Economics

DBS Flash

Rates: Coronavirus drives wave of Asian rate cuts

Strategy/Rates

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Duncan Tan
Strategist

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *There is heightened impetus for Asian central banks to cushion the Coronavirus fallout*
- *In our view, Asian central banks can cut rates, even if DM central banks stay on hold*
- *Among low- and mid-yielders, front-end swap rates are biased lower*
- ***Implications for investors** – Position via 1y1y KRW IRS, 1y1y MYR IRS and 10y China Government Bonds.*

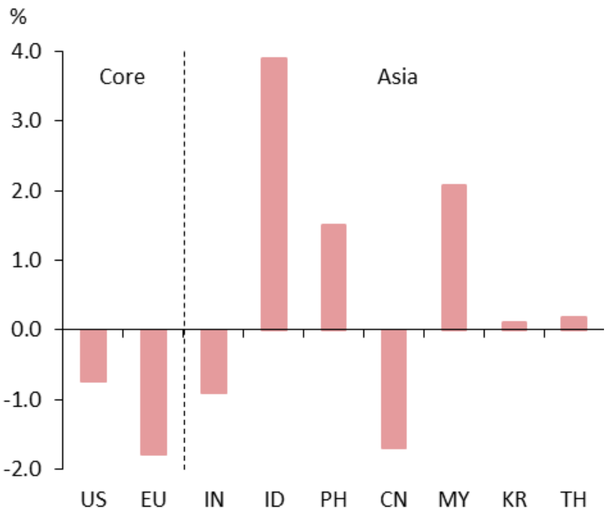
One consequence of the Coronavirus outbreak has been the heightened impetus for Asian central banks to cushion the resulting shock to regional economic activity. **Since virus fears intensified in mid-January, central banks of China, Malaysia, Thailand and Philippines have cut rates (India and Indonesia stayed on hold).** Especially in Bank Negara Malaysia and Bank of Thailand's cases, the decision to cut was very much against consensus.

Contrast that to DM central bank decisions over the past 3 weeks, with the Fed, ECB, Reserve Bank of Australia (RBA), and Bank of England (BOE) all keeping rates unchanged in January. In RBA and BOE's case, there was in fact some expectations that they would cut rates with market pricing assigning a ~25-50% probability (pre-decision). In Fed Chairman Powell's press conference on 29th January, while he acknowledged the virus outbreak as a downside risk, he didn't seem overly concerned or gave any indications that the outbreak had moved the Fed closer to a cut.

Thus far, the economic shock has been more regional vs global and thus, DM central banks have been more sanguine about the impact on their respective economies. A few questions of natural interest for Asian investors then - Can Asian central banks cut with DM central banks on pause? And in some cases, cut rates to new historic lows? How will bond markets react?

We think Asian central banks can cut without the Fed's cover, and bond market reaction would be benign. Domestically, low inflation and positive real yields (China and India are exceptions) gives Asian central banks some cover/room to cut rates. Looking ahead, the risks of rising inflation appears to be low with energy prices continuing to fall and domestic demand generally sluggish across the region. Externally, global liquidity is flush, global monetary stance is still accommodative and major central banks (Fed/ECB/BOJ) are still purchasing assets/injecting liquidity. In the current context where rate cuts in Asia are intended to cushion the economic shock vs leveraging the economy, we think bond markets will react positively.

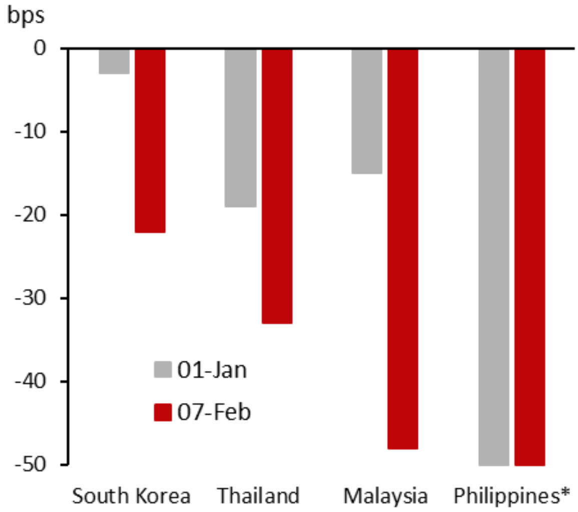
10Y Real Rates (10Y Yield - CPI)



Source: Bloomberg

For selected low- and mid-yielders in Asia, the impetus for greater monetary support would be a huge positive for front-end swap rates. China, the epicentre of the outbreak, clearly has plenty of policy room to cut rates, largely because they were conservative in easing last year. Our economists are expecting an aggressive 60bps lowering of the Loan Prime Rate and 300bps reduction to banks' reserve requirement ratios this year. Outside of China, the low-yielders of Thailand and South Korea and mid-yielders of Malaysia and Philippines are amongst the most economically exposed to a slowdown in Chinese tourism, investments, demand and production. We have already seen against-consensus cuts from Bank of Thailand and Bank Negara Malaysia, while Bangko Sentral ng Pilipinas appears to be front-loading its communicated cut quantum for 2020.

2020 Rate Cut Pricing



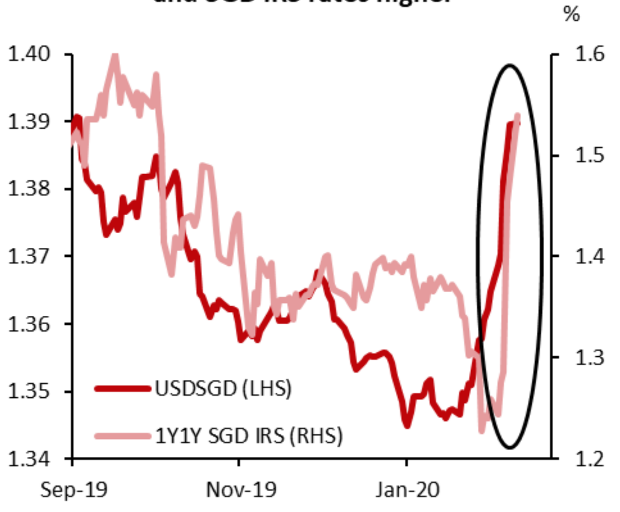
Source: Bloomberg

Note: * - BSP guidance

We recognize that swap markets in those countries have already moved to price in some amount of rate cuts, but feel that positioning for easing is still attractive. In our view, there continues to be little clarity on the likely severity and duration of the Coronavirus outbreak. Uncertainty around regional growth trajectory, both extent and duration of current slowdown and strength of subsequent recovery, is likely to remain high for some time. Therefore, the balance of risks is skewed towards front-end swap rates staying at present or moving to lower levels.

We have excluded Hong Kong and Singapore from our list of expected beneficiaries for idiosyncratic reasons. HKD's peg to the USD means that Hong Kong Monetary Authority's base rate decisions has to follow the Fed (we are expecting no change to Fed Funds target range this year). Due to the Monetary Authority of Singapore's unique FX-based policy, declines in SGD/SGD NEER on the back of greater easing expectations tend to drive front-end swap rates higher, not lower.

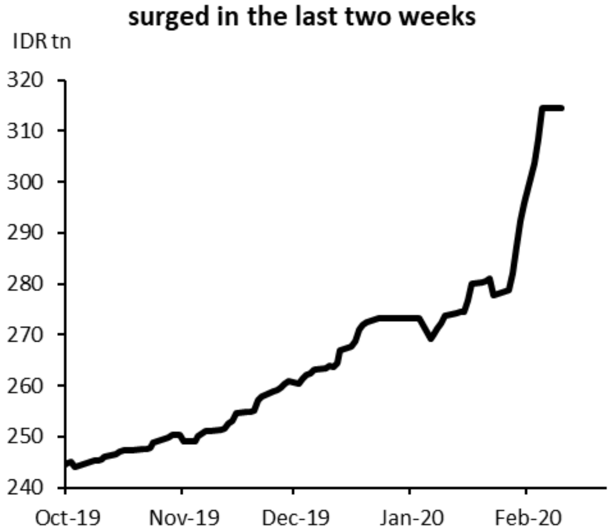
MAS 5th Feb comments drove SGD weaker and SGD IRS rates higher



Source: Bloomberg

The economies of high-yielders - India and Indonesia, are more insulated and thus, necessity for cuts could be lower. The ability to cut is also debatable. The Reserve Bank of India (RBI) could be constrained by above-target inflation (onshore OIS rates are actually pricing for RBI to hike). While the IDR has been the most resilient Asian FX this year, Bank Indonesia (BI) may be wary about cutting rates at a time when market sentiments are fragile and bond inflow momentum is slowing. As reported by Bloomberg on 3rd February, BI has pledged to intervene in bond and currency markets to guard against Coronavirus-induced volatility. Considering the smaller scope for RBI and BI rate cuts, front-end INR and IDR swap rates are likely to underperform Asian peers.

BI's ownership (gross) of IndoGBs surged in the last two weeks



Source: Bloomberg

Group Research - Economics & Macro Strategy Team

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Chang Wei Liang
Macro Strategist
+65 6878-2072 weiliangchang@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia-
+65 6878-2842 eugeneleow@dbs.com

Duncan Tan
Rates Strategist - ASEAN
+65 6878-2140 duncantan@dbs.com

Nathan Chow
Economist/Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Masyita Crystallin
Economist - Indonesia, & Philippines
+62 21 2988-4003 masyita@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Radhika Rao
Economist – Eurozone, Thailand & India
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia & Vietnam
+65 6878-6727 irvinseah@dbs.com

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