



# FROM THE FIXED INCOME DESK

## Monthly Outlook

### Summary

- US Treasury (UST) yields remained largely unchanged in May. The impact of a disappointing US payroll figure was offset by the release of the US Federal Reserve (Fed)'s April meeting minutes, which revealed that most policymakers favoured a rate hike in June should the US economy continue to improve.
- According to the People's Daily, an official media outlet of the Chinese Communist Party, a "person of authority" stated that China's economic growth would follow an "L-shaped" trajectory in the coming years, as the nation addresses the issues of excess industrial capacity and high leverage.
- The Philippine central bank will introduce a narrower interest rate corridor effective June 2016, in the hope that this will enhance the efficiency and effectiveness of monetary policy transmission.
- Asian credits registered gains in May, despite higher risk-free rates. For high-grade, spreads continued to tighten into a month of heavy new issuance. Asia high-grade returned 0.17%. Asia high-yield outperformed high-grade, gaining 1.03% for the month.
- In China, data released in May revealed strong sales momentum in the property sector. In the first four months of 2016, volume growth was 46%, while prices rose 12%. These figures bolstered positive sentiment towards real estate bonds.
- Rodrigo Duterte, mayor of the southern city of Davao, emerged as the clear winner of the Philippine presidential elections. Markets await details of the president-elect's economic platform and economic advisers. Mr. Duterte will be inaugurated as the Philippines' President on 30 June, for a six-year term.
- Despite a slow start to the month, activity in the primary market picked up after the release of US April employment data. There were 28 new high-grade issues totaling around USD 17bn, with issuance from China dominating new supply. New issuance in the high-yield space remained muted, with 3 new issues amounting to around USD 1bn.
- We maintain our constructive view on Indonesian bonds, and see a fair chance of a rating upgrade by S&P in the next 12 months. Meanwhile, we have a more bearish view on Thai and Korean bonds. We expect the Indonesian Rupiah to outperform its regional peers on the back of increased inflows.
- Recent data suggesting a moderation in the pace of growth in China and the recent depreciation trend of the CNY bears monitoring, as this could rekindle concerns over capital outflows from China.
- While the technical backdrop remains broadly supportive, this could be dampened if the pace of new issuance remains brisk.

## Asian Rates and FX

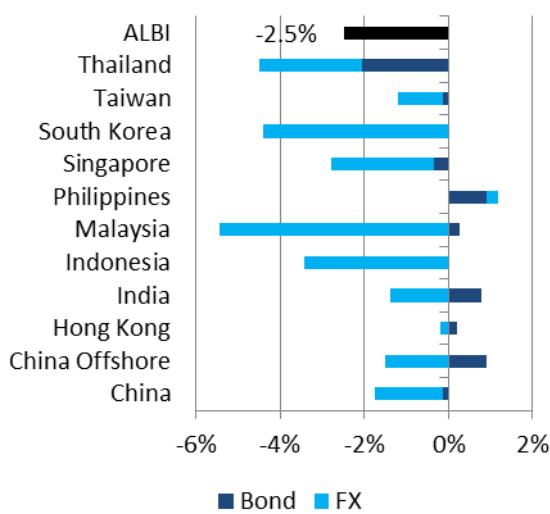
### Market Review

- Yields of US Treasuries largely unchanged

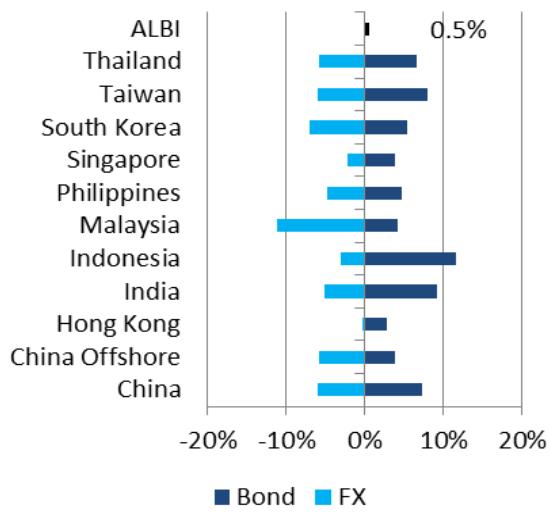
Yields of US Treasuries (USTs) initially declined, prompted by a disappointing US April payrolls report. However, risk-free rates subsequently jumped following the release of the US Federal Reserve's April meeting minutes. Markets quickly repriced a higher possibility of a June rate hike, as it became apparent that most policy makers favoured a rate hike in the coming months, should the US economy continue to improve. Overall, the 10-year point on the UST curve ended the month about 1bp higher compared to end-April levels.

### Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 May 2016



For the period from 29 May 2015 to 31 May 2016



Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of future performance. Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 May 2016

- Chinese economic growth expected to be "L-shaped"

The People's Daily, an official media outlet of the Chinese Communist Party, published an economic commentary that quoted a "person of authority". According to "the person of authority" – believed to be a senior government official – economic growth in China will follow an "L-shaped" trajectory in the coming years, as the country seeks to address issues of excess industrial capacity and high leverage. The article also highlighted that high leverage could lead to a systemic financial crisis, and advocated urbanisation as a means to reduce housing inventories.

- Philippine central bank introduced a narrower interest rate corridor

The Bangko Sentral ng Pilipinas (BSP) announced that it will narrow the interest rate corridor (IRC). Effective 3 June 2016, the central bank will use the overnight reverse repo rate as its benchmark rate. The standing overnight lending facility will serve as the ceiling for the IRC, with the standing overnight deposit facility as its floor. The BSP hopes that the narrower spreads between ceiling and floor rates – at 100 bps compared to the previous 350bps – will enhance the efficiency and effectiveness of monetary policy transmission.

### Market Outlook

- Overweight Indian and Indonesian bonds; underweight Thai and Korean bonds

We maintain our constructive view on Indonesian bonds and see a fair chance of a rating upgrade by S&P within the next 12 months. The move by Bank Indonesia to shift to a new policy benchmark will facilitate better price discovery, whereas the removal of withholding tax on bond interest payments, if implemented, should bolster demand for Indonesian bonds. Meanwhile, we hold a bearish view on Thai bonds. Benefits of further rate cuts in Thailand are becoming limited as the transmission of lower interest rates into the real economy has been subdued. This has led to increased focus on fiscal stimulus, in contrast to monetary easing. With four new monetary policy committee members within the Bank of Korea, we do not foresee further interest rate cuts in Korea in the near-term.

- Overweight IDR; underweight THB and KRW

We maintain that the Indonesian Rupiah will outperform regional peers, on the back of increased inflows into Indonesian equity and bond markets. These inflows, together with better growth prospects for the country pursuant to an anticipated recovery in domestic demand, should provide support for the Indonesian Rupiah. In contrast, we expect the Thai Baht to underperform as the Bank of Thailand's preference for a weak currency (to support the export sector) tips the scales towards further weakness for the currency. Meanwhile, plans by the Korean National Pension Fund to increase its overseas investments, along with a bias towards looser fiscal and monetary policies in Korea, are likely to place downward pressure on the Korean Won.

## Asian Credits

### Market Review

- Asian credits registered gains

Asian credits registered gains in May, despite higher risk-free rates. For high-grade, spreads continued to tighten into a month of heavy new issuance. Asia high-grade returned 0.17%. Asia high-yield outperformed high-grade gaining 1.03% for the month as high-yield spreads tightened more.

- Chinese property bonds supported by strong sales momentum

Chinese data released in May revealed strong sales momentum in the property sector. In the first four months of 2016, volume growth was 46%, while prices rose 12%. These figures bolstered positive sentiment towards real estate bonds.

- Philippines held peaceful elections

On 9 May, Filipinos headed to the polls to elect, among others, a new President. Rodrigo Duterte, mayor of the southern Philippine city of Davao, emerged as the clear winner with a strong mandate. Markets await details of the president-elect's economic platform and economic advisers. Mr. Duterte will be inaugurated as the Philippines' President on 30 June, for a six-year term.

- Financials dominated new supply within the high-grade space

The primary market had a slow start to the month, but subsequently picked up pace after the release of US April employment data. In May, there were 28 new high-grade issues totaling around USD 17bn, with issuance from China dominating new supply. New issuance in the high-yield space remained muted, with 3 new issues amounting to around USD 1bn.

### JP Morgan Asia Credit Index (JACI)

Daily returns for the period from 29 May 2015 to 31 May 2016

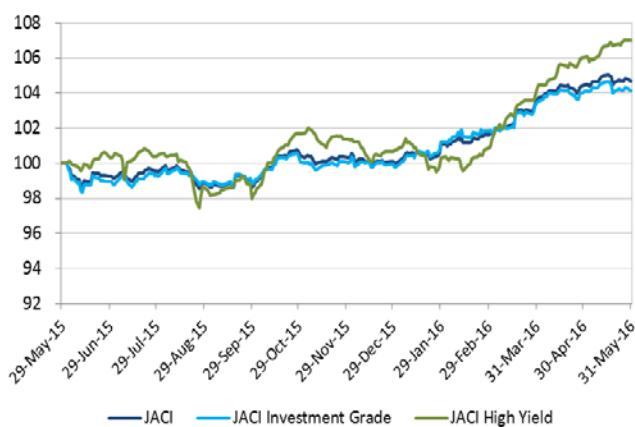
### Market Outlook

- Risk events in June could result in higher volatility

Heading into June, volatility could pick up into risk events like the BREXIT vote and the Federal Open Market Committee (FOMC) meeting, especially after recent proclamations by a number of FOMC members that a rate hike could be on the cards in the coming months. Recent data suggesting a moderation in the pace of growth in China and the recent depreciation trend of the CNY bears monitoring, as this could rekindle concerns over capital outflows from China.

- Technicals broadly still supportive, but could be damped by brisk supply

The technical backdrop remains broadly supportive. Spreads have continued to tighten in the face of sizeable new issuances in the past 2 months, particularly for high-grade. However, the technical backdrop could be damped if the pace of new issuance continues. Tighter valuations coupled with high expected supply in the near-term suggest a more defensive stance.



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 May 2016

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