Economics & Strategy Research

DBS Monthly

Four ways Asian growth can bottom in 2H19

Economics/Strategy/Rates/FX/Equities/Credit

Group Research

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Taimur Baig
Chief Economist
taimurbaig@dbs.com

Nathan Chow
Strategist / Economist
nathanchow@dbs.com

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

- ***Economics***: *July ends on a high note for financial markets, but Asian trade data remain weak. For growth to bottom out, there has to be (i) more tangible signs of China's demand stabilisation, (ii) a bottoming out of global electronics demand, (iii) less despondency with trade war and more getting-on-with-it by the participants in the supply chain, (iv) stable exchange rate dynamics around Fed and ECB policy easing.*

- ***FX:*** *Germany, UK and Singapore are on recession watch. The anticipation of monetary easing in these countries are keeping their exchange rates – EUR, GBP and SGD – weak.*

- ***Rates***: *it is time for the global rates rally to take a breather. Fed and ECB easing are largely priced in.*

- ***Equities***: *We like Indonesia Banks which can benefit from interest rate cuts, Singapore Banks which are paying high dividend yields, and are selective on Thai and Malaysia Banks.*

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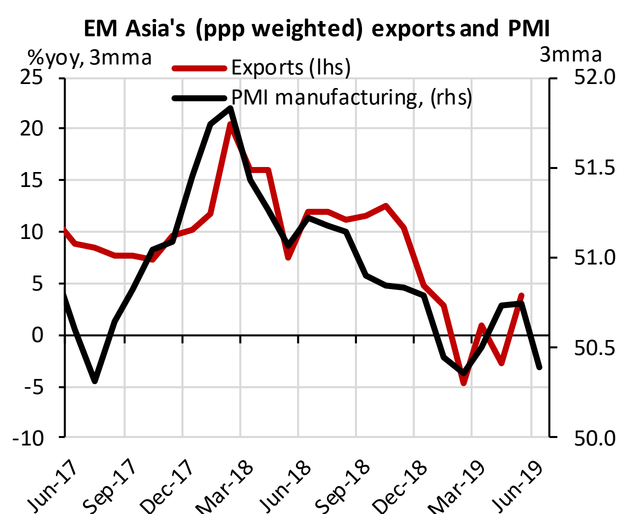
Refer to important disclosures at the end of this report.

Can strong markets pull up the real economy?

Expectations of monetary accommodation by the Federal Reserve and the European Central Bank have been a strong tonic for financial markets in July. With 2Q earnings numbers and June dataflow from the US also supporting bullish sentiments, global markets have been in a sweet spot, rallying across the board, notwithstanding weak manufacturing and trade data out of Europe and Asia.

Asia's trade figures, after suggesting a bottom in April/May, have turned weak again. June exports have been disappointing with so far, with China, India, Indonesia, Singapore, and South Korea reporting weaker outturns than the previous month. But some other trade markers have fared better. The Baltic Dry Freight index, for instance, has had an excellent July. Along with some pickup in commodity prices, there are some reasons to expect that a better set of numbers could be the characteristic of 2H19.



Source: CEIC, DBS

We are somewhat optimistic that between the supportive US dataflow and buoyant financial markets, trade and growth will pick up worldwide. We are keeping an eye on four developments for a constructive 2Q:

- **More tangible signs of China's demand stabilisation**. Our Nowcasting model is pointing at stable demand in China in 3Q, despite headwinds from weak trade and poor sentiments. Credit growth, freight movement, and retail sales will shed light on the stabilising dynamic, in our view. Supportive measures from PBOC will help.

- **A bottoming of global electronics demand**. Between uncertainty about 5G rollout due to trade war and a weak product pipeline, the global electronics cycle has been undergoing a lean patch. There could be some turnaround in parts demand as new products are introduced later this year.

- **Less despondency with trade war**. As tariffs and tweets lose their shock value, we expect managers of multinational companies to just get on with this new environment (re-route, re-brand, diversify sourcing, raise prices, increase productivity).

- **Stable exchange rate dynamics**. Unless President Trump goes the length of instructing the US Treasury to intervene in the FX market by selling USD, low rates worldwide should ensure low currency volatility. That would help keep capital flows orderly and add to the narrative of a stronger second half of the year.

Taimur Baig

FX: Economic worries and monetary easing

Monetary policy easing biases and recession risks continue to dominate sentiment in currency markets. Geopolitical risks such as Iran have been unable to supplant global slowdown worries. The notable countries on recession watch are Germany, UK and Singapore. Despite wide expectations for a Fed cut on July 31, the US dollar has held up well on the weaknesses of the sizable components in the DXY, namely, the euro and sterling.

The European Central Bank's easing stance has set a dovish tone for the euro. With no improvement in Eurozone economy, the ECB has paved the ground to start easing monetary policy in September. More clarity on its plans to resume asset purchases will be forthcoming after the German Constitutional Court hearings (on July 30-31) over its quantitative easing programme which the EU Court has already ruled as legal. ECB President Draghi will probably deliver rate cuts before his term ends in October and leave the heavy lifting to his successor, former IMF Chief Christine Lagarde. On QE, the lesson fro 2014-15 was that it was a "buy the rumour, sell the fact" play for the euro.

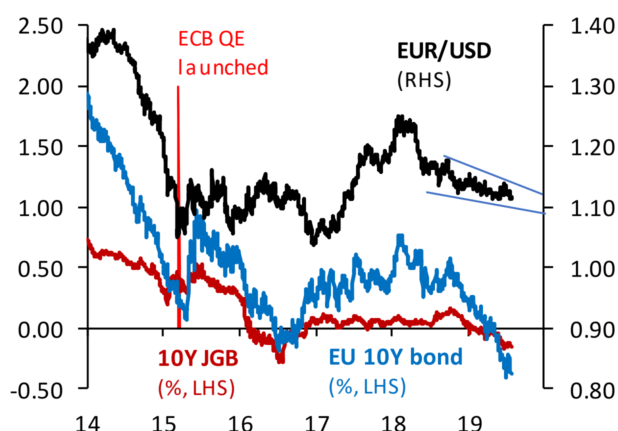
The euro's fall today is notably flatter than 2014-15 because the Fed is moving to cut rates this month, and not towards its post-crisis rate hike in 2015.

Implication: EURUSD remains on a slow but steady fall towards 1.10

The British pound can't wrest itself from hard Brexit and UK recession risks. Prime Minister Boris Johnson has appointed Brexit hardliners into his new cabinet. This has kept alive his pledge to take the UK out of the EU on October 31 with or without a deal. The Office for Budget Responsibility has warned that a no-deal Brexit would send the UK economy into a recession from 4Q19 into 2020. Yet, scepticism remains that Johnson can overcome the political hurdles to deliver Brexit. Even so, the uncertainties of the process have led The National Institute of Economic and Social Research to warn of a one-in-four chance of a UK recession. According to recent Reuters polls, the odds of a no-deal Brexit now stands at 30%, an outcome that could drive GBPUSD down to 1.17-1-25.

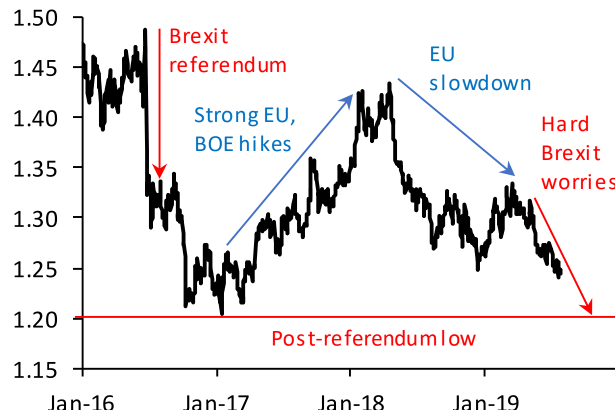
Implication: GBPUSD is set to trade in weaker 1.20-1.25 range.

EUR fell ahead of ECB's QE in March 2015



Sources: DBS Research, Bloomberg data

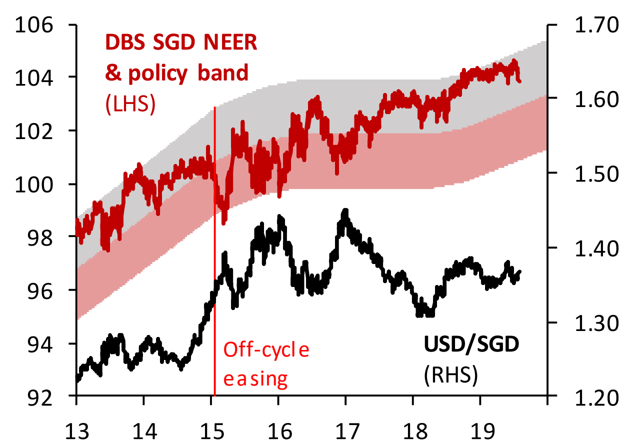
GBPUSD eyeing post-referendum low on hard Brexit fears



Sources: DBS Research, Bloomberg data

The case for a trade-weighted depreciation in the Singapore dollar has strengthened. GDP growth has averaged 0.6% YoY in 1H19, below its official 1.5-2.5%. Our economist has downgraded Singapore's growth to 0.7% for 2019, implying our expectations for a lowering in the official growth. Both MAS core and CPI inflation have fallen to 1.2% YoY and 0.6% in June respectively, just above their official forecast ranges. On Friday, the unemployment may rise above its post-crisis range of 1.8%-2.2% in 2Q19.

USD/SGD to rise on SGD policy easing



Sources: DBS Research, Bloomberg data

We expect the Monetary Authority of Singapore to ease the SGD policy in October by slightly flattening the gradient of the policy band. Based on the previous easing experience that started in January 2015 (an off-cycle move), the SGD nominal effective exchange rate (NEER) should retreat from the upper half into the lower half of its policy band. Back then, the USD was firm against Singapore's trade-weighted basket of currencies from the ECB paving the ground for its quantitative easing programme launched in March 2015.

Implication: According to our model, the weaker half of the SGD NEER band was last estimated to be 1.38-1.41 in USD/SGD terms.

The Australian dollar's depreciation has yet to run its course. The Reserve Bank of Australia has reaffirmed its strong commitment to its 2-3% inflation target and kept the door open for a third rate cut. The cash rate target was lowered back-to-back in June-July by a total 100 bps to a record low of 1%. The AU 2Y bond yield hit a new lifetime low of 0.87% on July 25.

Implication: AUDUSD weak in a 0.65-0.70 range

Philip Wee

Rates: Time to take a breather

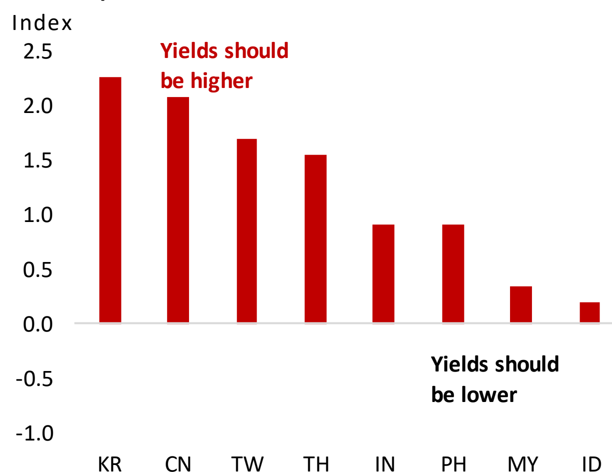
It is time for the global rates rally to take a breather. Interest rates across the globe have adjusted significantly lower over the past few months. In the developed market space, upcoming Fed "insurance cuts" have been well-communicated. Even as US data stays firm and the stock market hovers near its record high, economic uncertainties are deemed sufficient to nudge the Fed into a shallow easing cycle. "Insurance cuts" are not new. **There were two instances in the 1990s that can provide guidance on how things would play out – the 1995/96 and the 1998/99 episodes.**

Firstly, "Insurance cuts" should not amount to more than two or three. In both cases, the Fed cut by a cumulative 75bps within a short span of time. This was judged to be sufficient to stabilize the US economy. Note that the Fed did embark on further hikes when downside risks subside. **We think USD rates may have turned too dovish on the Fed in the current cycle.**

Secondly, the US stock market will determine the magnitude of rate cuts. Aggressive rate cut cycles (>3 cuts) tend to be accompanied by a deep slump in US equities, which foreshadows weaker data. Moreover, tightening financial conditions (from falling stock prices) would usually prompt the Fed to react with more urgency. Stock prices have been remarkably resilient thus far, suggesting that the easing cycle may be shallow.

Thirdly, Fed cuts tend to steepen the UST curve. In this regard, there is no difference between "insurance cuts" versus "recession cuts." Unless inflation or growth expectations become unhinged, there is no reason for longer-term USD rates to head down by the same magnitude. Instead, looser policy in the immediate term implies higher inflation expectations (and therefore higher rates) over the longer term. **However, this needs to be balanced against a weak global growth backdrop. A dovish European Central Bank (ECB) will restrain steepening in the UST curve.**

Asia: Gap to ARVI Indicator



Source: Bloomberg, DBS

Similarly, it may be better to await more attractive levels before receiving Asia rates. After the surge over the past few months, our Asia Rates Valuation Indicator (ARVI) suggests that many of the markets that we track now look rich. Against a backdrop of modestly rising USD rates and a rebound in USD strength, some profit taking is likely to take place. Beyond the short term, however, we think that Asia rates will still be attractive amid global yield scarcity. Moreover, the easing cycle across Asia has further to run with Korea and Indonesia joining peers in cutting rates in July.

Eugene Leow

Equities: Selected opportunities in Asia Banks

Given the monetary easing stance adopted by central banks in the region, there are expectations that lower interest rates will place most Asia Banks in a disadvantaged position as net interest margin (NIM) get compressed. However, Bank earnings are generally impacted with a 3-6 months lag and, depending on how quick deposits and loans get re-priced, impact on various countries may be different. Moreover given the weaker economic growth ahead, other drivers such as provisions, fee income, loan growth are more important to watch in assessing the outlook for Banks.

Among Asia Banks, we believe the Indonesian banking sector should benefit from BI's recent rate cut as deposits tend to reprice faster than loans (usually a 6-month repricing gap), thus providing support for net interest margins (NIMs). Banks with higher proportion of time deposits (TDs) and higher portion of fixed rate loans (vs floating rate loans) should benefit from the rate cut. Besides NIM expansion, we also look for Banks which can grow in the micro lending business or is on a recovery path from higher provisions previously made.

In Singapore, we expect a decent set of 2Q19 results deriving from marginal NIM improvement, strong loan growth, and fee income. According to our channel checks, repricing of loan book as well as mortgages are still ongoing in 2Q19 following that in 1Q19. During the Apr-May'19, industry loan growth was also numbers amid slowing economy; 2Q19 loan drawdowns for Singapore banks likely to be on track with guidance. The broader market has been relatively resilient through 2Q19, despite a market correction seen in May'19. We believe that wealth management income through 2Q19 could be relatively supported, post 1Q19's recovery from 4Q18's lows. **The spotlight is on dividends**. While we don't expect any upside surprises on dividends as banks would prefer to maintain their existing dividend levels and preserve more capital, high dividend yields among Singapore Banks should make them a defensive pick in this challenging environment.

NIM compression is not an issue with Thai Banks as we see less likelihood for BoT to cut interest rates. Thai Banks have reported 2Q19 results which is a mixed bag. We saw three negatives (weaker fee income, lower non-NII, higher OPEX) and two supportive factors (stronger loan growth and lower provisions) to 2Q19 results. Nonetheless, we believe loan growth and fee income should exhibit stronger growth in 2H19, **given a better economic outlook after the new cabinet is set in place**. **We prefer Banks which have larger exposure to business loans and can capture the opportunity to grow along with the new investment cycle.**

Among Asia Banks, we believe **Malaysia Banks should be the most impacted by lower interest rates as the sector revenue faces headwinds from margin pressure and moderating loans growth**. We look for Banks which can benefit from an uptick in capital market activity, thus translating to better non-interest income for the banks.

We like Indonesia Banks which can benefit from interest rate cuts, high dividend yielding Singapore Banks, and are selective on Thai and Malaysia Banks.

Joanne Goh

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Growth, Inflation, Policy Rates & FX forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2017	2018	2019f	2020f	2017	2018	2019f	2020f
China	6.9	6.6	6.2	6.0	1.6	2.1	2.3	2.3
Hong Kong	3.8	3.3	2.5	2.0	1.5	2.5	2.7	2.5
India*	8.2	7.2	6.8	6.8	4.5	3.6	3.4	3.6
Indonesia	5.1	5.2	5.2	5.1	3.8	3.2	3.2	3.4
Malaysia	5.9	4.7	4.5	4.2	3.8	1.0	0.9	1.6
Philippines**	6.7	6.2	6.1	6.1	2.9	5.2	3.1	3.1
Singapore	3.9	3.2	0.7	1.8	0.6	0.4	1.1	1.5
South Korea	3.1	2.7	2.1	2.4	1.9	1.5	0.5	1.5
Taiwan	3.1	2.6	1.9	1.8	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	3.4	3.5	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.6	6.3	3.5	3.5	3.8	3.4
Eurozone	2.5	1.9	1.2	1.5	1.5	1.8	1.2	1.3
Japan	1.9	0.7	0.7	0.5	0.5	1.0	1.1	1.6
United States***	2.3	2.9	2.5	1.5	2.1	2.4	1.7	1.6

* refers to year ending March ** new CPI series *** eop for CPI inflation

	Policy interest rates, eop							
	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	6.25	5.75	5.50	5.25	5.25	5.25	5.25	5.25
Indonesia	6.00	6.00	5.75	5.75	5.75	5.50	5.50	5.25
Malaysia	3.25	3.00	3.00	2.75	2.75	2.75	2.75	2.75
Philippines	4.75	4.50	4.25	4.25	4.25	4.25	4.25	4.25
Singapore**	1.95	1.95	1.80	1.60	1.60	1.60	1.60	1.60
South Korea	1.75	1.75	1.50	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	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Vietnam***	6.25	6.25	6.25	6.25	6.00	5.75	5.75	5.75
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
United States	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00

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

	Exchange rates, eop							
	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q4 20
USD/CNY	6.71	6.87	7.00	6.95	6.90	6.85	6.80	6.75
USD/HKD	7.85	7.81	7.85	7.84	7.83	7.82	7.81	7.80
USD/INR	69.2	69.0	71.0	71.5	71.0	70.5	70.0	69.5
USD/IDR	14243	14126	14500	14400	14300	14200	14100	14000
USD/MYR	4.08	4.13	4.25	4.23	4.21	4.19	4.17	4.15
USD/PHP	52.6	51.3	55.0	54.5	54.0	53.5	53.0	52.5
USD/SGD	1.36	1.35	1.40	1.39	1.38	1.37	1.36	1.35
USD/KRW	1135	1155	1180	1170	1165	1160	1155	1150
USD/THB	31.7	31.0	33.0	32.8	32.6	32.4	32.2	32.0
USD/VND	23189	23301	23500	23450	23400	23350	23300	23250
AUD/USD	0.71	0.70	0.64	0.66	0.68	0.70	0.72	0.74
EUR/USD	1.12	1.14	1.08	1.09	1.10	1.11	1.12	1.13
USD/JPY	111	108	112	111	110	109	108	107
GBP/USD	1.30	1.27	1.22	1.24	1.26	1.28	1.30	1.32

Australia, Eurozone and United Kingdom are direct quotes

Rates forecasts

		2019				2020			
		Q1a	Q2	Q3	**Q4**	Q1	Q2	Q3	**Q4**
US	3m Libor	2.60	2.32	2.35	**2.10**	2.10	2.10	2.10	**2.10**
	2Y	2.26	1.75	2.00	**2.10**	2.20	2.20	2.20	**2.20**
	10Y	2.41	2.01	2.10	**2.20**	2.30	2.40	2.50	**2.50**
	10Y-2Y	15	25	10	**10**	10	20	30	**30**
Japan	3m Tibor	0.07	0.07	0.05	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.17	-0.22	-0.17	**-0.15**	-0.15	-0.15	-0.13	**-0.10**
	10Y	-0.08	-0.16	-0.10	**-0.10**	-0.05	-0.05	0.00	**0.00**
	10Y-2Y	9	6	7	**5**	10	10	13	**10**
Eurozone	3m Euribor	-0.31	-0.35	-0.30	**-0.30**	-0.30	-0.30	-0.30	**-0.30**
	2Y	-0.60	-0.75	-0.60	**-0.55**	-0.55	-0.55	-0.50	**-0.50**
	10Y	-0.07	-0.33	-0.25	**-0.20**	-0.15	-0.10	-0.05	**-0.05**
	10Y-2Y	53	42	35	**35**	40	45	45	**45**
Indonesia	3m Jibor	7.21	6.95	6.55	**6.55**	6.55	6.30	6.30	**6.05**
	2Y	6.78	6.74	6.10	**6.00**	5.90	5.80	5.80	**5.80**
	10Y	7.63	7.37	7.00	**6.80**	6.90	7.00	7.10	**7.20**
	10Y-2Y	86	63	90	**80**	100	120	130	**140**
Malaysia	3m Klibor	3.69	3.46	3.44	**3.19**	3.19	3.19	3.19	**3.19**
	3Y	3.38	3.29	3.40	**3.40**	3.40	3.40	3.40	**3.40**
	10Y	3.77	3.63	3.90	**3.95**	4.00	4.00	4.10	**4.10**
	10Y-3Y	39	34	50	**55**	60	60	70	**70**
Philippines	3m PHP ref rate	5.55	4.09	4.50	**4.25**	4.00	4.00	4.00	**4.00**
	2Y	5.83	4.95	5.20	**5.10**	5.00	5.00	5.00	**5.00**
	10Y	5.62	5.07	5.25	**5.25**	5.25	5.25	5.25	**5.25**
	10Y-2Y	-21	12	5	**15**	25	25	25	**25**
Singapore	3m Sibor	1.94	2.00	1.80	**1.60**	1.60	1.60	1.60	**1.60**
	2Y	1.92	1.66	1.75	**1.80**	1.90	1.90	1.90	**1.90**
	10Y	2.07	2.00	1.95	**2.00**	2.05	2.15	2.25	**2.25**
	10Y-2Y	15	34	20	**20**	15	25	35	**35**
Thailand	3m Bibor	1.88	1.88	1.85	**1.85**	1.85	1.85	1.85	**1.85**
	2Y	1.78	1.75	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	2.43	2.12	2.20	**2.30**	2.30	2.40	2.50	**2.50**
	10Y-2Y	65	37	40	**50**	50	60	70	**70**
China	1 yr Lending rate	4.35	4.35	4.35	**4.35**	4.35	4.35	4.35	**4.35**
	3Y	2.91	2.92	2.80	**2.80**	2.80	2.80	2.80	**2.80**
	10Y	3.36	3.24	3.10	**3.15**	3.20	3.25	3.25	**3.25**
	10Y-3Y	45	32	30	**35**	40	45	45	**45**
Hong Kong	3m Hibor	1.76	2.46	1.95	**1.80**	1.80	1.80	1.80	**1.80**
	2Y	1.45	1.78	1.70	**1.75**	1.80	1.80	1.80	**1.80**
	10Y	1.47	1.51	1.75	**1.90**	2.00	2.10	2.20	**2.20**
	10Y-2Y	2	-27	5	**15**	20	30	40	**40**
Korea	3m CD	1.90	1.78	1.65	**1.40**	1.40	1.40	1.40	**1.40**
	3Y	1.69	1.47	1.60	**1.60**	1.60	1.60	1.60	**1.60**
	10Y	1.83	1.60	1.85	**1.95**	2.05	2.15	2.25	**2.25**
	10Y-3Y	14	13	25	**35**	45	55	65	**65**
India	3m Mibor	7.42	6.78	6.40	**6.05**	6.05	6.05	6.05	**6.05**
	2Y	6.88	6.30	6.00	**6.10**	6.20	6.30	6.30	**6.30**
	10Y	7.22	6.88	6.60	**6.60**	6.70	6.80	6.90	**7.00**
	10Y-2Y	34	58	60	**50**	50	50	60	**70**

%, eop, govt bond yield for 2Y and 10Y, spread bps

Group Research

Economics & Strategy

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

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

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

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

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

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

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

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

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

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

Duncan Tan
FX and Rates Strategist – Asean
+65 6878-2140 duncantan@dbs.com

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

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DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.PT Bank DBS Indonesia, DBS Bank Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000. Company Registration No. 09.03.1.64.96422.