Focus on short-term fixed income

2Q 2021 in review: APAC central banks hold steady – but start getting ready

June 30, 2021

IN BRIEF

Australia

- Economic data remained strong during the second quarter, as robust exports and successful containment of the Covid-19 pandemic boosted business and consumer optimism.
- Proactive fiscal policies and low interest rates fueled a rebound in the property and services sectors, helping unemployment rapidly decline to pre-Covid levels.
- With inflation and wage growth still subdued, the Reserve Bank of Australia (RBA) pledged to keep base rates unchanged until at least 2024, pushing short-tenor bank bill swap (BBSW) yields lower and steepening the yield curve.

China

- Economic growth moderated in the second quarter as the post-pandemic export surge faded and tighter fiscal restrictions dampened domestic demand and consumer confidence.
- Several localized Covid-19 outbreaks contributed to the weaker consumer data but helped accelerate China's vaccine rollout.
- The government noted the uneven recovery, and with inflation in check, the central bank committed to a more neutral monetary policy stance, supporting a modest decline in interest rates and further flattening of the yield curve.

Hong **Kong**

- Hong Kong's economy benefited during the second quarter from robust Chinese and international growth and continued government support, which encouraged a recovery in business confidence and local demand.
- Easing of social distancing and lockdown restrictions during the period triggered a rebound in the services sector and helped reduce unemployment.
- The Federal Reserve's (Fed's) commitment to keep base rates low, combined with excess local liquidity, continued to drag HIBOR yields lower throughout the quarter.

Singapore

- Singapore's economy continued to recover in the second quarter, supported by improving manufacturing, services and construction activity, although consumer demand was negatively impacted by a Covid-19 resurgence and partial lockdown.
- At its semi-annual meeting in mid-April, the Monetary Authority of Singapore (MAS) left key parameters of its monetary policy unchanged but revised up growth and inflation targets.
- Fading reflation concerns and the Fed's commitment to keep base rates low helped drive Singapore swap offer rate (SOR) yields lower and flatten the curve during the quarter.

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AUSTRALIA - MIXED MESSAGES FROM THE RBA

Market review

First quarter gross domestic product (GDP) increased by 1.8% quarter over quarter (q/q), supported by robust household consumption and private investments. This was the third consecutive positive reading, although annual GDP growth of 1.1% year over year (y/y) reflected fading low-base effects from Covid-19.

During the second quarter, export demand remained solid while strong commodity prices boosted the current account surplus, industrial production and business confidence. Low interest rates and strong demand supported retail sales and the property market, where house prices hit multi-year highs. Despite a slow vaccine rollout, strict quarantine measures throughout the period helped successfully contain Covid-19, while temporary, regional lockdowns caused limited economic disruption. This supported further reopening of the services sector, which boosted consumer confidence and employment. In fact, the unemployment rate dropped sharply to a pre-pandemic low of 5.1%, while job creation over the past 12 months completely offset the losses due to Covid-19.

Despite the strong economic data, inflation of 1.1% y/y remained below the RBA's target range and wage growth of 1.5% y/y was also muted. This encouraged the central bank to leave base rates and its yield curve control target unchanged throughout the quarter, while the RBA Governor reaffirmed the bank's commitment to low rates and ample liquidity. Short-term bank bill swap (BBSW) yields declined during the quarter while the yield curve flattened. Meanwhile the AUD weakened towards six-month lows on broad USD strength.

Portfolio commentary

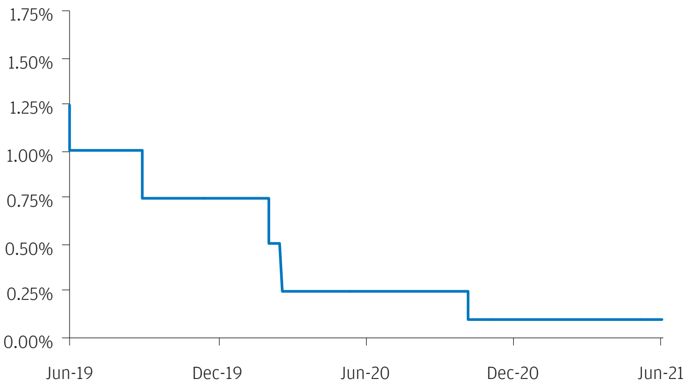
The AUD Liquidity Strategy maintained a neutral duration position during the quarter, adding intermediate-tenor fixed-rate securities and longer-tenor floating-rate notes to support the yield. The portfolio remained well diversified, with key holdings in time deposits, repurchase agreements, commercial paper, certificates of deposit and floating-rate notes, and had good liquidity from a high percentage in overnight and sub-one-week maturities. Average credit quality was AA-.

Outlook

During the second quarter, the pace of economic recovery and job creation surprised to the upside, beating the RBA's forecasts as Australia extended its post-Covid normalization. International and domestic demand remained strong, boosting business and consumer confidence in the sustainability of the post Covid-19 recovery.

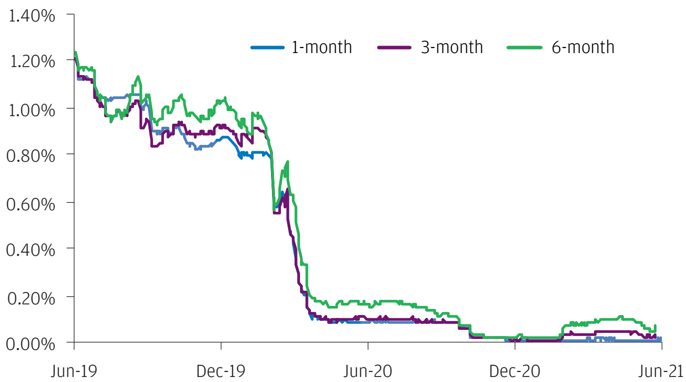
The RBA acknowledged the strength of the rebound, but it emphasized that Australia was still in the early stages of the recovery and further lockdown disruption remains a risk due to the sluggish vaccine rollout. Combined with low inflation and wage growth, this suggests the central bank will keep interest rates at record lows for the foreseeable future. Nevertheless, the RBA also confirmed it would consider altering its yield curve control forward guidance and quantitative easing program at its July meeting; this could trigger further curve steepening, as investors anticipate an eventual end to extraordinary monetary policy support.

RBA OVERNIGHT CASH RATE (OCR)



Source: Bloomberg; data as at 30 June, 2021.

BBSW YIELDS



Source: Bloomberg; data as at 30 June, 2021.

KEY ECONOMIC DATA

AUSTRALIA	May-21	Apr-21	Mar-21	May-20
Gross domestic product (seasonally adjusted % y/y)	-	-	1.1%	-
Unemployment rate (%)	5.1%	5.5%	5.7%	7.0%
Employment change (thousands)	115.2	(30.7)	69.3	(264.8)
Exports (% y/y)	-	9.3%	-5.3%	-17.7%
Headline inflation (Consumer Price Index, % y/y)	-	-	1.1%	-
Core inflation (trimmed mean, %y/y)	-	-	1.1%	-
Retail sales (%y/y)	-	25.0%	2.2%	5.8%
Building approvals (%y/y)	-	39.2%	50.0%	-9.6%

Source: Bloomberg data as of 30 June 2021.

The portfolio is actively managed; holdings, sector weights, allocations and leverage, as applicable are subject to change without notice. Diversification does not guarantee investment returns and does not eliminate the risk of loss.

CHINA – ECONOMIC NORMALIZATION TRIGGERS REASSURING POLICY SIGNALS

Market review

Annual GDP growth jumped to a record high of 18.3% y/y in the first quarter thanks to low-base effects of the pandemic in early 2020. While first quarter GDP growth was positive for the fourth consecutive reading, it slowed to 0.6% q/q as robust exports failed to offset weaker domestic demand during temporary Covid-19 restrictions over the Chinese New Year holiday. Exports moderated in the second quarter while slower credit growth weighted on fixed asset investments and a Covid-19 resurgence in southern China suppressed consumer sentiment. Inflation remained relatively muted throughout the second quarter as food prices, which represent a key component, actually declined.

The government confirmed that the recovery remained uneven and pledged to maintain support for fragile sectors; it also focused on implementing structural reforms and accelerated China's vaccine rollout. Meanwhile, the People's Bank of China (PBoC) maintained its "prudent but stable" monetary policy, leaving its Medium-Term Lending Facility and Loan Prime Rates unchanged for the fourteenth month, while ensuring adequate liquidity via open market operations. However, as part of an effort to calm the pace of renminbi appreciation, the central bank hiked its reserve requirement ratio for foreign currency by 200 bps to 7%.

Investor expectations for interest rates tightening faded and SHIBOR declined modestly during the quarter while the yield curve flattened. Repo rates were also steady, trading in a relatively tight range throughout the period. Finally, the renminbi eased back from a three-year high, but remained one of the best-performing currencies relative to the USD during the quarter.

Portfolio commentary

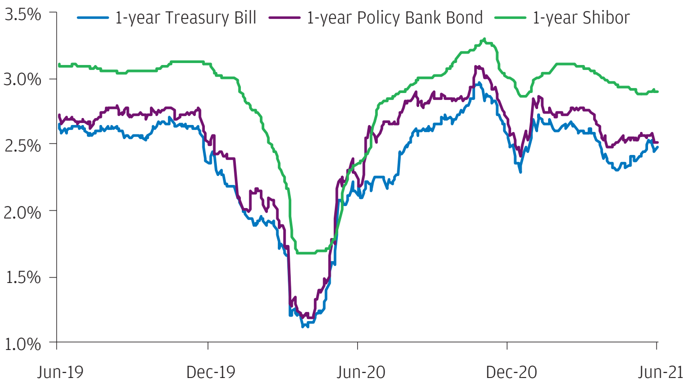
The RMB Liquidity Strategy maintained a long duration policy during the quarter, locking in higher reinvestment yields and benefitting from month-end spikes in reverse repurchase (repo) yields. The strategy remained well diversified, with key holdings in negotiated time deposits, Shanghai stock exchange repo, policy bank bonds, commercial paper and negotiated certificates of deposit. The portfolio had good liquidity with a high percentage of holdings in overnight and sub-one-week maturities.

Outlook

During the second quarter, Chinese economic data normalized as the volatile impact of the Covid-19 pandemic faded from the annual numbers. The economic boost from strong exports receded, while property tightening measures, lower money supply and partial lockdowns dampened domestic demand.

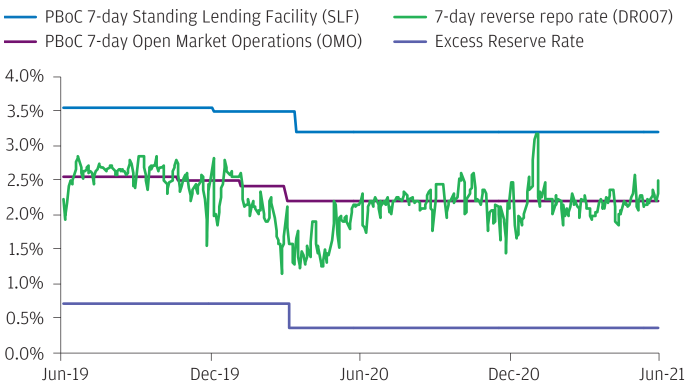
The government's renewed commitment to stability and pledge to continue structural reforms should help reduce systemic risks and boost longer term-demand. The accelerated vaccine rollout should also support consumption and consumer confidence as the risk of further lockdowns subsides. Finally, with domestic inflation remaining low, the PBoC is likely to maintain a more stable monetary policy stance, implying that interest rates will remain range-bound at current levels

MARKET INTEREST RATES (%)



Source: Bloomberg; data as at 30 June, 2021.

PBOC INTEREST RATE CORRIDOR (%)



Source: Bloomberg; data as at 30 June, 2021.

KEY ECONOMIC DATA

CHINA	May-21	Apr-21	Mar-21	May-20
Retail sales (% y/y)	12.4%	3.0%	34.2%	-2.8%
Fixed asset investment (% y/y)	15.4%	19.9%	25.6%	-6.3%
Industrial production (% y/y)	8.8%	9.8%	14.1%	4.4%
Consumer Price Index (y/y)	1.3%	0.9%	0.4%	2.4%
Foreign exchange reserves (USD billion)	3,222	3,198	3,170	3,102
Exports (% y/y)	27.9%	32.3%	30.6%	-3.5%

Source: Bloomberg data as of 30 June 2021.

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HONG KONG – EXCESS LOCAL LIQUIDITY CONTINUES TO WEIGH ON HIBOR RATES

Market review

First quarter GDP jumped 5.4% q/q, the third positive reading as stronger exports and higher government spending helped offset weaker private consumption. Annual GDP growth hit an 11-year high of 7.9% y/y, although the number was flattered by the low-base effects of the pandemic in early 2020.

Strict quarantine and testing measures helped successfully contain Covid-19 throughout the second quarter and allowed the government to ease social distancing and lockdown measure; authorities simultaneously broadened vaccine access to all adults. As a result, business and consumer confidence rebounded and a recovery in the service sector boosted employment – although unemployment of 6.0% remains well above pre-pandemic levels. Stronger demand from China and the US supported robust exports and lifted industrial production to a decade high of 2.6% y/y; increased domestic demand in return supported higher imports. Retail sales moderated overall, as lower supermarkets sales offset the recovery in the restaurant sector. Local inflation remained subdued as higher fuel prices were offset by lower food and housing costs.

The Hong Kong Monetary Authority's (HKMA) aggregate balance remained unchanged at a record high of HKD 457 billion during the quarter, with excess liquidity in the local financial system weighing on Hong Kong bond yields throughout the period. HIBOR yields edged lower while the curve flattened further. Concurrently, the Fed's commitment to keep base rates low underpinned flat USD LIBOR yields, leaving HIBOR-LIBOR spreads largely unchanged. The HKD remained on the strong side of convertibility, strengthening slightly compared to the previous quarter-end.

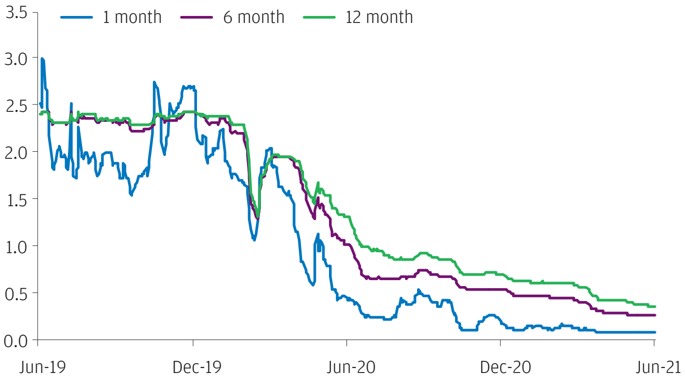
Portfolio commentary

The HKD Liquidity Strategy maintained a stable duration strategy during the quarter, as primary and secondary market supply remained constrained. With short-tenor yields declining further, the portfolio increased its holdings of time deposits and laddered maturities across the curve to support the yield. The strategy remains well diversified across time deposits, commercial paper and certificates of deposit. Weighted average maturity (WAM) ranged from 23 days to 40 days. The portfolio had good liquidity, with a high percentage of holdings in overnight and sub-one-week maturities. Average credit quality remained unchanged at A+.

Outlook

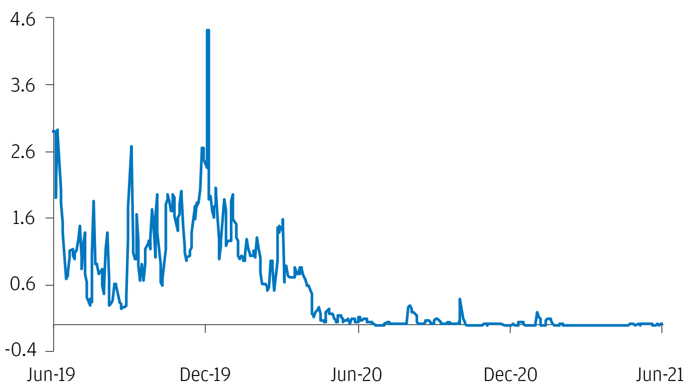
Hong Kong's economy displays positive signs of recovery as Chinese and global demand support exports, local Covid-19 cases have declined significantly and the vaccination rate continues to gain traction. Easing social distancing restrictions and reopening the service sector is further boosting domestic demand although consumer confidence remains subdued due to high unemployment and ongoing uncertainty. In particular, the slow vaccine participation rate across Asia and several regional Covid-19 outbreaks continue to stymie efforts to reopen the border and revitalize the important travel and tourism sectors. With the HKMA focused on maintaining adequate liquidity in the financial system, and the Fed committed to keeping rates low, HIBOR rates are expected to remain low for the foreseeable future.

HONG KONG HIBOR



Source: Bloomberg; data as at 30 June, 2021.

HKD OVERNIGHT INDEX AVERAGE (HONIA)



Source: Bloomberg; data as at 30 June, 2021.

KEY ECONOMIC DATA

HONG KONG	May-21	Apr-21	Mar-21	May-20
Gross domestic product (not seasonally adjusted, % y/y)	-	-	0.1	-
Exports (not seasonally adjusted, % y/y)	24.0%	24.4%	26.4%	-7.4%
Retail sales value (not seasonally adjusted, % y/y)	-	12.1%	20.2%	-32.9%
Consumer Price Index (not seasonally adjusted, % y/y)	1.0%	0.8%	0.6%	1.5%

Source: Bloomberg data as of 30 June 2021.

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SINGAPORE – ACCOMMODATIVE MONETARY POLICY – FOR HOW LONG?

Market Review

First quarter GDP increased by 3.1% q/q on broad based strength, marking the third consecutive positive reading and returning the annual rate to pre-Covid levels at 1.3% y/y, although the numbers do not yet fully reflect the rebound from 2020's second quarter nadir.

Economic growth was mixed in the second quarter; weaker developed market demand for goods negatively impacted Singapore's exports and industrial production, although the Purchasing Managers' Index (PMI) remained positive for the eleventh month in a row. While strict quarantine and testing measures helped contain Covid-19 throughout the second quarter, a resurgence in May triggered a partial lockdown and negatively affected consumer sentiment. Retail sales remain impacted by closed borders and limited tourists, although the annual pace surged to a record high due to base effects. Inflation trended upwards during the quarter, with headline CPI hitting an eight-year high of 2.3% y/y due to higher fuel prices and a low base; core CPI increased by a more modest 0.8% y/y.

At its semi-annual monetary policy meeting in April, the MAS kept all policy parameters of the Singapore dollar nominal effective exchange rate (S$NEER) policy band unchanged, leaving the appreciation slope at 0%. On a hawkish note, the central bank removed references to keeping policy accommodative "for some time" from its latest monetary policy statement. Singapore swap offer rate (SOR) yields declined during the quarter before retracing slightly towards quarter-end; the yield curve steepened. S$NEER has fluctuated slightly above the mid-point of the policy band, and appreciated modestly, reflecting in part the strengthening of the SGD against most reserve currencies as global risk sentiment improved.

Portfolio commentary

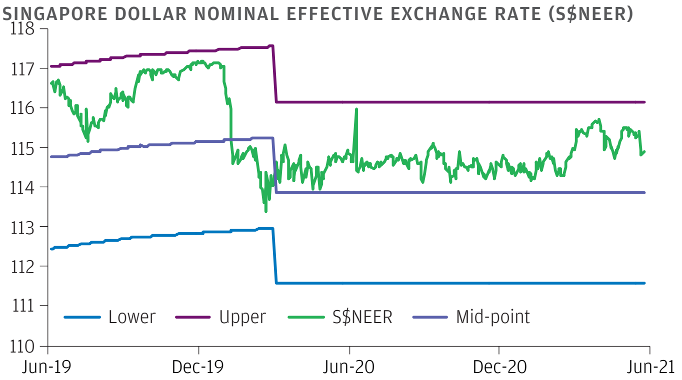
During the quarter, we lengthened the SGD Liquidity Strategy duration following the MAS meeting, locking in higher yields further out the curve. The portfolio remained well diversified with a mix of time deposits, repos, Treasury bills, floating rate MAS bills, and certificates of deposit. Liquidity is good, with a high percentage of fund holdings in overnight and sub-one-week maturities. Average credit quality was unchanged at AA.

Outlook

By the end of the second quarter, economic data from Singapore continued to show improvements, supported by solid activity in manufacturing, services and construction, although the pace of the recovery moderated as fiscal support and export demand faded. The recent Covid-19 outbreak and subsequent partial lockdown negatively affected consumer confidence and spending – but also boosted the vaccine rollout, which should reduce the risk of future Covid-19 disruptions.

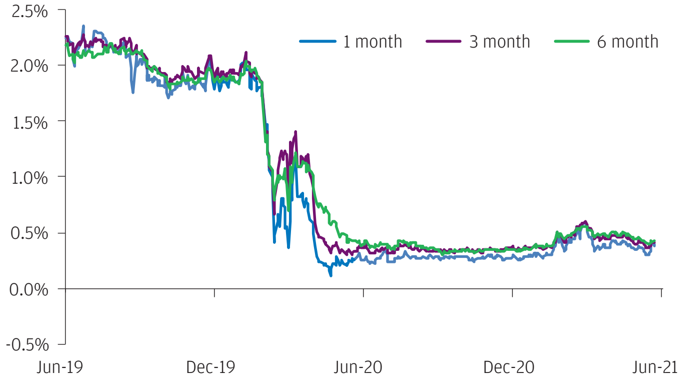
The MAS remains upbeat and has allowed the S$NEER to resume its upward climb towards the top of its trading range, supported by strong liquidity inflows. This suggests local interest rates could continue to grind gradually lower over the coming months, offsetting any concurrent increase in US LIBOR yields.

SINGAPORE DOLLAR NOMINAL EFFECTIVE EXCHANGE RATE (S$NEER)



Source: Bloomberg; data as at 30 June, 2021.

SGD SOR YIELDS



Source: Bloomberg; data as at 30 June, 2021.

KEY ECONOMIC DATA

SINGAPORE	May-21	Apr-21	Mar-21	May-20
Purchasing Managers' Index	50.7	50.9	50.8	46.8
Industrial production (% y/y)	30.0%	2.3%	9.2%	-7.9%
Non-oil domestic exports (% y/y)	8.8%	6.0%	11.9%	-4.6%
Core Consumer Price Index (% y/y)	0.8%	0.6%	0.5%	-0.2%

Source: Bloomberg data as of 30 June 2021.

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