Ravi Menon: Asia – short-term bumps along long-term growth path

Remarks by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the opening of Korea's National Pension Service Office, Singapore, 17 September 2015.

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Dr Choi Kwang, Chairman and Chief Executive Officer, National Pension Service

Ladies and gentlemen, good afternoon

I am delighted to join you to celebrate the opening of the Singapore office of Korea's National Pension Service (NPS). This is an exciting development for Singapore's asset management industry.

- NPS manages one of the largest pension funds in the world, with KRW 500 trillion of assets under management.

The decision by NPS to set up an office here is significant.

- This will be NPS's first overseas office in Asia and its third in the world after New York and London.

In setting up an overseas office in Asia, NPS is affirming the long-term growth prospects for the region. NPS is clearly taking a strategic view of Asia against the backdrop of recent market volatility and moderation in growth.

Asia's recent tantrum: what does it mean?

Financial markets, including those in Asia, have experienced a surge in volatility over the past several weeks.

- Equity markets have taken a beating. The stock indices in Emerging Asia are down by an average of 18% since their highs in Q2 this year, with the Chinese stock market correcting the most, by about 40%.[1]
- Currency markets saw sharp movements. The depreciation of the RMB, alongside a pullback of foreign funds from the region, triggered downward pressures on the region's currencies. Since the RMB move on 11 August, Emerging Asia currencies have depreciated by an average of 3.2% against the US Dollar, with some falling by as much as 7%.[2]

While markets seem to have calmed somewhat, a sense of uncertainty prevails and the risk of renewed volatility remains. What is happening?

Financial markets are essentially coming to terms with four significant "re-pricings".

- First, the stock markets in China are adjusting downwards from unsustainably high levels.
- Second, the RMB has become de-coupled from the US Dollar and is moving towards a more market-determined exchange rate.
- Third, oil and commodity prices have eased considerably this year, marking the end of what some have called a "super-cycle".

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[1] *Emerging Asia economies refer to China, India, Korea, Hong Kong, Taiwan, Singapore, Thailand, Malaysia, Indonesia and the Philippines.*

[2] *Excluding the Hong Kong Dollar.*

- Fourth, the effects of an impending interest rate hike in the US – the first after seven years of extremely easy monetary policy – are being priced in across Asian markets.

These are not necessarily unwelcome developments.

The correction in China's stock market is not surprising given the stretched valuations that had developed over the preceding year. And it serves to deflate some of the excesses that have built up in the system, such as the rapid rise in margin financing.

The 2.5% depreciation of the RMB against the US Dollar since August is consistent with the divergence in growth momentum between China and the US. It must also be seen in the context of the 15% appreciation of the RMB in real effective terms during the year to July. The move towards a more market-determined exchange rate is in line with the broader liberalisation and internationalisation of the currency.

The gradual tightening of financial conditions in Emerging Asia as interest rates normalise in the US will serve to rein in the excessive credit expansion seen in some of the regional economies in recent years. It is not a bad thing to break the psychology of monetary over-dependence on the part of markets and even some policymakers.

Talk of currency wars is over-blown and comparisons with the Asian Financial Crisis are over-done.

To be sure, some of the gyrations in financial markets have reflected concerns among investors about the moderation of growth in Asia.

- The sluggish recovery in the G3 economies has taken the wind from many trade-oriented Asian economies.
- At the same time, the transition to domestic-led growth has been bumpy. Structural reforms to raise human capital, spur new investments and reduce impediments to growth have not proceeded quickly enough in many countries.

So, downside risks remain, and there may be further bumps along Asia's growth trajectory. But Asia is still expected to grow faster than other emerging economies.

- In China, debt overhang and excess capacity will be a drag. But sustained monetary and fiscal stimulus measures should help to pre-empt a sharp slippage in economic activity.
- In the ASEAN countries, a slowdown in export growth will have a negative impact. But public infrastructure spending and private consumption on the back of higher real incomes due to the decline in oil prices should help to shore up growth.
- Overall, growth in Emerging Asia is likely to stay above 6% in 2015, not too far below last year's 6.6%.

Looking beyond this adjustment period, the medium- to longer-term outlook for Asia continues to be bright. Ultimately, economic fundamentals matter the most, and the longer-term drivers of growth in the region remain positive.

- First, demographics across much of the region remain favourable, with the proportion of the working age population continuing to rise in most Asian economies.
- Second, the emergence of a sizeable middle class and ongoing urbanisation will underpin a continued expansion in domestic consumption and investment.

And Asia has the potential to do even better, if it continues to press ahead with deeper regional integration and domestic structural reforms.

Diversification for enhanced returns

The significance of Asia's growth and its implications for long-term investment returns are not lost to global asset managers. The increasing interest in the region is also motivated by the need at many pension funds and sovereign funds to achieve more diversified investment portfolios.

- These funds are increasingly diversifying their portfolio allocations across geographies and reducing the home bias towards investment in domestic markets.
- They are also diversifying across assets to include more non-traditional assets such as real estate, private equity and infrastructure, which promise sustained and attractive risk-adjusted returns.

Emerging Asia offers both asset and geographical diversification.

- Emerging Asia will remain one of the fastest growing regions in the world offering prospects of higher long-term returns, while the depth and liquidity of its asset markets should continue to improve.
- The growth dynamics of Emerging Asian economies is not only different from that of developed Europe and America but also differentiated from one another.
- Emerging Asia offers great potential for the development of alternative investment assets such as infrastructure, for which the region has enormous need.

I congratulate NPS on the opening of its Singapore office and wish you continued success in your regional strategy.