BLACKFRIARS ASSET MANAGEMENT

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Asia Insight

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Market Review

The MSCI AC World Index fell 6.0% in January, the MSCI Asia ex Japan Index declined 7.6% while the MSCI Japan Index slumped 8.2%. Not a great start to 2016.

Hong Kong (-9.3%) and China (-12.7%) led the region downward although encouragingly Indonesia, Malaysia and Thailand managed to record small gains. By sector, property (-12.8%) and financials (-11.2%) were weakest.

All returns above are stated in USD terms.

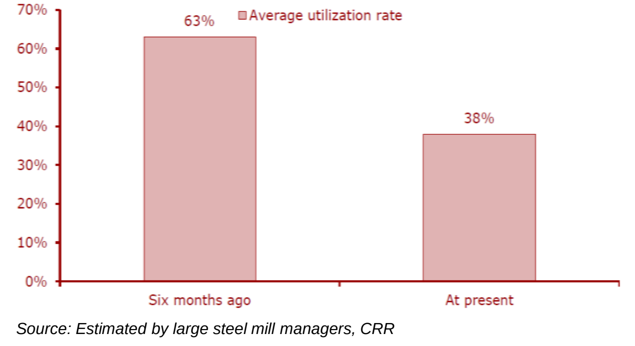
Global Growth to Disappoint (Again)

At 0.7% annualised the fourth quarter GDP number from the United States did not impress, accompanied as it was by a 1.8% annualised decline in non-residential investment and a 5.1% seasonally adjusted m-o-m fall in December durable goods orders. While Chinese New Year always plays havoc with 1Q monthly data points, the 18.5% and 20.1% slump in Korea's January exports and imports tell a similar story. Korea remains an excellent global trade "canary". Needless to say expectations of further FOMC interest rate rises are evaporating and bond yields are falling. These data points, plus further QE moves by the ECB and BoJ (see on), suggest another year of deflationary pressures and additional monetary madness lies ahead.

In stark contrast, China's 4Q15 real GDP growth came in at a robust 6.8% y-o-y! Really? One week later Wang Baoan, Head of the National Bureau of Statistics, was detained for "suspected serious violations of discipline". One suspects that his previous role as Head of the Finance Ministry's Economic Construction Office – which oversaw the boom in state investment in infrastructure post the GFC – is a more likely source of transgressions rather than simply issuing dodgy GDP data. The witch hunt by the current administration continues. The more realistic read of the official data would be the reported 5.8% y-o-y increase in 4Q15 nominal GDP. For 2015 as a whole the primary sector (agriculture) grew 4.5%, the secondary sector (mining, manufacturing, construction etc.) grew 0.9% while the tertiary sector (services) expanded by 11.7% in nominal terms.

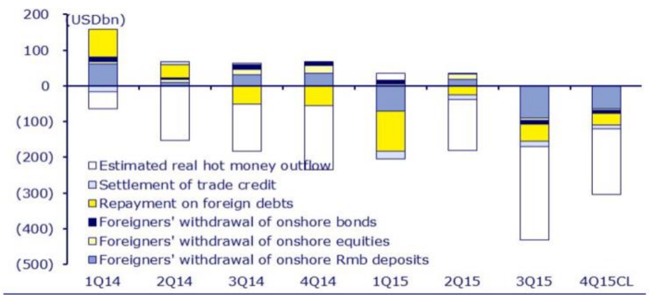
The reality remains that heavy industry in China is in outright depression. CLSA's China Reality Research estimates that over 60mn tonnes of steel capacity was closed in 2015 and last month the State Council announced a target 100-150mn ton reduction in capacity during 2016. While these cuts are significant they are not sufficient to close the supply/demand gap.

Average Utilization Rate of Captive Iron Ore Mines of Big Steel Mills



Source: Estimated by large steel mill managers, CRR

Decomposition of Capital Outflow



Source: CLSA, PBOC, SAFE, CEIC

Control

The six million dollar question remains, can the Chinese authorities retain control over the Renminbi in the context of $1tr of capital outflows over the past year? CLSA's Francis Cheung recently attempted to make the distinction between the unwinding of carry trades and repayment of offshore debt, which one would expect following the August 2015 currency adjustment, and pure domestic capital flight. His conclusion is that perhaps 40% of the capital outflows in 2H15 can be attributable to the first two implying there is a degree of true capital flight. That said both domestic interbank rates and system wide deposit growth remain stable. Tighter implementation of existing capital controls suggest that the authorities can retain control for now but this needs monitoring.

Booming

Turning to more cheerful matters the Philippines posted excellent 4Q15 GDP numbers with q-o-q seasonally adjusted growth accelerating to 8.2%. 3Q15 growth numbers were also revised upward. Robust consumption and a sustained investment upswing remain the drivers. While the forthcoming Presidential elections will no doubt cause jitters from time to time, the acceleration of infrastructure spending should underpin another year of solid growth. The Philippines remains a favourite of ours.

Negative

The Bank of Japan surprised markets by joining the ECB, the Swiss and others in introducing negative interest rates on certain excess reserves deposited at the central bank. The Bank described its decision as a pre-emptive move aimed at guarding against a deterioration in corporate and consumer sentiment. In reality it is likely that it was more of a warning shot aimed at the FX market which had taken the yen/dollar rate as high as Y116 earlier in the month. The BoJ seems keen to preserve the one really effective element of Abenomics, namely a weaker currency. The undeclared global currency war rolls on.

Outlook

All in all, a difficult start to 2016 with rising strains in high yield bonds, a collapsing oil price, further weakness in other commodities and China fears dominating trading. While difficult to remain overly optimistic amongst the daily carnage, we note that TSMC lifted its 2015 dividend by 33%, HDFC turned in another solid quarter of growth, Sands China maintained their dividend. Many more results to come in February.

HT&SD