EAST ASIA UPDATES

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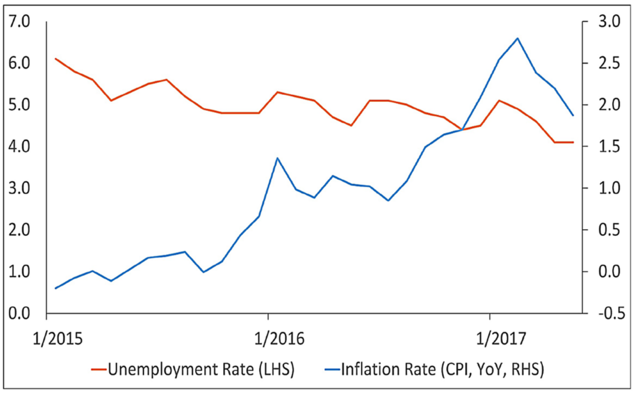
The Fed increases its benchmark interest rate for the second time in 2017

The Fed raised its benchmark interest rate by 25 bps to 1%–1.25% despite low inflation of 1.9% in May 2017, against a backdrop of record low unemployment of 4.3% in May 2017 and consumer price inflation hovering around the 2% target over the past 6 months (Figure 1). While this is the second time the Fed increased its benchmark interest rate in 2017, Governor Yellen signalled that another hike is on the horizon this year if the economy performs as the Fed had planned in order to keep it from overheating.

The Fed is pressing on with its plans to start shrinking its US$4.5 trillion balance sheet this year by reducing reinvestment of maturing bonds, in practice reducing its holdings of US Treasury securities by stopping reinvesting the principal of securities when they mature. Although the immediate impact of the hike on East Asia's developing economies will be limited, the monetary authorities are cautious about the Fed's plan to reduce its holdings of US Treasury securities as it may affect financial market players' portfolio allocations in that they are likely to increase their US treasury security holdings at the expense of developing country assets.

Figure 1. US Unemplyoment and Inflation Rate (%)



Source: CEIC, US Bureau of Labor Statistics, 2017.

Tough time for keeping the global economic recovery on track: consequences for East Asia

East Asian countries managed to maintain stable and relatively robust growth in the first quarter of 2017 supported mainly by a robust trade performance and private consumption.

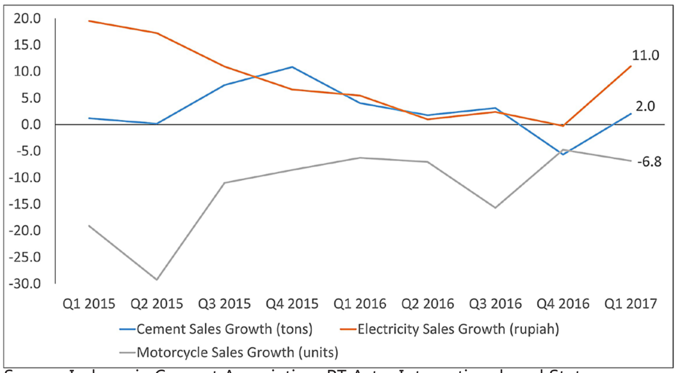
The end of quantitative easing and uncertain fiscal policy amongst developing countries are perceived as a risk to major developing East Asia countries maintaining their economic growth momentum. While China may continue its fiscal splurge, it seems unlikely the West will do so in the following quarters. Therefore, East Asian countries should rely on their own strength to maintain the healthy growth of the last few quarters.

The real sector, however, did not see any significant improvement in Q1-2017 compared with Q1-2016: cement, electricity, and private vehicle production and sales did not see a significant recovery from the previous years. While private consumption saw moderately stable growth, a closer look at the cement and vehicle sales data reveals that the recovery in the real sector remains tenuous. This is due to the fact that both cement and vehicle sales, often seen as a litmus test of consumer confidence, have been growing unsteadily over the past 2 years (Figures 2–4).

INDONESIA

In Indonesia, Q1-2017 cement and electricity sales showed positive growth compared to the negative growth posted in the previous quarter. Cement sales growth was relatively low at just 2% compared to 4% growth in Q1-2016 (Figure 2). Although electricity sales expanded by 11% compared to Q1-2016 (Figure 2), it is important to note that there was a gradual price hike in electricity sales from Rp605 per kWh in 2016 to Rp791 per kWh in January 2017 to Rp1,034 per kWh in March 2017 for average consumers (900-VA consumers) that may distort the data reading from the actual improvement of demand for electricity. Last, the continuous negative growth of motorcycle sales, one of the goods in high demand amongst Indonesians, is a reflection of continuing low purchasing power. In Q1-2017, motorcycle sales were 1.4 million units compared to 1.5 million units in Q1-2016.

Figure 2. Indonesia Real Sector Indicators Movement (%)

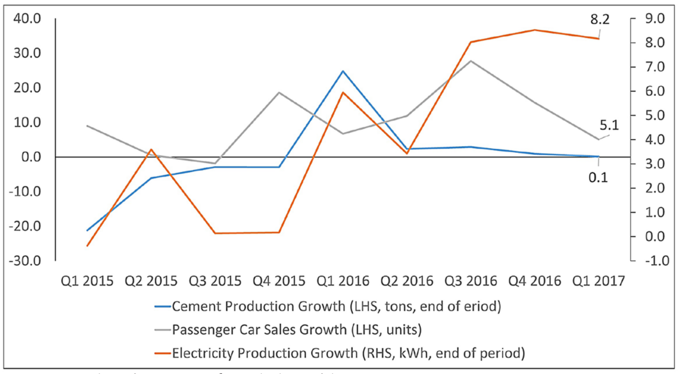


Source: Indonesia Cement Association, PT Astra International, and State Electricity Company, 2017.

CHINA

In China, passenger car sales and electricity production saw positive growth in Q1-2017 compared to the same period last year (Figure 3). The continued positive growth of passenger car sales is a positive sign for the economy as it shifts from an investment driven economy to one that relies more on consumption growth showing a sign the economy is heading towards stable growth. Cement sales, however, increased by a mere 0.1% from 201.4 million ton in March 2016 to 201.6 million ton in March 2017.

Figure 3. China Real Sector Indicators Movement (%)

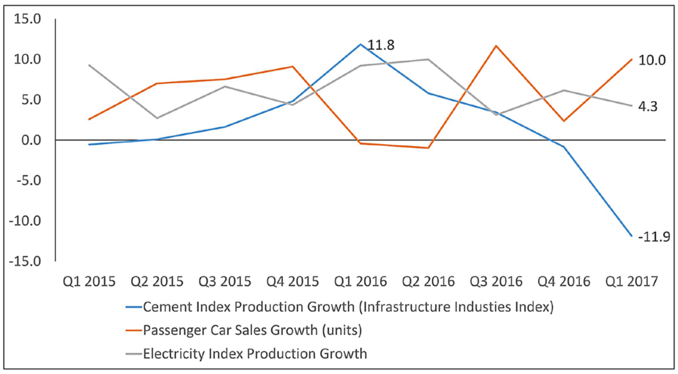


Source: National Bureau of Statistics, China, 2017.

INDIA

India posted lower-than-expected growth in Q1-2017, as the economy expanded by 6.1%, lower than what had been expected by analysts. It was the lowest growth rate in the past 2 years and resulted in a FY2017 growth rate of 7.1%, down from 8% in FY2016. Cement production contracted by 11.9% in Q1 2017, compared with Q1 2016. Although this appears to be a cause for concern, it may be due to a cyclical dynamic in the production cycle as Q1 2016 saw drastically high cement production growth.

Figure 4. India Real Sector Indicators Movement (%)

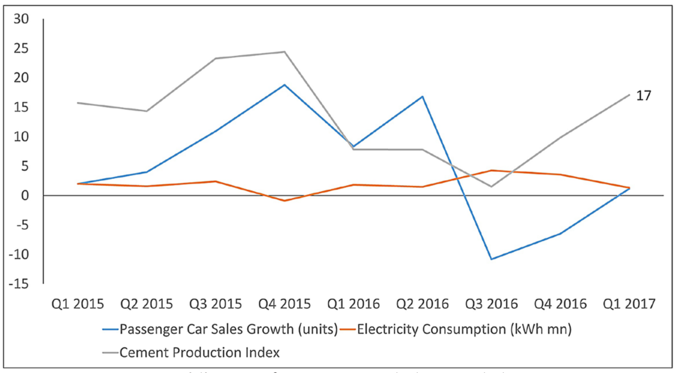


Source: Central Statistics Office and Society of Indian Mobile Manufacture, 2017.

SOUTH KOREA

The Republic of Korea grew by 2.9%, year-on-year, in Q1 2017. During this period, the construction sector saw robust 12% growth, which was mainly concentrated in the building construction sub-sector where growth was 19.4%. The real sector indicator saw positive movement, manifested in a robust increase of cement production, which rose by 17%, year-on-year, in Q1 2017. However, motor vehicle sales did not show positive movement as they expanded by only 2% from 368,000 units in Q1 2016 to 374,000 units in Q1 2017 after negative growth in the second half of 2016.

Figure 5. Korea Real Sector Indicators Movement (%)



Source: Korea Automobile Manufacturers Association, Statistics Korea, Korea Electric Power Corporation, 2017.

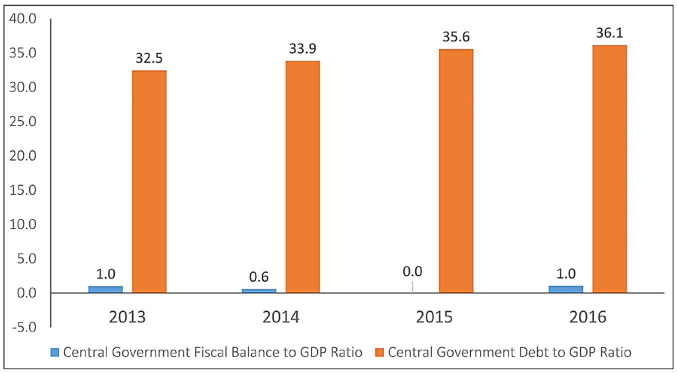
South Korea elects a new president

Moon Jae In was elected as the Republic of Korea's new president after winning 41% of the vote with strong support from 20–50 year-old South Koreans, ending months of political turmoil caused by the former president's impeachment. His three main campaign promises are public sector jobs creation, social safety net expansion, and chaebol reformation. In practical terms, his proposed economic policies come down to the following four key measures.

First, he is proposing to push through a supplementary budget of around US$8.8 billion to boost public investment. Second, he has pledged to raise basic pension income for citizens over 65 years old and double the amount of subsidy given to mothers in the first 6 months of maternity leave, increasing it to US$1,757 a month. Third, he intends to reform the chaebols by promoting transparency and democratic management to increase efficiency in the Republic of Korea's corporate sector. And fourth, he promises to create more than 500,000 new jobs a year, with 810,000 jobs to be created in the public sector during his 5-year term. Given the Republic of Korea's relatively low government debt to GDP ratio and its fiscal surplus, President Moon is expected to have sufficient fiscal space to achieve his goals.

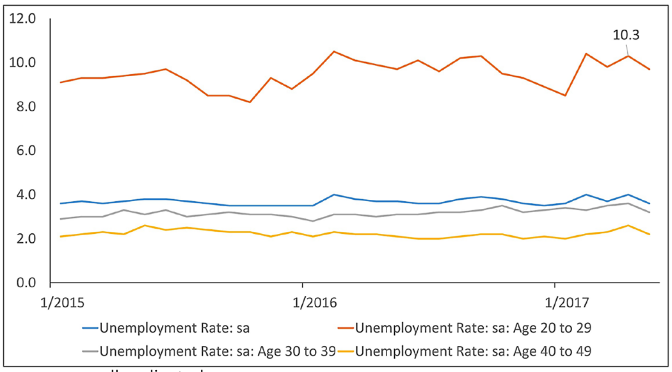
It is critical for President Moon to deliver on his promises to stave off further public protests by younger people as a consequence of Korea's high youth unemployment rate (Figure 6). President Moon will also need to focus on critical national security issues, i.e. a belligerent North Korea and the power struggle between the United States and China in the region.

Figure 6. Republic of Korea Public Finance Indicators (%)



Source: Statistics Korea, Bank of Korea, and Ministry of Strategy and Finance Korea, 2017.

Figure 7. Republic of Korea Unemployment Rate by Age Groups (%)



sa = seasonally adjusted.
Source: Statistics Korea, 2017.

For more information, please contact:
Jaysa Prana (jaysa.prana@eria.org); **Lili Yan Ing** (liliyan.ing@eria.org)

ERIA Economic Research Institute for ASEAN and East Asia

Sentral Senayan 2, 5th and 6th floors
Jalan Asia Afrika No.8
Senayan, Central Jakarta 10270, Indonesia
Tel: (62-21) 57974460
Fax: (62-21) 57974463
E-mail: contactus@eria.org