

Capital Flows Back to U.S. as Markets Slump Across Asia: Economy
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By Shamim Adam and Kevin Hamlin

Aug. 20 (Bloomberg) -- Asia's role as the world's growth engine is waning as economies across the region weaken and investors pull out billions of dollars.

The Indian rupee fell to a record low today, Thailand is in recession and Indonesian stocks have slumped about 20 percent since their peak. Chinese banks' bad loans are rising and economists forecast Malaysia will post its second straight quarter of sub-5 percent growth this week.

The clouds forming in Asia as liquidity tightens and China's slowdown curbs demand for commodities and goods are fueling a selloff of emerging-market stocks, reversing a flow of money into the region in favor of nascent recoveries in the U.S. and Europe. Emerging markets from Brazil to Indonesia have raised borrowing costs in 2013 to try to aid their currencies as the prospect of reduced U.S. monetary stimulus curbs demand for assets in developing nations.

"The eye of the storm is directly above emerging markets now, two years after it hovered over Europe and four years after it hit the U.S.," said Stephen Jen, co-founder of hedge fund SLJ Macro Partners LLP in London and former head of foreign-exchange strategy at Morgan Stanley. "This could be serious for Asia."

Of the \$155.6 billion investors poured into developed-market equity exchange-traded products in the first seven months this year, North American funds received \$102.4 billion or 65.8 percent, according to BlackRock Investment Institute. Japan attracted a record \$28 billion, while Europe-focused funds got \$4.3 billion. In contrast, \$7.6 billion flowed out of emerging-market funds.

Swinging Back

"The pendulum is swinging back in favor of the advanced countries," said Shane Oliver, Sydney-based head of investment strategy at AMP Capital Investors Ltd., which oversees about \$130 billion. "It's one of these things that happens once a decade or so when you see a turn in relative performance. We've entered a tougher, more difficult period" for Asia.

The IMF in July cut its forecast for growth this year in developing Asia by 0.3 percentage point to 6.9 percent.

In the past three months the MSCI Asia Pacific Index has fallen 9 percent, compared with a 1.2 percent decline in the Standard & Poor's 500 Index and a 2.4 percent drop in the Stoxx

Europe 600 Index. Signs of a stronger U.S. economy may prompt the Federal Reserve to begin paring its \$85 billion in monthly bond purchases as soon as next month.

India's benchmark stock index is down more than 5 percent in the past week and Thailand has fallen more than 6 percent. Indonesia's Jakarta Composite Index lost 10 percent in that period and is down about 20 percent since its close on May 20.

Rupee Plunge

Indian policy makers led by Prime Minister Manmohan Singh are battling to stem the rupee's plunge, attract capital flows to bridge a record current account deficit and revive growth. The currency has weakened about 28 percent versus the dollar in the past two years, reviving memories of the early 1990s crisis, when the government received an International Monetary Fund loan as foreign reserves waned.

"It seems now the pain is going to be in the emerging markets," said Nitin Mathur, an analyst in Mumbai at Espirito Santo Investment Bank who expects sectors with higher valuations such as consumer goods to suffer the biggest declines. "The problems in India are not temporary blips. The problems are much more serious which will take a lot of effort to get resolved."

In Thailand, the economy entered recession last quarter for the first time since the global financial crisis. Toyota Motor Corp. said last month industrywide car sales in Thailand will fall 9.5 percent this year. The government cut its 2013 growth forecast yesterday as exports cooled and local demand weakened, with higher household debt restricting scope for monetary easing.

Thai Credit

Thailand's private-sector credit as a share of gross domestic product has "increased significantly" in recent years raising concern about financial stability, Krystal Tan, an economist at Capital Economics Ltd. in Singapore, said in a Bloomberg Brief commentary.

Taiwan last week cut its 2013 growth and exports forecasts and said the global outlook for the second half is worse than in May. The island's export orders unexpectedly rose for the first time in six months in July, the government said today.

"We are seeing a turning point," said Freya Beamish, Hong Kong-based economist with Lombard Street Research, who says China's competitiveness has been hurt by labor costs that are 30 percent too high. "China's seeing flat to falling growth on our estimates so the region's clouds are already here."

Sentiment is also being subdued by the prospect of a decline in U.S. stimulus, money that often finds its way to

export-based countries in payment for goods.

Seeking Clues

Investors will be looking for clues on how quickly the U.S. Federal Reserve will trim its \$85 billion in monthly asset purchases when the Federal Open Market Committee's July meeting minutes are released on Aug. 21.

The \$3.9 trillion of cash that flowed into emerging markets over the past four years has started to reverse since Chairman Ben S. Bernanke talked about a tapering in quantitative easing this year. The slowdown in Fed bond buying will probably begin next month, according to 65 percent of economists surveyed by Bloomberg from Aug. 9-13.

The JPMorgan Emerging Markets Currency Index has declined 3.2 percent since Bernanke's June 19 tapering comment. The Bloomberg Dollar Index, which monitors the greenback against 10 major currencies, is up about 1 percent over the same period.

"The emerging Asia story is crumbling and dollar is once again the king," said Indranil Pan, chief economist at Kotak Mahindra Bank Ltd. in Mumbai.

Gold Imports

India's moves to tighten cash supply, restrict currency derivatives and curb gold imports since July failed to arrest the rupee's slump to a record low of 64.12 per dollar during trading today. UBS AG says a drop to 70 is possible.

The deficit widened to an unprecedented 4.8 percent of GDP in the year ended March 31. The government plans to narrow the gap to 3.7 percent, or \$70 billion, this year, Finance Minister Palaniappan Chidambaram said Aug. 12.

India's slump is worse than elsewhere in Asia because the country has failed to carry out long-overdue structural changes to the economy, said Pan at Kotak Mahindra Bank.

"In India, we have great policies on paper but the gap between the what's on paper and the implementation is unduly large," R.C. Bhargava, chairman of Maruti Suzuki India Ltd., the nation's biggest carmaker by volume, said in an interview.

"If we just implement what's already there, we can get back on track in the next two to three years."

Too Optimistic

Richard Jerram, chief economist at Bank of Singapore Ltd., says the market declines reflect overly ambitious expectations rather than fundamental weakness in the economies.

"There's a good structural story based on the underlying

domestic demand,” said Jerram, who has analyzed Asian economies for two decades. “What you see at the moment is reaction from expectations being unrealistically positive maybe 12 months ago, to now becoming more realistic.”

One bright spot is Japan, which has seen its economy bounce back on Prime Minister Shinzo Abe’s fiscal and monetary stimulus.

The Topix stocks index has risen 31 percent this year.

Abe has yet to show that he can sustain the recovery by restructuring company and labor laws and taming the nation’s debt, which topped 1 quadrillion yen (\$10 trillion) in June.

“Asia still has potential in the next three years or more, but in the shorter term, momentum for business is slowing down,” said Shuichi Hirukawa, senior fund manager at Mizuho Asset Management Co. in Tokyo. “Investors may become more cautious.”

China Signs

China’s economy last quarter extended the longest streak of expansion below 8 percent in at least two decades, curbing earnings at companies such as Hong Kong-based Cathay Pacific Airways Ltd. Still, there are signs of improvement. Industrial output rose more than economists estimated in July, after larger-than-forecast rebounds in exports and imports and improvement in gauges of manufacturing and service industries. China is making efforts to bolster confidence. Overall liquidity in China is ample as banks channel more funds to agriculture and small businesses in the world’s second-largest economy, People’s Bank of China Governor Zhou Xiaochuan said on state broadcaster China Central Television yesterday.

“Some Asian countries, especially India, have their own significant domestic challenges,” said Jim O’Neill, the former Goldman Sachs Group Inc. economist who coined the term BRIC in 2001 to describe Brazil, Russia, India and China. “But China is slowing primarily to improve its growth model and at 7-7.5 percent annual growth is still delivering \$1 trillion nominal GDP. And Japan, still Asia’s No. 2 economy, is looking better than it has done for a very long time.”

‘Very Global’

The slowdown in economies such as Indonesia and Thailand is part of a “very, very global” weakness, World Bank Chief Economist Kaushik Basu told reporters in New Delhi yesterday.

The U.S. recovery “was so slow that even the slightest pick up is looking like a pick up,” Basu said. “I don’t think the Asian situation is any worse. In fact, if anything, Asia is probably better off than the rest of the world.”

That may not help markets in Asia as money continues to flow back to Europe and the U.S., said Oliver at AMP Capital. Norway said today its economy expanded in the second quarter after a contraction in the previous three months. The Federal Reserve Bank of Chicago will release a report on U.S. economic activity for July.

“Asia will still be a stronger part of the world than the U.S. or Europe but compared to people’s expectations Asia is likely to come in a little bit lower than expected,” he said. The IMF in July forecast global growth of 3.1 percent and projected advanced economies would expand 1.2 percent this year.

Stocks Opportunity

“We see this drop as an opportunity to buy selectively those stocks that have been overpriced” such as banks and consumer shares, Kiekie Boenawan, Jakarta-based head of investment at PT Schroder Investment Management Indonesia, wrote in an e-mail yesterday.

Investors will be scanning data from Chinese factories to Malaysian growth this week for further signs of weakness.

An Aug. 22 flash reading for China on a manufacturing purchasing managers’ index by HSBC Holdings Plc and Markit Economics is expected to come in at 48.2 for August, from 47.7 in July, according to the median economist estimate compiled by Bloomberg. A reading below 50 indicates contraction.

Malaysia’s central bank on Aug. 21 may post data showing 4.7 percent economic growth in the second quarter from a year earlier, after rising 4.1 percent in the January-March period, its slowest rate since September 2009, according to the median estimate of economists in a Bloomberg survey.

Brazil’s Real

Slumping currencies and inflation risks in emerging markets are adding to pressure on central banks to raise interest rates. Brazil increased its benchmark rate this year more than any major economy to prevent higher prices from slowing consumption and investments. The real weakened beyond 2.4 per dollar for the first time in four years yesterday. Indonesia’s rupiah touched 10,728 today, its weakest level since April 2009.

Higher rates in turn would hit consumers in countries where cheap mortgages and easy credit have fueled housing booms. “Southeast Asian consumers have taken on much higher debt in the last few years,” Royal Bank of Scotland Group Plc analyst Sanjay Mathur wrote in a July 18 report. He said the largest increase was in Malaysia, where household debt increased by 20 percent of GDP between 2008 and 2012.

There's a feeling that "the rest of the world's getting a bit better and Asean's had its sort of burst of credit-enhanced growth," said Edward Teather, an economist at UBS AG who covers Southeast Asian markets from Singapore. "It's raining already."

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