Asia FX Update:

Risk dynamics and USD weakness dominate

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Treasury Research & Strategy
Global Treasury

Terence Wu
(+65) 6530-4367
TerenceWU@ocbc.com

OCBC Bank

Asian FX Key Themes

- Economic outcomes remain depressed – that is a fact (p. 3-5, 7). It is also a fact that the outcomes are mostly in-line if not better than estimates (p. 8). However, this could be a factor of overly pessimistic estimates in the first place. Nevertheless, the glass-half-full interpretation in terms of macro trajectory is hard to shake up (p. 10). The broader portfolio flow environment for Asia remains challenging, but the sustained market optimism has resulted in greater interest in traditional high-yielders (p. 13-14). In terms of Asian govie bonds, expect the IDR bonds to outperform in the near term.

- **Summary of research view**: How the Sino-US tensions evolved since it re-emerged in the front pages have been light on the actual policy front. Thus, its impact on broader USD-Asia pairs seemed to be limited. Instead, USD-Asia has broadly tracked broad USD prospects (p. 11). However, the impact is still clear to see within China and the RMB complex, and we expect it to keep the RMB complex under pressure, and underperforming against the rest of the Asian currencies (p. 12). Overall, we still expect South Asian currencies to outperform the North. On the SGD front, ongoing USD weakness may keep the SGD NEER just above the parity level, but we see this dynamic as temporary. Domestic economic imperative should instead drive the SGD NEER below the parity level on a more permanent basis. Overall, with the lack of strong upside impetus in the SGD NEER, the decline in USD-SGD should stay largely USD-driven for now. Expect 1.3850 to be a floor on a multi-session horizon (p. 16).

Short term FX/bond market views and commentary

	USD-Asia	10y govie (%)	Commentary
China	↔/↓	↔/↑	NPC highlights include higher targets for fiscal deficit ratio and aggregate social financing growth. This leaves room for more fiscal and monetary stimulus, although a big-bang stimulus may not be immediately obvious. Loan relief for SMEs extended to Mar 2021. Recovery after the re-opening of the economy is under way, but data suggests that it will be a slow grind. Sino-US tensions are raised after a new security law imposed on HK. However it remains very much a war of words for now. May Caixin manufacturing PMI are back in expansionary territory, but the official gauge dipped lower compared to April. Apr industrial production continue to print better than expected but retail sales continue to weigh heavily. April exports rose 3.5% yoy, against expectations of -11.0% yoy. 1Q GDP at -6.8% yoy vs. expected -6.0% yoy. Apr CPI prints continue to be softer than expected at 3.3% yoy, while the PPI shows -3.1% yoy. Apr growth in monetary aggregates were firmer than expected. Short term gyrations in the USD-CNH and USD-CNY will be Sino-US headline driven, but expect the PBOC to be always at hand to keep it under a lid.
S. Korea	↔/↓	↔	The BOK cut its policy rate by 25 bps to 0.50% in its May meeting, and downgraded the FY2020 growth forecast to -0.2% yoy, from 2.1% yoy. For now, further cuts may not be forthcoming given that conventional policy room is now limited. If conditions worsen, the BOK may instead have to adopt asset purchases. Bond markets rallied in response. Man. PMI dipped for the fifth consecutive month in May to 41.3, from 41.6. May exports slumped -23.7% yoy, while imports also contracted -21.1% yoy, with no end to pain in sight for the trade sector. Industrial production also declined -6.0% yoy in Apr. May core and headline CPI in line with estimates are 0.5% yoy and -0.3% yoy. Expect the USD-KRW biased higher, with Sino-US headlines being the near term driver and heavy economic prints being the structural driver.
Taiwan	↔/↓	↔	The CBC still has room to cut its policy rate, although fiscal policy is playing a larger role in supporting the economy. FY2020 growth forecast cut to 1.3-1.8% yoy. 1Q GDP growth at 1.59% yoy, firmer than estimates. May man. PMI slipped further to 41.9, from 42.2 prior. April exports printed -1.30% yoy, slipping further from the Mar numbers. Apr headline CPI at -0.97% yoy, worse than expected. Do not rule out some upside pressure for USD-TWD for now.

Short term FX/bond market views and commentary

	USD-Asia	10y govie (%)	Commentary
Singapore	↔/↓	↔	1Q GDP printed -4.7% yoy saar and -0.7% yoy. Ugly, but better than estimates. Official growth forecast downgraded again to -7.0% to -4.0% yoy, from -4.0% to -1.0% yoy. The Fortitude Budget was larger than expected, underlying the role of fiscal policy as the main support for the economy. MAS still regards monetary policy as appropriate, so the SGD NEER is not likely to dip towards the bottom end of the policy band. However, the SGD NEER should slide organically to account for the worsened macro expectations. Apr NODX rose 9.7% yoy vs. mkt. expectation of -5.0% yoy, still supported by pharma exports and a low base effect (Sino-US trade war in 1H 2019). Apr headline and core CPI printed -0.7% yoy and -0.3% yoy respectively, softer than expected. May official PMI prints failed to recover from the previous month's depressed readings, coming in at 27.1, vs 28.1 prior. 1.4000 may be an interim locus for USD-SGD, before 1.3850 supports on a multi-session horizon.
Thailand	↓	↔/↑	BOT cut policy rates further by 25 bps, in a close 4-3 vote in the committee. 1Q GDP fell 1.8% yoy, against expectations of a -3.9% yoy contraction. Official growth forecast downgraded to -6.0% to -5.0% yoy. Even as the economies reopen, the tourism-reliant Thai economy may not see a strong recovery so long as global travel does not pick up. May man. PMI recovered to 41.6 from 36.8, but remained deep in in the contractionary zone. April custom exports grew at 2.12% yoy, defying estimates of a -3.00% decline. Imports however, slumped -17.13% yoy. May headline CPI printed -3.44% yoy, with core CPI also coming in softer than expected at +0.01% yoy. Although the BOT expects May to be a trough for price pressures. Expect the USD-THB downside to be limited for now, with the BOT sounding concerns over THB strength.
Malaysia	↔/↓	↔/↑	1Q GDP turned out firmer than expected at 0.7% yoy, supported by strong private consumption. A contraction is expected in 2Q, with consumption hampered by MCO restrictions. BNM cuts its policy rate by 50 bps in April. It appears that the BNM is putting priority on growth at this stage. Further cuts by the BNM may stay relatively muted in the coming months. May man. PMI recovered to 45.6, from 31.3 prior. Apr exports slumped -23.8% yoy, hit by soft global demand and MCO restrictions. A breach of 4.2850/00 in the USD-MYR may see it capitulate lower towards 4.2500.

Short term FX/bond market views and commentary

	USD-Asia	10y govie (%)	Commentary
India	↔	↔/↓	The RBI cut its policy rate by 40 bps to 3.35% in an emergency meeting on 22 May, and implied that it could ease further. The RBI also extended the moratorium on loan repayments for three months. The RBI expects the economy to contract in the fiscal year through Mar 2021. Selected relaxation of restrictions for certain industries and offices are under way, even though the virus count continue to rise. 1Q GDP printed 3.1% yoy growth, better than the estimated 1.6% yoy. May man. PMI recovered marginally to 30.8, from 27.4 prior. This suggests that India may be lagging in terms of restarting the economy compared to the other Asian economies. Apr exports shrank -60.3% yoy, highlighting the supply chain disruption in the economy. USD-INR still exhibits a supported stance, but may turn heavy on USD weakness.
Indonesia	↔/↓	↓	The BI kept rates unchanged again at 4.50% on 19 May, preferring to prioritise IDR stability. Nevertheless, the BI continue to see scope for further cuts. 1Q GDP at 2.97% yoy, with further softening expected in 2Q and 3Q. Fiscal deficit currently expected to be at 6.30% of GDP, and increased issuance is expected to finance spending. May headline and core CPI at 2.19% and 2.65% yoy respectively, continuing a decline on a monthly basis. May man. PMI edged up slightly to 28.6, from 27.5 prior, perhaps one of the weakest in the South Asia for now. April exports slumped 7.02% yoy, worse than the expected -3.95% yoy. Latest bond auction saw a strong response, with bid-to-cover ratio at more than 5x. Inflow momentum has also returned, especially on the bond front. Expect this to translate into lower back-end yields.
Philippines	↓	NA	The BSP is highlighting a pause from rate cuts after substantial easing this year, although the room to cut is still present. Calls for fiscal support is also stepped up. BSP open to purchasing more government securities in light of the COVID-19 hit. 1Q 2020 GDP shrank -0.2% yoy, against expectations of 2.9% yoy. 2Q GDP expected to take a bigger hit compared to 1Q. Apr CPI firmer than expected at 2.2% yoy, firmer than expected. May man. PMI recovered to 40.1, from 31.6 prior. Feb exports grew by a softer than expected 2.8% yoy. Feb remittances grew 2.5% yoy, softer than expected.

COVID-19: Daily number of confirmed cases turning higher

- Total confirmed cases has topped 6.5m, and the daily growth of new cases seemed to be turning up again.
- Vaccine-related headlines have taken a back seat, and it seems like we are nowhere closer to a workable vaccine. Positives may be drawn from a lower fatality rate, and a higher recovery rate. Both developments should reduce the pressure on healthcare resources globally.
- Charts drawn from the daily [COVID-19 Monitor](). Please refer to the publication for further details.

Chart 1: Total confirmed cases globally reached 6.56 million

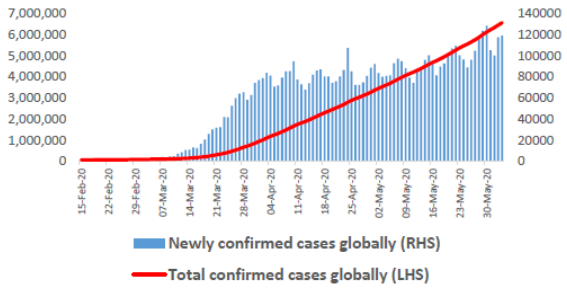


Chart 2: Top 10 countries with no. of confirmed cases (tests per million)

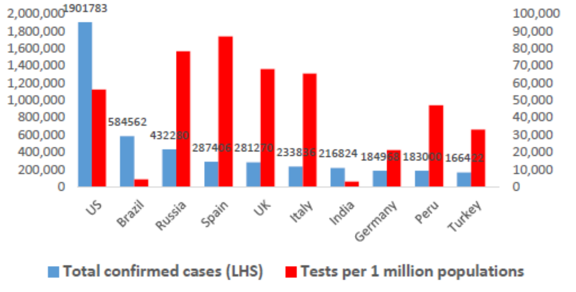


Chart 21: Europe reported the highest fatality rate

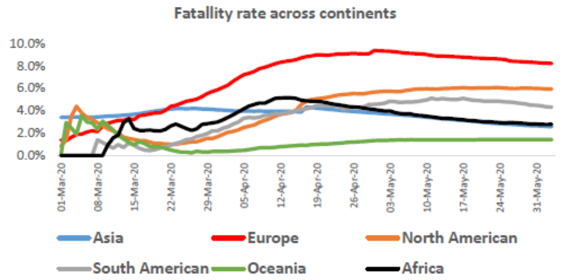
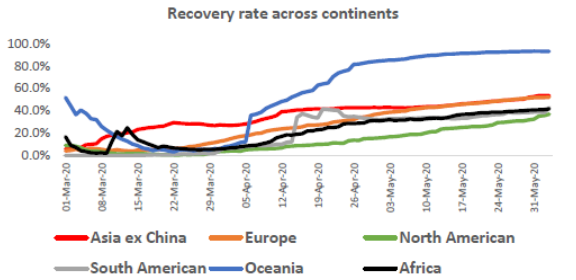
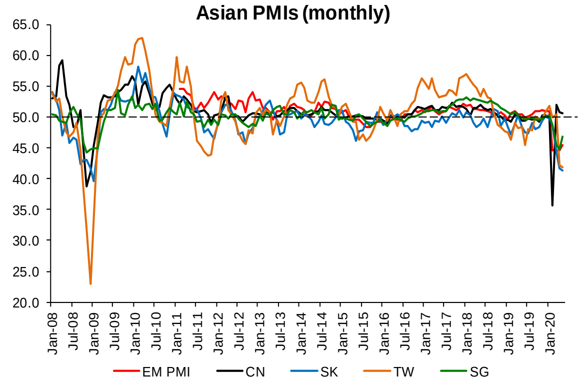


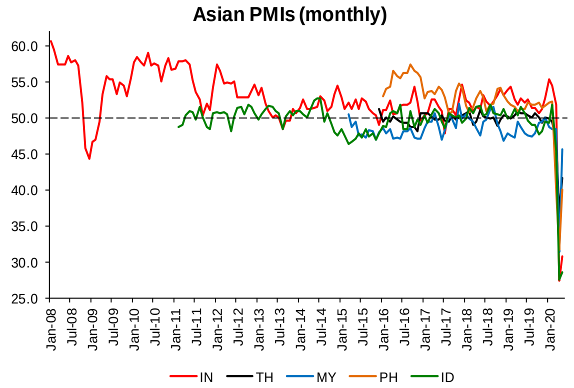
Chart 22: Recovery is picking up

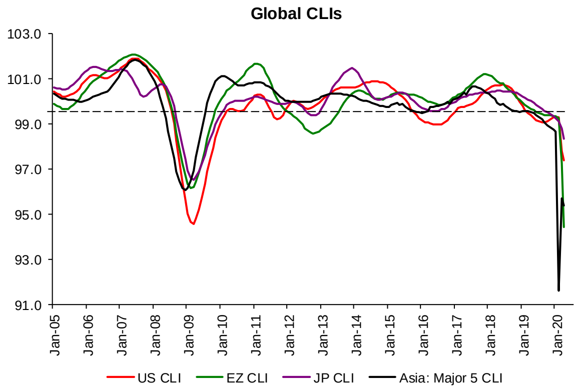


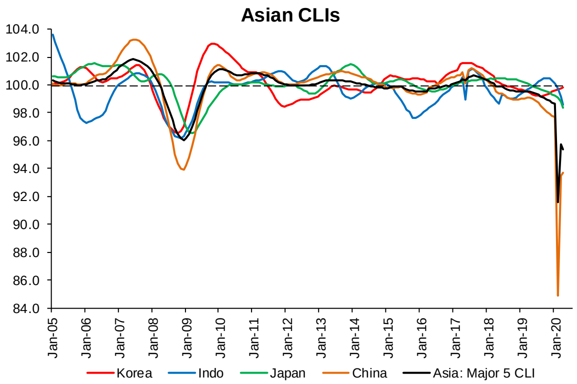
Macro trajectory: Really a V?

- Manufacturing PMIs in South Asia saw a rebound in May – perhaps not surprising after printing heavily depressed figures in April. Countries like Thailand, Malaysia and Philippines saw a good jump back to the 40s level, while India and Indonesia are relative laggards with small improvements.
- More worryingly, PMI prints in North Asia and Singapore continued to slip. At this juncture, PMI sub-indices also suggest that global supply chains have yet to smoothen out.
- **Markets have started to price in a V-shaped recovery. However, a multi-month decline in PMIs akin to 2008 cannot be ruled out just yet.**



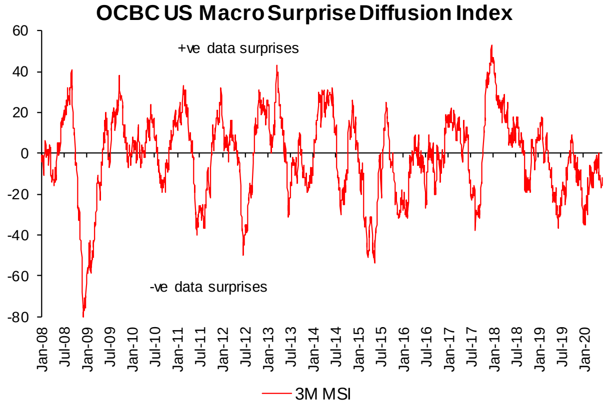


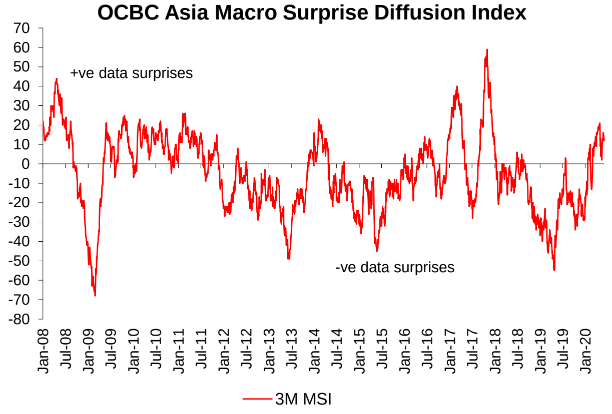


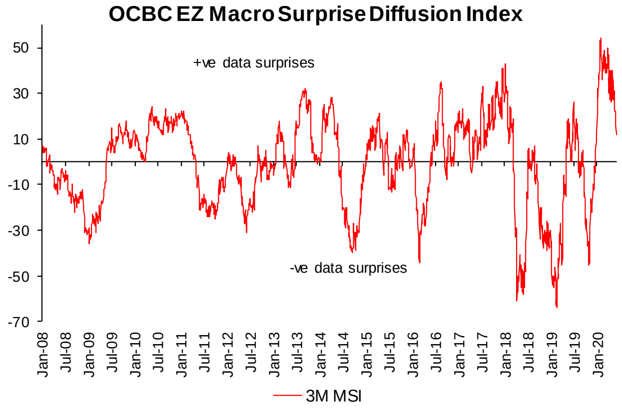


Macro trajectory: Really a V?

- The deep troughs in 2008 seen on our Macro Surprises Indices (MSI), which track actual data outcomes against consensus estimates, have not materialized this time. In fact, the MSIs still look broadly supported in Asia and the US.
- Market participants have interpreted this as the global economy being less impacted than expected, thus explaining the positivity. However, do note that this could also be a reflection of consensus estimates being overly weak, which is not inconceivable in the context of an economic shutdown. **The fact remains that the actual data-prints remain very depressed by usual standards, and the evidence points more to a shallow, gradual recovery than a rapid V-shaped one.**

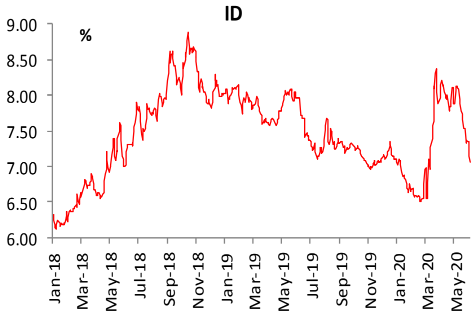


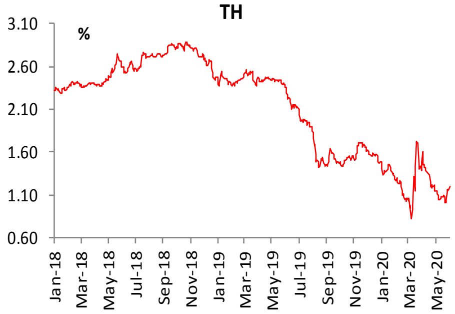


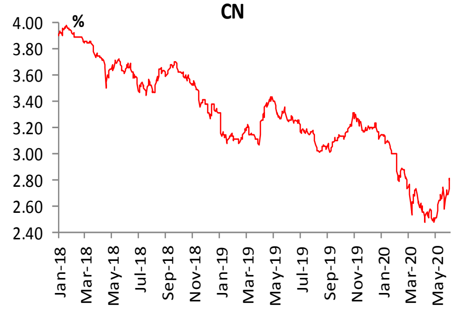


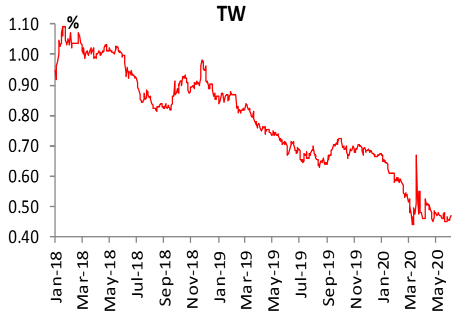
Asian 10y yields: Change of tack at PBOC?

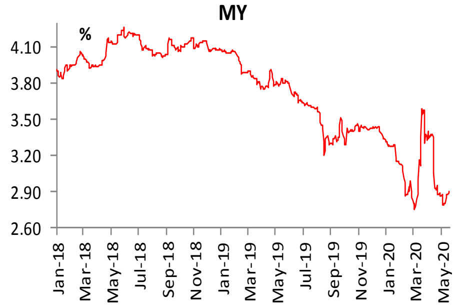
- The PBOC launched a credit support plan to support loans to SMEs earlier this week, but Chinese yields rose as the market questioned if it is a replacement for broader monetary easing. This may keep the low-yielders, especially North Asian yields supported until there is further clarity. **On the flipside, with macro optimism growing, expect a rotation towards traditional high-yielders like Indonesia and Indian government bonds to take advantage of the yield differential** – note that bond inflows into both countries have already picked up (p. 14-15).

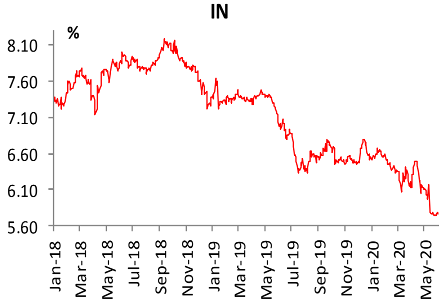


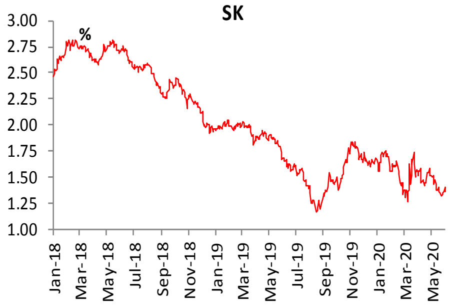


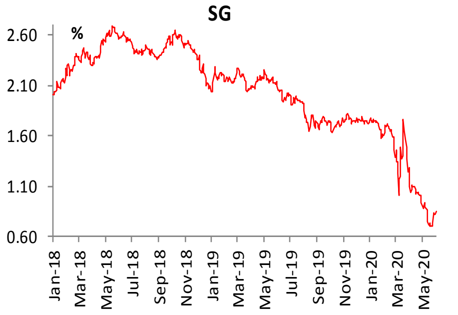






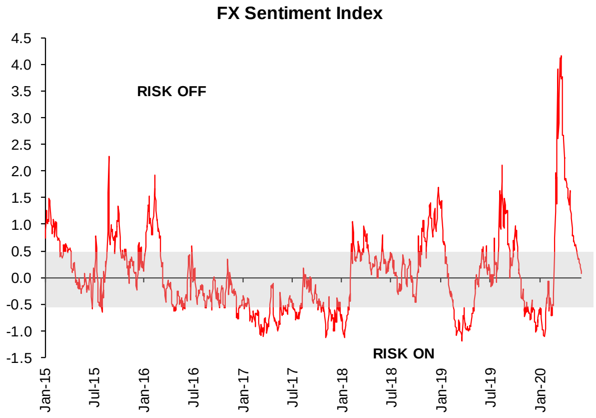


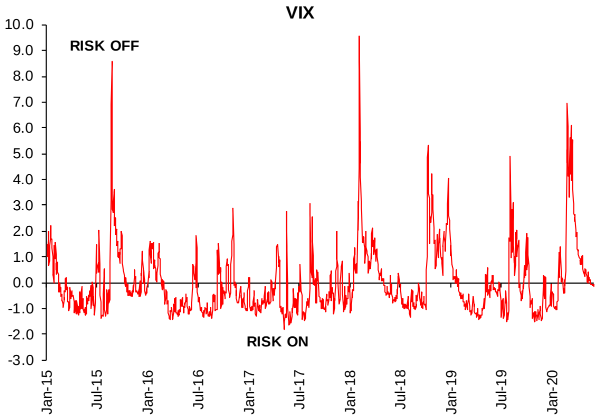


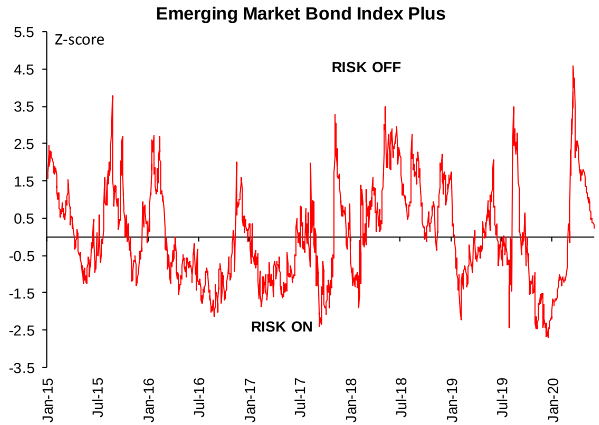


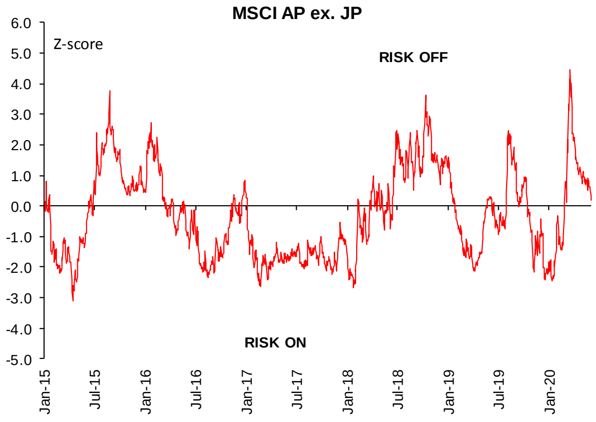
Risk rally going strong

- Investors are gripped by the notion of a potentially swift economic recovery. The **FX Sentiment Index** (FXSI), along with some equity-related sub-indices, has moved into the Risk-On half of the scale – something that is not seen since mid-February.
- Negative geopolitical developments are far in the background at this moment. Initial market concerns over Sino-US tensions have very much fizzled out. **The fundamental stance on both sides still seems to be keeping the Phase 1 agreement intact**, and exchange verbal barbs and low-impact policy tweaks like airline access in the meantime. These are not going to derail the current risk-on mode.









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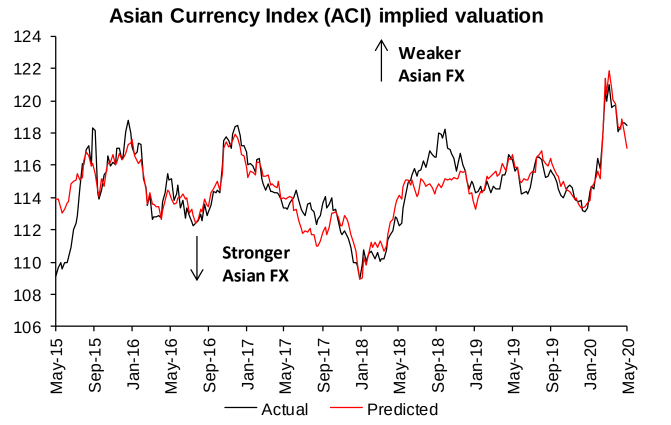
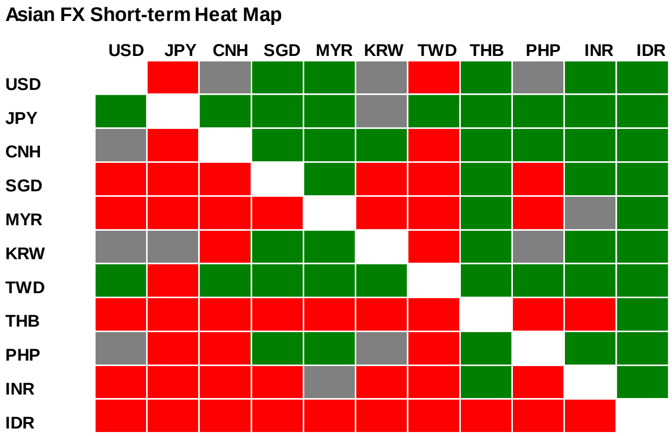
USD-Asia heavy on broad USD weakness

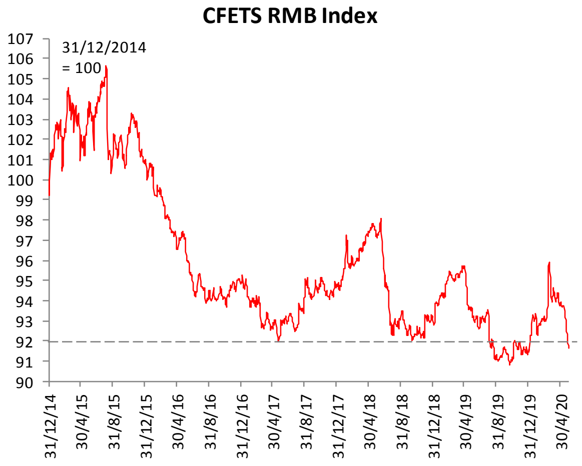
- Market optimism proved to be more enduring than we previously thought, and the risk premium factored into the broad USD is being consistently undermined. USD-Asia has moved yet lower. **Going forward, for the next leg of USD-Asia directionality, we watch for two issues: (1) the sustainability of the current risk rally, and (2) downside support levels for USD-Asia pairs.**
- At present, we are hard-pressed to find any catalysts that may jeopardize the risk rally. Data-prints are not rosy, but the glass-half-full interpretation will be hard to shake out. Thus, there is argument for further downside for USD-Asia. However, this should be seen in the context of the extent of USD-Asia moves so far. The USD-IDR, in particular, have already returned to pre-COVID levels. Material downside supports are coming into view, and we think this should limit the pace of USD-Asia downside.
- **We continue to see no justification for explicit Asian FX weakness in the near term. Thus, USD-Asia to track the broad USD for now. Overall, we expect South Asian currencies to outperform, being less responsive to Sino-US issues and better flow dynamics.**

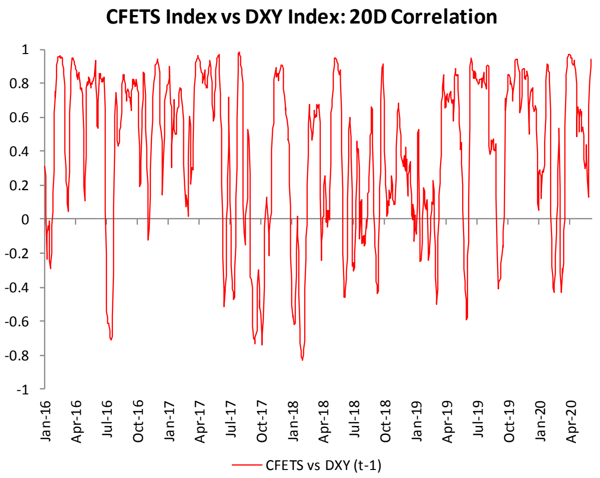


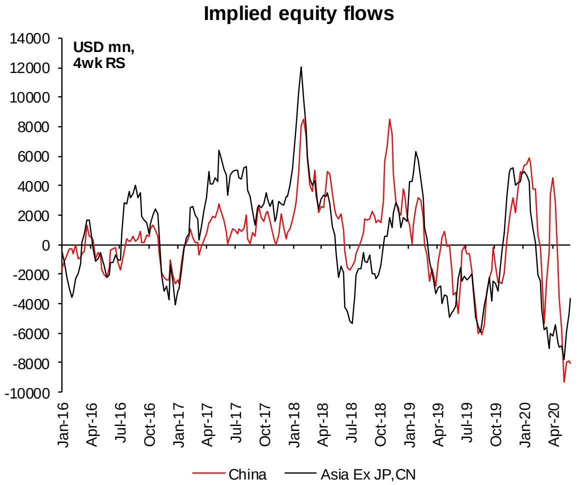


Look harder for impact of Sino-US issues

- The impact of Sino-US tensions seemed to be isolated to China and the RMB complex for now. Note that despite the recovery in implied equity flows across Asia (ex. JP, CN), the same recovery has bypassed China. Outflow momentum from China is actually at the highest since 2015.
- Despite the decline in USD-CNY, the sharp decline in the CFETS RMB Index complex has not abated. Instead, it has continued to track the DXY lower. This suggests that the RMB is underperforming the rest of Asia. **Going forward, even though the Sino-US tensions may not have a larger impact on USD-Asia, we expect it to put pressure on the RMB complex, and cause it to underperform the rest of the Asian currencies.**







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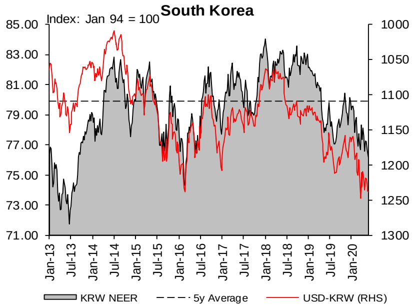
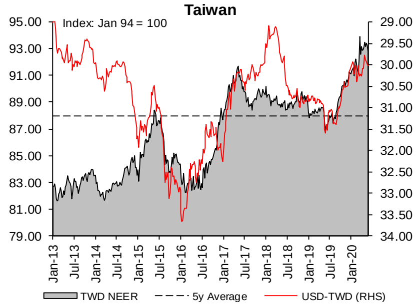
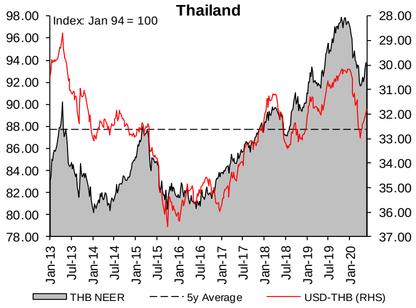
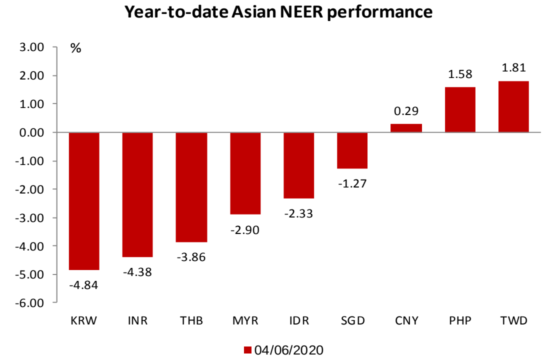
NEERs: North Asians compromised by Sino-US issues

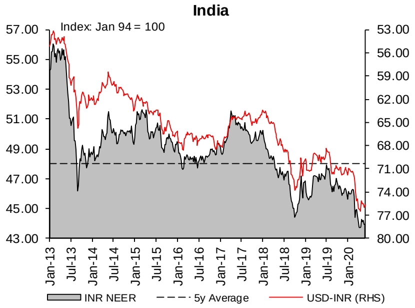
- North Asians, especially the RMB, underperformed since the previous Update. However, the likes of KRW should catch up on USD weakness, especially since Sino-US issues have proven to be less pressing than first expected. Meanwhile, the turn higher in THB NEER have attracted BOT attention. Expect THB strength to be contained in the coming weeks.

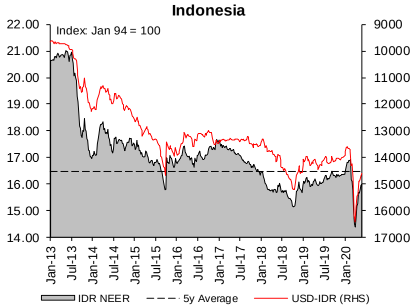


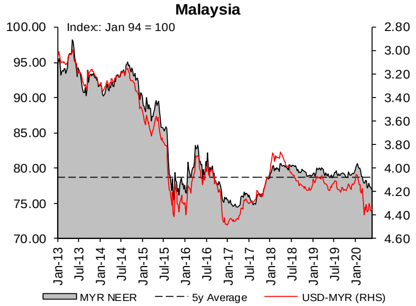


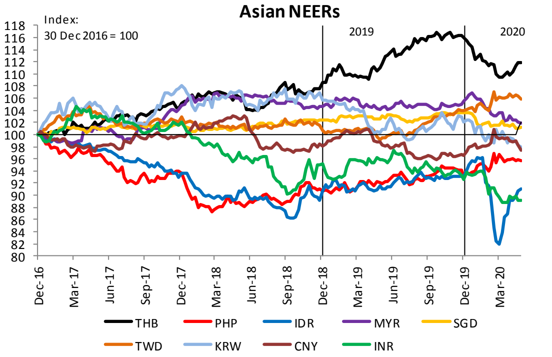






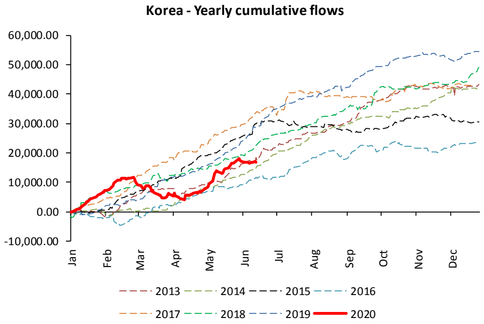


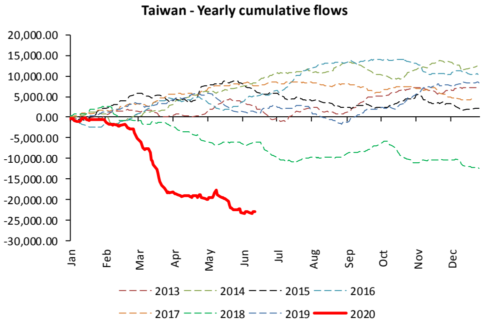


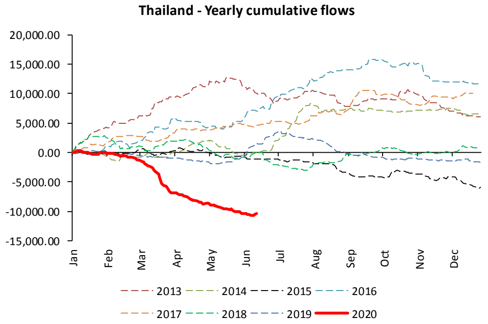


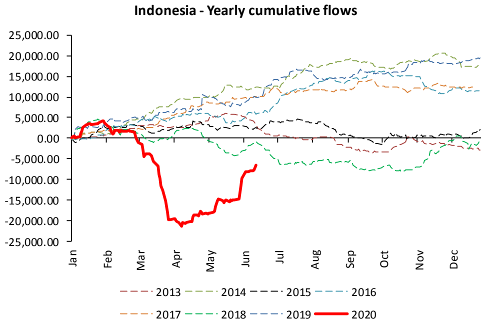
Asian portfolio environment has mostly worsened…

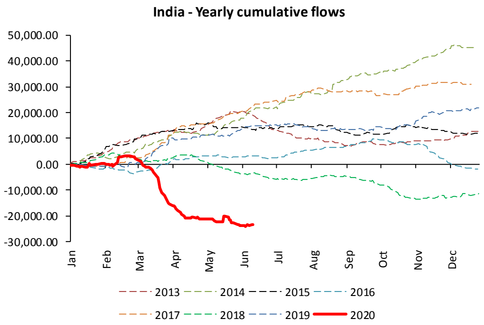
- In particular, inflow momentum into South Korea has stalled, and equity outflow momentum from Taiwan is picking up pace. Indonesia, however, has seen a resurgence in bond inflows as optimism in the macro recovery re-ignites the search for yield dynamic.

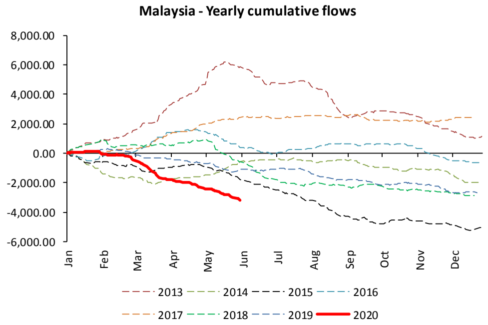












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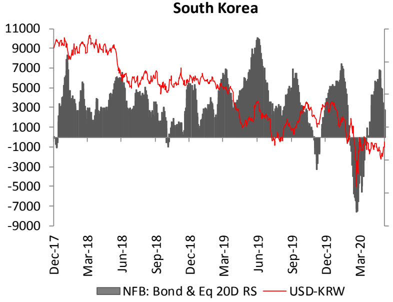
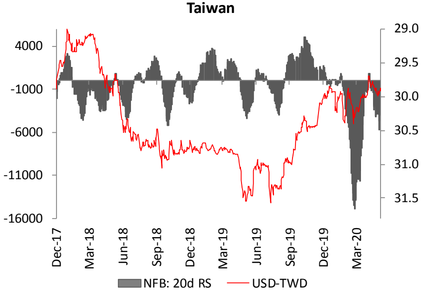
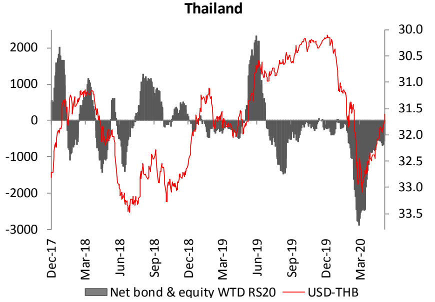
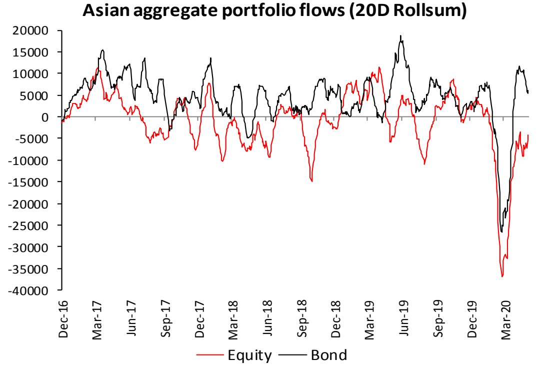
…however USD-Asia has not reacted as expected

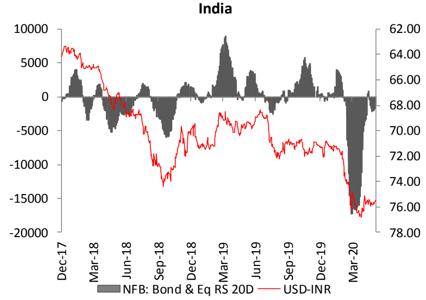
- With the exception of USD-TWD and USD-IDR, portfolio flow dynamics have not materially driven USD-Asia. The other USD-Asia pairs – such as USD-MYR, USD-THB and USD-KRW – have mostly reacted to USD weakness instead.

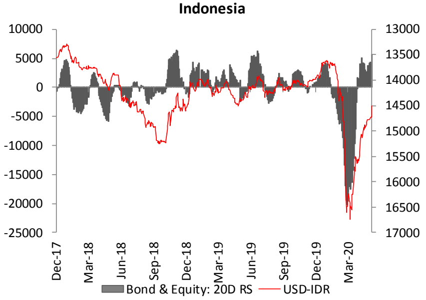


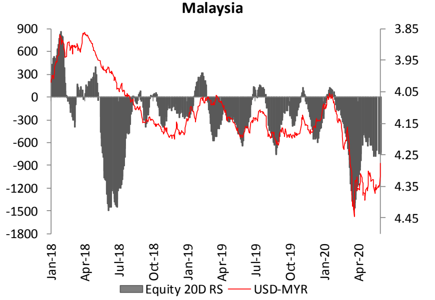


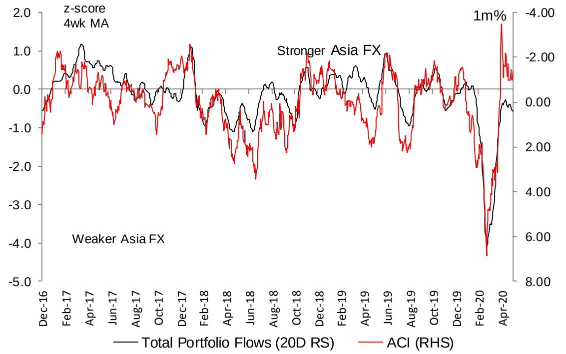






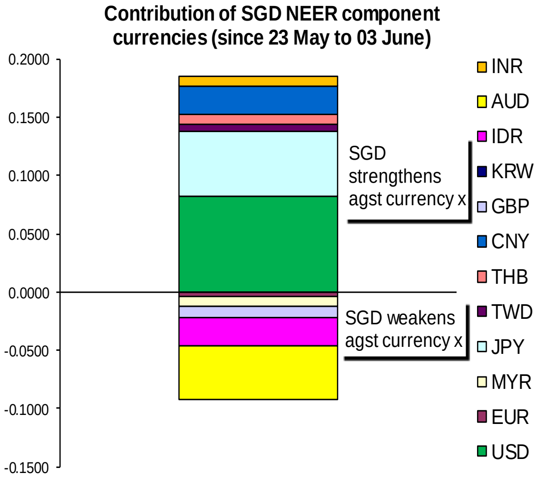


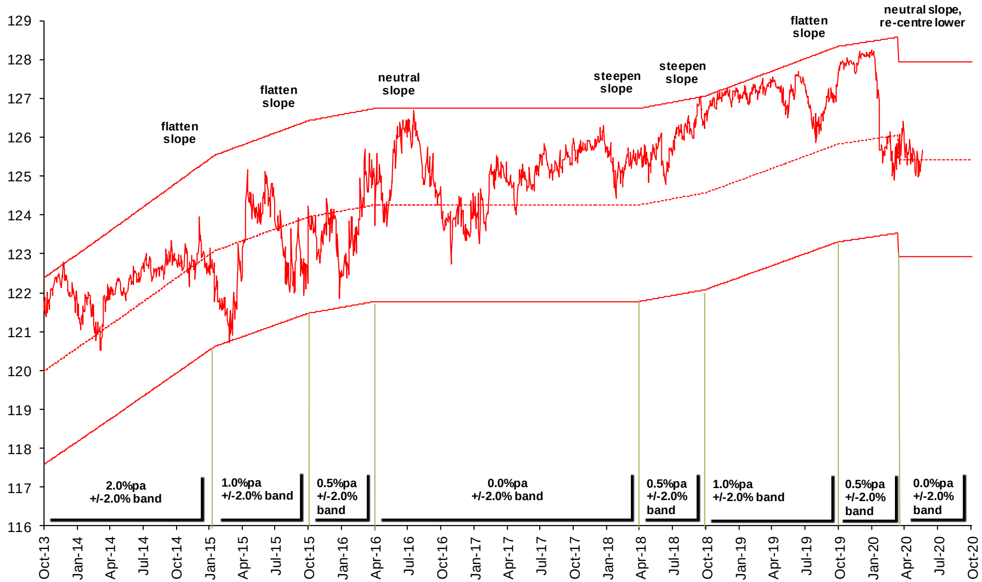




SGD NEER: USD weakness supports for now

- We still lean towards downside risks for the domestic economy, and this informs our fundamental view that the SGD NEER should be slightly below parity (up to -0.50%) to account for that. Admittedly, broad USD weakness may have placed a floor on the SGD NEER temporarily, but we still prefer to await firmer evidence that the recovery is stronger than expected before we review our stance on the SGD NEER.
- Going forward, we still do not expect the SGD NEER to organically strengthen. Thus, the USD-SGD is expected to mainly track broad USD prospects. With downside supports breached quickly, we expect 1.3850 to be a firmer support on a multi-session horizon.





OCBC Bank

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Research & Strategy
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Howie Lee
Thailand, Korea & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu
Hong Kong & Macau
dicksnyu@ocbcwh.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com

Co.Reg.no.:193200032W

OCBC Bank