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Sovereign Risk In Southeast Asia Pivots On Politics

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Sovereign Risk In Southeast Asia Pivots On Politics

Even as the global economic uncertainty drags on, political developments have the most potential to shape sovereign rating trends in parts of Southeast Asia. Amid pressures on credit metrics from weaker commodity prices and the continuing deceleration in Chinese growth, credit support for sovereigns in much of the region have remained broadly stable. Political forces, however, are on the move in Malaysia, the Philippines, and Thailand. In some scenarios, S&P Global Ratings believes the outcomes may undermine support for sovereign creditworthiness in these countries.

Overview

- Sovereign credit ratings in Southeast Asia have kept a stable or positive outlook, despite the weak external environment.
- Political developments in some countries could have credit implications, especially in the longer term.
- Political instability in Malaysia and Thailand remain a risk, while support for stability in the Philippines could weaken if political uncertainties increase after the presidential elections.

Economic And Financial Metrics Hold Up Against Weak Global Economy

Southeast Asian economies have performed relatively well despite the weak external environment. Real GDP growth in 2015 fell from 2014 levels in some cases. However, most developing economies in the region had kept growth above 4.5% (see chart 1). And despite lower commodity prices affecting export receipts, most of the economies maintained current account surpluses. In Indonesia, where an external shortfall exists, the current account deficit shrank to 2.1% of GDP. Fiscal deficits in most cases either improved or deteriorated but remained at modest levels. Developments on these fronts have helped to maintain stable or positive (Indonesia) outlooks on our Southeast Asian sovereign ratings (see table 1).

Domestic developments in a few Southeast Asian countries could have implications for the sovereigns' credit trends. In some scenarios, their credit support may weaken or an existing positive trend may halt. In the case of Malaysia, the risk is that the ongoing 1MDB saga could lead to an abrupt change in the government. The key question in the Philippines is whether political stability will continue after the presidential election. And, in Thailand, the main uncertainty is when political normalization will happen to allow policymakers to focus on issues that affect the long-term growth potential of the economy.

Chart 1

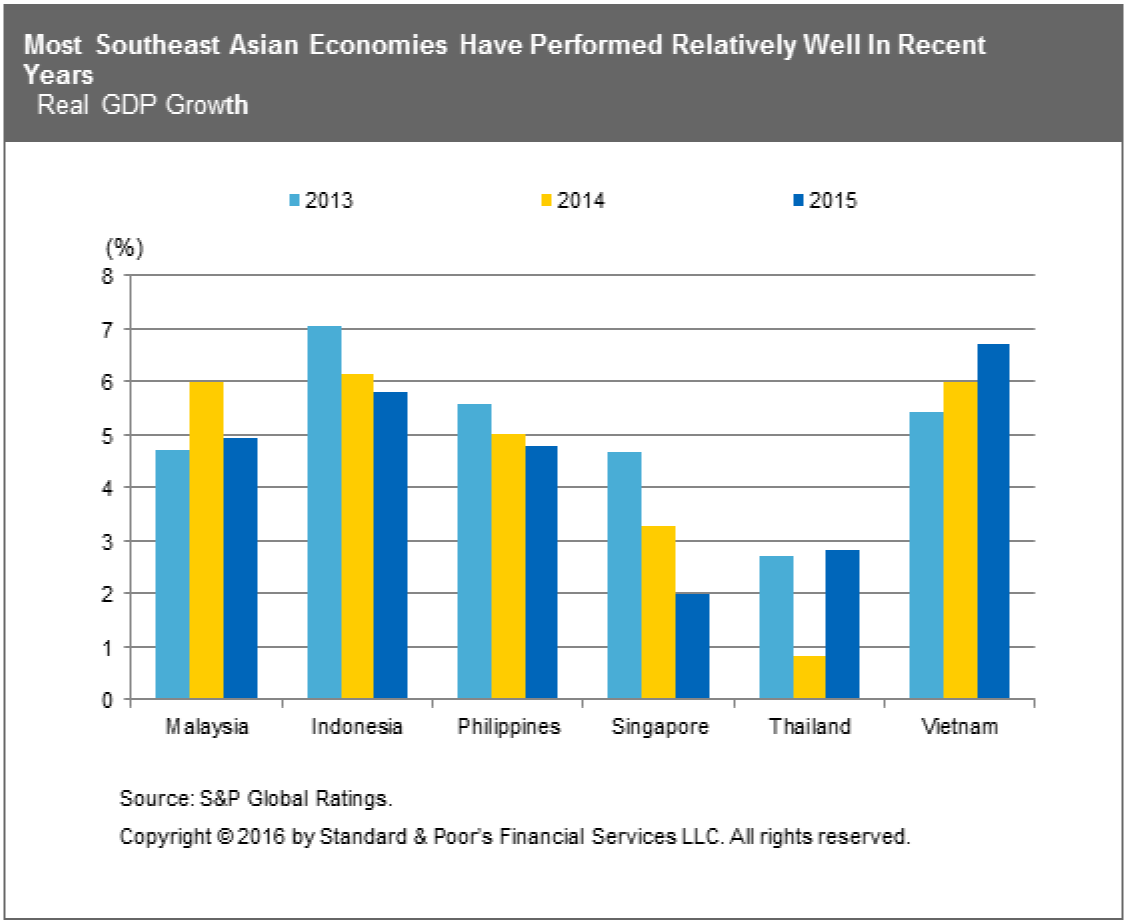

Table 1

Foreign Currency Ratings And Outlook On Southeast Asian Sovereigns	
Singapore	AAA/Stable/A-1+
Malaysia	A-/Stable/A-2
Thailand	BBB+/Stable/A-2
Philippines	BBB/Stable/A-2
Indonesia	BB+/Positive/B
Vietnam	BB-/Stable/B

Source: S&P Global Ratings.

1MDB Divides UMNO

For more than a year, the acronym 1MDB (1Malaysia Development Bhd.) has dominated Malaysian political discussions. Allegations of financial mismanagement and irregularities at this state-owned company have led to police investigations and lawsuits in a number of countries. Most recently, the company returned to the headlines again when it missed an interest payment on a bond it had issued. But what looms larger than the potential financial losses related to the company is the threat to Malaysian political stability--making the company an important development for the government's credit standing.

We do not expect 1MDB to pose a heavy contingent liability to the government. A parliamentary committee reported in April 2016 that the company's debt amounted to approximately Malaysian ringgit (MYR) 50 billion (close to US$13 billion; 4% of GDP). The committee also assessed total assets at a little above that amount, likely including projects such as the high-profile Tun Razak Exchange and Bandar Malaysia developments in Kuala Lumpur. Over the past year or so, the company has shown its ability to sell some of these assets to raise funds. In addition, the recent 1MDB default showed the government's reluctance to extend its support for debts beyond the MYR17.6 billion (US$4.5 billion; 1.4% of GDP) that the government has direct risk exposure to.

The possible implications of 1MDB for political stability are a bigger concern. Prime Minister Najib Razak is closely linked to the company, in which he was the chairman of the recently dissolved board of advisors. The company also faces allegations about funds channeled to accounts controlled by Najib. The pressure on him to step down as prime minister has been mounting as a result. While the opposition remains relatively weak, opponents within the PM's own UMNO party have also been seeking to unseat him.

Najib appears to have consolidated power within UMNO for now, especially after a strong win in the recent Sarawak elections. Nonetheless, a disorderly change in the government cannot be ruled out. The party appears to be more divided than any time since 1987, when then-PM Mahathir's differences with Tengku Razaleigh Hamzah split the party. Unlike this previous episode, Najib's opponents have no clear leader to coalesce around. And voter support for UMNO and its Barisan Nasional (BN) allies are a far cry from levels in 1987. Should the current government be forced out abruptly, Malaysian politics could enter a period of significant uncertainties that could unsettle investor and consumer confidence. Policy consistency could also be negatively affected.

Is The Philippines Ready For Another Independent-Minded President?

Like in neighboring Indonesia, the Philippines could soon see a former mayor become president (although this would not be a first). Following the excitement over Senator Grace Poe's eligibility to run for the country's top political office, it now appears that Rodrigo Duterte is the man to beat. Currently the mayor of the city of Davao, Duterte hails from a regional political family. He has been credited for making the city one of the safest in the country with his controversial tough stance against crime.

If elected, Duterte will be the second recent president to come from outside the elite families who traditionally dominated national politics. The experience of the first, Joseph Estrada, provides a cautionary tale. During his two and a half years as president, Estrada had implemented policies that negatively affected the interests of some of the Filipino elites. These included limiting the use of sovereign guarantees for government contracts with private suppliers and expanding rural land reform. His weak relationship with these powerful interests could have been a reason for his ouster in early 2001.

The risk of political uncertainty is, therefore, somewhat higher in a Duterte presidency. All the other presidential candidates have experience with national politics. A couple of them are also from families with long involvements in national politics. They are widely expected to pursue gradual policy changes, not unlike the Aquino administration.

Duterte's style, if he assumes the presidency, is more uncertain.

Used to a hands-on approach in governing a city that is his political base, he could take some time getting used to the many compromises required in the national leadership position. Some measures he is considering could change the status quo, including liberalizing the telecom sector and constitutional amendments to strengthen the power of local governments. He could faces strong resistance if he pushes some of these changes aggressively.

And if Duterte's style leads to serious political battles, it could damage one of the Aquino administration's key achievements--a sustained period of political stability. This stability had improved consumer and investor sentiments. These improvements help to explain the stronger investment spending and economic growth during this presidency. They also contributed to our two rating upgrades on the Philippines since 2013. A return of political confrontations could weaken the improving trend for sovereign credit metrics.

Thai Military Finds It Tough Turning Back The Clock

The policy environment in Thailand is unlikely to improve much in the near future, as political uncertainties remain high. Two years after the coup of May 2014, the military-backed government remains less than confident that it can shape the country's political future in its favor. Consequently, it is now attempting to extend its influence beyond the elections that it promised by mid-2017.

To this end, the current government is pushing to adopt a new constitution that critics said would lead to unstable elected governments and weaken democracy. For the first five years after the next election, the military--through the National Council for Peace and Order (NCPO)--can also appoint all members of the senate. The draft constitution allows this body to play a role in the selection of a prime minister, who can be an unelected official. Many Thai politicians are naturally against the adoption of this proposal, which will be put to a national referendum on Aug. 7. Nevertheless, the military appears undeterred and is actively preventing opponents of the draft charter from campaigning against it.

But even if the referendum rejects the draft charter, Prime Minister Prayuth has promised to hold new elections based on a rewritten constitution. Until he made this clear in mid-April, earlier expectations was for an election to proceed under one of Thailand's previous constitutions. Given the weak Thai economic performance since the coup, the prime minister is likely to keep his word to go ahead with an election rather than be blamed for a further deterioration of growth prospects. There is no guarantee, however, that he will write a constitution that Thai politicians will accept. So the political bickering could go on for a while.

Meanwhile, we expect little to change in improving the country's infrastructure or education system. Thanks to Thailand's relatively conducive investment climate and its attraction as a tourist hub, growth remained at close to 3% in 2015. However, the continued political instability is damaging the economy's potential even as international competition intensifies with the rapid development of Vietnam and Myanmar's opening. Even without a possible violent confrontation in the country, a further slowdown in Thailand's economic growth trajectory could erode its sovereign credit metrics over the next few years.

Strong external balance sheets and steady growth of domestic demand are key reasons for the stable sovereign credit trends in most parts of Southeast Asia amid the global economic uncertainties of recent years. But these attributes balance the impact of weak external developments only if political and policy stability exist. In some scenarios, however, the balance may shift for some sovereigns if the developments highlighted above weaken this stability in the respective countries.

Related Criteria And Research

Related Research

- Malaysia 'A-/A-2' Foreign Currency And 'A/A-1' Local Currency Ratings Affirmed; Outlook Stable, March 28, 2016
- Ratings On The Republic Of The Philippines Affirmed At 'BBB/A-2'; Outlook Stable, April 21, 2016
- Ratings On Thailand Affirmed At 'BBB+/A-2' And 'A-/A-2'; Outlook Stable, Dec. 21, 2015

Only a rating committee may determine a rating action and this report does not constitute a rating action.