eastspring investments
A Prudential plc company

Market commentary

Fixed income market review and outlook

August 2026

Review

- The Federal Reserve's federal funds rate range stood at 3.50% to 3.75% in August 2026. The US economy added 162,000 jobs in August 2026, significantly exceeding market expectations of 56,000 and following an upwardly revised increase of 23,000 jobs in July. The unemployment rate remained unchanged at 4.1% (Jul: 4.1%). Inflation pressure persisted, with the headline PCE Price Index holding steady at 3.7% y-o-y in July (Jun: 3.7%), while the core PCE Price Index remained elevated at 3.3% (Jun: 3.3%), well above the Federal Reserve's 2% target. In August 2026, the Federal Reserve also announced that it would at least double the size of its long-dated bond buyback programme, raising the cap from US$2 billion to a minimum of US$4 billion per operation to improve market liquidity and ease broader borrowing costs. Consumer sentiment weakened, with the University of Michigan Consumer Sentiment Index declined to 51.7 in August from 55.2 in July, reflecting ongoing cost-of-living pressures and heightened geopolitical concerns stemming from the conflict in the Middle East. Meanwhile, business activity remained resilient. The Manufacturing PMI eased to 54.6 (Jul: 55.6) but continued to indicate expansion in the manufacturing sector, while the Service PMI rose to 55.4 (Jul: 54.1), signalling stronger growth in services activity.

- The Bank of England ("BoE")'s Bank Rate stood at 3.75% in August 2026. Headline inflation increased to 2.9% y-o-y in July 2026 (Jun: 2.6%), mainly driven by higher household energy costs following a 13% rise in Ofgem's energy price cap, while core inflation remained unchanged at 2.6% (Jun: 2.6%). Retail sales volumes grew 1.6% y-o-y in July (Jun: revised 3.8%). On the production side, industrial production declined by 0.2% y-o-y in Jun (May: revised 1.0%), while manufacturing production expanded by 0.5% y-o-y (Apr: revised 2.0%).

- The European Central Bank ("ECB")'s key interest rates unchanged in August 2026, with the deposit facility rate at 2.25%, the main refinancing rate at 2.40% and the marginal lending facility at 2.65%. Headline inflation accelerated to 3.3% y-o-y in August (Jul: 2.9%), remaining above the ECB's 2.0% target, largely driven by higher energy prices amid ongoing tensions in the Middle East, while core inflation moderated slightly to 2.4% (Jul: 2.5%). Industrial production increased 0.1% y-o-y in June (May: revised -0.1%) and manufacturing production increased 0.2% y-o-y (Apr: revised -0.1%).

- The Reserve Bank of Australia kept its cash rate unchanged at 4.35% at its August 2026 meeting, as earlier rate hikes continued to moderate economic activity and ease labour market conditions, although persistently high inflation, elevated inflation expectations and higher commodity prices remained upside risks. In Asia, both the Bank of Korea and the Central Bank of Philippines raised their policy rate by 25 basis points (bps) to 3.00% and 5.00%, citing persistent inflationary pressures amid resilient economic activity. Elsewhere, Bank Indonesia and the Bank of Thailand kept their key interest rate at 5.75% and 1.0%, respectively. Meanwhile, the Bank of Japan and Bank Negara Malaysia ("BNM") did not hold monetary policy committee meetings in August 2026.

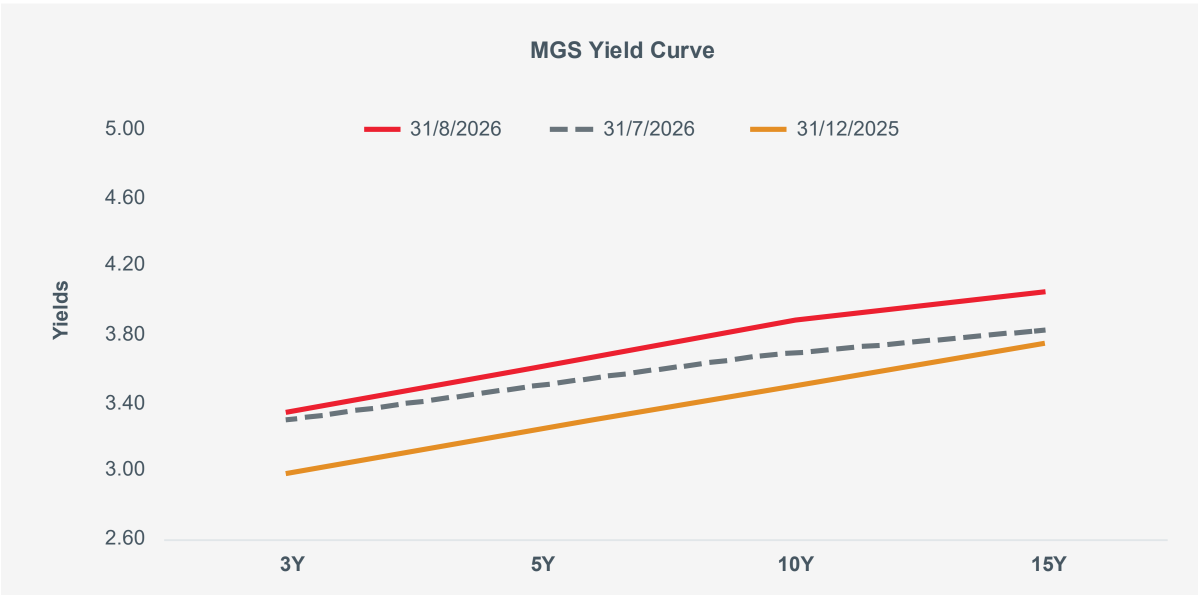
- The People's Bank of China kept its key lending rates unchanged in August 2026, maintaining the 1-year and 5-year loan prime rates steady at 3.0% and 3.5%, respectively, as policymakers balanced the need to support a slowing economy and the weak property sector against external uncertainties arising from the conflict in Middle East. In USD terms, imports grew 28.2% y-o-y in August (Jul: 27.5%), supported by strong commodity demand and AI-related trade activity, despite softer imports of certain industrial metals and soybeans amid supply constraints and trade tensions. Exports increased 25.0% y-o-y (Jul: 23.9%), driven by robust global demand for AI-related technology products, particularly integrated circuits, despite ongoing shipping disruptions and heightened trade tensions with key trading partners. Domestic activity remained mixed, with retail sales growth moderating to 0.6% y-o-y in July (Jun: 1.0%), while industrial production expanded by 4.5% y-o-y (Jun: 5.3%). However, fixed asset investment contracted by 6.7% y-o-y in Jan-Jul 2026 (Jan-Jun: -5.7%), reflecting continued weakness in the property sector. Excluding property sector, fixed-asset investment declined by 5.7%.

- In July, both headline and core inflation eased to 1.8% (Jun: 1.9%), mainly due to slower increases in retail fuel prices. The unemployment rate remained stable at 3.0% in June (May: 3.0%). BNM's international reserves amounted to US$132.0bn as of 31 August 2026 (31 July 2026: US$132.1bn), sufficient to finance 4.7 months of retained imports and cover 0.9x of short-term external debt. Meanwhile, the Ringgit appreciated by 1.5% m-o-m against the US dollar to 4.025 at end-August (end-July: 4.086), supported by resilient domestic economic growth and a weaker US dollar.

- Four auctions were held in August 2026, reopening of 5Y MGII 10/31, reopening of 30Y MGS 7/55, reopening of 7Y MGII 3/33 and reopening of 20Y MGS 4/46. The auctions received an average bid-to-cover ratio of 2.05x.
  - RM5.0b reopening of 5Y MGII 10/31 averaging yield of 3.529% at a bid-to-cover ratio of 2.402x;
  - RM5.0b (including RM2.0b private placement) reopening of 30Y MGS 7/55 averaging yield of 4.213% at a bid-to-cover ratio of 2.017x.
  - RM5.0b reopening of 7Y MGII 3/33 averaging yield of 3.696% at a bid-to-cover ratio of 2.147x; and
  - RM5.0b (including RM1.5b private placement) reopening of 20Y MGS 4/46 averaging yield of 4.189% at a bid-to-cover ratio of 1.635x.
- In August, Malaysia's MGS and GII yields edged higher, increasing between 3 bps and 23 bps as investors remained cautious amid mixed domestic data and continued uncertainty surrounding the global interest rate outlook. Foreign investors turned net buyers during the month, recording substantial net inflows of RM15.9 billion (July: RM5.6 billion net outflow), which brought YTD net inflows to RM19.3 billion. Meanwhile, the 10Y UST yield was unchanged at 4.75% (Jul: 4.75%). Investors remained cautious as they monitored key U.S. economic data releases and signals from Federal Reserve policymakers for indications on the future path of monetary policy.

BENCHMARK	Dec 2025 Yield	Jul 2026 Yield	Aug 2026 Yield	MOM Change	YTD Change
3-year MGS	3.00%	3.30%	3.35%	5 bps	35 bps
5-year MGS	3.26%	3.49%	3.61%	12 bps	35 bps
10-year MGS	3.49%	3.70%	3.87%	17 bps	38 bps
15-year MGS	3.75%	3.82%	4.04%	23 bps	30 bps

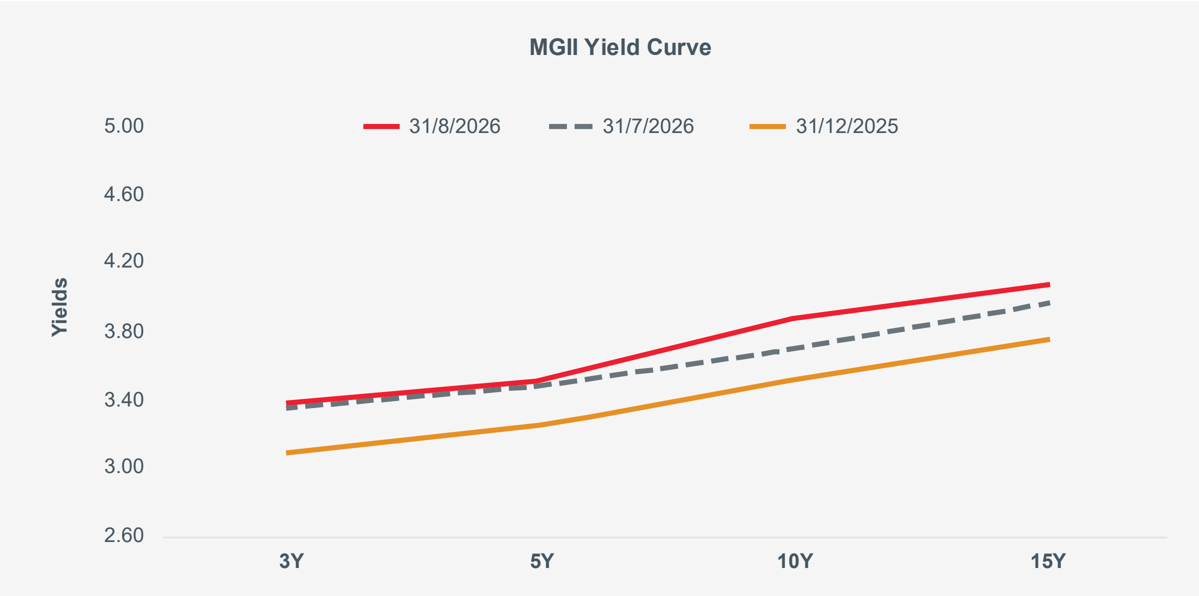
Source: Bloomberg



Source: Bloomberg

BENCHMARK	Dec 2025 Yield	Jul 2026 Yield	Aug 2026 Yield	MOM Change	YTD Change
3-year MGII	3.09%	3.35%	3.38%	3 bps	29 bps
5-year MGII	3.25%	3.48%	3.51%	4 bps	27 bps
10-year MGII	3.52%	3.70%	3.87%	17 bps	35 bps
15-year MGII	3.74%	3.95%	4.06%	11 bps	32 bps

Source: Bloomberg. *MGII3Y Index



Source: Bloomberg

Outlook

- The Federal Reserve's July 2026 FOMC meeting minutes, released in August, pointed to a more hawkish stance as concerns over persistent inflation intensified. At the recent Jackson Hole symposium, Fed Chair Kevin Warsh signalled a departure from traditional forward guidance, emphasising that bringing inflation back towards the 2% target remains the central policy objective and indicating that further interest rate hikes remain a possibility. Reflecting the shift in market sentiment, investors currently price in a 54% to 58% probability of a 25-bp hike at the upcoming September FOMC meeting. Meanwhile, the ongoing conflict involving Iran and the closure of the Strait of Hormuz have pushed crude oil prices above $90 a barrel, raising concerns that higher energy costs could feed through to broader consumer prices and reinforce near-term inflationary pressures. Longer term, the market continues to face structural challenges from a growing supply-demand imbalance in the US Treasury market. US public debt surpassed US$40 trillion in August, while the fiscal deficit remained elevated at approximately 6% of GDP. Additional risks to the outlook include escalating tariff and trade tensions, persistent supply chain disruptions, China's structural deflationary pressures, and rising geoeconomic fragmentation.

- BNM expects the economy to grow by 4% to 5% in 2026, supported by resilient domestic demand, stronger-than-expected export performance, robust E&E demand and sustained investment activity despite external headwinds. While elevated global commodity and energy prices amid ongoing Middle East tensions may exert some upward pressure on inflation, BNM expects the overall impact on both headline and core inflation to remain manageable, supported by domestic policy measures and stable demand conditions. Headline inflation is projected to average at 1.5% to 2.5% in 2026. At its meeting on 3 September 2026, BNM removed the word "appropriate" from its assessment of the current monetary policy stance, instead stating that the stance is "consistent with the outlook of continued price stability and sustainable economic growth". This subtle change in language has been interpreted by some economists as a modest hawkish signal, potentially paving the way for a policy rate increase in early 2027.

- Three auctions are expected in the month of September 2026, reopening of 10-yr MGII 7/36, reopening of 7-yr MGS 4/33 and reopening of 30-yr MGII 1/56. While broad liquidity in the system remains ample, short-term interbank liquidity has shown signs of tightness. The outcome of these auctions is likely to be influenced by prevailing market sentiment from both local and foreign investors facing OPR normalisation risk. On the corporate front, we expect demand to stay resilient despite these factors, driven by ongoing institutional demand for bonds even though spreads being compressed significantly.

Table 1: Indicative Rates (%)	
	31 Aug 2026
MBB O/N*	1.00%
MBB 1-Week*	1.10%
MBB 1-Mth FD*	1.75%
MBB 6-Mth FD*	1.85%
MBB 1-Year FD*	1.90%
1-mth BNM MN	2.92
3-mth BNM MN	2.96
3-mth KLIBOR	3.47
CP	
1-mth (P1)	3.55
3-mth (P1)	3.68

Source: Bloomberg/Bondstream
* Maybank2u.com.my

Table 2: Indicative Bond Yields (%)					
	3Yr	**5Yr**	**7Yr**	**10Yr**	**15Yr**
MGS	3.42	3.61	3.82	3.91	4.07
GII	3.36	3.61	3.84	3.91	4.08
Swap rate*	3.65	3.69	3.76	3.88	4.03
AAA	3.72	3.88	4.02	4.19	4.37
AA1	3.75	3.91	4.05	4.22	4.41
AA2	3.82	3.96	4.10	4.28	4.50
AA3	3.88	4.02	4.14	4.34	4.60
A1	4.23	4.45	4.65	4.93	5.32
A2	4.88	5.25	5.56	5.97	6.53
A3	5.53	6.04	6.43	6.92	7.60

Source: Bloomberg*/Bondstream

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