

Outlook for Asia

AGF Asian Growth Strategy, AGF Asset Management Asia Ltd.

Heightened market volatility raises concerns

The global economic growth outlook has softened with the U.S. economy as the sole engine of growth amidst a lackluster recovery in both Japan and the Eurozone. China, the region's major trading partner, continues to see declining momentum as the economy undergoes a difficult transition from investment-led to consumption-led growth. Consequently, both trade-dependent economies and commodity exporters in the region face a challenging outlook. Coupled with uncertainty over U.S. interest rate policy, the Asian markets have deteriorated in recent months.

GDP growth forecasts (%)

| | 2014 Actual | 2015 Forecast | 2016 Forecast |
|-------------|----------------|------------------|------------------|
| Asia* | 6.3 | 5.9 | 6.0 |
| China | 7.3 | 6.9 | 6.5 |
| Hong Kong | 2.5 | 3.1 | 2.5 |
| India** | 7.3 | 7.4 | 7.4 |
| Indonesia | 5.0 | 4.8 | 5.4 |
| Malaysia | 6.0 | 4.9 | 4.7 |
| Philippines | 6.1 | 5.8 | 6.0 |
| Singapore | 3.0 | 2.1 | 2.5 |
| South Korea | 3.3 | 2.5 | 3.0 |
| Taiwan | 3.7 | 1.5 | 2.5 |
| Thailand | 0.9 | 2.7 | 3.5 |
| Vietnam | 6.0 | 6.3 | 6.3 |

Source: Bloomberg as of November 17, 2015. Note: *Asia includes China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam. **India's fiscal year runs from April-March.

Not all doom and gloom; green shoots emerging

Despite the market turmoil, we believe Asian market fundamentals remain sound. While the regional economies remain vulnerable to the anemic global trade, weaker Asian currencies have increased Asia's global competitiveness. In fact, September trade figures from Singapore and Malaysia showed that exports have rebounded and surpassed expectations, due in part to favourable exchange rates. There is also ample room for monetary easing in most Asian countries within the current disinflationary environment and still high real interest rates. In recent months, China, Taiwan and India have all cut their interest rates. Into 2016, the effects of these interest rate cuts and fiscal stimulus should begin to be felt in the region, particularly in China.

Policy rate trend by country (%)

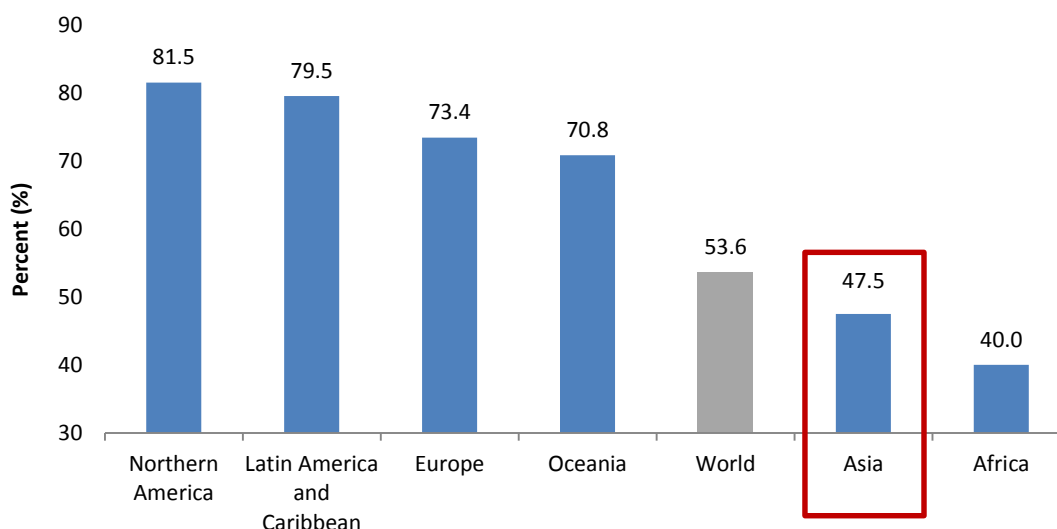
| Country | | 4Q14 | 1Q15 | 2Q15 | 3Q15 | Current | Last Change |
|-------------|-------------------|------|------|------|------|---------|---------------------|
| China | 1-Yr Lending rate | 5.60 | 5.35 | 4.85 | 4.60 | 4.35 | 26 Oct 15 (-25bp) |
| Hong Kong | Base | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 17 Dec 08 (-100bp) |
| India | Repo rate | 7.00 | 6.50 | 6.25 | 5.75 | 5.75 | 29 Sep 15 (-50bp) |
| Indonesia | BI rate | 7.75 | 7.50 | 7.50 | 7.50 | 7.50 | 17 Feb 15 (-25bp) |
| Korea | O/N call rate | 2.00 | 1.75 | 1.50 | 1.50 | 1.50 | 11 Jun 15 (-25bp) |
| Malaysia | O/N call rate | 3.25 | 3.25 | 3.25 | 3.25 | 3.25 | 10 Jul 14 (+25bp) |
| Philippines | Reverse repo rate | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 11 Sep 14 (+25bp) |
| Taiwan | Rediscount rate | 1.88 | 1.88 | 1.88 | 1.75 | 1.75 | 24 Sep 15 (-12.5bp) |
| Thailand | 1-day repo rate | 2.00 | 1.75 | 1.50 | 1.50 | 1.50 | 29 Apr 15 (-25bp) |

Source: Bloomberg

Positive long-term growth prospects

Over the longer term, positive demographics and indicators such as high savings rates, rising disposable incomes and increasing infrastructure spending remain supportive of growth for the region. According to 2014 statistics from the United Nations Department of Economic and Social Affairs, Asia is the second-least urbanized region of the world, with only 47.5% of the population living in urban areas. However, it has the second-fastest rate of urban population growth of 2.5% per annum over 2010-2015. From now until 2020, Asia is expected to maintain its urbanization trend at an average annual growth of 2.1%. Given that rapid economic growth is closely linked with urbanization levels, prospects for the Asian markets remain largely positive.

Percentage of population residing in urban areas in 2014 (%)



Source: United Nations, Department of Economic and Social Affairs

Government spending and stimulus to prop up growth

In the first half of the year, several governments, particularly those in South East Asia, have not met their infrastructure spending targets needed to raise economic output and productive capacity. However, recent data points suggest that there was a marked pick-up in infrastructure spending in Malaysia and Indonesia.

Over the past two months, the Indonesian government also announced six economic stimulus packages as well as its intention to reduce the corporate income tax rate from 25% to 18% in a bid to boost the economy. In Thailand, stimulus measures were launched recently for small and medium-sized enterprises and the property sector.

Benefitting from trade agreements

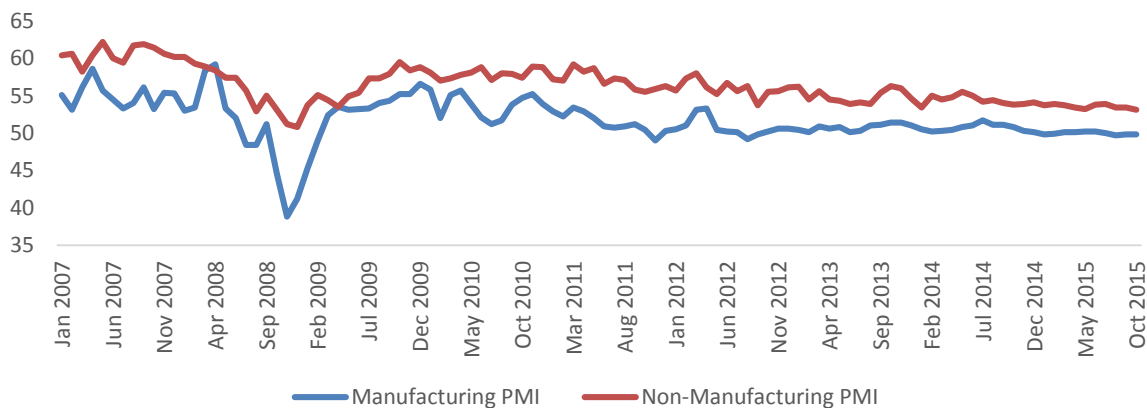
On October 5, 2015, the Trans-Pacific Partnership (TPP) agreement was finally reached between the U.S. and its Pacific Rim trade allies, including Japan, Singapore and Malaysia. The agreement, which needs to be ratified by the 12 individual countries, will account for 40% of global output and should, over time, reduce trade barriers and enhance growth for the region, especially less developed members like Vietnam and Malaysia. Other initiatives such as the ASEAN Economic Community and China’s Silk Road should also benefit the region over the long term.

OUTLOOK FOR CHINA

Experiencing broad-based weakness

Almost all recent economic indicators have pointed to a continued slowdown in growth. Fixed-asset investment growth softened progressively to only 10.9% year-on-year growth in August 2015 from 16.1% in September last year. Retail sales growth also slowed to a five-year low of 10.0% year-on-year in April before recovering slightly to 10.8% in August. The manufacturing Purchasing Managers’ Index (PMI) struggled to stay above the neutral 50 mark for most of 2015 as Chinese factories have responded more slowly to stimulus, partly due to weak external demand. Reflecting sluggish demand, Chinese exports for July and August showed a year-on-year contraction of 8.3% and 5.5%, respectively (in U.S.-dollar terms).

Resilient service sector helps to cushion the slowdown in manufacturing



Source: Bloomberg. Monthly data from January 31, 2007 to October 31, 2015.

Government intervention to stimulate growth

To boost growth, the People's Bank of China (PBoC) further loosened monetary policy by cutting the benchmark one-year lending rate by 25 basis points in October, the sixth cut in the current cycle. The PBoC also cut the reserve requirement ratio for large banks by 50 basis points and removed the deposit rate ceiling, accomplishing interest rate liberalization. On the fiscal side, NDRC, the government planning agency, stepped up the approval process of a number of infrastructure projects and made funding more readily available. After lifting housing purchase restrictions nationwide except for the four tier-1 cities over the last 12 months, the authorities have also reduced down payment requirements on mortgages for both first and second home buyers. To stimulate consumption, the government has also recently cut the purchase tax on small cars from 10% to 5%.

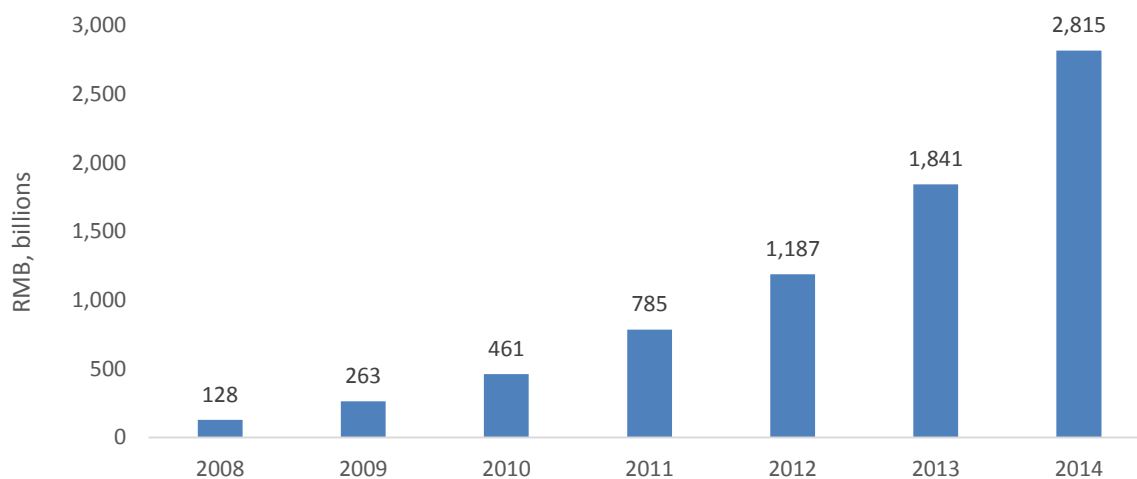
Economic reforms and policy measures in place

In September, the central government issued a framework document on deepening reforms for state-owned enterprises (SOEs). The aim is to improve the competence of SOEs, enhance management of state assets, promote mixed ownership and prevent the erosion of state assets. The government also took positive steps in the management of local government debt. The size of the local government debt swap scheme for 2015 was raised twice from RMB1 trillion to RMB3.2 trillion in August. This debt swap scheme is expected to help avoid a potentially damaging local government debt default and reduce shadow banking distress. With the government taking more aggressive policy measures, we expect China's economy to show signs of stabilization in the coming months.

Consumption-led growth coming into fruition

The ongoing rebalancing of the Chinese economy from investment led to consumption led has started to bear fruit and will increase the economy's self-reliance and therefore resilience in the long term. In our view, the booming Internet industry in China is set to help accelerate this transition.

Gross merchandise volume of China's e-commerce market



Source: iResearch, Bloomberg, November 17, 2015

According to iResearch, gross merchandise volume (GMV) of China's e-commerce market totaled RMB2.8 trillion in 2014, which represents a 67.3% compound annual growth rate (CAGR) between 2008 and 2014.

The strong growth in GMV continued into 2015. On China's Singles' Day, an annual online shopping spree held on November 11, Alibaba Group, China's largest e-commerce company, recorded a total GMV of RMB91.2 billion (USD14.3 billion), up about 60% year-on-year from last year's RMB57.1 billion. To put this in perspective, the strong Singles' Day sales of Alibaba Group this year were more than double the total e-commerce sales from Thanksgiving, Black Friday and Cyber Monday combined. This is encouraging as it highlights the strong consumption potential of Chinese consumers.

Well-positioned for recovery and growth

Historically, the markets have been over-aggressive in anticipating interest rate hikes, and may see a reprieve should the U.S. Federal Reserve Board's actions turn out more dovish. With the sharp sell-off in Asian equities and currencies in the third quarter of 2015, we believe that a lot of the negative news has now been priced in. On a trailing price-to-book (P/B) basis, Asia ex-Japan reached a low of 1.2x, close to the lows of 1.1x seen during the global financial crisis in 2009, before rebounding to 1.3x with the rebound in markets in October.

MSCI Asia ex-Japan P/B



Source: Bloomberg

CONCLUSION

Overall, we remain optimistic on the secular rise in Chinese consumer demand and the strong economic activity in the region. We believe we are strategically aligned to capitalize on the recovery and long-term growth potential in the Asian economies given our overweight position in China and consumption plays. In addition, Internet companies look poised to benefit from the e-commerce boom and rise in online advertising.

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