

# Asia/Oceania Weekly Outlook



Oscar Sánchez  
1 (416) 862-3174  
oscar\_sanchez@scotiacapital.com

- **Record yen strength to remain driver of Japanese economic rebalancing**
- **Korean won weakness fuels the uptrend in export shipments so far into the third-quarter**
- **Australia's adroit economic management fails to translate into political gains**
- **Thai bath strength to continue as central bank guards upward inflationary trend**

## Record yen strength to remain driver of Japanese economic rebalancing

Export volumes out of Japan have yet to show the effects of record-high JPY. The Bank of Japan's real trade balance report displayed a significant pickup in export volumes for July. The index reached 123.8 last month; a pickup from the 120.8 and 110.3 three-month averages for the first and second quarters, respectively. The data is derived from export receipts and export/import price indexes, and is not seasonally adjusted. Barring seasonal effects, the trend in Japanese foreign shipments remain in stark contrast with yen strength. Looking more closely at JPY recent fluctuations, we note that during April-June the currency strengthened vis-à-vis the Euro (6.6% in average quarterly values), while weakening against the US dollar (-1.4%). Japanese exports to both China and the US have therefore benefited from a higher average USDJPY, while foreign sales to Europe were hurt by a lower EURJPY. International Monetary Fund direction of trade statistics for 2009 indicate Japanese shipments to China and the US accounting for 18.8% and 16.4%, respectively; while exports to Europe represent 9.2% of total foreign sales. This explains in part the lagged response from exports to the rise in the value of the yen, while also opening a window into what to expect in coming months. So far in the third-quarter, average currency trends have USDJPY and EURJPY lowering in unison. A further exchange rate impact on the country's exports remains thus only a matter of time.

GDP growth in Japan registered a meager 0.1% q/q gain in the second-quarter which was in part pay-back from the 1.1% previous three-month gain. A fall in the contribution of net exports was instrumental to the slowdown. However, as explained above export volumes only slowed slightly, while imports increased significantly. As a logical result of strengthening currency trends, that prevail so far, import volumes continued to tread higher in July, rising to an estimated 104.7, from the 99.3 average index level for the first-half of 2010. A pickup in the demand for foreign goods speaks of an enhanced outlook for consumer spending which remains supported by confidence indicators, growing labour market participation and rising bank credit flows to individuals. The number of jobs created during July increased more than the size of the labour force –which continued to accelerate– resulting in a small reduction in Japanese unemployment to 5.2%. Real household spending fell (0.4% m/m) in July, following June's strong pickup (2.9%). In our view this indicates that the still favourable external outlook continues to trickle down to the domestic market. Private consumption represents 57% of Japanese GDP, while exports stand at 15.4%. This figures stand in contrast with Germany and China where the export/output share reaches 41% and 37%, respectively.

## Korean won weakness fuels the uptrend in export shipments so far into the third-quarter

South Korean merchandise exports continued on an upward trend through the beginning of the third-quarter. The value of monthly sales of goods to China, where one-fourth of total foreign sales are directed, broke through the US\$10 billion mark in July, while corresponding figures to the US and Japan continued to rise over-and-above average values registered through the first-half of 2010. The trends are corroborated when focusing on export volume indexes which continue to reach unprecedented heights. Korean won (KRW) weakness has helped propel exports as the currency has lost 2.9% against the US dollar so far this year, standing now at 1191. The KRW was weaker on average during the second-quarter excerpting a favourable tone to the country's foreign sector. The effect has continues so far through August, leading us to expect no disruption in the trend. Merchandise exports have

been the major driver of the South Korean economic recovery in tune with the rest of the Asian region, with the outlook for consumers improving as economic activity gains have spilled into the domestic market. Although a survey of consumer confidence captured a slight retraction in the mood of shoppers during August, few changes were observed, as most indicators remained elevated with the overall index continuing to show optimists outnumbering pessimists. Rising private sector employment numbers have accompanied a swelling labour force, with the gains in the latter exceeding job creation. This has compounded with a discontinuation of public sector economic support programs to result in a small rise in the unemployment rate. The still favourable economic landscape for the country has already caused swift gains in investment spending, and we continue to anticipate a similar pickup in consumer spending patterns in coming months. We expect the Korean economy to grow 5.5% in 2010 followed by a return to trend growth (4.5%) in 2011.

#### **Australia's adroit economic management fails to translate into political gains**

Australia's Labour Party failed to capitalize on its ability to keep a buoyant economy during the global slowdown. Australia's economy, like the US, not only avoided a second Great Depression, but manoeuvred swiftly around the Great Recession as GDP contracted only in the final three months of 2008. The stellar economic performance failed to be reflected in the polls as Labour's preference amongst the electorate dwindled almost steadily from a peak back in February. The turning of the tables in voters' sympathy started with ex-prime minister Rudd but continued after a slight ascent in June under current Prime Minister Julia Gillard. The downturn resulted in Labour's coming short of the 76 seat mark to lead the 150-seat House of Representatives, with the current vote tally leaving Labour with 72 seats and the Liberal-National coalition led by Tony Abbott at 70. The inconclusive outcome hints at the public's unhappiness with both parties, as political momentum swings towards independents leaving a hung parliament.

Notwithstanding Labour's electoral setback, the Australian economy remains solid with leading indicators continuing to display gains. Inflationary concerns remain tamed with evidence of second-quarter wage deceleration leaving the door open for a sidelined central bank. Although the Reserve Bank of Australia has underlined

the possibility of further interest rate hikes—the benchmark rate has been raised by 150 basis points since October—retaining the status quo in the last three monetary policy meetings. Some effects of political swings onto the economy have been felt, however, as investment spending accelerated its contraction through the second-quarter. Spending on plant and equipment and building and structures contracted 4% q/q in the April-June period, following a 1% fall in the previous quarter. Corporate retrenchment follows disenchantment with government's decisions to raise excise taxes and the proposal of a resource rent-tax on mining profits. The likelihood of implementation of the tax hangs now on the country's political balance.

#### **Thai bath strength to continue as central bank guards upward inflationary trend**

Rising interest differentials will continue to provide strength to the Thai baht (THB). The exchange rate stands today at 31.3 per US dollar, the strongest in over two years. The Bank of Thailand implemented a second monetary policy normalization move in August raising the benchmark interest rate by 25 basis points to 1.75%. The central bank's decision came on the back of a somewhat deteriorating outlook as yearly inflation accelerated to 3.4% in July. The inflationary pickup comes as a backdrop to better than expected economic performance with the effects of the May turmoil on investment, consumer spending and trade flows having seemingly faded quickly. Economic activity during the turbulent April-June period came in significantly better than expected with Thailand's GDP advancing at a 0.9% quarterly rate. THB strength—the volatile currency still managed to stand 1.6% higher on average during the second-quarter—failed to put a dent on export momentum with the value of shipments reaching pre-recession levels. Double-digit quarterly gains in sales to China have been a key explanatory element. Although sales to that country represent only 12% of total export value, they accelerated through the first-half inking an unprecedented US\$2.2 billion monthly figure in June. On the domestic picture, a strong rebound in consumer confidence from the April bottom places the indicator within close distance of the early-2010 peak. The effects have been reflected in rising automobile sales which reached 70.6 million units in June. Although tourism is likely to remain weak as it was most seriously hit by the political turmoil, the recovery in domestic demand accompanied by continued export strength remain the economic drivers into the second-half. We now expect Thailand's GDP to expand by 5.5% y/y in 2010 followed by a 4% gain in 2011.

## INTERNATIONAL RESEARCH GROUP

**Pablo F.G. Bréard, Head**

1 (416) 862-3876

pablo\_breard@scotiacapital.com

**Tuuli McCully**

1 (416) 863-2859

tuuli\_mccully@scotiacapital.com

**Estela Ramírez**

1 (416) 862-3199

estela\_ramirez@scotiacapital.com

**Oscar Sánchez**

1 (416) 862-3174

oscar\_sanchez@scotiacapital.com

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### Scotia Economics

Scotia Plaza 40 King Street West, 63rd Floor  
Toronto, Ontario Canada M5H 1H1  
Tel: (416) 866-6253 Fax: (416) 866-2829  
Email: scotia\_economics@scotiacapital.com

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