Asia outlook: Charging ahead in the Year of the Horse

January 2026

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HSBC Asset Management

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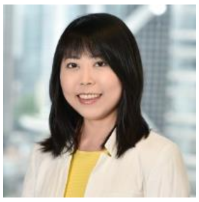


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Asia macro update

Asian economies have showed notable resilience to an increase in trade and geopolitical tensions, global policy uncertainty, and sporadic developed market (DM) bond volatility during 2025. Asia is adapting to a more complex global geoeconomic landscape while standing at the forefront of the global artificial intelligence (AI) revolution. The region's economic prospects remain broadly solid in 2026, albeit with likely divergence across economies in their growth and policy paths amid local idiosyncrasies. We believe that fiscal policy stands ready to respond to growth disappointments in emerging market (EM) Asia as the region is approaching the end of its monetary easing cycle.

Growth resilience amid persistent external uncertainty

Several factors may have contributed to Asia's resilience. Effective tariff rates have been lower than feared at the time of the initial announcement last April, thanks to exemptions and reversals in key sectors, especially semiconductors, electronics and pharmaceuticals, which make up the bulk of exports in some Asian economies. The US-China trade truce and US trade agreements with other Asian economies helped ease trade tensions.

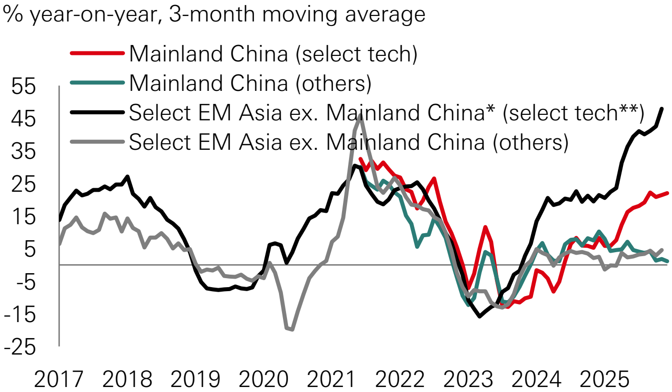
The tariff headwind has also been cushioned by a front-loading of exports ahead of new levies, ongoing regional supply-chain reconfiguration, strong AI-led exports and investment, and policy easing in many economies. Disinflation helped real incomes of households while lower energy prices eased firms' costs. Financial conditions also eased across much of Asia in 2025, aided by monetary easing, credit spread compression, equity market gains, and a weaker USD, while fiscal policy generally loosened.

Asia's trade endures and adapts

As a major beneficiary of the AI-driven capex cycle, Asia has bolstered its tech exports and deepened regional trade. However, trade in non-AI / non-tech goods remained subdued (Fig. 1), reflecting the tariff impact, lower commodity prices, weak investment in these sectors, and strong competitive pressures from Chinese goods in non-China domestic markets. China's trade surplus surged to a record of nearly USD 1.2 trillion in 2025, boosted by its manufacturing/export competitiveness, increased investments abroad, and ongoing import substitution – which has been aided by strong policy push toward technology self-reliance (Fig. 2).

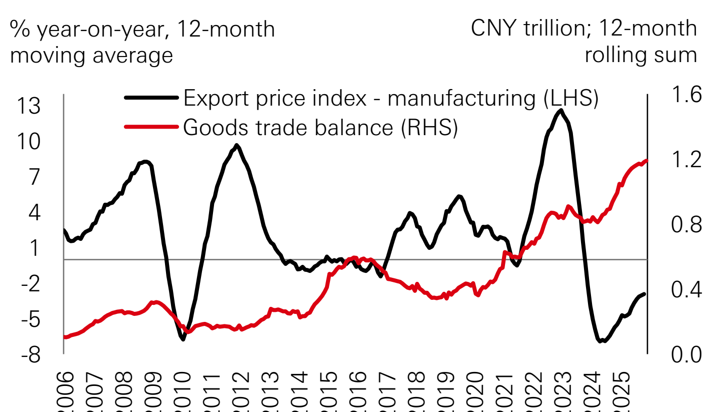
Fig. 1: Strong tech exports vs. subdued non-tech

% year-on-year, 3-month moving average



Note: *Includes India, Indonesia, Korea, Malaysia, Singapore, Taiwan, Thailand and Vietnam. **Includes semiconductors and electrical & electronic products
Source: CEIC, HSBC Asset Management, January 2026

Fig. 2: China's record-high trade surplus in 2025



Source: CEIC, HSBC Asset Management, January 2026

Source: HSBC Asset Management, as of January 2026.

Asia macro (cont'd)

Asia's export growth is likely to moderate in 2026, as last year's very strong tech export growth (largely driven by an AI capex boom in the US) will be hard to replicate, and global goods trade volume growth is forecasted to slow this year due to delayed impact of higher tariffs and trade policy uncertainty, according to the World Trade Organisation. Downside risks remain from renewed trade/geopolitical tensions and supply-chain disruptions.

That said, Asian exports may continue to expand at a decent pace this year on solid AI demand and the memory supercycle. Asia adapts to rising trade protectionism and geoeconomic fragmentation by diversifying export markets, shifting supply chains, deepening intra-regional trade, and increasing technological adoption. ASEAN is set to sign the world's first comprehensive regional digital economy agreement this year to boost cross-border trade and services. India is accelerating its export diversification through free-trade agreements (FTAs) and strategic partnerships, as steep US tariffs have inflicted pain on labour-intensive sectors (Fig. 3). The India-EU FTA will be a big step towards this end, as India and the US remain engaged in negotiations to sign a trade deal.

Uneven recovery and K-shaped industrial growth

Last year's AI boom led to upside growth surprises in some of the region's tech-heavy economies. However, the AI-driven growth recovery has been K-shaped so far, with weakness in certain domestic demand-oriented and non-tech sectors. Spillovers of AI investment to investment in other sectors or the broader economy – e.g., through job and wage gains to boost domestic consumption – have been muted, largely due to the high capital intensity and dependence on imported machinery and equipment. The AI boom also contributed to divergent economic performances across the region, with underwhelming growth outturns in some of the more domestic demand-driven economies, such as Indonesia and the Philippines. In some cases, domestic political uncertainty affected confidence, policy efficacy and reform momentum (e.g., Philippines and Thailand), though pro-growth macro policies provided some offsets. Returning to political / policy stability would help restore economic growth. Overall, the outlook for Asia's domestic demand likely hinges on policy support and local idiosyncrasies.

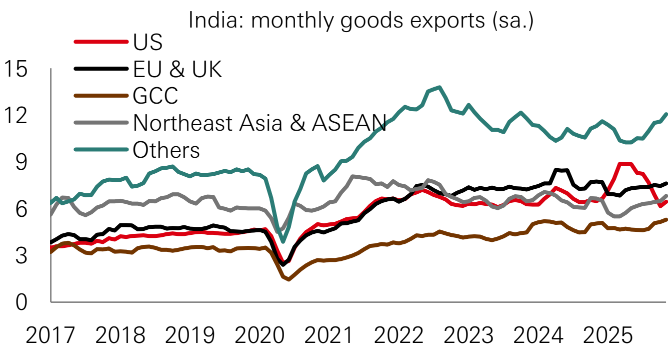
China achieved its 2025 real GDP growth target of 5%, largely driven by strong exports and solid industrial production, even as domestic demand weakened in H2 partly on fading fiscal policy impulse and anti-involution efforts. Economic imbalances remain a challenge (Fig. 4), underscoring the urgent need for structural rebalancing toward a consumption- and services-driven economy for sustainable growth and fundamental reflation. Policymakers at the December Central Economic Work Conference (CEWC) prioritised expanding domestic demand through boosting consumption and stabilising investment for this year, the start of China's new Five-Year Plan. While the policy shift towards domestic demand has started, the progress is likely to be gradual.

Supportive macro policies with fiscal prudence

Asian economies will need to lean more on domestic growth drivers this year amid lingering external uncertainty, potentially increasing pressure for policy stimulus and economic reforms. We expect economic growth to remain resilient in most parts of Asia, but the growth outlook will likely depend on each economy's domestic strength and policy support. Amid heighted external uncertainty, fiscal policy has been active across the region, as low inflation in EM Asia enabled nearly synchronised monetary easing cycles last year. Due to lagged effect, easing from the prior year should continue to support the economy this year.

Fig. 3: India's quest for export diversification

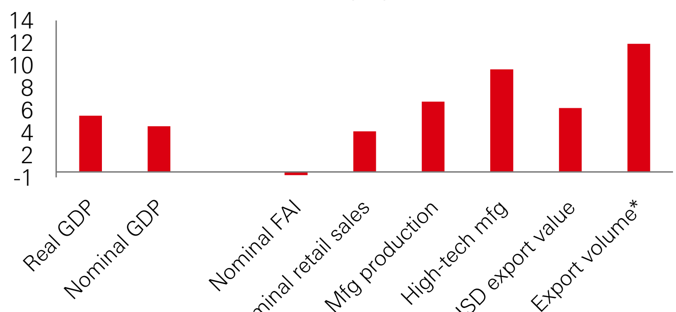
USD bn, 3-month moving average



Source: CEIC, HSBC Asset Management, January 2026

Fig. 4: China needs to rebalance its economy

% year-on-year, 2024-2025 average growth



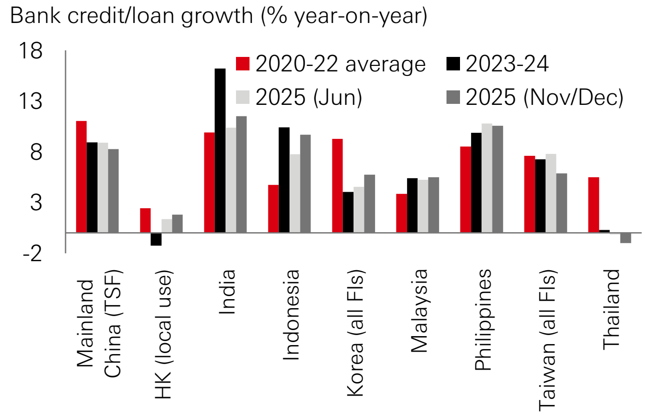
*Average monthly growth rate as of November 2025. FAI refers to Fixed Asset Investment. Mfg refers to Manufacturing.
Source: CEIC, HSBC Asset Management, January 2026

Source: HSBC Asset Management, as of January 2026.

The K-shaped recovery presents challenges for policymakers and may necessitate targeted, rather than universal, support. We expect fiscal policy to be less aggressive than in 2025 as Asian governments continue to strike a fine balance between fiscal prudence and growth support. Several years (or even decades) of improved policy credibility has helped safeguard EM Asia macro stability and kept external imbalances in check, as fiscal consolidation has strengthened debt sustainability. However, external headwinds and weak domestic revenue generation have affected fiscal consolidation efforts of several governments, reducing their fiscal headroom.

Still, we believe fiscal policy stands ready to respond to growth disappointments in Asia (Fig. 5). Fiscal support will likely be targeted and aligned with long-term strategic objectives. India's fiscal rule changes from targeting the fiscal deficit to targeting debt in the FY27 Budget allows the government some flexibility in setting the annual fiscal deficit target. Infrastructure spending remains a key driver and an avenue for ASEAN to participate in AI democratisation. Industrial policy will likely place a high priority on mitigating the vulnerability of domestic industrial ecosystems to trade and geopolitical tensions, as shareholder-friendly / corporate governance reforms in economies such as Korea, Singapore and China should remain supportive of investor sentiment toward regional capital markets.

Fig. 5: Mixed credit/loan growth trajectories



TSF refers to Total Social Financing. FIs refers to financial institutions.
Source: CEIC, HSBC Asset Management, January 2026

Approaching the end of the rate-cutting cycle

Inflation is likely to "normalise" higher across the region this year from a low base but remain benign – within or closer to central bank targets. Food price normalisation and higher gold prices added to the upside recently. Core inflation has firmed in some (e.g., Korea, Malaysia and Singapore) amid solid growth momentum. The worst of China's deflationary cycle appears to have ended, in our view, aided by reflationary policy efforts. But reflation is likely to be a slow burn and requires further reforms on structural rebalancing. This, coupled with a stronger CNY, could mean reduced deflationary spillovers from Chinese exports to the region. A new round of cuts in China to export tax rebates for solar and battery products could be seen as a mini-step toward external rebalancing to temper potential trade tensions. The resultant sector consolidation should be conducive for anti-involution.

We expect monetary policy to be less synchronised this year, as country-specific macro and financial conditions drive divergence. We see the scope of further modest and opportunistic easing in some ASEAN economies. But in general, we see the region as nearing the end of its rate-cutting cycle with the policy outlook hinging on evolving growth-inflation trends and financial stability considerations (including FX volatility). Liquidity conditions should remain supportive of policy transmission and domestic economies. Central banks in economies benefiting more from AI tailwinds could potentially pivot toward a hawkish policy stance, such as Singapore's central bank.

AI tailwinds and challenges

Asia is a critical player in the global AI ecosystem, underpinned by its dominance in cutting-edge semiconductor manufacturing (e.g., in Korea and Taiwan) and innovative software development. India and Southeast Asian economies, especially Singapore, Malaysia and Vietnam, accrue gains through their roles in the AI value chain, from assembly to data centers. Mainland China's technological innovation is poised for strong policy-driven growth in 2026 and beyond, with AI placed at the centre of the country's economic agenda and industrial upgrading plans. Asian governments have generally moved quickly to develop AI strategies and policies to foster an enabling macroeconomic environment. As technology diffusion grows, the benefits of AI could broaden out to include power grid investment, AI-enabled services and productivity gains in complementary sectors.

Asian economies are well positioned to reap productivity gains from AI investment and adoption, on account of their greater digital readiness. This helps to offset long-term growth constraints such as an aging population and global geoeconomic fragmentation. However, a broader AI adoption also raises concerns about potential job displacement, skill mismatches and economic disparities. Government support, such as more effective social safety nets, reskilling programs for affected workers, and regulations to promote ethical use of the technology may help mitigate risks of AI-induced disruptions and achieve an inclusive AI transition.

Source: HSBC Asset Management, as of January 2026.

Asia fixed income

Uncertainties around global policies, global growth, interest rates and AI investments are shaping the current global investment landscape. In this environment, Asian bonds are expected to stay resilient, supported by the region's favourable macroeconomic dynamics, structural reforms, supply chain realignment, and AI development. Economic growth is robust in Asia – particularly in India and ASEAN, inflation in the region remains benign, and mainland China's pro-market stance adds further support. Solid fundamentals, relatively attractive yields and supportive technicals offer additional tailwinds for Asian bond performance in 2026.

Asia credit

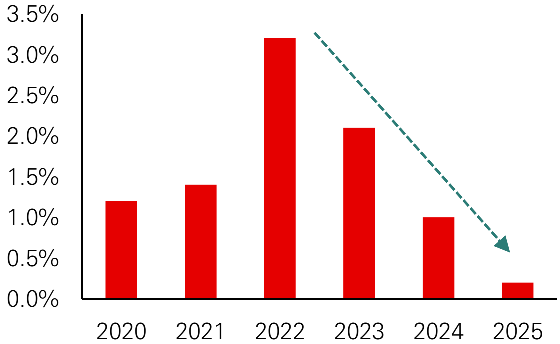
Interest rate support fading, yet overall fundamentals hold firm

Following a strong 8.2% return in the Asia credit market in 2025 – marking the third consecutive year of healthy gains (6.8% annualised)[1] – returns in 2026 may moderate, reflecting the US interest rate outlook and the more limited scope for spread tightening in the Asia investment grade space. However, solid credit fundamentals continue as a key driver of performance. There may be a potential for a cyclical upswing that could compress spreads in 2026 and unlock idiosyncratic alpha opportunities through credit selection.

A robust regional macro environment has helped sustain solid credit fundamentals in the Asia investment grade credit market, with credit rating upgrades outpacing downgrades and default risks staying low. Fallen angel risk has continued to subside, with only about USD 1 billion (accounting for 0.2% of Asia investment grade market) downgraded to high yield in 2025 (Fig. 6). Strong credit profiles of investment grade issuers should help support resilience through periods of market volatility. In the high yield space, default rates have fallen back to the low levels seen prior to 2020 while idiosyncratic risks over the past year have not meaningfully spilled over into the broader market. Asia high yield default rate is forecasted to further improve to 2.5% in 2026,[2] thanks to the clean-up of the sector over the last few years.

Fig. 6: Improving Asia credit fundamentals

Asia investment grade bonds downgraded to high yield



Source: JPMorgan January 2026 report, data as of 31 December 2025.

Valuations and technicals

Credit spreads in both the Asia investment grade and high yield markets are at historically tight levels, and the ongoing compression of spreads has reduced differentiation across rating categories. That said, all-in yields remain compelling.

Within Asia investment grade credit, while spreads remain tight, valuations are relatively attractive due to their shorter duration (Fig. 7). Meanwhile, Asia high yield bonds offer high carry and spread compression potential compared to global peers (Fig. 8).

The technical backdrop of the Asia credit market with a shrinking supply in the past three years has been favourable for the market. Local currency funding should also continue to reduce US dollar supply while broadening sources of income. In 2026, new supply is expected to pick up to about USD 200 billion – though still well below the previous levels seen in 2019-21.[2] We anticipate that this will be well-absorbed as demand in the region remains robust, driven by Asian wealth creation and excess liquidity.

Fig. 7: Investment grade bonds valuations

	Yield (%)	Spread (bps)	Duration (yr)
Asia USD IG Corp	5.0	69	4.2
US IG Corp	4.9	79	6.6
Euro IG Corp*	5.0	77	4.5
EM USD IG Corp	5.3	98	4.9

Note*: Euro IG Corp yields listed are USD hedged.
Source: JPMorgan, BofA, 31 December 2025.

Fig. 8: High yield bonds valuations

	Yield (%)	Spread (bps)	Duration (yr)
Asia USD HY Corp	8.4	443	2.9
US HY Corp	7.1	296	2.9
Euro HY Corp**	7.3	276	2.9
EM USD HY Corp	7.9	364	3.8

Note**: Euro HY Corp yields listed are USD hedged.
Source: JPMorgan, BofA, 31 December 2025.

Note 1: Source is Bloomberg, using JACI Composite, as of 31 December 2025. Note 2: Source is JPMorgan December 2025 report, data as of 21 November 2025.
Source: HSBC Asset Management, as of January 2026.

Asia fixed income (cont'd)

Asia credit (cont'd)

Key views

Within the investment grade market, we see opportunities in select regional bank and insurance subordinated debt, mainland China TMT, Indonesia commodities and utilities. Within the high yield market, we are seeing opportunities in mainland China industrials, India commodities and cyclicals, select India renewables, India financials, regional high yield commodities, frontier sovereigns and select banks.

Asia local currency bonds

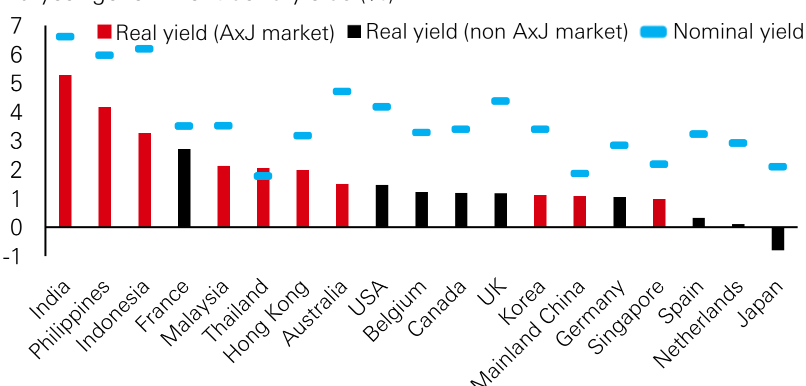
After delivering a 7.8% return in 2025 on a USD unhedged basis,[3] Asia local currency bonds continue to warrant a positive outlook, supported by sound fundamentals in Asian economies, a constructive view on regional currencies, and the relatively high yields (Fig. 9).

Inflation rates in the region are close to or below central bank targets, and there may be room for modest monetary policy easing (Fig. 10). In mainland China, monetary policy is expected to remain moderately loose and will be used to support growth and price recovery, with the flexible and efficient use of various policy tools. The PBoC has also pledged to promote high-level financial opening-up and RMB internationalisation, overall positive for RMB bonds. In India, inflation is expected to stay below the central bank target, leaving room for further monetary easing depending on growth conditions. Coupled with the prospect of a prudent fiscal budget for FY2027, this creates a supportive environment for India bonds. Although Bloomberg's decision on the potential inclusion of India government bonds in its global aggregate index has been deferred to mid-2026, the continued eligibility review means that a positive medium-term tailwind remains in place.

Overall, Asian currencies have been undervalued on a Real Effective Exchange Rate (REER) basis over the past few decades. Asia currencies may strengthen, driven by AI flows, widening rate differential versus the US dollar, stronger external positions and tech supply chain realignment. We expect a modest RMB appreciation in line with the domestic policy agenda. The INR, which has been under pressure, could recover depending on the tariff situation and equity sentiment. The MYR is expected to benefit from domestic growth prospects and supply chain diversion on AI related activities. The KRW's recent correction can be viewed as a medium to longer term opportunity, with potential domestic market reforms and index inclusion serving as drivers.

Fig. 9: Real rates across Asia are attractive

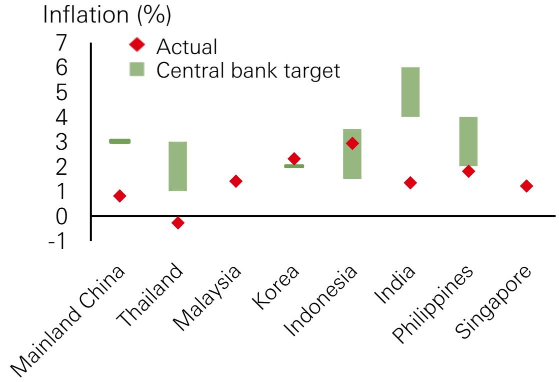
10-year government bond yields (%)



Real yield uses 10-year government bond rate and subtracts latest year-on-year CPI figure as of 12 January 2026. Nominal yield is based on the 10-year government bond rate. Source: Bloomberg, HSBC Asset Management, as of 12 January 2026.

Fig. 10: Inflation is in central bank comfort zone in most major Asia economies

Inflation (%)



Actual CPI figures are latest year-on-year figures released, latest data as of 12 January 2026. Source: Bloomberg, HSBC Asset Management, as of 12 January 2026.

Potential risks

We remain mindful of risks arising from uncertainties around the US Fed's rate cut path, lingering concerns over the global growth outlook, and global policies. Additionally, idiosyncratic credit events, such as issuer-specific issues, may cause short-term market fluctuations, as we have seen in late 2025.

Note 3: Asia local currency bonds: Markit iBoxx ALBI Index Unhedged USD. Source is Markit, Bloomberg, 31 December 2025.
Source: HSBC Asset Management, as of January 2026.

Asian equities

The Asia Pacific ex Japan equity market demonstrated remarkable resilience and growth in 2025, achieving a 32.3% return in USD terms, the best annual performance since 2017.[4] The region outperformed global equities and US equities by 7.2% and 11.7%, respectively, during the year.[4]

Globally, market leadership and corporate profits are expected to keep broadening out, especially to Asia and other emerging markets. This indicates that economic de-risking and improved policy have potentially made Asia structurally less volatile. Asia's overall economic outlook remains favourable for equity markets, supported by regional trade integration, resilient domestic demand, and accommodative fiscal and monetary policies. The outlook for Asian equities in 2026 remains constructive, with markets offering broad sector diversification and high-quality growth opportunities.

Potential risks to the Asian equity market, which we closely monitor, could stem from geopolitical events, US-China relations, AI super cycle marked by elevated valuations, and trajectory of the monetary easing cycle.

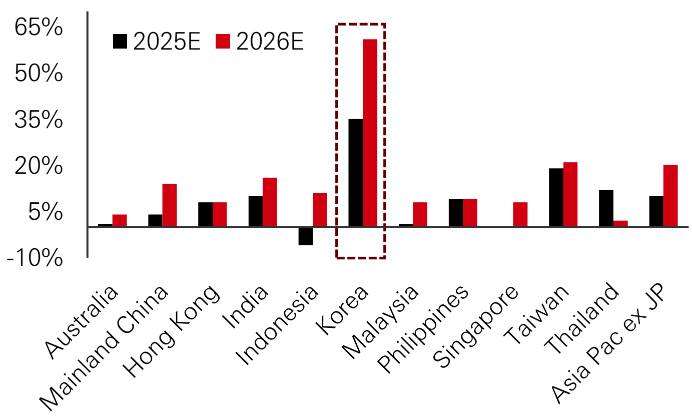
Earnings growth and valuations

Looking ahead, Asian equities should continue to be supported by solid earnings outlook, proactive policy measures, structural reforms, and technological advancement. Earnings growth is forecasted to accelerate from 10% in 2025 to 20% for Asia Pacific ex Japan equities in 2026, led by strength in Korea and Taiwan (Fig. 11).

While valuations have risen, they continue to stay reasonable overall, trading at 14.8x 12-month forward P/E (Fig. 12). Most Asian markets are trading around their long-term average forward P/E ratios, while Korea and parts of ASEAN screen notably cheap relative to history. Regional valuation disparities highlight the diversity of return opportunities, emphasising the importance of active management in navigating this environment.

Fig. 11: Earnings growth remains solid

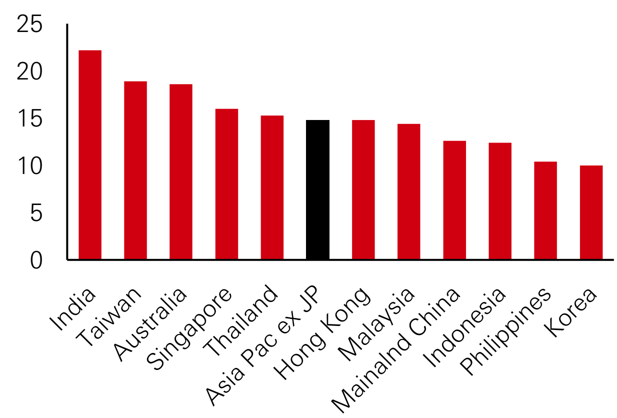
Market consensus EPS growth (%)



Source: IBES, Goldman Sachs Research, 10 January 2026; Asia Pac ex JP refers to the MSCI Asia Pacific excluding Japan index.

Fig. 12: Asian markets' valuation underpinned by strong earnings growth and solid fundamentals

12-month forward P/E ratio (x)



Source: MSCI, Bloomberg, Goldman Sachs Research, 10 January 2026; Asia Pac ex JP refers to the MSCI Asia Pacific excluding Japan index.

Korea and Taiwan

Within the region, Korea and Taiwan stood out in 2025, posting gains of 99% and 39%, respectively.[4] We believe that AI-related sectors can continue to be a market driver in 2026, with Korea and Taiwan—markets with high contribution to AI innovation—poised to benefit further. Any acceleration in global AI capex is positive for Korea and Taiwan, as both have high exposure to key semiconductor and IT hardware segments that benefit from increased spending on AI servers and data centers. This includes Korea's strength in memory and high bandwidth memory (HBM) and Taiwan's concentration in advance chip manufacturing. Additionally, further progress on corporate governance reforms in Korea would be well received by investors and could potentially boost market sentiment.

Note 4: Asia Pacific ex Japan equity: MSCI AC Asia Pacific ex Japan Net Total Return USD Index; Global equity: MSCI AC World Net Total Return USD Index, US equity: S&P 500 Index (TR), Korea equity: MSCI Korea Net USD Index, Taiwan equities: MSCI Taiwan Net USD Index. Source is Bloomberg, MSCI, 31 December 2025.
Source: Bloomberg, HSBC Asset Management, as of January 2026

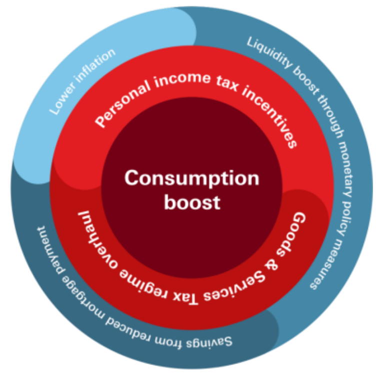
Asian equities (cont'd)

India

Indian equities returns were relatively muted in 2025, but we expect a potential reversal in 2026. The market is expected to benefit from the domestic economy's strong structural growth drivers, the government's ongoing reform initiatives – including last year's overhaul to the Goods & Services Tax (GST) regime, accommodative central bank policies, and a continued structural shift in household savings. Moreover, the national budget, to be announced in February, could act as a driver for the market. Externally, any moderation in tariffs between the US and India could serve as a meaningful catalyst, particularly for export-driven sectors, though it is worth noting that India's exports of goods to the US is only 2% of GDP. Overall, policies aimed at fostering economic growth, infrastructure development, and job creation are likely to support investor sentiment and reinforce the structural themes driving India's long-term investment potential.

While Indian equities' valuations are relatively rich, they have moderated and the P/E premium over Asian peers has narrowed. The latest earnings season reflects stronger cyclical/profit growth momentum under a supportive policy environment, despite clear divergence.

Fig. 13: India's drive to push consumption growth amid GST overhauls and tax cuts



Source: Reserve Bank of India, HSBC Asset Management, December 2025.

Our strategy maintains a focus on large-cap stocks with solid earnings growth. We have a preference for financials – including private sector banks, non-banking financial companies, and structural domestic plays such as asset management firms. We also favor the real estate sector, driven by a strengthening demand upcycle, and consumer sectors, both staples and discretionary, where GST reforms and tax incentives are expected to benefit consumers.

China

Chinese equities could continue to see momentum in 2026, following last year's 31.2% return.[5] China's macro policies are expected to stay supportive of economic growth and capital markets. Combined with China's export and manufacturing competitiveness, this should help provide a cushion against potential headwinds. Aside from pro-market policies, other market drivers include innovation, capital flows and corporate earnings.

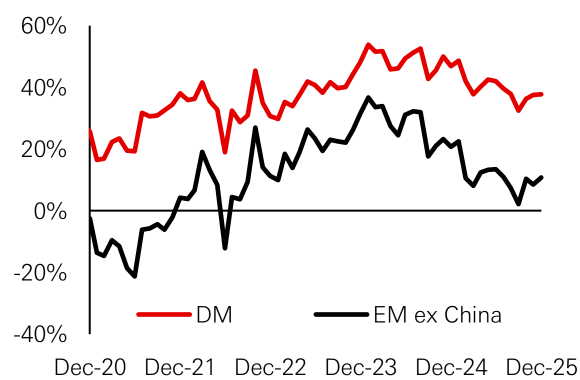
China is clearly positioning innovation as a pillar of the country's long-term strategy. Chinese companies are increasingly holding leading roles in areas of AI, robotics and innovative drugs. Overall, growing AI adoption and tech breakthroughs should enhance productivity and benefit AI-related names.

Capital flows from domestic investors should continue to drive the market, even following the record high inflows in southbound capital flows into Hong Kong listed equities last year. Generally, the relatively low equity participation and the huge amount in excess savings by mainland Chinese households indicate that there is significant room for reallocation towards equities that could result in meaningful inflows.[6] In the context of global portfolios, Chinese equities' low correlation with other major markets (at 0.33 vs developed markets)[7] and attractive valuation discounts could encourage more global inflows (Fig. 14).

Fundamentally, Chinese equities' corporate earnings are seeing signs of stabilisation, with a structural improvement in return on equity (ROE), which has been underpinned by corporate driven actions, shareholder return initiatives, government support for the private sector, and new tech leaders.

Fig. 14: Chinese equities trade at a discount

MSCI China discount on forward P/E



Source: Goldman Sachs Research, December 2025.

Note 5: Chinese equities represented by MSCI China Net USD Return. Source is Bloomberg, MSCI, 31 December 2025. Note 6: Goldman Sachs Global Investment Research, November 2025. Note 7: Based on weekly correlation between Chinese equities (MSCI China Index) and developed market equities (MSCI World Index) over 5 years. Source is MSCI, Bloomberg as of 31 December 2025.
Source: HSBC Asset Management, as of January 2026.

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