A Prudential plc company

MARKET COMMENTARY

Fixed income market review and outlook

July 2022

Review

- As widely expected, the Fed delivered another 75bps hike to bring its policy rate to 2.25% - 2.50% at its Jul 2022 FOMC meeting following the white-hot inflation report that showed Jun 2022's inflation jumped 9.1% YoY (May: 8.6%), the fastest pace in 40 years. At his press conference, Fed Chair Powell reiterated FOMC's strong commitment to bring inflation down to its 2% target and indicated that job market remains robust. Powell acknowledged that a period of growing below potential may be needed to restore price stability and signalled that another usually large increase could be appropriate but will be data dependent.

- Meanwhile, the Advance 2Q2022 GDP report indicated that the US real GDP retreated at a seasonally adjusted annual rate of 0.9% after a 1.6% contraction in 1Q2022. The lower real GDP reflects decreases in private inventory investment, residential fixed investment as well as government and business capex that were partly offset by increases in exports and personal consumption. While two quarters of negative GDP growth is often treated as a technical recession, the broader economy, including job growth and consumer spending, remains healthy.

- Globally, central banks stepped up their tightening pace. In Jul 2022, the Bank of Canada surprised the markets with a 100bps hike, bringing its policy rate to 2.5%, within its estimated neutral rate range of 2% to 3%. Similarly, Reserve Bank of Australia, Reserve Bank of New Zealand and Bank of Korea raised their policy rates further by 50bps each. Meanwhile, ECB decided to raise its benchmark deposit rate by 50bps to 0% instead of the guided 25bps and revised its forward guidance to a meeting-by-meeting approach. Major central banks are expected to front-load and go well above the top of neutral range to fight the entrenched inflation in the coming months. In ASEAN, both Singapore and Philippines announced off-cycle policy moves where MAS re-centered its SGD NEER midpoint upward to prevailing levels and BSP delivered a pre-emptive 75bps hike to bring its policy rate to 3.25% to curb inflation.

- Separately, British Prime Minister Boris Johnson agreed to step down after a wave of resignations from his government. Johnson will remain the caretaker Prime Minister until his replacement is announced by the ruling Conservative party on 5 Sep 2022. Meanwhile, Italian Prime Minister Mario Draghi's second resignation was accepted by President Sergio Mattarella who subsequently dissolved the parliament and officially called for an early election for Italy on 25 Sep 2022. Draghi had stepped down after losing support from his three major coalition partners which triggered the collapse of his coalition government.

- China's 2Q2022 GDP slowed sharply to 0.4% YoY (1Q2022: +4.8%), bringing its 1H2022 GDP growth to 2.5%, well below its official target growth rate of 5.5% for 2022. That said, Jun 2022 economic data rebounded strongly with retail sales, industrial production and fixed asset investment expanding 3.1% YoY, 3.9% YoY and 5.8% YoY respectively (May 2022: -6.7%; +0.7%; +4.7%) although property sector investment worsened to -9.6% YoY from the previous month's -7.7%. It is also worth noting that the ease of lockdowns had supported China's Jun 2022 exports, which grew a better than expected 17.9% YoY (May 2022: 16.9% YoY). Meanwhile, policymakers vowed to proactively boost demand, stabilize the property market and support the platform economy at the July 2022 Politburo meeting. While the target growth of around 5.5% was not abandoned, it was replaced with a more pragmatic rhetoric of achieving the best possible result, an indication that it is increasingly challenging to achieve the original target growth given the still restrictive zero-Covid policy that is like to stay until the conclusion of the 20th National Congress of the Chinese Communist Party, scheduled to be held in end-2022.

- The Russia-Ukraine conflict has effectively morphed into a protracted crisis and there is no sign yet of when it will end, especially as Russia was reportedly looking to annex more Ukrainian territory beyond the Luhansk and Donetsk regions. The crisis, which worsened the supply chain issue, has exacerbated the global energy and food crisis. That said, the departure of the first grain ship from Ukraine's port of Odesa, following the signing of the UN-backed agreement in Jul 2022, has raised hopes that global food crisis could ease in the coming months. Closer to home, the US-China tensions escalated in early Aug 2022 when House Speaker Nancy Pelosi visited Taiwan despite warnings from China. Pelosi is the highest-ranking elected US official to visit the self-ruled island in 25 years and her itinerary includes a meeting with Taiwan's President Tsai. While the Biden administration reiterated that Pelosi's visit does not signal a change in its "One China" principle, Beijing sent warships and planes to the median line of the sensitive waterway and conducted large-scale military drills and missile tests around Taiwan.

- ADB lowered Malaysia's 2022 and 2023 GDP growth to 5.8% and 5.1% from 6.0% and 5.4% respectively to reflect the increased uncertainty and weaker global growth. Similarly, IMF cut ASEAN-5's 2023 GDP growth by 0.8% to 5.1% but kept the region's growth forecast of 5.3% unchanged for 2022. This follows IMF's decision to lower its global GDP growth by 0.4% and 0.7% respectively for 2022 and 2023 to 3.2% and 2.9% respectively. On the political front, Malaysia passed the historic Anti-Hopping Bill, one of the key conditions of the Memorandum of Understanding signed between the current government and opposition that expired in Jul 2022. In essence, the much-awaited Bill prohibits members of Parliament from switching party, which is important for Malaysia's long-term political stability.

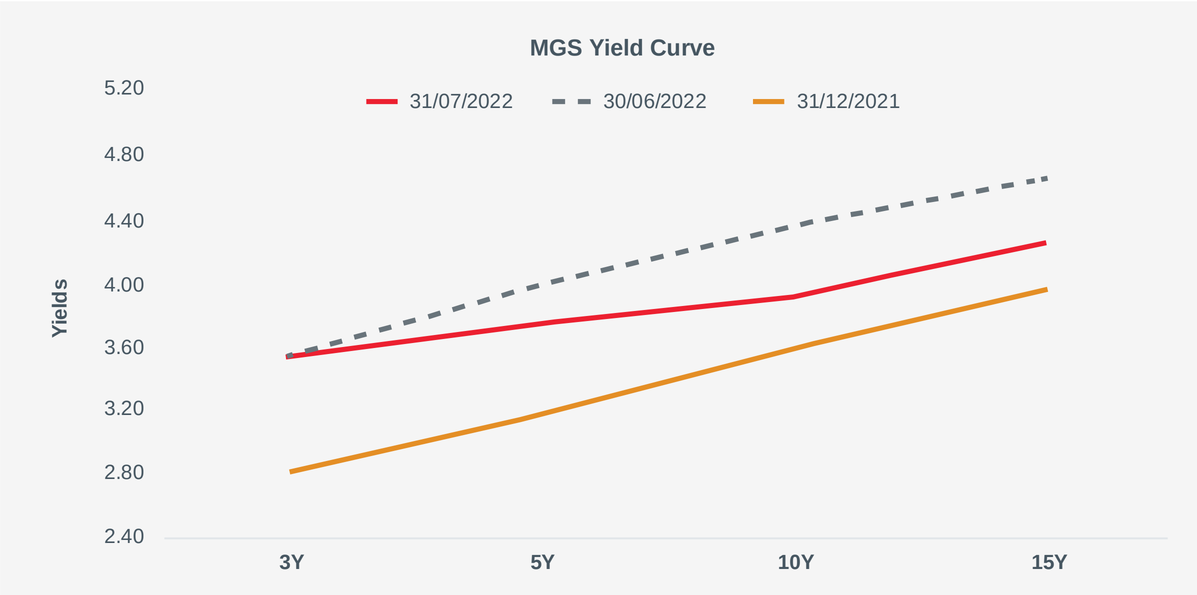
- BNM raised its OPR by a further 25bps at its Jul 2022 MPC meeting, bringing the policy rate to 2.25%, reiterating that any adjustments going forward will be done in a measured and gradual way as it continues to assess Malaysia's inflation and growth outlook. Globally, BNM noted that the economic recovery has continued to be supported by the re-opening of economy and improving labour market conditions although the strength was partly offset by rising cost pressure, the Russia-Ukraine crisis and lockdowns in China. BNM also expects the inflationary pressures to cause central banks to tighten their monetary policy at a faster pace and the pace of global growth to moderate. On the domestic front, BNM opines that firm demand, the re-opening of international borders as well as realization of multi-year projects will lend support to growth although downside risks to growth including weaker global demand remain. Meanwhile, headline and core inflations are expected to come in within BNM's forecasted range of 2.2% to 3.2% and 2.0% to 3.0% for 2022 although headline inflation may be higher in some months due to base effect from electricity prices.

- Three auctions were held in the month of July 2022, the re-opening of the 10Y MGII 10/32, the re-opening of the 20Y MGS 10/42 and the re-opening of the 7Y MGII 07/29. The auctions received an average bid-to-cover ratio of 2.721x.
  - RM3.5b re-opening 10-year MGII averaging 4.117% at a bid-to-cover ratio of 3.105x;
  - RM2.5b re-opening of 20-year MGS averaging 4.598% at a bid-to-cover ratio of 2.656x; and
  - RM4.5b re-opening of 7-year MGII averaging 3.917% at a bid-to-cover ratio of 2.403x

- Malaysia's MGS curve bull flattened in the month of Jul 2022. The yields of the 3-, 5-, 10- and 15-year MGS fell 1bp, 25bps, 42bps and 40bps respectively to close the month at 3.50%, 3.71%, 3.88% and 4.22% respectively. Similarly, yields of MGII closed lower with the yields of the 3-, 5-, 10- and 15-year MGII declining 9bps, 36bps, 28bps and 42bps to close the month at 3.48%, 3.76%, 3.98% and 4.25% respectively.

BENCHMARK	Dec 2021 Yield	Jun 2022 Yield	Jul 2022 Yield	MOM Change	YTD Change
3-year MGS	2.81%	3.51%	3.50%	- 1 bp	+ 69 bps
5-year MGS	3.16%	3.96%	3.71%	- 25 bps	+ 55 bps
10-year MGS	3.56%	4.30%	3.88%	- 42 bps	+ 32 bps
15-year MGS	3.94%	4.61%	4.22%	- 40 bps	+ 28 bps

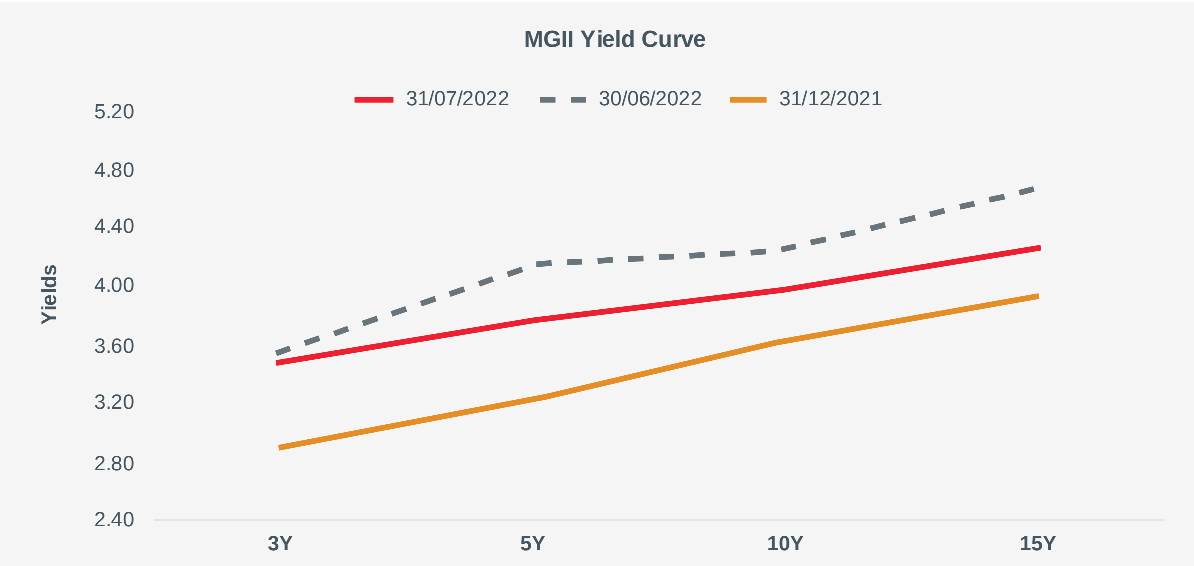
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2021 Yield	Jun 2022 Yield	Jul 2022 Yield	MOM Change	YTD Change
3-year MGII	2.90%	3.57%	3.48%	- 9 bps	+ 58 bps
5-year MGII	3.21%	4.13%	3.76%	- 36 bps	+ 55 bps
10-year MGII	3.62%	4.26%	3.98%	- 28 bps	+ 35 bps
15-year MGII	3.93%	4.67%	4.25%	- 42 bps	+ 33 bps

Source: Bloomberg



Source: Bloomberg

Outlook

- Malaysia's Jun 2022 headline inflation rate accelerated further to 3.4% YoY (May 2022: 2.8% YoY), the highest in 12 months, as Food & Non-Alcoholic Beverages and Transportation prices rose 6.1% YoY and 5.4% YoY respectively. The increases were partially moderated by softer growth in Housing, Water, Electricity, Gas and Other Fuels prices (+1.2% YoY). Likewise, core inflation moved higher to 3.0% YoY (May 2022: +2.4% YoY), lending support for a hawkish BNM. For 1H2022, headline inflation averaged 2.5% (1H2021: +2.3% YoY). Overall, full year inflation is expected to remain modest, coming in within BNM's forecast of 2.2% to 3.2%. However, inflationary risk remains tilted to the upside with the revision of certain subsidies on top of the potential replacement of blanket petrol subsidies.

- Aggressive tightening by key central banks over the past two months coupled with the elevated inflation have heightened recession fears. In view of the uncertainties on the macroeconomic front, Powell commented that the magnitude of future hikes will be data dependent. While the Fed's latest move has effectively eroded the spread between USD and Asian rates significantly, central banks in the region are expected to remain vigilant in their next move. In the near term, volatilities in the global market are expected to persist as sentiments continue to be weighed by concerns on global growth and inflation outlook. In Malaysia, inflationary pressure has been staying relatively muted thus far but markets will watch closely on signs of a possible change to the current fuel subsidy scheme. For 2022, we believe the main themes surrounding the Malaysian bond market are 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 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. 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-Jul-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
1-mth BNM MN	2.32
3-mth BNM MN	2.47
3-mth KLIBOR	2.68
CP	
1-mth (P1)	2.86
3-mth (P1)	3.19

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)

	3yr	5yr	7yr	10yr	15yr
MGS	3.58	3.75	3.86	3.90	4.25
GII	3.44	3.73	3.88	3.97	4.29
Swap rate*	3.41	3.50	3.60	3.69	4.06
AAA	3.99	4.23	4.41	4.51	4.83
AA1	4.08	4.35	4.56	4.67	4.97
AA2	4.16	4.47	4.71	4.82	5.11
AA3	4.25	4.60	4.85	4.98	5.26
A1	4.97	5.39	5.75	5.97	6.32
A2	5.58	6.12	6.53	6.91	7.41
A3	6.18	6.82	7.30	7.84	8.49

Source: Bloomberg*/Bondstream