Asian Fixed Income: Navigating the selloff

Asian Fixed Income team

Key points

- **Asia fixed income remains well supported:** Attractive all-in yields and resilient domestic fundamentals could provide a buffer against continued market uncertainty.
- **AI investment could create differentiated opportunities:** Asia's relatively limited AI-related credit exposure has helped insulate the region from recent volatility, while future infrastructure investment could broaden the credit opportunity set.
- **Domestic growth stories remain attractive:** Markets such as India offer exposure to domestically oriented businesses benefiting from manufacturing expansion and long-term infrastructure investment.
- **A more benign energy backdrop could provide support:** Lower energy-price pressures could benefit major importers such as India and Indonesia, as well as selected higher-yielding frontier sovereigns.
- **We continue to favor high yield:** Recent spread widening and market dispersion may create opportunities for disciplined security selection.

The outcome of the US midterm election should have a limited impact on Asia fixed income, given many Asian economies are supported by domestic demand, benefit from solid underlying fundamentals and are at different stages of their economic cycles. We remain constructive on Asia fixed income despite recent market volatility, given compelling all-in yields, which provide a decent buffer for investors against uncertainties. Looking ahead, we see a few potential medium-term catalysts, including stronger foreign investment flows into select Asian economies and a more benign inflation backdrop. Together, these factors could further strengthen macroeconomic resilience across the region and help maintain a supportive environment for Asian bonds.

Asia fixed income has also been more resilient to recent AI-related market volatility, given limited AI-related issuance in the region compared with other global credit markets, and hence lower direct exposure to the significant capital expenditure requirements associated with the theme. That said, reduced uncertainty around policy and regulatory changes in the region could favour AI-related investments. Markets such as Malaysia could also be well positioned to benefit given competitive energy costs, land and water availability, and strong connectivity to the broader Asian technology ecosystem. A ramp-up of foreign investment in digital and AI-related infrastructure could provide multi-year tailwinds for domestic investment, currencies, employment and corporate credit fundamentals in these economies. At the same time, potential new bond issuance associated with infrastructure investment could also broaden the Asia credit opportunity set, particularly after several years of relatively constrained net supply. Markets that have lagged in terms of AI-related infrastructure investment, such as Chinese mainland, could see a pick-up in related issuance in the coming years.

A potential near-term reallocation away from the new economy could also benefit markets that have greater exposure to the old economy, such as India. Fundamentally, we believe India's investment case remains anchored by its large domestic economy, manufacturing expansion and substantial infrastructure requirements. The Indian bond market provides investors with a set of domestically oriented and cash-generative businesses that benefit from multi-year structural investment trends, potentially providing an attractive area for investors to diversify exposure away from the new economy, especially if the pace of global AI-related capital expenditure begins to normalize.

We also see the prospect of an improving backdrop for Asia's energy-importing economies. A reduced probability of a sharp increase in energy prices could help contain inflationary pressures, reduce volatility in external balances and provide regional

central banks with greater policy flexibility. Major net energy importers such as India and Indonesia could be important beneficiaries, while the impact could be even more pronounced for higher-yielding frontier sovereigns such as Sri Lanka and Pakistan, where lower energy import costs could support current accounts, strengthen foreign-exchange buffers and contribute to further improvement in sovereign credit fundamentals.

Overall, we continue to believe that attractive all-in yields, resilient regional fundamentals and the potential for improving external conditions provide compelling reasons for investors to consider an allocation to Asia fixed income. We continue to favour High Yield over investment-grade credits due to relative yield and spread attractiveness, particularly following the recent widening in credit spreads. At the same time, dispersion across markets and issuers remains elevated, potentially creating attractive idiosyncratic opportunities where disciplined security selection may offer additional spread and total-return potential.

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