

# Catch-2022

## Asia's shifting growth model

An investor's guide to the year ahead for Asian economies and markets.

# Asia



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## Asia's shifting growth model

**Heading into 2022, the Asia-Pacific will remain the main economic growth engine for the global economy. But as the past two years of pandemic-induced dislocations have demonstrated, there will be surprises, twists and turns along the way. As the recovery unfolds, market leadership continues to evolve across the region, and the looming prospect of higher inflation is likely to mean the return profiles of some markets will prove more resilient than others.**

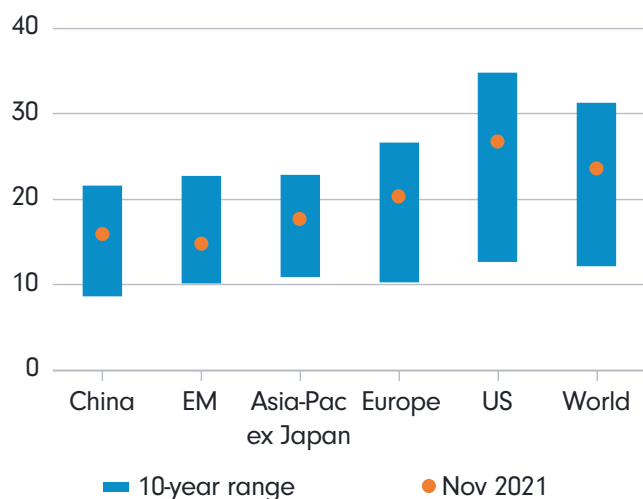
Asia's underlying growth drivers will remain robust in 2022, but capital market performance will diverge across the region as the global recovery from the pandemic continues. Regional economies will need to adjust to a challenging external environment as global policy makers seek to simultaneously keep the recovery on track while also ensuring that inflation is kept in check. At the same time, the net zero transition is already bringing price and energy supply chain pressures to the fore, adding another dimension for governments and investors across the region to consider. It's a balancing act, and we think investors need to pay close attention to the divergent support factors in play across the Asia-Pacific to capture how each market is positioned for 2022.

### China

China led the region and arguably the world in 2020 when its economy and markets were 'first in, first out' of the pandemic's initial wave. But 2021 painted a very different picture for China, as a convergence of factors including a tightening policy stance, increased regulatory intervention and challenges from global supply chain disruptions to energy shocks weighed on performance. Over the past year, China's policymakers have taken aim at inequality while also seeking to address structural imbalances like excessive leverage and potential abuses of monopoly power. While this has created short term uncertainties it should lead to a more sustainable growth model for China in the mid to longer term.

## An inflection point for Chinese equities

P/E ratios of regional equity markets



Source: Refinitiv, Bloomberg, data is for MSCI Indices as of Nov. 1, 2021. Price-to-earnings ratio based on 12-month trailing earnings.

As markets head into 2022, we see signs that sentiment on China may be turning a corner. Volatility in China's markets increased in the past year due to this combination of conservative fiscal and monetary policy settings alongside a campaign of heightened regulatory action - which encompassed tech, property and education among other sectors - but these pressures appear to have plateaued, at least for the near term. Nor do the market ructions that stemmed from financially troubled property developer China Evergrande represent any sort of broader 'Lehman moment' for the country, in our view. Instead, we see scope for policy to loosen in the coming quarters. And given the selloff we saw in 2021, we think Chinese markets have been trading at quite attractive levels, especially relative to their historical valuations. We're optimistic that 2022 could bring a very different return picture for China.

## India, Southeast Asia

If 2020 was the year for China's markets to outperform, the baton in 2021 was passed to India and other regional markets. This perhaps came as a surprise to many investors, as India in particular staged a robust recovery from the pandemic and also benefited from a very strong market for new listings. Now, given the valuation premium that India now trades at, we wouldn't be surprised to see a bit of consolidation from this point and would expect we've entered a period of more modest returns. That said, around the region and in places like Southeast Asia we still see good prospects for investors. Broadly speaking, the fundamental base case for growth remains, including attractive demographics and trends like accelerating digitalisation that are still very much in place.

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## Bracing for inflation

As inflationary pressures accumulate around the world and central banks take note and respond in turn, what is likely to be the impact on Asian markets? Contrary to some expectations, we don't think this is likely to prove a strong headwind for markets in the region. Unlike in the taper tantrum of 2013 or during liftoff of the previous rate hike

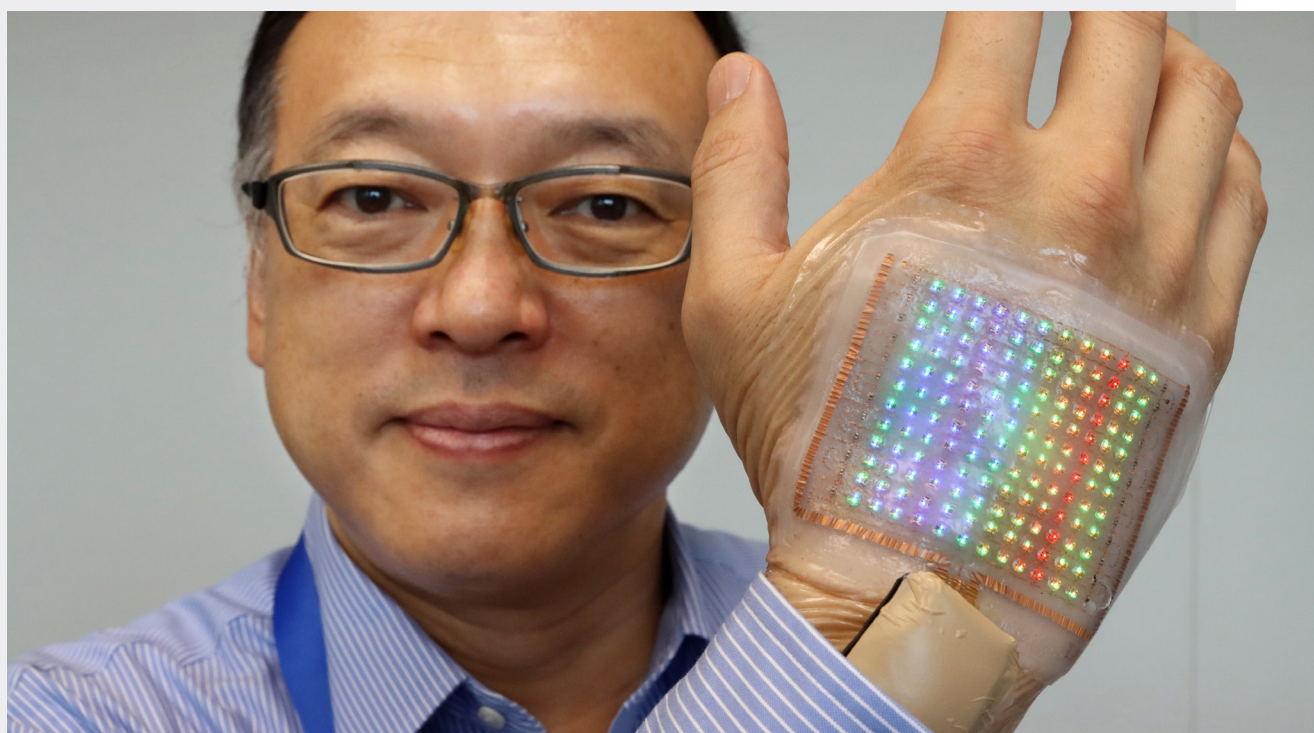


cycle in 2015-2016, Asian economies today are in a much stronger position, with many sitting on robust foreign currency reserves after accumulating large current account surpluses thanks to surging exports and capital inflows. It is also worth considering that we may experience, for the first time in many decades, inflation across Asia at lower levels than what may be experienced elsewhere in the world.

In this context, where should investors look for good sources of returns? In bond markets, despite the recent volatility around China's property developers, Asian high yield credits still look attractive, especially on a relative basis. But, given the prospect for higher inflation, investors also need to think about allocating more broadly. To this extent, equity markets in Australia and Japan have historically proven more resilient in inflationary periods, offering attractive total shareholder returns

but also stronger downside protection of the sort that will help to add diversity to portfolios.

Finally, a more general word about the earnings outlook. While the recovery across the region has been somewhat uneven from one market to the next, what we have clearly seen is a robust earnings outlook and strong activity in the IPO market. The result of this is a more gradual change in the composition of regional markets, where higher growth firms in sectors like health care, e-commerce and software are really taking a more prominent role as they build on accelerating trends such as greater digitalisation of the economy. Ultimately this will mean that the region will demand a higher average valuation on a through-cycle basis.



Revolutionary skin-wearable health monitoring system, Tokyo. (Credit: Yoshikazu Tsuno / Contributor, Getty Images)

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