

MARKET COMMENTARY

Fixed income market review and outlook

August 2022



Review

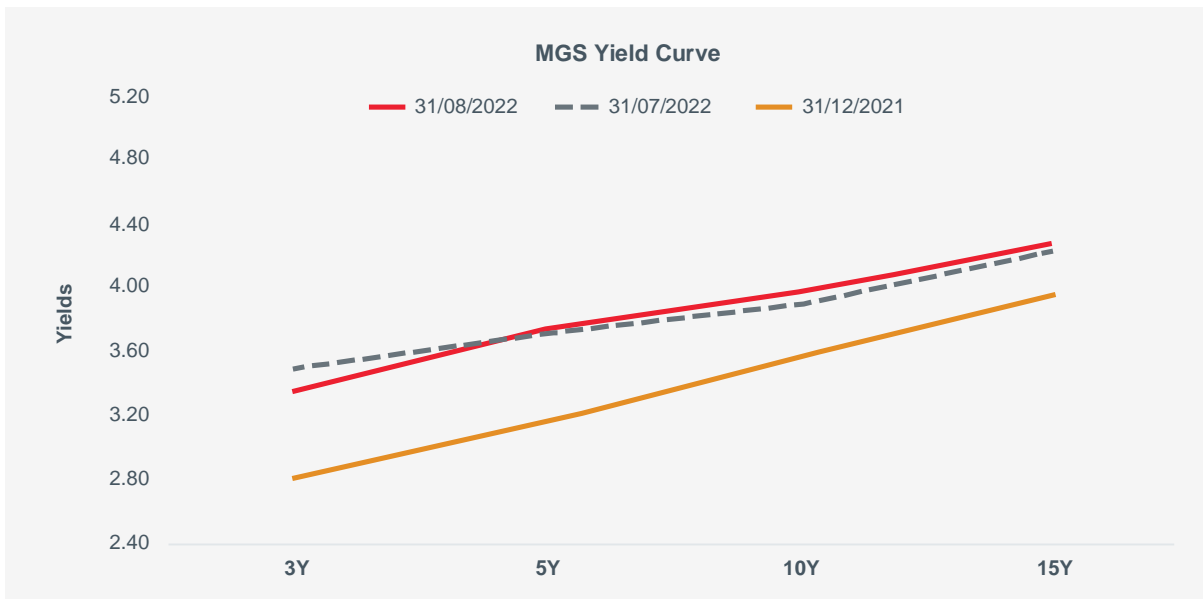
- › All eyes were on Fed Chair Powell's Jackson Hole speech in end-Aug 2022. His message was consistent with the Jul 2022 FOMC minutes, which reiterated Fed's commitment to lower inflation to 2% and suggested that policy rates might stay elevated after the neutral rate is reached, possibly resulting in a sustained period of weak growth and higher unemployment. The minutes also confirmed the ramping up of the Fed's quantitative tightening from Sep 2022 with a rundown of USD60b US Treasury and USD35b in mortgage-backed securities.
- › The Second Estimate of US' 2Q2022 GDP report came in at -0.6%, slightly higher than the 0.9% contraction (1Q2022: -1.6%) in the Advance Estimate report, reaffirming the US technical recession. That said, job gains remained large at 315K in Aug 2022 albeit fewer than Jul 2022's 526K. While unemployment rate rose for the first time in a year to 3.7% (Jul 2022: 3.5%), it was a result of an influx of people coming in to look for work. The latest job report serves as a sign that the US economy is still healthy. Meanwhile, the Jul 2022 CPI surprised to the downside at 8.5% YoY (Jun 2022: 9.1% YoY), mainly on lower energy prices, core inflation was flattish, coming in at a stickily high level of 5.9% YoY. The latest data seemed to suggest that inflation has peaked but failed to convince policymakers to shift their still hawkish comments. Separately, the Congress passed the USD740m landmark tax, climate and health-care Inflation Reduction Act on 7 Aug 2022.
- › Globally, central banks continued with their tightening pace. In Aug 2022, Bank of England ("**BoE**") delivered a 50bps hike to lift its policy rate to 1.75%, the biggest rate hike since 1995 and the sixth consecutive hike since Dec 2021, after the UK reported its record high inflation of 9.4% in Jun 2022. BoE also revised lower its 2022 and 2023 GDP forecasts to 3.5% and -1.5% from 3.75% and -1.25% previously. Similarly, Reserve Bank of New Zealand maintained its hawkish tone and increased its official cash rate to 3.00%, the fourth consecutive 50bps hike while Reserve Bank of India announced a higher-than-expected 50bps hike, lifting its benchmark repo rate to 5.4% as inflation is likely to remain above its upper tolerance range of 6%. Likewise, Bank of Korea raised its base rate by another 25bps to 2.50% despite noting the increase in economic downside risks. In ASEAN, Bank of Thailand lifted its policy rate by 25bps to 0.75% while Bangko Sentral ng Pilipinas raised its policy rate by a further 50bps to 3.75% as it revised upward its CPI forecast to 5.4%, beyond its 2%-4% target range. Meanwhile, Bank Indonesia surprised investors with a 25bps hike, bringing its policy rate to 3.75% as inflation is set to overshoot its target range of 2%-4% especially after the Indonesian government revealed plans to hike subsidized fuel prices.
- › China's Jul 2022 economic data surprised to the downside with retail sales and industrial production growing at slower rates of 2.7% YoY and 3.8% YoY respectively (Jun 2022: +3.1%; +3.9%). Meanwhile, fixed asset investment softened to 5.7% YoY for the 7M2022 (1H2022: +6.1% YoY). In response, PBoC unexpectedly cut its 1Y MLF as well as the 1Y and 5Y LPR by 10bps-15bps to help stabilize the property sector, despite alerting the market earlier that the expected higher structural inflation pressure may limit its scope to cut interest rates. In addition, PBoC also urged financial institutions to step-up financial support to the property sector and maintain stable loans growth. Other new stimulus measures introduced include a RMB200b in special loan to support the completion of unfinished residential projects, likely triggered by the recent mortgage boycotts, as well as incremental quotas of at least RMB300b in policy bank financings and RMB500b in local government special bonds. Meanwhile, the ruling Communist Party will start its 20th China Congress, held every 5 years, on 16 Oct 2022 with President Xi poised to secure his historic 3rd term and cement his position as China's most powerful leader since Mao Zedong.
- › The US-China relations nosedived following House Speaker Pelosi's controversial visit to Taiwan despite China's strong objection. The infuriated China called Pelosi's visit as a "provocation" and took several aggressive actions including firing ballistic missiles encircling Taiwan and sanctioning Pelosi. China's 72-hour large-scale military drills had resulted in cancelation of flights and disruption to shipping lanes and was described by Taiwan as an apparent simulation of an invasion of the self-ruled island. China also cut off defense, climate change and other bilateral cooperation talks with Washington and announced more military drills near Taiwan in the coming months. Elsewhere, Kyiv's request for a two-year freeze on payments on its USD20b international bonds had been approved by bondholders while European gas prices jumped as Moscow's decision to shut the Nord Stream

pipeline for three days in end-Aug after a 10-day maintenance curtailment in Jul 2022 raised concerns over possible supply halt this winter.

- ▶ On the political front, Thailand's Constitutional Court suspended Prime Minister (“PM”) Prayuth's official duties pending a legal review of his 8-year tenure as PM although incumbent administration remains unaffected under Deputy PM General Prawit who has assumed the role of caretaker PM in the interim. In Malaysia, former PM, Najib Razak became the first Malaysian PM to be sentenced to jail after failing to overturn the lower courts' guilty conviction over abuse of power and corruption.
- ▶ Malaysia posted a stronger than expected 2Q2022 GDP of 8.9% YoY (1Q2022: 5.0% YoY), as the re-opening of economy boosted private consumption (+18.3% YoY) and investment (+6.3% YoY) and supported the labour market recovery. On the external front, imports expanded 14.0% YoY, driven by higher intermediate imports, outpacing exports that grew 10.4% YoY. In 1H2022, GDP grew at a healthy 6.9% YoY. That said, Finance Minister warned that the 2023 outlook will be more challenging on China's stumbling growth and Fed's aggressive monetary tightening.
- ▶ The Budget 2023 will be tabled on 7 Oct 2022 instead of its original schedule on 28 Oct 2022, paving the way for an early general election. Earlier on, Finance Minister Tengku Zafrul indicated that the government has no plan to implement new taxes including GST, windfall tax and inheritance tax in the near future. He also shared that Malaysia's inflation would be a shocking 11% in the absence of the existing subsidy schemes. While studies on targeted subsidies are ongoing, it is understood that new schemes will only be implemented after the country is no longer facing high inflationary pressures.
- ▶ Three auctions were held in the month of Aug 2022, the re-opening of the 5Y MGS 11/27, the re-opening of the 20Y MGII 09/41 and the re-opening of the 15Y MGS 04/37. The auctions received an average bid-to-cover ratio of 2.343x.
 - ▶ RM5.0b re-opening 5-year MGS averaging 3.798% at a bid-to-cover ratio of 2.044x;
 - ▶ RM3.0b re-opening of 20-year MGII averaging 4.410% at a bid-to-cover ratio of 2.742; and
 - ▶ RM2.5b re-opening of 15-year MGS averaging 4.249% at a bid-to-cover ratio of 2.244x
- ▶ Malaysia's MGS curve steepened slightly in the month of Aug 2022. The yields of the 3-year MGS fell 14bps to close the month at 3.36% while the 5-, 10- and 15-year MGS rose 3bps, 9bps and 3bps respectively to close the month at 3.74%, 3.97% and 4.25% respectively. On the other hand, yields of MGII closed mixed. Yields of the 3- and 15-year MGII declined 5bps and 1bp to end the month at 3.43% and 4.25% respectively. Meanwhile, the 5- and 10-year MGII increased 4bps and 5bps to close the month at 3.80% and 4.03% respectively.

Benchmark	Dec 2021 Yield	Jul 2022 Yield	Aug 2022 Yield	MOM Change	YTD Change
3-year MGS	2.81%	3.50%	3.36%	- 14 bp	+ 56 bps
5-year MGS	3.16%	3.71%	3.74%	+ 3 bps	+ 58 bps
10-year MGS	3.56%	3.88%	3.97%	+ 9 bps	+ 41 bps
15-year MGS	3.94%	4.22%	4.25%	+ 3 bps	+ 31 bps

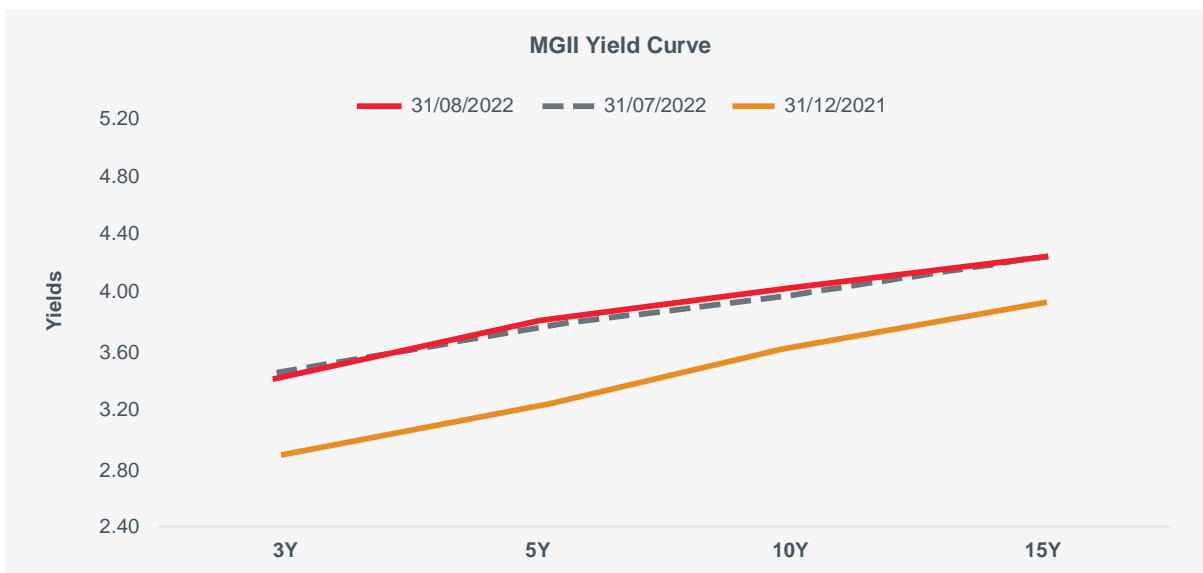
Source: Bloomberg



Source: Bloomberg

Benchmark	Dec 2021 Yield	Jul 2022 Yield	Aug 2022 Yield	MOM Change	YTD Change
3-year MGII	2.90%	3.48%	3.43%	- 5 bps	+ 53 bps
5-year MGII	3.21%	3.76%	3.80%	+ 4 bps	+ 59 bps
10-year MGII	3.62%	3.98%	4.03%	+ 5 bps	+ 41 bps
15-year MGII	3.93%	4.25%	4.25%	- 1 bp	+ 32 bps

Source: Bloomberg



Source: Bloomberg

Outlook

- ▶ Malaysia's Jul 2022 headline inflation accelerated to 4.4% YoY (Jun 2022: 3.4% YoY), the highest in 14 months, as Food & Non-Alcoholic Beverages and Transportation prices rose 6.9% YoY and 5.6% YoY. The increases were partially moderated by softer growth in Housing, Water, Electricity, Gas and Other Fuels prices (+3.8% YoY). Similarly, core inflation rose higher to 3.4% YoY (Jun 2022: +3.0% YoY), the highest level in six years, a reflection of the broadening increase in prices of goods and services on the back of demand recovery. For 2022, inflation is expected to remain modest, as subsidies flatten the path, coming in within BNM's forecast of 2.2% to 3.2%.
- ▶ The tug of war between recession and growth will continue to bring volatility to the markets. This follows the still strong US job report as well as Powell's Jackson Hole speech that left few doubts about the Fed's hawkish stance to fight inflation. In Malaysia, inflationary pressure has crept up although the impact has largely been contained by the various subsidy schemes in place. In the near term, investors are expected to shift their focus to headlines related to the brought forward Budget 2023, as well as signs of an early general election following the recent political developments. Going forward, we believe the main themes surrounding the Malaysian bond market will be Malaysia's economic growth, inflationary pressures and monetary policy normalization, potential general elections, as well as the supply-demand dynamics.
- ▶ There will be three auctions in the month of Sep 2022, the re-opening of the 3Y MGII 10/25, the re-opening of the 7Y MGS 04/29 and the new 15.5Y MGII 03/38. While there is still ample liquidity in the system, the outcome of these auctions is likely to be influenced by prevailing market sentiment. On the corporate front, we expect mixed demand for corporate bonds as investors continue to be selective in their investments.

Table 1: Indicative Rates (%)

	31-Aug-22
MBB O/N*	0.70
MBB1-Week*	0.80
MBB 1-Mth FD*	1.95
MBB 6-Mth FD*	2.30
MBB 1-Year FD*	2.35
CP	
1-mth (P1)	2.87
3-mth (P1)	3.20

Source: Bloomberg/Bondstream

* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3yr	5yr	7yr	10yr	15yr
MGS	3.43	3.70	3.91	3.98	4.28
GII	3.44	3.79	3.92	4.00	4.29
Swap rate*	3.55	3.67	3.76	3.94	4.31
AAA	4.00	4.23	4.40	4.50	4.74
AA1	4.08	4.34	4.55	4.66	4.91
AA2	4.15	4.44	4.69	4.81	5.08
AA3	4.22	4.54	4.83	4.96	5.24
A1	4.96	5.38	5.73	5.95	6.30
A2	5.57	6.11	6.51	6.89	7.39
A3	6.17	6.81	7.28	7.82	8.47

Source: Bloomberg*/Bondstream

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