Asia FI & FX Strategy Watch

Charting Asia: Resiliency tested

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GEM FI & FX Strategy
Asia

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Asia rates & FX in key charts

We put together 12 key charts we are watching to assess our Asia FX and rates views and recommendations. These can be distilled into the following key themes:

1) **Asia FX is resilient** – There is little sign of financial contagion or spillovers into Asia FX; portfolio inflows and FX reserves are rising.
2) **Long live the recovery** – Exports are down, but China recovery is up. However, China recovery upside risks are not yet fully priced.
3) **2Q will see China tourism comeback** – Flight bookings are back to 35-55% of Asia top destinations pre-COVID levels.
4) **Negative carry a headwind** – Favors long IDR, PHP and INR. Our preferred long is IDR.
5) **Bullish IDR** – Tourism and terms of trade will give an added boost to the rupiah.
6) **HKD yield gap is holding HKD back** – Despite continuous aggregate balance drains, HIBOR is struggling to increase resulting in the HK-US rates gap to be wide and FX forward points to be deep.
7) **KRW know your equity flow** – Negative headlines around the semiconductor industry has not impacted foreign interest in the Korean electronics sector.
8) **TWD hedging costs remain challenging** – The wide policy rate gap between Taiwan and the US is increasing the lifers' hedging cost as they search for alternatives.
9) **THB is golden** – The rally in gold prices is another positive for THB.

Timestamp: 13 April 2023 04:00PM EDT

12 Key charts we are watching

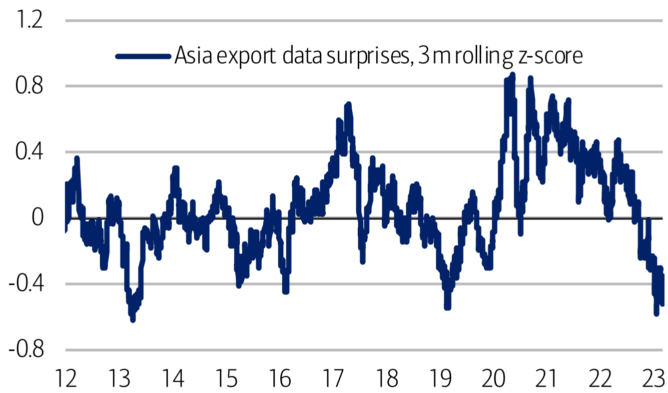
We put together 12 key charts that we are watching to assess our Asia FX and rates views and recommendations.

1. Asia export data surprises (past decade) **(Exhibit 1)**
2. China "reopening pricing" has pulled back **(Exhibit 2)**
3. Correlation between EM FX and Bank of America GFSI **(Exhibit 3)**
4. FX intervention across Asia **(Exhibit 4)**
5. 12-month FX carry across Asia **(Exhibit 5)**
6. Chinese outbound seats by top destinations, % of 2019 **(Exhibit 6)**
7. Hong Kong 12-month forward points and 1-year interest rate differential **(Exhibit 7)**
8. IDR to benefit from tourism recovery as well **(Exhibit 8)**
9. IDR's terms of trade advantage offset by low conversion and accumulation of FX deposits **(Exhibit 9)**
10. Korea equity inflow by sector (US$ bn) **(Exhibit 10)**
11. 12-month hedging cost to sell USDTWD **(Exhibit 11)**
12. THB correlated to higher gold prices **(Exhibit 12)**

What to watch

Exhibit 1: Asia export data surprises (past decade)

Extreme data surprises can be a contrarian indicator



Source: Bloomberg

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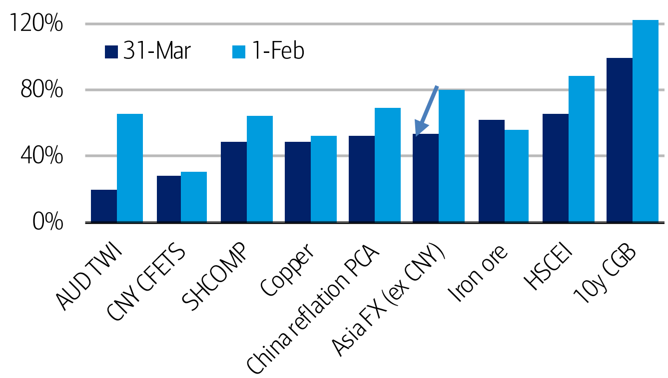
- Asia export data surprises are at their most negative in years despite hopes for a recovery in China's import impulse.
- Current extreme levels can be a contrarian indicator as forecast revisions make downside surprises less likely.
- China's economic recovery should make itself felt in regional exports in late 2Q and 3Q.
- Korea should be a key beneficiary as China share of Korea exports, provides a substantial counterbalance to EU and US exports.

Exhibit 2: China "reopening pricing" has pulled back

March saw a pullback in reopening pricing measured by retracement to Mar 2022 highs (pre Shanghai lockdown) from Nov 2022 lows (pre reopening).



Source: BofA Global Research

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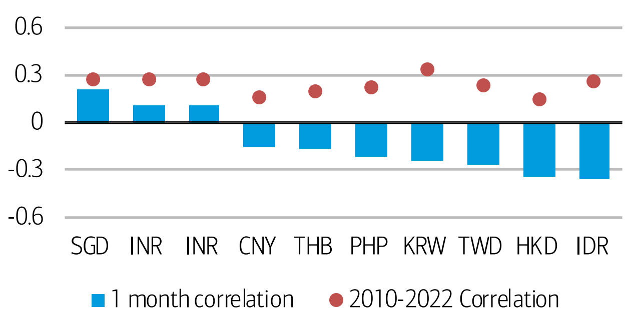
- We examine a host of China benchmarks and related to proxies to gauge China's reopening and recovery being priced in.
- Asia FX no longer "perfectly priced" for China reopening; recovers when export cycle turns & external conditions stabilize.
- CNY CFETS has underperformed but this is consistent with likely current account deterioration later this year.

Exhibit 3: Correlation between EM FX and Bank of America GFSI

Correlation measured over the past month and past 12-years



Source: BofA Global Research

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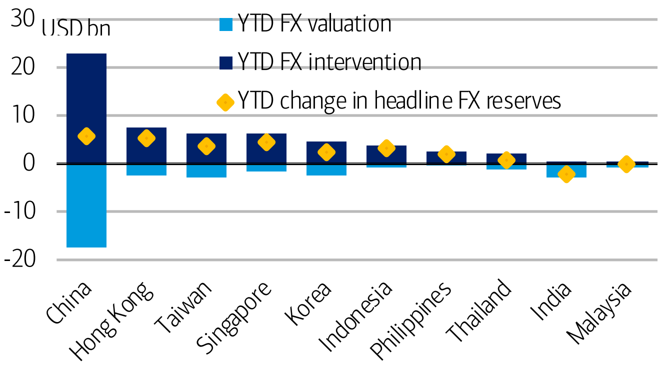
- Asian currencies showed remarkable resilient in the face of Global Financial Stress in March.
- The correlation of Asia FX returns with the BofA Global Financial Stress index were mostly negative or low in March.
- This compares with the long-term correlations that do show a spillover effect of financial stress contagion to Asia FX depreciation over the past 12 years.
- A combination of a very proactive US and Swiss policy response and flush liquidity in Asia appears to be limiting financial spillovers for now.

Exhibit 4: FX intervention across Asia

China FX reserve accumulation is rising modestly again as portfolio inflows pick up



Source: BofA Global Research estimates, Bloomberg

Note: YTD refers to till Feb-23

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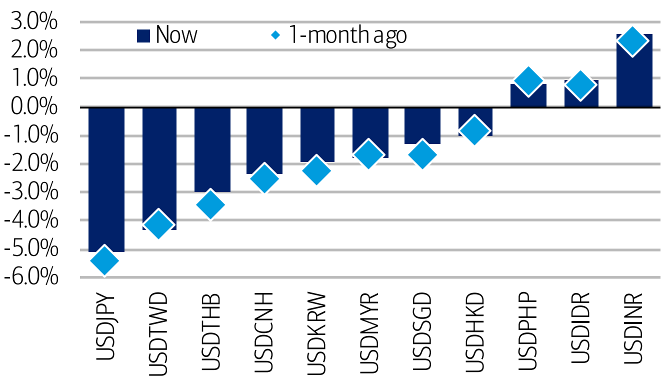
- Asia central bank reserve accumulation is back.
- After accounting for the negative FX valuation effects from USD strength, FX reserves have risen year-to-date in China (USD5.4bn), HK (USD5.1bn) and Taiwan (USD3.44bn).
- The exception is India where we estimate year-to-date, FX reserves have fallen a modest USD2bn in FX value adjusted terms.

Exhibit 5: 12-month FX carry across Asia

The negative carry to sell US$ in Asia remains high even after the recent rally in US rates



Source: BofA Global Research, Bloomberg

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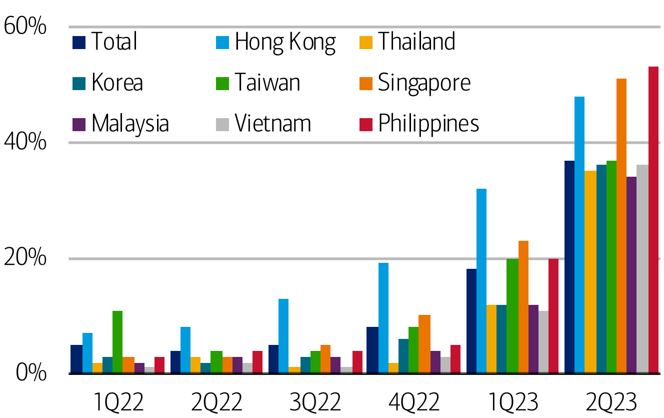
- The recent rally in US rates has not materially changed the carry cost to sell US$ in the Asia.
- Across the majority of the low-yielders, the negative carry to sell US$ remains near cycle highs.
- Unless the Fed signals for an immediate cut, or growth and equity sentiment in Asia rebound, we see little incentives for international investors to sell USD-Asia now.

Exhibit 6: Chinese outbound seats by top destinations, % of 2019

Timetabled data points to meaningful recovery in 2Q 23



Source: Diio, BofA Global Research

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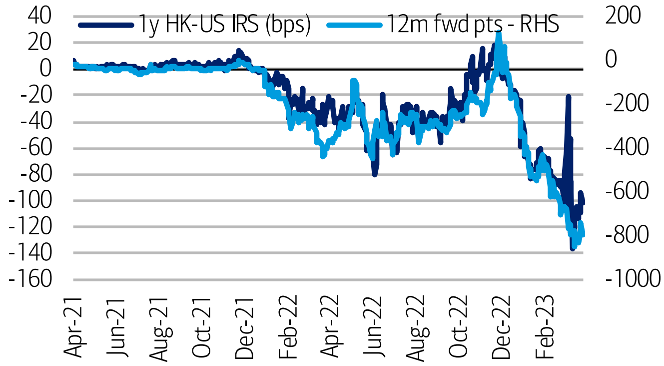
- Our transport analysts have looked at timetabled data to gauge the recovery of outbound travel.
- Based on their estimates, China outbound travel should approach 37% of its pre-COVID 2019 level by end 2Q this year.
- Specifically, HK, Thailand and the Philippines will even achieve 50% of their pre-COVID tourist arrivals in 2Q.
- Ultimately, outbound China tourism should normalize by the end of this year.

Exhibit 7: Hong Kong 12-month forward points and 1-year interest rate differential

HKD forward points are being dragged lower because of widening interest rate differentials with the US



Source: Bloomberg

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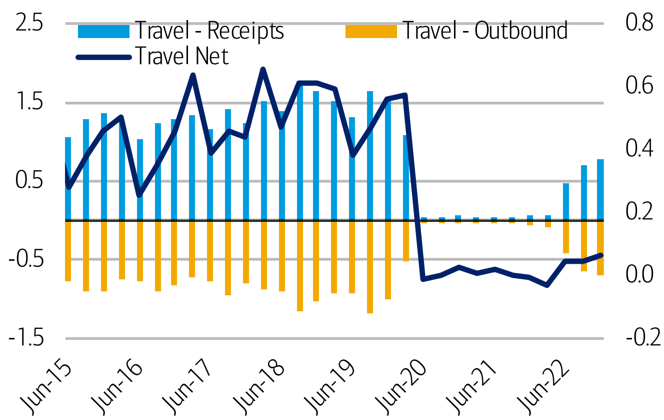
- Despite the rally in US rates since the implosion of Silicon Valley Bank (SVB), 1-year Hong Kong rates have outperformed relative to their US counterparts.
- The market is pricing in for no more material aggregate balance drain from the HKMA and the 3-month HIBOR fixing will rise by another 30bps over the next 3 months.
- The near record lows in FX forwards are making the cost to buy call spreads on USDHKD cheap and the pay-out of ratio high if spot USDHKD stays at the 7.85 level.

Exhibit 8: IDR to benefit from tourism recovery as well

Travel receipts, outbound payments (% GDP, lhs) and net balance (% GDP, rhs)



Source: BofA Global Research

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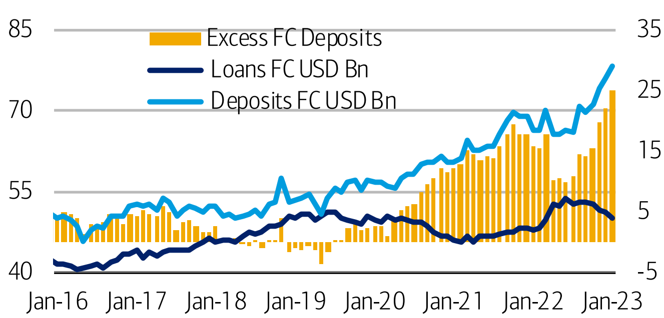
- IDR's terms of trade advantage on goods exports has been well-flagged but tourism recovery would help reduce the services exports deficit.
- Outbound tourism had recovered faster but China re-opening would also support net tourism recovery.
- Historically, tourism revenues have netted close to 0.6% of GDP and gross inflows of 1.5% of GDP would also be positive factor for growth.

Exhibit 9: IDR's terms of trade advantage offset by low conversion and accumulation of FX deposits

Indonesia banks' foreign currency (FC) loans, deposits (USD Bn, lhs) and net excess deposits (USD Bn, rhs)



Source: BofA Global Research

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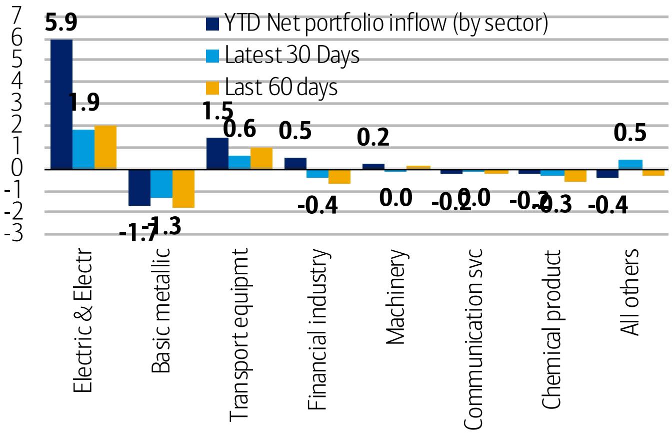
- IDR's external accounts have been in surplus not just due to higher commodity prices, but also backed by structural improvement towards more value-added exports.
- However, low domestic deposit rates have reduced the repatriation and conversion into IDR, leading to BI having to deploy its reserves to stabilize IDR.
- Despite low domestic USD rates, net USD deposits have continued to accumulate rapidly on both higher deposits and loan repayments. Higher onshore USD liquidity may support IDR further if USD softens and interest-rates differentials becomes favorable for IDR.

Exhibit 10: Korea equity inflow by sector (US$ bn)

Net portfolio flow to Korea began stagnating in the second half of 1Q23



Source: BofA Global Research, Bloomberg

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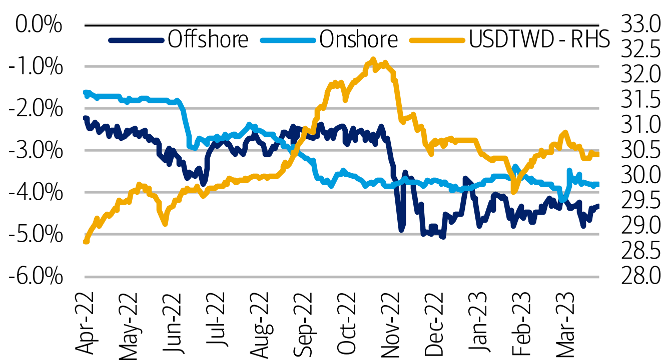
- After an impressive start for the first six weeks of 2023, net equity portfolio flow to Korea has slowed for the remainder of 1Q.
- Negative headlines around the semiconductor industry have not impacted foreign interest in the Korean electronics sector.
- Foreign portfolio inflow into the Korean electronics sector remain strong despite the current situation of a supply glut.
- Further weakness in net portfolio flow to Korea is an upside risk to our 1Q23 expectation for USDKRW to reach 1,270.

Exhibit 11: 12-month hedging cost to sell USDTWD

Taiwan lifers' cost to hedge US$ positions remains high & at close to 4%



Source: BofA Global Research, Bloomberg

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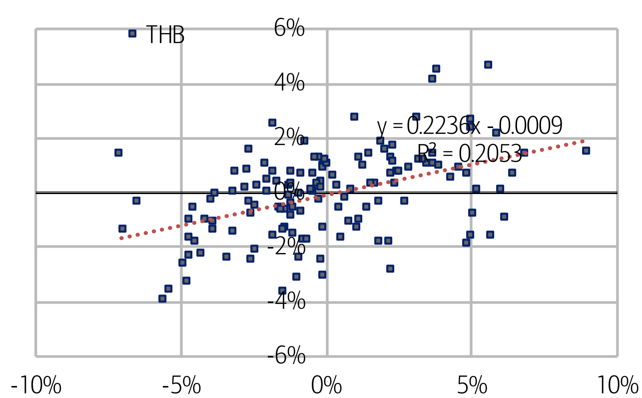
- Hedging cost for Taiwanese lifers remains high across both the deliverable forward (DF) and non-deliverable forward (NDF) curves.
- Taiwanese lifers will likely absorb the increased FX hedging cost by running down provisions for FX reserves.
- We judge the use of FX reserves to be an accounting treatment and will not impact the amount US$ Taiwanese lifers will sell to the DF and NDF market.

Exhibit 12: THB correlated to higher gold prices

Weekly returns of THB (y-axis, %) vs gold (x-axis, %)



Source: BofA Global Research

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- Tourism recovery, lower oil prices and reduction in freight costs have improved Thailand's current account to a surplus.
- Beyond these factors, the market also trades THB based on its positive correlation to gold prices. This is noted in our regression of THB's weekly returns on gold price changes.
- While Thailand's net gold exports are around 0.5-1% of GDP on average, 0.22x beta to gold is consistent with these net exports being around 10-20% of overall current account surplus.

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