EAST ASIA UPDATES

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Rising Commodity Prices Due to Reduced Supply, Not to Increased Demand

Energy, agriculture products, and metals and minerals price indexes rose in February 2017 continuing the upward trend since January 2016 (Figure 1). In the first two months of 2017, the increase in prices of commodities was due to decreased supply rather than increasing demand for commodities, especially energy and metals and minerals.

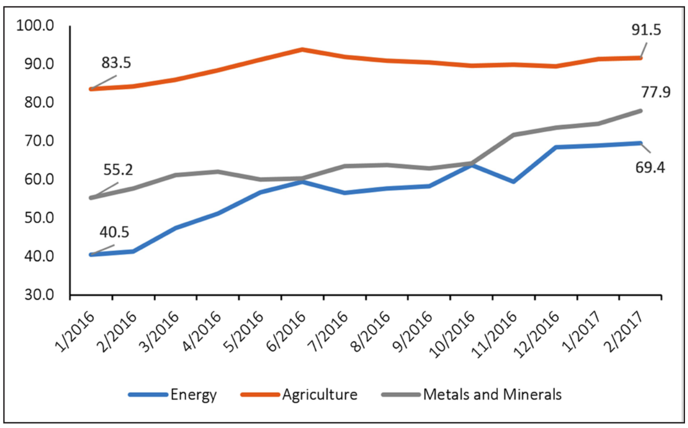
Three factors influenced the decreased supply of energy and metals and minerals. First is the agreement between Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries to cut oil production, which, complemented by an unexpected decline in China's oil production, resulted in an increase in quarterly average oil price from US$46.5 per barrel in September – November 2016 to US$54.8 per barrel in December 2016 – February 2017.

Second, there has been a copper production strike at Escondida, the world's largest copper mine located in Chile, as the workers and corporation have not been able to reach a settlement and thus the three-year wage agreement expired at the end of February 2017. In addition, production has halted at Freeport McMoran in Indonesia, the second-biggest copper mine in the world, due to issues over the contract of work and special mining permits.

Third, the enactment of new environmental measures in the mining sector in the Philippines, the world's top nickel ore supplier, has affected the supply of nickel ore significantly. The decision resulted in the closure or suspension of 28 of the country's 41 mines.

The recent increased commodities prices threaten to push up inflation in resource-rich Southeast Asian countries.

Figure 1. World Bank Commodity Price Indices for Low and Middle Income Countries (2010=100)



Source: World Bank, 2017.

East Asian Monetary Condition in Q1 2017: Reserves Supported by Increased Commodity Prices

Countries around the world are cautiously observing the latest developments of the global economy. Southeast and East Asian economies are bracing themselves for shocks that might arise from the world's major economies, particularly those of the United States, China, and Europe.

In 2016, resource-rich East Asian countries seemed to be in good shape, with quite strong GDP growth – mainly driven by an expansion of private consumption, due in part to lower interest rates in each economy – and relatively low inflation (Table 1).

Table 1. Economic Growth, Inflation Rate, and Policy Rate of Selected Natural Resources Abundant Countries

Country	GDP Growth 2016 (%)	Annual Average Inflation Rate 2016 (%)	Policy Rate February 2017 (%)	Foreign Reserves (bn US$)	
				Feb 2016	Feb 2017
Indonesia	5	3.53	4.75	104.5	119.8
Malaysia	4.2	2.1	3	95.6	95
Thailand	3.2	0.19	1.5	167	183
Australia	2.4	1.5	1.5	43.7	51.4
China	6.7	2.0	2.25	3,231	3,005

Source: National statistics offices and central banks, 2017.

The improvement of GDP growth was also due to the increase of export value as commodity prices have been increasing in 2016, which also resulted in the accumulation of several countries' foreign reserves. But this year Southeast Asian economies must brace themselves for a series of potential shocks from the US, including a tightening of monetary policy, a shift towards protectionist trade policies, and expansionary fiscal policies – meaning that the US government is likely to issue new government bonds to finance infrastructure projects – that could hurt the international flow of capital.

Southeast Asian economies are also closely monitoring China's financial stability, as credit growth remains high and spending on infrastructure and property construction rose in the second half of 2016. If the construction bubble were to burst, ASEAN nations fear the financial shocks would reverberate throughout the region.

Elsewhere, political developments in Europe, including the uncertainties of Brexit and the rise of populist, far-right, and anti-European Union politicians above all in the Netherlands, France, and Italy could hit world trade volumes.
Based on their latest policy statements, Southeast and East Asian central banks are holding their benchmark interest rates to maintain stability and growth momentum.

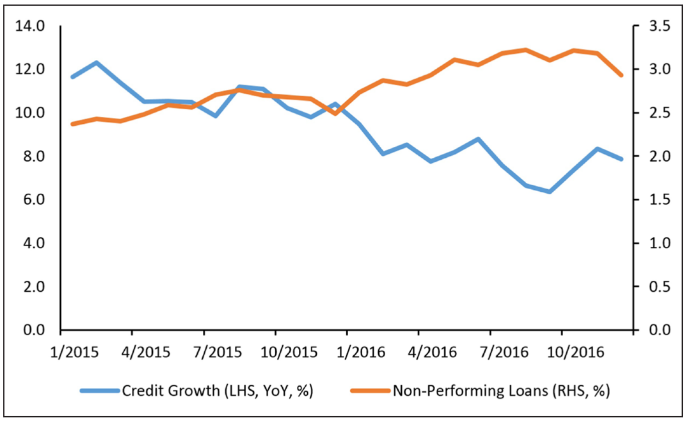
INDONESIA

Bank Indonesia (BI) held its BI 7-day Reverse Repo Rate (BI 7-day RR Rate) at 4.75% with Deposit Facility at 4.00% and Lending Facility at 5.50%. The decision took into account the ongoing developments in global economic conditions, improvement of growth fuelled by healthy private consumption growth, improvement of the current account deficit to GDP ratio that fell to -1.8% in 2016 from -2% in 2015, and an inflation rate that has been within its target of 4±1%.

On the financial system stability front, the Non-Performing Loan (NPL) ratio was on an increasing trend in 2016 with an average rate of monthly NPLs of 3%. At the same time, credit growth in December 2016 of 7.9% was lower than in December 2015 when it was 10.5% (Figure 2). But a healthy capital adequacy ratio of 22.7% and a decrease in the credit interest rate by 79 basis points as a result of monetary and macro-prudential policy easing has brought a sense of optimism to the financial sector.

All these factors considered, the decision of BI to hold its interest rate is in line with its goal of maintaining macroeconomic and financial system stability while supporting domestic growth momentum – the relatively low benchmark rate can help the financial sector to improve in 2017 while taking into account global factors that may disrupt the domestic economy.

Figure 2. Indonesia Commercial Banking Credit Growth and Non-Performing Loans Ratio

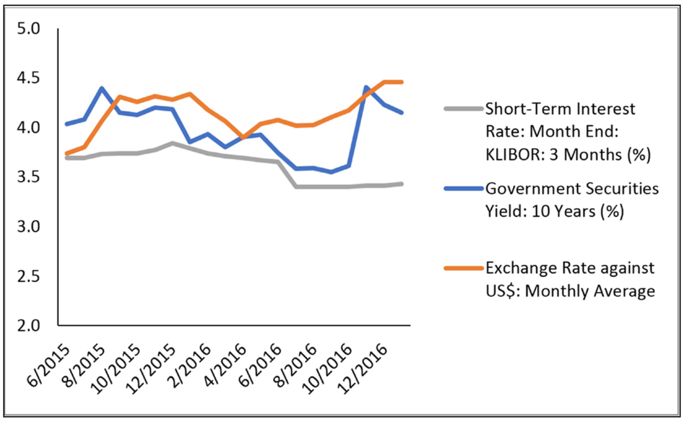


Source: Indonesia Financial Service Authority, 2017.

MALAYSIA

Bank Negara Malaysia (BNM) kept its Overnight Policy Rate (OPR) at 3.00% at its meeting on 2 March 2017. The decision was taken against a backdrop of improvements in economic performance in the major advanced economies and the likelihood of a shift towards the use of fiscal policy in developed economies, which the Central Bank expects would support the Malaysian economy through an increase in exports. Robust GDP growth of 4.5% year-on-year in the fourth quarter was driven by an expansion in private consumption and an increase in the value of exports – due to an increase in both commodity prices and volumes – including LNG, refined petroleum, timber, and rubber. In addition, the stabilisation of the ringgit against the US dollar and a decrease in government securities yield in the first 2 months of 2017 indicates an improvement in Malaysia's financial system stability (Figure 3).

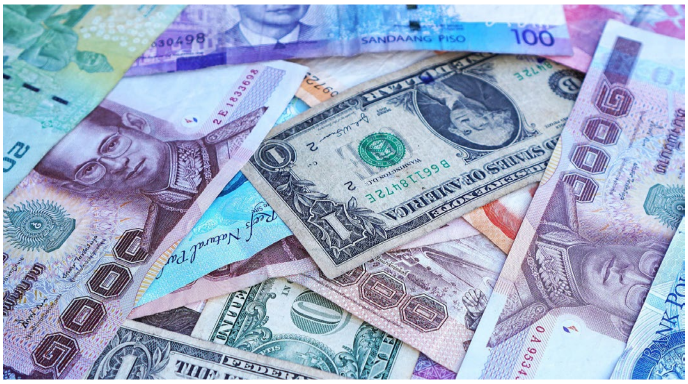
Figure 3. Malaysia Monetary Indicator Movement



Source: Bank Negara Malaysia, 2017.

THAILAND

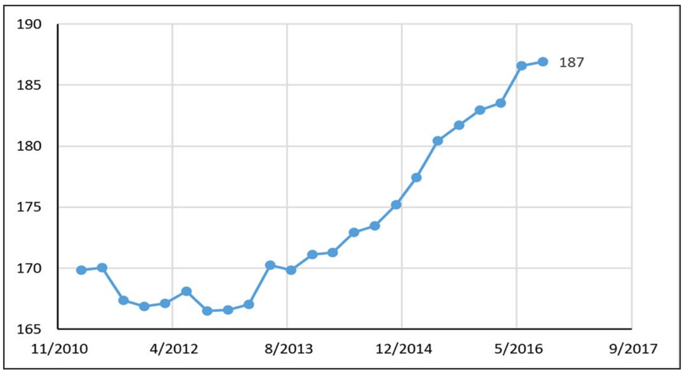
Bank of Thailand (BOT) maintained its policy rate at 1.5% in the expectation that the economy would recover at a faster pace in 2017. The expectation is based on improvements in two main indicators in 2016. First, an increase in Thailand's total goods exports by 4.5% compared with 2015, driven by a 6.8% growth in exports of processed agricultural products and a 6% growth in exports of manufacturing products. Second, a 9% increase in international tourist arrivals compared with 2015. However, the condition of the financial sector might not be as good, as loans expanded by only 2% in 2016, a decline from 4.6% growth in 2015. An increase in the NPL ratio from 2.6% in Q4 2015 to 2.8% in Q4 2016 is another indicator of financial sector vulnerability.



AUSTRALIA

The Reserve Bank of Australia (RBA) kept its cash rate unchanged at 1.5% at its last meeting on 8 March 2017. While higher commodity prices in the last quarter of 2016 provided Australia's economy with a much-needed boost, an increasing household debt ratio has put a limit on further possible monetary easing (Figure 4). With the economy expected to grow by 3% in 2017, a decreasing unemployment trend of 5.4% at the end of 2016, and an inflation rate of 1.5% at the end of 2016, the high household debt ratio is likely to be the main risk factor in the economy, as it may affect future household consumption patterns.

Figure 4. Australia Household Debt to Disposable Income Ratio (%)

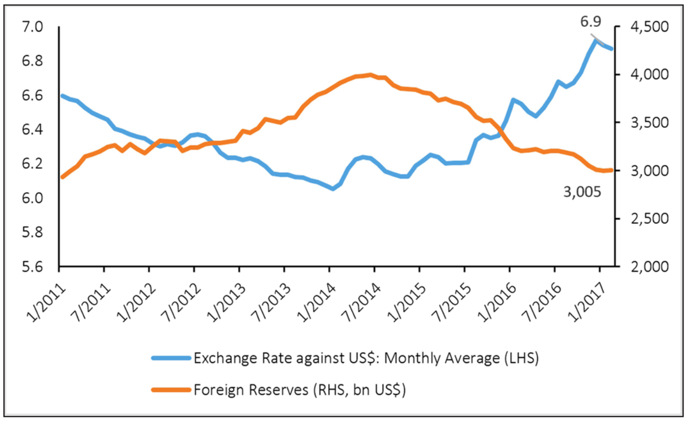


Source: Reserve Bank of Australia, 2017.

CHINA

In order to maintain confidence and preserve the Yuan value, the People's Bank of China (PBoC) has been keeping tight controls on money flowing out of the nation as the exchange rate against US Dollar, at 6.9 Yuan per US Dollar, and foreign reserves, at 3 trillion US Dollar, have reached its lowest level since 2011 (Figure 5). The implementation of capital control measures included among others: (i) tighter approvals for foreign asset acquisitions, (ii) increase disclosure requirements on foreign exchange purchases by individuals, (iii) and limits on banks' cross border Renminbi remittances.

Figure 5. China Exchange Rate and Foreign Reserves Movement: 2011-2017



Source: CEIC, The People's Bank of China, 2017.

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