Investment update

12 March 2010

Philip Hunter, manager of the Old Mutual Asian Select Fund

Philip Hunter rejoined Old Mutual in September 2008 from US wealth manager Bessemer Trust, where he was a fund manager focusing on Asia. He previously worked within the Old Mutual group for 11 years, holding a variety of fund management and analytical roles and focusing on Asia-Pacific markets and the global financial sector. Prior to this he was an analyst at private client investment group Merchant Securities. Phil is a CFA Charterholder.

Exit plans for Asian economies

By Philip Hunter, manager of the Old Mutual Asian Select Fund

The economies of the Asia Pacific region enjoyed a rapid recovery in 2009, helped by a combination of large fiscal and monetary stimulus measures. Attention has now turned to how policy will be normalised to avoid inflationary pressures and speculative bubbles fuelled by very loose monetary policy. Here, we outline the measures already put in place by the authorities to help balance the achievement of growth goals with the avoidance of problems.

The two major concerns today are inflation and speculative bubbles. Inflation concerns have risen as headline inflation rates have picked up from last year's negative levels. A large contribution to the upturn has been the base effect of comparing current prices with those at the worst point of the downturn in 2009. It is not clear that inflation has been caused by the stimulus measures. In China, where food prices are an important component of the CPI basket, the impact of a harsh winter on the price of vegetables is adding to the pressure.

The recovery in property prices is seen as primary evidence of speculative excess and there has been much focus on headline property price rises in China in 2009. After falling 0.4% in 2008, prices rose 7-8% on average last year, with increases of more than 13% in high end properties in Beijing and Shanghai.

Recognising the positive impact of stimulus packages, we have already seen fiscal and monetary measures being withdrawn. As early as September last year the Chinese authorities recognised the success of their massive investment stimulus and announced they would suspend approval of new projects

Asian authorities have removed stimulus measures by means of a range of monetary policy tools. Starting with the more conventional use of interest rate rises, the Reserve Bank of Australia moved first, in October 2009, and on four subsequent occasions. Elsewhere in Asia where exchange rates are pegged (or have a quasi peg) to the US dollar, there is not the flexibility to raise rates ahead of the Fed. Although this means that we have not yet seen wholesale increases in benchmark interest rates, central banks have used alternative tools.

In China, monetary policy is effectively controlled through restrictions on new lending quotas in the state owned banking system. Interest rates have a limited effect in the Chinese economy as the bond market is in its infancy compared to more developed economies. The state instead controls the amount of new loans using a process of 'window guidance'. Excess liquidity is also managed within the banking system via required reserve ratios. In China the reserve ratio has been increased twice already this year, with the market expecting further adjustments over the course of the year. This method is also in use in India.

The theory of having direct control over the quantum of new lending has its downside, as witnessed in January. Without any official announcement of interest rate policy there can be an information vacuum when news is communicated via media reports of banks having had their loan quotas cut, leading to fears that tightening is more aggressive than the policy intention. Unlike announcements of interest rate changes, it takes a number of weeks for the reality to emerge. Rather than lending quotas being cut, banks were reminded that monthly quotas were to be adhered to.

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As the authorities are not increasing interest rates too far in advance of the Fed, we are also seeing specific policies introduced to target areas where very low rates have led to speculative property market activity. In Singapore, Hong Kong and China stamp duty has been introduced or increased, alongside more stringent requirements for banks to demand higher deposits in an attempt to temper speculative property market activity.

In conclusion, we do not expect the incremental tightening of policy to date and the anticipated further removal of stimulus over the course of 2010 to cause regional economic growth to falter. HSBC has forecast expansion of more than 7% for the Asia ex Japan region in 2010. The overall recovery has gained traction and broadened out from investment-led growth as the recovery in the export sector continued apace in the final quarter of 2009. In the coming months the transition towards fully self-sustaining growth will be closely monitored.

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