

Asia's true economic priorities start to show

SINGAPORE: Asia's export-reliant economies are starting to show their true colours.

After months of fighting hard to combat rising inflation in their economies, policy makers are revealing their real intention, which is boosting growth through higher exports and beggar-thy-neighbour currency depreciation.

Growth in the past two years was strong, leaving them free to single-mindedly focus on keeping prices down. That benign situation has now metamorphosed into one in which Asia is staring at prospects of weaker demand in its biggest export markets, the United States and China.

Rising oil prices and outflows of capital as interest rates are tightened globally are other risks.

Analysts say that probably means central banks are going to cut interest rates prematurely and show more tolerance or even a preference for weak currencies.

South Korea was the first to stumble. Officials there set off a sharp fall in the won this week and warned of a deteriorating current account balance. Thailand has said it will slow the baht's rise to give exporters time to adjust.

Indonesia, where core inflation is running at nearly double the 5-6 percent target band, is talking about cutting its main policy rate aggressively. That rate is now 12.25 percent.

"On balance, there is still a growth focus rather than inflation focus in Asia," said ABN AMRO Bank's strategist Shahab Jalinoos. "So there is a risk that we see stronger inflation than the market expects and that Asian central banks seem to be behind the curve."

In a region where exports can make up almost the whole economy, mercantilism can be forgiven.

Yet these compulsions are of Asia's own making, from policies adopted after the 1997/98 crisis that rewarded consumers for saving and industries for producing goods for overseas markets.

"It is probably more reasonable to consider these central banks to be export targeters than anything else," said Sailesh Jha, an economist with Credit Suisse.

"Inflation is a concern but not the primary target. It just becomes an issue related to their views on the currency."

Lowering the inflation guard

In the 1990s, most Asian central banks directed policies towards keeping their exchange rates virtually fixed.

The Asian crisis, during which Indonesia's inflation jumped to 80 percent, forced a change in thinking.

South Korea, followed by the Philippines, Thailand and Indonesia started pursuing inflation targets. Singapore and India also have price stability among their top priorities.

These countries raised rates to varying extents alongside the US Federal Reserve's two-year tightening cycle, India being a notable latecomer to the trend. Strong export growth also afforded South Korea the luxury of a 21 percent rise in the won in two years. Thailand, rated the most credible inflation fighter in the region, raised rates 13 times in the two years to June to keep core inflation within a targeted zero to 3.5 percent band.

In the past two years, oil prices were driven up by heavy demand for fuel in economies expanding solidly. Now, tensions in the Middle East have pushed crude prices above \$75 a barrel, making it a supply-side cost that could cause consumers to tighten their purse strings.

Governments across Asia made bold changes that passed higher fuel prices down the distribution pipeline last year and now, for reasons ranging from turbulent politics to delayed budgets, are unable to offset that blow with public spending and tax cuts.

"The question is what if you have a growth slowdown because of cost-push-induced inflation," said Ramkishan Rajan, a professor at George Mason University in the United States.

"Then, if I don't raise interest rates, that could worsen inflation and my inflation credibility gets compromised."

Westpac Bank economist Huw McKay reckons central banks in South Korea, Malaysia, Thailand and Taiwan should keep raising rates at least until policy is more neutral than accommodative.

Rajan says allowing currencies to rise would be one way for Asia to keep a lid on imported inflation while growth slows.

But most of Asia will be tempted to do what Korea is doing talking down their currencies in order to cushion exporters from any slowdown in global demand.

"Inflation-targeting frameworks here are a long way from what they should be. Forex is still important and there is some incentive to allow some easing in these currencies," said JPMorgan strategist Claudio Piron.

There is, however, one hitch. Investors could swarm to emerging markets after the Fed stops raising rates.

"If people shift their flows into Asia and other markets, that capital flow in itself could generate strong domestic demand and appreciation in these currencies," Piron said. Reuters

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