in the breadth of the surplus for the time being. In addition, while foreign direct investment is increasing, investing foreign companies are sending more and more interest and dividends to their home countries. Therefore, the primary income balance, which records the receipts and payments of interest and dividends, etc., of external debts and credits, may be expected to continue to show a growing deficit. Moreover, with regard to the secondary income balance, which records the receipts and payments of assets without consideration between residents and non-residents, although surpluses continue strongly in those countries that have many overseas workers, given the lack of strength in the recovery of the global economy, these surpluses cannot be expected to expand very significantly.

＜The Credit of Passenger Transport Service, Travel Service and Foreign Tourists＞



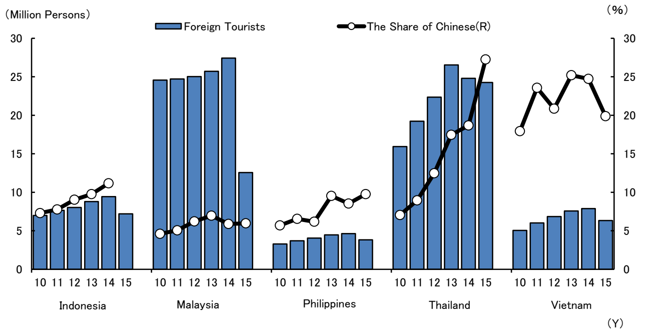
Note : 2015 are the annualized values of January-June. Vietnam's data is transport service export and travel service export.
Source : Tourism-related offices, GSO, IMF

Against this backdrop, the importance of the services account balance, which occupies a certain size within the balance of current account, is growing. The services account balance comprises “transportation services (freight and passenger)”, “travel services”, and “other services”. Given the slowing growth in global trade volume, it is highly unlikely that freight transportation credit will be able to play the role of driver in the effort to convert the services account balances into the black, and to expand the surplus. As for other services credit, it is weak except for the Philippines, where BPO (Business Process Outsourcing) is active, so there is much attention being paid to the expansion of credit in passenger transportation services and travel services as one possible solution.

■ Focus is on winning Chinese tourists and increasing per capita expenditure

In ASEAN5, since 2010, receipts for passenger transportation services and travel services have generally been in expansion mode, due to the increase in the numbers of tourists from foreign countries. The reasons for this increase in the number of foreign tourists include the fact that the efforts made by countries to attract tourists have paid off, and that the middle income tier in China has expanded. The share of Chinese tourists in ASEAN5 is growing in conjunction with, or even faster than, the increasing the total number of tourists. In Thailand in particular, that percentage has risen from 7.05% in 2010 to 27.3% in 2015, and it may be taken that the increase in the number of Chinese tourists is pushing up the overall figure.

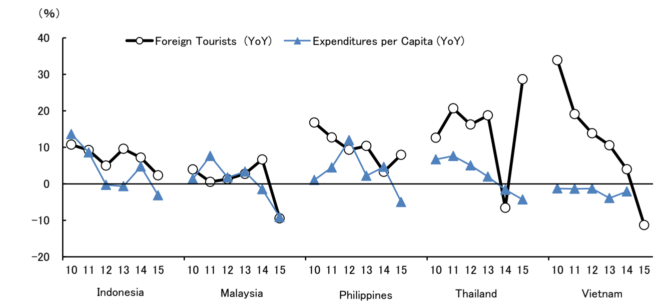
＜Foreign Tourists and The Share of Chinese＞



Note : The data of 2015 is January-September in Indonesia and the Phillipines, January-June in Malaysia, January-Octorber in Thailand and Vietnam. Chinese in Malaysia includes HongKong and Macao.
Source : Tourism-Related Offices

In China, along with the rise in income levels brought about by economic development, the middle income tier is expanding greatly. According to the International Labor Organization (ILO), the number of people in the “developing middle class” (per diem spending of $4 or more) in 2002 (per capita GDP: $1,138) was 400 million, rising to 800 million by 2010 (per capita GDP: $4,504). The International Monetary Fund (IMF) is forecasting that the per capita GDP for 2015 will be $8,280, doubling from 2010, and will reach $12,000 or higher by 2020, so it is not difficult to conceive that the 350 million people who formed the “near poor” (per diem spending of between $2 and $4) and the 130 million people who formed the “moderately poor” (per diem spending of between $1.25 and $2) in 2010 will have joined the ranks of the middle income tier by 2020. In the effort to improve the balance of services, for each country the focal point will be how well they can attract this middle income tier in China.

＜Foreign Tourists and Expenditures per Person＞



Note : The data of 2015 is January-June.
Expenditures per Capita = (Credit of Passenger Trasport Service + Credit of Travel Service) / Foreign Visit Arrivals
Malaysia is only passenger transport service. Vietnam is transport service export and Travel service export. All data is dollar-based.
Source : Tourism-related offices, GSO, IMF

However, the foreign tourist figures for 2015 show that growth is slowing in Indonesia, and has changed to a decline in Malaysia and Vietnam. Also, per capita expenditure growth among foreign tourists has fallen below the previous year’s levels, with the exception of Vietnam, from where data are unavailable.

In the future, it will be important not only to increase the number of Chinese tourists, but also to increase their per capita expenditure through the delivery of higher added value services.

It goes without saying that it will be imperative for the countries of ASEAN5 to work on the improvement of their investment environments and the development of their infrastructure, and to further the higher added value of their exports through the sophistication of their manufacturing industries. Nevertheless, when it comes to working out ways of converting the balance of current account to a surplus, and of expanding the surplus, given that services account balances are playing an ever greater role in supporting current account balances, it will also be necessary to give consideration to the fostering and enhancement of service industries that can satisfy the needs of visiting tourists.

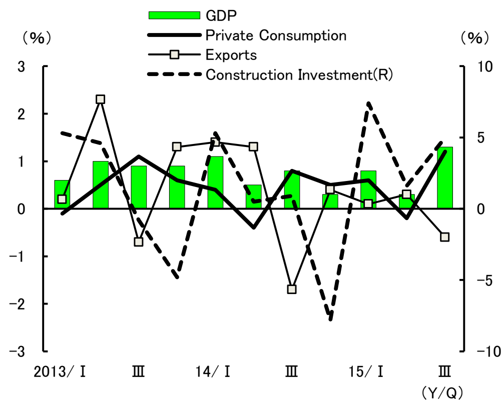
(Yuta Tsukada)

Korea Domestic demand to continue strong, but with risks

■ Domestic demand supports economic growth

South Korea's real GDP growth rate (provisional figures) for the July to September quarter, 2015, was 1.3%, compared to the previous quarter (2.7%, compared to the same period in the previous year). Fixed capital formation was 3.1%, compared to the previous quarter (of which construction investment was 5.0%), private sector consumption 1.2%, similarly, and government consumption 1.7%. On the other hand, goods and services export growth was minus 0.6%, compared to the previous quarter (of which, goods export growth was minus 1.3%), with this quarter characterized by domestic demand bolstering economic growth. The expansion in domestic demand has been largely due to numerous economic stimulus measures implemented by the government.

＜Growth Rates of Korea's GDP(QoQ)＞



Source: The Bank of Korea, Economic Statistics System

In addition to a partial relaxation of the mortgage loan to value and debt to income ratios in an effort to vitalize the real estate market in August, 2014, the policy interest rate has been lowered four times since 2014, resulting in an increasing tendency in construction investment, particularly in housing investment.

Just as the formulation of the extra budget has contributed to an increase in government consumption, the strengthened momentum of private sector consumption has benefited from the expansion in real gross domestic income (the falling price of crude oil has also been a contributory factor) and lower interest rates, as well as from the positive effects of consumption stimulus measures trotted out at the end of August. These include the lowering of the special consumption tax rate levied on automobile and luxury household appliances (from 5% to 3.5% until the end of December), and the expansion range of the nation's biggest shopping event, etc. Also, the sales of automobiles have been posting double digit growth, compared to the same period in the previous year, since September.

■ Future risk factors

While export growth recovery lags, it is expected that domestic demand will continue to be comparatively strong. However, in addition to concerns over a recoil in response to the consumption stimulus measures, the following risk factors will need to be paid attention to, in the near future.

One is the increase in household debt. Much of that debt is in the form of mortgages, but there are also education loans, business capital loans, and borrowing for living expenses among the low and middle income tiers. Because of the debt increases, the government in recent years has introduced measures to try to control the debt increase to an appropriate pace, as well as measures to enhance financial soundness, etc. The Park administration has been focusing its efforts on debt adjustment (for example, by shifting from short term high interest loans to longer term, low interest loans), but the household debt total had grown to 1,166 trillion won by September, 2015, over 10% up on one year ago. This is because of the relaxation of real estate lending regulations as part of economic stimulus measures, and the lowering of interest rates.

Because mortgages tend to be concentrated in the mid to high income tiers, there may be no need for excessive concern, but if interest rates change to an upward rising phase, then the burden of repayment will increase, and there is a danger that there will be an increase in non-performing loans, mainly in the low to mid income tiers.

Another risk factor is the trend towards restructuring. Poor export growth has caused deteriorating business performance among marine transport, shipbuilding and other industries, so there is a move towards receiving support from banks, coupled with cutting staff levels and reorganizing businesses. Restructuring is essential for the vitalization of the economy, but there is a danger that the process could result in increases in unemployment and non-performing loans.

Therefore, along with domestic and foreign demand trends, it will also be important to pay attention to these risk factors in the months ahead.

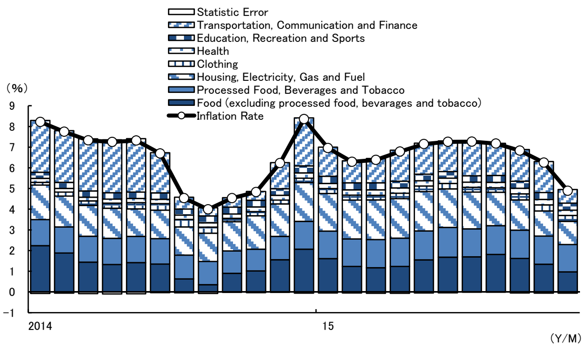
(Hidehiko Mukoyama)

Indonesia Growing expectations of interest rate cut

■ Inflation rate 4.9% for November, 2015

According to Statistics Indonesia, the inflation rate for November, 2015, was 4.9%, falling 1.4% points from the previous month. This means that the inflation rate has fallen within central bank's target range (3.0% to 5.0% for 2015) for 13 consecutive months. In terms of goods and services, transportation, communication and finance were at 3.5%, down 4.4% points from the previous month, while food (excluding processed food, beverages and tobacco) posted 5.0%, down 1.9% points from the previous month, and these together applied downward pressure overall.

<Inflation Rate and Contribution by Goods and Services (YoY)>



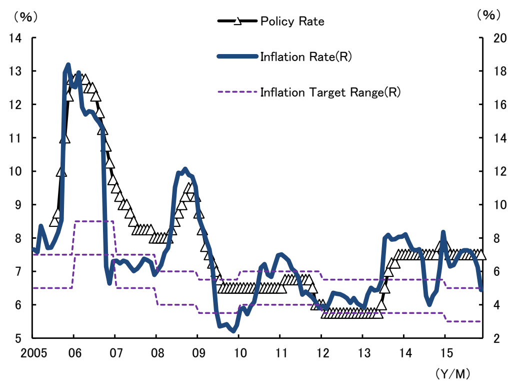
Note : Weight is 2007 standard.
Source : BPS

As part of the reason for the big drop in November's inflation rate, the waning of the influence of the fuel subsidy reductions carried out in November, 2014, may be pointed out. President Joko, who took office in October, 2014, made the decision to cut the gasoline and diesel fuel subsidies on November 17, 2014. This meant that the prices of gasoline and diesel went up by 2,000 rupiah per liter each from the next day, the 18th, bringing the price of gasoline up to 8,500 rupiah per liter, an increase of 31%, and that of diesel to 7,500 rupiah per liter, an increase of 36%. Transportation operators, such as taxis and buses, and carriers, passed on the increase in transportation costs in the form of higher fares and prices, resulting in a big increase in commodity prices, principally in transportation, communication, finance and food.

■ No rate cuts until after the turmoil of US rate hikes calms down, and even then the pace will be cautious

Meanwhile, the economy still lacks vigor. The real GDP growth rate for the July to September quarter, 2015, was 4.7%, compared to the same period in the previous year, holding steady from the April to June quarter, and still below the growth level (6.0%) thought necessary in order to maintain employment stability in Indonesia.

<Policy Rate and Inflation Rate>



Source : Bank Indonesia, IMF, CEIC

Against this backdrop, there are growing expectations that interest rates will be cut as a means of bolstering the economy. Examination of the policy interest rate and the inflation rate reveals a very high degree of interrelation. Taking into account the interrelation that has existed thus far, and the fact that the inflation rate has stayed within the target range, it could be said that the current policy interest rate is high (7.5%), and that there is room for it to be cut significantly. In fact, taking the relationship between the policy interest rate and the inflation rate since 2005 and then estimating the policy interest rate that best conforms to the most recent inflation rate, the result is a rate of 6.8%, so that there is room for the policy interest rate to be reduced by about 0.7% points.

Still, there is only a very slight possibility that Central Bank will embark upon rate cuts soon. Amidst expectations that the US will go ahead with its first interest rate hikes in nine years, if Indonesia were to cut its rates at the same time, the resulting interest rate gap could well trigger a sharp depreciation of the rupiah against the dollar. Also, in the first place Indonesia has a twin deficit (current account deficit and fiscal deficit), and an economic structure that makes currency depreciatory pressure likely to build up. Given that Central Bank's mission is to stabilize prices and the currency, it would be reasonable to assume that monetary easing in Indonesia should come after the market turmoil caused by US interest rate hikes has subsided, and that the pace should be a gentle one.

(Yuta Tsukada)

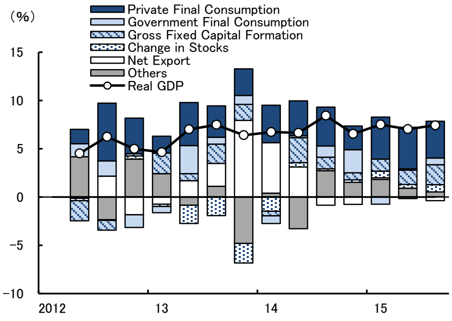
India *Domestic demand driven growth to continue*

■ Real GDP growth rate 7.4% in Q3

India's economy continues to grow at a steady pace. The real GDP growth rate for the July to September quarter, 2015, was 7.4%, compared to the same period in the previous year, picking up speed from the April to June quarter (7.0%, similarly).

In terms of individual demand items, private sector consumption continued strongly at 6.8%, similarly, due to increased real purchasing power, in turn stemming from the stability of the inflation rate and the lowering of the policy interest rate, and gross fixed capital formation also posted stable growth at 6.8%, similarly, mainly in transportation related sectors and other public works investments. Meanwhile, export growth slowed for the fifth consecutive period, due to poor foreign demand, mainly as a result of economic deceleration in China.

<GDP Growth Rate and Contributions by Expenditures>



Note: Year on Year

Source: Ministry of Statistics and Programme Implementation

Also, examination of the supply side statistics GVA (Gross Value Added) shows that, in spite of poor rainfall in the monsoon period, growth in agriculture was 2.2%, compared to the same period in the previous year (1.9%, similarly, in April to June), marking two consecutive quarters where growth was higher than in the previous quarter, and growth in the manufacturing industry was strong at 9.3% (7.2%, similarly). Construction industry growth slowed to 2.6% (6.9%) but, overall, production has stayed strong across a wide range of industries.

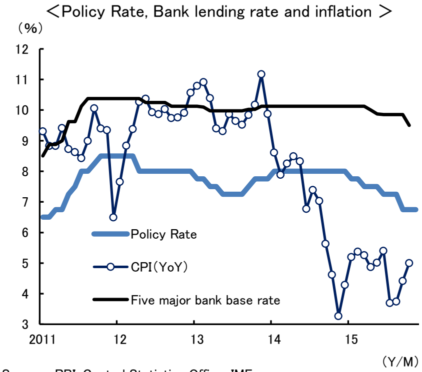
Looking forward, although there are concerns that consumption growth will be stunted by the stagnation of incomes in agricultural communities, in addition to an improved consumer sentiment as a result of the stable inflation rate, and lower lending rates, there are expectations of increased foreign direct investment in response to the relaxation of restrictions on foreign capital, and it looks likely that domestic demand driven growth will continue strongly.

■ Concrete results required from government policies

Since 2014, the consumer price index has fallen significantly. In addition to the stagnating prices of crude oil, government efforts at food supply management have paid off, and soaring food prices have been reined in, so it may be expected that, for the foreseeable future, the consumer price index will continue to be fairly stable.

Against this backdrop, Reserve Bank of India has lowered its policy interest rate four times in this fiscal year. As a result, bank lending rates have been lowering gradually, and the decline in the domestic credit balance has begun to slow. This is expected to give future investments a bit of a boost. Meanwhile, the accompanying statement of the September Monetary Policy Committee meeting stressed that the 0.5% policy interest rate cut was made in anticipation of the inflation target being achieved (CPU growth rate for January, 2016, less than 6%, year on year). In addition, given the fact that US interest rate hikes are imminent, it is expected that there will also be a cautious approach to interest rate cuts.

<Policy Rate, Bank lending rate and inflation >



Source: RBI, Central Statistics Office, IMF

While the economy continues to perform strongly, there is little evidence of any progress with domestic reform. Legislative assembly elections were held in Bihar province through October and November, 2015, in which the ruling Bharatiya Janata Party (BJP) suffered a painful defeat. In the lower house, BJP has a simple majority of seats, but in the upper house, where seats are decided by indirect election by state legislators, the party has little more than 20% of seats. This means that proposed bills such as the implementation of a goods and services tax face a tough passage through parliament. Although aggressive top level diplomacy has been carried out for the purposes of attracting foreign capital, India is now directly confronting a stage where it needs to produce more specific results of reforms in the relaxation of foreign capital restrictions, and the like.

(Kentaro Matsuda)