Most Asian emerging market (EM) countries’ sovereign credits performed very well in 2023 YTD (as of November 1) in credit spread terms (Figure 1). There are a few main reasons for this:

1. Most Asian EM countries have seen stable economic fundamentals. Aside from some exceptional cases or periods, the majority of Asian EM countries have also kept inflation under control and their fiscal balances are largely contained;
2. Geopolitical risks in other regions have made Asian countries seem like relatively safer investment destinations;
3. High USD interest rates have pushed sovereign and quasi-sovereign issuers in EM Asia away from issuing hard currency bonds and they have either issued in local currencies to meet the funding demand or opted to wait a bit longer before they test the USD bond market;
4. Relatively robust domestic economic activities have generated healthy local investor demand for local sovereign hard currency bonds.

This strong performance has made Asian EM sovereign bonds quite expensive and spread levels are tight right now compared to the past year. Apart from distressed sovereign issuers, Asian EM sovereign bonds’ spread levels are tighter compared to other emerging market bonds. We can use the JPMorgan Emerging Market Bond Global Diversified Index ("EMBI div") as an example. The spread levels for BBB, BB and B rated sovereign and quasi-sovereign issuers were 170bps, 269bps and 590bps respectively. Investment grade ("IG") rated emerging Asian sovereign issuers, such as Malaysia, Philippines, India, and Indonesia are all trading tighter than the EMBI div BBB index level spread. Even Vietnam, as a BB rated sovereign issuer, is trading inside that level. For some high yield issuers, such as Mongolia, and Papua New Guinea (both B rated), these Asian sovereigns are trading richer compared to the EMBI div B index level spread.

Figure 1 – Spread range in the past year: Performing EM Asia vs EM Indexes
We are likely to see some of these favourable conditions turn in the new year. Inflationary pressures are picking up again in EM Asia as commodity prices have been pushed higher on the back of geopolitical risks. Throughout 2023, the interest rate differential between Asia and developed markets has been shrinking. We are likely to see that trend reversed in 2024 if we do not see large economic slowdowns globally. If we indeed run into a big risk-off event, EM Asia’s sovereign bond spreads will widen out. On the other hand, even if the US and other developed market central banks start thinking about cutting rates, EM Asian central banks will probably still need to keep their policy rates relatively high to contain inflation as well as prevent capital outflows. We expect this will cause more EM Asian sovereign and quasi-sovereign issuers to raise debt in the USD bond market.

As global growth is likely to slow down, we believe Asian local investors’ accumulation of USD and thus their USD investment demand will decline in 2024. On the fundamental side, we foresee that EM Asian economies will also face some risks. Other Asian EM countries used to ride on the strong growth momentum from China for their own economic activities in the past. The growth rate in China is likely to shift into a lower gear for the coming years as China has abandoned its old investment-led growth model.

Thus, we believe it is important to exercise caution when investing in EM Asian sovereign bonds. We do not foresee large downgrade risks in Asian sovereigns given these countries have accumulated some fiscal room and foreign reserve buffers to get through tough times. If EM Asian sovereign spreads widen out to be on par or even wider than the similarly rated EM peers, we still believe Asian EM sovereign bonds are better investments than the EM bonds of other regions.
Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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