ASIA MONTHLY

May 2018

株式会社日本総合研究所

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

Topics *Monetary policy in Asian emerging countries at a turning point*

Until now, Asian central banks have adopted ultra-accommodative monetary policies aimed at boosting their economies. Recently, however, some countries are turning the steering wheel and starting to normalize their monetary policy.

■ Signs of change in the post-Lehman downward interest-rate trend

Since the winter of 2017, there have been signs of substantial change in monetary policy in Asian emerging countries. Since the recession that was sparked by the failure of Lehman Brothers, policy interest rates in Asian emerging countries have, as a general trend, been on the slide. This is because due to the economic slumps in advanced economies, structural transformation in China, falling resource prices, and delays in restructuring their own economies, Asian emerging countries have lacked the stable and robust growth they enjoyed before the Lehman collapse. As a result, the central banks of Asian emerging countries have generally had to maintain extremely loose monetary policies in order to boost their economies, though there have been phases where they have temporarily hiked interest rates in response to increases in inflation. Even in 2017, for example, Vietnam reduced rates in July, while India and Indonesia followed suit in August, with Indonesia making an additional rate cut in September.

Since the winter of 2017, however, a shift in monetary policy has begun to occur, with South Korea and Malaysia raising interest rates, for example. In November 2017, the South Korean central bank changed its policy rate from 1.25% to 1.5% after determining that the economy was following a stable recovery path. Real GDP had grown by 3.8% in the July-September 2017 quarter to reach its highest level for three and a half years, while semiconductor exports were expected to continue increasing on the back of expanding worldwide IT-related investment, such as investment in IoT. In Malaysia, meanwhile, the economy had grown at a slower pace than its potential economic growth rate (5.0%) during 2016, but going into 2017 exports recovered, which was the main factor behind the fact that the economy started growing much faster than the potential growth rate. In response, the Malaysian central bank upped its policy rate by 0.25 points in January 2018.

＜Comparison of Policy Rates of Asian Emerging Counties After the Lehman Shock＞

Country	2008/08 (%)	Minimum (%)	(Period,Y/M)	2018/03 (%)
South Korea	5.250	1.250	2016/6～2017/10	1.500
Taiwan	3.625	1.250	2009/2～2010/5	1.375
Indonesia	9.000	4.250	2017/9～2018/3	4.250
Malaysia	3.500	2.000	2009/2～2010/2	3.250
Philippines	6.000	3.000	2016/5～2018/3	3.000
Thailand	3.750	1.250	2009/4～2010/6	1.500
Vietnam	14.000	6.250	2017/7～2018/3	6.250
India	9.000	4.750	2009/4～2010/2	6.000

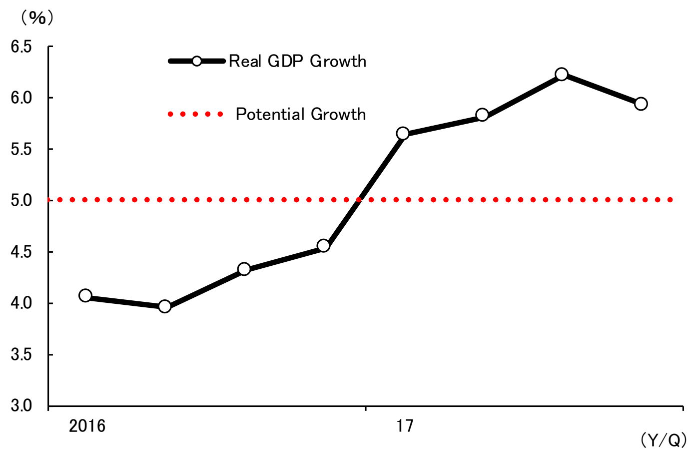
Source: Each Country's central bank, CEIC
Note1: Bank Indonesia changed its poliy rate from "BI Rate" to "7 day reverse repo rate" from August 2016.
Note2: Bangko Sentral ng Pilipinas intoroduced the Corridor sysytem in June 2016.

■ Normalization of monetary policy the aim of rate hikes

The important thing here is in both South Korea and Malaysia, inflation is not increasing significantly, and has remained stable at a low level for quite some time. In fact, inflation rates in Asian emerging countries in 2017 were low, ranging from close to 0% to only as high as around 5%. In other words, these rate hikes have not been aimed at monetary tightening for the purpose of reining in inflation or asset bubbles. Rather, the focus has been on normalizing monetary policy, which has hitherto been ultra-accommodative, once the economic outlook is sustained recovery. Even now, the South Korean and Malaysian central banks continue to hold the view that policy interest rates are at accommodative levels.

These moves toward the normalization of monetary policy are not limited to South Korea and Malaysia. In the Philippines and Taiwan, too, robust economic expansion is making it highly likely that interest rates will be raised in the near future. Even in Thailand, the March 2018 meeting to decide monetary policy saw objections to maintaining the current monetary policy stance raised, which means that it is possible that pressure to lift rates will grow in the future.

＜Malaysian Real GDP Growth and Potential Growth＞



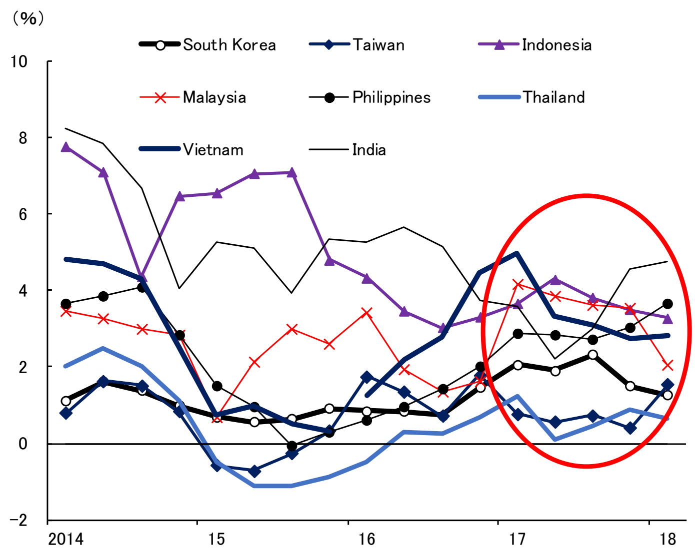
Source : Department of Statistics Malaysia, IMF

■ Normalization based on caution

Considering at the future outlook, while taking into account the political timetable, which includes elections in 2018 and 2019, it would seem highly likely that central banks will continue to normalize monetary policy at a fairly cautious pace.

That being said, recently the trend toward the normalization of monetary policy at a cautious pace has become slightly less clear. One thing that cannot be ignored is that the background that led to the central banks of Asian emerging countries acquiring room to consider the normalization of monetary policy is that, as was mentioned above, inflation rates have been stable at a relatively low level. Recently, though, this assumption has begun to break down. Since entering 2018, crude oil prices have risen by approximately 20% to hover at around \$66 a barrel (compared with an average of \$53 a barrel during 2017). Furthermore, with the U.S. economy steadily expanding, the view has begun to emerge that interest-rate hikes by the FRB will accelerate at a faster-than-expected pace. If the pace of rate increases exceeds expectations, the downward pressure on the currencies of Asian emerging countries may intensify significantly. If these phenomena become reality, inflation rates in Asian emerging nations will rise, and regardless of how their economies are performing, the central banks will be forced to raise interest rates not in order to normalize monetary policy, but with the aim of curbing inflation. If this happens, an adverse effect on their economies will be unavoidable.

＜Inflation Rate in Asian Emerging Countries＞



Source : Each country's statistics office

If Asian emerging countries are to smoothly normalize monetary policy while achieving stable economic expansion, they will need to give adequate attention to oil prices and the pace of FRB interest-rate hikes.

(Yuta Tsukada)

Hong Kong *Maintaining solid growth but, exposed to risk factors*

■ Rapid growth of 3.8% in 2017

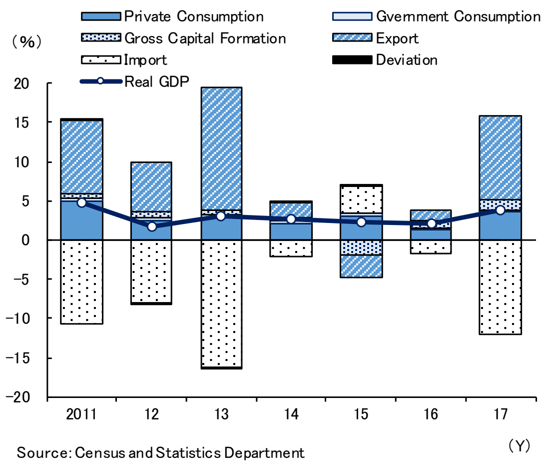
In 2017 Hong Kong's real GDP grew by 3.8% compared with the previous year, the highest level seen since 2011.

Regarding the degree of contribution of each GDP component, 10.7 points rises in exports as a result of the ongoing global economic recovery was the main driver. Exports of goods were brisk, but service exports, which had experienced a sharp decline, also climbed on the back of a rebound in the number of visitors from mainland China. And with employment and incomes both rising, private consumption was solid, recording an increase of 3.6 points.

Going into 2018, both domestic and external demand have remained strong.

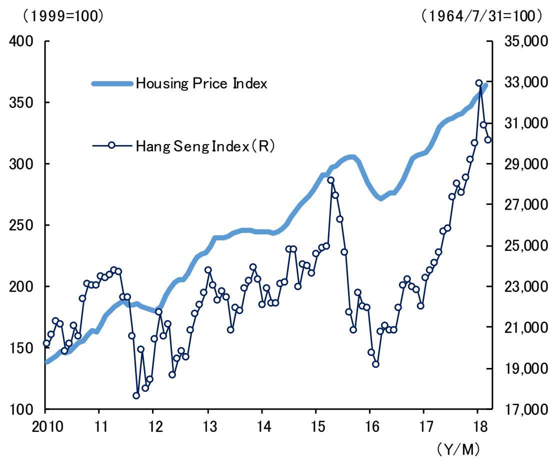
Retail sales in February jumped 29.8% year on year (figures below are also year on year). Sales of goods in a wide range of categories, including foods and durable goods, saw significant increases, and sales of jewelry also jumped. The rise is partly attributable to the fact that Chinese New Year, which fell in January in 2017, fell in February this year, but even if the effect of that is removed by looking at January and February together, sales still increased by a significant amount, 15.7%, in those two months compared with the same period the previous year. Furthermore, the asset effect of soaring stock prices and housing prices can be pointed to as a background factor behind the strong levels of consumption in the territory. Hang Seng Index has been fluctuating at high levels, while the prices of houses are continuing to rise.

＜GDP Growth Rate and Contributions by Expenditures＞



Source: Census and Statistics Department

＜Housing Price Index and Hang Seng Index＞



Source: Statistics Department, Rating and Valuation Department

On the other hand, exports in February (as measured in Hong Kong dollars) exhibited only a small increase of 1.7%. Like consumption, they were affected by the Chinese New Year falling later, and increased by 10.7% in the January-February period. In addition, the number of visitors from overseas continue to rebound, climbing 9.9% in January-February. With the world economy, and particularly the economies of advanced countries, recovering, exports are expected to remain solid for the time being.

■ Internal and external risk factors

In March 2018 by-elections took place for four seats that had been vacated due to their members no longer being eligible to hold them. The seats had been held by members of Pan-democracy camp and members of localist groups, but two of them were captured by candidates in favor of closer ties to Beijing, weakening the influence of Umbrella Movement. The campaign was also marked by turmoil as, for example, China blocked candidates advocating independence from China from running. With the number of Pro-Beijing camp assembly members increasing, it is possible that the China could wield greater influence in the Hong Kong politics going forward.

With internal politics at a difficult phase, concerns about the situation overseas have also rapidly emerged. Against the backdrop of increasing tariffs on steel and aluminum by US President Trump, there are worries that US-China trade friction could escalate. Because Hong Kong serves as a logistics hub for Asia, if the sign of protectionism increases, this is highly likely to have a huge impact on the territory's economy.

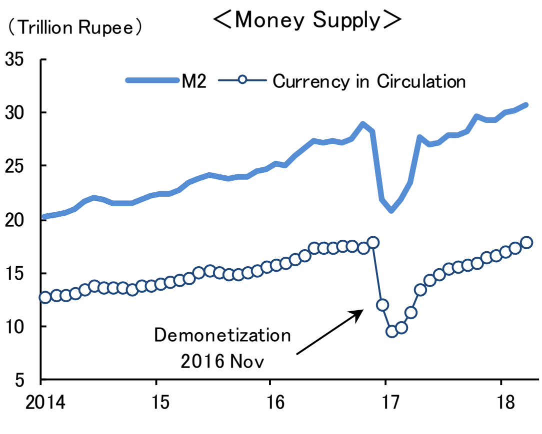
(Kentaro Matsuda)

India *Dissipation of factors driving down the economy*

■ Balance of currency circulating back at highest level since the demonetization of high-rupee banknotes

Following a period of turmoil following the purge of high-rupee banknotes in November 2016 and the introduction of the GST (Goods and Services Tax) in July 2017, the economy has been steadily recovering since the second half of 2017.

The balance of cash circulating had been recovering at a slow pace since the demonetization of 1,000-rupee and 500-bills, which had accounted for approximately 85% of the value of cash in circulation as a result of delays in the distribution of new banknotes and a rapid expansion in online banking. However, in addition to the economic recovery, significant cash donations were made in connection with the state-assembly elections that took place in February-March 2018, and these factors helped the balance to recover to the pre-purge level in February 2018.

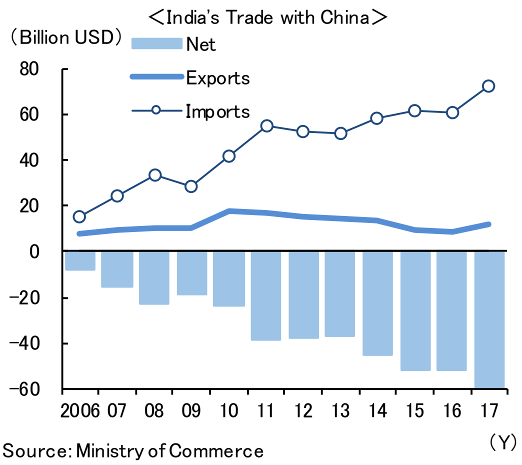


Source: Reserve Bank of India

Regarding monetary policy, on the other hand, concerns about inflationary pressures stemming from the economic rebound and the possibility of cash outflows resulting from the normalization of monetary policy in the West have led the central bank to maintain the policy interest rate (repo rate) at 6.0%, the level it was reduced to in August 2017. At the policy meeting held in early April 2018, one committee member advocated an increase of 0.25 points, which was what had also occurred at the previous meeting. The other members, however, argued for the rate to be kept at the same level given that pace of food-price increases had slowed recently and that the consumer-price forecast had been revised downward to reflect this. Going forward, it is expected that the current policy rate will be maintained until the economic recovery becomes more resilient. Attention will also be paid to the amount of rainfall and agricultural output during the monsoon season (June-September) as well as trend with international oil prices.

■ Widening trade deficit with China

With the economy bouncing back and resource prices bottoming out, imports are continuing to rise, which is drawing attention to the country's trade deficit with China. Although India is less dependent on Chinese trade and investment than other Asian countries, its trade deficit with China continues to expand, reaching around $60 billion in 2017, which is equivalent to more than 2% of GDP. Against this backdrop, in late March discussions on trade cooperation took place in Delhi between representatives of the Indian and Chinese commerce ministries. The talks covered measures to promote exports by Indian companies to China and investment in India by Chinese firms as ways of alleviating external imbalances. Going forward, if the correction of external imbalances results in the integration of India's "Make in India" strategy with China's "One Belt One Road" initiative, China's presence in the Indian economy can be expected to increase.



Source: Ministry of Commerce

(Shotaro Kumagai)

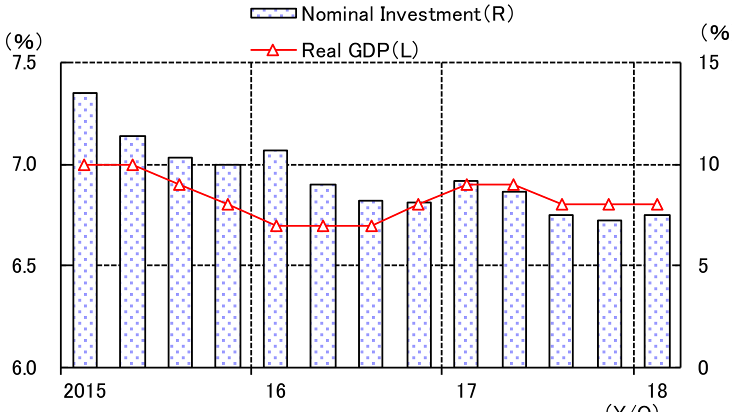
China Economy stable thanks to internal and external demand

■ Economic growth of 6.8% in January-March

In the January-March quarter of 2018 real GDP grew by 6.8% year on year, comfortably beating the government's target for 2018 of 6.5% growth. Supported by robust internal and external demand, the Chinese economy is stable.

Regarding the degree of contribution of each demand component, investment has rebounded. Fixed-asset investment (excluding that by rural households) was up 7.5% on the same period a year earlier, and grew by more than it did during the whole of 2017 (7.2% year on year). The driving forces were an expansion in infrastructure investment and an improvement in propensity to invest among private-sector companies.

<Real GDP, Fixed-Asset Investment (YoY)>



Source: National Bureau of Statistics
Note: Investment figures are year-to-date excluding rural households.

A look at consumption reveals that nominal retail sales in January-March climbed 9.8% year on year, which was slightly slower than in 2017. Nevertheless, the robust growth is continuing. Online sales were particularly brisk, driving an overall expansion in consumption, and this owed much to a steady improvement in employment and incomes.

Regarding external demand, March exports dipped 2.7% year on year, marking their first fall in 13 months. However, the drop is likely to be only temporary, as the world economy is recovering and exports to ASEAN and Hong Kong are still rising. In addition, the March figure was in some sense a reaction to the sharp spike that occurred in February. On a quarterly basis, January-March exports increased 14.0% compared with the same period the previous year, exhibiting the fastest rate of growth seen since July-September 2014 (13.0%). Imports are also continuing to rise on the back of robust domestic consumption and industrial production.

■ Announcement of additional measures for opening the country up

Regarding the outlook for the economy, domestic demand is expected to continue to expand. If the national government is intent on achieving its target of doubling real GDP in 2020 compared with 2010 levels, there is a little likelihood of constructive measures being taken that would put the brakes on the economy. The steady increase in personal consumption resulting from the ongoing improvement in employment and incomes and the expansion in capital expenditure occurring in connection with the automation of manufacturing processes can also be expected to provide support for the economy.

Recently, the Trump administration in the U.S. has been leaning toward protectionist trade policies, and as trade friction with the U.S. intensifies, a drop in exports has emerged as a potential risk factor. In fact, the Xi Jinping administration has adopted a tough stance, imposing retaliatory tariffs in reaction to U.S. trade sanctions, for example. Going into April, however, the government has announced a four-point package of additional steps to open up the Chinese economy. The points include the relaxation of restrictions on market entry and the expansion of imports. So the government is also taking action to ease trade tensions (see bottom-right table). It would therefore appear that the risk of falling into a worst-case scenario of exports from both the U.S. and China falling as a result of repeated tit-for-tat retaliation, and this leading to adverse effects for world trade, has receded for the time being.

Provided that the Xi administration steadily takes steps like this, the Chinese economy can be expected to continue to expand as it has done until now, and the recent steady expansionary trend looks set to remain in place.

(Junya Sano)