

Asia Focus

Estimating the Real Economy Fallout in Asia from the European Debt Crisis

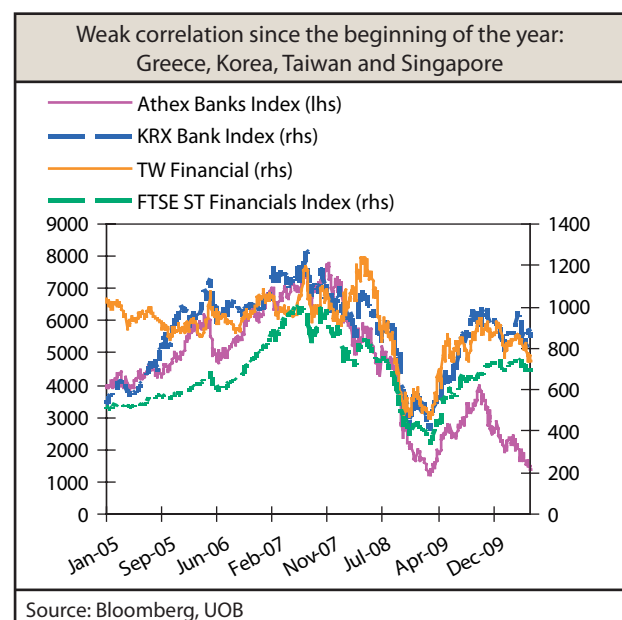
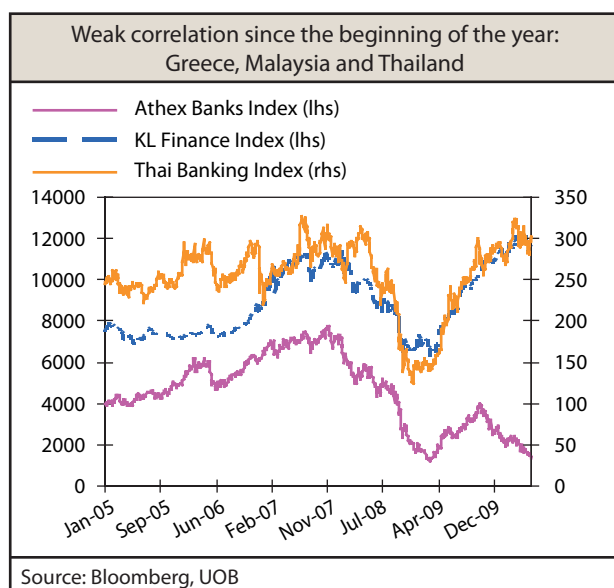
- *The weak correlation between Athen's banking stocks and the regional banking/financial stocks showed that the contagion risk to the banks has been well-contained and Asian banks' direct exposure is likely to be manageable even as there are valid concerns that any sharp spike in risk aversion could lead to large capital outflows from the region.*
- *We believe the most direct impact on Asia is still from the conduit of the real economy which would increase the growth risk for at least the next two years. We estimate that the income effect of a slowdown in economic growth in the EU economies will have a greater dampening impact on demand for Asian exports than the price effect of the EUR depreciation (against the respective Asian currency).*
- *In Asia, Singapore, Malaysia and China are the most vulnerable to any economic slowdown or EUR weakness. Overall, translating to GDP impact, Singapore and Malaysia are likely to suffer the largest fallout from a decline in exports to the EU.*
- *Aside from trade, the prospects of weaker growth in EU as well as the extended EUR weakness will also have an impact on the tourism industry. In terms of tourism dependency, Thailand appears to be most exposed to any drop in tourist arrivals from EU-16 countries.*

Since Greece's fiscal and debt woes came to light, market has been grappling with contagion fears. The loss of confidence deepened the crisis in Europe, leading to sharp market reaction to rumours that Hungary has manipulated its fiscal data at one point. The DJIA has fallen by as much as 12% from its peak in April to its low in early-June while the MSCI Asia Pac-ex Japan Index slumped up to 19% from its April peak.

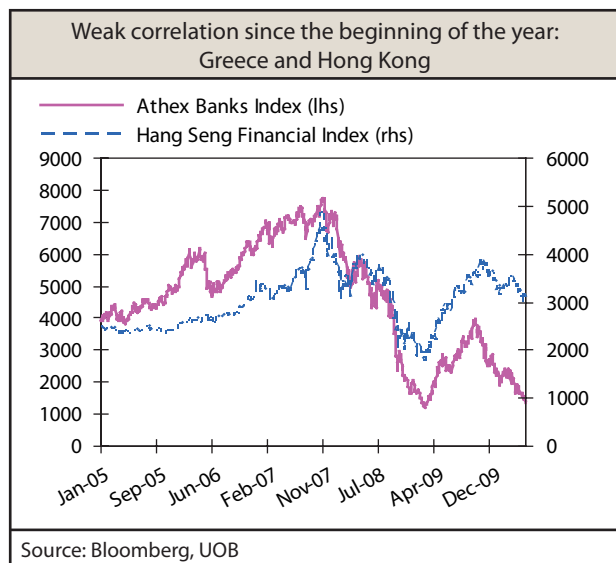
Contagion risk on Asian banking sector appear manageable for now

Although the Greek banking sector equity index has fallen

by more than 40% since the beginning of the year, Asian banks appear to have fared better. The weak correlation between Athen's banking stocks and the regional banking/financial stocks showed that the contagion risk to the banks has been well-contained and Asian banks' direct exposure is likely to be manageable. Nonetheless, there are valid concerns that any sharp spike in risk aversion resulting from the European debt and fiscal crisis could lead to large capital outflows from the region. Meanwhile, we believe the most direct impact on Asia is still from the conduit of the real economy which would increase the growth risk for at least the next two years.



Asia Focus



The sharper focus on public debt and control of fiscal deficits in the EU countries as some of them embark on their economic and fiscal austerity programs, could dampen the recovery in global demand. This was against the backdrop of still lackluster jobs market recovery in the US. The real economic impact will also come from the inevitable weakening of the EUR as the lack of fiscal flexibility meant that monetary policy will be loose as the EU economy adjusts. This in turn meant that European demand for Asian exports will likely be reduced. So far this year, the EUR has lost more than 13% against USD, which rendered it the worst performing currency.

From the exports perspective

The EU-16 region is as important an export destination for the key Asian exporter countries as the US, accounting for an average 13.8% of total exports for these Asian countries compared to 12.6% for the US last year. Among the Asian countries, the Philippines, China and Singapore were most reliant on demand from the EU and therefore are likely to suffer most from any cutbacks in European consumption demand.

EU-16's share of Asian exports

Exports (2009) to:	US	EU
(% total exports)		
Philippines	17.7	20.7
China	18.4	19.7
Singapore*	10.8	14.5
South Korea	10.4	12.8
Thailand	10.9	11.9
Indonesia	9.3	11.2
Malaysia	10.9	10.8
Hong Kong**	12.6	8.7
Asia average	12.6	13.8
Source: CEIC, UOB		
*Non-oil domestic exports		
**Domestic exports		

EU exports demand from Asia is a function of the EUR currency value and GDP in the EU. A regression of these variables indicates that the income effect of a slowdown in economic growth in the EU economies will have a greater dampening impact on demand for Asian exports than the price effect of the EUR depreciation (against the respective Asian currency) which makes Asian exports pricier and therefore less competitive. The pass-through of income effect is also much faster than that of price effect which would usually take more than one quarter. Interestingly, we found that the price effect for exports to EU from Taiwan, Indonesia and the Philippines are not significant at the 5% level. The relationship of the currency with exports could be diminished if the exports are quoted in a different currency other than the EUR or the domestic unit, or if the exports could be more easily hedged (probably in the case of commodity and agricultural exports).

In Asia, Singapore, Malaysia and China are the most vulnerable to any economic slowdown or EUR weakness. In China for instance, we estimate that a 1% drop in EU GDP will cause a 4% drop in China's exports to the EU. Comparatively, a 1% depreciation in EUR against the RMB will result in a contraction of 1.5% in China's exports to the EU.

Overall, translating to GDP impact, Singapore and Malaysia are likely to suffer the largest fallout from a decline in exports to the EU. This is intuitive as a result of their relative dependence on trade. We estimate that a 10% drop in Singapore's exports to EU will shave its GDP by around 0.8%.

Asia Focus

Aside from trade, the prospects of weaker growth in EU as well as the extended EUR weakness will also have an impact on the tourism industry. In terms of tourism dependency, Thailand appears to be most exposed to

any drop in tourist arrivals from EU-16 countries, which account for around 13% of total tourist arrivals in the country.

Impact of weaker exports demand from EU on GDP in Asia			
Exports to EU	Output-effect 1% drop in EU GDP	Price-effect 1% drop in EUR/Asian	Impact on GDP assuming 10% drop in exports to the EU
China	-4.0%	-1.5%	-0.3%
Malaysia	-2.2%	-1.6%	-0.7%
Singapore*	-2.6%	-1.8%	-0.8%
Thailand	-1.0%	-0.9%	-0.6%
Taiwan	-1.7%	-1.1%**	-0.4%
Indonesia	-1.1%	-0.0%**	-0.2%
Philippines	-1.1%	-0.8%**	-0.5%
Note: * refers to NODX **not significant at 5% level Regressions run with 4 lags of each independent variable.			

EU-16's share of Asian tourist arrivals									
	China *	Malaysia	Taiwan	Hong Kong	South Korea	Philippines*	Singapore	Indonesia*	Thailand
EU-16 tourists (% of total in 2009)	1.1	2.1	2.4	2.6	3.4	3.4	5.6	8.4	13.0
Note: *2008									