FX Insight

Will ASEAN FX Catch A Cold When China Sneezes?

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On China's Growth Moderation, RRR Cuts, Regulatory Changes

The past few months were marked by bouts of risk aversion that had lifted USDAxJ for the most part before modest retracements recently. Risk factors include uncertainties surrounding the Fed tapering schedule and concerns that the delta variant would derail global recovery as infections surged globally. China was also put to the test of the highly transmissible delta variant that caused the broadest outbreak in the country since the start of the pandemic. Authorities reacted with lockdowns and aggressive testing and the impact became evident in recent economic data.

Recent statements issued by the PBoC and Politburo suggest that PBoC has likely shifted towards an easing bias and thus, bets on reserve requirement ratio (RRR) cuts remain alive. Nonetheless, the central bank is likely serious about remaining prudent while ensuring growth supports are "flexible" and "targeted". **RRR cuts are likely to be used sparingly in tandem with other liquidity tools**. Meanwhile, with regards to the latest bout of regulatory tightening in China, we note that **down-moves in China equities did not seem to have significant spillover impact on regional equities nor lasting drags on regional currencies**. There were signs of a FX dip in late Jul, with the RMB pulling down regional FX to some extent, but declines were shallow and transient.

Broadly Tightened Co-movements Between RMB and ASEAN FX

Admittedly, if RMB sentiments had taken a more drastic hit, ASEAN FX moves could look quite different. We employ a simple model used by McCauley & Chang (2018) to evaluate co-movements in RMB and ASEAN FX. **Results show broadly tighter linkages between RMB and the ASEAN FX bloc in the last 1.5 years (since Covid-19 onset) versus the preceding half-decade**—especially for SGD, THB, IDR. This not only reflects increased trade and investment linkages, but also likely a more unique set of factors (lockdowns, vaccine optimism, reopening plays, threats from mutations) nudging risk sentiments in similar directions during this period.

Interestingly, while still significantly positively intertwined, the extent of co-movement between MYR and RMB showed a modest decline. First, MYR could be reacting less to RMB swings simply because it is less volatile itself, due in part to BNM's efforts in recent years to enhance FX liquidity. Second, **a VAR approach shows that USDMYR is subject to a complex set of drivers**. Oil price moves accounted for a large part (35%) of MYR variance in recent years, followed by political & fiscal uncertainty (using CDS as proxy, 19%), US-MY yield differentials (17%), RMB moves (16%).

More broadly for the region, the tightened linkages imply that there is scope for RMB to act as an anchor for ASEAN FX sentiments, mitigating interim concerns from Fed tapering and growth de-rating bets. This "benign anchor" effect is conditional on sustained RMB resilience, which has been on display in recent months despite intermittent China growth drags, PBoC policy bias, regulatory policy shifts. In particular, China's cross-cycle policy design could mitigate downside pressures on the RMB that we normally see in previous easing episodes.

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As China Slows, How Concerned Are We for FX?

"When America sneezes, the world catches a cold"

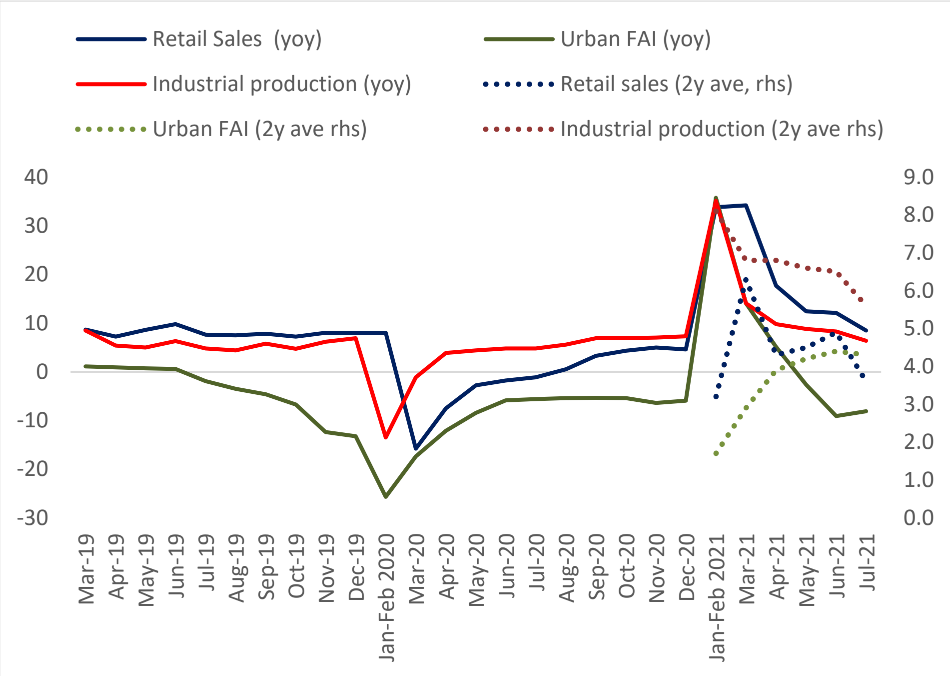
Unknown

This phrase has often been used to describe the US dominance in terms of political, military and not least of, its economic leadership. The last time America had a housing predicament, the rest of the world was plunged into the Global Financial Crisis. In recent decades, China is becoming a more significant bearer of a contagious sneeze and in this report we look into signs of China slowing down, its likely potential policy mix, and implications for RMB. The next section investigates the spillover implications for ASEAN FX, including whether co-movements of ASEAN FX and RMB remain intact post-Covid. And the final section concludes by discussing the upcoming Sep FOMC event.

Fears of a China Slowdown Adds to Recent Risk Aversion

The past few months were marked by bouts of risk aversion that had lifted USDAxJ for the most part before modest retracements recently. There were a few factors including uncertainties surrounding the Fed tapering schedule and concerns that the delta variant would derail global recovery as infections surged globally. China had been known as the first-in-first-out economy but was also put to the test of the highly transmissible delta variant that caused the broadest outbreak in the country since the start of the pandemic. The authorities reacted with swift and harsh lockdowns and aggressive testing and the impact of these lockdowns became evident in recent economic data.

Chart 1: China Activity Slows Down Broadly in Jul Due to Delta



Note: 2 year average growth is used for data this year to have a better gauge of growth momentum with less distortion from base effects.
Source: National Bureau of Statistics, Bloomberg, Maybank FX Research & Strategy

We focus on the 2-year average growth, denoted by the dotted lines in the chart. Retail sales, which ticked higher since Apr, lost momentum with two-year average growth at 3.6% for Jul, underscoring the dampening effects of the delta-driven Covid outbreaks and lockdowns. 2-year average growth for industrial production softened to 5.6%y/y in Jul from previous 6.5% while urban FAI slowed a tad to 4.3%y/y in Jul from previous 4.4%.

Earlier this week, China's Aug manufacturing PMI dropped to 50.1 from previous 50.4. The survey suggests production was barely expanding, while services PMI (a subset of non-manufacturing) plunged into contraction at 45.2 for the month (vs. previous at 52.5), adding to concerns that China's activity would deteriorate further. Construction remains a silver lining with a PMI at 60.5. China's leading index had already flagged a cyclical downturn in the early part of this year and this could be further aggravated by the recent delta-triggered lockdowns. Eyes are on the next set of activity prints for the full extent of damage in Aug.

Chart 2: Aug PMI: Manufacturing Softens while Services Contracts

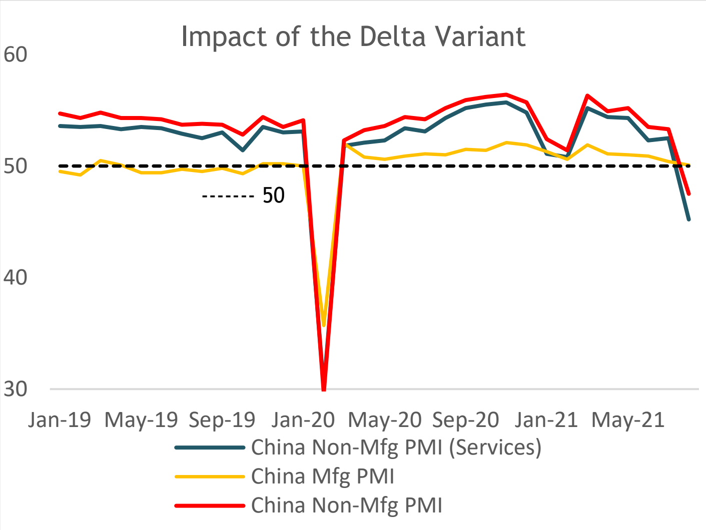
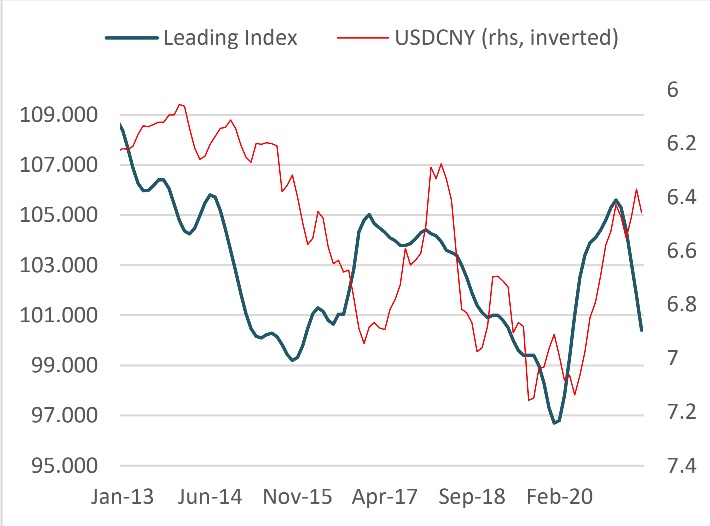


Chart 3: Leading index Flags Downside Pressure on the Economy



Note: The index consists of Hang Seng Mainland Freefloat Index, industrial product sales, M2 money supply, new fixed-asset investment, logistics index, FDI contract value, consumer expectation index, and spread over treasury.
Source: NBS, CEIC, Bloomberg, Maybank FX Research & Strategy

Table 1: China's GDP Forecast

	2019	2020	2021f	2022f	2035f*
Real GDP (%)	6.0	2.3	8.4	5.6	4.7

Source: f denotes consensus forecasts taken from Bloomberg.
2035f is an average yearly projection based on Xi's vision of doubling GDP by 2035.*

For 2021-2022, domestic demand could be propped up by government investment while external demand should continue to ride the tailwinds of moderate global recovery. Beyond 2021, growth for China is likely to drift lower towards its potential growth. In Nov 2020, President Xi envisioned China to double its GDP by 2035 and that works out to be an average annual growth of 4.7% for the next 15 years.

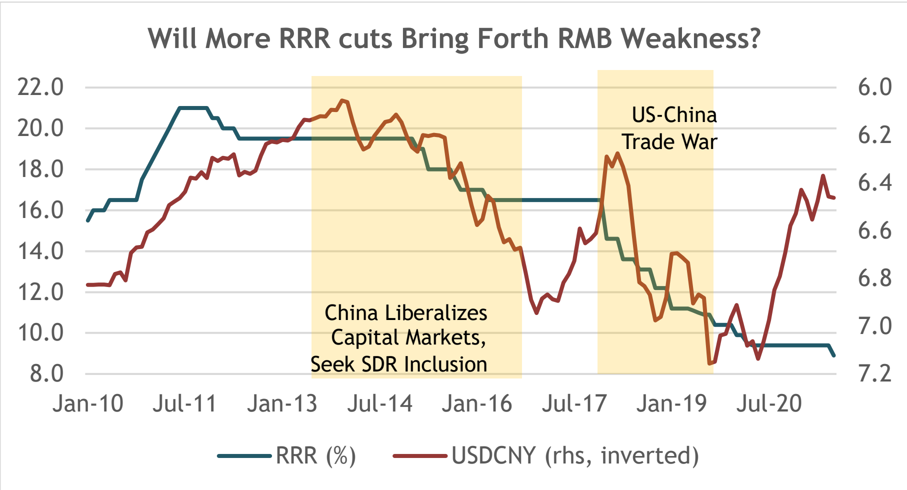
RMB Remains Stable In Spite of Weaker Macro Prospects, Regulatory Crackdown

RMB managed to remain relatively resilient to the recent bouts of USD strength even as broader sentiment, slower global (and domestic growth) as well as regulatory crackdowns threatened the currency. China's swift lockdowns raised concerns on its zero-Covid strategy but these measures have also proven to be effective in bringing infections down by the end of Aug. As of 31 Aug, China has administered at least 1 dose of vaccines for 73% of its population according to Our World in Data. It is hard to say if the country will continue with its zero-tolerance strategy for Covid when its vaccination rate is higher. **There is a possibility that China could be more open to an endemic future with Covid-19 should the local vaccines prove to be effective with every outbreak that comes.** In addition, China's mRNA vaccines are in the works, developed by Walvax Biotechnology Co. Vice-Chair Huang Zhen expressed confidence that its efficacy can match that of Pfizer-BioNtech's.

PBoC to Ease Further? And more RMB Weakness?

Despite the weak Jul data, MLF and OMO rates were left unchanged for Aug. As such, **the 1Y and 5Y loan prime rates were also correspondingly steady at 3.85% and 4.65%.** However, recent statements issued by the PBoC and Politburo suggest that PBoC has likely shifted towards easing bias and thus, bets on reserve requirement ratio (RRR) cuts remain very much alive. **If we just rely on historical data in the past decade, RRR cuts typically come in a bunch and have been accompanied by a rise in USDCNY.** However, it is equally important to examine the other key factors that contributed to weakness in the currency in those periods and may not be as relevant to the current environment.

Chart 4: RRR Cuts Typically Sees RMB Weakness in the Past Decade



Source: PBoC, Bloomberg, Maybank FX Research & Strategy

Between 2013-2016, China was easing capital controls, pushing forth yuan internationalization plan that includes seeking IMF SDR inclusion, resulting in fears of capital outflows and exacerbated RMB weakness. This was not helped by the fact that there was a one-off devaluation as a result of a change in the USDCNY reference rate fixing methodology in Aug 2015.

For 2018-2019, trade war dominated and RMB was a reflection of the softer economy under pressure in addition to the risk aversion that rippled across global markets.

At this point in Sep 2021, PBoC is less likely to make a significant FX policy change and the Biden administration has so far been less willing to impose additional trade measures that have greater economic impact. Even so, it is clear that the economy is in a cyclical downturn. We do not rule out more RRR cuts but the central bank is likely serious about remaining prudent while ensuring growth supports are "flexible" and "targeted". Since 4Q 2020, PBoC has a rather specific aim of keeping "growth of money supply and aggregate financing to the real economy (AFER) generally in line with nominal GDP". Clearly, the central bank still wants to keep a check on macro leverage and thus, **RRR cuts are likely to be used sparingly in tandem with other liquidity tools.** The last RRR cut was announced in Jul, ahead of a spike in MLF maturing in Aug. **The next broad 50bps cut for the RRR could be announced in Oct ahead of another surge of MLF coming to maturity in Nov (CNY1bn) and Dec (950mn) 2021.**

China Takes the Longer-term View

In the face of a cyclical downturn, China seems to be taking the longer-term view. Authorities started to tighten regulations on multiple sectors with increasing intensity since July.

China's Agenda

Mitigating Risks in National Security, Consumer Data Privacy, Anti-Monopoly

- Overseas Listing: Prohibits the overseas listing of data-heavy technology companies
- Cloud Computing: Tianjin officials have asked state-owned companies to migrate their data from private sector operators (Alibaba and Tencent) to a state-backed cloud system by 2022 according to Reuters.
- Algorithms: Tighten oversight of algorithms used in tech companies (including e-commerce and social media platforms) to target users. The Cyberspace Administration of China prohibits the use of algorithm models to encourage users to spend excessively.
- Didi Chuxing not allowed to accept new users in Jul and its app removed from App stores after it listed on the NYSE. Sources cited saying that the firm had illegally collected users' data.

Common Prosperity (Wealth Redistribution…)

- President Xi urged wealthy individuals and companies to "give back more to society".
- Income Inequality
  - In July, food platforms were ordered to ensure delivery personnel earn minimum wage.
  - PBoC pledged to keep their focus on "common prosperity" and urged to strengthen financial infrastructure in rural areas for the benefit of the farmers.
  - Targeted RRR, rediscounting and relending facilities flagged to support rural.
- State Council Meeting (27 Aug) – **5-year blue print -** Expand vocational Education, Boost employment, Ensure Wages keep pace with productivity.
  - 55mn urban jobs to be created by 2025
  - Official urban unemployment rate capped at 5.5%.
  - "steadily raise share of wages in terms of GDP"

Curbing Capital Excesses and Addressing Other Social ills

- Tuition Centre
  - Ban for-profit centres to lower cost of child rearing; complements efforts to boost fertility and three-child Policy
- Gaming - warned that online gaming is akin to "Spiritual Opium",
  - minors (below age of 18) can only spend 3 hours on gaming (one hour on Fri, Sat, Sun)
- Idol Culture
  - Bar platforms from publishing popularity lists of celebrities and regulate sales of fan merchandise amid some controversies involving certain celebrities
- Property (Housing is for living in, not for speculation)
  - mortgage rates were said to have adjusted higher for both first and second home purchases in Shanghai
  - Banks increase stringency of requirements for mortgage loans
  - Vice Premier Han Zheng wanted to quicken the development of government-subsidized rental homes
- Macro/Financial Stability
  - Tech banks provision of finance services: Cap on online lending with limit set on cross-provincial online loans and individuals. Ant group was ordered to separate its payment business from personal finance business
  - Bitcoin
    - 90% of the mining operations shut in the short term according to Global Times.
    - China barred banks and online payment firms from use of cryptocurrency for payment or settlement in May 2021.

Source: Maybank FX Research & Strategy, Various Sources of News

Fiscal Stimulus is Thus Needed as Much as Monetary Policy Accommodation for Cross-Cycle Policy

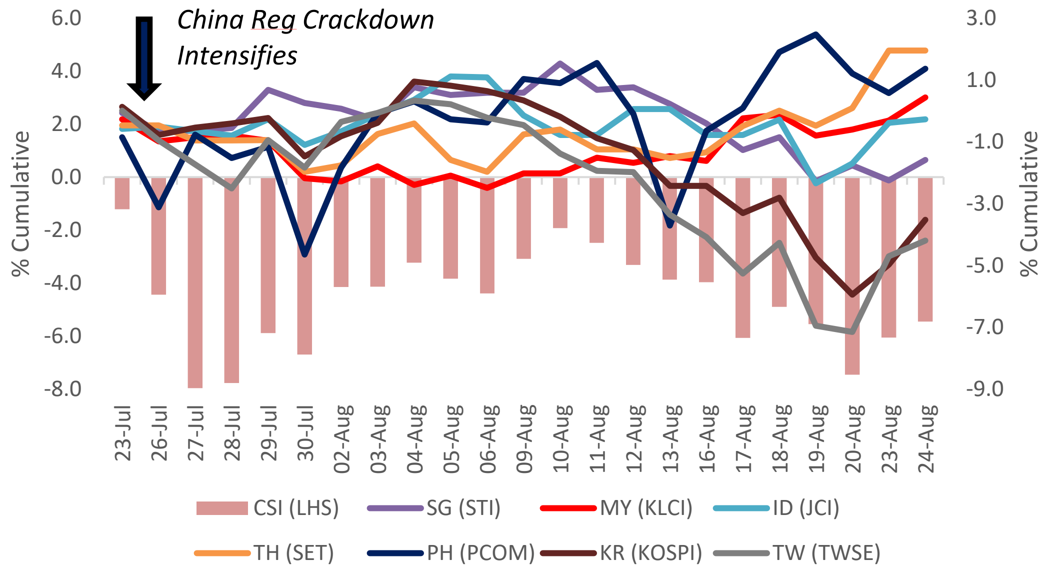
China's agenda is broad and medium term. This somewhat ties in with Xi Jinping's dual circulation strategy - to get domestic demand up (common prosperity) and to promote its manufacturing sector higher on the value chain. Fiscal stimulus is thus required to cushion cyclical pressures as well as to improve infrastructure that can achieve the above medium-term goals. As such, unlike previous easing cycle, targeted RRR cuts (along with other liquidity tools) could be used relatively sparingly with fiscal stimulus. This policy mix (cross-cycle policy design) could mitigate downside pressures on the RMB that we normally see in previous easing episodes.

ASEAN FX: Still Taking Cues from RMB

Regulatory Policy Shock Not a Large Dampener on RMB and ASEAN FX

In this section, we first take a look at how/to what extent regional equities and FX were impacted by the latest bout of regulatory tightening in China.

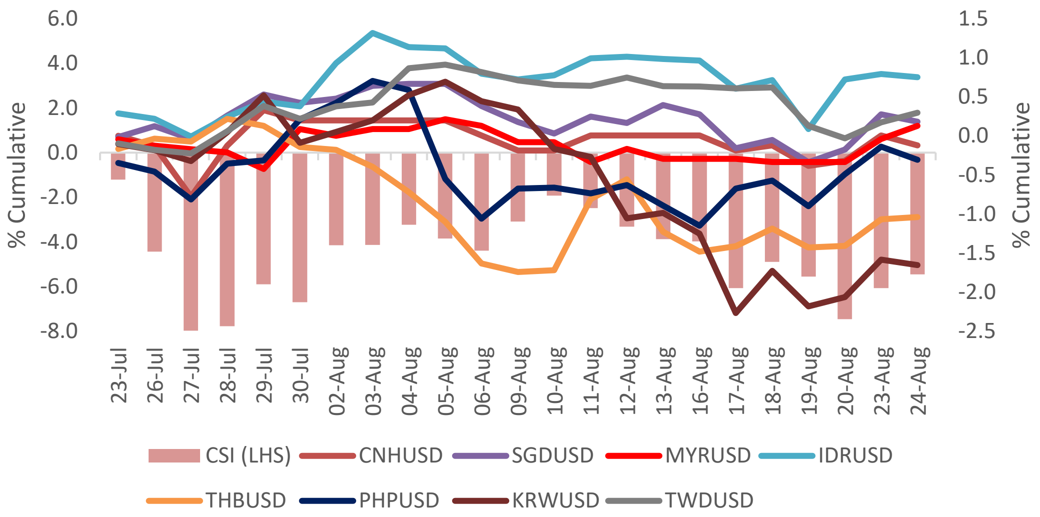
Chart 5: Cumulative % Changes in China Equities (CSI300) & Regional Equity Indices from Onset of Regulatory Crackdown



Source: Bloomberg, Maybank FX Research & Strategy

Equities-wise, broader contagion from China was less discernible, possibly due to the somewhat domestic nature of the shock. Drags on KOSPI and TWSE were attributable to broader semiconductor, electronics correction. A slight weighting change in MSCI could have weighed on TWSE as well.

Chart 6: Cumulative % Changes in China Equities (CSI300) & AxJ FX from Onset of Regulatory Crackdown



Source: Bloomberg, Maybank FX Research & Strategy

Similarly, down-moves in China equities on regulatory shocks did not seem to have a lasting impact on currencies. **There were signs of a dip in late Jul (at the start of the regulatory change), with the RMB pulling down regional FX to some extent, but declines were shallow and transient**. Subsequent declines in THB (orange) and KRW (brown) were again, likely due to respective idiosyncratic factors.

THB sentiments were dampened by factory lockdowns amid Covid surge, and warnings from authorities on potential worsening of the contagion trajectory (although case counts eventually tapered off instead). KRW was dragged down in part by equity outflows (MTD -US$5.1bn in Aug) on aforementioned memory chip correction.

Evaluating Extent of Co-movement in CNH & ASEAN FX

While the recent changes in regulatory environment in China did not have a significant impact on regional FX, one reason could be that RMB itself held rather steady over the period, with the USDCNH largely seeing two-way swings in the 6.45 to 6.53 range.

Admittedly, if RMB sentiments had taken a more drastic hit, ASEAN FX moves could look quite different. In this section, we employ a simple workhorse model used by McCauley and Chang (2018)[1] to evaluate co-movements in yuan and regional FX.

I.e., have linkages between ASEAN FX and yuan shifted post-Covid? Can shocks to yuan still lead to volatile swings in ASEAN FX? Or conversely, can a stable yuan help impart more resilience to ASEAN FX, even amid other global shocks?

The model takes the form

$$\Delta \text{ASEAN FX} = C + \beta 1 * \Delta \text{CNH} + \beta 2 * \Delta \text{EUR} + \beta 3 * \Delta \text{JPY} + \beta 4 * \Delta \text{VIX} + \varepsilon,$$

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[1] Jun 2018, Robert N McCauley and Chang Shu, BIS working Papers No. 727, *Recent RMB Policy and Currency Co-movements.*

Where ΔASEAN FX is the daily percentage change in individual ASEAN currencies vis-à-vis the USD, and ΔCNH, ΔEUR and ΔJPY are the daily changes in, respectively, the yuan, euro and yen vis-à-vis the USD. Changes in VIX are included to control for shifts in global risk environment.

The regression is estimated for each individual ASEAN FX. β1—the co-movement coefficient between the RMB and the ASEAN FX in question—is the figure that we are focusing on.

Given that the USD is used as the numeraire, currencies with an estimated β1 >0.5 can broadly be interpreted as "lying more in the RMB zone than in the dollar zone".

We examine β1 for ASEAN FX over two key phases:

(i) Sep 2015 to 22 Jan 2020: We choose a period post the Aug 2015 RMB fixing reform, which arguably changed the RMB's structural behavior, up to just before Wuhan was locked down due to Covid-19 on 23 Jan 2020.

(ii) 23 Jan 2020 to Aug 2021: This period captures the onset of Covid-19 as well as subsequent recovery in activity and sentiments, where shifts in global monetary and fiscal policy settings could have led to changes in RMB behavior.

Table 2: β1—Co-movement Coefficient Between RMB and ASEAN FX

	SGD	MYR	IDR	THB	PHP
Sep 2015 to 22 Jan 2020	0.37	0.35	0.44	0.30	0.32
23 Jan 2020 to Aug 2021	0.45	0.25	0.88	0.46	0.29

Note: All coefficients are significant at the 1% level.
Source: Maybank FX Research & Strategy Estimates

Table 3: Standard Deviation of Daily % Changes in ASEAN FX

	SGD	MYR	IDR	THB	PHP	CNH
Sep 2015 to 22 Jan 2020	0.31	0.49	0.44	0.28	0.31	0.29
23 Jan 2020 to Aug 2021	0.28	0.30	0.67	0.32	0.29	0.28

Source: Maybank FX Research & Strategy Estimates

We note a few key observations from the regression results.

First, all ASEAN FX remains structurally and positively tied to RMB moves in the post-Covid period. β1 is found to be statistically significant at the 1% level for all ASEAN FX. The extent of co-movement with RMB for SGD, THB, IDR have broadly risen post-Covid, compared to the 2015-2019 reference period, while that of MYR has declined modestly. The reading for PHP has come off slightly but can be largely taken as remaining similar over the two periods.

The broadly tighter linkages between RMB and the ASEAN FX bloc not only reflects increased trade and investment linkages over the years, but also likely a more unique set of factors (lockdown drags, vaccine optimism, reopening plays, threats from virus mutations) nudging risk sentiments in similar directions during the past one and a-half years.

This increase in sensitivity is most discernible for IDR. One reason could be that with US treasury yields at relative historical lows over the past one and a-half years, **higher-yielding CNH and IDR have become more subject to similar "carry" inflows or outflows to/from the region.** From the chart below, we see that from Apr 2020 to Aug 2021, flows into/out of Chinese and Indo debt were directionally similar for 13 out of 17 months.

Chart 7: Chinese and Indo Debt See Similar Directional Flows

Source: Bloomberg

For MYR, we postulate two reasons for its modest decline in co-movement with RMB. One, the volatility of MYR has declined meaningfully in the past one and a-half years compared to 2015-19. As shown in the table above, the standard deviation of daily % change in MYR (vis-à-vis USD) has declined from 0.49% to 0.30% in the latter period. This could be due in part to BNM’s efforts in recent years to enhance both the FX and secondary bond market liquidity. As such, **MYR could be reacting less to CNH swings simply because it is less volatile broadly**.

Second, compared to regional FX, **there might be more notable idiosyncratic drivers for MYR moves, including oil prices, political uncertainty, among others**. We investigate this in a box below. **The findings imply that even as CNH may not be the dominant determinant for MYR moves, it still holds significant influence over the currency**.

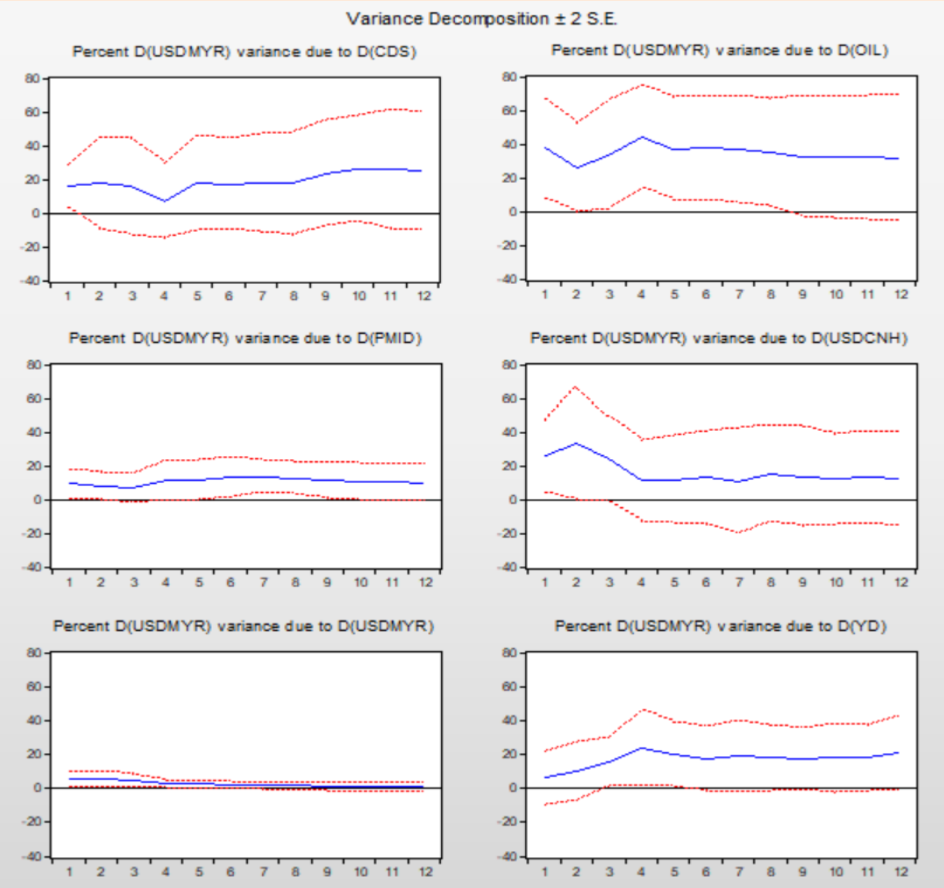
The previous section makes the case that ongoing risk factors, including intermittent growth drags, PBoC policy bias, regulatory policy shifts etc., are unlikely to pose outsized drags on yuan sentiments. In this case, given broadly tightened RMB-ASEAN FX linkages, there is scope for RMB to act as an anchor for ASEAN FX to some extent as well, mitigating concerns from Fed tapering concerns and growth de-rating bets (see next section for discussion).

Box: What Drives the MYR?

To investigate this, we estimate a VAR (variable autoregression) model using changes in the following variables, using 2018-2021 monthly data:

- USDMYR,
- Oil Prices (Malaysia's reliance on oil revenues)
- USDCNH (RMB tendency to act as anchor for AxJ FX)
- US-MY Yield Differentials (reflective of portfolio flows trends)
- 5Y Msia Credit Default Swaps (proxy for political, fiscal uncertainty)
- PMI Differentials between US and MY (proxy for growth differentials)

Variance Decomposition Results



Driver	Variance Decomposition (%, 12m Avg.)
Oil	35%
5Y Msia CDS	19%
US-MY Yield Diff	17%
USDCNH	16%
US-MY PMI Diff	11%

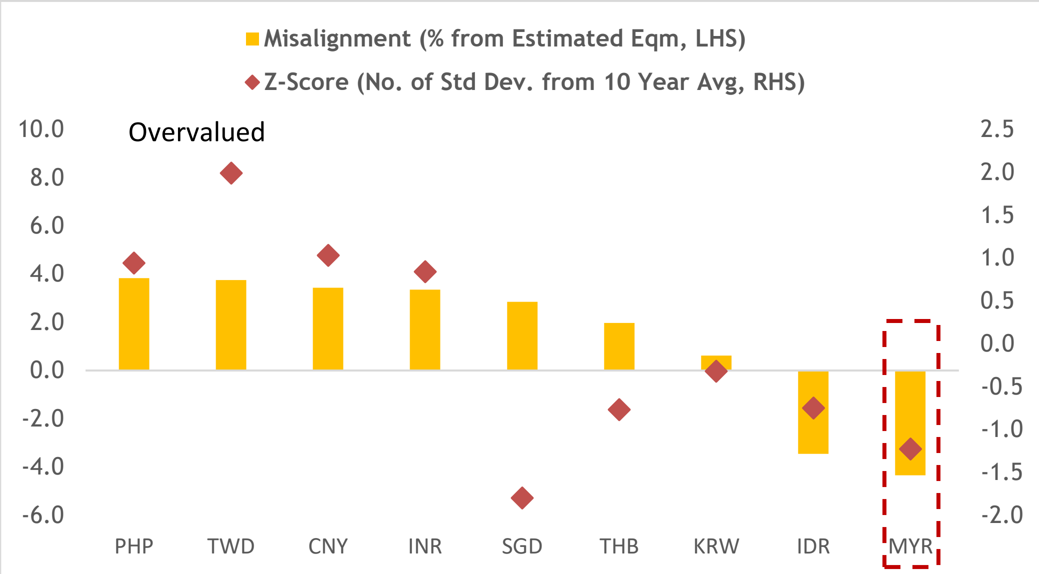
Source: Maybank FX Research & Strategy Estimates

We note that in recent years, MYR variance was tied to a greater extent to oil price moves (35%). Political & fiscal uncertainty (as captured by CDS) accounted for around 1/5 of volatility, while RMB moves accounted for around 16% of MYR variance.

The results suggest that more benign MYR performance going forward would depend to a large extent on resilience/recovery in oil prices, stabilization in the political environment and fiscal dynamics, no sudden bout of Hawkish taper concerns, as well as a sustained positive yuan narrative.

Given the complex set of factors involved involved, we also take the opportunity to refresh our fair value model (see here for model specification) for regional currencies.

Model-Derived Estimates of REER Misalignment and BBG Z-Scores



Note: Yellow bars indicate fair value misalignment estimates from proprietary model (2006 to 2021 data) taking into account net foreign assets, trade exposure, short-run nominal rates differentials (vs. peers), inflation differentials (vs. peers). Orange dots (Z-scores) are extracted from BBG on 2 Sep, indicating how high/low current REER values are vs. 10-year average.

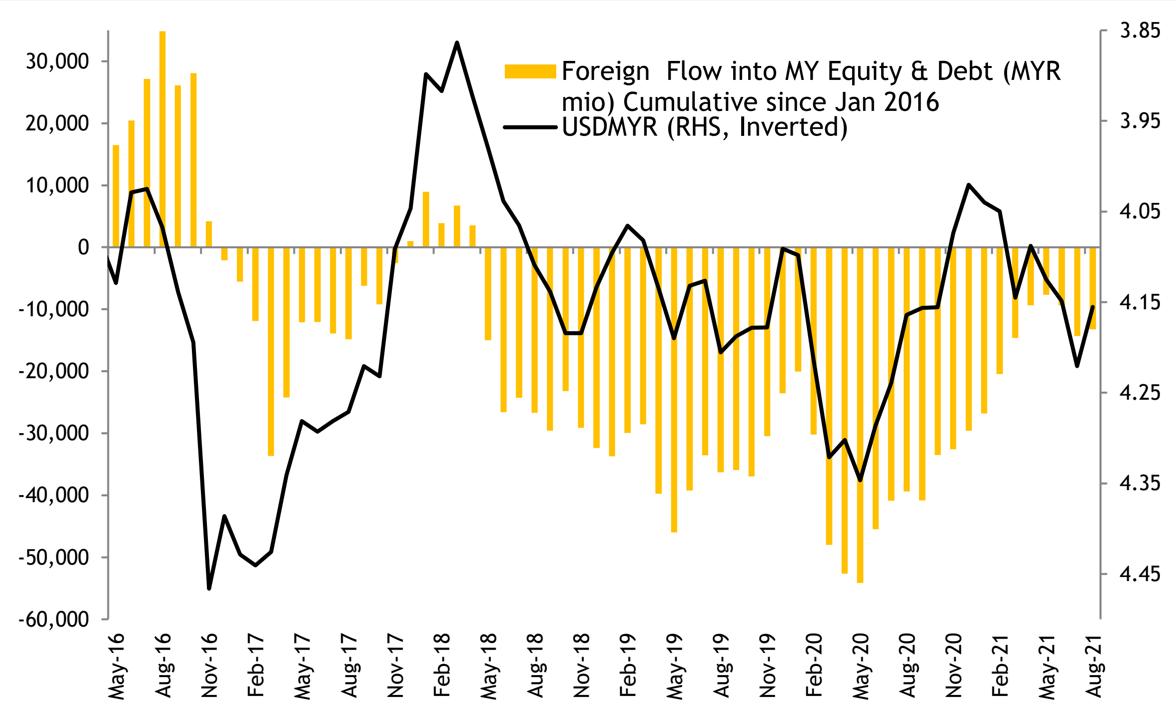
Source: Bloomberg, Maybank FX Research & Strategy

The BBG Z-Score reading and our fair value model largely agree that MYR is still modestly undervalued. The model estimates the degree of undervaluation at around 4.3% in REER terms currently.

MYR - Room for Gains

Aug 2021 turned out to be the month MYR posted its biggest monthly gain (vs. USD) in 9 months as the pair declined more than 1.6% from above 4.24 levels to below 4.16 levels. The relevance of the abovementioned drivers for MYR was affirmed in part by developments towards the end of the month, including (i) buy-on-dips in oil prices setting in, with brent price rising to >US$70/bbl from interim trough of US$65/bbl, (ii) some stabilization in the political environment, with the new Cabinet lineup retaining Ministers of Finance (Tengku Zafrul) and Economy (Mustapa Mohamed) and signs of cooperation between Government and Opposition to tackle pandemic and economic recovery (various media outlets reported that the meeting post-appointment of Prime Minister between PM Ismail and Opposition leaders was seen as a good start), and (iii) Powell's dovish taper messaging at Jackson Hole, which divorced rate hikes from the taper schedule, and was broadly positive for risk assets. Alongside the USD pullback, we also note foreign fund inflow into local equities (for month of Aug: foreign inflows +US$251.2mio; FT KLCI up nearly 7%). Tentative signs of turnaround in Covid situation likely also aided sentiments.

Continued Portfolio Inflows is Supportive of MYR's Recovery



Source: Bloomberg, Maybank FX Research & Strategy

While Malaysia's daily Covid cases remain elevated, we note early signs of turnaround with 7d moving average turning lower (~21k cases per day) and daily infections falling (below 19k cases per day on 1 Sep). On the ground, there are also very tentative signs that Covid situation may be turning: hospital bed utilisation is decreasing in some cities in KL, Negri Sembilan and Putrajaya while the number of people visiting Covid assessment centres (CACs) have fallen 30% - 50% in Aug. Vaccination is also progressing with more than 42% of population fully vaccinated and about 57.5% of population having received their first shot (as of 26 Aug). PM Ismail is said to be looking for an acceleration in pace of inoculation targeting at least 50% of adult population fully vaccinated by end-Sep for these 6 states - Perak, Terengganu, Johor, Kedah, Kelantan and Sabah.

As of writing, 89.5% of adult population in Klang Valley is already fully vaccinated. Further confirmation of Covid situation improving in Malaysia (leading to phased economy reopening), a gradual Fed normalisation and intact global growth momentum could add positives to MYR.

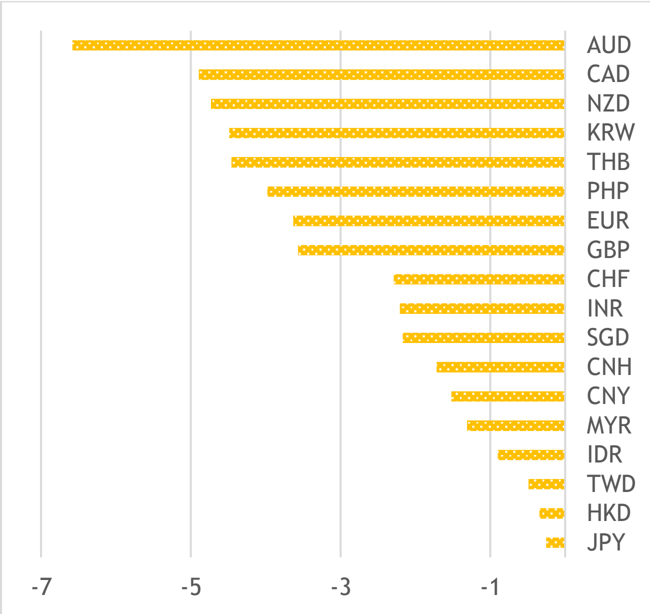
Concluding Remarks

Growth Momentum Slowing for Some but Global Growth De-rating Fears Overblown. Deceleration in growth momentum is starting to show up in the region. Specifically manufacturing PMIs for Indonesia, Thailand and Malaysia are in contractionary for back-to-back months. Persistent delta variant spread globally has seen extension of lockdowns, tighter restrictions in NZ, Australia, Korea, some ASEAN regions and even in some cities in China, in turn affecting activity momentum and investor sentiments. De-rating of growth trades and fears of faster Fed policy normalisation typically weigh on pro-cyclical FX including AXJs and commodity-linked. And the FX markets have seen some of these factors played out. On a 3-month change, AUD, KRW, THB amongst others were down between 6% and 9% at one point as of mid-Aug 2021 (before the mild recovery since).

Chart 8: Growth Momentum Decelerating in AXJ; Indonesia, Thailand and Malaysia Mfg PMIs in Contractionary Territory

Headline Release	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Feb-21	Jan-21
U.S.	61.1	63.4	62.1	62.1	60.5	59.1	58.6	59.2
Eurozone	61.4	62.8	63.4	63.1	62.9	62.5	57.9	54.8
U.K.	60.3	60.4	63.9	65.6	60.9	58.9	55.1	54.1
Japan	52.7	53	52.4	53	53.6	52.7	51.4	49.8
Australia	52	56.9	58.6	60.4	59.7	56.8	56.9	57.2
China	49.2	50.3	51.3	52	51.9	50.6	50.9	51.5
India	52.3	55.3	48.1	50.8	55.5	55.4	57.5	57.7
Malaysia	43.4	40.1	39.9	51.3	53.9	49.9	47.7	48.9
Philippines	46.4	50.4	50.8	49.9	49	52.2	52.5	52.5
Indonesia	43.7	40.1	53.5	55.3	54.6	53.2	50.9	52.2
Thailand	48.3	48.7	49.5	47.8	50.7	48.8	47.2	49
ASEAN		44.6	49	51.8	51.9	50.8	49.7	51.4
Global		55.4	55.5	56	55.8	55	53.9	53.6

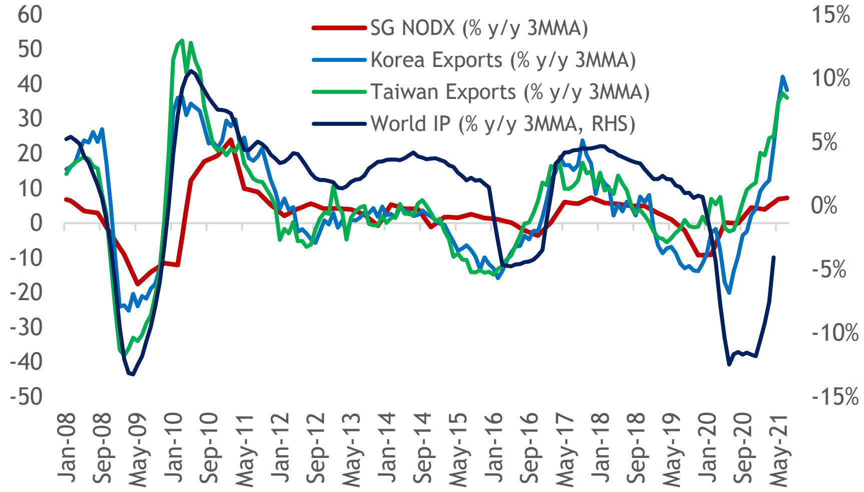
Chart 9: AXJs and Commodity Linked FX Worst Hit (3-month % Change prior to Jackson Hole on 27 Aug)



Source: Bloomberg, Maybank FX Research & Strategy

We question if fears of global growth de-rating were justified or blown out of proportion. While growth momentum is slowing for some countries amid prolonged lockdown, border restrictions, we opine that some of those fears may be overdone. Recent exports data from Korea, Taiwan and Singapore (bellwether for global trade) suggests that external demand remains resilient despite delta variant spread. In addition prelim PMIs from the major DMs such as EU, US and UK suggest that manufacturing and services sectors remain in expansionary territories. Any slip-off was largely due to supply side constraints (labor, material shortage resulting in supply chain disruptions, etc.) rather than a pullback in demand.

Chart 10: Exports' Resilience Suggests External Demand Still Intact



Source: Bloomberg, Maybank FX Research & Strategy

Fed Taper is Not Fed Tightening. Fed Chair Powell's speech at Jackson Hole (27 Aug) eased concerns of faster pace of policy normalisation. While he did say that the **Fed could start to taper this year**, he also emphasized that the Fed **is in no hurry to raise rates** as there is still "much ground to cover to reach maximum employment". On inflation, he reiterated that upward price pressure was due in part to supply-chain disruptions owing to Covid and is likely to be transitory as such. In particular **the absence of a specific schedule for tapering asset purchases was interpreted as dovish**. Overall Fed's reassurance that **tapering does not necessitate rate hike** and that there is **considerable time between taper and start of rate hike** eased fears of faster than expected pace of policy tightening.

Still Room for AXJs to Recover, Unevenly. Looking on, a Fed announcement possibly as early as at 23 Sep or 3 Nov FoMC for taper to commence around the turn of year is likely, and probably largely priced in. Our base case is for a gradual pace of tapering bond purchases by $10bn/month, winding down its entire $120bn per month asset purchases before end-2022 and to begin raising rates in 1H 2023. We believe that clarity on Fed policy, reassurance of orderly, gradual Fed policy normalization (combination of taper but no rate hikes) alongside stable RMB could still create an environment conducive for risk proxies, including AXJs. Furthermore vaccine supplies coming on-stream and ASEAN ramping up its inoculation drive could potentially set the stage for ASEAN economies to reopen. This should bode well for recovery momentum and support AXJ FX.

One note of caution though, is that FoMC leans hawkish in 2022 as Mester, Rosengren, Bullard and Esther George will vote on the FoMC. A more hawkish FoMC could bring about fears of faster pace of policy normalisation (i.e., earlier rate hike or quicker pace of taper) especially if US economic data surprise to the upside. We caution that more Fed "noise" can heighten volatility and this may set up a challenging climate for AXJ FX in 2022.

Table 4: FoMC Tilts More Hawkish in 2022

Members	Roles	Policy Inclination	Voting in 2021	Voting in 2022	Voting in 2023
Eric S Rosengren	Fed Boston	Hawk		Yes	
Loretta Mester	Fed Cleveland	Hawk		Yes	
James B Bullard	Fed St. Louis	Hawk		Yes	
Esther L George	Fed Kansas City	Hawk		Yes	
Raphael W Bostic	Fed Atlanta	Hawk	Yes		
Patrick Harker	Fed Philadelphia	Hawk			Yes
Robert Kaplan	Fed Dallas	Hawk			Yes
Randal Keith, Quarles	**Board of Governor**	Neutral	Yes	Yes	Yes
Michelle W Bowman	**Board of Governor**	Neutral	Yes	Yes	Yes
John C Williams, New York	**Fed New York**	Neutral	Yes	Yes	Yes
Thomas I Barkin, Richmond	Fed Richmond	Neutral	Yes		
Mary C Daly, San Francisco	Fed San Francisco	Neutral	Yes		
Jerome H Powell	**Board of Governor**	Dovish	Yes	Yes*	Yes
Richard H Clarida	**Board of Governor**	Dovish	Yes	Yes	Yes
Lael S Brainard	**Board of Governor**	Dovish	Yes	Yes	Yes
Christopher Waller	**Board of Governor**	Dovish	Yes	Yes	Yes
Charles Evans	Fed Chicago	Dovish	Yes		Yes
Neel Kashkari	Fed Minneapolis	Most Dovish			Yes

Note: Board of Governors and the President of the Federal Reserve of New York are ***Permanent Voters (7 in bold)*** *while the rest rotates*. The spectrometer can change based on developments.
*Powell's current term will end in Feb 2022. It is not known if he will remain for another term
Source: Bloomberg Spectrometer, Federal Reserve, Maybank FX Research & Strategy

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