BLOG

Macroeconomic Challenges Facing Investment Banks in Asia

Guest Blogger

Over the past decade the global managers of investment banks have invested in building their Asia capabilities, especially their exposure to Greater China. One major issue for managers today is whether or not the opportunities in the next decade will require continued investment, status quo or disinvestment. The value of IPOs in Asia ex Japan has declined this year but will this trend persist over the next few years?

I'd argue for a cautious approach. Analysts have been forecasting China's economic demise for years with little to show for their pessimism. It's always hard to forecast economic and market turning points. Although wise with hindsight today, few of us accurately forecast the extent of the bust of overleveraged US and European financial markets in 2008. Nevertheless I'm nervous about China's total debt to GDP ratio of over 200%. It's pretty clear that debt needs to be serviced and paid down. Economic growth will slow as savings are diverted to debt repayment. As the economy slows there will be a bad debt problem in some areas.

As China slows, Australia's resource exports fueled growth will be hit and GDP growth rates will likely be more pedestrian than in recent years.

India also looks like a dodgy investment proposition. At 1.2% in 2012 (Source: OECD), it attracted the lowest foreign direct investment (FDI) as a percentage of GDP among the major emerging economies Brazil, Russia, China, Indonesia. In mitigation, India also attracted a proportionately higher share of portfolio investment flows as compared to Indonesia and China. Some portfolio investment flows can be long term investments.

FDI is a good source of longer maturity capital inflows to fund a current account deficit. It's dangerous to fund a current account deficit with short maturity funds because an outflow of funds can put pressure on your ability to fund the deficit. In Asia, India and Indonesia are frequently lumped together as victims of the ongoing capital outflows from emerging economies yet Indonesia's deficit is mostly covered by FDI whereas India has to fund more than half of its current account deficit with potentially shorter maturity funds.

The bigger challenge in India is the limited room for manoeuver due to relatively high inflation, the poor fiscal position, and most importantly, weak political will to push critical reforms through.

Nevertheless, India has less of an absolute debt problem than China. The stock of private sector domestic debt as a percentage of GDP has been rising steadily but still remains lower than that of

Brazil and well short of China’s spectacular figure. However, the Indian manufacturing sector is exposed to rising import costs following the decline of the Indian rupee and I’d expect to see bank sector bad debts rise over the next year or two. Indian manufacturing is also suffering from weak infrastructure and lack of investment over several years.

Slower economic growth and the risk of downside surprise from the domestic financial sector makes two of Asia’s major economies less powerful candidates to supply business to investment banks over the next few years.
