SINGAPORE FIXED INCOME REVIEW

MARKET REVIEW

In January, the Singapore government bond market saw losses of 0.57%, bringing 3-month returns to 2.52%. The 3-month SIBOR rate was unchanged at 1.89%. The Singapore curve bear-steepened with yields higher by up to 16 basis points (bps) in the long end of the curve while yields in the front end were up to 17 bps lower. Singapore government securities (SGS) underperformed US Treasuries (USTs) on the whole during the month. USTs saw yields lower by up to 7 bps in the belly while front-end yields were lower by up to 4 bps.

Industrial production (IP) growth slowed by more than expected in December, tumbling to 2.7% year-over-year (YoY), from 7.6% in November. On a sequential basis, IP growth fell by 5.6% month-over-month (MoM) on a seasonally adjusted (sa) basis, more than reversing the 3.1% expansion in November. The disappointment mainly stemmed from the electronics segment, where output fell 6.8% YoY in December, from 11.1% in November, driven by a decline in semiconductor production. This offset surprisingly strong biomedicals output growth of 29.9% YoY, up from 17.2% in November, in contrast to plummeting pharmaceutical exports in December. Consumer Price Index (CPI) inflation edged up to 0.5% YoY in December from 0.3% in November. Private road transport prices fell 3.7% YoY, following a decline of 3.6% in November, as the easing of the price decline in certificate of entitlement (COE) quota premiums for cars was offset by a smaller increase in retail petrol prices. Accommodation costs fell 1.9% YoY, following a 2.1% decline in November. The Monetary Authority of Singapore's (MAS) measure of core inflation, which excludes private road transport and accommodation, picked up to 1.9% YoY in December, from 1.7% in November. The increase reflected in part higher services costs, driven by higher holiday expenses and airfares.

OUTLOOK

The start of the year was marked by weakness in leading indicators across the globe, specifically in developed markets. The Institute for Supply Management Manufacturing Production Index slid from 59.3 to 54.1 in December. A drop of this magnitude has only been seen four times since 1980, three of which took place when the economy was in recession. The latest International Monetary Fund projections show that the US economy is likely to slow by 0.3 percentage points (pp) in 2019, while emerging market (EM) economies are only likely to slow by 0.1 pp (with most of the slowdown contributed by China). At the margin, this should support undervalued EM currencies versus the relatively overvalued US dollar. The partial US government shutdown saw a reprieve though clouds continue to lurk on the horizon for a political stalemate. US President Donald Trump continues to insist on US$5.6 billion of funding for a barrier along the US-Mexico border. The Democrats had initially signaled a willingness to approve US$1.3 billion for border security but this was rejected by Trump. Vice President Mike Pence had also approached the Democrats with a compromise offer of US$2.5 billion but Trump would not accept this deal either.

The Federal Open Market Committee (FOMC) left the fed funds rate target range unchanged, as universally expected. However, the changes to the post-meeting statement were dovish, as the policy outlook section removed any explicit mention of "further gradual increases" in the funds rate, emphasizing the FOMC's desire to be "patient" in the face of "muted" inflation. In a separate statement, the Committee stated that it would be "prepared to adjust" balance sheet normalization "in light of economic and financial developments." The FOMC slightly revised its earlier guidance regarding the conditions under which it could adjust its balance sheet normalization plan, saying it would "be prepared" to alter the size and composition of its balance sheet "if future economic conditions were to warrant a more accommodative policy than can be achieved solely by reducing the federal funds rate," compared with its earlier guidance that it could resume reinvestment if "a material deterioration in the economic outlook were to warrant a sizable reduction in the Committee's target for the federal funds rate."

The People's Bank of China (PBoC) will cut the reserve requirement ratio (RRR) by 50 bps on Jan 15 and 50 bps on Jan 25. The bank's required reserves will drop by RMB1.5 trillion. This is following after it created the Targeted Medium-Term Lending Facility (TMLF) in December to provide commercial banks with additional funds, at a lower interest rate, to increase lending to small private companies. Earlier in the month, it relaxed the criteria for its differentiated RRR system by defining loans to small and micro-sized companies as those less than RMB10 million, larger than the previous definition of RMB5 million or below. The PBoC indicates that after replacing expiring MLF in 1Q19 and including the liquidity released by the two targeted measures, the net increase in liquidity is RMB800 billion. The central bank emphasizes that the RRR cut is a way to mitigate seasonal spikes in liquidity demand ahead of the Chinese New Year (falling on February 5 this year), and that monetary policy remains prudent. Beijing's latest policy moves reflect its increasing concerns about looming growth headwinds and its increased willingness to step up policy easing and stimulus. Headline CPI came in weaker than expected, rising 1.9% YoY in December, easing from 2.2% in November. For the full year, CPI rose 2.1% YoY in 2018, up from 1.6% in 2017. With vegetables prices higher and pork prices lower, overall food inflation YoY was kept stable in December from the previous month. Producer Price Index (PPI) inflation slowed to 0.9% YoY from 2.7% in November. For the full year, PPI rose 3.5% YoY, moderating from 6.3% in 2017. With vegetable prices higher and pork prices lower, YoY overall food inflation was kept stable in December from the previous month.

Labour markets in China remain a key indicator of both downside risks and significant policy actions by Chinese officials. Various media reports suggest there have been job cuts and hiring freezes in internet, fintech and healthcare sectors recently, alongside earlier-than-expected departures of migrant workers to hometowns due to production suspensions. Meanwhile, the pace of labor force contraction at industrial enterprises has been accelerating after the total number of employment peaked in 2014. Structural changes, such as over-capacity reduction in upstream sectors, moving up along the supply chain from labor-intensive industries to capital/tech-intensive industries, and automation replacement amid technology innovation, are important factors behind such a decline. The booming new-economy sectors helped absorb the redundant low-skilled labors from the manufacturing sectors with services becoming the largest employer sector in China since 2011 (45% of total employment in 2017). Owing to the rapid development of e-Commerce, "express delivery" employed about three million people in 2018 (versus merely 0.2 million people in 2007). E-platforms covering transportation, lodging, food delivery and other household services in 2017 employed 7.2 million people, up from 5.9 million people in 2016. The net increase of 1.3 million people employed accounted for 9.7% of the new urban employment in 2017. That said, further weakness in labour markets and downward pressure on wages are rising and policymakers will take pre-emptive measures to manage expectations of job stability alongside stimulus measures to cushion negative growth shocks. Demand in the urban labor market continued to outstrip supply, according to data collected by local employment service agencies in around 100 major cities. The overall demand-to-supply ratio was on an upward track since 1H16, reaching a record high of 1.36 in September 2018.

South Asia stands in better cyclical shape given its relatively low exposure to the tech/semiconductor downcycle and the broader headwinds from China. Asia is expected to continue to lead EM growth at 4.4% for 2019 (down from 4.8% in 2018) led by China (6.1%) and India (7.2%), bringing regional growth to 5.6%. This even as developed markets will see growth decline from 2.3% to 2.1%. Tightening in financial conditions, however, affects individual economies unevenly; growth in Indonesia, India and the Philippines is arguably least sensitive to changes in financial conditions. Debt service ratios for the non-financial private sector in Indonesia (4.8%), India (7.0%) and Thailand (9.8%) are far lower than those elsewhere, reflecting lower overall debt. A given rise in funding costs, therefore, exerts less of a drag on overall demand. Lower oil prices could help counteract the recent tightening in financial conditions across the region. Inflation pressures, already remarkably subdued in most of Asia, are likely to ease further. With lower price pressures, central banks have less need to further hike interest rates.

Singapore's growth outlook is clouded by slowing global growth and persistent structural shifts in trade patterns. Singapore is in a favorable position to mitigate against the risks, and capitalize on the opportunities from the corresponding trade diversion, as well as the reshuffling of supply chains by global companies in the medium term. The longer-term growth outlook remains moderate as demographic headwinds and a continued low tolerance for a rise in immigration point to a structural slowdown of traditional human capital employment-driven growth. The service sector remains a key pillar supporting employment (at 80% of total employment) picking up the decline in the manufacturing sector.

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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EnTrustPermal
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* As of 31 December 2018.