October 2018

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ASIAN FIXED INCOME OUTLOOK

Summary

- In September, the US Federal Reserve (Fed) raised interest rates by 25 basis points (bps). The monetary authority removed the clause that policy rates are "accommodative", and modestly raised its growth forecasts for this year and next. Bond yields rose on the back of positive US growth data, and receding global fears as sentiment over Emerging Market (EM) currencies somewhat stabilised.

- Overall, 10-year yields ended at 3.06%, about 20bps higher compared to end-August and 2-year UST yields rose by 19bps over the same period.

- Asian credit registered slight losses in September, prompted mainly by the rise in US Treasury (UST) yields. Asian high-grade returned -0.33%, with spreads tightening about 3bps. High-yield corporates outperformed, returning 0.48%, as overall risk sentiment improved and caused spreads to tighten about 11bps.

- Within the region, inflationary pressure was mixed. August Consumer Price Index (CPI) inflation in the Philippines, China, Singapore and Thailand accelerated, while it moderated in Malaysia, South Korea and India.

- Central banks in Indonesia and the Philippines further tightened monetary policies. Both monetary authorities have raised rates by a cumulative 150bps since May. Moody's and S&P downgraded the ratings of several issuers linked to Local Government Financing Vehicles (LGFVs).

- Meanwhile, the primary market activity picked up in September. There were 34 new issues worth around USD 18.3bn in the high-grade space, while high-yield saw a total of 12 issues amounting to about USD 3.3bn.

- On local currency bonds, we continue to prefer Malaysian and Chinese, with Malaysia offering relatively attractive and stable real yields. We also expect Bank Negara Malaysia to remain in the periphery for rate hikes in the near-term. Meanwhile, Chinese policymaker's resolve to inject money into the economy should be supportive of bond prices, although we are cognizant that the October supply risk may add pressure in the short term.

- On currencies, we continue to expect the ringgit and baht to outperform regional peers. The baht's stable and services driven current account surplus, as well as Malaysia's strong current account position, are some factors that support both currencies.

- Heading into 4Q2018, US-China trade tensions and monetary policy tightening in the US continue to be headwinds for Asian credit. Indonesia and India credit remain susceptible to broader EM developments as well as increased scrutiny over their twin deficits. The primary market for issuances was reasonably active in September but still came in less than expected. Some pick-up is expected after early October. Meanwhile, all-in yields look attractive from a historical context.

Asian Rates and FX

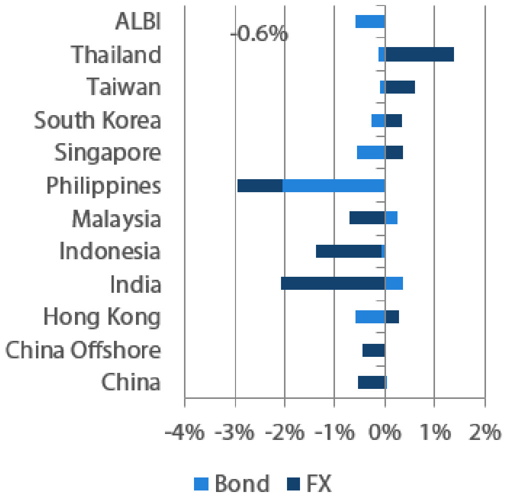
Market Review

US Fed raised policy rates by 25bps

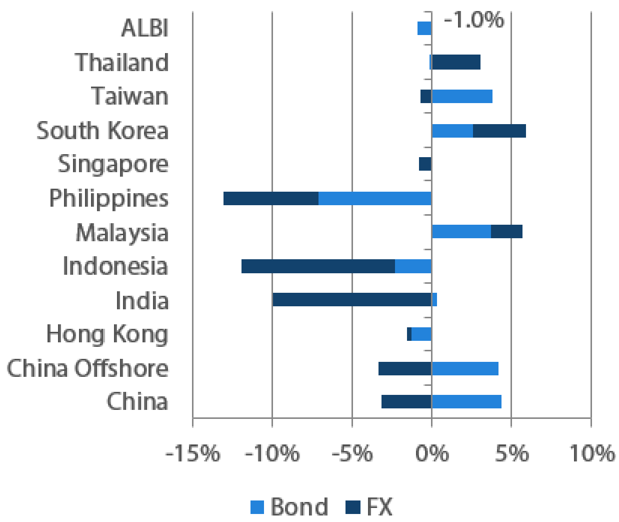
The US Fed raised interest rates by 25bps in a well-anticipated move. Notably, the monetary authority removed the clause that policy rates are "accommodative", and modestly raised its growth forecasts for this year and next. Overall, 10-year yields ended at 3.06%, about 20bps higher compared to end-August.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 30 September 2018



For the year ending 30 September 2018



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 30 September 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.

Inflation picture across Asia was mixed in August

August headline CPI inflation in the Philippines, China, Singapore and Thailand accelerated, and moderated in Malaysia, South Korea and India. Inflationary pressure in the Philippines rose sharply - to 6.4% Year-on-Year (YoY) in August - exceeding the central bank's projected range. The pick-up was led by food costs. Notably, inflation is now above the official inflation target of 2-4% for the sixth consecutive month. Similarly, higher food-price inflation was a main driver of CPI in both Thailand and China. Meanwhile, a favourable base effect from fuel price hikes last year prompted the moderation in Malaysia's CPI inflation, while a sharp reduction in food-price inflation was a main driver of the lower inflation in India. In Indonesia, both headline and core CPI stayed broadly stable relative to July.

Central banks in Indonesia and the Philippines further tightened monetary policy

The Bangko Sentral ng Pilipinas (BSP) delivered another 50bps hike for a second consecutive meeting, substantiating its resolve to rein in inflation expectations. The central bank noted that CPI pressures are "broadening", due to a range of factors including FX volatility and elevated external risks. It maintained its hawkish stance, and raised its inflation forecasts to 5.2% (from 4.9%) this year, and to 4.3% (from 3.7%) in 2019. Similarly, Bank Indonesia (BI) hiked interest rates by 25bps – the fifth time that the central bank has tightened monetary policy since May – as it attempts to contain capital outflows amid a weaker rupiah. As with the BSP, BI also maintained a decisively hawkish tone. Notably, both monetary authorities have now raised their respective policy rates by a cumulative 150bps since May.

China announced it will issue CNH bills

The People's Bank of China (PBoC) and Hong Kong Monetary Authority (HKMA) signed an agreement to issue yuan-denominated bills in the offshore market. The size and timing of bill issuance have not been announced. According to the PBoC, this move "aims to enrich the spectrum of renminbi financial products of high credit rating in Hong Kong, improve the yield curve of renminbi bonds in Hong Kong and support the development of offshore renminbi business in Hong Kong." Markets took the news negatively, as they read it as an effort by the Chinese central bank to tighten liquidity in the offshore market.

Market Outlook

Positive on China and Malaysia bonds

The US economy continues to advance unimpeded, and the Fed has indicated that it is likely to continue this normalisation cycle. Against such a backdrop, bond yields are likely to rise slightly. However, we also see further escalation, rather than resolution, of trade tensions in the near-term. This, together with the upcoming US mid-term elections scheduled in November, are likely to trigger renewed bouts of 'safe-haven' demand. We expect these two factors to act as firm counter-forces against strong US economic data in driving long-end UST yields in the next few months. Consequently, we see risk of UST yields moving lower at this point. While sentiment over EM currencies somewhat improved in September, investors are likely to continue to tread cautiously, on leverage concerns surrounding some EM countries such as Turkey and Argentina. Within Asia, we foresee sentiment toward high yielders such as India, Indonesia and the Philippines to remain fragile, on account of their greater external vulnerabilities. Instead, 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, which are raising interest rates, Bank Negara Malaysia is expected to remain in the periphery in the near-term. Meanwhile, the Chinese policymaker's resolve to inject money into the economy to support growth should be supportive of bond prices. However, we are cognizant that October supply risk may add some pressure in the short-term.

Positive on ringgit and baht

We continue to expect the ringgit and baht to outperform regional peers. The baht's stable and services driven current account surplus, together with a hawkish Thai central bank, are factors that support demand for the currency. Malaysia also enjoys a strong current account position. This, coupled with continued robust economic activity and high oil prices, should allow the ringgit to be more resilient relative to peers.

Asian Credits

Market Review

Asian credit ended lower in September

Asian credit registered slight losses in September, prompted mainly by the rise in UST yields. Asian high-grade returned -0.33%, with spreads tightening about 3bps. High-yield corporates outperformed, returning 0.48%, as overall risk sentiment improved and caused spreads to tighten about 11bps. Overall spreads had initially widened on the back of pressure from EM volatility. Further escalation in China-US trade tensions also contributed to initial weak market sentiment. Mid-month, global fears ebbed and sentiment over EM currencies somewhat stabilised, after Turkey's central bank lifted policy rates by 625bps. EM bond inflows followed with risk assets rallying, causing spreads to tighten. Meanwhile, positive US growth data prompted UST yields to tread higher. Comments from ECB President Mario Draghi that he expects a "relatively vigorous" pick-up in underlying euro-area inflation contributed to the rise in core European bond yields and also pressured UST yields higher. Separately, the US Fed raised interest rates by 25bps in a well-anticipated move, with the monetary authority removing the clause that policy rates are "accommodative". Overall, 10-year yields ended at 3.06%, about 20bps higher compared to end-August and the 2-year UST yields rose by 19bps over the same period. For 3Q2018, Asia high-grade returned 0.76%, as credit spread compression and carry offset the rise in UST yields. For the quarter, 10-year UST yields rose by 20bps and the 2-year UST yields rose by 29bps. Asian high-yield corporates outperformed, returning 2.13% as credit spreads tightened by 16bps.

Moody's and S&P downgraded LGFVs

S&P Global Ratings and Moody's Investors Service downgraded the ratings of several issuers linked to Chinese regional and local governments, on the view that support from local governments for LGFVs will weaken over time. S&P added that the downgrades also "reflect the gradual weakening of the (financing vehicles') roles and links with their local-government parents." However, market reaction to the downgrades was largely muted, as they were largely expected. India credits came under pressure from a variety of drivers including Indian Rupee (INR) weakness, high oil prices weighing on the current account deficit and a number of idiosyncratic developments in the financial sector.

Primary market activity picked-up in September

Primary market activity picked-up in the month, with total issuance amounting to about USD 21.64bn. There were 34 new issues worth around USD 18.3bn in the high-grade space, including USD 3bn from Bank of China (Hong Kong) capital instrument, USD 2.4bn from Sinopec Group, and a USD 1bn sovereign issuance from Republic of Korea. Within high-yield, the space saw a total of 12 issues, amounting to about USD 3.3bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 30 September 2017

Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 30 September 2018

Market Outlook

Headwinds remain for Asian credit going into 4Q2018

The trade tensions between China and the US continue to escalate and seem increasingly likely to be protracted. Despite this, Asian credit spreads have remained well-supported. Nevertheless, monetary policy tightening, especially in the US, looks set to continue. This should remain a headwind for fixed income assets going into the coming quarter. Local currency weakness has abated for a number of countries such as in Indonesia and India. However, credit in these countries remains susceptible to broader EM developments and increased scrutiny over their twin deficits in an environment of tighter US monetary policy and rising oil price. The impact of the additional tariffs imposed on the Chinese economy and the broader impact to other Asian countries remain uncertain, even as the Chinese authorities have undertaken targeted measures to stabilise economic growth.

Reduction in new issuances more a function of lackluster demand; all-in yields look attractive from historical context

In terms of supply technical, the primary market for issuances was reasonably active but still came in less than expected in September. Primary activity should see some pick-up after early October. Unless supply comes in significantly heavier than expected, spreads should remain driven more by macro developments. While high-grade and high-yield spreads do not look particularly cheap on a historical basis, all-in yields for high-grade and high-yield corporates (at 4.82% and 8.30% respectively) have risen sharply with UST yields and are now above the historical averages seen over the last five years.

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