

On the ground in Asia

Monthly Insights: Asian Fixed Income (June 2024)

Fundamentals backdrop for Asian credit remains supportive

By the Asian Fixed Income Team
17 July 2024

Summary



- US Treasury (UST) yields declined across the board in June as several key economic indicators fell short of expectations. At the end of the month, the benchmark 2-year and 10-year UST yields settled at 4.76% and 4.40%, respectively, 12 basis points (bps) and 10 bps lower compared to end-May. Within Asia, headline inflation prints for May accelerated in China, Malaysia, Thailand, Singapore and the Philippines. On the other hand, Indonesia, India and South Korea experienced a slight moderation.
- We favour South Korean, Indian and Philippine government bonds and have adopted a neutral stance on Indonesian bonds.
- Asian credits gained 1.23% in June, despite credit spreads widening about 9 bps as UST yields eased. Asian investment-grade (IG) credit slightly underperformed its Asian high-yield (HY) counterpart, returning 1.21% with spreads widening about 10 bps. Asian HY credit returned 1.32% with spreads widening by 12 bps.
- The increase in new issue supply amidst falling all-in yields prompted modest profit-taking which drove spreads wider over the month. We view such technical correction as healthy and believe it creates better entry opportunities. Demand for Asia credit remains robust from regional institutional investors looking to lock in attractive yields. However, the emergence of certain negative risk factors may result in modestly higher volatility in Asia credit spreads in the second half of the year.

Asian rates and FX

Market review

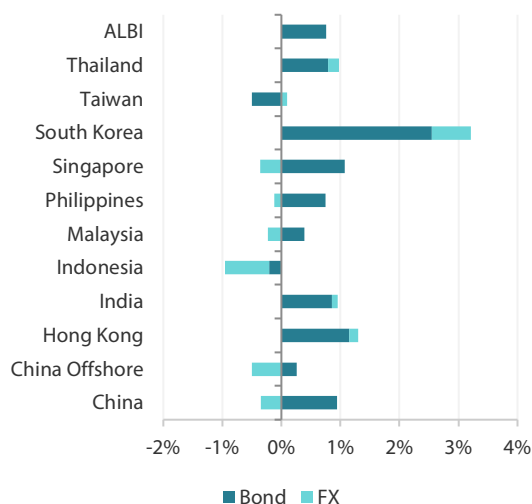
UST yields ease further in June

In June, UST yields declined across the board as several key economic indicators fell short of expectations. A significant portion of the Treasury bond rally was spurred by signs of moderating inflation. Both the consumer price index (CPI) and producer price index for May showed softer-than-expected increases, prompting market reassessment of future US interest rate cuts. The rally gained further momentum from an increase in continuing claims for jobless benefits. Notably, the decline in yields persisted despite the June Federal Open Market Committee dot plot surprising the market with projections of only one rate cut this year, down from the three estimated in March.

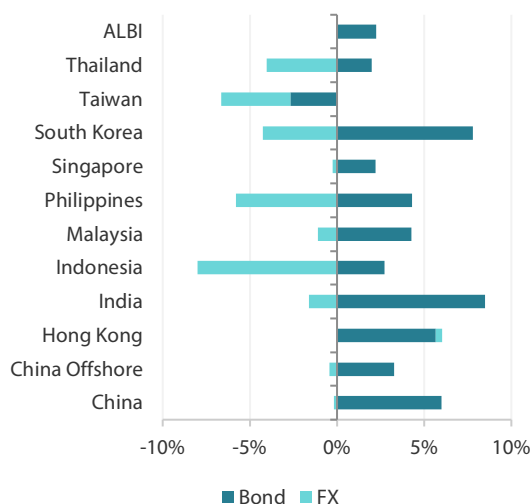
Meanwhile, the European Central Bank delivered its widely anticipated 25 bps policy rate cut and offered “data-dependent” forward guidance. Towards the end of June, however, UST yields partially rebounded from their earlier decline following statements from US Federal Reserve officials emphasising a patient and data-dependent approach. At end-June, the benchmark 2-year and 10-year UST yields settled at 4.76% and 4.40% respectively, 11.9 bps and 10.2 bps lower compared to end-May. Separately, the US dollar strengthened against most major currencies in June, driven by mounting political uncertainties in France and escalating concerns over economic growth in China.

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

For the month ending 30 June 2024



For the year ending 30 June 2024



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 30 June 2024.

Central banks leave their policy rates unchanged

Monetary authorities in Thailand, Indonesia, India and the Philippines left interest rates unchanged in June. The Bank of Thailand (BOT)’s Monetary Policy Committee voted 6 to 1 to keep its one-day repurchase rate steady at 2.50%, with one member voting for a 25-bps reduction. Alongside this decision, the central bank maintained its economic growth forecasts for 2024 and 2025 at 2.6% and 3.0%, respectively, and projected headline inflation at 0.6% for 2024 and 1.3% for 2025.

Bank Indonesia (BI) held its benchmark seven-day reverse repo rate at 6.25%, aligning with its pre-emptive, forward-looking approach to control inflation and strengthen the rupiah, according to BI Governor Perry Warjiyo. Despite global uncertainties, Indonesia’s growth remains robust, supported by central bank and government policies, with 2024 growth projected at 4.7% to 5.5%. BI also expects both headline and core inflation to stay within the target ranges in 2024.

In the Philippines, the Bangko Sentral ng Pilipinas (BSP) kept its key policy rate unchanged. According to the central bank’s monetary board, inflation risks have shifted to the downside, primarily due to the effect of reduced import

tariffs on rice. The central bank revised its risk-adjusted inflation forecast down to 3.1% for 2024, from 3.8%, and to 3.1% for 2025, down from 3.7%. BSP Governor Eli Remolona indicated that the anticipated decrease in price pressures could allow the central bank to lower rates by 25 bps in the third quarter and another 25 bps in the fourth quarter.

Elsewhere, the Reserve Bank of India (RBI) held its policy repo rate steady at 6.50%. The Monetary Policy Committee also decided to continue focusing on the withdrawal of accommodation. Notably, two external members voted to reduce the policy rate by 25 bps and change the policy stance to neutral.

Headline inflation prints mostly accelerate in May

Overall inflation prints for May accelerated in China, Malaysia, Thailand, Singapore and the Philippines. On the other hand, Indonesia, India and South Korea experienced a slight moderation. The Philippines' headline CPI accelerated to 3.9% year-on-year (YoY) from 3.8% in April, driven by faster increases in utility and transport costs. However, core inflation, which excludes volatile food and energy items, eased to 3.1% in May from 3.2% in April.

In Singapore, core inflation remained steady at 3.1% YoY for three consecutive months through May, with an increase in services inflation offset by lower inflation for electricity and gas, retail and other goods. Headline inflation rose to 3.1% YoY in May from 2.7% in April due to higher prices for vehicles and petrol. Policymakers expect core inflation to gradually moderate for the remainder of the year, with a more noticeable decline anticipated in the fourth quarter.

Thailand's headline inflation accelerated to 1.54% YoY in May from 0.19% in April, returning to the BOT's target range of 1–3% for the first time in 13 months. The acceleration was driven by low base effects and the removal of the diesel price subsidy. Excluding energy and raw food prices, core inflation remained largely steady at 0.39% YoY.

Conversely, Indonesia's annual inflation rate eased more than expected to 2.84% YoY in May from 3.0% in April, staying within the central bank's target range of 1.5% to 3.5%. Meanwhile, the annual core inflation rate slightly increased to 1.93% in May, up from 1.82% the previous month.

PBOC considers trading CGBs in the secondary market

People's Bank of China (PBOC) Governor Pan Gongsheng announced in June that the central bank might resume trading Chinese government bonds (CGBs) in the secondary market as a new method to manage liquidity. He also revealed that the PBOC is considering refining its official policy rates to allow a single short-term rate in guiding banks, noting that the seven-day reverse repo rate has essentially assumed this function and de-emphasised the 1-year Medium-term Lending Facility rate as a policy rate.

Malaysia cuts diesel subsidies

As part of a widely-publicised fiscal subsidy rationalisation plan, Malaysia reduced diesel subsidies on 10 June, a measure expected to save the government approximately Malaysian ringgit (MYR) 4 billion annually. As a result, the price of diesel increased by around 56%, bringing it more in line with market prices. The government also intends to implement similar changes for gasoline subsidies in the future.

Indian election surprise

In India, the results of the parliamentary elections in June surprised markets, with Prime Minister Narendra Modi's party failing to secure an outright majority, causing initial weakness in Indian bonds and equities. However, sentiment reversed when the new cabinet's composition indicated policy continuity, with senior ministers from the previous Modi government retaining their positions.

Market outlook

Positive on South Korea, India and Philippine bonds

We favour South Korean, Indian and Philippine government bonds and have adopted a neutral stance on Indonesian bonds.

Recent dovish remarks from the Philippine central bank governor indicate a potential shift towards rate cuts, with lower-than-expected inflation prints in April and May providing the monetary authority with ample room to lower rates.

Price pressures in India have been consistently easing, and the growing divide within the RBI's Monetary Policy Committee suggests that a pivot towards easing may happen soon. Indian government bonds were included in JP Morgan's GBI-EM Index starting 28 June, with an initial 1% weight that will increase by 1% each month, reaching a

maximum of 10% by March 2025. This gradual increase is expected to further support the strength of Indian bond prices.

In South Korea, the central bank released its mid-year assessment of monetary policy, presenting a more dovish inflation outlook, citing weak domestic demand and easing supply-side pressures. We take this to suggest an impending policy rate normalisation. Additionally, the steady disinflation in core CPI provides the central bank more leeway to ease rates earlier than regional peers.

In contrast, sentiment towards Indonesian government bonds will likely be weighed down by persistent fiscal slippage concerns until a new finance minister is appointed.

Asian credits

Market review

Asian credits register gains anew in June

Asian credits returned +1.23% in June despite credit spreads widening about 9 bps due to UST yields easing. Asian IG credits slightly underperformed Asian HY credits, gaining 1.21% despite spreads widening by about 10 bps. Meanwhile, Asian HY returned +1.32%, even as spreads widened 12 bps.

Following significant spread compression since the start of the year, Asian credit spreads widened in June amid falling UST yields and a pick-up in new issue supply. Investors took profits on some Chinese property names after a substantial rally in the sector in recent months. Official home price indices in China, which continued to decline in May despite significant government stimulus measures, also affected sentiment. Other economic activity data in China continued to show mixed signals across various segments of the economy.

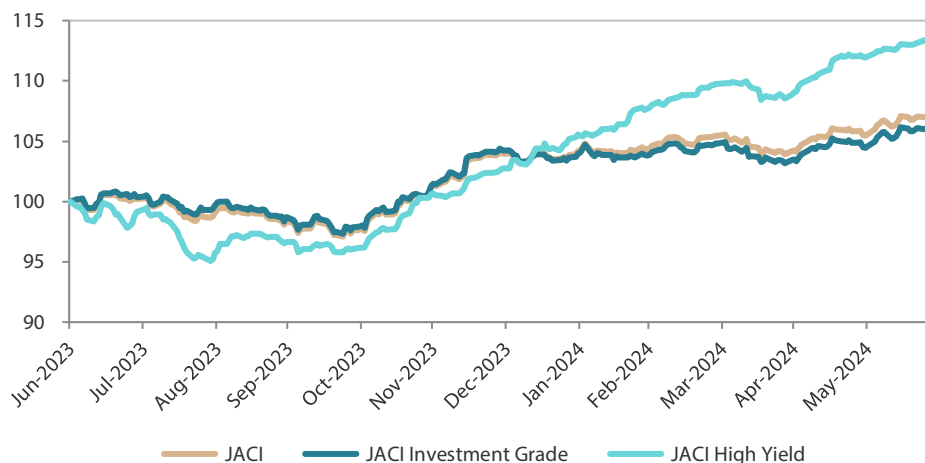
Elsewhere, global ratings agency Fitch kept the Philippines’ credit rating at “BBB” with a “stable” outlook, citing the country’s robust medium-term growth potential, stable debt levels and strong macroeconomic policies. By the end of June, spreads for all major country segments widened, with South Korean credits outperforming and Macau credits underperforming.

Primary market activity picks up in June

The month saw a notable pick-up in new supply, with issuers concentrated in China and South Korea. The IG space saw 22 new issues amounting to USD 13.4 billion, including the USD 2.35 billion three-tranche sovereign issue from Indonesia’s Perusahaan Penerbit SBSN, the USD 2.0 billion three-tranche issue from LG Energy Solution and the USD 1.0 billion sovereign issue from the Republic of Korea. Meanwhile, the HY space saw five new issues amounting to USD 2.15 billion.

Chart 2: JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 30 June 2023



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

Source: Bloomberg, 30 June 2024.

Market outlook

Healthy technical correction creates better entry opportunities amidst supportive fundamentals

The fundamentals backdrop for Asian credit remains supportive. In China, overall policy stance remains incrementally accommodative. However, given the still-fragile recovery in the real economy, particularly in the property market, more easing measures are likely to be implemented. Meanwhile, macroeconomic and corporate credit fundamentals across Asia ex-China are expected to stay resilient, with a recovery in exports growth potentially offsetting softer domestic conditions. While non-financial corporates may experience a slight weakening in both leverage and interest coverage ratios stemming from lower earnings growth and higher funding costs, we believe there is adequate ratings buffer for most, especially the IG corporates. Asian banking systems remain robust, with strong capitalisation and strong pre-provision profitability providing buffers against moderately higher credit costs ahead.

The pick-up in new issue supply amidst falling all-in yields prompted modest profit-taking which drove spreads wider in June. We see such technical correction as healthy and believe that it creates better entry opportunities. Demand for Asia credit remains robust from regional institutional investors looking to lock in attractive all-in yields, even as fund flows into emerging market hard currency funds remain subdued. Looking ahead, however, some risks such as local political uncertainties, trade tensions, concerns over the US presidential election outcome in November and the growth-inflation dynamic in developed economies may result in modestly higher volatility in Asia credit spreads in the second half of the year, compared to the serenity of the first half.

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: 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.

Luxembourg and Germany: This document is communicated by Nikko Asset Management Luxembourg S.A., which is authorised and regulated in the Grand Duchy of Luxembourg by the Commission de Surveillance du Secteur Financier (the CSSF) as a management company authorised under Chapter 15 of the Law of 17 December 2010 (No S00000717) and as an alternative investment fund manager according to the Law of 12 July 2013 (No. A00002630).

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. An offering of any investments, securities or investment advisory services with respect to securities may only be made by receipt of relevant and complete offering documentation and agreements, as applicable. 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.

Canada: The information provided herein does not constitute any form of financial opinion or investment advice on the part of Nikko AM and it should not be relied on as such. It does not constitute a prospectus, offering memorandum or private placement memorandum in Canada, and may not be used in making any investment decision. It should not be considered a solicitation to buy or an offer to sell a security in Canada. This information is provided for informational and educational use only.