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Asian rates and FX outlook 2024

Potential higher returns and lower volatility

By the Asian Fixed Income Team
December 2023

Outlook for 2024

US Treasury (UST) yields rallied in 2023, although at the start of the year the consensus was that yields would decline. The benchmark 10-year UST yield moved from a low of 3.25% in April 2023—at the height of the US banking crisis that sparked fears of economic distress—to touch a 16-year high of 5.02% towards end-October[1], when data pointed to continued resiliency in the US economy. A confluence of factors, such as higher US Treasury funding needs, rising geopolitical tensions and elevated oil prices, contributed to the selloff in USTs over 2023. Amongst the drivers, the hawkish monetary policy outlook by the US Federal Reserve's (Fed)—it took the Federal Funds Rate to 5.50% (as of November 2023)[2], while indicating rate cuts are unlikely in the short term—was arguably, we think, the primary factor that prompted the relentless rise in UST yields in 2023.

The Fed's aggressive monetary tightening finally appears to be approaching—if not already at—an end. Throughout 2023, investors eagerly watched US jobs data and inflationary readings, debating the timing of the last rate hike. Recent rhetoric from Fed officials suggests the central bank is not ruling out another increase in 2023, as labour market conditions remain tight, business activity continues to be more robust than expected and inflation stays above the Fed's 2% target[3]. That said, some members of the Federal Open Market Committee (FOMC), including Fed Chair Jerome Powell, have pronounced that the recent sharp move higher in long-end yields has done part of the tightening job; Powell has reiterated on multiple occasions that the central bank is committed to move forward "carefully" with further rate moves. Our call is that the Fed is likely done raising interest rates. Nonetheless, we foresee the policy environment remaining restrictive, with the Fed keeping rates unchanged for most of 2024, as it continues to assess the cumulative impact of tighter financial conditions to the economy and on inflation. Keeping interest rates

[1] Source: Bloomberg, December 2023
[2] Source: Bloomberg, December 2023
[3] Source: Bloomberg, December 2023

higher for longer increases the risk of stress in the financial system through various channels, and the situation needs to be monitored.

Thus far, tighter monetary policy has made a modest impact on US household spending and business investment. We expect the US economy to show signs of slowing over the coming quarters, with clearer evidence of ebbing economic strength by mid-2024. The abrupt rise in longer-term rates could see higher interest costs start biting across more corners of the economy than they have until now, as debt-servicing and refinancing costs for households and businesses increase. Consumer spending has been a key component to keeping the US economic engine roaring far longer than many had anticipated. The gradual run-down of US consumers' excess savings and resumption of student loan payments after a three-year pause may translate to a modest slowdown in spending. Meanwhile, wage growth has moderated, and we expect lagged effects of prior interest rate hikes to translate to smaller pay increases and a gradual cooling in the labour market, which may also cause consumers to pull back on spending. Separately, fiscal policy is likely to turn less expansionary as the federal government reins in spending as part of the debt ceiling agreement.

Encouragingly, underlying US inflation has cooled; since June 2023 core prices have run significantly closer to the Fed's target. As wage pressures ebb and consumer spending slows, we expect inflationary pressures in the US to further subside. That said, we expect that a full return to the Fed's 2% inflation target is unlikely to be within reach in 2024.

Thereafter, we believe the hurdle for the Fed to signal rate cuts would be largely driven by the severity of demand contraction resulting from the aggressive monetary tightening. We foresee this happening no earlier than the tail-end of 2024 as we see it taking place only in the face of marked softening in the labour market and convincing signs that inflation is under control and significantly closer to the Fed's 2% target. If the Fed does lower rates in 2024, we expect an adjustment of no more than 25-50 basis points (bps)*.

* The forecast is not necessarily indicative of future performance.

From a market perspective, we expect Fed expectations to remain the primary driver of UST and US dollar moves in 2024. Given our Fed forecast, we believe upside risk to yields is relatively limited. Yields, on the other hand, are unlikely to shift materially lower given all the factors discussed. Meanwhile, we believe broad-based dollar strength will wane in 2024 with the Fed expected to stop hiking rates and as the US economy slows down.

Over in Asia, the challenging external environment—prompted largely by rapidly weakening growth in China since the second quarter of 2023 together with a delay in the revival of the semiconductor industry cycle—has weighed heavily on trade recovery in the region. We expect economic activity in most Asian countries to remain broadly stable in 2024. China's recovery momentum will likely be a significant wild card for regional growth. Although Chinese policymakers have unveiled a raft of measures to spur growth, the country's economic momentum remains sluggish and its labour market sentiment is still lacklustre. India and the Philippines are expected to register fairly robust growth in 2024, and open economies like South Korea and Singapore may benefit from a pick-up in exports.

As for monetary policy direction, we expect most central banks in the region to keep policy rates unchanged, at least for the first half of 2024. China is likely to be an exception, as it could introduce additional monetary accommodation to support its sluggish economy. Monetary policy is expected to remain relatively tight as central banks in the region face still-high US interest rates and manage the need to anchor their currencies. As for inflation, China may see a slight acceleration from low levels, while disinflation trends are likely to continue in the rest of the region.

Looming elections in India, Indonesia, South Korea and possibly Singapore mean policies in these countries may lean towards supporting growth. Although we expect increased fiscal support ahead of these elections, the size is likely to be minimal. Our base case is that political transitions in these countries will be smooth with Asia's political backdrop remaining stable post elections.

In all, 2024 is likely to be a year of higher returns and lower volatility for Asian local government bonds with UST yields expected to stabilise and start easing. We expect sentiment towards Asia's bond markets to turn increasingly positive, attracting capital inflows and providing technical support (through portfolio inflows) that was largely lacking in 2023. We have an upbeat view of long Indian government bonds due to their attractive carry and favourable technicals. The inclusion of Indian government bonds into JP Morgan's Government Bond Index–Emerging Markets Index (GBI-EM) from June 2024 is expected to provide support for these bonds. Meanwhile, a potential inclusion into the FTSE Russell World Government Bond Index may provide an additional boost for South Korean government bonds.

We believe that Asian currencies strengthening against the dollar will be a dominant theme in 2024, as we expect demand for the greenback to wane as the Fed's rate hiking cycle comes to an end.

The key downside risks to our investment thesis are worse-than-expected Chinese GDP growth, higher-than-expected energy prices and greater geopolitical uncertainty.

Individual country outlooks

China

China appears on track to meet or slightly exceed its 2023 growth target of "around 5%"*. For 2024, the IMF's GDP forecast for China is at 4.6% with market consensus at 4.5%*. Recent policy announcements on the fiscal front have shown that the central government is willing to support struggling local government finances, and the market will be watchful as to whether the recent increase in China's official fiscal deficit above 3% of GDP will be maintained in 2024. Economic momentum is sluggish, while business and labour market sentiment remains lacklustre. The real estate market will be watched closely as the downturn in this key pillar of the Chinese economy will have to stabilise for the economy to have a stronger footing. On the external front, China's export growth may face challenges from the global slowdown and geopolitical concerns may continue to slow foreign investments into the country. However, there is renewed hope that the recent thaw in relations with major developed countries could provide a boost.

* The forecast is not necessarily indicative of future performance.

China's Inflation remains tepid, with the spike in prices seen in many other regions all but missing in the country following its post-COVID reopening. Headline inflation is close to flat while core inflation is at 1%[4]. Prices are expected to firm up somewhat in line with energy and other major commodity prices but largely remain under control. Thus, there is room for additional monetary accommodation to continue, although the People's Bank of China (PBOC) may be cautious in the near term given its goal of stabilising the currency.

The stable growth outlook and low inflation dynamics engender a benign environment for Chinese local currency bonds. In the near term, slightly tighter funding conditions that may result from measures to stabilise the currency could lift bond yields. However, positive real rates do offer value to investors, and the prospect of future monetary easing could give the bonds a further boost.

China's current account is still likely to remain positive, allowing it to offset investment outflows to some extent. With a huge foreign currency reserve and policymakers' tendency to smooth the renminbi's movements in the foreign exchange market, we expect the currency to remain stable.

South Korea

South Korea is likely to print full-year 2023 growth at 1.4%, while consensus growth estimates for 2024 is at 2.1%*. The semiconductor industry remained in a slowdown for most of 2023 and this, together with higher imported oil prices, hurt South Korea's external economy. Dynamic random access memory (DRAM) prices did bounce back from what looked like a bottom in September 2023; if recovery is sustained, this could help boost growth. The domestic economy, especially consumption, has held up much better than expected for the better part of 2023 but appears to be slowing down in the last couple of months. South Korea consolidated fiscally in 2023 (with a budget deficit of 2.6%) and although we will see some increase in 2024 (planned deficit of 3.9%)[5], this is largely due to lower revenue projections. Fiscal discipline continues to be a feature of the current administration of South Korean President Yoon Suk Yeol.

* The forecast is not necessarily indicative of future performance.

Inflation should continue to moderate from the high levels seen earlier in 2023 with the Bank of Korea (BOK) forecasting headline CPI to fall from current 3.6% towards 2% in late 2024[6]. The slowing domestic economy and a cooling in inflation could indicate the BOK commencing monetary accommodation in the second half of 2024,

[4] Source: Bloomberg, December 2023
[5] Source: Bloomberg, December 2023
[6] Source: Bloomberg, December 2023

especially if it is apparent by then that the Fed is done with its hiking cycle. The risk to this outlook lies in oil and other commodity prices continuing to rise significantly and impacting input costs as a result.

On politics, we are watchful of legislative elections due in 1H2024, as the results could affect the future trajectory for fiscal policies.

With the base case of slowing growth and inflation, monetary accommodation and fiscal discipline, we are constructive on South Korean local currency bonds. The possible inclusion into the FTSE World Government Bond Index in 2024 could provide a further boost to the country's bonds.

Regarding currencies, a recovery in the semiconductor industry could fuel South Korea's exports and investment flows; on the other hand, energy and other commodity prices could rise and have a negative impact.

India

India is expected to register better growth compared to its regional peers in 2024. The Reserve Bank of India (RBI) sees the economy expanding 6.5% in the fiscal year (FY) ending March 2024 and 6.6% in FY2025*, supported largely by buoyant domestic demand and investment growth. Forward-looking surveys by the RBI point to a recovery in consumer sentiment and a moderation in household inflation expectations. Meanwhile, reforms undertaken by Prime Minister Narendra Modi's government in past years have facilitated foreign direct investment flows and placed the country on the radar of international investors and multinational companies.

* The forecast is not necessarily indicative of future performance.

We believe India's domestic inflation has peaked as vegetable prices are seen reverting to normal levels. Absent further seasonal shocks to food prices, we expect overall inflation to moderate in the months ahead, providing room for the central bank to shift to a neutral monetary policy stance. We believe the RBI is unlikely to cut policy rates anytime soon as dollar strength puts the Indian rupee under weakening pressure. However, if dollar demand wanes and domestic inflation becomes more anchored, the RBI could start prioritising growth over inflation and commence lowering policy rates. We see this happening as early as the first quarter of 2024.

India government bonds will now officially form part of JP Morgan's GBI-EM Index and will be the second biggest emerging market (EM) country in the index by April 2025. This, together with ebbing inflation, is expected to provide solid support for India government bonds and the rupee vis-à-vis government bonds and currencies of regional peers as foreign interest in the market increases. We remain constructive on Indian bonds given their attractive real yields and expect their yields to fall further in 2024. Meanwhile, we expect the rupee to remain broadly stable as improving services balances help to partly mitigate the trade deficits in the current account. We expect the resumption of inflows into EM prompted by decreased hawkishness from the Fed to further support domestic bonds and the rupee.

Elevated oil prices and poor monsoons are key risks to India's growth. Meanwhile, political noise will likely rise in 2024, as general elections are due to be held around April or May. Nonetheless, we do not foresee politics being a key risk for India in 2024, projecting incumbent Prime Minister Modi to be re-elected on the back of his high approval ratings.

Singapore

The Monetary Authority of Singapore (MAS) expects GDP growth in 2023 to come in at the lower half of its 0.5–1.5% forecast range. For 2024, growth is projected to be closer to its potential rate, with the output gap remaining slightly negative*. Prospects for the Singapore economy are subdued in the near term due to softer global demand, but it is seen gradually picking up later in 2024 as inflation continues to ease and the electronics cycle recovers modestly.

Singapore's 2024 headline CPI is projected to ease to around 3.0–4.0%[7], with moderation in private transport and accommodation inflation offsetting the one-off impact of the Goods and Services Tax increase. For 2024, MAS expects core inflation to slow to an average of 2.5–3.5% with prices tempered by favourable supply conditions.

After moving aggressively to dampen inflation by strengthening the Singapore dollar (SGD) at an unprecedented pace of five times since October 2021, MAS left its monetary policy unchanged in 2023. The central bank will be

[7] Source: Bloomberg, December 2023

shifting to a quarterly (from semi-annual) monetary policy schedule in 2024 as part of continuing efforts to enhance communications. This will also afford greater flexibility to react nimbly to changes in economic conditions. With the current appreciating policy band sufficient to help dampen still-elevated inflation, MAS is likely to stay on hold through 2024, barring a significant weakening of global growth which would warrant policy easing.

The current estimated SGD nominal effective exchange rate ("S$NEER") policy band slope of 1.5%[8] will likely keep the Singapore dollar resilient versus the US dollar and firm against the trade-weighted basket of currencies going into 2024, supported by Singapore's strong external balance. On the rates front, we expect Singapore Government Securities to continue outperforming against USTs, particularly in the long end of the curve. Unlike the US, which has ramped up issuances to fund its deficit, Singapore has not had to resort to such means. Meanwhile, the issuance of sovereign and statutory board green bonds is likely to increase as the nation aims to achieve net zero by 2050.

Malaysia

Bank Negara Malaysia (BNM) is projecting full-year 2023 GDP growth to be about 4%, against the backdrop of a lacklustre global economic recovery offset by domestic drivers. For 2024, Malaysia sees growth at 4-5%*, driven by private sector expenditure, improving global demand and new infrastructure spending. The government expects 2023 headline CPI rising to 2.5-3.0% and sees inflation at 2.1-3.6% in 2024*. The wider forecast range for 2024 reflects factors such as planned tax hikes as well as the government's intention to review fuel subsidies. Risks to inflation include supply-related factors such as global commodity price movements, geopolitical uncertainties and climatic conditions.

* The forecast is not necessarily indicative of future performance.

BNM resumed its normalisation path in 2023 by hiking its Overnight Policy Rate (OPR) by 25 bps to 3.00% in May, following 100 bps of tightening in 2022. The central bank has emphasised that it took a more prudent approach in normalising monetary policy, with adjustments calibrated to a "measured and gradual" pace to support sustainable economic growth. We expect the OPR to be maintained at 3% in 2024*, with BNM likely to cut rates only if growth significantly undershoots expectations. The central bank also vowed to intervene in the foreign exchange market to stem currency movements "deemed excessive".

* The forecast is not necessarily indicative of future performance.

Malaysia's six state elections in August 2023 preserved the political status quo and provided some relief, contributing to near-term political stability. Now the main focal point is whether Prime Minister Anwar Ibrahim's unity government will push its economic policies and reform agenda forward. According to the 2024 budget, the fiscal deficit is projected to narrow to 4.3% of the GDP versus 5.0% in 2023. This will be supported by 1) revenue-enhancing measures including the raising of service taxes and the introduction of capital gains and luxury taxes, and 2) reduction of operating expenditure through the gradual implementation of subsidy rationalisation programmes mainly on fuel and electricity. This reaffirms the government's commitment to fiscal consolidation at a gradual pace and supports expectations that the country's credit ratings will remain stable.

Malaysia's current foreign currency debt exposure amounts to less than 3% of total debt[9]. Gross issuance for 2024 is likely to remain similar to 2023, at about Malaysian ringgit 180 billion[10]. The lower government bond borrowings resulting from a reduction in the 2024 budget deficit is expected to be offset by a run-down in outstanding T-bills. Supply will likely remain supported by onshore real money demand and steady inflows from the Employees' Provident Fund. While we could expect near-term weakness for the ringgit, we think that its valuation is cheap and pressure on the currency may gradually dissipate in 2024 as the Fed turns less hawkish and the Chinese renminbi stabilises.

[8] Source: Bloomberg, December 2023
[9] Source: Bloomberg, December 2023
[10] Source: Bloomberg, December 2023

Thailand

Thailand's economic recovery has been slow thus far, given weak external demand and the economy's heavy reliance on international tourism. Heading into 2024, Thailand's economy is poised to see a recovery, with growth being supported mainly by fiscal stimulus. Prime Minister Srettha Thavisin has vowed to put reinvigorating the sluggish economy as his government's first priority. Among other things, he has promised cash handouts to eligible individuals and loan moratoriums to farmers and small businesses. The government will also soon cut energy prices and continue to ease visa processes for travellers from select countries.

Bank of Thailand (BOT) projects headline inflation to average 1.6% in 2023 and 2.6% in 2024*. It sees risks of stronger inflation due largely to the government's stimulus plans. This notwithstanding, the central bank signalled at its most recent monetary policy committee meeting that the policy rate is now "consistent with the neutral level", which we take to mean an extended pause hereon for the BOT.

Lingering uncertainty around Thailand's financing needs—post the new government's announced expansionary and populist policies—has placed upward pressure on Thai government bond yields. The budget is expected to be approved in early 2024. Going forward, demand for Thai government bonds could be supported by lower UST yields. However, we see Thai government bonds remaining vulnerable to the budget's final details and impact of the Thai government's fiscal stimulus measures (including the panned digital cash handout scheme). Regarding currencies, we expect continued improvement in the current account and tourism flows to support the Thai baht in 2024.

Key risks to Thailand's growth include slower tourist arrivals, a worse-than-expected slowdown in the global economy and the fiscal budget being delayed.

* The forecast is not necessarily indicative of future performance.

Indonesia

Bank Indonesia (BI) projects the country's GDP growth to be in the 4.5-5.3% range in 2023. For 2024, BI Governor Perry Warjiyo expects growth to be within a range of 4.7-5.5%*. We share the view that growth will stay largely stable in 2024, with election-related spending supporting recovery in domestic demand, offset by slower investment spending as higher interest rates weigh on business sentiment. The ramp up of construction within Indonesia's new capital city will also be supportive of growth, while the outlook for commodity prices hinges largely on China's ability to spur its economy. Taking a longer-term perspective, Indonesia's growth story centres on plans to benefit more from the anticipated boom in the global EV industry—including the development of its domestic nickel processing and refining sectors, as well as domestic production of EV batteries.

* The forecast is not necessarily indicative of future performance.

The central bank prioritised FX stability for most of 2023, as dollar strength triggered broad-based weakness among currencies in the region. From now until early 2024, anchoring the Indonesian rupiah will likely continue to be the main determinant of BI's monetary policy action as inflation has eased and is comfortably back within its target. Thereafter, we see room for the central bank to commence rate cuts to spur growth.

Finance Minister Sri Mulyani Indrawati has declared that the country's budget balance is likely to end 2023 below the projected 2.28% deficit, on the back of better-than-expected revenue collection. The Ministry of Finance also has significant cash balances with BI. A larger drawdown of accumulated reserves in 2024, together with larger fiscal space as revenues exceed targets, gives the government the option of lowering bond sales in 2024.

We hold a constructive view on Indonesian bonds going into 2024. Demand will likely increase when upward pressure on global bond yields eases as market focus turns to Indonesian bonds' attractive real yields relative to their regional peers. We anticipate foreign inflows to improve in 2024 as the Fed is expected to conclude its tightening cycle. In addition, we expect manageable fiscal deficits and domestic bond offerings, benign inflation and possible monetary policy easing by BI to provide further support to Indonesian bonds. We expect the Indonesian rupiah to stay relatively stable in 2024.

Politics will likely take the spotlight by end-2023, as campaigning for general elections (scheduled in February 2024) gets into full swing. We expect key policies—such as infrastructure development of EV supply chain—to continue after the election.

Philippines

Growth for the Philippines in 2024 is expected to remain strong relative to the rest of the region, but it may come in lower than the government's target of 6.5-8.0%*. For growth, the principal supportive factor remains consumer spending, although elevated interest rates is likely to have a constraining effect. While the government's increased infrastructure spending could provide an offset, we expect any acceleration to be modest amid the ongoing fiscal consolidation.

Although headline inflation has eased from previous highs, October 2023's 4.9% print remains elevated and above the Bangko Sentral ng Pilipinas' (BSP) 2-4% target[11]. Similarly, core inflation has decelerated but continues to be high. Moving forward, we see scope for a return to the central bank's target only in late 2024 given the remaining supply-side risks, which include escalation in food prices due to El Nino and still-elevated oil prices.

Although we share the view that BSP's hiking cycle is over, we believe the central bank will retain a hawkish stance on monetary policy. As global central banks maintain higher-for-longer policy rates, BSP will also have to keep a buffer in terms of policy rate differentials to stem currency depreciation, which has an inflationary effect through fuel and food imports.

The government has set a budget deficit ceiling equivalent to 6.1% of the GDP for 2023 and is targeting a return to 3% by 2028*. The gradual fiscal consolidation aims to support growth as policymakers seek to rely mainly on strong revenue growth (rather than reductions in fiscal spending) for this adjustment.

* The forecast is not necessarily indicative of future performance.

We hold a neutral to positive view on Philippine rates going into 2024. Yields have risen to attractive levels, and real yields are positive. We anticipate Philippine government bond yields to start easing once inflation comes within the central bank's target range. Decelerating growth, along with declining developed bond market yields, could further support Philippine peso bonds later in 2024. However, potentially high bond supply, as the government takes a more measured approach in fiscal consolidation, could cap any gains by bonds. Nonetheless, international bond issuance may offset some of the impact on the local peso bond supply.

We see potential for the Philippine peso in 2024 to rally in line with other Asian currencies as the US dollar weakens. Resilient remittance inflows is seen holding up the currency, while current account deficit concerns could offset any gains. Overall, the BSP can draw on its ample foreign exchange reserves to manage currency volatility if needed.

[11] Source: Bloomberg, December 2023

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