Economics & Strategy Weekly

Weekly: Pandemic alert

Economics/Strategy/Rates/FX/Equities

DBS Group Research

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- *There is growing evidence that the coronavirus infection stemming from Wuhan, China has spread across regions.*
- *Widespread fallout would undermine the Chinese and regional economic cycle just as it was beginning to show signs of stabilisation around improving external demand.*
- *Pandemics cost a lot—loss of lives and curtailment of activities hurt sentiments, GDP, and markets.*
- *In the near-term, Lunar New Year festivities would be affected. But if that is price for containing a deadly disease, no one will object. Asia remembers SARS all too vividly and is not ready to allow repeat.*

Latest coronavirus infection: Lessons from past pandemics

Spike in sales of masks and gloves, nervousness in equity markets, spate of travel cancellations and restrictions, rally in G3 bonds, softening of commodity prices—this week's market developments were typical of a budding pandemic scare. The epicentre of Coronavirus contagion is Wuhan, a city of 11 million in central China. While the Chinese authorities have moved in expeditiously to quarantine the areas from where the virus began to spread, there is growing evidence that the disease has spread to some places around China and overseas. Unfortunately, long before train and airline travel out of Wuhan was suspended, many students and migrant workers had left town for the Lunar New Year holidays.

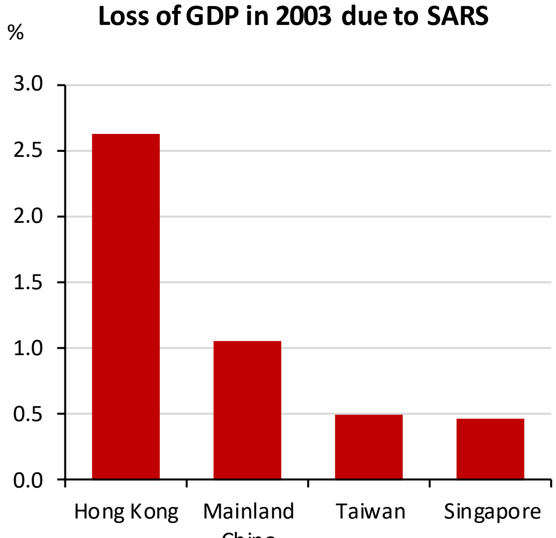
Widespread fallout would undermine the Chinese and regional economic cycle just as it was beginning to show signs of stabilisation around improving external demand. Equally crucial would be the dent to confidence in the Chinese public health system, as it could reveal insufficient investment in health safety and sanitation by some city governments.

We will hope that the spread of the virus will be limited with the containment actions that are being taken by healthcare professionals in the region. But we should be open to the possibility that things will get worse before they get better. The cost of the recent pandemic episodes has been considerable, as the following analysis will illustrate.

Let's begin with SARS. A viral respiratory illness caused by a coronavirus, it was first reported in Asia in February 2003. Over the next few months, the illness spread to more than two dozen countries in North America, South America, Europe, and Asia before the global outbreak was contained. According to the World Health Organization, a total of 8098 people worldwide became sick with SARS during the 2003 outbreak. Of these, 774 died, largely in Mainland China and Hong Kong.

Beyond the tragic loss of human lives, the outbreak caused a sharp decline in travel, tourism, and commerce in Mainland China, Hong Kong, Singapore, and Taiwan. As far as the financial market response, both Hong Kong and Singapore saw about 100bps decline in bond yields and 15% decline in equity market valuation. The loss of GDP was as high as 2.5% for Hong Kong and around 0.5% for Singapore.

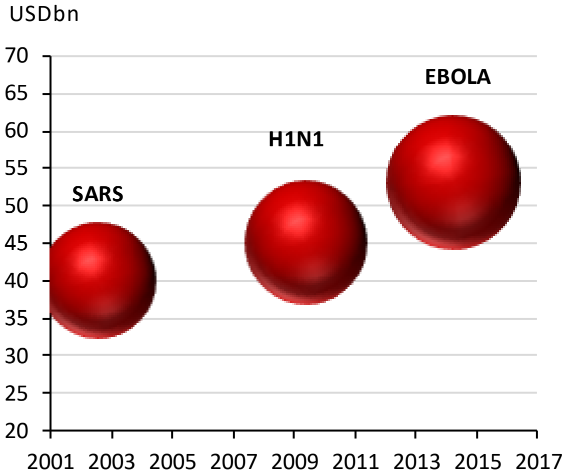
Loss of GDP in 2003 due to SARS



Source: NCBI, DBS

Other notable pandemics in recent years have been H1N1 influenza in North America, Africa, and South-East Asia (2009) and viral fever Ebola in West Africa (2014-16). Just like SARS, by the time the outbreaks were contained, considerable resources and lives were lost.

Cost of recent pandemics



Source: www.resolvetosavelives.org, World Bank, DBS

The key lesson from these episodes is that economies with advanced healthcare infrastructure and a well-rehearsed policy response system can absorb the shock, contain the damage, and bounce back quickly. Transparent and expeditious disclosures about the fallout and risks could very well dent public sentiments, but are essential for awareness to spread.

Lunar New Year festivities in the region will be affected by the ongoing developments and the tourism and sales data for January would not be particularly strong as a result. It is however too early to start guessing major downsides to economic and financial indicators. While we wait for successful containment, this episode will nonetheless be a reminder that pandemics are real and not that rare. Exercising vigilance is essential.

Taimur Baig

FX: Consolidating on tempered optimism

The Chinese yuan may have stabilized into a 6.80-7.00 range against the USD after the signing of the Phase 1 trade deal on January 15. US Treasury Secretary Steve Mnuchin reckoned that Phase 2A would be another mini deal with partial tariff rollbacks. No one expects such a deal to be concluded before the US Presidential elections scheduled for November 3. The worsening Wuhan coronavirus issue has led to some short covering. However, USDCNY is not likely to rise above 7.00, a level associated with the US branding China a currency manipulator.

It is too premature to be bullish on the euro which is unlikely to deviate far from 1.10. Eurozone is bracing for an escalation in trade tensions with America. US President Donald Trump wants a "big trade deal" with the EU to avert a 25% tariff on EU autos. US trade deficit with the EU did not narrow this year and was about 21% of its total deficit. The European Central Bank has looked past the improvement in sentiment and kept to its "looser for longer" stance. The ECB is only expected to taper asset purchases in 2021 before moving towards a rate hike in 2022. The ECB will be preoccupied with its strategic review of policy this year.

Sentiment has improved for Malaysia but USDMYR does not appear ready to move below its 4.05-4.10 range. The Ministry of Finance has forecast a modest economic recovery to 4.8% in 2020 from 4.7% in 2019. The cautious outlook was reaffirmed by Bank Negara Malaysia's surprise and possibly one-off rate cut on January 22. The overnight policy rate was lowered by 25 bps to 2.75%. CPI inflation averaged 0.7% in 2019, its lowest since 2009.

Philip Wee

Rates: A more balanced policy mix

- We have completed a three-part series - **US** (PDF, HTML), **Eurozone** (PDF, HTML) and **Japan** (PDF, HTML) that explores how G3 rates will be impacted as policy makers tilt towards a more balanced monetary / fiscal mix
- With G3 central banks on pause, fiscal and growth dynamics will be the key determinants driving govvie curves
- Some fiscal premium is warranted for the longer tenors, driving curve steepening across the DM space. However, the magnitude will be capped as the hurdle for tightening is set high
- US's fiscal policy is already the most simulative in the G3. Even further fiscal accommodation is unlikely as long as the House is split
- Pressure for European governments to do more on the fiscal front is building. But do not expect a material deterioration in the overall budget in 2020
- Fiscal consolidation is delayed in Japan and a fiscal stimulus package has been announced. The BOJ is clearly uncomfortable if 10Y yields drift too far below the 0% yield target

Budget Balance (% of GDP)	2009	2019	2020f	2021f
US	-10.1	-4.7	-4.8	-4.7
Eurozone	-6.2	-0.5	-0.7	-0.8
Japan	-9.4	-5.5	-5.5	-5.5

Source: Bloomberg, DBSf

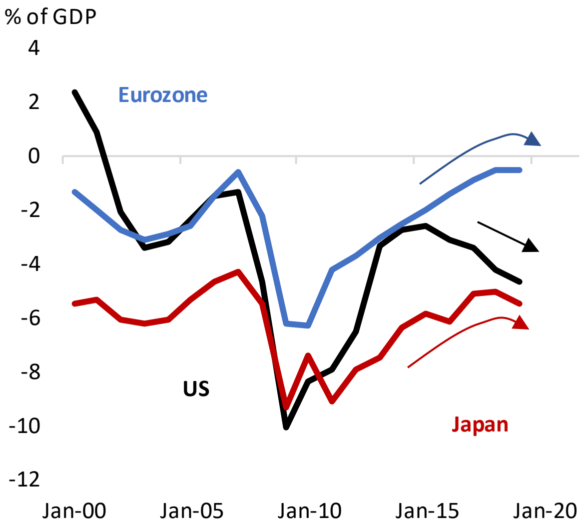
Debt / GDP (%)	2009	2019	2020f	2021f
US	84	106	107	107
Eurozone	80	87	87	88
Japan	178	201	202	202

Source: Bloomberg, DBSf

Implications for investors

- Tactical steepening across the 2Y/30Y and 5Y/30Y of the USD curve
- EUR interest rates are about appropriate after the recent rise / steepening moves. We prefer paying EUR interest rates swaps on dips
- BOJ will maintain the 10Y yield target at ±0.2%. Trading the range is still the clearest way to handle JPY rates
- A cautious recovery with major central banks on hold amidst a stronger fiscal push point modest steepening pressure on DM curves. These dynamics reinforce a carry environment, potentially benefitting higher yielders in Asia
- Wuhan virus worries will probably depress long-end DM rates in the immediate term, presenting more attractive opportunities for these strategies

G3 Budget Balances



Source: Bloomberg, CEIC, DBS

Eugene Leow

Credit: Hong Kong's downgrade—limited impact seen

Hong Kong's credit rating was taken down a notch by Moody's to 'Aa3' on 21 January. The rating firm cited its diminished assessment of Hong Kong's institutional capacity as a reason for the rating cut, with the government seemingly unable to address issues fostering persistent unrest.

This marks **Hong Kong's second rating downgrade since the beginning of mass protests**, with Fitch having also downgraded Hong Kong to 'AA' last September. While the current fiscal year and FY20-21 are likely to register deficits due to the government's economic support measures and a drop in land sales, **Hong Kong's credit quality is still fundamentally strong.** Its fiscal position is buttressed by over HKD1trn of fiscal reserves (36% of GDP), and the territory has always been a paragon of fiscal discipline, running fiscal surpluses over the last 15 years.

As such, the downgrade should result in only minimal impact on the Hong Kong government and corporate bond market. Indeed, **Hong Kong's IG bonds have seen only small changes in their OAS**, with spreads widening by just an average 1.1bps across 18 issues on the day of the downgrade. Furthermore, slightly wider spreads can be partially attributable to concerns over rising 'Wuhan' flu cases.

Relatively calm bond markets is in line with the muted reaction following Fitch's downgrade on 5 Sep 2019. Back then, Hong Kong IG bonds posted an average OAS increase of just 3.4bps in the week after the downgrade. We believe Hong Kong's fiscal position remains firmly secure for now, but **risks of a slow burn are set to increase, the longer protests continue unabated.**

Chang Wei Liang

Highlights of the week:

G3 rates outlook for 2020: Part 3 (Japan)
G3 rates outlook for 2020: Part 2 (Eurozone)
G3 rates outlook for 2020: Part 1 (US)
China: A mild recovery in sight
Ten Economics Themes for 2020

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2018	2019f	2020f	2021f	2018	2019f	2020f	2021f
China	6.6	6.1	5.8	5.6	2.1	2.6	2.3	2.5
Hong Kong	3.0	-1.7	1.5	1.5	2.4	2.7	2.5	2.5
India	7.4	5.0	5.8	6.4	4.0	3.5	4.2	4.5
*India (FY basis)**	*7.1*	*6.8*	*5.0*	*5.8*	*3.6*	*3.4*	*3.9*	*4.2*
Indonesia	5.2	5.0	5.0	5.1	3.2	3.1	3.4	3.2
Malaysia	4.7	4.5	4.6	4.6	1.0	0.9	1.6	1.8
Philippines**	6.2	5.9	6.3	6.3	5.2	2.8	3.5	3.3
Singapore	3.1	0.7	1.4	1.8	0.4	0.6	1.1	1.5
South Korea	2.7	2.1	2.4	2.3	1.5	0.4	1.5	1.3
Taiwan	2.7	2.3	2.0	2.2	1.3	0.6	1.0	1.1
Thailand	4.1	2.5	3.0	3.2	1.1	0.8	1.2	1.3
Vietnam	7.1	7.0	6.8	6.7	3.5	2.8	2.9	3.0
Eurozone	1.9	1.2	1.3	1.5	1.8	1.2	1.2	1.3
Japan	0.8	0.7	0.5	0.9	1.0	0.5	0.7	0.6
United States***	2.9	2.2	1.9	1.8	2.0	1.7	1.7	2.0

* refers to year ending March i.e. 2020 represents FY20 - year ending March 2020 ** new CPI series *** eop for CPI inflation

Policy interest rates, eop

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	5.15	5.15	5.15	5.15	5.15	5.15	5.15	5.15
Indonesia	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Malaysia	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
Philippines	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Singapore**	1.60	1.60	1.60	1.60	1.60	1.60	1.60	1.60
South Korea	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Taiwan	1.38	1.38	1.38	1.38	1.38	1.38	1.38	1.38
Thailand	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Vietnam***	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20
United States	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75

* 1-yr lending rate; ** 3M SOR ; *** prime rate

Exchange rates, eop

	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
USD/CNY	7.20	7.15	7.10	7.05	7.00	6.95	6.90	6.85
USD/HKD	7.85	7.84	7.84	7.83	7.82	7.81	7.80	7.80
USD/INR	72.0	72.5	73.5	74.0	73.5	73.0	72.5	72.0
USD/IDR	14200	14300	14400	14500	14450	14400	14350	14300
USD/MYR	4.20	4.18	4.16	4.14	4.13	4.12	4.11	4.10
USD/PHP	52.0	51.5	51.0	50.5	50.4	50.3	50.2	50.1
USD/SGD	1.40	1.39	1.38	1.37	1.36	1.36	1.35	1.35
USD/KRW	1180	1175	1170	1165	1160	1155	1150	1145
USD/THB	31.0	30.8	30.6	30.4	30.3	30.2	30.1	30.0
USD/VND	23300	23300	23300	23300	23300	23300	23300	23300
AUD/USD	0.64	0.65	0.66	0.67	0.68	0.69	0.70	0.71
EUR/USD	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	110	109	107	106	105	105	104	104
GBP/USD	1.20	1.21	1.22	1.23	1.24	1.25	1.26	1.27

Australia, Eurozone and United Kingdom are direct quotes

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).