ASIA MONTHLY

August 2013

株式会社日本総合研究所

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

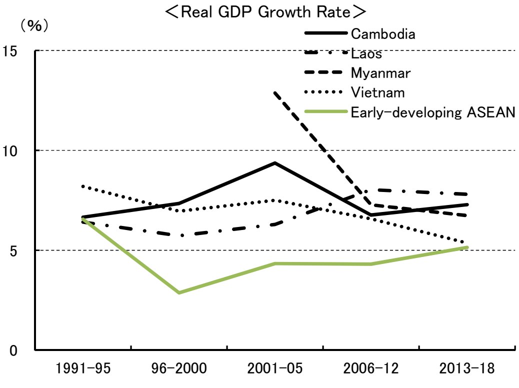
Topics Indochina's economic growth and "Thai Plus One"

In recent years, low income countries of ASEAN have been attracting more and more attention. One factor behind this is that, while maintaining high levels of growth, these countries have lower labor costs than their neighbors, and a new supply chain of Japanese companies as "Thai Plus One" is beginning to take concrete shape.

■ Maintaining high growth levels

In recent years, Cambodia, Laos and Myanmar (CLM) have been attracting attention as the "last frontier of South East Asia". These three countries, with the addition of Vietnam, are often referred to as "late-developing ASEAN". The name refers to the fact that, although these countries joined ASEAN from the 90s onward, their income levels have been low in comparison with the early-developing ASEAN economies (Singapore, Brunei, Malaysia, Thailand, Indonesia and the Philippines). The average per capita GDP in the early-developing ASEAN economies in 2011 was $4,446, whereas that of the late-developing ASEAN economies was just $923. In consideration of this income disparity, while the early-developing ASEAN countries implemented tariff liberalization in 2010, it was agreed that this could be postponed till 2015 for CLM + Vietnam.

＜Real GDP Growth Rate＞



Note: 2013-18: outlook

Source: IMF, *World Economic Outlook, April 2013*

However, examination of actual GDP growth rates shows that these countries' economies have been growing at a faster pace than early-developing ASEAN in recent years, and that they are expected to maintain this pace over the next five years.

The motive power behind these high levels of growth has been direct investment and other forms of foreign capital including ODA. In the past, the assumption has been that, in order to permit the economies of low income countries like CLM to take off (to maintain high levels of growth), domestic savings rates would need to be raised. However, with the further advancement of economic globalization in the 21st century, large amounts of foreign capital have begun to flow into low income economies and, as long as their governments have clear development strategies, a lack of domestic capital can no longer be said to be an inhibiting factor in the economic growth of low income countries. For example, Cambodia's foreign direct investment worth in 2011 was $846 million, 6.5% of GDP.

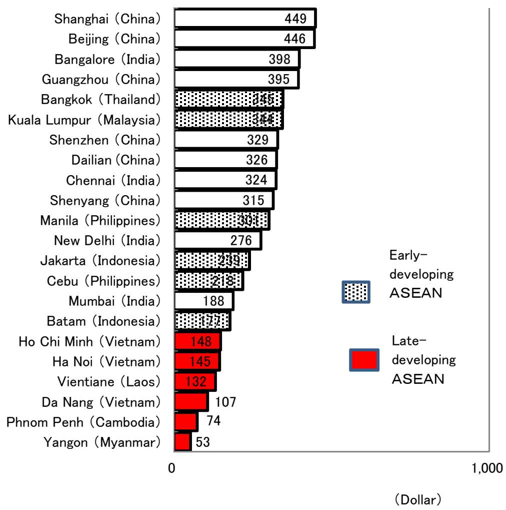
■ Growing feasibility of a business model as "Thai Plus One"

Additionally, as wage levels in China and in early-developing ASEAN tend to increase, CLM are attracting growing attention as relocation destinations for labor-intensive production facilities. The figure at lower right shows the results of a JETRO comparison of workers' wage levels in different countries. It can be seen from that wage levels in late-developing ASEAN are significantly lower than those in China and early-developing ASEAN.

Under these conditions, transportation infrastructure development as part of the Greater Mekong Sub-region (GMS) development project, advanced by the Asia Development Bank (ADB) in its capacity as secretariat, makes the creation of the new business model Thai Plus One, which will link the cheap labor forces of CLM with Thailand's industrial sites, all the more feasible.

The GMS development project was started in 1992 and, as of September, 2011, a total of 55 projects, worth some $14 billion, had been implemented. Among these, work on the development of three cross-border economic corridors (north south corridor, east west corridor, southern corridor) is almost complete. Among Japanese automobile parts and

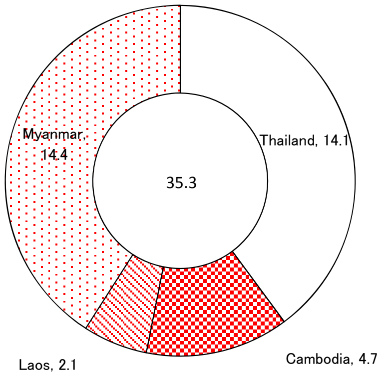
＜Wage Levels in East Asia (per Worker: $/month)＞



Source: JETRO

components manufacturers, electronic parts and components manufacturers and consumer goods manufacturers operating in Thailand, some have begun to relocate their labor intensive production processes to border regions in Laos (Savannakhet) and Cambodia (Koh Kong, Poi Pet). As yet there have been no signs of such activity in Myanmar, due to the lack of progress in democratization and open-door policies in that country, but, in the future, as construction progresses on industrial sites close to Myanmar's borders with Thailand, the region's economic corridor, it is expected that there will be an acceleration of this kind of development in Myanmar. Since Cambodia and Laos have smaller populations, they are likely to face labor shortages and rising wage costs in the near future. Myanmar, however, has a growing young labor force, with a potential that is not to be missed. According to UN world population prospects, as of 2010, the population size of the 15 to 29 age group is 14.1 million for Thailand and just 4.7 million for Cambodia and 2.1 million for Laos. In contrast, Myanmar has a population of 14.4 million in this age group, slightly more than even that of Thailand.

＜Population aged 15～29 (2010)＞
(million persons)



Source: UN, *World Population Prospects: The 2012 Revision*

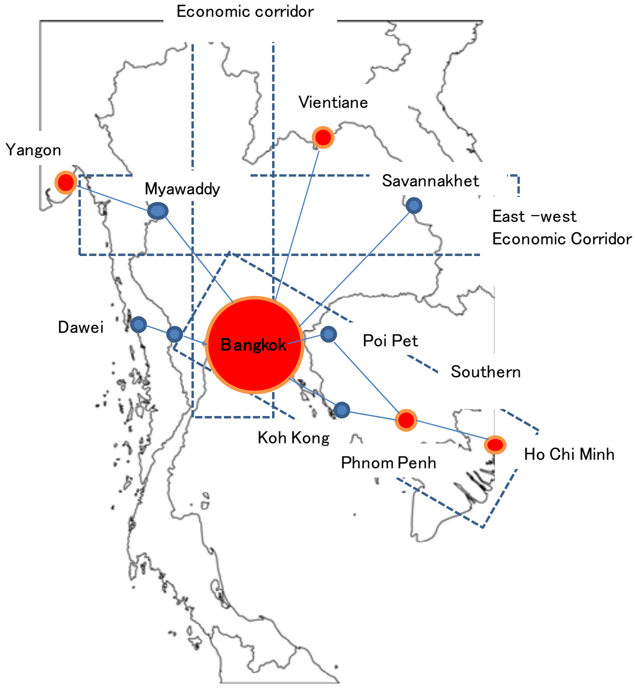
Going forward, along with the realization of the ASEAN economic partnership in 2015, if customs tariffs among CLM can be abolished and one-stop service implemented, facilitating import and export procedures, then logistics costs will be able to be reduced further. The Thai government has revealed that it plans to invest more than Bt2 trillion by 2020 in the development of this kind of transportation network linking Thailand and its neighbors.

■ Dawei Port Project

Furthermore, from a mid to long term perspective, the outcome of Myanmar's Dawei Port Project is thought likely to have a strong impact on the competitive strength of Thai Plus One. The Dawei project plans to construct large industrial sites and harbor facilities. If Dawei can be connected to Bangkok through trunk routes, exports will be able to go directly to India, the Middle East and Africa, instead of using the current route to bypass the Malacca Strait.

The road link between Dawei and Bangkok is seen as an extension of the Southern Economic Corridor, and may very well create a new economic zone by linking Vietnam's Ho Chi Minh City and Cambodia's Phnom Penh. Japanese Prime Minister Shinzo Abe visited Myanmar in May and promised over 90 billion yen in aid. It is not yet clear to what purpose this aid will be put, but it is hoped that it will target infrastructure development that will help boost the competitive strength of the industrial sites in Thailand where many Japanese firms are established.

＜Map of "Thai Plus One"＞



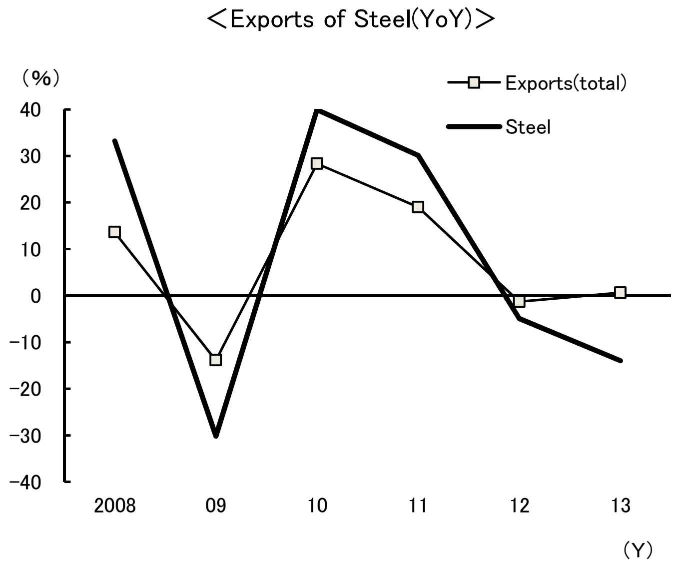
Source: JRI

(Keiichiro Oizumi)

Korea "China factors" behind struggling exports

■ Falling exports and the "China factors"

South Korea's exports have ceased to function fully as the engine of growth. This has been due to the "China factors" described below.



Note: Exports in 2013 is in the first 5 months of the year.
Source: CEIC Database

One of these has been the economic deceleration in China (S. Korea's largest export partner) and other emerging economies. In the last two years, real GDP growth figures have been falling right across the board, with Brazil falling from 2.7% to 0.9%, Russia from 4.3 to 3.4%, India 7.8% to 4.0%, and China from 9.3% to 7.8%. As this trend develops globally, to the extent that Korean companies worked hard to open up markets in the newly developing economies, they are now suffering from this economic deceleration.

In the days when China's economic growth was continuing at over 10%, along with the growth in China's industrial production, exports from resource-rich countries expanded and the prices of primary products increased swiftly. Soaring increases in the prices of raw materials caused a shift in earnings from resource-importing countries to resource-exporting countries, and contributed to expanded consumption. Against the backdrop of robust consumption and resource development, investments also expanded. The growth in trade between the resource providing countries and China spurred an increase in demand for shipping and vessels, but as China's pace of growth began to slow, this mechanism began to work in reverse. In terms of shipbuilding, in 2012, Korea's volume of work – in – hand had slowed to around 40% of its 2008 peak. The slump in shipbuilding has also had an effect on the iron and steel industry.

Another China factor has been the modulation of the Chinese economy. Excess production capacity is becoming a problem. In China, as part of economic stimulus policies, there was major investment in public works in the wake of the Lehman Brothers collapse. Primary materials industries, such as iron and steel and petrochemicals, were proactive in ramping up production (including increasing production capacity). However, the subsequent blunting of demand has left them with excess production capacity. As a result of swollen inventory, cheap Chinese products have flooded Asian markets, aggravating Asian market conditions. Along with shipbuilding, iron and steel products have been a staple of Korean exports, but in 2012 and 2013 (January to May), export growth overall has slumped. In addition to falling demand, the deterioration of market conditions is having a detrimental effect.

■ Multi-faceted perspective required

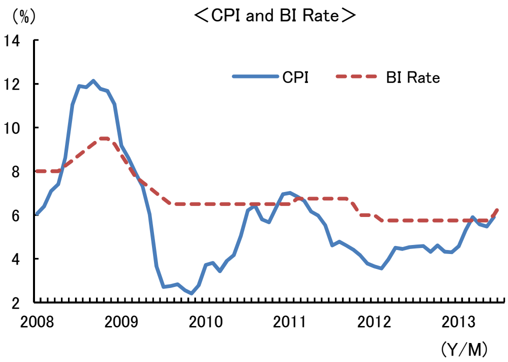
In late June, 2013, summit talks were held between Korea and China. Many business leaders were present, re-emphasizing the importance that Korean firms place upon China. Korea – China collaborative links concerning security (with respect to North Korea) and economic diplomacy are expected to grow stronger in the months and years ahead, but at a private sector economy level there is expected to be more progress in the "relativization" of China. This is because the emergence of the so-called "China risk", with labor shortages, rising wage costs, environmental issues, political and social instability, etc., has led to a growing move to redress what is seen as "over-dependence on China". In that sense, it is necessary to consider the Korea – China relationship from a multi-faceted perspective.

(Hidehiko Mukoyama)

Indonesia Concerns as fuel subsidies are cut

■ Policy interest rate raised for first time in 28 months

Bank Indonesia's Monetary Policy Committee voted to raise the policy interest rate (BI rate) by 0.25% to 6.00%, on June 13. This marked the first time that Central Bank had raised the policy interest rate in two years and four months. The consumer price increase rate for May was 5.5%, compared to the same period in the previous year, slightly down from 5.6% in the previous month. However, as the government had decided to cut fuel subsidies from mid June, resulting in an increase in fuel prices, the decision was taken to raise the policy interest rate as a precautionary measure against rising commodity prices.



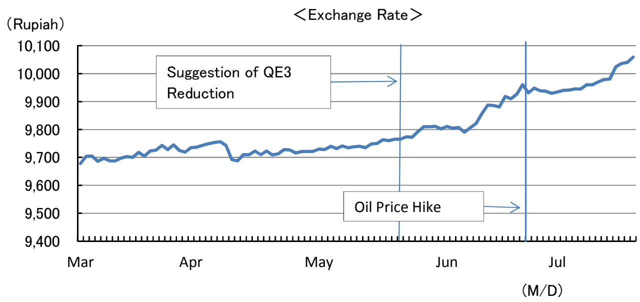
Source: Bank Indonesia

The subsidy cuts caused the price of a liter of gasoline to go up by 44%, to 6,500 rupiah, and a liter of diesel by 22%, to 5,500 rupiah. This was the second fuel price hike under the Yudhoyono administration, the last one being a 28.7% increase in May, 2008. Public reaction against the price hike has been strong, and an opinion poll reported 80% of respondents saying that they did not support the price rise. There is a possibility that the price rise will have some effect in next year's general election (April), and presidential election (July).

Nevertheless, part of the reason for the government's decision to raise fuel prices has been growing market unease over the expanding current account and budget deficits, and the continued weakening of the rupiah. Due to the fall in prices of primary products such as coal, palm oil and rubber, and increased imports of crude oil and gas, the trade surplus has contracted, resulting in the expansion of the current account deficit, continuing over five consecutive quarters till the January to March, 2013, quarter. Meanwhile, the spread of motorbike and automobile ownership brought about increased demand for petroleum products and increased subsidy payments, which caused the budget deficit to swell. This coincided with the revelation of a likely contraction in US quantitative easing, and the rupiah and share prices fell together from late May.

■ World Bank lowers growth forecast to 5.9%

With the raising of fuel prices, all manner of economic forecasts for 2013 have been revised. World Bank lowered its July forecast for economic growth in 2013 from 6.2% to 5.9%. Meanwhile, Central Bank expects that the rise in the consumer price increase rate as a result of the fuel price hikes will stop at 7.2% up on the previous year. Central Bank's view is that, though commodity prices will rise during the July to September quarter, 1) the stable supply of foodstuffs, 2) ripple restraint of transportation costs as a result of the increased fuel prices, and 3) a stable rupiah, will cause prices to settle gradually.



Note: Exchange rate is an average of Selling and Buying
Source: Bank Indonesia

At the same time, Central Bank expects the current account deficit to grow in the months ahead. This is because, while the prices of primary products continue to fall, imports of non-crude oil and gas are increasing. Also, Central Bank assumes that, as direct investment and securities investment continue to perform solidly, if the improved fiscal balance as a result of the cutting of fuel subsidies can slow the rupiah's depreciation, the capital outflow will contract and the capital account surplus will expand. While the cutting of fuel subsidies may cause the economic growth rate to fall, it will provide macro-economic management stability over the mid to long term, and increase the sustainability of economic growth. It remains to be seen whether market developments will correspond with Central Bank's scenario.

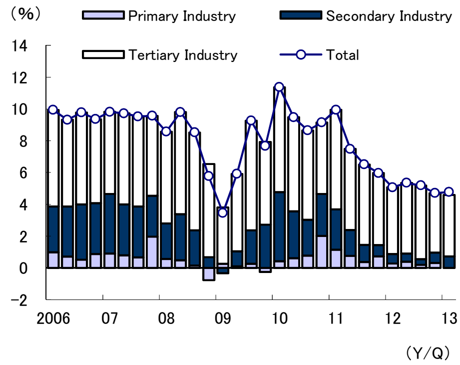
(Yuji Miura)

India Concerns over negative impact of currency depreciation

■ Real growth in 4% range for two consecutive quarters

India's economy is in the doldrums. Real GDP growth in the January to March, 2013, quarter was 4.8%, compared to the same period in the previous year, practically unchanged from the 4.7% posted in the previous quarter. In terms of individual industries, while primary products lost momentum due to unseasonable weather, an improvement in investment sentiment from last autumn onwards resulted in increased growth, albeit by a small margin, in construction, manufacturing and other secondary industries. As a result, the growth rate for fiscal 2012 (April, 2012, to March, 2013) was 5.0%, compared to the previous fiscal year, the lowest growth rate since 2002, when monsoons resulted in a significant negative growth rate for primary products. Though there have been continued interest rate reductions implemented since the start of 2013 in order to try to buoy the economy, economic indices still fail to show any clear sign of a rally.

＜Real GDP Growth (Y o Y)＞

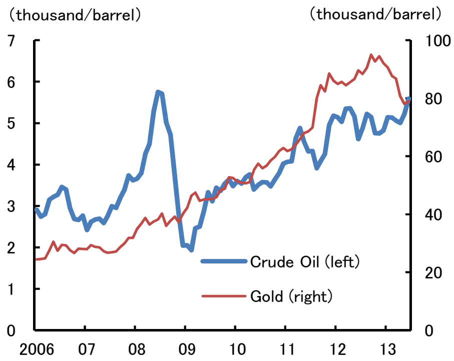


Source: Ministry of Statistics and Programme Implementation

■ $1 = 60 rupee range in late June

Under these circumstances, there is concern of late about the possible impact of rupee depreciation in the wake of speculation of the early downscaling of QE3 (the third round of quantitative easing policies) in the US. Market interest in the possible downscaling of QE3 has been intensifying since May, leading to share and currency depreciation, and the exchange rate went to the $1 = 60 rupee range at one point in late June. If a vicious cycle of currency depreciation and current account deficit expansion should develop, further financial easing will become more difficult to implement and the economic slump may well become a protracted one. However, because the global contraction of investment money will exert downward pressure on the prices of crude oil and gold, which account for over half of India's trade balance deficit, the expansion of the current account deficit due to currency depreciation will likely be offset to some extent. In fact, the international price of gold has fallen significantly and, in spite of the rupee's continued depreciation, rupee denominated import prices are decreasing. On the other hand, there has been little change in the international price of crude oil and rupee denominated import prices are increasing. Further, the rise in the price of crude oil not only works to expand the current account deficit, but also causes the fiscal deficit to expand because of increased subsidy spending on domestic petroleum products.

＜Crude Oil and Gold Price＞



Source: Bloomberg.L.P

In order to lessen any negative fallout from capital outflow resulting from the scaling back of QE3, it will be very important to increase the proportion of inward direct investment, which is much more stable than inward portfolio investment. Since September of last year, in spite of the fact that the government has revealed economic reform plans that include relaxation of restrictions on foreign investment, inward direct investment has yet to convert to an increasing trend. This is believed to be due to the fact that foreign companies' investment in India is hampered by 1) the final approval of direct investment application being the prerogative of state governments, 2) the levy of taxes on transactions that span state borders, and 3) the inordinate time taken to complete administrative procedures involved in the purchase and sale of land and buildings and land expropriation. It is anticipated that there will be no additional reforms introduced until after the general election in the spring of 2014. In the meantime, it is expected that the macro-economy will continue to be vulnerable to foreign investors' money flow.

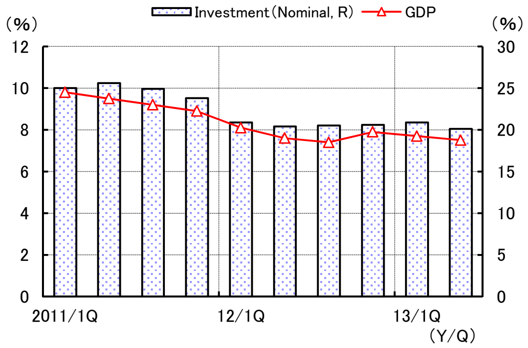
(Shotaro Kumagai)

China Economic growth slows to 7.5% in Q2

■ Domestic and external demand slump

China's real GDP growth rate for the April to June quarter was 7.5%, compared to the same period in the previous year. The growth rate has fallen below the previous quarter's level for two consecutive quarters, an ever clearer indication of economic deceleration.

＜Real GDP, Investment in Fixed Assets＞
(Y o Y)



Note: Nominal Investment figures are year-to-date.
Source: National Bureau of Statistics

The main cause of this deceleration has been the slump in exports. Exports for June were minus 3.1% compared to the same period in the previous year, converting to negative growth. With the exception of the months of January and February, which typically see significant fluctuation in growth rates due to the effects of the Lunar New Year holiday, this marks the first year on year negative growth since November, 2009. This is believed to be due to the fact that orders received from overseas have failed to grow, against the backdrop of a strengthening renminbi. In terms of major export countries and regions, while there have been some slight improvements in the figures for exports to Japan and the EU, an overall decline is continuing. Given the downward trend in exports to ASEAN, and the negative growth in exports to Hong Kong, it would be difficult to expect any sudden recovery in the latter half of the year.

It has also been pointed out that domestic demand is struggling. For example, investment in fixed assets (excluding rural households) stayed sluggish from the start of the year and posted 20.1% growth compared to the same period in the previous year, the lowest level since January to May, 2012 (20.1%, similarly). Part of the reason for this is thought to have been the fact that the Xi Jinping administration has identified plant and equipment expansion plans in overproducing industries and large scale real estate developments, for example, as hindrances to structural reform, and has adopted a restrictive policy stance. In addition, poor industrial production and export growth has led to a decline in plant and equipment investment in the corporate sector, leading to a drop in investment growth overall.

Meanwhile, nominal total retail sales for June grew 13.3%, compared to the same period in the previous year, 0.4% point above the figures for May. While this may be said to represent something of a mild recovery (on an actual basis, the figures have stayed unchanged through 2013), it still lacks the strength to be able to make up for the lack of growth in investments and exports.

■ Signs of impending policy switch to avoid economic slowdown

As regards the trend of economic deceleration, a spokesperson for the National Statistics Bureau positively evaluated the results of macro-economic controls, as well as claiming that the pace of deceleration was within the anticipated range. As suggested by these statements, the Chinese government appears to be committed to prioritizing structural reform, while accepting some degree of economic slowdown.

Meanwhile, from late June onwards there appear to have been signs of an impending policy switch. On June 28, Zhou Xiaochuan, governor of the People's Bank of China, stated that Central Bank would "adjust liquidity at the proper time to ensure market stability". Also, Premier Li Keqiang, on a tour of local regions in early July said that the government's economic management policy would be to ensure that the rate of inflation was restrained to within a certain range, while ensuring that economic growth rates and employment levels did not fall below a minimum range. These statements are believed to indicate that, while maintaining its policy of structural reform, the government is prepared to take appropriate measures to address turmoil in the financial markets and any sudden deceleration in economic growth. However, viewed from the perspectives of struggling local governments and industries, this could be taken as a signal of an impending policy shift. Much attention will be focused on the Xi administration in the future, to see whether they will cave in to demands for a policy switch, suspend their commitment to structural reform, and implement large scale economic stimulus policies.

(Junya Sano)