Economics & Strategy Weekly

Weekly: Breathing space

Economics/Strategy/Rates/FX/Equities

DBS Group Research | December 13, 2019

Taimur Baig
Chief Economist
taimurbaig@dbs.com

Chang Wei Liang
Macro Strategist (FX and Credit)
weiliangchang@dbs.com

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

- *From the Fed to ECB to phase one trade deal to UK elections—everything has gone the markets' way this week*
- *Fed and ECB have taken on an asymmetric monetary policy stance—the bar to tighten is much higher than the bar to ease.*
- *A limited US-China trade deal takes away uncertainty for at least a few months. Key issues remain unresolved, however, leaving considerable risk on the table for next year.*
- *We expect equity froth to remain, US dollar to weaken, yields to rise, and EM to rally*
- *This presents considerable breathing room for markets and economies going into 2020*

Goldilocks to end the year

From the Fed to ECB to phase one trade deal to UK elections—everything has gone the markets' way this week. This presents considerable breathing room for markets and economies going into 2020.

First, the year's final monetary policy meetings from key central banks paved the way for a highly accommodative stance to be maintained in 2020. Both the Fed and ECB have taken on an asymmetric monetary policy stance—the bar to tighten is much higher than the bar to ease. Consequently, even if inflation picks up a tad next year, there will be little concern about monetary policy turning hawkish.

ECB

In her first meeting as ECB president, Christine Lagarde made it clear that interest rates will stay at record lows in 2020, although she saw a modest pick-up in lending and a marginal improvement in the outlook. Receding risk of a disorderly Brexit and some improvement in trade related sentiment will likely help reduce the pernicious risk of negative rates in the Eurozone, in our view.

Fed

In the US, the Federal Reserve also signalled a prolonged pause ahead, with a striking asymmetry in the policy stance. By announcing a dramatic increase in market intervention (through repurchase operations), the Fed also made it clear that it is determined to avoid the type of cash crunch that disrupted markets in

September. From our perspective, the Fed has clearly moved on from the "midcycle adjustment" type thinking to a more dovish strategy, with a pledge to hold rates low as long as inflation is muted. In this context, what is remarkable is the convergence of views among FOMC participants: in September, seven out of the twelve expected the Fed funds rate to be above 2% in 2020; this week everyone saw the rate to be below 2% next year.

Trade deal

After months of back and forth and scaling back of the scope of trade negotiations, a limited US-China trade deal arguably reduces global market uncertainty for at least a few months. Key issues remain unresolved, however, leaving considerable risk on the table for next year.

The contours of the phase one agreement feature the following:

- China to import USD50bn worth of farm goods annually (the corresponding figure in 2017 was USD24bn).
- China to tighten intellectual property protection.
- China to open up its financial services market to US companies.
- US to refrain from imposing new tariffs on Chinese goods bound for the US.
- Existing tariff on USD360bn of Chinese goods will be partially rolled back.
- Tariffs can be snapped back if China does not live up to its obligations in the deal.

Thornier issues like subsidies for state enterprises and technology transfer will be part of a subsequent deal, which will take at least another year or longer.

UK elections

Exit polls suggest a resounding win for the UK Conservative Party under the leadership of Boris Johnson, paving the way for Brexit next month. The considerable majority will help PM Johnson to end the three-year political standoff, and move on to negotiating a post-Brexit trade deal with the EU. Independent of how challenging or protracted those negotiations turn out to be next year, the short-term implication for UK markets is unambiguously positive, with the British Pound the clearest beneficiary.

What do these developments mean for the early part of 2020?

- Already expensive equity markets to become even more costly, riding on a relief rally with so many uncertainties dissipating.
- Capital flows to become more emerging markets oriented (helping hard currency debt issuers) and the US dollar to weaken as non-US prospects improve.
- Fixed income curves in developed markets bull steepen somewhat.

This is our last Weekly of 2019. We wish our readers a restful holiday and a very happy new year. We will return in early-January with our top-10 economic themes and investment strategies for the year.

Taimur Baig

FX: Averting a harsh Christmas

This week will not solve the many medium-term challenges confronting the world. **Several key developments will, however, ease some of the choke points** that have started to weigh on business and consumer confidence. First, the Fed and ECB have reassured that monetary policies will remain accommodative amidst more upbeat tones for their economies. **The Fed's pledge to hold rates steady throughout 2020 will provide one important pillar of predictability** to nurture the fragile recovery.

China and the US have reportedly reached a Phase 1 trade deal in principle that would not only suspend US tariffs on December 15 but also include some tariff rollbacks. Offshore USDCNH has fallen below 7.00 with onshore USDCNY not far behind. **The British pound has rallied to 1.35 in anticipation of a Tory majority** at the UK election. If so, Prime Minister Boris Johnson and the Conservative Party would "Get Brexit Done" on January 31, 2020. Beyond this, Brexit is not over. Next comes the arduous task of negotiating UK's future relationship with the EU within a shortened transition period that ends on December 31, 2020.

In summary, **Christmas is approaching with less pessimism of a harsh winter.** The Fed and other central banks have helped to shovel the snow. The easing of trade and Brexit worries would warm Christmas dinners but prayers will be for the birds to return in spring. Mindful that the **political gridlocks for trade and Brexit have only been loosened and not broken**, speculators will be tempted to take profit near year-end.

Philip Wee

Rates: Last hurdles cleared

Sentiment got a lift as the last two hurdles (uncertainties over the US's December 15 tariffs on Chinese imports and UK's general elections) got cleared. This mix of events and a Fed likely on hold for an extended period have reduced the uncertainty premium embedded in asset prices for large parts of this year. 10Y US yields are up by 14bps overnight, touching 1.93% (close to the top of the 1.5-2.0% trading range) amid a broad selloff across DM govvies. Contingent on a global cyclical recovery, we think that 10Y US yields will drift into the 2.0-2.5% range in 2020. In the short-term, however, we think that buying interest will emerge as 10Y yields approach 2%. We maintain our out of consensus call for 10Y US yields to touch 2.2% in end-2020 (consensus: 1.93%), a view we have held since late August.

Asian assets are likely to cheer these positive developments with sizable FX moves over the past twelve hours. The performance in Asia govvies will be divergent. Lower-yielding govvies (including Singapore, Korea and Thailand) would likely see mild selloffs across most tenors given their higher correlation with DM rates. However, given the resultant Asia FX strength, yield increases in Asia are likely to be relatively muted compared to US. Meanwhile, the higher yielders (India and Indonesia) are likely to see some much-needed reprieve. The surprise Reserve Bank of India (RBI) hold shocked the market, bear flattening the curve in the process. For Indonesia, discussions to ease the 3% budget deficit limit has also spooked investors. With global events shaping up more positively, the appetitive to add risk should sooth nerves somewhat.

Eugene Leow

Credit: India on watch

S&P has flagged that it could downgrade India's BBB- rating if growth fails to recover, which will tip the country from investment to speculative grade if it happens. Indian bond yields rose on the back of the news, even though S&P's India outlook remains stable. Risks of a downgrade are back-loaded, depending on whether Indian structural growth could match expectations. A softer than expected growth trajectory certainly implies difficulties for a fiscal turnaround.

Beyond growth uncertainty, India is also trying to address persistent credit strains for non banking financial companies (NBFCs) and housing finance companies (HFCs). The government has announced **a 10% first loss guarantee scheme for public sector banks purchasing assets from NBFC/HFCs**, up to a limit of INR1trn of BBB+ rated assets (around 0.5% of GDP) and covering a period of 24 months from purchase.

Could 2020 finally mark the end of India's NBFC liquidity stresses? The guarantee scheme should faciliate NBFCs' access to liquidity from banks, while posing only small risks to the sovereign. However, **liquidity stresses are not likely to be fully alleviated,** given increased credit differentiation amongst strong and weak NBFCs. As non-performing asset formation for NBFCs has shown no signs of peaking, caution is still warranted absent more forceful measures.

Chang Wei Liang

Highlights of the week:

- DBS Annual Chartbook: 2020 in 72 charts

Key Forecasts

	GDP growth, % YoY				CPI inflation, % YoY, ave			
	2018	2019f	2020f	2021f	2018	2019f	2020f	2021f
China	6.6	6.1	5.8	5.6	2.1	2.6	2.3	2.5
Hong Kong	3.0	-1.7	1.5	1.5	2.4	2.7	2.5	2.5
India	7.4	5.0	5.8	6.4	4.0	3.5	4.2	4.5
*India (FY basis)**	*7.1*	*6.8*	*5.0*	*5.8*	*3.6*	*3.4*	*3.9*	*4.2*
Indonesia	5.2	5.0	5.0	5.1	3.2	3.1	3.4	3.2
Malaysia	4.7	4.5	4.6	4.6	1.0	0.9	1.6	1.8
Philippines**	6.2	5.9	6.3	6.3	5.2	2.8	3.5	3.3
Singapore	3.1	0.6	1.4	1.8	0.4	0.6	1.1	1.5
South Korea	2.7	2.1	2.4	2.3	1.5	0.5	1.5	1.3
Taiwan	2.7	2.3	2.0	2.2	1.3	0.7	1.0	1.1
Thailand	4.1	2.5	3.0	3.2	1.1	0.8	1.2	1.3
Vietnam	7.1	6.9	6.8	6.7	3.5	2.5	2.9	3.0
Eurozone	1.9	1.2	1.3	1.5	1.8	1.2	1.2	1.3
Japan	0.8	0.7	0.5	0.9	1.0	0.5	0.7	0.6
United States***	2.9	2.2	1.9	1.8	2.0	1.7	1.7	2.0

* 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							
	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
China*	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
India	4.90	4.90	4.90	4.90	4.90	4.90	4.90	4.90
Indonesia	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Philippines	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Singapore**	1.60	1.60	1.60	1.60	1.60	1.60	1.60	1.60
South Korea	1.25	1.25	1.25	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	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Vietnam***	6.00	6.00	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	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20	-0.20
United States	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75

* 1-yr lending rate; ** 3M SOR ; *** prime rate

	Exchange rates, eop							
	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21
USD/CNY	7.20	7.15	7.10	7.05	7.00	6.95	6.90	6.85
USD/HKD	7.85	7.84	7.84	7.83	7.82	7.81	7.80	7.80
USD/INR	72.0	72.5	73.5	74.0	73.5	73.0	72.5	72.0
USD/IDR	14200	14300	14400	14500	14450	14400	14350	14300
USD/MYR	4.20	4.18	4.16	4.14	4.13	4.12	4.11	4.10
USD/PHP	52.0	51.5	51.0	50.5	50.4	50.3	50.2	50.1
USD/SGD	1.40	1.39	1.38	1.37	1.36	1.36	1.35	1.35
USD/KRW	1180	1175	1170	1165	1160	1155	1150	1145
USD/THB	31.0	30.8	30.6	30.4	30.3	30.2	30.1	30.0
USD/VND	23300	23300	23300	23300	23300	23300	23300	23300
AUD/USD	0.64	0.65	0.66	0.67	0.68	0.69	0.70	0.71
EUR/USD	1.08	1.09	1.10	1.11	1.12	1.13	1.14	1.15
USD/JPY	110	109	107	106	105	105	104	104
GBP/USD	1.20	1.21	1.22	1.23	1.24	1.25	1.26	1.27

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

Ma Tieying, CFA
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Radhika Rao
Economist – Eurozone, India, & Thailand
+65 6878-5282 radhikarao@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21-2988-4003 masyita@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@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.