February 6, 2023

FX Insight

Refreshing the BEER and A look at JPY-ASEAN linkages

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Refreshing the BEER

With the DXY index already down 11% from its Sep peak, we feel compelled to search for any stark currency misalignments by conducting a fair value assessment at this point using our Maybank Behavioural Equilibrium Exchange Rate Panel (Maybank-BEER). Another key theme that has yet to play out fully is the potential for further monetary policy normalization/tightening by BoJ. Speculations remain rife on BoJ's next move and that is contributing significantly to recent JPY's strength. In this report, we look into whether ASEAN FX is able to benefit from further JPY appreciation.

USD has Room to Fall Further. MYR, JPY Most Undervalued.

We shared our Maybank BEER model approach in Jan 2020, right before the pandemic started. We find it timely to refresh our Maybank BEER Model at this point. Our variables include net foreign assets, trade openness, short-term nominal interest rate differential (deviation from trading partners' weighted average), inflation differential (deviation from trading partners' weighted average). Our model estimation suggests that the USD remains the most overvalued amongst the G7 currencies while JPY is most undervalued. Amongst the regional currencies, PHP is overvalued (higher inflation) while MYR is undervalued (higher short-term nominal rates and low inflation) which may suggest a long MYR/PHP medium term play, especially in light of PHP's fundamental vulnerabilities. We note that SGD is moderately overvalued and could adjust a tad in the medium term.

JPY Strength has Spillover Effects on Certain ASEAN FX

Another key theme that has yet to play out fully is the potential for further monetary policy normalization/tightening by BoJ and concomitant JPY appreciation. We had a look into whether the ASEAN FX is able to benefit from further JPY gains. From our own investigations, we found only negligible effects on the MYR, SGD and PHP from JPY strengthening. However, the spillover effects onto the IDR and THB were much stronger possibly due to the high level of Japanese FDI inflow into Indonesia and Thailand. Regardless, the effects as a whole were more limited and the DXY is still by far the largest driver of ASEAN FX's performance.

Strategies

Our BEER estimates suggest that beyond the near term there is less scope for JPY depreciation in the short-term and we could see fundamental adjustment in the USDJPY pair lower. Hence, going short USDJPY carries a fairly desirable risk-reward ratio given that losses can be limited. In terms of JPY-ASEAN FX cross currency pairs, we recommend going long JPYPHP simply because the JPY stands a good chance to outperform the PHP as the latter's gains are likely to be more limited amid vulnerable fundamentals. Nearer to home, MYR is most undervalued and continues to be supported by the prospect of improvements in its external accounts in light of China re-opening. That could underpin its outperformance against the relatively vulnerable PHP as well as against the moderately overvalued SGD.

Searching for FX Opportunities in Misalignments

Right into the turn of the year, markets were treated with multiple boosts of euphoria including Fed's downshifts in tightening, better than expected economic activity in Europe as well as China's re-opening.

With the DXY index already down 11% from its Sep peak, we feel compelled to search for any stark misalignments by conducting fair value assessment at this point using our Maybank Behavioural Equilibrium Exchange Rate Panel (Maybank-BEER).

Unwinding the Angsts of 2022

In 2022, we had the war in Ukraine, surge in commodity prices, multi-decade high inflations as well as synchronous central bank aggressive tightening that drove USD higher against the rest of the world. The greenback's dominance was especially stark against ASEAN FX as the sharp slowdown in China's growth weighed on the region.

Into the turn of the year, we saw a dramatic turnaround.

Fig 1a Various Asset Classes Rally Into the Turn of the Year

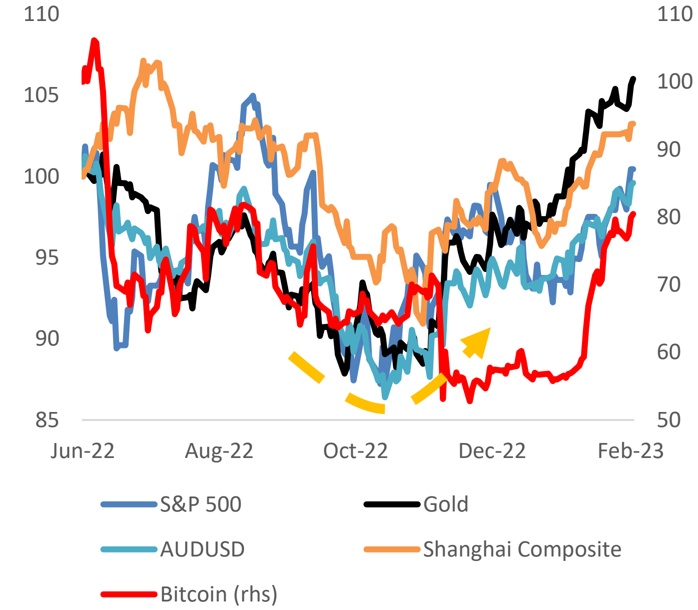
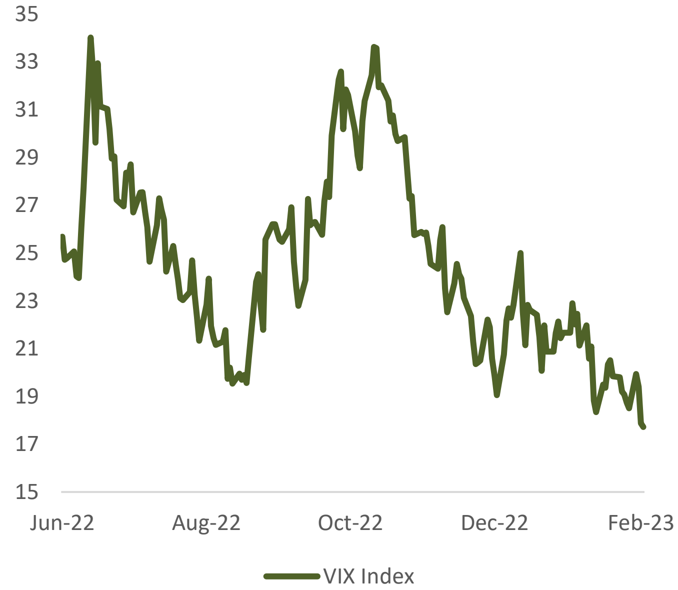


Fig 1b… As Volatility Plummets



Note: For Figure 1a, all prices are index to 100 = 1 Jun 2022.
Source for both Figure 1a and 1b: Bloomberg, Maybank FX Research

Risky assets rallied with relief as Fed slowed its pace of rate hikes in Dec and then again on the 1 Feb. Central banks in the rest of the world (BNM, BI, BSP, etc) took the cue from the lead hawk to ease their pace of tightening respectively or even signal a pause (BoC). This was a sharp contrast to BOJ where members of its Policy Board now contemplate the side effects of ultra-accommodative policies. Inflation trajectories are still key to the respective monetary policy stance. Central banks that face stronger inflationary pressure (such as RBA) could be forced to remain on the tightening cycle a while more.

Markets were given an additional boost of euphoria by China's rush to re-open and ease (almost) all mobility restrictions ahead of Spring Festival. Bourses across the world are in the green YTD. Concerns of Europe's energy crisis also eased with the help of a warmer winter. It seems that most of 2022 angst and concomitant USD underpinnings have unwound. We retain a somewhat bearish call on the greenback this year on average.

However, with the DXY index already down 11% from its Sep peak, we feel compelled to search for any stark misalignments by conducting fair value assessment at this point using our Maybank Behavioral Equilibrium Exchange Rate Panel.

Using the Maybank BEER in Search of FX Misalignments

Our Maybank BEER Model was first unveiled in Jan 2020, right before the pandemic started. We find it timely to refresh our Maybank BEER Model at this point not just because we are at the start of the year but also due to the fact that we are arguably at inflection points in terms of monetary policies, macro-economic cycles for certain major economies and as markets become a tad more comfortable with a stalemate status for the war in Ukraine.

Once again, we like to remind readers of caveats. Empirically-derived "equilibrium" or "fair" FX valuations provide the most value add when they are used to supplement existing understanding of market conditions. They are not meant to provide point forecast for fixed durations and it is common for long stretches of time to pass before spot values converge towards their so-called "equilibrium" in the medium term.

Still, the BEER could be useful to inform us of severe misalignments that could exist between current spot levels and valuations suggested by key structural and fundamental drivers. The greater the deviation of the currency is from its cyclical drivers or fundamentals, the more likely it is to see some form of reversions.

Characteristics of the Maybank-BEER Panel

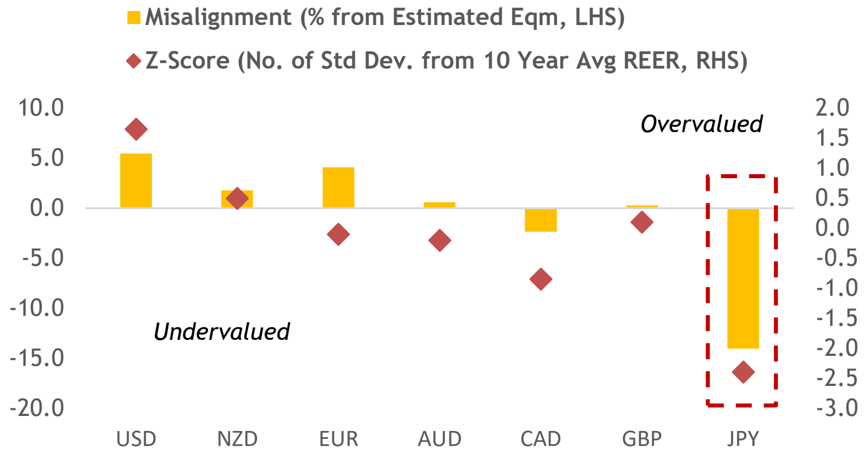
- **Tracks Misalignments in REER terms (i.e., basket of trading partners' currencies).**
- **Relevant for 3 to 5 Year View**
- Adapted from BEER literature (Clark & MacDonald, 1999)
- Quarterly Data, Dynamic OLS Panel Estimation
- Data used in Panel for *Country I* include:
  - Net Foreign Assets (% of GDP)
  - Trade Openness (Total Trade as % of GDP)
  - Short-term Nominal Interest Rates Differential (%-Pt Deviation from Trading Partners' Weighted Average)
  - Inflation Differential (%-pt deviation from Trading Partners' Weighted Average)

Findings: USD Has More Room to Fall and JPY is still Significantly Undervalued

Apart from our BEER model estimations, we overlay the deviations of our model estimates with a set of REER z-scores extracted from Bloomberg on 2 Feb as a point of reference (red diamonds) for Figure 2. We note that across G7 currencies, most of the misalignments estimated by the Maybank BEER model are roughly in line with the Bloomberg's REER z-score.

Our model estimation suggests that the USD remains the most overvalued amongst the G7 currencies. The Maybank-BEER panel estimates that the USD REER is overvalued by about 5.5% from the REER perspective. The z-score of Bloomberg's USD REER suggests that it is 1.7 standard deviation from its 10y average. This further validates our core 2023 view that the bearish USD trend could still extend based on its fundamentals.

Fig 2: USD Has Room To Fall

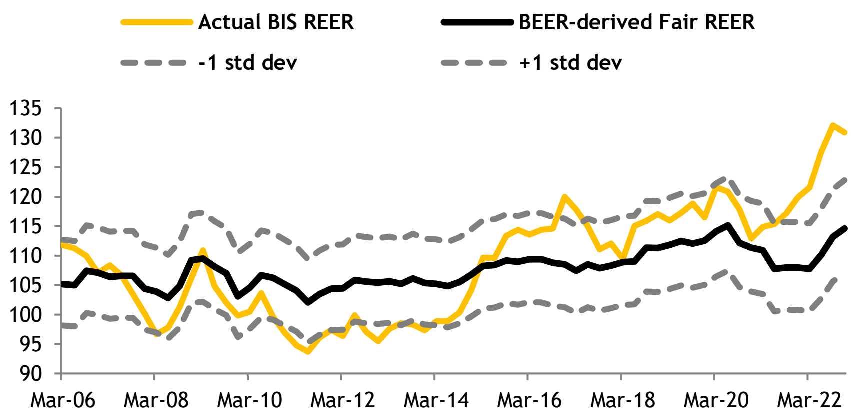


Source: Maybank FX Research & Strategy Estimates, Bloomberg

EUR is moderately overvalued based on the BEER model. The JPY on the other hand, is the most undervalued G7 currency at around -14% away from what its fundamentals suggest. This also corresponds with what Bloomberg's z-score suggest at -2.4 standard deviation from its 10yr mean. As for NZD, AUD, CAD and GBP, they are relatively close to their fair values based on the BEER model as well as Bloomberg's REER z-scores. Taken together, we continue to favour shorting the USD against the JPY.

Based on our estimates, the USD BEER has only just started to adjust within the last quarter and could have more room to go.

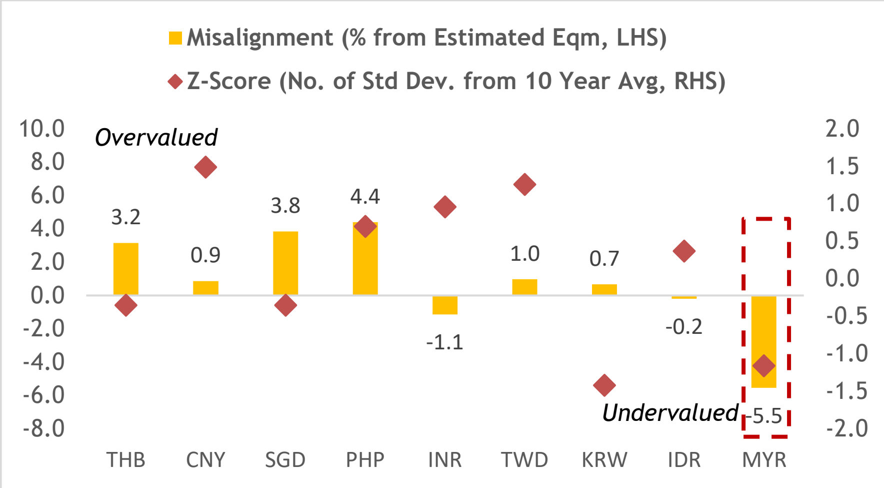
Fig 3: the USD BEER has started to adjust lower



Source: Maybank FX Research & Strategy Estimates

FX Fair Values and Misalignments in the Region

Fig. 4: MYR remains Undervalued based on Maybank BEER estimates



Source: Maybank FX Research & Strategy Estimates, Bloomberg

Maybank BEER Implied Fair Value

	USD	EUR	JPY	CHF	GBP	CAD	AUD	NZD
Overvaluation(+)/ Undervaluation(-)	5.5	4.1	-14.0	0.1	0.3	-2.4	0.6	1.8

	CNY	SGD	MYR	IDR	INR	THB	KRW	TWD	PHP
Overvaluation(+)/ Undervaluation(-)	+0.9	+3.8	-5.5	-0.2	-1.1	+3.2	+0.7	+1.0	+4.4

Note: The over/undervaluation applies to the REER trade weighted currency from tbe Maybank BEER model.

Source: Maybank FX Research & Strategy Estimates

MYR remains the most undervalued amongst Asian Currencies with an estimated 5.5% appreciation to go before it reaches its equilibrium REER. This aligns with the z-score of its REER extracted from Bloomberg and strengthens our bullish view of the currency this year. China's demand recovery could potentially lift the exports receipts for the MYR, positive for its trade balance.

At this point, quite a number of regional currencies seem to be a tad overvalued including SGD, THB and PHP based on our model estimates. PHP is seen to be the most overvalued and could be vulnerable for bearish reversion against the undervalued MYR. This could be due to Philippine's high inflation relative to weighted partner's average. The same can be said for the SGD and THB as well, but to a smaller extent.

The SGD is understandably overvalued due to its safe haven allure in times of uncertainties but that also subjects the SGD to potential underperformance given that the environment is becoming more benign for risk taking with central banks dialing back their tightening pace as well as greater economic resilience seen in global growth, bolstered by China's reopening. In addition, the MAS' SGD policy moves over the past 2 years, has led to a strong SGD appreciation to address expected and current inflationary pressures. Our house view of a further policy move in April suggests this would continue to contribute to SGD support. Nonetheless, the model suggests that in the medium term, some level of adjustment in the SGD may come in.

On PHP, the currency's weak fundamental situation puts it in a continued unfavourable situation in our downside scenario. The Philippines' twin budget and current account deficit is likely going to remain wide into 2023 and could subject the PHP to depreciation pressure this year.

On the other hand, the return of Chinese tourists would be the biggest boon for the currency going into 2023. Tourist arrivals from China accounted for 28% of total visitor arrivals and tourism receipts pre-pandemic. This would play a major role in helping to swing the current account back into a surplus in 2023. Thailand was in fact the most visited destination by Chinese traveller pre-pandemic in 2019.

So in terms of relative value play, we would recommend Shorting the PHP vs. the MYR in the regional space. And we also prefer a short USD position against the JPY.

Given that JPY is the most undervalued currency based on the Maybank BEER estimates and the potential for further monetary policy normalization by the BoJ, we will delve into the possible linkage of JPY and most Asian currencies in the next section.

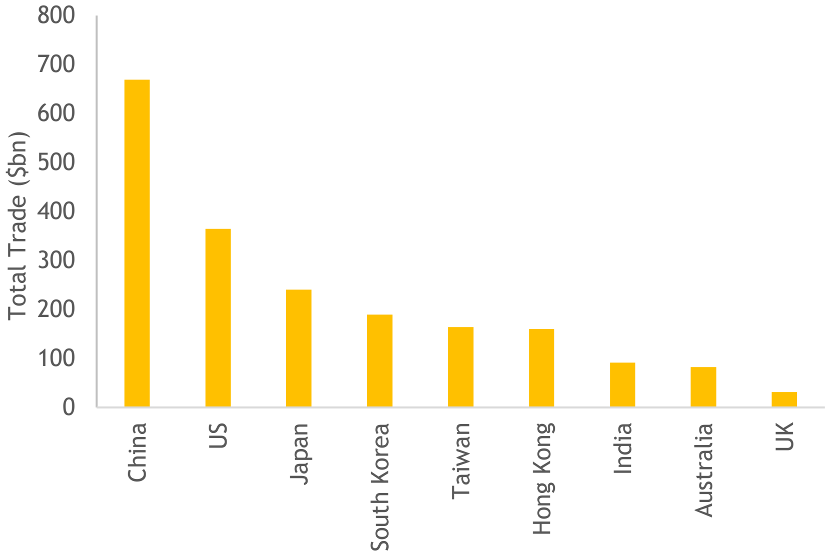
Will There be Spillover Effects From the JPY to the ASEAN FX?

Another key theme that has yet to play out fully is the potential for further monetary policy normalization/tightening by BoJ. Outgoing BoJ Kuroda will end his term on 8 Apr. For much of 2022, Kuroda has maintained a consistent dovish stance in his monetary policy guidance. That is why the sudden decision to widen the YCC band from +/-0.25% to +/-0.50% in Dec caught the markets by surprise. **Speculations remain rife on BoJ's next move and that is contributing significantly to recent JPY's strength. In this report, we look into whether ASEAN FX is able to benefit from further JPY appreciation.**

Japan's Strong Trade Relationship with ASEAN

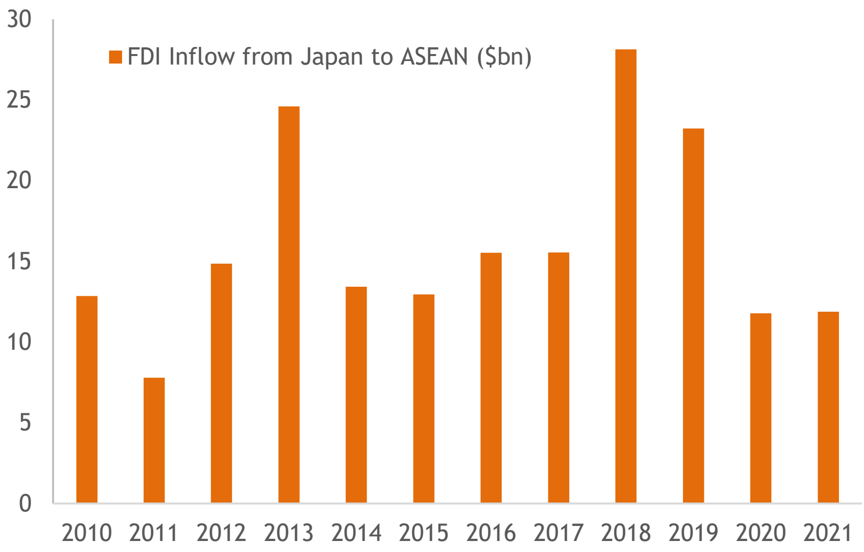
Japan has traditionally been among ASEAN's largest trading partners with the country ranking as the third biggest trading partner in 2021. Total trade between both Japan and ASEAN stood at an astounding $240.4bn, just behind China and the US. Japan was also ASEAN's fourth largest external source of FDI among ASEAN's Dialogue Partners in 2021, with the total amounting to $12.0bn. Pre-pandemic in 2019, Japan was actually the second largest external source of FDI among ASEAN's Dialogue.

Fig. 5: ASEAN's Largest Trading Partners 2021



Source: Bloomberg, Maybank FX Research & Strategy

Fig. 6: Japan FDI Inflow Into ASEAN 2010 - 2021



Source: ASEAN, Maybank FX Research & Strategy

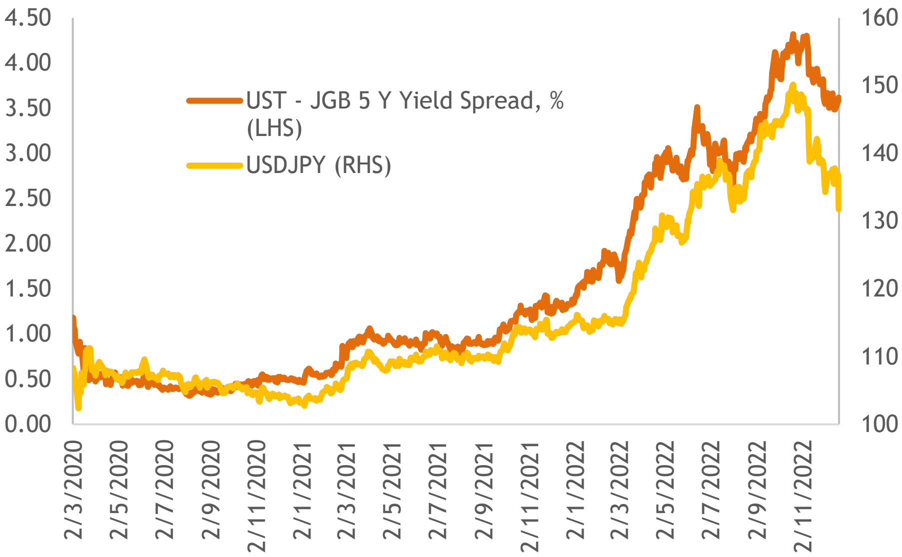
Bets on JPY Strengthening has Been Growing

Since the BOJ's band widening move in December, the USDJPY has fallen substantially as bets rose that this could mark the beginning of a tightening cycle for the BOJ. Prospects for the JPY we believe is going to be bullish for the rest of this year despite the recent heavy appreciation as the global macro environment increasingly turns more favourable. The Fed has become less hawkish (although market perception of them appears to be "dovish" somehow) and US inflation has been softening that should overall guide UST yields lower into this year. Such a development would provide a boost to the JPY given its strong relationship with the UST yields in recent times.

Additionally, we believe the BOJ is likely to further widen the YCC band by another 25bps to +/- 75bps given concerns of bond market functionality concerns. Whilst this may just be a marginal move, the further speculation it creates would likely give further support for the JPY. A move by the BOJ to widen the band further we believe would be part of a process to exit YCC gradually. As it stands, we do not think that YCC is sustainable given the issues that it has already caused to the bond market and keeping it for the long run would be challenging. However, an immediate exit out of YCC by the BOJ is unlikely to be done given the sudden electric shock it can cause to the market. Other actions by the BOJ such as exiting NIRP is unlikely to happen given that the economic case does not support it.

In the near term, speculative pressure towards the JPY may keep rising especially coming into the month of February when an announcement on the nominee for the new governor is expected. Nominations for the governor and deputy governor is set to be submitted to the diet on the 10 Feb. The frontrunners for the governor role are seen to be Masayoshi Amamiya and Hirohide Yamaguchi. The former is seen as more of a dove but he is known for bold measures if the economic situation calls for it. Markets would likely initially perceive his appointment as a form of continuation of Kuroda's governorship and this could lead to upward moves in the USDJPY pair. In contrast, JPY bulls would be emboldened if Hirohide Yamaguchi was to be announced as the nominee given his track-record implies that he is more of a hawk. Even so, his appointment may not likely lead to an overnight unwinding of the YCC but it would give out a clear signal that the BOJ would be working to exit their loose monetary policy settings. Even though the two frontrunner candidates are a real contrast to each other, either of them would still have to face up to the reality of the situation, which is issues related to bond market dysfunction. Resultantly, either candidate would likely still widen the YCC band by 25bps to +/- 75bps.

Fig. 7: USDJPY and UST 5 Y - JGB 5 Y Yield Spread

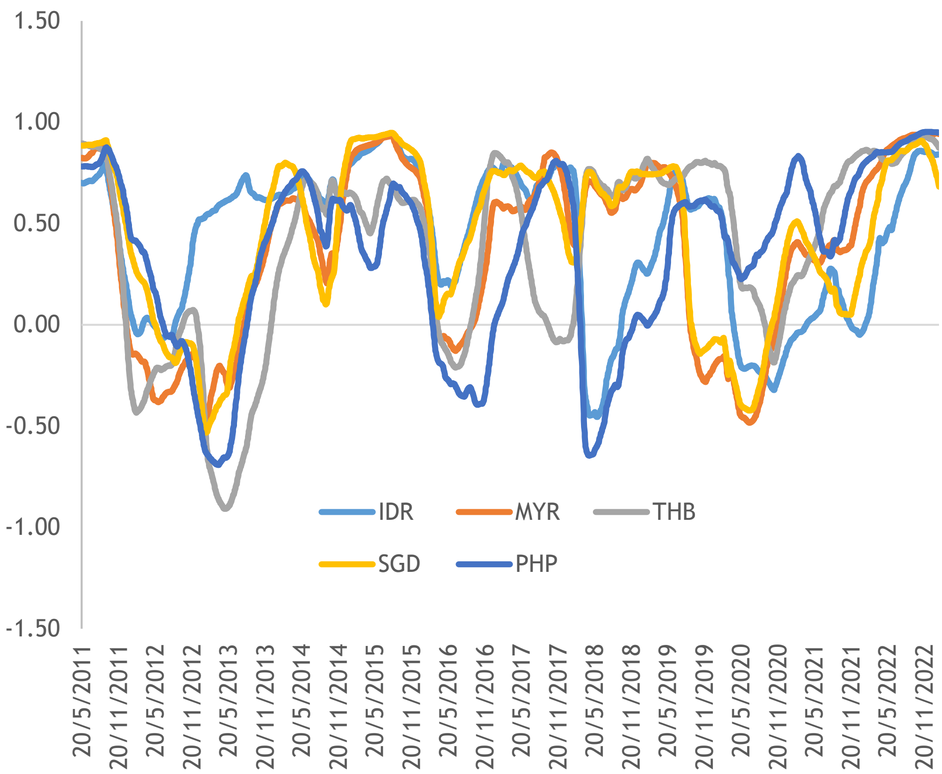


Source: Bloomberg, Maybank FX Research & Strategy

Would There be Spillover Effects to the ASEAN FX?

Looking at the history, we see that the relationship between the JPY and the key ASEAN FX isn't necessarily consistent from time to time (see fig. 8). There can be a strong positive relationship at certain points but in other times not so. In particular, the relationship appears more positively correlated in recent times.

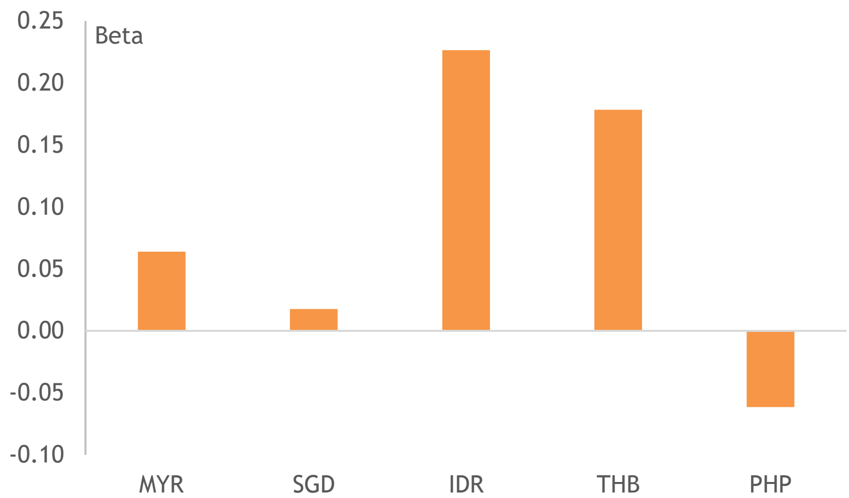
Fig. 8: 360 Days Rolling Correlation Between JPY and Key ASEAN FX



Source: Bloomberg, Maybank FX Research & Strategy

Given this phenomenon, we therefore undertook further investigation to determine whether the JPY had much of an effect on the key ASEAN currencies. We find that it generally was negligible for the MYR, SGD and PHP but the effect was much stronger somehow on the IDR and THB (see fig. 9).

Fig. 9: Effect of the JPY on Key ASEAN Currencies



Note: An ordinary least square estimate was conducted over 2010 - 2023 to determine the effects
Source: Bloomberg, Maybank FX Research & Strategy

Such results were interestingly very contrasting and we therefore decided to look deeper to find out the reasons behind it. One reason that we found was the source of FDI into both Indonesia and Thailand.

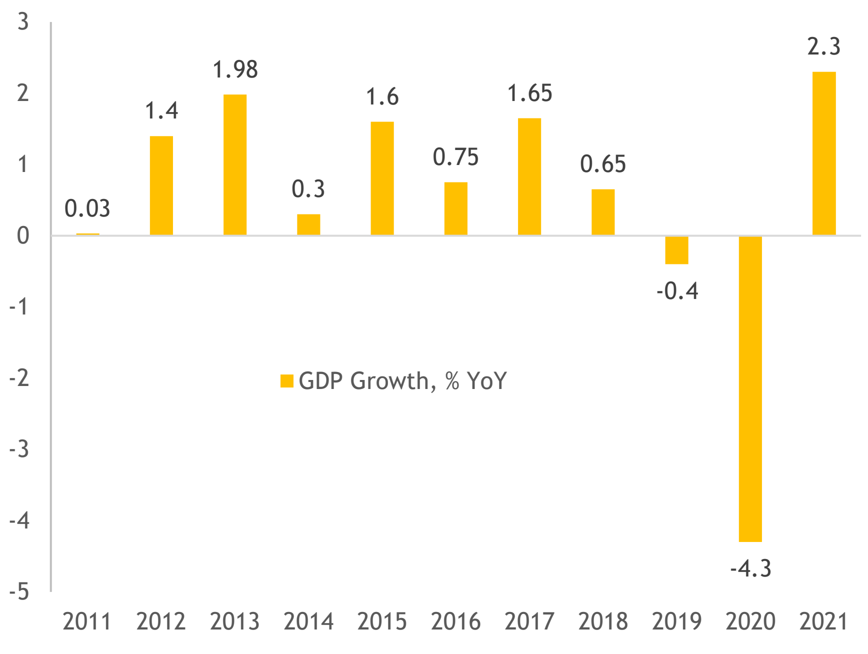
According to the OECD Investment Policy Review for Indonesia (published 2020), Japan accounted for 30% of FDI between 2010 -2019. ASEAN was larger at over 50% but more interestingly 95% of that ASEAN FDI was actually from Singapore. There is a possibility that the FDI from Singapore could also originate from other countries such as Japan given that many multinationals invest in South East Asia via Singapore. Overall, this means that Japan may have a very outsized role in investing in Indonesia. In 2022, Japan was ranked as fourth behind Singapore, China and Hong Kong. However, again this ranking may not truly reflect Japan's true FDI position in Indonesia given that a lot of the country's investment into Indonesia could have been done through Singapore.

As for Thailand, Japan was the largest source of FDI in 2021 and made up 28.6% of all foreign investment. Japan was again top in 2022 with the total value of investment standing at 39.5 billion baht, which was around 31% of all foreign investment.

Regarding the other currencies, the JPY spillover effects could be more negligible simply because they are not be able to benefit from large amounts of Japanese FDI (even if Japan maybe among the top investors in their country) and the support via the trade channel from Japan may not be strong given the sluggish Japanese economy over the last decade or so (see fig. 10).

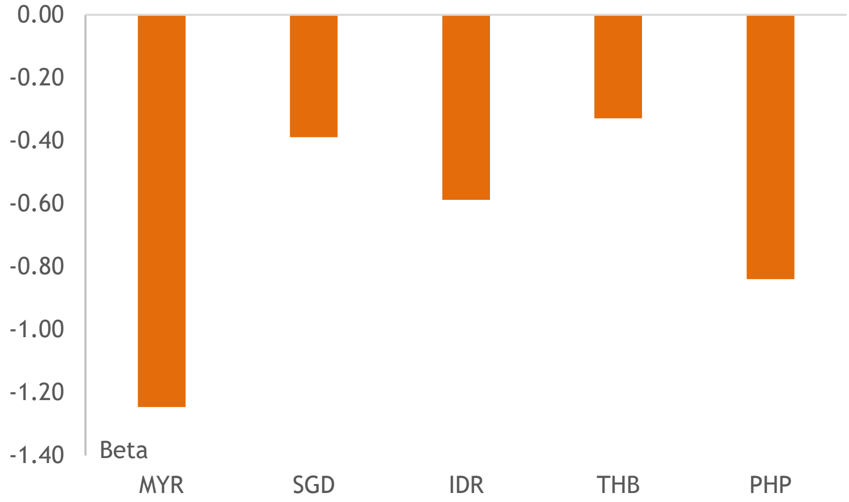
Despite the impact the JPY may have on certain ASEAN currencies, we would still like to note that the DXY by far has the largest impact on the ASEAN currencies (see fig. 11).

Fig 10: Japan's GDP growth between 2011 - 2022



Source: Bloomberg, Maybank FX Research & Strategy

Fig 11: The Effect of the DXY on Key ASEAN Currencies



Note: 1) An ordinary least square estimate was conducted over 2010 - 2023 to determine the effects 2) A negative number implies that an increase in the DXY index would decrease the value of those currencies
Source: Bloomberg, Maybank FX Research & Strategy

US Monetary Policy and USD to be the Driver

As a whole, we see that the spillover effects from JPY appreciation to the ASEAN FX to be limited and that US monetary policy and the DXY are generally going to be the more dominant driver of the JPY and ASEAN FX complex. As it stands, there is an increasing likelihood of Fed rates peaking soon amid cooling US inflation, which would lead the UST yields lower, diminish USD strength and give a boost to JPY and the ASEAN FX.

Conclusion: Currency Plays a Possibility in the Medium Term.

While the BoJ's apparent flexibility on the current policy stance and potential imminent moves has shifted the balance of risks in favor of further JPY strength, the combination of no imminent exit from YCC and a more constructive view on US growth for 2023 relative to consensus fears of a recession may allow the Dollar be resilient against the Yen in the near-term but our BEER estimates suggest that beyond the near term there is less scope for JPY depreciation in the short-term and we could see fundamental adjustment in the USDJPY pair lower.

Hence, going **short USDJPY carries a fairly desirable risk-reward ratio** given that losses can be limited. In terms of JPY-ASEAN FX cross currency pairs, we recommend going **long JPYPHP simpl**y because the JPY stands a good chance to outperform the PHP as the latter's gains are likely to be more limited amid vulnerable fundamentals.

Nearer to home**, MYR continues to be supported** by the prospect of improvements in its external accounts in light of China re-opening. That could underpin its outperformance against the **relatively vulnerable PHP as well as against the moderately overvalued SGD**.

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