# Asian Fixed Income

## Monthly Commentary

January 2012

### Indices Performance Table

| | 30/12/2011 | 1M (US$) | 3M (US$) | YTD (US$) |
|---|---|---|---|---|
| JPM Asian Currency Index (ADXY) | 115.16 | -0.59% | -3.75% | -1.12% |
| HSBC Asian Local Bond Index (ALBI) | 239.97 | 0.76% | -3.29% | 5.00% |
| JPM Asian Credit Comp Index (JACI) | 152.84 | 0.89% | -0.53% | 4.12% |
| MSCI Asia Pacific ex Japan Equity Index | 392.78 | -0.05% | -10.42% | -17.98% |
| US Treasury 10-Year (bps) | 1.88 | -19 | -35 | -142 |
| Oil | 98.83 | -1.52% | 11.28% | 8.15% |

Source: Bloomberg

### Economic & Market Overview

Asian local currency bond markets performed well in December as weak economic data increased concerns over a sharper slowdown in the region. Elsewhere, there were worries over further credit downgrades in the Eurozone as Fitch Ratings downgraded five European banks. But this was mitigated by the European Central Bank's injection of around 500 billion euros into the banking system and improving US data.

Some regional economies showed further signs of slowing. India's industrial production contracted for the first time in two years, while forward-looking manufacturing indicators pointed to slowdowns in Taiwan and Korea. In Malaysia, industrial output rose but export growth softened in October. Thailand continued to feel the impact of the recent floods, as consumption and investment activity shrank in November. Exports also fell year-on-year because of weak external demand and supply-chain disruptions. In contrast, China's growth remained well supported. The December manufacturing PMI was higher than expected at 50.3, while exports and imports posted month-on-month growth in November.

The shift towards monetary easing continued, with Thailand's central bank cutting its benchmark repo rate by 25 basis points to 3.25% to support the economy's recovery after the recent severe flooding. Policymakers in Indonesia, Korea, Taiwan and the Philippines kept key rates unchanged, while India's central bank signalled an easing bias. Inflationary pressures moderated as food and non-food prices stabilised, although wholesale price inflation remained elevated in India.

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### Asia Dollar Credit

Asian credit markets rebounded from November's losses, as the JP Morgan Asia Credit Index gained by 0.89%. During the month, high-yield outpaced investment-grade bonds. High-yield quasi sovereigns led the way with a gain of 1.91%. At the sector level, industrials outperformed, while Indonesia was the best-performing country. There were only two new investment-grade issues: a US$600 million, 5-year bond from Tencent Holdings and a US$500 million, 5.5-year bond from Hana Bank.

### Currencies

Asian currency performance was mixed. Balance of payments pressure weighed on the rupee, while the baht, won and peso also sold off against the US dollar. In contrast, the yuan outperformed, underpinned by China's pact with Japan to promote direct currency trading and the 70 billion yuan currency swap agreement with Thailand. The rupiah and ringgit also saw marginal gains compared to end-November.

### Local Currency Government Bonds

During the month, Indonesian bonds outperformed with 2-year and 10-year yields falling by 30 bps and 70 bps respectively, owing to expectations of further rate cuts and Fitch Rating's upgrade to BBB-. Short-dated yields also fell in most markets, excluding Hong Kong and Singapore. The Philippine, Indian and Thai bond markets posted gains of 3%, 2.46% and 0.76% respectively. Philippine bonds performed well on hopes of some policy easing, with 10-year yields falling close to 50bps. This was in light of decelerating growth as sluggish electronics demand dampened exports.

The Indian market was supported by a Moody's upgrade of domestic government debt, in addition to soft industrial production numbers amid a slowdown in wholesale inflation. Thai bonds were bolstered by expectations of further rate cuts after the central bank opted to reduce the policy rate by 25 bps in November. Short-dated Korean bonds posted gains as geopolitical risks on the peninsula escalated following the death of North Korean leader Kim Jung-il. Markets in Malaysia and Taiwan were stable. China bond yields fell as liquidity conditions improved after the central bank cut local banks' reserve requirement ratios by 50 bps in November.

On the other hand, the Singapore market stagnated while Hong Kong underperformed as both 2-year and 10-year yields rose by more than 10 bps. This contrasted with US Treasuries, which saw the yield curve flatten as 5-year and 10-year yields fell by 10 bps and 17 bps respectively.

## Outlook

We expect markets to remain volatile in the short term, as the slowing global economy and escalating European fiscal crisis test the resilience of regional economies. Growth and inflation are likely to decelerate in Asia, with policymakers seen adopting more growth-supportive measures. China and India's economic outlook will be crucial in determining sentiment, as these countries are key regional lynchpins. Policy rate expectations are starting to be priced in, and we may have to reposition for a re-pricing of such expectations as global risk factors and growth stabilise. In Asian credit, demand is expected to rise as investors who have stayed on the side-lines look to use some of their cash, but a heavy supply pipeline, particularly in the sovereign and investment grade space, could dampen the market.

## Focus: Ratings boost for Indonesia

**Indonesia Sovereign bond ratings**

| Rating Agency | Current rating | Notches below investment grade | Last upgrade |
|---|---|---|---|
| Standard & Poor's | BB+ | 1 | 8 Apr 11 |
| Moody's | Ba1 | 1 | 17 Jan 11 |
| Fitch | BBB- | 0 | 15 Dec 11 |

Source: Various rating agencies, CLSA, 2 Jan 11

Demand for Indonesian government bonds is likely to rise following Fitch Ratings' upgrade of the country's long-term debt to BBB- from BB+. Fitch cited Indonesia's resilient economic growth, low public debt ratio and prudent macro policy framework in its decision, which saw the country regain investment-grade status after a 14-year hiatus. The central bank is confident that the upgrade will bolster growth prospects, with the lower risk premium and cheaper borrowing costs supporting the financing of economic activity. Analysts expect similar rating upgrades from Standard & Poor's and Moody's to follow shortly.

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**Important information**



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