

Chart of the Week: Widening EM credit spreads driven by high yield bonds

Economics/Strategy/Rates/FX

Group Research

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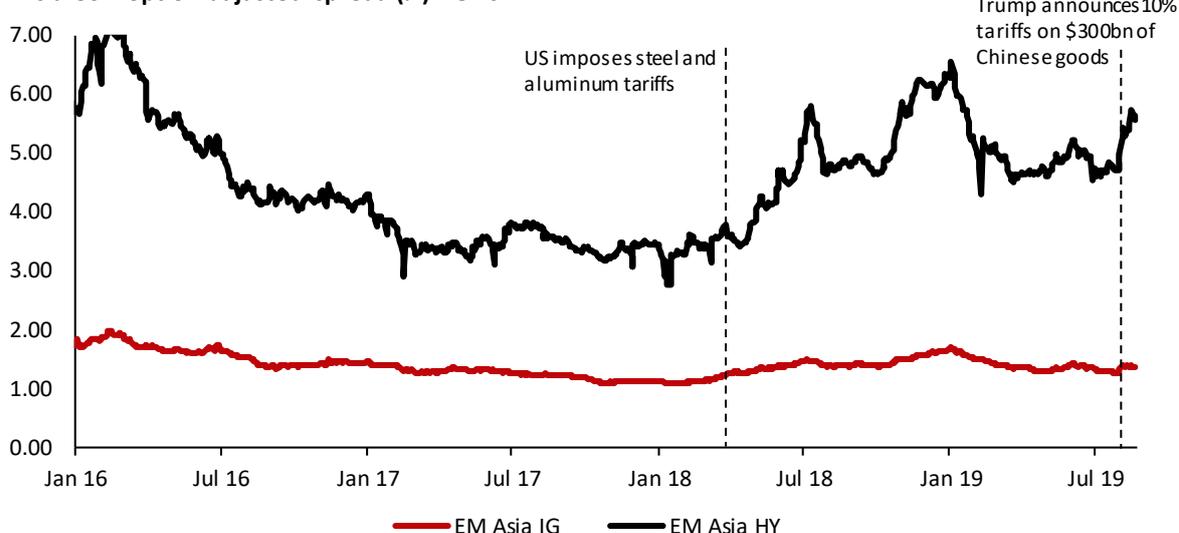
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Key Events:

- Bank of Korea will likely maintain policy rate at 1.50%.
- US GDP growth in 2Q19 could possibly inch up a tad while India could see marginal slowdown in the same quarter.
- Industrial production growth across Asia will likely continue to remain in the red

Chart of the Week: EM Asia Credit – Widening spreads driven by HY bonds

Escalation in US-China trade war and recession worries have proved adverse for Asian credit markets so far this month, but with uneven impact. IG bonds saw a marginal widening of spreads, but still notched gains for the month as Treasury yields slid. This corroborates the historical experience of IG bonds, which outperform on policy easing even if spreads widen. HY spreads tend to have higher sensitivity to slowdowns, and Asian HY spreads have now widened back to January's stressed levels.

EM Asia USD option-adjusted spread (%): IG vs HY


Source: Bloomberg, DBS

*Option-adjusted spread (OAS) is the yield spread added on top of US Treasury yields for discounting a corporate bond's payments to match its market price, with a dynamic pricing model used to account for any embedded options.

Event	Consensus	DBS	Previous
Aug 26 (Mon)			
Singapore: industrial production (Jul)	-5.8% y/y	-4.3% y/y	-6.9% y/y
Hong Kong: trade balance (Jul)	-HKD 45.2bn	-HKD 32.6bn	-HKD 55.2bn
-- exports	-8.4% y/y	-5.0% y/y	-9.0% y/y
-- imports	-8.5% y/y	-8.0% y/y	-7.5% y/y
Aug 29 (Wed)			
US: GDP (2Q, S)	2.0% q/q saar	2.2% q/q saar	2.1% q/q saar
Aug 30 (Fri)			
Korea: industrial production (Jul)	-3.0% y/y	-3.6% y/y	-2.9% y/y
Japan: industrial production (Jul, P)	-0.5% y/y	-2.2% y/y	-3.8% y/y
South Korea: BOK Repo Rate	1.50%	1.50%	1.50%
Eurozone: CPI (Aug)	1.0% y/y	1.1% y/y	1.1% y/y
India: GDP (2Q)	5.7% y/y	5.5% y/y	5.8% y/y

Eurozone: Inflation is likely to stay benign and well below the 2% target, backing the central bank's dovish guidance. While a revision to the economic parameters is unlikely at the upcoming review, nonetheless, expectations are high that before ECB Chief Draghi steps down, more easing measures are likely to be introduced – including a modest cut in the deposit facility rate (accompanied by a tiered deposit mechanism), cheaper financing scheme and signal upcoming purchases of senior bank bonds, equities etc.

Hong Kong: Trade figures should have stayed weak in July due to external uncertainties. Outward and inward shipments, which contracted 9.0% and 7.5% respectively in June, are forecasted to further weaken to -5% YoY and -8% in July from the intensified trade war. Imports are also expected to slump further due to weakening domestic demand amid domestic instability; retail sales value recorded the fifth YoY decline of -6.7% in June, with unemployment rate edged up by 0.1% point to 2.9% after staying at the 20-year low for 15 months.

India: June quarter (1QFY20) growth numbers due this week are likely to mark a slowdown from 1Q19's 5.8% YoY. Our estimate at 5.5% is more conservative than consensus, as moderation in consumption was likely accompanied by a delay in public sector disbursements in midst of (the then) general elections. Most other lead indicators that we track, including auto sales, production, core industries index, service sector categories reinforce a broad-based pullback in activity. We suspect that the weaker momentum likely extended into September quarter before stabilization sets in. In anticipation, the government initiated slew of sector specific measures last week and more are likely over the coming fortnight.

Korea: The Bank of Korea is expected to stand pat this week, a temporary pause after cutting rates by 25bps to 1.50% in July. The rise in Japan-South Korea trade tensions, uncertainties in China-US trade relations, dovishness of the Fed/ECB, and rate cuts by other Asian central banks all suggest that the BOK would be open to further easing. This is especially because domestic growth, inflation and job data have remained sluggish and showed little signs of a pickup (e.g., July exports, PMI, consumer confidence, CPI). We continue to call for another 25bps rate cut in 4Q, which will take the benchmark repo rate to a record low of 1.25%.

Singapore: Industrial production output for July is expected to continue to shrink amid overhanging trade war gloom. The headline production index is likely to decline by 4.3% YoY, compared to -6.9% previously. Though this can be considered an improvement, the very fact that it remains stuck in the red for the past fourth consecutive months underscores the downside risks on the external front. Trade disputes between the US and China continues to drive a wedge between an already weak global demand and regional supply chains. As a small and open economy, Singapore's manufacturing is obviously bearing the blunt of the impact. Outlook for the manufacturing sector remains grim. And expectation is that production growth will continue to remain in negative in the coming months.

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

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