
DSGAsia

The impact of the current global turmoil on Asian stock, bond and foreign exchange markets

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ADB I Roundtable on Capital Market Reform

Tokyo, 2-3 March 2009

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Independent Asian Economic & Political Analysis

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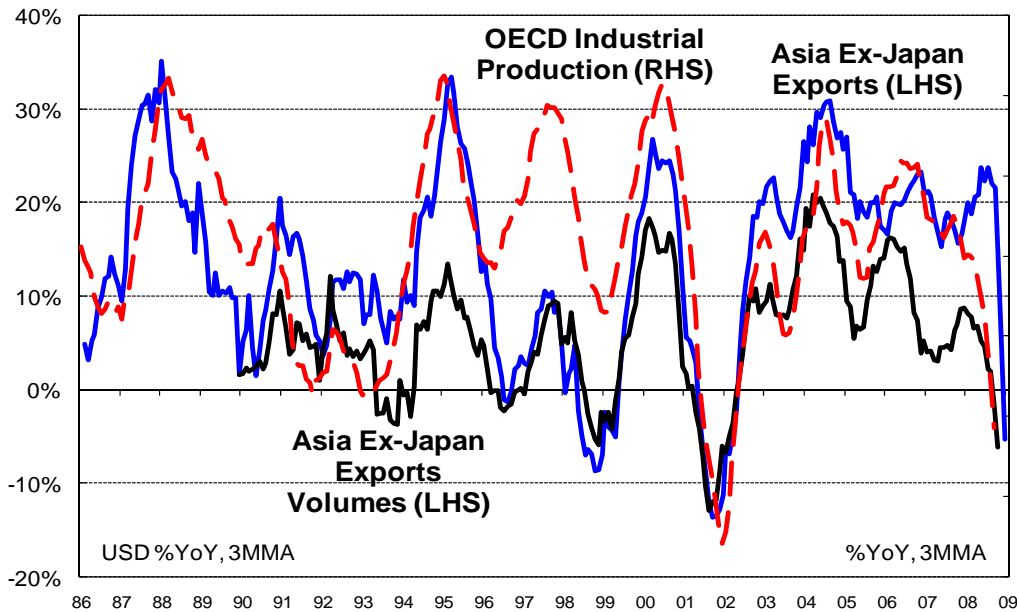
DSGAsia's two minute big picture view

- **Asia was globalised on the way up and was going to decouple on the way down. Yeah right! The idea that the region was going to remain unscathed in the context of the collapse of the biggest credit Ponzi scheme of all time was always delusional. If anything we are and remain warrants on global growth**
- **Debt deflations are, well, deflationary. Bonds are not (yet) in a bubble and accelerated issuance will be easily accommodated. Let's hope the funds raised are deployed wisely! Inflation will come but not this year at least. Equity cheapness is illusory; it is the wrong part of the capital structure to be in at this juncture**
- **Banking systems in the West are pretty much insolvent and state injections of capital and nationalisations are only just beginning. The costs of the clean-up continue to be materially underestimated. An Asian-crisis type bill of 15-20% of global GDP, or USD7-10, trillion beckons**
- **Our greatest concern is the sign that a Japanese-style warehousing approach to bad assets and failed companies is being contemplated. This will be the difference between an extremely nasty few years and a decade or more of stagnation**
- **Whether recent policy responses in the West – many of which have hitherto been only theoretical constructs – work, remains to be seen. Great Depression Risk II may have fallen but is still around 20%**
- **Nevertheless, there is a case for Asia's "second round decoupling." Should the global economy stop getting worse later this year, the region's superior fundamentals should support relative outperformance in growth and asset prices**
- **What are these superior fundamentals? Banking systems are largely liquid and solvent, balance of payments are generally strong, and the scope for fiscal expansion is material. Institutional capability to deploy effectively will be a crucial differentiating factor across the region**

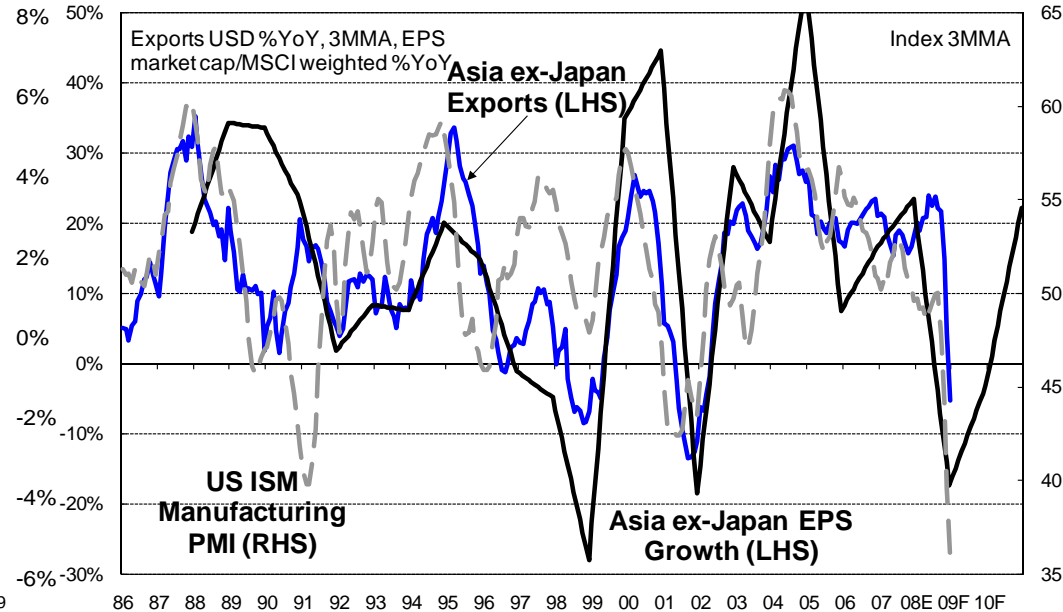


Where was the decoupling? Asia's micro analysts remain delusional

Asia Exports and OECD Industrial Production

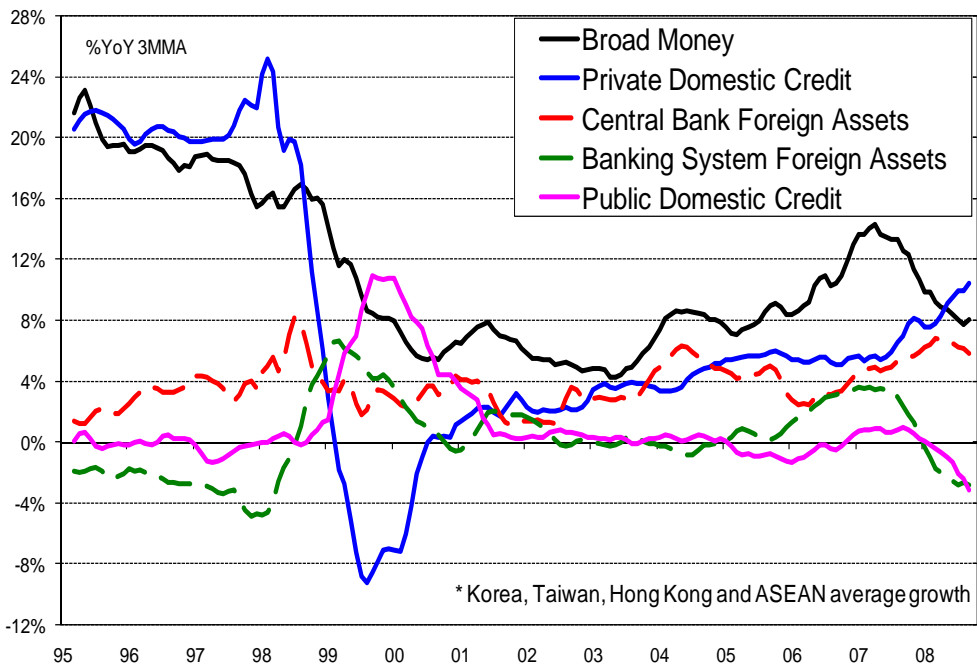


Asia ex Japan Exports & EPS Growth and the US ISM Manufacturing PMI

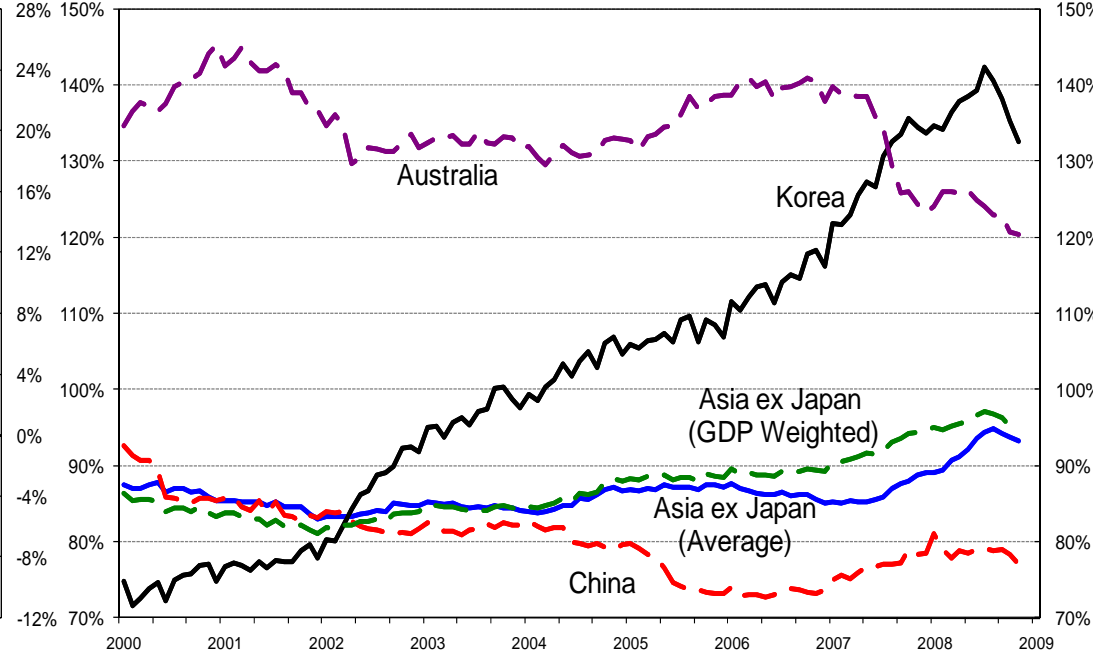


Private credit will slow but liquidity sources seem pretty secure and credit crunches should be avoided. Korea is the worrying exception

Contributions to Asian* Broad Money Growth

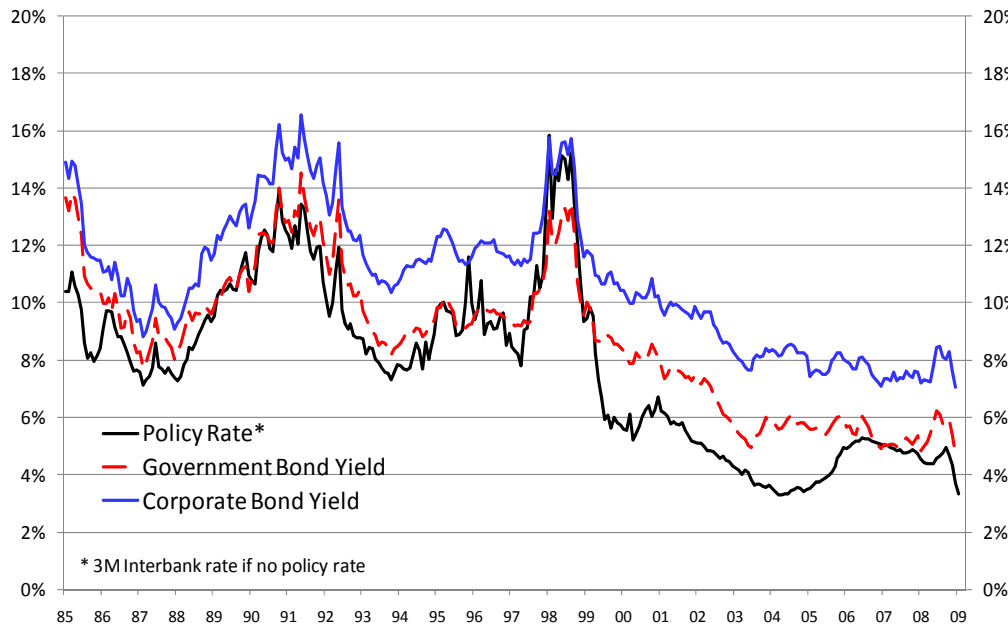


Loan Deposit Ratios Adjusted for Reserve and Statutory Liquidity Requirements

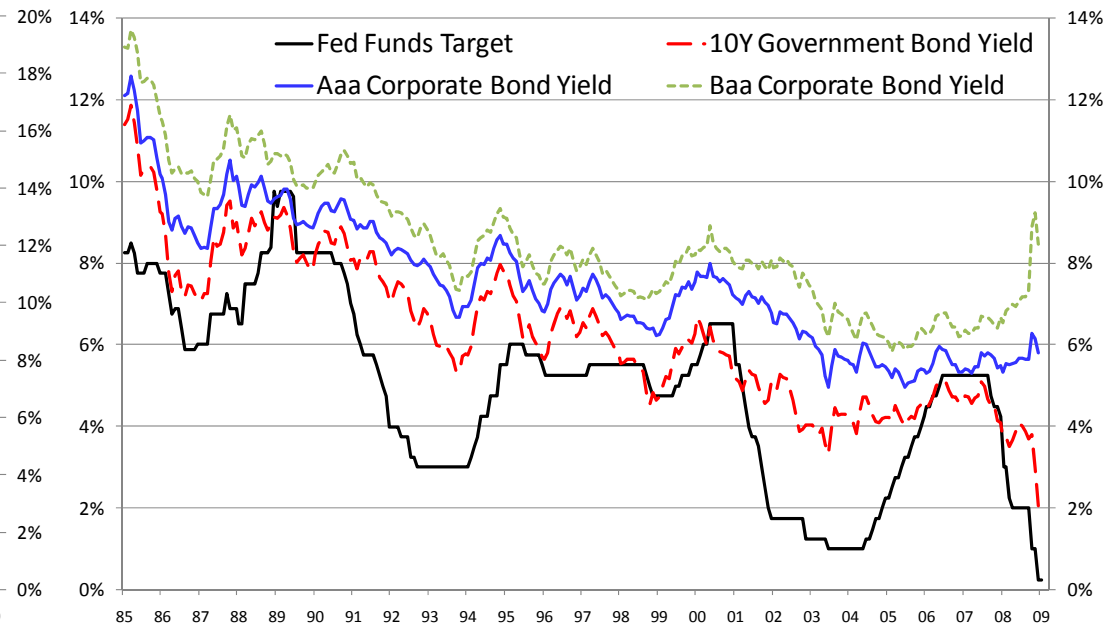


With inflation no longer a problem, there is plenty of scope for monetary easing across the region. Unlike elsewhere, corporate credit costs are not blowing out

Asia ex-Japan Interest Rates (Simple Average)

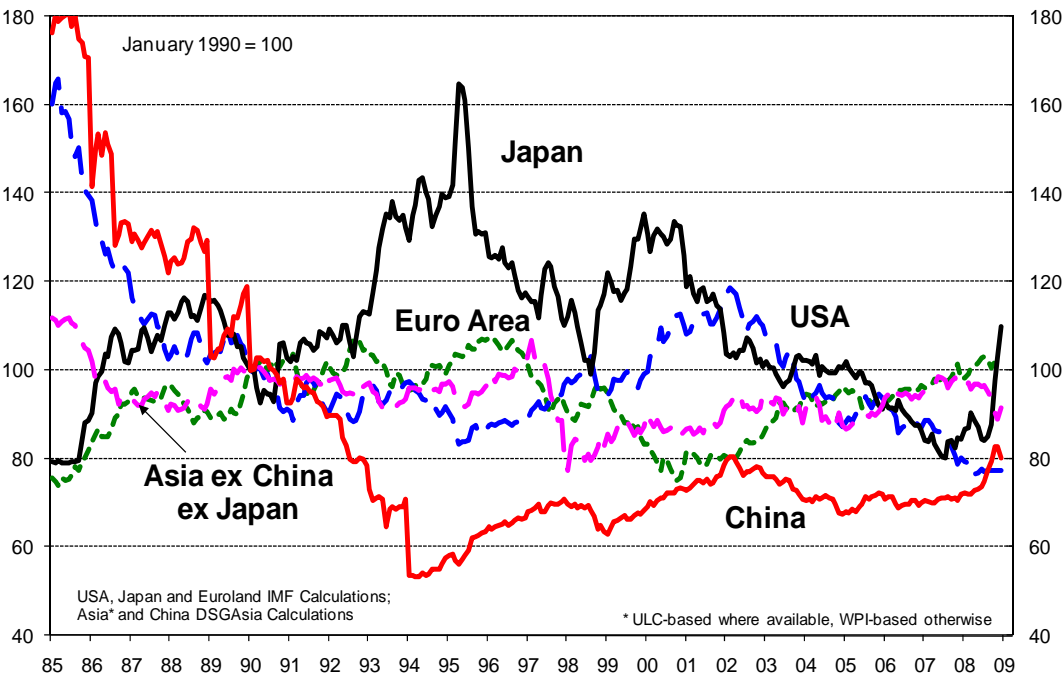


US Interest Rates



China's exchange rate advantage has ended. After recent moves, almost all of which were justified by fundamentals, few Asian currencies are out of line

Real Unit Labour Cost-Based Trade-Weighted Exchange Rates



- Last year's regional currency divergence trades were almost wholly justified by divergent BoP positions, albeit the imbalances were nowhere near 1997 magnitudes
- Nominal realignments, position squaring and swap agreements have pretty much dealt with any problems
- Asian units should be firm but in a strong dollar and weak external demand environment, appreciation pressures will be strongly resisted
- With the euro likely to become increasingly existentially challenged, the arguments for Asian currency union will be even harder to make
- Managed TWIs are probably the way to go but even here, coordination will be problematic
- Statements of solidarity are always worthy but the stark regional reality is that Mercantilism and Nationalism continue to reign

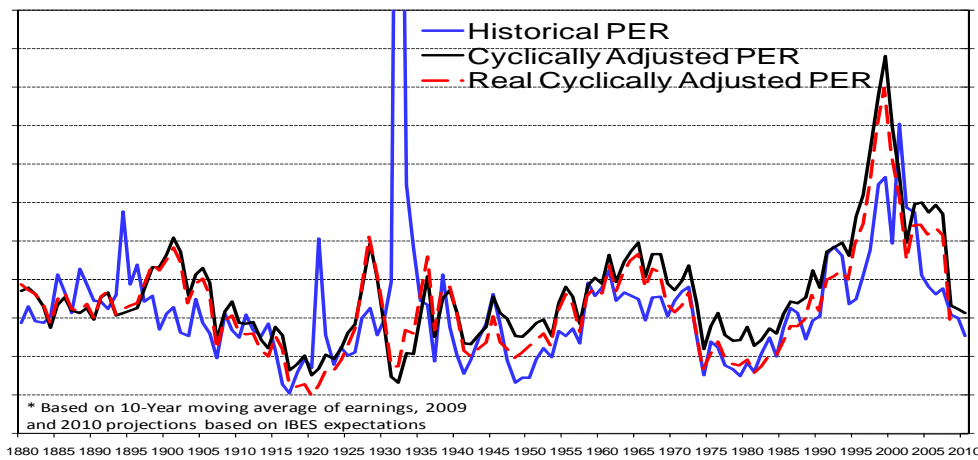


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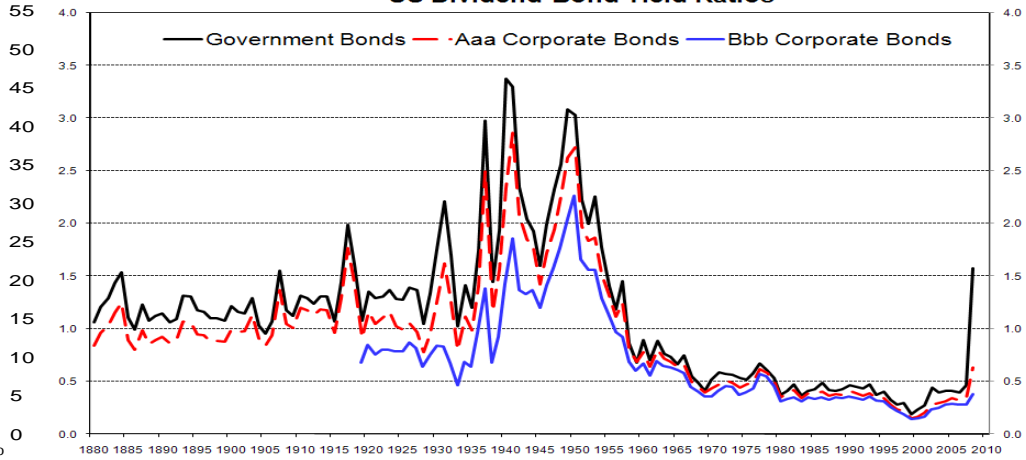
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Asian equity valuations seem relatively attractive if one can trust the earnings and book

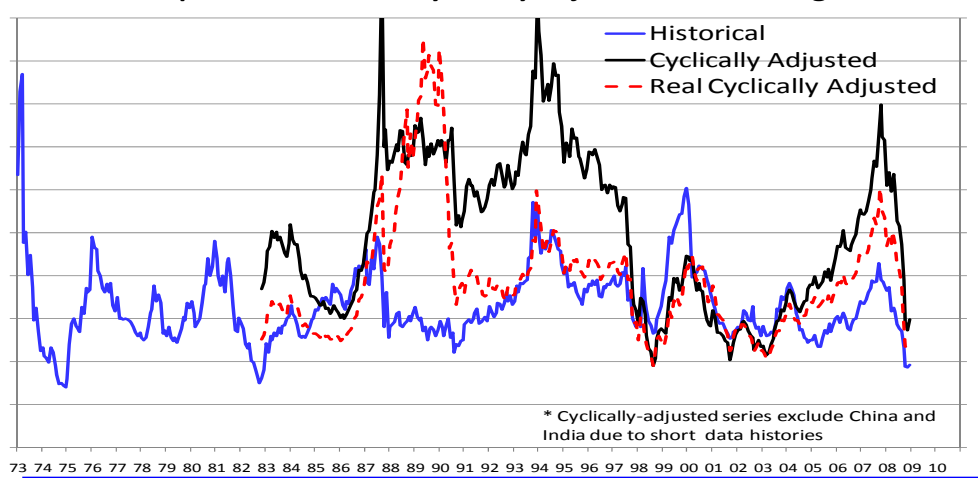
US Historical and Cyclically Adjusted* Price Earnings Ratios



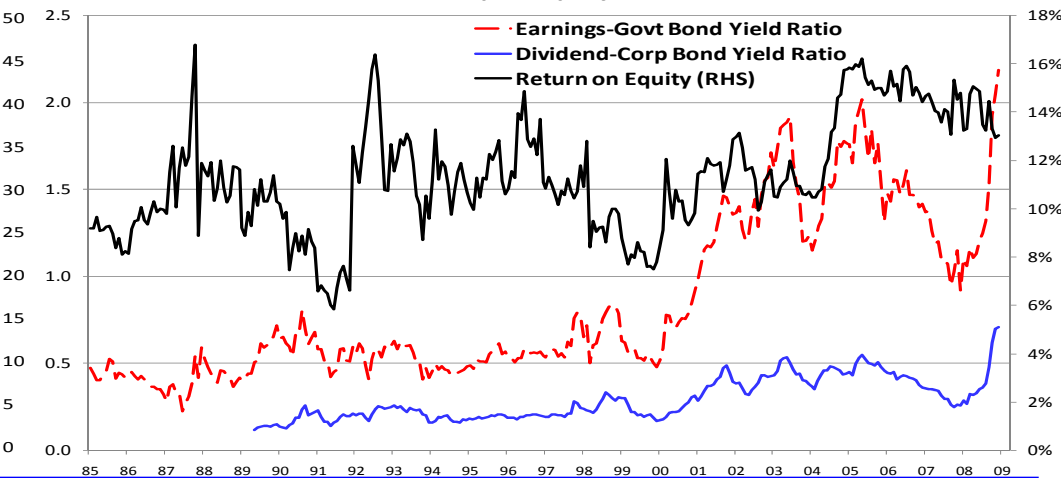
US Dividend-Bond Yield Ratios



Asia ex-Japan Historical and Cyclically Adjusted Price-Earnings Ratios



Asia ex-Japan Equity Valuations



Conclusions

- **We cannot stress enough the necessity of the US and Europe eschewing the warehouse approach. Take this path and we are looking at a lost decade or even worse**
- **Assuming we are not going to warehouse and global policy responses gain some traction, then Asian “second round decoupling” becomes a real possibility**
- **Crucially, we are unlikely to see wholesale credit crunches in this neck of the woods albeit NPLs will rise and certain institutions (and one or two countries) may find themselves in real distress**
- **Balance of payments imbalances have been largely dealt with and thus currency (not to mention inflation) constraints on monetary easing have generally disappeared**
- **Nevertheless, liquidity will still tighten. Foreign banks are withdrawing and local banks will have to fill the void which they may struggle to do in short order. Meanwhile puny local corporate bond markets will be of little help**
- **Regional equity markets are a lot more realistically valued at this juncture but are not outrageously cheap given both domestic earnings risk and the continued overvaluation of American stocks**
- **Moreover, corporate governance remains lousy in far too many jurisdictions with local investors often the biggest sceptics. The politicians need to decide to properly empower market regulators rather than allow the local bourses to continue to be run as insiders’ clubs**

