By Koh Liang Choon,
Head of Fixed Income, Asia

nikko am
Nikko Asset Management

# ASIAN FIXED INCOME OUTLOOK

February 2018

## Summary


- There was a sharp rise in US Treasury (UST) yields in January on the back of positive macro news, steady rise in oil prices and speculation that central banks in developed markets will start winding back on stimulus measures. Overall, 10-year UST yields ended the month at about 2.71%, about 30 basis points (bps) higher compared to end-December.

- Asian credits registered losses in January as carry and spread tightening were not sufficient to cushion the rise in UST yields. The tightening in spreads was further supported by strong capital flows into emerging markets bond funds over the period.

- In 4Q2017, regional economies registered fairly robust growth while headline inflation printed mixed. China grew fastest among major Asian economies while expansion in South Korea was tempered in the last quarter.

- Meanwhile, Bank of Korea left interest rates unchanged and raised its 2018 GDP growth forecast by 0.1% to 3.0%. Bank Negara Malaysia, on the other hand, raised its overnight policy rate by 25bps to 3.25% and sounded more confident of the growth outlook.

- Activity in the primary market picked-up significantly in January. For the month, total issuance amounted to about USD 32.3bn. Meanwhile, the high-yield space saw 38 new issues amounting to around USD 12.8bn.

- We continue to believe that Indonesia bonds will provide attractive returns relative to regional peers. Demand is likely to be buoyed by potential index inclusion in widely tracked global indices, manageable inflationary pressures and accommodative monetary policy. On the currency front, we are positive on the Malaysian Ringgit and Singapore dollar, while maintaining our cautious view on the Philippine Peso.

- While yields overall have become more attractive, spreads are still on the expensive side. Total returns will likely be driven by UST yields. Primary activity should continue to remain active before the Chinese New Year with China likely to provide the largest amount of issuance across high-grade and high-yield. This will be another factor that prevents spreads from tightening too much in the near term. However, with the macro backdrop in Asia still healthy, a material widening of spreads is not likely, barring an abrupt rise in UST yields.


## Asian Rates and FX

### Market Review

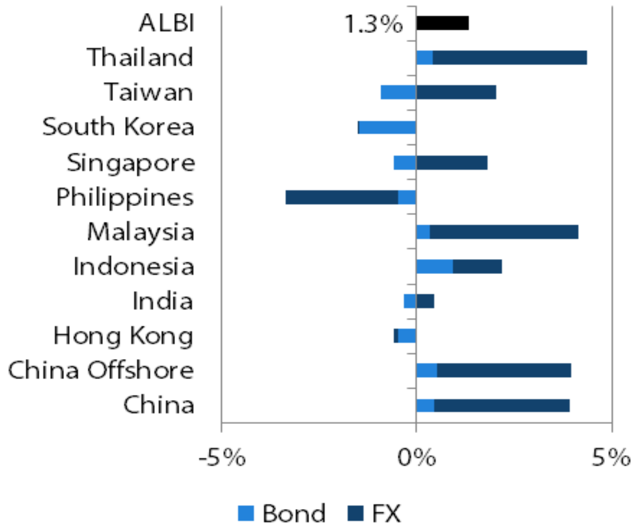
#### A sell-off in US Treasuries (USTs)

There was a sharp rise in UST yields in January. Positive macro news from both developed and emerging markets fuelled expectations that global growth could remain well above recent trend. This, together with the steady rise in oil prices, prompted markets to price in a pick-up in inflation. Speculation that central banks in developed markets will start winding back on stimulus measures to normalise monetary policy, placed further upward pressure on UST yields. A quick resolution to the US government shutdown resulted in minimal impact to the market. Meanwhile, trade tensions between US and Asia intensified, after President Trump imposed stiff penalties on US imports of solar panel and washing machines.

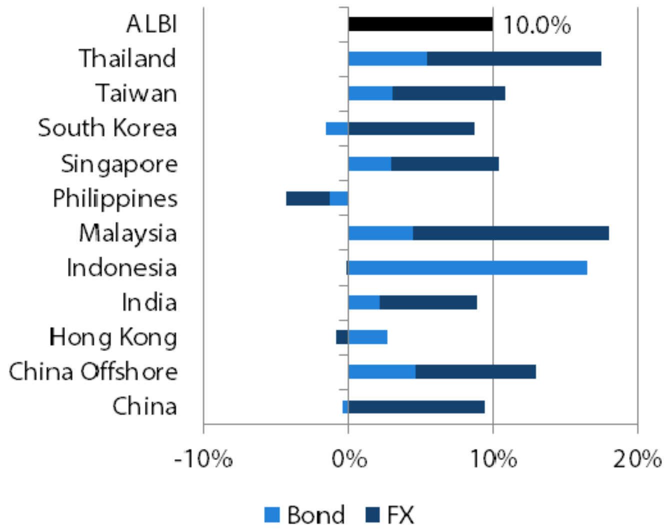
Towards month-end, cautiousness prevailed ahead of the Federal Open Market Committee (FOMC) meeting and publication of US' inflation and employment data. Overall, 10-year UST yields ended the month at about 2.71%, about 30 basis points (bps) higher compared to end-December.

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

For the month ending 31 January 2018




For the year ending 31 January 2018




Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 January 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.

### Regional economies register fairly robust growth in the fourth quarter of 2017

In the last three months of 2017, the Chinese economy grew fastest among major Asian economies. GDP growth printed 6.8% year-on-year, driven in part by strong export growth. Fourth quarter growth in the Philippines moderated to 6.6%, from an upwardly revised 7.0% in the prior quarter. By sector, growth in manufacturing and services sectors moderated but remained robust, while construction sector growth slowed. In Singapore, GDP growth in the same period came in at 3.1%. Manufacturing once again drove the acceleration. Growth within the services sector moderated slightly, while activity in the construction sector continued to contract. Elsewhere, expansion in South Korea tempered in the fourth quarter, prompted by a fall in automobile exports.

### Headline inflation measures printed mixed in December

Regional countries printed mixed headline inflation readings in the last month of 2017. In Singapore and Thailand, headline CPI moderated, while a similar measure for retail inflation was unchanged in the Philippines. Elsewhere, Malaysia saw a pick-up in December CPI inflation, driven mainly by a rise in the transport component. Following five months of moderation, headline CPI rose in Indonesia. The acceleration was due largely to a rebound in food inflation, which was in turn partly due to a reversing base effect. Higher food prices similarly drove India's CPI to advance 5.2% in December, whereas the rise in non-food prices in China prompted the uptick in the headline inflation print.

### Bank of Korea moderated its 2018 inflation forecast

Bank of Korea, in a unanimous decision, left interest rates unchanged. The central bank raised its 2018 GDP growth forecast by 0.1% to 3.0%, on improved exports, but lowered its 2018 headline inflation forecast by the same magnitude, to 1.7%. It maintained its accommodative monetary policy stance, and provided little hint of near-term rate action.

## Market Outlook

### Positive on Indonesia bonds

We continue to believe that Indonesian bonds will provide attractive returns vis-à-vis regional peers. Demand will get a boost from potential index inclusion in widely tracked global indices. Inflationary pressures are likely to remain fairly anchored, supported in large part by the government's effort to improve food supply management across the country. We expect monetary policy to remain accommodative as policymakers continue to focus on fuelling domestic growth ahead of provincial elections.

### Prefer Malaysian Ringgit and Singapore Dollar over the Philippine Peso

Robust growth in Malaysia and a hawkish Bank Negara support our positive view on the MYR. Sustained higher oil prices will further lift Malaysia's fiscal and current account balances, providing another tail wind for the currency. Meanwhile, the Monetary Authority of Singapore has paved the way for a return to an upward-sloping SGDNEER band in 2018. Improvement in the labour market and signs of dissipating slack leads us to believe that there is now an increased likelihood of an FX policy adjustment in April. In contrast, we anticipate the Philippine Peso to underperform regional peers in 2018, as concerns on the country's deteriorating current account trend re-emerge due to the infrastructure build-out.

## Asian Credits

## Market Review

### A weak start for Asia credits

Overall Asian credits registered losses in January, as carry and spread tightening were not sufficient to cushion the sharp rise in UST yields. Asian high-grade returned -0.74%, and Asian high-yield corporates returned 0.22%. The tightening in spreads was further supported by strong capital flows into emerging markets bond funds over the period.

### Bank Negara Malaysia raised its policy rate; Chinese economy grows 6.9% in 2017

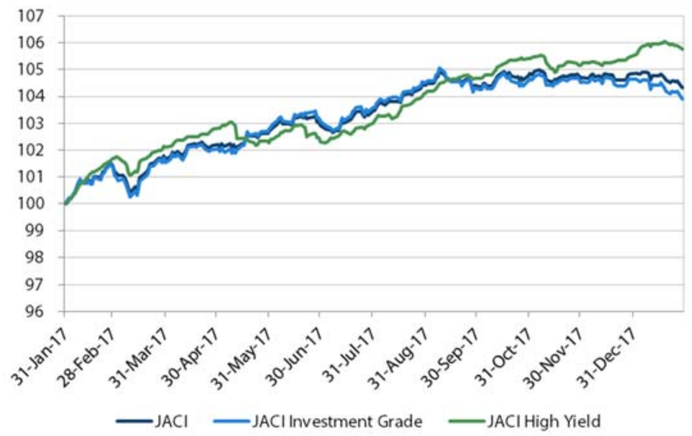
Bank Negara Malaysia raised its overnight policy rate by 25bps to 3.25%, but left the statutory reserve requirement ratio unchanged. The policy statement reverted to a more neutral tone compared to November's statement. Although the central bank sounded more confident of the growth outlook, it expects headline inflation to fall in 2018. It cited the need to "prevent the build-up of risks that could arise from interest rates being too low for a prolonged period of time" as the main reason for the move. Elsewhere, China’s economic expansion accelerated for the first time in seven years in 2017. Full-year growth registered 6.9% (from 6.7% in 2016). Markets took this as positive for credit fundamentals, supporting sentiment towards Chinese credits.

### Flurry of primary activity in Asian credits

Activity in the primary market picked-up significantly in January. For the month, total issuance amounted to about USD 32.3bn. There were 31 issues amounting to about USD 18.7bn within high-grade, including a USD 2bn sovereign issue from the Philippines and USD 5bn from Chinese internet company Tencent Holdings. Meanwhile, the high-yield space saw 38 new issues amounting to around USD 12.8bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 31 January 2016




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

## Market Outlook

### Direction of UST yields to drive returns; supply to continue into February

While yields overall have become more attractive, spreads are still on the expensive side. Total returns will likely be driven by UST yields as it is unlikely that spreads, which have remained resilient in face of rising USTs yields, can tighten significantly to compensate for further sharp rises. Primary activity should continue to remain active before the Chinese New Year lull in mid-February with China likely to provide the largest amount of issuance across high-grade and high-yield. This will be another factor that prevents spreads from tightening too much in the near term. However, with the macro backdrop in Asia still healthy, a material widening of spreads is not likely, barring an abrupt rise in UST yields.

## Important Information

addressee only and must not be passed to, issued to, or shown to the public generally.

**Kuwait:** This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

**Kingdom of Saudi Arabia**: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

**Oman**: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

**Qatar (excluding QFC)**: The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

**United Arab Emirates (excluding DIFC)**: This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.