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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- US Treasury (UST) yields rose in the first half of the month buoyed by hawkish comments from the Federal Reserve (Fed), a solid US jobs report and possible scale back of quantitative easing (QE) by the European Central Bank (ECB). While the Fed raised short-term interest rates, as expected, the absence of a more hawkish tone from the central bank triggered a drop in UST yields. As a result, the 10-year point on the UST yield curve ended at 2.39%, largely unchanged compared to end-February levels.

- Chinese officials lowered 2017 GDP growth forecasts to 'around 6.5%', down from last year's range of 6.5-7.0%. Local revenue bond issuance is also expected to be increased and the country's value-added tax regime to be simplified. Meanwhile, the central bank lifted short-term interest rates.

- In India, Prime Minister Modi's Bharatiya Janata Party secured a landslide victory in the country’s biggest state assembly. This win gives Modi an edge over opposition ahead of the national election in 2019, where he is expected to seek a second term.

- Asian credits made slight gains in March as credit spreads tightened on the back of strong flows into Emerging Markets. Asian high-grade returned 0.19% and Asian high-yield corporates returned 0.39%.

- Korea is slated to hold special elections on 9 May to replace impeached leader Park Geun-hye's. Moon Jae-in, from the Democratic Party of Korea, is currently seen as the front-runner in the upcoming elections.

- The primary market continued to be busy in March. The total issuance amounted to about USD 35.9bn in the month – 31 issues worth USD 20.5bn from high-grade and 33 issues worth USD 15.4bn from high-yield. Notably, Chinese issuers dominated the supply pipeline.

- We foresee high yielders like Indian and Indonesian bonds outperforming as the Fed appears inclined towards adopting a gradual tightening path. Meanwhile, we remain cautious on Philippine bonds. On the currency front, IDR and INR will are expected to outperform on the back of high carry levels, strong foreign direct investment, and more resilient foreign exchange reserves. Conversely, we are cautious on the PHP.

- Volatility is likely to remain, fuelled by uncertainty surrounding President Trump’s policies, elections in Europe, and the potential withdrawal from QE by the ECB and Bank of England. That said, a gradual tightening path taken by the Fed should be supportive of risk assets. We can expect improving macro and micro conditions in Asia as well as range-bound UST yields, USD and crude oil prices to support the Asian credit space. However, we note that spread valuations have become increasingly tight on a historical basis.

Asian Rates and FX

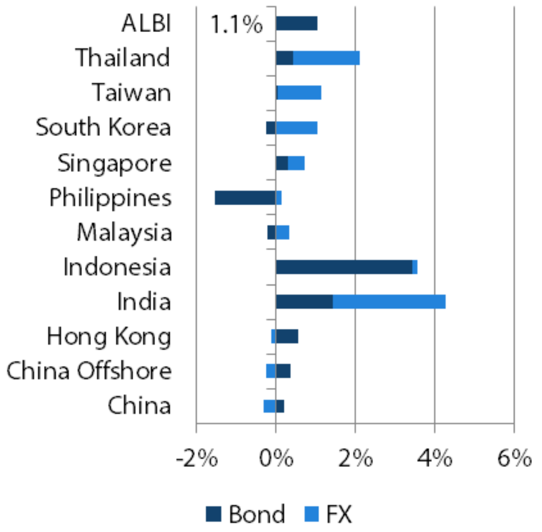
Market Review

- UST yields ended largely unchanged in March

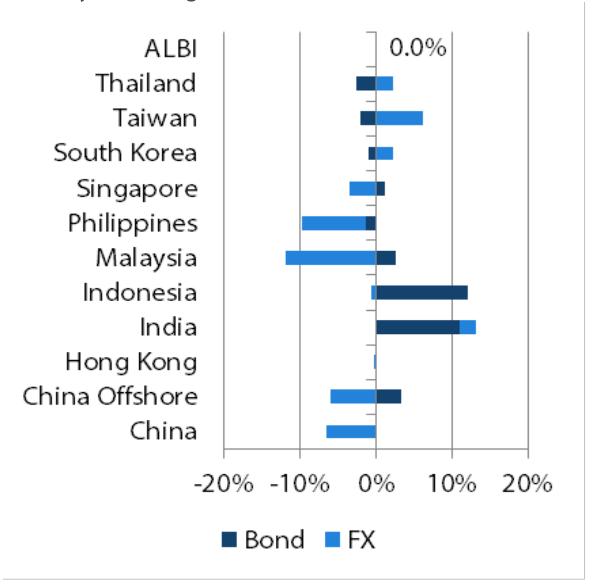
Hawkish comments from the Federal Reserve (Fed) officials, a solid US jobs report and indication from European Central Bank (ECB) President Mario Draghi that they are set to pare back extensive accommodation seen in previous years, led US Treasury (UST) yields on an upward path in the first half of the month. On 15 March, the Fed raised short-term interest rates by 25 basis point (bps). The notable absence of a more hawkish tone from the Fed triggered a broad-based weakening of the US Dollar. Yields dropped in the latter half of the month, as investors re-assessed their optimism about President Trump's economic plans, after Republicans scrapped a vote on legislation to repeal and replace Obamacare. Overall, the 10-year point on the UST yield curve ended at 2.39%, largely unchanged compared to end-February levels.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 March 2017



For the year ending 31 March 2017



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 March 2017

- China sets a lower growth target for 2017

China's National People's Congress convened for its annual session on 5 March. The government announced a targeted GDP growth at 'around 6.5%', down from last year's range of 6.5-7.0%. To support this, the fiscal deficit target is set at 3% of GDP, unchanged from last year. Notably, local revenue bond issuance is expected to be increased by RMB 400bn to RMB 800bn this year and the value-added tax regime to be simplified. Meanwhile, the People's Bank of China (PBoC) lifted short-term interest rates, citing the Fed rate hike and the need to cool domestic asset inflation. Reverse repurchase rates for 7, 14 and 28-days went up by another 10bps each, following similar increases in February. 6-month and 1-year MLF rates were also raised by 10bps each. Increases in MLF rates were last done in January. The central bank also re-iterated its commitment to a neutral and stable monetary policy stance, with Governor Zhou stating that domestic interest rate is not the tool to use against currency depreciation.

- Bharatiya Janata Party (BJP) wins big victory in Indian state election

Indian Prime Minister Narendra Modi's BJP party secured 312 of the 403 assembly seats in the Uttar Pradesh (India's largest state) state legislature. This was a big victory for the prime minister, and an overwhelming endorsement of his November 2016's demonetisation programme. The landslide win positions Mr. Modi to secure another five-year term in the general elections due to be held by 2019.

Market Outlook

- Maintain preference for Indonesian bonds; cautious on Philippine bonds

The Fed's inclination to stay on a gradual tightening path should be supportive of risk assets while capping the pace of increase in UST yields. Positive flows into Emerging Market (EM) bonds are likely to persist, as UST yields remain largely range-bound. Against such a backdrop, we foresee high yielders like Indian and Indonesian bonds outperforming. Meanwhile, our cautious view on Philippine bonds remains. Strong growth and rising inflation are likely to result in the underperformance of the space relative to peers. We note that the Philippine central bank governor finishes his term in July, and that the administration's favoured candidate for the post has been vocal about his preference for tightening monetary policy.

- Prefer IDR and INR

We maintain that high carry currencies such as Indonesian Rupiah (IDR) and Indian Rupee (INR) will continue to outperform amongst Asian currencies. Both countries have attracted greater foreign direct investment, resulting to marked improvement in their basic balances. Moreover, monetary authorities in both countries have built back their reserves, and are in a better position to manage currency volatility. Meanwhile, we expect the Philippines' narrowing current account surplus to drag on the Philippine Peso (PHP).

Asian Credits

Market Review

- Asian credits registered slight gains in March

Overall Asian credits managed to make slight gains in March as credit spreads, which traded in a relatively narrow range in the month, tightened on the back of strong flows into Emerging Markets (EM). Asian high-grade returned 0.19% and Asian high-yield corporates returned 0.39%.

- Korea to hold presidential elections in May

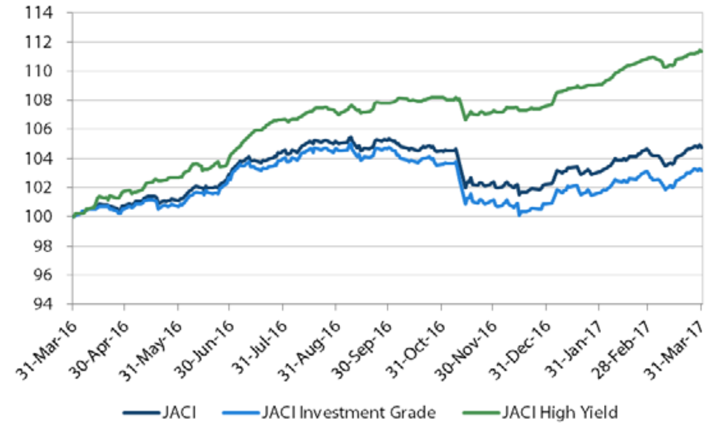
The Constitutional Court of South Korea, in a unanimous decision, upheld the National Assembly's decision to impeach President Park Geun-hye. Elections will take place on 9 May, with Prime Minister Hwang Kyo-ahn - the current acting president - to continue his responsibilities until a new leader is elected. Opinion polls conducted shortly after Park's ouster showed liberal candidate Moon Jae-in of the opposition Democratic United Party leading.

- Primary market activity remained strong

The primary market continued to be busy in March. Total issuance amounted to about USD 35.9bn – 31 issues worth USD 20.5bn from high-grade and 33 issues worth USD 15.4bn from high-yield. Notably, Chinese issuers dominated the supply pipeline, with financial companies such as China Cinda Finance, Export-Import Bank of China and Bank of Communications Financial Leasing among the heavy issuers.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 from 31 March 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 March 2017

Market Outlook

- Risk sentiment to remain constructive but toned down from the start of the year

Market's expectations of US President Trump's reflationary agenda will probably adjust down, but not be abandoned altogether, as he moves on to the more important tax reform. In Europe, however, uncertainties around the French Presidential and Italian elections could again result in some volatility. The potential withdrawal from quantitative easing (QE) programmes by the ECB and Bank of England, and their impact on government bond yields and global risk appetite, also calls for close monitoring.

- Demand for Asia credit to be supported by positive technicals; valuations suggest caution

Across Asia, slightly improved corporate earnings and stable macro fundamentals should provide support to the credit space. Additionally, the combination of range-bound UST yields, USD and crude oil prices is likely to be conducive for positive flows into EM hard currency bonds and Asian credit overall. At the same time, however, spread valuations have become increasingly tight on a historical basis, and this calls for caution.

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