

November 29, 2024

Response of APAC Central Banks to FX Depreciation Pressure

APAC and emerging market currencies came under significant pressure in November, driven by the repricing of US interest rates and the resurgence of the US dollar. The US SOFR for December 2025 implies yields of around 3.80%, up from around 3% at the beginning of October. Adding to EM and APAC currency woes is the uncertainty of the US tariff strategy. As we saw during the US-China trade war in 2018-19, the prospect of higher US tariffs is likely to lead to the strengthening of the US dollar and a weakening of the currencies of countries where tariffs were imposed.

The latest on tariffs is that US President-elect Trump has pledged to implement a 25% tariff on all products from Mexico and Canada and an additional 10% tariff on goods from China beginning on Inauguration Day, January 20, 2025. Europe and South Korea, as major US trading partners, are also at risk.

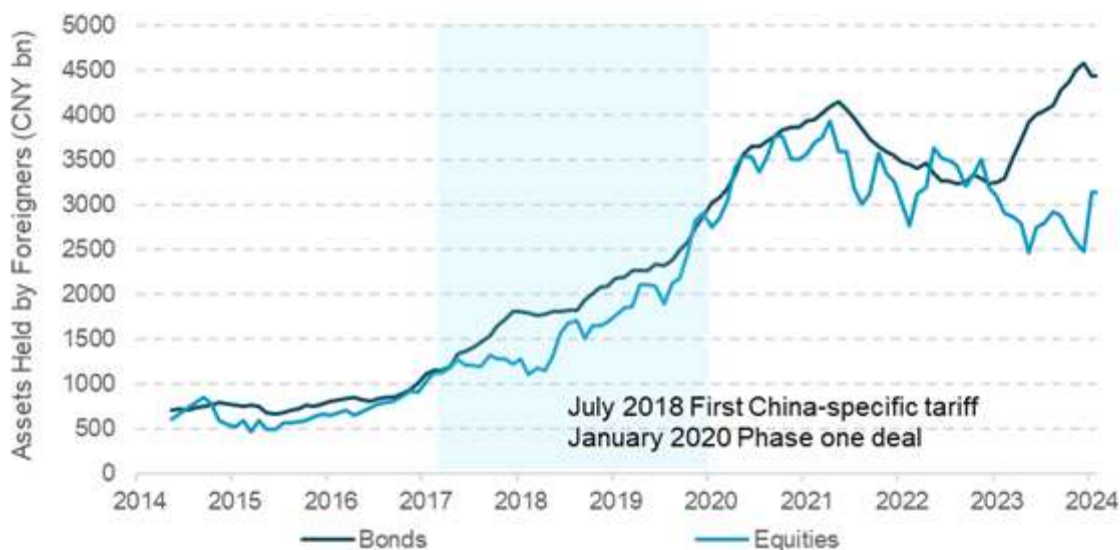
Heightened financial market volatility, a potential resurgence of trade and tech tension, and regional downside growth risks are likely to weigh on sentiment in the region in 2025. The latest IMF World Economic Outlook projects that growth will slow in 2025, with real GDP in China coming in at 4.5% (2024: 4.8%), South Korea at 2.2% (2.5%), Taiwan at 2.7% (3.7%), India at 6.5% (7.0%), and Malaysia at 4.4% (4.8%). The Philippines and Thailand are expected to see real GDP improve in 2025, climbing to 6.1% (5.8%) and 3.0% (2.8%), respectively. The success of stimulus measures to stabilize macro condition in China will play a pivotal role in APAC's growth dynamic. October data releases, the first snapshot since the

monetary and fiscal stimulus announced at the September Politburo meeting, showed mixed readings with a bottoming of investment activities and credit growth remaining sluggish. The job is not done yet. We see persistent stimulus measures ahead before a full recovery of domestic confidence.

While asset risks might be to the downside, we would warn against being overly pessimistic based solely on the impact of tariffs. For example, during the initial phase of the US-China trade war in 2018-19, total Chinese equities held overseas, as per PBoC data, saw a 16% drawdown from the CNY 1,323bn high in May 2018, declining to CNY 1,113bn in October 2018 before reaching new highs in February 2019. Meanwhile, foreign holdings of Chinese bonds remained almost unchanged. Foreign holdings of Chinese equities amounted to CNY 3,135bn as of September 2024.

In our view, regional central banks in APAC are well equipped to deal with currency depreciation pressure using a wide range of tools, such as currency intervention, incentives for capital repatriation, the encouragement of the conversion of export proceeds through attractive short-term interest rates, a tightening of currency funding to raise the cost of shorting, etc.

Exhibit #1: RMB Financial Assets Held by Overseas Entities



Source: BNY, Bloomberg L.P.

How have regional central banks responded to the latest round of currency depreciation? Reactions were mixed, involving a wide range of measures. The People's Bank of China (PBoC) responded swiftly to CNY depreciation pressure. In mid-November, the Chinese central bank reinstated its counter-cyclical factor (CCF) to manage daily USD/CNY fixings

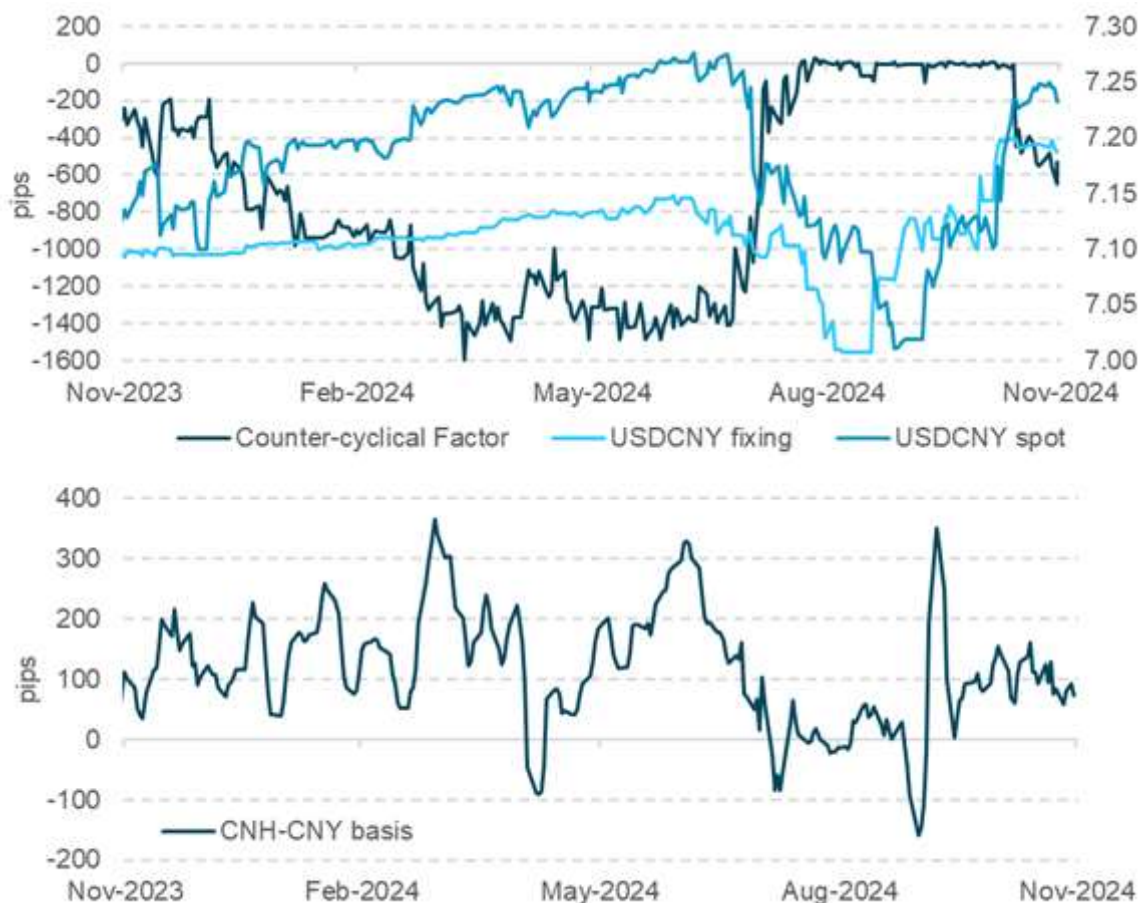
after a selloff of nearly 2% following the US election. This is the strongest signal of PBoC's intention to cap USDCNY upside. The Chinese yuan is allowed to trade within a band of +/- 2% from the daily USDCNY fixing set at 9:15 a.m. In addition to the CCF, PBoC raised funding costs for offshore CNH to make it more expensive for speculators to short CNH. These strategies seem to have had the desired effect of containing the weakening of CNH. The CNH-CNY basis spread remains relatively stable within 100pips (see Exhibit #2).

At the other extreme is Bangko Sentral ng Pilipinas (BSP), the Philippines central bank. BSP has maintained its dovish stance, brushing aside PHP depreciation momentum and stating that it is on course for more rate cuts at its December meeting, followed possibly by 100 basis points in cumulative cuts in 2025. USDPHP posted all-time highs in November.

At its latest policy meeting in November, Bank Indonesia (BI) did not explicitly comment on IDR volatility, but it did reiterate its triple intervention strategy in managing IDR stability. BI appears to be comfortable with the upside USDIDR adjustment and is keeping open its options for further normalization of rates.

Despite the heightened implied volatility of APAC currencies, the overall sell-off over the past few weeks has been relatively orderly along with the rise of the US dollar. We believe an overly complacent central bank is currency negative, and we will continue to monitor central bank reactions.

Exhibit #2: China's Counter-cyclical Factor Is Back in Play



Source: BNY, PBoC, Bloomberg L.P.

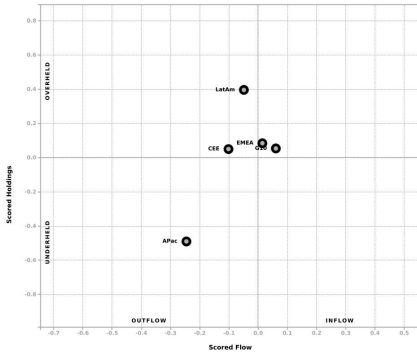
The fear of a potential escalation in trade tensions continued to weigh on sentiment in the region. Over the past week, APAC currencies posted the most outflows and are underheld on an aggregate basis. Within APAC, CNY was the only currency with inflows against outflows in the rest of the region, most in SGD. CNY inflows might be related to the unwinding of hedges with renewed selling of Chinese fixed income, especially in Chinese corporate bonds. Chinese corporate bonds have posted six straight weeks of outflows.

The most notable observation over the past week is the shift in market positioning. iFlow shows substantial easing of IDR scored holdings, from around 1.7 at the beginning of October to around 1 as of this week, suggesting increased hedge demand on FX volatility and a quickly increasing short positioning in TWD. TWD scored holdings, at around -2.5, are close to their most underheld level since January 2023.

Elsewhere, investors' flows were broadly negative in both the equities and fixed income complex. Selling of Chinese equities stood out.

Exhibit #3: APAC FX Was Underheld and Sold; Unwinding of IDR Longs

FX Scored Flow & Scored Holdings



Source: BNY, WM/Refinitiv

FX

SUBCLASS
FORWARD + SWAP

Scored Flow & Scored Holdings

INVESTOR BASE
ALL

5

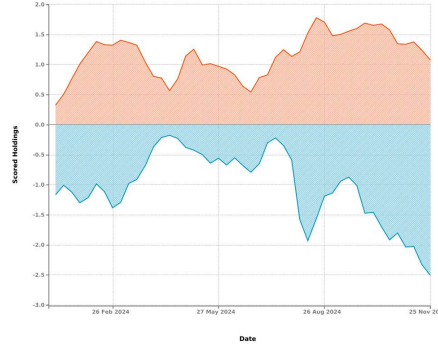
CURRENCY
AGGREGATES

DATE RANGE:
11.19.2024 — 11.25.2024

Weekly

AVERAGED

FX Scored Holdings



Source: BNY, WM/Refinitiv

Scored Holdings	INVESTOR BASE	ALL
FX	SUBCLASS	FORWARD + SWAP
Averaged	Weekly	
IDR	INVESTOR BASE	ALL
Scored Holdings	INVESTOR BASE	ALL
FX	SUBCLASS	FORWARD + SWAP
Averaged	Weekly	
TWD	INVESTOR BASE	ALL
DATE RANGE:	01.02.2024	11.25.2024

Source: BNY, Bloomberg L.P.

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

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