MARCH 2023

Investment Navigator
Asia Edition

Hard Landing? No Landing? How Should I Land?

Summary

- Consensus moved from a “hard landing” last November to “no landing” in February 2023. Investors who are concerned about rising market volatility can consider income opportunities.
- Recent re-pricing in rate expectations creates opportunities in high quality US Treasury and investment grade bonds yielding 4% to 7% after the recent rise in yields. Monetary policy acts with a lag.
- Equally, we were contrarian upgrading China (up 50% from lows) and Europe (up 30% from lows) last November when hard landing had already been priced in. Data surprised to the upside in non-US equities and we remain buyers of dips after the rally.

Market Narrative Changes: Stronger Growth and Stickier Inflation

The macro-economic outlook has improved globally, as reflected by recent data in the past weeks. US non-farm payroll figures were better than expected, US unemployment rate dropped to 3.4% (the lowest since 1969), and retail sales illustrated the still resilient US consumer. In fact, while savings have been run down, the consumer has been tapping credit card spending.

In the short term, this has helped offset any hit from inflation. However, how this would progress during the year is crucial. Furthermore, while US CPI figures were in line with forecasts, PPI figures were ahead, reflecting the challenge that the Federal Reserve faces. Nevertheless, those bears in the hard landing camp at best have been deferred.

European PMIs also beat expectations, and so did inflation in some major Eurozone countries. Therefore, the market narrative has changed in February. Inflation has proved to be stickier than expected and incoming data was stronger than expected. Expectations for higher policy rates have therefore heightened, causing bond yields to rise with US 10-year yields hitting 4%.

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Moderate Upward Revision of Rate and Growth Forecasts

With sticky inflation, stronger-than-expected growth and resilient consumption, **we have moderately revised upwards our estimates for the Fed's and ECB's terminal rates by one hike of 25bps. We now expect the Fed to end its cycle at 5.25% in May and the ECB at 3.5% (deposit rate) in June.** We do not expect rate cuts this year from either central bank. <u>Again, we repeat the same message we conveyed at the beginning of the year – Pause not Pivot in 2023.</u>

Our 12-month forecasts of 2-year US Treasury yield of 4.0% and 10-year of 3.5% remain unchanged. In fact, surprisingly, the 10-year yields briefly went below our 12-month forecasts, falling to 3.4% in January.

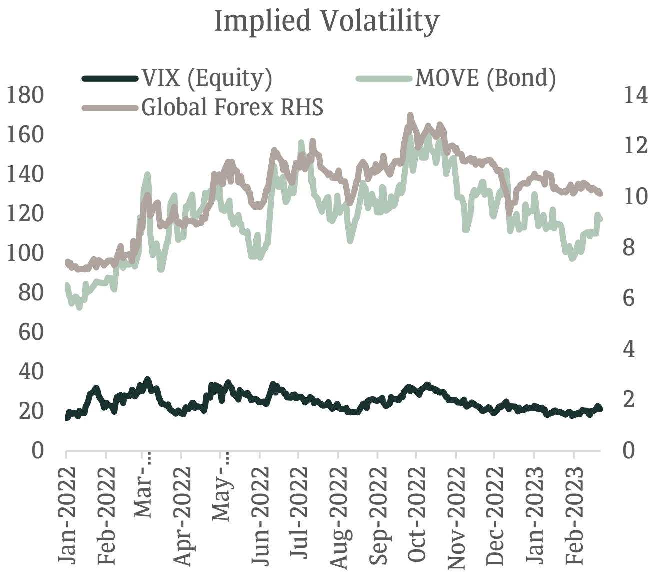
We expect continued yield volatility given the evolving growth and inflation outlook. However, yield sell-offs should be gradually bought. Bonds are back, disinflation is the longer-term trend, and monetary policy acts with long lags. Nonetheless, central banks will not hit their inflation targets until 2024. It is a process, not an event. Labour shortage and job openings in the service industry remain robust. In addition, we have revised our GDP growth forecast for the US from 0.3% to 0.7% for 2023, and from -0.2% to 0.2% for 2024.

Income Opportunities amid Market Volatility

Indeed, there is no clear visibility on whether the US economy will be heading for a soft landing, a recession, or even a no-landing scenario. Market volatility has been rising as the market tries to interpret future Fed rates from economic data released every day.

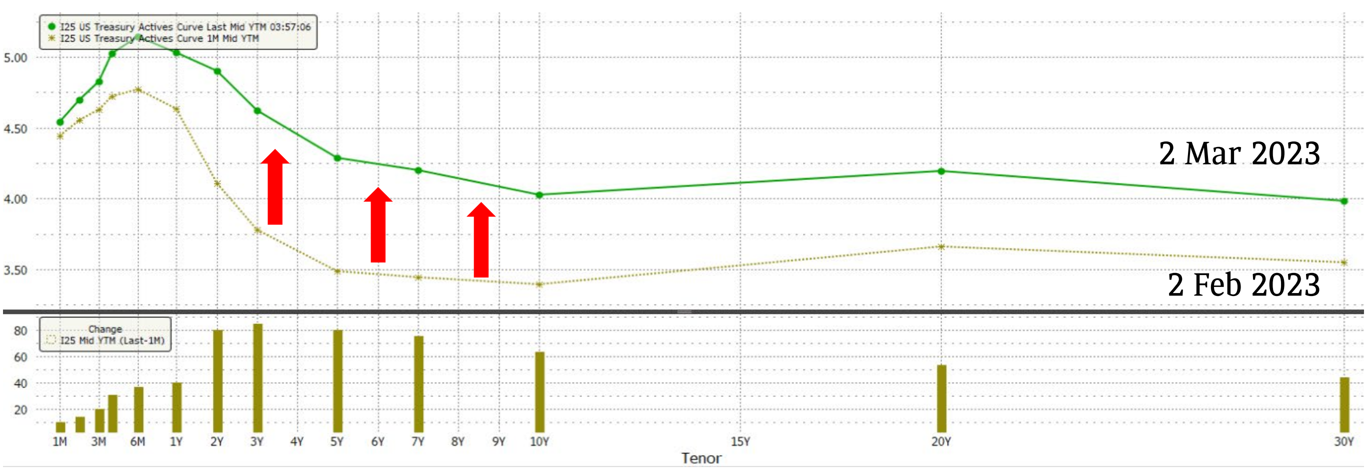
The recent rise in yields provides a better entry point for adding to quality investment grade bonds, and a chance to extend to medium-term duration. There are also income opportunities from income funds, structured products (to monetise the higher volatility), Asian REITs and high-dividend stocks.

MARKET VOLATILITY IS RISEN AGAIN



Source: Bloomberg, BNP Paribas (WM), as of 2 Mar 2023. Past performance is not indicative of current or future performance.

THE WHOLE US YIELD CURVE HAS GONE UP, WITH 2-YEAR TO 7-YEAR SEEING THE MOST UPWARD ADJUSTMENTS



Source: Bloomberg, BNP Paribas (WM), as of 2 Mar 2023. Past performance is not indicative of current or future performance.

China Data Beats Consensus Forecasts

China's aggregate PMI rose to a 14-month high of 52.4 in February. The China NBS manufacturing PMI climbed to 52.6 from 50.1, while the non-manufacturing index also rose to 56.3 from 54.4. There was a pickup in both the construction and the service sectors. We have been bullish ahead of consensus on a rebound of China growth, and the figures from February were encouraging.

So far in 2023, China has been the only major economy easing both monetary policy and fiscal policy. It is in a very different part of the economic cycle than the rest of the major economies globally. Investors can consider continuing to "buy the dips" in China equities.

Conclusion

The market has shifted from a consensus (not including ourselves) hard landing fear in November to a "no landing" view in February on the back of better growth and stickier inflation. This provides opportunities to add positions in fixed income, as monetary policy acts with a lag and yields should be lower in one year's time. Yields on US Treasuries and investment grade corporates are at multi-decade highs.

There are also income opportunities from income funds, structured products (to monetise the higher volatility), Asian REITs and high-dividend stocks.

We took a view opposite to the "hard landing fear" by upgrading China and Europe equities to overweight last year. These markets had rebounded by 50% and 30% respectively from their lows. Chinese and European data continues to surprise to the upside. We remain buyers of non-US equities including China on pullbacks.

Overview of our CIO Asset Allocation for March 2023

	Views Current	Views Prior	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	Europe, UK, Japan, Latin America, China, South Korea, Singapore and Indonesia		■ **We maintain our positive view on non-US equities. Europe and China up double digit in January.** Key drivers include falling US inflation, lower long term interest rates, improving macro liquidity, and easing energy prices.
			Sectors	Oil & Gas, Financials, Healthcare, Materials, Semiconductors, Precious/"battery" Metals		■ Momentum, earnings and valuations are still very supportive to Energy, some Metals & Mining, Health Care and Financials.
			Styles/ Themes	Megatrend themes		■ **Security, circular economy, and income growth themes**
BONDS	=	=	Govies	US Treasuries		■ **We now expect 2-year yields to reach 4% and 10-year yields to reach 3.5% in the US in 12 months.** ■ **We are positive** on US government bonds
	+	+	Segments	Investment Grade, Emerging Markets Bonds (USD + local currency)		■ **We are positive on US and Euro IG corporate bonds, and EM bonds in hard and local currency.**
CASH	-	-				
COMMO-DITIES	+	+		Gold & Oil		■ **Gold - positive**: Gold to trade in the $1850-2000 range. ■ **Oil - positive**: Brent to climb back to $90-105 range. ■ **Base metals – positive: demand should be supported by the Chinese post-Covid recovery and decreasing recession risks in Europe.**
FOREX			USDCNY			■ **We stay positive on CNY, with a 3-month target of 6.75 and 12-month target at 6.50.**
ALTER-NATIVE	+	+		Real Estate (warehouses, healthcare, UK commercial); Global Macro, Relative Value & trend-following Hedge Funds		■ **We prefer Global Macro and Relative Value strategies, as well as trend-following CTAs** given the strong trends this year. ■ **We are neutral on Event Driven, and Long/Short Equity.**

Note: + Positve / = Neutral / - Negative

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2022	2023f	2024f	2022	2023f	2024f
Developed	US	2.1	0.7	0.2	8.1	4.2	2.4
	Japan	1.2	0.9	0.3	2.5	2.2	1.2
	Eurozone	3.4	0.2	1.3	8.4	5.0	2.4
	UK	4.4	-0.9	0.8	9.0	6.8	2.1
North Asia	China	3.0	5.1	5.3	2.0	2.7	2.5
	Hong Kong*	-0.8	3.9	3.0	1.9	2.4	2.5
	South Korea	2.6	1.2	1.7	5.1	3.5	2.1
	Taiwan*	3.3	2.8	2.1	3.1	2.2	1.4
South Asia	India	8.3	6.2	6.5	7.9	5.9	5.5
	Indonesia*	5.3	5.0	5.4	4.6	5.5	3.2
	Malaysia*	5.4	4.4	4.9	3.2	2.8	2.4
	Philippines*	6.5	5.0	6.0	5.3	4.3	3.1
	Singapore*	3.0	2.3	2.6	5.5	3.0	2.0
	Thailand*	2.8	3.7	3.6	6.3	2.8	1.5

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 28 February 2023
** IMF data and forecasts as of 28 February 2023*

GROWTH

- The expansion phase of the business cycle in the US does not seem to be over, though the ongoing relatively strong growth increases the risk of stickier inflation. Soft landing may be even harder to achieve, while a 'delayed landing' seems the more likely scenario.
- We have revised our growth forecast to be more in line with the recent stronger-than-expected economic data. Only the UK will see negative growth for 2023, while all regions are looking at low growth, instead of negative growth in 2024. Considering the recent business surveys, a recession is looking more and more unlikely.

INFLATION

- Inflation seems to have peaked in mid-2022 and should continue to fall while remaining significantly above the target of 2% by late 2023.
- We expect US inflation to lead the decline. US inflation could fall rapidly in the coming months, on the back of moderating demand, easing supply chain pressures, a weaker housing market and lower fuel prices. We also see easing labour market pressures, as corporate focus turns to reducing staff rather than adding.

Equities

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: POSITIVE

Positive	Neutral	Negative
COUNTRY		
UK Japan Emerging Mkt Eurozone	US	-
SECTOR		
Energy Healthcare Financials Materials	Comms. Industrials Utilities Real Estate Technology Consu. Discre.	Consu. Sta.

OVERALL ASIA: POSITIVE

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

- Equities across the board pulled back in February, due to a stronger US economy and stubborn inflation prints, which have pushed bond yields and USD higher.
- **We remain positive on Equities overall**, and continue to recommend building stock exposure gradually, using short-term market consolidations to add, **favouring Value and World ex-US over US**.
- Chinese equities saw a pullback in the traditionally festive month, after surging on reopening optimism in prior months. **We continue to stay positive on Chinese equities in the medium to long term, and deem any volatility as opportunity to accumulate, particularly since valuation remains cheap and as earnings continue to revise upward.**

		1-month (%)	YTD (%)	2022 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2023f	EPS Growth (%) 2023f	EPS Growth (%) 2024f	ROE (%) 2023f
Developed	US	-2.6	3.8	-20.8	18.8	4.1	2.0	0.6	12.0	17.9
	Japan	0.7	5.4	-6.6	13.0	1.4	2.5	8.2	3.1	8.8
	Eurozone	1.6	11.3	-14.5	12.6	1.7	3.2	1.1	8.1	12.3
	UK	1.5	5.6	3.0	10.5	1.7	3.7	-3.9	3.3	14.0
	Asia Ex-Japan	-6.9	0.8	-21.5	13.3	1.5	3.0	0.9	18.5	8.8
North Asia	China	-9.9	0.7	-22.4	11.0	1.4	3.2	15.0	14.3	10.0
	China A-shares	-2.1	5.1	-21.6	13.9	2.4	2.0	17.4	14.1	12.4
	Hong Kong	-7.0	-3.0	-7.8	14.2	1.1	3.4	31.4	12.1	5.5
	South Korea	-0.1	9.3	-26.4	14.0	0.9	2.4	-36.4	49.1	6.6
	Taiwan	0.3	10.4	-24.7	14.3	2.3	4.2	-16.4	18.3	14.3
South Asia	India	-3.8	-7.7	1.6	20.5	3.4	1.4	23.3	15.0	14.7
	Indonesia	0.8	-0.2	10.4	13.3	2.6	2.3	4.1	6.8	18.6
	Malaysia	-2.5	-2.9	-4.3	13.3	1.4	3.6	11.7	6.7	0.6
	Philippines	-3.9	-0.7	-7.3	14.7	1.9	1.6	17.1	11.4	11.1
	Singapore	0.7	1.6	4.4	13.2	1.4	4.1	22.9	9.7	9.6
	Thailand	-3.2	-4.3	6.3	17.6	2.0	2.3	20.0	11.0	10.4

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 28 February 2023

Fixed Income

POSITIVE NEUTRAL NEGATIVE

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

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

		Total Return (%) 1-Month	YTD	2022	Yield-to-Worst (%)
Asia	Asia USD Bond	-1.6	1.3	-11.7	6.2
	Asia Local Currency Bond	-5.5	0.2	-8.6	4.5
	China	-1.4	1.6	-10.9	6.6
	Hong Kong	-1.5	1.7	-10.5	5.6
	India	-1.8	0.1	-9.7	7.8
	Indonesia	-1.9	1.0	-12.9	5.6
	Singapore	-1.4	1.0	-11.0	5.6
	South Korea	-1.0	0.7	-8.6	5.5
	Philippines	-2.1	0.6	-14.2	5.7
Other Regions	US 10-year Treasuries	-2.6	-12.3	-12.1	3.9
	US Investment Grades (IG)	-2.6	-12.7	-13.0	4.8
	US High Yield (HY)	-1.3	-9.0	-11.2	8.6
	Emerging Market USD Bond	-1.5	-10.6	-12.1	7.1

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 28 February 2023

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

- **The Fed raised interest rates by 25bps to 4.5%-4.75% in its February 2023 meeting, dialing back the size of the increase for a second straight meeting but still pushing borrowing costs to the highest since 2007.** All participants continued to anticipate that ongoing increases would be appropriate until data provided confidence that inflation was on a sustained downward path to 2%, which was likely to take place some time.
- **We have revised higher our estimates for the Fed's and ECB's terminal rates by 25bps** in light of sticky inflation, stronger-than-expected growth and resilient consumers. **We now expect the Fed to end its cycle at 5.25% in May and the ECB at 3.5% (deposit rate) in June. We do not expect rate cuts this year from either central bank.**
- **The 12-month target for the US 2-year treasury yields is 4%, while the US 10-year treasury yield target remains at 3.5%. We revised up 30-year to 3.75% from 3.5%.**
- **We stay positive on Hong Kong credit.** We believe the worst is arguably over for Hong Kong property as confidence recovers and the rate hiking cycle is coming to an end. We expect HK GDP and HK issuers' business profiles to gradually recover as China's economic activities pick up and border reopening resumes.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

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

COMMODITIES

Positive	Neutral	Negative
Gold Oil Base metal		-

DXY: The dollar index rebounded strongly to 105 in February from a low of 100, as **hawkish Fed concerns kept DXY bulls hopeful** particularly given the stronger-than-expected US economic data.

CNY: The yuan took a breather in February after three successive months of appreciation, on the back of reopening and improving economic fundamentals. **We stay positive on CNY, with a 3-month target of 6.75 and 12-month target at 6.50.**

AUD: The outlook for Australia-specific commodities remains positive. In February, Australia's central bank raised its interest rate, surprising the market. The board expects further increases in the coming months. This will improve the interest rate differential with the US. **We maintain our 3-month target of 0.70 and increase our 12-month target to 0.73.**

GOLD: February erased most of the metal's January gains as interest rate tensions reappeared and the dollar recovered part of its losses. Nonetheless, an eventual easing in interest rate tensions, a softening dollar and above-average purchases by central banks should underpin gold, which remains our preferred hedge against tail risks. **12-month target: $1850-2000.**

OIL: We expect oil prices to creep higher due to Chinese demand recovery and limited excess capacities. Disruption risks remain high. **We expect Brent prices to trade in the $90-105 range in the coming months.**

BASE METALS: Despite giving up part of their January gains in February, we remain positive on base metals as demand should be supported by the Chinese post-Covid recovery and decreasing recession risks in Europe. **Our medium-term outlook remains bullish given the huge needs of energy transition.**

Forex Forecasts

		Spot	3-month		12-month	
		As of 28 Feb 2023	View	Target	View	Target
Developed	USD Index*	104.87	=	103.7	-	101.9
	Japan	136.2	+	130	+	128
	Eurozone	1.061	=	1.06	=	1.08
	UK	1.211	=	1.20	+	1.23
	Australia	0.674	+	0.70	+	0.73
	New Zealand	0.617	+	0.65	+	0.65
	Canada	1.361	+	1.32	+	1.30
Asia Ex-Japan	China	6.939	=	6.75	+	6.50
	Hong Kong*	7.850	=	7.85	=	7.85
	South Korea*	1,323	+	1,260	+	1,175
	Taiwan*	30.47	=	30.2	=	29.3
	India	82.67	=	82.0	=	82.0
	Indonesia*	15,250	=	15,400	=	14,700
	Malaysia*	4.488	+	4.28	+	4.07
	Philippines*	55.35	-	58.5	-	58.6
	Singapore*	1.346	=	1.30	+	1.22
	Thailand*	35.34	+	33.20	+	30.50

Note: + Positve / = Neutral / - Negative

Source: BNP Paribas (WM) as of 28 February 2023
**BNP Paribas Global Markets forecast as of 28 February 2023*

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