DBS Monthly

Living with volatility

Economics/Strategy/Rates/FX/Equities/Credit

Group Research

August 30, 2019

Taimur Baig
Chief Economist
taimurbaig@dbs.com

Irvin Seah
Economist
irvinseah@dbs.com

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

- ***Economics***: *Volatility made a strong comeback in August, with markets and economies whiplashed by oscillating trade tensions. Flight to safety has materialised into surging gold price and soaring stock of negative yielding debts; China's slowdown is exerting drags to global demand and inflation; USD remains strong; commodities are weak; geopolitical uncertainty is high. While global central banks appear ready to act to ease policy to counter recessionary risks, doubts are rising of the efficacy of such actions.*

- ***FX:*** *Multiple event risks in September. Brace for more volatility.*

- ***Rates***: *Demand for safety amidst a highly uncertain outlook will keep G3 yields lower for longer*

- ***Credit***: *The size of the Asian USD credit market (both high yield and investment grade) has continued to rise this year despite the challenging growth backdrop. For this, markets have dovish central banks to thank.*

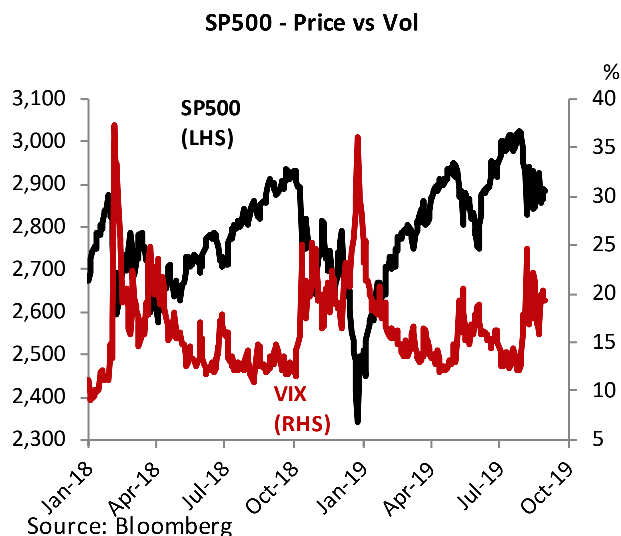
- ***Equities***: *Consider high yielding Singapore REITs as bond alternatives*

Refer to important disclosures at the end of this report.

Economics: High vols likely to persist

With the passing of a torrid summer, will September bring some respite? After a rather quiet first half, VIX and FX volatility jumped in July/August and the markets displayed strong flight to safety concerns, with bonds and gold soaring, and stocks (among asset classes) and emerging markets (among geographies) experiencing considerable selloffs.

SP500 - Price vs Vol

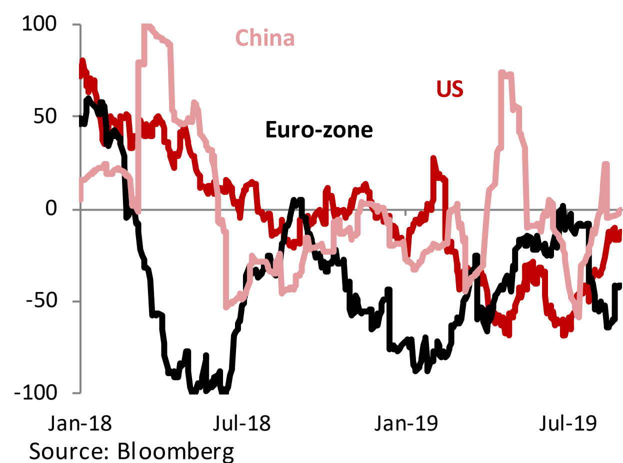


Source: Bloomberg

There are two major narratives at play. First, independent of trade wars (which have been instrumental in hurting investment sentiments worldwide), there are powerful drags to the global economy at play, with China slowing down, and electronics and auto sectors undergoing deep cyclical adjustments. A scenario that sees China and the US signing some sort of a trade deal would still leave these drags to the global economy in place.

Second, the spillover from slowdown in China and EU, and the unrest in financial markets, has had very little impact on US retail sales, housing, wages, and employment. Delays in tariffs on electronics imports, sizeable decline in long term interest rates, and S&P500 still up by 16% since end-2018, are still likely to keep the US on pace for comfortable 2%+ growth the rest of this year, in our view. Indeed, with the Fed poised to accommodate further and no fiscal uncetainty through 2020 owing to the recent debt celining agreement, US growth momentum in early next year looks likely to be robust as well, regardless of what the inverted yield curve seems to be indicating.

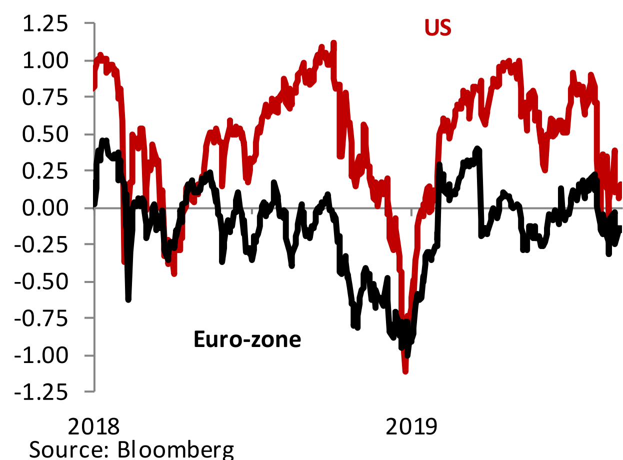
Economic Surprise Indices



Source: Bloomberg

This contrast between the US holding up while the rest of the world continues to weaken is going to be problematic for the markets. Asset markets will be pulled in both directions as conflicting growth data and charged political rhetoric persist, ensuring heightened volatility.

Financial Conditions Indices



Source: Bloomberg

Taimur Baig

FX: Another month of volatility in September

The USD Index (DXY) Index is still grinding higher towards 100. We expect the Fed to cut in 4Q19 and not at the next FOMC meeting on September 18. The USD has been resilient to the dovish Fed outlook. Global trade tensions have kept the US economy and the USD strong relative to the rest of the world. The Fed did not subscribe to US recession fears implied by the inverted US yield curve. The Fed considered its rate cut in July a "mid-cycle adjustment" to global growth risks, especially those pertaining to the trade war, judged to be weighing on the US economy. Until US data stop surprising on the upside and falter, drag the major US stock indices sharply lower, the greenback is unlikely to give up its relative strength.

The Chinese yuan's depreciation bias is intact unless China and US achieve a breakthrough at the Washington trade talks in early September. The 10% US tariffs on the remaining USD300 of Chinese are set to take effect on September 1; some goods will be exempt till December 15. A month later on October 1, US tariffs will go up by an additional 5% to 15% on the USD300bn, and to 30% on the USD250bn. For the new tariffs to lift USDCNY towards 7.40, the USD must also firm gloablly.

Euro tipping into a lower 1.05-1.10 range. The European Central Bank is set to lower its deposit rates and restart asset purchases at its meeting on September 12. The Eurozone economy is weak from recession risks in Germany, Italy and the UK and vulnerable to increased odds of a disorderly Brexit and US President Trump seeking to "whiplash" (threaten tariffs) EU into a trade deal.

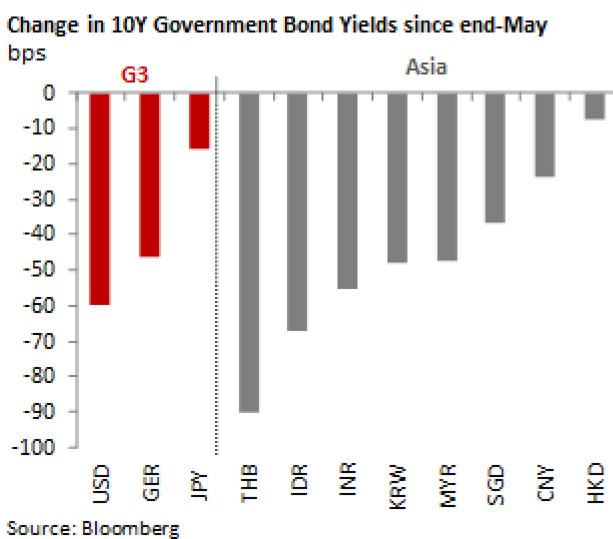
British pound to break below 1.20 on increased odds of a no-deal Brexit. Prime Minister Boris Johnson has prorogued parliament to deliver Brexit with or without a deal on October 31. The Queen has approved Johnson's request for the government to hold a Queen's speech on October 14. This will undermine legislative efforts to delay Brexit or a vote of no-confidence in the government from preventing a no-deal Brexit from happening by default. To avoid a no-deal Brexit, Johnson will need to use the five-week suspension period to renegotiate a deal with EU that must also be supported by British MPs.

Australian dollar is depreciating towards 0.65 and lower. Selling pressures on the external front are led by the China-US trade war and a weaker CNY. The domestic front is dominated by the Reserve Bank of Australia's newfound dovishness. If 2Q19 GDP growth (out on September 4) falls to GFC-lows, the cash rate target is seen falling another 50 bps to 0.50%, a level the RBA has said would consider unconventional stimulus.

Philip Wee

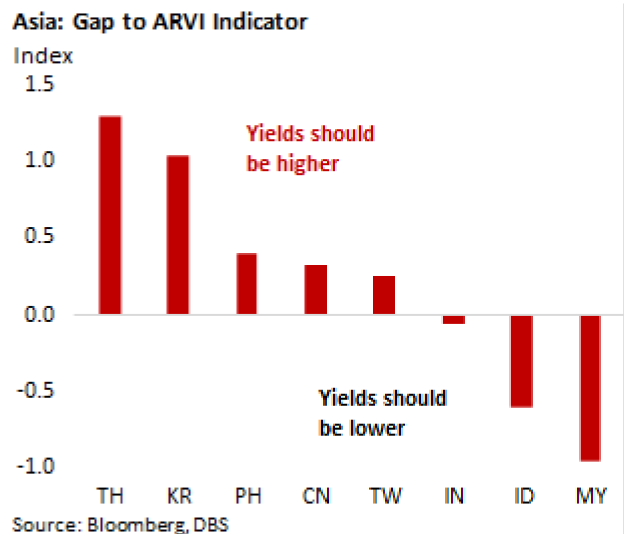
Rates: Seeking refuge

Demand for safety amidst a highly uncertain outlook will keep G3 yields lower for longer. The list of worries has increased in recent months as investors now have to deal with the re-escalation of China-US trade war (after a brief truce), the risks of a hard Brexit, EM stress (largely Argentina) and political uncertainties in Hong Kong. G10 central banks, which are already facing growth moderation, now have to contend with these ongoing headwinds. **Our G3 rates forecast have been lowered to reflect this reality.**



The ECB arguably faces greater urgency to ease policy. Aside from an extended period of weak data, inflation expectations (as measured by the EUR 5Y5Y inflation swap) also collapsed to an all-time low in June. Hints of upcoming asset purchases and rate cuts did not manage to lift this estimate much. **The downward distortion to EUR rates is acute amid a shortage of German papers and the prospect of the ECB looking to take even more supply off the table** supports the case for an extended period of depressed EUR interest rates. Fear of missing out at a time when the total amount of negative yielding debt exceeds USD 16tn is prompting a desperate search for yield in the developed market space even at these expensive levels.

Against a challenging growth backdrop, Asia govvies will be supported by looser monetary policy. In August, India, the Philippines, Thailand and Indonesia cut rates, taking cues from the Fed. Further easing is probably in the offing across Asia as better data appears elusive at this point. In any case, lower DM rates should embolden Asia central banks to cut rates more aggressively. The tricky part lies with gauging risk sentiment and managing currency risks. A further deterioration in risk sentiment can have negative implications on Asia fx, thereby constraining the ability of central banks to ease. On the bright side, Asia assets appear to have turned more resilient to negative trade war narrative. Growth concerns will likely dominate. Accordingly, **we have also re-centred our interest rates forecasts across Asia lower.**



Eugene Leow

Equities: High yielding Singapore REITs as bond alternatives

As global bond yields continue to be depressed by global central banks' monetary easing and the amount of negative-yielding assets continue to mount, this has made a lot of **other asset classes look a lot more competitive.**

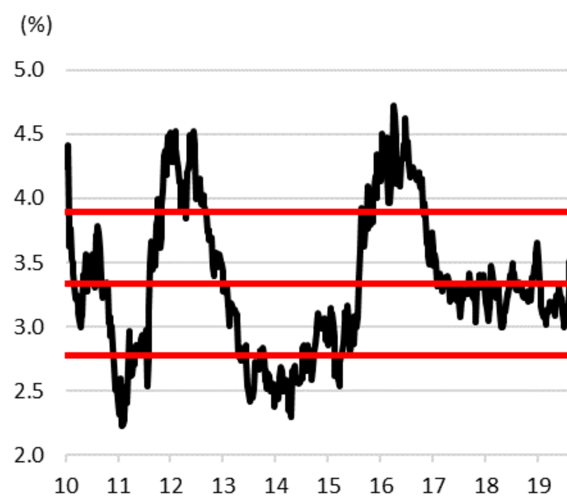
Dividend-yielding stocks can thus become attractive as an alternative to bonds as an income generating investment. In addition, its quality of having lower volatility when compared to the overall market is enhancing its appeal as a volatility hedge and risk diversifier. High-yielding stocks thus behave like bond proxies, reflecting characteristics of both the equity and fixed income markets.

In particular, we look for stocks which can pay sustainable dividends, even through trough cycles and bad times. We also look for stocks which can grow their dividends, such as having a fixed payout ratio policy and thus dividends will grow with their earnings. These will require investors to analyse their historical dividend payment record. Investors will also have to evaluate the businesses and see if they can generate positive free cash flows to support the dividends they're paying out.

One sector that stands out is the Singapore REITS sector which offers both yield and growth. We continue to like the sector and believe that the REITS can continue to sustain their dividend payouts. The structure of REITs is such that these companies have to distribute at least 90% of their distributable income to investors. The REITs in the Retail and Industrial sectors should continue to see good rental revision rates and room to grow their DPUs (distribution per unit) as new retail strategy from online to offline ("OTO") is becoming more popular. E-commerce and China diversification continue to demand industrial, logistics and warehousing spaces where Industrial landlords will benefit. In the past one year, many REITs had also engaged in fund-raising exercises to make yield-accretive acquisitions. MAS is also mulling to increase the debt/equity ratio, and if raised, could open up more opportunities for yield-accretive acquisitions amidst a low interest rate environment.

The yield spreads between dividends and bond yields have returned to above average levels again despite the strong performance of the REITs sector due to the lower bond yields. We believe the sector is still attractive and **investing in REITS is still a good proposition as bond proxies, and form an integral part in the income generating side of a portfolio.**

Singapore REITS' sector yield spread (Dividend yield minus Singapore 10-year bond yield)



Source: Thomson Reuters, DBS

Joanne Goh

Credit: Asian USD credit market reaches $1trn mark, despite ongoing slowdown

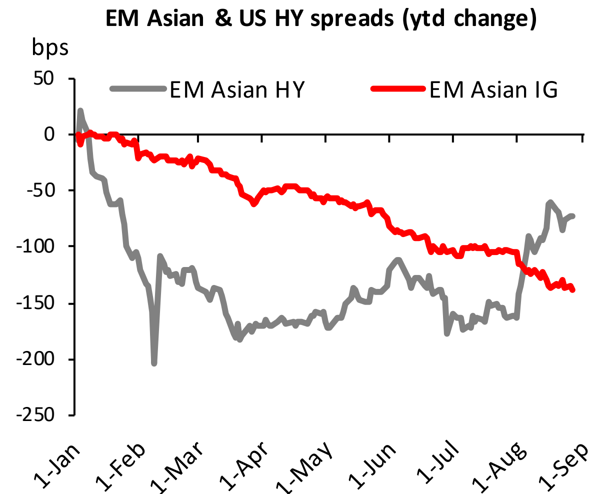
Emerging markets' Asian USD-denominated credit has reached a major milestone, with the Bloomberg Barclays EM Asian credit index's market capitalization finally crossing the USD 1trn dollar mark this week. The market has grown by a blistering 24% from year ago level, pointing to the rapid ascendency of bond issuance in Asia, and the substantive deepening of Asian credit markets.

The value of Asian USD credit has climbed despite the challenging growth backdrop, as China's slowdown deepened. For this, markets have dovish central banks to thank.

With the Fed having adjusted rates lower in July and the ECB poised to announce new stimulus, the quantum of global bonds offering a loss-to-maturity (i.e. a negative yield) has risen to a whopping USD16.2trn (see DBS Flash: Tracking the universe of positive yielding bonds, 27 Aug 2019). We think the increased prevalence of negative yields are driving investors further down the credit curve in a search for yield, albeit within safe risk parameters.

Investment grade bonds have been the prime beneficiaries, with Asian IG bonds seeing their average yield easing by 36bps in August alone, and is now down 140bps since the end of 2018.

EM Asian & US HY spreads (ytd change)



Source: Bloomberg, DBS

High-yield bonds were mixed, in line with historical experience of being more susceptible to growth headwinds than IG bonds. Within the HY space, we see signs of a growing divergence between US Corp HY and Asian HY bonds.

Typically, spreads between the two HY bond indices are highly correlated. However, the escalation in China-US trade tensions and consequent RMB weakness have led to reduced appetite for Chinese credit. Wider Chinese spreads have given rise to a persistent gap between Asian and US HY bonds— a gap which might persist absent more forceful policy catalysts from China.

Chang Wei Liang

REPORTS

- India: Helpful steps to reverse cyclical slowdown; more to come
- Indonesia: Another pre-emptive rate cut
- G3 Rates: Seeking refuge
- Indonesia: Surfacing economic weakness
- China: Slowing growth; more stimulus to come
- Navigating the sovereign bond landscape
- India: Is a coordinated policy response likely?
- Japan: 5 challenges in the second half
- Singapore's dour growth outlook
- Japan-South Korea trade fight a lose-lose scenario
- India: Rates pricing in cuts, FX vulnerable to global cues
- Taiwan: Trade war, tourism ban and the rise of MIT
- Philippines: Expecting another 50bps of rate cut this year
- India: RBI breaks from convention, cuts by 35bps
- Hong Kong focus - Growth downgraded
- Understanding China: Uneven impact of trade war on provinces
- FOMC yields to markets; will yield again

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	0.0	0.5	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	5.0	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	0.5	1.1
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	0.8	0.7	0.5	0.5	1.0	0.8	1.3
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	5.40	5.25	5.25	5.25	5.25	5.25
Indonesia	6.00	6.00	5.50	5.25	5.25	5.25	5.25	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	4.00	4.00	4.00	4.00	4.00
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	1.50	1.50	1.50	1.50	1.50	1.50
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	7.10	7.20	7.15	7.10	7.05	7.00
USD/HKD	7.85	7.81	7.85	7.85	7.85	7.84	7.84	7.83
USD/INR	69.2	69.0	71.0	71.5	72.0	72.5	73.5	74.0
USD/IDR	14243	14126	14450	14500	14550	14600	14650	14700
USD/MYR	4.08	4.13	4.22	4.25	4.24	4.23	4.22	4.21
USD/PHP	52.6	51.3	53.3	53.6	53.9	54.2	54.5	54.7
USD/SGD	1.36	1.35	1.40	1.42	1.41	1.41	1.40	1.40
USD/KRW	1135	1155	1230	1250	1240	1230	1220	1210
USD/THB	31.7	31.0	31.0	32.0	31.8	31.6	31.4	31.2
USD/VND	23189	23301	23200	23220	23250	23270	23300	23330
AUD/USD	0.71	0.70	0.66	0.64	0.65	0.65	0.66	0.66
EUR/USD	1.12	1.14	1.10	1.08	1.09	1.09	1.10	1.10
USD/JPY	111	108	107	109	109	108	108	107
GBP/USD	1.30	1.27	1.18	1.16	1.17	1.18	1.19	1.20

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	1.65	**1.65**	1.65	1.70	1.75	**1.85**
	10Y	2.41	2.01	1.75	**1.75**	1.75	1.90	2.00	**2.20**
	10Y-2Y	15	25	10	**10**	10	20	25	**35**
Japan	3m Tibor	0.07	0.07	0.05	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.17	-0.22	-0.20	**-0.20**	-0.15	-0.15	-0.13	**-0.13**
	10Y	-0.08	-0.16	-0.20	**-0.20**	-0.15	-0.15	-0.10	**-0.10**
	10Y-2Y	9	6	0	**0**	0	0	3	**3**
Eurozone	3m Euribor	-0.31	-0.35	-0.50	**-0.50**	-0.50	-0.50	-0.50	**-0.50**
	2Y	-0.60	-0.75	-0.80	**-0.80**	-0.70	-0.60	-0.50	**-0.50**
	10Y	-0.07	-0.33	-0.50	**-0.50**	-0.50	-0.40	-0.30	**-0.20**
	10Y-2Y	53	42	30	**30**	20	20	20	**30**
Indonesia	3m Jibor	7.21	6.95	6.30	**6.05**	6.05	6.05	6.05	**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	3.25	**3.25**	3.25	3.30	3.35	**3.40**
	10Y	3.77	3.63	3.25	**3.25**	3.25	3.40	3.50	**3.70**
	10Y-3Y	39	34	0	**0**	0	10	15	**30**
Philippines	3m PHP ref rate	5.55	4.09	3.85	**3.60**	3.60	3.60	3.60	**3.60**
	2Y	5.83	4.95	3.65	**3.65**	3.60	3.70	3.75	**3.85**
	10Y	5.62	5.07	4.15	**4.15**	4.15	4.30	4.40	**4.60**
	10Y-2Y	-21	12	50	**50**	55	60	65	**75**
Singapore	3m Sibor	1.94	2.00	1.80	**1.60**	1.60	1.60	1.60	**1.60**
	2Y	1.92	1.66	1.65	**1.65**	1.60	1.60	1.60	**1.65**
	10Y	2.07	2.00	1.70	**1.70**	1.70	1.80	1.90	**2.00**
	10Y-2Y	15	34	5	**5**	10	20	30	**35**
Thailand	3m Bibor	1.88	1.88	1.60	**1.60**	1.60	1.60	1.60	**1.60**
	2Y	1.78	1.75	1.55	**1.55**	1.55	1.55	1.55	**1.55**
	10Y	2.43	2.12	1.75	**1.75**	1.75	1.90	2.00	**2.20**
	10Y-2Y	65	37	20	**20**	20	35	45	**65**
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	**2.70**	2.70	2.70	2.70	**2.70**
	10Y	3.36	3.24	3.00	**2.80**	2.80	2.90	3.00	**3.00**
	10Y-3Y	45	32	20	**10**	10	20	30	**30**
Hong Kong	3m Hibor	1.76	2.46	2.05	**1.80**	1.80	1.80	1.80	**1.80**
	2Y	1.45	1.78	1.80	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	1.47	1.51	1.55	**1.55**	1.55	1.70	1.80	**2.00**
	10Y-2Y	2	-27	-25	**-25**	-25	-10	0	**20**
Korea	3m CD	1.90	1.78	1.62	**1.37**	1.37	1.37	1.37	**1.37**
	3Y	1.69	1.47	1.25	**1.25**	1.25	1.25	1.25	**1.25**
	10Y	1.83	1.60	1.35	**1.30**	1.25	1.35	1.45	**1.55**
	10Y-3Y	14	13	10	**5**	0	10	20	**30**
India	3m Mibor	7.42	6.78	6.30	**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

Chang Wei Liang
Strategist
+65 6878-2072 weiliangchang@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

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

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.
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.