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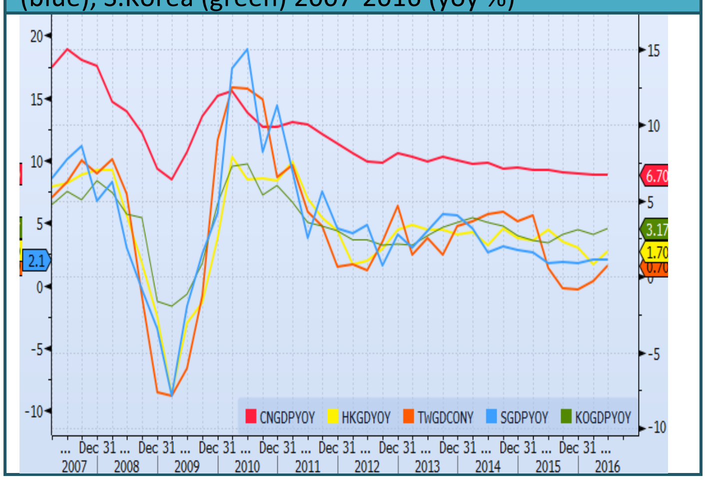
ECONOTE No. 53 Asia: A summary of developments-mostly good **21/8/2016**

Summary	Investment Conclusions
The G3 economies continue to struggle, each for different reasons: the US because of likely rate hikes, Japan because neither monetary nor fiscal policies work ,and the EU because of anemic growth, low inflation and Brexit. In Asia, the very different economies which form the "Asian" geographical notion, are doing very different things. GDP growth rates vary currently (2Q.16 yoy) from 7.9 % in India, 6.7% in China, and 7.0% in Philippines to 0.7% in Taiwan, inflation is not a threat, exchange rates, in general, strengthening versus the USD, and interest rates being cut or left unchanged. So much for the USD link to Asia. But all eyes are on China, because of its (undeserved) role as the locomotive of global growth.	Three small Asian equity markets, Thailand, Indonesia and the Philippines have done extremely well, since the start of the year, be noted, and in USD terms, and will likely continue to do so. Two medium- sized ones; Taiwan and Korea have also done well. Asian interest rates offer, in general and except for Hong Kong, wide differentials to the G3 negative yields. This has driven EMK funds back to Asia, but the G3 bond markets are an explosive combination of high prices and lengthening duration and this means that any "correction" will blow back on the Asian bonds. Stick to these small equity markets and to short tenor EMK paper.

There is no such place as "Asia"

Between April and July 2016 seven out of the ten Asian economies surveyed here cut official rates, the ones NOT doing so being Hong Kong (pegged to the Fed rate), China and Singapore the latter following a forex and not an interest rate rule. This little detail tends to be forgotten in the usual expectation that a Fed hike will hurt the Asians. Interest rates in Asia have long disconnected from the Fed as their forex rates are not somehow "pegged" to the USD, excluding Hong Kong, and the managed and capital controls- supported CNY.A hike by the Fed will impact, first and foremost, the global and, hence, the Asian equity markets, but not directly their real economies. As Figs 1 and 2 show, the trends in several Asian GDP growth rates are modestly accelerating. In specific, the trends are up for Thailand, Indonesia, India and the Philippines, rates may have bottomed in S.Korea, Hong Kong, Taiwan and Singapore, while for China and Malaysia the trend stays downwards. A number of points need to be made here: For **Thailand**, after the recent plebiscite on the constitution, the military will likely stay in power indefinitely even after an election. So far politics have not affected the "Teflon" economy, but this may not be the case in the medium term. In **Malaysia** politics have impacted sentiment as the financial scandal does not seem to subside and the political environment stays divided. In **Taiwan** and in **S.Korea** the governments introduced expansionary policies in order to sustain the modest recovery now visible in both economies. In Taiwan the policy issues are further complicated by the election of president Tsai whose attitude to China, and to the economic links therein, are less simple than before.There is now an effort to make Taiwan less economically dependent on China and the PRC authorities have considered this to be another potential step towards fomenting independence.

Fig.1: GDP: China (red), HK (yel), Taiwan (orange), Sing (blue), S.Korea (green) 2007-2016 (yoy %)



Source: Bloomberg

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China and India: different tales from the rest

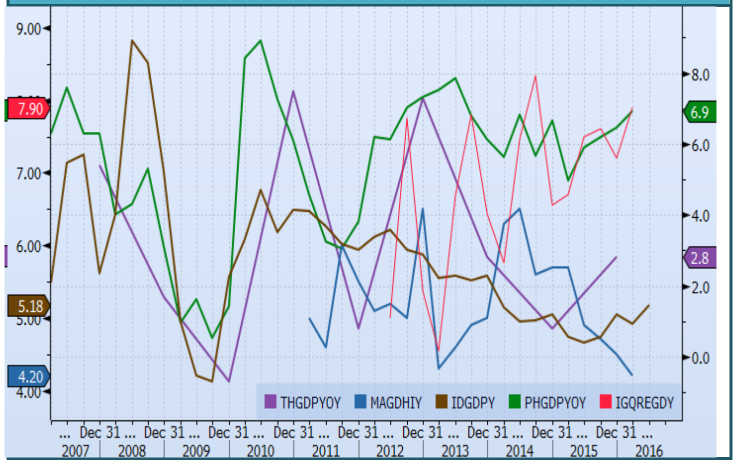
China's deceleration (since 2010 be noted, nothing recent) has been interpreted as either a secular decline while the structure of the economy changes from exports-led growth (which was never the case as, in most recent years, net exports made a negative contribution to GDP growth, a little detail widely ignored), or a sign of impending financial disaster.The latter also ignored the fact that net global lenders never go bankrupt globally or domestically. China's deceleration simply reflects the decline in investment growth, triggered by policy actions to reduce excess capacity and waste, the impact on the exports sector of the G20 weakness, albeit modest in terms of GDP growth as we have pointed out, and the massive losses in the poorly handled and inflated equity markets where state intervention was a disasterous waste of money. **India's** economy continues to grow well, but with no chance under the Modi administration of achieving growth rates of 10-15%, attainable if bold reforms were to be instituted. A great deal was made of the passing of the GST reform, two years into Modi's government, which will unify the indirect taxation system. This is an administrative reform and has no structural impact or consequence on the sorely needed reforms of the labor market, of retail and wholesale distribution opening to foreign participation, rural and urban land reform, drastic reform of the near bankrupt state banking system, a revitalization of infrastructure investment and, hardly ever mentioned, a truly gigantic effort to bring to a high standard the abysmal state of primary education and especially that available to girls. It is absurd for India to send missions to Mars when illiteracy runs, in global absolute and comparative terms, exceptionally high in some states and especially among women. Case rests.

FACT BOX: Small Asian equity markets are doing well.

To August 20th, the equity markets in Thailand and Indonesia were up YTD in USD by 24.0% and 23.0% respectively, while the Philippines followed with a respectable 15.0% return. The bigger markets of Taiwan and Korea followed with 12.0% and 10.0% returns. (All figures rounded).

It would have been convenient if the macro performance of these economies were strong enough to provide support for this performance, but it is not. Taiwan has currently the lowest GDP growth rate in Asia (0.7% yoyo 2Q.16) while Thailand's current growth at 3.5% is in the lower range in the countries surveyed. Chinese equities are yielding a negative 14.0% while the Mumbai index returns stand at a modest XX%. This simply confirms that GDP growth and equities returns are not linked.

Fig 2: GDP Growth: India (red), Thai (violet), Mal (blu), Indo (brown) 2007-2016 (yoy %)



Source : Bloomberg

In a purplexing world stick to simplicity

Among the discussion of a "new normal" in terms of an extended period ,even of decades, of near zero rates, and the conundrum of central banking policy, the discussion has become totally G3-centric.Asian central banks have not pushed rates to zero, Asian economies are growing at such diverse rates, from very high to very low, as to make nonsense of any cyclical explanation, and their equities markets yield from negatives in the teens, to positives in the twenties.

The saying "include me out please" should be fervently adopted by most Asian policy makers and in China in particular whose large economy is domestically driven and whose external lending position insulates it from any fear of systemic instability. India can do miracles if its political system and its citizens choose to do so.The well worn argument that drastic economic reforms in India will harm the poor simply ensures that the poor stay harmed by low growth rates and by state expenditures in the wrong places, other than the ones which raise productvity, such as in primary education, and hence raise people out of poverty.In the middle of the travails of the G3, Asia offers a clear vision that what happens in the G3 is not necessarily of very significant relevance or of importance to Asia. If you find this hard to believe look at "their" and at "our" numbers. "It is the economy stupid" after all.

Andrew Freris (writing completed 21 August 2016)