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FROM THE FIXED INCOME DESK

Monthly Outlook

Summary

- 10-year US Treasury (UST) yields ended the month at 2.28%, about 11 basis points (bps) lower compared to end-March levels. Mixed economic data and rising geopolitical tensions drove sentiment over the month. Towards the month-end, market sentiment improved after pro-euro French presidential candidate Emmanuel Macron secured the most number of votes in the first round of elections.

- Geopolitical tensions escalated over the month, as North Korea conducted a missile test ahead of a widely anticipated summit between US President Donald Trump and Chinese President Xi Jinping. The US President urged China to cooperate in ending North Korea's nuclear and missile threat, in exchange for better trade terms.

- The Indian central bank left its policy repo rate unchanged, but narrowed the policy rate corridor to 50bps from 100bps. Elsewhere, Bank Indonesia left interest rates unchanged, and eased rules on lenders' reserve requirement ratio.

- Overall Asian credits ended higher in April, with gains driven by lower UST yields, as credit spreads widened. A sizeable amount of new issuance also caused some widening in spreads, especially in more recent issues. Asian high-grade returned 0.47% and Asian high-yield corporates returned 0.67%.

- In China, first quarter GDP growth came in at 6.9% year-on-year (YoY), buoyed by government infrastructure spending and strength in the housing market. Meanwhile, the banking regulator published a set of guidelines aimed at controlling risks in the banking sector.

- Primary market activity remained relatively robust in April. The total issuance amounted to about USD 28.5bn – there were 33 new issues worth around USD 22.1bn from high-grade and 19 issues worth around USD 6.5bn from high-yield.

- Positive flows into emerging market bonds are likely to persist, as UST yields remain largely range-bound. Against such a backdrop, we foresee high yielders such as Indonesian bonds outperforming. Meanwhile, we remain cautious on Philippine bonds. On the currency front, IDR and INR are expected to outperform on the back of high carry levels, strong foreign direct investment, and more resilient foreign exchange reserves. Conversely, we expect the Philippines' narrowing current account surplus to drag on the PHP.

- While healthy demand should continue to support the Asian credit market, the recent uptick in the supply of new issues is likely to temper any spread tightening. At the same time, valuations are still on the expensive side, with Asian credit spreads at the tighter end of the historical range.

Asian Rates and FX

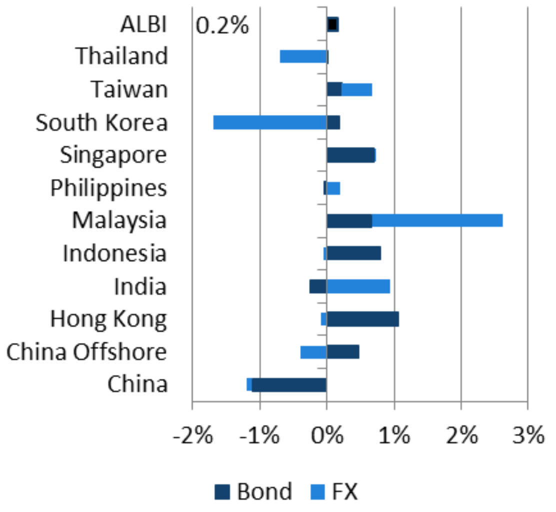
Market Review

- UST yields ended higher in April

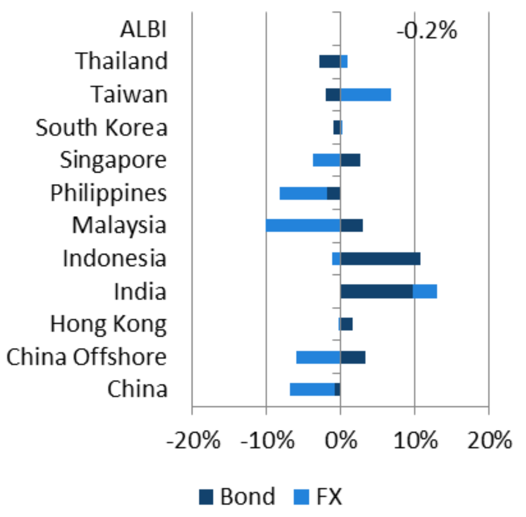
Yields traded in a tight range at the start of the month. Despite minutes of the March Federal Open Market Committee (FOMC) meeting revealing that the central bank's balance sheet reduction could start "later this year", market reaction was relatively muted as investors assessed this development alongside mixed economic data which included a drop in unemployment rate, a slightly lower ISM manufacturing index and a moderation in factory order growth. A rise in geopolitical tensions subsequently prompted markets to take on a cautious approach. Reports that the US launched a missile attack on Syria and dropped a bomb in Afghanistan, and that its warships were sailing towards the Korean Peninsula, sent UST yields lower. Over in Europe, a surge in far-left French presidential candidate Jean-Luc Melenchon's popularity and the announcement of snap elections in the UK further contributed to the subdued trading of risk assets. Market sentiment subsequently improved, and UST yields rose, after pro-euro French presidential candidate Emmanuel Macron secured the most number of votes in the first round of elections, and was deemed likely to score a victory in the final vote due early May. Overall, 10-year UST yields ended the month at 2.28%, about 11 basis points (bps) lower compared to end-March levels.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 30 April 2017



For the year ending 30 April 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, 30 April 2017

- Geopolitical tensions escalated

The month saw a broadening of geopolitical concerns. North Korea conducted a missile test ahead of a widely anticipated summit between US President Donald Trump and Chinese President Xi Jinping. Further tests prompted the US to send an aircraft carrier strike group as well as a nuclear submarine to the region. The US President urged China to cooperate in ending North Korea's nuclear and missile threat, in exchange for better trade terms. Tensions simmered towards the month-end, with the US pledging to step up sanctions to force North Korea to resume dialogue over its nuclear programme – a better outcome than some market expectations of heightened military altercation.

- Reserve Bank of India (RBI) narrowed its policy rate corridor

The Indian central bank left its policy repo rate unchanged, but narrowed the policy rate corridor to 50bps from 100bps. According to the RBI, the adjustment was deemed necessary to better align the weighted average call rate to the central bank's policy rate. We note that the government's demonetisation exercise at the end of 2016 had distorted the short-end of the yield curve, as massive liquidity flooded the system. The surprise move caused a jump in the Indian Rupee and a sell-off in Indian bonds. Meanwhile, the RBI warned against upside risks to inflation, citing a possible rise in food prices, effects of GST implementation as well as an increase in pay commission allowances.

- Monetary Authority of Singapore (MAS) left FX policy unchanged

The MAS left its FX policy unchanged, and maintained its cautious outlook. Ahead of the release, there were growing expectations of a more hawkish tone in light of an improvement in global growth, which supported strength in the Singapore Dollar. The monetary authority maintained that a "neutral policy stance is appropriate for an extended period", but noted the global growth backdrop had "improved slightly" since its last policy meeting. On the domestic front, MAS declared labour market conditions to "have slackened since the last policy review", and signaled limited upside risks to inflation.

- Bank Indonesia (BI) eased rules on lenders' reserve requirement ratio; Jakarta elected a new governor

Bank Indonesia left interest rates unchanged, and eased rules on lenders' reserve requirement ratio. To allow banks some flexibility to better manage liquidity, the central bank lowered the daily minimum primary reserve requirement ratio to 5% from 6.5%. This will take effect from July. However, banks would will to ensure that at least a 6.5% average of total deposits is maintained with the central bank in a period of two weeks. Meanwhile, Jakarta Governor Basuki "Ahok" Tjahaja Purnama lost in his re-election bid. Following a campaign that incited political and religious tensions in the Indonesian capital, Anies Baswaden, a former Indonesian education and culture minister, is slated to be the new governor.

Market Outlook

- Maintain preference for Indonesian bonds; cautious on Philippine bonds

The Fed's inclination to stay on a gradual tightening path should be supportive of risk assets while capping the pace of increase in UST yields. Positive flows into Emerging Market (EM) bonds are likely to persist, as UST yields remain largely range-bound. Against such a backdrop, we foresee high yielders like Indian and Indonesian bonds outperforming. Meanwhile, our cautious view on Philippine bonds remains. Strong growth and rising inflation are likely to result in the underperformance of the space relative to peers. We note that the Philippine central bank governor finishes his term in July, and that the administration's favoured candidate for the post has been vocal about his preference for tightening monetary policy.

- Prefer IDR and INR; cautious on PHP

We maintain that high carry currencies such as Indonesian Rupiah (IDR) and Indian Rupee (INR) will continue to outperform amongst Asian currencies. Both countries have attracted greater foreign direct investment, resulting in marked improvement in their basic balances. Moreover, monetary authorities in both countries have built back their reserves, and are in a better position to manage currency volatility. Meanwhile, we expect the Philippines' narrowing current account surplus to drag on the Philippine Peso (PHP).

Asian Credits

Market Review

- Asian credits gained in April

Overall Asian credits ended higher in April, with gains driven by lower UST yields, as credit spreads widened. A sizeable amount of new issuance also caused some widening in spreads, especially in more recent issues. Asian high-grade returned 0.47% and Asian high-yield corporates returned 0.67%.

- China's CBRC tightened regulations; Chinese economy grew 6.9% YoY in the first quarter

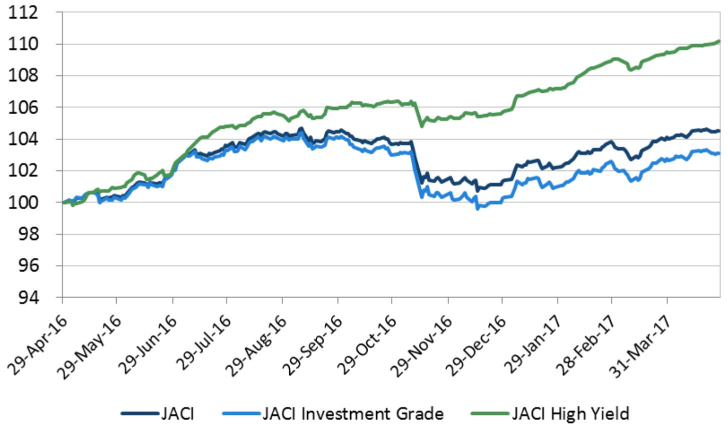
The China Banking Regulatory Commission (CBRC) published a set of guidelines aimed at controlling risks in the banking sector. The guidelines will increase the scope of monitoring liquidity risk to include interbank business, investment, custodian business and wealth management products (WMPs), and covers areas such as property related loans, on and off balance sheet bond holdings, and implicit guarantees. As regulators stepped up efforts to clamp down on potential risks of WMPs in particular, banks have been unwinding their investments, which have caused a squeeze in liquidity conditions in the onshore bond market. Notably, the Chinese central bank described the guidelines as part of financial deleveraging and said it expects more of such measures in the future. Meanwhile, government infrastructure spending and strength in the housing market supported an acceleration in Chinese economic activity in the first quarter of 2017. The 6.9% year-on-year (YoY) growth was the fastest growth rate since the third quarter of 2015.

- Primary market activity remained busy

Primary market activity remained relatively robust in April, with total issuance amounting to about USD 28.5bn. There were 33 new issues worth around USD 22.1bn in the high-grade space, while high-yield issuance saw some moderation with 19 new issues worth around USD 6.5bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 from 29 April 2016



Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 30 April 2017

Market Outlook

- Risk sentiment to remain constructive but risk events linger

In Asia, concerns are likely to persist over Korea given the ongoing tensions. In early May, the second round of the French presidential elections should continue to be in focus although Emmanuel Macron is widely expected to win this run-off. While the US Federal Reserve (Fed) is not expected to raise rates in the coming FOMC meeting, it seems inclined to stay on a gradual tightening path while beginning to signal its intent to reduce its balance sheet. While China continues with the deleveraging process which is a longer-term positive, the near-term impact from tightening onshore liquidity and rising onshore bond yields bears monitoring.

- Demand for Asia credit to be supported but supply deluge and valuations suggest caution

Continued regional demand for USD Asian credit and positive flows into emerging market (EM) hard currency bonds should support the market. However, the recent uptick in the supply of new issues which could continue in the coming month is likely to temper any spread tightening. At the same time, valuations are still on the expensive side, with Asian credit spreads at the tighter end of the historical range.

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