nikko am

Nikko Asset Management

From The FIXED INCOME Desk

Monthly Outlook

April 2015

Koh Liang Choon
Head of Fixed Income
Nikko AM Asia Limited

Summary

- Prices of the US Treasuries (USTs) ended March higher, with 2-year and 10-year USTs yields closing the month 6 basis points (bps) and 7bps lower respectively.

- India lowered its repo rate to 7.5% from 7.75% amid benign inflation rates. Similarly, both Thailand and Korea delivered 25bps cuts to their respective key interest rates.

- Elsewhere, the Chinese authorities introduced various relaxation measures to support the property sector. In the same period, China held its 3rd session of the 12th National People's Congress (NPC), announcing its policy targets and reform plans for the year.

- Indonesia announced a series of regulations aimed at improving the country's trade balance, including temporary anti-dumping import duties to up the competitiveness of local companies.

- The Asian credit market registered a positive performance in March with Asian high-grade credits and Asian high-yield credits returning 0.70% and 0.30% respectively. Overall credit spreads ended wider by about 4bps as lower USTs yields drove returns.

- In March, there were a total of 15 new issues amounting to USD 10.55bn in the high-grade space, and 4 new issues totalling USD 1.28bn in the high-yield space.

- We believe that central banks in India, Thailand and Korea will continue to lean towards looser monetary policies, which should provide support for their respective government bonds.

- On currencies, we favour RMB and INR, while holding an underweight view on the SGD, MYR and KRW.

- We expect volatility of total returns, particularly for high-grade, to continue driven more by the underlying treasury movements. Asian credit spreads should remain supported given the positive backdrop from the easing measures seen in Asia.

ASIAN RATES AND FX

Market Review

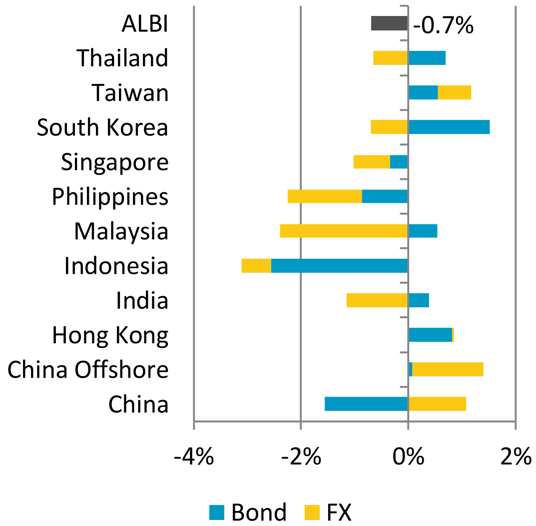
US FED TOOK ON A DOVISH TONE DURING THE MARCH FOMC MEETING

Yields of the USTs ended lower

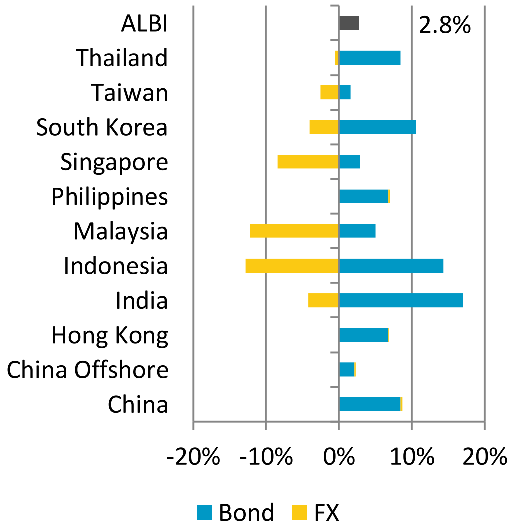
Prices of USTs ended the month higher. A strong February non-farm payroll report and a fall in the unemployment rate to 5.5% from 5.7% initially pushed yields soaring, but subsequent weak US economic data coupled with the start of the European Central Bank's bond buying program placed downward pressure on yields. The dovish March Federal Open Market Committee (FOMC) meeting also contributed to the lower yields during the month. While the US Fed's omission of the word "patient" from its post-meeting statement was widely expected, the more subdued growth and inflation forecasts for the year and the succeeding two years surprised markets. Overall, yields of 2-year and 10-year USTs eventually closed the month 6bps and 7bps lower respectively. Meanwhile, oil prices spiked towards the end of the month as Saudi Arabia launched air strikes against Yemeni rebels.

HSBC Asian Local Bond Index (ALBI)

For the month ending 31 March 2015



For the period from 31 March 2014 to 31 March 2015



Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of the future performance.
Source: HSBC Asian Local Currency Bond Indices, Bloomberg, 31 March 2015

India, Korea and Thailand cut interest rates

The Reserve Bank of India (RBI), in a second surprise inter-meeting move, lowered the repo rate by 25bps to 7.5%. The decision came after the government and the central bank reached an agreement on a monetary policy framework which gave RBI the legal mandate to target inflation for the first time. The RBI will aim to bring inflation below 6% by January 2016, and 4% (+/-2%) thereafter. Meanwhile, both the Bank of Thailand (BoT) and Bank of Korea (BoK) similarly and unexpectedly delivered 25bps cuts to their respective key interest rates. The BoT's Monetary Policy Committee members voted four-to-three in favour of the reduction, with disappointment in the growth outlook being the primary driver of the decision. The BoK decision was similarly not unanimous, as two board members voted for no change in the policy rate.

■ *China concluded the 12th NPC, a 7% GDP growth rate target was set for 2015*

China's 12th NPC held its third annual meeting from 5 to 15 March, announcing its policy targets and reform plans for the year. Key economic targets established by Premier Li Keqiang in his government work report included a GDP growth target of 'around 7%', which is lower than the 2014 target of 7.5% and actual growth rate achieved in that year of 7.4%. This is also the lowest growth target since 2004. On top of this, the government projects consumer price index (CPI) inflation to be 3.0%, M2 supply to increase by around 12%, and a budget deficit of RMB 1.62trn, or 2.3% of 2015 GDP. The NPC accorded substantial attention to reform progress in the areas of fiscal policy, taxation and financial markets. According to the People's Bank of China, China will continue to pursue a prudent monetary policy, and there is a significant probability of a full liberalisation in the interest rate mechanism in 2015. It was further announced that a deposit insurance scheme will be launched in the first half of the year, and that the country is actively lobbying to have the RMB included in the International Monetary Fund's (IMF) basket of Special Drawing Rights (SDR).

■ *Indonesia introduced regulations to improve the trade balance*

Over the month, President Jokowi announced several economic structural reform policies which aimed at improving the trade balance. A new anti-dumping import duty policy will be imposed to up the competitiveness of local companies. Visa exemptions will be accorded to 30 countries in a bid to boost foreign exchange income from the tourism industry. The government has also mandated increased use of biofuel as a mixture for diesel oil, and plans to revise tax allowance and tax holidays for specific sectors and companies to attract foreign and domestic direct investments.

■ *Deceleration of inflation pressures persisted*

The CPI in Indonesia fell substantially, registering 6.3% year-on-year (YoY) from a 7.0% print in the previous month, due to lower prices of staple foods. Thailand remained in deflation, with headline CPI falling 0.5% YoY from a 0.4% drop in the previous month. Inflation in Singapore similarly remained in negative territory, as CPI dipped 0.3%, albeit edging slightly higher from the previous month's -0.4% reading. At the same time, lower oil and weak service prices were the main factors that contributed to the 0.5% YoY CPI reading in South Korea. Softer fuel prices likewise served as a drag on Malaysia's inflation which slipped to 0.1%. Meanwhile, CPI in the Philippines and India printed slightly higher than January levels. In China, price pressures registered 1.4% YoY against a 0.8% reading in the previous month, with the upside surprise attributed mainly to the Lunar New Year.

Market Outlook

INDIA, THAILAND AND KOREA TO LEAN TOWARDS LOOSER MONETARY POLICIES

■ *Favour India, Thailand and Korean government bonds*

We believe that central banks in India, Thailand and Korea will continue to lean towards looser monetary policies. Demand for Indian local government bonds will be supported by anticipation of softer inflation prints as weakness in oil prices persist. The BoT has lowered its 2015 GDP growth and inflation forecasts, citing "weak confidence, lower-than-expected government spending and domestic demand" as key reasons for the revision in the growth outlook. In Korea, deflationary pressures persist, and the BoK has signalled that a downward revision to its economic forecasts is likely to be announced at its April meeting.

■ *Favour RMB and INR*

Comments from Chinese policymakers post-NPC confirmed that reform progress is a top agenda. We believe that one of the priority reform policies is the internationalisation and liberalisation of the RMB. This will provide ample support for the currency, particularly as China actively lobbies for inclusion of the RMB in the IMF's SDR. We maintain our preference for the INR on relatively stronger growth potential of the Indian economy, as well as expectations that the current account deficit will remain well contained as oil prices remain weak.

■ *Cautious on SGD, MYR and KRW*

We believe that the SGD, MYR and KRW will underperform regional peers. Further weakness in the KRW is likely, given expectations of continued monetary easing bias by the BoK. Persistent weakness in Singapore's non-oil domestic exports and industrial production figures has increased the risk of band widening by the Monetary Authority of Singapore during its next scheduled meeting in April. At the same time, the MYR's sensitivity to oil prices and rising concerns over Malaysia's reserves adequacy will put further downward pressure on the MYR.

ASIAN CREDITS

Market Review

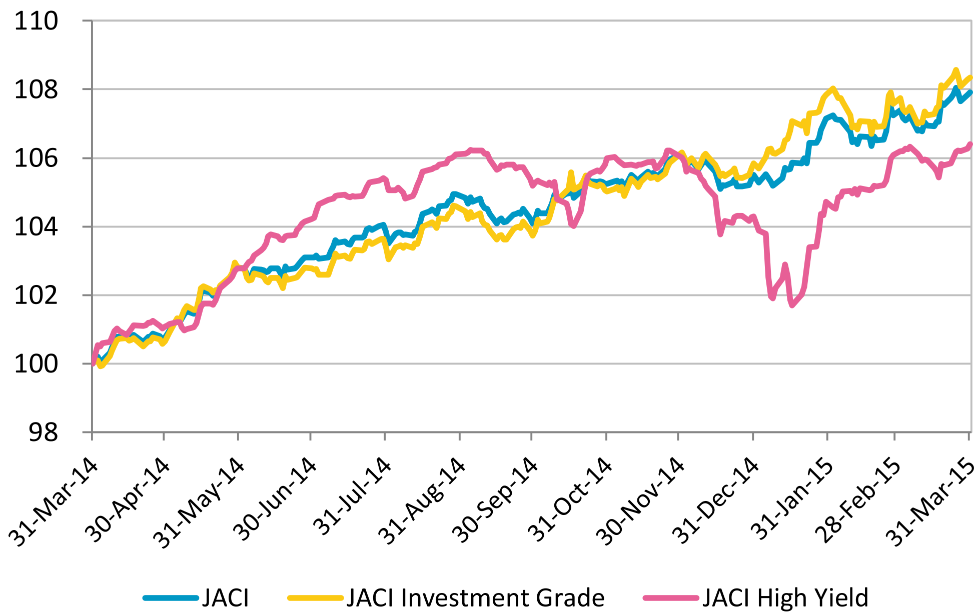
ASIAN HIGH-GRADE CREDITS RETURNED -0.70%, WHILE ASIAN HIGH-YIELD CREDITS RETURNED 0.30%

■ *Asian credits ended the month higher on positive returns from USTs*

The Asian credit market registered a positive performance in March. Overall credit spreads ended wider by about 4bps as lower USTs yields drove returns. Asian credit spreads began to widen in early March due to concerns over the US Federal Reserve's (Fed) policy path, impact of a rapidly strengthening USD on Asian economies and weak data from China. Spreads retraced some of the widening towards month-end as policy easing seen in some countries alleviated concerns. Overall, Asian high-grade credits returned 0.70% in March as spreads remained largely unchanged, while Asian high-yields credits returned 0.30% despite spreads widening by about 12bps. For the quarter, Asian high-grade returned 2.36% and high-yield corporates returned 2.17%.

JP Morgan Asia Credit Index (JACI)

Daily Returns for the period from 31 March 2014 to 31 March 2015



Note: Returns in USD. Past performance is not necessarily indicative of the future performance.
Source: JP Morgan, 31 March 2015

China announced additional property relaxation measures

Following a 10th straight month of YoY declines in average home prices, the Chinese authorities announced several relaxation measures to support the property sector. Down payments for buyers of second homes were lowered to 40% from the previous 60%, while first-home buyers who borrow from their local housing provident funds will pay a minimum 20% down payment from the previous 30%. At the same time, business tax on the sale of an 'ordinary' home will now be waived for properties held for at least two years, down from the previous minimum of five years. This supported sentiment towards Chinese property credits.

Primary market activities picked up in the high-grade space

During the month, there was a slight pickup in primary market activities within the high-grade space, where there were a total of 15 new issues amounting to USD 10.55bn. In contrast, new issues within the high-yield space remained subdued, with only 4 new issues totalling USD 1.28bn in March.

Market Outlook

ASIAN CREDIT SPREADS TO REMAIN SUPPORTED BY EASING MEASURES IN ASIA

Returns tethered to external developments; Chinese credit spreads to benefit from easing measures

Volatility of total returns, particularly for high-grade, is likely to continue to be driven more by the underlying treasury movements. Divergent monetary policies globally looks set to continue with a rate hike by the US Fed remaining on the cards. On the other hand, Asian credit spreads should remain supported given the positive backdrop from the easing measures seen in Asia. The recent easing measures seen from China should be supportive of Chinese related credits, especially those in the more cyclical sectors. Some spillover demand European investors arising from very low yields offered by many European fixed income markets should also be supportive of Asian credits.

Valuations no longer appear cheap but technicals supportive

Valuations no longer appear cheap from a historical basis with the exception of selected countries and sectors even after some widening seen in March. However, without a meaningful pick up in new issuance, spreads are unlikely to widen significantly from here. With the underwhelming amount of new issuance in February and the manageable supply seen in March, technicals should be supportive into the initial part of the second quarter.