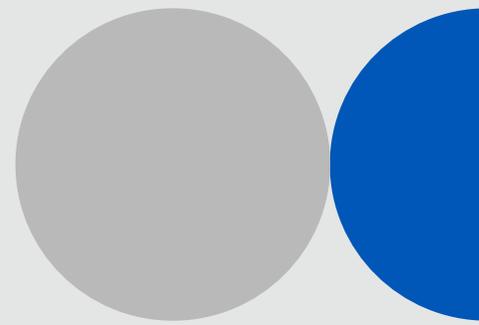


# Asia: leading the way

June 2023



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**After lagging global market returns for several years, Asia could now be well placed to take advantage of current global economic and thematic trends.**



After a challenging few years, abrdn believes Asia could be well placed to take advantage of current global economic and thematic trends. Significantly increased debt, elevated inflation and much higher interest rates have the potential to bring Western economies' period of relative dominance to an end. The risk situation in Asia looks considerably more benign, which could support relative equity performance in the years ahead.

## Paradigm shift in global interest rates

In the period that followed the global financial crisis in 2008, the very low interest rates that prevailed in major Western economies helped developed market equities outperform their Asian counterparts. Companies were able to borrow money cheaply and use leverage to fund shareholder returns; for example, through share buyback programmes. The sharp rise in inflation last year and subsequent unprecedented pace of monetary tightening brought an end to this latest profit cycle. With debt much more expensive, earnings are now under pressure and businesses are being pushed to deleverage and cut costs. The banking sector in the US and Europe has also seen significant new pressures, including the collapse of several regional institutions stateside.

High levels of public sector borrowing in the developed world are also notable. As in the corporate sector, looser central bank policy helped fuel a rise in the indebtedness of Western governments – and this could have implications for both monetary policy and economic performance. Elevated government debt levels mean that central banks, such as the US Federal Reserve and the European Central Bank, may now be more constrained in their ability to raise rates sufficiently enough to control inflation.

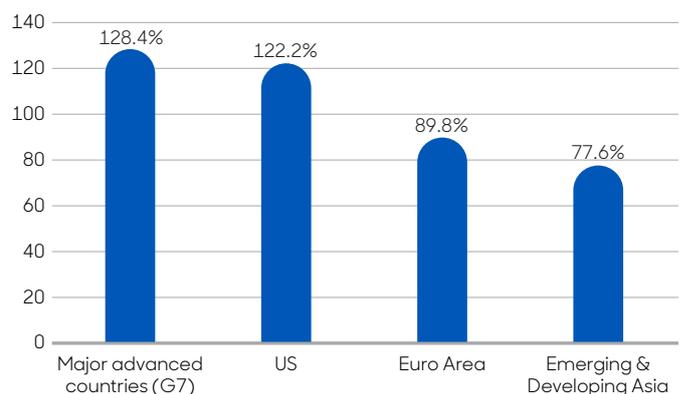
## Asian markets more comfortably positioned

The risk situation in Asia looks considerably more benign, which could support relative equity performance in the years ahead. Companies in Asia (ex-Japan) have been more prudent about using leverage to boost returns. Their cost of debt since the global financial crisis never hit the low levels of developed markets, and their cautiousness could also be linked to domestic uncertainties. As a result, balance sheets among listed Asian businesses are less stretched and therefore less vulnerable to the new increased interest-rate environment.

Similarly, ever since the Asian financial crisis, Asian governments (ex-Japan) have been more careful about creating imbalances and taking on too much debt. While this does not make the region immune to wider concerns about the global financial system, it does give a degree of protection. It also potentially leaves scope for using monetary policy to control inflation.

## General government gross debt by region

% of GDP



● General government gross debt

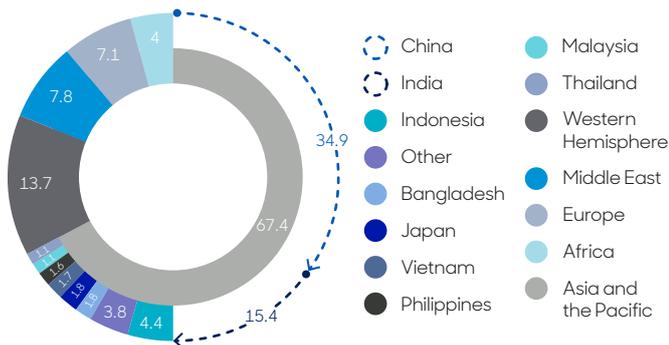
Source: IMF World Economic Outlook, April 2023; Grouping based on IMF classifications.



## Asia's importance for global growth

Asia's increasing importance as a driver of global growth can't be understated. According to abrdn's Research Institute, by 2050 four of the top seven largest global economies will be Asian.<sup>1</sup> Even over the near term, although exaggerated by the positive growth impact of China's recent re-opening, it's striking that the IMF projects that over two-thirds of global growth in 2023 will come from Asia. Within this (as shown below) the two standout contributors will be China and India, which together are forecast to account for over half of global growth in 2023.<sup>2</sup>

### Projected regional and country drivers of global growth in 2023 (%)



Source: IMF World Economic Outlook, April 2023; Grouping based on IMF classifications; <https://www.imf.org/en/Blogs/Articles/2023/05/01/asia-poised-to-drive-global-economic-growth-boosted-by-chinas-reopening>

Many of the key long-term drivers of Asian growth, such as rising incomes, large populations and increasing financial intermediation, have been well understood for some time. However, another element which we think is particularly relevant is the region's importance for some of the widely acknowledged key thematic drivers of global growth. In this respect, two areas of note are the region's increasing importance in the global technology value chain, and the global drive for decarbonisation and environmental sustainability.

## Asian centrality for global decarbonisation

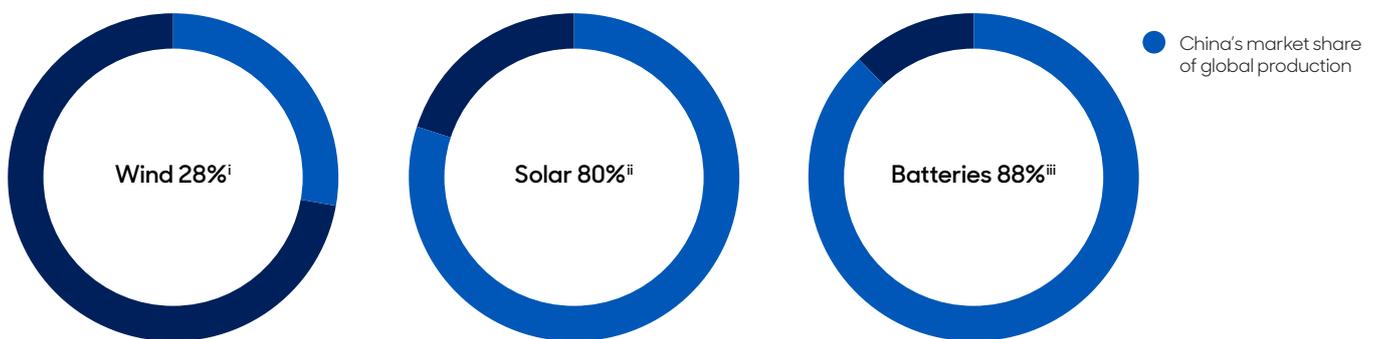
One of the most important global themes is the drive towards decarbonisation and environmental sustainability. Asia's increasing importance here is being driven in large part by some of the highest incidents of smog and vulnerability to climatic risks, such as rising sea levels and more extreme weather conditions.

China, perhaps more than any country, is leading the way on this front, driven by its commitment to achieve carbon neutrality by 2060. The latest figures from the National Energy Administration showed solar installation capacity in the country rose to a record 34 gigawatts (GW) in Q1 of 2023, nearly tripling the previous high of 13GW in the same period of 2022. New wind power installations also reached a record high, with an additional 10.4GW capacity added in Q1 of 2023, 32% higher than same the period in 2022. As such, renewable sources of power, including nuclear, exceeded 50% of China's installed power capacity in Q1 of 2023, overtaking fossil fuel-based capacity for the first time in history.<sup>3</sup>

A notable consequence of China's environmental drive has been its increasing importance, and in some cases dominance, in the production of essential infrastructure items that enable the global transition to renewable energy sources. By way of example (as shown below), China already accounts for 80% of global solar silicone module production, 88% of global lithium-ion battery production, with a 28% share in the global production of wind turbines.

In electrical vehicles (EVs), China now has the highest penetration level of all major markets, with EVs accounting for more than a quarter of total vehicle sales in 2022.<sup>4</sup> And with a proven, highly efficient, domestic EV production infrastructure, Chinese EV makers are also starting to make significant inroads in other countries.

### China's production market share in key green infrastructure goods



Source: BloombergNEF, November 2022. <sup>i</sup> Refers to wind turbine market share in 2021. <sup>ii</sup> Refers to solar silicone module capacity in 2021. <sup>iii</sup> Refers to capacity for lithium-ion batteries for all end uses, as of October 2022.

<sup>1</sup> abrdn Research Institute, May 2023.

<sup>2</sup> IMF World Economic Outlook, April 2023; Grouping based on IMF classifications; <https://www.imf.org/en/Blogs/Articles/2023/05/01/asia-poised-to-drive-global-economic-growth-boosted-by-chinas-reopening>.

<sup>3</sup> <https://edition.cnn.com/2023/05/12/economy/china-carbon-emissions-record-intl-hnk/index.html#:~:text=China's%20record%20carbon%20emissions%20expected,clean%20energy%20push%2C%20report%20says&text=China's%20carbon%20emissions%20will%20likely,think%20tank%20said%20on%20Friday>.

<sup>4</sup> <https://www.counterpointresearch.com/china-ev-sales-2022/>; March 2023.

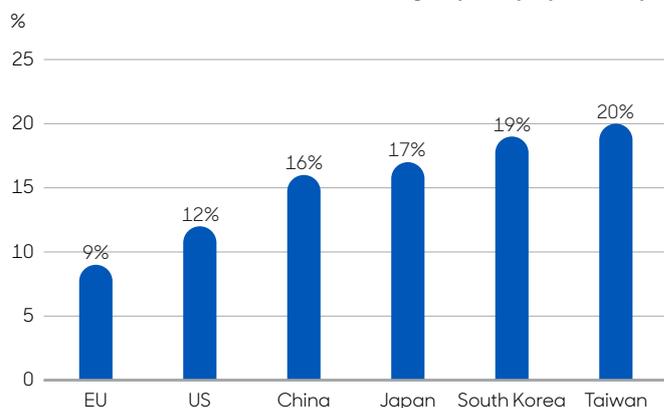
## Asia's leading role in the global-tech value chain

Probably the single most value-additive part of the global economy is the technology sector – an area in which Asia is emerging as a global leader. A lot of attention, both investment-orientated and political, is often paid to the rise of China. This is perhaps unsurprising, with the Australian Strategic Policy Institute claiming that China is already the global leader in 37 of the 44 the most 'critical' technologies. These include biological manufacturing, drone technology and critical minerals processing.<sup>5</sup>

However, while China is an increasingly important technology player, other Asian countries also occupy vital positions in the global-tech supply chain, notably South Korea and Taiwan. Indeed, in terms of chip production, which is arguably the single most important part of the global-tech value chain, Taiwan and South Korea have the biggest shares of global semiconductor production capacity, followed by Japan and China.<sup>6</sup> Unsurprisingly, it is computing power (i.e. chip processing power) that is integral to many of today's major tech themes, such as the 'internet of things', virtual reality and artificial intelligence. And it's Asian companies, led by the likes of Taiwan Semiconductor Manufacturing Company (TSMC) and Samsung Electronics, that lead the way by providing some of the most critical building blocks.

When it comes to assessing the importance of Asia in global-tech value chain, the US-China trade war is hard to ignore. This is in part driven by US efforts to prevent China dominating the tech domain. However, while this is a major risk factor, it's not necessarily bad for the wider region. For example, global tech companies' efforts to diversify supply chains away from China also benefits other Asian nations since much of the relocation will likely be within the region, in countries such as India and Vietnam. Another consequence of the trade war is China ramping up efforts to boost its domestic technology capabilities, which could present some interesting investment opportunities.

Global semiconductor manufacturing capacity by country



● Share of global capacity

Source: S&P Global, January 2023.

## Putting everything together

With the world shifting to a 'new normal' paradigm of higher inflation and higher interest rates, the credit standing of both countries and companies will gain added importance in coming years. In this respect, Asia looks relatively well positioned compared to other global regions. At the same time, Asia's stronger long-term growth outlook suggests its contribution to global growth will continue to rise. Among the key factors supporting Asian growth in coming years will be the region's centrality in the global-tech value chain and as an enabler of the global drive for decarbonisation.

<sup>5</sup><https://www.aspi.org.au/report/critical-technology-tracker>, March 2023.

<sup>6</sup>S&P Global, January 2023.

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