Weekly: Forecasting Asia's 2020 funding requirement

Economics/Strategy/Rates/FX/Equities

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- *The markets are stepping into 2020 with little concern about debt sustainability in the sovereign or corporate space.*
- *Armed with USD5.5trln in FX reserves, Asian emerging market economies may appear in good shape to deal with external finances.*
- *But the financing obligations of some Asian economies are very large relative to their reserves.*
- *India, Indonesia, and Malaysia top the list of funding vulnerability. The reserves cushion of China and the Philippines have diminished as well.*

Looming rollover needs

Given this year's sharp decline in bond yields and extensive policy easing carried out by central banks worldwide, the markets are stepping into 2020 with little concern about debt sustainability in the sovereign or corporate space. As the stock of negative yielding debt (investment grade) has ballooned to USD12.5trln, any company or country coming to the market with modestly positive yielding issuances looks set to receive considerable bid and enjoy spread compression.

The global economy needs such benign conditions to persist through 2020. While low energy and agriculture commodity prices as well as overall slowing of import demand have kept the current account deficit of Asian economies like India and Indonesia under check, funding conditions are matters of critical importance for all economies, regardless of the size or sign of their current account balances.

The reason for this is simple; both sovereign and private sector external financing needs run independent of current account dynamics. For instance, a country like China, which has sustained current account surpluses for decades, still needs fresh foreign capital every year to take care of external debt redemption and rollover needs.

Related to financing requirement is each economy's external buffer, namely international reserves. Asian central banks, by international comparison, have pursued prudent policies in recent decades, boosting their reserves base. We expect EM Asia's reserves to exceed USD5.5trln in 2020.

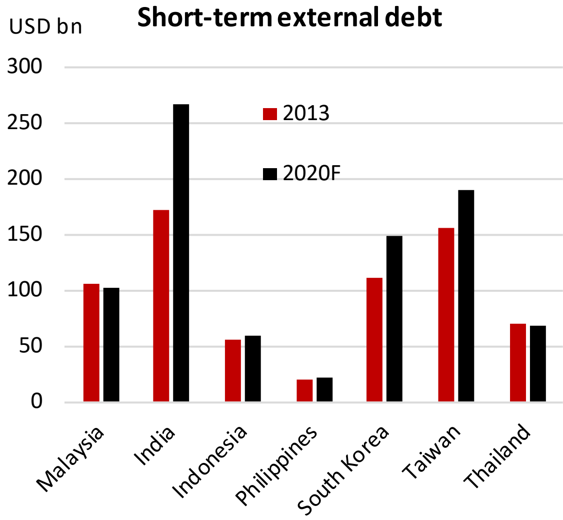
But is that ample? Repeated bouts of foreign exchange volatility during the course of this decade have taught investors that spikes in global risk aversion take place frequently, and currencies are often the first casualty. Also, the data show that markets tend to invariably put pressure on those currencies that face the most external funding needs.

In the following analysis, we bring together discussions on three key variables related to external financing. First, we look at short-term debt in Asia. We leave China's outsized figures out of the first three charts and examine its case later. We also leave out Hong Kong and Singapore from this analysis, as these financial centres, by virtue of being the booking and reporting hub of numerous multinational companies, are characterised by current account and debt figures that are not comparable with the other economies.

As for short-term debt, note that the calculation should not only include debt with maturity of one year or less, but also longer-term debt that's falling due in the next twelve months (i.e. short term debt on a residual maturity basis), foreign currency deposits in the banking system, and trade credit. Not all such liabilities are equally risky, but they all have to be financed nonetheless. For comparison, we plot similar outturns from 2013, the last time Asian economies saw severe funding crunch (around the taper tantrum episode). We refrain from scaling the figures by GDP as we want to shed light on the volume of funding needed in a comparable manner. Also, we take care of scaling issues toward to the end of the analysis.

Short-term debt

The rollover needs of our selected seven Asian economies in 2020 are nontrivial, amounting to USD855bn. Note that these figures are likely to be understated, as among these seven economies, we only have original maturity debt data of Malaysia, South Korea, and Taiwan (while the rest, appropriately, report on residual maturity basis). Compared to 2013, India's obligations are up the most (54%).

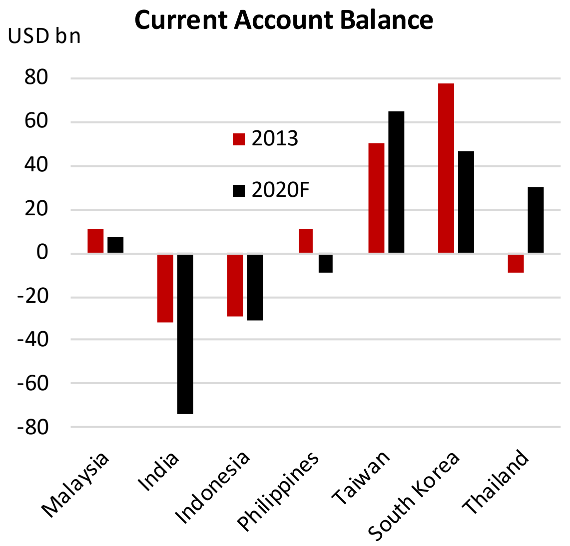


Source: IMF, World Bank, country authorities, DBS

Current account

For the 2020 current account forecast, we take the IMF's projections. Again, India's figures are the most striking relative to 2013.

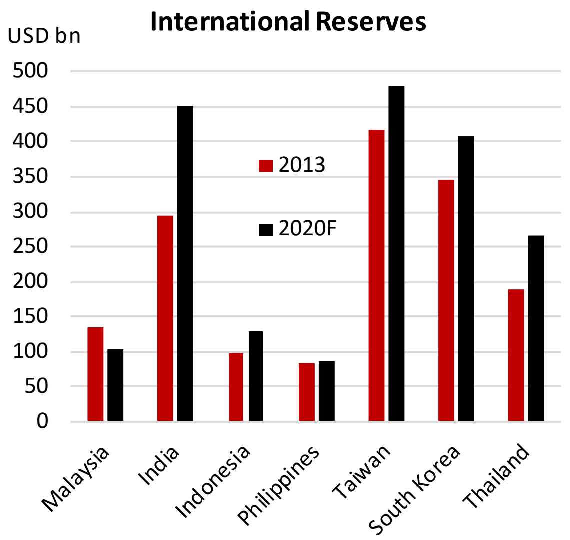
Also of note is the fact the Philippines will likely see a current account deficit in 2020, while Thailand is slated to report a large surplus.



Source: IMF, World Bank, Country authorities,

FX reserves

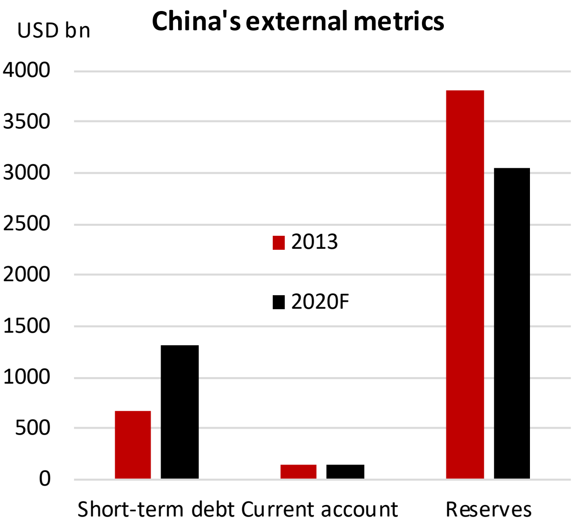
Having been chastened by currency volatility of 2013, the central banks of both India and Indonesia have made progress in strengthening their war chests, but India's reserves accumulation is by far the most impressive in Asia. Taiwan, South Korea, and Thailand have also moved into more comfortable territory.



Source: IMF, World Bank, country authorities, DBS

China

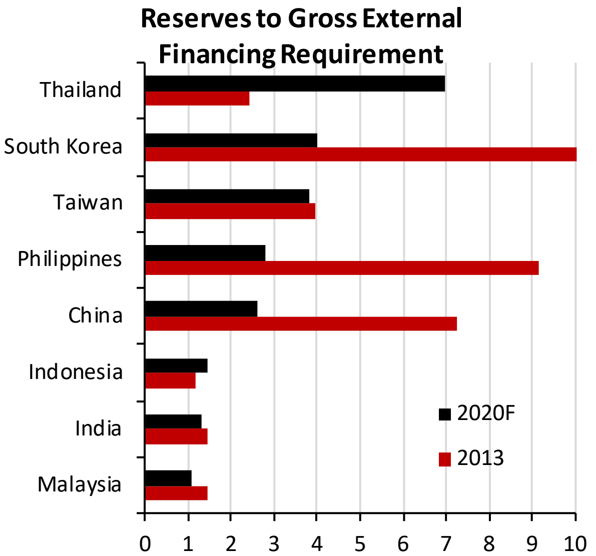
China's corresponding figures are so much larger than the rest that they require examination in isolation. Looking at its three critical external metrics, it is clear that China's obligations have risen while their reserves cushion has declined markedly in recent years.



Source: IMF, World Bank, country authorities, DBS

Putting it all together

Now we put everything together for the eight economies in our analysis. The denominator of the ratio plotted in the following chart is the gross external requirement (short term obligations plus the current account), while the numerator is international reserves.



Source: IMF, World Bank, country authorities, DBS

Relative to 2013, only one economy in our eight-country sample has seen a sizeable rise in funding cushion—Malaysia. The bottom three are India, Indonesia, and Malaysia; we expect the currencies of these economies to face the most stress if funding conditions were to tighten next year. But even among the surplus economies of Asia, the worsening of the ratio is striking, especially in the cases of China, South Korea, and the Philippines. Of these three, we detect growing external vulnerability in two economies—China and the Philippines.

Taimur Baig

FX: Buy CNY, sell GBP

For the two major event risks in December, **the odds for a China-US trade deal are higher than those for a majority government at the UK elections.** The British pound peaked against the Chinese yuan at 9.18 on October 21 and has since retreated below 9.00 this week. The GBPCNY cross rate has potential to trade lower towards 8.70-8.90.

The highlight this week was the rebound in the Chinese yuan; USDCNY closed below 7.00 for the first time since August 2. According to the Chinese Commerce Ministry**, China and the US are working towards resolving trade tensions via trade deals that cancel tariffs in phases.** This has not been confirmed by the US. Nonetheless, the possible Xi-Trump signing of a Phase 1 trade deal in December is now viewed as a positive event risk. USDCNY could return towards 6.90, where it took off in August to 7.00 and above on tit-for-tat tariffs.

After averting a no-deal Brexit on October 31, the British pound has not been able to break above 1.30 against the USD. Polls, businesses and bookies expect a hung parliament at the UK snap elections on December 12. Without an end to the political paralysis that prevented Brexit from happening, the EU will be reluctant to extend Article 50 a third time. Hence, **the odds of a no-deal Brexit on January 31, 2020, cannot be totally discounted.** Brexit risk was a reason that prompted **two Bank of England members** to break rank and **vote for a rate cut** at the policy meeting on November 7. GBPUSD is likely to give back some of the rise from 1.22 to 1.30 chalked in October.

Philip Wee

Rates: 2% in sight for 10Y US yields

Overnight, 10Y US yields briefly traded above 1.95% before closing at 1.92%, levels not seen since early August. Most of this is driven by optimism that phase one of the China-US deal (if agreed and signed) would progressively lead to an unwinding of tariffs that have been put in place over the past two months. This opened up the possibility of an upside surprise, beyond what a trade truce (what market participants were generally expecting) offers. Shorter tenor yields also had similarly large upward adjustments over the past several weeks. USD rates are now barely pricing a cut in 2H20, from three cuts just two months ago.

We maintain our call that DM (and US) longer-term yields have bottomed and that the Fed's mid-cycle adjustment is done. 10Y US yields are close to the top of our 1.5-2.0% range. From a normalization perspective (reducing of negative tail risks) and taking into account still-weak global economic numbers, we think that 2% should be about appropriate. Further upside surprise on the trade talks could drive a squeeze higher in US yields (above 2%), but that may not be last. Once economic numbers show more concrete signs of bottoming out, we think that 10Y yields can sustainably stay in the 2.0-2.5% range. **Compared to consensus, we are significantly more bearish on USTs. We expect 10Y yields to hit 2.2% in end-2020 (consensus: 1.86%).**

Eugene Leow

Credit: Emerging market discipline in China

Last week, **two firms owned by China's most prestigious universities saw concerns bubble up in capital markets**. Their USD-denominated bonds, with combined nominal value of over $4bn, saw a 5-10% sell-off from the previous week's close. What is more surprising was that the sell-off occurred amidst clearly improved US-China trade news and a firmer RMB.

Clearly, **reputation and the implicit guarantees arising from being state-owned are no longer valued that highly** today. Markets have become more uncomfortable with either years of negative cash flow or spotty profitability experienced by the firms. Perhaps it also symbolizes the rise of market discipline— a development that aligns well with the authorities' desire to reduce moral hazard and increase discernment on the part of investors.

Spill-overs into the wider Chinese credit market are small, suggesting that investors have become more discerning of idiosyncratic risks. The Bloomberg Barclays China IG and HY USD spreads both saw a slight narrowing of around 2-4bps. The tiny spread compression failed to offset a rather significant jump in US treasury yields, resulting in higher yields across the Bloomberg Barclays EM Asian and China indices.

Chang Wei Liang

Highlights of the week:

India: Growth to slow before turning the corner
Thailand: Eyes on BOT on sub-potential growth
Chart of the Week: China-Vietnam trade diversion

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	-1.7	1.5	1.5	2.5	2.7	2.5
India	6.9	7.4	5.4	6.0	3.3	4.0	3.3	4.0
*India (FY basis)**	*8.2*	*7.1*	*6.8*	*5.5*	*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	3.1	0.6	1.4	0.6	0.4	0.6	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	2.3	2.0	0.6	1.3	0.7	1.0
Thailand	3.3	4.1	2.5	3.0	0.7	1.1	1.0	1.3
Vietnam	6.8	7.1	6.9	6.8	3.5	3.5	2.5	2.9
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	0.5	0.7
United States***	2.3	2.9	2.2	1.9	2.1	2.4	1.7	1.6

* refers to year ending March i.e. 2020 represents FY20 - year ending March 2020 ** 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	4.90	4.65	4.65	4.65	4.65
Indonesia	6.00	6.00	5.25	5.00	5.00	5.00	5.00	5.00
Malaysia	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
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	6.00	6.00	6.00	6.00
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	1.75	1.75	1.75	1.75	1.75

* 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).