



A balanced Asia is poised to deliver

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East Asia's emergence as an economic force of late is as striking as Japan's rise was a few decades ago. The region excluding Japan accounted for 26.7% of world growth over the past five years compared with just 5.7% in the 1960s.

The figures are just as impressive at an industry level for the nine countries found in the MSCI Far East Free (ex-Japan) Index (China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand), the benchmark for the IOOF/Perennial Asia Trust.

Asia ex-Japan now makes 11 million cars a year, more than one-sixth of the world's total. Asia ex-Japan makes 45% of the world's steel and 40% of the world's semi-conductors. About 10% of world's wealth now resides in Asia ex-Japan (and 40% including Japan).

Yet this is not reflected in world share markets. Asia ex-Japan only comprises a little more than 2% of the MSCI World Index compared with close to 60% for the US.

But if Japan's experience from 1960 to 1990 is any guide, Asia could be on the verge of a few decades of solid share-market returns.

What Japan's record during the 1960s reveals is that high economic growth figures, by themselves, don't always lead to impressive share market returns. It was only in the 1970s and 1980s when economic growth was seen as sustainable and balanced that Japan's share markets thrived – even if the economy growth on an average-per-annum basis was lower than before (but still respectable).

When investors warmed to Japan's economy from the early 1970s, the country's share market returned 20% per annum for the next two decades or so in US-dollar terms for foreigners.

Perennial Asia thinks economic growth in Asia ex-Japan has become more sustainable and balanced since the Asia crisis of 1997. It expects regional share markets will benefit in coming years when more investors recognise this development.

The spark

If there was one thing that altered the perception foreigners had of the Japan's economy it was the rise of the yen after it was floated in 1972. Over the next 20 years, the currency rose from its fixed rate of 360 to the US dollar to less than 100 yen (where it trades nowadays).

For some reason, a rising currency helps convince investors a country has economic muscle. It's good financial public relations.

Perennial Asia thinks the relaxation of the Chinese currency's peg of 8.3 yuan to the US dollar in July could trigger a similar public-relations boost for China and the rest of Asia ex-Japan, where



many currencies are linked to the US dollar. These currencies are likely to rise because Asian economies are generating substantial trade and current-account surpluses.

Rising Asian currencies could encourage Asian governments to adopt a more domestic demand focused growth policy, which will lead to a more sustainable and balanced economic structure. There are signs that such policies are being implemented.

Firstly, governments took steps after the Asia crisis to make economic growth more reliable and balanced. These measures included financial reforms to strengthen banking systems and policies aimed at developing domestic-demand driven economies rather than export-driven ones.

Secondly, the emergence of a manufacturing sector in China has opened new markets for its neighbours. China's booming car and semi-conductor industries are buying Korean steel, Japanese machineries and Taiwan technologies. This has diversified the sources of export-led growth for these countries.

Thirdly, Asia ex-Japan has become more democratic. Only China, of the nine countries in the index, isn't democratic. Thailand recently saw the first re-election of a government that had run its full four-year term. Democracy usually enshrines property rights, adds transparency to government decisions and lowers political uncertainty – factors that encourage economic development.

Fourthly, corporate governance in Asia has improved. International disclosure standards such as consolidated financial statements and quarterly reports have been adopted by many large Asian companies and independent directors are appearing on boards. Many Asian companies are adopting international accounting standards. Better governance boosts investor confidence and encourages investment because businesses have more information on which to base decisions.

When the world catches up on all this, Asia's share markets are likely to benefit.

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