

May 2025



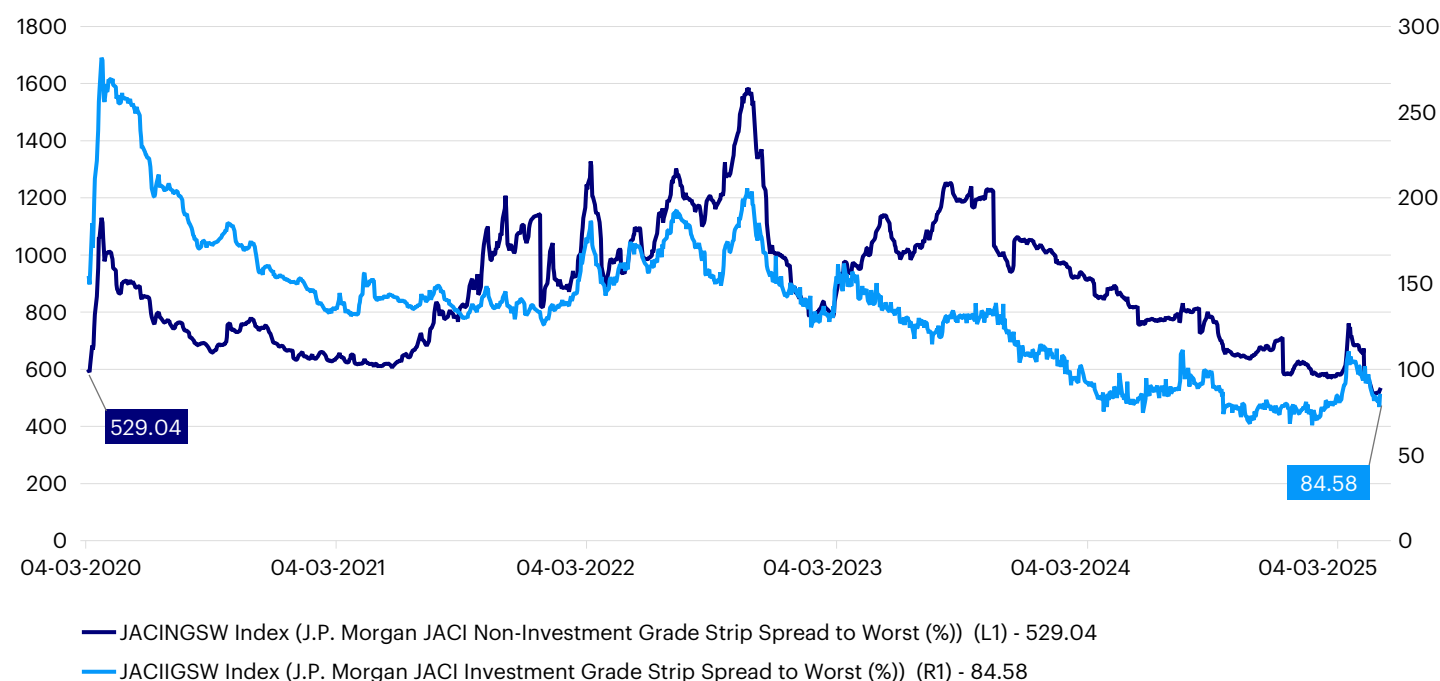
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Trade tariffs have remained a key driver of market volatility and market fluctuations in response to various headlines are almost a daily occurrence. The US announcement of reciprocal tariffs on April 2 came as a major negative surprise, triggering a broad sell-off in global risk assets and a rally in US treasuries. Ongoing uncertainty and challenging market conditions dampened investor risk appetite, leading to wider credit spreads.

Within the Asia investment grade (IG) space, India and Indonesia IG credits experienced notably sharper declines during the initial sell-off, underperforming their regional peers. Japan insurance and Australian bank subordinated debts also lagged, primarily due to crowded positioning, as the correction reflected prior investor overweights.<sup>1</sup> Whereas while India underperformed as well, additional pressure stemmed from military conflicts with Pakistan, prompting heightened caution toward issuers with assets near the conflict zone.

We then saw a de-escalation in tensions between the US and Asia/China following a 90-day truce of implementing tariffs. The market breathed a sigh of relief, and Asia credit markets recovered most of their recent losses. The Asia investment grade (IG) credit market has exhibited resilience despite a challenging environment and registered a positive return of 2.13% year-to-date<sup>2</sup> supported by strong technicals and yield carry.

**Figure 1: JACI Investment Grade versus JACI High Yield (Feb 2020 – Feb 2025)**



Source: Bloomberg, data as of May 19, 2025.

1. Bloomberg, data as of April 2025.
2. Bloomberg, data as of May 16, 2025.

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The spikes in market volatility and widening of Asia credit spreads since the announcement of Trump's "Liberation Day" tariffs on April 2 have come full circle. JP Morgan Asia Credit Index (JACI) IG spreads have widened from +76 basis points (as of Feb 28, 2025) to +111 bps (on Apr 7, 2025) and fully retraced the widening to +84bps (as of May 16, 2025) (Figure 1). Spread performance, however, exhibited notable divergence across individual countries. Indonesian and Philippine IG were notable outperformers, with spreads tighter than levels prior to "Liberation Day". Technicals have been extremely strong despite rich valuations and escalated rates volatility.

In the US, trade tariffs have increased the risk of a US recession. Economists have lowered growth forecasts for the US economy, raised inflation forecasts, and increased 12-month recession probabilities. Business and consumer surveys are pointing to slower growth and a gloomy outlook, which highlights potential vulnerabilities in US consumer spending and the labor market. However, the Fed has signaled that it will be patient before acting and needs to see hard data that shows softness.

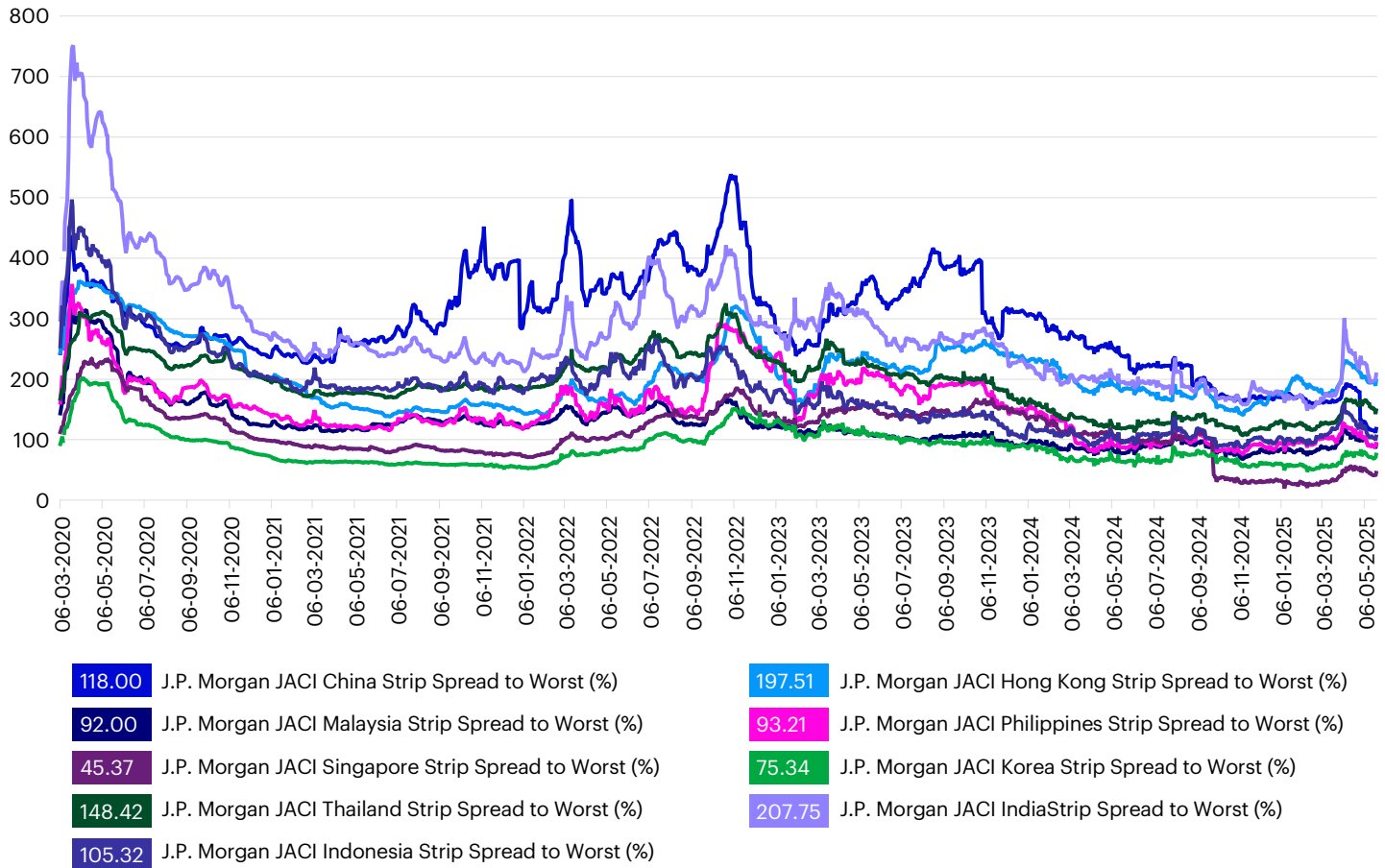
Optimism returned to market as of mid-May as we saw a thaw in US-China relations which helped to lower recession risks. However, the macro backdrop deteriorated again when Moody's cut the US sovereign credit rating down one notch to Aa1 from AAA, citing the growing burden of financing the budget deficit and rising interest costs. The decision lifted treasury yields to reflect more risk and further dampened sentiment towards owning US assets. US treasuries were already facing a growing pile of debt and less foreign demand in early April when treasury yields rose and the dollar weakened in reaction to Trump's initial tariff announcement. We are seeing signs that investors are considering shifting away from US dollar-denominated assets. Investors are increasingly seeking alternatives in the other developed market (DM) currencies or regional local currencies as they expect the sell-off in the dollar to continue. The Asian credit market is already feeling the effects of de-dollarization, and the trend is expected to reshape regional financing dynamics.

We expect emerging markets (EM) Asia economic growth to be impacted by the trade tariffs. The market is adopting a wait-and-see approach with limited conviction following the 90-day truce. Generally, economists have reduced their GDP forecasts across most regional economies, but they expect the Asian countries to remain resilient, supported by accommodative central bank policies and benign inflation. The outlook for Asian IG issuers remains constructive for 2H 2025, with expectations of resilient credit fundamentals amid slower global growth. Despite tariffs from the US, Asian corporate and bank credit fundamentals are expected to remain resilient though earnings growth may see a negative impact. In addition, the leverage ratio for Asia IG corporates remains relatively low. Lower local rates are likely to ease overall financing costs. Prudent balance sheet management continues to provide buffer against potential economic headwinds.

Valuations are once again close to historical highs from 2024 levels (Figure 2). The only period when spreads have been tighter than current levels for an extended time horizon was during 2024 when the macro backdrop was benign, with steady global growth, low recession risks, and gradually falling inflation. Despite the easing of trade tensions, we argue the macro conditions are unlikely to return to the "Goldilocks"-like conditions that characterized much of 2024. Therefore, we foresee little room for spreads to further tighten from current levels.

Despite the fiercest tariff talks with the US in recent history, we are turning more constructive on China IG as we expect the economy to stabilize and companies to benefit from the government's easing policy and fiscal stimulus. We expect growing interest in China credit, which is mostly due to 1) strong supportive technicals, and 2) expectations of more easing by China policymakers to stabilize the Chinese economy.

**Figure 2: Asia credit spreads by country over the past five years (Feb 2020 – Feb 2025)**



Source: Bloomberg, data as of May 19, 2025.

In conclusion, we anticipate US interest rate volatility to remain elevated in 2H 2025, reflecting ongoing uncertainty around the debt burden, US treasury supply and declining demand. The tariff discussion and US rates will continue to exert a dominant influence on the asset class. However, Asia IG credit is expected to remain resilient, supported by accommodative regional central bank stances and solid fundamentals across major Asian economies. We expect credit spreads to stay volatile as well with the continuous headlines. Whilst yield carry continues to be attractive, managing tail risk is important, and it is important to stay up in credit quality. We expect opportunities will emerge in the coming months but maintain our relative defensive stance.

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# 2025 Midyear Investment Outlook – Asia Fixed Income: Investment Grade

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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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