



Hong Kong and Asian currency bonds in light of accelerating inflation

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HSBC 
Global Asset Management

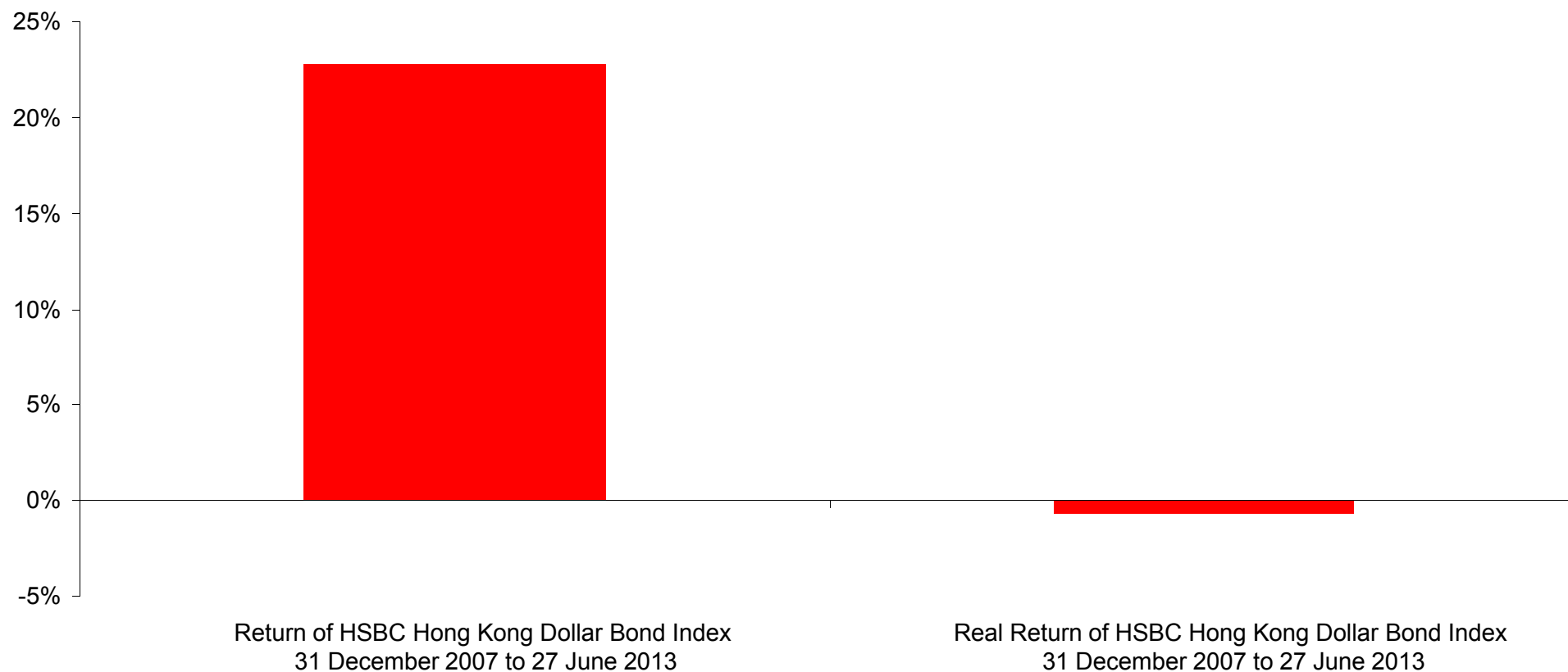
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What people have said about inflation.....

- ▶ “Inflation is taxation without legislation”
 - Milton Friedman
- ▶ “Inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man”
 - Ronald Reagan
- ▶ “The way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation”
 - Vladimir Ilyich Lenin
- ▶ “Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair”
 - Sam Ewing
- ▶ “In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value”
 - Alan Greenspan

Why is inflation important for bond investors?

- ▶ Inflation erodes the value of fixed coupons



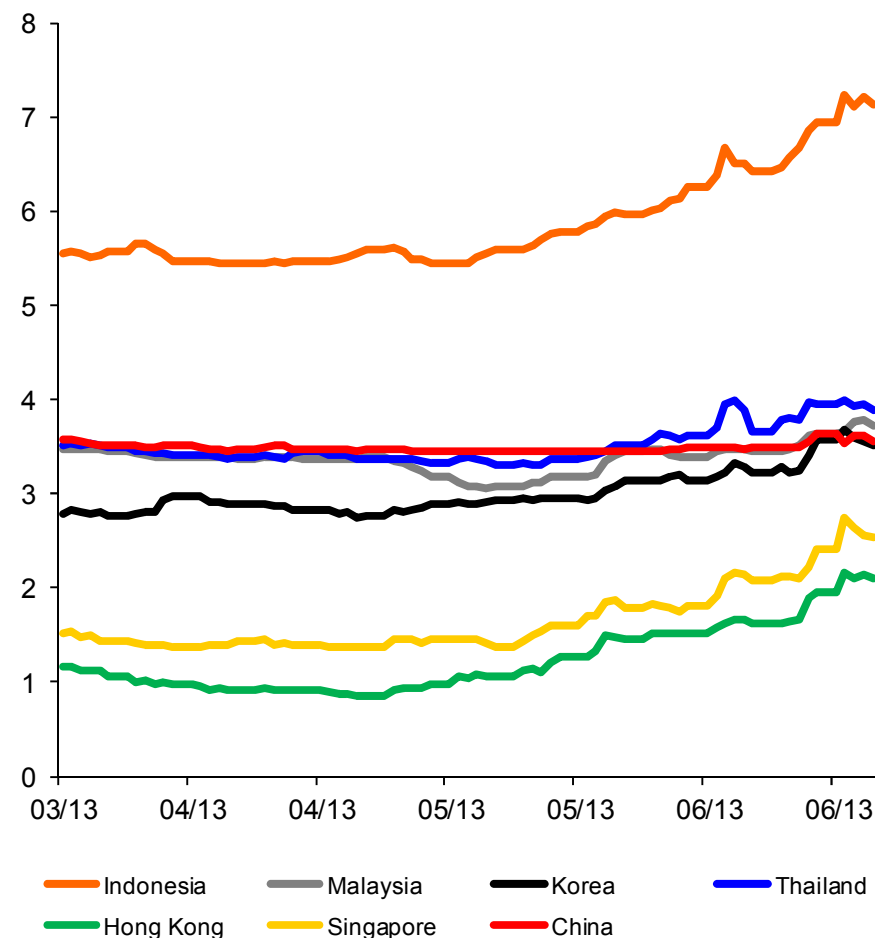
Source: HSBC Global Asset Management. Data as of 27 June 2013.

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What has happened to Asian yields in the light of recent bond market turmoil?

- ▶ Bond yields throughout the world and Asia have moved into a new trading range
- ▶ Hong Kong ten year yields have moved up from a low of 0.85% to over 2% in the space of 8 weeks
- ▶ Note that the relatively closed China bond market has remained pretty much unchanged- the same is broadly true of India

10 year government bond yields



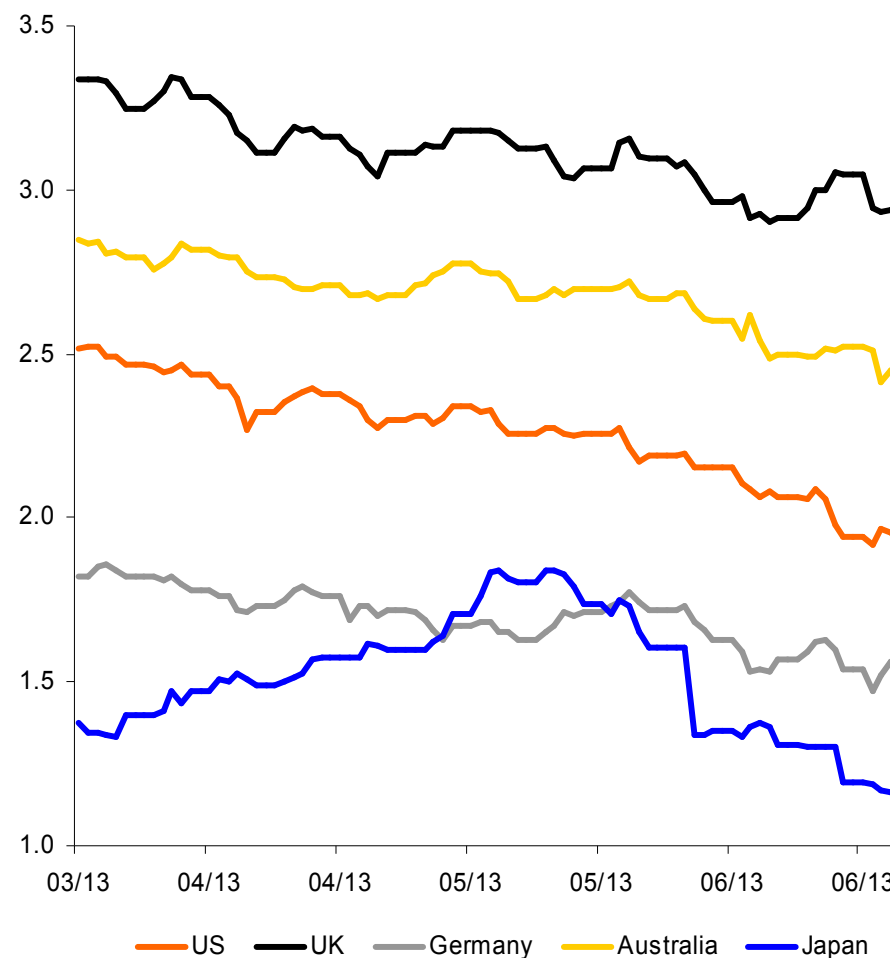
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This has NOT, however, been the result of increased inflation expectations globally

- ▶ In fact, quite the opposite- breakeven rates have fallen across the world
- ▶ A breakeven rate is the yield gap between conventional bond yields and inflation linked real yields

Breakeven inflation rates

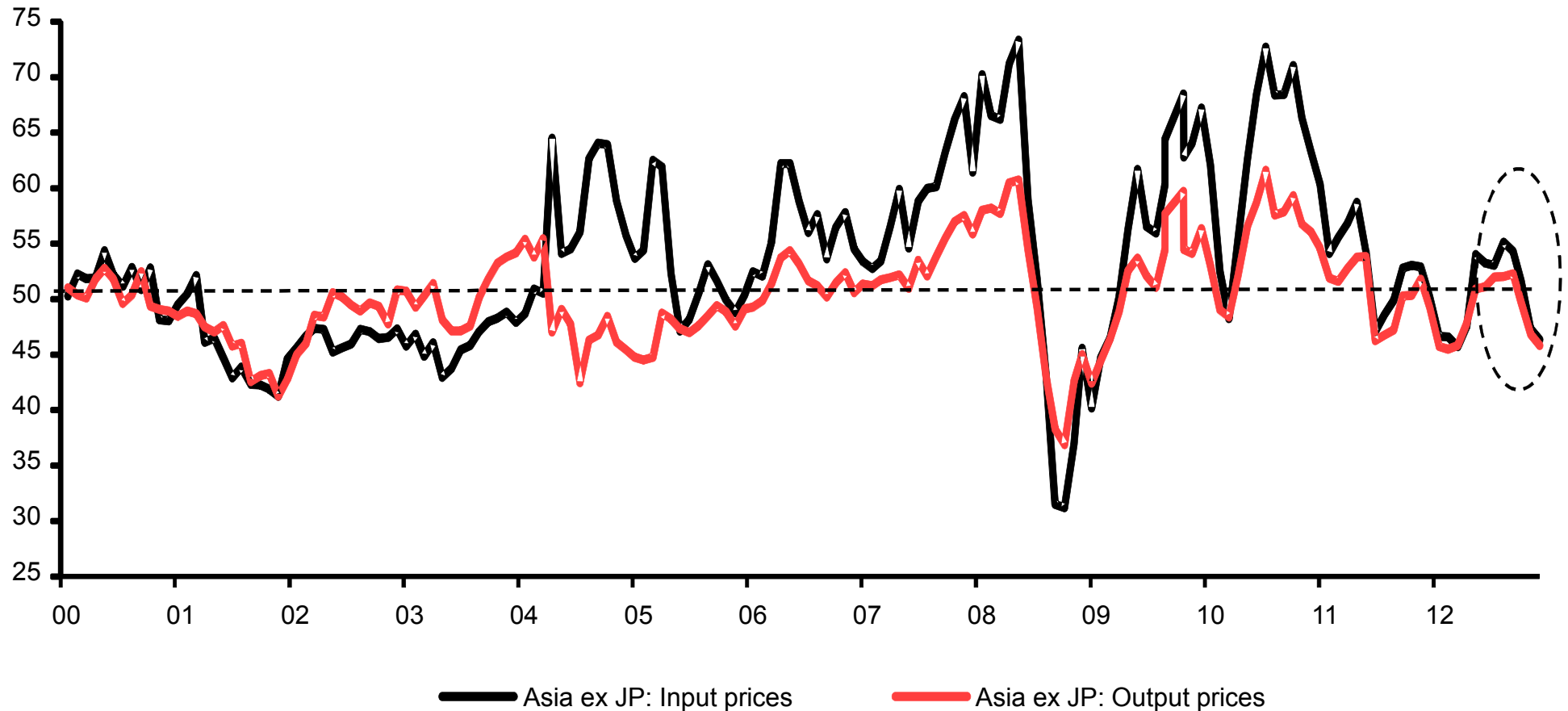


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Indeed, price pressures in Asia are subdued, and therefore real interest rates are rising

HSBC PMI: Asia



Source: Markit HSBC. Data as of June 2013.

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Generally, real bond yields in Asia compare favourably to those in developed countries, although Hong Kong is an exception

Asia	Headline inflation	10 year bond yield	Real yield
Korea	1.0%	3.46%	2.46%
China	2.1%	3.49%	1.39%
Malaysia	1.8%	3.70%	1.90%
Thailand	2.3%	3.84%	1.54%
Indonesia	5.5%	7.06%	1.56%
Philippines	2.6%	3.75%	1.15%
Hong Kong	3.9%	2.02%	-1.88%
Singapore	1.6%	2.46%	0.86%

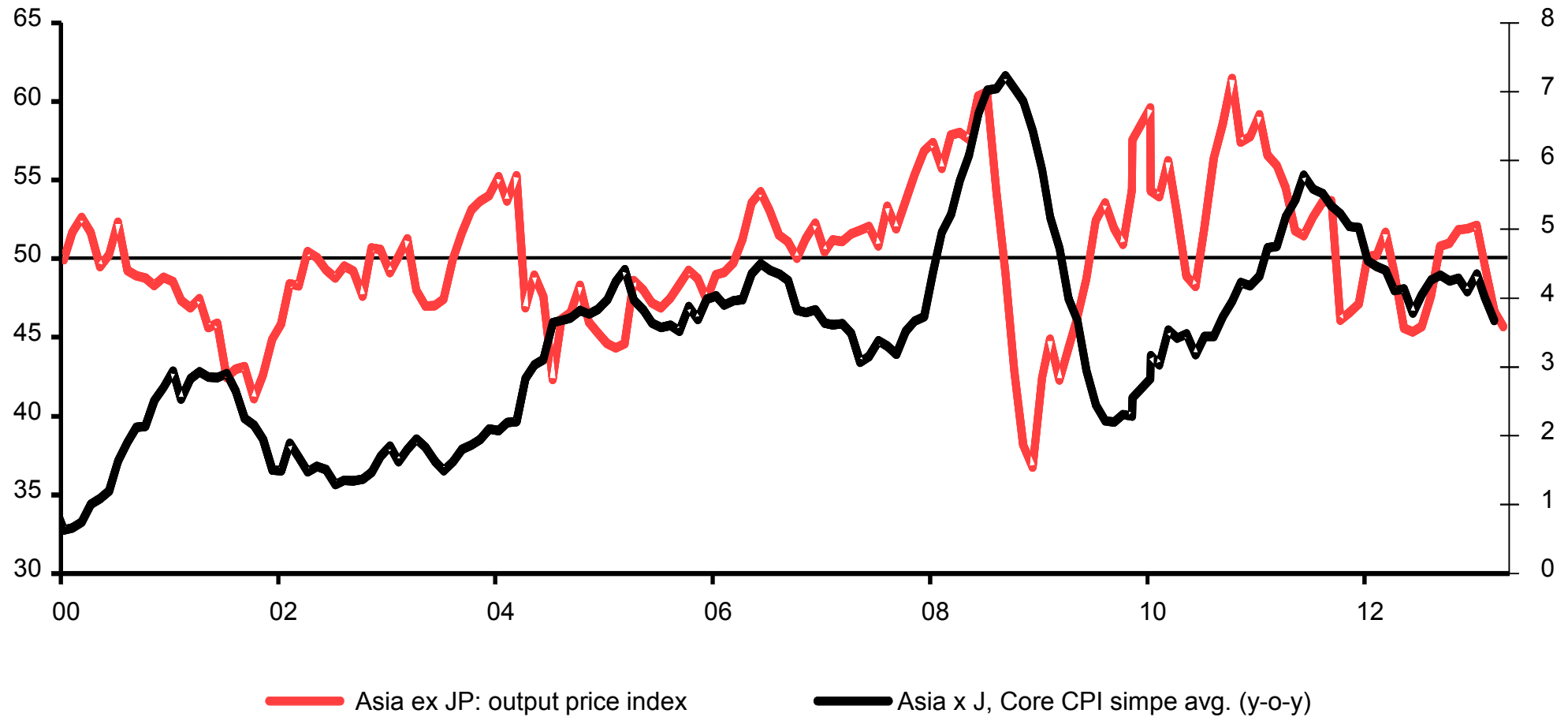
Major developed	Headline inflation	10 year bond yield	Real yield
US	1.4%	2.53%	1.13%
UK	2.7%	2.45%	-0.25%
Canada	0.7%	2.49%	1.79%
Australia	2.5%	3.79%	1.29%
Switzerland	-0.5%	1.01%	1.51%
Japan	-0.7%	0.84%	1.54%
Germany	1.5%	1.77%	0.27%
France	0.8%	2.37%	1.57%

Source: HSBC Global Asset Management. Data as of 30 June 2013.

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Asia's core price pressures are in decline in line with the rest of the world

HSBC PMI: Asia

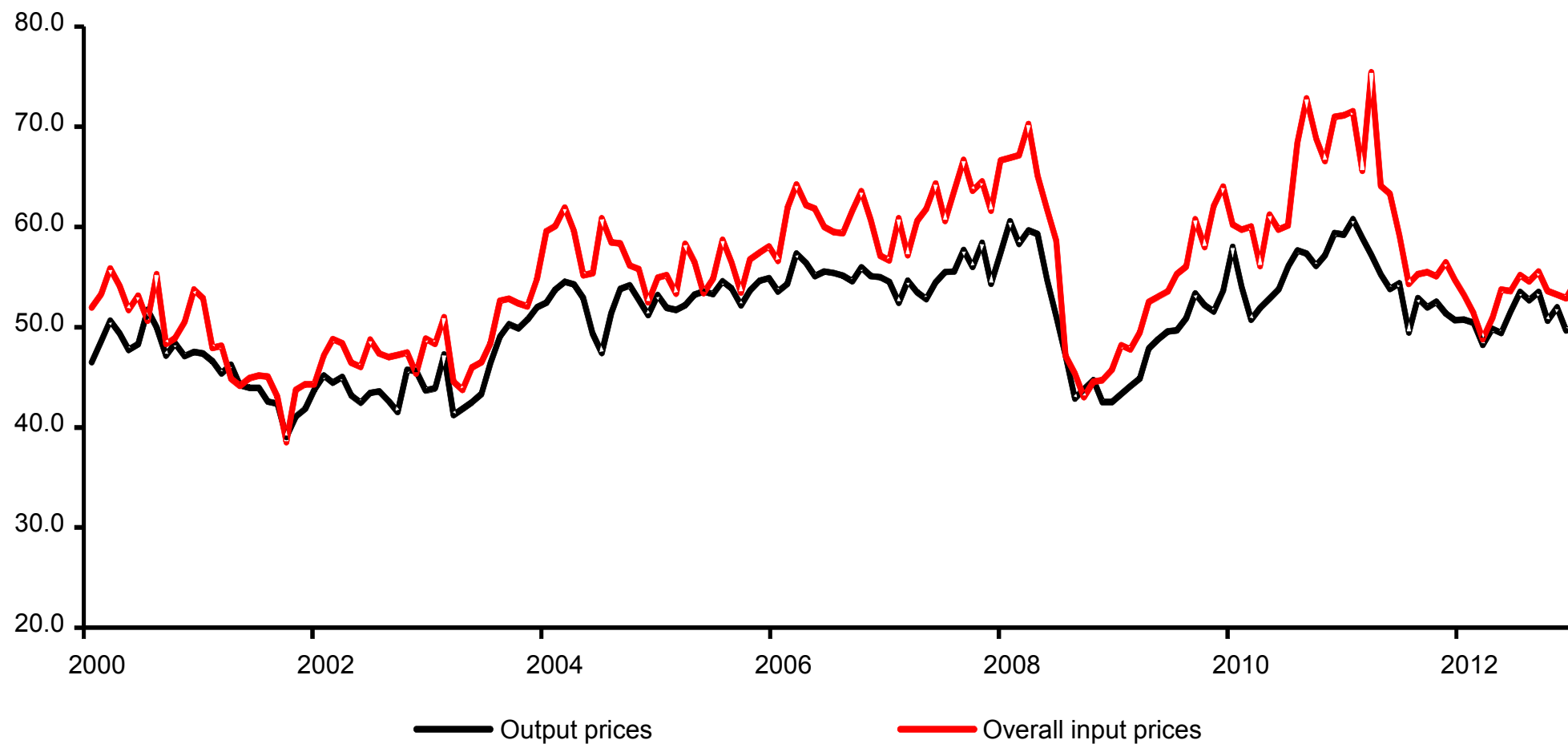


Source: Markit, HSBC. Data as of June 2013.

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And the outlook for Hong Kong is also benign on the face of it

HSBC PMI: Hong Kong

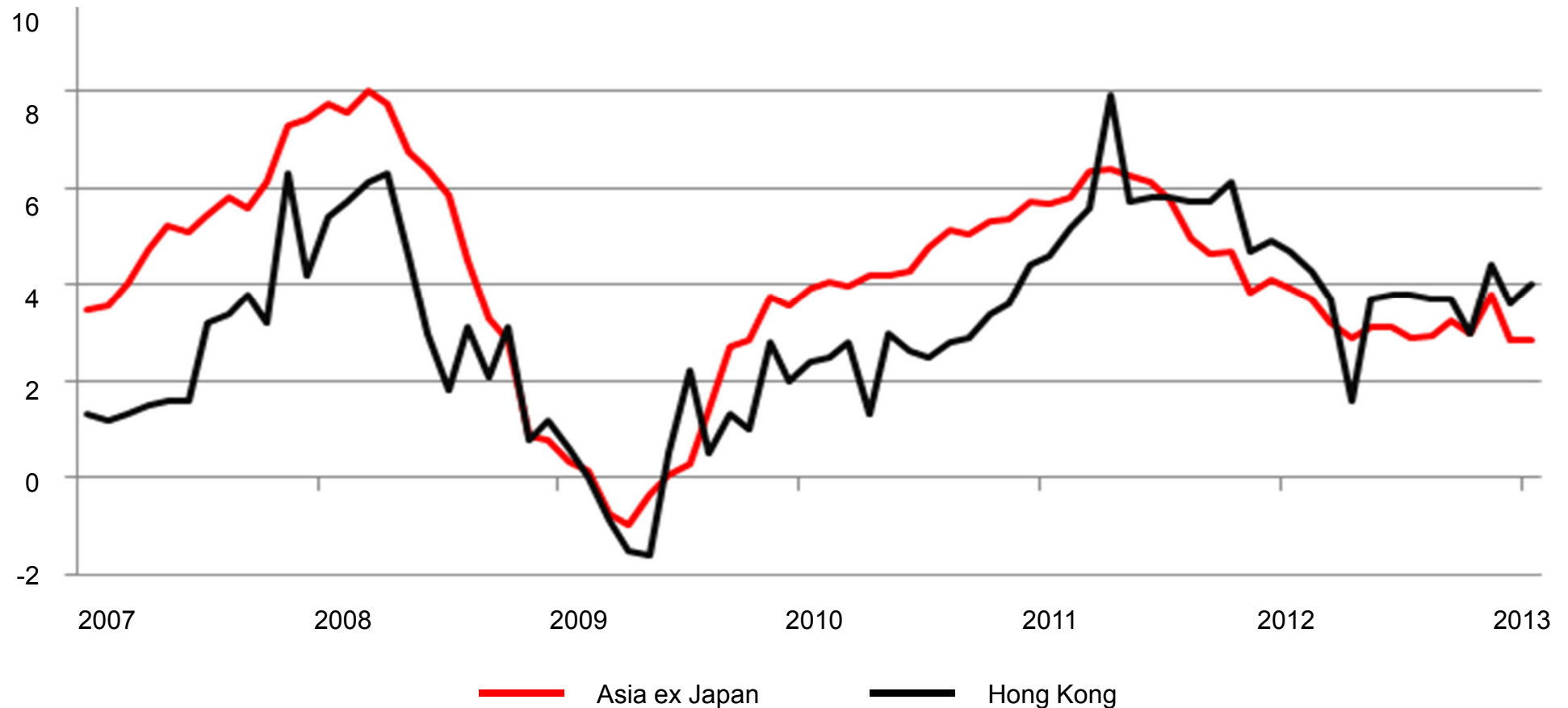


Source: Markit, HSBC. Data as of June 2013.

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However, as ever, tight labour market conditions are a concern from an inflation point of view

Inflation (% yoy)

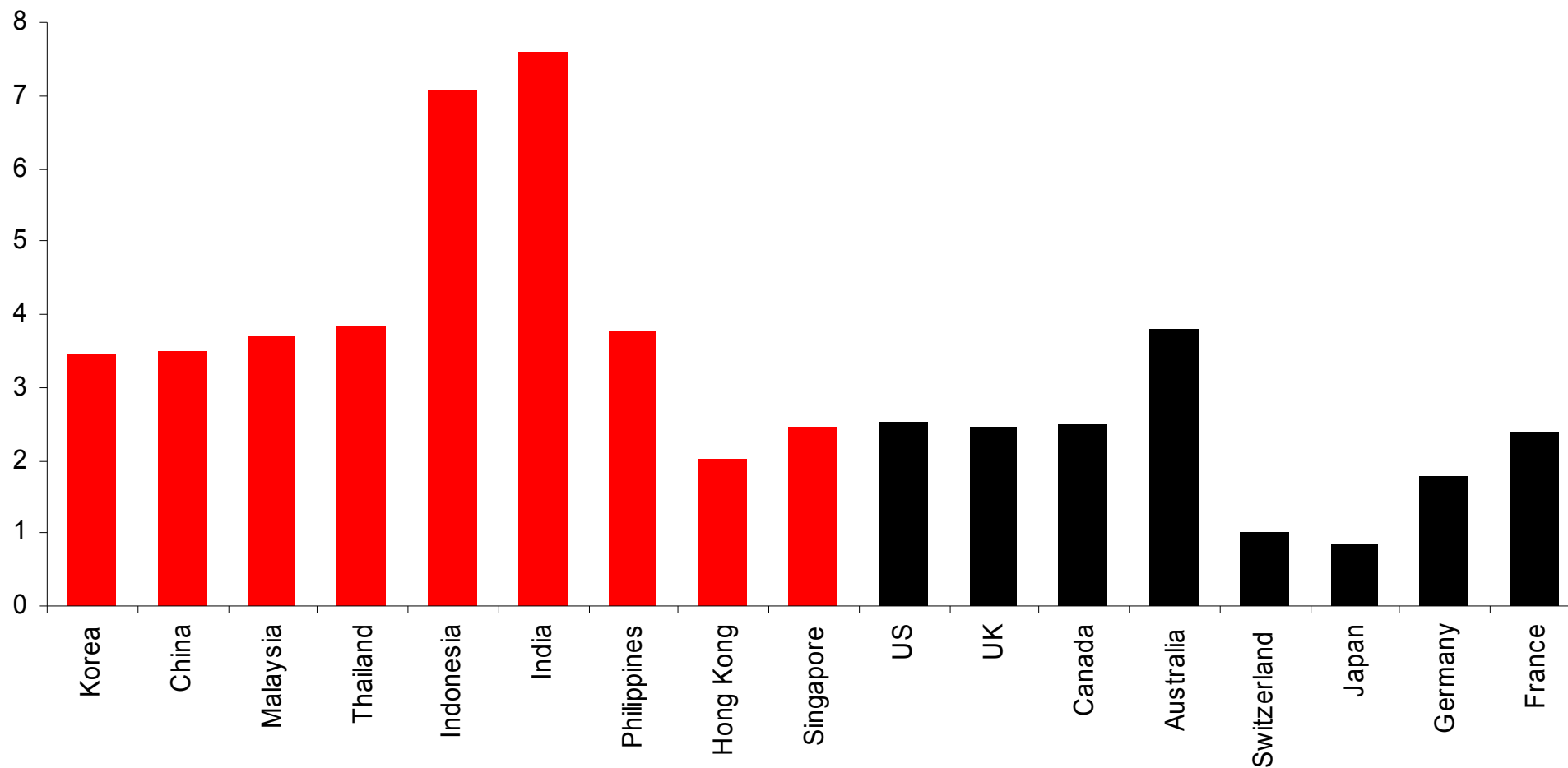


Source: CEIC, HSBC. Data as of June 2013.

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With this in mind, bond yields are generally attractive in Asia....

Ten year bond yields (%)

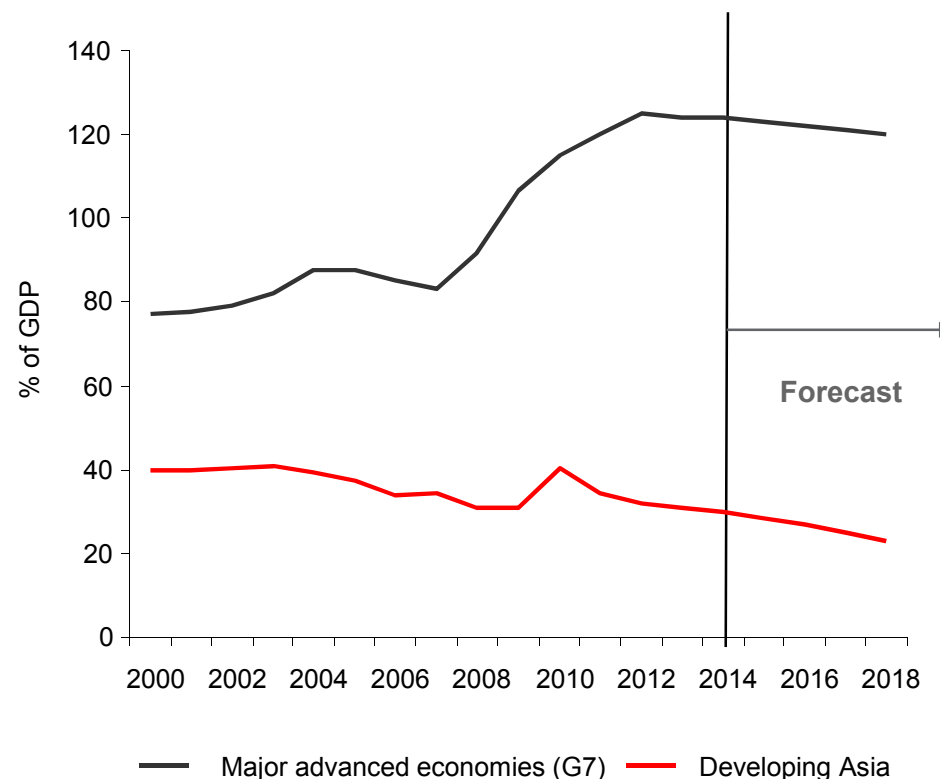
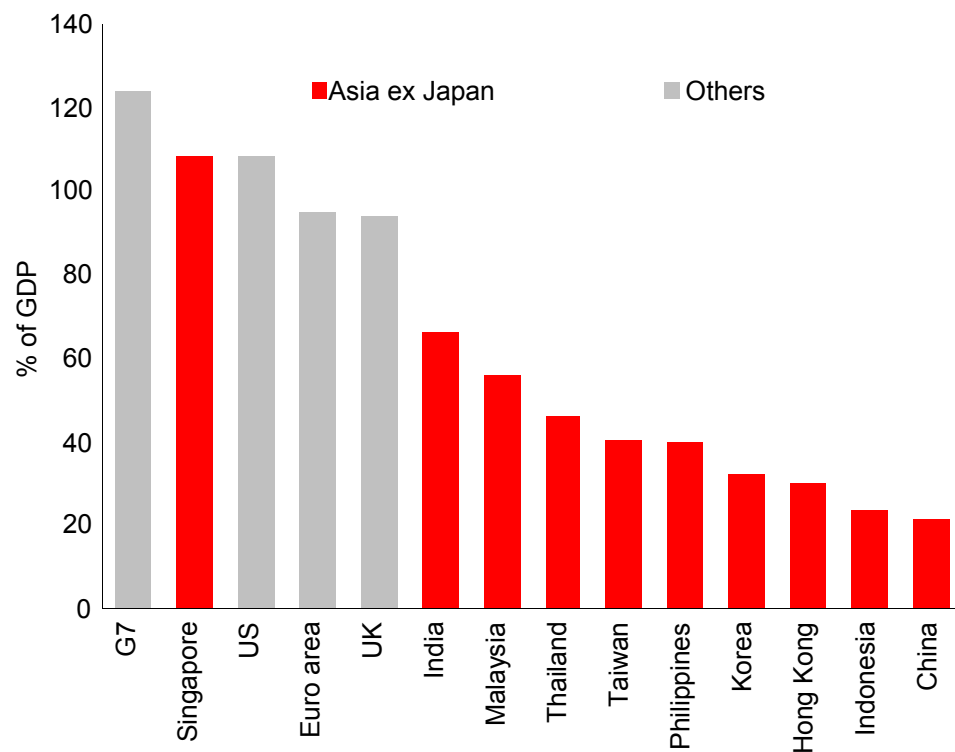


Source: HSBC Global Asset Management. Data as of June 2013.

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Especially when considering the fundamental qualities....

Government gross debt as a % of GDP



Debt levels in developed markets and developing Asia are heading in opposite directions

Source: IMF, World Economic Outlook Database. Data as of April 2013.

Note: Major advanced economies (G7) is composed of 7 countries: Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

Developing Asia is composed of 27 countries: Republic of Afghanistan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Fiji, India, Indonesia, Kiribati, Lao People's Democratic Republic, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Thailand, Democratic Republic of Timor-Leste, Tonga, Tuvalu, Vanuatu, and Vietnam. Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purposes only.

Not surprisingly, this means that Asian sovereign ratings are improving

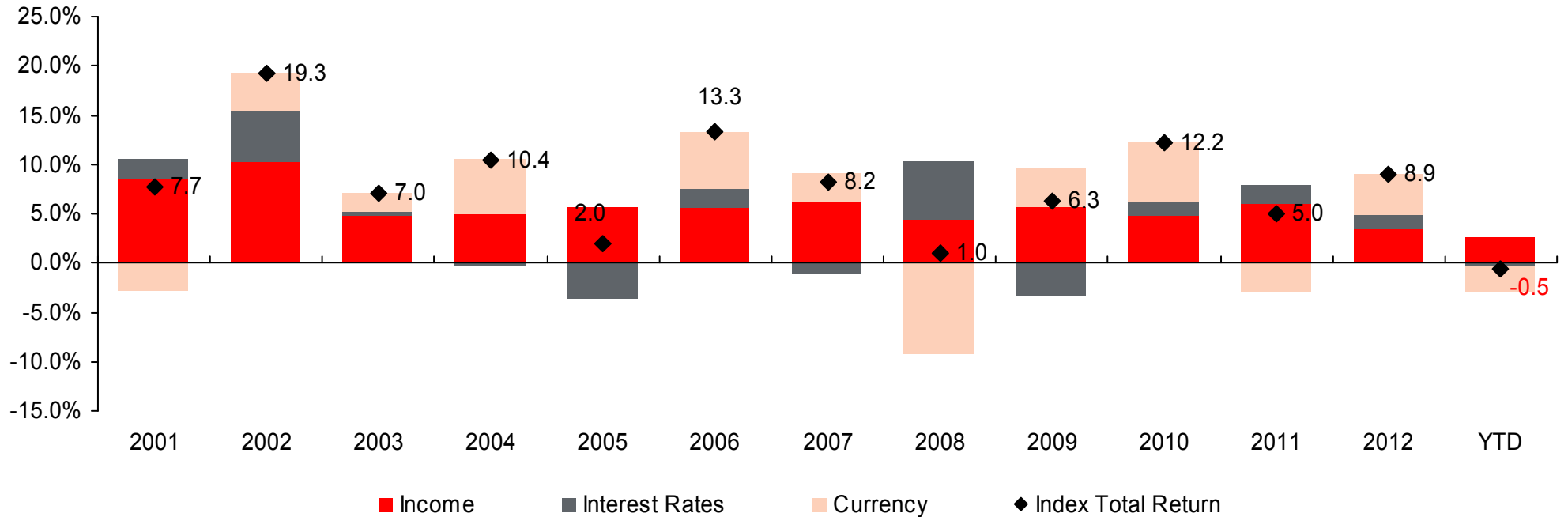
Country / territory	Current rating	Most recent rating change	Credit rating agency
China	AA-	Dec 2010 upgrade	S&P
Hong Kong	AA+	Dec 2010 upgrade	S&P
India	BBB-	Dec 2011 upgrade	Moody's
Indonesia	BBB-	Jan 2012 upgrade	Moody's
Malaysia	A	Jul 2011 downgrade	S&P
Philippines	BBB-	May 2013 upgrade	S&P
Singapore	AAA	Feb 2011 upgrade	S&P
South Korea	AA-	Sep 2012 upgrade	S&P
Taiwan	AA-	Feb 2011 upgrade	S&P
Thailand	A-	Apr 2009 downgrade	Fitch

Source: HSBC Global Asset Management. Data as of May 2013.

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Returns can come from capital appreciation, income and currency

Return components of Asian Local Currency Bond Index



Asian Local Currency Bond Index – 2001- May 2013

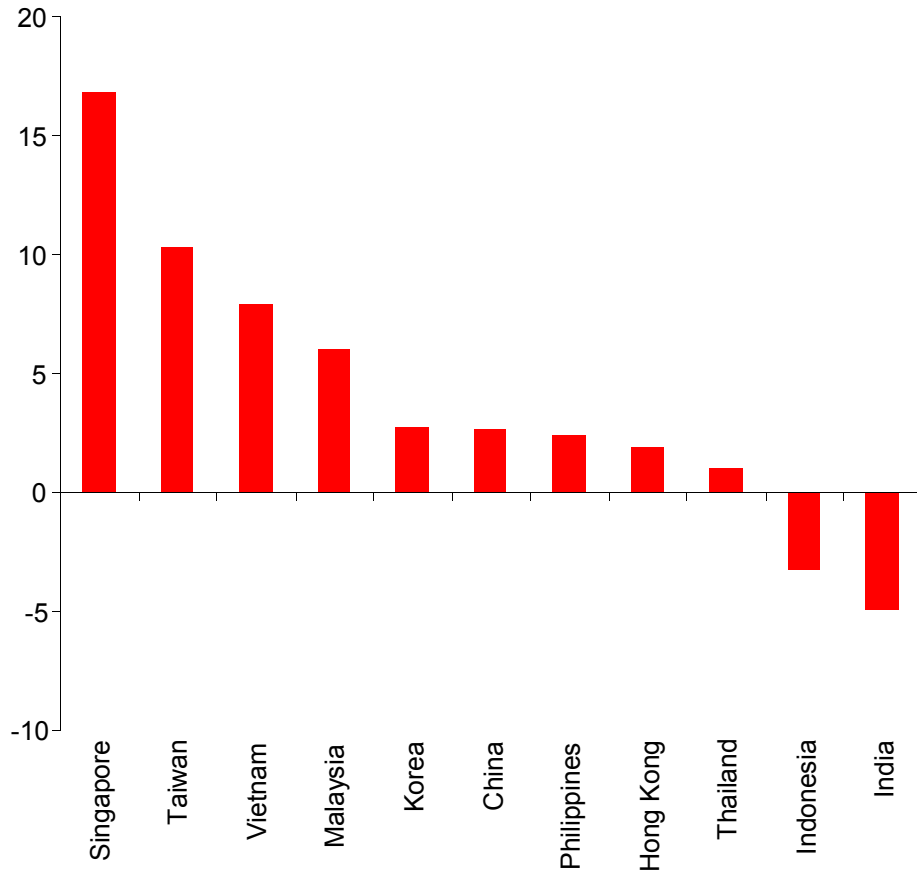
	Total return	Income	Interest rate	Currency
Return (pa)	8.0%	5.9%	0.9%	1.2%

Source: HSBC Global Asset Management and Bloomberg. Data as of 31 May 2013.
Past performance is not indicative of future performance.

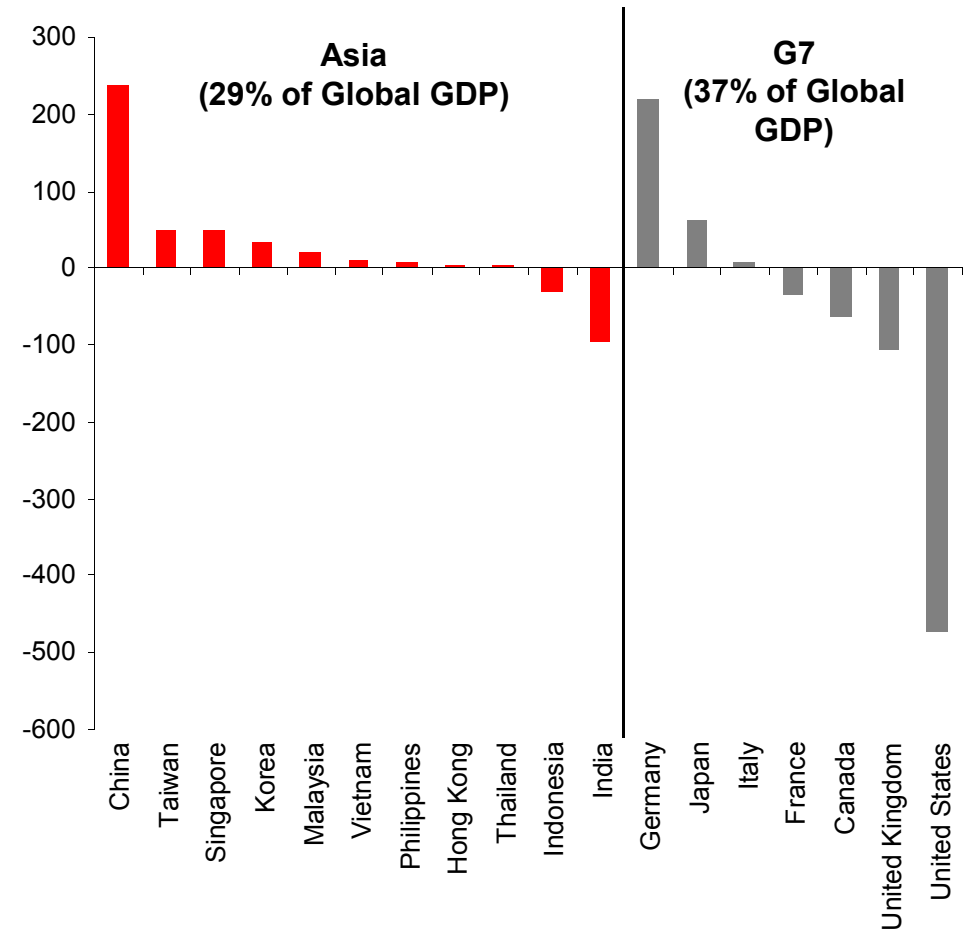
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The current account positions of Asian economies are generally very strong

Current account balance as % of GDP



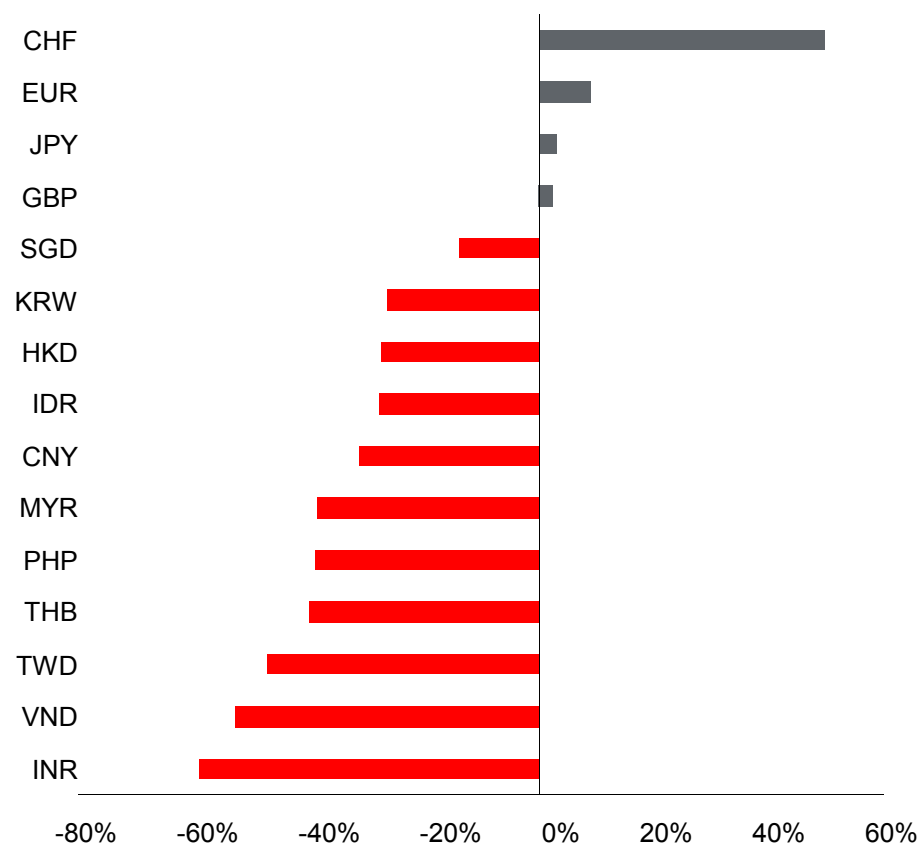
Current account balance (USD bn)



Source: IMF World Economic Database. Data as of April 2013.

On a PPP measure, Asian currencies remain very undervalued against the US dollar and even more so against a number of other currencies

% under/over valued versus USD on PPP



	PPP versus USD	Spot (30 Apr 2013)	% under/over valued
CHF	1.61	1.08	49.63%
EUR	0.83	0.76	9.03%
JPY	100.50	97.44	3.14%
GBP	0.66	0.64	2.51%
SGD	1.06	1.23	-13.94%
KRW	810	1,101	-26.38%
HKD	5.63	7.76	-27.44%
IDR	7,036	9,723	-27.63%
CNY	4.24	6.16	-31.27%
MYR	1.88	3.04	-38.29%
PHP	25.26	41.17	-38.66%
THB	17.60	29.27	-39.87%
TWD	15.59	29.49	-47.13%
VND	9,900	20,925	-52.69%
INR	22.00	53.67	-59.01%

Source: IMF World Economic Database. Data as of April 2013 – PPP estimates for 2013. Any forecast projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC accepts no liability for any failure to meet such forecasts, projections or targets. For illustrative purpose only.

In summary.....

- ▶ Inflation is a key threat to investors, especially bond investors, and especially in a low yielding environment
- ▶ However, the inflation picture is looking reasonably encouraging across the world and in Asia
- ▶ Asian bonds look relatively attractive, despite the recent volatility
- ▶ Hong Kong bonds offer high quality and better yields than a few months ago!

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