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Maybank

FX Insight

Taking A Step Back To See Further Out

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Evolving From China-Centric to Global Shock

For navigating near-term FX trades and exposures amid the current volatile environment, readers can refer to our comprehensive piece sent out earlier—Navigating COVID Storm. What this new piece aims to do though, is to take a step back from the chaos in March and consider what has changed in the world since the start of the year. In particular, we note that the risk to markets has evolved from a China-centric shock, to a global shock. We refresh our earlier risk scoring tables, keeping this in mind, and layer on a longer-term focus/perspective.

Focusing on Longer-Term Structural Shifts

Certain structural concerns are likely to stay intact for the next 1 year or more: (i) the extent to which populations are ravaged by Covid eventually, (ii) the extent to which macro-economies will be impacted by the almost inevitable softening in global demand, (iii) the extent/duration to which oil prices remain soft, as OPEC+ sorts out their affairs. These structural concerns are addressed in our longer-term risk scorings.

Near-Term Moves Vs. Longer-Term Risks?

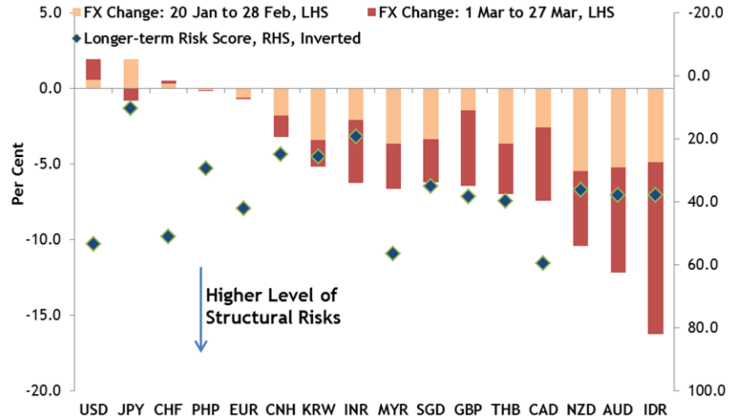
SGD & THB: Among first to be hit by Covid concerns, they now look to have adequately priced in some of the longer-term risks.

PHP: Relative resilience thus far as markets had focused on its lower dependence on external demand; but this could wane as lockdowns start impacting domestic economic activity.

MYR: Higher longer-term risk score partly reflects uncertainty over medium-term trajectory of oil. If dislocations in oil markets do not resolve later, MYR could still see some downside pressures. In the interim though, directional bias could follow other AxJ FX.

IDR: Near-term FX moves are amplified by portfolio flows amid global risk aversion. Aversion to carry trades could persist for now. But beyond some point, Covid situation clarity would translate to lower asset volatility and carry trades could come into favor again.

Longer-term Risk Scores Vs. FX Change Since Onset of Covid



Unfamiliar Times

For navigating near-term FX trades and exposures amid the current volatile environment, readers can refer to our comprehensive piece sent out earlier—Navigating COVID Storm, which highlights the extent of current volatility across asset classes, and evaluates concerns over current USD strength, market concerns over EM outflows, twin deficits etc.

What this new short piece aims to do though, is to take a step back from the chaos in March and consider what has changed in the world since the start of the year.

We take the chance to re-evaluate recent structural shifts, pulling together some thoughts and studies we have put out over the course of the past two months. Hopefully the end-result will give readers some mental anchors for where the state of FX might be further out.

Evolving From A China-Centric Shock to a Global Shock

Earlier on, our Distilling the Covid-19 Effect piece in mid-Feb had introduced risk scores for the currencies we monitor, taking into account:

- Contagion concerns (via confirmed cases, air connectivity, population density, WHO survey of preparedness)
- Growth concerns (via tourism receipts dependence, supply chain linkages to China, exposure to China's domestic demand).

(For interest, the original risk scoring tables can be found in the Appendix.)

What has obviously changed since then is that the risk to markets has evolved from a China-centric shock, to a global shock in the form of escalating Covid contagion in parts of Asia as well as the West. Never-before seen lockdowns of entire populations are bringing key parts of daily economic activity to a halt. In Asia in particular, our economist colleagues have investigated the resilience of various ASEAN economies amid the lock-down (see Lockdowns & Resilience).

To combat the outbreak, monetary policy had moved fast among global central banks (see Fed's Bazooka and its Implication on FX, ECB's Extraordinary Measures in Extraordinary Times, RBA Utilizes Cash Target, Moves to Yield Target). MAS is likely to follow suit this coming Monday (SGD NEER - MAS Easing Partly Priced In) as well with aggressive policy easing.

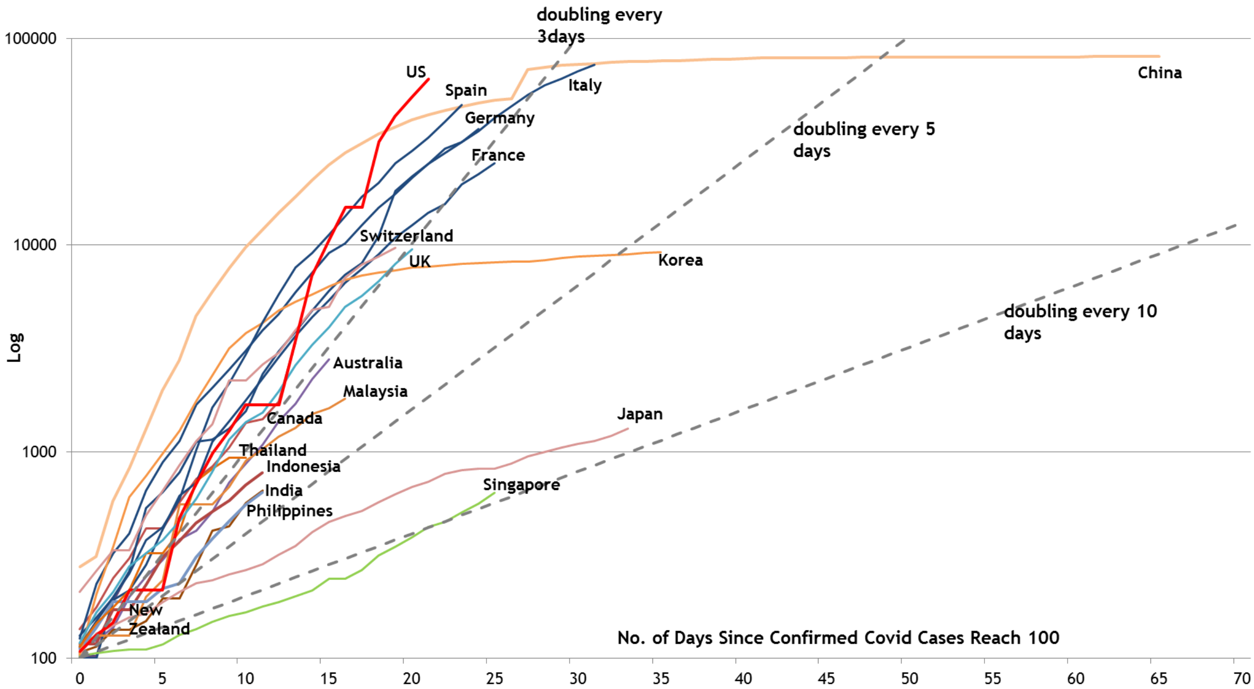
In recent days, we are also beginning to see a wave of concerted fiscal stimulus, in the range of up to 10% of GDP for countries who can afford it, in a bid to mitigate the impact of the stalling in economic activity. Singapore's supplementary budget of S$48bn introduced yesterday for instance, was up to 7 times as high as its initial Covid-targetting stimulus of S$4.6bn in Feb.

While it is early days yet to ascertain whether current policy action is sufficient, we think that in the FX world at least, **certain structural concerns are likely to stay intact for the next 1 year or more**:

- **The extent to which populations are ravaged by Covid eventually**. The wide variance in case counts among countries shows the key difference that government initiatives in early days can make in influencing the contagion curve.
- **The extent to which macro-economies will be impacted by the inevitable softening in global demand** over the next several quarters, despite best efforts in monetary/fiscal stimulus. The impact of supply chain disruptions will likely be amplified by current widespread lockdowns globally.
- **The extent/duration to which oil prices remain soft**, as OPEC+ sorts out their affairs. (OPEC+ agreement expires next week at the end of March).

The aim here will be to construct a refreshed risk scoring table based on these structural factors.

1) Pace of Covid Contagion Reflects Extent of Domestic Macro Shock



Source: WHO Situation Reports, ourworldindata.org, Maybank FX Research & Strategy

Note: To get a sense of the pace of Covid doubling in a country, the slope of the contagion curve should be compared to the slope of the grey dotted lines. For instance, cases in China had rose at a pace which was faster than "doubling every 3 days" initially, but the slope had tapered off within 2-3 weeks of cases first reaching 100. Singapore on the other hand, has roughly observed a pace of "doubling every 10 days" since cases first reached 100.

Recent experience dictates that that heightened contagion in a country will likely result in protracted lockdowns in various forms. This will lead to spillover drags on domestic services sectors such as retail, recreation and F&B, on top of the original hit sustained by exporters and hospitality sectors.

Here, we proxy the likely magnitude of eventual damage to economic activity with the tentative extent of effectiveness in contagion control. Obviously the pace/slope of the contagion curve differs according to time of evaluation, but we derive an ordinal ranking of sorts by looking at curve slopes over roughly comparable time periods. Contagion containment effectiveness rankings are as such, ordered from most (1) to least (19) effective.

Ranking	Country	Ranking	Country
1	Singapore	11	Korea*
2	Japan	12	UK
3	New Zealand	13	Switzerland
4	Philippines*	14	France
5	India	15	Italy
6	Indonesia*	16	Germany
7	Australia	17	Spain
8	Malaysia	18	China*
9	Thailand	19	US
10	Canada		

Source: Maybank FX Research & Strategy

While China and Korea are "ranked" lower due to their sharp slopes in the beginning, we note that they have both successfully flattened the contagion curve later on. Meanwhile, the disproportionate deaths to confirmed cases in Indonesia (78 deaths out of 893 cases) and Philippines (45 deaths out of 707 confirmed cases) vs. peers could suggest that there could be under-detection of cases currently. Their risk scores will be adjusted later on to reflect this.

2) Global Demand Slowdown & Broad Supply Chain Disruptions Are Just Beginning

	% of GDP	
Country/ Currency	Supply chain - Imports & Exports of Intermediate Goods	Exposure to External Demand
USD	13	9
EUR	24	18
JPY	18	13
CHF	88	39
GBP	27	21
CAD	37	23
AUD	24	16
NZD	23	21
CNH	23	16
SGD	119	56
MYR	87	43
IDR	24	17
INR	26	16
THB	69	42
KRW	52	27
TWD	72	39
PHP	33	21

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

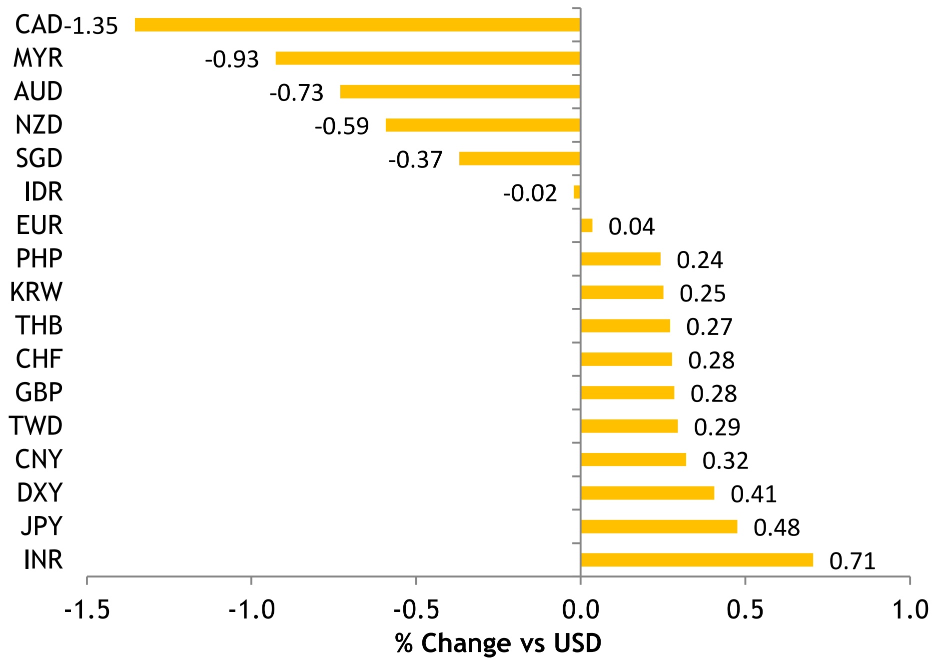
Note: Data from OECD is derived by decomposing the actual input of each country in the production of goods & services consumed worldwide. Latest data point is 2015 due to complexity of calculations.

The above table is a refreshed version of the original tables in our Distilling the Covid-19 Effect piece focusing on exposure to China-centric supply chains and domestic demand. We have modified the figures such that they reflect a country's **overall exposure to global supply chains as well as all external demand.**

Unsurprisingly, trade or tourism-dependent currencies such as SGD, MYR, THB, KRW, TWD could see longer-term negative impact. The focus here is on the differentiated extent that a protracted period of soft global demand will have on the more "open" economies. Similarly, we will transform these indicators into factor scores at the end of this piece.

3) Oil Market Dislocations Could Be Protracted

Estimated FX Sensitivities to -10% Decline in Oil Price



Source: Bloomberg, CEIC, Maybank FX Research & Strategy Estimates
Note: Values used in regression are in log-form where applicable, and data from the past 5 years are utilized.

Lastly, we re-visit our estimated FX sensitivities (to oil) first introduced in our The Domino Impact of An Oil Shock piece, where we discussed the impact of an oil shock. Notably our suggestion then that: "if Saudi tactics harden Russia's stance and Russia also ramps up supply starting Apr, we do not rule out the risk of an aggressive price war (for market share) leading oil prices towards US$25, with cascading effects on equities and commodity-linked and AXJ FX"—seems to have played out rather well over the past two weeks.

As we write, we note that the oil industry is facing developments which last happened more than 3 decades ago—some producers are shutting down operations as the Covid-led lockdowns have further reduced energy demand across the globe. Some emerging markets with less developed storage infrastructure, e.g. Pakistan, are already starting to see insufficient storage capacities.

While Saudi and Russia could come under increasing pressure from both allies and other global powers to come to the negotiation tables to restore some order in the oil markets, this could take time to play out. Besides expected swings (both-ways) in oil-proxies CAD and MYR alongside oil price volatility in the interim, longer-term disorder in oil markets could impinge on the performance of CAD and MYR further out as well.

Similarly, we convert the FX sensitivities to oil moves from the chart above to risk scores below.

Combining Information into Longer-term Risk Scores

	Pace of Covid Contagion *(Damage to Domestic Economy)*	Exposure to External Demand, Supply Chains *(Protracted Global Demand Softness)*	Exposure to Oil Shocks *(Dislocations in Oil Markets)*	Combined Longer-Term Risk Score
USD	100	14	0	53
EUR	71	26	0	42
JPY	11	19	0	10
CHF	66	72	0	51
GBP	61	30	0	38
CAD	51	36	100	60
AUD	36	25	54	38
NZD	36	29	44	36
CNH	38	24	0	25
SGD	6	100	27	35
MYR	41	75	69	57
IDR	63	25	0	38
INR	26	25	0	19
THB	46	67	0	40
KRW	28	46	0	26
PHP	43	33	0	29

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

For each indicator discussed above, we create a scaled risk score by indexing the largest value in each indicator at 100. We derive the combined risk score via weighting the "Pace of Covid Contagion" factor by 50% and the other two by 25% each.

We give largest weight to the first factor as we believe that there is greatest uncertainty (economic, policy, social) associated with this risk factor, which could magnify the eventual damage to sentiments and activity.

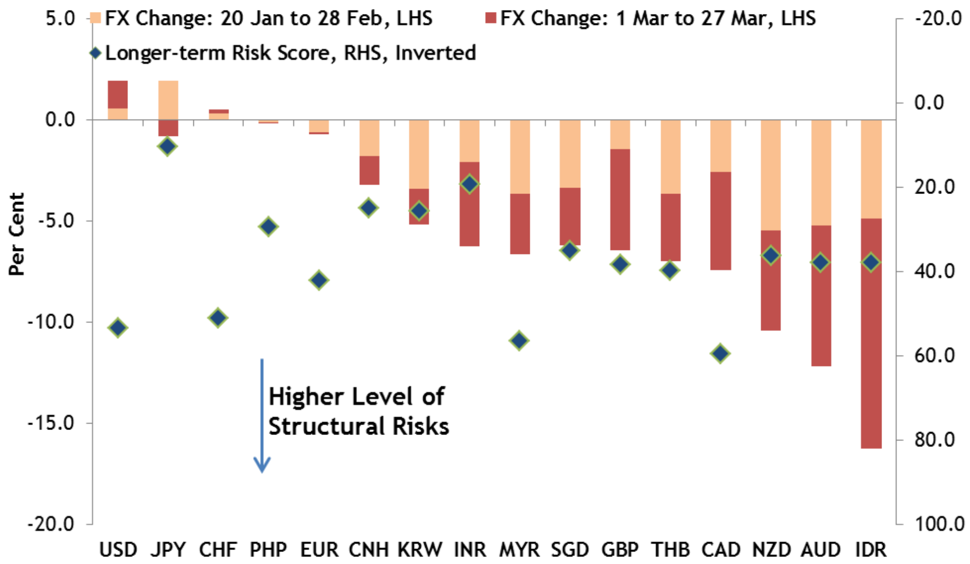
In the computations, we make the following adjustments:

For "Pace of Covid Contagion", we halve Korea and China's initial scores as contagion curves have tapered off. We double Indonesia and Philippine's initiation scores due to disproportionate death to case ratios suggesting potential under-detection at this point.

For "Exposure to External Demand, Supply Chains", we average sub-scores derived from the two respective indicators.

For "Exposure to Oil Shocks", we only derive scores for FX which are likely to see negative impact from soft oil prices. We keep scores for the rest at 0.

Longer-term Risk Scores Vs. FX Change Since Onset of Covid



Source: Maybank FX Research & Strategy Estimates

As a last step, we take a look at computed longer-term risk scores vs. recent FX changes for selected currencies.

Recent demand for USD on liquidity, semi-haven needs seem to be keeping it buffered against its high contagion risks. We note that the US$2tn fiscal package might be keeping sentiments supported in the interim as well. But if US is unable to flatten the contagion curve (like China, Korea), eventual corporate failures and heightened job losses could mean that its haven shine might dissipate over the course of the year.

Among ASEAN currencies in particular, we are cautious of some dampening in PHP sentiments after its relative resilience in the past two months. In particular, markets had focused on PH's lower dependence on external demand earlier in being (relatively) positive on its growth outlook, but this could wane as lockdowns start impacting domestic economic activity.

For the SGD and the THB, they were among the first to be hit by Covid concerns. The currencies seem to have priced in an adequate level of longer-term risks for now. Singapore in particular just confirmed a heroic S$55bn of fiscal stimulus aimed at blunting Covid's impact on the economy.

For the MYR, the longer-term risk score was brought higher in part by concerns over eventual oil developments. This suggests that if dislocations in oil markets do not resolve in the later part of the year, MYR could still see some downside pressures from this factor. In the interim though, directional bias might follow other AxJ FX as the market shifts between broad risk-on/off modes. We note too, that the just-announced MYR250bn (US$58bn) stimulus package (including MYR$20bn announced earlier), which dwarfs the MYR67bn spent during GFC, could help mitigate some of the negative sentiments associated with the extension of the national lockdown to 14 Apr, even as there are concerns over the potential sources of funding. MYR50bn will be to guarantee working capital loans, while singles and low-to-middle income households will receive MYR10bn in one-time payments. In particular, MYR5.9bn will be dispatched to help protect jobs of low-earning workers.

For the IDR, near-term FX moves were likely amplified by sharp portfolio flows amid bout of global risk aversion. As long as global market volatility remains escalated, we could see continued softness in IDR alongside aversion to carry trades. So near-term market concerns are valid. But beyond some point, when markets have more clarity on the global Covid situation, volatility could ease across asset classes and carry trades could come into favor again, especially with more appealing, wider yield differentials between IDR-US bonds.

Appendix – Risk Scoring Tables (from Distilling the Covid-19 Effect, Mid-Feb)

Risk Scoring Matrix (1): Quantifying Contagion Concerns

Country/ Currency	Contagion Concerns				
	Confirmed Cases (as of 17 Feb)	Air Connectivity	Pop. Density (Log)	Preparedness (Higher = Less Prepared)	Risk Score
USD	15	186	3.6	9	36
EUR	35	200	4.9	14	50
JPY	59	153	5.8	6	52
CHF	0	114	5.4	13	33
GBP	9	317	3.6	7	43
CAD	7	173	1.4	1	20
AUD	15	158	1.1	10	27
NZD	0	99	2.9	10	23
SGD	75	240	9	9	75
MYR	22	229	4.6	5	41
IDR	0	191	5	37	54
INR	3	117	6.1	25	44
THB	34	156	4.9	21	52
KRW	29	233	6.3	6	50
TWD	20	-	6.5	-	49
PHP	3	153	5.9	31	51

Source: WHO, OAG, Bloomberg, Maybank FX Research & Strategy Estimates
Note: Scaling is achieved via indexing the largest value in each indicator at 100. Preparedness score for EU is average of Germany and France's scores.

Risk Scoring Matrix (2): Quantifying Growth Concerns

Country/ Currency	Growth Concerns					
	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 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.
* 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.

Combined Risk Scoring vs. FX Change

	Contagion Concerns	Growth Concerns	Combined Risk Score	FX Change % vs USD (20 Jan to 17 Feb)
SGD	75.0	44.2	60	-3.1
THB	51.5	72.1	62	-2.7
NZD	22.8	21.6	22	-2.7
EUR	50.1	8.2	29	-2.3
AUD	27.3	28.7	28	-2.1
KRW	49.6	44.6	47	-2.0
MYR	41.5	60.0	51	-1.9
CAD	20.5	9.5	15	-1.4
CHF	33.0	12.0	23	-1.4
INR	44.2	7.3	26	-0.5
IDR	54.0	15.0	35	-0.5
TWD	49.4	77.6	63	-0.1
PHP	50.6	25.4	38	0.9

Source: Maybank FX Research & Strategy Estimates

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