CIO Weekly

12 October 2021

Key Points

- **Equities:** The situation faced by China property developers will not lead to systemic contagion on the economy
- **Credit:** Bonds losing market share despite QE
- **FX:** Divergences in policy normalisation underpins DXY strength; Speculators turned net short EUR
- **Rates:** Balance of risks towards global rates tilted to the upside; US 10Y yields revised up to 1.80% this year before hitting 2.2% in 2022
- **Thematics:** Are refinancing risks a cause for concern in China Property?
- **The Week Ahead:** Keep a lookout for US change in initial jobless claims; Japan industrial production numbers

GLOBAL CROSS ASSETS

Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	34,496.06	-0.7%	12.7%
S&P 500	4,361.19	-0.7%	16.1%
NASDAQ	14,486.20	-0.6%	12.4%
Stoxx Europe 600	457.53	0.1%	14.7%
DAX	15,199.14	0.0%	10.8%
CAC 40	6,570.54	0.2%	18.4%
FTSE 100	7,146.85	0.7%	10.6%
MSCI AxJ	806.83	0.7%	-4.3%
Nikkei 225	28,498.20	1.6%	3.8%
SHCOMP	3,591.71	0.0%	3.4%
Hang Seng	25,325.09	2.0%	-7.0%
MSCI EM	1,265.65	0.7%	-2.0%
UST 10-yr yield*	1.61	0.0%	69.9
JGB 10-yr yield*	0.09	6.1%	7.0
Bund 10-yr yield*	-0.12	-19.7%	45.0
US HY spread*	2.95	0.0%	-65.0
EM spread*	326.43	0.0%	3.5
WTI (USD)	80.52	1.5%	66.0%
LMEX	4,455.10	2.1%	30.5%
Gold (USD)	1,754.15	-0.2%	-7.6%

Source: Bloomberg
* Changes in basis points

Equities: China banks unaffected by real estate developers

China real estate (RE) developers have come into the limelight of late, triggered by the looming risks of Evergrande (3333 HK) defaulting on its debts. In spite of the news flow and recent development surrounding the sectors, we are of the view that the difficult situation faced by some property developers will not lead to systemic contagion on other parts of the economy.

Against the backdrop of growing debt levels and stubbornly high land prices, the government has introduced measures to curb excessive lending to the property development sector and improve the financial health of developers, with the rollout of the "three red lines" guidance in August 2020. We view the criteria as prudent. They include:

1. Debt-to-asset cap at 70%
2. Net gearing ratio ceiling of 100%
3. Cash to short-term debt ratio of above 1x

As such, the net debt of the five largest listed RE developers has been falling since 1H 2020 as they have taken steps to manage their balance sheet quality.

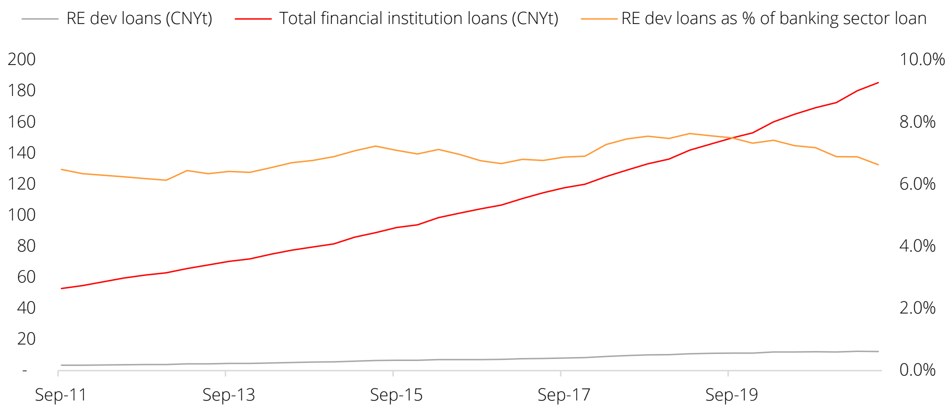
In reality, the banking sector's exposure to the RE development sector has been maintained at a manageable level. RE developers' total gross loans amounted to CNY12.3t as at 2Q, accounting for less than 7% of total banking sector CNY loan outstanding (Figure 1). We are cognisant that policymakers will remain supportive of the banking sector and take steps to prevent any contagion arising from real estate related issues.

The banking sector has mechanisms in place to guard against unexpected swings in asset quality. Since the middle of the last decade, banks have consistently maintained loan loss provisions between 180% and 190%. Banks have demonstrated their ability to maintain stable balance sheet quality despite economic volatility.

At 6-7% yield, China large banks are good long-term dividend yield plays supported by their commitment and ability to maintain healthy levels of dividend distributions. The payout ratio of 30% from net profit after tax is low by any measure and we expect this to be sustainable.

Yeang Cheng Ling | Strategist

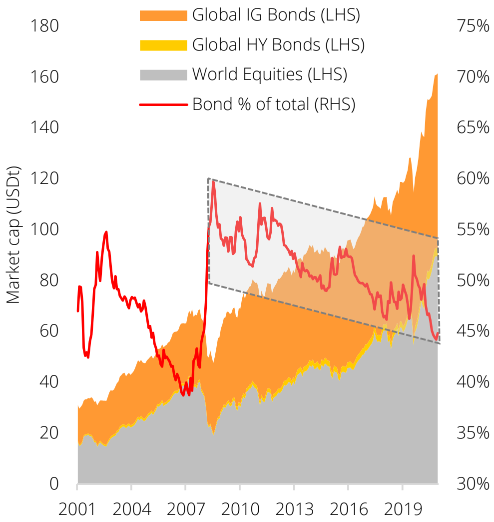
Figure 1: Banks' exposure in property development at manageable level



Source: Bloomberg, DBS

Credit: Bonds losing market share despite QE

Figure 2: Bonds losing market share despite QE



Source: Bloomberg, DBS

Despite the trillions of dollars that had flowed into bond markets over the last decade because of quantitative easing (QE), the market capitalisation of global bonds has continued to fall relative to equities since peaking in 2009 (Figure 2). Not even the colossal amounts of sovereign and corporate issuances during the 2020 pandemic could reverse this trend. What this demonstrates is that with bond yields trading close to zero (and some USD12b in negative territory), there are limits to how much further prices can appreciate without even more drastic central bank intervention. As central banks have signalled a more hawkish pivot while inflation looms on the horizon, it comes as no surprise then that bond prices have seen weakness in the last month – with the 10Y US treasury yield surging above 1.6%.

We believe that bond investors need to be prepared for a season where valuations and fundamentals would start to matter again, and not be caught up in a chase for yield that is not commensurate with the risks that one is taking. Moreover, with inflation consistently surprising on the upside in recent months, investors need to be mindful of lower yielding bonds that may not keep up with purchasing power (i.e. negative real returns). One should take the opportunity to rebalance and de-risk portfolios from such lower-yielding bonds, and redeploy proceeds into credit markets with more fair valuations (such as in Asia) while the opportunities exist.

Daryl Ho | Strategist

FX: Divergences in policy normalisation

Despite another big miss in US nonfarm payrolls, the US Dollar Index (DXY) ended last week at 94, underpinned by an increase in the US 10Y treasury yield above 1.60% for the first time since early June. This week, the FOMC minutes and many Fed speakers will reaffirm that the Fed will start tapering asset purchases at the FOMC on 3 November.

Table 1: Many Fed discussions on monetary policy this week

Fed official	12 Oct	13 Oct	14 Oct	15 Oct	16 Oct
Charles Evans	06:00				
Richard Clarida	**23:15**				
Raphael Bostic		00:30	22:00		
Thomas Barkin		06:00		01:00	
FOMC minutes			**02:00**		
Lael Brainard			**04:30**		
Michelle Bowman			08:00		
James Bullard			**08:35**	**23:45**	
Lorie Logan				00:00	
Mary Daly				**01:00**	
Patrick Harker				06:00	
John Williams					**00:20**

Source: Bloomberg, DBS. Time is SGT

Table 2: Fed has met significant criteria for taper

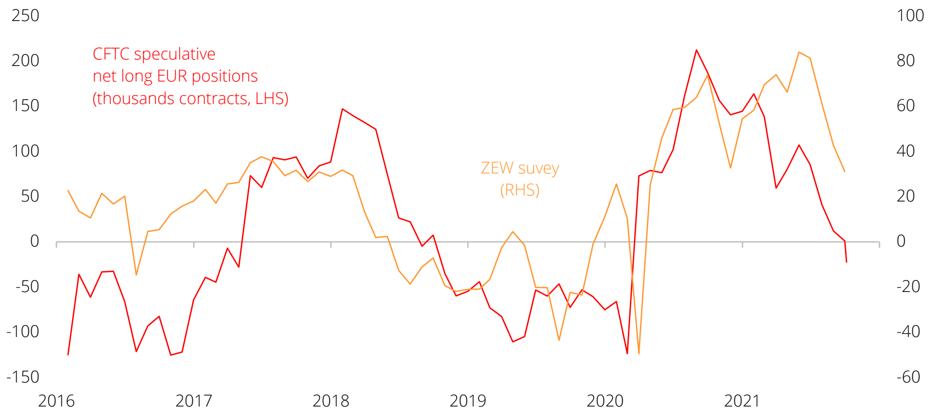
US indicator	Actual Aug-21	Actual Sep-21	Fed's forecast* 4Q21
Unemployment rate, %	5.2%	4.8%	4.8%
PCE deflator, % y/y	4.3%	--	4.2%
Core PCE deflator, % y/y	3.6%	--	3.7%

Source: Bloomberg, DBS. Time is SGT

Like it or not, the US unemployment rate and PCE deflator did hit the Fed's 4Q21 targets in its summary of economic projections. Core PCE deflator is not far behind especially after average weekly hour earnings continued to increase to 4.6% YoY in September from 4.0% in August. On 13 October, consensus expects CPI inflation to hold at 5.3% YoY for a second month in September, and core inflation to increase to 4.1% from 4.0%.

Speculators turned net short EUR for the first week since March 2020, convinced that the European Central Bank lacked the Fed's urgency to address what it considered to be transitory inflation. Today, ECB Chief Economist Philip Lane will reiterate that inflation was not accelerating in the Eurozone. On Tuesday, another slide in the ZEW Survey could trigger speculators to give up their gross long EUR positions.

Figure 3: EUR could extend its decline if ZEW falters again



Source: Bloomberg, DBS

In Asia, we expect the Monetary Authority of Singapore to end the neutral SGD NEER policy stance on 14 October. If so, the flat slope of the policy band will give way to a modest and gradual appreciation path of 0.5% a year. The centre and the width of the band will remain unchanged. Although Singapore is learning to live with the pandemic, there is no reason to do the same with inflation. CPI inflation has been firm at 2.4-2.5% y/y since May and averaged 1.8% in the first eight months vs the official inflation forecast of 1-2%. As witnessed in 2018, we see USD/SGD rising with the USD globally on a hawkish Fed for the rest of the year despite the return of an appreciating SGD policy. The rise of the SGD NEER to around 1% above the midpoint of the policy band had been better reflected by the SGD's strength against EUR, KRW, THB, PHP, and in recent weeks, against TWD, INR and JPY.

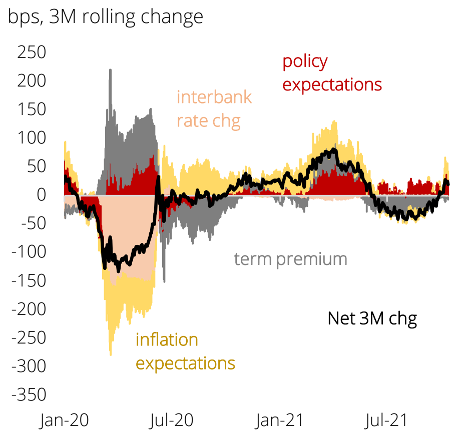
Philip Wee | FX Strategist

Rates: 10Y aiming for 1.80% next

10Y US Treasury yields hit our target of 1.6% last Friday despite the payroll miss (actual: 194k, consensus: 500k). Note that the headline figure masks underlying strength as net revisions brought in an additional 169k jobs while the largest detractor to payrolls was from the public sector (-117k). Meanwhile, the unemployment rate dropped to 4.8%. Reconciling the record job openings with somewhat weak jobs growth can be challenging. However, we think that the abundance of jobs, rapidly rising earnings suggests that supply side issues are at play. People may be unable or unwilling to work given current conditions, which may be pandemic related. These dynamics suggests that the labour market is "tight" even if total employment is about 5m below the pre-pandemic high. Seasonal adjustment also play role and have probably distorted headline nonfarm payrolls to the downside. Unadjusted figures put September's job gains at 654k and the total over the past two months at 1146k, more than sufficient for the Fed to announce taper in November.

We are revising up our USD rates forecasts and now expect 10Y yields to touch 1.80% this year before a milder drift to 2.2% in 2022. SGD and HKD rates forecasts have also been adjusted accordingly (see Figure 4).

Figure 4: Breakdown of changes in 10Y UST yield



Source: Bloomberg, DBS

Market, fundamentals, and the Fed are now aligning. We think that global growth is decent with reopening underway. Inflation is clearly more persistent than policymakers expect. These suggests that policy normalisation should get underway, if not already started. The Great Withdrawal from the Developed Markets space should start with taper, followed by rate hikes thereafter. The BOE, RBC, RBA, RBNZ, and Norges Bank have already embarked on normalisation with inflation a more pertinent challenge than growth.

We think that the balance of risks towards USD and global rates are tilted to the upside on the continued recovery picture. Note that the market has probably not digested President Biden's infrastructure and social spending bills that are likely to be passed (albeit watered down from the USD4t) later this year. The debt ceiling is an issue pushed to December, but in all likelihood, the Treasury will not run out of funds until January or February. The biggest downside risk to our view of higher rates is a deeper-than-expected slowdown in the Chinese economy. The biggest upside risks to our view are the unhinging of inflation expectations.

Our strategy for USD rates remains unchanged and we prefer to pay on dips, spread across the 3Y,5Y,7Y, and 10Y tenors. With taper imminent, we think that the focus would soon shift towards the timing, pace and terminal Fed funds rate, putting more upward pressures on the intermediate tenors. We still believe that cyclical curve flattening would take place over the coming few quarters.

Eugene Leow | Rates Strategist

Thematics: China Property – Are refinancing and liquidity risks sector-wide concerns?

- Only five of 35 Chinese developers we track have more than two sizeable repayments due in the next six months
- China's property sector can still tolerate a 17 ppt decline in average cash collection vs 1H21 in the extreme case that refinancing channels are shut
- We like names that have superior financial strength and are poised to outperform on land acquisitions

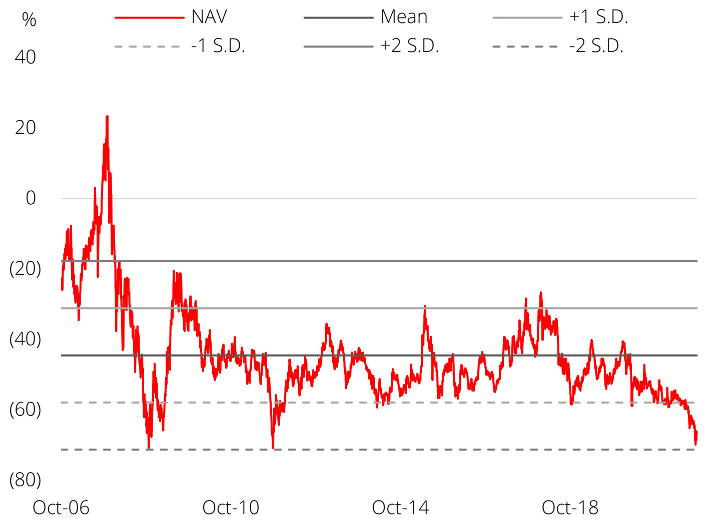
Should we be worried about Chinese developers' offshore refinancing risks? Only for a few selected names. Having analysed the offshore bond principal and interest repayment schedules for the developers we track, only five out of 35 (including Evergrande (3333 HK) and Fantasia (1777 HK)) have more the two sizeable repayments (>USD100m) to be made in the next six months. These are the outliers that would be subject to higher refinancing pressure. Contrary to market scepticism, Sunac China (1918 HK) made the safe list with no substantial repayments due up to April 2022, together with other safe names such as Longfor (960 HK) and COLI (688 HK). Kaisa (1638 HK) and Ronshine (3301 HK) might face higher refinancing pressure which may warrant investor attention.

What about overall liquidity risk on a fundamental standpoint? Largely manageable. Our short-term debt coverage analysis suggests that in the event all refinancing channels are shut, most developers will still be capable of repaying their short-term debts twice over after settling normal operating expenses – as long as they can: 1) secure the same cash collection level vs 1H21; and 2) put a halt on land purchases. There is on average a 17 ppts buffer on cash collection vs 1H21 before the sector runs into severe liquidity risk. Country Garden (2007 HK) and COLI are the best performers and can tolerate >3.5mths of mortgage delay or >40% drop in cash collection under our extreme case.

Opportunity to accumulate quality names with strong liquidity positions. While share price volatility in the sector will likely continue in the near term due to concerns over developers' liquidity and refinancing risks, DBS Group Research remains optimistic on the sector given its improved policy risk profile. We recommend that investors watch for entry opportunities during this wave of volatility to accumulate quality names. COLI, Logan (3380 HK), and Country Garden are some noteworthy names with strong balance sheets and capacity for land acquisitions to underpin future presales growth.

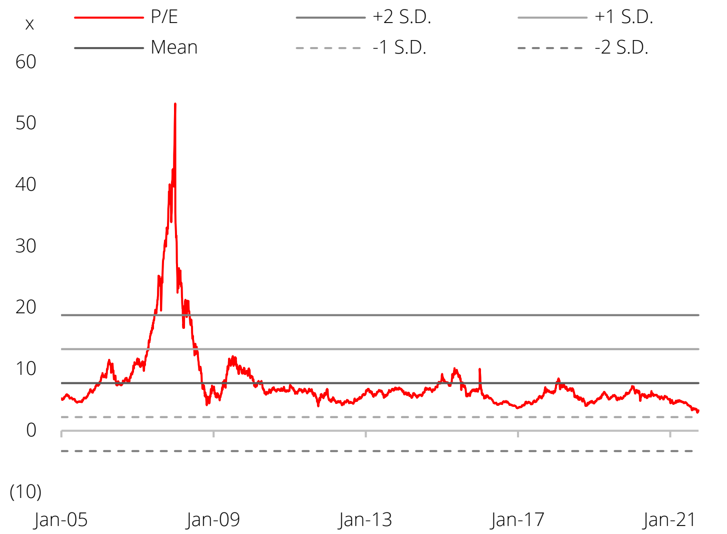
Danielle WANG | Analyst
Ken HE | Analyst
Jason LAM | Analyst
Zoe Zhang | Analyst
Ben Wong | Analyst

Figure 5: Discount to net asset value (NAV)



Source: Thomson Reuters, DBS

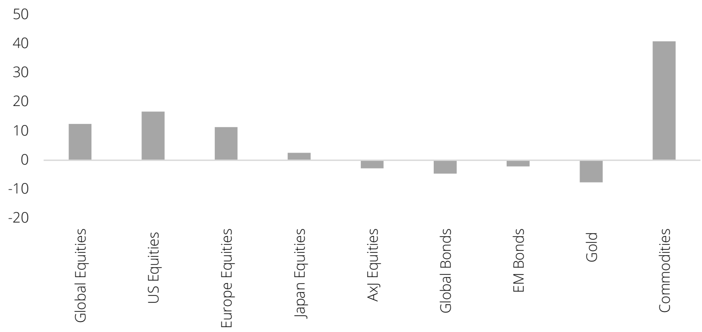
Figure 6: Price-to-earnings chart



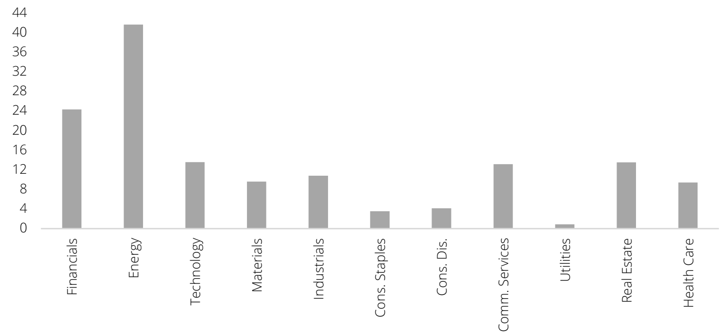
Source: Thomson Reuters, DBS

CIO Markets Watch

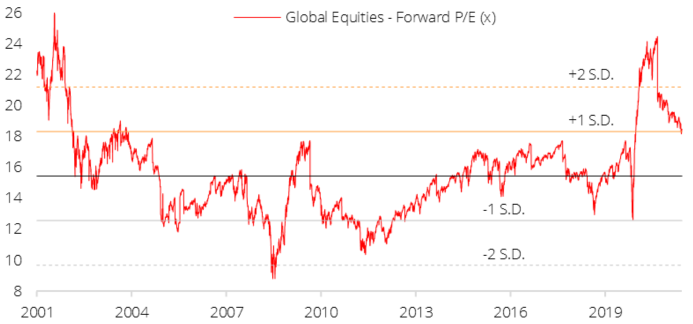
Global Cross Assets YTD Returns



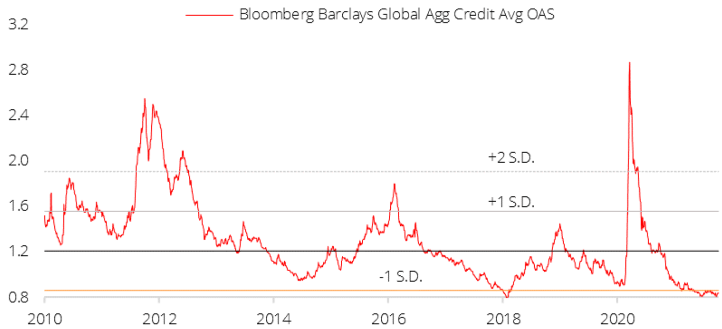
Global Sector YTD Returns



Global Equity Valuation



US Corporate Spreads



INDEX RETURNS

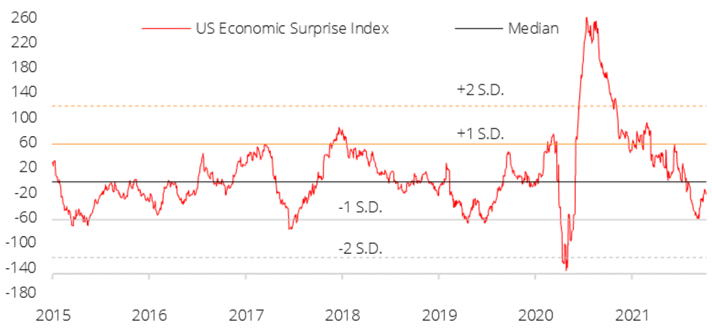
	1 week	MTD	QTD	YTD
Equities				
S&P 500	1.4%	1.2%	1.2%	16.1%
NASDAQ	1.6%	0.3%	0.3%	12.4%
Russell 2000	0.1%	0.7%	0.7%	12.4%
Stoxx Europe 600	1.5%	0.6%	0.6%	14.7%
Nikkei 225	0.2%	-3.2%	-3.2%	3.8%
MSCI WORLD	1.3%	0.8%	0.8%	12.7%
MSCI ACWI	1.4%	0.9%	0.9%	10.7%
MSCI Asia ex-Japan	2.3%	0.7%	0.7%	-4.3%
MSCI EM	2.4%	1.0%	1.0%	-2.0%
HSCEI	5.6%	3.1%	3.1%	-16.2%
SHCOMP	0.7%	0.7%	0.7%	3.4%
Hang Seng	5.4%	3.0%	3.0%	-7.0%
STI Index	0.8%	0.9%	0.9%	9.5%
Fixed Income				
Barclays Global Aggregate	-0.9%	-0.6%	-0.6%	-4.6%
Barclays US Aggregate	-0.7%	-0.5%	-0.5%	-2.0%
Barclays US High Yield	-0.3%	-0.3%	-0.3%	4.2%
Barclays Euro Aggregate	-0.6%	-0.5%	-0.5%	-2.7%
Barclays Euro High Yield	-0.5%	-0.5%	-0.5%	3.7%
JPM EMBI Global	-0.5%	-0.6%	-0.6%	-2.1%
JPM EMBI Global Diversified	-0.5%	-0.6%	-0.6%	-2.6%

PRICES & SPREADS

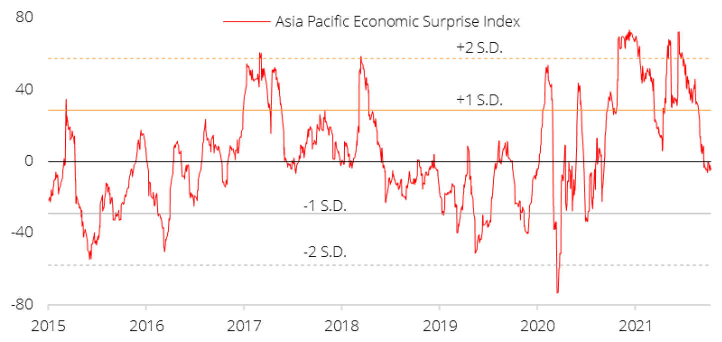
	Spot	3Q21	2Q21	4Q20
Rates				
Fed Funds Target	0.25	0.25	0.25	0.25
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00
BOJ Policy Balance Rate	-0.10	-0.10	-0.10	-0.10
US Treasury 10-yr	1.61	1.49	1.47	0.92
Japanese Govt Bond 10-yr	0.09	0.07	0.05	0.02
German Bunds 10-yr	-0.12	-0.20	-0.21	-0.57
Spreads				
US Agg Corporate Spread	0.86	0.84	0.80	0.96
US Corporate HY Spread	2.95	2.89	2.68	3.60
Euro Agg Corporate Spread	0.89	0.87	0.86	0.95
EM USD Agg Spread	2.88	2.87	2.57	2.68
Currencies				
US Dollar Index (DXY)	94.3	94.2	92.4	89.9
EUR/USD	1.16	1.16	1.19	1.22
USD/JPY	113.3	111.3	111.1	103.3
USD/CNY	6.5	6.4	6.5	6.5
Commodities				
WTI Oil	81	75	73	49
London Metal Exchange (LMEX)	4455	4161	4152	3415
TR/CC CRB Commodity	236	229	213	168
Gold	1754	1757	1770	1898

CIO Economics Watch

US Economic Surprise Index



Asia Pacific Economic Surprise Index



MACRO CALENDAR

	Date	Period	Survey	Prior
United States & Eurozone				
Initial Jobless Claims (US)	14-Oct	09-Oct	320k	326k
CPI m/m (US)	13-Oct	Sep	0.30%	0.30%
U. of Mich. Sentiment (US)	15-Oct	Oct	73.5	72.8
Retail Sales Advance m/m (US)	15-Oct	Sep	-0.20%	0.70%
MBA Mortgage Applications (US)	13-Oct	08-Oct	--	-6.90%
Industrial Production m/m (US)	18-Oct	Sep	0.20%	0.40%
PPI Final Demand m/m (US)	14-Oct	Sep	0.60%	0.70%
Empire Manufacturing (US)	15-Oct	Oct	25	34.3

MACRO CALENDAR

	Date	Period	Survey	Prior
Asia				
Industrial Production m/m (JP)	14-Oct	Aug	--	-3.20%
GDP y/y (CN)	17-Oct	3Q	5.00%	7.90%
CPI y/y (CN)	13-Oct	Sep	0.80%	0.80%
Core Machine Orders m/m (JP)	12-Oct	Aug	1.40%	0.90%
Non-oil Domestic Exports y/y (SG)	17-Oct	Sep	--	2.70%
Tertiary Industry Index m/m (JP)	15-Oct	Aug	--	-0.60%
PPI y/y (CN)	13-Oct	Sep	10.50%	9.50%
GDP y/y (SG)	13-Oct	3Q	6.60%	14.70%