

Asia credit – a resurgence rooted in resilience and relative value

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Key takeaways

- The Asia credit market has seen solid performance year-to-date and is generally outperforming other major bond markets
- The US rate cutting cycle as well as Asia's supportive macroeconomic backdrop should sustain Asia credit's momentum
- While Asia is exposed to a US/global growth slowdown, India, China and parts of ASEAN are likely to stay resilient as these are domestic demand-oriented economies
- Repayment capabilities of Asian dollar issuers are enhanced and credit quality can potentially be improved given the increasing strength of Asian currencies and the renewed interest in Asia local currency bond markets
- While there has been a downward move in global bond yields year-to-date, Asia credit's yields continue to look attractive. Together with relatively low duration, favourable technical factors, and continued resilience, the case for diversifying into Asia credit remains strong
- The US Fed rate cut is positive for investor sentiment, but we acknowledge the risk that US recession fears can re-emerge on any signs of economic weakness as long as the policy rate remains in restrictive territory. Further market volatility is possible, but we are equipped to navigate market moves and any dips can present opportunities for our Asia bond strategies

Source: Bloomberg, HSBC Asset Management, September 2024.

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Macroeconomic support for Asia credit

Global easing cycle

The US Federal Reserve lowered rates by 50bp on 18th September, marking the first cut in four years and kicking off the US rate cutting cycle, which is expected to contribute to the momentum of Asia credit markets. The choice to cut by 50bp reflects the Federal Open Market Committee's (FOMC) judgment that the risks to its dual inflation and employment mandate have shifted into better balance, meaning that upside risks to inflation have moderated while downside risk to employment has increased. At the September meeting, the FOMC also published its updated projections, which see a desire to deliver a soft landing for the US economy; the projections see inflation reverting to target, unemployment leveling off to an acceptably low level, growth remaining solid and the policy rate ultimately returning to a more neutral level over time.¹ While the move is positive for investor sentiment, we acknowledge the risk that recession fears can re-emerge on any signs of economic weakness as long as the policy rate remains in restrictive territory. Other sources of risk, such as election uncertainty or geopolitical stress can come into play.

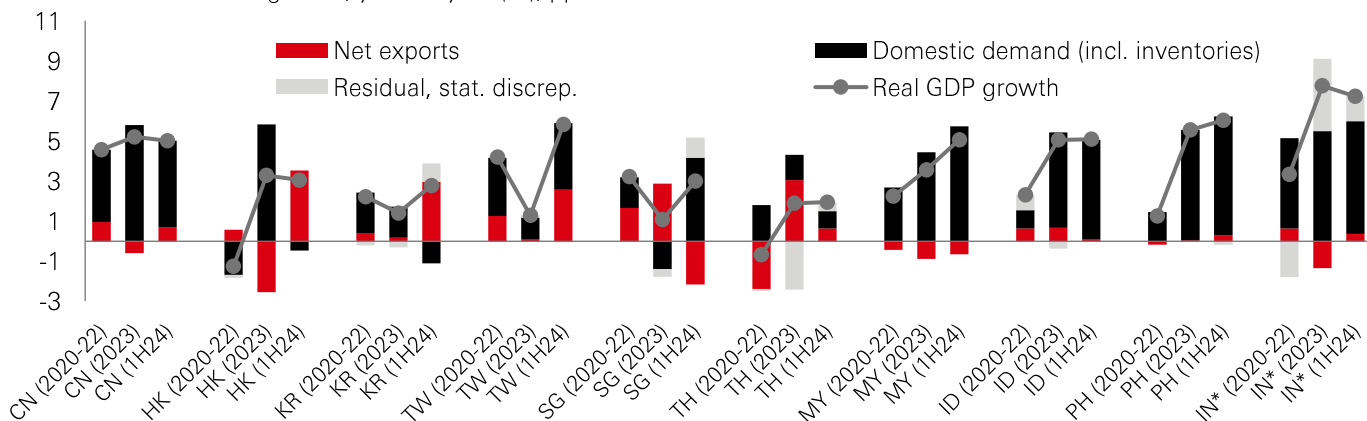
The US rate cutting cycle gives room to Asian economies to ease their monetary policies as central banks weigh growth and financial stability amid benign inflation. The rate cuts should also help ease foreign exchange pressures. The US dollar has been weakening against almost all Asian currencies in the last month, which has positive implications for Asian companies; this means that repayment capabilities of Asian dollar issuers are enhanced and credit quality can potentially be improved. Asia credit should benefit from the global easing cycle, especially Asia high yield, as the Fed's intention to move to a more supportive stance becomes clear.

Positive macro outlook in Asia

While Asia is exposed to a US/global growth slowdown, India, China and parts of ASEAN are likely to stay resilient as these are domestic demand-oriented economies, i.e. less dependent on external demand.

Fig. 1: India, China and parts of ASEAN less dependent on external demand

Contribution to real GDP growth, year-on-year (%); ppt



Note*: Calendar year for India. CN=Mainland China, HK=Hong Kong, KR=South Korea, TW=Taiwan, SG=Singapore, TH=Thailand, MY=Malaysia, ID=Indonesia, PH=Philippines, IN=India. Source: CEIC, HSBC Asset Management, August 2024.

At the same time, Asia is investing more in itself, with China continuing to be an important partner for Asian countries. From an FDI perspective there is upside for these economies from the “friend shoring” phenomenon, being that Chinese companies might invest in third jurisdictions to mitigate geopolitical risks to supply chains. That being said, countries like Indonesia, Thailand, India and Korea have maintained geographic diversification of foreign capital inflows; Indonesia's share of total foreign direct investment (FDI) from China, for instance, is 23% while its share coming from ASEAN is 33%.² Within Asia, India stands out as the least China dependent economy – domestic demand in the country remains resilient amid external uncertainties and structural reforms have been key.

Note 1: Source is US Federal Reserve, 18 September 2024. Note 2: Source is Citi, Haver, HSBC Asset Management, March 2024. Source: HSBC Asset Management, September 2024.

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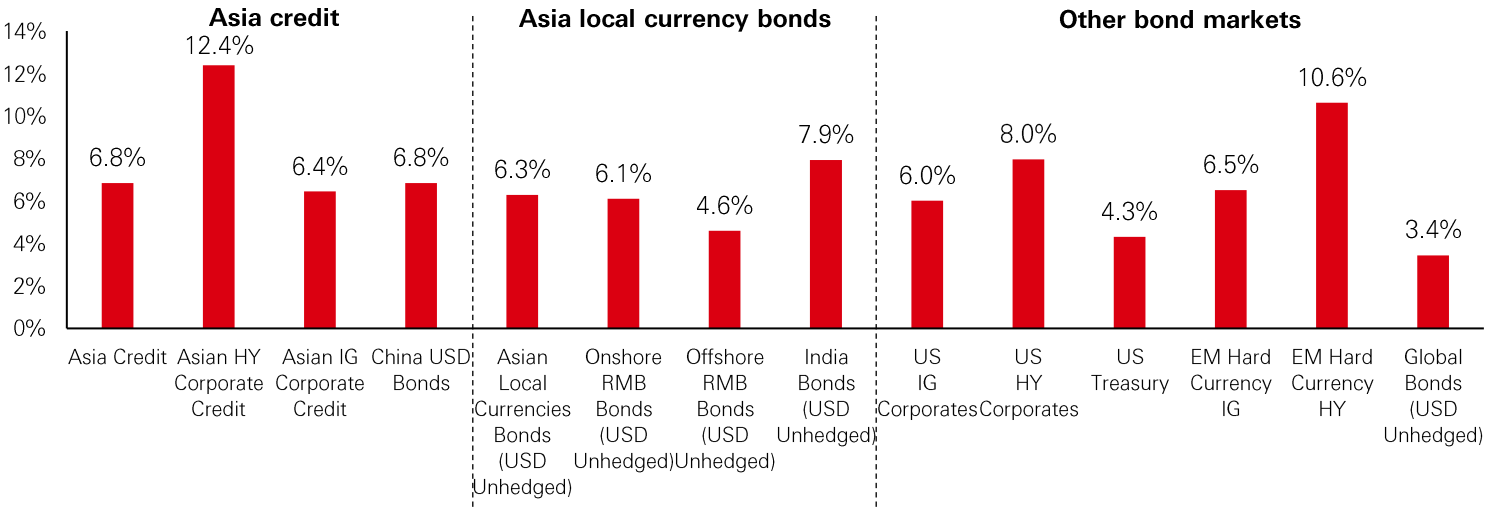
Asia credit's resilience

Performance

The Asia credit market has seen solid performance year-to-date and is generally outperforming other major bond markets. Asia high yield stands out as one of the best performing bond markets this year. The Asia local currency bond market is also seeing renewed interest, with particularly strong performance in the last three months.

Fig. 2: Asia bond markets' solid performance

Year-to-date performance (as of 19 Sep)



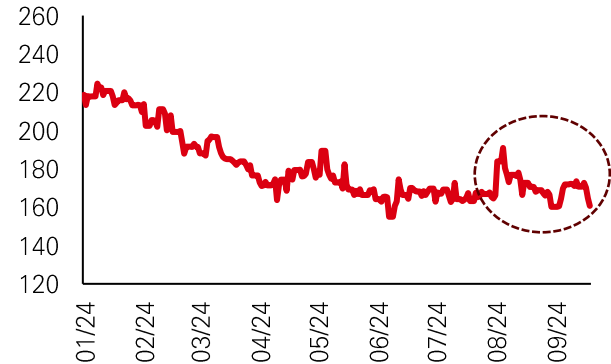
Source: Bloomberg, JPMorgan, Markit, 19 September 2024.

Diversification

The market turmoil that swept through global markets in July and August perhaps re-emphasized the role that Asia bonds can play as a diversifier for global bond portfolios. During this July/August period, Asia credit spreads widened just modestly, and that move has reversed since (Fig. 3). Asian issuers also benefit from the region's overall positive macroeconomic outlook, which stands apart from the fading growth momentum of developed economies, such as the US.

Fig. 3: Asia credit spreads

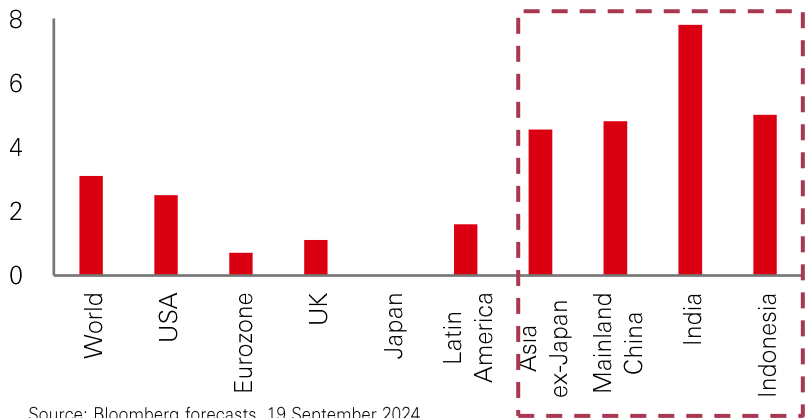
JACI spreads (bp)



Source: JPMorgan Asia Credit Index, 17 September 2024.

Fig. 4: Asia ex Japan GDP growth vs rest of world

2024 forecast GDP growth (%)



Source: Bloomberg forecasts, 19 September 2024.

Source: HSBC Asset Management, September 2024.

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Asia credit's resilience (continued)

Supply demand dynamics

Asia credit supply continues to be low, with USD 130 billion of gross supply being forecasted for the year and a negative net financing of USD -107 billion.³ As seen earlier, the solid performance of Asian local currency markets, the weakening US dollar and increasing strength of Asian currencies are contributing to the repayment capabilities of Asian companies, including dollar issuers. Their access to onshore local currency funding gives them the advantage of multiple sources of liquidity.

Meanwhile, Asia credit continues to be supported by healthy local demand, such as that from Chinese investors. Together this creates a favourable technical dynamic for Asia credit and should help with the resilience of the market.

Duration and yields

Asia USD bonds' relatively low duration of only 2.5 years for high yield and 4.0 years for investment grade means that the asset class is less sensitive to spread movements versus comparative markets.

While there has been a downward move in global bond yields year-to-date, Asia credit's yields continue to look compelling, not just relatively, but also historically in absolute terms, with current yields still above their 5-year historical average (Fig. 5 & 6).

Fig. 5: Investment grade bonds yields & duration

	Yield (%)	Duration (yr)
Asia USD IG Corp	5.1	4.0
US IG Corp	4.8	6.9
Euro USD IG Corp*	4.8	4.5
EM USD IG Corp	5.2	4.9

Note*: Euro IG Corp yields listed are USD hedged.
Source: Bloomberg, JPMorgan, 19 September 2024.

Fig. 6: High yield bonds yields & duration

	Yield (%)	Duration (yr)
Asia USD HY Corp	9.4	2.5
US HY Corp	7.2	3.0
Euro HY Corp*	7.5	2.7
EM USD HY Corp	8.0	3.5

Note*: Euro HY Corp yields listed are USD hedged.
Source: Bloomberg, JPMorgan, 19 September 2024.

Asia investment grade markets continue to be relatively stable

Credit fundamentals for the Asia investment grade market remain intact, helped by the strong structural makeup of the investment grade universe, which consists of creditworthy business titans, national champions, state owned enterprises and quasi sovereigns.

In our HSBC Asia bond strategies, we see attractive opportunities in Mainland China TMT companies, which have strong balance sheets and cashflows. We prefer selective subordinated bank bonds. We also like many Indian and Indonesian issuers which have the tailwinds of participating in high growth economies.

Fig. 7: Asia investment grade opportunities

Asia investment grade most overweight sectors

Tier 2 Banks (Thailand, Korea, Singapore)
Mainland China IG Industrials
Mainland China Internet
Bank AT1s
Macau consumer
Japan financials

Source: HSBC Asset Management, September 2024.

Note 3: Source is JPMorgan, June 2024.
Source: HSBC Asset Management, September 2024.

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Improvement in Asia high yield

A more diversified universe

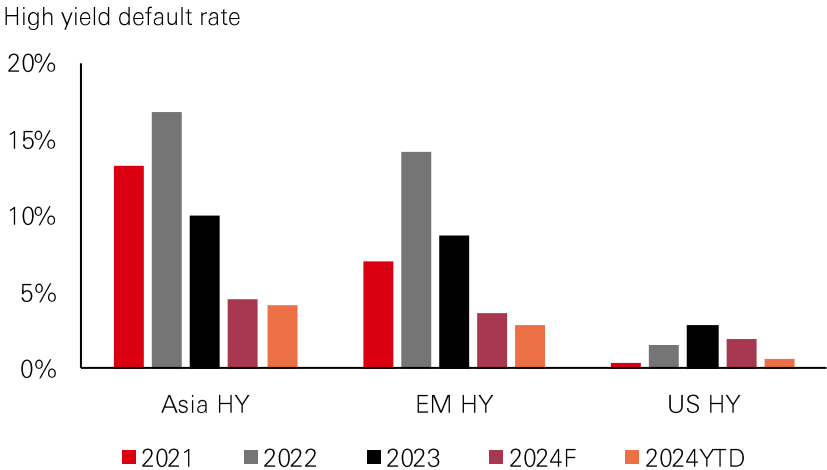
The Asia high yield market's transformation over the last couple of years has led to increased diversification, with a much smaller weight in mainland China property, currently making up about 7.9% of the universe, versus 38% at the end of 2020.⁴ The universe now has a larger weight in fast growing companies, sectors and regions, including India and Indonesia. Meanwhile, China policymakers have stepped up action to stabilize the property sector, and we believe support will continue until there are clear signs of stabilization.

Moderating default rate

We believe that easy access to funding, strong balance sheets, a resilient economy, and an increasing strength in Asian currencies will enable the vast majority of Asian companies to repay their debts in the coming years.

Nearly all defaults expected for 2024 have already occurred, so that, according to our forecasts, the Asia high yield default rate could settle back to the very low levels as witnessed for many years before the China property crisis.

Fig. 8: Asia high yield default rate moderating



2024F refers to 2024 Forecast. Source: JPMorgan, report dated 15 August 2024.

Investment opportunities

Within Asia high yield, we prefer Macau leisure which continues to recover, and India renewables which are much in demand both as investments and in terms of the service they provide. Indian cyclical and Indonesian property enjoy the benefits of high growth, and frontier sovereign can provide additional alpha opportunities at current distressed levels. Our remaining exposure to mainland China property concentrates on the highest quality private sector participants.

Fig. 9: Asia high yield opportunities

Asia high yield most overweight sectors

India renewables
India non-bank financials
Macau consumer
China industrials
Indonesia property

Source: HSBC Asset Management, September 2024.

Asia credit with HSBC Asset Management

Asia's favourable macro dynamics, China's ongoing policy support, and the global easing cycle continue to provide a positive environment for Asia bonds. We believe further volatility is possible in a global market challenged by US growth concerns and political uncertainties, but we are equipped to navigate market moves and any dips can present opportunities for our Asia bond strategies. We continue to emphasize fundamental research at HSBC Asset Management and aim to invest for the optimal balance of risk and reward in the investment opportunities we seek on behalf of our clients.

Note 4: Source is JPMorgan, HSBC Asset Management, August 2024.
Source: HSBC Asset Management, September 2024.

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