ASIA WEEKLY:
Bailout Impact

For the Week Ended
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It is open to debate how much of the downside in the economic cycle has been taken away by the "nationalization" of Fannie Mae and Freddie Mac after the U.S. federal government takeover of the two mortgage giants. Certainly, one might question whether the latest actions by the Treasury and the Federal Reserve will have any effect whatsoever on the current slowdown in the real economy.

Mortgage loan growth may still be feeble and require the encouragement of loan officers. The measures will not likely help with the unemployment problem at home in the short term or with the growing problems in Europe. However, despite the lack of impact on real growth, the actions do signal a desire among authorities to prevent falling prices. Falling prices can delay both investment and consumption decisions more than might be the case otherwise. In addition, the bailout of Fannie and Freddie may help with demand for new loans—an important step in helping the U.S. domestic imbalance. Consumers may still need to work off debt but there are other potential borrowers, including corporate entities, investment funds and financial firms. The measures are aimed at re-igniting risk appetite and, as such, may help slow or even reverse the depreciation in asset prices.

What might this mean for Asia? The slowdown in real economies will cause Asia to slow down too—and analysts are becoming more pessimistic about profits in the short term. However, the actions of the Treasury and the Fed do remove some anxiety that Asian Central Banks would be forced to act alone to fight the deflationary impact of the U.S. slowdown.

The recent moves by the Treasury may help the process by which Asia reflates relative to the U.S., and this environment may be helpful for Asian financial stocks. They have been seen for too long as carrying the same kinds of credit risks as the Western banks, and Asian financial stocks suffered as their counterparts in the U.S. fell. Moves to reduce risk in the U.S. and global financial systems seem likely to favor Asian banks, which have clean balance sheets and strong underlying economies. Reducing risk in the U.S. debt market may also take pressure off regional currencies as investors worried that much of the official foreign exchange reserves were held in Fannie and Freddie debt.

The breathless performance of the markets in Asia when first reacting to the news of the bailout signals investors' excitement surrounding this move and the possible benefits from a reflation of the region. However, short-term risks to real growth remain. To an extent, the more cyclical markets responded most optimistically; however, they also face the highest risk in terms of a continued slowdown in the real economy. Strong, cash-generative franchises in stable, growing industries are still the preferred investment target. More importantly, Asia had recently shown a valuation discount to the U.S., suggesting that investors were already factoring in a fairly mundane pace of growth for the region and a shrinking risk appetite. The Fannie and Freddie bailout will not change this growth in the short term, but it does ameliorate the deflationary pressure and nervousness that could have put the growth at further risk. The U.S. government takeover may indeed have helped stabilize regional valuations and improved the risk/reward scenario for our markets.

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