

Asian Economic and Bond Market Outlook

Q3 2017 | Market Commentary

Rebound in demand for Asian exports and the non-realisation of protectionist trade policy year-to-date from the new US President have enabled Asian economies to register robust growth numbers so far. The exports growth momentum going forward may begin to slow down. However, it is a mixed picture when it comes to whether domestic demand can make a larger contribution just as exports growth slows. Chinese domestic consumption is expected to stay robust as the economy continue to rebalance towards consumption driven economy despite the ongoing focus on deleveraging and economic reform would dampen economic growth. High household debt and property prices may call for tighter macro prudential measures to deal with specific sectors of the economy for countries such as Korea, Thailand and Malaysia. Some Asian governments would further increase spending to spur growth. Lower energy prices have been a boon to Asian economies which are net energy importers, while keeping inflation prints at low levels. This allows Asian central banks to keep accommodative monetary policy stance for longer time although many are monitoring closely the increased leverage in the system after long period of low interest rates and higher government spending. Asian bond markets may be supported by positive investor appetite for risk. Though, minor profit taking may set in after recent rally. Against the backdrop of positive emerging market sentiment, uncertainty in US politics and market expectations of slower Fed rate hikes, Asian currencies may stay at elevated level but further large appreciation from current levels would likely see currency interventions from central banks.

Country Specific Outlook

China

A very strong economic performance from the Chinese economy in the first half of 2017 is not expected to be repeated in the second half of the year. We expect overall GDP growth for the year to be closer to the upper end of the 6.5% to 6.7% range. The expected slowdown reflects the authorities ongoing efforts to curb leverage in the economy. Property sector is expected to slowdown with the authorities implementing sales restrictions, increasing land supply in certain cities and experimenting with public housing. Property developers are expected to make fewer land transactions as house sales have softened. A better-than-expected economic growth in the first half of the year would arguably provide ample opportunities for the government to push ahead further reform measures which would trim growth slightly. National Financial Work Conference has set priorities for next five years to make the financial sector better the real

economy, containing financial risks and deepening financial reforms. The deleveraging focus is expected to widen from financial sector to non-financial corporate, local government and state-owned enterprises. This is expected to result in lower money supply growth. There will be further increase in focus to improve the efficiency of resource allocation as China has higher incremental capital-output ratio (ICOR), meaning more capital investment required to generate a unit of output, than other Asian peers according to analysis from International Monetary Fund. The line up of the next leadership team under President Xi, who is seeking a second term, would be keenly followed in the coming months. We do not expect this to create instability in the financial markets. Chinese inflation is expected to remain subdued. The People's Bank of China (PBoC) is expected to deploy the wide range of money market operation tools to maintain a tightening bias. Bond yields are expected to move sideways with an upward bias. Capital outflow concern has eased and the authorities are comfortable with the current Chinese renminbi (RMB) exchange rate level. We can expect RMB to trade within the range of 6.7300 to 6.8000 in the next few months.

Hong Kong

Hong Kong economy received a strong boost from external trade and domestic consumption in the first half of the year. While exports may continue to do well, we expect the momentum to taper off over time given expected moderate slowdown in China and stronger Hong Kong dollar with higher US rates expected in coming months. Rebound in tourist arrival and spending may continue to support private consumption. The buoyant property market has kept house prices strong, hitting record high in April 2017. We expect further property tightening measures by the government and at the same time the government would increase land supply and cooperate with property developers that own agricultural lands to convert these into private and public housing to meet housing demand. Rise in US and Hong Kong interest rates may lead to higher mortgage rates and property market correction, dampening consumer sentiment and spending. Inflationary pressure is subdued expected to average at around 1.5% to 2%. The newly elected Chief Executive, Carrie Lam, has announced large funding to education recently. It is uncertain if she would succeed in getting further stimulus plan through the fiscally conservative lawmakers. She is expected to tread carefully to balance the need to protect the rights and interests of Hong Kong against maintaining cordial relationship with China and handle any demonstrations with care. Hong Kong bond yields are expected to rise slightly on the back of expected US Fed rate hikes.

South Korea

The political uncertainty surrounding Korean economy eased after the Presidential election which saw Moon Jae-in became the new President of South Korea. General economic sentiment has improved as the government indicated that job creation is among one of its policy priorities. The lift in employment sentiment would augur well for private consumption. Strong exports notably in capital goods and semiconductor sectors may continue to keep exports growth at robust level. With house price growth not showing signs of slowdown and household debt rising, policy tightening in the form of lowering of loan-to-value (LTV) and debt-to-income ratio (LTI) by 10% to 60% and 50% respectively would help dampen the property market. Supplementary budget to be implemented by the government would also boost economic growth. Provocative actions from North Korea may keep geopolitical tension high and can create negative shocks to the economy should this trigger any military confrontation. Barring any such accident, overall GDP growth for 2017 is expected to be around 3%–3.3%. Inflationary pressure is expected to rise on the back of higher growth, averaging around 2.5%. Recent rhetoric from Bank of Korea (BoK) officials would be interpreted as gradual shift in monetary policy stance from neutral to cautious as government fiscal expansion takes its course. However, we expect BoK to keep policy rates unchanged at 1.25% for the next few months to allow economic expansion to deepen. Korean bond yields may rise moderately on the back of less dovish comments from BoK and potential increase in bond supply. The Korean won (KRW) is expected to stay well bid due to general positive emerging market sentiments, trading within the range of 1,100 to 1,150 for the coming months.

Thailand

The recent upswing in exports growth momentum may provide the tailwind necessary for Thai economic growth. Improving tourist arrivals will play a key role in providing some support to domestic consumption. Overall GDP growth for 2017 would rise by 3.5% to 4%. However, beneath this positive number lies some concerns. Reliance on the external driven factors are not sufficient to sustain growth over time. The challenge to the domestic economy remains. Low capacity utilisation rate of around 60% is a tell-tale sign of manufacturing overcapacity, leading to weak private investment. Political uncertainty is a source of declining consumer confidence. High household debt adds on to the lacklustre household spending. The military government has repeatedly postponed the general election, now expected to be held in the second half of 2018. Prolonged delay in the election may sow the seeds of electoral suspicion on the true commitment of transition to civilian rule. Fiscal expenditure will be another major growth driver to counter the above and the government still has its work cut to push this further along. Inflationary pressure is not a near term concern as headline inflation is expected stay below or at 1% against the Bank of Thailand (BoT) target range of 1%–4% as energy costs stay low and the Thai baht has appreciated. Such benign

inflation outlook and uncertainty on growth outlook in coming quarters would persuade BoT to keep policy rates unchanged even though current GDP growth is strong. The central bank continues to articulate the need to maintain accommodative monetary policy stance to support economic growth while preserving financial stability. Bond yields are expected to stay in the lower of trading range with such accommodative stance. BoT feels the baht has appreciated too quickly. With Thailand's current account surplus still at healthy level, the baht may trade towards the strong side of 33.00 to 34.00 in coming months.

Malaysia

We expect growth to accelerate to around 5% this year after the better-than-expected Q1 GDP growth of 5.6%, thanks to a strong recovery in export growth and government spending. Exports are likely to continue to be supported by improvement in global trade, notwithstanding a moderation in commodity prices. With a strong economic backdrop, there is a chance that elections may be called earlier this year, which could boost government spending. Infrastructure spending will also be boosted by the construction of the East Coast Rail Line and the Singapore-Malaysia High Speed Rail project. Consumer spending however would remain sluggish as it remains constrained by high household debt. Despite stronger growth outlook, inflation is expected to stay moderate at around 3.5% due to lower fuel prices. Hence, the probability of a rate hike is low. We expect the central bank to keep policy rate unchanged at 3%. Given strong growth expectations, we think the government is well placed to meet its fiscal deficit target of 3% this year although there is a risk that spending could increase ahead of the elections. Malaysian ringgit (MYR) is likely to remain stable at current levels while bond yields could rise due to higher growth expectations and supply risk.

Indonesia

We expect 2017 GDP to improve to around 5.3% due to recovery in infrastructure spending and private consumption which help to offset the drag from commodity exports. Government spending is expected to gain traction this year as the government approved a revised budget to widen the 2017 fiscal deficit to 2.9% of GDP from the 2.4% announced earlier. This increase in government spending would help to support growth. Private consumption is likely to be bolstered by improved consumer sentiment and rising business confidence, boosted by S&P's sovereign ratings upgrade in May. Export growth is likely to be driven by non-commodity goods. Inflation, which has risen gradually this year due to higher electricity tariffs and other administered process, is expected to average at around 4%, within Bank Indonesia's target range of 3%–5%. Given the benign inflation backdrop, monetary policy is expected to stay unchanged. Bond yields are expected to rise on profit-taking activities and increase in bond issuance. We expect Indonesia rupiah (IDR) to weaken to 13,500 against a backdrop of a stronger USD due to rate hike expectations in US.

