Outlook for Sovereign Ratings in Asia: Rebuilding Momentum After the Storm

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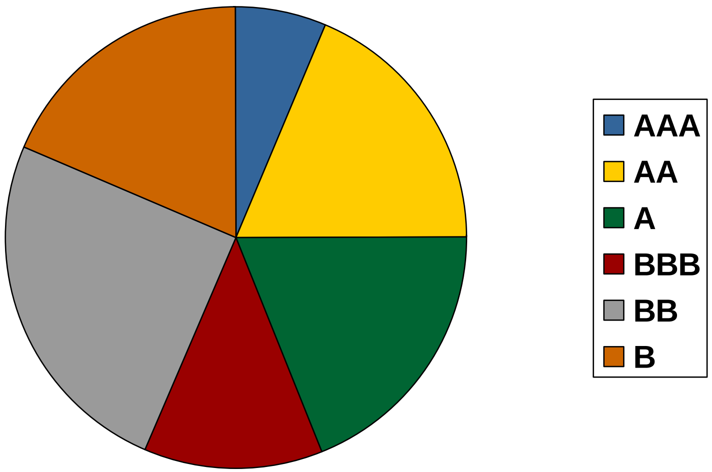
Asia Sovereign Ratings, Dec 2009 – positive bias is increasing?

Cambodia	B+
China	A+
Hong Kong	AA+
India	**BBB-/neg**
Indonesia	**BB-/Pos**
Japan	AA
Korea	A
Malaysia	A-
Mongolia	**BB-/neg**
Pakistan	B-
Philippines	BB-
Singapore	AAA
Sri Lanka	**B/Pos**
Taiwan	**AA-/neg**
Thailand	**BBB+/neg**
Vietnam	**BB/neg**



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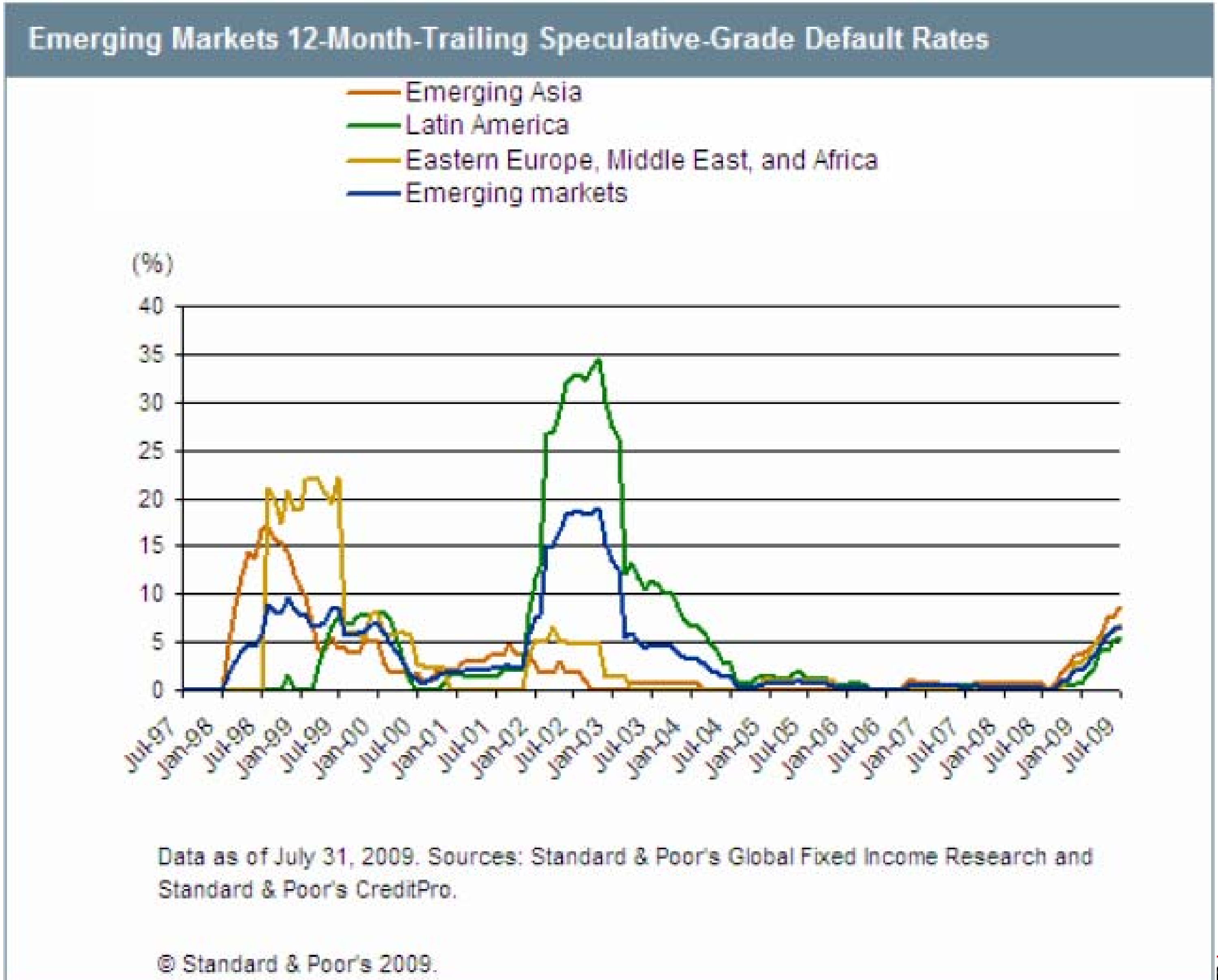
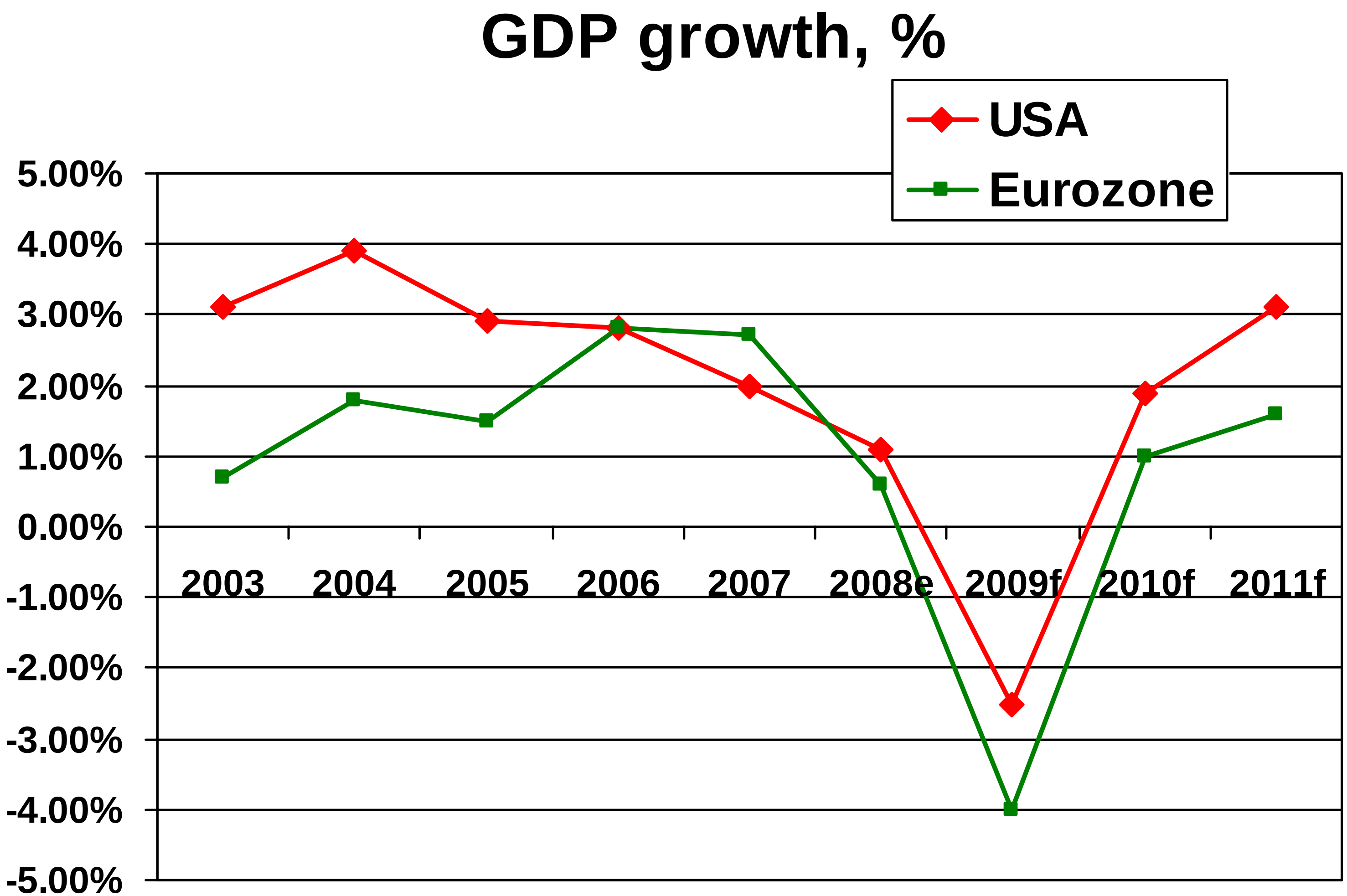
Defaults have risen but are short of historical peaks



The U.S. and Europe: is economic recovery sustainable?



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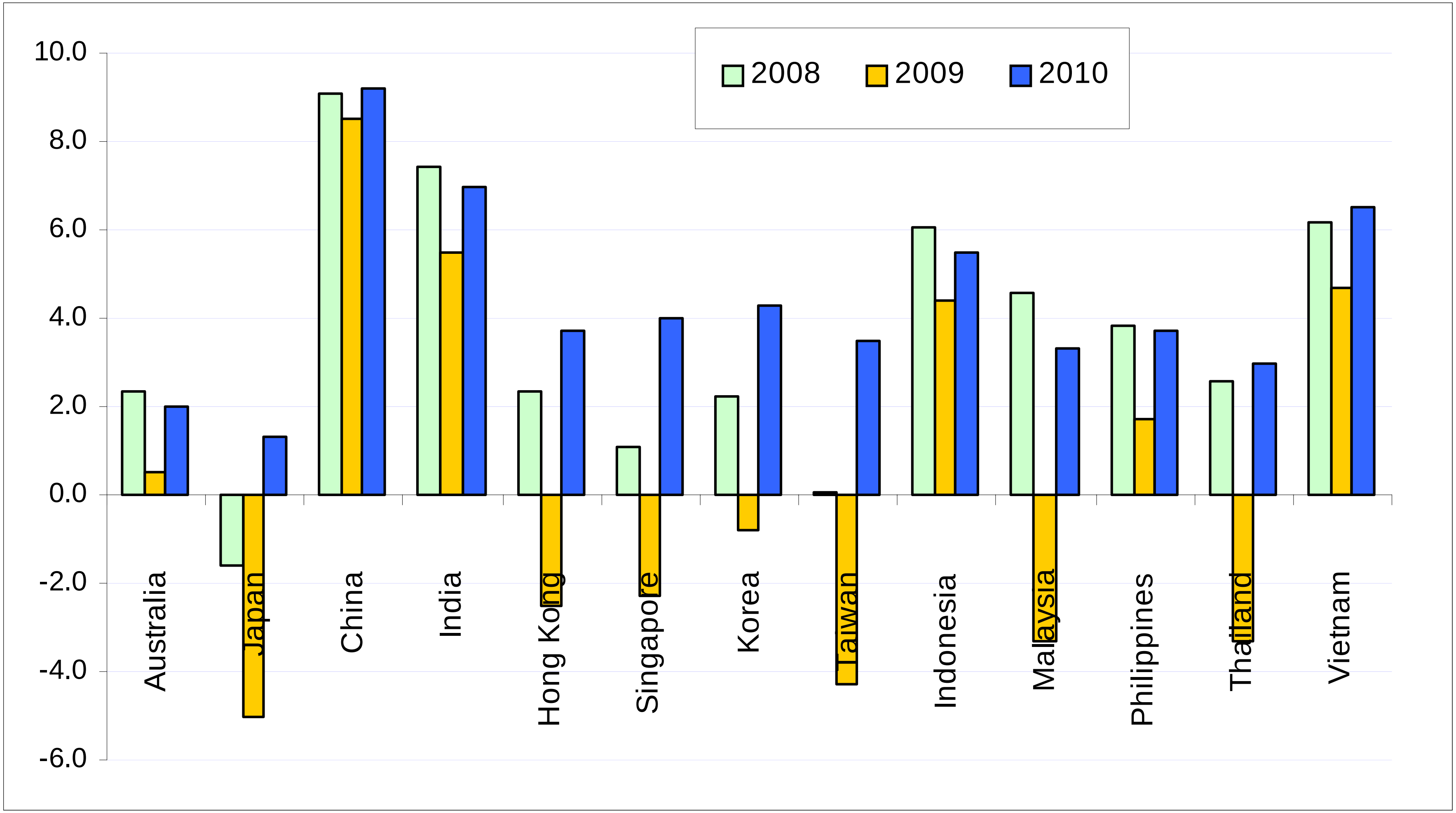
Global economic slowdown vs domestic demand

- Global slowdown has taken its toll; domestic demand is not sufficient to compensate for a reduction in exports; some sovereigns are more affected than others
  - Largest fall in GDP growth in high value manufactured export reliant countries and commodity exporters
  - Corporate defaults have risen, NPLs are growing modestly
  - Effect on credit quality of sov-s, primarily via ensuing deterioration in fiscal & debt ratios, and potential rise in contingent liability of banking sector
- Base case: pick up in growth from 2010, but nowhere close to pre-crisis levels

Asia growing next year



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Fiscal and monetary responses

- Central banks eased monetary policy
- Governments engaged in fiscal stimulus
- Government debts increased
- Costs of banking sector and broader GRE support are manageable so far

Issues:

- “Exist Strategies”: timing and sequence
  - $\Rightarrow$ **Possibility of exiting too late or too early or other policy mistakes**
  - $\Rightarrow$ **M-T strategies for fiscal consolidation and debt reduction**
  - $\Rightarrow$ **Coordinating across AP and globally vs. different speed of recovery**
- Debt markets: crowding out by the public sector?

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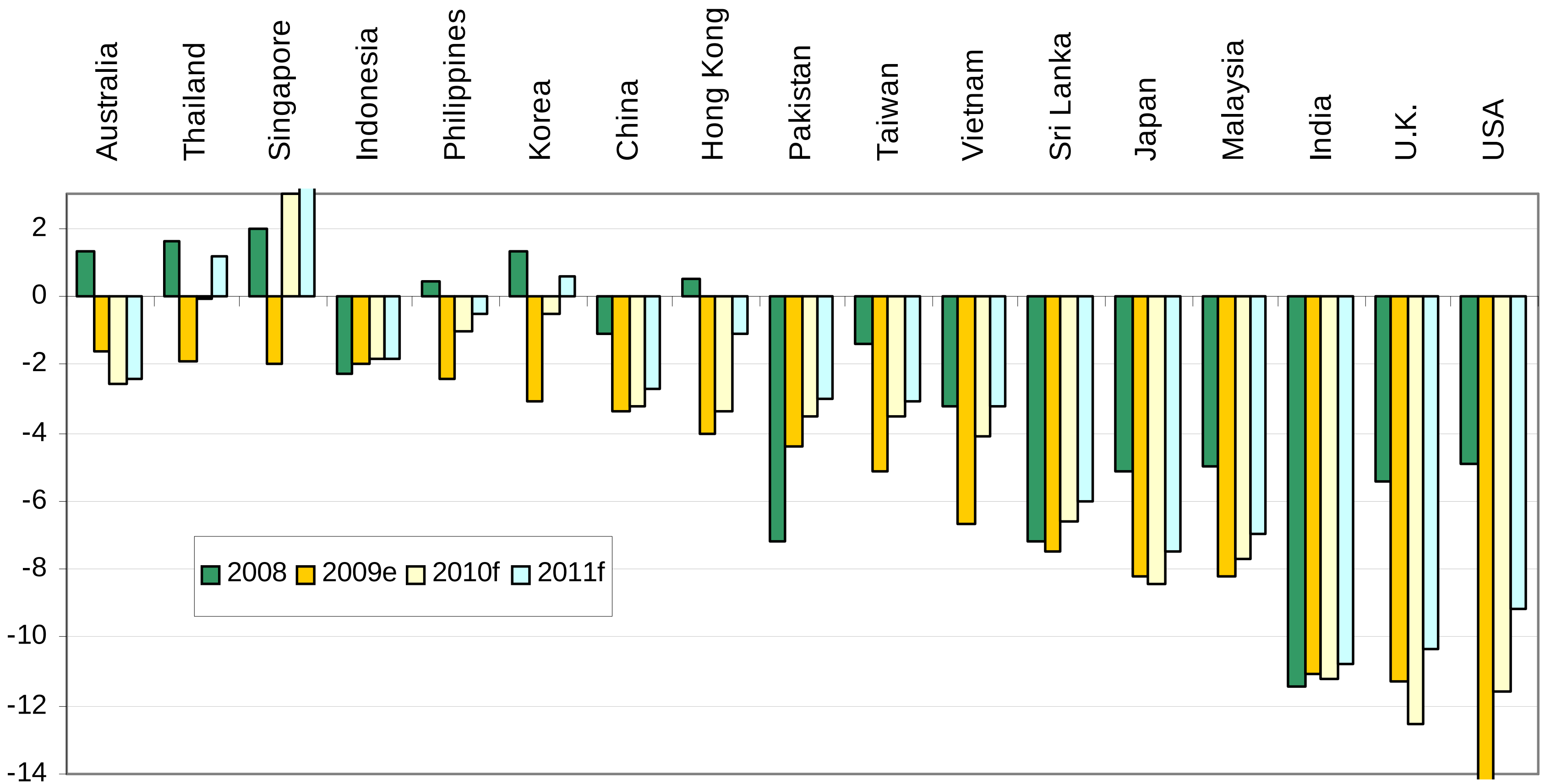
General Government Balance, % of GDP



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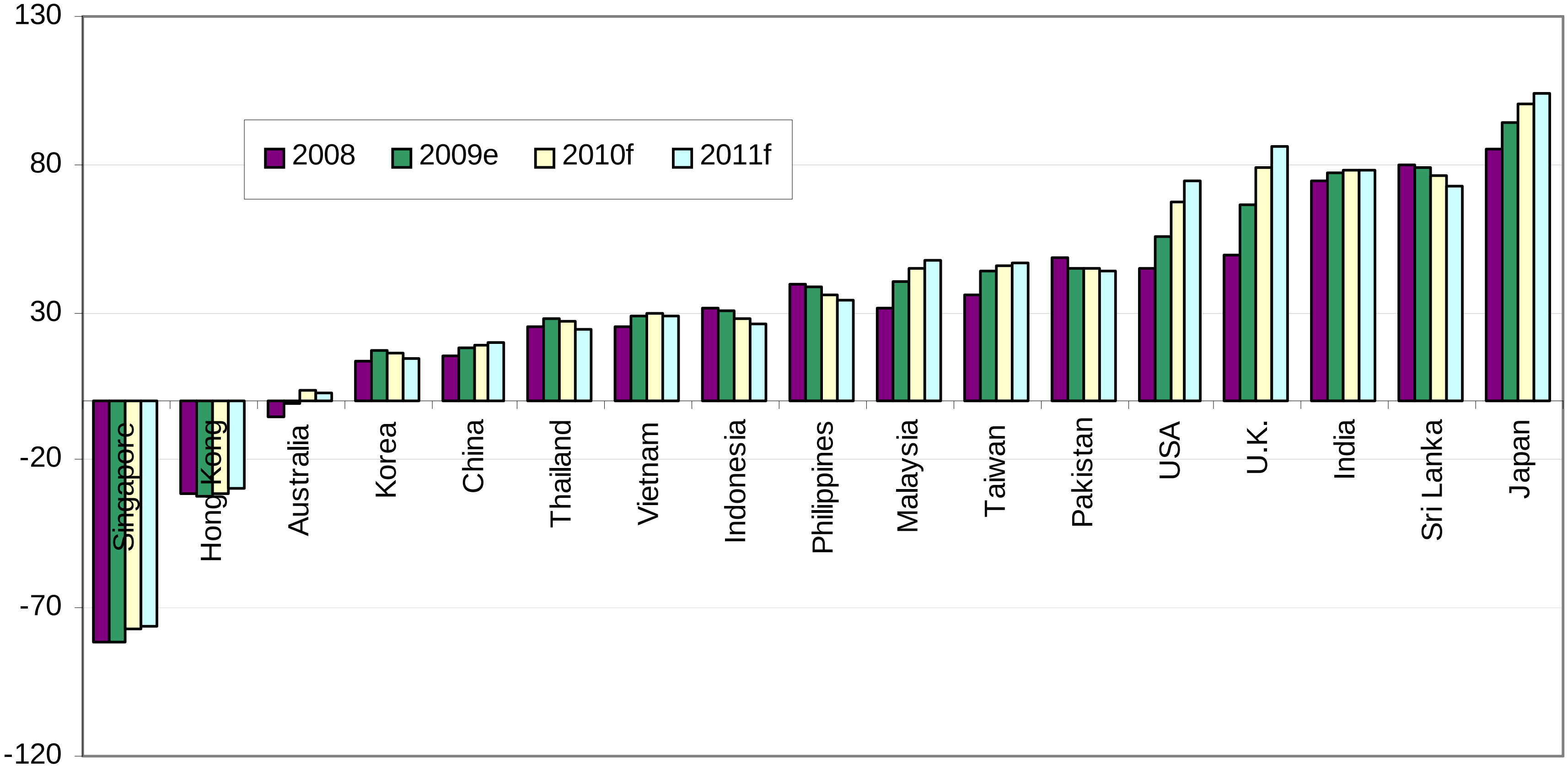
Net General Government Debt, % of GDP



But external positions remain sound

- Imports dropped more than exports
- Low levels of external debt with some exceptions
- FX reserves have risen or stabilized after a modest reduction
- External liquidity should remain a moderate credit strength for the region

Issues:

- Appreciation pressures on Asian currencies
  - ⇒ Protectionism with regards to capital and trade flows?
  - ⇒ Complications in monetary policy, exchange rate and reserve management?
  - ⇒ Coordination of currency appreciation strategies with trading partners?
- Remittances flows

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Malaysia Sovereign Ratings

- **Foreign Currency A-/Stable/A-2; Local currency A+/Stable/A-1**
- **Economy hit hard by sharp global economic decline, and is still in a sensitive period of recovery**
- **But: no signs of loan quality deterioration, absolute NPLs continued to decline into June 2009**
- **Malaysia's Budget For 2010 Could Reduce Fiscal Pressures**
  - Government's target for 2010 fiscal deficit of 5.6%, is significantly smaller than the 2009 estimate of 7.4%
  - Plan to structurally improve expenditures, and plans to cut subsidies for fuel, food, and education by 15%
- **Sovereign ratings are likely to depend on how quickly growth recovers and fiscal consolidation takes place over medium-term**

Back to Asia: Negative bias in rating actions is softening

- – Risk on the downside could come from weaker US/Europe, commodity prices & inflation, policy mistakes in ‘exist strategies’ and idiosyncratic political risk
- – Where structural weakness, and/or ongoing political instability hamper adjustment, ratings could come under pressure
- – However, many Asia sovereigns have faced the downturn from position of relative strength and good policy mix will likely help retain their ratings; Asia has faired better in the crisis

In the medium term: structural reforms remain key (financial sector, service sector, fiscal reforms, labor reform, public sector transparency & administrative capacity); development of domestic capital markets and alternatives to export-led growth; regional integration

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