

# U.S. Marco

## U.S. Debt, the debt ceiling & the impact of FED rate hike

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Phillip Securities Research Pte Ltd

20 March 2017

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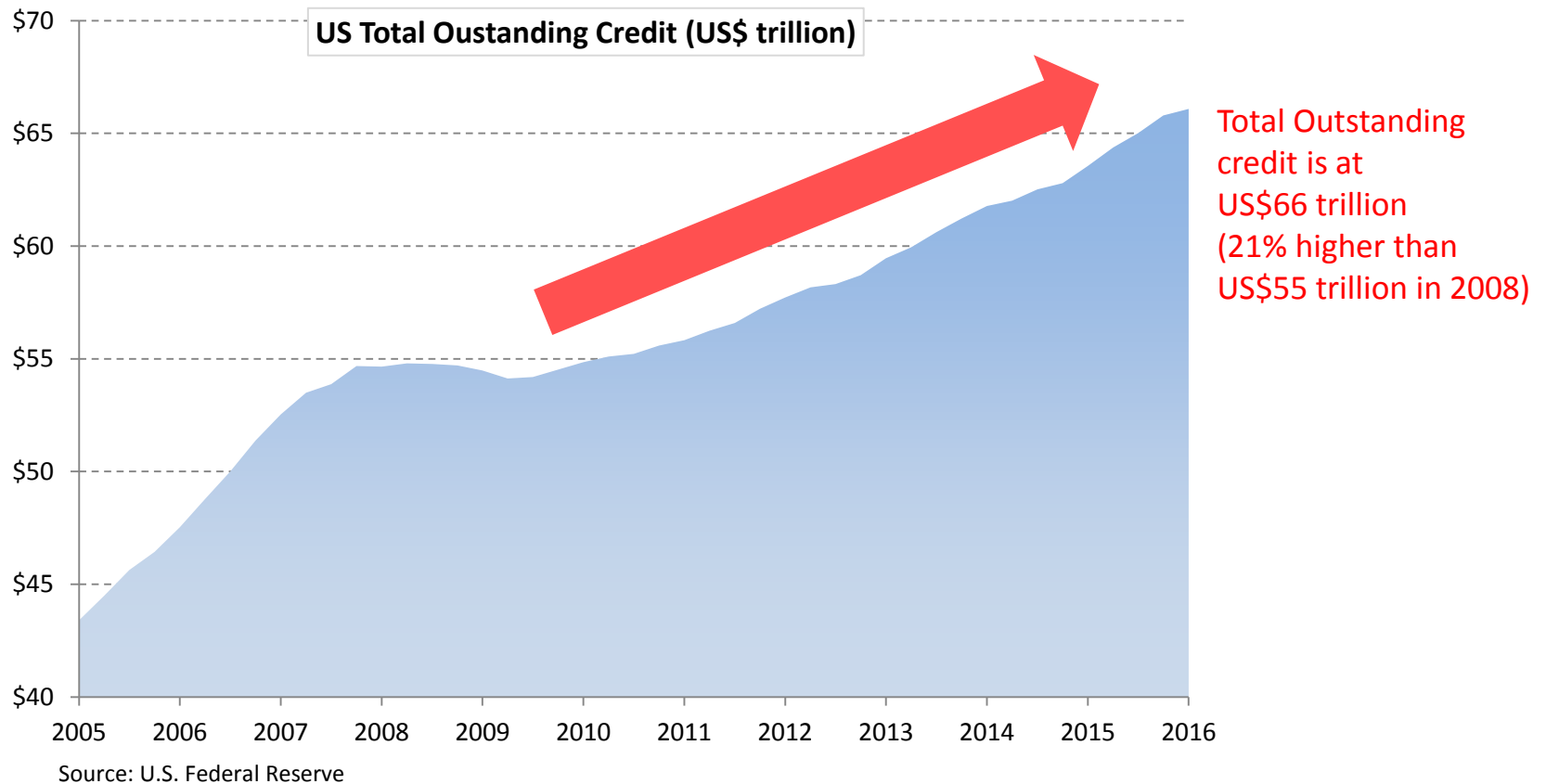
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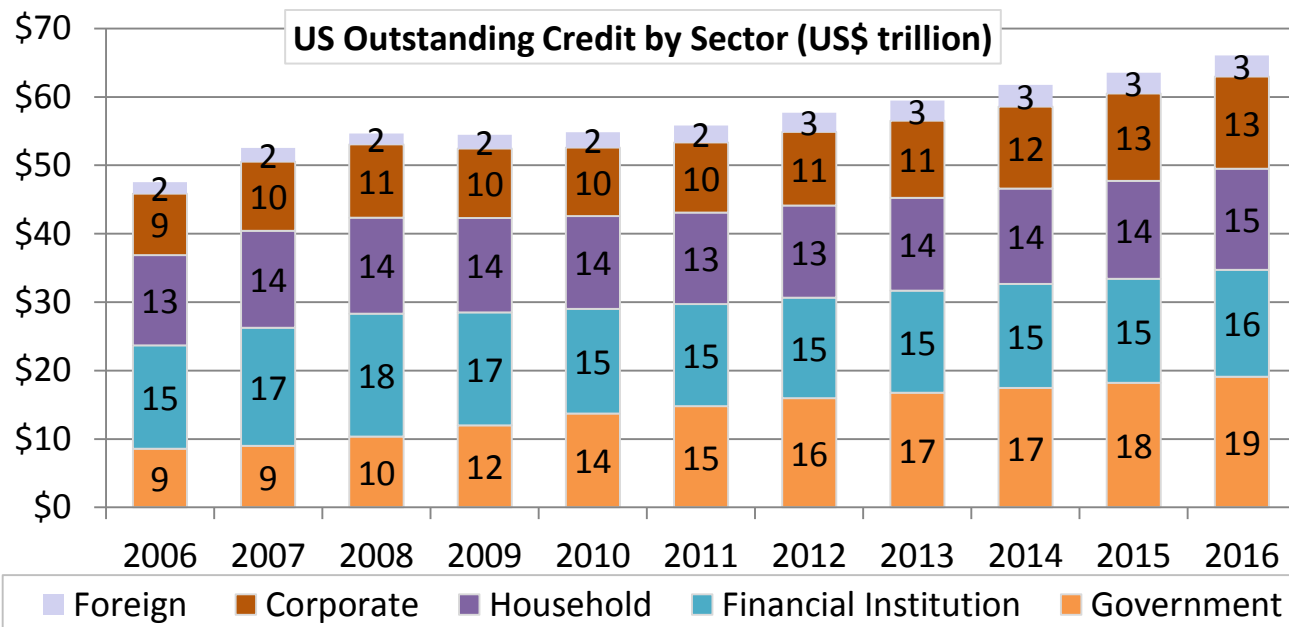
# 1. Background of U.S. Debt

- Since the Global Financial Crisis (GFC) in 2008 the U.S. economy has not **deleverage**. In fact US total Credit has increased by 21% since 2008.



# 1. Background of U.S. Debt

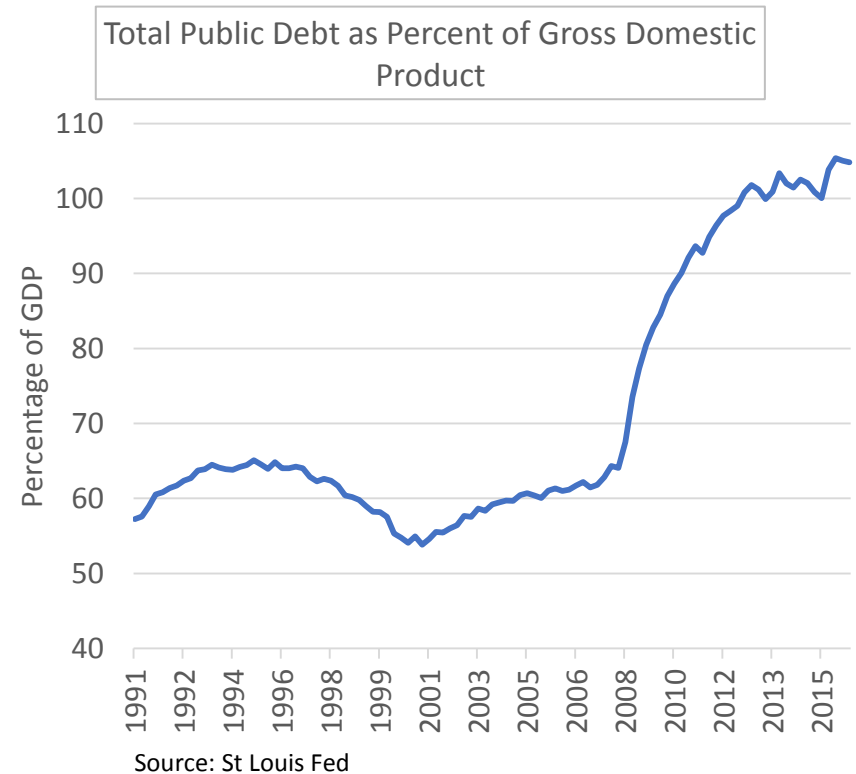
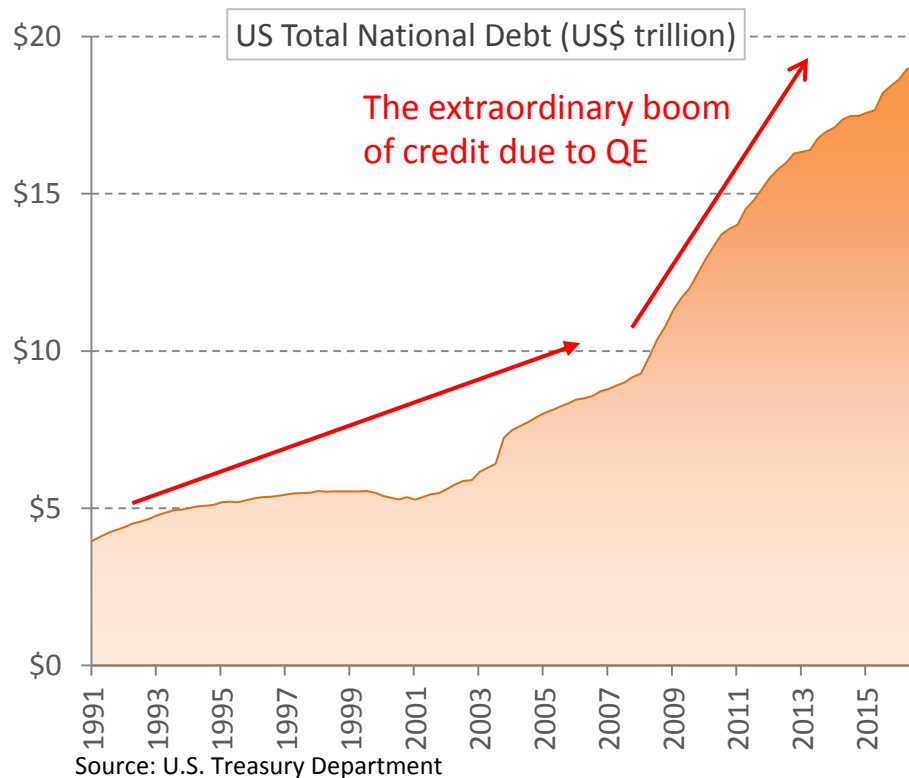
- **Government** has taken up the slack for credit consumption, swelling their liabilities to well over US\$19 trillion.
- **Corporates America** have taken advantage of the low interest rate environment to leveraged up and do share buyback.
- **Financial institutions**, which were at the epic centre of GFC, de-leveraged till mid-2014 and have steady increase their debt since.



Source: U.S. Federal Reserve

## 2. U.S. Government Debt & its ceiling

- U.S. National Debt now stands at \$19.9 trillion.
- National Debt as a percentage of GDP is at the all time high, surpassing 2008 high.



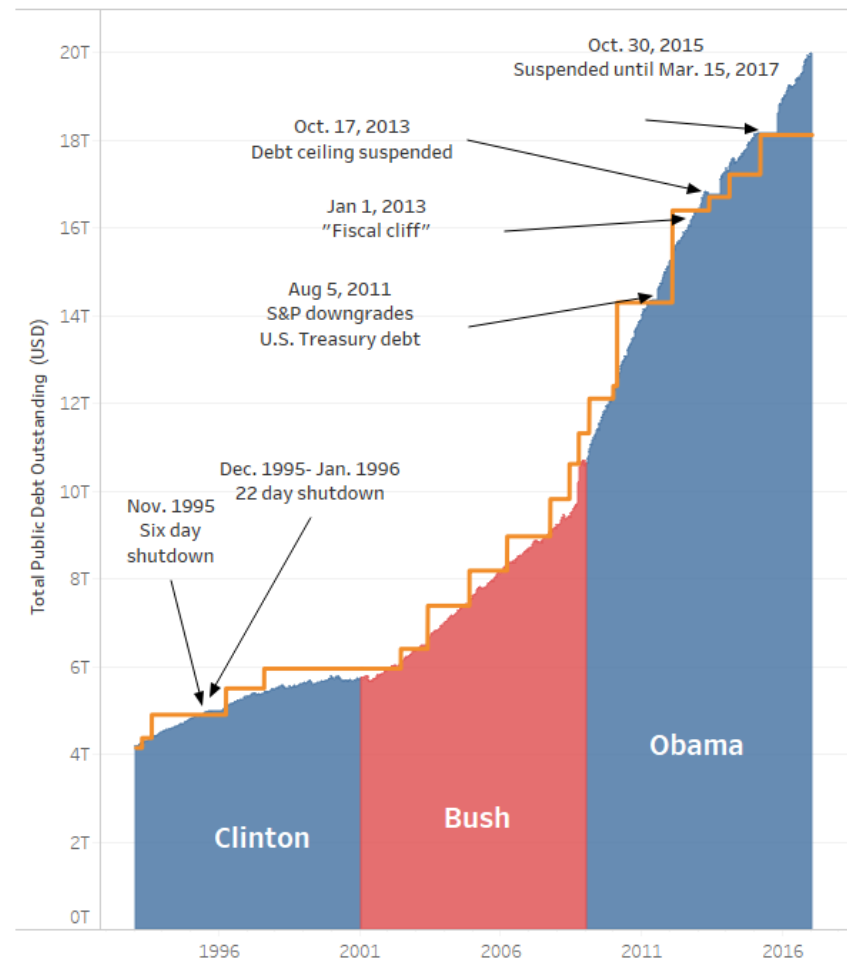
## 2. U.S. Government Debt & its ceiling

### Debt Ceiling Background

- ***Bipartisan Budget Act of 2015*** enacted in November 2015
- The Act will suspended the debt ceiling through till 15<sup>th</sup> March 2017.
- On 16<sup>th</sup> March, the limit was reset to reflect the cumulative borrowing.
- Estimated debt ceiling is at \$19.85 trillion after 16 march.

### Self-inflicted crises

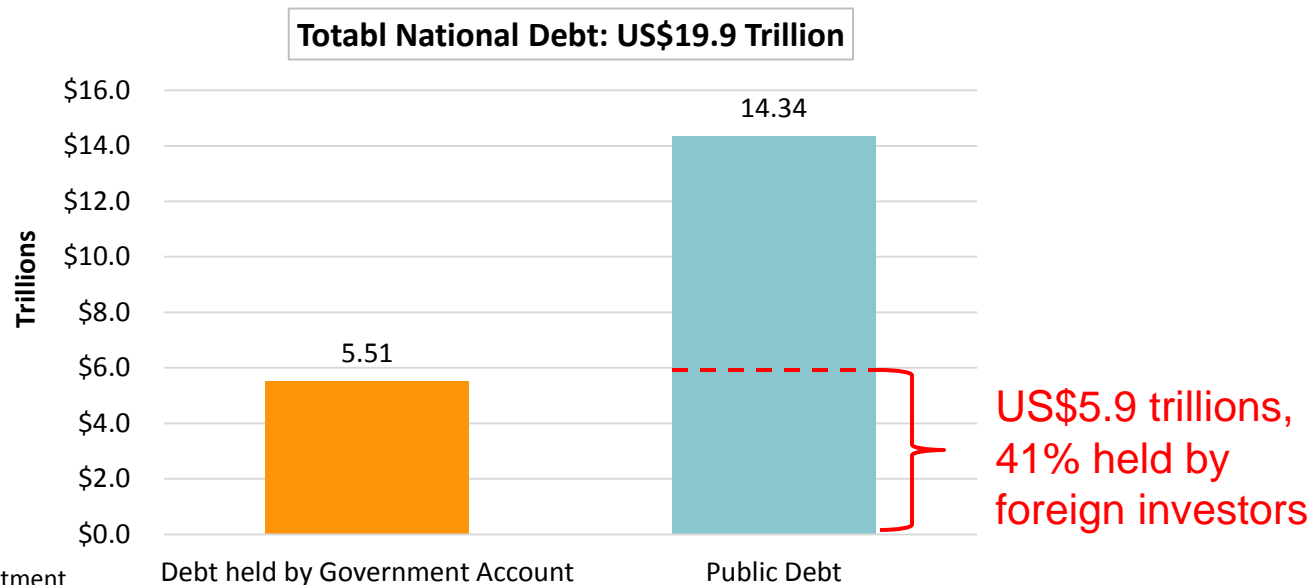
SOURCE: US Treasury



## 2. U.S. Government Debt & its ceiling

### Which Debt are subjected to the Limit?

- Debt subject to the statutory limit comprises two main components:
  1. debt held by government accounts. (debt issued to the federal government's trust funds and other federal accounts for internal transactions of the government)
  2. debt held by the public (securities that the Treasury issues to raise cash)



Source: U.S. Treasury Department

## 2. U.S. Government Debt & its ceiling

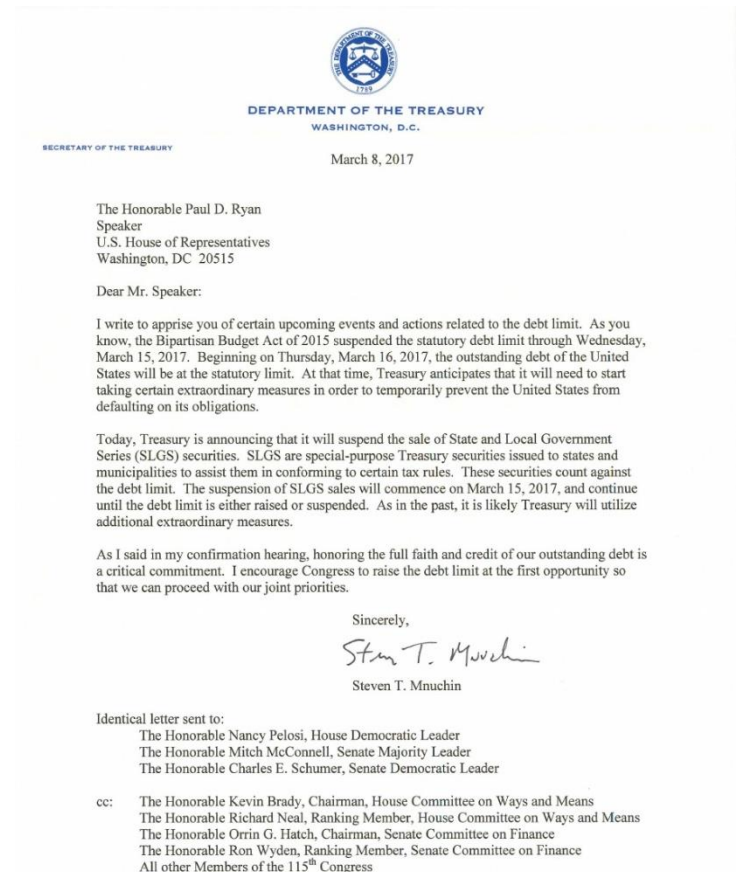
### Current Situation

- U.S. Treasury has no room to borrow under standard operating procedures.
- U.S. Treasury would begin taking the **extraordinary measures** that would allow it to continue to borrow for a limited time.



**Steven Mnuchin**

77th United States Secretary of the Treasury





## 2. U.S. Government Debt & its ceiling

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### Extraordinary Measure

1. Suspend the investments of the Thrift Savings Plan's G Fund.
2. Suspend investments of the Exchange Stabilization Fund.
3. For the Civil Service Retirement and Disability Fund (CSRDF) and Postal Service Retiree Health Benefits Fund (PSRHBF), suspend the issuance of new securities.
4. Suspend the issuance of new State and Local Government Series (SLGS) securities and savings bonds.
5. Exchange Federal Financing Bank securities, which do not count against the debt limit, for an equal amount of Treasury securities held by the CSRDF.

## 2. U.S. Government Debt & its ceiling

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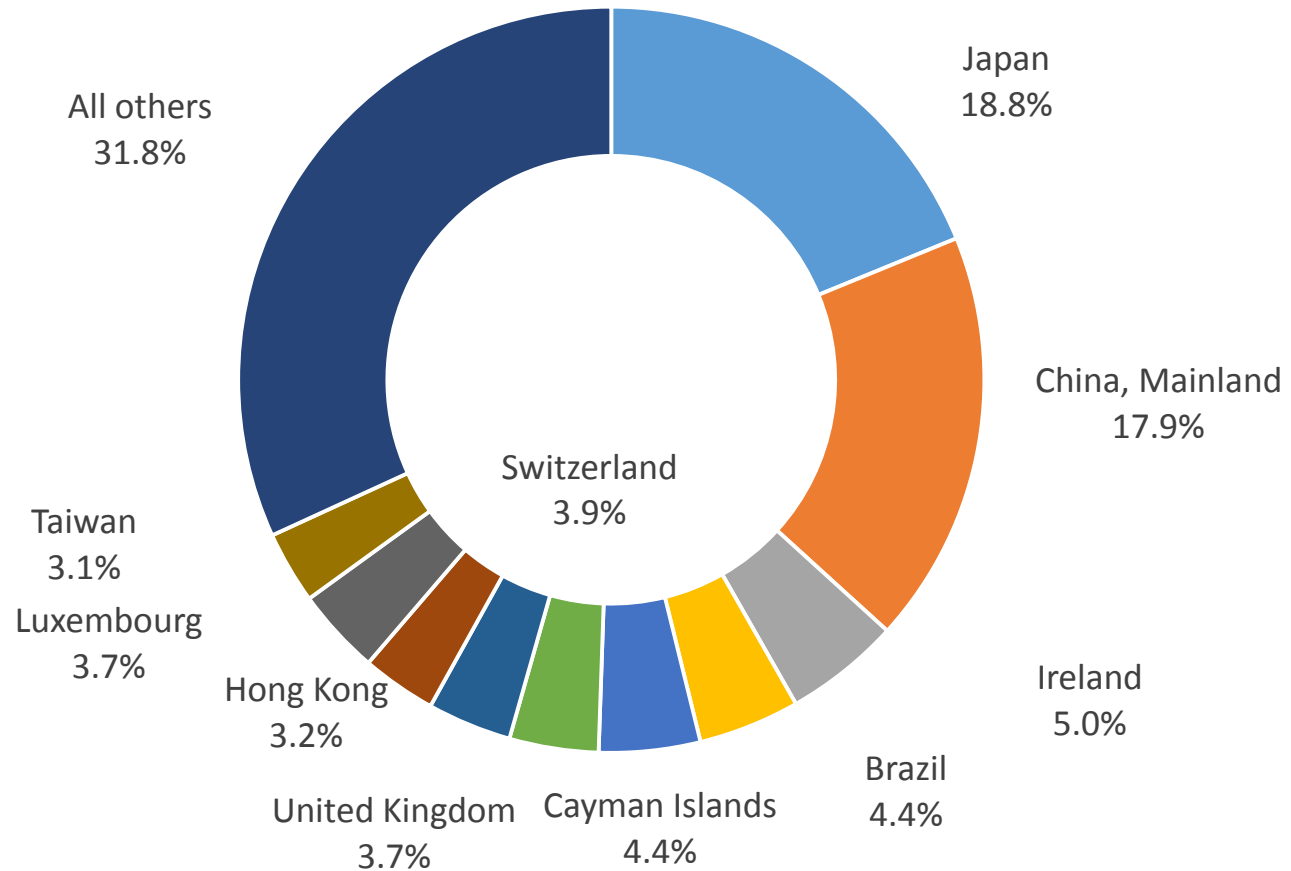
### Dead Line

- The Congressional Budget Office (CBO) projects the measures to be exhausted in the **Fall of 2017 (Sept to Nov)**. Though an earlier or later date is possible.
- At such a time, the U.S. Treasury will run out of cash and the government will be unable to fulfil its obligation.
- This will be the first time in the history of the United State of America to default on their debt obligation.
- In recent history, the closest they came was the government shutdown which lasted 16 days in Oct 2013.

## 2. U.S. Government Debt & its ceiling

### Default on U.S. Treasuries?

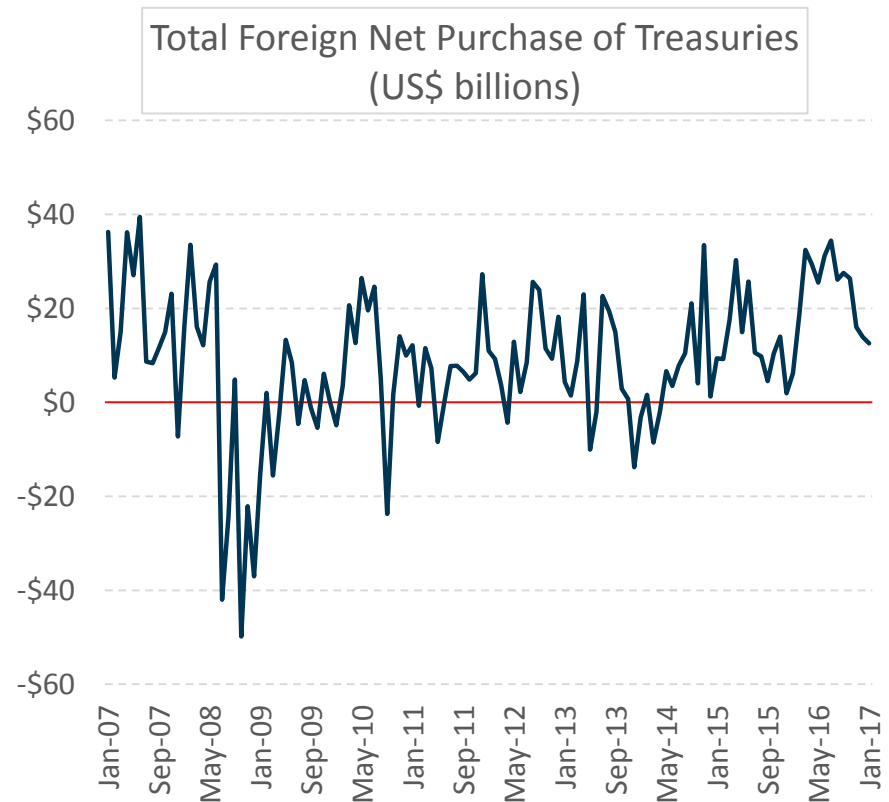
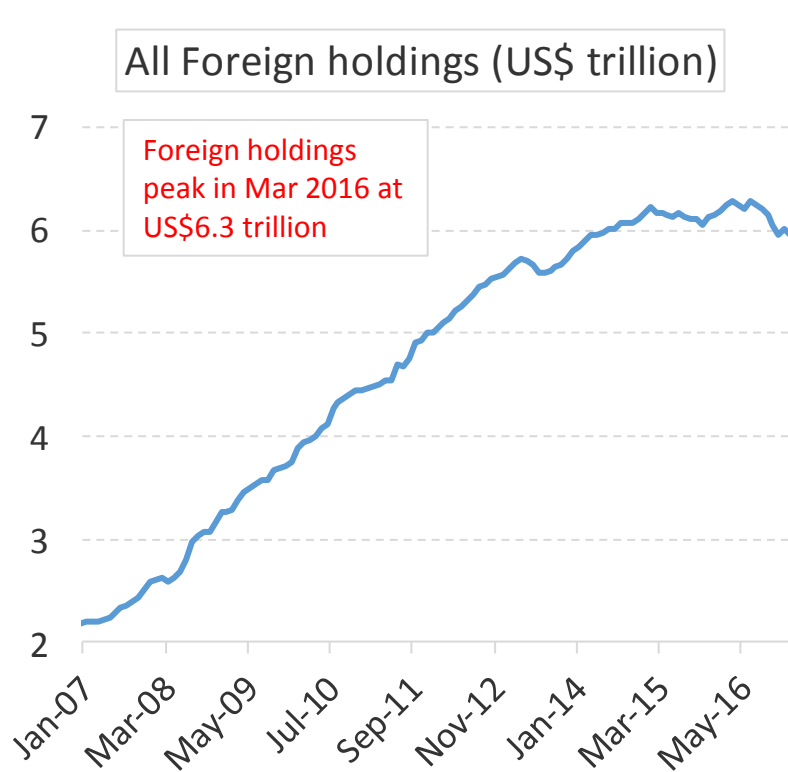
- Major foreign holders of U.S. Treasuries



Source: U.S. Treasury Department

## 2. U.S. Government Debt & its ceiling

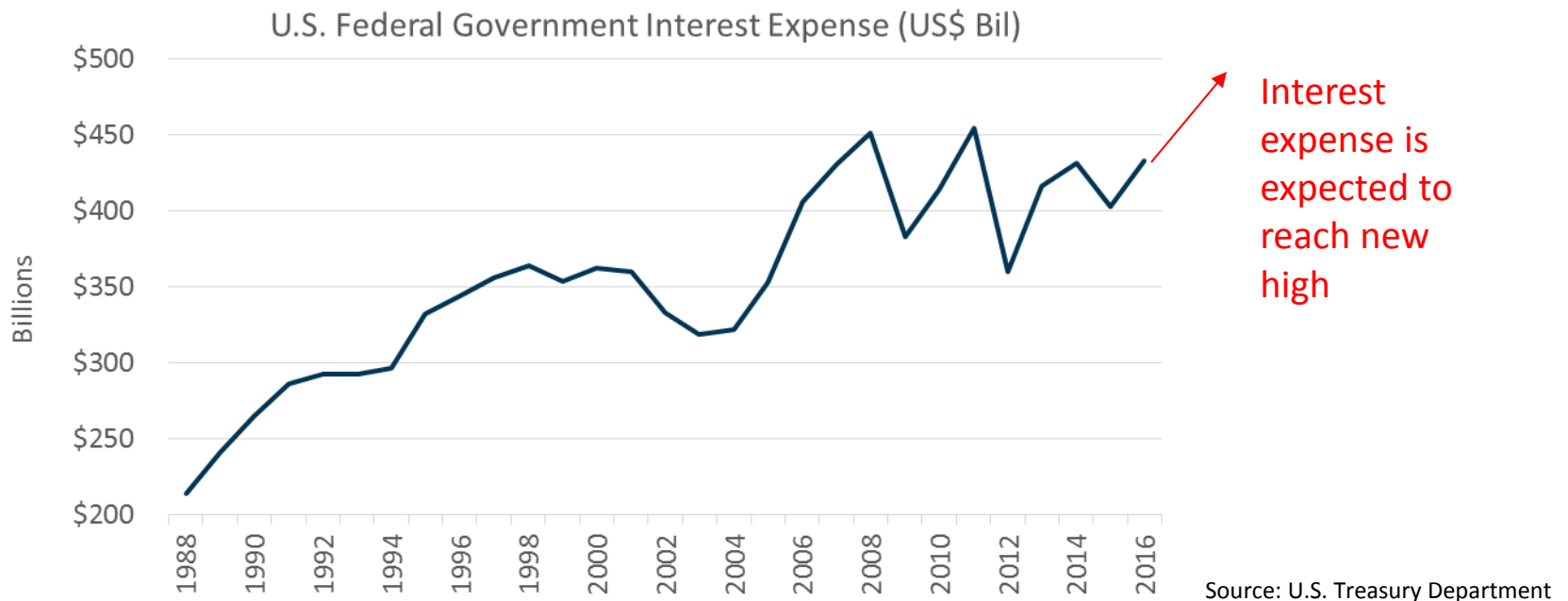
- Trend of major foreign holders of U.S. Treasuries is heading downwards
- This translate to the weakening confidence in the U.S. credibility.



Source: U.S. Treasury Department

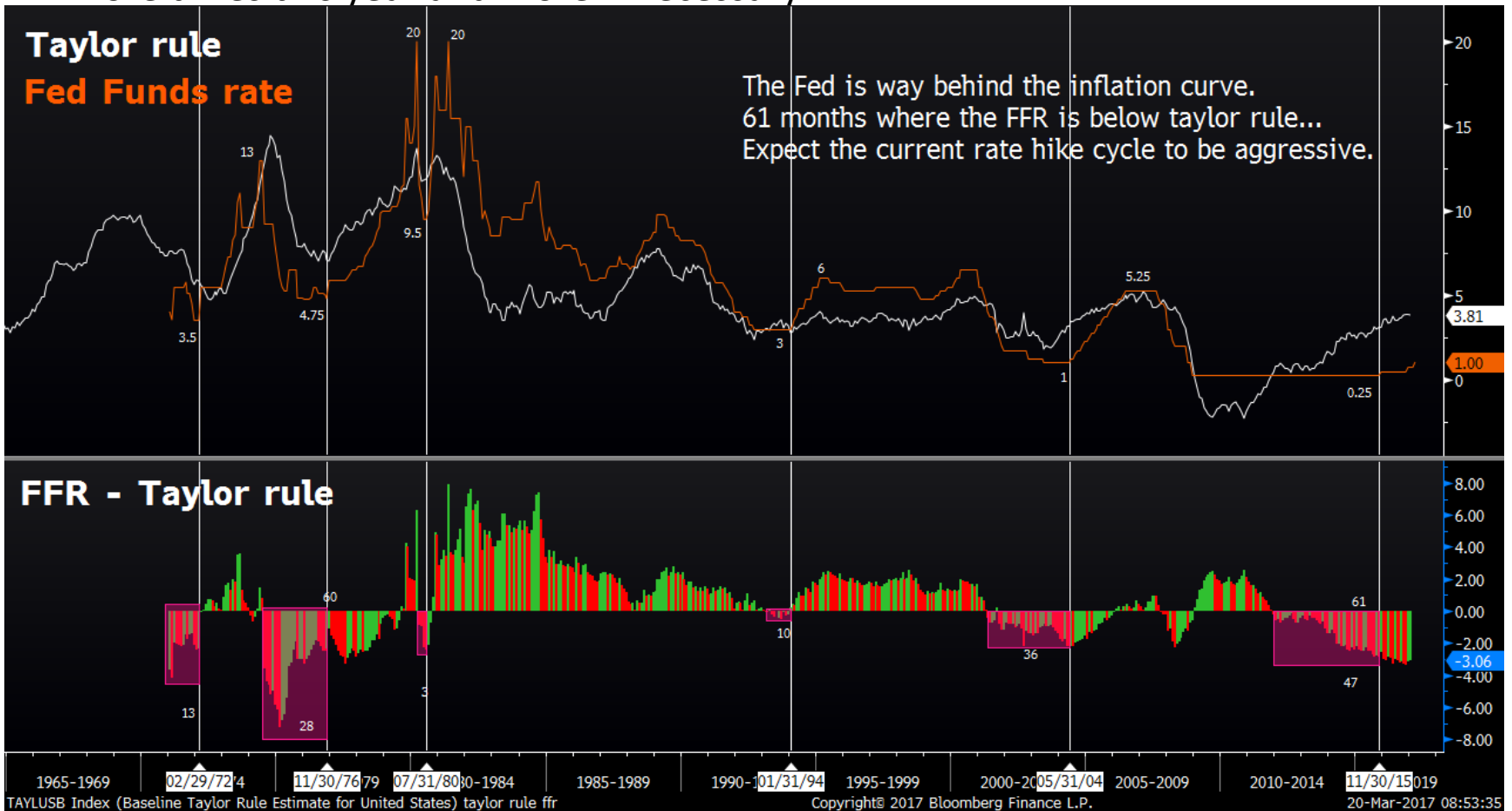
# 3. Impact of Fed Rate Hike

- Federal Reserve (Fed) hike its interest rate by 25bps on 15 March, bringing the Fed Fund rate to 1 percent.
- It was a “Dovish” hike as they reiterate their view of just 2 more rate hike this year.
- As with any form of debts, an increase in interest rate will increase the debt repayment burden for the U.S. Government.



# 3. Impact of Fed Rate Hike

- We believe that the Fed is behind the curve and will stick to the plan to hike 2 more times this year and more if necessary.



# 3. Impact of Fed Rate Hike

- Historically, the Fed has raised rates when the government debt continues to increase. The last time the Fed raise rate continually was in May 2004.
- However throughout the history, from Paul Volcker to Janet Yellen, no Fed Chairman has even raised the interest rate without drastically cutting rates later.
- In short, we felt that the Fed is increasing rates now so that they have more room for monetary easing later.

**Periods of Federal Reserve interest rate hike**

	Period of first rate Hike	Percentage points <u>increase</u> in Fed Fund rate	Months of continuous <u>increase</u>
1	April 1983, February 1984*	3.25	16
2	March 1987, February 1988*	3.75	23
3	January 1994	3.00	13
4	May 1999	1.75	12
5	May 2004	4.25	25

\*There was a pause in increment between the 2 dates

Source: Bloomberg

**Periods of Federal Reserve interest rate cut**

	Period of first rate Cut	Percentage points <u>decrease</u> in Fed Fund rate	Months of continuous <u>decrease</u>
1	September 1984	-5.88	17
2	May 1989	-6.75	26
3	June 1995	-0.75	17
4	December 2000	-5.50	19
5	August 2007	-5.00	39

1. The United States is currently at unprecedented debt level.
2. In an rising interest rate environment, U.S. Treasury will feel the increase pressure of it's interest payment burden.
3. However, the situation is not unique as we have been through a period of high debt and increasing interest rate environment before.
4. As long as they can continue their fiat currency system, without opposition from other countries, they will continue to accumulate more debt.

## Implication

1. Alternative currency: Cryptocurrency such as Bitcoin, IMF's Special Drawing Rights (SDR)
2. Moving back to the Gold Standard. Each U.S. dollar bill is a legal tenor to a certain amount of gold.

Tradable Instruments  
SGX: GLD US\$ (O87)



# Singapore REITs

## No surprises from Yellen - maintain Underweight

Tan Dehong

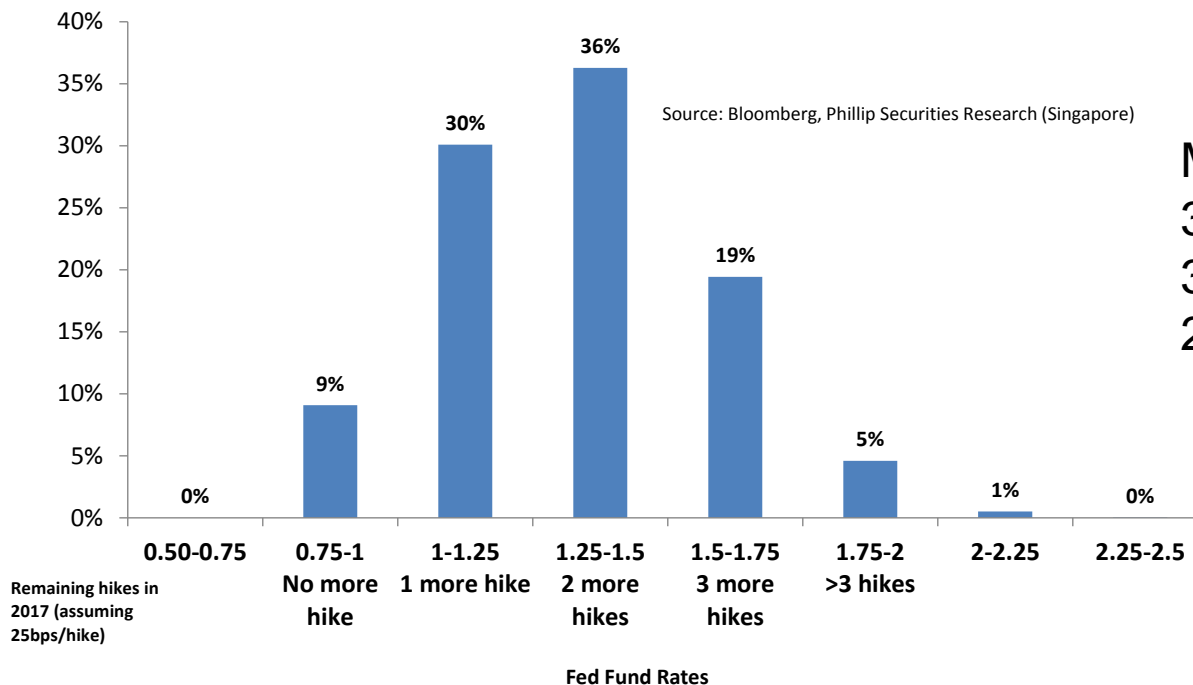
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# S-REITs: No surprises...March rate hike was already fully priced in

## March Rate hike – Market were already pricing in a 100% expectation for a rate hike.

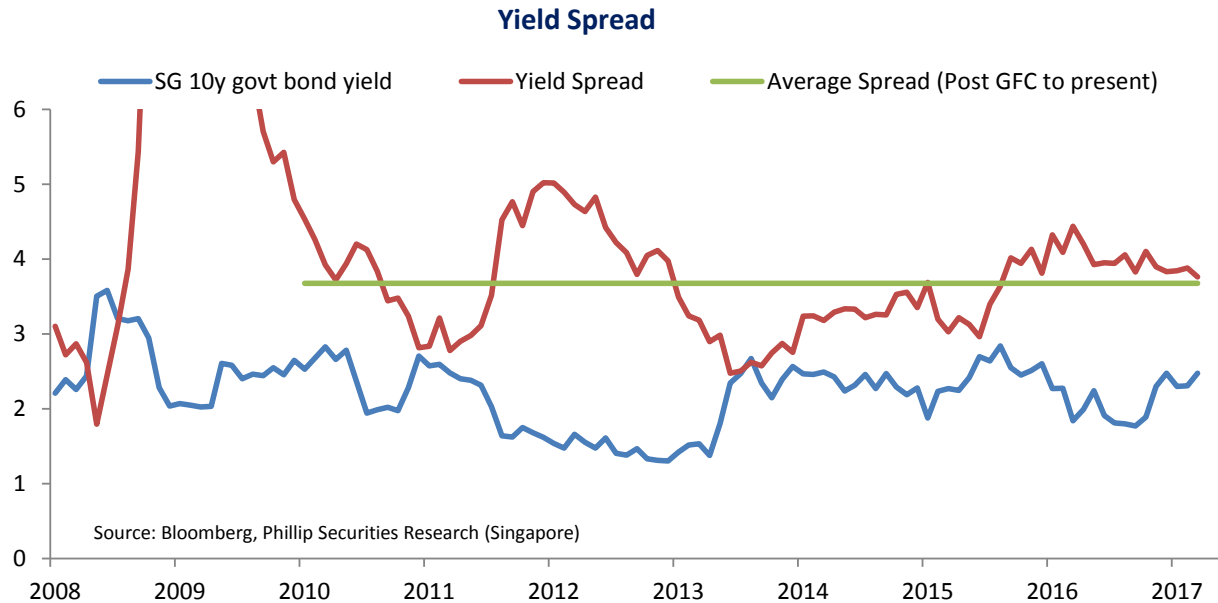
Market Implied Expectations for Fed Fund levels by Dec 2017



Market expectations:  
 36%: Total 3 rate hikes  
 39%: <3 rate hikes  
 25%: >3 rate hikes

# Yield Spread close to 7 year average but... Macro environment is more challenging now

## S-REITs historical yield spread vs Singapore 10 year govt bond yield



## No longer “Rising tide lifts all boats”

We favour REITs with lower gearing, supported by favourable macro-economic conditions or those with favourable long leases. Our **ACCUMULATE** ratings remain for **Croesus Retail Trust**, **Mapletree Industrial Trust** and **First REIT**.

# S-REITs: Normalizing interest rates – Adopt a bottoms up approach

	Mkt. Cap. (\$\$mn)	Price (\$\$)	PSR RATING	PSR TARGET PRICE (\$\$)	P/NAV	Trailing yield (%)	Total Returns YTD (%)	Gearing (%)	% of debt on fixed rate	Average borrowing cost (%)	% debt expiring in 2017/current FY	% debt expiring in 2018/next FY
<b>Healthcare</b>												
PARKWAYLIFE REAL ESTATE	1,476	2.44			1.42	4.97	4.28	36.3	99	1.4	2.0	0.0
FIRST REAL ESTATE INVNT TRUST	1,000	1.29	ACCUMULATE	1.32	1.28	6.57	3.25	31.1	92	4.0	34.2	35.8
<b>Hospitality</b>												
ASCOTT RESIDENCE TRUST	1,786	1.075			0.84	7.69	4.01	39.8	82	2.4	8.0	12.0
CDL HOSPITALITY TRUSTS	1,380	1.39			0.90	7.19	8.29	36.8	61	2.5	0.0	35.0
FAR EAST HOSPITALITY TRUST	1,065	0.59			0.65	7.34	0.22	32.1	71	2.5	35.0	28.0
OUE HOSPITALITY TRUST	1,224	0.68			0.89	6.78	5.08	38.1	69	2.5	10.1	30.5
FRASERS HOSPITALITY TRUST	1,249	0.68			0.91	7.80	4.62	33.7	88	2.6	14.4	15.3
ASCENDAS HOSPITALITY TRUST	843	0.75			0.89	7.23	6.38	33.3	66	2.6	20.8	37.9
<b>Retail</b>												
CAPITALAND MALL TRUST	6,824	1.925			1.02	5.78	3.92	34.8	97	3.2	6.7	16.0
MAPLETREE GREATER CHINA COM	2,712	0.97			0.80	7.61	2.63	40.5	85	2.8	0.0	7.0
SPH REIT	2,464	0.965			1.03	5.71	2.98	25.8	86	2.8	0.0	37.6
FRASERS CENTREPOINT TRUST	1,826	1.985	NEUTRAL	2.00	1.03	5.94	5.99	29.7	56	2.1	25.4	7.6
STARHILL GLOBAL REIT	1,592	0.73			0.79	7.00	1.00	35.2	99	3.2	0.0	35.4
CAPITALAND RETAIL CHINA TRUST	1,241	1.42	NEUTRAL	1.44	0.86	7.08	6.80	35.3	54	2.8	46.0	10.6
LIPPO MALLS INDONESIA RETAIL	1,094	0.39			1.00	8.74	7.76	31.5	70	N.A.	19.2	37.6
CROESUS RETAIL TRUST	650	0.855	ACCUMULATE	0.93	0.89	8.37	6.73	46.1	100	2.0	11.9	38.9
<b>Commercial</b>												
CAPITALAND COMMERCIAL TR	4,569	1.54	NEUTRAL	1.63	0.86	5.90	6.93	37.8	80	2.6	5.0	16.0
SUNTEC REIT	4,478	1.76			0.82	5.68	7.96	37.7	60	2.6	3.4	38.0
KEPPEL REIT	3,385	1.02			0.71	6.25	1.96	39.0	75	2.5	0.0	14.0
MAPLETREE COMMERCIAL TR	4,235	1.475			1.10	5.49	8.78	37.0	81	2.6	0.0	0.0
FRASERS COMMERCIAL TRUST	1,002	1.25			0.81	7.86	1.99	36.0	85	3.0	24.0	24.0
OUE COMMERCIAL REIT	892	0.685			0.74	8.99	3.59	39.9	79	3.6	0.0	49.4
<b>Industrial</b>												
ASCENDAS REAL ESTATE INV TR	7,119	2.47			1.19	7.32	12.36	31.8	66	3.0	9.7	22.5
MAPLETREE INDUSTRIAL TRUST	3,019	1.675	ACCUMULATE	1.74	1.22	6.76	3.88	29.4	67	2.6	2.8	17.0
MAPLETREE LOGISTICS TRUST	2,675	1.07			1.04	6.90	6.76	38.7	76	2.3	3.0	13.0
KEPPEL DC REIT	1,319	1.17	NEUTRAL	1.15	1.23	5.20	1.06	28.3	83	2.3	0.7	34.9
AIMS AMP CAPITAL INDUSTRIAL	856	1.34			0.91	8.37	3.24	34.6	84	3.7	0.0	25.0
CACHE LOGISTICS TRUST	729	0.81	REDUCE	0.73	1.04	9.54	2.31	43.1	63	3.6	0.0	35.3
SOILBUILD BUSINESS SPACE REIT	664	0.635	NEUTRAL	0.68	0.88	9.56	1.65	37.6	87	3.4	0.0	32.3
SABANA SHARIAH COMP IND REIT	479	0.455			0.71	9.15	22.47	43.2	90	4.2	26.7	20.4
VIVA INDUSTRIAL TRUST	748	0.775			0.98	8.98	4.03	39.4	90	4.0	0.0	22.0

Source: Bloomberg (Updated 15 March 2017), Company Results as of 31 Dec 2016, Phillip Securities Research (Singapore)

# How about developers in a rising interest rate environment?

## Continue to advocate switch from REITs to developers

Source: Bloomberg (Updated: 20 March 2017)

	Mkt. Cap. (S\$mn)	Price (S\$)	PSR RATING	PSR TARGET PRICE (S\$)	Upside to TP	P/NAV (x)	TOTAL RETURNS (%)			
							trailing yield (%)	1MTH	3MTH	1YR
<b>PROPERTY RELATED ALTERNATIVES</b>										
<a href="#">HO BEE LAND</a>	1,544	2.320	ACCUMULATE	2.64	14%	0.53	3.0	(0.4)	10.0	9.4
<a href="#">UOL GROUP</a>	5,568	6.920	ACCUMULATE	7.19	4%	0.69	2.2	6.9	11.3	19.5
<b>PSR Coverage high dividend yield counters with upside to TP (Ranked by market cap)</b>										
<a href="#">COMFORT DELGRO</a>	5,350	2.480	ACCUMULATE	2.92	18%	2.16	3.7	6.3	(1.9)	(11.3)
<a href="#">SHENG SIONG GROUP</a>	1,413	0.940	ACCUMULATE	1.06	13%	5.61	3.9	(0.5)	0.5	13.6
<a href="#">OLD CHANG KEE</a>	106	0.870	BUY	0.98	13%	3.34	6.9	1.2	6.1	42.8
<a href="#">NAM LEE PRESSED METAL</a>	88	0.365	BUY	0.52	42%	0.67	5.5	0.0	2.8	33.0

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Soh Lin Sin, Consumer | Healthcare

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Peter Ng, Property | Infrastructure

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