OCBC Bank

Prepared by Treasury Research & Strategy

SGS REVIEW & STRATEGY

February 2017

Your monthly guide on trend and outlook for Singapore government securities

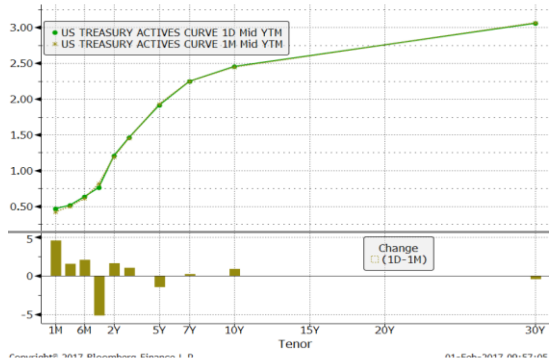
Fundamental Highlights

Markets shudder with each new Trump executive order.
With a new POTUS in the White House, the Chinese saying of "may you live in interesting times" seem applicable as market players unwind the Trump trade for the USD and UST bonds. Amidst the brightening economic indicators, the FOMC is also unlikely to rock the boat on 2 Jan but the nuancing of the FOMC statement will be of key interest. The futures market has currently priced in around a 70% probability of a first FOMC rate hike only at the June meeting, which explains why the 10-year UST bond yield has been capped at 2.6% since mid-Dec. Looking ahead, we can anticipate more currency volatility with Trump's concern for USD strength, especially given that a deal (aka 1985 Plaza Accord) is not in the pipeline anytime soon, but the bond market is likely to behave as long as the Fed stays its hand for now. As we near 2Q, especially given our call that the FOMC could hike 25bps in June, and the inevitable prospect of a discussion in 2H17 to taper the Fed's balance sheet, the recent compression of UST-SGS bond spreads is likely to be temporary at best and risks a repeat of the 2013 taper tantrum. There has been more green shoots of late, especially the cyclical rebound for the manufacturing PMIs. China's non-manufacturing PMI points to a soft landing, but policy support is likely to be restrained this year. Asia also remains on the potential receiving end of Trump's policies.

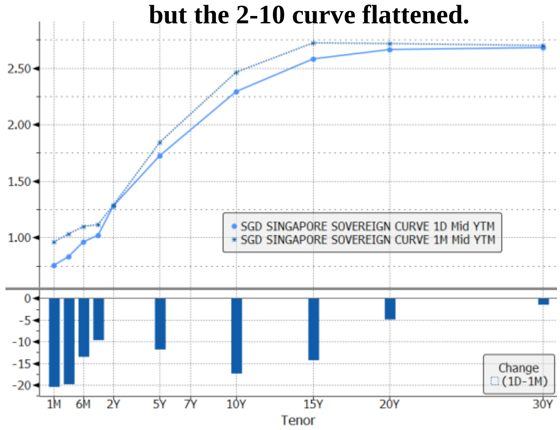
SGS Review and Outlook

Manufacturing lift but services momentum softens.
Bank loans growth accelerated from 1.1% yoy (+0.4% mom) in Nov to 2.9% yoy (+1.1% mom) in Dec16, the hihest since Feb15, and was lifted mainly by the rebound in business loans from -0.2% to +2.8% yoy (+1.7% mom), largely driven by the turnaround in manufacturing (from -6.2% to +0.9% yoy), building/construction (from -0.4% to +1.7% yoy), as well as sustained momentum in financial institutions (+16.9% yoy). Consumer loans also remain healthy at +3.1% yoy (+0.5% mom), up from +3.0% yoy in Nov, as housing/bridging loans accelerated to 4.0% yoy (previously 3.7% yoy) and car loans also improved. However, the leading indicators suggest the 1H17 outlook remains soft. The latest quarterly business expectations survey for manufacturers showed a net 2% upbeat about business conditions, down from +4% a quarter ago, albeit higher than the -22% a year ago. Electronics firms were most optimistic at +26%, whereas the transport engineering (-29%) and general manufacturing (-23%) clusters were most pessimistic. A net 14% of services firms also tip less favourable business conditions ahead, wrose than the -8% a quarter ago and the lowest since one year ago (-18%). The most pessimistic firms were in accommodation (-44%), transport & storage (-43%), real estate (-39%), F&B services (-30%) and retail trade (-22%). In tandem with the slower business activity, a net 4% of services firms would cut hiring. The recent 2-year SGS bond reopening fetched a cut-off yield of 1.36% with a 6bp tail and a bid-cover ratio of 2.5x. Next is the 10-year re-opening auction on 24 Feb. Look to receive on next bond market sell-off.

Trump trade faded in January, but UST bond yields ended little changed.



SGS bonds rallied in January but the 2-10 curve flattened.



The 3-month SOR has retraced with the USDSGD, but SIBOR remains relatively steady

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