MACROECONOMIC UPDATE

DECEMBER 2019

PEFINDO
CREDIT RATING AGENCY

RECESSION RISKS ARE RECEDING, BUT WE STILL FACE UNCERTAINTY

PEFINDO is of the view that the threat of a recession in 2020 has receded, mainly due to the normalization of the yield curve and the progress in the trade negotiations between the United States of America (US) and China. However, there are still uncertainties ahead. The US and other countries may have their own respective risks, and interconnected geopolitical threats and other non-economic risks need to be navigated in order to take advantage of more opportunities in 2020.

POSSIBILITIES FOR THE US ECONOMY

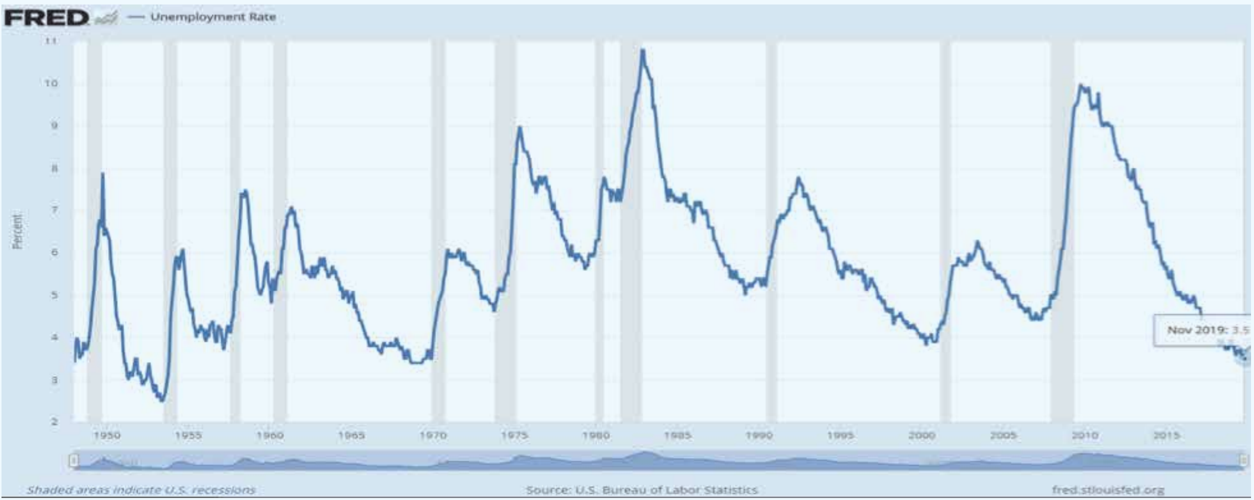
Recession fears were at their highest levels in mid-2019, when the two-year US government bond yield rose higher than the 10-year bond in what is known as an inverted yield curve. That suggests that investors foresaw higher risk in the future. At the same time, an inverted yield curve has preceded the past five recessions, including the most recent slowdown between 2007 and 2009.

However, since the 10-year Treasury yields climbed back above the two-year yields in September and above the three-month rates in October, recession worries have abated. As of early December 2019, S&P Global Ratings is estimating the chance of a US recession in the next year to be between 25%-30%, versus 30-35% in its August 2019 projections. Bank of America's official statement in December also places the probability of a recession in the next year at just 18 percent, much lower than its August prediction of more than a 30 percent chance.

The improvement of trade deal talks between the US and China in December has likewise made the threat of a recession in 2020 recede. At the same time, the US – Mexico – Canada Agreement (USMCA) will be ratified shortly. Both trade deals are expected to positively contribute to US economic growth, which could also build business confidence and positive market sentiment for the global economy.

But uncertainties remain. Wells Fargo's head of real asset strategy, John LaForge, has been quoted as saying: "Although recession is a low probability, but we are almost 11 years into an economic expansion, the longest in history and we are inching closer to that probability". The Wolters Kluwer survey of 51 economists projected that the US economy will only grow an average of 1.8% year-on-year (yoy) in 2020, down from 2.3% yoy this year and a healthy 2.9% yoy in 2018 that matched a post-recession high. At the same time, the large tax cuts in the US for mostly big corporations and high-income households aimed at generating the jobs needed to keep unemployment low and to trigger a more sustainable growth on the contrary made the US goverment struggle with trillion-dollar budget deficits and an increasingly heavy debt load. If the US economy were to slow any further, for whatever reason, then unemployment would begin to rise and recession becomes more likely to happen sooner.

FIGURE 1.
US UNEMPLOYMENT RATE



Source: *Fed St.Louis (2019)*

Nevertheless, we need to keep in mind that the US presidential election will take place in 2020, and that since 1900, there has only been one recession, in 1948.

GLOBAL ECONOMIC RISKS

The recovery of the US economy will hopefully push the global economy in the same direction. Besides the trade deal, global manufacturing surveys started to recover in mid-2019, and most central banks around the world are still in accomodative policy stances. These made global recession risks seem low. The Fulcrum Nowcast Model, which measure uncertainty, shows the recent recession risk of the US currently standing about 5% and for the eurozone 15%.

But individual countries may have different degrees of exposure to their own respective risks. The main uncertainties in the European Union (EU) come from Brexit, slowing economic growth — especially dragged down by the slowdown of Germany, and uneven recovery of EU countries from the 2008 financial meltdown that could pull the world into a new recession.

FIGURE 2.
SIZES OF CORPORATE LOCAL CURRENCY BOND MARKET IN ASIA

FIGURE 2.1.
IN PERCENT OF GDP

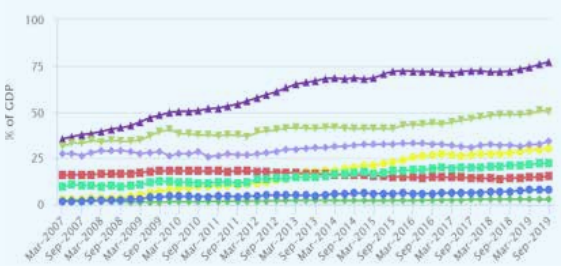
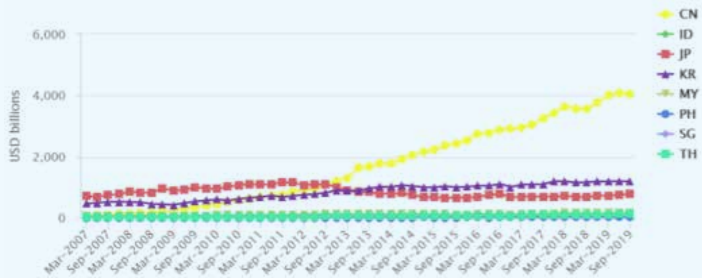


FIGURE 2.2.
IN USD BILLION



Noted: *CN – China; ID – Indonesia; JP – Japan; KR – Republic of South Korea; MY – Malaysia; PH – The Philippines; SG – Singapore; TH – Thailand.*
Source: *Asians Bond Online - ADB (2019)*

Meanwhile, Asia faces China's new normal growth, as well as domestic challenges such as massive public, household, and corporate debt (300 percent of gross domestic product) and aging demographics (labor shortages, pension, and healthcare demands). At the same time, falling interest rates in Asia also made the median total debt-to-total equity for non-financial companies in the MSCI Asia Pacific Index reach about 44% in the first nine months of 2019, slightly higher than the 41% seen in 2007 — before the global financial crisis. The highest median debt-to-equity levels by country are dominated by the firms domiciled in Macau, Thailand and the Philippines. But the good thing is the increasing rates are mostly used to invest in new projects as trade tensions ease.

Aside from economic issues, interconnected geopolitical threats – such as the Middle East, the Korean Peninsula, and the South China Sea problems – as well as protectionism, digital disruption, climate change, political violence, and other forces of disruption have introduced unprecedented levels of volatility for the economy and for businesses to navigate. This means we need to prepare for global risks in 2020 and the possibility of a recession, and navigate them to grab more opportunities.