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ASIAN FIXED INCOME OUTLOOK

November 2017

Summary

- US Treasuries (USTs) fell in October, as prospects of higher growth and inflation increased after the US Senate approved the Republican-backed budget for 2018. The uncertainty surrounding the US Federal Reserve chair succession also weighed on USTs. Overall, 10-year UST yields ended the month at 2.38%, about 5 basis points (bps) higher compared to end-September.

- Conversely, Asian credits remained resilient and ended higher in October, as spread compression offset the rise in US Treasury (UST) yields. Lower than expected issuance from China and the Chinese central bank's announcement of targeted cuts to the reserve requirement ratio in 2018 supported sentiment.

- China held its 19th National Party Congress, where President Xi refrained from setting a long term growth target, stating that the government would aim for high quality and sustainable growth.

- In Korea, the central bank raised its growth and inflation forecasts for the year, and left interest rates unchanged. Elsewhere, India expanded plans to recapitalise its public-sector banks over the next two years, and committed to additional banking reforms over the next quarter.

- Primary market activity slowed slightly in October. The high-grade space had 22 new issues worth USD 12bn, including USD 2bn of China sovereign bonds. The high-yield space saw 22 issues amounting to USD 11bn.

- Markets are likely to experience higher rate volatility for the rest of the year. We expect prospects of US tax reform to place further pressure on long duration positions in the markets. We favour Malaysian and Indonesian bonds given their historically lower correlation to USTs. Meanwhile, we are cautious on Korean bonds.

- On the currency front, we are likely to see continued support for the MYR while our preference for the RMB is reinforced by China's strong current account surplus. In contrast, we remain bearish on the PHP.

- We continue to expect Asian credit returns to be driven by the direction of UST yields. Credit spreads are likely to be range-bound as the heavy pipeline of new issuance offsets a solid Asian economic growth backdrop. In China, with the deleveraging process progressing onshore, rising onshore yields could be a headwind for offshore USD credits.

Asian Rates and FX

Market Review

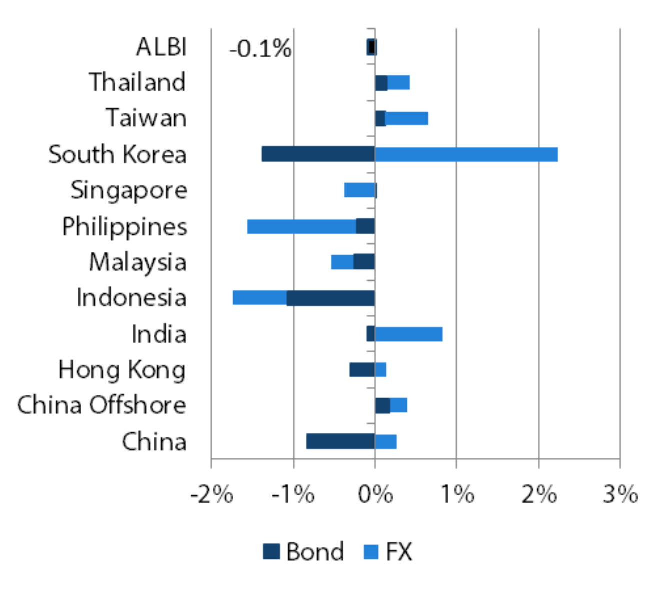
- US Treasuries (USTs) ended lower in October

US rates were trading in a relatively tight range until the US Senate approved the Republican-backed budget for 2018 – clearing a critical hurdle in the Trump administration's push to overhaul the tax code. UST yields rose as prospects of higher growth and inflation increased. The uncertainty around US Federal Reserve (Fed) chair succession supported the bearish bias in USTs.

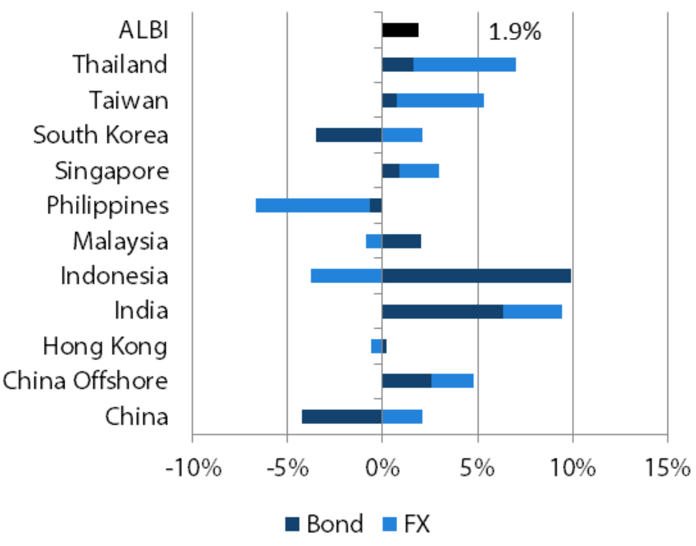
Towards month-end, the European Central Bank declared that it would continue buying government bonds deep into next year, albeit in reduced monthly amounts, providing some downside pressure to yields. Overall, 10-year UST yields ended the month at 2.38%, about 5 basis points (bps) higher compared to end-September.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 October 2017



For the year ending 31 October 2017



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 October 2017

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.

- Bank of Korea (BoK) raised its growth and inflation forecasts

BoK raised its growth and inflation forecasts for this year amid signs of the economy gaining strength. The central bank now expects GDP to print 3.0% (from 2.8%), and the headline consumer price index (CPI) to register 2.0% (from 1.9%) this year. The upgraded outlook is the BoK's third upward revision this year and came after the central bank, in a divided vote, left interest rates unchanged, with one dissenting member voting for a rate increase.

- Monetary Authority of Singapore (MAS) kept its neutral policy stance

The MAS kept the SGD nominal effective exchange rate (NEER) slope, centre and band width unchanged, despite third-quarter GDP growth coming in at the fastest pace in more than three years. The monetary authority noted that the economy has performed "slightly better than envisaged" since its last policy meeting, and that inflation has kept well within expectations. It added that economic growth this year will probably print at the upper half of its 2-3% forecast range, and expand at a slightly slower pace in 2018. In a separate interview, MAS Managing Director Ravi Menon said that Singapore needs to be on guard for inflation pick-up, stating that inflation will climb at some point if economic growth continues to strengthen.

- Malaysian prime minister pledged to narrow fiscal deficit

Malaysian Prime Minister Najib Razak unveiled the 2018 budget. Details reveal that the government remains committed to its fiscal consolidation agenda, despite the upcoming general election. The government is projecting an expansion of 5.2-5.7% in 2017 and 5.0-5.5% for 2018. The fiscal deficit target for 2017 was maintained, while that of 2017 was marginally reduced to 2.8% of GDP. The government expects inflation to register between 2.5-3% next year, slightly lower than the 3-4% level forecast for 2017.

Market Outlook

- Prefer Indonesia and Malaysia bonds over Korean bonds

Markets are likely to experience higher rate volatility for the rest of the year, with focus primarily on policy developments in the US, Fed chair succession and prospects for US tax reform by year-end. We anticipate the latter to continue to place further pressure on long duration positions in the markets, as expectations for stronger growth and inflation escalate. Against such a backdrop, we see Indonesian and Malaysian bonds outperforming regional peers, given their historically lower correlation to US Treasuries. The Malaysian government's commitment to its fiscal consolidation agenda, as evidenced in the recently announced budget, is a further positive for Malaysian bonds. Meanwhile, our cautious view on Korean bonds remains, as we see an increasing probability of a BoK rate hike soon.

- Prefer MYR and RMB over PHP

Malaysia's growth has been surprising on the upside. The country has been attracting greater foreign direct investment, which, together with the liberalisation in hedging regulations, is likely to continue to support positive sentiment towards the Malaysian Ringgit. Our preference for the RMB is reinforced by China's strong current account surplus. Moreover, the potential inclusion of Chinese rates into global bond indices should sustain demand for the currency. In contrast, although there have been signs of improvement in the Philippines' current account and trade numbers of late, we maintain that the outlook for the country's current account position continues to be weak, on the back of massive medium term infrastructure spending plans.

Asian Credits

Market Review

- Asian credits registered gains in October

Overall, Asian credits remained resilient and ended higher in October, as spread compression offset the rise in US Treasury (UST) yields. Credit spread compression was supported by lower than expected issuance from China. China's widely expected issuance of USD-denominated sovereign bonds helped push spread compression of Chinese high–grade bonds, while the People's Bank of China (PBoC)'s announcement (at the end of September) of targeted reserve requirement ratio (RRR) cuts in 2018 also supported sentiment. Overall, Asian high-grade returned 0.34%, underperforming Asian high-yield corporates which returned 0.73%.

- China's National Congress mainly a political event

China's Communist Party held its 19th National Congress in the month. The party amended its charter to adopt a political ideology named after President Xi Jinping, granting him power unmatched in recent decades. In his Party Work Report, the president reiterated a previous goal of attaining a moderately prosperous society by 2020 but refrained from specifying a growth target. The lower emphasis on the growth rate ties in with the president's statement that the government would aim for growth that is of higher quality and sustainable.

- India announced recapitalisation plan for banks

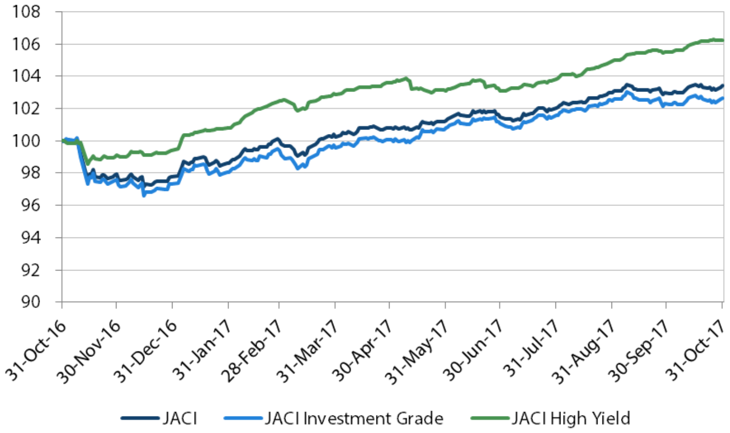
India's government announced an expansion of plans to recapitalise its public-sector banks over the next two years, and committed to announce additional banking reforms over the next quarter. Public sector banks will receive about USD 32bn in funds, which the government hopes will loosen credit conditions, and boost investment and growth. Spreads of weaker Indian banks tightened on the back of this news.

- A slowdown in primary market activity

Primary market activity experienced a slight slowdown in October. The high-grade space had 22 new issues worth USD 12bn, including USD 2.0bn of China sovereign bonds which were priced tighter than expectations. Meanwhile, the high-yield space saw 22 new issues amounting to around USD 11bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 31 October 2016



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

Market Outlook

- Direction of UST yields to dictate returns; credit spreads likely range-bound

With the Fed widely expected to hike rates in December, other factors such as the nomination of the Fed chair and some other members of the US Federal Open Market Committee (FOMC) and progress of the tax reform deal are the likely drivers for the direction of UST yields. With spreads already at tight levels on a historical basis, the catalysts that could drive spreads appreciably tighter remain elusive especially if the pipeline of new issuance picks up significantly. However, with the Asian economic growth backdrop still decent and some economies surprising to the upside, significant spread decompression does not appear likely in the near term.

- China spread compression theme paused for now

For China credits, the spread compression theme of China's state-owned enterprises (SOEs) versus the sovereign issues is likely to take a pause with the focus shifting back to fundamental developments and the supply pipeline that is expected to remain heavy into year-end after the short recess of issuance into the 19th party congress. With the deleveraging process progressing onshore, rising onshore yields could be a headwind for offshore USD credits.

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