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FEBRUARY 2024

2024 Asia Pacific Market Outlook

4 Themes Investors Should Watch

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The U.S. Fed's potential rate cuts should stabilise the Asia credit market overall, but have a mixed impact on the region's economies.


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After major developed market (DM) economies showed surprising resilience in 2023, we anticipate a downshift toward stagnation or mild contraction in 2024. DM inflation is finally easing, hiking cycles are ending, and attention has shifted to the timing and pace of eventual rate cuts.

In Asia Pacific, where markets are as diverse as its cultures, the outlook for each economy varies.

Those with more interest-rate-sensitive, variable-rate debt markets, such as Australia and New Zealand, are likely to slow at a faster rate, led by weaker consumption growth. In emerging Asia, robust domestic demand and the U.S. Federal Reserve's (Fed) planned cuts should support sustained, albeit moderated, growth. Meanwhile, Japan looks headed for potential hikes as it departs from 25 years of deflation.

Here are four things we're watching in Asia in 2024 – and what it means for investors.

1. TERM PREMIUMS COULD RISE AS JAPAN PHASES OUT ULTRA-LOOSE MONETARY POLICY AFTER 20+ YEARS

While central banks in other DMs have paused rate hikes or are planning rate cuts this year, we expect the Bank of Japan (BOJ) to abolish its negative interest rate policy (NIRP) by the March or April Monetary Policy Meeting, followed by a modest policy rate hike from -0.1% to 0.25%.

With inflation likely to remain persistent due to strong wage growth, the conditions for exiting NIRP should be supportive. We expect 2024 headline inflation at around 2.8% year-on-year (yoy), primarily driven by the service sector, and wage growth from 2.5%-3.5% yoy (vs. a 10-year average around 0%), largely due to ongoing labour shortages.

In terms of quantitative easing, we anticipate the BOJ will stop expanding its balance sheet when NIRP ends. After that, we expect a gradual and flexible balance sheet reduction, bringing potentially higher yields (or "term premium") for long-dated Japanese government bonds (JGBs) as private investors will need to step in to replace the BOJ's buying.

The ultra-loose monetary policy that Japan has pursued for the last 20+ years thus looks set to be finally phased out. Late last year, the BOJ de facto ended its yield curve control, and announced that the 1% cap on 10-year yields would now be a reference rate rather than a hard limit.

Despite a bruising start to 2024 with the Noto Peninsula earthquake on New Year's Day, we anticipate minimal macroeconomic impact on the Japanese economy, and project real GDP growth of around 1% yoy for FY2024.

2. MARKET SENTIMENT TOWARDS CHINA MAY SHIFT AS STRATEGIC SECTORS SHOW SECULAR STRENGTH

The sentiment around China's economy has been overwhelmingly bearish due to persistent headwinds, including a fragile property sector, geopolitics, demographics, and debt. But the Chinese government's focus on several strategic sectors could help offset some of the drag. Our baseline forecast is for annual GDP growth to slow to 4.5%-5% in 2024 from 5.2% in 2023.

We expect supportive – but not aggressive – stimulus measures. Fiscal policy will be the primary driver, with a higher on-budget deficit financed by central and local government bonds. This should offset reduced revenue from land sales and lower local government financing vehicle (LGFV) borrowing.

Fiscal resources are expected to be directed towards infrastructure investment in leading edge sectors (such as the digital economy and AI) and R&D for manufacturing upgrades to move up the value chain to higher-tech, higher-value products (such as electric vehicles, renewables, and aerospace components). In 2023, for example, China's auto exports surged 58% to 4.91 million, driven by electric vehicle growth, to overtake Japan (4.42 million) as the world's top car exporter.[1]

Monetary policy will likely remain accommodative, with credit growth at around 9.5% yoy. We forecast one or two rate cuts in 1H 2024, totalling about 20 basis points. Structural monetary policy tools will continue to support targeted sectors, including green, high-tech, and public housing initiatives.

Economies with more interest-rate-sensitive markets are likely to slow at a faster rate

We anticipate minimal regulatory tightening and incremental support for the private/commodity housing market, aimed at stimulating demand and ensuring the completion of unfinished projects. However, we project another year of contraction, with housing fixed asset investment falling 3%-5% yoy.

Deflation will ease due to the base effect of pork and commodity prices. We expect CPI inflation will average around 1%, and PPI inflation around 0% in 2024, due to weak domestic demand and overcapacity.

3. FRAGILE AUSTRALIAN HOUSEHOLDS TO STRUGGLE UNDER THE WEIGHT OF HIGH DEBT LEVELS AND HIGH INTEREST RATES

The Reserve Bank of Australia (RBA) started increasing rates later and hiked at a more gradual pace than other central banks. Its last hike was in November 2023, taking the cash rate to a 12-year high of 4.35%. Since 2022, the cash rate has risen by 4.25 percentage points, to tame inflation that peaked at 7.8% in 4Q 2022 vs. the RBA's target of 2%-3%.

We think the RBA is close to, if not already at, its terminal policy rate for this hiking cycle – about 1% lower than the Fed Funds Rate. But do not let the optically lower terminal level fool you.

In our view, the current cash rate level is as tight as households have experienced in Australia, given continued growth in mortgage debt and a widening of mortgage rates relative to the cash rate. Additionally, the majority of mortgages in Australia are variable rate, which results in a more rapid pass-through of tighter monetary policy.

Indeed, household balance sheet strain is already visible in sluggish real consumption growth and contracting real disposable incomes. We expect household spending to deteriorate further over coming quarters, leading to softer business confidence and a weaker labour market. These dynamics should allow the RBA to begin an easing cycle in the second half of 2024.

1 Source: Japan Automobile Manufacturers Association, China Association of Automobile Manufacturers.

4. INDIA AND INDONESIA LEADING THE WAVE OF STRONG GROWTH MOMENTUM AMONG ASIA'S EMERGING MARKETS (EM)

We are especially constructive on India's economy and forecast continued strong GDP growth of around 7% yoy in FY2024, driven by resilient domestic demand, as well as strong growth in capital expenditure.

Despite weaker foreign direct investment, foreign portfolio investment is improving significantly, which we estimate will create a US$50 billion balance of payments surplus in 2024, vs. a US$9.1 billion deficit in 2023. This is due to strong equity market performance and the anticipated inclusion of Indian government bonds in global EM bond indices later this year – factors that have also helped the Rupee outperform other Asian currencies.

We continue to see space for some EM Asia currencies to appreciate

The Indian government's budget deficit continues to reduce gradually, with a 5.9% target in 2024 and potentially 4.5% by 2026, due to strong tax revenues and flexible spending on capital projects.

Headline inflation is slowly moving towards 4%, within the 2%-6% target set by the Reserve Bank of India (RBI), with core inflation already dipping under 4% in December. However, due to food inflation and El Nino risks and taking financial conditions into consideration, the RBI might be cautious about cutting interest rates too soon – we expect cuts of 25 to 50 basis points in 2024.

We are equally positive on the outlook for Indonesia and forecast stable GDP growth in 2024 at around 5% yoy. Although we expect a small current account deficit of -1% this year due to lower commodity prices, Indonesia's economic prospects remain promising with a shift towards higher value metal exports and a reduction in the fiscal deficit to -1.8% in 2023 from -6.1% in 2020.

Inflation has been kept under control and is likely to remain within the 1.5%-3.5% target range. With currency stability the top priority, there is a risk that Bank Indonesia may under-deliver on our base case for rate cuts, which is 75-100 basis points in 2024.

Among other Asian EMs, we also expect strong real GDP expansion in the Philippines and Vietnam. EM currencies tend to benefit from lower U.S. interest rates as this can ease the burden from USD-denominated debt and also enhance the appeal of local investments. EMs finished 2023 on a strong footing, and we continue to see space for some EM Asia currencies to appreciate.

INVESTMENT IMPLICATIONS

The Fed's expected rate cuts, which would cause U.S. Treasury yields to fall and the dollar to weaken, will have varied implications for Asia Pacific economies.

Over the cyclical horizon, given Australia's rate-sensitive market, we favour an overweight to long-dated Australian Commonwealth government bonds, with 10-year rates likely to outperform Treasuries.

We expect Japanese rates to underperform global rates given the BOJ's gradual policy normalization in 2024 and the rise in term premium. We favour an underweight position to Japanese duration.

Technicals remain supportive for Asia credit, in our view

Interest rates on 10-year China government bonds (CGBs) are expected to have relatively low volatility and be range-bound at around 2.5% with limited correlation to Treasuries. Between CGBs and policy banks,[2] we favour an underweight to the latter, given tight spreads and upside surprise in supply from their role in the pledged supplementary lending programme.[3]

Indian government bonds offer value, in our view, with 3+% real yields on 12-month forward inflation estimates. The same goes for Indonesian government bonds, which offer nearly 4% real yield even on a spot inflation basis and have favourable demand-supply dynamics. We are positive on the Indonesian Rupiah and Indian Rupee as we expect reform-based governance to continue post-elections and the economies to remain secular drivers of EM growth.

In Asia credit, we expect more issuance this year after a rather dry 2023, supported by reinvestment demand from bond maturities. Technicals remain supportive, as we expect negative net financing for 2024 due to plentiful and cheap onshore financing. Issuers are using local financing to buy back USD-denominated bonds.

In investment grade credit, we see opportunities in some Japanese banks, as well as Australian companies in defensive sectors that are less exposed to discretionary household spending and that are expected to benefit from strong population growth and elevated – though moderating – inflation, such as toll roads and regulated utilities. For high yield, we see value in select Chinese and Indonesian companies.

2 China's three policy banks are the Agricultural Development Bank, the China Development Bank, and the Export-Import Bank of China.

3 The pledged supplementary lending (PSL) programme, initiated in 2014, is a targeted funding tool of the People's Bank of China that provides cheap long-term cash to policy banks (by accepting their loans as collateral) to fund lending to the housing and infrastructure sectors.

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CMR2024-0130-3359477