TD Bank Financial Group

TD Economics

Special Report

January 21, 2009

EMERGING ASIA: NATURE VS. NURTURE

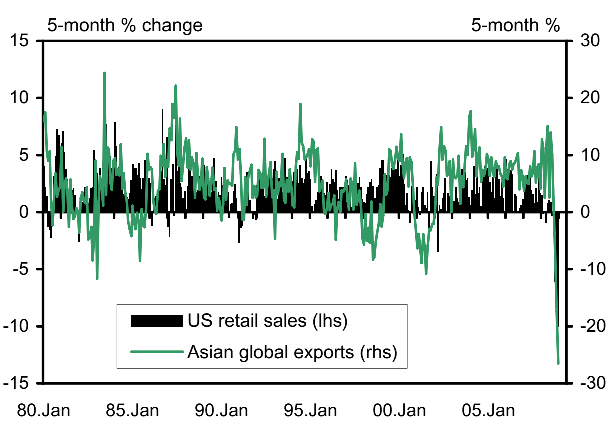
With Asian statistical releases generally ahead of the curve, the first official GDP releases for the fourth quarter are trickling in around Asia. From the trade data, we know things were bad, but looking at some of the consensus estimates for these GDP releases, the markets may not yet have internalized just how bad.

Singapore's preliminary GDP showed a 12% Q4 contraction (SAAR). **China's economy is expected to show a 6.8% y/y expansion, down from 9% in Q3. Our figures suggest China's y/y growth rate may actually fall closer to 5.9%**, and while China doesn't release real Q/Q figures, our estimates suggest that would represent a 4-5% contraction (SAAR) in the fourth quarter. But Korea could take home the Rusted Globe award for biggest contraction in the fourth quarter, with **our models suggesting the Korean economy contracted by 21% (SAAR) in Q4**, after expanding by 2% in Q3 – the consensus expectation right now is for a contraction of less than half that.

HIGHLIGHTS

- **Asian economic figures coming in suggest a very sharp contraction in the last quarter of 2008 – and potentially much sharper than markets are now expecting.**
- **Chinese GDP figures to be released tomorrow may show the year-over-year growth rate falling below 6%.**
- **However, once upon a time, economic forecasts had not just downside risks, but upside risks as well.**
- **On this note, there is the potential that the sharp decline in energy prices to date may stimulate global consumer spending later this year and provide a lift to Asian trade.**

ASIAN GLOBAL EXPORTS AND U.S. CONSUMERS



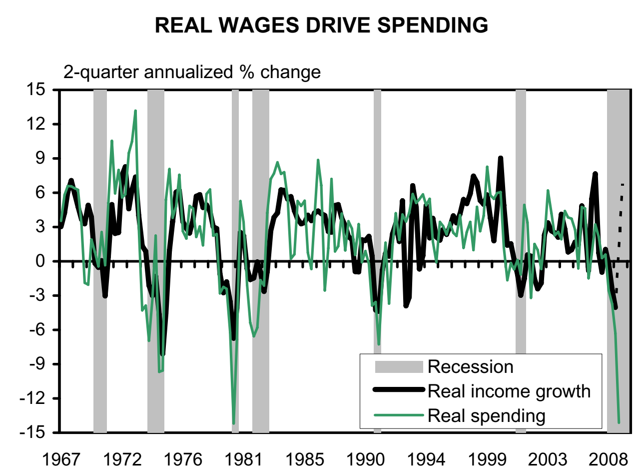
Source: National statistical agencies, Haver Analytics, and TD Economics

Now Asia is not alone, they're just first out of the gate. The US economy probably contracted by 6%, Japan 7%, and Brazil 13%, all representing the worst respective performances in decades. But the interesting question is not how bad was it, but how is that shock working through the system? On that note, it seems the relevant analysis is one of nature vs. nurture. The Q4 results were driven much more by nature – the retrenchment of the US consumer and crunch in credit financing. Looking into 2009, the more important driver is likely to be the nurturing component – the relative health of domestic banking systems and ability to process the relative shocks. For commodity exporters, these shocks are dramatic declines in earnings that must be distributed through the domestic system. But commodities are not the only thing declining on a nominal basis. The shock for Asian EMs has been the shocking nominal decline in Asian exports, in part driven by the nominal fall in

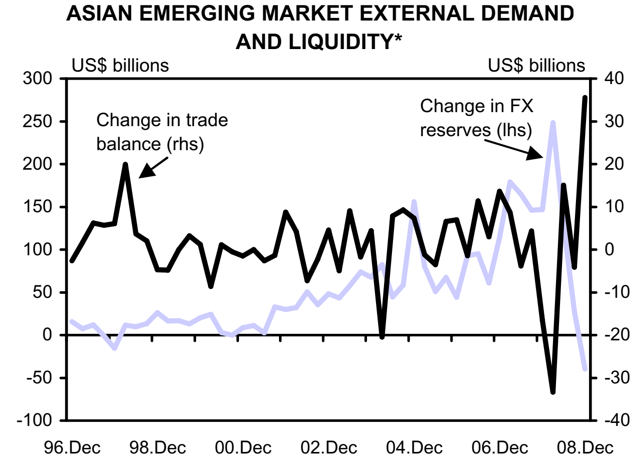
US retail sales. Our calculations suggest that, among other factors, 85% of the decline in nominal U.S. retail sales filters through into a decline in nominal Asian exports. In other words, **all else equal, a 10% contraction in U.S. retail sales implies an 8.5% contraction in global Asian exports**.

Asian currencies depreciated sharply in the fourth quarter (14% Asia ex-Japan, even more ex-Japan and China given the renminbi's stability), but as they should given the economic shock we now know hit these economies at the end of last year. That depreciation is a stabilizing factor in the economy, helping to dampen the pass-through into the domestic economy. And in the absence of widespread US$-denominated debts in Asian EMs, the scope for currency swings to drive solvency problems appears limited. But this does not mean these economies will avoid a recession. All four of the Asian Tigers are already in recession and will be joined by other local markets. It turns out a lot of that much-vaunted domestic demand that would sustain everyone was very much dependent on exports, which itself was very much dependent on US consumers. But these are your run-of-the-mill recessions, at least as far as the dynamics go, with the open question what the extent of bankruptcies, job losses, etc will be in the region as the shocks filter through.

But on the nature front, it should at least be considered that maybe all is not lost when it comes to the U.S. engine. With U.S. nominal income in December still to be reported, it looks like real income growth in the U.S. over the second half of 2008 was running at about 2.5% (SAAR). Even if the pace of decline in nominal income growth in the U.S.



Forecast for 2008Q4 and 2009Q1 by TD Economics as of January 2009; Source: Haver Analytics



*China, India, Indonesia, Korea, Malaysia, Phillippines, Taiwan, Thailand; Source: National statistical agencies and Haver

were to increase over the next three months, **the pace of real income growth in the U.S. could possibly accelerate to between 3.5-7% in Q1** – with the latter looking like the more likely result right now. That sort of jolt would drive U.S. retail spending, U.S. consumers, and by proxy, Asian exports.

By our estimations, the Asian trade balance in Q4 increased by its largest margin yet (in US$ terms) – the result of imports contracting much more than exports. That is the sign of the domestic recession in the local markets, the sharp contraction in Q4, and the needed adjustment. But it is also a sign of adjusting the level of inventories, which means less concern of overhang, as well as mitigating some of the pressure on fx-reserves right now. So we have real income growth in the U.S. and rising purchasing power for many commodity importers (Asian EMs included), some bounce in non-energy commodities, credit and lending data picking up in China, and some early European and U.S. indicators showing some change in direction into January. And let's not forget that fiscal stimulus is the new black. Global credit concerns are far from over. But as bad as it was in Q4, and as much as that shock will still need to filter through into Asian EMs and others in the months ahead, we shouldn't ignore the fact that the global economy is trying to heal itself.

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