

Asian outlook: **NAVIGATING THE DOWNTURN**

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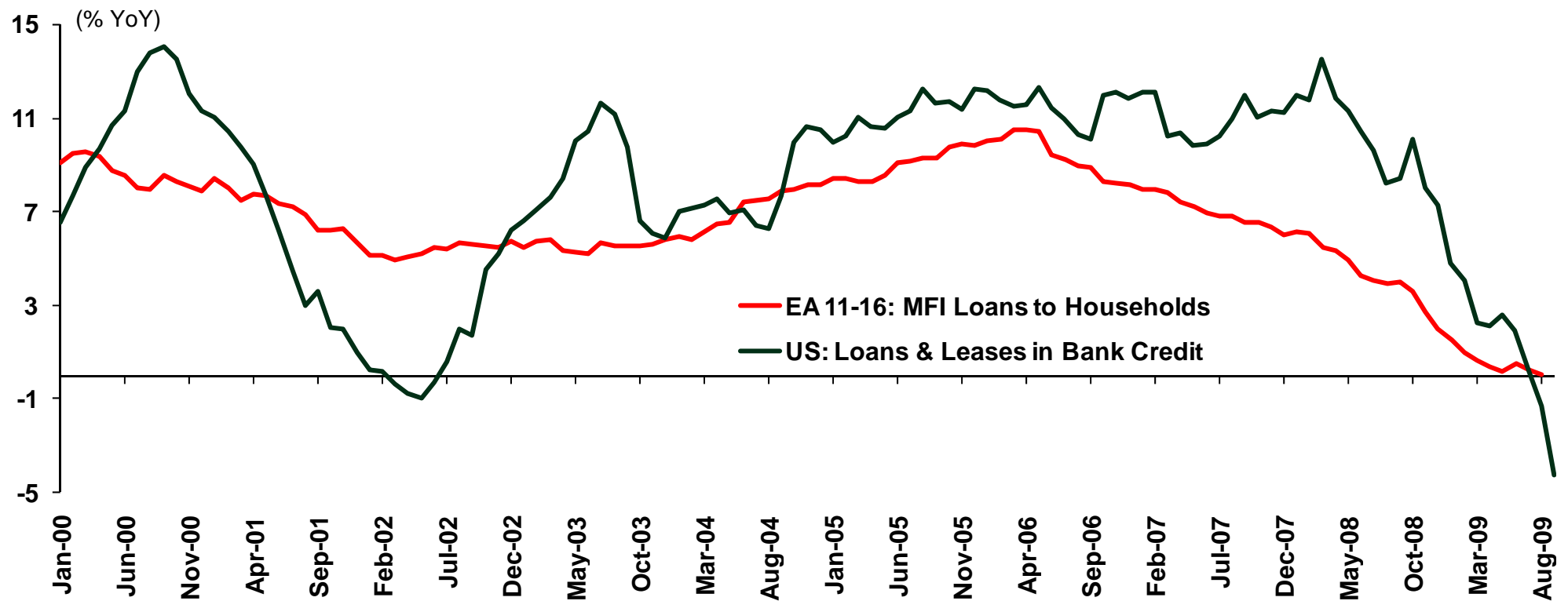
Global assumptions

- We are in the eye of the storm. Equity markets are mistaking the nature of the problem
- Credit contraction in the US, UK and Europe will be ongoing for many years. Public debt IS private debt
- Global demand trends have now reset to a lower trajectory
- Export-led growth models are deficient
- Property rights are paramount for endogenous growth

Loan growth in US and EU

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Private sector deleveraging has only just begun



Source: US Federal Reserve/ European Central Bank/ Haver Analytics

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Reflation efforts diverge

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Differential bang for the buck

	Private non-financial sector Loan/GDP Ratio (2008)	Latest non-financial credit growth (% YoY)	Loan addition (as a % of GDP)	Latest nominal GDP growth (2Q09)
US	48.7	-1.3	-0.6	-2.5
EU	77.7	1.0	0.8	-6.9
China	107.6	30.4	32.7	3.3
India	31.5	14.3	4.5	7.5
Korea	177.7	7.7	13.7	0.6
Taiwan	140.8	-1.6	-2.3	-4.4

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The crisis: Next stages

- Option ARMs reset and result in more bank closures/mortgage defaults
- US municipal bonds default
- Shipping industry defaults climb – claim European banks
- Monetary expansion runs out of steam and opposition to renewed QE mounts
- Inflation in China rises, industrial expansion stutters

Growth and policy in 2010

- GDP growth will now face the headwinds of rising taxes and static interest rates. Spending programmes will be scaled back. Debt, debt, debt
- Real GDP growth in the US no better than 0-1%. In Europe, 0-2%. Globally, <3%
- Asian growth rates will level out and weaknesses in domestic demand will be exposed
- Policy initiatives in Asia have amounted to more of the same old, same old: government spending and weak currencies

Protecting your portfolio in 2010

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- Maximum cash – US insiders are sellers
- Overweight gold and gold miners – debasement play
- Long long-dated treasuries – inflation not an issue
- Favour blue chip defensives in consumer staple industries
- Overweight liquid, large cap companies – prepare for a fast exit
- Hedge with six months (end March 2010) puts – marginal monetary tightening
- Underweight banks – taxpayer handout year was 2009. The backlash begins now
- Fundamentals will reassert themselves – stocks generally are overvalued

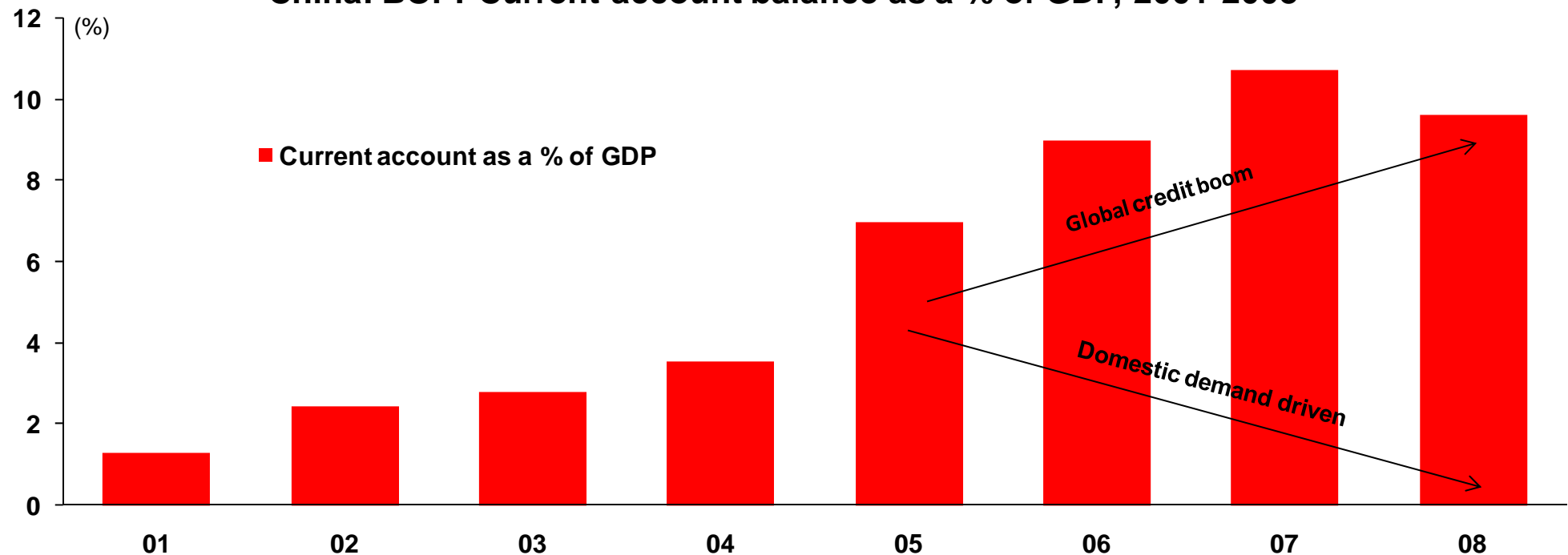
China: The next Great Crash?

- Chinese entrepreneurs are among the best in the world. They respond to price signals like no others
- Problem is that the price signals sent by Beijing are wrong
- The exchange rate is undervalued and has prompted Chinese businesses to build out capacity to service the export market
- Interest rates have been set too low. Capital perceived as free
- Now, monetary policy is easier than anywhere in the world – the renminbi would be in freefall if the capital account were open

China's current account mess

Big surpluses are as bad as big deficits

China: BOP: Current account balance as a % of GDP, 2001-2008

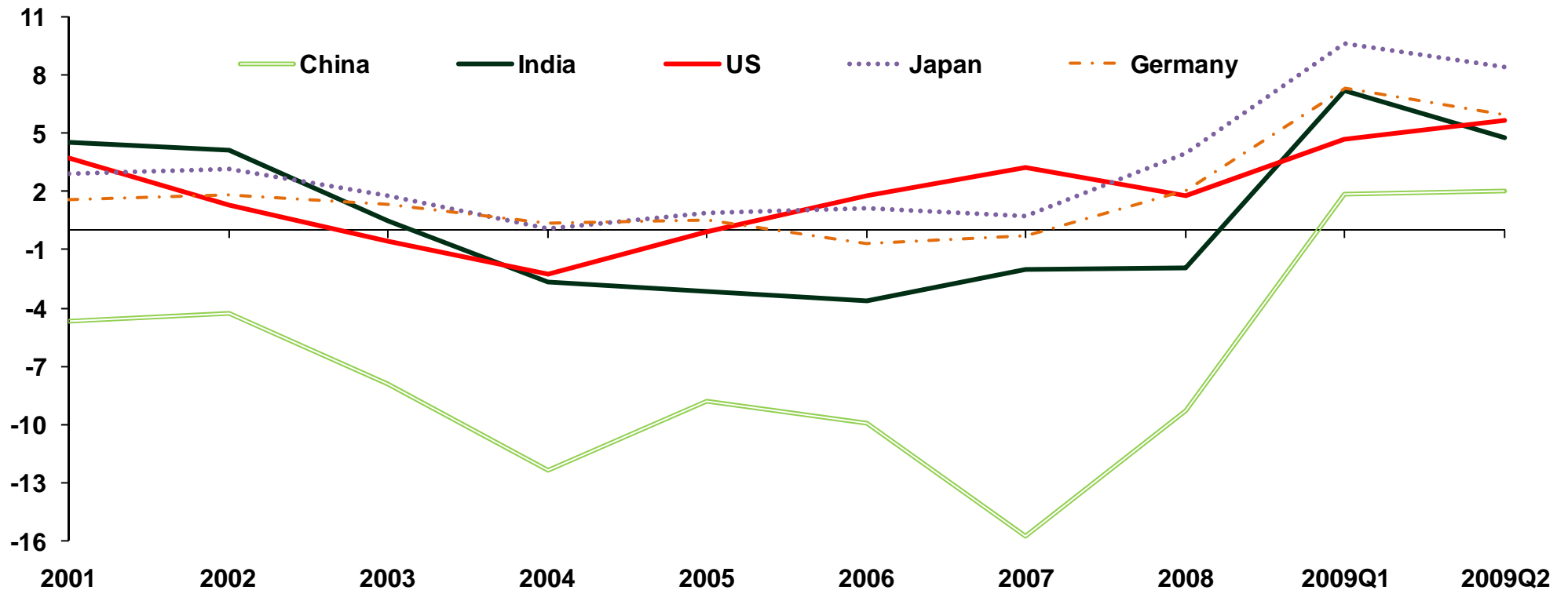


Source: Haver Analytics

Real interest rates in selected countries

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Capital has just turned expensive in China



Source: Haver Analytics

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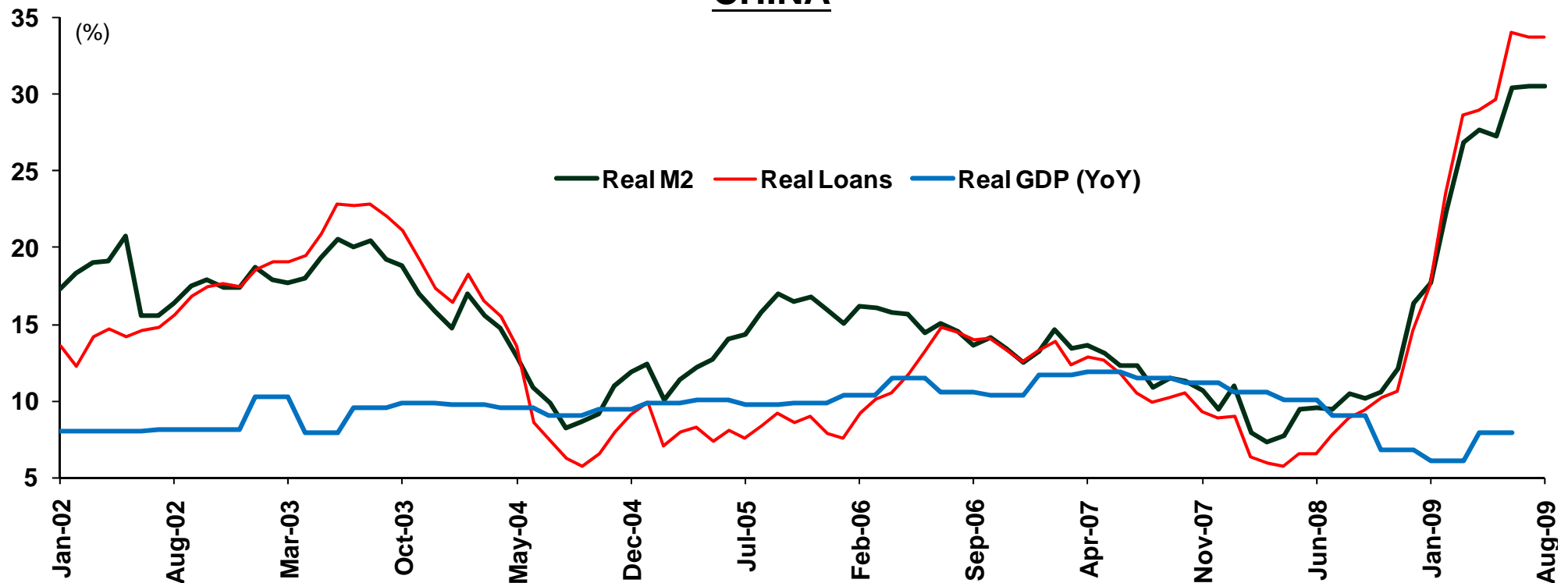
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China real M2 & loan growth VS real GDP

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Nowhere freer – but no repeat in 2010

CHINA



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Japan: A different mindset

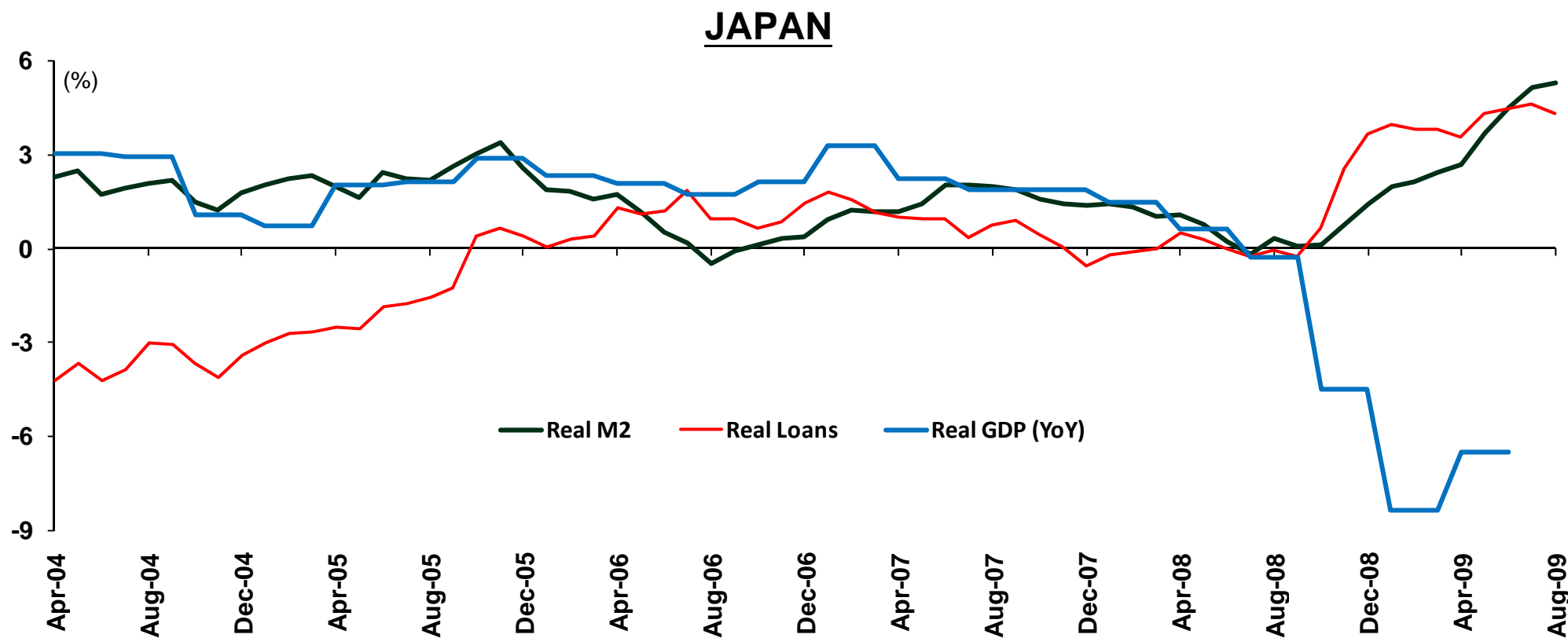
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- Economists are not trained to analyse Japan
- In economies where population is falling, growth is not an imperative. Security is
- Zero percent GDP growth in Japan means that per capita GDP rises
- A weakening yen is not welcomed by the majority of Japanese. Deflation is better than inflation
- Excess liquidity goes immediately to government paper

Japan free liquidity

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Japanese liquidity is plentiful but investors prefer bonds



Source: Haver Analytics

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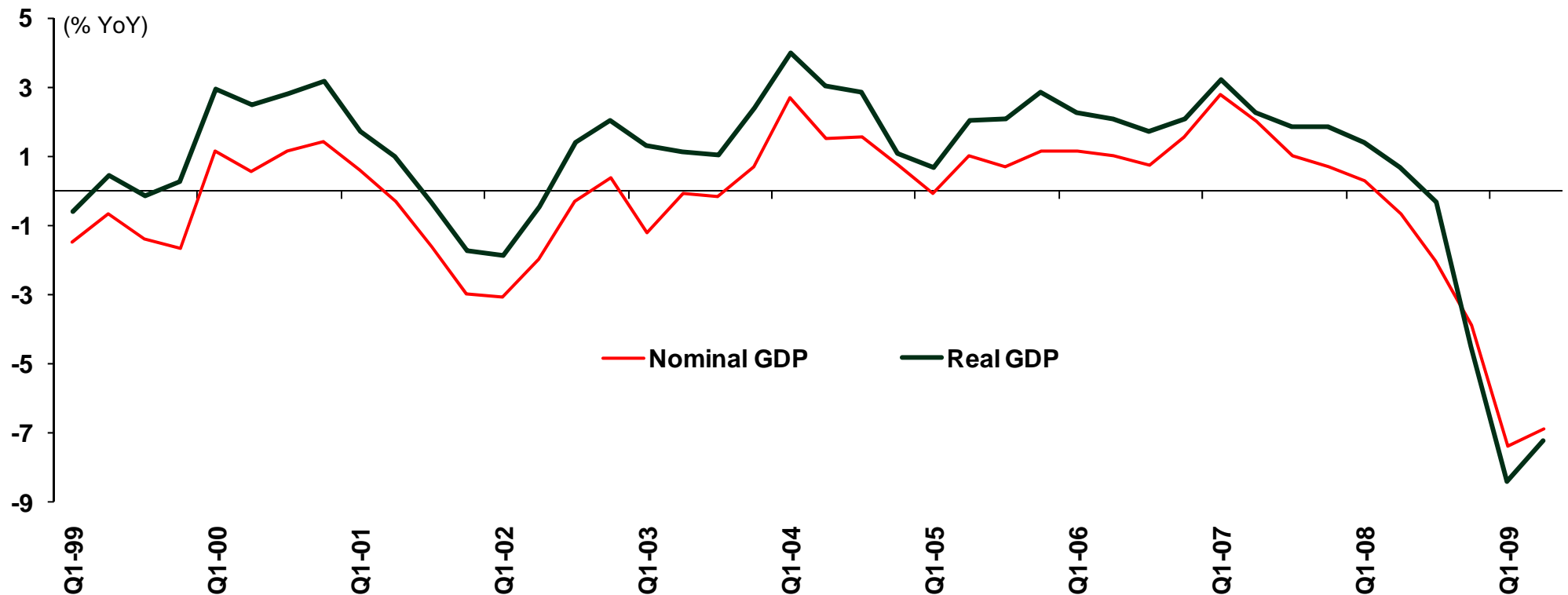
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Japan: The worst recession in the world

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Japan has suffered output losses a multiple of the US



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India: Remarkable resilience

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- In the current global recession India has recorded no back-to-back quarterly contractions
- No financial institution in India has gone bust or remotely come under pressure
- Economic growth is being fuelled from within – domestic demand coming increasingly from the bottom-up (rural areas rather than urban)
- Private domestic investment fuelled by household savings growth is the key driver
- Short-term monsoon concerns will prove to be overblown

Embracing the elephant (*Asianomics* No.6)

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- Rural India is on the march. Private property, roads, technology and media are the underpinnings of endogenous growth
- Rural India growing faster than urban – from the bottom up
- Regionally, India is a structural overweight
- Pricing signals are better than elsewhere
- Bang for the buck has been good
- Demographic dividend

Demographics favour India

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Chinese and North Asian societies ageing

Year	China	India	Indonesia	Korea	Japan
2010	71.9	64.3	67.2	72.8	64.2
2020	69.6	67.0	69.6	71.2	59.9
2030	67.2	68.8	69.3	64.2	58.4
2040	63.0	69.6	66.6	58.0	53.8

*Population aged 15 - 64 (Source: UN World population prospects database)

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Asia: 'Decoupling' not in sight

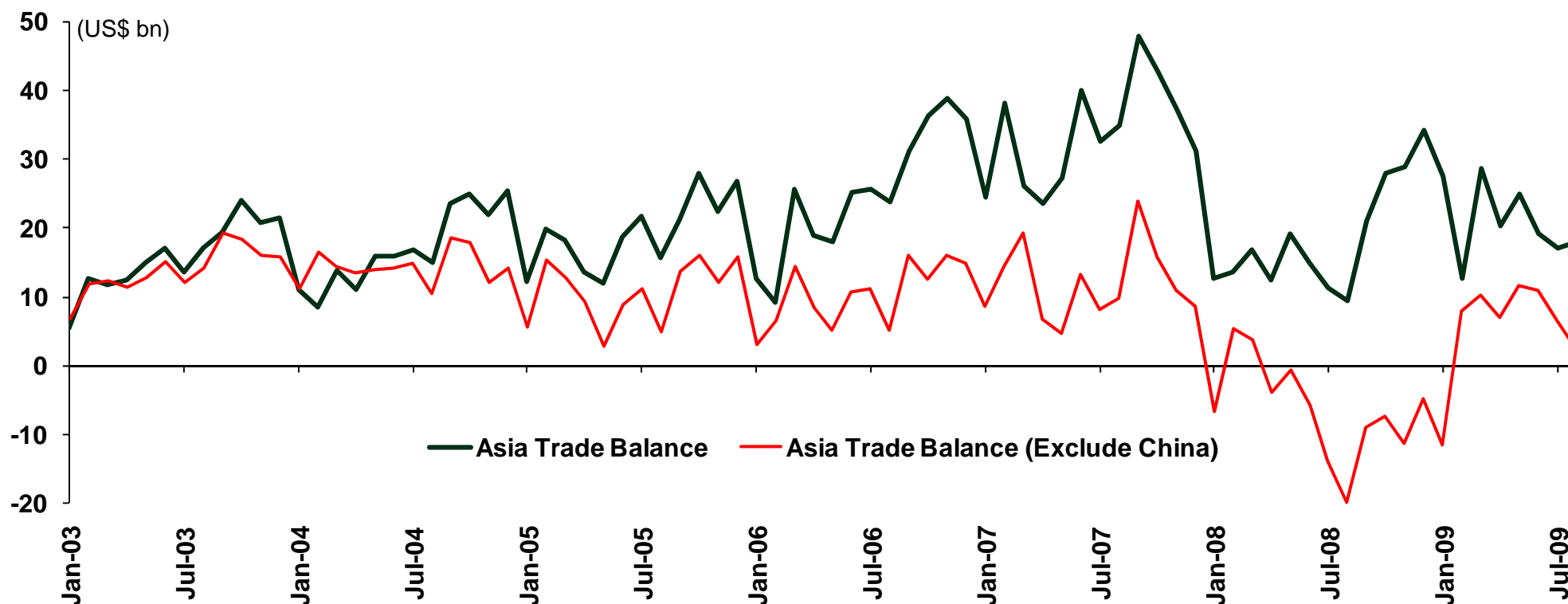
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- Asian savings rates have **increased** since the crisis began
- International reserve accumulation has decelerated – but not as fast as the slow down in activity
- Little in the way of government initiative to promote domestic demand
- Asia needs to break the implicit dollar peg and take a leaf out of India's playbook
- Indonesia, the Philippines and Singapore on the right track

Asia and Asia ex-China trade balances

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Non-China trade balances have soared as savings rise



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