iFlow
MACRO MORNING BRIEFING

July 18, 2024

Flows and Valuation Supportive for KRW

Global tech recovery and insatiable AI demand have greatly benefited South Korea as well as Taiwan. After strong Q1 GDP growth, at 1.3% q/q and 3.3% y/y, the South Korea Leading Indicator index points to further upside momentum in the coming one or two quarters. Business and consumer confidence posted good gains, supported by strong exports and production growth. The Korea June PMI surged to 52.0, the highest reading since April 2022 (52.1), following a prolonged period of contraction since H2 2022. Industrial production eased off its January 2024 highs of 13.4% y/y but remains at a respectable 3.8% y/y growth rate as of May. The most significant contributors are in the export sector, especially semiconductors and automobiles, both in terms of volume and prices.

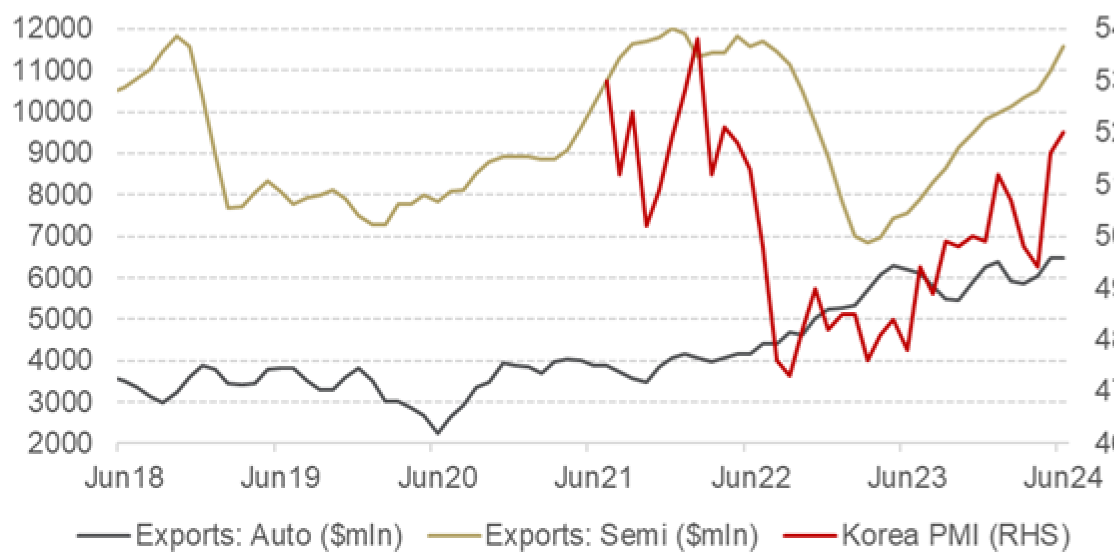
Note that the average prices for South Korean automobiles shipped overseas hit new record highs in H1 2024 at $25,224, according to the Korea Automobile & Mobility Association. Korean exports of information and communication technology (ICT) hit 28.2% YTD y/y as of June, totaling $108.9bn or 31.1% y/y in June.

While exports and the manufacturing sector are charging ahead, the recovery of domestic demand has been mixed. Corporate refinancing pressure, especially in the real estate sector, household indebtedness and loan delinquency rates are some of the frequently cited issues. South Korea has the highest debt-service ratio in the private non-financial sector at 23.6% in Q4 2023, according to BIS.

The overall tightening of availability of funding or rising credit risks is best reflected in the latest Loan Officer Lending Survey, which showed a broad tightening of lending standards in

Q2. This trend is forecast to continue into Q3 for both corporate and household loans. The lending standard for SME corporates, with an index of -11, is the most negative reading since Q1 2017, and household non-mortgage loans is the most stringent of all at -19 as of Q3 2024.

Exhibit #1: Korea Semiconductor and Auto Export Growth and Improving PMI Sentiment



Source: BNY

Despite the improving growth profile, the lower inflation trajectory, with June headline and core CPI at 2.4% y/y and 2.2% y/y from 3.2% and 2.8% y/y at the end of 2023, has prompted a subtle shift in the Bank of Korea's policy member bias and interest rate expectations over the past two months. While BoK has kept rates unchanged at 3.5% this year in a unanimous decision, two members were open to a rate cut at the latest policy meeting in July, compared with only one dovish biased member in the April and May meetings.

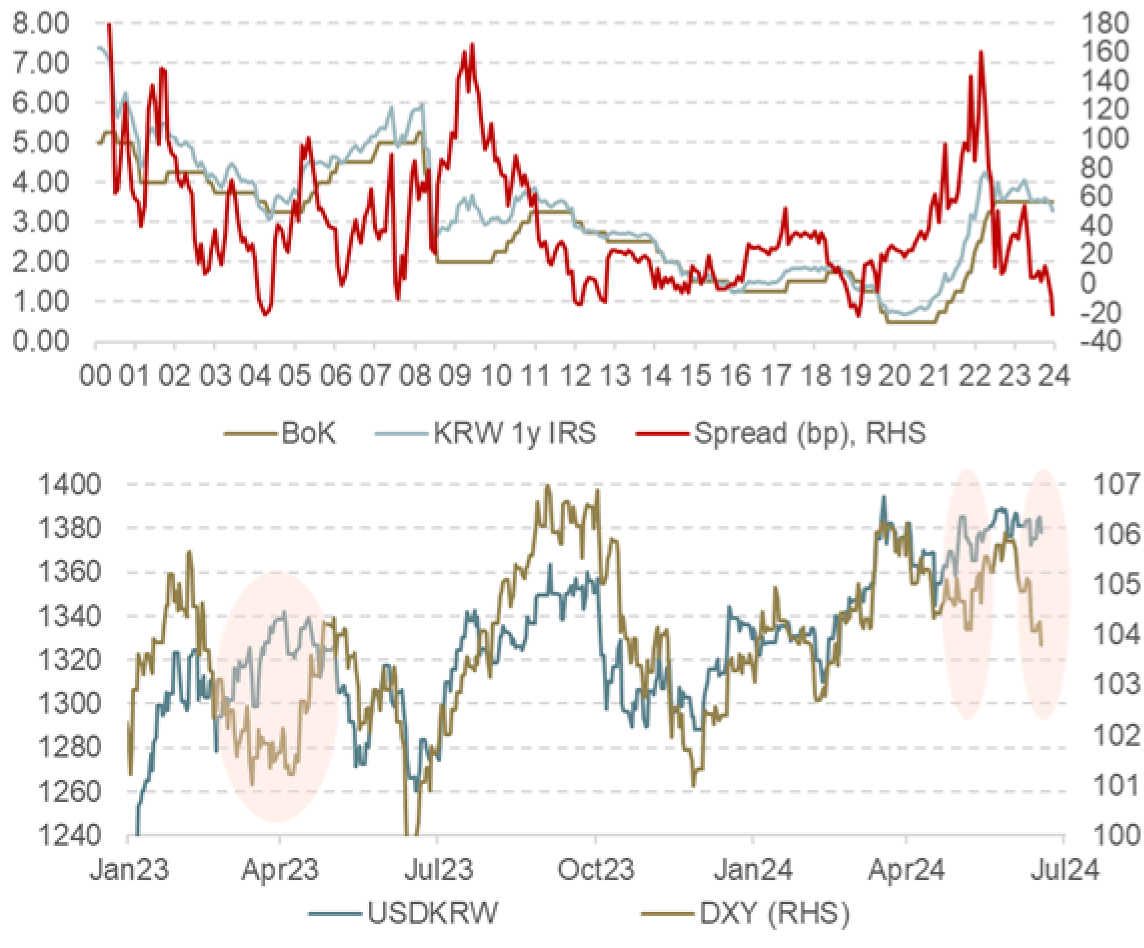
With no prospect of an aggressive policy easing, both in terms of timing and magnitude, the current market expectation has, in our opinion, run too far ahead of itself. The spread between the KRW 1yr interest rates swap and base rate is at a historic low of around -20bp (see chart).

Despite the BoK warning that market expectations of rate cut are somewhat excessive, the front-end rate continues to drift lower. We think this might be one of the factors contributing to the dislocation of USDKRW against the USD dollar in recent weeks. USDKRW had been sticky on the upside despite a softer USD dollar, strong equities performances and accelerating portfolio inflows into both equities and the fixed income market.

Indeed, there have been a few episodes of USDKRW-USD dollar dislocation, most recently in late May 2024 and April 2023, with individual and idiosyncratic drivers (see chart).

In short, we respect market dislocations as a normal market dynamic, but we are also convinced that they are not sustainable. With solid and improving fundamentals, there is no reason why the Korean won should be the worst performing currency in APAC. The valuation of the won is attractive.

Exhibit #2: Excessive Rate Cut Pricing and USDKRW-DXY Dislocation



Source: BNY

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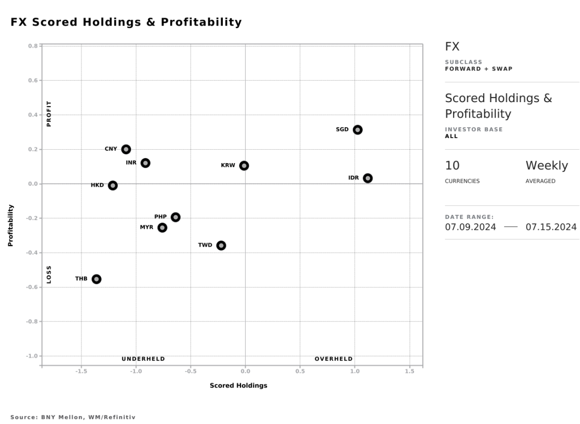
iFlow shows mixed APAC FX flows over the past week. Outflow pressures were dominated by the Philippine peso, with PHP-scored holdings falling deeper into underheld territory. One consolation for the PHP outflows was the surge in demand for domestic bonds. Elsewhere, the mood in APAC FX is generally positive, supported in part by a softer US dollar as well as the risk-on mood. Note that iFlow Mood is positive and statistically significant, while iFlow

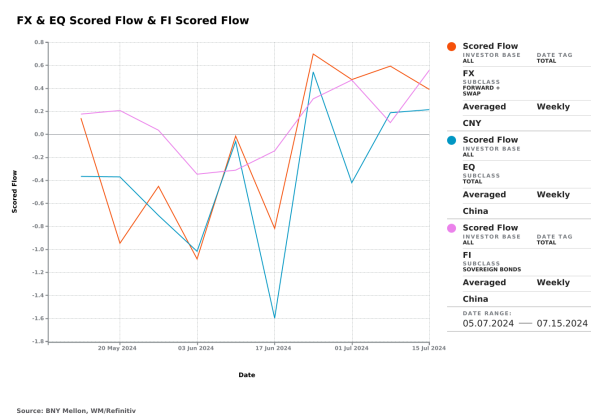
Carry is fast approaching neutral levels from a previously negative and significant zone.

The most notable observation is the positive shift in investor tone toward China. The latest iFlow data shows demand into the Chinese currency, equities and sovereign bonds, with a flattening out of selling pressure in the corporate bond space. Elsewhere, Korean won inflow momentum continues into its 13th straight week, along with accelerating demand in the equities space. Korean won-scored holdings are neutral, from -0.5 at the beginning of the year. Deficit-related outflow pressure on the IDR subsided in June and has posted steady inflows into currencies, equities and the sovereign bond space since the beginning of the month.

Lastly, the recent rally in APAC currencies saw the profitability of THB, MYR and PHP turn negative, joining TWD in the underheld and unprofitable quadrant.

Exhibit #3: iFlow Showed a Positive Shift in Sentiment Toward China





Source: BNY

Disclaimer & Disclosures

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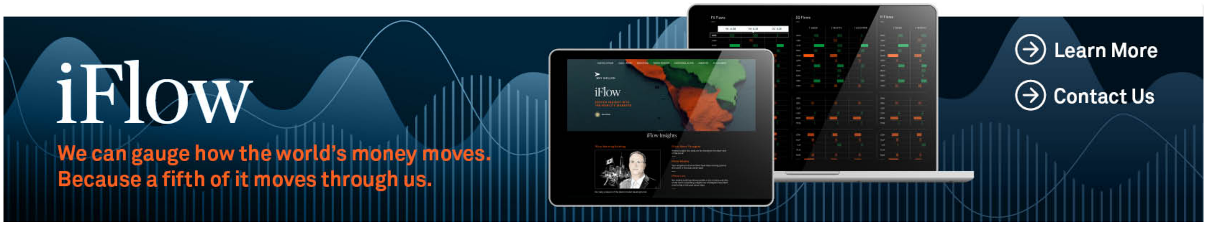

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