Top-10 investment strategies for 2019: #5 Bullish 10Y China Government Bonds

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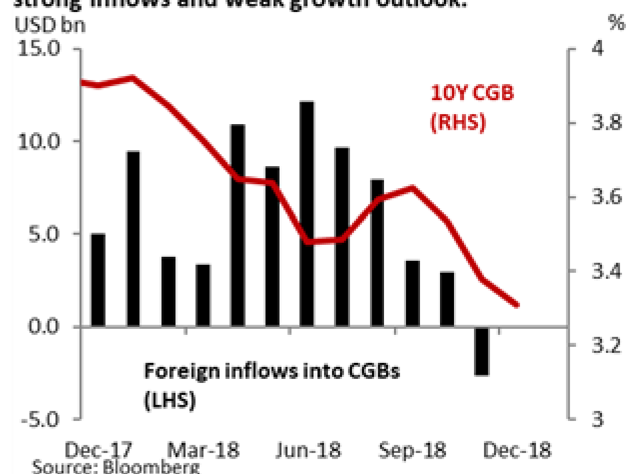
#1 Bet on more rate hikes by the Fed
#2 Looking for USDSGD to hit 1.40
#3 Long Indonesian equities
#4 Support for high grade credit, especially BBB

- *Slowing growth, increasing liquidity, further stimulus and easing should provide a favourable backdrop for CGBs.*
- *We see 10Y CGB yields falling towards 3%.*
- *Foreign inflows could stay robust in 2019, especially with the upcoming inclusion in Bloomberg Barclays Global Aggregate Index (expected April 2019).*

Bullish 10Y China Government Bonds

Our China Nowcast model continues to show a downward trend in China's growth trajectory. Growth is projected to fall below 6.5% in 4Q2018 and below 6.0% in 1Q2019. Our economists expect further fiscal stimulus and monetary easing from government and central bank to stabilise growth. More cuts to banks' reserve requirement ratios are likely. This combination of slowing growth, increasing liquidity, further stimulus and easing should provide for a favourable backdrop for China Government Bonds (CGB). In 2019, we expect CGB yields to stay low and see the 10Y tenor (3.31% at end-2018) falling towards 3% in the short term.

CGB yields decoupled from rising global rates amid strong inflows and weak growth outlook.



Source: Bloomberg

Foreign inflows into CGBs have been very strong in 2018 (USD70bn through November) while much of EM saw outflows. Global investors could continue to find CGBs attractive for their prospect of capital gains (from falling yields) and portfolio diversification (from low correlation to US Treasurys). Foreign demand should also get a big boost from CGBs' upcoming inclusion in the Bloomberg Barclays Global Aggregate Index (expected April 2019). With USD2.5tn of AUM tracking the index, CGBs could see inclusion inflows of USD22-27bn in 2019 (based on 5.5% weight to be phased-in over 20 months and roughly equal split between CGBs and policy banks bonds).

To be sure, onshore interest rates have fallen significantly and positive new narrative on a possible China-US trade deal could drive yields higher. However, we think that China is still in the midst of a cyclical slowdown and there is little fundamental reason why rates should head higher just yet.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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