

# Asia Pacific Executive Brief March 2010

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**Editor:** Richard Martin ([richard.martin@imaasia.com](mailto:richard.martin@imaasia.com))  
**Regional Economist:** Glenn Levine ([glenn.levine@imaasia.com](mailto:glenn.levine@imaasia.com))  
**Assistant Editor:** Kostas Panagiotou ([research@imaasia.com](mailto:research@imaasia.com))

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## Global outlook

<p><b>Delinking in 2009</b>  ... and diverging in 2010  ... Asia is on a strong upturn  ... while the West faces weak growth at best</p>	<p>The global economy entered 2010 with a surge in growth in Asia, led by China and India, and a weak recovery in advanced economies. As Asia's two big economies effectively delinked from the growth cycle in the West during 2009 the outlook for 2010 has two very different stories. In advanced economies growth will be weak this year with a risk of a double dip recession in some of the major markets, particularly the US. By contrast, growth is surging in China and India and both face the risk of overheating by mid-2010 unless steps are taken to cool demand. Both also face a spike in inflation in Q2'10 due to demand running well ahead of supply. China's neighbours, from Japan and Korea in the north to Australia in the south, have benefited from the surge in China's demand. So too have countries like Brazil and Euro-based exporters, although the effect is less apparent in US exports. Consequently there is great interest around the world in whether China can cool parts of its market, particularly real estate, without tanking growth as a whole. Our assessment in this month's Asia Brief is that it can. One result will be continuation of the rapid realignment in global markets that started in 2009.</p>
<p><b>Deleveraging will run for 3-6 years in the US</b>  ... with big falls in housing capex  ... &amp; weak consumer growth</p>	<p>The latest Q4'09 estimates indicate that the US economy contracted 2.4% in 2009 and as the economy barely grew in 2008 the real measure of GDP indicates that the US economy was the same size in 2009 as it was in 2006 (in current prices the 2009 economy was roughly the same size as the 2007 economy). By far the biggest factor in the US recession has been an 18.4% plunge in private fixed investment in 2009 with overall fixed investment down 14.8% taking into account a 7% lift in government fixed investment. We expect private fixed investment to contract slightly in 2010 mainly due to continued cuts to housing investment. Consumer spending fell 0.6% in real terms last year following a 0.2% fall in 2008. The outlook for consumer spending, which accounts for an outsized 71% of GDP in 2009, is not good. There is every sign that US households have entered a multi-year deleveraging phase that will run for three to six years and end with personal consumption's share of GDP returning to a more normal 66-68%.</p>
<p><b>RISKS</b>  ... public debt in the West  ... inflation and asset bubbles in Asia</p>	<p>Three major risks confront the global outlook and company operations. By far the biggest of the three is a surge in public debt in the advanced economies. This is already creating instability in the Euro area. Over the medium-term it will be a major drag on growth in Europe, Japan and the US. It is also likely to force abrupt changes to tax and public spending, which politicians in advanced economies have been too slow to acknowledge. Japan's mountain of public debt (gross over 220% of GDP and net over 100%) is particularly worrying. The other two risks lie in Asia. The first is a spike in inflation in Q2'10 as Asia's fast take off has created shortages from commodities through components to skilled labour. The second is a surge of capital into Asia seeking speculative and long-term growth opportunities. Asia managed this badly the last time around, which led to the 1997 Asia Crisis. Whether it will do better this time is unclear.</p>
<p><b>Currency realignment</b>  ... waiting for the Yuan to rise</p>	<p>We expect China to restart appreciation of its Yuan on the US\$ in Q2'10 as one of several measures to dampen inflation. With the Yuan moving up central banks around Asia are likely to allow a gradual appreciation in its wake to help curb inflation while also protecting export growth (increasingly driven by China). As we expect mild US\$ strength to continue through most of 2010 the major winner – in terms of export competitiveness – will be the Euro.</p>

IMA Asia's forecasts	2007	2008	2009	2010	2011
World – Real GDP growth, %	5.2	3.0	-0.8	3.9	4.3
- US	2.1	0.4	-2.4	2.2	2.8
- Euro area	2.7	0.6	-3.9	1.3	1.8
- Asia/Pacific (14)	6.0	2.8	0.7	5.2	5.4
- NICs (4)	5.8	1.8	-0.8	5.4	5.5
- Developing Asia (7)	11.1	8.0	6.8	8.6	8.4
- ASEAN (5)	6.2	4.6	1.4	5.3	5.6
World goods & services trade volume, % growth	7.3	3.0	-10.0	5.8	7.0
Interest rates, US Fed target rate, year end, %	4.25	0.25	0.25	1.00	2.50
Inflation, CPI, US, year avg., %	2.9	3.8	-0.3	1.7	1.8
Inflation, CPI, Euro area, %	2.1	3.3	0.3	0.8	1.5
Crude oil, avg of 3 spot crudes, US\$	71	97	62	80	88
US\$ / Euro 1, year average rate	1.37	1.47	1.39	1.37	1.34
Yen / US\$1, year average rate	118	103	94	98	102

The Asia/Pacific 14 = the countries on the forecast summary page. NICs are the newly industrialised countries = Korea, Taiwan, HK, Singapore. The ASEAN 5 = Indonesia, Thailand, Malaysia, Philippines and Vietnam. Developing Asia = Asean 5 + China and India. IMA Asia forecasts.

Richard Martin, IMA Asia ♦ Email: [richard.martin@imaasia.com](mailto:richard.martin@imaasia.com)

## Regional outlook

### Summary of forecasts in this month's Asia Brief

<b>GDP (Expenditure), real growth, %</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Japan	2.4	-1.2	-5.2	1.6	1.2
China	13.0	9.6	8.7	9.7	9.4
Hong Kong	6.4	2.1	-2.7	5.0	5.8
Taiwan	6.0	0.7	-1.9	4.8	4.7
South Korea	5.1	2.2	0.2	5.8	5.8
Indonesia	6.3	6.0	4.5	6.0	6.4
Malaysia	6.2	4.6	-1.7	4.5	5.0
Philippines	7.1	3.8	0.9	5.1	5.2
Singapore	8.2	1.4	-2.0	5.5	6.0
Thailand	4.9	2.5	-2.3	4.4	4.5
Vietnam	8.4	6.2	5.3	6.1	6.5
India (CY)	9.9	6.3	5.7	7.9	7.2
Australia	4.9	2.2	0.3	2.8	3.7
New Zealand	3.1	-0.7	-1.0	3.1	3.1

<b>Inflation, CPI year average, %</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Japan	0.0	1.4	-1.4	-0.3	-0.2
China	4.8	5.9	-0.7	4.5	4.0
Hong Kong (composite CPI)	2.0	4.3	0.6	2.0	3.5
Taiwan	1.8	3.5	-0.9	2.5	1.8
South Korea	2.5	4.7	2.8	3.5	3.8
Indonesia	6.4	9.8	4.8	6.0	6.5
Malaysia	2.0	5.4	0.6	2.0	3.0
Philippines	2.8	9.3	3.3	5.5	5.0
Singapore	2.1	6.5	0.2	2.5	1.9
Thailand	2.2	5.4	-0.9	3.0	3.5
Vietnam	8.5	23.1	6.7	11.0	9.0
India (CY CPI urban non-manual workers)	6.5	7.7	11.7	15.0	9.0
Australia	2.3	4.4	0.6	2.0	2.5
New Zealand	2.4	4.0	2.1	1.8	1.8

<b>Exchange rate to US\$1, year avg.</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Japan	118	103	94	98	102
China	7.61	6.95	6.83	6.50	6.20
Hong Kong	7.80	7.79	7.75	7.75	7.75
Taiwan	32.8	31.5	33.1	30.9	30.1
South Korea	929	1,100	1,277	1,150	1,095
Indonesia	9,164	9,757	10,356	9,500	9,135
Malaysia	3.43	3.34	3.52	3.39	3.29
Philippines	46.1	44.5	47.6	46.7	45.8
Singapore	1.51	1.41	1.45	1.45	1.43
Thailand	32.2	33.0	34.3	32.7	32.0
Vietnam	16,063	16,506	17,860	19,626	21,333
India (FY)	41.2	43.8	48.3	46.9	46.0
Australia	1.19	1.20	1.27	1.10	1.07
New Zealand	1.36	1.43	1.60	1.45	1.38

Sources: CEIC, central banks, and national statistics offices. Forecasts are by country directors and IMA Asia.

## Regional outlook

### Political & policy issues to watch

**Political risk** While Asia sailed through the global financial crisis without a rise in political risk companies will need to watch three of the 14 countries in the Asia Brief for higher risk this year. The risk in Thailand is imminent and substantial, with massive pro-Thaksin street demonstrations expected in mid-March. The long-term political outlook is also very uncertain, which is undermining investment and growth. A milder rise in political risk accompanies the May elections in the Philippines, with an uncertain electoral process and little to guarantee a stable or competent government. Japan's political system is also under strain with governments likely to be short-lived and the potential for fragmentation of the main parties.

#### Watch

- Thailand
- Philippines
- Japan

#### Asia's strong fiscal position

##### ... will pay off in 2010

Asia exited the 2009 global recession with governments in good fiscal shape, with the notable exception of Japan. Some governments (see the HK page) have even reported unexpectedly good revenue growth. As a result, Asia ex-Japan should have no trouble maintaining a fiscal stimulus this year and could lift public spending if required. With the exception of Japan, which is being threatened with a downgrade, Asia's sovereign risk ratings have remained stable, which will underpin stability and investment in 2010.

#### Big budgets in China & India

##### ... underpin growth and stability

Critically for Asia's 2010 growth and stability the fiscal outlook in China and India is good. China aims to curb its fiscal stimulus this year, with spending growth set to fall to 11% from 21% last year, which should leave a budget shortfall of 2.8%. India's 2010/11 budget delivered on two critical elements: a plan to rein in the deficit and continued investment in infrastructure. The government is relying on strong nominal GDP growth to rein in the budget deficit, which looks likely to work.

### Outlook for the market

#### 2010 starts with a bang in Asia

Much of Asia reported exceptionally strong year-on-year growth in Q4'09 due to a surge in demand from China, inventory rebuilding, stimulus spending and a low base in Q4'08 GDP. An equally big jump in growth is likely to be reported for Q1'10 for similar reasons with many of our clients reporting very strong sales through to early March. Our 2010 forecast for the region remains at 5.3% with upside potential from 0.8% growth last year.

#### Demand from China is lifting the region

While Asia's 2010 recovery is broad-based import demand from China is playing a prominent role in lifting the region. China-bound exports are the main factor lifting Japan out of recession. Korea, Taiwan, Hong Kong, and Australia are also major beneficiaries with the lift in export demand extending as far as India. It is demand from China that will help other Asian governments trim their own stimulus spending this year.

#### Local demand is also rising

##### ... from consumers

The lift in Asia's consumer confidence indices over the last six months has been stronger than in any other region, which reflects not just faster GDP growth but also strong stock market rebounds and rising home prices. This should allow governments to end various fiscal supports for consumer spending without a significant drop in retail sales. Falling unemployment and stronger wage growth should lift consumer spending in 2H'10.

##### ... & investors

Fixed investment could boom across Asia in 2010. In fact with money flooding into the region and local investors aggressively expanding their operations Asian governments may have to cut their own capital spending plans, ramped up during the 2009 world recession, sooner than expected.

#### Watch for a spike in inflation

##### ... bringing higher rates

Asia faces a short but sharp bout of inflation through mid-2010 as demand is recovering much faster than expected and shortages of labour, materials, and services like container shipping have emerged in Q1'10. However with the exception of India and Vietnam we don't expect double digit inflation. Asia's central banks will, however, have to lift their policy rates from near record lows in the next few months. Bank Negara is the first of Asia's central banks to follow Australia's lead in lifting interest rates. Others will have to move soon.

#### The Yuan will lead Asia's currencies up

We continue to expect China to restart Yuan appreciation in Q2'10 as one of several measures to curb inflation. Zhou Xiaochuan, governor of the People's Bank of China, has recently hinted as much. This will also pave the way for other Asian exporters to allow their currencies to rise without fear of undermining export competitiveness.

## Japan

### Political & policy issues to watch

#### July upper house polls

##### ... the risk of gridlock and fragmentation

Japan faces a collapse in policy effectiveness as PM Hatoyama's DPJ-led government, which ousted the LDP from power last year, confronts a slide in popular support and a slow building but still massive fiscal crisis. In the upper house elections this July Hatoyama had hoped his DPJ would win enough seats to do without the support of minor parties, which have stalled and confused policy. But with popular support at 37% and falling (from 71% last September) Hatoyama's coalition could lose its upper house majority. If the opposition LDP wins back control of the upper house with help from minor parties it would block DPJ policies. Some fragmentation of both major parties also seems likely this year.

#### Nearly all policies will be driven by public debt

##### ... cuts to public services

##### ... and lifting the GST from 5% towards 10%

Virtually all policy in Japan over the next decade will turn on the management of public debt, with net debt over 100% of GDP this year and gross debt over 220%. The government has dropped plans to achieve a primary balanced budget by FY2011 in favour of stabilising the debt to GDP ratio by 2015 and starting to cut the ratio after 2020. This likely means a decade of cuts to public investment and to the public wage bill as well as a lift in the consumption tax from its current 5% towards 10% (in many European countries the rate is closer to 20%). PM Hatoyama has promised not to lift the consumption tax for four years but this promise will likely be broken as were promises of increased family spending that helped win him the election six months ago. The government aims to outline its fiscal recovery strategy in June. A crisis is not imminent as 95% of public debt is held locally by acquiescent households and institutions, like the Post Office. Japan's rock-bottom interest rates have also allowed the government to pay just 1.5% interest on its debt, which has kept debt servicing costs down. But global debt rating agencies are now threatening to cut Japan's sovereign rating. If the market doesn't like the fiscal plan in June then Japan could well face a slow but steady rise in the cost of debt.

### Outlook for the market

#### A brief upturn in 2010

##### ... driven by China exports

##### ...and a weak investment lift

Last month we lifted our 2010 GDP forecast from 0.8% to 1.6% as there were signs that the global demand recovery would lift exports and that Japan's own stimulus was producing a weak lift in local demand. The data over the last month confirms both trends. Export growth in January (in Yen terms) jumped to 40.8%yoy from 12%yoy in December. Import growth also lifted for the first time in 15 months, climbing 9.1%yoy. While the imbalance in export and import growth underscores just how weak domestic demand is the resulting jump in the trade surplus will provide a direct boost to the GDP calculation while also encouraging new investment in capacity. On a rolling 12-month basis the trade balance has soared from a deficit of Yen 1.1tr last April to a surplus of Yen 3.8tr for the year to January 2010. This trade recovery was undoubtedly the key, if not the only factor, behind a 0.9% lift in fixed investment in Q4 over Q3'09, the first quarter on quarter growth in investment in seven quarters.

#### The consumer slide should ease as pay edges up

While the medium to long-term outlook for consumer spending is poor a weak recovery is likely this year as both sentiment and wages improve. January saw companies lift salaries for the first time in two years as demand for labour strengthened. The lift was marginal at best and followed a 5.9% drop in total cash earnings in December as winter bonuses were slashed. But overtime hours in January increased 3.4%yoy, the first gain in 18 months. Retail sales rose 2.6%yoy in January, the first rise in 17 months.

#### The long-term outlook is poor

##### ... as deflation undermines the economy

Japan is in a deflation trap and there's little sign that it will escape in the next year; indeed the BOJ expects deflation to continue to 2012. By contrast the government wants an end to deflation this year and is putting pressure on the BOJ to expand its quantitative easing program and to push term lending rates down. The BOJ is edging in this direction but it is already buying Yen 1.8tr in government bonds a month and it is afraid that further quantitative easing may simply be printing money to fund public debt. When quantitative easing accelerates later this year we expect the Yen to weaken.

	2007	2008	2009	2010	2011
GDP, real growth, %	2.4	-1.2	-5.2	1.6	1.2
CPI, year average, %	0.0	1.4	-1.4	-0.3	-0.2
Overnight call rate, year end, %	0.50	0.21	0.10	0.10	0.10
Yen to US\$1, year average	118	103	94	98	102

Sources: 2007-2009 data from the BOJ and government sources; 2010-2011 forecasts by IMA Asia.

## China

### Political & policy issues to watch

#### Aiming for 8% growth

##### ...with central direction of the economy

China aims to achieve 8% GDP growth in 2010 in order to lift incomes, avoid any marked rise in unemployment, and ensure social stability. Three specific challenges will need to be managed this year: cooling a real estate bubble, curbing a spurt in inflation, and restarting currency appreciation without undermining exports. China will aim to achieve these goals mostly through direct commands issued from the top of the party and state hierarchies as well as from the Peoples' Bank of China (PBC, the central bank). President Hu Jintao and Premier Wen Jiabao will be keen to leave a strong and stable economy as they prepare to hand over power to China's next leadership team (the so-called "fifth generation") starting in 2012.

#### Public spending will slow to 11% growth from 21% in 2009

The 2010 budget announced in March cuts growth in spending to 11% from 21% last year. Public works spending, which doubled last year, will be held to a 7.3% rise this year, with most of this focused on completing projects already underway. Few new projects are likely to be launched. Growth in social security spending will be trimmed to 10% from 12% last year while growth in education spending will slow to 14% from 16% in 2009. While the expenditure growth numbers have been trimmed the overall stimulus should still be strong with the budget deficit rising to 2.8% of GDP from 2.1% in 2009 and 0.4% in 2008.

#### Tackling a real estate bubble

##### ... via controls on investors, banks and local governments

The real estate bubble is due to an unhealthy 3-way relationship between local governments desperate for revenue from land deals, massive and poorly controlled lending by state banks (often under the direction of local governments), and speculative investors ranging from state owned enterprises to cash-rich households. One result is insatiable demand for high-end housing that no one lives in, with vacancy rates that can run as high as 30-60% in some regions. A second outcome is spiralling housing costs, which have triggered a wave of criticism across the internet. Over the last few months the government has started restricting bank lending for real estate, instructed local governments to end speculation, and restricted real estate purchases for investment. Activity slowed sharply in February, but it is hard to tell if this is a trend or just the lunar new year's impact.

### Outlook for the market

#### Near 10% growth

##### ... despite cuts to the monetary and fiscal stimulus

We expect China to return to near 10% growth this year even though it aims to pull back on its fiscal and monetary stimulus. China's trade surplus, which helped drive GDP growth over 10% from 2003 to 2007, will gradually diminish as import growth outpaces export growth. This reflects the growing strength of domestic demand (without fiscal and monetary stimulus) and a prolonged pullback in US consumer demand. The trade surplus peaked at US\$297bn in 2008 before falling to \$198bn in 2009. By 2015 we expect it to be around \$50-100bn. With this transition to domestic driven growth we expect slower but more balanced GDP growth in the 7-9% annual range through to 2015.

#### Local demand is surging

China's economy has entered 2010 on a surge in growth, which has given the government room to pull back on its fiscal and monetary stimulus. For the first two months combined imports surged 64%yoy while export growth was a more modest 31% (as a result the trade surplus for the first two months fell 50%). Industrial value added (China's measure for industrial production) for the first two months combined rose 20.7%yoy. Consumer demand is both strong and accelerating. Growth in production for the first two months combined was 85%yoy for cars, 79%yoy for goods vehicles, and 26%yoy for motorbikes.

#### Inflation will spike in mid-year

##### ... the Yuan will start rising in Q2'10

Inflation measured by the CPI jumped to 2.7%yoy in February, close to the 3% limit set by Premier Wen in his NPC presentation at the start of March. A 5.4%yoy jump in the Producer Price Index (PPI) confirms our clients' view that China is at the start of a sharp inflation spike as demand for materials, components and labour exceeds supply. We expect PPI inflation to exceed 10% within a few months and the CPI rate to exceed 5% through mid 2010. We expect China to restart Yuan appreciation at an annual pace of 4-6% in Q2'10 as one of several steps to controlling inflation.

	2007	2008	2009	2010	2011
GDP, real growth, %	13.0	9.6	8.7	9.7	9.4
CPI, year average, %	4.8	5.9	-0.7	4.5	4.0
PBOC 1-year loan, at Dec., %	7.47	5.31	5.31	6.39	7.47
Yuan to US\$1, year average	7.61	6.95	6.83	6.50	6.20

Sources: 2007-2008 data from CEIC and government agencies; 2009-2011 forecasts by IMA Asia.

## Hong Kong

### Political & policy issues to watch

#### A steady fiscal stimulus in 2010

#### ... with scope to lift the stimulus if needed

HK is set for a more expansionary budget in FY2010/11 (starting April 1) than in the fiscal year that finishes in March 2010. Total spending is slated to rise by 8.9% following a fall of 6.8% in Y2009/10. Last year, Financial Secretary John Tsang had expected revenues to collapse and accordingly he pruned expenditure, which drew considerable criticism at the time. However, revenues fell just 2.5% and the 2009/10 budget ended up with a surplus of 0.8% of GDP as revenues rose by HK\$47bn more than expected to \$308bn following strong recoveries in the stock and property markets. This lifted the fiscal reserve to HK\$508bn by March 2010 or 29.6% of GDP, which puts HK in a strong fiscal position. For 2010/11 the government expects revenues to fall by 5.3%, leaving a budget deficit of 1.5% of GDP in place of this year's small surplus. But once again this may be too conservative with the economy likely to do better than the government expects. The budget assumes GDP growth of 4-5% in FY2010/11, which again looks conservative, and inflation of 2.3%.

#### Steps to curb a property bubble

Tsang used the budget to outline plans for curbing a property bubble. Boosted by massive capital inflows, particularly from China, housing prices rose 30% in 2009, with the luxury segment jumping by more than 40%. The government will try to increase the supply of housing by faster approvals for new apartments and increasing the number of urban residential sites for sale by auction or tender over the next two years. Meanwhile, the stamp duty on transactions for property worth over HK\$20m (US\$2.58m) will rise to 4.25% from 3.75%.

#### ... and to boost HK's financial role in China

Tsang also announced steps aimed at capturing a bigger share of China's financial business, which Shanghai dominates, to augment HK's traditional role as a regional financial hub. Yuan trade settlement services, both within and outside HK, will be refined and the Yuan bond business will be developed. The stamp duty on Exchange Trade Funds will be waived to promote the asset management industry.

### Outlook for the market

#### Upside risk to our 5% GDP forecast

HK should have little trouble reaching our forecast of 5% growth in 2010 after a much milder fall of 2.7% in 2009 than we expected a year ago. The risk is on the upside of our 2010 forecast with GDP growth of 6-7% more than possible based on strong China business, a property and construction recovery, and a rebounding finance sector. GDP grew 2.6%yoy in Q4'09 after four consecutive quarterly declines with growth boosted by a 10.9%yoy rise in domestic demand. Domestic demand was lifted by a 14.7%yoy surge in fixed investment (due to public works and a lift in building construction), a massive increase in inventories, and a 4.9%yoy rise in private consumption.

#### ... as growth surges in Q1'10

Measuring the latest trends is tough because of the Chinese new year holiday (in February this year as opposed to January last year). However, many of our clients report very strong demand in January with March sales also tracking ahead of plan. The Purchasing Managers Index (PMI) registered 54.6 in February, well above the 50 expansion/contraction dividing line. PMI components, such as employment and input costs, reached highs for the current expansion. Exports surged 39.5%yoy in January from 18.7%yoy in December. Imports also advanced 18.4%yoy in January from 9.2%yoy in December. The unemployment rate continued to fall, hitting 4.5% in January from 4.7% in December and a recent peak of 5.8% in August.

#### The risk from higher inflation

HK exited a brief period of deflation last September with the CPI index now hovering around 1%yoy growth. Yet inflationary pressure is building. The structure of the HK\$ peg to the US\$ requires HK's interest rates to follow the US's, which could leave the city exposed to a jump in inflation this year. However, the current strength of the US\$ - and thereby the HK\$ - will help to moderate inflation through lower import prices.

	2007	2008	2009	2010	2011
GDP, real growth, %	6.4	2.1	-2.7	5.0	5.8
Composite CPI (04/05), year average, %	2.0	4.3	0.6	2.0	3.5
Discount window base rate, % year end	5.75	0.50	0.50	1.50	3.00
HK\$ to US\$, year average	7.80	7.79	7.75	7.75	7.75

Sources: 2007-2009 from Censtat, HKMA, and CEIC; 2010-2011 by IMA Asia.

Dr Mark Michelson, Chairman Asia CEO Forum (HK)

Tel: (852) 9481 4070 ♦ Email: [mcmichelson@gmail.com](mailto:mcmichelson@gmail.com)

# Taiwan

## Political & policy issues to watch

- Pursuing a trade pact with China** The extent to which Taiwan should improve its relations with China remains the central policy debate in Taiwan. President Ma Ying-jeou won government in March 2008 on the promise of improved commercial ties with China and since then has signed a series of agreements with Beijing to open up cross-straits transport, travel, and (in January) investment in banks and financial services (the rules for which have yet to be released). However, the DPP, the main opposition party, has regained political momentum with a campaign to slow cross straits ties as they argue this will undermine the local economy and weaken Taiwan's independence. Despite this, Ma is pressing ahead with an economic cooperation framework agreement (ECFA) with China, which he hopes to conclude in May or June. The deal could open up significant trade and investment opportunities for Taiwanese companies in the mainland. Foreign direct investment (FDI) from Chinese firms into Taiwan should also increase. Total approved FDI from all sources fell to US\$4.8bn in 2009 from \$8.2bn in 2008 and \$15.4b in 2007. Significant Chinese FDI into Taiwan only started a few months ago with US\$30m reported for both December and January.
- ... Chinese FDI starts to trickle into Taiwan**
- Mid-term blues** The opposition DPP has continued to claw back ground against the ruling KMT party. In by-elections on February 27, the DPP won three of the four seats on offer. This still leaves the KMT with a healthy majority, controlling 75 of the 113 seats in the Legislative Yuan, while the DPP has 33 seats and independents have the remaining five. The DPP now have over a quarter of the seats, which allows them to propose bills including moves to impeach the president or amend the constitution. The next full legislative election is not due until December 2011 or January 2012 while Ma, who is eligible for a second term, doesn't face a presidential contest until March 2012.
- ... the KMT loses a few more by-elections**

## Outlook for the market

- GDP growth surges in Q4'09** Taiwan's economy surged 9.2%yoy in Q4'09 as global demand rose due to worldwide inventory rebuilding and stimulus measures. The Q4'09 surge was led by exports, with the US\$-based trade measure for exports up 16.9%yoy in Q4'09, which included a 41%yoy jump in exports to China/HK. The trade surge continued into 2010 with total exports for the first two months combined up 54%yoy. Industrial production jumped 27%yoy in Q4'09 after four quarters of decline and then soared 70%yoy in January. The industrial production index is now back in line with the historical highs reached in late 2007 and early 2008. The strong rebound in export manufacturing flowed through to domestic demand with private consumption rising 6.3%yoy in Q4'09 and fixed investment climbing 11.1%yoy. We've nudged our 2010 GDP forecast up to 4.8% from 4.5% last month and we may raise it again within a few months.
- ... as China demand led to a surge in exports**
- The threat from weak capex to long-term growth** The Q4'09 surge in fixed investment followed six consecutive quarterly declines. By mid-2009 fixed investment had fallen to just 15% of GDP from 22% prior to the global downturn. This is too low if Taiwan is to preserve its position as an export-manufacturing economy. Manufacturing, particularly at the low-end, will continue to move to China where labour is cheaper. The key question is whether high-end manufacturing will continue to expand in Taiwan.
- Consumer demand is rising** Consumer demand was supported in 2H'09 by government subsidies, including tax waivers on new car purchases, which expired at the end of 2009. It's not yet clear whether this momentum has continued in 2010. Retail sales fell 7.5%yoy in January but this could be LNY-related as well as some consolidation after a very strong Q4'09. Consumer confidence jumped to a four year high in February. This suggests that consumer demand should continue in 2010 even as the stimulus incentives are unwound. The employment outlook should improve throughout the year as export manufacturing comes back on line.
- Inflation and rates head up in 2010** Consumer price inflation hit 2.4%yoy in February from 0.3%yoy in January. To help curb inflation the official interest rate is expected to rise some 100 basis points by year end. This will contribute to mild appreciation for the NT\$.

	2007	2008	2009	2010	2011
GDP, real growth, %	6.0	0.7	-1.9	4.8	4.7
CPI, year average, %	1.8	3.5	-0.9	2.5	1.8
Official discount rate, year end, %	3.38	2.00	1.25	2.25	2.75
NT\$ to US\$1, year average	32.8	31.5	33.1	30.9	30.1

Sources: 2007-2008 government data and CEIC; 2009-2011 forecasts by IMA Asia.

## South Korea

### Political & policy issues to watch

- Lee regains political ground**  
**... as the economy recovers**
- Following a collapse in popularity after taking office two years ago, President Lee Myung-bak is enjoying a political rebound as the economy lifts from recession. Mr Lee has made job creation his main goal this year, aiming to create some 200,000 new jobs compared to annual average job growth of 323,000 for the 2000-07 period followed by a loss of 12,000 jobs in 2008 and 16,000 in 2009. To push through legislation for the jobs program he needs the support of his dysfunctional parliament, although this is becoming easier as the economy improves.
- Watch the June local polls – a key test of support for Lee**
- The June 2 local elections will provide a gauge of President Lee's popularity halfway through his single five year term. A strong showing in June would help him to proceed with his economic reform agenda, which stalled in his first two years because of infighting within his own party, the GNP, and the onset of the global recession. The improving economy will help his chances, although reform will probably slow from 2011 as various factional leaders in the GNP jockey for support ahead of the 2013 presidential election.
- Debate over Sejong delays policy making**
- The February parliamentary session was dominated by discussions about the development of Sejong city. This vast real estate project, which initially included relocating Korea's capital, was bequeathed to Lee by his predecessor. Lee has attempted to scale it down to a more manageable plan for making Sejong a Korean R&D hub but has run into opposition from construction firms committed to the bigger project as well as his political opponents. Lee may call a referendum on the issue before June. Meanwhile, a panel of high level lawmakers has been formed to try to salvage something from the mess. The next parliamentary session begins in April and may again be overshadowed by this issue.

### Outlook for the market

- Exports to drive GDP growth in 2010**
- The export manufacturing sector will drive Korea's 2010 growth. Export growth hit 31%yoy in February with exports to China surging (up 98%yoy in January) and shipments to the US recovering (up 16%yoy in January). The sustainability of this recovery depends largely on what happens in China. At the moment China is buying a lot of Korean capital goods, including ships, and this should continue as long as China powers ahead with their investment-driven recovery. This export strength is mirrored in Korea's industrial production numbers, up 34%yoy in December and 36.9%yoy in January.
- A weak start for consumers to 2010**  
**... but growth should lift as employment rises**
- The outlook in the consumer sector is less clear. Consumer demand surged in Q4'09 with shoppers increasing their end of year spending to take advantage of the car tax concession. But our FMCG clients report a mediocre start to 2010. The unemployment rate jumped to 4.7% in January from 3.2% in December, although this may actually point to stronger consumer demand down the road as it reflects more people returning to the job market looking for work as the big export factories gear up. Our 2010 forecast is for 2.5% real consumer growth compared to headline GDP growth of 5.8%.
- A recovery in construction**
- A rise in stimulus-related public works helped to support the construction sector in 2009. Public construction orders increased 58%yoy in 2009, while private orders fell 22%yoy. Private construction is now recovering, with private orders up 11%yoy in December and the housing market showing signs of life. With the Bank of Korea set to keep interest rates low we could see a solid rise in private construction activity this year.
- Sticking with low interest rates**  
**... but rates will rise soon, as will the Won**
- The Bank of Korea (BOK) held off a rate hike in Q1'10 even as the economy rebounded. While inflation has been stable around the 2.7%yoy reading for February, a key factor behind the lack of action appears to have been government pressure to keep rates low. A new BOK governor will be named shortly and will have to work out whether he can push a rate hike through before the June local elections. We've revised our year end rate target to 2.75% from the current record low of 2%. We expect a gradual Won appreciation to continue through 2010 as the economy recovers.

	2007	2008	2009	2010	2011
GDP growth, %	5.1	2.2	0.2	5.8	5.8
CPI, year average, %	2.5	4.7	2.8	3.5	3.8
BOK Overnight call rate, year end, %	5.00	3.00	2.00	2.75	3.25
Won to US\$1, year average	929	1,100	1,277	1,150	1,095

Sources: 2007-2008 government data (NSO, BOK) and CEIC; 2009-2011 forecasts by IMA Asia.

## Indonesia

### Political & policy issues to watch

- The Bank Century case wraps up**  
... leaving a stronger government  
... while weakening SBY's opponents
- A cabinet shakeup and possibly the restructuring of President Yudhoyono's coalition government loom in the wake of parliament's failure to impeach Finance Minister Sri Mulyani or Vice President Boediono over the bailout of Bank Century in 2008 (Boediono was at that time head of the central bank). None of the official legal and prosecutorial agencies, including the anti-corruption commission (KPK), the AGO or the anti-money laundering agency (PPATK), have found anything implicating the finance minister or the VP in corrupt activity. The blow back from parliament's impeachment effort must now be expected. The various investigations revealed Mulyani and Boediono to be hard working reformers who garnered growing public support as the case progressed. By contrast, the MPs who pushed the case were revealed to be political opportunists. Supporters of President Yudhoyono ("SBY") are now expected to seek retribution by expanding tax investigations into businesses affiliated with Golkar chairman Aburizal Bakrie and pushing for quick progress on criminal charges filed against M. Misbakhun, the ranking PKS MP who led the push against the Bank Century bailout. Both PKS and Golkar are members of the governing coalition yet many now question whether they should keep their cabinet seats or remain in the coalition. Meanwhile Prabowo Subianto's Gerindra is growing more responsive to overtures from SBY. There is a chance Gerindra will tone down its criticism of the Bank Century bailout, which could provide the foundation for it to join the coalition.
- Rio Tinto wins approval under the new mining law**
- In early February the government released two new regulations governing the controversial 2008 mining law, which most analysts see as a major barrier to foreign investment in mining. However, the new rules have allowed Rio Tinto to become the first foreign company to win approval under the new law.

### Outlook for the market

- Economic growth accelerates in early 2010**  
... driven by commodities and consumers
- Indonesia's economy is accelerating at the start of 2010. January cement sales jumped 13%yoy, underscoring the expansion in construction activity and the recovery in property loans. The fact that cement sales outside Java rose 16%yoy (compared to 11% in Java) highlights the strength of rural, commodity-driven economic centers in the outer islands. With exports surging 59%yoy in January on the back of renewed global demand for commodities led by China, many consumers will have more money in their pockets to spend. Coupled with Bank Indonesia's strategy to push credit growth by keeping interest rates low, this is a boon for consumer spending and helped push vehicle sales up 67%yoy in January to a new monthly record.
- Indonesia's firms gear up for strong growth**  
... with strong demand for bonds
- The burst of corporate bond deals in January, totalling US\$870m (the largest month in a decade), highlights the plans by businesses to expand their operations in anticipation of stronger growth. State power utility PLN, private power company Star Energy, petrochemical firm Chandra Asri and the financial units of Astra Sedaya Finance and BCA Finance have already tapped the market. Pending issues include PLN again (a possible US\$2bn global bond), state oil and gas firm Pertamina (\$1.5bn), telecommunications leader Telkom (\$100m), infrastructure holding Bakrie & Brothers (\$200m), Bank Mandiri (\$300m), Bank Negara Indonesia (\$300-400m) and Bank CIMB Niaga (\$100m).
- A strong currency will help cap inflation**  
...fiscal risk is also contained
- Inflation and fiscal stability will be issues to watch as the year progresses. Inflation accelerated to a 9-month high of 3.8%yoy in February and higher oil and food prices have just forced the government to spend an extra US\$4.7bn in subsidies this year, which will push the 2010 budget deficit out to 2.2% of GDP from the initial target of 1.6%. However, with the rupiah climbing to Rp9,365 to US\$1 for January (from Rp11,355 a year ago) and foreign buying of government bonds at a record high of Rp119 trillion as of mid-February, both inflation and the fiscal deficit look manageable.

	2007	2008	2009	2010	2011
GDP, real growth, %	6.3	6.0	4.5	6.0	6.4
CPI, year average, (2007=100), %	6.4	9.8	4.8	6.0	6.5
REF: CPI inflation using Dec on Dec, %	6.6	11.1	2.8	6.0	6.5
Interest rate (30-day SBI), at Dec., %	8.00	9.25	6.50	8.00	8.50
Rupiah to US\$1, year average	9,164	9,757	10,356	9,500	9,135

Sources: 2007-2008 government data (BPS, BI) and CEIC; 2009-2011 forecasts IMA Asia on guidance from CastleAsia.

James Castle and Andri Manuwoto, CastleAsia, PT Jasa Cita

Tel: (62 21) 572 7321 ♦ Fax: (62 21) 572 7329 ♦ Email: [castle@castleasia.com](mailto:castle@castleasia.com)

## Malaysia

### Political & policy issues to watch

- PM Najib's goals**  
**... rebuilding support for UMNO**  
**... a new model for development**
- PM Najib Razak faces two challenges: rebuilding support for the UMNO-led coalition that has ruled Malaysia since independence; and reversing a slide in investment that is undermining growth. The two challenges are related. The political challenge is being handled on two fronts. High-profile opposition leader Anwar Ibrahim has been charged (for a second time) with sodomy and UMNO must hope that the court case currently underway will undermine his credibility or see him jailed. On a second front, PM Najib plans to announce a new national development plan at the end of March to replace the discredited New Economic Program (NEP), which did much to foster corruption in UMNO and to deter investment. Thus the link between Najib's political and economic challenges.
- The challenge of falling investment**  
**... particularly in manufacturing**
- PM Najib's new economic blueprint – the "New Economic Model" (NEM) – will hopefully start to unwind decades of discrimination under the NEP against Malaysians of Chinese and Indian descent as well as foreign investors. While the NEP deterred investment, the massive net direct investment outflow reported between Q3'07 and Q3'09 (M\$51bn or US\$15bn) had more to do with the overseas expansion of "government linked companies" (GLCs), the most notable of which is national oil company Petronas. This appears to have irritated the government and might have been a factor in a recent and unexpected leadership change at Petronas. However, by sector the biggest concern is a collapse in investment approvals for manufacturing, which suggests that one of Malaysia's two engines of wealth creation is faltering (the other engine being oil and gas revenues).
- Cutting the fuel subsidy**  
**... & imposing a 4% GST**
- Najib has also launched reforms to fiscal policy, central to which is a cut in the use of fuel subsidies and the imposition of a goods and services tax (GST) at a 4% rate in 2011 in an effort to lower reliance on oil and gas revenues (currently 40% of all public revenues). However, the latest proposals for a new fuel subsidy program have just been deemed impractical. The government hopes to come up with a more practical way to cut fuel subsidies before the October budget.

### Outlook for the market

- Rising global demand lifts Malaysia's export driven economy**
- Despite the political challenges outlined above we've raised our 2010 GDP forecast from 4% to 4.5% as the global recovery lifts demand for Malaysia's commodity and manufactured exports. GDP fell 1.7% in 2009, although growth lifted to 4.5%yoy in Q4'09 after three consecutive declines. While a fall of 1.7% for the year as a whole doesn't sound much, the peak to trough decline in GDP was 10.9% (Q3'08 to Q1'09) with fixed investment sliding 18.4%. The upturn in Q4'09 was driven by an 11.5%yoy gain in net exports and an 8.2%yoy lift in fixed investment after four quarters of decline. Private consumption rose 1.7%yoy in Q4'09 while net exports swung to 11.5%yoy growth from a 16.9%yoy decline in Q3'09.
- Export growth surges in early 2010**  
**... car sales also lift**
- Most monthly indicators point to a strong lift in economic activity in recent months. Growth in industrial production accelerated to 8.9%yoy in December from -0.8%yoy in November. The value of manufacturing sales increased 16.2%yoy in December, after thirteen successive declines. Exports surged 37.1%yoy in January from 18.7%yoy in December. Imports also increased 31%yoy in January from 23.3%yoy in December. Passenger car sales, which have been growing in double digits since October, expanded 32.8%yoy in January. Malaysia's leading index reached a new high for the current expansion of 173.1 in December from a recent low of 156.6 in December 2008.
- Interest rates are rising**  
**... & so is the M\$**
- In early March Bank Negara (BN, the central bank) became the first Asian central bank to raise interest rates with a hike in its policy rate to 2.25% from 2%. The move reflects BN's judgement that a recovery is now underway and the deflation of 2009 is over. We expect a gradual lifting of rates over the course of this year. Boosted by positive developments in the economy, the M\$ has been on gradual upswing against the US\$. It is currently trading at 3.33, up 12.2% from its year-ago low.

	2007	2008	2009	2010	2011
GDP, real growth, %	6.2	4.6	-1.7	4.5	5.0
CPI, year average (2000=100), %	2.0	5.4	0.6	2.0	3.0
Central bank overnight policy rate, Dec, %	3.50	3.25	2.00	3.00	3.50
Ringgit to US\$1, year average	3.43	3.34	3.52	3.39	3.29

Sources: 2007-2008 government and Bank Negara data plus CEIC; 2009-2011 forecasts by IMA Asia.

## Philippines

### Political & policy issues to watch

**The May elections** The May 2010 presidential poll is shaping up as a two horse race. Senator Benigno "Noy" Aquino still leads in opinion polls but businessman-cum-lawmaker Senator Manuel "Manny" Villar is spending his way into contention with a big TV campaign. The two outsiders are Joseph Estrada, who was forced from office in 2001 by a popular uprising, and the administration's candidate Gilberto Teodoro. Estrada, who is unlikely to win, could emerge as a king-maker if his support proves decisive to one of the two leading candidates. Senator Aquino is running on an anti-graft platform in the mould of his mother, former President Cory Aquino. Senator Villar is running on an anti-poverty program. Both are pro-business. The best chance for stability and continuity is a clear victor. None of the main candidates are noted reformers so continued weak reform is the best that can be expected. With new and untested voting machines to be used there is also a risk of an electoral failure with a period of uncertainty after the poll.

**... Aquino Vs. Villar**

**... pray for a quick and clear result**

### RISK in 2010

**... fiscal reform to keep bond holders happy**

While none of the candidates has a comprehensive platform, whoever wins in May will have to give priority to outlining a fiscal recovery strategy. The 2009 budget deficit blew out to a record Peso 299bn (US\$6.5bn or 3.9% of GDP) and the 2010 deficit could well be bigger as the government's infrastructure spending hits full speed and most of last year's tax breaks are kept in place. Tax collections dropped to 12.8% of GDP last year so priority will have to be given to lifting tax rates or imposing new taxes. If nothing is done, international bond holders will become nervous about repayment, putting the Peso under pressure. Plans to keep the deficit below Peso 293bn (US\$6.4bn or 3.5% of GDP) are also hostage to any pre-election spending commitments.

### Outlook for the market

**GDP growth lifts over 5% in 2010**

**... as the global recovery lifts demand for offshore workers**

We've lifted our Philippines forecast by a whole percentage point this month as we expect strong growth in Asia and a revival in global shipping to boost demand for – and remittances from – offshore Filipino workers (OFWs). A rise in export earnings (as much from services as goods) and election-related spending should also help lift 2010 GDP growth to 5.1% this year from 0.9% last year. OFW remittances grew 5.6% in 2009 to US\$17.4bn and although this is down from annual rates of 13-25% in the prior four years, it was much better than the fall of 5-10% that many had expected. As a result, consumer spending grew 3.8% in real terms last year. OFW inflows lifted to 11%yoy in the final two months of 2009 as the global shipping sector recovered, which suggests 2010 is likely to see OFW remittances return to 15%+ growth. This should help consumer spending (an abnormally large 80% of GDP) lift by 4.2% this year and overall GDP lift by 5.1%.

**But a drought will hit rural families**

El Nino has brought drought to the Philippines and will have a negative impact on households largely reliant on farm income. But keep in mind that it is the provinces who supply most of the 9m+ OFWs and their remittances will soften the impact of the drought.

**A brief recovery for manufacturing**

The short-term outlook for manufacturing has improved. Real growth in manufacturing GDP lifted to 1.3%yoy growth in Q4'09 after falling 7.6%yoy through the first three quarters. Exports jumped 24%yoy in December after a fall of 21.9%yoy through the first 11 months. In January export growth accelerated to 42.5%yoy. But there is still a lot of spare capacity in the industrial sector, suggesting little new manufacturing investment in 2010.

**Capex will lift in mining & BPO**

The big gap in the recovery is fixed investment, which fell 1.6%yoy in Q4'09 and by 3.5% for 2009 as a whole. A mild recovery to 4% growth is expected this year, with a focus on the gas and mining sectors as well as business process outsourcing (BPO).

**Rates to rise after May**

With inflation running over 4%yoy since December we expect to see the central bank begin to tighten interest rates after the May elections. Provided the elections produce a stable result the Peso is likely to remain under mild appreciation pressure on the US\$.

	2007	2008	2009	2010	2011
GDP growth, %	7.1	3.8	0.9	5.1	5.2
CPI, annual average, %	2.8	9.3	3.3	5.5	5.0
Central bank overnight loan rate, year end	7.25	7.50	6.00	6.50	7.00
Peso to US\$1, annual average	46.1	44.5	47.6	46.7	45.8

Sources: 2007-2008 BSP data and CEIC; 2009-2011 forecasts by IMA Asia.

**Peter Wallace, Managing Director, The Wallace Business Forum**

Tel: (63 2) 810 9606 ♦ Fax 810 9610 ♦ Email: [wbfplw@smartbro.net](mailto:wbfplw@smartbro.net)

## Singapore

### Political & policy issues to watch

#### A mild fiscal stimulus continues in 2010

Singapore's 2010 budget (year starting April 1) will see a mild fiscal stimulus continue with spending slated to rise by 8.1% although the basic budget deficit will drop to 2.6% of GDP from 3.3% of GDP in FY2009. Last year's deficit turned out a lot smaller than expected, thanks to the earlier and stronger-than-expected recovery of the economy and the property market. With last year's surge in private construction easing the government has lifted development spending by 12% while operating expenditure will rise at a more modest 6.8%. The budget assumes GDP growth of 4.5-6.5% in 2010. There is some speculation that the budget opens the way for an early election, although this has little relevance to the outlook as the ruling PAP's dominance is unlikely to be challenged.

#### Tackling a fall in productivity

##### ... by supporting innovation and training

##### ... & increased charges on cheap migrant labour

Singapore is all about social engineering of scale rarely tried elsewhere. The 2010/11 budget exemplifies this tradition by tackling a slump productivity growth to 1% pa in the last decade from 3% pa in the 1990s and 5% pa in the 1980s. The aim is to lift productivity growth to 2-3% this decade, which would be consistent with average annual GDP growth of 3-5%. The budget allocates S\$1.1bn a year over the next five years in the form of tax benefits, grants, and training subsidies to support productivity growth. Companies can tap this money to support innovation and the introduction of productivity-enhancing work practices. At the same time, the government will raise the levy companies pay for low-paid work permit holders by S\$10-30 per worker. The levy will increase by about S\$100 over the next three years. To make locals more employable, the government will top up the wages of lower-paid Singaporeans by between S\$150 and S\$400 a month, with older workers getting a larger wage subsidy. This scheme will also be extended to workers earning up to S\$1,700 a month from the current S\$1,500 a month.

### Outlook for the market

#### A broad recovery triggers fast growth in 2010

Singapore performed better than expected in 2009, although as a global trade and finance centre its economy was bound to take a knock. GDP expanded 4.1%yoy in Q4'09 from 0.7%yoy in Q3'09, limiting the decline for the whole of 2009 to -2%. However, this masks a steep peak-to-trough decline of 9.6% (Q3'08-Q1'09). Both domestic and external demand helped lift economic activity in Q4'09. Private consumption was up 4.3%yoy from 0.8%yoy in Q3'09, while fixed investment was up 8.3%yoy from 1%yoy in Q3'09. A big boost came from net exports, which surged 114.2%yoy, as exports increased 4.5%yoy and imports fell 1.8%yoy. Being extremely open to international trade and investment flows, Singapore is well placed to benefit disproportionately from the ongoing global economic recovery. Given the improved global outlook, we lift our GDP growth forecasts to 5.5% for 2010 and 6.0% in 2011 from 4.8% and 5.2% respectively.

#### Watch for a jump in visitor arrivals

##### ... which should boost retail sales

The economy started 2010 on a strong note, with trade and production data growing at double digits. Non-oil exports were up 20.8%yoy in January after rising 26.1%yoy in December. Imports surged 29.1%yoy in January from 16.5%yoy in December. Industrial production expanded 39.4%yoy in January from 14.6%yoy in December. Visitor arrivals were up 17.6%yoy in January from 9.4%yoy in December. The Singapore Tourist Board expects tourist arrivals to increase by a massive 20-30% this year, after falling 4.3% in 2009. Tourist revenue is expected to increase 41-50% in 2010, due to the opening of the two integrated resorts (casinos) in the island-state. One opened in mid-February and the other is due to open in April. This should help lift retail sales, which have been weaker than other areas of economic activity in the current recovery. Excluding cars, retail sales have been growing at around 3%yoy in November and December 2009.

#### Little inflation

The CPI moved timidly into positive territory (up 0.2%yoy in January), after spending the previous seven months in mild deflation. A combination of a stronger economy, higher commodity prices and a newly-introduced property tax will lift the inflation rate to 2.5% in 2010 from 0.2% last year. The next monetary policy review is coming up in April, but we see not compelling reasons for the MAS to alter its current "neutral" stance.

	2007	2008	2009	2010	2011
GDP, real growth, %	8.2	1.4	-2.0	5.5	6.0
CPI, year average, %	2.1	6.5	0.2	2.5	1.9
3 month interbank interest rate, Dec, %	2.38	1.00	0.69	1.25	2.25
S\$ to US\$, year average	1.51	1.41	1.45	1.45	1.43

Sources: 2007-2008 government data and CEIC; forecasts for 2009-2011 by IMA Asia.

## Thailand

### Political & policy issues to watch

- The threat from civil unrest**  
 ... contained by a comprehensive response  
 ... and a unified military
- One observation from the start of street protests by the pro-Thaksin “red shirts” is the comprehensiveness of the government’s containment of unrest. In part this reflects a surprisingly unified military with no hint of factional disputes typical of the last five decades. It also reflects a more developed security system and a carefully calibrated response to the protests by PM Abhisit’s government. The Internal Security Act (ISA) has been brought into force, transferring law and order control from the police to the Internal Security Operations Command (Isoc), which is chaired by PM Abhisit. The ISA covers Bangkok, all of Nonthaburi, and 21 other districts until March 23. The cabinet has also placed 17 other laws under Isoc, including laws on disaster prevention, medical emergencies, road traffic, water transport and radio operations. All of this suggests that in the short-term PM Abhisit’s coalition government should ride out the protests. Yet this does little to clarify Thailand’s medium term political outlook, which remains fraught with uncertainties.
- More stimulus spending in 2010**
- Only a quarter of the government’s Baht 193bn (US\$5.9bn) stimulus package has so far been disbursed. The delay has led to some reallocation, with extra funds going to the high-speed train system linking Bangkok and Rayong and a deep seaport in the Gulf of Thailand. With a lot still to be spent, government spending is likely to remain a major driver of growth in 2010. This will push the budget deficit to a peak of 6% of GDP this year but with net public debt still less than 50% of GDP the risk is acceptable.
- Some projects resume in Map Ta Phut**
- The Central Administrative Court has approved the resumption of construction work on seven suspended projects in the Map Ta Phut industrial zone. This could eventually pave the way for work to resume on the other 57 projects that are still on hold following last December’s court ruling, which halted the projects. The ruling has undermined investor confidence and, along with the ongoing political mess, looks likely to deter foreign and domestic fixed investment in 2010.

### Outlook for the market

- Modest 2010 growth**  
 ... driven by the global recovery  
 ... but also held back by local risks
- The Thai economy ended 2009 with a 5.8%yoy surge in GDP following three quarters of falling GDP. The Q4’09 increase was due to a jump in export growth driven by demand from China. In US\$ terms the trade measure of exports grew 11.9%yoy in Q4’09 after falling 20%yoy through the first three quarters. Exports to China alone in Q4’09 jumped 50%yoy. The export surge continued into January with exports up 31%yoy (including an 87%yoy jump in exports to China). The jump in exports lifted the manufacturing production index by 14%yoy in Q4’09 with growth of 28.6%yoy reported for January. The index is now in line with its all time high set in March 2008. Industrial capacity utilisation in January was 60.4%, down from 66-68% in the boom years of 2005-07, and this may slow new investment in capacity in 1H’10. We anticipate 4% real growth in manufacturing output in 2010, which will help to drive a 4.4% GDP expansion this year. Political risk and uncertainty surrounding Map Ta Phut pose significant downside risks.
- A mild consumer upturn in 2010**
- The consumer sector tends to be relatively insulated from the political scene and the mild 1.1% spending fall in 2009 was due to falling manufacturing employment as much as the political malaise. Demand should lift in 2010 as consumer confidence continues to recover. Retail sales increased by 7.8%yoy in December and will be boosted this year by an expected rise in tourist arrivals. The baht is still fairly cheap and the global economy is steadily improving, both of which should lift Thai tourism. Consumer demand is expected to grow 2% in 2010 and 3% in 2011.
- Rates on hold until 2H’10**
- Inflation has risen in recent months with CPI growth at 3.7%yoy in February. Yet the central bank is in no hurry to increase interest rates. We’ve revised our year end interest rate target to 2%.

	2007	2008	2009	2010	2011
GDP, real growth, %	4.9	2.5	-2.3	4.4	4.5
CPI (2002 index), year average, %	2.2	5.4	-0.9	3.0	3.5
Central bank, 14-day repo, year end, %	3.25	2.75	1.25	2.00	3.50
Baht to US\$1, year average	32.2	33.0	34.3	32.7	32.0

Sources: 2007-2008 NESDB, Bank of Thailand, and CEIC; 2009-2011 forecasts by Dataconsult and IMA Asia.

Christopher Bruton, Consultant, Dataconsult Ltd

Tel: (66 2) 233 5606/7 ♦ Fax: (66 2) 236 8143 ♦ Email: [chris@dataconsult.co.th](mailto:chris@dataconsult.co.th)

## Vietnam

### Political & policy issues to watch

**Preparing for the 11<sup>th</sup> Congress in Jan 2011** The 11<sup>th</sup> Congress of Vietnam's Communist Party, due in January 2011, will increasingly influence policy decisions this year. During this event, which is held every five years, the Party elects its 160-member Central Committee and 15-member Politburo and sets broad socioeconomic policy guidelines. The 11<sup>th</sup> Congress is unlikely to challenge Vietnam's pro-market orientation, accompanied by fast-increasing trade and investment links with the world economy. However, a recent crackdown on political dissent may reflect a power struggle between the party's liberal faction, represented by PM Nguyen Tan Dung, and pro-China conservatives, represented by defence and intelligence officials.

**The high growth strategy has risks** PM Nguyen expects the economy to grow 7% in 2010 and 7-8% in 2011 and 2012, while hoping to keep inflation below 7%. However, pushing for faster GDP growth carries with it the risk of growing imbalances. Inflation surged to 8.5%yoy in February from 7.6%yoy in January and a low of 2%yoy last August, while the 12-month rolling trade deficit ballooned to US\$15.8bn from \$6bn last June. Inflation will head higher in the next few months following a 6.8% lift in electricity prices and the steady weakening of the Dong exchange rate, which pushes up import prices.

**Talking with the EU about an FTA** In early March, Vietnam and the European Union (EU) agreed to start negotiations for a Free Trade Agreement (FTA). A successful FTA might help end the EU's anti-dumping duties on Vietnamese footwear, which were extended for another 15 months at the end 2009. The EU is pursuing bilateral trade agreements with each of the 10 ASEAN member countries individually due to the different level of economic development of each country.

### Outlook for the market

**Stronger exports should lift 2010 GDP** After GDP growth fell to 3.1%yoy in Q1'09, the economy steadily recovered to reach 7.7%yoy growth in Q4'09. Exports are critical to the economy's growth rate and the recovery in global growth in 2010 should allow GDP growth to lift to 6.1% this year from 5.3% last year.

**... but 2010 has started with a surprising slump in exports and production** The Tet holiday of the Lunar New Year fell in February this year and in January last year, creating a major distortion in the monthly statistics. To adjust for this distortion, we compared the January-February period with successive two-month periods of 2009. The comparison points to some surprising weakness in key areas at the start of 2010. The growth of industrial production eased to 14.4%yoy in Jan-Feb from 21.8%yoy in Dec-Jan and 21.3%yoy in Nov-Dec. Export growth slipped to just 1.5%yoy in Jan-Feb from 27%yoy in Dec-Jan and 39.6%yoy in Nov-Dec. Despite the cheap Dong, visitor arrivals dropped 35.2%yoy in Jan-Feb, after rising 5.7%yoy in Dec-Jan and 15.9%yoy in Nov-Dec. Actual foreign direct investment (FDI) fell 40.2%yoy in Jan-Feb. It is too early to tell whether the Jan-Feb weakness is the beginning of an extended slowdown or a temporary dip. It is something that we need to watch closely in the coming months. Other indicators, such as imports, experienced a modest slowdown (up 41.5%yoy in Jan-Feb from 53.6%yoy in Dec-Jan), while retail sales continued to expand strongly (up 37%yoy in Jan-Feb from 23.7%yoy growth for full 2009).

**Inflation heads up, forcing rate hikes and a weaker Dong** The central bank kept its policy interest rate steady at 8% in March, but the removal of the cap on lending interest rates announced in late-February represents an effecting monetary tightening as borrowers face higher interest changes. Following two successive devaluations in November and February, the Dong is hovering at 19,110 against the US\$. This is an all-time low and about 11% below its year-ago level. We expect further Dong weakness in the coming months as the authorities seem unable to bring inflation and the trade deficit under control.

	2007	2008	2009	2010	2011
GDP, real growth, %	8.4	6.2	5.3	6.1	6.5
CPI, yoy, % (2005=100 from 2007)	8.5	23.1	6.7	11.0	9.0
Central bank's base rate, year end, %	8.25	8.50	8.00	9.50	10.00
REF: Base rate x 150%, year end, %	12.38	12.75	12.00	14.25	15.00
Dong to US\$1, year average	16,063	16,506	17,860	19,626	21,333

Source: 2007-2008 data from the IMF and CEIC; 2009-2011 forecasts by IMA Asia.

## India

### Political & policy issues to watch

**A good budget for 2010-11**  
**... less stimulus and a lower deficit**

The FY2010/11 budget presented by Finance Minister Pranab Mukherjee has initiated a 'calibrated exit' from last year's stimulus. The Finance Minister expects the deficit to be 6.8% of GDP this year and 5.5% next year based on forecast GDP growth of 8.5%, buoyant tax revenues, and a mere 6% increase in non-capital, non-development spending. While the forecasts are questionable the stock markets have reacted positively and more importantly, so have bond markets. Yields on long term paper have barely risen in the last few weeks, implying market confidence in the government's borrowing programme. Expenditure growth is put at 8.6% in FY2010/11 from 15.6% in FY2009/10.

**Watch for key bills to stall in parliament**

The budget has yet to be passed by parliament, partly because of widespread political opposition to the excise and customs tariff hike on fuels, and partly because of parliament's current focus on the Women's Reservation Bill. Over a decade in the making, the bill seeks to allocate 33% of seats for women MPs. A number of parties have opposed the bill, largely because they want further quotas within the overall 33% quota for the communities they represent, and have threatened to block the passage of the budget if the Congress Party insists on its passage.

**... including a bill on liability for nuclear power**  
**...and the fuel price bill**

Another bill, that seeks to set a limit on the liability of nuclear power plant operators in the event of a mishap, might also become a casualty in this wrangle, as might any chance of a hike in subsidised fuel prices, as recommended by the Kirit Parikh Committee. The Civil Liability Bill is an essential step in enabling India's efforts to import nuclear fuel and technology to set up power plants, while the fuel price hike is essential if oil marketing companies are to stay in business. The Congress Party may well be forced to back down for the moment on the Women's Reservation Bill, but that will be no more than a temporary reprieve. The problem will repeatedly present itself in the next few months, unless the Congress Party can build greater political consensus around it.

### Outlook for the market

**A manufacturing surge drives growth in 2010**  
**... capex will also lift**

Despite a delayed monsoon in late 2009 India's economy has entered 2010 on a surge in growth driven by the industrial sector. Inflation has also jumped and the challenge this year will be curbing inflation while maintaining growth. The final quarter of 2009 saw a 14.3%yoy jump in manufacturing GDP, which helped to offset a 2.8%yoy fall in agriculture GDP (due to a delayed monsoon). The government has quite a bit of its stimulus yet to run and is ramping up infrastructure spending, which will help to lift fixed investment by 12% in 2010. Construction is expected to rise 9%. Surging domestic demand has lifted imports, pushing out the trade and current account deficits. A larger current account deficit in 2010 could put downward pressure on the currency if investors become risk averse.

**Strong data on manufacturing**

Industrial production jumped 16.7%yoy in January and the PMI, a good guide to the production outlook, rose to 58.5 in February. Production of capital goods rose 56%yoy in January while consumer goods rose 32%yoy. India's industrial sector will be lifted this year by both stimulus spending and solid increases in consumer and business demand.

**The threat from inflation**

Higher food prices and a lift in year-ago oil prices have pushed CPI inflation above 15%yoy and whole sale price index (WPI) to 8.6%yoy in January. Neither the government nor the central bank is doing enough at present to tackle inflation, although the Reserve Bank of India (RBI) is likely to push through several rate hikes by mid-2010. If inflation does get out of control, which is a real risk in the next quarter, the RBI would be forced into aggressive rate hikes, which would likely trigger a slump in investment and consumer spending.

<b>Calendar year starting January</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
GDP (Expenditure), real growth, %	9.9	6.3	5.7	7.9	7.9
Inflation - WPI, year average, %	4.6	8.5	2.0	7.5	7.0
Inflation - CPI, urban non-manual, yr avg, %	6.5	7.7	11.7	15.0	9.0
RBI lending (repo) rate, year end, %	7.75	6.50	4.75	6.00	7.50
Rupee to US\$1, RBI Ref Rate, yr avg.	41.2	43.8	48.3	46.9	46.0

Sources: 2007-2008 data from the government (NCI, RBI) and CEIC. 2009-2011 forecasts by IMA India and IMA Asia.

**Adit Jain, Chairman, IMA India**

Tel: (91 124) 459 1200 ♦ Fax: (91 124) 459 1250 ♦ Email: [aditjain@ima-india.com](mailto:aditjain@ima-india.com)

## Australia

### Political & policy issues to watch

- Labor should win the next election** The incumbent Labor government should win the next federal election due to be held before the end of the year. The opposition, led by the Liberals, have made headway in recent months, particularly over a botched home insulation scheme initiated by the government last year. But Labor, which has 83 seats to the Liberal-led coalition's 64 seats in the lower house, has a large buffer to counter any swing against them.
- Policymaking has been slow** Despite a large lower house majority, policymaking under Labor has stalled in the Senate where Labor lacks a majority and must win the support of either the opposition or all seven remaining senators (five Greens and two independents). Labor claims the Senate blocked 41 bills in 2009, which is four times as many as any Senate in the last 30 years, although this includes numerous bills on emissions trading (rejected twice) and private health insurance. The government will re-introduce its emissions trading bill to the senate for a third time but it has little chance of passing. The focus will then shift to Labor's health care reforms, which may also stall due to opposition in the Senate.
- ... big reforms to health care are proposed**
- Stimulus spending to continue** Australia sailed through the 2009 global recession thanks to export demand from China, an absence of finance sector risk, and a large and effective fiscal stimulus. With the economy lifting the stimulus should be cut. But an election is also approaching and both Labor and Liberals are pushing out an array of unfunded promises. So far these haven't spooked the markets as public debt is less than 8% of GDP (one tenth of the average for all advanced economies).

### Outlook for the market

- A strong 2010** Fixed investment will be a key demand driver this year. Australia's mineral wealth and close ties to China will propel an investment boom through 2010 and 2011. Several big mining projects, which were cancelled in 2008 and 2009, have now been taken up again and other big projects such as the A\$50bn (US\$45bn) Gorgon Gas project are set to begin. Business investment increased 3.5%yoy in Q4'09, which helped to push GDP growth to 2.7%yoy. The headline GDP figure would've been higher if not for a 5.1%yoy jump in imports, also linked to the investment surge, as firms imported capital machinery. This is fanning a widening trade and current account imbalance but shouldn't pose a problem since the money is being largely put into productive resources. We have bumped up our 2010 fixed investment forecast to 3.5% but left the overall GDP figure unchanged at 2.8%.
- ... driven by fixed investment in mining**
- Unemployment continues to fall** Demand for workers has continued to increase with the unemployment rate falling to 5.3% in January after another 54,000 jobs were created. The surge in business investment tipped for 2010 will ensure that employment growth continues this year. Not surprisingly, consumer confidence also remains high although we are expecting only mild consumer demand growth in 2010. Retail sales are growing slowly (+3%yoy in January) and households remain highly indebted, which will temper demand this year.
- ... mild growth in consumer demand**
- Construction should boom** The local construction industry should be operating at full capacity in 2010. The residential property market has rebounded nicely with house prices rising 13.6%yoy in Q4'09. Residential construction could rise this year. Add to this the expected surge in business investment and a sharp increase in spending on many of the government's public works projects, and it all adds up to an upbeat 2010 for the construction sector.
- More interest rate hikes ahead** The RBA resumed tightening in March, hiking interest rates another 25 basis points to 4% against a backdrop of strong economic indicators. Inflation is not a problem (+2.1%yoy in Q4'09) but rates will continue to rise towards 5% by year's end as the central bank seeks a more neutral policy rate as the economy recovers.

Year ending December 31	2007	2008	2009	2010	2011
GDP, real growth, %	4.9	2.2	0.3	2.8	3.7
CPI, year average, %	2.3	4.4	0.6	2.0	2.5
RBA cash rate, year end, %	6.75	4.25	3.75	5.00	6.25
A\$1 = US\$, year average	0.84	0.83	0.79	0.91	0.93
US\$1 = A\$, year average	1.19	1.20	1.27	1.10	1.07

Source: 2007-2008 data from the ABS; 2009-2011 forecasts by IMA Asia.

Glenn Levine, Regional Economist, IMA Asia

Tel: (61 2) 9252 4336 ♦ Email: [glenn.levine@imaasia.com](mailto:glenn.levine@imaasia.com)

## New Zealand

### Political & policy issues to watch

#### PM Key is in a strong position

NZ is set for a period of political stability and steady reform under a right-of-centre government. The next general election need not be called until November 2011 and even at this early stage it seems unlikely that the incumbent government will be removed from office. PM John Key's government enjoys a strong lead in opinion polls while the opposition Labour Party is in disarray. The Nationals-led government holds 58 seats in the 122 seat legislature and can pass legislation with the help of either the ACT Party (5 seats) or the Maori Party (5 seats).

#### ... and should push ahead on reforms in 2010

With the domestic economy in recession and then the onset of the global financial crisis, PM Key had little time to push ahead with his reform agenda last year. But now that the dust has settled we can expect the government to use its mandate for economic reform. The government's aim is to make the New Zealand economy more dynamic and bring it up to GDP/capita levels of other developed countries (notably Australia). The 2010/11 budget is the government's first opportunity to prove their economic credentials and outline a plan for tax reform.

#### The first step is tax reform

The 2010/11 budget is due on May 20. NZ resisted the urge to push through large stimulus measures in 2009, which has helped them to keep their credit rating and budget finances in decent shape. The budget deficit will peak this year at 4.2% of GDP and should be back in balance by 2015. The focus this year will be on changes to the tax system, with the GST rate likely to rise from 12.5% to 15% while deductions on investment property may be closed, allowing the government to cut either personal or company taxes. These changes would encourage saving as well as investment. Over time the government aims to align the company (30%), trust (33%), and top personal tax rates (38%).

#### ... watch the May 20 budget

#### ... the GST to rise to 15%

### Outlook for the market

#### Low economic risks

NZ has emerged from an extended recession in relatively good shape. Economic risks are low and a broad-based recovery should push GDP growth to 3.1% in 2010. Business confidence is now at a ten-year high with a net 50% of respondents expecting conditions to improve in the next 12 months. This partly reflects the end of the recession as well as increasing optimism about the year ahead. Export prices are rising with demand for soft commodities, including dairy powder, lamb and beef, remaining firm. Exports are rising strongly, up 31%yoy in January in US\$ terms. Profits among Kiwi companies are likely to rise and investment will be a key growth driver in 2010. Fixed investment is tipped to increase 3% in 2010 and 3.8% in 2011.

#### Economy is well placed for a 2010 rebound

#### Unemployment undermines the consumer outlook

Rising unemployment undermines the 2010 consumer outlook. The jobless rate jumped to 7.3% in Q4'09 from 6.5% previously and is likely to peak at around 7.5% in 1H'10. Wage and employment growth will remain sluggish this year. Consumer confidence also dipped in Q4'09. The one thing supporting consumer demand at the moment is net immigration, which has surged in recent months as fewer residents move offshore. But with the Australian economy recovering even faster than NZ it's difficult to see this trend being sustained. We anticipate a mild 1.8% lift in consumer demand in 2010.

#### A cautious property outlook

The steady rise in house prices between 2003 and 2007 allowed householders to borrow against the rising value of their home, pushing up consumer demand. The housing market recovered slightly in 2009 with median house prices up 1.4% and sales rising 24%. House prices and residential construction will be fairly flat in 2010. Possible changes to the tax treatment of investment property (see above) would be negative for the housing market.

#### Rates to rise slowly from mid-2010

The RBNZ is on track to lift rates from mid-2010. Inflation remains low, and with some softness in demand, interest rates will rise slowly in 2H'10. The currency outlook remains stable, although any wave of global risk aversion would be negative for the NZ\$.

#### Calendar years

	2007	2008	2009	2010	2011
GDP(Expenditure), real growth, % *	3.1	-0.7	-1.0	3.1	3.1
- GDP(Production), real growth, % *	3.2	0.2	-1.6	2.3	3.3
CPI, year average, %	2.4	4.0	2.1	1.8	1.8
- CPI inflation, Dec Q on Dec Q, %	3.2	3.4	2.1	1.2	2.6
Official cash rate, year end, %	8.25	5.00	2.50	3.00	5.00
NZ\$1 = US\$, year average	0.74	0.70	0.63	0.69	0.72
US\$1 = NZ\$, year average	1.36	1.43	1.60	1.45	1.38

## Asia Brief contributors

The Asia Pacific Executive Brief is produced by a unique network of in-country experts who run briefing and advisory programs that are designed to help senior executives monitor and anticipate critical business developments through timely insights and analysis. Further information on the markets and the peer group briefing programs is available from the Country Directors listed below.

- Asia & Global**      **Sydney & Singapore:** Richard Martin, Managing Director, IMA Asia ♦ Web: [www.imaasia.com](http://www.imaasia.com)  
Tel: (61 2) 9252 4336 ♦ Fax: (61 2) 9252 4339 ♦ Email: [richard.martin@imaasia.com](mailto:richard.martin@imaasia.com)
- Australia**      **Sydney:** Glenn Levine, Regional Economist, IMA Asia ♦ Web: [www.imaasia.com](http://www.imaasia.com)  
Tel: (61 2) 9252 4336 ♦ Fax: (61 2) 9252 4339 ♦ Email: [glenn.levine@imaasia.com](mailto:glenn.levine@imaasia.com)
- Sydney:** Larnie Muirhead, Client Support Manager, IMA Asia ♦ Web: [www.imaasia.com](http://www.imaasia.com)  
Tel: (61 2) 9252 4336 ♦ Fax: (61 2) 9252 4339 ♦ Email: [larnie.muirhead@imaasia.com](mailto:larnie.muirhead@imaasia.com)
- China**            **Canberra:** Chris Nailer, Associate Director, IMA Asia & Director MBA program, ANU  
Tel: (61 2) 9252 4336 ♦ Email: [chris.nailer@imaasia.com](mailto:chris.nailer@imaasia.com)
- Beijing:** John Gruetzner, Vice Chairman, Intercedent Limited ♦ Web: [www.intercedent.com](http://www.intercedent.com)  
Tel: (86 10) 6410 7136 ♦ Email: [john.gruetzner@intercedent.com](mailto:john.gruetzner@intercedent.com)
- Hong Kong**      **Hong Kong:** Mark Michelson, Chairman, IMA Asia ♦ Web: [www.imaasia.com](http://www.imaasia.com)  
Tel: (852) 2251 8940 ♦ Fax: (852) 2251 8943 ♦ Email: [service@imaasia.com](mailto:service@imaasia.com)
- India**             **New Delhi:** Adit Jain, Chairman, IMA India ♦ Web: [www.ima-india.com](http://www.ima-india.com)  
Tel: (91124) 459 1251 ♦ Fax: (91124) 459 1250 ♦ Email: [aditjain@ima-india.com](mailto:aditjain@ima-india.com)
- Indonesia**      **Jakarta:** James Castle, Chairman, CastleAsia ♦ Web: [www.castleasia.com](http://www.castleasia.com)  
Tel: (62 21) 572 7321 ♦ Fax: (62 21) 572 7329 ♦ Email: [castle@castleasia.com](mailto:castle@castleasia.com)
- Japan**            **Canberra:** Chris Nailer, Associate Director, IMA Asia & Director MBA program, ANU  
Tel: (61 2) 9252 4336 ♦ Email: [chris.nailer@imaasia.com](mailto:chris.nailer@imaasia.com)
- Malaysia**        **Kuala Lumpur:** Datuk Paddy Bowie, Managing Director, Paddy Schubert Sdn. Bhd.  
Tel: (60 3) 2078 4031 ♦ Fax: (60 3) 2078 7034 ♦ Email: [pshubet@po.jaring.my](mailto:pshubet@po.jaring.my)
- New Zealand**   **Wellington:** Colin James, Managing Director, The Hugo Group  
Tel: (64 4) 385 6249 ♦ Fax: (64 4) 384 9175 ♦ Email: [colin.james@synopsis.co.nz](mailto:colin.james@synopsis.co.nz)  
Web: [www.thehugogroup.com](http://www.thehugogroup.com)
- Pakistan**        **Karachi:** Babar Ayaz, Managing Director, Mediators (Pvt) Ltd  
Tel: (92 21) 565 6113 ♦ Fax: (92 21) 565 6112 ♦ Email: [mediator@cyber.net.pk](mailto:mediator@cyber.net.pk)
- Philippines**    **Manila:** Peter Wallace, President, The Wallace Business Forum ♦ Web: [www.dataphil.com](http://www.dataphil.com)  
Tel: (63 2) 810 9606 ♦ Fax 810 9610 ♦ Email: [wbfplw@smartbro.net](mailto:wbfplw@smartbro.net)
- South Korea**    **Seoul:** Tony Michell, Managing Director, Korea Associates Business Consultancy  
Tel: (82 2) 335 2614 ♦ Fax: (82 2) 323 4262 ♦ Web: [www.kabc.co.kr](http://www.kabc.co.kr)  
Email: [tonymichell@kabcltd.com](mailto:tonymichell@kabcltd.com)
- Singapore**      **Singapore:** Catherine Bell, General Manager, IMA Asia ♦ Web: [www.imaasia.com](http://www.imaasia.com)  
Tel: (65) 6221 5710 ♦ Fax: (65) 6221 3348 ♦ Email: [catherine.bell@imaasia.com](mailto:catherine.bell@imaasia.com)
- Singapore:** Peter Baldwin, Managing Director, Intercedent Asia ♦ Web: [www.intercedent.com](http://www.intercedent.com)  
Tel: (65) 6222 7008 ♦ Fax: (65) 6222 9070 ♦ Email: [peter@intercedentasia.com](mailto:peter@intercedentasia.com)
- Thailand**         **Bangkok:** Christopher Bruton, Managing Director, Dataconsult Ltd  
Tel: (66 2) 233 5606/7 ♦ Fax: (66 2) 236 8143 ♦ Email: [chris@dataconsult.co.th](mailto:chris@dataconsult.co.th)
- Vietnam**         **Bangkok:** Christopher Bruton, Managing Director, Dataconsult Ltd  
Tel: (66 2) 233 5606/7 ♦ Fax: (66 2) 236 8143 ♦ Email: [chris@dataconsult.co.th](mailto:chris@dataconsult.co.th)

## IMA Asia 2010 Schedule

### Schedule of Events: March 2010 onwards

When travelling in the region, please contact Larnie Muirhead if you would like to attend any of the sessions listed below. Phone +61 2 9252 4336 or email [larnie.muirhead@imaasia.com](mailto:larnie.muirhead@imaasia.com).

#### Sydney

18 Mar	<b>Q1 Asia Forecast Update</b>
16 Apr	<b>Top 100 China Consumer Cities</b> , with Clint Laurent
14 May	<b>Asia CEO Forum – Profitability in China and India</b>

#### Melbourne

19 Mar	<b>Q1 Asia Forecast Update</b>
15 Apr	<b>Top 100 China Consumer Cities</b> , with Clint Laurent
13 May	<b>Asia CEO Forum – Profitability in China and India</b>

#### Hong Kong

25 Mar	<b>Q1 Asia Forecast Update</b>
21 Apr	<b>Top 100 China Consumer Cities</b> , with Clint Laurent
25 May	<b>Asia CEO Forum – Acquisition Strategies in Asia</b>

#### Shanghai

24 Mar	<b>Q1 Asia Forecast Update</b>
22 Apr	<b>Top 100 China Consumer Cities</b> , with Clint Laurent
26 May	<b>Asia CEO Forum – Acquisition Strategies in Asia</b>

#### Singapore

26 Mar	<b>Q1 Asia Forecast Update</b>
20 Apr	<b>Asia CEO Forum – Top 100 China Consumer Cities</b> , with Clint Laurent
21 Apr	<b>Asia CFO Forum – Managing the challenges in your regional team</b>
19 May	<b>Asia CFO Forum – Working with the Asia CEO</b>
20 May	<b>Asia CEO Forum – Managing People Risk in Asia</b>

For details on our Network Partners' schedules, please see our website: [www.imaasia.com](http://www.imaasia.com).