ASIAN ECONOMIC PROSPECTS: COPING WITH RISING RISKS

Presentation to

ECONOMICS SOCIETY OF SINGAPORE

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IN A NUTSHELL

- Cyclical prospects under a cloud
  - Geo-political risks → oil price shock
  - US slowing: external demand?
- Resilience to shocks is the key now
  - External position more robust
  - Investment rates to rise
- Bottom line: difficult times ahead
  - But region can absorb shocks better

POLITICAL RISKS

Geo-political risks rising

- Middle East: expanding conflict
  - Oil prices, risk premium to surge
- Korean peninsula
  - Result: Sino-Japan ties worsen
- Indo-Pakistan relations
  - Mumbai bombings raise tensions
- Thai, Malaysian risks - manageable

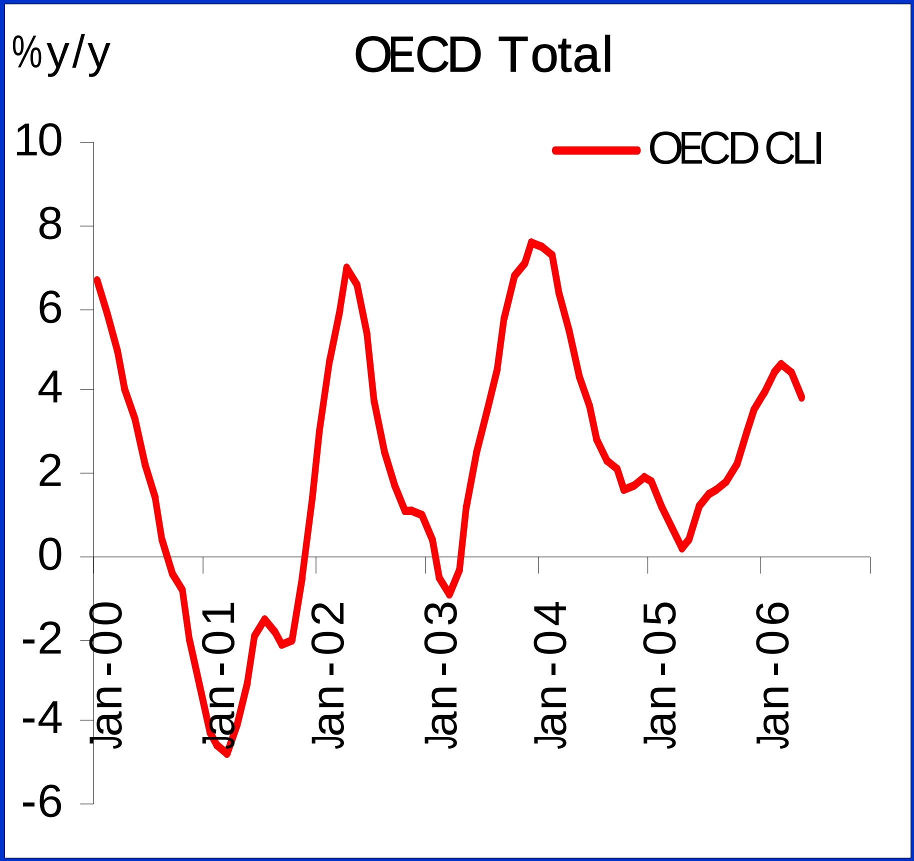
ECONOMIC PROSPECTS

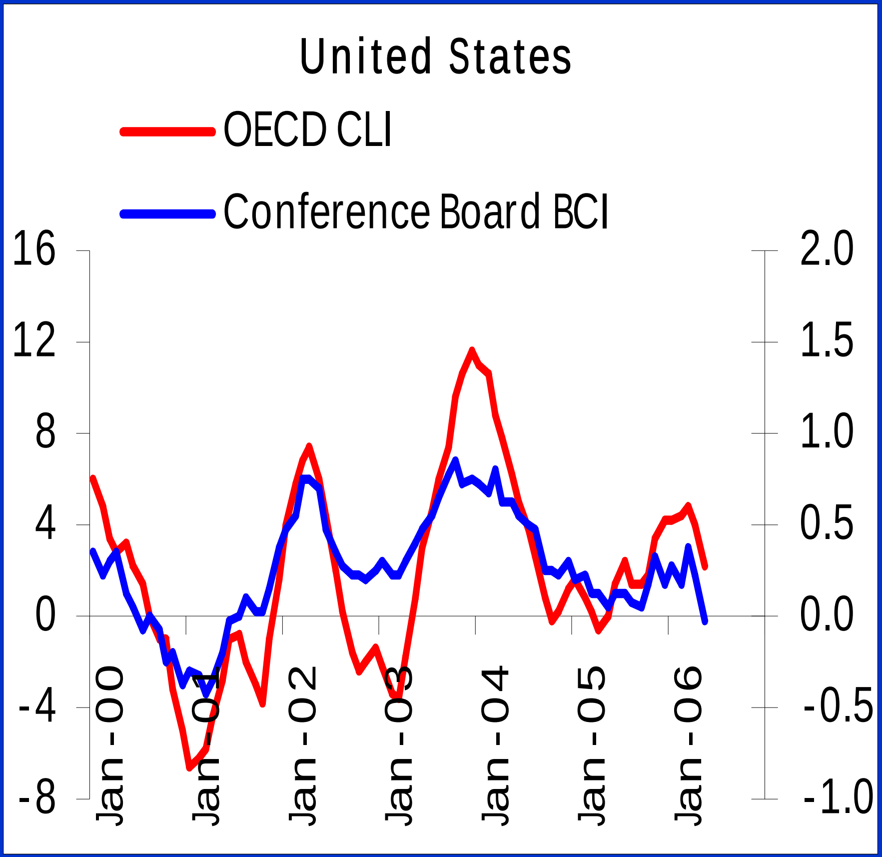
Global economic risks

- Global demand growth murkier
  - Lead indicators in OECD weaker a bit
- Tech demand – so far, so good
  - Electronics demand vital to SE Asia
- Lagged effect of rising rates, oil prices
  - Monetary conditions tighter
  - Oil prices nearing Oil Shock levels

CYCLICAL PROSPECTS

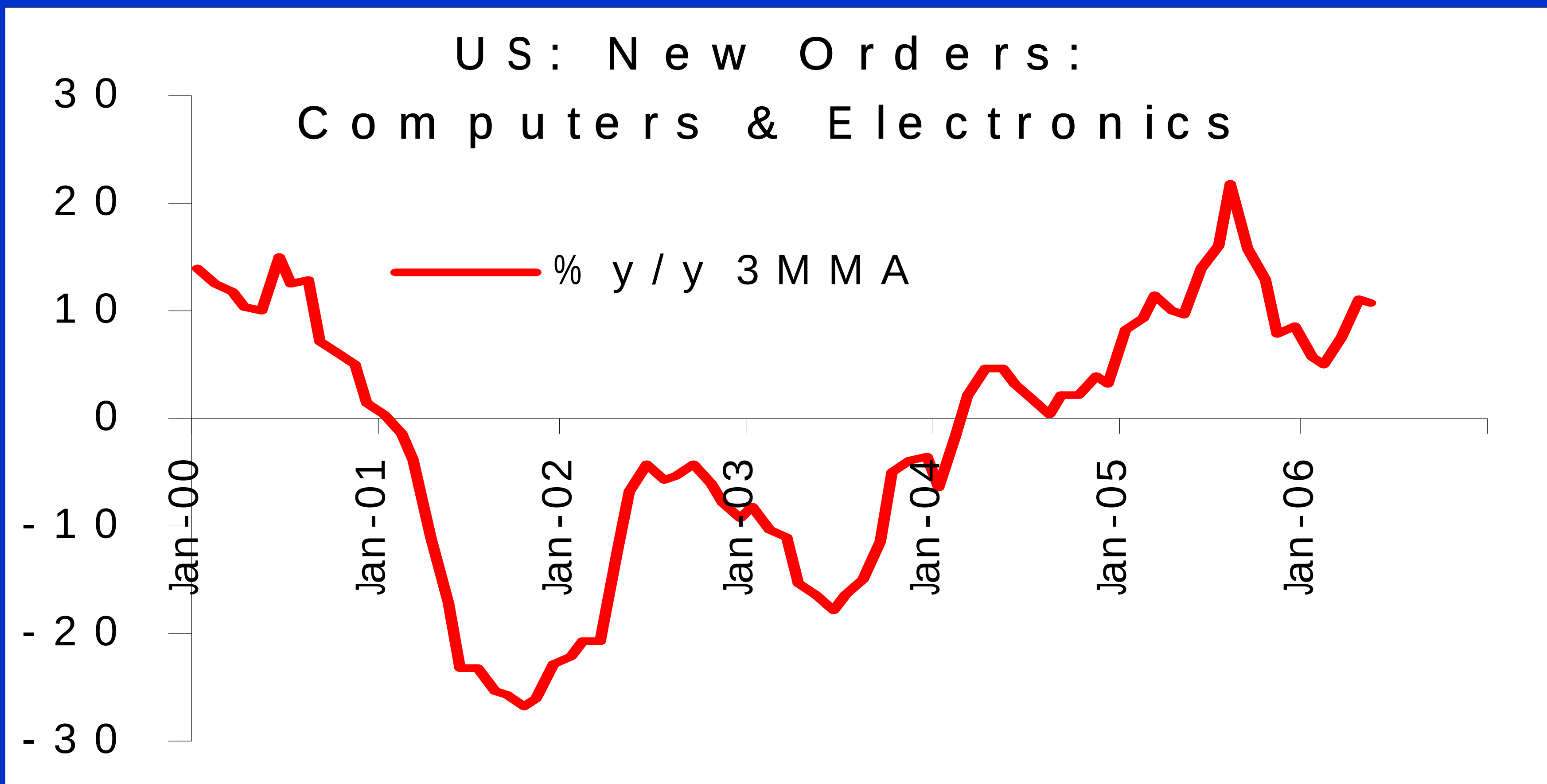
OECD lead indicators flash warning





CYCLICAL PROSPECTS (2)

Tech demand indicators fair



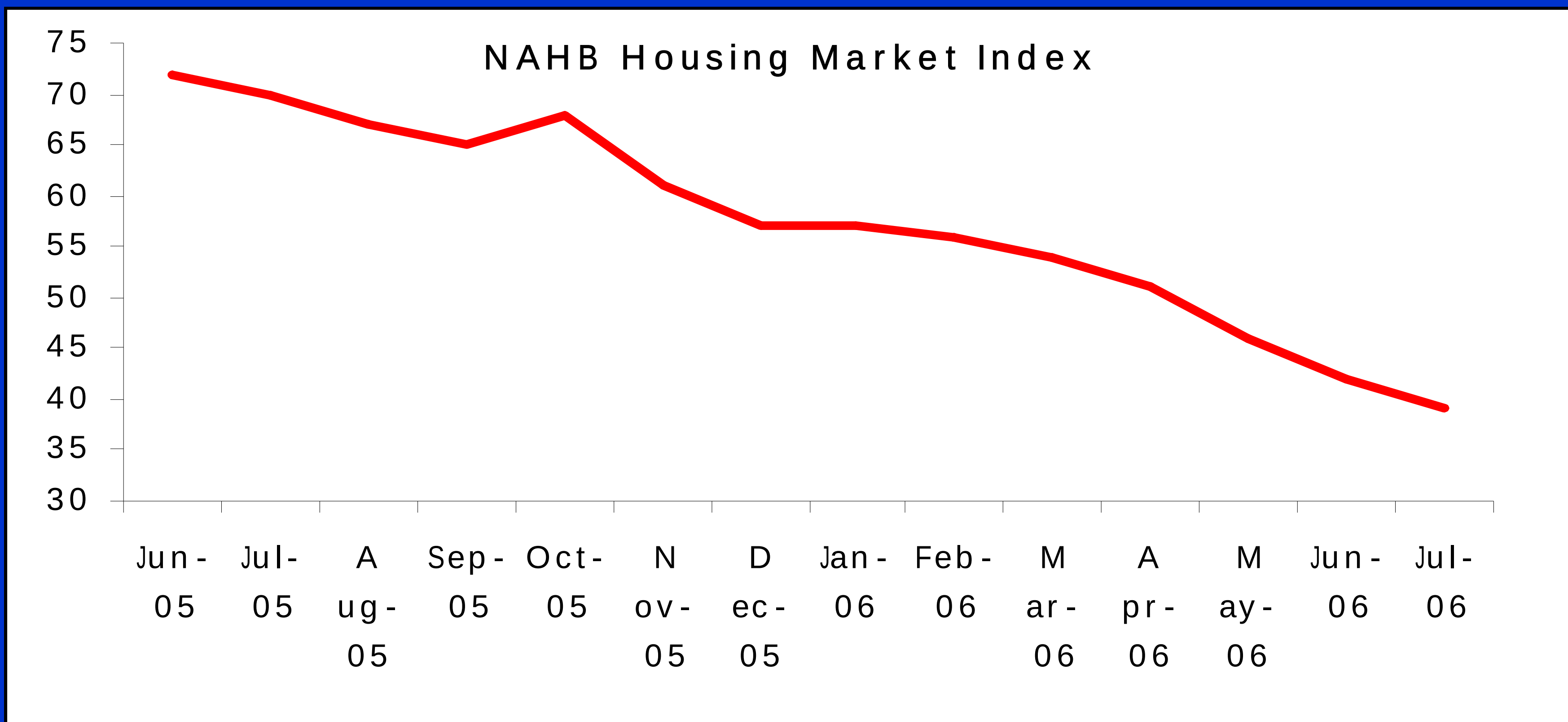
US: CONCERNS RISING

Confluence of positives ending

- Economy boosted by
  - Unprecedented monetary, fiscal stimulus
  - Massive housing boom
- Consumption likely to slow
  - Housing boom ending
  - Jobs and incomes not enough to support

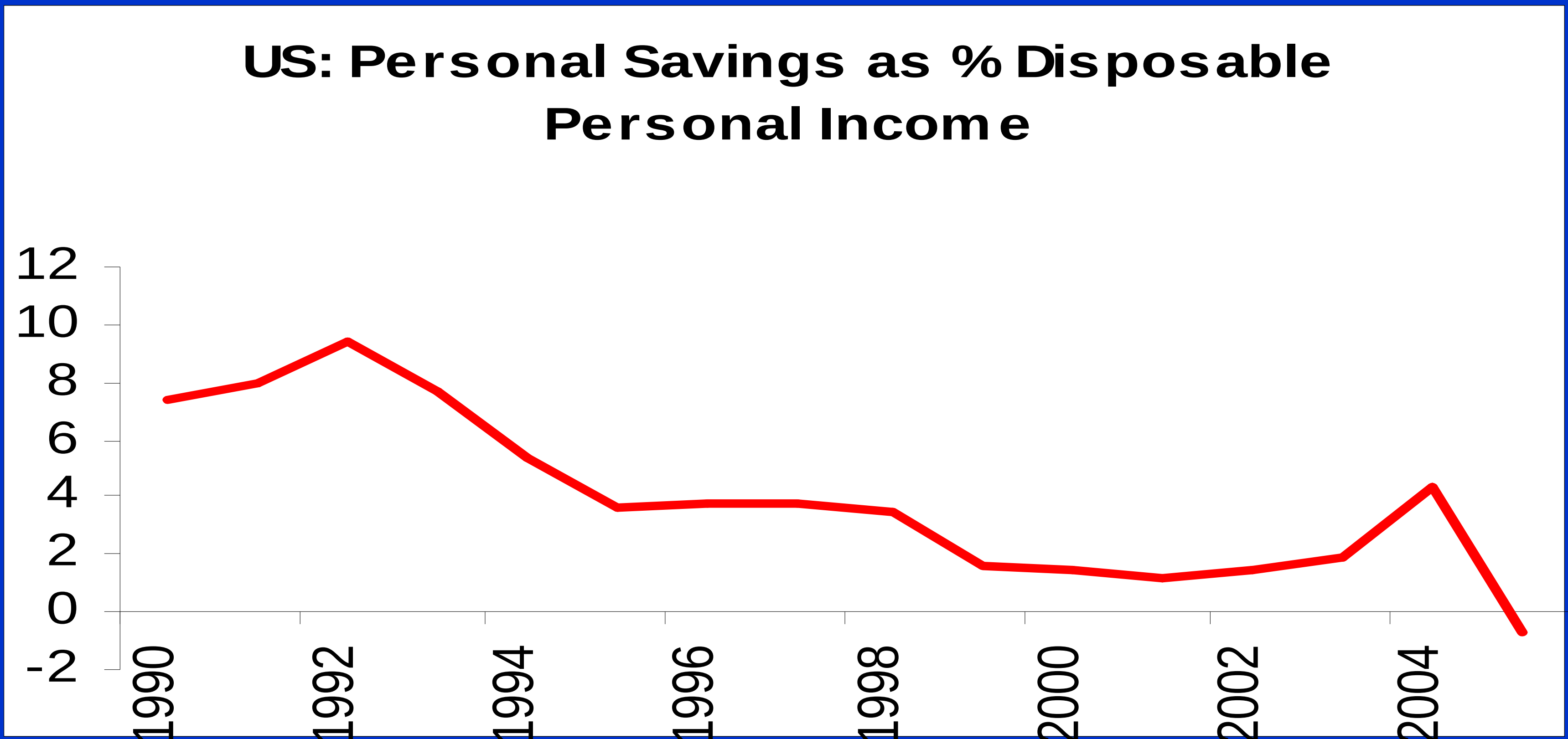
US: HOUSING BOOM WANES

- Inventory of homes at 6.5 months.
- Housing-related employment easing
- Mortgage applications decelerating



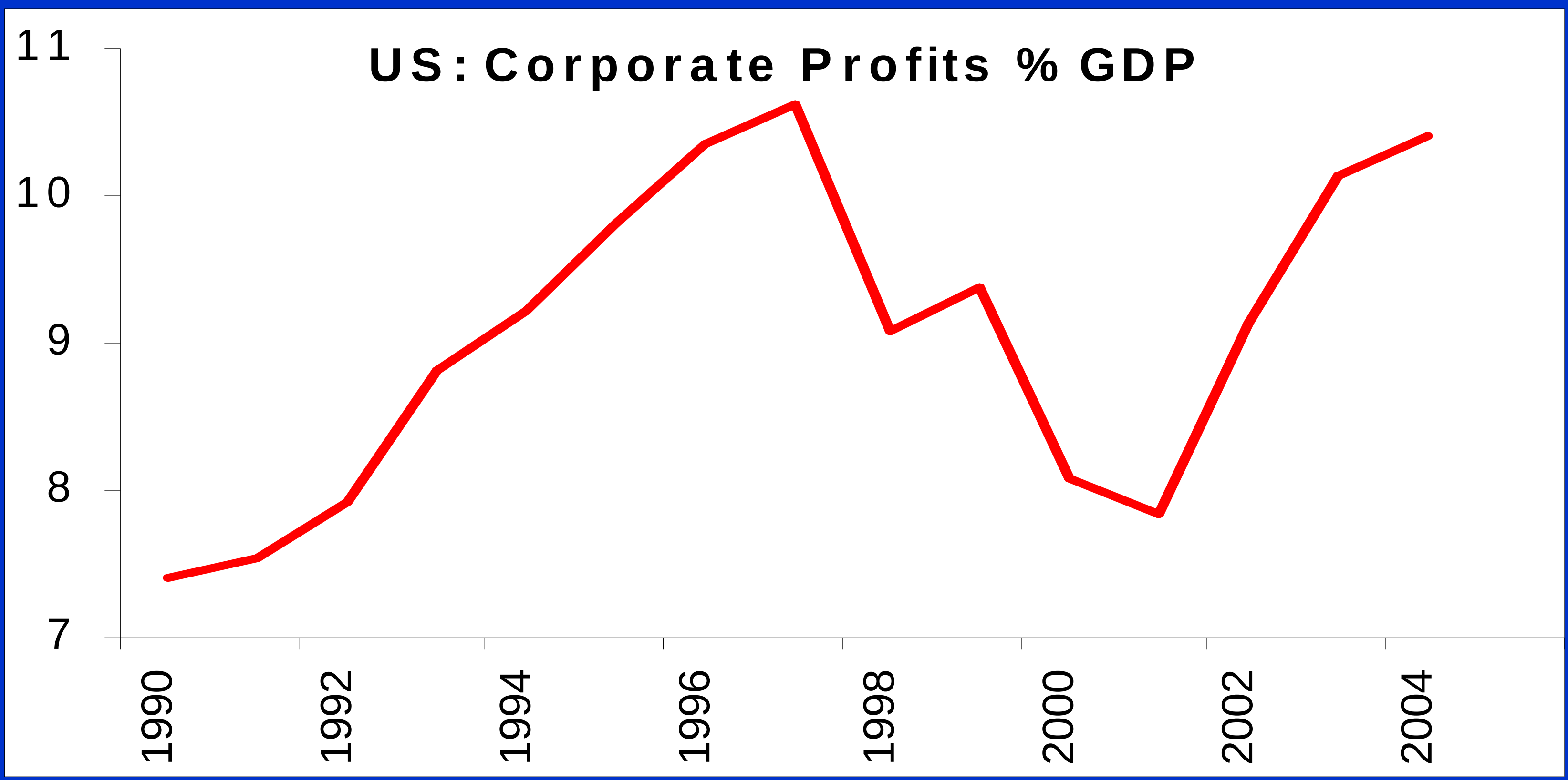
US: SAVINGS RATE TOO LOW

- Savings rate lowest since 1933
- Trigger for rise: end of housing boom



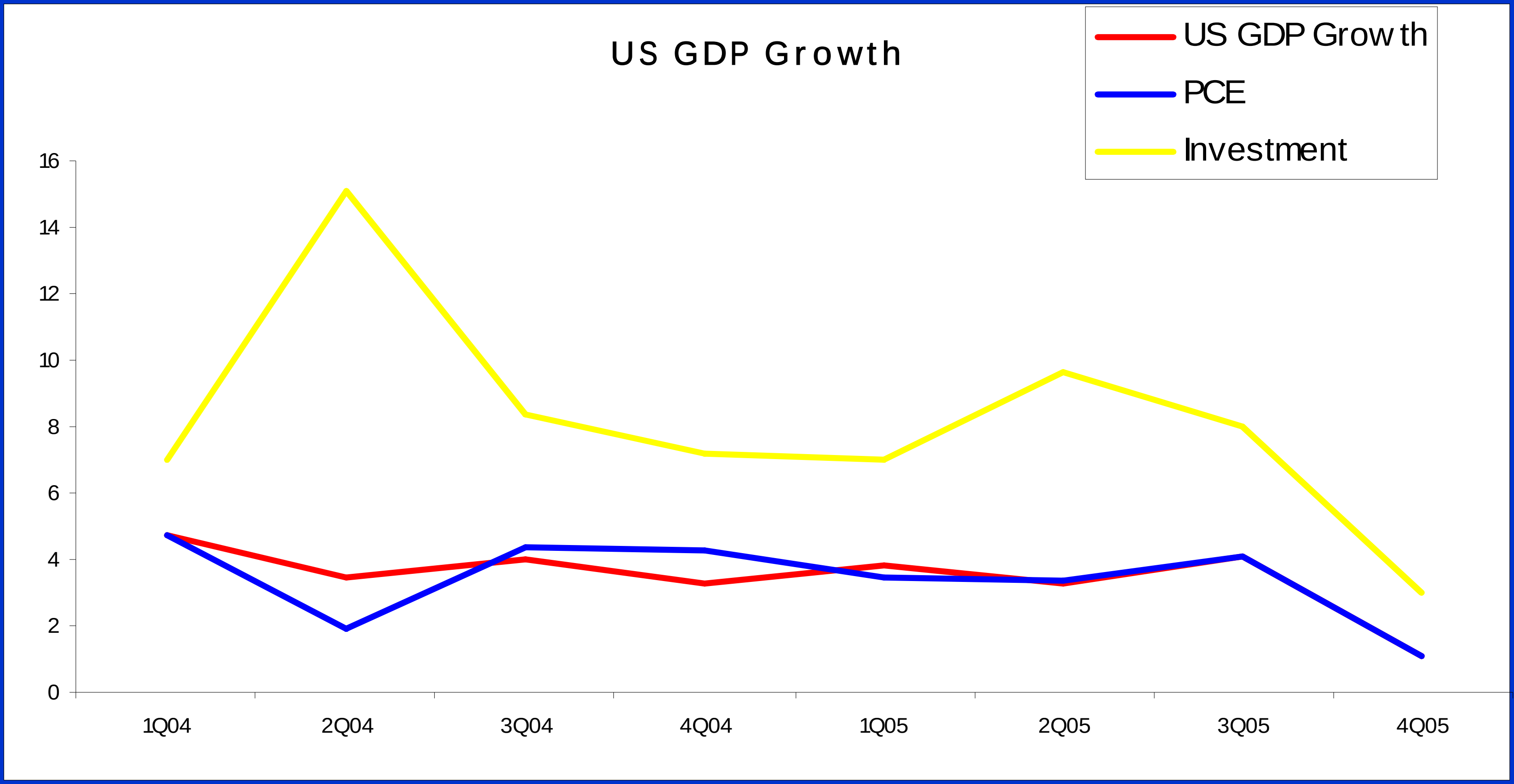
US: BACKLASH VS COMPANIES

- US profit/GDP ratio unusually high
- Invites backlash against companies



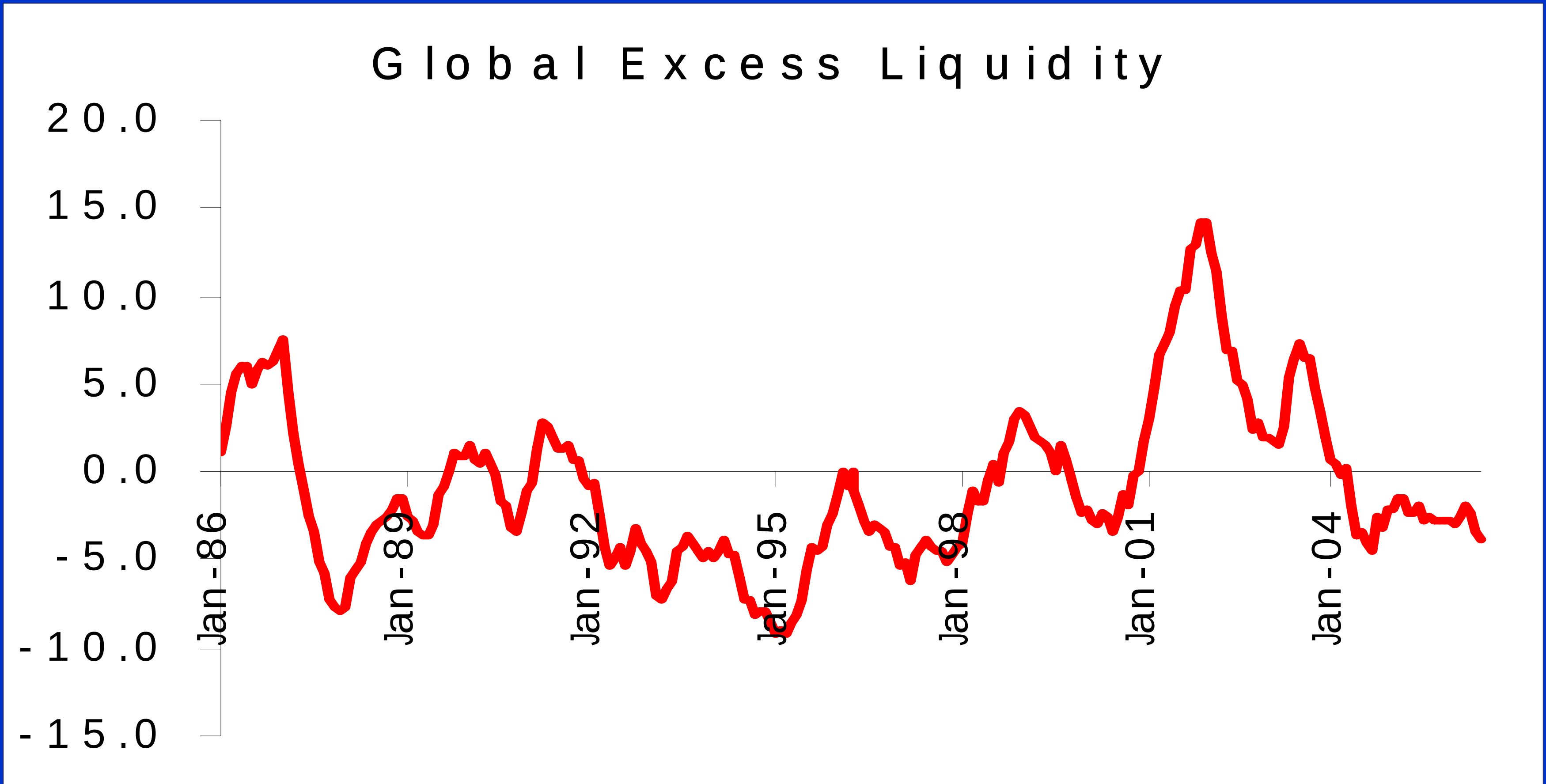
US: CONSUMPTION DRIVES GDP

Investment fair but not enough



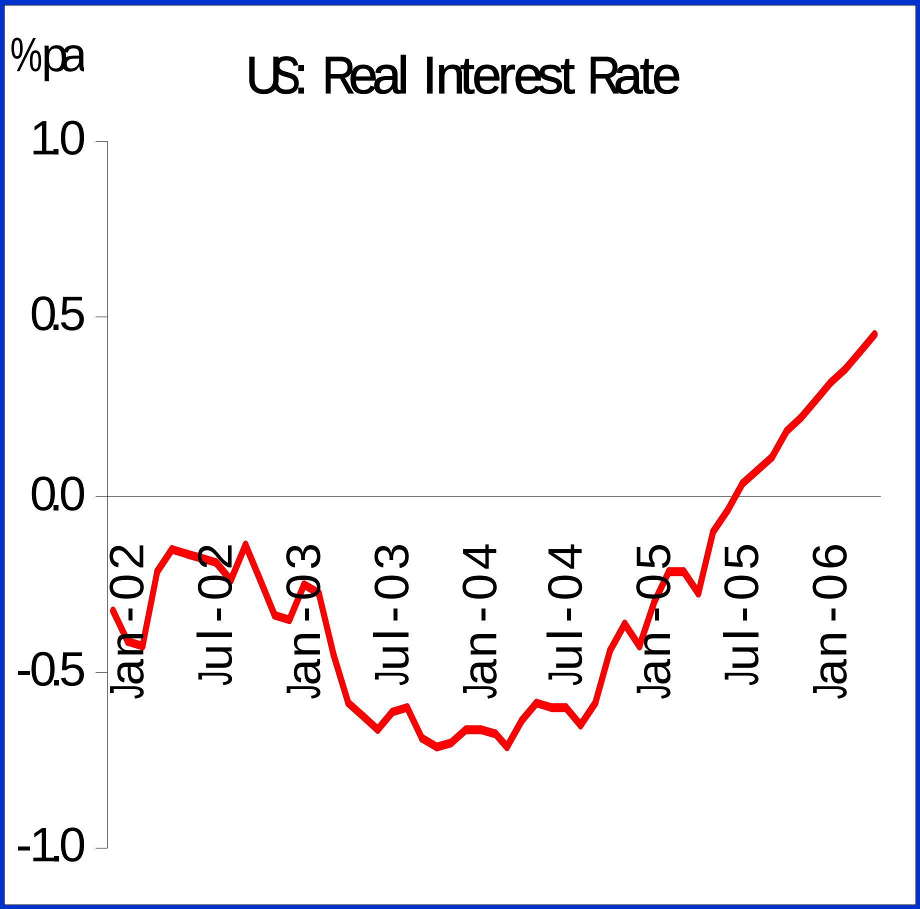
GLOBAL LIQUIDITY HIGH BUT ...

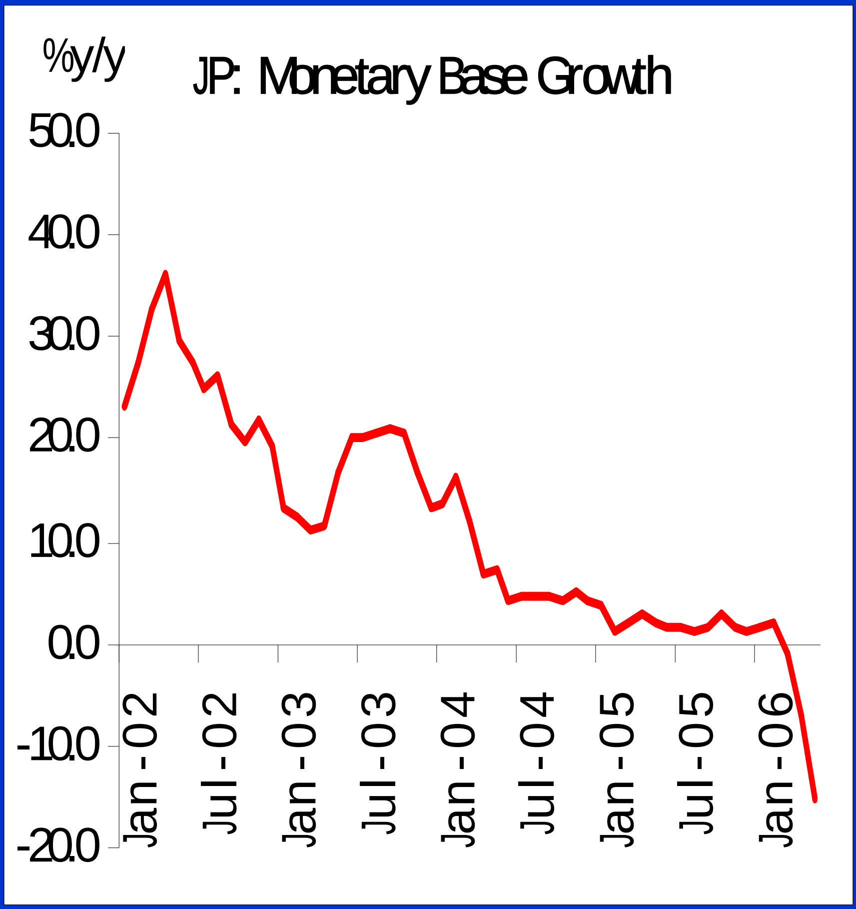
Centennial excess liquidity: warning sign



GLOBAL LIQUIDITY - NEGATIVE

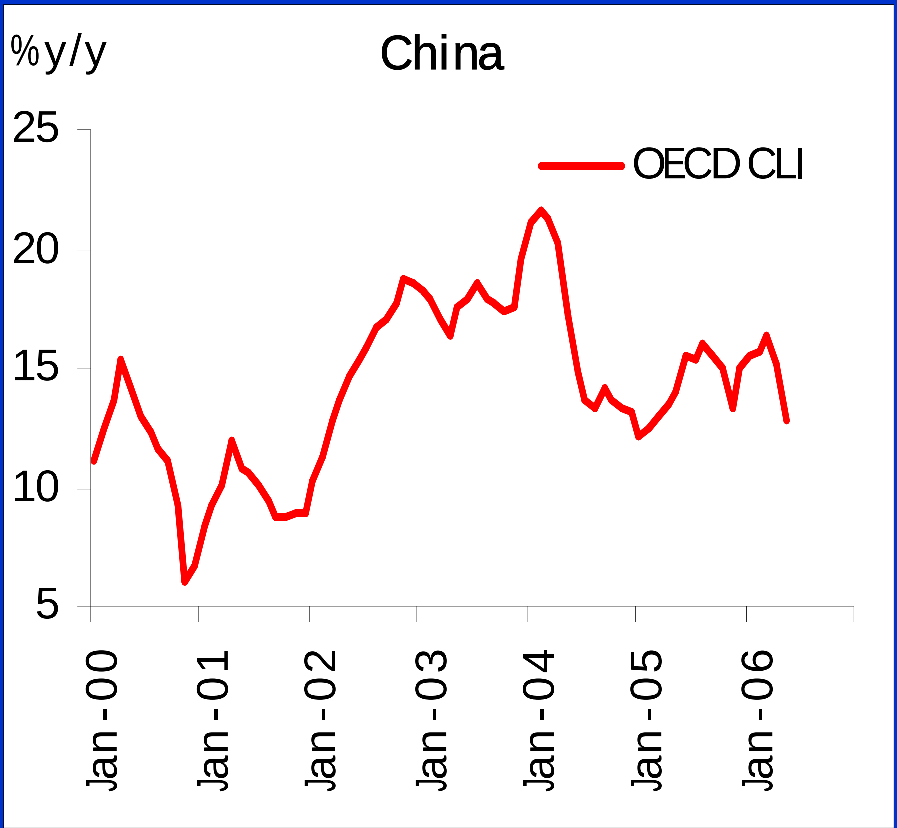
US, Japan – more tightening

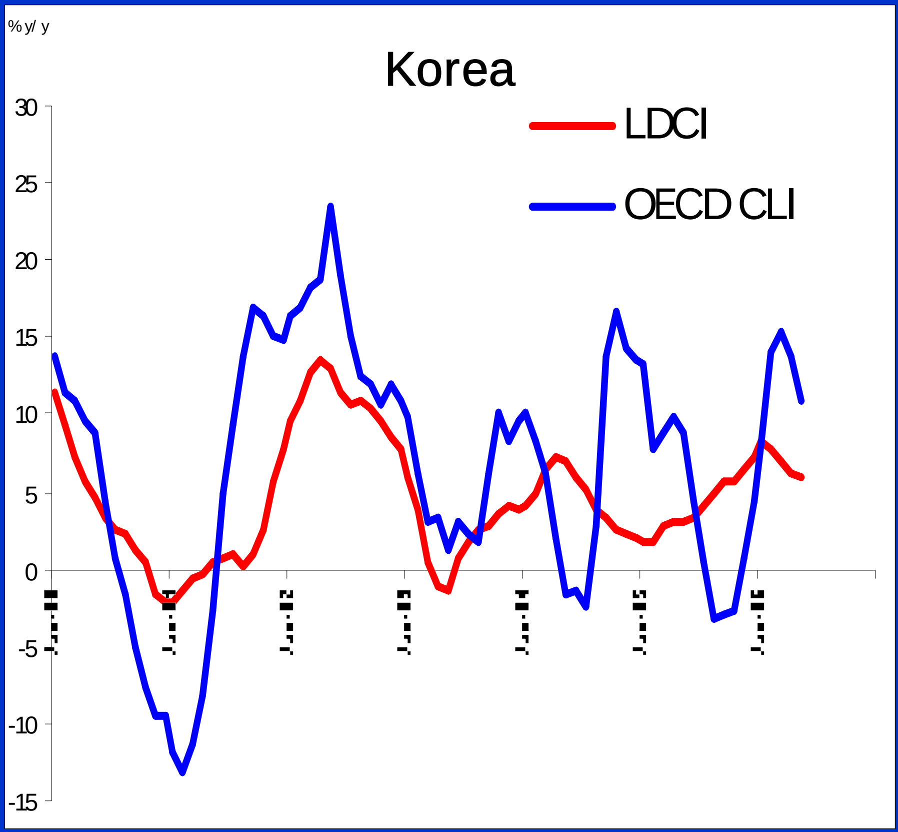




IMPACT ON ASIA

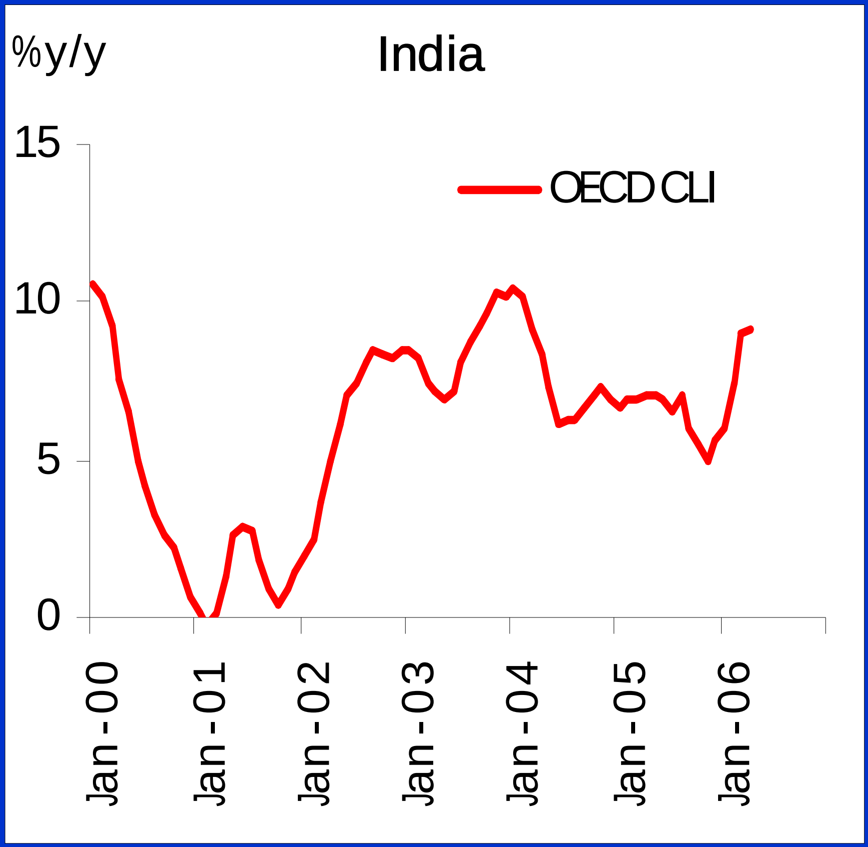
Regional lead indicators point to moderation

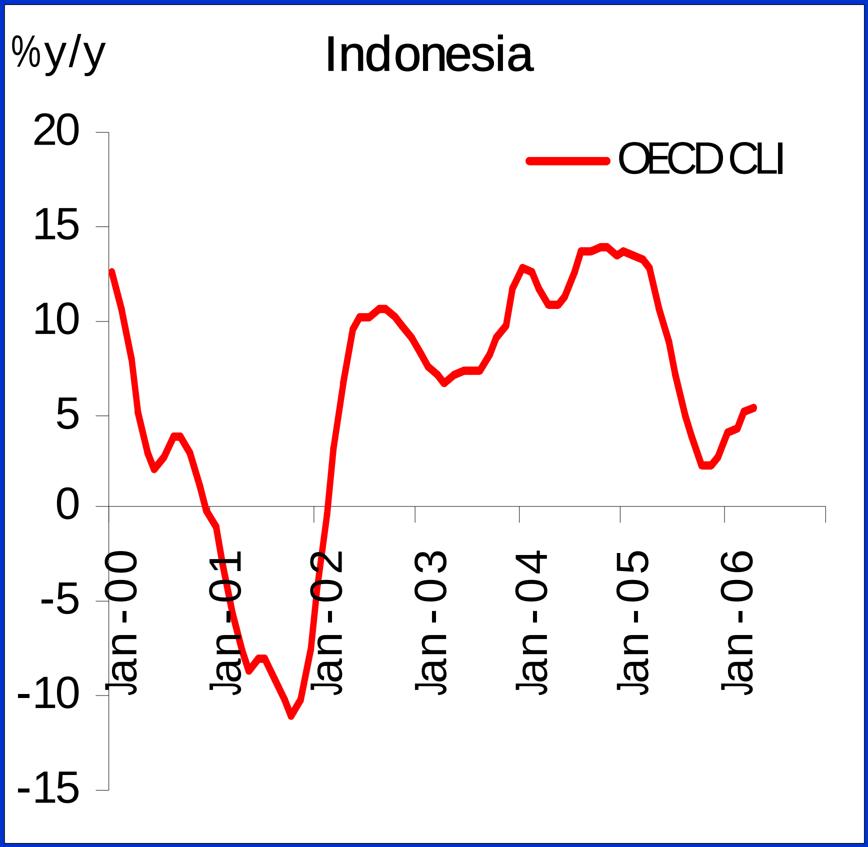




IMPACT ON ASIA (2)

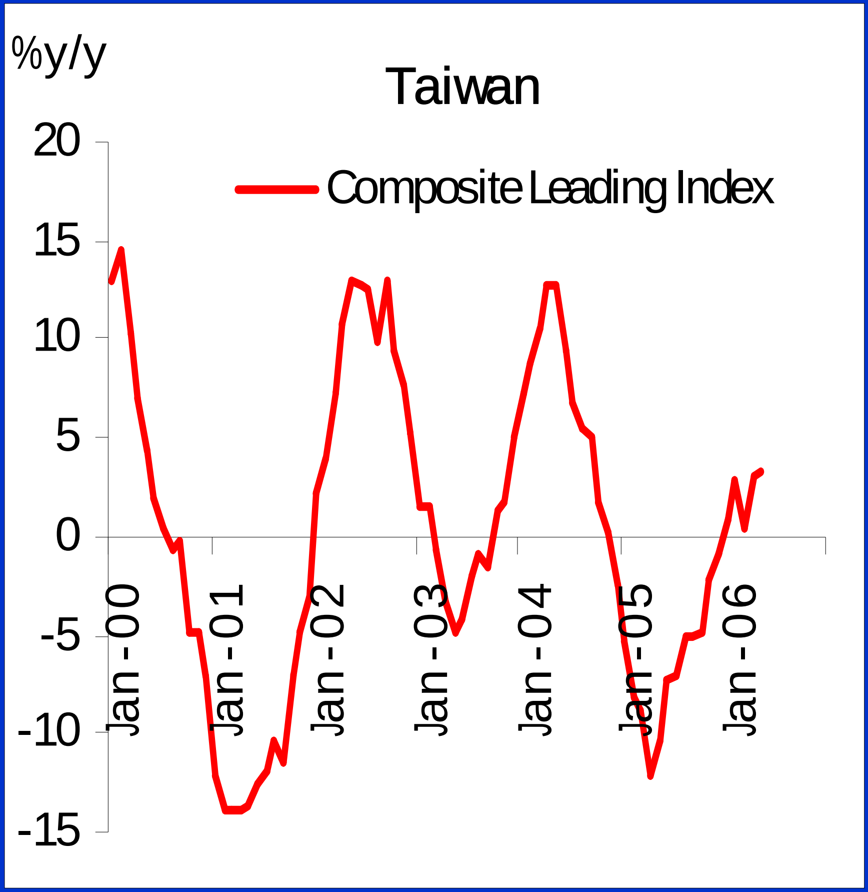
But others seem to be better off

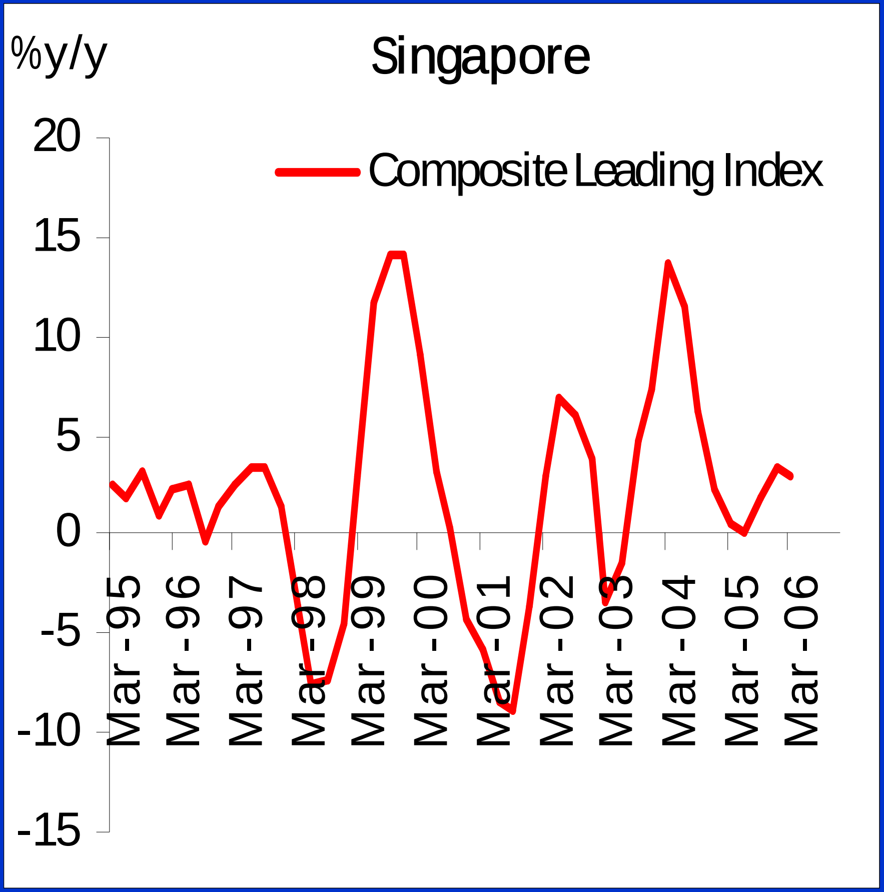




IMPACT ON ASIA (3)

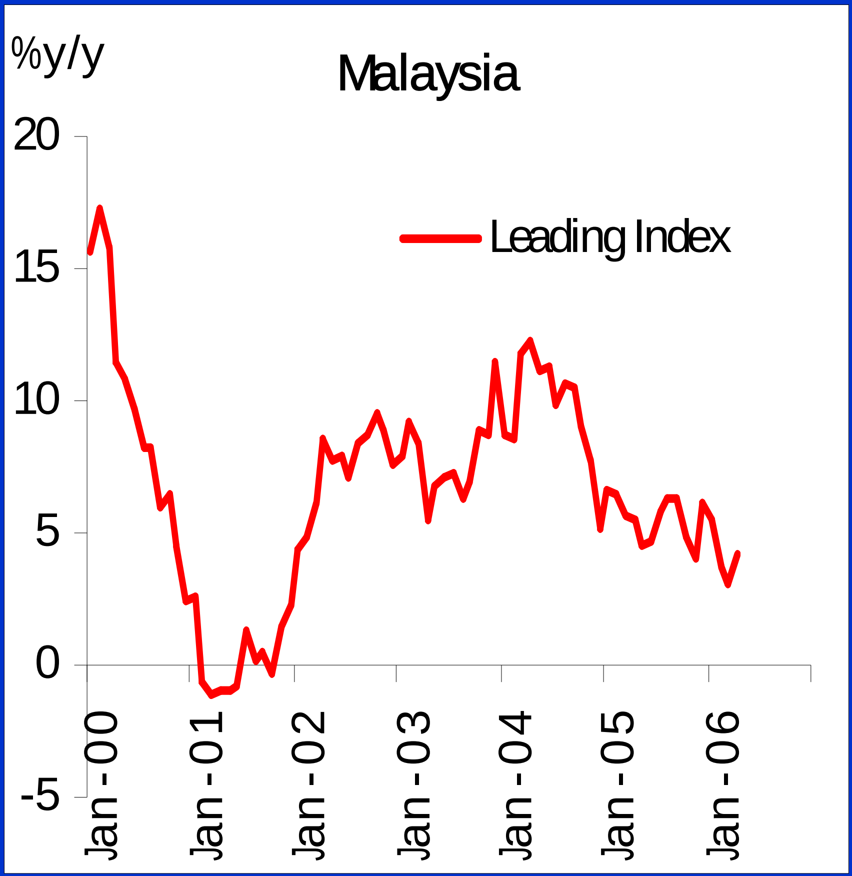
But others seem to be better off

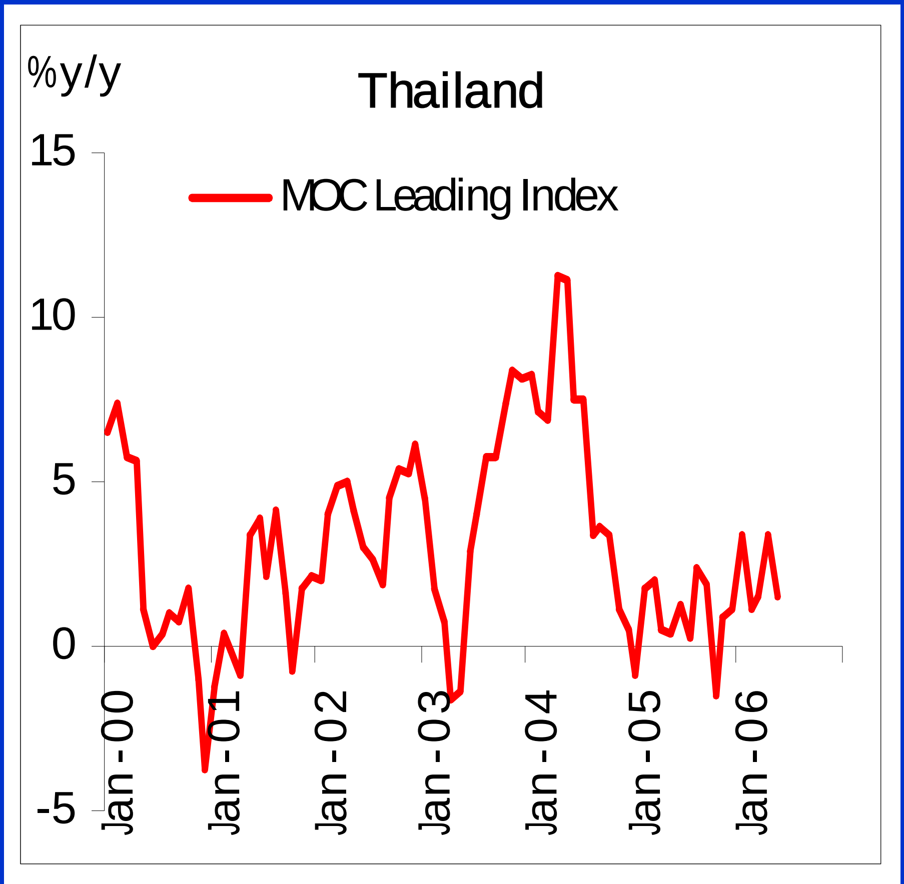




IMPACT ON ASIA (4)

Malaysia and Thailand cloudy





RESILIENCE IS THE KEY

Impossible to predict precise shock

- Initial hit – Asia is open will suffer
  - Export diversity helps – markets, products
  - Singapore, HK, Malaysia worst off
- Amplifiers and shock absorbers
  - Currency flexibility, capital flows
  - Banks, corporates – financial strength
- Ability to respond effectively
  - Govt, companies, labour market flexibility

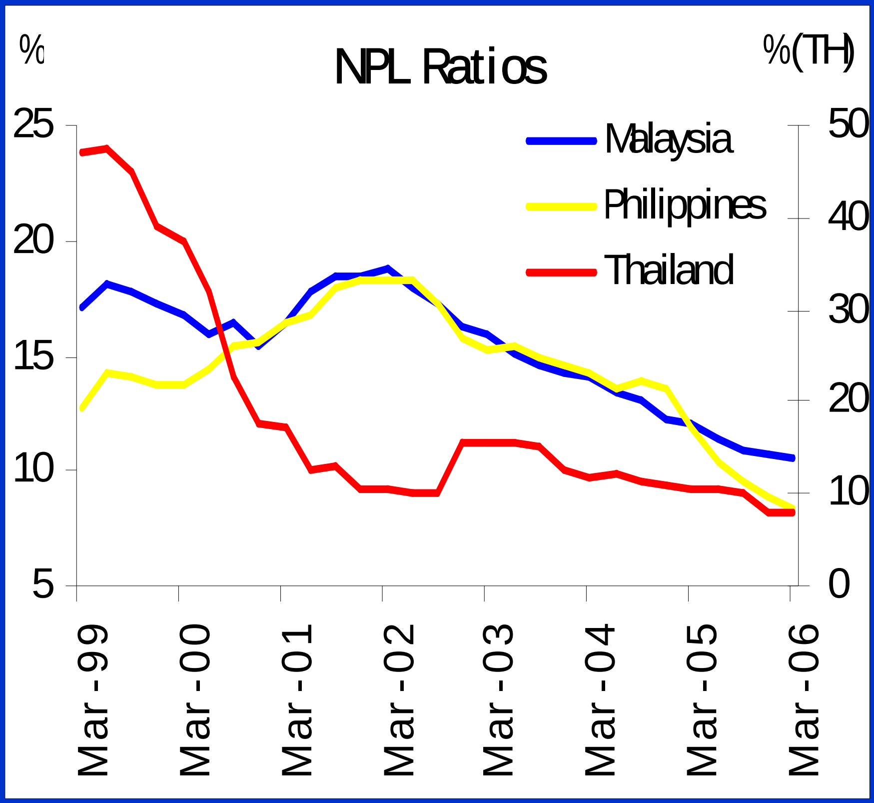
HOW RESILIENT IS ASIA?

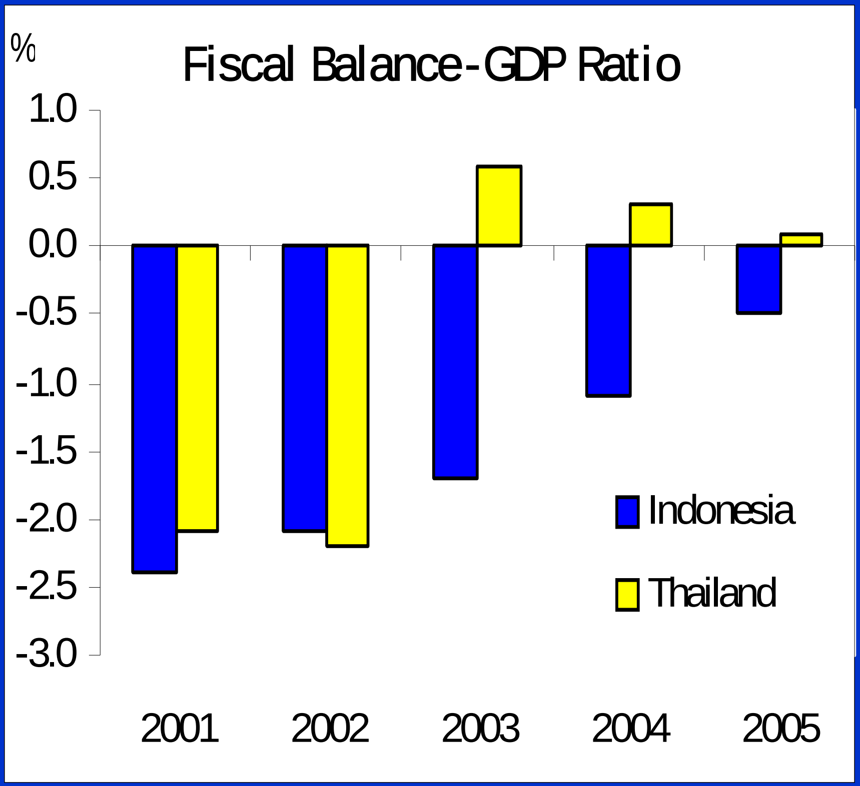
Resilience has improved

- Economies more diversified
  - Japan's recovery helps
  - New niches of activity expanding
- Domestic demand has healed
  - New investment cycle starting
- Better policy:
  - exchange rates flexible more anticipatory

ASIAN RESILIENCE BETTER

Financial sectors stronger, fiscal balance restored





CHINA: RISKS REMAIN

- Short term strength
  - Massive monetary easing, now reversing
- Over-investment via bad lending
  - Huge excess capacity in more sectors
  - Big increase in illegal lending
- Corporate sector under pressure
  - Pricing power falling, cashflows hurt
  - Financial stresses emerging

CHINA: TRIGGER FOR SLOWING?

Timing of slowing unpredictable

- External shock could be trigger
  - Unexpected downturn US/global demand
- Policy dilemmas rising
  - Exchange rate vs interest rate vs admin
- Domestic shock possible
  - Political: rising social tensions
  - Financial: signs of more stresses

INDIA: HOW SUSTAINABLE?

Short term risks, long term surge

- Monetary policy behind the curve
  - Rates to rise, credit growth too high
  - External accounts deteriorated, inflation
  - Vulnerable to oil prices, capital outflows
- Long term: acceleration
  - Easing constraints, new growth areas…
  - Manufacturing competitiveness to rise

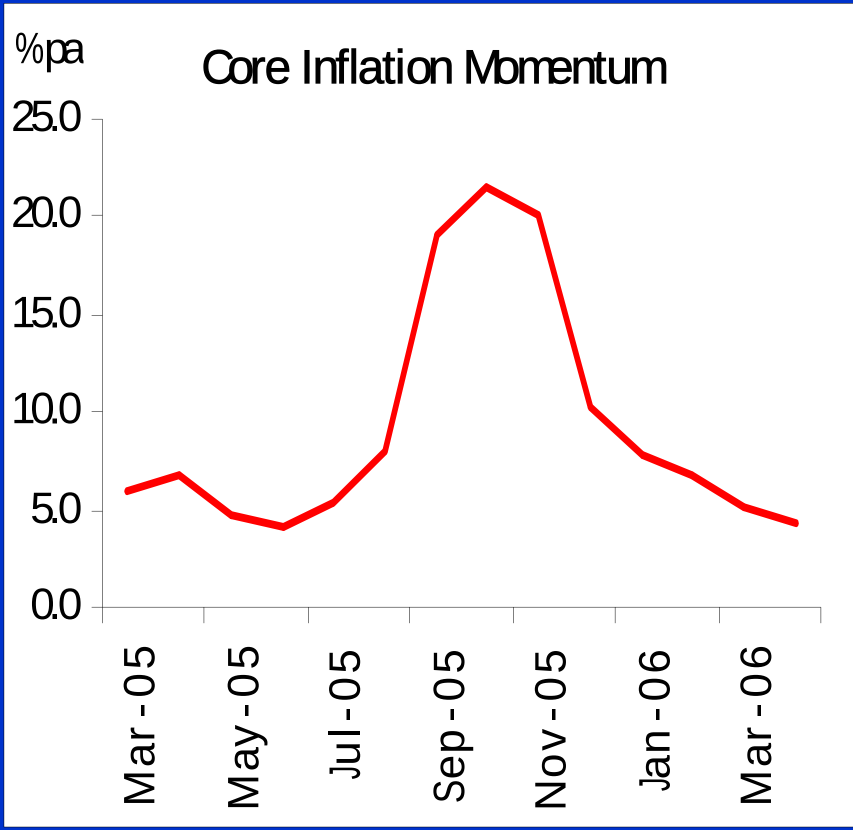
INDONESIA: BACK ON TRACK

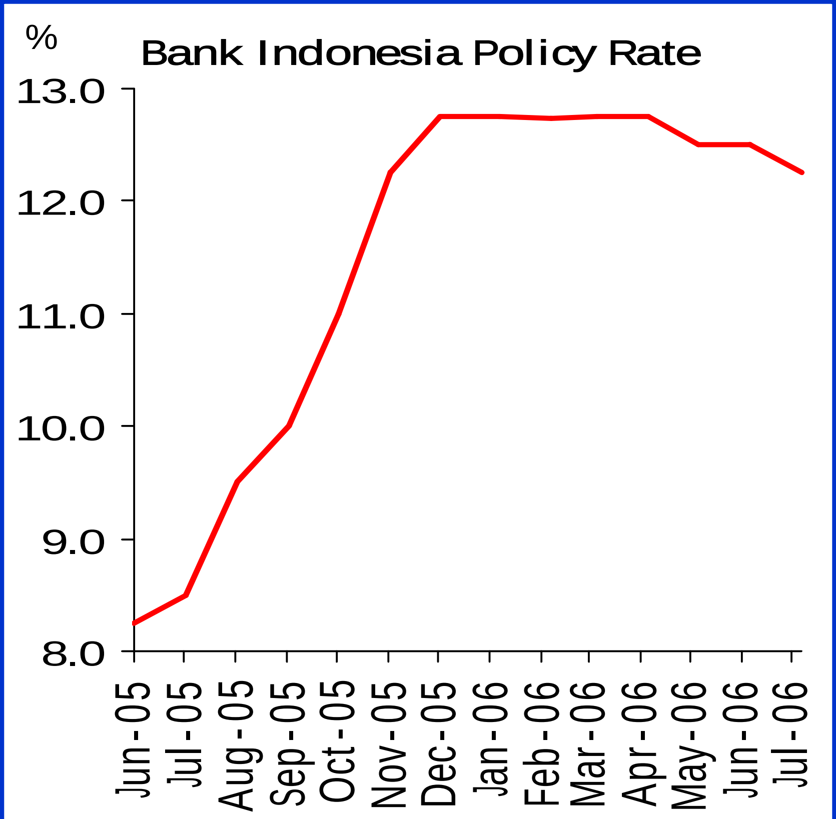
Despite the bad news

- Confidence returning, stabilising
  - New economics team
  - Reforms – slow but cumulatively strong
- Monetary policy is easing
  - Rates cut, more cuts likely
- Govt spending to rise
- Risks: Avian flu is getting serious

INDONESIA: FALLING INFLATION

Allowing interest rates to fall, spurring growth





MALAYSIA: STRONGER

Vulnerable to global demand cycle but:

- 9MP spending to be ramped up
- Policy changes boost supply side
  - Restructuring GLCs, subsidy cuts
- Offshore services: highly competitive
  - 3rd ranked globally after India, China
- Fall in private investment reversing
  - ROEs improving, capacity utilisation too

MALAYSIA: LONG TERM

Some positives but worries growing:

- Niches: education, transport, health
- Large oil finds

BUT

- Political uncertainty a negative
  - Short and long term issues
- Long term risk – competitiveness

SINGAPORE: REBOUNDING

Restructuring producing benefits

- New sources of growth emerging
- Extraordinary resilience to oil prices

Reversal of previous negatives

- Regional recovery
- Property, construction turnaround
- Job market booming: boosts demand

SINGAPORE: GROWTH AREAS

Promising areas of growth

- Pharmaceuticals:
  - Diversifying from electronics
- Services
  - Financial: wealth management
  - Oil related services/manufacturing
  - IT services: computer animation
  - Creative industries

THAILAND: WEAKER

Sharp slowdown in 4Q06

- Investment to fall, public invt down
- Exports holding up

Offset by 2005 negatives disappearing

- Avian flu, drought, tsunami effects

Politics the key risk: turning point near

- Tensions high, compromise soon?

THAILAND: STRUCTURAL POSITIVES

Competitive niches emerging

- Manufacturing
  - autos, auto parts, appliances
- Services
  - Healthcare, regional HQs, ...

Re-balancing rural vs urban

- More policies to improve balance

PHILIPPINES: HOLDING UP BUT …

Despite bad news, growth has recovered

- Strong remittances
- Agri output rising

Major structural fault lines

- Fiscal deficit better, still a drag
- Manufacturing competitiveness?
- Political risks likely to intensify
  - President has narrow window

CONCLUSION

External – confluence of negatives

- Geo-political risks unpredictable
- Imbalances → crunch point?

Economic prospects

- Ex-oil risks are rising – US etc
- Asian resilience has improved
- SE Asia could surprise well in 2007