

A bull and a bear sculpture are positioned on a background of a financial chart. The bull is on the right, facing left, and the bear is on the left, facing right. The chart shows various data points and lines, including a red line and a blue line. The text "2022 Asian Rates and FX Outlook: Regional recovery expected" is overlaid on the chart in a large, white, sans-serif font.

2022 Asian Rates and FX Outlook: Regional recovery expected

By the Asian Fixed Income team

December 2021

Outlook for 2022

We expect global economic growth to persist in 2022 but at a more moderate pace. In the US, strong domestic demand and further fiscal stimulus are seen supporting GDP growth. The US Federal Reserve (Fed) commenced tapering asset purchases in November 2021, as it expects the economy to keep improving, particularly after supply chain issues are resolved. The Fed could end its asset purchases around mid-2022 and then begin hiking rates as the pandemic subsides—a scenario that is seen to have been largely priced in by global markets. We see expansion in Europe sustained by continued increases in vaccination rates and mobility.

In contrast to the Fed, the European Central Bank (ECB) is seen keeping its monetary policy loose, with ECB President Christine Lagarde recently declaring that inflationary pressures continue to stem from transitory factors linked to the reopening of the economy.

After leading the global recovery in 2021 we expect China's growth to slow in 2022. Admittedly, the Chinese government's decision to tighten policies in a number of sectors has heightened concerns towards how much growth could slow. To soothe the concerns of businesses and investors, the People's Bank of China (PBOC) has vowed to ensure a "healthy property market" and policymakers have directed banks to somewhat loosen lending to the property sector. We take these as signs that the government stands ready to announce incremental and targeted loosening to ensure decent GDP growth.

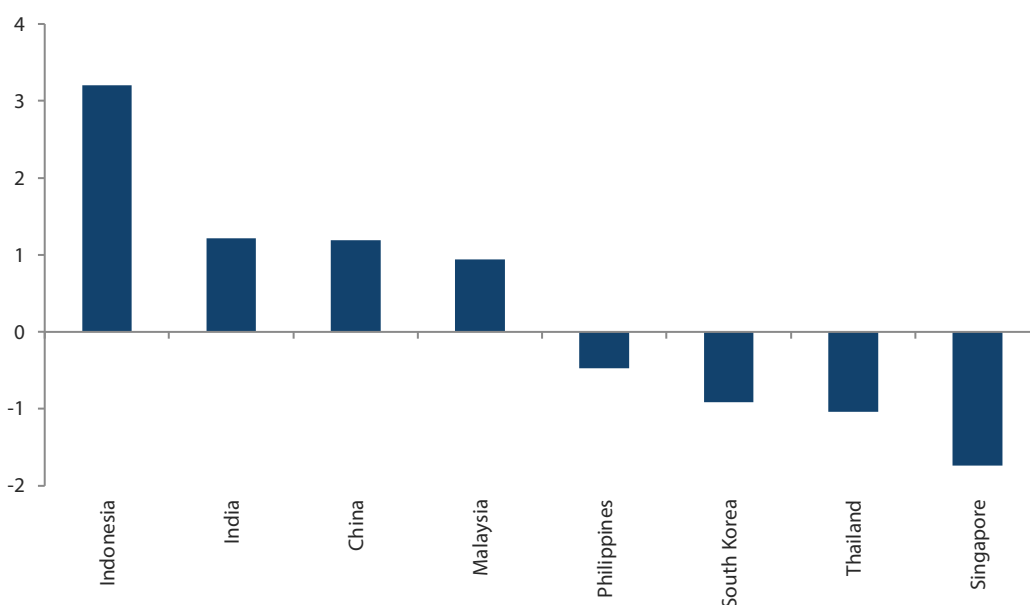
Meanwhile, the recovery in Asia ex-China is likely to improve significantly in 2022. Countries have abandoned their zero-COVID strategies and transitioned to "living with COVID", slowly reopening their economies and borders amid rising vaccination numbers. Singapore, where more than 85% of the population is now fully vaccinated, has expanded its vaccinated travel lane scheme to more than 15 countries as of mid-November 2021. In South Korea, more than 70% of the population is fully vaccinated, and the government has eased a range of restrictions. Close to 50% of Thailand's population is fully vaccinated; since November 2021, the country has stopped quarantine requirements for vaccinated visitors from more than 60 specified countries. We anticipate these developments to boost private sector confidence, providing an important tailwind for Asian ex-China growth in 2022.

Heading into 2022, we retain our preference for mid- to high-yielding bonds. We expect Indonesian bonds in particular to be supported by low domestic inflation and their attractive real yield. In China, the PBOC is likely to keep liquidity stable in the near term through its open market operations (OMO) and medium-term lending facility (MLF) operations, while preserving policy cushions such as interest rate or reserve requirement ratio (RRR) cuts as a last resort—and only if economic fundamentals deteriorate significantly. Government bond issuance should remain manageable while local government special bonds for infrastructure investment will likely increase. Meanwhile, we expect low yielding countries to be more sensitive to US rates.

On currencies, we expect the US dollar to resume its ascent against most regional currencies when US rates re-adjust higher and the Fed starts raising rates. The performance of Asian currencies will likely depend on varying degrees to factors such as the impact of oil and commodities on the current accounts of regional economies, the extent of success in the further reopening of borders and the outlook for economic growth. Overall, Asia's strong fundamentals should keep regional currencies relatively resilient.

In our view, the biggest downside risk to global markets is the continued imbalance between supply and demand, causing inflationary pressure to last longer than the markets had previously assumed. This could prompt the Fed to tighten earlier than anticipated. Meanwhile, another sharp spike in COVID-19 cases during the winter season is another potential risk that could delay the normalisation of economic activities. Other idiosyncratic factors include political developments (such as presidential elections in South Korea and the Philippines) that could affect policy direction.

Chart 1: Asian real rates (%) – 5-year yields vs CPI



Source: Bloomberg, as of 25 November 2021.

Individual Country Outlooks

China

We expect growth by China to slow in 2022 after it led the global recovery in 2021. The Chinese government's policy-tightening drive has led to growth concerns, but the PBOC has vowed to ensure a "healthy property market" and policymakers have directed banks to somewhat loosen lending to the property sector. We take these as signs that the government stands ready to ensure decent GDP growth.

China's consumer price index (CPI) inflation picked up in October 2021, but it remains at a relatively low level. Looking ahead, favourable base effects as well as higher commodity costs could drive CPI inflation higher, although weak overall demand is likely to limit the rise. In contrast, producer price index (PPI) inflation—which hit a record high of 13.5% in October 2021—could moderate due partly to fading base effects and foreign production capacities resuming as more countries set aside COVID-19 restrictions.

The PBOC is likely to keep liquidity stable in the near term through its OMO and MLF operations, while preserving policy cushions such as interest rate or RRR cuts as a last resort, and only if economic fundamentals deteriorate significantly. Overall, we believe the central bank's policies will lean towards easing.

Government bond issuance should remain manageable while the amount of local government special bonds for infrastructure investment will likely increase. Chinese government bonds are seen benefitting from slower growth, continuous foreign inflows—boosted partly by their inclusion to the FTSE World Government Bond Index (WGBI) in

October 2021—and manageable supply. Meanwhile, the renminbi (RMB) has been well supported, backed by the country's large trade surplus. Moving forward, we expect relatively strong net export performance and continued inflows to support the RMB, although demand for the currency could be partially offset by rising regulatory uncertainty and the tightening China-US interest rate differential.

South Korea

Relative to its peers South Korea's GDP growth stayed resilient in 2021, thanks largely to strong exports. GDP growth is likely to moderate in 2022 but remain at healthy levels; capacity expansion in response to the global chip shortage could be tempered by slower Chinese growth and the normalisation of pandemic-related tech demand. Since November 2021 the government eased a range of restrictions and adopted a gradual reopening plan with more than 78% of its population fully vaccinated. We expect mobility to increase in light of these developments and support private consumption expenditure. Separately, upcoming presidential (March 2022) and local (June 2022) elections could provide South Korea with fiscal policy tailwinds.

The Bank of Korea (BOK) was the first central bank in the region to begin normalising monetary policy, raising interest rates by a total of 50 basis points (bps) in the latter half of 2021. The BOK was seen to have tightened the policy rate to ensure financial stability and address rising inflationary pressures. We expect the central bank to stay on the path of steady and gradual normalisation in order to avoid any policy missteps. Notably, the BOK will undergo leadership changes as incumbent Governor Ju-yeol Lee's term expires in April 2022.

In 2022 we expect South Korean bonds to move with a higher correlation to US Treasuries (USTs) compared to their regional peers. Meanwhile, the South Korean won could underperform as the country's growth momentum slows and its trade surplus narrows.

Malaysia

GDP growth in Malaysia is likely to accelerate in 2022, as domestic activity normalises and borders reopen. The government successfully accelerated its COVID-19 vaccine roll out, with over 77% of the population fully vaccinated as of November 2021. Consequently, policymakers are preparing to treat COVID-19 as an endemic and fully reopen economic sectors by December 2021. Vaccinated travel lanes with neighbouring Indonesia and Singapore were opened in November 2021, while plans are underway for the country to reopen its borders to other international tourists by 1 January 2022.

Going forward, we expect upward pressure on inflation as economic activity picks up in tandem with the easing of border restrictions. Nonetheless, any move towards higher prices is likely to be gradual, allowing Bank Negara Malaysia (BNM) to remain on hold in the first half of 2022. We maintain that the central bank is more likely to keep its current accommodative stance for an extended period to support the nascent economic recovery.

We approach 2022 with a constructive view on Malaysian rates. Supply is likely to remain heavy, as the 2022 budget remains expansive, with the government pencilling in a fiscal deficit of 6.0% of GDP. That said, we see BNM's prolonged pause, together with relatively higher real rates, more than offsetting the pressure stemming from supply risks. Separately, we expect still-elevated commodity prices to benefit the ringgit.

Lastly, we are mindful that political developments in Malaysia are likely to continue to be a risk to investor confidence. We note that general elections—which are due to be held on or before July 2023—may be called as early as the second half of 2022.

Singapore

Within Asia, Singapore has led the way in both reopening and normalisation efforts. Although there have been delays to domestic reopening as daily infection cases rose quickly, the government's overall strategy of treating COVID-19 as an endemic remains intact. More than 85% of Singapore's population is now fully vaccinated, and the country has expanded its vaccinated travel lane scheme to more than 18 countries. For 2022, growth is likely to slow, with expansion by Singapore's tourism and consumer-facing sectors tempered by moderation in China's economy.

Inflation has risen sharply in the second half of 2021. Core inflation may stay robust in the near term after reaching 1.5% in October. We expect inflationary pressures to be supported by an improvement in labour market conditions and high energy prices. As core inflation prints remain elevated, the MAS could further tighten its FX policy, allowing the Singapore dollar to remain attractive against its regional peers.

While we expect Singapore Government Securities (SGSs) to retain a higher correlation to USTs, SGSs could outperform USTs on the back of ample domestic liquidity and the attractiveness of the Singapore dollar.

Thailand

Thailand's economic recovery has been slow so far, due to the economy's heavy reliance on international tourism. Heading into 2022, growth is expected to rebound, reflecting the aggressive border reopening that started in November 2021. That said, tourism arrivals are unlikely to return to pre-pandemic levels anytime soon, as China's COVID-zero approach inhibits the flow of Chinese tourists. Meanwhile, vaccination progress has greatly improved. Close to 57% of Thailand's population is fully vaccinated, with several key tourism cities having reached higher figures of full vaccination coverage. This should support improvement in private sector consumption.

Headline inflation has crept higher of late, but it remains well within the central bank's 1-3% target range. The acceleration has been driven partly by rising fuel prices. Core inflation, which excludes energy and raw food prices, has remained weak, as demand-pull inflation pressures remain muted. The government has announced measures to reduce domestic costs, including an extension of the cap on diesel prices, which should provide some anchor to overall inflation in the coming months.

Bank of Thailand (BOT) has kept monetary policy accommodative, and it continues to emphasise the need to support the economic recovery as a policy priority. At its most recent monetary policy committee (MPC) meeting, the central bank's policy statement still sounded cautious regarding the overall economic outlook, although it did say that downside risks to growth have decreased. We expect the BOT to leave policy rates unchanged for some time, so as not to derail the recovery momentum.

The government raised the public debt limit to 70% (from 60%) of GDP in September 2021. In addition, it unveiled a substantially higher bond issuance target of Thai baht (THB) 1.1-1.3 trillion for FY2022 (from THB 847 billion for FY 2021), prompting the Thai government bond yield curve to steepen. With this behind us, UST direction is expected to remain the main driver of Thai government bonds. Separately, the direction of the Thai baht could, to a great extent, be determined by the increase in tourism receipts.

Political risk remains low. Anti-government protests have been held, but they have been largely under control. Politics will be closely watched in 2022 as political activity could pick up with next elections due by early 2023.

India

India's economy staged a remarkably strong comeback in 2021, following a devastating second wave of COVID-19 infections. The V-shaped recovery was driven largely by growth in private investments and consumer spending. Meanwhile, in October 2021 India crossed the one billion mark for the number of vaccine doses administered, and it expects to achieve its target of inoculating the entire adult population with at least one dose by the end of the year. The rising vaccination rate, easing of travel restrictions under the pandemic and the release of pent-up demand are expected to be the main drivers of growth recovery in 2022.

Elevated inflation is likely to persist in 2022 on the back of robust domestic demand. Sticky core inflation, along with stronger signals of demand recovery, are likely to reinforce market expectations of monetary policy normalisation. So far, the Reserve Bank of India (RBI) has maintained its accommodative stance, but it has taken steps to withdraw its extraordinary policy support via declaring an end to the government securities acquisition programme and undertaking larger variable reverse repo rate operations. Against a backdrop of strong growth and elevated inflation, a rate hike by the RBI appears imminent. That said, we believe that the RBI will follow a gradual path as it normalises monetary policy, to temper risk of policy missteps. Meanwhile, we expect the rupee to be vulnerable to further sharp moves in oil prices.

Separately, five state elections are scheduled for early 2022, including in the most populous state of Uttar Pradesh. Current opinion polls suggest that Prime Minister Modi's Bharatiya Janata Party is set to retain power.

Indonesia

As with the rest of Asia ex-China, we expect Indonesia's recovery to improve significantly in 2022, as the government transitions to living with COVID, slowly reopening its economy and borders amid rising vaccination numbers. As of November 2021, about 33% of the country's population was fully vaccinated. The government expects this to increase to 50% by the end of 2021. Bank Indonesia (BI) expects full year 2021 GDP growth to register between 3.5-4.3%, while the finance ministry sees growth at 4%.

Inflation is likely to remain low, allowing BI to keep interest rates unchanged for a while, barring a major risk-off sentiment in markets. At its most recent meeting, the central bank declared that policy rates are likely to remain low for another year. That said, we do not expect the interest rate differential between Indonesia and the rest of the region to widen unduly, and we anticipate BI to eventually adjust the policy rate as it balances supporting the economic recovery against the risks of rising inflation in the latter half of 2022.

Indonesian local government bonds (IndoGBs) have stayed relatively resilient despite the weakening by USTs. An accommodative monetary policy, low inflation, strong demand from local financial institutions and positive bond supply technicals were key factors that supported demand for Indonesia bonds. We hold a constructive view on IndoGBs going into 2022, supported by low domestic inflation and their attractive real yield. For now, foreign positioning remains relatively light. Any improvement in overall risk sentiment could trigger increased foreign flows into the emerging market debt space, which would bode well for IndoGBs. Separately, the outperformance of the Indonesian rupiah against its regional peers may persist in the coming months, supported by the country's trade surplus generated by elevated commodity prices.

Philippines

GDP growth in the Philippines surpassed expectations in the third quarter of 2021 as private consumption growth surged on the back of pent-up demand following lockdowns in the previous months. As of November 2021, close to 40% of the population was fully vaccinated. With infections also declining markedly, the government relaxed some local restrictions on movement, although the country remains effectively closed to foreign tourists. Moving forward, we anticipate the rebound in GDP growth to reflect recovery in private consumption (supported by increased mobility) as well as increased infrastructure spending by the government in the run-up to the national elections in 2022.

Overall inflation has surpassed the Bangko Sentral ng Pilipinas (BSP)'s 2-4% target for most of 2021, and it could stay relatively elevated in response to higher demand as economic conditions normalise. Even as it warned of risks to inflation in the coming year, we expect the central bank to take a gradual approach to monetary policy normalisation, prioritising monetary policy support for now to ensure a sustained recovery. That said, we believe that of the region's central banks the BSP is likely to be among the first to deliver rate hikes should second-round effects suggest inflation could stay elevated for longer.

We approach 2022 with a cautious view on Philippine rates, given the negative real rates; we also have a subdued view on the peso. We are cognizant that the country's external position remains strong thanks to resilient remittance inflows. However, we expect import growth to further recover in 2022 on normalising economic activity. This could weigh on the country's current account position and the currency in turn.

The country is holding its general elections in May 2022, when registered voters will choose, among others, a new president. Currently, there is no clear front-runner among the candidates. Despite the uncertainty in outcome, we do expect the elections to be relatively clean, with limited incidents of violence. Heading into the May elections, we expect the Philippine peso to become more volatile.

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document neither constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree 80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.