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ASIAN FIXED INCOME OUTLOOK

Summary

- In July, US Treasury (UST) yields rose. US-China trade tensions continued to persist. The risk of a trade war between the US and Europe tempered after the two countries announced they will cut trade barriers. This, together with a strong second quarter GDP print from the US, and speculation that the Bank of Japan may scale back its massive monetary stimulus, led risk-free rates to jump.

- Overall, 2-year and 10-year yields ended at 2.67% and 2.96%, respectively, about 14 basis points (bps) and 10bps higher compared to end-June.

- Asian credit registered gains in July despite higher UST yields as credit spreads tightened. High-grade spreads tightened by around 10bps to 179bps and high-yield corporate spreads tightened by around 30bps to 517bps. Overall, Asian high-grade returned 0.44% and Asian high-yield returned 1.94%.

- Within the region, inflation was mixed in June. The Chinese economy grew 6.7% in the second quarter, while advanced estimates reveal that Singapore's economy expanded by 3.8%. Monetary authorities in Indonesia and the Philippines remained hawkish.

- In China, policy easing gathered momentum as the government called for “more proactive” fiscal policy to spur growth. These efforts led to gains in Chinese risk assets, sending Chinese credit spreads tighter.

- Meanwhile, the primary market activity remained modest. There were 21 new issues worth around USD 10.9bn in the high-grade space, while the high-yield space saw a total of 9 issues amounting to about USD 2.65bn.

- On local currency bonds, we are positive on Malaysia and China bonds as the former offers relatively attractive real yields and we also expect Bank Negara Malaysia to remain in the periphery for rate hikes in the near-term. As for the latter, the Chinese policymakers' resolve to inject money into the economy should be supportive of bond prices.

- On currencies, we expect the Malaysian Ringgit (MYR) to outperform the Korean Won (KRW) and Renminbi (RMB) due to Malaysia's improving current account position, robust economic activity and higher oil prices.

- Looking forward for Asian credit, spreads should remain volatile. In China, the recent measures announced have eased the refinancing concerns that had risen in recent months. However, the US-China trade tensions and the US Federal Reserve (Fed) tightening its monetary policy continue to remain key risks.

- Additionally, the floodgates of new issuances that was halted by the weak sentiment until mid-July should return, limiting any scope for spread tightening in the secondary market.

Asian Rates and FX

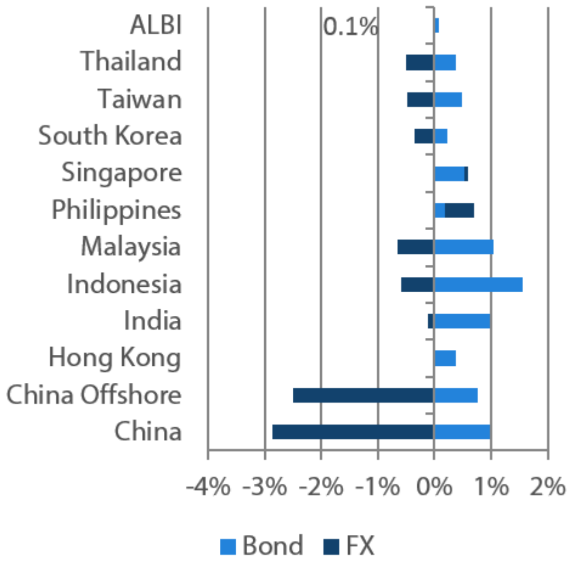
Market Review

Yields of USTs rose in July

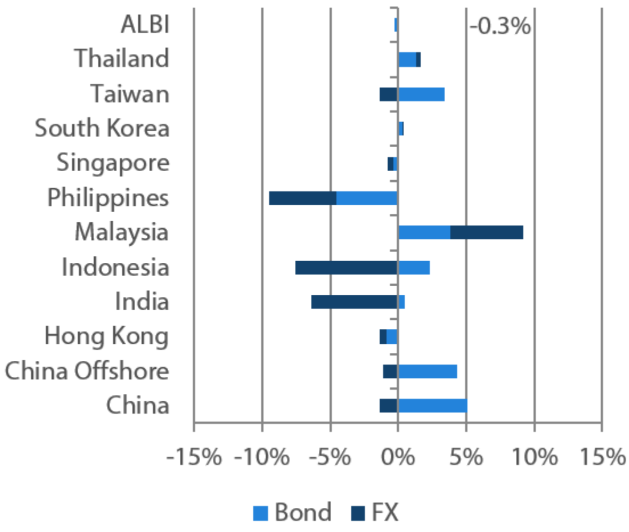
Trade tension was a focal point for markets during the month. On 6 July, the US began raising import duties on more than USD 30bn worth of Chinese imports. Chinese policymakers responded with similar punitive tariffs on an equal amount of US imports. The US further ramped up trade tensions as it threatened to slap tariffs on the entire USD 500bn worth of imports from China. Against such a backdrop, markets were largely reluctant to push bonds yields too far in any direction, leaving long-end treasury yields trading at a very tight range. Short-end yields, however, gradually rose on the back of mostly positive economic data. The risk of a trade war between US and Europe tempered after the two countries announced they were working to lower tariffs on industrial goods. This, together with a strong second quarter GDP print from the US, and speculation that the Bank of Japan may consider moves to scale back its massive monetary stimulus, subsequently led risk-free rates to jump. Overall, 2-year and 10-year yields ended at 2.67% and 2.96%, respectively, about 14bps and 10bps higher compared to end-June.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 July 2018



For the year ending 31 July 2018



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 July 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 June

Headline Consumer Price Index (CPI) inflation in the Philippines, India, China and Singapore accelerated in June, while similar inflation gauges in Malaysia, Indonesia and Thailand moderated. The 5.2% Year-on-Year (YoY) CPI print in the Philippines breached both the central bank's projected range of 4.3-5.1% for the month, and the official target range of 2-4%. Much like the previous months, the pick-up came across the board. Retail inflation in India also accelerated in June, on the back of a rise in fuel inflation. Although the headline number undershot expectations, core inflation remained firm, rising to 6.6%. In Thailand, a moderation in food inflation offset the rise in energy prices, causing overall CPI to register lower in June compared to May. Base effects and slower inflation in most commodity groups save for food and transport were the reasons for the deceleration in inflationary pressures in Indonesia. Elsewhere, Malaysia's headline CPI print tumbled to 0.8% YoY in June, reflecting the removal of the goods and services tax on 1 June.

Chinese economy expanded 6.7% in the second quarter

Economic activity in China printed 6.7% YoY in the second quarter, marginally slower than the 6.8% reading in the prior quarter. For the first half of 2018, GDP growth was 6.8% - well above the government's target of 'about 6.5%' for the full year. Meanwhile, growth indicators reported for June signalled growth is cooling for the world's second-largest economy. Fixed asset investment growth for the first six months of the year was at a record low, while industrial output for June tumbled to 6% - the slowest growth rate in over two years. Retail sales were a bright spot, as growth rebounded to 9.0% in June. Trade data for the month came in weak, as export growth moderated and import growth tumbled.

Monetary authorities in Indonesia and the Philippines remained hawkish

Following policy rate hikes in June, monetary authorities in Indonesia and the Philippines remained hawkish in their rhetoric. Bangko Sentral ng Pilipinas (BSP) Governor Nestor Espenilla said that the monetary authority "is considering a strong follow-through monetary adjustment" at its policy meeting in August. Mr. Espenilla cited the need to rein in the country's record high inflation rate, stating that "sustained pressures on the peso could adversely affect inflation expectations." Similarly, Bank Indonesia (BI), despite leaving policy rates unchanged this month, remains "hawkish" and focused on stability, especially with regard to the currency, according to BI Governor Perry Warjiyo. The BI governor further elaborated that monetary policy would remain "pre-emptive, front-loading and ahead of the curve."

Singapore's economy grows 3.8% in the second quarter; government announced new property cooling measures

Advanced estimates reveal that the Singapore economy rose 3.8% YoY in the second quarter of 2018, following a 4.3% expansion in the first three months of the year. A slowdown in manufacturing sector growth was the main reason for the lower GDP print, although services sector growth similarly moderated. The construction sector remained in contraction but at an easing rate, as private sector construction activities continued to be weak. Separately, policymakers announced a tightening of macro-prudential policies on the residential property market, raising additional buyers' stamp duty rates and lowering the loan-to-value limits for housing loans. The changes were announced a day after Ravi Menon, Managing Director of the Monetary Authority of Singapore, cautioned on the "euphoria" in the property market.

Market Outlook

Positive on China and Malaysia bonds

Trade policy remains a key driver of uncertainty for markets. As trade tensions between the US and China persist, the risk of major disruptions in the global economy rises. Market expectations of slower growth will provide support for bonds. However, recent economic data from the US affirm strong growth momentum for now. Thus, in the event the US lifts its hardline approach toward trade with China, market focus would revert to the pace of Fed tightening, likely prompting yields higher. Within Asian local government bonds, we prefer Malaysia and Chinese bonds. Malaysia government bonds offer relatively attractive real yields. Moreover, unlike other central banks in the region who are raising interest rates, Bank Negara Malaysia is expected to remain in the periphery in the near-term. Meanwhile, Chinese policymakers' resolve to inject money into the economy to support growth should be supportive of bond prices.

Expect MYR to outperform KRW and RMB

We expect the USD rally to continue, amid lingering global trade tensions and further policy tightening from the US Fed. Within the region, we expect the ringgit to outperform the won and renminbi. Malaysia's current account position has been improving, and economic activity remains robust. Consequently, we see the ringgit being less vulnerable to a risk aversion this round, with higher oil prices providing additional support. In contrast, we see the won and renminbi to be the most exposed to supply chain disruptions from the ongoing trade war.

Asian Credit

Market Review

A positive month for Asian credit

Asian credit registered gains in July, despite higher UST yields, as credit spreads tightened. The month started with a weak tone as Asia credit was weighed down by the sell-off in Chinese equities markets and fears of further negative news on the global trade front. A slew of favourable US economic data, together with encouraging earnings, prompted sentiment to subsequently improve. This, together with a strong second quarter GDP print from the US, and speculation that the Bank of Japan may consider moves to scale back its massive monetary stimulus triggered a jump in risk-free rates towards the end of the month. Notable was the return of inflows to Emerging Markets (EM) hard currency bond funds. As Chinese policy turned to support growth towards middle of July, risk sentiment and inflows into emerging market bond funds found further support and high-grade spreads tightened by around 10bps to 179bps and high-yield corporate spreads tightened by around 30bps to 517bps. Overall, Asian high-grade returned 0.44% and Asian high-yield returned 1.94%. Meanwhile, 10-year yields ended at 2.96%, about 10bps higher compared to end-June.

Policy easing in China gathers momentum

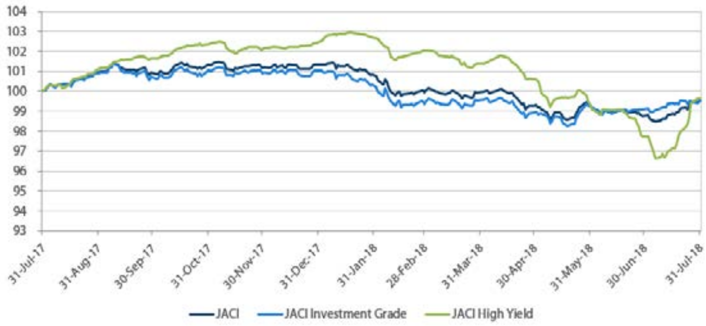
China's State Council called for "more proactive" fiscal policy to spur growth. It also announced a ramp up in construction projects to boost the economy, and signalled some loosening of regulations on LGFV financing, as it guided financial institutions to provide funding to LGFVs with reasonable needs. Separately, the People's Bank of China injected more than RMB 500bn in one-year loans through its Medium-term Lending Facility (MLF), and moved to soften implementation of tightened regulation for wealth management products. These efforts spurred gains in Chinese risk assets, sending Chinese credit spreads tighter. Sentiment towards China high-yield industrials and LGFVs improved significantly as concerns over re-financing was moderated.

Primary market activity remained modest

The primary market was virtually closed in the first week of July, as market anxiety over possible ratcheting up of trade tensions led issuers to remain on the sidelines. As sentiment improved, activity in the primary market slowly normalised. Total issuance amounted to about USD 14.27bn. There were 21 new issues worth around USD 10.9bn in the high-grade space, including USD 1.35bn from Temasek Holdings. Within high-yield, the space saw a total of nine issues, amounting to about USD 2.65bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 31 July 2017



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

Market Outlook

Spreads to remain volatile as the focus returns to trade tensions and other macro risks

Spreads should remain volatile in the coming months. While spreads are unlikely to re-test the widening seen in early July, they are also unlikely to tighten meaningfully going forward. In China, the recent measures announced should ease refinancing concerns that had risen in recent months. These concerns were most acutely felt in the high-yield industrials and LGFV space, where spread tightening was most sharp as sentiment improved after the announced measures. However, the intensifying and increasingly protracted trade tensions between China and the US as well as the broader impact to other Asian countries remain a worry. With the US GDP data reflecting still robust growth and a tight labour market, the Fed remains on the tightening path. This should remain a headwind for fixed income returns. The floodgates of new issuances that was halted by the weak sentiment until mid-July should return in the coming months. This should limit any scope for spread tightening in the secondary market.

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