

Can Asia Hold its Place at the Edge of the Global Abyss?

Asia - Inside the Global Economy
Asia Entrepreneurship Forum 2012

Macau

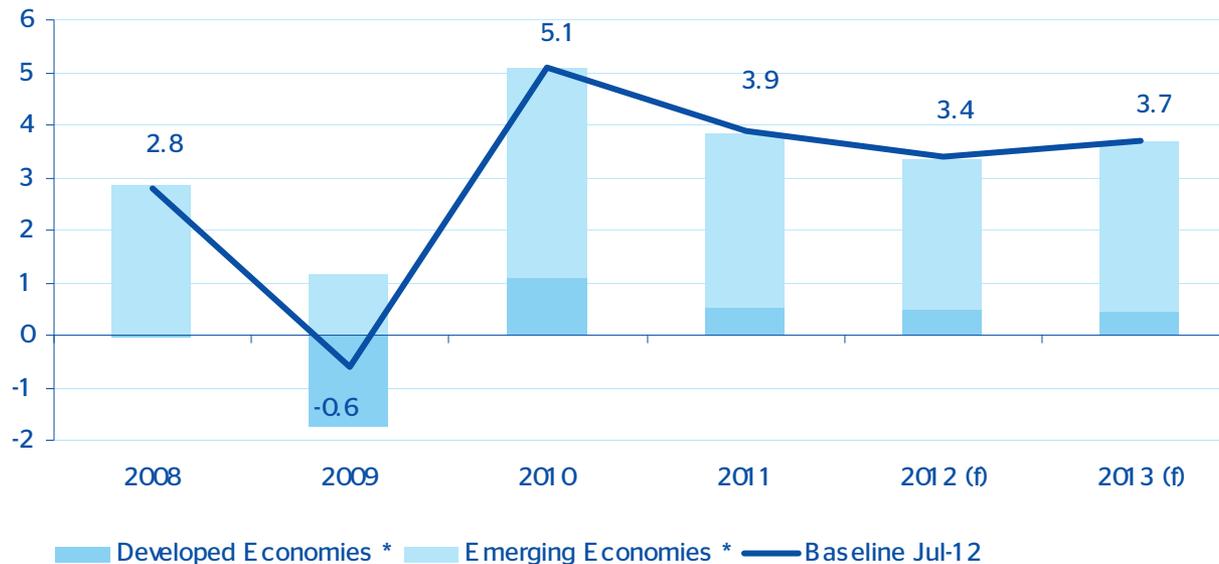
Alicia Garcia-Herrero
Chief Economist for Emerging Markets, BBVA
September 20, 2012

The global backdrop

- Global growth will recover gradually in 2013 with policy action in the US and Europe.
- Despite recent positive policy steps, downside risks to growth remain.
- Emerging economies are on track for a soft landing, buttressed by domestic demand and growth-supporting policies.

Global growth (%)

Source BBVA Research

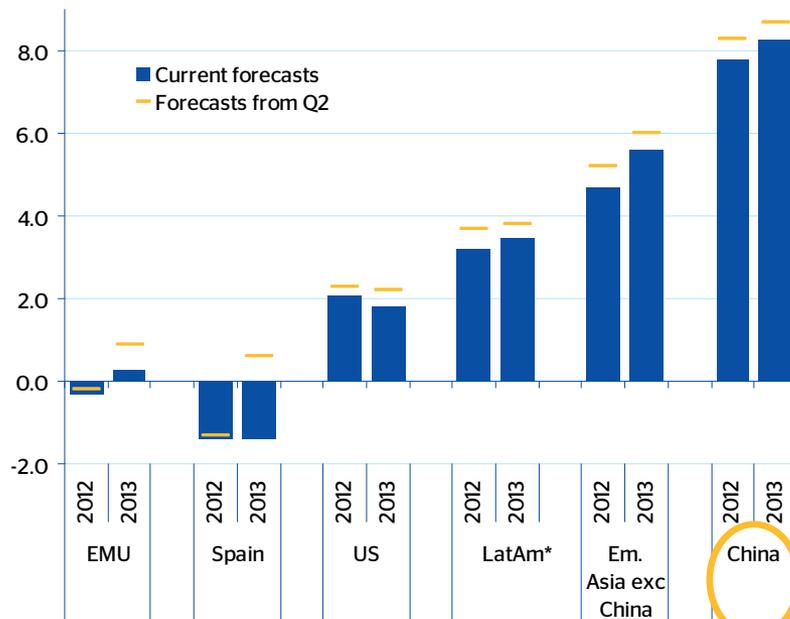


Asia still a growth engine, led by China

- Though slowing, emerging markets are still the engine of global growth, and Emerging Asia leads the pack
- The region's larger economies—China, India, and Indonesia—have propelled growth in recent years, with China accounting for around one-third of global growth
- Asia has strong fundamentals—solid fiscal positions, high reserves, and sound banking systems

GDP growth forecasts have been lowered...

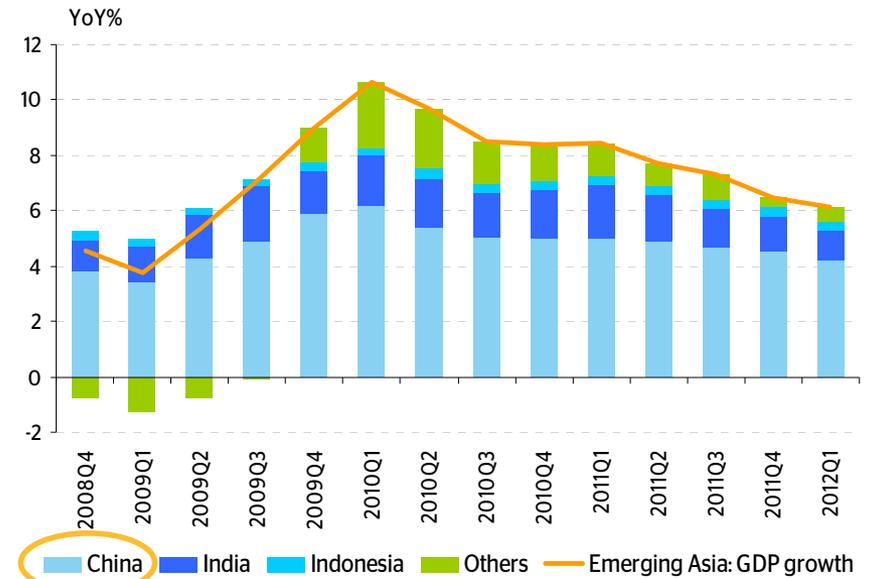
Source: CEIC and BBVA Research



* LatAm: Arg, Bra, Chi, Col, Mex, Per, Ven

...but Asian growth remains relatively high

Source: CEIC and BBVA Research

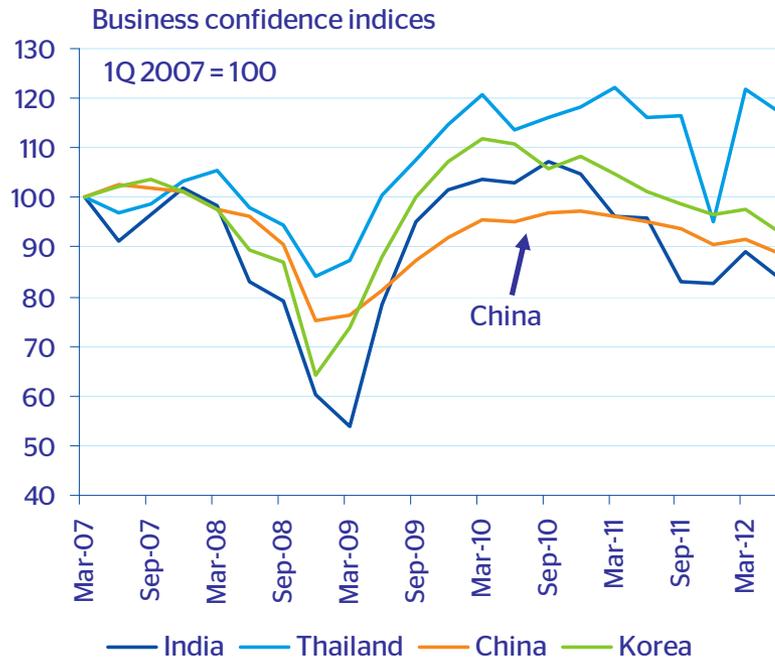


Asia's resilience is the buzzword

- Exports have slowed substantially and the outlook remains uncertain, resulting in falling business confidence
- However, the fallout has been limited, as utilization ratios show that Asia continues to operate near pre-crisis levels

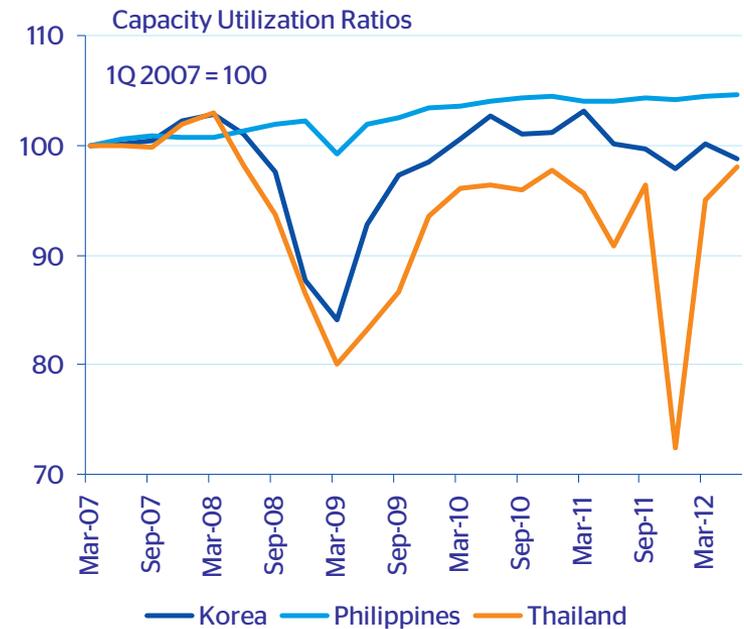
Business confidence has been falling...

Source: CEIC and BBVA Research



...though capacity utilization ratios remain near 2007 'pre-crisis' levels

Source: CEIC and BBVA Research

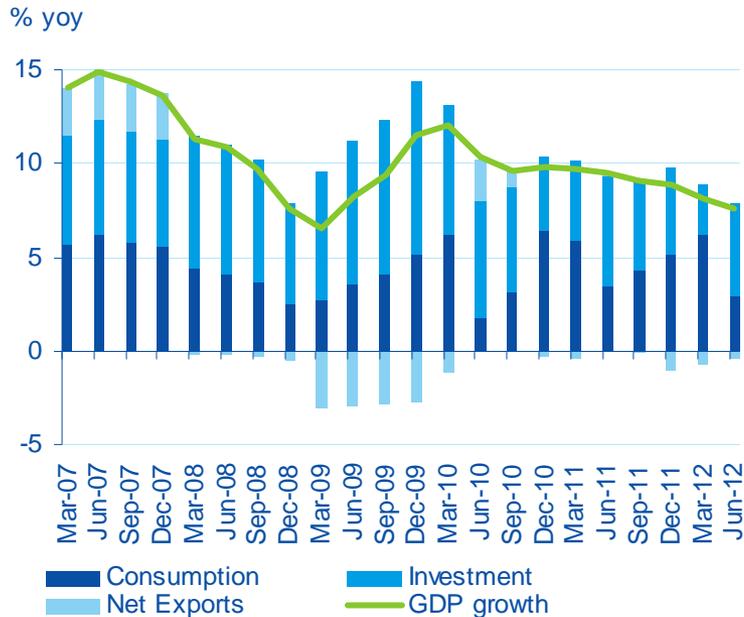


China is slowing, but moderately!

- Q2 growth slowed to 7.6% y/y, below previous expectations
- The contribution of net exports has been negative, offset by strong domestic demand (investment)
- PMI and activity indicators have continued to weaken in Q3

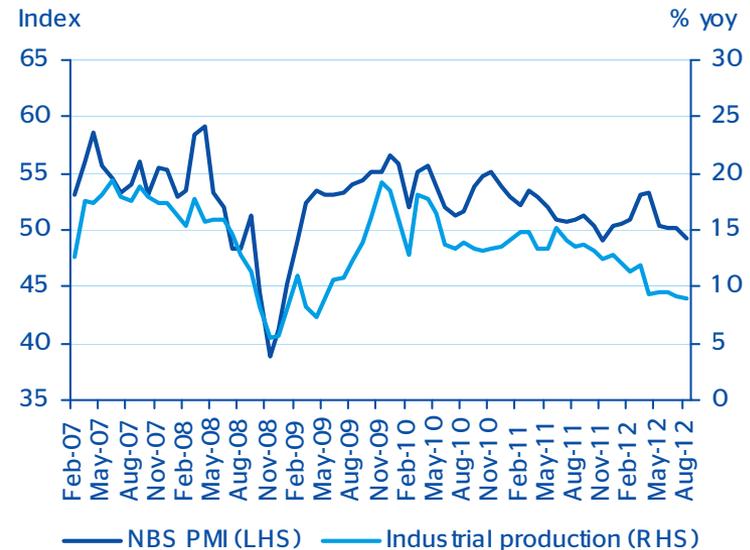
Q2 GDP growth fell to a three-year low

Source: NBS, CEIC and BBVA Research estimates



PMI and industrial production are continuing to weaken

Source: CEIC and BBVA Research

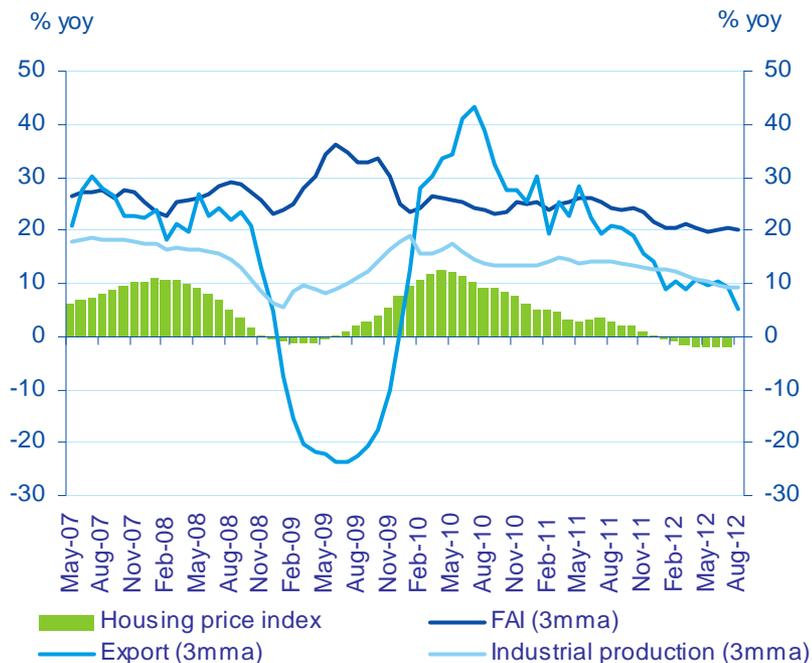


China: risk of a hard landing

Near-term risks are being addressed through stimulus policies to counter weakening external demand, and through measures to prevent a buildup of domestic financial fragilities. Medium-term risks remain.

Weakening economic indicators underscore downward risks to economy

Source: CEIC and BBVA Research



Slowing export growth due to the deteriorating global environment (high risk)

Falling housing prices that could constrain investment, although recent data show the market may have bottomed (low risk)

Local government debt and the aftermath of rapid shadow bank lending could lead to a rise in NPLs; interest rate liberalization could undermine bank profits and lead to financial instability (moderate risks over the medium term)

Leadership transition could generate political risk and additional uncertainty (low risk)

Strong labor markets clearly help

- Consumer confidence has faltered as the crisis has continued
- But labor markets are still strong, helping to sustain domestic demand

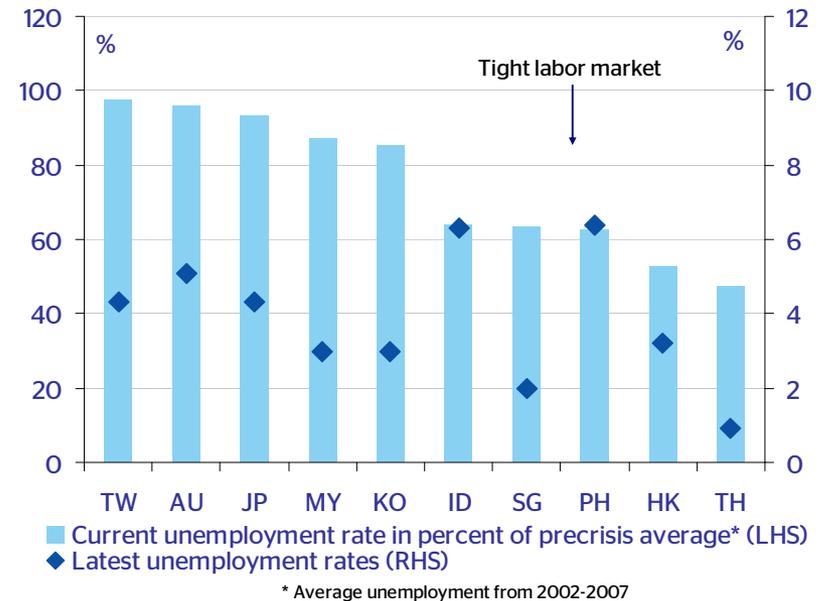
Consumer confidence has faltered recently...

Source: CEIC and BBVA Research



Though domestic labor markets remain robust

Source: CEIC and BBVA Research

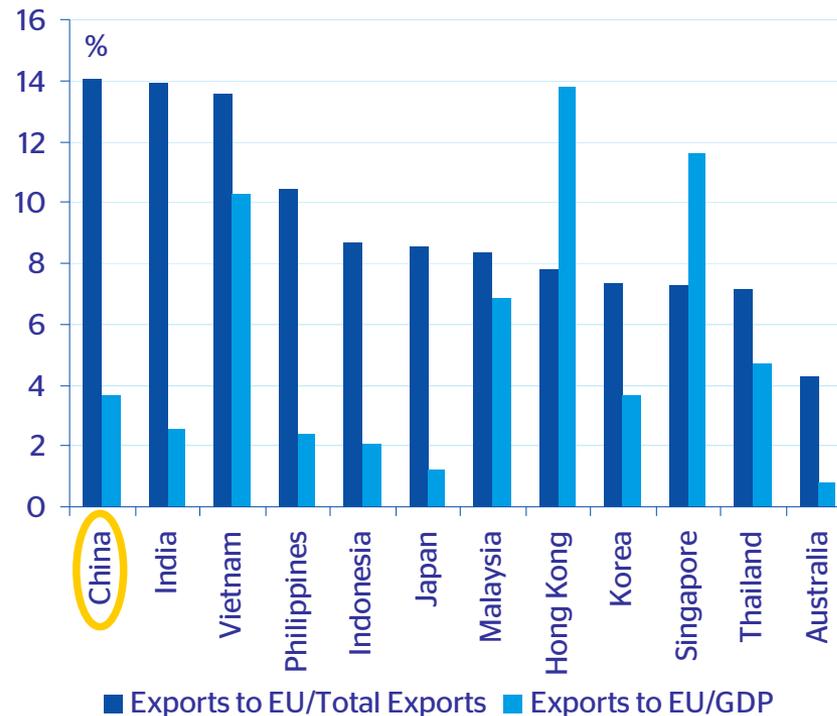


Europe's impact on China and the rest of Asia: the trade channel

- Asia has a relatively large trade exposure to Europe, especially China, India, and Vietnam
- The crisis is causing authorities to focus on rebalancing their economies towards domestic growth

China and India have the highest % of their total exports shipped to the EU

Source: IMF and BBVA Research

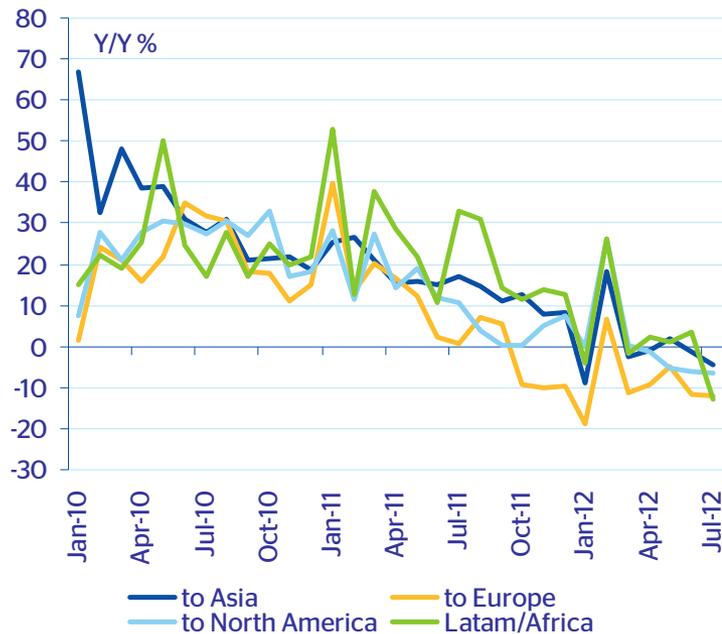


What about exports?

- Demand from Europe has fallen sharply, but the weakness in external demand is now broad-based

Exports* to Europe and North America have been weak since the end of last summer

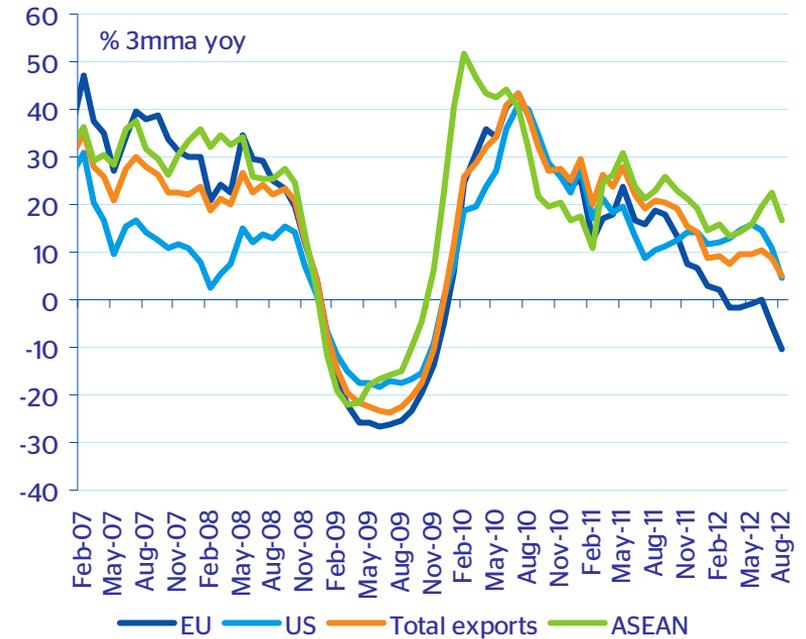
Source: CEIC and BBVA Research



* Denotes exports from KO, TW, SG and HK

China's exports to Europe have fallen sharply

Source: CEIC and BBVA Research

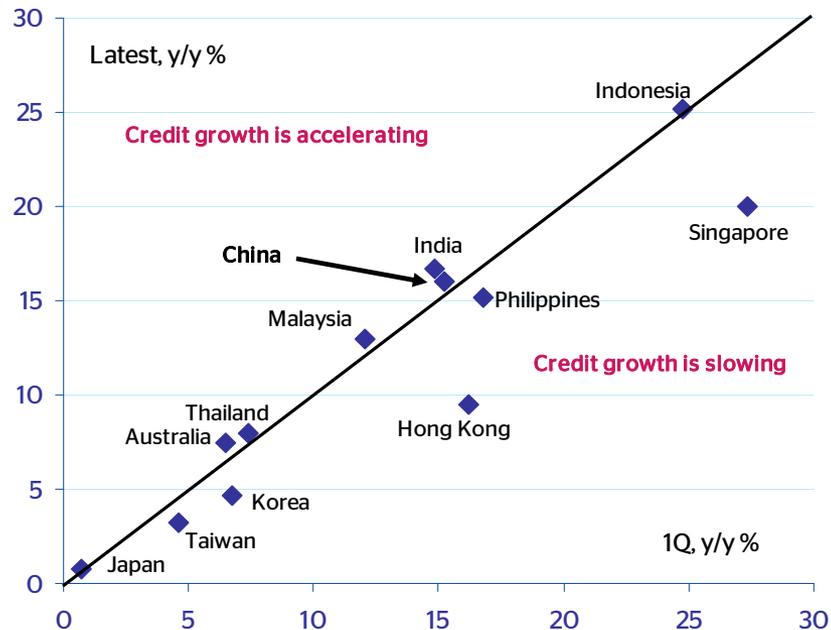


Europe's impact on China and the rest of Asia: the financial channel

- Strong liquidity and well-capitalized banking systems are enabling regional lenders to offset European bank deleveraging
- The impact of the European crisis through financial channels is very limited

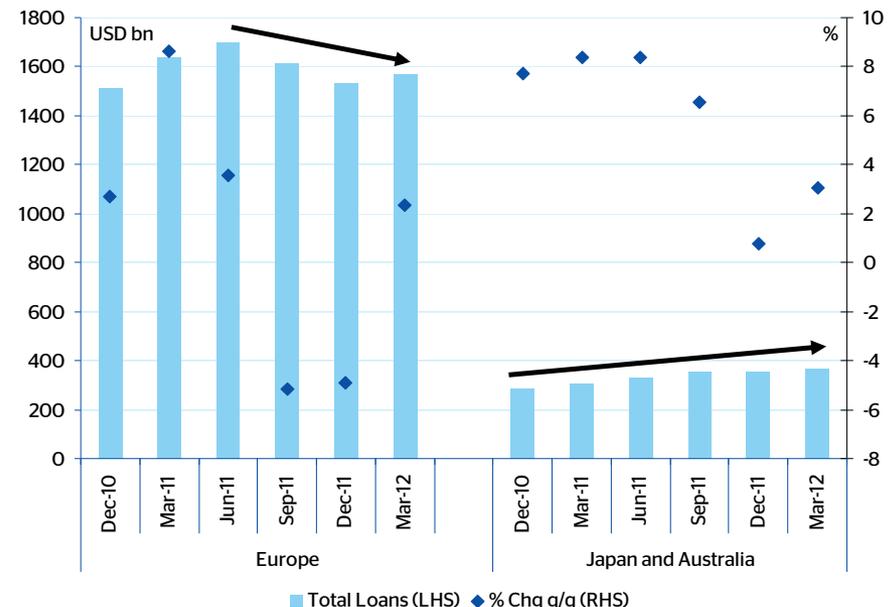
Credit growth in Asia has remained strong despite the European crisis...

Source: CEIC and BBVA Research



...and local banks are filling the gap from European bank deleveraging

Source: CEIC and BBVA Research

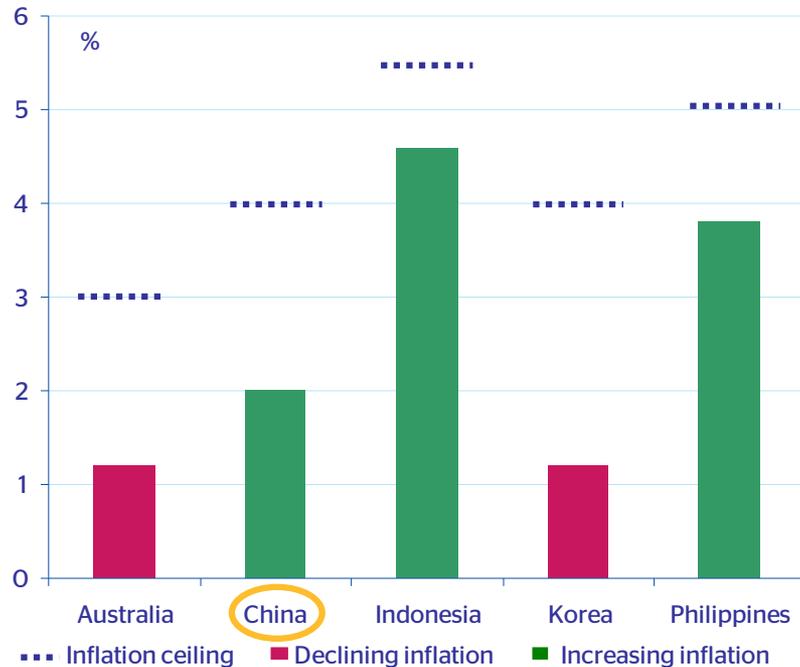


Falling inflation enables policy easing, in China and elsewhere

- Inflation has fallen due to weak global demand
- Further fiscal and monetary policy support may be needed to re-ignite growth momentum
- QE3 may boost capital inflows and lead to higher asset prices

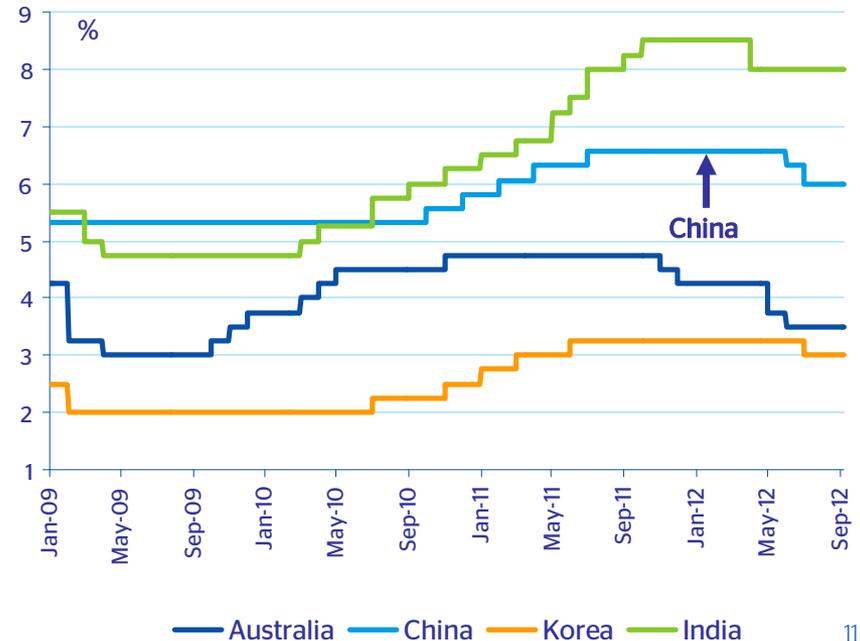
Inflation remains below official ceilings...

Source: CEIC and BBVA Research



...leaving policymakers with room for further interest rates cuts

Source: CEIC and BBVA Research



Risks to the downside notwithstanding the FED & ECB

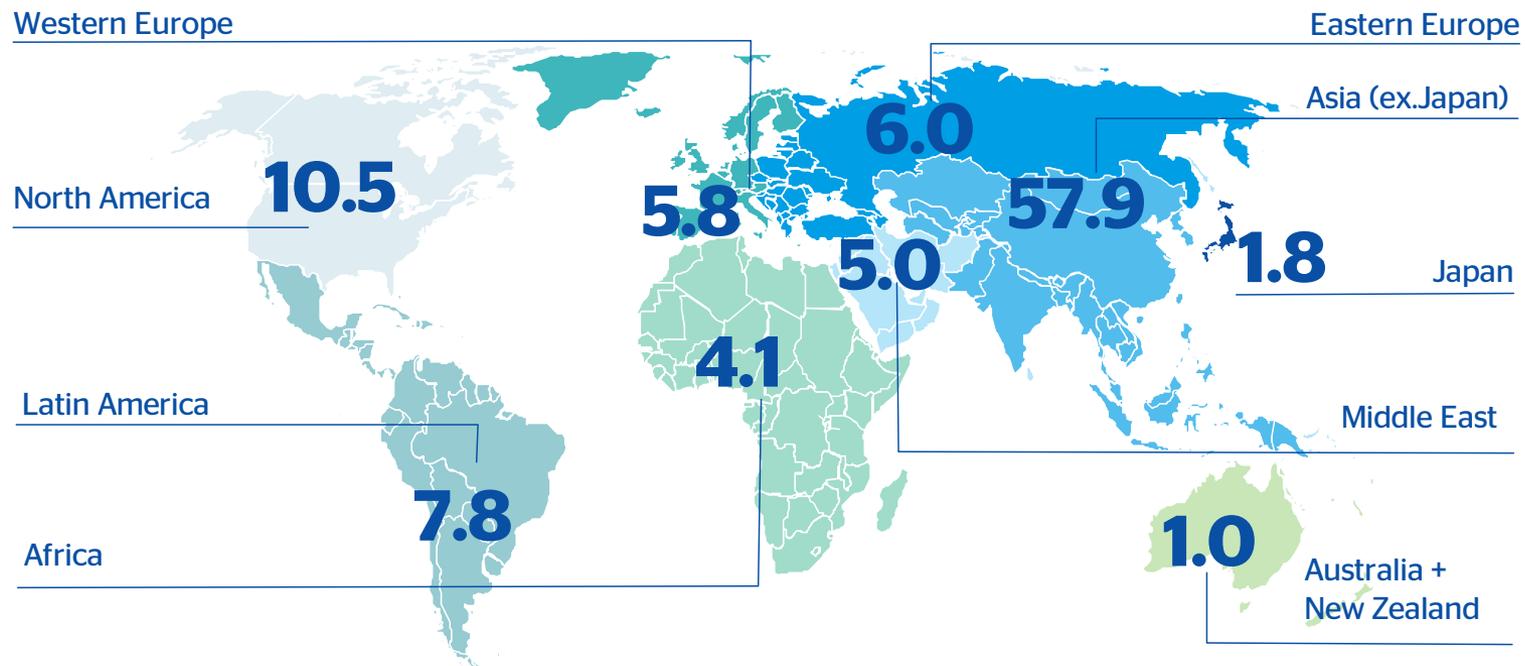
- Primary risks:
 - Ongoing difficulties in the external environment
 - Possibility of a hard-landing in China
 - Increased borrowing costs due to bank deleveraging
 - Geopolitical risks, including in the Middle East (and North Korea, though lower now)
- On the domestic side, spillovers from weak exports
- Country-specific risks:
 - India's lagging reform agenda
 - Japan's high public debt level
 - Leadership change in China
 - Presidential election in Korea (December)

No matter how big the abyss, everything is relative: this century will be Asia-centric

- Emerging Asian economies to contribute 58% to global growth in next 10 years
- China is the largest contributor at 34% of global growth followed by India at 12%
- 5 of the 9 EAGLE economies are located in Asia

Contribution to global economic growth by region, 2011-2021 (%)

Source: BBVA Research and IMF WEO



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