Sovereigns – Asia Pacific:

2019 outlook stable as domestic strengths counter rising external, policy uncertainties

RESEARCH PUBLICATION

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Contents

1. Solid fundamentals underpin credit quality Slide 6
2. US-China tensions to weigh on growth prospects, with further downside risks Slide 9
3. Tighter global financing conditions raise debt affordability and government liquidity risks Slide 12
4. Risk of credit-negative shifts in policy priorities in parts of APAC Slide 14

Key messages

1 Solid fundamentals, including rising incomes and competitiveness, generally ample foreign exchange reserves and often sizeable domestic savings, will underpin credit quality

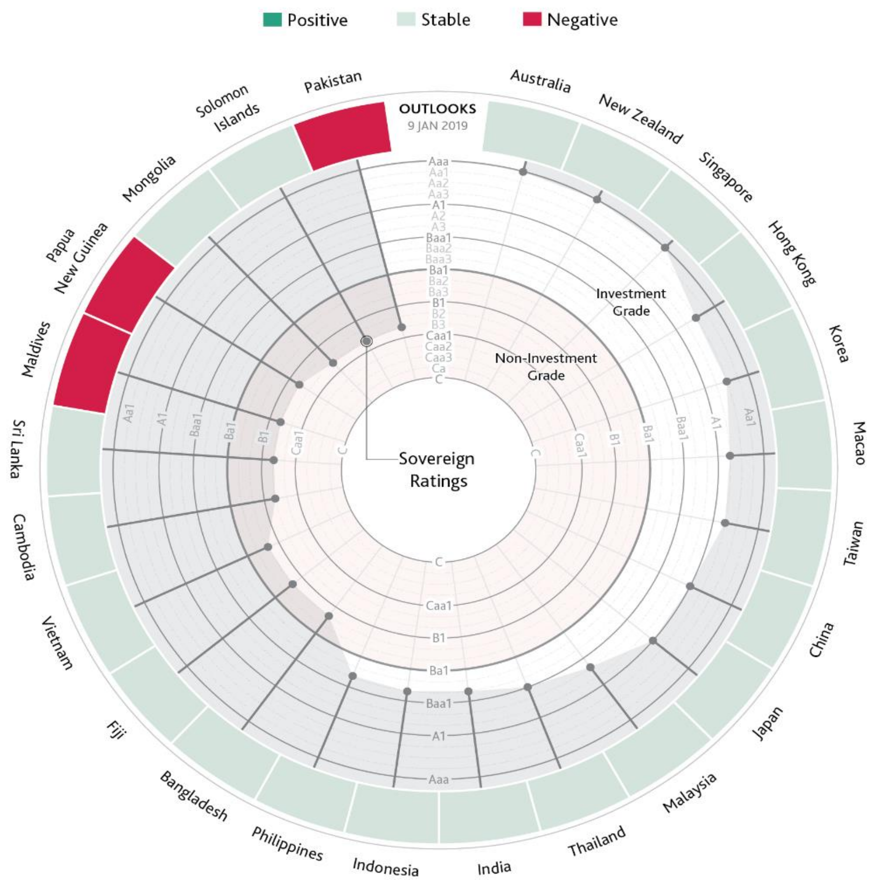
2 Ongoing US-China tensions will weigh on near-term growth; structurally lower investment would hurt medium-term growth potential

3 Tighter global financing conditions raise debt affordability and government liquidity risks, particularly for some frontier markets

4 Shifts in domestic policy priorities pose varied risks, including slower fiscal consolidation, obstacles to addressing long-standing financial-sector weakness, lower near-term investment as focus on social equity raises costs

Stable outlook for APAC sovereigns

Most APAC sovereign ratings carry stable outlooks, but three have negative outlooks
(As of 9 January 2019)



Source: Moody's Investors Service

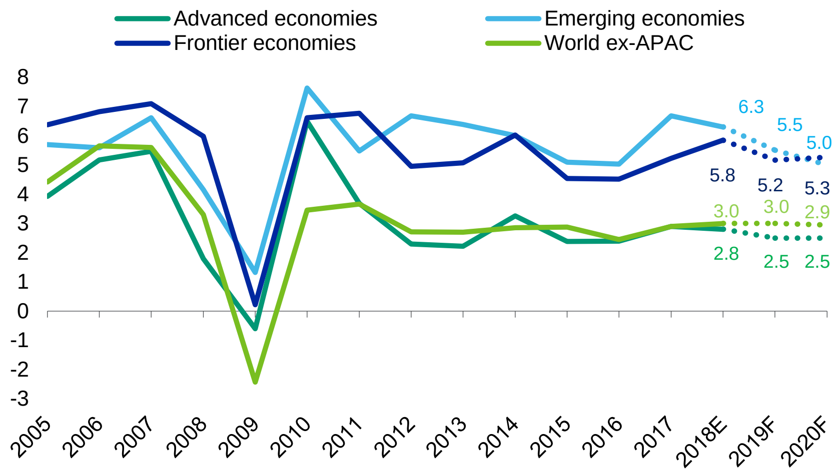
1

Solid fundamentals underpin credit quality

APAC growth is slowing, but domestic fundamentals provide support

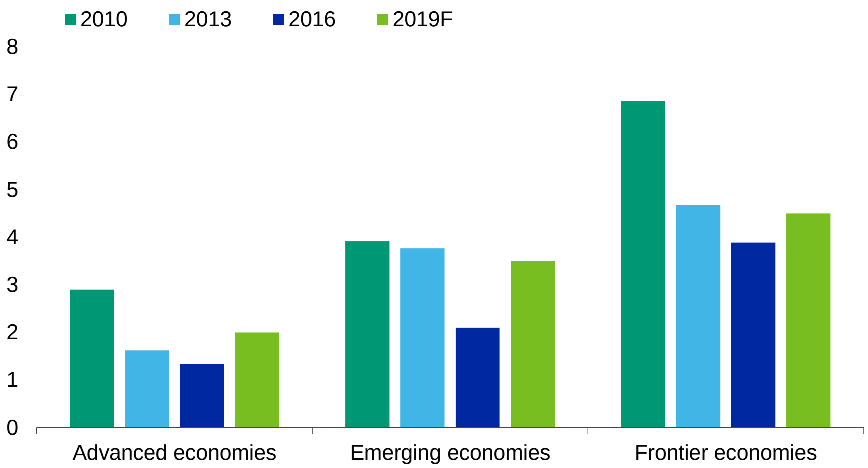
- » Slowdown most pronounced in emerging and frontier markets, but rising incomes, infrastructure investment will underscore robust growth.
- » Monetary policy to remain accommodative in advanced economies with inflation still benign.

Growth will decelerate in 2019 as global trade slows
(Annual percentage change in real GDP, median for each group)



Source: Moody's Investors Service

Inflation will increase from low levels but remain benign
(Annual percentage change in CPI, median for each group)

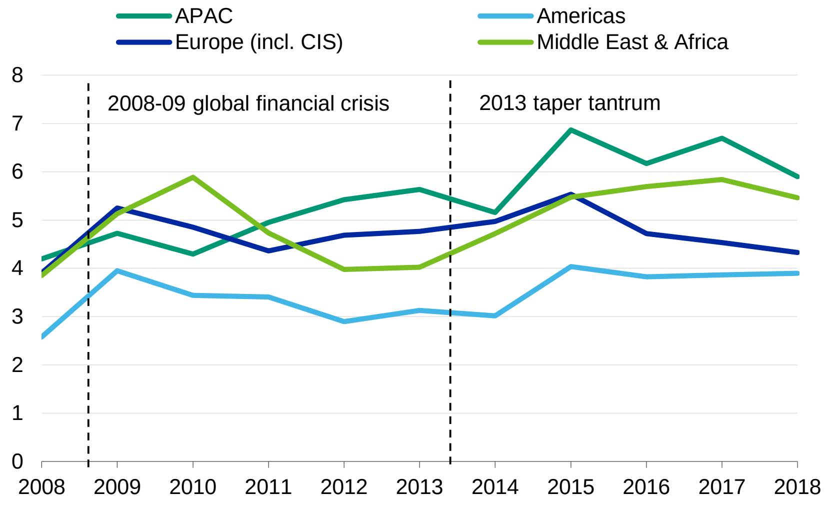


Source: Moody's Investors Service

External buffers are large, and domestic investor base is generally sizeable

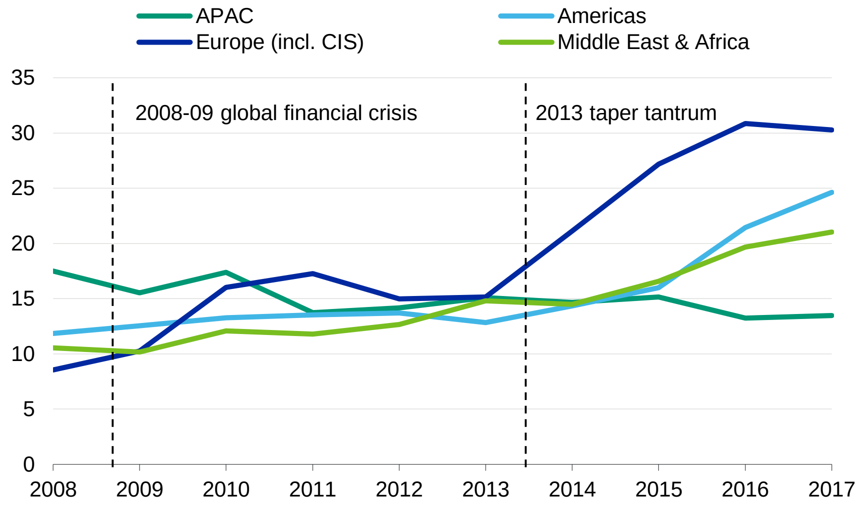
- The build-up in foreign exchange reserves and relatively low external debt on average in APAC shelters the region from the impact of tighter global financing conditions.
- Exposure is concentrated in some frontier markets.

APAC foreign reserves coverage of imports highest globally
(Number of months of imports, median for emerging and frontier markets in each region)



Sources: National authorities, Moody's Investors Service

APAC government external debt is lowest globally and remains modest
(% of GDP, median for emerging and frontier markets in each region)



Sources: National authorities, Moody's Investors Service

2

US-China tensions to weigh on growth prospects, with further downside risks

Regional trade integration amplifies spillovers of US-China tensions

Trade and investment restrictions

Slower GDP, export, import growth in China

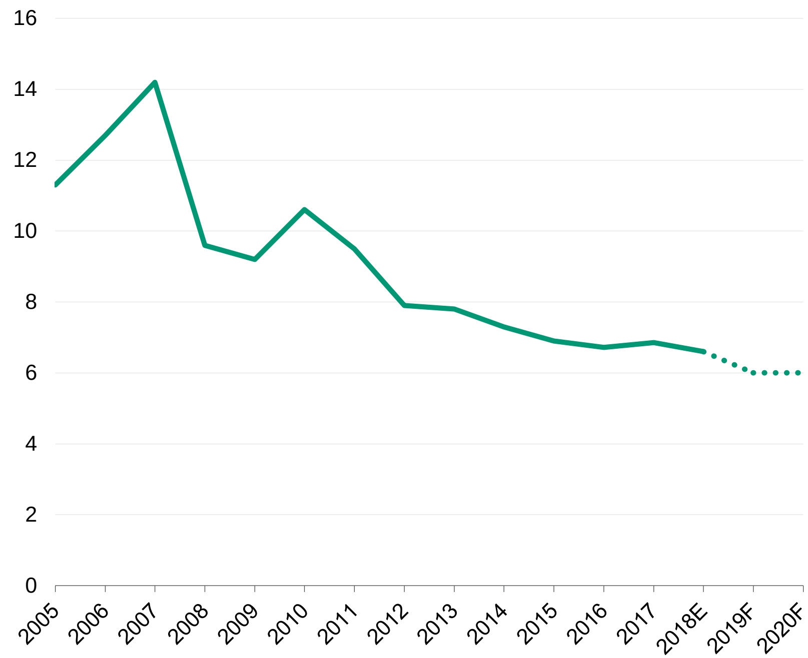
Lower exports to serve China's final demand

Lower exports to supply parts in Chinese exports to the US

Lower investment and consumption

Source: Moody's Investors Service

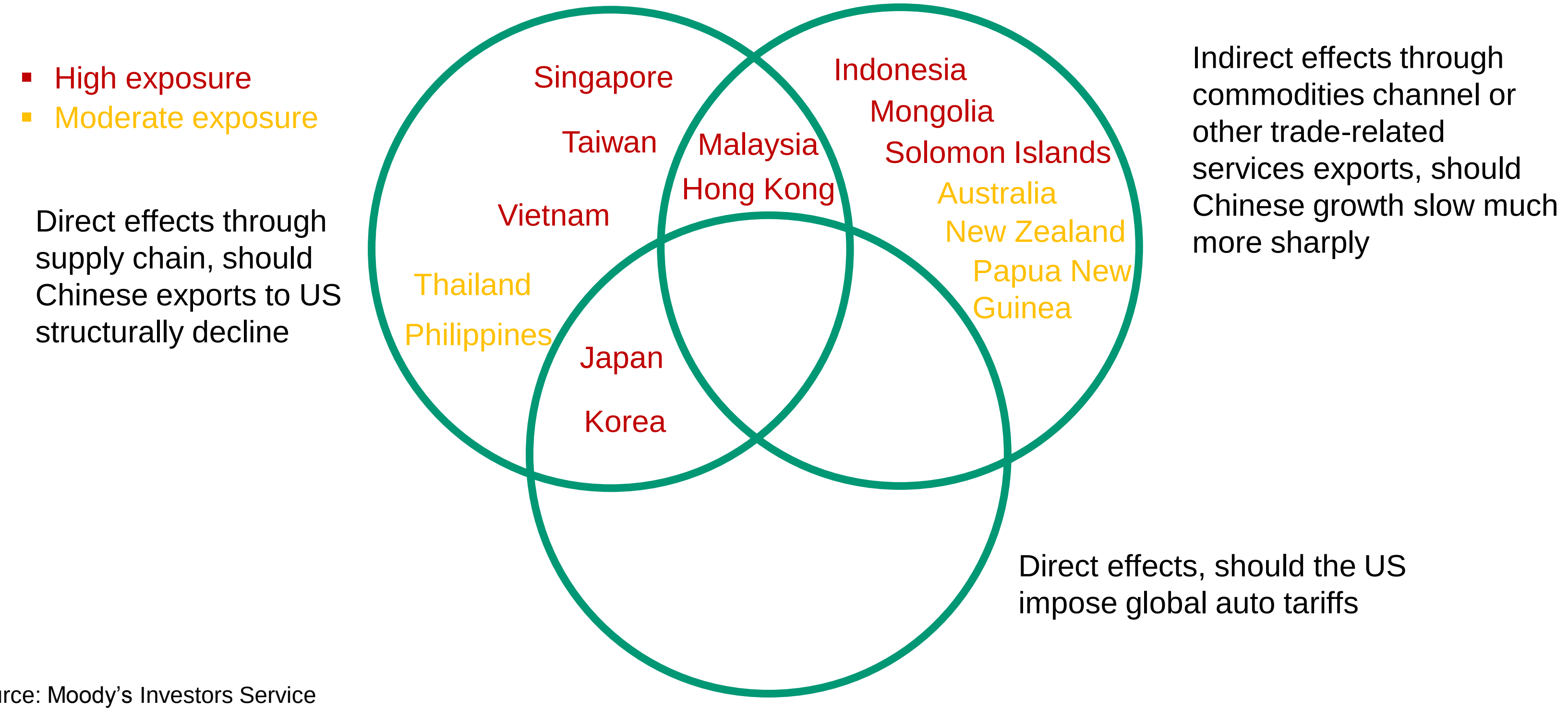
Slowing growth in China
(Annual percentage change in real GDP)



Source: Moody's Investors Service

Hong Kong and supply chain economies most exposed to lower Chinese exports

- Commodity exporters vulnerable to slower-than-expected Chinese growth.
- Some supply chain economies could benefit from substitution effects if US demand shifts, but supply chains do not evolve overnight.



Source: Moody's Investors Service

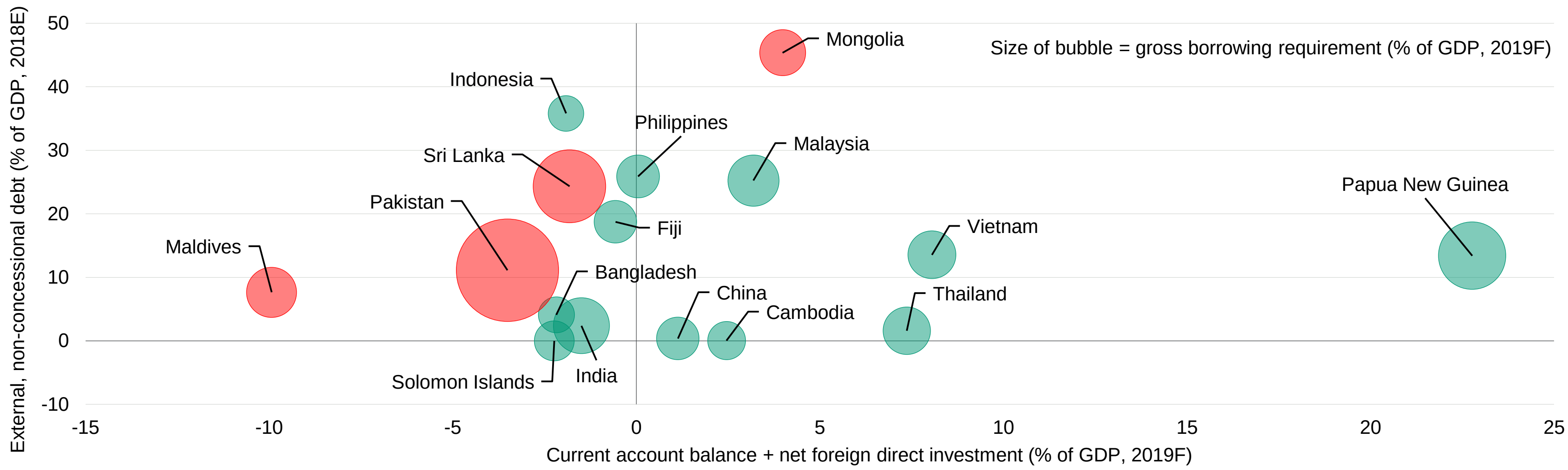
3

Tighter global financing conditions raise debt affordability and government liquidity risks

Some frontier markets vulnerable to tightening external financing

- Foreign reserve adequacy in Pakistan and Sri Lanka is low; gross borrowing requirements are high.
- Mongolia is reliant on external borrowing, while current account deficit in Maldives is wide.

The Maldives, Mongolia, Pakistan and Sri Lanka are particularly vulnerable to shifts in external financing conditions



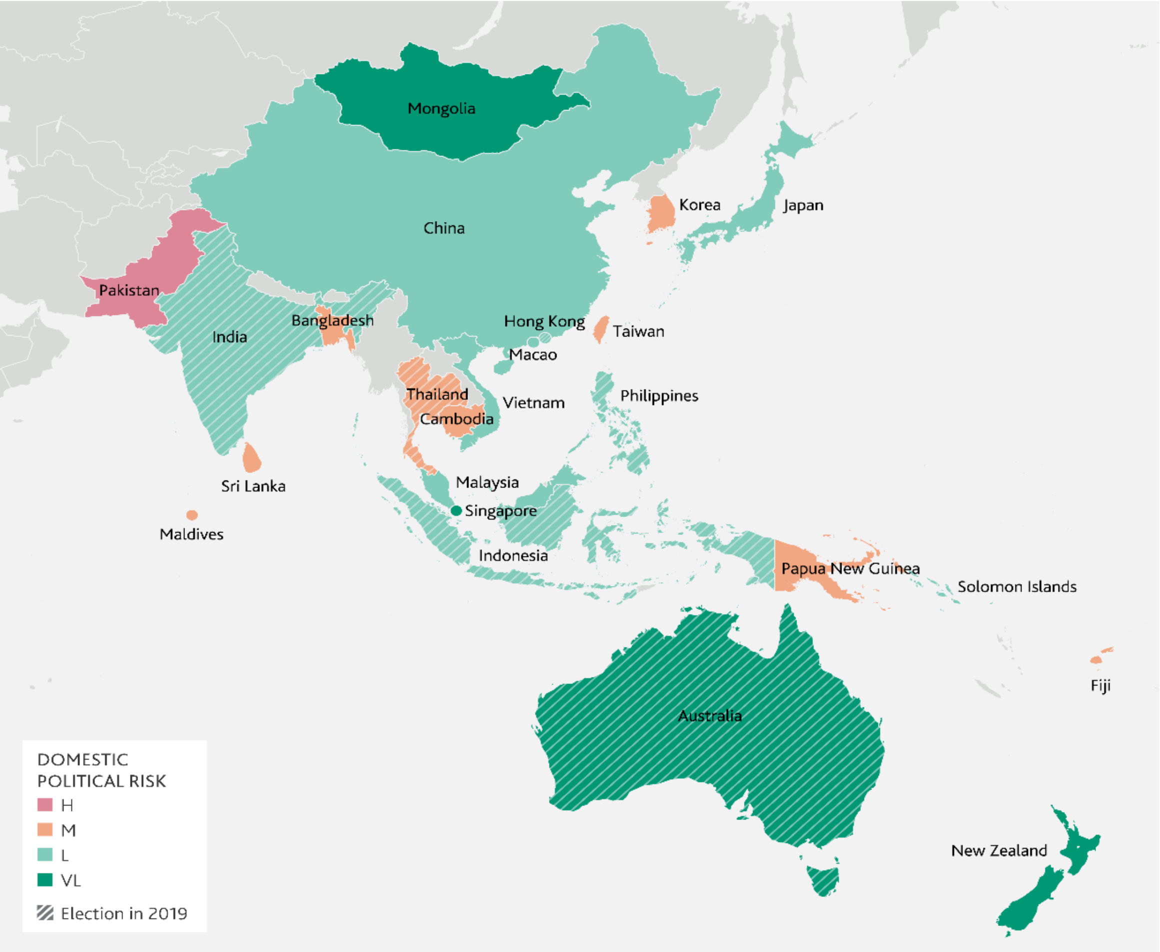
Source: Moody's Investors Service

4

Risk of credit-negative shifts in policy priorities in parts of APAC

2019 elections unlikely to result in significant policy shifts

» Domestic political risk is generally moderate to low where elections are scheduled to take place.



Sources: Moody's Investors Service

Changes in domestic priorities could, however, have credit-negative implications

» **Fiscal challenges** have increased most notably in Malaysia and Sri Lanka, in different contexts.

» **Banking and financial sector challenges** are intertwined with politics in Bangladesh, India and Vietnam.

» **Social policy tilt** in Japan and Korea, while fostering more inclusive growth, could weigh on near-term economic activity.

Global credit conditions to weaken amid slowing growth and rising risks

Credit risks will build in 2019 as economic growth slows, funding costs rise, liquidity tightens and market volatility returns. Trade tensions and growing geopolitical risks will likely escalate and have significant sector and regional impacts. Advances in digital technologies could trigger productivity improvements as well as business disruptions, while the ESG issue that is most likely to materially influence credit in 2019 is carbon transition risk.