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Maybank

FX Insight

When the Elephants (USD, RMB) Rumble…

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AXJs Fates Intertwined with RMB

Just as AXJ FX have somewhat priced in recent shifts in Fed front-loading of rate hikes, the emergence of new uncertainties arising out of China's extended lockdown, rapid and sharp depreciation in CNH and global growth slowdown warrant some caution ahead. In particular, the former is relevant for AXJ FX given the significant positive correlation between regional FX and RMB. A more adverse scenario would be if a lack of promised follow-through in policy support dampens domestic macro activity, and continued outflows from Chinese assets drag on the yuan further, weighing on AxJ FX for longer. The timing of the forex RR cut announcement suggests that 6.60 could be an interim resistance for the pair but with Apr PMI data due this weekend, we cannot rule out further yuan weakness. Any confirmation of a broad lockdown in Beijing or infection spread could also weaken yuan sentiment. We think USDCNH could find support at around 6.5450/6.5080. Resistance at 6.60 before 6.6470.

Fed Hike Cycle: More Like 1994 than 1980

We also revisit past Fed tightening cycles that may look similar to the current cycle. While there are similarities (high inflation, elevated oil prices, Fed tightening) between 1980 and today, the market landscape and policy regime then were vastly different from today. Today's environment may not warrant a Volcker-shock but a case of front-loading of rate hikes to arrest inflationary pressures. In fact, Fed's Bullard cited the 1994 tightening cycle as an analogy on how fast Fed should move. We stick to our caution that in the near term, USD could still see intermittent upward pressure (USD smile of risk aversion, US data outperformance/monetary policy divergence) but USD upside may not mirror the 1980s episode of high double-digit gains.

MYR Weakness Largely Driven by Exogenous Factors

The bulk of MYR losses accelerated in 2Q as some underpinning factors start to deteriorate. MYR weakness was largely driven by exogenous factors, including the continued rise in UST yields, USD (further triggered by hawkish comments from Powell and Daly), sharp and continued decline in CNH (of which MYR has a strong correlation to), IMF's downgrade of global growth, risks of China slowdown amid extended lockdowns, slippage in oil prices and ongoing war in Ukraine (sentiment, china proxy play). On technical, next key resistance at 4.38 - 4.40 levels. A decisive break above this could see USDMYR re-visit 2020 pandemic high of 4.4490 levels. We expect USDMYR to range between 4.35 – 4.45 over the next few weeks assuming USDCNH range remains contained around 6.55 – 6.65.

Winds of Change: Yield, Yen and Yuan

Sharp and rapid depreciation in CNH (>3.5% vs USD in a week) triggered the recent decline in AXJ FX. Elsewhere, mounting worries of global growth slowdown, fears of China hard landing as covid lockdowns spread beyond Shanghai to Beijing and threats of aggressive Fed tightening continue to undermine broad market sentiments.

In this report, we aim to touch on a few key points, starting with (1) USD move, potential Fed rate hike cycle this round and a look back at 1979-81, 1994 periods; (2) AXJ moves during past 2 cycles of Fed tightening post-2000; (3) Recent FX moves show AxJ FX leaning towards caution amid elevated global risk aversion. Meanwhile, JPY and CNY depreciation narratives are also sharply in focus. While both are impacted by the recent UST yield upswing, underlying nuances are significantly different. We look at each in turn; and finally (4) MYR's recent decline – causes and outlook.

DXY: Not a 1980-Style Shocker

While there are similarities (high inflation, elevated oil prices, Fed tightening) between 1980 and today, the market landscape and policy regime then were vastly different from today.

For instance, 10y UST yields were on average much higher in 1970s-80s at around 9% on average while 10y yields averaged 2% over the last decade; Fed's conduct of monetary policy targeted monetary aggregates then vs. inflation targeting via rates and forward guidance communications today. While inflation today is indeed re-visiting 1980s high, the inflation pressures this episode only started building up from last year vs. in 1970s-80 where US was already confronted with 6 – 7 years of inflation build-up (that period was also dubbed the Great Inflation). Hence then-Fed Chair Volcker needed to raise rates sharply to combat inflation.

Comparison between Past Fed Hike Cycles: Current Regime Closer to 1994

	1979 - 81	1994	Current
Monetary Policy Regime	Monetary targeting	Inflation targeting	Inflation targeting
Inflation	• 1979 - 82 average of 7.6% • 14.8% high on Mar-1980	• 1990-2000 average of 3% • Peak of 3.3% on Mar-1993	• 2012-2022 average of 2% • 8.5% high at Mar-2022
Policy rate move	Rate rose from 11.2% average in 1979 to a peak of 20% in Jun-1980	+300bps hike from 3% to 6% in 12 months, including 2* 50bps hike and 75bps hike	+25bps in Mar-2022 to 0.25% - 0.50% • Markets pricing in another +240bps hike, including 3*50bps hike for May, Jun and Jul FoMCs
Changes in 10y UST Yield	• 1972-82 average of 9% • High of 15.8% in Sep 1981	• 1990-2000 average of 6.5% • High of 7.9% in Nov-94	• 2012 - 2022 average of 2% • Last at 2.85%
Changes in DXY	+49% from 1980 trough to 1982 peak	-17% decline from start of 1994 (peak) to 1995 trough	+13% from May-2021 trough (first Fed's hawkish pivot) to current

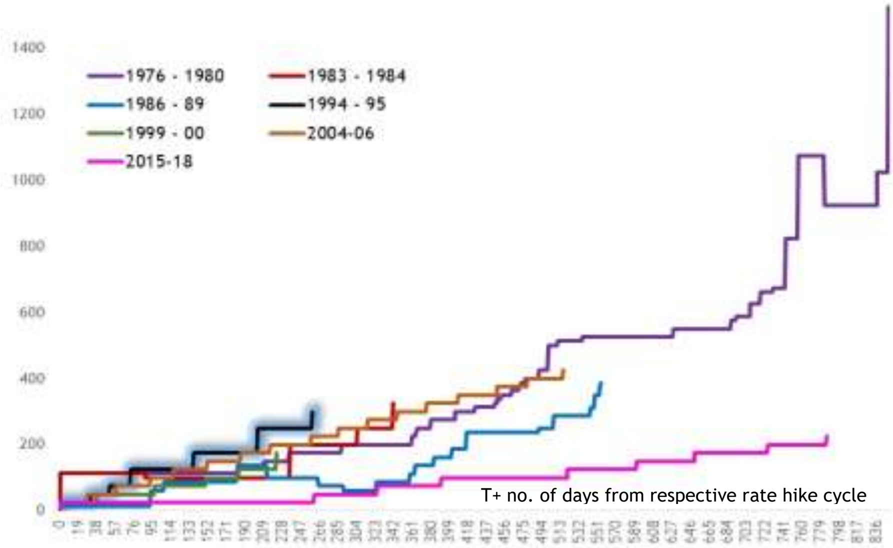
Source: Maybank FX Research & Strategy

Rate Hike Cycle: More Like 1994 than 1980

Today's environment does not warrant a Volcker-shock but a case of front-loading of rate hikes to arrest inflationary pressures. In fact, Fed's Bullard cited the 1994 tightening cycle as an analogy on how fast Fed should move.

- That cycle was indeed one of the fastest but most compressed cycle since 1980s, where then-Fed Chair Greenspan tightened by 300bps over a 1y period in 1994-95, which included two 50bps hike and one 75bps hike. "Soft-landing" was achieved, recession and inversion of 2y10y yield curve was also averted.

Current Cycle More Like 1994 Cycle of Fed Front-loading Rate Hikes



Source: Bloomberg, Maybank FX Research & Strategy

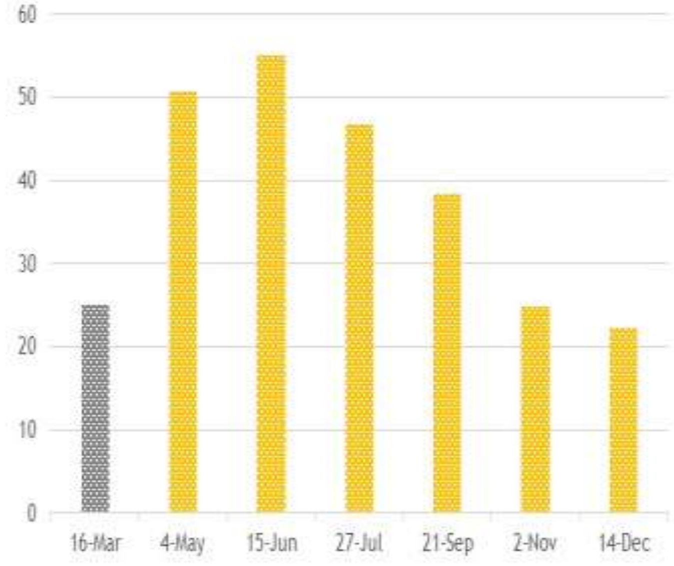
Next Few Fed Hikes Likely in Clips of +50bps

Several Fed officials also spoke about moving policy stance to neutral or restrictive. Fed's estimation of neutral is around 2.4% while Fed's dots plot and 30d fed fund futures (markets-implied) expects rates to peak around 2.75% in 2023-24 and 3.43% in Nov-2024, respectively.

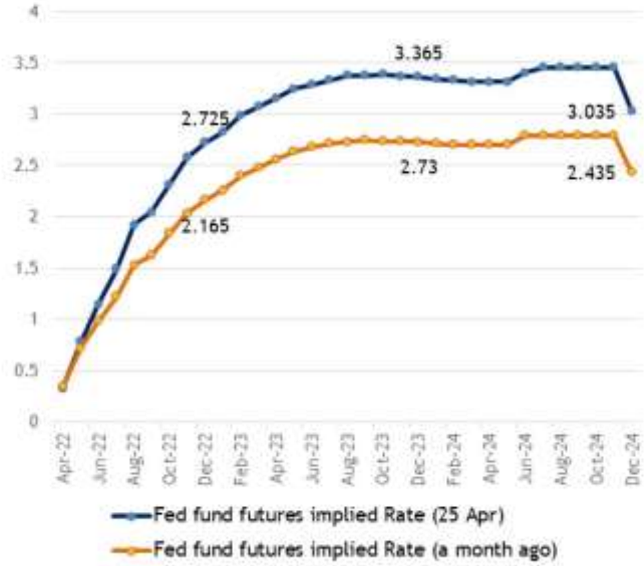
Last week, Fed Chair Powell said he saw merit in the argument for front-loading rate hikes and that 50bps hike will be "on the table" for 4th May FoMC. Daly (non-voter) said 50bps hike are likely at a couple of FOMCs. She also said *that a near-certain series of interest rate hikes over the coming months could tip the economy into a shallow recession, though she noted that isn't her expectation.*

OIS-implied (as of 25 Apr) shows further front-loading of rate hikes with 50bps hike priced for next 3 FoMCs (in May, Jun and Jul), up from 2 FoMCs previously while about 56% probability is priced for Sep FoMC. For the year remaining, Fed fund futures are expecting another 243bps rate increase (equivalent of 9 – 10 hikes of 25bps each).

3 Hikes of +50bps Each Priced for Next 3 FoMCs



Market Re-pricing for Steeper Rate Hike Trajectory



Note: As of 25 Apr 2022
Source: Bloomberg, Maybank FX Research & Strategy

The **potential scale of Fed rate increase this episode is expected to be sharp but may still pale in comparison to the Volcker-shock in 1980**. Moreover, expectations for steeper rate trajectory and faster pace of rate hike expectations are already in the price (thanks to forward guidance today unlike in 1980).

Near Term Caution for USD Strength Remains…

On this note, we stick to our caution that **<u>in the near term, USD could still see intermittent upward pressure</u>** (USD smile of risk aversion, US data outperformance/monetary policy divergence) **but USD upside may not mirror the 1980s episode of high double-digit gains**. Instead, we see USD as nearing its peak unless global growth slumped into recession, disorderly market sell-off (i.e. CNH rapid depreciation) or war in Ukraine broadens to more territories /further escalates (nuclear, etc.). DXY resistance at 102, 102.98 levels.

… But DXY Closer to Peak

Potentially, we could transit into a scenario of (1) inflation peaking and (2) policy focus potentially shifting towards engineering a soft landing (from combating inflation). This scenario could see UST yields come off while yield curve flattens. This may also imply that pace of USD gains could also start to ease or even turn lower in due course.

We further opined that one should not rule out the case of buy rumor, sell fact in the lead up to 4th May FoMC. The run-up in UST yields could ease when QT, rate hike announcement is made. We also noticed the gradual paring down of long USD positioning even as DXY continued to test fresh multi-year highs. The divergence between higher DXY and easing DXY long position is not sustainable in the medium term. Further unwinding in USD long will exert downward pressure on price.

Divergence in Price vs Position Not Sustainable in Medium Term

Source: Bloomberg, Maybank FX Research & Strategy

Background – US TWI Rose Double-Digit % in 1980s

Fed's US TWI index (USD vs. G10) indicated a 48% appreciation in USD from 1980 trough to 1982 peak. Separately over a longer period from 1980 trough to 1985 peak, US TWI appreciated about 88%.

Sharp Rise in Fed Trade-weighted USD vs G10 FX in 1980s

Source: Board of Governors of Fed Reserve System

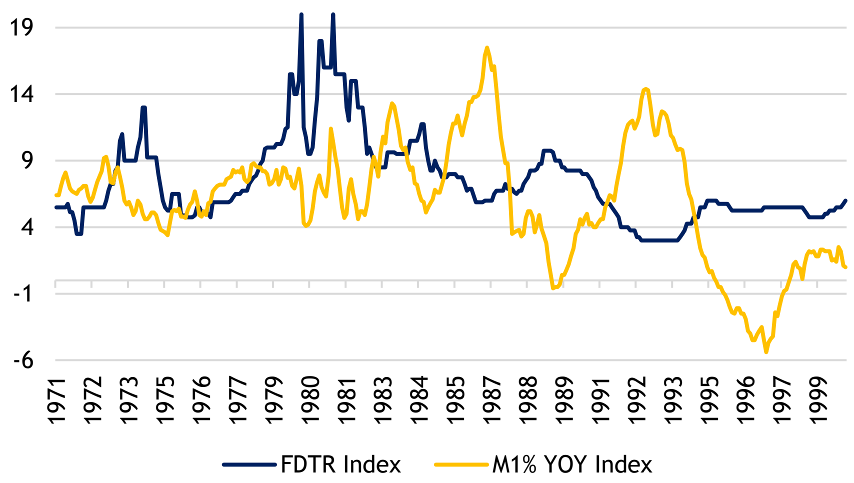
USD's appreciation back then and the environment (late-1970s to early 1980s) – high inflation, high oil prices (Iranian revolution resulted in oil output decline and worries of further supply disruption), aggressive Fed tightening (under Volcker) to combat inflation - looked similar to today's environment of inflation scaling multi-decade highs, sharp rise in oil prices amid war in Ukraine and post-pandemic demand as well as Fed guiding for faster pace of tightening (to neutral or even restrictive).

We attempt to look at 2 parts: (1) though the macro situation then and today looks similar, circumstances such as policy regime, market environment differs; (2) USD strength back then was not solely due to interest rate differential but also other factors (next subsection).

(1a) Policy Regime and Market Environment Differs

Between Oct-1979 and Oct-1982, the Fed under Volcker changed its monetary operating procedures to de-emphasize fed fund rate as operating target and increased commitment to **target the quantity of money** — specifically non-borrowed reserves. FOMC members then expected that the new approach to monetary policy would result in greater volatility in the fed funds rate. Below chart shows how the average fed funds rate fluctuated greatly between 1979 and 1982. In 1980, U.S. inflation peaked. The dollar moved up and down in response to much greater swings in U.S. interest rates as a result of the Federal Reserve's pursuit of monetary targeting and the imposition and relaxation of credit controls[1]. It was also argued that the change in operating procedures did not result in improved monetary control[2]: fluctuations in M1 growth increased, rather than decreased as might have been expected, and the Fed missed its M1 growth targets in all three years of the 1979-82 period.

Fed Fund Rate and M1 Growth Remained Volatile in 1979 - 82 Period



Source: Bloomberg, Maybank FX Research & Strategy

Former Fed Chairman Ben Bernanke had also shared[3] how monetary aggregates have not been more influential in US monetary policymaking

[1] https://ies.princeton.edu/pdf/E170.pdf
[2] https://www0.gsb.columbia.edu/faculty/fmishkin/PDFpapers/00BOMEX.pdf
[3] https://www.federalreserve.gov/newsevents/speech/bernanke20061110a.htm

despite the strong theoretical presumption that money growth should be linked to growth in nominal aggregates and to inflation.

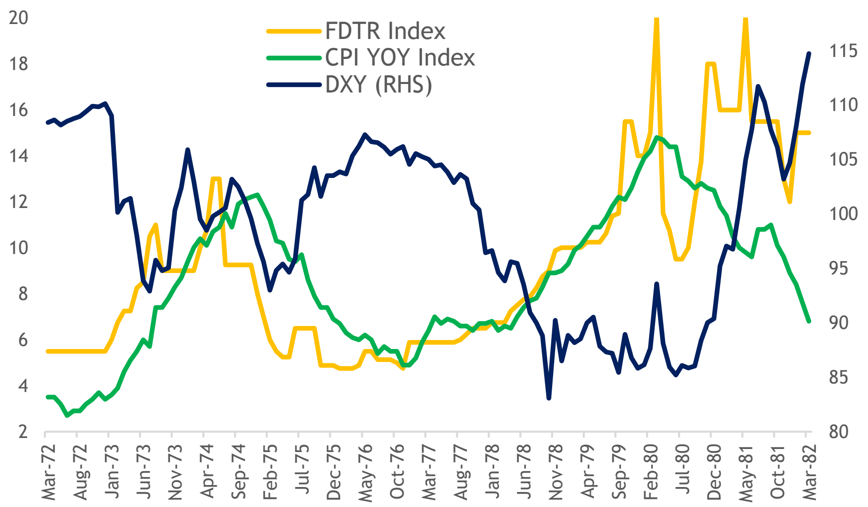
In practice, the difficulty has been that, in the United States, deregulation, financial innovation, and other factors have led to recurrent instability in the relationships between various monetary aggregates and other nominal variables. For example, in the mid-1970s, just when the FOMC began to specify money growth targets, econometric estimates of ***M1 money demand relationships began to break down, predicting faster money growth than was actually observed****. This breakdown--dubbed "the case of the missing money" by Princeton economist Stephen Goldfeld (1976)--significantly complicated the selection of appropriate targets for money growth.*

Similar problems arose in the early 1980s--the period of the Volcker experiment--when the introduction of new types of bank accounts again made M1 money demand difficult to predict. Attempts to find stable relationships between M1 growth and growth in other nominal quantities were unsuccessful, and formal growth rate targets for M1 were discontinued in 1987

Today, Fed's policy is no longer about using monetary aggregates to guide FoMC policy – a change since Feb 1994 by Alan Greenspan. Fed policy since then is about inflation targeting and formal announcements of Fed setting the target interest rate (at which commercial banks borrow and lend their excess reserves to each other overnight).

Back in late 1970s - early 80s, the Fed was battling inflation that had been building for 6 – 7 years since 1973. Hence then Fed Chair Volcker needed to roll out a policy that pushed rates from 11.2% average in 1979 to peak of 20% at one point in Jun-1981 to counter double-digit inflation. But in the current situation, the Fed is dealing with a surge in inflation that only began last year

Build-up of Inflation in US Started Since 1973



Source: Bloomberg, Maybank FX Research & Strategy

US was also a net oil importer then. Higher oil prices fed into long term inflation expectations quickly and there were upward spirals. Expectations can get derailed quickly. But today US is no longer as dependent on oil imports. When it deems prices too high, it can release strategic reserves, like it recently did, and bring energy prices down.

(1b) USD Strength in 1980 -85 Was Due to Many Factors

After reviewing price action then and taking into consideration several economic literature, we found that strong USD in the 1st half of 1980 decade was due to multiple variables. Sustained signs of falling US inflation and rise in real interest rate differentials saw USD appreciating against all major FX in 1981 but these were not the only set of variables. Relative current accounts also played an important role. While the US current account swung from a deficit in the 1H 1980 to a surplus during the 2H, several European countries, including Germany, continued to run large current-account deficits. By the mid-Oct 1980, the USD began to rise against European currencies. The deutsche mark, especially, came under selling pressure as Germany's current-account deficit failed to shrink.

Various political and economic problems facing Western Europe also worked in favor of dollar. International investors were increasingly eager to place their funds in U.S. assets. However, foreigners could not lend to America because the U.S. current account was in surplus, and so the rising net foreign demand for dollar-denominated U.S. assets could result only in an appreciation of the dollar.

We also noted a paper[4] from the Princeton University that may have best summarised USD performance during the 1980 – 85 period[5].

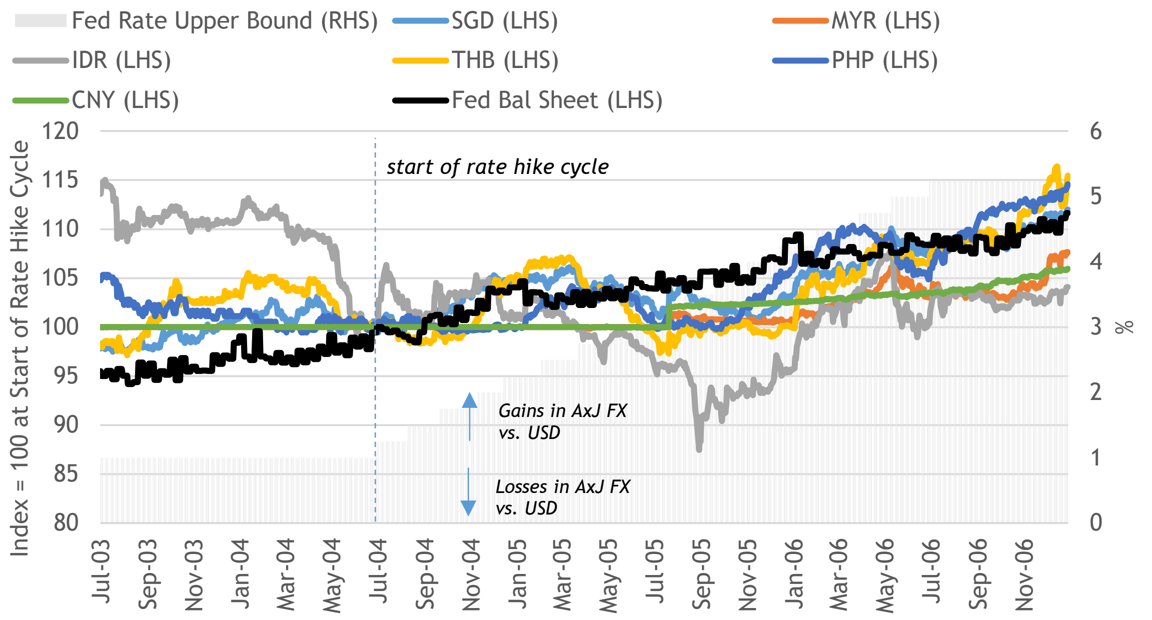
> *The elements of economic performance that promoted the dynamics of the strong dollar were the **rapid decline in U.S. inflation**, **the strong noninflationary recovery of the U.S. economy**, and **stagnation and unemployment in Europe**. These policy and performance developments interacted to give rise to a high level of relative confidence in the U.S. economy and high relative rates of return on dollar-denominated U.S. assets. The fact that the value of the dollar soared even as the U.S. current-account deficit reached massive proportions reflected not only the increasing willingness of international investors to accumulate dollar-denominated U.S. assets but also the increasing opportunity to do so in an environment of liberalization and de¤regulation of international capital flows.*

[4] E170.pdf (princeton.edu)

(2) AXJ Performance during Past Episodes of Fed Tightening

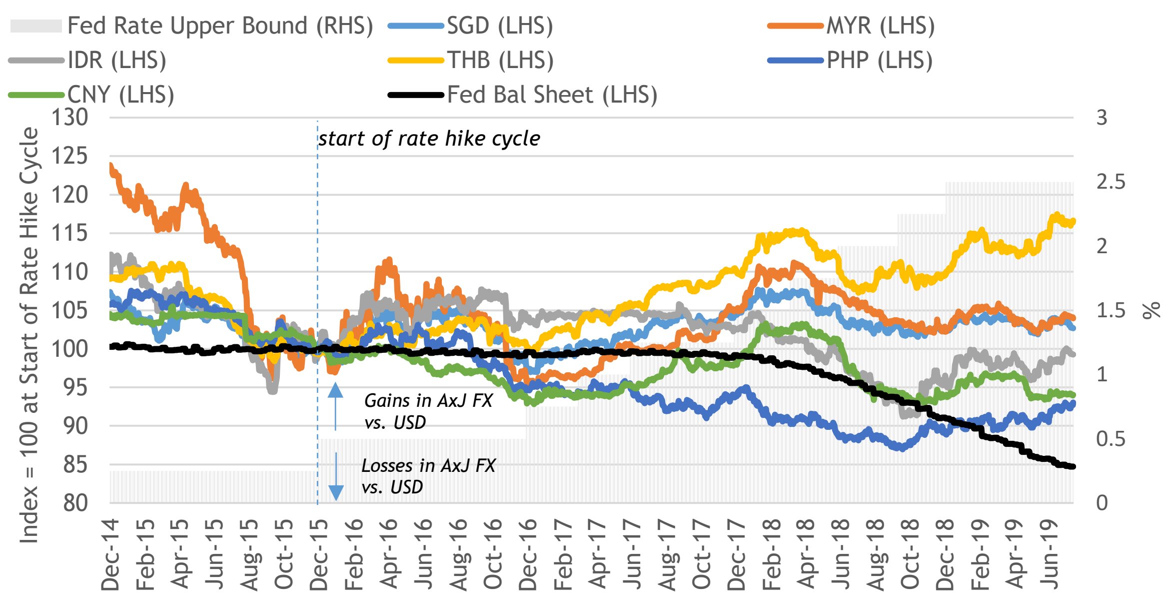
AxJ FX data is patchy pre-1990s. To understand what matters for AxJ FX in an era of Fed policy tightening, we look to the rate hike cycles in mid-2000s and 2010s.

Episode: +425bps in Fed Rates from Jun 2004 to Jun 2006



Note: Moves in AxJ FX are relative to USD. CNY and MYR were pegged/fixed in early 2000s.
Source: Bloomberg, Maybank FX Research & Strategy

Episode: +225bps in Fed Rates from Dec 2015 to Dec 2018



Note: Moves in AxJ FX are relative to USD.
Source: Bloomberg, Maybank FX Research & Strategy

Looking at the two charts above, we glean a few insights for AxJ FX, which also gel with our findings in our earlier reports.

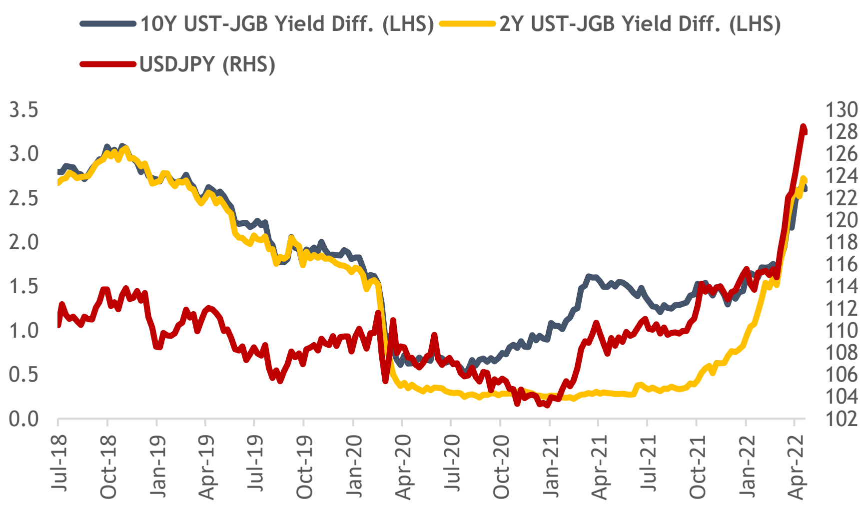
- **AxJ FX tend to see losses in the lead-up to the start of the Fed hike cycle**, with IDR, THB and MYR being more sensitive to Fed tightening messaging in such periods.
  - Still, we note that the MYR depreciation ahead of the 2015 Fed hike was likely due in part to the ~halving in brent prices from mid-2014 to late 2015. By 2H 2015, the pace of decline in oil prices had moderated, and MYR depreciation pressures had dissipated accordingly.
- With Fed action priced in prior, **AxJ FX losses tend to unwind once the actual Fed rate hike cycle starts**.
- The impact of balance sheet taper is less clear. Even though a decline in Fed balance sheet appears to dampen AxJ FX sentiments over the course of 2018, this period notably coincides with ramping up of trade tensions between US-China and concomitant yuan softness.
  - As yuan pares losses from late 2018, AxJ FX show some modest recovery as well, in spite of continued Fed QT.

(3) Taking Stock of Recent Sharp Moves in JPY and CNY

Recent FX moves show AxJ FX leaning towards caution amid elevated global risk aversion. Meanwhile, JPY and CNY depreciation narratives are also sharply in focus. While both are impacted by the earlier UST yield rally, underlying nuances are somewhat different. We look at each in turn.

For JPY, BoJ stands out as a major policy laggard as it remains committed to ultra-dovish policy accommodation. Messaging from officials were also a tad mixed earlier. FM Suzuki said a rapidly weakening JPY is bad for the economy. But BoJ has yet to shift from earlier stance that weaker JPY is net positive for economy. This absence of broader discomfort with a significantly weaker JPY has underpinned USDJPY's rise towards 130 earlier.

Earlier Spike in USDJPY Mirrored Widening in 2Y UST-JGB Differentials



Source: Bloomberg, Maybank FX Research & Strategy

But we note some signs of hesitation in USDJPY upswings recently.

- On UST yields, some retracements have occurred amid some signs of pushback from Fed officials towards Bullard's suggestion for larger (+75bps) hikes.

- Brent is also seeing modest jitters on China growth fears, and given Japan's net oil importer status, any extension of bearish oil sentiments could help exert downward pressures on USDJPY.

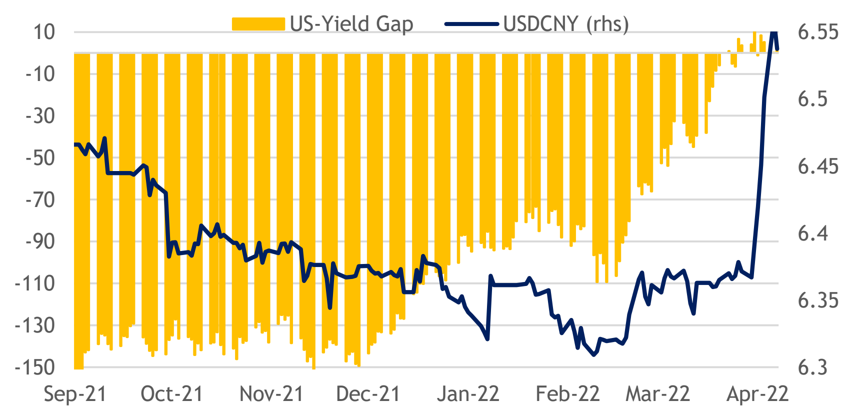
- Earlier, Yellen's meeting with FM Suzuki had also led to market chatters on possibility of coordinated FX intervention to prop up the JPY. We note that likelihood of such coordinated intervention remains low when US is trying to fend off inflationary pressures, but we do not rule out stronger retaliation from BoJ (e.g., adjusting YCC yield cap) if more one-way moves (higher) in USDJPY materializes at a rapid pace.

- On net, key resistance at 130 could still help resist interim up-moves. Any advances past 130 could see rally slow in pace; next resistance at 135.15 (2002 high).

Meanwhile for RMB, recent bout of softness can be tied explicitly to rising domestic Covid risks. On 13 Apr, President Xi vowed that China needs to adhere to "Covid Zero" even as "economic costs mount". Shanghai started its partial lockdown on 28 Mar which quickly transformed into a broader lockdown for the city and there are speculations of the same happening to Beijing soon as Covid infections rise there.

Strict adherence to zero-Covid strategy saw USDCNY finally breaking out from a long-established 6.30-6.40 range, spurred all the more by a stronger-than-expected USDCNY fix (+101pips above median estimate on 20 Apr) by PBoC. The US-CH yield spread has also recently inverted into a premium, adding to the list of factors for USDCNY to rise. As a result, USDCNY ascended from a low of 6.3691 on 20 Apr to a high of 6.5774 on 25 Apr, a +2.2% move. The move was led by the USDCNH pairing which rose more than +3.5% from 6.3777 on 19 Apr to a high of 6.6092. USDCNH-USDCNY premium widened to close at 300pips at one point before narrowing to 260pips at last sight.

US-CH Yield Gap Has Inverted into a Premium

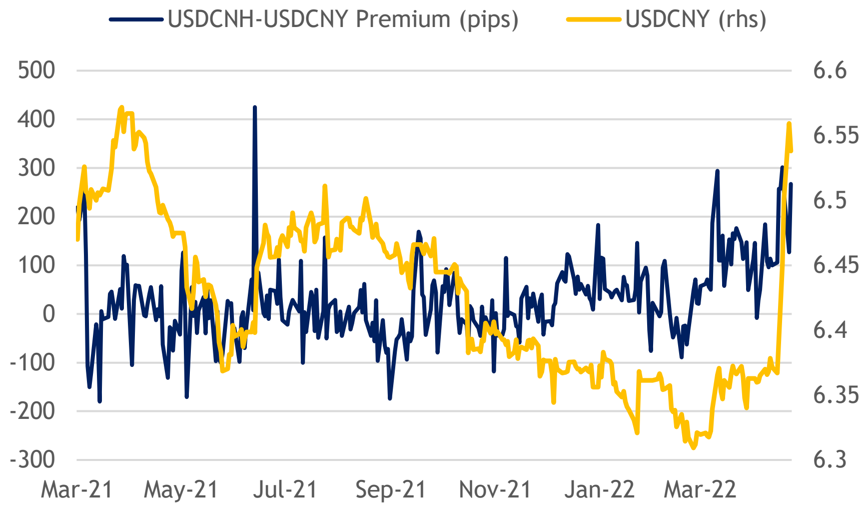


Source: Bloomberg, Maybank FX Research & Strategy

After five consecutive days of USDCNH rally, PBoC announced a lowering of the forex deposit reserve ratio by 1ppt late evening yesterday (25 Apr). PBoC stated that it is a move "to increase banks' capabilities of forex fund use". This move was followed by a modestly lower-than-expected USDCNY fix this morning (26 Apr) and more pledges of support for the real economy from the central bank.

This combination was successful in lifting Hang Seng Index and CHINEXT from recent lows and allowed USDCNH to take a breather after a strong rally. The timing of the forex RR cut announcement suggests that 6.60 could be an interim resistance for the pair but with Apr PMI data due this weekend, we cannot rule out further yuan weakness. Any confirmation of a broad lockdown in Beijing or infection spread could also weaken yuan sentiment. We think USDCNH could find support at around 6.5450/6.5080. Resistance at 6.60 before 6.6470.

Widening USDCNH-USDCNY Premium Suggest Rising Pressures on the USDCNY



Source: Bloomberg, Maybank FX Research & Strategy

More broadly for AxJ FX, we think that **aggressive pace of Fed rate hikes has been priced in somewhat**, and the **recent bout of 1-2% declines among regional FX capture deterioration in sentiments regarding global growth outlook (IMF and World Bank downgrades), reflecting risks of China slowdown amid extended lockdowns as well as persistent drags from ongoing war in Ukraine and protracted sanctions on Russia**.

Critically, above-mentioned **yuan depreciation pressures have spilled over quickly to AxJ FX, similar to what happened during the emerging trade war in 2018**. In particular, **MYR's sensitivity to negative shifts in global growth outlook could be magnified given that its economy is more exposed to external/China demand, and its dependence on oil export revenues** (*elaborated below in MYR section*)**.**

In comparison, while other regional FX are similarly down versus the USD MTD in Apr, the magnitudes of softening are more modest.

- IDR sees support from elevated commodity export prices, even as latest partial ban on palm oil exports introduces new uncertainties (for perhaps 1-2 months).

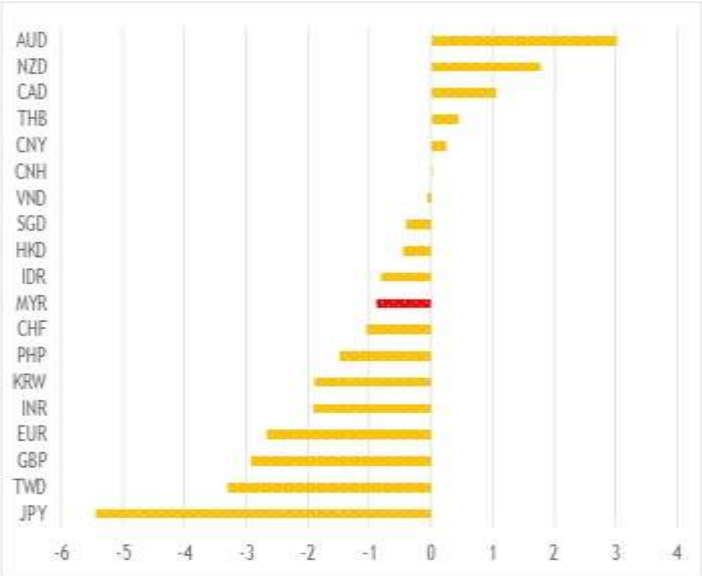
- For SGD, MAS' front-loading of policy tightening (Oct, Jan off-cycle slope steepening, followed by band recentring and slope steepening in Apr) and continued reopening stance bodes well for sentiments.

- For PHP and THB (net oil importers), losses were more pronounced in late-Feb to March when Ukraine war led to a sudden shock in oil markets. Entering 2Q, oil has moderated from highs albeit remaining in elevated ranges. Similarly, both FX are trading near the lower end of 2022 ranges, but moves may be less one-way going forward.

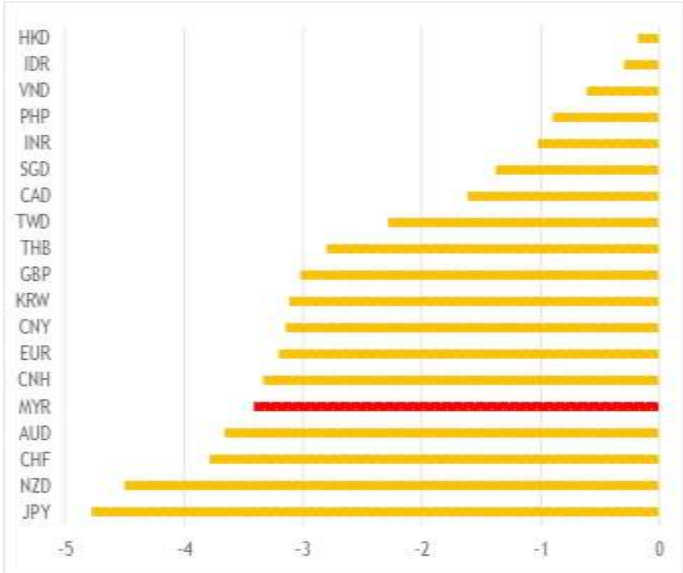
(4) MYR Moves – Causes and Outlook

Spot USDMYR is currently at around 4.3520. It was at 4.2040 at end March. On YTD basis, MYR fell by 3.3% vs. USD but the bulk of the losses accelerated in 2Q as some underpinning factors start to deteriorate.

MYR Not the Biggest Loser in 1Q



MYR Losses Accelerated in 2Q



Source: Bloomberg, Maybank FX Research & Strategy

MYR weakness was largely driven by exogenous factors, including the continued rise in UST yields, USD (further triggered by hawkish comments from Powell and Daly), sharp and continued decline in CNH (of which MYR has a strong correlation to), IMF's downgrade of global growth, risks of China slowdown amid extended lockdowns, slippage in oil prices and ongoing war in Ukraine (sentiment, china proxy play). The latter's move was mirrored in the MYR move vs USD. The USDCNY was at a low of 6.34

at end March and has since moved to 6.57 levels (as of 26 Apr), reflecting the close correlation between the two currencies relative to others in the region.

- Recent Fed speaks turned more hawkish. OIS-implied now shows further front-loading of rate hikes with +50bps fully priced for May, Jun and Jul FoMCs. To some extent, Fed's comments from Powell also prompted another increase in rate hike trajectory. Previously, markets were pricing about 9 hikes (of 25bps each) remaining for this year but this has shifted slightly more hawkish as OIS-implied now shows about 10 hikes this year.

- We also note that MYR's sensitivity to abovementioned global/China risk events could be magnified given that its economy is more exposed to external demand (exports at 61% of GDP in 2020, second-highest among ASEAN-5 just behind SG), and that share of trade linkages are with China are outsized at just below a quarter.

- On monetary policy, BNM is also expected to lag most regional peers in terms of rate hike cycle— our house view only expects 1 hike this year, reflecting increasing divergence with Fed's hawkish signalling.

- Brent crude prices have also declined by 25% since hitting a peak of $139/bbl in early-Mar. Softer oil prices was also due to growing concerns of weaker demand from China amid extension of covid lockdowns in Shanghai and possibly in Beijing. There is also reports of Libya restoring production in coming days while EU Foreign policy chief had earlier commented that EU member states do not agree to full embargo on Russian oil. Softer oil prices amid weaker demand will weigh on net-oil exporter, MYR.

USDMYR (Weekly): Bullish but Overbought

USDMYR spot last at 4.3530 levels. Bullish momentum on weekly chart intact though RSI is rising into overbought conditions.

Sustained price action above 4.3420 levels (76.4% fibo retracement of 2020 high to 2021 low) could see next resistance at 4.38, 4.40 levels. A decisive break above could see USDMYR re-visit 2020 pandemic high of 4.4490 levels.

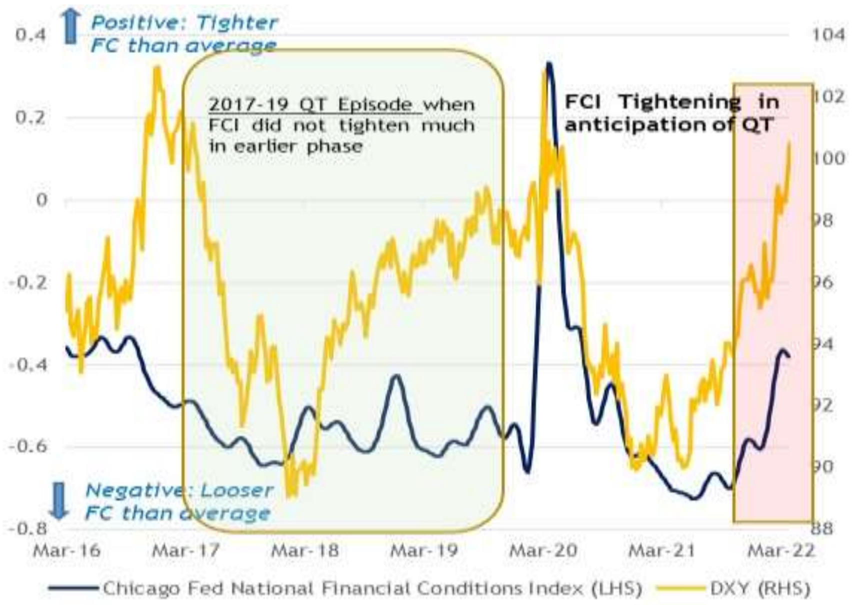
Support at 4.3420, 4.2760 (61.8% fibo) and 4.2220 levels.

Concluding Remarks

In the next several months, the fate of AxJ FX could be more intertwined with shifts in yuan/China growth outlook, versus Fed policy stance, unless Fed springs a negative surprise in QT parameters.

- Currently, Fed proposed balance sheet run-down with a cap of $95bn/month ($60bn in Treasuries and $35bn in MBS) – this is nearly 2x the peak cap of $50bn/ month in the 2017 – 19 QT episode, and in line with market estimates. The run-off should see a vote and confirmation at the next FoMC meeting (4th May), with roll-off commencing as soon as in May or Jun.
- The reality of Fed double tightening (balance sheet run-off and rate hikes) is not new but is coming closer (in terms of timeline). Uncertainty on this front may undermine risk assets and provide temporary support for the USD.
- We note that while financial conditions did not tighten much during QT in 2017 -19, financial conditions are tightening this time round since 4Q 2021. Further tightening in financial conditions can undermine risk sentiments and lend support to USD.

Financial Conditions Tightening This Episode



Source: Bloomberg, Maybank FX Research & Strategy

A more adverse scenario would be if a lack of promised follow-through in policy support dampens domestic macro activity, and continued outflows from Chinese assets drag on the yuan further, weighing on AxJ FX for longer.

For USD-AxJ pairs to revert to a downtrend, we would require clearer signs of turnaround in sentiments in China, perhaps when curbs start easing in the weeks ahead or when authorities announce more discernible policy support. The FX deposit RR cut yesterday (which allows greater injection of FX liquidity into onshore market) is a good start, but might not be sufficient to turn the tide for now.

Markets would also require more certainty that we've reached the end of hawkish surprises from US Fed. In past Fed tightening episodes, AxJ FX tend to see losses against USD heading into the Fed rate hike cycle, but these losses tend to unwind as expected rate hikes proceed. Next FoMC on 5th May 2am (SG/MY time) could be crucial.

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