FX Insight

TWD: Relative Resilience

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On Idiosyncratic Factors and Broad USD Softness

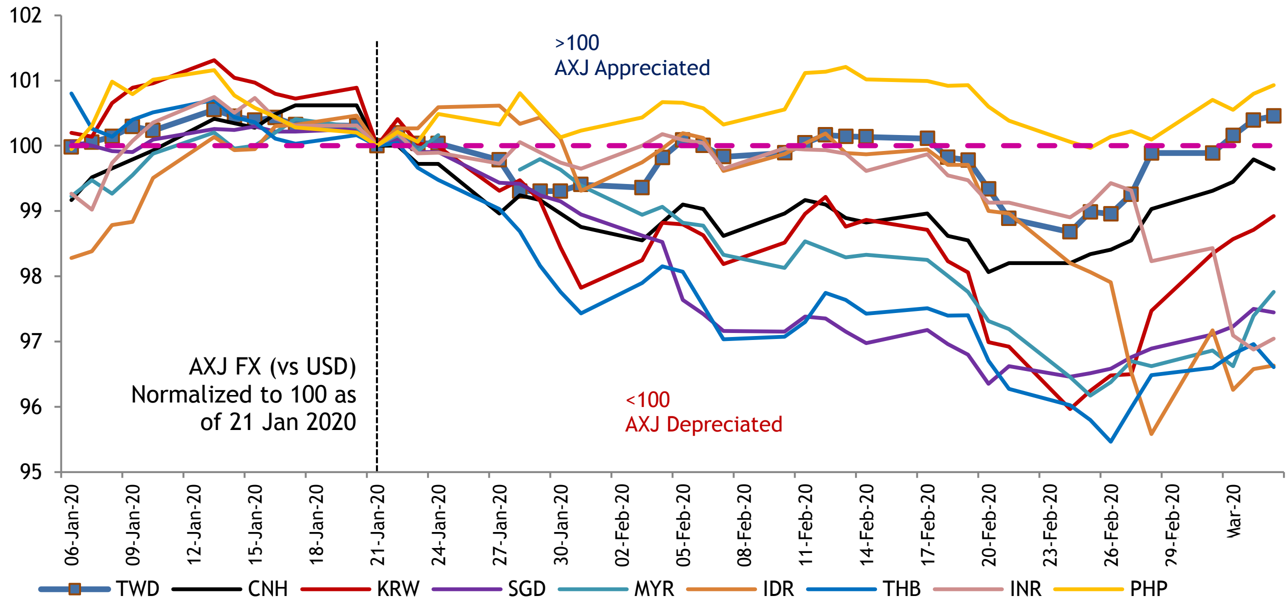
We retain our view of relative resilience for TWD in the AXJ FX space but remain cautious of COVID-19 development. TWD could come under pressure if the outbreak persists for longer or intensifies in severity. There is a risk of a token cut at the upcoming CBC MPC on 18 Mar, given the global wave of monetary easing but we do not see the need to lower rates as there may be little benefit to lower them further and it remains unclear if banks will pass the full benefit of the rate cut to end-consumers. Our short term augmented tracking equilibrium model suggests that TWD is ~3% undervalued to our model estimate.

Since COVID-19 outbreak intensified on 21 Jan, two currencies displayed relative resilience amongst other FX in the AXJ region - PHP and TWD. As seen in chart 1 at the peak of market uncertainty, IDR, THB, KRW, SGD and MYR were down between 4% and 5% (vs. USD) while TWD was only 1% weaker and PHP appears to escape unscathed this episode.

For PHP, we attributed its resilience to (1) lower dependency on external demand (vs. regional peers); (2) low reported cases of COVID-19; (3) carry allure and historically lower PHP volatility; and (4) softer USD and larger than expected Fed rate cut.

For TWD, its resilience can be attributed to (1) the recovery momentum in global semiconductor market since late 2019; (2) supply chain substitution/diversion effect (from Korea and Japan) arising out of COVID-19; (3) reshoring inflows from China back to Taiwan; (4) COVID-19 conditions perceived to be under control (reported cases at 42 and 1 death as of 5 Mar) relative to other North Asian nations; and (5) larger than expected 50bps Fed rate cut and softer USD.

Chart 1: PHP and TWD Displayed Relative Resilience



Source: Bloomberg, Maybank FX Research & Strategy

USD Softness a Breather for AXJs but Further Gains Likely Leashed

Recent USD weakness (as a result of an erosion of dollar's carry and risk on status) and Fed monetary easing provide a temporary breather for AXJs. In particular Fed's 50bps cut at the unscheduled but somewhat expected inter-meeting (3 Mar) to bring Fed fund target range to 1% - 1.25% demonstrated policymakers' commitment to act decisively when needed.

As of writing, markets are pricing in a 96% probability of another 50bps cut at the upcoming FoMC meeting (18-19 Mar) and another 50bps for the rest of 2020. Elsewhere Bank of Canada cut policy rate by 50bps (4 Mar) while RBA and BNM each cut 25bps (3 Mar).

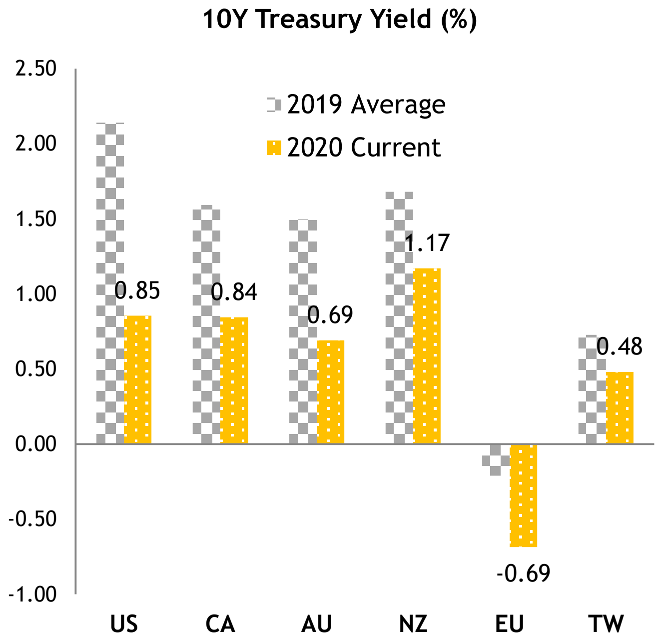
Synchronous monetary easing and fiscal stimulus support from around the world should lend support to markets and (hopefully) support economic activities while on the FX front, **USD could still stay soft while growth/risk-on proxy FX finds a breather.**

Negative Sentiment Can Offset Benefits of Softer USD

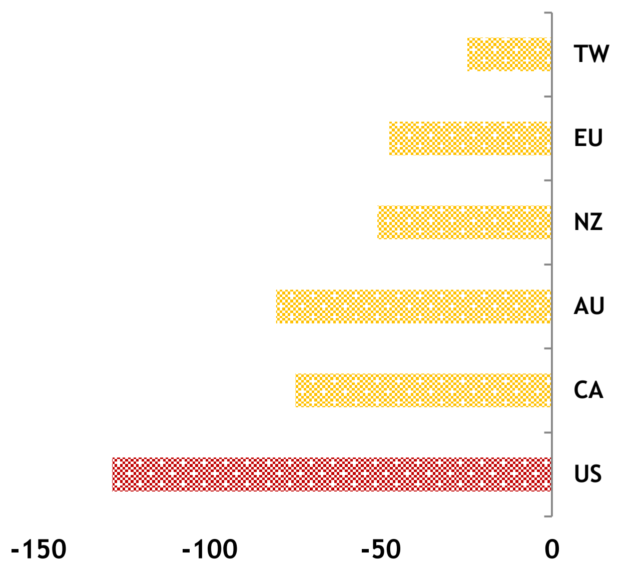
But it is **prudent to stay cautious as COVID-19 situation remains fluid and contagion appears un-arrested in some parts of the world** including Italy and S. Korea. Markets may run out of patience if COVID-19 takes longer to go away and the **subsequent spill over effect on broad sentiment, manifesting itself on deeper sell-off in equities, HY credit and subsequently softer macro data in coming months will mean that AXJs gains may be leashed** even with a softer USD as negative sentiment can somewhat offset USD softness effect.

At some stage the **USD decline will also slow especially when UST yields have fallen low enough for USD to regain its safe haven status, re-joining its traditional safe haven peer - JPY**. At that point, USD could be bid, alongside JPY when sentiment is risk-off.

USD No Longer 'King' Carry FX in G7 World



An Rapid Erosion of >120bps for 10y UST between 2019 and 2020



Note: Current as of 5 Mar 2020
Source: Bloomberg, Maybank FX Research & Strategy

TWD – No Complacency on its Resilience and Still Worth a Caution

Despite TWD's resilience, **COVID-19 remains one of the biggest unknown risk factor that could pose risk to our bias and it is still worth a caution especially if COVID-19 outbreak persists for longer and outbreak becomes more severe, resulting in deeper damage to global economy and market sentiment.**

In the unfortunate scenario of continued closures of factories and manufacturing plants in China amid deterioration of COVID-19 outbreak, TWD could come under pressure and the Taiwan's economy will be impacted via trade (amid weaker external demand), supply chain disruption and tourism.

According to OECD TIVA database, Taiwan's intermediate goods imports and exports from/to China (proxy for supply chain) is the highest amongst the list of regional countries (we tracked).

Some of the findings from our previous study – Distilling COVID-19 Effect also show that weakening in Chinese demand (13% of TW GDP is exposed to China's domestic demand as estimated by OECD, 2015) and slowdown in visitor arrivals from China will also impact Taiwan (China accounted for nearly ¼ of inbound tourist arrivals to TW as of 2018).

Excerpt of our Risk Scoring Matrix Table: Growth Concerns

	Growth Concerns					
Country/ Currency	**Tourism: China Visitors' Share**	**Tourism: Receipts as % of GDP**	**Supply Chain: Intermediate Goods From China (% of GDP)***	**Supply Chain: Intermediate Goods To China (% of GDP)***	**Exposure to China's Domestic Demand (% of GDP)***	**Risk Score**
USD	13.5%	1.2%	1.4%	0.7%	1.2%	8
EUR	6.0%	1.6%	1.0%	1.2%	1.7%	8
JPY	26.9%	0.9%	1.7%	2.2%	2.6%	14
CHF	5.3%	3.0%	1.4%	1.8%	2.4%	12
GBP	3.2%	1.1%	1.0%	0.6%	1.2%	6
CAD	3.4%	1.2%	1.8%	1.8%	1.7%	10
AUD	26.7%	2.3%	2.1%	5.2%	4.9%	29
NZD	14.8%	3.0%	1.9%	2.8%	4.2%	22
SGD	14.5%	5.5%	2.8%	9.1%	7.8%	44
MYR	14.6%	5.8%	9.1%	12.7%	8.5%	60
IDR	13.5%	1.8%	2.4%	2.1%	2.5%	15
INR	2.7%	1.1%	2.3%	0.9%	1.1%	7
THB	27.8%	11.5%	7.7%	7.9%	7.0%	72
KRW	43.9%	1.1%	6.0%	10.5%	6.9%	45
TWD	**24.4%**	**4.3%**	**5.5%**	**19.4%**	**13.0%**	78
PHP	17.6%	2.3%	3.2%	5.0%	3.9%	25

Source: CEIC, Bloomberg, OECD-TiVA Database, Maybank FX Research & Strategy Estimates

Note: Scaling of the risk score is achieved via indexing the largest value in each indicator at 100. Tourism and supply chain sub-scores are computed before averaging with scores for exposure to Chinese domestic demand. Tourism data are as of 2018; estimate for EU is average of Germany & France's. The higher the more vulnerable the country is.

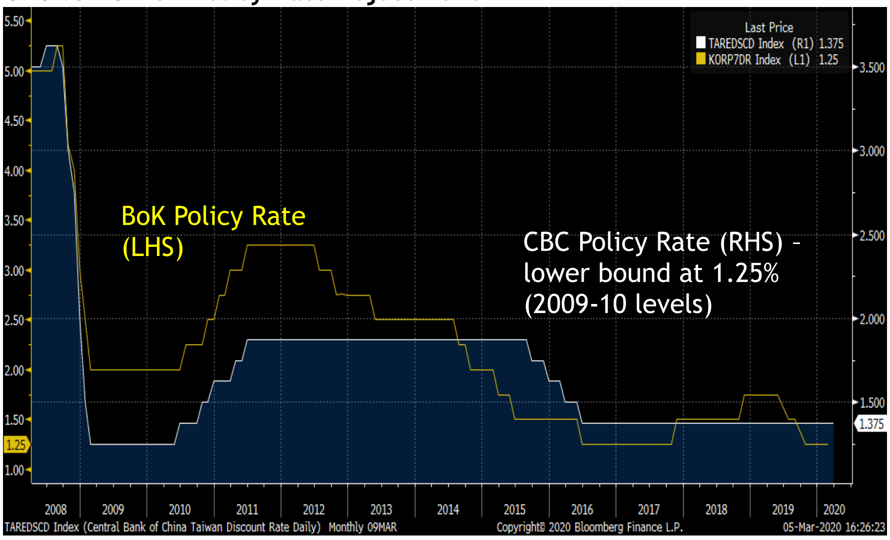
* Computed by OECD by decomposing the actual input of each country in the production of goods & services consumed worldwide. Latest data point is 2015 due to complexity of calculations.

No Need for CBC to Cut Rates but Risk of Symbolic Cut Remains

The Central Bank of the Republic of China (CBC) MPC will have its next policy decision due on 19th Mar. There are some **expectations of a pre-emptive and symbolic rate cut of 12.5bps to bring benchmark rediscount rate to 1.25%** (from current 1.375%) especially after the wave of global monetary easing in the DM world including Fed, BoC, RBA as well as in the EM world (see table 1), in response to potential COVID-19 impact on economic activities. This could possibly happen if Fed delivers another cut at the 18-19 Mar FoMC, on top of its 50bps emergency cut (3 Mar).

There is a **risk that CBC may follow suit but we do not see the need to** at this stage. Benchmark rates are already near its lower bound and there is ample liquidity in the banking system. There may be **very modest benefit to lower them further as any reduction could risk the compression of net interest margin**. It is also **uncertain if banks will pass the full benefits of the CBC cut (if any) to end-consumers**, as seen from RBA and BoC's recent case. In addition, unlike its peers, the CBC does not engage in frequent manoeuvring of its benchmark rates. Apart from 2008-09, the CBC only moved rates on 9 occasions over the past 10 years as compared to BoK, which has moved rates on 17 occasions.

CBC vs BOK on Policy Rate Adjustment



Source: Bloomberg, Maybank FX Research & Strategy

Further justification to keeping rates on hold at 1.375% includes steady growth outlook, despite growth downgrade by the government to 2.37%, from 2.72% for 2020. The **revision lower was due to COVID-19 outbreak but that said the government estimated that the effects of COVID-19 will cause no more than 0.5ppts drop to GDP for 2020**. In fact the **government was even planning to upgrade 2020 growth forecast before the outbreak of COVID-19**. We still expect **growth fundamentals to be underpinned by global semiconductor recovery, reshoring flows and downside to be partially mitigated by supply chain diversion**. This is on assumption that COVID-19 outbreak does not persist beyond 2 quarters.

Near term, we recognised the risk of a slowdown in 1Q, as seen from the plunge in Jan export orders (-12.8% y/y), decline in both exports (-7.6% y/y) and imports (-17.7% y/y) data as well as Feb Mfg PMI (slumped back to contraction territory of 49.9). Incoming Feb data could look worse given that COVID-19 outbreak intensified (in other parts of the world) last month.

Table 1: AXJ Monetary Policy Response YTD

Country	Policy Response
Taiwan	-
S. Korea	Held policy rate at record low levels of 1.25% at its last MPC (on 27 Feb); market speculation of emergency MPC to lower rate
China	Lowered rates by 10bps across MLF, LPR, 7d & 14d reverse repos (in Feb 2020)
Singapore	MAS' comments (5 Feb) that its current exchange rate band has sufficient room to accommodate an easing of the local currency even as policy stance remains unchanged
Malaysia	Cumulative cut of 50bps to policy rate (in Jan and Feb) to 2.5%. Our Economist sees prospect of another 25bps cut in May MPC
Indonesia	Cut policy rate by 25bp to 4.75% (in Feb); introduced 5 measures (on 2 Mar) including lowering of FX reserve requirement to 4% (from 8% previously), etc. Another 25bps not ruled out in coming months. See here for details.
Thailand	Cut policy rate by 25bps to record low of 1% (in Feb); chance of another 25bps cut at this month's MPC
Philippines	Cut policy rate by 25bps to 3.75% (in Feb); Rules out off-cycle policy rate cut but likely to cut another 25bps this month

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Thoughts on Other North Asian FX: CNH and KRW

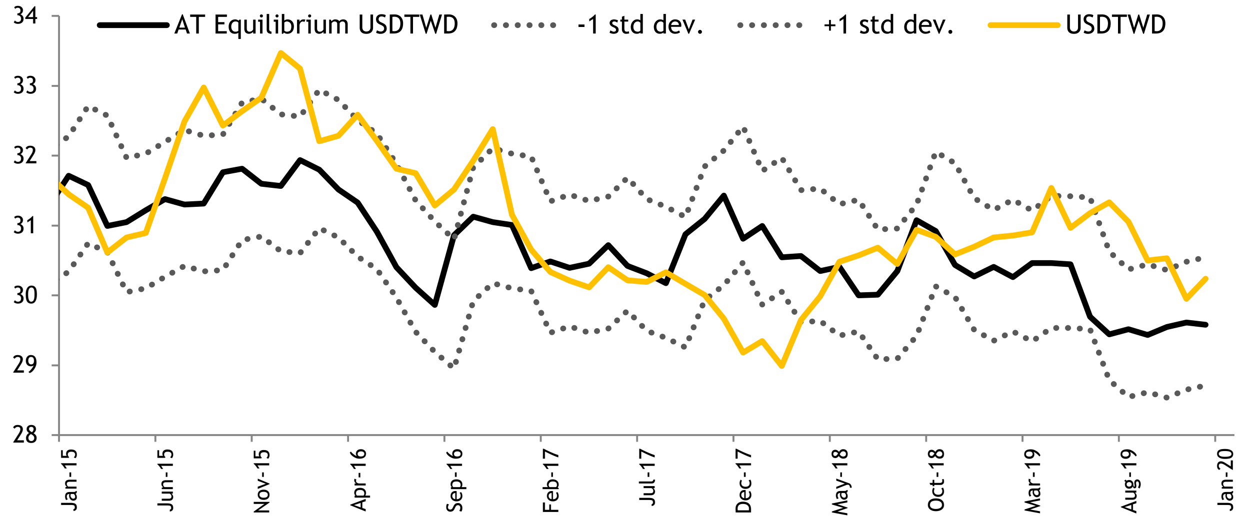
We observed that the "epicentre" of COVID-19 contagion has already started to shift from China to US. California Governor has declared state of emergency after the first death was reported while many new cases and deaths are reported across many states in the US, including NY. On the other hand, China's COVID-19 situation appears to show early signs of improvement – number of Chinese patients who have recovered (53,783) from COVID-19 exceeded those who are still being treated (23,730), according to data as of 6 Mar. CNH could strengthen at the expense of a softer USD, as a result. 6.92 is a key support before 6.85 levels.

Unfortunately for S. Korea, the COVID-19 situation remains severe. Total reported cases went above 6000. Number of recoveries (135 patients) paled in comparison with those still infected (of 6109 patients). It is likely KRW stays under pressure in the interim. USDKRW is at risk of re-visiting its recent highs of 1220. Support seen at 1180 levels.

In sum, we favor long in TWD, CNH over short in KRW on a relative play basis.

ST-AT Equilibrium Model Suggests TWD Still Have Room to Strengthen

Our short term (ST) augmented tracking (AT) equilibrium model which aims to capture shorter-term dynamic changes in bond yield and inflation differentials, the state of world equities and bonds, as well as a capture of tech cycle (using SOX as a proxy) suggests that current spot TWD is ~ 3% undervalued relative to our model estimate of about 29.10 (vs. USD).



USDTWD - Testing Interim Support

USDTWD has traded lower since the turn into 4Q 2019 and is now trading near its recent lows. Last seen at 29.98 levels. Bearish momentum on daily chart remains intact but RSI shows sign of turning higher. Immediate support at 29.85/90 levels (interim double bottom) likely to provide some support. A **bounce higher from this level towards 30.10 (21, 50 DMAs), 30.27 (100 DMA) should not be ruled out in the near term**. However should 29.85/90 support breaks, downside could gather traction towards 29.95 (76.4% fibo retracement of 2018 low to 2019 high). A stretch towards 28.95/29.00 levels (2018 low) should also not be ruled out.

USDTWD (Daily Chart): Interim Double Bottom Supports for Now

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