We believe macro factors will continue to take center stage in 2024. Higher central bank policy rates, tightening financial conditions and intensified geopolitical tensions remain the main drivers for Asia credit and overall risk sentiment. Since the September Federal Open Market Committee (FOMC) meeting, longer-term US treasury yields have risen significantly. Stronger than expected US data, a hawkish Fed, and an increasing supply of US treasuries (UST) have contributed UST yield movement. Fed Chair Jerome Powell’s view is that the US economy has been more resilient than many expected. The recent increase in longer-term treasury yields can be interpreted as a tightening of financial conditions, and it has been equated to a 25-basis point rise in rates, which provides the Fed more time to access incoming data before considering its next move. Fed members’ emphasis has shifted away from “further tightening of monetary policy” towards keeping rates elevated for longer than previously thought.

However, it is still too early to declare victory and the Fed wants to hold rates steady until employment or inflation materially shifts. The “higher for longer” narrative remains a major risk factor at least for the first half of 2024 given the robust US economic activity and tight labor market. We believe the Fed is done with hiking. We expect inflation to remain above target and US rates to remain elevated across the curve until tighter financial conditions push the economy into a mild recession next year.

Geopolitical tensions in the Middle East are likely to stay elevated between Western world and Islamic countries. However, we anticipate a gradual improvement in US-China relations in 2024 which could help ease global geopolitical tensions. We will closely monitor this situation as event risks like these can change our risk sentiment and investment thesis drastically.

We believe China’s economic growth has been bottoming out in August and September from the significant weakness in Q2 and July of this year. September and Q3 data beat estimates and economists have predicted that China will achieve 5.4% GDP growth in 2023. Monetary and fiscal stimulus has accelerated since the July Politburo meeting. Policymakers are tackling weak domestic demand by driving consumption and stabilizing employment. An additional RMB 1 trillion in special Chinese government bond issuance was announced in October to support local fiscal and public investment which a clear sign of a more proactive fiscal policy going forward. The People’s Bank of China (PBoC) has ample policy room to support China’s economic recovery. Prospective PBoC rates cuts are likely to be accompanied by increased support for the Renminbi from the Chinese authorities. In the coming months, we expect another policy rates cut of 10 basis points and additional fiscal stimulus from the central government. Developments arising from the December Central Economic Work Conference will be key to signal the 2024 macro policy setting. For the China property market, after months of a concentrated set of easing measures announced since late August, we still have not seen compelling evidence that these steps have effectively boosted property sales. We continue to expect an “L-shaped” recovery path for the property sector next year, due to persistent weakness and record high housing inventory in lower-tier cities, not to mention still-tight refinancing channels for private developers.

Asia credit has outperformed its global peers year-to-date. However, we continue to see a huge divergence in credit spread performance among different Asian countries. Technical support is clearly behind the relative outperformance. Credit spreads from Asia ex-China outperformed China as China has suffered from deepening property woes and a slower than expected recovery from re-opening. Credit spreads of Southeast Asian countries like Indonesia, the Philippines and Malaysia, have returned to their tightest levels pre-Covid, benefitting from relatively stable economic momentum, benign inflation, and global emerging market inflows. Asia sovereign fundamentals largely remain solid due to moderate debt levels and fiscal discipline. Inflation has peaked in most Asian countries, which has kept local rates supportive. Given the heightened US rates volatility, and stretched valuations, investors are likely to remain cautious and avoid high beta Asia credit.

Source: Bloomberg, data as of October 24, 2023
Investment implications

The Asia credit market remains challenging against the backdrop of US rates in the “higher for longer” narrative. With the elevated rates volatility and lingering geopolitical risks, investors are likely to remain relatively conservative in their positioning until they see clarity. We expect rates volatility to reduce toward end of the year and well into 1H 2024. In our view, lower rates volatility plus attractive carry should provide good technical support for Asia credit in the medium term. While we do not see scope for material spread compression in Asia investment grade (IG), we believe the relatively high all-in yields should be supportive for the space in 2024. We continue to believe that US treasury yields are unlikely to rise much further. At the same time, we think current yield levels of 6 to 7% already make a compelling medium-term case for investing in high quality bonds.

Negative net supply in Asia’s credit market remains the main supportive technical factor. We have seen cash rich Asian corporates start buying back their own bonds to lower finance costs. A new trend that we observe that is further shrinking the investment universe. We expect supply to remain muted in 2024 given the rates volatility and cheaper funding costs in the local currency market.

Despite the strong technicals, Asia valuations are not particularly attractive compared to global IG. Asia IG credit spreads are trading at only marginal discount to US IG. With the ongoing uncertainties, we think Asia IG credit spreads, especially those spreads already close to pre-Covid levels, will remain volatile in 1H 2024. Spreads at the index level might drift wider before valuations become compelling again. Performance divergence is likely to remain between China and Asia ex-China. Also, we believe state-owned enterprises will continue to outperform bonds issued by privately-owned entities. Strong government support and access to low-cost funding are essential for Asian credit. Credit differentiation remains key.

Figure 2 – Asia credit spreads by country over the past five years

Source: Bloomberg, data as of October 24, 2023
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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