

**Asia**

**International Conference of Commercial  
Bank Economists**

Munich, Germany  
1<sup>st</sup> July 2009

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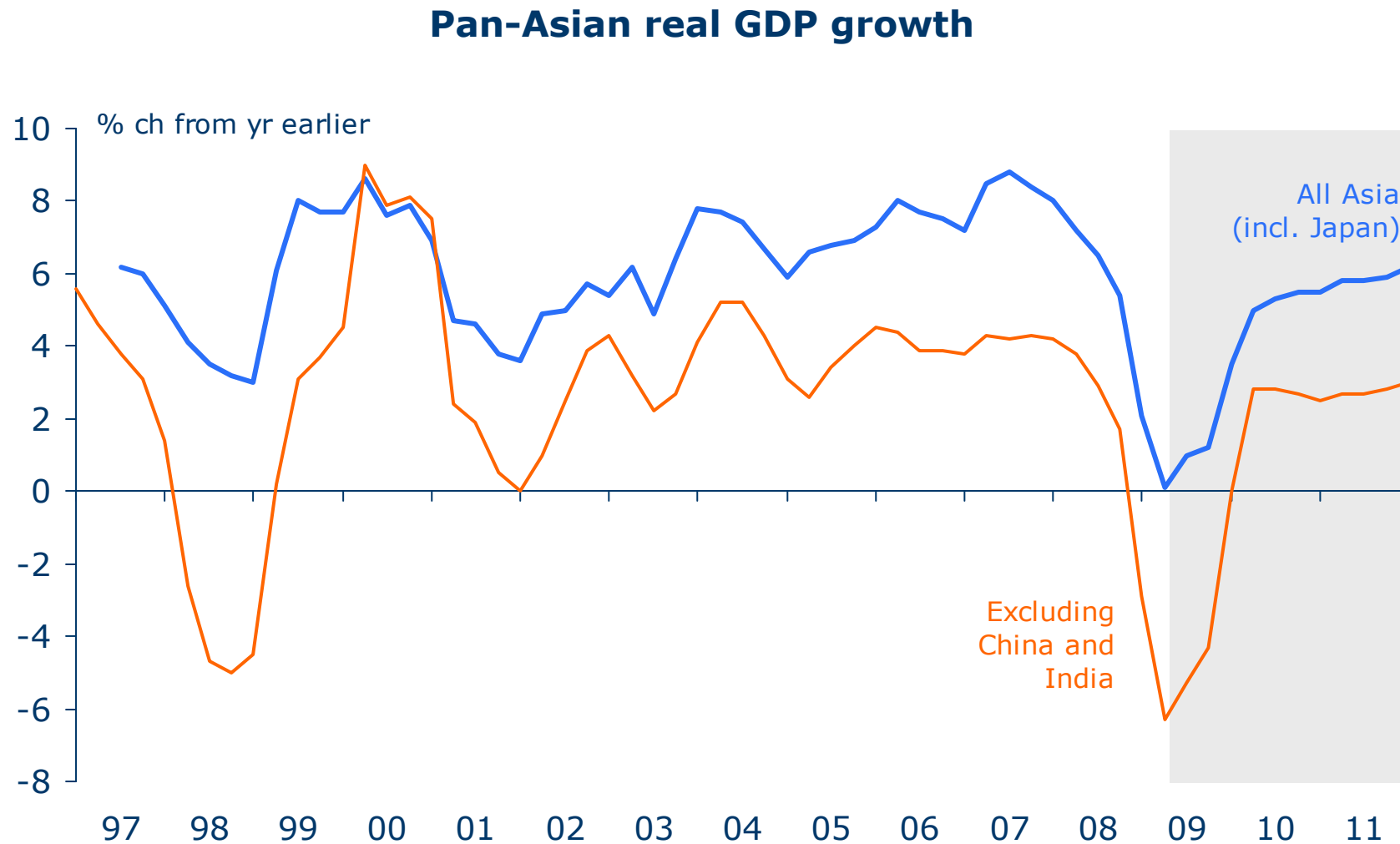
- **Asia has been hard hit by the 'Great Recession'. Pan-Asian real GDP growth dropped from a peak of 8.8% over the year to Q2 2007 to just 0.4% over the year to Q1 2009 (compared with a trough during the Asian crisis a decade earlier of 3.0%). Excluding China and India, Asian GDP growth plummeted from +4.2% to -6.3% over the same interval (compared with a trough of -5.0% during 1998), a more dramatic turnaround than for any other major region.**
- **The 'Great Recession' has shattered the illusion that Asia had 'decoupled' from the business cycles in the US and Europe. On the contrary, having sought to 'insure' themselves against a repetition of the crisis of a decade ago (which was brought on by an abrupt turnaround in private capital flows) by consciously seeking to run large current account surpluses and thereby build up large foreign exchange reserves, Asian countries made themselves highly vulnerable to a 'current account shock' – which is the main channel through which the downturn which began in the US and Europe has been transmitted to Asia.**
- **Hence the economies which have fared worst in Asia are those which have had the highest exposure to trade in advanced manufactured goods – Japan, the NIEs (Korea, Taiwan, Hong Kong and Singapore), Malaysia and Thailand. In these countries it is not just exports, but also business investment, which have declined sharply. By contrast, economies with less dependence on exports of sophisticated manufactures and larger domestic markets and where consumer spending has continued to grow (China, India, Indonesia, Philippines and Vietnam) have been less adversely affected.**
- **China's slowdown owes more to the bursting of its own domestic investment bubble than it does to declining exports. China's very strong policy response is focussed on reviving domestic demand, and is evidently succeeding, but this will do little to lift China's neighbours.**
- **Elsewhere the fiscal policy response to the downturn has been strong (especially in Korea and Indonesia) but monetary policy has been more cautious despite the decline in inflation over the past year.**
- **Industrial activity has rebounded in Q2 signalling that the worst of the contraction is now over. However sustained recovery in the smaller Asian economies will be dependent on an upturn in US and European demand while Japan is likely to take even longer. By contrast China, India and Indonesia will experience earlier and stronger recoveries.**
- **Key risks to a sustained Asian recovery include a renewed slump in demand for Asian exports from the US and Europe, surging commodity prices, protectionism and global financial market instability.**

## Forecast summary

	Exports as % of GDP	Manu- facturing as % of GDP	Real GDP growth (%)			CPI inflation (%)		
			2008	2009	2010	2008	2009	2010
Japan	17.4	23.3	-0.7	-6 <sup>3</sup> / <sub>4</sub>	1 <sup>1</sup> / <sub>2</sub>	1.0	-1	- <sup>1</sup> / <sub>2</sub>
China	41.8	43.0	9.1	7	8 <sup>1</sup> / <sub>4</sub>	5.9	- <sup>3</sup> / <sub>4</sub>	0
Korea	46.0	26.0	2.4	-3	2 <sup>3</sup> / <sub>4</sub>	4.7	2	2 <sup>1</sup> / <sub>4</sub>
Taiwan	68.4	27.0	0.3	-5 <sup>1</sup> / <sub>4</sub>	4	3.5	-1	1 <sup>1</sup> / <sub>2</sub>
Hong Kong	208.5	2.2	2.6	-6 <sup>3</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>	4.3	1 <sup>1</sup> / <sub>2</sub>	2
Singapore	259.5	24.6	1.2	-7 <sup>1</sup> / <sub>2</sub>	3	6.5	0	1 <sup>1</sup> / <sub>4</sub>
Indonesia	49.5	26.8	6.1	4	5	9.9	5 <sup>3</sup> / <sub>4</sub>	5 <sup>3</sup> / <sub>4</sub>
Thailand	72.0	40.1	2.7	-3 <sup>3</sup> / <sub>4</sub>	3 <sup>3</sup> / <sub>4</sub>	5.5	0	2 <sup>3</sup> / <sub>4</sub>
Philippines	46.7	41.0	3.9	1	4 <sup>3</sup> / <sub>4</sub>	9.3	5	5 <sup>1</sup> / <sub>2</sub>
Malaysia	118.4	29.1	4.7	-3 <sup>1</sup> / <sub>2</sub>	4	5.4	1	2
Vietnam	76.8	24.5	6.3	4 <sup>1</sup> / <sub>4</sub>	6 <sup>1</sup> / <sub>4</sub>	23.1	7 <sup>1</sup> / <sub>4</sub>	5 <sup>1</sup> / <sub>4</sub>
India	21.8	13.7	7.4	5	6 <sup>1</sup> / <sub>2</sub>	6.4	1 <sup>3</sup> / <sub>4</sub>	4 <sup>1</sup> / <sub>2</sub>
Asia			5.3	1 <sup>3</sup> / <sub>4</sub>	5 <sup>1</sup> / <sub>2</sub>			

*Note:* exports and manufacturing as shares of GDP derived from 2008 constant price national accounts, except for manufacturing share for Japan and India, and both exports and manufacturing for Vietnam which are from 2007 accounts.  
*Sources:* national statistical agencies, IMF (for GDP weights), ANZ (for forecasts).

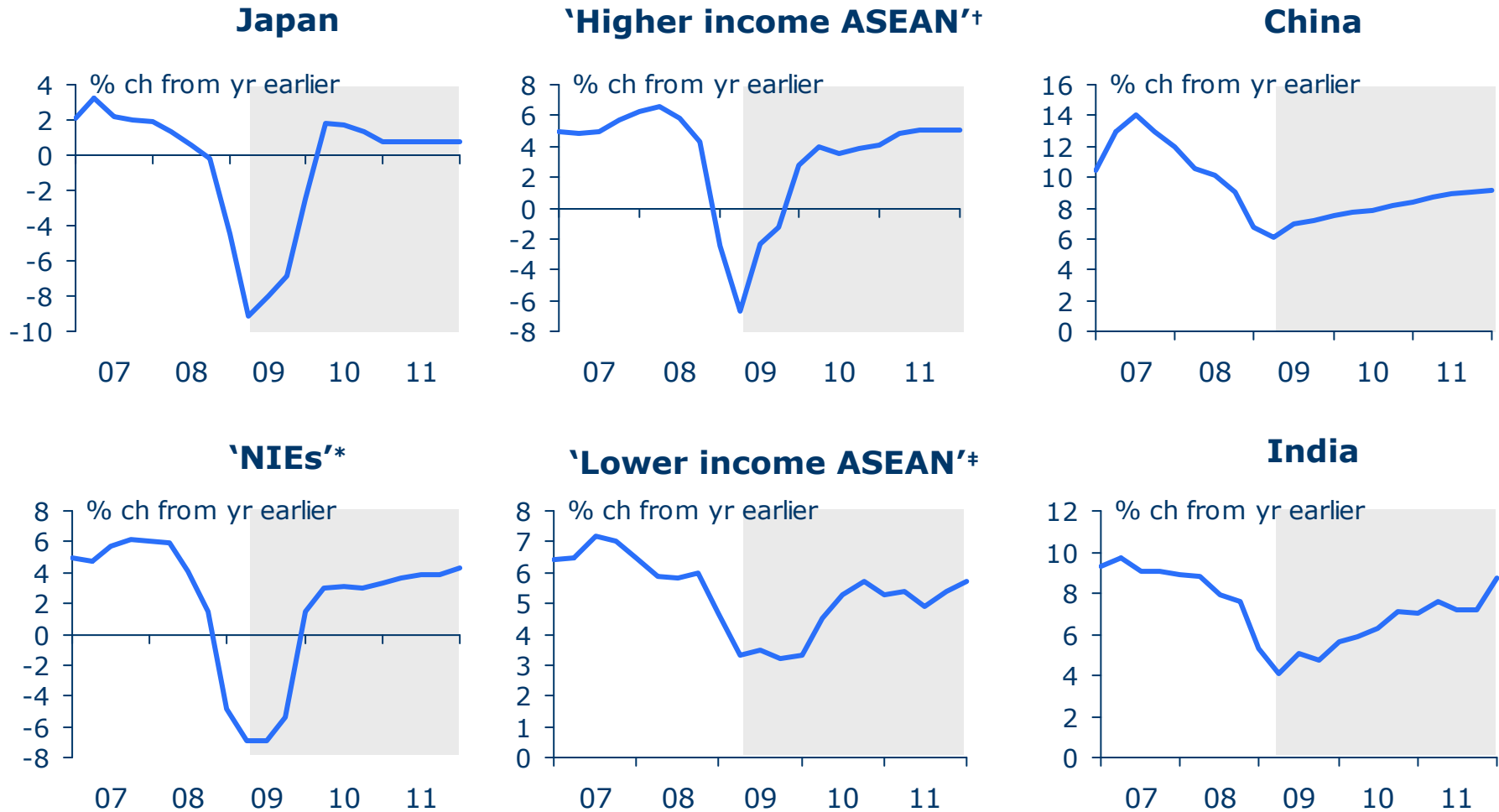
# The 'Great Recession' has hit Asia hard



Note: aggregates compiled using as weights GDP at 2008 PPPs.  
Sources: national statistical agencies, IMF (for GDP weights), ANZ (for forecasts).



**Asian economies: economic (real GDP) growth**

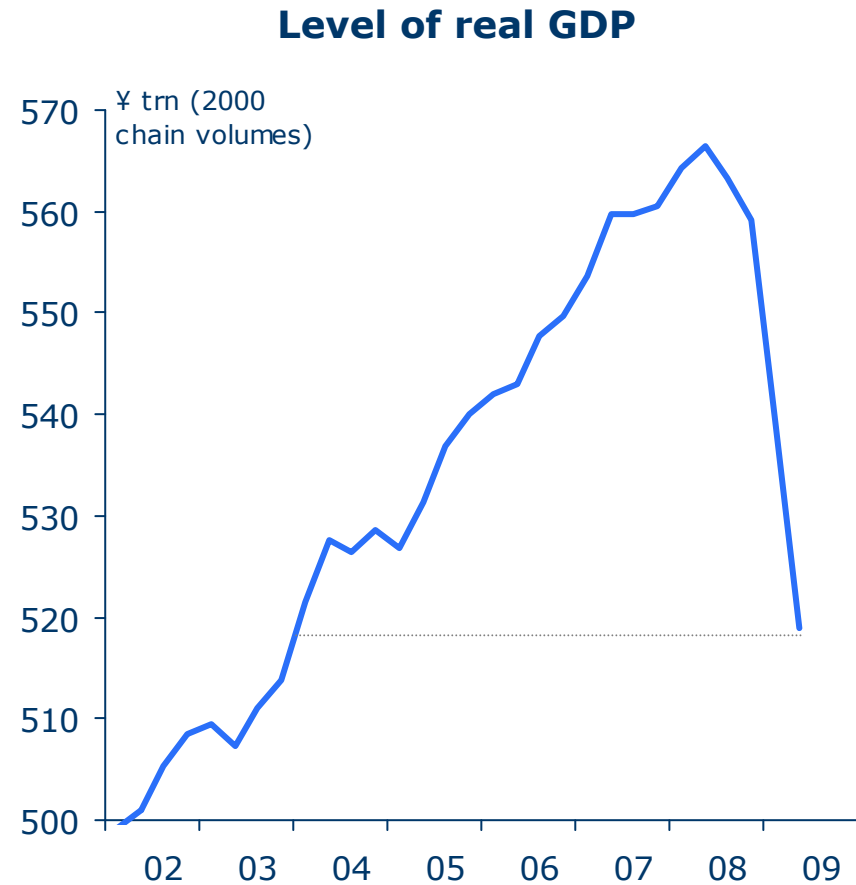
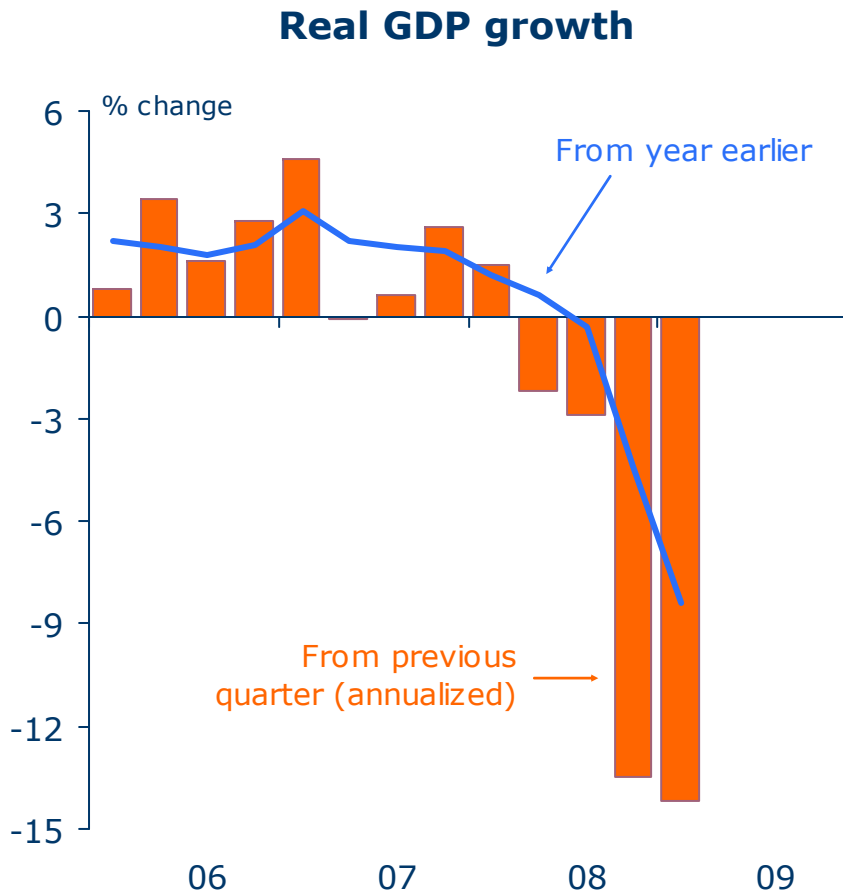


\* NIE's ('newly industrializing economies') are Korea, Taiwan, Hong Kong & Singapore. † 'Higher income ASEAN' are Malaysia & Thailand. ‡ 'Lower income ASEAN' are Indonesia, the Philippines & Vietnam. All aggregates combined using 2008 GDPs at PPP. Sources: national statistical agencies, IMF, ANZ.



- **Japan is experiencing the most severe contraction of any in the G7. Real GDP declined at a 13.9% annual rate over 08Q4/09Q1 (cf. US 6.0%, Euro zone 8.2%, UK 6.7%, Canada 4.6%) to be 8.4% lower than in 08Q1, back to where it was 5½ years earlier (ie in 03Q3).**
- **Japan's exports – concentrated in advanced consumer and capital goods (which bore the brunt of the downturn in US and European demand) were absolutely hammered, falling at a 60% annual rate (no I haven't omitted a decimal point) in volume terms over 08Q4/09Q1. And business investment fell at a 30% annual rate. Together these triggered a savage decline in industrial production which dropped 35% (not annualized) between July 08 and February 09, to its lowest level since July 1978.**
- **For Japan's corporate sector the effects of the downturn were amplified by the ~30% appreciation of the yen between mid-2008 and early 2009 (since only partly reversed). 09Q1 operating profits were down 78% from a year earlier, to their lowest level since 1975. However Japanese employers have again resisted mass layoffs; employment has fallen by 'only' 2% since end-07 (cf. 4% in the US), instead cutting hours worked and bonuses. With the labour force also declining, unemployment has thus risen only 1 pc pt, to 5.0%.**
- **Japan is once again experiencing deflation. To date the fall in consumer prices largely reflects lower food and petrol prices, but in the presence of an 'output gap' estimated at ~8% of GDP, deflation is likely to become more broadly-based.**
- **Despite having by many measures the worst fiscal position of any major Western government, Japan has implemented substantial fiscal stimulus measures worth 2.4% of GDP in 2009 and 1.8% of GDP in 2010, resulting in fiscal deficits of nearly 10% of GDP in both years.**
- **Although the BoJ pioneered 'quantitative easing' in 2001-05, it has been more hesitant about doing so during the current crisis. It has stepped up outright purchases of JGBs, as well as buying CP, corporate bonds and stocks (from banks); but (in contrast to other major central banks) its aggregate balance sheet has not expanded significantly since the onset of the crisis.**
- **With the inventory liquidation phase of the downturn complete, production and exports have rebounded in Q2. Business and consumer confidence are clearly improving but are still at low levels by historical standards. However domestic private demand is likely to remain weak for an extended period. Hence although the economy will stop contracting in the second half of 2009, growth in 2010 is unlikely to exceed 1½%.**

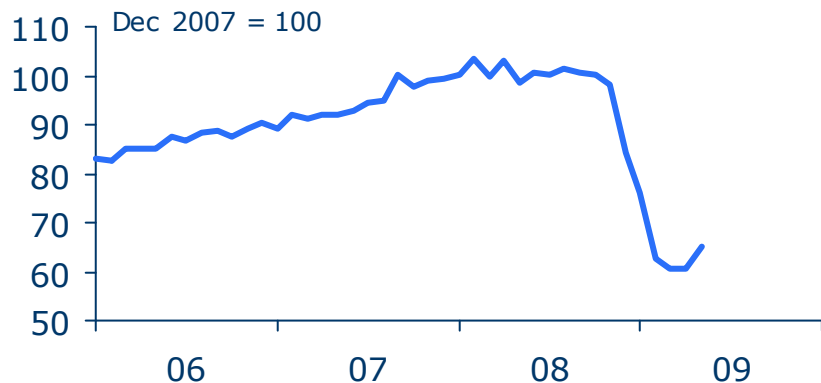
# Japan's economy has shrunk more than any other in the G7



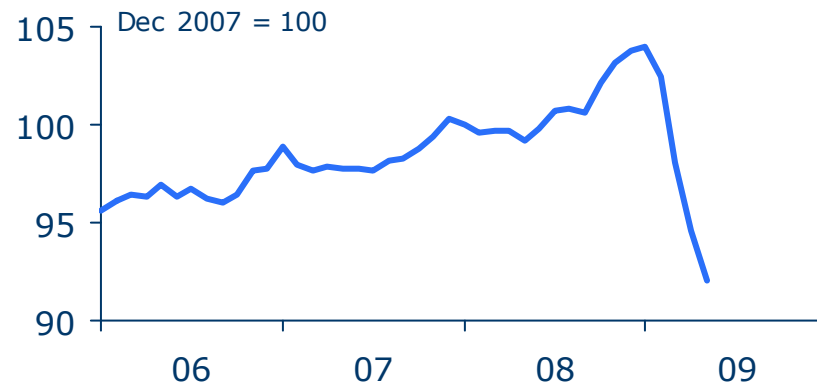
- **Japan's economy contracted at a 14% annualized rate over the last quarter of 2008 and first quarter of 2009, to be 8.4% smaller than in the first quarter of 2008. The level of real GDP in the first quarter of 2009 was lower than at any time since the third quarter of 2003.**

# Worst of Japan's downturn is probably over

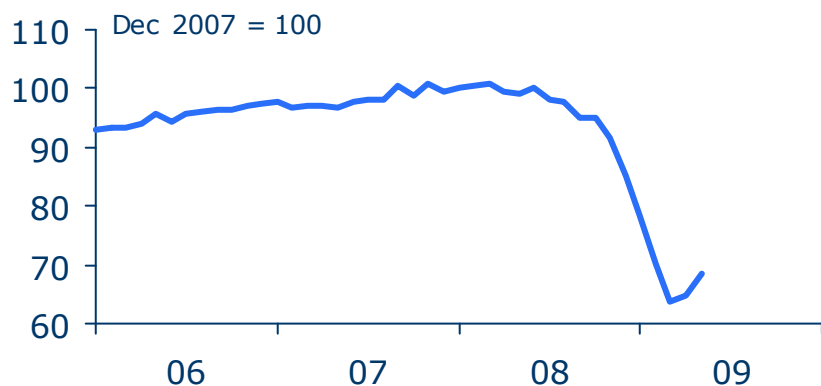
### Export volumes



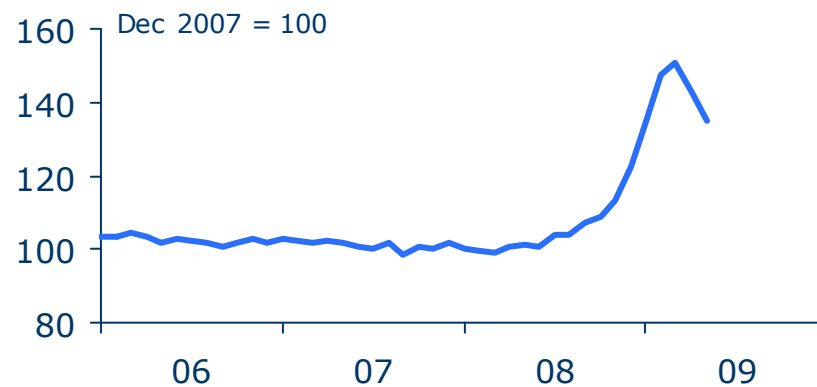
### Inventories



### Industrial production



### Inventories-sales ratio



- **The abrupt fall in Japan's exports beginning in October last year prompted a massive inventory cycle which took industrial production down to its lowest level in almost 21 years. That cycle has now been completed, and production rebounded in Q2.**

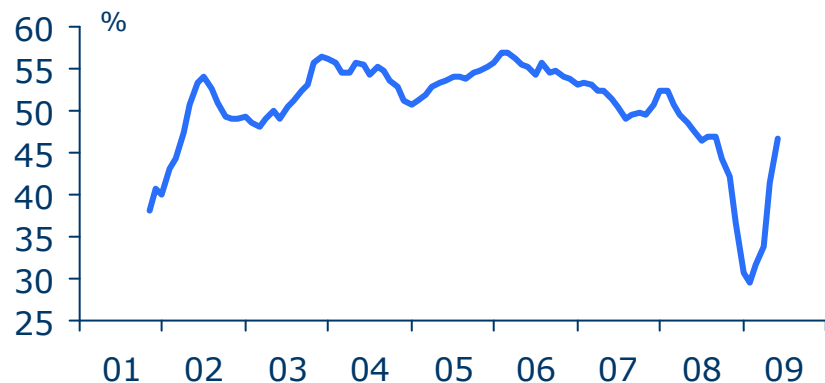
Sources: Bank of Japan; METI.



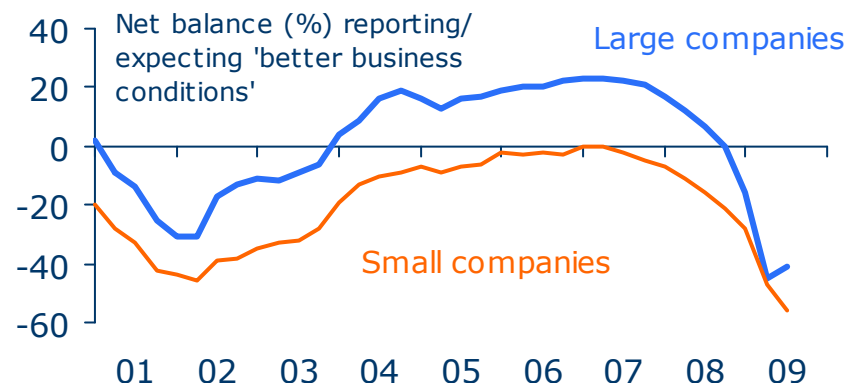


# Business and consumer confidence are improving

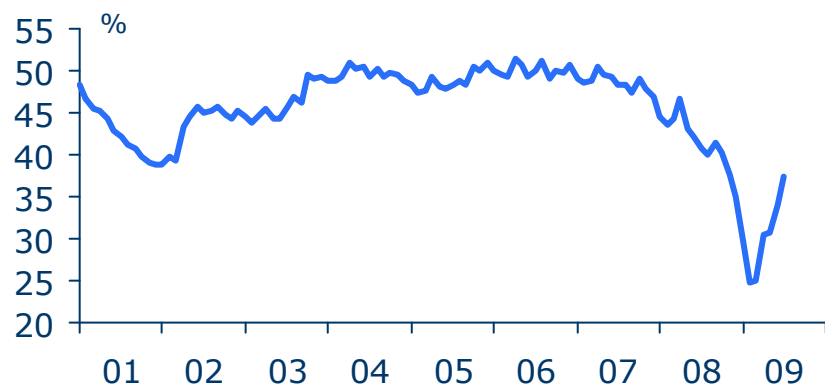
### Purchasing managers' index



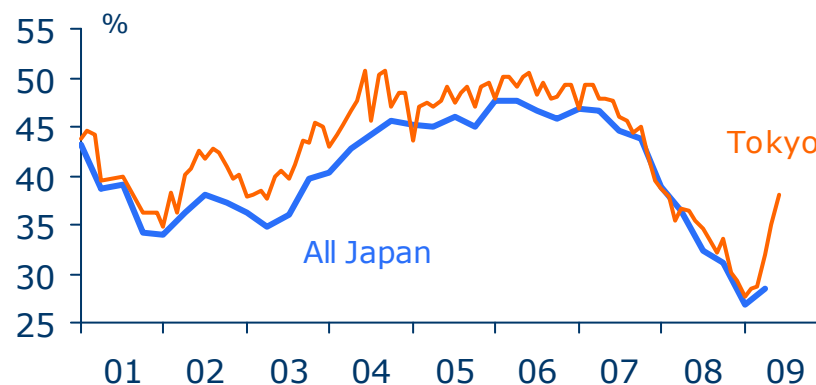
### BOJ Tankan survey



### Shokochukin small business survey



### ESRI consumer confidence survey



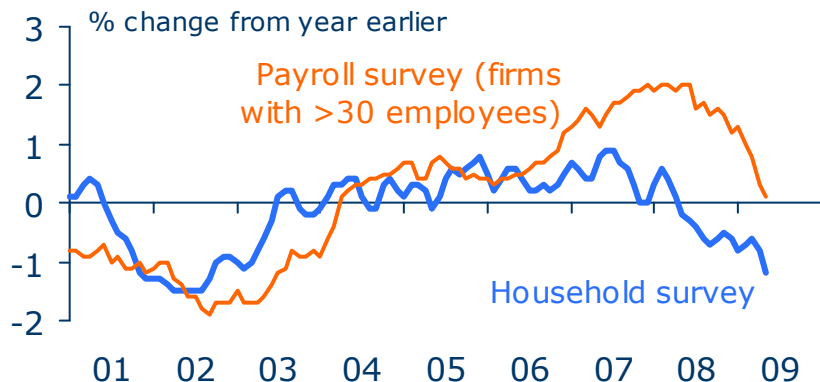
- **Business and consumer confidence have improved significantly over the past few months (note that the Tankan survey is quarterly and the Q2 survey is due next week), though none of the surveys is yet pointing to an expanding economy**

Sources: Nomura/JMMA; Shoko Chukin Bank; Bank of Japan; Economic & Social Research Institute.

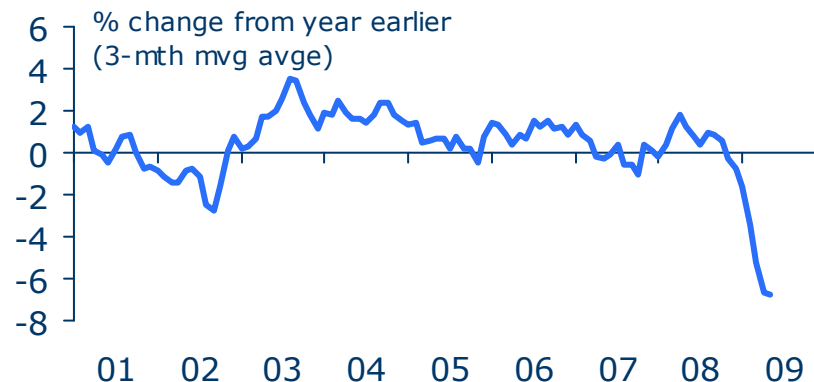


# Employers have cut hours and pay rather than jobs

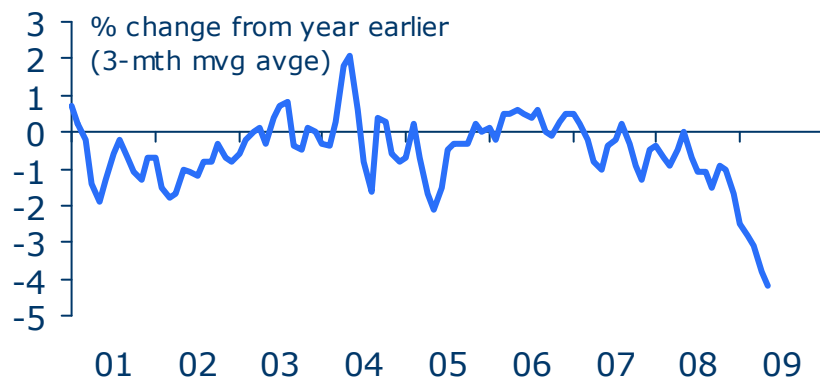
### Employment



### Employee cash earnings



### Average hours worked



### Unemployment rate

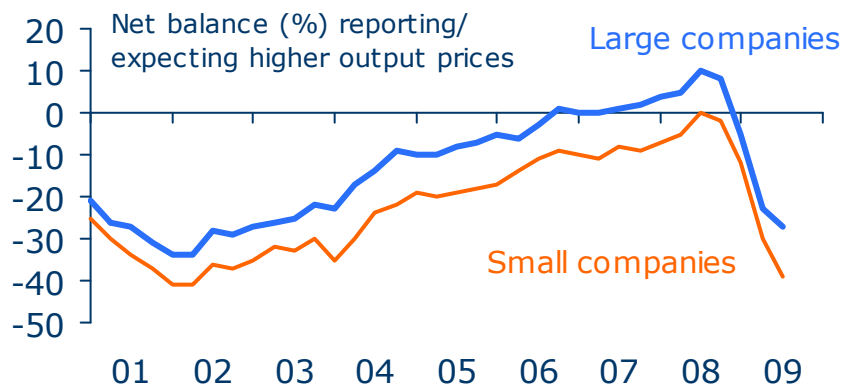


- **As is traditionally the case in Japan, large employers have sought to achieve reductions in their wages bill by cutting hours and pay rather than jobs. Together with the fact that Japan's labour force is now declining, this has meant that unemployment has risen by less than in most other countries despite a much larger contraction in real GDP.**

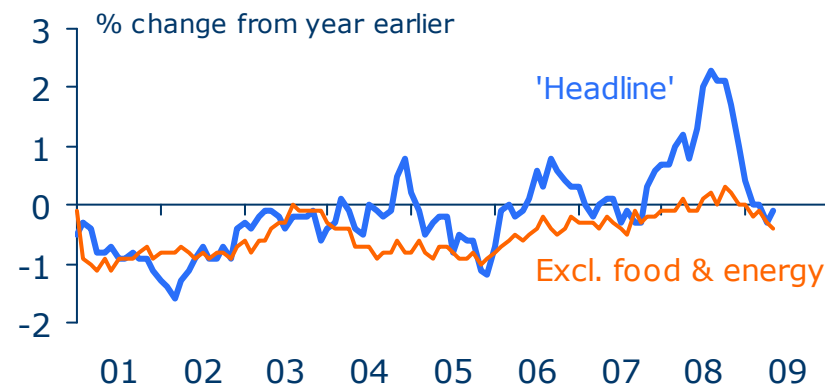
Sources: Japan Health, Labour & Welfare Ministry; CEIC.



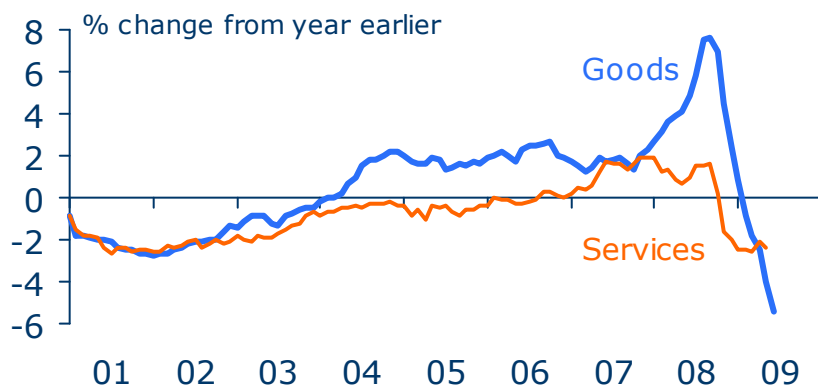
### Tankan output prices diffusion index



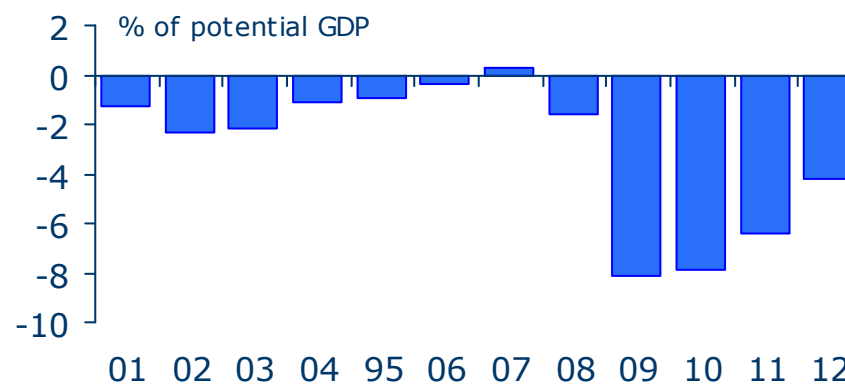
### Consumer prices



### Corporate goods & services prices



### 'Output gap'



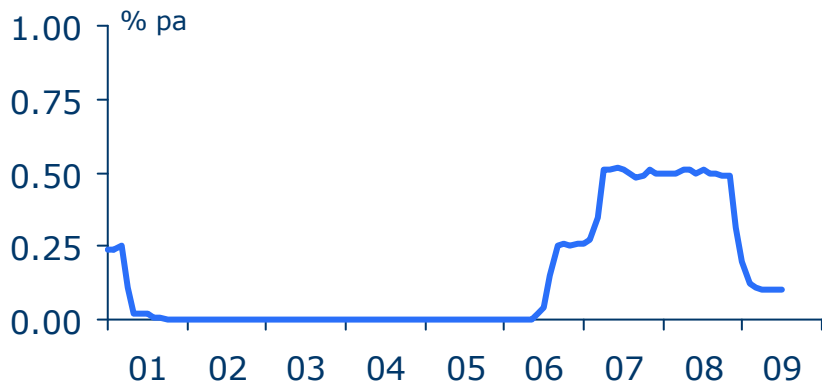
- Japan is once again experiencing deflation. And the large 'output gap' (the broadest measure of spare capacity' this year and in prospect for the next few years suggests that deflation is likely to become more entrenched (unless for some reason the yen depreciates sharply)**

*Note:* 'corporate' goods and services price indices measure the prices of goods & services bought and sold by companies, and are broadly analogous to PPIs. *Sources:* Bank of Japan; Home Ministry; IMF WEO April 2009.

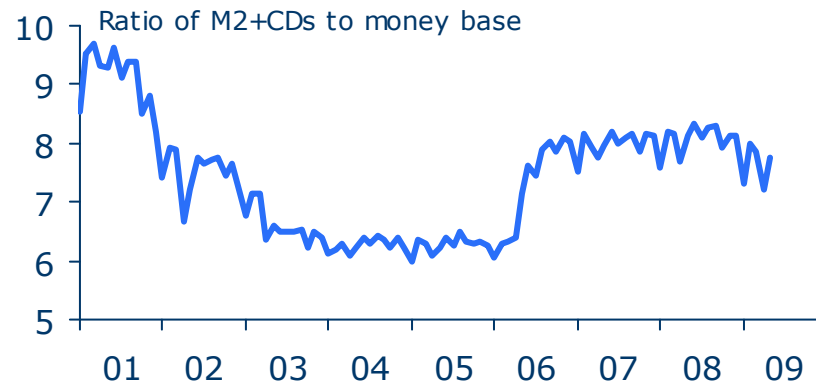


... but the BoJ's policy stance is less aggressive than 2001-06

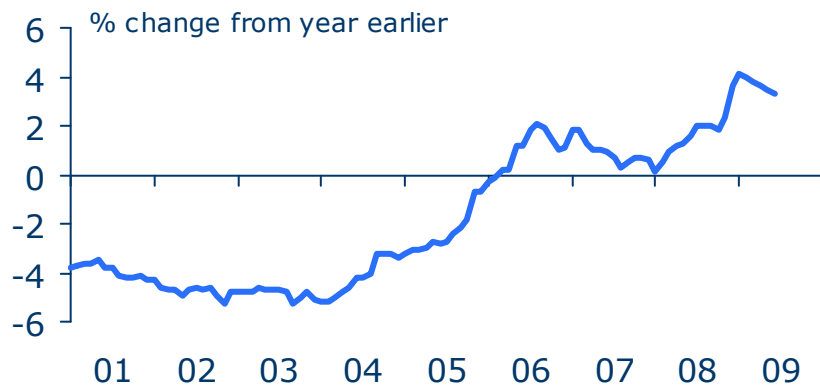
**BoJ call money rate**



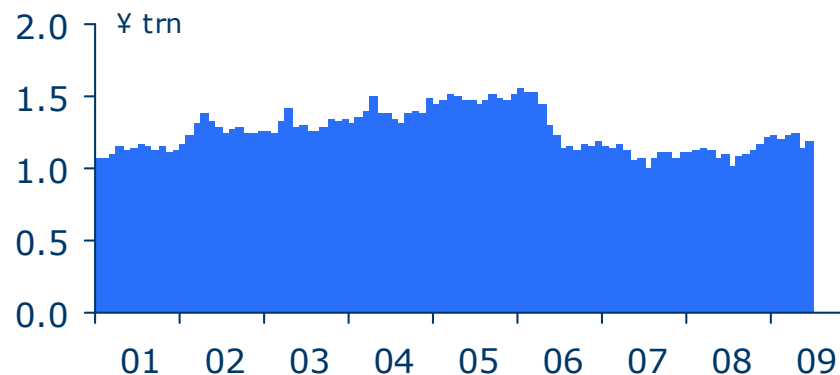
**'Money multiplier'**



**Bank lending**



**BoJ balance sheet**

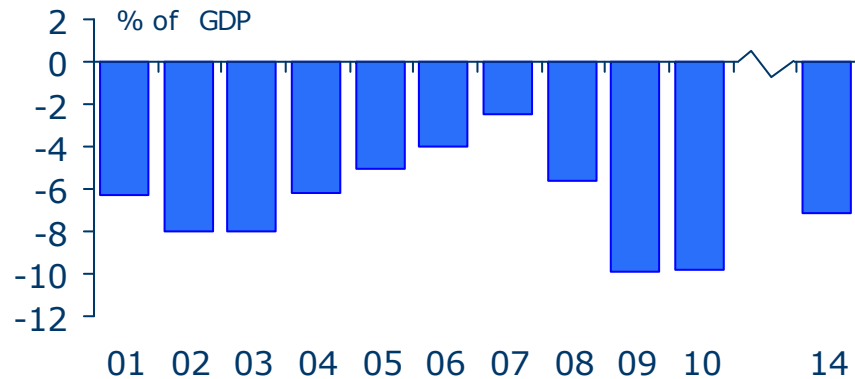


- **The BoJ has eased monetary policy less aggressively than in 2001-06 and in particular hasn't resorted to large-scale 'quantitative easing'. That's because the Japanese banking system hasn't been much damaged by losses on loans and securities and is still functioning more or less normally – unlike banking systems in the US and some European countries.**

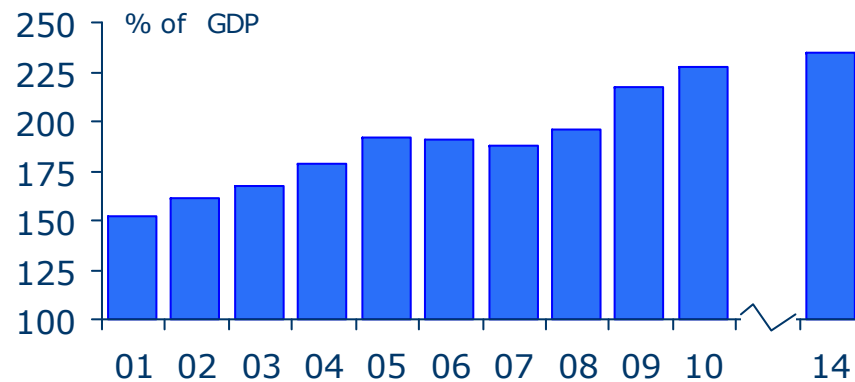
Source: Bank of Japan.



### Fiscal balance



### Government gross debt

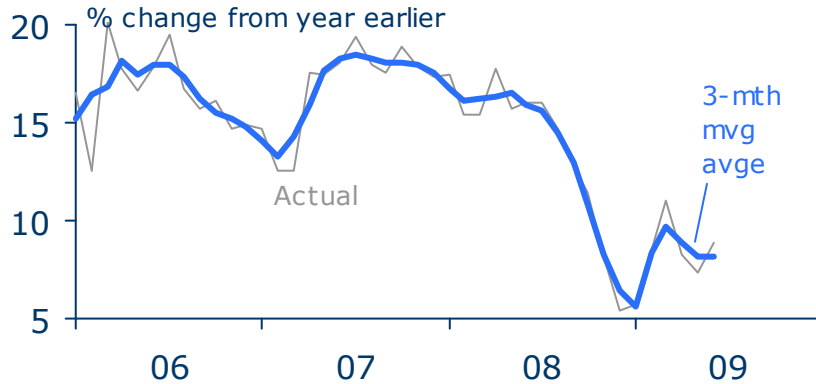


- Japan has implemented three fiscal stimulus packages since the onset of the crisis entailing 'headline' national government expenditures totalling over ¥27trn or over 5% of GDP (spread over two years)
- The most recent package (announced in April) was the largest in Japanese history, entailing around ¥7trn in public works spending, ¥5trn in income transfers and ¥3trn in support for lending by development banks.
- The IMF estimates the total cost of Japan's discretionary fiscal measures at 2.4% of GDP in 2009 and 1.8% in 2010 (cf. 2.0% and 1.8% of GDP for the US)
- Together with the cyclical deterioration in tax revenues these fiscal measures will push Japan's budget deficit out to nearly 10% of GDP in 2009 and 2010, and lift gross public debt to 227% of GDP by 2010 (net public debt of 115% of GDP)
- Japan must eventually face large tax increases to reduce this debt burden and meet the fiscal costs of a rapidly ageing population.

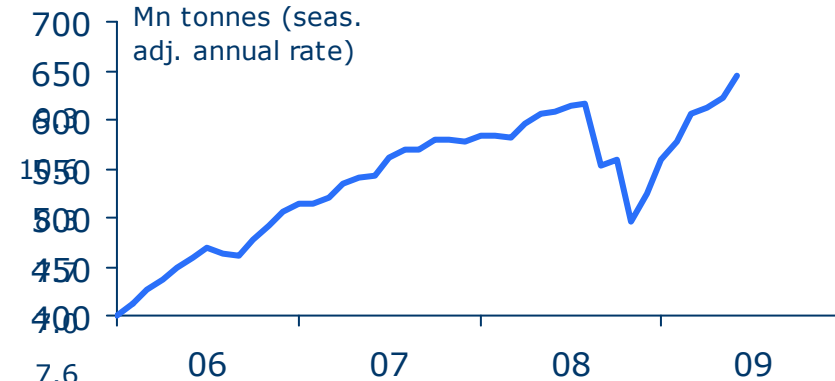
Sources: IMF, *World Economic Outlook* April 2009 database and Staff Position Note 09/13, *Fiscal Implications of the Global Economic and Financial Crisis*, 9 June 2009.

- **In March 2007, Chinese Premier Wen Jiabao described China's growth as 'unstable, imbalanced, unco-ordinated and unsustainable'. He was right. China's double-digit growth rate between 2003 and 2007, peaking at 14% in mid-2007, clearly exceeded its potential. It was accompanied by 'bubbles' in China's property and stock markets, and by an external surplus whose magnitude was contributing to instability in the global economy.**
- **The bursting of China's 'bubbles' over the first half of 2008 has been a larger contributor to the subsequent slowdown in China's economy than the decline in Chinese exports (which did not begin until Q4 2008), although weakness in exports is now the principal drag on China's overall rate of growth in 2009.**
- **Chinese authorities have engineered an aggressive monetary and fiscal policy response to the downturn with a view to lifting real GDP growth back to 8% (which they regard as the minimum required to prevent rising urban unemployment and preserve social stability) by the end of 2009.**
- **The fiscal stimulus (announced last November) has been massive, the 'headline' amount of Yn 4trn being equivalent to 13% of annual GDP. Even allowing for the inclusion in this total of previously announced measures, spending by local governments and SOEs, it still represents discretionary spending equivalent to 3.1% of GDP in 2009 and 2.7% in 2010.**
- **Monetary policy measures include lower interest rates, expanded lending quotas, relaxed lending conditions and increased direct support for lending to SMEs.**
- **These measures have prompted an unambiguous lift in domestic demand, particularly fixed asset investment and targeted areas of household spending (including household durables and motor vehicles), although it is less clear that this upturn is self-sustaining; and export demand will remain weak until global demand picks up. China's growth rate should average at least 7% in 2009 and 8% in 2010.**
- **China is experiencing headline deflation this year, largely on account of the unwinding of last year's surges in fuel and food prices. Structural reforms to energy and water prices and more recent increases in commodity prices will prevent deflation from becoming entrenched.**
- **The PBoC has kept the yuan steady at 6.83 against the US\$ since July last year (which has implied an appreciation in trade-weighted terms) and will likely maintain this level until export demand has 'normalized' and overall growth exceeds 8%.**

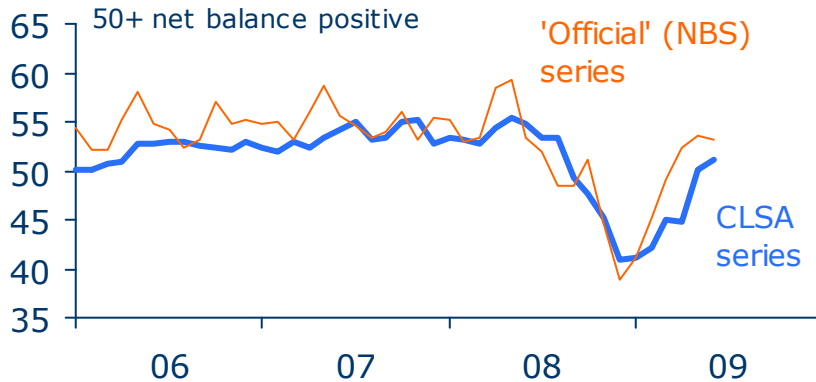
### Industrial production



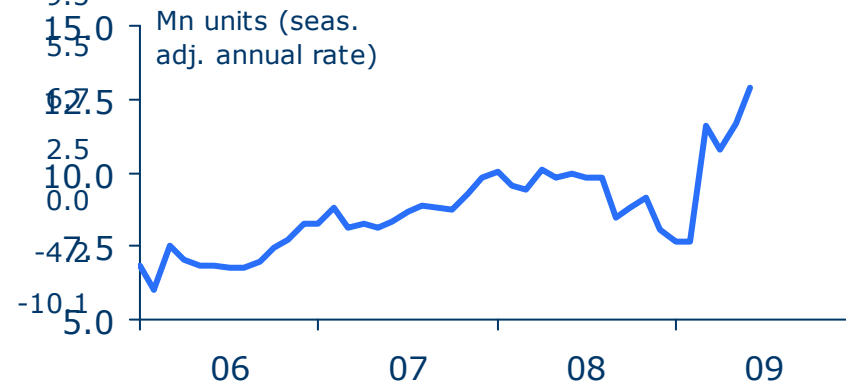
### Finished steel production



### Purchasing managers' indices



### Motor vehicle production

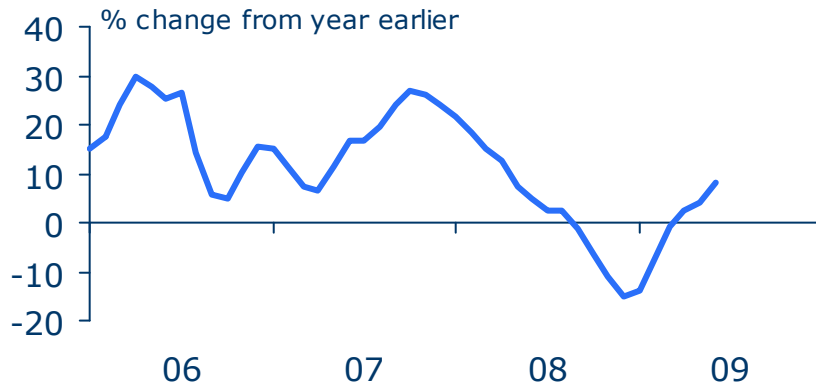


- China's growth rate has picked up since the beginning of this year as fiscal and monetary stimulus measures have started to take effect. The upturn has been concentrated in heavy industry (reflecting the focus of the stimulus measures on fixed asset investment) and autos (the object of specific purchase incentives)**

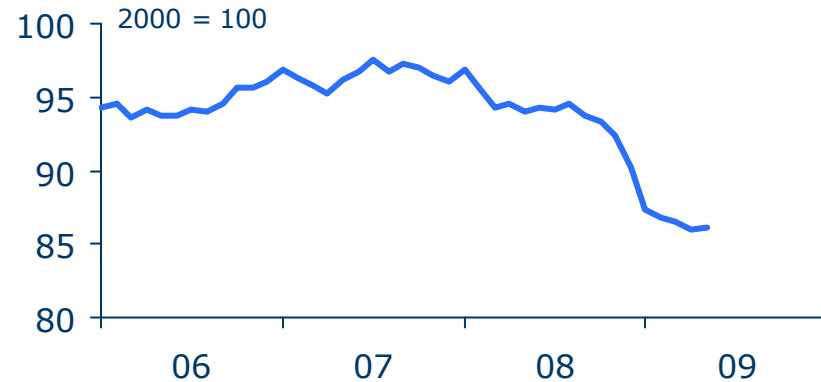
Sources: China National Bureau of Statistics; CLSA; China Iron & Steel Association; China Association of Automobile Manufacturers; CEIC.



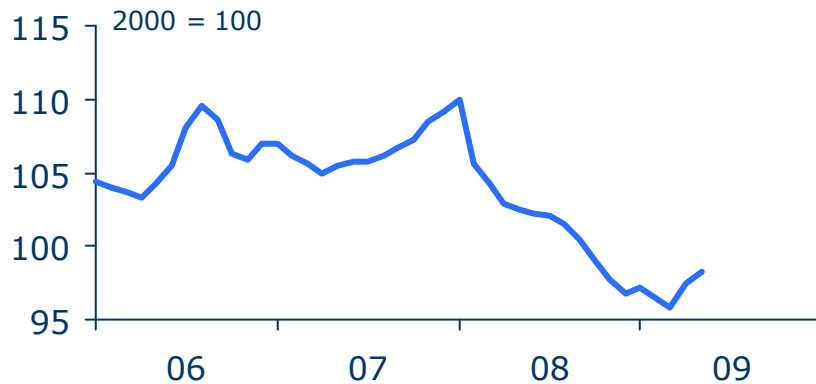
### Construction activity



### Consumer confidence index



### Real estate sales prices



### Retail sales

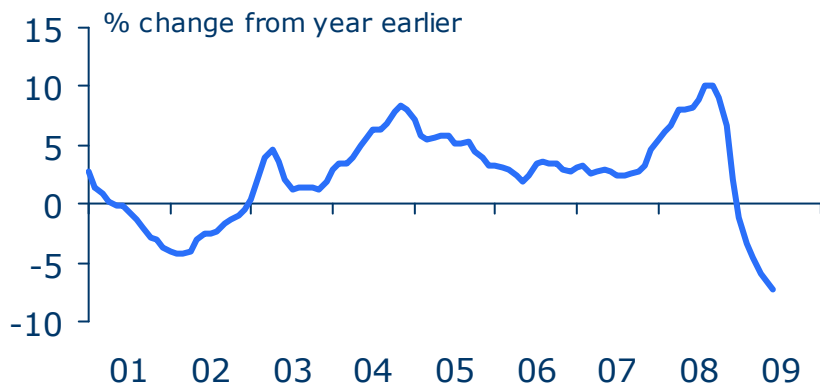


- After slumping through 2008, construction activity has rebounded this year in response to fiscal and monetary policy stimulus. Household spending has also increased reflecting targeted support for purchases of household appliances and autos, although apprehension about job losses is keeping consumer confidence subdued.**

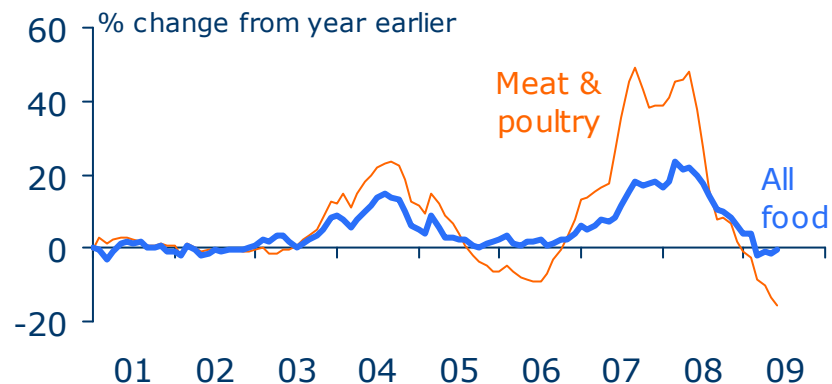


# China is experiencing deflation – but it’s unlikely to persist

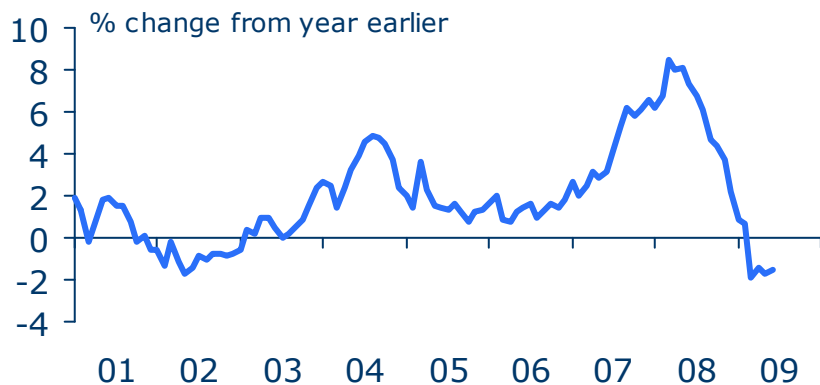
### Producer prices



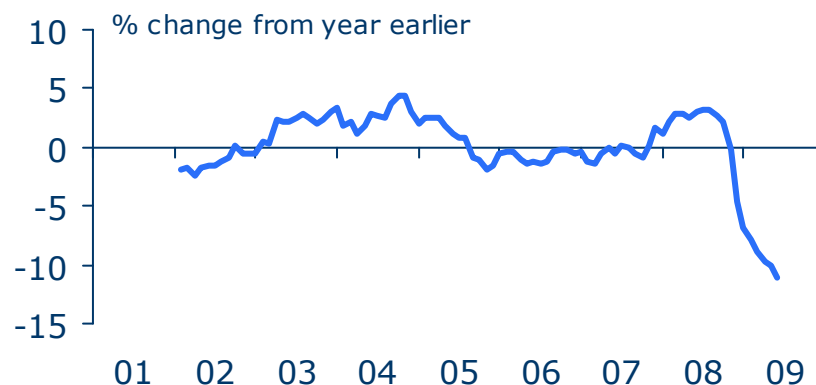
### Consumer food prices



### Consumer prices



### Consumer housing costs



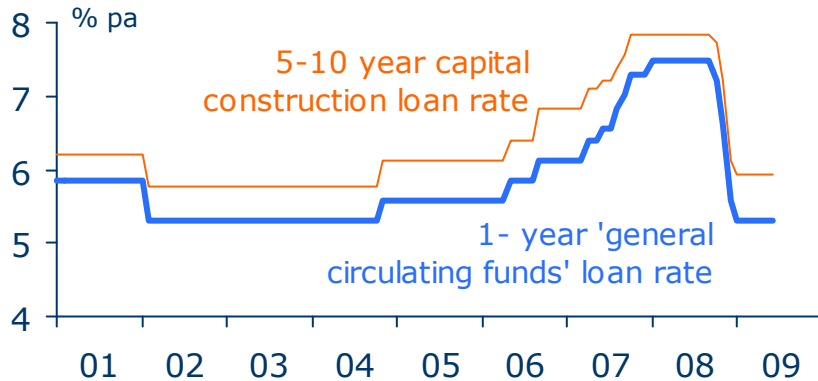
- **Inflation has turned negative this year, almost entirely due to the unwinding of the surge in food prices in the first half of last year and (at the consumer level) falling rents. Deflation is unlikely to become entrenched, however. Planned structural reforms to energy and water pricing (entailing price increases) may be accelerated if required to that end.**

Source: National Bureau of Statistics.

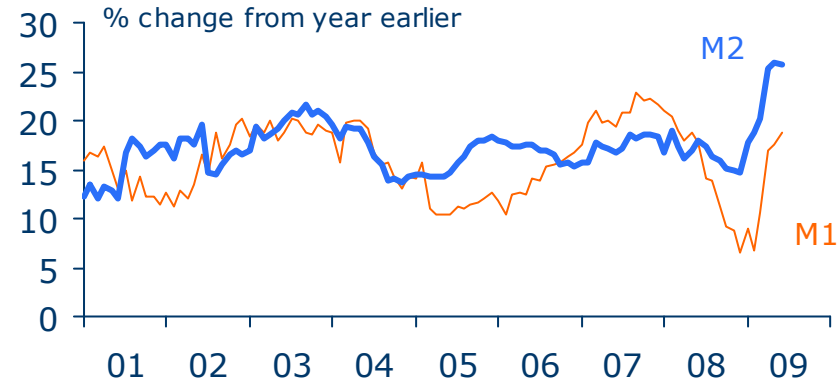


# Bank lending has been stepped up sharply

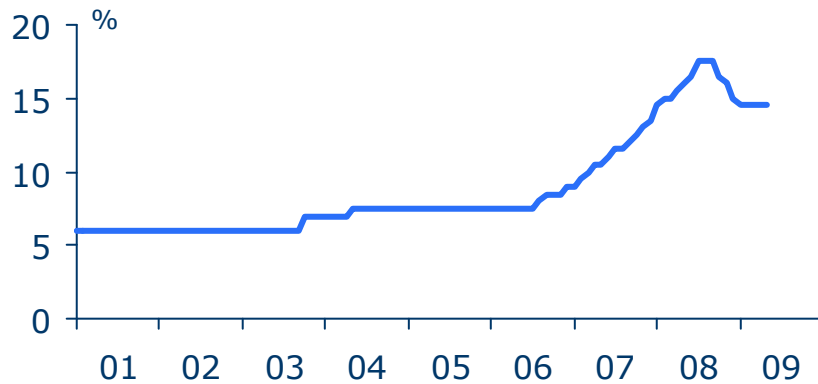
### Interest rates



### Money supply growth



### PBoC required reserve ratio



### Bank lending

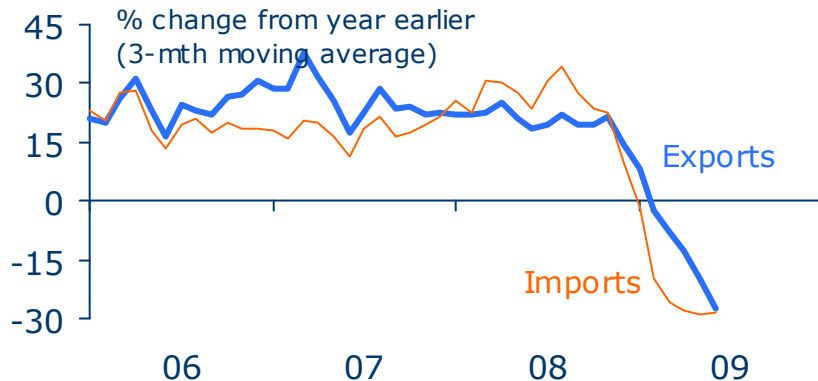


- **The PBoC has adopted what it calls a 'moderately loose' monetary policy. Monetary easing has been provided more through expansion of credit quotas and lending conditions than via reductions in interest rates or reserve requirements (in fact real interest rates have risen given the fall in inflation). Much of the Q1 surge in credit was in short-term bills; monetary authorities are now seeking to steer credit growth towards infrastructure project lending**

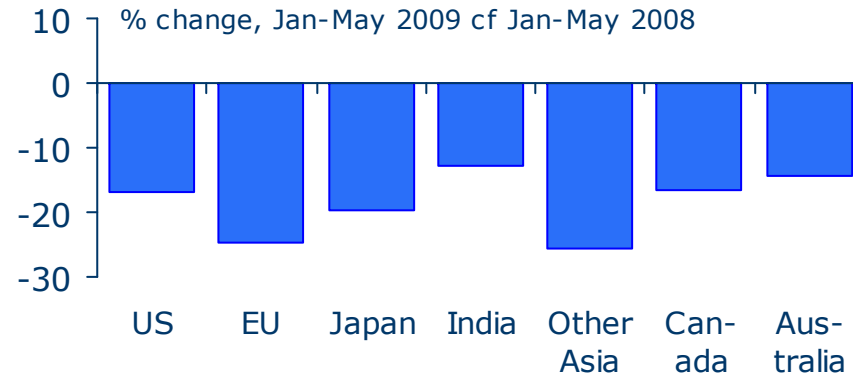
Source: People's Bank of China.



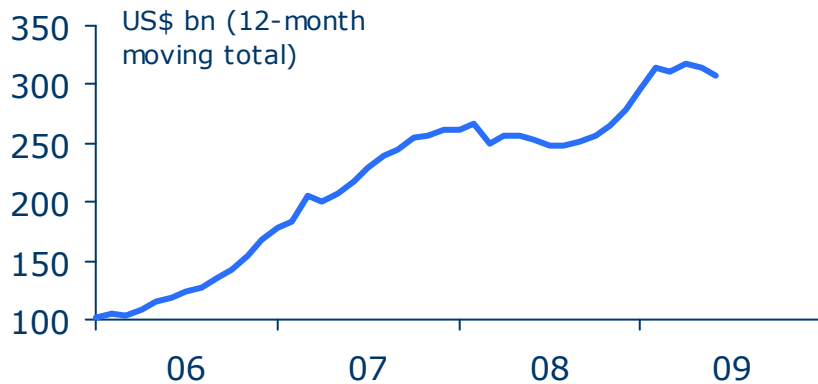
**Exports and imports**



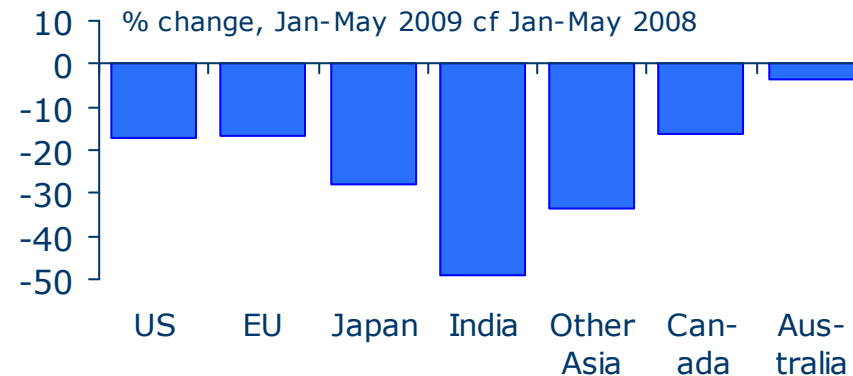
**Exports by destination**



**Merchandise trade balance**



**Imports by source**



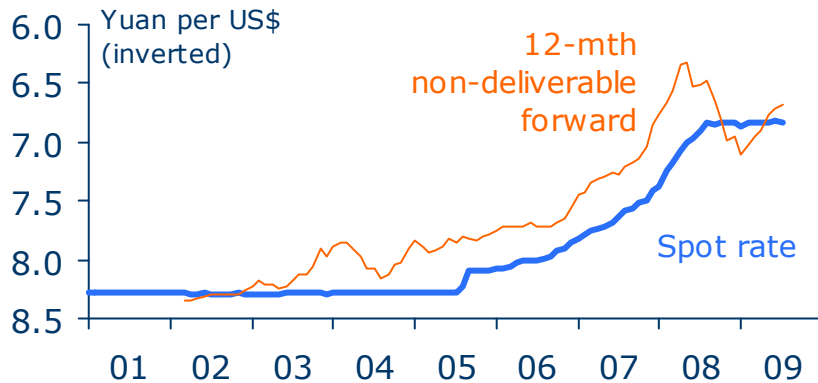
- China's exports are still declining, reflecting continued weakness in nearly all of China's major export markets. Given China's role as an 'assembly hub' for final products in regional production networks, China's imports have also fallen sharply – especially from other Asian countries (though China has been stepping up commodity imports). It will be difficult for China to reach its 8% growth target until exports start recovering.**

Source: China National Bureau of Statistics.

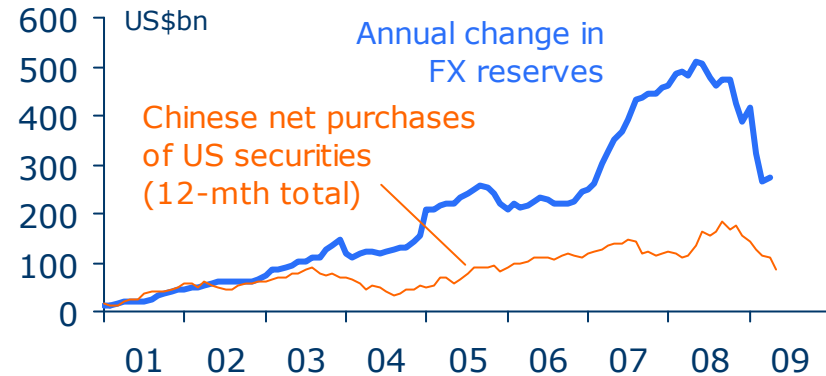


# Yuan has been kept stable against US\$ since July last year

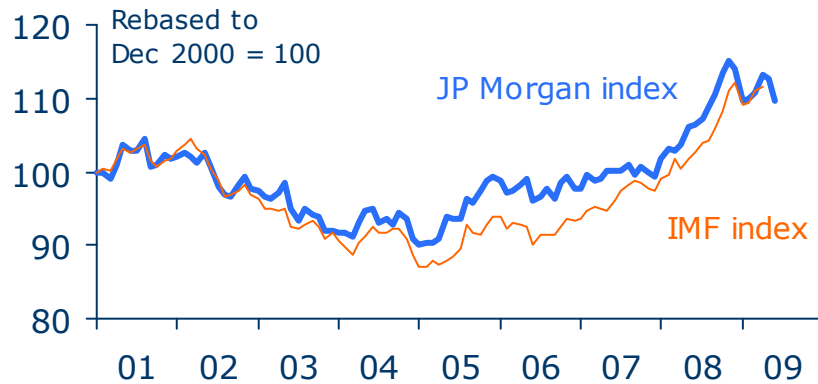
### Yuan vs US\$



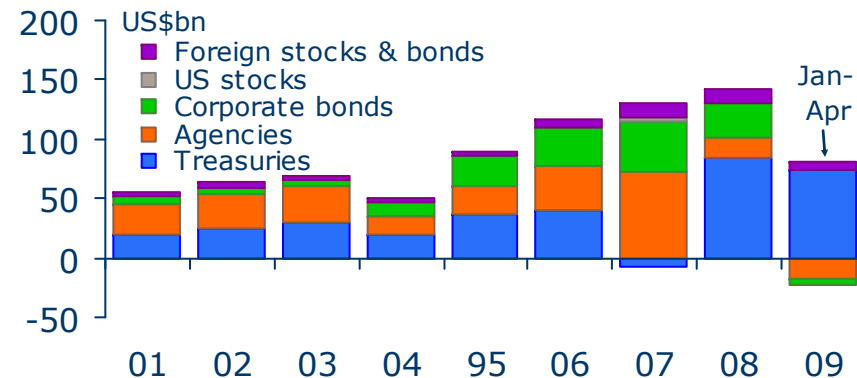
### FX reserves



### Real effective exchange rate



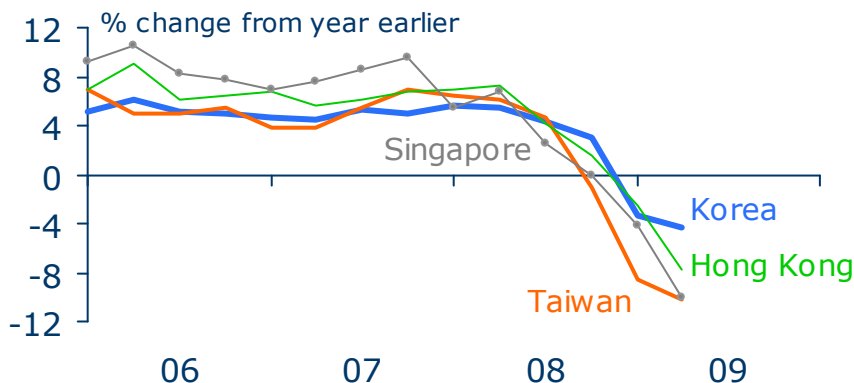
### Chinese securities purchases from US



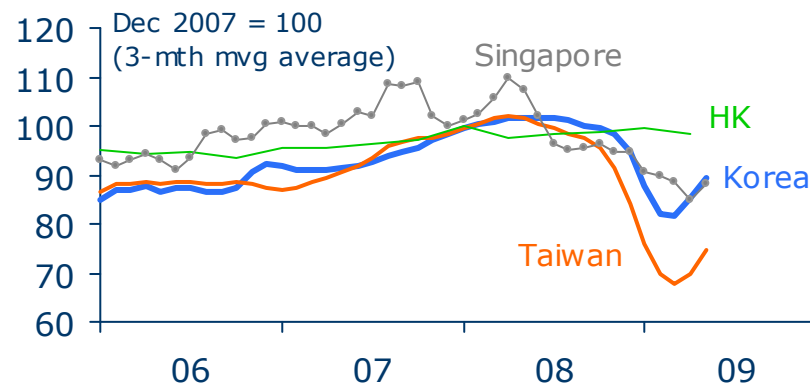
- China has sought to keep the yuan steady against the US\$ since last July (although that has implied some appreciation in trade-weighted terms). China's rate of reserve accumulation has slowed because of a decline in its trade surplus, a drop-off in inward FDI and some apparent capital outflows. China has continued to acquire significant volumes of US Treasury securities though it has been a net seller of agency and corporate bonds since mid-2008.**

- The so-called 'newly industrializing Asian economies' have been severely impacted by the contraction in global manufacturing trade associated with the financial crisis. Exports represent a very large share of their GDP (over 200% for Singapore and Hong Kong, 68% for Taiwan and 45% for Korea); manufactures account for between 75% and 97% of their exports; and the bulk of their exports go either to the US & Europe or China – each of whose imports have fallen sharply. Over the year to Q1 2008 export volumes fell by 11% in Korea, around 20% in both Singapore and Hong Kong, and 27% in Taiwan.
- The impact of declining exports has been amplified by sharp downturns in fixed capital investment, of between 12.6% (Hong Kong) and 33.8% (Taiwan); and in household consumption spending, of between 1.4% (Taiwan) and 4.4-5.5% (Korea, Singapore and Hong Kong). Korea also experienced a substantial inventory liquidation cycle.
- The end result has been contractions in real GDP of more than 10% for Singapore and Taiwan over the year to Q1 2008, in both cases the largest on record, and of 7.8% for Hong Kong and 4.3% for Korea, in each case the largest since the Asian crisis of a decade ago. Unemployment has also risen sharply in Taiwan (to a record high), and to a lesser extent in Hong Kong, Singapore and Korea (in each case thus far to less than during the post- 'tech wreck' recessions of 2001-02).
- Residential property prices have fallen by around 10% from previous peaks in Hong Kong and Taiwan, and by more than 20% in Singapore, although by only 2% in Korea.
- Each of these economies has implemented significant fiscal stimulus packages amounting to 'headline' commitments of 4-5% of GDP in Hong Kong, Taiwan and Korea, and as much as 8% of GDP in Singapore, with net discretionary fiscal cost averaging (according to IMF estimates) of about 2¾% of GDP in 2009. However very little of these packages 'spill over' into 2010, suggesting that further measures may be necessary to provide continued support for economic activity next year.
- The Korean currency depreciated by as much as 40% against the US\$ from end-2007 until March 2009, whereas the S\$ and NT\$ weakened by less than 8% at their greatest extent.
- As with Japan, there have been clear signs of a bottoming-out in industrial activity during Q2 – particularly in Korea. However a sustained upturn in these economies is unlikely ahead of a revival in demand from advanced economies, ie not until 2010.

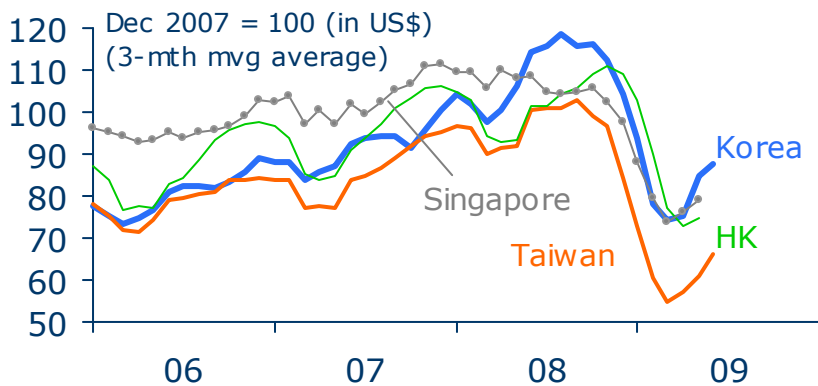
### Real GDP growth



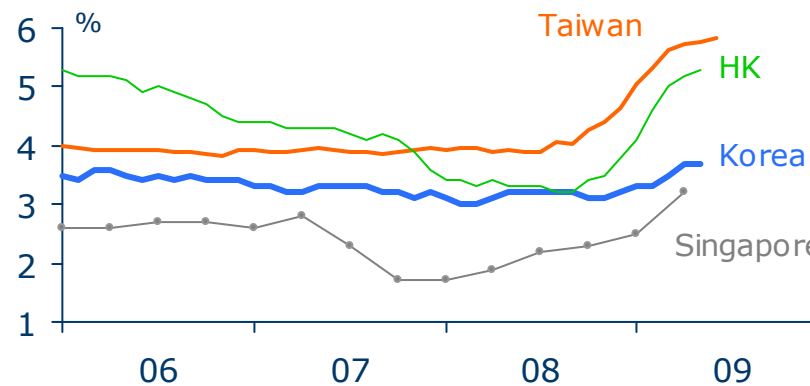
### Industrial production



### Merchandise exports



### Unemployment



- Of the more advanced 'emerging' East Asian economies, Taiwan has been the hardest hit by the contraction in global and intra-regional trade, and Korea (in most respects) the least. Korea's relative out-performance reflects the larger depreciation in its currency, and its more resilient residential property market.
- There is some evidence of a bottoming out in manufacturing activity in these economies, but a sustained upturn requires a recovery in discretionary spending in OECD countries.

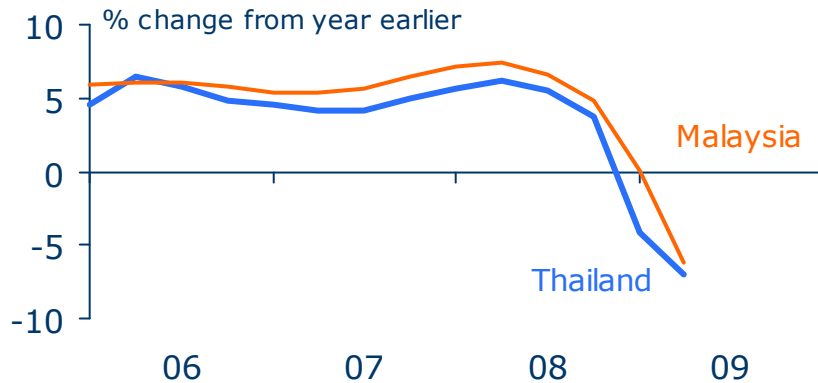
Sources: national statistical agencies; CEIC; ANZ.



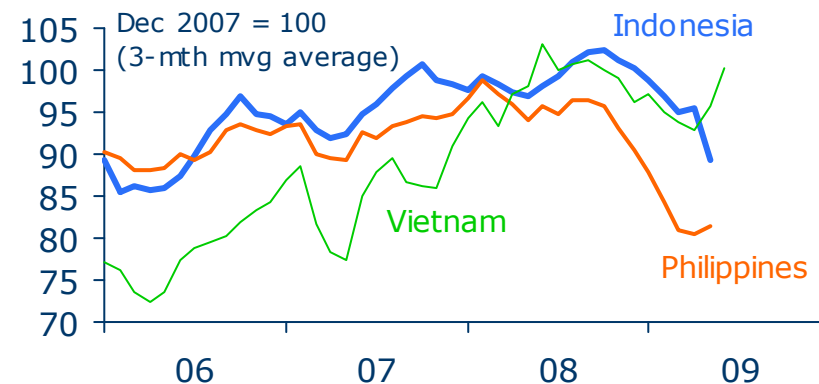
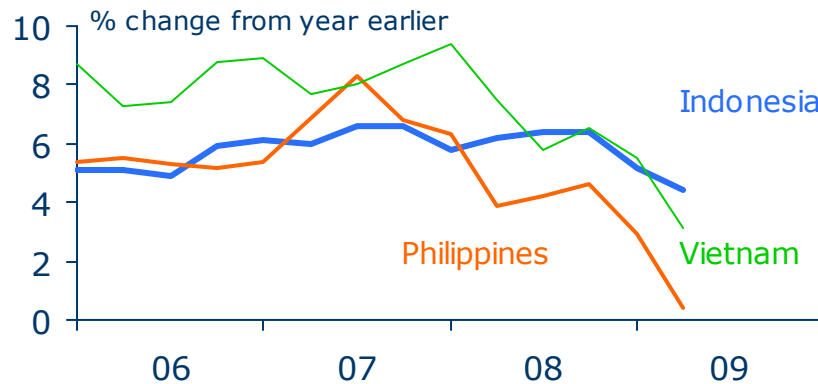
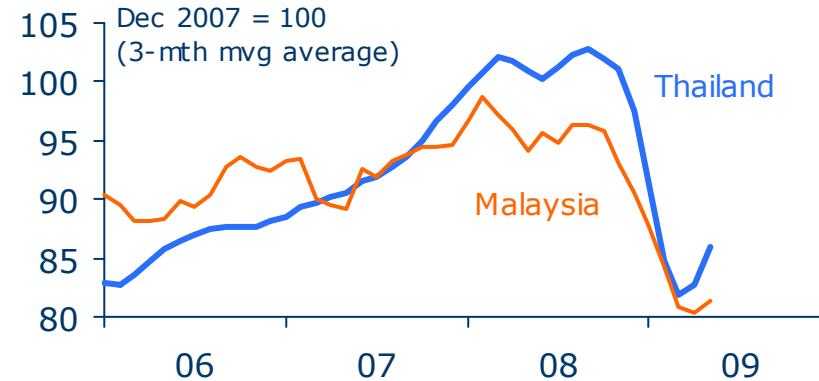
- **It is useful to distinguish Thailand and Malaysia, for whom exports of manufactured goods represent a large share of GDP, from the remaining ASEAN economies whose export sectors are relatively smaller and less technologically advanced.**
- **In terms of their exposure to the global economic downturn, Thailand and Malaysia have more in common with the NIEs than with their ASEAN neighbours, with large manufacturing sectors (over 40% of GDP) and high export dependencies (73% and 110% of GDP respectively). Political unrest has been an additional negative factor for Thailand, with an adverse impact on tourism in particular, as well as on confidence more generally. Both countries experienced 15-16% declines in export volumes over the year to 09 Q1, substantial falls in fixed investment (16% in Thailand, 11% in Malaysia) and substantial inventory cycles (subtracting 8 and 10 pc pts respectively from annual GDP growth), resulting in the sharpest contractions in economic activity since the crisis of a decade earlier.**
- **There are some indications of a modest pick-up in economic activity in Thailand in Q2, although these are more difficult to detect thus far in Malaysia. Malaysia has enacted two fiscal stimulus packages, the second (in March) ostensibly amounting to almost 9% of GDP, although the bulk of it took the form of credit guarantees. Political uncertainty remains an on-going risk factor for Thailand.**
- **The other ASEAN economies (Indonesia, Philippines and Vietnam) are less dependent on exports of advanced manufactured goods and have thus been less affected by the sharp downturn in global demand for products such as household durables and autos, and by the contraction in intra-regional trade. Growth in economic activity has slowed since early 2008 – more so in the Philippines than in the other two – but has nonetheless remained positive.**
- **Indonesia's recovery from the crisis of 1998 – during which the economy contracted by 18%, inflation peaked at over 80%, and the 30-year rule of President Suharto came to an end – has been truly remarkable. Indonesia has evolved into a functioning stable democracy. The probable re-election of Susilo Bambang Yudhiyono as President (with former central bank governor Boediono as his running mate) on 8 July (after his party gained the largest share of the vote in the April parliamentary election) will strengthen prospects for further economic reform, including firmer action against entrenched corruption.**

# Malaysia and Thailand harder hit than other ASEAN economies

### Real GDP growth



### Industrial production



- **Thailand and Malaysia, with their greater dependence on exports of autos and high-tech products (respectively), have been harder hit by the global downturn than Indonesia, the Philippines and Vietnam, whose exports are less elaborately transformed and account for a smaller share of GDP.**
- **As for the NIEs, there are indications that the downturn in industrial activity in Thailand and Malaysia troughed towards the end of Q1.**

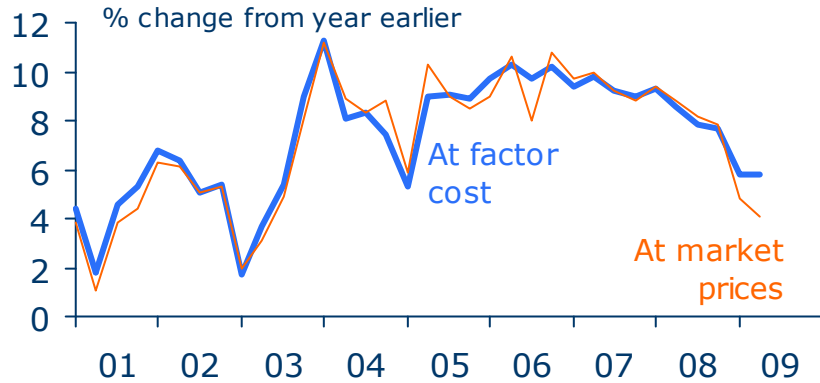
Sources: national statistical agencies; CEIC; ANZ.



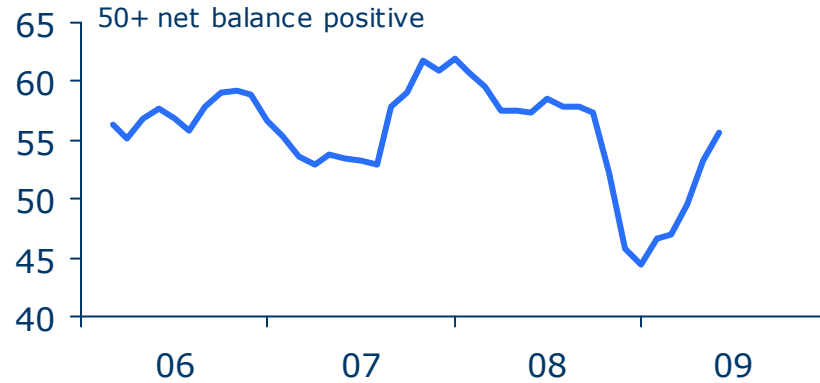


- **India is still a relatively closed economy by Asian standards, with exports accounting for 21% of GDP (although this proportion has doubled over the past decade); hence it has been less affected by the brutal contraction in global and intra-Asian trade (especially in manufactured goods) than other Asian economies.**
- **However with fixed investment (a good deal of it financed externally) accounting for 80% of India's total economic growth between 2003-04 and 2007-08, the impact of the financial crisis on the availability of credit has resulted in a significant deceleration in real GDP growth since the middle of last year. The impact of the global financial crisis is also apparent in the sharp slowdowns in India's finance, insurance & real estate and trade, hotels, transport & communications sectors.**
- **The relatively poor condition of its public finances prior to the onset of the crisis has limited India's scope to use discretionary fiscal policy to support economic activity. Three separate packages announced since December 2008 have included excise duty reductions, increased depreciation allowances, public sector wage rises, additional public spending and expanded credit guarantees amounting to a 'headline' total of 3% of GDP but (according to IMF estimates) equivalent to a fiscal impulse of just 0.6% of GDP in each of 2009 and 2010.**
- **Monetary policy has shouldered a greater share of the response to the global crisis, with the RBI cutting its main policy indicator rate from 9% to 4¾%, lowering the banks' cash reserve ratio from 8¾% to 5% and providing liquidity support equivalent to almost 7% of GDP. The rupee was also allowed to depreciate by more than 20% from late 2007 through March this year, although it has since risen by around 8%.**
- **Inflation, which was the primary focus of monetary policy prior to the onset of the crisis, has fallen sharply at the wholesale level but far less so at the consumer level.**
- **There are some indications of a rebound in manufacturing activity in recent months, but a more broadly-based economic upturn seems unlikely before the end of 2009. However growth should average around 6½% in 2010.**
- **National elections on 16 May unexpectedly resulted in a significant strengthening of the position of Prime Minister Manmohan Singh's UPA Coalition, which will now no longer need Communist Party support and thus should be able to implement more wide-ranging reforms.**

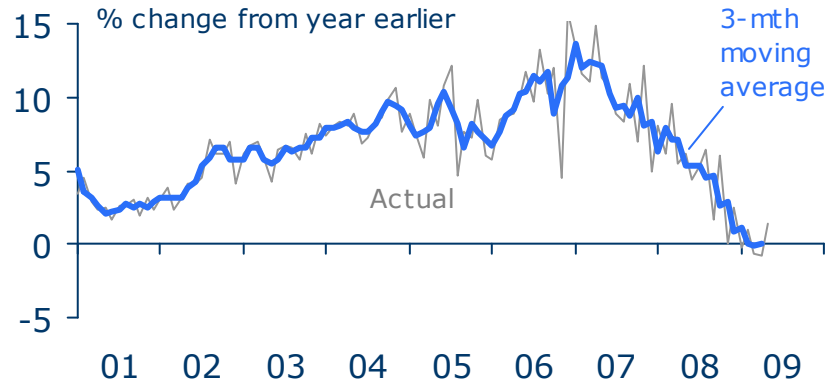
### Real GDP growth



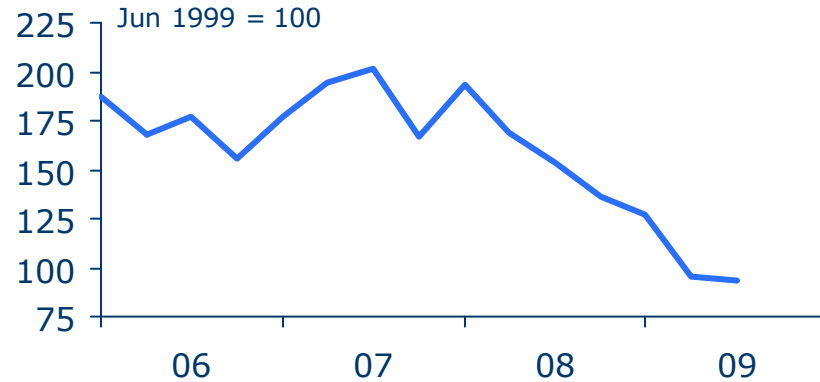
### Purchasing managers' index



### Industrial production

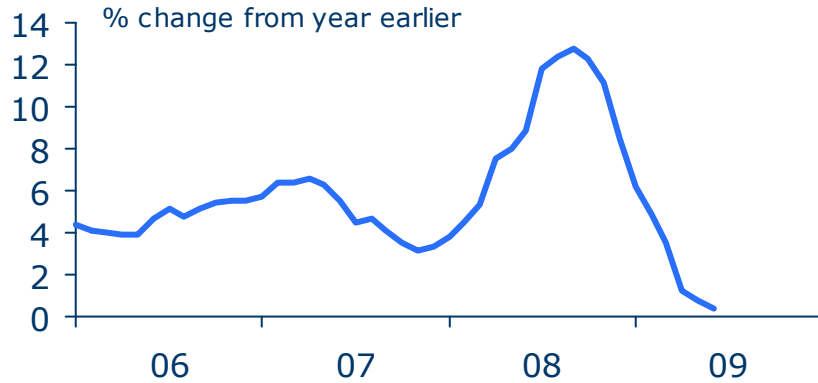


### Business optimism index

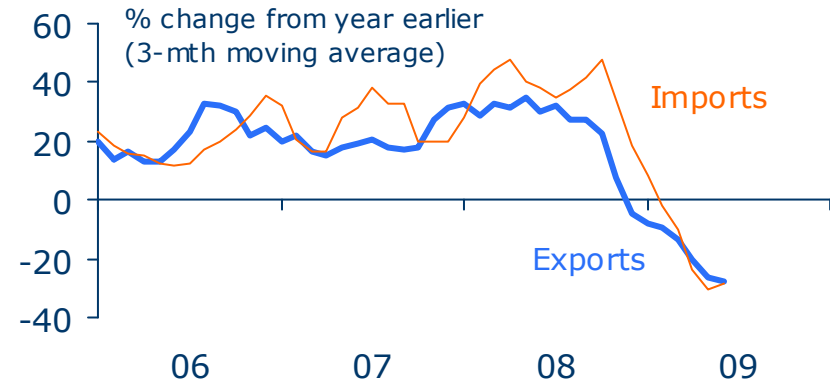


- **India's economy has slowed significantly since mid-2008, led by softer fixed investment and household spending. India's purchasing managers' index points to a revival in manufacturing activity although this is not yet apparent in official statistics. Broader measures of business confidence remain at low levels.**

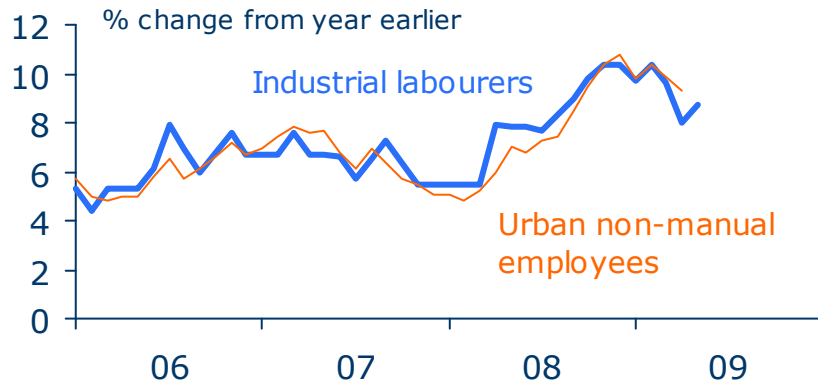
### Wholesale prices



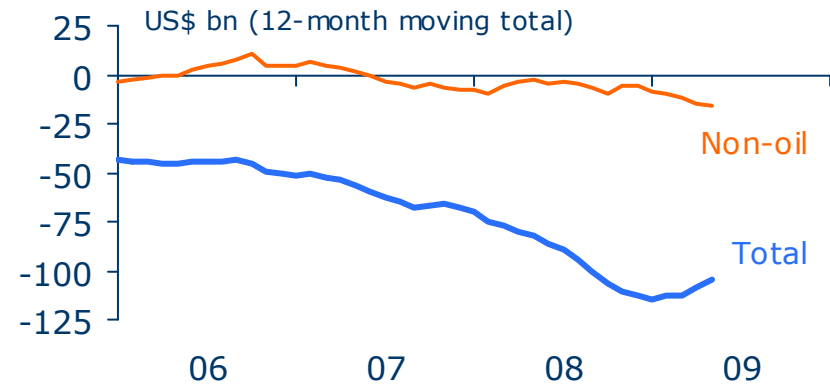
### Exports and imports



### Consumer prices



### Merchandise trade balance

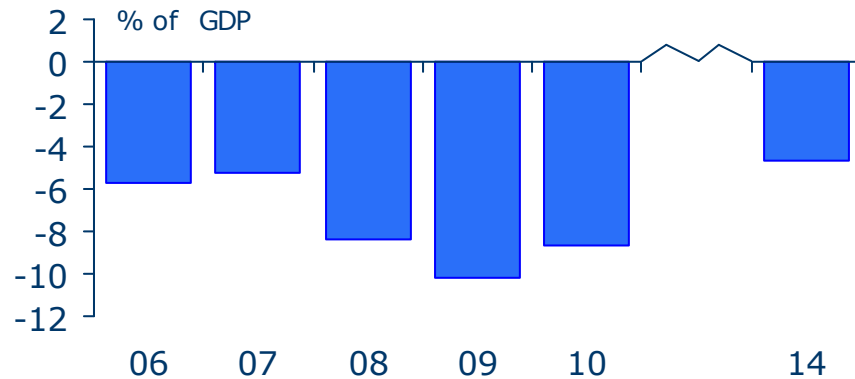


- Wholesale price inflation (the most-commonly followed inflation measure in India) has fallen to zero this year, although price pressures have persisted at the consumer level
- India's exports have declined substantially although lower oil prices have prevented a deterioration in the trade balance.

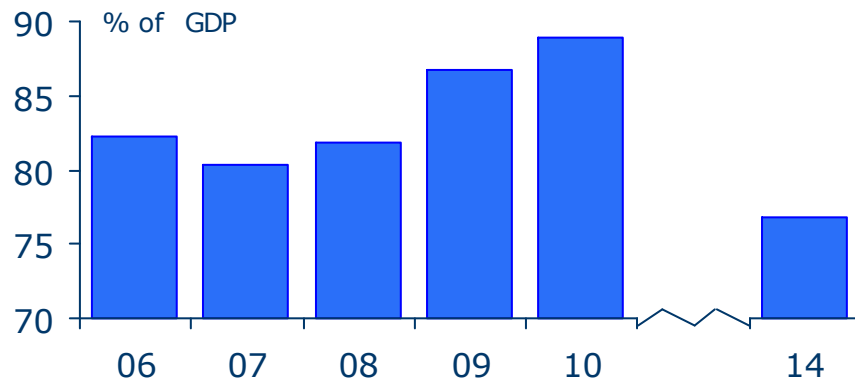
Sources: Central Statistical Organization of India; CEIC.



### Fiscal balance



### Government gross debt

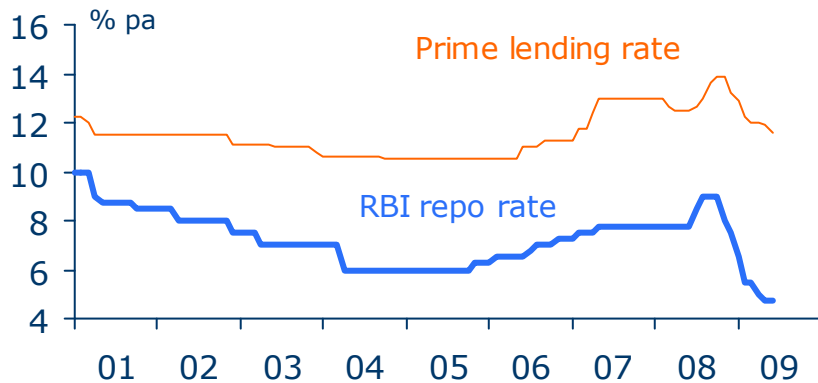


Note: data refer to combined fiscal balance and debt of central and state governments. Sources: Ministry of Finance; IMF Staff Position Note 09/13, *Fiscal Implications of the Global Economic and Financial Crisis*, 9 June 2009.

- Following the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003, India had made progress in reducing its chronic fiscal deficits. The central government's deficit had been cut from over 6% of GDP in 2001-02 to less than 4% in 2006-07 and was on track to meet the FRBM mandated target of less than 3% of GDP by 2009-10. State deficits had also been reduced from 4% to 2½% of GDP over the five years to 2007-08.
- The provisions of the FRBM Act were suspended in December 2008 to allow the Government to implement the first of what has turned out to be three fiscal stimulus packages in response to the crisis.
- Specific measures have included cuts in excise duty, infrastructure spending, increases in public sector pay, credit guarantees for micro and small firms, and expanded safety-net provisions for rural poor.
- Overall, however, fiscal policy has played a smaller role in India than in most other Asian countries.

# The RBI has sought to offset the tightening in credit conditions 29

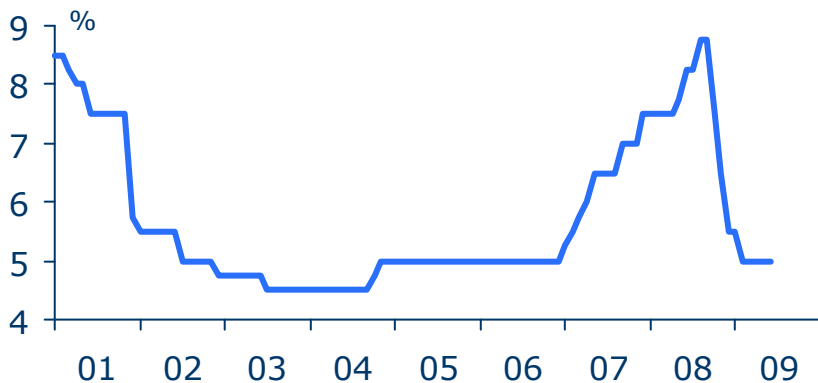
### Interest rates



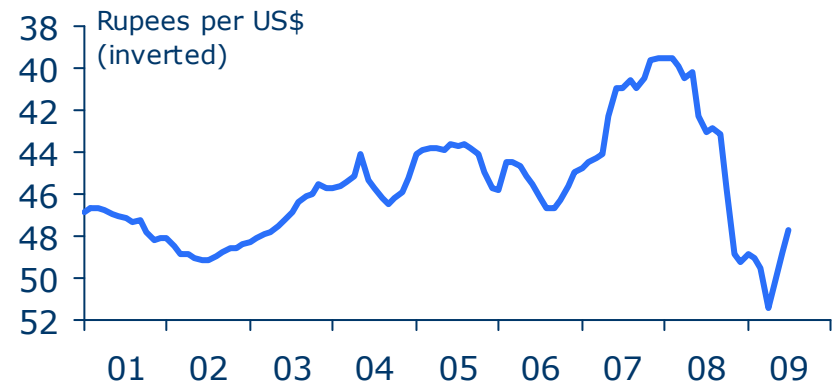
### Bank lending



### RBI cash reserve ratio



### Rupee vs US\$



- **Although India's banking system has remained sound and well-capitalized, its dependence on external financing has exposed it to the tightening in global financial conditions, which the RBI has sought to counter by cutting policy interest rates, easing reserve requirements and providing substantial additional liquidity.**
- **The rupee came under considerable pressure during 2008, with RBI reserves falling by US\$66bn from May to January. The rupee has strengthened since February.**

Source: Reserve Bank of India; Thomson Financial Datastream.



- **Asia's sharp economic downturn has resulted largely from its heavy dependence on exports of discretionary consumer and capital goods to the United States and Europe, either directly or (increasingly over the past decade) indirectly via China. Beyond the rebound in manufacturing activity (from the previous inventory liquidation phase) now under way, Asia's short-term prospects are shaped by the timing and sustainability of the recovery in consumer and capital spending in the US and Europe. If that turns out to be delayed or short-lived, so too will be the Asian recovery.**
- **Notwithstanding the success thus far of its aggressive stimulus measures, China no less than most other Asian economies also needs a recovery in demand for its exports to sustain overall growth at its target rate of 8%. Failure to do so could lead to rising social unrest. The stimulus-induced upturn in Chinese investment spending will have only limited 'spill-over' benefits for other Asian economies (though it will lift demand for commodities).**
- **Hence from a medium-term perspective Asia needs to pursue more 'balanced' growth, just as much as the US does, with (in Asia's case) more growth coming from domestic demand (especially household consumption and public investment) and less from exports. The biggest medium-term risk for Asia is that this doesn't happen, and that unsustainable imbalances between Asia and the rest of the world re-emerge as the global economy recovers.**
- **Japan faces three specific challenges – the possibility of a major political upheaval at the elections due by early September; the most advanced and rapid demographic change in the world; and (by most measures) the worst set of public finances in the OECD.**
- **The inscrutable and unstable North Korean regime represents an on-going security threat to North Asia, one potentially magnified by Kim Jong Il's apparent desire to be succeeded by his third son Kim Jong Un. The possibility of the regime's collapse is also a significant economic risk especially for South Korea.**
- **Political unrest is an ongoing risk for Thailand, given the deepening divide between rural voters and Bangkok's middle class (roughly, pro- and anti- former PM Thaksin) and separatist sentiment in the south. In Malaysia, UMNO's 52-year monopoly on political power is looking less secure. A new president in the Philippines will be elected in March 2010.**
- **Although India's May election gave the UPA Coalition a stronger and more secure mandate for reform, India's public finances remain daunting, and on-going tensions with Pakistan represent a continuing security risk.**

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