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Topics China's minimum wage hikes maxed out

China's minimum wage level has increased 60% since 2009. While further raises are expected under the Xi Jinping administration, the side effects are beginning to be noticed. The challenge going forward will be whether wage levels can be controlled through the reform of state enterprises.

■ Minimum wage level up 64.1% compared with 2009

In China, the minimum wage level has been raised by a significant margin, in order to correct the income disparity and to facilitate the shift towards a consumption driven economy. According to a statement by the Ministry of Human Resources and Social Security at the end of April, 25 provinces, cities and autonomous regions raised their minimum wage levels in 2012 by an average of 20.2%, year on year. In 2010, 30 provinces, cities and autonomous regions raised their minimum wage levels by an average of 22.8%, year on year, and again 30 in 2011 raised these levels by an average of 22.0%, with an average minimum wage hike of over 20% for three consecutive years. Meanwhile, the consumer price increase rate in the cities was 3.2% in 2010, 5.3% in 2011 and 2.6% in 2012. When these average increase rates are considered as national averages, the real increase in the minimum wage level comes out at an annual average of 18.0% for the past three years, which works out to a 64.1% increase compared with 2009.

The raising of the minimum wage level may be considered to have grown from a limited phenomenon in 2009, involving only the seven provinces and cities of Shanxi, Shanghai, Jiangsu, Zhejiang, Fujian, Guangdong and Tianjin, to a nationwide phenomenon from 2010. Part of the background to this appears to have been an attempt to alleviate the impact of the Lehman Brothers collapse on low income earners and to boost social stability. The 12th Five Year Plan (2011 to 2015), adopted in 2011, called for per capita earnings growth rates in the cities and agricultural communities not to fall below the GDP growth rate (actual basis in all cases), and this has been the grounds for the continued raising of the minimum wage level.

Measures prioritizing the income growth rate were fleshed out in the November, 2012, 18th Party Congress Work Report, when Xi Jinping was elected to the post of General Secretary of the Communist Party, which read "Not only GDP, but also incomes must be doubled (in comparison with 2010) by 2020." Looking back over the long history of the Party Congress, there are no other mentions of doubling income growth rates. The 18th Congress was the first to witness such a statement. In February, 2013, the State Council (government) released its Several Opinions on Deepening Reform of the Income Distribution System (hereafter "*Opinions*"), in which it indicated the way forward to realizing the doubling of incomes. The *Opinions* contain a wide range of policies (figure at right), but the most immediate effect in doubling income growth is expected to come from the numerical target of "raising the minimum wage levels to 40% of the average wage level in those areas by 2015".

＜Main Policy in Several Opinions on Deepening Reform of the Income Distribution System ＞

Wage・Labor
- Raising the minimum wage levels to 40% of the average wage level in those areas by 2015
- Raising the collective labor agreement rate to 80% by 2015
- Control the state and state holding company's wage not only total base but also by per capita base

Tax
- Introduce tax payer cognition number system
- Strengthen the real estate tax on transaction and possession
- Introduce inheritance tax in appropriate time

Social Security
- Allocate 5% of SOE's benefit under central government to social security fund
- Unify the base medical insurance for urban and rural inhabitants

Financial Market
- Liberalize interest rates and protect depositors' rights

Source: Government Web（http://www.gov.cn/zwgk/2013-02/05/content_2327531.htm）

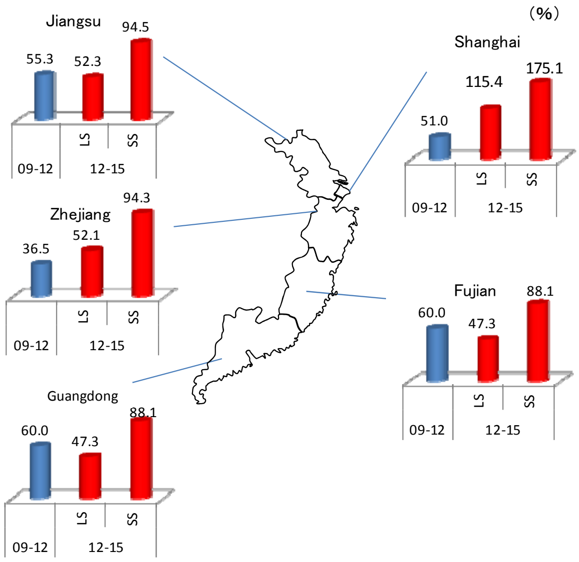
■ Minimum wage levels to be at least 50% up on 2009 levels

The average wage level referred to in the Opinions indicates the average wage levels in "city units", while the term "those areas" indicates administrative units for which the minimum wage level has been set. "City units" refers to the formal sector, comprised of state enterprises, stock companies, limited companies, and foreign capitalized companies, which in China are clearly distinguished from the informal sector, comprising private businesses and the self-employed. Since a clear, numerical target of raising the minimum wage level to 40% compared to the average wage level by 2015 has been set, by provisionally entering the growth rate of the average wage level, it is possible to estimate to what degree minimum wage levels will grow by 2015.

The figure at right is a graph showing the rate of increase (09 – 12) in minimum wage levels between 2009 and 2012 in the provinces and cities of the south east region, home to the core of the manufacturing industry, and the amounts by which these levels will need to rise (12 – 15) between 2012 and 2015, in order to achieve the target of growth to 40% of average wage levels. With regard to the latter, in the first half of 2013 some local governments used the released wage increase guidelines to formulate two separate scenarios, a low scenario (LS) that assumed an annual average 6% growth rate for average wage levels, and a standard scenario (SS) that assumed an annual average 15% growth rate.

If each of these local governments were to adopt the standard scenario, many of the cities and provinces in the south east would need to raise their minimum wage levels to around 100% of the 2012 levels by 2015. On the other hand, if the low scenario were adopted, with the exception of Shanghai city and Zhejiang province, minimum wage growth levels in the region in comparison with the period in the years 2009 to 2012 have been rather slow, but even so, increases of around 50% would be required.

<Minimum Wage in Southeast Region>



Source: Author's calculation

■ Restraining wage increases in the city units is a challenge

Will minimum wage levels continue to rise in the future? China is facing the emergence of some issues that may be described as side effects from the raising of minimum wage levels, as described below, and policies that only call for the raising of minimum wage levels are facing inevitable rethinking.

First, raising minimum wage levels while the economy is slowing has had a negative impact on corporate earnings. According to the National Statistics Bureau, minimum wage increases in May put pressure on small and medium sized enterprises' business, and the Bureau expressed the view that the pace of wage increases would decelerate. If local governments continue to raise minimum wage levels in the months and years to come in order to reach the targets outlined in the Opinions, there is a possibility that employment and exports will suffer as a result.

Second, the raising of minimum wage levels does not always mean that income disparities will be corrected. The Gini coefficient in 2012 was 0.47, just 0.02 points down from the figure in 2009. Part of the background to this is that average wages in the "city units" have been growing at more or less the same level as minimum wages. Shanghai's minimum wage level grew at an average 14.7% in the three years between 2009 and 2012, while average wages grew at a rate of 10.5%, similarly.

Third, minimum wage levels in the central western region are fast approaching their upper limits. From the perspective of achieving balanced economic development, the minimum wage levels in the central western region were set relatively high and the flow of agricultural labor into the eastern regions was restricted. However, the minimum wage levels in the provinces, cities and autonomous regions of China's central western region have already reached between 40% to 60% of the per capita GDP, and are close to the 70% set by the International Labor Organization (ILO) as the average for developing countries. Further minimum wage level hikes in the central western region could harm private sector investment in the region, as well as urbanization.

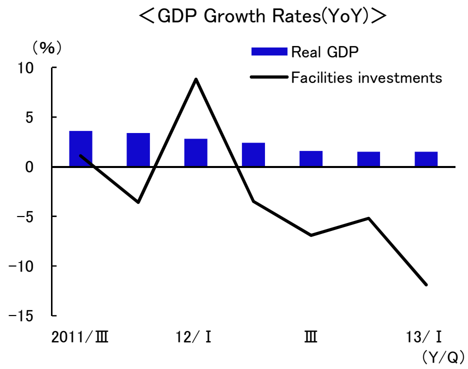
In order to address these issues at the same time as achieving the targets set forth in the Opinions, average wage levels will need to be significantly restricted. The Opinions talks of controlling wage levels in state enterprises and state owned holding enterprises, but as of June, 2013, there have been no signs of any movement to take specific action to achieve this, either in central or local government. The question of whether the government can actually control wage levels in its own state owned enterprises in the first place needs to be re-addressed. In order to ensure that efforts to redress income disparity and to shift to a consumption driven economic model, the central government will need to practice what it preaches and take the lead in beginning the work of reforming the state enterprises.

(Yuji Miura)

Korea "Creative economy" finds the going slow

■ Major companies report falling profits

In South Korea, there is a growing view that the so-called "cheap yen airstrike" since last autumn has caused Korean firms to suffer. These claims are backed up by the fact that export performance has fallen since the rapid yen depreciation, and that profits in won terms have decreased. As if to lend further credence, in the January to March quarter of this year, Hyundai Motors' operating profit was minus 10.7%, compared to the same period in the previous year; that of LG Electronics minus 10.0%; SK Innovation (mainly oil refinery and petrochemical business) minus 5.5%; and S. Korea's largest steelmaker, POSCO, minus 4.7%.



Source: The Bank of Korea, *Economic Statistics System*

In addition, due to the slump in domestic and foreign demand and worsening corporate earnings, facilities investment levels are below those of the same period in the previous year.

However, worsening business performance figures cannot be wholly blamed on the weak yen and strong won. The business environment surrounding large corporations has become tougher with regard to the following two points. First, economic growth rates among the emerging economies have begun to slow. Real GDP growth rates in the last two years have declined consistently, with Brazil falling from 2.7% to 0.9%, Russia from 4.3% to 3.4%, India from 7.8% to 4.0%, and China from 9.3% to 7.8%. Another point is Chinese over-production. Large scale investments were carried out in the wake of the Lehman Brothers collapse, ramping up production capacity in iron and steel and petrochemicals, but demand subsequently cooled, leaving China with surplus production capacity. As a result, cheap Chinese products have flooded the markets of Asia, leading to tougher business conditions.

On the other hand, meanwhile, Samsung Electronics has been supported by strong "smart phone" sales, enjoying an operating income growth of 54.3% over the same period, worth 8.78 trillion won (Hyundai Motors' operating income was 1.87 trillion won).

■ Focus points of future policy management

As the business environment surrounding companies becomes more difficult, attention needs to be paid to the following points with regard to future policy management.

The first is whether polices to achieve a creative economy can be pushed forward. In her inaugural address, President Park Geun-hye spoke of (1) creating a new way forward based on a virtuous cycle of national advancement and the happiness of the people, propelled by (2) a *creative economy* and economic democratization, with the *creative economy* achieved through (3) the convergence of science and technology with industry, and the fusion of culture with industry.

The plan for a creative economy is to invest 40 trillion won over the next five years in the creation of venture enterprises, the fostering of an environment that will produce creative technologies and ideas, and the fusion of information technology with traditional technologies, for example. It is expected that there will be an increase in investments once these measures are introduced, but it will likely take some time before this becomes a cohesive flow. If the economy continues to stagnate, traditional style economic stimulus measures will be prioritized, with the possibility that there will be a lack of real initiative towards the realization of a *creative economy*.

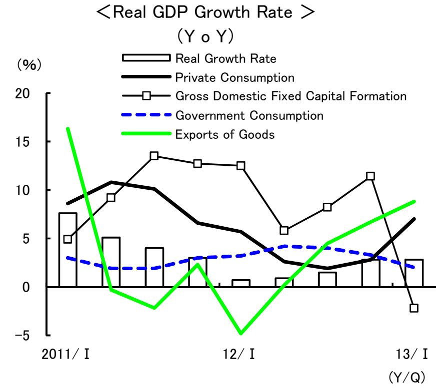
Another point is whether the President can count on the cooperation of the Samsung Group. It is no exaggeration to say that the participation of the Group, with its overwhelming political clout, will be key to deciding whether the government's policies (*creative economy*, economic democratization) can be advanced successfully. In June the Group announced that it would invest 1.2 trillion won by 2017 in order to raise the technical level of its parts and components manufacturers through human capital development and technical training, patent licensing, etc., for the realization of the creative economy and the sharing of profits with small and medium sized enterprises.

In the months ahead, the focus of attention will be on whether initiatives to achieve a new economic society can be effectively advanced.

(Hidehiko Mukoyama)

Hong Kong *Private consumption driving economic recovery*

■ Q1 GDP growth rate 2.8%, year on year



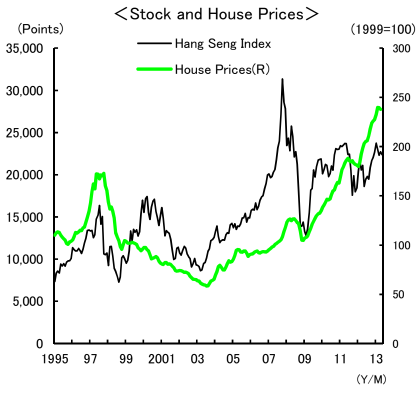
Source: Census and Statistics Department of Hong Kong

Hong Kong's real GDP growth rate for the January to March quarter was 2.8%, compared to the same period in the previous year, exactly the same as the revised figures for the October to December quarter, 2012. However, comparing quarter on quarter growth on a seasonally adjusted basis, while the previous quarter posted 1.4%, January to February could only manage 0.2%, indicating that the economic recovery has lost some impetus recently.

In terms of demand items, gross domestic fixed capital formation growth was minus 2.2% compared to the same period in the previous year, the first negative growth since the April to June quarter, 2009. This was because, despite the fact that the public sector was able to maintain positive growth, private sector construction investment and plant and equipment investment both posted lower figures than the same period in the previous year. Given the uncertainty of the future of foreign demand and credit tightening measures in the real estate market, companies appear to be holding back on investments. And, while capital goods export growth was up 8.8%, compared to the same period in the previous year, marking four consecutive quarters of positive quarter on quarter growth, this figure has been inflated by the special factor of the sudden surge in gold exports. When this element is factored out, growth has in fact been quite modest. In contrast, private consumption was up 7.0%, similarly, well up on the previous quarter's 2.8%. The government cites 1) a healthy employment environment (although drifting slightly upwards, the unemployment rate for the January to March quarter was 3.5% after seasonal adjustments, which is still fairly low by Hong Kong standards), and 2) the growth in real incomes. As far as recent figures are concerned, the economic recovery may be judged to be being driven by private consumption.

With respect to the economic situation described above, the government holds that this is more or less according to expectations, and has decided to keep its real GDP growth forecast for the whole year (between 1.5% and 3.5%, compared to the same period in the previous year) unchanged.

■ Disparity correction essential for sustained growth of consumption



Source: Hong Kong Government, CEIC

In terms of plus factors for Hong Kong's economic outlook from the April to June quarter onwards, there is the fact that tighter controls on the real estate market are beginning to take effect. The house price index (1999 = 100) was 0.3 points below the previous month's level for two consecutive months, in March and April, a sign that the upward trend in house prices is beginning to slow. If the overheating in the real estate market can be resolved, it should be possible for the government to concentrate on tackling other policy issues, such as stimulating domestic demand.

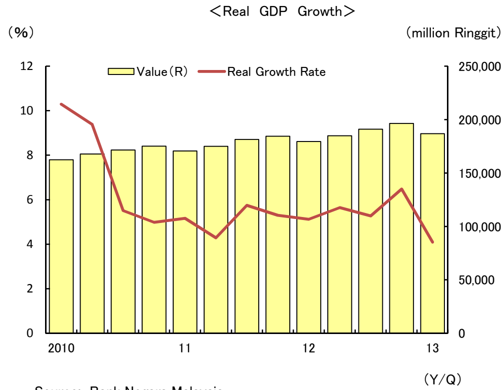
There appears to be little prospect of any rapid recovery in exports to the industrialized markets, and it is expected that private consumption will continue to drive the economic recovery. At the present moment in time, factors supporting the recovery in private consumption, such as a low unemployment rate, have continued, and retail sales for April continued to grow at a high 19.4%, compared to the same period in the previous year. Meanwhile, a dock workers' strike that has continued for some 40 days since late March is drawing wider support from the general public. Part of the reason for this appears to be a sense of dissatisfaction on the part of the general public with regard to the widening income gap (according to government calculations, the Gini coefficient rose from 0.476 in 1991 to 0.537 in 2011). The Hong Kong government will need to implement wealth disparity correction measures quickly. Such measures will not only contribute to social stability but also to sustainable consumption growth.

(Junya Sano)

Malaysia 4.1% growth in Q1

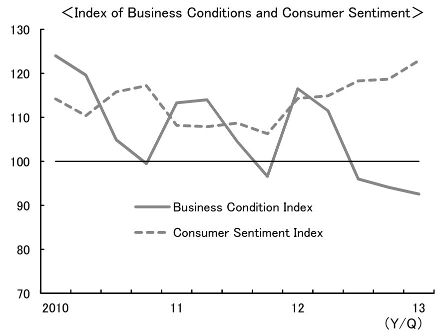
■ Domestic demand drives growth in January to March quarter

Malaysia's real GDP growth rate for the January to March quarter in 2013 was 4.1% compared to the same period in the previous year, a slight deceleration on the 6.5% posted in the previous quarter.



Source: Bank Negara Malaysia

Though external demand was weak due to the economic stagnation in the industrialized economies, domestic demand growth was 8.2% in the same period, driving economic growth. Private consumption growth maintained a strong 7.5% in the same period, boosted by (1) greater disposable income, (2) a good employment environment, (3) the introduction of minimum wage levels, and (4) providing living subsidies for low income earners. For example, automobile sales figures were up 13.7%, similarly, and credit card loan balances up 7.7%.



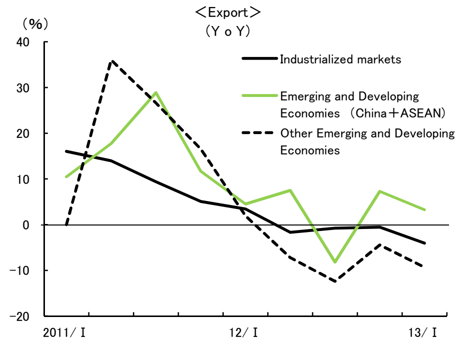
Source: MIER

The consumer confidence index produced by MIER (Malaysia Institute for Economic Research) for the January to March quarter stood at 122.9 points up from 118.7 points in the previous quarter, and private consumption is expected to fuel economic growth in the months to come.

Furthermore, capital formation grew 13.2% in the same period, down from 16.0% in the previous quarter, but still a high level nonetheless. A breakdown of the total shows private investment up 10.9% by mainly domestic market oriented manufacturing and service related businesses, and public sector investment up 17.3% due to expanded plant and equipment investment by state owned petroleum and gas companies, and greater infrastructure investment in transportation and education.

■ Expanding exports to emerging and developing economies key to sustainable growth

Due to the deceleration in export growth, business confidence is deteriorating, in contrast with the consumer confidence index. Export growth in the January to March quarter was minus 2.4%, compared to the same period in the previous year. While exports to China and ASEAN were able to maintain a 3.2% positive growth, those to industrialized markets fell to minus 4.1%.



Source: Bank Negara Malaysia

However, the causes of the export slowdown are not to be found in the economic stagnation of the industrialized countries alone. With the exception of China and ASEAN, exports to emerging and developing economies have suffered negative growth for four consecutive quarters, falling steeply to minus 9.3% in the January to March. Considering that import markets in the emerging and developing countries have expanded since the Lehman shock, it may be said that Malaysia has failed to take advantage of this.

In order to sustain economic growth for Malaysia, exports to emerging and developing economies other than China and ASEAN will need to be promoted. In particular, entry into Middle East and Islamic markets, with which Malaysia has strong cultural ties, will be a key. In the general election held on May 5, the ruling Barisan coalition (BN) won 133 out of 222 seats, confirming the continuation of the Najib administration. The Najib administration is expected to work to strengthen its trade relations with the Middle East and Islamic markets.

(Keiichiro Oizumi)

Philippines *Continued strong growth expected*

■ 7.8% real GDP growth in Q1, 2013

The Philippines' real GDP growth rate in the January to March quarter was 7.8%, compared to the same period in the previous year, passing the 7% mark for the third consecutive quarter, and well above the advance forecast of around 6%. This was the highest level of growth since the 8.9% posted for the April to June quarter, 2010, and exceeded the government's whole year target of between 6% and 7%. The biggest factor behind the rising growth rate has been the continued strong performance of domestic demand, encouraged by monetary easing and increased government expenditure. On the other hand, manufactured goods exports fell to minus 8.4%, due to poor growth in electronics related products, the main export item.

In terms of domestic demand growth, household consumption was up 5.1%, and government consumption 13.2%. Fixed capital formation grew 16.8%, of which construction growth was 33.7% and durable equipment 9.4%. In the construction industry, public sector growth was 45.6% and private sector growth 30.7%. Since the middle of last year, the industry has been characterized by private sector expansion, stimulated by the good performance of public sector.

In terms of industrial origin, growth in the agricultural sector was 3.3%, industry 10.9%, and services 7.0%. Within industry, manufacturing growth was 9.7%. A wide range of industries, including food manufactures, chemical products, basic metals, machinery and equipment, and rubber and plastic products have performed strongly. In the services sector, financial intermediation grew a strong 13.9%, mainly due to increased bank lending, encouraged by the strong economy.

■ Continued strong growth expected

Encouraged by high economic growth and price stability, consumer and corporate sentiment are becoming extremely positive, and it is expected that domestic demand will continue to perform strongly in the future. According to the Central Bank, the overall business confidence index for economic trends for the April to June quarter was 54.9%, the highest level since the survey was begun in 2007. Fitch Ratings raised the Philippines' sovereign rating to investment grade in March, and Standard and Poor's followed in May. Therefore, it is anticipated that investments will increase further in the future. In addition, the fact of growing government expenditure in infrastructure development is being seen as one factor that strengthens the possibility of sustainable economic growth. Government infrastructure related expenditure in the period January to April was up 45% compared to the same period in the previous year, worth 75.2 billion pesos. Traditionally, the main driver of Philippine economic growth has been the services industry. However, if infrastructure is further developed, it is possible that the relative importance of manufacturing will increase.

Meanwhile, inflation has been settling, with the consumer price index increase rate for May at 2.6%, reflecting the stability of food and crude oil prices and the strength of the peso. The Central Bank's consumer price index increase rate forecast is 3.2% for 2013 and 3.4% for 2014, staying within the target band of 3 to 5%. In the Monetary Policy Committee of June, the policy interest rate was kept unchanged, with the Central Bank keeping a careful eye on the situation. Nevertheless, caution still needs to be paid to potential risk factors, such as inflationary pressure following the growth of domestic demand, and an asset price bubble caused by the rapid increase of capital inflows.

＜GDP Growth Rates by Industrial Origin＞

(y o y,%)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Real GNI	3.3	1.9	2.0	3.8	5.7	6.5	7.3	6.4	7.1
Real GDP	4.6	3.2	3.0	3.8	6.5	6.3	7.3	7.1	7.8
Agriculture, hunting, forestry and fishing	4.3	8.1	2.0	−2.4	1.1	0.6	4.4	4.9	3.3
Industry Sector	6.9	−1.8	−0.2	2.9	5.3	5.8	7.1	8.9	10.9
Manufacturing	8.1	5.8	2.0	3.3	6.0	4.3	5.8	5.5	9.7
Construction	1.4	−26.1	−10.6	4.4	1.5	11.6	17.8	29.9	32.5
Service Sector	3.3	5.3	5.1	5.8	8.4	7.7	8.0	6.5	7.0
Transport, Storage and Communication	4.2	4.2	4.6	4.1	9.7	9.3	9.4	4.4	3.5
Financial intermediation	6.4	11.6	1.4	1.5	8.7	7.0	8.6	8.8	13.9

Source: National Statistical Coordination Board

(Satoshi Shimizu)