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- *Appetite for Asian government bonds have surged*
- *In 2H19, investors' focus could shift from duration opportunities to carry/coupon.*
- *Asian bonds can juice portfolio returns and improve diversification.*
- *Low FX volatility is supportive of foreign demand*
- **Implications for investors** – *We expect inflows to stay robust in 2H; Asian bond rally to continue*

**Fed and ECB support boost foreign buying**

Current market expectations that both Fed and ECB would provide stimulus to cushion downside growth risks, and likely engineer a soft landing, are improving risk sentiments and boosting demand for Asian government bonds. In June, foreign buying of Asian bonds rose across the board, largely on the back of stronger

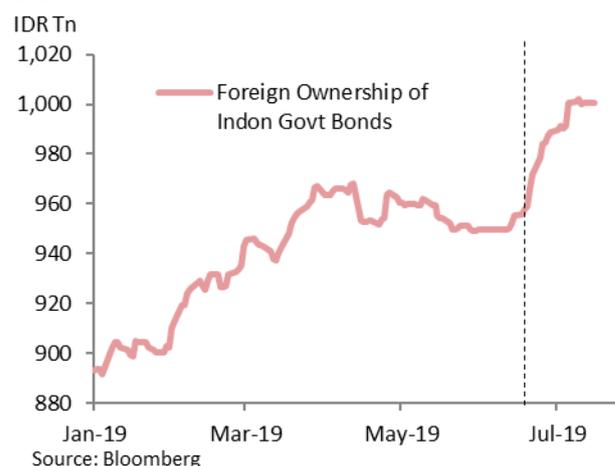
Fed and ECB communications of their dovish intentions. In 2H, we expect foreign inflows to stay robust. Fed and ECB support would be the main enabler but there are also other supporting factors at play.

**Asian Government Bonds - Foreign Inflows (USD mn)**

	2018	2019	
	Mth Avg	Jan-May Avg	June
China	6,257	1,153	4,014
South Korea	1,158	831	4,681
Indonesia	324	801	2,760
India	-230	-268	1,174
Philippines	100	-84	
Thailand	371	-335	1,742
Malaysia	-417	-285	1,606

Source: Central bank websites, Bloomberg

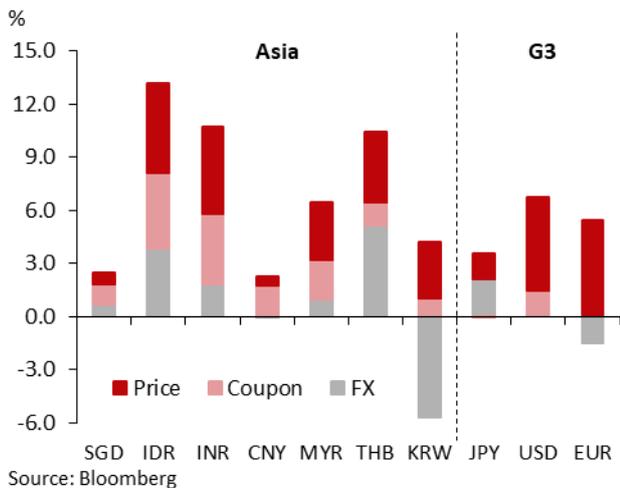
Indonesia government bonds is one market where daily data on foreign ownership is available (others are monthly). We see a clear surge in net foreign buying post the ECB Forum on Central Banking (17-19 June) and FOMC meeting (18-19 June).

**Net foreign buying of Indon Govt Bonds surged post ECB Forum and Fed FOMC.**

**Asian government bonds can juice portfolio returns and improve diversification**

Fixed income across the world has had a huge rally in 1H. When we look at the composition of returns in the G3 and Asia government bond space, price has overwhelmed coupon (this doesn't happen too often). Ultimately, it is a sign of how rich bonds have become. Now that considerable monetary stimulus and slower global growth has been priced in, there is much less room for yields to fall lower as compared to start of the year. The argument that negative German Bund yields are attractive because they can fall lower on ECB stimulus is not holding up as well now. Consequently, we think investors' focus in 2H will shift from duration opportunities to looking for attractive carry/coupon. This would be based off expectations that total returns would be primarily driven by carry/coupon (price returns to play a smaller role).

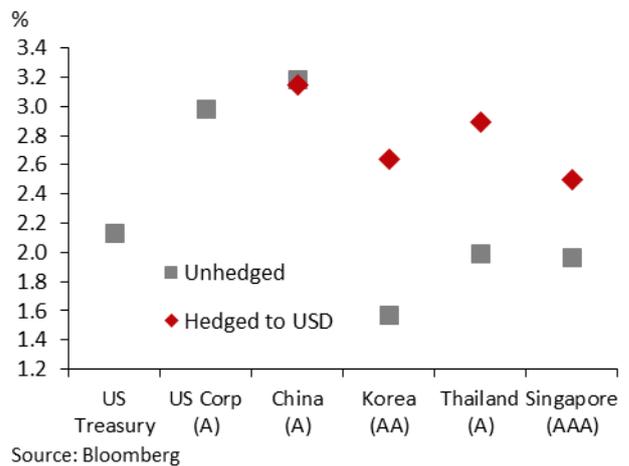
**YTD 10Y returns, price returns higher than coupon.**



With much of Developed Markets bonds sinking deeper into negative yields territory, this is where we think higher and positive-yielding Asian government bonds can come in. Ultimately, the assurance of Fed and ECB

support would give investors greater confidence that global growth wouldn't slow too sharply, and thus allow them to increase allocations to Asian bonds (and other Emerging Markets) to juice up portfolio returns. From a yield vs credit risk perspective, Asian bonds could also be a good alternative to US and Europe corporate bonds.

**Asia's low yielders offer attractive yield spreads over UST Treasury and comparable yields to US Credit.**

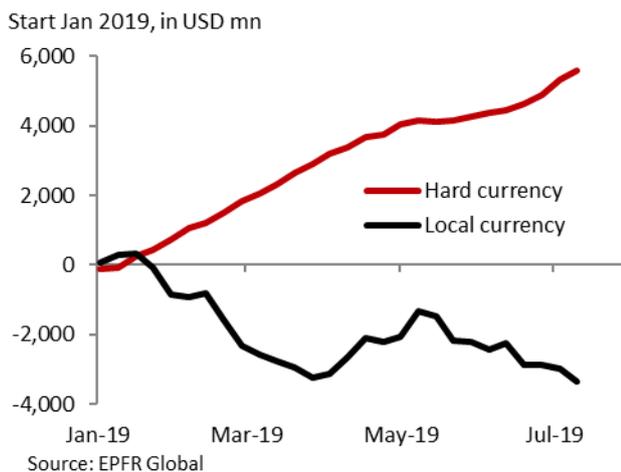


Furthermore, we think there is still decent risk premium embedded in Asian government bonds. Yield spreads against US Treasury can compress further if global growth stabilizes or Fed/ECB stimulus turns out to be larger than expected.

**FX trends are supportive**

In our view, FX trends this year could also be supportive of foreign demand for Asian government bonds. In 1H, investors were not bullish on Asia FX and thus, appetite for FX exposure was poor. Based on EPFR data, fund inflows were skewed towards hard currency bonds. In fact, local currency bonds saw net outflows of USD3346mn.

**Cumulative Fund Flows into Asia ex Japan Bonds**



DXY and ADXY are largely unchanged from start of the year. Notably, volatilities have fallen to quite low levels with markets seemingly pricing for currencies to trade in tight ranges.

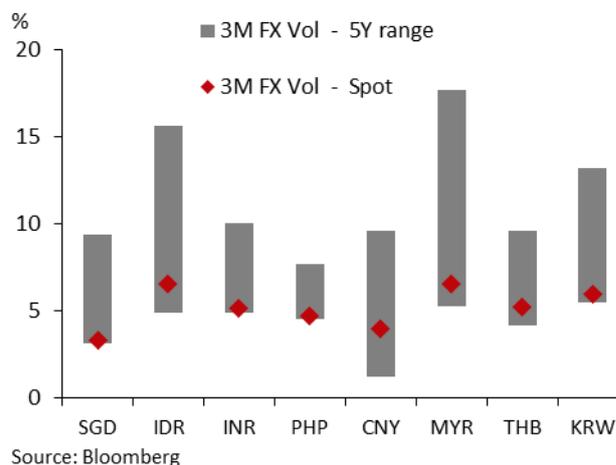
**Asia and G10 currencies are largely unchanged from start of the year.**



There is not a lot of differentiation in the FX world right now. Growth is slowing synchronously across the world and central banks have turned dovish together. For Asia FX, slower global growth and lingering trade uncertainties (tends to weaken Asia FX) are

being offset by Fed/ECB dovishness (tends to weaken USD and EUR). This should especially spurn interest in Asian high yielders (Indonesia, India, Philippines) where bond demand is generally quite dependent on currency volatility (higher yields meant to compensate for greater FX risks). If their currency volatilities stay low, clipping 5-7% coupons on their bonds is highly attractive.

**Asia FX vols are really low compared to their 5Y ranges.**



There are a couple of key risks to our view. If markets' confidence in core central banks' ability to prop up global growth falters, we are likely to see outflows from Asian government bonds and yield spreads against US Treasury widen. Escalations of US-China trade tensions could trigger CNY volatility and spillover onto other Asian currencies, dampening demand for Asian bonds. Considering that we could be quite late in the cycle, we think it is prudent to be more defensive in our selection, regardless of what the Fed or ECB does. Hence, we prefer low betas like China, South Korea and Thailand government bonds swapped to USD (see [link](#)).

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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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