



# HOUSEVIEW

## Global Economic Outlook

### World

- The global economy was slowing before the failure of Lehman Brothers. The US, European and Japanese economies had all exhibited clear signs of weakness, and contagion to emerging economies was next. The financial crisis has not caused an economic crisis – it has exacerbated a pre-existing condition.
- For this crisis the questions are – how long and how deep will the contraction be? What we know is that all leading indicators are still turning down and the phenomenon is globally synchronised.
- The financial crisis is likely the worst since WWII. But the nadir has probably passed – the avalanche of co-ordinated public monies and measures have started to return some life to money and credit markets.

### United States

- Two quarters of negative real GDP growth probably constitutes a “shallow recession”. This cycle, which must also cope with a financial crisis as well, has the prospect of at least three consecutive quarters of negative real GDP growth.
- The recession will be similar to the 1973-75 and 1981-2 downturns.
- Household net worth is estimated to have declined a massive \$US7.4 trillion between 2Q07 and the end of 2008. This will be by far the greatest drop (even in percentage terms) than any postwar downturn. This will cause the household savings rate to rise decisively higher by the end of 2009.
- Consumption expenditure, the biggest single driver of the US economy, will be under duress despite the cushion of falling energy prices.
- The Fed may cut rates to zero if that were expected to have an impact.

### Europe

- The preoccupation of European central banks with inflation concerns dissipated as the downside risks to economic growth rapidly rose.
- With the financial crisis emerging as the dominant economic force and commodity prices collapsing, policy rates still have a long way to fall.
- Macroeconomic data continues to highlight downward momentum in the real economy. Labour markets have only just started to deteriorate; there has been a sharp fall in demand for exports despite a much more competitive currency.
- The ECB will need to continue to cut interest rates and waive the budget deficit constraints imposed by the Maastricht Agreement.

### Japan

- The economic outlook has deteriorated decisively over the past few weeks, suggesting this contraction will be as bad as the 1975 oil-shock recession.
- The government has acted by announcing a fiscal package amounting to 1% of GDP and the Bank of Japan has cut interest rates by 20 basis points.
- Interestingly the consensus among Japanese people is that while these measures may ease the severity of the downturn, the cause of the fundamental problem – a global financial crisis – was due to offshore drivers.

## Global Market Insights

### Equities

- There has been a retreat from equities as investors are haunted by multiple fears and uncertainties – concerns about the prospects for economic growth, corporate earnings and availability of credit. Risk aversion has risen to heights rarely seen before and the asset class suffered from what was aptly described as the biggest margin call in history.
- It is a trite understatement to observe that market sentiment is negative – indeed the greatest worry is that positive factors are so shrouded in fog. Be that as it may, there is strong empirical evidence that buying cheap equity markets, despite poor earnings, has been a particularly lucrative strategy.
- Historically profits and stock prices have decoupled from one another when valuations are cheap, inflation has begun to fall, interest rates have fallen significantly and once global lead indicators of economic growth have bottomed. We are moving in this direction.
- This is a bear market and even though a lot of bad news has been already priced into equity markets, we recommend neutral exposure international stocks.

### Who Said That?

*“Just as consumers used debt to buy “stuff” they wanted now, so did businesses, banks, and governments. It powered a huge global growth boom. The Great Unwind will have the opposite effect, softening demand and weakening spending and growth. What leveraging did for growth, deleveraging will take back.*

--- John Mauldin, Author and Columnist

## Bonds

- A recession, which impacts all countries around the globe, is in prospect. It will take a combination of aggressive monetary easing and vast “Keynsian” fiscal stimulus to prevent a protracted and deep economic contraction.
- However bond yields of medium to long duration, have not reacted to the deteriorating economic conditions as much as could be expected. In fact, there has been a sustained shift out of bonds (and equities) in to cash and near cash securities.
- One explanation is that investors expect stronger growth and higher inflation – if only this were a possibility! Another explanation is risk adversity - the volatility of longer duration securities is pushing investors, especially risk-conscious banks, into the short end of the yield curve.
- But the most enduring explanation is that the “Keynsian” fiscal stimulus will bring with it a level of issuance probably never seen before. In the US, as a percentage of GDP, the budget deficit in the coming fiscal year is expected to reach 8.2%, a full five percentage points above the current fiscal year shortfall. Total borrowing of the US government will most likely hit US\$1.725 trillion in fiscal year 2009, equivalent to 12% of GDP.
- We continue to recommend an underweight exposure to international bonds and a clear overweight of Cash.

## Returns

- October was a month of catastrophic falls in equity prices, with no place to hide. The only markets not to experience double digit losses were Finland and Switzerland.
- Japan and European bonds had a good month though Treasuries struggled. All major bond markets have managed positive returns year to date.

Equities Benchmark	October	Year-to-Date	12 Months
MSCI World (Local currency terms)	-16.37%	-35.39%	-38.66%
Bond Benchmark	October	Year-to-Date	12 Months
World Govt Bond Index (Local currency terms)	0.46%	3.32%	4.64%

## Asia Pacific Economic Outlook

### Overview

- Asia will remain the fastest growing region in the world. Even so it will not escape a severe slowdown.
- Trade linkages with the global economy will drag Asia into recession-like environment. Lost exports will weaken consumption and investment across the region.
- Central banks after several years of tightening, have begun to ease monetary policy, though the timing and magnitude has varied from country to country.
- A 1998-style financial meltdown looks unlikely as Asia’s banking and corporate sectors remain well capitalised. External positions, such as current accounts and foreign reserves are in much better condition.
- There will be divergence of economic performance – economies with large domestic markets or greater policy flexibility can maintain relatively strong growth.

### China

- China has abundant liquidity in its financial system and there is no credit freeze; all money markets, including interbank markets, are operating normally.
- Chinese policymakers are taking aggressive steps to prevent a significant or protracted decline of economic growth below trend – both fiscal and monetary.
- We expect real GDP growth to be between 7% and 8% in 2009.

### North Asia

- The economy is slowing rapidly in **Hong Kong** and the downturn in Q4 2008 could be particularly sharp. Distressed financial and weak property markets, bode poorly for employment and in turn consumption and investment.
- The Bank of **Korea** slashed rates to try to stimulate economic activity. The government instigated a number of measures to avert a currency crisis.
- The **Taiwan** economy has historically displayed a strong correlation to global business cycles – a below trend rate of GDP growth in 2009 should be expected.

### South Asia

- Policy officials in **India** have taken number of steps to ease liquidity constraints. Inflation has moderated significantly. Growth continues to moderate.
- Growth will slow in **Malaysia** as the economy responds to the global slowdown. Policymakers have room to manoeuvre on both monetary and fiscal policy.
- **Thailand’s** economy is highly export sensitive and will suffer the full brunt of the global slowdown. Political uncertainty may constrain effective fiscal spending.
- We expect sub-par growth in **The Philippines** in 2008. If inflation drops to single digits interest rates are likely to be cut to try to stave off a major slowdown in growth.

### Pacific

- Economic activity in **Australia** is slowing faster than expected. Further cuts in interest rates are most likely and further fiscal stimulation is expected.
- **New Zealand** interest rates remain high and the urgency to cut them increases. Lack of action will prolong its recession. Both these factors will put pressure on the NZ\$.

## Asia Pacific Market Insights

### Equities

- Markets have had a bounce after two months of attrition. However they will struggle to make much progress from here.
- Global growth is slowing sharply with Asian exports and earnings tumbling in the face of a US economy that is going to shrink. Risk remains at high levels as measured by the TED spread and credit default insurance.
- A key factor for the market outlook over the next few months will be how much corporate earnings disappoint. While 2008 numbers have been pruned to more sensible levels, 2009 earnings estimates still seem to be optimistic.
- Investors and analysts alike will spend the next 6-9 months figuring out quite how bad the downturn will be and what will be the impact on equity prices. During that time two themes will help investors survive – cashflow and dividend yield.
- The 12 month forward PE for MSCI Asia ex Japan got down to 7.0 times recently, as low as it has been in 15 years. But it would have been significantly higher if we were to be more realistic about 2009 earnings, perhaps as high as 12.0 times. If we valued markets on price to book-value(PBV), then we are at 1.3 times - PBV has been higher in 90% of the last 33 years. And the last time dividend yields were at these levels were 1998 and 1990. Valuations are equivocal at this point.
- We believe that it is too early to assume that the October market lows marked the end of the bear market and a new bull market has begun. Underweight Asian equities is recommended.

### Bonds

- Two longer term issues stand out in Asia: firstly, since the demand for its products will remain sluggish for some time, a reorientation of the region's economies will be required so that they become more self-reliant and growth is generated from domestic sources and secondly, most countries in the region enjoy excess savings and so are in a good position to generate investment funds locally.
- Clearly the focus of economic policy has moved to trying to sustain growth rather than to monitoring inflation. As well, regional central banks are pumping liquidity into systems to help ease strain in domestic money markets, and some governments offered blanket guarantees on bank deposits.
- Asian local currency bond markets will continue to be driven by flight to safety and more dovish central banks.
- The risks to markets include additional bond supply as fiscal pump priming occurs and a further deterioration in foreign investors appetite for risk.
- We recommend being neutral this asset class and being clearly overweight cash.

### Returns

- An impossible month for Asian stockmarkets. The region clearly underperformed the global benchmark. Its best market was Malaysia at -14.87%!

Equities Benchmark	October	Year-to-Date	12 Months
<b>MSCI Asia Pacific Ex Japan</b> (Local currency terms)	-21.73%	-49.04%	-53.09%

- Bond returns took on equity characteristics in October 2008! Returns were atrocious. The best market still incurred a negative return in the double digits - Singapore. Over 12 months bonds have clearly outperformed equities.

Bond Benchmark	October	Year-to-Date	12 Months
<b>JACI Composite Index</b> (USD terms)	-15.63%	-19.29%	-18.93%

Recommended Asset Exposures	
<b>International Equities</b>	Neutral
<b>Asian Equities</b>	Underweight
<b>International Bonds</b>	Underweight
<b>Asian Bonds</b>	Neutral
<b>Cash</b>	Overweight

	Key Drivers	Key Risks	Risk Rating
<b>World Economy</b>	<ul style="list-style-type: none"> <li>Deleveraging of consumer, financial and corporate sectors.</li> <li>Continued co-ordinated approach to the financial and economic crises.</li> </ul>	<ul style="list-style-type: none"> <li>US, Europe and Japan all decline into recession.</li> <li>Protectionism emerges.</li> </ul>	<p>High</p> <p>Low</p>
<b>Global Equities</b>	<ul style="list-style-type: none"> <li>Prospects for economic growth.</li> <li>Earnings growth and the extent of revisions.</li> </ul>	<ul style="list-style-type: none"> <li>Earnings downgrades surprise on the downside.</li> <li>Availability of credit diminishes.</li> </ul>	<p>High</p> <p>Medium</p>
<b>Global Bonds</b>	<ul style="list-style-type: none"> <li>Extent and pace of bond issuance.</li> <li>Interest rate cuts.</li> </ul>	<ul style="list-style-type: none"> <li>Government guaranteed bonds (from all sources) will crowd out non-governemnt guaranteed paper.</li> </ul>	<p>High</p>
<b>Asian Equities</b>	<ul style="list-style-type: none"> <li>Extent Asia is impacted by the global economic slowdown.</li> <li>International investors appetite for risk.</li> </ul>	<ul style="list-style-type: none"> <li>Earnings revisions surprise to the downside.</li> <li>Valuations fail to halt market slide.</li> </ul>	<p>High</p> <p>High</p>
<b>Asian Bonds</b>	<ul style="list-style-type: none"> <li>Foreign capital flows.</li> <li>Bond issuance to cover fiscal deficits.</li> </ul>	<ul style="list-style-type: none"> <li>Central banks cuts interest rates.</li> </ul>	<p>High</p>

## Key Forecasts

	Real GDP				Inflation				90 Day Interest Rates*		10 Year Bond Yields	
	2008E#	ING	2009E#	ING	2008E#	ING	2009E#	ING	Actual 31-Oct-08	ING Forecast For Next 3 Months	Actual 31-Oct-08	ING Forecast For Next 3 Months
<b>The World</b>	2.7	-	1.9	0	4.6	+	3.4	0				
<b>USA</b>	1.4	-	0.0	0	4.3	0	2.8	0	0.49	Steady	3.95	Steady
<b>Europe</b>	1.2	-	0.5	-	3.5	0	2.6	0	4.76	Lower	3.90	Steady
<b>Japan</b>	0.7	0	0.5	0	1.4	0	1	0	0.88	Steady	1.46	Steady
<b>Australia</b>	2.5	0	2.1	-	4.2	+	3.2	0	5.80	Lower	5.16	Lower
<b>China</b>	9.8	-	8.8	-	7.0	+	4.8	+	6.66	Lower	7.20	Lower
<b>Hong Kong</b>	4.0	-	3.1	-	4.7	0	4.3	0	3.34	Lower	2.37	Steady
<b>India</b>	7.3	-	7.2	-	7.8	+	6.6	0	7.05	Lower	7.45	Lower
<b>Indonesia</b>	5.9	0	5.3	0	10.5	+	8.2	0	8.67	Lower	17.30	Lower
<b>Malaysia</b>	5.5	-	4.5	-	5.8	0	4.1	0	3.66	Lower	4.35	Lower
<b>Philippines</b>	4.5	-	4.5	-	9.9	0	7.1	0	4.25	Lower	9.47	Lower
<b>Singapore</b>	3.0	0	2.4	0	6.4	0	3.0	0	3.09	Lower	2.94	Steady
<b>South Korea</b>	4.3	0	3.8	0	4.8	+	3.6	0	5.98	Lower	4.69	Lower
<b>Taiwan</b>	3.9	0	3.6	0	3.8	+	2.5	-	2.09	Steady	1.98	Steady
<b>Thailand</b>	4.8	-	4.2	-	6.5	+	3.7	+	3.99	Lower	3.77	Lower

Consensus Forecast, ING Bias ("+" Higher, "0" in line, "-" Lower than Consensus Forecast)

\* Australia 90 day BBSW Rate, Hong Kong Malaysia Singapore and Thailand 90 Day Interbank Rate, Indonesia Japan and Korea 90 day Deposit Rate, China 1 Year Loan, India 90 Day Treasury Bill and Taiwan 90 Day Commercial paper Secondary Mkt

# Asia Pacific Consensus Forecasts - Consensus Economics Inc.