BNY

iFlow

MACRO MORNING BRIEFING

September 12, 2024

APAC FX's Crude Opportunity

Brent decline can further support APAC FX

- Savings buffer to improve further as import bills fall
- Potential FX reserve improvement may boost currency resilience
- Passing on gains to households can provide a true valuation lift

Balance of payments strength to solidify regional currencies

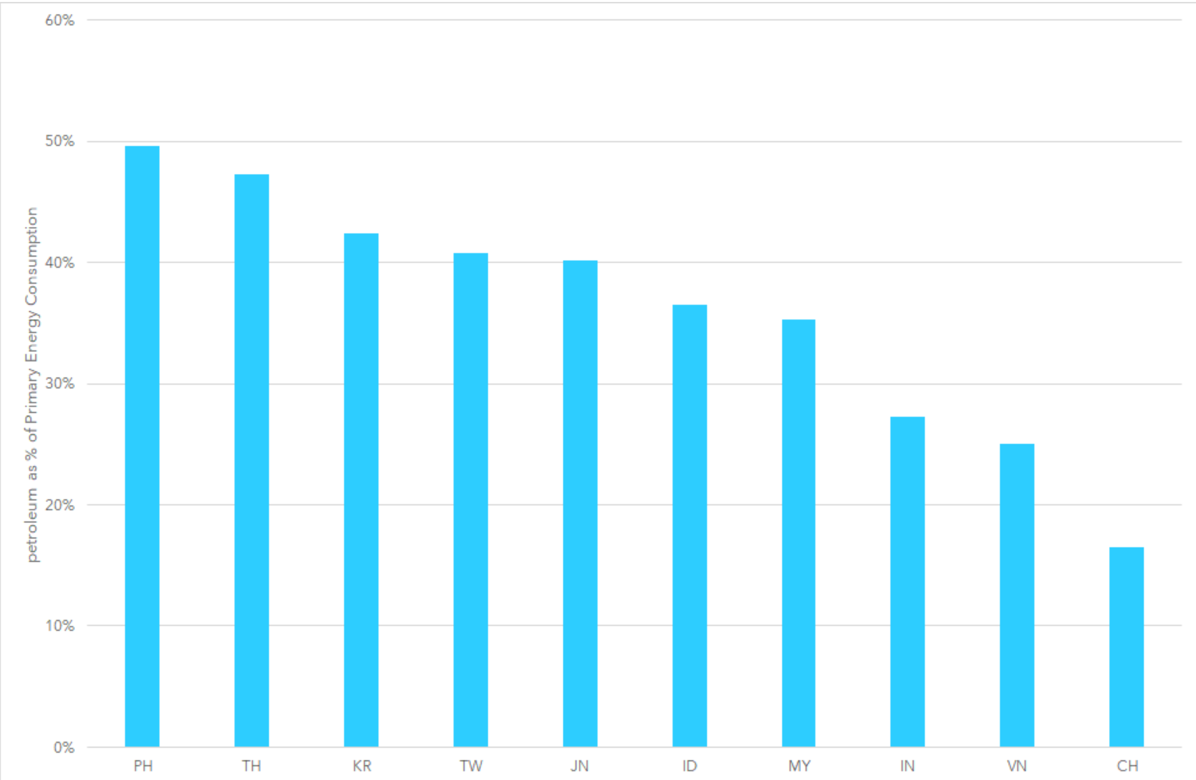
One of the key features of global balance of payments during the supply shock in recent years was the sharp rise in energy import bills. However, the manifestation of such pressures came in different forms. In developed markets, the wage-price spiral required aggressive rate hikes to control. In frontier markets with severe exposure to imported energy, FX reserve levels fell sharply and the International Monetary Fund (IMF), in hindsight, must feel relieved that balance of payments crises were generally avoided; similar to G10, very large rate hikes were part of the painful solution and these economies will be last in line to cut rates.

In APAC, the energy price shock was also material, and traditional surplus countries even ran trade deficits for brief periods to account for the rise in import bills. However, at the same time, traditional impulses of manufacturing-driven economies kicked in and, in general, economies in the region were able to exercises very strong wage restraint to avoid exacerbating the rise in producer costs and jeopardize competitiveness. Meanwhile, China's relative late exit from COVID and lack of synchronicity with the global growth cycle at the time also acted as a form of demand restraint. However, the end result across Asia was that nominal rates did not rise sharply compared to peers, but to the detriment of currencies, with some esoteric exceptions such as IDR and INR.

However, now the process has begun to reverse. Brent crude futures appear to have fallen decisively below $70/bbl and the global demand outlook means the risk to prices is skewed to the downside. Although export volumes also look set to soften, further domestic demand weakness means that balance of payments will probably improve up ahead and potentially provide currencies in the region with a valuation lift. Even if current accounts are stable, rate differentials relative to the dollar and other EM currencies are no longer moving against the region, and we expect further improvements in asset allocation as a result.

In the near term, the marginal lift from lower energy import bills could have a substantial impact on flows given the scale of declines in energy prices. Exhibit #1 shows the primary energy consumption exposure ratios of key APAC economies, using data from the US Energy Information Administration. The ratios are calculated based on the amount of petroleum and other liquids consumed as a share of total consumption. We can see the economies most exposed to oil, which we define as having petroleum consumption ratios above 40% of the total, represent economies across the value-added manufacturing chain. The Philippines and Thailand stand to see the largest improvements, but the strongest presence felt in the global manufacturing chain would be the potential for declines in input costs for Korean, Taiwanese and Japanese exports, which in turn could help tame global inflation as well.

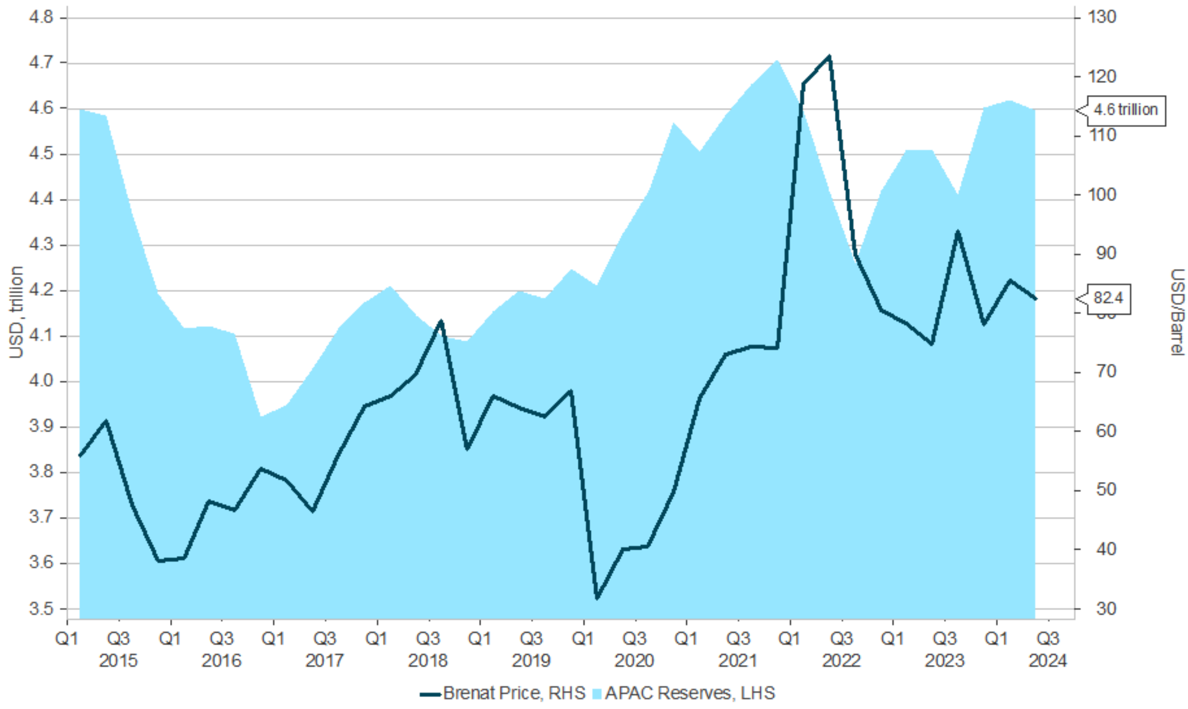
Exhibit #1: Primary Energy Exposures in APAC (2022)



Source: Energy Information Administration, BNY

Another increasingly important anchor for currencies in a global risk-off environment would be reserve buffers – a point that needs no reminding in APAC. Traditionally, reserves are meant to help cover several months' worth of import needs. There were some material risk cases in 2022 across emerging and frontier markets, though in APAC perhaps the most high-profile stress case was Sri Lanka, and even there some of the financing issues were self-inflicted. At present Pakistan's situation is still being closely monitored. However, for the rest of the region reserve buffers are ample, and we believe the current run lower in oil prices can provide the region with a further lift assuming other current account components remain the same, given the historical relationship between the two (Exhibit #2). We acknowledge that financing gaps and twin deficits in key developed economies never attract the discount which fundamentals support, but this does not mean that asset allocation shouldn't increasingly favor surplus economies either. As the outflow risk from low rates ebbs, regional currencies should see further support as excess savings stay onshore.

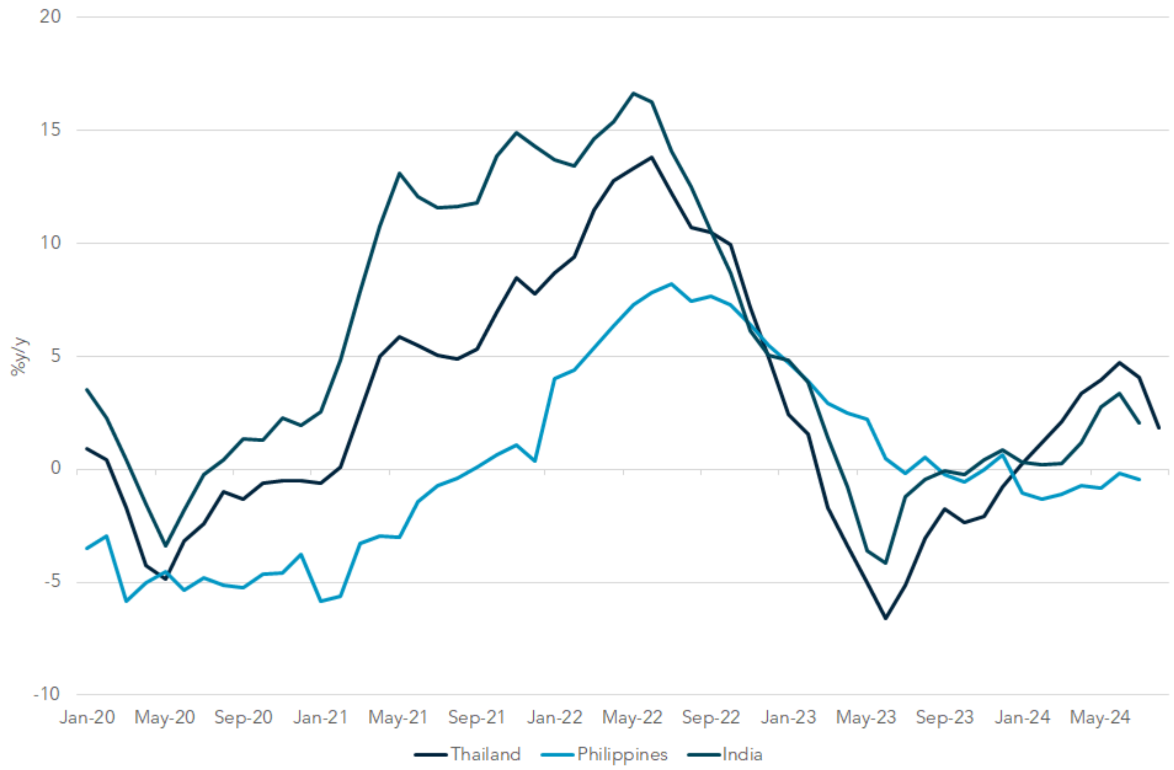
Exhibit #2: FX Reserves vs. Brent Prices



Source: Macrobond, BNY

Returning to the issue of producer prices and the risks to the rest of the world in an increasingly fierce market for high value-added goods, there will be an immediate impact on input costs as raw material and energy production expenditures fall. Given that wages were not the biggest factor behind inflation in APAC in the first place, or at least not to the level seen elsewhere, this will only strengthen net income streams for the region and support asset allocation through equities as well as FX. We can see that for Thailand, the Philippines and India, for example, PPI has already peaked whereas in the Philippines output prices are falling (Exhibit #3). These countries are not considered key high value-added exporters yet, but there is clear scope for improvement as the new trend of "friendshoring" or "derisking" allows them to take advantage of relatively low labor costs, and this will now be complemented by lower input costs.

Exhibit #3: PPI, Thailand, India, Philippines

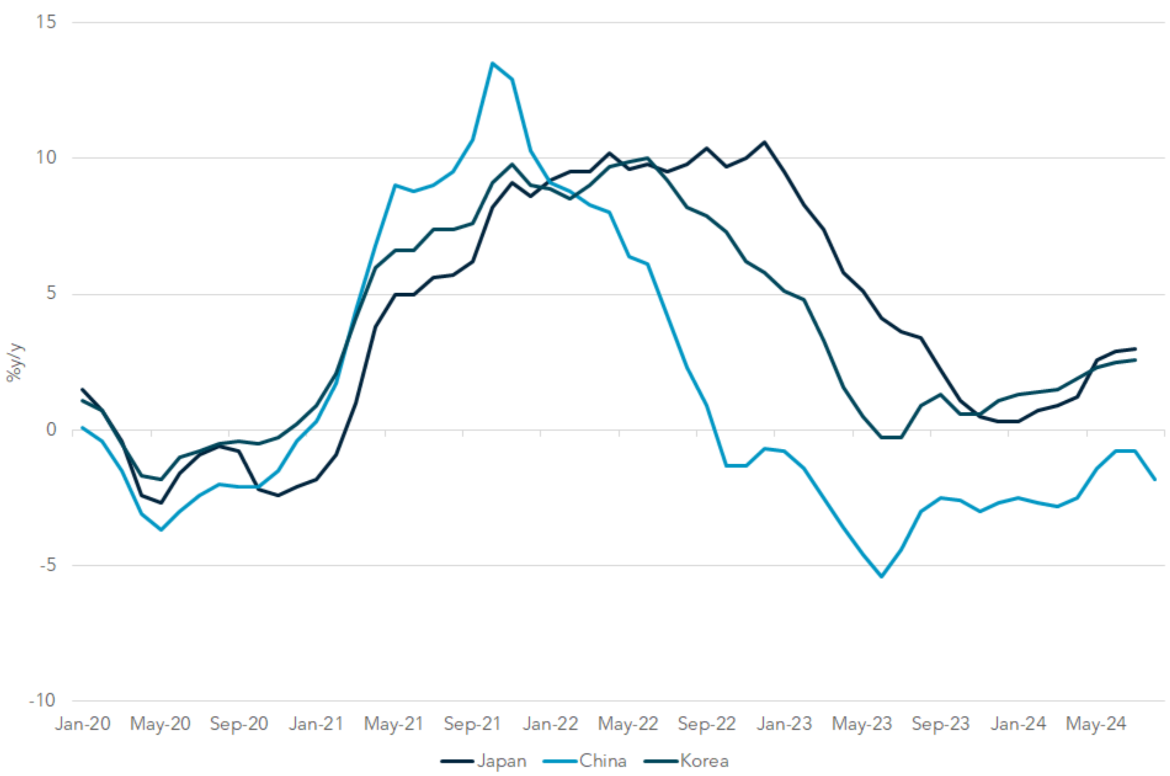


Source: Bloomberg, BNY

From the developed world's perspective, the impact of lower PPI from China, Japan and Korea remains the most significant. China's PPI figures earlier this week will be uncomfortable domestically and internationally. On the one hand, tackling outright deflation remains a key policy objective for the People's Bank of China, which has signaled an imminent required reserve ratio (RRR) cut. However, international investors might fear that the country's new industrial strategy means deflation will be exported through a weaker currency and pricing power. There could even be a margin buffer as input costs decline – though admittedly China will benefit less from lower oil prices due to its coal dependency.

In contrast, Japan and Korean PPI are now recovering despite lower input costs and higher oil exposure. While their exporters may also fret over China's price outlook, Japan would be the first to highlight that wage growth is now finding momentum after decades of stagnation. Korea's semiconductor prowess, meanwhile, means that it also has greater pricing power due to weak price elasticity. Now that both economies' energy bills will decline, margins can improve, subject to currency moves. Crucially, we believe that marginal income gains should be passed onto the household and maintain real wage momentum. This will be the ultimate confirmation of productivity growth and allow the exchange rate to adjust through the inflation channel rather than only through the nominal channel. This type of valuation adjustment is far more preferable for export income and will help the economy over time. The bottom line is that the drop in oil and energy prices globally represents another upside risk to APAC currencies, especially those of exporters. Central banks and corporates should see the structural benefits and let the valuation adjustment process run its course.

Exhibit #4: PPI, Japan, China, Korea



Source: Macrobond, BNY

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNY.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF

Can't see the email? View online

This message was sent from an unmonitored email box. Please do not reply to this message.

.