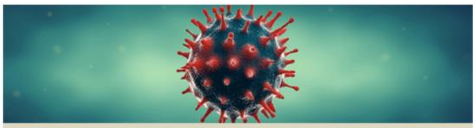
Special risk survey: HK, Japan, Singapore buffeted by coronavirus, as Taiwan shows 'counter-intuitive' strengths

Jeremy Weltman Friday, February 21, 2020

Euromoney asked its panel of Asia analysts to assess the effects on investor risk of the novel coronavirus (Covid-2019) disease outbreak. This, the second of two reports on the results, looks at investor domains in Asia beyond China.

Taiwan's risk score is still on track, while other areas of Asia, including Hong Kong (above) are feeling the effects of coronavirus



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Euromoney conducted its special 'crowd-sourcing' survey among a subset of its normal contributor universe who are all experts on political, economic and financial risk in Asia.

The results revealed one surprise. Taiwan's risk score has increased even more, indicating an improving risk profile, though that doesn't imply it will not be affected by coronavirus.

What it does show is that investor risk is a multi-factor concept, and that Taiwan has other strengths offsetting the intuitive coronavirus effect.

Euromoney regularly asks its expert panel to evaluate 15 economic, political and structural risk indicators, plus capital access. These assessments are then compiled with debt ratings to produce a total risk score.

Taiwan's risk score had already improved last year, notably in the fourth quarter, and what this result shows is that the trend has continued, and it would have been more pronounced were it not for the coronavirus effect.

Political risk, for one, has calmed after president Tsai Ing-wen was re-elected and her Democratic Progressive Party retained its majority in the Legislative Yuan, with government stability one of the indicators to be upgraded.

Her government has also taken decisive action to control and prevent the spread of the virus, while notably retaliating against a travel ban imposed by the Philippines, forcing Filipino authorities into a U-turn. This has reinforced president Tsai's positive public perception.

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> The risk of novel coronavirus affects the short-term economic prospects of Taiwan, including the growth rate of private consumption and tourism
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Economic risk, for another, had been improving, with Taiwan's GDP growing by 3.4% year on year in the fourth quarter of 2019, indicating the economy was stronger than its contemporaries, partly due to companies relocating from mainland China to avoid US tariffs on Chinese imports.

Scores for economic growth, employment/unemployment and government finances have shown steady improvement.

As such, it indicates Taiwan is in a stronger position to withstand any temporary effects of disruption to the electronics manufacturing chain, drop in tourist inflows, or other distortions, despite the island's exposure to mainland China, which accounts for up to 40% of its exports and 30% of GDP.

Analysts such as Wei Jen Hsieh, a contributor to Euromoney's risk survey who is assistant vice-president from The Export-Import Bank of the Republic of China in Taiwan have noted there will be economic repercussions.

"The risk of novel coronavirus affects the short-term economic prospects of Taiwan, including the growth rate of private consumption and tourism," he says.

"Overall, the government of Taiwan announced on February 12, 2020, that its economic growth rate in 2020 would be 2.37%, which is 0.35 percentage points lower than the 2.72% forecast in November 2019."

Others such as professor Friedrich Wu at Nanyang's Technological University are becoming more fearful of the risks: "Given the expected supply-chain disruptions and poor consumer sentiment, the official GDP forecast is inexplicably optimistic, and the aid package totally insufficient, especially compared to Singapore's just-announced $4.6 billion fiscal package to support businesses and residents affected by the coronavirus."

Mild effects

As for Hong Kong, Japan and Singapore, their total risk scores have been downgraded, though even these are all by less than 0.2 percentage points. This is far less dramatic than for China, which is more directly affected by the spread of the virus, as well as the economic and political fallout.

Moreover, all of these investor locations were less risky than China leading up to the event as measured by their higher global rankings in Euromoney's survey, and remain so.

Ultra-safe Singapore is now third behind Switzerland and Norway. Hong Kong is 12th, Taiwan 18th and Japan 33rd, with China further down in 47th place.

The virus has created a fear factor about the risk of the disease spreading, forcing governments to adopt effective control and prevention measures. It is also affecting product supply chains that are heavily reliant on Chinese manufacturing and other types of cross-border trade across the region.

However, there is little expectation it will have long-lasting effects, and certainly will not create the potential longer-term political implications some analysts are anticipating for China.

On Euromoney's panel of Asia experts is Milos Vulanovic, associate professor of finance at the EDHEC Business School. He believes that while coronavirus has potential for short-term dislocation such as slowing business activity, its impact on Asian economies such as Hong Kong and Singapore will not be significant.

"In the short term," he says, "Covid-19 has the potential to disrupt the markets for all of the inputs of production, both in these Asian countries as well as with their trading and financial markets partners, and we can expect fluctuations in currency markets of economies exposed to China."

However, in reference to the academic work undertaken by Rudiger Dornbusch in his famous 1976 paper modelling the dynamics of exchange rates and their reaction to sudden events, he notes the message can be summed up in one word: "overshooting" – meaning it will not have any longer-term effects for currencies or financial assets, despite its uncertain nature.

Hong Kong

Even before the coronavirus outbreak, Hong Kong's risk profile had been deteriorating due to the months-long violent protests and riots harming the local economy, and causing GDP to contract in the third and fourth quarters of 2019.

It was one of the 10 investor locations to be downgraded the most in Euromoney's regular quarterly surveys, shedding 1.6 points in the fourth quarter alone.

"The government had already predicted the economy would suffer a recession in 2020," says ECR expert Friedrich Wu, a professor at Nanyang Technological University. "Now the coronavirus is dealing the economy a second, perhaps even severer blow."

Wu mentions that there has already been a loss of trust between a majority of local residents and the government, hampering the latter from putting in place effective public policies to combat the territories' economic and health malaises.

"Going forward, I can only see more paralysis, half action and mutually acrimonious accusations. Hong Kong is sliding down the abyss," he warns.

Japan

Japan is already witnessing an export slump and subdued private consumption, with GDP shrinking at its fastest pace in almost six years during the fourth quarter of 2019 due to global trade frictions and the rise in sales tax.

The risks posed by the coronavirus in 2020 will come from numerous sources, says risk expert Sher Mehta, director of macroeconomic research and country analysis at Virtuoso Economics.

He lists a big drop in Chinese tourists visiting Japan, the disruption to supply chains of Asia, possibility of adverse impact on Japan's massive investment in the forthcoming 2020 Olympic games, stumbling of global demand for its exports and a substantial hit to its exports to China (Japan's second-largest export market).

On top of that there will be lower business confidence and capital spending, as well as a slowdown in the retail sector. Plus, safe-haven assets such as the Japanese yen are in demand, as investors worry about the outbreak of the coronavirus. This in turn has downside implications for Japanese exports.

Consequently, because of the immediate and possible lagged downside impact of the coronavirus on Japan's exports, private consumption, tourism, business and consumer confidence, corporate earnings, factory production and investment, "downside risks to growth are on the ascendant," Mehta says.

> The effect of coronavirus will also probably pass over in a month or two, which should save the Tokyo Olympics
> - Sher Mehta, Virtuoso Economics

However, he does not foresee any lasting impact, or the government standing by and doing nothing.

"Given the probability of the Japanese government launching some support to the tourism sector and the firms adversely affected by the fall in foreign tourists, along with government fiscal stimulus, this will put a floor under growth.

"The effect of coronavirus will also probably pass over in a month or two, which should save the Tokyo Olympics."

Nevertheless, the economic outlook for 2020 is uncertain, meaning the environment for the Japanese financial industry seems more challenging at a time when net interest margins are being squeezed and there is slump in lending.

"Banks will probably face more downward pressure on revenues and profits," says Mehta, "due to the adverse immediate and lagged impact of coronavirus on overall economic activity in Japan and on its stock markets. Consequently, financial risks are on the rise, but moderate."

Singapore

Hong Kong's crisis had given some support to Singapore as a comparatively safer financial centre, and though it will unlikely be able to fully withstand the effects of coronavirus it is better positioned to do so as it is already the safest investor location in Asia.

Although the government has already lowered its forecast for GDP growth, it has also responded well by introducing a substantial package of stimulus measures, but there is no room for complacency as Nanyang's professor Wu illustrates, noting the fact China is Singapore's largest trading partner for both exports and imports and has already registered dismal growth of 0.7% in 2019.

Before coronavirus took hold, private-sector economists were forecasting 1% to 1.5% growth for 2020, but this is now unlikely to be achievable and Singapore may even slide into recession this year.

"Singapore's exports to China account for 13% of total exports and 10% of GDP. The city state is also host to $50 billion of Chinese FDI stock, 3.6 million Chinese visitors per annum, and thousands of students from China," Wu remarks.

"So Singapore is extremely vulnerable to any sharp downturn in China. The government has already implemented a ban on visitor arrivals (regardless of citizenship) from China, and raised its disease outbreak response system condition to orange – just below the highest level of red."

Rippling out

Euromoney is in the process of embarking on its latest quarterly survey among its full universe of more than 300 economists and other risk experts worldwide. This should give some impression of how coronavirus adds to global trade frictions and other economic and geopolitical risks affecting investor risk over the coming months.

Several contributors to the survey have already indicated how the effect of China's dominant position in the global supply chain, trade and tourism will affect other countries given the disruption to production.

The first quarter 2020 survey is an opportune time to make another assessment of the crisis, as it will conclude towards the end of March, allowing analysts more time to see how the effects unfold.

Survey contributor Matthieu Pautonnier, chief production officer and senior quantitative economist at TAC Economics, believes that South Korea, Japan, Thailand, Indonesia, Malaysia and India will be hit the hardest in Asia, with the US and Germany also sensitive "as they operate as global hubs interconnected with the Chinese hub of value chains".

He sees pressure on commodity prices as China is the largest buyer of many, though the oil price effect will be tempered by the Middle East political risk premium.

For financial assets, the coronavirus outbreak means increased exchange rate volatility (notably to the yuan and other emerging market currencies), a decline in equity markets and lower "safe haven" bond yields.