

ANDBANK RESEARCH

Global Economics &
Markets

MACRO & MARKETS

Alex Fusté

Chief Economist

alex.fuste@andbank.com

+376 874 369



Working paper - 31

Asia – 2013 Outlook: “More than you think”

ANDBANK /
Private Bankers

November 2012

A few considerations before starting the analysis

- ✓ *Everything I have read lately refers to the recent slowdown seen in Asia ...*
- ✓ *... and everybody suggest that this is due to a drop in international trade...*
- ✓ *... which in turn is due to the difficulties experienced by developed economies.*
- ✓ *In this sense, given the current weakness in those economies, that will probably persist in 2013 (and so we believe), most market participants think that 2013 is shaping up the most challenging since 2008 for Asia.*
- ✓ ***Here in Andbank, we think just the opposite***

Asian countries have been effective in the use of instruments to accelerate or reduce pace of activity ... *what suggests that they are now much more autonomous than you think*

- One of these instruments is the budgetary control.
- Asia compares very well versus the rest of the world. **Budgetary equilibrium in the last 2 years** vs 4.4% average deficit in the world !!

Government Budget Balance											
Percent of GDP											
FactSet Economics Standardized Database											
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
World Total	-4.1	-4.6	-5.7	-1.5	0.4	-0.8	-1.6	-2.1	-2.7	-2.0	-0.6
+ Asia											
Asia Total	-0.7	0.0	-1.1	1.4	2.2	-0.6	-1.1	-1.4	-2.0	-1.3	-2.5
+ Eurozone											
Eurozone Total	-2.1	-3.4	-4.4	-1.6	1.2	-0.5	-1.0	-2.0	-3.3	-3.0	-3.2
+ North America											
North America Total	-7.5	-8.0	-9.6	-4.2	-1.1	-1.3	-2.3	-2.9	-3.1	-1.9	0.9
+ Latin America											
Latin America Total	-1.4	-1.9	-2.5	1.9	0.6	-1.7	-0.7	1.3	-0.2	-1.9	-1.9

Regional aggregates are calculated using real GDP weighted averages, fixed to 2010

And there is a kind of pattern in the use of budget execution ...
unlike the West, meaning that these economies apply a countercyclical criteria

- Throughout 2012, the region as a whole has incurred budget surplus ...
- ... this could explain why economic activity has slowed in the 3Q2012
- Suggesting a significant capacity for these economies to gain traction again!

Government Budget Balance		Percent of GDP		FactSet Economics Standardized Database						
	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011	12/2010	09/2010	06/2010	03/2010
World Total	-2.2	-5.0	-4.7	-4.0	-2.0	-5.8	-5.4	-4.6	-3.8	-4.6
+ Asia										
Asia Total	0.9	1.0	-1.9	-0.6	1.6	-1.9	-1.5	-1.2	1.9	1.3
+ Eurozone										
Eurozone Total	-2.8	-1.8	-2.9	-1.3	-1.1	-3.3	-2.9	-3.6	-2.3	-4.8
+ North America										
North America Total	-3.0	-10.5	-7.7	-7.8	-3.6	-11.1	-9.3	-7.3	-7.3	-8.2
+ Latin America										
Latin America Total	0.0	-1.1	-1.3	-1.1	-0.5	-2.9	-0.5	-1.6	-1.7	-4.1

Regional aggregates are calculated using real GDP weighted averages, fixed to 2010

Our most preferred within Asia (in terms of budget control), are

...

- China and Singapore are the ones that most have to incur surplus in order to avoid overheating (a good sign of budgetary control).
- South Korea also seems a country that shows good dynamics in activity, making it not necessary to incur strong deficits
- India and Malaysia are the ones where government must offset the lack of dynamism in private sector.

Government Budget Balance		Percent of GDP		FactSet Economics Standardized Database							
	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011	12/2010	09/2010	06/2010	03/2010	12/2009
[-] Asia											
China	3.4	5.4	-2.5	-0.2	4.0	0.1	-2.6	-1.0	4.6	6.4	0.8
Hong Kong	-2.0	2.9	12.5	0.8	-2.1	3.5	16.0	-1.8	-2.5	6.4	14.1
India	-8.7	-5.8	-4.6	-6.1	-8.5	-9.9	-2.0	-5.6	-2.5	-6.0	-7.0
Indonesia	-	-	-	-	-	-	-0.7	-0.7	-0.7	-0.8	-1.5
Malaysia	-3.4	-2.6	-11.4	-5.9	0.4	-2.6	-8.9	-4.0	-3.8	-5.6	-11.3
Philippines	0.0	-1.4	-5.3	-1.5	0.4	-1.2	-2.2	-2.9	-2.8	-6.5	-2.7
Singapore	11.0	5.7	7.8	12.3	11.1	1.4	5.9	9.7	8.5	-4.7	-1.0
South Korea	-0.9	-0.9	1.4	1.3	-0.2	-0.4	1.3	0.6	-1.0	-0.7	-1.5
Taiwan	2.7	-6.9	-4.4	-1.6	4.4	-4.4	-6.6	-0.9	0.6	-5.7	-6.0
Thailand	5.3	-12.1	-5.3	1.6	7.0	-7.3	-7.5	0.4	5.5	-8.7	-5.4
Asia Total	0.9	1.0	-1.9	-0.6	1.6	-1.9	-1.5	-1.2	1.9	1.3	-1.2

Additionally, the region shows the lowest debt ratios ...

Government Debt	Percent of GDP		FactSet Economics Standardized Database								
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
World Total	84.7	80.4	76.0	66.0	63.6	69.2	65.0	64.2	63.3	60.9	58.5
[-] Asia Emerging											
China	9.5	9.3	8.6	8.3	10.7	-	12.4	11.8	11.8	1.2	12.8
India	50.0	50.8	55.4	51.5	53.6	55.6	58.9	62.8	66.0	68.6	65.4
Indonesia	-	-	-	-	-	-	-	-	-	38.2	44.6
Malaysia	53.5	53.1	53.3	41.3	41.5	42.2	43.8	45.7	45.1	43.0	41.3
Philippines	27.4	30.1	32.6	31.3	37.1	44.1	52.7	60.0	68.4	65.9	68.0
Thailand	29.3	29.7	28.6	23.5	24.1	24.9	26.2	27.9	27.6	31.0	24.8
Asia Emerging Total	20.4	20.4	20.9	19.2	21.5	48.1	24.4	25.1	25.9	20.3	27.4
[+] Eurozone											
Eurozone Total	87.9	85.5	79.9	70.5	66.7	68.8	70.2	69.3	68.6	67.3	67.4
[+] North America											
North America Total	90.0	85.0	77.3	64.2	60.0	59.8	59.5	59.1	58.1	56.5	55.0
[+] Latin America											
Latin America Total	34.2	36.5	38.2	33.5	38.5	40.8	42.9	54.2	59.0	61.1	41.6

Regional aggregates are calculated using real GDP weighted averages, fixed to 2010

Being China (9.5%), Philippines (27.4%), South Korea (35%) and Thailand (29%) the ones with **more capacity of action in fiscal policy.**

And more importantly ... the world's savings are in their hands

- Accumulating almost 65% of global FX Reserves

Foreign Exchange Reserves									
Bil. USD, AR FactSet Economics Standardized Database									
	2011	2010	2009	2008	2007	2006	2005	2004	2003
World Total	9,880.2	8,917.5	7,887.0	6,824.2	6,203.9	4,923.6	4,101.6	3,630.5	2,945.5
✚ Asia									
Asia Total	6,495.1	5,866.7	5,167.1	4,401.0	3,936.0	3,153.6	2,693.1	2,446.1	1,906.0
✚ North America									
North America Total	357.7	309.9	284.2	214.4	196.7	172.8	166.6	177.7	173.2
✚ Europe									
Europe Total	1,675.8	1,558.0	1,355.0	1,166.9	1,226.8	952.1	760.8	707.4	614.0
✚ South America									
South America Total	550.9	469.5	409.5	367.5	326.7	205.8	157.1	136.9	120.0
✚ Middle East & Africa									
Middle East & Africa Total	740.9	658.0	616.6	632.6	475.7	371.8	273.2	119.7	94.0

Reserves, excluding gold.

Suggesting a high capacity to intervene in the economy when necessary without having to increase international debt

- So, please. Do not cut your veins if you see that activity in Asia slows !!

Foreign Exchange Reserves	Percent of GDP										
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
World Total	13.4	13.9	14.2	12.0	12.6	11.7	11.0	11.0	10.0	8.7	7.6
Asia Emerging											
Bangladesh	7.9	10.6	11.5	7.1	7.6	6.3	4.8	5.7	5.0	3.5	2.8
China	43.9	48.3	48.4	43.1	43.8	39.4	36.4	31.8	24.9	20.0	16.3
India	15.8	18.3	22.3	20.7	25.0	20.4	17.8	20.1	18.2	14.7	10.4
Indonesia	12.7	13.3	11.7	9.7	12.7	11.3	11.6	13.6	14.9	15.8	17.0
Malaysia	47.3	44.1	49.5	40.9	54.1	52.4	50.6	52.8	39.8	33.1	31.8
Pakistan	6.9	8.2	7.3	5.0	9.8	9.1	9.2	10.1	13.0	10.8	5.3
Philippines	29.9	27.7	23.0	19.1	20.2	16.4	15.4	14.4	16.3	16.4	17.7
Sri Lanka	10.6	13.5	11.0	6.1	10.4	9.6	10.9	10.3	12.0	9.5	8.2
Taiwan	82.5	88.4	92.1	72.9	68.8	70.7	69.4	70.9	66.5	53.7	41.6
Thailand	48.4	52.5	51.4	39.9	34.5	31.5	28.8	30.2	29.5	29.9	28.0
Vietnam	11.0	12.0	17.7	26.6	33.0	22.0	17.1	15.5	15.7	11.7	11.3
Asia Emerging Total	40.9	44.5	45.4	39.4	40.5	36.9	34.5	32.5	27.4	22.7	18.7
Eurozone Total	2.0	2.1	1.9	1.4	1.6	1.7	1.8	2.0	2.4	3.2	3.3
North America Total	1.7	1.6	1.6	1.1	1.0	1.0	1.0	1.2	1.3	1.3	1.1
Latin America Total	13.0	13.0	13.8	11.7	12.9	10.1	9.6	10.3	10.6	9.2	7.5

Additionally, high Fx reserves is a very good indicator of the **strength of the local currency** (as it reflects the support behind that currency)

What suggest that **Foreign Direct Investment will probably continue flowing** into these economies ...

... Keeping stable probabilities for a **"healthy" growth** (domestically driven)

Another positive aspect is the low level of household debt.

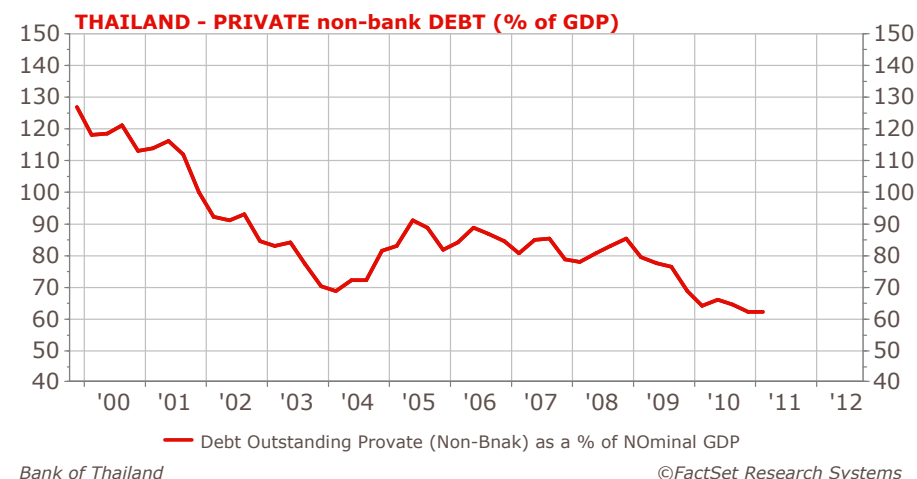
■ Sound familiar?

Thailand was the place where the Asian crisis began.

The origins? The usual ones. **An unprecedented overextension of the financial sector.**

Thai economy developed in a bubble full of “hot money”. At that time, South-east Asia attracted 50% of Investment flows. From 1985 to 1996, Thailand’s GDP grew at 9% each year.

On May 14, 1997, “someone” decided to start selling assets on this country (first stocks, then houses, debt, and finally currency).



Asian crisis gave place to an increase in the propensity to save in these countries.

This explains the relatively low level of debt, high savings and the excessive accumulation of reserves

The combination of this three factors, probably converts this region in the most solid one in the world, today.

... one (if not the most) solid regions in the world ... and so investors are beginning to feel



See how in the last three years, foreign investors accumulate each year a higher portion of the relatively small amount of public debt outstanding issued by these economies. (from the 8% seen in average in 2009 to the 19% currently)

Accordingly, the region starts to hog again the most of the global investment flows.

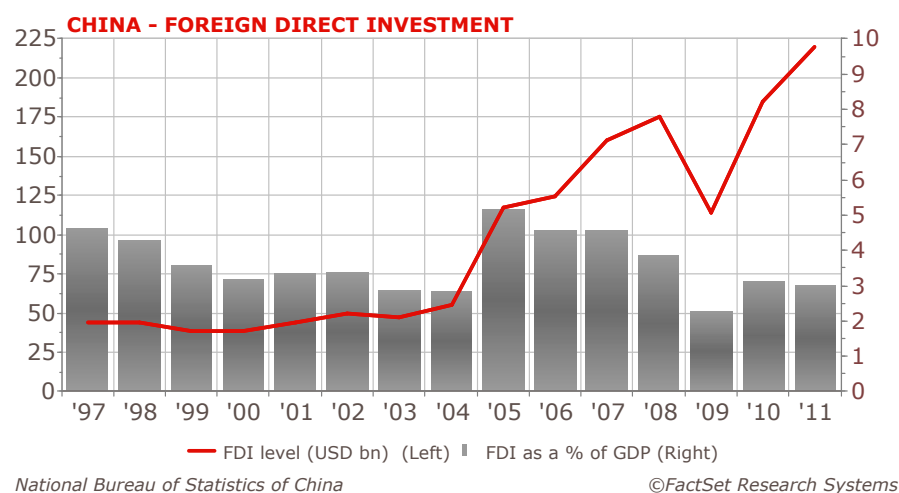
An aspect that, along with the enormous public investment capacity, facilitates the maintenance of a more than acceptable pace in the economy.

As we see it, this region will be one of the few (if not the only) where direct investments will have more economic sense

...

... and so foreign investors (enterprises) think too (see chart below)

And public sector has demonstrated that can also intervene the economy when necessary.



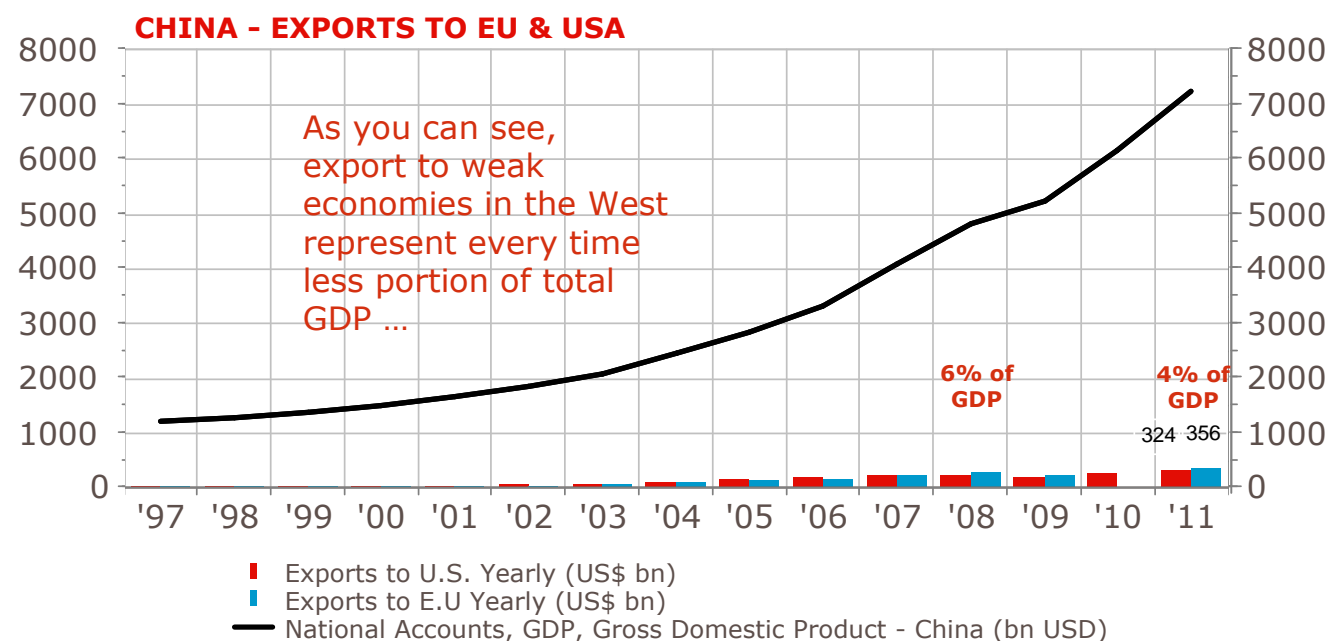
But, what could jeopardize economic progress in Asia?

- **Maybe a persistent slowdown of consumption in developed economies?**
- **I do not know. Let us see:**

Most market participants still consider these economies as “highly dependent” on the West ...

... and they fear that a persistent slowdown of consumption in developed economies could endanger future growth in Asia.

Let's take China as a representative example

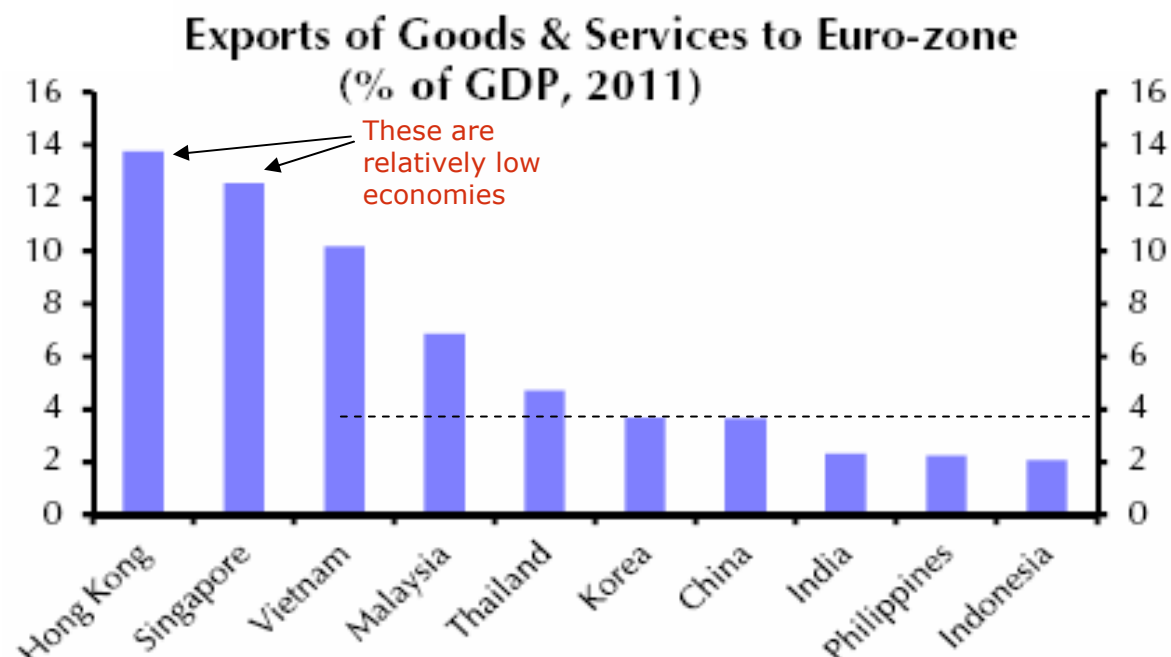


National Bureau of Statistics of China

©FactSet Research Systems

Let's understand, once and for all, that this threat has actually declined!

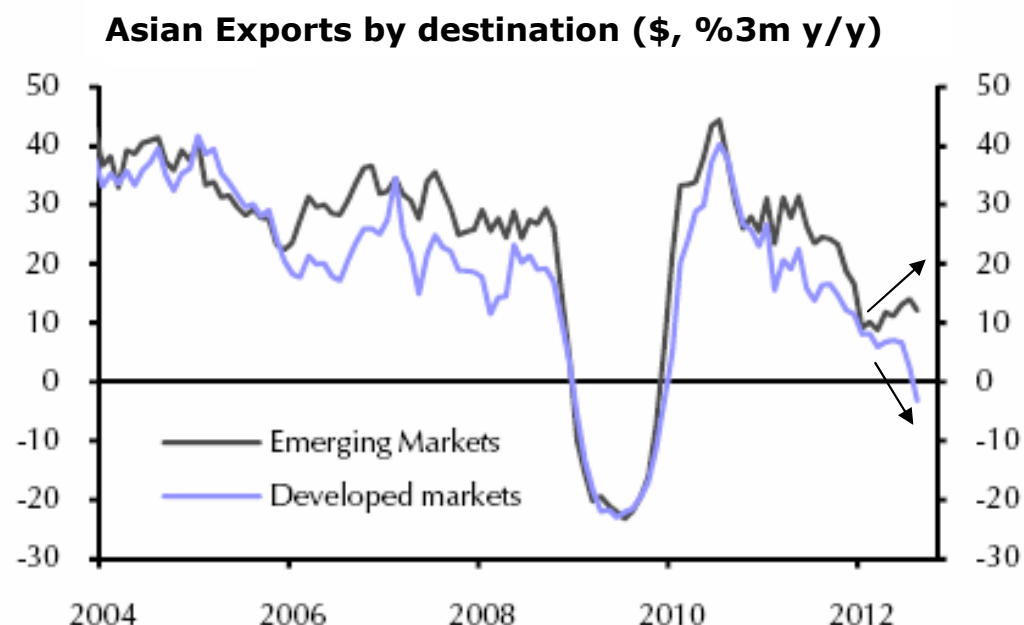
If we think in terms of the entire region, we see how this lower dependence has spread to most countries



We can see how this lower dependence on trade with the West is not only attributable to China

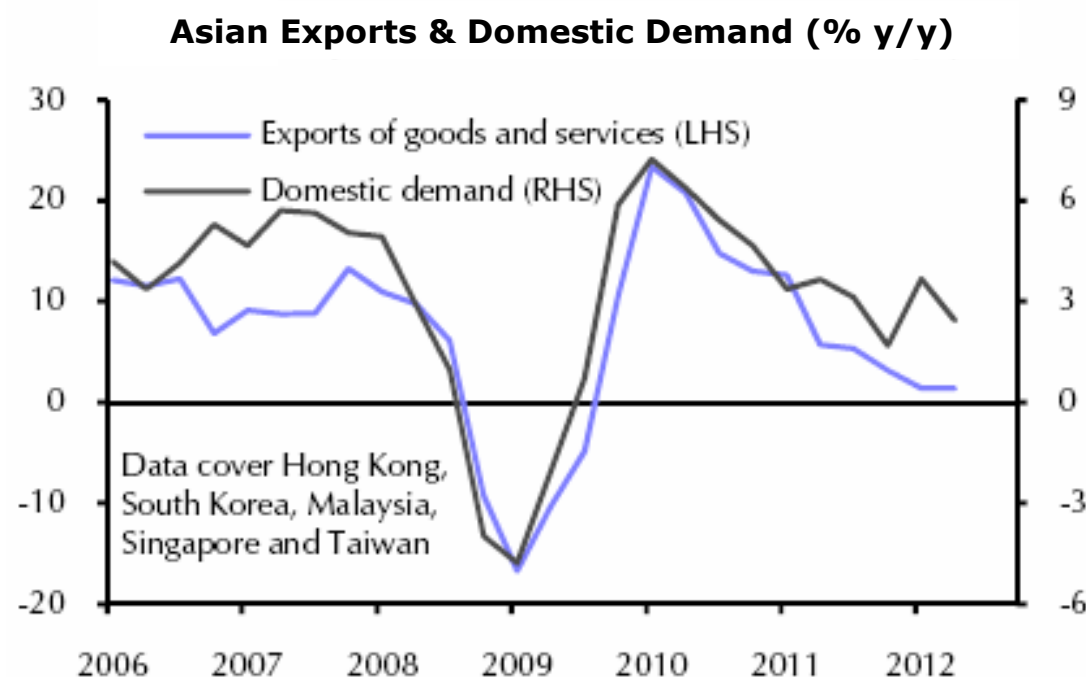
And in terms of trade, intra-regional trade (within emerging markets) has taken over inter-regional one...

Something that if continues, will have important implications!!



See how while trade with developed economies has plummeted in 2012, trade of Asiatic economies within the region has ACCELERATED to a double digit pace !!

And more importantly. Domestic demand has held up relatively well at regional level ...

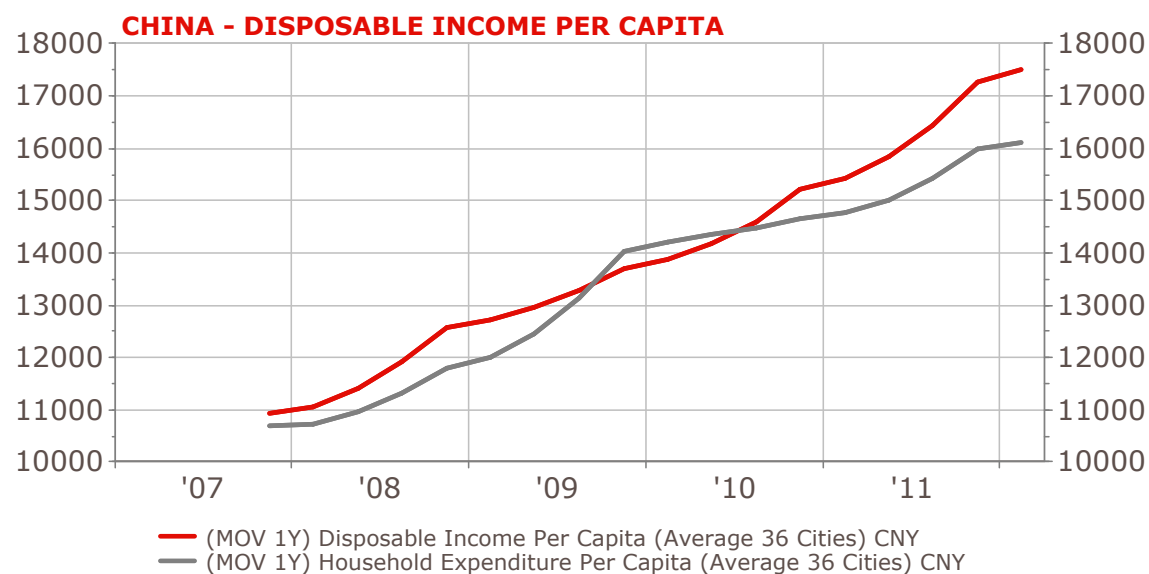


... even in the smaller trade-dependent economies (such as Hong Kong, Singapore, or Vietnam) ...

... though we recognize that this could not continue if global economy continue performing so badly.

What feeds this domestic driver?

Despite the slowdown seen in 2011 (and 2012), economic activity was strong enough to allow per capita disposable income to grow at a significant pace during the entire 2011 (and presumably during 2012)

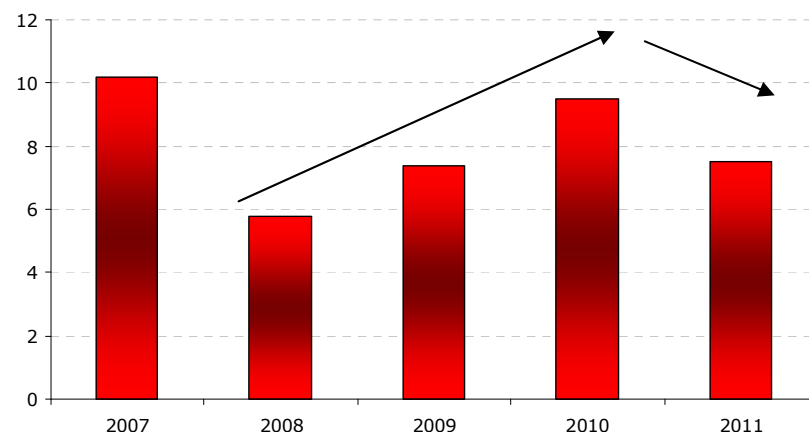


National Bureau of Statistics of China, Andbank

©FactSet Research Systems

Another important aspect to consider is Monetary Policy

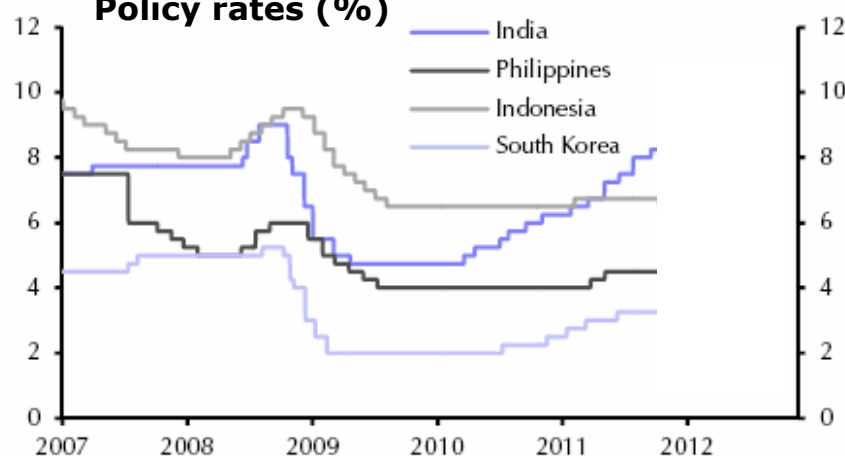
Emerging Asia (incl China) % y/y



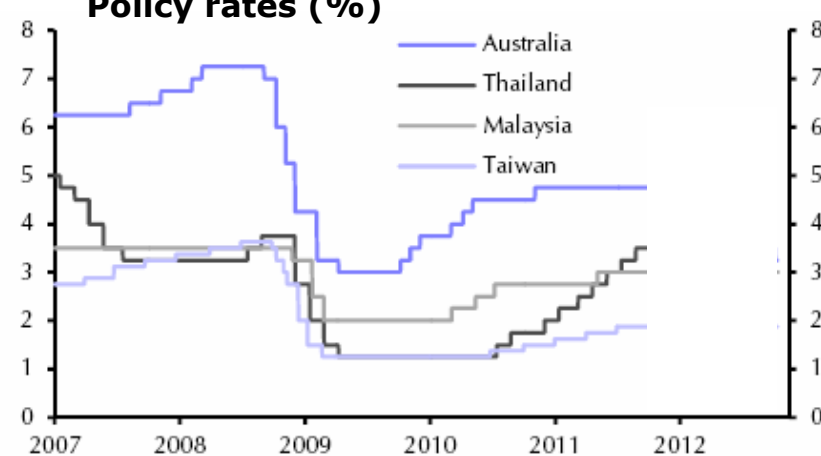
We can not abandon the perspective, and must keep in mind that in 2010 these economies were overheating ...

... and that situation moved these governments toward a tightening cycle of monetary policy during 2010 & 2011, that could explain late 2011 & 2012's slowdown

Policy rates (%)



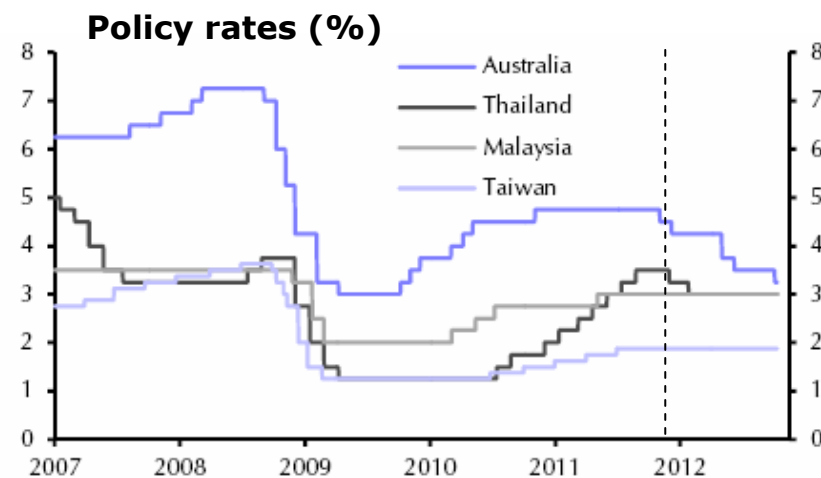
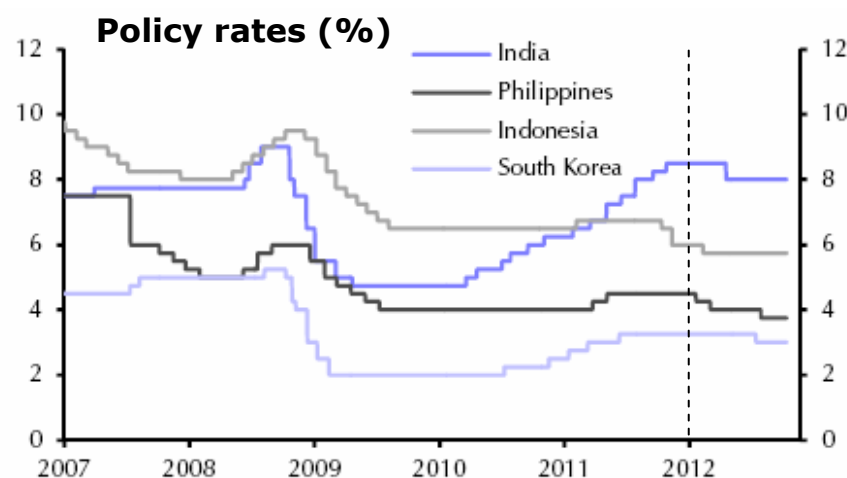
Policy rates (%)



A tightening cycle that became “easing cycle” by the start of 2012 in every of these economies ...

... What makes us think in the following terms:

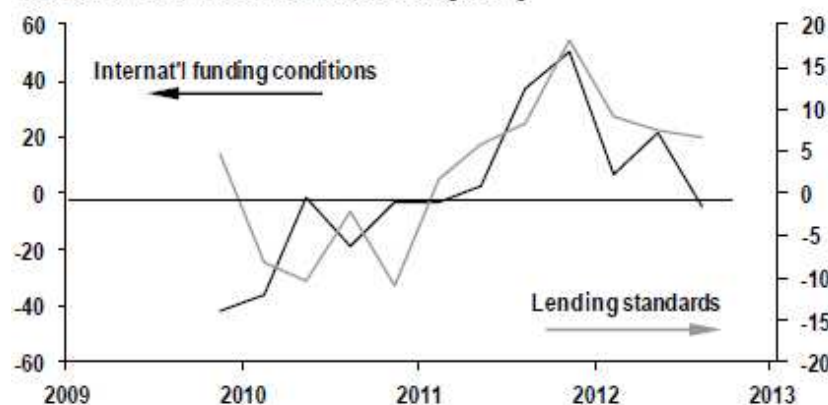
If a tightening monetary policy in 2011 lead these economies into an economic slowdown in 2012, the 9 months of easing monetary policy seen so far this year should favour a rebound in activity in 2013.



And EM bank tightening is gradually abating

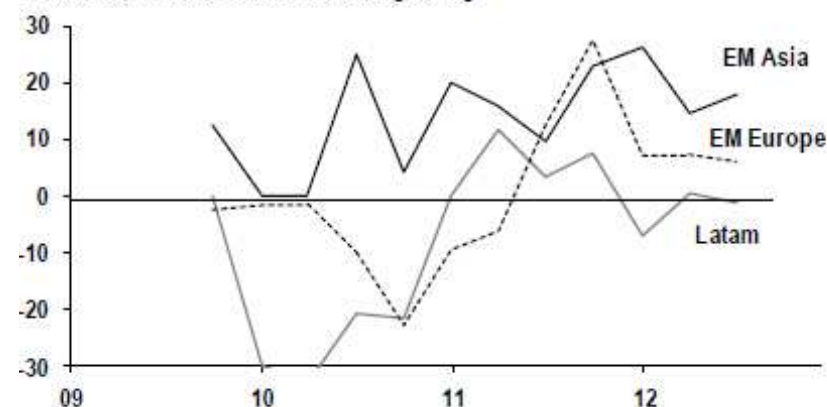
EM bank international funding conditions and lending standards

Net %, both scales; above zero indicates net tightening



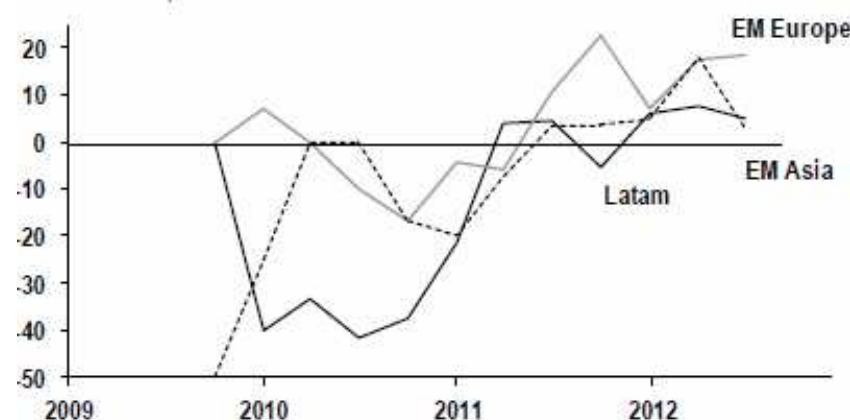
EM bank credit standards

Net % balance; above zero indicates tightening



EM bank non-performing loans — next three months

Net % balance; above zero indicates more NPLs

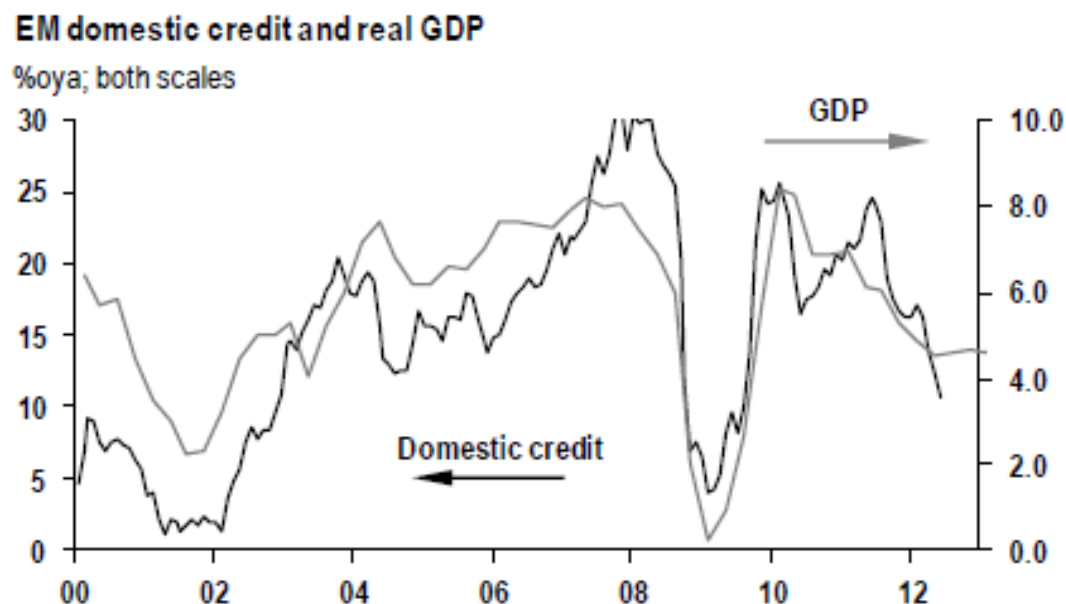


Weak growth in developed economies partly explains why growth in EM has been below trend during 2012, **nevertheless an even bigger factor behind the economic slowdown was the turn toward a more restrictive credit conditions among EM banks during 2011.**

Last IIF suggests that this process has not yet run its course, and that NPL ratios has improved considerably in some EM, **what leaves us with all the room toward a new easing cycle.**

Remember that policy tightening in the region is typically transmitted through the banking system in the form of stricter lending terms...

Thus, it is a very good new that we see a halt in this process (considering that credit has played a crucial role in the EM cycle over the past decade).



The credit cycle turned in 2011 caused by a more cautious stance from commercial banks in the region. Additionally, Central banks in EM (Asia) continued the process of raising interest rates and requesting more bank reserve requirements to combat overheating in both, the economy and the asset markets.

All these trends are now reversing. What makes us to feel more confident when it comes to a possible acceleration of the economy in the region.

What about the rest of risks?

Is Chinese property market on the verge of a bubble?

Three mechanisms to gauge this risk:

First mechanism: "Price to Income"

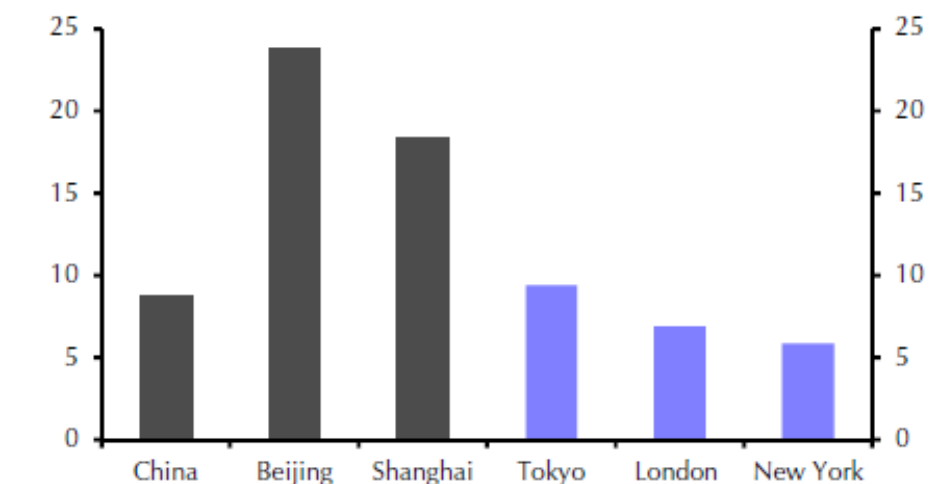
The most reliable way to assess whether current house prices are sustainable (or in a bubble) is to compare prices with incomes.

Based on this, there are specific cities in which property prices are extremely high but **prices across the whole country are not too stretched.**

In cities like Beijing and Shanghai, an average house would cost 24 and 18 years of pre-tax income respectively (too high).

But at country level, an average house still costs 8 years of average pre-tax income.

CHART 4: HOUSE PRICES RELATIVE TO AVERAGE INCOMES
(2011)



Sources – CEIC, Capital Economics, National Sources

What about the rest of risks?

Is Chinese property market on the verge of a bubble?

Three mechanisms to gauge this risk:

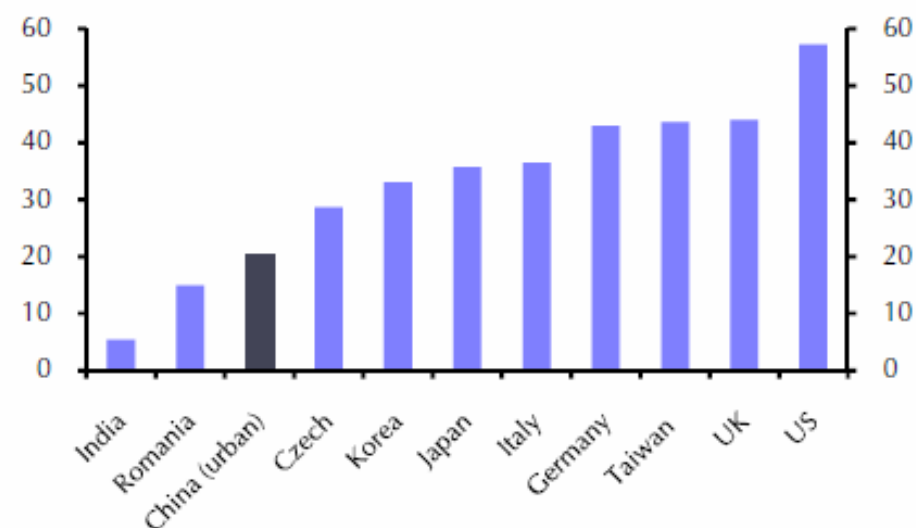
Second mechanism: “Squared meters of property per capita”

We can also gauge if the property market is in a bubble from a Demand stand point.

If we compare the squared meters owned by citizens in different countries, we can see how Chinese citizens (urban) keep a much lower rate of property, even compared with some of the developing asia economies (such as Taiwan)

From this perspective, it can not be said there is a bubble in the property market at country level.

CHART 9: RESIDENTIAL PROPERTY PER CAPITA
(SQ. M., LATEST AVAILABLE YEAR)



Sources – National Sources, Capital Economics

What about the rest of risks?

Is Chinese property market on the verge of a bubble?

Three mechanisms to gauge this risk:

Third mechanism:

"Investment as a % of GDP"

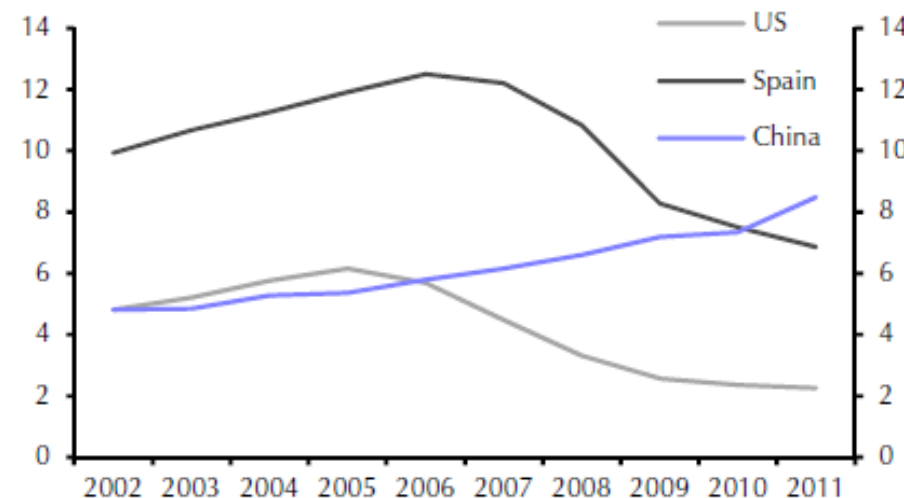
Another way to gauge if the sector is overheated could be determining the share that property investments represents on GDP, and then compare this figure with countries in which property bubble as been evidenced.

Based on this analysis, Chinese investments in residential property as % of GDP (8.5%) stays well below the 13% seen in Spain in the peak of 2007 ...

... However, is considerably higher than the 6% peak seen in the US during the 2005-2006 period.

It could be said that property investment in China is not at a super-bubble levels (like those seen in Spain), but could be considered that is in a highly accelerated mode.

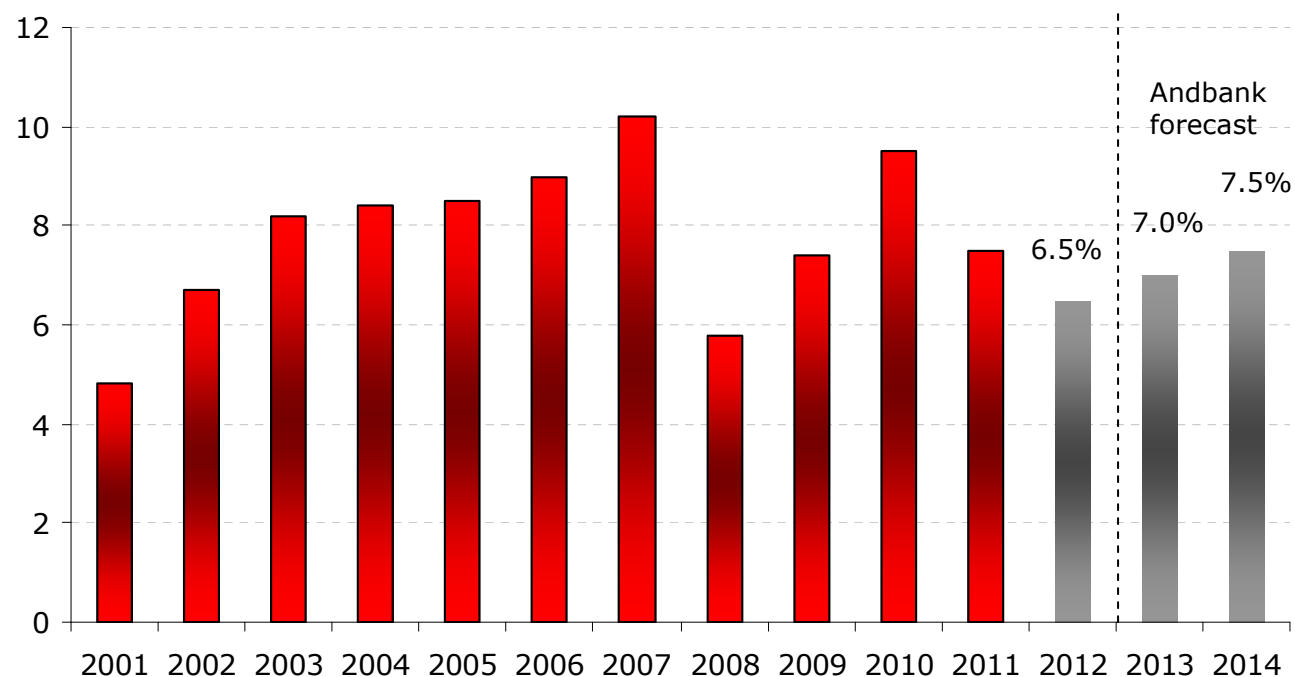
CHART 15: INVESTMENT IN RESIDENTIAL PROPERTY (% GDP)



Sources – CEIC, Thomson Datastream, Capital Economics

Asia - Our projections

Emerging Asia (incl China) % y/y



In summary, not only we do not expect a slowdown in 2013 but we foresee an acceleration of pace. If wrong, we believe we will err above. We consider that risks of overheating are higher than risks of recession.

Our conclusions for Asia

1. Asian countries have been effective in the use of instruments to **accelerate or reduce** pace of activity, suggesting they are now **much more autonomous** than you think
2. There is a kind of pattern in the use of budget execution meaning that these economies apply a countercyclical criteria **this could explain why economic activity has slowed** in the 3Q2012
3. Additionally, the region shows the lowest debt ratios, and more importantly, the **world's savings are in their hands**, accumulating almost 65% of global FX Reserves, representing more than 40% of their annual GDP ...
4. ... suggesting a high capacity to intervene in the economy when necessary **without having to increase international debt**
5. High Fx reserves is a very good indicator of the strength of the local currency as it reflects the support behind that currency, what suggest that **Foreign Direct Investment will probably continue flowing** into these economies
6. The combination of three factors: Low level of debt, high savings and the excessive accumulation of reserves, will favour economic dynamics.

Our conclusions for Asia

7. Most market participants still consider these economies as “highly dependent” on the West, but we have reasons to think that **this threat has actually declined!**
8. **Intra-regional trade (within emerging markets) has taken over** inter-regional one.
9. Economic activity was strong enough to allow **per capita disposable income to grow at a significant pace** during the entire 2011 (and presumably during 2012)
10. Overheating in 2010 moved these governments toward a tightening cycle of monetary policy during 2010 & 2011. They are now **easing monetary policy and we could see the effects during 2013.**
11. EM **bank tightening is gradually abating.** Last IIF suggests that NPL ratios has improved considerably in some EM, what leaves us with all the room toward a new easing cycle.
12. The combination of all the factors mentioned so far, converts **this region in the most solid worldwide.**
13. In summary, we foresee an acceleration of pace. If wrong, we believe we will err above. We consider that risks of overheating are higher than risks of recession. We recommend add exposure to the region via mutual funds investing in government debt (local currency) and regional equity indices.

Legal Disclaimer

All the sections in this publication have been prepared by the team of analysts from the financial institution.

The views expressed in this document are based on the assessment of public and private information. These reports contain evaluations of a technical and subjective nature on economic data and relevant social and political factors, from which the financial institution's analysts have extracted, evaluated and summarized the information they believe to be the most objective, subsequently agreeing upon and drawing up reasonable opinions on the issues analysed herein.

The opinions and estimates in this document are based on the market events and conditions that took place before the publication of this document, and therefore cannot be determining factors in the evaluation of future events that take place after its publication.

The financial institution may hold views on financial instruments that differ completely or partially from the general market consensus. The market indices chosen have been selected following the exclusive criteria that the financial institution regards as most appropriate.

The financial institution cannot in any way guarantee that the predictions or events given in this document will take place, and expressly reminds readers that any past performances mentioned do not in any circumstances imply future returns; that the investments analysed may not be suitable for all investors; that investments can fluctuate over time in terms of their share price and value; and that any changes that might occur to interest rates or currency exchange rates are other factors that may also make it unadvisable to follow the opinions expressed herein.

This document cannot be regarded, under any circumstances, as an offer or proposal to buy the financial products or instruments that may have been mentioned, and all the information herein is for guidance purposes and should not be regarded as the only relevant factor when it comes to making a decision to proceed with a specific investment.

This document does not, therefore, analyse any other determining factors for properly appraising the decision to make a specific investment, such as the risk profile of the investor, his/her knowledge, experience and financial situation, the duration or the higher or lower liquidity of the investment in question. Consequently, investors are responsible for seeking and obtaining the appropriate financial advice in order to assess the risks, costs and other characteristics of any investments they wish to make.

The financial institution cannot accept any responsibility for the accuracy or suitability of the evaluations or estimates of the models used in the valuations in this document, or any possible errors or omissions that may have been made when preparing this document.

The financial institution reserves the right to change the information in this document at any time, whether partially or in full.