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## ***Where does Asia stand as we approach a new world order?***

- China's economic growth will become sustainable as it shifts from a reliance on exports to promote domestic consumption over the next several years.
- There is evidence of economic decoupling in Asia, however the region remains dependent on global fund flows and global sentiment in the shorter-term and hence stock markets have been unable to decouple.
- This new economic model for China has very significant implications for the global economy and the Asian region as it moves away from over-dependency on exports.

**Mark Konyn, CEO Asia Pacific, and Raymond Chan, CIO Asia Pacific, at RCM** share their perspectives on Asia and its place in the new world order which is emerging out of the financial crisis.

**Mark Konyn, CEO Asia Pacific at RCM**, comments:

### **Overview**

"There has been a clear period of growth in Asia over the past 20 years, but also evidence of insufficient tools to manage that growth – particularly in China. More recently as China has integrated more into the global economy it has been able to move beyond the boom and bust cycles of the 80s and 90s. This has been coincident with China entering the World Trade Organisation. Since then China has experienced sustained growth, built on manufacturing and exporting. Whereas this has represented a big step towards China combating poverty and liberalising its economy, we have to question whether this is sustainable. Less than a third of China's economy is explained by domestic consumption, which is far less than Japan, Europe and certainly the US.

"During November's G20 meeting, China was content to have a seat at the table, but did not express a strong voice. At April's meeting there appeared a change of approach. China assumed more responsibility as a leading global economy and helped to frame the agenda, raising issues relating to the financial support for emerging economies and shifting discussion ahead of the meeting to reserve currency themes. More recently China has been establishing bilateral agreements where trade will be settled in Chinese currency, implying that the Central Bank's policy to sterilise dollars out of their economy and invest in US treasuries will slowly adjust. Asia now needs to look ahead to boost its domestic consumption and shift perception that it is simply a high beta player on the global markets.

"Emerging markets have become more significant in a global context. We are seeing better treatment of minority shareholders generally in Asia, closer links between economic growth and earnings and profits, and there's every expectation that opportunities to diversify portfolios and benefit from underlying growth will be realised."

**Raymond Chan, CIO Asia Pacific at RCM**, adds:

### **Decoupling**

"There is evidence of Asia experiencing economic decoupling, with Chinese GDP growing at 10% per annum, Indian at 7% per annum and Korean and Indonesian growing at 4-5% per annum, in comparison with European GDP growth which is less than 2%. Asia will continue to grow at a faster rate than the developed economies, as most countries within Asia run a healthy fiscal stimulus or a comfortable fiscal deficit – a big contrast to the developed countries. All Asian economies are running very strong current account surpluses, providing the source for the funding for the deficit in the developed countries.

"In contrast, there has been no decoupling of the stock markets at all. The Asian market bottomed in 2003 and we saw a five year boom market which ended in 2007. The Asian markets outperformed the global markets significantly during this period. It is also difficult to argue that the equity markets around the world could decouple from each other as there is no boundary on the flow of money. It is interesting to see that the Asian markets have formed a pretty solid base in the last two quarters and this year they are starting to outperform the global markets again. We are comfortable in saying that we may have seen the worst for the Asian markets, although to sustain the performance structurally Asia needs to change its economic model.

"Despite the volatility of the Asian markets, Asia Pacific has seen an increased share of global markets. Looking at the Asian ex Japan's share in the MSCI World Index, they've gone up by 67% to almost 5% - this very much at the expense of the European and Japanese markets. We believe the share of the Asian markets will continue to increase in the MSCI World because this region is structurally growing faster than the rest of the world and will continue to do so in the foreseeable future. Ten years ago we didn't see any Chinese names among the world's biggest companies... today we have five.

### **Is China always going to be the world's manufacturer?**

"Asia has done well because of exports. It has become the global manufacturing hub, taking advantage of the cheap land, cheap labour and undervalued exchange rates. With the income and profits that the manufacturers generated, the central banks have used foreign reserves to purchase US government debt and keep interest rates low for US consumers to consume. It was a successful model but we believe that the music has now stopped. US consumers are going to be more selective on spending, the savings ratio has gone from negative to a positive 4-5%, and the central banks in Asia are more reluctant to fund the US deficit by buying treasuries at any price, recognizing the exposure to currency risk.

### **What should the new economic model be?**

"Asian governments have to reform their economies, diversifying the export model and building domestic consumption and investment. Particularly in China savings rates need to reduce and this will require significant reforms that provide a safety net including pension and health reforms. There are signs recently that foreign reserves are diversifying in to gold, resources and commodities and that the financial crisis is likely to speed up this process. China has already concluded various deals in the oil and material sectors with countries such as Brazil, Russian and Australia. We believe that this strategy should position China for longer term growth in a more sustainable manner.

"For the Asian countries to consume more and to change their economic models we also need to see stronger currencies. At present the Chinese currency is not convertible, although Beijing has announced that Shanghai is going to become an International Financial Centre by 2020. This means the Renminbi will be convertible by then. China is going to trap some of this foreign currency while expanding the global and regional adoption of Renminbi by increasing consumption – a very important step for China to lay down the path to free its currency.

"Over the last 30 years since China opened its doors to the world, we have seen its GDP per capita expand from a few hundred dollars to the current level of around 5,500. We believe the focus on domestic consumption to drive economic growth, means that the GDP per capita will continue to expand so that it can reach the level of its Asian neighbours, such as South Korea.

### **So how do we manage risks in Asia?**

"Some of the risk factors in Asia include liquidity, corporate governance, and a lack of transparency and accountability. However, the Asian markets have room to reduce their risk profile, and the Chinese government is already working to improve transparency. The biggest risk we believe is protectionism and no one will benefit from it if it arises. On the surface it will hurt the capital formation in Asia, but on the flip side if it happened it would certainly accelerate the distribution of investor capital into the domestic economy.

### **Conclusion**

"While there's evidence of decoupling in the economic growth between the East and the West, we should expect correlation of the stock markets around the world to persist. Despite the volatility of the Asian markets, Asia Pacific has structurally increased its share of global markets and this will continue. China has to redeploy some of its capacity to focus on domestic consumption and the gradual opening up of the capital account and the adoption of the Renminbi will accelerate a path for China to offer greater prosperity.

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“From a stock market point of view, the best trades should focus on stocks that are company specific. Online gaming companies, banks and mobile phone companies have offered investors tremendous returns up to now. Asian markets are young and dynamic but they do have higher risks. However, at the margin we are seeing the risk spread between the developed and Asian markets narrowing.

“The events in the West in the last 15 months have encouraged the East to rethink its economic model and this will have a profound impact on what the world will look like in the future. This really is a once in a lifetime opportunity.”

**- Ends -**

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