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Nikko Asset Management

# From The FIXED INCOME Desk

Monthly Outlook

## February 2015

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## Summary

- US Treasuries (USTs) rallied in January, with the 10-year UST yield ending the month at 1.64% which was 53 basis points (bps) lower than end-December.
- In January, the Monetary Authority of Singapore (MAS) reduced the slope of the SGD NEER policy band to slow the appreciation of the currency. At the same time, India's central bank cut key interest rate by quarter point to 7.75%.
- Meanwhile, Indonesia's headline inflation rose to 8.4% year-on-year (YoY) in December from 6.2% in November, while lower-than-expected headline inflation was registered in Thailand, the Philippines and Malaysia.
- Despite a volatile month for Asian credit spreads, both Asian high-grade and high-yield registered positive returns.
- Asian high-grade credits gained 1.89% in January with returns mainly bolstered by the rally in USTs. Asian high-yield credits returned 0.37% despite a sell-off earlier in the month due to concerns over Chinese property credits and declining commodity prices.
- In January, there were 19 issues amounting to USD 18.15bn in the high-grade space, and only 5 issues amounting to USD 1.59bn in the high-yield space.
- We remain cautious on both SGD and MYR. We expect the weakness in JPY and EUR to persist and given the high basket weight of both currencies in the SGD NEER, the SGD is likely to remain relatively weak. Also, the significant drop in Malaysia's FX reserves, together with softer oil price supported our cautious stance on the MYR.
- Meanwhile, we favour PHP and INR as they historically exhibit relatively low correlation to the JPY.
- Asian credit spreads remain vulnerable to external factors, including commodity prices that are affecting the macro outlook for different countries. In addition, further monetary policy loosening could potentially happen in China which will likely boost the sentiment towards Chinese credits in the near-term.

# ASIAN RATES AND FX

## Market Review

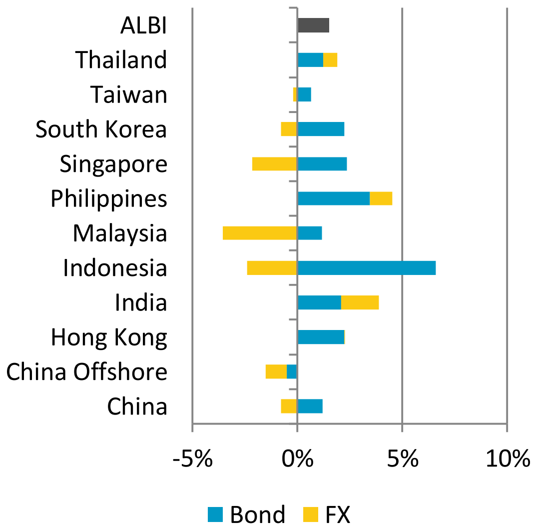
US FED STICKS TO "PATIENT" TACK ON RATE HIKE

### *USTs rallied in January*

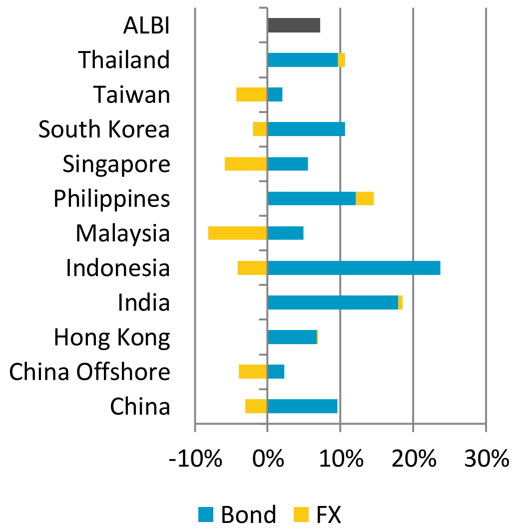
USTs made strong gains following an eventful January. The 10-year point on the US yield curve moved from a high of 2.21% at the start of the month to close at 1.64%. Treasury yields declined at the beginning of the period, as inflation and growth expectations fell further, on lower energy prices. Mid-month, capital markets experienced volatility following the surprising decision by the Swiss National Bank to abandon its three-year old cap of the Swiss franc against the euro. A week later, the European Central Bank (ECB) finally announced a surprisingly aggressive asset purchase program. Currency markets reacted forcefully, with the EUR cheapening markedly relative to the USD and other major currencies. At the end of the month, the Federal Open Market Committee reiterated it would remain "patient" on rate hikes, despite an upgrade of its assessment of domestic economic conditions. It has also included the monitoring of "international development" in its future assessments of policy stance.

## HSBC Asian Local Bond Index (ALBI)

**For the month ending 31 January 2015**




**For the period from 31 January 2014 to 31 January 2015**




Note: Bond returns are in local currencies while FX and ALBI returns are in USD. Past performance is not necessarily indicative of the future performance.
Source: HSBC Asian Local Currency Bond Indices, Bloomberg, 31 January 2015

### *Reserve Bank of India (RBI) cut interest rate by 25bps*

In January, the RBI delivered, in a surprise unscheduled meeting, a 25bps cut of the repo rate to 7.75%. A series of positive inflation data in recent months as oil and food prices have slid led the central bank to move rates lower. Meanwhile, RBI governor Raghuram Rajan seemed to imply that the next move would be a further reduction in rates, as he stated that "once the monetary policy stance shifts, subsequent policy actions will be consistent with this stance."

### *MAS surprised markets with an unscheduled move to ease policy*

The MAS reduced the slope of the SGD NEER policy band, surprising markets in an unscheduled move. No change was made to the width and the midpoint of the band. The "off-cycle" move, the first in 13 years, was made in response to a "significant shift in Singapore's Consumer Price Index (CPI) inflation outlook for 2015" since the last meeting in October. Headline inflation for 2015 is now projected to fall within -0.5-0.5%, down from an earlier forecast of 0.5-1.5%, while core inflation is expected to register between 0.5-1.5% this year from a forecast of 2-3% back in October 2014, largely due to the sharp plunge in oil prices.

### Indonesia lowered fuel prices; December inflation print registered higher than expected

Effective 19 January 2015, the Indonesian government reduced retail prices of diesel and gasoline further, to IDR 6600/litre and IDR 6400/litre from IDR 7600 and IDR 7250 respectively. This followed the 7% cut in prices on 1 January 2015, when the government shifted to a new fuel subsidy system. Meanwhile, headline inflation in December jumped to 8.4% YoY from 6.2% in the previous month, registering higher than the expected 7.9% print. The surprise in inflation came on the back of a surge in transportation costs following the 33% hike in retail fuel prices in November. In contrast, headline inflation in Thailand, the Philippines and Malaysia recorded lower than expected in December on account of the continued drop in oil prices.

### Malaysia revised its 2015 fiscal deficit target to 3.2% of GDP

Prime Minister Najib Razak announced revisions to the country's fiscal year 2015 budget. The government now projects GDP growth to fall within 4.5-5.5% for 2015, down from the previous forecast of 5.0-6.0%. It similarly revised its Brent crude oil price assumption lower, to an average of USD 55/bbl from USD 100/bbl. As a result, 2015 fiscal deficit target is now estimated to be slightly higher, at 3.2% of GDP, from an initial target of 3.0% announced in October. Operating expenditure will be cut by MYR 5.5bn, while development expenditure will remain unchanged at MYR 48.5bn. Externally, the current account surplus is expected to fall between 2-3% of Gross National Income, lower than the initial estimate of 4.3%.

## Market Outlook

MALAYSIA'S FX RESERVES DROPPED TO THE LOWEST LEVEL SINCE MARCH 2011

### Cautious on SGD and MYR

We maintain our cautious view on both the SGD and the MYR. Our expectation is for JPY and EUR weakness to persist, as the Bank of Japan and the ECB further expand their balance sheets. The high basket weight of both currencies in the SGD NEER leads us to expect the SGD to remain relatively weak vis-à-vis other regional currencies. Meanwhile, data as of 15 January 2015 from Bank Negara Malaysia reveals that Malaysia's FX reserves have fallen to its lowest level since March 2011. The significant drop in the country's FX reserves, together with softer oil price is the reason behind our cautious stance on the MYR.

### Favour PHP and INR

We favour PHP and INR as they historically exhibit relatively low correlation to the JPY. In addition, we are of the view that the INR will be relatively resilient against a broad-based USD strength environment, as lower oil prices translate to continued improvement in India's current account position. Sustained capital inflows should lend further support to the currency. Meanwhile, the stronger growth potential and large current account surplus of the Philippines should lead to a relatively stable PHP.

# ASIAN CREDITS

## Market Review

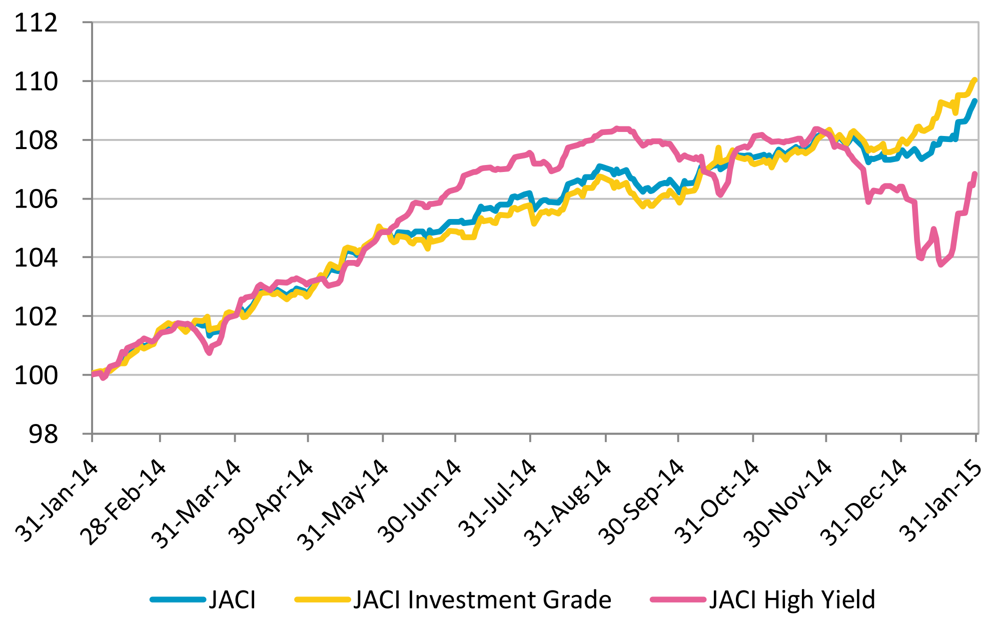
ASIAN HIGH-GRADE CREDITS GAINED 1.89%, WHILE ASIAN HIGH-YIELD CREDITS RETURNED 0.37%

### *Asian credits registered positive returns*

Despite a volatile month for Asian credit spreads, Asian high-grade and high-yield registered positive returns in January. Overall, Asian high-grade credits gained 1.89% despite overall credit spreads widening by about 19bps largely over declining oil prices, weakness in other emerging markets (EM) region and anticipation of a large new issue pipeline. High-grade returns were buoyed mainly by the rally in USTs, which made strong gains over an eventful January. The 10-year point on the US yield curve moved from a high of 2.21% at the start of the month to close at 1.64%. In addition, the surprisingly aggressive asset purchase program announced by the ECB during the month lent support to risk assets, including Asian credit.

## JP Morgan Asia Credit Index (JACI)

**Daily Returns for the period from 31 January 2014 to 31 January 2015**




Note: Returns in USD. Past performance is not necessarily indicative of the future performance.
Source: JP Morgan, 31 January 2015

### *High volatility in high-yield credits driven by concerns over Chinese property credits and declining commodity prices*

Asian high-yield credits ended the month 0.37% higher despite a major sell-off earlier in the month given the weak sentiment from the Chinese property developer Kaisa Group's technical default and concerns over rapidly declining commodity prices impacting the credit fundamentals of a number of credits. Towards month-end, sentiment improved as speculation was rife that a takeover of Kaisa Group was imminent after the Shenzhen local government was reported to be actively seeking new investors to buy the company's assets. On 30 January 2015, property developer Sunac China Holdings Ltd was reported to have agreed to buy a 49.3% stake in Kaisa Group. The positive development on Kaisa Group over the month led to some tapering off of negative sentiment towards the Chinese property sector. Commodity prices halting their rapid decent also supported sentiment towards commodity names.

### Slower pace of new issuance in the high-yield space

There were a total of 19 issues amounting to USD 18.15bn in the high-grade space in January. However, the supply of new issues in the high-yield space was significantly lower due to the weak sentiment, with only five issues amounting to USD 1.59bn compared to USD 4.5bn issued a year ago.

## Market Outlook

EXPECT CHINA TO LOOSEN MONETARY POLICY FURTHER IN THE NEAR TERM

### External factors and China to be main drivers in near-term

While fundamentals in Asia appear to be better than those in other EM regions, Asian credit spreads remain vulnerable to external factors. These include commodity prices affecting the macro outlook for different regions or countries, and developments in Europe over Greece and Russia. In addition, while recent data indicates that growth in China has been slowing, the possibility of further monetary policy loosening or stimulus from China remains a possibility. This should be a factor that supports the sentiment towards Chinese credits in the near-term. However, the expectation that the supply of new issues from China may be elevated is likely to cap any significant spread compression. In particular, within high-yield credits space, the resolution of the Kaisa Group episode and the treatment towards offshore debt holders will be a keenly watched development.