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Global outlook

- Preparing for a slump in growth**
 ... in the US,
 ... the Eurozone,
 ... and Japan
- While rising inflation has grabbed headlines over the last month central banks are quietly shifting their focus to a slump in global growth that is expected to last well into 2009. At the start of last month the IMF slashed its US growth forecast to 0.5% for this year and 0.6% for next year. Since then the European Central Bank has cut its Eurozone forecast to 1.7% for 2008 and 1.5% for 2009 while the Bank of Japan has slashed its FY 2008/09 (to March) forecast from 2.1% to 1.5%. Taken together these three markets accounted for 56% of the global economy last year and an even larger share of global imports. Uniformly there's a view that inflation should start easing in late 2008 as growth in the developed economies falls by some 50% from the pace set in 2007. But few forecasts are ever right, even those by central banks. Two of the uncertainties getting most of the attention at present are the threat of stagflation (persistently high inflation despite weaker growth) and the impact on the developed countries of continued strong growth in emerging markets.
- Watch for an easing in inflation by end 2008**
- Stagflation currently looks unlikely. The main push to inflation is coming from a jump in commodity prices rather than an outbreak of big wage increases or big price increases by companies. Some easing in the growth of commodity prices will occur in 2H'08 although many commodity prices will be sustained at high levels for several more years.
- Strong growth in Asia**
 ... as part of global rebalancing
- The positive impact of sustained strong demand growth in emerging markets – delinking if you like - looks like having a bigger impact on the global forecast. This month's Asia Brief confirms that the region is having a surprisingly good start to 2008 despite spiralling oil prices, fears over food shortages, and a near-recession in the US. Two factors have been important. First falling exports to the US are being offset by strong sales to emerging markets in Latin America, Europe, and elsewhere in Asia (see, for example, this month's Korea page). Within this trend the dominant story is China's gargantuan appetite for imports, which grew 28%ytd to US\$366bn in the first four months. Second, Asia's strong trade balances and rising foreign reserves have helped push Asian currencies up on a falling US\$, which has partly muted the inflationary impact of high commodity prices.
- The US**
 ... modest growth outside of housing, autos & finance
- The US grew a better-than-expected 2.5%yoy in Q1, with a smaller trade deficit offsetting much weaker consumer growth (up 1.9%yoy - the slowest pace since Q4 2000) and a continuing contraction in private fixed investment (down 2.8%yoy, its seventh consecutive quarter of decline). However, the downturn is not as severe as the IMF fears (see above) with the economy shedding just 20,000 jobs in April. US consumer confidence is at a five-year low (the Conference Board survey) and consumer demand is likely to remain weak well into 2009. Outside of the housing, automotive and finance sectors modest growth is expected to continue with strong results for firms with large overseas sales.
- Eurozone slows**
 ... hit by weaker US growth & finance sector problems
- After two years of above trend growth the Euro zone is now expected to see a slide in growth from 2.6% last year to 1.7% this year and a slightly weaker 1.5% in 2009 according to the latest forecast from the European Commission. The main culprits in this halving of growth are a collapse in US growth and the negative impact of financial market turmoil on both consumers and corporates. Inflation, which hit a record 3.6% for the Eurozone in March, eased to 3.3% in April and is expected to average 3.2% for the year before easing to 2.2% next year. As this is still above the comfort zone for the European Central Bank (ECB) it is unlikely to cut its policy rate.

Real GDP growth, %	2005	2006	2007	2008	2009
World	4.4	5.0	4.9	3.7	3.8
US	3.1	2.9	2.0	0.8	1.5
Euro area	1.3	2.7	2.6	1.7	1.5
Japan	1.9	2.2	1.8	1.5	1.2
Asia/Pacific* (excluding Japan)	7.3	7.8	8.0	7.0	6.9
ASEAN-6*	5.1	5.9	6.5	5.5	5.5
World merchandise trade volume, % growth	7.5	9.2	6.8	5.6	5.8
Global semiconductor sales, % growth	6.8	8.9	3.2	2.0	4.0
Interest rates, US Fed target rate, year end %	4.25	5.25	4.25	2.00	2.75
Inflation, CPI, US, %	3.4	3.2	2.8	4.0	3.5
Inflation, CPI, Euro area, %	2.2	2.3	2.1	2.5	2.1
Oil price West Texas, yr avg US\$ & % change	\$55 34%	\$68 20%	\$73 11%	\$105 44%	\$105 0%
US\$ / Euro 1, year average rate	1.24	1.28	1.37	1.54	1.40
Yen / US\$1, year average rate	110	116	118	107	103

* Asia is defined as the countries on the forecasts summary page; the ASEAN-6 are Indonesia, Thailand, Malaysia, Philippines, Singapore and Vietnam. Sources: BEA (US), European Central Bank, the IMF, WTO, SIA, central banks in Asia and forecasts by IMA Asia.

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Regional outlook

Summary of forecasts in this month's Asia Brief

GDP (Expenditure), real growth, %	2005	2006	2007	2008	2009
Japan	1.9	2.4	1.8	1.5	1.2
China	10.4	11.1	11.4	10.0	9.5
Hong Kong	7.1	7.0	6.3	4.4	3.6
Taiwan	4.2	4.9	5.7	4.5	4.2
South Korea	4.2	5.0	4.9	4.4	4.1
Indonesia	5.7	5.5	6.3	6.1	6.6
Malaysia	5.0	5.9	6.3	5.5	5.0
Philippines	4.9	5.4	7.3	6.3	5.5
Singapore	6.6	7.9	7.7	3.9	4.9
Thailand	4.5	5.0	4.7	5.2	5.0
Vietnam	8.4	8.2	8.5	6.4	7.0
India (FY starting 1 April from FY 2004/05)	9.2	9.7	8.2	7.5	8.1
Australia	2.8	2.8	3.8	3.0	3.2
New Zealand (expenditure measure)	2.8	1.5	2.9	1.4	1.3

Inflation, CPI year average, %	2005	2006	2007	2008	2009
Japan	-0.3	0.3	0.0	0.8	0.8
China	1.8	1.5	4.8	6.0	3.5
Hong Kong, (composite CPI)	0.9	2.0	2.0	5.0	4.0
Taiwan	2.3	0.6	1.8	2.8	2.0
South Korea	2.8	2.2	2.5	3.8	2.8
Indonesia	10.5	13.1	6.4	8.5	8.0
Malaysia	3.0	3.6	2.0	3.5	2.5
Philippines	7.7	6.3	2.8	6.0	4.0
Singapore	0.5	1.0	2.1	4.8	2.5
Thailand	4.5	4.7	2.3	5.0	3.5
Vietnam	8.3	6.6	8.5	15.0	14.0
India – FY CPI urban non-manual workers	4.6	6.6	6.0	6.5	6.0
Australia	2.7	3.5	3.0	3.8	3.5
New Zealand	3.0	3.4	2.4	3.7	2.5

Exchange rate to US\$1, year avg.	2005	2006	2007	2008	2009
Japan	110	116	118	107	103
China	8.19	7.97	7.61	6.98	6.65
Hong Kong	7.77	7.77	7.80	7.80	7.80
Taiwan	32.2	32.5	32.8	30.4	29.5
South Korea	1,024	955	929	995	964
Indonesia	9,751	9,141	9,164	9,050	8,960
Malaysia	3.79	3.66	3.43	3.17	3.08
Philippines	55.0	51.3	45.9	42.0	41.9
Singapore	1.66	1.59	1.51	1.40	1.34
Thailand	40.2	37.9	34.5	31.5	30.0
Vietnam	15,832	15,970	16,010	16,100	16,263
India (FY)	44.1	45.3	40.5	39.7	38.9
Australia (A\$1 to US cents)	0.76	0.79	0.84	0.90	0.93
New Zealand (NZ\$1 to US cents)	0.70	0.65	0.74	0.75	0.69

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

Regional outlook

Political & policy issues to watch

- New governments in north Asia**
- President Lee's new government in South Korea is having a bumpy start characterised by policy confusion and a sharp fall in popularity. With the possibility that his Grand National Party (GNP) will split at its June internal elections he could lose his recently won legislative majority within weeks of the new assembly sitting for the first time on May 31. This spells trouble for talks on the resumption of US beef sales to Korea and the passage of the Korea US free trade agreement (KORUS). President Ma Ying-jeou looks set to have a better start on May 20 when he is sworn into office in Taiwan. He has a solid mandate for reform following his big win in the presidential contest in March and the landslide victory for his party, the KMT, in January, which gave it a two thirds majority.
- ... an uncertain start in Korea
- ... a better start in Taiwan
- North Asia's scope for a major realignment**
- North Asia could see a major improvement in regional relations over the next two years, which would underpin stronger growth while realigning commercial opportunities in one of the world's hottest growth markets. Economic ties between Japan and China have grown quickly and, as this month's Japan report notes, it is demand from China, rather than the US, that supports Japan's export sector, and thereby its economy. While political and social relations have been fragile at best, both sides are now talking of a "warm spring". An even faster rapprochement seems possible between China and Taiwan after President Ma's new administration takes office in Taipei on May 20.
- Asia's financial centres**
- With New York and London laying off some 25,000+ bank staff in the last few months how are Asia's two small financial hubs faring? Rather than reflecting the trauma of Western financial markets both cities reflect the surge in Asian growth. Staff and office space are at a premium and any local cutbacks by global banks, which may be announced in the next month, would be welcome relief in markets that have run out of capacity.
- ... what crisis?
- Political change in southeast Asia**
- PM Samak in Thailand is embarking on revisions of the military-guided 2007 constitution that would open the way for a return to politics for 111 banned Thai Rak Thai politicians, including former PM Thaksin. Once the revisions are passed Samak is expected to call an early election. The military and Thai elite will be uncomfortable with this so the overall course of Thai politics this year is quite uncertain. In Malaysia, PM Abdullah is fighting for his survival and could be toppled in UMNO elections in December. Dealing with politicians and senior bureaucrats in both these governments will be complicated this year.
- ... watch Thailand and Malaysia

Outlook for the market

- A good start to 2008**
- Data through to April confirms a surprisingly good start to the year for most of Asia. Exports have done better than expected and in quite a few cases have accelerated from the growth rate achieved in full 2007. While it is very likely that export growth will slow over the remaining months of 2008 the impact of the US and EU slowdown has been softened by growth in exports to oil exporters and those emerging markets that are doing well from strong commodity prices. Domestic demand in Asia is also holding up well and looks set to remain firm this year despite slightly higher interest rates. Japan and New Zealand are the two exceptions with both likely to slow significantly this year.
- ... strong exports & good local demand
- Dependence on China**
- This month's report points to strong growth in China over the first four months and growing reliance on China for export growth across the rest of Asia. The big risk for the region is that China falters. China's leaders are openly talking of the policy challenges they face. Fortunately they look set to pull-off a gradual easing in growth over the next two years with lower inflation and sustained domestic demand.
- The threat from inflation**
- Rising inflation has become the main concern for regional central banks and quite a few governments. Several of the countries that subsidise fuel prices – notably India, Indonesia and Malaysia - are likely to be forced into cutting these in the next few months, which will push inflation up and suppress local demand. Deep-pocketed China will likely hold off any change in subsidies until after the Olympics. As inflation rises and interest rates edge up considerable volatility can be expected in exchange rates. The NZ\$ looks set for a fall as the risk-averse Yen carry trade slows and interest rate differentials start to narrow. While the US\$ has done well in recent weeks we still expect most Asian currencies to edge up on the greenback over the rest of this year.
- ... and volatile currencies

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Japan

Political & policy issues to watch

- Dwindling support for PM Fukuda** Last month we wondered how much damage the opposition DPJ could do to the LDP- led government by stalling renewal of a key fuel tax on April 1. The DPJ put up a good fight (literally) with scuffles in parliament but the LDP eventually won a pyrrhic victory with renewal of a Yen 25.1/litre fuel tax, (without which there was a US\$25bn hole in the budget). Unfortunately this came in the middle of the Golden Week holiday, which displeased Japanese motorists. With Clouseau-like timing the government also annoyed a second block of voters last month by implementing a new medical insurance plan that deducts costs directly from pensions for those 75-years or older. Accordingly, the latest opinion polls put support for PM Fukuda's cabinet at a 7-year low of 19.8%.
- The outlook - ... expect more stalled legislation ...which may trigger a change in PM or an early poll** With support for the cabinet now below that of PM Abe's cabinet when Abe resigned last September it will be hard for the Fukuda cabinet to survive in its current form until a planned election after the July 2009 G8 meeting in Japan. Voter displeasure with the government was made clear on April 27 with a spectacular by-election loss for the LDP in Yamaguchi. After the victory the DPJ committed to transforming itself into a party capable of running government. This remains its main problem. Some 10-years after it was founded in its current form it has little unity on key policies and many within it are unhappy with its mercurial leader, Ichiro Ozawa. While voters are delighted that it is hammering the inept LDP government opinion poll support for the DPJ is, at 17%, even lower than that for the LDP. Despite this the DPJ's tactical goal this year is likely to remain forcing an early election through its control of the upper house and its ability to launch censure motions. The LDP may well respond by ditching Fukuda as its leader in favour of a more popular PM.

Outlook for the market

- Growth will drop to sub 1.5% into 2009** With the US close to recession some hard questions are being asked about the outlook for Japan, the world's second biggest economy. Leading a downward revision in forecasts is the latest semi-annual report from the Bank of Japan (BOJ) in which the forecast for FY 2008/09 (to March) has been slashed from 2.1% (made last October) to 1.5%. At the same time the BOJ's "core" inflation forecast has been tripled from 0.4% to 1.1%. The central bank sees a general weakening in production, earnings and spending over the next 12 months but it believes Japan should still come close to its "potential" growth rate of 1.4% through exports and offshore earnings of major companies.
- Relying on exports to China** On the trade front the BOJ expects strong growth in emerging markets to help offset a slump in exports to other OECD members. This appears to be the story in trade results for Q1 with overall exports up 7.5%yoy, while exports to the US fell 7%yoy. Exports to China climbed 7.1%. China replaced the US as Japan's largest trade partner last year with US\$236bn in 2-way trade. However, Japan's production numbers are weaker with industrial production dropping 3.1%yoy in March, its biggest fall in five years. Housing starts also surprised on the downside in March, dropping 15.6%yoy, undermining hopes for a rebound from a regulatory debacle in June 2007 that caused a contraction in construction last year.
- A stable but weak consumer market** The employment market is performing better than expected suggesting – as the BOJ argues – that Japan's major companies are doing well. Partly prompted by new rules from April 1, companies increased the number of general (i.e. full-time) employees by 2.3%yoy in March, the fastest pace in 15 years. Overtime pay also rose strongly, up 4.1%yoy, which helped push total cash earnings up by 1.2%yoy for March. But the improvement on the income side for households is not flowing through into expenditure, which dropped 1.6%yoy in real price adjusted terms in March.
- No more rate hikes** Monetary policy has just shifted with the Bank of Japan (BOJ) dropping its two-year long preference for edging up its policy rate following its pessimistic growth outlook for FY 2008/09. Despite higher inflation the BOJ now sees a slide in global demand as the main threat to the economy. This should stall the Yen's recent climb on the US\$.

	2005	2006	2007	2008	2009
GDP, real growth, %	1.9	2.4	1.8	1.5	1.2
CPI, year average, %	-0.3	0.3	0.0	0.8	0.8
Over-night call rate, year end, %	0.00	0.25	0.50	0.50	0.50
Yen to US \$ 1, year average	110	116	118	107	103

Sources: 2005-2007 data from the BOJ and government sources; 2008-09 forecasts by IMA Asia.

China

Political & policy issues to watch

The high-growth model is starting to fracture
... policies will favour lower growth in 2009
... with a bigger role for local demand

While curbing inflation - now at a 12-year high – is China's top policy goal this year there are plenty of other challenges confronting policy makers. On one hand Beijing wants fast growth to assist laid-off workers from state owned enterprises (SOEs) find new jobs. The central bank has assisted this transition with an undervalued Yuan (boosting the export sector) and cheap capital (boosting investment). Yet it is also aware that these settings can stoke excessive demand and inflation. So far China has kept such inflation in check by administrative measures (price controls and investment restrictions) but there is growing concern that these are warping the economy and undermining profits, particularly for SOEs in power and oil. Moreover, China wants to cut back its large trade surplus by encouraging its households to save less and spend more. But if households are spooked by inflation they may do the opposite. With a major slowdown in exports expected by the government (see below) the stage is set for a shift towards policies favouring slower, more balanced growth with a greater role for consumers and less emphasis on exports.

Outlook for the market

A strong first four months
... pointing to 10%+ GDP growth this year

There is little sign that China's economy is slowing in data for the first four months. Retail sales adjusted for inflation grew 13.2%yoy in Q1 (in line with Q4'07) or an unadjusted rate of 20.6%yoy. Trade data for April shows exports growing at 21.7%yoy (or 21.5%ytd for the first four months), slightly down from the 25.7% pace set for full 2007. By contrast, import growth accelerated to 26.5%yoy for April (or 28%ytd for the first four months), which is significantly faster than the 20.8% import growth reported for full 2007. The faster pace for import growth helped trim the trade surplus for the first four months by 7.9%ytd to US\$58bn. The overall picture is of continued strong local demand and a slight easing in exports. By contrast, China's commerce ministry is forecasting export growth of just 10% this year due to an expected sharp fall in demand from the US and EU. A significant slowing in exports is almost certainly ahead and the data to April hints that this may have started. But China's GDP growth is likely to surprise on the upside for several more quarters.

Inflation
... food prices should ease
... but non-food prices are rising

China's inflation problem this year has been mostly to do with food prices, which started rising rapidly last year due to pork shortages. Food, and particularly pork prices, appear to have stabilised in the last month and are now expected to ease in 2H'08. However, non-food inflation, which has been running at just 1-1.5%yoy, looks set to rise in 2H'08 as higher wages and other production costs feed into the market. The CPI has been over 8%yoy since February and looks set to remain close to that rate through mid year following an 8.1%yoy reading for the producer price index (PPI) in April. This is well above the central bank's target of 4.8% for this year. The Olympic Games, which start on August 8th, may be putting upward pressure on the PPI as some manufacturers, expecting closure of some polluting factories and power stations, are reported to be stockpiling goods.

The Yuan
... curtailing upward pressure from HK

The PBOC is expected to tighten controls on capital inflows, particularly from Hong Kong. The Bank of China (HK), Hong Kong's clearing bank for Yuan, has already widened the buy-sell spread in order to raise the cost of Yuan deposits to HK customers. Yuan deposits in HK have soared 72% from end 2007 to Yuan57bn by early May. Local banks also have been helping HK customers open Yuan deposits on the mainland, although this trade may just have been stopped by the PBOC. Hong Kong's demand for Yuan is one factor pushing the black market rate up to 6=US\$1. HK depositors get almost nothing on their HK\$ deposits (due to the US\$ peg) but gain a higher rate and appreciation on Yuan savings.

Expect a 7% Yuan rise in 2008

Since a surprisingly fast 4.3% Yuan appreciation on the US\$ in Q1, the PBOC has virtually halted the currency's rise. Yet a return to Yuan appreciation would help China tackle inflation and a large trade surplus. A return to more gradual appreciation is likely over the rest of this year. The 1-year forward price for the Yuan, which had indicated a 14% appreciation rate in March, now points to expectations of a 7% annual rise.

	2005	2006	2007	2008	2009
GDP, real growth, %	10.4	11.1	11.4	10.0	9.5
CPI, year average, %	1.8	1.5	4.8	6.0	3.5
PBOC 1-year loan, at Dec., %	5.58	6.12	7.47	8.22	8.22
Yuan to US \$ 1, year average	8.19	7.97	7.61	6.98	6.65

Sources: 2005-2007 data from CEIC and government agencies; 2008-2009 forecasts by IMA Asia.

Hong Kong

Political & policy issues to watch

- Watch for a lift in public spending**
...as funds flow to big projects
- Hong Kong is well positioned for a substantial lift in government spending over the next few years. This should help deal with infrastructure constraints while also offsetting some of the lost momentum expected in external trade. The government has just announced a record surplus of HK\$123.7bn (US\$15.9bn) for FY2007/08, which ended in March. This is double the previous year's surplus as booming share and property markets boosted stamp duties. The windfall will make it easier to finance a series of large projects including the Shatin-Central link, the Guangzhou-Shenzhen-HK express rail link, the Airport-Shenzhen rail link, and the HK-Zhuhai-Macau bridge. It has also allowed the financial secretary to deliver HK\$40bn worth of tax concessions and handouts, including a 75% cut in salaries tax for one tax year up to a limit of HK\$25,000 and a permanent 1 percentage point cut in both salaries and profits taxes. All these measures will help sustain growth into 2009 and even 2010.
- Still discussing major healthcare reform**
- The government is midway through consultations on a major overhaul of Hong Kong's health system, as the current financing arrangements are unsustainable as the population ages. Currently 1 in 8 persons is 65 or older, but this ratio is expected to rise to 1 in 4 by 2033. Any reform will undoubtedly place much greater reliance on private funding, which will create new opportunities for health insurance.
- More hotel rooms by 2010**
- The government has acknowledged the acute shortage of hotel accommodation and will release 10 sites for new hotels. While HK received 28m visitors last year (up 116% from 2006) the number of hotel rooms remained flat for two years at 56,600.
- Port expansion**
... any takers for CT10?
- Lee Ka-shing, Asia's richest tycoon, recently threw cold water on the proposed new port container terminal in Hong Kong, known as CT10, saying that HK will not be able to compete with neighbouring Shenzhen, which will overtake Hong Kong within four years as the world's third-busiest cargo port. As a key player in both HK and south China ports this may simply be a negotiating ploy but the debate reflects a key change in HK's economy.

Outlook for the market

- Slower growth as external demand weakens**
- We expect GDP growth to ease towards 4.4% in 2008. With the labour market remaining strong and interest rates hovering at 2%, consumer spending should continue to support growth. However, the downturn in global demand is expected to adversely affect trade, investment, and even tourist flows.
- But good local demand**
... + watch for a rebound in asset markets
- Retail sales jumped 17.5%yoy in Q1'08, maintaining the strong expansion of Q4'07. However, investor appetite for housing has been dented following the steep decline of the HK stock market from late-2007. The rate of new mortgage loans approved fell to 51.8%yoy in March from a cyclical peak of 136%yoy in January. Moreover, real estate agents are reporting a definite cooling in both prices and transactions since the start of the year. There is scope, however, for a recovery in both the stock and property markets this year despite problems in the US. This could push up local demand much faster than expected in our current forecast.
- Less inflation due to a technical distortion**
- Hong Kong's inflation rate eased to 4.2%yoy in March from 6.2%yoy in February. Unfortunately the lower CPI rate does not reflect any easing in inflation as it was caused by a one-off public housing rent holiday given in February 2007, which distorted the overall inflation figures. Monetary policy remains very expansionary as it faithfully mirrors that of the US due to the currency peg system.
- HK residents abandon the HK\$**
- The sharp decline of the HK\$ against non-US\$ currencies prompted a flow of funds out of HK\$, resulting in a 40%yoy rise of Chinese Yuan deposits by Hong Kong residents in February 2008.

	2005	2006	2007	2008	2009
GDP, real growth, %	7.1	7.0	6.3	4.4	3.6
Composite CPI (04/05), year average, %	0.9	2.0	2.0	5.0	4.0
Discount window base rate, % year end	5.75	6.75	5.75	3.75	4.25
HK\$ to US \$ 1, year average	7.77	7.77	7.80	7.80	7.80

Sources: 2005-2007 from Censtat, HKMA, and CEIC; 2008-2009 by IMA Asia

Taiwan

Political & policy issues to watch

President Ma takes over on May 20
... with scope for major policy change

A new KMT administration is due to be sworn into office for a 4-year term on May 20 after eight years of rule by President Chen Shui-bian of the DPP. President-elect Ma Ying-jeou and his deputy, Vincent Siew, won a decisive 17-point victory in March. This followed the KMT's landslide win in the January legislative elections in which it obtained a two thirds majority. The Chen administration always faced an opposition (KMT) controlled legislature that frustrated most of its policy initiatives. The incoming Ma administration will have unchecked support from the legislature. This alone suggests a period of rapid policy change after eight years of minimal change. The two policy areas to watch are relations with China and steps to revive economic growth.

Ma's cabinet
... skilled
... & cautious on China

There are few surprises in President-elect Ma Ying-jeou's new cabinet line-up with most being experienced professionals. The one controversial choice is Lai Shin-yuan - a former lawmaker of the pro-independence Taiwan Solidarity Union - as the chairwoman of the Mainland Affairs Council, responsible for overseeing cross-straits relations. Ms Lai is well known for her pro-independence sympathies. Both sides of politics have been surprised, but observers note that Ms Lai is a skilled negotiator and agrees with Mr. Ma's "Three No's" policy: no to reunification, no to de jure independence and no to war. Ms Lai's appointment suggests that the Ma administration is not going to jump into bed with China at any cost.

Outlook for the market

A great start for exports
... which will sustain GDP this year

Taiwan's export sector had an unexpectedly strong start to the year, with shipments jumping 17.6%yoy (US\$ basis) after growth of just 10.1% for full 2007. The pace slowed a bit in April to 14%yoy for the month and the best months may now be behind us for this year. The lift in exports helped boost industrial production by 11.4%yoy for Q1 – Taiwan's third quarter in a row of 11%+ growth in industrial production. The strong start to the year has prompted optimism over growth for the rest of this year. Premier Chang Chun-hsiung, who estimates that Q1 GDP growth was 5.1%yoy, says Taiwan is on track to achieve 4.8% growth this year. Meanwhile a leading think tank, the Chung-Hua Institution for Economic Research (CIER), is more optimistic, expecting Q1 growth to top 6.3%yoy; it has also revised its full-year estimate upwards by 0.5% to 4.7%. A primary driver of this growth will continue to be high Chinese demand for Taiwan's optical, electronic, machinery and telecommunications products.

But consumers have yet to rally
... but watch for a public sector pay rise

Taiwanese consumers really felt the pinch during the first quarter as real wage growth was at its worst level since 1981, with negative growth of 1.52% caused by a growing local CPI. Should inflationary pressures prove to be manageable, analysts look to a promised public service pay rise to lead the way in improving Taiwan's wage standard and stemming the loss of high calibre graduates to foreign markets with better pay prospects. Historically, the country's private sector has followed any pay rises in the public sector due to competition in the labour market.

... and a mini real estate boom
... based on better ties with China

President-elect Ma has proposed opening Taiwan's real estate market to Chinese buyers once frequent cross-straits flights have been established. Combined with an expected increase in demand from mainland tourists and Taiwanese businessmen choosing to buy homes in Taiwan and commute to China, this has created a strong sense of optimism in the real estate market. There will be an estimated increase in the visa quota for Chinese to 3,000 per day in the near future and potentially 750,000 Taiwanese (of the approx. 1.5 million living in China) are expected to resume residence on the island. Accordingly, this month has seen record bids on commercial properties in Taipei, with much interest by foreign investors. Taipei housing prices have started to rise in expectation of a mini-boom.

	2005	2006	2007	2008	2009
GDP, real growth, %	4.2	4.9	5.7	4.5	4.2
CPI, year average, %	2.3	0.6	1.8	2.8	2.0
Official discount rate, year end, %	2.25	2.75	3.38	3.75	3.63
NT\$ to US \$ 1, year average	32.18	32.53	32.84	30.40	29.50

Sources: 2005-2007 government data and CEIC; 2008-09 forecasts by TASC and IMA Asia

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South Korea

Political & policy issues to watch

A poor start for President Lee President Lee, who took office on February 25, has had a muddled start to his single 5-year term. Only part of this can be blamed on the opposition, which retains control of the legislature until May 31, when Lee's party, the GNP, will take control following its narrow victory in the April elections. Lee has two other problems. First, his own party is in danger of fragmenting even before the 18th National Assembly sits for the first time (see below). Second, Lee's poor selection of ministers and his poorly thought out policy positions have undermined his reputation as an effective corporate manager and former mayor of Seoul. This has contributed to a surprisingly fast loss of public trust in Lee's government. Lee's way forward may include a cabinet reshuffle early in 2H '08.

Lee's party could split Based on the April election results the Grand National Party (GNP), which has a narrow majority in the legislature, could get a two thirds majority if conservative minor parties and independents joined in a government block (thereby allowing the government to override all opposition). Yet this now seems a distant dream. Park Geun-hye, the GNP's powerful chairwoman until she stepped down to contest the GNP primaries against Lee last year, will stand for re-election to the GNP chairmanship in July. If she wins, which is a distinct possibility, she would fragment the conservative side of politics. This would greatly reduce the Lee government's ability to pass policy.

Watch for the US beef deal and KORUS to stall How all this will work out will become clearer in the next two weeks as Korean politicians stake out their positions on renewal of US beef imports and approval of the free trade agreement with the US (the KORUS FTA). Until the last few weeks many hoped that approval for both would be achieved in the final days of the 17th Assembly. But with the new government losing momentum, and politicians sensing popular dislike of both deals, the prospects for either passing are diminishing. President Lee may well have to turn to other, much smaller FTA's in the pipeline (Canada, Australia) for progress on the trade front.

Outlook for the market

A strong start of exports With exports up 27%yoy in April (or 20%ytd for the first four months) South Korea's manufacturing sector has had a surprisingly good start to 2008, although export growth should ease later this year. Weak exports to the US (down 2.8%ytd in Q1 to US\$11.1bn) have been offset by strong growth to emerging markets and the EU. By scale, the two biggest buyers in Q1 were China (up 21% to US\$22bn) and the EU (up 18% to \$15bn). But export growth to some emerging markets was staggering: Vietnam up 92% to \$2.2bn, Singapore up 51% to \$4bn, India up 28% to \$2bn, Brazil up 88% to \$1.3bn, and oil-rich UAE up 47% to \$1.2bn. The surge in exports helped Korea cope with fast rising oil prices and cut the trade deficit for April to just US\$46m from a high of \$3.9bn in January, which had worried markets. Industrial production grew a solid 10-11%yoy in each of the first three months.

But consumers are likely to remain cautious Unfortunately Korean consumers are acting more as if their manufacturing-driven economy was in a slump rather than steadily growing. The retail sales index by volume was up just 3.9%yoy in Q1, the weakest rise in the last five quarters. Durable goods (up 8.3%) and automobiles (up 9.5%yoy) did best while semi-durables (up 4.6%yoy) and non durables (up a meagre 1.6%) did less well. Political uncertainty, talk of a US recession, and rising inflation may well have worried consumers and with all these factors likely to remain prominent through this year consumer demand growth will be muted.

A weak Won policy Finance Minister Kang Man Soo's preference for a weaker Won triggered a fall from 950 to around 1,000 to US\$1 in March, with the currency expected to stay around that level while Kang is in office. This will push inflation above the central bank's medium-term target range of 2.5-3.5% for much of this year and may prevent any further rate cuts.

	2005	2006	2007	2008	2009
GDP growth, %	4.2	5.0	4.9	4.4	4.1
CPI, year average, %	2.8	2.2	2.5	3.8	2.8
BOK Overnight call rate, year end, %	3.75	4.50	5.00	5.00	4.75
Won to US \$ 1, year average	1,024	955	929	995	964

Sources: 2005-2007 government data (NSO, BOK) and CEIC; 2008-09 forecasts by EABC and IMA Asia

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Indonesia

Political & policy issues to watch

Dissatisfaction of voters
... the risk of anti-government voting in 2009

High food and energy prices, an inept bureaucracy, and a slowing economy are likely to create a very competitive 2009 parliamentary election. The PKS, a Muslim conservative-turned reformist party, has already tapped into voter dissatisfaction to win gubernatorial contests in West Java and North Sumatra. In the latter case they even won in majority Christian districts on a platform calling for cleaner government. Disillusionment with major parties like PDIP, Golkar and PD was clearly evident. So too was the surprising inability of the big parties to put out the cash normally seen in local polls. While the 12 month campaign set for the 2009 elections (compared to less than a month for the 2004 polls) supposedly favours the larger, better-funded parties, the evolving political landscape might well thrust smaller parties like PKS into stronger positions in the next parliament.

President SBY still leads in the presidential race

For the 2009 presidential race, President Yudhoyono ("SBY") remains the man to beat given the quality of other contenders. In fact, Megawati's apparent decision to run again virtually assures that no credible third candidate will emerge. This should help SBY, as he beat Megawati by a large margin in 2004 and he maintains a solid lead over her in all opinion polls. SBY's biggest problem is that it looks like he will be forced into cutting fuel subsidies before the election, something he has been desperate to avoid. Apart from undermining his support this might lead him to pursue controversial policies in other areas in an effort to retain popular support.

Stepping up the anti-corruption campaign

The government has stepped up its anti-corruption campaign as President Yudhoyono seeks to burnish his anti-graft credentials ahead of the 2009 poll. The Anti-Corruption Commission (KPK) has already moved on an alleged scandal at Bank Indonesia that has led to the arrest of the outgoing central bank governor, and it is now expanding its anti-corruption efforts to parliament and state-owned enterprises (SOEs). Not coincidentally, the central bank, parliament and SOEs have in the past been a source of funds for political parties. The current clamp down may well deprive SBY's opponents of one source of funds.

Outlook for the market

Expect a fuel price hike in 2008
... which will depress demand (but not like 05)

A fuel price hike within the next few months is now quite likely given record high oil prices and strong growth in domestic fuel consumption in the first four months of the year. The revised 2008 budget, recently approved by parliament, states fuel prices can be raised if Indonesian crude exceeds US\$100/barrel. Together with statements by a string of top policy makers and industry players, this should give the president political cover for a modest lift in local fuel prices before the elections. Much the same process occurred in 2005. We expect this will lead to a modest easing in domestic demand but no where near the collapse that occurred over the nine months following the 2005 price hike.

Inflation & weak stock market
... but sales are brisk

Inflation remains a major problem as food prices climb to record levels despite a healthy rice harvest. The local stock and bond markets have taken a beating and consumer confidence has dropped to levels not seen since 2005. Despite this, other economic signals remain relatively bullish, with companies posting strong Q1 numbers and confirming a favourable outlook for the rest of the year. Cement sales were up 6.6%yoy in Q1 with particularly strong growth in the outer islands – Sumatra up 14.6% and Kalimantan up 18.4%yoy. Local motorcycle sales also jumped 72.3%yoy in April taking growth in the first four months to 43.7%ytd. On balance, high price commodity prices appear to be a net benefit for farmers and rural communities, who comprise a large chunk of the economy and a significant number of votes.

	2005	2006	2007	2008	2009
GDP, real growth, %	5.7	5.5	6.3	6.1	6.6
CPI, yr avg 45 cities, (BI 2002=100), %	10.5	13.1	6.4	8.5	8.0
Interest rate (30-day SBI), at Dec., %	12.75	9.75	8.00	9.00	8.50
Rupiah to US\$1, year average (BI spot)	9,751	9,141	9,164	9,050	8,960

Sources: 2005-2007 government data (BPS, BI) and CEIC; 2008-09 forecasts by CastleAsia and IMA Asia

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Malaysia

Political & policy issues to watch

- PM Abdullah's battle to survive within UMNO**
... watch
Deputy PM Najib Razak
- The seven months until the December conference of UMNO, the party that has led government since independence, will be marked by intense politicking and a rush towards reforms that reduce corruption and improve transparency. PM Abdullah's goal is to deflect all calls for his immediate resignation and to retain the party's support in the leadership vote in December. If a challenger does step forward in December it will almost certainly be his own deputy, Najib Razak, who he recently anointed as his successor at some indeterminate time in the future. The main thrust of Abdullah's survival strategy is swift implementation of reforms that he promised four years ago but never delivered because of strong resistance from UMNO-linked interest groups. These include: setting up an independent committee to vet prospective judges and offering compensation (but no apology) to senior judges who were sacked by PM Mahathir; strengthening the role of the Anti-Corruption Agency and allowing it to report to parliament, instead of the prime minister only; protecting whistleblowers; and more transparency in the awarding of government contracts.
- A popular but fragmented opposition**
... with a high profile leader
- A ban on contesting for political office on opposition leader Anwar Ibrahim has now lapsed. It's unclear yet whether he will now look for a suitable by-election to enter parliament. His main focus over the next year will be an attempt to draw together the three main parties in a very diverse opposition: PAS (a fundamentalist Islamic party), the DAP (a secular Chinese party), and Keadilan (Anwar's own relatively new multicultural party). This will be a difficult task. There is talk that some MPs from the government might be won over to the opposition. While this seems unlikely at present, both the government and the opposition are engaged in a bidding contest for the favour of the MPs from East Malaysia, the group considered most likely to switch if they are given the right incentive.
- The rising cost of fuel subsidies**
... with cuts to other spending
- The election setback for the government in March derailed plans to reduce Malaysia's generous fuel subsidies, estimated at US\$5.7bn this year. This is placing enormous pressure on the federal budget, which is running at a deficit of over 3% of GDP. The subsidies remain under review, but the emphasis has shifted towards differentiated subsidies by petrol grade and curbing wastage and petrol smuggling. Full details are expected to emerge before the presentation of the FY2009 budget in August. The new government also decided to cancel a planned high-speed train project between Kuala Lumpur and Singapore (estimated cost of US\$3.2bn), as part of a post-election review of public-works projects.

Outlook for the market

- Slower growth ahead**
... as domestic demand eases
... and exports remain weak
- Malaysia's growth is expected to ease to 5.5% this year from 6.3% in 2007, as domestic demand, the main driver of last year's growth, loses momentum. Weaker global growth this year also means that exports, which grew just 2.7% last year, are unlikely to compensate for weaker domestic spending. However, consumer demand held up well in Q1 with passenger car sales up 25.7%yoy for Q1, which suggests that the boost to consumption from a big public sector wage hike in 2007 has spilled over into this year. This should help sustain growth in the current quarter but is expected to fade in 2H '08. The central bank's low interest rate strategy, while bringing a gradual lift in lending growth to 10%yoy by March, has not triggered a lift in housing approvals for private developers, which dropped to an annual rate of 118,479 in March from a high of 236,590 in mid 2007.
- Keeping rates on hold**
... with a firmer M\$
- Bank Negara, Malaysia's central bank, kept its policy rate steady at 3.5% in April, a level that has prevailed since mid-2006. Malaysia's inflation rate, which reached a 13-month high of 2.8%yoy in March, is the lowest in Asia bar Japan, partly due to a vast array of subsidies and price controls. A faster appreciation of the M\$ has also helped offset the impact of higher global prices for oil and food. The Ringgit has risen 11.1% against the US\$ since September 2007. With pressure to cut the fuel subsidy this year a small lift in rates will be needed to help curb inflation.

	2005	2006	2007	2008	2009
GDP, real growth, %	5.0	5.9	6.3	5.5	5.0
CPI, year average (2000=100), %	3.0	3.6	2.0	3.5	2.5
Central bank overnight rate at Dec., %	3.00	3.50	3.50	3.75	4.00
Ringgit to US\$1, year average	3.79	3.66	3.43	3.17	3.08

Sources: 2005-2007 Bank Negara and CEIC; 2008-09 forecasts by IMA Asia

Philippines

Political & policy issues to watch

- A cabinet revamp looms**
... as Arroyo settles in for her last two years
- A cabinet revamp is expected soon as President Arroyo enters the final two years of her term. She has suggested that Defense Sec. Gilbert Teodoro will keep his present position contrary to unofficial reports that he will be transferred to the Department of Justice. It's a guessing game for the rest of the positions. A one-year ban on appointment of candidates who lost in the 2007 elections will lapse on May 14 so loyal political allies, particularly those who lost in the senate race, will look for promotion.
- The opposition is fragmented**
- Former President Joseph Estrada, who remains an opposition stalwart, has hinted that he may join the 2010 presidential race. This is most likely an attempt to force an early consolidation of a fragmented opposition camp, which currently has four likely contenders for the presidency (Loren Legarda, Panfilo Lacson, Manny Villar and Mar Roxas). Without some consolidation they are unlikely to do well against the administration's candidate.
- Mining still faces opposition**
... but is unlikely to be blocked
- Recently two petitions against the Mining Act were filed in the Supreme Court by three members of the House of Representatives and several private citizens. The first petition assailed the constitutionality of the Mineral Production Sharing Agreements (MPSA) on the contention that the state is not able to receive its just share as the owner-in-trust of the country's natural resource base. The second petition stressed that considering the breadth, number, and extent of mining applications, the state stands to lose large amounts of revenues under the fiscal policy that governs the mining industry. However, the petitioners don't have wide support and are seen more as a nuisance factor than a serious threat. The court is not likely to overturn its December 2004 ruling that opened the way for a resumption in mining investment. Some US\$10 billion in investment is expected in the next few years.

Outlook for the market

- Weaker exports in 2008**
... offset by a lift in spending on infrastructure & agriculture
- Weaker US growth will undermine exports and cut around one percentage point off growth this year but the downturn will be cushioned by a lift in infrastructure and agricultural spending. The government aims to lift infrastructure spending to some 4% of GDP, up from 3.2% in 2007, with a lot of this spent in Q2'08. The Arroyo administration has also announced a P48bn program to increase food production. Other areas of growth this year include a boom in hotel and office space construction. However, there are already signs of weaker consumer spending with passenger car sales for March down 7%yoy, the first monthly fall since mid 2007. Fortunately remittances from offshore Filipino workers (OFWs) do not appear to have been hit by the US downturn and were up 15.5%ytd for the first two months with roughly \$1.3bn arriving each month.
- Scope for a small rise in the budget deficit**
- The unplanned lift in government spending is likely to require a budget deficit this year despite earlier plans for a balanced budget. International credit ratings agencies are likely to monitor this development closely as the country's credit rating is very dependent on implementation of the administration's fiscal program. The outlook is presently "stable" for S&P and Fitch, and "positive" on a lower rating for Moody's. The agencies are likely to stick with these ratings if the deficit is relatively small and tax collection efficiency is improving.
- Higher inflation**
... with higher rates & a weaker Peso
- Inflation surged to 8.3%yoy in April with rice prices jumping 25%yoy despite the subsidized sale of imported rice under a program that could cost the National Food Authority at least P43bn this year. The Philippines is the world's largest rice importer, buying some 10-20% of its rice requirement offshore. The lift in inflation has undermined the local stock market and the Peso, which is down almost 3% on the US\$ so far this year. Watch for a lift in interest rates in an effort to curb inflation. The Peso, which had been close to 40=US\$1, will likely ease to around 42 average over 2008 before edging up again in 2009.

	2005	2006	2007	2008	2009
GDP growth, %	4.9	5.4	7.3	6.3	5.5
CPI, annual average, %	7.7	6.3	2.8	6.0	4.0
Central bank overnight RRP, year end	7.50	7.50	5.25	6.00	5.50
X-rate to US\$1, an. Av.	55.0	51.3	45.9	42.0	41.0

Sources: 2005-2007 BSP data and CEIC; 2008-2009 forecasts by the Wallace Business Forum & IMA Asia.

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Singapore

Political & policy issues to watch

- Social welfare** The IMF's latest Article IV report has just been released and it's worth reading if Singapore is an important market for you (a free download at www.imf.org). The IMF thinks Singapore should use its large budget surpluses for social welfare programs for unskilled, older workers who are losing out as the labour-based industries give way to high value-added industries. But it's clear that Singapore is unwilling to set up a permanent welfare state apparatus, arguing that the best form of welfare is the plentiful availability of jobs (unemployment is just 2%). Instead it prefers to tailor welfare-type payments to meet changing economic circumstances on a discretionary basis. For example, S\$3bn will be distributed to households this year in the form of growth dividends, personal tax rebates, and workforce income supplements to older workers. All of this should help cushion the impact of rising prices on mid to low-income households this year
- ...a preference for discretionary support**
- ... which should help consumer spending**
- Privatising power, before boosting output** Following its sale to the Chinese Huaneng Group in early March, Singapore power company Tuas Power Ltd. is considering building a S\$2bn coal-fired plant. Tuas Power supplies about 25% of Singapore's power needs and was the first of the country's three power companies to be privatised. The government intends to privatise the other two by mid-2009, a move that will lead to increased competition in the power sector. Average daily demand reached 4,545MWh in 2007 and has been growing by 3-4%pa over the last four years with most of the demand coming from manufacturing and other industries.

Outlook for the market

- A surge in growth in Q1** The economy accelerated to 7.2%yoy in 1Q'08 on preliminary estimates, reversing a sharp drop to 5.4%yoy growth in Q4'07. This turnaround was driven by a 13.2% surge in manufacturing, which more than offset an easing in explosive construction growth last year (up 20.3%) to 14.6%yoy for Q1'08. The local consumer market also looks healthy. Q4'07 saw a 14.8%yoy jump in outbound tourism to a record 1.9m. While the consumer side should remain strong this year an expected slow down in trade will pull 2008 GDP growth towards the lower end of the government's 4-6% forecast for this year.
- But watch for weaker growth from Q2** The March trade statistics show how the downturn in global demand is affecting Singapore's growth. Seasonally-adjusted, non-oil domestic exports fell 6.6%yoy, as exports to the US and the EU plunged 28%yoy and 24%yoy respectively. This is consistent with the message from leading indicators of economic activity, such as the purchasing managers' index, which gradually fell to 49.5 in March from a cyclical peak of 53.8 in November 2007. Another area of emerging weakness is the property market, where both prices and transactions are slowing down. In 1Q'08, the number of house sales was almost half of that in the previous quarter. However, lagging indicators, such as bank loan growth (up 21.8%yoy in February) and the unemployment rate (at full employment level of 2% in 1Q' 08) have yet to register any weakness.
- ... as exports & construction cool**
- Manufacturing base expands** Net investment commitments in manufacturing soared 82% last year to S\$16.1bn with the biggest increases in chemicals (up 236% to S\$8.6bn) and electronics production (up 18.5% to S\$5.1bn). European investors led the way with a 257% jump in investment to S\$8.3bn.
- A faster S\$ rise to help slow inflation** Inflation hit a new 26-year high of 6.7%yoy in March, boosted by surging global commodity prices and domestic price pressures. The Monetary Authority of Singapore (MAS, Singapore's central bank) responded with a faster appreciation of the S\$ in an attempt to dampen the impact of rising import prices on domestic inflation. The MAS expects inflation to peak at around 7%yoy by mid-2008 and decelerate in 2H'08 as world growth slows and commodity prices ease.

	2005	2006	2007	2008	2009
GDP, real growth, %	6.6	7.9	7.7	3.9	4.9
CPI, year average, %	0.5	1.0	2.1	4.8	2.5
3 month interbank interest rate, Dec, %	3.25	3.44	2.69	3.69	3.89
S\$ to US \$ 1, year average	1.66	1.59	1.51	1.40	1.34

Sources: 2005-2007 government data and CEIC; forecasts for 2008-2009 by IMA Asia.

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Thailand

Political & policy issues to watch

Amending the constitution

... the return of Thai Rak Thai and possibly Thaksin

PM Samak's government has started work on amending the military-guided constitution of 2007. The amendments will likely bring back most of the provisions of the 1997 constitution, enable the rehabilitation of the 111 banned Thai Rak Thai (TRT) politicians, protect minor parties from threatened dissolution, and reduce or eliminate the powers vested in the senate and independent agencies. It is uncertain whether the changes, which will exonerate Dr. Thaksin, will result in his return to the premiership although that door will be opened. If the amendments go forward as planned, it is likely that parliament will be dissolved and a new election held before the end of 2008, with a resurrected TRT well placed to win a majority. The return of TRT, even if under a different name, might well trigger demonstrations in Bangkok and deep anxieties among the elite and military. PM Samak will use his close connections with the highest levels of the elite and military to defuse these anxieties. If there is strong opposition to the amendments, Samak could dissolve the national assembly and proceed to an early election leading a campaign for the proposed constitutional amendments. Given strong rural support for Samak's People Power Party, he should win a majority and the right to pass the amendments.

The rise of rural voters

...Bangkok is less dominant

Those who believed that the Democrat Party's relative success in the last election was a stepping stone on the path towards a middle class parliamentary victory may be overlooking fundamental changes in the economy. Bangkok used to represent some 40% of GDP, but now it is little more than a quarter. With strong rises in commodity prices, backed by populist policies, it is the upcountry areas, and more particularly the rural part of upcountry areas, that are growing the fastest. Tourism, which reached 14.5m in 2007, is growing at 12%pa, with most arrivals going to areas outside of Bangkok. The upcountry parties best suited to benefit from the rise of affluence outside of Bangkok are the PPP (a TRT stand-in that is dominant in the North and Northeast) and Chat Thai (strong in central Thailand and led by Suphanburi-based Banharn Silapa-Archa). The Democrat Party, which is mainly based in Bangkok and the already affluent south, cannot gain the advantage, as the south, with a smaller population, has fewer seats.

Outlook for the market

A mild lift in GDP in 2008

...helped by infrastructure spending

... + a revival in consumer & corporate spending

While most of Asia will slow this year Thailand is set to achieve slightly better growth. Much of last year's growth came from a sharp climb in government spending, which grew 10.8% in real terms. This year the government-directed stimulus is likely to shift from direct spending to joint public-private (mostly the latter) spending on some of the mega-projects promised by the Samak administration, including a Baht 367bn (US\$11.8bn) double track rail expansion. The main weakness last year lay in private sector demand, with consumer spending and fixed investment both rising just 1.4%. This year, both look set for 4-5% real growth. Passenger car sales, which fell 11.3% last year, rose 39.1%yoy in Q1 with rebounds also for commercial vehicles (down 6% in 2007 and up 7.7%yoy in Q1) and the important 1-tonne truck market (down 9.8% in 2007 but up 6%yoy in Q1). Cement and motorcycle production, which fell throughout 2007, grew 9.2%yoy and 31.3%yoy respectively in March. Exports have also had a good start, rising 20.8%yoy in Q1 on a US\$-basis or 11.4%yoy Baht-basis, with both these first quarter results being stronger than full-year growth in 2007.

Higher inflation

... watch for a rate rise & stronger Baht

The recovery in demand, combined with strong cash inflows on commodity exports, will put upward pressure on inflation, which climbed to 6.2%yoy in April. This has ended talk of a rate cut and suggests that the Bank of Thailand should consider lifting rates, although the government will likely object to this. An economic recovery and the prospect of a rise in interest rates should bring an end to recent Baht weakness and may see the currency return to 30=US\$1 by year end.

	2005	2006	2007	2008	2009
GDP, real growth, %	4.5	5.0	4.7	5.2	5.0
CPI (2002 index), year average, %	4.5	4.7	2.3	5.0	3.5
Central bank, 14-day repo, yr end, %	4.00	5.00	3.25	3.75	4.25
Baht to US \$ 1, year average	40.2	37.9	34.5	31.5	30.0

Sources: 2005-2007 NESDB, Bank of Thailand, and CEIC; 2008-2009 forecasts by Dataconsult and IMA Asia.

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Vietnam

Political & policy issues to watch

- The battle to curb inflation**
... attacking excessive SOE investment
- Vietnam's battle against rampant inflation is shaping up as a battle against wasteful investment by state-owned enterprises (SOEs). In this regard, it is similar to a battle that Beijing is fighting with Chinese SOEs. PM Nguyen Tan Dung is going after the large SOEs that took advantage of market reforms to diversify their businesses and, in some cases, to enrich their boards. He blames them for contributing to inflation through grossly inefficient investments in glamorous areas where they have no expertise, such as banking, securities, and real estate. SOEs account for 60% of outstanding loans by state-run banks and 70% of foreign loans, yet their output is just 40% of GDP. SOEs have until May 20 to identify their inefficient investments and then move to liquidate them. However, the definition of "inefficient" is vague and there is widespread resistance by firms and provincial authorities. Moreover surging foreign direct investment (FDI), funded from capital inflows rather than local banks, is as much a factor behind high demand growth (see below).
- Tariff hike on imported cars**
- As expected Vietnam is resorting to ad hoc tariff hikes to curb a jump in its trade deficit. Tariffs on imported cars have been increased for the second time in less than a month (from 60% to 83%) after car imports soared 409%yoy in 1Q'08.
- Scrambling to find more power**
- Unable to cope with rising power consumption, electricity company EVN intends to increase its purchase of power from China this year to 3.5bn KWH, or 31% higher than last year. EVN is currently building 45 new power plants, which will add 14,589 MW by 2010. Vietnam is experiencing frequent power cuts, as demand outstrips supply. In 2008, electricity consumption is expected to grow by 17-18%, compared to a 15% increase in supply.

Outlook for the market

- A slight easing in GDP this year**
... due to steps to curb real estate ventures
- The fall in first quarter GDP growth to 7.5%yoy is either a bump in the road or the start of a slowdown that will run through this year. We think it is the latter as growth is clearly exceeding capacity and a modest easing to around 6.5% growth for 2008 would help. Much of the first quarter slowdown was driven by a slump in construction from 12%yoy growth in Q4'07 to 3.3%yoy in Q1'08. This appears to be due to a government-mandated tightening of credit to real estate ventures. This is one of several factors behind a fall in big city residential prices since April, which will cool off the construction sector this year. Outside of construction the other main sectors of the economy performed well in Q1'08. Growth in manufacturing (up 10.3%yoy), services (up 8.3%yoy), and utilities (up 11.5%yoy) was in line with strong growth for these three sectors reported last year.
- Surging demand**
... driven by a jump in FDI
- On the demand side, the slowdown in GDP growth was mainly due to a blow-out in the trade deficit, which – at US\$11.1bn - was four times bigger for the first four months than for the same period a year ago. Imports jumped 75.1%ytd for April while exports grew only slightly faster than trend at 28%yoy. The tightening of monetary policy since early this year has yet to impact consumption spending, while import-intensive capital spending, driven by FDI inflows continues at a furious pace. As widely reported FDI approvals in Vietnam in 2007 (up 136% to US\$17.9bn) exceeded, for the first time, India's FDI approvals (up 12% to \$15.9bn). As always there is a big gap between FDI "approvals" and actual flows. But India can deploy FDI at that level without distorting its economy; Vietnam can not.
- More price controls and higher rates**
+ a weaker Dong
- Inflation reached 21.4%yoy in April and with monetary policy barely working, companies should expect more price controls on goods and services. The central bank has yet to establish an effective policy rate that can influence the market. The challenge is made more difficult by a high level of dollarization, although new rules that restrict US\$ lending (typically at 9-10% versus 18-20% for Dong) came into effect on April 25. The Dong has also been allowed to weaken this year, which will add to inflationary pressure.

	2005	2006	2007	2008	2009
GDP, real growth, %	8.4	8.2	8.5	6.4	7.0
CPI, yoy, % (2005=100 from 2007)	8.3	6.6	8.5	15.0	14.0
Short-term lending rate, year end, %	11.40	11.18	11.50	12.50	11.50
Dong to US \$ 1, year average	15,832	15,970	16,010	16,100	16,263

Source: 2005-2007 data from the IMF and CEIC; 2008-2009 forecasts by IMA Asia.

India

Political & policy issues to watch

Inflation triggers a return to arbitrary controls over industry As it prepares for elections in five states, the Congress party, which leads a broad coalition government at the federal level, is desperate to control inflation, which is undermining popular support. Cuts to import duties for certain key commodities have had a limited impact. Now export taxes are being considered, although these will also have minimal impact. The government also proposes to investigate the steel industry for cartel behaviour and to return it to control by the Essential Commodities Act, which would allow the government to control production, supply, and pricing for steel. To stave off reregulation the steel companies have offered to hold prices steady for a few months.

Sidestepping a battle over quotas in education
... with a helpful court ruling Revisions to the quota system in education is a second tricky area for the Congress party and while the details are hard for outsiders to understand they are potentially explosive in India's political debate. A recent Supreme Court ruling has upheld the government's decision to reserve 27% of seats in centrally-funded educational institutions for OBCs (other backward classes), while debarring the 'creamy layer' (essentially India's elite) who happen to come from OBCs. The OBC children thereby excluded have parents that meet one of the following criteria: annual incomes exceeding Rs250,000; employed in a constitutional position; or holding a senior defence or public service position. The court's decision has been lauded by anti-quota activists. The Congress Party, which is also keen to portray the court's decision as a victory for itself, has decided not to challenge the creamy layer and instead focus on implementing the reservations.

Outlook for the market

Tighter monetary policy is slowing the economy
... particularly for low income households Faced with a steady tightening of monetary policy, India's economy is gradually slowing, with local analysts cutting forecast GDP for 2008-09 to 7.0-7.5%. Vehicle sales have been particularly hit with 2-wheelers down 8.6%yoy in the March quarter while growth for the slightly less rate sensitive passenger car market slowed to 8.9%yoy from 17.1% growth over full 2007. Industrial production has held up rather well, rising 8.6%yoy in February, but the pace is likely to slow over the next six months. The slowdown is also clear in corporate results, with net sales growth for listed companies slowing to 21% for the March quarter from 32% in the prior quarter. Fast rising costs contributed to net profit growth slowing from 44% to 16%.

High inflation should ease in 2H '08
... watch the monsoon Inflation on the widely watched wholesales price index (WPI) reached 7.4%yoy in March, well above the 5% target of the Reserve Bank of India (RBI). In an effort to control prices the RBI has focused on draining liquidity from the market. Over April the cash reserve ratio for banks was raised by 75 basis points to 8.25% April (with the last 25bp hike to take effect on May 24). With the economy slowing the RBA has been reluctant to lift its policy rate from 7.75% although a 25bp hike to 8.00% is possible in the next few months. The government is forecasting a near normal monsoon this year, which should provide a strong boost to crop production and help lower prices later this year.

A weak rupee for now – but a return to appreciation is likely While the rupee is currently weak due to concerns over inflation and a slowing economy the large interest rate differential to US rates will eventually start to push the currency higher towards the end of this FY. We have, however, lowered our year average forecast for the rupee to around a 2%pa appreciation on the US\$ in FY2008-09 and FY2009-10.

<i>Fiscal year starting 1 April</i>	2005-06	2006-07	2007-08	2008-09	2009-10
GDP (Expenditure), real growth, %	9.2	9.7	8.2	7.5	8.1
Inflation - WPI, year average, %	4.4	5.4	4.6	6.5	4.5
Inflation - CPI, urban non-manual, yr avg, %	4.6	6.6	6.0	6.5	6.0
RBI lending (repo) rate, year end, %	6.50	7.50	7.75	8.25	8.25
Rupee to US\$1, RBI Ref Rate, yr avg.	44.1	45.3	40.5	39.7	38.9

Sources: Historical data from the government (NCI, RBI) and CEIC. Forecasts by IMA India and IMA Asia.

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Australia

Political & policy issues to watch

- The new Labor government's policies**
- ... gradual tax reform** Australia's new Labor government is interested in tax reform. Business, which currently faces some 56 separate federal and state taxes, hopes reforms will cover federal, state, and local taxes. But with Rudd not committing to a review within two years and having already ruled out any increase in the GST (value added tax) from 10% little will change in his first term. Also in the pipeline is the planned introduction of the emissions trading scheme in 2010, which may offer scope to cut the corporate tax rate from 30% to 25% or less.
- ... ending federal state duplication** A litmus test of the Rudd government's ability to reform federal-state regulatory duplication will be how it handles the creation of a national system of occupational health and safety (OH&S) rules backed by a competitive national market for workers' compensation. Currently businesses operating across state borders have to deal with up to eight workers' compensation schemes and often very different OH&S regimes.
- ... introducing paid maternity leave** Companies should prepare for some changes to maternity leave as unions and some business groups push for the introduction of a national, tax-payer funded, paid maternity leave scheme for all Australian women. While some unions are pushing for 26-weeks paid maternity leave, this has been already been dismissed by the government, which has asked the Productivity Commission to complete a review of parental leave by February 2009.
- NSW power privatisation looms (at last)** Plans by the NSW Labor government to override stiff union opposition to privatise its retail electricity companies and lease out its generators for 99 years, while retaining transmission and distribution, should go through with conditional support from the opposition. The market is now watching to see if any side-deal is cut with unions, which might undermine the value of the assets.
- Handling China**
- ... curbing big acquisitions** China's voracious appetite for Australia's commodities has seen Chinalco, a Chinese state owned enterprise (SOE), take a 9% stake in Rio Tinto. Other takeover attempts by Chinese SOEs include Sinosteel's hostile takeover bid for West Australian iron ore producer Midwest. At present the Foreign Investment Review Board (FIRB) has the power to scrutinise and reject all Chinese investment worth over A\$100mn. As part of the FTA negotiations with Australia, China is pushing to have this A\$100mn threshold lifted to allow Chinese companies to invest around A\$1 billion at a time. This would put them on the same footing as US companies under the US/Australia FTA signed in 2005.
- ... a key issue for the FTA**

Outlook for the market

- 2008 - a mild slowdown**
- ... cushioned by tax cuts & rising exports** While recent surveys point to a steady decline in consumer and business confidence several factors should soften the downturn expected this year. The most immediate of these are tax cuts promised in the May budget, even though Treasurer Wayne Swan will aim for a fiscally tight budget to help curb inflation. This may well mean some big cut backs in other areas of government spending. Commodity exports are also set to jump over the next year with a recovery in grain production and higher prices for coking coal.
- Inflation will remain a worry**
- ... the A\$ will ease** March quarter headline inflation rose to 4.2%yoy. But with the economy slowing the central bank will likely hold off any further rate rise, although it will remain wary of the potential for strong resources demand plus tax cuts to push inflation higher. We've edged our A\$ year-average forecast up to 90 US cents. This is still below the average rate for the first four months and reflects the potential for a mild pull-back in the forces that have been driving the A\$ higher (the Yen carry trade, rising commodity prices).

<i>Year ending December 31</i>	2005	2006	2007	2008	2009
GDP, real growth, %	2.8	2.8	3.8	3.0	3.2
CPI, year average, %	2.7	3.5	3.0	3.8	3.5
RBA cash rate, year end, %	5.50	6.25	6.75	7.25	7.00
A\$1 = US\$, year average	0.76	0.79	0.84	0.90	0.93
US\$1 = A\$, year average	1.31	1.26	1.19	1.13	1.08

Sources: 2005-2007 government data (ABS, RBA); 2008-09 forecasts by the CEO Forum and IMA Asia.

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New Zealand

Political & policy issues to watch

The May budget With an election looming – but not yet called – PM Helen Clark's Labour-led government faces an uphill battle to hold onto government as the economy slows. Finance Minister Michael Cullen's 9th Budget on 22nd May will launch the unofficial re-election campaign with personal tax cuts. While Cullen has delivered a 3% cut in the company tax rate to 30% (which took effect on 1 April), expanded write-offs for research and charitable giving, and a streamlined and simplified company tax system, he has resisted cuts in personal rates, channelling booming revenues instead to social and other spending, and into generous rebates for families with children and with a parent in work. He did promise in 2005 to semi-index personal tax thresholds to inflation from 2008 but reneged. Cullen has said cuts will take effect from April 2009 but may opt for a cash rebate in October, preceding the election due by 15 November. Cullen has in the past talked of cuts of about \$NZ1.5 billion (about 0.8% of GDP) building over time in line with a programme he will set out in this year's budget. A poll published in the New Zealand Herald on 30 April rated tax cuts the issue most respondents said was most likely to influence their vote.

... at last Labour will offer personal tax cuts

... before facing voters in late 2008

The opposition Nationals will campaign on bigger tax cuts Whatever Cullen does, the National party will top, though details will be held back until the election campaign. This may not be by a large amount for the next year or two -- while National proposes to run slightly lower fiscal surpluses over the business cycle and proposes to make more active use of the government's healthy balance sheet (net debt was 1.1% of GDP at end-February), it is determined not to risk turning the present structural surplus into a structural deficit. But it aims over time to "restructure" the tax system. Though what that means is unclear at this stage, the party does over time want to reduce the proportion of household incomes going to tax.

The promise of expanded optical fibre broadband National leader John Key is proposing expanding optical-fibre-based broadband access to all businesses and, over time, four-fifths of homes -- the optical fibre would go right to houses, not just to cabinets in suburban streets as Telecom Corporation, the owner of the local loop, is now rolling out. Key expects the rollout to cost around \$NZ4.5 billion, towards which the government would commit \$NZ1.5 billion as a way of remedying what he calls a "market failure". Critics think Key's move might end up being a subsidy to Telecom -- just when the government has forced a three-way split to loosen its monopolistic grip on the loop and open it up to competitors.

Outlook for the market

A downturn in 2008 The NZ economy is slowing with the only uncertainty being over how hard the landing will be. Employment fell at its fastest pace in 20 years in Q1 (down 29,000 or 1.3%) while unemployment moved up to 3.6% from 3.4% in the prior quarter. Much will now depend on what happens to housing. The median house price rose in March from February but that was because the lower-priced end of the house market has stalled. Compared with March 2007, the number of sales in March was down 53% and the "days to sell" was up 48%. Various calculations suggest that house prices are at least 30% overvalued. The median price rose 76% between March 2002 and the peak in November 2007. Unravelling this will compound recent falls in consumer confidence and sluggishness in retail sales.

... with higher unemployment

... and weaker consumers

Watch for rate cuts The central bank left the official cash rate unchanged at a high 8.25% in April but the tone of its accompanying commentary shifted to putting more weight on the slowing economy's likely downward push on inflation (3.4% in the year to March, outside the Bank's 1%-3% target band). A rate cut in late 2008 is now a distinct possibility and as this weakens the Yen carry trade, a sharp fall in the NZ\$ is possible.

... and a falling NZ\$

Calendar years	2005	2006	2007	2008	2009
GDP(production), real growth, % *	2.8	1.5	2.9	1.4	1.3
GDP(expenditure), real growth, % *	2.8	2.2	3.2	1.6	1.5
CPI, year average, %	3.0	3.4	2.4	3.7	2.5
Official cash rate, year-end, %	7.25	7.25	8.25	7.50	6.75
NZ\$1 = US\$, year average	0.70	0.65	0.74	0.75	0.69
US\$1 = NZ\$, year average	1.42	1.54	1.36	1.34	1.45

* NZ sources. Colin James focuses on production GDP; we focus on expenditure GDP. Forecasts: The Hugo Group and IMA Asia

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IMA Asia

Asia Strategic Forecast 2008

5 city Schedule

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MARCH	1ST QUARTER
13th Sydney 14th Melbourne 17th Shanghai 18th Hong Kong 19th Singapore	<i>Regional Strategic Forecast Update to 2015</i> - Richard Martin, MD, IMA Asia <i>Asia's Consumer Expenditure Outlook to 2015</i> - Clint Laurent, MD, Global Demographics
JUNE	2ND QUARTER
5th Melbourne 6th Sydney 11th Shanghai 12th Hong Kong 13th Singapore	<i>Regional Strategic Forecast Update to 2015</i> - Richard Martin, MD, IMA Asia <i>Managing India's Slowdown</i> - Adit Jain, MD, IMA India
SEPTEMBER	3RD QUARTER
4th Sydney 5th Melbourne 9th Singapore 11th Hong Kong 12th Shanghai	<i>Regional Strategic Forecast Update to 2015</i> - Richard Martin, MD, IMA Asia <i>The Outlook for China to 2015</i> - Hugh Peyman, Director, Research Works
NOVEMBER	4TH QUARTER
20th Sydney 21st Melbourne 24th Shanghai 25th Hong Kong 26th Singapore	<i>Regional Strategic Forecast Update to 2015</i> - Richard Martin, MD, IMA Asia <i>Human Resource Strategy for Asia</i>

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