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**TEYMOOR NABILI, CNBC:**

Stephen Chang is Asia Portfolio Manager of PIMCO and joins us live now. Stephen, welcome. Thanks for joining us.

**STEPHEN CHANG, PIMCO:**

Well, thank you. Good to be here.

**NABILI:**

So let's pick up the China theme. I mean, constantly and continuously addressed on the program, obviously, and by the markets everywhere. Tell me your thoughts.

**CHANG:**

Well, China, as we have talked about, the Politburo has read out on Monday evening with a more pro-growth stance. Now, one can argue that they have set the tone and direction through both in terms of supporting the private sector and also signaling a few places where they want to stimulate more growth and support. The measures so far have been a bit vague and we will be waiting to see whether any of these like major decisions that have been made at the Politburo level will translate into specific measures through the different agencies. The market is skeptical. While there was a stock market rebound yesterday, it seems to be consolidating and fading out somewhat already. We think it's going to be a bottoming out process. It will take time for many of these measures to have their effect. For example, in the housing market, which has been facing quite a lot of difficulty, that process might be quite long in our view. And so we will have to see how these measures will be adjusted along the way. It will be a pretty bumpy, bumpy path still ahead.

**WILL KOULOURIS, CNBC:**

And it will be a bumpy path ahead. So I'm going to shelve that conversation for now. We will dive into China because there isn't as much immediacy for China as there is perhaps for somewhere else in Asia. That is, of course, the B.O.J. And there's some wild speculation, as it relates to, are we going to see any kind of movement on the YCC, plus 75 plus 100? What are your expectations, firstly, in terms of what you think they're going to do on Friday? And secondly, is there any set of circumstances because a lot of people are suggesting that if you were to see them, in a sense, surprise the market a little bit now with the widening by 50 basis points or even the abolition of YCC or even kicking it down the yield curve, that you could see quite unintended set of circumstances in terms of the requisite impact on global bonds as well. Is that something that you're thinking has the potential to happen?

**CHANG:**

The market is handicapping less than- its a pretty small chance of YCC being adjusted on Friday. We think it's about one third chance, so it's still less than a half for this particular meeting, but we think by the end of the year, yield curve control will have been adjusted. And from our standpoint, the Bank of Japan is still having a new governor and the inflation dynamics need to be more secure. Unlike, perhaps, compared to the Fed and maybe the ECB on the other side, which are also meeting this week, they would want to make sure the inflation is actually fading. The Bank of Japan is on the other side, hoping that inflation will be more secure before they take off the yield curve control. And on top, the Bank of Japan will also be potentially thinking about if yield curve control is happening, then they may also need to adjust the forward money-based guidance as well. So it's a little bit more complicated on that front.

**KOULOURIS:**

Yeah, and I completely agree with you, especially considering some of the signaling we even got from, the government spokespeople earlier on this week trying to nudge the BOJ, perhaps to think about the fact that inflation might not be a sticky to the upside as they're perhaps thinking, but I've got to ask you, are you right now in terms of your own deployment, have any kind of horizon about testing that yield curve control; do you think it's going to happen any time this year, for example, because people are testing it right now, but it's not the same kind of velocity or veracity that we've seen in the past in terms of the widow maker?

**CHANG:**

We are positioned to be somewhat underweight duration in a modest manner in JGBs. So we do think there are steps that they will take by the end of the year. And with that happening, then I think the market will react according to that. The magnitude is still harder to handicap, but the direction seems pretty clear to us.

**NABILI:**

Expand a little bit more on your positioning bond-wise than Stephen, given not only what's happening in Japan, but the FOMC?

**CHANG:**

The FOMC this week, I think, the market has priced in 25 basis points. We are not looking at anything different from the market at this point. We think the Fed Chairman will continue to keep the options open, maybe even for September. So the talk will still be more on the hawkish side of things. From our standpoint, the duration view on the US is more neutral at this point. If I pull it back to Asia, I think we actually see more interesting relative value and interregional differences in different countries where we think we have more positions rather than taking a directional US rate view at this point.

**NABILI:**

So how does this thinking filter into your currency strategies?

**CHANG:**

Again, on currency, I think the US dollar has been very strong, but the Fed, if anything, is closer to the end of their tightening, but still may have one hike this week and potentially one more by the end of the year. So in terms of the way we look at it, we have a few stories in Asia where we see more of a medium-term, more secular, positive stories in the likes of India, in Indonesia, given the reforms, its demographics, and basically more resilient nature of the economies now versus the more fragile state perhaps 10 years ago. So these might be more, more of a longer-term, positive overweights in FX for us, and then we would fund it through some of the lower yielders, for example, in Singapore dollar. And potentially we're also looking at fundamentals in the Philippines having a higher current account deficit with the central bank likely to have finished and maybe having inflation coming down towards the target, towards the end of the year. So the currency there might be under more pressure compared to the other ones that we're long.

**KOULOURIS:**

Can I just ask you, and I promise we'll get to China in our next stage of our conversation, but in terms of your expectations, whether it be the resiliency we're seeing in Asia, you know, the fact of the matter is if we were to see anything significant coming through in terms of recession in the US, and you know, you can take your pick and the indicators are flashing that maybe not the end of this year, but pretty certain, in some form or another, it's going to be by the start of next year, and the same goes for over there in Europe. If we see the US dollar catching a bid yet again, what are the consequences playing out for Asia, both on a credit standpoint, both on a currency standpoint? Is there not going to be some inherent risk there of fragility?

**CHANG:**

I think if US inflation were sticky and the Fed needed to do more, the general resentment would be reduced in Asia. Typically, you have that kind of competing of a higher interest rate asset in the US versus those in the region, growth might also be impacted. So we think there will be a beta impact if the dollar stays strong, and the Fed might need to do more. But our base case is that the US will get into a growth picture, which might be pretty close to zero, or maybe even into a recession, albeit maybe given the current, kind of the current situation and condition of the US economy. If any recession hits maybe more of a shallow one. So not a whole lot of imbalances. So I think the impact to the rest of the region might be somewhat more muted than prior cycles.

**KOULOURIS:**

But you're not worried about broad flows because you're seeing, you know, you can just look at the last ECB survey. Credit conditions are tightening across the board in Europe. They're tightening very much so in America, we're probably going to get more confirmation of that when the sluice comes out on the 31st. And if you're seeing this tightening of credit, if you're seeing this, this, you know, the detrimental impact that'll have on flow and then coupling that with the potential for a significant economic downturn, but the variance in terms of significance–

**CHANG:**

I hear you. I think so.

**KOULOURIS:**

Doesn't that affect EM, though, significantly?

**CHANG:**

Yeah, I hear I think more of the more credit intensive to the economy with more of a funding in US dollar will be impacted. We've been calling for more of a cautious stance in credit favoring investment grade over high yield. I think I mentioned about some of the stories that, for example, in India and Indonesia, they're more domestic driven rather than kind of going along with let the global trade cycle. So that's an area which we're more comfortable to invest in. For example, in the credit area, we remain quite cautious and be more bottomed up driven and looking for resiliency so that it won't be as affected by the credit training that you're highlighting coming from the global liquidity condition tightened by the Fed and the ECB.

**KOULOURIS:**

Exactly. Steven, stay right there because we've got a lot more to talk about. I'm going to dive into China when we come back from the break.

**KOULOURIS:**

Let's get back to Stephen Chang, Asia Portfolio Manager of PIMCO. Now, Stephen, I've got to ask you because there's always a lot of consternation when you talk to anyone that does trade in the paper as to whether or not we should be scooping up China bonds. Do you think that considering all of the potential credit risk that you could see there, stimulus or know that that the real good levels now is a time to be to be buying them?

**CHANG:**

If we look at the China market, there are different parts to it. There is the onshore government bond rates paper and then you get the US dollar more around the Chinese companies corporate debt paper. From the local rate onshore paper, the direction of travel, is that there might be slightly easier policy from the monetary angle and some of the Politburo readout would suggest that there could be some support. Again, that might translate to- continue to be more of a flush liquidity situation, maybe even a very modest rate cut. So that remains a pretty steady market in our view, albeit offset by potentially some supply of bonds that could be used to fund some of the growth initiatives. I think on the credit side, mostly on the US dollar paper, there are two different worlds out there. One part is the State Owned Enterprise and the very high quality investment grade type of a paper. Those valuations are fair to slightly expensive in our mind. Fundamentals are fine and would stay resilient, but at this point, we don't think valuation is a place where we want to enter. And then on the higher yield angle, it is trading into a very high yield and maybe even in some cases like property in distress areas, more policies need to come through to give that more confidence. Many issuers are worried about the next maturity coming up and how they can pay for it. Some of that might have cash on hand, but in other ways, the refinancing is kind of having difficulty. I mean, there might be some onshore programs that could be utilized for guaranteed types of issuance, but we have seen those sizes to be relatively modest and perhaps not adequate to fulfill some of the upcoming maturities.

**KOULOURIS:**

So where are the best opportunities? If we're just talking strictly sovereigns, you know, people that maybe don't have the biggest risk profile in the world, where are you looking then to capture the best value, but also at the same time, perhaps not get so much volatility at the same time?

**CHANG:**

I think from a China credit standpoint, we have an underweight exposure. Some of the holdings that we have would be in the investment grade, to kind of private enterprise area where we see some value and they're not trading as rich as some of the State Owned Enterprise bonds in the investment grade space. Otherwise, our Asia wide credit holdings, we have been adding to some of the new issuance in Korea where we find the pricing to be quite attractive, given its rating and the resilience. We're really looking for some of these names that can provide good support and resilience through the credit cycle, and as we have said earlier in this broadcast, there are still tightening happening by central banks, and so we want to be somewhat cautious on credit beta as a whole.

**NABILI:**

All right, Stephen, we're going up to leave it there. Thank you for being with us today.

**CHANG:**

Thank you.

**NABILI:**

Stephen Chang of PIMCO.