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Nikko Asset Management

# From The FIXED INCOME Desk

**Monthly Outlook**

## May 2015

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## Summary


- Yields of the US Treasuries (USTs) traded in a relatively tight range, eventually ending higher at month-end. At 2.03%, the 10-year point on the UST curve was up 11 basis points (bps) compared to the level at end-March.

- In April, China cut bank reserves again to counter a slowdown in the economy. Thailand also cut its key interest rate and announced plans to ease foreign exchange regulations to facilitate capital outflows.

- Meanwhile, Singapore kept its monetary policy unchanged and its central bank said that growth was evolving with expectations and inflation could pick up. Similarly, Indonesia maintained its benchmark interest rate but has adopted a more subdued outlook on global growth.

- The overall Asian credit market posted another month of positive performance in April despite higher USTs yields. Total return of investment-grade corporates came in at 0.21% in April, while Asian high-yield credit returned 1.85%.

- The month of April saw a deluge of new issues, albeit heavily skewed towards the high-grade space where there were a total of 23 new issues totalling USD 21.4bn.

- We are positive on India and Thai government bonds as we expect the respective central banks to continue leaning towards a looser monetary policy. In contrast, we hold an underweight view on Korean government bonds on the belief that a potential additional rate cut may be essentially priced-in by now.

- On currencies, we continue to favour RMB but hold an underweight view on SGD, MYR, THB and KRW.

- Volatility of returns is likely to remain high as volatility in risk-free rates have picked up significantly even as credit spreads have remained relatively more stable. Meanwhile, we expect the supply of new issuances to remain high in the coming month with China investment grade issuing the majority.

# ASIAN RATES AND FX

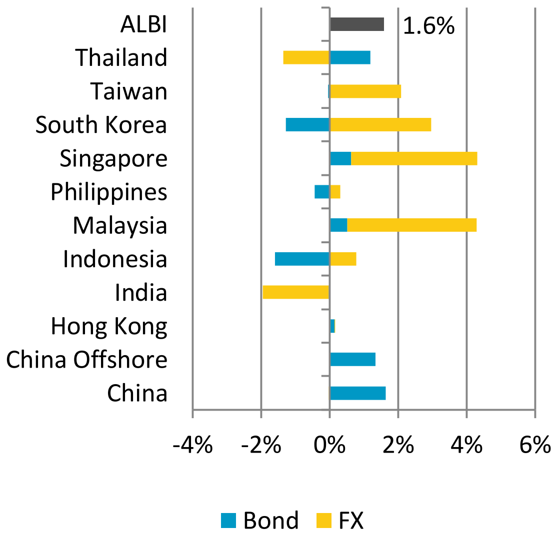
## Market Review

■ *Yields of USTs ended higher*

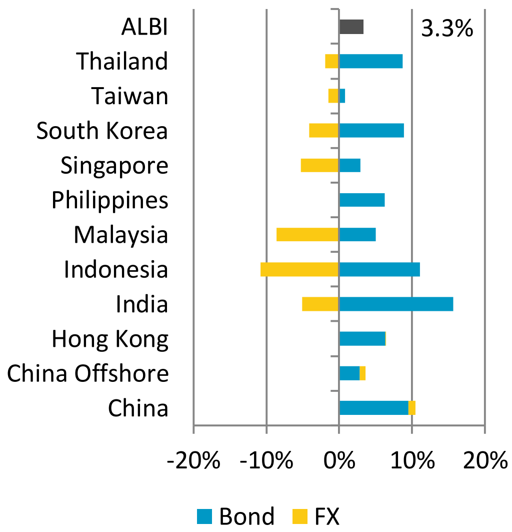
Yields of USTs traded in a relatively tight range, eventually ending higher at month-end. At 2.03%, the 10-year point on the UST curve was up 11bps compared to the level at end-March. Inflation expectations heightened during the month as oil prices recovered. Saudi Arabia raised its crude-oil selling prices for Asian buyers, and supply data from Cushing Oklahoma suggested a pick-up in US demand. Although economic data out from the US were generally weak – March non-farm payrolls printed sharply lower than market consensus and first quarter GDP growth expanded at its slowest pace in a year – USTs weakness was also in response to the abrupt rally in yields of German bunds amid signs of a recovery in Eurozone growth.

### HSBC Asian Local Bond Index (ALBI)

**For the month ending 30 April 2015**




**For the period from 30 April 2014 to 30 April 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, 30 April 2015

CHINA CUT BANK RESERVE REQUIREMENT TO SPUR GROWTH

■ *China delivered a cut in banks' reserve requirement ratios (RRR)*

On 19 April 2015, the People's Bank of China announced a 100bps universal cut in banks' RRR, marking the second industry-wide cut in two months. Notably, this cut is the biggest single reduction since 2008, and followed remarks by Premier Li Keqiang that the Chinese economy continues to face downward pressure this year, and that the government will roll out more targeted easing measures to support growth, if necessary. Meanwhile, on top of the system-wide RRR cut, additional targeted ratio cuts were announced for rural financial institutions, the Agricultural Development Bank and selected state banks and joint stock banks.

■ *Moody's raised its sovereign outlook on India and Korea to positive*

During the month, Moody's Investors Service upgraded the outlook of both India and South Korea to 'positive' from 'stable'. According to Moody's Investors Service, the perception that Indian policymakers "are establishing a framework that will likely allow India's growth to continue to outperform that of its peers over the medium-term; and improve India's macro-economic, infrastructure and institutional profile" prompted the change in outlook for India. In the case of South Korea, the revised outlook was prompted by improved public debt management.

## Singapore and China registered a GDP growth of 2.1% and 7% in 1Q15 respectively

Singapore's 1Q15 GDP advance estimate showed economic growth unchanged at 2.1% year-on-year (YoY) from the previous quarter. This came in higher than expectations. Contraction in the manufacturing sector remained a drag, while expansion in the construction sector was boosted by a pick-up in the private sector, particularly in the residential segment - construction activities. In China, growth was registered at 7% YoY in 1Q15, representing the slowest quarterly expansion since early 2009. This was in line with estimates but below the 7.3% growth in the previous quarter. Notably, other growth indicators reported in the month signaled continued weakness in the economy. Specifically, growth in industrial production plummeted to 5.6% in March, a considerable drop from the 6.8% registered in the months of January and February combined. Electricity production contracted, and cement output declined. Trade data for March also came in weak as exports fell sharply following a surge in February. Coupled with a slowing rate of decline in import growth, China recorded a substantially smaller trade surplus of USD 3.08bn in March, after a record high USD 60.6bn in February.

## Monetary Authority of Singapore (MAS) left its FX policy unchanged

The MAS maintained its FX policy of a modest and gradual appreciation of the SGD NEER policy band, leaving the slope and width of the band, as well as the level at which it is centered, unchanged. Ahead of the release, there were growing expectations of further easing, which had pressured the SGD NEER to the bottom of the band. MAS reiterated its growth forecast of 2-4% this year, relatively optimistic at external sector outlook, highlighting "incipient signs of a turnaround" in the Eurozone and Japan, on top of improving US economic conditions. On inflation, the MAS expects both core and headline numbers to soften before "rising towards the end of the year and into 2016". Notably, it mentioned "continued tightness in the labour market", after omitting mention of this in the previous inflation development report.

## Indonesia turned dovish on growth; implement macro-prudential policies to boost bank lending

Bank Indonesia (BI) kept interest rates unchanged. However, in a dovish shift from last month's statement, it adopted a more subdued outlook on global growth, describing the recovery as "sluggish" and characterising the pick-up in US growth as being "weaker than expected". On the domestic front, although the central bank maintained its 2015 GDP growth forecast unchanged at 5.4-5.8%, it now expects growth to come in "nearing the lower end" of the range. Growth in the first quarter was described as "moderate", with a "rebound forecasted" in the succeeding quarter. Consistent with this new assessment, BI noted that more "accommodative" macro-prudential policies will be implemented. The central bank will expand the definition of deposits relative to banks' computation of loan to deposit ratios (LDR), and ease the upper LDR limit for banks that fulfil certain obligations, in the hope of boosting bank lending.

## Thailand lowered its key policy, relaxed foreign exchange regulations

The Bank of Thailand (BoT) monetary policy committee members voted five-to-two in favour of another 25bps reduction in the key interest rate. Disappointing economic recovery, weaker export growth and a lower inflation environment were primary drivers of the decision. Although the central bank kept its 2015 official GDP growth target unchanged, it highlighted that risks were skewed to the downside, and that the relatively strong Thai Baht has put downward pressure on exports. The day after, the central bank announced that it plans to ease foreign exchange regulations to facilitate capital outflows. According to the BoT, the measures have received in-principle approval from the Ministry of Finance.

## Market Outlook

EXPECT INDIA AND THAILAND TO CONTINUE LEANING TOWARDS A LOOSER MONETARY POLICY

### *Overweight India and Thai government bonds; underweight on Korea*

We maintain our overweight view on Indian and Thai government bonds, and shift our outlook on Korean bonds to underweight. We are of the view that the BoT will continue to lean towards a looser monetary policy, as the pace of recovery remains anaemic. In addition, supply side backdrop for the Thai bond market remains supportive, with fairly light issuance scheduled in the third quarter (April to June). Similarly, as underlying inflationary pressures remain muted amid lingering weak growth momentum, we expect the Reserve Bank of India to continue with monetary easing. Meanwhile, we downgrade our view on Korean government bonds to underweight on the belief that a potential additional rate cut may be essentially priced-in by now. In addition, the uncertainty over the upcoming sizable mortgage-backed securities supply is likely to negatively affect Korean government bonds.

### *Favour RMB; cautious on SGD, MYR, THB and KRW*

We continue to favour the RMB, and hold an underweight view on the SGD, MYR, THB and KRW. The Chinese authorities' pursuit of the RMB's internationalisation, as it actively lobbies for inclusion of the currency in the International Monetary Fund's basket of Special Drawing Rights, should continue to provide support for the outperformance of the currency vis-a-vis its regional peers. Notably, Premier Li has openly described the current value of the RMB as "stable", saying that the government does not wish to boost exports via a devaluation of the currency. Meanwhile, although we maintain the view that the SGD and MYR will underperform regional peers, we have trimmed down on the magnitude of our underweight positions on both currencies, on the premise that the recent weakness in the USD may linger in the short term; as stretched positioning gets unwound and on the back of the uptick in oil prices. Nonetheless, we believe SGD will remain a preferred funding currency due to its low yield and MYR will continue to be dragged by concerns over the reserves and fiscal positions. Lastly, we are turning more defensive on the THB on growing signs that officials have leaned towards bias for a weaker THB, and on the KRW on expectations of continued monetary easing by the Bank of Korea.

# ASIAN CREDITS

## Market Review

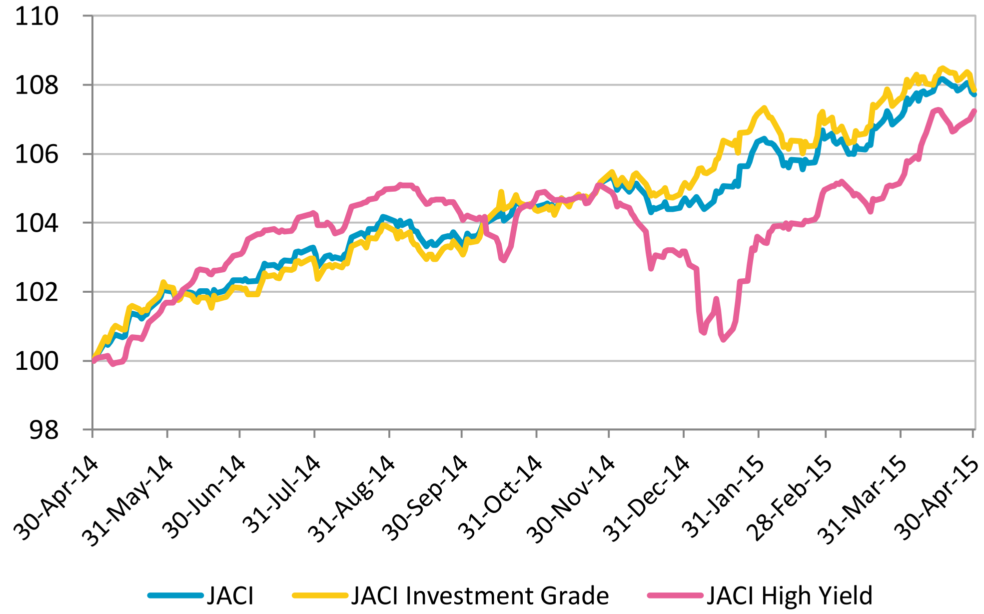
ASIAN HIGH-YIELD CREDITS SUPPORTED BY STRONG GAINS WITHIN THE CHINA HIGH-YIELD SECTOR

*Asian credits ended the month higher despite higher USTs yields*

The Asian credit market registered another positive performance in April, on the back of tighter credit spreads, as yields of the USTs – which traded in a relatively tight range over the month – eventually ended higher. At 2.03%, the 10-year point on the UST curve ended the month 11bps higher compared to the level at end-March. Overall, total return of investment-grade corporates came in at 0.21%, underperforming Asian high-yield credit returns of 1.85% as the latter was supported by strong gains within the China high-yield sector.

## JP Morgan Asia Credit Index (JACI)

**Daily Returns for the period from 30 April 2014 to 30 April 2015**




Note: Returns in USD. Past performance is not necessarily indicative of the future performance.
Source: JP Morgan, 30 April 2015

*Flurry of new issues in April*

The month of April saw a deluge of new issues, albeit heavily skewed towards the high-grade space. Compared to the high-yield space with six new issues amounting to USD 1.34bn, the investment-grade space saw a total of 23 new issues totaling USD 21.4bn during the month with the majority of the issuance from China.

## Market Outlook

VOLATILITY IN RISK-FREE RATES HAVE PICKED UP SIGNIFICANTLY

■ *Volatility of returns to stay high; China continued easing measures to be supportive of China credits*

Volatility of returns, especially for investment grade, is likely to remain high as volatility in risk-free rates have picked up markedly even as credit spreads have remained relatively more stable. The path of risk-free rates from signs of potential monetary policy changes will continue to be led by economic data released given the mixed picture of late. Within Asia, with continued signs of growth moderating in China, the expectation for further easing is likely to support sentiment towards Chinese credits.

■ *Sizeable expected new issuance pipeline could test market*

The expectation is for the supply of new issuances to remain high in the coming month with China investment grade issuing the majority. This could put a cap on the amount of spread compression in secondary issues even as the Chinese authorities continue on the easing path.