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Asia stocks drop as U.S. fiscal issues loom

By Sarah Turner, MarketWatch

SYDNEY (MarketWatch) — Asia stocks dropped on Thursday, as the conclusion of the U.S. election stoked fears about upcoming fiscal challenges for Washington and the potential effects on Asian economies.

Japan's Nikkei Stock Average (TYO:JP:100000018) fell 1.7%, while Australia's S&P/ASX 200 index (ASX:AU:XJO) lost 0.8%, and South Korea's Kospi (KRX:KR:SEU) dropped 1.3% after a late open.

In China, Hong Kong's Hang Seng Index (HSI:HK:HSI) fell 1.4%, while the Shanghai Composite Index (SHA:CN:000001) retreated 1%

China's week-long conference to usher in the country's next leaders and policies kicked off Thursday, although as yet there was little clarity on content or timing of any announcements. Read: China's leadership transition raises questions

But, with U.S. voters choosing President Barack Obama over challenger Mitt Romney, who had taken a harder line on China, Sino-U.S. relations now looked less likely to sour further.

Jun Ma, China equity strategist at Deutsche Bank, said that market-oriented reforms in China such as liberalizing the financial sector, opening up the capital account and greater yuan flexibility are likely to progress more smoothly, as they "can be more easily carried out in a friendly international environment."

Why China likes the status quo

Another four years of Obama is not a bad thing to China. J.P. Morgan's China CEO of investment banking explains w hy China likes the status quo.

HSBC strategists considering potential impact from the U.S. election in terms of the country's relationship with China also welcomed Obama's reappointment, saying that "the last thing the world needed, at a time of economic fragility, was a fresh stand-off between these two economic superpowers."

"If the market chooses to ignore the good news, it would suggest they are worried about the fiscal cliff," the HSBC strategists said.

Wall Street closed Wednesday with heavy losses, with the Dow Jones Industrial Average (DJI:DJIA) suffering its biggest one-day drop this year, as investors moved to price in the implications of Obama's re-election in terms of the U.S. "fiscal cliff" of tax hikes and spending cuts that will take place in January if no action is taken.

Fresh concerns about Europe's economic health also emerged Wednesday after German industrial production fell sharply in September and the European Commission slashed its 2013 euro-zone growth forecast to 0.1% from 1%.

Read: U.S. stocks slammed on fiscal-cliff fears

Barry Knapp, strategist at Barclays Capital, said that the U.S. election broadly maintained the status quo of a polarized federal government and that, “while the result means that highly accommodative policy is here to stay,” U.S. fiscal policy “remains problematic for risk sentiment.”

Knapp highlighted risks to U.S. economic growth from potential tax increases, which he said the market was not discounting.

“This leaves Asia, particularly China, in a difficult spot. European demand is weak, and if U.S. demand also softens, the recent signs of stabilization — which we think may have been flattered by smartphone product launches — could fade, leading markets to expect another leg lower for global growth,” Knapp said.

Bank of America Merrill Lynch economists said that they believe that the impact of U.S. decisions on the fiscal cliff in terms of Asia markets would depend on how severe it gets.

“I look at Asia, and I look at emerging markets in general, and I see a much healthier environment” than in the West, said Ethan Harris, co-head of global economics research at the bank during a recent press conference in Hong Kong.

However, the beginnings of any economic re-acceleration in these emerging markets would likely level off in an environment with very weak growth in the U.S., the economists believe.

“I think Asia will slow a little bit in reaction ... to the U.S. weakness,” Harris said.

Korean exporters, sometimes seen as bellwethers for global demand, weighed down the South Korean market on Thursday, with Kia Motors Corp. (KRX:KR:000270) (OTN:KIMTF) down 1.7% and LG Electronics Inc. (KRX:KR:066570) (OTN:LGEIY) falling 4%.

A Bloomberg News report said LG Electronics, along with Japan’s Panasonic Corp. (TYO:JP:6752) (NYSE:PC) , could face fines from the European Union for allegedly fixing cathode-ray-tube prices. Shares of Panasonic lost 0.5% in Tokyo. Read: LG, Panasonic, Philips could face Europe fines.

Meanwhile, other Tokyo-listed exporters fell, with the dollar (ICAPC:USDJPY) buying 79.82 yen Thursday, down from ¥79.98 late Wednesday and from ¥80.36 Tuesday.

Strategists at Bank of America Merrill Lynch said dollar-yen positions remained sensitive to U.S. fiscal cliff scenarios. “Long [U.S. dollar vs. yen] is extraordinarily so, being predominantly driven by rate differentials,” they said, adding that “recent appreciation in dollar/yen could reverse.”

Among Japanese exporters, Canon Inc (TYO:JP:7751) (NYSE:CAJ) lost 2.6%, Pioneer Corp. (TYO:JP:6773) (OTN:PNCOF) fell 3.5% and Honda Motor Co. (TYO:JP:7267) (NYSE:HMC) dropped 3.4%.

Isuzu Motors Ltd. (TYO:JP:7202) (OTN:ISUZY) , however, managed to gain, rising 4.7% after reporting a 25% increase in first-half net profit.

Weighing on the Hong Kong market, casino operator Galaxy Entertainment Group Ltd. (HKG:HK:27) (OTN:GXYEY) fell 3.9% after Permira sold its 5.9% stake in the firm. Rival Sands China Ltd. (HKG:HK:1928) (OTN:SCHYY) lost 1.8%. Read: Permira selling its remaining stake in Galaxy.

Growth-tied resource firms fell after sharp losses for most commodities in New York on Wednesday, where crude-oil futures dropped almost 5%.

In Hong Kong, Aluminum Corp. of China Ltd. (HKG:HK:2600) (NYSE:ACH) traded down 2%, and PetroChina Co. (HKG:HK:857) (NYSE:PTR) moved lower by 2.6%.

Energy and material-sector firms also weakened in Australia, with Oil Search Ltd. (ASX:AU:OSH) (OTN:OISHY) down 1.1% and Rio Tinto Ltd. (ASX:AU:RIO) (NYSE:RIO) giving up 1.4%, while Fortescue Metals Group Ltd.

(ASX:AU:FMG) (OTN:FSUMF) lost 2.5%.

Meanwhile, data out Thursday highlighted Japan's economic problems, with core machinery orders down 4.3% in September from the previous month, a larger drop than the 2.0% fall that economists had expected. In August, core machinery orders — which exclude orders for ships and power equipment — fell 3.3%.

In separate data, the Finance Ministry said September's current-account surplus narrowed by a sharp 69% to an unadjusted ¥503.6 billion ($6.4 billion) below a projection from Nikkei and Dow Jones Newswires for a ¥762.3 billion surplus.

Economists at Capital Economics said that a brewing territorial dispute with China, which began "in earnest" in September, had "contributed to a large fall in exports and industrial production during the month. This is likely to have affected investment intentions, and will therefore have weighed on machinery orders."

Industrials trading lower after the machinery data included Mitsui Engineering & Shipbuilding Co. (TYO:JP:7003) (OTN:MIESF) down 2%; Komatsu Ltd. (TYO:JP:6301) (OTN:KMTUY) off 2.3%; and Hitachi Construction & Machinery Co. (TYO:JP:6305) (OTN:HTCMY) , lower by 2.4%.

MarketWatch's Kristene Quan contributed to this report.