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Amundi ASSET MANAGEMENT

10 October 2017

Opportunities ahead in Asia EMs, despite increasing geopolitical tensions

INVESTMENT TALKS

Alessia BERARDI
Senior Economist

Mauro RATTO
Head of Emerging Markets

With the contribution of:
Qinwei WANG
Economist

EM Asian economies outlook has been improving and it's expected to mildly improve further. We closely monitor geopolitical risk in the region.

What is your macro economic outlook for China and other main Asian EM countries for the coming 6 months?

Alessia Berardi: EM Asian economies outlook has been significantly improving in the last quarters and it's expected to just mildly improve further or stabilise in the near future. Asian economies are well positioned in terms of exports combination and the region benefits a lot of economic integration and proximity to China that has shown a strong economic performance so far. India has been the striking exception with its story of two shocks (demonetisation first and GST later); however, the country has shown a certain degree of resilience and we do expect some improvement mainly based on households consumptions.

On China, although the economy is widely expected to soften ahead, we think it could stand more resilient than before, without disrupting too much the region. Compared to previous few years, positive conditions for Chinese economy are more broadly based, with rebound of global trade and private sector, while structural pressures to its traditional sectors also look easing, with meaningful overcapacity cut and destocking in property sector. With ongoing structural transition and catching up of financial regulations, which is more coordinated, we expect macro risks, particularly debt issues, to be less a concern.

With major Central Banks changing their monetary policy, what are the implications for Asian economies?

Alessia Berardi: Although more major Central Banks seem to start considering normalization, we expect the pace to be gradual. This should keep monetary policy in the region relatively accommodative, with benign inflation dynamics. In some economies we expect very marginal tightening going forward with few actions on the policy rates.

Meanwhile, there is still room for fiscal policy in the region, with overall fiscal lever being neutral or mildly expansionary. Thailand and Philippines are fiscally less fragile to pursue stimulus. India has recently announced fiscal stimulus package to address the short-term slack in economy from recent policy shocks. The new government of South Korea looks willing to use more of its fiscal hand with a supportive supplementary budget for H2.

In any case, external vulnerabilities have diminished almost in all Asian economies over last few years, which makes the region relatively better prepared for external shocks.

What is your short and medium-term outlook on the Asian currencies, including the Renmbimbi? And what is your view on the USD and its impact on Asian economies?

Alessia Berardi: We have a neutral view on Asian currencies in the short-term, while we are moderately constructive in the medium-term. Most Asian economies saw significant improvements in external position, while majority of currencies in the region are slightly undervalued from medium-term perspective. We continue to see room for some appreciation, especially in India and Indonesia.

We expect the US dollar to remain weak into coming years despite possible short-term volatility, which could also help to support Asian currencies overall.

In particular, if a weak dollar is here to stay, we expect RMB to be bottoming out, moving around current levels in near term with further moderate appreciation ahead. On one side, all major factors behind RMB depreciation pressures in previous years have been turning around, including the dollar strength, export and the country's outlook. On the other side, upside also looks capped, with the PBOC's concerns about too strong RMB to hurt the economy. Overall, we think risks linked to RMB depreciation and capital outflows should be under control. More importantly, in such a benign environment, the PBOC seems to be able to resume its long-term agenda for FX regime reform to achieve a more flexible currency and pushing RMB internationalisation.

What are the biggest headwind for Asia in the coming 6 months?

Alessia Berardi: A top concern is geopolitical risk, which shifted from Europe to the Asia region, regarding North Korea and tensions between US and China. While our base case remains in favour of a peaceful solution, we stay alerted by closely monitoring the developments.

In addition, any surprises in US policy and strong dollar would challenge the stability conditions in overall EMs and Asia region. A hard-landing of China would also hurt the region badly, particularly the North Asia, but this is not our central scenario.

What is your short and medium-term investment outlook for Asian EM Equity?

We expect EM equities to outperform EM debt and DM equities, with small and mid-cap stocks offering attractive upside potential. We believe downside risk in EM debt markets should be mitigated.

Mauro Ratto: Assuming that global growth continues at current levels and interest rates move higher at a measured pace, we expect Emerging Market and Asian equities to be well supported. Valuations still look attractive, notably versus Developed Markets. However, we notice that valuations have gone up a lot in Asian emerging markets and, going forward, we believe they will grow more in line with the earnings trend.

The best upside appears to be in value sectors and sectors linked to the traditional economy such as financials and industrials. We maintain a high conviction call on Chinese Equities for the next 6 months. Chinese economic growth could surprise on the upside, while State Owned Enterprises (SOEs) are delivering better than expected earnings growth. We expect SOE's to report solid profits over the next few quarters, with the possibility that profits surprise the market on the upside in most sectors excluding the IT consumer sector. In addition, capital discipline and better governance remain a consistent theme which could support the market. Attractive opportunities include industrials, consumer discretionary as well as cement and steel companies on supply reform and solid demand driven by infrastructure projects and housing construction.

What is your short and medium term investment outlook for the Asian EM Fixed Income?

Mauro Ratto: Yields and spreads in Sovereign and Corporate Emerging Market debt remain tight. We expect spreads to oscillate around current levels reflecting strong macro and earnings momentum.

From a risk perspective, we believe that investors are exposed to an asymmetric risk to the downside in debt markets and therefore we believe this risk may be mitigated with a preference for short dated higher average quality corporate bonds that should benefit from carry in case of any volatility. However, we do not expect an underperformance in the near term. Improved quality of balance sheets and financial conditions remain supportive. In addition, we expect profit growth to accelerate and we believe that Emerging Market companies will continue to improve further their ability to convert their top line growth into cash. In such an environment defaults should remain low. With growth intact, positive flows and valuations generally still attractive Emerging Market Debt in local currencies should outperform Debt in hard currencies. Strong investors' demand for passive instruments and better supply-demand dynamics should also favour sovereign bonds over corporate bonds.

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