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Level 20,One IFC,1 Harbour View Street, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com, Website: www.ecognosisadvisory.com, Facebook: @ecognosis

ECONOTE No. 82: An Asian cheap and cheerful cheat-sheet 31/3/2019

Summary

At the time that the main preoccupation of the developed markets is the likelihood of a global recession led by the slowing US economy, it is worth, once again, to remove the US from focus and stick to other facts, such as the cycles of major and minor Asian economies and their fiscal and monetary policies. The "Americanocentricity" (pardon the neologism) of investors and commentators never fail to surprise and depress, as it revalidates a constant nightmare. We all look at the same data and come to totally different conclusions. Whether accuracy in macroeconomic interpretation leads to accurate financial market forecasts is a different story but the evidence is negative. GDP growth data are poor equity pickers. But as an example, we focus on the investment implications of the widespread obsession that the world, and Asia in particular, follows USD interest rates when it clearly does not.

Investment Conclusions

The G3 economic cycles do not offer strong hopes for 2019, with the US, the only bright spot in the G3, now being faced with inverted yield curves, and the doom these forecast, and serious discussion as to when the Fed will cut rates! Meanwhile "back at the ranch", so to speak, the Asians are registering since 3Q.17 widely varying GDP growth rates, from HK's 1.3% yoy to India's 6.6% yoy in 4Q.18 and with half of the economies decelerating while the other half registering flat to bottoming growth rates. Five out nine Asian central banks had been hiking with the other 4 cutting or not moving. Asian forex rates should have weakened versus the USD but several did not. If there is a group of markets ready to offer some diversification portfolio opportunities, "Asian" markets are the ones.

Getting rid of the boring macros first !

Trends. Taking the last thre quarters which we have data for GDP yoy growth rates, (2Q.18 to 4Q.18), the Fact Box shows that (a) there was no economy with accelearing GDP growth (b) Five economies were registering deceleration, China, HK, Taiwan, India and Singapore (c) Three were registering flat growth, Indonesia, Malaysia and the Philippines and (d) two showed mixed signals, S.Korea and Thailand.In other words half of the economies examined here were not decelerating.Far more importantly, the differences between growth rates were as wide as ever. In 4Q.18 HK registered 1.3% yoy while India 6.6% yoy.**In sum there are no signs of impending recession in Asia although each economy has a different tale to tell.** A selective thumbnail outline of some of the economies could start with **China's** slowdown, which has been the main issue of concern, although we have to stress here that there is scarcely ,if any, evidence of the impact on its GDP growth of the US tariffs.This does not mean that the tariffs have no impact, but the extent of the impact is likely to have been quite small given that net exports growth have, historically, added just a few basis point to China's GDP growth,well less than those of investment and consumption.Following the Feb.2019 annual People's Congress, the government introduced a number of expansionary fiscal and monetary measures, and partially reversed the tightening policies associated with loans deleveraging.**India's** prospects are now tightly linked with the outcome of the forthcoming April-May elections, but the economy has shown some signs of a be impacted by uncertain elections result, but which would not stop populist fiscal measures irrespective as to which is the ultimate winner. **S.Korea's** economy suffered some collateral damage from the US-China trade war, but there are signs that economy may be bottoming out. **Taiwan's** economy felt partially the impact of the slowdown of exports from China.On-going political confrontation with China has not been helped by efforts to diversify Taiwan's export markets away from China.The economy of **Hong Kong** has decelerated partially because of its links with China and by the higher interest rates resulting from the peg, but the pausing of the Fed may give some respite.

Fig.1: Asian central bank policy rates moves since 2016 to date

	Rise	Cut	Net (*)
China	No change	-	-
Hong Kong	9	0	9
S.Korea	2	1	1
India	1	4	-1
Taiwan	0	1	-1
Indonesia	4	3	1
Malaysia	1	1	0
Thailand	1	0	1
Philippines	4	1	3
Singapore (**)	-	-	-

(*) Rises minus cuts
(**) Forex rather than interest rate adjustment policy
HK follows lockstep the Fed moves given the HKD-USD peg.

Source: Bloomberg,

Interest rates and forex trends are slightly more sexy !

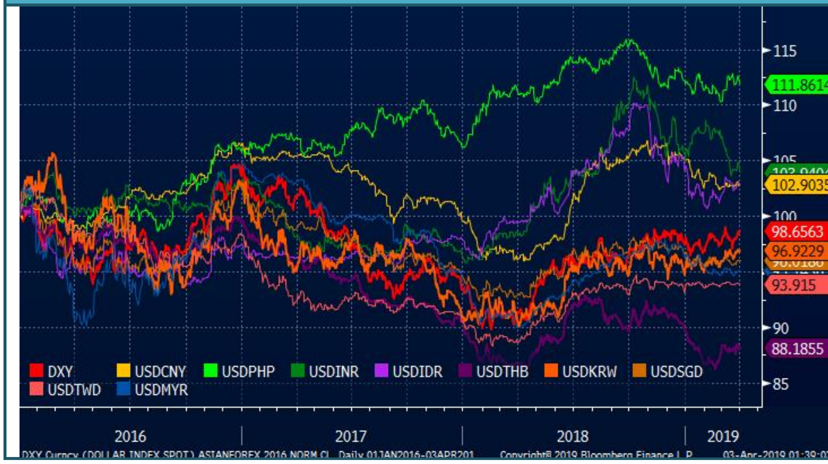
The data in Fig. 1 show that since Dec.2015 when the Fed embarked in 9 hikes of 25bps each, Asia's reaction, bar that of Hong Kong, has hardly been slavishly automatic. Including, the USD-pegged Hong Kong, Asian central banks responded with 2 net cuts, 5 net hikes and 2 net zero or no moves. Given that the Asian moves were around the 25bps level, the quantitative responses versus the 225bps US Fed was derisory! Basic 101 Economics tells us that you can either fix the exchange rate or interest rates, but not both. Other than the USD pegged HKD, Asian central banks do use the option of letting their forex rates take any impact from higher USD interest rates. The jumbled lines in Fig.2 tell their own story. All forex rates have been set to 100 in 2016, the year that the US Fed started to hike till now. (More accurately Dec. 2017). Follow the thick red line, which is the USD index (DXY) versus a basket of currencies. Any of the multicolored lines above the Which weakened versus the USD since 2016.These currencies are CNY, IDR, INR, and PHP. The currencies, which stayed close to or "bunched around" DXY and, therefore, either strengthened or did not move significantly against the USD, were SGD, KRW, TWD, THB and MYR. In sum, there is just no evidence that Asian central banks, bar Hong Kong, had either a strong forex policy versus the USD or linked their own domestic official rates to the US Fed funds rates in order to protect or stabilize, if necessary, their currencies. This is a typical case of the analyst's nightmare: "Ask me of a country and will tell you a different story". There are no generalizations as to official interest or forex policies since the Fed started to hike. Symmetrically, it is very unlikely that there will be a generalized tale to tell once the Fed starts to cut, as it is rumored it may do in 2019!

Fact Box: Asia: GDP growth rates, yoy % 2017-2018

	3Q.17	4.Q17	1Q.18	2Q.18	3Q.18	4.Q18
PR	6.8	6.8	6.8	6.7	6.5	6.4
HK	3.6	3.4	4.6	3.5	2.8	1.3
Ind	6.3	7.0	7.7	8.2	7.0	6.6
Tw	3.1	3.4	3.1	3.3	2.4	1.8
S.K	3.8	2.8	2.8	2.8	2.0	3.1
Sin	5.1	3.7	4.7	4.2	2.4	1.9
Idn	5.0	5.2	5.0	5.3	5.2	5.2
Ml	6.2	5.9	5.4	4.5	4.4	4.7
Th	4.5	3.9	5.0	4.7	3.2	3.7
Phi	7.2	6.5	6.6	6.2	6.0	6.1

Source: Bloomberg

Fig.2: Asian forex rates to the USD (2016=100)



Source: Bloomberg

The inevitable bit about conclusions

There is no evidence that the cycles of the 10 Asian economies examined here are closely related to those of the G3, and even more importantly, as GDP growth rates have a disturbingly low correlatation with stock indices performances,there is no evidence that G3, or more specifically US GDP cycles, have impacted Asian equities performance in a systematic manner. Furthermore, there is no evidence that the USD interest rates cycles have been systematically reflecetd in the interest and exchange rate perfomances of Asian economies, bar Hong Kong.

Equity performance YTO have the S&P 500 outperforming all Asians bar SHCOMP.As the macro stories in these markest do not have any prospect of surprises, one has to look to shifts in policies or politics for any chance of a strong performance.The elections in **Thailand** will, whoever eventually forms the government , bring more populist policies in an economy and forex rate which can cope with a wider fiscal deficit.If this is coupled with a modest and decent exit of the army from active politics, this will be very bullish for the economy and the markets.The reverse, however, holds for **India**, where after 5 years of a very poor record of reform and liberalisation (inclduing the absurd disaster of the notes withdrawal) the Modi administration could be retuned as a coalition.If the Congress wins, this will too guarantee a coalition.Indian coalitions are not famous for bold and fast reforms and hence, the scenario of a Modi coalition will introduce populist but not structural reform policies, a poor outlook for the economy and for the stock market.We do not expect significant policy changes out of the forthcoming elections in **Indonesia**.The resolution of the US-China trade war could benefit sentiment in **Taiwan and S.Korea**. We remain suspicious of the very abrupt reversal of fortunes in the **SHCOMP,** after the disastrous 2018, and when there are no policy nor macro indicators to justify this.It will then follow that the **HSI** rally is ,for now ,equally suspicisous.

Andrew Freris (writing completed on 31/3/2019)