

Sliding West Puts Asia to Test

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Key Messages

- Growth marked down as risks in advanced countries, which have limited ability to fight another recession, rise
- The adverse feedback loop between low growth, weak sovereigns and financial sector are active
- Asia cannot avoid the short-term pain of another recession in advanced countries
- Medium term growth potential of Asia not hampered by lowering of growth prospects in the West





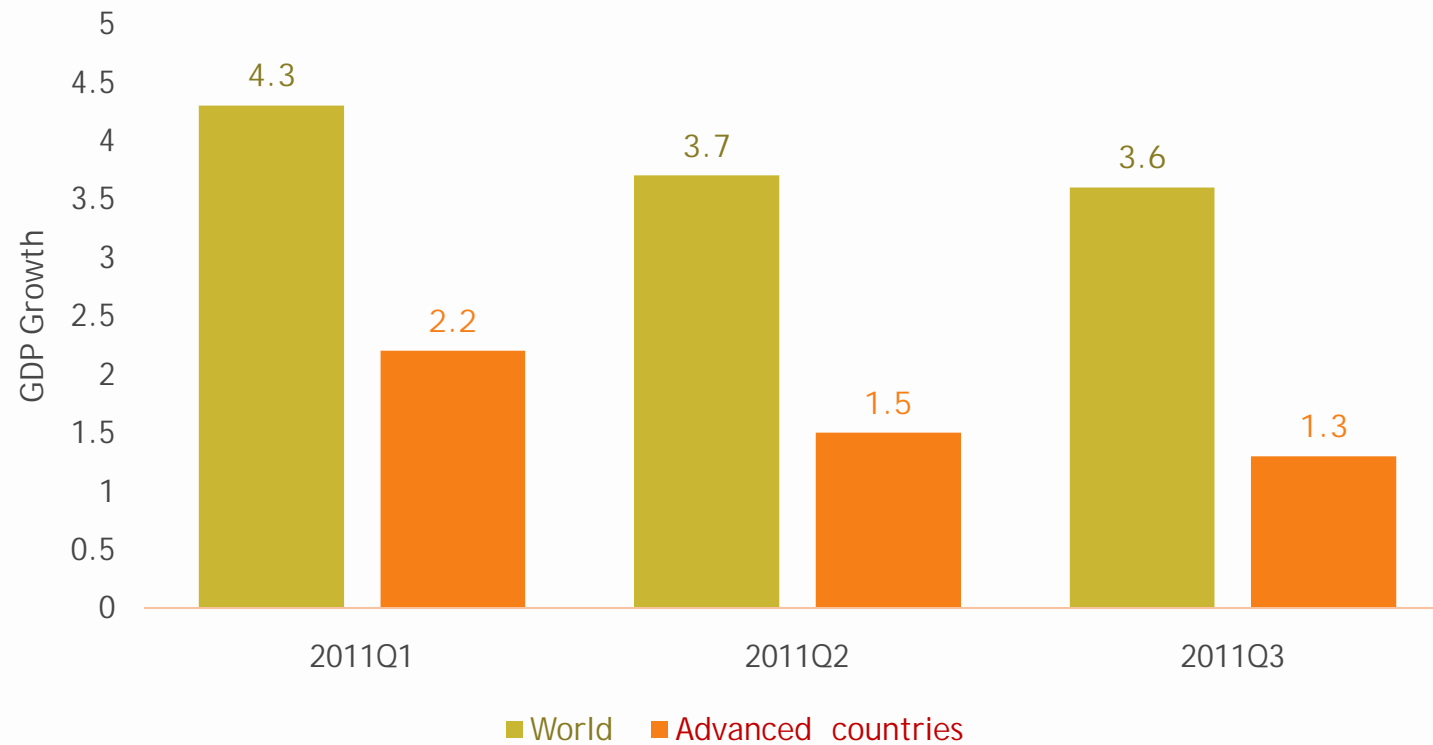
Post crisis world economy: Uneasy setting

- Vulnerabilities following from the crisis
 - De-leveraging
 - Weak financial sector
- New Global Risks
 - Middle East and North Africa (MENA)/supply disruptions in oil
 - Japan earthquake and tsunami
- China slowdown fears





Sliding growth in advanced countries



Source: IMF, 2011



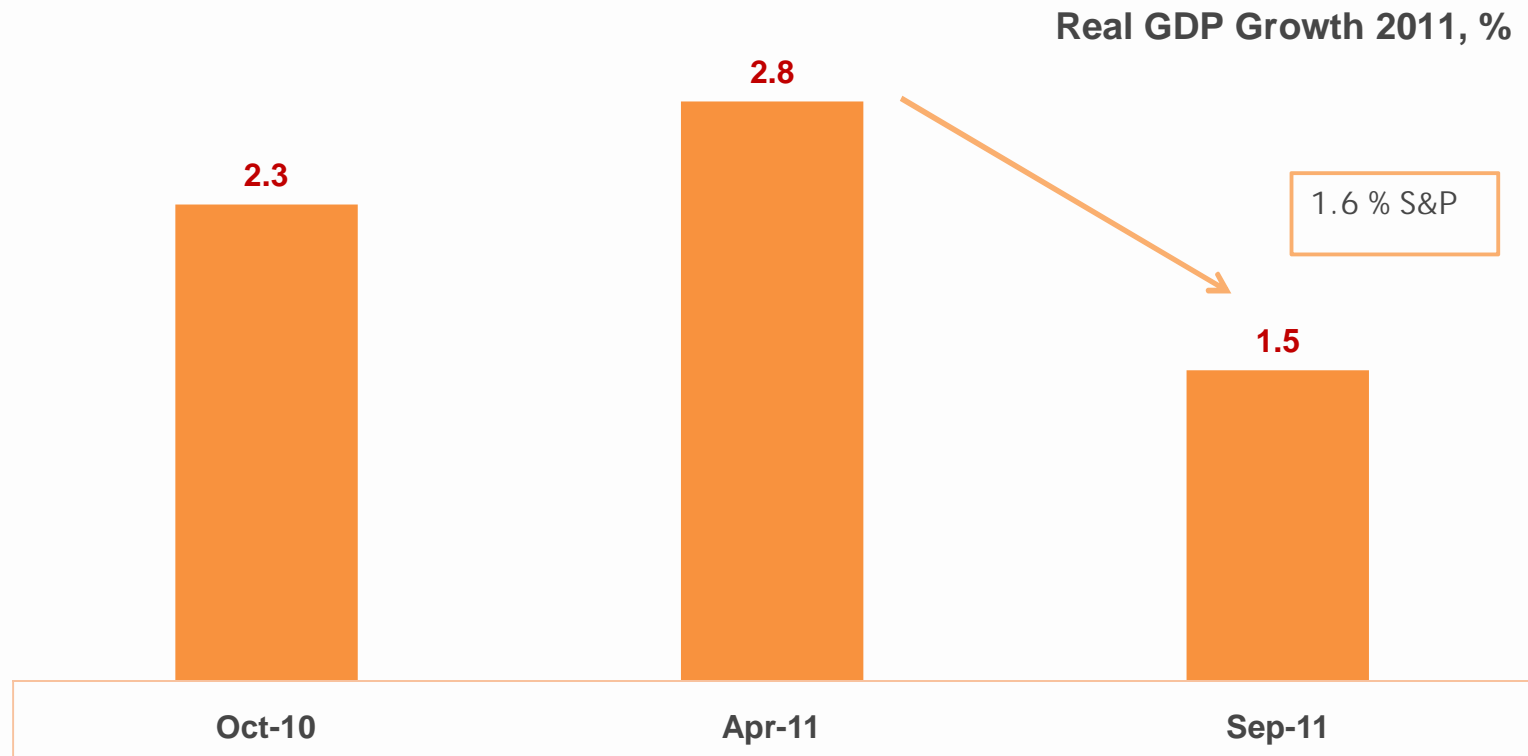


United States





Half speed recovery gets weaker-US

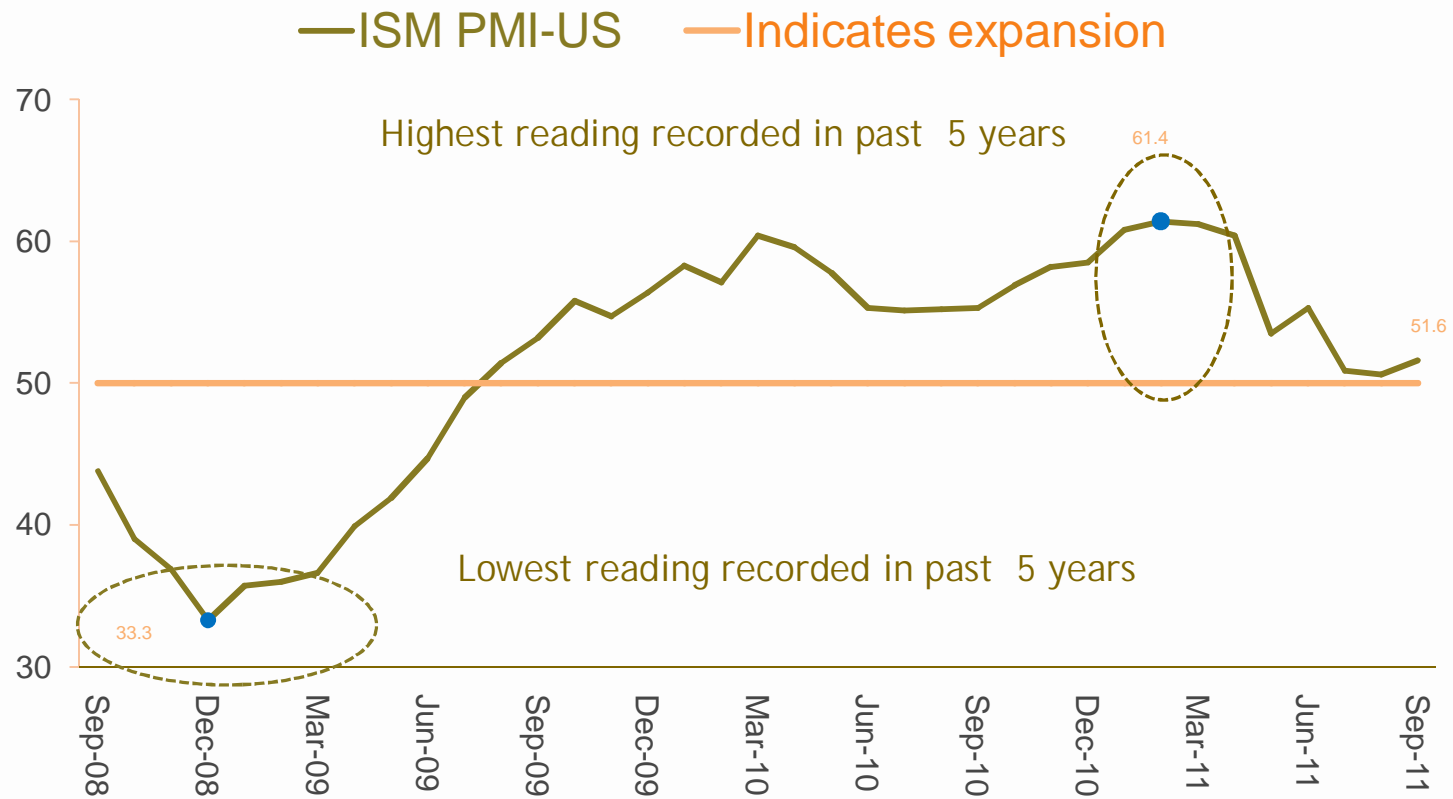


Source: IMF WEO, October 2010, April 2011, October 2011





Purchasing Managers Index- US



Source: ISM, 2011





Why is US recovery faltering?

- 40% probability of a double-dip recession (S&P)
- Inability of monetary easing to revive the economy due to de-leveraging
- Limited fiscal bandwidth
- Loss of jobs and weak housing markets
- Loss of wealth; Negative equity for many households
- Low consumer confidence/consumers likely to save more and borrow less



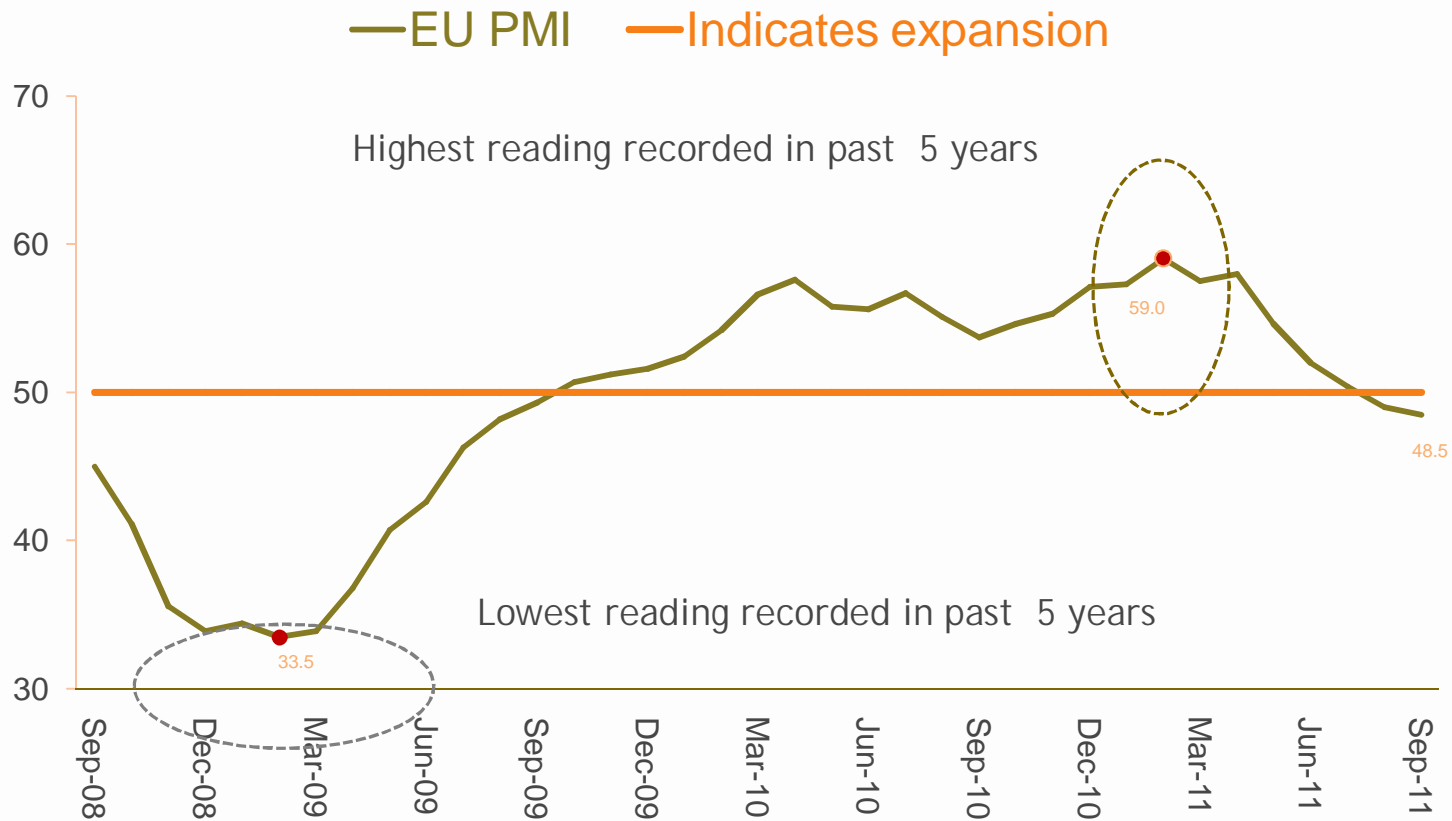


Europe





Purchasing Managers Index - Europe



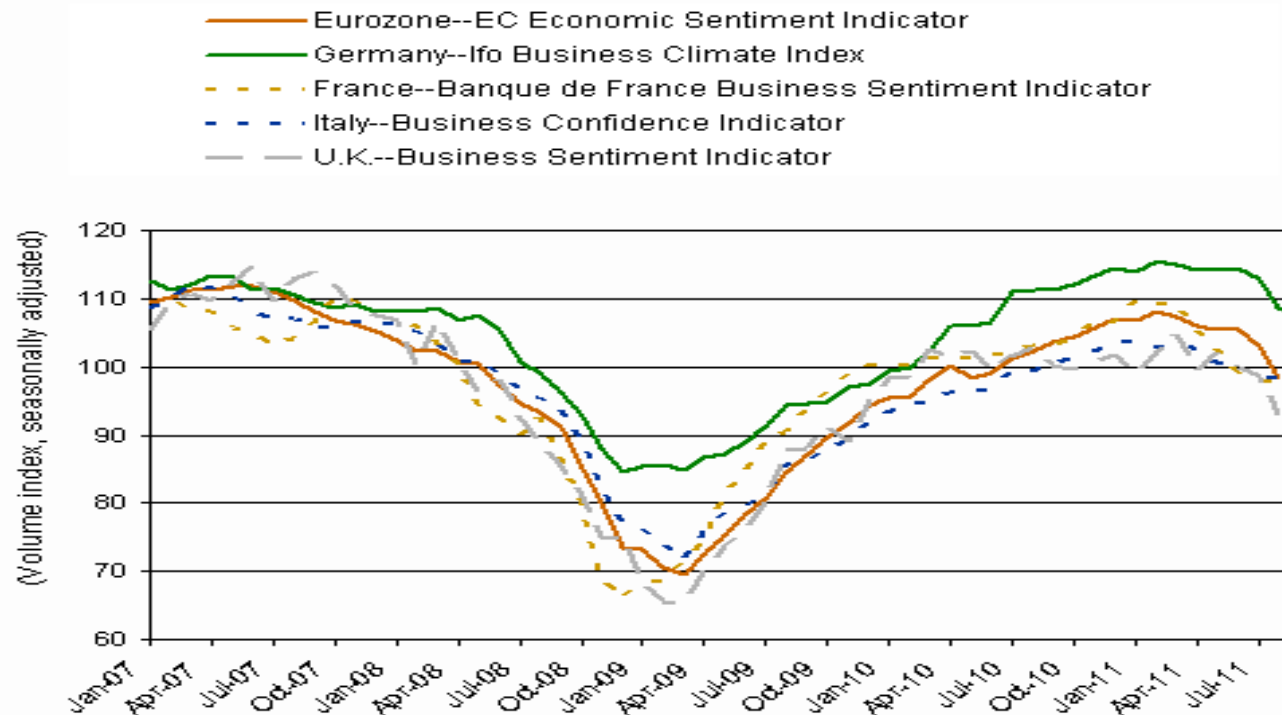
Source: ISM, 2011





Dipping business confidence in Europe

Business Sentiment In Europe Is Falling

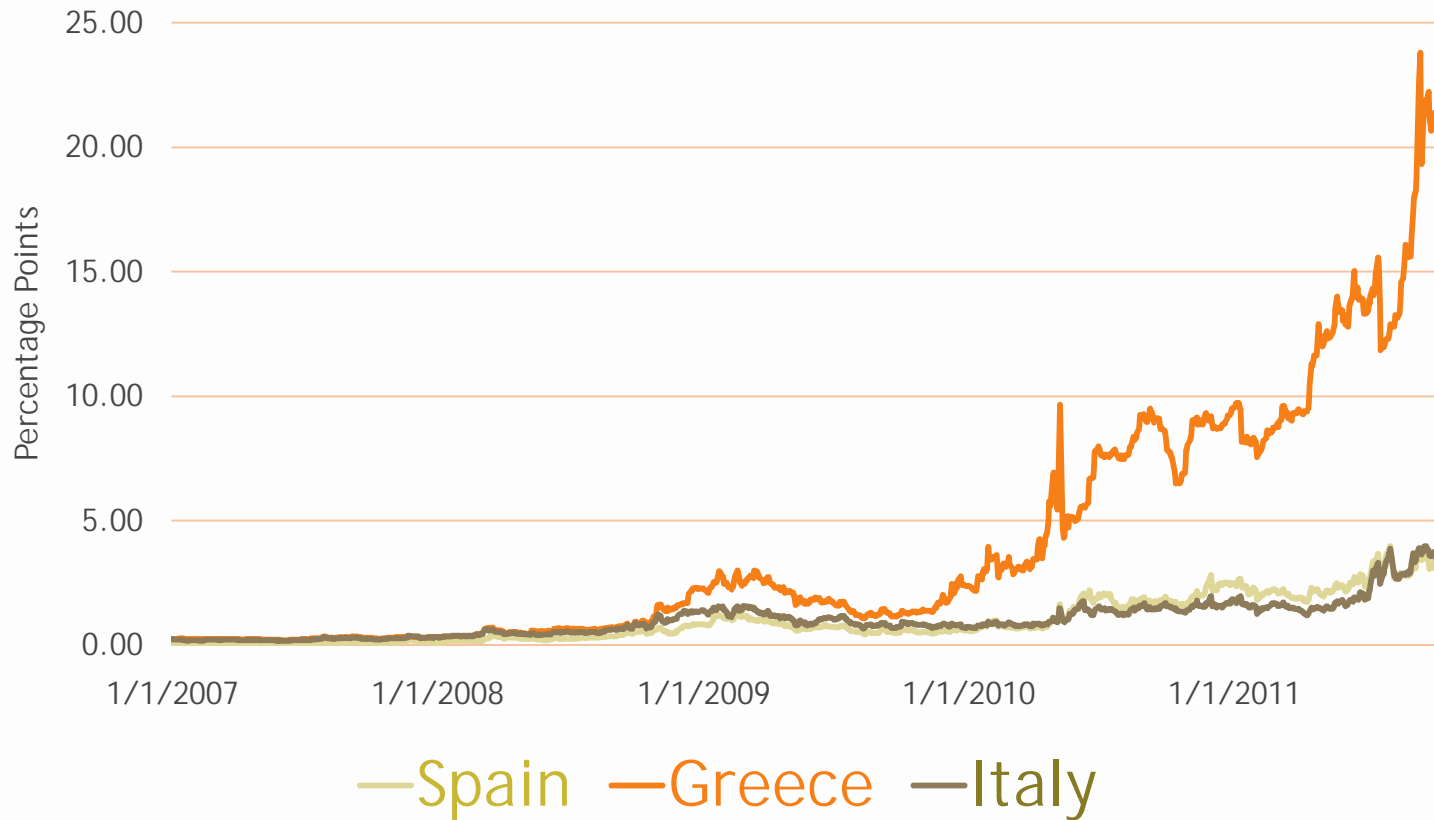


Source: Eurostat.

© Standard & Poor's 2011.



10 year sovereign spread to German Bund



Source: Bloomberg, 2011





Europe risks on the rise

- Europe set to see very weak economic growth in the second half of 2011. S&P forecast for 2011 is 1.6% which is projected to weaken to 1.1% in 2012
- Purchasing Manager's Index (PMI) in Euro zone plunged to sub-50 in September 2011 (indicating contraction in activity)
- Fear of a global credit freeze; Sovereign issues have spread from smaller economies such as Greece, Ireland and Portugal, into bigger European economies such as Italy and Spain
- Spain and Italy ratings saw a downgrade by one notch within a month in September
- Banks exposure to weak sovereigns make them vulnerable





Europe risks on the rise

- Higher yields means rising liabilities and reduced asset values for stretched banks.
- Banks could reduce their balance sheets to improve their solvency ratios- rising cost of capital and downside to investment
- Latest EU deal and political compulsions
 - 1.4 trillion regional bailout fund
 - Private sector banks to take 50% haircut on Greek bond holdings
 - Relieves short term worries
 - Liquidity issues being resolved through the drip-feed approach, insolvency remains unaddressed-Political compulsions



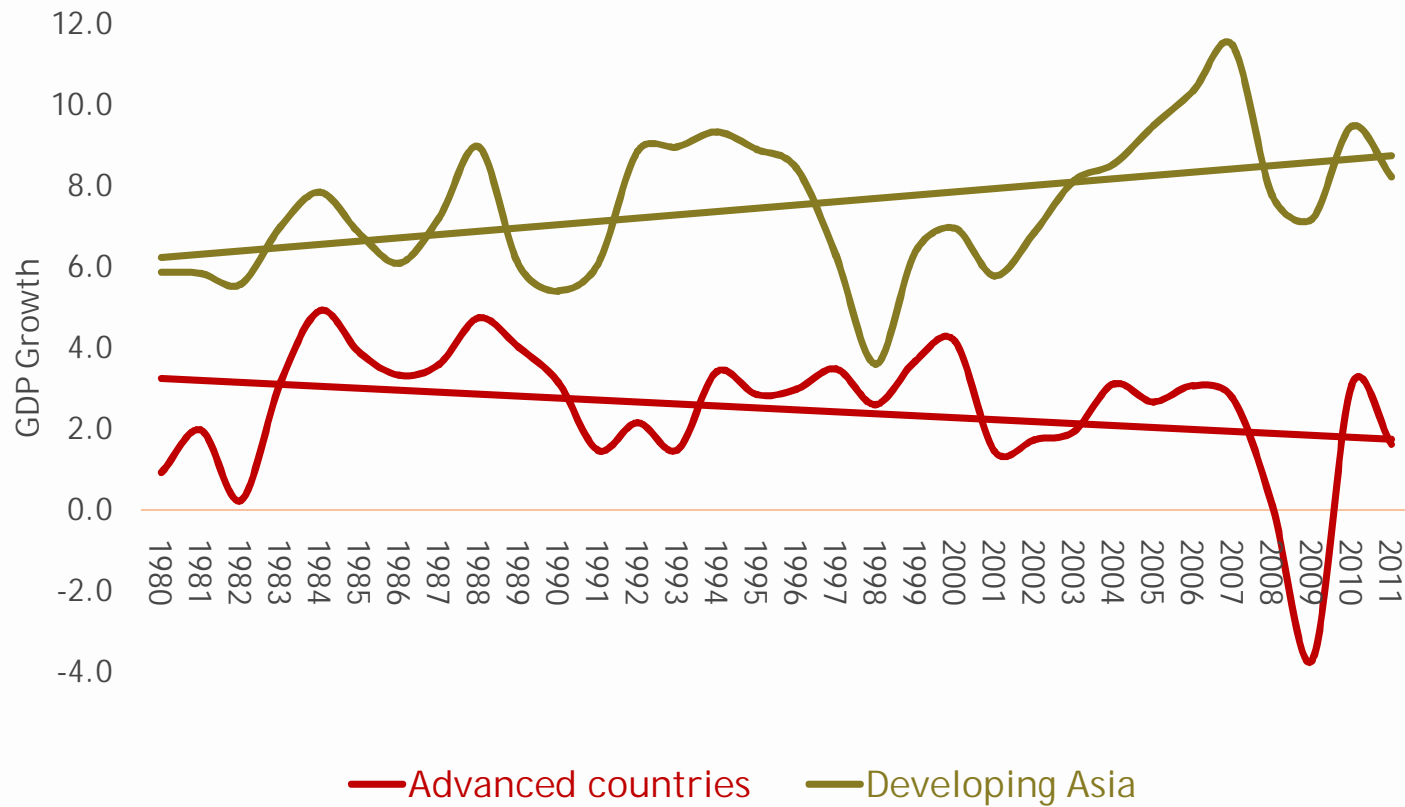


Asia





Advanced countries and Developing Asia

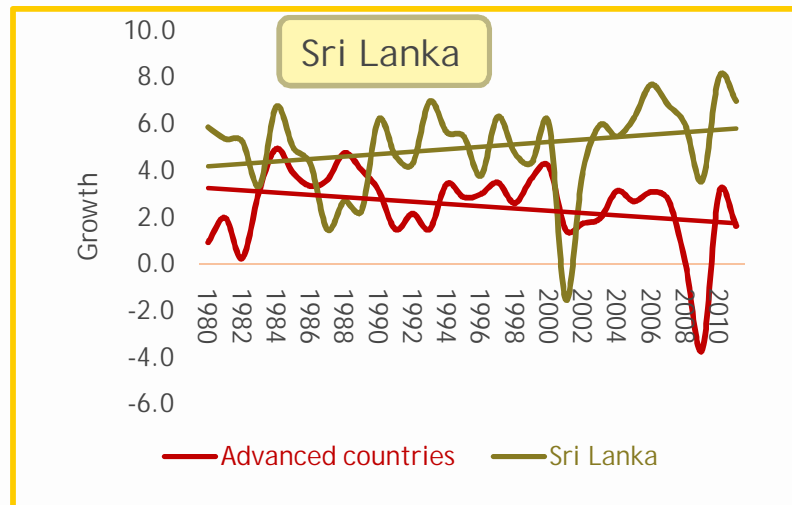
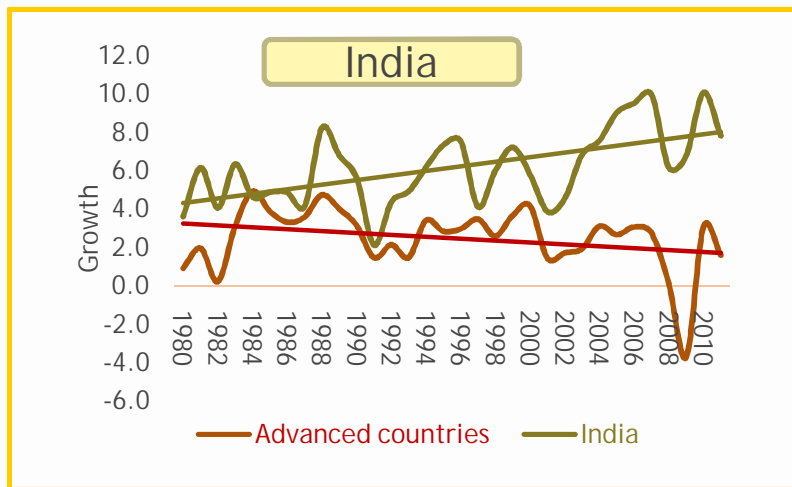


Source: IMF, 2011





Synchronized cycles; Divergent trends



Medium term growth prospects for Asian economies are not lowered by lowering of growth trajectory of the West

BUT

Pain of a double dip cannot be avoided in the short run

Source: IMF, 2011



Transmission through trade channel

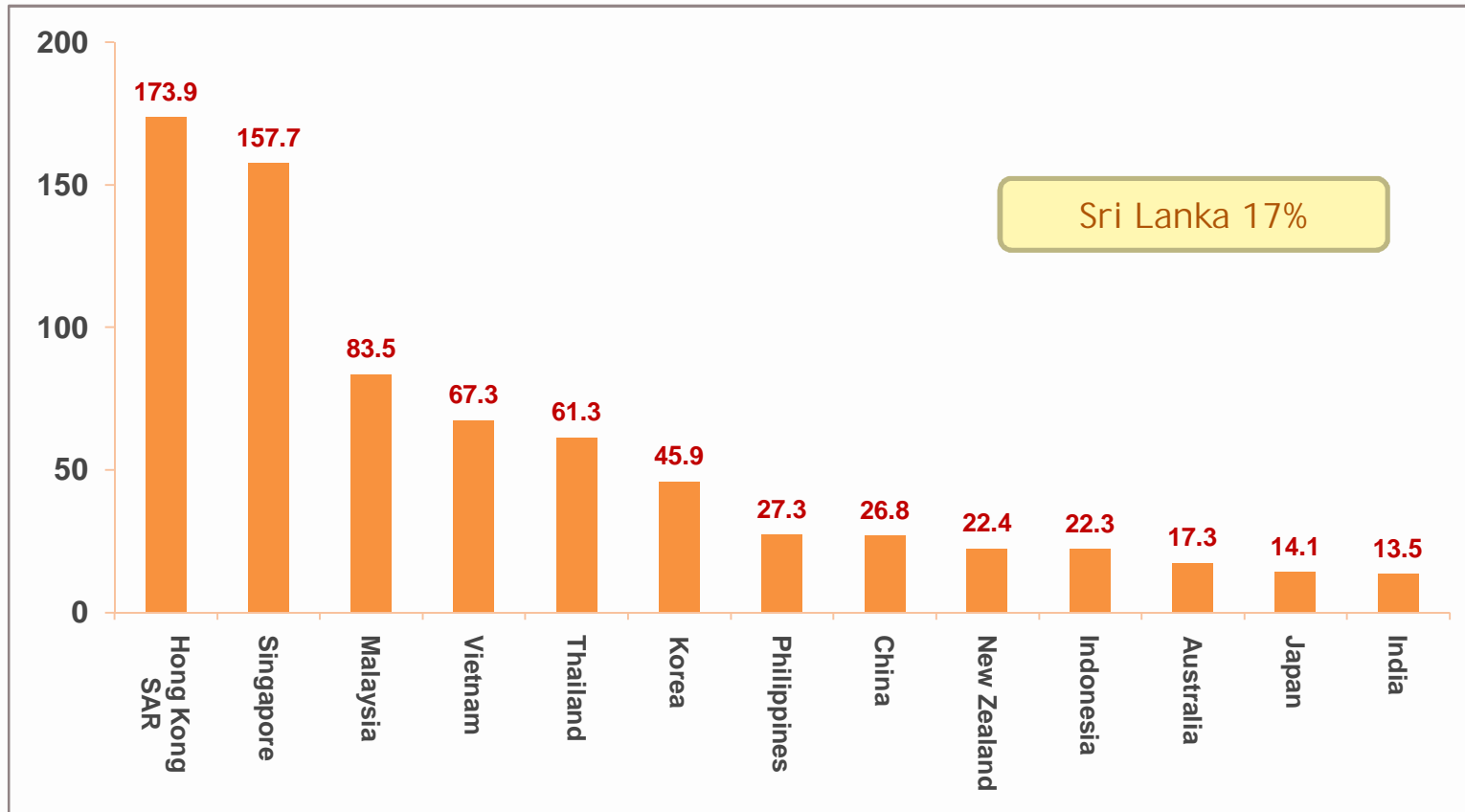
- EU is an important trading partner of APAC region. 15 per cent of regions exports go to EU countries
 - In case of crisis, Euro will weaken and not support exports from APAC region
 - Exports from Europe do not significantly use APAC inputs
- Asia's Exports to US reducing but significant
- Exports to China have been gaining prominence
- Some buffer is provided by rising intraregional exports.





Export dependence in Asia Pacific

Merchandise exports as % of GDP, 2010



Source : CEIE and CRISIL Ltd

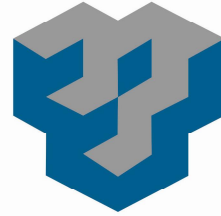




Global context to Asia's ascent

- Speedier drift of economic power to East from West
 - China and India important contributors to the convergence
- Asia likely to double its share in world GDP to 51% from 27% currently (Asian Development Bank, 2011)
- Global re-balancing: China shifting from export orientation to domestic consumption





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