Asian Fixed Income

Q1 2025 Outlook

First Sentier Investors

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Global/US

As we move into 2025, US growth and Trump's policies upon his inauguration will be the key drivers of credit markets. We believe US growth will likely moderate as Biden's government spending along with job creation will soon cease. In fact, our team has strong conviction that Trump would immediately undo many of Biden's policies, sharply reduce spending in the government related sectors, before shifting the attention to boost the private sector. With other regions also slowing, especially in Europe, we could move into a period of slower global growth as Trump's pro-business policies will take time to impact the real economy.

Despite a pessimistic outlook on growth, there are some bright spots that could at least improve market sentiments

- Market has been digesting Trump's 2.0 and its impact on markets will likely be just a shade of 2016.
- China's commitment to boost growth is very encouraging, even though we maintain they will not repeat the same mistake of 2008 which led to excesses in their economy.
- Trump may not hit other countries with as hard a tariff as he had promised. Given how interconnected the world is, tariffs are bad for everyone, including the US.

Europe

In Europe, the European Central Bank (ECB) began its rate cuts in June and continues to tread a fine balance between growth while keeping the last mile of inflation in check. With the manufacturing economies in Europe struggling to emerge from its doldrums to find its competitive footing, the growth story in Europe has been bleak and the export driven region is vulnerable to shocks emanating from US tariffs. We see ECB continuing to remain accommodative in policy even as it strives for fiscal consolidation. Inflation has been getting under control as gas prices retreated over the year. Service inflation remains one of the stickier components that the ECB continues to watch, but with weaker growth forecasts ahead for the region, the trend is likely lower for inflation.

Asia

China's policies have been highly accommodative with continuous policy measures aimed at stimulating consumer sentiment and destocking excessive property inventory. However, the multilayered problems causing China's slowdown means that we don't expect a quick recovery. In other words, we still need actual consumer confidence and pre-sales numbers in the property sector to pick up on a sustained basis before market confidence can be restored. Nevertheless, we are of the belief that China will not repeat the same mistake of 2008 which led to excesses in their economy. The Chinese economy will emerge much stronger from this consolidation process and we maintain a positive long-term outlook for the economy.

The Bank of Japan's (BoJ) exit from its negative interest rate policy (NIRP) and yield-curve control (YCC) policy has not come easy after 17 years in a negative interest rate environment. There has been encouraging increases in real wages that hint promisingly to a stronger domestic growth environment – the yearned after 'virtuous cycle'. We see the BoJ gradually implementing its rate hikes over the year. As the BOJ normalises interest rates, the yen's strength has seen signs of revival, not only on the back of the Fed's rate cuts, but also potentially as a safe haven currency, should markets end up with a hard landing scenario.

Asian economies have been resilient thus far. Some have benefitted from the tech upcycle, but effects from China's slowdown are not negligible. The growth outlook in Asia is showing signs of weakness especially for export-oriented countries including Singapore, South Korea and Taiwan, not only due to China's slowdown, but also the lackluster demand from other regions. We believe that this trend is likely to continue. Within the Asian region, countries with a stronger domestic story, such as India, are likely to fare better. Against this weakening external backdrop, we see policy divergence emerging among Asian central banks as some remain on pause while others begin to cut rates along with the Fed's easing cycle. The moderating inflationary backdrop and healthy fundamentals remain favorable tailwinds for Asian economies and currencies. We remain constructive on the region's longer-term growth prospects as Asian economies continue to move up the value chain in the global economy. Asian local currency bonds have regained some footing on first signs of the Fed's pivot, and the changing tides in fund flows favoring Asian markets could further boost Asian local bond returns.

Credit

Credit spreads globally are extremely tight. With spreads of Asian Investment Grade (IG) now less than 20% of all in yields, there is very little room left for surprises. There is low incentive to hold longer dated bonds too at this juncture. In Asia, fundamentals remain sound despite pockets of weakness - Indonesia faces a deteriorating fiscal balance though it is still on solid footing especially when compared with other EM peers. Bond supply in 2025 will remain modest, thereby supporting demand-supply technicals. Still elevated long end rates may also further deter issuers from issuing bonds. Due to the high US interest rate environment and a negative sentiment towards China, Asian bonds has not been a beneficiary of investment inflows, particularly in 2022-2023, but we noted that 2024 has seen some positive turn in sentiments. Should interest rate differentials narrow and/or China's story improve, Asia could see the largest upside.

With the weakness we anticipate in the global economy, a risk-off scenario could occur very swiftly at current valuation levels. We are poised to take opportunity of risk-off market conditions while maintain our high quality bias with a focus on diversification. We prefer issuers with the liquidity and resilience to withstand a hard global landing, should such a scenario emerge.

Rates

Across our portfolios, we are maintaining a neutral stance in US rates. While returns remain attractive from an all-in yield perspective, volatility could play out more visibly from Trump's policies and geopolitical events. As Trump's campaign promises play out, the Fed's path for rate cuts may see some initial recalibration, particularly if growth shows signs of resilience and inflation begins to trend higher. Our base case, however, is that the US economy is running low on growth momentum, and the Fed is likely to continue cutting policy rates throughout the year, with an objective of bringing the Fed fund rate to the 3-3.5% range. The pace of rate cuts could fluctuate as the Fed remains data dependent instead of being forward looking.

Source : Company data, First Sentier Investors, as of end of December 2024.