Asia insulates itself from Europe

by Michael Collins, Investment Commentator at Fidelity

November 2011

In February this year, Bank Indonesia raised its benchmark rate for the first time in three years, to subdue inflation, then surging above 7%. Last month, the central bank unexpectedly cut interest rates and flagged more rate reductions, even though inflation remains unbeaten.

Bank Indonesia's policy U-turn on October 11 is among a series of decisions Asian officials have taken recently to insulate the world's fastest-growing region from slower global growth and any European upheavals. The good news for investors is that Asian authorities have scope to buttress their thriving economies against global troubles. Public debt is relatively low and interest rates are at levels that allow them to be cut to good effect.

Policymakers in China, Korea, Malaysia, the Philippines and Singapore are among those who are bracing their economies because evidence is mounting that strife in the developed world is hampering the region's growth. Of special note was a report that showed China's exports fell 2.1% in September from the previous month, to herald the second consecutive monthly drop in China's trade surplus. This helped to crimp China's economic growth to 9.1% in the year to September, the slowest pace in two years. In October, a key manufacturing index for China dropped to its lowest level in three years. Korea's export growth also cooled in September and October, while the country's industrial production fell 1.9% in August after shrinking 0.3% in July. Singapore's exports unexpectedly dropped in September. Taiwan's economy shrank 0.3% in the September quarter, its first contraction since 2009.

The drop in global demand is prompting countries such as Malaysia, the Philippines and Singapore to lower growth forecasts for 2011 and 2012. The IMF has trimmed its growth prediction for Asia to 6.3% for 2011 and 6.7% for 2012 – still healthy rates, it must be said. "While domestic demand remains strong, Asia has clearly not 'decoupled' from advanced economies," the IMF said.[1]

The list of steps that Asian countries have taken of late to shield themselves from a troubled global economy includes the Philippines introducing Asia's first fiscal-stimulus package for 2011. After exports dropped for a fourth straight month in August, Manila on October 12 announced a package of public works and anti-poverty measures worth 72 billion pesos (A$1.7 billion), while cutting its 2011 growth forecast by 0.5% to 5%.

A day later, Beijing announced tax breaks and easier access to bank loans for small businesses, as Europe's woes added to the urgency of countering the effects of China's recent tightening of monetary policy on small manufacturers. Amid concerns about how China's bad-debt-laden financial system would cope with a renewed global crisis, Central Huijin Investment, which is part of the country's sovereign wealth fund, revealed it is buying stakes in the country's four big banks. China's Prime Minister Wen Jiabao said on October 25 that Beijing will make adjustments at a "suitable time and by an appropriate degree" to keep China's economy moving.[2]

Malaysia's government on October 7 announced that in its fiscal 2012 budget it will hand cash to the poor, raise wages for public servants and boost spending on transport, to help higher private investment and consumption make up for sluggish global growth. Kuala Lumpur reduced its forecast for 2011 growth by 0.75% to 5%.[3]

Well-placed Asia

On October 14, Singapore's central bank said it will slow its currency's climb to help its economy withstand a drop in exports. "Given the stresses and fragility in the advanced economies, the prospects for growth in Singapore's major trading partners have deteriorated," the central bank said, announcing the decision.[4] The Monetary Authority of Singapore, which uses movements in the Singapore dollar to fight inflation, said it will still let the currency appreciate because inflation above 5.5% exceeds its target.

So far, Indonesia and Pakistan are the only countries in east or south Asia to have cut benchmark rates this year (as the Reserve Bank of Australia did on November 1). Bank Indonesia, explaining why it lopped its reference rate by 25 basis points to 6.5% last month, flagged further rates cuts and other measures "to mitigate the impacts of declining global economic and financial performance on Indonesia".[5]

Other central banks have ruled out any more of the rate increases that have featured across Asia since the start of 2010 as part of a drive to quell inflation.

While the Bank of Thailand in October refrained from raising rates for the first time this year because the country is grappling with the worst floods in more than 50 years, the Bank of Korea's policy-setting committee was explicit about how the uncertainty from Europe is prompting it to keep rates on hold. "The committee judges that downside risks to growth have expanded – due mostly to the likelihood of the sovereign debt problems in Europe spreading," the committee said in a statement on October 13, after deciding to keep rates steady for a fourth consecutive month.[6] Bank of Korea has increased rates five times in 2010 and 2011 to get inflation, which is above 5%, under its 4% ceiling. (The Bank of Thailand has raised rates nine times since July 2010.)

Authorities in countries such as China, Hong Kong, India, Korea and Singapore are constrained by inflation from undertaking bolder monetary and fiscal steps to protect their economies. (The Reserve Bank of India, in fact, on October 24 raised rates for the 13th time in 19 months to control inflation that is running close to 10%.) But most have enough scope to make a difference thanks to how policymakers have normalised monetary and fiscal policies since stimulating their economies three years ago.

As occurred in Australia, once the crisis of 2008 to 2009 eased, central banks boosted interest rates to more normal levels in nominal terms. So they can cut again, if the situation warrants.

While fiscal deficits are still above pre-crisis levels in many countries, pacy economic growth has improved government finances and officials have capacity to spend if needed. The G20 economies had a public-debt-to-GDP ratio of more than 100% in 2010, a figure that is projected to reach 125% by 2015. Public debt levels in Asia ex-Japan, by contrast, are only around one-third of GDP and are projected to decline to less than one-fifth by 2015.

As well, banks, companies and consumers are in good shape debt-wise across the region. Asia ex-Japan companies, for instance, are holding about US$1 trillion in cash and are confident enough about their outlooks to be boosting cash-payout ratios (thus increasing dividend returns).

So Asia's politicians and central banks shouldn't have to make too many unexpected steps to shield their economies as much as possible from global woes.

Financial information comes from Bloomberg unless stated otherwise.

1 IMF. Media release No. 11/360. "Asia needs to navigate the uncertain global environment and build inclusive growth, says the IMF's Asia-Pacific Regional Economic Outlook. 13 October 2011. http://www.imf.org/external/np/sec/pr/2011/pr11360.htm

2 Bloomberg News. "China's Wen fuels speculation with fine-tuning plan". 26 October 2011.

3 Malaysia’s Ministry of Finance. “The 2012 budget speech.” 7 October 2011. http://www.treasury.gov.my/pdf/budget/bs12.pdf

4 Monetary Authority of Singapore. Monetary policy statement. 14 October 2011.
http://www.mas.gov.sg/news_room/statements/2011/Monetary_Policy_Statement_14Oct11.html#

5 Bank Indonesia. “BI Rate decreased 25 bps to 6.5%.” http://www.bi.go.id/web/en/Ruang+Media/Siaran+Pers/SP_133311.htm

6 Bank of Korea. Monetary policy decision (October 13, 2011). http://www.bok.or.kr/eng/index.jsp

7 Fidelity

Important information

Any references to specific securities should not be taken as recommendations.

Investments in small and emerging markets can be more volatile than investments in developed markets.

Investments in overseas markets can be affected by currency exchange and this may affect the value of your investment.