Active is: Finding new sources of income

Amid low returns from "safe" bonds, look to Asian risk assets

by Christiaan Tuntono | 06/05/2019

Summary

Thanks to positive macroeconomic news, China's resilient growth and room to cut rates in India and Indonesia, the outlook for Asia-Pacific risk assets is good. Corporate bonds, emerging-market debt and dividend-paying stocks can play a critical role for investors in search of income potential.

Key takeaways

- "Riskier" assets in the Asia-Pacific region offer attractive income potential for investors dissatisfied with the returns of traditionally "safe" bonds
- After a tough 2018, Asian risk assets have been supported by Federal Reserve policy, easing US-China trade tensions and stabilising growth in China
- China's growth outlook is positive for Asia overall and should help the region's equity markets, including dividend-paying stocks
- India and Indonesia have room to cut their policy rates, which should help their bonds

With traditionally "safe" bonds offering limited returns globally, we suggest investors actively hunt for income among "riskier" income generators such as corporate bonds, emerging-market debt and dividend-paying stocks. Asia-Pacific risk assets can play a critical role for investors, given the region's positive macroeconomic news, China's resilient growth and the potential for lower rates in India and Indonesia.

A favourable macro backdrop for Asia-Pacific

In 2018, the Asian market was dragged down by concerns over rate hikes by the Federal Reserve, rising tension in the US-China trade relationship and slowing growth in China. But since the beginning of 2019, these three key factors have become tailwinds that support Asian risk assets.

1. **The Fed is more patient.** Additional Fed rate hikes and further strength in the US dollar seem unlikely this year. This should help stem the outflow of capital to the developed markets from Asia and the emerging-market world.
2. **A full-blown US-China trade war seems less likely.** Despite the recent escalation in tensions, we think the threat of weaker global trade and financial shocks will push the US and China to put aside their differences and eventually settle for a trade deal. Both sides remain engaged in negotiations despite the sabre-rattling rhetoric; market sentiment can shift drastically on sign of any positive development.
3. **China's growth looks more stable.** Proactive fiscal and monetary stimulus measures from the Chinese government seem likely to stabilise the country's growth this year. China's government has set 6%-6.5% as the official growth target for 2019, and we believe the authorities have the willingness and means to achieve it.

Resilient growth dynamic in China

Given the release of China's stronger-than-expected credit, growth and GDP data in the first quarter, we think the market will agree with our view that a sharp deceleration in Chinese growth is unlikely this year. This would be supportive for the Asia-Pacific region given how dependent regional economies are on trade with China. As the following table shows, China has become the most important export destination among many Asian economies – surpassing even the United States and the European Union. This gives us additional confidence in Asia's growth potential despite the risk of slowing demand in the developed world.

Asia's export economy depends on China

Export exposure in value-added terms by destination of final demand (% of GDP)

	China	Japan	ASEAN	US	EU	Rest of world
Taiwan	13.4	2.8	3.2	6.7	4.2	10.5
Hong Kong	9.6	1.3	2.6	3.0	4.3	8.3
Malaysia	9.6	4.2	6.8	6.1	4.9	16.1
Singapore	8.1	4.3	8.0	7.0	10.4	20.1
Korea	7.7	1.8	2.2	5.6	3.3	10.0
Thailand	7.2	3.6	5.1	6.1	4.9	16.0
Vietnam	6.2	4.2	3.5	9.4	5.7	14.4
Philippines	4.1	2.4	1.9	4.7	2.6	6.2
Japan	2.9	N.A.	1.4	3.2	1.7	5.1
Indonesia	2.7	1.8	1.8	2.4	1.8	7.4
India	1.1	0.5	0.9	4.1	2.7	5.9
China	N.A.	1.3	1.0	4.0	2.7	7.1

Source: OECD-WTO TiVA database, Allianz Global Investors Economics & Strategy. ASEAN: Association of Southeast Asian Nations. Data as at 2015.

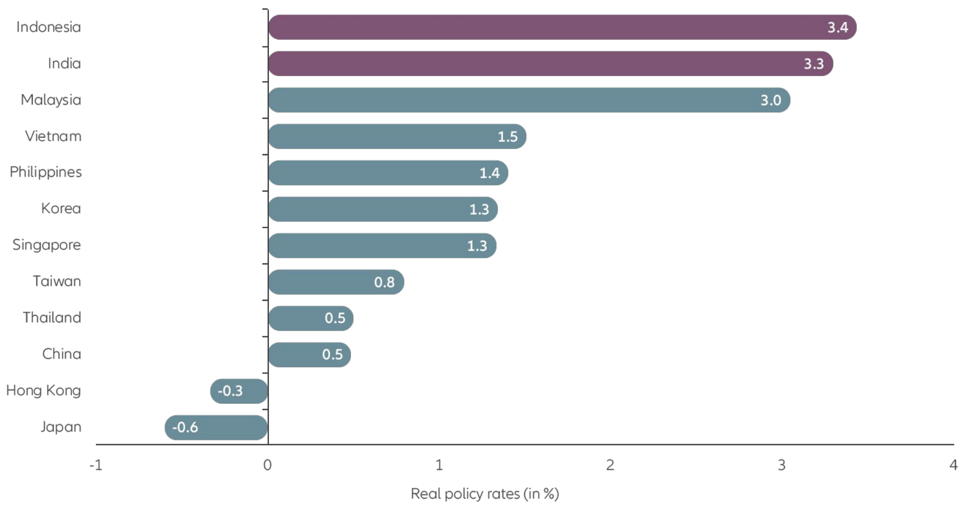
Another factor supporting our optimism on Asia is the expected bottoming-out of the tech cycle in mid-2019. We expect the global semiconductor sales cycle to benefit from a pickup in demand from major tech firms that plan to expand data centres, and from a pre-build in inventory by a key smartphone and 5G equipment manufacturer. This should help North Asian economies, which have a heavy tech focus in their export mix.

Room for policy rate cuts

Central banks in domestic-demand-driven economies like India and Indonesia should also help support growth momentum in Asia. The accompanying chart shows the real policy-rate levels of key Asian countries; India, Indonesia and Malaysia are relatively high at 3% and above.

India and Indonesia have room to cut rates

Real policy rates (in %) of key Asia-Pacific central banks



Source: CEIC, Allianz Global Investors Economics & Strategy. Data as at March 2019.

Given globally low inflation and a stable external environment thanks to an accommodative Fed, we think the central banks of India and Indonesia will cut policy rates to guide down their domestic interest-rate levels and support their economies. We expect the Reserve Bank of India to make a 25 basis-point cut in June, with the potential for more in late 2019, and we expect Bank Indonesia to start cutting rates in the second half of the year.

Infrastructure investments are also important for India and Indonesia's growth. We think it is important for these two economies to improve their basic infrastructure – such as power stations, roads, railroads, ports and airports – to solicit private investments and push forward the industrialisation process. India's

Narendra Modi and Indonesia's Joko "Jokowi" Widodo agree, which is one of the reasons why they pledged to keep investing in infrastructure in their re-election campaigns. Of course, structural reforms are also needed to upgrade the legal and fiscal foundations and help the economies of these countries become more efficient and productive.

Investment implications

- Stable growth in China is positive for Asia, and it should help the region's equity markets and dividend-paying stocks.
- A turnaround in the tech cycle would be positive for North Asia's economies, benefiting the tech sector and supporting export growth.
- India and Indonesia, along with other economies such as Malaysia and the Philippines, have room to cut their policy rates, which should help their fixed-income securities.

Further reading

This is part of an ongoing series on the importance of income from our team of strategists, economists, CIOs and portfolio managers. Explore the links below for more:

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About the author

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Summary

The European Commission has set out to achieve both economic and sustainability goals. Our ESG Strategy team summarises the important implications for investors, from an overview of the Sustainable Europe Agenda targets to three potential policy scenarios for sustainable development.

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