



Three things for investors to look out for in Asia in 2023

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Key points

- The implications of China successfully re-starting its economy stretch well beyond its borders, into wider Asia and around the world, Europe in particular
- Hedging costs have meant Asian investors have demonstrated an increasing preference for euro bonds in 2022, which we expect to continue this year
- We expect ESG to continue to gain more attention in Asia, with a growing universe of ESG-integrated and green assets for investors to consider

The relentless tightening of monetary policy in the wake of runaway inflation marked 2022 down as one of the most challenging ever years for financial markets.

Investors have had to grapple with geopolitical turmoil in the wake of Russia's invasion of Ukraine and the subsequent spikes in energy and food prices.

Global markets remained volatile throughout 2022, with the S&P 500 enduring its worst annual performance since 2008ⁱ while global bonds fell into a bear market for the first time in over 70 years.ⁱⁱ Commodities were among the few risk assets that ended the year in positive territory.ⁱⁱⁱ

For 2023 the focus will be on calibrating the impact of tighter financial conditions with global growth. With demand moderating and supply chain pressures easing, these factors - coupled with higher inventories and tighter monetary policy - are together likely sufficient to bring inflation back towards central bank targets over the next two years.

Looking at the investment landscape more broadly, with investors fleeing almost every asset class last year, the amount of cash sitting on the side-lines with global investors is at a decade high, potentially indicating a support for risk assets in 2023.^{iv}

However, until the timings become clearer for likely ups and downs in the growth picture, the investment environment may stay more of a trading one than a trending one, with slower growth, still elevated inflation and higher yields largely favouring bonds. And as we near the end of the interest rate hike cycle, the months to come should be months of stabilisation, consolidation, and income investing.

Focusing on Asia, below we examine three market trends we believe are likely to shape markets and direct investor flows in 2023.

China's re-emergence

All eyes will be on China in 2023 – and despite the myriad of challenges it is facing, there are reasons for optimism. The world's second-largest economy may prove to be counter-cyclical to the global growth slowdown; its ongoing easing of monetary policy and mild inflation offer room to support its growth recovery from an expected 3% in 2022 – versus 5.5% in wider Asia – to potentially 5% in 2023.^v And recent developments from Beijing indicate that growth is becoming a greater priority for 2023.^{vi}

The implications of China successfully re-starting its economy stretch well beyond its borders, into wider Asia and around the world, Europe in particular. The potential uplift the economy could enjoy from a reinvigorated export market, domestic services and consumption could be very powerful, and for global markets should help alleviate some of the supply chain issues, in turn easing inflationary pressures.

Chinese equities have room to rally too, given the market has been derated to historic lows, with the Shanghai Composite down some 27% over 2022.^{vii} Recent optimism has seen stocks move higher, but any rebound is unlikely to happen in a straight line, as questions remain over how smooth China's growth journey will be from here.

Investor concerns about the housing market downturn, de-globalisation, technology restrictions, private-sector policy and an aging population will keep China's potential growth in focus beyond excitement about the long-awaited reopening – which is itself creating concerns over the impact of a new surge in COVID-19 cases.^{viii}

Harnessing bond yields

Hedging costs are increasingly directing investor flows globally, notably in Asia. Given the global backdrop of tightening monetary policy, with the exception of Japan and China, in 2022 we witnessed a shift of Japanese investor preference away from US dollar-based assets increasingly into euro-based assets and Japanese governments bonds (JGBs).

With the Federal Reserve hiking interest rates faster than other central banks, the US dollar was a major outperformer in 2022; the dollar index posted its biggest annual advance since 2015, and the dollar itself strengthened against every G10 currency.^{ix} This has made US dollar assets hedged into local currency less attractive. However, the European Central Bank initiated its monetary tightening cycle well after the US, making euro assets more attractive on a hedged basis, due to the narrower interest-rate differential.

Therefore, as US dollar interest rates are higher than those in Europe, the cost for Japanese investors to hedge their dollar holdings are higher than that for euro holdings. Simply put, investors get less yield in Japanese yen from US dollar bonds than from euro bonds. Hence, we have observed an increasing preference for euro bonds in 2022, which we expect to continue in 2023, as the policy gap between the US and Eurozone is not expected to close.

The Bank of Japan's (BoJ) yield curve control policy – where it guides short-term interest rates at -0.1% and aimed to keep 10-year bond yields within 0.25% either side of its 0% target – made JGBs unattractive relative to hedged global assets. However, at the end of 2022 – earlier than markets anticipated – the BoJ joined in the global central bank policy action, announcing in a surprise move that it was adjusting its yield curve control policy, with the 10-year yield now able to move in a wider band, within 0.5% of target.

Tellingly in November, Japanese institutional investors offloaded a net ¥1.9trn (\$14.1bn) of overseas debt, marking an all-time high, as JGBs assets are becoming more attractive.^x We expect this trend away from particularly US dollar assets to accelerate if the BoJ were to completely end its yield curve control. Japanese money would be more inclined to stay at home, which could put pressure on US dollar bond yields.

ESG momentum

Few asset classes emerged unscathed from 2022 and portfolios targeting environmental, social and governance (ESG) factors were no exception. As we enter 2023, we think ESG themes are likely to benefit from the aftermath of the pandemic and the Ukraine war, as the focus hardens on energy transition and food security, as well as re-shoring trends provoked by geopolitics.

We also expect social themes to gain more attention, as the deteriorating labour market and the impact of inflation bring potentially harmful consequences. Companies want to do more in this area for their consumers – and their investors – while asset managers are developing more sustainable investment products to meet ever-growing demand from clients of all types.

In Asia the landscape is evolving, with companies, investors, regulators, and other stakeholders working together to put frameworks in place that allow for transparent and accurate ESG information flow to drive change. We see this as an exciting journey to be part of, and an opportunity to make a real impact. Asia as a region is economically and culturally diverse, and it is expected that the transition risks and impacts

of climate change will not be distributed equally between the nations. The pathways for transition will be unique to each country.

Participation and ESG disclosures by corporates in Asia are improving rapidly – for example, when we look at the Task Force on Climate-Related Financial Disclosures (TCFD), which helps guide corporate ESG reporting, out of 3,400 pledged TCFD supporters worldwide, nearly 25% of the companies are

in Japan, with around 10% from across Australia, Singapore, India, Hong Kong and Mainland China.^{xi}

At the same time, investors are finding a growing universe of ESG-integrated and green assets in which to invest – and this is only going to grow in Asia, and worldwide. Globally, the green bond market hit a US\$2trn milestone at the end of the third quarter, and some estimates see issuance reaching US\$5trn per year by 2025.^{xii}

ⁱ [S&P 500 logs its worst annual performance since 2008 | S&P Global Market Intelligence \(spglobal.com\)](#)

ⁱⁱ [Global bonds are in first bear market in 76 years based on two centuries of data, says Deutsche Bank - MarketWatch](#)

ⁱⁱⁱ [Nasdaq, S&P, and Dow slide to start the 2023 trading year | Seeking Alpha](#)

^{iv} AXA IM 2022

^v World Bank Estimates, November 2022

^{vi} [China plans to expand domestic demand to spur economy - state media | Reuters](#)

^{vii} Factset, as at 29 December 2022

^{viii} [China defends its COVID response after WHO, Biden concerns](#), Reuters, 5 January 2023

^{ix} [U.S. dollar down, still set for best year since 2015 \(cnbc.com\)](#)

^x [Japan's life insurers are dumping foreign bonds at a record pace | The Japan Times](#)

^{xi} [Task Force on Climate-Related Financial Disclosures | TCFD\) \(fsb-tcfid.org\)](#)

^{xii} [Green Bond Market Hits USD2tn Milestone at end of Q3 2022 | Climate Bonds Initiative](#)

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