Manulife
Investment Management

2024 *Outlook*

- Five macroeconomic themes for 2024
- Accelerating momentum amid a transitioning macro backdrop

... and more

Five macroeconomic themes for 2024

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In this 2024 annual outlook, Frances Donald, Global Chief Economist and Strategist, and Alex Grassino, Head of Macroeconomic Strategy, dive into the five major forces that will drive global economies and markets in 2024.

1 Darkest before dawn: Peak growth in this cycle is behind us.

A challenging year for growth

Technical recessions or not, 2024 will be a much more challenging year for growth globally compared with 2023. That economic hardship won't be felt equally across income groups or countries, with the US more likely to withstand the tightening in the system relative to many other major economies as the country's domestic focus, strong employment profile, and relative consumer health should all provide support.

Conversely, countries that are heavily exposed to international trade and constrained by their ability to borrow are likely to face significant headwinds during the first half of the year, with gradual improvement as central banks begin easing financial conditions. Indeed, 2024 won't feel anything close to the Roaring Twenties thesis that ran rampant from 2021 to 2023. While no cycles are equal, this environment prescribes late-cycle investing strategies, especially in the first half of the year. That said, for many economies, it's often darkest before dawn, and sometime in 2024, it will be time to think about the beginning of the next cycle. Jumping too prematurely on this eventual rebound, however, is dangerous, as troubled waters are still yet to be crossed.

Drivers of successful economies in 2024

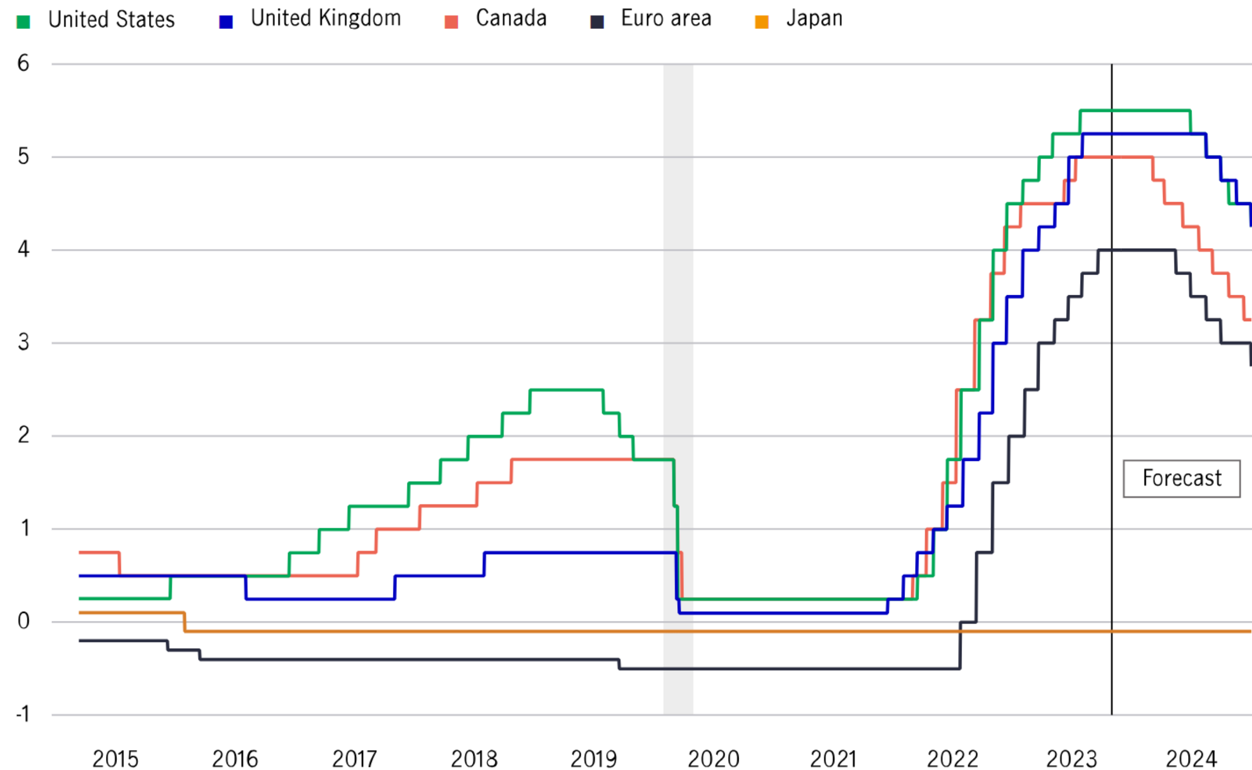
- Lower debt sensitivities – Countries with debt profiles (at the government, corporate, and consumer levels) that are either relatively unlevered or that have longer maturity profiles are likely to feel the pain of higher interest rates less acutely.
- More fiscal room – Countries that have the scope to add in government stimulus as a countercyclical measure are likely going to be able to better mitigate the full effect of slowdowns than those that don't.
- Less manufacturing export sensitive – We're in an environment where key drivers of the business cycle have become desynchronised. Coming out of the pandemic, the focus has shifted from a goods-driven to a services-driven economy, with the manufacturing sector weakening materially. Consequently, economies that are dependent on manufacturing and the export of goods are likely to feel the brunt of a manufacturing slowdown more acutely.
- Exports geared toward essential commodities – While the manufacturing impulse might have slowed materially, supply chain disruptions have left demand for core commodities at high levels. For example, climate and supply chain issues have left key crop prices high and have been a boon to exporters in those commodities.

2 Critical concessions: Central banks reluctantly move past peak rates.

The fight against inflation continues

A material and global disinflation took hold in 2023, but 2024 will likely show that the last leg of the inflation battle is more difficult – not just because year-over-year price growth will struggle to return to the post-global financial crisis/pre-COVID norm, but because central banks will, in our view, ultimately begin easing before inflation definitively returns to target, thereby risking a reacceleration in demand and a possible re-emergence of inflationary pressure.

Global rates are expected to fall in 2024 (%)



Source: National central banks, Macrobond, Manulife Investment Management, as of 30 Nov 2023. The gray area represents recession.

Central banks are faced with an uncomfortable predicament: Do they ease in the face of deteriorating growth despite the likelihood that inflation is still materially above target (and, in price level-terms, sizably higher than pre-COVID)? We expect that, ultimately, they'll either directly or indirectly concede that their blunt tools aren't the right ones to definitively address the current inflationary environment.

This realisation will likely be driven by the very nature of present-day inflation: Central bank tools are designed to cool demand-driven inflationary pressure but are less effective against supply shocks, regardless of whether these shocks are caused by enhanced pandemic-related protocols, climate change, or geopolitical tensions. Certain central bankers have already conceded the point, outlining their constrained ability to countermand external shocks.

The consequence of this dynamic is that provided inflationary pressures aren't an acute point of concern, policymakers are likely to relent in the face of weaker growth and choose to reduce restrictive policies in order to counterbalance a softening economy.

This trend will be especially true for central banks with dual mandates, such as in the US or New Zealand, or in economies that, because of high amounts of leverage, are particularly sensitive to higher rates; Canada, with its levered consumer and expensive home prices, would be one such example.

However, it's important to note that there's a difference between normalising policy toward more neutral levels (which would imply that monetary policy is neither restrictive nor stimulative) and switching to easing mode (which would create an environment in which low interest rates actually stimulated the economy). In this environment, we view this latter as unlikely, especially with inflation still running above most central banks' target.

Within this context, in which the limits of central bank policy become evident, we expect a growing dialogue around new non-traditional central banking tools such as central bank digital currencies and the use of targeted tools, such as those available during times of financial system stress. We also anticipate more focus on core central banking assumptions – from the appropriate neutral rate of respective economies to the concept of a 2% inflation target, which is used in many developed-market economies.

Key questions confronting central banks this year

Inflation targets: Is 2% the right target?

As economies slow at a faster pace than inflation normalises, the pressure to ease current monetary policy stances will intensify. If the last leg down in inflation back toward traditional targets proves difficult to achieve, a growing chorus of voices could potentially call for lowering the bar to cuts by raising the inflation target.

Terminal rates: The post-COVID economy looks different: have we moved to a persistently higher interest-rate environment?

We suspect the answer to this question is yes, but admittedly, the bar to being in a higher-rate environment is extremely low, given that central banks kept policy rates at essentially zero for the better part of a decade, which we wouldn't expect to see again for some time, barring an acute crisis.

New tools: Are quantitative easing and tightening things of the past?

We doubt it. Quantitative tightening is still ongoing in many economies, including the US. We tend to think of policies like this as akin to putting more tools in the toolbox, to be used as the situation warrants. That said, just because they're available doesn't mean they'll need to be used.

3 The big shift: From a demand-driven to a supply-driven world.

The drivers of our global economies (and the market implications of such) are shifting away from traditional demand-side factors and toward the supply-side influences of the world: Because of a shifting geopolitical environment, globalisation has been replaced with friend-shoring/onshoring, climate events have translated into supply chain disruptions for key commodities, and post-pandemic policies have resulted in meaningful delays across supply chains. While the supply-side driver conversation has focused on inflation for much of the post-COVID period, it's bleeding across a wide range of core economic narratives, including labour markets and productivity, and will continue to do so in 2024 and beyond. We don't necessarily view a more supply-dominant world as a one-way trade (although it's certainly structurally supportive of real assets), but rather that the relative importance of many indicators, economies, and politics will shift. Importantly, this will require careful assessment of traditional forecasting tools. It will also likely open up new investment opportunities: On a regional basis, any friend-shoring/onshoring efforts that would occur from strategic supply chain realignments could prove interesting, as could thematic investments that are more closely tied to strategic government priorities, such as green investment or defense spending.

Data that needs more focus in a supply-driven world

Labour shortages – An aging workforce could continue to affect employment dynamics in two ways: First, as the 55+ cohort approaches retirement the pool of available labour is affected; Second, the departure of more experienced workers could leave institutions with knowledge gaps.

Artificial intelligence – Expanded use of artificial intelligence (AI) could potentially lead to a productivity miracle similar to what was seen during the earlier days of the internet, where seemingly above-trend growth and modest inflationary pressure combine.

The weather – An increasingly important part of supply chain disruptions and corresponding price shocks are climate events.

Asset classes that could receive more investor attention

Strategic commodities – Raw materials that are either non-discretionary (e.g. agricultural assets) or strategically important will be an area of focus.

Fixed income – Our base case is that while central banks ease, they don't lower policy rates to the point where they're stimulative to the economy. This is at least partly because of incremental modest pressures caused by the realignment of supply chains. Consequently, with higher base-level yields, the return profile around fixed income is likely to be fundamentally different relative to other asset classes than it was in a zero-rate world.

Relative beneficiaries of supply chain realignments – With onshoring and friend-shoring becoming more pervasive structural factors in supply chains, countries that are deemed more secure are likely to benefit from continued foreign investment. Similarly, companies responsible for supporting onshoring initiatives are likely to benefit.

4 Out of sync: Desynchronisation expands and accelerates.

While global desynchronisation is now a well-understood macro theme, it often gets specifically viewed through the lens of US-China economic decoupling or other measures of broad deglobalisation forces. In 2024, we see these elements of global desynchronisation accelerating but also expect to see other areas of uncoupling. For one, the global economy is still distorted by the COVID shock and the global manufacturing and services sectors are uncharacteristically disconnected: Manufacturing has experienced a period of weak or negative growth; it's already evident in export-centric countries like Germany, which is already teetering on the edge of a recession. Conversely, while demand for services is moderating, it still remains relatively healthy: Spain is a good example. That's problematic for forecasting models, but it may also present opportunities even as some areas of the global economy falter. We also expect that growth challenges in 2024 won't be distributed equally across economies or income groups, once again muddying the idea of a single, simple global economic forecast applicable to all. In 2024, we also expect to see more focus on intraregional stories. In addition to dynamics such as the European example above, the same general dynamics can be applied to the emerging markets: Certain countries are likely to feel the full impact of Mainland China's structural slowdown and/or US growth challenges differently.

Better understood areas of desynchronised growth

The divergence between goods and services – The manufacturing sector has already experienced a slowdown as a shift from goods to services has occurred. This is in part due to a shift away from using discretionary income on items back toward services such as vacations and dining out.

Timing around exiting lockdowns – Countries that took longer to emerge from restrictive lockdowns are still to varying degrees enjoying that post-opening surge, while regions that exited earlier are closer to normalising. For example, even though it ultimately proved short-lived, China's exit from lockdown conditions was the impetus for a short-term risk-on rally late in 2022 and in early 2023.

Less well-recognized areas of desynchronised growth

Long(er) and more variable lags – Market participants understand and expect that the global monetary policy tightening experienced over 2022 and 2023 should lead to a lower growth environment. What's less clear is how quickly the full impact of those moves will be felt.

Labour market dynamics – Because of recent employer trauma around scarcity of labour, it's possible that companies will go to greater lengths to retain workers even against a backdrop of slowing growth, which could in turn support the economy and extend the cycle.

What happens when policy eases? – Several themes that dominated 2023, such as cash as an asset class and the bifurcation between US new and existing home sales, were due to high policy rates. As central banks ease, the opportunity cost of certain decisions (refinancing a mortgage, flows into money market funds) will diminish, possibly reversing certain trends.

5 Fiscal dominance: Governments grow and become more disruptive.

The COVID pandemic and, more recently, the rise in fiscal stimulus unlocked a surge in global government spending, some of which was likely necessary and net positive and some of which was likely excessive and inflationary. In 2024, we expect the growing government share of spending in both individual countries and the world to become more prominent and structural. It will likely show more tangible impacts, including the disruptive nature of a significant increase in sovereign bond supply and the rising costs of large sovereign debt overhangs. Several major elections will become focal market events, decreasing visibility around key policy initiatives and increasing volatility: The Netherlands has recently undergone one such election, and the US election in November 2024 is also likely to require a lot of attention. More strategically, countries with more fiscal room to support their economies through weak economic times will be advantaged, although how that government spending is dispensed (e.g., green spending versus defense spending versus direct redistribution spending) will matter.

Accelerating momentum amid a transitioning macro backdrop

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Further monetary tightening by the US Federal Reserve (Fed) and the ongoing ructions in China's real estate sector again weighed on Asian fixed income in 2023. However, a potential pivot from the Fed in late 2023 and Asia's resiliency led to positive returns and outperformance for the year. As Endre Pedersen, Murray Collis, and the Pan-Asian fixed income team argue, a changing global rate environment positions the asset class to accelerate in 2024 with attractive nominal yields and carry opportunities. Credit is slated to continue posting positive performance amid a diversifying investment universe, with potential upside for selective markets and sectors with strong credit fundamentals.

Investors entered 2023 with arguably greater certainty than the previous year. The threat of inflation was well known, and it continued to dominate the macroeconomic landscape and monetary policy. Indeed, after the Fed hiked rates by a historic 425-450 basis points (bps) in 2022, the US central bank delivered a further 100 bps of hikes last year, bringing the federal funds rate to 5.25%-5.50% by August 2023. The Fed subsequently paused from September onwards.

However, uncertainty persisted, as investors wondered when the Fed would halt and whether the US economy could ultimately achieve a 'soft landing'. As a result, US Treasuries experienced significant volatility, particularly longer-duration bonds. The 10-year Treasury, which began the year at 3.88% peaked at around 5%, before receding at the year's end. The MOVE Index, a measure of US Treasury option volatility across maturities, spiked in 2023 to the highest level since 2008.

Against this backdrop and despite heightened volatility, Asian fixed income outperformed global fixed income and the broader emerging market universe (see Chart 1).

Chart 1: Global fixed income performance (2019-2023)

Source: Bloomberg, as of 31 Dec 2023. Asian fixed income = JACICOTR; EMD = JGENVUUG; global fixed income = LEGATRUU. Rebased to 100 as of Jan 2019.

From a credit spread perspective, Asian investment grade (IG) bonds continued demonstrating resilience, tightening by roughly 32 bps in 2023[1]. This was mainly due to a shorter duration profile and an investment universe containing a greater concentration of state-owned firms in more resilient regional economies. IG's total return grew by 7.4%, driven by solid credit fundamentals and falling US Treasury yields towards the end of 2023[2].

Asian high yield (HY) also posted a positive return, albeit at a slower pace of 4.8%, amid the strong performance of regional sectors such as Indian renewables and Macau gaming, offsetting the volatility and adverse sentiment of China's property sector[3].

2024: Yield and carry opportunities remain relatively attractive with a resilient regional economic profile

As we move into 2024, the interest-rate environment is likely to stabilise after the high volatility experienced over the past two years.

Our base case is that the Fed is near or at the end of its current rate hiking cycle. Once this is confirmed, we believe several positive catalysts will emerge to stabilise the macroeconomic environment and benefit Asia.

Indeed, even as the IMF estimates global economic growth to decelerate this year to 2.9%, Asia is projected to be the fastest-growing global region at 4.2% in 2024 due to its diversified growth profile.

China's economic growth lagged market expectations in 2023. Still, we believe that recent signals of strengthening fiscal and monetary policy and more targeted measures to help the property sector, such as recent reports of a list of developers eligible for financing, are constructive.

Equally important, economies, such as India and Indonesia, have developed new sources of growth that can add to the region's resiliency.

India posted the fastest growth in Asia among large economies in 2023 due to robust government investment in infrastructure and successful manufacturing onshoring schemes like the Production Linked Incentives. Meanwhile, Indonesia is developing a domestic supply chain to produce electric vehicle batteries that allow value-added activities pertaining to key minerals, such as bauxite and nickel, to remain onshore.

In the next section, we will break down our 2024 Asian fixed income outlook into three areas: credit, rates, and currency.

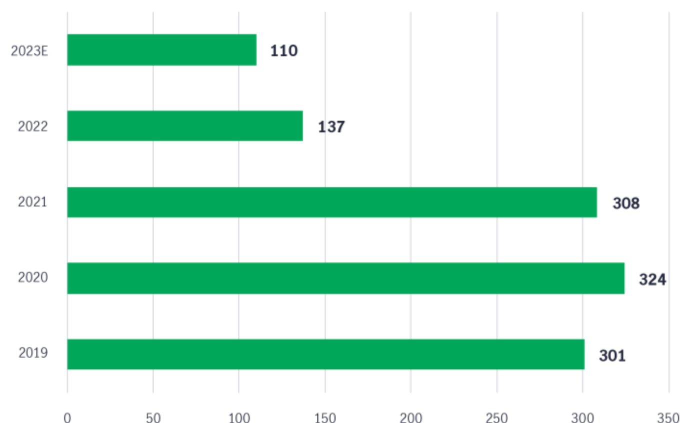
2024 IG: Continued strong credit fundamentals

Asian IG credit posted resilient performance in 2023 despite a volatile global market, due to strong credit fundamentals and robust regional economic growth, both are expected to continue in the new year.

Supply-side factors also played a role: Asian credit issuance declined by 22% year-on-year in 2023 (see Chart 2) due to higher yields for USD-denominated bonds, which has led many companies to seek cheaper domestic funding options.

Moving into 2024, although we expect lower yields to incentivise a gradual rise in IG issuance, we don't expect the net supply of bonds to be positive this year (given maturities) unless the Fed embarks on an aggressive rate cut cycle.

Chart 2: Asia credit total issuance, 2019-2023 (US$bn)



Source: J.P. Morgan, as of 29 Dec 2023.

Additionally, although we see some potential spread widening for IG bonds if Treasury yields continue to move lower, the overall total return of the market should still be positive as declining nominal yields outweigh the loss due to widening credit spreads.

Based on this backdrop, we are constructive on selective pockets of regional IG opportunities. As always, bottom-up credit selection remains imperative.

- **Selective privately-owned enterprises (POEs) in China**, primarily with a credit rating of 'BBB'. Although China's economy will likely remain volatile in 2024, we believe that selective POEs with strong fundamentals are poised to outperform and benefit from China's structural consumption growth.

- **Asian regional bank capital bonds** can offer a compelling risk-reward proposition. Indeed, Asian banks have shown resiliency after a raft of US banking failures in March 2023. Overall, the state-owned backing of many Asian banks augurs well, as they are less volatile and more likely to be viewed as systemically important by governments across the region.

  For example, we see opportunities in Indian banks backed by strong economic performance, improving asset quality, and growing demand for corporate and consumer lending. Additionally, we are constructive on the bank capital bonds of more stable and well-capitalised Australian banks, where we see attractive valuations. By moving down the credit curve, we can obtain higher yields while managing risk among internationally renowned financial institutions with robust corporate governance.

  Finally, these instruments also play a key role in portfolio diversification, particularly as overall issuance in the regional IG space has lagged over the past two years.

2024 HY: Evolving opportunities in an expanding credit universe

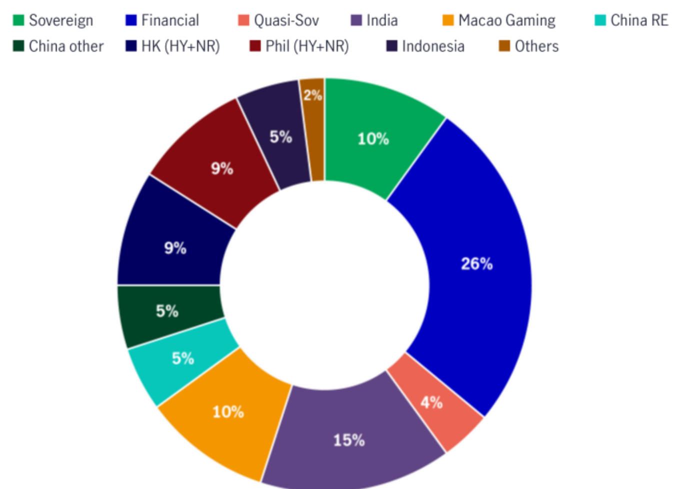
China property continued to weigh on HY performance and investor sentiment in 2023. But as we have previously pointed out, China property is playing a less critical role in the HY investment universe as a significant number of firms have defaulted, with some declaring bankruptcy. Since 2021 when the Chinese property sector slump started, 115 defaults totalling US$144 billion have been registered.

We believe the sector will stabilise over the long term amid the continued supportive measures by the government; however, it will not return to the days when it contributed roughly 25-30% of the country's GDP.

Indeed, we envisage the sector continuing to contract and undergo significant consolidation. The path to this inevitable outcome will likely see continued volatility, that said, the number of defaults is expected to gradually decrease over time.

Perhaps more important for investors, with China property only currently accounting for roughly 5% of the J.P. Morgan Asia Credit Index (JACI) HY (approximately 40% at its peak), we expect there are evolving opportunities in a diversifying credit universe. Thus, further volatility in the sector should have less influence on market performance than larger corporate segments such as Indian renewable energy and Macao gaming (see Chart 3).

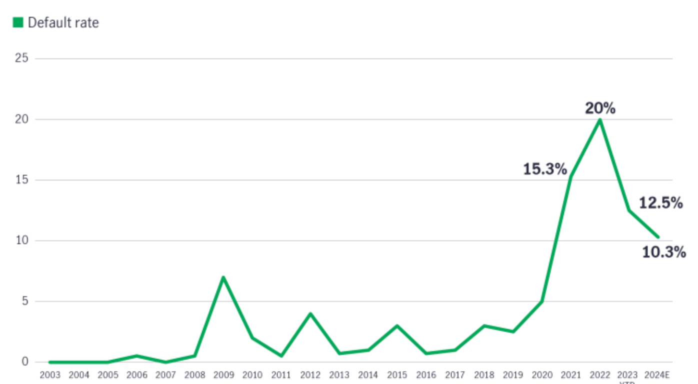
Chart 3: JACI HY composition by sector



Source: J.P. Morgan, as of 15 Nov 2023.

Furthermore, entering 2024, the credit fundamentals of the overall Asian HY space are expected to improve further. While defaults remain elevated at 12.5% (estimated) in 2023, far above the historical average, they are forecast to notably decelerate to 10.3% in 2024[4] (see Chart 4).

Chart 4: Asian HY historical default rates, 2003-2024E



Source: Goldman Sachs, Nov 2023.

Overall, we are constructive on the following HY segments for 2024:

- **Indian infrastructure** names are attractive, with a strong macro story and robust government support. India's economy is arguably the strongest in the region, and the Indian government has earmarked US$120 billion for infrastructure investment in the upcoming fiscal year. This has led to an improving credit profile: roughly 29% of credit upgrades in India during the first six months of 2023 were related to infrastructure – the most of any sector.

- **Macao casinos** have resilient credit fundamentals post-China's reopening in early 2023. Although China's economic growth has been slower than expected, Macao's recovery continued with an uptick in tourists during the Golden Week, which led to some credit upgrades. We also see attractively valued opportunities in the sector within the Asian HY space.

  Overall, the landscape of the Asian HY market has changed dramatically over the past three years to become more diversified from a geographic and sector basis.

- **China's property sector** currently constitutes a significantly smaller proportion of the HY universe than before (roughly 5%) than before. The government has expanded support beyond the supply side (developers) to include the demand side (consumers), in addition to the deep discounts presented in the market. Overall, we are cautiously optimistic and are highly selective on issuers during this K-shaped consolidation process.

2024 Rates: Selective opportunities in high-yielding markets

As the Fed is near or at the end of its tightening cycle, we envisage a constructive environment for Asian rates in 2024.

Overall, Asian central banks have varied in their responses to a hiking Fed in 2023: Amid a more benign inflationary environment, some regional central banks, such as those in India and Indonesia, did not match the Fed's pace with continued rate hikes.

With the Fed and other global central banks likely On pause and receding regional inflationary pressures in 2024, we believe some Asian central banks have room for potential rate cuts.

As Asian local-currency rates markets have largely outperformed US Treasuries due to a more measured approach to inflation this year[5], we remain constructive on three high-yielding markets in 2024.

- **Indonesia** offers an attractive nominal yield, with the 10-year government bond roughly at 6.50%[5]. Further, we believe that Bank Indonesia has potential room to cut rates after hiking its policy rate to 6% in October, primarily to protect the currency. Inflation has steadily fallen and remained within the central bank's target of 4%[6]. Finally, the fiscal situation is seeing improvement, with projected fiscal deficits for 2023 and 2024, respectively, both estimated to be lower than the 2.35% posted in 2022.

- **India** arguably boasts the strongest fundamentals regionally and offers an attractive 10-year government bond yield of around 7.20%[5]. Growth remains robust with 3Q GDP at 7.6% (year-on-year), which is the strongest in the region, while inflation has receded and the trade and current account deficits have stabilised.

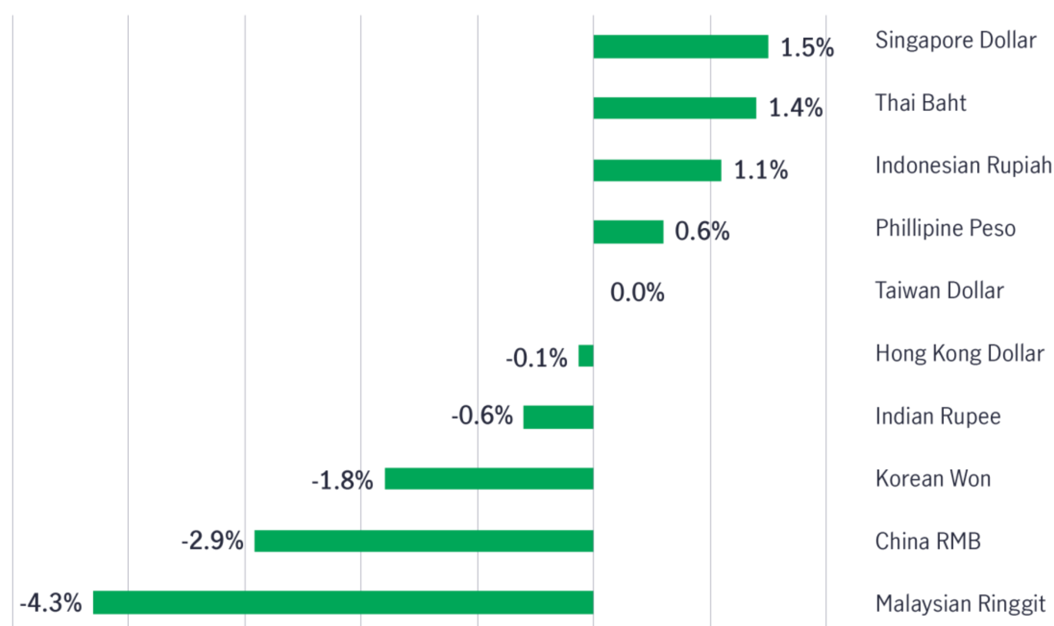
  In addition, the market may benefit from potential further inclusion in global indices: the J.P. Morgan GBI-EM suite of indices will include Indian government bonds starting in June this year, with Bloomberg and FTSE also considering the country for inclusion in 2024.

- Finally, **the Philippines** offers relatively attractive valuation opportunities, given its higher volatility profile. The country's rate environment has displayed historically high beta with the Fed; thus, it could benefit more than other regional markets when the Fed pauses its current rate hiking cycle.

2024 Currency: Rupiah and Won forecast as bright spots

The US dollar had a volatile 2023, with the DXY initially strengthening on the back of higher rate differentials, only to end the year roughly flat. Asian currencies posted a mixed performance, with several markets enjoying gains against the greenback in 2023 (see Chart 5).

Chart 5: Asian currency performance vs US dollar



Source: Bloomberg, as of 31 Dec 2023.

We believe that once the Fed signals it has stopped its rate hiking cycle, this will be broadly supportive of Asian currencies in 2024. We are particularly constructive on two currencies:

- **Indonesia's rupiah** is poised for greater stability and performance in 2024 due to an improved global rate environment and potential increases in portfolio and foreign direct investment. Foreign investors currently hold less than 15% of outstanding government bonds, while this was close to 40% before the outbreak of COVID-19 in 2020. This proportion could potentially increase with higher yields and a more stable currency. Foreign direct investment is also accelerating as the country builds a domestic ecosystem to produce electric vehicle batteries and other high-tech products.

- **Korea's won** is also slated to perform after a late-year rebound in 2023. Exports posted positive year-on-year performance in October for the first time in 13 months after the trough in semiconductor demand passed. With demand for semiconductors and artificial intelligence-related products expected to rise over the near term, Korea's exports will likely remain upbeat and contribute to a positive current account in the new year.

Conclusion

After 18 months of Fed interest rate hikes and further consolidation in the Chinese property sector, Asian fixed income rebounded into positive territory in 2023 and show signs of green shoots for 2024.

This momentum can continue in 2024 on the back of a more accommodative Fed, strong regional and corporate economic performance, and resilient credit fundamentals. We believe Asian bond markets have the potential to significantly outperform globally, as we move closer to an ending of the Fed's monetary tightening cycle and bottoming of the Chinese property sector.

However, markets are likely to remain volatile in the interim. In addition to the potential risks over evolving inflation and monetary policy, Asia will experience key elections this year in India, Indonesia, Taiwan, and South Korea – not to mention significant elections outside the region in the US.

Bottom-up credit analysis remains imperative as credit is expected to remain challenging as higher rates may lead to slowing economic activity. Selective rate markets and currencies could also contribute based on the back of solid fundamentals.

[1] Source: Bloomberg, as of 31 Dec 2023. JACIIGBS. [2] Source: Bloomberg, as of 31 Dec 2023. JACIIGTR. [3] Source: Bloomberg, as of 31 Dec 2023. JACINGTR. [4] Source: Goldman Sachs, as of 24 Nov 2023. [5] Bloomberg, as of 31 Dec 2023. [6] Bank of Indonesia website.

For more insights, please visit
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