

RECESSION markers

GDP/CPI

Malaysia's growth down sharply



BNM

Economic performance of key economies



BNM, RESEARCH REPORTS

Inflation

Prices on the way down



BNM, RESEARCH REPORTS

US housing starts and permits

A small rebound

US COMMERCE DEPARTMENT

Feb 08	Feb 09	change y-o-y	Jan 08	change m-o-m
Building permits for privately owned houses				
981,000	547,000	-44.2%	531,000	+3%
Construction of houses that have started				
1,107,000	583,000	-47.3%	477,000	+22.2%
New houses that have been authorised, not started				
176,000	112,200	-36.5%	117.5	-4.5%

Note: Housing starts and permits are an important economic indicator because of their multiplier impact on the other sectors of the economy, primarily retail, manufacturing and utilities. In February, housing starts showed an improvement, bringing a sliver of hope that the US economy is bottoming out.

It can't be good if central banks print so much money

As global interest rates fall to zero amid a deepening recession, central banks across the world are resorting to quantitative easing to help reflate their ailing economies.

In economics speak, quantitative easing is a monetary policy tool that allows central banks to boost money supply in the financial system by buying up assets such as government bonds and mortgage-backed securities.

In plain speak, it means central banks are using the printing press to create new money to buy up these assets.

Quantitative easing has not been widely practised in the past but it is almost synonymous with Japan which adopted this policy in 2001 after interest rates, already at zero, could go no lower in its bid to lift its economy out of the doldrums.

Now, quantitative easing is fast turning out to be the battle cry of central banks for 2009, never mind that it hasn't proved to be very effective in Japan. Since late last year, the big countries in the industrialised world have resorted to quantitative easing, led by the US Federal Reserve, where the policy rate is now between 0 and 0.25%.

Since then, Japan (which stopped quantitative easing in 2006), the UK, the euro zone and Switzerland have all jumped on the quantitative easing bandwagon. The US Fed last week said it was pumping another US\$300 billion into the financial markets to buy long-term Treasury bills, on top of US\$750 billion already committed last November to buy up assets.

While there is no certainty that quantitative easing will help reflate a world economy that is fast sinking into one of its worst recessions ever, central banks really have run out of ammunition to fight it, insofar as monetary policy tools are concerned.

The consequences of quantitative easing are falling bond yields and the creation of a bubble in the bond market, and currency devaluation. Devaluation is a certainty because additional money will dilute the value of every dollar that is already in the pocket.

Random thoughts

| BY ANNA TAING |



Further down the road, a fallout is possibly even hyper-inflation, if the exit strategy is not well managed, given that the new money printed will have to be dealt with once recovery takes place.

But many economists are of the view that it is a gamble that must be taken, so long as it is undertaken to improve liquidity, improve the balance sheets of banking institutions and in the process, boost lending and restore consumption.

Yet, given that quantitative easing is going to be a key policy, going forward, global financial markets must be prepared to deal with the heightened volatility in the short term, given its impact on currencies and asset prices.

More importantly, such volatility is not good for cross-border trade and capital flows which, in turn, will hurt global economic recovery.

Indeed, the US dollar in the last six months has seen its ups and downs. Last week, a day after the quantitative easing was announced, the greenback fell against the euro, pound, Canadian dollar and other world majors.

It is also stirring a debate on whether in the long term, the US dollar's status as a safe haven will be challenged.

The volatility and devaluation, though, could be good news for commodities such as gold and other precious metals, which

are seen as the best hedge against inflation. Certainly, several investment gurus have singled out gold as the biggest beneficiary of quantitative easing.

At this stage, economists agree that inflation is not the immediate concern. DBS Research, in a report, says that inflation is not a short-term concern. "Certainly not in the short term, where people are more worried about falling prices, that is deflation... when prices start to percolate again, it will mean that banks are lending again and companies are borrowing and hiring. In short, we are out of the woods. Signs of inflation should be cheered, not feared," says the research house.

Today, markets are already warning that quantitative easing is facilitating a competitive devaluation of major global currencies, a phenomenon where central banks are deliberately allowing their currencies to weaken to deter imports and boost exports.

For economies like Malaysia which are export-dependent, such a development does not bode well for an early recovery of their export performance. More significantly, the world is watching to see what China will do, obviously because it is the world's largest exporter and because it is expected to lead the world out of the current recession.

The effectiveness of quantitative easing as a policy tool is still largely untested. Indeed, Japan has shown that the risks could outweigh the gains, when such a policy action resulted in the build-up of a bond bubble in 2003 and spawned a huge yen carry trade that started unravelling some three years ago.

What is really needed at this point is more coordinated policy actions by central banks across the world. In this regard, the Group of 20's meeting in London from April 2 will be an important event to watch.

Rebalancing the global economy

One conventional view of global imbalances begins by noting that over the last two decades, China and other rapidly-growing economies in Asia undertook development and exchange rate policies that encouraged exports and raised domestic savings. The integration of those economies into the world's trade and financial systems brought about, in mirror image, high trade deficits and steep borrowing in richer, developed economies like the US.

This account deduces that high savings out East caused borrowing and current account deficits elsewhere — capital flowed uphill from the poorer countries to richer ones — because world interest rates were low and falling throughout the 1990s and early 2000s. The world confronted a Global Savings Glut driven by Asian Thrift. Outside of Asia, current account deficits and high borrowing were simply passively responding to market signals.

The low world interest rates did more than induce high borrowing in the US. They sparked a race for yield, where financial market participants were compelled to search ever more creatively for higher returns, overlooking how greater returns obtain only with greater risk. The financial sector ballooned as banks lent to yet other banks, dealing in progressively exotic financial instruments. Unnoticed, this massive build-up replicated many times over the risk of the original outlays.

In 2007, these multi-varied chains unwound off the US subprime mortgage crisis, resulting



| BY DANNY QUAH |

in a 180° turnaround in the blind faith which previously was the norm in financial transactions. Before, financial instruments that were only dimly understood were nonetheless transacted in billion-dollar volumes. Now, parties face each other with a general lack of trust. Normal lines of business — almost surely, the majority of them worthwhile — cannot raise funds, so goods and services are simply not being produced and traded.

What's wrong with this picture?

There are many things instinctively attractive, and likely even right, with that global picture I just drew.

The US began from trade balance in 1990 and then over the next couple of decades, saw its current account explode into progressively larger deficit. By 2006, the US economy was consuming US\$900 billion more than it was producing. That trade deficit, 7% of US GDP, was alone as large as the total output of goods and services produced by the billion-people economy of India. Despite this massive US borrowing on international capital markets, world interest rates and inflation rates were low and falling. But some of the reasoning in the story does not hold up to scrutiny.

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Quick bites

February CPI up 3.8%

Malaysia's Consumer Price Index (CPI) for February rose 3.8% year on year and 3.7% month on month, according to the Department of Statistics. The highest reading was recorded in the index for food and non-alcoholic beverages, which rose 9.2% y-o-y. The non-food index rose just 1.1%.

Manufacturing sales fall

The country's manufacturing sales fell 22.7% or RM10.8 billion y-o-y in January. According to the Department of Statistics, the manufacturing sector slashed 97,805 jobs in January, with the number of employees in the sector dropping to 990,794.

Lower US industrial production

Industrial production in the US fell 11.2% y-o-y to 99.7 and 1.4% m-o-m in February for four consecutive months, its lowest level since April 2002. CPI, however, rose 0.4% in February after a 0.3% rise in January. The gains push the annual inflation rate up to 1.8%.

Singapore exports continue to plunge

Key exports dipped 24% in February. It was the country's 10th straight month of decline in non-oil domestic exports, after a record fall of 35% in January. Total trade in February fell 22.1% to almost S\$54 billion as shipments to Singapore's top markets, except China, were all down.

Bankruptcies on the rise

Bankruptcy petitions in Hong Kong doubled in February from a year ago, totalling 1,500 — the highest level since October 2003 — as its economy slipped further into recession. — Compiled by Kathy Fong

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Rebooting the world's banking systems

FROM PAGE 8

For one thing, why did financial markets, faced with low returns, turn creative in exactly the way that they did. Sure, easy credit facilitates greater borrowing. But in the history of the world, most borrowers, when faced with high or low interest rates, somehow find a way to behave responsibly and not over-extend their financial dealings.

Why then the "race for yield"? This part of the story is important and is something we are only beginning to understand. But just as important is the Asian Thrift side in explaining the global economic crisis.

Asian Thrift

When you plot US bilateral trade accounts against China, the timeline mimics the US trade deficit overall. Doesn't this mean China's economic policies drove global imbalance?

When you graph US bilateral trade accounts against the EU, the timeline there too mimics the US trade deficit overall. Indeed, when you plot US bilateral trade accounts against the oil-exporting countries, again, that timeline mimics the US trade deficit overall. When you add together EU and oil-exporter trade surpluses against the US, the result is a bilateral trade surplus series that matches almost exactly China's bilateral trade surplus against the US.

It turns out that, as a fraction of its overall trade deficit, the US trade deficit against China has been pretty much constant the last 20 years, as have been the ratios for the US trade deficit against the EU and against the oil exporters respectively.

The fact is, for the last two decades, the US has been massively over-consuming not in any special way relative to China or East Asia. Instead, the US has been doing this against most of the world.

If the cause of global imbalance is Asian Thrift or under-priced Chinese

renminbi, then there must also have been EU Thrift and Oil-Exporter Thrift, and under-priced European currency and under-priced oil. Perhaps so. But a more parsimonious explanation is that US profligacy drove the entire constellation of global imbalances: running large trade deficits became the US' comparative advantage.

Global policies

Under the view that surplus savings drove global imbalances, the policy recommendation on many people's agenda is to get the surplus countries to boost domestic demand. If global imbalances were due to some surplus country — say, China — manipulating its currency or otherwise under-pricing its exports, then reasserting the correct prices there would again restore trade balance. In each case, the move would further allow the current deficit countries to grow from the increased international demand without worsening their trade deficit position. Global balance would begin to be restored.

If, however, the root cause of global imbalances was the profligate habits of the current deficit countries, something more nuanced is required. What that alternative policy recommendation is should also reflect some perhaps lesser-known facts about the current global distribution of economic activity.

World GDP now runs about US\$50 trillion a year. The US, on the one hand, and the UK and the Euro region on the other, each accounts for about one-quarter of the world economy.

In counterpoint, however, consider the following.

The last two times the US economy went into recession was 1991 and 2001. In the first of those, US output actually fell, the same way it will do this year. But in 1991, China contributed to world economic growth three times at market exchange rates what the decline in US GDP turned out to be — East and Southeast Asia contributed nearly 20 times. In 2001, China contributed to world economic growth nearly one and a half times the US' contribution, again at market exchange rates — East and Southeast Asia, nearly double.

Over the recent US recessions, East and Southeast Asia have more than respectably held up their end of world economic growth.

Of course, as is true every other time as well, this time the recession is different. Emerging economies now face sharply declining export demand, falling commodity prices, and rapidly shrinking FDI. In the category of bad news, Taiwan's exports in January 2009 are 40% lower than a year ago. In South Korea, the decline in industrial output over the past year is the steepest on record. Russia's industrial output fell 20% in January from the previous month. Japan's industrial production fell by 21% in the three months to November 2008, and its GDP fell last quarter by the steepest rate of decline since 1974.

Even China's exports fell 13% in 4Q2008. But actually this means they are only 3% lower at the end of 2008 than a year before, hardly

a catastrophic collapse. Even without a global economic and financial crisis, China's economy was already having a rough 2008, with paralyzing ice storms in February last year, the massive Sichuan earthquake in May, and then the tight grip of the Beijing Olympics in August.

On a more positive note, the Shanghai stock market has continued to rise since China's RMB4 trillion fiscal stimulus announcement last November — it was up 13% by mid-February this year from the start of the Chinese New Year. Total bank loans in China rose 19% at the end of 2008 from the 12 months before, and continued their climb in January. New cellphone subscriptions in India reach a record of 11 million in January 2009, as rural customers — who don't typically own land or hold extensive financial portfolios, and so are unaffected by plunging stock markets and real estate prices — continue to see the benefits from digital mobile telecommunications. Malaysia's financial system has only 0.3% of its banking capital exposed to the US subprime mortgage market, and profits remain high.

Sure, export demand is down everywhere but, with some notable exceptions, many of Asia's financial structures are now relatively stripped of short-term foreign-currency denominated commercial bank loans.

To be sure, there has never been any question that some export demand decline in the circle of economies surrounding China would be in the works, given the sharp reduction in US and EU demand. Globalisation pretty much forbids decoupling.

However, globalisation lives quite happily with clustering. So, three things useful to know about Japan, still the world's second largest economy: First, as a fraction of Japan's total trade that it undertakes with China, has more than tripled in the last 15 years; second, Japan's trade with the US reached a peak of 35% in the mid-1980s, and since then the ratio has fallen to 15%; and third, Japan's trade with China exceeded that with the US for the first time ever in 2006 and continues to expand.

And, finally, three similar things to remember about South Korea, Asia's largest economy after Japan and China: First, as a fraction of Korea's total trade that Korea undertakes with China, has quadrupled in the last 15 years; second, Korea's trade with the US topped out at over a third in the mid-1980s, and since then it has fallen to only 10%; and third, Korea's trade with China exceeded that with the US by 2004, even earlier than did Japan's, and continues to grow too.

Policy prescription

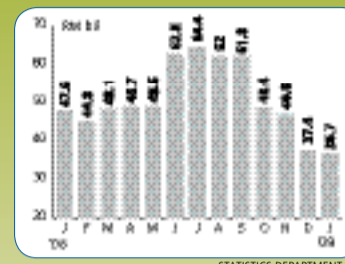
What does this leave on policy prescription? Three emerge.

First, much of the world's banking and financial systems need to be rebooted. Financial intermediation needs to resume. But just as in rebooting a modern computer system, the virus — toxic debt in this case — needs to be isolated and excised, or otherwise the system will simply be reinfected when it does come up again. A "bad

LOCAL indicators



Sales value of manufacturing sector



STATISTICS DEPARTMENT

M'sian manufacturing sales

Sales	Jan 09	Jan 08	Change
Value	RM36.7 bil	RM47.5 bil	-22.7%
Number of employees	990,794	1,088,599	-9%
Salaries/wages paid (RM mil)	RM1.96	2.15	-9.2%

STATISTICS DEPARTMENT

Car production

Segment	Feb 08	Feb 09	Variance
PV	38,056	36,985	▼ 2.8%
CV	3,752	3,647	▼ 2.8%
Total	41,808	40,632	▼ 2.8%

MALAYSIAN AUTOMOTIVE ASSOCIATION

Car sales

Segment	Feb 08	Feb 09	Variance
PV	35,437	33,281	▼ 6.9%
CV	3,090	3,394	▲ 9.8%
Total	39,527	36,675	▼ 4.8%

MALAYSIAN AUTOMOTIVE ASSOCIATION

Market performance in February 2009

Sales volume in February 2009 was 1,126 units or 3% lower than the previous month.

- Low consumer confidence due to uncertainties caused by the current global economic crisis.
- Stringent evaluation of applications for hire purchase loans.
- Higher sales of light commercial vehicles came from deliveries of back orders.

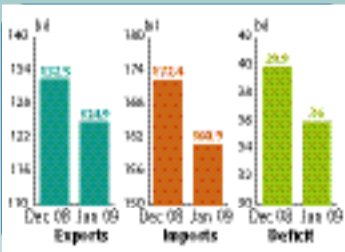
GLOBAL indicators

Key currency movements

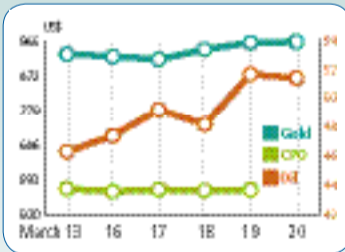
	March 13	March 20
USD vs MYR	3.71	3.65
USD vs EUR	0.78	0.73
USD vs AUD	1.52	1.45
USD vs SGD	1.54	1.51
USD vs GBP	0.71	0.69
USD vs Yuan	6.84	6.83

BLOOMBERG

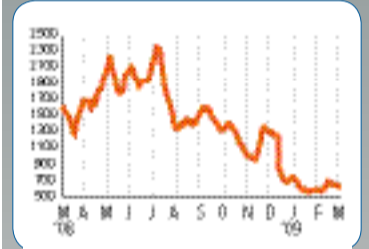
US trade performance



Crude oil/CPO/gold prices



Baltic Dirty Tanker index



The Baltic Dirty Tanker Index, the barometer for the transport of crude oil via tanker vessels, slipped 21 points over the week to close at 635 points last Thursday. A dip in the Baltic Dirty Tanker Index indicates cheaper cost for shipping crude oil, indicating a slowdown in economic activity.

The slide in the Baltic Dirty Tanker Index came on the back of news that the Organisation of Petroleum Exporting Countries (Opec) would cut crude oil shipments by 3.3% for the four weeks ending April 4. Opec said that it would load 22.4 million barrels a day in the four weeks in review, down from 23.2 million barrels for the four weeks ended early March.

There is a current oversupply of tankers, brought about by rising US crude oil inventories and new tankers coming on stream after overzealous shipbuilding activities in the past.

now buy US Treasury bills?

Third, if excess savings in one part of the world are a problem for the global economy, recognise that they are a nation's savings, not an individual's. Chinese consumers have savings rates not dramatically different from consumers elsewhere (everywhere, of course, except for the US). Instead, it is the corporate sector and the government together that provide the bulk of high savings in China. If a nation saves more because it confronts high national risk and insecurity, the situation is not helped by stoking yet greater fear from external protectionist and alarmist rhetoric. **E**

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In the pipeline

23 MAR US to announce existing home sales for February

24 MAR US to announce house price index. Market consensus anticipates the index to drop 0.8% m-o-m in January versus a 0.1% increase in December

25 MAR Japan to announce merchant trade balance for February

26 MAR Singapore to announce industrial output for February

27 MAR China to announce industrial profit year to date