Weekly: Interim relief

Economics/Strategy/Rates/FX/Equities

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Taimur Baig
Chief Economist
taimurbaig@dbs.com

Duncan Tan
Strategist
duncantan@dbs.com

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

- *Favourable newsflow related to trade war, Brexit, China stimulus, ECB, and Iran have helped risk sentiments this week, making for a constructive September so far.*
- *Some further (but modest) weakness in the USD can be expected in the near term, leading into FOMC*
- *We think conditions have aligned for somewhat higher US interest rates*
- *Improvement in broader risk sentiment has not followed through in the offshore Chinese USD credit market, warranting caution*

Interim relief

From the ECB cutting deposit rates and promising more QE, hints of an "interim" China-US trade deal, mild improvement in sentiment over Iran, and some reduction in the chance of a hard Brexit, the markets have had room to breathe this week, making for a fairly constructive September so far.

Beyond these headline commanding developments, however, are four secular sources of difficulties for the global economy. The malaise presently observed in energy, industrial metals, auto, and electronics sectors reflect slowing demand in China, structural decline in conventional energy usage, and change in consumption trend (e.g. lengthening of phone upgrade cycles, preference for ride hailing instead of owning). Regardless of trade deals and ebbing of political risks, the pressure on sales and earnings will remain for many companies, in our view.

Amidst signs of stimulus efficacy and demand stabilisation in China, it is important keep in mind that Chinese companies have a wall maturity in 4Q and next year, necessitating orderly dollar funding conditions. It is striking that despite worldwide fixed income rallies, cost of dollar funding has not eased lately. Global investor sentiments may not be focused on China credit risks at this juncture, but it won't take much for this so start commanding news headlines in the coming months.

Taimur Baig

FX: Scope for excessive pessimism to pause in September-October

In the immediate term, the US dollar will be pressured by expectations for the Fed to follow, at next week' FOMC meeting, the dovish policy announcements out of Europe and China. Our view remains for the Fed to avoid a back-to-back rate cut on September 18 and ease on October 30 instead. There is also a need to give China and the US the benefit of the doubt to find middle ground for an "interim trade deal". Escalating trade tensions from here may prove counterproductive as it will push weakened economies in the rest of the world to ease monetary policies more aggressively than the Fed. It was also evident that President Donald Trump has started to set his sights on his re-election in 2020. The tax cut for middle-income Americans under consideration for 2020 was reminiscent of the corporate tax cut dangled ahead of the 2016 elections.

The above Fed cut expectations have stymied the European Central Bank's stimulus bazooka to push the euro below 1.10 in the short-term. ECB President Mario Draghi delivered an asset purchase programme at his final governing council meeting on September 12. The APP will restart on November 1, when Christine Lagarde takes the reins at the ECB from Mario Draghi, at a pace of EUR20bn per month and end shortly before the ECB starts raising rates. The ECB's forward guidance for rates to stay lower for longer is likely to be extended beyond its mid-2020 guidance based on the downward revisions in its growth/inflation forecasts.

The pressure for the British pound to break below 1.20 vs USD has subsided for now. The Queen has given the final approval to the Benn-Bill that seeks to extend the Brexit deadline from October 31 to January 2020 if the UK and the EU cannot agree on a deal by October 19. The UK parliament, meanwhile, has been suspended for five weeks into the Queen's speech scheduled for October 14. **Unfortunately, the upside for GBPUSD is also limited around 1.25.** Prime Minister Boris Johnson could still find a loophole to lead the UK out of the EU without a deal on October 31. And delaying Brexit Day would only prolong the political paralysis and increase recession risks.

The Chinese yuan has retreated from its 11½-year. USDCNY has fallen from 7.18 to 7.08 during September 3-12. The People's Bank of China has helped to allay China slowdown concerns by scheduling cuts in the banks' reserve requirement ratios on September 16, October 15 and November 15. China and the US have provided tariff concessions to each other. For now, these gestures of goodwill have been enough to fuel optimism for the trade war to stop escalating into the Washington trade talks in early October. The decisions by President Trump to delay tariffs by two weeks and China by a year suggest that negotiations are likely to remain too uneven/unequal to end the prospect of a prolonged trade war. This, however, did not mean that **a concessionary "interim trade agreement" is not impossible**. President Trump is considering rolling back tariffs in exchange for China's commitment on intellectual property and purchases of US farm products. Lastly, **the US Treasury Department wants to discuss, at the trade talks, the CNY's depreciation** after it labeled China a currency manipulator. The next USTD Currency Report is scheduled for release in mid-October.

Philip Wee

Rates: Cautious on DM govvies

The global narrative is taking a turn for the better. Notably, there has been a thaw in China-US trade tensions as both sides moved to delay / rollback tariffs. There was also news that an interim trade deal is being mulled. With the market perceiving that HK's political situation and that hard Brexit risks have receded somewhat, we think **conditions have aligned for higher USD rates.** Moreover, we are wary on duration in the DM space given that rates have generally already factored in aggressive monetary policy easing.

DM rates may have traced a bottom 2-3 weeks ago when trade tensions and hard Brexit fears were acute. Flows are likely to be more balanced as the fiscal drumbeat in the Eurozone gets louder. In any case, DM yields at these depressed levels are vulnerable to pushbacks from central banks against overly loose monetary policy. The interplay between monetary policy and trade war dynamics bears watching. **A trade war thaw could conceivable reduce the need for "insurance cuts."** We think the 2Y to 5Y segment of the curve (which is still aggressive factoring in cuts) may be most vulnerable to any shifts in Fed expectations.

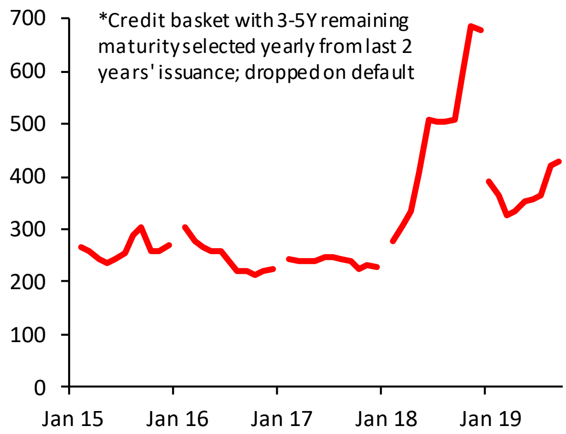
We think that there is scope for Asia rates/govvies to outperform US Treasuries over the coming few weeks as sentiment improves. In particular, **we like Indo govvies** (for the high absolute yields) **and SGSs** (for the high relative yields compared to AAA-rated peers and USTs). **MGSs also screen well** in our Asia Rates Valuation Indicator (ARVI).

Eugene Leow

Credit: Chinese corporate spreads are still widening despite recent market optimism

Improvement in broader risk sentiment has not followed through in the offshore Chinese USD credit market. In fact, our selected basket of Chinese credits (with 3Y-5Y remaining maturity) has seen another widening of spreads, on average.

China: Offshore USD non-bank corp g-spread (bps)



Source: Bloomberg, DBS

One pertinent headwind is the coming maturities of credits issued in the 2016/17 period, of which a significant proportion has turned distressed. As shown above, the average spread for this pool soared by over 400bps over the course of 2018. It could be challenging for these names to refinance, in turn precipitating credit events that spill over to the broader market.

Chang Wei Liang

Equities: Neutral in Thailand amid weak growth and stimulus

Following such weaker-than-expected 2Q GDP release, we have downgraded Thailand's 2019 GDP growth to 3%, and next year's to 3.2%. 2Q19 corporate earnings were also weak, tumbling 20% y-o-y, and thus dragging down 1H19 earnings to -17%. We have cut our EPS growth to 0% for 2019 and +8% for 2020.

The weak external growth environment is likely to pose further downside risks to Thailand given the economy's high dependence on exports, as well as the country's high household debt dampening private consumption. Note that exports of goods & services contributed 73% to total GDP in 2Q19. The country's household debt has been rising sharply in the past 10 years from 53.5% of GDP at early 2009 to 78.7% at end- 1Q19. This was driven mainly by consumer loans, especially auto and mortgage loans.

In support of the weakening economy, Bank of Thailand has cut policy rate by 25bps to near Global Financial Crisis ("GFC") level, and has also delayed the implementation of a standardised debt service ratio (DSR) calculation for all consumer loans from 4Q19 amid a sluggish economy. Given that the new government is fully formed and some form of stimulus measures for consumption were recently approved by the Cabinet, market sentiments should improve.

Given the weak outlook but better market sentiments, we maintain our Neutral stance on Thailand.

Looking forward, we have four investment themes for 4Q19. They are (i) beneficiaries of the US-China trade tension, where the industrial property players are likely to benefit; (ii) tourism recovery in 4Q19 due to low-base effect and government's stimulus measures to boost foreign tourist arrivals via extension of visa-fee waiver and domestic tourism; (iii) beneficiaries of government stimulus measures; and (iv) high-yield plays amid a low-interest rate environment.

Joanne Goh

Highlights of the week:

SGD rates: Policy easing and rate outlook
Taiwan: Made-in-Taiwan (MIT) back to the fore
South Korea Chartbook: More stimulus needed, more coming
Thailand: External chill weighs on growth
China: More easing in the pipeline

Key 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	6.2	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	3.0	3.2	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	5.00	5.00	5.00	5.00	5.00
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	1.25	1.25	1.25	1.25	1.25
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

Group Research

Economics & Macro 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).