China credit starts to rebound - Valuation still compelling

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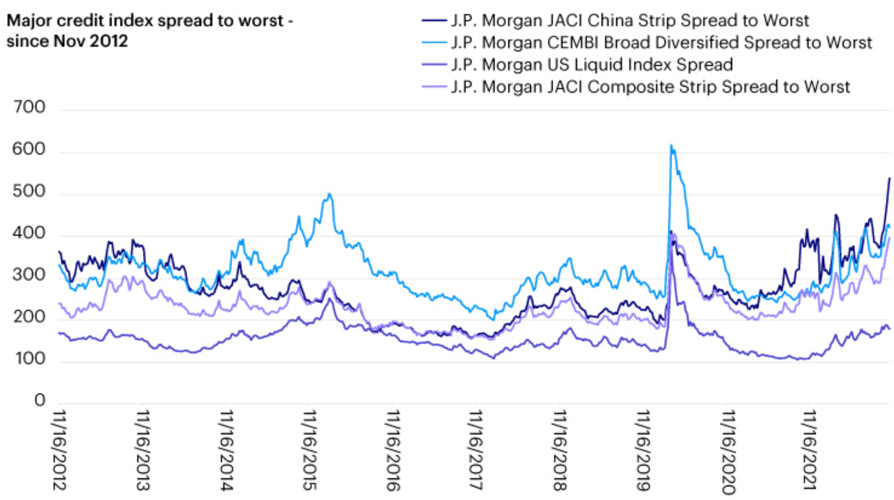
We believe China credit has reached an attractive valuation level since late October and we have finally started to see a rebound in Asia credit, particularly in China credit, in the second week of November. As of November 14, the J.P.Morgan Asia Credit Index (JACI) investment grade (IG) spread tightened 23 bps and JACI high yield (HY) spread tightened 198 bps on 1-week rolling basis. China also announced the reduction of the quarantine time for overseas travelers and close contacts of infected people, from "7 +3" to "5+3" on November 11, which is a significant relaxation of the zero-Covid policy. In addition, the People's Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC) jointly announced a package of 16 measures to ensure financial support to stabilize the property sector on November 13. The market has been recovering further after the news release. Based on these latest developments, we remain positive on the opportunities in Asia and particularly China credit.

- Valuation of China credit has reached the most attractive level in the past decade as of November 1. This could be seen as a "why not" moment for investors that are looking for the right timing to add exposure to this asset class.

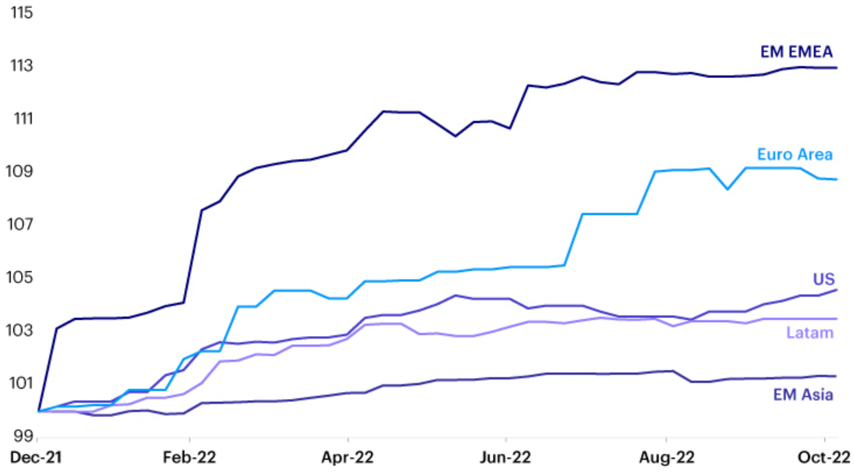
Figure 1 – Valuation of China credit has reached the most attractive level in the past decade



Source: J.P.Morgan, Invesco, data as of 1 November 2022, Data frequency: weekly. **Past performance does not guarantee future results.** An investment cannot be made in an index.

- In the macro space, the rate hiking pressure faced in Asian countries is more subdued compared to developed markets. The latest gas price shock has affected Euro area inflation expectations more so than other regions. The recent wave of upside CPI revisions is also much less of an Asia phenomenon. Moderate inflation pressures enable Asian policy makers to have more flexibility on macro policies in order to boost economic growth. Asian countries have relatively stable and resilient fundamentals and consensus fiscal balance forecasts also show that room for fiscal stimulus is generally larger for most Asian countries.

Figure 2 – Asia inflation picture is more sanguine compared to developed markets



Sources: J.P.Morgan, Bloomberg L.P., data as of 4 November 2022. Represented by J. P. Morgan CPI Forecast Revision Index. Data frequency: weekly

Figure 3 – Room for further fiscal stimulus is generally larger for Asian countries

		Current Account (% of GDP)			Fiscal balance (% of GDP)		
		2021	2022F	2023F	2021	2022F	2023F
Asia	China	1.8	2.0	1.2	-3.8	-5.5	-4.5
	Japan	4.0	1.1	1.4	-6.4	-6.8	-4.5
	South Korea	-	1.9	2.7	-2.9	-2.8	-1.1
	Indonesia	0.3	0.4	-1.0	-4.6	-3.9	-3.0
	India	-1.1	-1.5	-3.4	-6.2	-6.9	-6.4
	Malaysia	-	1.8	2.6	-6.4	-6.0	-5.0
	Philippines	-	-4.4	-3.8	-8.6	-7.5	-6.2
	Singapore	18.1	17.0	15.9	-1.6	-0.8	0.3
	Thailand	-	-1.4	2.2	-5.5	-4.4	-3.3
Others	US	-3.6	-3.9	-3.4	-10.8	-4.3	-4.2
	EU	2.4	0.7	1.2	-5.1	-4.2	-3.6
	UK	-	-5.7	-4.4	-7.4	-7.3	-6.5
	Canada	0.0	0.7	0.1	-12.6	-2.2	-1.6
	Brazil	-	-1.5	-1.5	-4.4	-6.2	-7.4
	South Africa	-	0.5	-1.1	-5.5	-5.2	-5.1

Sources: Bloomberg L.P., data as of 11 November 2022.

- In China, the country's 20th Party Congress (CPC) announced the new leadership in Beijing. While a few new faces were spotted in the new Politburo and Standing Committee, President Xi's position has been strengthened, which is in line with our expectations. The latest mention of the emphasis on China's economy during the CPC is consistent with policies that had been communicated in the past. We are expecting swifter policy implementation to take place as new leadership has been solidified and the uncertainty from earlier in the year has now faded, to a large extent. The reduction of the quarantine requirement suggests a significant loosening of China's zero-Covid policy and strengthens the stance that policymakers are focusing on supporting the economy.

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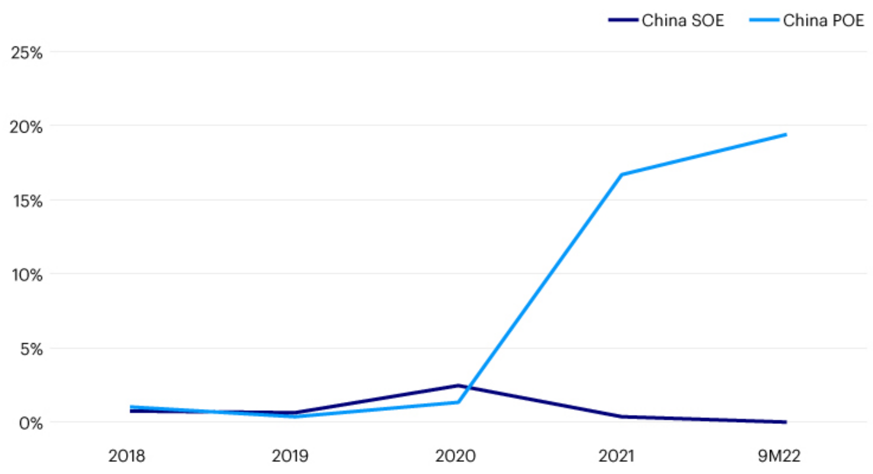
- We see the underlying China USD fixed income market as the biggest beneficiary of these trends in the near term. Unlike the equity market, the majority of China fixed income issuers are state-owned enterprises (SOEs). Since the conclusion of the CPC, we've seen the position of Chinese SOEs strengthen and these issuers have historically demonstrated low default rates and solid fundamentals (Figure 4). We expect Chinese SOEs to enjoy more support on market expansion, gain better funding access and demonstrate further strategic importance.

- On the privately-owned enterprises (POEs) side, as most China POE offshore debt issuers in the USD market are the market leaders in various sectors in China, we believe they may be able to weather the leadership transition well and outperform SMEs (small and medium-sized enterprises). The relatively high default rate of China private corporates this year has largely been due to the liquidity crunch in China's property sector. We've started seeing substantial joint support from the PBOC and CBIRC to stabilize the sector as of November 13. While the strong recovery in China property names have kicked in, we are turning cautiously optimistic and prefer issuers that have better credit quality at this stage.

Figure 4 – Default rate of China USD bond issuers



Source: HSBC, Invesco, data as of 30 September 2022.

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