

Market Review

The Singapore bond market had a quiet year-end trading session in December, range trading in ultra-thin liquidity. For the month, the UOB Singapore Government Bond All Index (the Index) posted a paltry gain of 0.02%. For 2011 as a whole, Singapore government securities (SGS) benefitted from a flight to quality against a backdrop of heightened risk aversion, posting a gain of 6.78%, the strongest outturn since 2008.

Market sentiment continued to be driven by lingering concerns over developments in the Eurozone (EU) debt crisis. While execution risks remain, the European Summit in early December did make good progress in addressing the region's stress points, by providing a liquidity backstop for banks and sovereigns. Critically, EU policy makers must build upon this foundation that has been laid down, through decisive actions by fiscal authorities toward reform and austerity. During the month, the UST continued to hold firm across the curve, with outperformance in the 10-year which closed 19 bps lower in yield. By contrast, with the exception of the 10-year which ended 5 bps lower in yield, the SGS finished the month mostly weaker, in tandem with a sluggish Singapore dollar (SGD) which lost 1.2% in December. The 2-year underperformed to be 13 bps higher in yield, reflecting the ongoing normalization of short-term SGD interest rates. Consequently, the 2-year/10-year yield spread gapped wider to 18 bps.

Economic releases continued to point to a deceleration in real sector momentum. The advance estimate of Q4 GDP surprised on the downside to come in at 3.6% YoY (consensus 4.3%), weighed down by manufacturing and construction. Adjusted for seasonal factors, GDP shrank 4.9% QoQ annualized in the final quarter. For the year as a whole, GDP growth averaged 4.8%, slightly undershooting the official growth projection of 5%. Inflation pressure remained a concern, with CPI inflation staying elevated at 5.7% YoY (consensus 5.3%) in November. Property measures aimed at cooling the housing market were announced in early December.

Outlook

Singapore narrowly averted a technical recession in Q3, thanks to a surge in pharmaceuticals production, but posted QoQ contraction in Q2 and Q4. The government warned of a prolonged period of growth slowdown, as a small open economy is more vulnerable to the vagaries of global demand. The official projection puts 2012 GDP at 1-3%, which would be the slowest since 2009. Nevertheless, the downside risk to growth is mitigated by significant room for fiscal expansion if needed, especially given the country's solid fiscal finances. Meanwhile, inflation concern will likely limit the room for a significant loosening of the exchange rate. The Monetary Authority of Singapore will likely adhere to the current stance of a modest and gradual appreciation path for the SGD at the next policy announcement in early April.

On strategy, we view a neutral-to-slight overweight duration position as appropriate as we move into 2012. We expect broadening safe-haven demand for SGS, given that Singapore is one of a handful of sovereigns now rated triple-A by all three international rating agencies. We remain positioned for a curve flattener. There is limited long-end supply in the pipeline until end-Q1. We will seek to bolster carry through exposure in high-quality corporate and bank credits.

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IMPORTANT INFORMATION

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