

ANDBANK RESEARCH

Global Economics &
Markets

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Asia & Latam markets – A messy re-run of 1994?

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Concerns in Asia, and therefore in LATAM, over a Fed monetary tightening have a long tradition and founded historical reasons.

The Fed's tightening cycle of 1994, which saw interest rates hiked by 300bp inside a year, was a definite factor in the configuration of the Asia's financial crisis of 1997.

US rate hikes pushed up interest rates and yields on Asian sovereign debt as well, in an environment in which these economies had a very high maturing & net borrowing requirements.

This contagion effect came as a result of a "de facto" outsourcing of these countries' monetary policy at that time.

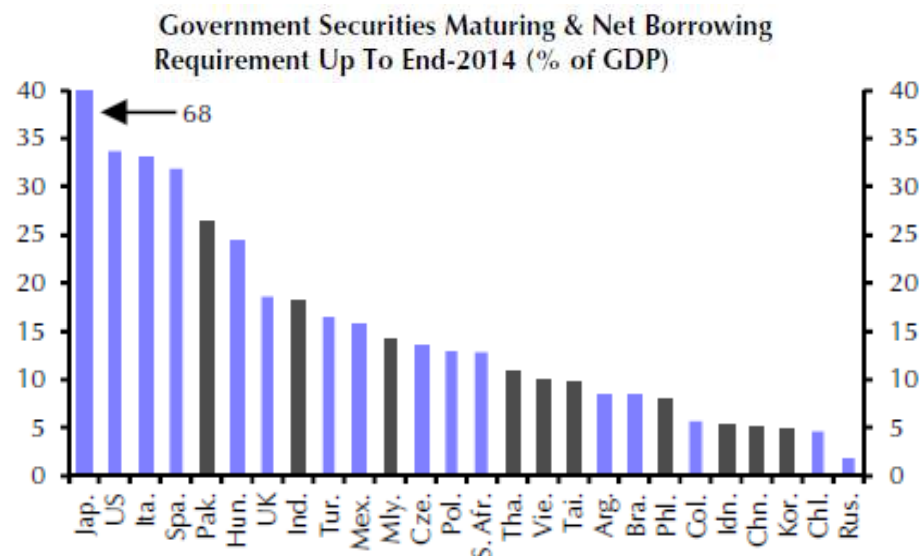
The recently announced Fed "tightening", have fueled fears of a messy re-run of 1994. Nevertheless, and I know that what I am going to say sounds like a cliché, I have no choice but to express my conviction that this outsourcing (and contagion effect) no longer exists. At least, in the way it was in the past.

As the Fed prepares to taper its QE program, fears of a messy re-run of 1994 have escalated. We think this is exaggerated.

On this issue we side with the arguments of analysts such as D. Martin* in the sense that we think these concerns are exaggerated.

Our positioning on this issue is based on four arguments:

1. Most EM Asian countries have financing requirements equivalent to only the 8% of their GDP on average over the next 18 months (see the chart), unlike 1994, where borrowing requirements were much higher and, therefore, a significant rise in yields were simply lethal)
2. Treasury yields are likely to remain structurally low. At least until the US Fed raises its policy rate, which we think it is still a couple of years away from doing
3. Low policy rates in Asia should also act as an anchor on local-currency bond yields, keeping bond prices well supported
4. Fed tightening will presumably only occur against a backdrop of stronger US growth, which for most Asian economies would be an important offset to higher borrowing costs



Sources – Bloomberg, IMF, Capital Economics

Removing Pakistan and India (not covered in our analysis), the rest of EM Asian countries have extremely low financing requirements, equivalent to 8% on average for the next 18 months.

The low financing requirements come as a result of the lowest debt ratios in the world*

Government Debt		Percent of GDP													
		FactSet Economics Standardized Database													
		03/2013	12/2012	09/2012	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011	12/2010	09/2010	06/2010	03/2010	12/2009
World Total		101.9	93.0	91.8	91.1	88.7	81.7	80.9	81.0	80.2	77.9	76.6	76.1	75.0	73.1
Asia Emerging															
China		-	-	-	-	-	7.3	9.6	10.4	11.7	7.1	9.5	10.1	11.3	6.7
India		-	44.4	48.7	47.2	42.0	42.6	46.4	45.0	40.3	42.5	47.2	47.3	43.2	47.0
Indonesia		14.0	14.5	13.5	13.4	13.6	13.8	13.7	15.1	15.8	15.8	15.6	15.2	16.2	16.2
Malaysia		54.8	51.5	51.0	51.1	51.9	49.5	49.1	50.1	50.9	48.2	49.3	50.0	49.7	46.5
Philippines		-	20.9	25.3	24.9	27.4	24.2	28.7	27.4	29.8	25.9	31.0	29.0	31.9	27.9
Thailand		30.5	29.5	30.7	31.1	30.0	31.4	28.9	28.2	27.9	29.0	28.6	28.8	27.6	27.0
Asia Emerging Total		36.5*	38.8	41.0	40.2	37.9	19.1	21.2	21.5	21.6	18.9	21.5	21.9	21.9	19.4
Eurozone															
Eurozone Total		-	93.0	91.3	91.5	89.7	87.8	86.6	86.8	86.1	84.6	81.8	81.6	80.8	79.0
North America															
North America Total		99.4	98.5	96.8	96.8	91.7	90.4	88.4	87.6	87.9	86.2	84.6	83.3	80.7	79.0
Latin America															
Latin America Total		33.5	30.9	32.0	31.7	33.8	31.8	32.3	32.5	34.3	32.7	33.8	33.5	35.5	33.4

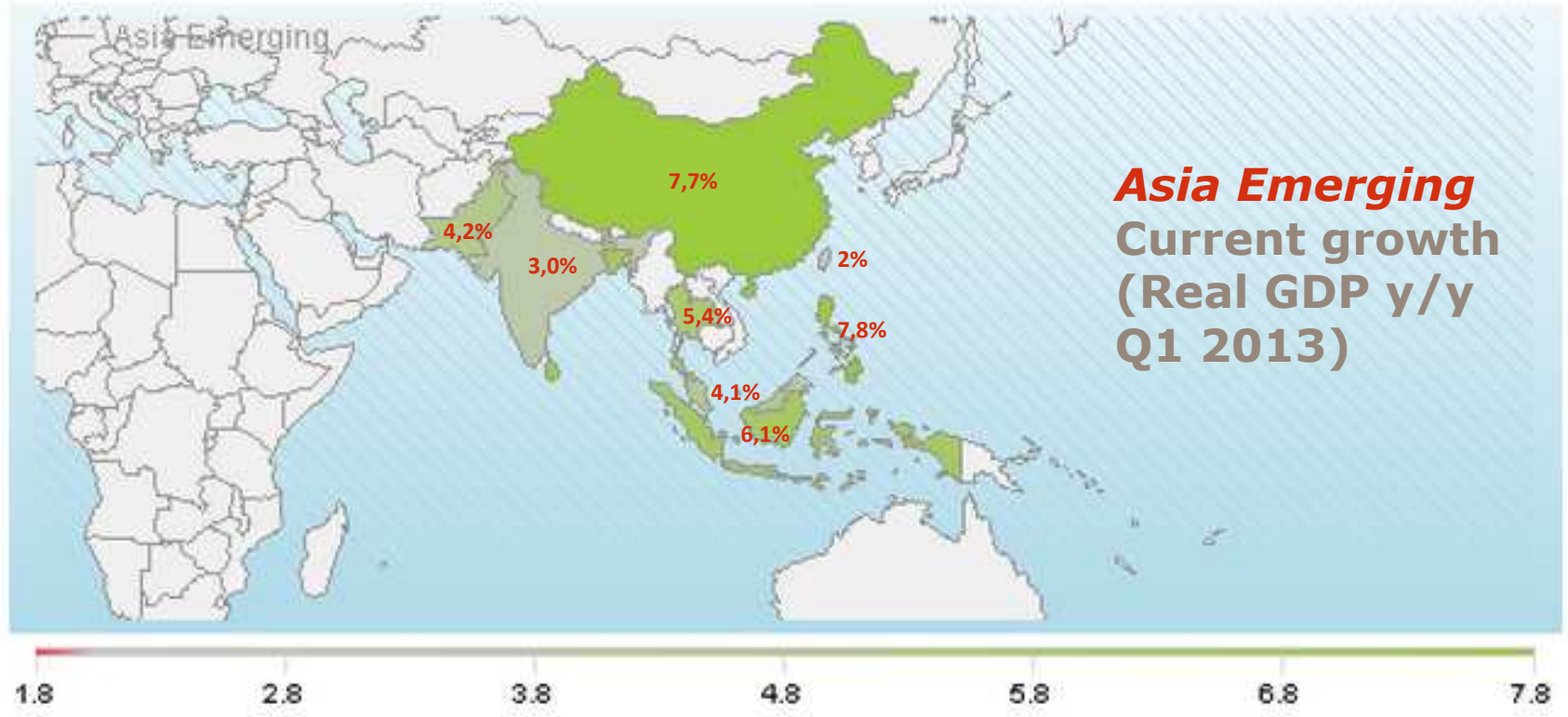
Regional aggregates are calculated using real GDP weighted averages, fixed to 2011

* Assuming that Chinese data remains stable, the regional debt as a % of GDP would be fixed near the 20% area

Despite the Chinese-driven slowdown, regional growth is still healthy

Region Heat Map

Real GDP Growth ▾



Asia Emerging – The only region in the world still growing at a significant pace ... Thus, the only region where it is still worth investing in Gross Fixed Assets

Real Gross Domestic Product	Percent Change Vs. 1 Year Ago		FactSet Economics Standardized Database						
	03/2013	12/2012	09/2012	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011
World Total	0.7	0.9	1.1	1.5	1.8	2.0	2.4	2.5	3.2
+ Asia Emerging									
Asia Emerging Total	6.0	7.0	5.7	6.0	6.5	6.8	7.5	7.9	8.7
+ Europe									
Europe Total	-0.5	-0.3	0.0	0.2	0.7	1.3	2.0	2.1	3.0
+ Latin America									
Latin America Total	2.3	2.8	2.5	2.8	3.5	3.6	4.3	4.5	5.2
+ North America									
North America Total	1.8	1.7	2.5	2.3	2.6	2.1	1.8	2.0	2.0

Regional aggregates are calculated using real GDP weighted averages, fixed to 2011

And where the pattern in the use of budget execution continues

... meaning that these economies apply a countercyclical criterion. In other words, the slowdown has been politically & locally driven...

... which shows the economic autonomy of the region

Government Budget Balance		Percent of GDP		FactSet Economics Standardized Database											
	03/2013	12/2012	09/2012	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011	12/2010	09/2010	06/2010	03/2010	12/2009	
World Total	-3.4	-4.2	-3.2	-1.8	-4.6	-4.9	-3.9	-2.1	-5.6	-5.6	-4.6	-3.8	-4.4	-6.5	
Asia Emerging															
China	4.2	-1.5	-2.7	3.4	5.4	-2.5	-0.2	4.0	0.1	-2.6	-1.0	4.6	6.4	0.8	
India	-3.1	-2.6	-6.3	-8.2	-5.4	-4.3	-5.7	-7.9	-9.0	-1.9	-5.2	-2.3	-5.5	-6.6	
Indonesia	-	-	-	-	-	-1.1	-1.1	-1.2	-1.2	-0.7	-0.7	-0.7	-0.8	-1.5	
Malaysia	-6.4	-8.7	-3.7	-2.7	-2.6	-11.0	-5.7	0.4	-2.5	-8.6	-3.9	-3.7	-5.3	-10.7	
Philippines	-2.5	-4.7	-2.7	0.0	-1.4	-5.3	-1.5	0.4	-1.2	-2.2	-2.9	-2.8	-6.5	-2.7	
Taiwan	-7.6	-3.8	-0.1	2.7	-6.9	-4.4	-1.6	4.4	-4.4	-6.5	-0.9	0.6	-5.8	-6.0	
Thailand	-3.8	-10.3	0.7	5.4	-12.1	-5.3	1.6	7.0	-8.9	-7.5	0.4	5.5	-8.7	-5.4	
Asia Emerging Total	0.8	-2.8	-3.2	0.6	1.2	-3.7	-1.7	1.4	-2.4	-3.2	-2.0	2.0	1.5	-2.3	

Regional aggregates are calculated using real GDP weighted averages, fixed to 2011

And more importantly ... the world's savings follow a positive marginal pace towards this region

- Foreign exchange reserves grew US\$123bn in Q12013 compared to Q12012, representing still 62% of total global FX Reserves. No other region shows a similar trend.

Foreign Exchange Reserves Bil. USD, AR FactSet Economics Standardized Database

	03/2013	12/2012	09/2012	06/2012	03/2012	12/2011	09/2011	06/2011	03/2011	12/2010	09/2010	06/2010
World Total	10,850.6	10,850.5	10,738.2	10,503.6	10,422.6	10,191.0	10,166.2	10,069.1	9,692.5	9,221.8	8,970.4	8,419.8
Asia												
Asia Total	6,770.2	6,685.6	6,648.2	6,549.5	6,647.4	6,495.1	6,430.2	6,404.1	6,161.0	5,866.7	5,630.1	5,266.3
Europe												
Europe Total	1,944.1	1,942.4	1,910.2	1,814.8	1,684.7	1,670.6	1,740.9	1,705.9	1,652.7	1,561.6	1,592.7	1,489.9
Latin America												
Latin America Total	766.6	761.5	757.6	748.0	728.5	706.0	691.1	670.0	637.4	601.0	577.6	534.9
North America												
North America Total	380.3	378.0	376.0	371.5	365.8	357.5	346.7	338.6	321.6	309.9	303.8	284.4

Reserves, excluding gold.
Regional aggregates are calculated by summing the data for all countries in that region

... suggesting a high capacity to intervene in the economy when necessary without having to increase international debt

Foreign Exchange Reserves Percent of GDP FactSet Economics Standardized Database

	03/2013	12/2012	09/2012	06/2012	03/2012	12/2011	0
World Total	11.7	11.1	11.9	11.9	12.0	10.8	
Asia Emerging							
Bangladesh	-	10.7	9.4	8.7	7.8	8.2	
China	45.3	31.4	41.8	43.2	48.4	33.8	
India	13.2	13.8	15.9	15.4	13.5	14.6	
Indonesia	11.4	12.5	11.9	11.6	12.2	12.4	
Malaysia	45.7	43.2	44.5	44.2	45.1	45.0	
Pakistan	-	4.8	5.3	5.4	5.8	7.1	
Philippines	28.4	25.5	29.1	27.0	29.2	26.9	
Sri Lanka	-	-	12.4	11.5	9.9	9.7	
Taiwan	84.0	81.7	83.9	83.3	85.3	86.0	
Thailand	43.4	44.6	47.9	46.4	48.6	52.8	
Vietnam	-	-	-	-	17.0	11.2	
Asia Emerging Total	39.8	30.9	37.2	37.8	40.6	32.9	
Europe							
Europe Total	7.0	7.6	7.8	7.5	7.1	6.7	
Latin America							
Latin America Total	16.0	13.7	14.3	14.1	13.6	13.0	
North America							
North America Total	1.9	1.9	1.9	1.9	1.9	1.9	

Reserves, excluding gold.

... and thus, with a high ability to cope with the rising cost of servicing foreign-currency debt if the US dollar rises sharply (unlike in 1994)

Additionally, high Fx reserves are a very good indicator of the **strength of the local currency** (as they reflect the support behind that currency)

Which suggests that **Foreign Direct Investment will probably continue to flow** into these economies ...

... Maintaining the likelihood of **"healthy" growth** (domestically driven)

Let's look at this in perspective (and use our own reflection of the past) Why we say that this is a politically driven slowdown? And driven by whom?

- The Chinese National Congress often marks significant turning points in the broad direction of Chinese economic policy (resulting in favourable changes in the economy of the region, and thus, globally. For example, following the 14th Party Congress (1992), Jian Zeming and Zhu Rongji pushed a wave of liberalization, culminating in the entry of China in the WTO. Or following the 16th Party Congress (2002), when Hu Jintao and Wen Jiabao gave greater support to enterprises, reduced burdens on farmers, and expanded social welfare programs).
- Considering the adaptive nature of all succession processes, we believe it is legitimate to see progress in certain key economic areas. In the early stages of 2013, Beijing announced four crucial economic reforms:
 1. PBOC will accelerate the introduction of a deposit insurance system (a move widely seen as a prerequisite for large-scale and broader changes in the financial system)
 2. PBOC pledged to go ahead with interest rate liberalization (a move seen as crucial to improve capital allocation and boost domestic consumption)
 3. PBOC has announced that it will expand **cross-border use of the RMB**, including by individuals
 4. It will expand **quota programs** allowing investment into and out of the country (making the bond market bigger)
- In our view, this is a good way for the PBOC to give an appropriate response to the investment community. For the RMB to become a kind of regional reserve currency, it needs the backing of a big and liquid RMB-denominated bond market.
- *The Times* said that Beijing's internationalization of the yuan is currently in a high growth phase and that the currency could soon catch up with the Yen and the British Pound. Current obstacles are: 1) The lack of will and capacity of enterprises to use the yuan for quoting prices in trades. 2) The internationalization of financial institutions lags behind trade activities. 3) Small number of yuan in forex markets still remain in the path. **Said this, the prospects are for an increase in the use of the yuan in trade with Latin America, the African union and South Korea.**

Where is the catch?

(indeed, everything has its cost)

- All this can happen only if China is able to deliver a credible currency and a reliable bond market ...
- Both of which are only compatible with low inflation ...
- ... Which means that PBoC CANNOT embark on significant monetary easing, or must reduce liquidity injections to the system when consumer credit grows at 30%, etc...
- To some extent, policymakers must sacrifice a portion of growth (and equity markets) to ensure the credibility of the RMB and its bond market.
- Now do you understand why we recommend increasing the exposure of your portfolio to the entire RMB world and satellite currencies?

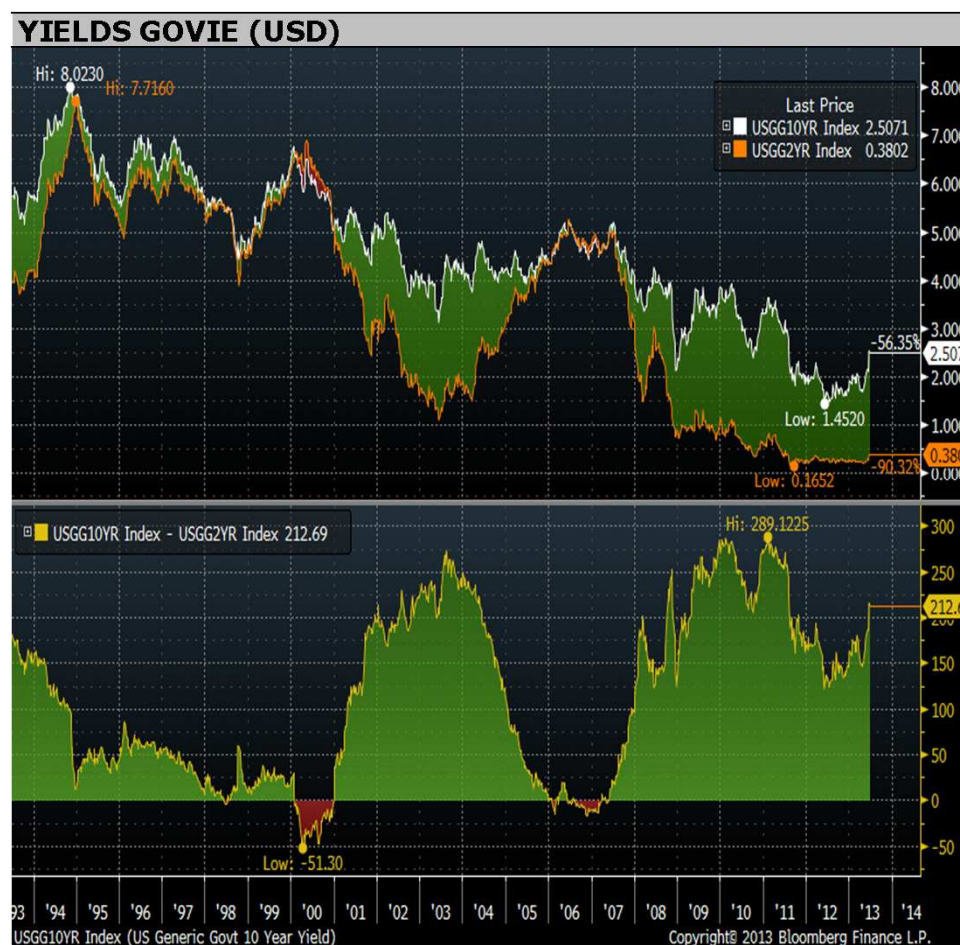
We recommend to keep your positions in EM Asian & Latam bonds despite recent falls in prices.

Global Market Environment

Core Fixed Income – US Dollar.

Performance & Perspectives

- Significant upward shift in the slope of the USD yield curve during the last month. As in previous episodes, it has been the long end that has experienced a major pick-up in yield (of 70 bps from 1.78% to 2.50%). After this, the 2-10 years slope is fixed at 212 bps (well above its long-term average, and higher than the 178 bps in previous month)
- **Fundamental outlook:**
 - ✓ **Short end of the curve:** Our fundamental view for the economic growth and inflation in the US is consistent with a relatively dovish stance in the Fed policy rate. We foresee short maturities (0-2 years) remaining well-anchored at historical lows (around 0.25%). However, in the short run 2 year yields could go slightly higher.
 - ✓ **Long end of the yield curve (10 years):** Our fundamental range for the 10 yr Treasury yield **remains stable at 1.5% - 2.5%**. Therefore, at current levels, and according to our expectation on growth and inflation, we feel structurally comfortable by gradually buying Treasuries at 2.50% - 2.60%. We estimate that the 10 yr yields will trade again within our fundamental range in the medium term. Obviously nobody can say where the “market dynamics” could bring the 10yr yield. In fact, seeing at the intensity of the dynamics, the 3% level can not be ruled out.

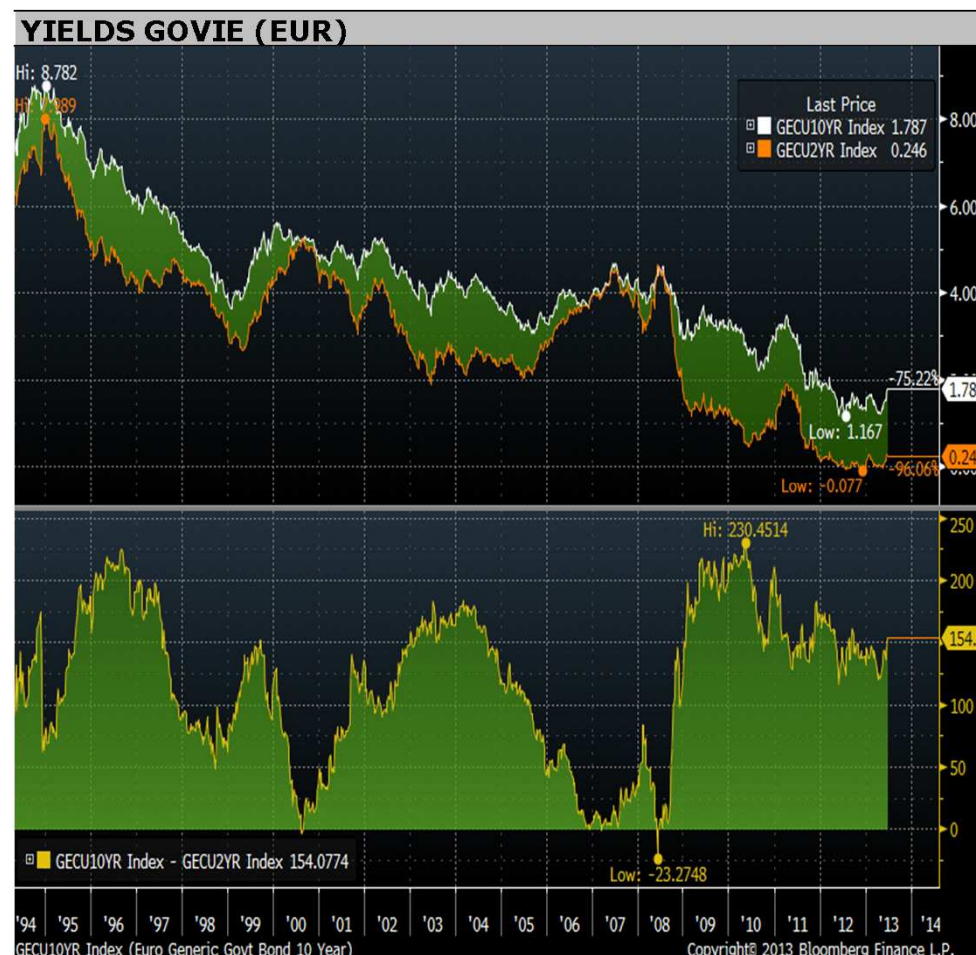


Global Market Environment

Core Fixed Income – Euro.

Performance & Perspectives

- Once again an upward shift in the slope of the EUR yield curve during the last month. As in previous episodes, it has been the long end (10-year maturity bonds) that has experienced a major pick-up in yield (of 36 bps from 1.42% to 1.78%). After this, the 2-10 years slope is fixed at 154 bps (well above its long-term average)
- **Fundamental outlook:**
 - ✓ **Short end of the curve:** Our fundamental view for the economic growth and inflation in the Eurozone is consistent with a relatively dovish stance in the ECB policy. We foresee short maturities (0-2 years) remaining well-anchored at historical lows (around 0%). In the short run, yields in the short end of the curve could break the 0,25%.
 - ✓ **Long end of the yield curve (10 years):** Our fundamental range for the 10 yr bund yield remains stable at 1.5% - 2.0%. Obviously nobody can say how strongly these range limits can be broken. Recently, the lower band was broken by more than 25 b.p, and maybe this time the upper band could be broken in the same way (25-35 bps).
 - ✓ Nevertheless, according to our expectation on growth and inflation, we consider that **10 year bund yield at 2% represent a good opportunity of entry.**



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