June 13, 2012
Europe to get worse before it gets better

Q: All the volatility we're seeing in the markets. Any resolution in sight to what's happening? Does it get worse before it gets better? How does an investor trade or invest in this environment?

It has to get worse before it gets better. All the conversation that we have seen about the Spanish bank bailout and Greek exit actually does not matter for a medium term portfolio investor. The economic trajectory for Europe is certain. There has to be credit contraction. There's going to be a recession for the next couple of years. Unemployment has to rise. Businesses have to fail. There is nothing to buying in Europe that is European.

Q: How does Asia deal with this though? We've seen resilience so far but now that China is slowing down, doesn't that present a real threat to market and economies across Asia Pacific?

Indeed, the biggest threat to the global economy today is that the US, Europe and China are all facing a synchronized slowdown and that is going to impact Asia very detrimentally. The only possible shining light is if the US is able to prevent a fiscal cliff and therefore have a moderate economic growth next year. China's definitely going to slow down. In fact, China's 5-year plan of investing in the high technology areas, is going to impact the rest of Asia, very negatively over the medium term.

Q: Let's talk about Indonesia because it is the market we don't pay much attention to. But every investor I talked to is looking at Indonesia. Why is it a compelling story and how does it relate to China?

Indonesia was the darling for the last couple of years because of very strong domestic demand. Bank Indonesia has already made the policy mistake of over stimulating an economy which had very strong domestic demand, and the very strong commodity prices have led to an overheating economy. As a result, the economy has gone from a current account surplus to a current account deficit of about 1.5% of GDP within 1 year, and that's why the Rupiah has fallen so steeply.

Q: The consumer potential here, how significant is that in terms of Indonesia. And also Indonesia is supplying China's shift to a domestic demand led structure.

It's very strong from a population perspective and an income perspective. But we have to remember that Indonesia has repressed inflation so the cost of goods in Indonesia is artificially held down which is why domestic demand has been very strong. What Indonesia really needs to do is to have a pass through of its oil prices into the domestic market. That is inflationary but that it has to be done.

Q: Let's talk about the Southeastern Asian markets and the resilience of these markets. As you look at places like Jakarta, Kuala Lumpur, Singapore, what is your impression of how they are faring in the global slowdown that we were seeing? Are these places to invest?

Any economy across Asia which has followed an export lead model over the last decade is going to be hit by the US and European crises. There is no doubt about that. They can be small winners and small losers but everyone is going to be negative. The only two potential economies which have a chance of coming out of this better are India and Indonesia. Indonesia as we discussed has domestic problems. India is exactly the same. The political problems are putting a stranglehold on investment in India. So, if it wasn't for these political problems, I would have said that India and Indonesia are the best place to invest today.

Q: The Rupee is Asia's worst performer so far this year. We are hearing a lot of investors are pulling their hair out that the Indian government is basically hampering reform, which it desperately needs.

Yes, India has a political problem that's very clear. They have supply side bottlenecks which are leading high inflation. They have managed that inflation very well over the last year by tightening monetary policy, but as a result of that they have strangled the investment cycle. So both the domestic investor and foreign investor are very confused as to what the policy going to be going forward. They need to give a very clear outline of what the policy is going to be, and they need to start pushing reform which is liberalizing multi-brand retail, liberalizing insurance, having pass-through of the oil subsidies, implementing GST, and implementing a land acquisition bill.

Q: Finally, I have to ask you about Felda Global Ventures. This is a Malaysian palm oil plantations operator. Its IPO is expected to price today in KL and is expected to be a blockbuster IPO, over-subscribed from what we understand. A company probably most people have never even heard of. How significant is this that places like Malaysia are seeing blockbuster IPOs, while in Hong Kong they are pulling IPOs?

There are hundreds of companies which are waiting to get money from the primary market. In China alone, there are probably hundred companies. But as we all know it is not a conducive environment to raise capital today. Anything which is related to internet has been strangled because of the Facebook IPO, and anything that relates to exports has been strangled because of the business environment. This is one of the unique cases which is not related to either of them. So, there obviously has to be some demand to that kind of company.

Full video link: http://www.businessweek.com/videos/2012-06-12/gupta-europe-to-get-worse-before-getting-better