SINGAPORE FIXED INCOME REVIEW

MARKET REVIEW

In October, the Singapore bond market saw weakness; most of the curve saw yields rising, led by the front end of the curve, alongside a bear-flattening of the US Treasury (UST) curve. The Asian Local Bond Index (ALBI) Singapore Government Bond Index was unchanged for the month, bringing year-to-date gains to 3.46%. Interbank market liquidity was unchanged in the month of October, with the three-month interbank rate at 1.12%.

The UST curve bear-flattened, with front-end yields rising more than the long end. The 3-month yields rose by 9 basis points (bps) while 1-year yields were higher by 13 bps. 5-year USTs were wider by 8 bps to 2.02%, while the yield on 10-year USTs was higher by 5 bps at 2.38%.

Singapore government securities (SGS) outperformed USTs in the long end, anchored by long-end domestic investors even as front-end yields were driven by the bear-flattening of the UST curve. The belly outperformed, with the yield on 3-month bills widening 5 bps to 1.23%, while the 1-year yield was 12 bps higher at 1.35%. The 2-year yield was higher by 3 bps at 1.42%, the 5-year yield widened by 1 bp to 1.66%, while the 10-year was unchanged at 2.15%. At the long end, the 30-year SGS widened 4 bps to 2.55%.

Headline Consumer Price Index (CPI) inflation in September was unchanged from August at 0.4%, in line with consensus expectations. Private road transport inflation fell to 2.1% in September from 2.6% in August, while the decline in accommodation costs was unchanged from August at 3.9%. The upside surprise to the forecast was core inflation, which edged up to 1.5% year-over-year (YoY) in September from 1.4% in August, slightly above consensus of 1.4%. Communication and miscellaneous goods and services inflation also rose by more than expected. Industrial production (IP) growth slowed to 14.6% YoY in September from 19.5% in August, beating expectations (consensus was for 10.0%). This slowdown is more modest than the sharp decline in non-oil domestic export (NODX) growth. The main source of the upside surprise was electronics IP growth, which maintained robust levels, even as biomedicals and transport engineering weakened.

The 3Q17 Labour Market Advance Release by Singapore's Ministry of Manpower (MOM) showed signs of improvement in labour market conditions, with declines in unemployment rates, stable retrenchments and strong hiring in the services sector. Employment dipped as cuts in lower-skilled manpower in the construction and marine sectors were offset by strong hiring in the services sector. Excluding foreign domestic workers, total employment slipped by 2,500 in 3Q17, driven mainly by contractions in the construction (-9,800) and manufacturing (-6,000) sectors. The services sector added a strong 14,900 jobs (13,100 if foreign domestic workers are excluded), helping to mitigate the drag on total employment from the layoffs in construction and manufacturing.

NODX fell unexpectedly in September, to -1.1% YoY from 16.7% in August, well below expectations (consensus was for 12.7%). On a sequential basis, seasonally adjusted NODX fell by 11.0% month-over-month (MoM), reversing the 4.2% expansion in August. The downside surprise came from electronics export growth which fell to -7.9% YoY in September from 20.8% in August, led by integrated circuits. Non-electronics export growth also slowed sharply to 1.9% from 15.0% in August, led by a 36.0% plunge in pharmaceuticals exports (which tend to be volatile), deteriorating further from a 9.1% decline in August. The advance estimate of 3Q17 GDP showed that Singapore's economy expanded by a strong 6.3% quarter-over-quarter (QoQ) on a seasonally adjusted annual rate (saar), from 2.4% in 2Q17. On a YoY basis, growth accelerated to 4.6% YoY from 2.9% in 2Q17. The robust QoQ growth was driven partly by the manufacturing sector, which expanded by a strong 23.5% QoQsaar, robust expansions in the electronics, biomedical manufacturing and precision engineering clusters. Retail sales for August came in at 3.5% YoY, higher than expected. Excluding autos, retail sales were up 3.7%, just beating consensus. Motor vehicle sales have been softer this year, largely due to base effect as certificate of entitlement (COE) supply peaks out. Luxury item sales contracted in August, although department store sales were better at 4.4% YoY. Sales at petrol service stations (higher fuel prices) and medical goods remained strong.

OUTLOOK

Prospects for global growth in the near term remain sound, with the global recovery strengthening across both advanced economies and emerging markets (EMs). The International Monetary Fund (IMF) revised up slightly its global growth forecasts for the second time to 3.6% for 2017 and changed its view of the balance of risks for growth to “broadly balanced” in the near term, from “slightly tilted to the downside” back in April. Such a growth backdrop would imply a low chance for further easing amongst developed economy central banks due to a fear of adverse side effects, financial stability considerations, a lack of need for further stimulus and concerns about upside risks to inflation in the future. The IMF highlighted the risk of rising household debt globally as a key risk to financial stability. The key finding from the IMF’s Global Financial Stability Report October 2017, published ahead of its annual meeting, is that there is a trade-off between a short-term boost to growth from higher household debt and its medium-term costs to macroeconomic and financial stability, which may result in lower growth, consumption and employment. The median household debt-to-GDP ratio in emerging economies has increased to 21% in 2016 from 15% in 2008, while in developed economies it is 63% from 52% in 2008. Mortgage debt accounts for half of household debt in developed economies; in emerging economies it captures about one-third or less. In its report, the IMF also highlighted that countries with flexible exchange rates and better financial regulation and supervision are better placed to mitigate the risks. Asia’s strength remains its heterogeneous nature with a diversity of both high-income and emerging economies, with technological and developmental stage diversity and, on the whole, positive demographics, with declining working-age populations in certain economies offset by large and emerging young populations in others. As a share of global trade, Asia now stands at 25% or more than twice that of the US at 11%. Interestingly, while 15% of Asian exports go to the US, 21% of US exports go to Asia. More importantly, intra-region trade is now the predominant driver of exports, with intra-region trade at around 50% (an all-time high), as the region becomes more interdependent. Asia remains in a relative sweet spot, with diversified drivers of growth anchored by China, India and Southeast Asia. It is a region that should continue to dominate global growth, tending to benefit from the upside while being insulated against a significant downside. India, Indonesia and the Philippines remain well poised within the easy-growth category on the back of large, young and lower-income populations.

President Xi Jinping delivered his three-and-a-half-hour speech, from his 13-chapter comprehensive Party Work Report at the recently concluded China Communist Party Congress. The macro policy priorities and development strategies discussed in the report were largely in line with expectations. Going ahead, the focus should be on supply-side structural reforms, pushing for upgrades in quality and efficiency of growth, with higher total factory productivity growth. Governor Zhou Xiaochuan made a reform appeal in a recent interview, as he defined a “troika” of three drivers of China’s opening up: trade and investment opening, exchange rate reform and relaxation of capital control. He said China should continue to open up its economy, despite the difficulties and challenges. At the G50 Finance Ministers and Central Bank Governors’ Meeting on 12-13 October, highlighted that economic growth in China has been strengthening, as indicated by recent data. GDP grew by 6.9% in the first half of the year, and the momentum is expected to continue in the second half. Imports and exports grew strongly, with the current account surplus expected to shrink further. Fiscal revenues continued to grow, and prices remained stable. The governor warned that Chinese companies have taken on too much debt, and argued for less financial leverage as well as fiscal reforms to constrain local government borrowing. Macroeconomic indicators, though, continue to be strong, with real GDP growth on track to hit 6.9% for the full year and equity markets pulling ahead with strong domestic confidence in both the political dynamism in place and the structural economic trajectory.

Singapore continues on its path of restructuring in view of the shifting competitive landscape and domestic demographic challenges. There remains an urgent need to position the economy as well as the labour force higher up the value chain given the constraints of labour implied by tighter immigration policy. The recent report by the government’s Committee on the Future Economy concluded that growth is likely to average 2%-3% per year over the next decade, down from a previous expectation of 3%-5%. With little political room to maneuver in terms of immigration, growth will have to come from productivity, which remains dismal at 0.6% per year for the past decade. The government has downshifted its productivity growth forecast to 1%-2% over the next decade, instead of the previous aim of 2%-3%. Public sector infrastructure projects will be brought forward to start in FY2017 and FY2018 to help mitigate the slowdown in private-sector construction.

Medium growth remains moderate, driven by stabilsation in external demand. Growth continues to be broad-based, supported by manufacturing, services and construction sector demand. The service sector remains a key pillar supporting employment, at 73% of total employment, picking up the decline in the older manufacturing sector. Singapore continues to be anchored by its fundamental strength, with an estimate of sovereign foreign net assets at around 90% of GDP as of year-end 2016, according to Fitch. With its balanced fiscal policy mandate and its high current account surplus—projected at 19% of GDP for 2016, or an average of 18% for the past five years—structural underpinning remains firm. Household debt remains constrained by high mortgage levels—at 75.3% as of year-end 2016, up from 73.8% at year-end 2015—with mortgages at 56.8% of GDP. This and a more-hawkish US Federal Reserve monetary policy stance provide little room for monetary policy easing by the Monetary Authority of Singapore (MAS). The burden of growth support will continue to be on the fiscal and administrative side of the house. We expect the MAS to hold its neutral SGD nominal effective exchange rate bands amidst a modestly improved outlook for global growth and inflation.

We are cautious of the rapid expansion of the Singapore credit market and the relatively low level of risk premium the market is pricing into bonds issued by new entrants. We remain highly selective and will place a strong emphasis on sound credit fundamentals as a key premise. We believe our long-term approach will allow us to ride out any volatility in the next few months and we will seek to minimize our risk exposure. In terms of strategy, we continue to adopt a tactical approach to positioning across the SGS curve in view of global growth headwinds and monetary policy divergence among central banks. We will seek to bolster carry-through exposure in high-quality corporate and bank credits.

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* As of 31 October 2017.