Weekly: Asia's defensive game

Economics/Strategy/Rates/FX/Credit

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- *Glimmer of hope around trade war and Brexit has buoyed financial markets in recent days*
- *We are however doubtful if such developments will offer much more than ephemeral relief*
- *There is sufficient risk in the horizon to compel global policy makers to remain on the defensive side.*
- *We expect some more monetary easing in Asia to follow the Fed; but the real action is likely to be in the fiscal arena next year.*

Monetary easing has been on for a while; 2020 to see fiscal at play

Asset markets have gyrated the past couple of months around the backdrop of a global economic slowdown and a multitude of geopolitical risks, with the last few days reflecting a risk-on mood with some glimmer of hope over a China-US trade deal and an orderly Brexit. The DXY has weakened a tad, equity markets have rallied, and VIX has eased markedly through the course of this week.

But this is unlikely to mark the beginning of a major turnaround, in our view. A trade deal can only offer interim relief on China-US matters as the antagonism between the two superpowers is in fact widening. The decision by the US this week to blacklist some Chinese companies and restrict the visas of some Chinese diplomats on human rights grounds show clearly that many areas of confrontation have opened up beyond agriculture purchases and market access. China and the US will continue to find it difficult to reach common ground on Hong Kong, Taiwan, North Korea, Uighurs, Belt-and-Road, cyber security, and tech dominance, in our view, regardless of what happens on the trade front in the near term.

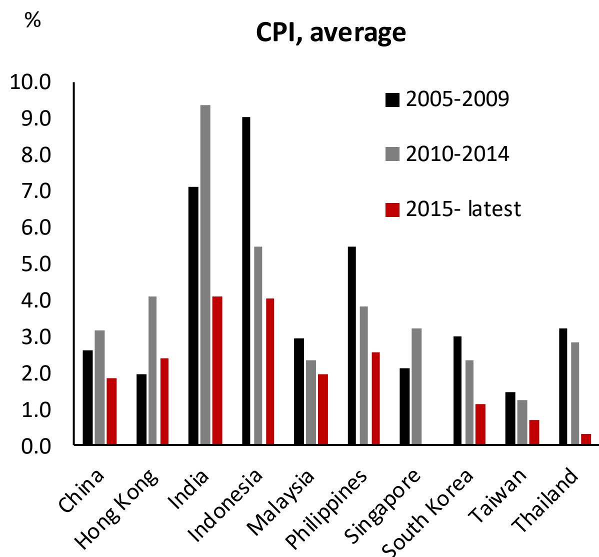
Similarly, on Brexit, a sharp rally of GBP underscores relief among market participants weighed down by chronic uncertainty. But there should be no illusion that the UK remains a divided nation, the Irish solution (with Northern Ireland becoming a special economic zone) may well turn out to be

Refer to important disclosures at the end of the report

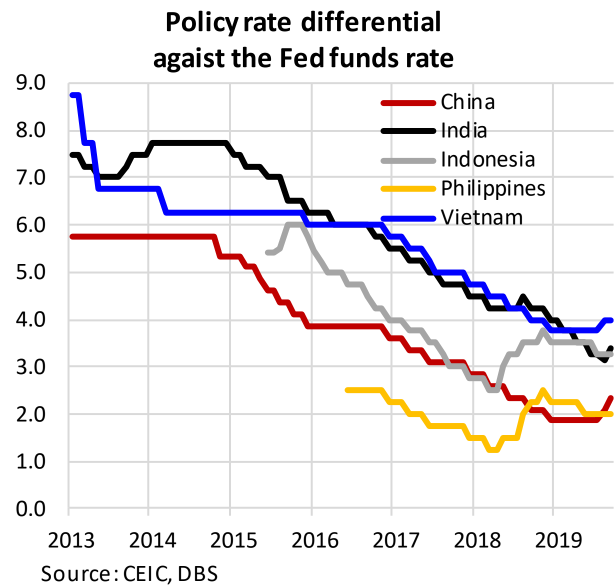
unimplementable, and the overall economic outlook remains bleak.

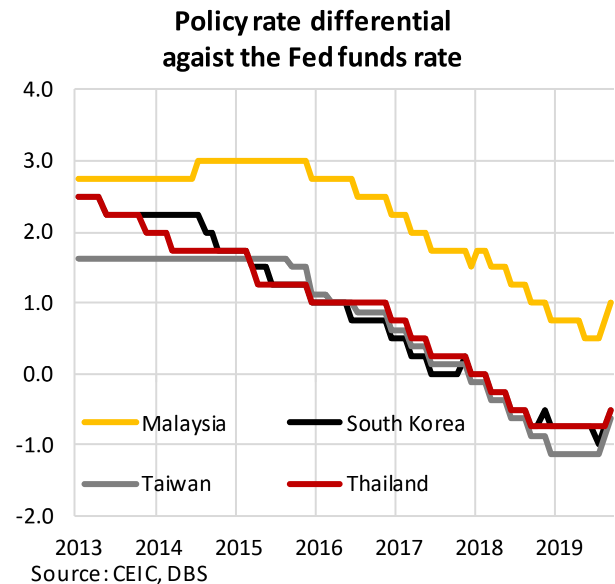
From the perspective of Asia's policy makers and businesses, the euphoria of the market is by no means reason for complacency. We have pointed out through the course of this year that a large part of the global economic slowdown has little to do with trade wars. A secular decline in auto and electronics demand, crises in some emerging markets (Argentina and Turkey), and most critically, a structural slowdown in China, will continue to cast shadow on the outlook.

Playing defence at this juncture, therefore makes sense. Depressed agriculture commodity and energy prices have pushed down inflation in the region in recent years, allowing central banks to ease monetary policy. Indeed, our analysis of policy rate differential between Asian economies and the US shows clearly that monetary policy easing, on a relative basis, began way back in 2015. Only with the Fed's recent rate cuts, signs of the cycle's bottom have emerged.



If global demand remains in the doldrums, we will expect Asian central banks to match the Fed in the coming quarters. No Asian central banks will allow their rate differential to spike against the USD, in our view.





Fiscal worries are not paramount in Asia, especially with such low rates. Pro-growth budget initiatives are in the pipeline in India, Indonesia, South Korea, and Thailand. It's the right time to play defence, in our view.

Taimur Baig

FX: False hopes vs realistic expectations

It is premature to abandon our call for Chinese yuan to end the year weaker at 7.20 vs USD. A partial deal, if achieved at the China-US trade talks in Washington on October 10-11, would only provide a short-lived relief rally for the CNY. If talks fail, US tariffs will increase as scheduled to 30% from 25% on USD250bn of Chinese goods on October 15, followed by a new 15% levy on the remaining USD160bn on December 15.

The US's latest measures to limit capital flows to China and US investments in China suggest that the **US may be looking beyond tariffs to step up pressure on China towards the "big deal" that President Trump wants**. In turn, this should keep up expectations for China's growth to fall below 6% in 2020. GDP data out on October 18 is likely to show another fall in growth towards the floor of this year's official 6-6.5% forecast.

Next week will be an important week for the British pound. On October 10, Prime Minister Boris Johnson and his Irish counterpart Leo Varadkar announced they may have found a "pathway to a possible Brexit deal". Any Brexit deal would need the support of all EU27 nations and fragmented UK House of Commons. Expect more rhetoric and volatility into the European Council meeting on October 17-18.

Prime Minister Johnson will be tested at the Queen's Speech on October 14. He is expected to resist pressures to resign if he loses the vote here. The fragmented opposition parties lack the unity to form an alternative government and would refrain from proposing a no confidence vote.

If no deal is achieved, legal experts reckoned that **PM Johnson will not be able to circumvent the Benn Act** and request, by October 19, the EU for a Brexit extension to January 31, 2020. Brussels is willing to consider a further delay (out to June 2020) on the condition that the UK holds an election or referendum. **Hungary is not expected to break ranks** with the other EU nations and support the extension.

A no-deal Brexit can be averted on October 31 if PM Johnson abandon his "do or die Brexit" for a "People vs Parliament" election in December or later. Only then can we **expect a limited relief rally for the GBP**. There should be **no complacency that the Brexit mess is over**. The polls are still suggesting another hung parliament and not a united government with a strong majority at the next elections. The prospect of more political paralysis will keep alive UK recession risks and prospects for the Bank of England to cut rates. Hence, **GBP can still resume its fall when reality sinks in again.**

Look for the Monetary Authority of Singapore (MAS) to **slow the appreciation path of the SGD** nominal effective exchange rate (NEER) **policy band to 0.5%/year** from its current 1% pace at its policy review on October 14. Clearly, we are not looking for the SGD policy to turn neutral. Our economist expects Singapore to avert a technical recession. He expects advance GDP growth of +2.5% QoQ saar in 3Q19 vs the -3.3% posted in the previous quarter. We also expect Singapore to avoid deflation. Our forecast for **USDSGD to rise above 1.40 in the medium-term** is predicated on our expectation for a firmer USD especially against the Chinese yuan and European currencies.

Philip Wee

Rates: Fiscal easing in Asia to steepen bond curves

Three Asian countries (India, South Korea and Thailand) have recently stepped up on fiscal support, to complement easier monetary policy, in boosting economic activity. All else equal, fiscal loosening and the resultant increase in bond issuances should steepen bond curves and widen bond-swap spreads. For India, the government has cut the corporate tax rate from 30% to 22%. While the estimated USD20bn tax cut cost is expected to be partly offset by RBI dividend, our economist sees rising risk of a miss to the FY20 fiscal deficit target of 3.3% (budgeted). This has been greatly reflected through steepening of GSec curve and persistent widening of GSec-OIS spreads.

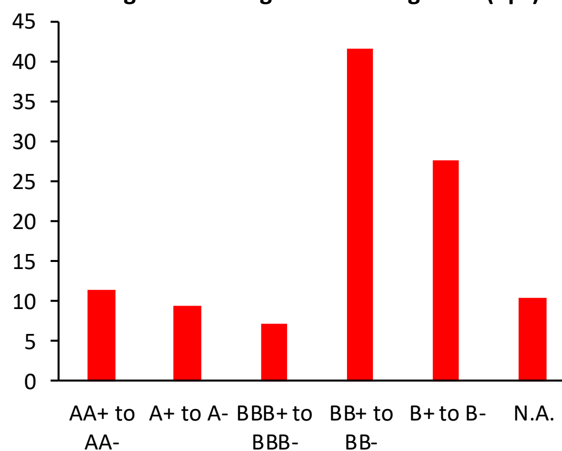
For South Korea, prospects of more expansionary budgets have had little impact on the KTB curve. Based on the 2020 Budget proposal (link), fiscal deficit is expected to increase from 1.9% to GDP in 2019 to 3.6% in 2020. From 2021 to 2023, government spending is projected to rise at an average rate of 5.6% per year. As a result, government debt is projected to climb significantly, from 37.1% to GDP in 2019 to 46.4% in 2023. We think markets are under-pricing the size of future increases in net issuances and its impact on KTB curve. Steepening pressures could intensify in the following months as market pricing catches up. In terms of yield levels, greater supply-related risk premium would offset some of the downward pull by the weak economic outlook. Hence, we have turned more neutral on the direction of KRW rates vs bullish previously.

Duncan Tan

Credit: Hong Kong's ample fiscal buffers to restrain negativity

Worsening unrest in Hong Kong has resulted in an invocation of the Emergency Regulations Ordinance. That said, emergency powers are restricted to a ban on the wearing of masks in public gatherings, and there are no plans to bring in more laws. Despite negative political developments, the impact on Hong Kong's credit markets has been restrained. Hong Kong's 5Y USD CDS (credit default swap) has bumped up slightly to 40bps from its August's nadir, but it is still well below 2016 highs.

The key factor underpinning resilience is Hong Kong's substantive fiscal buffers. The government has notched up consecutive fiscal surpluses since 2004, and reserves are also more than ample to anchor the HKD peg. As such, disruptions to growth from the unrest pose little threat to Hong Kong's fiscal position, which remains rock-solid.



Source: Bloomberg, DBS

The Hong Kong corporate bond market has also seen spreads widened somewhat since the start of August, alongside an escalation in the protests. As with the sovereign CDS market, the overall impact has been small.

The investment grade buckets have seen their OAS (option-adjusted spread) widened by less than 15bps on average since 1 Aug. While spreads for the high-yield buckets have widened by a slightly larger 30bps-40bps, they still beat performance of HY Chinese credits in the same period.

Clearly, markets are sanguine about Hong Kong even if disruptions are expected to weigh on growth. Fiscal prudence, reserves buffers, sound financial regulation and well-functioning capital markets are all demonstrable strengths insuring Hong Kong against financial spill overs from street unrest.

Chang Wei Liang

Highlights of the week:

Eurozone chartbook: Slippery growth seeks fiscal support

RCEP & India: Weighing the benefits of regionalism

Macro insights video: Five reasons why trade wars matter to India

Singapore: A gentler SGD slope in a tougher environment

Chart of the week: Global nickel price and Indonesia

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	5.7	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	2.8	3.4
Eurozone	2.5	1.9	1.0	1.1	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	5.25	5.00	5.00	5.00	5.00	5.00
Malaysia	3.25	3.00	3.00	2.75	2.75	2.75	2.75	2.75
Philippines	4.75	4.50	4.25	3.75	3.50	3.50	3.50	3.50
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	6.00	6.00	5.75	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	-0.20	-0.20	-0.20	-0.20	-0.20
United States	2.50	2.50	2.00	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	7.15	7.20	7.15	7.10	7.05	7.00
USD/HKD	7.85	7.81	7.84	7.85	7.85	7.84	7.84	7.83
USD/INR	69.2	69.0	70.9	71.5	72.0	72.5	73.5	74.0
USD/IDR	14243	14126	14195	14500	14550	14600	14650	14700
USD/MYR	4.08	4.13	4.19	4.25	4.24	4.23	4.22	4.21
USD/PHP	52.6	51.3	51.8	53.6	53.9	54.2	54.5	54.7
USD/SGD	1.36	1.35	1.38	1.42	1.41	1.41	1.40	1.40
USD/KRW	1135	1155	1196	1250	1240	1230	1220	1210
USD/THB	31.7	31.0	30.6	32.0	31.8	31.6	31.4	31.2
USD/VND	23189	23301	23203	23220	23250	23270	23300	23330
AUD/USD	0.71	0.70	0.68	0.64	0.65	0.65	0.66	0.66
EUR/USD	1.12	1.14	1.09	1.08	1.09	1.09	1.10	1.10
USD/JPY	111	108	108	109	109	108	108	107
GBP/USD	1.30	1.27	1.23	1.16	1.17	1.18	1.19	1.20

Australia, Eurozone and United Kingdom are direct quotes

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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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