FX Asia Fortnightly

Treading Cautiously

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ASEAN FX is likely to trade cautiously ahead as external events continue to serve as guide posts. Looming US tariffs on USD200bn of Chinese exports, ongoing market angst over EMs, and trade talks between US and its trading partners including Canada, EU and Japan continue to weigh on ASEAN FX. At the same time, markets will also be eyeing CPI data out of US for further clues on Fed rate hike trajectory. A less aggressive rate hike trajectory amid easing trade tensions and EM risks could see the USD drift lower and lift ASEAN FX higher ahead. A slew of China data including CPI, new yuan loans, etc. is also on tap sometime in the week of 10 Sep and data outperformance should be supportive of the yuan and provide some relief to ASEAN FX as well. Escalating EM stresses though could weigh further on the IDR with an overshoot towards 15000-levels cannot be ruled out.

BOJ and BoT meets on 12 Sep and there is little to indicate that either central bank will change direction. BOJ is still a ways from its 2% inflation target, making it unlikely for any policy tightening in the foreseeable horizon. Meanwhile, BoT has the policy space to be patient before beginning the process of normalising policy. BOT is expected to normalise policy only in 4Q.

Our in-house model implies that SGD NEER is trading 0.72% above the implied midpoint of 1.3851, suggesting it is on the stronger side of the SGD vs. other trading partner currencies.

IDR Weakness Could Persist For A While Longer

ASEAN FX was put under pressure by contagion concerns from EM stresses in the past week triggered by crises in Turkey, Argentina and South Africa. Concerns that more EMs could blow-up could lead to further pullback in funds and exacerbate the outflows from EMs. In particular, the IDR was the worst hit in ASEAN, falling around 2.1% since 28 Aug. The IDR's vulnerability was due to the country's twin deficits, large foreign holding of its domestic assets and dependence on external sources for funding. Aside from macro-fundamentals, various market indicators also suggest that the IDR remains under pressure. The rise in Indonesian CDS by about 30bp since Aug that reflects increase concerns over spillover effects from EM contagion risks, though a credit default event by Indonesia seems unlikely at this point. USDIDR forward points suggest that market is looking for further IDR weakness ahead as reflected in the spike in the forward points since end-Aug. While the spike in the forward points has eased from its recent high (of 339) to 200 at the point of writing, it remains elevated and suggests that downside pressure on the IDR could remain for now. USDIDR 3-month at the money option volatility has spiked to a two-year high of 13.26 on 5 Sep as concerns over spill-over from EM risks escalated. When compared to its 5-year average of around 9.5, the contrast is even starker. The USDIDR vols were mostly below its 5-year average for the past year or so. It has now spiked beyond its 5-year average and this signals that the USDIDR could remain supported ahead. Technical chart suggests that risks are still to the upside, though there is a potential for a pullback given overstretched conditions. Resistance is around the 15000-levels. Support around 14650-levels.

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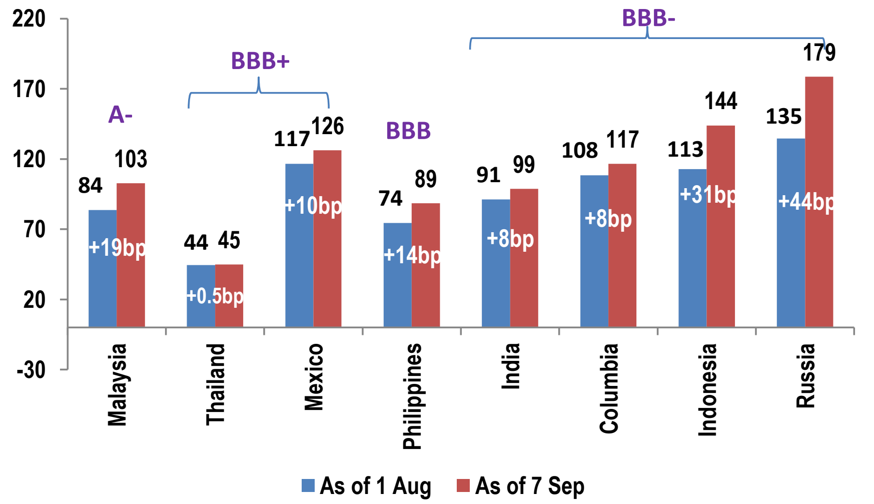
Flavour of the Week: IDR Weakness Could Persist For A While Longer

- ASEAN FX was put under pressure by contagion concerns from EM stresses in the past week that spurred portfolio outflows. These EM stresses had been triggered first by the crisis in Turkey, followed by Argentina and then South Africa. Concerns that more EMs could blow-up could lead to further pullback in funds and exacerbate the outflows from EMs.

- In particular, the IDR was the worst hit in ASEAN, falling around 2.1% since 28 Aug. The IDR's vulnerability was due to the country's twin deficits (2Q current account deficit: 3.04%; 2018 estimate for fiscal deficit: -2.12%), large foreign holding of its domestic assets (around 40%) and dependence on external sources for funding. Aside from macro-fundamentals, various market indicators also suggest that the IDR remains under pressure.

- Risks that contagion fears from EM risks have risen as reflected in rising CDS for Indonesia. But there does not appear to be an imminent risk of a meltdown in Indonesia. The rise in Indonesian CDS by about 30bp since Aug that reflects increase concerns over spillover effects from EM contagion risks (Chart 1). Nevertheless, the rise in CDS though does not appear excessive as compared to the taper tantrum period in 2013 when the premiums had jumped 80bp. A credit default event by Indonesia seems unlikely at this point. At the same time, Indonesia's CDS may have risen more markedly than its peers in the BBB- credit rating space but is not the worst. Russia's CDS has risen by even more.

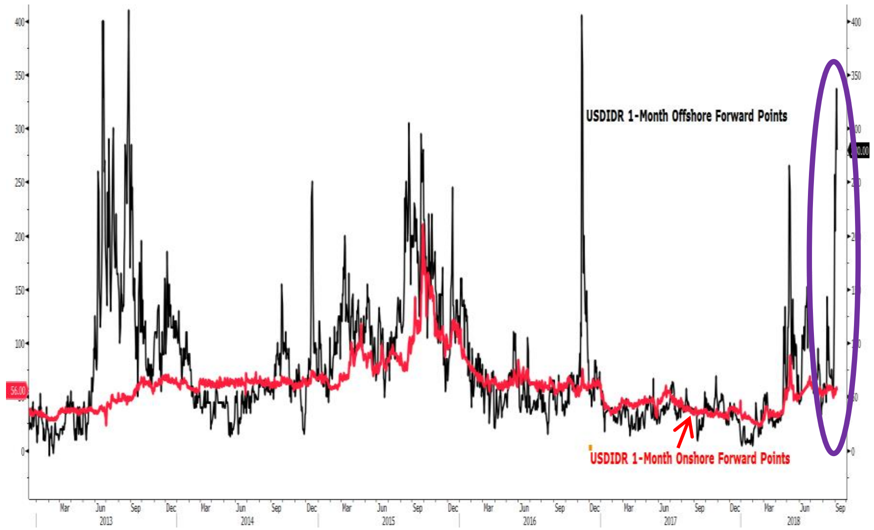
Chart 1: ID 5-Yr CDS Has Climbed Higher Since Aug



Note: (1) Countries are grouped by S&P credit ratings
(2) Change in CDS between 1 Aug and 7 Sep show within bars
Source: Bloomberg, Maybank FX Research & Strategy

- USDIDR forward points suggest that market is looking for further IDR weakness ahead as reflected in the spike in the forward points since end-Aug (Chart 2). While the spike in the forward points has eased from its recent high (of 339) to 200 at the point of writing, it remains elevated and suggests that downside pressure on the IDR could remain for now. At the same time, onshore forward points have remained relatively stable around the 56-levels. This divergence between onshore and offshore forward points could reflect ample liquidity onshore and also intervention by the BI to curb IDR volatility.

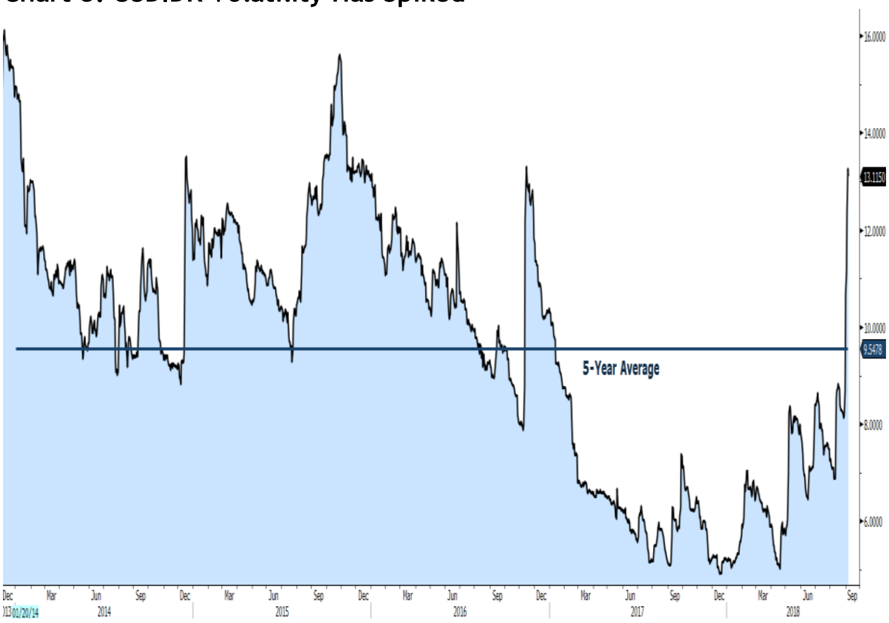
Chart 2: Offshore Forward Point Premium Has Risen



Source: Bloomberg, Maybank FX Research & Strategy

- USDIDR 3-month at the money option volatility has spiked to a two-year high of 13.26 on 5 Sep as concerns over spill-over from EM risks escalated (Chart 3). When compared to its 5-year average of around 9.5, the contrast is even starker. The USDIDR vols were mostly below its 5-year average for the past year or so. It has now spiked beyond its 5-year average and this signals that the USDIDR could remain supported around current levels for now.

Chart 3: USDIDR Volatility Has Spiked



Note: USDIDR volatility is proxied by USDIDR 3 Month at the money option volatility
Source: Bloomberg, Maybank FX Research & Strategy

Despite all the concerns over the vulnerability of the IDR, we believe that the measures introduced by the government as well as BI, including a policy of import substitution, the use of biodiesel as an alternative to crude oil, and introduction of overnight index swaps and interest-rate swaps for hedging by corporates, should help with the current account deficit and temper the sell-off in the IDR. At the same time, expectations that BI could move again on its policy rate, possibly through another unscheduled meeting, should also be supportive of the IDR. Continued intervention in both the FX and bond markets by BI should also help to curb volatility in the IDR and yields given ample foreign exchange reserves. Already we are seeing the forward points coming off and the gap between onshore-offshore forward points could narrow, suggesting that contagion fears from EM stresses have tapered amid softer USD.

Clarity on further risks from EM stresses remains cloudy. Much will depend on policy responses of the central banks and governments of the vulnerable economies. Failure to introduce credible policies could cause further market angst and put EMs under further pressure.

Chart 4: USDIDR Weekly Chart - Upside Bias But Potential For Retracement

Source: Bloomberg, Maybank FX Research & Strategy

Last seen around 14890. USDIDR has risen to levels not seen since the Asian Financial Crisis in 1998. Momentum indicators remain bullish bias on the weekly chart, and stochastics remains in overbought. This suggests risks are still to the upside, though there is a potential for a pullback given overstretched conditions. Resistance is around the 15000-levels. Support around 14650-levels.

Key Data and Events Ahead

	10-16 Sep	17-23 Sep
Japan	• **Mon:** GDP (2Q F), Current Account (Jul) • **Tue:** Tertiary Industry Index (Jul), Machine Tool Orders (Aug F) • **Wed:** - Nil - • **Thu:** PPI (Aug), Core Machine Orders (Jul) • **Fri:** Capacity Utilisation, Industrial Production (Jul)	• **Mon: Public Holiday** • **Tue:** - Nil - • **Wed: BOJ Policy Balance Rate**, Trade (Aug) • **Thu:** LDP Presidency Election • **Fri:** CPI (Aug), Nikkei PMI Mfg (Sep P), All Industry Activity Index (Jul)
China	• **Mon:** PPI, CPI (Aug), Money Supply, Aggregate Financing, New Yuan Loans (Aug - due 10-15 Sep) • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** Retail Sales, Industrial Production, FAI Urban (Aug)	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -
South Korea	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** Unemployment Rate (Aug) • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** PPI (Aug)
Singapore	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** Retail Sales (Jul) • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon:** NODX (Aug) • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -
Malaysia	• **Mon: Public Holiday** • **Tue: Public Holiday** • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon: Public Holiday** • **Tue:** - Nil - • **Wed:** CPI (Aug) • **Thu:** - Nil - • **Fri:** Foreign Reserves (14 Sep)
Indonesia	• **Mon:** - Nil - • **Tue: Public Holiday** • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon:** Trade (Aug) • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** Campaigning For 2019 Presidential Election Begins
Philippines	• **Mon:** - Nil - • **Tue:** Trade (Jul) • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon:** Overseas Remittances (Jul) • **Tue:** - Nil - • **Wed:** BoP (Aug) • **Thu:** - Nil - • **Fri:** - Nil -
Thailand	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** Foreign Reserves (7 Sep)	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed: BoT One-Day Bond Repurchase Rate**; Custom Trade (Aug - due 19-24 Sep) • **Thu:** - Nil - • **Fri:** Foreign Reserves (14 Sep)
India	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** CPI (Aug), Industrial Production (Jul), Trade (Aug - due 12-15 Sep) • **Thu:** - Nil - • **Fri:** Wholesale Prices (Aug), **Public Holliday**	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -
Vietnam	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:** - Nil - • **Fri:** - Nil -	• **Mon:** - Nil - • **Tue:** - Nil - • **Wed:** - Nil - • **Thu:**- Nil - • **Fri:** - Nil -

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