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Research Report
Fixed Income

August 2024

Unlocking Opportunity in Asia Fixed Income

PAiF
ABF Pan Asia Bond Index Fund

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PAiF
ABF Pan Asia Bond Index Fund

Foreword

Kheng Siang Ng
Asia Pacific
Head of Fixed Income,
Head of State Street
Global Advisors Singapore

Asia-based asset managers and owners are increasingly optimistic about the region's fixed income markets due to a favorable economic outlook and strong income opportunities. An industry survey commissioned by ABF Pan Asia Bond Index Fund (PAIF) shows rising allocations to fixed income, partly supported by the region's diverse economies.

Other factors are stability, attractive yields, and growing diversity of domestic investor bases in terms of types and size. Efforts to liberalize markets and enhance financial infrastructure across the region are boosting global investor interest. Despite some concerns, the region's positive long-term outlook makes it a compelling destination for fixed income investments.

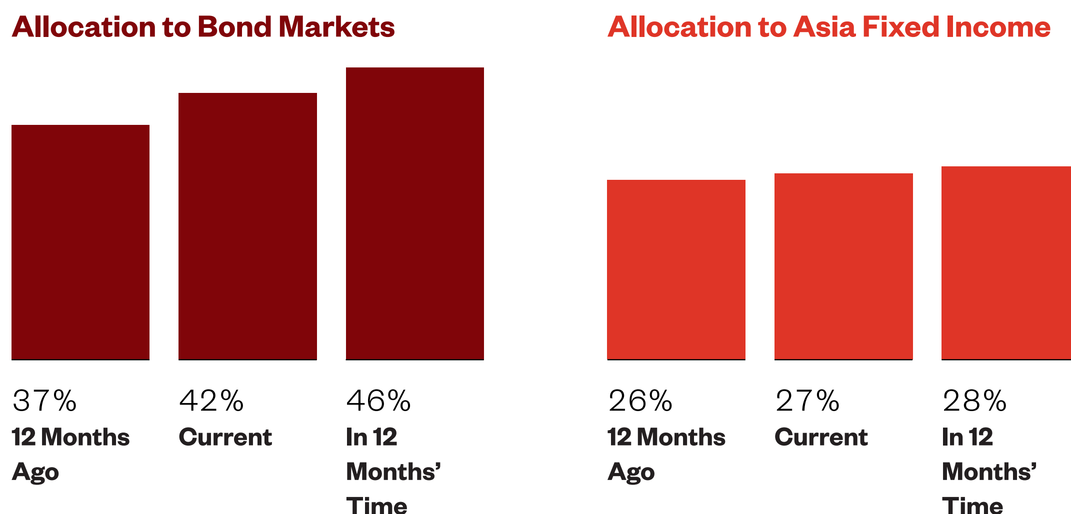
Growing Optimism Towards Asia-Pacific Bond Markets

Asia-based asset managers and owners are warming to fixed income markets in their region thanks to a combination of a promising economic outlook and strong diversification and income opportunities. The recent cycle of interest rate hikes has restored a crucial role for bonds, which is to generate income. Before the United States (US) Federal Reserve increased interest rates in March 2022, high-quality bonds were languishing at historically low yields for more than a decade. There are now widespread expectations in the financial community that global interest rate cuts are likely as inflation gradually comes under control, which suggests there is potential for continued outperformance in many of the Asia bond markets.

> **"Investors have been lapping up these yields. In the 20 years I've worked in this market in Asia, the periods where we've had this level of yield for quality investment-grade state-owned borrowers have been rather fleeting. You really don't get these yields for long historically. You've seen big investor bases pivot to fixed income."**
>
> — Owen Gallimore, Head of Asia Pacific Credit Analysis, Deutsche Bank

That optimism is reflected in a survey commissioned by PAIF of 600 Asia Pacific-based asset managers and owners. It finds that these institutions expect to allocate nearly 46 percent of their assets to fixed income in the next 12 months, compared with 42 percent now and 37 percent 12 months ago.

Figure 1
Asia Pacific-based Asset Managers and Owners Are Looking for Diversification and Income, but Concerned About Inflation and Recession



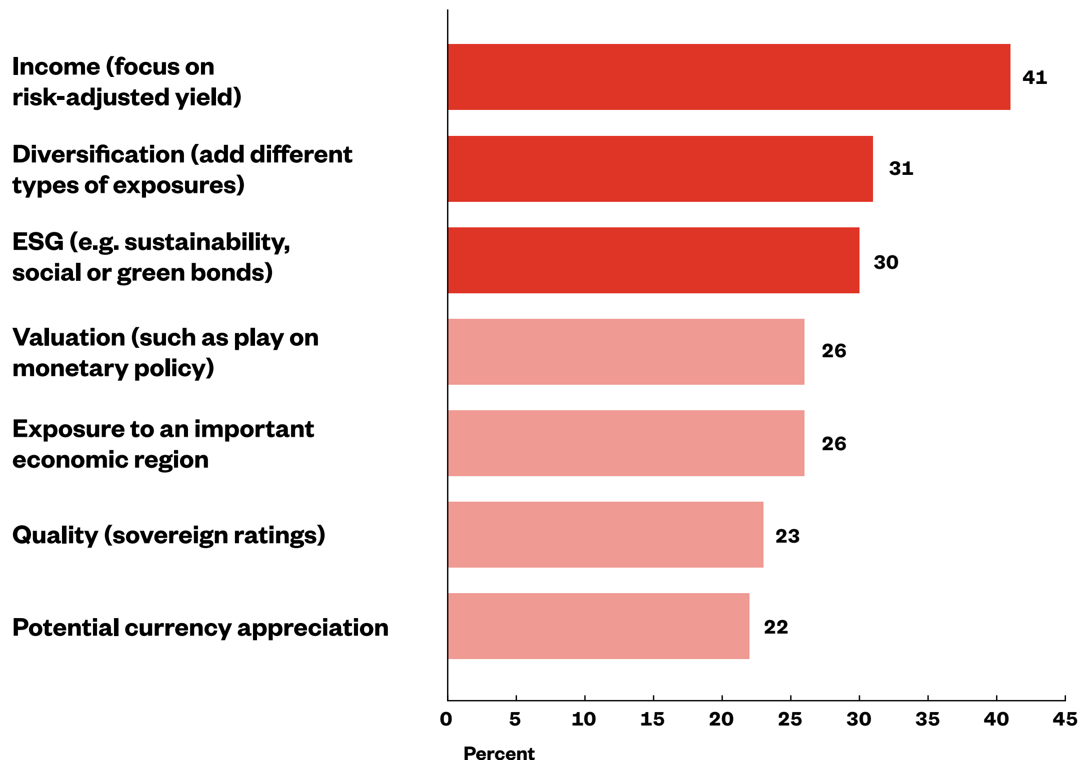
Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Asset Managers Are Seeking Income and Diversification

The survey shows that Asia holds a number of attractions for asset managers and owners in terms of their fixed income asset allocations. The region is made up of a wide range of jurisdictions at different stages of economic development, from the Philippines and Indonesia — high-growth emerging market economies — through to those that are mature with strong credit ratings, such as Singapore and Hong Kong.

The PAIF survey reveals that 41 percent of asset managers and owners are investing in bonds to generate income, compared with 31 percent who are seeking diversification and 30 percent who are motivated by sustainability-related goals. When it comes to investing in bonds across Asia ex-Japan, a third of asset owners and managers say that "diversification" is the main attraction closely followed by income and improving economic conditions at 32 percent each.

Figure 2
Income is the Primary Motivation for Investing in Bonds



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Asia Pacific-based asset managers and owners consider diversification and income as the most attractive aspects of Asia's (excluding Japan) government bond market, but have a number of key concerns.

Figure 3
What Asia-based Asset Managers and Owners Are Looking for in Fixed Income

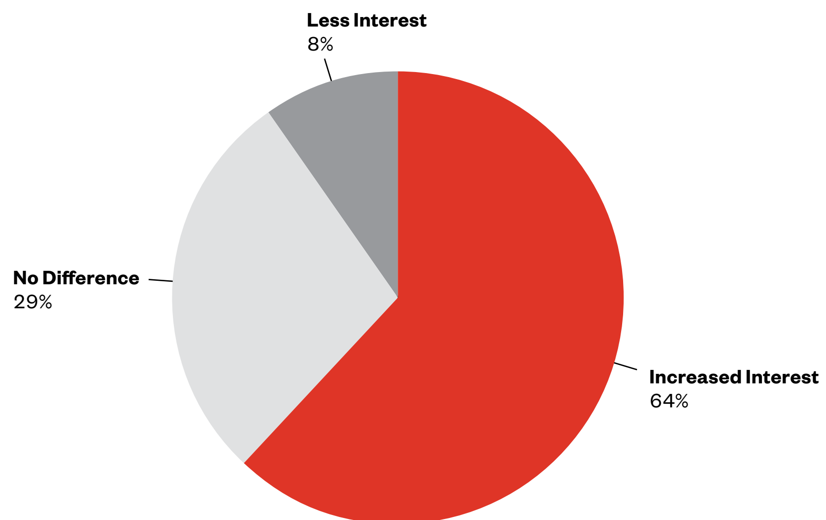
Top Attractive Aspects	
Diversification	33%
Income	32%
Improving Economy	32%

Top Key Concerns	
Recession	37%
Inflation	37%
Geopolitics	35%
Currency Depreciation	35%

Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Echoing the desire for diversification, 64 percent of asset managers and owners are more interested in investing in government bond markets across Asia rather than in a single government bond market in the region. That compares with 29 percent saying it makes no difference to them and 8 percent who say it is of less interest. In response to a question about maximum concentrations in individual Asian bond markets within an ETF portfolio, 70 percent of asset managers and owners say the concentration should be no more than 35–45 percent and 38 percent say 25–35 percent is enough. Only 8 percent are comfortable with a single market concentration exceeding 50 percent, meaning that 92 percent prefer single market exposure to be below 50 percent of the fund's assets.

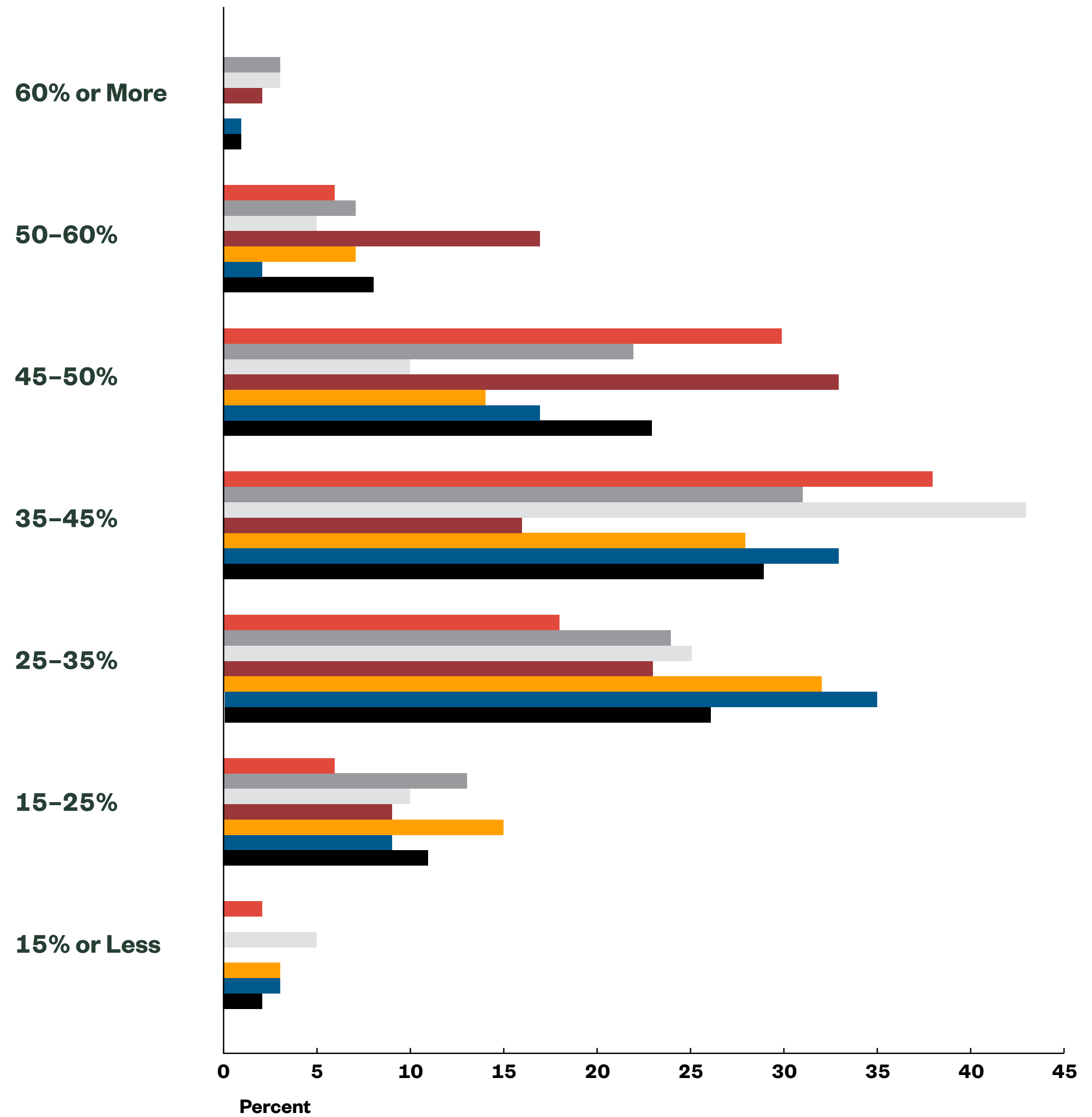
Figure 4
Diversification Trumps Single Exposures



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Over half of investors are comfortable with 25-45% of a fund being invested in a single jurisdiction.

Figure 5
Investors Comfortable With Relatively High Concentrated Exposures



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Figure 6
The Economies of the Eight Markets That Make up the Markit iBoxx ABF Pan-Asia Index Are a Good Example of the Diversity of the Asia Region

Market	GDP per Capita (USD)	Real GDP Growth Rate (%)	Inflation Rate (Year on Year) (%)
Singapore	$84,734	1.1	4.8
Hong Kong	$50,697	3.3	2.1
South Korea	$33,121	1.4	3.6
China	$12,614	5.2	0.2
Malaysia	$11,649	3.7	2.5
Thailand	$7,172	1.9	1.3
Indonesia	$4,941	5.1	3.7
Philippines	$3,726	5.6	6.0

Sources: World Bank Group, Bloomberg Finance L.P., State Street Global Advisors, from January 1, 2023 to December 31, 2023. GDP per capita in current USD terms rounded to the nearest dollar.

The region gives investors access to a wide range of bond maturities, yields, and sovereign ratings. This means asset managers and owners have an opportunity to build diverse fixed income portfolios within the Asian region that are geared to a variety of economic scenarios.

The diversification opportunities are also related to the behavior of these markets. For example, bond markets in Singapore and Hong Kong are more aligned to movements in US interest rates. For developing countries, such as the Philippines and Indonesia, trends in credit ratings play a particularly important role in their performance over the long term.

> **“Stability is a key feature of Asia government bonds. If we rank emerging market bonds based on their carry-to-volatility ratio, Asia offers quite a few strong candidates for stable carry investments. India and Malaysia government bonds take the top two spots, while China and Indonesia are not far off.”**
>
> —Pin Ru Tan, Head of Asia Pacific Rates Strategy, HSBC

Asian bonds demonstrated better risk-adjusted returns[1] than their US counterparts. From January 2001 to June 2024, Asian bonds saw volatility levels of 4.59 percent, compared with 4.82 percent for US bonds. But they delivered an annualized return of 4.78 percent versus 3.10 percent in USD terms during that period. These markets have quite different economic drivers. Indonesia and Malaysia are more commodity-sensitive, mainland China is a manufacturing and exporting powerhouse with a huge domestic economy, and Singapore and Hong Kong are advanced financial hubs.

> **“If you need that diversification then you cannot ignore this region. You have established yield curves, you have good fundamentals, and those are all supportive for a diversified portfolio. You are looking for opportunities — not just in terms of valuations, but in terms of where you can find liquidity and at what points of the curve you are looking to be positioned.”**
>
> —Alaa Bushehri, Head of Emerging Market Debt, BNP Paribas Asset Management

Figure 7
Financial Data of the Eight Markets That Make up the Markit iBoxx ABF Pan-Asia Index

Market	Cash / Policy Interest Rate (%)	10-year Government Bond Yield (%)	Local Currency Long Term Rating	Debt-to-GDP Ratio (%)
Singapore	3.43	3.20	AAA	170.8
Hong Kong	5.75	3.42	AA+	50.2
South Korea	3.50	3.27	AA	45.5
China	3.45	2.20	A+	22.7
Malaysia	3.01	3.99	A	64.3
Thailand	2.50	2.67	A-	54.3
Indonesia	6.25	7.04	BBB	39.0
Philippines	6.50	6.57	BBB+	60.1

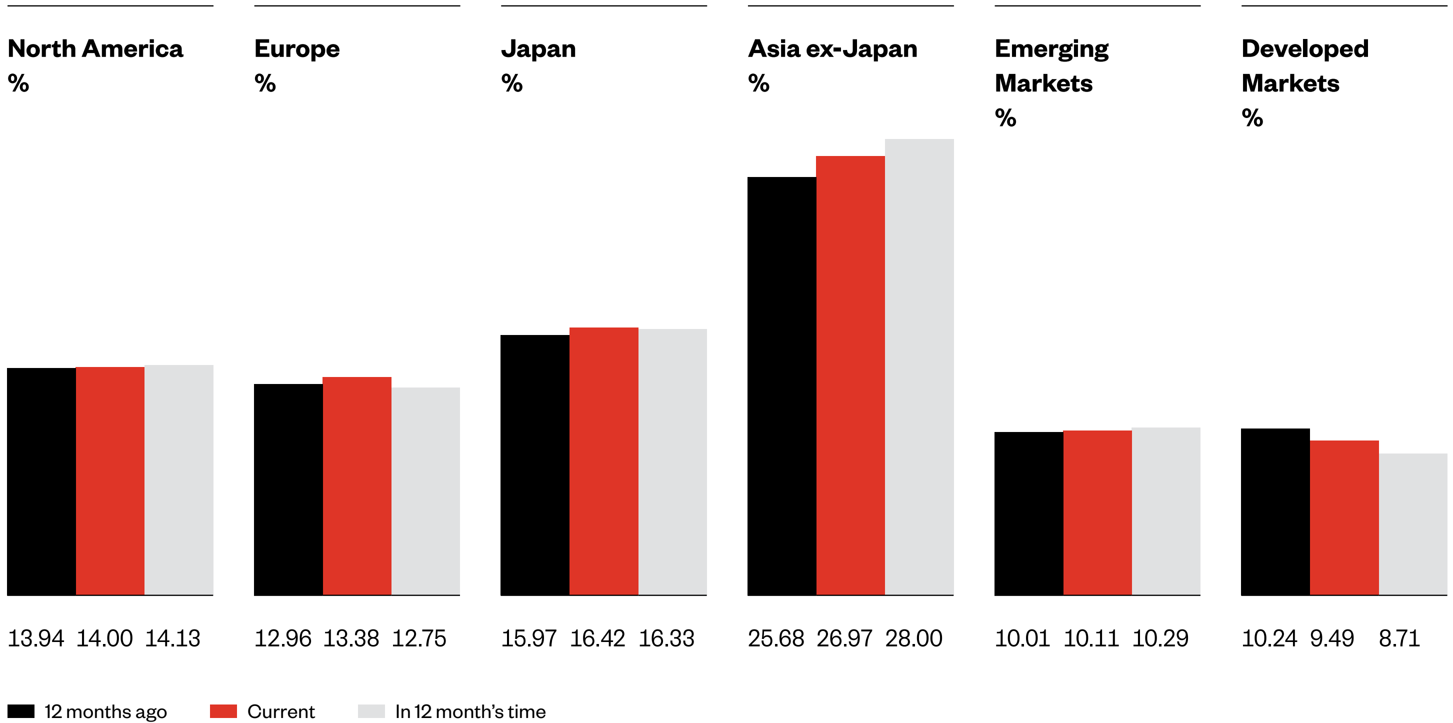
Sources: Cash policy interest rate = Bloomberg Finance L.P., refers to the central bank policy rates and the SORA for Singapore, as at June 28, 2024; 10-year government bond yield = Bloomberg Finance L.P., 10-year government bond yields, as at June 28, 2024; sovereign rating = S&P Global Ratings, Bloomberg Finance L.P., as at June 28, 2024; debt-to-GDP ratio = CEIC data, government debt as percent of nominal GDP, as at December 31, 2023, except China which is as at September 30, 2023.

Asia's bond markets also offer a good alternative to other fixed income markets. “I think a lot of investors are now looking to diversify away from their traditional bond exposures because they can see that the various markets in Asia do behave differently,” says Kheng Siang Ng, Asia Pacific Head of Fixed Income and Head of Singapore at State Street Global Advisors, who adds that many of these investors are selling some of their US Treasury holdings to buy Asia fixed income.

Asset Managers and Owners Are Bullish on Asia

Asia's compelling economic backdrop is reinforcing investor sentiment: on average, asset managers and owners plan to allocate 28 percent of their fixed income investments to Asia ex-Japan in the coming 12 months, compared with 27 percent today and 25.7 percent 12 months' ago. The next most important destination for asset managers and owners' fixed income allocations is Japan, which is steady at about 16 percent over the three time frames. This is followed by North America, which is also steady at about 14 percent over the period surveyed.

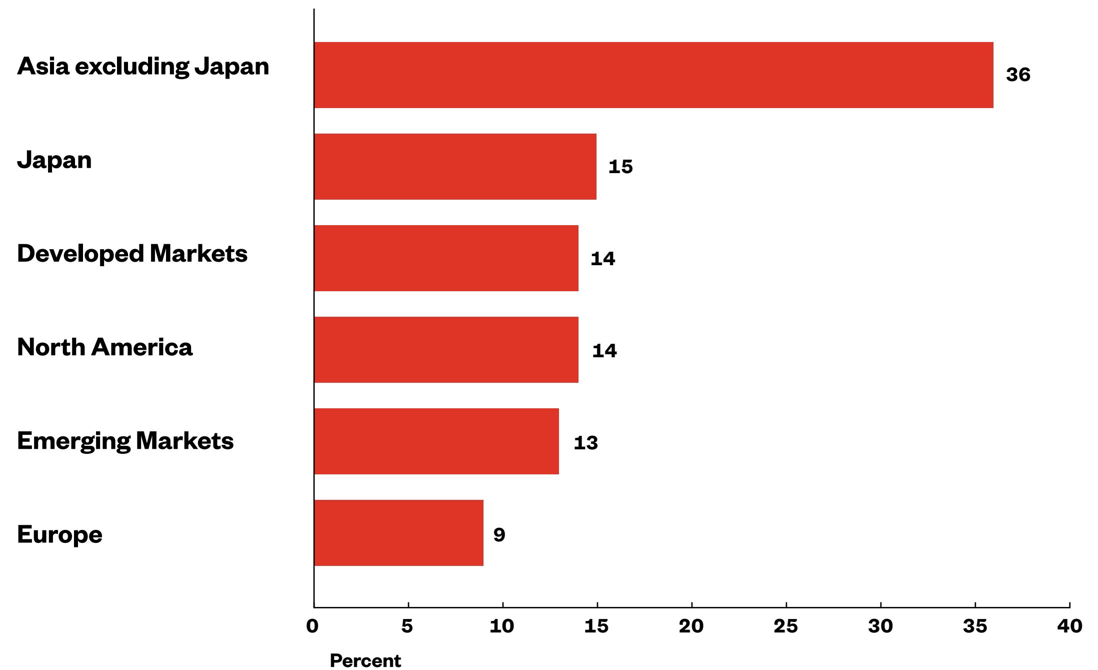
Figure 8
Allocations to APAC Region Will Increase



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

When asked about which fixed income region they expect to perform best in 2024, 36 percent of asset managers and owners say Asia ex-Japan, followed by 15 percent saying Japan, and 14 percent saying North America. Only 9 percent are optimistic about Europe's bond market being a top performer.

Figure 9
The Market You Expect to Produce the Best Returns in Bonds in 2024



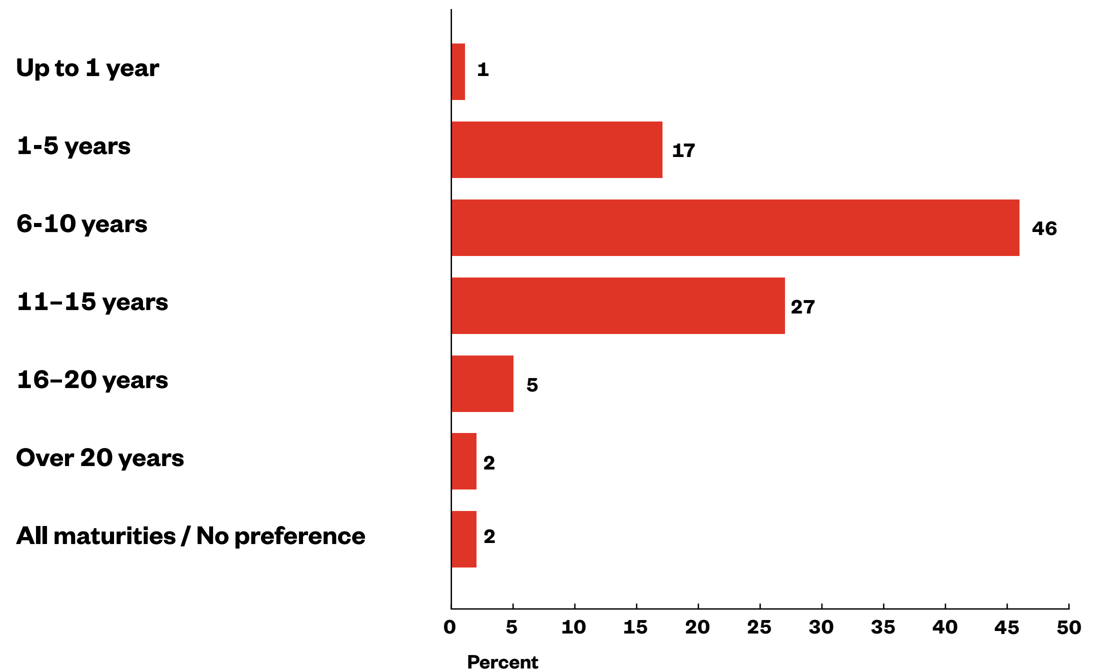
Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

> **Whether you look pre-Covid or post-Covid, the fundamentals have continued to be strong, and they are expected to remain at that healthy trajectory moving forward."**
>
> — Alaa Bushehri, Head of Emerging Market Debt, BNP Paribas Asset Management

Bond Preferences

In terms of bond maturities for Asia bonds ex-Japan, 64 percent of asset managers and owners prefer bond maturities up to 10 years; the 6–10 years range is the most popular, at 46 percent. Just 7 percent prefer to hold maturities over a period of 15 years.

Figure 10
Asset Managers and Owners Prefer a Asia Ex-Japan Government Bond Maturity of 9.3 Years



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

The focus of most asset owners and managers might be under 10 years, but the eight markets that make up Markit iBoxx ABF Pan-Asia Index support a wide range of maturities. For example, Hong Kong, Thailand, and Philippines government bonds have maturities up to 20 years. For Indonesia, Malaysia, and Mainland China these stretch to 30 years. Mainland China recently started adding 50-year bonds, and South Korea and Singapore have already established 50-year bonds.

Longer-dated bonds tend to become more popular when the yield curve is positive and when investors want to lock in attractive long-term yields to avoid reinvestment risk. And demand for bond maturities depends to a large extent on their use. Banks, for instance, have a preference for short-dated, high-quality bonds — largely to satisfy regulatory capital requirements related to the Basel regulatory framework.

Life insurers and pension funds usually lean toward longer local currency maturities because they have to match their assets with liabilities, which tend to be long term. Other investors, such as asset and wealth managers, often have more discretion in their mandates and will therefore choose points in the maturity curve where they think the best opportunities are.

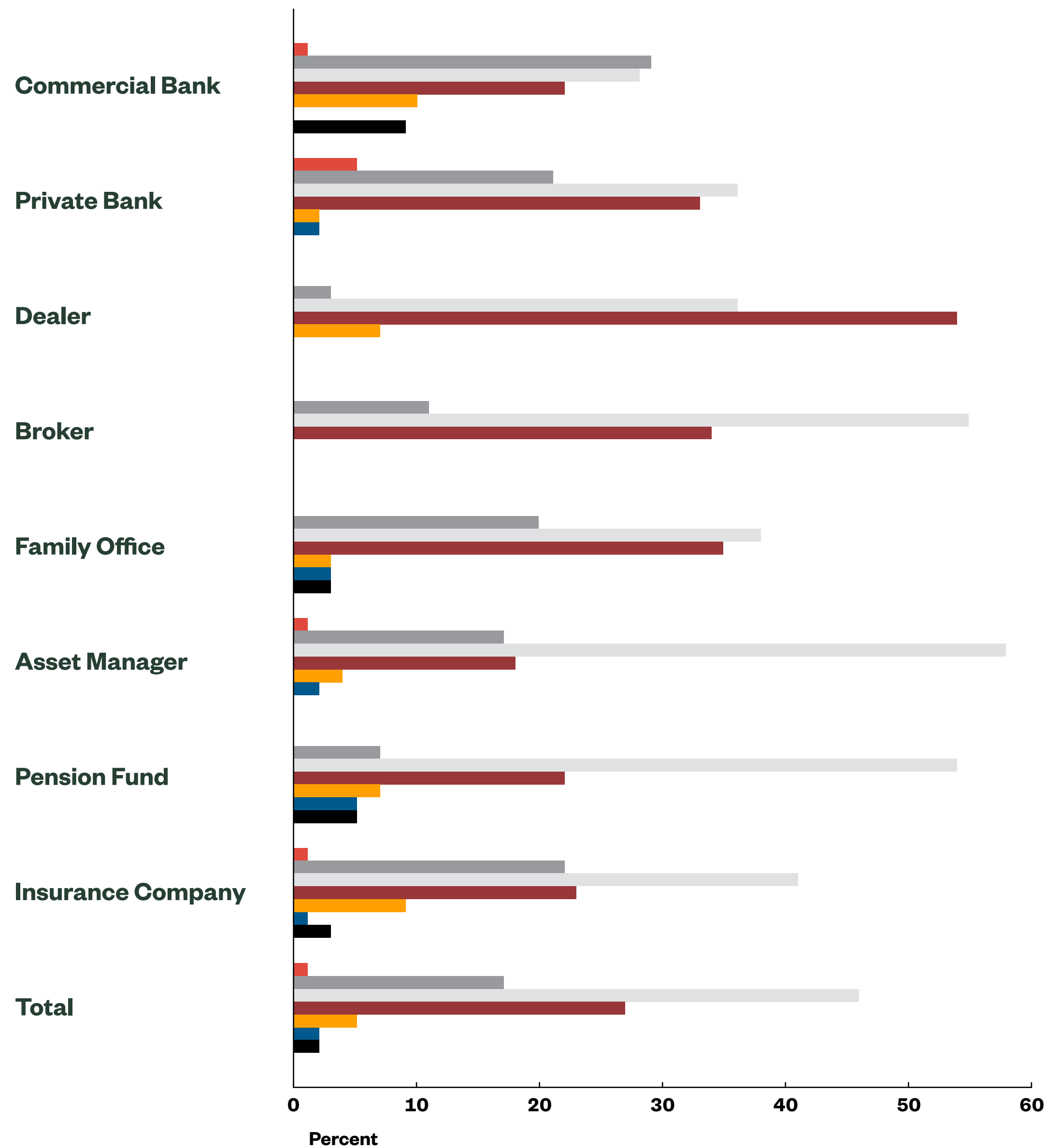
> **Insurance companies sell insurance policies and typically need longer duration assets to meet those liabilities — particularly life insurers. Pension funds, endowments and large corporates basically want income generation. They typically prefer investment grade bonds where the protection of principal is highest.”**
>
> — Andy Suen, Co-Head of Asia Fixed Income and Portfolio Manager, PineBridge Investments

Many Asia-based asset managers and owners are focusing on 5–10-year maturities in the hope of capitalizing on expected cuts in interest rates across much of the region, particularly once the US Federal Reserve starts to ease monetary policy. They expect those maturities to provide an optimal level of valuations once rates are cut.

Figure 11

Maturity Preferences Depend on Type of Financial Institution

- Up to 1 year
- 1–5 years
- 6–10 years
- 11–15 years
- 16–20 years
- Over 20 years
- All maturities / No preference



Source: PAIF, “Unlocking Opportunity in Asia Fixed Income” survey, February 2024.

Markets Are Becoming More Friendly to Investors

Many Asian markets have been steadily liberalizing their capital markets and growing the investor base of their bonds.

> **“Many of these countries are reforming domestic regulations and enhancing their financial infrastructure to open up the domestic fixed income market. The opening-up of China’s huge onshore bond market is a critical example.”**
>
> — Freddy Wong, Head of Asia Pacific, Invesco Fixed Income

Mainland China, partly with the help of Hong Kong as an international financial gateway, has been at the forefront of these efforts. For example, the introduction of Bond Connect, a mutual market access scheme that allows Hong Kong and mainland Chinese investors to invest in each other’s bond markets, has given offshore investors easier access to China’s onshore bond market. Mainland China’s authorities have also introduced Swap Connect, a derivatives market access scheme allowing international investors to trade and clear onshore RMB interest rate swaps. This enables offshore market participants to hedge RMB interest rate bond investments more efficiently.

> **“The opening-up efforts have had a positive impact. And together with Chinese onshore bond inclusion in global bond indices we have observed significantly higher interest from global investors in China onshore bonds.”**
>
> — Freddy Wong, Head of Asia Pacific, Invesco Fixed Income

On November 24, 2023, the Hong Kong Exchanges and Clearing Limited (HKEX) announced plans to launch China Treasury Bond Futures, which means that foreign investors can hedge exposures to these bonds in Hong Kong. This further cements the city’s role as the leading offshore RMB hub. There has also been activity in other Asian markets. In 2018, Indonesia introduced domestic non-deliverable forwards to help foreign investors hedge their rupiah exposures. It forms part of the central bank’s initiatives to maintain stability in the exchange rate while also boosting liquidity. Some of these markets aim to create more liquidity at the long end of the bond curve by issuing longer-dated sovereign bonds more frequently and by developing bond exchanges.

> **“The most important things countries can do to make their local bond markets more attractive is to make sure there is liquidity and also to address operational hurdles.”**
>
> — Alaa Bushehri, Head of Emerging Market Debt, BNP Paribas Asset Management

Climbing the Quality Curve

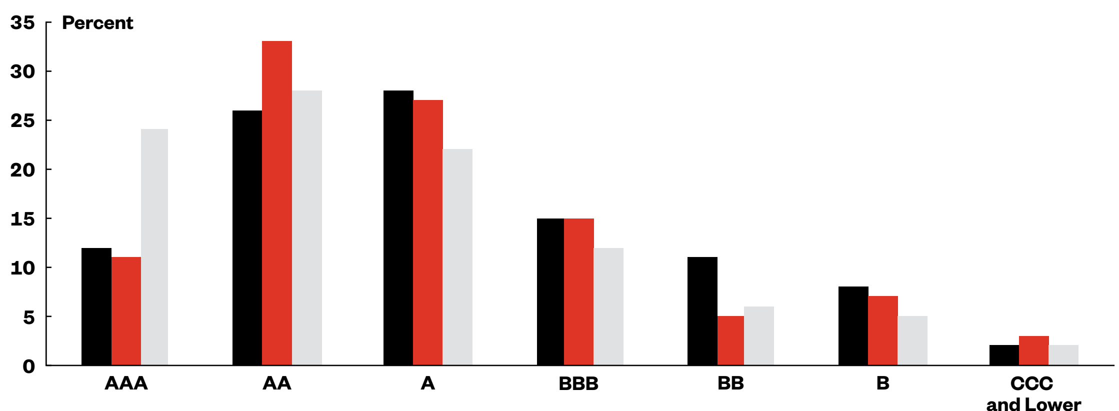
Local institutions tend to favor sovereign and quasi-sovereign bonds because these have better liquidity than corporate bonds, and they also tend to seek higher credit ratings. Asia Pacific's institutional investors — particularly life insurers, banks, pension funds, and foreign investors — have an ongoing appetite for investment-grade bonds, and they provide stable capital flows into these assets.

> **"The Asian investor base is quite a conservative one. You'll find that a lot of the growth in assets under management tends to be for low-risk mandates. You see a lot of the demand for the financials, commodities, and state-owned corporates."**
>
> — Owen Gallimore, Head of Asia Pacific Credit Analysis, Deutsche Bank

However, when it comes to the quality of bonds, Asia-based asset managers and owners are increasingly leaning toward the higher end of the credit spectrum. A year ago, 66 percent of the asset managers and owners in the survey said that the lowest-rated bonds they were willing to hold were all rated A and above. This has now risen to 71 percent, and is 74 percent for investing intentions in 12 months' time.

Asia Pacific-based asset managers and owners are increasingly leaning towards A-plus credits, while interest in BBB and lower appears to be diminishing.

Figure 12
Moving Up the Credit Quality Curve

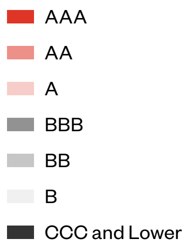


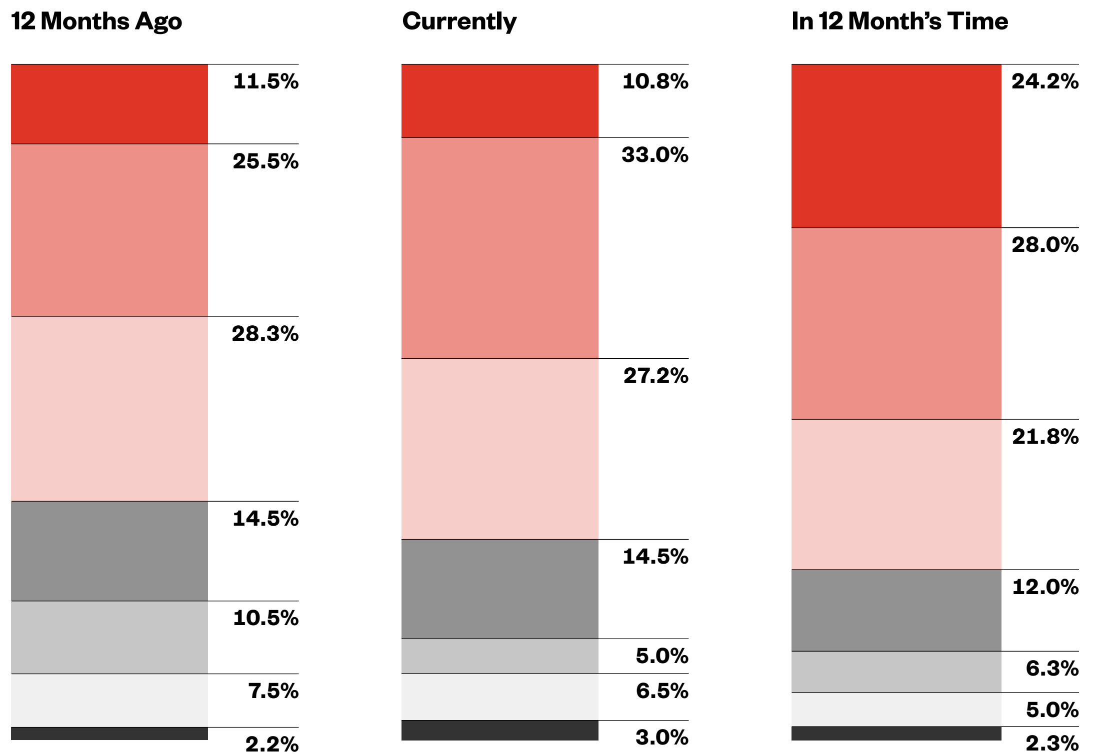
Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

> **If you look at spread performance, the BBBs have outperformed. So the spread differential between BBB and A, for example, has compressed, and with the spreads being quite narrow there are some investors who prefer to go for higher-quality bonds. But I'd say that that is more of a market development than a structural change."**
>
> — Andy Suen, Co-Head of Asia Fixed Income and Portfolio Manager, PineBridge Investments

Digging deeper into the survey data shows there are a notable changes in interest in AAA-rated bonds, from 12 percent a year ago to 11 percent now and to 24 percent for 12 months' time. Over the corresponding period there is a drop in interest in bonds rated BBB and lower: 36 percent, 30 percent and 25 percent respectively. This shift in the quality spectrum tends to favor sovereign and quasi-sovereign issuers.

Figure 13
Interest Diminishes in Low-rated Bonds





Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

> **A and above ratings have been pretty popular with clients — they are seeking quite high quality bonds. Some clients are attracted to higher-quality bonds because they got burned by their exposure to poor-performing, lower-quality credits. Those investors have responded by taking a more defensive positioning in their portfolios."**
>
> — Marie Tsang, Fixed Income ETF Strategist, State Street Global Advisors

The Sovereign Ratings Outlook is Positive

As at June 2024, the quality of sovereign local currency bonds for much of Asia has either remained stable since 1998 or has been on an upward trajectory. According to S&P Global Ratings, Indonesia made a dramatic improvement from B- to BBB, South Korea jumped from BBB+ to AA, and Thailand went from A- to A and then slipped back to A-.

China, meanwhile, went from BBB+ in 1998 to A+ in September 2017, and it still held that rating in June 2024. But the country is on credit watch — mostly because of problems in the real estate market and concerns about local government debt. The Chinese authorities are taking decisive steps to diversify the economy, boost domestic consumption, and manage any fallout from debt problems.

In the year to June 30, 2024, the Bloomberg China Aggregate Index, which covers China government and corporate RMB bonds, delivered a return of 6.04 percent in local currency terms.[2]

> **“You had the real estate problems in China, which affected high yield. But ironically, investment-grade China has been one of the best-performing classes in the world during the past two years.”**
>
> — Owen Gallimore, Head of Asia Pacific Credit Analysis, Deutsche Bank

Investors expect China to retain a high-quality investment rating thanks to the size and dynamism of its economy, which has so far proven resilient to economic challenges.

Among the large developed Western nations, the US, the United Kingdom (UK), France and Spain have all been slipping down the quality curve, though all are still rated A or above. Italy, meanwhile, is clinging on to investment-grade status at BBB following decades of economic stagnation and high fiscal deficits. Over the next decade there is a strong possibility that these sovereign ratings will deteriorate further because of lax fiscal policies, ballooning welfare commitments, lackluster productivity growth, and stagnating economies.

Is Interest in Green Bonds Waning?

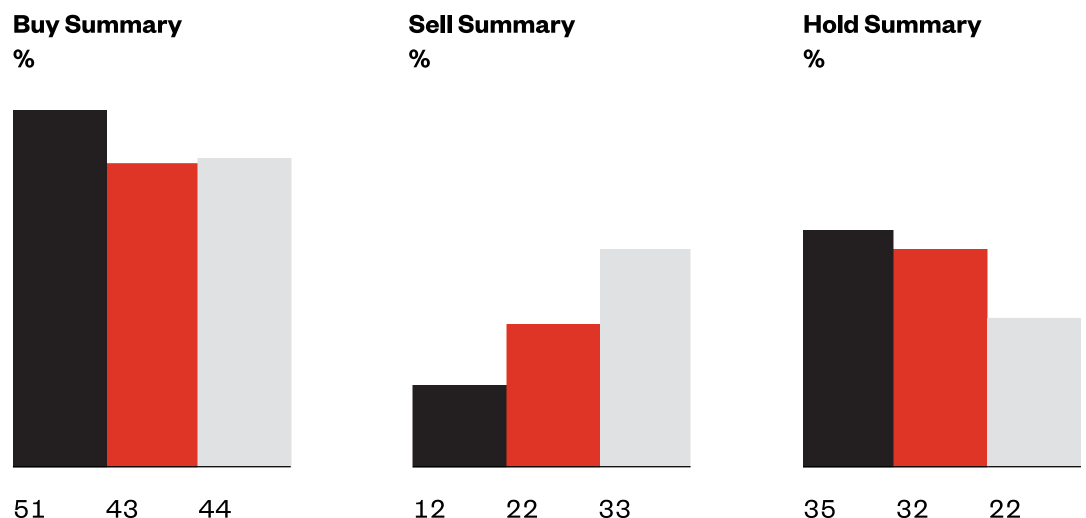
A surprising finding in the PAIF survey is that Asia-based asset managers and owners say there is a slowdown in interest in green bonds. This is despite a host of initiatives across the region designed, for instance, to reduce pollution.

A year ago, buying green bonds was a priority for 51 percent of asset managers and owners. This has now fallen to 43 percent and only increases slightly to 44 percent in 12 months' time. In contrast, selling intentions went from 12 percent to 22 percent and then 33 percent respectively.

There is a steadily falling interest in green bonds, with more investors buying fewer of them, selling them, and generally reducing their holdings over the surveyed periods.

Figure 14
Fading Interest in Green Bonds

12 months ago
Current
In 12 month's time



Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Waning interest is surprising given that mainland China in particular has made significant strides in decarbonization, with big increases in renewable energy and its emergence as a global leader in making electric vehicles. It was also one of the first markets to initiate a green taxonomy, making it a pioneer alongside the European Union (EU). Other jurisdictions including Singapore and Hong Kong have also made considerable efforts in this area. The former with its initiatives around greening the economy, and the latter with its development of financial markets and products that are designed to support sustainable development.

Possible explanations for this dulling in appetite for green bonds include regulators' and some institutional investors' focus on greenwashing, which is where issuers make unsubstantiated claims that the proceeds of their bonds will fund activities that meet environmental standards. Regulators, particularly in the EU, are taking steps to stop greenwashing, which has caused apprehension among some investors about buying these bonds.

Another possible explanation is that regulatory standards are still evolving across the region — though they are already well developed in mainland China, Hong Kong and Singapore. But there is also fragmentation of regulatory standards across the region, which makes it more difficult for investors to judge the credentials of a bond that is labeled as green.

The Long-term Outlook for Green Bonds Remains Positive

The lack of a large, dedicated investor base that focuses on sustainable investing in Asia Pacific — unlike in Europe — is also reflected in the pricing of green bonds. For example, issues in the region, with some exceptions, tend to trade at similar prices to conventional bonds, while in Europe they typically trade a few basis points below equivalent conventional bonds. But there is evidence that environmental factors are having some impact on pricing. For example, bonds issued by renewable energy issuers tend to trade on tighter credit spreads than equivalent issuance from polluting sectors such as coal.

A similar situation exists in other areas of fixed income sustainable investing.

> **"In general, sustainable bonds consistently exhibit a lower new issue premium than conventional bonds in the primary market, and also tend to have lower yields in the secondary market given stronger demand. The oversubscription rate is normally very high for sustainable bonds in the new issue book building"**
>
> — Freddy Wong, Head of Asia Pacific, Invesco Fixed Income

Interest in green bonds is likely to grow in the years ahead — not least because so many of the region's governments want to decarbonize their economies, which will require enormous investment. China is already a leader in this area, but in the years ahead others are expected to issue more green, social and sustainability (GSS) bonds to fund decarbonization. Many Asian markets such as Indonesia have so far focused their GSS bond issuance on financing social housing projects.

But many Asian asset managers and owners are still committed to buying or holding green bonds. For 19 percent of them, it is to encourage the development of a new bond market segment, followed by a desire to outperform conventional government bonds at 17 percent, with favorable tax treatment coming in at 15 percent.

Figure 15
Primary Motivation for Investing in Green Bonds

	Percent
To encourage the development of a new segment of the bond market	19
I believe they will outperform conventional government bonds	17
Favorable tax treatment for holding green bonds	15
To support climate-friendly government policies	14
Investment mandate (my fund must include these bonds)	12
Corporate internal guidelines	11
Expectations placed by my investors	10
I do not invest in green bonds	1

Source: PAIF, "Unlocking Opportunity in Asia Fixed Income" survey, February 2024.

Asset Managers and Owners Have Macroeconomic Concerns

Although Asia-based asset managers and owners rate the region as a destination for investing in fixed income, they do have some concerns. Top risks cited by respondents are:

37%	35%	35%
Recession and inflation	Geopolitics	Currency depreciation

The rampant US dollar has imposed pressure on many currencies around the world, including in Asia Pacific. Many of the authorities across the region are taking action to defend their currencies against the strength of the US dollar, and this should provide some comfort to foreign investors.

The Indonesia rupiah, for instance, has experienced four-year lows, which has prompted the central bank to raise its seven-day reverse repo rate (benchmark rate) by 0.25 percent to 6.25 percent in an effort to halt the slide.[3] It was also a pre-emptive strike designed to keep the country's inflation rate within the central bank's 1.5 percent–3.5 percent target.

Senior policymakers in China, South Korea and Japan have all publicly expressed concern about the strength of the US dollar, and the latter two have issued joint statements with their US counterparts in a bid to curb the currency's strength. This raises the prospect of central banks taking concerted coordinated action to stabilize currency markets, if necessary, which in the medium to long term could benefit Asian fixed income markets.

However, a lot of that pressure is likely to be alleviated when the US Federal Reserve decides to ease its monetary policy — possibly some time in 2025, given the persistence of inflationary pressures in the US.

The Picture is Still Bright

Despite the macroeconomic concerns of some in the survey, the positives seem to far outweigh the negatives for the Asia region in the eyes of asset managers and owners. This can partly be characterized by the growth in local bond markets. Not only are they getting deeper, but a lot of borrowers — from corporates through to sovereigns — have been switching their funding away from US dollars toward domestic markets. This is a strong indication that investors have confidence in their domestic markets as they are buying up this issuance.

In China, high-quality domestic borrowers such as some state-owned enterprises, which are perceived as enjoying government support, can pay coupons above 3 percent in renminbi, compared with more than 5 percent if they borrow in US dollars.

The considerable issuance of Chinese domestic bonds expected over the next five years will put the depth of the market to the test. One major source of new bonds will be from the country's five largest banks, which are classified as global systemically important banks.

Global systemically important banks carry higher levels of regulatory capital than other banks because of their enormous balance sheets and the damage their failure would do to the economy. To meet the capital requirements of the latest Basel III regulatory standards, which are coming into force in China, these five banks will have to issue debt known as total loss-absorbing capital (TLAC) bonds to meet two deadlines: January 2025 and January 2028.

There are many different estimates of how much capital they will need to raise, and a lot will depend on the composition of their balance sheets, the performance of their loans, and deposit levels. For example, International Financing Review,[4] citing Fitch Ratings, said the five banks may need to issue RMB 1.6 trillion (US$224 billion) by 2025 and RMB 6.2 trillion (US$870 billion) by 2028. Other estimates suggest total TLAC issuance will be much lower, at about US$500 billion.

> **"We are assuming that 10 percent of that will be issued in the US dollar market and 90 percent domestically. And we believe both the local and offshore markets can absorb this issuance."**
>
> — Andy Suen, Co-Head of Asia Fixed Income and Portfolio Manager, PineBridge Investments

Many institutional investors see China's big five banks as quasi-sovereign, with ratings agencies including government support ratings in their credit assessments of these institutions.

The Maturity Curve is Lengthening

Domestic retail investors are being encouraged to buy government bonds. China is marketing RMB 1 trillion 20–50-year bonds to domestic investors, and these trade on the Shanghai and Shenzhen stock exchanges rather than being sold over the counter. This approach makes it easier for local retail investors to access the bonds. The Chinese government is also looking to create more liquidity at the long end of the year curve to broaden its funding choices.

The popularity of these new long-dated bonds is partly a result of retail investors seeking safe havens for their capital due to a lack of investment opportunities in the battered real estate sector, domestic equity market volatility, and falling bank deposit interest rates.

Although borrowers in Asia are tapping into local markets more, South Korea stands out among the eight Markit iBoxx ABF Pan-Asia Index jurisdictions for turning toward the offshore US dollar bond market. With the encouragement of the authorities, many of the country's big conglomerates are borrowing more in US dollars, and a large proportion of their earnings are in that currency anyway. And South Korean borrowers have sold unprecedented volumes of US dollar bonds: issuance rose by 17 percent in the four months to April 2024 to US $17.6 billion, according to Bloomberg.

There is a Growing Pool of Savings

Apart from cheaper funding making domestic markets more attractive for bond issuance than in US dollars, the region's burgeoning middle classes and the increase in high-net-worth individuals are providing more local capital.

That pool of domestic capital is set to grow, which is likely to steadily boost the size of Asia's markets. In June 2023, Boston Consulting Group (BCG) forecast that the growth in the value of personal assets globally would increase by an average of 5.3 percent a year until the end of 2027.[5] But in Asia ex-Japan, the value of personal assets is expected to increase by 7.8 percent over that period. BCG believes Hong Kong will overtake Switzerland in 2025 as a wealth management center.

Capgemini's 2023 World Wealth Report, meanwhile, found that 32 percent of the world's high-net-worth individuals[6] live in the Asia region. Relevance, a firm specializing in high-end luxury marketing, estimates that mainland China has by far the most ultra-high-net-worth individuals in Asia: 51,000. This is followed by Japan (17,000), Hong Kong (15,000), Taiwan (8,000), and Singapore (7,500).

Another factor favoring the region's bond markets is demographics. Wealthy societies such as Japan, South Korea, and Hong Kong are aging, and older investors tend to favor the relative safety of fixed income investments over other asset classes such as equities.

Despite some concerns around inflation, currency depreciation, and recession, the Asia region provides a compelling mix of income and diversification opportunities for asset managers and owners. This is reinforced by the region's positive long-term economic outlook and more favorable prospects around credit upgrades in contrast to many of the large, developed jurisdictions.

Endnotes

1 FTSE Russell Indices, S&P Global, calculations by State Street Global Advisors, US bonds reference the FTSE US Government Index, while Asia bonds reference the Markit iBoxx ABF Pan-Asia Index, both in USD terms.

2 Bloomberg Finance L.P., in CNY terms as of 30 June 2024. The Bloomberg China Aggregate Index tracks CNY-denominated fixed-rate Treasury, government-related (including policy banks) & corporate securities on the China Interbank Bond Market.

3 Bloomberg Finance L.P., date as of 24 April 2024.

4 International Financing Review, China sees first TLAC bonds

5 Boston Consulting Group, Global Wealth Report 2023.

6 Capgemini, World Wealth Report 2023.

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* Pensions & Investments Research Center, as of December 31, 2023.
† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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