MIRAE ASSET LENS ISSUE 6 Part 3

Asian Financials: A Tough Operating Environment

In this Issue

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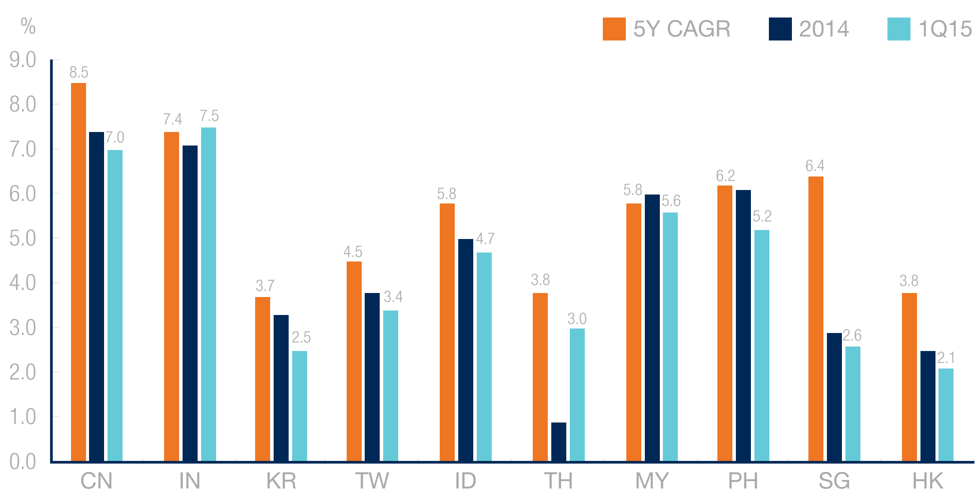
Asian Financials: A Tough Operating Environment

As economic activity shows signs of slowing down across Asia, central banks are seeking alternative measures to stimulate consumption and reverse indications of lagging investment growth. According to analysts, the slowdown in real GDP growth masks an even sharper slowdown in nominal GDP growth. While consumption has abated, fixed investment growth continues to worsen, posing further risk to both foreign and domestic markets.

Real GDP Growth in Asia

Source: CEIC, Credit Suisse, Mirae Asset Global Investments (June 2015)



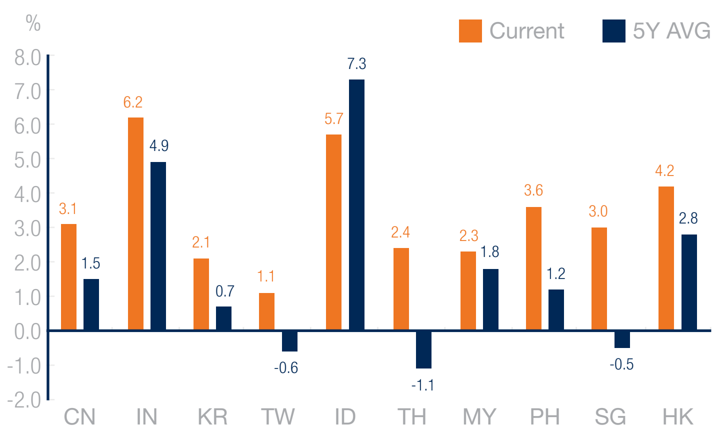
Growth is slumping across the region on slower demand and consumption.

Asia Braces for Disinflation

Headline consumer price indices are dropping across Asia and though the majority remain in positive territory, the producer price index has been negative in all countries except Indonesia, which has persistently gained over the past year in particular, while China has trended downward over the past three years. As a result, in the first quarter of 2015, the GDP deflator (an overall measure of inflation) was negative in four of the ten Asian countries.

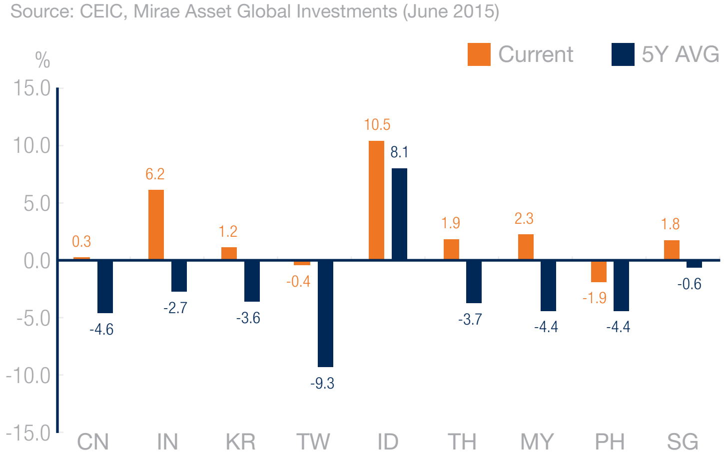
Consumer Price Index (CPI)

Source: CEIC, Mirae Asset Global Investments (June 2015)



Producer Price Index (PPI)

Source: CEIC, Mirae Asset Global Investments (June 2015)



Consumer inflation is trending lower, adversely affecting producer prices in all countries in the region (ex-Indonesia).

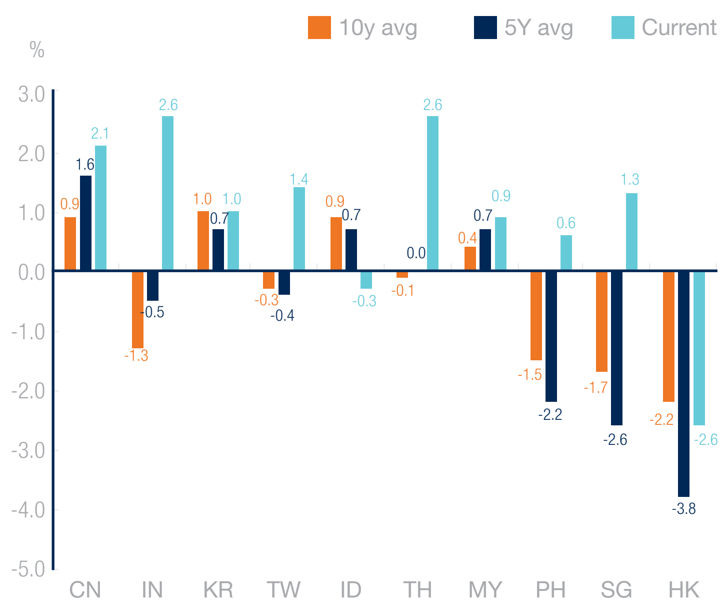
Additionally corporate sector sales and profit growth remain under pressure as deflation persists. Corporates account for more than two-thirds of total loans across Asia, representing a key driver for credit growth as well as asset quality risks for the banking sector. Such deflationary pressures are weighing heavily on the real interest cost for corporates and households alike, presenting further obstacles toward economic growth.

Although some of the central banks in the region have cut policy rates, inflation has been falling more sharply, thereby leading to rising real interest rates. As it stands, Asian central banks appear reluctant to trim rates ahead of the US Fed rate hike cycle.

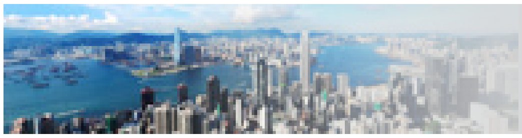
Asia Real Policy Rates*

Source: CEIC, Mirae Asset Global Investments (June 2015)

* Real policy rates are defined as nominal 3M interbank rates less concurrent inflation



Real rates have moved up across Asia, inflation has dropped more pronouncedly, for rising real interest rates.



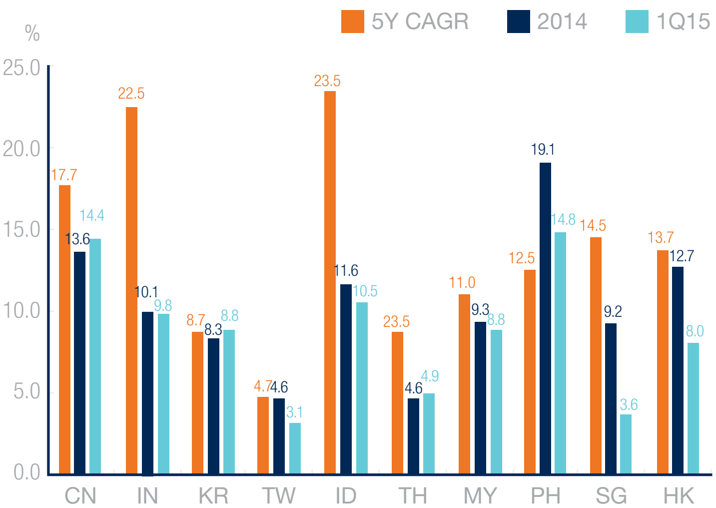
Implications for the Financial Sector

Macro-economic factors affect all key earnings' drivers of banks, hence the importance of the broader macro environment for the financial sector. Nominal GDP growth underpins demand for loans, while interest rates impact banks' net interest margins and deposit inflows. Real interest rates determine the interest burden on corporates, translating into the asset quality for banks.

We are now seeing a slump in domestic demand across the region, with loan growth at the lowest levels since 2009. The slowdown in credit stems from weaker corporate demand reflecting a pause in the investment cycle (as seen in the slower growth in gross fixed capital formation). The investment cycle slowdown is largely triggered by overcapacity in China, and various other factors, including lower capacity utilization and policy bottlenecks. Private corporate capex is expected to remain sluggish due to both weak incentives for corporates to invest and constraints affecting their ability to invest.

Banking System Loan Growth Across Asia

Source: CEIC, Mirae Asset Global Investments (June 2015)



Credit growth is decelerating on the back of a reduction in capital expenditures and investment.

With slower growth – owing to scarce demand with capital abundance thanks to easing by central banks – and lower inflation leading to even lower nominal GDP growth, loan demand has dropped sharply across all countries. Furthermore, rising real interest rates have put pressure on the corporate sector, which account for two-thirds of bank loan books. In such an environment, investors would prefer countries where monetary easing will have the ability to deliver a boost to domestic demand coupled with low credit penetration and favorable demographics, particularly apparent in India, Indonesia, and the Philippines.

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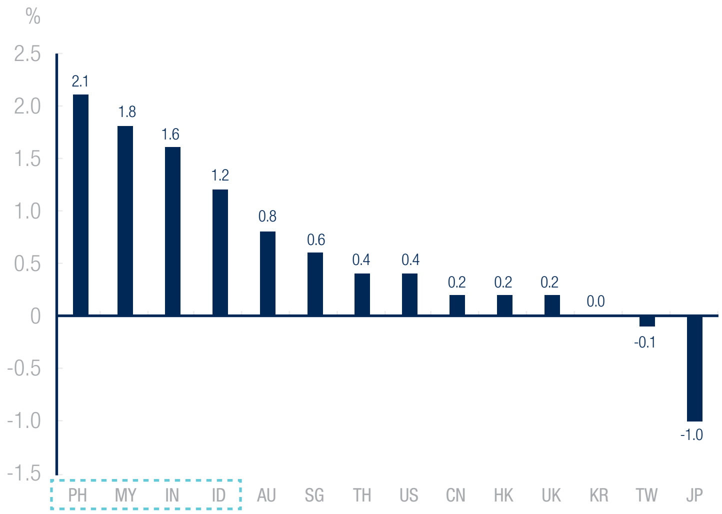
Attractive demographics alongside strong labor population growth, if tapped well, can lead to a durable growth potential. Once more, countries that stand out based on these characteristics include India, Indonesia, and the Philippines. Penetration levels remain low in these three countries (particularly consumer credit) offering an attractive growth opportunity for banks with a significant presence in these segments.

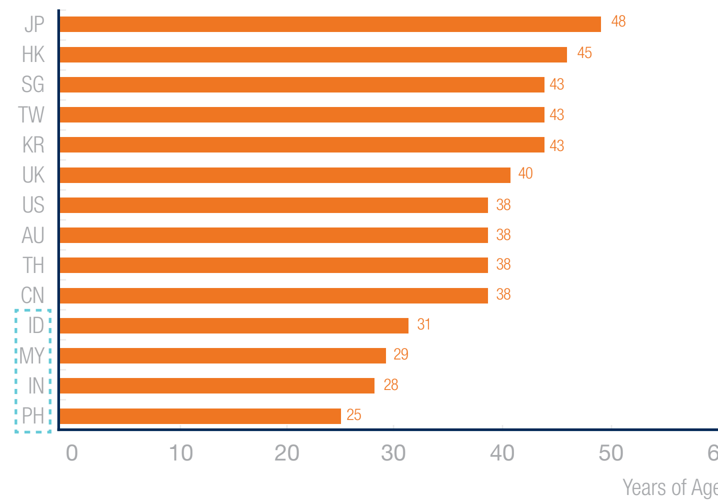
Labour Population Growth CAGR (2010-2020)

Source: UN, Department of Social Economic and Social Affairs, World Population Prospects (2012 Revision); Mirae Asset Global Investments (June 2015)



Median Age (2020 Estimated)

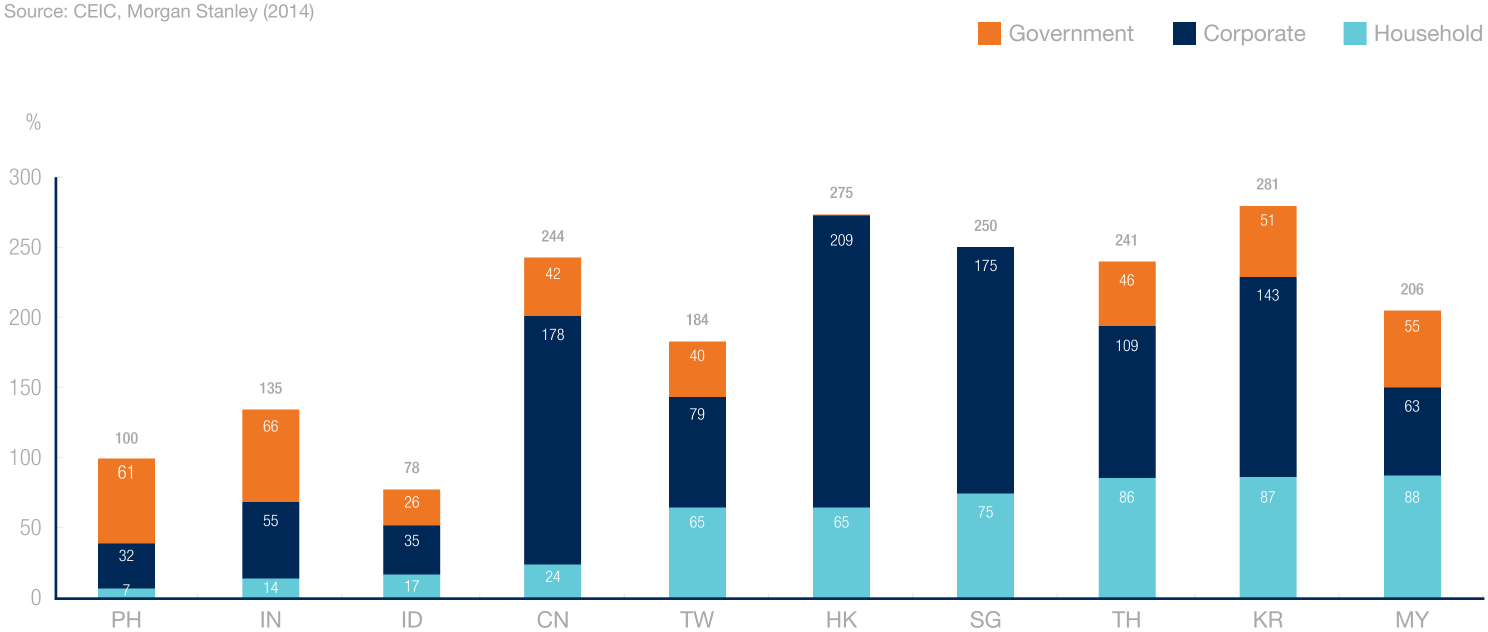
Source: UN, Department of Social Economic and Social Affairs, World Population Prospects (2012 Revision); Mirae Asset Global Investments (June 2015)



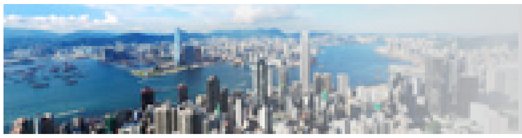
Asia boasts preferential demographics, with labour pool growth and a low median age, particularly in the Philippines, India, and Indonesia.

Credit Penetration by Segment (as a % of GDP)

Source: CEIC, Morgan Stanley (2014)



The Asian consumer remains unlevered, presenting retail banks with considerable opportunity for growth.



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Asia's Reduced Financial Contagion Risks

Asia's emerging markets continue to benefit from liquidity-easing measures stemming from 2009 as credit penetration has increased over the last five years. Concern has centered on countries running twin deficits in their government budget and current accounts, such as Indonesia, India to some extent, and much of ASEAN. However, such vulnerabilities have eased since the taper talks began in mid-2013, and most of the countries – alongside their asset classes – have somewhat corrected themselves. This gives us confidence that we would not see a repeat of the "taper tantrum" prevalent during mid-2013, brought on by statements surrounding Fed tapering. Despite this, it may be too soon to rule out short-term volatility when US interest rates eventually start rising.

> *Vulnerabilities have eased since the taper talks began in mid-2013, and most of the countries – alongside their asset classes – have somewhat corrected themselves.*

Asia Country Scorecard: Current vs. 2013 Taper Tantrum

Source: UBS, Mirae Asset Global Investments (June 2015)

	Bond Yield Spread vs. US Treasury Bill			Forward P/E			Exchange Rate (vs. USD)			Current Account (% of GDP)			FX reserves (US$ bn)		
	Current	Apr-13	Difference	Current	Apr-13	Change (%)	Current	Apr-13	Change (%)	Current	Apr-13	Difference	Current	Apr-13	Change (%)
China	114	182	-68	12.3	8.8	39.8	6.2	6.2	-0.5	2.5	1.5	1.0	3,730	3,534	5.5
Hong Kong	-84	-82	-2	16.7	14.9	12.1	7.8	7.8	0.1	1.5	1.5	0.0	345	307	12.4
India	569	606	-37	16.9	13.5	25.2	63.6	53.8	-15.4	0.5	-1.7	2.2	353	296	19.3
Indonesia	600	383	217	14.7	15.1	-2.6	13,122	9,734	-26	-2.2	-3.2	1.0	105	101	4.0
Korea	34	110	-76	10.2	7.9	29.1	1,094	1,101	1	9.3	6.2	3.1	372	329	13.1
Malaysia	165	170	-5	16.0	14.6	9.6	3.6	3.0	-15.5	-0.5	4.0	-4.5	102	136	-25.0
Philippines	181	181	0	19.9	20.5	-2.9	44.5	41.2	-7.4	5.8	3.5	2.3	71	72	-1.4
Singapore	19	-30	49	13.9	14.1	-1.4	1.3	1.2	-7.6	22.5	17.9	4.6	246	259	-5.0
Taiwan	-65	-46	-19	13.2	14.1	-6.4	30.6	29.5	-3.3	14.5	10.8	3.7	419	405	3.5
Thailand	62	172	-110	13.9	12.3	13.0	33.4	29.3	-12.2	4.0	-1.0	5.0	153	169	-9.5
Japan	-181	-106	-75	15.7	15.1	4.0	121.0	97.6	-19.3	1.5	0.7	0.8	1,193	1,189	0.3
Australia	75	142	-67	16.7	14.2	17.6	1.3	1.0	-23.7	-3.5	-3.3	-0.2	46	41	12.2
US				17.6	14.0	25.7				-1.6	-2.4	0.8	40	48	-16.7

The Taper Tantrum in the summer of 2013 served as a wake-up call, reducing vulnerabilities in ASEAN.

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