NEW STRAITS TIMES

28 November 2011

Asean and the global sovereign debt problem

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There's still investor confidence, but Asean leaders must reduce fiscal deficits and debt levels

Asean Sovereign Bond Ratings

Country	S&P	Fitch	Moody's
Cambodia	B+ (stable)	Nil	B2 (stable)
Indonesia	BB+ (positive)	BB+ (positive)	Ba1 (stable)
Malaysia	A- (stable)	A- (stable)	A3 (stable)
Philippines	BB (stable)	BB+ (stable)	Ba2 (stable)
Singapore	AAA (stable)	AAA (stable)	Aaa (stable)
Thailand	BBB+(stable)	BBB (stable)	Baa1 (stable)
Vietnam	BB- (negative)	B+ (stable)	B1 (negative)

SOURCE: asianbondsonline.abd.org (Accessed 24 Oct 2011)
NOTE: Brunei, Laos and Myanmar have not been assigned ratings by the three rating agencies.

LET us be clear on one thing: Asean economies do not have sovereign debt problems like those of their counterparts elsewhere.

They are -- indeed the whole region is -- literally on a different continent where public debt default is concerned.

This opinion is backed up by hard facts. Ten-year government bond yields are down year-to-date for all Asean countries except Vietnam. Low bond yields are a sign of strong demand and, in turn, imply high investor confidence.

Vietnam is struggling with macroeconomic rebalancing difficulties but even then its deficit and debt burdens do not look anything close to Europe's stricken economies.

External debt has been growing for three economies -- Indonesia, Thailand and Malaysia -- but debt service ratios (debt repayments and interest over exports) are single digit except for Indonesia.

The world's three major rating agencies, Moody's, Standard & Poor's and Fitch, consider the outlook of most Asean economies to be stable except for Vietnam (negative) and Indonesia (positive).

Indonesia, Asean's largest economy, recently issued a US$1 billion (RM3.2 billion) sukuk bond at a four per cent yield, less than half that of two years ago. Its debt is expected to join Singapore and Malaysia as investment grade soon.

Credit default swaps (CDS), essentially insurance against debt defaults, are generally higher but this is more reflective of world conditions. The CDS cost of some of the world's safest economies have also gone up.

But while Asean economies are not anywhere close to defaulting on their debt, they are also not without economic vulnerabilities. They are certainly not immune from what happens in Europe or elsewhere.

Asean economies are open and can expect to be impacted in trade, investment and finance. Several times this year, regional bourses have been shaken by fears that Europe's sovereign debt crisis will travel outwards.

This is likely to continue as Italy totters and Spain hopes. There is little Asean economies can do but try and ensure their economies are as strong and resilient as they possibly can be.

The major focus will be on how they manage their public finances. Policymakers are acutely aware of this but how much they can do is constrained by their domestic politics.

In 2009, public spending rose across Asean in order to ward off the effects of recession. Despite some moderation since, it largely remains at elevated levels. Indonesia is the exception and hence investor acclaim.

Asean leaders have been trying hard to convince investors and bankers that they are serious about reducing fiscal deficits and debt levels.

Public debt is projected to shrink by one to three per cent of gross domestic product (GDP) by the end of their next financial years.

The problem is that a great deal hinges on whether GDP growth forecasts are realised.

If the world economy tips into a serious recession, debt figures will balloon quickly and spending cuts will have to be considered.

On their present course, those economies with public debt levels above 50 per cent of GDP (Laos, Malaysia and Vietnam) would seem unable to withstand a moderately severe downturn.

Depending on depth and duration, even those in the mid-40 per cent and below (Thailand, Philippines and Myanmar) could need to introduce spending restraints to stay out of trouble.

Public spending cuts are likely to aggravate recession and are hugely unpopular. Countries where the public sector accounts for a large part of economic activity will, of course, be harder to manage.

The question is therefore not how capable economic technocrats are but how willing politicians are to "bite the bullet". Populist politics simply does not make for good economics.

There is indeed a need to increase the growth trajectory through private sector-led economic transformations. But excellent economic policies do not replace the political resolve to follow them through.

Despite what some Americans seem to think, there is no quick fix for the world economy.

The world economy must grow out of its problems but it would seem necessary that it must first contract before it can do so.

A resolution is thus highly unlikely to be cheap or short-term for the world at large, either economically or politically.