WSJA(6/14) Europe's Woes Vex Asian Exporters

13 Jun 2010, 21:46

(From THE WALL STREET JOURNAL ASIA)

By Alex Frangos

HONG KONG -- Economic woes in Europe and the accompanying decline in the euro are already digging into the profits of Asia's manufacturers. The worry is that the pain will spread more broadly if European demand for Asian exports falters.

Companies based in Asia that sell everything from sweaters to solar panels in Europe are feeling the pinch already. Orders placed last year when the euro was 20% stronger against local currencies are now forcing Asian businesses to take losses or renegotiate prices with European customers.

"For euro-based orders, we could lose our shirts and pants and underwear," says Willy Lin, managing director of Milo's Knitwear International Ltd., a 52-year-old, family-owned sweater maker based in Hong Kong that caters to high-end European labels.

The euro's move could prove a temporary annoyance. The bigger question is whether a slowdown in Europe will sap demand over the longer term for Asian goods. It's critical because Asia's manufacturing economies have become the engines of global growth. And Asia needs Europe as a customer. The European Union accounts for around 13% of exports from Asia's 10 largest economies, excluding Japan, according to Singapore-based bank DBS. The U.S. makes up 11%.

Trade data don't show ill-effects from Europe's stumbles yet. China's May exports grew 48.5% from the year before, or 10.9% on a seasonally adjusted basis from the month before. Korea and Taiwan have also reported strong May trade figures. But exports don't respond instantly.

Cuts in European government spending could have "very negative effects on developing countries that rely on exports for growth," said International Monetary Fund Managing Director Dominique Strauss-Kahn, speaking earlier this month at the Group of 20 meeting of ministers in Busan, South Korea.

Asian economies, especially China, have been criticized for their export-oriented economic models. The countries have pledged to make their economies more reliant on internal demand, creating policies that encourage businesses and consumers to save less and spend more.

"Emerging-market countries have to take actions to advance their own growth to compensate," for a downturn in Europe, said Mr. Strauss-Kahn.

But those shifts could take years to show results. For now, Asia still needs the developed world to sustain its growth. Hence the worry about Europe.

"There are some early signals showing the euro-zone problems are spreading to the global economy," the Bank of Korea said last week even as it announced that Korea's domestic economy is performing well. It's still expected to grow more than 5% this year.

The drooping euro is the most immediate threat.

High-end electronics manufacturers have been among the first exposed. CLSA analyst Saurabh Chugh estimates Taiwanese computer maker Acer Inc. gets half its revenue from Europe. In percentage terms, its earnings fall 5% for every 1% decline in the euro versus the New Taiwan dollar, he estimates. Korean giant Samsung Electronics Co. counts 15% of its revenue in euros.

China's solar panel industry has been particularly affected. Solarfun Power Holdings Company Ltd., a Shanghai-based solar-equipment manufacturer, gets 85% of its sales in Europe.

The euro's move added a cloud to strong recent profits, among the best since Solarfun was founded in 2005. The company even recently lifted its earnings forecast for 2010, on expectations for continued strong demand despite the euro's drop.

Solarfun figures for every percentage-point decline in the euro versus the Chinese yuan, its profit margins shrink 0.4%, even after accounting for currency hedging.

"It's disruptive," says Solarfun Chief Financial Officer Gareth Kung. The euro's move has forced the company to renegotiate prices with customers in Europe and work harder to diversify its customer base to China and the U.S.

"Long term, our concern is that the financial crisis in Europe will actually weaken the support for the European government to provide subsidies for the renewable industry," Mr. Kung said.

Some fear Asian banks and corporations that rely heavily on European banks for funding could be hurt by a credit crunch in Europe, or a return of the evaporation of trade finance seen during the 2008 financial crisis.

Of course, it's possible that Europe's debt woes won't cause too much damage in Asia. Some say Asia's export economies will do fine so long as the U.S. keeps growing, even if Europe slows.

Europe's most important economy, Germany, continues to show healthy growth and is likely to benefit from the weak euro. Intra-Asian trade has also picked up on the back of strong local consumer spending.

"You'll see continued pressure on Asian export growth, but it's not enough to be qualitatively less optimistic on Asia overall," says Eric Fishwick, chief economist at CLSA Asia Pacific Markets.

Still, the fears are real. Mr. Lin, whose company makes around a million sweaters a year in factories in China and Hong Kong, says its financial position is strong and the short-term pain is endurable.

Longer term, he worries that the euro's plunge will make his goods more expensive compared with those of competitors in north Africa. And the quick currency moves have made European customers more wary than Americans.

"Everyone is more uncertain," he said. "Nobody wants to hold a lot of stock."

June 13, 2010 15:46 ET (19:46 GMT)