

Facing the Downturn

Dr. Taimur Baig
Director, Asia Economics
Deutsche Bank AG, Singapore Branch

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Key global growth and inflation summary

- A major recession for the world economy in 2009
- Growth in industrial countries to fall to the lowest since the Great Depression
- Global growth to be the lowest since in early 1980s
- For Asia, a region of export-dependent economies, this is a bleak outlook
- Relatively strong financial and corporate/household balance sheets mean 1998-type collapse unlikely, but growth will be the lowest in this decade

Source: DB Global Markets Research estimates

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Key global growth and inflation summary

| | GDP growth | | | | Inflation | | | |
|---------------------|------------|-------|-------|-------|-----------|-------|-------|-------|
| | 2007 | 2008F | 2009F | 2010F | 2007 | 2008F | 2009F | 2010F |
| US | 2.0 | 1.1 | -1.0 | 0.9 | 2.9 | 4.6 | 2.3 | 1.5 |
| Japan | 2.0 | 0.1 | -1.2 | 1.3 | 0.0 | 1.5 | 0.1 | -0.3 |
| Euroland | 2.6 | 0.9 | -1.4 | 0.4 | 2.1 | 3.4 | 1.4 | 1.3 |
| G7 | 2.1 | 0.8 | -1.1 | 0.9 | 2.2 | 3.6 | 1.7 | 1.2 |
| Asia ex Japan | 9.4 | 7.6 | 5.7 | 5.9 | 4.4 | 7.3 | 4.1 | 3.2 |
| Asia ex India/China | 6.0 | 4.5 | 2.2 | 3.9 | 3.7 | 7.4 | 5.2 | 3.6 |
| World | 4.7 | 3.2 | 1.2 | 2.5 | 3.6 | 5.6 | 3.1 | 2.6 |

Source: DB Global Markets Research estimates

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US: Despite bailout and monetary measures, outlook is bleak

- Job losses are mounting and the unemployment rate is rising at the fastest pace in 25 years
- With housing still working off its excesses and the fiscal stimulus package burning itself out, an employment shock could be quite detrimental to the US economy
- Increasingly in focus is the prospect for further direct fiscal support for the economy. This awaits the outcome of the Presidential election
- Fed funds rate has been lowered to 1%, but risks are growing for another cut

Eurozone: sharp slowdown ongoing

- The latest euro area economic data emphasize the downside risks to growth
- Latest indicators so far imply sharply slowing activity and a need to reduce a growing stock overhang
- Lower commodity and energy prices should be a source of relief, but challenges from a slower global economic and banking sector de-leveraging are looming
- As the corporate sector struggles with its increased debt burden and the labor market deteriorates (as we expect), further contraction of activity seems highly likely
- We expect a series of rate cuts by the ECB in coming months, with a terminal rate of 1.50% in 12 months

Inflation in G3

- The sizeable decline of oil prices since mid-July should help to ease inflationary pressures across the G3 countries, at least at the headline level
- Given pipeline price pressures, core inflation is likely to remain stickier near-term
- In the Euro area, headline inflation has started to ease, and is expected to move towards 3% at year-end. Core inflation is still on a gradual uptrend
- Inflation has probably peaked in Japan, but market takes very little notice of fundamentals

G3 FX view

- The EUR has remained under pressure against the USD
- The key drivers of EUR weakness remain the market believing the ECB's easing cycle would continue, the bigger picture convergence of the Euro-area and US growth cycles, a pick-up in US M&A inflows and the overvaluation of the EUR
- Our longer-term forecasts continue to call for USD strength
- We also remain of the view that any turn in the mature USD down-cycle will be more clearly expressed against EUR than JPY

Forex Forecasts

| | end-2009 | 12m |
|-----|----------|------|
| EUR | 1.25 | 1.22 |
| GBP | 1.57 | 1.59 |
| YEN | 93.7 | 92.7 |

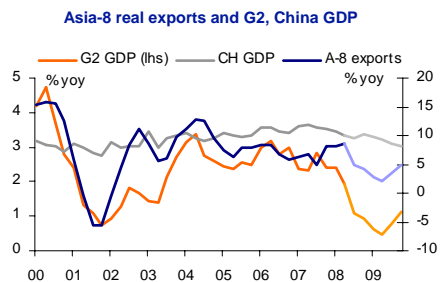
Source: DB Global Markets Research

Domestic demand in Asia

- There are only a few large economies with sizeable autonomous domestic demand—mainly China, India, and Indonesia
- For the smaller, fairly open economies in the rest of Asia, domestic demand has historically tended to follow the export cycle
- We are therefore skeptical of domestic demand resilience in most Asian economies during the global downturn
- In the first half of 2008, real export growth in Asia-8 proved surprisingly strong. But consumption growth in Asia-8 has been slowing over the past year, especially sharply in Q2
- Fixed investment growth has historically been highly correlated with exports (0.91 since 2000). As export growth slows over the next year, the slowdown in investment will likely intensify

Asia-8 exports reflect US/EU demand, not China

- Asia-8 export growth can best be explained by US/EU growth (the “G2”) not by growth in China
- G2 growth surprised to the upside in the first half of 2008 (when the US was weak, Euroland was strong, and vice versa)
- Our growth forecasts for the G2 imply Asian export growth approaching zero by mid-2009 but recovering by year-end



Sources: CEIC and DB Global Markets Research

No decoupling, but...

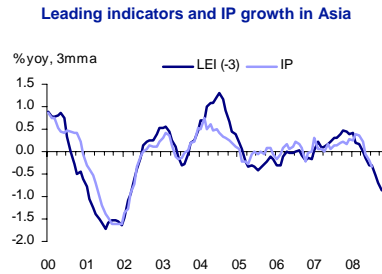


Sources: CEIC and DB Global Markets Research

Leading indicators are worrying

•Leading economic indicators for each of the economies indicate a slowdown in growth to below average growth by mid-year

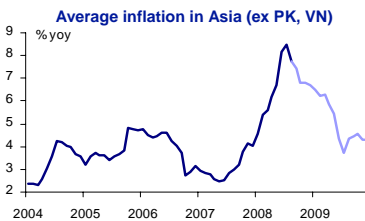
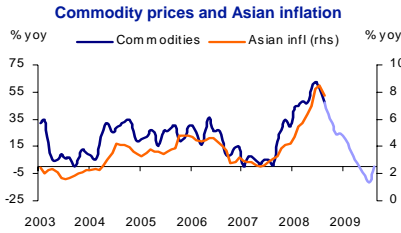
•The outlook is already worse than anything seen since 2001. Will it get as bad as the “tech wreck”?



Sources: CEIC, OECD and Deutsche Bank

Notes: OECD leading indicators used for China, India and Indonesia; national indicators used for Malaysia, Singapore, South Korea, Taiwan and Thailand. Simple averages of normalized LEIs and IP growth rates used to construct the chart.

Commodity prices are behind Asian inflation



Sources: IMF, CEIC and DB Global Markets Research

Currencies will find support in 2009

•Asian currencies have been surprisingly weak in recent months. There are three key reasons:

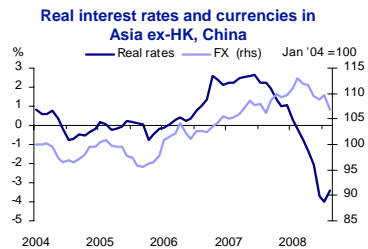
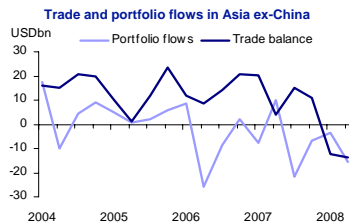
- Higher than expected oil prices pushed trade balances into deficit

- Portfolio capital outflows since mid-2007 have exceeded USD50bn

- “Other” capital outflows have increased in a combination of domestic capital flight and withdrawal of interbank funding

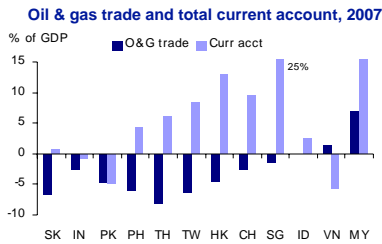
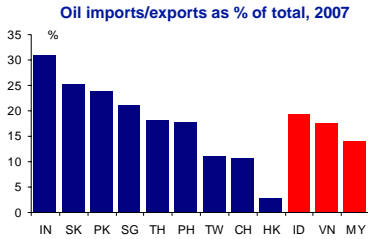
•Asian foreign exchange reserves (ex-China) have fallen sharply in recent months (by USD60bn in July and August) as portfolio and other capital outflows surged

•Falling inflation (with smaller declines in interest rates) will mean rising real interest rates in 2009 – back to positive territory around mid-year. This should help to restore some support for currencies. Lower oil prices will probably be even more important



Sources: CEIC and Deutsche Bank. Note: “FX” is an equally weighted average of exchange rates.

Who's vulnerable to falling oil prices?



Sources: CEIC and Deutsche Bank

- Asia is generally a region of commodity importers. In 2007 Indonesia, Vietnam and Malaysia were net petroleum exporters – so far this year, Indonesia and Vietnam have been net importers
- Rising crude oil prices pushed trade surpluses down rapidly among the traditional importers, significantly undermining support for their currencies
- Falling oil prices will help to restore current account surpluses and will also tend to lower inflation

Asian macroeconomic forecast summary

| | | 2007F | 2008F | 2009F | 2010F |
|-------------------------|-------------------|-------|-------|-------|-------|
| (% yoy, unless stated) | | | | | |
| China | GDP | 11.9 | 9.8 | 8.0 | 7.0 |
| | CPI | 4.8 | 6.3 | 2.8 | 2.5 |
| | CA bal., % GDP | 9.5 | 6.5 | 5.4 | 5.0 |
| | Fiscal bal. % GDP | 0.7 | 0.7 | -1.0 | -2.0 |
| Hong Kong | GDP | 6.4 | 2.5 | -1.8 | 3.0 |
| | CPI | 2.0 | 4.6 | 5.3 | 3.5 |
| | CA bal., % GDP | 13.5 | 12.3 | 14.9 | 12.9 |
| | Fiscal bal. % GDP | 7.5 | -1.5 | -5.6 | -6.2 |
| India | GDP | 9.3 | 7.7 | 6.0 | 6.8 |
| | WPI | 4.6 | 9.6 | 5.3 | 4.3 |
| | CA bal., % GDP | -0.8 | -1.6 | -1.5 | -1.0 |
| | Fiscal bal. % GDP | -6.2 | -7.5 | -7.4 | -7.2 |
| Indonesia | GDP | 6.3 | 5.9 | 4.8 | 5.0 |
| | CPI | 6.4 | 10.2 | 8.0 | 6.0 |
| | CA bal., % GDP | 2.4 | -1.0 | 1.4 | 1.5 |
| | Fiscal bal. % GDP | -1.2 | -1.6 | -1.6 | -1.5 |

Asian macroeconomic forecast summary

| (% yoy, unless stated) | | 2007F | 2008F | 2009F | 2010F |
|------------------------|-------------------|-------|-------|-------|-------|
| Malaysia | GDP | 6.3 | 5.3 | 3.6 | 4.5 |
| | CPI | 2.0 | 6.0 | 5.0 | 4.5 |
| | CA bal., % GDP | 15.5 | 16.3 | 12.7 | 11.0 |
| | Fiscal bal. % GDP | -3.2 | -4.5 | -4.5 | -4.0 |
| Pakistan | GDP | 6.8 | 5.8 | 3.2 | 4.0 |
| | CPI | 7.8 | 11.9 | 23.0 | 9.0 |
| | CA bal., % GDP | -4.8 | -8.4 | -6.5 | -3.5 |
| | Fiscal bal. % GDP | -4.3 | -7.4 | -6.0 | -5.0 |
| Philippines | GDP | 7.2 | 4.6 | 3.7 | 4.0 |
| | CPI | 2.8 | 9.4 | 5.2 | 5.0 |
| | CA bal., % GDP | 4.3 | 2.4 | 3.9 | 3.5 |
| | Fiscal bal. % GDP | -0.1 | -1.2 | -0.8 | -1.0 |
| Singapore | GDP | 7.7 | 2.0 | -2.0 | 1.5 |
| | CPI | 2.1 | 6.4 | 1.3 | 0.0 |
| | CA bal., % GDP | 24.3 | 16.5 | 17.6 | 19.3 |
| | Fiscal bal. % GDP | 13.4 | 10.3 | 4.2 | 4.6 |

Asian macroeconomic forecast summary

| (% yoy, unless stated) | | 2007F | 2008F | 2009F | 2010F |
|------------------------|-------------------|-------|-------|-------|-------|
| S. Korea | GDP | 5.1 | 4.0 | 1.7 | 3.5 |
| | CPI | 2.7 | 4.8 | 1.7 | 1.8 |
| | CA bal., % GDP | 0.6 | -1.6 | 0.7 | 1.4 |
| | Fiscal bal. % GDP | 3.8 | 2.0 | -1.5 | -1.2 |
| Taiwan | GDP | 5.7 | 3.4 | 0.0 | 3.1 |
| | CPI | 1.8 | 3.4 | -0.5 | 1.2 |
| | CA bal., % GDP | 8.3 | 5.4 | 3.2 | 4.1 |
| | Fiscal bal. % GDP | -0.3 | -0.5 | -3.0 | -2.5 |
| Thailand | GDP | 4.8 | 4.3 | 2.5 | 4.0 |
| | CPI | 2.2 | 5.5 | 0.6 | 1.5 |
| | CA bal., % GDP | 6.4 | 3.7 | 0.8 | 2.1 |
| | Fiscal bal. % GDP | -1.1 | -0.3 | -2.2 | -3.3 |
| Vietnam | GDP | 8.5 | 6.3 | 4.2 | 6.2 |
| | CPI | 7.9 | 23.9 | 11.6 | 8.0 |
| | CA bal., % GDP | -7.0 | -18.8 | -20.1 | -14.6 |
| | Fiscal bal. % GDP | -6.5 | -4.0 | -7.5 | -5.5 |