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**DSGAsia**

**Macro & Markets: Economic and  
Market Outlook 2009 and Beyond**

**Simon Ogus**

**Khazanah Megatrends Forum 2008**

**Kuala Lumpur – October 2008**

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Independent Asian Economic & Political Analysis



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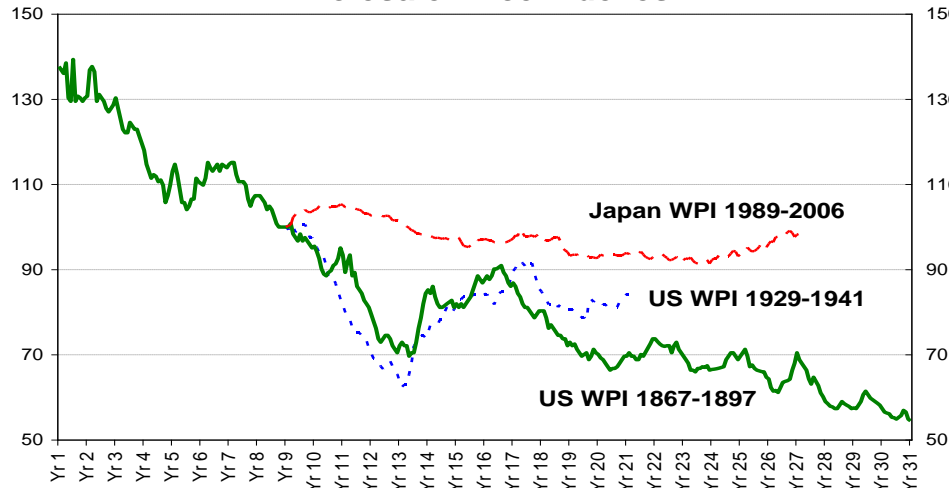
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**“The Chinese are very ingenious at imitation... they have imitated to perfection whatsoever they have seen brought out of Europe. In the Province of Canton they have counterfeited several things so exactly, that they sell them Inland for Goods brought out of Europe.”**

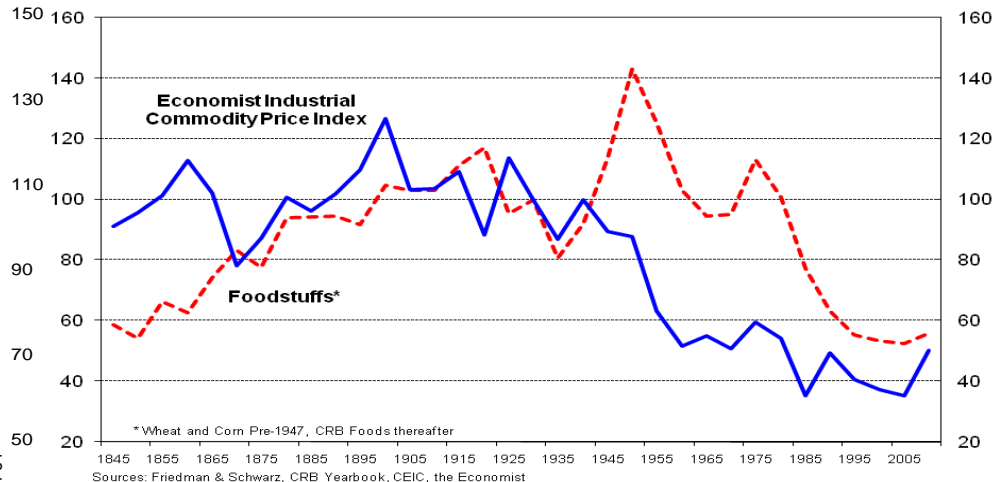
*Spanish missionary, Domingo Navarette, circa 1659-64.*

# Is China today the America of the 19th Century....?

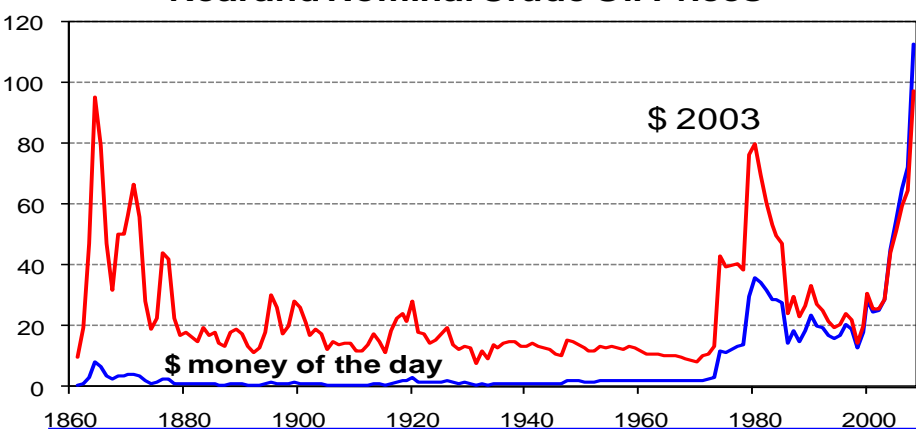
**Wholesale Price Indexes**



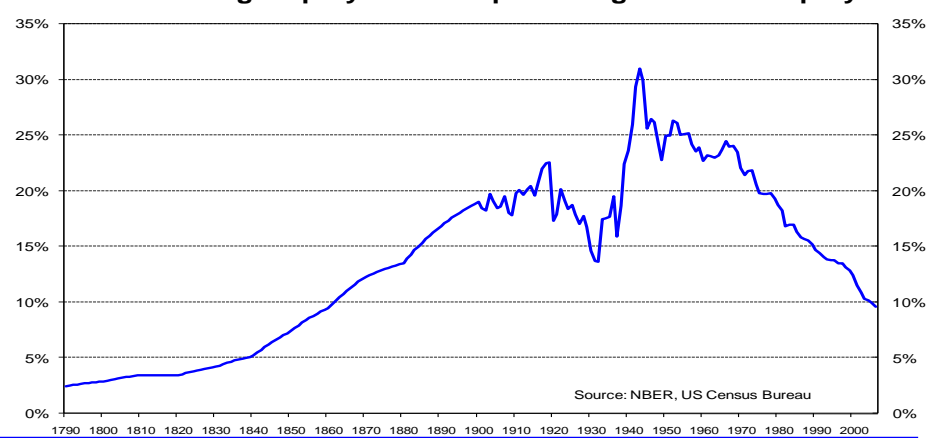
**Commodity Prices Relative to US Wholesale Prices**



**Real and Nominal Crude Oil Prices**

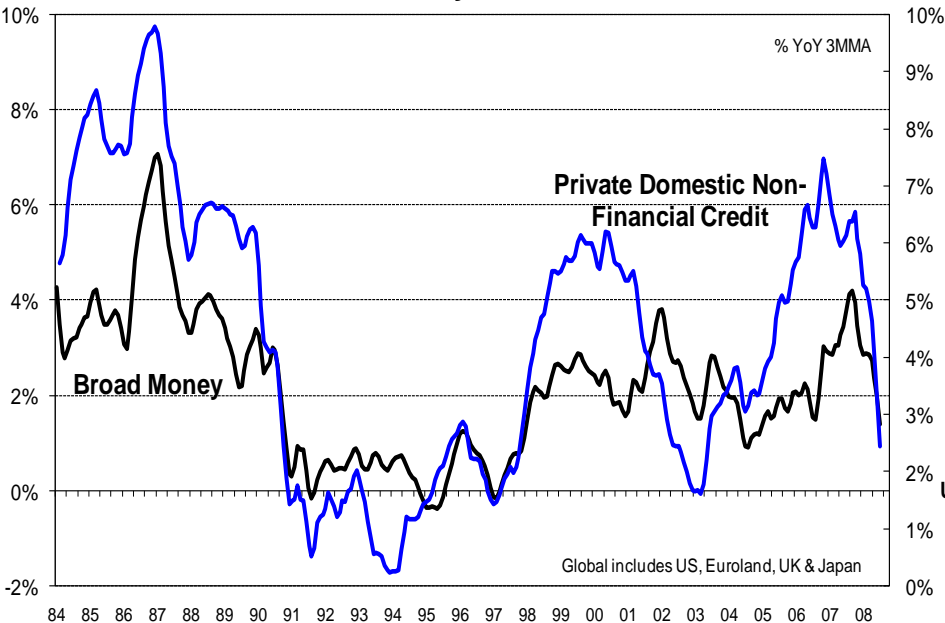


**US Manufacturing Employment as a percentage of Total Employment**

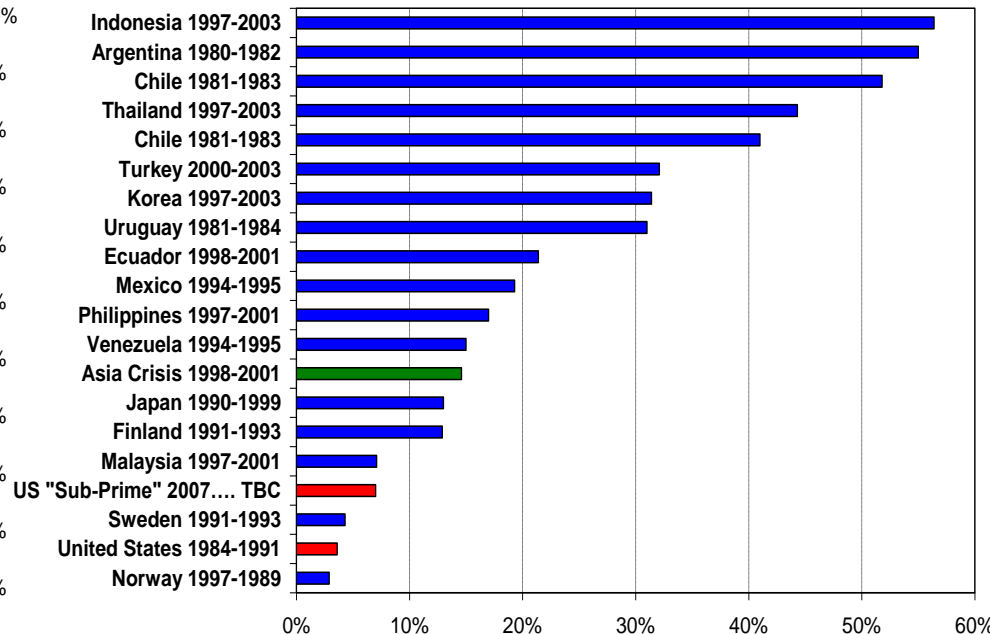


# Despite higher rates, the largest credit Ponzi scheme in history continued to grow. The soufflé is now collapsing

Global Real Money and Credit Growth



Costs of Banking Crises, % of GDP

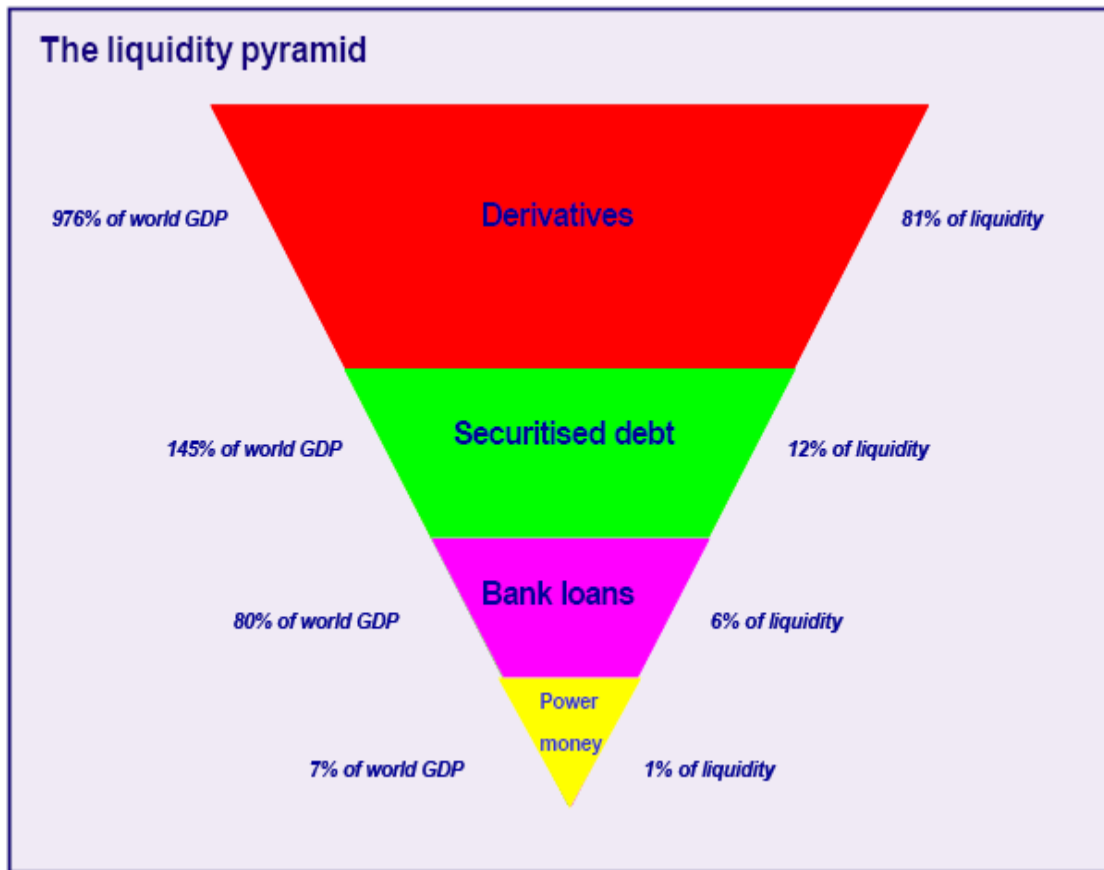


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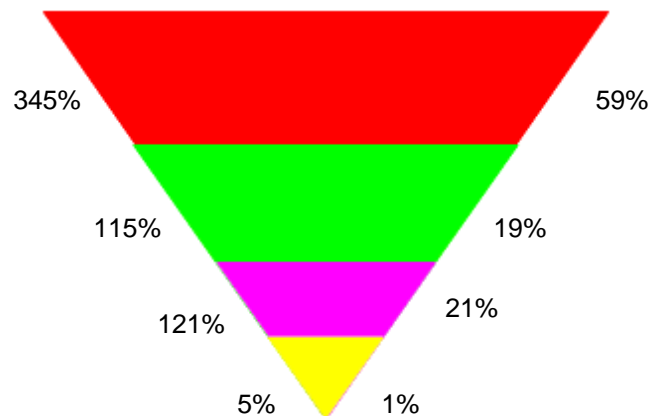
# A Natty Pictorial Representation – David Roche’s New Monetarism Liquidity Pyramid

**Current Total Liquidity: 1208% of World GDP**



Source: Independent Strategy

**Total Liquidity End 2000:  
586% of World GDP**



**US Financial Institutions' Level 3 Assets (Latest)**

USD bn	Level 3 Assets	Equity Capital	Level 3-Equity %
<b>JPMorgan</b>	99	126	79%
<b>Citigroup</b>	160	128	125%
<b>Lehman</b>	43	32	132%
<b>Bear (end 2007)</b>	20	13	154%
<b>Fannie Mae</b>	63	39	162%
<b>Goldman</b>	96	45	215%
<b>Merrill</b>	82	37	225%
<b>Morgan Stanley</b>	78	33	235%
<b>Freddie Mac</b>	157	27	587%

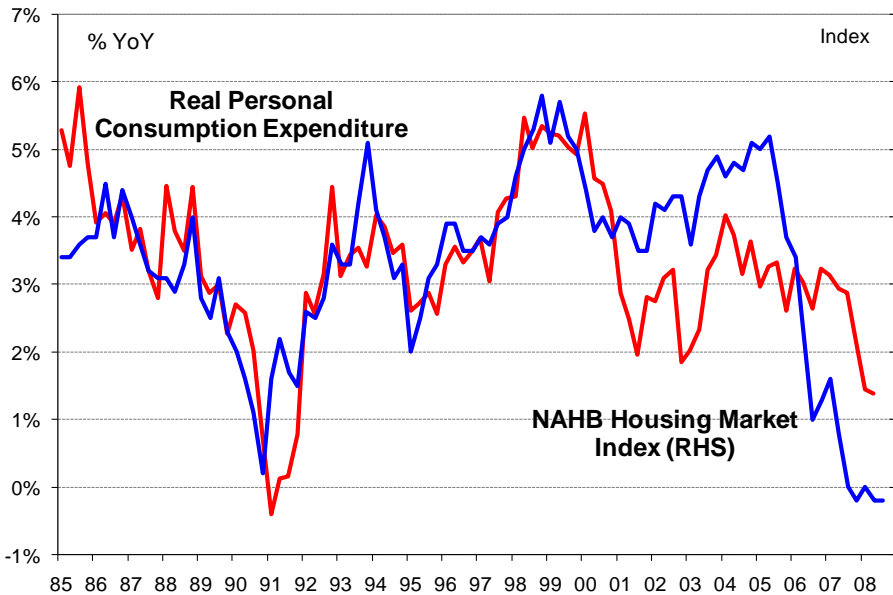


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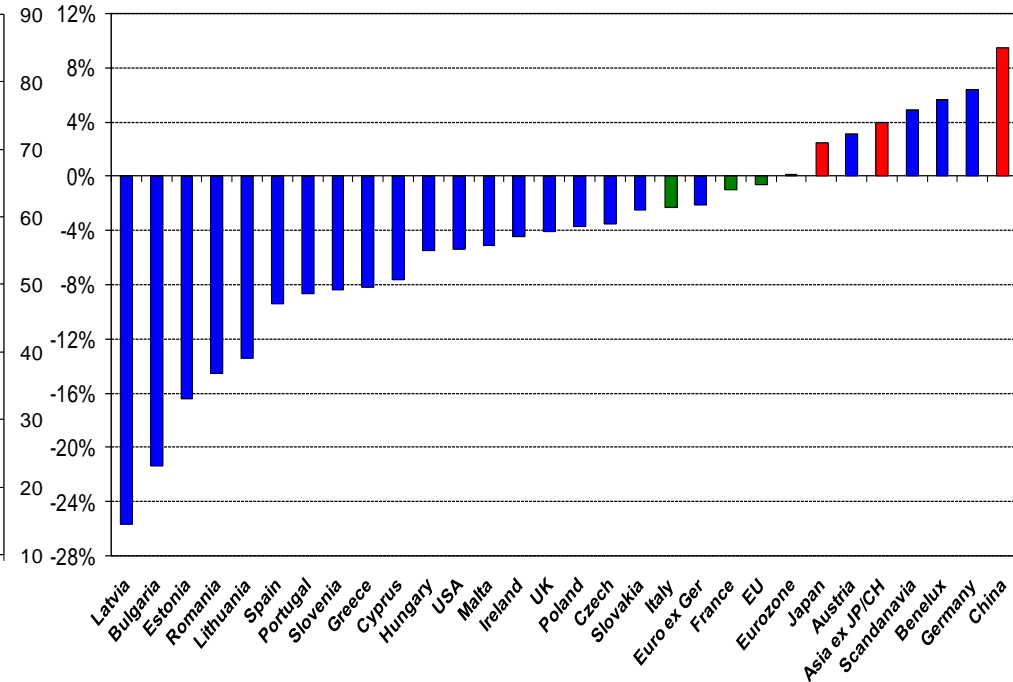
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# Wile E. Coyote has gone off the edge of the cliff. European lemmings will follow

US National Association of Home Builders Index and Real Consumer Spending

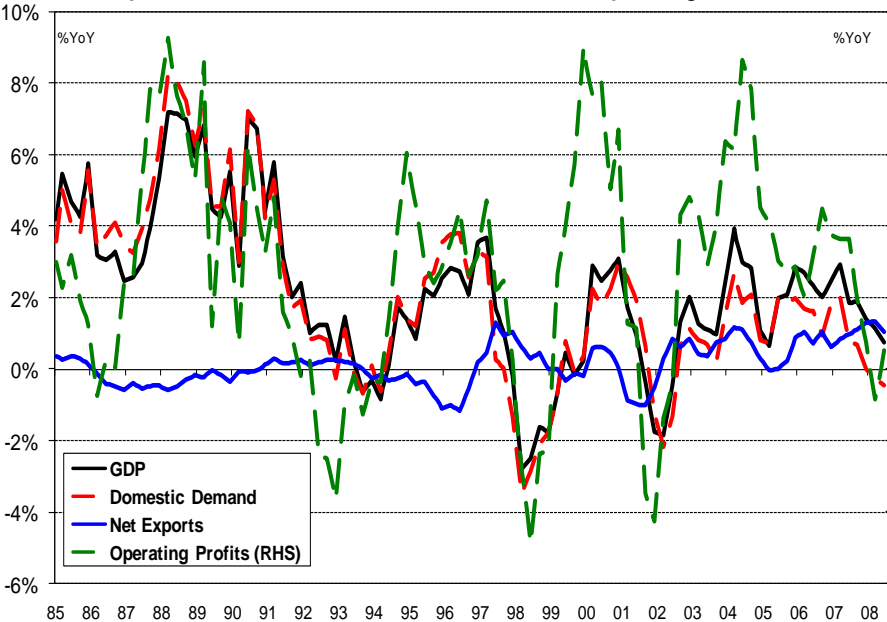


Current Account Balances as a Percentage of GDP 2007

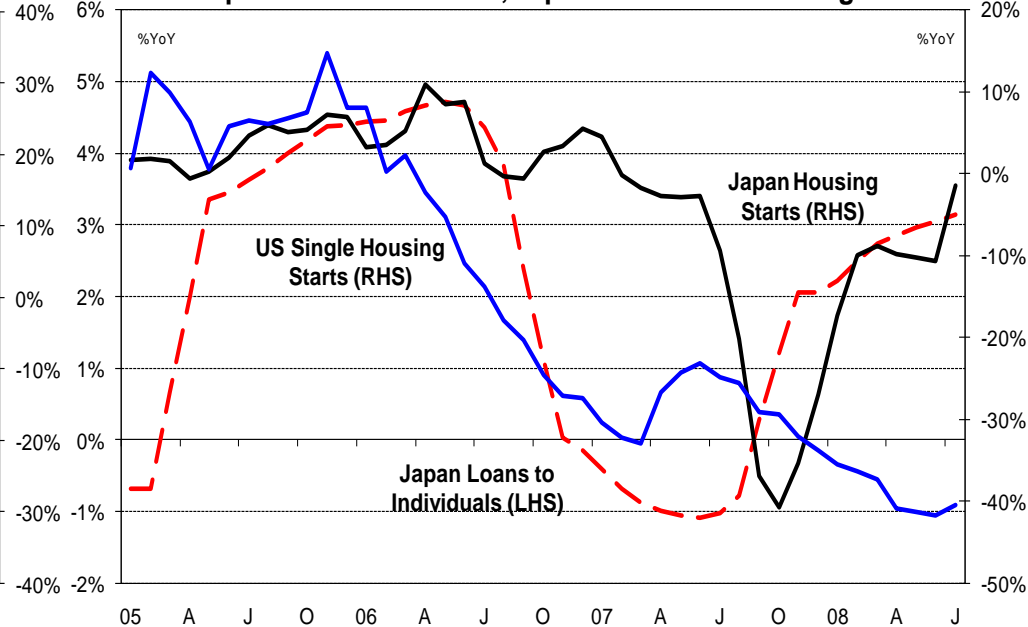


# Japan wins the G3 “Ugly Beauty Parade”. It is not going to be of much help to anyone but it is unlikely to cause much trouble either

Japan Contributions to Real GDP Growth and Operating Profits Growth

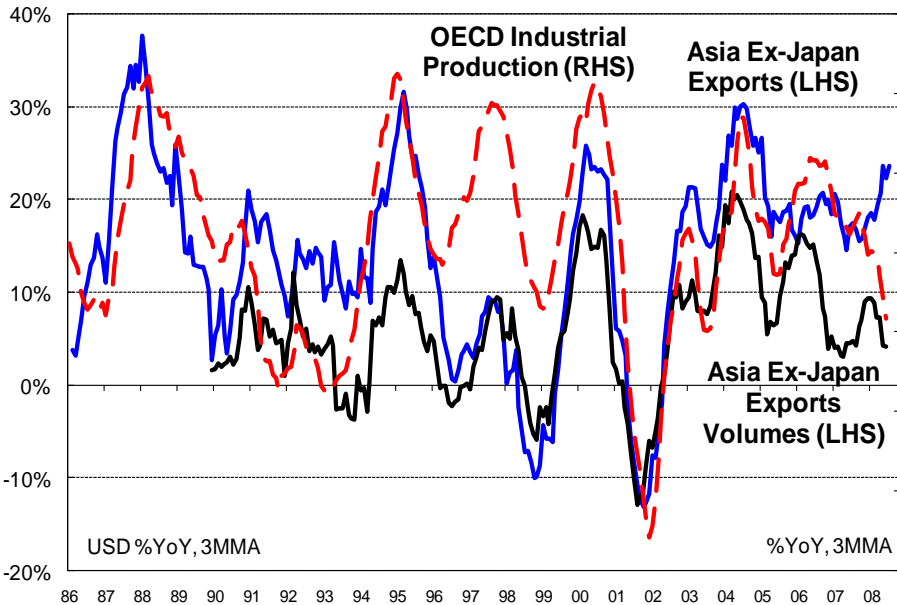


Japan Consumer Credit; Japan and the US Housing Starts

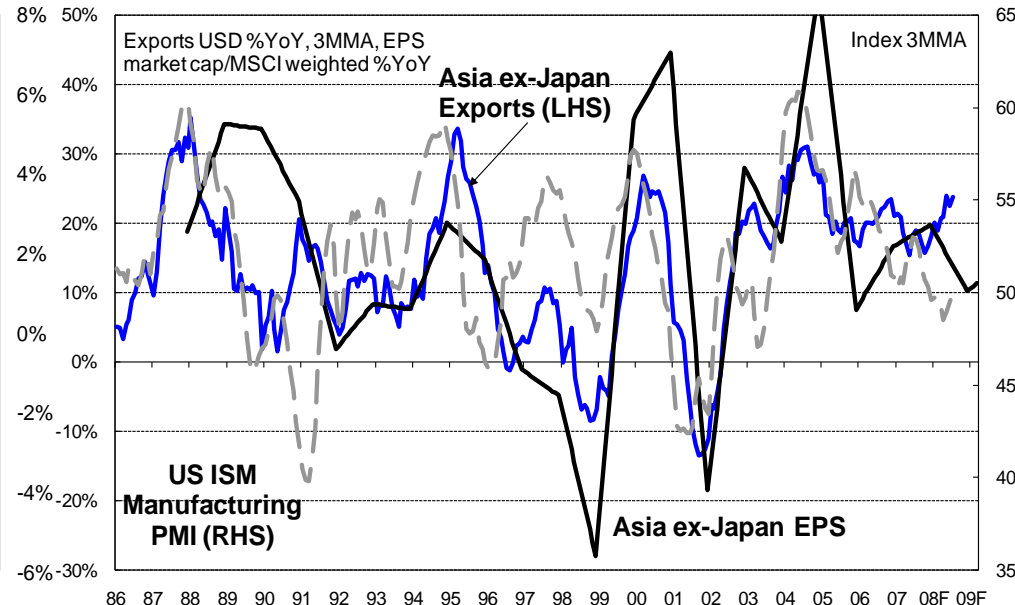


# Has the Asian region as a whole really decoupled?

**Asia Exports and OECD Industrial Production**



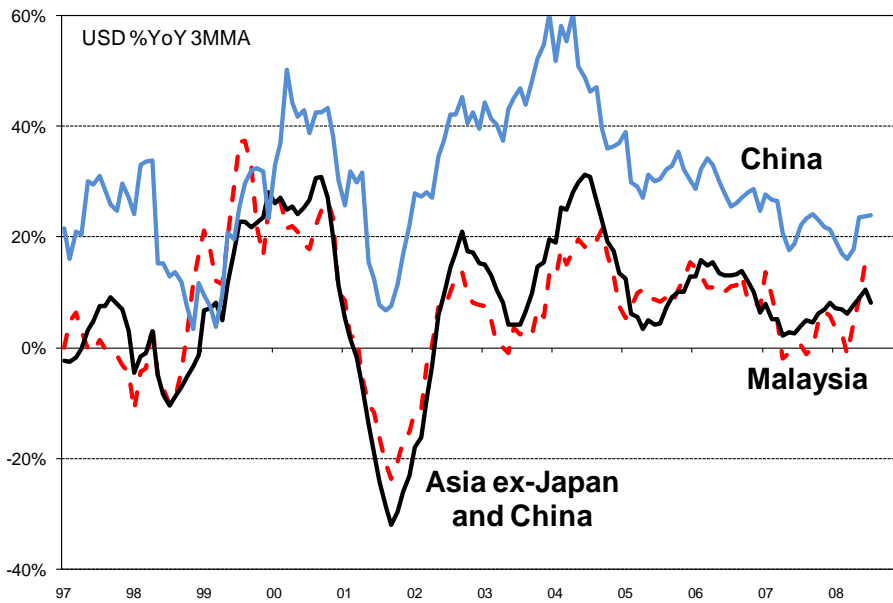
**Asia ex Japan Exports & EPS Growth and the US ISM Manufacturing PMI**



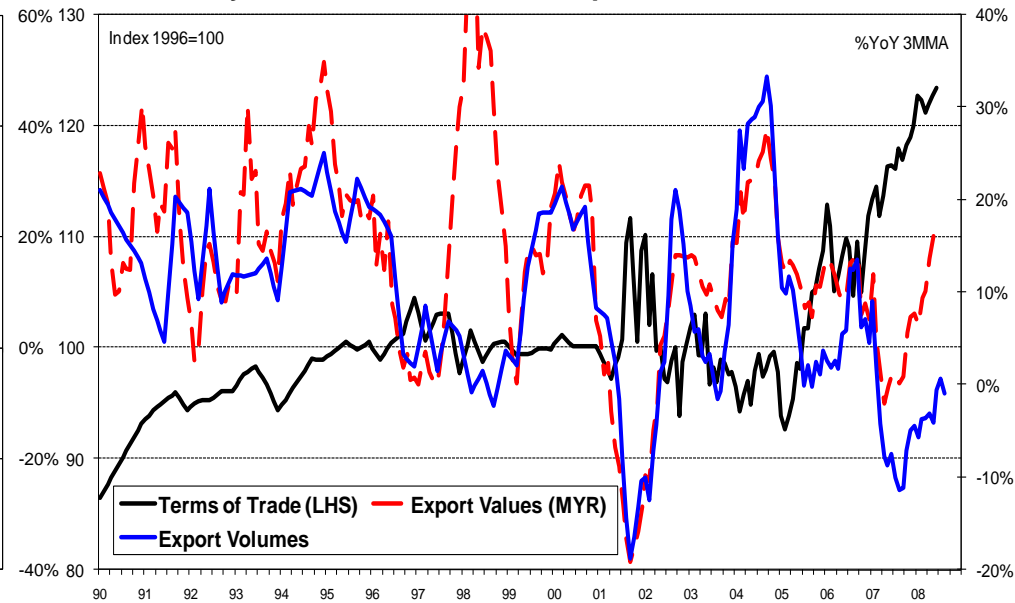


# With commodity prices falling back, Malaysian exporters could be amongst the region's most vulnerable

**Malaysia, China and Regional Electronics Exports**

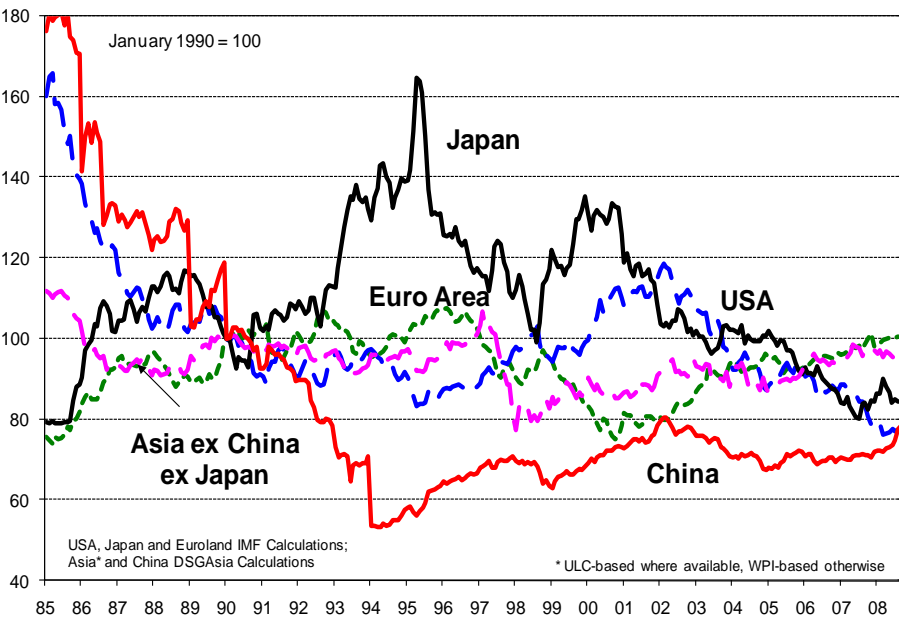


**Malaysia Terms of Trade and Export Values and Volumes**

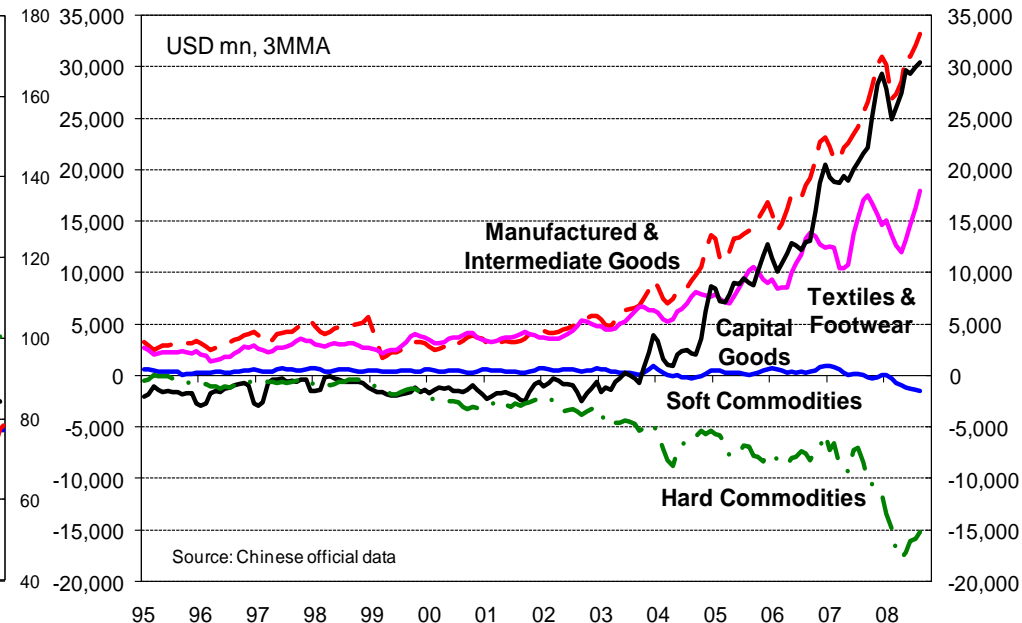


# China has moved rapidly up the value added and import substitution ladder. Low-end manufacturing aside, it remains hyper-competitive

Real Unit Labour Cost-Based Trade-Weighted Exchange Rates

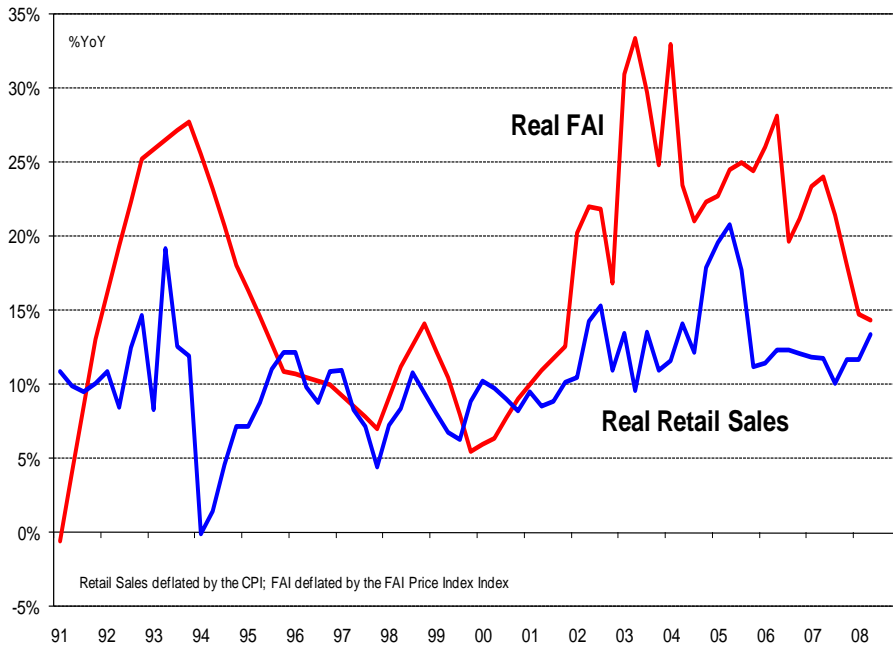


China Trade Balance By Product

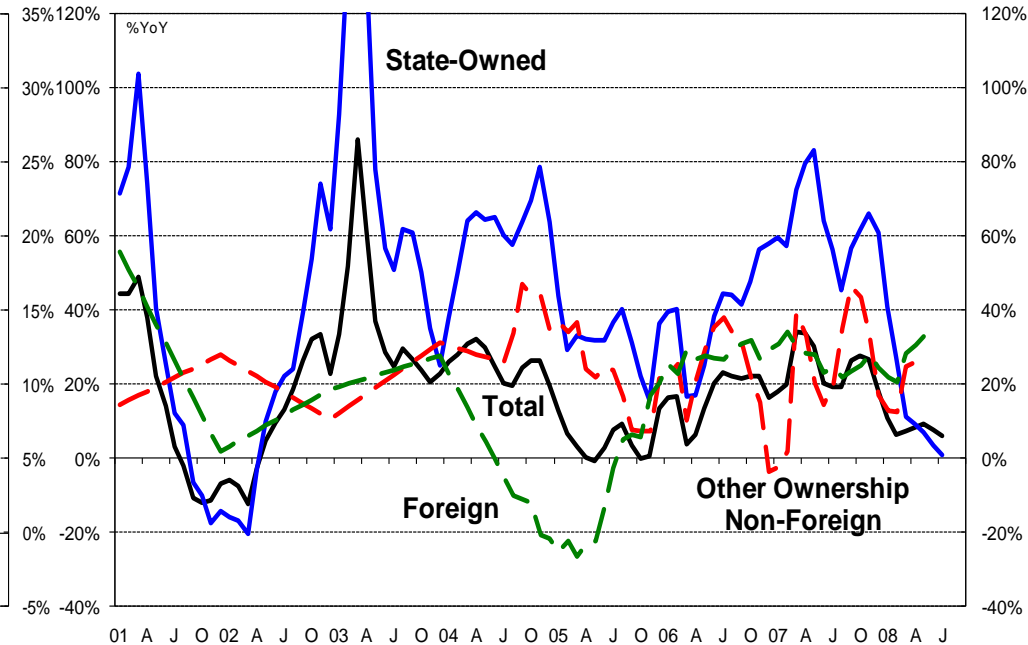


**Credit has been tightened and real investment growth and profits have slowed accordingly. Minimally levered consumers have been less affected**

**China Real Retail Sales and Fixed Asset Investment Growth**

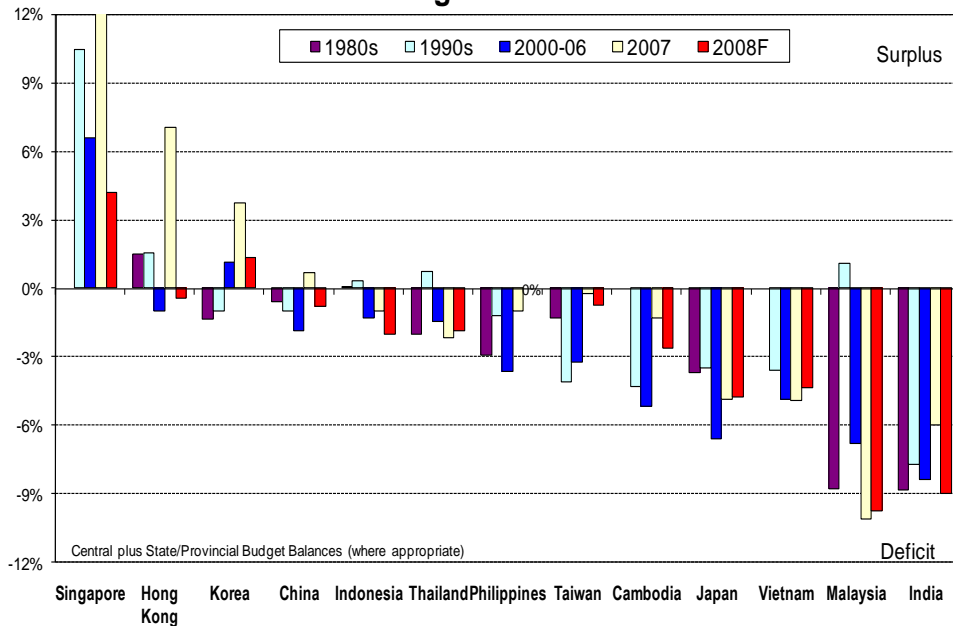


**China: Profit Growth per Enterprise by Type of Ownership**

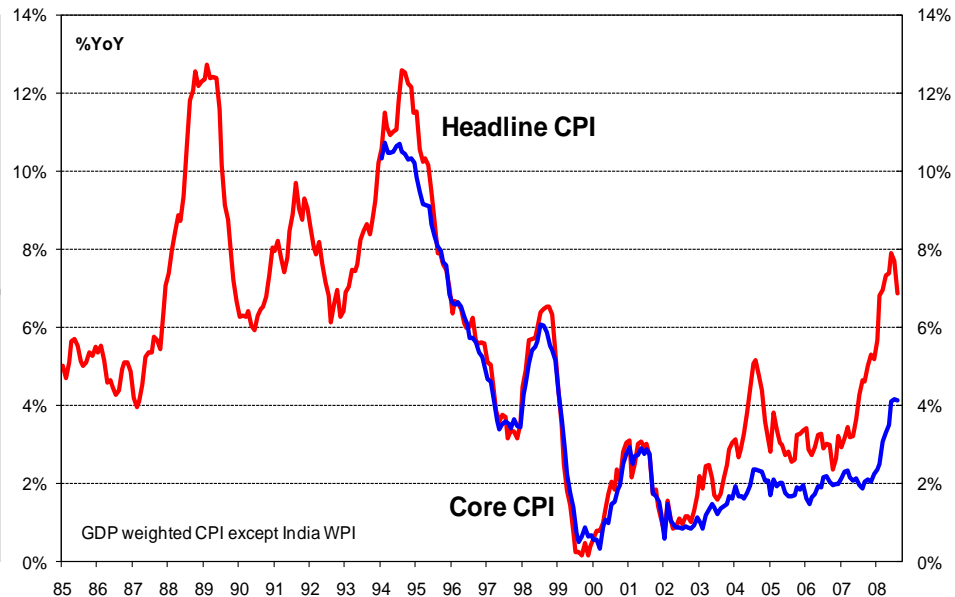


# Budgets are generally strong but inflation and food/oil subsidisation have restricted monetary and fiscal policy options. These restraints are easing

Government Budget Balances as a % of GDP

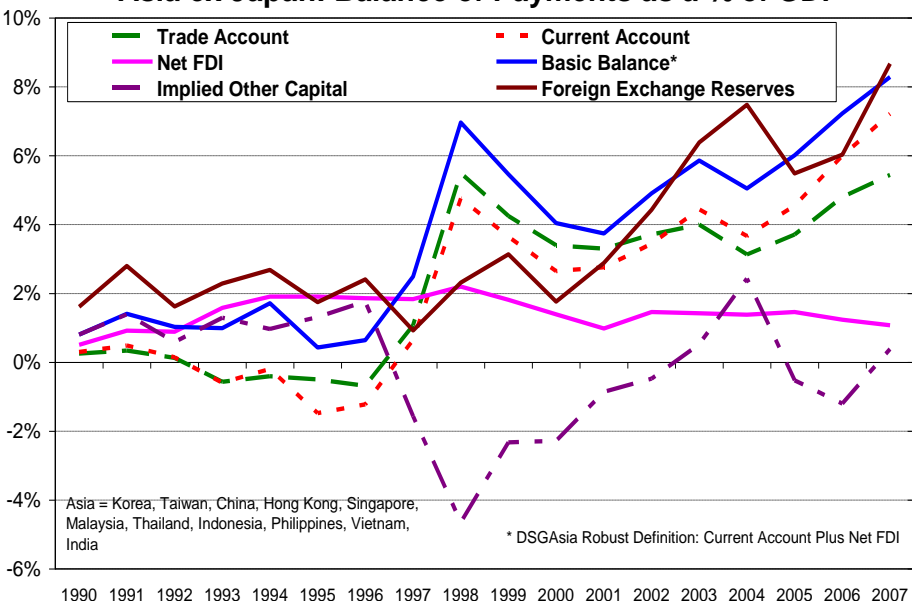


Non-Japan Asia Headline and Core Inflation

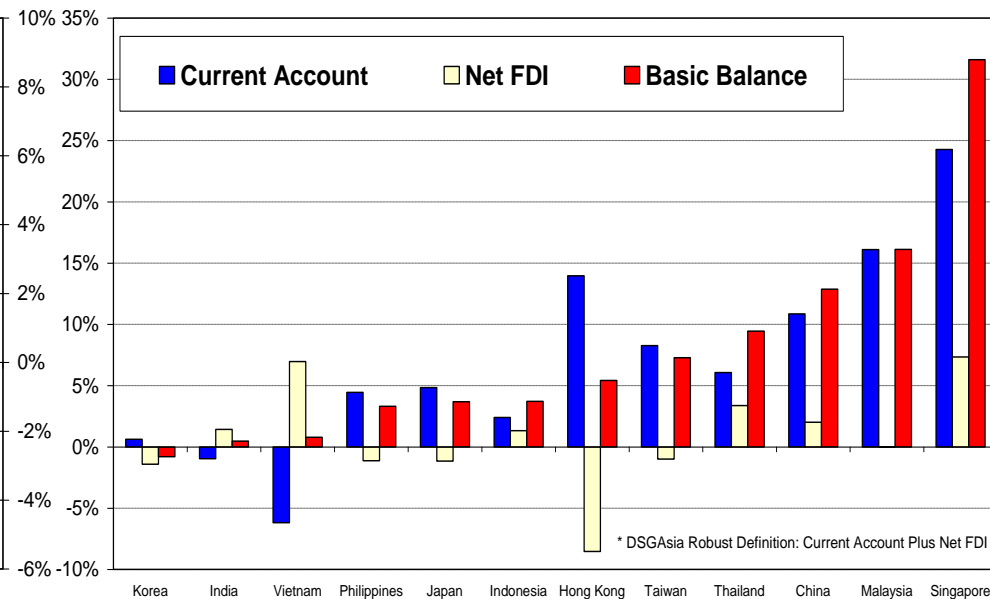


# Balance of Payments are largely in rude health. The region is facing a nasty growth slowdown but there will be no repeat of the late-90s Crisis

**Asia ex Japan: Balance of Payments as a % of GDP**

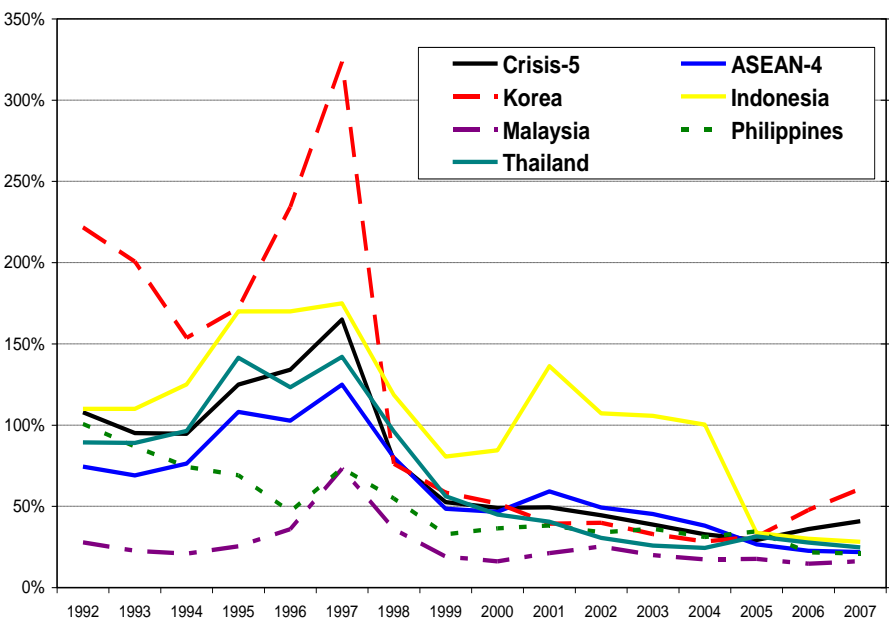


**Basic Balance\* Decomposition as a % of GDP, 2007**

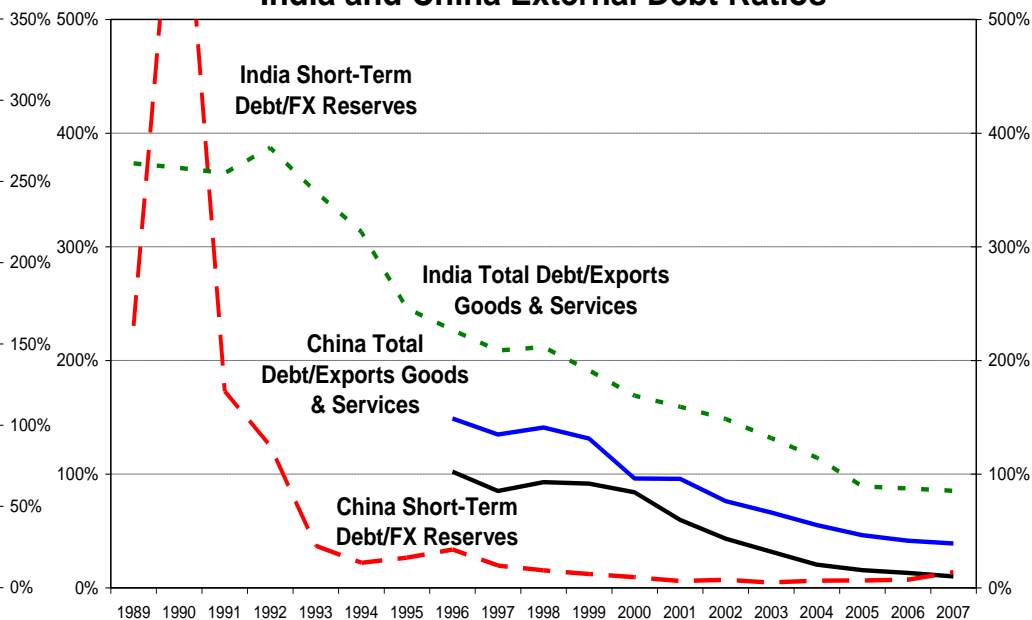


**The additional good news is that this time round debts have generally been sourced domestically and foreign borrowings have been largely long-dated**

**Short-Term External Debt as a Percentage of Foreign Exchange Reserves**

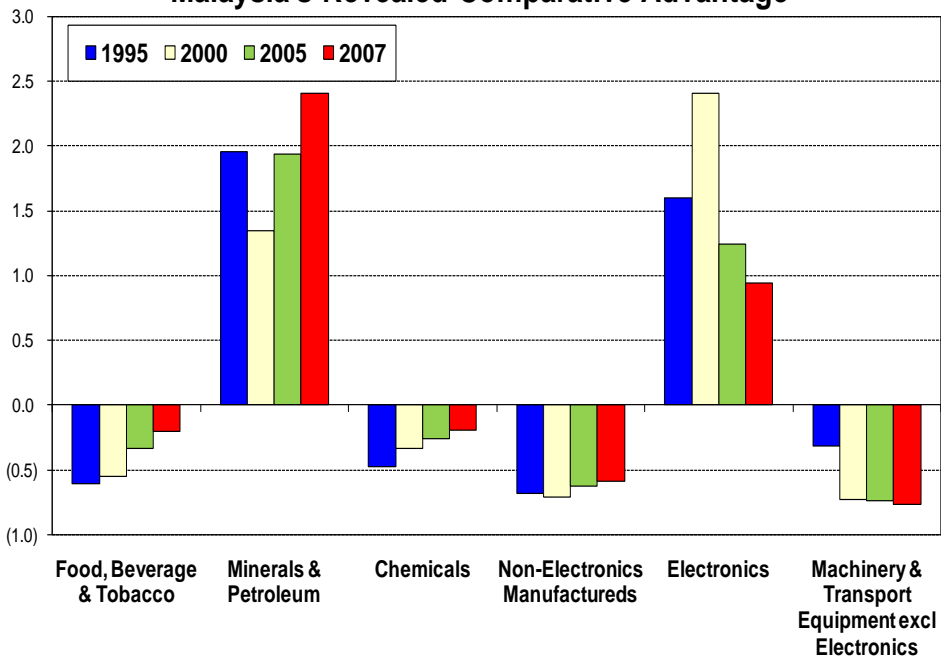


**India and China External Debt Ratios**

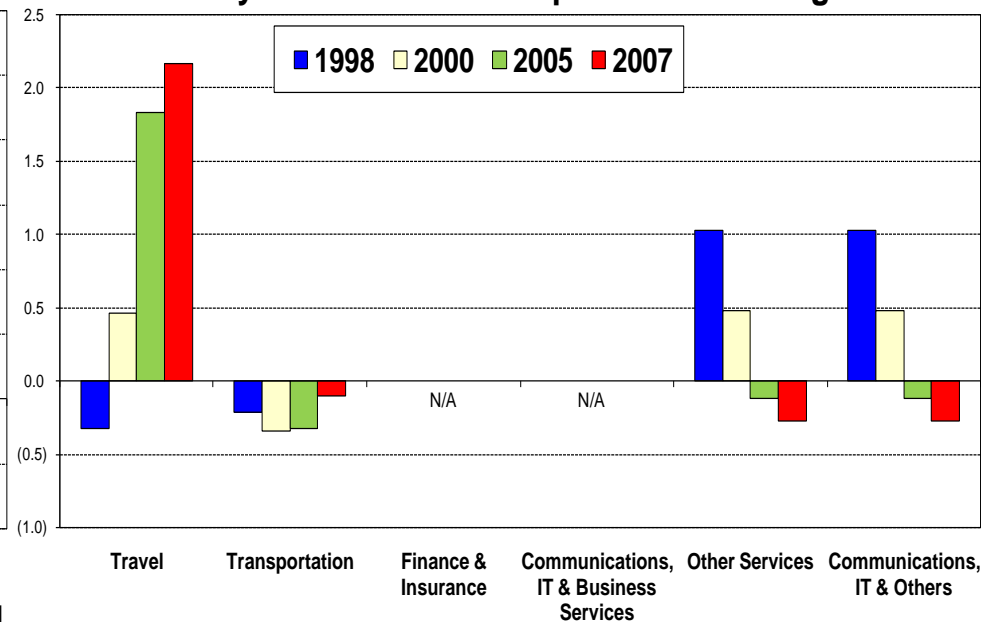


# Malaysia's Comparative Advantages Continue to Shift

Malaysia's Revealed Comparative Advantage



Malaysia's Revealed Comparative Advantage



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# Conclusions

- **The global credit Ponzi scheme is finally unwinding. The Fed is trying to pump things up one more time but sentiment bounces aside, the damage may be irreparable in a free market context**
- **Even after recent swoons, risk remains widely mispriced. Capital destruction and global output losses are still materially underestimated. The RTC concept reduces systemic risk but more will be needed**
- **At least the US now broadly understands just how bad the problem is. Europe is sleepwalking towards disaster while China is, understandably, keeping things relatively tight.... for now**
- **This was all inconsistent with continued rises in commodity prices. The structural bull story remains valid but as global demand slows further so industrial resource and energy prices should continue to come off their highs**
- **As commodity prices fall back, Asia's flirtation with stagflation will recede. Growth is still going to slow sharply but at least lower inflation allows room again for monetary and fiscal policy responses**
- **In the West, inflationary concerns are quickly going to give way to renewed deflation fears. It will be the subsequent reflation attempts that will ultimately undermine fiat money systems**
- **Commodity noise aside, gold will therefore further appreciate against a fiat currency basket. With dollar-euro turning, Beijing will continue to resist any meaningful TWI rise which will constrain the actions of its neighbours**
- **Asia's fundamentals are generally sound. Gearing and exposure to toxic credit and carry trades is low. FX and equity valuations are not desperately compelling but neither are they excessive**
- **Although the region cannot decouple from slower developed world demand, domestic balance sheet and balance of payments strength should permit "second-round" decoupling**
- **This all assumes that policy makers in America and Europe embrace a comprehensive approach to heading off complete financial sector meltdown and thus a re-run of the Great Depression. It is a worryingly big assumption!**

