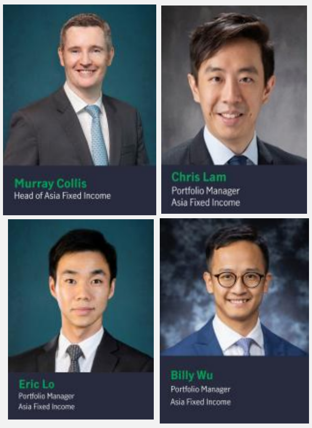
Manulife Investment Management

2026 Mid-year outlook: Asia Fixed Income

20 July 2026



Amid a complex geopolitical backdrop, Asian fixed income posted resilient performance in the first half of 2026. As inflation pressures have remained elevated, global central banks have pivoted to a more hawkish stance, including some in Asia. In this Mid-Year Outlook, the Asian Fixed Income team explains this important change in monetary policy expectations, and why the asset class is well positioned to capitalise on it.

Summary:

- Asian central banks have become incrementally more hawkish on the back of sustained inflationary pressures, with some hiking rates.
- With this change in interest rate dynamics, the need for selectivity has further increased. Asia Fixed Income continues to offer a range of opportunities that are value-added for investors' portfolios.
- Asian high-yield (HY) and investment grade (IG) hard currency bonds are attractive offering higher relative yields and shorter duration than global peers.
- Of the two, we prefer Asia HY in the second half of 2026, as the universe continues to provide the highest yield (a forward-looking metric) across all major global fixed income asset classes, offering a notable spread pick-up, while maintaining stable-to-improving credit metrics.
- In Asian IG, the asset class is expected to remain supported by favourable macro dynamics across Asia backed by healthy growth and accommodative policy.
- In local markets, Japan and India provide attractive investment opportunities.

Asian Fixed Income: Navigating a more hawkish central bank environment

The geopolitical tensions in the Middle East that emerged in late February 2026 marked a turning point for fixed-income assets globally, given the resulting surge in energy prices and pass-through impact on inflation.

Central banks, which have historically considered inflation as a core input when making monetary decisions, have become incrementally more hawkish, with some having hiked interest rates in the first half of 2026. Those include: the Reserve Bank of Australia, Bank of Japan, Bank Indonesia, and the Bangko Sentral ng Pilipinas. Additionally, the Monetary Authority of Singapore tightened monetary policy in April.

Even for the US Federal Reserve (Fed), which was originally expected to cut interest rates heading into 2026, the market now expects at least one 25-basis-point hike over the next 12 months, following recent economic data.

With this change in interest rate dynamics, the relative risk-reward of fixed income assets has also shifted in the second half of 2026 in favour of:

- **shorter duration bonds,** given relatively lower interest-rate sensitivity;

- **credits with stronger fundamentals** and a greater ability to withstand higher refinancing costs; and
- **selective local currency bonds** in markets supported by decent carry, backed by supportive local government fiscal and monetary policies.

As such, the investment thesis for Asia fixed income should become more appealing to investors' portfolios in the second half of 2026 than that of other global fixed income asset classes.

Asia credits, whether US dollar investment-grade (IG) or high-yield (HY) bonds, continue to offer higher yields with shorter durations – on an aggregate basis – than their global peers, and issuer fundamentals remain well supported by strong growth dynamics in the region. Asia local-currency bonds, meanwhile, offer selective opportunities for carry and diversification, particularly in markets where policy credibility and growth trajectory provide a stronger anchor for rates and currency performance.

With the recent shift in monetary policy expectations, the need for selectivity has further increased. Asia fixed income continues to offer a range of opportunities that add value to investors' portfolios.

Greater value-add from Asia-dollar bonds in the second half of 2026

Asia IG and HY hard-currency bonds share a common feature that remains underappreciated in the current environment: they offer higher yields and lower duration than their global IG and HY counterparts.

This means that investors can receive an additional income buffer from Asia-dollar bonds (through higher all-in yields) against interest rate volatility due to potential Fed tightening compared with bonds of similar credit quality in the US or Europe.

Asia HY provides portfolio yield enhancement and single-issuer-level diversification.

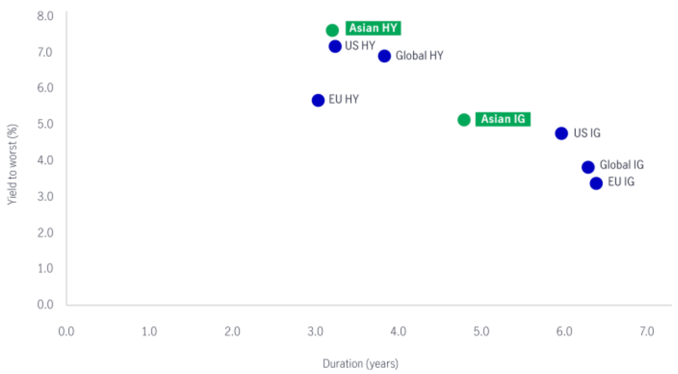
Between the two sub-classes, our preference remains tilted in favour of Asia HY in the second half of 2026, as the universe continues to provide the highest yield (a forward-looking metric) across all major global fixed income asset classes, offering a notable spread pick-up, while maintaining stable-to-improving aggregate credit metrics compared to the previous year.

The relatively lower duration profile also implies a lower likelihood that the asset class will deliver negative returns in the second half of 2026 due solely to Fed interest rate hikes, compared to longer-dated bonds. Furthermore, with a default rate of less than 2% expected for the full year, the chance of capturing the full yield from underlying bonds is much higher compared to recent years.

Most Asia HY corporate and financial issuers also have limited direct impact from higher energy prices, which is supportive of aggregate credit spreads. Individual credits currently offering the most compelling risk-reward are those driven by idiosyncratic credit stories and mispriced by the market.

The performance of these credits tends to have lower correlations with the broader market given different distinct catalysts and return drivers. It offers good diversification potential for investors' portfolios. Still, meticulous credit selection is paramount in capturing these opportunities and in avoiding negative credit events, especially given the monetary policy uncertainties in the second half of 2026.

Chart 1: Asian HY stands out globally, offering compelling all-in yields[1]



[1] Source: Manulife Investment Management, Bloomberg., as of 30 June, 2026.

Favourable regional macro trends support Asia IG and provide relative performance stability.

Asia IG, a more macro-driven asset class, is expected to remain supported by favourable macro dynamics across Asia in the second half of 2026, backed by healthy growth and accommodative policy, helping offset potential headwinds from monetary policy tightening and delivering relatively stable performance for investors.

Markets with macro drivers that are less correlated to global headwinds and the recent surge in energy prices are expected to stand out in the second half of 2026.

For example, South Korea should benefit from the ongoing recovery in global trade and from structural demand for semiconductors and advanced technology exports, driven by strong demand for artificial intelligence (AI)-related products, supporting both economic activity and corporate balance sheets.

In the Chinese Mainland, policymakers continue to implement targeted measures to stabilise the property market while advancing strategic priorities under the current Five-Year Plan, including technology self-sufficiency, advanced manufacturing, and green infrastructure, which is expected to underpin the stability of Chinese Mainland bonds in the second half of 2026.

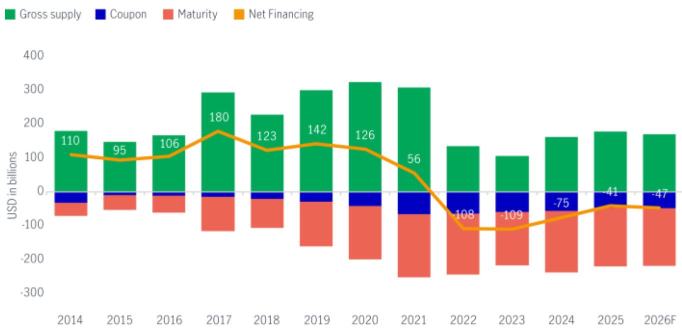
Elsewhere, Malaysia benefits from diversified growth drivers and a relatively lower sensitivity to oil-price volatility than in previous cycles, with its status as a net energy exporter helping to cushion the broader economy from elevated energy costs. The combination of positive domestic drivers and healthy corporate fundamentals should continue to anchor Asia IG performance in the second half of 2026, even amid incremental increases in central bank hawkishness.

Ultimately, for Asia-dollar credits, technical factors remain a compelling reason to invest. The market is on track for a fifth consecutive year of negative net supply, as issuance has remained relatively muted with many corporates continuing to favour refinancing in domestic markets (especially given the recent pivot towards potential US rate hikes).

At the same time, some have opportunistically issued bonds denominated in other currencies (i.e. the Singapore dollar, euro, Chinese renminbi and Australian dollar). Additionally, maturities and redemptions continue to outpace gross issuance, creating a persistent scarcity premium that supports aggregate valuations. While credit spreads are trading near recent historical tights, supportive technicals should help offset these headwinds.

Chart 2: Asia credit has remained resilient and recovered quickly from market volatility[2]

Chart 3: Net financing is expected to continue the negative territory in 2026[3]



[2] Source: Manulife Investment Management, Bloomberg., as of 30 June, 2026

[3] Source: Manulife Investment Management, JP Morgan., as of 12 June , 2026.

Value emerges from Asian local markets with attractive valuations and strong policy support.

Domestic demand, ongoing digitisation, and the AI-driven technology cycle continue to underpin fundamentals across key local economies in Asia. Within Asia local rates, a more selective, geographic-specific allocation is warranted to capture opportunities in the second half of 2026.

Markets where valuations have adjusted meaningfully or where policy support provides a clearer anchor offer better risk-reward for investors. For example, Chinese Mainland local-currency bonds remain supported by favourable fiscal measures and relatively stable monetary policy, while resilient macro fundamentals support Singapore and Malaysia local-currency bonds.

Two markets worth highlighting in this outlook are India and Japan local-currency bonds, which are backed by longer-term tailwinds.

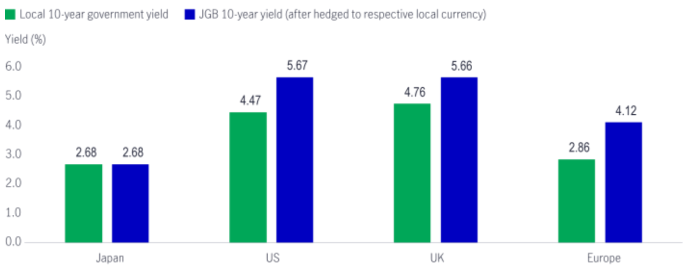
Japan offers renewed yield opportunities supported by policy normalisation and market depth.

Japan, being one of the first markets to pivot towards a more hawkish stance in this rate cycle, is regaining the spotlight in the local rates landscape, with Japan government bond (JGB) yields hovering near their highest levels in nearly three decades. With markets pricing in an additional rate hike by the Bank of Japan over the next 12 months, JGBs remain relatively attractive from a carry perspective. For foreign investors, JGBs also offer an attractive yield pick-up relative to other similarly rated developed-market bonds after hedging back to US dollars.

Japan's local bonds remain well supported by resilient export growth and improving wage dynamics. The Japanese government continues to indicate a willingness to provide support, underpinning growth through fiscal measures, including the potential for additional stimulus – such as the supplementary budget under consideration, focused on energy subsidies. With the potential for additional front-end supply to finance the government's budget, local JGBs offer tactical opportunities following the recent yield-curve steepening, given improved risk-reward and roll-down potential.

As one of the world's largest and most liquid bond markets, Japan deserves a place in investors' diversified global portfolios. The normalisation of Japanese rates is expected to support the growing appeal of JGBs in the second half of 2026, particularly for investors seeking to diversify away from the dollar and for high-quality options under current market conditions.

Chart 4: Potential yield pick-up from JGBs after hedging[4]



India combines attractive valuations with structural growth and policy tailwinds.

India bonds present compelling opportunities in Asian local markets due to their attractive carry, the region's strong economic growth, and the Indian government's supportive policies for bond investors. The recently announced measures – including the exemption for foreign institutional investors from capital gains and interest income tax earned on investments in Indian government securities, and the designation of certain long-tenor sovereign bonds as fully accessible – signal an investor-friendly shift to reinforce market confidence and enhance the structural appeal of the bond market.

These reforms significantly improve after-tax returns and remove longstanding barriers to foreign participation, effectively repositioning Indian sovereign bonds within global portfolios. Increased foreign inflows are expected to lower term premia,

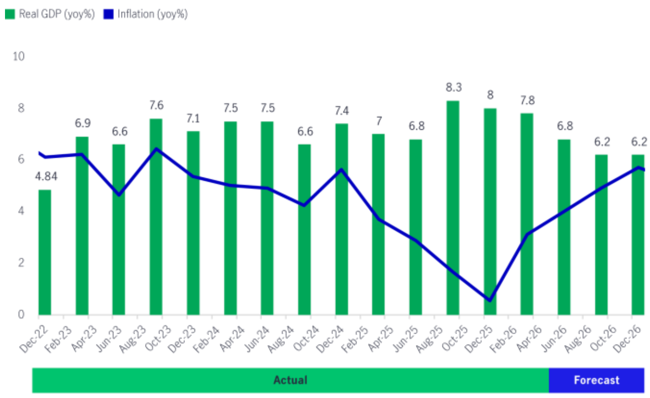
[4] Source: Manulife Investment Management, Bloomberg. Hedged yields adjusting using annualised 3-month CCY forwards. As of 30 June, 2026.

bolster long-end demand, and further support the rupee, reinforcing liquidity and market depth.

Recent volatility has created a more compelling and differentiated opportunity set for India bonds. Supported by elevated carry, improving market access, and structural tailwinds, India bonds offer attractive yields of around 7% and remain compelling in a global context, given India's investment-grade profile.

Increased foreign participation and the potential for further global index inclusion could provide an additional anchor for inflows and support long-end demand. The overall trajectory points toward gradually improving demand dynamics and more durable market support, reinforcing India's role as a key market for selective duration and carry opportunities.

Chart 5: India GDP and inflation growth[5]



Conclusion

The outlook for the second half of 2026 remains bright for Asia fixed income. Total returns are expected to be well supported, with carry remaining a key driver of returns, whether from an outright or currency-hedged basis, given multi-year low default rates. Furthermore, credit spreads across the region are expected to remain tight due to supportive macro conditions and negative net supply in the dollar bond markets, offsetting the potential impact from higher interest rates due to more hawkish central bank outlooks.

With lingering market uncertainty and volatility, the defensive nature of bonds and, in particular, Asia bonds – given their relative yield and duration advantage over global fixed income peers – becomes a worthy asset class for investors' portfolios in the second half of 2026 to help with return diversification and income enhancement.

[5] Source: Manulife Investment Management, Bloomberg. As of 30 June , 2026.

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Manulife Investment Management

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