Let’s Get Fiscal

Coming into 2020, a number of the factors that had weighed heavily on the region appeared to be dissipating giving rise to some cautious optimism. Then came Covid-19. Much of East Asia has dealt with the outbreak reasonably well albeit at the cost of wrenching recessions. South Asia’s response has been rather less impressive.

Much of East Asia has dealt with the outbreak reasonably well albeit at the cost of wrenching recessions….

South Asia’s response has been rather less impressive

Monetary and especially fiscal policy – the focus of today’s article – has been robustly and rapidly deployed, albeit to differing degrees, throughout Asia. Fortunately, the general fiscal starting position across the region was far from stretched which will allow most governments to bridge what, one hopes, will be relatively temporary shutdowns. Moreover, domestic fundamentals most everywhere remain largely sound with little evidence of major internal and external economic imbalances. The biannual chart anthology that accompanies this missive provides a promiscuity of pictorial perspective.

Fortunately, the general fiscal starting position across the region was far from stretched which will allow most governments to bridge what, one hopes, will be relatively temporary shutdowns

It is not my intention here to offer particular point forecasts, since, with so many shifting variables and uncertainties, the chances of rapid obsolescence are even greater than normal. Although increasing numbers of countries are tentatively re-opening, the risks from echo-outbreaks and still fragile economies and financial systems remain heightened. It is my working assumption though that as the world becomes more used to dealing with what seems likely to be a persistent, recurrent and mutating virus, it can better calibrate the trade-offs between public health and brutal economic shutdown.

Moreover, domestic fundamentals most everywhere remain largely sound with little evidence of major internal and external economic imbalances

The above by no means suggests a rapid return to normality as certain pockets of the capital markets appear to be pricing. But it does allow governments, firms and individuals to adjust their responses to a world of likely slower growth, more complicated and expensive management of supply chains and greater government interference. Little here implies an imminent productivity resurgence.

Based on such priors, the cross-country analysis here examines the initial positions and likely trajectories of a range of principal variables that can help one determine the sustainability or otherwise of a country’s medium-term fiscal path. Amongst those variables considered are:

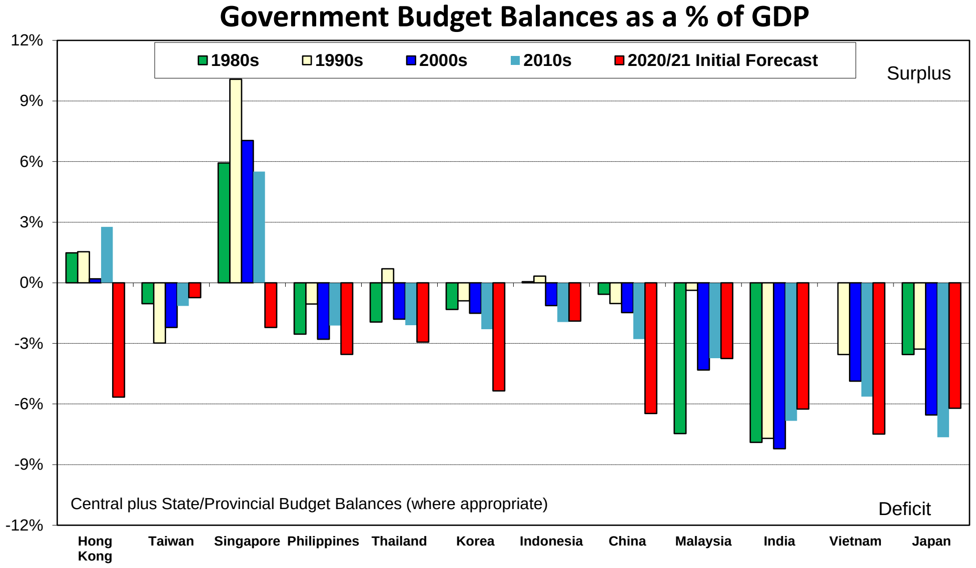
- Initial public sector debt metrics – ratios, stocks and servicing costs;
- Sources of debt financing, domestic or overseas, voluntary or captive;
- Balance of payments and currency constraints, or otherwise;

- Institutional capacity to allocate funds efficiently and deliver on productive outcomes;

- Institutional capacity to deliver on parallel growth-enhancing and employment-generating structural reforms.

The good news is that much of Asia came into the crisis in reasonably good shape and still has pretty decent growth potential. Execution will be everything.

Execution will be everything

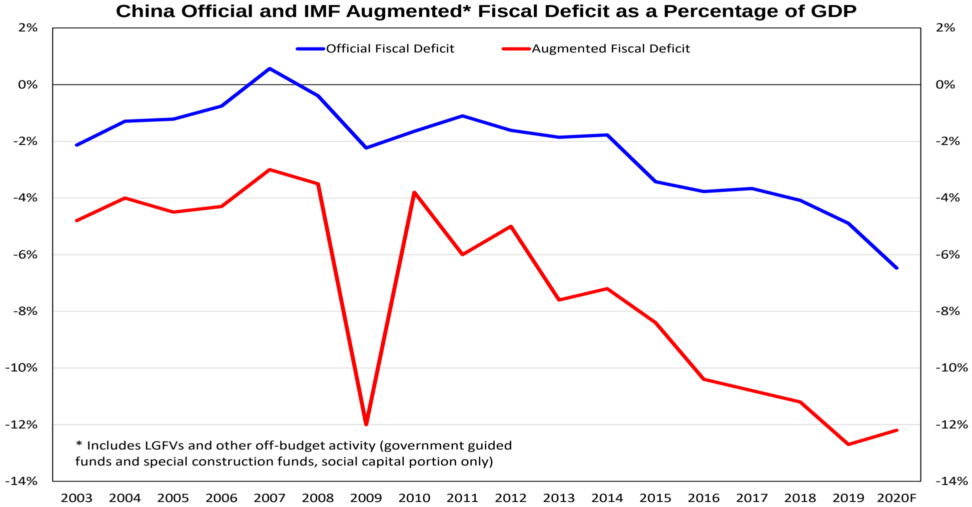


The long-term assessment of Asian fiscal outcomes charted above suggests a skew towards conservatism, albeit with a few notable outliers. Japan, which I have discussed at length in the past, has been the global postor child for a kind of fiscal profligacy that seemingly delivers very little in return. Malaysia, India and Vietnam have also shown persistent tendencies towards running sizeable deficits albeit pre-covid, the former two at least had been attempting to rein in their largesse. China's[1] fiscal record, meanwhile, has not been quite as robust as the headline figures might suggest since the official data do not capture the activities of local government platform companies and other off-balance sheet, quasi-fiscal entities. (The IMF does a decent enough job as anyone in trying to cut through the obfuscation as charted overleaf.)

[1] All the countries surveyed here announced their initial 2020-21 budgets either in late-2019 or early-2020 before the true destruction of covid was readily apparent. The unveiling of China's budget, meanwhile, was delayed until May so it already includes exceptional measures.

Let’s Get Fiscal

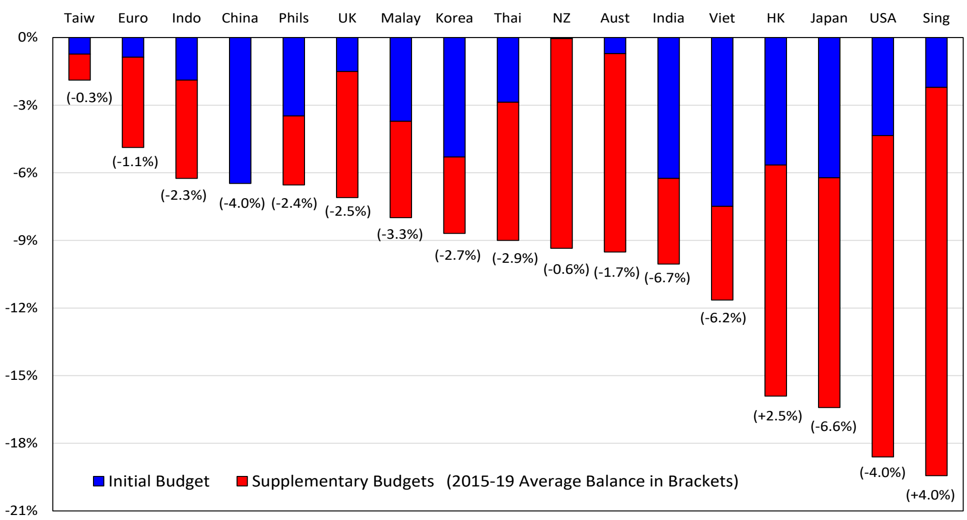
China Official and IMF Augmented* Fiscal Deficit as a Percentage of GDP



Coming into 2020, even the region’s habitual horders had been planning to open their wallets (somewhat) given the unfriendly international backdrop. The pandemic response subsequently prised them open rather more widely. For the chart below, I have resisted the temptation to just report the headline numbers announced, since some of the claims seem aimed more at shock and awe than having any particular grounding in reality. Japan is a serial employer of such tactics to the extent that the terms “fresh water” or *mamizu* describing actual government spending expected, as opposed to “total size” or *jigyōkibo* have passed into the modern lexicon. Nevertheless, in almost every case, the fiscal stimulus to be delivered is still sizeable.

Coming into 2020, even the region’s habitual horders had been planning to open their wallets (somewhat) given the unfriendly international backdrop

2020-21 Initial and Supplementary Budget Deficits as a Percentage of GDP

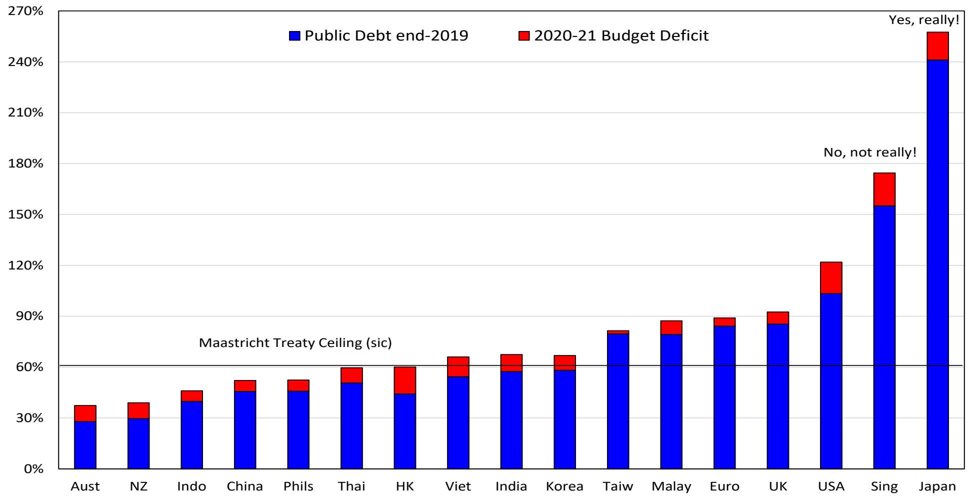


Let's Get Fiscal

The fiscal pushes being envisaged are unlikely to be enough to fully offset the drawdowns in the other components of growth, but they can at least help to cushion the pain, especially if, and it is a big if, governments are successful in getting the cash to those who need it the most. Leaving such judgements aside for now, it is encouraging that Asia ex-Japan's decades of relative fiscal parsimony, combined with an ability to deliver rapid rates of nominal growth, has meant that public indebtedness coming into 2020 was pretty comfortable across the board – even in more profligate Vietnam and India. Indeed, ten of the economies surveyed here would have met the EU's Maastricht Treaty debt ceiling test which is more than can be said for the majority of those who are supposed to be bound by such niceties.[2] Furthermore, even assuming that the fiscal expansions announced will be entirely debt financed does not materially alter the position, at least if one assumes that the demands of this year are not to be recurrent.

The fiscal pushes being envisaged are unlikely to be enough to fully offset the drawdowns in the other components of growth, but they can at least help to cushion the pain

Projected Public Sector Debt as a Percentage of GDP, end 2020



A number of issues warrant highlighting from the chart above. First, Australia and New Zealand stand apart from most of the rest of the developed world in their low levels of public debt. Moreover, both have done far more to future proof their pension systems while, as I discussed in my last outing,[3] their

[2] The eurozone aggregate above of course encompasses a Germany that (excluding sizeable contingent liabilities) owes only three pfennigs and a Club Med with debts more expansive than an elephant's scrotum.

[3] "Picking quarrels and provoking troubles in the foreign exchange rate markets", May 27th, 2020.

currencies seem relatively fairly valued currently. Hence, there is arguably less need for them to be debased as many.

Second, Hong Kong and especially Singapore seem to have inordinately high levels of public sector debt relative to their runs of structural budget surpluses. In the case of the SAR, almost 90% of official paper is HKMA-issued, in turn related to open-market operations and a desire to build out an indicative yield curve. Singapore, which has run even larger surpluses over time, has rarely deigned to allow its own citizens to spend or invest their own funds. Hence, funds sequestered for its Central Provident Fund are largely used to buy specially-issued government debt with the proceeds then channelled to official bodies who allocate domestically and overseas on behalf of the proles. In essence, net debt in both places is minimal (indeed probably negative all in) while even in Japan, which really does require copious government financing, the net position is only around half of the gross.

The big "if" of efficacy is whether governments will be successful in getting the cash to those who need it the most

Third, Malaysian indebtedness, while not disastrous, is a reflection of unchecked affirmative action policies for the majority which seem rather hard for governments of any ilk to rein in. Dysfunctional local politics neither give rise to great confidence that a major rethink is imminent nor that supply side reforms to reinvigorate growth *without leverage* are likely to be enacted. The Ringgit remains the cheapest currency in the region but one can see few immediate reasons for it to become meaningfully less cheap.

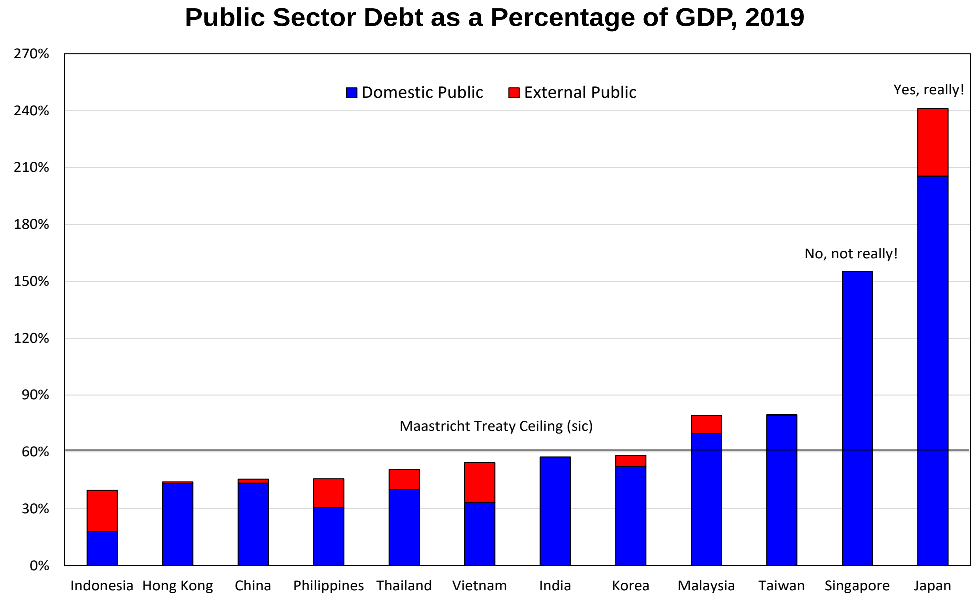
Finally, Taiwan and Korea bear close monitoring since both have been travelling down the slower potential growth-higher government expenditures path. Akin to the developed world in general, policies need to be enacted to reinvigorate productivity or structural levels of government indebtedness will only rise further. Both though have (dirtily) floating (and extremely cheap) currencies and relatively low levels of foreign borrowings, so neither will run into binding constraints any time soon.

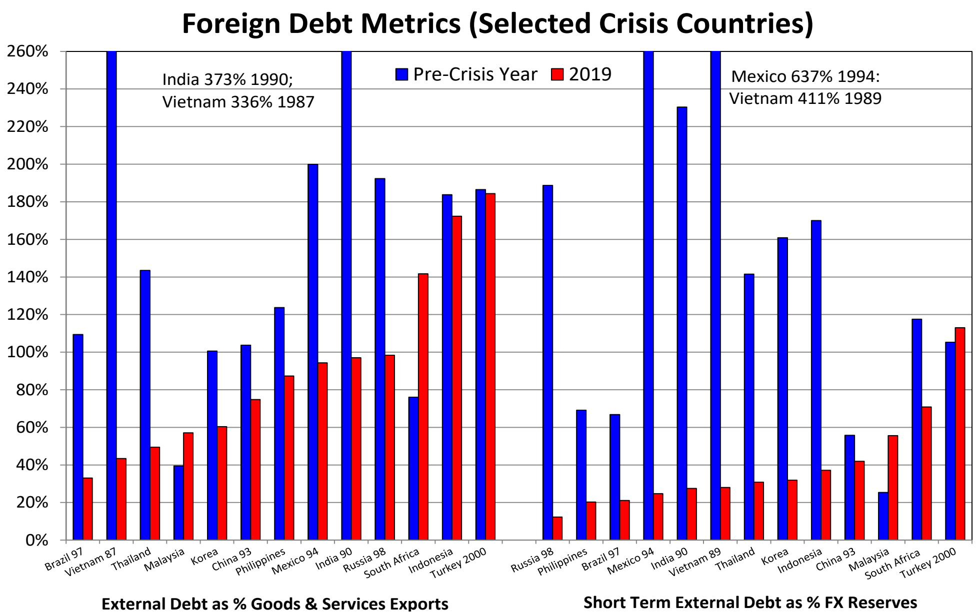
Asia ex-Japan's decades of relative fiscal parsimony, combined with an ability to deliver rapid rates of nominal growth, has meant that public indebtedness coming into 2020 was pretty comfortable across the board – even in more profligate Vietnam and India

Let's Get Fiscal

A further regional strength is a relatively low level of external public borrowings. Indeed, overall foreign debt positions are generally rather comfortable, with perhaps the marginal exception of Indonesia where still the situation is a world away from that observed on the eve of the 1997 Asian Crisis. Furthermore, currencies are far more flexible almost without exception and should not provide a binding constraint – within reason – to further fiscal and monetary easing.

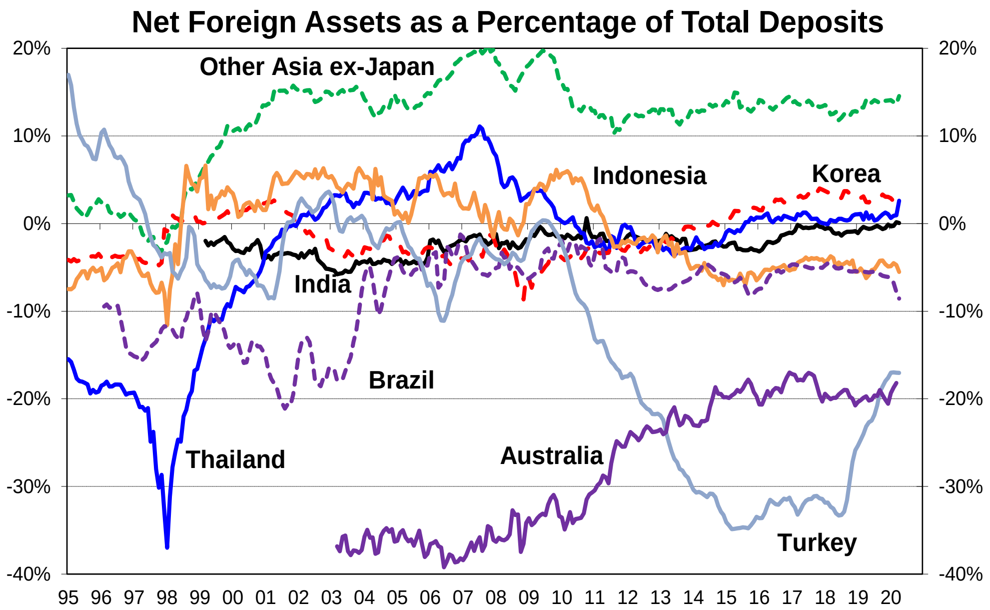
A further regional strength is a relatively low level of external public borrowings





Banking sector currency mismatches were major contributors to 1997's mayhem. Today, only Jakarta (again) has a (relatively small) negative imbalance (Australian banks are required to swap out any currency exposure in their foreign deposit funding). Moreover, at just shy of 40%, the foreign[4] ownership of Indonesian bond markets is by far the highest in the region while overseas investors also hold around 25% of the local equity market. (By way of contrast, foreign participation in the Chinese and Indian debt and stock markets is below a tenth.) For the avoidance of doubt, I am not trying to make an Indonesian collapse argument here. Many of its metrics look poor in an Asia-only context yet remain far superior to those recorded across Latin America and Africa. Nevertheless, Jokowi has every (macroeconomic) incentive to revisit his Omnibus Law push to simplify the tax system, bureaucratic and licensing demands, land acquisition, and especially the labour code once immediate covid concerns begin to dissipate.

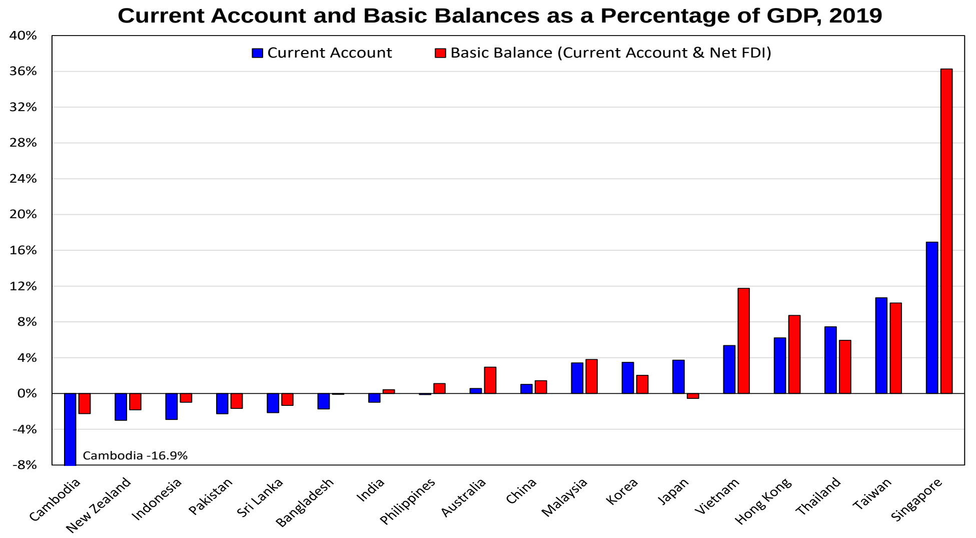
Banking sector currency mismatches were major contributors to 1997's mayhem; they are largely absent today

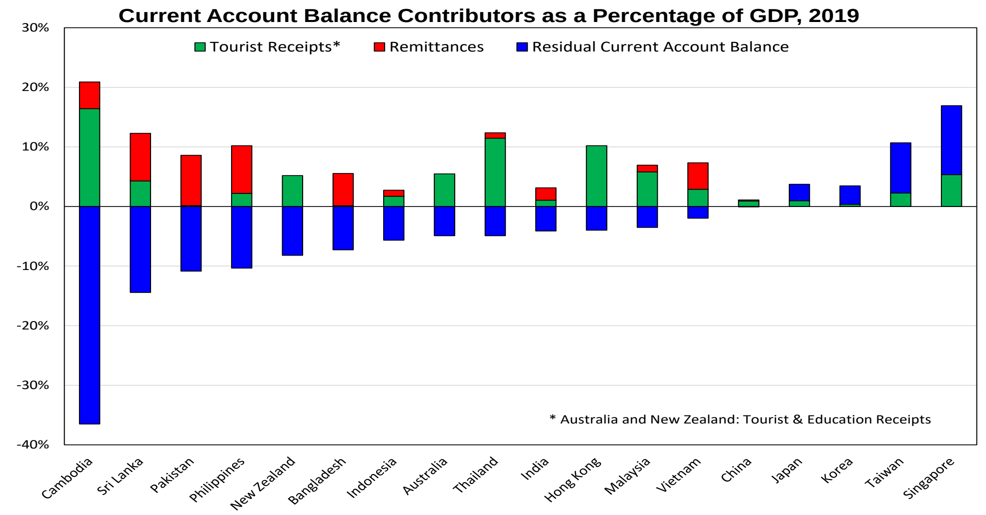


[4] Anecdotal lore has it that a sizeable chunk of the overseas ownership is actually round-tripping by Indonesians who have salted their funds away offshore and then reinvest in a more anonymous manner back in their homeland. I have yet to come across any hard numbers to back up this proposition, but common sense would suggest it probably has some merit.

A further tick on the plus side of the ledger is that increased government dissaving comes at a time when external imbalances are far from yawning – at least not on the debit side.

Increased government dissaving comes at a time when external imbalances are far from yawning – at least not on the debit side

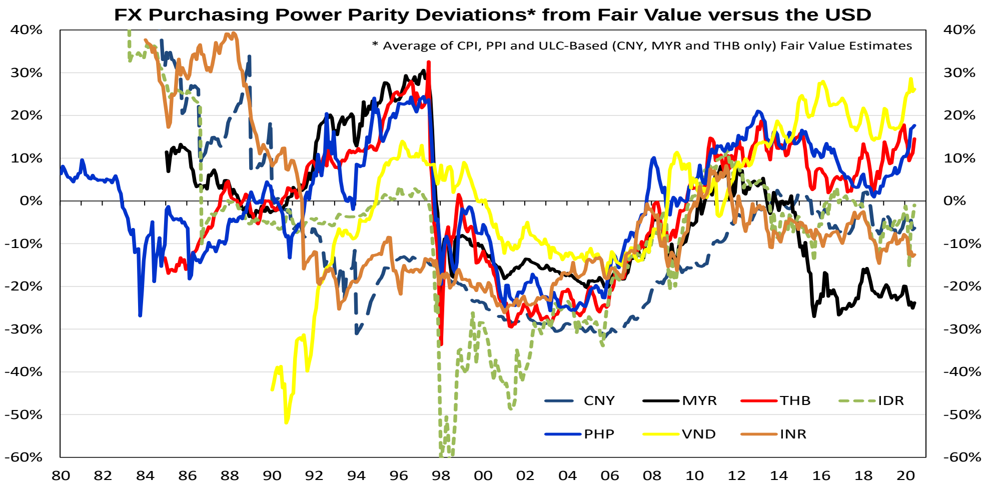




In fact, in many cases, current account positions have improved further this year as domestic demand has crashed even faster than its external counterpart. Nevertheless, it is worth highlighting that many of the region's poorer countries are heavily reliant on worker remittances and/or international tourism (chart above), both of which may struggle to recover significantly in short order. Should domestic demand begin to normalise at a time when overseas worker transfers and foreign arrivals remain constrained, then certain country current account positions could deteriorate rather abruptly. South Asia ex-India, Cambodia and the Philippines seem the most vulnerable here. Australia and New Zealand also deserve dishonourable mentions since tourist, education[5] and healthcare-related expenditures provide sizeable offsets to persistent domestic savings-investment gaps.

As noted earlier, local currencies are far more flexible than they were back in 1997, and hence the need to defend arbitrary exchange rate levels should not pose a binding constraint – within reason – to further fiscal and monetary easing. The PHP and the THB probably remain a tad too strong but hitherto the respective monetary authorities have been accumulating FX reserves as a result of interventions to prevent further appreciation. With consumer price inflation running at only 2% YoY in the Philippines and significantly in negative territory in Thailand, it is difficult to see why either central bank would resist too strongly should market forces start to push for depreciation.

Local currencies are far more flexible than they were back in 1997, and hence the need to defend arbitrary exchange rate levels should not pose a binding constraint – within reason – to further fiscal and monetary easing



Of probably greater concern is the VND. Vietnam runs sizeable current account and FDI surpluses and has a comfortable foreign debt position so faces little in the way of immediate balance of payments pressures. Yet the State Bank of Vietnam continues to eschew significant exchange rate flexibility which is potentially storing up trouble for further down the line.

Vietnam has been one of the major beneficiaries of production relocations over the last decade and has accordingly racked up basic balance surpluses in the range of 8% per annum. Meanwhile, the SBV has kept an extremely tight rein on its currency only accommodating a marginal, crawling depreciation

[5] Channelling former New Zealand Prime Minister Robert "Piggy" Muldoon's acerbic barb, foreigners seeking an Antipodean education arguably boost the average IQ in both their home and host countries.

against the US dollar well below inflation differentials. Arguably, strong productivity gains over the same period have served to offset some of the notional real exchange rate appreciation as evidenced by consistently robust exports and persistent current account surpluses – this is not Thailand 1997 by any means! But as many of Vietnam's neighbours discovered twenty-three years ago, holding on far too long to a heavily managed exchange rate without instituting countervailing policies to stimulate greater factor price flexibility, can lead to toxic outcomes. This is not to argue that Hanoi should seek to institute major changes while the current pandemic rages. However, given its position of relative strength, consideration of a policy of greater flexibility would appear to be prudent once the immediate shock of covid has dissipated.

China, for rather different reasons, also has its currency vulnerabilities which I have written on extensively in the past.[6] In short, in the context of a basic balance running at around zero, and a continued desire for Chinese citizens – the richer ones at least – to get their assets (and often their families too) out of the country, Beijing is far more reliant on the kindness of strangers than at any time since the early-1990s. Into the mix also needs to be thrown toxic international relations over a variety of issues both economic and political. These threaten, at the margin, to both crimp export potential and foreign capital inflows, implying the PRC's room for policy manoeuvre is somewhat more restricted than previously.

Vietnam and China, for rather different reasons, have their currency vulnerabilities but nothing seems immediately and seriously problematic

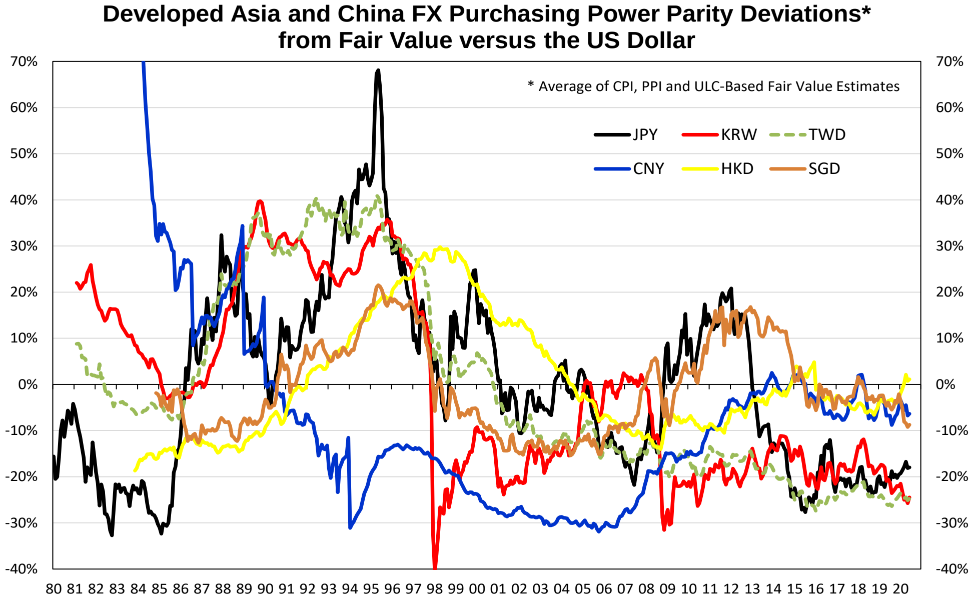
As with Vietnam, I am not expecting a major regime shift any time soon. However, should international drivers of liquidity and demand become more meaningfully constrained over time, the exchange rate could provide a pressure valve relief.

As the next chart overleaf suggests, a decade of real RMB appreciation (from egregiously undervalued levels) ended around 2015 and subsequently, with the adoption of an imperfect yet reasonably credible basket mechanism, the real exchange rate has been kept relatively stable. As indeed has been the case across most of developed Asia which has increasingly taken its cues from the CNY, and in the case of north Asia, locked in extremely undervalued currencies at a time when American attention has been focussed elsewhere. Singapore, meanwhile, appears to have restored competitiveness surrendered in its dash for growth of a decade ago. And as for Hong Kong, there is neither upside in the currency nor in me talking about it further in the near-term.

Should international drivers of liquidity and demand become more meaningfully constrained over time, exchange rates could provide pressure valve relief

[6] I would refer interested readers to my "Rattus Sinicus" article published January 14th, 2020, for a full exposition.

Let's Get Fiscal

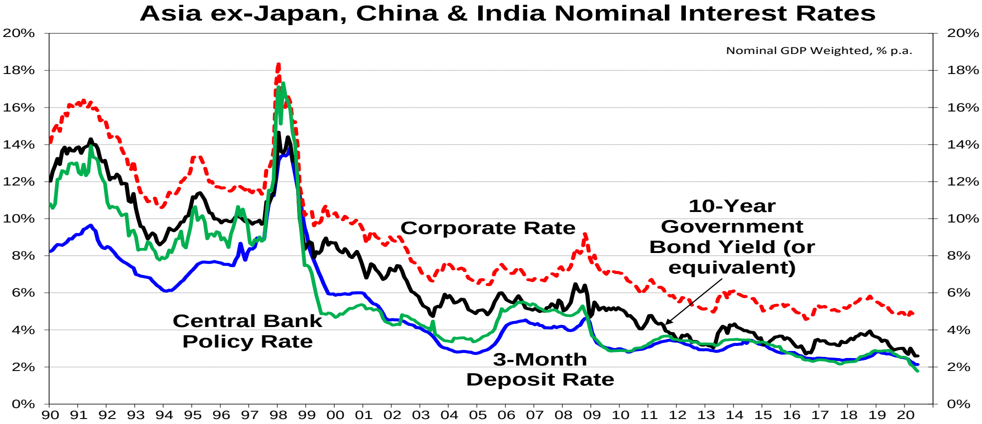


In sum, although the near-term growth outlook for the region looks pretty ugly, initial macroeconomic positions argue for considerable policy flexibility, at least to tide countries over the next couple of years. The rough rule of fiscal sustainability says that if a government's cost of debt service is equal to its nominal growth rate, then its public debt-to-GDP ratio should remain stable in the context of a balanced budget.[7] While 2020 nominal growth has clearly imploded, assuming 2021 will see some form of rebound, albeit probably not a full recovery, few if any in the region are likely to cross over into unsustainable territory.

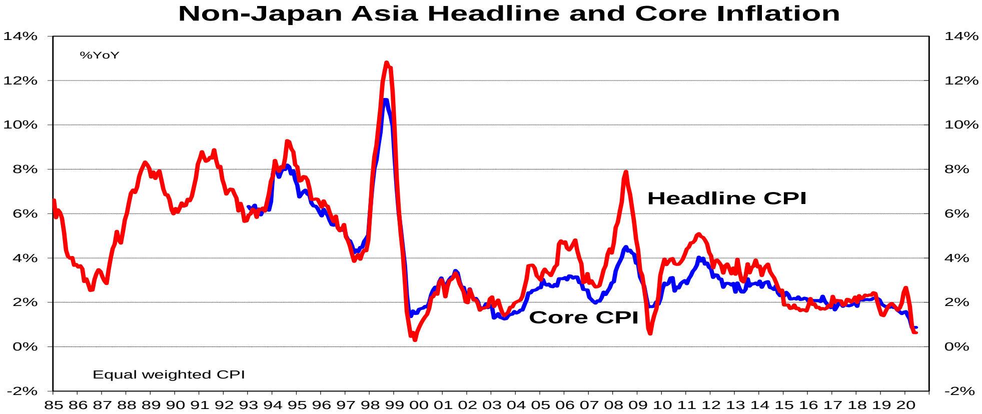
Initial macroeconomic positions argue for considerable fiscal and monetary policy flexibility, at least to tide countries over the next couple of years

[7] Please feel free to play about with the different values for each of these variables to come to your own assessments. However, let us take India, probably the most fiscally constrained country in our survey as a working example. This is a polity that has failed to run a fiscal surplus since independence but has rather racked up consolidated central and state government deficits of 6-7% of GDP on average for more than half a century. Yet because it has largely funded itself internally and, despite its bureaucracy and politicians, managed to generate nominal growth of around 12% per annum over the same period, its public debt ratio has been roughly stable for twenty years. 2020 could be a year of roughly zero nominal growth and a budget deficit equivalent to a tenth of economic output which will take public debt levels up towards 70% of GDP. Meanwhile, Indian 10-year government bond yields are around 6% implying a debt service next year of 4.2% of GDP assuming zero net amortisation. Assuming also that nominal growth rebounds to around 10%, and that budget deficits normalise, public debt should remain roughly stable.

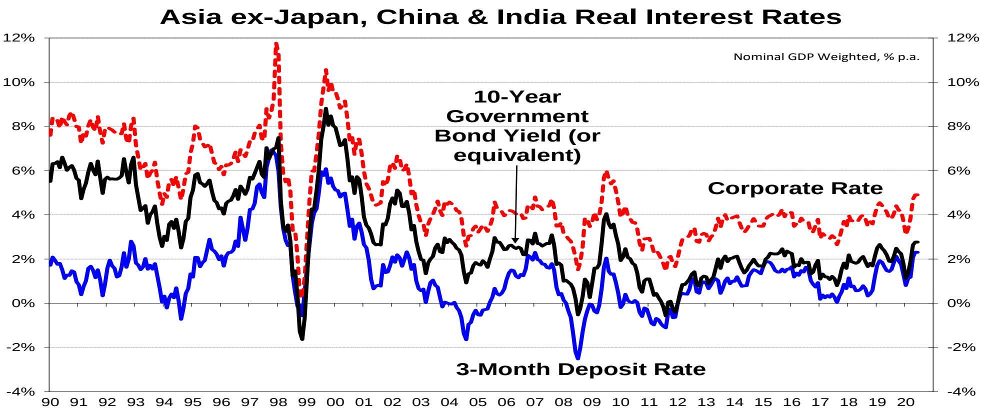
A general lack of currency constraints, and an intensifying global hunt for yield of any kind, means Asia can increasingly fund itself ever more cheaply.



Nominal rates may have been trimmed but inflation has also fallen sharply.

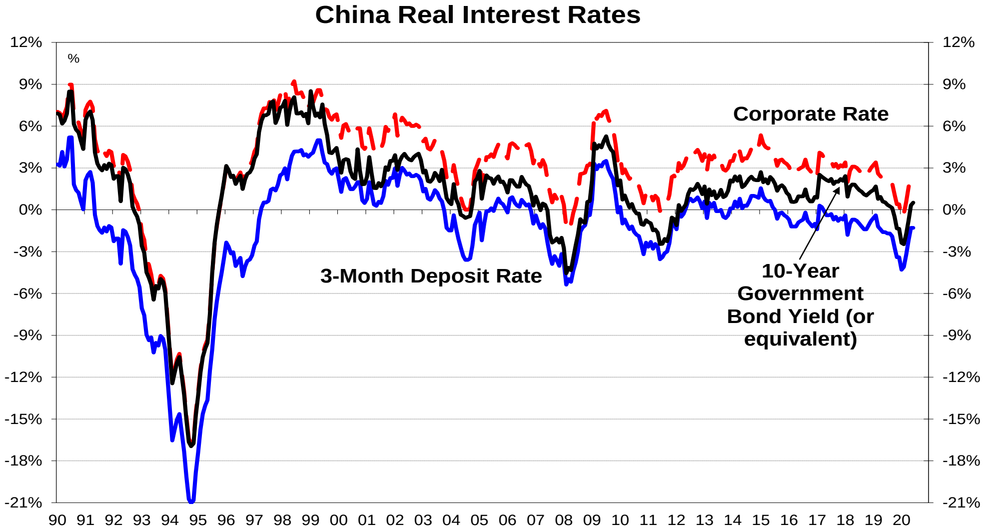


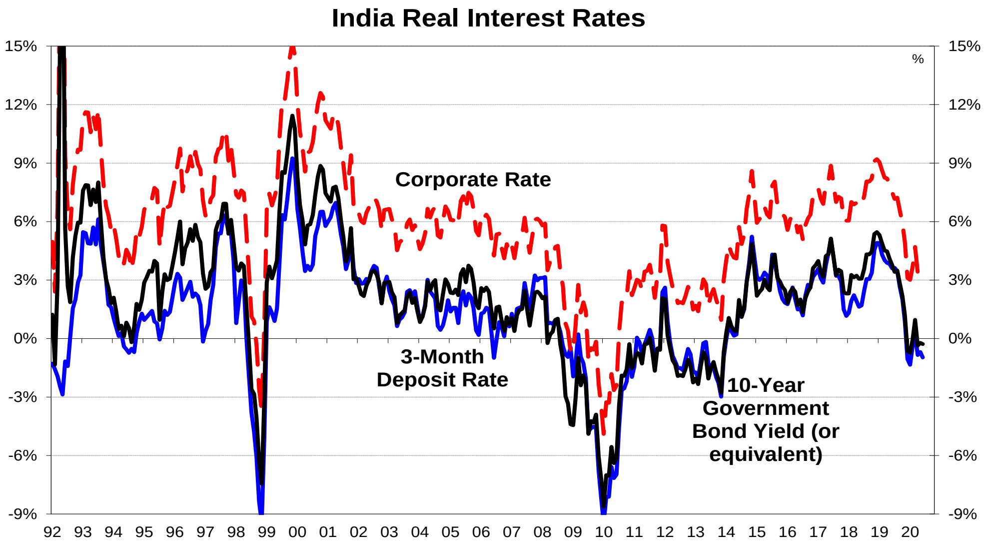
As a result, real interest rates, at least based on (temporary?) spot inflation developments, have been drifting upwards suggesting there remains further scope for monetary easing. (Some semblance of growth normalisation into 2021 should also be accompanied by at least a partial rebound in inflation.)



The aggregates plotted on the previous page mask a distinction between developed Asia and ASEAN. In the former (Singapore included here), rates are already flirting with zero while certain monetary authorities are taking their first baby steps into QE-purgatory. Meanwhile, across ASEAN, Thailand aside, nominal and real borrowing costs remain in positive territory, as they do in China and India[8] (charted below). The accompanying chart anthology presents each of the individual country aggregates.

A general lack of currency constraints, and an intensifying global hunt for yield of any kind, means Asia can increasingly fund itself ever more cheaply





[8] India's problem in recent years has been excessively high borrowing costs for the real economy, in turn a function of its failure to deal with a spreading, festering NPL problem.

Let's Get Fiscal

Hitherto, I have restricted my comments to bare statistical bones, albeit ones that appear to be reasonably clean after an initial picking. What though about the efficacy about such government interventions/interference? The success or otherwise of policy responses will only be truly assessable after the event but one can suggest various signs to watch for including:

What about the efficacy about such government interventions/interference?

1. Will the emergency funds disbursed find their way to their intended recipients or will they be partially diverted or indeed outright stolen?

2. Can longer-term disbursements be channelled more towards more productive activities such as infrastructure in countries with low or decaying capital stocks, or enhancing, in many cases, rudimentary healthcare, education and welfare systems?[9]

3. Will increases in government expenditure be accompanied by supply side reforms to encourage parallel private investments that can boost economic potential?

With respect to the first, the success or otherwise will be evidenced by how many individuals actually receive funds in their pockets, and how many small and medium-sized businesses are able to access credit or grants to ensure they can eventually re-open and hence retain their employees. The big picture aim should be to minimise a structural rise in bankruptcies and unemployment.

The big picture aim should be to minimise a structural rise in bankruptcies and unemployment

At the consumer level, improved financial access thanks to advances in fintech combined with an increased prevalence of direct benefit transfers, has probably meant that intermediary skim-off rates have fallen sharply over the past decade. Nevertheless, there are doubtless millions in the informal economy who are falling through the cracks. At the corporate level, anecdotes abound about small companies struggling to navigate bureaucratic application processes and persuade financial institutions to disburse credits to entities they have never been particularly keen on lending to. It remains to be seen too whether wage subsidy schemes will indeed result in worker retention or, in some cases at least, just be pocketed by unscrupulous employers who subsequently do a runner.

There are doubtless millions in the informal economy who are falling through the cracks

[9] Investments in healthcare, education and other areas that can help boost human capital endowments and wellbeing are often less attractive to politicians and their cronies since they are harder to extract sizeable, immediate rents from.

Let's Get Fiscal

On the infrastructure side, rapid build-outs in countries with low or decaying capital stocks both create employment and, assuming the projects have at least some merit, boost medium-term productivity. In theory, one should be indifferent as to whether the government directly executes such projects or provides the institutional space and guarantees for the private sector to deliver. In practice, it is often only the government that can ride rough-shod over institutional constraints that it has been largely responsible for erecting in the first place. The reality is that over the past decade, there has been no lack of financing available for both the developed and the more functional parts of the developing world, so taking interest rates even lower or direct monetary financing initiatives are all rather moot. Ameliorating land acquisition, restricting nimbyism, reining in sometimes spurious environmentalism, encouraging transparent tendering and ongoing project monitoring, etc., could all help accelerate capital deployments.[10] Failure to deliver here will merely result (yet again) in disbursed funds either being spontaneously privatised or diverted into financial speculation.

On the infrastructure side, rapid build-outs in countries with low or decaying capital stocks both create employment and, assuming the projects have at least some merit, boost medium-term productivity

Those of you who have suffered my screeds over the decades will be aware of my inherent scepticism. Nevertheless, I should stress that my ideological tendencies are not so absolutist as to lead me to argue that governments should be idly standing by in the face of a simultaneous demand and supply shock of such magnitude. Indeed, as I opined a couple of months ago in "Suppression begets depression and subsequently repression":[11]

"There is nothing quite as permanent as a temporary government intervention"

Make no mistake. The fusing of monetary and fiscal policy, is fully justified in the current situation in order to provide ***bridging finance*** *to ensure payrolls, working capital demands, debt payments, etc., can be met. Yet even if such measures help tide the global economy through the next six months or so, central banks have shown little predisposition towards reversing their previous, "emergency" interventions over recent decades and I suspect they will be unwilling and/or told not to reverse their actions this time either…. Modern Monetary Theory acolytes sense their moment in sun while Milton Friedman's dictum that* ***there is nothing quite as permanent as a temporary government intervention*** *is about to be fully tested.*

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[10] I am not arguing for just trashing the environment but as with everything in life there are trade-offs. Compare and contrast, for example, Eisenhower's highway build-out programme with the UK's Crossrail or HS2.

[11] April 16th, 2020.

Let’s Get Fiscal

My worldview has clearly been jaundiced though by a more than three-decade association with a Japan that has given us approaching thirty rounds of both monetary and fiscal stimulus since the bubble burst. Due to the country’s unique ownership and societal characteristics, I have never been in the Japan-collapse camp. However, its chosen path has been arguably little more than a (very expensive) holding exercise which would be extremely hard to replicate elsewhere.[12]

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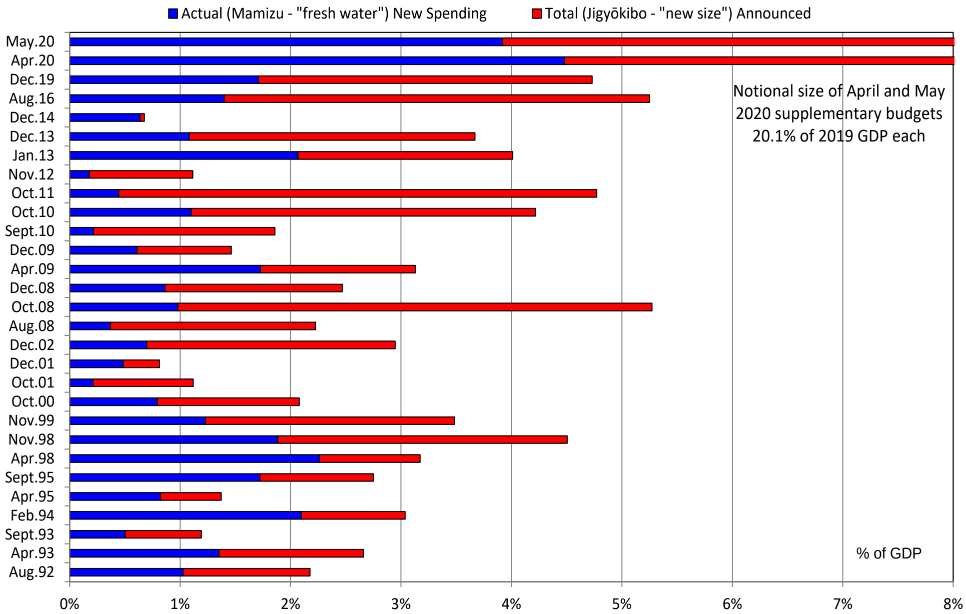
Japan: 29 Fiscal Stimulus Packages (and Counting) Since the Bubble Burst



Consider first fiscal policy. The chart above – one of my all-time favourites – shows that Tokyo has served up 29 fiscal stimulus packages since its bubble burst. As noted earlier, the “fresh water” elements of these packages have been less than meets the eye but they have still been sufficient, in the context of a low-growth and (until recently) diminishing-productivity economy to take public debt levels up towards two-and-a-half times GDP. Fortunately, Japan began this process as a hugely rich country with massive foreign assets and an inherent level of home bias and patriotism higher than just about anywhere else on the planet. Moreover, it remains a hugely rich, pleasant and safe place to hang out. As Deadboy & the Elephantmen once sang: *If This Is Hell, Then I’m Lucky*.

“If This Is Hell, Then I’m Lucky”

[12] See, for example, “Japan – Don’t try this at home”, November 25th, 2016.

The sister illustration is provided by this rather excellent graphic put together by Alhambra Partners in April 2019. We have probably moved on to QE27 or QE28 since then.

QE – to infinity and beyond….

This one goes up to more than eleven

Alt Classification	Category Classification	Date	Program	Description
QE1	**QE1**	3/19/2001		Purchase of JGB's in order to target current account (quantity)
QE2	**QE2**	10/11/2002		Increased JGB purchase target to 1.2T per month
QE3	**QE3**	12/19/2008		Outright JGB's expanded from 1.2T to 1.4T
QE4	**QE4**	1/22/2009		Purchase 3T CP & ABCP
	**	2/19/2009		QE4 extended to Sept 09 (instead of March) and **1T Corp Bonds**
		3/18/2009		QE3 expanded to 1.8T from 1.4T
		7/15/2009		Extends QE3 & QE4 to end of 2009
QE5	**QE5**	12/1/2009	FRO	10T 3M loans against eligible collateral at O/N call rate
QE6		3/17/2010	FRO	Expanded to 20T
QE7	**QE6**	5/21/2010	GSFF	3T 1Y loans to private fin'ls
QE8		8/30/2010	FRO	Expanded to include 10T 6M loans
QE9	**QE7**	10/5/2010	APP	5T in assets (3.5 JGB and bills, 1.0 CP, 0.5 ETFs J-REITs)
QE10		3/14/2011	APP	Expanded to add'l 5T (0.5 JGB, 1.0 bills, 1.5 CP, 0.45 ETFs, 0.05 J-REITs)
QE11		6/14/2011	GSFF	Expanded 0.5T
QE12		8/4/2011	APP	Expanded 5T in assets (2.0 JGBs, 1.5 bills, 0.1 CP, 0.9 Corp Bonds, 0.5 ETFs)
			FRO	Extend 6M 5T
QE13		10/27/2011	APP	Expand 5T JGBs
QE14		2/14/2012	APP	Expand 10T JGBs
QE15	**QE8**	3/13/2012	GSFF	Extend 2T private fin'ls incl. **1T US$**
QE16		4/27/2012	APP	Expanded 10T JGBs and small amounts of other
			FRO	**Reduced** 5T
QE17		9/19/2012	APP	APP expanded 5trln JGB's 5T bills
QE18		10/30/2012	APP	Expanded 5T JGBs, 5T bills and others
QE19	**QE9**		SBLF	BoJ will fund 100% net increase in lending to nonfins
QE20		12/20/2012	APP	Expanded 5T JGB's, 5 T bills
QE21	**QE10**	4/4/2013	QQE	Expand monetary base by 60-70T annually
QE22		10/31/2014	QQE	Increase to 80T annually
QE23		9/20/2016	QQE	with Yield Curve Control (YCC)

***This might fairly be classified as its own QE5 with the inclusion of Corporate Bonds in addition to CP*

Source: https://alhambrapartners.com/2019/04/08/the-forced-exile-of-bond-vigilantes/

Arguably the timeline above begins half a decade too late since the BoJ first doubled its balance sheet from around 10% to 20% of GDP between 1996 and 1999, a time when it also further cut interest rates from an already staggeringly high 1% to 0.5% and then subsequently to virtually zero. The central bank’s balance sheet trajectory is plotted over in the context of its other later-to-the-game peers. As with Communism, it clearly has not been the ideology that has been flawed but rather the execution.

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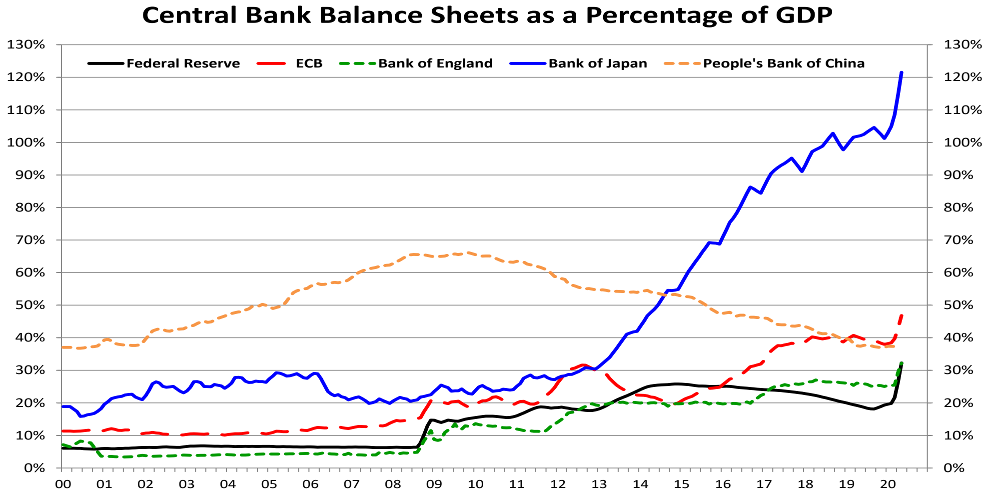
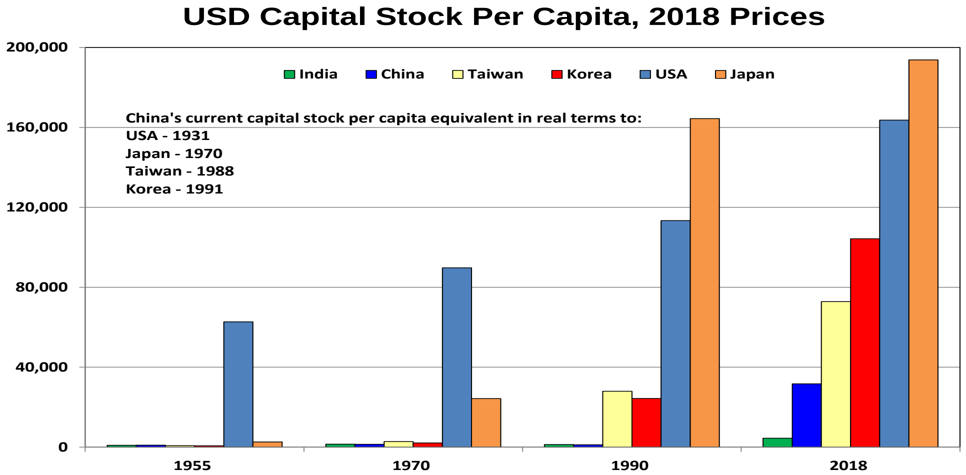
Let’s Get Fiscal



Focus on capital stock rather than fixed investment flows to assess productivity potential

Finally, significant **DSG*Asia*** ink has been spilled over years discussing the concept of capital stocks versus fixed investment flows. As the chart below illustrates,[13] the Japanese bubble burst when it was already extravagantly endowed with planes, trains, and automobiles hence the marginal benefit from trying to concrete every beach and give every citizen their own personal bullet train line was rather limited. Contrast this with China where the infrastructure build-out over the past thirty years, while doubtless providing copious opportunities for rent extraction, clearly has boosted economic efficiency. Oh, that India could have delivered even half as much.



[13] Apologies for not getting round to providing the 2019 updates but, trust me, the numbers do not change much over the course of single year.

Furthermore, while the PRC's capital accumulation has been as spectacular as anything seen since America's railway boom of the 19th Century, it still leaves the country with a capital stock akin to Japan's fifty years ago. This is not to argue that the marginal return to infrastructure is not falling but it should also be recognised that for every Shanghai, Shenzhen and Beijing, there are hundreds of other lower-tier destinations where even rudimentary connectivity and public services remain seriously lacking.

China still needs to invest more, albeit a little more carefully and targeted

The Chinese experience also needs to be placed in the context of the experience of its other poorer neighbours. Were these other countries to get their institutional acts together to create a more welcoming real economy investment environment for local and foreign capital alike, there is plenty of growth potential there to be harvested.

Across the poorer parts of the region, there is plenty of growth potential to be harvested