

EMERGING ASIA ECONOMICS WEEKLY

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Editor: Sukhy Ubhi

Asia's currency appreciation likely to slow

- **Emerging Asia's currencies have strengthened against the US dollar so far this year in large part because local policymakers have allowed appreciation to combat inflation. However, with inflation set to peak by the end of the year across the region and concerns over the global outlook growing, we suspect policymakers will soon become less tolerant of currency gains.**
- Nonetheless, we believe that further currency appreciation is likely. Widening interest-rate differentials between Asia and the major economies should continue to attract capital inflows and put upward pressure on local currencies. In addition, most countries in the region run large external surpluses while many currencies are still below their 2007-2008 peaks in real trade-weighted terms. (See pages 2-3.)

Data Previews (pages 4-5)

New Zealand CPI (Q2) (Sun. 17th Jul.) – *Lifted by fuel prices and policy changes*

Singapore Non-Oil Domestic Exports (Jun.) (Mon. 18th Jul.) – *Electronics still struggling*

Malaysia Consumer Prices (Jun.) (Wed. 20th Jul.) – *Boosted by electricity-tariff hikes*

Thailand Foreign Trade (Jun.) (20th – 25th Jul.) – *A temporary slowdown in export growth*

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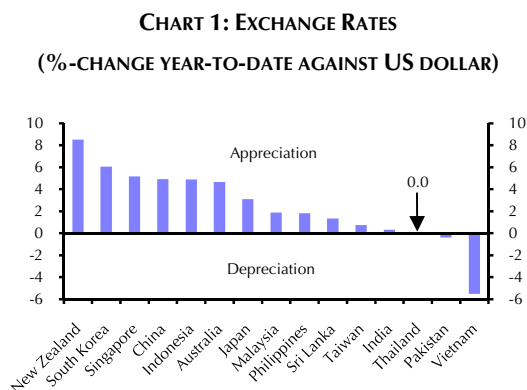
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Asia's currency appreciation likely to slow

This week's lead article focuses on currency trends in the region. Almost all local currencies have strengthened against the US dollar so far this year, which partly reflects weakness in the dollar but also because local policymakers have allowed appreciation to help combat inflation. However, with inflation set to peak by the end of the year across the region and concerns over the global outlook growing, we suspect policymakers will soon be wary of allowing their currencies to continue to appreciate at such a fast pace.

Why have Asia's currencies strengthened?

Almost all the major economies in the region have seen their currencies rise against the US dollar since the start of this year. (See Chart 1.) Regional currencies have generally regained or surpassed their levels prior to the global crisis, although the Korean won is a notable exception.

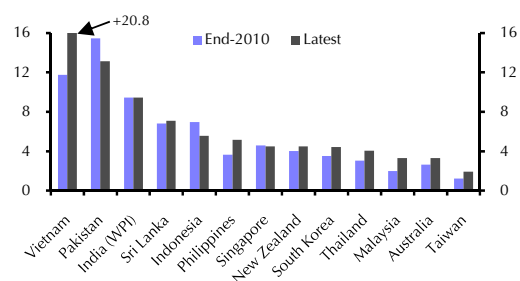


Source – Bloomberg. Data correct as of 15th July.

One of the main factors behind the strong appreciation has been the concern over rising inflation. In spite of several governments introducing measures such as food and fuel subsidies, inflation rates are typically higher now than at the end of last year. (See Chart 2.) Stronger currencies are another policy tool in the fight against inflation given that much of the upward pressure on local prices has, of course, come from higher global commodity prices. (See Chart 3.) Although inflation has peaked in some economies, it remains uncomfortably high in

many places. For example, inflation has eased in Korea since February but has consistently come in above the central bank's 2-4% target range in 2011, despite President Lee declaration of "war" on inflation early this year. Inflation in South Asia remains at politically-difficult levels. Meanwhile, inflation in Vietnam is the highest in the region and prices there are still accelerating.

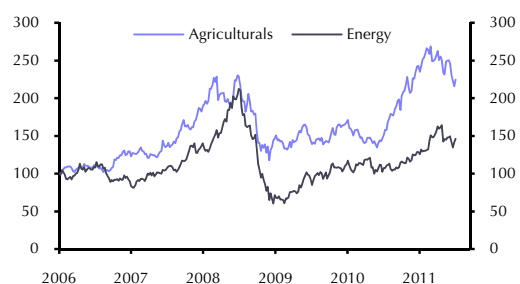
CHART 2: CONSUMER PRICES (% Y/Y)



Source – Thomson Datastream

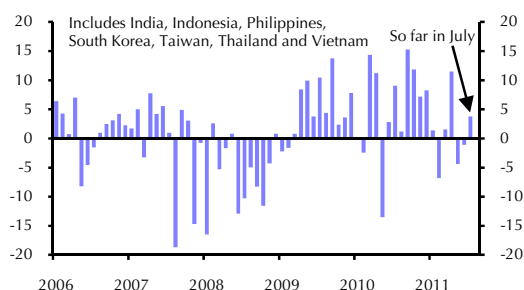
Another important factor has been rising interest rate differentials against the US and Europe. Owing to healthy economic fundamentals and strong growth prospects, almost all central banks across the region have been raising policy rates since the 2008-09 global crisis (Sri Lanka has been an exception). In contrast, policy rates in the US and euro-zone remain at exceptionally-low levels. This has led to capital flowing into the region in search of higher returns, pushing up the value of currencies across Asia. (See Chart 4 overleaf.)

CHART 3: S&P GSCI SPOT PRICE INDICES (JAN 06 = 100)



Source – Thomson Datastream

CHART 4: REGIONAL NET EQUITY INFLOWS (\$BN)



Source – Bloomberg. Data correct as of 15th July.

Also significant has been the appreciation of both the Chinese renminbi and the Japanese yen. Traditionally, governments in Asia have been wary of allowing their currencies to rise quickly for fear of losing competitiveness. However, following the Chinese government’s decision to allow the renminbi to start appreciating again in June 2010, other countries in the region have been more relaxed about their own currencies strengthening as well. The same applies to the Japanese yen, with the Korean authorities more tolerant of won appreciation as the currency of their main competitor has been strengthening.

The growing importance of intra-regional trade is another factor why currencies in the region have been appreciating so strongly this year. Although Europe and the US remain important trading partners for Asia, intra-regional trade has boomed since the financial crisis, with the result that most countries are less concerned about seeing their currencies rise against the US dollar or the euro, provided that they are able to maintain their competitiveness against their main trading partners in the region.

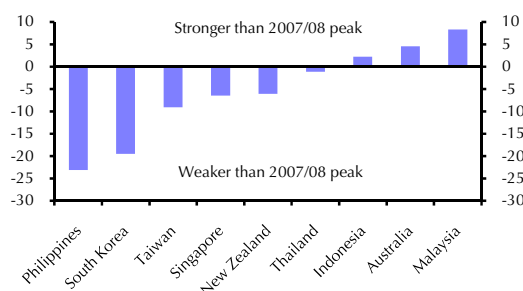
Conclusion

So far, most governments have been relaxed about currency gains as their focus has been on containing inflation. However, we think that any further appreciation is likely to be slow. Inflation should peak across most of the region by the end of this year, especially if we are right that global commodities prices have further to fall.

Moreover, policymakers are growing increasingly concerned about the outlook for the global economy. Worries over the sovereign debt crisis in the euro-zone and weaker growth in the US have featured prominently in recent central bank statements. If global growth does start to slow sharply, local policymakers may even look to weaken their currencies in order to protect their export sectors.

On balance, our current forecasts (published in the latest *Emerging Asia Economic Outlook* on 29th June) are that currencies will generally appreciate at a steady pace between now and end-2012. This partly reflects persistent external surpluses and many currencies still below pre-crisis levels in real trade-weighted terms. (See Chart 5.)

CHART 5: REAL EFFECTIVE EXCHANGE RATES
(% CHANGE JUNE 2011 RELATIVE TO 2007/08 PEAK)



Source – Bloomberg

The week ahead

The first key release of the week is **New Zealand’s** CPI (published on Monday, local time) which is likely to show that inflation rose in Q2 due to high fuel prices and earlier policy changes. **Malaysia** also publishes its latest CPI figures (Wednesday), which should show that inflation picked up due to hikes in electricity-tariff hikes.

Singapore (Monday) and possibly **Thailand** (20-25th) will release export data for June. We expect weakening global demand slowed export growth in both countries.

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Data Preview – New Zealand Consumer Prices (Q2) 23.45 BST Sun. 17th Jul.

Forecasts	Previous	Median	Capital Economics
Consumer Prices q/q(y/y)	+0.8%(+4.5%)	+0.8%(+5.1%)	+0.8%(+5.1%)

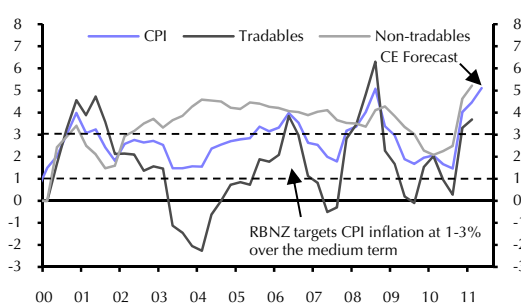
Lifted by fuel prices and policy changes

We expect New Zealand's inflation to have risen further above the Reserve Bank's (RBNZ) 1-3% target range in Q2, reflecting high global commodity prices and earlier policy changes.

Petrol and diesel prices fell in May and June in tandem with oil prices, but they still averaged above their Q1 levels and are likely to add around ½%-point to quarterly inflation. In addition, monthly data show that food prices rose by 1.1% q/q in Q2. Besides high food and fuel prices, earlier policy changes such as the GST hike in October mean that annual inflation is likely to have risen to around 5%. (See Chart 1.) Looking ahead, underlying price pressures should build in the second half of this year as the recovery gathers momentum. Recent GDP data showed that the economy grew at a brisk pace at the start of year

in spite of the February earthquake. What's more, earlier data were revised upwards which means that the economy has been stronger than was previously thought. The upshot is that we maintain our long-held view that the RBNZ will lift its cash rate later this year.

CHART 1: NEW ZEALAND CONSUMER PRICES (% Y/Y)



Sources – Thomson Datastream, Capital Economics

Data Preview – Singapore Exports (Jun.)

06.00 BST Mon. 18th Jul.

Forecasts	Previous	Median	Capital Economics
Non-Oil Dom. Exports m/m(y/y)	+7.5%(+7.8%)	-2.1%(+3.8%)	-2.3%(+2.0%)

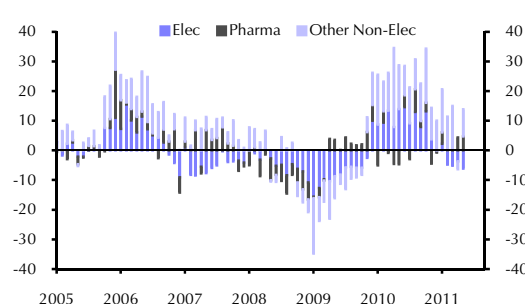
Electronics still struggling

We expect that growth of Singapore's non-oil domestic exports (NODX) moderated from 7.8% y/y in May to around 2.0% in June. This would be consistent with data showing a slip in container throughput, although the volatile pharmaceutical component is a wildcard.

Electronics is likely to have been the main drag on NODX last month, which would continue the trend seen so far this year. (See Chart 2.) Korea's already-released June export data showed that micro-chip exports were weak and are consistent with signs that global demand for semi-conductors has remained soft. A lagged impact from Japan's mid-March disaster on supply-chain links may also have affected Singapore's electronics shipments. We expect demand for

electronics will remain weak in the second half of this year and that it will continue to subtract from NODX. Overall, NODX should grow at a much more subdued single-digit pace this year, from the 23% expansion in 2010.

CHART 2: SINGAPORE NODX CONTRIBUTION (%-POINTS)



Sources – Bloomberg, Capital Economics

Data Preview – Malaysia Consumer Prices (Jun.)

10.00 BST Wed. 20th Jul.

Forecasts	Previous	Median	Capital Economics
Consumer Prices (y/y)	(+3.3%)	(+3.6%)	(+3.7%)

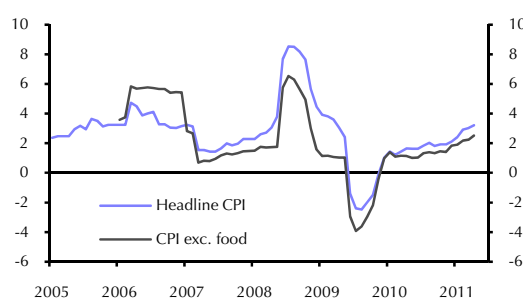
Boosted by electricity-tariff hikes

Malaysia's inflation is likely to have risen in June, mainly due to a hike in electricity tariffs at the start of the month. We forecast that CPI inflation rose to 3.7% y/y, from 3.3% in May.

Malaysia's inflation is one of the lowest in the region, but this in large part reflects generous food and fuel subsidies. These subsidies are now being gradually removed. We expect inflation to peak close to 4% later this year. Price pressures should then continue to recede next year. However, this is contingent on further and timely monetary policy tightening by Bank Negara Malaysia (BNM). BNM noted earlier this month that inflation risks are skewed to the upside, while the upward trend in non-food inflation suggests that price pressures are widespread. (See Chart 3.) We expect the overnight rate to be raised to 3.5% by

year-end in two 25bp hikes. However, with just two more policy meetings left this year and policymakers getting increasingly concerned about global growth, there is a significant chance that the second 25bp hike could be pushed out to next year.

CHART 3: MALAYSIA CONSUMER PRICES (% Y/Y)



Source – Thomson Datastream

Data Preview – Thailand Foreign Trade (Jun.)

20th – 25th Jul.

Forecasts	Previous	Median	Capital Economics
Exports (y/y)	(+17.6%)	(+10.0%)	(+5.0%)

A temporary slowdown in export growth

We forecast that Thailand's export growth slowed sharply in June, in large part due to supply-chain problems since Japan's disaster in March. But factory conditions have since improved and as a result any significant weakness in Thailand's industrial output and exports will be short-lived.

Thailand's export data tend to move in-line with trends in Korea, and Korea's export growth slowed sharply last month. Thailand's manufacturing output has been weak recently, though it did stabilise in May. This is consistent with Thailand's strong trade links with Japan, particularly in automobile production. (Japan is Thailand's most important source of inward investment, while around a tenth of Thailand's foreign shipments go to Japan.). Looking ahead,

the disruptions have now largely unwound while the company orders indicator is at a high level. (See Chart 4.) Accordingly, we expect exports and production will recover at a brisk pace over the next few months.

CHART 4: THAILAND EXPORTS & COMPANY ORDER BOOKS



Source – Thomson Datastream

Emerging Asia Diary

EMERGING ASIA

Date	Country	Release/indicator/event		Time (BST)	Previous*	Median*	CE Forecast*
Sun 17 th	NZ	CPI (Q2)	q/q(y/y)	23.45	+0.8%(+4.5%)	+0.8%(+5.1%)	+0.8%(+5.1%)
Mon 18 th	Spr	Non-Oil Dom. Exports (Jun)		06.00	+7.5%(+7.8%)	-2.1%(+3.8%)	-2.3%(+2.0%)
Tue 19 th	HK	Unemployment Rate (Jun)	s.a	09.30	3.5%	3.5%	3.5%
Wed 20 th	Twn	Export Orders (Jun)		09.00	+11.5%	-	-
	Mly	CPI (Jun)		10.00	(+3.3%)	(+3.6%)	(+3.7%)
	NZ	Net Immigration (Jun)	s.a	23.45	-360	-	-
Thu 21 st	Aus	NAB Business Confidence (Q2)		02.30	+11	-	-
	Chn	HSBC Manuf. PMI (Jul)		03.30	50.1	-	-
	HK	CPI (Jun)		09.30	(+5.2%)	(+5.6%)	-
Fri 22 nd	Twn	Unemployment Rate	s.a	09.00	4.4%	-	-

Expected During the Period:

20 th -25 th Jul	Tha	Customs Exports (Jun)		-	(+17.6%)	(+10.0%)	(+5.0%)
21 st -25 th Jul	Php	Monthly Budget (Jun)	Peso	-	-9.6bn	-	-

*m/m(y/y) unless otherwise stated; p = provisional estimate

KEY FORTHCOMING EVENTS/DATA

Date	Event	Date	Event
25 th Jul	Singapore CPI (Jun)	27 th Jul	China Industrial Profits (Jun)
25 th Jul	Taiwan Industrial Production (Jun)	27 th Jul	New Zealand Interest Rate Announcement
25 th Jul	South Korea Consumer Confidence (Jul)	28 th Jul	South Korea Current Account (Jun)
25 th Jul	New Zealand Exports, Imports (Jun)	28 th Jul	South Korea GDP (Q2 prov.)
25 th -29 th Jul	Vietnam CPI (Jul)	28 th Jul	Philippines Interest Rate Announcement
26 th Jul	Australia Conference Board Leading Index (May)	28 th Jul	Hong Kong Trade (Jun)
26 th Jul	Philippines Imports, Trade Balance ((May)	28 th -29 th Jul	Pakistan Interest Rate Announcement
26 th Jul	Singapore Industrial Production ((Jun)	29 th Jul	South Korea Industrial Production (Jun)
26 th Jul	India Interest Rate Announcement	29 th Jul	Singapore Unemployment Rate (Q2 prov.)
27 th Jul	New Zealand NBNZ Business Con. (Jul)	29 th Jul	Thailand Current Account Balance (Jun)
27 th Jul	Australia CPI (Q2)	29 th Jul	Taiwan GDP (Q2 prov.)

Selected Recent Publications

Date	Publication	
Mon 11 th	Capital Daily	Fragile US labour market casts a pall over commodity prices
	Japan Consumer Confidence	Confidence rebuilding from a low base
	China Economics Update	No need to panic over inflation surge
	Emerging Asia Economics Update	How big a worry is the suspension of US aid for Pakistan?
	US Housing Market Update	Don't fret over expected downward revisions to home sales
Tue 12 th	Capital Daily	Euro-zone fiscal crisis starts to spread
	UK Consumer Prices (Jun.) & Trade (May)	Core price pressures finally starting to ease?
	Japan Economics Update	Bank of Japan still (too) optimistic about growth
	Emerging Asia Economics Update	Bank Indonesia to resume rate hikes later this year
	Middle East Economics Update	The latest on Egypt's transition
	US International Trade (May)	Net trade to the rescue
	European Economics Update	The beginning of the end for the euro?
	Latin America Economics Update	Brazil: credit where credit's due?
China Economics Update	What was behind the lending rebound?	
Wed 13 th	Capital Daily	Even darker days ahead for the euro-zone
	UK Labour Market Data (May/Jun.)	Squeeze on real pay continues
	China Economics Update	Hard landing fears recede, but imbalances grow
	Euro-zone Industrial Production (May)	Industrial data confirm fading recovery
	Global Markets Update	Are the best days for German Bunds behind us?
	Canada Chart Book	Housing starts may have peaked this year
	European Economics Update	Italy's troubles raise risk of euro-zone break-up
	Emerging Europe Update	Dip in Polish inflation takes pressure off
	Emerging Asia Economics Update	Thailand's central bank to focus on fiscal developments
	UK Housing Market Analyst	No relief in sight for the housing market
Global Markets Focus	A mid-year review of our big calls	
Thu 14 th	Capital Daily	How long will German Bunds remain a safe haven?
	Emerging Asia Economics Update	Korea's policy rate has further to rise
	Emerging Asia Economics Update	Singapore's economic weakness will be short-lived
	European Commercial Property Update	How significant is the slump in Brussels office take-up?
	Global Markets Update	Would a US sovereign credit downgrade rattle Treasuries?
	Emerging Asia Economics Update	More policy tightening required in India
	US Retail Sales & Producer Prices (Jun.)	Households hardly increasing their spending at all
	Middle East Economics Update	Can it get any worse for the Arab world's equity markets?
	Bank of Canada Watch	Rising financial risks give further reason for pause
US Housing Market Monthly	Don't read too much into seasonal boost	
UK Quarterly Review	Growing apart or coming together?	
Fri 15 th	Capital Daily	How vulnerable are Treasuries to a US credit rating downgrade?
	Commodities Update	How high could gold prices go?
	UK Economics Weekly	Euro-zone crisis casts cloud over UK
	Japan Economics Weekly	Trying to keep the lights on
	Emerging Asia Economics Weekly	Asia's currency appreciation likely to slow
	European Economics Weekly	-
	Canada Economics Weekly	-
	US Economics Weekly	-

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