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**YVONNE MAN, BLOOMBERG:**

A lot on tap here this week, let's bring us Stephen Chang, MD and Asia Portfolio Manager at PIMCO joining us now. I want to talk about overall this, this China- I guess you could say this reopening story that's kind of fizzled out a little bit. Has anything the last few weeks changed in terms of what we've seen, whether it's a change at the top with the CSRC regulator, state funding into ETFs and the inflows that we've seen. As a fixed income portfolio manager, has anything changed in your mind?

**STEPHEN CHANG, PIMCO:**

Well, on the macro side, I think we are watching the holiday data very closely. And the first data series coming out seems to be stronger versus last year by a lot. And then even versus 2019, those numbers seem to have grown a decent amount. But if you take that last week out, the data on consumers has been quite lackluster income growth is not really there. The growth engine remains one where it's more that's a government led infrastructure led manufacturing and investment led. And those might help to get to the growth target. But in terms of dynamism and the most sustainable type of growth, we think it still needs some work. And we think the Premier, among other government officials, has come out to say that confidence needs to be sustained. And we'll be watching very closely for the next few weeks up into the two sessions at MPC. What specific policies might come through? There are a lot of people including myself that would like to see more to be done on the household and consumer side, rather than the manufacturing of other investment items. Because the other side would also have the spillover effect in our mind, that might create more capacity and more disinflation, maybe even deflationary pressure to other parts of the world as well.

**MAN:**

So are you kind of saying on the sidelines for now when it comes to your exposure to China, you mentioned before it's overwhelmingly bearish. Is it time to actually act now when things are so crowded in one way?

**CHANG:**

I think we're probably a little bit more neutral from a directional sense from a currency standpoint. They have been quite steady, almost around the 7.1, 7.2 area. And there is a tendency for them to keep it to be quite steady, particularly against the US dollar over the last number of months. And for interest rates, we think it's going to be in a pretty tight range. There are lots of factors that might make you think, okay, the economy is going down. Inflation is actually very low. But at the same time, how could they kind of push rates lower? They didn't move on the MLF. I personally think they probably may not do it this time on the loan prime rate either. With the interest rate already at these levels, they might use tools such as Triple-R and other targeted programs to get going, which may not have that much impact on interest rates.

**HASLINDA AMIN, BLOOMBERG:**

So Stephen, do you take a look that China stood pat on the one year MLF? How are you reading into that? Is it putting the yuan as a priority of bond bulls and what might the next move be?

**CHANG:**

We will be watching the two sessions very closely. But in terms of interest rate, there is some modest scope for rate cuts. We think there might be two cuts over the course of this year. But again, with this like 10 to 15 basis point type increments, it's more signal than actual impact for interest rate sensitive sectors. Most of the policies would come from fiscal, where they decided to increase in terms of deficit and where they targeted to spend. And as I was saying before, that may not have that much impact on interest rates.

**AMIN:**

Is there a lack of urgency on China's part to address all the issues and the concerns that investors have right now?

**CHANG:**

That's actually a very interesting and live debate that we're having ourselves, we're having with many different market participants. On one hand, you can look at the latest quarterly PBOC Monetary Report. If anything, it sounds slightly more constructive and might give you a bit of a sense that there is not that high of an urgency to ease. But then there are other comments coming out as I mentioned about the Premier. And you also look at the macro data. Some of those might suggest that more should be done and should be done quite quickly. So again, those two sessions will probably put the different camps into hopefully something of a conclusion. And we might be able to see some policy inflection points towards the later part of March and April.

**MAN:**

Stephen, I got your take on a few weeks ago. You came up with a report talking about the BOJ that they might actually start lifting rates as early as March or April. I mean, walk us through that call, and how this is all going to play out.

**CHANG:**

Yeah, I think what we were kind of referring to is they have negative interest rates at the moment. So they could take it to zero in the March or April meeting. It's a live meeting for both of them. And they are looking at likely inflationary data and probably some of the forward looking growth indicators such as the Tankan survey. The Japanese negotiation for wages typically happens around March. So they might have that data point already when they have the March meeting. And the Governor has come out and mentioned that even if they remove the negative interest rates, the monetary condition is still quite accommodative. And if inflation continues to stay around kind of 2% or kind of near their target level, there is scope for that to be done. And what we are arguing is, again, quite modest interest rate increase. First of all, taking the rate from zero to- from negative to zero. And then by the end of the year it could be 25 basis points. It might take a couple of increments. It could be 125 or 110 and 115.

**MAN:**

Yeah, I mean, obviously there's a technical recession. So I guess more, you know, slowly but surely is certainly one that you might warrant itself. I'm just wondering in terms of just how this is going to be reflected in the market. If they do, in fact, lift it to zero. I mean, is that likely going to be expressed in the bond market or more on one dollar yen?

**CHANG:**

In our mind, on the bond market side of GGBs, what also we would be watching very closely is the pace of the quantitative easing on the QE buying pace. We think they would slow it down and that would increase the term premium and lead the part of the curve like 5 to 10 year, to be higher in rate. So we'll be underweight duration, in our setup. The yen is much more driven by the U.S. interest rates and we can see over the last few weeks and many months and remember back in like ‘22, let's say before the Fed hike I mean, the dollar yen is like 110, 115 and we're now at-, call it 150. So the dollar yen is much more driven by U.S. rates and U.S. rates would in turn be more driven by inflationary data like what we have seen last week.

**AMIN:**

Stephen, how do you see the yen moving once the BOJ makes an exit from negative rates? Do you see a rapid increase or will it be slowly, slowly? I mean, how do you see the yen moving?

**CHANG:**

The yen is at a very cheap valuation and there are different flows that are happening that could also be helping investment into Japan or repatriation back into Japan but the biggest driver in our mind is still the rate differential. And again, even if we're talking about BOJ moving rates, the extent of the move and the expectation being priced in the curve, there is much more volatility coming through on the U.S. dollar side. So I think the U.S. dollar rates will drive the dollar yen much more but let's say the Fed is cutting more than expected. On the other hand, the BOJ starts to move and normalizing going up in terms of rate and that contrast could make the yen move quicker.

**AMIN:**

Stephen, on a broader basis, the high yield bond market. I mean, how do you see that playing out? Given that perhaps we will not see as aggressive rate cuts as first anticipated, might trouble be brewing in the space?

**CHANG:**

The high yield market, be it in the U.S. or in Asia, that would be more driven by the economic cycle. In the U.S., again, many people have tried to expect a recession and so far the U.S. economy has been highly resilient. There are many reasons being given for that and how much that might play out in 2024. In Asia, we are actually seeing the high yield spreads have come down quite meaningfully over the course of the last few months. To us, the supply has been very light. Meanwhile, there are different countries, for example, in Indonesia or India, where the local funding is actually cheaper for many of these issuers to tap. With that kind of on the backdrop, having some of the tender and buyback and callable bonds being matured early, the environment is more constructive. China is still one question mark, its still a decent part of that Asia high yield market. We talked about macro development and if that confidence also returned, I think that sector could perform quite well.

**MAN:**

What do you make of this U.S. exceptionalism? I mean, it's fueling the dollar in some ways. Is it just yield differentials that's really fueling the currency right now, or is there something else going on?

**CHANG:**

The U.S. economy has been very strong and is able to absorb those high interest rates. When we observe other countries and we have put in a report just published a week or two ago, there are economies, for example, in Australia, that would be much more rate-sensitive than the U.S. So as the U.S. keeps rates quite high because of the resilient growth or inflation not coming down as quickly as expected. I think there are other economies that would suffer and we think it's a good opportunity to add duration in those markets. But the U.S. so far has been able to have some exceptionalism as you said.

**MAN:**

Steven, great to have you. Steven, Chang there, MD and Asia Portfolio Manager at PIMCO joining us here in Hong Kong. We got plenty more ahead. This is Bloomberg.