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A View From Asia

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"The luxury of today is the necessity of tomorrow. Every advance first comes into being as the luxury of a few rich people, only to become, after a time, an indispensable necessity taken for granted by everyone." – Ludwig Von Mises.

Most of us can relate to that statement. The best manifestation of this societal norm is the smartphone. Perhaps the millennials of today might include ride-sharing and home-delivered food in that category. But could Von Mises have ever dreamt it could apply to policies by the central banks? As every major central bank talks about normalising monetary policy, all of us have to wonder whether asset markets and, in turn, the real economy are hooked on the necessity of quantitative easing.

Recent data indicates the global economy remains healthy with few clouds on the horizon. This naturally raises a question on the possibility of higher inflation across the world. Several data points suggest that inflation indeed is on the rise. If this portends a structural rise in interest rates, there will be an inevitable need to normalise monetary policy. At the same time, advances in AI, machine learning and robotics indicate a structural deflation, which could mean this nascent rise in inflation is just cyclical in nature.

Cleaner Chinese skies over chasing growth

Amidst this macro uncertainty, I do want to emphasise a distinct change for the better in the Chinese financial system. In no way do I suggest it is in pristine health. Accumulated debt from the stimulus-induced binge post 2009 and the spread of shadow banking to prop up the property markets very much remain a lurking risk. Yet, as I have mentioned before, the closures of capacity in several basic industries is a development worth noting. As a commentary from Gavekal Economics puts it: "There seems to be a change in the incentive system for the party officials and heads of governments across China."

In the past, every Chinese government official was measured by GDP growth they delivered, no matter the cost. If the by-product of that obsession with growth meant too much debt and rising leverage, or massive overcapacity, or pollution, so be it. But with President Xi Jinping now focused on reducing pollution, we have seen some drastic cuts in capacity in steel, coal, cement and maybe aluminium. If this change in focus is sustained, the new incentive system will mean that growth is subjugated to quality growth. The result will be better cash flows and healthier companies. This in turn helps the banking system, as the banks' non-performing loans have in probably peaked for the moment. Simultaneously, the quasi-nationalisation of Anbang Insurance is evidence of the seriousness of the authorities to clamp down on debt accumulation. A company formed in 2004 as a motor insurance firm had accumulated US$300bn of assets by 2017 – most of them acquired from borrowed short duration money!

Deeds not words

The risk of a trade war and imposition of tariffs is a real risk for economies across the world. Yet, similar to much that comes from this White House, I would rather wait and see how much of what is said is finally implemented. I recollect in the early days of the Trump administration talk of levying an import tax. Analysts worked on various scenarios and modelled spreadsheets with 'what if' scenarios. Ultimately, this talk came to naught. With a return of volatility, markets are bound to gyrate around worst-case scenarios of possible tariffs and extrapolate them to infinity. Personally, I still think that the improving global economic scenario and diminishing financial risks in China are bigger positives that outweigh the potential risk of trade war rhetoric.