Asia FX Update:

Starting the year with optimism

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Treasury Research & Strategy
Global Treasury

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Asian FX Key Themes

- The signing of the Sino-US Phase 1 deal is expected on 15 Jan, with investors on the lookout for the final details. The base case is a partial roll-back of the tariffs implemented in Sep 2019, translating to a “tariff-neutral” USD-CNH level just south of 7.0000. Coupled with a rebound in the USD, the decline in USD-Asia may be curtailed in the interim. Nevertheless, with positive risk sentiment still in play and ongoing macro consolidation, any USD-Asia upward extension may have little traction, and we are still biased for a lower USD-Asia beyond the immediate horizon.

- **Research view:** The divergence between the perceptibly lower USD-KRW and USD-TWD compared to levels just before the in-principle agreement and the more resilient USD-CNH is jarring. Both pairs may be overextended to the downside relative to tariff roll-back expectations. We prefer TWD to KRW on relative macro terms. Elsewhere, US-Iran tensions may potentially translate into a drawn-out affair, and translate to a structurally firm crude. This should weigh on an INR which has not benefited much from the trade progress. **Overall, prefer to stay negative on the KRW against the USD and TWD, and the INR against the USD.**

Short term FX/bond market views and commentary

	USD-Asia	10y govie (%)	Macro commentary
China	↓	↓	The impending finalization of the Sino-US Phase 1 deal, the unilateral reduction of selected tariffs, increased support for private sector, and further reserve ratio cuts – all steps that create a sense of positivity despite the still-anaemic economic growth. A slight improvement in a range of indicators, but still expect the PBOC to persist on a gradual easing bias. Dec official man. PMI unchanged at 50.2, although the Caixin gauge slipped slightly to 51.5 from 51.8. Nov exports contracted -1.1% yoy, against expectations of a 0.8% growth. Nov CPI better than expected at 4.5% yoy on one-off factors, PPI contracted by less than expected. Nov aggregate financing and new yuan loans better than expected, although money supply growth was under expectations. Nov industrial production and retail sales exceeded expectations, with the industrial production figure outperforming by a good margin.
S. Korea	↓	↔/↓	Some room for cautious optimism, especially with the Sino-US Phase 1 deal almost finalised. Although the BOK is still officially open to more rate cuts, the bar may be high after two cuts in 2019. Expect fiscal policy to pick up the slack in 2020. 3Q GDP growth decelerated further to 0.4% yoy, slowest since the financial crisis. Dec man. PMI at 50.1, fourth consecutive months of improvement. Nov exports continued to slump, printing a worse than expected -14.3% yoy. Imports also declined by more than expected. Nov core and headline CPI came in at 0.6% yoy and 0.2% yoy, worse than expected. Nov industrial production contracted -0.3% yoy, marginally less than expected.
Taiwan	↓	↔/↓	CBC static at 1.375% in Dec, with slight negative output gap and stable inflation outlook in 2020. Sounder fundamentals compared to Korea allows it to attract equity inflows, providing support for the TWD. 3Q GDP growth exceeded expectations at 2.91% yoy. Dec man. PMI tipped back into expansion zone at 50.8, from 49.8 prior. Trade sector firm, with export growth at 3.3% yoy in Nov. Nov headline CPI missed expectations at 0.59% yoy. Nov industrial production also firm at 2.15% yoy, stronger than expected.

Short term FX/bond market views and commentary

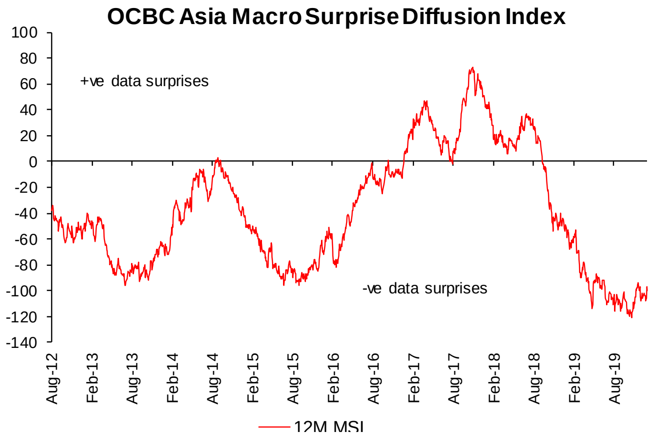
	USD-Asia	10y govie (%)	Macro commentary
Singapore	↓	↔	4Q GDP advance estimates printed 0.8% yoy and 0.1% qoq saar growth. Full year GDP growth at 0.7% yoy, stronger than expected. Indications suggest that the economy may have bottomed out in 2Q19, with consolidation expected in 2020. For now, we view that MAS is unlikely to need an unscheduled meeting ahead of April MPS. SGD NEER basket remained elevated, staying within an estimated +1.50% to +1.80% above parity range on global drivers. Dec official man. PMI firmed further into expansionary territory at 50.1, better than expected. Nov headline and core CPI both printed +0.6% yoy, with the headline measure in-line but core gauge below expectations. Nov NODX printed -5.9% yoy, better than expected (albeit due to some one-off distortion). Nov IP came in at a shocking -9.3% yoy, with analysts estimating at -0.8% yoy.
Thailand	↔/↓	↔/↓	Growth expected at 2.8% yoy in 2020, a level thought to be 'disappointing' by the BOT. BOT still open to using monetary policy even as policy rate is at historic low. BOT still 'actively managing' the THB to limit excessive appreciation. Nevertheless, barring outsized attempts to limit THB strength, expect the USD-THB to still ease south alongside Asian counterparts. 3Q 2019 GDP growth printed 2.4% yoy, below consensus of 2.7%. Dec man. PMI tipped back into expansionary zone at 50.1, from 49.3 prior. Nov custom exports declined at an accelerated pace of -7.39% yoy, worse than expected, with the strong THB pressuring. Dec headline/core CPI at 0.87% yoy and 0.49% yoy respectively, in-line to firmer than expected.
Malaysia	↓	↔/↓	BNM remained static at 3.00% in November, with the accompanying statement showing no signs of urgency in further rate cuts. We push back our expectation of a rate cut to mid-2020 for now. Nov CPI stood at 0.9% yoy, weaker than the expected +1.1% yoy. Dec man. PMI entered at 50.0, improving from 49.5 prior. Nov exports shrank -5.5% yoy (mkt: flat). Imports also slumped -3.6% yoy, less than market expectations. 3Q GDP stayed resilient at +4.4% yoy.

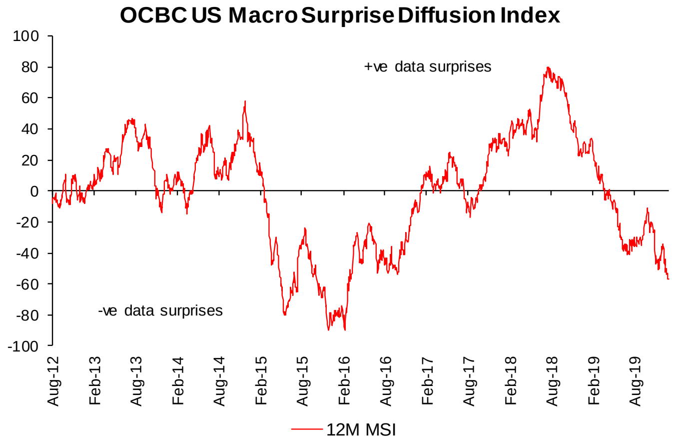
Short term FX/bond market views and commentary

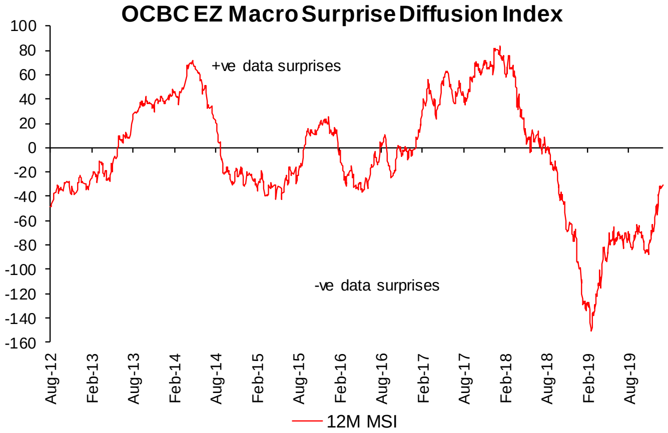
	USD-Asia	10y govie (%)	Macro commentary
India	↔/↑	↔/↓	RBI held rates unchanged at 5.15% in its December meeting, against analysts' expectations. Focus appears to be on fine-tuning the transmission mechanism, rather than rate cuts for now. RBI also cut full-year growth forecast to 6.1% from 6.9%. Concerns over growth weakness may have alleviated somewhat, marginally reducing the pressure on the RBI regarding rate cuts. Back-end yields remain depressed, while the curve exhibits steepening bias, on RBI policy action to buy more longer-dated debt. Nov headline CPI accelerated higher to 5.54% yoy on surging food prices, while the core measure slipped further to 3.15% yoy. Oct industrial production printed -3.8% yoy, again worse than the expected. Dec man. PMI spiked higher to 52.7, from 51.2 prior. Nov trade deficit marginally better than expected, on the back of a significant contraction in imports.
Indonesia	↔/↓	↓	BI held its policy rate unchanged at 5.00% in December. Further rate cuts not completely ruled out for 2020, but BI probably on a wait-and-see for now. Expect BI to be at hand to stabilize the IDR and bond markets if needed. However, talks of relaxing the 3.0% fiscal deficit limit may spook bond investors. Nov exports slumped more than expected, -5.67% yoy vs. mkt: -2.80% yoy. Trade balance surprised on the downside, with deficit significantly larger than expected. Dec headline CPI slipped further to 2.72% yoy, at the lower half of the target band. The core gauge also slipping. Dec man. PMI improved to 49.5, from 48.2.
Philippines	↔/↑	NA	BSP held the policy rate unchanged at 4.00% in its December meeting as expected, although rate-cutting may resume in early 2020. BSP may also choose to further cut the RRR for banks as a supportive measure. 3Q GDP firmer than expected at 6.2% yoy. Nov CPI firmer than expected at +1.3% yoy, but remains under the 2.0-4.0% target band. Oct exports edged a 0.1% yoy growth, better than expected. Dec man. PMI firmed to 51.7, from 51.4 prior. Nov remittances grew 8.0% yoy, stronger than expected.

US growth outlook softening quicker than expected

- Comparing the Macro Surprises Indices (MSI) across regions, what is striking is the rapid deterioration of the US MSI in Q4 2019. The US economy probably capitulated faster than what was expected 1-2 months back – providing a structural negative USD impetus.
- Comparatively, the Asian MSI is attempting to bottom out from a deep trough, with recent macroeconomic indicators showing some stabilization into the year end. The European MSI perhaps overstates the strength of the economic situation somewhat – the case in point is the Dec man. PMIs, which surprised positively, but mostly stayed deep within the contraction zone.







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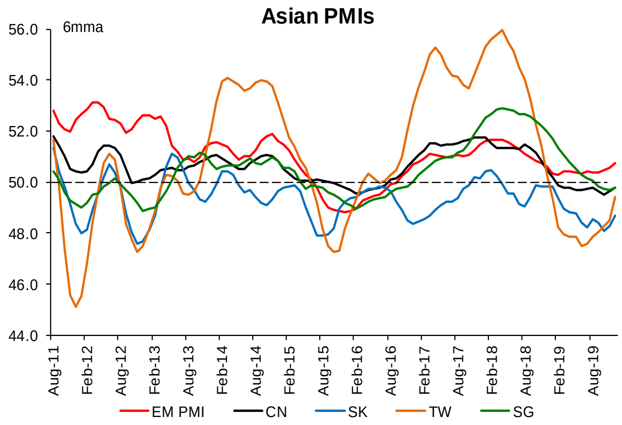
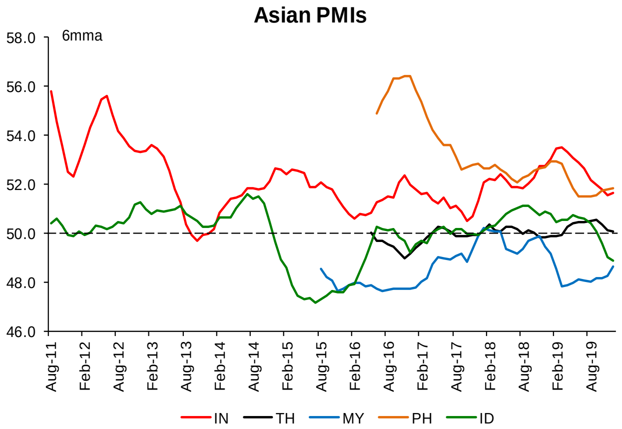
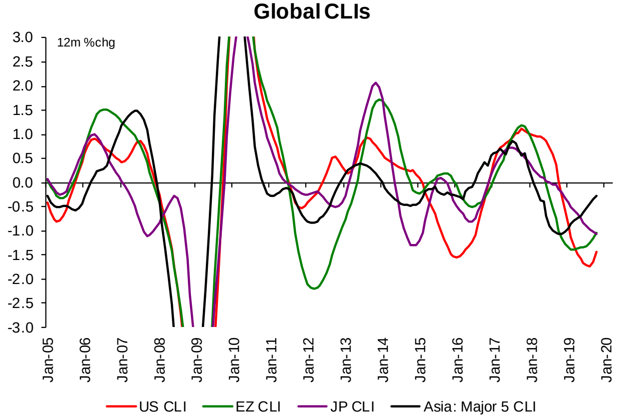
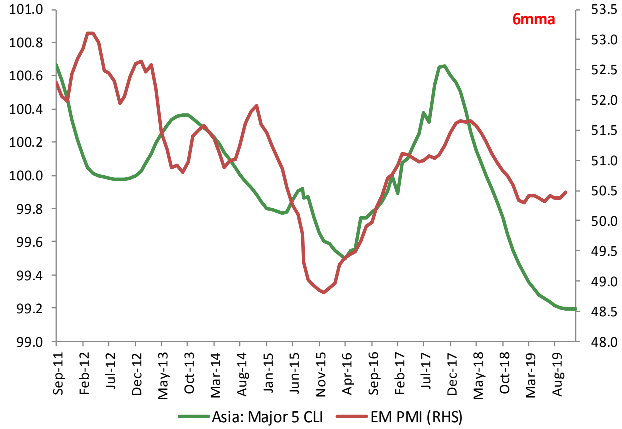
Asian PMIs stabilizing; Selected CLIs bottom out

- Asian manufacturing PMIs appear to be basing off a trough in Dec 2019, with 5 out of 9 tracked economies tipping back into the expansionary zone from sub-50.0 levels. Apart from data stabilization, positivity can also be drawn from supportive policy actions in China.
- Selected Asian CLIs – namely Indonesia and China, are attempting to base out. However, still early days yet to call a recovery.









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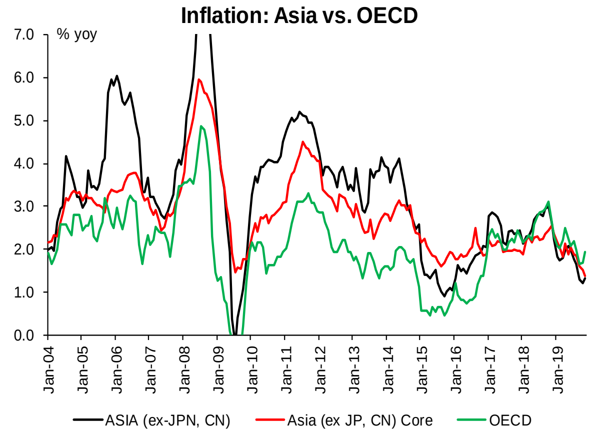
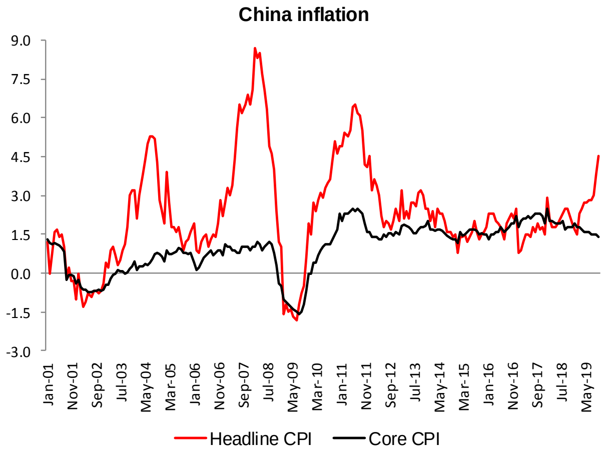
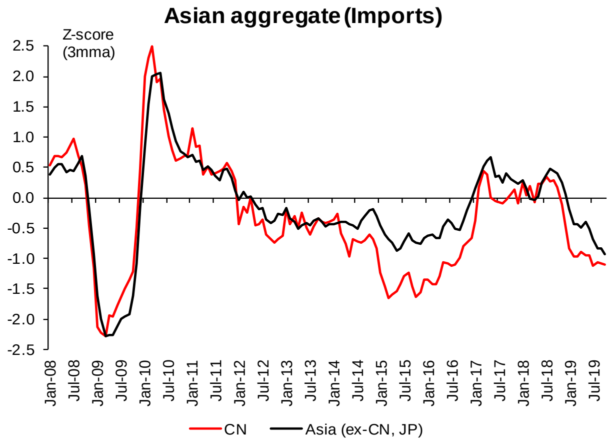
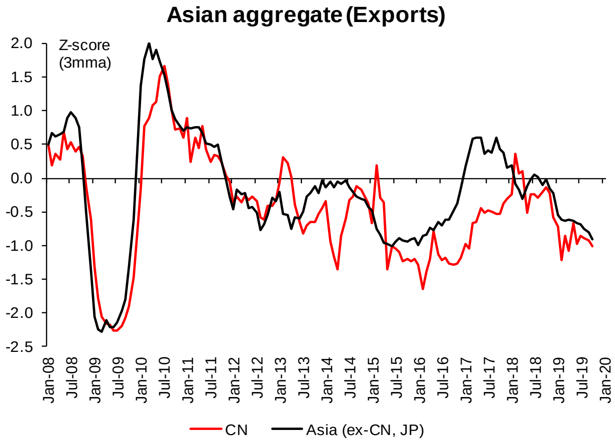
Headline inflation distorted; Trade sector still weak

- Headline inflation data in China and India spiking higher on once-off food-related factors – not an indication of uptick in economic activity. Asia-wide core inflation slumped to multi-year lows – telling a more accurate story. Except in India, do not expect this uptick in headline CPI to hold back central banks from easing bias.
- Trade sector still shows no signs of turnaround, with year-on-year contraction in exports seen in all tracked economies except Taiwan and Philippines.
- **Despite some increased macro stabilization, we are still awaiting stronger signals of a more sustained pick-up in activity.**









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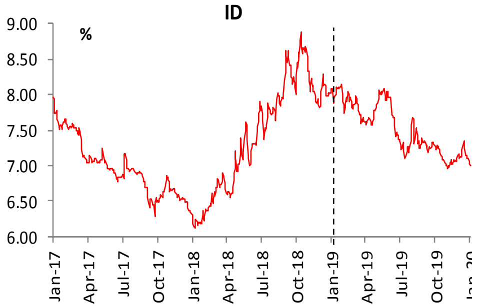
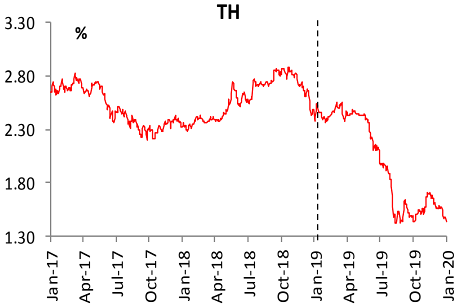
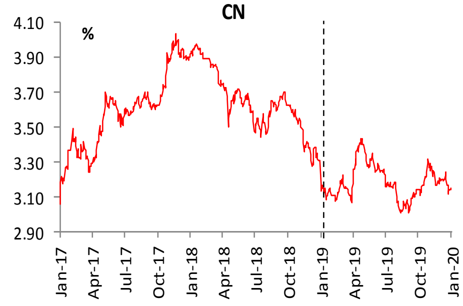
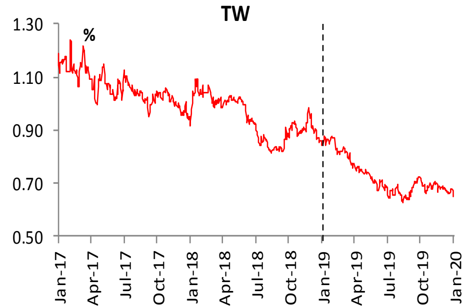
Asian 10y yields off lows, but downside pressure remains

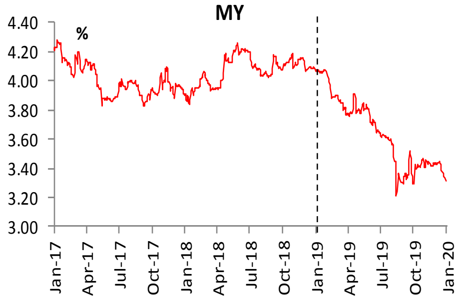
- Although most Asian central banks are on a wait-and-see mode, the persistently low inflation allows an easing bias even as the Fed is in a clear pause. Ongoing drip-feed of expansionary monetary policy in China may instead set the tone. With the exception of Taiwan, Singapore and (arguably) Thailand, Asian central banks may still have 1-2 cuts in 2020.

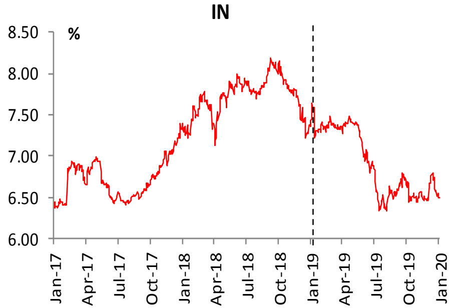


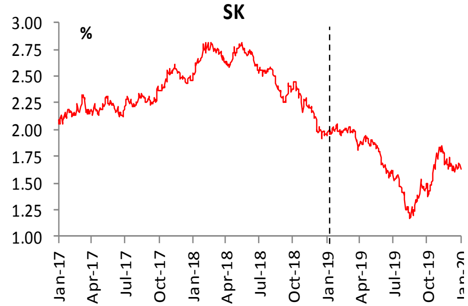


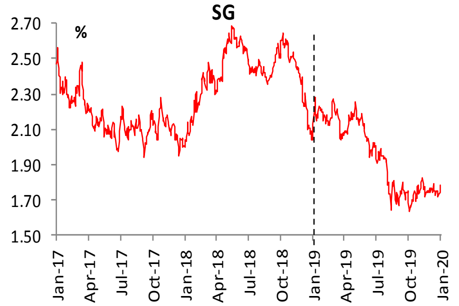












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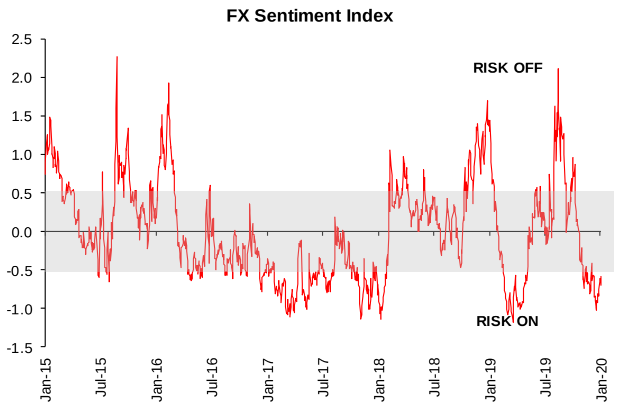
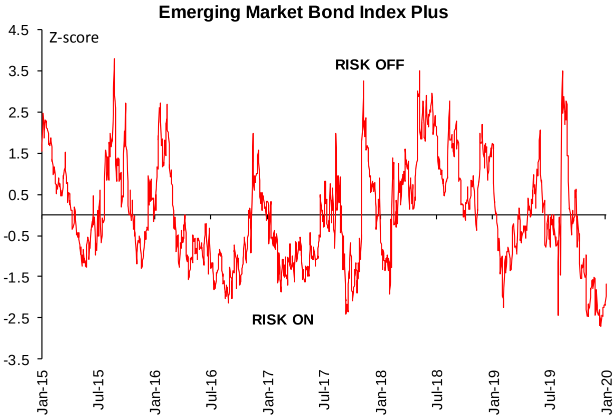
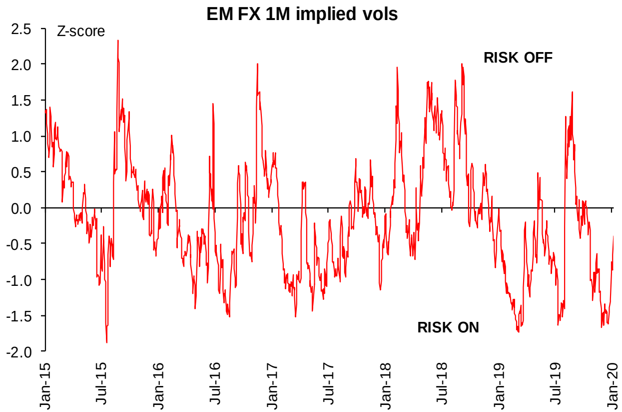
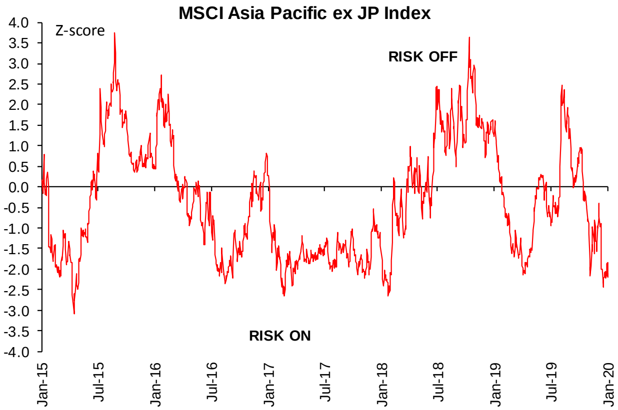
Underlying risk sentiment in Asia still positive

- Overall sentiment remains well-anchored at the Risk-On zone with the Sino-US Phase 1 deal expected to be completed in 15 Jan. Any hiccups from here could risk a sharp reversal in investor confidence.
- Episodic geopolitical risks (such as the recent US-Iran situation) may shake up sentiment periodically, but is unlikely (for now at least) to generate a sustained turn in overall risk climate.





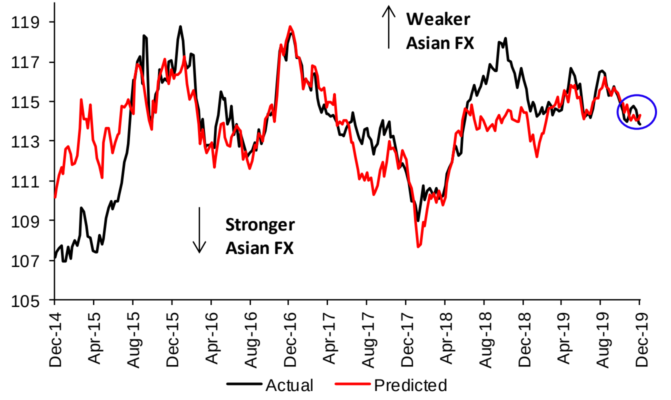




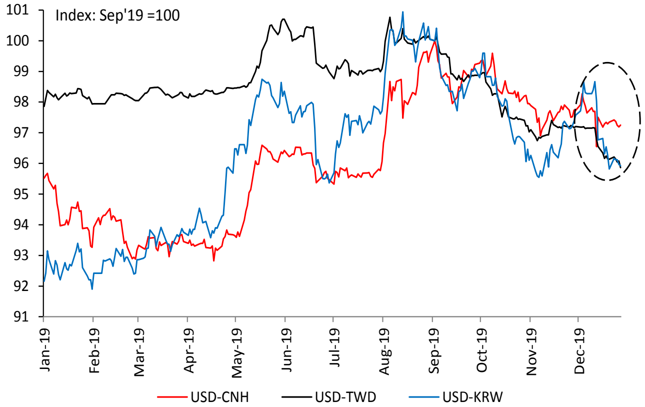
Asian FX looking at Phase 1 details for now

- Investors will want to scrutinize the level of tariff rollback on 15 Jan, and the corresponding "tariff-neutral" USD-CNY and USD-CNH rate. Meanwhile, gains in TWD and KRW may have overrun slightly relative to tariff rollback expectations.
- Recent US-Iran issues have given the market an excuse to take profit on recent gains in Asian FX. In this context, expect INR (firmer crude complex) and KRW (payback of Dec 2019 outperformance) to be most vulnerable, as long as risk-off sentiments persist.

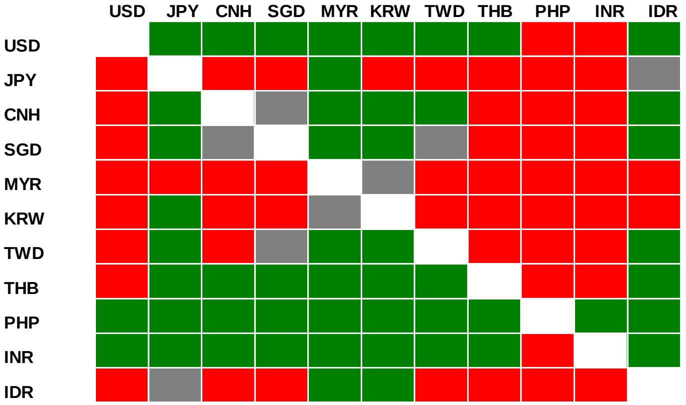
Asian Currency Index (ACI) implied valuation



Recent divergence between USD-CNH and USD-North

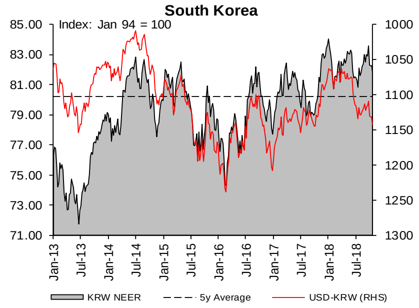


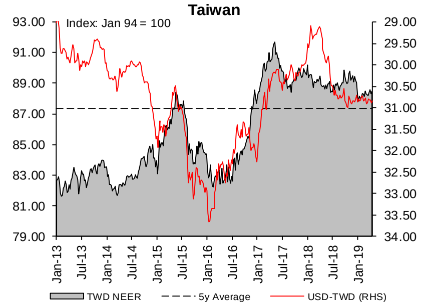
Asian FX Short-term Heat Map

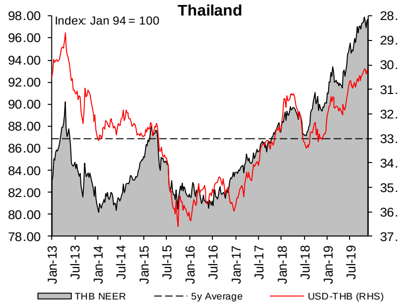


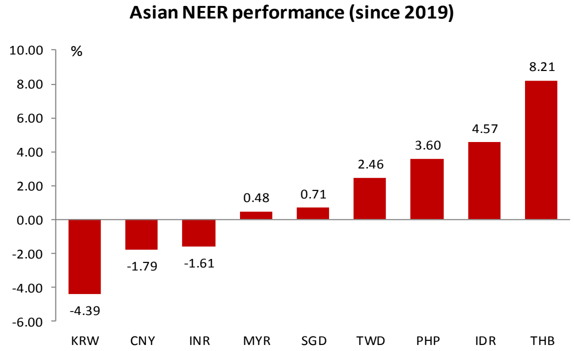
NEERs: THB the clear outlier

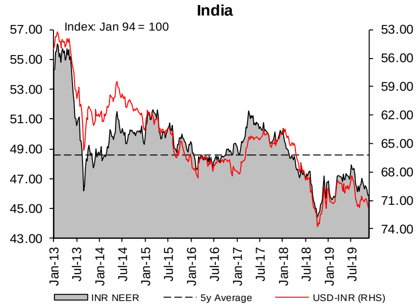
- Despite the recent run, Asian NEERs (except THB) remained aligned with historical norms. The THB continued to look expensive on an NEER basis, although the USD-THB retains a heavy posture. Key to watch is whether the USD-THB can establish a foothold at sub-30.000 levels.

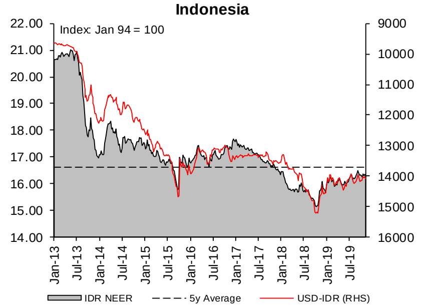


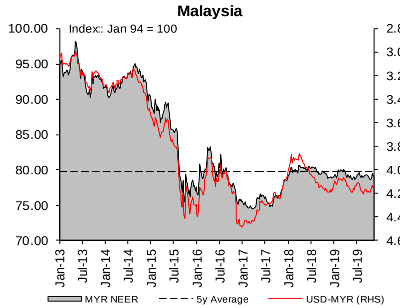


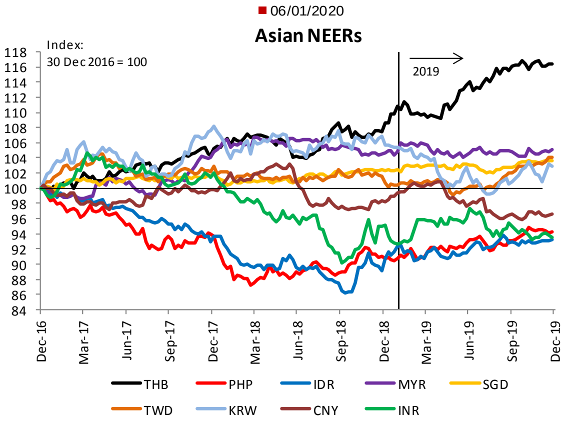












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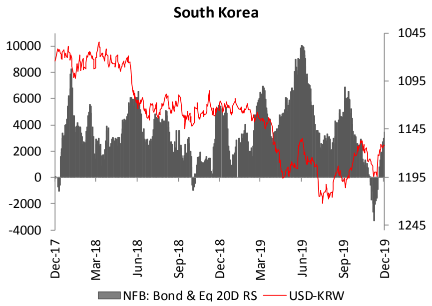
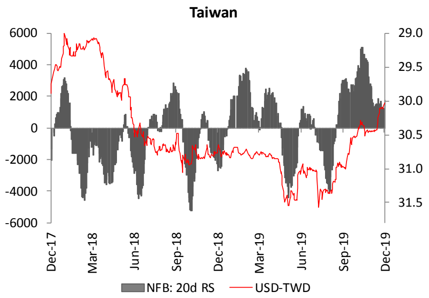
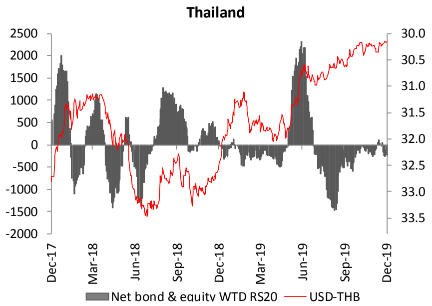
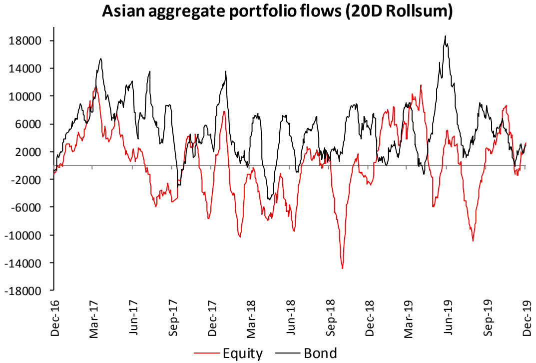
Actual portfolio flows rebounding – N.Asia favoured

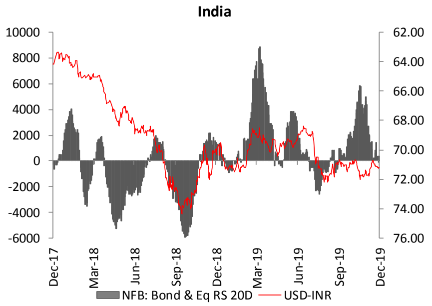
- Portfolio flows have broadly stabilized in response to improving risk appetite, with North Asia seeing selected pockets of strength. Note strong rebound in inflow momentum into South Korea, both on the bond and equity fronts. Inflow momentum to Taiwan has also stabilized. However, inflows to South Asia remain anaemic, apart from a tentative recovery in Indonesia.

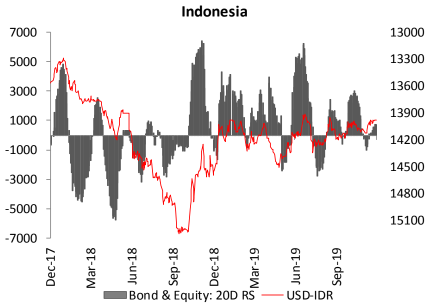


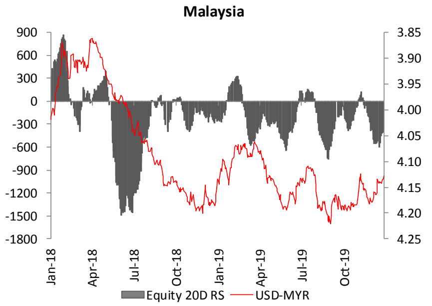


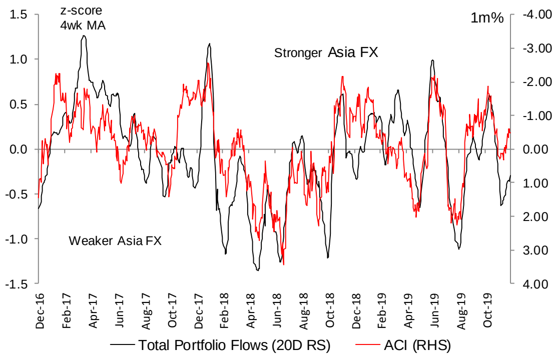












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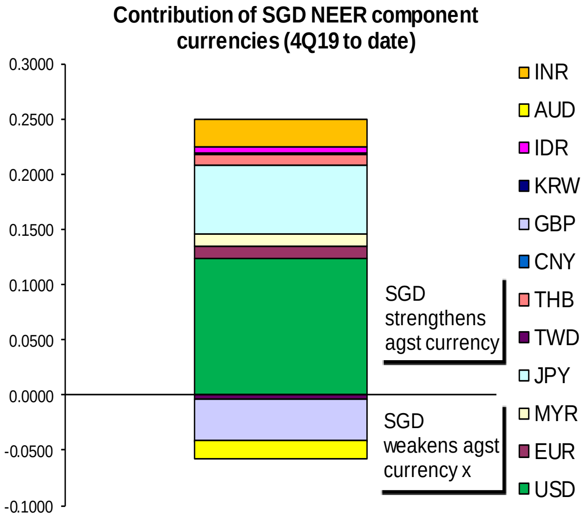
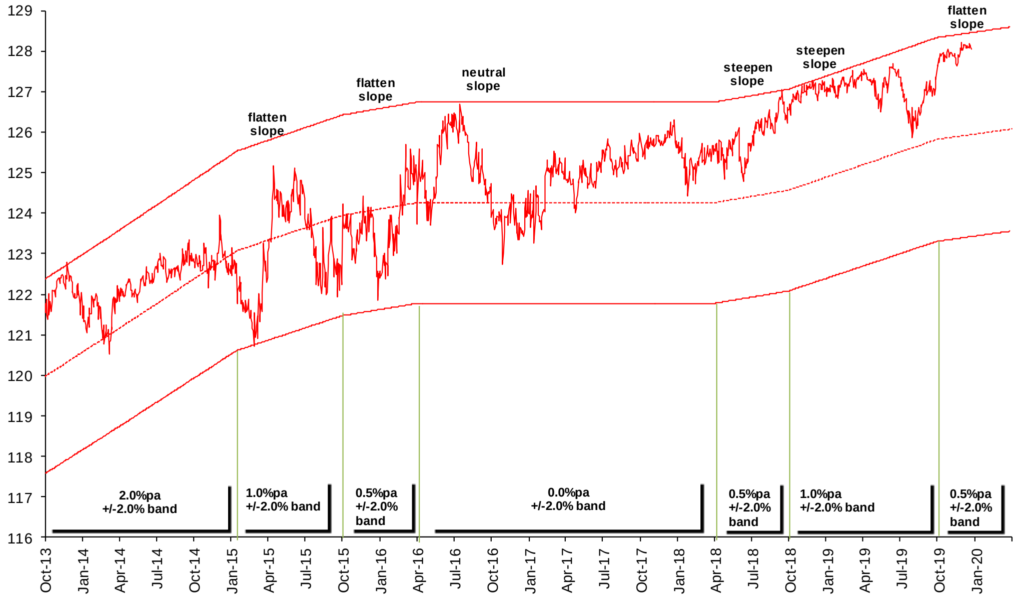
SGD NEER: Elevated on global cues

- Recent local data-prints have been improving, with the sense that the economy may have bottomed in Q2 2019. This partially removes the implicit weight on the SGD coming from soft domestic outlook. Externally, the SGD also remains supported on an improving global/Asia macro outlook and positive risk appetite. **USD-SGD downside may still be on the cards, although we look for 1.3450 to be a near term floor, unless the final details of the Phase 1 deal surprise on the upside.**





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