

Does East Asia Offer a Safe Haven?

By John Greenwood

Introduction and Overview

- Amidst the tightening of liquidity and bank runs in the US economy and an imminent US recession – towards yearend, in my view – does Asia offer a safe haven for investors?
- One way to answer the question is to make a judgement on “stand-alone” liquidity conditions – i.e., the trends of broad money growth – in Asia relative to their historical ranges and the requirements of each economy.
- On that basis, only China, and arguably India, can be said to be easing conditions sufficiently to generate positive asset returns in 2023.
- China has seen an acceleration of M2 from 8% to over 12% year-on-year. Although a domestic economic recovery from the lockdowns of 2020-2022 is a racing certainty, the question is: will it also translate into higher asset prices?
- Both Japan and most other smaller east Asian economies are generally seeing slow money growth that will likely remain subdued during 2023.
- In Japan’s case, M2 growth is slowing, returning – as predicted here last year – to the slow, sub-optimal growth rate of 2-3% experienced during most of the last 30 years. At the BOJ, Governor Kuroda is handing over to Prof. Kazuo Ueda having failed to achieve his mission of a sustained 2% inflation rate.
- Elsewhere among the smaller economies of East Asia, money and liquidity conditions are tight or tightening, although by no means as restrictive as in the US. Only Thailand is witnessing any acceleration of money growth.
- An alternative way to approach the haven question is to consider the channels by which the US or Chinese economies impact Asia, especially the trade and financial channels. Here the key question is: are the economies of East Asia sufficiently independent of conditions in the US to escape the business cycle downturn which seems certain to hit the US later this year?
- The SVB crisis in the US is symptomatic of the extreme tightening of money growth by the Fed, undermining asset values and threatening bank liquidity.

International Monetary Monitor Ltd

*The IMM Newsletter offers economic research written by John Greenwood, founder and Chief Economist of International Monetary Monitor Ltd. John was also the publisher, editor and lead author of **Asian Monetary Monitor**, a bi-monthly publication that he operated for 20 years from Hong Kong between 1977 and 1996. He was a pioneer of monetary research in Asia. From 1999 to 2021 he was Chief Economist at Invesco, based in London.*

To access my research please email your request to IMM@eri-c.com

Figure 1. Recent Broad Money Growth Rates in Asia

	Monetary Aggregate	Latest data	Latest 3 months at % annual rate	Latest year-on-year % change	Comment
China	M2	Feb	13.8%	12.8%	Accelerating
Japan	M2	Feb	1.7%	2.6%	Slowing down
India	M3	Feb	11.1%	9.5%	Mild acceleration
Korea	M3	Dec	0.0%	3.3%	Slowing sharply
Taiwan	M2	Jan	6.8%	6.9%	Steady at suitable rate
Hong Kong	HK\$M3	Jan	15.8%	1.6%	Very slow
Singapore	M2	Jan	1.2%	2.0%	Very slow
Malaysia	M3	Jan	3.3%	4.4%	Moderate slowing
Thailand	M3	Jan	5.0%	3.8%	Mild acceleration
Philippines	M2	Jan	6.7%	5.5%	Steady at slow rate
Indonesia	M3	Jan	9.8%	8.2%	Slowing trend intact

The performance of a number of Asian stock markets has been a disappointment in recent weeks, particularly the China mainland equity market since the end of January. Chinese equities had been identified as a favourite market for many investors in 2023 for two main reasons – first, the re-opening of the Chinese economy following the ending of China’s “dynamic clearing” lockdown policies against the Covid-19 pandemic in late November 2022, and second, the substantial acceleration of broad money (M2) growth since 2021 (Figure 2).

The main Chinese equity indices rallied strongly between the end of October and the end of January (+54% on the basis of the MSCI index of investable China shares), but since then there has been a significant setback (-17% on the same index). Among the key reasons for the sell-off were : (1) the growing hawkishness of the Federal Reserve following a series of strong datapoints for US inflation and the labour market, as well as the sustained inversion of the US yield curve; (2) the increase in geo-political tensions between the US and China over Taiwan and Ukraine, centering on the spy balloon incident, the possibility of China supplying arms and ammunition to Russia for use in Ukraine, and the cancelation of Secretary Anthony Blinken’s visit to China; (3) continuing concerns among foreign investors about arbitrary treatment by the Chinese regulatory authorities of entrepreneurs such as Jack Ma and just recently the disappearance of Bao Fan, founder and CEO of the investment bank, China Renaissance; and (4) finally the seeming failure of the Chinese economy – so far – to show strong signs of recovery. Although some data points, such as the PMI indicators for manufacturing and services and some property indicators, have improved, trade flows have stalled and outbound tourism has not yet recovered.

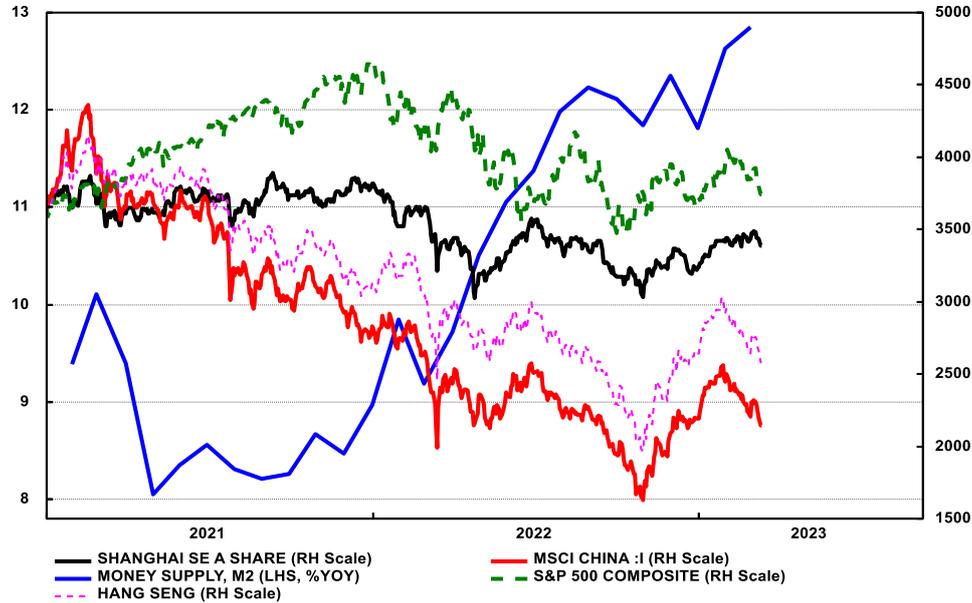
In the light of all this bad news holding back Chinese equity market performance in February and early March, is it reasonable to expect the recovery from last October to resume and for China’s equity markets – and the property markets – to enjoy a vigorous upturn in the remainder of 2023?



Figure 2. Chinese equities remain depressed despite surge in M2.

CHINA: STOCK MARKETS versus MONEY GROWTH

Equity indices rebased to January 1st, 2021

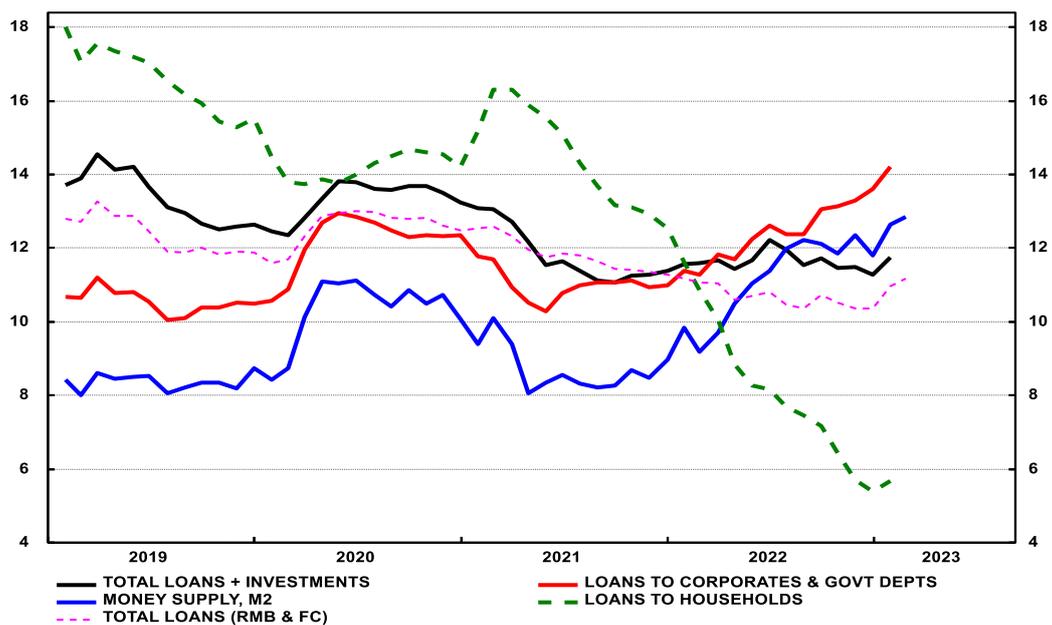


Source: Refinitiv Datastream

As Figure 2 illustrates, China's M2 (in blue) has accelerated from 8.1% in April 2021 and 8.5% in November 2021 to 12.8% in February 2023, a substantial acceleration for an economy the size of China's. Our first task is to explain why – aside from the factors cited above – Chinese asset prices are not responding to this very significant stimulus, and second to extend the analysis to other economies in East Asia.

Figure 3. Credit growth to non-financial corporates & govt has been subdued, while credit growth to households has plunged.

CHINA: M2 & BANK LENDING AFTER ONSET OF COVID (% YOY)

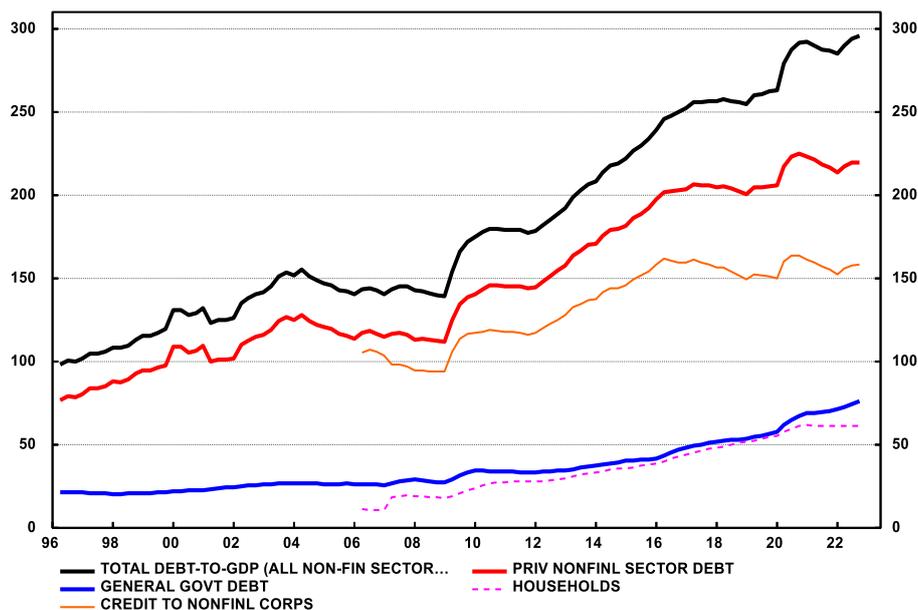


Source: Refinitiv Datastream

Figure 3 shows the growth of key credit counterparts of M2. On the one hand, the growth of credit to non-financial corporates and government departments (i.e., local provincial and municipal entities such as LGFVs rather than central government) shown in red has been growing roughly in parallel with money growth. On the other hand, loans to households - shown by the green dashed line - have been slowing sharply since the start of 2021, reflecting the problems in the property market and the risks individual buyers faced that their developer might not complete the building project.

In slowdowns or recessions elsewhere, the problems have always been greatest when large sectors such as households or banks are faced with the need to deleverage. Such conditions are the classic symptoms of balance sheet recessions. Although we do not have full data on Chinese households' balance sheets or financial assets, we do have consistent data from the BIS showing the leveraging up of mainland Chinese households in recent years, as shown in Figure 4. The data show that household debt had climbed from 11.5% of GDP in 2006 Q1 to over 60% by early 2020 and appears to have levelled off at 61.4% in 2022 Q3 (+49.9 percentage points), while non-financial corporate debt (which includes the large SOE sector) has increased from 105.3% of GDP to 158.2% (+52.9 percentage points) over the same period. In 2017 the authorities decided to control debt growth, but it was not until August 2020 that they stepped in with the specific policy of limiting leverage among real estate developers with their “three red lines” (three balance sheet ratios applied to developers' balance sheets). Initially (2017-2020), household debt continued to accumulate and has only stabilised since 2020.

Figure 4. Since the GFC, China's debt growth has been rapid.
CHINA: PRIVATE & PUBLIC DEBT-TO-GDP (%)
 BIS LIQUIDITY & CREDIT STATISTICS



Source: Refinitiv Datastream

My tentative conclusion from this bird's eye view of the rapid rise of Chinese household debt is that, at current income levels, and given the credit crunch facing

many developers, households are probably reluctant to leverage up further. Unless the non-financial corporate sector – whose debt ratio has been broadly static since 2016 – shows a willingness to become even more indebted, the scope for further easing of credit conditions in quantitative terms is probably quite limited.

Thus despite favourable monetary conditions – in the sense of ample growth of broad money – the prospects for a near term resurgence in Chinese equity or property prices are more restricted than they would typically be after such an acceleration of money growth. To be clear, I have no doubt that easy money will assist in promoting China’s domestic recovery later in the year, but it may be several more months before consumer and business confidence recovers enough to validate higher multiples in either the equity market or the property market. In the event of a US recession – which I fully expect towards yearend – the delay will be even longer.

For the other East Asian economies an important question is whether the upturn in China will boost their growth. Reverting to the table in Figure 1, only two economies are seeing even a modest acceleration of broad money growth: India and Thailand. While China bulls have argued that China has become increasingly important as a source of demand in the Asian region – and, in the view of some analysts, even as a source of global demand – this overstates the case in my view.

First, unlike the US which is a major importer of finished manufactured goods from Asian economies with a high value-added element accruing to the exporters and their employees in the source economy, China’s demand is far more focused on (1) raw materials which have a comparatively small value-added component and (2) semi-finished items or components that are assembled into final products in the mainland for re-export to other countries. It is true that China imports an increasing amount of capital goods, but these are generally not exported from the smaller East Asian economies, but from Europe, the US, and to a lesser extent from Japan. Hence the multipliers for Asian regional demand from China’s domestic spending are relatively limited.

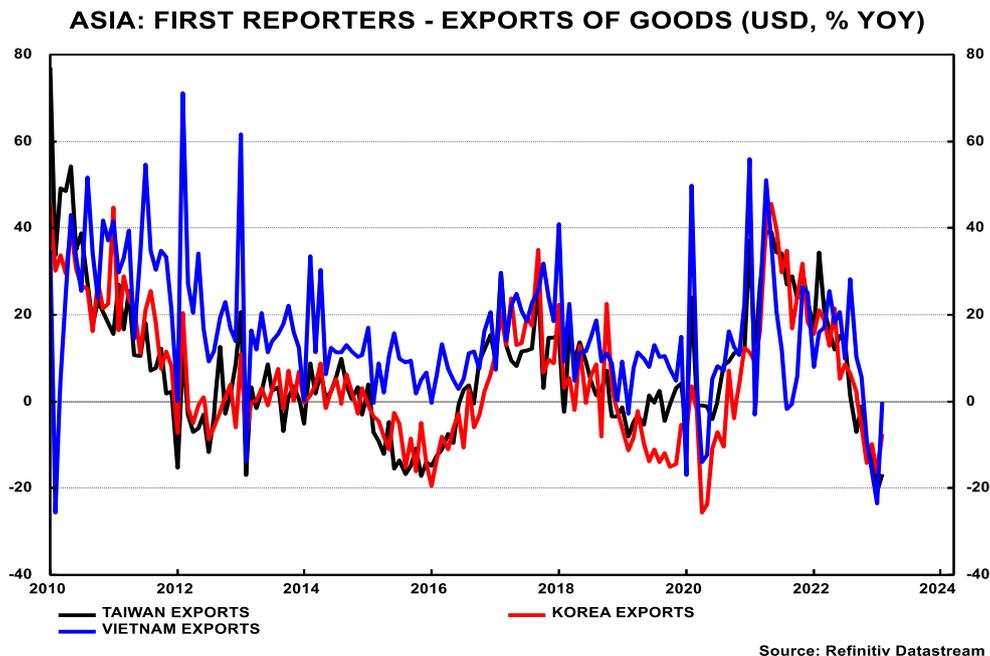
Second, despite China’s awesome rise as a global player and rival of the US in economic scale and political influence, in the crucial area of financial markets there are few economies in Asia where investors look to China rather than the US for the factors that set the tone, sentiment and liquidity conditions in their home markets. The reason, therefore, that so many Asian economies are still stuck in a slow money growth bind is that they mostly take their cues for policy settings from the US, where the US Fed is still squeezing money and credit, not from China which is easing.

Third, it is still predominantly US, European, and Japanese investors – and possibly some sovereign wealth funds – that comprise the bulk of investment flows to and from the East Asian markets. Chinese investors, whether individual or institutional, are still subject to foreign exchange and capital controls which greatly limit any influence they might otherwise have in setting prices in foreign asset markets.

Together, these three factors have prevented China’s monetary easing from having the impact it might otherwise have had on Asian regional stock markets or

economies. For the present these economies appear to be far more dependent on the US and global business cycle than on the state of the domestic Chinese economy.

Figure 5. Asian exports to remain on downward track in 2023.



Given the dominance of trade in the overall economic activity of the smaller East Asian economies it continues to make sense to monitor export orders and export growth as key leading indicators of overall GDP growth. To further simplify it is helpful to monitor the export growth of three economies that are highly engaged in global trade, and which also report their monthly data very promptly at the end of each month. Figure 5 shows the year-on-year percentage changes of exports of goods from Taiwan, Korea, and Vietnam (in USD terms) with the latest data recorded in the chart being for February 2023.

Before examining the current downturn, consider the data since 2010. Following a vigorous initial upturn after the GFC, growth in the period 2011-20 was subdued with two notable periods of weakness in 2015-16 and 2019. Only Vietnam's exports, which were rapidly gaining market share, remained buoyant during these downswings.

After the Covid lockdowns of 2020 and with the "re-opening" surge of economic activity across the developed world in 2021-22, Asian exports boomed from early 2021 until mid-2022, but since then they have plunged. The downturns in Asian exports are likely to be more prolonged than in the two earlier episodes because central banks in the developed economies are tightening policy to deal with inflation, and in several cases over-tightening. This time Vietnam's exports are no longer so buoyant. Looking ahead, the prospects for slowing nominal domestic spending in the US, the Euro area, the UK and elsewhere suggest that the trajectory for these economies will follow the template of 2015-16 at best, but will more likely see an

extended decline, especially if the US recession is deeper or more prolonged than the current consensus expects.

A useful tool for assessing these prospects is to compare the Conference Board’s leading economic indicator (LEI) for the US with a combined measure of the exports of the three “First Reporters,” (reported individually above in Figure 5), as shown in Figure 6.

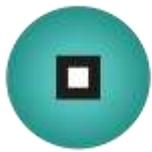
Figure 6. Conference Board’s LEI points to US recession, spelling a more prolonged downturn for Asian exports.



Source: Refinitiv Datastream

Although there have been times when the LEI was not a good predictor of Asian export growth – notably between late 2005 and mid-2007 – the forecasting record of the LEI for US recessions and for Asian exports during such downturns has been impeccable. In the comparatively short period shown in this chart, the LEI was an excellent predictor of the two US recessions of 2001 and 2008-09, leading Asian exports downward on each occasion. The implication is clear: a recovery in China will almost certainly not be enough to prevent Asian exports from experiencing a significant and prolonged decline in 2023-24.

In turn this means that most of the Asian economies will probably not provide a safe harbour for global investors during the forthcoming US recession. Far from being driven primarily by China, these economies remain fundamentally in the orbit of the US financial system and economy. My conclusion is that the only possibility of finding a safe haven in Asia would be if one or more of the three large economies of Asia – Japan, China, or India – was able to ply an independent path, easing monetary conditions (meaning accelerating broad money growth, not merely easing a narrow FCI measure), boosting asset values, enabling their domestic economy to



revive (as China did in 2009-11), and ultimately raising the overall price level. But Japan's money growth is headed in the wrong direction; China's acceleration of money growth, though substantial, will need to be sustained for longer and will only percolate to other smaller economies of Asia in a limited way; and India's monetary upturn is too small and insufficiently sustained to have the necessary impact.

Summary and Conclusion

- US monetary growth has been declining for a year, pointing to a US recession as and when the excess of money balances held by households and firms is used up. Does Asia offer a safe haven for investors?
- Asia could offer a safe harbour for investors if monetary growth in the region was independent of developments in the US, and Asian central banks were co-ordinating monetary accelerations across the region. However, our brief survey of Asian monetary growth finds that these conditions are not currently being fulfilled.
- Only China, and arguably India, can be said to be easing monetary growth sufficiently to generate positive asset returns in 2023.
- China has seen a significant acceleration of M2 from 8% to over 12% year-on-year. Although a vigorous economic recovery from the lockdowns of 2020-2022 is a racing certainty, the question is: will it also translate into higher asset prices?
- Both Japan and most other smaller east Asian economies are generally seeing slow or decelerating money growth that will likely remain subdued during 2023.
- In Japan's case, M2 growth is slowing, returning – as predicted here last year – to the slow, sub-optimal growth rate of 2-3% experienced during most of the last 30 years. Governor Kuroda is handing over to Prof. Kazuo Ueda having failed to achieve his mission of a sustained 2% inflation rate.
- Elsewhere among the smaller economies of East Asia, money and liquidity conditions are tight or tightening, although by no means as restrictive as in the US. Only Thailand is witnessing any acceleration of money growth.
- An alternative way to approach the haven question is to consider the channels by which the US or Chinese economies impact Asia, especially the trade and financial channels. Here the key question is: are the economies of East Asia sufficiently independent of conditions in the US to escape the business cycle downturn which seems certain to hit the US later this year?
- Again, this brief survey finds that Asian economies remain tied to the US in both trade and financial conditions. As long as this is the case it will be next to impossible for any of the smaller Asian economies to experience buoyant stock market trends when the US moves towards recession later in 2023 or in 2024.

Disclaimer

The information in this report has been prepared by International Monetary Monitor Ltd. (IMM). Materials available herein have no regard to the specific business objectives, financial situation or particular needs of any specific recipient. The research is published for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. The opinions, estimates and projections in this report reflect the current judgment and express views of the author as at the date of the report. They do not necessarily reflect the opinions of IMM and are subject to change without notice. Unless specifically stated otherwise, all price information is indicative only. No representation or warranty, either expressed or implied, is provided in relation to the accuracy, completeness, or reliability of the materials, nor are they a complete statement of the securities, markets or development referred to herein. The material should not be regarded by recipients as a substitute for the exercise of their own judgment. The financial instruments discussed in this report may not be suitable for all investors.

Copyright © 2023 International Monetary Monitor, not for distribution without express permission.
Registered office: c/o PKF Littlejohn, 15 Westferry Circus, Canary Wharf, London E14 4HD, UK.