YOUR GOALS,
OUR COMMITMENT.

On the ground in Asia

Monthly Insights: Asian Fixed Income (June 2023)

Favourable technical conditions may keep spreads tight for some time

By the Asian Fixed Income Team
14 July 2023

Summary

- US Treasury (UST) yields traded in a relatively tight range in June, with short and intermediate Treasury bonds underperforming. At the end of the month, the benchmark 2-year and 10-year yields were at 4.90% and 3.84%, respectively, up 49.5 basis points (bps) and 19.3 bps compared to end-May.
- Central banks of India, Indonesia and the Philippines left their policy rates unchanged, while inflationary pressures across the region eased further in May.
- We remain constructive on relatively higher-yielding government bonds, on the back of the supportive macro backdrop for these countries. Our favourable view of higher-yielders is further grounded on the view that lower-yielding government bonds will be more vulnerable to volatility in UST bonds. As for currencies, we see Chinese renminbi (RMB) weakness weighing on the outlook for Asian currencies in the near term. Against such a backdrop, we have a more favourable view of the Indian rupee.
- Asian credits returned +0.32% in June, driven mainly by a 20 bps tightening in spreads. Asian high-grade (HG) credit registered losses of 0.16%, while Asian high-yield (HY) credit registered total returns of +3.01%.
- We expect macro and corporate credit fundamentals across Asia to stay robust, albeit slightly weaker than in 2022. Resilient domestic demand and the recovery of tourism, particularly in India and ASEAN economies, are seen offsetting the weakness in goods exports. However, regional and global uncertainties, coupled with the resilience of Asia credit thus far, make the valuation of Asia HG credit look slightly stretched compared to both historical levels and developed market spreads.

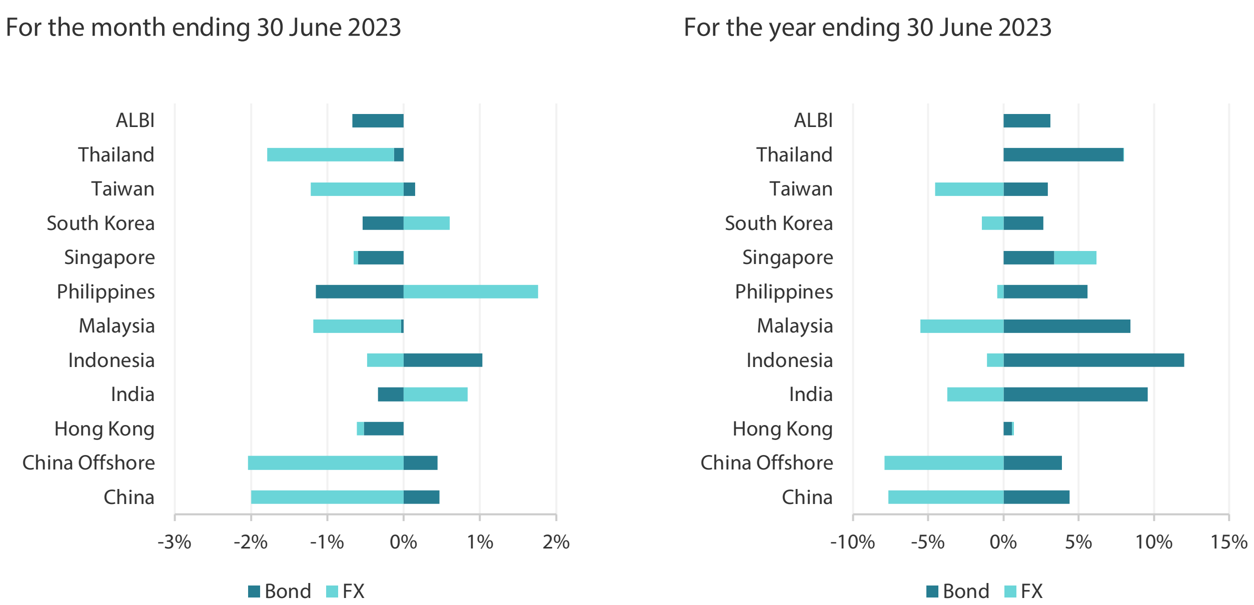
Asian rates and FX

Market review

The Fed holds rates steady

UST yields traded in a relatively tight range in June, with short and intermediate tenors underperforming. The month opened to rising yields after the US debt ceiling resolution prompted a rally in risk assets. Mid-month, the US Federal Open Market Committee (FOMC) kept its key rate unchanged—after raising it by a cumulative five percentage points since March 2022—but communicated that it was retaining a tightening bias. In particular, the FOMC signalled that two more increases are likely this year as inflation remains elevated. Although the pause was widely anticipated, the upward revision to the terminal rate estimate was largely unexpected. Besides the US Federal Reserve (Fed), other major global central banks including the Bank of England, the Bank of Canada and the European Central Bank—all of which delivered rate hikes—were likewise hawkish. Separately, key US economic data released in June remained largely above the Fed's comfort zone. First-quarter GDP growth was revised higher, nonfarm payrolls for May increased by a bigger-than-expected 339,000 and May's core consumer price index (CPI) remained sticky. At end-June, the benchmark 2-year and 10-year yields were at 4.90% and 3.84%, respectively, up 49.5 basis points (bps) and 19.3 bps compared to end-May.

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



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 30 June 2023.

Central banks of India, Indonesia and the Philippines leave their policy rates unchanged

Reserve Bank of India (RBI) Governor Shaktikanta Das cited uncertainty over the inflation outlook as the primary reason the central bank is staying focused on withdrawing accommodation. The RBI now projects annual inflation for the new fiscal year that started on April 2023 to register at 5.1% (from 5.2%), while it maintained the real GDP forecast at 6.5%. Over in the Philippines, Bangko Sentral ng Pilipinas (BSP) said "domestic growth momentum is expected to remain intact over the near term", although recent data "suggest a likely moderation in economic activity over the policy horizon". BSP also lowered its inflation forecast for 2023 to 5.4% (from 5.5%), while raising its inflation forecast for 2024 to 2.9% (from 2.8%). Separately, Eli Remolona was appointed as the next BSP governor, replacing Felipe Medalla when his term expires in July. Similarly, Bank Indonesia (BI) left its policy rate at 5.75%, with the overall tone of the policy statement remaining unchanged. BI reiterated its policy focus on maintaining currency stability and continues to forecast GDP growth of 4.5–5.3% for 2023, adding that it will employ macroprudential measures to bolster domestic demand.

Inflationary pressures ease further in May

Price pressures in the region moderated further in May. Singapore's headline CPI rose 5.1% year-on-year (YoY) in the month, lower than the 5.7% increase in April, reflecting lower core inflation as well as a fall in private transport inflation. Consumer prices in Indonesia rose 4.0% in May, down from 4.33% in April, returning to within the central bank's target range of 2–4% earlier than expected, prompted in part by lower transport and clothing inflation. BI had projected inflation to fall within the range only in the third quarter. In Thailand, price pressures moderated sharply, to 0.53% from 2.67%, undershooting the Bank of Thailand's target range of 1–3%. The lower CPI print was driven largely by a sharp drop in electricity inflation amid an extension of electricity subsidies to certain households. Meanwhile, headline CPI in India cooled in May, registering 4.25% YoY—the lowest since April 2021—printing firmly within the RBI's inflation band for the third consecutive month. Elsewhere, consumer price growth in the Philippines softened in May to 6.1% YoY from 6.6% in April as food and transport inflation eased.

Chinese economic data disappoints anew; People's Bank of China cuts key policy rates

Official data released in the month revealed that China's economic recovery continued to lose steam in May, prompting the government to revive its growth-supportive stance. Industrial production and retail sales growth slowed to 3.5% and 12.7% (from 5.6% and 18.4%), respectively. Fixed asset investment growth decelerated to 4.0% in the first five months of the year, down from 4.7% in the January to April period. The unemployment rate among young Chinese climbed to a new high of 20.8%. Meanwhile, aggregate financing (AF) came in at RMB 1.56 trillion, higher than April's RMB 1.22 trillion but missing estimates of RMB 1.90 trillion. Financial institutions offered RMB 1.36 trillion of new loans in May, also missing estimates of RMB 1.55 trillion. These translated to a marked easing in the growth of both outstanding AF and RMB loans—to 9.5% and 11.4% YoY, respectively, from 10.0% and 11.8% in April.

Responding to the slew of significantly weak data, the People's Bank of China (PBOC) lowered several policy rates and Chinese Premier Li Qiang declared that the government will take steps to boost demand. The seven-day repurchase rate, one-year medium-term lending facility rate, and one-year and five-year loan prime rates (LPR) were all trimmed by 10 bps each. The cut to the 5-year LPR—which serves as the benchmark rate for mortgage loans—undershot expectations of a 15-bps cut. Following this, the State Council pledged to roll out "more forceful measures" in a timely manner to "enhance the momentum of economic development, optimise the economic structure, and promote the sustained recovery of the economy". However, policy stimulus has been falling short so far, with no concrete details of nationwide measures announced, prompting an eventual reversal in risk tone.

Market outlook

Prefer higher-yielding bonds

Headline inflation for most countries in the region has eased considerably, and market focus has shifted to growth. These factors are fuelling increasing expectations of central bank pivots within the latter half of the year. We remain constructive on relatively higher-yielding government bonds, on the back of the supportive macro backdrop for these countries. Our favourable view of higher-yielders is further grounded on the view that lower-yielding government bonds could be more vulnerable to UST volatility.

Prefer Indian rupee

We see renminbi weakness—prompted by concerns over slowing domestic growth and the lack of considerable policy response from Chinese policymakers—weighing on the outlook for Asian currencies in the near term. We have a more favourable view of the Indian rupee against such a backdrop. We expect low oil prices and India's narrowing current account deficit to be supportive of rupee demand. In addition, the Indian government has recently sealed investment commitments from major multinational technology companies—a positive factor that will benefit long-term rupee demand, in our view.

Asian credits

Market review

Asian credits register positive returns in June

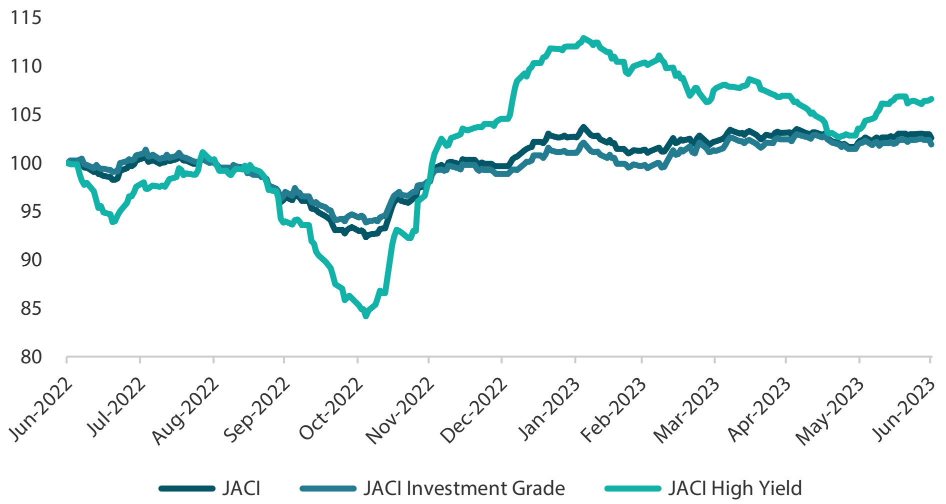
Asian credits returned +0.32% in June, driven mainly by a 20-bps tightening in spreads. Asian HG credits underperformed their HY counterpart, registering losses of 0.16% despite spreads narrowing 11 bps, as UST yields rose. Asian HY credit registered total returns of +3.01%, with spreads tightening 77 bps.

Asian credit spreads tightened steadily in the first half of the month. Positive risk tone was propped up largely by mounting speculation about a potential significant stimulus package from Chinese policymakers after activity and credit data were soft again in May. With data suggesting that the Chinese economic recovery is continuing to lose traction, the government revived its growth-supportive stance. In particular, the PBOC lowered several policy rates and Premier Li Qiang declared that the government will take steps to boost demand. Although some headlines reported a possible issuance of special treasury bonds to aid local government and boost business confidence, as well as probable substantial measures to address the beleaguered Chinese property market, policy stimulus eventually fell short, with no concrete details of nationwide measures being announced. This, together with another default in the China real estate space, prompted some reversal in risk tone, particularly within Chinese credits. However, encouraging US growth data released just before the end of the second quarter provided some offset, boosting demand for risk assets including Asian credits. Towards the end of the month, sentiment in frontier Asian economies turned positive as funding support from the International Monetary Fund appears more forthcoming to meet short-term external financing needs. Overall, spreads of all major country segments in Asia tightened in June.

Primary market remains subdued in June

Issuers raised a total of US dollar (USD) 9.12 billion in the primary market in June, although they were mostly sidelined before the FOMC meeting. The HG space saw 12 new issues amounting to about USD 7.60 billion, including the USD 2.0 billion two-tranche issue from Standard Chartered PLC. Meanwhile, the HY space saw eight new issues amounting to USD 1.52 billion in the month.

Chart 2: JP Morgan Asia Credit Index (JACI)
Index rebased to 100 at 30 June 2022



Note: Returns in USD. Past performance is not necessarily indicative of future performance.

Source: Bloomberg, 30 June 2023.

Market outlook

Asia macro and corporate credit fundamentals to stay robust, but valuation somewhat stretched

Macro and corporate credit fundamentals across Asia are expected to stay robust, albeit slightly weaker than in 2022. Resilient domestic demand and the recovery of tourism, particularly in India and ASEAN economies, are seen offsetting the weakness in goods exports. Asian banking systems remain strong; we expect a stable deposit base, robust capitalisation, benign asset quality and improving profitability to enable Asian banks to withstand the modestly more challenging growth environment ahead.

However, we are entering a more uncertain phase with multiple cross currents, both regional and global, at play. These include the Fed's next move, recession risk in the developed markets, softening of China's recovery momentum and ongoing geopolitical tensions. These uncertainties, coupled with the resilience of Asia credit thus far, make the valuation of Asia HG credit look slightly stretched compared to both historical levels and developed market spreads. At the same time, we think that more meaningful property easing measures from the Chinese authorities are needed to stabilise the China HY market—the delivery of which remains uncertain despite growing expectations. As such, we take a more cautious view towards risk in the near-term, while acknowledging that favourable technical conditions due to the much lower gross supply this year may keep spreads tight for some time.

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 nether 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 Decree80/98, 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.