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Maybank

FX Insight

Assessing Yuan-ASEAN Tethers

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Market Focus Turns to Ability to Endure External Risks

Yuan has weakened by ~10% YTD versus dollar. Looking at historical episodes of yuan depreciation, the magnitude of yuan softening and extent of concomitant drags on ASEAN FX differed depending on the nature and source of the shock. In 2018, trade war fears largely propagated through trade exposure and broader sentiment channels. At the onset of Covid in 2020, the sudden hit to energy, commodity and tourism demand (unexpected lockdowns) meant that FX of commodity exporters (MYR, IDR), tourism-dependent economies (THB) suffered significantly. In more recent months, given the swath of ongoing risk events (hawkish central banks, European energy crunch, China growth jitters etc.), **market focus has likely turned to the ability of each economy to absorb negative external shocks.** FX of countries which saw greater stresses in current account and fiscal balance (e.g., PHP) or which were slower to tilt hawkish in the face of rising inflation risks (e.g., THB) experienced larger drags.

Yuan Caution Intact Near-term; Covid-Zero Tones Key

Our baseline trajectory for the yuan going forward involves (i) **slowing in pace of softening in lead-up to party congress** as PBoC fights one-way yuan bets, even as power crunches, Covid-zero, property slump means that interim USDCNH moves above 7 cannot be ruled out; (ii) **potential yuan trough in 4Q and subsequent cautious optimism on policy support and possibly clearer conditions/timeline for exit from Covid-zero** after President Xi gains his third term. **Broadly, ongoing spillovers to ASEAN FX on account of China drags could also peak in 4Q and moderate thereafter.** But on net, any USDCNH moves lower into 2023 could be modest (end-2023 forecast at 6.85) given still-weak global demand. Any subsequent outward tourism flows in the later part of 2023 could also weaken BoP buffers for yuan.

Long SGD NEER, Relative IDR Appeal, Cautious on THB and PHP

Trends in trade balances and exports to China suggest that IDR and MYR could see resilience near-term. Between the two, we favor IDR given potential election risks for MY going forward. For SGD, concerns over slowing chips demand could be tempered in part by expectations for another round of MAS tightening in Oct. But strong SGD NEER (+1.4% above par) could imply limited room for upsides. For THB, intermittent lockdowns in major Chinese cities could disrupt supply chains and weigh on near-term output. Return of Chinese tourists will be a significant positive, but might be delayed till late 2023. For PH, exposure to Chinese demand is significantly lower versus peers, but twin deficit concerns have come into focus. Recent signs of easing in energy import burdens is a positive for THB and PHP, but may not be able to offset broader macro stresses. Given these assessments and TA considerations, we suggest:

	Our Strategies and Biases	Risk-reward ratio
1	Tactically enter long SGDCNY especially in the lead-up to the next scheduled MAS policy decision in mid-Oct on tightening play, given rising trend channel and bullish momentum on the weekly chart. Entry at 4.9350. First target at 4.98 before the next at 5.0260. Stoploss at 4.9100. Risk-reward ratio of 1:3.6.	1:3.6
2	IDRTHB has formed a rounding bottom that stretched from 2016. Stretched conditions, denoted by stochastics on the weekly chart could mean that the cross has room to pullback towards the 2.4270 for an opportunity to enter into a long IDRTHB position. First target seen at 2.5030 before 2.5720. Stoploss at 2.3560. Risk reward ratio of 1:2.0.	1:2.0
3	Long SGD NEER on dips below +1.0% above par	

Assessing Yuan-ASEAN Tethers

" China will not close its door to the world, and it will only become more and more open…"

President Xi Jinping
14 Oct 2021

This report is broadly divided into three broad sections. In the first, we run through recent ASEAN FX trajectories and key drivers, and delve into why relative ASEAN FX/yuan performance differs significantly across different periods of yuan depreciation.

In the second, we highlight potential key developments at the upcoming 20th National Congress of the CCP, which is expected to begin 16 Oct.

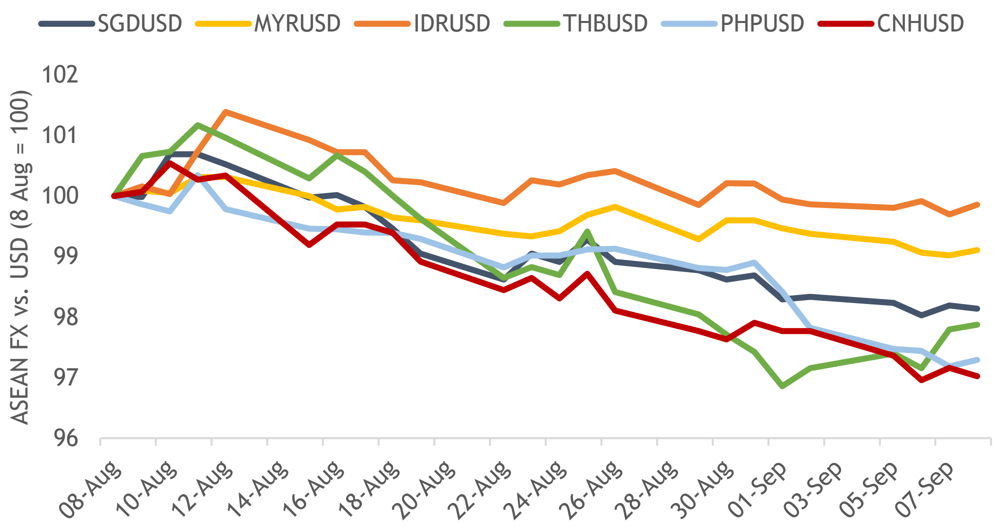
Lastly, we discuss potential phases of yuan moves going forward and concomitant ASEAN FX implications, given insights gleaned from the two earlier sections.

I. Yuan Weakness a Symptom, Not the Disease

Quick Recap of Recent ASEAN FX Moves

Yuan weakness is a symptom of ongoing Covid challenges and property sector woes facing the Chinese economy, and reflects in part growth and policy divergence versus the US. **While yuan-ASEAN FX moves remain positively correlated, a more varied set of idiosyncratic drivers are likely in play for ASEAN FX sentiments.**

Fig 1: ASEAN and Yuan Trajectories (Vs. USD) Over Past Several Weeks



Source: Bloomberg, Maybank FX Research & Strategy

In late Jul, using a Macro Vulnerability Scorecard device, we pointed out that THB and PHP may be more vulnerable to current account drags given elevated energy import burden, especially as supply-side constraints could mean that further declines in oil prices could be modest in extent. For Thailand in particular, positive spillovers from signs of recovery in tourism flows should be viewed with caution given that Covid-zero policies in China (easing more likely only in 2023) could imply sustained challenges on this front. Indeed, while both THB and PHP showed signs of tentative recovery vs. USD over late Jul to early Aug, such positivity soon fizzled out and both underperformed regional peers subsequently.

In the Jul report, we also noted that interim drags from macro balances could be relatively modest for Malaysia and Indonesia given expected support from commodity exports, notwithstanding latest moderation in prices. Both MYR and IDR has seen some resilience in recent weeks despite buoyant dollar strength.

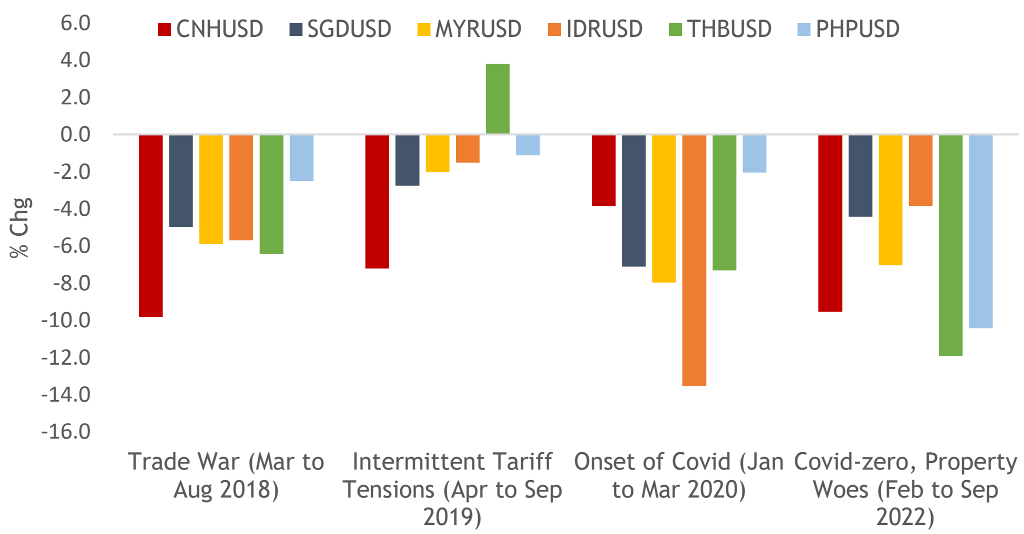
Meanwhile, we postulated that USDSGD may mirror broader dollar biases, but that SGD NEER should remain in +0.5% to +1.5% above par trading range given front-loading in policy normalization and robust macro fundamentals. Our estimated SGD NEER has mostly seen two-way swings around the +1.0% above par level since late Jul.

Besides idiosyncratic drivers, parts of the recent upswings in USD-AxJ pairs were arguably also due to dollar strengthening on the back of another set of hawkish messaging from Fed at Jackson Hole, i.e., Fed will be willing to let restrictive conditions remain around for longer to ensure sufficient demand destruction in bringing price pressures lower. This is expected to weigh on the global growth outlook as well as broader risk sentiments for some time.

Comparisons of Past Versus Current Episode of Yuan Weakness

Yuan has weakened by about 10% YTD versus the dollar, with much of the weakness emerging between Apr and early Sep. Looking at historical episodes of yuan depreciation, we note that the magnitude of yuan softening and the concomitant drags on ASEAN FX differed depending on the nature and source of the shock event.

Fig 2: Episodes of Yuan Weakness & Concomitant ASEAN FX Performance



Source: Bloomberg, Maybank FX Research & Strategy Estimates

For instance, the 2018 US-China trade war episode raised concerns over a period of lower aggregate growth momentum in both China (drag on exports) and US (higher input costs), and extent of drags on ASEAN FX depended in part on how exposed they were to final demand in US and China.

Table 1: Exposure of ASEAN GDP to US, China Demand

	Exposure to US' Domestic Demand (% of GDP)	Exposure to China's Domestic Demand (% of GDP)
SG	8.3	9.7
MY	5.8	8.3
ID	2.5	3.4
TH	6.2	6.9
PH	5.1	4.1

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

Note: Exposure reading is computed by OECD by decomposing the actual input of each country in the production of goods & services consumed worldwide. Latest data point is 2018 due to complexity of calculations.

By 2019, Huawei-linked headlines and Trump threats of further tariffs still weighed heavily on the yuan, but **the broader drags on regional sentiments had moderated, with markets more cognizant of potential benefits to ASEAN via supply chain reconfigurations and substitution in demand**.

At the onset of Covid in 2020, **the sudden hit to energy, commodity and tourism demand on account of unexpected lockdown expectations meant that FX of commodity exporters and tourism-dependent economies suffered significantly**. Among ASEAN FX, some resilience was only seen in PHP, given the more domestic-oriented nature of the Philippines economy. Yuan drag was modest at the time given that swift lockdowns had quickly brought down Covid case counts at a time when Covid infections in rest of world were spiking.

Table 2: ASEAN Dependence on Exports, Tourism

	Exports as % of GDP, 2019	Tourism Receipts as % of GDP, Pre-Covid
SG	175	6%
MY	65	6%
ID	19	2%
TH	60	12%
PH	28	2%

Source: Bloomberg, Maybank FX Research & Strategy

Moving to 2022, given elevated global price pressures and intensifying growth fears on account of war/sanction spillovers and broader withdrawal of monetary policy support, **market focus likely turned to the ability of each economy to absorb negative external shocks**. On this note, **FX of countries which saw greater stresses in current account, fiscal balance and which were slower to tilt hawkish in the face of rising inflation risks (i.e., more negative real interest rates) experienced larger depreciation pressures**.

In particular, we note much larger bout of depreciation in PHP versus earlier episodes of yuan softening. The more inward-looking nature of the Philippines economy no longer offers PHP sufficient buffers given significant stresses from its twin deficits. For THB, drags arising from the significantly negative real interest rate could remain intact even as BoT hints at further “measured” rate increases.

Table 3: Fiscal Balance, Current Account, Real Interest Rates in ASEAN

	Fiscal Balance (% of GDP, 2022E)	Current Account Balance (% of GDP, 2022E)	Real Interest Rate (%, Latest)
SG	-0.5	17	-4.3
MY	-6.0	1.3	-1.9
ID	-3.5	0.1	-1.0
TH	-4.3	-2.2	-7.2
PH	-7.5	-3.5	-2.6

Source: Bloomberg, Maybank IBG Research, Maybank FX Research & Strategy

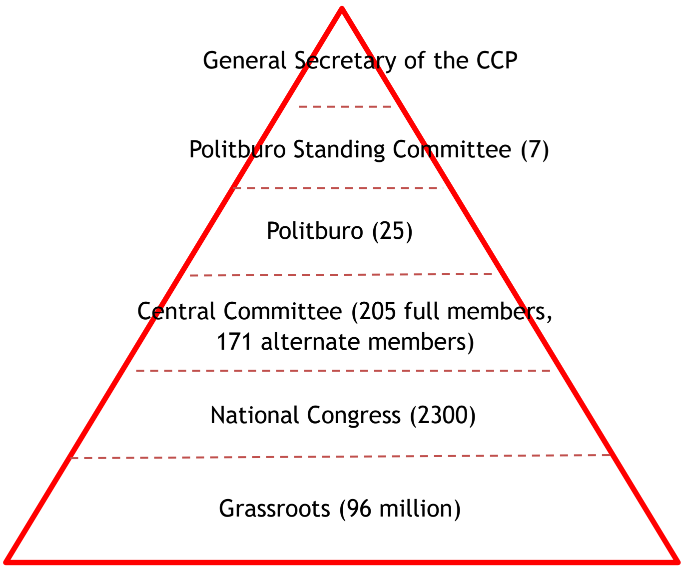
Note: Real interest rate is estimated by subtracting latest inflation reading from latest benchmark policy rate. For Singapore, 3M SIBOR is used as the nominal interest rate proxy. Data as of 8 Sep.

For ASEAN economies, fiscal deficits are broadly expected to narrow modestly into 2023, but such changes are expected to take time. On monetary policy, unlike DM central banks, size/pace of further hikes from regional central banks are also likely to be measured and gradual, while broader inflationary forces may only grind lower slowly. **This implies that shifts in the outlook for current account could be relatively key for ASEAN FX sentiments in the coming quarters.** In section III, we look more closely at how China policy nuances/demand shifts may influence ASEAN economies' current account dynamics going forward.

II. Ushering the 20th National Congress with Confidence

The Chinese Communist Party will hold its Party Congress (formally known as the 20th National Congress of the Chinese Communist Party) on the 16th Oct 2022. This event will witness *a review of the work done* since the 19th National Congress (past five years), *chart the course for the future* and *elect new central leadership*.

Fig. 3: Preparations for Leadership Reshuffle (except Xi)



Source: SCMP, Maybank Research & Strategy

Official preparation for the 20th National Congress began well in advance. The process to elect 2300 delegates from the 96 million Party members to the Congress started from Nov 2021. Given the unspoken rule that officials age 68 and above as of the date of the event would have to retire, there should be a natural reshuffle of leaders in the Politburo, except for President Xi. Back in Mar 2018, the National

People's Congress had voted to repeal the presidential term limits, paving the way for President Xi Jinping to secure an unprecedented third term this Oct. There are not many exceptions to the retirement rule – the most notable would have to be Wang Qishan who became Vice President at the age of 69 in Mar 2018, albeit leaving the Politburo the year before. He is reckoned as a strong ally of Xi. That said, apart from breaking party convention for his third tenure, President Xi is widely expected to adhere to the unspoken age retirement rule for the other top positions.

So at least 11 of the 25 politburo members could leave due to the retirement age rule including Chen Xi, Ding Xuexiang, Guo Shengkun, Liu He, Sun Chunlan, Wang Chen, Xu Qiliang, Yang Jiechi, Yang Xiaodu and Zhang Youxia, Li Zhanshu and Han Zheng. President Xi had said before that he is opposed to lifelong leadership. Given that the succession plan for the next General Secretary is still unusually murky at this point, there is a strong chance for most of the abovementioned members to retire in order to make way for younger cadres to enter the politburo this Oct.

In an environment of growing geopolitical tensions, we do not rule out **more exceptions** made this time especially for diplomatic juggernauts **Yang Jiechi and Foreign Minister Wang Yi (both above age 68)** who have been fronting talks with the West in recent years. Their presence in the next politburo could project a sense of foreign policy continuity.

Project "Looking Strong" - Political Stability Is Achieved Already?

Ahead of the event, China's No. 3 – Li Zhanshu (Standing Committee member, as well as top legislator) met with Putin in Russia, Vladivostok on 7 Sep for a 11-day trip. President Xi has also announced his first overseas trip since Jan 2020, visiting Kazakhstan on 14 Sep before making his way to Uzbekistan to attend the Shanghai Cooperation Organisation summit where he will also meet Putin. By making overseas trips so close to the Party Congress, Xi Jinping seems to be projecting confidence of achieving political stability already but we do not take this as a sign that Xi Jinping will ease international borders soon.

At a study session in late Jul, Xi Jinping flagged that the Party Congress is held at a "**critical moment in** our new journey of building a socialist, modern country". He elaborated that "we must firmly grasp the problem of unbalanced and inadequate development and focus on strengthening our weaknesses". He wishes for the country to "basically achieve socialist modernisation by 2035".

Key Strategic Policies Expected

Made in China 2025 Should Continue

At the start of 2021, President Xi declared that the country has lifted nearly 100mn people out of poverty by end 2020 and thereby fulfilling a pledge he made at the start of his presidency in 2012 to eradicate rural poverty. Thereafter, he moved on to coin the term "Common Prosperity" as a central political theme in that year and forcefully cracked down on various sectors (technology, platforms, private education, etc) in order to reduce systemic inequalities. While the Chinese government came down hard on "soft technology" such as applications, hard technology (such as chips, artificial intelligence, biotechnology, etc) are still highly regarded as key to its economic competitiveness.

In a way, Xi Jinping's Made in China 2025 to reduce technology reliance on other countries had contributed to the technology race between the US and China as well as the deterioration in bilateral relations. With the US already halting chip shipments to China (the most recent order was given to Nvidia), Biden approving the Chips and Science Act (to provide subsidies for RnD and to counter China), and the US forming a semiconductor alliance with Taiwan, South Korea and Japan, President Xi has to push on with the chip development race. Thus far, China's Semiconductor Manufacturing International Corp (SMIC) is now on par with US' Intel and one generation behind Taiwan's TSMC which can produce 5nanometer vs. SMIC's 7nanometer. Strengthening home-grown innovation is part of China's dual circulation plan and also found in the 14th five-year plan, released last year and the emphasis on semiconductor as a key industry was mentioned again by Xi Jinping on 7 Sep.

Climate Change Goals to be Reinforced, Especially with the Help of Russia

In Oct 2021, China provided a guiding document for the country to achieve peak carbon dioxide emissions by 2030 and to become carbon neutral by 2060. Within the document, guidelines were comprehensive ranging from the promotion of economic and social development in a green and low-carbon way, **deep industrial restructure to optimize industrial structures or to curb energy-intensive projects, development of clean, low-carbon efficient energy system, transportation and trade amongst others.**

China also reiterated their pledge to increase the share of non-fossil energy consumption to around 20% by 2025 and 25% by 2030 from 15.3% as of end 2019. Previously, it took six years for China to ramp up the share from around 10%. Coal and oil still make up around 70% of the energy consumption for the country. China is likely to pivot more towards natural gas imports to achieve its interim emission goals while it builds up its non-fossil fuel capacity. Russia's invasion of Ukraine has resulted in a longer-term rift between Russia, China and the rest of Western powers, given China's refusal to condemn Russia for its invasion. China is now able to count on Russia for its supply of cleaner natural gas energy. Ahead of the invasion in Feb, Russia also inked a 30y contract to supply gas to China via a new pipeline that will increase its annual supply by 10bcm from original target of 38bcm by 2025. This was on top of the pipeline that has been transporting natural gas from Siberia to Shanghai since Dec 2019.

More recently on 7 Sep, Xi emphasized on resource conservation, recycling economy and urged for China to "push for a green, low carbon lifestyle", also known as a "comprehensive saving strategy". He wants a "waste-free society" to be "vigorously developed".

Recall that PBoC has been focused on cross-cyclical policy designs where a combination of monetary and fiscal policies are implemented to achieve short-term objectives and also to take into consideration, longer-term goals. In line with the cross-cyclical policy, monetary policy easing has been provided with much calibration while the government has mainly tapped on lending/credit facilities, and infrastructure projects (financed by local government bonds) to support growth. **Transformation towards a "waste-free" society as well as the deep industrial restructure would require significant infrastructure spending which can also help with growth stimulation in the near-term.**

A Light Out of the Covid-zero Tunnel – Key to Clearing the Economic Gloom

Xi Jinping may have grander plans in store but none can be effectively executed without a light out of the Covid-zero tunnel. Thus far, Chinese government had provided a 33-point growth stimulus package (May) and followed up with a 19-point stimulus growth package (Aug) for further support. Thus far, these stimulus packages were not greeted with lasting enthusiasm. The low threshold for Covid cases and flash lockdowns have dampened consumption and private investment.

A brief recap on why Xi Jinping was so adamant on Covid-zero - China was able to become the first country to quash covid cases swiftly with strict lockdowns at the start of the pandemic. The World Health Organization lauded them for China for its "bold efforts" and the rest of the world followed suit with the lockdowns. By May 2020, the Chinese government declared victory over Covid at the delayed "Two Sessions". As such, the Covid-zero strategy has become synonymous with Xi Jinping's leadership and this was amplified all the more by the recent rush to lockdown >70 cities (estimates of number of people affected range between 65-300mn depending on whether you read Global Times or CNN) as a show of support for Xi Jinping ahead of the Party Congress.

There are a few arguable justifications for China to stick to its Covid-zero strategy – 1) low vaccination rate for the elderly; 2) inadequate healthcare facilities to deal with spikes in cases especially in the rural area; 3) millions already employed to carry out the Covid-zero strategy.

A key testbed would have to be Hong Kong which recorded one of the highest mortality rate during the Omicron wave in Apr 2022 and this was attributed to the low vaccination rate for the elderly. Only 49% of people aged 60 and above got two doses of vaccination at that point. **Ahead of the Party Congress, President Xi is keen to avoid a situation of rampant Covid outbreaks and high death rates that would weaken his disposition.**

On 4 Sep, the government had approved the world's first inhaled vaccine against Covid-19 made by China's own CanSino Biologics as a booster dose, in the hope of getting the vaccination rate higher. **At this point, it is still unclear if Covid-zero could be shifted after the Party Congress is over but we see an exit of the Covid-zero strategy as the most impactful policy that President Xi can provide for the economy at this juncture.** Any signs of higher tolerance for Covid from President Xi could reinvigorate animal spirits and support consumer and investor confidence. Activity could pick up more materially and some of that optimism could even spill into the languishing property sector notwithstanding ongoing credit/financing issues.

Making the Dynamic Covid-zero More Flexible

As with most countries, the lifting of restrictions should be phased. This is particularly important given how entrenched China is with Covid-zero already and the potential increase in unemployment that an exit can bring.

Approval of mRNA Vaccines May be On the Horizon

The Chinese government could probably start with the approval of clinical trials of Sinopharm's Omicron-specific mRNA Covid-19 vaccine. Application for clinical trials were submitted in mid-Aug and should the government provide a signal of greater confidence in the vaccine. **Any confirmation of a roll-out in the mRNA vaccine would probably be nearer the turn of the year.**

More Tolerance for Covid-Cases and Less Frequent Testing

Right now, the tolerance for Covid cases is rather low. The aim is still to stop the spread of Covid and to stamp it out completely. Threshold to trigger a major lockdown is around 5 consecutive days of 100+ cases recorded in a province/major city and mass testing is conducted frequently. This threshold could be shifted stealthily and gradually. **A shift of focus from Covid cases to hospitalization rate would mark the next milestone. We expect this to occur sometime in 1H 2023.**

A Re-emphasis on Dual Circulation Should Mean Closed International Borders For Longer

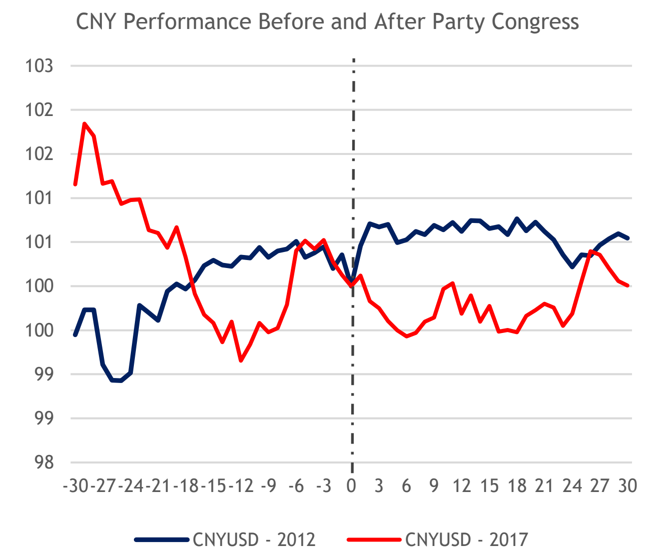
Within the 14th five-year plan, China wanted to aggressively strengthen its home-grown innovation and use its massive domestic market to boost its economy. In pre-Covid days, China used to have significant tourism imports but **a strong emphasis on innovation of key industries at home and using domestic consumption to power the economy could mean that international borders could be eased much later.** This could maintain the balance of payments buffer to support the yuan as well as encourage household spending at home. Any significant easing of quarantine requirements may occur only into the latter half of 2023. That could be the time where its current account surplus would start to narrow further, reducing support for the yuan.

III. Potential Phases of Yuan Moves

Lead-up to Party Congress: PBoC to Fight 1-Way Yuan Bets

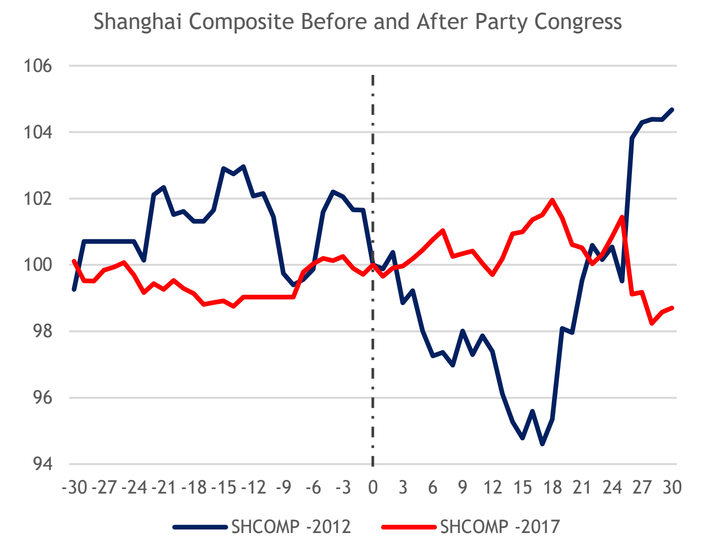
Leadership changes were smooth in the past. Recall that the powerful politburo standing committee used to consist of 9 members but has been reduced to 7 at the 18th Party Congress in 2012. Even so, both the 18th and the 19th Party Congress (2017) happened in an environment of relative calm. The yuan was stable before and after the events while local bourses also did not react negatively. 2022 is set to be vastly different where the economy is still being afflicted by the pandemic and lockdowns and the rest of the world faces high inflation and supply chain bottlenecks. **It is thus likely that PBoC will continue to push back against yuan weakness, albeit short of defending any specific level such as the 7-figure between now and the start of the Party Congress on 16th Oct.**

Fig. 4: Yuan was rather stable throughout in the two Party Congress Events



Source: Bloomberg, Maybank FX Research & Strategy
Note: Day 0 denotes the date on which Party Congress Started and prices are indexed to 100 for that day.

Fig. 5: The local bourse was not under much pressure ahead of the events



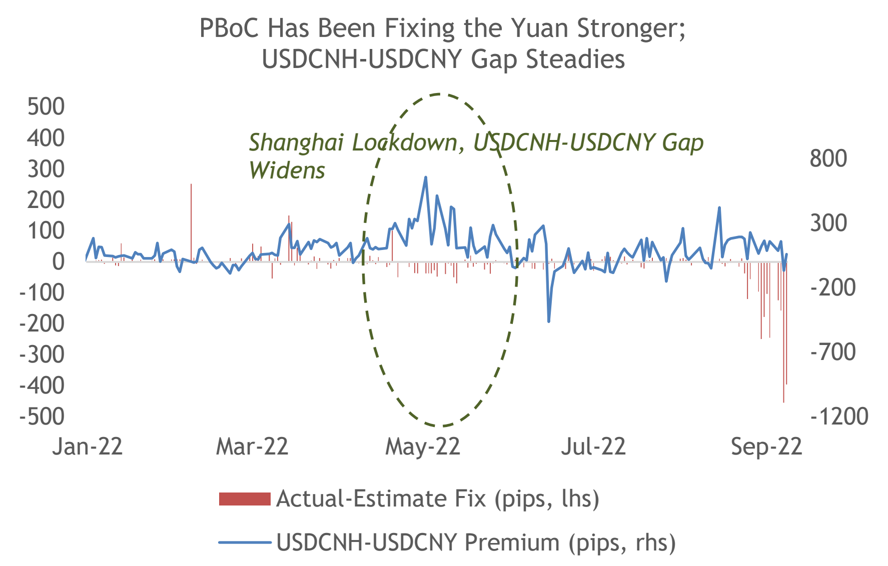
Source: Bloomberg, Maybank FX Research & Strategy
Note: Day 0 denotes the date on which Party Congress Started and prices are indexed to 100 for that day.

Thus far, PBoC has been using the daily USDCNY reference rate to convey its policy signals and to slow yuan depreciation. The USDCNY reference rate was fixed 395 pips lower than median estimate at 6.9148 on 8 Sep 2022, slightly smaller than the strongest fixing bias on record at 454pips on 7 Sep. This is the twelve consecutive day of strong fixing signal to stabilize the yuan.

On 5 Sep, PBoC also lowered forex reserve ratio by 2ppt to 6% with effect from 15 Sep. The last cut was done in late Apr (during the Shanghai lockdown) and served as intermittent brakes for yuan bears.

While not bringing USDCNH significantly lower, stronger signalling from PBoC appears to be slowing the USDCNH rally. The USDCNH-USDCNY gap remains relatively narrow more recently.

Fig.6: PBoC to Keep Yuan from Falling too Fast Before Party Congress



Source: Maybank FX Research & Strategy

It is worth noting that there is no particular level that PBoC defends. Doing so would only encourage further speculation against the yuan. As such, the USDCNY fix direction is largely still aligned with broader FX direction such as the overnight USD moves.

Should the USD and UST yields continue to rise further, China may choose to drop the forex reserve ratio further from the current 6% in order to raise the supply of foreign currencies. Another tool that China can use is the issuance of yuan bills to tighten liquidity conditions in the offshore market, more specifically Hong Kong. That is not done very frequently and is only used in very volatile market conditions.

Post-Party Congress Move – Cautious Optimism

President Xi, in breaking the party precedence of getting a third term as well as the retirement age for himself, may feel the pressure to announce policies that are definitively more supportive of growth relative to what has already been announced thus far. **As we have discussed above, an exit strategy out of Covid-zero would be the most impactful for the economy but this can only be done in phases with the bulk of easing likely to occur in 2023.**

We envisage a scenario where conditions supporting am eventual Covid-zero exit becomes clearer over time (potential hints at the Party Congress) in our outlook for the yuan but significant challenges on unwinding Covid-zero (e.g., low elderly vaccination rate) would imply a slow process. As such, initial positivity could even fizzle out at some point in 4Q before regaining traction as markets gain better visibility of policies thereafter.

As mentioned in the earlier part of the report, we look for China to focus more on hospitalization rather than Covid cases at one point. This would be a significant milestone that could happen in 1H 2023. Thresholds for lockdown should have been raised or removed entirely based on the healthcare capacity for different regions. We look for consumer confidence and investor confidence to improve more significantly then and yuan assets may look attractive when ongoing monetary policy tightening reached a point where growth jitters in the DM economies emerge more discernibly.

That said, we do not look for a full retracement of the USDCNY back to 1Q low of around 6.30. It is likely that the current account surplus would no longer be as robust given weakening external demand. Potential for China to ease international borders at some point (possibly 2H 2023) could mean more tourism-related outflows and potentially bringing its current account back into balance.

Dollar Thoughts…

A large part of the swings in USD-AxJ crosses in 2022 can be attributed to broader dollar swings. Going forward, if we look at these three prongs for recent dollar strength, essentially (i) weak EUR, (ii) broad haven demand, and (iii) hawkish Fed, market expectations for Fed outlook might actually continue to see more two-way swings after the latest adjustments towards expectations for higher for longer post clearer Fed messaging at Jackson Hole. Currently markets are expecting Fed policy rate to peak around 3.8-3.9% in March or May next year, before slowly grinding lower in the second half of 2023. The 4% handle may form some sort of interim resistance for Fed peak rate expectations, meaning that further boosts to dollar from hawkish shifts in Fed expectations should be more modest going forward.

But the other two prongs, which involves ongoing EUR weakness and broader haven demand, could remain in play for a while yet.

On EUR weakness, the current market focus is on the ongoing energy crisis. It is important to note that different European nations have different Winter consumption pace versus storage levels. In Germany and Italy for instance, one month's gas consumption in winter would use more than half of the entire national gas stock. Past usage trends for Spain, Belgium and Portugal suggest that they would be on track to consume more gas in a Winter month than they have in storage. So it's more or less given that gas stocks are insufficient for winter without continuous replenishing, or some form of rationing. On net, growth and sentiment drags are likely to remain in play into the turn of the year, weighing on EUR and concomitantly supportive of the dollar.

The dollar could hence remain in elevated trading ranges in the coming weeks or months. Any intermittent dips in DXY on position adjustments could be shallow until the impact of the various prongs we mentioned, including exceptional EUR softness, dissipate, which could take place probably at the earliest in early 2023.

Concluding Remarks - ASEAN FX Implications

As a reference, we first refresh our estimates of ASEAN FX's co-movement with yuan, via a simple workhorse model used by McCauley and Chang (Jun 2018, "*Recent RMB Policy and Currency Co-movements*"), a tool we have used before.

The model takes the form:
$\Delta\text{ASEAN FX} = C + \beta 1 * \Delta\text{CNH} + \beta 2 * \Delta\text{EUR} + \beta 3 * \Delta\text{JPY} + \beta 4 * \Delta\text{VIX} + \varepsilon$,

where ΔASEAN FX is the daily percentage change in individual ASEAN currencies vis-à-vis the USD, and ΔCNH, ΔEUR and ΔJPY are the daily changes in, respectively, the yuan, euro and yen vis-à-vis the USD. Changes in VIX are included to control for shifts in global risk environment. The regression is estimated for each individual ASEAN FX. We examine β1—the co-movement coefficient between the RMB and the ASEAN FX in question—over two key phases:

(i) 23 Jan 2020 to Dec 2021: This period captures the onset of Covid-19 as well as subsequent recovery in activity and sentiments, where yuan and ASEAN FX moves were arguably reacting to similar broader shifts in global risk attitudes (e.g., simultaneous injections of monetary and fiscal support, emergence of vaccines, variants).

(ii) Jan 2022 to Aug 2022: Differentiation in drivers impacting regional FX arguably came to the fore more discernibly this year.

Table 4: β1—Co-movement Coefficient Between RMB and ASEAN FX

	SGD	MYR	IDR	THB	PHP
23 Jan 2020 to Dec 2021	0.43	0.21	0.85	0.48	0.27
Jan 2022 to Aug 2022	0.25	0.24	0.16	0.37	0.05

Source: Maybank FX Research & Strategy Estimates

The results of our analysis suggests that with the exception of MYR and THB, co-movement of ASEAN FX with yuan moves have largely moderated in extent (versus prior estimates) thus far this year.

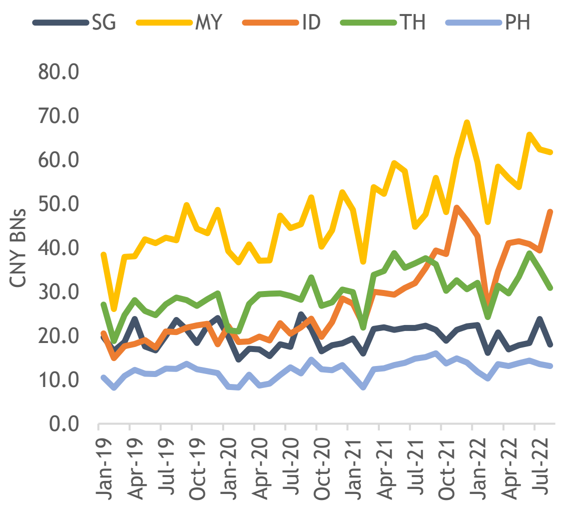
THB is currently most tightly linked to yuan in sentiment swings. This should not be surprising given market focus on China's Covid-zero policy, which weighs on both China growth momentum and Thailand tourism outlook.

To be clear, China growth dynamics and yuan moves will still be a significant driver of ASEAN FX sentiments going forward. But some variance in day-to-day swings should be increasingly expected given larger influences from other key idiosyncratic drivers.

We have discussed the potential trajectory for yuan going forward; (i) **slowing in pace of softening in lead-up to party congress** as PBoC fights one-way yuan bets, even as power crunches, Covid-zero, property slump means that interim USDCNH moves above 7 cannot be ruled out; (ii) **potential yuan trough in 4Q and subsequent cautious optimism on policy support and possibly clearer conditions/timeline for exit from Covid-zero** after President Xi gains his third term. But on net, any USDCNH moves lower into 2023 could be modest (end-2023 forecast at 6.85) given still-weak global demand. Any subsequent outward tourism flows in the later part of 2023 could also weaken BoP buffers for yuan.

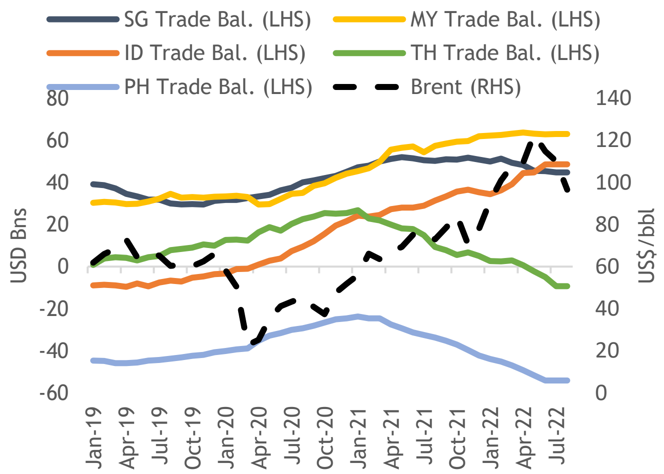
Broadly, ongoing spillovers to ASEAN FX on account of China drags could also peak in 4Q and moderate thereafter.

Fig. 7: China's Imports from ASEAN Economies



Source: Bloomberg, Maybank FX Research & Strategy

Fig. 8: Trends in ASEAN Trade Balances



Source: Bloomberg, Maybank FX Research & Strategy

Looking at recent trends in China's imports from ASEAN, we note some resilience in trade with ID and MY, suggesting that demand for commodities remain intact. Concomitantly, upswings in USDIDR and USDMYR have been more contained recently and likelihood of more significant bouts of IDR or MYR depreciation could be reduced. Between the two, we favor IDR given potential election risks for MY going forward.

For SGD, concerns over slowing chips demand could be tempered in part by expectations for another round of MAS tightening in Oct. But strong SGD NEER (+1.4% above par) could imply limited room for upsides.

For THB, our economist team noted that Thailand's export growth decelerated in Jul on the back of a marked slowdown in industrial products as semiconductor shortage disrupted the production of electronics and cars. Lockdown measures in some major Chinese cities likely lengthened delivery times. Sentiments could remain cautious in the coming months before potentially seeing a more discernible recovery next year, conditional on some easing in China's Covid-zero stance. In-house macro projections suggest the largest improvement (among ASEAN economies) in current account balances between this year and the next for Thailand—i.e., from deficit of 2.2% of GDP in 2022 to surplus of 2.0% of GDP in 2023.

For PH, exposure to Chinese demand is significantly lower versus peers, but twin deficit concerns has come into focus. Trade deficit has notably widened further for much of 2022. Declining FX reserves (US$99bn in Aug 2022 versus US$109bn in Dec 2021) has likely exacerbated bouts of sentiment drags.

Recent signs of easing in energy import burdens is a positive for THB and PHP, but may not be able to offset broader macro stresses.

Given these assessments and TA considerations, we recommend:

	Our Strategies and Biases	Risk-reward ratio
1	Tactically enter long SGDCNY especially in the lead-up to the next scheduled MAS policy decision in mid-Oct on tightening play, given rising trend channel and bullish momentum on the weekly chart. Entry at 4.9350. First target at 4.98 before the next at 5.0260. Stoploss at 4.9100. Risk-reward ratio of 1:3.6.	1:3.6
2	IDRTHB has formed a rounding bottom that stretched from 2016. Stretched conditions, denoted by stochastics on the weekly chart could mean that the cross has room to pullback towards the 2.4270 for an opportunity to enter into a long IDRTHB position. First target seen at 2.5030 before 2.5720. Stoploss at 2.3560. Risk reward ratio of 1:2.0.	1:2.0
3	Long SGD NEER on dips below +1.0% above par	

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