HSBC Global Management

Chinese Fixed Income Outlook – Going whole hog on China bonds in 2019

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Are you expecting a better year for the Asian fixed income market in 2019 after a challenging 2018?

I think as we all know, 2018 was a difficult year for many asset classes, including Asian USD bonds, which recorded its first negative return since 2013.

However, we expect a much better year for Asian bonds in 2019, mainly because the two main factors that dragged down the market in 2018 have turned positive already. Firstly, the markets were concerned about the Federal Reserve rate hikes in 2018, which provided a negative sentiment for fixed income generally, which affected all the asset classes as well. However, that has almost completely reversed with most investors anticipating a slower rate hike pace in 2019. Secondly, Chinese USD credits, which represents a very significant portion of the Asian market, traded weaker in 2018 as deleveraging in China led to much tighter liquidity and raised concerns of increasing defaults in China. Again, the story is completely different now as maintaining economic growth appears to be the priority, which means liquidity is significantly looser. Furthermore, China has aggressively cut the RRR recently that has flooded the market with liquidity that would be very positive for the Chinese credit market.

What is the outlook for liquidity in China? How would it impact China bonds?

We believe liquidity would remain loose in China with monetary policy maintaining a loosening bias. This should create a very favorable environment for corporate refinancing, which should reduce default fears and, even more importantly, lead to lower funding costs for corporates. This means there is room for market yields to come down, leading to potential price gains for corporate bonds. Besides, as onshore liquidity is ample, we would expect less supply in the USD market to further improve the supply demand dynamics. Also, the yield to maturity of Chinese USD bonds tend to be high relative to other sectors, so investors can also enjoy an attractive coupon carry.

How do Chinese bonds measure up against the Asian credit universe?

Broadly speaking within the Asian credit universe, we prefer Chinese issuers mainly because they offer the most potential for spread compression as well as providing relatively more attractive yield carry. For example, the top tier Chinese SOEs are yielding more than some lower rated issuers from some other Asian countries. Also, the reduced focus on deleveraging in China would provide a very good backdrop for these Chinese issuers, especially as they have underperformed in 2018 due to this same factor. More specifically, we favor the strongest of the Chinese SOEs as they are fundamentally strong companies, while still enjoying a lot of support from the government. Besides, we also prefer Chinese property developers as the much improved funding conditions will be particularly beneficial for this sector.