Economic Research

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Economic Monitors: Updates on India, Singapore South Korea and Australia

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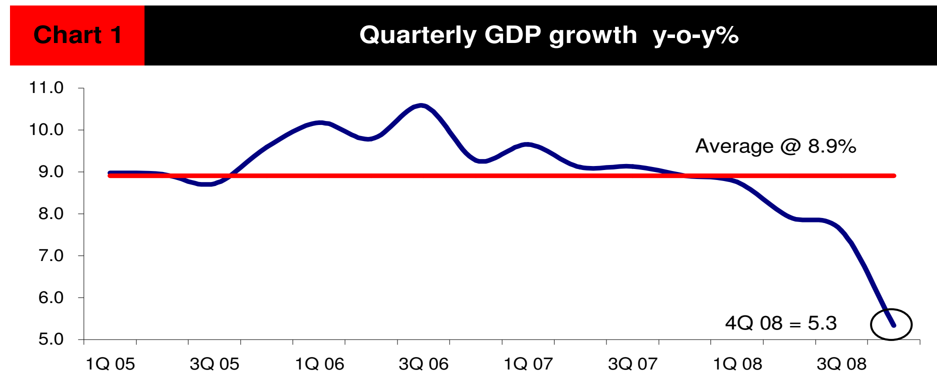
India | Sustaining growth momentum

Downward pressure on growth….

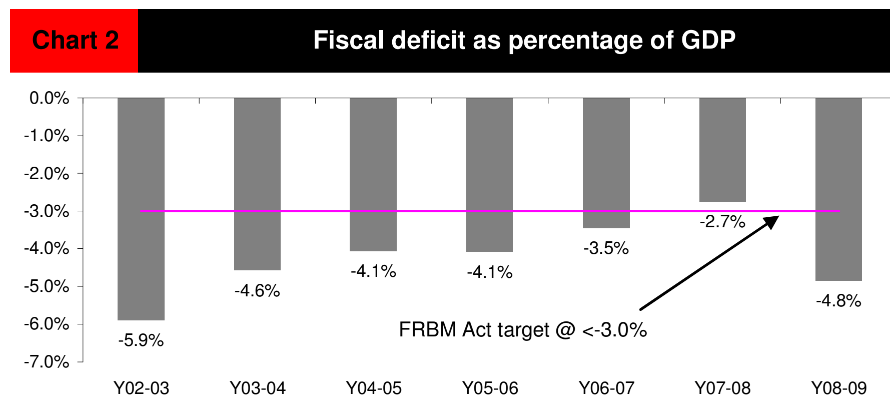
Following a synchronized recession in major developed economies, Indian economy, once touted as Asia's next tiger, is now undergoing a bumpy growth path. The 5.3% year-on-year (y-o-y) growth in the quarter ended December 2008 was the weakest since 2005 and well below the 4-year average growth of 8.9%. Key components of domestic demand - consumption and investment - decelerated during the December quarter, leaving the government to take up the slack in order to maintain a respectable growth rate. Growth in private consumption moderated to 5.4% from 6.9% in the preceding quarter while investment decelerated sharply to 5.3% after expanding at a double digit pace in the preceding quarter.



Source: Bloomberg

Fiscal stimulus leads to widening budget deficit

Against such a backdrop, the government is expected to step up on public spending in an effort to provide a catalyst for economic growth in the near term. The interim budget 2009-10 which was tabled on February 16, projected a ballooning fiscal deficit of 6.0% of GDP in 2008-09 (2007-08: 2.7%) but will improve slightly to 5.5% of GDP in 2009-10. This suggests the budget will not be on track to meet the government's target under the Fiscal Responsibility and Budget Management (FRBM) Act 2003 which calls for an elimination of deficit by 2008-09. This is in spite of the government's success in adhering to its fiscal consolidation program which resulted in a decline in budget deficit from 6.0% of GDP in 2001-02 to 2.7% in 2007-08. Notwithstanding, the threat from a weakening external sector should not be underestimated and taken lightly. As such, we are of the opinion that the government has responded wisely by temporarily disregarding the FRBM target.



Source: Ministry of Finance India

Sovereign rating outlook was downgraded

Due to rising government spending, international credit rating agency, S&P Services, revised its sovereign rating outlook on India from stable to negative on February 24 but left the rating at BBB-. S&P cited farm loan waivers and salary hikes for government employees as primary reasons for the country's worsening fiscal situation. In addition, government debt will likely escalate from 78% of GDP in 2009-10 to 82% – 85% of GDP in the next few years. This, to a large extent, will cause difficulty for the government to pump prime the economy particularly when savings (37.7% of GDP) continue to be outpaced by investments (39.0% of GDP). Hence, the economy is critically dependent on external financing.

Weak rupee posts a great challenge for external borrowings

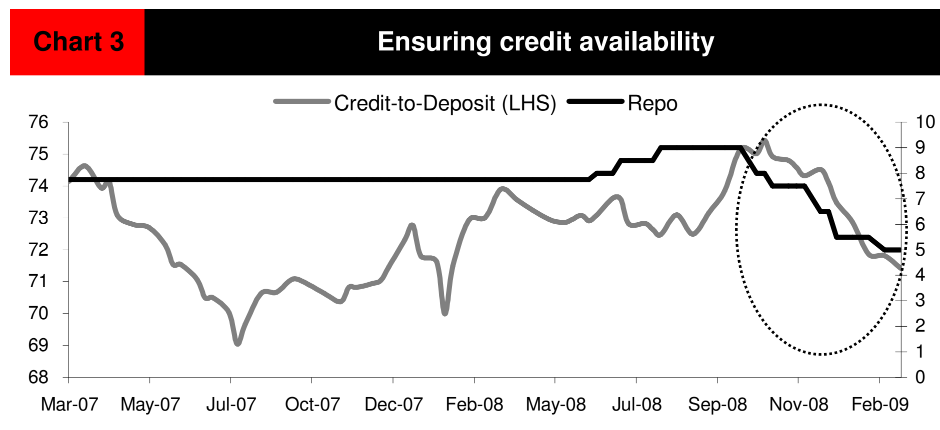
The Indian rupee has depreciated by 28% since the beginning of 2008 when the US sub-prime mortgage crisis unfolded. This weakness will have negative repercussion on the economy as a significant part of funding for new assets in private firms comes from the External Commercial Borrowings (ECB)[1] which constitutes 27.1% of total external debt in the quarter ended September 2008. Hence, weaker rupee will translate into higher borrowing cost for businesses and impede investment activities going forward.

Apart from ECB, financing from the equity market is equally important for many companies. However, given the weakened economy, the benchmark Sensex Index has declined by a massive 55.8% since January 2008. The prevailing weakness of the equity market is a major constraint for corporate to raise funds as major international investors who off-loaded their existing holdings following the collapse of Lehman Brothers in September 2008 stay away.

RBI may cut rates further

In a bid to restore confidence and to ensure availability of credit, the Reserve Bank of India (RBI) has responded aggressively through an accommodative monetary policy. On March 6, Reverse Repo and Repo rate was brought down by 50 bps each, to 3.50% and 5.00% respectively. These brought a total 400 bps cut in the Repo rate and a 250 bps cut in Reverse Repo since October 2008. We think there is room for further monetary easing actions in the near term as inflationary pressures have clearly receded. The sharp decline in the Wholesale Price Index (WPI) to 0.44% in the week ended March 7 from a high of 12.42% in September 2008 suggests that disinflationary trend has gained momentum in the economy, giving another reason for the RBI to keep trimming interest rates in the near future.

Chart 3 **Ensuring credit availability**



Source: Bloomberg

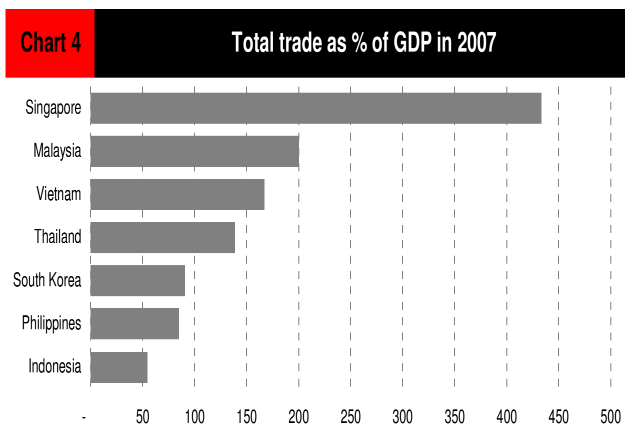
[1] Review of the Economy 2008/09, Economic Advisory Council

Singapore | Externally vulnerable

Crushed by collapse in external demand

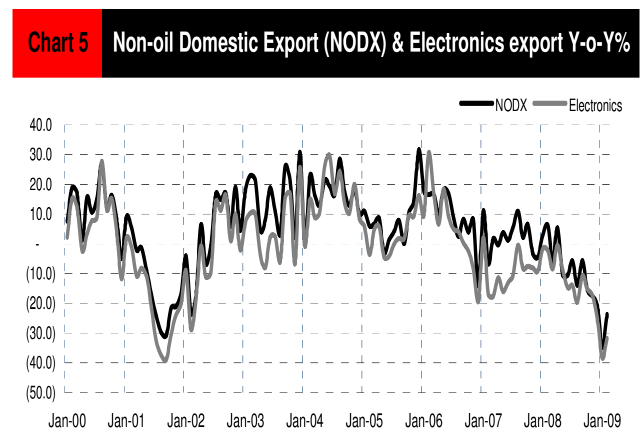
Judging by total trade ratio – a combination of exports and imports as percentage of GDP – Singapore is the most open economy within Southeast Asia. With international trade flows constituting more than 4 times the size of its GDP, Singapore's economy is high susceptible to changes in external demand. Following the collapse in global trade brought on by synchronized recession in major developed economies, demand for Singapore's non-oil domestic export (NODX) has contracted sharply since May 2008, putting downward pressure on economic growth. The latest economic release shows NODX plummeted by a double-digit 23.7% y-o-y in February due to plunging demand in global semiconductors and pharmaceuticals, Singapore's two major export components.

Chart 4 Total trade as % of GDP in 2007



Source: Key Indicators for Asia and the Pacific 2008, ADB & MARC estimate

Chart 5 Non-oil Domestic Export (NODX) & Electronics export Y-o-Y%



Source: Bloomberg

How deep will the recession be?

The economy was almost at a stand-still in 2008, growing by a mere 1.1% after recording a blistering 7.8% expansion in 2007. What is more worrying is the quarterly trend as GDP contracted by a massive 16.4% seasonally adjusted annualized quarter-on-quarter (q-o-q) basis in the 4Q2008, following 2.1% decline in the earlier quarter. Manufacturing sector, which comprises electronics, chemicals, biomedical manufacturing and precision engineering, was the main casualty, falling by 21.3%. Services-oriented industries were not spared either evidenced by the 29.2% contraction in the financial services sector in 4Q2008 from 13.1%, followed by wholesale & retail trade (-27.1%) and transport & storage (-14.2%).

Going forward, Singapore's external sector is expected to bear the brunt of the weakness in global economy which according to the World Bank, will shrink by 1.7% in 2009, its first contraction since World War II. What has become a concern now is that Singapore's economic conditions will not only deteriorate because of reduced trade activities but also because of rising unemployment especially in export-oriented industries. Already, unemployment rate has reached 2.6% in the 4Q2008 after averaging at 2.1% in the preceding three quarters. As a result, consumers are tightening their purse strings, evidenced by 10.2% plunge in retail sales in January. Against such a weak backdrop, the Ministry of Trade and Industry (MTI) anticipates the economy to contract by between 2.0% and 5.0% in 2009.

Table 1: Gross Domestic Product (GDP)

Quarter-on-quarter Annualised Growth % (Seasonally Adjusted)							
Sector	4Q 07	2007	1Q 08	2Q 08	3Q 08	4Q 08	2008
Total	**(1.6)**	**7.8**	**12.2**	**(7.7)**	**(2.1)**	**(16.4)**	**1.1**
Goods Producing Industries	(17.3)	7.2	45.6	(35.9)	(0.8)	(16.2)	(1.0)
Manufacturing	(24.8)	5.9	60.2	(45.9)	(5.2)	(21.3)	(4.1)
Construction	41.4	18.2	(9.6)	59.9	23.5	10.3	20.3
Services Producing Industries	10.9	8.1	5.6	7.6	(1.7)	(15.0)	4.7
Whole & Retail Trade	6.7	7.4	7.9	3.8	(0.8)	(27.1)	2.6
Transport & Storage	9.7	5.0	4.5	4.6	(3.2)	(14.2)	3.1
Hotels & Restaurants	1.0	4.9	(1.4)	0.7	(0.4)	0.6	1.2
Information & Communication	7.8	6.5	5.7	11.4	5.9	(0.9)	7.2
Financial Services	23.4	15.7	8.2	7.4	(13.1)	(29.2)	5.5
Business Services	11.1	9.1	3.4	10.1	8.4	(0.8)	7.4

Source: Ministry of Trade and Industry Singapore

The government responded with a stimulus package

As rapidly waning global demand calls for an expansionary fiscal policy, the government responded by introducing the Resilience Package in January 2009, amounting to SGD20.5 billion or 8% of GDP. The main thrust of the package is to save as many jobs during this economic downturn, and help viable companies to stay afloat. The five components in the package are:

I. **Jobs for Singaporean** – the government will introduce among other things, Jobs Credit scheme that will encourage businesses to preserve jobs during the current economic downturn. Apart from that, the government will increase allocations for training and provide additional support for lower-income workers who have suffered from wage reduction.

II. **Stimulating bank lending** – the government will extend SGD5.8 billion in capital for a Special Risk-Sharing Initiative (SRI). Under this program, an enhanced Bridging Loan Program (BLP) will cater loans up to SGD5 million (up from SGD500,000) to meet the working capital needs of mid-sized firms. Also, the government will increase its share of risk on these loans from 50% to 80%.

III. **Enhancing business cashflow & competitiveness** – the government will implement tax measures and grants amounting to SGD2.6 billion. Among the measures introduced were the 40% tax rebate for industrial and commercial properties for 2009 and enhanced loss-carry back provision.

IV. **Supporting families** – the government will spend a sum of SGD2.6 billion on households this year. This includes the doubling of GST Credit in 2009 that will be paid out on March 1 and personal income tax rebate which will be capped at SGD2,000.

V. **Building a home for the future** – the government will spend SGD4.4 billion on developing first class infrastructure.

MAS to adopt a weakening bias

The Monetary Authority of Singapore (MAS) is expected to adopt a weakening bias in its exchange rate policy at its upcoming monetary policy meeting slated in early April. Following the previous meeting on October 10, 2008 MAS shifted its policy band from upward to zero percent appreciation of the SGD Nominal Effective Exchange Rate (SGD NEER). Weak global growth as well as continued disinflationary trend (CPI grew by 1.9% in February 2009 compared with 2.9% in the preceding month) allow SGD to be on a weaker side in order to promote the external sector.

South Korea | Still affected by credit crunch

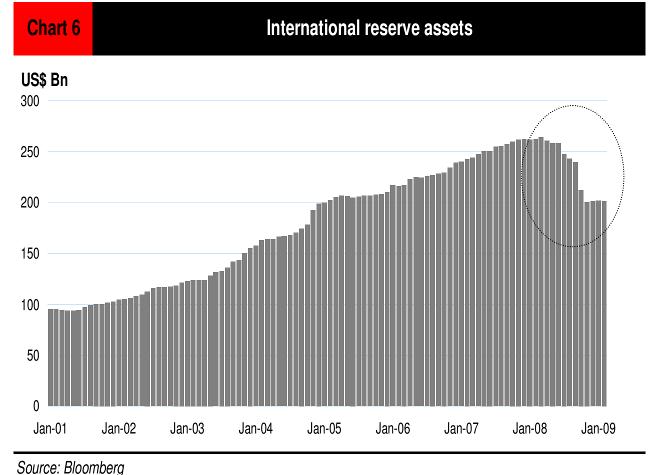
De-leveraging process has stabilized

Since the onset of global credit crunch in 2007, the Korean Won and equities have been hammered, resulting in a 25.7% currency depreciation and a massive 38.7% fall in stock market in 2008. By March this year however, the situation has somewhat stabilized with the benchmark KOSPI index posted a 13.6% gain to reach 1,160.8 points, reversing the 8.9% loss recorded in the preceding month. Similarly, the Won strengthened against the greenback by 10.9% after suffering a 10.1% decline in February 2009. As a result, international reserve assets remained steady hovering around US$200 billion since November last year, an indication that capital outflows have somewhat eased. A flurry of positive news from the US housing market, where housing starts unexpectedly climbed 22% in January and new home and existing sales rose 4.7% and 5.1% recently and on China's economy provided a much needed comfort to foreign investors who are still holding Korean assets.

Chart 5 Korean Won and KOSPI 100 Index

Source: CEIC

Chart 6 International reserve assets



Source: Bloomberg

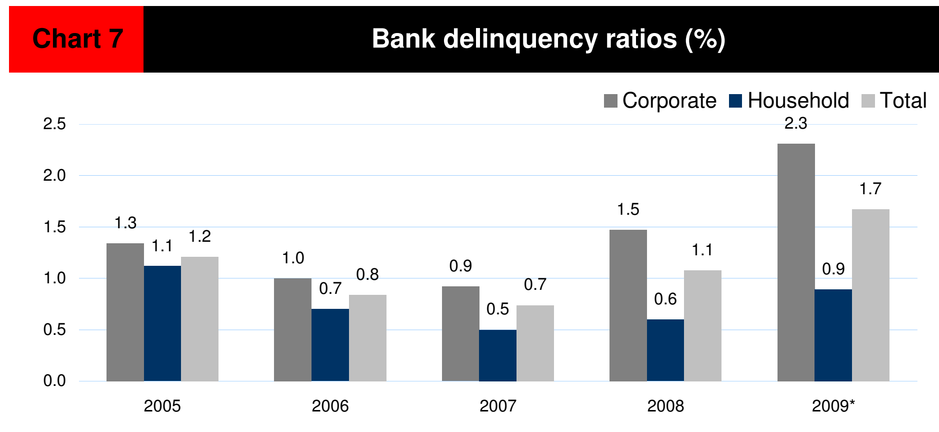
Credit availability remains a critical issue

Despite the improvement on external front, credit availability remained a nagging issue in the economy. Aggressive rate cut by the Bank of Korea (BoK) has yet to result in a meaningful recovery in lending activities, evidenced by the continued decline in the growth of monetary aggregates to 9.2% in January 2009, from an average 11.9% expansion in the preceding 12 months. Apart from that, pessimistic sentiment among businesses and consumers has added strain on lending as prospects for global and domestic demand as well as labour market conditions remain bleak in the near term. A survey done by the BoK to gauge manufacturers' confidence showed the reading fell to a record low in January while consumer sentiment index hovered below the 100-point threshold in March 2009.

Rising delinquency ratio puts additional constraint on lending

With the economy going through a distressing period, banks' asset quality is expected to deteriorate, leading to more stringent lending standards for both consumers and businesses. This is reflected in banks' delinquency ratio which has climbed by 0.66 percentage points to 1.67% in February from January 2009. The rise was primarily driven by an increase in delinquencies of corporate loans in which, Small & Medium Enterprises (SMEs), was the major culprit. Delinquency ratio among SMEs rose by 1.27% to 2.67% in February, a stark contrast with large corporations whose delinquency ratio edged up by a mere 0.35% to 0.63%. In the same month, household delinquency rose slightly to 0.89% from January's 0.82%.

Chart 7 Bank delinquency ratios (%)



Source: Financial Supervisory Service (FSS), Korea

** as of February 2009*

BoK may not be done with its rate cut

On March 12, the BoK left its key policy rate unchanged at 2.0%, after delivering a total 325 bps cut since October 2008. The Governor cited that the central bank will closely monitor the effects of previous cuts, signaling that additional policy easing will not be ruled out especially if economic growth continues to be hammered by weak external conditions. To date, exports which accounts for 60% of the Korean economy, continue to bear the brunt of waning global demand, contracting by 21.2% y-o-y in March, its fifth consecutive month of decline since November last year. Similarly, imports slumped by 36.0%, compared with a 30.9% contraction in February, reflecting lower import of intermediate goods, low oil prices and the overall weak demand from Korea.

Supplementary budget primarily aimed at stabilizing employment

On the fiscal front, the Ministry of Strategy and Finance (MOSF) unveiled the Supplementary Budget for Job Creation on March 24 amounting to KRW28.9 trillion. Of this amount, KRW17.7 trillion will be executed as fiscal expenditures and KRW11.2 trillion will be used to make up for the expected shortfall in revenues. The amount is twice as big when compared to the supplementary budget introduced during the Asian Financial Crisis in 1998 (KRW13.9 trillion). According to the MOSF Minister, Yoon Jeung-hyun, the latest stimulus package is envisaged to create 550,000 jobs in the economy. Because of the sheer size of the package, fiscal deficit will likely widen to 5.4% of GDP in 2009 from -1.7% of GDP in 2008 while government-debt-to-GDP ratio is anticipated to climb from 32.5% of GDP in 2008 to 38.5% in 2009. Although rising, the debt ratio remains relatively lower than the average debt ratio of OECD which stood at 75.4% of GDP and other advanced countries such as the US (62.8% of GDP), UK (47.5% of GDP), Japan (170.3% of GDP). Given this, the government has the financial flexibility to raise additional borrowings to finance its deficit spending.

External headwind could prolong and deepen the recession

Despite commendable efforts by the government through fiscal and monetary sides, the economy will be at the mercy of global economic conditions, which at this juncture, has not shown much signs of an imminent recovery. Deteriorating labour market conditions have steadily weaken domestic demand as rising unemployment rate keeps consumers from spending. At the same time, investment plans are scaled down as lackluster business sentiment prevails. Not surprisingly, the MOSF predicts the labour market to lose 200,000 jobs this year and forecasts the economy to contract by 2%

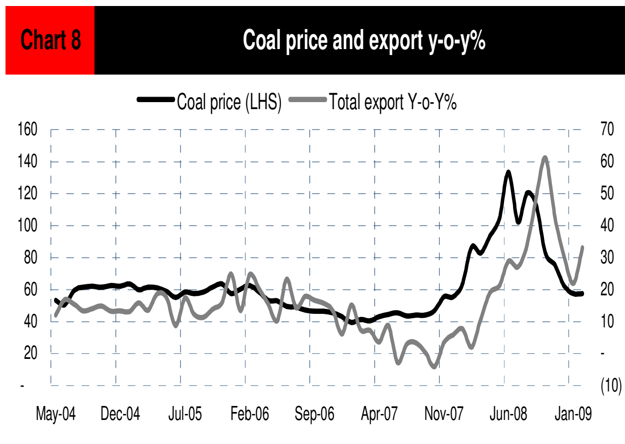
Australia | Heightening recession risk

Not immune to global economic woes

Although exports account for only one-fifth of the economy while consumption represents the biggest slice of Australia's GDP, the country has not been spared from the ongoing global economic crisis. The fallout from the crisis has evidently cascaded into commodities market leading to a collapse of commodity prices. The significant correction in commodity prices has had a great consequence on the broad economy that is highly dependent on commodity exports.

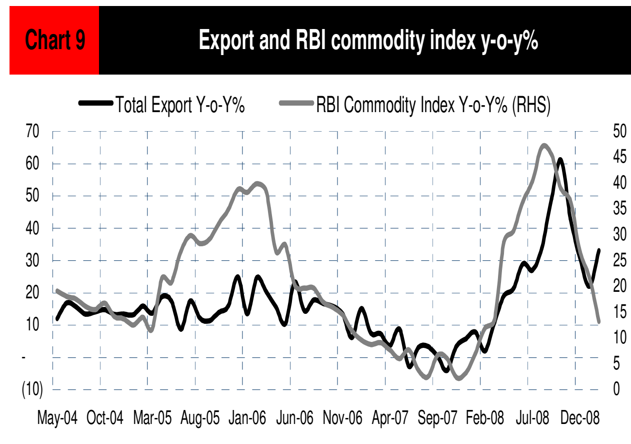
As a result, Australia's 16 consecutive years of economic expansion came to abrupt end when its GDP fell by 0.5% on a q-o-q basis in the quarter ended December 2008. During the quarter under review, domestic demand almost screeched to a halt growing by a mere 0.1% after expanding by 0.3% and 1.1% in the preceding two quarters while exports registered a back-to-back decline, contracting by 0.8%. With the prospect of global economy remaining bleak as reflected by the IMF's latest forecast of a global output contraction of between 0.5% and 1%, a possibility of economic recession cannot be ruled for the Australian economy.

Chart 8 Coal price and export y-o-y%



Source: Bloomberg

Chart 9 Export and RBI commodity index y-o-y%



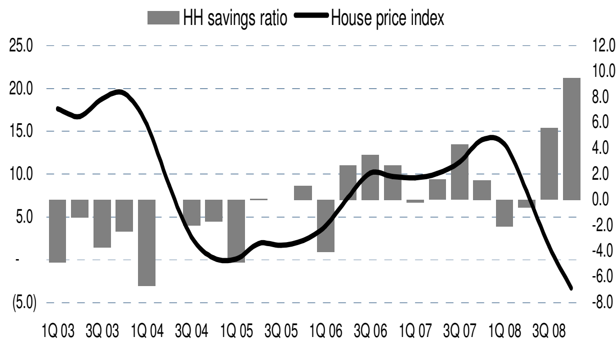
Source: Bloomberg

Destruction in wealth and rising unemployment suggests weak household spending

Faltering global demand has significantly affected Australia's household sector. In particular, a rapid decline in asset prices has resulted in evaporation of household wealth while rising unemployment rate has put immense downward pressure on income growth. House price index in 8 major cities declined by 3.3% in the quarter ended December 2008 while the benchmark S&P ASX 200 index slumped by 53.4% from its peak on November 1, 2007. Tighter financing conditions have also exacerbated the decline in house prices, a signal that housing market will unlikely to recover anytime soon.

Heightened uncertainty in labour market which resulted in lackluster consumer sentiments has induced consumers to prefer cash as their assets. A gauge for consumer sentiment fell to 85.6 points in March and has remained below the 100-point threshold since early 2008. Not surprisingly, household savings ratio climbed to 9.5% in the quarter ended December 2008 from 5.6% in the preceding quarter. As a result, household spending registered an anaemic growth of 0.1% in the last two quarters of 2008. Given the current economic scenario, household spending is expected to remain subdued as a sharp fall in consumer sentiment will likely translate into lower consumption in the near term.

Chart 10 House savings ratio vs. House price index y-o-y%



Source: Australia Bureau of Statistics (ABS)

Chart 11 S&P / ASX 200

Source: CEIC

No liquidity trap but….

In its monetary policy meeting on April 7, the Reserve Bank of Australia (RBA) reduced its key rate by 25bps to 3.00% as the contraction in the global economy continued during the first few months of this year, and most assessments of the near-term outlook have been further marked down. The RBA opined that the monetary policy transmission mechanism was working to deliver large reductions in interest rates to borrowers. To date, the RBA has delivered 425 bps rate cuts since September last year. The RBA also believes that monetary policy is not in a state of liquidity trap suggesting that the central bank has not lost its credibility in supporting growth. However, credit growth which grew by a double digit pace in the first 9 months of 2008, continued to moderate to 5.4% in February from 6.1% in the preceding month. This could be a signal that further monetary easing is warranted particularly when sentiment among businesses and consumers are not likely to pick up anytime soon.

Second stimulus aimed at infrastructure projects

The second fiscal stimulus package of AUD42 billion of 2.0% of GDP announced in February was dubbed is 'Nation Building and Jobs Plan' and as the name implies, is aimed at boosting infrastructure projects such as upgrading and maintaining primary schools (AUD14.7 billion), boosting the national stock of community housing (AUD6.6 billion), giving tax breaks to small businesses (AUD2.7 billion) and providing regional road repairs (AUD890 million). This is in contrast with the first stimulus package of AUD10.4 billion or 1.0% of GDP known as Economic Security Strategy which emphasized on improving disposable income through various bonus payments for pensioners and low-to-middle income earners. The second stimulus measure is expected to generate 90,000 jobs over the next two years and lift GDP growth to 0.5% in 2008-09 and 0.75% - 1.00% in 2009-10. However, with the increase in government spending, fiscal deficit is projected to widen to 1.9% of GDP in 2008-09 and 2.8% of GDP in 2009-10, after remaining in surplus in the past six years.

External demand key to full recovery

In recent months, positive vibes from US and China have given some respite to the exchange rate as well as the equity market. As a result, Australian dollar (AUD) strengthened by 13.3% against the greenback between March 9 and April 6 while the S&P ASX 200 index gained 19.4% during the same period. However, the question remains whether this could be a temporary correction or a reversal in trend as confidence and sentiment among businesses and consumers are still fragile at this juncture. As such, we believe policy makers are ready to respond with both monetary and fiscal actions to support flagging household spending. Therefore, we foresee a possibility of further reduction in RBA's cash rate by 75 bps in the near term from the current level of 3.00%. On the fiscal side, we believe that a third fiscal stimulus package could be rolled out as previous government budget surplus allows policy makers to engage in anti-cyclical measures.

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