

# ASIA INSIGHT

6<sup>th</sup> November 2017

## Market review

Asian equities moved higher in October with the MSCI AC Asia ex Japan Index advancing 4.7% while the MSCI AC World Index gained 2.1%. Korea (+8.4%) and India (+7.4%) led the way while Malaysia (-0.3%) and Indonesia (+0.1%) lagged. By sector, Energy (+6.7%) and Information Technology (+6.9%) moved smartly higher.

All returns above are stated in USD terms.

## Federal Reserve – another dove

Markets breathed a sigh of relief following President Trump's nomination of Jerome Powell as the new Chairman of the Federal Reserve. Powell, an existing board member and a 'dove', is unlikely to change the policy map laid down by Janet Yellen which promises a gradual, but flexible, reduction in the size of the Federal Reserve's balance sheet.

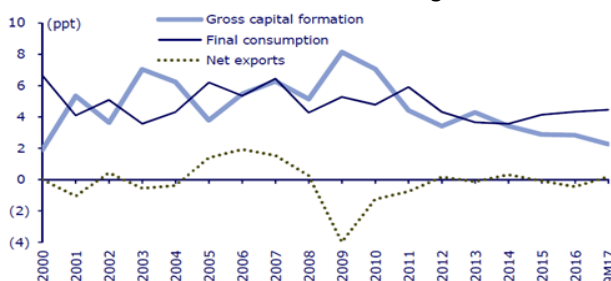
Quantitative easing was introduced in early 2009 and from the lows recorded in early March that year the MSCI AC World index has rallied almost 250%, a compound rate of return in excess of 15%. This is twice the average rate of return over the past thirty years. Quantitative tightening could, or should, have the reverse impact on asset prices. The appointment of another 'dove' as Chairman reduces but does not eliminate this possibility.

## Beautiful China

Over the past five years General Secretary Xi Jinping has reversed or eliminated the majority of the disastrous economic policies of his immediate predecessors, Messrs Hu and Wen. Specific supply-side reforms and tighter control of the capital account have both been actioned very effectively while Xi's new slogan "Beautiful China" suggests further substantial efforts to curb pollution. Economic growth has slowed but the quality of this growth, driven more by rising consumption levels than by investment, has improved markedly. The chart below illustrates the declining role of gross fixed capital investment in generating growth in the economy. Consumption trends remain positive.

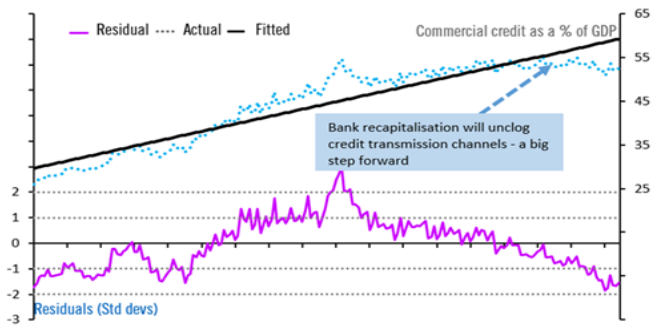
More importantly, Xi has restored the credibility of the Communist Party in the eyes of the Chinese people with the high profile anti-corruption agenda of the past five years. Xi is set to stay in power for a considerable period; markets love certainty. A stable, if slower, growing Chinese economy lies at the heart of Asia's future.

**Contribution to China real GDP growth**



Source: National Bureau of Statistics, CEIC Data

## India bank recapitalisation – biting the bullet



Source: Haver Analytics and Asianomics Ltd

## Recapitalised India

Prime Minister Modi's administration continues to impress. Last year's demonetisation and the introduction of a nationwide Goods and Services Tax this summer have presented a variety of short-term disruptions to producers, traders, retailers and consumers. Despite these challenges, the economy has continued to expand, driven primarily by rising consumption which is itself a product of India's outstanding demographic profile. While not perfect, the huge simplification of the indirect tax system will aid commerce and lift tax receipts.

Elsewhere, the success of the rural and urban PMAY housing schemes continues. Rural housing construction grew 67% to 3mn units in FY17 and over 60% of the target FY18 budget for urban units has already been disbursed. Affordability, mortgage payment to income, remains at record lows.

The missing link has been an upturn in the investment cycle. The availability of credit required to fund investment has been severely compromised in recent years by the poor financial health of the public sector banks which, collectively, account for roughly two thirds of the banking sector. The chart above illustrates the below trend growth in credit in India over the past four years and more.

The recent announcement by the Modi administration of a US\$32bn recapitalisation of the public sector banks is therefore highly significant. Details remain somewhat sketchy but, to state the obvious, a recapitalised banking system will be in a position to fund the overdue upturn in the investment cycle which will power India's economic growth for years to come.

## Outlook

Still driven by a depressingly small number of large caps, regional indices continue to outperform developed markets. If valuations are no longer so obviously compelling in some specific areas, we still see good investment opportunities across the region as we look toward 2018. This is particularly true of some recently overlooked markets across ASEAN and the Indian subcontinent.