

On the Ground in Asia

Monthly Insights: Asian Fixed Income (March 2022)

Rates markets seen stabilising after steep rise, regional currencies expected to enjoy greater support

20 April 2022

By the Asian Fixed Income team

Summary



- The US Treasury (UST) yield curve shifted higher in March, with front-end yields underperforming, as the US Federal Reserve (Fed) communicated its resolve to curb inflation. The UST 10-year bond yield rose 51.4 basis points (bps) to 2.341%, while the 2-year bond yield increased by 90.2 bps to 2.337%.
- Some central banks kept their respective policy rates unchanged. The Bank of Thailand (BOT) and Bangko Sentral ng Pilipinas raised their inflation forecasts. The inflationary picture was mixed across the Asian regions in February.
- During the month, Chinese Premier Li Keqiang said that China would set a gross domestic product (GDP) growth target of “around 5.5%” in 2022 and that consumer price index (CPI) inflation is expected to be within 3.0%. Separately, Vice Premier Liu He announced that the authorities would push to stabilise the financial markets.
- Asian credits retreated 2.03% in March as the rise in UST yield offset gains from spread tightening. Asian high-grade (HG) credits declined 1.91%, with spreads narrowing 7.1 bps. Asian high-yield (HY) fell 2.60%, as spreads contracted by 25.8 bps.
- We have eased our cautious view towards duration as we expect global rates to consolidate from current levels. On currencies, we are positive on the Malaysian ringgit (MYR), Indonesian rupiah (IDR) and Singapore dollar (SGD).
- In our view, the global and regional developments have presented greater downside risks to the macro backdrop and corporate credit fundamentals across Asia, which could result in greater differentiation across countries and sectors. However, this may not lead to a meaningful widening in Asian credit spreads due to existing buffers. We therefore remain cautious and selective towards risk for now.

Asian rates and FX

Market review

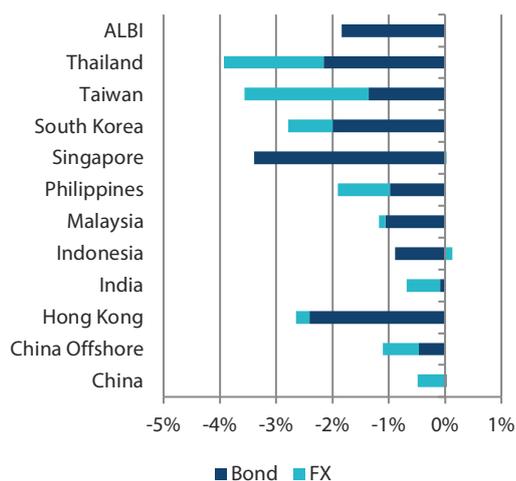
UST yields rise in March

The selloff in USTs intensified in March, with yields climbing between 28.6 to 90.2 bps across the curve. Front-end yields underperformed, as the Fed communicated its resolve to curb inflation. Risk-free rates initially fell amidst weak sentiment as the crisis in Ukraine evolved. Subsequent firmer CPI inflation reading from the US heightened expectations that the Fed could accelerate monetary policy tightening, prompting a sharp rise in rates. The continued upward move in yields was further supported by the European Central Bank’s unexpected acceleration in winding down its monetary stimulus. The Fed delivered a well-telegraphed 25 bps rate hike mid-month, with Chairman Jerome Powell hinting that balance sheet reduction could start as early as May. Bond yields moved sharply higher again, as risk assets strengthened and several Fed officials—including the chair—suggested that the central bank is prepared to raise interest rates more aggressively if needed. At the end of March, the benchmark 2-year and 10-year UST yields were at 2.337% and 2.341%, respectively, 90.2 bps and 51.4 bps higher compared to end-February.

Chart 1: Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 March 2022

For one year ending 31 March 2022



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 March 2022

Note: Bond returns refer to ALBI indices quoted in local currencies while FX refers to local currency movement against USD. ALBI regional index is in USD unhedged terms. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Inflationary picture mixed in February

Headline CPI inflation in South Korea, India, Thailand and Singapore accelerated, while similar inflation gauges eased in Malaysia and Indonesia and remained unchanged in China and the Philippines. Thailand’s February CPI read at 5.28% year-on-year (YoY), the highest since September 2008. The CPI climbed well above the Thai central bank’s target range amid a rise in fresh food and energy costs. Meanwhile, higher private transport inflation prompted the acceleration in Singapore’s headline CPI. In Malaysia, CPI inflation moderated for the third straight month in February, due partly to slower non-food inflation. Elsewhere, inflationary pressures remained relatively low in Indonesia, with headline CPI easing to 2.06% YoY (from 2.18% YoY), while core CPI rose to 2.03% YoY (from 1.84% YoY).

Monetary authorities raise their inflation forecasts but leave policy rates unchanged

Central banks in Indonesia, Malaysia, Thailand and the Philippines kept their respective policy rates unchanged despite acknowledging risks from rising commodity prices, pledging to support economic recovery. The BOT raised its 2022 CPI inflation forecast to 4.9% YoY (from 1.7% YoY), above its 1-3% target, citing supply-side factors. The BOT also revised its 2022 GDP growth forecast down to 3.2% (from 3.4%), noting higher oil and commodity prices and slower external

demand. In the Philippines, the Bangko Sentral ng Pilipinas similarly raised its 2022 CPI inflation forecast above its 2-4% target. It now expects headline CPI to register 4.3% YoY this year, from an earlier forecast of 3.7% YoY, owing to higher oil prices.

China sets 2022 growth target of “around 5.5%” ; policymakers push firmly to stabilise financial markets

Chinese Premier Li Keqiang announced a fairly aggressive GDP growth target of “around 5.5%” for 2022 with CPI inflation expected to be within 3.0%. China’s fiscal deficit target for 2022 was set at around 2.8%. While the target is lower than the 3.2% of 2021, government spending for 2022 will include fiscal savings and SOE profits from the previous year. The government also aims to “step up implementation” of monetary policy, stabilise the housing market and allow more flexibility in annual energy consumption targets. Separately, policymakers made a solid push to stabilise financial markets. Vice Premier Liu He hosted a Financial Stability and Development Committee meeting, during which authorities pledged to mitigate risks surrounding the property sector, complete “rectification work” on internet companies as soon as possible and work on resolving the issue over listing of Chinese firms in US markets. The Ministry of Finance had also decided to defer broader trials of a property tax plan.

Market outlook

Easing cautious view towards duration; favour MYR, IDR and SGD

Global rates rose steeply in March, largely due to concerns around swifter global liquidity withdrawal on the back of upside inflation risks. Markets have now priced in a further 200 bps increase in the Fed funds rate by year-end. We have eased our cautious view towards duration as we expect global rates to consolidate from current levels. We anticipate regional currencies to enjoy relatively greater support going forward, as global rates markets stabilise. Within the region, we continue to favour the MYR and IDR, both of which may continue to benefit from high commodity prices. We also anticipate better demand for the SGD against other regional currencies, as we expect the Monetary Authority of Singapore (MAS) to further tighten its FX policy in April, which would likely lead to a stronger appreciation of the SGD nominal effective exchange rate (NEER) basket.

Asian credits

Market review

A volatile month for Asian credits

Asian credits retreated by 2.03% in total return due to the sharp rise in UST yields, which more than offset the 11.2 bps narrowing in overall credit spreads. Asia HG performed better than its high-yield counterpart, declining 1.91% despite spreads narrowing 7.1 bps. Asia HY returned -2.60%, with spreads contracting 25.8 bps.

Asian credits experienced extreme volatility in March. Overall risk tone was weak at the start of the month, as markets remained focused on the Ukraine crisis. Concerns of inflationary pressures rising further as a result of higher commodity prices prompted the initial rise in spreads. Subsequently, incremental lockdowns in key Chinese cities, news of possible delisting of some Chinese companies from US equities markets and idiosyncratic headlines within the Chinese property sector further weighed on already-fragile market sentiment. Mid-month, sentiment dramatically reversed after Chinese Vice Premier Liu He vowed to roll out policies to support the economy and capital markets. In particular, a re-assurance that the crackdown on internet companies was coming to an end and a declaration that “forceful and effective measures” will be implemented to mitigate risks surrounding property developers led to a strong rebound in Chinese credits which practically erased earlier heavy losses. Investor sentiment improved further after the Chinese central bank pledged to step up monetary policy support and on reports that Chinese authorities are studying a plan for a sizable new stability fund to backstop troubled financial firms.

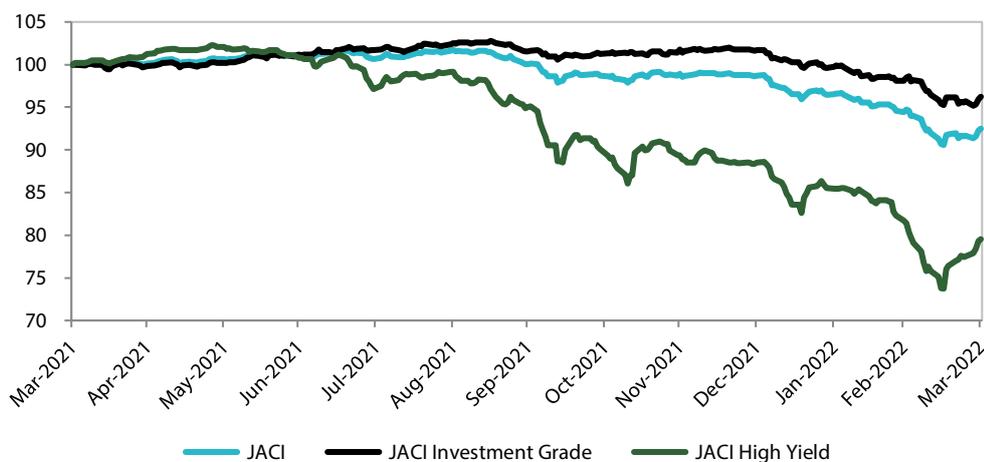
Spreads of all major geographical-segments, save for Thailand, Singapore and Hong Kong, tightened in March. The outperformance of Indonesian credits was partly attributed to positive domestic macro news, as well as the stabilization of Emerging Market (EM) fund flows and global risk sentiment in the second half of March. On frontier markets, Sri Lanka sovereigns tested record lows as the country’s economic crisis deepened. During the month, the International Monetary Fund (IMF) declared the country’s public debt has risen to “unsustainable levels”, and foreign exchange reserves are insufficient for near-term debt payments.

Primary market activity picks up in the latter half of March

Activity in the primary market picked up in March, with most issuers entering in the latter half of the month as volatility decreased. The HG space saw 28 new issues amounting to US dollars (USD) 15.2 billion, including the USD 2.1 billion three-tranche issue from United Overseas Bank, USD 2.25 billion three-tranche sovereign issue from the Philippines, USD 1.75 billion two-tranche sovereign issue from Indonesia and USD 1.5 billion issue from DBS Bank. Meanwhile, the HY space saw approximately USD 4.7 billion worth of new issues raised from 34 issues.

Chart 2: JP Morgan Asia Credit Index (JACI)

Index rebased to 100 on 31 March 2021



Note: Returns in USD. Past performance is not necessarily indicative of future performance.
Source: Bloomberg, 31 March 2022

Market outlook

Greater downside risks to fundamentals but existing buffers to prevent meaningful spread widening

Many of the risk factors that adversely affected Asian credits in early March remain in place. However, there have been marginal improvements in some of these factors, and the shock impact on risk sentiment has likely peaked even as the medium-term fundamental impact on growth and inflation remains uncertain. The Russia-Ukraine war continues to drag on, but as of this writing high-level talks have taken place in an attempt to at least reach a ceasefire. In response to the sharp rise in oil and other commodity prices, governments have announced fiscal and other targeted measures to ease the pressure on inflation and household finances. This includes the US government’s decision to release a significant amount of oil from its strategic reserve over the next six months. An aggressive tightening cycle by the Fed seems imminent, but the US rates market has already re-priced significantly and this should limit the upside risk to UST yields from here. Meanwhile, top policy makers in China have provided reassurance to address key issues of concern, including the health of the property sector and listing status of Chinese firms on US stock exchanges, although policy measures announced so far remained modest and somewhat fragmentary, and the new COVID flare-ups in key regions may exert further downward pressure on growth.

These global and regional developments have presented greater downside risks to the macro backdrop and corporate credit fundamentals across Asia, and there will likely be greater differentiation across countries and sectors. However, given existing buffers, we do not anticipate the downward risks to overall fundamentals will lead to a meaningful widening in Asian credit spreads, even if the room to tighten further after the retracement in the second half of March could be limited in the near-term. We therefore remain cautious and selective towards risk for now.

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.