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## Asian Outlook: An Early Peek Into 2009

- Despite widespread pessimism as to the depth and duration of the current global recession, one should not lose sight that Asia's fundamentals are sounder than they were ten years ago during the Asian financial crisis.
- However, Asia's key weakness is its exposure to external trade which is now buffeted by both lower demand and a global credit crunch that weakens remaining trade activities.
- One crucial unknown is the depth and duration of current global recession, and this uncertainty is one of the main causes for the financial markets' intense volatility in recent months.
- Currently, financial markets appear to be pricing in a 1997/98-type of recession scenario for Asia. At the minimum, it looks increasingly likely that Asia would be facing the same sort of downturn ten years ago and that means the cycle has only just begun, and it would be long and difficult process for Asia.
- Based on this preliminary assessment, we are factoring at least several quarters of negative y/y growth rates for some Asian countries into 2009. In particular for Singapore, output in the entire first half of 2009 is likely to shrink, for a full year growth forecast of 0.8%.

### Asian Fundamentals Still Sound

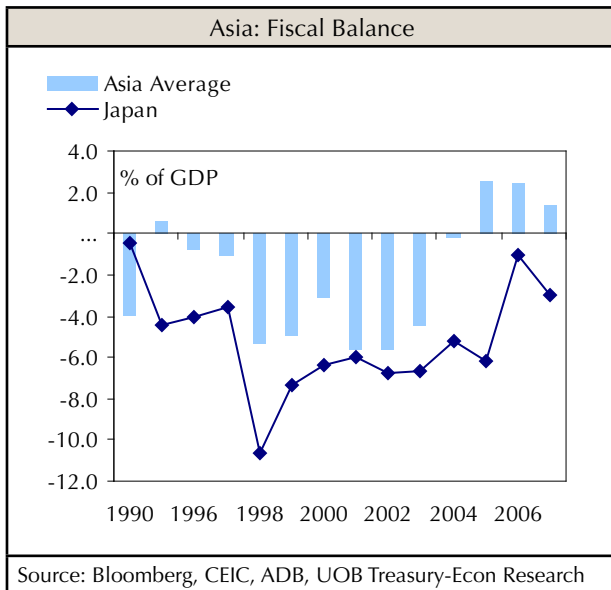
Despite widespread pessimism and uncertainty as to the depth and duration of the current global recession, one should not lose sight that Asia's fundamentals are sounder than they were ten years ago during the Asian financial crisis.

Since the Asian financial crisis in 1997/98, all three levels of economic participants in Asia, i.e. governments, corporates, and consumers, have reformed significantly in terms of key economic indicators.

Although there are pockets of weaknesses and vulnerability (e.g. South Korea and Indonesia), a quick look at some of these indicators generally reveal a favourable picture for most of Asia.

At the government level, fiscal positions have restored to positive balances in the past few years in Asia overall, after years spending and subsequent to the Asian financial crisis, repairing of a damaged economy. The deleveraging process after the 1997/98 crisis also saw debt loads coming off, with external debt down to an average of 75% of GDP by 2006, compared to peak of 130% of GDP in 1998 and even than before the run-up to the crisis. This last point is crucial as funding has become increasingly difficult during this episode of crisis, despite huge liquidity injections by central banks throughout the world, as risk aversion heightens and capital preservation is at the topmost priority for capital owners.

Similarly, at the corporate level, both leverage ratio and efficiency/profitability have improved significantly since 1998. Based on data of listed companies in Hong Kong, Singapore, Malaysia, Indonesia, and Thailand, it is clear that debt load has declined significantly. This is most evident in Indonesia, which had the highest leverage among the group in 1998 at 50% debt-to-asset ratio, and became the least leveraged by 2007. In terms of profitability as well, returns on equity have also gone from the days of "growth at all costs" to highly efficient users of capital.



Similarly, Asian consumers have stayed disciplined compared to ten years ago, with spending trending down (which means savings have gone up) and leverage also coming down. Although the loan-to-deposit (LD) ratio has risen, the uptrend only started in 2007 and should not be construed as a structural shift, given the rise in confidence over the past two years that coupled with strong performances in the equity and property markets. Going forward, the spending pattern is likely to remain conservative for Asian consumers, who are now buffeted by uncertain prospects, and the LD ratio is expected to head down once again as consumers pull back and financial institutions become cautious.

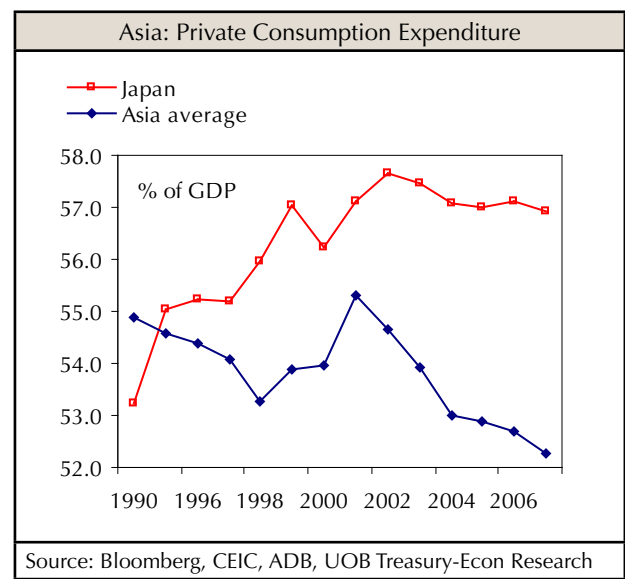
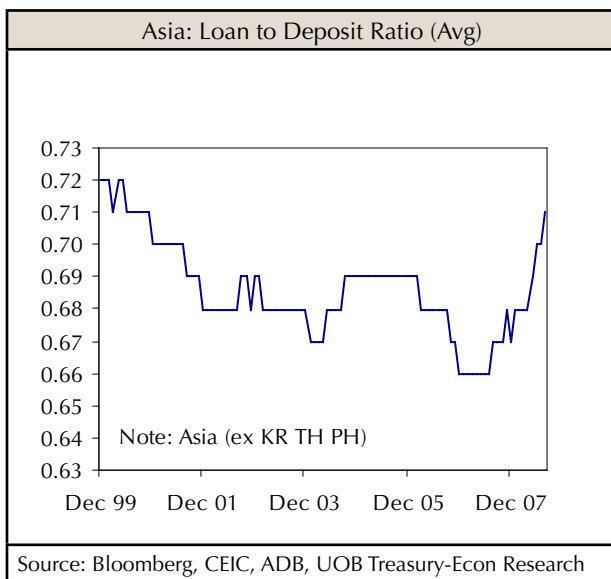
Even with all the improvements over the past ten years, Asia has increased its exposure to external trade. This reliance on external trade will be a key weakness in the current global recession as both private spending and investments in advanced economies pull back as a result of the credit crunch. Whatever demand that is left is faced with the difficulties of obtaining trade financing and working capital loans as banks turn cautious and preserve capital against the deterioration of asset quality. This means that export-dependent Asia is facing a double whammy just at the wrong time: an already weakened external demand is being constricted by tight credit conditions.

Asia Corporate: Debt to Asset Ratio (Average)				
%	1998	2000	2006	2007
Hong Kong	22.5	21.5	17.8	23.0
Singapore	21.3	25.4	25.0	23.2
Malaysia	27.0	22.8	23.4	20.6
Indonesia	50.0	35.8	20.8	17.4
Thailand	43.9	44.7	24.0	23.8
Average	32.9	30.0	22.2	21.6

Asia Corporate: Return on Equity (Average)				
%	1998	2000	2006	2007
Hong Kong	11.7	16.9	24.6	42.1
Singapore	-0.7	10.5	24.0	23.3
Malaysia	1.6	11.0	15.3	21.9
Indonesia	-25.8	-3.0	8.7	21.1
Thailand	-2.4	3.4	7.3	5.4
Average	-3.1	7.8	16.0	22.8

Source: Bloomberg, UOB Treasury-Econ Research estimates



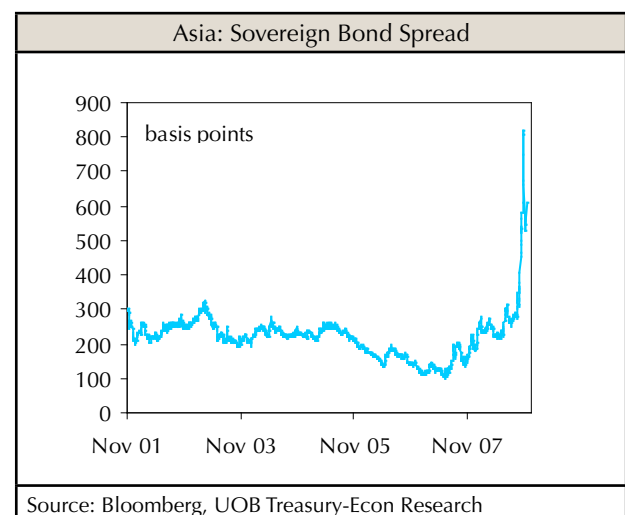
### What Are Financial Markets Pricing In?

With the evolving of the global credit crunch into the worst crisis in at least one generation and even the worst since the Great Depression, it is not surprising that the financial markets have been continuously assessing the duration and the depth of this global economic recession. This uncertainty has resulted in extreme volatilities in price actions across equities, currencies, and commodities markets.

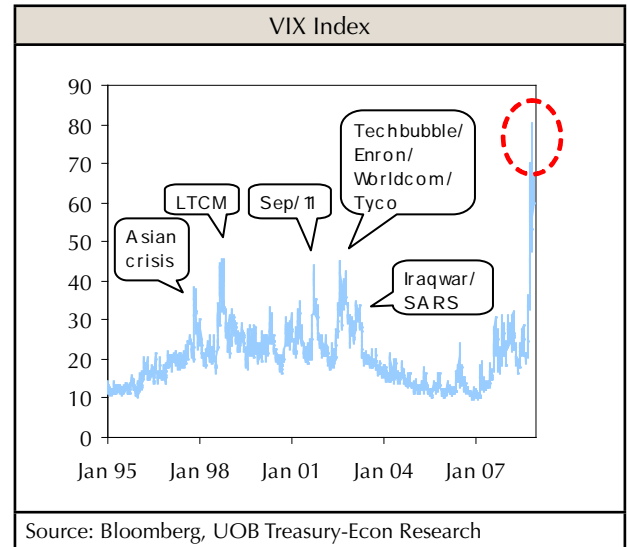
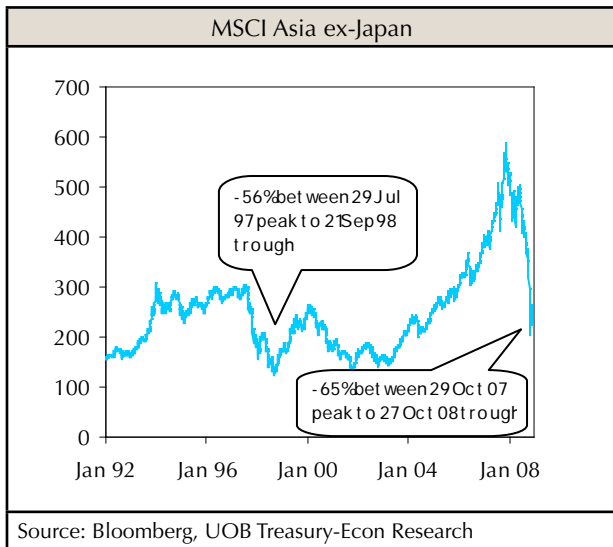
For Asia, the financial markets appear to be pricing in a recession similar to those experienced in 1997/98 financial crisis, which may be at odds (i.e. optimistic) with the severity of the global credit crisis. For instance, sovereign bond spreads have risen significantly, partly as a result of Asian governments assuming private sector credit risk through deposit guarantees, and partly due to risings risk of defaults as economic growth slows and export earnings deteriorate across Asia.

In equity markets, the MSCI Asia ex-Japan has corrected sharply since the peak in Oct 2007, to the extent of about 65% decline. Interestingly, the 1997/98 Asian financial crisis also saw a similar correction over the 12-month period, with the peak-to-trough decline of 56% between 29 July 1997 and 21 Sep 1998. This suggests that market participants may be looking at similar extent of decline in economic activities.

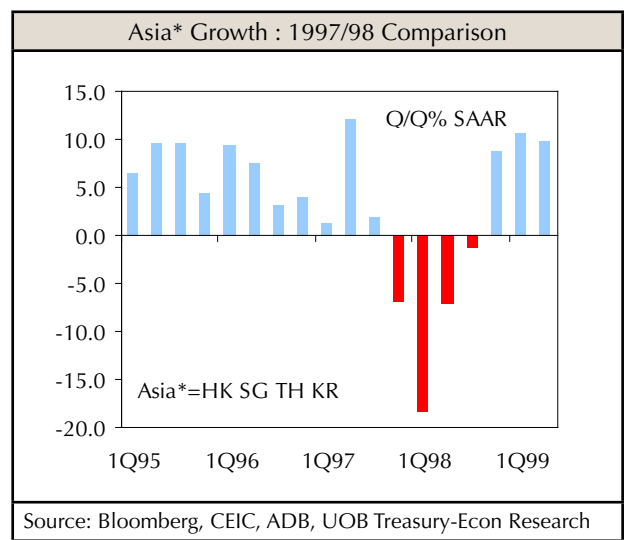
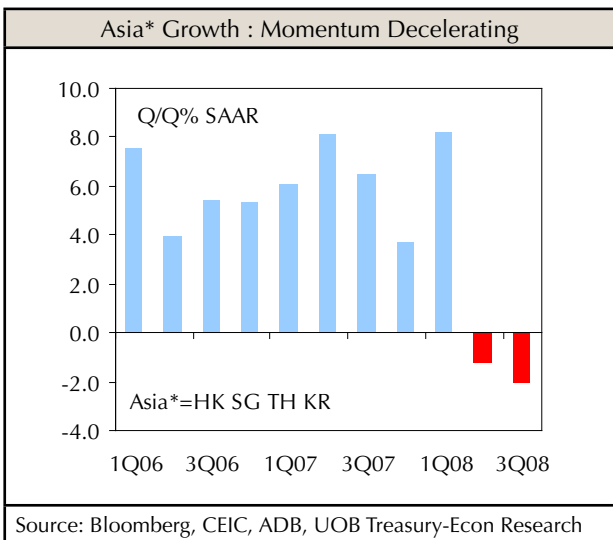
The volatility index or “fear index” VIX has behaved in an extremely volatile manner as well, as market participants attempt to grasp the extent of the fallout from the global credit crisis, which is spreading to the real economy. The VIX hit record high of 80 on 27 Oct, and this scale far exceeds the previous crises, e.g. during LTCM crisis in Sep 1998 and the tech bubble burst/Enron episode in 2001-2002.



Given that financial markets tend to overreact or undershoot to events, it may be instructive to have a quick recap of what happened to Asian growth momentum during the 1997/98 crisis.



Asia experienced four executive quarters of q/q SAAR declines during 1997/98 as the full impact of deleveraging hit the economy. In this round, Asia has only seen two consecutive quarters of contractions in 2Q08 and 3Q08, and the extent is comparatively shallower than the 1997/98 episode.



It should be noted that for both episodes prior to entering into these periods of contraction, growth momentum has averaged around 7% in the preceding 3 years. This means that in both instances, Asia has expanded at a similar pace just prior to the recession.

If history repeats, this would suggest that Asia should see a fairly challenging 1H2009 as the momentum of declines gathers speed. While the situation remains dynamic, our preliminary projections show that several countries e.g. Singapore and Taiwan will see y/y contractions in 1H2009, while broad-based growth weakening is seen throughout the countries under our coverage. In particular for Singapore, output in the entire first half of 2009 is likely to shrink, for a full year growth forecast of 0.8%, which is the slowest since the -2.4% in 2001.

It should be noted that these projections are preliminary and presented for guidance, and will be subject to revisions depending on incoming data and events that are still unfolding.

Quarterly GDP Growth Forecasts								
y/y % change	2007	2008F	2009F	4Q08F	1Q09F	2Q09F	3Q09F	4Q09F
US*	2.2%	1.4%	-0.1%	-1.7%	-0.5%	0.5%	0.5%	1.2%
Singapore	7.7%	2.7%	0.8%	2.2%	-1.6%	-0.7%	2.2%	3.2%
Malaysia	6.3%	5.1%	3.0%	3.2%	2.4%	1.7%	2.7%	4.9%
Indonesia	6.3%	5.4%	3.6%	4.1%	3.3%	2.3%	3.3%	5.5%
China	11.9%	9.5%	8.3%	8.6%	8.0%	8.3%	8.2%	8.5%
Hong Kong	6.4%	1.9%	2.4%	-2.0%	0.8%	1.1%	1.3%	1.7%
Taiwan	5.7%	3.5%	0.5%	2.0%	-1.5%	-0.6%	1.8%	2.3%
South Korea	5.0%	4.1%	1.5%	2.1%	0.8%	0.2%	1.2%	3.8%
Source: CEIC, UOB Treasury-Econ Research								
*annual rate for quarterly forecasts (based on information through Nov. 6)								

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