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ECONOTE No. 58: "Trump" outlook for 2017 for the smaller Asian economies **12/2/2017**

Summary	Investment Conclusions
The focus of this Econote is on the prospects for 2017 of 8 smaller Asian economies. The context of our theme is that the US is not as important for most Asian economies as it is commonly believed. Trump's declared trade policies cover the NAFTA and China. Any trade restrictions on the latter will have very diverse effects in Asia where China trade dependency varies widely. To this direct effect, collateral damage must be added which, again, will vary. The outlook for Asian growth rates is stable. Asian local interest rates are disconnected from the rising USD rates and, hence, Asian forex rates (bar HK) are not mechanically linked to the USD. Asian equities will be hit by any US equity volatility, but will be cushioned by stable forex rates and strong domestic economies.	Gratuitously we offer the unrealistic suggestion that the best way for investors to deal with Trump is to completely ignore all his policy statements, let alone his insistent Twitterings. Publicity is the core of his act and absence of audience will likely kill it. But we digress. Some of the smaller Asian equity markets did well in 2016 and will likely continue to do so in 2017, especially those with lower export dependency on China, such as Thailand, Indonesia and the Philippines. S.Korea, Taiwan and Hong Kong, especially the latter, may feel more acutely the "expectational" impact of a China trade war. The rise in USD rates is, now, the constant threat over Hong Kong and its property sector.

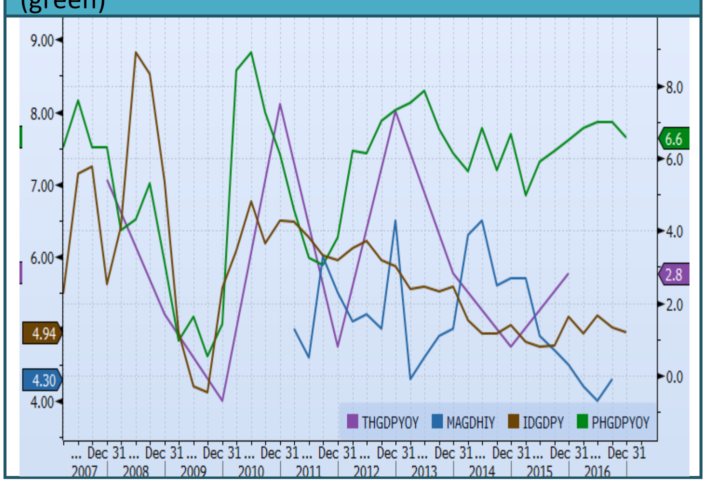
Asian cyclicals remain sound but not exciting……

As the "China trade war" threat will keep popping up, here are three basic points to keep in mind**. One:** Of the 8 economies examined here, only three HK, S.Korea and Taiwan sell more than 25% of all their exports to China. The other 5, sell up to or less than 13% of their totals. So export dependency is concentrated and not all Asians will be hit equally should China, as the result of a slowdown of its GDP growth because of a trade war, starts to import less. **Two:** and this we have pointed out so many times in past Econotes so as to make it, by now, very boring, China's net exports growth adds, at best, less than 10 bps for every 100 bps GDP growth. Hence China's growth is not directly exports –driven, and any constraints on its exports growth will not have a major impact on its GDP growth. **Three**: It is important, however, not to underestimate the disruption on intra-Asian supply chains by any disruption of China's exports, irrespective of the direct export dependency of any single Asian country on China.

Fig.1 shows that the Philippines continues to hold the near-record for growth in Asia, bar China, close to the 6.5% while Thailand and Malaysia may be bottoming but with Indonesia on its flat growth. Thailand's politically uncertain environment has not yet damaged its prospects. Philippines may prove to the world that sound fiscal and monetary policies plus infrastructure investment could be more important than erratically volatile presidents.

Hong Kong's flat trajectory (Fig.2) will not be helped by higher USD rates and fears of China "trade war". Singapore is, overall, very trade dependent to avoid a hit should China trade, and also global trade were to suffer. S.Korea is significantly China- trade dependent and, hence, its growth could be impacted, but so far it has exhibited sound macro balances helped by looser fiscal and monetary policies. Taiwan's recovery could be shortened by a China recession.

Fig.1 GDP, Thai (violet), Mal (blue), Indon (br), Phil (green)



Source: Bloomberg

…while Asian central banks stay resolutely unconnected from the USD

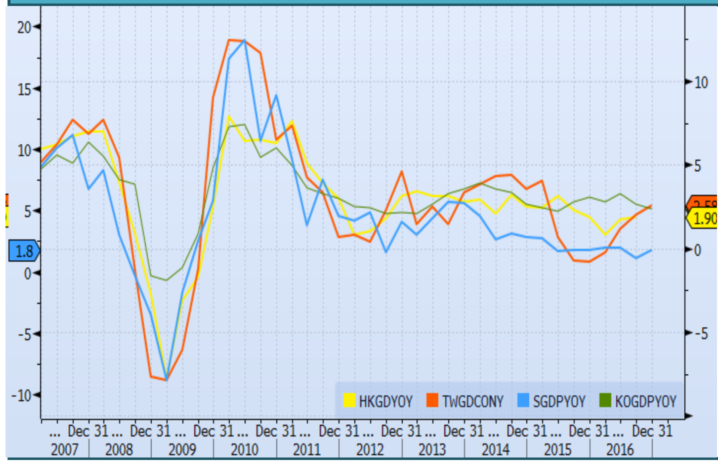
In the course of 2016 the only of the Asian central banks examined here which hiked, was Hong Kong's following the Fed's hike in December. Thailand kept its rates unchanged, while Singapore kept its exchange rate policy. The other 5 central banks all cut their rates during a year where the expectations were focused on when would the Fed hike. The inflation trends in these 8 economies are quite variable, from deflation in Singapore, to flat or mildly accelerating rates in the rest of the economies. Even if inflation pressures were to increase, given the growth trends of these economies, it would be unlikely that their central banks would hike anytime soon in 2017.It cannot be argued too forcefully that the Fed's possible hikes will play little or no role in the decisions of these Asian central banks, whose focus will remain on their growth trends rather than on the USD rate differentials. Which brings us directly to forex trends

FACT BOX: Why threats of "trade wars" do not matter for a lot for the smaller Asians

Trump's threatened "trade wars" consisted of four items: 1.Renegotiate NAFTA 2.Impose border tax on imports to the US by US- based companies, which set up factories overseas 3.Impose a 45% tariff on Chinese imports as well as declare China a currency manipulator 4.Withdrawal from the Transpacific Trade Partnership. The only threat, which, if materialized, will impact smaller Asian, is the imposition of tariffs on China. Any drop in China's exports to the US (be noted 15% of China's total, so no dramas here!) will disrupt the supply links with Taiwan and S.Korea and transshipments via Hong Kong, but the rest of the Asians surveyed here will not be directly affected. See also comments in the main text.

Mercifully, and except for China, the rest of these Asian economies were not accused to be currency manipulators. Even if they were accused so, one glance at the their rate policies would have shown this to be untrue. At worst, Fed hikes may weaken Asian currencies, as these Asian central banks will not match these rises. The case of Hong Kong must be signaled here as its property sector has not, clearly, noticed the change in Fed's policy which will signify the end of the negative real rates currently "benefiting" the economy thanks to the HK-USD peg.

Fig 2 GDP HK (yel), Taiwan (red),Sing (blu), S.Kor(green)



Source: Bloomberg

What is there to conclude ?

Pre-Trump's election, it was easy to point out that the fiscal and monetary policies of the G3 economies were in totally different paths, with the Fed tightening and ECB and BoJ loosening, but with different fiscal regimes in all three.Trump's election will now add a fiscal loosening in the US coupled with the existing monetary tightening thus adding one more variable in the confusing mix.There is also the little detail of the continuing threat of "trade war(s)". It would now follow that Asia should be, in relative terms, a haven of certainty given its relative and multifaceted decoupling from the US and of the limited collateral damage of any China-US trade disruption.Any NAFTA disruption will affect the 3 countries concerned, but given the relative unimportance of Canada and of Mexico in Asian trade flows, the collateral damage would likely be modest any way. We are very aware of the fears of investors of the added uncertainty going forward in 2017 and, hence, our focus on modest positions in smaller Asian equity markets and avoidance of UST. As this hardly fills up a portfolio, we will continue to report on investment opportunities in real assets and on niche property/ real estate opportunities in particular, but always in the context of our regulatory regime which prohibits specific and named investment venues or paper assets.

Andrew Freris (Writing completed on 12/2/2017)