CUIRS INVESTMENT RESEARCH

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Global Macro Insight

APAC FX: Pressure cooker (Part I)

KEY MESSAGE

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Global demand is under recovery, but divergence appears. Terminal demand are in the recovery phrase]. Resilience of the export cycle also remains highly dependent on US demand. Still, headwinds persist. outlook for consumer & industrial electronics remains subdued.

Carry is still the king. It remains the most popular one in the Foreign exchange market given 5 reasons, including 1) Vol-adjust carry; 2) Global liquidity backdrop; 3) Fed reaction function; 4) US Growth revisions, and 5) Positioning. Furthermore, valuations are now less appealing, which suggests that returns will come more from pure carry than price moves.

Andipodean FX shall benefit from robust global demand, while JPY weakness shall keep with huge yield disadvantages. Global demand is key for both AUD & NZD to carry. We also raise USDJPY 2024YE to 140 to accommodate less expectation on the Fed's rates cut.

PBoC shall keep RMB at what it is, while the bar for higher fixing is not high. Pressure on RMB has formed with unfavourable factors appearing, and market is pushing USDRMB higher as global demand recovery makes less responsibility for China to keep RMB at a stable range.

Fundamentally bullish Korean Won & Taiwan dollar, but local outflows hinge the strength. Stellar performance on foreigners' inflows didn't buffer currency as investors are keen on conducting macro hedge this year. Local outflows continue as US rates stay elevated, while KOSPI Value-up reform may pressure more on KRW.

Fig. 1: CUIRS APAC FX Forecast (End of period)

APAC FX Forecast	Spot	2024 Q2	2024 Q3	2024 Q4	2025 Q1
G10 APAC					
AUDUSD	0.6576	0.645	0.655	0.670	0.680
NZDUSD	0.6010	0.600	0.620	0.630	0.640
USDJPY	151.60	148	145	140	138
North Asia					
USDCNH	7.2459	7.30	7.10	7.00	6.90
USDHKD	7.8284	7.82	7.80	7.77	7.75
USDTWD	32.108	32.50	32.00	30.50	30.00
USDKRW	1350.90	1350	1330	1300	1275
ASEAN					
USDTHB	36.584	36.00	35.50	34.00	33.00
USDMYR	4.7450	4.75	4.70	4.60	4.50
USDSGD	1.3488	1.33	1.32	1.30	1.28
USDIDR	15839	15700	15500	14900	14700
USDINR	83.27	83.50	84.00	83.00	83.00
USDPHP	56.50	56.00	55.50	54.50	54.50
USDVND	24590	25000	24800	24800	24600

Source: CUIRS Investment Research. Data as of 6th Apr 2024

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Exports: K-shape recovery

Recovery path remains. From board base perspective, terminal demand are in the recovery phrase, amid at a gradual path. China's export has recorded a positive y/y growth in Jan-Feb – in a way to avoid lunar new year distortion. The other broad measures also hint at a stabilization of the trade cycle, although it is not clear whether the world is headed into another period of vigorous export expansion or if the recent, positive signs are part of an inventory correction, driven by better-than-expected, if not overly robust, end-demand.

Meanwhile, US durable goods orders, excluding transportation, another useful leading indicator for Asian exports, are at a record level. That is encouraging, even if other measures, like the US ISM manufacturing PMI, have pulled back of late. Still, while at a record, US durable goods orders are not showing signs of a sharp acceleration. Geographically, the resilience of the export cycle also remains highly dependent on US demand.

Divergence appears among Asia. Thanks to the competitive supply chain for advanced chip manufacturing, both Korea and Taiwan exports are now experiencing a meaningful rebound along with the blooming demand for developing AI models. Moreover, Korea's semiconductor export recorded a double-digit y/y growth as the robust momentum of memory cycle upturn continues with top players' reduction. The recent quake in Taiwan raises concern about chip supply, hence we expect the chip price to be well-supported in the near term, which could be the tailwind for North Asia exporters.

Contrary to North Asia, Southeast Asia exports are not yet out of the woods due to its low-end electronics powerhouse status. The exports also count on Chinese demand – remaining subdued as the oversupply persists nationwide, further reducing the demand for exporting overseas products. **One spotlight is Singapore** - whose NODX (Non-Oil Domestic Exports) has successfully been out of the red on a year-on-year basis. This is largely related to its chip manufacturing (mostly memory chips). **Another is Vietnam** - Exports expanded by over 14% y/y in March, bringing quarterly growth to 17% y-o-y. This is largely driven by an upturn in the electronics cycle, benefiting from being a key production hub for Samsung's smartphones.

Still, headwinds for electronics persist. Outside of AI-related hardware demand, which benefits a relatively narrow set of economies and producers, and the specific supply-chain gains witnessed by Vietnam, the outlook for consumer and industrial electronics generally remains subdued. Globally, new orders for both categories continue to contract, limiting upside for Asian exports until terminal demand snaps back.

Fig. 2: Export recovery remains intact

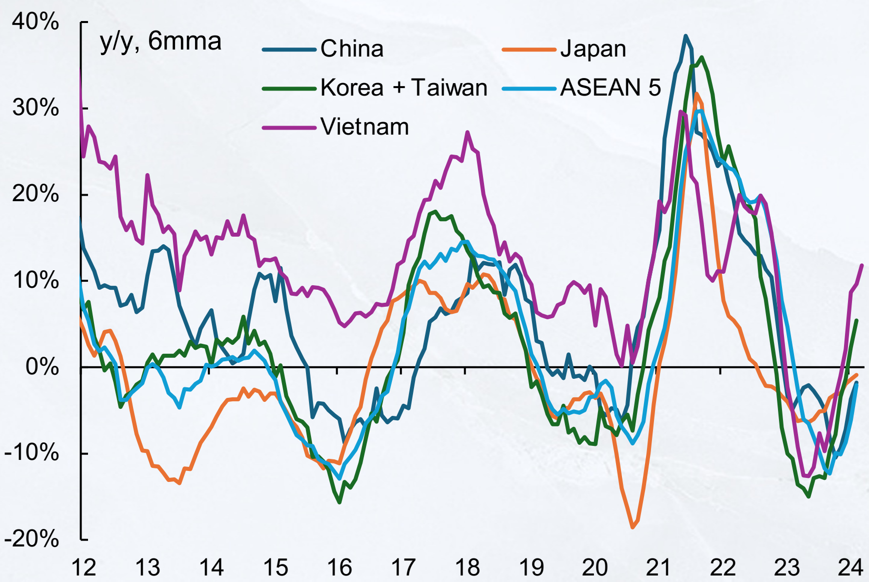
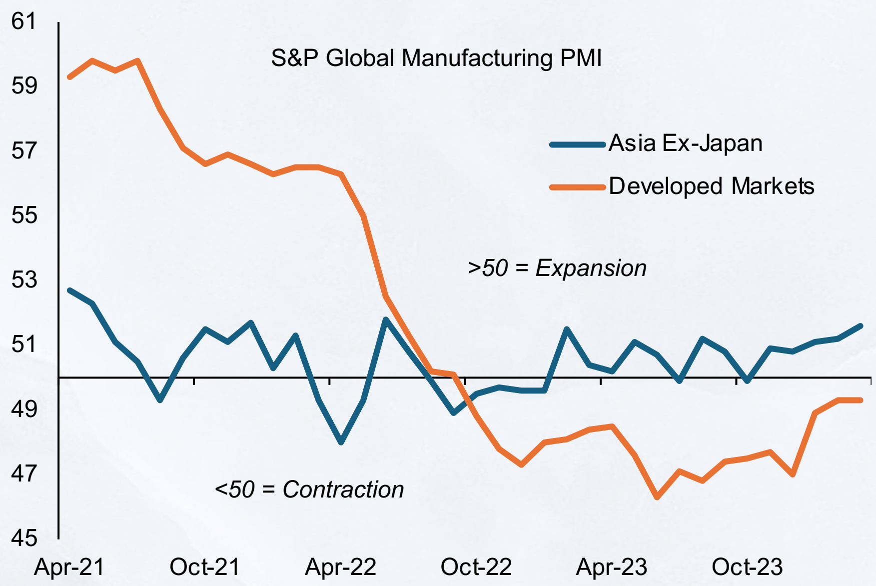


Fig. 3: Terminal demand has improved marginally



Inflation: Back to earth

The broader picture on inflation across Asia is encouraging. For example, average headline and core price gains in emerging Asia have settled down and are now broadly back to their pre-pandemic norms. There are notable variations across the region, with some economies seeing inflation turn out to be stickier than initially hoped. Among APAC, government has implemented price controls and subsidies on energy. An extension would help keep energy inflation subdued.

What helped in recent months, is the fall in global energy prices as well as cooling food cost pressures. For the latter in particular, major production disruptions from the El Niño have so far not occurred, allowing prices to cool (or preventing renewed spikes), especially in Southeast Asia. In general, however, with global crude prices ticking up again of late, there is a risk that the disinflation effect from lower energy costs could fade, reducing, or even reversing the drag on headline CPIs.

There are, however, pockets of surprisingly sticky price pressures. In fact, services price inflation across the region has accelerated again in sequential terms, with annual readings not even back down to their pre-pandemic norm. Still, overall wage growth is likely to pick up, reflecting the structural changes in the labour market. After declining real income growth over the past year, as income gains didn't keep up with inflation, it seems likely that households could see mild, real increases again this year (helped by lower headline inflation as well as a pick-up in wage growth). After declining over the past year, this should help consumer spending recover gradually into 2025.

More broadly in Asia-Pacific, most labour markets have also recovered robustly, with unemployment rates generally below their pre-pandemic level. Still, in some markets, such as Indonesia, Vietnam, Thailand, and mainland China, unemployment is still higher than before, hinting at ongoing labour market slack. In most places, labour market participation rates have also increased, though considerable slack remains in Hong Kong. For central banks, there is little reason to rush to cut rates. In fact, a recent, surprise rate hike by Taiwan's central bank (CBC) is a reminder of the stickiness of local price pressures.

Fig. 4: APAC headline & Core CPI inflation

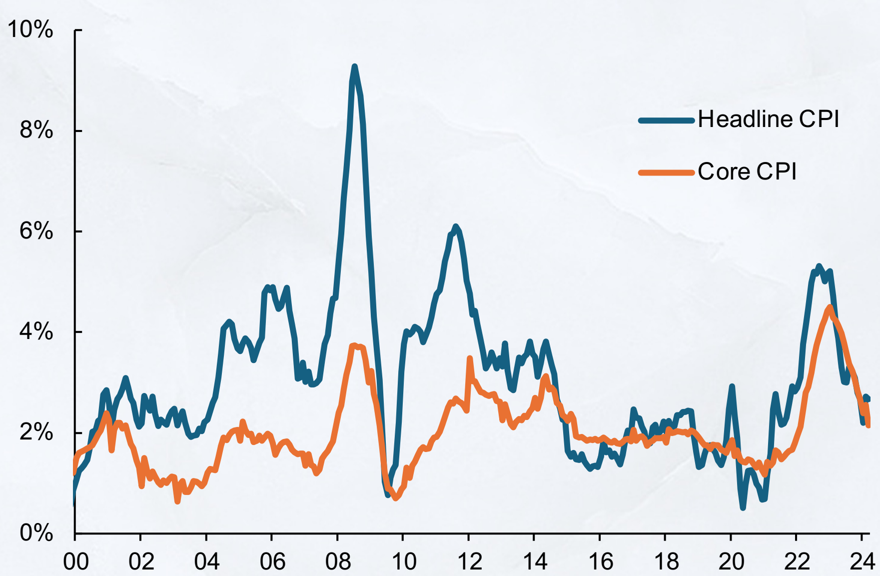
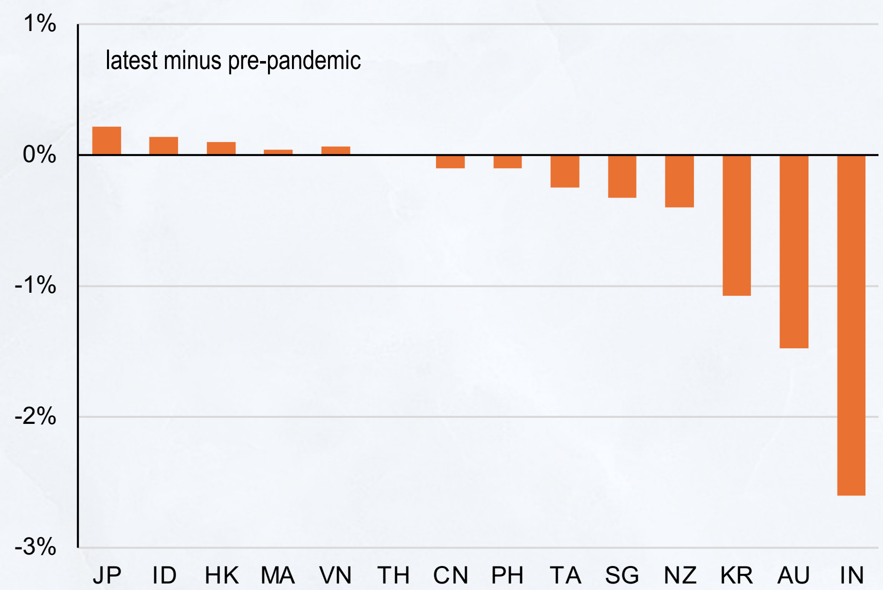


Fig. 5: Unemployment rate changes



Portfolio flows: Persistently supportive

Emerging Asia witnessed cumulative inflows into debt and equity markets which were the highest as compared to the past four years. The increase in overall inflows were led by strong equity inflows. Within Asia, there were equity inflows in all countries. In Feb, Korean equity markets witnessed the highest equity inflows worth USD6.12bn followed by Taiwan's USD3.4bn. Furthermore, There have been gradual inflows into EM Asia debt YTD. Inflow pace has also slowly increased over Feb. In Feb, there were inflows into the Indian bond markets worth USD2.37bn. Other markets witnessed outflows.

In China, There are USD39bn inflows on bonds in Jan-Feb. This was mainly related to ASW advantages on front-end, as stated in our *China NPC Preview*. However, yield gap between 1y UST & 1y NCD with FX hedged has recently converged, making the ASW no longer attractive. The foreigner may unwind some bond carry position as US rates rise again with re-pricing Fed's rates cut cycle. Nevertheless, Stock Connect records net outflows in Jan-Feb, but extremely cheap valuation and inspiring signs on economy continue to attract foreigners. Finally, USD8.5bn inflows were recorded via Northbound in Feb, which partially reflect that market is regaining confidence on Chinese market (*Bloomberg*, Apr 1, 2024).

Fig. 6: Portfolio inflows turn supportive to FX…

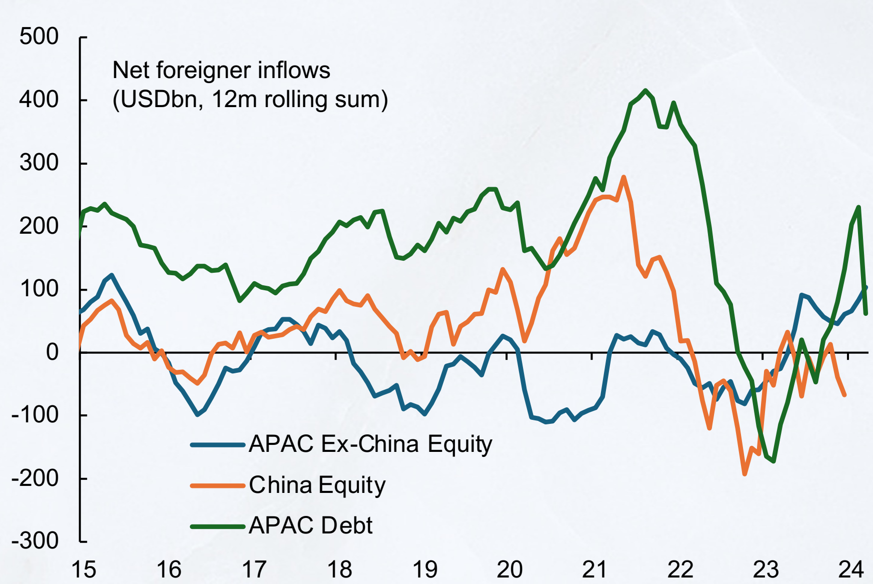
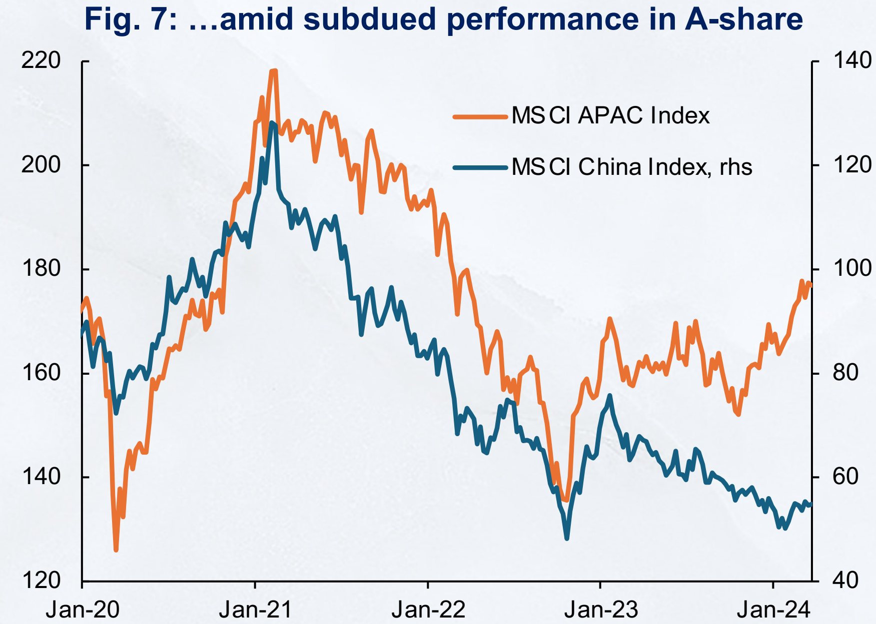


Fig. 7: …amid subdued performance in A-share



Valuation & Positioning: Carry is (still) the king

As overall APAC FX lacks yield advantages versus the greenback, the valuation has been depressed since 2022 when the Federal Reserve started its tightening cycle. However, Asian central banks intervened in the FX market to manage the volatility/devaluation various times during 2022-2023, successfully keeping USD-Asia stable. The historical record shows that overall one-time depreciation of Asian FX versus USD won't exceed 20%, with KRW & JPY as exceptions.

So far, the carry trade (borrow low yield, buy high yield to earn the rates gap) remains the most popular one in the Foreign exchange market given 5 reasons, including **1) Vol-adjust carry; 2) Global liquidity backdrop; 3) Fed reaction function; 4) US Growth revisions and 5) Positioning**. Furthermore, carry trade valuations are now less appealing, which suggests that going forward, returns will come more from pure carry than price moves. Asian currencies are likely to be under pressure in 2024 with low-yield and low-volatility characteristics continuing, in our view. However, the fundamental has recovered amid at a slower pace as mentioned, thus we are of the view that Asian FX will experience a gradual recovery in 2024. The past glory in 2020-21 may not be repeated as we are heading to the high-interest rates era.

Fig. 8: Asia FX revisit its trough again along with persistent yield disadvantages

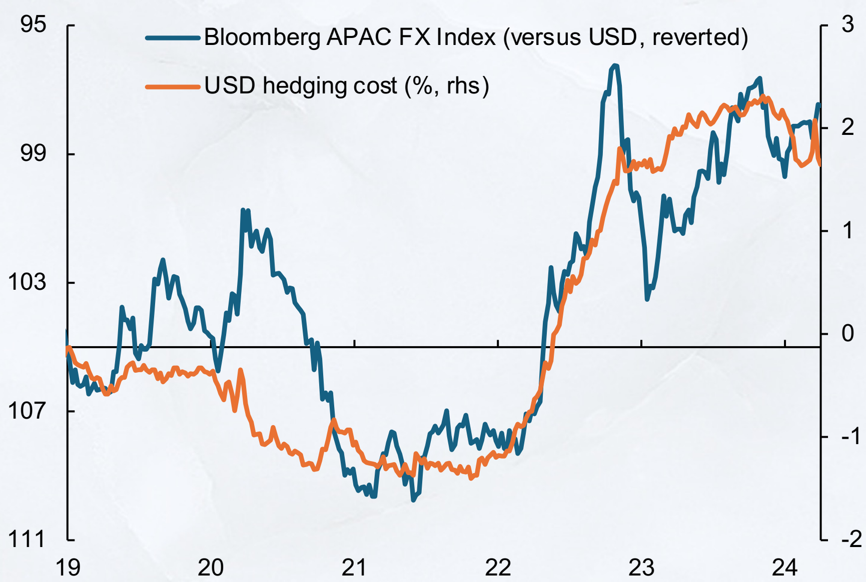
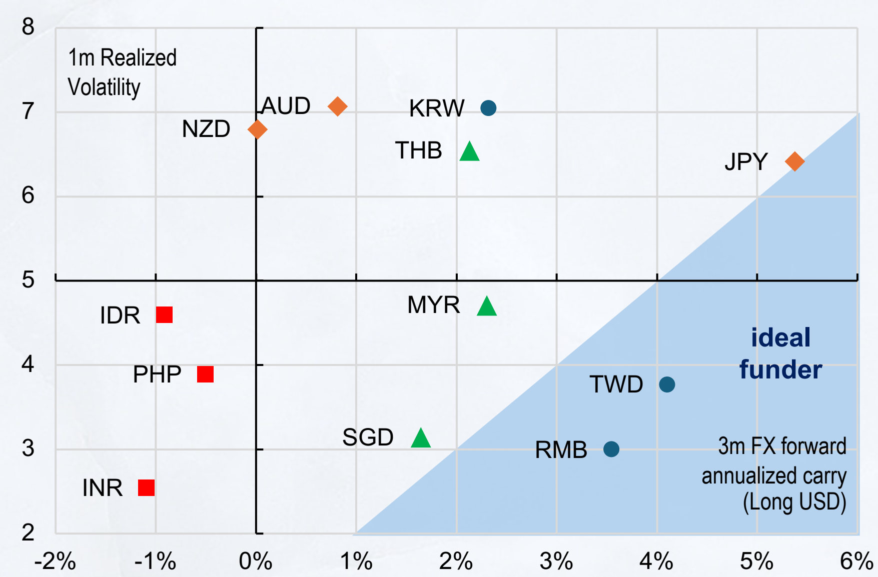


Fig. 9: Carry-to-vol ratio



Contrary to other peers, most Asian CBs list currency stability in their monetary policy terminal goal, like BI & CBC. They mainly use NEER as the gauge to evaluate whether the currency is over/undervalued. Hence, we can see that overall APAC FX is not at extreme value (judging by NEER 10y Z-score; Fig. 9), despite the valuation being depressed when versus USD. Among all, SGD outperforms given Monetary Authority of Singapore (MAS) uses SGD NEER as the main monetary policy tool to achieve its goal (taming inflation) as Singapore heavily relies on trade – which we will discuss in Part II.

The devaluation of JPY and KRW should continue. For Yen, the almost-zero interest rates keep attracting market to conduct JPY-funded carry trade through the high volatility and BoJ's path to policy normalization. This would work in other funding currencies like RMB and TWD, thus we expect both to underperform hereafter. As of Won, the currency should closely follow the DXY with its procyclicality, hence the devaluation will only diminish after the greenback weakens – which should be the 2024 2H story in our view. **Among APAC FX, we continue to prefer trades like short TWDINR, offering attractive carry with low vol. Also, we are bullish on IDR, KRW, and AUD from fundamental perspectives.**

Fig. 10: APAC FX NEER (10y Z-score)

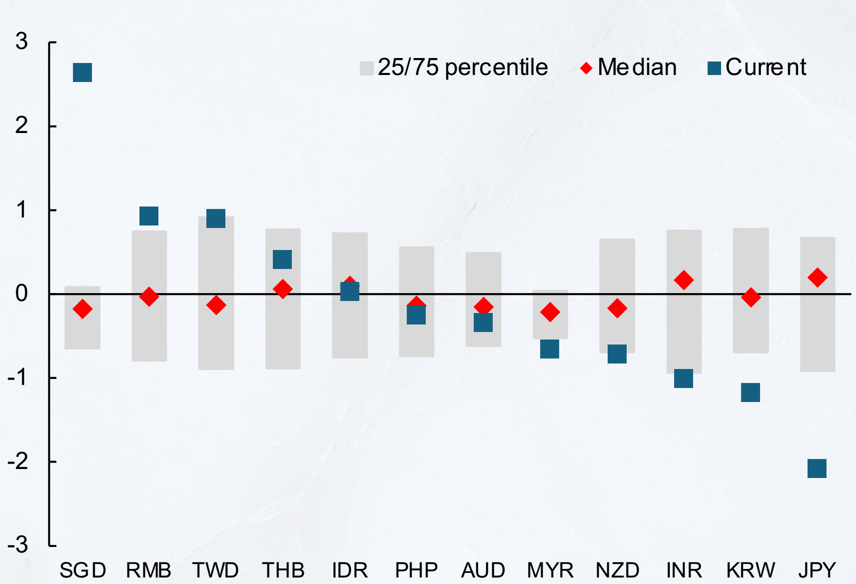
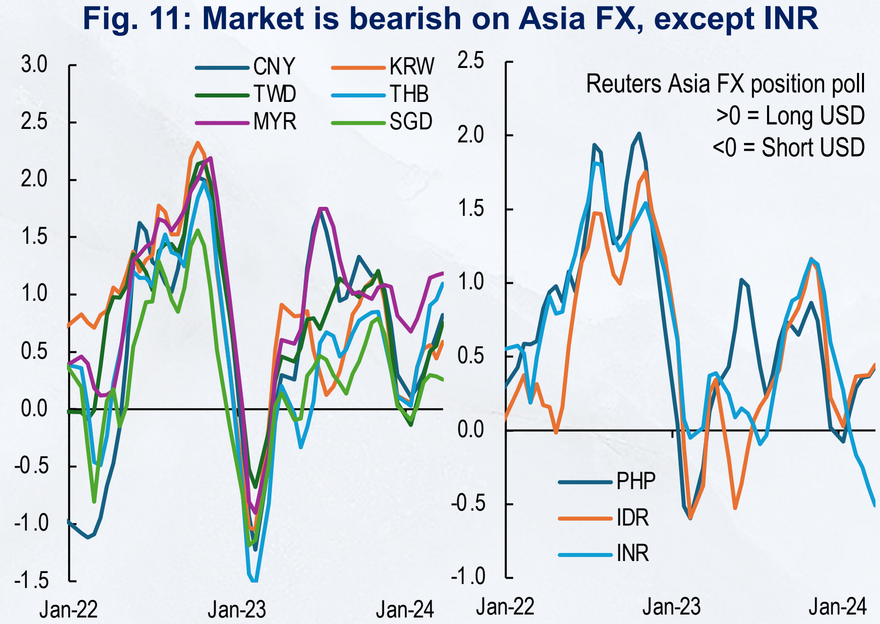


Fig. 11: Market is bearish on Asia FX, except INR



G10 APAC: Hard to refuse attractive USD yields

Global demand key to fight carry. Surprisingly robust demand for industrial metals since 2022 has supported the AUD. China's iron ore imports rose by 6.6% in 2023 in volume terms despite a nationwide property slump. Resilient Chinese demand was partly a function of increasing exports of steel products last year, and partly by growing demand in non-property steel demand (e.g., auto and infrastructure). On the other hand, markets have attached relatively less importance to the supply-side fluctuations (i.e., natural catastrophes and OPEC+ production curbs) impacting energy and dairy prices.

Antipodean FX Outlook: No pain no gain. Both Aussie and Kiwi this year shall be driven by three main factors: **1) Markets expectations on rates cut for Fed; 2) China's growth outlook; 3) Both RBA & RBNZ monetary policies**. As we stated in our wrap-up, the current reprice-in on Fed rates cut cycle is driven by both upside surprises in US and elsewhere. This may help explain why despite a notably more hawkish policy outlook for the Fed, global equities – a key driver for Antipodean currencies – have been quite resilient.

Meanwhile, China shows more green shoots in March - offering some respite. And the outperforming consumption compared to pre-pandemic further strengthen the story of "China is back". However, we remain cautious as the dragon needs more time to heal the damage from gloomy housing market. The market also sees RBA & RBNZ cut later than the Fed with a lack of domestic supply capacity. Altogether, **we expect a more supportive dynamic for Antipodean currencies in 2024**, though the upward room is limited as options market price in (**Fig. 13**).

Fig. 12: Antipodean FX correlation with commodities

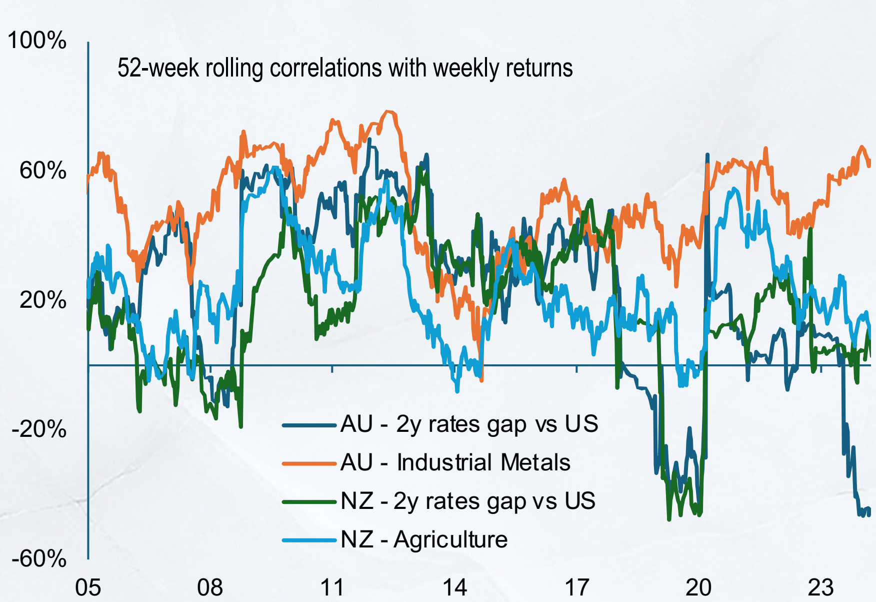
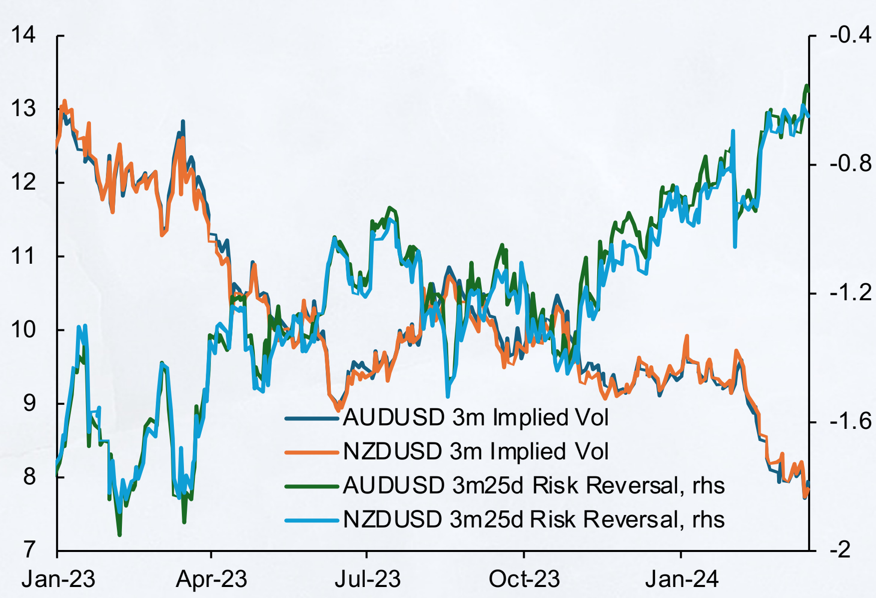


Fig. 13: Options market expects a range-bound outlook



We like long AUDNZD because Australia has a lower risk of a hard landing. The housing market rebound in Australia has been more powerful than New Zealand's. House prices are important to the macroeconomic outlook because mortgage debt is elevated versus most G10 peers (**Fig. 14**). The transmission mechanism of monetary policy relies on adjustments to household consumer behavior, and the risk of restrictive rates causing a disorderly spiral of rising defaults and sharp economic contraction is very low. In New Zealand, depressed house prices and high levels of household debt have increased the risk of risk of restrictive rates, causing a disorderly spiral of rising defaults and sharp economic contraction. Judging from OIS curve, the market is of the view that RBNZ could cut more with a more restricted level of policy rates (**Fig. 15**).

Fig. 14: Household debt is higher compared to most DM

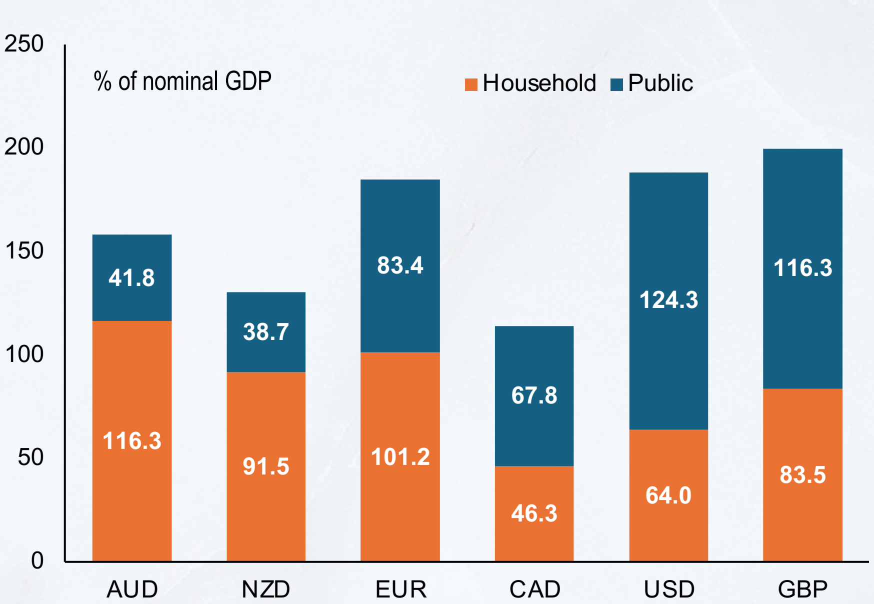
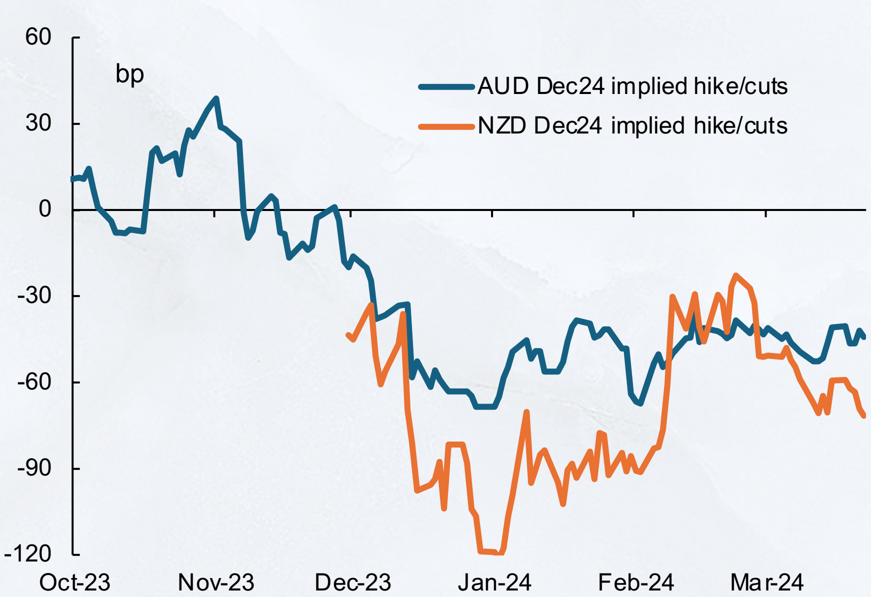


Fig. 15: Market see more probability for RBNZ to cut



JPY: "Kitchen Sink" approach may kick in to fight devaluation. Our base case for JPY is to recover gradually in 2024. However, market's expectation readjustment on Fed's rates cut cycle triggered forecast revision to 140 at 2024YE (original: 135). We acknowledged the risk of weaker Yen with a more resilient US economy, however, messages from Fed officials recently suggest an interesting argument – they regard rates cut as the base case in 2024, which strengthens our confidence for the current forecast 140 as USDJPY always acts as the most sensitive currency toward US rates & risk appetite.

It's time for MoF's to respond. USDJPY has risen on what the market saw as the BoJ's "dovish hike" at its March monetary policy meeting. The yen's decline can continue if the Fed does not cut the rate as much as the price. We argue FX intervention is a realistic option for Japanese government to combat the yen's weakness. The risk of intervention increases with USD/JPY 152-155 and/or 1m implied vol above 10. Moreover, the magnitude of intervention may be initially limited to JPY2-4trn / shot and JPY11-12trn total, and smoothing type of intervention may be more likely this time. However, FX intervention is not a fundamental fix for the yen; But intervention would present a modest headwind to recent spread widening in US rates and support knee-jerk front-end spread tightening.

Fig. 16: Policy divergence should buffer JPY in 2024

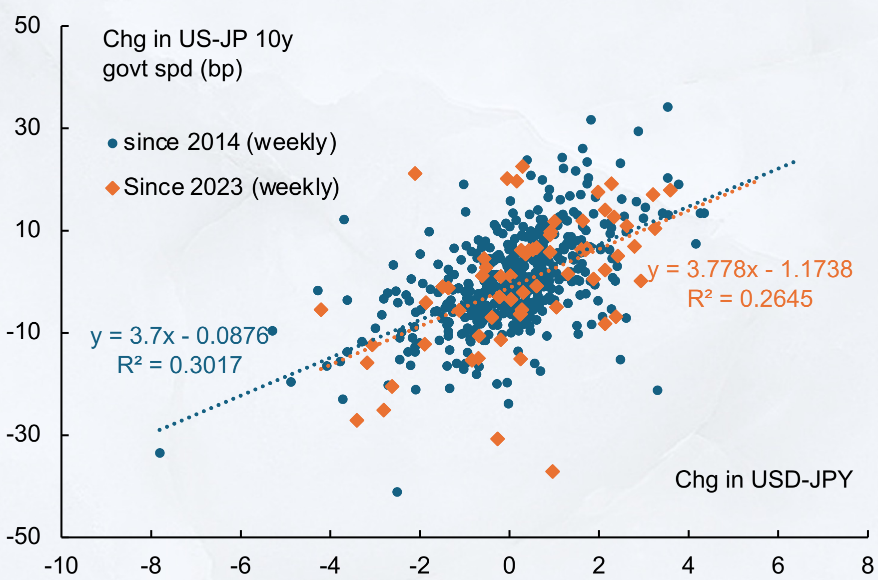
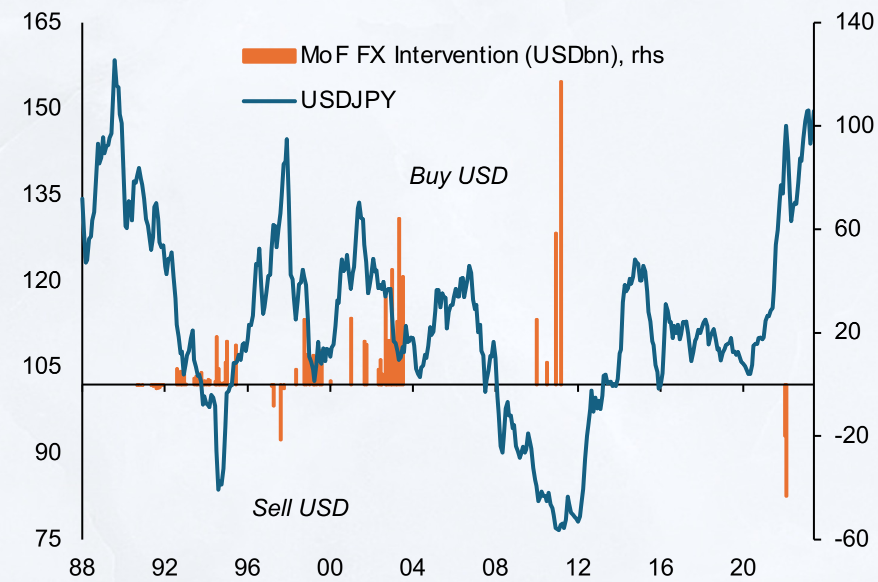


Fig. 17: MoF intervention risk is rising



USDJPY is a buy on intervention-related dips before Fed cuts, as carry remains king in low-vol environment. For Japan to use domestic policies to reverse the JPY weakness, we believe that a "kitchen sink" approach is required. This likely means engendering a material shift in capital back to Japan via a combination of changed GPIF asset allocation and more aggressive BoJ rate hikes. Another BoJ hike may come as early as July if the JPY keeps weakening, as of now it seems that the BoJ will be reactive to currency weakness rather than proactive in trying to encourage currency strength.

CFTC data suggests that short JPY positioning was at relatively extreme levels from a historical perspective as of 2 April. Some typical drivers of USD-JPY also move to the detriment year-to-date. For instance, DXY strengthened by nearly 4%, US-JP 10-year GBs spread rose by 40bps, and global equities (positively correlated with the pair given its proxy of risk appetite for carry trades) were up, although there was a correction recently. Apart from external factors, with NISA changes effect from 2024, investment limits for NISA were raised. In Jan-Feb, investment trusts bought USD15bn of foreign equities, three times what they normally buy on average. Hence the stellar performance of Nikkei this year so far didn't provide a strong buffer as the outflows undermined the currency. Moving forward, risk-off sentiment in global equities may buffer yen as market takes it as a "safe-haven", but the effect would be short-lived as carry is too attractive.

Fig. 18: Speculators rebuild short JPY positions

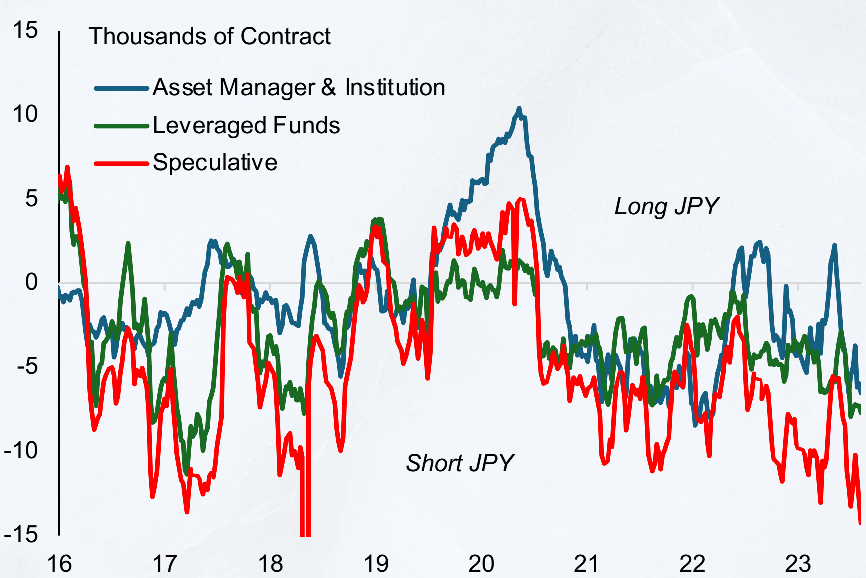
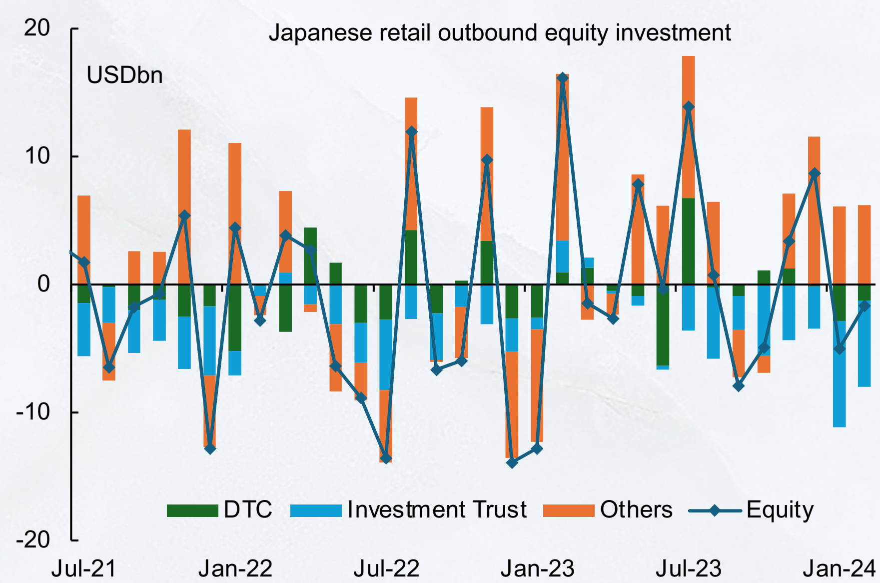


Fig. 19: NISA outbound investment continues



North Asia: Limited Upside amid blooming AI demand

RMB: All eyes on policy. PBoC has been keeping the USDRMB stable by setting the USDCNY fixing at around 7.1 since the last year end (Fig. 20). CNY fixing continues to set at 7.10 level after allowing the onshore spot to rise above 7.2 last Friday, implying that the PBoC may be trying to stabilize the currency. Nevertheless, the pressure on RMB has been built over the past few weeks, in our view, given that 1) Weak JPY after BoJ; 2) Strong US data; 3) Surprising SNB cut; 4) Rising concern of potential tariff increase; 5) PBoC stated that there's room for RRR cut.

Market is pushing for higher USDCNH: The following narrative calls for the PBoC to loosen its grip on FX: 1) Global growth has turned better this year, as evidenced in PMIs, exports and the electronic cycle. Even China's own growth data are improving. The pressure for China to hold the currency from the global community is lower, in our view. 2) Risk of increasing tariff on China post the US presidential election should be noted. While it makes sense for China not to devalue the currency before the actual tariff placement to not be accused of competitive devaluation, we do think the PBoC needs to relax a bit to allow for market adjustment, for example, through corporates' hedging activities. 3) China's domestic PPI numbers remain depressed. In the last two periods when PPI was this depressed (end of 2015 and 2018), the RMB ended weaker versus both the dollar and the basket in the following year.

Fig. 20: RMB is currently under great pressure

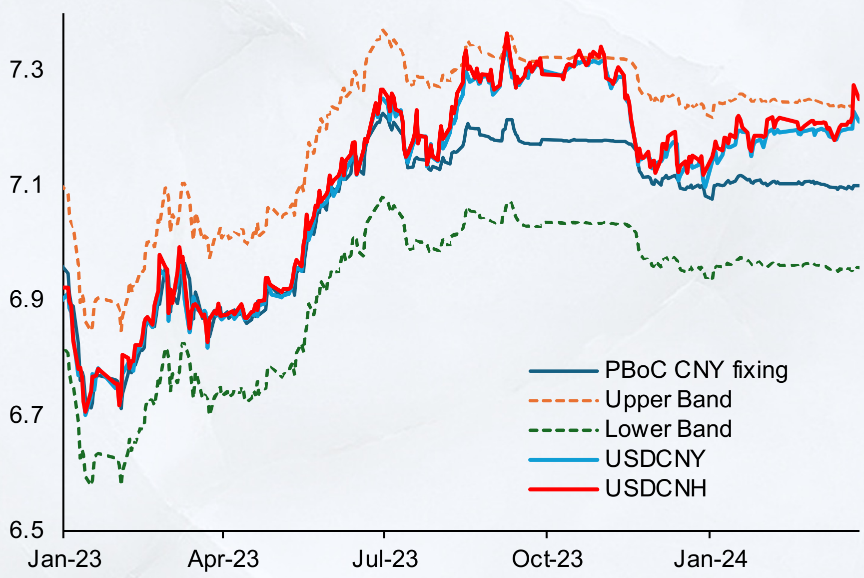
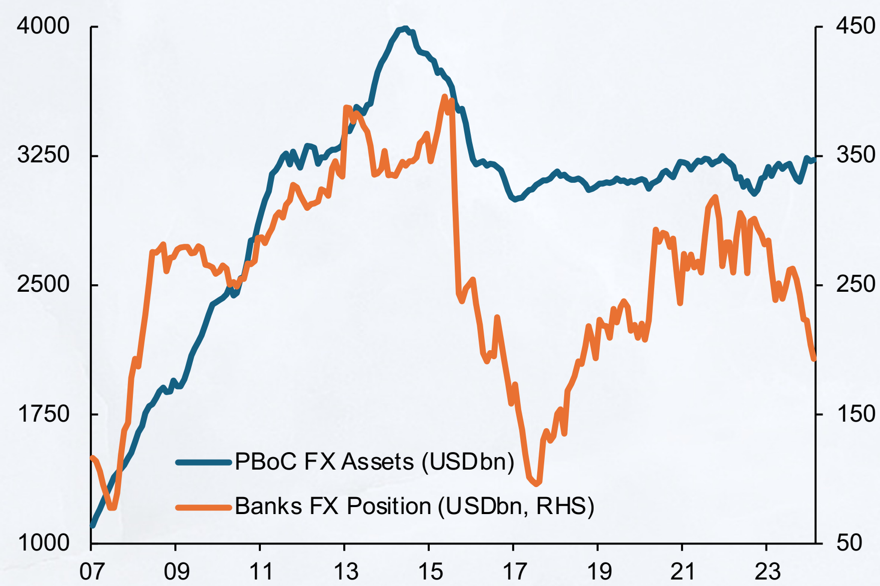


Fig. 21: Most FX selling are from state-own banks



RMB is still on the way to internationalization. Recall that back in 2015-16, the PBoC used USD833bn of FX assets (25% of total asset) on its balance sheet for intervention. But in 2022-23, the PBoC has been much more restrained with such substantial direct intervention. Instead, we find that domestic banks in China appear to have made more FX sales (**Fig. 21**).

Hurdle for higher fixing into the summer will not too much. USDCNH spot could test 7.3 again, but USDRMB is going to fluctuate within the 7.1-7.3 range before Fed cuts, in our view. The hurdle for higher fixing into the summer will not too much. USDCNH spot could test 7.3 again, but USDRMB is going to fluctuate within the 7.1-7.3 range before Fed cuts, in our view. A much larger catalyst is required to break the range, like USDJPY breaking 155, and/or more concrete developments in US-China tariffs. Seasonality-wise, the effect of dividend outflows will kick in around May, hence the flows in the next couple of months will be a bit challenging (**Fig. 22**).

Fig. 22: Dividend seasonality could add more pressure

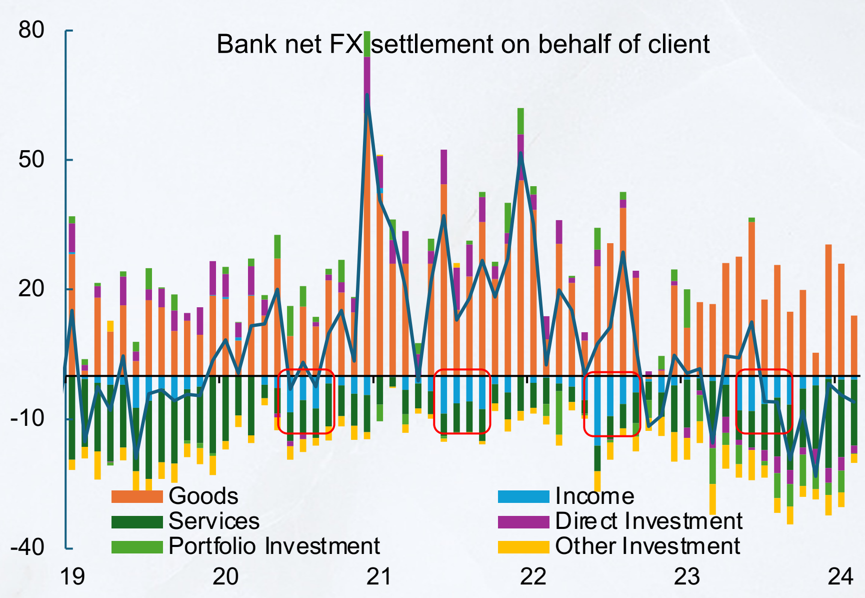
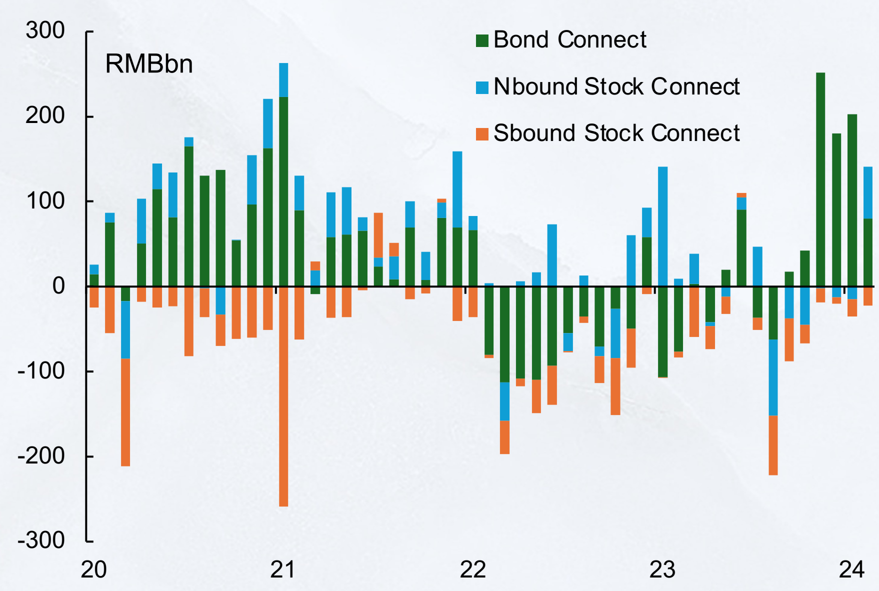


Fig. 23: Cross-border portfolio flows stay as the biggest uncertainty



HKD: Waiting for the Fed. Should the Fed cutting cycle result in USDHKD hitting 7.75 and triggering a strong-side convertibility undertaking (CU), this will lead to the backing portfolio growing, which will also raise the HKMA's total FX reserves. In our view, the hit on stronger CU is unlikely the case in 2024 with the standpoint that China's demand will face gradual recovery, providing only a little buffer on HK assets. Fed's rates cut cycle in 2019 also suggests that a gradual path won't bring HKD back to 7.75 rapidly. However, the foreign portfolio inflows could become supportive of HKMA's FX reserve if China introduces a set of encouraging measurements on the growth front with HKD reaching strong-side CU. Before the Fed kick-off its easing cycle, we expect TT to trade in between 7.82 as the rates differentials is still skewed to weaker HKD, albeit very small. Any surprising news on US rates is not likely to push USDHKD back to 7.85 with tight liquidity (HKD45bn), especially when both Fed's dot plot & market have same rate cut expectation - 75bps in 2024.

Fig. 24: USDHKD is well capped at 7.75-7.85 range

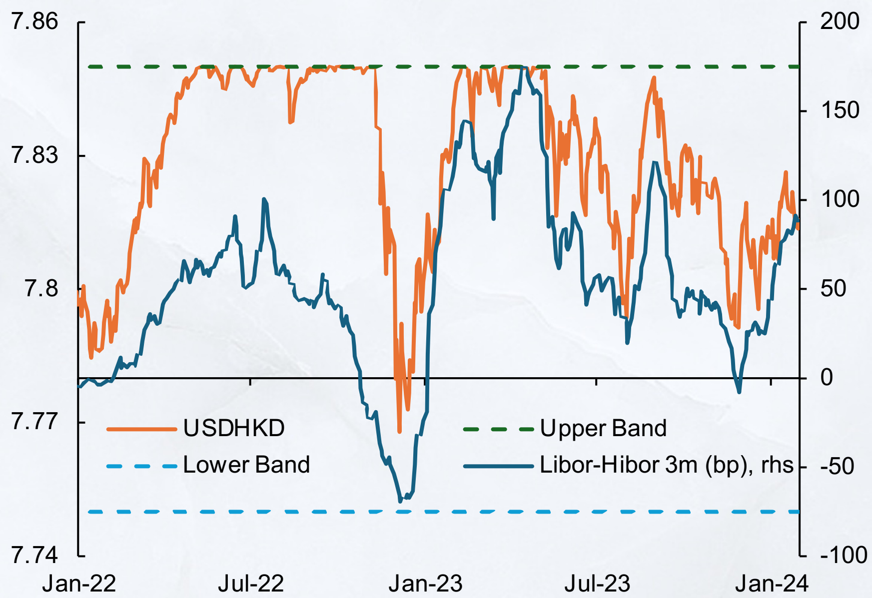
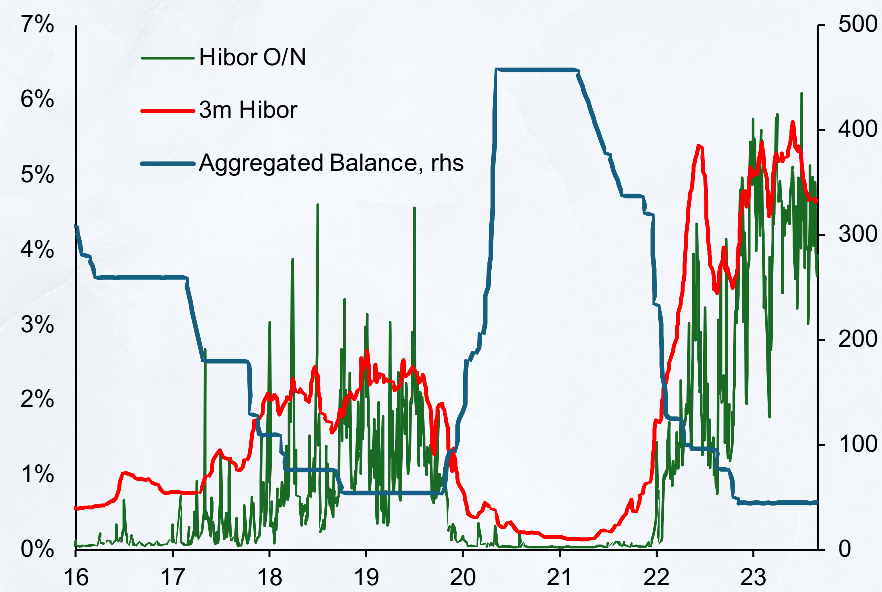


Fig. 25: as designed mechanism will adjust HKD liquidity



TWD: Local outflows hamper fundamental strength. Taiwan dollar has well followed the electronic cycle since 2010 as the island has served as the powerhouse of high-end tech hardware and advanced semiconductors (**Fig. 25**). It's clear that Taiwan is on a recovery path with persistently robust momentum on tech demands, especially for IoT products like servers. However, the upward cycle this time didn't buffer the currency as it did in the 2010s, which we attribute to the widened rates spread versus other economies. As a high-saving economy, Taiwan has kept low interest rates. CBC's tightening cycle also remains measured compared to Asian peers, by only hiking 87.5bps in total. This makes local fixed income unattractive as an investment and, in turn, encourages locals to remit their income to foreign currency for higher returns, which can be seen on lifers' investment portfolio - over 60% are foreign investments.

Limited investment channels also push local savings toward foreign assets. In Taiwan, bond issuances from the public and private sectors are limited as they remain prudent on fiscal (or financing) and hold abundant cash positions with their habits. Hence the TWD-denominated Bond ETFs (targeting foreign debt securities) are popular with AUM totaling USD60bn, increased by 20bn since 2022. Taiwanese lifers are also keen on Bond ETF as it can avoid the FX hedging (as it's classified as a TWD asset) and provide foreign exposure simultaneously. Currently, lifers are all under-hedged to avoid the profitability erosion from punitive FX hedging costs. In our view, their hedging behaviors are now opportunistic, which means that they will only step into the NDF market when there's a sharp drop in USDTWD, like late 2022 & 2023.

Fig. 26: TWD & Electronic Shipment

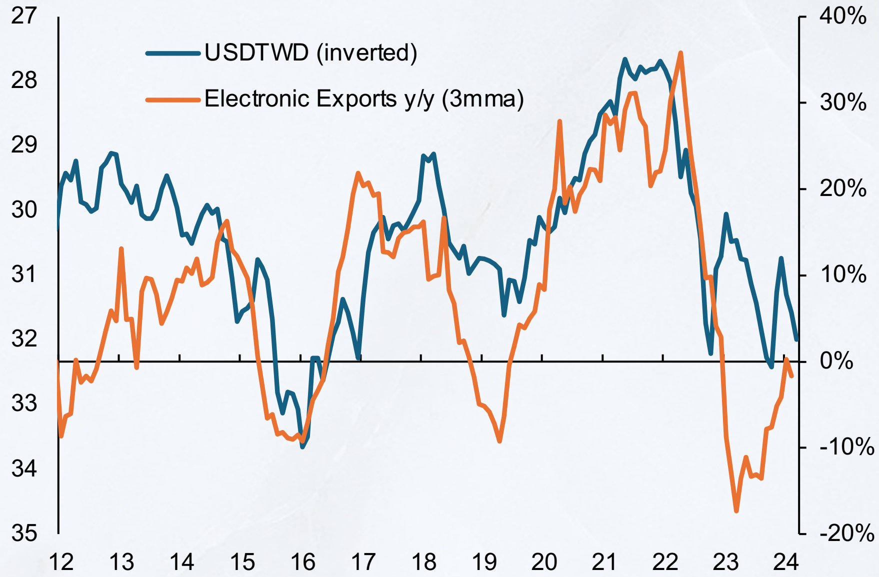
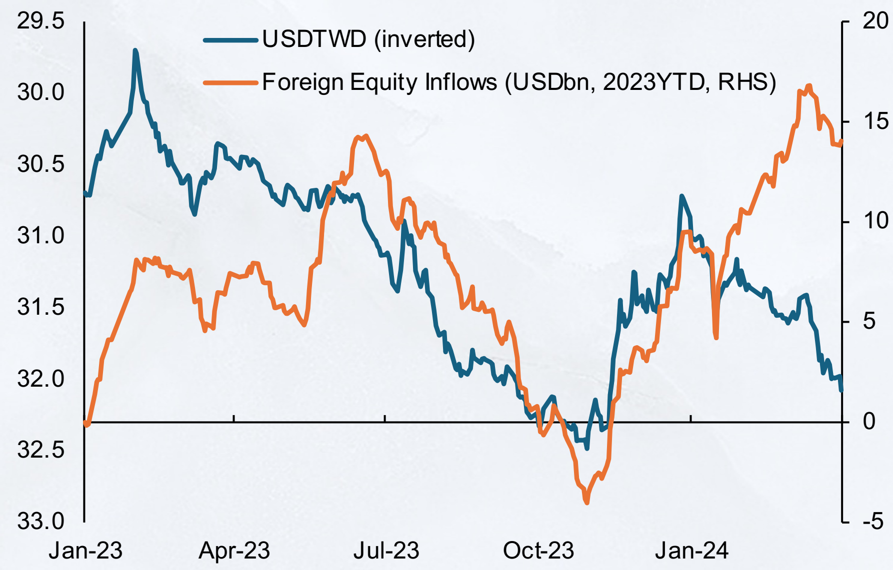


Fig. 27: TWD & Equity inflows



Equity markets are blooming but didn't help currency. Foreigner equity inflows take a lion's share of FX trading in Taiwan as they account for 40% of the total TWSE market share, making TWD highly correlated to equities, but a divergence has appeared (**Fig. 26**) recently with two factors: 1) local outflows are more robust to take advantage of low valuation on US fixed-income asset before Fed cuts; 2) foreigners are keen on using swap & NDF as macro hedge this year, decreasing direct FX spot transaction. Altogether, we see strong fundamental support for TWD, but widened rates spread continue to encourage local investment outflows this year. Hence, we think USDTWD will be range-bound, similar to the RMB. The currency should face stronger pressure in summer with huge dividend seasonality outflows (USD25bn), but the CBC will be ready to manage the volatility. Our 2024YE forecast for USDTWD uprise to 30.5 with Fed re-adjustment.

KRW: Heavy outflows keep its toes. Similar to Taiwan, Korea is now under recovery along with an upward electronic & especially DRAM cycle. The better outlook from both Samsung & SK Hynix also strengthens local confidence in economic outlook. However, the momentum of terminal demand seems to weaken a bit (but remain intact) as DRAM prices suggest. Government and BoK also introduced some measurements that provide supportive dynamics for KRW as we stated in our *BoK review*. Despite that, Korea's current account surplus is not as strong as Taiwan's, which makes the currency vulnerable to energy price moves (like what we saw in 2022). The recent spike in commodities in the wake of improving global demand could cap Won's strength given it heavily relies on imported energy.

Fig. 28: Korea C/A surplus continue to widen

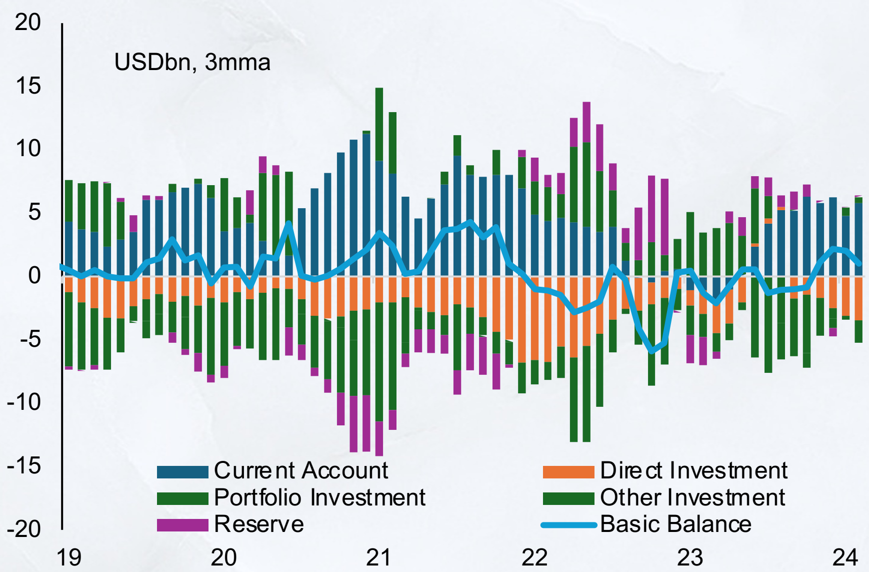
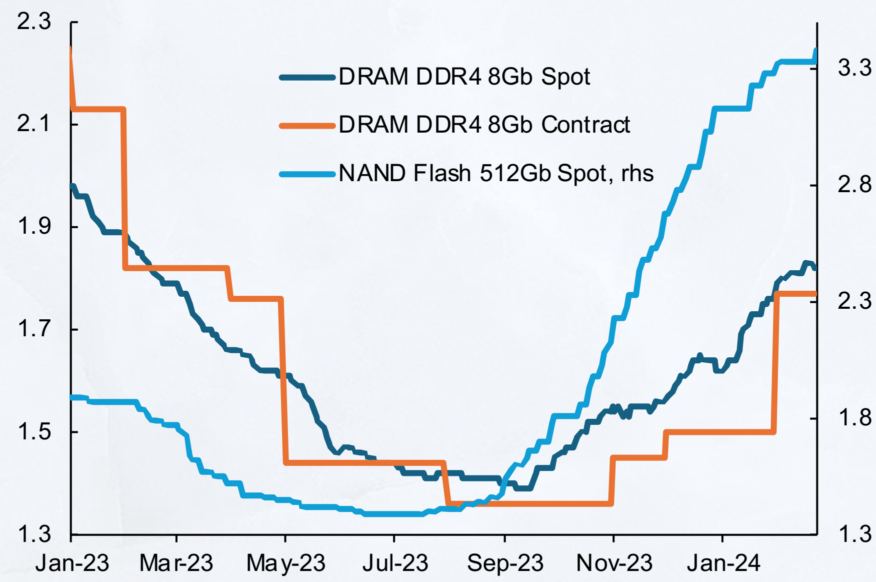


Fig. 29: Momentum of DRAM cycle has weakened a bit



Whole cross-border flow picture seems quite precariously balanced. In Jan-Feb, for portfolio outflows: there were cUSD5.5bn from NPS, cUSD5.5bn from retail investors, and cUSD5bn from financial institutions (**Fig. 30**), twice that of 2022-23. Good news is that foreigners' portfolio inflows have been strong. There have been cUSD14bn of equity inflows YTD, compared to the cUSD11bn recorded in all of 2023. But there is a risk of equity outflow arising from positioning adjustment (rotation to underweight markets) and/or risk aversion (from geopolitics or a hawkish Fed).

NPS's robust outflows limit KRW upside. Over 2024, we expect the NPS's structural demand for USD to remain strong. Total USD needs of the NPS as much of that will depend on relative performance between domestic & overseas equities (**Fig. 31**). If the reform momentum behind Corporate Value-Up continues, it is likely to lead to a higher weight in domestic equities that will result in more USD buying as the NPS is pushed to rebalance. Overall, we are bullish on KRW from a fundamental perspective, but flow dynamics and high volatility characteristic raise the bar to forecast.

Fig. 30: Local portfolio outflows (Year-to-date)

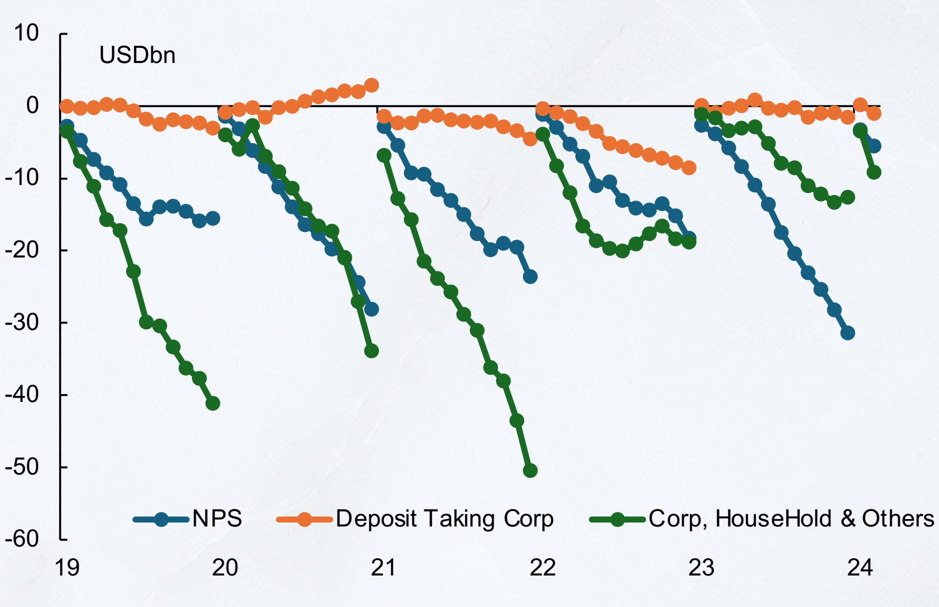
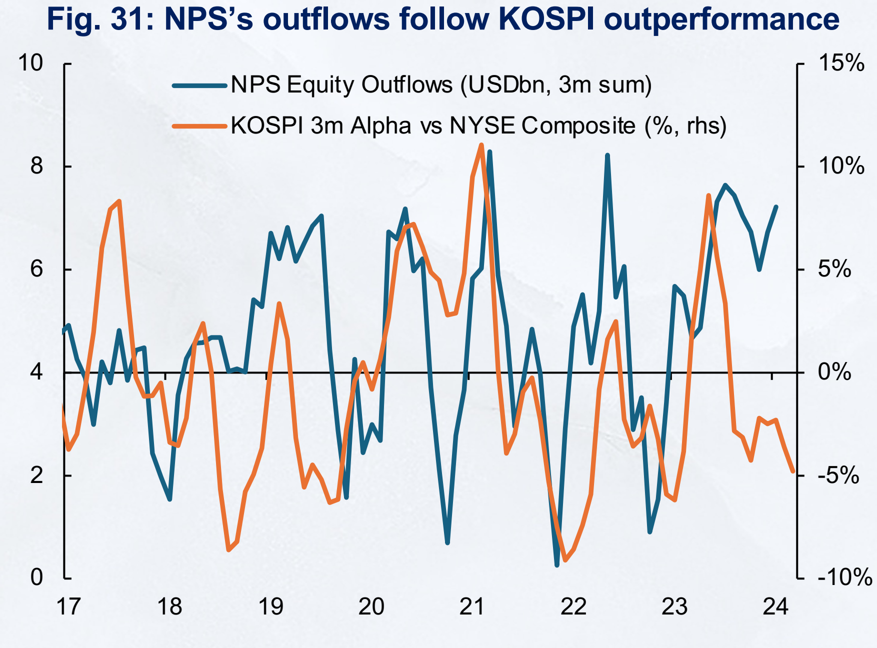


Fig. 31: NPS's outflows follow KOSPI outperformance



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