

ECONOMICS: ASIAN PERSPECTIVES

# MODEST REACTION SEEN IN ASIA AFTER BOJ'S NEGATIVE RATE MOVE

+ Anthony Chan, Asian Sovereign Strategist—Global Economic Research, anthony.chan@abglobal.com

Asian central banks are unlikely to emulate the Bank of Japan's negative rate policy, at least for now. But they may ease sooner than previously thought, given that real interest rates have been too high to start with. Likewise, their currencies may track the yen, given the upward pressure on the US dollar resulting from the BoJ action.

**Ripple Effect**

The Bank of Japan's (BoJ) announcement of a negative-interest-rate policy stunned Asian capital markets and raised a number of questions. Will it set off more easing and currency weakness in the region? Will more Asian central banks move to negative rates? Is there portfolio action we should be taking?

We think the likelihood of other Asian central banks following suite remains remote, since nominal rates across the region are still well above zero.

Still, as the BoJ's policy move pushed the yen and Japanese government bond (JGB) yields lower, the pressure on central banks across Asia to cut interest rates has increased, as has the pressure on their currencies.

After all, as we have been arguing for some time, real interest rates—nominal rates minus the inflation rate—in most Asian countries are too high, given the current economic slowdown (*Display 1*).

We have been forecasting lower bond yields and weaker currencies across the region on a six-month horizon, and the BoJ's action has only increased the risk

that these will happen sooner than later, particularly as gradual US Federal Reserve rate hikes have already been priced in.

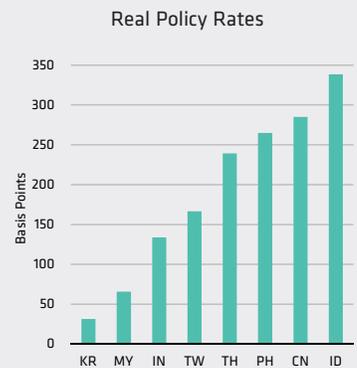
**Ripe for Rate Cuts**

The most appealing market is Indonesia's local-currency bonds, given their high nominal and real yields. India is next, but we expect the Reserve Bank of India to hold steady in our base-case scenario because of the need to maintain reasonably tight real rates to ensure the credibility of its inflation-targeting policy.

China, too, has some room to cut the one-year benchmark lending rate. But a recently leaked document suggests that the People's Bank of China (PBOC) is worried about cutting the reserve requirement ratio and interest rates too aggressively, as that may accelerate capital outflows and exacerbate the downward pressure on the renminbi (RMB). Therefore, the central bank may prefer using open market operations and high-frequency liquidity adjustments to directly control the quantity of money.

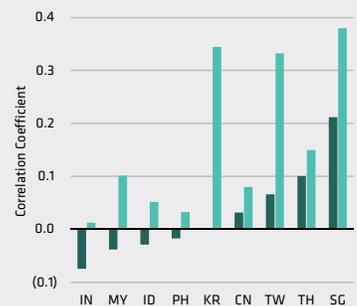
The country which has a lot of similarity with Japan is South Korea—an aging population, slowing structural growth, low

Display 1  
Real Rates Remain High in Most of Asia



As of February 1, 2016  
 KR = South Korea, TH = Thailand, TW = Taiwan, MY = Malaysia, PH = Philippines, CN = China, IN = India, ID = Indonesia  
 Source: CEIC Data and AB

Display 2  
Asian Yields, Currencies Poorly Correlated with Japan's



As of February 1, 2016  
 Source: CEIC Data and AB

nominal and real rates and a large current account surplus. But we don't think the Bank of Korea's (BOK) inherently reactive stance on monetary easing will change. Even so, we expect the pressure from the BoJ's actions to increase the odds for an earlier-than-expected BOK rate cut.

Taiwan is moving in the same direction as South Korea and Japan, but on a less pronounced scale. The central bank has always been conservative, and changes have come gradually.

### US Dollar Strength

Currencywise, the yen's renewed weakness against the US dollar, which also prompted the euro's depreciation against the greenback, will likely keep an upward pressure on the US currency against its trade-weighted basket. This likely means more downward pressure on Asian currencies, particularly the RMB.

There are many questions on what China might do with its currency after the BoJ's negative rate move. Many investors fear that this could increase the odds of a major RMB devaluation and an economic disaster. They believe China may be the next "credit event" in the world market.

While this argument cannot be entirely thrown out of the window, we think that a more likely outcome is that China closes its

capital account further to defend currency stability. There is already some evidence of this in various capital-flow and investment channels over the past weeks.

Many leading policymakers around the world, including the head of the International Monetary Fund, have warned against China's intervention to prop up the RMB, saying it was wasting its reserves. But they have been conspicuously quiet about Beijing's move to gradually close the capital outflow channels. There has been no criticism that such a move would jeopardize the RMB's reserves currency status.

### Risk/Reward Propositions

The risk/reward for shorting the RMB does not look attractive to us. On the other hand, those for receiving local rates in Indonesia and South Korea are the most attractive, even with the currency exposure hedged.

Historically, Asian yields and JGB yields have shown low correlation, as have Asian currencies and the yen (*Display 2*). Interestingly, however, South Korean bond yields have been fairly highly correlated with Japan's lately—more so than the won has been with the yen. This may sound counterintuitive, given the close export competition between the two countries,

but the won has appreciated significantly against the yen over the past few years, depressing the correlation.

Elsewhere, shorting the Singaporean dollar and the Taiwanese dollar as funding currencies for US dollar portfolios continues to look reasonable. India will remain a stand-alone market in both the interest rate and currency markets, owing to its low correction with Japan.

In China, the PBOC has been maintaining a strong RMB fixings in recent weeks, and the CFETS basket index has remained generally quite stable. We still expect no RMB devaluation, but we anticipate that a continued modest easing in local yields in the next six months.

We have been waiting for Japanese money to flow into Asian markets in search of higher yields, ever since the second round of the BoJ's bazooka easing in October 2014. But the flow has mainly gone to the US and, to a less extent, Europe. Japanese gross portfolio flows into Asia have totaled only US\$16 billion since Oct 2014, substantially smaller than US-bound funds, at US\$123 billion. We don't think the negative-rate policy will make a marked change to this trend. ■

---

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

Note to Canadian Readers: AllianceBernstein provides its investment management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc.

Note to European Readers: This information is issued by AllianceBernstein Limited, 50 Berkeley Street, London W1J 8HA. Registered in England, No. 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA).

Note to Austrian and German Readers: This information is issued in Germany and Austria by AB Europe GmbH. Local paying and information agents: Austria—Uni-Credit Bank, Austria AG, Schottengasse 6-8, 1010 Vienna; Germany—BHF-Bank Aktiengesellschaft, Bockenheimer Landstrasse 10, 60323 Frankfurt am Main.

Note to Swiss Readers: Swiss Representative and Swiss Paying Agent: BNP Paribas Securities Services, Paris, succursale de Zürich. Registered office: Selnaustrasse 16, 8002 Zürich Switzerland, which is also the place of performance and the place of jurisdiction for any litigation in relation to the distribution of Shares in Switzerland. The Prospectus, the key investor information documents, the Articles or management regulations and the annual and semi-annual reports of the concerned fund may be requested without cost at the offices of the Swiss representative.

Note to Australian and New Zealand Readers: This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia) or the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice.

Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India: This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

Note to Readers in Malaysia: Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

Note to Singapore Readers: This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). ABSL is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore to conduct regulated activity in fund management and dealing in securities. AllianceBernstein (Luxembourg) S.à r.l. is the management company of the portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. This document has not been reviewed by the MAS.

Note to Taiwan Readers: AllianceBernstein L.P. does not provide investment advice or portfolio-management services or deal in securities in Taiwan. The products/services illustrated here may not be available to Taiwan residents. Before proceeding with your investment decision, please consult your investment advisor.

Note to Hong Kong Readers: This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited (聯博香港有限公司), a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission.