September 2018

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ASIAN FIXED INCOME OUTLOOK

Summary

- In August, the US Treasury (UST) curve flattened. Near-term yields rose due to expectations of a September Federal Reserve (Fed) rate hike, while mid to long-dated yields fell. Escalating US-China trade tensions and the weaker-than-expected July US jobs report pushed UST yields lower at the start of the month. Investor sentiment for risky assets was affected by Turkey's political and economic headlines, but subsequently improved on the back of a positive turn in Mexican-United States trade relations.

- Overall, 10-year yields ended at 2.86%, about 10 basis points (bps) lower compared to end-July, while 2 year-yields fell by 4bps to 2.63%.

- Asian credits registered another month of positive returns in August. Lower UST yields lifted the market as credit spreads widened on the back of heightened macro risks in several Emerging Market (EM) countries. Consequently, Asian high-grade returned 0.66%, outperforming high-yield corporates which returned 0.10%.

- Within the region, inflationary pressures rose in July. Meanwhile, India posted the fastest second quarter GDP growth in the region. GDP growth accelerated to 8.2% Year-on-Year (YoY) (from 7.7% in the first quarter), led by a pickup in domestic private demand.

- In central bank news, monetary authorities in India, Indonesia and the Philippines raised policy rates. The People's Bank of China (PBoC) reintroduced reserve requirement on FX transactions and counter-cyclical factor in CNY fixing, in a bid to support its currency. Amid worsening growth prospects and a trade war with the US, Chinese policymakers also called to stabilise growth and financial markets.

- Meanwhile, the primary market activity remained modest. There were 15 new issues worth around USD 10.68bn in the high-grade space, while the high-yield space saw a total of 13 issues amounting to about USD 2.94bn.

- On local currency bonds, we are positive on Malaysia and China bonds as the former offer relatively attractive and stable real yields. We also expect Bank Negara Malaysia to remain in the periphery for rate hikes in the near-term. As for the latter, Chinese policymaker's resolve to inject money into the economy to support growth should be supportive of bond prices.

- On currencies, we expect the Thailand Baht (THB) to outperform the Indian Rupee (INR) and Indonesian Rupiah (IDR). Thailand's large account surplus and hawkish comments from Thai government officials should be supportive of the THB.

- Looking forward for Asian credit, spreads should remain volatile. Ongoing US-China trade tensions, heightened macro risks in EM countries particularly in Turkey and Argentina, as well as the continued weakening of local currencies and bonds in Indonesia and India, are some key concerns. The primary market for issuances that had re-started in August is likely to continue into September, limiting any scope for spread tightening in the secondary market.

Asian Rates and FX

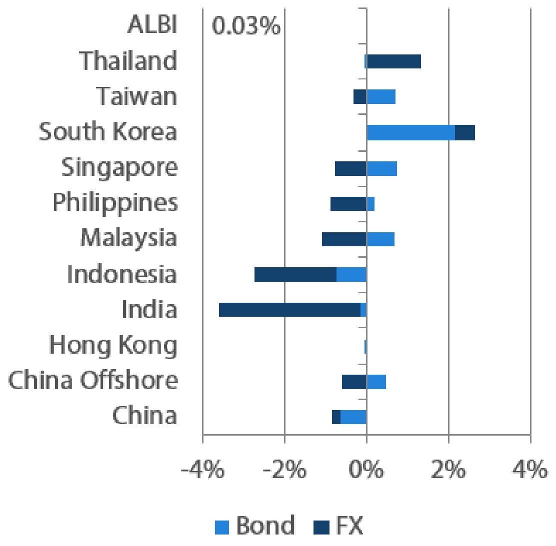
Market Review

USTs registered gains in August

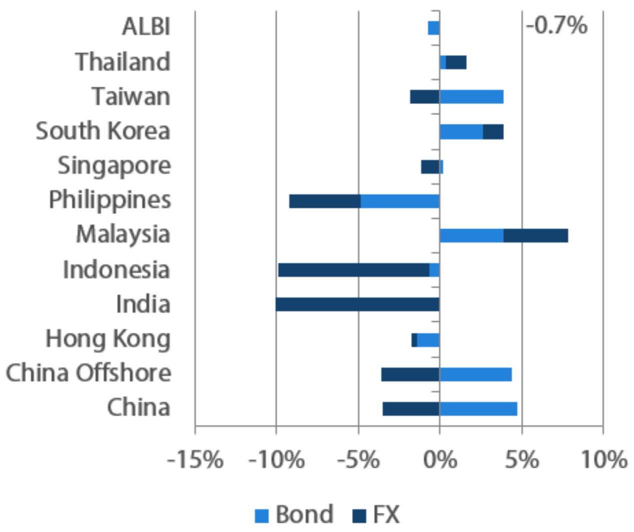
The UST yield curve flattened in the month, as near-term yields (supported by expectations of a September Fed rate hike) rose, and mid to long-dated yields fell. Escalation of trade tensions between the US and China and the weaker-than-expected July US jobs report pushed UST yields lower at the start of the month. Turkey's political and economic headlines drew attention soon after, as US-imposed sanctions triggered an unraveling of Turkish assets, causing the Lira to take a sharp stumble. Investor sentiment for risky assets was adversely affected, and demand for treasuries rose further. Risk sentiment improved towards month-end, on the back of a positive turn in Mexican-United States trade relations, prompting USTs to give up some of its earlier gains. Overall, 10-year yields ended at 2.86%, about 10bps lower compared to end-July.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 August 2018



For the year ending 31 August 2018



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 August 2018

Note: Bond returns refer to ALBI indices quoted in local currencies while FX refers to local currency movement against USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Inflationary pressures rise across Asia in July

Headline Consumer Price Index (CPI) inflation prints across the region saw an acceleration in July. Inflationary pressures in the Philippines rose significantly to 5.7% Year-on-Year (YoY) from 5.2% in June. Much like previous months, the pick-up came across the board. The rise in Thailand's headline inflation rate was also broad-based. Notably, the latest print of 1.46% is the fourth consecutive month that headline CPI has registered within the central bank's target range of 1-4%. In Singapore, although headline CPI was unchanged at 0.6% in July, core inflation, which leaves out accommodation and private road transport costs, jumped to a four-year high. Elsewhere, rising fuel prices led headline CPI prints in both Malaysia and China to register higher in July.

India posted the fastest second quarter GDP growth in the region

The Indian economy grew fastest among major Asian economies in the second quarter of 2018. GDP growth accelerated to 8.2% YoY (from 7.7% in the first quarter), led by a pickup in domestic private demand. In the Philippines, the 6.0% GDP growth print - a three-year low - came in much lower than expected. Construction sector activity was a bright spot, agriculture sector growth decelerated, while mining sector growth contracted. GDP growth in Malaysia similarly moderated. At 4.5% YoY, this also came well below expectations. The main drag was net exports, which offset a pick-up in domestic demand growth. In Thailand, growth in the second quarter eased to 4.6%. However, although this was lower than the upwardly revised 4.9% expansion in the previous period, it was encouraging that domestic demand gained more traction in the April to June period, with private consumption growth accelerating at the strongest pace in 21 quarters.

Monetary authorities in India, Indonesia and the Philippines raised policy rates anew

The Bangko Sentral ng Pilipinas (BSP) raised its policy rate by a more aggressive 50bps in August. This move follows back-to-back 25bps rate hikes in May and June, and was "necessary to rein in inflation expectations", according to BSP Governor Nestor Espenilla. The central bank maintained its hawkish tone, and left the door open to more rate hikes. In addition, it significantly raised its inflation forecasts to 4.9% (from 4.5%) and 3.7% (from 3.3%) for 2018 and 2019, respectively. Similarly, Bank Indonesia hiked interest rates by 25bps, and maintained its hawkish rhetoric. The central bank said that the move was consistent with maintaining the attractiveness of the domestic financial market and keeping the current account deficit manageable. Meanwhile, the Reserve Bank of India's monetary policy committee voted 5-1 to raise rates by another 25bps, although the policy stance was left "neutral". Separately, following the better-than-expected second quarter GDP growth print in Thailand, Bank of Thailand Governor Governor Santiprabhob said that the central bank needed "to have enough bullets in hand" to build policy space for future uncertainty.

PBoC reintroduced reserve requirement on FX transactions and counter-cyclical factor in CNY fixing

The Renminbi (RMB) experienced marked volatility in the month. Fresh threats of trade measures from the US put the RMB under pressure in early August. In a bid to support its currency, the PBoC reinstated a reserve requirement that makes shorting the CNY costlier with forwards. Optimism that trade talks between the US and China mid-month could yield some progress allowed the CNY to recover most of its losses. However, the recovery was constrained by renewed emerging market concerns after the sharp stumble in the Turkish Lira. Towards month-end, the central bank reintroduced a 'counter-cyclical' factor to its daily CNY fixing mechanism to counter the bias toward a weaker yuan.

Market Outlook

Positive on China and Malaysia bonds

Markets have largely priced in a September rate hike by the US Fed. Fed Chairperson Jerome Powell's recent comments at Jackson Hole were interpreted as largely dovish, notably his reference to the economy as strong but not overheating. Meanwhile, we may see trade tensions between the US and China escalating further soon, as a new round of tariffs on USD 200bn China imports into the US could be implemented as early as September. China had previously threatened to retaliate with additional tariffs on USD 60bn of US goods. This, together with continued turbulence in EM currencies, will dampen investor risk appetite in the near-term, supporting demand for perceived 'safe-haven' assets. Within Asian local government bonds, we continue to prefer Malaysia and Chinese bonds. Malaysia government bonds offer relatively attractive and stable real yields. Moreover, unlike other central banks in the region who are raising interest rates, Bank Negara Malaysia is expected to remain in the periphery in the near-term. Meanwhile, Chinese policymaker's resolve to inject money into the economy to support growth should be supportive of bond prices.

Expect THB to outperform INR and IDR

Amid the weak tone in markets, we are cautious of the INR and IDR and expect the THB to outperform regional peers. Investor focus on challenges for funding India and Indonesia's current account deficits are likely to put pressure on the INR and IDR. Meanwhile, Thailand's large current account surplus should allow the THB to be relatively resilient vis-à-vis peers. Hawkish comments from Thai government officials will also provide support for the THB.

Asian Credits

Market Review

Another positive month for Asian credits

Asian credits registered a second consecutive month of positive returns in August. Lower UST yields lifted the market, as credit spreads widened on the back of heightened macro-risks in several EM countries. Consequently, Asian high-grade returned 0.66%, outperforming high-yield corporates which returned 0.10%. Overall, the 10-year UST yield eventually ended at 2.86%, about 10bps lower compared to end-July. The yield curve continued to flatten with the 2-year UST yield lower by 4bps to 2.63%.

Chinese policymakers called for stabilising growth and financial markets

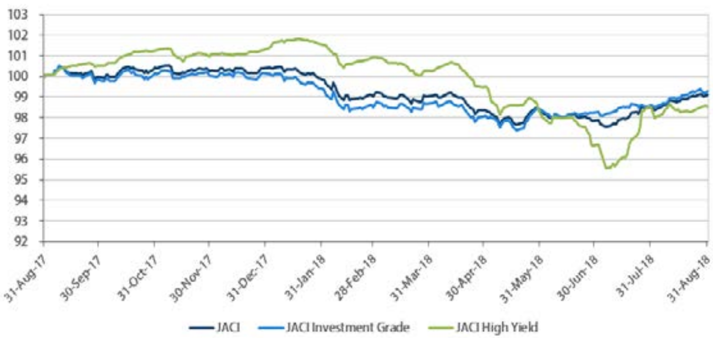
Amid worsening growth prospects and a trade war with the US, China's top decision-making body vowed to stabilise employment, financial markets, international trade, foreign investment, and market expectations. Echoing the State Council's call for "more proactive' fiscal policy to spur growth, the Politburo vowed to utilise fiscal policies to expand domestic demand and increase infrastructure investment, and further clarified the monetary policy shift towards easing. Following the call, the China Banking and Insurance Regulatory Commission (CBIRC) published a circular to "further improve the quality and efficiency of credit easing." Separately, the Ministry of Finance reiterated the call to speed up issuance of special-purpose local government bonds.

Primary market activity remained quiet

A combination of the usual summer month lull and overall risk aversion in markets led the primary market activity to remain modest in August. Total issuance amounted to about USD 13.59bn. There were 15 new issues worth around USD 10.68bn in the high-grade space, including a large USD 5.5bn issuance across 3 tranches from Sands China. Within high-yield, the space saw a total of 13 issues, amounting to about USD 2.94bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 31 August 2017



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 August 2018

Market Outlook

Spreads to remain volatile given a number of macro risks and supply pressure

Asian credit spreads should remain volatile heading into September. The intensifying and increasingly protracted trade tensions between China and the US show no signs of abating. The impact of the additional tariffs to the Chinese economy and the broader impact to other Asian countries remain a concern even as the Chinese authorities have undertaken targeted measures to stabilise economic growth. Worries over twin deficit countries have mounted over developments in the broader EM space, in particular those in Turkey and Argentina. Continued weakening of local currencies and bonds from countries such as Indonesia and India should continue to weigh on sentiment towards hard currency issues from these countries, at least in the very near-term. However, the economic fundamentals for these countries have improved since the taper tantrum in 2013 as acknowledged by the sovereign rating upgrades since. The policy response to stabilise the local currency and local bond market, from Indonesia in particular, has also been proactive. In terms of supply technical, the primary market for issuances that had re-started after sentiment stabilised in August is likely to continue into September. This should limit any scope for spread tightening in the secondary market.

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