IMA
Insight beyond information

Richard Martin

India CEO Roundtable
Jaipur, December 2014

A Shifting Axis: Re-Assessing the Global Economy

CONSUMER HEALTH WARNING
"About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know." *Keynes, 1937*

A Shifting Axis

Despite the many uncertainties, the recalculated numbers still show a dramatic shift in global market share in the decade from 2008.

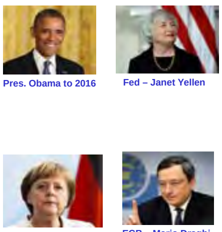
The Pluses for 2015
- Lower oil & commodity prices
- A strong US recovery

The Risks for 2015
- Greece & the Euro area (again!)
- QE & forex volatility
- China overshoots with its cooling measures

Big challenges to national growth models
- Europe
- North Asia

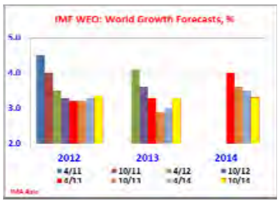
A Shifting Axis = Politics Counts

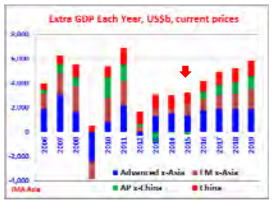
Xi Jinping to 2023
PBOC Zhou Xiaochuan
PM Modi to 2024
RBI Raghuram Rajan
PM Abe to 2018
BOJ Kuroda
Pres. Jokowi to 2024
BI Agus Martowardojo



Pres. Obama to 2016
Fed – Janet Yellen
Chancellor Merkel to 2017 or 2021
ECB – Mario Draghi

Stuck in a World Where Growth Disappoints



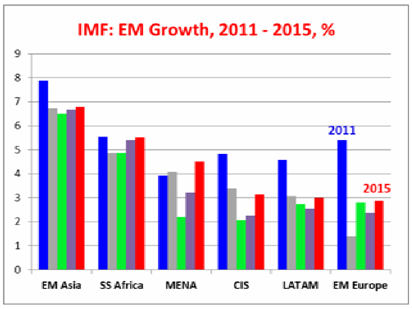


From 2012, global growth has consistently disappointed, with the IMF cutting growth forecasts for the "next year" in every one of its semi-annual forecasts since October 2011.

Structural challenges are not being addressed and have overwhelmed cyclical trends.

In average years from 2004 to 2011, World GDP grew by \$4-6 trillion. Mining and manufacturing capacity expanded to meet growth. 2015 could be the 4th year of over-capacity, putting further downward pressure on prices.

Emerging Markets: the BRICS Story Fades



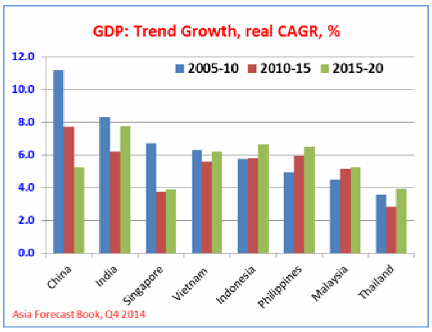
Why does EM Asia hold onto 6%+ growth?

China dominates in EM Asia growth
- But ASEAN & India grow as fast as China

The rise of EM depends on
1. Political stability
2. Good policies
3. Relations with China

Plus an adverse shift in geopolitics & oil prices hurts some EM:
- Putin goes feral
- Islamic radicals
- US fracking + S. Arabia drive oil price down

EM Asia: Growth Outlook



Politics & policy explain most of the forecasts.

China – Xi pushes rebalancing

India – Modi reforms government

Singapore – Voters don't agree with the PAP's big city plan

Vietnam – FDI in export factories after WTO entry

Indonesia – Jokowi reforms government.

Malaysia – PM Najib stabilizes govt.

Thailand – high political risk

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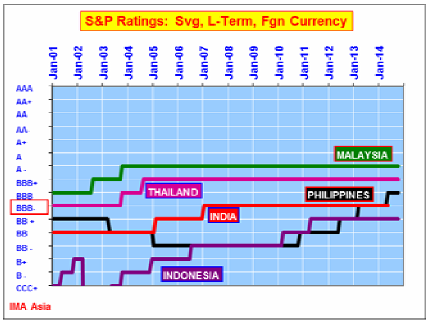
EM Asia: Improving Sovereign Risk



Achieving investment grade (IG, BBB-) brings access to global capital.

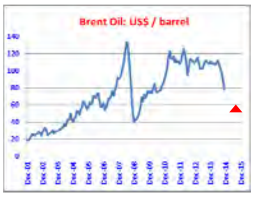
It also brings risks as if offshore borrowing rises and:
- Sales growth slows
- Interest rates rise
- Currency falls

Indonesia may win IG in 2015 so that the 5 core ASEAN states are all IG.

For India and ASEAN the game is about winning global capital

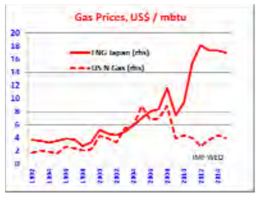
The Impact of Falling Oil Prices

The global benchmark for oil has fallen 35% or $40 from last November.



- Traders expect a floor at $60
- A $1tr annual boost for consumers; that should lift sentiment and spending
- A big plus for non-oil exporting EM as it reduces macro risk (fiscal, BoP, inflation)
- A big risk for OPEC & Russia

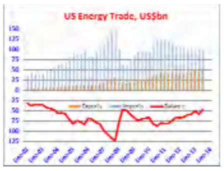
Waiting for the 2nd shoe to drop. LNG faces new supply and a falling oil peg.



Asia's long-term LNG contracts run off Japan's Custom-cleared Crude index and that should drop 30% by Q1'15.

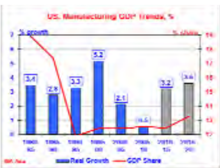
Watch for $14 LNG in Asia + a move to spot pricing, an end to the crude oil link, and an end to the destination clause.

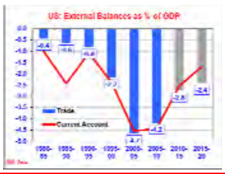
Fracking's Impact on Oil Prices & the US Economy



The US is ending its ban on oil & LNG exports. The big export gains are 2 years away when the US may become a net energy exporter.

Some 20% of the 4-year surge in capex is due to the rise of fracking.





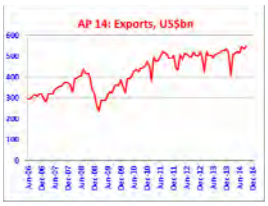
Energy intensive manufacturing moves to the US to tap cheap power. Ditto for chemical companies seeking cheap feedstock.

A smaller CAD means less foreign debt and stronger GDP growth.

▲ Good ▼ No Gain or Bad

	Impact of falling oil price in Asia	Consumer	Corp	Govt	BoP
Japan	Halts big electricity prices hikes as nuclear power dropped. Cuts trade deficit. Less need for a govt to rescue of utilities.	▲	▲	▲	▲
China	Helps complete domestic fuel price transition to global pricing.	▲	▲	▲	▲
HK		▲	▲	▲	▲
Taiwan	Will help adjustment to loss of 4th nuclear plant	▲	▲	▲	▲
Korea		▲	▲	▲	▲
Indonesia	Two quarter hit to consumers by 30% fuel price hike in Nov. A boost for govt spending on infrastructure & services. Lowers macro risk.	▼	▲	▲	▲
Malaysia	Tax hikes and subsidy cuts limit impact on consumer. Govt revenue (30% from O&G) takes a hit. Export earnings drop.	▲	▲	▼	▼
Philippines	No subsidies left so a big boost across the economy and trade account.	▲	▲	▲	▲
Singapore	Straight flow through to consumers and corporates with a mildly firm S$.	▲	▲	▲	▲
Thailand		▲	▲	▲	▲
Vietnam	Lower oil prices may help break the tangled web of SOE fuel subsidies, power monopolies, and big debts at operators.	▲	▲	▲	▲
India	Lower fuel prices will help consumers and car sales, while lowering the current account and fiscal deficits.	▲	▲	▲	▲
Australia	A big loss for LNG exports – halving the resource boom in Australia's outlook (weakens A$ by 2020). Hits govt tax and royalty revenue.	▲	▲	▼	▼

The Challenge for East Asia from Low Global Growth



Import growth, US$ basis, %

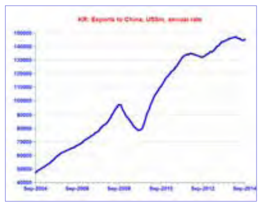
	2002 -2012	2013	YTD 2014	2015	2016	2015-2020
China	19.9	7.3	1.8	5.0	6.0	8.5
US	6.9	0.3	3.4	6.0	8.0	7.5
EU	10.1	-0.1	1.8	2.5	3.5	4.0

The Asian exporter's dilemma: Korea's example

In the 6 years since the GFC, Korean exports …

- To the US have risen by $20b a year
- To the EU have fallen by $8bn

- To the China have risen by $50b a year
- But growth stopped in 2014



As a result, export growth is stuck at 2%yoy.
No factory overtime, no household income lift, no rise in local demand.

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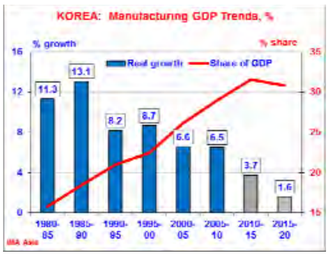
What will worry Korea for the next decade

Weak exports for 2012-14 will segue into a structural decline in manufacturing in Korea



A jump in Outbound Direct Investment (ODI) as Samsung and others move labor-intensive production to Vietnam (mobile phones) and India (auto parts).

To lift GDP, FM Choi sets out to drive up domestic demand by:

▪Forcing the chaebol to run down their cash reserves by lifting capex and salaries in Korea.

▪Easing restrictions on lending for home purchases - and urging households to borrow more. But HH debt is 160% of disposable income (the US in 2007 was 140%).

▪Watch for a property bubble followed by a 2015 bust.

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Why we are hopeful about US import demand

PAY as a share of national income has bottomed and is about to head up, so PROFITS will head down.

Growing consumer confidence lowers the savings rate, which pushes up consumption.

- Unemployment drops from 5.8% towards 5%
- Hourly pay growth lifts from 2%yoy to 3-4%
- Hours worked/week lift from 34.5 to 36
- Income growth lifts from 3% to 5%pa

- Savings rate stabilizes at 4-5% of income
- Home prices up 6%yoy; DJIA up 15%yoy.
- Petrol and energy prices falling
- Consumer spending lifts to 3-4%pa from 2%

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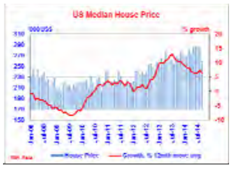
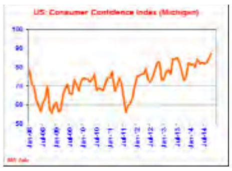
Good Trends for US Consumer Indicators





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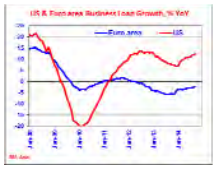
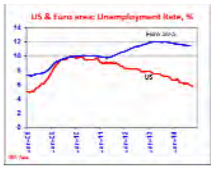
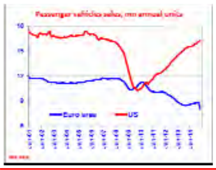
The Euro Area: Why No Recovery?







Rules for Recovering from Balance-Sheet driven Recessions:

A property bust hits the three private sector balance sheets
▪Households
▪Banks
▪Corporates

The only way for them to deleverage is for the government (the 4th balance sheet in an economy) to spend & take on debt.

The US did this fast

The Euro area won't do it

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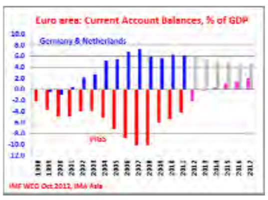
A Painful Rebalancing of North & South Europe

The Euro area operates under two fixed beliefs:

- No easy exit from the Euro (so wages and prices have to fall)
- Fiscal austerity is paramount, which means soaring unemployment



- While the US recovers to two thirds of its pre-GFC trend growth the Euro area will be lucky to get to half its pre-GFC growth trend.
- None of the structural reforms are growth positive in the short-term and Europe is moving very slow on deregulating domestic and labour markets

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Europe Risk: The Window is Closing for Mario Draghi

Germany

Merkel
CDU

Greece

Alexis Tsipras
SYRIZA

France

Marine Le Pen
National Front

Italy

Beppe Grillo
FIVE STAR
MOVEMENT

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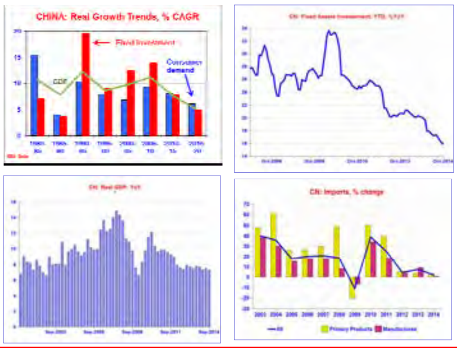
Rebalancing China

But Rebalancing China Means 2 More Years of Weak Imports



China's goal from 2011 has been to halve capex growth from 14%pa and sustain consumer growth at 7%.

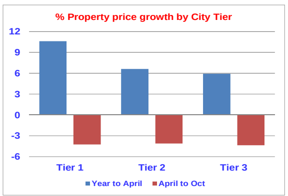
That requires slamming the brake on fixed asset investment (FAI).

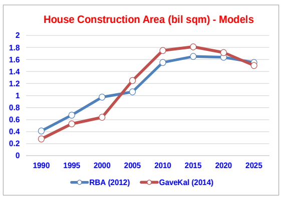
As fixed investment is 45% of GDP that means slowing GDP to around 7%.

It also means slowing imports of coal and iron ore.

Manufactured goods imports also fall.

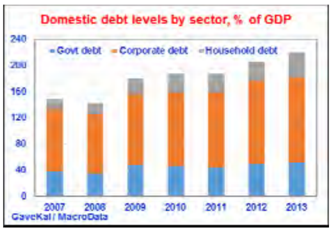
A Big Change in the China Housing Story





Rebalancing China means the start of painful consolidation

What path does China take to deleveraging?



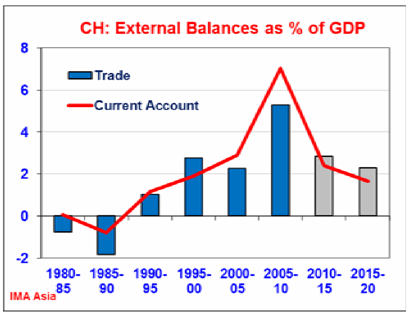
Option 1
A long slow grind
Keep the zombies moving as growth slows & start them on rehabilitation.

Option 2
Let the market do it
Put a market price on capital and make courts independent. Gamble that it's creative destruction so no long-term jump in the unemployed

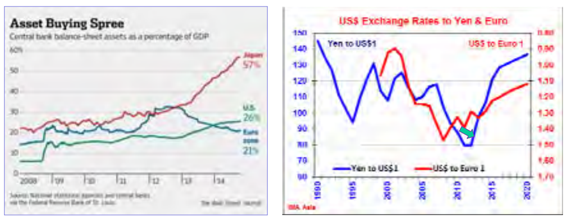
Option 3
Let the government carry it
Continue building leverage but on the government balance sheet (Japan)

- All options mean a loss of growth for the next two years.
- Option 2 has the best medium-term revival outlook.

China is Serious About Opening up to Imports



Guessing the Impact of QE Divergence on Currencies

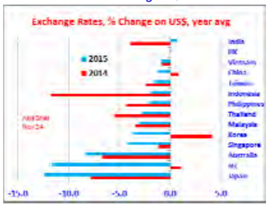


Watch for currency volatility in 2015 as the world's 3 big currencies realign.

Bottom line: Is the US recovery strong enough to lift the Euro area and Japan?

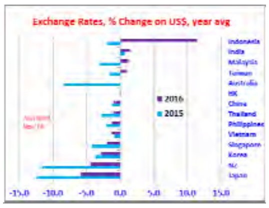
Asia Pac Currencies: What May Happen in 2015 & 2016

2015
Almost everyone gives up ground on a fast rising US$.



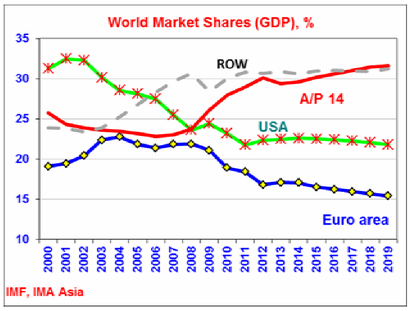
Japan – super QE
NZ & Aust – no rate rises & export challenges
Indonesia – does better than the 2013 rout
India – a very attractive 2015 story

2016
Depreciation on the US$ eases and a handful of currencies lift on the US$.



Indonesia – rebounds from 12,000 and returns to 9-10,000 as confidence recovers.
India – may climb faster than our forecast.

A Shifting Axis



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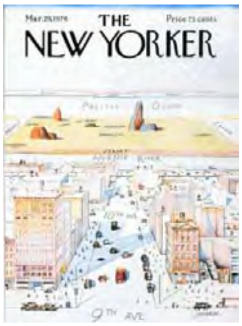

Saul Steinberg's March 29, 1976 "View of the World from Ninth Avenue" cover of The New Yorker