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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- US Treasury (UST) yields traded in a tight range in February. Risk assets rallied and UST yields rose in the first half of the month, on the back of the prospect of tax cuts and a Dodd-Frank overhaul in the US. Subsequently, yields were pressured lower by concerns about a possible victory by Marine Le Pen in France's presidential elections. Overall, the 2-year and 10-year points on the UST curve ended the month about 6 basis points (bps) higher and 6bps lower respectively.

- India released its 2017-18 budget, where it committed to lower the fiscal deficit and reduce government debt. The government also cut corporate tax rates for small and medium enterprises, as well as income tax rates for the lowest tax bracket.

- Moody's upgraded Indonesia's debt rating outlook to 'positive' from 'stable', citing improvements in the government's policy effectiveness and the strength of its institutions.

- Asian credits generally rose in February, helped by the rally in risk assets. Despite heavy new supply after the Lunar New Year holidays, Asian high-grade returned 1.34% and Asian high-yield corporates returned 1.55%.

- The Chinese central bank hiked its short-term lending facility rates, suggesting that it is intent on containing rapid credit growth, as well as mitigating further capital outflows.

- Meanwhile, the Indian central bank left policy rates unchanged in February, citing higher inflationary expectations and a projected rebound in growth.

- Activity in the primary market remained robust despite the Lunar New Year holidays. The investment-grade space had a total of 20 new issues amounting to USD 12.9bn, while the high-yield space saw a total of 17 new issues amounting to USD 6.1bn.

- We maintain our preference for Indonesian bonds and the Rupiah. Demand is likely to be supported by attractive carry, as well as the country's improving fundamental outlook. Conversely, we are cautious on Philippine bonds, the Korean Won (KRW) and Singapore Dollar (SGD). Korea and Singapore will be vulnerable to protectionist trade policies by the Trump administration, given the open and export-oriented nature of their economies.

- Volatility is likely to remain, with the US Fed on a tightening path, uncertainty surrounding the policies of the new US administration, and risk events including elections in Europe. With spreads at the tight end of the historical range, we remain cautious even as the demand backdrop for Asian credit appears to be intact.

Asian Rates and FX

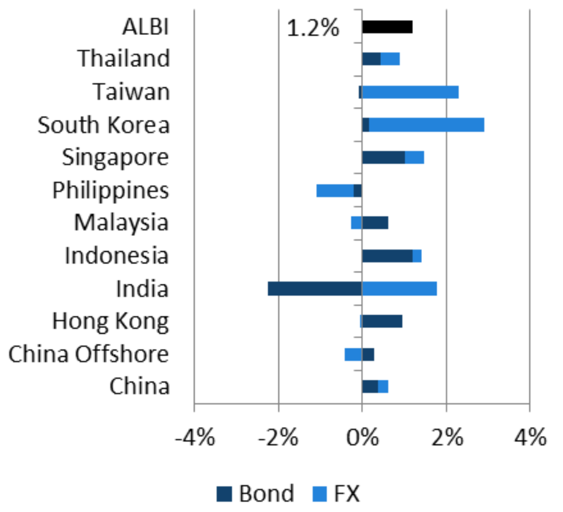
Market Review

- UST yields traded in a tight range in February

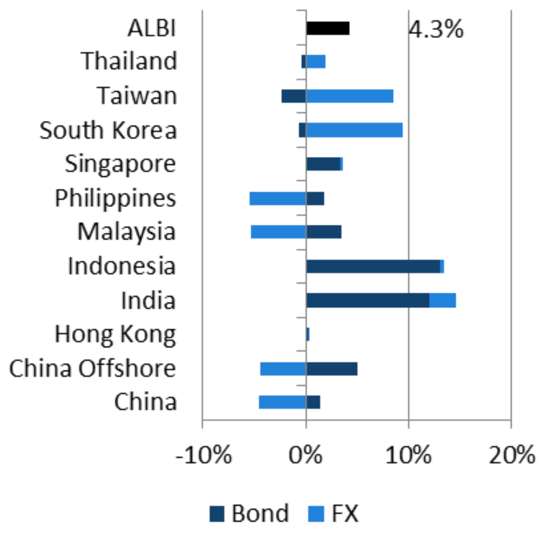
US Treasury (UST) yields traded in a relatively tight range in the month, with politics driving market direction for the most part. President Trump's pledge to release a 'phenomenal' tax reform involving tax cuts, as well as prospects of a Dodd-Frank overhaul, fueled risk assets to rally and UST yields to rise in the first half of the month, with markets opting to look beyond a relatively hawkish congressional testimony by Federal Reserve (Fed) Chairperson Janet Yellen as well as strong job gains and inflation prints in January. Subsequently, concerns about a possible victory by anti-Euro Marine Le Pen in France's presidential elections and worries about a delay in tax and spending policies in the US pressured yields lower. The 2-year and 10-year points on the UST curve ended about 6 basis points (bps) higher and 6bps lower respectively, compared to end-January levels.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 28 February 2017



For the year ending 28 February 2017



Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of future performance. Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 28 February 2017

- India presented a prudent budget

India's Finance Ministry released the 2017-18 budget, where it committed to lower the fiscal deficit to 3.2% of GDP for the Fiscal Year (FY) 2018, from 3.5% in FY 2017. In addition, the budget proposed to reduce general government debt from the current 68% of GDP to 60% by 2023. Meanwhile, corporate tax rates were cut by 5% for small and medium enterprises having a turnover of less than INR 500mn. Personal income tax rates for the lowest tax bracket were similarly lowered by 5%. Overall, the budget showed noticeable restraint on the expenditure side. In the same light, tax revenues were budgeted realistically.

- Moody's upgraded Indonesia's outlook

Credit rating agency Moody's revised its debt rating outlook for Indonesia to 'positive' from 'stable'. It attributed the improved outlook to "emerging signs of a reduction in structural constraints on Indonesia's rating, including its level of external vulnerability and the strength of its institutions." It likewise commended the government's improving policy effectiveness, and said that it expects GDP growth in Indonesia to remain higher relative to similarly-rated peers.

Market Outlook

- Maintain preference for Indonesian bonds; cautious on Philippine bonds

We maintain our preference for Indonesian bonds. Demand for Indonesian bonds is likely to be supported by the attractive carry offered by the space, as well as the improving fundamental outlook of the country. We also see upside risk to bond prices in the event that a credit rating upgrade by Standard & Poor's materialises. Meanwhile, our cautious view on Philippine bonds remains. Strong growth, rising inflation and a narrowing current account surplus are likely to result in the underperformance of Philippine bonds relative to peers.

- Prefer IDR and INR; underweight KRW and SGD

We think high carry currencies such as Indonesian Rupiah (IDR) and Indian Rupee (INR) will continue to outperform amongst Asian currencies. Both Bank Indonesia and the Reserve Bank of India are unlikely to cut rates further given that inflation is expected to rise (albeit gradually). This, together with their stable external balance and improved fiscal outlook, should provide support to the currencies. In contrast, we maintain our cautious view on the Korean Won (KRW) and Singapore dollar (SGD). We believe these countries will be most vulnerable to the risk of heightened protectionism from the US, given the open and export-oriented nature of their economies.

Asian Credits

Market Review

- Another positive month for Asian credits

Overall Asian credits rose in February, helped by the rally in risk assets. Despite heavy new supply after the Lunar New Year holidays, Asian high-grade returned 1.34% and Asian high-yield corporates returned 1.55% as spreads tightened.

- PBoC further tightened monetary policy

The Chinese central bank hiked its market-based policy rates in the month, following increases to medium-term lending facility (MLF) rates in January. The overnight short-term lending facility (SLF) rate rose by 35bps, while 7-day and 1-month SLF rates increased by 10bps each. These moves suggest that the PBoC is intent on containing rapid credit growth, as well as mitigating further capital outflows.

- RBI signalled an end to the rate cut cycle

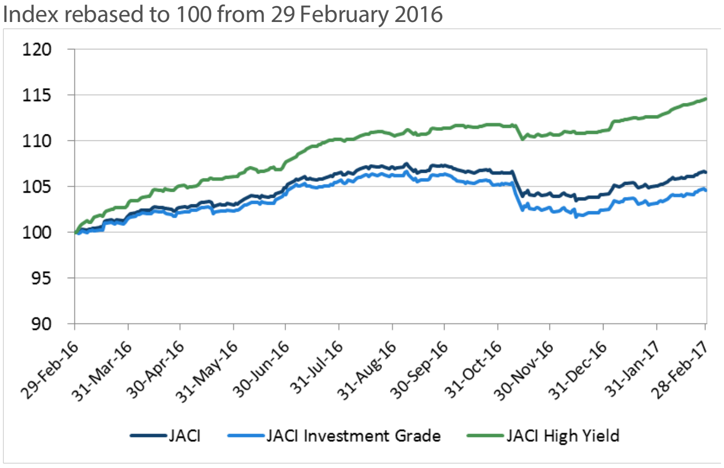
The Indian central bank left policy rates unchanged in February, and modified its stance to neutral from accommodative. The Reserve Bank of India (RBI) cited higher inflationary expectations and a projected rebound in growth as reasons for the change. Against a medium-term target of 4%, the central bank expects headline consumer price inflation to register in the 4.5-5.0% range in second half of fiscal year (ending March) 2018. On the growth front, it sees Gross Value Added (GVA) growth rebounding to 7.4% in fiscal year 2018 from 6.9% in 2017.

- Primary activity remained robust

Activity in the primary market remained robust, despite Asia celebrating the Chinese New Year holidays. The investment-grade space had a total of 20 new issues amounting to USD 12.9bn, including USD 1bn from a Hong Kong sovereign sukuk issue. Meanwhile, the high-yield space saw a total of 17 new issues amounting to USD 6.1bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 from 29 February 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 28 February 2017

Market Outlook

- Uncertainty and market volatility expected to pick-up; spreads at tighter end suggest caution

Volatility is likely to remain, with the US Fed on a tightening path, uncertainty surrounding the policies of the new US administration, and risk events including elections in Europe. In addition, with spreads at the tight end of the historical range, we remain cautious even as the demand backdrop for Asian credit appears to be intact with inflows into emerging market hard currency bonds continuing to be positive.

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