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MACRO MORNING BRIEFING

June 27, 2024

APAC H1 Macro Review & H2 Outlook

Global assets endured significant volatility over the first half of this year. The primary catalysts behind difficult market conditions were vacillations in expectations for US interest rates, prolonged conflicts in Ukraine and Gaza, renewed and escalating trade tensions with China, and uneven growth recoveries, notably in China, the Eurozone, and the UK.

Within APAC, high hopes for China's economic recovery to gain momentum failed to materialize. Markets' patience is wearing thin, especially with China's manufacturing PMI for May unexpectedly falling back into the contraction zone after only two months of signaling expansion. The 'green shoots' of recovery in real estate-related equities also proved to be short-lived, despite a series policy measures targeting that sector of the economy.

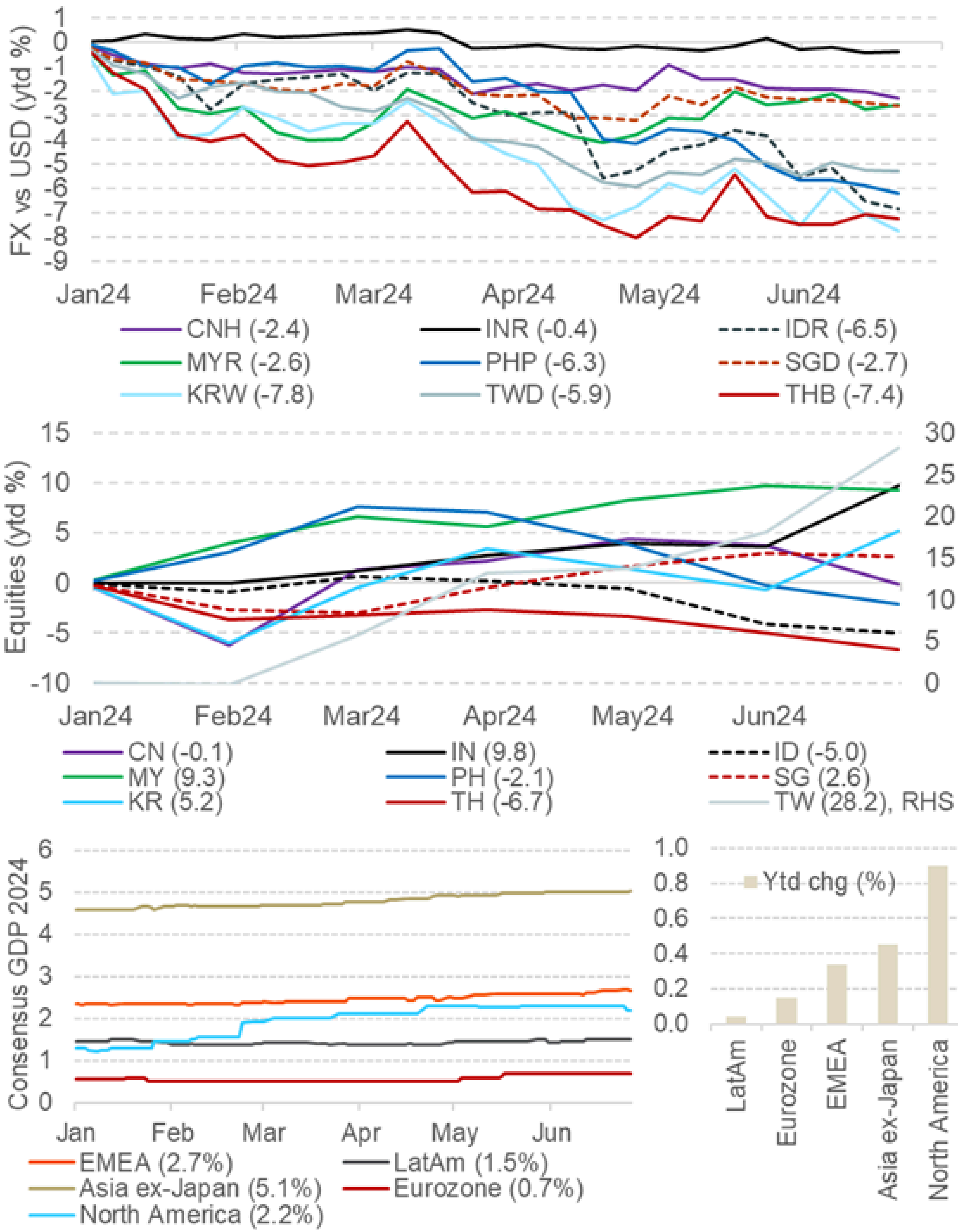
China aside, overall growth momentum in APAC has been encouraging. Bloomberg’s 2024 GDP consensus for Asia ex-Japan has been revised higher, from 4.6% at end-2023 to 5.05% as of June, led by solid performances in India (+7.8%) and Vietnam (+5.9%). What's more, the tech-related boom has led to a substantial rebound in growth in Taiwan and South Korea, where consensus projects 2024 GDP at 3.7% y/y (1.3% y/y in 2023) and 2.5% y/y (same in 2023), respectively. A recovery in tourism has benefited Southeast Asia economies, especially Thailand, Malaysia, Indonesia, Singapore, and the Philippines.

Growth and capital inflows from foreign investors have supported regional equities. Taiwan's Taiex leads the pack with a 28% year-to-date gain, followed by gains of nearly 10% in India and Malaysia. Thailand's stock market has fared the worst, -7% year-to-date, on uncertainties around implementation of the “digital wallet” stimulus program. China’s Shanghai Composite is flat on the year after retracing a 6%+ year-to-date gain in May.

Equity inflows and performance have not benefited the respective APAC currencies so far this year, however. We attribute the weakness in regional currencies to various factors, including US dollar strength, acute yen depreciation, fiscal and deficit concerns (Thailand, Indonesia, South Korea, and Malaysia) and, most recently, concern over potential for a largescale selloff in RMB. Note that the PBoC re-deployed the Counter Cyclical Factor to keep USDCNY fixings at the lows since the beginning of the year. Such measures had hit an extreme where USDCNY spot is near the 2% topside of the trading band, which rationally had the PBoC loosen its grip and, therefore, result in USDCNY extending higher.

Politics as a potential driver for APAC assets, e.g., elections in Taiwan, Indonesia, and South Korea, came and went with minimal disruption. Volatility in India assets on Modi’s BJP party failing to obtain a majority in that country's election lasted for only one day.

Exhibit #1: APAC FX & Equities H1 Scorecard And GDP Consensus



Source: BNY

We discuss below the key indicators and metrics which we think will have the greatest impact and influence on the evolution of regional currencies in the second half of the year.

China's real estate sector. We see more aggressive policy measures ahead, on top of effective implementation of the rescue packages announced already. We will be closely monitoring both housing prices and changes in inventories. De-stocking of housing inventories is a long-game, and the aim is to stabilize, not to engineer a rebound.

Stabilization of sentiment in China would be positive for the region, in our view.

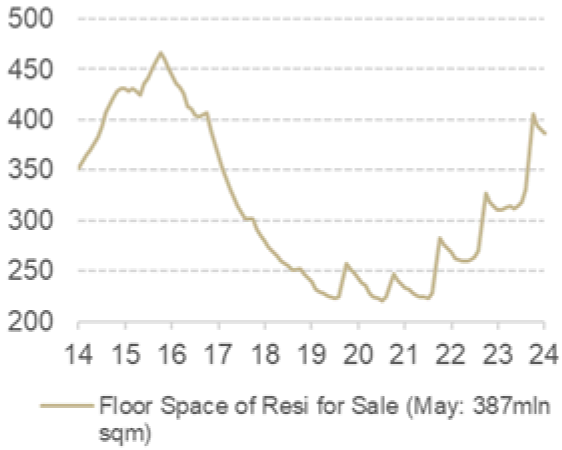
Fiscal and deficit dynamics. The lack of fiscal discipline or the failure to reign in excessive subsidies has been a drag on THB, MYR, KRW, and IDR. The large spending program for 2025 in Thailand is likely to weigh too, but it might be compensated for by the recovery in tourism. For Korea, focus is on if the government could bring the deficit back in line after substantial widening of deficit-to-GDP ratio to -3.9% from -2.6% in 2023. Despite Korea's strong recovery, the government has been extending subsides and price caps to alleviate pressure on consumers. Indonesia's fiscal strategy under new President Prabowo is likely to be heavily scrutinized later in the year. Recent reports that Indonesia plans to increase its debt-to-GDP by 2% per annum for five years have created a stir in the currency market.

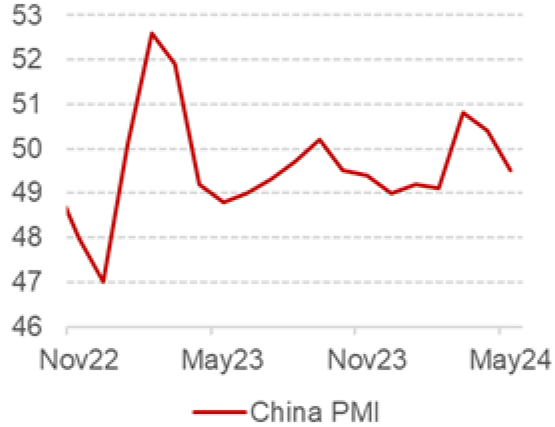
Freight costs and commodity prices. Rising freight costs are an increasing a source of concern – we don't think this has received the deserved attention. The Global Freightos Baltic Index (measures 40' container prices) has nearly tripled from its end-2023 lows ($1365), reaching over $4400 as of June 21. Higher freight cost prices could impact regional FX in multiple channels via higher import prices, terms-of-trade pressure, and inflationary pressure, all of which would be negative for FX due to limited room for policy maneuvering. One consolation in the commodity space is relatively stable crude oil prices. Continuity in coming months could contribute negatively to headline inflation due to base effects.

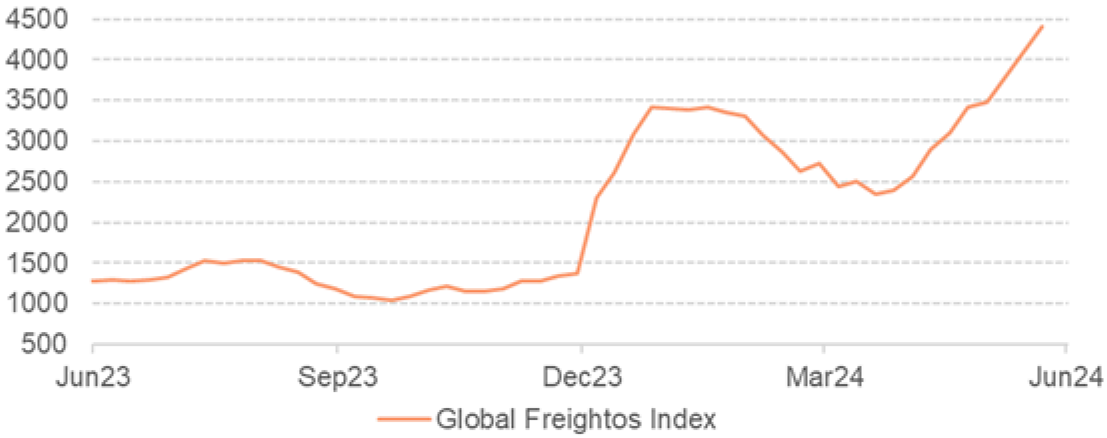
Central banks' policy bias. Early policy adjustments on lower inflation trajectories have not played out well in APAC. Overtly dovish comments from Korea and the Philippines have led to substantial depreciation momentum. The most dramatic turnaround was in Indonesia, where IDR depreciation forced Bank Indonesia to make an abrupt turn: a surprise rate hike contrary to expectations for a rate cut. While we don't see interest-rate differentials as a primary factor for currency valuation, we do think a dovish central bank could do more damage to a currency than a hawkish central bank would benefit a currency.

Another factor to watch is foreign investors' flows. We are convinced that the tech-related boom will endure into next year, but wary of an abrupt reversal of flows that could be negative for regional currencies and asset prices. A longer-term concern of ours is levels of indebtedness, notably in Thailand and South Korea, as well as overall debt-service ratios.

Exhibit #2: Macro Factors To Watch In H2







Source: BNY

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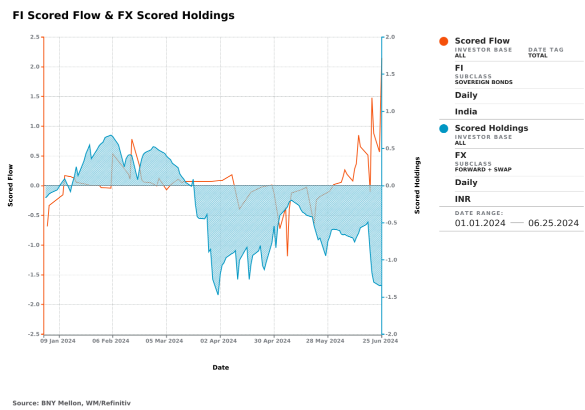
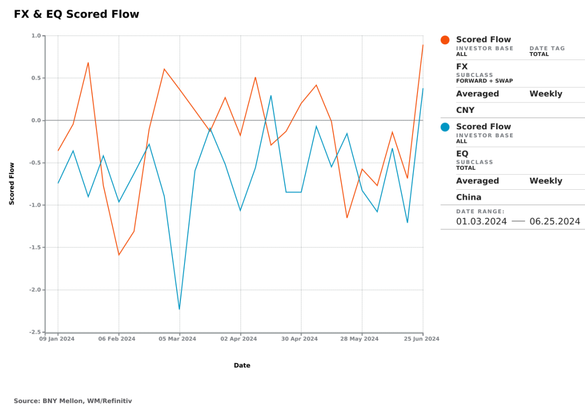
iFlow shows mixed APAC FX flows over the past week. Most striking was significant INR outflows: weekly average scored -1.5, the most since September 2023. The sharp decline in INR scored holdings to -1.2 along with a resurgence in buying of India sovereign bonds (weekly average scored 0.99) suggest the bonds were bought on a hedged basis.

The other interesting observation is stabilisation of sentiment towards China assets. CNY flows turned after five weeks of outflows, to the largest weekly inflows since the beginning of the year. A similar shift was seen in equities, where investors net bought for first time since mid-April. China sovereign bond flows were stable without a major trend.

Enthusiasm for Korea assets continued: won inflows, steady sovereign bond buying, and accelerated demand for equities. KRW scored holdings are neutral for the first time since October 2022; they were most underheld, around -2.5, in January 2023. IDR flows stabilised after weeks of heavy selling. IDR is overheld (0.57 weekly average scored holdings) and unprofitable (-0.49%), so could be susceptible to further unwinding in a risk-off environment.

Exhibit #3: India Sovereign Demand Surges; China Sentiment Shifts





Source: BNY

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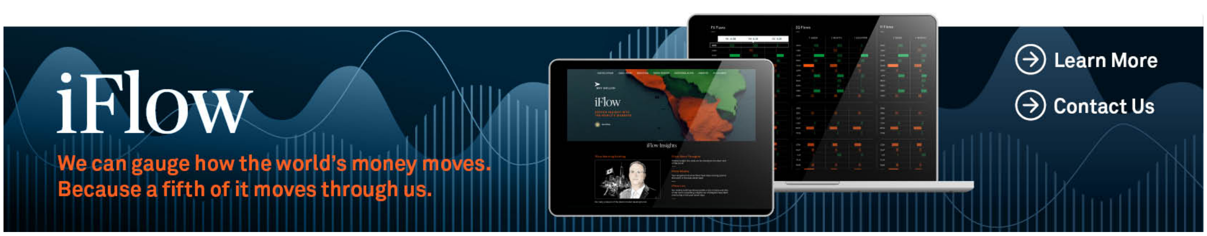

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