EAST ASIA
UPDATES

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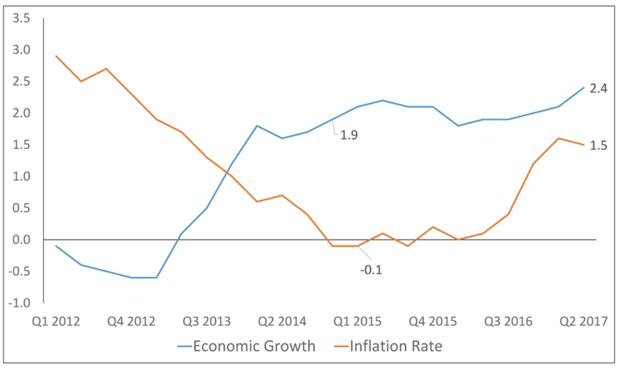
Monetary tightening is on the horizon

Basing its decision on solid job gains, a low unemployment rate, a moderate expansion of household spending, and a pickup in business fixed investment, the Federal Open Market Committee (FOMC) of the United States (US) maintained the interest rate paid on required and excess reserves at 1.25% and kept open the possibility of another rate increase later this year. The Committee also declared its intention to begin a balance sheet normalisation programme by decreasing the reinvestment of principal payments it receives from securities held starting next month. The interest rate hike and the Federal Reserve's balance sheet normalisation programme would seem to suggest that the quantitative easing era in the US has come to an end.

Fischer's early exit will leave four out of seven Federal Reserve Board seats vacant and lowers the chance of Yellen, who also favours a gradual tightening of monetary policy to maintain financial system stability, staying at the Fed for a second term after the end of her current term in February 2018. So far, Randal Quarles, head of The Cynosure Group and a former partner at the Carlyle Group, a private equity firm, has been nominated by President Trump as the Fed's new vice-chair for supervision, responsible for overseeing the operation of financial institutions in the economy.

In the European Union, the 2 trillion euros put into the market through asset purchase programmes has provided a stimulant for the region. It helped it achieve its highest economic growth since Q2-2011, at 2.4% in Q2-2017 (Figure 1), and stimulated the financial market as evident from a distinct decline in bond yields from 1.9% in January 2014 to 0.4% in August 2017. However, the quantitative easing has yet to stimulate price levels as inflation was only 1.5% in August 2017, well below the 2% target (Figure 1). To maintain positive growth development in the European Union economy and achieve its 2% inflation target, it is highly likely that the European Central Bank will wind down its asset purchase programme in 2018, having already assured the market that the current measures will continue throughout 2017. Similarly, the Bank of England has signalled its intention to increase short-term rates this year to dial down the higher inflation risks in the economy.

Figure 1. European Union–28: Economic Growth and Inflation Rate (%)



Source: Eurostat, 2017.

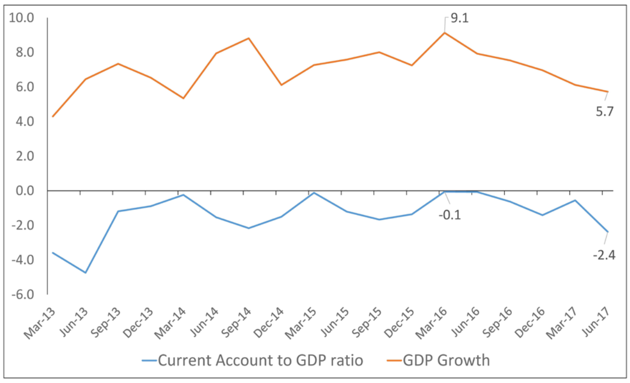
INDIA

Prime Minister Modi's government faces three main challenges as it enters the final stretch of its first term, with economic growth having declined for 5 quarters in a row and its current account deficit to GDP ratio at its highest for 4 years (Figure 2). First, India is currently facing difficulties in maintaining its economic growth momentum and providing employment for its people despite attempts at economic reform that so far have failed to deliver the desired results. Second, demonetisation has not been able to eliminate black money from the economy as 99% of the demonetised money value was legally exchanged into banknotes. Third, the Goods and Services Tax, which has only recently entered into force and is expected to result in a significant improvement in the ease of doing business in India, has the potential to make it harder for poorer states to lure investors due to their loss of fiscal autonomy.

Further, India's US$154 billion information and technology (IT) industry, which currently employs 3.9 million people, is also facing a host of problems in 2017. First, economic and political factors ranging from tighter rules for work permits in the US, Singapore, Australia, New Zealand, and the United Kingdom have reduced the access for Indians to work overseas. Second, a strong rupee and weak IT spending in retail, banking, and the financial services sector have dampened the revenue of the IT sector. Third, automation and digitisation are changing job descriptions across the IT sector, resulting in jobs disappearing and creating an urgent need for worker retraining programmes.

Moving on, the government should come up with a new strategy to boost growth in order to maintain economic growth and employment levels. From the macroeconomic policy perspective, there needs to be a balance between increasing public investment on infrastructure and public services, on the one hand, and keeping the fiscal deficit under control, on the other. From a structural changes perspective, although structural change is a painful and a long process, the government should persevere with privatisation and unilateral reform of trade and investment facilitation to improve India's competitiveness.

Figure 2. India's Current Account to GDP ratio and GDP growth (%)

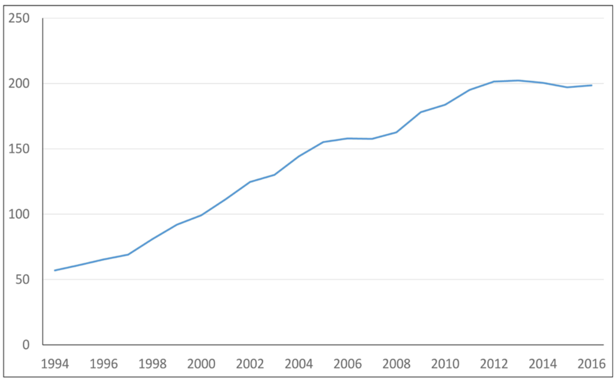


Source: Reserve Bank of India, 2017.

JAPAN

Japan's GDP grew by 1.4% in Q2-2017 on the back of healthy private and public consumption but weak private investment. This is a positive development as Japan's economy has now expanded for 9 successive quarters. This can be seen as a signal that Abenomics, a set of economic policies that have been applied by Prime Minister Shinzo Abe since December 2012, seems to be working relatively well. From the monetary easing point of view, the ability of the Bank of Japan to maintain low interest rates means low payments to service government debt, which has allowed Japan to maintain central government debt of 200% of GDP for 2 decades without suffering any of the crises that had been predicted by many economists (Figure 3).

Figure 3. Japan's Central Government Debt to GDP Ratio (%)



Source: Ministry of Finance, Japan, 2017.

REPUBLIC OF KOREA

Delicate situation in relation to the US on trade issues amidst provocations by North Korea

In the midst of North Korea's provocations, President Trump's announcement that he will review the US–Korea Free Trade Agreement has driven a wedge between the US and the Republic of Korea. While the administration has reiterated its ironclad commitment to maintaining security in the region, Trump's determination to review or even withdraw from the deal has brought advantages neither to the Republic of Korea nor the US.

Samsung is expected to continue to perform well even though its CEO is behind bars

Lee Jae-yong, the Samsung heir, was sentenced to 5 years in prison for bribery and corruption, which also contributed to the impeachment of former President Park Geun-hye. Nevertheless, Samsung Electronics reported a record-high operating profit of ₩14.1 trillion in Q2 2017 in his absence, and is expected to remain strong in the short run with the company currently run by professional managers. However, longer-term risk remains as the current top management is likely to be hesitant to take large-scale risks with mergers and acquisitions and other kinds of large investments.

SOUTHEAST ASIA

At this year's ASEAN Economic Ministers' (AEM) Meeting held from 7 to 11 September 2017 in Manila, the ministers reaffirmed ASEAN's commitment to open regionalism in spite of uncertainties regarding the global economic recovery and policy and rising protectionist trends. First, the ministers welcomed the finalisation of the paper on 'RCEP Key Elements for Significant Outcomes by End of 2017', which outlines the realistically achievable negotiating areas that can be accomplished by the end of 2017. Second, the ministers noted the status of negotiation for further trade and investment liberalisation with existing partners, i.e. the ASEAN–Korea Trade in Goods Agreement, the investment agreement under the ASEAN–Japan Comprehensive Economic Partnership Agreement, and conclusion of negotiations on the ASEAN–Hong Kong Free Trade Agreement and the ASEAN-Hong Kong Investment Agreement. Third, the ministers noted ASEAN's continued collaboration with its non-free trade agreement dialogue partners by welcoming the launch of the US–ASEAN Connect framework in the area of energy, innovation, policy, and business and the establishment of the US–ASEAN Connect Center in Jakarta, endorsing the ASEAN–Russia Trade and Investment Cooperation Roadmap, and endorsing the Terms of Reference for a Joint Feasibility Study on a ASEAN–Canada Free Trade Agreement. Furthermore, ASEAN will continue its efforts to improve transparency of non-tariff measures (NTMs).

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