

# Investing in Asia amid seismic policy shifts

## A multi asset perspective

December 2024



### Key takeaways

- US policy shifts may have a more moderate impact on domestically driven economies (India, Indonesia, Philippines) compared to exports-reliant economies (South Korea, Japan, Vietnam)
- While the incoming US administration's policy agenda may strengthen the US dollar in the short term, it could potentially weaken the dollar in the medium term, which would bode well for Asian assets
- The global rate cut cycle benefits Asian local bonds due to potential domestic rate cuts and a weaker US dollar in the medium-term
- Asian investment grade bonds are also attractive as they offer quality fundamentals with relatively low duration and favourable technical factors
- China's stimulus efforts could also benefit the rest of Asia, especially economies and sectors more tied to Chinese final demand
- India's structural growth story and surging demand for data centres in ASEAN are two key investment themes in Asia our team focuses on



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### Potential implications of US policy shifts for Asia

#### International economic impact yet to be seen

As the incoming US administration's policy agenda starts to unfold in the coming months, it could have significant implications for Asian economies. For better context, during his campaign, Donald Trump openly advocated for imposing broad-based tariffs on imported goods, with plans for tariffs as high as 60% on Chinese products and ranging from 10% to 20% on goods from other nations (see Figure 1).

Asian economies reliant on goods exports could be more vulnerable to these policies, notably North Asian nations such as South Korea and Japan, as well as select Southeast Asian economies including Vietnam. Despite exports constituting a relatively minor portion of China's economy, the country might still feel the effects of these tariffs, due to its lukewarm domestic demand and the outsized magnitude of the proposed tariffs on Chinese imports.

Source: HSBC Asset Management, November 2024.

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On the other hand, economies in Asia that are more domestically oriented and less reliant on goods exports, such as India, Indonesia, and the Philippines, may experience a milder impact from this potential policy shift. Depending on the extent to which the incoming US administration will be using trade tariffs as a bargaining tool to secure trade concessions from other countries, the magnitude of their impact on Asian markets and the corresponding implications might vary, from an investment perspective.

**Fig. 1: Trump administration’s policy agenda – select priorities**

Fiscal policy	<ul style="list-style-type: none"> <li>• Extend the Tax Cuts and Jobs Act (TCJA)</li> <li>• Cut corporate tax rate to 15% from 21%</li> <li>• Exempt social security benefits from taxation</li> <li>• Possible defense spending increase</li> </ul>	Immigration	<ul style="list-style-type: none"> <li>• Seal the southwest border</li> <li>• Crackdown on illegal immigration</li> </ul>
Trade & industry	<ul style="list-style-type: none"> <li>• 10-20% tariff on all imported goods</li> <li>• 60% tariff on imports from China</li> <li>• Push for deregulation</li> </ul>	Environment	<ul style="list-style-type: none"> <li>• Increase fossil fuel production</li> <li>• Eliminate the Green New Deal</li> </ul>
		Geopolitics	<ul style="list-style-type: none"> <li>• Unpredictable approach to China</li> <li>• More isolationist</li> <li>• Threat of reduced support for NATO</li> </ul>

Source: HSBC Asset Management, as of 6 November 2024

### Will US dollar strength last?

Some of the policies proposed by the Trump administration, such as corporate tax cuts and tariff implementations, might, if enacted, widen the fiscal gap and drive up import prices. This could exert upward pressure on treasury rates and hence also the dollar. In addition, anticipation of higher corporate profits from potential tax cuts and deregulation may attract capital inflows, further strengthening the dollar. Market reactions leading up to and after the election have already seen increases in US treasury yields and the dollar, reflecting expectations surrounding the election outcome and the accompanying proposed policy changes. Furthermore, Asian countries affected by US tariffs may witness currency depreciation due to reduced external demand and potential monetary easing to counter economic slowdowns. Such actions could contribute even more to relative US dollar strength.

Historically, higher US treasury rates and a stronger dollar have induced capital outflows from emerging markets into the US market, due to a wider yield differential. This trend could have short-term implications for Asian financial markets. However, it should be noted that Asian central banks have policy tools (including macro-prudential measures) and, for the most part, sufficient FX reserves buffer to defend against sharp or disorderly currency movements – the type that would have serious and wide-ranging economic impact.

In the short term, the dollar is expected to maintain its strength, mainly driven by the market’s anticipation of future policy shifts, as discussed above. However, the longer-term outlook is less clear, as uncertainties persist regarding the extent of policy implementation by the new administration and global investors’ reactions to a worsening fiscal picture in the US. In fact, the US Congressional Budget Office has already declared that the US fiscal trajectory is already on an unsustainable path. Consequently, while the dollar may experience initial strength, there is a possibility that it could weaken in the medium term. Moreover, the current US economic environment is still consistent with a cyclical cooling heading into 2025, further supporting the thesis that the dollar might face downward pressure in the medium term, which could bode well for Asian assets.

That said, global and emerging market investors should want to focus on local fundamentals for their asset allocation, rather than putting too much emphasis on the fluctuation of currency strength.

### Asian asset class positioning amidst the global rate cut cycle

Although we might witness short-term volatility in US interest rates due to the recent developments mentioned above, our base case for a soft economic landing remains. Therefore, we expect the global rate cut cycle to continue in the medium term. Notably, Asian central banks will have the bandwidth for policy easing on the back of further US rate cuts. We believe this is beneficial for Asian local bonds, while also being cognizant of recent Asian currency weaknesses in Asia that have given rise to some near-term uncertainty. Within credit, we are constructive on Asian investment grade bonds which offer quality fundamentals with relatively low duration, benefit from favourable technical factors, such as healthy local demand, and enjoy continued resilience going into the new year.

Source: HSBC Asset Management, Bloomberg, as of November 2024

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We also see many opportunities within Asian equities. For example, we observe a strategically solid demand picture for the semiconductor and other AI-related sectors, which are a key profit engine for some Asian economies. With that said, we are tactically realigning our focus away from momentum-driven sectors towards areas that could be better suited for the late stage of the business cycle. On a macro level, China's policy support, room for monetary easing, and other idiosyncratic structural factors are positive catalysts for equity investments in the region, despite external uncertainties.

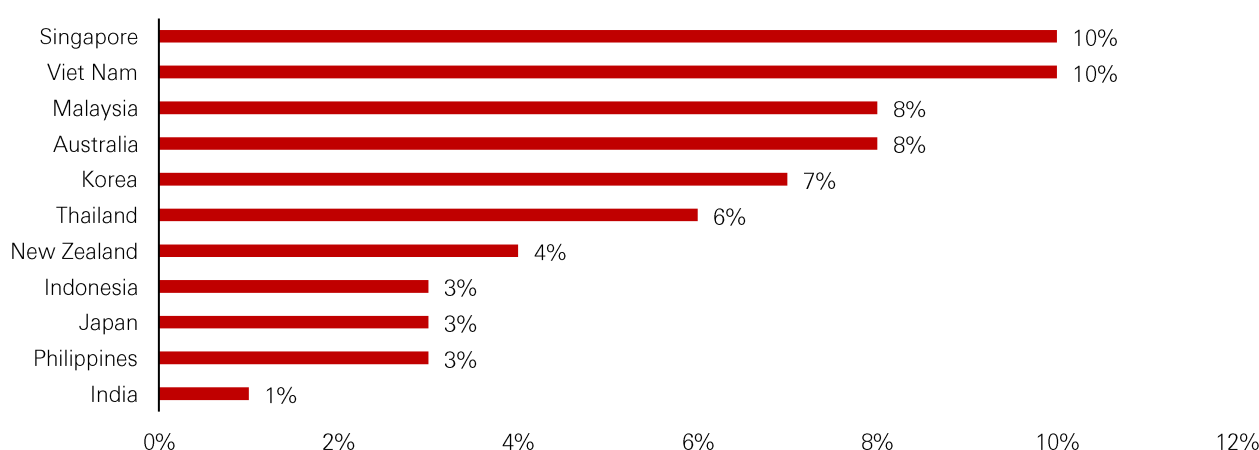
## Who stands to gain from China's ongoing stimulus efforts?

Since late September 2024, China has shifted its policy stance to stabilise structural weaknesses and promote economic growth (for details, see [China's pro-growth policy pivot and market implications](#), 30 October 2024). More recently, on November 8, China approved a substantial increase of RMB 6 trillion in the local government debt limit to facilitate the swapping of hidden debts. This move, which expands the total swap scale to RMB 12 trillion, aims to alleviate the burden of hidden debts owed by local governments to creditors. The anticipated positive economic impact of this measure lies in its potential to free up local governments in the medium term, enabling them to pivot their focus towards growth-oriented endeavors, instead of fulfilling interest payment obligations.

Due to the support of the various stimulus measures, particularly a relending program, the potential benefits for Chinese equities are significant. The relending program enables listed companies to borrow from a select group of 21 financial institutions endorsed by the PBOC, facilitating share buybacks and increases in shareholding. As a result, this program provides direct support for domestic stock prices. Although we believe in the necessity for further stimulus and reform measures targeted at boosting consumption and countering deflationary pressures to sustain long-term investor confidence, we do note that the valuations of Chinese stocks are currently inexpensive and the positioning of international investors in Chinese equities remains light. This provides a substantial margin of safety, especially when accompanied with judicious stock picking practices. We especially favour Chinese quality growth companies, while also preferring dividend-paying companies against the backdrop of a potential deflationary cycle and a property market downturn.

On a broader scale, a potential stabilisation of China's economy could bring positive implications for Asia as a whole, considering the impact via the trade channel. According to OECD data illustrated in Chart 1 Vietnam and Singapore are among the key economies poised to benefit from this trade dependency. Furthermore, Chart 2 identifies the sectors within the Asia region (excluding China) that stand to gain the most from a Chinese economic recovery, based on their contributions as a percentage of Asia's (excluding China) total value-added embedded in China's final demand. Notably, computers & electronic and mining & quarrying are the key Asian sectors poised to benefit from an upswing in Chinese economic activity.

**Chart 1: % of economy's total value-added serving China's final demand**

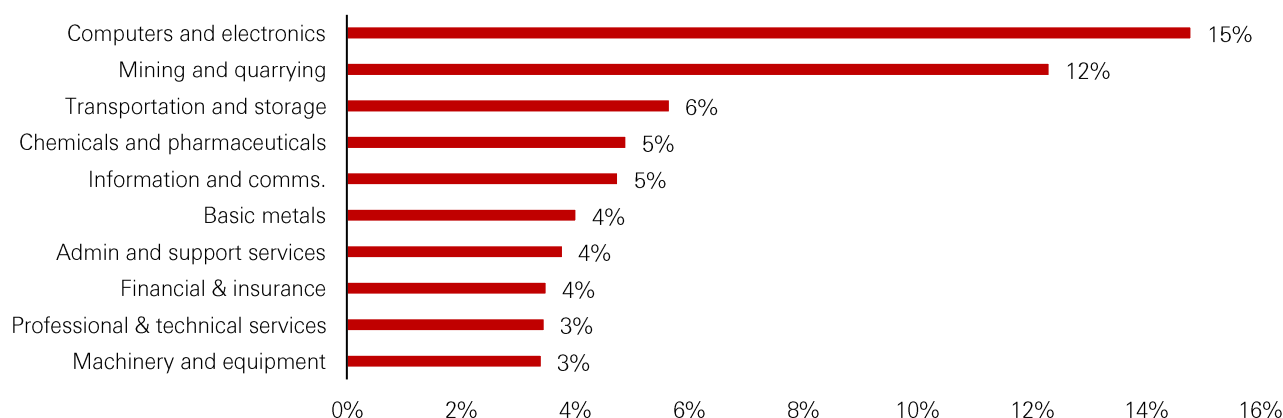


Source: HSBC Asset Management, OECD Trade in value-added database, as of November 2024

Source: HSBC Asset Management, Bloomberg, as of November 2024.

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**Chart 2: Sector as a % of Asia's (excluding China) total value-added in China's final demand**



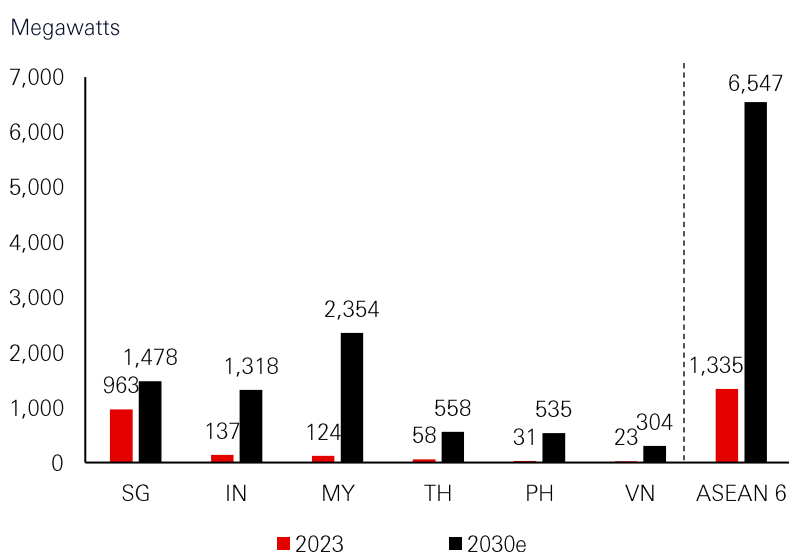
Source: HSBC Asset Management, OECD Trade in value-added database, as of November 2024. Sector allocation are as of date indicated and should be relied thereafter. This information shouldn't be considered as a recommendation to invest in the sectors shown.

## Compelling investment themes prevailing in Asia

For much of this year, we have been talking about India's structural growth story, the premise of which we believe will continue to prevail in the medium term. India's federal government continues to invest heavily into infrastructure. Meanwhile, young demographics and rising urbanisation continue to drive consumption. India also continues to offer a strong and stable earnings growth story, although we are cognizant of rich valuations in parts of the market. There is also healthy technical support as we see increasing demand coming from domestic investors, injecting continuous liquidity into the market. Moreover, the inclusion of local government bonds into various market indices offers further technical support on the fixed income side.

Our detailed research into the ASEAN region, which includes in-depth analyses of individual countries to identify their idiosyncratic growth drivers, has led us to believe that Malaysia is an economy in the region that has been under the radar of global asset allocators. Malaysia boasts solid growth momentum compared to some of its regional peers, helped by strong consumption and investment trends. For example, the data centre industry across ASEAN has experienced explosive growth over the past decade, driven by ever-increasing demand for cloud services and the use of web-enabled devices globally. With AI and machine learning set to transform this industry, Malaysia, being a key player in this industry alongside Singapore, is poised to reap the benefits from the escalating market demand (see Chart 3).

**Chart 3: ASEAN data centre demand, 2023 vs 2030e**



Source: Cushman & Wakefield, DC Byte, JLL, HSBC Global Research, HSBC Asset Management, as of November 2024

Source: HSBC Asset Management, as of November 2024.

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Japan has also captured our attention, as it displays favourable signals in its equity valuations and earnings. Also, a resurgence in foreign investor interest has added to the market's attractiveness. We are closely monitoring the implementation of structural reforms within the economy, recognizing that their impact may need time to materialize. However, we do acknowledge that Japan's domestic economy remains interconnected with external factors, including China's growth trajectory and the incoming US administration's policy agenda.

With Asia being such a vast investment universe, there are many exciting opportunities to uncover. We will continue to identify investment ideas that not only bring diversification but also offer robust growth prospects for our clients' portfolios.

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