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MACRO MORNING BRIEFING

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APAC Currencies-Equities Anomalies

Asia-Pacific currencies have been under pressure this year from multiple factors. The broad include reappraisal of the Federal Reserve's rate path, the uneven nature of China's recovery, and rising geopolitical tensions. More specifically, deficit concerns appear responsible for additional downside pressure on THB, IDR, KRW and CNY, and political uncertainty seems to be hindering THB, IDR and INR. Will the Fed's recent dovish tilt (our summary) be sufficient to lend support to APAC FX? We are not convinced yet, as negative sentiment continues to hold sway over the steady APAC ex-China growth recovery.

While ongoing concerns around China's growth prospects and skepticism about the effectiveness of the latest rescue package aimed at the real estate sector are the main drags on sentiment, a wide confluence of factors has led to dislocations in the typical correlation between foreign investor flows and local asset prices, including currencies. We have noticed a frequent asymmetric bias where foreign investor outflows to spark depreciation pressure on domestic assets, but foreign investor inflows have only a muted impact.

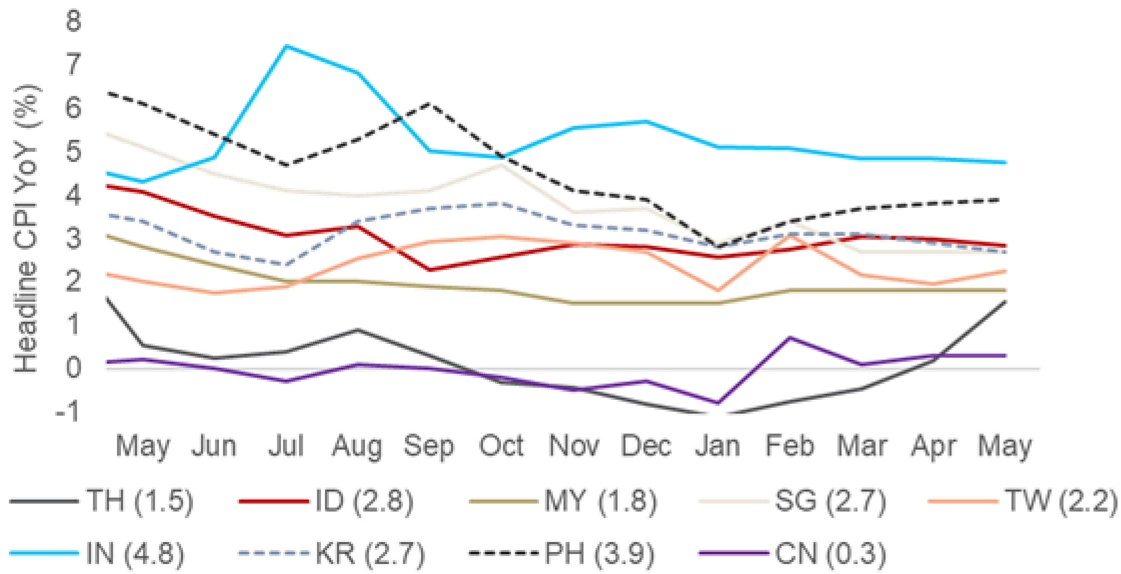
South Korea and Taiwan offer two cases in point. Despite record year-to-date foreign inflows of $15.4bn into Korea equities, KOSPI rallies have been limited and KRW this year (to June 13) is -6% vs. USD. In the other direction, foreign outflows from Taiwan equities earlier this year led to a correction in the Taiex and substantial weakening of TWD. Year-to-date net foreign equity investment into Taiwan is $2bn, Taiex +24%, and TWD -5% vs. USD.

External factors aside, we think near-term rate expectations exert a dominant influence on local currencies. Monetary policy stances across APAC are diverse, ranging from easing in

China, to leaning dovish in Thailand and India, to hawkish in Indonesia and Taiwan, and to neutral in Malaysia and Singapore. The central banks in South Korea and the Philippines have openly discussed the prospect of a rate reversal. The Bank of Thailand at its latest meeting voted 6-1 to keep its policy rate unchanged, the dissenting vote in favour of a 25bp cut. The Reserve Bank of India at its latest meeting voted 4-2 to keep its policy rate unchanged, the two dissenting votes in favour of a 25bp cut. The Central Bank of the Republic of China (Taiwan) on Thursday (press release) kept its policy rates unchanged (+12.5bp in March) but hiked reserve requirement ratios 25bp (property market red hot).

Generally speaking, we see little merit in a dovish policy shift simply on the back of a lower inflation trajectory. The potential boost to economic growth or asset prices from a small rate reduction is likely to be limited but could generate greater downside/volatility in FX, which in turn could pose a risk to financial stability. Another side effect of easier monetary conditions might be renewed accumulation of debt by households with already-high indebtedness, notably in South Korea and Thailand. Lastly, there remains considerable uncertainty around the trajectory of inflation, not least given elevated commodity prices and renewed acceleration in freight costs. The Freightos Baltic Index (measures 40' container prices) has nearly tripled from its end-2023 lows ($1365), reaching over $4000 as of June 7.

Exhibit #1: APAC Inflation Trajectory vs Global Container Pricing Index

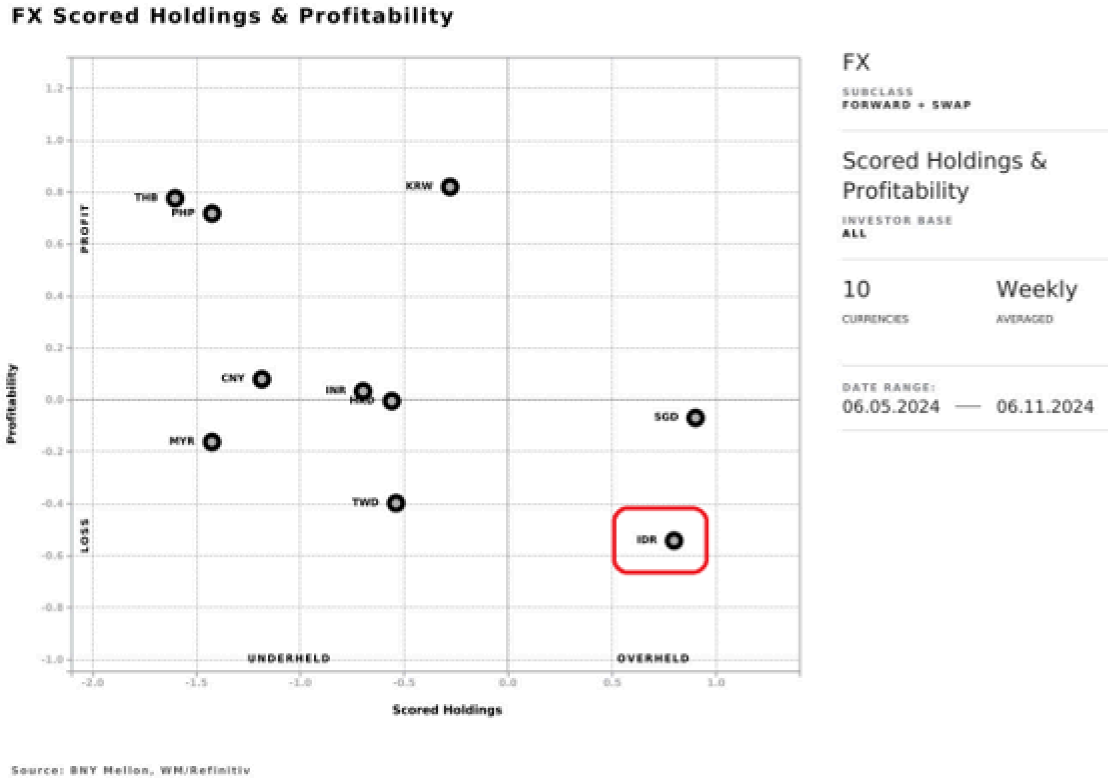


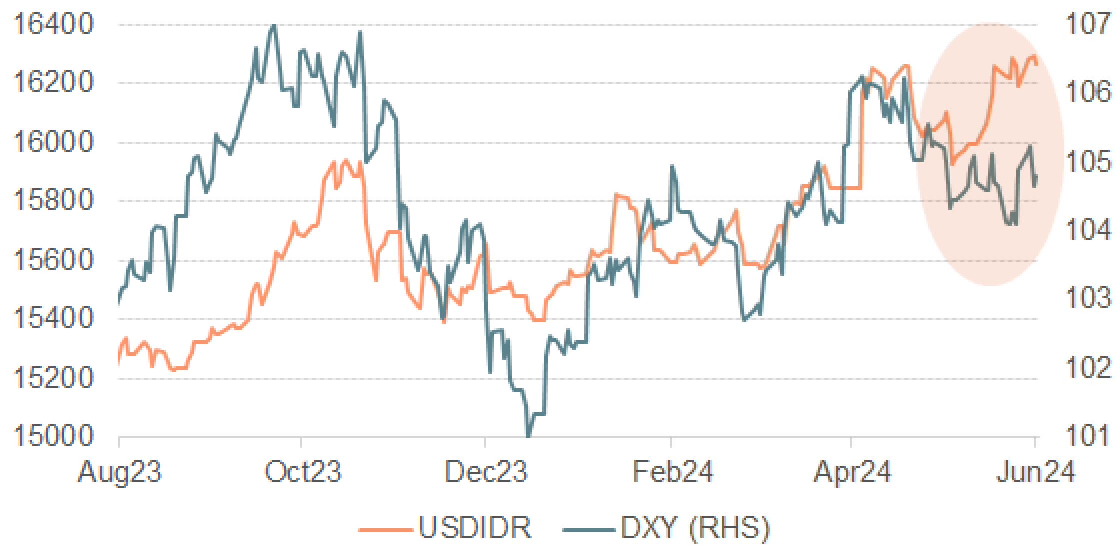
Source: BNY, Bloomberg L.P. https://terminal.freightos.com/freightos-baltic-index-global-container-pricing-index/

The most striking dislocation within APAC is Indonesia's rupiah. The positive impact from the surprise rate hike in April was short-lived, with USDIDR going on to challenge all-time highs just shy of 16300. Despite its recent weakening trend, IDR remains one of the most favoured currencies in the region: iFlow data shows IDR the only overheld and unprofitable APAC currency. This suggests risk of a further unwinding of positions.

The level of USDIDR presents a challenge to Bank Indonesia, which might opt for countermeasures to safeguard FX stability, else risk further dislocation. We think unusual IDR weakening in the context of hawkish and tightening central bank serves as a warning region-wide: any pre-mature dovish shift may lead to undesirable FX consequences.

Exhibit #2: IDR Overheld & Unprofitable Within APAC





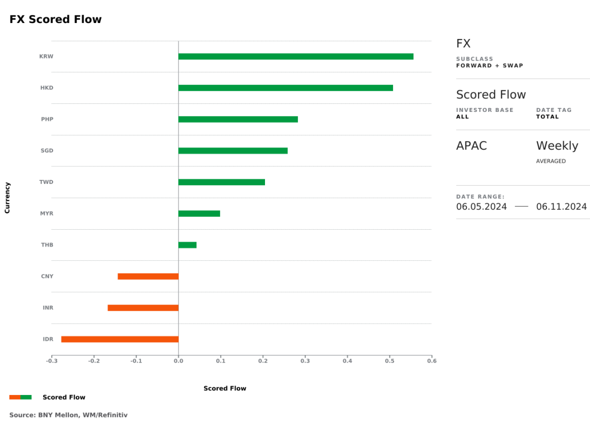
Source: BNY

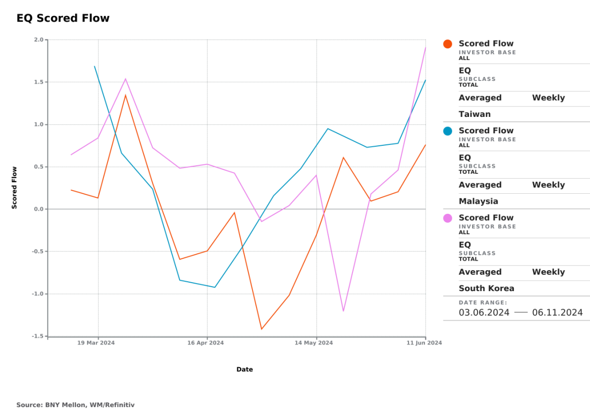
iFlow data for the past week shows inflows into global currencies as USD was sold mildly into the FOMC. While political uncertainty appears responsible for significant outflows from MXN, that seems to have had only a limited impact on GBP, EUR, ZAR and INR flows.

APAC currency flows were dominated by accelerated KRW inflows: weekly average scored flows of +0.56 and the eighth straight week of buying. The strong inflows have narrowed the KRW underheld: weekly average scored holdings at -0.28, the least underheld in the past three months. Other APAC FX holdings are near the middle to bottom of their ranges. APAC FX flows elsewhere were mixed: selling in CNY, IDR, and INR, and buying otherwise.

In term of asset flows, sentiment towards China remains weak: continued selling across asset classes, especially corporate bonds. China aside, overall sentiment towards APAC was broadly balanced. South Korea equity inflows jumped: weekly average scored flows of 1.91, the strongest weekly since July 2019. Malaysia and Taiwan equities also posted good buying, with weekly average scored flows of 1.52 and 0.76, respectively.

Exhibit #3: Strong Demand For South Korea, Taiwan & Malaysia Equities





Source: BNY

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

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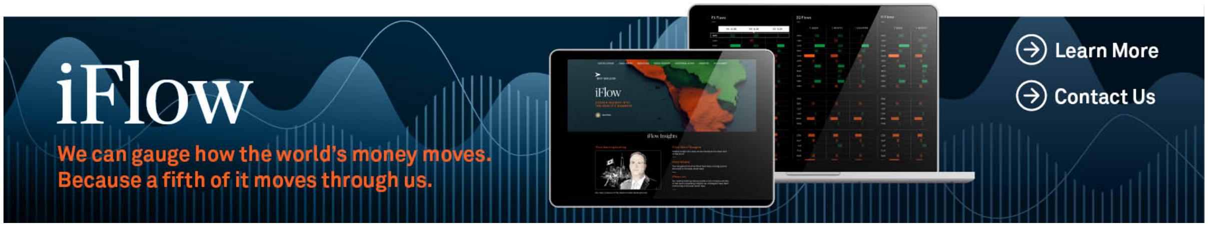

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