FX Flash

Positive Mood Needs Good Data to Reinforce AXJ Gains

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Plenty of Events: No Negatives at Least

We update our FX views in this report taking into consideration the occurrence of a few significant events over the last 72 hours or so including: (1) a partial deal between US and China; (2) MAS policy decision to ease policy was within expectations; (3) positive progress on brexit talks between UK and EU; (4) Fed announced purchase of $60bn of Treasury bills per month starting 15th Oct could help to ease funding stress; (5) Malaysia budget announcement suggests fiscal discipline is reined in.

Partial Phase-1 Deal Yet to Be Signed - Caution Warranted

The partial deal (agreed in-principle) between US and China (11th Oct) should temporarily boost sentiments, remove some of the depreciation pressure on CNH and provide relative support for AXJ FX, including KRW and TWD. The actual signing of the agreement is still 4 - 5 weeks away and past experience suggests there is still room for disappointment (i.e. breakdown while drafting agreement). This is especially so as Trump said details still must be ironed out. Markets' "provision" for such disappointment could still see "half-hearted" (or cautious) gains in AXJ FX in the lead up to the actual signing, which may take place at **the sidelines of the APEC leaders' summit in Chile on 17th Nov 2019**. Both President Xi and Trump are expected to meet.

Re-escalation in US-China Tensions Possible Despite Progress

Moving forward, this partial deal, or "phase 1" as Trump termed it, is only one part of the resolution of a bigger dispute encompassing trade, technology transfer, intellectual property protection, Huawei issue, etc. Focus will be down to the timeline of resolving the rest.

Total trade deal is far from sight and the lack of visibility at this stage could still un-nerve FX markets and pose 2-way risks to AXJs. However far from sight does not mean that trade talks cannot progress materially especially when China has drawn up a list of harder issues with a timeline to resolve them in 2020. We expect US-China to come to another partial or phase-2 of the deal in 1H 2020, ahead of US Presidential elections.

Hence at this stage, we keep our FX forecast trajectory and values unchanged.

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Trade-linked FX to Benefit but Cautious of Excessive Gains

USDCNH is expected to take cues from daily USDCNY fix. Move lower not ruled out but downside could still be restrained as emphasis shifts to Chinese economic data releases this week – trade (today); inflation (Tue) and 3Q GDP, Sep activity indicators (Fri). Risk of China headline 3Q GDP slipping just under 6% may well provide the support on dips in USDCNH. That said, expectations of this print have been set rather low with Premier Li Keqiang acknowledging the challenge of maintaining a growth pace above 6.0%. Hence, a growth print that beats of consensus of 6.1% may be able to add steam to RMB bulls. Afterall, the stronger Sep PMI-mfg hints of some positive impact kicking in from infrastructure boosts and other fiscal stimulus provided earlier this year. Immediate support at 7.07, 7.03 and 7.0050 levels likely to hold. Resistance at 7.12 (21, 50 DMAs), 7.14 levels.

USDTWD via 1m NDF has fallen about 2% since the start of the month on a combination of factors including pick-up in demand for 5G network development helping Taiwanese semiconductor companies, a beneficiary in supply chain shifts arising out of US-China trade dispute and positive sentiment from phase-1 of the partial China trade deal. Bias remains for USDTWD to stay under pressure but the large move seen earlier this month may have slightly overdone. We do not rule out retracement higher towards 30.8 (spot) but **bias remains for downside play.** Support seen at 30.35 (50% fibo retracement of 2018 low to 2019 high), 30 levels (61.8% fibo).

1m USDKRW NDF traded a low of 1177 levels last Fri amid positive sentiment arising out of US-China trade talk progress. But domestic growth concerns, deflation risks, ongoing Japan-Korea trade spat and potential BoK rate cut (16^{th} Oct) are likely to limit gains in KRW. Immediate support at 1177 (61.8% fibo retracement of Jul low to Aug high) before 1166 (76.4% fibo) likely to provide interim supports.

But we look for near term rebound towards 1185, 1195 levels. Though Korea may have averted a technical recession in 2Q, ongoing trade disputes and rising concerns of slowing global growth have resulted in shifts in supply chain network and had dented demand. With Sep inflation slowing to -0.4% y/y, S. Korea may be at risk of entering into a few months of deflation. If this is not quickly addressed and becomes longer than expected, investments, asset values and incomes could be affected and this can lead to lower consumption and further weigh on growth and its currency. **We expect BoK to cut policy rate by 25bps at the upcoming MPC on 16^{th} Oct**.

MAS Eases Policy as Expected - USDSGD Downside Limited; Look for Mild Rebound

Our house view for MAS to “reduce the slope of the SGD NEER ‘slightly’ from the current +1% appreciation path to +0.5%, but keep the width and centre of the policy band unchanged” was realized.

USDSGD dropped momentarily from around 1.3720 to 1.3680 after the decision early this morning, but quickly rebounded to hover around 1.371. Notably, most of the USDSGD down-move from last Friday morning's ~1.38-level was on trade policy optimism out of US-China talks, and the influence of these developments is expected to continue early this week. We expect USDSGD to take cue from USDCNH in the interim, but further downsides for the pair could be limited, especially as SGD NEER is now seen at around +1.4% above mid-point of the policy band. We continue to look for a downward bias in SGD NEER (to below +1.0% relative to policy mid) given its elevated level. USDSGD's next support at 1.3650 (200 DMA). Resistance at 1.3790/1.3820 (21, 50 DMA), 1.3840 (23.6% Fibonacci retracement from Jul low to Sep high).

Brexit Negotiations Surprisingly Picked Up Pace; Positive for GBP

Fears of hard brexit receded fairly quickly after joint statement (10 Oct) from PM BoJo and Irish Premier Varadkar said they see "pathway to a possible deal". Subsequent meetings between EU and UK brexit negotiators on Fri were described as "constructive". Despite notable progress, the timeline to reach a tentative deal by the upcoming EU Summit (17 – 18 Oct) may still be too tight to meet. A technical extension beyond 31st Oct (brexit day) to ratify the withdrawal agreement is not ruled out.

Though an exit is imminent, possibility of a transitional agreement with resolution on Irish borders (instead of a hard/disorderly exit) is a near term positive. Looking on, a clean break with EU allows UK to move on to forge new trade relations with its trading partners.

Our call to accumulate GBP on dips, looking for move towards 200 DMA (11 Sep) has come close to meeting its objective. Bias remains to accumulate GBP on dips but **continue to caution that brexit developments remain fluid and will subject GBP to 2-way swings**. Pair was last seen at 1.2600 levels. Momentum and stochastics indicators on weekly, daily chart are bullish bias. Bullish divergence on weekly MACD is underway. Next resistance at 1.2880 (38.2% fibo retracement of 2018 high to 2019 low), 1.3170 (50% fibo) and 1.3450 (61.8% fibo). Support at 1.2530 (23.6% fibo), 1.2410 (100 DMA).

We emphasize that not all is one-way positive for GBP as brexit discussions are known to flip-flop and UK is still grappling with growth issues at home. Downside surprise to economic data and/or less-positive comments coming from UK or EU on brexit proposal could still dampen GBP gains.

No Negative Surprise from Malaysia Budget: Neutral on MYR

Malaysia's budget announcement was largely in line with expectation with no major surprises. 2020 budget deficit is projected to improve to 3.2% of GDP, from 3.4% in 2019, though projection is wider than previous target of 3%. We do not expect much impact on MYR to come through via Malaysia budget.

External drivers such as US-China trade talk progress, Fed policy, FTSE-Russell review decision in Mar-2020, cross asset movements in global equities and oil prices will more than likely drive direction for MYR. In particular positive mood from US-China phase-1 deal could support equity sentiment and oil prices; and these are supportive of MYR gains. However market "provision" for disappointment and expectations of BNM rate cut at its next MPC meeting (5th Nov) could still keep MYR gains leashed. Key support for USDMYR at 4.16 before 4.14 levels. Resistance at 4.20, 4.22 levels.

Conclusion - Sustained AXJ Gains Require Good Data

In conclusion month of October could shape up to be a positive month for risk assets and non-USD FX but we think some of those appreciation in non-USD FX may have been priced to some extent.

While positive mood could still keep gains in AXJ FX intact, concerns of low growth at risk of being protracted for longer, market scepticism on US-China trade deal and concerns on overvaluation in equity markets could still keep sentiment leashed, hence keeping further AXJ FX gains at bay. **Clearer signs of growth stabilisation or rebound are needed for sustained AXJ gains beyond sentiment-fuelled ones**. In particular China growth and activity data this Fri (18th Oct) will provide those cues especially when market expectations for China GDP are skewed to the downside. Upside surprise on China data may add momentum to further AXJ gains.

On relative value plays, we prefer long TWD vs. short KRW and SGD on monetary and economic divergence.

We take partial profit on our USDCNH position at 7.0760 as we write this morning with small gains of 0.5% amid the uncertainty on what could transpire within these 4-5 weeks before the deal is inked at the APEC Summit. We stand by our view that a break of the 7.07-support could open the way towards 7.00. At this point, the deal that has been announced so far is leaner than we expected even as it still suggests warmer ties between the US and China. That said, we do not rule out the potential for stronger economic data (eyes on 3Q GDP this Fri 18th Oct) that can usher in the next leg of RMB gains beyond 7.00.

Medium Term View - USD to Trade Lower

While the USD may still see some support in the interim on its dual characteristics of "carry" and "safe haven" as well as a lack of alternative reserve currency, we are of the view that **USD strength cannot be sustained in the medium term**. US economy will not escape unscathed in an environment of global growth and trade slowdown.

Continued USD appreciation and slowing global growth will result in tighter financial conditions, resulting in the need for Fed to turn more dovish. Though Fed claimed that its recent move to conduct monthly purchase of $60bn Treasury bills starting 15th Oct and to last into 1H 2020 is targeted at maintaining bank reserves in the system and does not represent policy easing, we do not rule out the case of Fed turning dovish (either via forward guidance at the upcoming FoMC on 31st Oct and/or further rate cuts). Dovish guidance would take the USD lower, especially when USD long positions are stretched at 30-month high. We expect upside to be capped at 99-levels and look for DXY to trade lower towards 96 levels.

Structural medium term factors such as deterioration in twin deficits of current and fiscal accounts in US, ongoing reserves diversification away from USD could then come into play, supporting the sell USD bias. The risk of US intervening to counter USD strength should also not be ruled out especially when President Trump's patience on USD strength and the Fed is wearing thin. Though we see a low chance of direct US intervention, the threat of US intervention gaining traction could undermine the USD.

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