

ASIA

Global recession? Unlikely, says **Roger Smith**, who shares his Asian market tips



EUROPE'S FUTURE?

It was dry and cold on Christmas Eve on my second visit to Japan's fascinating ancient capital, Kyoto. It is also home of course to the Protocol on Climate Change, so readily ignored by the USA, China and other serious polluting nations. I was, as a keen gardener, determined to see again the great formal gardens of Japan's historic former capital. In the hive of activity that is the Japanese city, these pockets of tranquility are highly valued by all, locals and visitors, alike. In a way there is a metaphor for Japan itself. Pockets of excellence like the great Japanese corporate super-brands amid the rush of ugly post WWII urban development.

It still astonishes me that an island country, largely in economic recession since 1991, barely twice the size of the UK, and with only 25% of the land able to be used for habitation or development, is still the second largest global economy. (America is still number 1, Germany number 3 and now China has surpassed the UK to number 4.) With such an economy as Japan, geared to industrial development, innovation and excellence, comes wealth creation on a massive scale. With a deflationary environment comes a base bank rate of 0.5%! Taxis, hotels, food are quite reasonably priced now, compared to London, and Japan's reputation as an expensive holiday destination should definitely be in decline.

Asia is and will be the engine of global prosperity while the mature economies of the USA and Western Europe will struggle to compete.

Russia's current ascendancy is only based on high oil and gas prices. They have few other assets, skills or manufacturing power and a sharply declining population.

The current discussion in Asia is whether the expected downturn in the US economy in 2008 will have a depressing effect on the Asian economies. Asian stock markets have had a good run in the recent three years, so some price adjustment downwards is inevitable in 2008 as the fears of a US recession circulate. Japan's stock market, however, has had a stop-start result over the same period, proving unsatisfactory to most investors. Forecasters are again divided on whether 2008 will be a good year for the Japan recovery. The one advantage in a nervous global market is that Japan's index is already depressed and has little downside risk, unlike the Asian and China indices. So growth-orientated, adventurous, longer term investors could take a five-year view and take a holding in a good Japan fund such as Schroder Tokyo or Fidelity Japan.

Recession or short turbulence?

I tend to think the latter. Forecasts for Asian markets have to be separated from those for Japan, however. Asian markets have been boosted in recent years by factors such as positive macro economic news, strong earnings growth, healthy levels of takeover activity and corporate consolidation as well as a dynamic supply of liquidity in the market—there comes the possible 'crunch'. The incompetence of American bankers and rating

agencies which have got us into the current global banking crisis will bring about the expected downturn in the US economy. The US sub-prime loan losses are, however, expected to have little impact on Asian liquidity levels but the US consumers are Asia's key customers. We have Asian demographics to consider; the populations are typically much younger than in the west and have smaller numbers of elderly citizens to support. India is producing 2.5m graduates a year, while China's growth rate has averaged 10.4% pa for the last four years. But we have new factors in play in 2008 and the future—oil receipts and sovereign wealth.

The sovereign wealth funds from the Arab oil states, Singapore and China have huge cash reserves to invest in the markets and can pick up corporate super-brand assets cheaply in the ongoing downturn in world prices. While the UK's flagship P&O shipping group became a Dubai owned super-brand, J Sainsbury narrowly escaped the wealthy clutches of the Qatari's in 2007. Singapore has rescued one US bank from its sub-prime losses while Arab wealth has rescued another. China is investing heavily to try and block the proposed merger of Australia's largest iron ore producer BHP Billiton with the UK's flagship minerals group Rio Tinto to prevent one company largely controlling the price of iron ore. This is evidence that we are in quite a different ball game in 2008 but a full global recession seems unlikely. ❖



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