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Topics *Changing monetary policy stances of Asia's emerging economies*

The monetary policy stances of Asia's emerging economies are changing from "accommodative" to "neutral". While there is only a slight possibility of a sudden shift all the way to tight monetary policy, there has been no improvement in the persistent concerns over the outflow of capital, and the situation continues to be uncertain. The governments of these countries are going to need to implement swift economic structural reform.

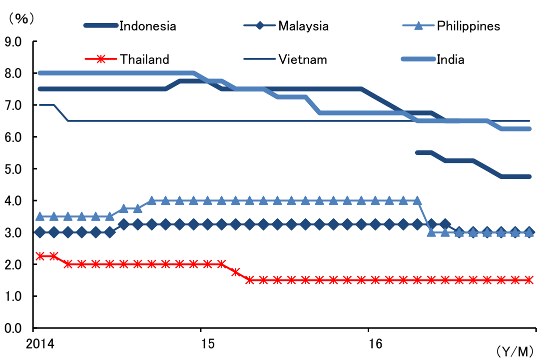
■ From accommodative monetary policy to neutral

The monetery policies of Asia's emerging economies (Indonesia, Malaysia, Philippines, Thailand, Vietnam, India) are beginning to change their orientation.

In response to a decline in inflationary pressure accompanying the fall in the price of crude oil and other natural resources, the central banks of Asia's emerging economies began to ease monetary policies from 2015. Indonesia promptly lowered its policy interest rate in February, 2015, and Vietnam, while it did not embark upon interest rate cuts, did instruct the commercial banks to lower their mid and long term loan interest rates.

Nevertheless, in recent times, the central banks of these countries have been modifying their monetary stances. In India, in spite of growing anticipation that the impact of the abolition of some banknotes in early November would be a slump in consumption and lower interest rates, Reserve Bank of India's Monetary Policy Committee voted at its December meeting to keep the policy interest rate unchanged. Even in Indonesia, where intermittent interest rate cuts had continued from the start of 2016 also, the policy interest rate has been kept unchanged since November.

＜Policy Rate in Asia's Emerging Economies＞



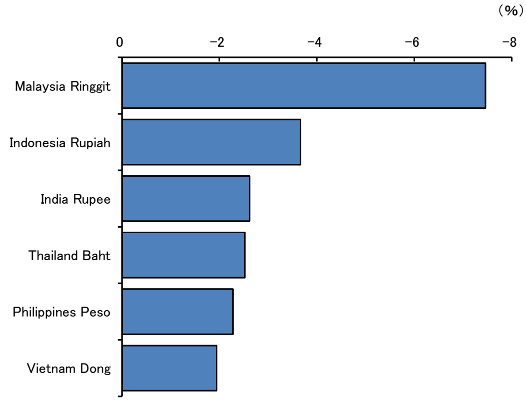
Note: Bank Indonesia changed their policy rate from "BI rate" to "7 days reverse repo rate" since August 2016.
Source: Central Bank in each country

■ Growing inflationary concern

As background to this, there is the growing concern over inflation, stemming from the following two sources.

The first is the acceleration of currency depreciation in the region. Asia's emerging economies are highly dependent on imports, of consumer goods and the like, so that currency depreciation is very prone to triggering inflation. Under these circumstances, Donald Trump's victory in the US presidential elections in November, 2016, triggered anticipation of an upswing in the US economy, encouraged by increased government spending, and long term interest rates went up. As this prompted the transfer of capital to the US, currency depreciation accelerated in Asia's emerging economies. Accommodative monetary policy tends to accelerate currency depreciation and import inflation, so many countries had no choice other than to switch their accommodative money policy stances back to a neutral position.

＜Currency Depreciation Rate in Asia 's Emerging Economies＞



Note: The data are the comparison between 8th November 2016 and 31st December.
Source: Bloomberg L.P.

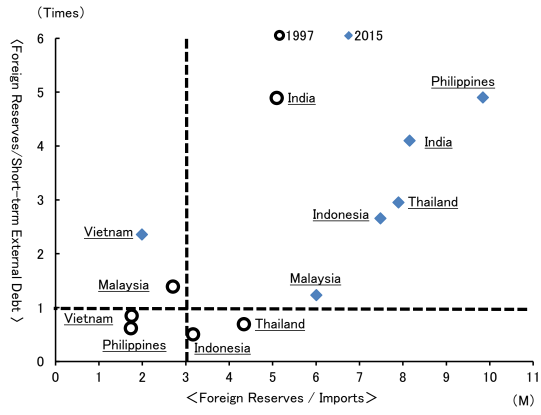
The second source may be said to be the rally in the price of crude oil. The price of crude oil, against the backdrop of China's economic deceleration, tumbled from $108 per barrel in the summer of 2014 to $29 per barrel by the start of 2016. Following suit, inflation rates in Asia's emerging economies also fell sharply. However, the falling crude oil prices bottomed out in February of 2016 and, in response to subsequent developments such as the OPEC (Organization of Petroleum Exporting Countries) member nations' agreement to reduce production, and a global economic recovery, changed to upward growth and rose as high as the lower $50 range per barrel by the end of 2016.

■ Possibility of a switch to tighter monetary policy is low for the time being

If currency depreciation and inflationary pressure continue to become more pronounced, the possibility of a switch to a tighter monetary policy cannot be completely ruled out. However, for the following two reasons, the outlook is that monetary policy will probably maintain a neutral stance for the time being.

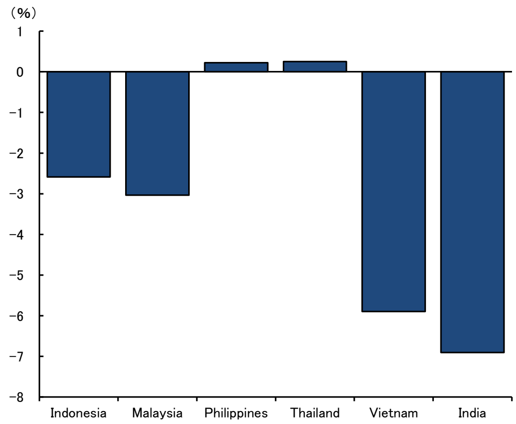
First, these countries have sufficient foreign currency reserves now and the sense of urgency that would prompt them to raise interest rates to protect their own currencies is not so acute. The foreign currency reserves of these countries are significantly higher than they were at the time of the 1997 Asian currency crisis and, with the exception of Vietnam, are equivalent to their short term external debt, or more than three months' worth of imports, which are considered rough guides to a safe level. Further, a characteristic feature of Vietnam's import value ratio is that, due to the processing and assembly of smartphones and other products, the import ratio against economic scale is higher than those of other countries in the region. Taking these factors into consideration, it may be said that, for each of these countries, the risk of a currency crisis following large scale capital outflow has been significantly reduced.

＜Foreign Reserves against Short-term External Debts and Imports In Asia's Emerging Economies＞



Source: World Bank

＜Fiscal Balance Against Nominal GDP (2015)＞



Source: IMF

Second, it is thought unlikely that the price of crude oil will rise significantly. The crude oil supply and demand balance is trending towards recovery, and this is expected to lead to a rise in crude oil prices. However, it is still unknown as to whether crude oil production will actually be cut, as per the OPEC agreement, and if crude oil prices do go up, this is expected to trigger a ramping up of shale oil production in the US. For that reason, it is felt that there is only a slight possibility that crude oil prices will rise at a rapid pace.

As described above, there is thought to be only a very slight possibility that the Asia's emerging economies will suffer economic overkill as a result of sudden monetary tightening. However, it is no mistake so say that it is now more difficult for countries to play the monetary easing card as a means of stimulating their economies. These countries have only just recently managed to escape from a period of economic deceleration, and in order to make their economic recovery a certainty, they will have no choice but to try to boost their economies through fiscal expenditure.

That having been said, there are not a few emerging economies that have concerns about the sufficient capacity of their fiscal policies. If countries are reckless in the expansion of their fiscal expenditure in order to stimulate their economies, they run an ever greater risk of the sudden depreciation of their currencies due to a loss of confidence in their fiscal policies. In order to avoid this kind of risk, these countries will need to construct much more robust economic and fiscal platforms through economic structural reform. In some countries, work on initiatives to reform fiscal policy has already begun. In November, the Vietnamese National Assembly approved the "Economic Restructuring Plan for 2016 - 2020" which calls for the reduction of the fiscal deficit to within 3.5% of nominal GDP, and also urged the government to strictly control public debt, now edging close to the statutory upper limit (65% against nominal GDP). Also, in the Philippines, the Duterte administration is attempting to implement a wide ranging reform of the taxation system, which has changes to the classifications of personal income and an expansion of the range of items subject to value added tax as its foundations. The focus of attention in the future will be whether the implementation of these kinds of reforms will be able to win the confidence of the markets in their respective countries.

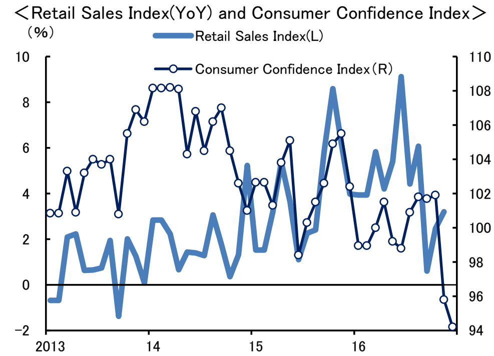
(Yuta Tsukada)

Korea Concern over slowing consumption

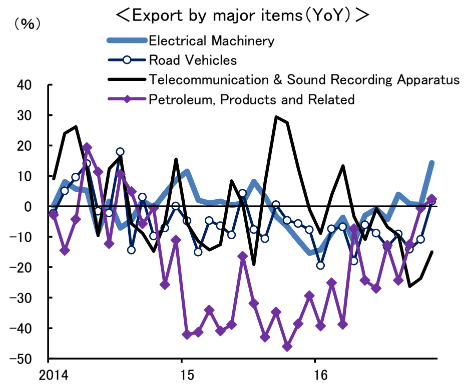
■ Consumer sentiment deteriorates significantly

In Korea there is growing concern over the deceleration of private sector consumption, which has supported economic growth thus far.

In terms of recent consumption trends, domestic automobile sales moved to negative growth at -5.8% in December, 2016, compared to the same period in the previous year (and the same hereafter). Though November's retail turnover was able to maintain positive growth at 3.2%, year on year, consumer confidence fell below the benchmark 100, declining to the same level as in April of 2009. Part of the reason for this appears to have been the impact of an increasing sense of uncertainty over the future of the economy as a result of political turmoil in the wake of a vote to pass a motion of impeachment against President Park Geun-hye, on suspicion of her involvement in the alleged intervention in national affairs by one Choi Soon-sil. Given this set of circumstances, it is expected that growth in consumption will continue to lack strength for some time to come.



Note: The January and February data were combined to adjust for the impact of the Lunar New Year
Source: Bank of Korea, National Statistical Office



Source: Korea Customs Service

On the other hand, corporate manufacturing is continuing on a recovery trend. Following improvements in shipping and inventory balances, production in manufacturing rose to 5.0% growth in November. Part of the context of this improvement is the recovery of exports, which had been struggling thus far. Exports overall posted fairly robust growth in November at 6.4%. In terms of specific export items, electrical equipment grew a massive 14.3%, and, in the wake of the bottoming out of the prices of crude oil, petrochemical product exports exceeded the previous year's figures for the first time in 27 months. Further, as the US and other industrialized countries continue their gradual economic recovery, it is expected that the recovery in exports can be maintained.

In addition, the "2017 Economic Policy Plan", announced on December 29, 2016, provides for more than 20 trillion won to be spent on invigorating the economy by countering the economic slowdown and providing support for employment, and also provides for an accelerated fiscal implementation in the period January to March, 2017, the largest ever of its kind. There is a strong probability that, while the export recovery continues, the boost to the economy by increased government spending will mean that a large scale economic deceleration can be avoided. However, given that tigther restrictions on housing transactions will likely mean a waning of the booster effect of construction investment, the outlook is that the pace of growth will continue to be modest at best.

■ President Park's authority suspended

On December 9, the National Assembly passed a motion to impeach President Park. In addition to the three opposition parties, there were votes to pass the motion from the ruling Saenuri party also, and the motion was carried by 234 votes, well over the two thirds that were needed. As a result, President Park's authority was suspended with immediate effect, and Prime Minister Hwang Kyo-ahn was appointed acting president. Subsequently, the Constitutional Court will deliver a verdict within 180 days on whether to accept or reject the impeachment. If the court votes to impeach, the president will be dismissed and presidential elections will be held within 60 days. However, even if the impeachment motion is rejected, it is expected that it will be difficult for President Park to continue her administration effectively, having lost so much of her ability to unify, and it seems likely that policital turmoil will continue. Following on from this, it is expected that there will be delays in domestic structural reform and in foreign diplomacy, and there are fears that economic deceleration could be protracted.

(Kentaro Matsuda)

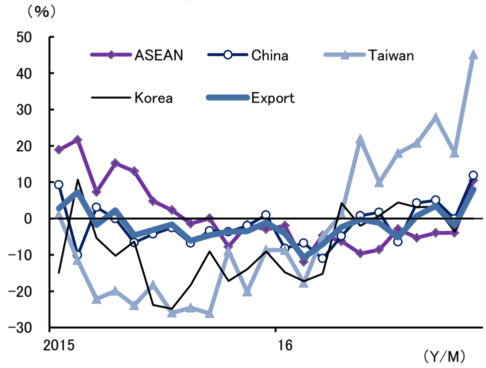
Hong Kong *Modest recovery, but risk factors persist*

■ Exports remain firm

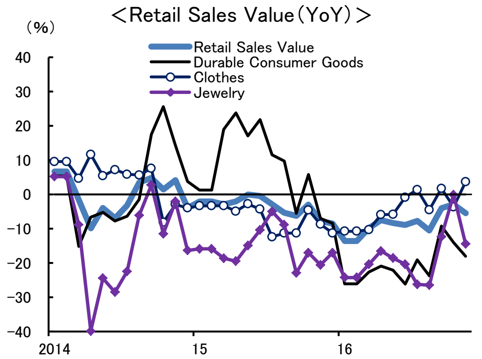
In Hong Kong, while the export recovery continues, the rally in private sector consumption is at a very pedestrian pace, and the economy continues to lack strength.

Examination of recent external demand shows that November's exports grew 8.1%, compared to the same period in the previous year (and the same hereafter), the strongest pace of growth since June, 2014. In terms of export destinations, exports to China, which account for about 50% of the export total, improved strongly to 11.8% growth, and exports to ASEAN grew 10.5%, turning to positive growth for the first time in 14 months. In addition, exports to Taiwan, where exports of electronic parts and components are strong, have increased rapidly. While exports to the US and EU have contracted, exports overall continue to perform solidly. Further, local industry exports have changed to positive growth since last September, and the improvement in corporate earnings is expected to be accompanied by a recovery in investment sentiment.

On the other hand, the recovery in exports of services has been limited. In terms of the numbers of foreign visitors, while there has been an increase in the numbers of visitors from countries other than China, the number of visitors from mainland China, which account for over 70% of visitors from other countries and regions, is lower than in the previous year. While the pace of decline has contracted recently, in light of the continuing economic deceleration in China there is only faint hope of any rapid recovery in these numbers.



Source: Census and Statistics Department



Note: The January and February data were averaged to adjust for the impact of the Lunar New Year
Source: Census and Statistics Department

As the numbers of visitors from the Chinese mainland continue to fall, retail turnover continues to stagnate. In terms of individual items, jewelry contracted massively to -14.5%, as did durable consumer goods at -18.0%. However, housing prices and share prices, having bottomed out at the start of 2016, are in recovery mode, in response to which consumer sentiment is improving, and a significant slump in consumption in the region is expected to be avoided.

As for the future, it is expected that the economy will continue to recover, mainly due to the improvement in export growth. However, given that it may be envisaged that 1) when US interest rates are raised, Hong Kong's interest rates will follow suit and go up, and 2) real estate price control measures will cause a housing market recession, it seems that the potential for economic downswing will linger for some time.

■ Election campaigning for the next Chief Executive gets fully underway

Campaigning for the election of the next Chief Executive, slated for March, 2017, is getting fully underway. In response to the news that the current Chief Executive, Leung Chun-ying, appointed in 2012, will not be running in the upcoming election, Chief Secretary for Administration Lam Cheng Yuet-ngor, and Financial Secretary John Tsang and others are considering running. Prior to the election campaigns, the Democratic Party and other non pro-Beijing parties had won over 300 seats on the Election Committee (1,200 members), more than they had last time, but the influence of the Democratic Party, which currently has no candidate, is seen as rather limited. From the perspective of whether a person can be selected who will be able to improve relations with China and ease political conflict and who can tackle economic challenges, the direction of the Chief Executive election will attract much attention.

(Kentaro Matsuda)

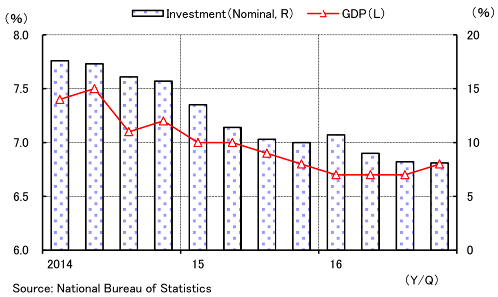
China 6.7% economic growth in 2016

■ Support measures enable growth within target range

China's real GDP growth rate in the October to December quarter of 2016 grew 6.8%, compared to the same period in the previous year, gaining 0.1% points on the July to September quarter. This means that the growth rate for the whole year was 6.7%, year on year, reaching the government's target (6.5% to 7.0%).

In terms of individual demand items, policy measures have led to a halt in the decline in investment growth. Fixed asset investment (excluding rural households) for the whole year 2016 has been flat and steady, after bottoming out in the January to July period. Investment in infrastructure (excluding electric power) and state owned enterprises (including government agencies) expanded at a faster pace than the actual performance for 2015, and the judgement is that public utility-led investment has bottomed out.

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



Source: National Bureau of Statistics
Note: Nominal investment figures and year-to-data excluding rural households.

While consumption continues its trend of deceleration, nominal retail turnover grew just over 10%, compared to the same month in the previous year, and just over 7% in real terms, continuing to expand at a comparatively steady pace. The main reason has been the growth in automobile sales. The tax reduction measures for compact cars was originally due to end within the year (at the end of 2016, the plan was changed to "a smaller reduction, extended for one year"), leading to last minute rush demand, and automobile sales for 2016 were up 13.7%, year on year, the highest growth in three years, and the highest sales number ever, at approximately 28 million vehicles. In addition, an influx of capital as a result of monetary easing policies has contributed to an increase in housing sales, as well as expanded sales of electric household appliances.

On the other hand, trade figures for both exports and imports have fallen below the previous year's level for two consecutive years. Against the backdrop of global economic stagnation, exports in particular grew negatively at -7.7%, the biggest slump since the -16.0% posted in 2009.

With support from economic stimulus policies coming to an end in 2016, it is assumed that China's economy will once more begin to slow in 2017. As reasons for this, 1) a significant blunting of automobile sales following the smaller scale of tax reduction, and 2) a peak in housing sales due to tougher price control measures, may be considered. While a major decline in the economic growth rate will likely be avoided due to expanded public works investments, the economic growth rate for the whole year 2017 is expected to be 6.5%, coming in under the actual performance for 2016. o flowed into the real estate market and is believed to have been one factor boosting housing purchases.

■ Emphasis on asset bubble suppression in 2017 economic management

The Xi Jinping administration is expected to conduct its economic management in 2017 based on the decisions taken at the Central Economic Work Conference at the end of 2016. The Conference affirmed the continuation of "making progress while ensuring stability" and "proactive fiscal and prudent monetary policies", so economic management will basically follow the previous year's line.

<Main Points of The Central Economic Work Conference>

Decisions	Main Points
Basic Economic Management in 2017	・Making progress while ensuring stability
Fiscal & Monetary Policy	・Maintaining proactive fiscal policy, and prudent monetary policy
	・Under the prudent and nuetral monetary policy, preventing turbulence, restraining bubble growth, and avoiding system risk
Property Market	・Working to prevent turbulence and restrain bubble growth. Promoting home purchases and the supply of rental housing
Structural Reform	・Continuing the reduction of excess capacity and real estate inventory, alleviate burden on businesses, and making progress

Source: Chinese Communist Party's Official Site

These developments have indicated a policy of promoting home purchases and the supply of rental housing, all the while working to prevent turbulence and restrain bubble growth in the real estate market. The background context to this is the Xi administration's desire to slash real estate inventory and make this a result of structural reform. Also, the fact that real estate related revenues are an important source of finances for local governments may be presumed to be one factor encouraging these initiatives. As the Xi administration implements economic management in an attempt to achieve both structural reform and economic stability, real estate market countermeasures will be the touchstone.

(Junya Sano)