

2013 Outlook: Asia Bond Markets

12/2012

In 2012 (as of 30 November), the HSBC Asian Local Bond Index (ALBI) delivered total returns of 8.62%¹, exceeding major developed bond markets such as German Bunds, UK Gilts and US Treasuries which generated returns of only 4.1%, 3.5% and 2.8%, respectively². The contributions of returns as of 30 November 2012 come from a combination of: higher coupon, bond price appreciation and currency returns from Asian local currency bonds. The average coupon income for ALBI, thus far in 2012, is around 3.8%³. For the past ten years, coupon income of ALBI averaged over 4.5%, and an average annual return of 7.3%⁴. For 2013, we remain constructive on Asian local currency bonds and expect an annual return slightly higher than the coupon rate.

Macro economics

As a region, Asia ex Japan is expected to continue to provide superior growth relative to developed markets in 2013. Although we see some positive signs of economic activities from US and EU, they are not expected to be particularly strong on the back of their deleveraging process. Growth in Asia, in particular China and India, appears to have bottomed which should be positive to both sovereign and corporate debts. However we are not expecting a "U" shape recovery from China and India. We continue to be positive on Southeast Asia economies, as these domestically-driven economies are more insulated from the volatilities in the developed markets.

Sovereign rating

Asia sovereign debts should benefit from a probable rating upgrade trajectory at a time when the developed markets face rating pressure. In 2012, Asia sovereigns have experienced six upgrades and two downgrades⁵. While the ratings momentum will likely slow for Asia sovereigns in 2013, we still expect more upgrades than downgrades. Indonesia, which already achieved Investment Grade status from Moody's in January 2012 and from Fitch in December 2011, is a likely candidate for an upgrade from Standard & Poor's. China, Hong Kong and Sri Lanka are potential upgrade candidates by Moody's. On the negative side, we see potential rating pressure on Fiji, Pakistan and India. The Indian government has promised a slew of reforms, including liberalising foreign direct investment (FDI), reducing capital inflow frictions, and increasing fuel prices. Should these reforms fail to materialise, there could be a potential ratings downgrade in India.

Asia sovereigns have seen more upgrades than downgrades in 2012

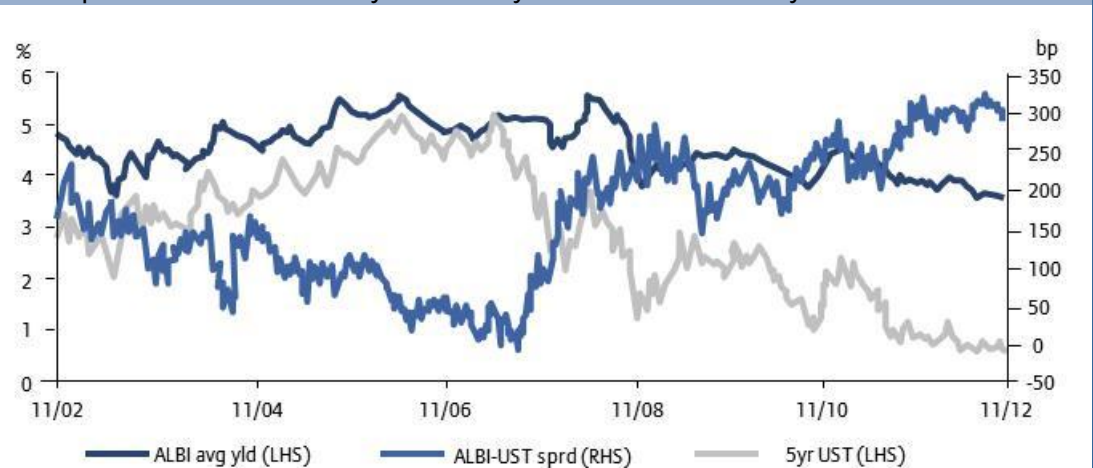
| Country | Date | Rating Agency | Current Rating | Current Outlook | Previous Rating | Previous Outlook |
|-------------------|-----------|---------------|----------------|-----------------|-----------------|------------------|
| Upgrades | | | | | | |
| Indonesia | 18-Jan-12 | Moody's | Baa3 | Stable | Ba1 | Stable |
| Philippines | 4-Jul-12 | S&P | BB+ | Stable | BB | Positive |
| Korea | 27-Aug-12 | Moody's | Aa3 | Stable | A1 | Stable |
| Korea | 6-Sep-12 | Fitch | AA- | Stable | A+ | Positive |
| Korea | 13-Sep-12 | S&P | A+ | Stable | A | Stable |
| Philippines | 29-Oct-12 | Moody's | Ba1 | Stable | Ba2 | Stable |
| Downgrades | | | | | | |
| Pakistan | 13-Jul-12 | Moody's | Caa1 | Negative | B3 | Stable |
| Vietnam | 29-Sep-12 | Moody's | B2 | Stable | B1 | Negative |

Source: J.P. Morgan, Moody's, S&P and Fitch, as at November 2012

Yield spreads

Asia local currency bonds as an asset class have historically and are still expected to deliver attractive risk-adjusted returns. While most credit spreads are trading at historical low levels, the spread between ALBI average yield and the five-year US Treasury benchmark, at around 300 basis points, is the widest since 2001⁶. Even Asian USD bonds, (HSBC Asian Dollar Bond Index ADBI), yield is trading at 280 basis points on top of five-year US Treasury⁷.

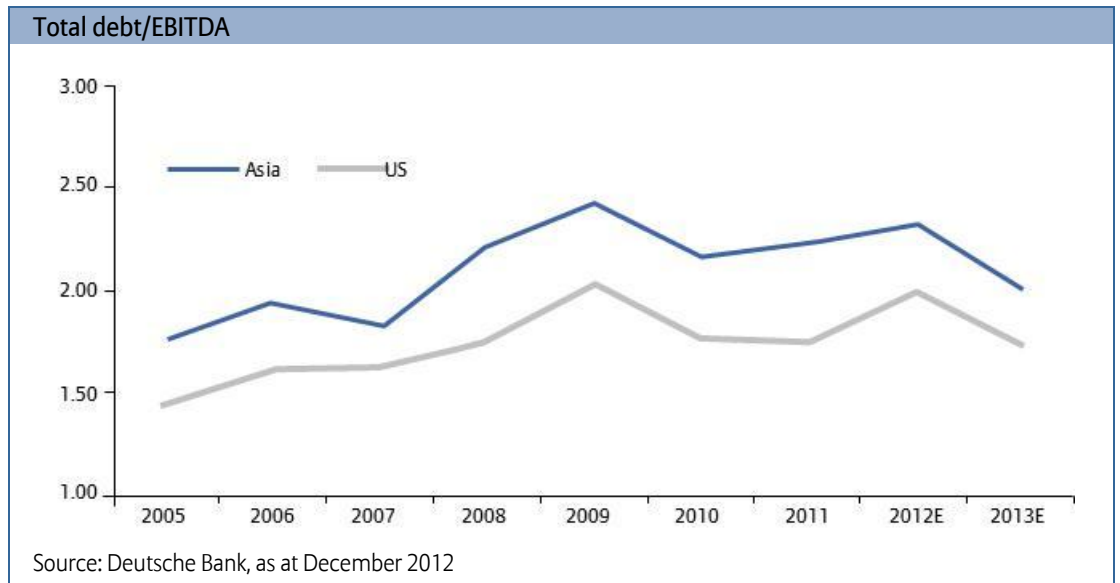
Yield spread between ALBI and 5-yr US Treasury benchmark at historically wide levels



Source: HSBC, Bloomberg, as at December 2012.

Corporates

The fundamentals of Asian corporations should improve in the coming year given the initial signs of macro-economic improvement in China and India. Overall we are expecting Asian corporate earnings to stabilise in 2013 with revenue growth to be similar to 2012. Corporate debt level is forecast to decline in 2013 as Asian corporations have been scaling back their capital expenditure.



¹ Source: Bloomberg, from 30 December 2011 to 30 November 2012

² Source: Asia-Pacific Rates Guide 2013, HSBC Global Research, as at December 2012

³ Source: Asia-Pacific Rates Guide 2013, HSBC Global Research, as at December 2012

⁴ Source: Asia-Pacific Rates Guide 2013, HSBC Global Research, as at December 2012

⁵ Source: Asia Credit Strategy and Outlook for 2013, J.P. Morgan, as at November 2012

⁶ Source: Asia-Pacific Rates Guide 2013, HSBC Global Research, as at December 2012

⁷ Source: Asia-Pacific Rates Guide 2013, HSBC Global Research, as at December 2012

Information herein is based on sources we believe to be accurate and reliable as at the date it was made. We reserve the right to revise any information herein at any time without notice.

No offer or solicitation to buy or sell securities, nor investment advice or recommendation is made herein. In making investment decisions, investors should not rely solely on this material but should seek independent professional advice.

Investment involves risks, in particular, risks associated with investment in emerging and less developed markets. Past performance is not indicative of future performance. Investors should read the fund prospectus for further details, including the risk factors, before investing.

This material has not been reviewed by the SFC in Hong Kong and the Monetary Authority of Singapore, and is published for information only, and where used in mainland China, only as supporting materials to the offshore investment products offered by commercial banks under the Qualified Domestic Institutional Investors scheme pursuant to applicable rules and regulations.

Issued by Allianz Global Investors Hong Kong Limited (Singapore office: Allianz Global Investors Singapore Limited (Co. Reg. No. 199907169Z)).