

COMMENTARY

Taking stock of Asian financials

The outlook is positive, but a near-term risk could be aggressive tightening of monetary policy

ASIAN economies have rebounded strongly from the credit crisis and are expected to be the fastest growing region in the world in the next few years. This new economic cycle is, however, different from previous economic cycles in that Asian economies are not relying as heavily on exports for growth but are also being driven by domestic demand.

The growing importance of domestic demand is a long-term structural change that is taking place in Asia. A sector which is in a good position to benefit from the increasing importance of domestic demand is Asian financials. Fund manager **JOLENE SEETHO** at UOB Asset Management, shares her views on the outlook the sector.

Asian financial institutions have emerged from the recent global financial crisis in relatively better shape than their counterparts in the United States and Europe. Having learned the



lessons from Asia's own financial crisis in the late '90s, both Asian banks and borrowers entered the recent downturn with much stronger balance sheets, which reflects the sector's resilience.

Compared to a decade ago, Asian banks are much better capitalised, have low loan-to-deposits and have stronger risk management practices.

With the exception of Korean banks,

Asian banks by and large have strong deposit bases, low dependency on wholesale funding and low exposure to riskier foreign debt instruments.

Looking beyond the cyclical recovery, the outlook for Asian financial institutions is also positive from a structural point of view as Asian financial institutions are direct beneficiaries of Asia's emergence as a global economic power. Quite simply, a higher level of economic activity leads to a concomitant increase in the demand for financial services.

One area of financial services that is under-penetrated in Asia is consumer lending. When incomes are low, people usually buy what they need by using cash. But when incomes rise, credit worthiness also rises and consumer lending becomes more common. Households can borrow to buy a large range of products – motorcycles, cars, phones, household appliances. Mortgages also become more widely available.

In a modern economy, the financial sector is part of everyday life and necessary for doing business. Financial services that are also likely to enjoy steady growth include insurance (life, fire, property and motor), banking services like remittances, foreign exchange, trade financing, as well as corporate finance advisory. We also expect to see rising demand for wealth management services as more people in Asia become affluent.

Economic growth also drives capital market activities in Asia. The financial sector plays an important role in facilitating the capital-raising needs of private corporations and governments through initial public offerings (IPOs), secondary offerings, merger and acquisitions, rights, and the issuance of bonds. Capital market players like exchanges, brokerages and investment banks will therefore benefit as the region becomes economically and financially more sophisticated.

Against this macro backdrop, a

potential near-term investment risk in our view for Asian financials could be the aggressive tightening of monetary policies by central banks in Asia as inflation resurfaces. However, inflation in Asia is likely to peak in the second half of this year and if tightening turns out to be moderate, it is not likely to derail Asia's economic recovery. The appreciation of Asian currencies is also relieving some inflation pressure.

Asset quality could be another risk in coming years, in particular assets fuelled by China's credit boom last year. To that extent, we view that the early moves by the Chinese regulators to tighten supervision on bank-lending and to curb speculation in property as positive over the medium to long term. Overall, we believe that asset quality should be manageable as long as economic growth is sustained and the banking systems stay sound.

IMPACT OF EUROPE'S SOVEREIGN DEBT ISSUES ON ASIAN FINANCIALS

Equity markets have been volatile in recent weeks triggered in part by concerns of the sovereign debt problems in Europe. The Asian financials sector is relatively unaffected by the European debt crisis as Asian banks and financial institutions do not have significant reported holdings of debt in the affected European economies. As mentioned, Asian banks also have strong deposit base and liquidity positions. Even Korean banks have lowered their dependency on wholesale funding.

Since the US credit crisis, investors have, however, been cautious and swift in backing away from any signs of financial trouble. However, unlike the Lehman episode, the European debt crisis has so far not caused, in our view, a spillover into the global economy.

The concerns about Europe are nevertheless lingering and could continue to keep financial markets edgy for a while.

Another source of concern for equity investors are the measures China has been undertaking to cool its property market. These have been more aggressive than what the market had been expecting and the continued announcement of new policies continue to act as headwinds, especially for Asian markets.

However, we believe that markets are pricing these concerns in and that the ongoing recovery in the global economy and corporate earnings has the potential to drive equity markets higher over the coming months, but the path ahead is not likely to be smooth. ■