Asian Insights

Third quarter 2016

Asia's commitment in policies and reforms

One of the commonalities between most Asian governments is the dedicated commitment they have in using policies and initiatives to strengthen their economies. In particular, most Asian countries have used monetary policies and provided fiscal measures to promote demand over the short term, and at the same time, continued pursuing structural reforms to enhance longer-term growth prospects. In monitoring Asia, we share our view on what we believe are the key policy and reform developments taking place in the region.

Monetary policies

Currently, many Asian central banks are choosing to maintain an easing monetary bias as a shorter-term strategy to ease financing costs and provide liquidity. The decision is supported by the fact that inflation is still low and nominal policy rates are well above zero. This is in contrast to developed economies, where the current policy rate has already approached or come close to the "zero" floor. Since June, five central banks cut rates, with Taiwan and Malaysia easing following the Brexit referendum in late June. We believe the continued accommodative monetary easing, resulting in lower financing costs, will help to improve profit margin for Asian corporates.

Asia monetary policy from January 2014 to present

Country	Current policy rate (%)	Latest magnitude (%)	Last rate cut date	Policy bias
China	4.35	-0.25	Oct-15	Easing
Hong Kong	0.75	+0.25	Dec-15	Easing
Taiwan	1.375	-0.125	Jun-16	Easing
India	6.50	-0.25	Apr-16	Easing
Korea	1.25	-0.25	Jun-16	Easing
Indonesia	5.25	-0.25	Jun-16	Easing
Malaysia	3.00	-0.25	Jul-16	Hold
Philippines	3.00	-1.00	Jun-16	Hold
Thailand	1.50	-0.25	Apr-15	Easing
Japan	-0.10	-0.20	Jan-16	
EU	0.00	-0.05	Mar-16	
US	0.50	+0.25	Dec-15	

Source: Bloomberg; Invesco, as of Aug. 31, 2016

Fiscal policies

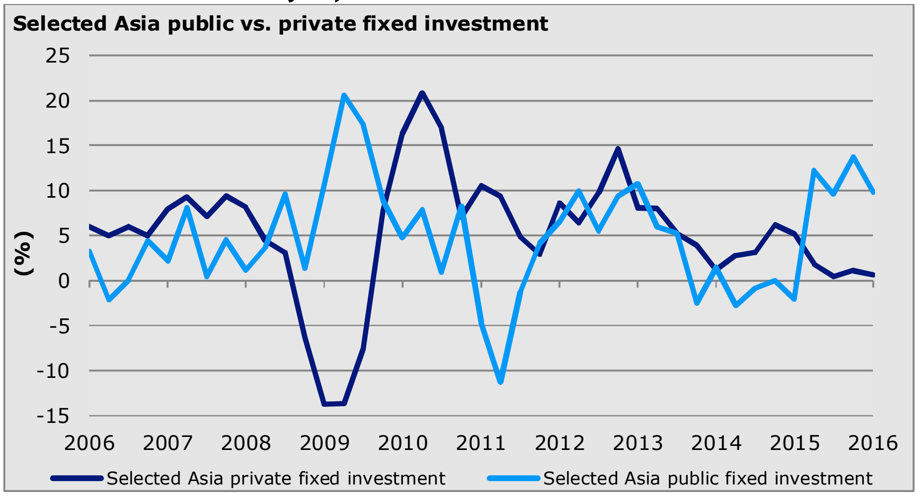
Since late 2015, we have already seen some Asian governments increase their fiscal spending. In fact, a relatively low debt-to-GDP ratio of less than 40% for most Asia ex-Japan countries provided grounds for the governments to continue spending.[1] The increased public investment was aimed at boosting economic growth in concert with their accommodative monetary policies. More importantly, the spending was targeted at laying down the foundation for future growth, such as job creation, and a better connection between regions and countries, which

[1] Source: FactSet; Government debt-to-GDP is only relatively high for Malaysia and Singapore at over 50% and 100% in 2015, respectively. Other Asia ex-Japan countries' debt-to-GDP ratios are 40% or less.

could lead to an increase in property investment, consumption and, potentially, private capital investment. Below are some of the recent fiscal spending measures.

- In **China**, the Ministry of National Development and Reform Commission recently released a plan calling for RMB 4.7 trillion ($721.8 billion, or 6.9% of 2015 GDP) in funding for 303 projects over the next two years.[2] This includes railways, roads, waterways, airports and metro systems.
- In **Korea**, the government announced a 20 trillion won ($17.1 billion or 1.3% of GDP) fiscal stimulus package, which includes measures to support environmentally friendly infrastructure spending. Korea is one of the countries in Asia running a fiscal surplus.[3]
- The **Philippines** recently approved its Three-Year Rolling Infrastructure Program (TRIP) for 2017 to 2019 to promote the optimal use of public resources for infrastructure development. The plan is designed to ensure that once public projects are started, they are properly funded until completion.
- **Thailand** is also considering doubling its infrastructure investment budget under the new administration after two decades of limited public investment.

Public fixed investment jumped since 2015



Sources: Credit Suisse, CEIC, Bloomberg
Selected Asia countries include Hong Kong, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand.

Structural reforms

There have been structural excesses or inefficiencies that held up growth for some Asian countries in recent years. We believe that successful reforms to remove these excesses and improve productivity will enhance growth prospects in Asia over the longer term. In particular, we see some key structural reforms taking place in the two largest countries in Asia – China and India:

- **India: The passage of the Goods and Services Tax (GST)** is regarded as a "game changer," as it will unite the country under "one nation, one tax," replacing the 16 state and federal taxes with a single tax when implemented. This change increases efficiency by removing interstate trade barriers,

[2] Source: China's State Council, May 11, 2016
[3] Source: CEIC as of March 2016

integrating India's economy seamlessly into a single national market. Moreover, the GST passage also paves the way for sustainable economic growth. A simplified tax structure increases the country's attractiveness for international investors, makes goods cheaper, increases export competitiveness and widens the tax base, resulting in higher tax revenue. Ultimately, all these factors are forecast to increase GDP growth by 0.9% to 1.7%, according to the National Council of Applied Economic Research (NCAER).

- **China: Supply-side reform** is taking shape. First, the government is dedicated to reducing total crude steel capacity by 8% to 13% over the next five years and total coal capacity by 9% to 18% in the next three to five years. This could result in job cuts for the two industries. Although the capacity reduction will involve plant closures and job losses, in our view, it will be positive for longer term growth as productivity should improve. The process will be gradual and not made in one push. Furthermore, the State-owned Assets Supervision and Administration Commission recently announced a pilot program for reform of seven large state-owned enterprises (SOEs), having them establish boards and promote mixed ownership. In our view, the launch of pilot programs is a positive signal as it shows that the government is eager to actively pursue reform in those areas.

Conclusion

Looking ahead across the Asian region, policymakers are committed to use short-term and long-term policy initiatives in driving growth. This includes monetary and fiscal measures to enhance domestic demand conditions and overall productivity over the short term, as well as engaging in structural reforms for healthier long-term growth, such as India's GST passage and China's supply-side reform. We continue to monitor the policy developments and also the pace of structural reforms. Regardless of the macro outlook, our focus on bottom-up stock selection remains the same. We continue to seek quality companies with sustainable leadership and competitive advantages that enable them to benefit from the long-term growth opportunities in Asia.

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Market highlights

We are positive on the options available for policymakers. Structural reforms are producing positive results in India. Some of the countries within the Association of Southeast Asian Nations (ASEAN) region, such as Indonesia and the Philippines, are seeing some improvement in their economies. In China, accommodative fiscal and monetary policies have helped to support growth. Korea's economy is being driven by the resilience in consumer spending. In Taiwan, easy monetary policy has assisted growth. Countries that are still facing structural headwinds include Malaysia, Singapore and Thailand.

China: We are positive on China given its accommodative policies, resilient consumer spending and attractive valuations. Economic indicators show areas of the economy contributing favorably to growth, such as in infrastructure investment and consumption. However, overall momentum has yet to be strong enough to suggest a change in trend away from slower but more sustainable growth. Meanwhile, the government is committed to pursuing structural reforms on various fronts, which is expected to be favorable for longer-term growth prospects.

Hong Kong: We favor Hong Kong due to supportive policies and reasonable valuations. The investment opportunities in Hong Kong continue to be influenced by developments overseas and in mainland China. One weakness is in consumer spending, which is not expected to turn around on a sustainable basis as tourist activity remains slow. As for housing, conditions appear to be stabilizing as policy has been on hold for some time.

India: We continue to favor India as its medium-term growth outlook is improving, boosted by higher disposable income and improving corporate profitability. India's government is making progress with reform from increasing foreign direct investment, to policies to improve the financial system and encourage infrastructure development.

Korea: In Korea, macro fundamentals are slowly improving, but growth momentum remains subdued given structural impediments to growth, such as excess stock and leverage. Consumer demand has been relatively resilient – although the weakness in external demand continues to suppress manufacturing. The government is supporting the economy using both monetary and fiscal policies, and this will likely continue.

Indonesia: We remain positive on Indonesia given improving growth and liquidity conditions. With the government placing a higher priority on reform, as well as a central bank that turned accommodative at the start of the year, near-term conditions look positive. The government also opened up to more foreign investment for the first time since 2014, which should support medium-term growth.

Taiwan: Since the start of the year, Taiwan's central bank has lowered rates two times with a bias for further easing if necessary. Domestic demand is being driven by improving consumption, and external demand is starting to turn. The government, meanwhile, has adopted a more prudent approach to fiscal policy.

Thailand: We remain cautious on Thailand despite the fact that the acceleration in fiscal spending has helped to support growth and consumer spending is improving. The concerns are that structural challenges remain due to high debt and weak wages. Moreover, sluggish external demand will continue to pose a headwind to overall growth.

Malaysia: We maintain a low rating for Malaysia as domestic activity is still weak while exports continue to be a drag on growth. With public debt relatively high, it limits the government's ability to resort to fiscal measures to aid the economy. The central bank recently eased for the first time in seven years, but further action is unlikely.

The Philippines: We continue to be positive with regards to the Philippines. Macro conditions are solid, with double-digit growth continuing in many parts of the economy, from production to retail sales. The focus will be on the structural reforms implemented by the new president's administration.

Singapore: We maintain a low position in Singapore as cyclical and structural headwinds persist. Although property market conditions have improved, other aspects of the economy, such as retail demand, remain weak.

Australia: We are cautious on Australia as domestic conditions remain weak, even though there are some signs that external demand is on the mend due to the low base and higher commodity prices. As for policy support, there is limited room for fiscal relief as the deficit target has been reached.

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