Maybank

FX Insight

Final Lap to Elections and Beyond

Asian FX Still Driven by US Elections & Covid Development
A handful of twists and turns took place recently. Trump was diagnosed as being infected with Covid-19, stimulus talks were halted (subsequently resumed but showing less progress), and Biden extended his lead over Trump after first televised debate. In particular, widening of Biden's lead appears to have been positive for Asian FX on net, even as markets are again turning a tad cautious this week.

Potential for Disruption, Delays; Are Markets Complacent?
Our underpinning assumption remains for Biden to win the Presidential Elections with a Democratic Clean Sweep (Scenario 4 in report). That should be a USD negative outcome given higher likelihood for less combative foreign and trade policies, and larger fiscal stimulus packages. However, even as we are just 3 weeks ahead of Polling Day and Biden's lead has just widened to around 10 pts (based on Real Clear Politics Average Polls), we are still wary of some underpriced volatility.

For instance, the profiles of Biden supporters and their likely mode of voting via mail could mean a potential scenario where Trump leads in initial polls as in-person votes can be tallied faster, and that could provide room for opportunistic FX plays with Trump's lead associated with stronger USD (trade war, smaller fiscal stimulus), before an eventual Biden-win confirmation brings the USD back lower again. We highlight this not as a baseline scenario, but as an example of how the USD is still vulnerable to election timelines and developments.

On the ASEAN FX front, our simple model of FX volatility—incorporating interest rate volatility, US macro policy volatility and RMB-induced volatility (while also controlling for reflation expectations)—also suggests that markets might be a tad complacent.

"Window" in 2021 for Lower FX Vols & ASEAN FX Outperformance
There is a chance for a "window" of benign macro conditions in 2021, alongside gradual demand recovery, tame price pressures and lower-for-longer rates, anchored on continued positive vaccine developments. While this "lower-vol" backdrop would likely occur on "relative" terms (i.e., still elevated vs. pre-Covid days), intuitively, a modest downtrend in FX vols could be beneficial for ASEAN FX still.

Historically, periods of declines in ASEAN FX volatility have been accompanied by strengthening ASEAN currencies—most discernible for IDR, followed by MYR, THB, SGD. We are cognizant of idiosyncratic domestic risks, so an ASEAN FX basket approach could be useful. Notably, Asian FX is also in somewhat of a "sweet spot" vs. majors and other EM FX, when comparing volatility and carry. Among these, we like the CNH. On net, we prefer a long CNH+ASEAN FX basket funded out of EUR short.

Asian FX as "Sweet Spot" for Carry Plays into 2021?
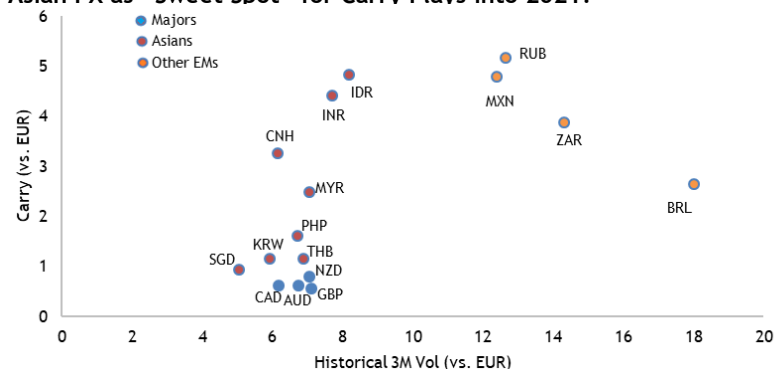
Note: Carry is proxied by differentials in 3M rates.
Source: Bloomberg, Maybank FX Research & Strategy

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"God Does Not Play Dice With The Universe"

Albert Einstein 1945

While 3rd Nov was booked well in advanced for the US Elections, events such as the COVID-19 pandemic are largely seen as unpredictable shocks. But such shocks can lead to less-random outcomes, if responses are rational. Just as Einstein believed that there are fundamental structures to the universe' behavior, so have we attempted to connect the dots between market moves and macro drivers in our FX coverage over the pandemic period. We briefly recap our recommendations thus far in Section 1 of this report.

Meanwhile, since our last FX Insight report in late Aug (*US Elections & Implications on AxJ*), there is now more clarity on the potential pathways leading up to polling day and beyond. Given how the pandemic has changed the environment for polling, we think there could be some room for FX swings due to potential disputes and delays, which we will go through in detail in Section 2.

We had argued previously that a Biden win would eventually be net positive for Asian currencies, including RMB, as the trade tension uncertainties under the Trump era continue to unwind. Section 3 highlights the potential for RMB as a conduit of strength for other currencies, including how its relationships with ASEAN currencies have been shifting over time.

Last but not least, as we stand at the cusp of a likely bumpy end-2020 and look forward with cautious optimism into 2021, it would be useful to dig a little deeper into another pertinent aspect of FX markets, i.e., FX vols. Deeper trends here would arguably be linked to the broader macro and policy environment, which has shifted sharply in 2020. We end off with some trade recommendations based on risk-reward considerations.

1. What We Said in 2020 and How They Played Out So Far

2020 has been dominated by the COVID-19 pandemic, the market crashes in Mar and the uneven but irrefutable resurrection of risk assets thereafter. **Our Apr 17 note (*Phoenix from the Ashes*) recommended positioning for recovery** and we were **especially bullish on North Asian FX** (KRW, CNH and TWD) as we looked for technology-reliant economies to outperform and China's recovery to gain traction.

That panned out well, North Asian FX (green) eked out more gains and rose by an average of 7.3% since the turn of markets around 19 Mar, a tad higher than ASEAN FX at 6.2% gains over the same period. It is also worthy to note that ASEAN FX gains have slowed while gains in North Asian FX seems to have accelerated in more recent days as indicated by the trend lines below (chart on next page).

The slowdown in ASEAN FX gains were actually foretold by our subsequent piece dated 12 June and titled – ASEAN FX Gains – More To Go? In which we warned that recovery is priced and there could be a temporary phase of consolidation before the next leg of gains for ASEAN FX. ASEAN FX had remained elevated in consolidative plays since.

Figure 1: North Asian FX Outperform (Anticipated by *Phoenix from the Ashes*)

North Asian FX Appreciated A Tad More Than
ASEAN FX
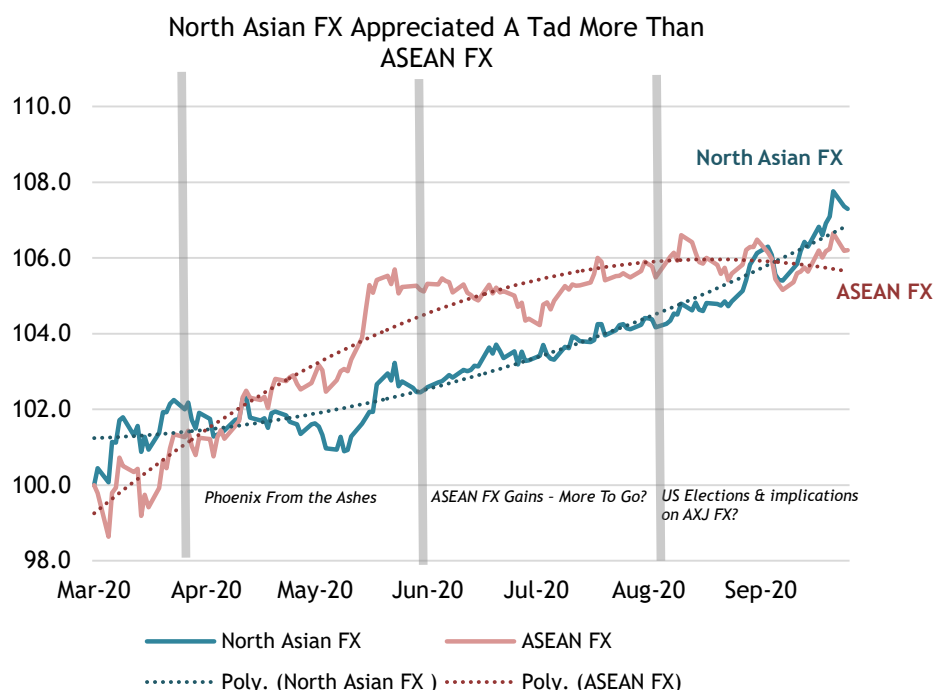
Note: FX baskets are indexed to 19th Mar 2020. North Asian FX consists of CNH, KRW and TWD (vs. USD series) equally weighted. ASEAN FX consists of SGD, MYR, THB, IDR and PHP (equally weighted).
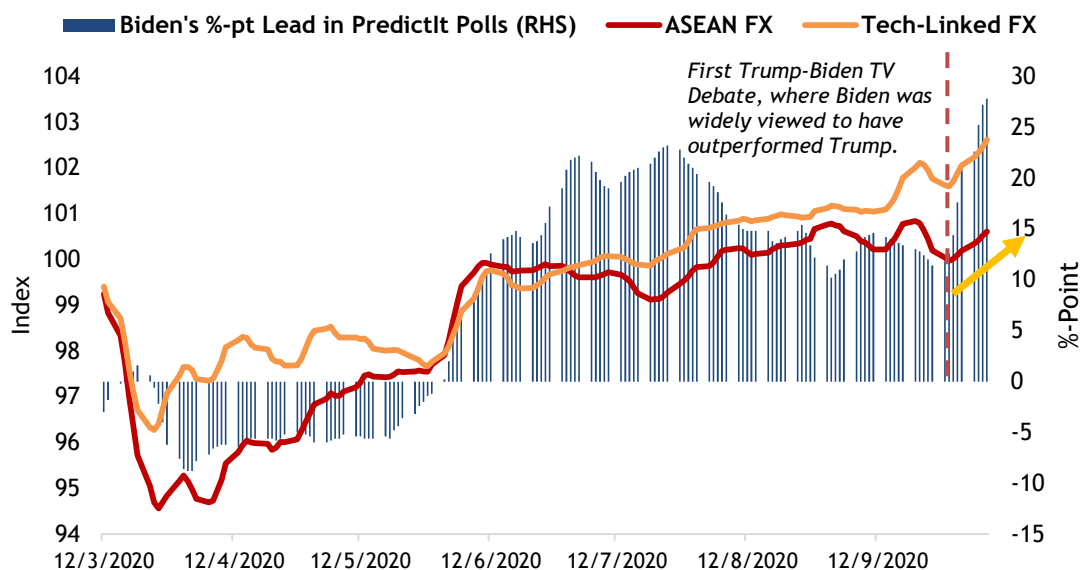*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

Then came the focus on US Elections 2020. Our note on US elections & Implications on AXJ FX dated 21 Aug, had expected a Biden-win to be more negative for the USD (vs. a Trump victory) but we were also wary of some USD strength that typically presents itself before the US elections. After the note was published, the DXY index rose from a low of 92.14 to a high of 94.64 on 25 Sep. The rise of the greenback coincided with the fall in equities amid the US fiscal impasse (which still remains). We also attribute some of the greenback appreciation on Biden's narrowing lead (then) and concomitantly, greater election uncertainty at that point.

The DXY index has since reversed out its gains along with the rebound in Biden's lead, especially after the 1st Presidential debate on 29th Sep and Trump's contraction of COVID-19 thereafter. USD moves were well in line with our FX bias stated in that report. In particular, the outperformance of the Asian currencies vs. other DM currencies since the debate (and rebound of Biden's lead) was in line with our view that a Biden victory alongside a Democrat clean sweep could be more positive for Asian FX and some part of that could already be priced along with the latest updates in polls.

As of last check, Biden's lead is still wide at around 10 pts according to Real Clear Politics Average Polls. Based on PredictIt Polls which is based on bets, Biden's lead differential has been steady at 25-30pts since the first Presidential Debate. We plot Biden's lead with FX baskets' moves, and found that ASEAN FX and Tech-linked FX gains have broadly coincided with periods of Biden gaining in lead, even from earlier on in the year.

Figure 2: A Biden-Win Is Net Positive for Asian FX as Shown by Recent Moves

Note: FX Baskets are indexed to 100 on 4 Mar. ASEAN FX basket refers to equal-weighted SGD, MYR, THB, IDR, PHP (vs. USD) series. Tech-linked FX refers to SGD, KRW, TWD.
Source: Bloomberg, Maybank FX Research & Strategy Estimates

2. Taking Stock of Fresh Developments in the Run-Up to US Elections

A handful of twists and turns took place recently. Trump was diagnosed as being infected with Covid-19, stimulus talks were halted (subsequently resumed but showing less progress), and Biden extended his lead over Trump after first televised debate, etc. We take stock on some of these developments in this section of the report and explore how they may or may not affect our FX biases stated in US elections & Implications on AXJ FX.

In particular, we look closely at:

1. When will full Election results (including mail-in votes) be known?

2. Potential Election dispute – What can happen and timeline

Early Polling Already Underway ahead of 3 Nov Election Day

The United States will hold elections on 3 Nov 2020 but due to the Covid pandemic, adjustments have been made. Some voters can visit a polling location or cast their absentee ballot in-person in states that allow one or both methods, starting in Sep. For instance, in-person voting started as early as 9 Sep for Alabama while voters in Minnesota, South Dakota, Virginia and Wyoming started on 18 Sep. However, not all voters start that early. Voters in Florida, Mississippi and New York can only cast their in-person votes on 24 Oct, while voters in Oklahoma have to wait till 29 Oct to cast their in-person votes.

Democrats in the Lead but Too Early to Jump to Conclusions

According to a CNN and Edison Research Survey of election officials in 36 states reporting voting data, more than 7 million Americans have already casted their votes (as of 11 Oct). So far Democrats lead Republicans in the 6 states reporting returns by party. That said, it is too early to conclude that Biden will ultimately win.

Figure 3: Biden Supporters Favor Mail-In while Trump's Supporters Favor Voting in-person on Election Day
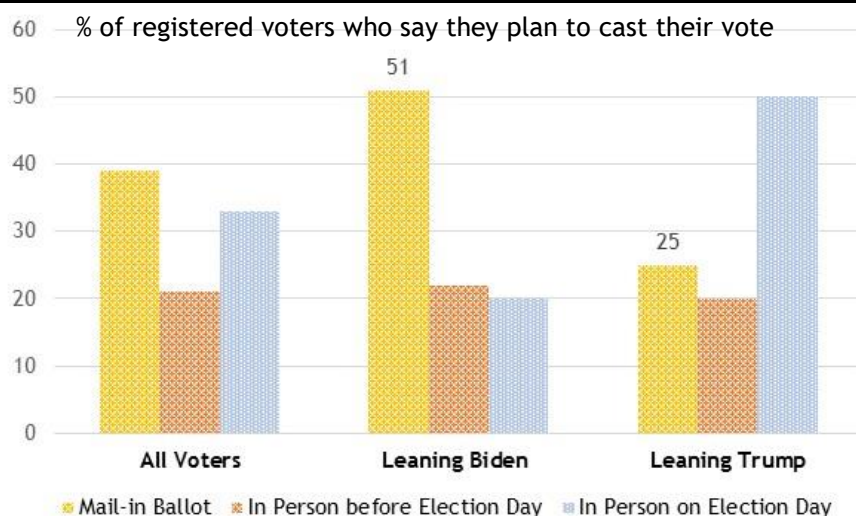
Note: Survey of US adults conducted 30 Sep – 5 Oct, based on registered voters. No answer responses and those who say they don't plan to vote or are not sure how they plan to vote are not shown. Voting method categories combine those who plan to vote and those who say they have already voted.
Source: Pew Research Center, Maybank FX Research & Strategy

Trump Could Take Early Lead on Election Day but Not Conclusive

A study by Pew Research Center indicates Trump's supporters prefer voting in-person on Election day while Biden's supporters favor mail-in votes. This basically suggests that **in-person votes reported on 3 Nov Election day could indicate an early lead in favor of Republicans** and that absentee votes counted later could be in favor of Democrats.

Final Election Results at Risk of Being Delayed for Up to Weeks

On election day, 3 Nov, opening and closing time for polls on the day varies in each state. For Florida, voting opens at 7am (EST time) and closes at 7pm (EST). And as soon as the polls close for that state (depending on the time zone), there will be a projection based on exit polls. This should typically give an indication of who won the state. The first projections typically come from the East Coast states. In 2016, the election was called for Trump at about 0230am (EST time) or 230pm (SG/KL time the following day) after victory in Wisconsin put him over the 270 electoral votes required.
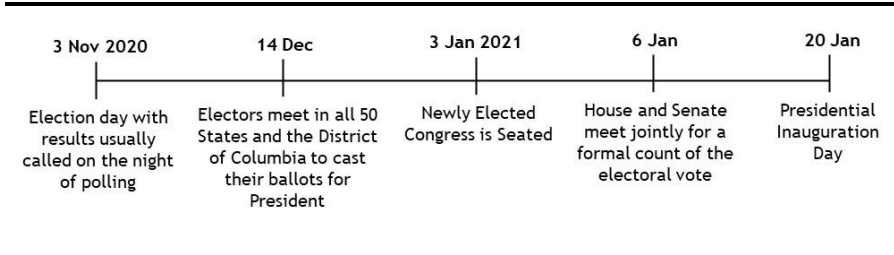
But this year the **results on 3 Nov may not be as clear-cut due to postal ballots.** An estimated 80mio postal ballots will be cast this time out of projected 153mio registered voters (based on Michael McDonald, a political scientist at University of Florida). This implies that slightly more than half of total votes will be cast by post for 2020 while in 2016, only about a quarter of votes were cast by post.

There are concerns that there will be delays in reporting of results as postal votes may take time to arrive, would take time to count after they arrive, and different states have different rules over how and when they can be counted. **Potentially it may take up to days or even weeks to finalise election results.** Take for instance, some states such as California, Washington, Illinois (amongst the 25 states + district of Columbia) will accept ballots received after Election day (within 1-week grace period with the exception of Washington with grace period as long as up to 23 Nov) so long the ballots are postmarked on or before Election day (3 Nov). These states represent 354 (or 66%) of the nation's 538 Electoral College votes.

Figure 4: Different Rules over States' Acceptance of Ballots

Ballots must be received on or before Election Day				
AL	AZ	AR	CO	CT
DE	FL	GA	HI	ID
LA	ME	MO	MT	NE
NH	NM	OK	OR	RI
SC	SD	TN	VT	WY

Ballot must be postmarked on or before Election Day but can be received later				
AK	CA	DC	IL	IN
IA	KS	KY	MD	MA
MI	MN	MS	NV	NJ
NY	NC	ND	OH	PA
TX	UT	VA	WA	WV
WI				

Source: CNN, Maybank FX Research & Strategy

Figure 5: Typical Timeline Post-3 Nov

3 Nov 2020	14 Dec	3 Jan 2021	6 Jan	20 Jan
Election day with results usually called on the night of polling	Electors meet in all 50 States and the District of Columbia to cast their ballots for President	Newly Elected Congress is Seated	House and Senate meet jointly for a formal count of the electoral vote	Presidential Inauguration Day

Source: Maybank FX Research & Strategy

A Re-visit to US Electoral College System

It is important to note that the **US citizens do not elect their President directly.** Instead the **US uses an Electoral College system**, where the President and Vice-President are elected through an indirect process. The US citizens vote in the General Election to determine a set of representatives (known as "electors") to the US Electoral College, who will then vote for the candidates. **The US President is not chosen by popular vote**. Recall back in 2000, George W. Bush lost the popular vote to Al Gore, but won the elections on the Electoral College vote of 271 to 266. Again in 2016, Trump won the electoral college but Democratic opponent Hilary Clinton won the popular vote.

Electors are apportioned to each of the 50 States and to the District of Columbia (otherwise known as the Capital, Washington D.C.), roughly according to population.

The number of electors in each State is made up of the number of Senators (2 in each State) and Congressional District representatives. A big State (in terms of population) such as California is assigned 55 Electors (the most in any State). Based on the "winner takes all" rule and the tradition in 48 out of the 50 States, the winner gets all the 55 electoral votes while the loser get none (in California's example). There are 2 States out of the 50 that do not follow this tradition -

States of Maine and Nebraska, which will allocate their electors based on the winner of each district and the overall winner of that State.

There are 538 Electors in total, corresponding to 435 representatives and 100 Senators, in the 50 States as well as the District of Columbia (3 Electors). **To win, a candidate needs 270 votes.**

Swing States ("Battlegrounds") Matter

In the last 5 Presidential Elections since 2000, 38 States have voted for the same party. Based on number of registered voters in California, 46.3% (increase from 45.1% in 2016) of the voters are Democrats and only 24% (declined from 27.1% in 2016) are Republicans. It is widely expected that California goes to Democrats for the upcoming vote. On the other hand, Texas (which has the second highest electoral votes at 38) has seen Republicans winning every election since 1996. And it is widely expected that Republicans get Texas.

There are about 13 States which are considered as swing states (subject to changes as the day goes by, in the lead up to polling day), where the Democratic and Republican registration numbers are nearly even. These States could swing either way and could determine the outcome of the election. In particular, 6 of these swings states – Florida (29); Pennsylvania (20); Michigan (16); North Carolina (15); Arizona (11) and Wisconsin (10) – are likely to be pivotal to capturing the White House as they represent 101 of the 270 electoral votes needed. Results cannot be known until the mail-in votes are fully counted. Democrat Biden or Republican Trump will have to win at least 3 to capture an electoral majority.

Figure 6: Electoral College Map (as of 13 Oct) – 270 Votes Needed to Win
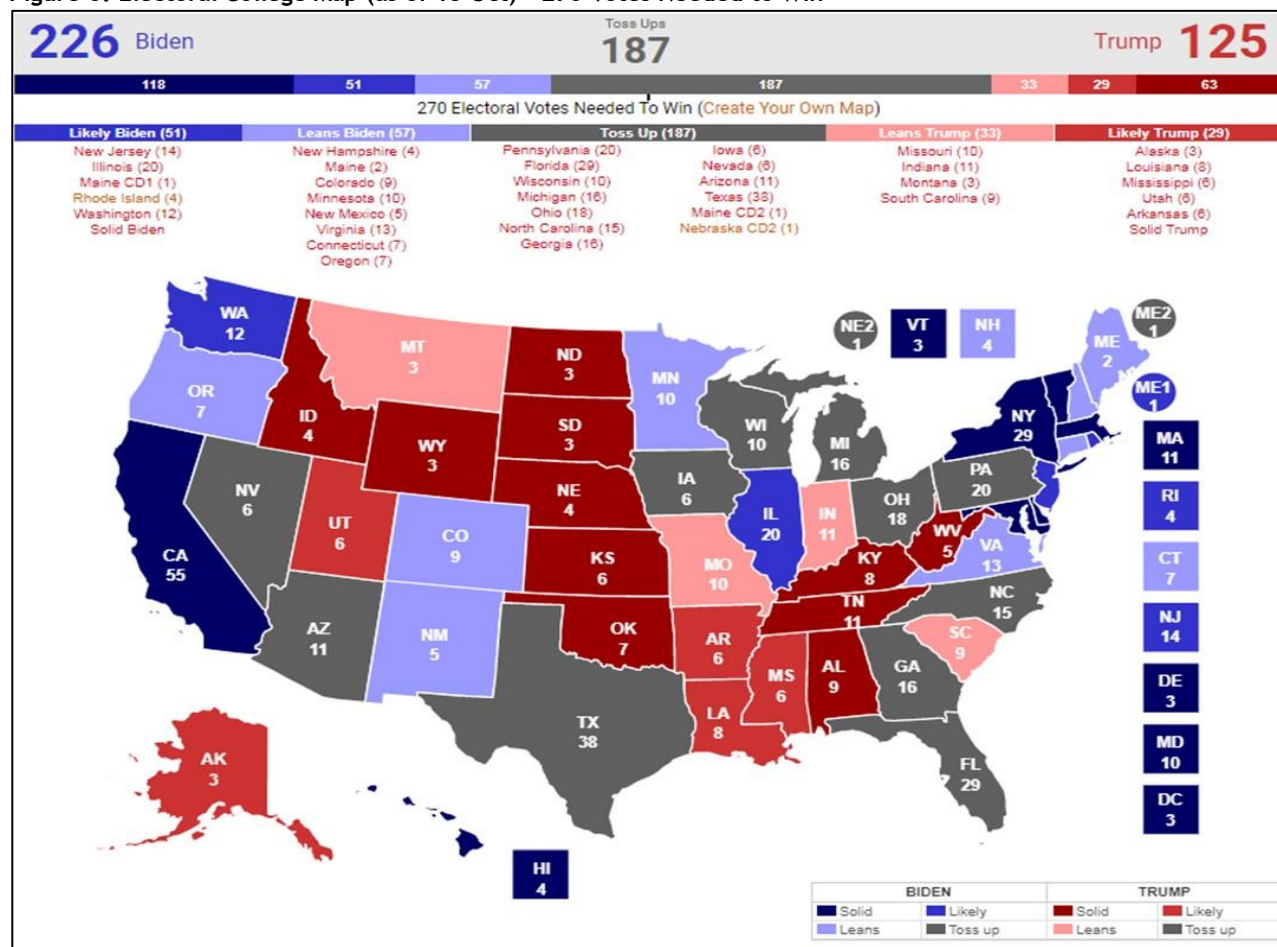
Note: CA (55) refers to 55 electoral votes for California in the Electoral College
Source: Realclearpolitics.com, Maybank FX Research & Strategy

Potential Volatile Price Action on 3 Nov and the Next Few Days

Trump may take an early lead given his supporters' preference for in-person voting on Election day. Market price action in light of Trump possibly prematurely claiming victory could see risk aversion play in the interim (scenario 1 of our table below): AXJ FX, including RMB, SGD, MYR and KRW under pressure while USD and safe haven proxy FX such as JPY could find demand.

- Scenario 1 of Trump win and Republicans retaining Senate is associated with a pick-up in trade uncertainty (fears of re-escalation in US-China tensions, use of tariff threats, etc.). This would be negative for Asian FX sentiment as markets are not as positioned for this scenario as compared to current poll/market expectations of blue wave.

But subsequent tally of postal ballot in coming days (post-3 Nov) could swing results in favor of Biden. The initial risk-off bets could unwind as markets re-price scenario 4 probabilities: AXJ FX could regain lost ground while USD softness resumes.

- Scenario 4 of Biden win and Democrats taking over Senate allows for Biden to implement wide-ranging policies including Covid-response fiscal stimulus, expand healthcare coverage (i.e. bolstering affordable Care Act). On US-China relations, we expect a Biden Presidency to take on a different approach – less confrontational, more strategic - on China, as opposed to Trump. We also believe Biden Administration is less likely to resort to trade tariffs threat as the only tool of choice. On net, this would be a positive for Asian FX.

That said, the election drama probably does not end here and there is a real risk of a candidate not accepting defeat and disputing results, especially if the margin of loss is narrow. In particular Trump has previously claimed that mail-in voting will result in fraud and refused additional funds for US postal services. He has also refused to commit to peaceful power transition. Lawsuits in battleground states questioning the validity of postal ballots are likely and this could drag on into Dec. Disputes ending up in Supreme Court or Congress can even stretch into Jan 2021.

Such a scenario of election outcome uncertainty would undermine sentiment and pose upward pressure to USD, while appreciation trends for Asian FX could pause in the interim.

Table 1: Scenarios and FX Implication – Flip Flops between #1 and #4 Possible as Election Results are Likely to be Delayed as Mail-In Votes are Tallied

	Senate	
	Republicans Retain Control	**Democrats Take Over**
Trump Win	**Scenario #1 - Status Quo; Trump retains Presidency and Republicans retain control of the Senate** For a start, a continuation of current policy agenda of de-regulation, boosting manufacturing sector and potentially extension of tax cuts. May translate into a near-term positive for market sentiment but lack of clarity on second term policy agenda raises doubts if positive market sentiment can be sustained. Policy continuity of America First foreign policies. US-China tensions at risk of re-escalating. Trade policy uncertainty and FX vols likely to pick up. 🔻 *RMB and AXJ FX including SGD, MYR, KRW* 🔼 *USD and safe-haven proxy FX JPY.*	**Scenario #2 - Legislative deadlock as HoRs and Senate are under Democrats while President is of different party – Republican** Policy compromises, pertaining to domestic issues (stimulus, tax cuts, etc.) will be challenging and less forthcoming. Could hamper post-Covid recovery momentum. Potentially weighing on risk assets. But on foreign trade issues, Trump is likely to continue with prior policies and practices, i.e., re-negotiating trade deals on bi-lateral instead of multi-lateral approach and relying on the use of executive powers. US-China tensions could still be at risk of escalation. 🔻 *RMB, SGD, MYR likely and could be amplified* if risk assets come under pressure, especially if slow US recovery drags on global growth momentum.

Biden Win	Scenario #3 - Status Quo in Congress with a change of Presidency	Scenario #4 – Democratic Clean Sweep (Blue Wave)
	Split congress may imply curtailed stimulus spending (risks of economic recovery momentum being derailed) and difficulty in increasing taxes (may be positive on risk sentiments). Biden's plans may have to be deferred till after mid-term elections in 2022 to carry them out (provided Democrats can take over the Senate). On net this may imply market neutral. Biden Presidency may imply m**ore predictability and** less confrontational (but strategic) approach to China. ⬆ *AXJ FX including RMB, SGD, MYR, KRW.*	Consensus base case scenario. Fiscal expansion policy can be pushed through with ease. Positive for sentiments in interim but subsequent focus on tax hike proposal could weigh on sentiments (later stage). House panel proposal to break up tech giants may undermine sentiment but not an immediate risk. Biden Administration is probably less likely to resort to trade tariffs threat as the only tool of choice and lower risks of new trade tariff implementation. ⬆ *RMB and AXJ FX including SGD, MYR, KRW* ⬇ *USD (due to rise in fiscal deficits)*

Source: Maybank FX Research & Strategy

A Key Risk that the Democrats Could Pose to Markets is Warren's Proposal to Break up Giant Technology Companies

The dominance of giant technology companies has been under increasing scrutiny of the Democrats and while there have been anti-trust legislations to limit mergers that are deemed anticompetitive or acquisitions that unfairly increase prices, stifle innovation or reduce wages, etc. in recent years, Senator Elizabeth Warren (a former hopeful Presidential Candiate) proposed to break up companies, specifically Google, Amazon and Facebook in Apr 2019.

"Giant tech companies have too much power. My plan to #BreakUpBigTech prevents corporations like Amazon from knocking out the rest of the competition. You can be an umpire, or you can be a player—but you can't be both. #WarrenTownHall"

~Elizabeth Warren (23 Apr 2019)

That seems to have gained traction. A house panel proposed a set of antitrust reforms after a 16-month investigation via a rather lengthy (400+page) report on 6 Oct. The report targeted Amazon, Google, Facebook Inc. and Apple Inc, accusing the firms of using their control over markets to take out competitive threats that could stifle innovation, fewer choices for consumers and a "hobbled democracy". The report recommends structural separation to bar a dominant platform from operating in competition with the firms dependent on it. The House also calls for "line-of-business restrictions – to limit the markets in which a dominant firm can engage in". In addition, the report also suggests raising the portability of consumer's data between services so that sites and services can better collaborate.

This proposal is seen as the "Glass-Steagall for the Internet" – the law in 1933 that separated commercial from investment banking that was later repealed. The release of the report in early Oct did not trigger a significant drop in the Big Technology companies named (declines were around 1%) simply because there is a lack of specific action to take the companies out of certain markets (such as ensuring Apple does not own the iOs) without crippling their respective business models. In addition, these four companies have provided services that are generally popular and their "efforts to neutralize potential competitors" have also brought down prices for consumers in the short-run and we are certainly not in an inflationary environment in the near-term. Nonetheless, we cannot rule out some jitters in the market as the top five (Amazon, Microsoft, Apple, Alphabet, Facebook) account for approximately 20% of S&P market capitalization and any real threat from a Democrat-controlled Congress could trigger significant volatility in equity markets.
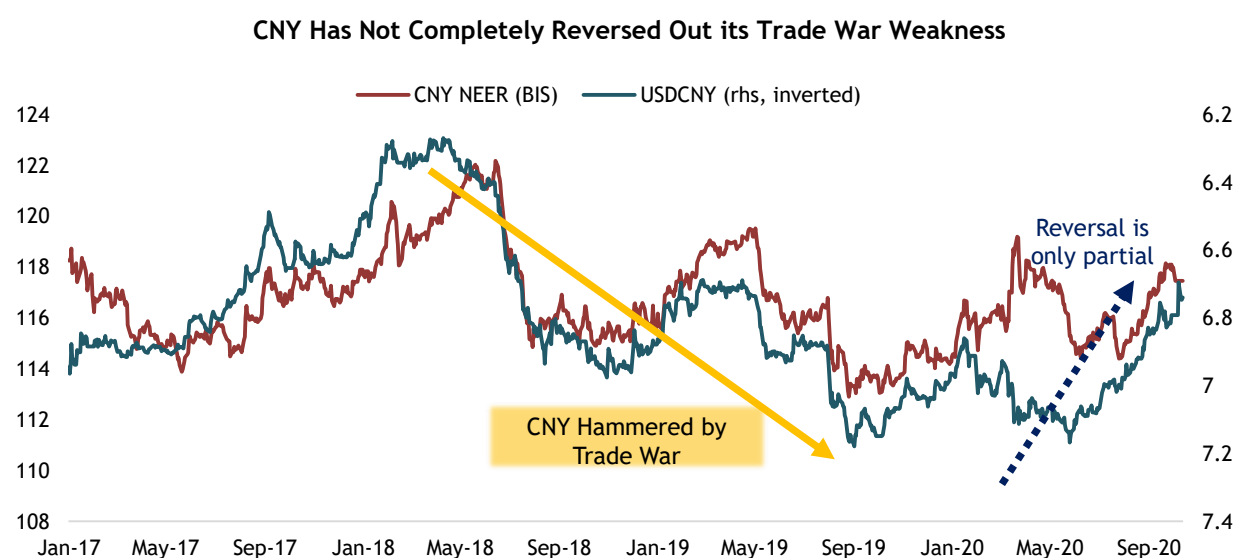
3. RMB – A Conduit of Biden's Win and More… on Other Currencies

A Potential Biden Win and Its Impact on FX… Via RMB

Moving back to Asia, a key link of a possible Biden victory and AxJ gains could be through China. It is highly likely that Biden will neither revive trade war nor unwind existing tariffs on China. While Trump has made the Trade War on China his signature, Joe Biden has served as Vice President to Obama and is more likely to take on China by using a more multilateral approach (similar to the Obama's administration).

As such, we can likely expect US to have closed door dialogues with traditional allies and partners to build a credible coalition in attempts to counter/contain China. Biden would likely choose to distant himself from Trump by avoiding tariffs altogether. Without the threat of tariffs that have injected significant volatility into the currency, RMB is thus propelled by the increasing likelihood of a Biden win (and a possible Democrat Clean Sweep) as indicated by the polls, taking the non-USD currencies along with it.

Figure 7: Will RMB Continue to Outperform?

CNY Has Not Completely Reversed Out its Trade War Weakness

Legend: CNY NEER (BIS), USDCNY (rhs, inverted)

Annotations: "CNY Hammered by Trade War", "Reversal is only partial"

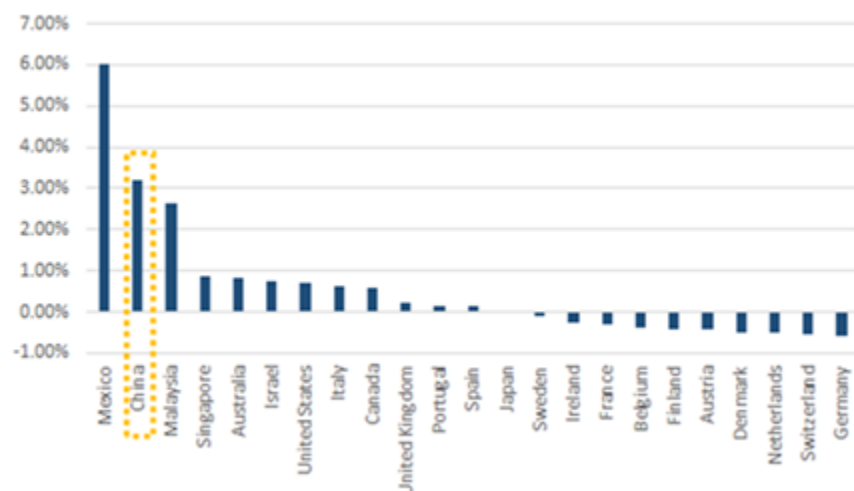*Source: Bloomberg, Maybank FX Research & Strategy*

At this point, it is worth asking whether the RMB has room to gain after appreciating around 7% against the USD (onshore and offshore) since its trough in May. The move from 7.20 to 6.74 (at last seen) seems substantial enough but this has not completely reverse out the effects of the trade war. Granted, most of the tariffs imposed were not removed by the phase 1 trade deal but the macro context has changed significantly since.

We recall that USDCNY started 2018 around 6.20 and rose in reaction to tariff threats, growth and monetary policy divergence between the US and China over the period of 2018-2019. However, the COVID-19 pandemic has drastically switched the situation. China has emerged out of the health crisis earlier than the US. The Fed rate cuts and QE had completely eroded the rate advantage of the greenback while China had started to shift its priority from growth bolstering to financial stabilization and rate easing has come to a pause for a while. The divergence of monetary policies between the Fed and PBoC as well as economic recovery are now in the favour of the RMB and that could continue to underpin the currency into 2021.

This does not take into account the fact that China is still considered rather underinvested with global investors only owning less than 10% of the outstanding Chinese Government Bonds (CGB). With FTSE Russell's declaration in Sep that China is finally included in its World Government Bond Index (albeit with a final

confirmation in Mar and the inclusion to take effect in Oct 2021), China's bond markets are expected to continue to see further inflow from passive investors as well as active investors that are lured in by its carry.

**Figure 8: China is a Higher Yielding Country in WGBI after its Inclusion in Oct 2021**

Note: 10y yields are taken as of 14 Oct 2020.
Source: Bloomberg, FTSE Russell, Maybank FX Research & Strategy

While there are varying estimates (there is a consensus that foreign ownership could hit 14-15% in the next two years) on how much passive inflows we can expect with China's inclusion, the net risks to the RMB is still inarguably to the upside, barring an unexpected reversion to significant tensions with the US and allies.

Figure 9: Steady Rise in Foreign Investors' Holdings of CGBs
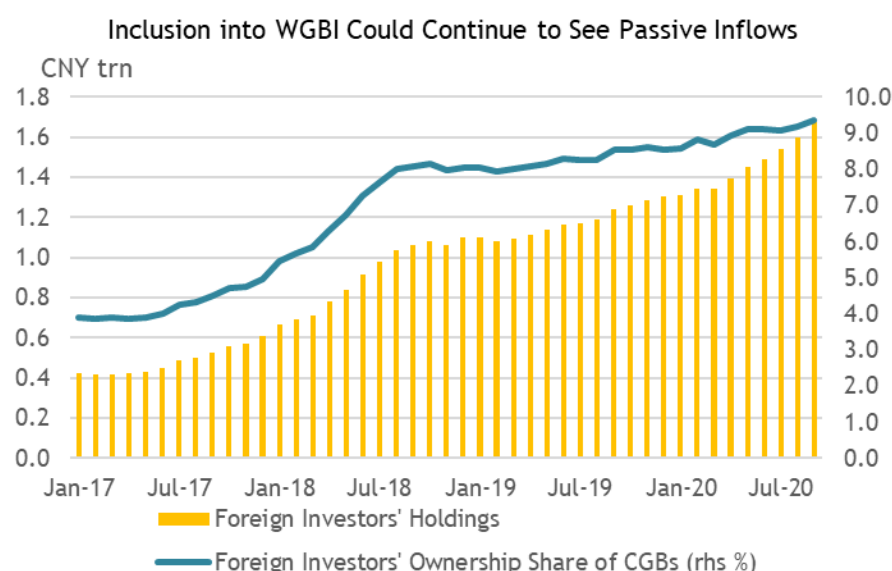
Source: China Central Depository & Clearing, Maybank FX Research & Strategy Estimates

RMB's Effect on Other Currencies

Given that risks to the RMB are still to the upside, we expect some of that strength to spill over into the rest of FX space. In fact, we found that the influence of RMB's appreciation in the FX space has increased this year because of the benign trade environment. This effect is proxied by the magnitudes of movements in respective currencies (vs. the USD) during the 5 periods of significant RMB appreciation (which we identify) in the past 4 years. To clarify, there were windows of appreciation even as bouts of US-China tensions occurred in recent years. These could be periods when talks took a positive turn, for instance.

For example, for every 1% rise in CNY over 28 Dec 2016 – 8 Sep 2017, the SGD rose by around 0.9% vs. the USD. Fast forward to 29 Sep 2017 – 27 Mar 2018, and SGD only saw a 0.4% rise (alongside every 1% appreciation in CNY), as the overhang of US-China trade tensions could have capped recovery in regional sentiments. In 2020, we witnessed a slightly stronger sensitivity to RMB again with a 0.5% appreciation seen alongside every 1% appreciation in RMB over 27 May to 8 Oct. **The average sensitivity of other FX to RMB appreciation (denoted by the black line) also showed a dip during the trade war and then a recovery in 2020.**

Not all ASEAN FX has an increased sensitivity to CNY's strength this year as we note that the sensitivity of the PHP to CNY has diminished. Meanwhile, it could be said that moves in the CNY are more closely intertwined with USD (DXY index) this year, when compared to the three episodes in 2017-2019 (trade war period).

We do like to point out that CAD, GBP, NZD and AUD have relatively higher sensitivity to swings in the CNY during its period of significant appreciation over 27May – 8 Oct this year. This could be largely due to their inherent high beta (to broad shifts in market risk), and a risk-on narrative was ongoing for much of this period. That could contribute to some extent, the broader weakness of the USD.

Figure 10: RMB's influence was Curbed in Trade War Period But Has Rebounded
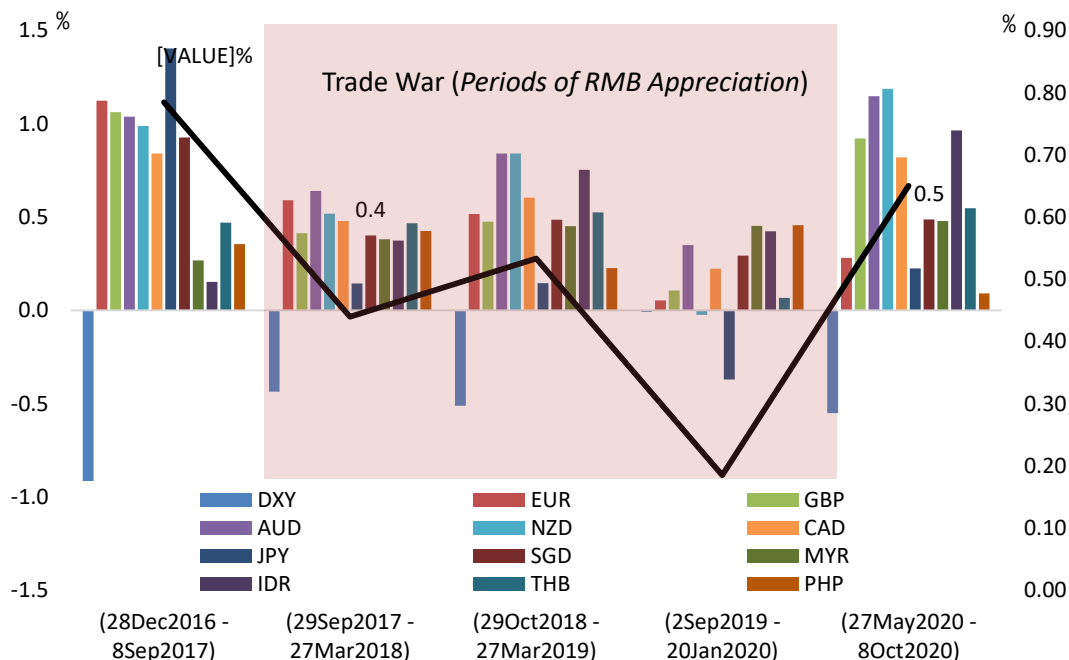
Note: These five periods denote periods of significant CNY appreciation in the past 4 years.
Source: Bloomberg, Maybank FX Research & Strategy Estimates

4. Are Markets too Optimistic? A Dive Into ASEAN FX Vols

Looking Past Elections…Recovery Narrative Appears Intact

There are signs that markets are cautiously optimistic about the post-US elections world. S&P 500 for instance, is still > 6% higher vs. its interim trough in late Sep. We have discussed above in detail the **shift in policy/stimulus narrative as Biden's lead over Trump widened after their first TV debate**.

Also anchoring sentiments somewhat is the fact that despite some recent pauses in high-profile vaccine trials, **the broad vaccine development effort continues apace**. To date, more than a dozen vaccine candidates are either in phase III large-scale efficacy tests or approved for early/limited use. Various collaborative efforts are also being closely watched. Operation Warp Speed (OWS), a collaboration of several US federal government departments and more than 18 biopharmaceutical companies, has four of their six vaccine candidates in phase III trials, and all six are reported ready for manufacturing at industrial scale.

On potential global distribution challenges, we note that just last week, China has joined COVAX, a global effort (led by WHO) aimed at fair and equitable distribution of Covid-19 vaccines once one becomes available. Of the candidates in phase III trials, around four are being developed by Chinese vaccine makers. Other countries that have committed include Germany, France, Brazil and Canada for instance. The broad consensus is that efforts to fast-track vaccine development could see the earliest vaccines come to market anytime from end-2020 to mid-2021.

Markets have also likely recalibrated somewhat the expected profile of the economic recovery. While recent bouts of Covid resurgence in parts of US and Europe likely imply that any macro projections at this point come with wide uncertainty bands, and the IMF continues to warn that "the global economy's long ascent back to pre-pandemic levels of activity remains prone to setbacks", important market sentiment anchors have remained largely intact. I.e., China's recovery thus far has largely surprised to the upside, and US continuing jobless claims remains on a downward trajectory.

In their latest *World Economic Outlook*, the IMF has also revised modestly the extent of the global contraction in 2020 (-4.4% vs. -5.2% in June outlook), even as it tempered slightly its outlook for 2021 (+5.2% vs. +5.4% prior).

Figure 11: IMF Projections—China Outperforms, ASEAN Could See Credible Bounce in 2021
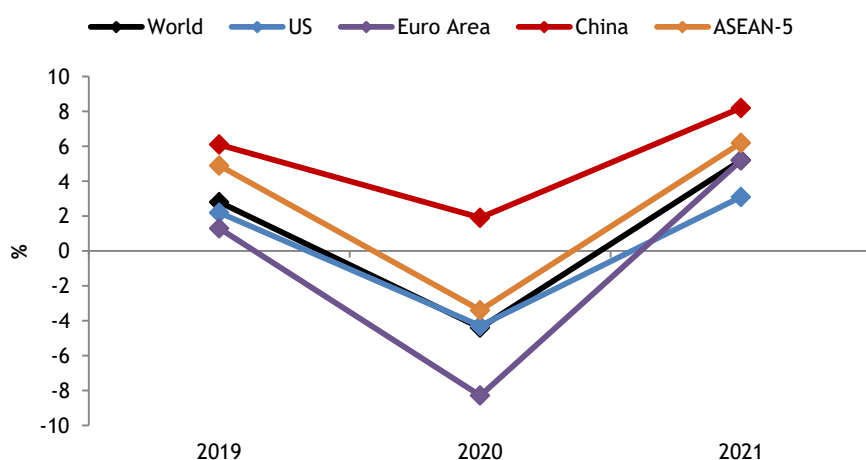
Source: IMF World Economic Outlook (Oct)

IMF MD Kristalina Georgieva said that the 2020 crisis might not have been as bad as the IMF originally thought, but cautioned the path ahead will be a "difficult climb". Latest projections still see China outperforming peers by a stretch.

China's growth forecast this year was raised from 1.0% in Jun to 1.9% in the Oct review. While ASEAN could see a relatively significant contraction in 2020, extent is expected to be more modest vs. DMs. Credible bounce next year also likely.

On net, barring a Trump win, **there could be a window (several quarters or longer) where most countries see a gradual recovery in domestic and external demand, with price pressures remaining largely soft and interest rates remaining lower (for longer)**. The key risk here is of course, whether the eventual tapering off in fiscal stimulus disbursements at some point around the globe disrupt the recovery momentum.

**Vol Curves Reflect Event Risk, Shifts in Macro and Policy Environment**

We remind readers that in various insight pieces **since March**, the team has largely cycled through a host of frameworks **(largely) in support of AxJ FX recovery**. These include betas derived from linkages with tech recovery trends and China activity rebounds, REER/CDS/Carry metrics, broad comparisons with past crisis episodes, empirically linking higher chances for Biden victory to AxJ FX outperformance etc.

As we stand at the cusp of a likely bumpy end-2020 and look forward with cautious optimism into 2021, it would perhaps be useful to dig a little deeper into the drivers of ASEAN FX volatility. After all, while sharp spikes in vols are usually news-driven, deeper trends would arguably be linked in part to the broader macro and policy environment.

And to some extent it does seem like markets are beginning to price in some moderation in sentiment swings for ASEAN FX next year. Vol curves are usually upward-sloping (the further out the timeline, the less visibility in market conditions), but the key risk event in end-2020 has resulted in a "kink" for most Vol curves. A dip after the 1 to 2-month mark (after the dust settles from US elections) is observed for most USD-ASEAN FX vols, and expectations seem to be that the curve will only returns to its upward slope 12-18 months out.

The resulting "U-shaped" profile is most discernible for the USDSGD and USDTHB curves (see below). The shape of the curve is somewhat intuitive in that (i) vols dip after a key risk event and (ii) the whole Vol curve is still structurally higher than what it was this time last year, given the uncertainties surrounding vaccines, border reopening, renewed portfolio flows etc., even post-US elections.

Figure 12: "U-Shaped" Vol Curves for USDSGD and USDTHB
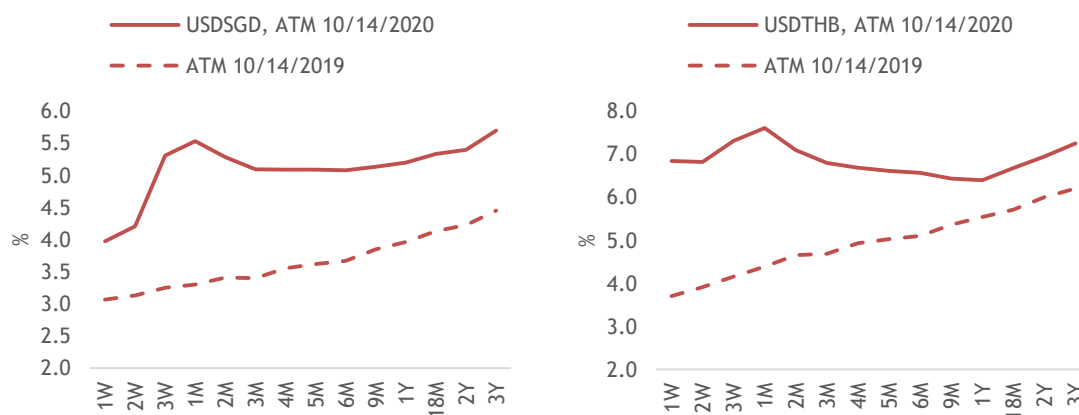
Source: Bloomberg

Model Suggests a Tad of Market Complacency Pre-elections (Not Excessive)

The key variable we look at here is the average of 3M implied volatilities for USD-ASEAN FX pairs (i.e., USDSGD, USDMYR, USDIDR, USDTHB, USDPHP), in monthly

data form. This series is available from 2006.

We employ a simple model which takes into account the following factors in explaining ASEAN FX vols:

- 3M10Y US Term Premiums: To a certain extent, this reflects differentials in near-term and long-term risk/growth expectations, and may be a proxy for broad reflation sentiments. Enters model in level terms.

- Interest Rate Volatility: We take the volatility of the differentials between US Fed rates and average of ASEAN policy rates. This variable is meant to capture uncertainty surrounding shifts in differential monetary policy conditions between US and ASEAN. 3MSIBOR is used as a proxy for Singapore's "policy rate" given its usage of an exchange rate monetary policy tool.

- USDCNY 3M Implied Vol: China's tight trade and investment linkages with ASEAN often means that their currencies display significant co-movement. Spikes in USDCNY volatility over the past few years during bouts of trade tensions have presumably spilled over to USD-ASEAN FX pairs as well.

- US Macro Policy Volatility: The Baker, Bloom and Davis daily news-based Economic Policy Uncertainty Index is based on analysis of newspaper content and captures volatility in expectations surrounding the trajectory in US economic policies. *Index of 100 = Long-term Average.* Potential changes in policy regimes as a result of events (e.g., Covid) or US elections can have deep implications for ASEAN assets.

Results shown below but note that coefficients are not comparable as variables have different units.

Table 2: Model Coefficients

	ASEAN Implied FX Vols
Constant	3.46**
3M10Y	0.89**
Policy Rate Volatility	4.86**
USDCNY 3M Vol.	0.37**
US Policy Uncertainty	0.0025*
Observations	*164*
Adjusted R-Squared	*0.51*

Note: Implied Vols refer to average of ATM 3M Vols of USD-ASEAN pairs. ** denotes significance at the 1% level, * denotes significance at the 10% level.
Source: Maybank FX Research & Strategy

Figure 13: Option-Implied ASEAN FX Vols Slightly Lower than Model Estimate
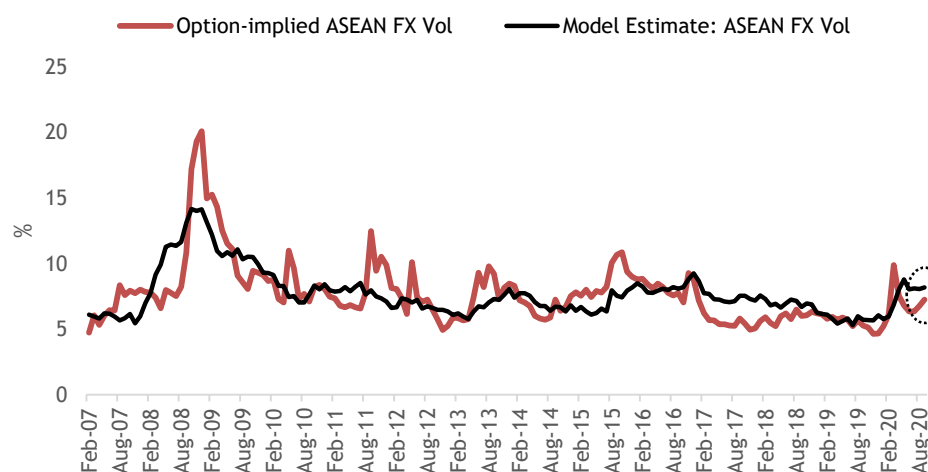
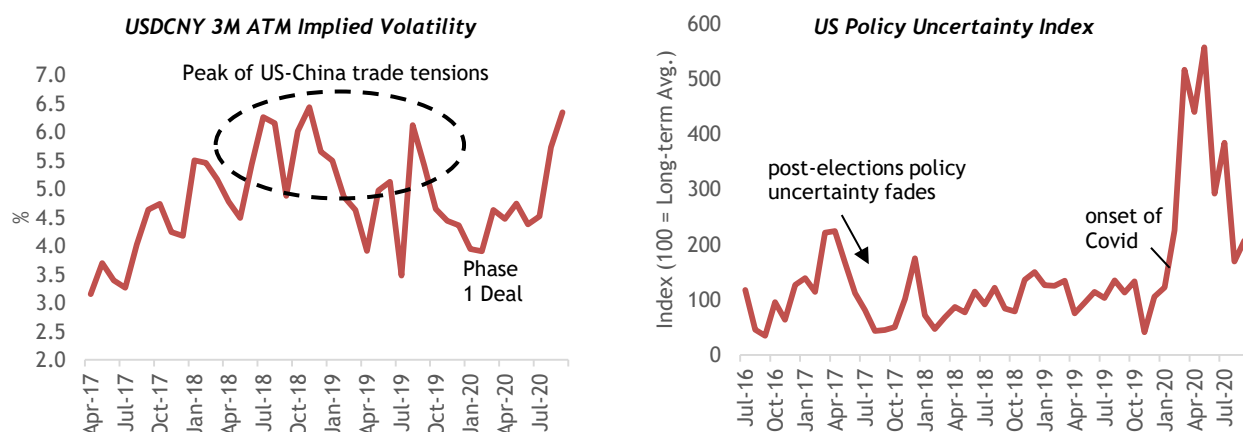*Source: Bloomberg, Maybank FX Research & Strategy Estimates*

These results suggest that while there may be a tad of market complacency (i.e., underpricing of risks), especially with US elections around the corner and all the associated risks we highlighted above regarding potential results disputes, **the extent of "complacency" is likely not excessive at this point.**

Chance for Relatively Benign Macro and Policy Tones to Anchor "Window" of Decline in ASEAN FX Vols in 2021

We also attempt to be more forward-looking and evaluate a potential trajectory for ASEAN FX vols into 2021, based on our current biases surrounding the model drivers.

- 3M10Y US Term Premiums: If the reflation narrative deepens, there is a chance for the yield curve to continue steepening. In our projections though, we keep the term premium at its end-Sep 2020 value, as we have less certainty on this front.

- Interest Rate Volatility: The Fed has introduced the idea of Average Inflation Targeting (AIT) in its monetary policy framework recently, with a discernible tolerance for a higher level of "overheating" in the US economy before rates would potentially be normalized. More details are likely to be fleshed out over its next few policy meetings. On the ASEAN front, we note that regional central banks, including MAS, BNM, BI, BoT, BSP, have also stood pat in recent policy meetings, and largely hinted that accommodative monetary policy conditions will be around for at least the next few quarters. Given these conditions, the volatility in US-ASEAN monetary policy differentials could decline into 2021. *For simplicity, we assume that this variable will converge to its 2018-19 average value by end-2021.*

- USDCNY 3M Implied Vol: USDCNY vols are now even higher than its 2018-19 average, when US-China trade tensions were rampant. As discussed earlier, a Biden presidency would presumably be less (directly) combative with China and also likely avoid the use of tariff tools in conflict (most harmful for CNY). USDCNY vols have a decent chance of falling towards levels seen in the pre-trade tensions era. *We assume that this variable may converge to its 2013-17 average by end-2021.*

- US Macro Policy Volatility: Looking at the 2016 US elections, US policy uncertainty spiked in the half-year period following Trump's election win (Nov 2016), and as markets recalibrated expectations surrounding his policy stances. Nonetheless, uncertainty eased off quickly to below long-term average (index value of 100) by mid-2017. *We assume that this variable will converge back to, and remain near 100 by mid-2021.*

Figure 14: Uncertainties Surrounding US-China Tensions and US Policy May Fade in 2021, Conditional on Biden Win


Source: Bloomberg

Figure 15: ASEAN FX Vols Could See a Modest Lull (Relative) in 2021, Anchored On Post-Biden Policy Shifts
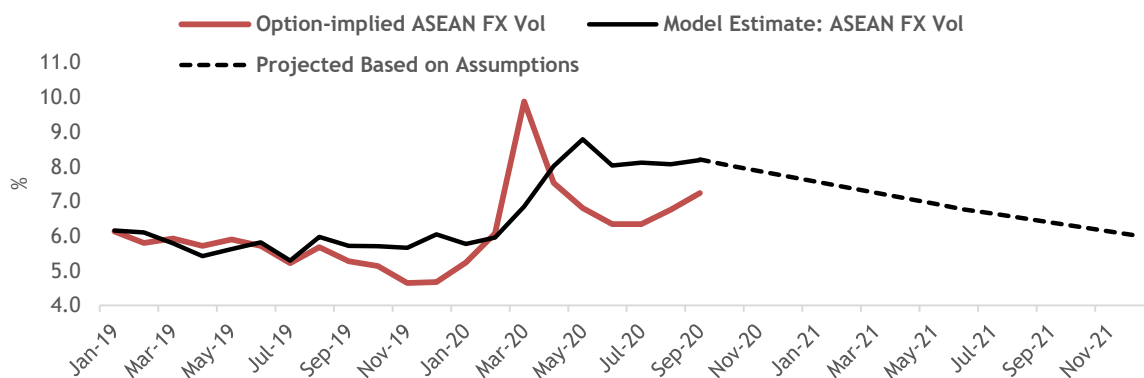
Source: Bloomberg, Maybank FX Research & Strategy Estimates

We acknowledge that the "lower-vol" backdrop we are painting occurs on "relative" terms, with FX vols levels still likely to remain elevated vs. pre-Covid days for some time. But intuitively, a modest downtrend in FX vols could be beneficial for ASEAN FX still. To verify this, we compute historical correlations between ASEAN FX vols and ASEAN FX performance. I.e., when ASEAN FX vols decline, do ASEAN FX benefit?

We check this against EUR and JPY crosses to avoid periods of broad USD appreciation or depreciation from distorting the results.

Figure 16: IDR, and to Some Extent, MYR/THB/SGD Tend to Benefit in Broad Environment of Falling ASEAN FX Vols
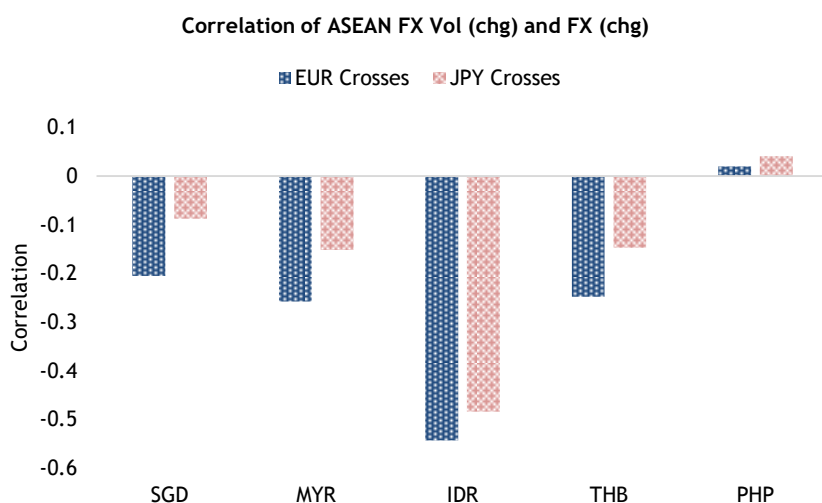
Source: Maybank FX Research & Strategy Estimates

Negative correlations between ASEAN FX Vol changes and ASEAN FX level changes suggests that periods of declines in ASEAN FX volatility are indeed accompanied by strengthening currencies. This is most discernible for IDR, followed by MYR, THB, SGD.

A word of caution though.

For the IDR, while we remain positive on the currency on a 12 to 18-month horizon, we caution that near-term performance could see two-way swings still. For one, there are still no signs of tapering in domestic Covid contagion. Average daily new cases in Oct MTD still stands above 4k, compared to 3.7k in Sep and 2.1k in Aug. Second, while markets have been broadly receptive of the newly-passed "Job Creation" bill, it remains to be seen if implementation can be smooth, especially with protests against the bill still ongoing.

For MYR, it has been finding support from both external and domestic factors – in particular amid a softer USD environment, supported oil prices, RMB strength and positive risk-on tone alongside positive progress on vaccine development. Recently though, there have been tentative signs of political uncertainty. We remain watchful of developments surrounding Anwar's claim to majority parliamentary support as well as the palace's stance on the issue, but do not expect excessive weakening in MYR at this point.

For THB, two key risk factors are domestic protests and the soft tourism outlook. The student-led protests for greater democracy and for curbs to the Monarchy's powers seem to be gathering traction, even as it has yet to weigh significantly on the THB. On tourism, revenues are unlikely to return to pre-Covid levels until 2022 or 2023. On a positive note though, current account is likely to remain in surplus, albeit at reduced levels (consensus forecasts of +3.1% of GDP in 2020, vs. 6.8% in 2019).

For SGD, Singapore will likely have manageable macro tolls (i.e., fiscal stresses, resident labour losses) coming out of the pandemic. Given (i) negative but narrowing output gap, and (ii) improving but below-2% core inflation in 2021, our Taylor rule estimates (here) suggest that SGD NEER could remain on the stronger side of the policy band (i.e., modestly "stronger" vs. trading partners' FX) in 2021.

Given the idiosyncratic risks on display for some economies, we think that a long ASEAN FX basket approach might be more apt on net. While gains in PHP may lag peers if we do see a benign macro environment (see chart above), PHP can still be useful as a "stabilizer" of sorts in the basket, as it tends to be less sensitive to changes in volatility environments.

Vol/Carry Comparisons for More Currencies

To more robustly compare risk/reward characteristics, we also look at vol/carry scatterplots for a larger group of currencies. EUR crosses are used due to its attractive funding characteristics.

Figure 17: Asian FX in "Sweet Spot" for Carry Plays?
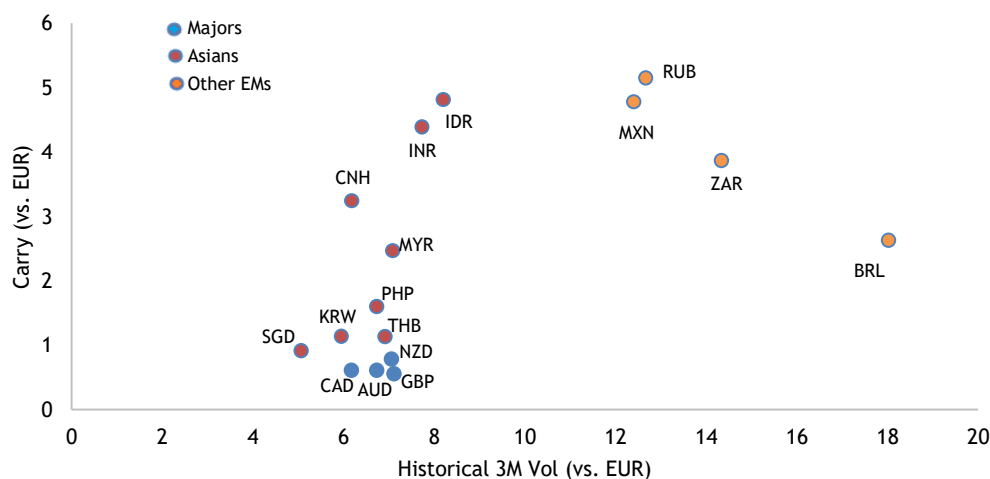
Note: Carry is proxied by differentials in 3M rates.
Source: Bloomberg, Maybank FX Research & Strategy

The scatterplot suggests that Asian FX is in somewhat of a "sweet spot" in the current environment. They have roughly the same degree of volatility as majors, but earns relatively higher carry. On the other hand, their volatilities are significantly lower than that of other EM FX.

In particular, INR, IDR and CNH seem to be attractive targets for carry plays. We have discussed CNH and IDR at length earlier in the report. We are less positive on the INR given elevated inflationary pressures that could continue to limit policy maneuvers that could otherwise stimulate demand. We thus prefer a long ASEAN+CNH Basket strategy.

Conclusion

FX Plays Around the US Elections

Our underpinning assumption remains for Biden to win the Presidential Elections with a Democratic Clean Sweep (Scenario 4). That should be a USD negative outcome given higher likelihood for less combative foreign and trade policies, and larger fiscal stimulus packages. However, even as we are just 3 weeks ahead of Polling Day and Biden's lead has just widened to around 10 pts (based on Real Clear Politics Average Polls), we are still wary of some underpriced volatility. For instance, the profiles of Biden supporters and their likely mode of voting via mail could mean a potential scenario where Trump leads in initial polls as in-person votes can be tallied faster, and that could provide room for opportunistic FX plays with Trump's lead associated with stronger USD (trade war, smaller fiscal stimulus), before an eventual Biden-win confirmation brings the USD back lower again. We highlight this not as a baseline scenario, but as an example of how the USD is still vulnerable to election timelines and developments. On the ASEAN FX front, our simple model of FX volatility—incorporating interest rate volatility, US macro policy volatility and RMB-induced volatility (while also controlling for reflation expectations via 3M10Y US premiums)—also suggests that markets might be a tad (but not excessively) complacent.

We are also wary of the recent proposal by a House Panel to break up Big Technology companies and the potential for bouts of risk-off sentiments to emerge if signs are that such efforts gain traction. While this could be a concern for investors should Congress becomes fully controlled by Democrats, it is hard to envisage a more concrete legislation that could happen soon after elections and in such delicate times.

Into the Turn of the Year

The widening Biden-lead has to some extent, supported the narrative of a rising RMB. Risks to the currency could remain to the upside based on macro improvement, monetary divergence as well as its recent efforts to draw global investors into its underinvested financial markets. The influence of the CNY strength (on other FX) might have been curbed during trade war years but its role as a sentiment anchor seems to have returned somewhat, and that bodes well for most ASEAN currencies.

As we stand at the cusp of a likely bumpy end-2020 and look forward with cautious optimism into 2021, we think after the dust from the US elections have settled, there is a chance for a "window" (several quarters or longer) of benign macro conditions to set in, where most countries see a gradual recovery in domestic and external demand, with price pressures remaining largely soft and interest rates remaining lower (for longer). Obviously this is anchored on continued positive vaccine developments.

While this "lower-vol" backdrop we are painting would occur on "relative" terms (with FX vols levels still likely to remain elevated vs. pre-Covid days for some time), intuitively, a modest downtrend in FX vols could be beneficial for ASEAN FX still. Historically, periods of declines in ASEAN FX volatility are indeed accompanied by strengthening ASEAN currencies. This is most discernible for IDR, followed by MYR, THB, SGD. We are cognizant of idiosyncratic domestic risks, so an ASEAN FX basket approach could be useful.

Lastly, we show that Asian FX is in somewhat of a "sweet spot" vs. majors and other EM FX, when comparing volatility and carry. They have roughly the same degree of volatility as majors, but earns relatively higher carry. On the other hand, their volatilities are significantly lower than that of other EM FX. Among relative Asian higher-yielders, we like the CNH. We thus add it to the ASEAN FX basket for a long CNH+ASEAN FX basket (funded out of EUR short).

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