FX Insight

Are The Stars Aligning?

Look for Gains in AUD, KRW, RMB and Softer JPY

We question if the stars are aligning for more risk on trades. The withdrawal of the Hong Kong extradition bill may be a catalyst in an environment that could already be priming for more risk-on trades. We view this event as another sign that the US-China trade tensions could de-escalate. Positive development on this front could mean more gains for RMB especially when more bad news are priced in than good.

There are also other news (fading fears of a no-deal Brexit) and impetus to our view, namely stretched positioning and the 2-year high in Gold/oil ratio (a level that only occurs in one-tenth of the time in the past 10 years) could be susceptible to a reversal. These inflexion points typically send powerful price signals to risk sentiments. In this episode, a potential peak in gold/oil ratio followed by a reversal lower could see equity markets higher as well as typically risk-on proxies such as USDJPY, AUD and KRW.

We had stated here, here and here that we are bearish on the USDCNH in the near-term and we see a potential for USDCNY (and USDCNH) spot to head towards the 7.09 in a convergence towards the USDCNY fix which has been held at around the 7.08-handle. The USDCNH is also bearish with a rising wedge already violated and bearish divergence with the MACD likely to be playing out already. In our GM Daily dated 4 Sep (today), we had looked for USDCNH to find first support at 7.14. Next support at 7.10.

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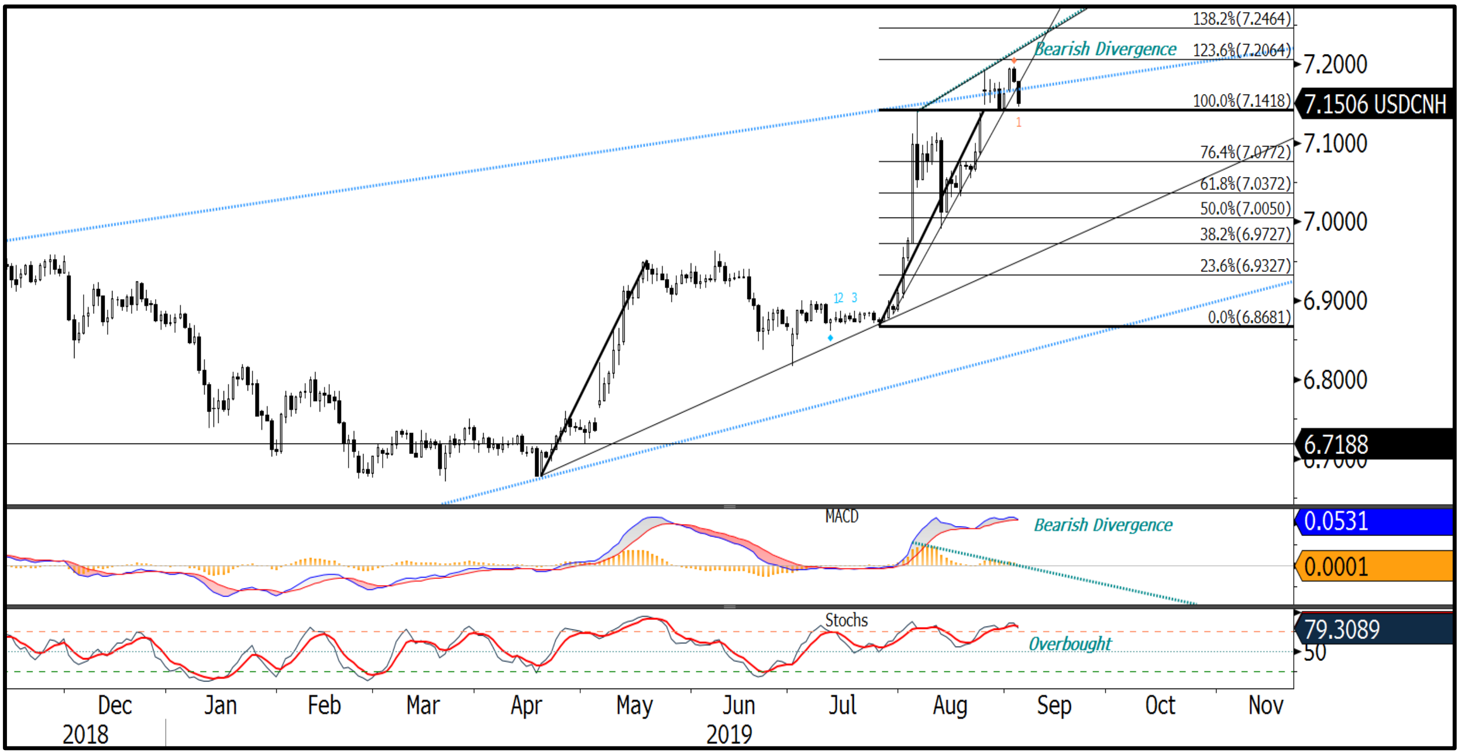
USDCNH (Daily Chart) - Breaks Out of the Rising Wedge



Source: *Bloomberg, Maybank FX Research & Strategy*

HK CE Carrie Lam Formally Withdraws Extradition Bill

USDHKD swung lower in late Asian hours after the South China Morning Post (SCMP) reported that Hong Kong Chief Executive Carrie Lam would formally withdraw the extradition bill that has triggered millions to take to the streets of Hong Kong in protest. China Foreign Ministry spokeperson Geng Shuang declined to comment when asked about the reports.

Hang Seng Index rose 4% after the news. USDJPY was also led higher. USDHKD was last seen around at day low of 7.8380, down from its day high of 7.8452. USDCNH came off under the 7.16-handle as a result.

We may be jumping the gun as the withdrawal of extradition bill is just one of five key demands made by the protestors but this piece of positive news adds to our suspicion that something positive could be brewing from the US-China trade talks as we recalled Trump's tweet in mid Aug (below).

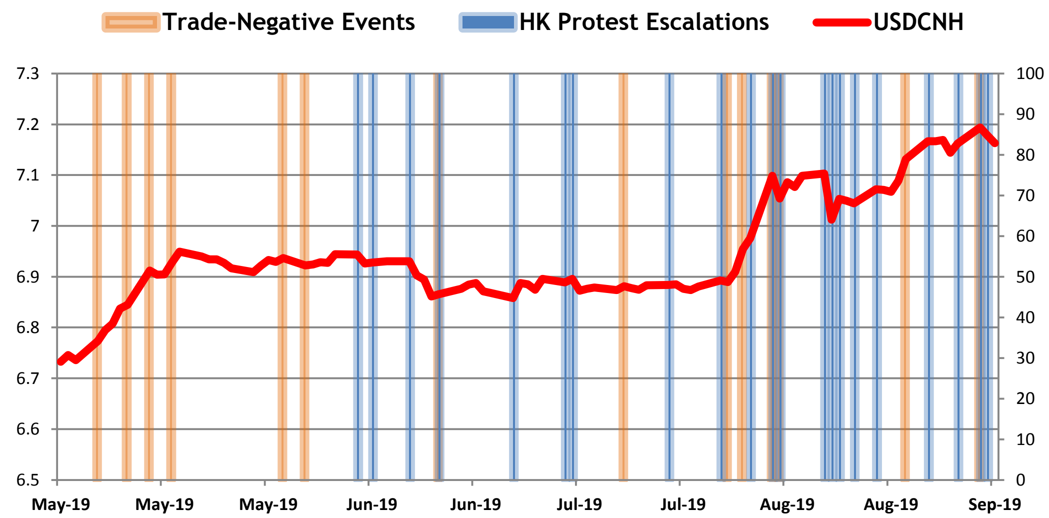
"Of course China wants to make a trade deal. Let them work humanely with Hong Kong first"

- 15th Aug 2019 @realDonaldTrump

The tweet alludes to the possibility that China's resolution with Hong Kong could be one pre-condition for progress in its trade talks with the US. This comes after the US rejected China's request for a delay of the tariff that took effect on 1st Sep (last Sun). These events underscored how highly motivated China is for a progress on the US-China trade talks ahead of the hugely symbolic 70th anniversary of the People's Republic of China that falls on 1st Oct.

The persistent USDCNY fix at the 7.08-handle which has been showing a huge deviation from most estimates had been one of the early signals of positivity for RMB. As stated in our FX Flash - RMB - The Fix Beckons The Spot dated 30 Aug 2019, we anticipate that the USDCNY spot would converge towards the USDCNY fix as they tend to do so in periods where USDCNY fix are unusually "stable" or rather, show strong policy guidance for RMB strength. However, this can only be sustainably achieved if there is some progression in the US-China trade talks given its dominance in driving USDCNH, compared to HK protest escalations (Chart below)

Trade Negative Events Still A Dominant Driver of USDCNH



Source: Bloomberg, Maybank FX Research & Strategy

USD and US rates Environment Turning Benign?

The withdrawal of the Hong Kong extradition bill may be a catalyst in an environment that could already be priming for more risk-on trade. The USD and US rates environment could be turning benign for USDAxJ too.

The ISM manufacturing PMI dipped under 50 for Aug – the first contractionary print since Trump takes office. ISM measures of new orders, employment and production are also below the 50-mark. Poor data reinforced the notion that US cannot escape unscathed from US-China trade war and adds to recession fears for US. The harsh reality of trade war's negative repercussion on US could affect Trump's hopes for re-elections next year and we do not rule out the chance that he could soften his stance against China (potential positive for risk sentiment and AXJs if it happens). We had pointed out in our FX Monthly Issue 8 – Feud or Feint? Dated 30 Aug 2019, *with markets still cautious and skeptical of recent quick de-escalation (coming from Trump), any chance of good news (delayed tariffs) probably not priced now, could help USD/AXJs lower eventually.*

Softer ISM manufacturing data now puts greater emphasis on US ISM-non mfg, ADP employment tonight, payrolls data and Powell's speech this Fri. Another poor run of data could increase market bets for Fed to ease more or perhaps Powell may signal further easing, instead of just a mid-cycle adjustment. This can possibly take the strength out of USD. (We had shared here that downside surprise to US data could drag DXY lower).

Turning Bullish on AUD

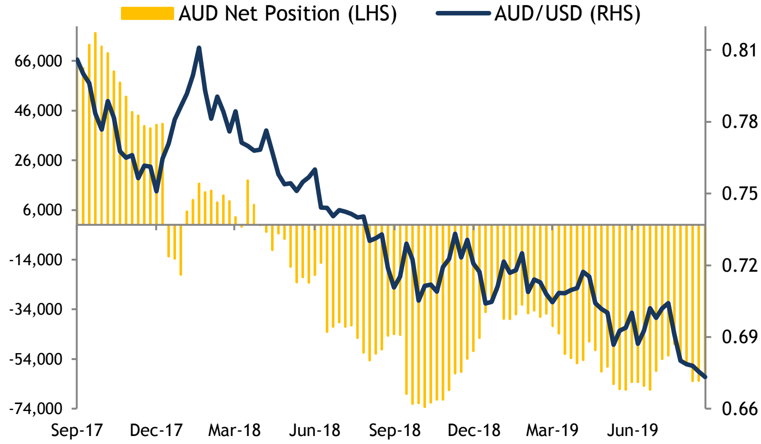
In such a positive risk environment, AUD could outperform as we had noted in our FX Insight – Exploiting the Behaviours, Asymmetries and Dispersion in FX dated 28 Jun 2018. The antipode has been sensitive to US-China trade talks progression/regression and whilst it has been weighed by weakness in its data in the first half of the year after consecutive quarters of declines in the housing prices, recent signs of stabilization in home prices as well as firmer wage growth has kept the AUDUSD above the 0.67-figure for much of Aug. With August behind us, short positions that have been accumulated could unwind into Sep.

Australia's GDP for 2Q turned out to be in line with consensus at 0.5%q/q (s. adj) steady from the previous quarter. Consumption expenditure picked up pace to 0.7%q/q from previous 0.3% and was largely underpinned by the acceleration in government spending. Net exports was also a strong contributor to headline, buoyed by the improving terms of trade. Australia also clocked the first current account surplus in 44 years. AUDUSD went on a small relief rally towards the 0.6780-resistance after the GDP release, unwinding some concerns of a recession before the data was out.

In our FX Monthly, we had noted that *"certain domestic data started to show some signs of stabilization"* including housing prices, manufacturing and wages growth. These had been keeping the AUDUSD supported on dips above the 0.67-figure for much of Aug.

Despite the downside biasness in the AUDUSD that was threatening the key-0.67, we held our forecast for the AUDUSD at 0.68 for the end 3Q and 4Q this year. We actually expect AUDUSD to hover within 0.66-0.70 range for the rest of the year ***with some potential for recovery in Sep in case of progression in the US-China trade talks***. The recent moves in the antipode suggest that the AUD recovery could be in play.

Unwinding of Stretched AUD Net Shorts Could see Sharp Rebound



Source: CFTC Positioning, Maybank FX Research & Strategy

AUD was last seen at 0.6780 levels. An interim bottom may have formed around 0.6650 – 0.67 levels. Bullish momentum on daily chart remains intact. On weekly chart, a bullish divergence could potentially be forming. Risks skewed to the upside. Next resistance at 0.6870 (50 DMA) before 0.6920 (100 DMA). Support at 0.6710, 0.6670 levels.

AUDUSD (Weekly): Potential Bullish Divergence?

Source: Bloomberg, Maybank FX Research & Strategy

We see potential for AUD to strengthen not just against the USD but also against SGD. Even as our economist now looks for Singapore to dodge a recession, we still hold the view for MAS to ease in Oct and that should keep the SGD weak ahead of the mid-Oct event. AUDSGD might find more impetus to head higher with the break of a key resistance level at around 0.9430.

Gold/ Oil Ratio at Inflection Point - Signalling Risk-On Mood Ahead?

While gold/oil ratio measures how many barrels of crude oil does one troy ounce of gold buys, it is also used as a market proxy of risk sentiment. In particular, **inflection points tend to send out strong signals of market turbulence or opportunities** for equity markets as well as for FX markets.

Typically when gold/oil ratio bottoms and turns higher, equity indices including MSCI World index (MXWO, proxy for global equities), S&P500 decline (risk off). The reverse is also true when **gold/oil ratio peaks and turns lower, equity indices run higher (risk-on).** In some episodes, classic risk-on FX proxies including USDJPY trades higher as well.

Another Inflection Point Coming?

Source: Bloomberg, Maybank FX Research & Strategy

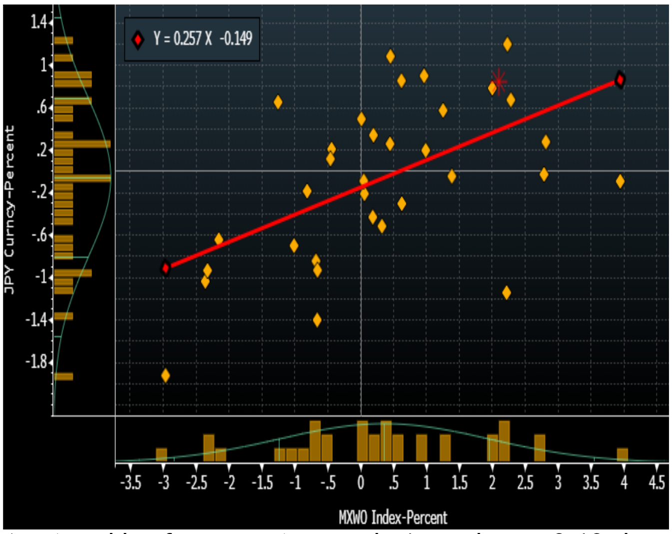
Looking at specific time periods since 2016, gold/oil ratio peaked around 41-levels in Feb-2016 before turning lower (~65%) to around 14 levels in Oct-2018. The same period also marked the near 50% rise in MSCI World index (as a proxy for global equities) from 1,480 to 2,200 levels. This is one instance of risk-on trade.

Subsequently in the 2018 (risk off) episode, gold/oil ratio bottomed at 14-levels in Oct-2018 and ran higher towards 25-levels in Dec-2018. MSCI World index fell by 18% from 2,200 to 1,795 in the same period. During this risk-off period from Oct to Dec 2018, USDJPY also fell by ~5% from 114.50 in Oct-2018 to sub-108 levels towards end-2018.

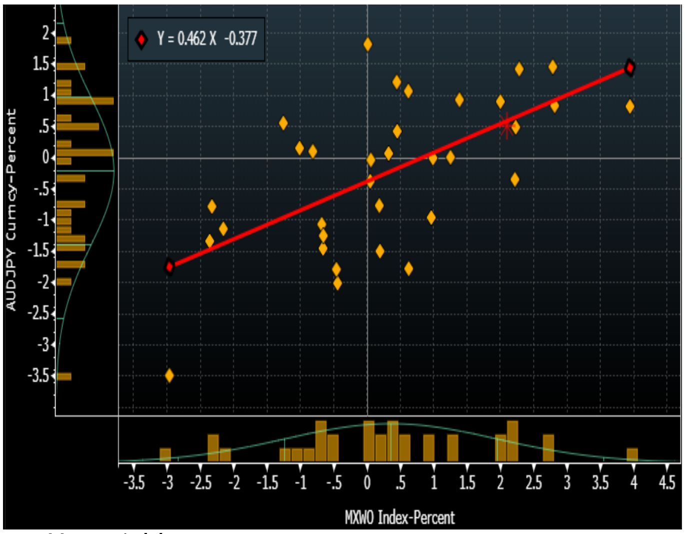
Into the turn of 2019, gold/oil ratio peaked at 25-levels in late Dec-2018 before turning lower to 17-levels in Apr-2019. MSCI World index rose by ~20% from 1,795 to 2,170 levels. In the same period, USDJPY rose from sub-108 to above 111-levels.

Fast forward, we could potentially be at the point of inflection again, with gold/oil ratio rising to 26-levels, a level only seen in about 10% of the time in the last 10 years, suggesting possible peak soon. **Should there be a case of gold/oil ratio making its peak and turning lower in the weeks ahead, we could see risk-on sentiment fuelling the rise in classic risk-on FX proxy including long AUDJPY, USDJPY and short USDKRW.**

Positive Correlation between USDJPY and MXWO



Positive Correlation between AUDJPY and MXWO



1y (weekly frequency) correlation above 0.60 between Y variables (USDJPY, AUDJPY) and MSCI World Index (independent X variable)
Source: Bloomberg, Maybank FX Research & Strategy

Gold/oil ratio Distribution on Daily Close: 2009 to 2019

Gold/Oil Ratio	% of Sample Period
0 - 10	0
10 - 15	40
15 - 20	32
20 - 25	18
Above 26	**10**

Source: Bloomberg, Maybank FX Research Estimates

On **KRW,** though we retain a bearish bias amid trade war concerns, risk of BoK cutting rates in 4Q and down-cycle in global semi-conductor market weighing on Korean corporate profits and asset prices, we see some chance of a technical recovery in the weeks ahead from a positioning point of view given that quite a significant chunk of bad news have been priced in making KRW possibly asymmetrically more sensitive to any good news - especially on positive political development (US-China, Japan-Korea) if any, which is typically fluid (2-way risks) and/or if Fed turns more dovish than expected. (as shared in our last FX Monthly).

We reiterate our observation that Korea's consumer sentiment has plunged to 31-month low in Aug. Historically the correlation between

Korea's consumer confidence and KRW is positive and the last time both consumer confidence and KRW declined this sharply was back in Jan-2017. But subsequently for the rest of 2017, both consumer confidence and KRW strengthened sharply amid global synchronous recovery. We are not suggesting that a recovery turn is coming but wish to highlight that should there be optimism; USDKRW could possibly be near its inflection point (i.e. room for further upside may be limited).

While USDKRW broke up to the upside for the month of Aug, the rally found interim resistance around 1222. Pair subsequently consolidated in the 1200 – 1220 range of a large part of Aug and was last seen at 1208 levels. Bullish momentum on weekly chart remains intact but shows tentative signs of fading while stochastics is rising into overbought conditions. Elsewhere a potential bearish divergence could be in the making, as seen on weekly MACD. Upside likely capped at 1225 resistance. We look for a move lower towards 1180/85 levels.

1m USDKRW NDF (Weekly) Technical Outlook: Bias for Downside Play

Source: Bloomberg, Maybank FX Research & Strategy

Technicals Are Consistent with Potential Risk-On Signalling

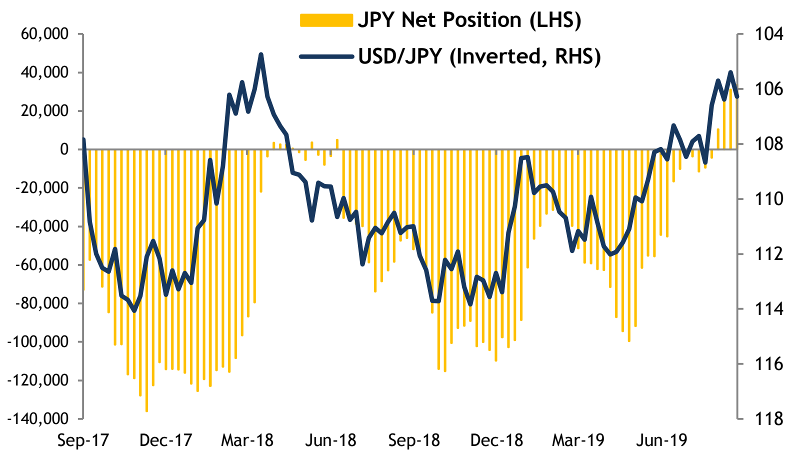
USDJPY has seen wild swings on risk-on-off instances, alongside tariff related announcements by US/China and shifts in market views on trade policy outlook. Nonetheless price action suggests an interim bottoming around 105 levels, with a potential falling wedge in the making. This is typically associated with a bullish reversal. Pair was last seen at 106.20 levels. Bearish momentum on weekly chart is fading while stochastic is showing signs of turning from oversold conditions. A potential bullish divergence could also be in the making. Rebound risks not ruled out especially when JPY long rises to more than 2-year high. Area of resistance at 107.10 (23.6% fibo retracement of 2018 high to 2019 low) –

107.20 (50 DMA). Decisive break above this is required for further upside towards 108 to gather momentum. Support at 105.50, 104.60 levels.

USDJPY (Weekly Chart): Bullish Divergence Forming?

Source: Bloomberg, Maybank FX Research & Strategy

Overcrowded? Long JPY Positioning Vulnerable to Squeeze



Source: CFTC Positioning, Maybank FX Research & Strategy

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