

ECONOMICS: ASIAN PERSPECTIVES—JANUARY 6, 2012

Asia Outlook: Cyclical Downturn in Growth and Inflation to Bring More Policy Easing

■ **Anthony Chan**
 Asian Sovereign Strategist—Global Economic Research

We expect a further slowdown in growth and inflation across the region this year, but see few signs of collapse. High savings and investment rates, functional banking systems and the absence of excessive financial leveraging are favorable factors that will help underpin growth, in our view.

Risk of Collapse Seems Remote

Asia's growth and inflation cycles peaked in 2011 and we expect to see a further cyclical slowdown of both trends across the region in 2012. Despite fears of an outright recession in Europe, recent trends across Asia show few signs of a collapse in growth. With our global economic team still expecting a pickup in US growth to around 3% this year and emerging economies to expand at a respectable 5.2%, the risk of Asia experiencing the kind of economic contraction seen in 2008–2009 remains remote. Indeed, Asia's high saving and investment rates, together with banking systems that continue to function normally and the absence of excessive financial leveraging, are favorable factors that will underpin the region's

Display 1
 Slower Growth and Tamer Inflation

GDP and Inflation Forecasts						
(% Change)	GDP Growth			Inflation		
	2010	2011F	2012F	2010	2011F	2012F
China	10.3	9.3	8.3	3.3	5.5	3.2
Hong Kong	6.8	5.1	3.6	2.4	5.3	4.2
India	8.6	7.5	6.8	9.4	9.5	6.5
Indonesia	6.1	6.4	5.1	5.1	5.4	3.6
Korea	6.1	3.6	3.0	3.1	4.3	3.0
Malaysia	7.2	5.2	4.0	1.7	3.2	2.5
Philippines	7.3	3.4	3.0	3.8	4.6	3.0
Singapore	14.5	4.9	3.2	2.8	5.2	3.0
Taiwan	10.8	4.3	3.2	1.0	1.4	1.0
Thailand	7.8	1.5	4.0	3.3	3.9	3.5
Asia Total	9.2	7.5	6.7	4.1	5.7	3.6
Asia Total (ex China & India)	7.7	4.4	3.7	3.1	4.2	3.0

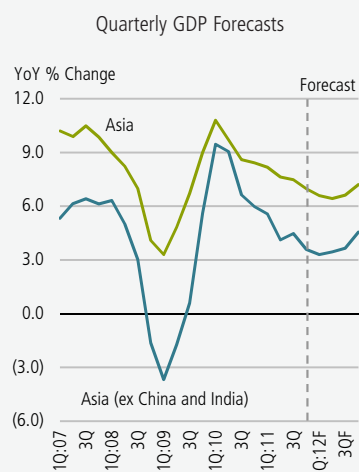
As of January 4, 2012
 Source: CEIC Data and AllianceBernstein forecasts

growth (**Displays 1 and 2, next page**).

Barring another oil price shock or a drastic rebound in global commodity prices, the downturn in Asia's inflation is a near certainty. China has demonstrated that the cyclical downturn in its inflation can be as dramatic as the upturn; Indonesia's structural disinflation has continued to surprise even the most bullish forecasters; and even India's sticky inflation trend has peaked and is likely to decelerate more

markedly in the coming quarter or two. Policymakers are acting accordingly. Indonesia and Thailand have already cut their respective policy rates, China has shifted to monetary easing with a 50 basis point cut in the reserve requirement ratio (RRR) and the Philippines' central bank turned dovish in its December policy meeting and hinted at a possible rate cut in first quarter 2012. As the growth and inflation mix becomes even more favorable to policy relaxation in the coming few

Display 2
Growth to Level Out in Second Half 2012



Data through fourth quarter 2012
Source: CEIC Data and AllianceBernstein forecasts

Display 3
Rate Easing Across Asia

Country	Policy Rates	January 4, 2012	Forecast	
		(Percent)	Next 6 Months	Next 12 Months
China	1-Year Working Capital Loan	6.56	6.31	6.06
Hong Kong	Base Rate	0.50	0.50	0.50
India	Overnight Repo Rate	8.50	8.25	7.75
Indonesia	1-Month SBI Rate	6.00	5.50	5.50
Korea	1-Week Repo Rate	3.25	3.00	2.75
Malaysia	Overnight Policy Rate	3.00	2.50	2.50
Philippines	Reverse Repo Rate	4.50	4.00	3.75
Taiwan	Official Discount Rate	1.88	1.63	1.38
Thailand	Overnight Repo Rate	3.25	2.75	2.50

As of January 4, 2012
Source: Bloomberg, CEIC Data and AllianceBernstein forecasts

months, we expect the interest-rate easing trend to spread to the rest of the region during first half 2012 (**Display 3**).

Key Points to Watch

With inflation becoming less of a policy concern in China, we expect the People's Bank of China (PBOC) to start cutting the policy rate by late in the first quarter or early in the second, and to also reduce the RRR by a further 200 to 300 basis points in the next six months. We think, too, that tax incentives to stimulate household consumption (for example, the purchase of motor vehicles and appliances) could be reintroduced in coming years. Such fiscal stimulation, if implemented, would be a more sensible way of boosting aggregate demand than directly increasing investment, as happened in 2008.

Equally importantly, we expect that policy relaxation in the property market will significantly lift sentiment towards China in 2012. If the drastic contraction in sales volume continues and results in a meaningful correction in real estate prices (say, an average 15%–20% decline from the peaks in major cities), the tight sector-specific measures now in place should start to be relaxed in the spring.

Also, the renminbi's recent gains against the US dollar reinforce our long-held belief that the Chinese currency will resume its structural appreciation trend. We look for the RMB to appreciate at around 2%–4% a year against the greenback—a rate which, in our opinion, would not be too difficult for Beijing to bear.

India's inflation will start to show a more meaningful slowdown to around 6% year on year by February/March from more than 9% in 2011. We expect this to convince the Reserve Bank of India (RBI) to start trimming interest rates by second quarter 2012. Whereas inflation in China and Indonesia could fall below 4% in the next few quarters, however, the structural bottleneck in India should keep the country's underlying inflation at around 5%–6%. This means that the RBI is likely to ease policy less aggressively than some of its regional peers.

Malaysia may call for an early general election in 2012. Our concern is that the government may boost fiscal spending and exacerbate the already large fiscal shortfall. The perceived risk of more bond issuance could result, in our view, in a steepening in the local yield curve.

Significant Risks

Asia's direct exposure to the European banking system is limited but, if de-leveraging in Europe causes global banks to pull liquidity out of Asia, the downside tail risk for Asian growth will certainly grow. A liquidity crunch that sabotages Asia's trade finance, for example (a repeat of that which took place during the global financial crisis in 2008–2009) would quickly send the region into an outright recession.

The tail risk could also be on the upside should global growth prove to be far more robust and resilient than currently envisaged. That would particularly be the case if, for example, Asia's growth cycle were to bottom out in the first half of 2012 rather than the second half. Under such circumstances, many central banks which have already begun to ease policy would be forced, embarrassingly, to contemplate a policy U-turn. This would be particularly negative for local bond markets, where a further lowering of yields is widely expected. ■

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