OCBC Bank

Prepared by Treasury Research & Strategy

SGS REVIEW & STRATEGY

July 2017

Your monthly guide on trend and outlook for Singapore government securities

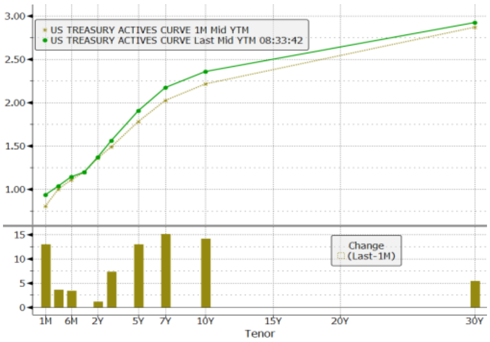
Fundamental Highlights

Global bond markets spooked by potential synchronised monetary policy accommodation withdrawal.
The 1H17 market environment was very benign as investors looked past geopolitical risks such as the UK's triggering of Article 50 for Brexit, Dutch and French elections. Global risk appetite was healthy and portfolio funds returned to Emerging Markets, including Asia. Towards end-June, the FOMC announced intentions to begin unwinding its balance sheet later this year, followed by similar hawkish rhetoric from other central banks like the ECB, BOE and BOC, which prompted a rethinking of global bond market valuations. This is likely to herald greater market volatility in 2H17, whether across currencies and fixed income asset classes, notwithstanding greater confidence that global growth prospects are improving. Given that foreign portfolio flows had returned to Emerging Markets including Asia in 1H17, the risk of reversal cannot be discounted. Upcoming potential risk events to watch for include German elections, ongoing North Korean tensions, China policy risks ahead of the 19th Party Congress, Malaysia's general elections, and a synchronized withdrawal of monetary policy accommodation by major central banks, amongst others. Fed chair Yellen's congressional testimony could shed some light on how to interpret the muted inflation, especially wages, and rate hike trajectory going forward.

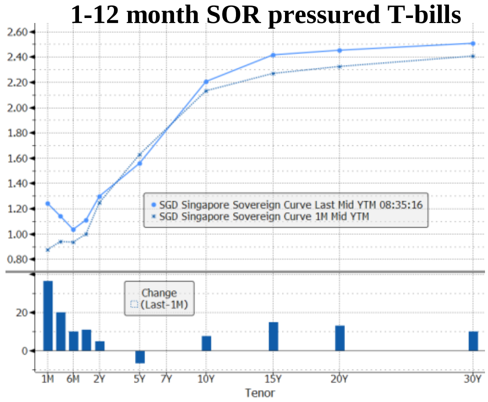
SGS Review and Outlook

Stable fundamentals, but choppy SOR in near-term.
MAS's annual report sounded more upbeat, noting that downside risks around baseline growth forecasts have declined, albeit tail risks arising from economic policy and geopolitical uncertainties persist. As such, 2017 growth is likely higher than 2016's 2%, even though growth has been somewhat uneven sectorally but this is to be expected in the initial stages of an external-led pickup and should broaden to the rest of the economy over the course of the year. Apart from the trade-related cluster that has been a major growth driver this year, the modern services cluster is also poised for higher growth in 2H17 whereas the domestic-oriented cluster may still remain weak in certain segments like real estate and retail. MAS also reiterated that the monetary policy stance remains appropriate for an extended period, predicated on domestic inflation and growth prospects keeping to their projected trajectories, and it is not time yet to ease the property cooling measures as demand remains firm amid a continued low interest rate environment and the investors' global search for yield continues. Meanwhile, bank loans growth remained healthy, growing for the 8th straight month, albeit at a slower pace of 6.8% yoy (+0.3% mom) in May, bringing Jan-May17 to +5.6% yoy. Our full-year 2017 bank loans growth remains at 7% yoy, with 2Q17 tipped at 6.0% yoy. The uptick in SOR had pressured the shorter-dated domestic T-bills. Expect further volatility with the ongoing repricing of global market valuations on the prospect of coordinated withdrawal of monetary policy accommodation. There is a re-opening of the 7-year SGS bond on 1 August.

UST curve steepening led by market concerns over FOMC balance sheet unwinding intentions



SGS yield curve followed suit, but jump in 1-12 month SOR pressured T-bills



The 3-month SOR-SIBOR compressed sharply.

Group Treasury

Treasury Research & Strategy
Selena Ling *(65) 6530 4887*
Lingssselena@ocbc.com.sg