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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- US Treasury (UST) yields rose in April, as hopes of stabilization in the Chinese economy underpinned demand for riskier assets. Despite the US Federal Reserve's decision to maintain interest rates, the 10-year point on the UST yield curve ended the month about 7 basis points (bps) higher.

- The Reserve Bank of India (RBI) cut its repo rate by 25 bps, and announced various measures to improve liquidity management, retaining its dovish tone overall. Elsewhere, Bank Indonesia maintained interest rates.

- In South Korea, the conservative Saenuri party failed to win the expected majority in parliamentary elections. This could potentially hurt the momentum of the President's reform programs. Meanwhile, the central bank lowered its growth and inflation forecasts for the year.

- The Monetary Authority of Singapore eased currency policy by removing its appreciation bias for the SGD. Separately, advance estimates revealed the economy grew by 1.8% year-on-year in the first quarter.

- Asian credits generally rose in April. Rising commodity prices and better-than-expected economic data from China underpinned the near-term macro outlook in Asia. Within Asian credits, high-yield outpaced investment grade, with Indonesian and Indian bonds outperforming.

- News of rising defaults in China's onshore bond market, as well as the postponement of several new issues, raised concerns in the offshore USD market. However, the impact to offshore USD Chinese credits has been muted so far.

- Activity in the primary market accelerated in April: the investment grade space had 23 new issues amounting to USD 14.25bn, while the high-yield space saw 3 deals amounting to USD 850mn of issuance.

- We maintain our constructive view on Indonesian and Indian bonds, as their central banks remain accommodative, but have a more bearish view on Thai and Korean bonds. We expect the Indonesian Rupiah to outperform its regional peers on the back of increased inflows.

- While signs of China's economic growth stabilizing should ease concerns of a sharp slowdown, the rise in onshore defaults is likely to raise concerns about Chinese credits in the medium term.

- With valuations becoming less compelling, we are maintaining a neutral stance with a tilt towards better quality credits. The underperformance of a number of new issues of late which priced at aggressive levels also suggests a more cautious approach in the primary market.

Asian Rates and FX

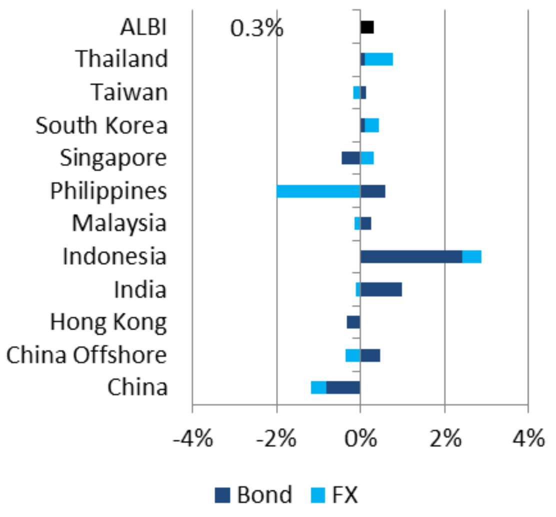
Market Review

- Yields of US Treasuries ended higher

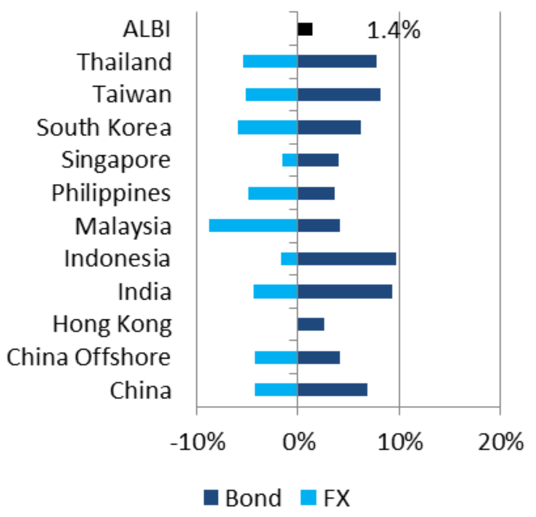
Yields of USTs climbed steadily for the most part in the month. Hopes of stabilization in the Chinese economy, due to recent economic numbers printing better than expected, underpinned demand for riskier assets. Fears of rising inflation, as oil prices climbed, further supported the increase in yields. However, yields pushed lower towards the end of the month, as the Federal Reserve left interest rates unchanged, and signaled it was in no rush to raise borrowing costs. Despite this, the 10-year point on the UST yield curve ended the month about 7 basis points (bps) higher compared to end-March levels.

HSBC Asian Local Bond Index (ALBI)

For the month ending 30 April 2016



For the period from 30 April 2015 to 30 April 2016



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: HSBC Asian Local Currency Bond Indices, Bloomberg, 30 April 2016

- RBI delivered a 25bps interest rate cut

The Reserve Bank of India (RBI) cut the repo rate by 25bps, and announced measures to improve liquidity management. Among others, it narrowed the policy rate corridor to +/- 50bps from +/- 100bps, and lowered the minimum daily compliance on the Cash Reserve Ratio Requirement by 5%. The monetary authority maintained its view that CPI inflation will inch towards its previous target of 5% by March 2017, and projects headline inflation to moderate to 4.2% by March 2018. Overall, the RBI retained its dovish tone with a note that it will respond “with further policy action as space opens up”.

- South Korea’s ruling party suffered a political defeat; BoK lowered growth and inflation forecasts

South Korea’s conservative Saenuri Party failed to win the expected majority in the parliamentary elections, as it secured only 122 seats out of 300. The strong showing of the country’s main opposition party will likely cause the President’s reform programs to lose steam. Meanwhile, the Bank of Korea (BoK) left interest rates unchanged, but cut its 2016 GDP growth and inflation forecasts by 0.2% each – to 2.8% and 1.2%, respectively.

- MAS eased currency policy; Singapore economy expanded 1.8% YoY in the first quarter

The Monetary Authority of Singapore (MAS) eased its currency policy, removing the appreciation bias for the SGDNEER, but keeping the width of the policy band, and the level at which it is centered, unchanged. The central bank expects the economy to expand at a more modest pace this year and sees a milder pickup in core inflation. Weak consumer sentiment and a reduction in labour market tightness were other reasons highlighted for the move. In a separate report, advance estimates revealed that economic growth in the first quarter registered 1.8% year-on-year (YoY) – the same pace as in the previous three months. Compared to the fourth quarter of 2015, activity in the manufacturing sector contracted by a smaller magnitude, while growth in the construction sector accelerated.

- BI left rates unchanged, adopted seven-day repurchase rate as new benchmark rate

During the month, Bank Indonesia (BI) maintained interest rates, and announced changes to the structure of its monetary policy operations. Effective 19 August 2016, the seven-day reverse repo rate supersedes the BI rate as its benchmark – a move it hopes will bolster the efficiency and effectiveness of monetary policy transmission.

Market Outlook

- Overweight Indian and Indonesian bonds; underweight Thai and Korean bonds

We maintain our constructive view on Indonesian bonds and see a fair chance of a rating upgrade this year by S&P. Notably, the move by Bank Indonesia to shift to a new policy benchmark will facilitate better price discovery. Our positive view on Indian bonds similarly hinges on expectations that the country’s central bank will remain accommodative on the back of a benign inflationary environment. The Indian government’s demonstration of its resolve towards fiscal consolidation should also be positive for Indian bonds. Meanwhile, we hold a bearish view on Thai bonds. Benefits of further rate cuts in Thailand are becoming limited as the transmission of lower interest rates into the real economy has been subdued. This has led to increased focus on fiscal stimulus, in contrast to monetary easing. With four new monetary policy committee members within the BoK, we do not foresee further interest rate cuts in Korea in the near-term.

- Overweight IDR; underweight THB and KRW

We maintain that the Indonesian Rupiah will outperform regional peers, on the back of increased inflows into Indonesian equity and bond markets, as the central bank continues to ease. These inflows, together with better growth prospects for the country pursuant to anticipated recovery in domestic demand, should provide support for the Indonesian Rupiah. In contrast, we expect the Thai Baht to underperform as the Bank of Thailand's preference for a weak currency (to support the export sector) tips the scales towards further weakness for the currency.

Asian Credits

Market Review

- Asian credits registered gains

Overall Asian credits rose in April, as the rally in risk assets continued. Rising commodity prices and hopes of stabilization in the Chinese economy underpinned the broader near-term macro outlook in Asia. Within Asian credits, high-yield outpaced investment-grade, with Indonesian bonds outperforming, buoyed by the three consecutive rate cuts by Bank Indonesia in the first quarter of the year. Indian high-yield bonds similarly registered decent gains, especially the commodity related issues.

- Rising onshore bond defaults in China heightened concern but impact muted so far

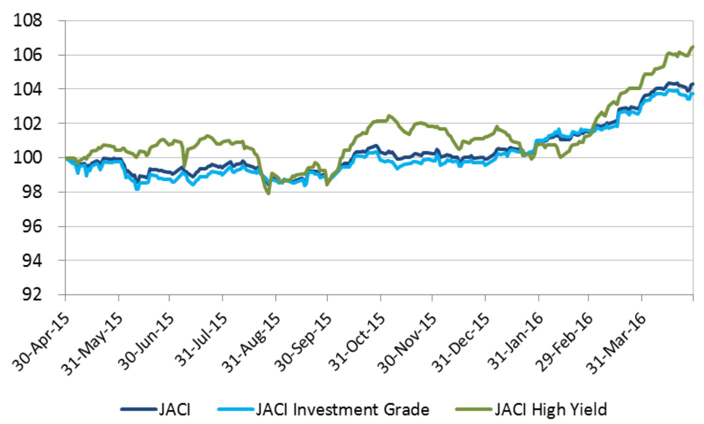
News of rising defaults in China's onshore bond market including the news of China Railway Materials, a State-owned Enterprise (SOE) looking to engage in debt restructuring, has raised some concerns in the offshore USD bond market. News of the postponement of several new issues further accentuated worries. However, the impact to USD Chinese credits traded offshore has been muted so far. Malaysian credits remained supported even as the dispute between Abu Dhabi's IPIC and 1MDB escalated with 1MDB defaulting on a number of bonds. The appointment of Datuk Muhammad Ibrahim, the current deputy Bank Negara governor, as the new governor of the central bank supported sentiment towards Malaysia credits.

- Primary market saw a further pick-up in activity

Overall activity in the primary market accelerated in April. There were 23 new high-grade issues totaling around USD 14.25bn in the month, compared to 13 new issues amounting to USD 7.75bn in March. This includes a dual tranche Malaysian sovereign sukuk issuance of USD 1.5bn. New issuance in the high-yield space remained muted with 3 new deals adding up to USD 850mn in April, compared to 3 new issues of USD 800mn in the previous month. Separately, Huawei, an unrated Chinese Infocomm technology company, issued an USD 2bn 10-year bond.

JP Morgan Asia Credit Index (JACI)

Daily returns for the period from 30 April 2015 to 30 April 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 30 April 2016

Market Outlook

- China's onshore developments bear close monitoring

While signs of China's economic growth stabilizing should ease concerns of a sharp slowdown, the rise in onshore defaults is likely to raise concerns about Chinese credits in the medium term. The news of a central SOE undergoing debt restructuring should give pause to the assumption that centrally owned SOEs enjoy implicit government backing and amplify the uncertainty over which companies will ultimately come under government support. Fundamentally weaker and less strategic credits in industries facing over-capacity are likely to come under more intense scrutiny.

- Technicals broadly supportive but valuations increasingly less compelling

Overall valuations are becoming less compelling with spreads ending April near year-to-date tights especially in light of the still-present challenges of a slowing and rebalancing Chinese economy, and low albeit recovering commodity prices. With this, we remain with a more neutral stance with a tilt towards better quality credits. In particular for high-grade, with the supply of new issues picking up, the positive technicals from a period of slow primary market activity in the past few months is being eroded. The underperformance of a number of new issues of late which priced at aggressive levels also suggests a more cautious approach in the primary market.

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