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Views from Asia following the recent US and Europe banking sector volatility

Market update

Our investment teams share their thoughts on Asian financials, how the different scenarios for the US dollar could impact Asian currencies and China's latest cut to its reserve requirement ratio.

Markets appear to have stabilised slightly following the recent volatility in the US and European banking systems[1] as global central banks moved to reassure investors. In line with the swift response by the US regulators to stem contagion fears, the Swiss National Bank stepped in on Thursday to offer liquidity support to Credit Suisse (CS) while the European Central Bank (ECB) indicated that it stood prepared to provide liquidity support to the euro area financial system. Over the weekend, UBS agreed to buy CS for USD3.2bn, in a historic deal brokered by the Swiss regulators. The Federal Reserve, ECB, the Bank of England, the Swiss National Bank, the Bank of Canada, and the Bank of Japan have also announced daily swap lines to improve access to dollar liquidity.

VIEWS FROM ASIA

While the US and European banking stocks had corrected sharply, the impact on Asian financials has been more contained. Since March 8, the MSCI World Financials Index has fallen 10.6% while the MSCI Asian Financials Index is down 4.2%[2]. According to **Sundeep Bihani**, Eastspring's Asian equities portfolio manager, most Asian central banks tend to be conservative in their oversight of the banks and apply strict standards when it comes to bank funding parameters. Many of the Asian central banks have also not forgotten the lessons from the 1997 Asian Financial Crisis. He favours Asian financials that have higher than regulated capital levels, and where the durations of their assets and liabilities are well matched. For the Asian banks that he likes, their hold-to-maturity investments are typically only a small percentage of total assets, and their short-term liquidity coverage ratios are high relative to history.

That said, **Sundeep** is monitoring the potential second-round effects that can come from tighter USD liquidity, higher counterparty risks and wider global credit spreads. In such instances, he believes that the larger better-capitalised, low-cost funded banks will tend to fare better.

While Japanese financials have sold off with the MSCI Japan Financials Index down 9.8%[3] since March 8, **Ivailo Dikov**, Eastspring's Head of Japan Equities, believes that this is largely due to revised market expectations of a flatter Japanese yield curve rather than a result of contagion fears. He remains highly selective within the Japanese banking sector, favouring banks that manage their interest risks well, do not actively use hold-to-maturity securities and where the duration of their domestic bond portfolios is very short. He prefers larger banks with ample and sticker deposits – in his view, big, diversified, and well-capitalised banks are likely to benefit should there be a flight in deposits. The team continues to look for long-term opportunities within the sector which will benefit from restructuring and cost efficiencies.

[1]At the point of writing – 20 March 2023. [2]Bloomberg. As of 17 March 2023. In USD terms. [3]Bloomberg. As of 17 March 2023. In USD terms.

Meanwhile, **Rong Ren Goh**, Eastspring's Asian bonds portfolio manager notes that Asian currencies have been relatively resilient amid the recent market volatility, on the assumption that the US and European developments would have a limited impact on Asia. As the Fed's rate hikes start to bite, the risk of a US recession is rising. He believes that just as interest rate differentials drove USD strength amid the Fed's aggressive rate hikes in 2022, USD strength could also moderate if markets start to price in less aggressive Fed rate hikes in the near term. This could potentially be supportive of Asian currencies.

However, **Rong Ren** cautions that if US and European regulators are not able to restore investor confidence and concerns about the health of the banking system - and by extension, of the US economy – escalates, a significant retrenchment in risk appetite could result in a stronger USD as in typical protracted risk-off episodes.

Meanwhile, Asian central banks remain watchful of the developments in the US and Europe. The People's Bank of China announced a 25bp cut to the Reserve Requirement Ratio (RRR) for almost all banks, effective 27 March. The cut is estimated to release about RMB 500 bn into the banking system. According to **Jingjing Weng**, Research Lead at Eastspring Shanghai, while the move reflects the Chinese government's commitment to boost demand and support China's post-pandemic recovery, its earlier than expected timing suggests that it could also be a pre-emptive move to ease interbank liquidity conditions and to strengthen market confidence in China in the wake of the banking sector volatility in the US and Europe.

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