Macro | FX Research and Strategy

Global

FX Insight

Lessons From SARS

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Profit-taking? Or More to Come…

Some profit-taking was observed among USDCNH and Asian FX yesterday morning and the moves seem to have come at a time of quiet data schedule and few headlines—one of which was the report of additional deaths from the coronavirus in Wuhan, alongside confirmation of human-to-human transmission of the SARS-like virus ahead of the largest domestic migration that takes place during LNY each year.

In this report, we **examine the impact on FX during the SARS crisis**, to draw some inference for potential FX moves from this new Wuhan virus that has spread to Beijing, Shanghai, Thailand, Japan and South Korea. Broadly, two broad phases (in FX impact) were observed during SARS.

Phase 1 - Via Market Sentiment

Looking at the actual timeline of SARS events as well as regional equity performance during that time, we gauge that the impact on market sentiments was probably focused in the short period from late Feb to mid-March 2003. Back then, among Asian FX, KRW also took the brunt of the event given its sensitivity to risk-on/off events. Besides KRW (-4.9%), softening were also seen in regional currencies, e.g., SGD (-1.2%) and PH (-1.1%) vs. the USD.

Phase 2: Via Decline in Real Economy

A second phase of FX impact can take place alongside damage inflicted on the real economy, usually via the subsequent decline in tourism (hotels, retail, F&B). Looking at visitor arrivals, we assess that greatest damage to the economy probably occurred **in the two months post phase 1** (i.e., Apr and May 2003), with a swift recovery after.

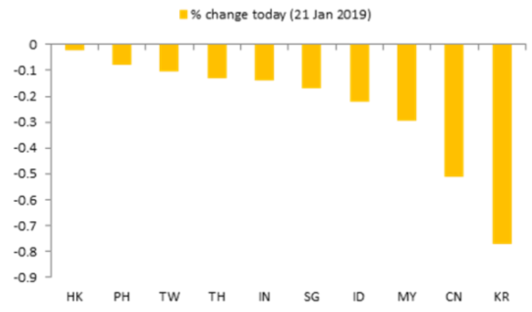
Here, we replace USD with THB as the reference currency, to avoid complications (start of the US-Iraq conflict in Mar 2003 affecting USD).

- TWD saw the most significant decline vs. THB, by around 2.8%, alongside greatest declines observed in tourist arrivals.
- SGD saw relatively modest impact of -0.8% over the period, likely due to international recognition of effective containment.
- KRW actually strengthened 1.2% vs. THB, likely a retracement of earlier exaggerated down-move in "phase 1".

Effects on FX Modest and Unlikely to Last

On balance, markets and economies were able to bounce back quickly from SARS in 2002-2003 when China and regional economies were less prepared for such outbreaks. This time round, the likelihood of containing the new coronavirus more effectively should be improved, and we do not expect persistent negativity to be priced into regional FX.

AxJ FX Performance on 21 Jan – KRW is Worst Hit



Source: Bloomberg, Maybank FX Research & Strategy

A Relook at SARS

USDCNH spiked yesterday morning and the moves higher seem to have come at a time of quiet data schedule and few headlines—one of which was the report of the fourth death from the coronavirus in Wuhan, China along with news that the disease had spread to health workers. The confirmation of human-to-human transmission of the SARS-like virus ahead of the largest human migration that takes place during Lunar New Year likely triggered some profit-taking amongst Asian FX. Sentiment-sensitive KRW took the brunt of the damage yesterday, falling around 0.8% vs. the USD.

In this report, we **examine the impact of FX during the SARS crisis**, to draw some inference for potential FX moves from this new Wuhan virus that has spread to Beijing, Shanghai, Thailand, Japan and South Korea. Broadly, two broad phases (in FX impact) were observed during SARS.

When Did the World Know about SARS?

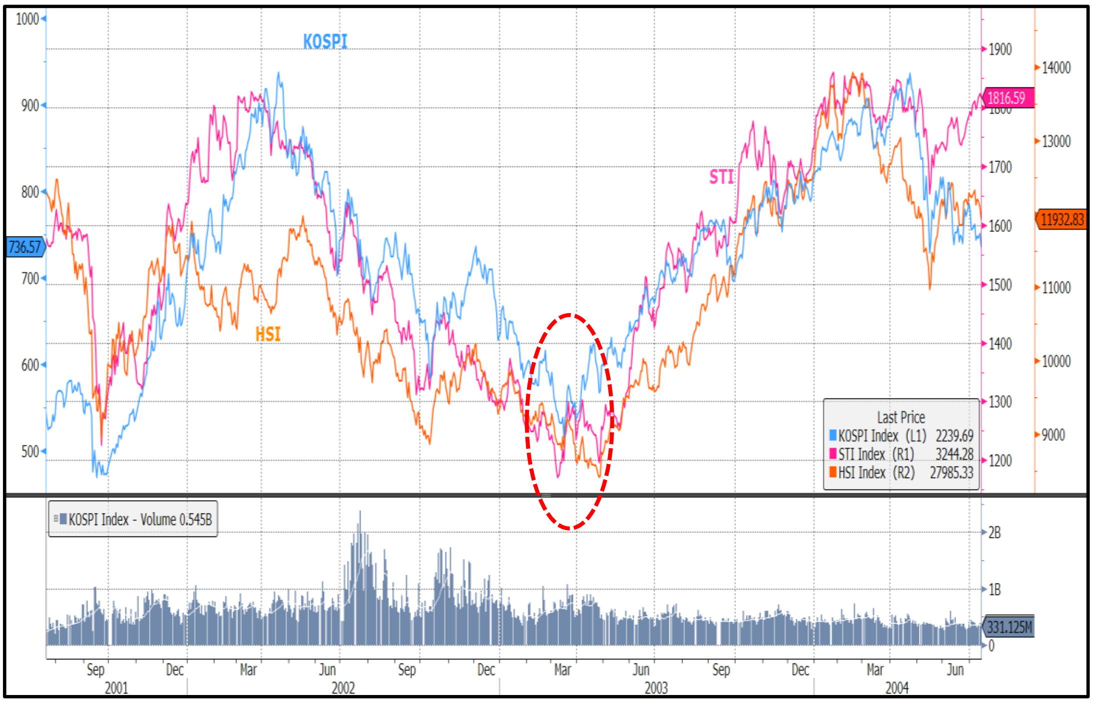
Although the first case of atypical pneumonia was reported in the Guangdong province in southern China on 16 Nov 2002, SARS only took to the limelight towards late Feb 2003 when a doctor who had been treating SARS patients in Guangdong arrived in Hong Kong on 21st Feb. 23 other guests developed SARS and an estimated 80% of them were due to contact with the doctor. Thereafter, some of these guests brought the virus to other regions including Hanoi, Toronto and Singapore. WHO only issued a global alert for a severe form of pneumonia on 12 Mar 2003.

SARS appeared on headlines during the global electronic downturn. Hence, equities were already on the decline from Dec 2002. Regardless, it was also apparent that SARS could have contributed to further negative sentiments, with STI, HSI and the KOSPI Index reaching a trough in 2Q 2003. The Hang Seng index reached a low of sub-8500 before rising substantially thereafter.

When was Equities Hit?

From the behavior of the equities, we deduce that the initial impact of SARS was probably through the sentiments channel, and this was felt most vividly in financial markets between 21st Feb and 18th Mar.

Regional Equities were Hurt by SARS But Not for Long



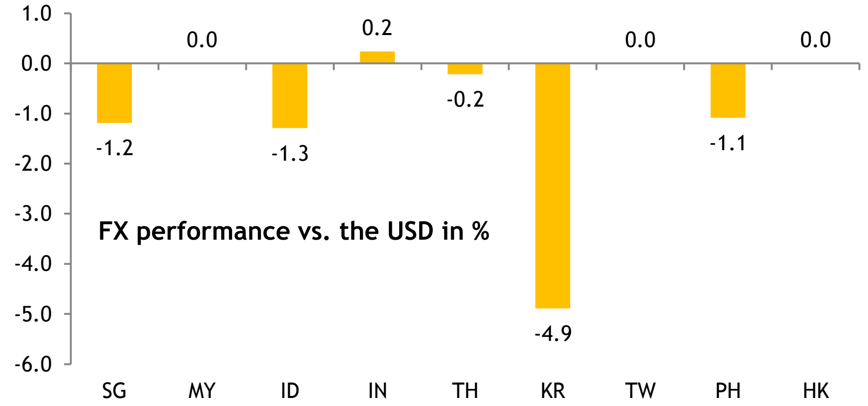
Source: Bloomberg, Maybank FX Research & Strategy

Phase 1 Impact of SARS - Sentiments Channel

Looking at the chart above, we marked the sentiment impact to be the first channel of influence on global markets.

Over the stipulated period (i.e., 21st Feb and 18th Mar 2003), regional FX was hurt with sentiment-sensitive KRW taking the brunt by (-4.9%), followed by IDR (-1.3%), SGD (-1.2%) and PH (-1.1%) vs. the USD.

KRW depreciated almost 5% between 21st Feb-18th Mar 2003



Source: Maybank FX Research & Strategy, Bloomberg

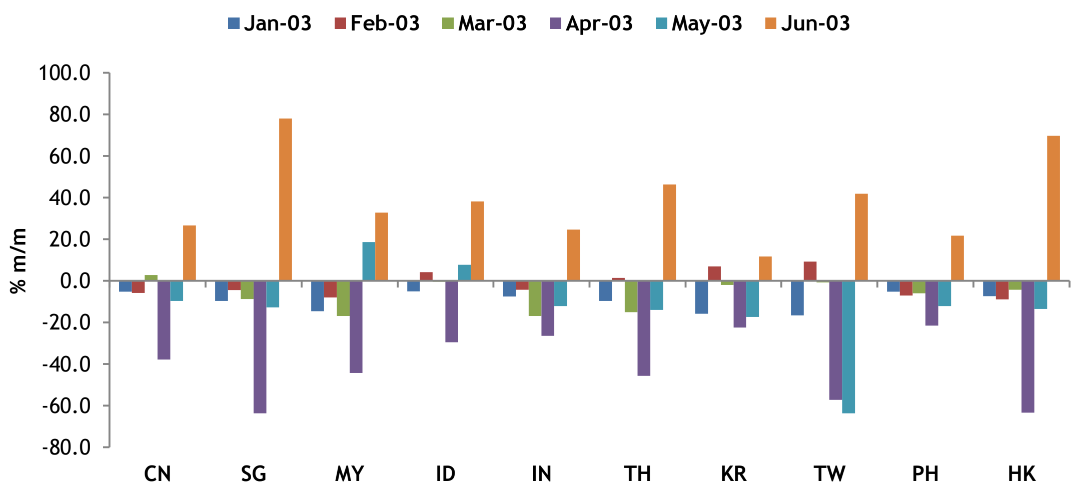
Note: HKD is pegged to the USD

Phase 2 Impact of SARS on Real Economy

After the initial impact on market sentiments, we define a "phase 2" where differentiated outcomes on FX likely occurred due to actual deterioration in the macro economy.

This phase is usually led by declines in activity seen in hotels and air transport (i.e., tourism), followed by that in restaurants, retail and land transport. Given that accommodation and F&B tend to be smaller sectors (by GDP shares) in most economies, the broad impact on the macro economy (and hence FX) could hence be relatively modest.

April and May 2003 Saw Greatest Negative Impact on Tourism



Source: Bloomberg, CEIC, Maybank FX Research & Strategy

Using tourist arrivals as a guide, we see that the **peak negative impact probably occurred over April and May** (purple and blue bars) for most regional economies, as a sharp rebound in visitor arrivals had occurred by June. This suggests that SARS-like events, **if contained effectively and in time, could see their negative impact unwind relatively fast**.

In analyzing the impact of "phase 2", another event we need to account for is the US-Iraq conflict in 2003. On 20 March 2003, US' surprise military invasion of Iraq began. These developments had various implications for currency, gold and oil. Within just 10 days, the dollar DXY index declined by around 2%, and this decline accelerated to cumulative 8% by end May 2003.

Given the large moves in USD, it would be misleading to look at the trajectory of USD-XX pairs when we try to evaluate the impact of SARs on Asian currencies. To circumvent this issue, **we compare the performance of Asian currencies against THB instead**, i.e., XX-THB crosses.

We choose THB as the reference currency here for two reasons. One, THB itself was relatively stable over this period on a trade-weighted basis. Two, SARs-related impact on Thailand's economy could be more contained given that there were no discovered SARs cases in Thailand.

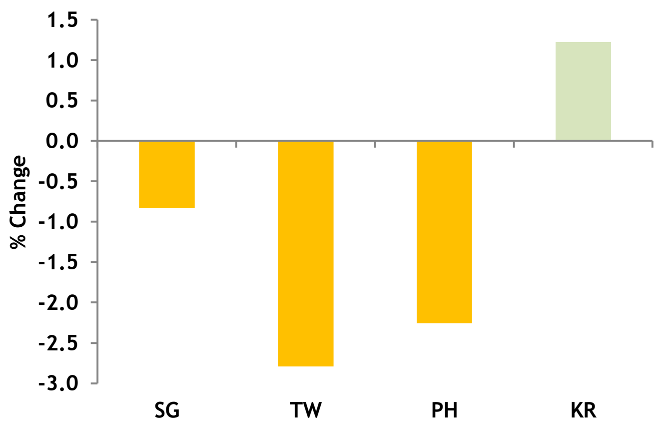
Number of Cases & Deaths in Asia

Country	Cases	Deaths
China	5328	349
Hong Kong	1755	299
Taiwan	346	37
Singapore	238	33
Philippines	14	2
South Korea	4	0

Source: WHO

Notably among the Asian economies, only some countries experienced actual SARS scares. Among these countries, China and Hong Kong had pegged currencies then.

% Change vs. THB (Apr to May 2003)



Source: Maybank FX Research & Strategy, Bloomberg

Among the rest, TWD saw the most significant decline vs. THB (reference currency), by around 2.8%. Incidentally, looking at the visitor arrivals chart above, we note that the % sequential declines for Taiwan were most severe among the Asian countries, indicating some linkage between the extent of damage to the economy and FX changes.

In comparison, SGD saw relatively modest impact of -0.8% over the period vs. THB, likely due to swift international recognition of the effectiveness of measures in SARS containment. We note that much of the sequential weakness in visitor arrivals to Singapore had faded by May. A study by MAS found that SARs had contributed slightly more than half of the 11% q/q saar decline (unrevised figure) in 2Q GDP that year, but was followed by a swift recovery in 3Q.

Meanwhile, KRW actually strengthened vs. THB over the period. This was likely a retracement of earlier down-move in “phase 1”, when markets recognized the short-lived nature of the event.

Impact of New Wuhan Coronavirus Could be More Modest than SARS

An important lesson from SARS was that China did not report the outbreak to the WHO until 10 Feb 2003 (vs. the first case detected on 16th Nov 2002). The government also discouraged its press to report on SARS. So the lack of timely information then created a lot of mistrust in the government. The present government seems determined to do better this time. China reported 27 people with pneumonia of unknown source to the WHO on 31st Dec 2019 with symptoms appearing since 8 Dec 2019.

President Xi Jinping urged for prompt disclosure of outbreak information and stronger international cooperation. He called for Party committee and government agencies to devise meticulous plans, mobilize all available resources and take concrete and effective measures to stop the spread of the sickness.

Echoing President Xi, the Central Political and Legal Affairs Commission also published a commentary yesterday morning warning that whoever withheld the information and delayed the disclosures of the cases would be “**nailed on the pillar of shame for eternity**”.

As of writing, state media reported that the number of cases has risen to 291 in China with 6 deaths. The last update was yesterday morning at 4, underscoring the commitment by the Chinese government to improve on their transparency. The Central Chinese city of Wuhan has also stepped up control of people travelling in and out of the city by banning outbound tour groups.

In terms of medical investigation and international cooperation, the identification of the virus was also faster as China shared the genetic sequencing of the virus and countries are now able to send suspected cases for tests for the virus.

Nonetheless, fear of contagion ahead of the LNY mass migration has triggered some profit-taking in the CNH after clocking a gain of 1.4%mtd. USDCNH rose above the 6.90-figure as a result - something that was written on the charts and our Daily yesterday morning. We also take the opportunity to close our long CNHPHP position at 7.3836 with a 1% profit. Spot reference at 7.3075.

Our studies in this report have shown that markets and economies were able to bounce back quickly from SARS in 2002-2003 when China and regional economies were less prepared for such outbreaks. This time round, the likelihood of containing the new coronavirus more effectively should be improved.

Hence, we do not see a huge reversal of Asian gains and expect merely modest unwinding of stretched positions. We had looked for a rebound in USDSGD and USDMYR in our FX Weekly published last Fri. For USDSGD, the clearance of the 1.35-figure is required for a break-out of the falling wedge. USDMYR could also head towards next resistance at 4.0950 (21-dma) from current 4.0715.

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