October 2023

Investment Navigator
Asia Edition

Is Crude Oil Cruel?
Q&A on Implications of Higher Oil Prices & Higher Bond Yields

Summary

- Global equities and bonds corrected with both nominal and real yields rising as increase in oil prices coupled with the supply and demand imbalances in US Treasury markets as well as the Fed's hawkish messages boosted the case for the "higher for longer rates" narrative. The recent sell-off was also driven by positioning and technical factors.

- We expect the US economy to weaken further into year end and our base case is still a moderate recession in 1H 2024 (an out of consensus call as consensus sees a soft-landing scenario), which would offset some "higher for longer" momentum.

- The current sentiment towards bonds reminds us of the sentiment towards equities in November 2022, when consensus saw new bear market lows in 2023. We took that opportunity to upgrade equities. Presently, the same consensus expects a soft landing with uncertainty on what is the ceiling on rising bond yields. Volatility creates opportunity.

- Any stabilisation in yields provides good entry for quality bonds with attractive yields and a chance to even extend duration to achieve potential equity-like returns in the medium term as we expect the Fed to cut rates from mid-2024 to mid-2025.

With the global equity markets sell-off, global bond yields at multi-decade highs, accompanied with strengthening greenback, there have been a lot of questions about the economic impact and investment implications of higher oil prices and our latest views on the "higher for longer" narrative. We attempt to address them in the Q&A below.

1. Is the recent rise in oil prices a major factor for higher US long-end yields?

Besides the hawkish Fed projections and comments in the latest FOMC meeting and the recent surprisingly resilient US economic data, the rebound in oil prices given the tighter supply outlook could be one of the reasons that contributes to "higher for longer" narrative amid concerns over inflation risk. In fact, US longer-term inflation expectations are

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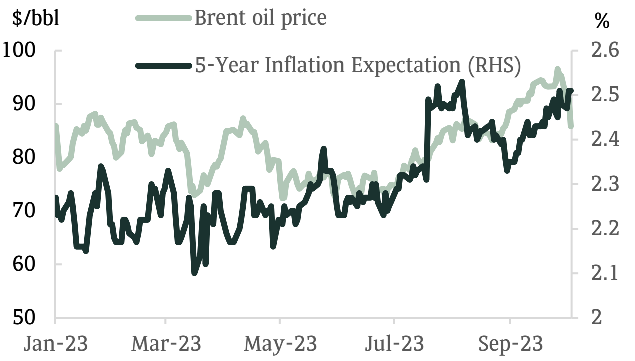
INFLATION EXPECTATIONS ROSE IN LINE WITH HIGHER OIL PRICES IN SEPTEMBER



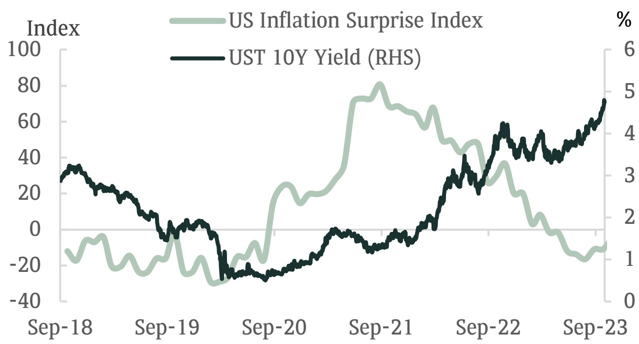
Source: Bloomberg, BNP Paribas (WM), as of 5 Oct 2023. Past performance is not indicative of current or future performance.

moving up again, in line with rising oil price, although recent inflation data generally continued to come out lower than expected (downside surprise).

There are also other key factors. Massive supply in long-end Treasuries accompanied by increasing fiscal burden in the US are bringing more uncertainty which has been driving up the "term premium" (compensation for uncertainty of holding longer maturities i.e. taking duration risk).

On technicals and positioning, yields breaking key levels and the huge unwinding of long positions in US Treasuries by leveraged bond funds after the hawkish Fed messages also contributed to sharp rise in yields.

INFLATION SURPRISES DOWNWARD, WHILE US BOND YIELDS CONTINUE TO RISE



Source: Bloomberg, BNP Paribas (WM), as of 5 Oct 2023. Past performance is not indicative of current or future performance.

2. Is oil price going to break $100/b?

Saudi Arabia's unilateral production cuts by 1 mb/d till the end of the year on top of the OPEC+/Russia restrictions are very significant. Furthermore, the Middle East conflicts over the weekend （7 October） raise risk premium in oil in the short-to-medium term though immediate areas involved do not have significant oil reserves.

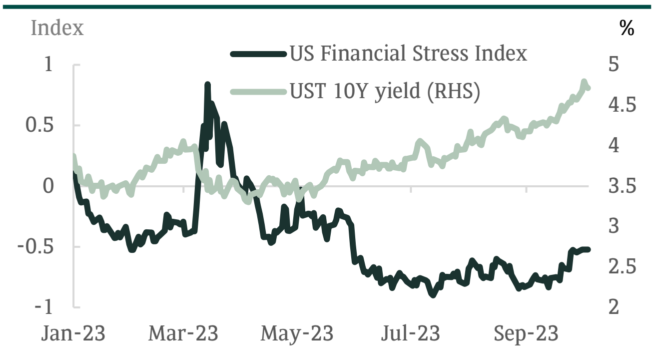
Thus, a spike above $100 is possible if geopolitical tensions escalate further. However, we do not expect Brent oil prices to sustain above $100 for a long period of time due to demand destruction driven by expensive energy prices and macroeconomic headwinds after aggressive rate hikes. We also expect a reasonable "supply management" by Saudi Arabia to avoid a sharp economic downturn. We expect Brent oil prices to go back to our target range of $85-95 in the medium term. In fact, recently oil prices are falling back on demand worries and the reduction of speculative longs in the market.

3. Does higher oil price accelerate the chance of a US recession?

Higher oil prices, rising bond yields and strengthening dollar are all "tax" on the US economy. Financial stress in the US banking system has been rising again in recent weeks (though a negative number means stress levels are still below average for now). The unrealized loss in some US lending institutions is getting bigger again with US bond yields moving up significantly.

Our base case scenario is still a moderate (not hard) US recession in 1H 2024 (an out of consensus call as consensus now is a soft-landing scenario). The lagged negative effects of aggressive rate hikes would be felt more significantly towards the end of

CLOSELY MONITOR US FINANCIAL STRESS INDICATOR AMID HIGHER YIELDS



Source: Bloomberg, BNP Paribas (WM), as of 5 Oct 2023. Past performance is not indicative of current or future performance.

this year. A steady cooling in the pace of US job creation on the order of about 30k per month year to date is estimated to drive job growth into negative territory by February 2024.

Consumption growth is under increasing pressure from tightening lending standards and fading excess savings. Higher energy prices also lower consumer sentiment when interest costs are already high.

Lastly, fiscal drag with expiring consumer support programs such as childcare subsidies and food assistance, resumption of student loan repayments, as well as the caps in the debt limit deal would have negative impact on growth.

A MODERATE US RECESSION IN 1H 2024 IS OUR BASE CASE SCENARIO

GDP Growth %	2022	2023				2024			
	Annual average	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
United States	2.1	0.5	0.6	0.7	0.1	-0.3	-0.1	0.2	0.3
Japan	1.0	0.9	1.5	-0.5	0.2	0.2	0.2	0.4	0.5
UK	4.1	0.1	0.2	0.3	0.1	-0.2	-0.1	0.1	0.2
Eurozone	3.4	0.0	0.3	0.0	0.0	0.2	0.3	0.4	0.5
Germany	1.9	-0.1	0.0	-0.1	-0.1	0.0	0.2	0.4	0.5
France	2.5	0.0	0.5	-0.2	0.0	0.1	0.2	0.3	0.4
Italy	3.8	0.6	-0.4	0.3	0.1	0.3	0.3	0.4	0.5
Emerging									
China	3.0	2.2	0.8	0.8	1.2	1.0	1.1	1.4	1.5
India	7.3	1.3	1.6	1.2	1.2	1.5	1.6	1.8	1.6
Brazil	2.9	1.8	0.9	-0.3	0.0	0.8	0.6	0.6	0.6

Source: BNP Paribas (WM), as of 30 Sep 2023.
Past performance is not indicative of current or future performance.

4. Are we expecting interest rates "higher for longer"?

Higher oil price is no doubt a moderate stagflationary shock i.e. putting upward pressure on headline inflation while weighing on economic activity. The extent of any oil move increases the risk of requiring tighter policy, which could either be achieved through a higher peak rate or a longer duration of restrictive rates. However, other key indicators of inflation: goods prices, wages, and rents are solidly in a down-turn. These are much larger components of overall inflation. Hence, given our oil view, we don't expect inflation surge aggressively in a slowing economy.

We maintain our view that the Fed and the ECB have reached the terminal rates: (1) recent inflation data largely suggested a continued disinflation trend in the US and Eurozone; (2) we expect second-round effects in core inflation will be more contained this time around as the magnitude of the shock is smaller and generally less excess demand in the economies. That said, higher oil price reinforces the "high for longer" environment and we expect rates to stay at current levels at least until mid-2024. Keeping nominal policy rates unchanged still implies a significant increase in real rates in a disinflation period, which are additional tightening to the economies. We expect the Fed to cut a total of 225bps from June 2024 to mid-2025, and the ECB to cut a total of 100bps from September 2024 to mid-2025.

5. What factors will drive US bond yields down again?

Significant decline in oil prices and/or worse than expected economic data especially some meaningful deterioration in the US job market would offset some of the momentum behind "higher for longer" narrative.

We stay with our view that rates have peaked and favour US Treasuries, Investment Grade bonds and TIPs. Any stabilisation in bond yields would give a good entry point to add to quality bonds with attractive yields and to take advantage of potential equity-like returns in the medium term by extending duration in the rate cuts environment. Our 12-month 10-year Treasury yield target is revised up to 3.75% from 3.5%, still representing good opportunities from the current yield levels.

6. What are the implications on equity markets?

Higher real yields tend to have a negative correlation to equity returns in the past. Therefore, any retreat in long-term bond yields could give some relief to equity markets.

We remain our preference for value stocks (vs growth stocks). Energy stocks still offer a catch-up potential. Recent rise in oil prices was barely followed by energy stocks. With consensus oil price forecasts still below current levels, we expect to see EPS upgrades in energy stocks. We also like healthcare and European financials. We are cautious with some expensive segments, such as consumer staples, consumer cyclicals and mega-cap US techs. Country and region wise, Japan, Europe and Latin America look more attractive than the US.

7. Why didn't gold perform as an inflation hedge in this environment of higher oil prices?

The sharp rise in longer-term real bond yields is a strong headwind for gold together with a strong dollar and AUM outflows out of gold ETFs. However, continued EM central bank purchases to diversify their reserves away from the greenback are downside support for gold. We remain medium term positive on gold as geopolitical risks, macroeconomic uncertainties and changing equities-bonds correlation persist. We expect gold to trade in the $1950-2150 range next year helped by the end of the tightening cycle and an expected weaker USD.

8. What are the key risks?

The key risks are that major central banks continue to raise interest rates more than expected, triggering sharper rise in yields, credit events and/or a deeper recession, which have not been priced by the markets.

CONCLUSION

The "higher for longer" narrative dominates current market sentiment and is driven by multiple factors including the Fed's hawkish tone, higher oil prices, resilient US data, rising term premium (requiring more compensation for Treasuries with longer maturities given uncertainty over US Treasury supply and US fiscal outlook) as well as yields breaking key resistant levels together with unwinding of US Treasury positions by leveraged funds.

Higher oil prices, rising bond yields and strengthening dollar are all a "tax" on the US economy. Our base case scenario is still a moderate US recession in 1H 2024 (an out of consensus call as consensus now is a soft-landing scenario).

Higher oil price is no doubt a moderate stagflationary shock, but we maintain our view that the Fed and the ECB have reached the terminal rates, though rates will stay at high levels until at least mid-2024. We believe more evidence of a weakening US economy would see yields peaked out.

Any stabilisation in bond yields would provide good entry points for quality bonds given attractive yields (16-year high) and chance to achieve potential equity-like returns (taking duration risks) in the medium term in the rate cuts environment in 2024 and 2025.

Higher real yields generally do not favour equity performance. Therefore, any retreat in long-term bond yields could give some relief to equity markets. We prefer value stocks (vs growth stocks) at economic turning points.

Overview of our CIO Asset Allocation for October 2023

	Views: Current	Views: Prior	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	Europe, UK, Japan, Latin America (selective), China, South Korea, Singapore & Indonesia		■ **We maintain our positive view on non-US equities, as seasonality is changing from a head- to a tailwind for equites.** Key drivers include falling US inflation, lower long-term interest rates, improving macro liquidity. Build stock exposure gradually on market consolidations.
			Sectors	Energy, Healthcare, Materials		■ Stay diversified including in some cheap and solid cyclical stocks (Energy, European Financials).
			Styles/ Themes	Megatrend themes		■ **Security, circular economy, electrification, and income themes.**
BONDS	=	=	Govies	US government bonds (maturities up to 10 years) US & UK inflation-indexed bonds		■ **We expect 10-year yields to reach 3.75% in the US.** ■ **We stay positive on US government bonds.**
	+	+	Segments	Investment grade, Emerging markets (EM) bonds (USD + local currency)		■ **We are positive on US and Euro investment grade (IG) corporate bonds.**
CASH	-	-				
COMMO-DITIES	+	+		Gold Oil Battery metals		■ **Gold - positive**: target range $1950-2150. ■ **Oil - positive**: Brent to stay at $85-95. ■ **Base metals – positive.**
FOREX			USDJPY			■ **Revised higher to 145 for USDJPY 3- and kept the same at 134 for 12-month targets**
ALTER-NATIVE	+	+		Real estate (healthcare, UK commercial); hedge funds (long-short equities, relative value); infrastructure (energy, transportation, water)		■ Neutral on overall real estate. Prefer listed real estate. ■ Neutral on event driven, and macro.

Note: + Positve / = Neutral / - Negative

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2022	2023f	2024f	2022	2023f	2024f
Developed	US	2.1	2.1	0.3	8.0	4.1	2.2
	Japan	1.0	2.0	1.0	2.5	3.2	2.5
	Eurozone	3.4	0.5	0.9	8.4	5.6	2.9
	UK	4.1	0.5	0.1	9.1	7.4	2.9
North Asia	China	3.0	5.1	4.5	2.0	0.5	2.0
	Hong Kong*	-3.5	3.5	3.1	1.9	2.3	2.4
	South Korea	2.6	1.2	1.8	5.1	3.4	2.3
	Taiwan*	2.5	2.1	2.6	2.9	1.9	1.7
South Asia	India	7.2	6.1	6.0	6.7	5.9	5.0
	Indonesia	5.3	5.0	5.0	4.2	3.4	2.7
	Malaysia	8.7	3.7	4.0	3.4	2.8	2.9
	Philippines*	7.6	6.0	5.8	5.8	6.3	3.2
	Singapore*	3.6	1.5	2.1	6.1	5.8	3.5
	Thailand	2.6	2.5	3.5	6.1	1.6	2.3

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 30 September 2023
** IMF data and forecasts as of 30 September 2023*

GROWTH

- Growth seems likely to lose momentum over the coming quarters on demand destruction as monetary policy looks set to remain highly restrictive for much longer. The strength of the US economy have thus far delayed the highly anticipated recession, and even brought back talks of a soft-landing scenario. Nonetheless, this is not our base case. We still see a mild recession around the first half of 2024. Labour markets are showing signs of softening, while forward looking indicators such as PMIs continue to suggest tougher times ahead.

INFLATION

- Inflation continues trending down in majority of countries, notably with the decline of headline and core PCE in the US, and both the consumer and producer inflation in Eurozone. The trend should likely continue, despite recent rally in energy prices, given the current restrictive policy in countries
- Inflation in China remains worrying, hovering near deflationary levels, albeit this should contribute to lower inflation in the western economics, as well as globally.

Equities

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
UK Japan Emerging Mkt Eurozone	US	-
SECTOR		
Energy Healthcare Materials	Comms., Industrials Utilities, Real Estate Technology Consu. Discre. Financials	Consumer Staples

OVERALL ASIA: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
China Singapore South Korea Indonesia	Taiwan India, Thailand Malaysia Philippines	-
SECTOR		
Comms. Consu. Discre. Consumer Staples Technology	Energy Materials Real Estate Financials Industrials Healthcare	Utilities

- Asian equity market corrected in September, in line with the global markets. Markets remained nervous that high oil prices might keep interest rates higher for longer, as central banks fight high inflation expectations.
- Hong Kong/China stocks remained disappointed against the backdrop of surge in US yields and the dollar, following a relatively hawkish Fed meeting as well as lingering domestic growth concerns in China.
- We have been seeing some stabilisation of economic data in China. However, market sentiment remains very weak. We still expect more targeted easing measures to come through. Autos, consumer durables, technology and tourism are potential policy beneficiaries.

		1-month (%)	YTD (%)	2022 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2023f	EPS Growth (%) 2023f	EPS Growth (%) 2024f	ROE (%) 2023f
Developed	US	-4.8	12.2	-20.8	18.3	4.1	2.1	1.8	11.8	17.8
	Japan	-0.4	23.4	-6.6	14.5	1.5	2.4	3.4	10.5	8.5
	Eurozone	-3.3	7.9	-14.5	11.4	1.6	3.3	3.9	6.6	13.8
	UK	2.8	1.7	3.0	10.3	1.7	3.9	-11.7	5.2	15.2
	Asia Ex-Japan	-2.9	-2.4	-21.5	12.3	1.5	3.1	0.8	21.4	9.9
North Asia	China	-3.0	-8.2	-22.4	9.6	1.3	3.6	16.1	15.6	10.7
	China A-shares	-2.0	-4.7	-21.6	12.3	2.0	3.0	15.7	14.2	12.3
	Hong Kong	-6.0	-19.9	-7.8	11.4	0.9	4.5	4.8	14.3	6.6
	South Korea	-3.3	13.2	-26.4	11.8	1.0	2.2	-35.5	70.4	6.0
	Taiwan	-2.7	13.7	-24.7	14.8	2.3	3.6	-21.8	22.2	12.6
South Asia	India	2.0	7.5	1.6	20.4	3.8	1.3	22.0	14.7	14.4
	Indonesia	-1.9	0.9	10.4	13.9	2.3	4.8	34.4	9.7	15.1
	Malaysia	-2.1	-5.1	-4.3	13.5	1.4	4.0	9.7	7.7	9.1
	Philippines	2.7	-2.7	-7.3	11.8	1.8	2.1	23.3	9.1	12.9
	Singapore	-0.2	-1.6	4.4	11.5	1.3	5.1	42.3	1.9	10.0
	Thailand	-5.7	-11.3	6.3	16.5	1.8	2.6	-11.3	14.8	8.8

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 30 September 2023

Fixed Income

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: NEUTRAL		
Positive	Neutral	Negative
EMD (LC) EMD (HC) IG UST	High Yield	-

OVERALL ASIA (USD): NEUTRAL		
Positive	Neutral	Negative
	India, China Philippines Singapore Indonesia Hong Kong	-

		Total Return (%) 1-Month	YTD	2022	Yield-to-Worst (%)
Asia	Asia USD Bond	-1.4	1.0	-11.7	6.6
	Asia Local Currency Bond	-3.0	-0.7	-8.6	4.6
	China	-0.8	0.0	-10.9	7.1
	Hong Kong	-1.4	1.8	-10.5	6.2
	India	-0.5	3.1	-9.7	7.6
	Indonesia	-3.1	-0.3	-12.9	6.1
	Singapore	-1.3	1.4	-11.0	6.2
	South Korea	-0.7	2.4	-8.6	5.8
	Philippines	-2.9	-0.6	-14.2	6.3
Other Regions	US 10-year Treasuries	-2.3	-1.6	-12.1	4.9
	US Investment Grades (IG)	-2.5	-1.2	-13.0	5.4
	US High Yield (HY)	-1.2	5.9	-11.2	8.9
	Emerging Market USD Bond	-1.2	0.8	-12.1	7.4

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 30 September 2023

US Treasury 12-month Yield Targets (%)	2Y	5Y	10Y	30Y
	3.50	▲3.70	▲3.75	▲4.00

- The **Fed held interest rates steady at 5.5% during the September FOMC**, in line with our expectations. In Europe, the **ECB hiked interest rates by another 25bps in September to 4% for the deposit rate**, in what seems like a final attempt to tame inflation. In our view, both central banks have reached terminal rate, and we now expect policy rates to stay at the current restrictive level for a sustained period. We envisage **interest rate cuts of 225bp rate cuts from June 2024 to mid-2025 in the US, and 100bp of rate cuts from September 2024 to mid-2025 in the eurozone.**
- Bond yields are currently overshooting. Our 12-month targets for the 10-year US Treasury yield is 3.75%. Hence we remain positive on **US government bonds (including maturities up to 10 years), especially as yields continues to climb higher.** The high volatility also provides opportunity for entry via various structure.
- On India fixed income, valuations overall for **IG and HY corporates look fair, and not as cheap compared to the rest of Asian peers.** Credit selection and diversification remains key in a higher for longer environment. **We remain cautious on the shadow-banking sector and prefer large public sector banks.** Among corporates, we prefer selective 5Y-8Y SOE bonds for now, vs 10Y bonds and private corporates. We also prefer quality Indian HY credits and sticking to selective BB-rated names.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

Positive	Neutral	Negative
JPY EUR GBP AUD NZD CNY KRW TWD IDR MYR PHP SGD THB	CAD INR	USD

Major Asian countries are yet to give a clear guidance as to how they will fight currency depreciation. More economic stimulus is expected in China which would help build up some economic momentum. In Japan, the BoJ's Governor had some hawkish comments after widening the yield curve control (YCC). **We expect the BoJ to end its negative interest rate policy in Q2 2024. Near term, the US dollar should remain strong versus Asian currencies.** We maintain our **USD/CNY 3-month target at 7.2 and our 12-month target at 6.8. We increase our USD/JPY 3-month target from 140 to 145 and maintain our 12-month target at 134.**

COMMODITIES

Positive	Neutral	Negative
Gold Oil Base metal		-

GOLD: We remain positive on gold, and expect the pressure of higher real yields and stronger dollar to ease going into 2024. EM central banks purchases, recession tail hedging and persisting geopolitical risks should also support the yellow metal. **We expect gold to trade in the $1950-2150 range next year.**

OIL: Future prices rallied in September, on the back of active "supply management" by the OPEC+. We expect that to continue, and **a spike above $100/b is possible, but Brent prices are unlikely to remain at that level** due to demand destruction. **We expect Brent prices to trade within the $85-95 range.**

BASE METALS: The trough in the contraction of the manufacturing activity seems behind us and the Chinese demand is not as weak as feared. We keep our medium-term positive stance because of the huge needs of the energy transition and the supply underperformance. **Copper has the best outlook.**

Forex Forecasts

		Spot	3-month		12-month	
		As of 30 Sep 2023	View	Target	View	Target
Developed	USD Index*	106.22	=	105.0	-	97.4
	Japan	149.2	+	145	+	134
	Eurozone	1.059	=	1.06	+	1.15
	UK	1.221	=	1.23	+	1.34
	Australia	0.645	+	0.68	+	0.70
	New Zealand	0.597	=	0.60	+	0.63
	Canada	1.352	+	1.32	+	1.30
Asia Ex-Japan	China	7.304	=	7.20	+	6.80
	South Korea*	1,349	=	1,310	+	1,270
	Taiwan*	32.28	=	32.0	=	31.3
	India	83.04	=	82.0	=	82.0
	Indonesia*	15,455	=	15,500	=	15,200
	Malaysia*	4.695	=	4.68	=	4.53
	Philippines*	56.58	=	58.0	=	58.3
	Singapore*	1.365	=	1.37	+	1.29
	Thailand*	36.41	+	35.00	+	33.00

Source: BNP Paribas (WM) as of 30 September 2023
**BNP Paribas Global Markets forecast as of 30 September 2023*

Note: + Positve / = Neutral / - Negative

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