

Report from the front line

September 2011

**Australian Industry Group
National Forum 2011
Canberra**

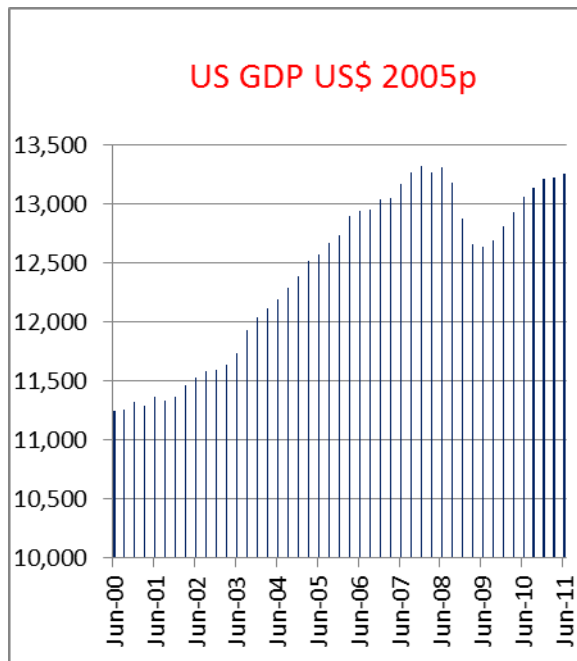
Richard Martin, IMA Asia



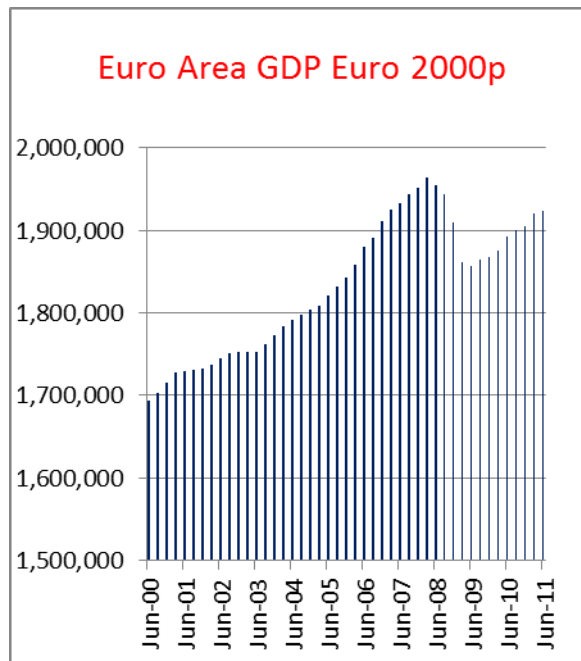
Global realignment

A weak triad: can emerging market growth continue?

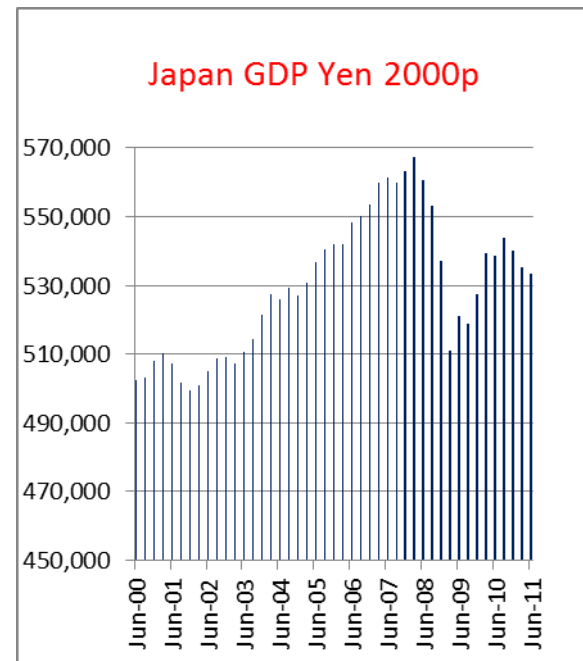
Growth Q2'08 to Q2'11 = **-0.4%**



Growth Q2'08 to Q2'11 = **-1.6%**



Growth Q2'08 to Q2'11 = **-4.8%**



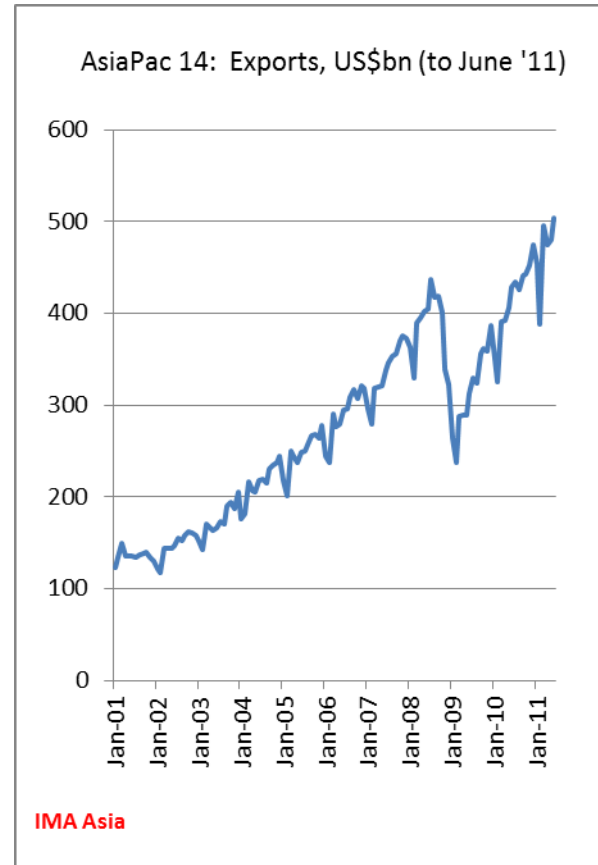
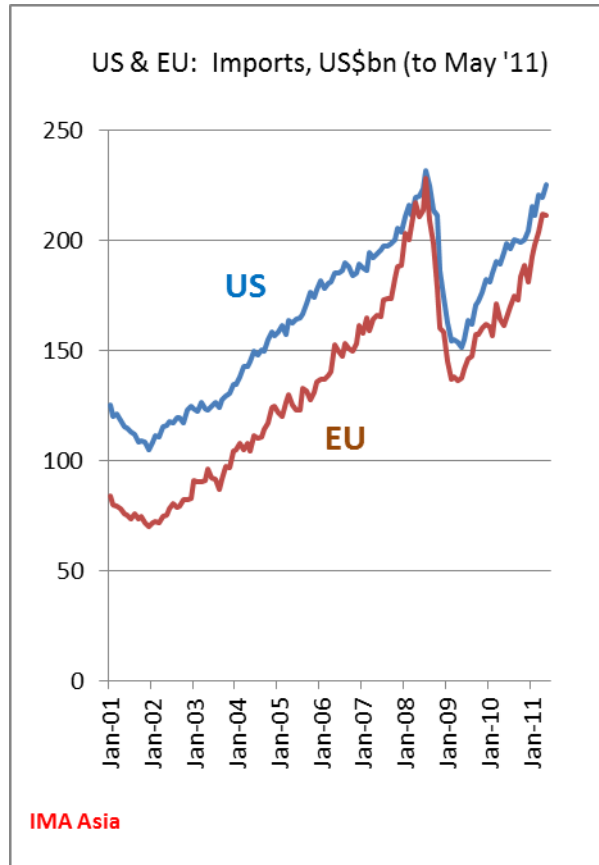
Share of World %

	GDP	USA	Euro	Japan	Triad	Imports	USA	Euro	Japan	Triad
2000		31	20	14	65	2000	19	14	6	38
2010		23	19	9	51	2010	13	13	5	31

Data from Asia Brief Excel Workbook

Global realignment

Exports: global trade realignment may be part of the answer



Imports for the US & EU have yet to return to their 2008 highpoint. Yet A/P's exports are 25% above their 2008 highpoint.

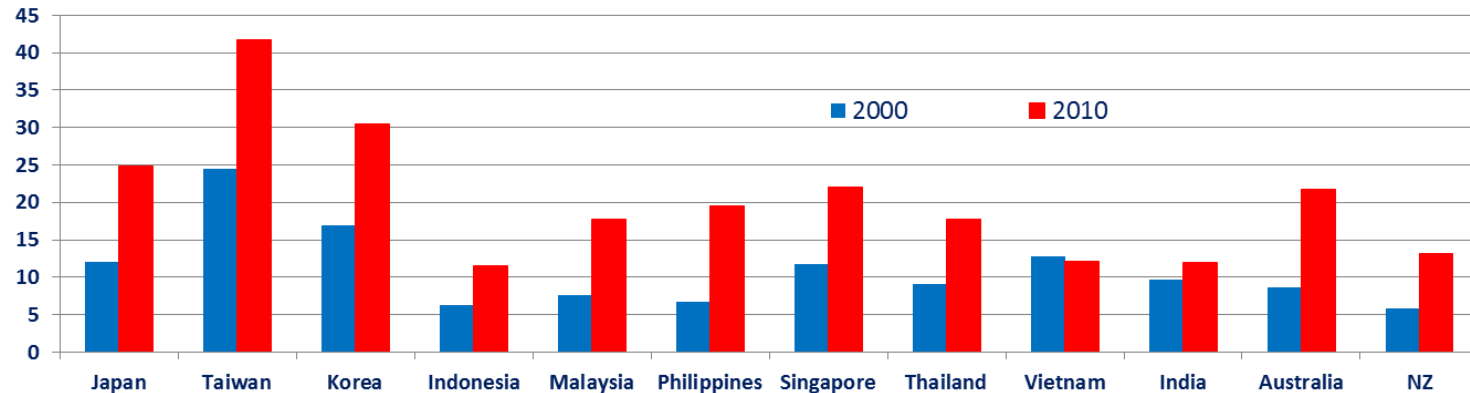
Asia's export growth has been to itself (mostly China but also ASEAN) and to other emerging markets.

Data from Asia Brief Excel Workbook

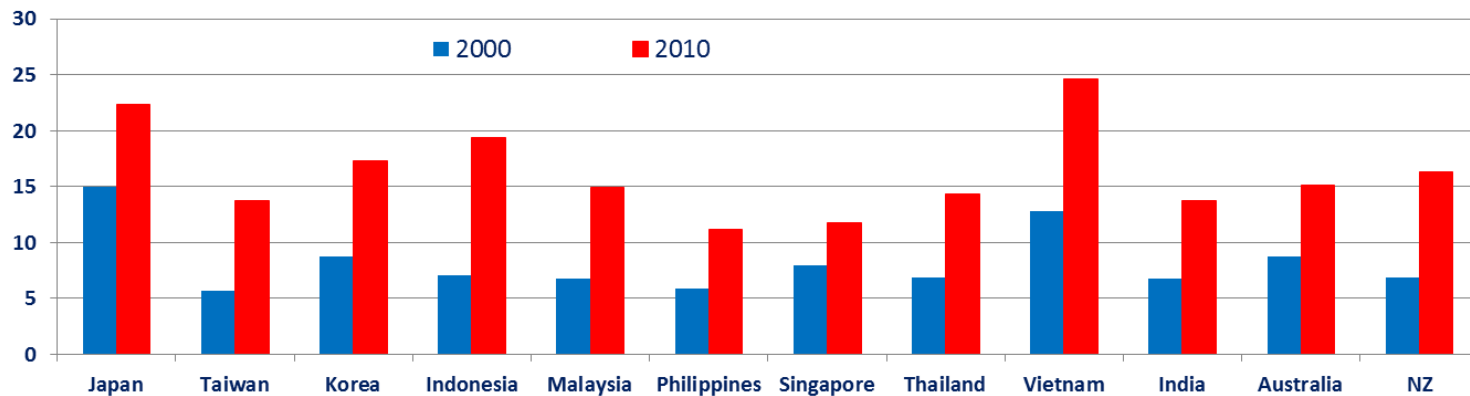
Global realignment

Exports: global trade realignment is largely driven by China

China's Share of Exports by A/P 14



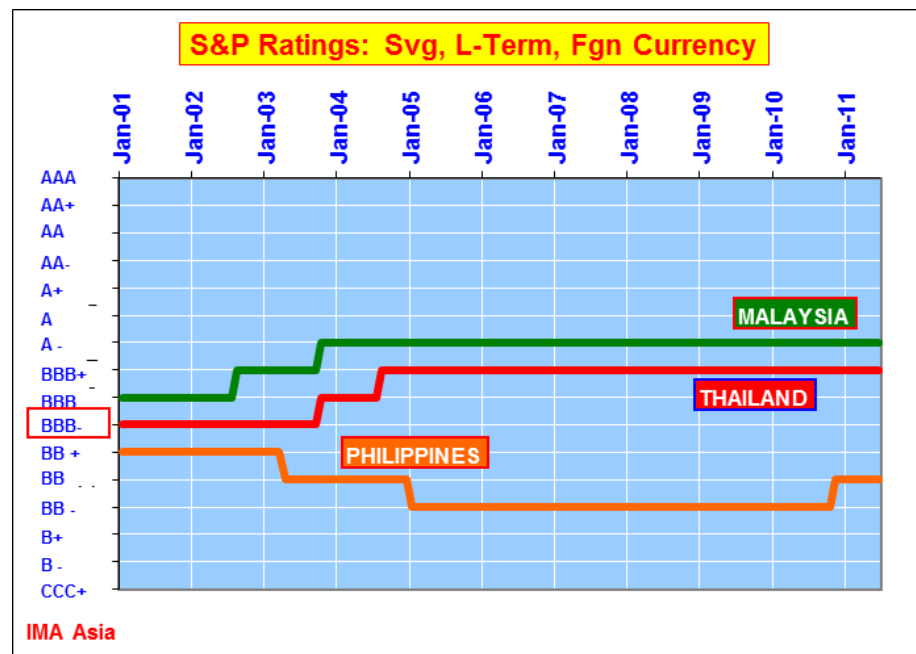
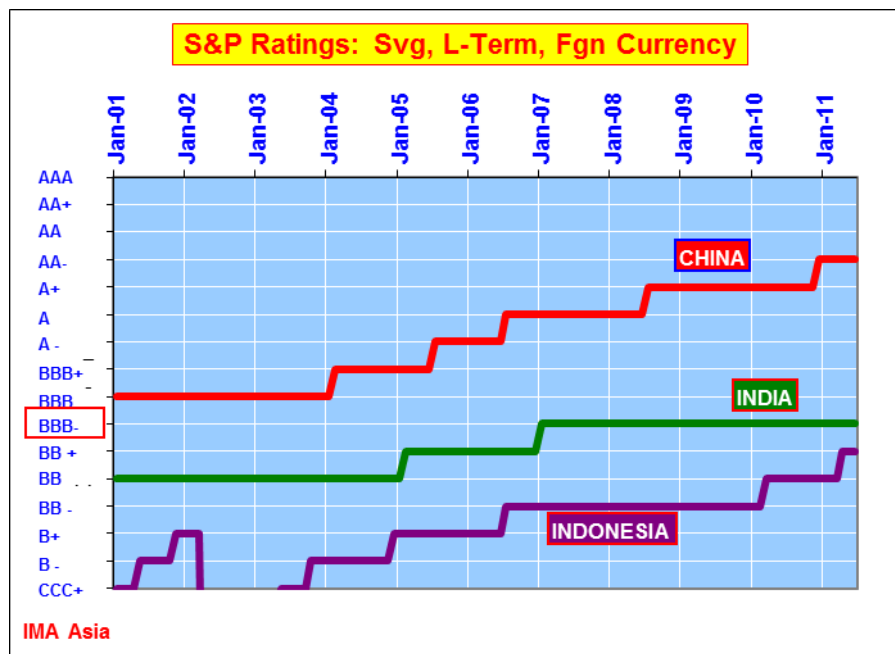
China's Share of Imports by A/P 14



Risk & Resilience

Sovereign risk ratings

Excluding Japan and Vietnam the risk ratings for Asia/Pac's 12 other main markets have steadily improved since the GFC.



QE1, 2 and 3

- Have been **fantastic** for emerging markets like Indonesia and the Philippines
- High yield, declining risk, and rising currencies
- Massive refinancing of public debt at cheaper rates

Risk & Resilience

Current account balances and foreign exchange reserves

Current account

% of GDP	Q2'11
Japan	6%
China	3%
HK *	6%
Taiwan	12%
Korea	2%
Indonesia	0%
Malaysia	11%
Philippines	2%
Sing NODX	18%
Thailand	2%
Vietnam	-
India*	-2%
Australia *	-3%
NZ *	-3%

* Q1'11

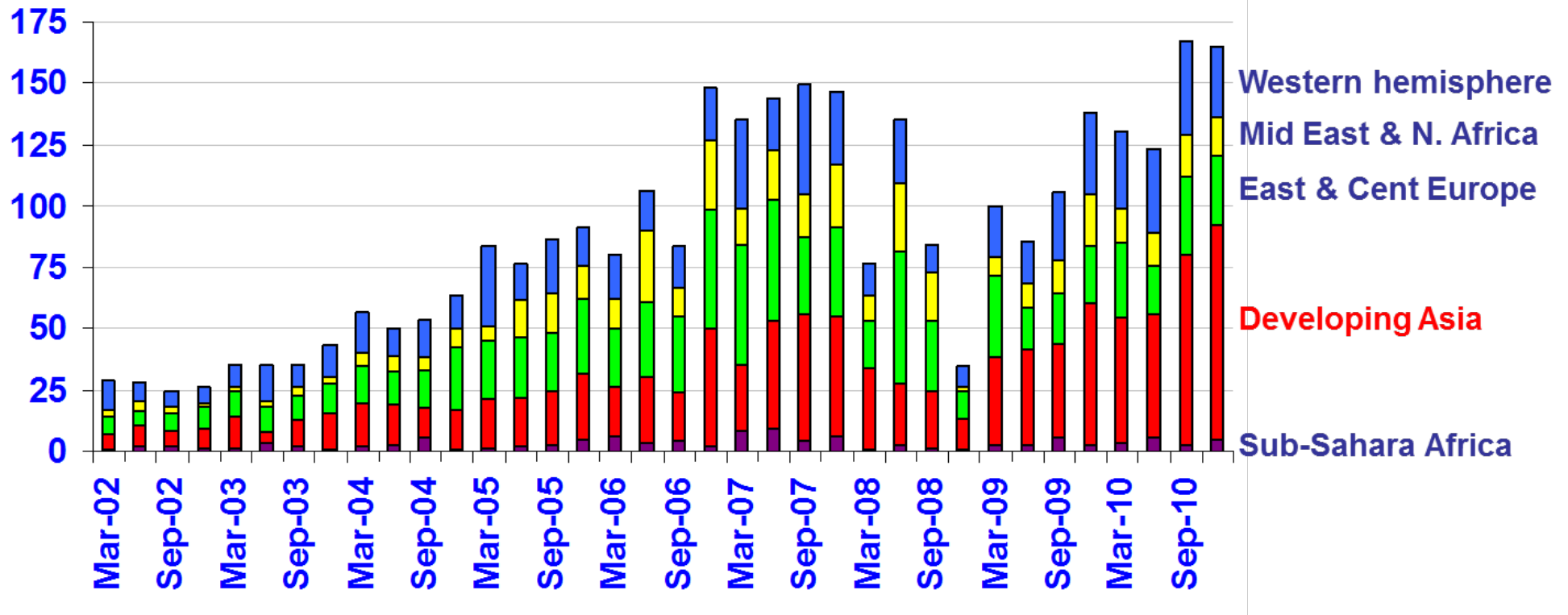
Foreign Exchange Reserves

Mid 2011	US\$bn	YoY% growth
Japan	1.152	8
China	3.197	30
HK	279	7
Taiwan	400	8
Korea	312	9
Indonesia	123	56
Malaysia	135	43
Philippines	72	47
Sing	249	20
Thailand	187	23
Vietnam	12	-11
India	316	15
Australia	-	-
NZ	-	-

Global rebalancing

Lower relative risk triggers capital flows to Asia

New Issues By Region, US\$bn

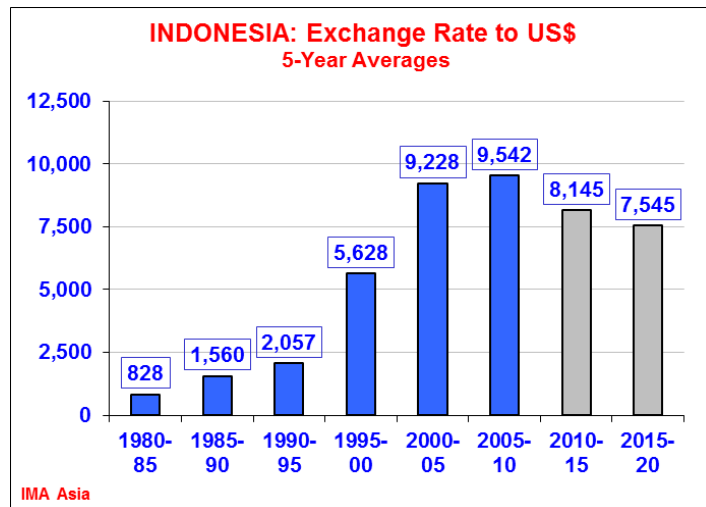
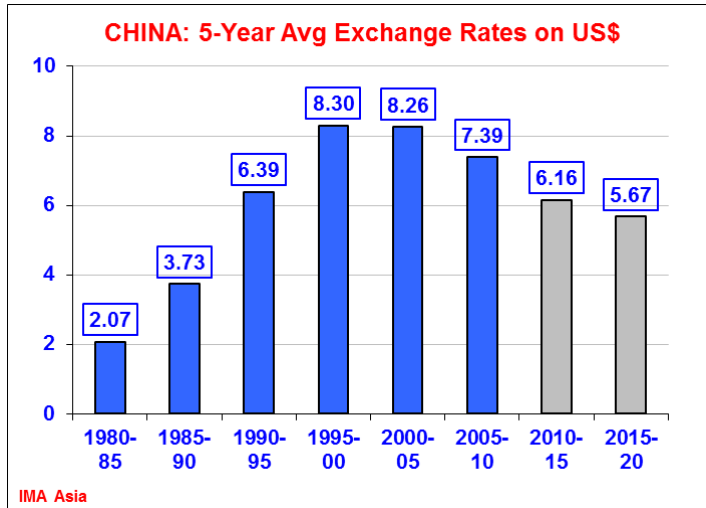


Issues of stock, bonds and syndicated loans

Global rebalancing

Currency realignment

Growth in Current GDP, US\$ basis, %



	2008	2009	2010
Japan	11.3	3.1	8.5
China	29.7	11.5	14.9
HK	4.0	-2.8	7.5
Taiwan	1.8	-5.7	14.0
Korea	-11.1	-10.8	19.0
Indonesia	17.6	6.7	30.6
Malaysia	19.0	-13.2	23.3
Philippines	15.6	-3.2	17.1
Singapore	6.8	-3.2	21.5
Thailand	4.1	-4.3	20.9
Vietnam	26.4	3.2	11.4
India	8.1	1.6	27.9
Australia	8.1	-5.0	25.6
USA	2.2	-1.7	3.8

Global rebalancing

A realignment of currencies

Why Indonesia was one of the world's fastest growing US\$ markets in 2010

2010 real GDP growth = 6.2%

Inflation = 5%

Rupiah appreciation on the US\$ = 15%

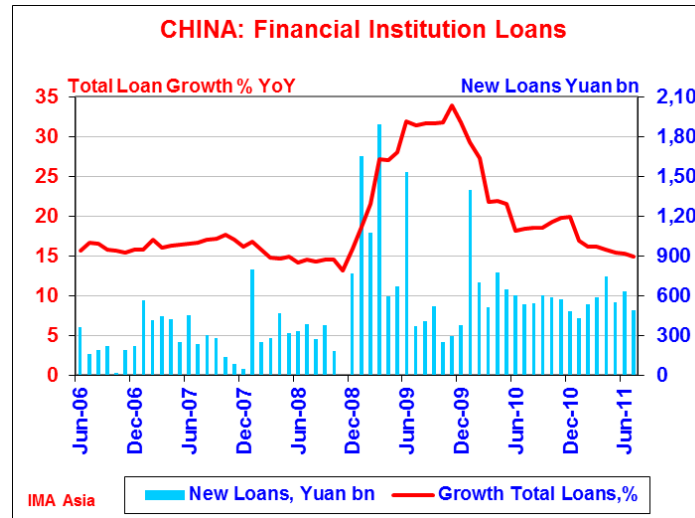
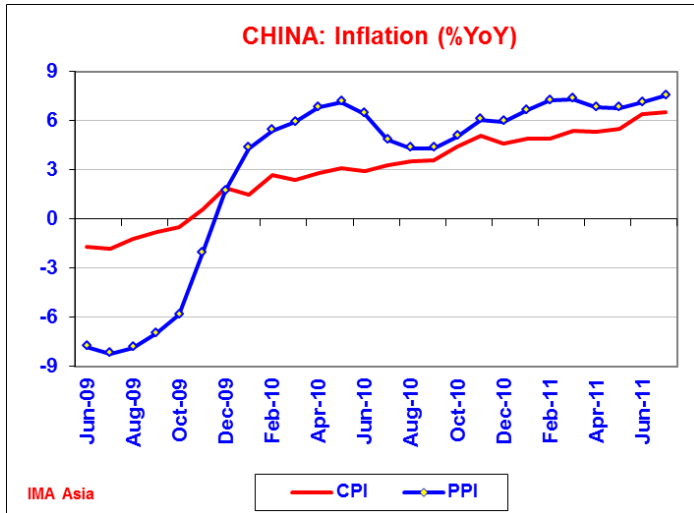
2010 current GDP growth in US\$ = 31%

Will Indonesia give this gain back?

Will Indonesia repeat it in 2011?

China

Inflation and steps to cool overheating

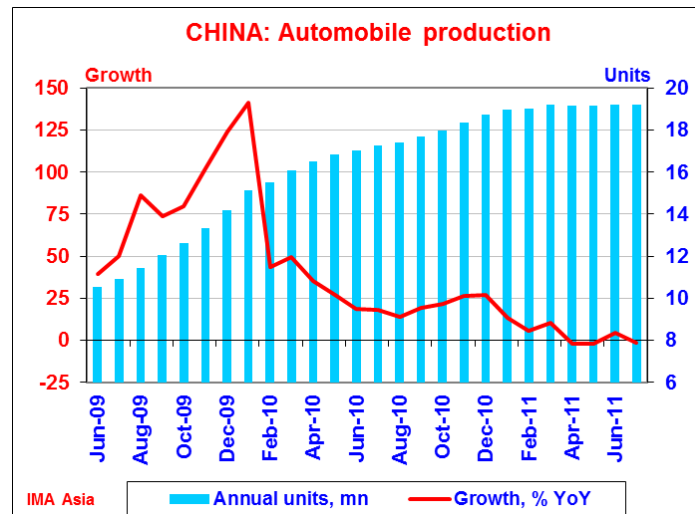
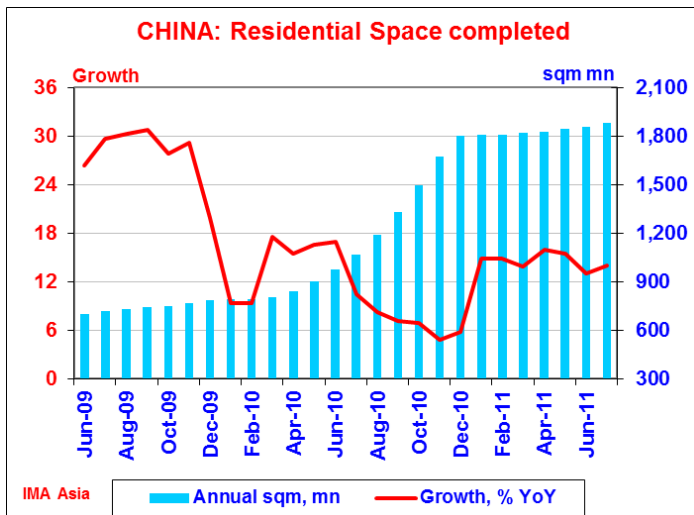


Inflation is being pushed up by:

- Food prices
- $D > S$
- Big pay rises

Mild monetary tightening by

- Bank RRR
- Instructions
- Interest rates

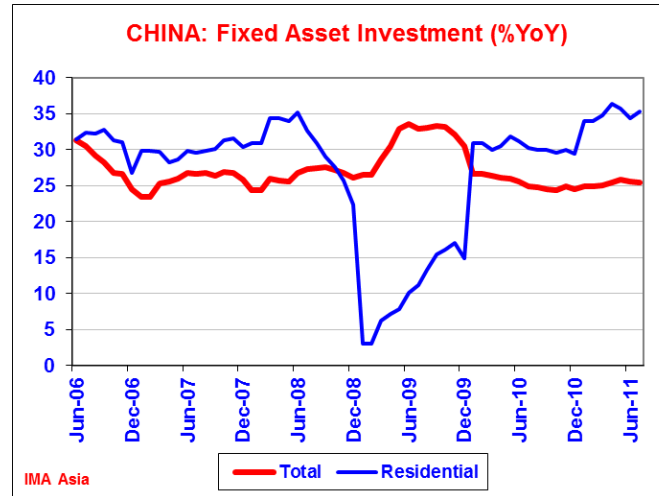
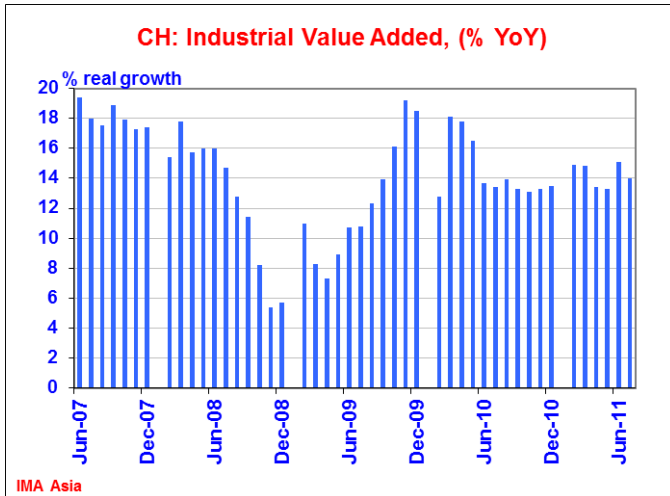


High end property development has slowed. Problems with 10m/annual social housing.

Vehicle sales stall with the sales incentive ending.

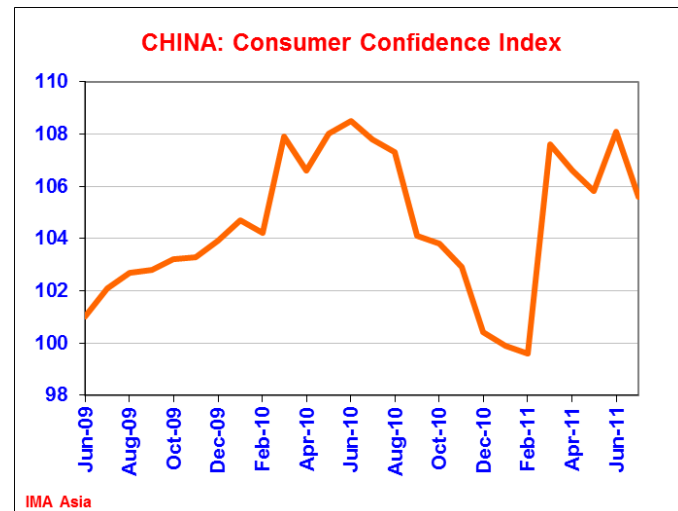
China

Most indicators point to a soft landing



China's measure for industrial production points to steady growth. Local demand accounts for 85% of production.

Fixed asset growth may still be too strong



China's measure of consumer confidence is reasonably good. It shows steady confidence.

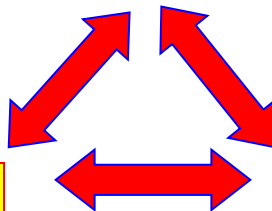
Retail sales have cooled but remain firm.

China's Financial Crisis

- Some 50% of China's growth in 2009 & 2010 was construction related
- Gross fixed capital expenditure hit 50% of GDP in 2010
- Housing – the impact of China's first fall for private housing
- Infrastructure – massive building or overbuilding – can consumers pay?
- Commercial – vanity projects and over-stretched developers

- Official NPLs at the big banks are 1% or less – the reality is probably 10-15%. This may be manageable by recapitalisation.
- Mid-sized banks have bigger problems & will be forced to merge.
- The government is closing down a large informal bank sector that also finances private SMEs.

**Non-Performing
Bank Loans (NPLs)**



**Construction
Bubbles**

**Local Government
Debt**

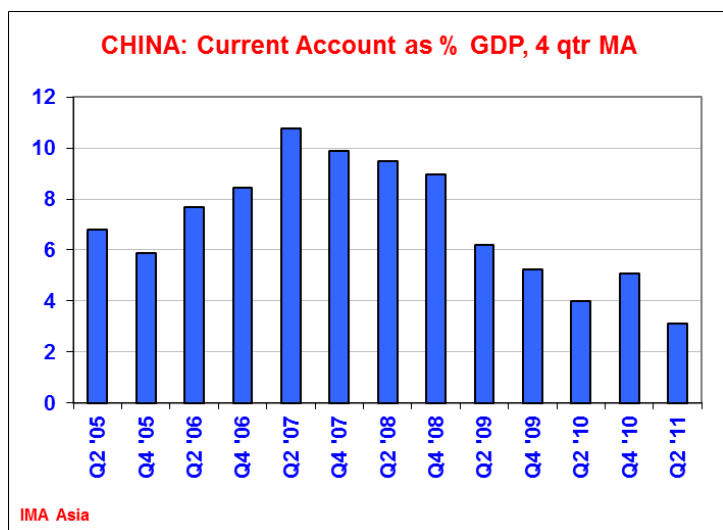
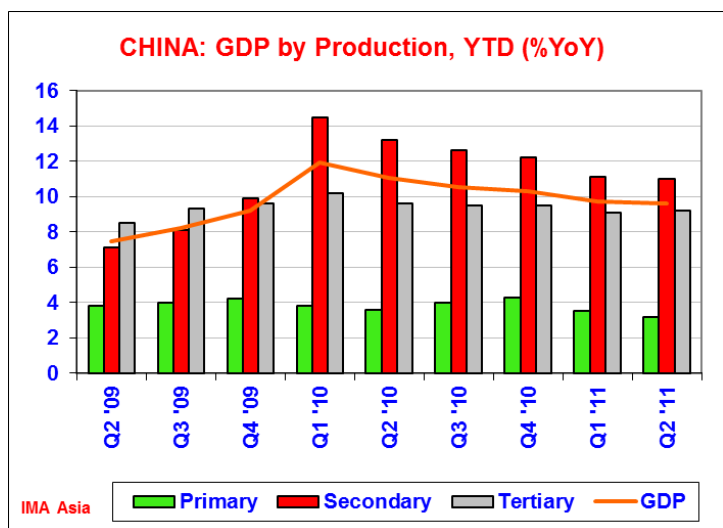
- Local govts aren't allowed to have debt so they formed over 1,000 SPVs.
- Local govts control access to land and to local banks.
- Total local govt debt equals 30%+ of GDP – mostly secured by inflated property prices.
- Assume 50% to infrastructure and 50% to property.

Autumn 2012

Hu & Wen want to leave a strong legacy.
The reformers want to continue running China.
It is China's second effort at a stable leadership change.

China

On track for a soft landing (9% growth into 2012)



- Inflation should ease by Q4'11. Monetary tightening has been mild, addressing high capital inflows and bringing non-bank lending under control.
- Abrupt policy changes from Q1'11 affecting housing, vehicles, infrastructure.
- Plenty of fiscal/monetary scope for extra stimulus if needed.

CHINA	2007	2008	2009	2010	2011	2012
GDP real growth, %	14.2	9.6	9.2	10.3	9.0	9.0
- Personal consumption	10.6	8.7	9.1	9.5	9.5	10.0
- Gross fixed investment	11.2	10.5	23.2	19.0	12.0	10.0
- Manufacturing	14.9	9.9	8.7	12.1	10.0	9.0
- Construction	16.2	9.5	18.6	12.6	9.5	8.0
Inflation CPI, yr avg	4.8	5.9	-0.7	3.3	5.8	5.0
Export growth, % US\$ basis	25.7	17.3	-15.9	31.3	20.0	18.0
Import growth, % US\$ basis	20.8	18.4	-11.3	38.9	23.0	19.0
Current account, % of GDP	10.6	9.6	5.9	5.3	4.8	3.5
Central bank rate, % yr avg	7.47	5.31	5.31	5.71	6.96	6.46
US\$ x-rate, yr avg	7.61	6.95	6.83	6.77	6.45	6.20
- change, %	4.8	9.5	1.7	0.9	5.0	4.0

Asia YTD

Trade: The export picture

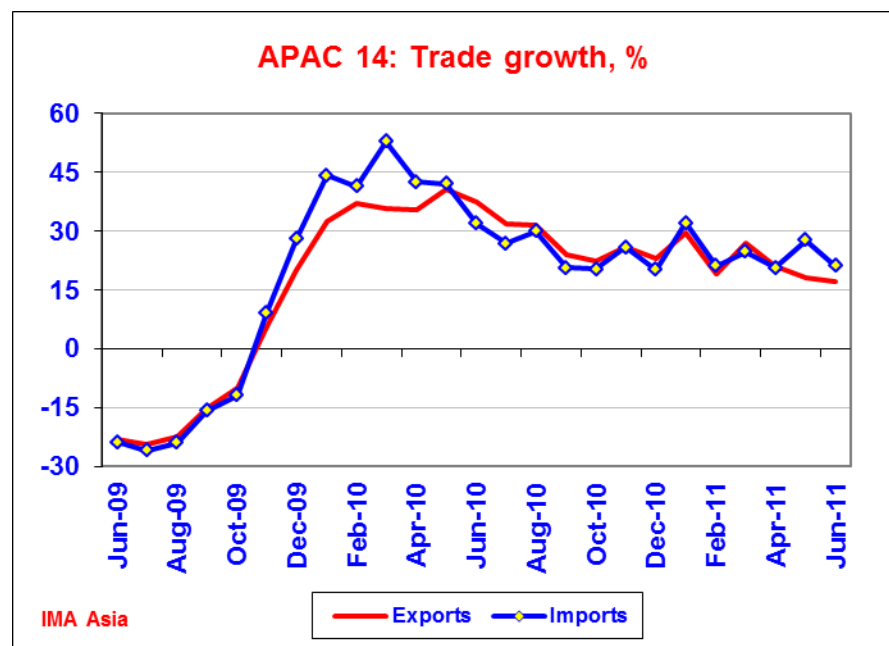
Export Growth, % YoY, US\$ basis

	2010	Q1 2011	Q2 2011	Jul '11
Japan	32.6	13.5	3.5	7.6
China	31.3	26.4	22.0	20.3
HK	22.7	24.2	7.9	9.1
Taiwan	34.8	19.1	13.7	17.2
Korea	28.3	29.6	19.6	25.2
Indonesia	33.1	27.7	44.0	
Malaysia	26.5	15.7	17.2	
Philippines	40.0	7.8	0.7	
Sing NODX	31.1	24.5	19.9	16.8
Thailand	28.5	26.7	19.2	39.9
Vietnam	26.7	35.1	28.8	54.6
India	33.4	61.1	45.7	
Australia	32.5	37.5	30.0	
NZ	31.9	18.9	26.3	
A/P 14	30.4	25.4	18.9	

➤ A gradual slowdown (not a collapse) in export growth within the bounds of our forecast for a weaker Q2 & Q3.

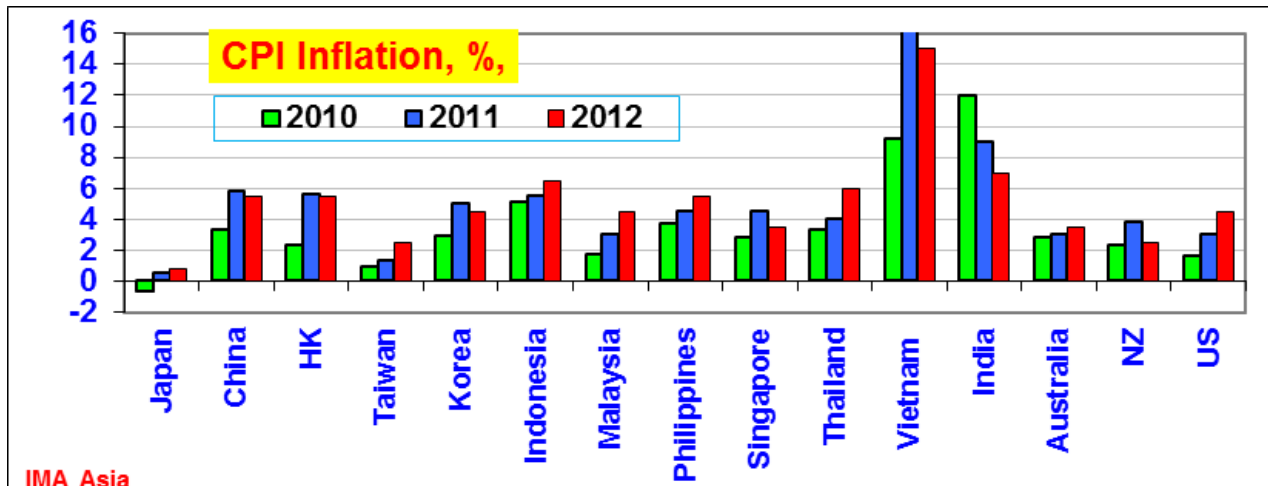
➤ **AT RISK FROM BIG EXPORT SLUMPS:**

- Japan
- HK
- Philippines



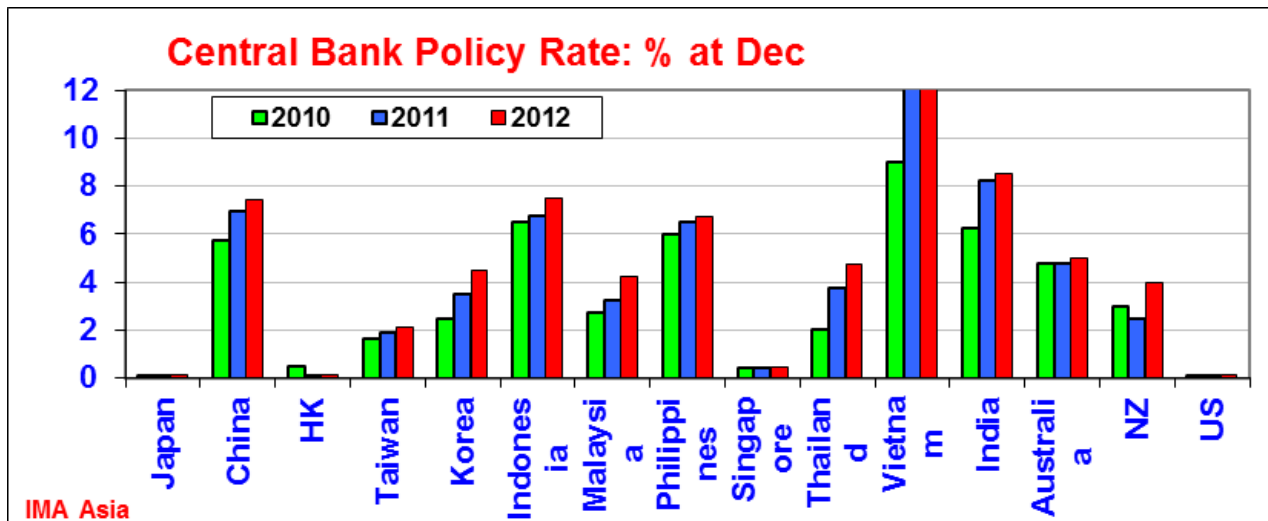
Inflation

2012: Expect more inflation and a “normalisation” of interest rates



The countries to watch for sustained or higher inflation are:

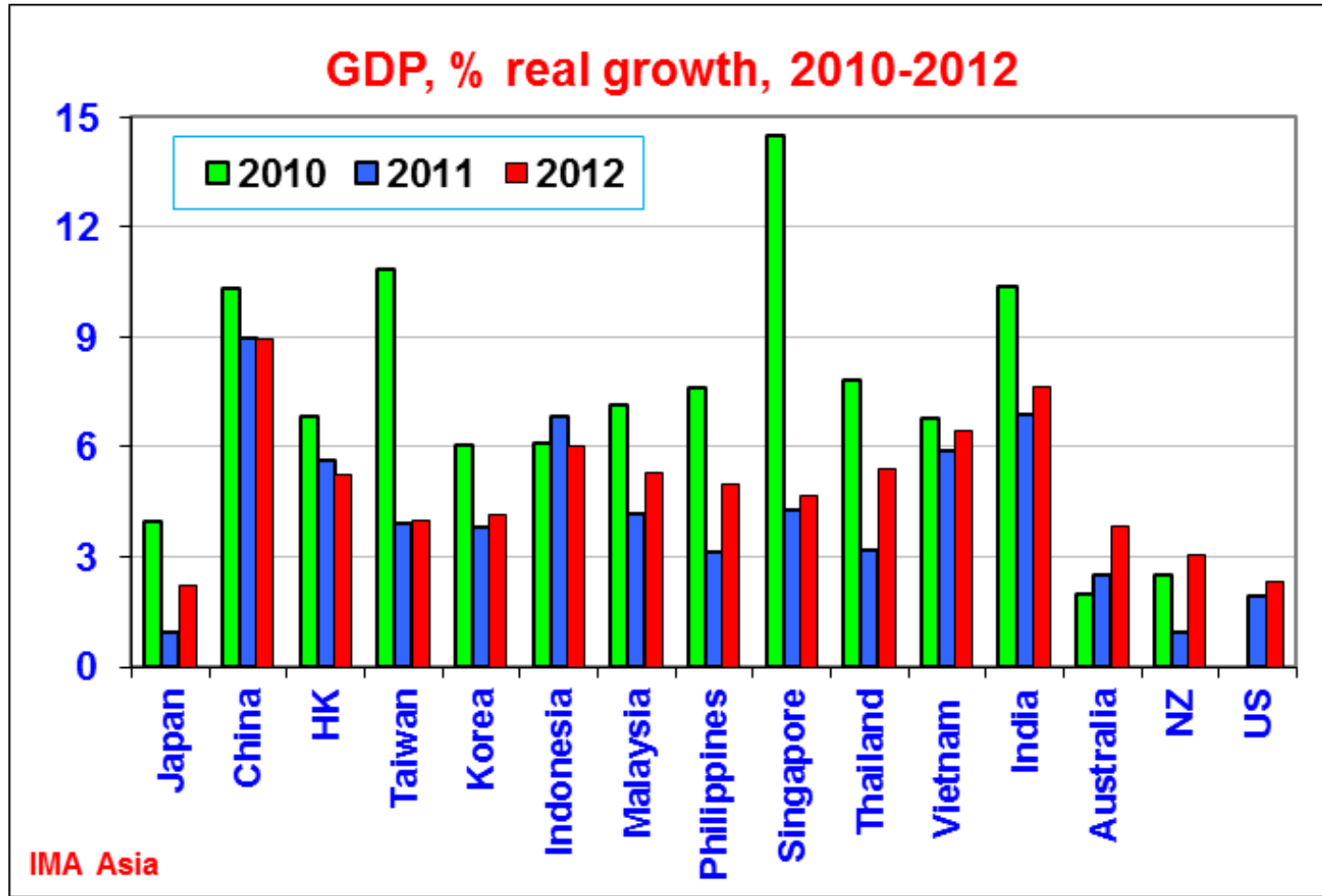
- China
- HK
- Indonesia
- Malaysia
- Thailand (new policies)
- Philippines



Asian central banks will be under pressure to return rates to normal levels in 2012 despite the US Fed holding its rate close to zero.

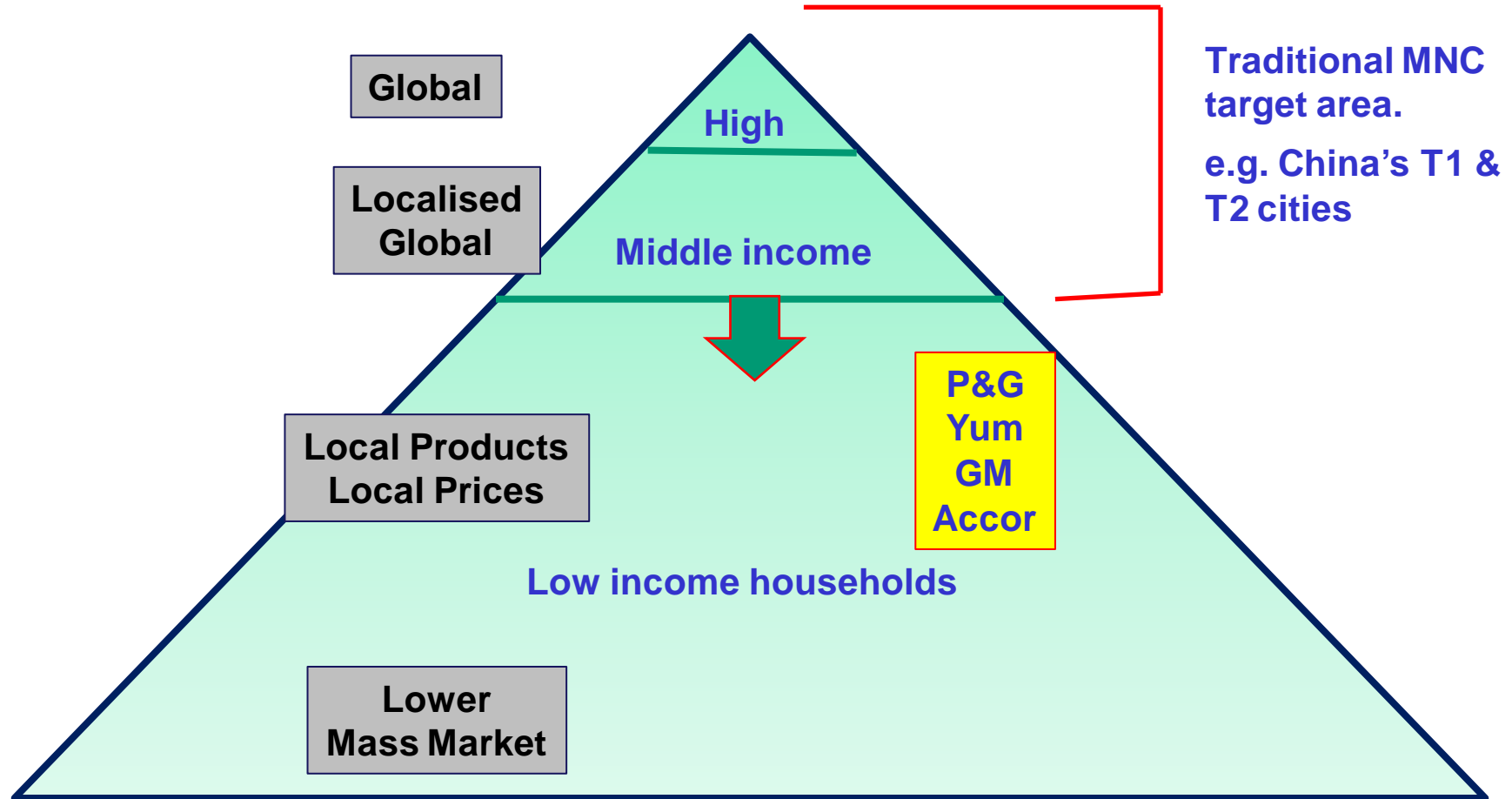
GDP outlook

Steady growth for Asia in 2012



Asia should benefit from a US recovery in 2012, capital inflows due to QE3, and isolation from Euro risk.

Asymmetric competition



A shift in competitive advantages

LOCAL FIRMS

- Protected by trade & investment barriers
- Local connection to buyers, suppliers, and regulators – speak the language
- Corruption – not an issue
- Lower overheads (no expats)
- No technology cost (often stolen)
- Low regulatory cost (ignore the rules)
- Low capital costs (China's SOEs)
- Lower labour cost & better labour access

INTERNATIONAL FIRMS

- Money
- Product portfolio
- International production scale
- IP and R&D capacity
- Proven systems (logistics, support, etc)
- High skilled managers with experience
- Expertise in finance, marketing, sales
- Strong suppliers (products & services)
- Home base advantages: stability in politics and operating environment

China drives the world's automotive industry

Global Light Vehicle Assembly Capacity Top 7 by Contribution to Growth

	Units m 2010	Units m 2015	Units m Growth	% Change Total	% CAGR	CTG %
China	14.5	24.9	10.4	72%	11.5%	39.0%
India	3.0	6.1	3.0	99%	14.8%	11.3%
USA	7.6	10.5	2.9	38%	6.6%	10.8%
Brazil	3.2	4.7	1.5	49%	8.1%	5.7%
Russia	1.3	2.8	1.5	113%	16.4%	5.5%
Thailand	1.6	2.8	1.2	71%	11.4%	4.3%
Argentina	0.7	1.2	0.5	73%	11.6%	2.0%

CAGR = compound annual growth rate; CTG = Contribution to growth

PWC Autofacts, April 2011

Corporate implications

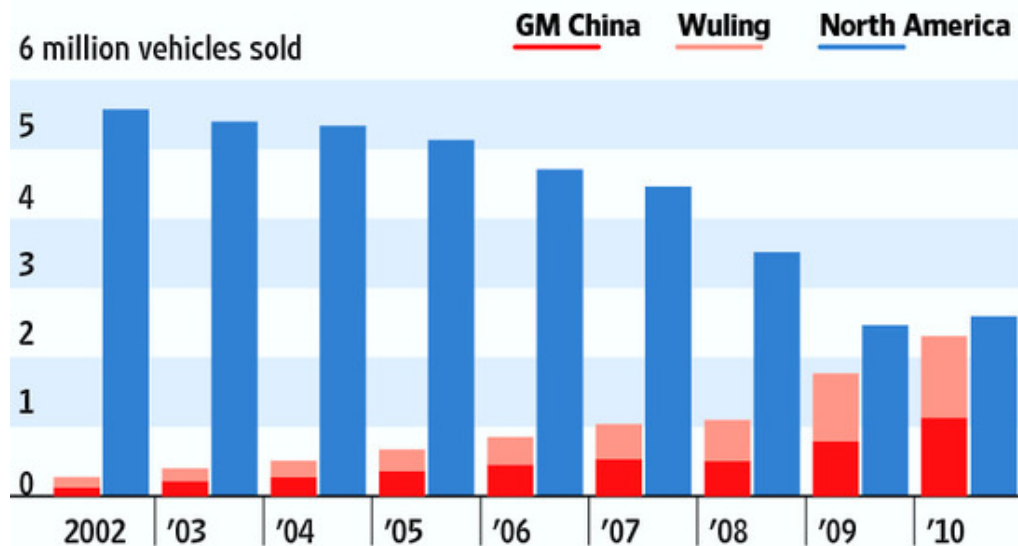
Adapting business structures to emerging markets

GM in China

(WSJ, 11/5/11)

Rising Tide

Vehicle sales at GM's two Chinese ventures almost rival home-market



Source: CSM Worldwide

2010 was the first year in which GM produced more cars in a foreign country (China – 2.35m units) than at home (2.2m units)

By 2015 GM aims to lift China sales to 5m units focusing on small, entry level vehicles

GM has a 49% stake in Shanghai GM (SAIC has 51%) and a 44% stake in Wuling (its partner SAIC has 50%).

The next wave of growth in China

Designing products for central and western China



2010-wulingyangguang
GM's JV with Wuling
(The entry level Microvan costs \$4500)

PWC Autofact's view of China's inland market for vehicles:

- Buyers will be more utilitarian in their preferences
- Favouring smaller, more fuel-efficient vehicles
- A preference for entry-level utilities, vans, and pickups that can serve multiple functions and are capable of traversing various road conditions.

Dealing with rapid, unexpected change

Big challenges for Western firms

- **BOARDS:** slow to act in times of volatility, unsure of realignment
- **MANAGEMENT:** Battling to realign key functions (R&D, head office)
- **WORKERS:** Harsh realities in Europe and US; India's graduates stay at home.

Big challenges for Asian firms

- Japanese firms battle a soaring Yen and a flat or declining home market
- PRD manufacturers battling rising Yuan and labour costs
- Indonesia contractors assuming they just have to beat the China price
- ASEAN's local (protected) champions – generally unaware that their protected world is changing (political change, the web, FTAs)
- Environmental concerns: Dalian – closure and relocation of PX plant; Thailand - Map Ta Phut industrial estate; Taiwan – shutdown of Formosa Plastic Group

A strong sense the boundaries are changing and so are the rules of engagement