

# On firmer footing

Investing across government bonds, high grade corporate bonds and local currency bonds can offer attractive overall yields while diversifying risks

By **RAYMOND LIM**

**T**HE global bond markets had to contend with significant uncertainty in the global economy in 2015.

Several themes that dominated 2015 created a volatile environment for bond markets. US GDP (gross domestic product) growth swung from 0.6 per cent in Q1 2015 to 3.9 per cent in Q2 before stabilising at 2.0 per cent in Q3. The Chinese economy eased from 7.0 per cent growth in Q1 to 6.9 per cent in Q3. Events such as the Greek referendum in July, the A-share market meltdown and the Ukraine crisis also added to uncertainty in the global bond markets. Amid these events, policy response was swift and targeted.

However, certain decisions added to the volatility in the markets. In January, the Swiss National Bank surprised the market by depegging the Swiss franc (CHF) from the euro. This led to a sudden appreciation of the CHF by almost 30 per cent. The Monetary Authority of Singapore eased its exchange rate policy in a surprise meeting on Jan 28, 2015 in response to sharply falling oil prices. The People's Bank of China (PBOC) also changed its foreign exchange

policy in August 2015, causing the renminbi (RMB) to weaken by almost 4 per cent in a short period of time.

Several emerging countries bore the brunt of the volatility in 2015. Emerging currencies weakened against the US dollar while local interest rates were also volatile. Among these markets, Brazil fared the worst as the country was beset by stagflation and political challenges. Turkey as well, suffered a lack of investor confidence. Closer to Asia, the initial euphoria and confidence in Indonesia President Joko Widodo gave way to realism as his reform momentum waned. Weak commodity prices also compounded the weakness in some Asian countries.

The fall in oil price adversely affected Malaysia as its key export of oil and oil-related products weakened. The ringgit also weakened on political challenges to Prime Minister Najib Razak. India and the Philippines fared better with the Philippine economy benefiting from strong current account surplus. Falling Consumer Price Index (CPI) in India gave the Reserve Bank of India room to cut policy rates aggressively and allowed India to continue to grow at above 7 per cent GDP growth.



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## Outlook for 2016

Much of these concerns should subside and the global economy should be on a better footing in 2016. This should have the desirable effect of stabilising emerging economies as well. We expect US growth to settle at a comfortable 2.2 per cent in 2016. Europe is on track for better growth and this is cemented by additional easing measures announced by the European Central Bank (ECB) in December 2015. European growth is expected to improve further to grow at 1.5 per cent in 2016. Growth in emerging economies is also expected to accelerate to 4.1 per cent led by stronger growth in India and Indonesia.

The Chinese economy has also stabilised from its weakness in H2 2015. Chinese manufacturing PMI (Purchasing Managers' Index) is improving and we have noted that eastern China cement prices are improving and commodity inventory is being destocked. Aggressive monetary easing in 2015 has also led to a strong recovery in M2 growth from 10.1 per cent in April 2015 to 13.7 per cent in November 2015.

The Central Economic Work Meeting has prioritised supply side structural reforms for 2016 and fiscal policy will be used prudently to support aggregate demand. We continue to expect the PBOC to ease interest rates and cut reserve requirement ratio aggressively in 2016.

In Indonesia, Mr Joko reshuffled his Cabinet in August 2015 and launched a series of fiscal packages to push forward his administration's reform agenda. We expect the central banks of Indonesia, Thailand, South Korea and India to cut policy rates further in H1 2016 to support economic growth. Fiscal spending will also be accelerated in order to provide a countercyclical boost to aggregate demand. We see a possibility for a more comprehensive fiscal stimulus in 2016 should growth weaken further.

Longer-term prospects for Asia remain bright. Transformational changes to the structure of the Chinese economy will provide further opportunities to expand and develop China's services sector.

Deposit and lending rates have been liberalised and foreign exchange policy has also moved closer towards a managed float regime. With these two key markets liberalised, we expect the pace of capital account opening to accelerate. The opening of China's capital account will be a major milestone in its reform process and will have a more significant impact than the nation's accession into the World Trade Organization in 2001.

The inclusion of the RMB in the SDR (Special Drawing Right) basket on Oct 1, 2016 will further catalyse global interest to invest in onshore RMB bond markets. The current yield of the SDR at 0.05 per cent is much lower than the yield of RMB and the RMB is likely to be more stable than the Japanese yen and euro where increased quantitative easing cannot be ruled out.

We also expect the QFII (Qualified Foreign Institutional Investor) and RQFII (RMB Qualified Foreign Institutional Investor) schemes to be simplified to allow foreign investors easier access to the domestic bond market. These two schemes may be merged into a single conduit and it will pave the way for onshore Chinese bonds to eventually enter the global bond indices.

## Investment strategies

The Fed has begun its interest rate normalisation with a 25 basis point (bps) hike in December 2015. However, we expect only another 50 bps of rate hikes in 2016. This will be lower than that guided by the Fed. We expect global bond yields to remain low in 2016 with the Fed being the only major central bank raising interest rates while the ECB, BOJ (Bank of Japan) and PBOC will have an easing bias. In this environment, we believe bond investors will continue to seek opportunities that offer higher yields and in markets that will be resilient to market volatility.

In this respect, investors can consider Singapore savings bonds as an attractive risk-free investment. The yield on Singapore savings bonds are high compared to global government bonds of similar credit and the flexibility to redeem without penalty will allow investors to reinvest at higher rates should interest rates rise.

For investors with a moderate risk profile, high grade corporate bonds offer attractive yields over government bonds. Singapore and Asian high grade corporate bonds have attractive credit spreads relative to global peers and the quality of Asian corporations remain healthy. Investors seeking higher returns can invest in emerging local currency bonds.

For example, countries such as India and Indonesia offer yields in excess of 7.5 per cent. A portfolio approach where investors invest across government bonds, high grade corporate bonds and local currency bonds can offer attractive overall yields while diversifying credit risks and currency risks. **W**

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