Economics & Strategy Research

DBS Monthly

Conditions for an improved EM outlook

Economics/Strategy/Rates/FX/Equities/Credit

Group Research

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- ***Economics****: Easing DXY and USD funding conditions, stable energy prices, signs of a trade war détente, fading of a hard Brexit scenario, and hints of a bottom in the global electronics cycle have the making of an improved outlook for emerging markets going into 2020. While geopolitical risks remain high and asset market valuations are frothy, sentiments are turning more favourable toward economies reliant on external funding to finance current account deficits. We examine the conditions necessary to keep the trend going.*

- ***FX:*** *Despite hopes for trade tensions and Brexit worries to recede, markets may be lulled into a false sense of security too.*

- ***Rates****: There has been a pushback from policy makers and the market against overly low interest rates. Asia govvies have done well amid a hint of optimism.*

- ***Credit****: Asian credit sentiment has improved on the back of a stronger RMB, and hopes of a partial trade deal.*

- ***Equities:*** *Slow growth and low rates will keep share price of Singapore's banks range-bound for the time being.*

Economics: What would it take for emerging markets to turn around in 2020?

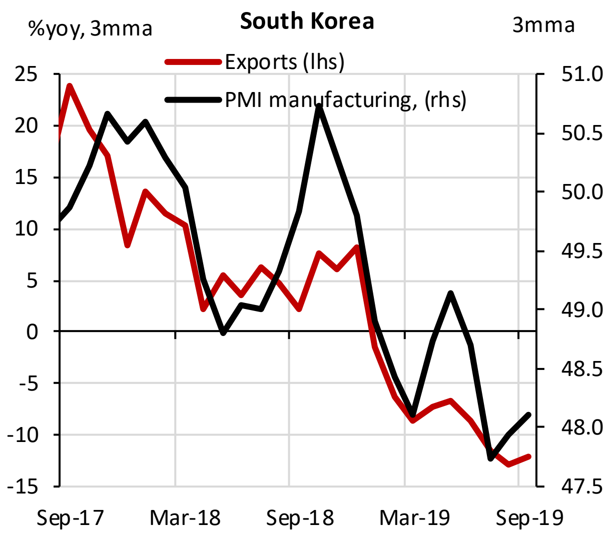
Investors are looking somewhat at ease going into the final stretch of 2019. In the recently concluded IMF annual meetings in Washington DC, the sentiment was subdued and yet unalarmed. Having experienced an extended period of downshift in inflation, interest rates, trade, and growth this year, markets and economies are resigned to a low normal, with noise from trade war, Brexit, and stress in emerging markets adding noise time to time. Asset markets were not seen as frothy, although corporate debt levels were deemed too high. There was low expectation of vigorous monetary or fiscal action from major economies next year, and much of the ongoing slowdown was seen as the result of a combination of unavoidable late cycle dynamics and various structural factors.

At the same time, easing DXY and USD funding conditions, stable energy prices, signs of a trade war détente, fading of a hard Brexit scenario, and hints of a bottom in the global electronics cycle have the making of an improved outlook for emerging markets going into 2020. While geopolitical risks remain high and asset market valuations are frothy, sentiments are turning more favourable toward economies reliant on external funding to finance current account deficits. We examine the conditions necessary to keep the trend going.

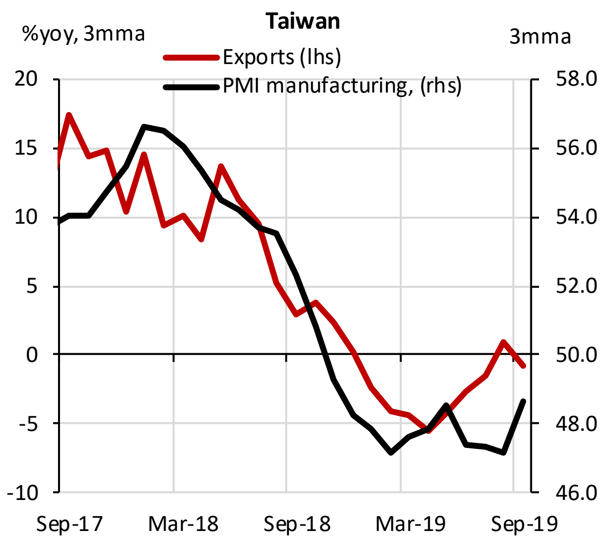
Trade

The conventional wisdom is that with US Presidential elections just a year away, and with US economic growth likely to fall below 2%, President Trump's interest in a trade war détente has risen considerably. The "first round" of trade deal may well mark the short-term bottom of trade friction.

Source: CEIC, DBS



Source: CEIC, DBS



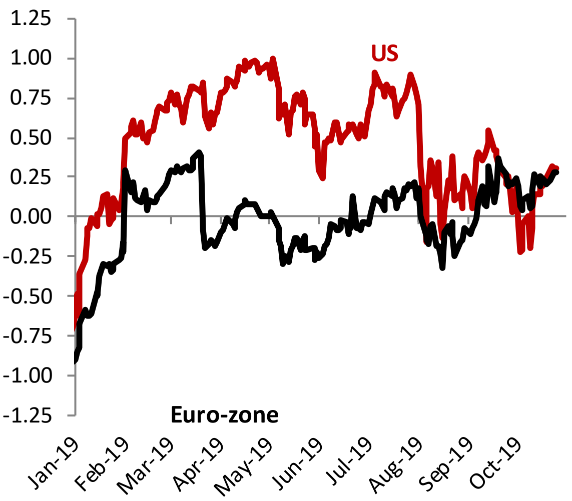
Source: CEIC, DBS

We are seeing signs of a trade trough in the bellwether economies of Asia. As per data available through September, exports growth of China, South Korea, and Taiwan are now in turnaround territory.

Liquidity, DXY, commodities, and rates

Also, financial conditions have become comfortable lately, thanks to central bank policy easing and reinforced liquidity measures. At the same time, the dollar strength has ebbed a tad, while commodities (both price level and volatility) have been tame. Risk aversion has weakened, while rates and spreads have turned favourable. Under these circumstances, emerging markets economies have caught a welcome breather, enjoying inflows and financial market stability.

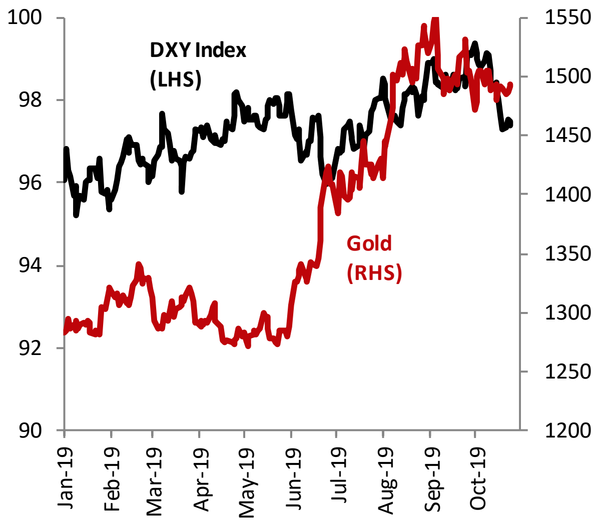
Financial Conditions Indices



Source: Bloomberg, DBS. Positive value denotes accomodative financial conditions

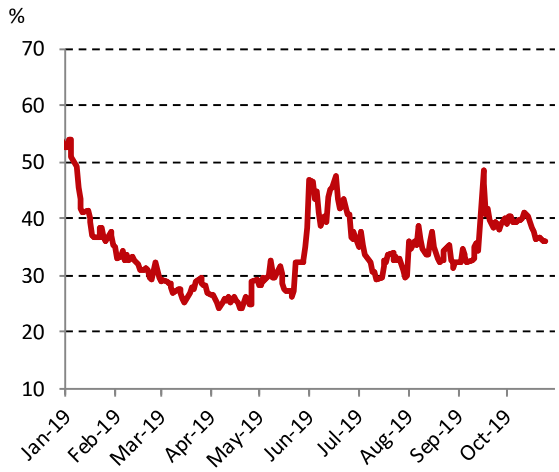
Going into 2020, most of these trends would need to persist for emerging markets to perform healthily. China's gradual slowdown and geopolitical uncertainties are two large drags to global demand; funding conditions, rates, USD, and long-term rates need to counter that challenge.

USD vs Gold



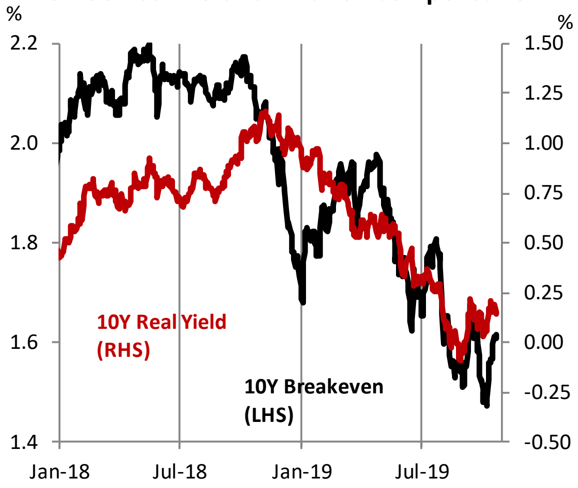
Source: Bloomberg, DBS

CBOE/NYMEX WTI Volatility Index



Source: Bloomberg, DBS

10Y US Real Yield vs Inflation Compensation



Source: Bloomberg, DBS

Taimur Baig

FX: Lulled into a false sense of security?

October has not been a good month for the US dollar but it did not derail its uptrend. The Fed has yet to fix the funding issues that emerged in September and has since stepped up repo interventions and expanded its balance sheet again. Consenus expects the Fed Funds Rate target range to fall another 25bps to 1.50-1.75% at the FOMC meeting on October 31. While the Fed's measures have offset some of the European Central Bank's dovish measures announced in September, **the US economic outlook has remained stronger relative to its weaker EU counterpart**. In fact, Germany is bracing for a technical recession in 3Q19.

Emerging Asian and commodity-led currencies were lifted by optimism for a temporary trade truce between China and the US. President Donald Trump called off tariff increases on Chinese goods due on October 15 after constructive trade talks in Washington on October 10-11. This has fuelled expectations for the presidents of both countries to sign a "Phase 1" trade deal at the APEC Summit around mid-November.

This is, however, not assured. Talks may extend beyond APEC if US trade negotiators insist on a proper and right deal. China wants the US to roll back existing tariffs in exchange for purchasing US agricultural products. Not surprisingly, the mid-rate for the Chinese yuan did not appreciate and has been stable around 7.07 vs USD since mid-September. According to US Treasury Secretary Steve Mnuchin, the planned tariffs on December 15 will proceed without a finalized deal.

Even if the trade deal passes, the prospect of prolonged trade policy uncertainties will keep sentiment guarded. US tariffs on EU goods imply that trade tensions may widen. If the US labels Vietnam a currency manipulator in its next currency report, it could set off alarm bells.

The recent appreciation in Asian currencies is considered a relief rally and unsustainable without a firm global recovery outlook. China's growth has slowed to 6% YoY in 3Q19, the floor of this year's official 6-6.5% target. The IMF has downgraded China's 2020 growth to 5.8%, the first sub-6% growth since 1990. The IMF also projected sub-5% growth for ASEAN-5 in 2019 and 2020. Hong Kong's economy is tipping into recession on trade war and protests. **Singapore has slightly eased its SGD policy** on October 14 **and left the door open for more easing** if the trade war spills over from the trade/manufacturing sectors into domestic demand/services.

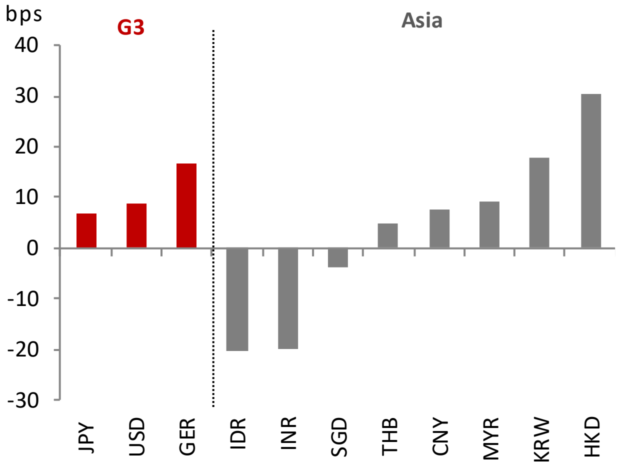
The British pound's rally on hopes of averting a no-deal Brexit on Halloween is not sound. The Brexit deal that Prime Minister Boris Johnson agreed with the EU has passed the House of Commons but still needs to be legislated. The opposition, however, appears keener for the EU to grant UK's request for a Brexit extension which was sent by Mr Johnson in an unsigned letter. The Conservative Party wants an election but this will require two-thirds of the MPs to support one. The Labour Party's approval ratings, however, have been hurt by its division over Brexit. When it comes to Brexit, twists and turns are unavoidable and unpredictable.

Philip Wee

Rates: Hint of optimism

While G3 central banks are still dovish**, there has been a pushback from policy makers (especially from the Bank of Japan) from overly low rates or overly flat curves.** We maintain that 10Y yields in the G3 economies may have already bottomed. Investors are also reluctant to chase yields lower given that the bond market appears to have priced in a lot of the bad news. Accordingly, the universe of negative-yielding bonds has also fallen by about USD 4tn from its recent peak.

Change in 10Y Government Bond Yields since end-September



Source: Bloomberg

Meanwhile, the Fed announced that it would buy USD 60bn of T bills per month till at least 2Q20 while providing a backstop via overnight and term repos (see here). With the market sensing that Fed bill buying is on the way, the 3M TED spread (Libor less T bill) widened out to 34bps as bills outperformed. However, still-elevated CP rates and Libor warrant caution. **QE-lite swaps T bills for reserves. However, it does not change the overall pool of liquid assets (loosely defined as reserves plus T bills) available for banks' regulatory requirements**. Viewed this way, the funding tightness may linger and banks may continue to tap the Fed's repo facilities.

In Asia, optimism showed up in the outperformance of Indonesia and India govvies over peers. 10Y Indo and India govvies rallied by 19bps and 16bps respectively amid dovish cues from their central banks. Notably the Reserve Bank of India (RBI) and Bank Indonesia (BI) both cut rates again this month. We argue that Indonesia govvies are enjoying a larger tailwind from Jokowi's Cabinet choices and also screen as slightly undervalued in our Asia Rates Valuation Indicator (ARVI). However, fiscal concerns (a wider deficit in 2020) are likely to weigh on the longer tenors. We reiterate our preference for shorter-dated govvies (out to the 2Y tenor).

China and South Korea govvies underperformed. For South Korea, KTB yields have, for some time, been pinned down by US-China trade uncertainties. Hence, talks of a "phase one" deal and signs of a more lasting de-escalation was always going to trigger a bigger bounce in KTB yields. Prospects of larger KTB issuances, on the back of more expansionary budgets ahead, have also been a support for yields. The upward momentum is, however, likely to lose strength soon, in our view. The economic outlook continues to deteriorate, and latest data releases do not suggest that a bottoming could be near.

In the case of China rates, markets were likely disappointed not to see reductions to the benchmark lending and loan prime rates this month. For now, PBOC still appears reluctant to shift to a bolder easing stance, though that has been the hope of many in markets.

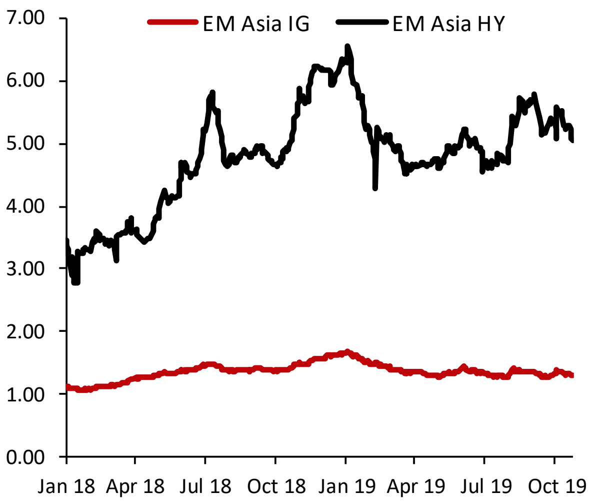
Eugene Leow, Duncan Tan

Credit: Dissipating risks anchor relief gains

Diminished risks of a no-deal Brexit in the aftermath of a Johnson deal, announcement of a US-China Phase 1 trade deal and signs of easing contraction in bellwether Korean exports have all served to bolster Asian risk sentiment. Besides broad firmness in emerging Asian currencies, almost all Asian equity indices have registered month-to-date gains (in USD terms), with Malaysia the sole exception.

Naturally, **credit markets have also seen sentiment improve in lockstep.** The Bloomberg Barclays EM Asia High-Yield index, being more sensitive to risk appetite, has seen its OAS (option-adjusted spread) narrow by around 30bps for the month, and is now back down to early August lows. Chinese HY spreads have compressed noticeably, helped by RMB gains as with reports of a possible currency pact in the Phase 1 deal.

Bloomberg-Barclays EM Asia USD OAS (%): IG vs HY



Source: Bloomberg, DBS

Could the pick-up in financial markets foretell a stabilisation in activity? Or is there a growth channel linked to "animal spirits" in markets? **What is of note is that global policymakers have seemingly inverted the narrative (away from negativity) over the trade war and Brexit.** Nobel Laureate Robert Shiller's recent book—"Narrative Economics"—expounds on the role of viral stories in driving economic fluctuations. If narratives are indeed a channel of transmission to the economy as hypothesized by Shiller, positive rhetoric could be helpful in shoring up both sentiment and activity, even if hard data remain little unchanged for now.

In China, the loan prime rate was kept unchanged at 4.20% for October, suggesting that **China's monetary policy stance could stay somewhat neutral for now**. That said, the suspension of the October US tariff hike, on top of a (partial) trade agreement that will be readied by the APEC Leaders' summit in November, should anchor broader credit conditions even if monetary policy accommodation remains more measured than forceful.

Chang Wei Liang

Equities: Impact on Singapore banks from a slower economy and lower rates

We remain neutral on Singapore banks and are of the view that share prices are likely to remain range bound. In the middle of a slowing global economy and lower interest rates, downside risks portend on net interest margin and loan growth.

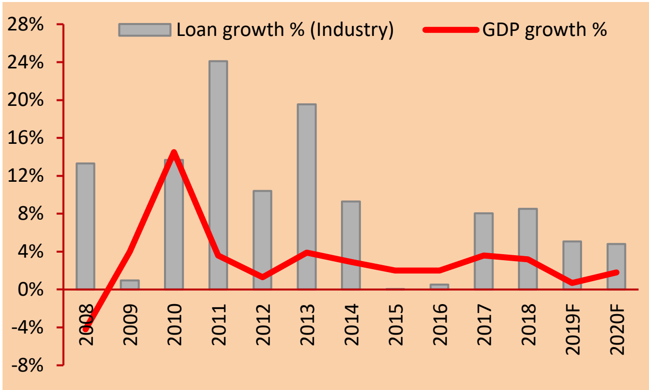
The NIM expansion cycle for Singapore Banks is likely to be over as loan yields and asset yields start to fall amidst a lower interest rate environment. Our sensitivity analysis shows that every 25-bp cut in interest rates may have 1-3bps impact on NIM for FY20F, while every 10-bp change in NIM has 5-7% earnings impact on banks' FY20F bottom line.

According to our channel checks, mortgage rates offered across Singapore banks for purchase or refinancing have also declined, so far by 20-30bps during Q319. At the same time, upward repricing of existing mortgages on higher base rates has largely been completed.

We expect credit costs to continue normalising against a slower global growth environment to c.20bps for FY19F (FY18: 16bps). However credit costs could be a wild card to earnings as pockets of stress experienced by banks' customers were non-geographic and non-sector specific. Oil & Gas, Commodity and Property related sector could be key areas of concern. Some banks could unwind expectations of credit cost and NPL declines in should growth outlook deteriorates further.

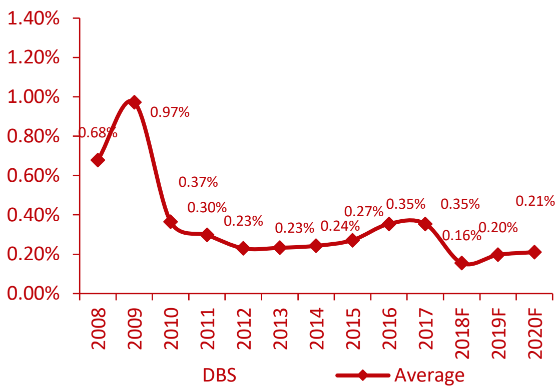
Slower-than-expected loan growth. Although loan growth is less sensitive to earnings, any deceleration as a result of weaker sentiment would dent top-line prospects. A sharper-than-expected slowdown in the Singapore property market will cause mortgage books to shrink faster.

Singapore: Loan growth (Industry)



Source: MAS, DBS Bank

Singapore Banks: Credit costs (Provision charge-off rate, average for 3 banks)



Source: Companies, DBS Bank

What may be a **silver lining for Singapore banks is that the sector may benefit from liquidity flow into Asia.** Valuations would also be supported by strong capital levels and decent dividend yields in view of heightened uncertainties arising from the trade war and investors' search for yields, should asset quality continue to hold up against slowing global growth.

Joanne Goh, Rui Wen Lim

REPORTS

Chart of the Week: China diversifies foreign reserves
Chart of the Week: Asia's policy rates versus the Fed
Chart of the Week: Global nickel price and Indonesia
Weekly: Watch out, inflation has bottomed
Weekly: Asia's defensive game
Weekly: Recession worries and declining rates
Notes from IMF Meetings: Settling for a low normal
China: How far can consumption drive the economy?
Indonesia: Look beyond the deficit
South Korea: Quite possibly the last rate cut this year
China: Trade talks surprise but not trade data
Singapore averts a technical recession despite weak growth
Malaysia budget 2020: Walking the tight rope
RCEP & India: Weighing the benefits of regionalism
Singapore: A gentler SGD slope in a tougher environment
India: How many policy rate cuts are left?
USD rates: Implications of QE-lite
Eurozone chartbook: Slippery growth seeks fiscal support

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	6.2	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	4.6	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	0.6	1.4	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

Rates forecasts

		2019				2020			
		Q1a	Q2	Q3	**Q4**	Q1	Q2	Q3	**Q4**
US	3m Libor	2.60	2.32	2.09	**2.10**	2.10	2.10	2.10	**2.10**
	2Y	2.26	1.75	1.62	**1.70**	1.70	1.70	1.75	**1.85**
	10Y	2.41	2.01	1.66	**1.75**	1.75	1.90	2.00	**2.20**
	10Y-2Y	15	25	4	**5**	5	20	25	**35**
Japan	3m Tibor	0.07	0.07	0.07	**0.05**	0.05	0.05	0.05	**0.05**
	2Y	-0.17	-0.22	-0.32	**-0.20**	-0.15	-0.15	-0.13	**-0.13**
	10Y	-0.08	-0.16	-0.21	**-0.20**	-0.15	-0.15	-0.10	**-0.10**
	10Y-2Y	9	6	10	**0**	0	0	3	**3**
Eurozone	3m Euribor	-0.31	-0.35	-0.42	**-0.50**	-0.50	-0.50	-0.50	**-0.50**
	2Y	-0.60	-0.75	-0.77	**-0.80**	-0.70	-0.60	-0.50	**-0.50**
	10Y	-0.07	-0.33	-0.57	**-0.50**	-0.50	-0.40	-0.30	**-0.20**
	10Y-2Y	53	42	20	**30**	20	20	20	**30**
Indonesia	3m Jibor	7.21	6.95	5.86	**5.90**	5.90	5.90	5.90	**5.90**
	2Y	6.78	6.74	6.22	**6.00**	5.90	5.80	5.80	**5.80**
	10Y	7.63	7.37	7.29	**6.80**	6.90	7.00	7.10	**7.20**
	10Y-2Y	86	63	107	**80**	100	120	130	**140**
Malaysia	3m Klibor	3.69	3.46	3.38	**3.19**	3.19	3.19	3.19	**3.19**
	3Y	3.38	3.29	3.12	**3.25**	3.25	3.30	3.35	**3.40**
	10Y	3.77	3.63	3.32	**3.25**	3.25	3.40	3.50	**3.70**
	10Y-3Y	39	34	19	**0**	0	10	15	**30**
Philippines	3m PHP ref rate	5.55	4.09	3.58	**3.60**	3.60	3.60	3.60	**3.60**
	2Y	5.83	4.95	3.86	**3.65**	3.60	3.70	3.75	**3.85**
	10Y	5.62	5.07	4.63	**4.15**	4.15	4.30	4.40	**4.60**
	10Y-2Y	-21	12	77	**50**	55	60	65	**75**
Singapore	3m Sibor	1.94	2.00	1.88	**1.60**	1.60	1.60	1.60	**1.60**
	2Y	1.92	1.66	1.66	**1.70**	1.65	1.60	1.60	**1.65**
	10Y	2.07	2.00	1.74	**1.70**	1.70	1.80	1.90	**2.00**
	10Y-2Y	15	34	8	**0**	5	20	30	**35**
Thailand	3m Bibor	1.88	1.88	1.62	**1.35**	1.35	1.35	1.35	**1.35**
	2Y	1.78	1.75	1.34	**1.30**	1.30	1.30	1.30	**1.30**
	10Y	2.43	2.12	1.47	**1.75**	1.75	1.90	2.00	**2.20**
	10Y-2Y	65	37	13	**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	2.78	**2.70**	2.70	2.70	2.70	**2.70**
	10Y	3.36	3.24	3.14	**2.80**	2.80	2.90	3.00	**3.00**
	10Y-3Y	45	32	36	**10**	10	20	30	**30**
Hong Kong	3m Hibor	1.76	2.46	2.26	**1.80**	1.80	1.80	1.80	**1.80**
	2Y	1.45	1.78	1.65	**1.80**	1.80	1.80	1.80	**1.80**
	10Y	1.47	1.51	1.21	**1.55**	1.55	1.70	1.90	**2.00**
	10Y-2Y	2	-27	-44	**-25**	-25	-10	10	**20**
Korea	3m CD	1.90	1.78	1.55	**1.37**	1.37	1.37	1.37	**1.37**
	3Y	1.69	1.47	1.30	**1.25**	1.25	1.25	1.25	**1.25**
	10Y	1.83	1.60	1.46	**1.30**	1.25	1.35	1.45	**1.55**
	10Y-3Y	14	13	16	**5**	0	10	20	**30**
India	3m Mibor	7.42	6.78	6.18	**5.80**	5.80	5.80	5.80	**5.80**
	2Y	6.88	6.30	5.78	**5.70**	2.70	5.75	5.75	**5.75**
	10Y	7.22	6.88	6.70	**6.60**	6.70	6.80	6.90	**7.00**
	10Y-2Y	34	58	92	**90**	400	105	115	**125**

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

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