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Global

FX Insight

ASEAN FX - IDR & PHP Most Vulnerable To Contagion From Turkey

IDR & PHP Most Vulnerable

The worst hit currencies in ASEAN due to the Turkish crisis are the IDR and PHP. Both Indonesia and Philippines suffer from twin deficits, and have been burning up their foreign exchange reserves to defend their currencies. Draining of the reserve buffers increases the vulnerability of the IDR and PHP to contagion risks. The high level of foreign ownership of domestic assets particularly in Indonesia makes it most vulnerable to spill overs from the Turkish crisis. Policy responses to the contagion from the Turkish crisis are unlikely to differ significantly between Indonesia and Philippines. Both are likely to continue to use their foreign exchange reserves to stabilise their currencies. Already the BI has lifted its policy rate by another 25bp to 5.50% and the BSP could potentially follow its lead. Indonesia is also planning to shore up its foreign currency reserves.

Weekly technical charts suggest that there are retracement risks to USDIDR with support around the 14370-levels. As for the USDPHP, daily technicals suggest upside risks with resistance around 53.640, 54-handle.

Analysts

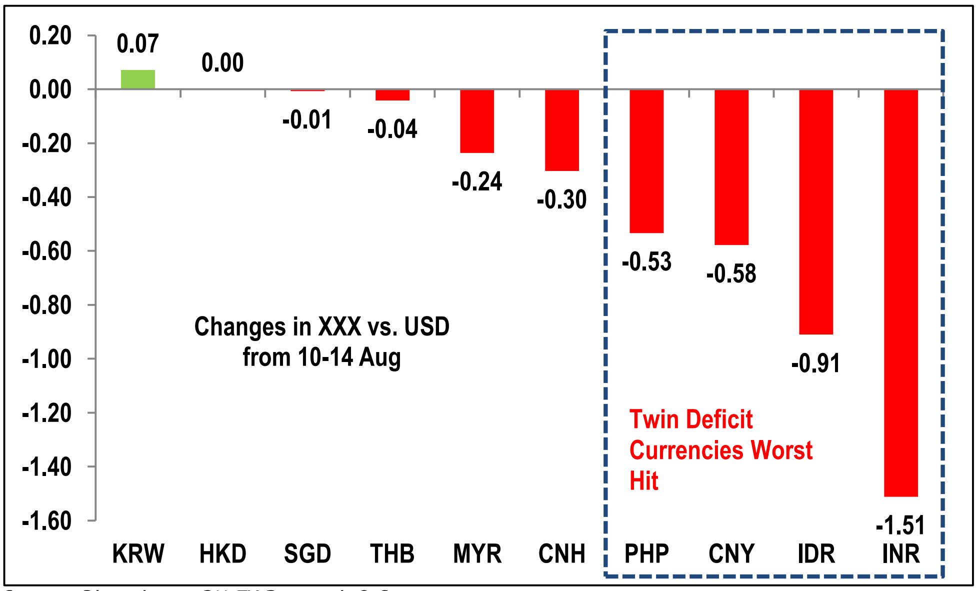
Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Chart 1: Contagion From Turkey Impacts Asian Twin Deficit Currencies The Most



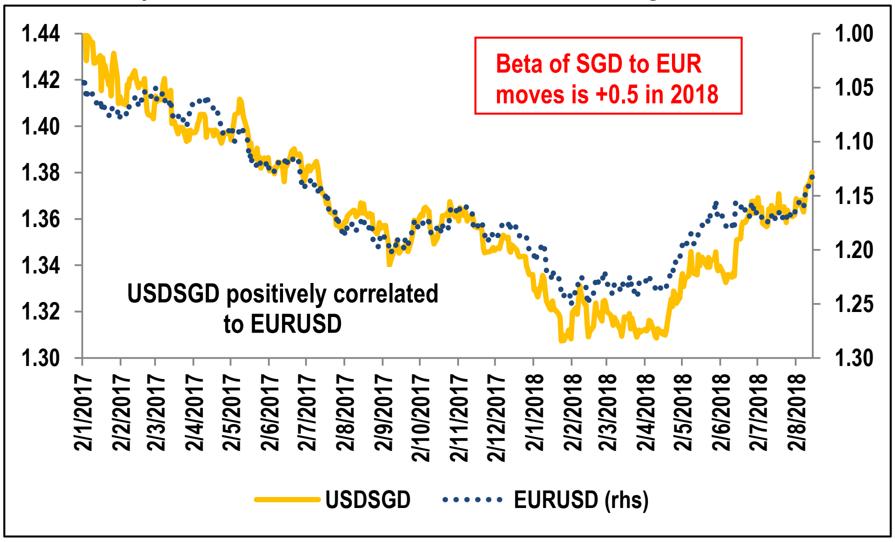
Source: Bloomberg, GM FX Research & Strategy

Indonesia and Philippines Most Vulnerable To Turkish Contagion

The crisis in Turkey triggered by the imposition of sanctions by the US is reverberating through the global financial markets, especially in emerging markets (see our report, *EUR - Cautious but Retain Medium Term Constructive Bias* dated 14 August 2018 for the impact of the Turkish crisis on European banks and the EUR). This in turn has triggered contagion risks that are impacting emerging market currencies. Broadly speaking, ASEAN FX has been relatively resilient amid this contagion given the healthy current account surpluses, strong foreign currency reserves, and fiscal policy space in the region (Chart 1).

This though does not mean there is no impact on ASEAN FX. For example, the spill-over from the Turkish crisis is felt by the SGD through its positive correlation with the EUR. The EUR, which is more exposed to the TRY due to European banks' exposure to Turkey, has been a drag on the SGD as seen in Chart 2.

Chart 2: Impact Of Turkish Crisis On SGD Felt Through EUR

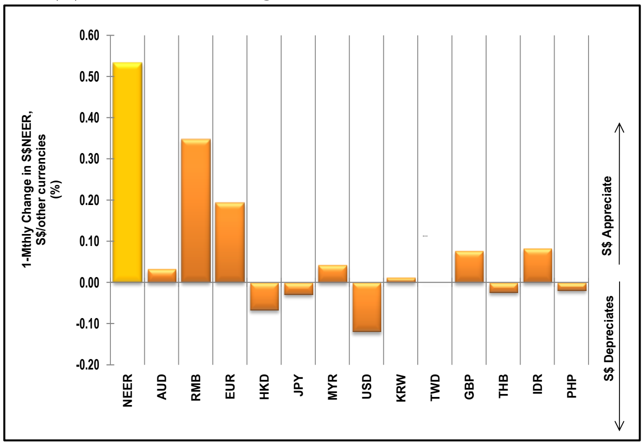


Source: Bloomberg, GM FX Research & Strategy

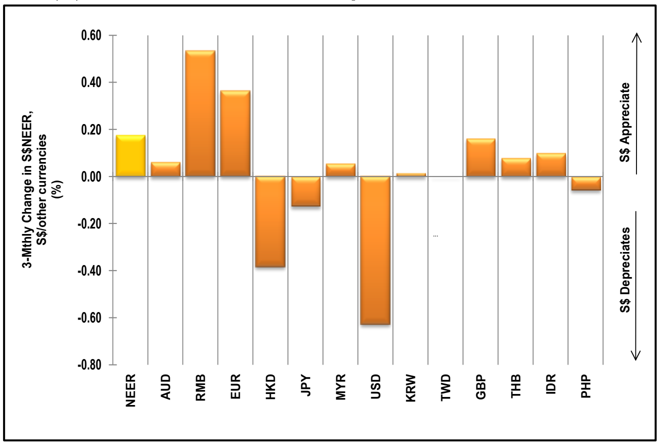
From a NEER perspective, the weakness in the USDSGD does not necessarily translate into a weaker SGD. In fact, the SGD has traded stronger against most of its trading peers' currencies in the SGD NEER basket in the past six-months. Since the MAS move to normalise policy in Apr this year, the SGD has been mostly stronger against its basket of trading partner currencies as reflected in Chart 3(b). Similarly, when compared to a month ago or six-months ago, the SGD has been stronger except against the HKD, JPY, USD and PHP (Chart 3(a) and (c)).

Chart 3: SGD Has Been Relatively Resilient

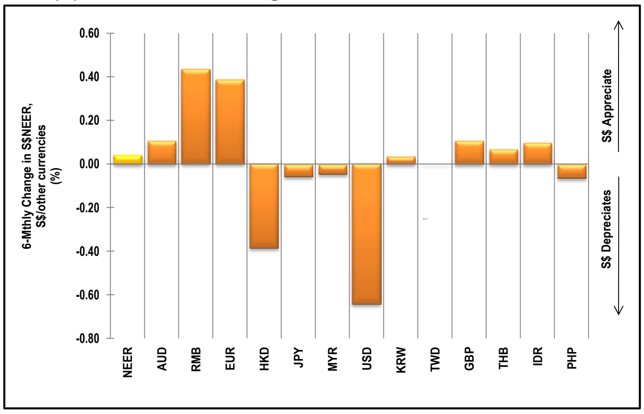
(a) vs.1-month ago



(b) since MAS move in Apr



(c) vs. 6-month ago

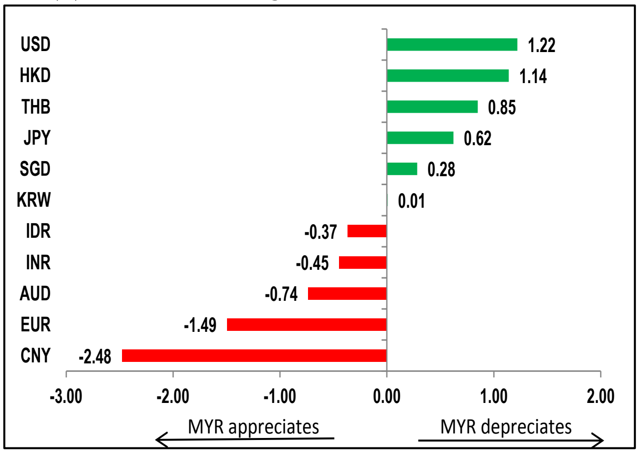


Source: Bloomberg, GM FX Research & Strategy

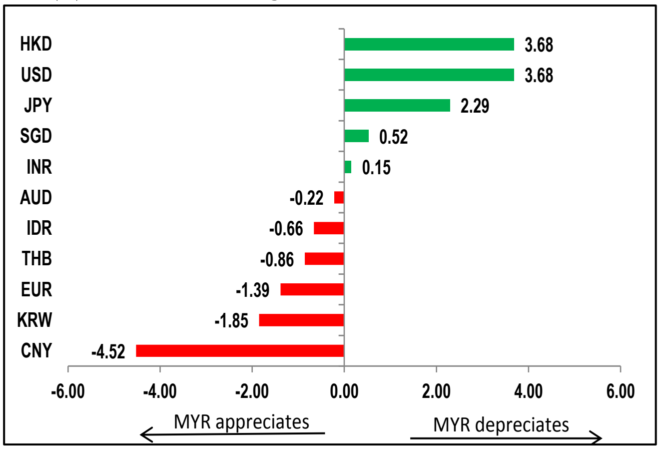
A similar case can be made for the MYR. The MYR was resilient in the past six months (Chart 4). The MYR had been relatively stronger against its major trading partners when compared to 1-month, 3-month and 6-month ago.

Chart 4: MYR Also Shows Resiliency

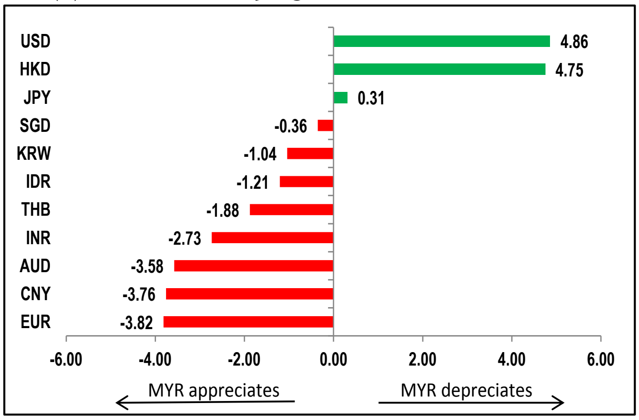
(a) vs. 1-month ago



(b) vs. 3-month ago



(c) vs. 6-monthly ago



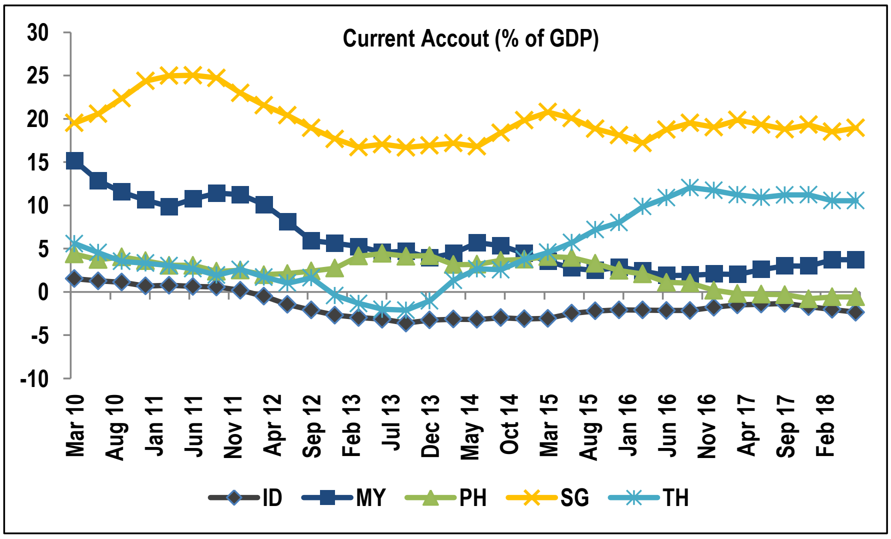
Source: Bloomberg, GM FX Research & Strategy

The exceptions are the IDR and PHP which are among the worst hit by contagion concerns emanating from Turkey as can be seen in Chart 1 above.

The commonality that both IDR and PHP share is that their economies' suffer from twin deficits, unlike their peers in the region. Domestically, while Indonesia's fiscal deficit is expect to hold steady around 2.5% of GDP in 2018 and 2019, that for Philippine is on the uptick towards 3.0% of GDP by 2019. More importantly, both Indonesia and Philippines are vulnerable due to their persistent current account deficits (Chart 5).

Providing most of the ASEANs with a bulwark against attacks on their currencies is their strong external reserves. With the exception of the Philippines, the rest of ASEAN have more than USD100bn in foreign reserves that can be used to defend their currencies. Excluding Singapore, which has been accumulating reserves since the start of the year, the rest of ASEAN have been burning up their foreign reserves to defend their currencies amid financial market volatility. In particular, Indonesia has spent nearly USD14mn since Feb in defence of the IDR, and the PHP nearly USD5bn (Chart 6). Draining of the reserve buffers increases the vulnerability of the IDR and PHP to contagion risks.

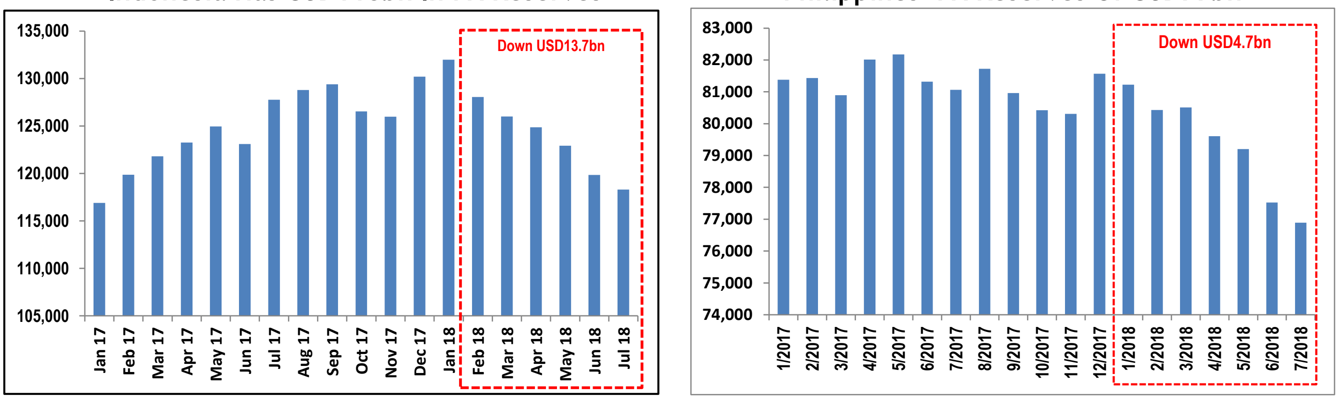
Chart 5: ID & PH Suffers From Persistent Current Account Deficits



Source: Bloomberg, GM FX Research & Strategy

Chart 6: ID & PH Burning Up Foreign Exchange Reserves To Defend Their Currencies

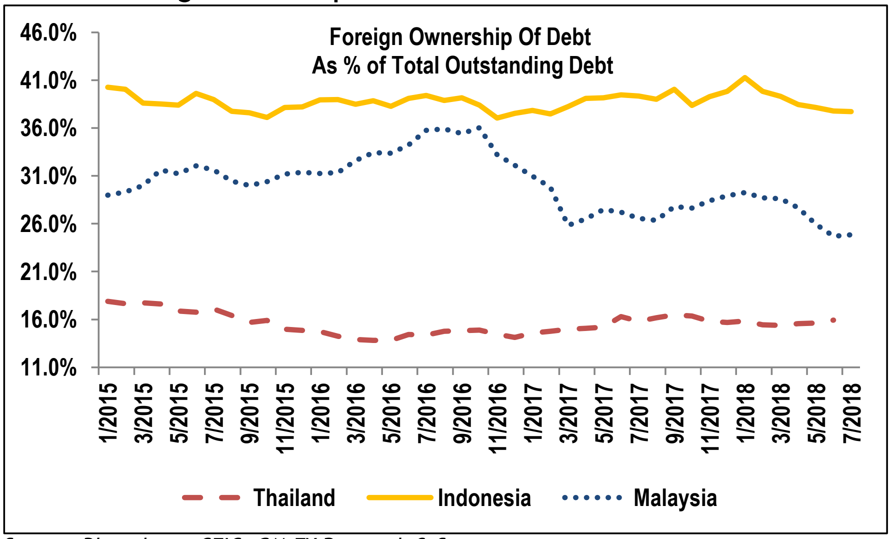
Indonesia Has USD118bn In FX Reserves | **Philippines' FX Reserves Of USD77bn**



Source: CEIC, GM FX Research & Strategy

Just as important is the high level of foreign ownership of domestic assets particularly in Indonesia. The high foreign ownership of government debt in Indonesia makes it most vulnerable to spill overs from the Turkish crisis. As chart 7 shows, foreign ownership of government debt remains elevated in Indonesia at close to 40% of total outstanding government debt compared to just 16% and 25% for Thailand and Malaysia respectively. In an environment of rising emerging market risk, foreigners are likely to reduce their exposure to emerging markets, including Indonesia.

Chart 7: Foreign Ownership Of Government Debt In ASEAN



Source: Bloomberg, CEIC, GM FX Research & Strategy

Policy responses to the contagion from the Turkish crisis are unlikely to differ significantly between Indonesia and Philippines.

Policy Responses From Indonesia

The Turkish crisis has accelerated the Indonesia authorities' need to deal with the shortcoming of the economy. Already, President Widodo is chairing a cabinet meeting to shore up the defences of Indonesia, in particular to build up its foreign currency reserves. As discussed above, Indonesia has used up nearly USD14bn in reserves since Feb to ensure the stability of the IDR amid Sino-US trade tension concerns and the fallout from the Turkish crisis.

The discussion is likely to lead to the acceleration of plans to bolster exports and reduce imports via the increase use of domestically available substitutes when possible. Leading the charge will be the expedited use of biodiesel to reduce oil imports. At the same time, the government will also push ahead with plans to accelerate the building of infrastructure for the tourism sector to increase visitor arrivals in the archipelago. Meanwhile, some projects will be delayed to reduce their impact on imports. This fiscal response should not only help to bolster its foreign currency reserves but also reduce the current account deficit.

On the monetary front, BI surprised with a 25bp hike to its 7-day reverse repo rate to 5.50% on 15 Aug amid global uncertainty triggered by the Turkish crisis. This move is in addition to the ongoing intervention in the FX and bond markets to keep the IDR and yields stable. Intervening in the financial markets alone is unlikely to be sufficient to stabilise the IDR. These measures should be supportive of the IDR with the IDR rebounding to hover below the 14600-levels at 14577 at the point of writing.

We cannot rule out the possibility of the BI keeping its tightening policy cycle going forward. BI Governor Warjiyo himself reiterated the hawkish stance of the central bank and warned that the central bank will be proactive with any further moves data-dependent. Continued downside pressure on the IDR should keep the BI policy stance on a hawkish bias. This leaves the Sep meeting open for another possible move by BI.

Chart 8: USDIDR Weekly Chart - Retracement Risks

Source: Bloomberg, GM FX Research & Strategy

USDIDR was last seen around 14577-levels. Bullish bias on the weekly chart remains intact but waning, while stochastics remains at overbought conditions. This suggests room for rebound risks in the horizon with any retracement likely to find support around the 14370-levels (76.4% fibo retracement of the 2015-2016 downswing). Resistance around 14650-levels ahead of 14830-levels (2015 high).

Philippines' Possible Policy Responses

Despite the turmoil in the financial markets, the Philippine government is unlikely to roll back its infrastructure spending programme. Instead, it is likely to push ahead with its "build, build, build" mantra to keep the domestic economy rolling. We are likely to see the monetary authorities taking up the mantle to ensure the stability of the PHP. Further intervention in the FX markets is likely to slow the USDPHP's climb.

Still, should the USDPHP continue its ascend towards the 54-handle, we can expect the BSP to take even more drastic action including the possibly of calling for an unscheduled meeting of the Monetary Policy Board to hike its overnight borrowing rate by another 25bp as the next schedule BSP policy meeting does not take place till 27 Sep. The pressure is on now for the BSP to hike again given the 25bp move by BI on 15 Aug. A move by the BSP could be supportive of the PHP.

Chart 9: USDPHP (Daily Chart) - Bullish

Source: Bloomberg, CEIC, GM FX Research & Strategy

USDPHP was last seen around 53.546-levels. Daily chart now shows bullish bias and stochastics climbing higher. Weekly chart though shows no strong momentum in either direction, while stochastics is at overbought conditions. Overbought conditions on the weekly chart could suggest retracement risks ahead but in the near term risks remain to the upside. Resistance is around 53.640-levels (2018 high on 26 Jun) ahead of the psychological 54-handle. Support around 53.290-levels (50DMA), 53-handle.

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Saktiandi Supaat	Christopher Wong	Fiona Lim	Leslie Tang
Head, FX Research	Senior FX Strategist	Senior FX Strategist	Senior FX Strategist
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378