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Investment Perspective

Economic uncertainties a boost for SGD bonds

Singapore's National Day celebrations this year will be tinged with concern about a potential recession. This suggests more stock market volatility to come, but can be positive for bonds.

3 Aug 2022

Soon approaching its 57th birthday, Singapore is like so many of us in middle age – experienced but still willing to learn, pragmatic but still open to new ideas, and cautious but still subject to risks.

Back in 2020, the country encountered one of its biggest-ever challenges. The Covid pandemic caused GDP to fall by 4.1 percent, the worst shrinkage since records began. But it also gave rise to one of the strongest recoveries, with GDP growth in 2021 spiking to 7.6 percent.

Now, as the country looks forward to its fully-reopened National Day celebrations, there are many who are wondering what the future holds. The Singapore government has already advised that GDP growth this year will likely come in within the lower half of its forecast 3 – 5 percent range. And as Prime Minister Lee Hsien Loong noted in his 2022 May Day Rally speech, Singapore's outlook is appearing more clouded, with a recession possible "within the next two years".

Singapore equities dampened by inflation and growth fears

Of greatest immediate concern is inflation. It was announced this week that June's core consumer price index (CPI) advanced by 4.4 percent compared to a year ago, a big jump from May's 3.6 percent and the fastest rise in over a decade. It reflects other record-breaking inflation trends around the world and will likely prompt the Monetary Authority of Singapore (MAS) to tighten further, having already hiked rates four times in the last nine months.

Given this, it is easy to miss the positive economic data that continues to emerge. For example, Singapore retail sales numbers for May jumped by 17.8 percent compared to a year ago, helped by re-opening activities and tourist arrivals. Non-oil domestic exports (NODX) rose a healthy 12,0 percent in May and 9.0 percent in June year-on-year.

Despite these positive indicators, the tension between higher inflation and slower economic growth is pulling markets in different directions. The Singapore stock market may have outperformed the US and Europe so far this year, but it is hard to see a sustained rise in the short term.

Safe haven investing increases demand for SGD bonds

On the other hand, Singapore bonds offer better prospects as investors seek protection from the threat of recession. The shift of funds from equities into bonds is helping to quell the downward pressure on bond prices. Meanwhile, Singapore's top AAA rating, one of only a few in the world, helps to maintain its safe haven status.

While short tenor bonds now appear more attractive following recent interest rate rises, investors are not being incentivised to take duration risk. In line with the US, the current yield differential between long and short tenor bonds are negligible. As such, corporate bond issuers and investors have been largely focused on maturities of no more than five years. These accounted for almost half of all corporate bond issuances in the first half of 2022 and the trend is unlikely to change in the second half, even for high grade issuers. But despite this short tenor and high quality, investors can achieve yields that are substantially higher than the average SGD fixed deposit rate.

Long term government bonds supported by ambitious programmes

In contrast, longer tenor government bonds (also known as Singapore Government Securities or SGS) continue to have some appeal, especially for insurers and other institutional investors. The MAS is scheduled to conduct new 10-year bond auctions in August. In addition, the passing of the Significant Infrastructure Government Loan Act (SINGA) has paved the way for a stream of new government bond issuances.

SINGA aims to borrow up to S$90 billion in the next 15 years to help finance the country's "nationally significant" infrastructure projects, including the Cross-Island Line and structures to combat rising sea levels. Its inaugural 30-year benchmark bond was over-bid by 1.58 times when it was issued in October 2021, with more issuances due later this year.

SINGA also paves the way for the government's sovereign green bonds, expected to be launched soon. Up of S$35 billion of green bonds will be issued to help finance Singapore's transition to a low-carbon economy under its Green Plan 2030. And this is only the start. The government hopes that this initiative will pump-prime the private sector to issue its own green bonds. With leading efforts from the government to encourage a more transparent and standardised green bond framework, the sustainable finance market in Singapore is set to evolve and deepen further.

Asia's sustainability agenda is helping drive the bond market

It is clear that Singapore's and other Asian countries' commitment to meet sustainability goals needs to go hand-in-hand with an effective and efficient sustainable finance market. The transition towards clean energy and social development targets costs money, and both the private and public sector will need to borrow this money via bond instruments.

This has already helped to propel the Singapore bond market, with outstanding SGS having already grown steadily to S$196.3 billion and outstanding SGD corporate debt to S$484 billion, as of end-2020. Going forward, Singapore's ecosystem of banks, investors and professional services makes it an ideal conduit for channelling international green capital into the region.

By building on its green finance and digitisation capabilities, Singapore stands an even better chance of becoming the centre for the region's green fund raising activities. This in turn provides investors with a single market from which to select from a broad range of sustainable companies and projects, and to identify those with the highest potential for positive returns.

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